The Pakistan Credit Rating Agency Limited

# FINCA MICROFINANCE BANK LIMITED (FINCA)

## RATING REPORT

| | INITIAL [JUN-17] |
|---|---|
| **Entity Rating** | |
| Long Term | A |
| Short Term | A1 |
| Outlook | Stable |

**REPORT CONTENTS**



JUNE 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 105 branches, with its head office in Lahore and plans to add another 15 branches by end of 2017
- Majorly owned by FINCA Microfinance Cooperatief (86.4%), a wholly owned subsidiary of FINCA International, Inc
- 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 a banking industry veteran with experience in leading positions at banks in Pakistan and US

## Risk Management

- Risk Management department oversees credit, operational and market risks
- System and operations department, headed by a seasoned resource, closely monitors all of the operations and also acts as a liaison between head office and branches
- New initiatives includes i) establishing Centralized Processing for fraud preventive measures, ii) introduced a "red flag" system to evaluate branches for fraudulent activities
- The bank has digitalize customer experience for branch banking services through automation of account opening and loan generation process

## Performance

- Gross Loan Portfolio (GLP) doubled (PKR 10,209mln), achieving a market share 7%
- Average loan size increased by 27% from last year, mainly by the lending to the medium and small enterprises; average loan size (PKR 75,866) remained higher than the industry (PKR 41,633)
- Similar growth pattern (83%) on deposit side, achieved market share of 9%
- Earning assets grew significantly to PKR 13.2bln at end-Dec16; deposits with other banks alone surged to PKR ~1.2bln
- NIMR increased by 71%, leading to better operational efficiencies; pre-provision operating profits formed 50% of the equity (Dec'15: 18%)
- Efforts to rationalize cost evident from the reduced cost-to-total revenue ratio (CY16: 58%, CY15: 79%, CY14: 93%), however, still needs attention
- Bank earned a net profit of PKR 631mln

## 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 be introduced this year; SBP approvals inline
- In collaboration with a technology provider, the bank has setup a mobile wallet app "SIMSIM"

## Asset Risk

- Quality of advances improved, evident from impaired lending being reduced by 9% and only forming 1.1% of the total advances
- ADR currently 91%, and plan to achieve an ADR of 100% next year; management needs to adopt contingency measures to address the associated risk of liquidity
- Investment in market treasury bills of PKR 1,885mln, the deposits with banks increased massively amounting to PKR 1,248mln

## 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 32% (Dec15: 29%); though needs management attention with the growth strategy as the surging deposits are stretching the liquidity
- In addition to deposits, running finance lines from various banks including JS Bank, UBL Bank and NIB Bank

## Funding & Capital

- Diversified fund base; in addition to deposits, running finance lines from various banks
- Aggressively mobilized deposits as evident by ~83% growth (PKR 11bln), on back of deposits exclusive branch; Individual deposits form 70% of total deposits, decreased from last year (87%); CASA mix moderate at 30%
- As the bank is at early stages of development, the cost of deposits is higher which is expected to normalize as the bank grows; top 10 depositors concentration remained at 29%
- 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 15% form 23% previously
- Healthy bottom-line translated into an improved internal capital generation (39%)

## RATING RATIONALE

The ratings reflect association of FINCA Microfinance Bank with a global microfinance organization – FINCA Microfinance Holding. 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 (CY16: 7% share in total gross loan portfolio of micro finance institutions). The bank was among the top two MFBs contributing into the GLP growth of the industry, in the recent period. 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, the bank intends to build inroads using digital platform. Meanwhile, the bank 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. The bank aims to digitalize its operations and strengthen its technology infrastructure, along with offering mobile wallet to its customers. The bank is poised to step into branchless banking domain.

## KEY RATING DRIVER

The rating is dependent upon the bank'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.

## INDUSTRY

Pakistan Microfinance Industry (MFI) comprises 51 microfinance institutions including 11 microfinance banks (MFBs). MFI outreach hovers around 4.6mln active borrowers, representing low penetration, as estimated market potential is 27mln microfinance clients. MFBs dominate the sector, representing 66% in total Gross Loan Portfolio (PKR 89,940 mln) and 43% of active borrowers at end-Dec16. For period ended Dec16, total gross loan portfolio and amount of deposits for MFBs increased by 11% and 5.3% YoY respectively.

