



MICROFINANCE

Sector Report – Sep'22

Sep'22

Research Report

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Executive Summary:

- Gross Loan Portfolio (GLP) clocked in at PKR~449bln - June'22, up by ~14% from PKR~393bln as at End-Dec'21. A growth of ~6% and 8% was recorded in 1QCY22 and 2QCY22 respectively.
- Among peer groups, MFBs continued to hold the highest share of the GLP (~76%), while MFIs and RSPs collectively held the rest (June'22).
- Active borrowers increased to ~8.5mln – June'22, up by ~4% from ~8.1mln as at End-Dec'21. Among peer groups, MFBs accounted for ~64% of the active borrowers while MFIs and RSPs accounted for the rest.
- Credit quality of the Sector dropped further with Portfolio At Risk (PAR>30 days) rising to ~6% - June'22, up from ~5.1% as at End-Dec'21. Among peer groups, the highest to record infection were MFBs (~6%). MFBs, holding the largest share in the pie, witnessed a weakened credit health with PAR>30 days increasing to ~6% - June'22 from ~5.1% as at End-Dec'21. Meanwhile, RSPs recorded a substantial improvement registering PAR>30 days at ~4.2% in - June'22 (~7.4% End-Dec'21).
- Overall disbursements were recorded at PKR~153bln in 1HCY22. Disbursements have picked up in the 2QCY22 by ~13% against zero growth in 1QCY22.
- Deposit base of MFBs clocked in at PKR~447bln – June'22, up ~6% from PKR~423bln as at End-Dec'21. The sector has shown on average a growth of ~31% in the period between (CY19-CY21) which clearly shows that the funding requirement through deposits is duly met. The increase can be mainly because of an upwards revision in policy rate to 15%.
- The Sector's bottom line closed in negative in 1HCY22 subject to ~24% increase in administrative cost and ~40.3% increase in provisioning charges.

SECTOR OUTLOOK: WATCH

CY22 is turning to be yet again a challenging year for the Microfinance Sector. One of the major highlights is the flashflood which has affected the lives of more than ~33mln people (or ~15% of the country's population) and submerged one-third of the nation under water. Almost ~1.1mln livestock is lost. Consequently, the key risk associated to the disaster is the risk of non-recovery from customers belonging to geographical areas that have undergone adversities due to the floods.

Needless to say, the flashfloods have emerged as an addition to the already rising woes of economic and political instability in the country. The last quarter of FY22 reflected loosening of almost all key economic indicators as a combined consequence of external shocks as well as overheating of domestic economy due to macro imbalances. As shown in the table below, inflation and interest rates have steeply risen in FY22, and continue to rise in Aug'22. Meanwhile a negative trade balance of PKR~40bln and declining foreign reserves have continued to put pressure on the PKR against USD. Moreover, investor sentiments remain low amid heated political environment, natural calamity of floods and rising fiscal and economic imbalances. FDI has also declined by --- in FY22 on a YoY basis.

	FY18	FY19	FY20	FY21	FY22	Aug'22
Average Inflation Rate (CPI)	3.90%	7.30%	10.70%	8.90%	21.30%	27.30%
Average KIBOR	6.39%	10.43%	11.95%	7.43%	15.40%	16.00%
Monetary Policy Rate (MPR)	5.95%	9.69%	11.75%	7.00%	9.70%	15.00%
PKRV	6.26%	10.20%	11.79%	7.28%	10.68%	15.60%
Average Exchange Rate (USD mln)	110.11	136.45	158.4	160.46	177.91	220.43
	FY18	FY19	FY20	FY21	FY22	Aug'22
Current Account Balance	-19,195	-13,434	-2,970	-1,852	17,318	-1.21
Exports	24,768	24,257	22,536	25,630	32,467	2,504
Imports	55,671	51,869	43,645	53,785	72,043	6,034
Trade Balance	-30,903	-27,612	-21,109	-28,155	-39,576	-3,530
Foreign Exchange Reserve	16,384	14,482	18,886	24,397	15,536	13,404

In a country grappling with food and fuel inflation, the national CPI in August-22 touched ~27.3% and will likely surge with food inflation being the natural outcome of widespread crop damage. The inflation could accelerate by over ~26% following the flood.

Rising inflation can hurt the repayment capacities of microfinance borrowers, who are already undergoing stress due to their crops, livestock, and business destruction. It would also elevate the already high administrative costs of the microfinance players, impacting their profitability. Further, spreads are also expected to shrink since the cost of funding will rise and almost negligible room exists to raise the already high APR under such circumstances, which otherwise would come at the cost of credit health. The infection ratio of the Sector is already growing – from ~5.4% in Dec'21 to ~6.8% in June'22.

During CY21, the Sector's GLP grew by a healthy ~21%. Out of its total GLPs microfinance banks have lent ~60% of their loan portfolio to Agri inputs and livestock, and they are most heavily impacted by the flash floods in 1HCY22. There is a high probability of a high number of loan delinquencies in CY22. Balochistan is the hardest hit province in terms of the calamity-struck districts, i.e., 32, followed by Sindh, with 23 districts being impacted. The third highest province is KPK with a total calamity struck district count of 17. The microfinance industry collectively has a penetration rate of ~41.3% in 2QCY22, with a branch network of ~4060 branches in ~139 districts of Pakistan.

The growth in deposits fell in CY21 to ~13% from ~40% in CY20 mainly because of low-interest rates that prevailed through most of CY21, similarly, the cost of funds (deposit and borrowings) ratio for the sector declined in CY21.

Barring exceptions, the Sector's performance remained satisfactory in CY21 and 1HCY22. Adequate loan loss provisions shielded against any major drag on equity. However, fresh NPLs are rising, which is a concern. Considering rising inflation ahead, uncertainties to crop outputs, and the aftermath of the flood, the NPLs are expected to increase, going forward.

The Sector's liquidity profile remains well covered. While MFBs are empowered to fund through deposits, MFIs have restricted funding avenues. Moreover, they do not possess Sponsor Financial Support. Liquidity risk is higher for MFIs, especially the small players. There are ~25 MFIs and RSPs in the Sector. Most of the small MFIs and RSPs have GLP of less than PKR~5bln making it challenging for them to absorb high debt and administrative costs.

Average Capital Adequacy of MFBs was recorded at around ~24% (excluding Advans, Sindh, and Pak Oman) in CY21 it is way above the regulatory requirement of ~15% providing sufficient cushion.

Overall Microfinance Sector has been undergoing a series of challenges since the past few years. Firstly, the pandemic, then rising economic vulnerabilities and now the flashfloods. The sector's resilience, however, remained intact throughout most of the past challenges that hampered its growth. The outcome of the flashfloods, is however, yet to unfold. As per our estimates, the damage of only major crops (cotton, wheat, sugarcane and rice) can amount to an additional import cost of over USD~5bln to the country. In the absence of any regulatory relief, the credit quality of the sector is expected to take a further dig, specially for those players where exposure in agri and livestock lending is high. Meanwhile, the growth momentum of GLP may also slowdown in the third and fourth quarters of CY22. Considering the prevalent challenges and the associated uncertainties as of now, the Sector continues to be placed on Watch.

