The Pakistan Credit Rating Agency Limited

FINCA MICROFINANCE BANK LIMITED (FINCA)

RATINGS REPORT

	CURRENT [DEC-17]	PREVIOUS [JUN-17]
Entity Rating		
Long Term	A	A
Short Term	A1	A1
Outlook	Stable	Stable
Instrument Rating	A	A

REPORT CONTENTS

DECEMBER 2017

Profile & Ownership
- FINCA Microfinance Bank Limited (FINCA) begin its operations in 2013, after FINCA International acquired the majority shares; previously Kashf Microfinance Bank
- The bank operates with a network of 113 branches, with its head office in Lahore
- Majorly owned by FINCA International (86.4%), through FINCA Microfinance Cooperatief U.A; a commercial arm registered in Holland
- Kashf Holdings (pvt) limited, the initial founder of the bank, holds ~5.2% stake in the bank

Governance and Management
- Nine member board of directors; six representative of FINCA International, one of Kashf and two independent member
- Ms Zarlasht Wardak – regional director of the MESA network – is the Chairman
- Mr. Mudassar Aqil – CEO of the bank – is an experienced banking industry veteran

Risk Management
- Risk Management department oversees credit, operational and market risks
- The bank has digitalize customer experience for branch banking services through automation of account opening and loan generation process
- Launched branchless banking app, SIMSIM, has reached 112,000 customers up till now

Asset Risk
- Gross Loan Portfolio continued to increasing trend in 9M17 (59% YoY); however, expansion of portfolio led to slight deterioration in the portfolio quality (impaired lending: 2.2%)
- Maintaining the liquidity, ADR normalized to 76% (CY16: 91%)
- Investment in Government Securities increased to PKR 4.5bln, forming ~21% of total assets

Performance
- Market share was sustained in 9M17; Gross Loan Portfolio 7%, Savings 11%
- Earning assets grew significantly to PKR 17.8bln at end-Sep17; constituting 80% of total assets
- NIMR increased by 57%, leading to better operational efficiencies
- Despite expansion, management was successful in rationalizing its cost evident from the reduced cost-to-total revenue ratio (9M17: 57%,9M16: 67%); continuing this improvement remains important
- Controlled expenses along with doubled fee income led to a generous pre-provision operating profits forming 43% of the equity
- Bank earned a net profit of PKR 653mln in 9M17 (9M16: PKR 302mln)

Sustainability
- A twofold strategy encompassing business growth through geographical expansion and through technology advancement; eyeing to double its size in two years' time
- Branchless banking to remain in focus
- In collaboration with a technology provider, the bank has setup a mobile wallet app "SIMSIM"

Liquidity
- Monitors liquidity through Asset and Liability Management Committee (ALCO), and aligns asset-liability mismatch accordingly
- Liquidity profile remained adequate as reflected by liquid-assets-to-deposits and borrowings (liquidity ratio) of ~38% (Sep16: 27%); though needs management attention with the growth strategy as the surging deposits are stretching the liquidity
- In addition to deposits, running finance lines (~PKR 850Mln) from various banks including JS Bank, UBL Bank and Faysal Bank

Funding & Capital
- Diversified fund base; in addition to deposits, running finance lines from various banks
- Aggressively mobilized deposits as evident by ~89% growth (PKR 17bln), on back of deposits exclusive branch; CASA mix form 27% of total deposits
- As the bank is at early stages of development, the cost of deposits is higher which is expected to normalize as the bank grows
- Owing to aggressive increase in advances, bank's CAR declined from 30% to 21% at end-Dec16; however remains higher that the regulatory requirement of 15%
- Equity to asset margin squeezed to 14% form 18% previously
- Healthy bottom-line translated into an improved internal capital generation (27%)

Instrument
- FINCA has issued a privately placed Term Finance Certificates of PKR 1.5bln
- Issue has an option to be issued in three equal instalments or in a single bullet within the availability period of nine months; with a tenor of 5 years and shall be redeemed in 16 equal quarterly installments. Profit will be paid quarterly at a mark-up of 3M Kibor + 1.5%.
- Instrument is secured against first pari passu charge over all future and present current assets along with 25% margin. In addition to this, a Debt Payment Account would be maintained which would be funded with an amount equal to principal and profit payment due at the end of each quarterly payment. Proceeds of this issue will be utilized for growth in bank's operations

