SECTOR UPDATE

MICROFINANCE

September, 2021

VIS Credit Rating Company Limited

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MACROECONOMIC REVIEW - PAKISTAN

The financial year (FY) 2021 continued with the same uncertainty prevailing as that in the fourth quarter of FY20 owing to emergence of the COVID-19 pandemic, however; the depressed economic indicators were largely rescued during the outgoing year. Pakistan has witnessed a V-shaped economic recovery with the provisional growth rate for FY21 estimated higher at 3.9% than the original target of 2.1%. The higher-than-expected GDP was an outcome of sound performance of agriculture, large scale manufacturing, construction and export sectors. Moreover, foreign exchange reserves are relatively healthy and fiscal deficit is manageable with the primary balance in surplus. The monetary policy remained relaxed with policy rate unchanged at 7% in order to maintain positive business sentiment by keeping the cost of borrowing low. In addition, Pakistan entered the international capital market after a three-year gap by successfully raising US $ 2.5b through Euro bonds. Furthermore, in line with the recovery of economic indicators all three major credit rating agencies, Moody's, Fitch and Standard & Poor's, reaffirmed Pakistan's sovereign credit ratings.

Overview - Microfinance

"Microfinance" refers to provision of financial services primarily comprising micro-loans and insurance to the unbanked socio-economic strata of population with the aim of financial inclusion and poverty eradication. Given Pakistan still remains a developing economy with majority of population having no access to commercial funding owing to sizable collateral requirements and high ticket-size, presence and outreach of micro-finance providers (MFPs) is considered crucial in assisting the less-privileged towards economic progression through availability of capital. The breakdown of all organizations involved in the microfinance sector is tabulated below:

Industry Segments	Dec'19	Dec'20	May'21	Regulatory Body	Regulations & Laws
Microfinance Banks (MFB)	11	11	11	State Bank of Pakistan (SBP)	• Prudential Regulations for MFBs, 2014 • Microfinance Institutions Ordinance, 2001
Microfinance Institutions (MFI)	17	20	21	Securities & Exchange Commission of Pakistan (SECP)	• NBFC Rules, 2003 • NBFC Notified Entities Regulations, 2008
Rural Support Programs (RSP)	6	5	5		
Others*	4	10	10		
Total	38	46	47		

** Others include organizations involved in microfinance while having different mainstream businesses*

The acronyms used in the report for different microfinance providers (MFPs) are presented in the table below alphabetically:

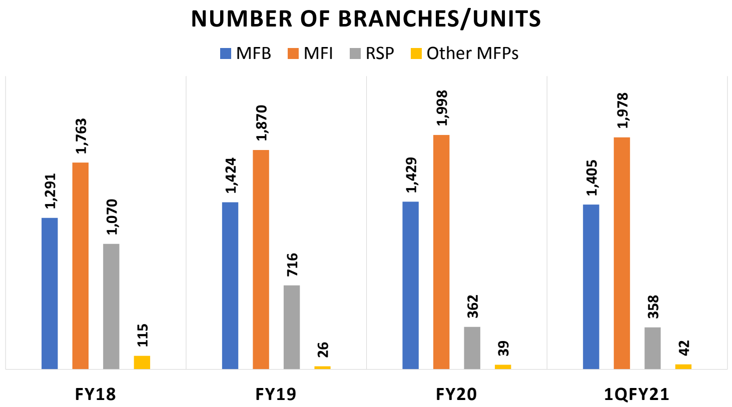
Sr. No	Microfinance Provider Name	Acronym
1	Advans Pakistan Microfinance Bank Limited	APMBL
2	Apna Microfinance Bank Limited	AMBL
3	ASA Pakistan Limited	ASA-P
4	FINCA Microfinance Bank Limited	FINCA MFB
5	Kashf Foundation	KF
6	Khushhali Microfinance Bank Limited	KMBL
7	Mobilink Microfinance Bank Limited	MMBL
8	NRSP Microfinance Bank Limited	NRSP-B
9	Pak Oman Microfinance Bank Limited	POMBL
10	Rural Community Development Programs	RCDP
11	Sindh Microfinance Bank Limited	SMBL
12	Telenor Microfinance Bank Limited	TMB
13	The First Microfinance Bank Limited	FMFB
14	U Microfinance Bank Limited	UMBL

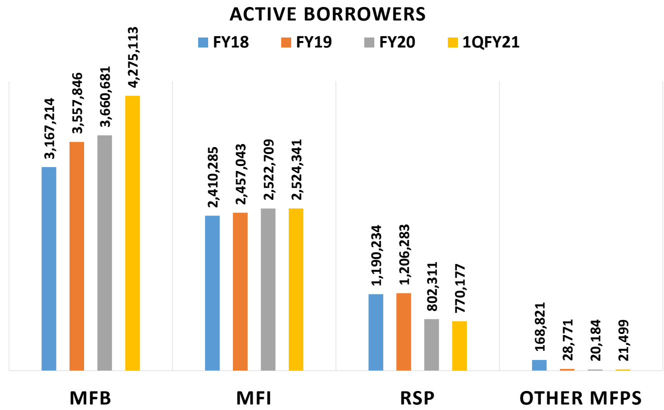
Outreach & Scale

Breadth of Outreach

Outreach witnessed a mixed trend during the review period given active borrowers and penetration rate improved; however, number of branches/units decreased on a timeline basis. Number of active borrowers exceeded the pre-covid figure of 7.3m with 7.6m borrowers at end-1QFY21, an increase of 8% in comparison to end-FY20. Among the industry segments, MFBs remained market leaders and witnessed an increase in their market share in terms of active borrowers as both MFIs and RSPs experienced a decline of 1% in their market shares which saw them close at 34% and 16% respectively. MFB peer group managed to add over 614,000 clients; the increase was mainly courtesy of MMBL as their uptake in digital credit through provision of nano and micro loans substantially improved. Digital products have exhibited wide reach to a large customer base by leveraging the high teledensity in the country while offering the convenience of mobile wallet (m-wallet) acquisition. Subsequently, by end-1QFY21, MMFB surpassed KBL with the largest market share of 18.5% in terms of clients followed by KMBL and Akhuwat. Moreover, the penetration rate has improved over the review period owing to tapping of more clients per branch coupled with increase in number of districts covered. On the other hand, total number of branches declined on a timeline basis; Akhuwat continued to maintain the largest geographic footprint nationwide by covering 97 districts followed by KMBL and FMFB with 82 and 81 districts serviced respectively. A brief analysis of the above variables is presented in the table and charts below:

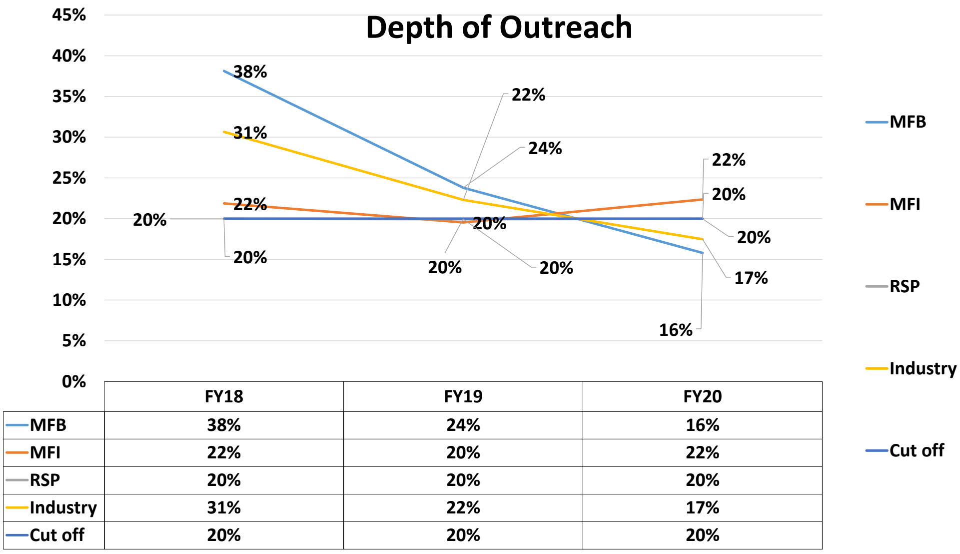
	FY18	FY19	FY20	1QFY21
Number of Branches /Units	4,239	4,036	3,828	3,783
Number of Districts Covered	135	138	139	139
Active Borrowers	6,936,554	7,249,943	7,005,885	7,591,130
Penetration Rate	33.8%	35.4%	34.2%	37.0%





Depth of Outreach

The depth of outreach is associated with the quality of outreach; the same is a measure of that the most underprivileged in a society have been served. In microcredit operations, it is measured by a proxy indicator where average loan balance per borrower in proportion to per capita gross national income (GNI) is calculated. A value of below 20% of GNI is assumed to mean that the industry is poverty focused. The comparison of this indicator revealed a decrease in the value of the entire industry with a notable declining trend witnessed in the MFB segment owing to provision of branchless banking loans. This suggests that all MFPs now target the underprivileged although MFBs were catering to the relatively developed segment of the same market historically. The trend is tabulated below:



	FY18	FY19	FY20
MFB	38%	24%	16%
MFI	22%	20%	22%
RSP	20%	20%	20%
Industry	31%	22%	17%
Cut off	20%	20%	20%

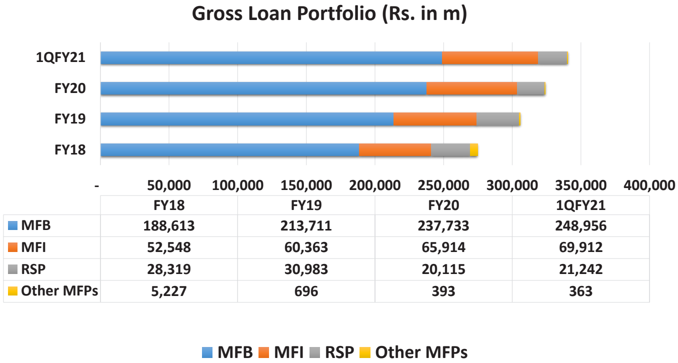
Asset Mix Overview

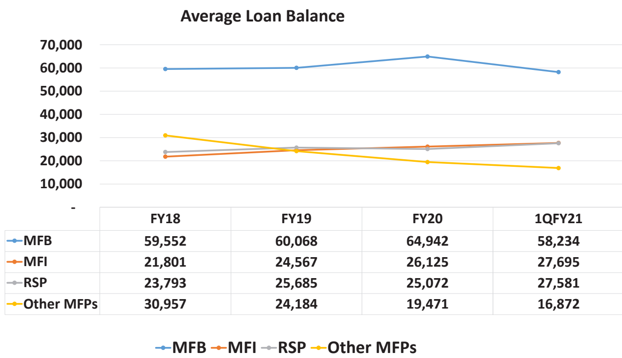
Loan Book & Disbursements

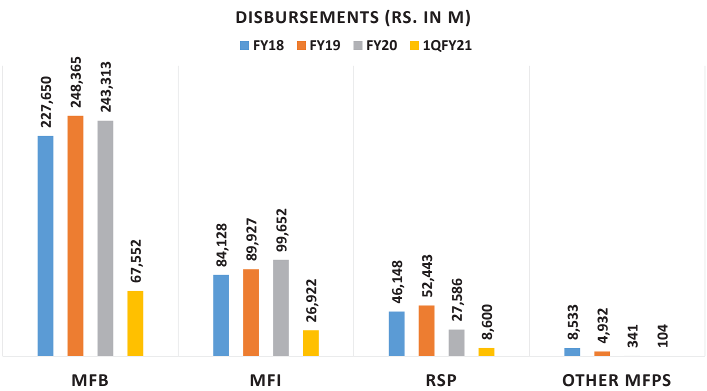
Prior to FY19, the microfinance sector was booming with a sizable 10-year CAGR recorded at 29% for gross loan portfolio (GLP). However, owing to economic dip in FY19 with GDP growth rate plummeting to 0.99% on account of political and financial instability, the micro-credit borrowers were stretched thin for liquidity resulting in heightened events of non-payment and deferrals. Therefore, FY19 served as a turning point for the microfinance industry with the sector sliding from aggressive growth to moderate 2-year CAGR of 13% for period ended FY20. With the unprecedented scenario posed by the ongoing pandemic, restoration of exponential growth mode of the sector is deemed unlikely; however, the sector is on the road to recovery as 10% growth was manifested in GLP in 1QFY21 as opposed to corresponding period last year. In line with the historic trend, MFB segment constitutes the highest share in micro-credit loan portfolio; the same has also witnessed a gradual increase on a timeline basis. Similarly, the period under review experienced a timeline increase in the numbers of loans disbursed; the same was a function of high number of digital loans disbursed by MMFB, while also contracting the average loan size to Rs. 25,022 (FY20: Rs. 36,175) in 1QFY21.

