



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
28-Apr-2020	A	A1	Stable	Maintain	YES
29-Oct-2019	A	A1	Stable	Maintain	-
29-Apr-2019	A	A1	Stable	Maintain	-
06-Nov-2018	A	A1	Stable	Maintain	-
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 (“the bank”) with a global microfinance organization – FINCA International. This affiliation supports FINCA Microfinance Bank in terms of building a strategy and also in establishing robust systems and controls. FINCA is a mid-tier player in Pakistan’s microfinance sector (End-Dec’19: ~7% share in total gross loan portfolio (GLP) and ~9% share in total microfinance deposits). The bank intends to build a stable and diverse deposit base. However, given the current business scenario, FINCA has also availed borrowings from SBP, under the line of credit (LoC) arrangement, to underpin its funding needs. The bank has stepped into the digital banking domain, however, the mix is currently small. Asset impairment ratio has risen to ~4.7% at End-Dec’19 (End-Dec’18: ~1.9%), which necessitates a cautious management approach. Average loan size of the bank is on the higher side in relation to its peers, which needs to be in check amidst rising industry infection ratio. The bank’s GLP has witnessed a dip in its growth pace, owing to tightening market conditions.

Under the current scenario, the nationwide lockdown due to the global pandemic - Covid-19, is certain to cast a significant impact on the whole microfinance industry. The key risks culminating from the current crisis are (i) loss of recovery (ii) halt in fresh disbursement and (iii) probable liquidity stretch. Though SBP’s Relief Packages have come handy to the sector in protecting the credit quality of the players, the out-turn of the situation, and its relative impact on the risk profiles of industry players, including FINCA, is yet to unfold in the days to come.

The ratings are dependent upon the bank’s ability to aptly combat the emerging risks under the current scenario in order to keep its business and financial risk profile intact. Meanwhile, the Ratings are also placed under “Watch” which reflects the need to oversee the risk profile of the bank against unavoidable challenges, going forward.

#### 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   MFI (Jun-19), Methodology   Correlation Between Long-Term And Short-Term Rating Scale (Jun-19)
<b>Related Research</b>	Sector Study   Microfinance (Sep-19)
<b>Rating Analysts</b>	Jibran Cheema   jibran.cheema@pacra.com   +92-42-35869504

## Profile

**Structure** FINCA Microfinance Bank Limited (herein referred to as "FINCA" or "the bank") was incorporated as a public unlisted company in June, 2008, under section 32 of the Companies Ordinance, 1984 (now the Companies Act, 2017). The bank operates with a nationwide network of ~130 branches.

**Background** Originally, Kashf Holdings (Pvt.) Ltd. established the bank in 2008. FINCA International acquired majority stake in the bank, through dilution of Kashf Holdings' shareholding in the year 2013.

**Operations** The bank offers a diversified range of financial products and services to low income wage earners as well as the self-employed community. Micro-lending products include (i) FINCA Karobari Karza – the premier lending product (ii) FINCA Izafi Karza (iii) FINCA Kashtkar Kazra (for farmers) (iv) FINCA Maweshi Karza (Livestock) & (v) FINCA Sonehri Karza (Gold-backed loans). The bank is also establishing its foothold in branchless banking operations.

## Ownership

**Ownership Structure** The bank is majorly owned by FINCA Microfinance Cooperatief U.A. (~86.4%), followed by Kashf Holdings (Pvt) Ltd. (~5.2%), International Finance Corporation (IFC) (~4.9%), Triodos Fair Share Fund (~2.7%) and Acumen Fund Pakistan (~0.8%).

**Stability** Simplified shareholding with one major shareholder represents a stable structure.

**Business Acumen** Based in Amsterdam – FINCA Microfinance Cooperatief U.A. operates as a subsidiary of FINCA International, Inc. FINCA International, a not-for-profit organization located in Washington D.C., is a founder of 21 microfinance institutions across the globe.

