

RATING REPORT

FINCA Microfinance Bank Limited (FINCA MFB)

REPORT DATE:

December 21, 2022

RATING ANALYST:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A	A-1
Rating Outlook	Negative		Rating Watch-Developing	
Rating Date	Dec 16, '22		April 30, '22	

COMPANY INFORMATION

Incorporated in 2008	External auditors: M/S KPMG Taseer Hadi & Co Chartered Accountants
Public Limited Unlisted Company	Chairman of the Board: Mr. Florin Lila CEO: Mr. Jahanzeb Khan
Key Shareholders (with stake 5% or more):	
FINCA Microfinance Cooperatief U.A -- 86.4%	
Kashf Holding (Private) Limited – 5.2%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Microfinance Banks (September 2021)

<https://docs.vis.com.pk/docs/Microfinance202109.pdf>

FINCA Microfinance Bank Limited (FINCA MFB)

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

FINCA Microfinance Bank Limited (FINCA MFB) previously *Kashf Microfinance Bank Limited*, was incorporated in June, 2008 as a public limited company under Companies Ordinance 1984 (now Companies Act 2017). The bank obtained the Microfinance banking license from SBP in August 2008 under the provisions of Microfinance Institutions Ordinance, 2001. The ultimate holding company of FINCA MFB is FINCA Impact Finance, a not-for-profit corporation incorporated in Washington, DC, USA.

Profile of Chairman

Mr. Florin Lila joined the Board in March, 2021. He holds a Master's degree in Economics for Business Analysis from Staffordshire University, United Kingdom. He has over two decades of experience in the banking and microfinance sector including multiple roles at the Executive Management and Board of Directors level in Europe, Africa and Asia.

Profile of CEO

Mr. Jabanzeb Khan joined as CEO of the bank in June, 2021. Mr. Khan has over 24 years of global experience in financial services. Most recently he had worked as Chief Strategy and Transformation officer at Telenor Microfinance Bank Limited. He has also worked at JPMorgan Chase & Co. and Deloitte Consulting. Mr. Khan holds a Bachelor of Science in Electrical Engineering from the University of Texas at Austin, Masters in Business Administration from University of Delaware.

Rating Rationale

The ratings assigned to FINCA MFB incorporate association of the bank with FINCA Impact Finance., a global microfinance organization operating in 17 subsidiaries, including Pakistan. Majority shareholding (86.4%) of the bank is vested with FINCA Microfinance Cooperatief U.A. FINCA MFB continues to receive support from its parent through transfer of technical expertise emanating from FINCA's global experience. The revision in ratings takes into account the lingering impact of Covid-19, weakening macroeconomic indicators along with the impact of the recent floods wherein portfolio credit quality and the financial risk profile of the Bank has weakened. The weakening of the financial profile has led to a negative bottom line, this along with weak asset quality indicators has placed the CAR at below the minimum regulatory requirement and is accordingly recognized in the ratings revision. The ratings also incorporate the observations of external auditors involving going concern assumption pertaining to reduction in markup income and CAR. In that regard, the ratings take note of the management's plan to recapitalize the bank in the forthcoming twelve months, however, are constrained by uncertainty pertaining to the timeline of achievement of plans when the Bank's lending operations are already impacted. The strengthening of the capital adequacy along with liquidity of the bank is important for the sustenance and review of ratings and outlook. VIS expects a capitalization plan to place the Bank's CAR and liquidity at levels which would support its financial risk profile, going forward.

Microfinance Outlook:

Microfinance sector outlook has changed significantly in the backdrop of the unprecedented impact of COVID-19. The sector high double-digit growth has been in check mainly due to overall economic downturn and more specifically asset quality issues of COVID impacted portfolio. In order to dampen the effect of pandemic, SBP provided regulatory relief whereby rescheduling and loan deferment was allowed. The central bank support helped the customers stay afloat, but inherently resulted into masking the potential losses which were realized after the expiry of SBP relief period. The core reason behind customer default was the massive decline in the purchasing power of the borrowers. Therefore, NPLs ratio of the MFBs exceeded 25% of the rescheduled portfolio. Currently, the overall risk profile of the sector is marked by higher cost of doing business in line with increased discount rate, asset quality issues resulting in portfolio losses and liquidity challenges and changed client behavior on account of subsidies offered to clients during pandemic. Consequently, profitability of the entire microfinance sector was adversely affected resulting in capital erosion. All put together, this has contributed to significant operating losses for many players in the sector and to the extent of breaching the regulatory requirement of capital adequacy prescribed by the central bank. The stress on CAR was evidenced across the sector as 4 microfinance banks out of 7 major players are facing regulatory breach and in the process of raising capital.