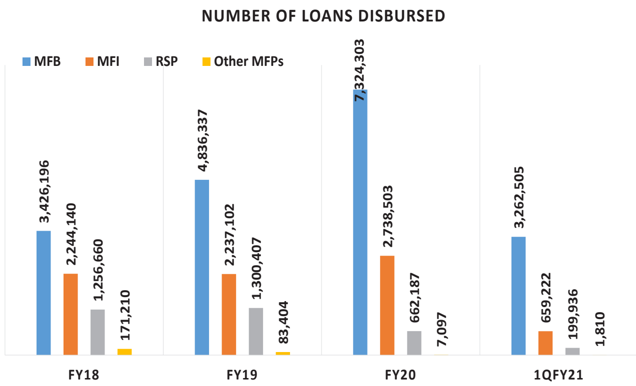
Given the advent of digital loans, the average loan balance amount per borrower is a better indicator of ticket sizes. The same has depicted an increasing trend on a timeline basis in line with progression of clients to successive loan cycles, inflationary pressure and introduction of enterprise loans entailing higher ticket size. In addition, higher disbursement amounts were recorded on a timeline basis indicating slight restoration of growth indicators. Contraction in disbursement amounts was witnessed during FY20 owing to all MFPs opting for portfolio consolidation and recovery activities as the repayment capacity of micro-credit borrowers was adversely impacted even prior to the pandemic; the same worsened in line with depressed economic activity owing to corona virus. In addition, with rollover of advances as permitted by SBP's relaxation to mitigate economic slowdown, the cash flow cycles were also confined for future disbursement as recovery was not made. The graphical representation of above discussed variables is illustrated below:

	FY18	FY19	FY20	1QFY21
Gross Loan Portfolio (Rs. in m)	274,707	305,753	324,155	340,473
Number of Loans Disbursed	7,098,206	8,457,250	10,732,090	4,123,473
Disbursements (Rs. In m)	366,459	395,667	370,892	103,178
Average Loan Balance	39,603	42,173	46,269	44,851



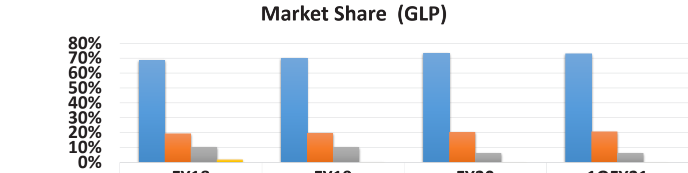




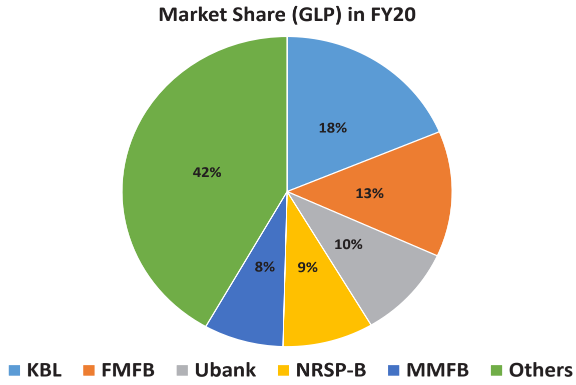


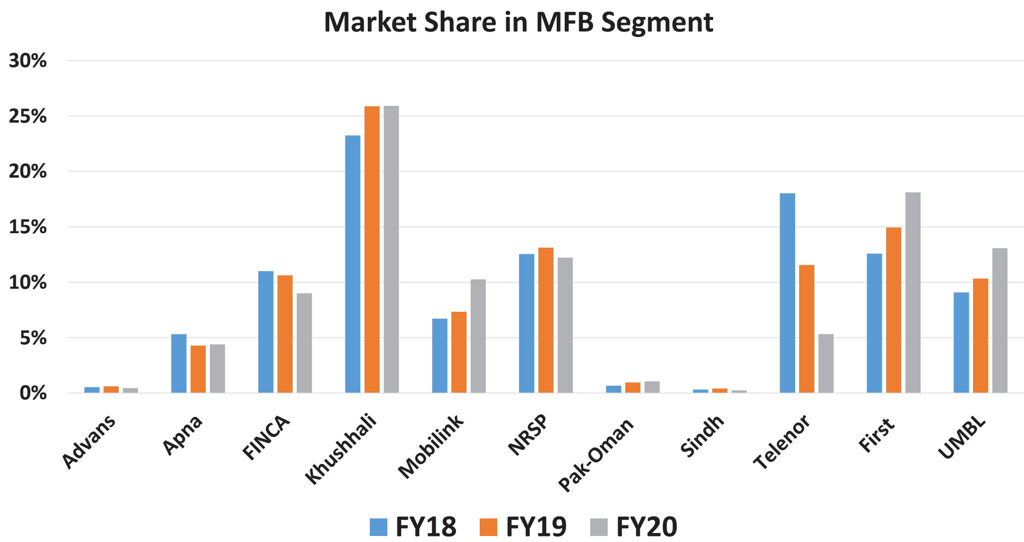
Market Share & Ratings

In the overall Microfinance Industry, MFBs constitute the highest market share in terms of GLP; however, the market size continues to remain nominal in comparison to commercial banks. A total of 11 MFBs are operating in the country with majority players having sound sponsors with noteworthy financial muscle and experience in the relevant industry; the same include both local or foreign investors. Implicit support from the sponsors is present at all times; moreover, VIS has witnessed extension of support both on financial and technical front historically in the time of need. Except for Advans and Sindh, all MFBs have nationwide operations. In terms of sample stratification, MFBs can be divided into large (market share of 15% or above), mid-tier (market share between 5%-15%) and small players (market share upto 5%). In terms of all MFPs, market share of KMBL is the highest followed by FMFB; the share magnifies further once seen in MFB peer segment context. Moreover, market share of a few MFBs especially UMBL and MMBL increased considerably over the last three years. Share of other players in the industry based on GLP has remained largely stable over the years. Small players include APNA MFB (~4%), Advans, Pak Oman and Sindh MFB each possessing a share of ~1% or less.

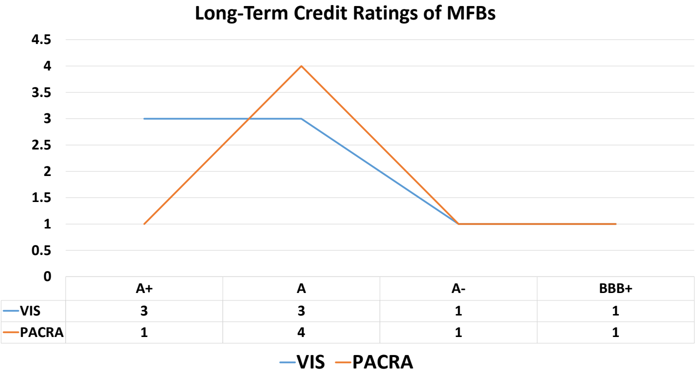


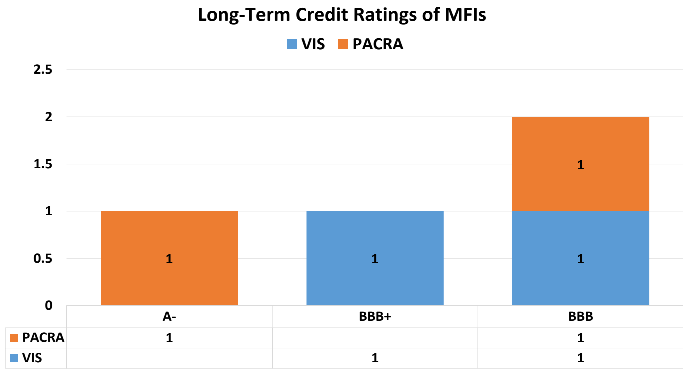
	FY18	FY19	FY20	1QFY21
MFB	69%	70%	73%	73%
MFI	19%	20%	20%	21%
RSP	10%	10%	6%	6%
Other MFPs	2%	0%	0%	0%