**Financial Strength** Financial muscle of the sponsors is considered strong.

## Governance

**Board Structure** The Board comprises seven directors, including five representatives of FINCA Microfinance Cooperatief U.A. A representative of Kashf Holdings (Pvt.) Ltd. and an independent director complete the composition of the Board.

**Members' Profile** The Board members have international exposure and carry diversified expertise. They have been associated with the microfinance industry, since long.

**Board Effectiveness** The Board of Directors has four committees for oversight of responsibilities namely (i) HR Committee (ii) Risk Management Committee (iii) Audit Committee & (iv) Digital Financial Services (DFS) Committee – the DFS Committee is formed to oversee operations and progress in the digital banking domain.

**Financial Transparency** The internal audit department directly reports to the Audit Committee ensuring independence from the rest of the organization. M/S KPMG Taseer Hadi & Co. Chartered Accountants, are the external auditors of the bank. An unqualified audit opinion was expressed on the financial statements for the year ended Dec'19.

## Management

**Organizational Structure** FINCA has a horizontally spread organizational structure comprising fourteen departments. A total of nine department heads, other than the CFO and COO, report directly to the CEO, while performance of four departments is entirely overseen by the COO and one by the CFO.

**Management Team** Mr. Farid Ahmed Khan joined the bank as the acting CEO in Sep'19. He is a seasoned financial services veteran, having more than 25 years of global experience in financial services, including fund management, investment banking, investment research, business development and project finance. Before joining FINCA, he was associated with the asset management wing of a leading commercial bank in Pakistan. He is assisted by an experienced management team.

**Effectiveness** Four management committees are in place, namely; i) Board Management, ii) Asset Liability Management (ALCO) iii) Risk and iv) IT Steering Committee, to ensure operational efficiency and efficient decision making.

**MIS** To support timely decision making of management, the MIS system generates detailed reports containing details regarding disbursement, repayment, recoveries, deposits and compliance.

**Risk Management Framework** The bank has in place a separate Risk Management department to oversee various risks including credit, operational, IT and market risks. Risk Management Committee meets on a regular basis to ensure that the risk profile of the bank remains within the Board's approved limit.

**Technology Infrastructure** The management has taken numerous steps towards digitizing its processes. The aim is to scale up the IT infrastructure for future business growth and network expansion. All branches have migrated to the new technology of Autosoft software.

## Business Risk

**Industry Dynamics** Pakistan's microfinance industry comprises 38 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes (RSPs) and 4 other projects. As at End-Dec'19, the total Gross Loan Portfolio (GLP) of the overall industry amounted to PKR~305,753m (End-Dec'18: PKR~274,707m), recording a growth of ~11%, on a YoY basis. MFBs dominate the industry with a share in lending portfolio of ~70%. The recent deceleration of growth is a result of deteriorating macroeconomic indicators. Going forward, the outbreak of the pandemic Covid-19, is expected to have a significant impact on the industry, since the consumers are part of a segment, which is deemed to be highly financially vulnerable. Reduced fresh disbursements and loss of recoveries may pose a challenge to the overall industry.

**Relative Position** The bank catered to ~3% of the borrowers of the industry (including MFIs, RSPs and other projects) as at End-CY19, grabbing a ~7% market share in terms of GLP, which stood at PKR~22,480m as at End-CY19 (End-CY18: PKR~20,868m), depicting a growth of ~8%. Moreover, the bank secured a share of ~9% of total deposits in the industry, as at End-CY19.

**Revenue** Interest/Mark up income of the bank increased to PKR~8,312m during CY19 (CY18: PKR~6,531m), depicting a substantial growth of ~27% YoY, in line with the increase in GLP. During CY19, the bank increased its relative proportion of Enterprise and Livestock lending, while the ratio of Agri-Input loans declined, compared to the prior periods.

**Profitability** Net interest mark up income increased to PKR~5,314m during CY19 (CY18: PKR~4,702m), showcasing a growth of ~13%. However, the net income of the bank decreased to PKR~653m (CY18: PKR~956m), owing to high administrative costs.