MICROFINANCE | SNAPSHOT

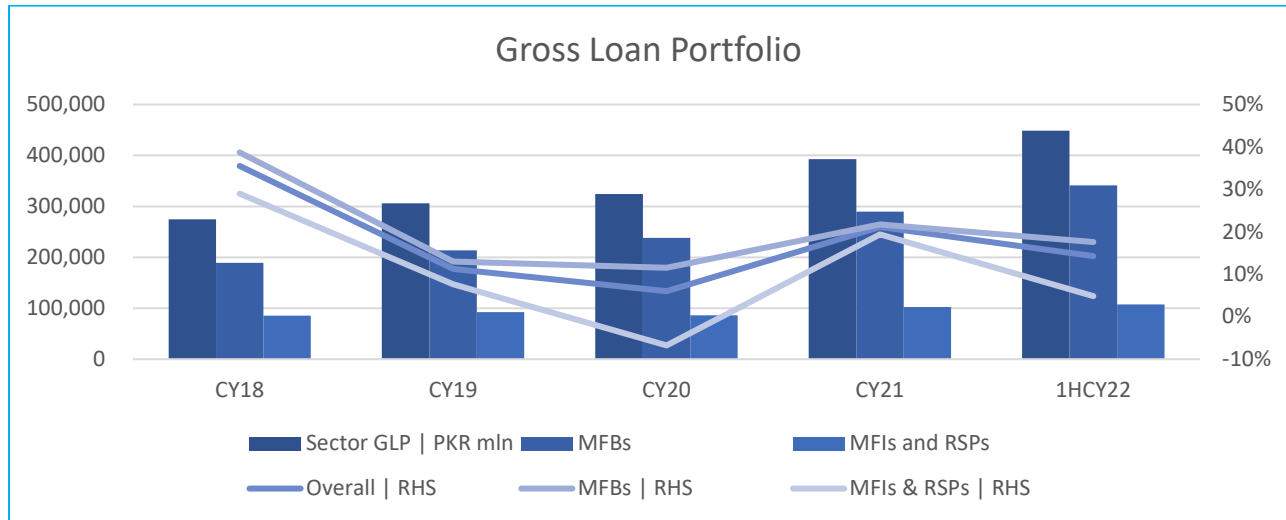
- The Microfinance Sector is divided into three Segments: Microfinance Banks (MFBs), Microfinance Institutions (MFIs), and Rural Support Programmes (RSPs).
- There are 11 MFBs, 17 MFIs, 4 RSPs, and 4 Other Institutions (reporting) in the Sector. MFBs holds the highest market share of ~76% in terms of GLP. For this Sector Study, MFIs, RSPs, and other Institutions are clubbed into one category.
- MFBs are regulated by the State Bank of Pakistan, while the SECP is the Regulatory body for MFIs and RSPs.
- Relevant applicable laws for MFBs include Prudential Regulations for Microfinance Banks, 2014, and Microfinance Institutions Ordinance, 2001. MFIs & RSPs, on the other hand, are governed through NBFC Rules, 2003 and NBFC Notified Entities Regulations, 2008. The institutions carrying out microfinance services are required to be registered with the SECP as NBMFCs.

MFBS	Sponsors	GLP (PKR mln)	Market Share (GLP) - June'22
Khushhali	UBL: 29.7%, Rural Impulse Fund II S.A SICAV-FIS: 24.6%, responsAbility Global Micro and SME Finance Fund: 19.9%, Shorecap II Limited: 14.3%, Others: 11.7%	80,766	24.48%
Habib MFB	HBL: 50.5%, AKAM: 29.7%, JICA, 8.8%, AKRSP: 11.0%	74,637	22.62%
U MFB	PTCL: 100%	50,944	15.44%
Mobilink	Veon, G.T.A A.E: 100%	39,467	11.96%
NRSP	NRSP: 52.1%, Acumen: 16.02%, IFC: 16.02%, KfW: 16%	30,715	9.31%
FINCA	FINCA Microfinance Cooperatief U.A. (FMC): 86.4%, Kashf Holdings: 5.2%, IFC: 4.9%, Triodos Fair Share Fund ("TFSF"): 2.7%	20,152	6.11%
Telenor	Telenor Pakistan B.V: 55%, Alipay (Hong Kong) Holding Ltd. :45%	10,593	3.21%
APNA	UIG: 70%, Others: 30%	12,711	3.85%
Pak Oman	LOLC Pvt Ltd: 50.1%, Sultanate Oman: 33.2%, Pak Oman Inv. Co: 16.7%	5,584	1.69%

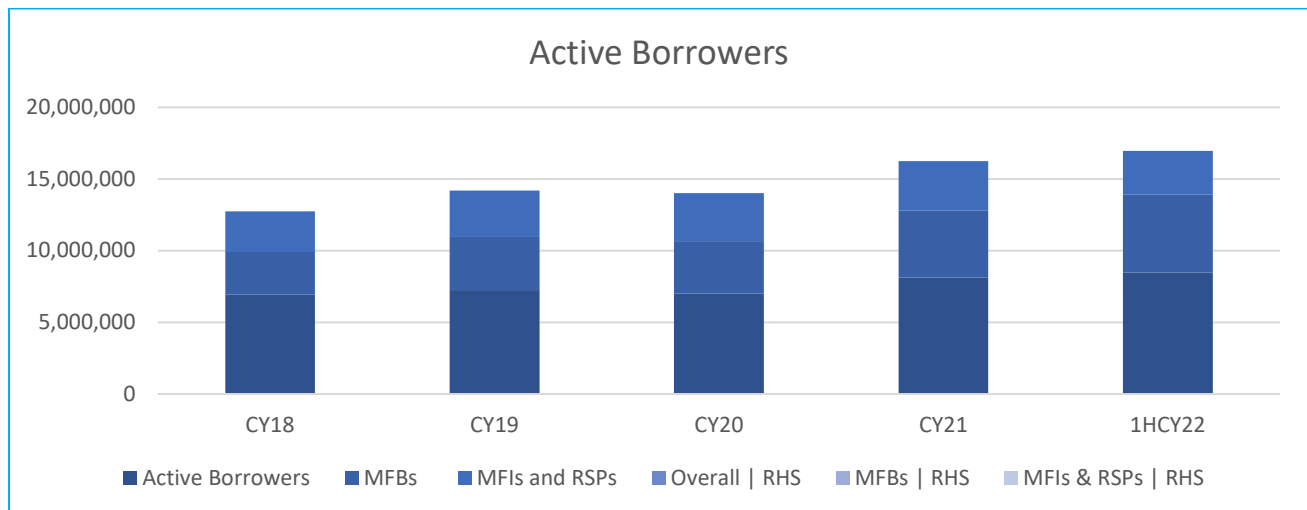
Advans	Advans SA SICAR: 100%	3,188	0.97%
Sindh MFB	Sindh Bank: 100%	1190	0.36%
Total MFBs		329,946	90.26%
MFIs & RSPs		35,585	9.74%
Sector Total		365,531	100.00%