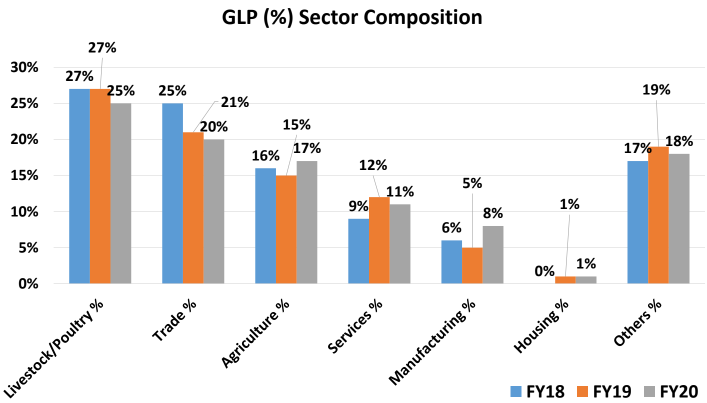
Further, MFBs have the highest ratings in the sector categories owing to higher asset size and market share, wide-spread outreach and stricter regulatory regime.

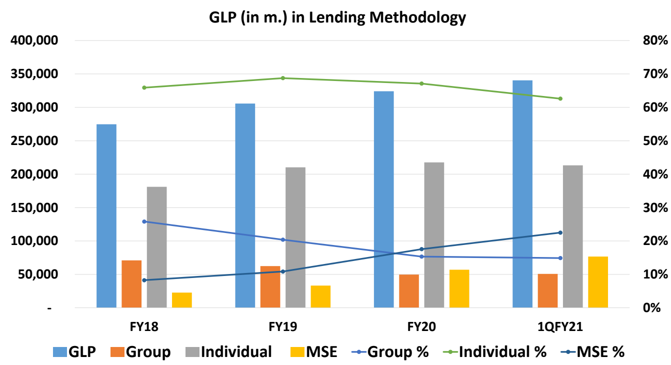




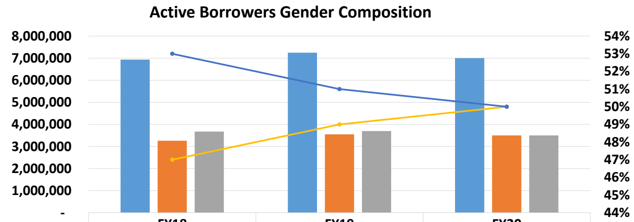
Product Specifications

Loan Portfolio in terms of active borrowers largely comprises livestock, agriculture digital/consumptive and trade-oriented loans. In terms of sectoral composition, highest repayment risk is associated with consumptive loans as there is no cash flow generation to support repayment; the proportion of same increased sizably during the period under review. However, the credit risk is largely mitigated as the consumptive loans are backed against gold/collateral and have negligible loss rate. On the other hand, with regards to GLP the highest contribution continues to be maintained by agriculture and livestock sectors. Further, with reference to lending methodology the concentration of group loans in total GLP was recorded lower while share of MSME loans increased on a timeline basis.



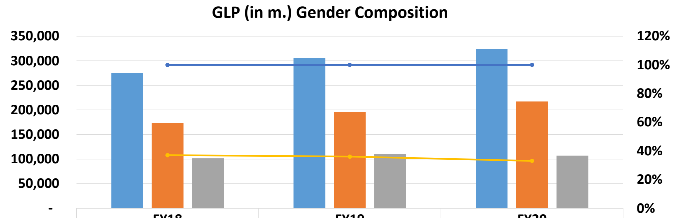


In addition, around two-thirds of total GLP and more than half of the active borrowers are male. The women representation in respect to GLP has declined; however, the same has increased in terms of active borrowers. Further, rural borrowers constitute around two-thirds of total borrowers in terms of rural to urban categorization. In addition, the proportion of secured portfolio has increased on a timeline basis. Based on top-4 microcredit providers constituting over 50% market share (KMBL, FMFB, UMBL & NRSP-B), 61% of the portfolio caters to bullet repayment structure. Micro-credit loans are generally short term in nature having an average life cycle of one year. Meanwhile, tenor of agricultural loans is dependent on the crop cycle.



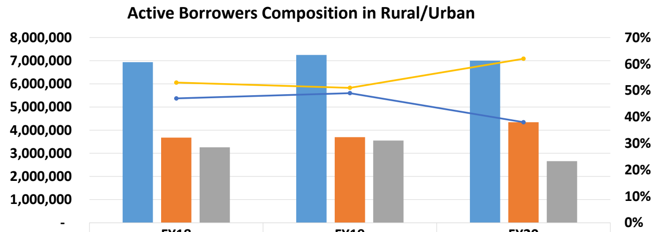
	FY18	FY19	FY20
Active Borrowers	6,936,554	7,249,943	7,005,885
Male	3,260,180	3,552,472	3,502,943
Female	3,676,374	3,697,471	3,502,943
Female %	47%	49%	50%
Male %	53%	51%	50%

Active Borrowers Male Female Female % Male %



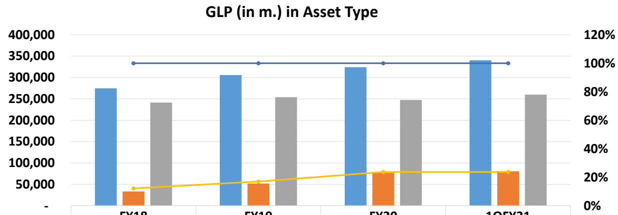
	FY18	FY19	FY20
GLP	274,707	305,753	324,155
Male	173,065	195,682	217,184
Female	101,642	110,071	106,971
Male %	63%	64%	67%
Female %	37%	36%	33%

GLP Male Female Female % Male %



	FY18	FY19	FY20
Active Borrowers	6,936,554	7,249,943	7,005,885
Rural	3,676,374	3,697,471	4,343,649
Urban	3,260,180	3,552,472	2,662,236
Rural %	53%	51%	62%
Urban %	47%	49%	38%