**Sustainability** Digital services remain to be the key driving force on the bank's growth. The bank's flagship product SimSim is growing steadily, with ~444,489 customers, as at End-CY19. In light of the safety precautions taken during the global pandemic, the importance of branchless banking, has risen manifold. On the other hand, the effect of Covid-19 will put pressure on the growth prospects, liquidity and future infection of the loan book, of all industry players.

## Financial Risk

**Credit Risk** FINCA's loan book is primarily concentrated in non-collateralized loans while representing a fairly diversified product segmentation in Livestock loans (~36%), followed by Agri-Input loans (~33%) and Micro-Enterprise loans (~31%). The bank's infection ratio rose to ~4.7% (End-CY18: ~1.9%). The bank has written off advances amounting to PKR~937m during CY19 (CY18: PKR~394m).

**Market Risk** Short term investments as at End-CY19 increased significantly to PKR~6,244m (End-CY18: PKR~3,827m). The addition majorly consisted of investment in government securities, which shall prove to be beneficial with respect to the Capital Adequacy Ratio of FINCA.

**Funding** The bank's funding is majorly fueled through deposits (End-CY19: PKR~23,911m, End-CY18: PKR~23,742m) constituting ~81% of the funding of the bank. Deposit base primarily consisted of time deposits (~69%). The total borrowing stood at PKR~5,553m (End-CY18: PKR~3,319m). The bank's advances-to-deposit ratio (ADR) rose to ~92% (End-CY18: ~87%), curtailing room for growth.

**Liquidity** Liquidity profile improved during the year, as the bank's liquid assets-to-deposits and borrowings ratio rose to ~32% at End-CY19 (End-CY18: ~29%). A rise in the investment in government securities led to an increase in liquid assets on an overall basis.

**Capital Adequacy** Capital Adequacy ratio (CAR) rose to ~20% as at End-CY19 (End-CY18: ~16%), mainly as a result of raising Tier-II capital, in the form of a subordinated loan from the Pakistan Microfinance Investment Company, amounting to PKR 800m.

