



The Pakistan Credit Rating Agency Limited

## Rating Report

### FINCA Microfinance Bank Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Apr-2018	A	A1	Stable	Maintain	-
30-Dec-2017	A	A1	Stable	Maintain	-
30-Jun-2017	A	A1	Stable	Initial	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect association of FINCA Microfinance Bank (FINCA) with a global microfinance organization – FINCA International. This affiliation supports FINCA Microfinance Bank in terms of building a wholesome strategy and also in establishing robust systems and controls. FINCA is a major player in Pakistan’s microfinance sector (Dec’17: ~7% share in total gross loan portfolio and ~10% share in total microfinance savings). 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. It has arranged sizeable running finance lines from various banks to support funding base. Sustained operational efficiencies in CY17 led to improved core profitability to an appreciable level. Asset quality remained strong although delinquency ratio dropped slightly. Meanwhile, the bank is eyeing tier II capital to strengthen its capital base. FINCA’s focus remains on digitizing its operations and strengthening of its technology infrastructure to expand its outreach. In this regard, it has already tapped on branchless banking domain through its mobile application SIMSIM which has increased its outreach to over ~120,000 customers by End-Dec’17. Many new products are on the cards. Improvement in performance indicators for branchless banking would gradually transpire. Strong banking practices with extended branch network acclaims FINCA’s efforts to provide long term solutions to their customers.

The rating is dependent upon FINCA’s ability to sustain its operational profitability while improving its market position. Progressing towards growth trajectory in digital banking remains critical amidst rising competition. With growing loan book, related risks mainly include sustenance of good credit quality, liquidity management and asset health. Successful execution of business strategy by the management team is imperative.

#### Disclosure

<b>Name of Rated Entity</b>	FINCA Microfinance Bank Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   MicroFinance Institutions (Jun-17),Methodology   Correlation between long-term and short-term rating scale(Jun-17),Methodology   Criteria Modifiers(Jun-17)
<b>Related Research</b>	Sector Study   Microfinance Bank(Apr-18)
<b>Rating Analysts</b>	Amara Gondal   amara.gondal@pacra.com   +92-42-35869504