Active Borrowers Rural Urban Rural % Urban %



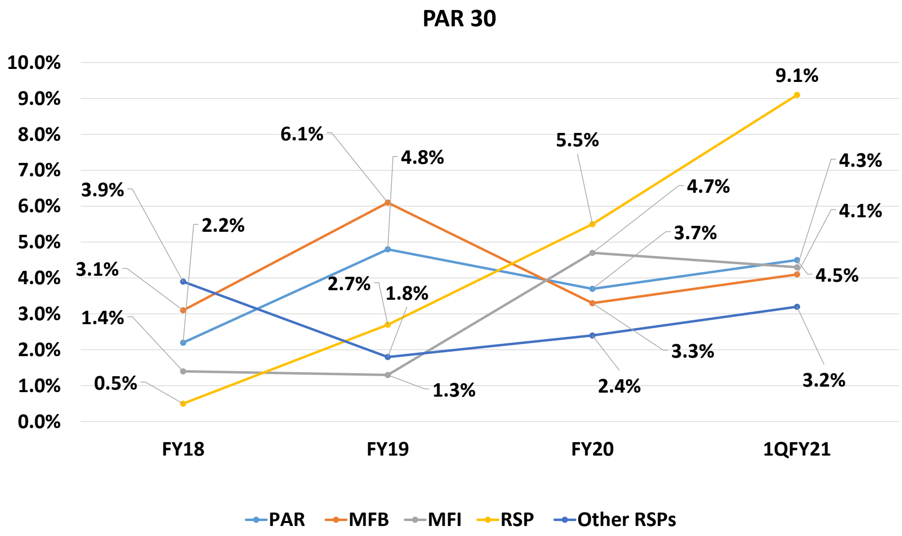
	FY18	FY19	FY20	1QFY21
GLP	274,707	305,753	324,155	340,473
Secured	33382	51816	76672	80631
Unsecured	241325	253937	247484	259842
Unsecured %	88%	83%	76%	76%
Secured %	12%	17%	24%	24%

GLP Secured Unsecured Secured % Unsecured %

In order to improve the efficiency of MFBs, SBP has increased the ceiling for house financing and microenterprise loans to Rs. 3.0m from Rs. 1.5m along with enhancement of limit of general loan to Rs. 350,000 from Rs. 150,000 during FY20.

Asset Quality

The analysis of components of advances reveals that Non-Performing Loans (NPL) decreased significantly during FY20 mainly on account of regulatory relief, provided by the apex bank, of extension of repayment by a year to microfinance borrowers to dampen the impact of COVID-19. As a result, portfolio at risk (PAR) for the industry exhibited an improved picture with the same declining to 3.7% (FY19: 4.8%) during FY20. Although PAR-30 on pan-sector basis improved during FY20, the same trend was not seen in MFIs and RSPs as the aforementioned players only deferred limited portions of applications received in order to keep the scenario on realistic basis for their particular organizations. PAR-30 holistically demonstrated improvement owing to sizable market share captured by MFBs; therefore, the trend for MFBs is replicated for the entire sector. On the other hand, the same ratio reported deterioration during the ongoing year on account of non-repayment by borrowers after completion of extension period. The dip in asset quality was expected given the repayment capacity of micro-credit borrowers was already impacted even prior to the emergence of pandemic. Asset quality remains a key rating concern going forward; hence the asset quality indicators will be stringently monitored over the due course, any adverse movement in the same may warrant revision in ratings. The trend in PAR-30 is presented in the chart below:



In the MFB segment, stemming from SBP's relaxation the NPLs for FY20 decreased to Rs. 8.1b as opposed to Rs. 13.2b in the preceding year; however, the same is not likely to be representative of actual asset quality until the rollover period is completed and repayments commence in entirety. Similarly, owing to the same reason gross and net infection of the segment shows improvement during the outgoing year. On the other hand, provisioning coverage (specific & general) has depicted an increasing trend on a timeline basis due to reduction in quantum of NPLs, high charge offs against provision and increased subjective general provision booked for the expected loan losses. Further, spike in provision and write-off amounts was seen during FY19 in line with sizable increase in NPLs representing that most of the loans classified as non-performing in the preceding year could not be recovered within the regulatory timeline of one month over 180 days. However, the same declined during FY20 in line with deferment scheme introduced. As a result, actual write-offs and provisions charged from income exhibited significant increase in terms of provision booked on balance sheet indicating expense against actual credit losses is higher than provisioning allocated. The continuation of the similar trend may prove vulnerable to profitability indicators of the segment going forward. Holistically, analysis of the asset quality indicators signal a heightened credit risk phase for the entire microfinance sector. The tabular representation of the above discussed variables is illustrated below:

	FY18	FY19	FY20	1QFY21
Non-Performing Loans (Rs. in b)	5.1	13.2	8.1	9.5
Gross Advances (Rs. in b)	189.7	214.7	239.7	250.7
Gross Infection (%)	2.7	6.1	3.4	3.8
Provision against advances (Rs. in b)	4.5	11.6	8.8	8.7
Provision Coverage (Specific + General) (%)	88.3	88.5	109.1	91.4
Provision against NPLS to Gross Advances (%)	2.4	5.4	3.7	3.5

	FY18	FY19	FY20
Provision & Write off (Rs. in b)	4.5	16.8	11.9
Provision & write-off to NPL Provisions (%)	100.4	144.4	134.9
Net Infection (%)	1.4	5.0	2.3

The highest credit risk is reported under enterprise loans primarily owing to high ticket size making repayment by borrowers difficult amid depressed economic activity. The infection ratio of agriculture loans has scaled down on a timeline basis owing to majority of the aforementioned having bullet repayment and being eligible for rescheduling under SBP covid-related scheme.

Impact of Covid & SBP Deferment Package

The unexpected advent of COVID-19 adversely impacted the economic activity at varying degrees with microfinance sector being no exception. The situation aggravated quickly given the cash generating capacity of micro-credit borrowers was severely affected even prior to onslaught of pandemic owing to unfavorable weather conditions for crops including untimely rains, drought in Thar region and delayed offtake of sugarcane crop in 1HFY19. The aforementioned factors led to deterioration of asset quality, compression of business activities and downturn in profitability and liquidity indicators of the entire sector. In order to mitigate the heightened credit risk that could have eroded the cushion kept for loss absorption of the entire financial sector, the lender of the last resort, SBP announced a deferment package. The final decision to defer outstanding installments was held by the industry players; different players adopted different strategies to defer their outstanding receivables. The decisions were largely based on factors including recovery cycles, probability of recovery of future receivables, acceptable profitability contractions and management of liquidity stress.

The monthly disbursement rates declined sharply for April and May of FY20 for the entire micro-finance sector stemming from lockdowns implemented on a periodic basis. However, an improvement is disbursements statistics was witnessed post May'20; further disbursement rates increased by over 60% by Sep'20 for most industry players. The sizable reduction in interest rate also acted as a catalyst in inculcating some normalcy in sector dynamics; however, optimal disbursement strategy will remain key to sustenance. Following a similar trend to disbursement, recovery rates also fell drastically below 30% in the first two months of the lockdown. However, a turnaround was seen post June' 20 onwards when recovery activities picked pace; the same currently clocks at an average recovery rate of 80% for the entire sector. The deferment numbers are presented in the table below:

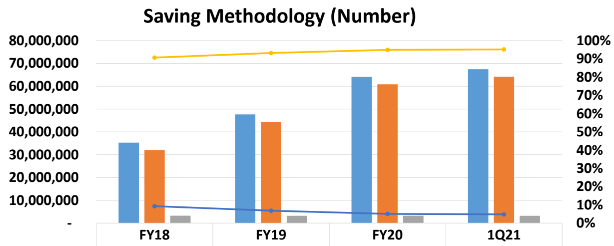
Loan Category	No. of Applications Received	No. of Applications Approved	% of Accepted Applications	Amount Approved
Microfinancing	1,736,113	1,717,665	98.9%	121.3
Total Financial Sector Deferment	1,883,552	1,825,466	96.9%	910.8
Microfinancing % of Total	91.2%	94.1%	N/A	13.3%