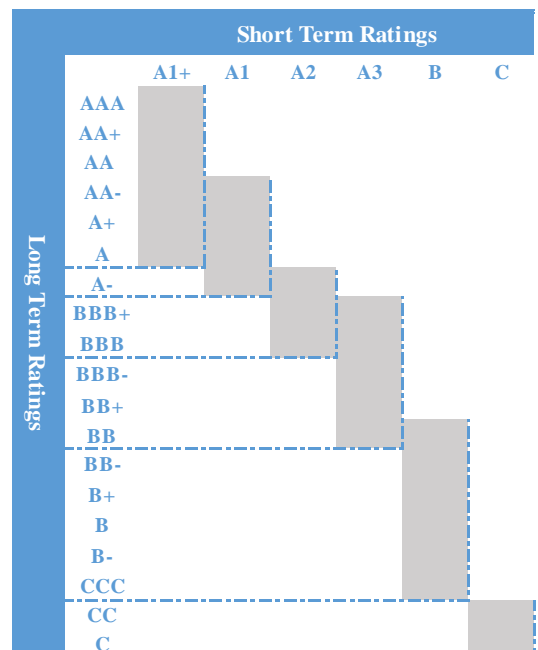


	PKR mln			
<b>BALANCE SHEET</b>	<b>31-Dec-19</b>	<b>31-Dec-18</b>	<b>31-Dec-17</b>	<b>31-Dec-16</b>
	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>
<b>Earning Assets</b>				
Total Finances	21,425	20,477	14,886	10,094
Investments	6,244	3,827	5,209	1,885
Deposits with Banks	1,446	2,489	1,557	1,248
	<b>29,116</b>	<b>26,794</b>	<b>21,652</b>	<b>13,228</b>
<b>Non Earning Assets</b>				
Non-Earning Cash	1,792	1,639	976	810
Net Non-Performing Finances	614	104	(23)	(12)
Fixed Assets & Others	5,790	3,743	2,536	1,592
	<b>8,196</b>	<b>5,486</b>	<b>3,490</b>	<b>2,390</b>
<b>TOTAL ASSETS</b>	<b>37,312</b>	<b>32,280</b>	<b>25,142</b>	<b>15,618</b>
<b>Interest Bearing Liabilities</b>				
<b>Deposits</b>				
CASA	7,477	7,052	5,717	3,394
Time Deposits	16,434	16,690	13,467	7,675
	<b>23,911</b>	<b>23,742</b>	<b>19,184</b>	<b>11,070</b>
<b>Borrowings</b>	5,553	3,319	1,669	1,350
<b>Non Interest Bearing Liabilities</b>	3,129	1,187	1,006	766
<b>TOTAL LIABILITIES</b>	<b>32,594</b>	<b>28,247</b>	<b>21,859</b>	<b>13,185</b>
<b>EQUITY (including revaluation surplus)</b>	4,716	4,030	3,275	2,420
<b>Deferred Grants</b>	2	2	8	13
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>37,312</b>	<b>32,280</b>	<b>25,142</b>	<b>15,618</b>
<b>INCOME STATEMENT</b>	<b>31-Dec-19</b>	<b>31-Dec-18</b>	<b>31-Dec-17</b>	<b>31-Dec-16</b>
	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>
Interest / Mark up Earned	8,312	6,531	4,809	2,986
Interest / Mark up Expensed	(2,998)	(1,828)	(1,256)	(648)
<b>Net Interest / Markup revenue</b>	<b>5,314</b>	<b>4,703</b>	<b>3,553</b>	<b>2,338</b>
Other Operating Income	799	676	564	441
<b>Total Revenue</b>	<b>6,113</b>	<b>5,379</b>	<b>4,117</b>	<b>2,780</b>
Other Income	156	126	129	110
Non-Interest / Non-Mark up Expensed	(4,168)	(3,490)	(2,461)	(1,683)
Pre-provision operating profit	2,101	2,015	1,785	1,207
Provisions	(1,090)	(435)	(407)	(219)
Pre-tax profit	1,012	1,580	1,378	988
Taxes	(358)	(623)	(523)	(357)
<b>NET INCOME</b>	<b>653</b>	<b>956</b>	<b>855</b>	<b>631</b>
<b>Ratio Analysis</b>	<b>31-Dec-19</b>	<b>31-Dec-18</b>	<b>31-Dec-17</b>	<b>31-Dec-16</b>
	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>
<b>Performance</b>				
ROE	15%	26%	30%	29%
Cost-to-Total Net Revenue	66%	63%	58%	58%
<b>Capital Adequacy</b>				
Equity/Total Assets	13%	12%	13%	15%
Capital Adequacy Ratio as per SBP	20%	16%	19%	21%
<b>Loan Loss Coverage</b>				
Impaired Lending / Gross Finances	5%	2%	1%	1%
Loan Loss Provisions / Non-Performing Advances	42%	74%	110%	110%
<b>Funding &amp; Liquidity</b>				
Liquid Assets / Deposits and Borrowings	32%	29%	37%	32%
Finances / Deposits	92%	87%	77%	91%
CASA deposits / Total Customer Deposits	31%	30%	30%	31%
<b>Intermediation Efficiency</b>				
Asset Yield	30%	27%	28%	30%
Cost of Funds	11%	8%	8%	7%
Spread	19%	19%	20%	23%

## Credit 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		Short Term Ratings	
<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>AA+</b> <b>AA</b> <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>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</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>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</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 and in economic conditions are more likely to impair this capacity.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</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>B</b>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</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>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	Obligations are currently in default.		



**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’.

**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. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

**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, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

**Harmonization** A change in rating due to revision in applicable methodology or underlying scale.

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(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

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- (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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- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (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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