ASSETS

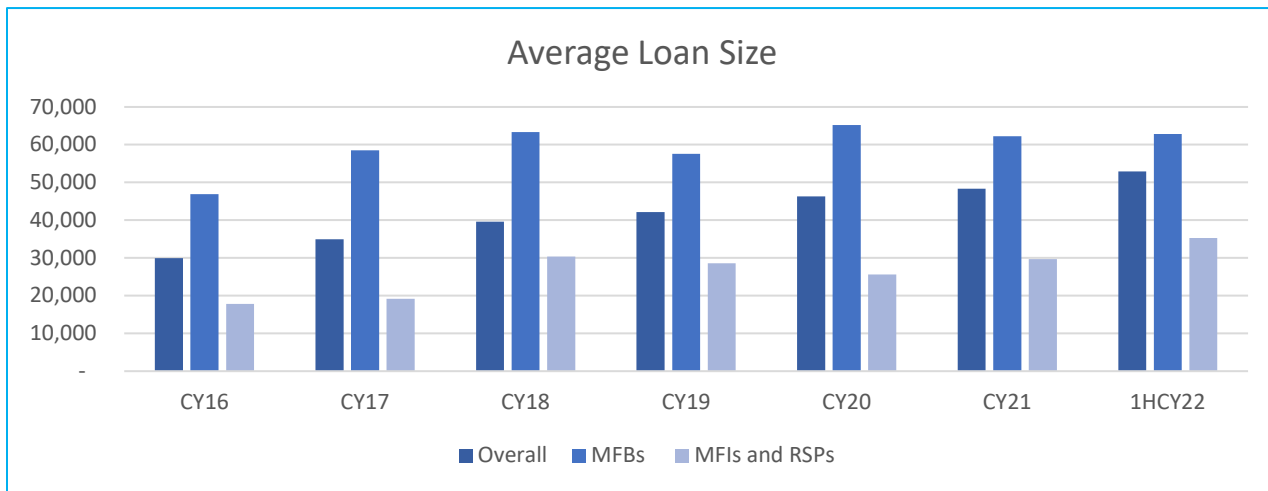
Gross Loan Portfolio | Peer Segments



Active Borrowers and Loan Size | Peer Segments



Average Loan Size | Peer Segments

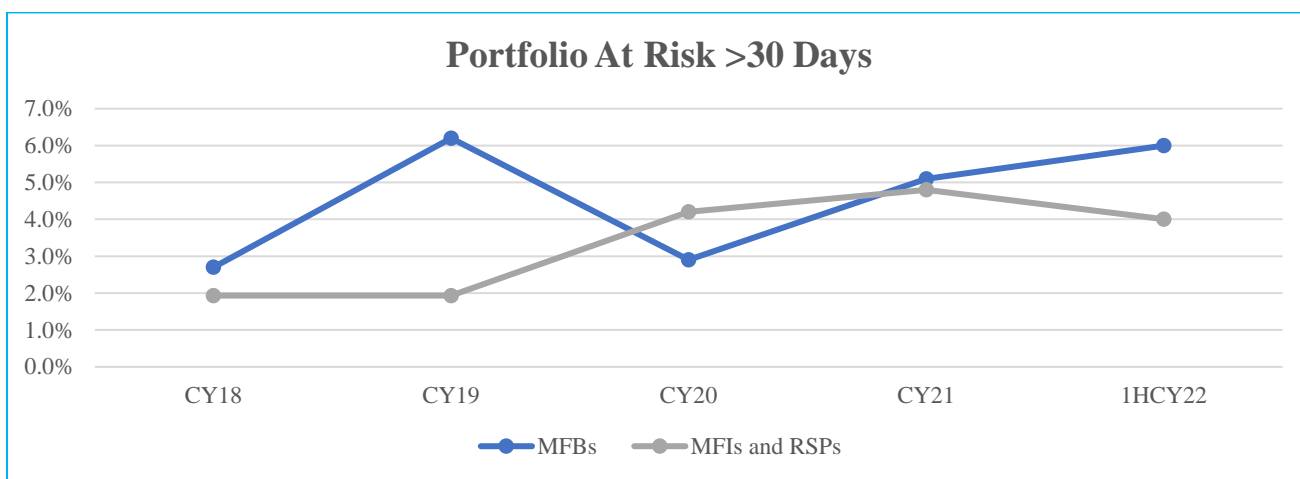


The growth rate of the Sector’s GLP has been on a continuous decline since CY18, but some signs of recovery were seen post-COVID-19 at the end of CY21 where GLPs posted growth of ~21% YoY, but now the cycle has been reversed by flash floods and it can be seen through a relatively low growth of ~14% at the end of 1HCY22.

MFBs’ growth rates have historically remained higher than the industry average, while MFIs and RSPs have witnessed slower growth momentum.

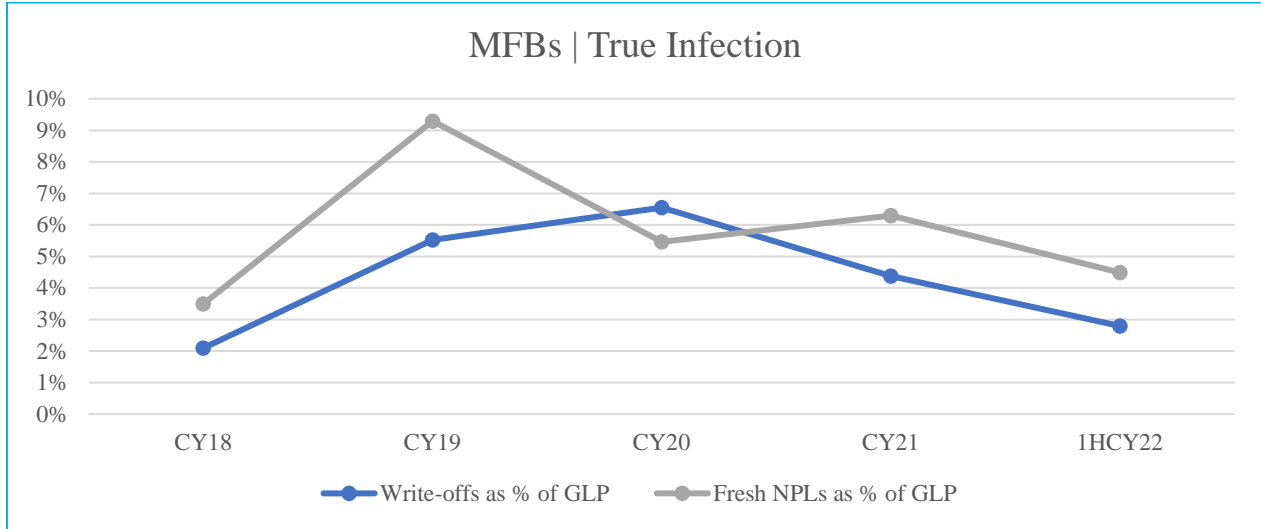
The Sector’s GLP showed growth in CY21 owing to the recovery from the COVID-19 pandemic. However, a recovery of ~14% was observed in 1HCY22.

Asset Health | Peer Segments



MFBs credit quality deteriorated significantly in CY21 with average PAR>30 days shooting up to ~5.1% from ~2.9% in CY20. Telenor MFB stood as the outlier, with its NPLs at ~17% relatively less than its previous high of 21% but still way above the industry average of ~7.1%.

Average NPLs of MFIs and RSPs from CY18 – 1HCY22 remained at 2%, a reflection of good credit controls. With the advent of COVID-19 in CY20 and flash floods in 1HCY22, the Infection ratio of MFIs and RSPs swelled to ~3.13%. This was expected since the liquidity level of MFIs does not encourage deferments and halted disbursements at large. It is expected that MFIs infection will remain above ~5% at the end of CY22.

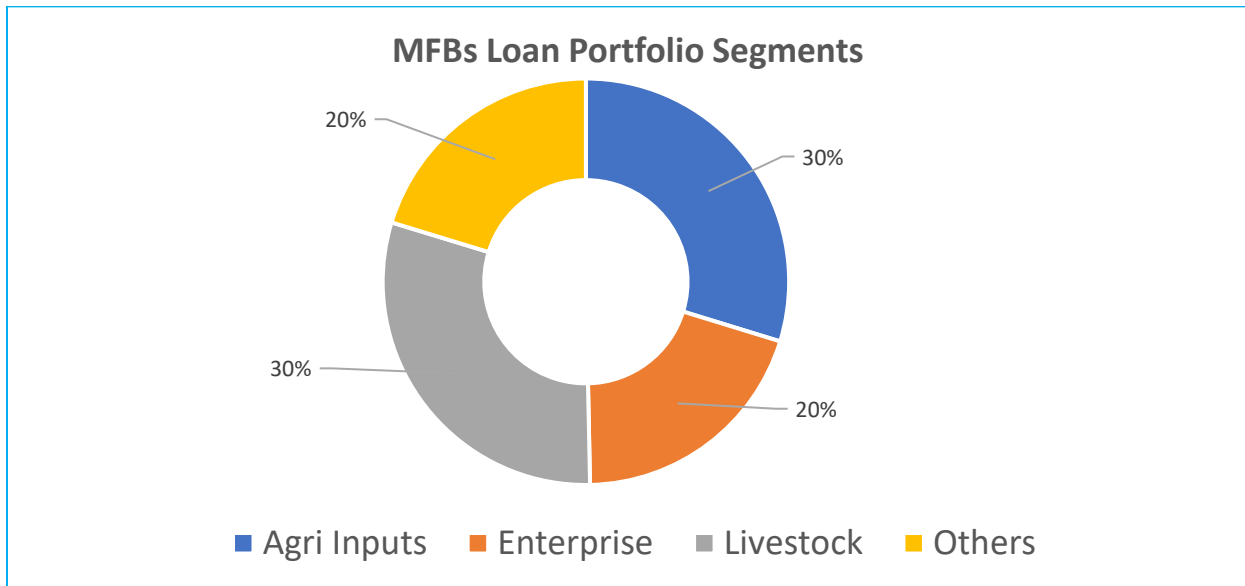


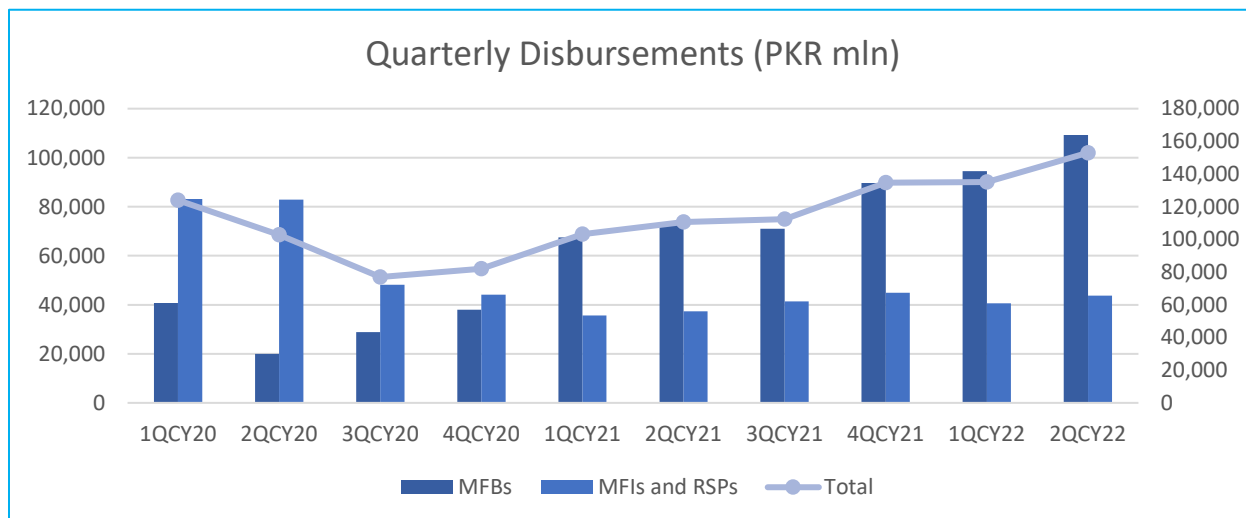
Fresh NPLs refers to the infection in the loans arising during a reporting period. These are determined based on the NPLs generated in a period and the write-offs charged during the period.