Salient Features of Regulatory Relief provided by SBP

- MFBs upon a written request of an obligor received before June 30, 2020, deferred repayment of principal loan amount by one year; provided that the obligor will continue to service the mark-up amount as per agreed terms & conditions. The deferment did not affect the credit history of the obligor and accordingly the same was not reported in the ECIB as restructuring. The eligibility criteria included that the loan was performing till 31st Dec'20.
- The financing facilities of such borrowers, who are unable to service the mark-up amount or need deferment exceeding one year, may be rescheduled/restructured upon their request. If the rescheduling / restructuring is done within 90 days of the loans being past due, such financing facility will continue to be treated as regular and reported in the ECIB accordingly.
- MFBs did not classify the financing facilities of borrowers who requested for deferment or rescheduling/restructuring, unless the payment obligations were past due by 90 days. If the deferment or rescheduling/restructuring is not executed successfully within the specified period of 90 days past due, such financing facilities will be classified as "Doubtful" as per prevailing instructions of Prudential Regulations for micro financing.
- The instructions on rescheduling / restructuring and classification of loans expired on March 31, 2021.

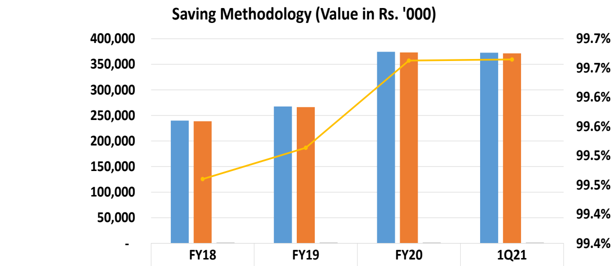
Funding Structure & Liquidity Profile

Only SBP-regulated MFPs (MFBs) are authorized for financial intermediation where public deposits are used to fund organization's loan portfolio. On the other hand, MFPs not regulated by SBP (MFI, NGOs, RSPs) can neither hold nor intermediate deposits from general public. These organizations however help in mobilization of savings from their members/clients to be placed with licensed commercial banks. In line with the regulation, number of savers along with value of savings is heavily dominated in MFB segment. Moreover, in terms of saving methodology, intermediation accounts for 100% of savings value and 59% of active savers. The discrepancy in number of savers and value of savings stems from the fact that all savings coming from savers associated with non-regulated MFPs are in turn deposited with MFBs.



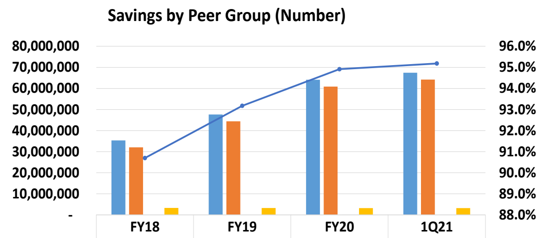
	FY18	FY19	FY20	1Q21
Total Number of Savers	35,293,602	47,642,271	64,112,657	67,442,325
Intermediation	32,009,797	44,390,660	60,852,016	64,193,616
Mobilization	3,283,805	3,251,611	3,260,641	3,248,709
Intermediation %	91%	93%	95%	95%
Mobilization %	9%	7%	5%	5%

Total Number of Savers, Intermediation, Mobilization, Intermediation %, Mobilization %



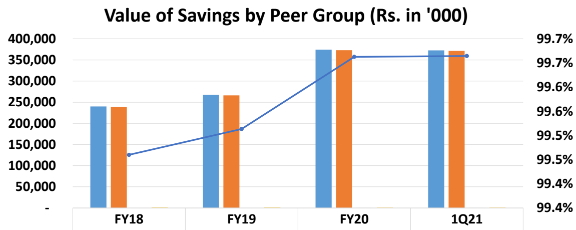
	FY18	FY19	FY20	1Q21
Total Value of Savings	239,963	267,591	374,362	372,572
Intermediation	238,667	266,289	373,099	371,322
Mobilization	1,296	1,307	1,263	1,250
Intermediation %	99.5%	99.5%	99.7%	99.7%

Total Value of Savings, Intermediation, Mobilization, Intermediation %



	FY18	FY19	FY20	1Q21
Total Number of Savers	35,293,602	47,642,271	64,112,657	67,442,325
MFB	32,009,797	44,390,660	60,852,016	64,193,616
MFI	-	0	58,295	58,295
RSP	3,283,805	3,251,611	3,202,346	3,190,414
MFB (%)	90.7%	93.2%	94.9%	95.2%

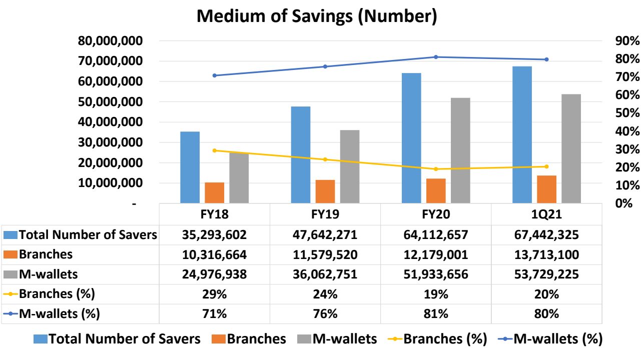
Total Number of Savers, MFB, MFI, RSP, MFB (%)

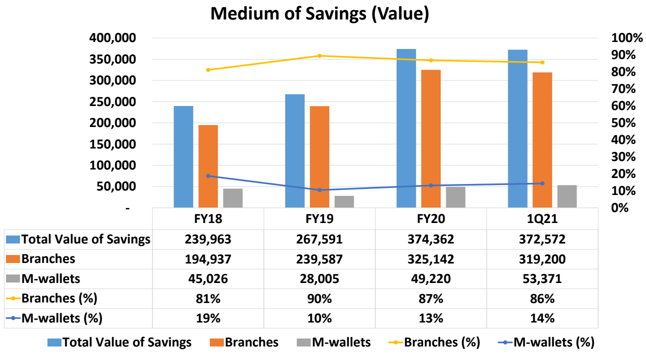


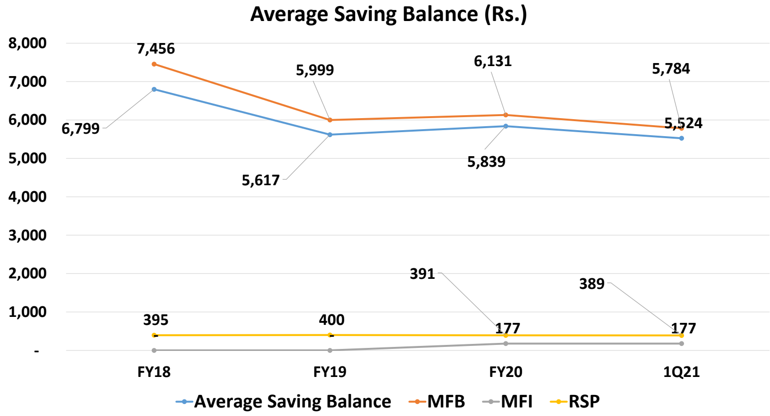
	FY18	FY19	FY20	1Q21
Total Value of Savings	239,963	267,591	374,362	372,572
MFB	238,667	266,289	373,099	371,322
MFI	-	-	10	10
RSP	1,296	1,302	1,253	1,240
MFB (%)	99.5%	99.5%	99.7%	99.7%