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# FINCA MICROFINANCE BANK LIMITED

PKR mln

| BALANCE SHEET | 31-Mar-17 | 31-Dec-16 | 31-Dec-15 | 31-Dec-14 |
|---|---|---|---|---|
| **Earning Assets** | | | | |
| Total Finances | 11,573 | 10,094 | 5,352 | 3,992 |
| Investments | 2,062 | 1,885 | 1,039 | 448 |
| Deposits with Banks | 912 | 1,248 | 410 | 604 |
| | **14,548** | **13,228** | **6,802** | **5,044** |
| **Non Earning Assets** | | | | |
| Non-Earning Cash | 748 | 810 | 357 | 314 |
| Net Non-Performing Finances | (13) | (12) | 66 | 2 |
| Fixed Assets & Others | 2,032 | 1,592 | 1,227 | 1,020 |
| | **2,767** | **2,390** | **1,650** | **1,336** |
| **TOTAL ASSETS** | **17,315** | **15,618** | **8,452** | **6,380** |
| **Interest Bearning Liabilities** | | | | |
| **Deposits** | | | | |
| CASA | 3,928 | 3,394 | 2,136 | 1,334 |
| Time Deposits | 8,554 | 7,675 | 3,921 | 3,322 |
| | **12,481** | **11,070** | **6,057** | **4,656** |
| **Borrowings** | 1,162 | 1,350 | 115 | 201 |
| **Non Interest Bearing Liabilities** | 1,006 | 766 | 346 | 241 |
| **TOTAL LIABILITIES** | **14,649** | **13,185** | **6,518** | **5,098** |
| **EQUITY (including revaluation surplus)** | 2,654 | 2,420 | 1,915 | 1,264 |
| **Deferred Grants** | 12 | 13 | 18 | 18 |
| **TOTAL LIABILITIES & EQUITY** | **17,315** | **15,618** | **8,452** | **6,380** |

| INCOME STATEMENT | 31-Mar-17 | 31-Dec-16 | 31-Dec-15 | 31-Dec-14 |
|---|---|---|---|---|
| | Annual | Annual | Annual | Annual |
| Interest / Mark up Earned | 1,072 | 2,986 | 1,900 | 1,247 |
| Interest / Mark up Expensed | (240) | (648) | (535) | (361) |
| **Net Interest / Markup revenue** | **832** | **2,338** | **1,365** | **886** |
| Other Operating Income | 125 | 441 | 283 | 219 |
| **Total Revenue** | **957** | **2,780** | **1,648** | **1,105** |
| Other Income | 19 | 110 | 43 | 16 |
| Non-Interest / Non-Mark up Expensed | (547) | (1,683) | (1,340) | (1,043) |
| Pre-provision operating profit | 430 | 1,207 | 351 | 78 |
| Provisions | 70 | (219) | (106) | (47) |
| Pre-tax profit | 500 | 988 | 245 | 31 |
| Taxes | (126) | (357) | (79) | 145 |
| **NET INCOME** | **374** | **631** | **167** | **176** |

| Ratio Analysis | 31-Mar-17 | 31-Dec-16 | 31-Dec-15 | 31-Dec-14 |
|---|---|---|---|---|
| **Performance** | | | | |
| ROE | 64.3% | 29.1% | 10.5% | 15.0% |
| Cost-to-Total Net Revenue | 56.0% | 58.2% | 79.3% | 93.1% |
| **Capital Adequacy** | | | | |
| Equity/Total Assets | 15.3% | 15.5% | 22.7% | 19.8% |
| Capital Adequacy Ratio as per SBP | 20.6% | 20.6% | 30.3% | 0.0% |
| **Loan Loss Coverage** | | | | |
| Impaired Lending / Gross Finances | 1.1% | 1.1% | 2.3% | 0.9% |
| Loan Loss Provisions / Non-Performing Advances | 109.9% | 110.3% | 47.6% | 94.0% |
| **Funding & Liquidity** | | | | |
| Liquid Assets / Deposits and Borrowings | 27.3% | 31.8% | 29.3% | 28.1% |
| Finances / Deposits | 92.6% | 91.1% | 89.5% | 85.8% |
| CASA deposits / Total Customer Deposits | 31.5% | 30.7% | 35.3% | 28.7% |
| **Intermediation Efficiency** | | | | |
| Asset Yield | 30.9% | 29.8% | 32.1% | 29.6% |
| Cost of Funds | 7.4% | 7.0% | 9.7% | 9.5% |
| Spread | 23.5% | 22.9% | 22.4% | 20.1% |
| **Outreach** | | | | |
| Branches | 105 | 105 | 105 | 105 |

# 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

| | |
|---|---|
| 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+<br>AA<br>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+<br>A<br>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+<br>BBB<br>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+<br>BB<br>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+<br>B<br>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<br>CC<br>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.

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| | |
|---|---|
| **Name of Issuer** | FINCA Microfinance Bank Limited (FINCA Bank) |
| **Sector** | Microfinance |
| **Type of Relationship** | Solicited |
| **Purpose of the Rating** | Independent Risk Assessment |

**Rating History**

| Dissemination Date | Long Term | Short Term | Outlook | Action |
|---|---|---|---|---|
| 30-Jun-17 | A | A1 | Stable | Initial |

**Related Criteria and Research**

| | |
|---|---|
| Rating Methodology | Microfinance Instituitions Methodology |
| Sector Research | Banking \| Microfinance - Viewpoint \| Feb-17 |

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Rating Team Statement

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