RATING RATIONALE

The ratings reflect association of FINCA Microfinance Bank (FINCA) with a global microfinance organization – FINCA International. This affiliation has supported FINCA not only in terms of building a wholesome strategy but also in establishing strong system and controls. FINCA is a major player in the market (Jun'17: 7% share in total gross loan portfolio of micro finance institutions). The extended branch network and introduction of deposit exclusive branches led the bank to aggressively mobilize deposits. The bank intends to build a stable and diverse deposit base. Given that the current deposit landscape is very competitive, building a granular (as well as low cost) deposit base is challenging. Accordingly, FINCA intends to build inroads using digital platform. Meanwhile, it has running finance lines from various banks to support funding base. The sustained quality of asset led to better operational efficiencies; hence, improving the operational profitability. FINCA aims to digitalize its operations and strengthen its technology infrastructure, along with offering mobile wallet to its customers. In this regard, it has stepped into branchless banking domain as well. The recently launched branchless banking app, SIMSIM, has reached 112,000 customers up till now. Strong banking practices with extended branch network acclaims FINCA's efforts to provide long term solutions to their customers. Offering such solutions would lead FINCA towards greater independence and financial stability which would help it serve its mission.

KEY RATING DRIVER

The rating is dependent upon FINCA's ability to sustain its operational profitability while improving its market position. With growing loan book, related risks mainly credit quality need close monitoring. The successful execution of business strategy by the management team remains important.

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FINCA MICROFINANCE BANK LIMITED

PKR mln

BALANCE SHEET	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9M	Annual	Annual	Annual
Earning Assets				
Total Finances	12,943	10,094	5,352	3,992
Investments	4,559	1,885	1,039	448
Deposits with Banks	1,249	1,248	410	604
	18,750	**13,228**	**6,802**	**5,044**
Non Earning Assets				
Non-Earning Cash	1,133	810	357	314
Net Non-Performing Finances	75	(12)	66	2
Fixed Assets & Others	2,238	1,592	1,227	1,020
	3,445	**2,390**	**1,650**	**1,336**
TOTAL ASSETS	**22,196**	**15,618**	**8,452**	**6,380**
Interest Bearing Liabilities				
Deposits				
CASA	4,682	3,394	2,136	1,334
Time Deposits	12,408	7,675	3,921	3,322
	17,090	**11,070**	**6,057**	**4,656**
Borrowings	1,089	1,350	115	201
Non Interest Bearing Liabilities	933	766	346	241
TOTAL LIABILITIES	**19,111**	**13,185**	**6,518**	**5,098**
EQUITY (including revaluation surplus)	3,075	2,420	1,915	1,264
Deferred Grants	9	13	18	18
TOTAL LIABILITIES & EQUITY	**22,196**	**15,618**	**8,452**	**6,380**

INCOME STATEMENT	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
	9M	Annual	Annual	Annual
Interest / Mark up Earned	3,436	2,986	1,900	1,247
Interest / Mark up Expensed	(872)	(648)	(535)	(361)
Net Interest / Markup revenue	**2,564**	**2,338**	**1,365**	**886**
Other Operating Income	386	441	283	219
Total Revenue	**2,950**	**2,780**	**1,648**	**1,105**
Other Income	105	110	43	16
Non-Interest / Non-Mark up Expensed	(1,731)	(1,683)	(1,340)	(1,043)
Pre-provision operating profit	1,323	1,207	351	78
Provisions	(256)	(219)	(106)	(47)
Pre-tax profit	1,068	988	245	31
Taxes	(415)	(357)	(79)	145
NET INCOME	**653**	**631**	**167**	**176**

Ratio Analysis	30-Sep-17	31-Dec-16	31-Dec-15	31-Dec-14
Performance	9M	Annual	Annual	Annual
ROE	32.8%	29.1%	10.5%	15.0%
Cost-to-Total Net Revenue	56.7%	58.2%	79.3%	93.1%
Capital Adequacy				
Equity/Total Assets	13.9%	15.5%	22.7%	19.8%
Capital Adequacy Ratio as per SBP	19.9%	20.6%	30.3%	0.0%
Loan Loss Coverage				
Impaired Lending / Gross Finances	2.2%	1.1%	2.3%	0.9%
Loan Loss Provisions / Non-Performing Advances	73.9%	110.3%	47.6%	94.0%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	38.2%	31.8%	29.3%	28.1%
Finances / Deposits	76.2%	91.1%	89.5%	85.8%
CASA deposits / Total Customer Deposits	27.4%	30.7%	35.3%	28.7%
Intermediation Efficiency				
Asset Yield*	21.6%	29.8%	32.1%	29.6%
Cost of Funds*	5.8%	7.0%	9.7%	9.5%
Spread*	15.8%	22.9%	22.4%	20.1%

****These ratios have been worked on a 9 months period basis.***

STANDARD RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**Highly speculative.** Significant credit risk. A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC **CC** **C**	**High default risk**. Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.