Following CY21, the fresh NPLs are on a rise again. Net NPL coverage was recorded at ~51% as of End-June'22. The ratio was above ~100% in CY20 due to the MFBS' prudence to record provisions against anticipated deterioration.

MFBS Loan Portfolio Segments:

The loan book of the sector is fairly diversified with each category having exposure in Agri, Livestock, Enterprise, and others.

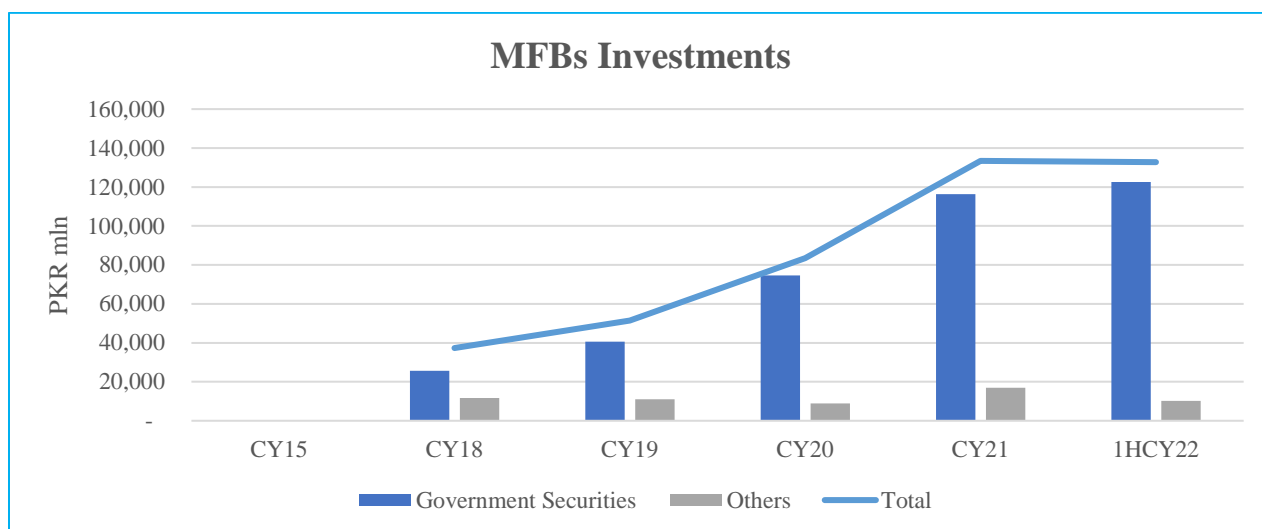




OTHER ASSETS:

Investments | MFBs

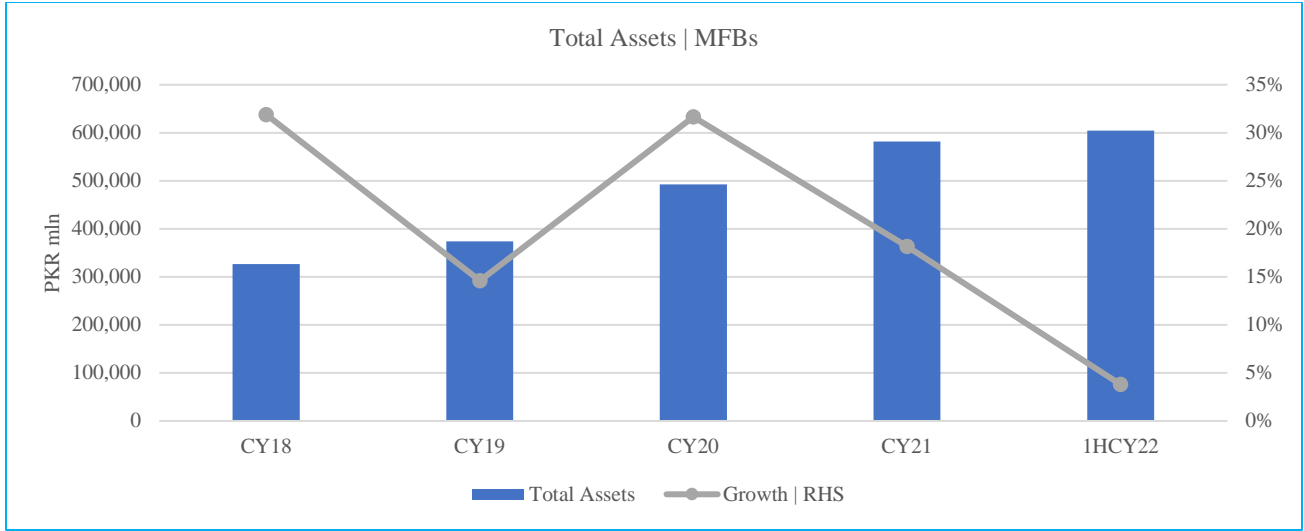
MFBs’ Investments are generally dominated by Government Securities majorly in short-term T-Bills. During CY21, GLP showed exponential growth, the Investments also grew by a record ~60% clocking in at PKR~133.4bln as of End-Dec’21 (PKR~84bln as of End-Dec’20). The increase was led by a rise in Government Securities to secure better returns. Investments fell slightly to PKR~132.8bln in 1HCY21.



Total Assets:

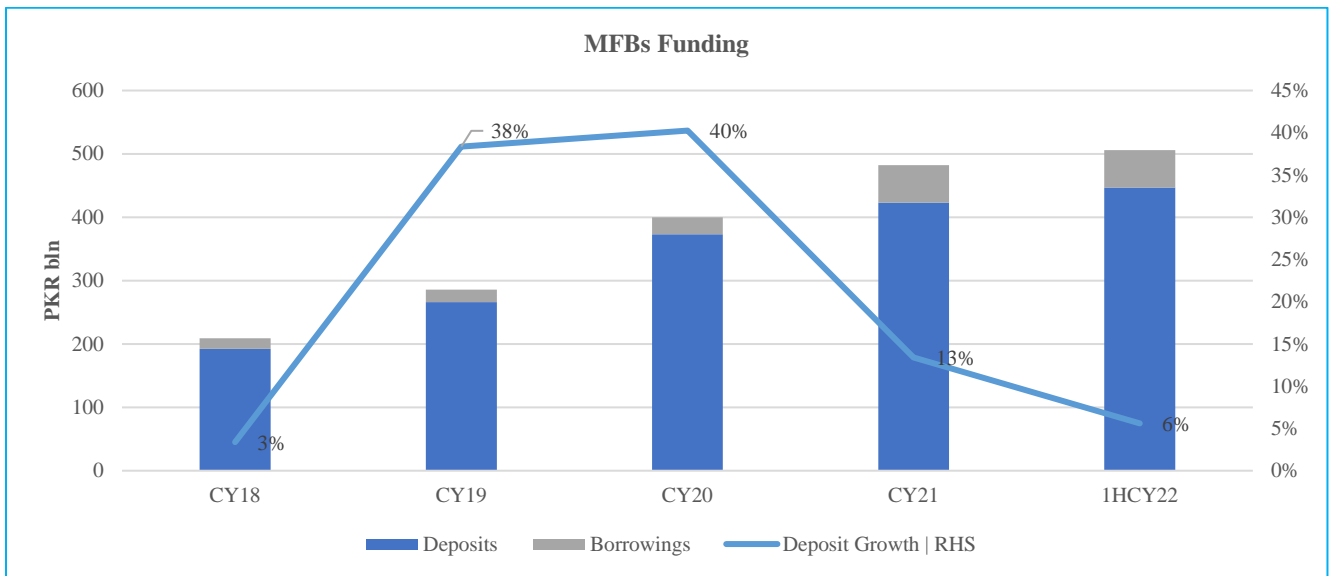
The total Asset base of MFBs has crossed half a trillion clocking in at PKR~582bln as of CY21. Almost 70% of the MFBs’ assets are deployed in Advances and Investments, which implies that the sector has at minimum ~70% earning assets on its books.