Total Value of Savings, MFB, MFI, RSP, MFB (%)

Further, majority of saving contribution is done by urban counterparts compared to rural population. Branchless banking saving platforms involving mobile wallets constitute the bigger chunk in reference to the number of clients; however, in terms of value majority savings are routed through branch networks. The increase in number of savers was driven by M-Wallets, as MMFB added an additional 3.5 million borrowers. By end-FY21, MMFB's market share increased in terms of depositors while KMBL maintained the largest deposit base with Rs. 86.7b and a market share of 23.3%. Further, with growth in number of savers due to m-wallets, the average saving balance has declined on a timeline basis. The districts with highest micro-saving outreach are Lahore, Karachi, Rawalpindi and Peshawar.







Total liabilities of MFBs increased to Rs. 443.8b (FY19: Rs. 329.6b) by end-FY20; however, the same were reported slightly lower at Rs. 437.0b by end-1QFY21. The growth of MFBs is largely fueled by deposit base as deposits constitute over 90% of the funding mix. The increase in the deposit base is likely due to the ongoing pandemic as the consumers have reduced spending and opted for saving strategy. On the other hand, increase in borrowings is limited and has remained range bound therefore borrowings in terms of total liabilities have remained on a lower side. The advance to deposit ratio (ADR) has declined on a timeline basis by end-1QFY21 in line with restricted lending activities carried out by MFBs owing to higher focus on portfolio consolidation; the same strategy is adopted to limit higher occurrence of NPLs as repayment capacity of micro-credit borrowers has dwindled amid pandemic crisis. MFBs have largely parked their excess liquidity in risk-free government securities which is evidenced from sizable growth in investment portfolio. The tabular illustration of the above factors is presented below:

	FY18	FY19	FY20	1Q21
Total Liabilities (Rs. in b)	279.0	329.6	443.8	437.0
Borrowings (Rs. in b)	21.5	19.8	26.9	20.6
Deposits (Rs. in b)	238.6	266.2	373.1	371.3
Investments (Rs. in b)	54.6	52.2	96.8	104.5
Deposits % of Funding Mix	86%	81%	84%	85%
ADR (%)	78%	78%	62%	65%

The analysis of deposit composition is considered critical in assessing the liquidity risk of the bank/sector. The proportion of current and saving accounts (CASA) in the overall MFB deposit mix has increased during the review period largely owing to increase in saving deposits as growth in current deposits has remained limited. Subsequently, the share of fixed deposits decreased on a timeline basis by end-FY20. In the past five years, the sector-initiated maneuvering towards shedding high-cost deposits for relieving pressure on spreads; the same has materialized and reflected positively on the deposit mix. In addition, retaining current deposits has relatively become easier in line with low interest rate scenario along with digital initiatives over the years. With improvement in CASA ratio, the granularity of the deposit base has improved; however, on the other hand stickiness of deposits is slightly compromised. Nevertheless, current deposits constitute one-fifth of the total deposit base, therefore, liquidity concerns for the sector have relatively reduced. Further, although the proportion of individual deposits has slightly decreased; the same continue to maintain a significant chunk further relieving granularity concerns. On the other hand, based on the top-4 micro-saving providers rated by VIS (KBL, FMFB, UBANK & NRSP-B) comprising 63% of total savings of the sector, the concentration of top-50 depositors based on weighted averages has increased to 50% (FY19: 43%) during FY20 indicating increased contribution of high-ticket deposits. The lowest concentration is reported by the market leader, KBL.

	FY18	FY19	FY20
Fixed	57.0%	55.2%	49.0%
Saving	24.0%	24.9%	29.7%
Current	19.0%	19.9%	21.3%
CASA	43.0%	44.8%	51.0%
Total Deposits (Rs. in b)	238.6	266.2	373.1

	FY18	FY19	FY20
Individual	61%	62.3%	60.1%
Corporate	23%	23.4%	25.0%
Bank	16%	14.3%	14.9%
Total Deposits (Rs. in b)	**238.6**	**266.2**	**373.1**

The liquidity profile of MFBs in terms of liquid assets has depicted a volatile trend in the last three reporting periods with improvement manifested in FY20 owing to excess capital being parked in liquid avenues given the micro-credit lending was mostly curtailed owing to advent of the pandemic. However, with slight stability in economic and financial statistics coupled with successful rollout of vaccine in the ongoing year, the lending activities have again gained momentum; hence, divestment is seen from the investment portfolio resulting in reduction in quantum of liquid assets during 1QFY21. Nonetheless, despite slight dip from FY20 numbers in line with focus on core financial intermediation activities, the liquidity profile of the segment is considered sound. However, if sizable deterioration of asset quality indicators is observed post-SBP deferment, liquidity indicators may come under pressure in the medium term.

	FY18	FY19	FY20	1Q21
Liquid Assets/ Total Assets	24%	28%	36%	31%
Liquid Assets/ Total Deposits	32%	40%	47%	42%
Liquid Assets/ ST Liabilities	37%	48%	51%	45%
Liquid Assets/ Deposits + Borrowing's and Bills Payable	30%	37%	44%	39%

Profitability

In the MFB segment, total markup income earned has exhibited an upward trajectory on a timeline basis predominantly on back of higher average microcredit and investment portfolios; markup on advances comprises the largest portion of interest income. Similarly, in line with growth in scale of operations, total markup expensed also increased with notable increase in deposits base. As a result, growth was witnessed in net markup income; however, net interest margin has dwindled over the years in line with decline in spreads of the MFB segment. Moreover, net interest markup in respect to total assets has also decreased owing to slight shift in the asset mix where higher proportional increase was manifested in investment portfolio; the same mainly entails risk-free avenues with lower yields in comparison to credit portfolio.