## The Pakistan Credit Rating Agency Limited

FINCA MICROFINANCE BANK LIMITED		MICROFINANCE SNAPSHOT
<b>Incorporation</b>	2008 – as Kashf Microfinance Bank	<ul style="list-style-type: none"> <li>• Composition of 11 Microfinance Banks (MFBs), 16 Microfinance Institutions (MFIs) and 6 Rural Support Programs (RSPs) with a credit outreach of ~44%, ~33% and ~19% respectively.</li> <li>• Gross Loan Portfolio recorded at PKR~202bln at End-Dec17 indicating a growth of ~10% in the 4QCY17.</li> <li>• Savings increased by ~15% in the 4QCY17 and recorded at PKR~163bln at End-Dec17.</li> <li>• Sector's outreach growth rate - over ~6% in the 4QCY17.</li> </ul>
<b>Legal status</b>	Microfinance Bank – Public Limited	
<b>Outreach</b>	116 branches - nationwide	
<b>Head Office</b>	DHA Phase 3, Lahore	
<b>OWNERSHIP</b>		
<ul style="list-style-type: none"> <li>▪ Ownership of FINCA Microfinance Bank (herein referred to as “the bank”) is dominated by FINCA International (~86.4%), followed by Kashf Holding (Pvt) Limited (~5.2%), International Finance Corporation (~4.9%) and Triodos Fair Share Fund (~2.7%).</li> <li>▪ The bank began its operations in 2013 after FINCA International acquired majority shares of the bank, previously named Kashf Microfinance Bank, through its subsidiary FINCA Microfinance Cooperatief U.A.</li> </ul>		
<b>GOVERNANCE</b>		
<ul style="list-style-type: none"> <li>▪ The Board of Directors comprises of 9 members; six representative of FINCA International, one of Kashf Holding and two independent directors.</li> <li>▪ .Ms. Zarlasht Wardak, representative of FINCA International, is the Chairperson of the Board.</li> <li>▪ The Board is branched into four sub-committees; (i) HR (ii) Risk Management (iii) Audit (iv) Digital Financial Systems committee (DFS). The DFS Committee is particularly formed to oversee developments in digital mobile banking.</li> <li>▪ Management Awareness Rating System (MARS) – a performance monitoring unit expressly in place to surveil the performance of Board as well as the Management of the bank.</li> </ul>		
<b>MANAGEMENT &amp; RISK MANAGEMENT</b>		
<ul style="list-style-type: none"> <li>▪ The CEO, Mr. Mudassar Aqil, is a banking industry veteran associated with FINCA Bank since 2011. He has an overall experience of ~20 years.</li> <li>▪ Management Committees are in place including Asset and Liability Management Committee (ALCO) specially designated to monitor liquidity profile of the bank.</li> <li>▪ Assertive pre and post disbursement risk control mechanism in place and a separate recovery department to monitor non-performing loan books and manage recoveries.</li> </ul>		
<b>ASSET RISK</b>		
<ul style="list-style-type: none"> <li>▪ Loan Book grew by ~48% YoY in CY17; secured loans represented ~2% of the total loan portfolio.</li> <li>▪ Infection risk inched up slightly ~1.5% at End-Dec17 (End-Dec16: ~1.1%), pertaining mostly to microenterprise loans - however remained in line with the industry peers.</li> <li>▪ Notable expansion in Investment portfolio - End-Dec17: ~21% of total assets, End-Dec16: ~12% of total assets. Investments solely comprise of Government Securities which restricts market risk to a significantly low level.</li> </ul>		
<b>PERFORMANCE</b>		
<ul style="list-style-type: none"> <li>▪ Market share with respect to gross loan portfolio was sustained in CY17 (~7%) and marginally increased with respect to deposits (End-Dec17: ~10%, End-Dec16: ~9%).</li> <li>▪ Earning assets reflected ~86% of asset base at End-Dec'17(End-Dec'16:~85%), however increased significantly (~64%) in CY17 due to increased investment and lending portfolio.</li> <li>▪ Net Interest/Markup revenue increased sufficiently by ~52% YoY transpiring into healthy operating results.</li> <li>▪ Bottom-line of PKR~855mln (CY16: PKR~631mln) was recorded, depicting a YoY increase of ~35% - a factor of successful rationalization of costs as evident from a stable cost-to-total revenue ratio of ~58% (CY16:58%).</li> <li>▪ Installation of digital multi-featured mobile wallet app named SIMSIM in collaboration with FINJA in Aug'17 – a Pakistani Fintech provider. At End-Dec'17, the total number of SIMSIM subscribers reached to 124,717. Going forward, management's strategy is pivoted around introducing digitalized products through innovation and technology that have distinctive features from other industry players.</li> </ul>		
<b>FINANCIAL RISK</b>		
<ul style="list-style-type: none"> <li>▪ Funding constitutes deposits and borrowings from financial institutions - deposits grew by ~73% in CY17; End-Dec17: PKR~19,184mln (End-Dec16: PKR~11,070mln). CASA constituted ~30% of the total deposit base at End-Dec17.</li> <li>▪ Liquidity profile remained stretched as reflected by the liquid assets-to-deposits and borrowing ratio of ~37% at End-Dec17 (~End-Dec16:~32%), though still necessitates management attention with the growth strategy since surging deposits stretch liquidity. Simultaneously, the bank has obtained running finance facilities from financial institutions to meet its liquidity requirements.</li> <li>▪ CAR stood at ~19% as compared to ~20% at End-Dec'17 – a factor of a trivial portion of secured lending in the total loan portfolio. Increase in Tier-II capital is in pipeline to strengthen CAR, going forward.</li> </ul>		