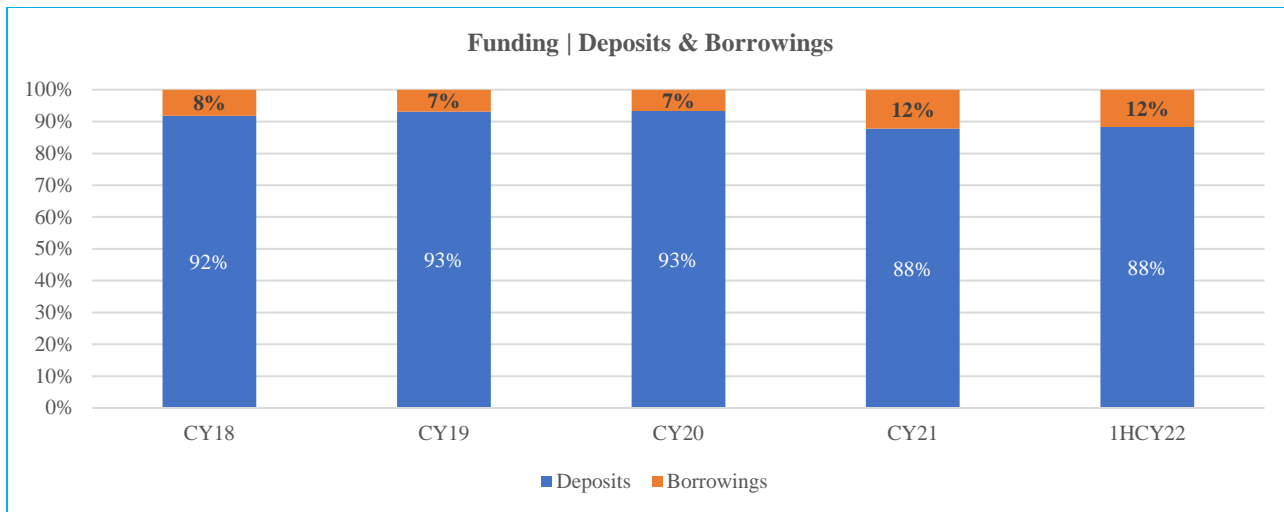
The Sector’s footing has sharply increased in the past decade due to a wide potential to grow. The momentum of growth is gradually softening now. The average growth in GLP is around ~13% between CY18 – CY21.



Source: PMN Annual Report | Pakistan Microfinance Review

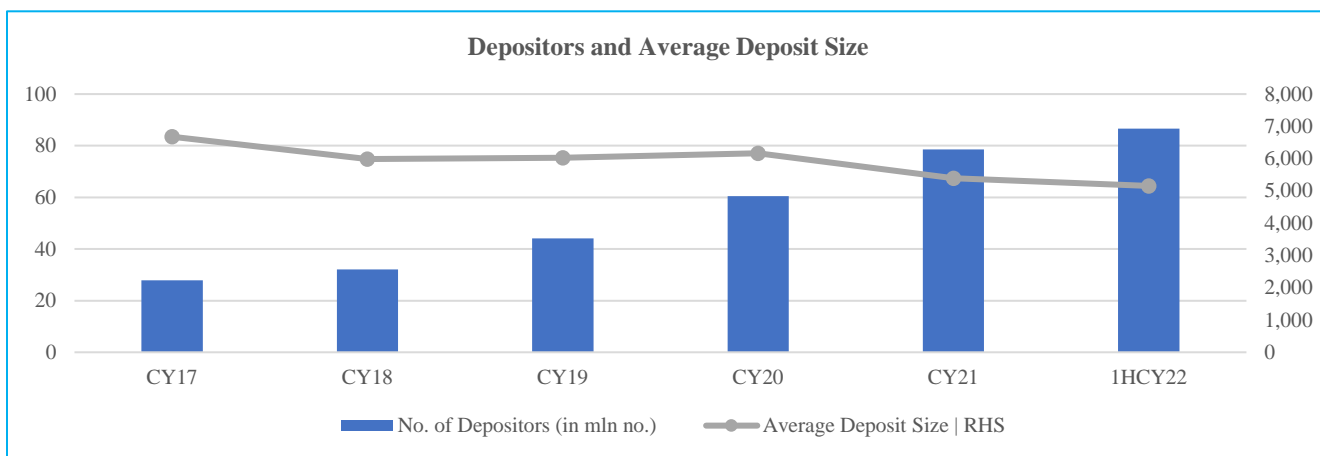
LIABILITIES | DEPOSITS & BORROWINGS



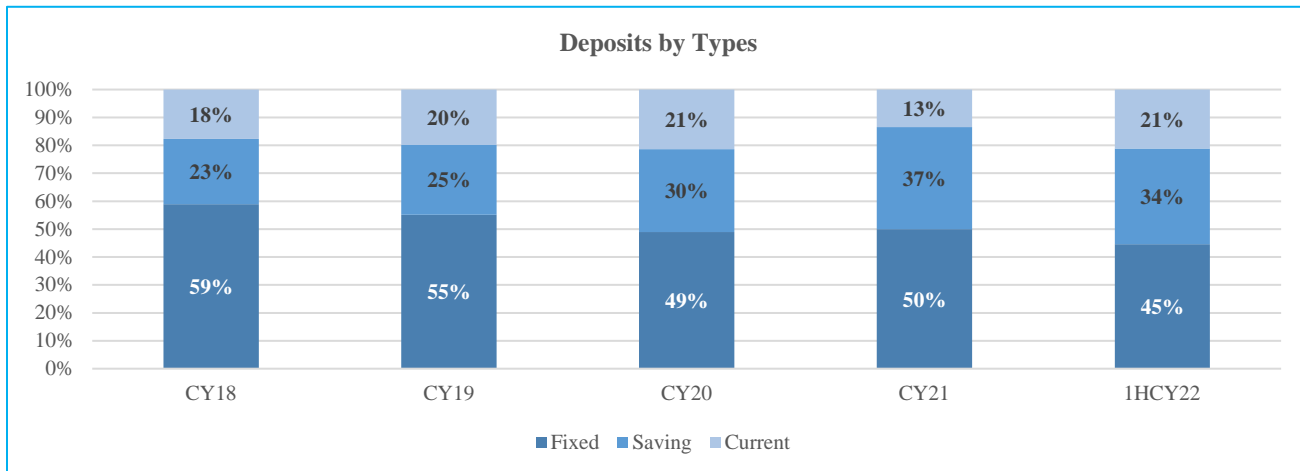


Total funding of MFBs was recorded at PKR~506bln as of End-June'22 (PKR~482bln as at End-Dec'21), of which ~88% pertained to deposits and ~12% constituted borrowings.

The deposit base of MFBs was recorded at PKR~447bln as of End-June'22 (PKR~423bln as of End-Dec'21). The growth rate of the Sector's deposits grew by ~6%. This was majorly driven by Current Accounts (~95% growth) and Savings Accounts (~16% growth). Growth in SA came on account of better saving rates offered by MFBs to attract more funds. Meanwhile, current accounts grew on the back of increased BB deposits.



The total number of MFBs Deposit Accounts as at End-June'22 was recorded at ~87mln (~79mln as at End-Dec'21). The average loan size hovered around PKR~5778 in CY20 and CY21. However, in 1HCY22, the number of deposit accounts increased by ~10% while deposits in value terms registered an increase of ~6% at the End-June'22.



