RATING REPORT

The First MicroFinanceBank Limited (FMFB)

REPORT DATE:
May 4, 2021

RATING ANALYSTS:

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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A+	A-1	A+	A-1
Rating Outlook	Rating Watch-Developing		Rating Watch-Developing	
Rating Date	*April 30th, '21*		*April 30th, '20*	

COMPANY INFORMATION

Incorporated in 2001	**External auditors:** M/s A. F. Ferguson & Co., Chartered Accountants, a member firm of the PwC network
Public Limited Unlisted Company	**Chairman of the Board**: Mr. Rayomond Kotwal
	President & CEO: Mr. Muhammad Amir Khan
Key Shareholders (with stake 5% or more):	
Habib Bank Limited (HBL): 50.5%	
Aga Khan Agency for Microfinance (AKAM): 29.7%	
Aga Khan Rural Support Programme (AKRSP): 11.0%	
Japan International Cooperation Agency (JICA): 8.8%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro Finance Banks (June 2019)
https://www.vis.com.pk/kc-meth.aspx

The First MicroFinanceBank Limited (FMFB)

OVERVIEW OF THE INSTITUTION

FMFB was incorporated in 2001 as a public limited unlisted company under the Companies Ordinance, 1984 (now Companies Act, 2017) and provides microfinance banking services to the market niche. The bank operates through a network of 210 business locations at end-FY20.

Profile of Chairman

Mr. Rayomond Kotwal has over 30 years of experience. Mr. Kotwal is currently the CFO of Habib Bank Limited.

Profile of CEO

Mr. Muhammad Amir Khan brings over 24 years of extensive experience in consumer and commercial banking with the Standard Chartered Bank, ABN Amro Bank and Royal Bank of Scotland.

Financial Snapshot

Total assets:
end-FY20: Rs.76.4b;
end-FY19: Rs. 47.2b;
end-FY18: Rs. 37.6b.

Total equity:
end-FY20: Rs. 6.7b;
end-FY19: Rs. 6.0b;
end-FY18: Rs. 5.5b.

Net profit:
FY20: Rs. 0.6b;
FY19: Rs. 0.5b;
FY18: Rs. 1.0b.

RATING RATIONALE

The First MicroFinanceBank Limited (FMFB) is one of the leading providers of microcredit service in Pakistan, with its network of 210 locations across Pakistan. The assigned ratings take into account strong ownership structure, as major shareholding of the bank is held by Habib Bank Limited (HBL) and the Aga Khan Development Network. The bank's microcredit portfolio witnessed a growth of 37% in FY20, one of the highest growth among industry peers; the same has resulted in sizeable increase in risk weighted assets. This along with higher provisioning booked against lending portfolio resulted in weakening of capitalization; CAR was at the minimum regulatory threshold of 15% at end-FY20. The parent company, HBL, has approved to inject equity to the tune of Rs. 2b in FY21 and Rs. 1b each in the following two years in order to support CAR. Ratings would remain sensitive to the timely equity injection by the sponsor during the ongoing year and beyond, and maintenance of CAR at an adequate level.

Despite significant increase in provisioning, the bank reported slightly higher profits mainly on the back of growth in lending portfolio and sustained markup spread. Liquidity position of the bank improved due to increase in liquid assets as a proportion of deposits and borrowings. Additional working capital lines have been arranged to support liquidity. During the ongoing year, the bank is primarily focused on recovery of the rescheduled loans. The bank had recovered around 13% of the rescheduled loans by end-Mar'21. Major portion of recoveries fall due in second and third quarter of 2021. In view of continued uncertainty and severity of impact of the pandemic on the economy in general and microfinance sector in particular, the outlook on the ratings will remain vulnerable.

Key Rating Drivers

Aggressive growth of lending portfolio amid pandemic: Despite economic slowdown and heightened risk of non-repayment of loans, microcredit portfolio witnessed a growth of 37% in FY20 vis-à-vis 33% in FY19. Given changes in prudential regulations such as increase in loan and borrower income limits of general loans, housing loans and enterprise loans by SBP, the bank introduced three new products of higher limit in each of the Agri, Livestock and Enterprise loans categories in FY20. The bank intends to continue its focus on larger loan segment including Roshanzar/Roshanzar Plus product. The management plans to launch Roshanzar Premium (upto Rs. 3m) in FY21 in order to expand MSME segment. Additionally, the bank would focus towards structural housing finance given enhancement in limit to Rs. 3m; these secured loans would also mitigate the credit risk of the bank.