**The Pakistan Credit Rating Agency Limited**  
**FINCA MICROFINANCE BANK LIMITED**

	PKR mln		
<b>BALANCE SHEET</b>	<b>31-Dec-17</b>	<b>31-Dec-16</b>	<b>31-Dec-15</b>
	Annual	Annual	Annual
<b>Earning Assets</b>			
Total Finances	14,886	10,094	5,352
Investments	5,209	1,885	1,039
Deposits with Banks	1,557	1,248	410
	<b>21,652</b>	<b>13,228</b>	<b>6,802</b>
<b>Non Earning Assets</b>			
Non-Earning Cash	976	810	357
Net Non-Performing Finances	(23)	(12)	66
Fixed Assets & Others	2,536	1,592	1,227
	<b>3,490</b>	<b>2,390</b>	<b>1,650</b>
<b>TOTAL ASSETS</b>	<b>25,142</b>	<b>15,618</b>	<b>8,452</b>
<b>Interest Bearing Liabilities</b>			
<b>Deposits</b>			
CASA	5,717	3,394	2,136
Time Deposits	13,467	7,675	3,921
	<b>19,184</b>	<b>11,070</b>	<b>6,057</b>
<b>Borrowings</b>	1,669	1,350	115
<b>Non Interest Bearing Liabilities</b>	1,006	766	346
<b>TOTAL LIABILITIES</b>	<b>21,859</b>	<b>13,185</b>	<b>6,518</b>
<b>EQUITY (including revaluation surplus)</b>	3,275	2,420	1,915
<b>Deferred Grants</b>	8	13	18
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>25,142</b>	<b>15,618</b>	<b>8,452</b>
<b>INCOME STATEMENT</b>	<b>31-Dec-17</b>	<b>31-Dec-16</b>	<b>31-Dec-15</b>
	Annual	Annual	Annual
Interest / Mark up Earned	4,809	2,986	1,900
Interest / Mark up Expensed	(1,256)	(648)	(535)
<b>Net Interest / Markup revenue</b>	<b>3,553</b>	<b>2,338</b>	<b>1,365</b>
Other Operating Income	564	441	283
<b>Total Revenue</b>	<b>4,117</b>	<b>2,780</b>	<b>1,648</b>
Other Income	129	110	43
Non-Interest / Non-Mark up Expensed	(2,461)	(1,683)	(1,340)
Pre-provision operating profit	1,785	1,207	351
Provisions	(407)	(219)	(106)
Pre-tax profit	1,378	988	245
Taxes	(523)	(357)	(79)
<b>NET INCOME</b>	<b>855</b>	<b>631</b>	<b>167</b>
<b>Ratio Analysis</b>	<b>31-Dec-17</b>	<b>31-Dec-16</b>	<b>31-Dec-15</b>
	Annual	Annual	Annual
<b>Performance</b>			
ROE	30%	29%	10%
Cost-to-Total Net Revenue	58%	58%	79%
<b>Capital Adequacy</b>			
Equity/Total Assets	13%	15%	23%
Capital Adequacy Ratio as per SBP	19%	21%	30%
<b>Loan Loss Coverage</b>			
Impaired Lending / Gross Finances	1%	1%	2%
Loan Loss Provisions / Non-Performing Advances	110%	110%	48%
<b>Funding &amp; Liquidity</b>			
Liquid Assets / Deposits and Borrowings	37%	32%	29%
Finances / Deposits	77%	91%	89%
CASA deposits / Total Customer Deposits	30%	31%	35%
<b>Intermediation Efficiency</b>			
Asset Yield	28%	30%	32%
Cost of Funds	8%	7%	10%
Spread	20%	23%	22%



## ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.			
<b>LONG TERM RATINGS</b>		<b>SHORT TERM RATINGS</b>	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.	<b>A1+:</b> The highest capacity for timely repayment.  <b>A1:</b> A strong capacity for timely repayment.  <b>A2:</b> A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.  <b>A3:</b> An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.  <b>B:</b> The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.  <b>C:</b> An inadequate capacity to ensure timely repayment.	
<b>AA+</b>	<b>Very high credit quality.</b> 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.		
<b>AA</b>	Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.		
<b>AA-</b>			
<b>A+</b>	<b>High credit quality.</b> 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.		
<b>A</b>			
<b>A-</b>			
<b>BBB+</b>	<b>Good credit quality.</b> Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.		
<b>BBB</b>			
<b>BBB-</b>			
<b>BB+</b>	<b>Moderate risk.</b> Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.		
<b>BB</b>			
<b>BB-</b>			
<b>B+</b>	<b>High credit risk.</b> 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.		
<b>B</b>			
<b>B-</b>			
<b>CCC</b>	<b>Very high credit risk.</b> "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.		
<b>CC</b>			
<b>C</b>			
<b>D</b>	Obligations are currently in default.		
<b>Rating Watch</b>	<b>Outlook (Stable, Positive, Negative, Developing)</b>	<b>Suspension</b>	<b>Withdrawn</b>
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 within foreseeable future, but may continue if underlying circumstances are not settled.	Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business or 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'.	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, a suspended rating should be considered 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.
<b>Disclaimer:</b> PACRA's rating is an assessment of the credit standing of an entity/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.			

### **Rating Team Statements**

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

### **2) Conflict of Interest**

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

### **Restrictions**

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

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- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA’s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA’s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA’s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA’s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)

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