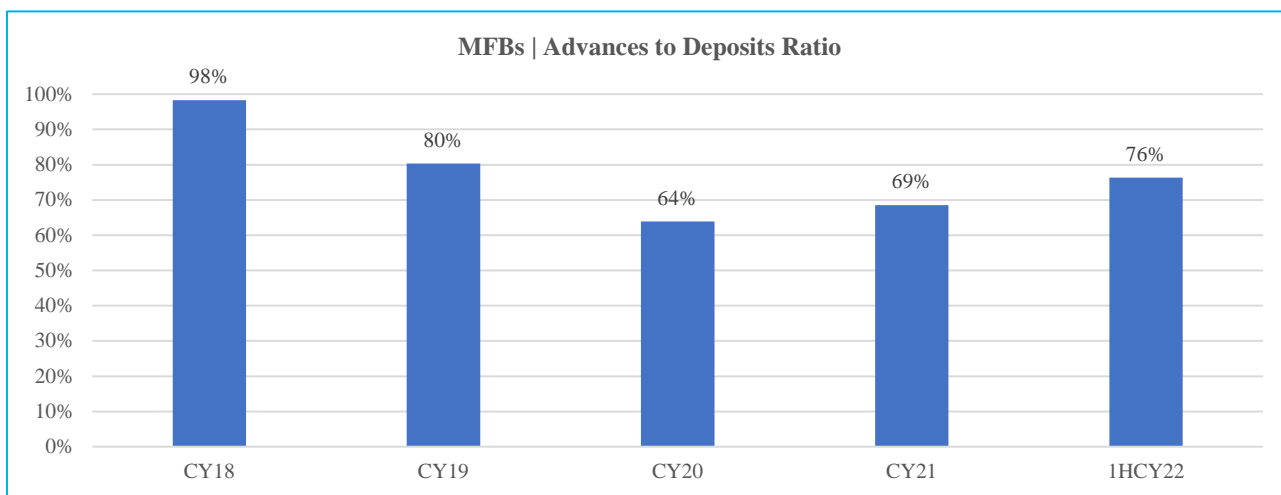
The MFBs Deposit Mix is inclined towards Fixed deposits and saving deposits (SA) collectively making ~79% of the deposit base as at End-June'22. The SA share has grown from ~23% of the deposits in CY18 to ~34% in 1HCY22, while Fixed deposits have reduced from ~59% (CY18) to ~45% (1HCY22).

CASA accounted for ~55% of the total deposit base as at End-June'22. This mix is very similar to the deposit segmentation in commercial banks, wherein the average CASA ranges around ~50%. Deposits make up ~80% of the MFBs' total liabilities.

While CASA share is high, the share of CA remains low, despite having a significant mix of branchless/m-wallet deposit accounts. Interestingly, M-wallets account for ~80% of the MFBs' deposit holders but only ~13% of the deposit value. This mismatch is justified based on the very low-ticket size of M-wallet deposit accounts.

On the other hand, a high proportion of interest/cost-bearing deposit base signals a higher average cost of funding. MFBs involved in digital banking, including Telenor, Mobilink, U Bank, and FINCA, has impressively increased their customer outreach on the branchless banking (BB) front. However, the share of BB deposits in value terms remains nominal.

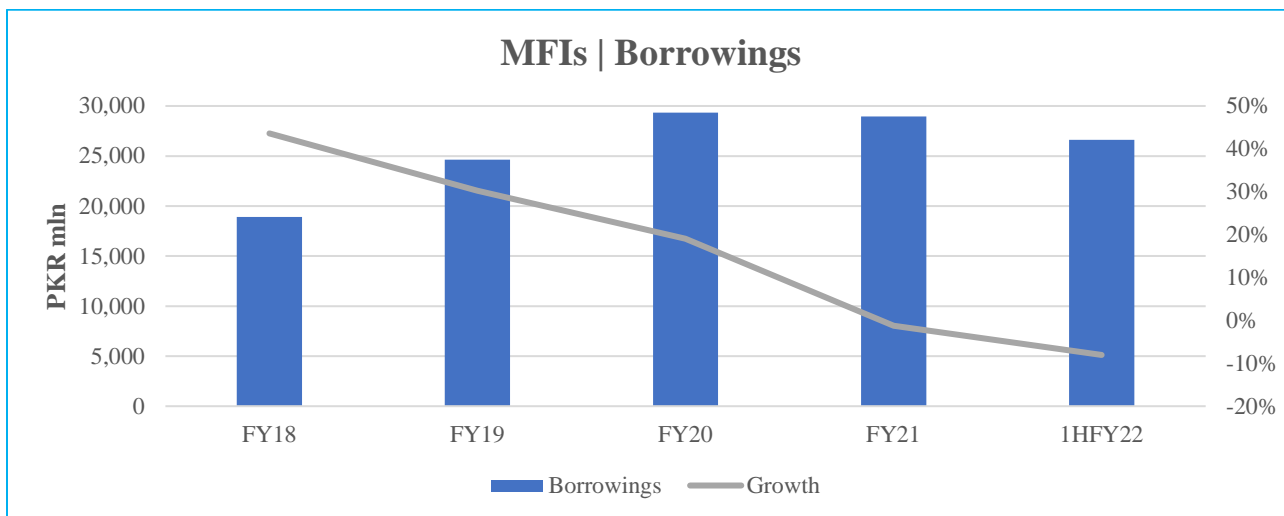
MFBs | Advances to Deposits Ratio (ADR):



ADR of the MFBs (CY18 – 1HCY22) averages around ~77%. The range has been broad from an exorbitantly high ~98% ADR in CY18 to as low as ~64% in CY20. CY20's ADR dropped dramatically for obvious reasons of muted lending while the deposit base experienced an uptick in growth.

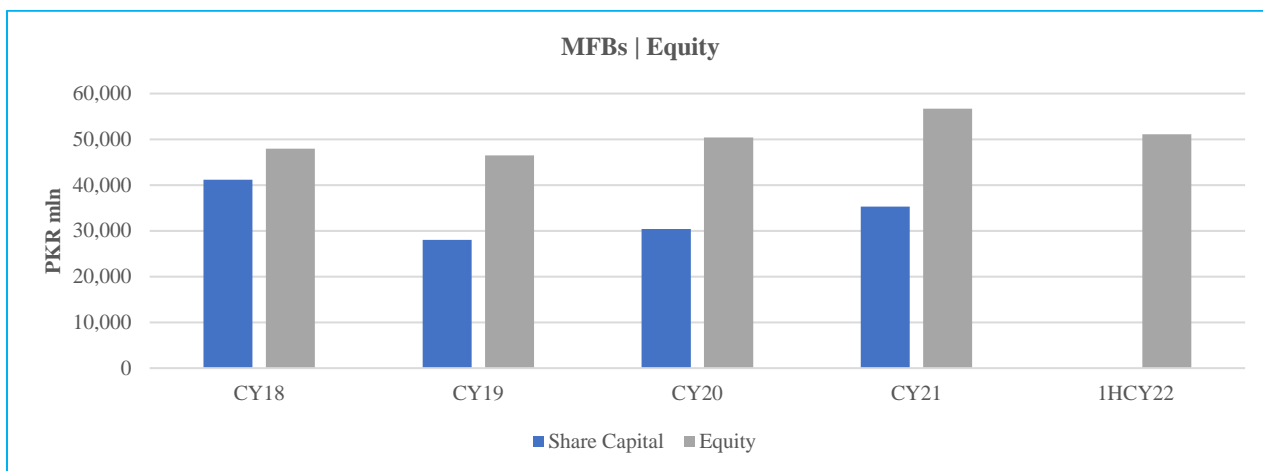
In 1HCY22, the ADR seems to be converging towards its average. Growth of ~95% and 16% was recorded for current and savings deposits respectively, while only fixed accounts grew by ~11% in 1HCY22.

MFIs | Borrowings:



Note: This data is based on PACRA Rated five (5) MFIs. There has been a constant decline in the borrowing trend for the last five years.