	FY18		FY19		FY20		1Q21	
	Amount (in Rs. b)	%	Amount (in Rs. b)	%	Amount (in Rs. b)	%	Amount (in Rs. b)	%
Markup Earned	**50.6**		**66.8**		**75.3**		**19.2**	
Loans & Advances	45.9	91%	57.3	86%	65.2	87%	16.3	85%
Investments	2.0	4%	3.6	5%	5.0	7%	1.7	9%
Deposits & Others	2.6	5%	5.9	9%	5.2	7%	1.1	6%

	FY18		FY19		FY20		1Q21	
	Amount (in Rs. b)	%	Amount (in Rs. b)	%	Amount (in Rs. b)	%	Amount (in Rs. b)	%
Markup Expensed (b)	**15.8**	**26.2**	**30.4**	**7.7**	**5.0**	**7%**	**1.7**	**9%**
Deposits	14.7	93%	22.9	87%	26.9	88%	7.1	92%
Borrowings	1.0	6%	2.8	11%	3.0	10%	0.6	7%
Others	0.1	1%	0.5	2%	0.5	2%	0.1	1%

Yield on markup bearing assets showcased volatility during the period under review; the same was primarily a function of movement in market interest rates. The yield on assets was reported higher in FY19 on account of high policy rate coupled with increased disbursement under MSME product segments involving relatively higher effective interest rates. In the outgoing year, return on assets dipped due to slash in discount rate from 13.25% to 7.0% by the central bank. In addition to reduction in interest rate, higher capital allocation to investment mix has also contributed to decline in yield on assets during FY20. On the other hand, cost of funds also presented a similar picture with increase reported in FY19 followed by a decline in the following year. Apart from the aforementioned reason, cost of funding in FY20 also decreased in line with reduction in proportion of fixed deposits as the same carry the highest rate of interest. Subsequently, as the impact of reduction in cost of funds was largely offset by decline in asset yield, spreads of the MFB segment declined only slightly while remaining range bound. Going forward, MFBs project yield on advances to decline on account of possible regulatory pressure on product prices; however, the same can be mitigated through increased lending in high interest yielding product lines. On the other hand, cost of funds is also projected to decline on account of lower benchmark rate along with shedding of high-cost deposits; thereby spreads are largely expected to remain at current levels.

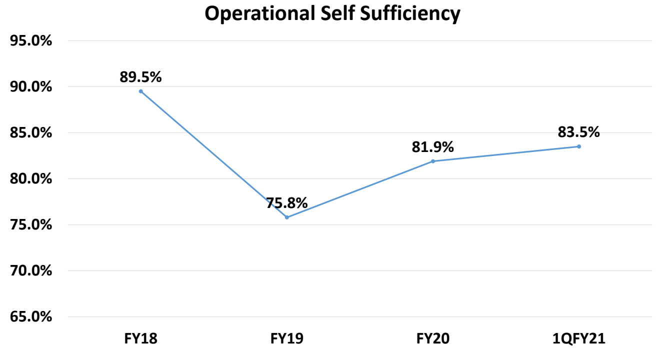
	FY18	FY19	FY20	1Q21
Return on Assets	20.7%	22.8%	21.7%	45.6
Cost of Funds	7.5%	10.6%	9.7%	56.4
Spreads	13.2%	12.2%	12.0%	11.4%

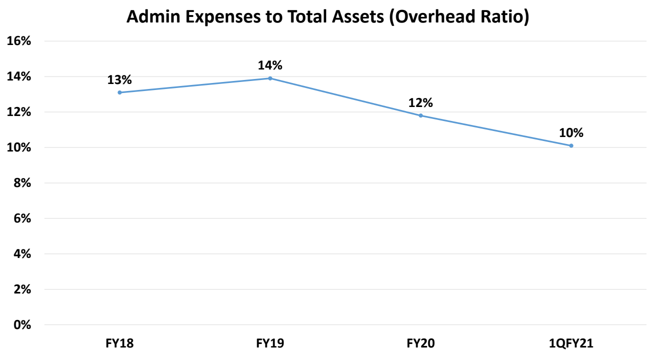
The rescheduling of loans under the SBP's directive put a cap on cash flows available for the disbursement of new loans along with decision to reduce micro-credit lending led to decline in number of branch-based loans disbursed, therefore, non-markup income including microcredit application processing fee decreased during FY20. Total administrative expenses of the banking sector increased on a timeline basis in line with growth in scale of operations resulting in increase in staff related expenses along with annual salary adjustments to compensate for inflationary pressure over the years. However, with sizable growth in the asset base overhead ratio has declined during the review period.

	FY18	FY19	FY20
Non-Markup Income (Rs. in b)	13.7	15.3	13.1
Administrative Expenses (Rs. in b)	25.8	47.1	48.5
Net Interest Income after Provisioning & Write-off (Rs. in b)	30.2	23.8	33.0

The loan loss provision peaked during FY19 in line with escalated credit risk owing to hampered debt repayment capacity of borrowers. Although, provisions have declined post announcement of SBP's covid relief package; however, the same still are on a higher side in comparison to historical trends. Subsequently, despite no major decline in mark-up spreads, profitability of the segment took a downward trend and turned negative primarily owing to increase in administrative and provisioning expenses coupled with reduction in non-markup income. As a result, operational self-sufficiency (OSS) ratio decreased on a timeline basis in line with higher provisioning recorded. However, slight improvement was witnessed in OSS during the outgoing and current year in line with reduced provisioning expenses in line with SBP deferment scheme.

	FY18	FY19	FY20	1Q21
Profit Before Tax (Rs. in b)	8.0	(5.9)	(3.4)	(0.1)
Profit After Tax (Rs. in b)	4.6	(8.1)	(5.9)	(0.7)
ROA (%)	1.6%	(2.3%)	(1.3%)	(0.1%)
ROE (%)	11.3%	(16.3%)	(11.7%)	(1.3%)





Capitalization Indicators

The paid-up capital and equity base of the microfinance banks augmented on a timeline basis on account of internal capital generation and additional equity injection by sponsors. However, the increase in paid-up capital was more profound by end-FY20 in comparison to augmentation of total equity base owing to incurrence of losses. No cash dividend was paid out during the outgoing year to strengthen the loss absorption capacity of the segment in line with heightened credit risk scenario. Further, the net NPLs as a percentage of the bank's Tier-I capital decreased to 11.1% (FY19: 20.6%) during FY20 as a combined impact of reduction in reported NPLs owing to restructuring scheme along with growth in equity base. Further, Capital Adequacy Ratio (CAR) was maintained at healthy levels exhibiting significant capacity for absorption of losses and room for growth.

	FY18	FY19	FY20	1Q21
Paid Up Capital (Rs. in b)	27.6	29.3	37.9	45.6
Total Equity (Rs in b)	49.0	50.4	50.2	56.4
Total Equity to Total Assets (%)	14.9%	13.3%	10.2%	11.4%
CAR (%)	22.6%	20.9%	19.0%	20.3%

Future Outlook

Based on the above discussed statistics including subdued GLP growth, limited disbursements, asset quality not presenting true picture and weak profitability indicators, VIS placed majority of the MFPs on 'Rating- Watch Developing' during the recent rating review. There is heightened repayment risk associated with deferred loans, especially with those entailing bullet payment, given the installments for entire rollover loans will become due post-Mar'22. Hence, credit risk scenario is expected to remain uncertain during the next two quarters. Therefore, the rating outlook will only be revised once the entire credit portfolio becomes regular again leading to assessment of operating performance of the institutions with basic level of certainty.

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