Financial Risk Profile of the Bank:

The non-performing loans (NPLs) of the bank increased on a timeline and were reported higher at Rs. 3.5b (FY21: Rs. 2.9b; FY20: Rs. 739.2m) by end-9MFY22, as the regulatory relief, provided by the apex bank, of extension of repayment by a year to microfinance borrowers to dampen the impact of COVID-19 ended on 31st March, 2021. Resultantly, gross infection and net infection increased during the rating review period. Given deterioration of asset quality, provisioning expense to the tune of Rs. 268.7m was booked against the micro-credit portfolio which resulted in FINCA MFB reporting negative bottom line of Rs. 729.3m during 9MFY22; however, the loss was lower in comparison to the corresponding period last year. Further, liquidity profile of the Bank has shown a downward trend as reported by reduction in liquid assets in respect to total deposits and borrowings along with increase in advances to deposit ratio to 80% (FY21: 74%) by end-9MFY22. Furthermore, equity base of the bank has depleted to Rs. 3.0b (FY21: Rs. 3.7b; FY20: Rs. 5.2b) owing to losses incurred during the outgoing year and onwards. Subsequently, net NPLs in relation to tier-1 capital increased considerably to 92.1% (FY21: 56.5%; FY20: 11.5%) in line with higher net NPLs and equity erosion.

FINCA Microfinance Bank Limited (FINCA MFB
Annexure III

FINANCIAL SUMMARY				
<i>(amounts in PKR millions)</i>				
BALANCE SHEET	31-Dec-19	31-Dec-20	31-Dec-21	30-Sep-22
Cash and Bank Balances with SBP and NBP	1,596	1,572	1,703	1,687
Balances with other Banks and/NBFIs/MFBs	1,643	2,849	279	122
Lending to Financial Institutions	-	-	-	-
Total Investments	6,244	6,449	10,300	7,692
Net Advances	22,039	21,246	18,827	19,697
Operating Fixed Assets	3,131	2,445	1,966	1,686
Other Assets	2,613	5,171	3,033	2,092
Deferred Tax Assets	46	118	1,015	1,772
Total Assets	37,312	39,851	37,122	34,749
Total Deposits	23,911	26,083	25,419	24,488
Borrowings	5,553	5,511	5,181	4,680
Other Liabilities	3,129	3,014	2,714	2,546
Tier-1 Equity	4,715	5,243	3,738	3,045
Net Worth	4,715	5,243	3,738	3,034
Paid-Up Capital	6,349	6,349	6,349	6,349
INCOME STATEMENT				
	31-Dec-19	31-Dec-20	31-Dec-21	30-Sep-22
Net Mark-up Income	5,314	5,590	2,533	939
Net Provisioning / (Reversal)	1,087	1,226	2,170	269
Non-Markup Income	954	845	924	717
Operating Expenses	4,102	3,761	3,555	2,851
Profit/(Loss) Before Tax	1,012	1,416	(2,342)	(1,527)
Profit/(Loss)after tax	653	905	(1,523)	(729)
RATIO ANALYSIS				
	31-Dec-19	31-Dec-20	31-Dec-21	30-Sep-22
Gross Infection (%)	4.7	3.4	14.8	16.8
Provisioning Coverage (%)	41.8	41.2	29.7	22.7
Net Infection (%)	3.7	2.9	11.6	14.1
Net NPLs to Tier-1 Capital (%)	16.7	11.5	56.5	92.1
Capital Adequacy Ratio (%)	19.8	20.9	15.2	-
Markup on earning assets (%)	30.3	29.4	25.2	-
Cost of Funds (%)	10.3	9.8	8.0	-
Spreads (%)	20.0	19.6	17.2	-
OSS (%)	149.0	162.8	87.4	-
ROAA (%)	1.9	2.3	n.m.	-
ROAE (%)	14.9	18.2	n.m.	-
Liquid Assets to deposits & borrowings (%)	32.2	34.4	40.1	32.6

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Annexure IV

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA

Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-

High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-

Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-

Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-

Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-

Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC

Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC

A high default risk

C

A very high default risk

D

Defaulted obligations

Short-Term

A-1+

Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1

High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2

Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3

Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B

Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C

Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES		Annexure V			
Name of Rated Entity	FINCA Microfinance Bank Limited (FINCA MFB)				
Sector	Microfinance Bank (MFB)				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	16-Dec-22	A-	A-2	Negative	Downgrade
	30-Apr-22	A	A-1	Negative	Maintained
	30-Apr-21	A	A-1	Rating Watch Developing	Reaffirmed
	30-Apr-20	A	A-1	Rating Watch Developing	Maintained
	30-Apr-19	A	A-1	Stable	Reaffirmed
	23-Apr-18	A	A-1	Stable	Reaffirmed
	31-Oct-17	A	A-1	Stable	Reaffirmed
	27-Apr-17	A	A-1	Stable	Reaffirmed
	09-Jan-17	A	A-1	Stable	Upgrade
	26-Apr-16	A-	A-2	Positive	Reaffirmed
	Instrument Structure	N/A			
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meeting/s Conducted	Name		Designation	Date	
	1. Mr. Ghulam Qadir		Chief Financial Officer	15 th Dec, 2022	