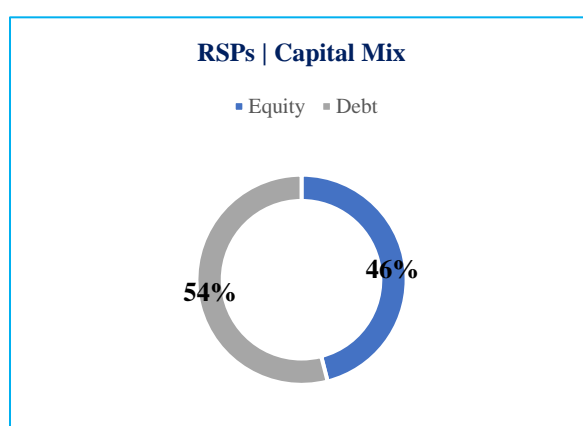
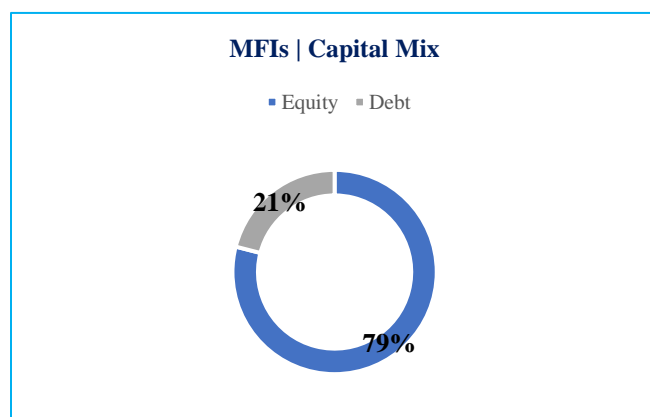
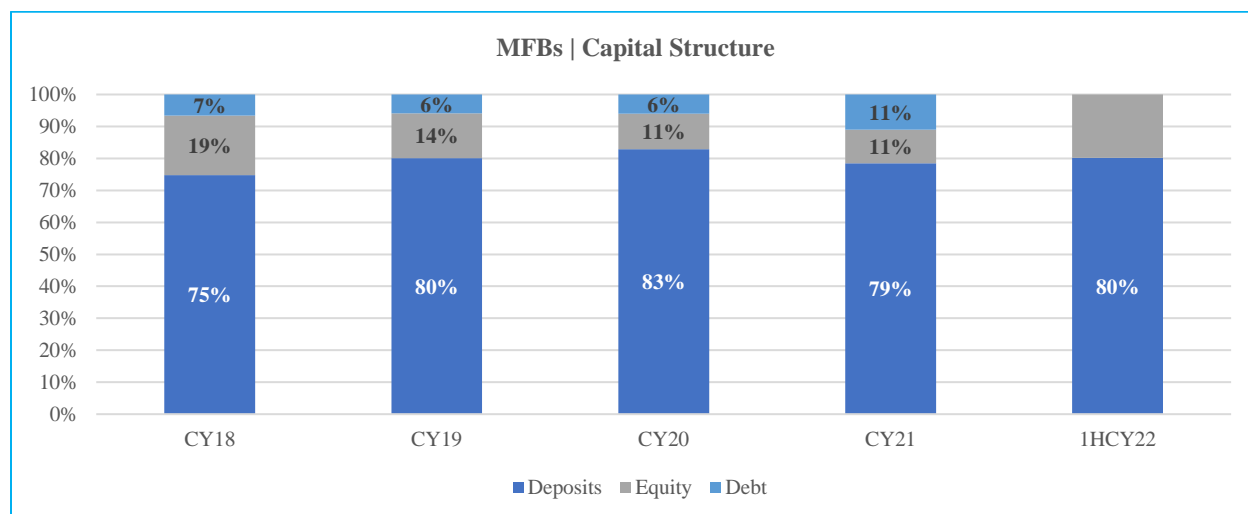
CAPITAL STRUCTURE



Total Equity of the MFIs Sector was recorded at PKR~51bln as at End-June'22 (PKR~57bln as at End-Dec'21), down ~10%. The Sector's equity represents ~8% of its total assets. Gross Loans advanced are approximately 9 times the Equity, while deposits attracted are a multiple of 10.

NPLs >30 days as a percentage of Equity were recorded at ~42% as at End-June'22. However, net NPLs or actual drag on equity remained low at ~7% since the Sector is well covered with provisions, around ~51% of the NPLs.

CAPITAL MIX



Capital Adequacy Ratios		
MFBs	CY20	CY21
Khushhali	19.60%	19.60%
The First MFB	15.00%	15.00%
U MFB	21.70%	16.40%
Mobilink	17.80%	16.10%
NRSP	16.00%	11.10%
FINCA	21.00%	15.30%
Telenor	19.00%	24.90%
APNA	11.80%	11.80%
Pak Oman	65.00%	39.10%
Advans	38.00%	21.10%
Sindh MFB	98.00%	73.40%
Average	31%	24%

MFBs' Average CAR was recorded at ~24% in CY20 (~31% in CY20). Excluding the small-sized banks (Advans, Pak Oman and Sindh MFB), the Sector's average CAR drops by around ~7%.

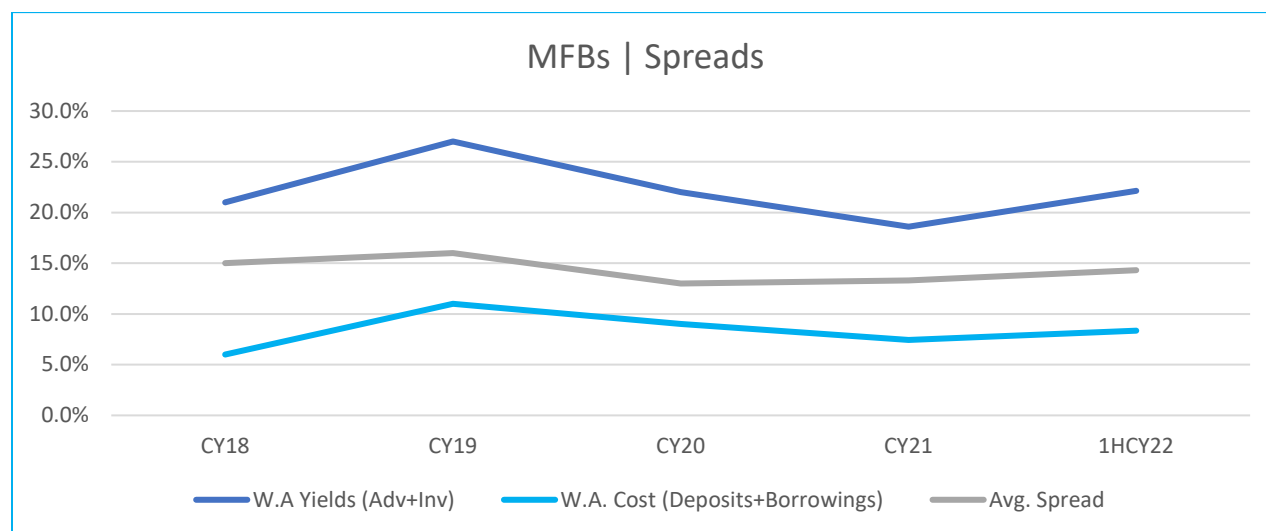
FINANCIAL PERFORMANCE:

Operating Performance	CY18	CY19	CY20	CY21	1HCY22
<i>MFBs / PKR mln</i>					
Mark-up/Return/Interest Earned	50,401	66,026	75,333	67,790	66,597
Mark-up/Return/Interest Expensed	15,845	26,674	30,972	21,620	31,366
Net Mark-up / Interest Income	34,556	39,353	44,361	46,170	35,230
Administrative expenses	35,879	47,104	48,524	43,065	53,470
Profit / (Loss) before taxation	6,621	-9,957	-3,071	-4,216	-6,152
Profit / (Loss) after taxation	3,893	-11,663	-5,602	-5,216	-5,884
EPS	1.5	-2.5	-0.4	-1.5	-0.1

Overall performance of MFBs reflected some pressure due to the unprecedented crisis in 1HCY22. Telenor MFB reflected an anomaly, with a high net loss of PKR~5bln in 1HCY22 (PKR~11bln in CY21, and PKR~11bln in CY20). The sector's bottom line turns positive when excluding TMFB. In CY21, the Sector added almost PKR~50bln to its investment portfolio funded through additional PKR~50bln deposits. This fostered the growth of NIMR in value terms. However, as a % of Mark-up income, NIMR continues to record at ~53%.

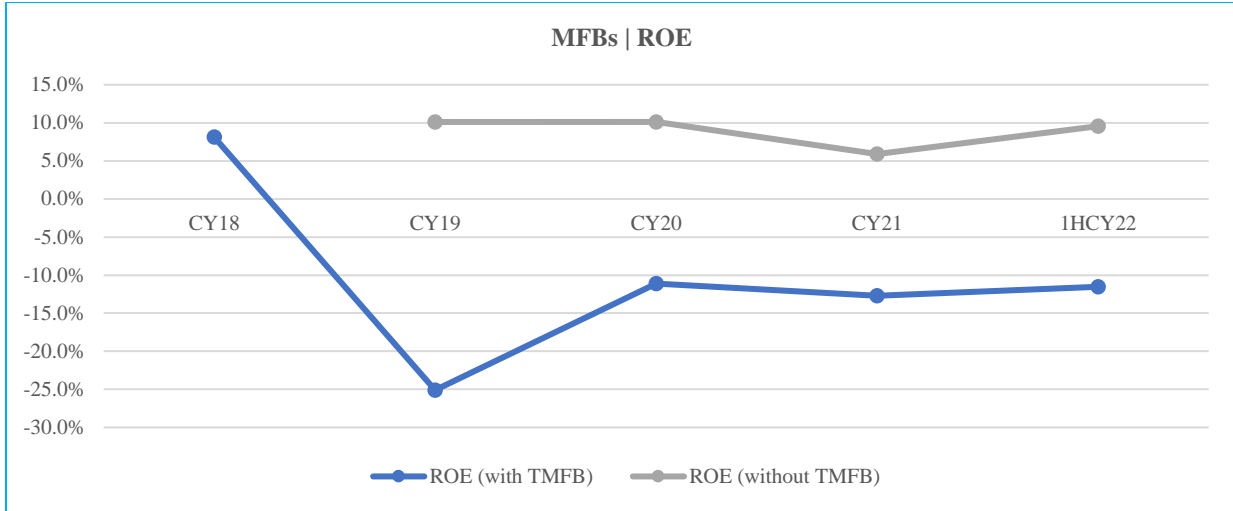
RATIO ANALYSIS

Note: Ratio Analysis is based on PACRA Rated Universe only. The ratios may vary on 100% population.



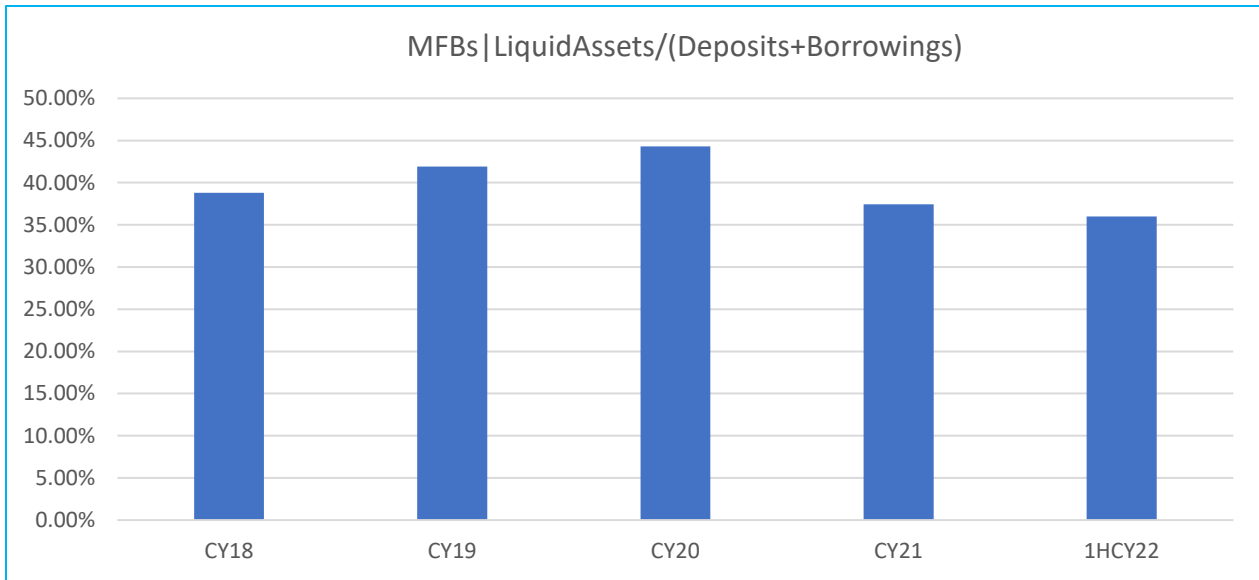
In CY21, the MFBs' focus was inclined towards secure investments, rather than lending, to reduce the risk of loss. The average spread of the banks, stayed at 13% in CY21 when compared with CY20. However, high-interest rates on the other hand would be a cause of concern for borrowers.

RETURN ON EQUITY:

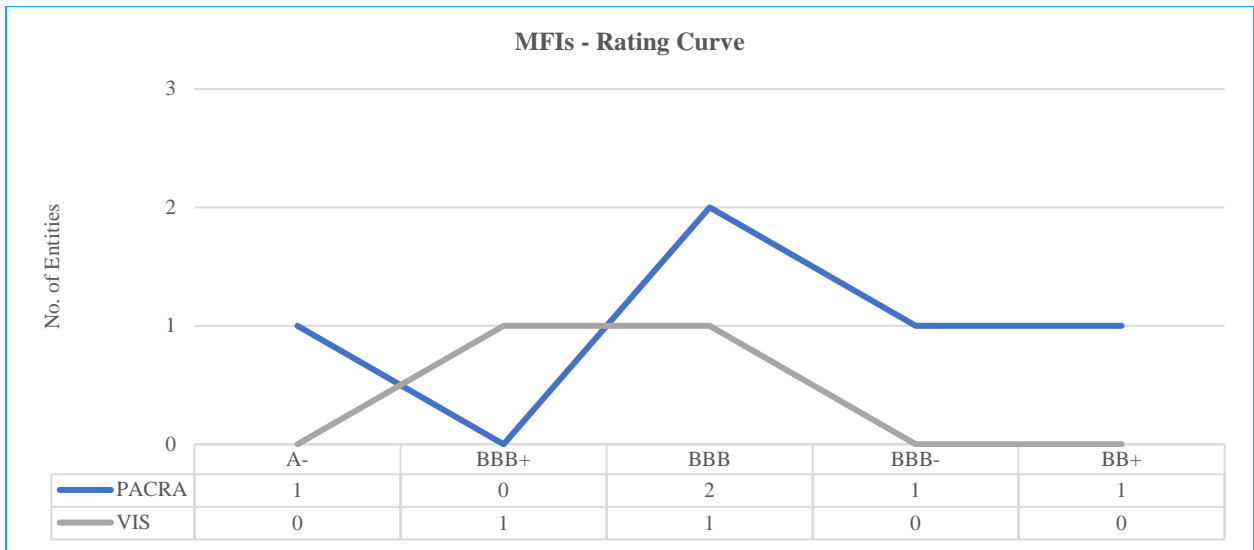
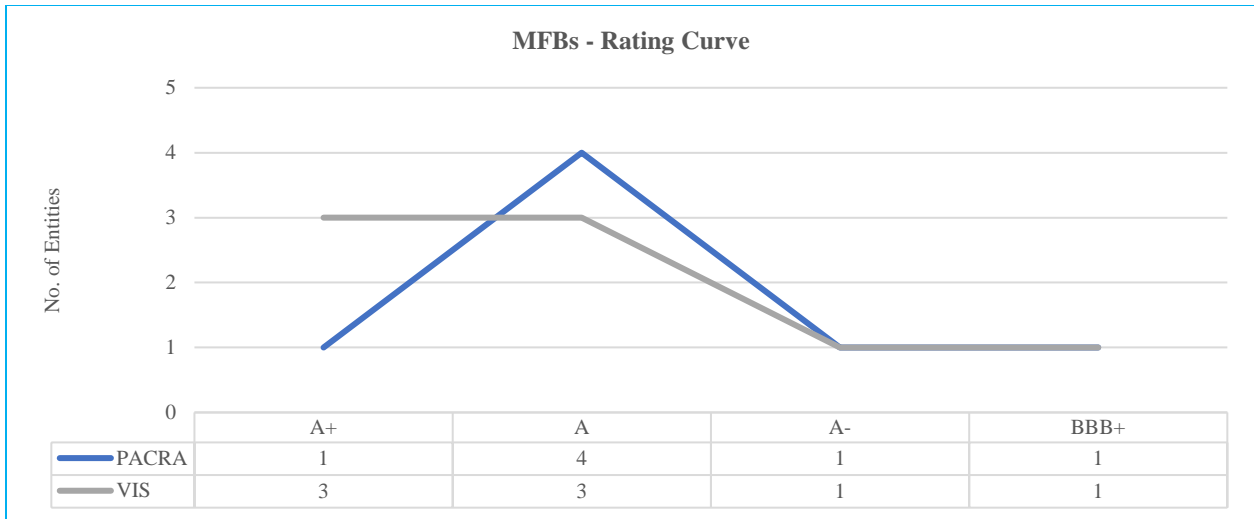


LIQUIDITY:

The Sector’s liquidity profile is analyzed by calculating the percentage of liquid assets it holds against its total funding, i.e., deposits + borrowings. The average liquid assets of MFBs are recorded at around ~40%. During CY21, the liquidity profile fell to ~37% (~44% in CY20) on account of a fall in liquid assets, particularly placed in short-term secured investments.



RATING CURVE



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- PACRA In-house database.

Research Team	Saniya Tauseef <i>AM / Research & Publishing</i> saniya.tauseef@pacra.com	Insia Raza <i>Research Analyst</i> insia.raza@pacra.com
Contact Number: +92 42 35869504		

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