The sector-wise concentration witnessed a slight change as agriculture and livestock segments contribution decreased to 48.0% (FY19: 52.7%) in overall portfolio given higher focus on microenterprise segment (FY20: 30.7%; FY19: 28.2%) and other category loans (FY20: 21.3%; FY19: 19.1%) mainly housing loans and running finance products. By end-FY20, the proportion of group lending was reduced considerably to 18.6% (FY19: 28.6%) given high probability of default on a timeline basis.

Recovery of rescheduled portfolio would be the main focus in the ongoing year: Loans rescheduled under regulatory relief amounted to Rs. 12.7b at end-FY20 and Rs. 14.7b at end-1QFY21. Further, in order to facilitate borrowers affected by the pandemic but not eligible for regulatory relief, FMFB introduced internal rescheduling package of Rs. 751m to defer the principal payment by one year and allowed a cooling period of five months for markup payment. Resultantly, gross and net infection improved to 2.8% and 2.0% (FY19: 3.5% and 2.4%) respectively, by end-FY20. Incremental infection also declined to 1.6% (FY19: 5.0%). Provisioning coverage decreased to 29.9% (FY19: 33.6%) in line with lower specific provisions against NPLs. However, in view of business challenges posed by Covid-19, the bank booked a general provision of Rs. 1.0b (FY19: Rs. 0.1m) in addition to mandatory provision of 1% on loan portfolio to cover for the risk of recovery of rescheduled portfolio.

Total recoveries against rescheduled portfolio amounted to Rs. 1.3b at end-FY20. The bank rescheduled another Rs. 2.1b in 1QFY21 under regulatory relief and recovered Rs. 709m. Risk management department has structured teams for effective recovery of rescheduled portfolio. Majority of the recovered amount was against loans maturing in 2QFY21. PAR has remained minimal in fresh disbursements. During FY21, the bank is focused on recovery of loans while enforcing credit controls and centralized monitoring to improve portfolio health.

Despite higher provisioning charge, profitability improved slightly on the back of growth in lending and investment portfolio: Albeit provisioning against NPLs increased significantly to Rs. 1.6b (FY19: Rs. 0.9b), the bank reported higher profit before tax of Rs. 815m (FY19: Rs. 701m) mainly driven by growth in investment and lending portfolio while maintaining markup spread. Operational Self-Sufficiency also remained largely stable at 107% (FY19: 108%). Yield on advances increased slightly, however, decrease in yield on investment portfolio and placements with financial institutions amid lower interest rate environment resulted in marginally lower overall yield during FY20. Cost of funds also decreased slightly; the bank posted markup spread of 13.9% during FY20 (FY19: 13.9%).

Liquidity position of the bank improved while capitalization indicators remained marginal: Deposits remained the primary source of funding for the bank and exhibited a significant growth during the outgoing year. Major growth in deposits was observed in First Daily Profit Account, 6-months TDR and 1-year TDRs. The proportion of institutional depositors increased to 70% (FY19: 60%) by end-FY20. While deposit concentration has remained high, these deposits have demonstrated stickiness over the years. The bank mobilized borrowings of Rs. 2b to meet liquidity requirements for business growth. Sub-ordinated term finance facility from parent company to the tune of Rs. 2b was also obtained during outgoing year to support CAR. Furthermore, the bank has standby working capital lines amounting Rs. 4.3b to supplement liquidity requirements.

Equity base of the bank expanded on back of profit retention. Meanwhile, CAR was recorded lower at 15.05% (FY19: 15.8%) at end-FY20 mainly on account of considerable increase in risk-weighted assets. Equity injection by parent company, HBL, in form of share capital through right shares issuance of Rs. 2b in the ongoing year and Rs. 1b in each of the following two years would support CAR, going forward.

Digitization to support competitive positioning in the wake of higher use of digital channels while ensuring information security and business continuity: Loan Origination System (LOS) has been implemented in 150 branches by end-1QFY21 This would enable onboarding at clients' doorsteps, with on-spot data collection and verification leading to improved credit controls. Branchless banking (First Pay) has also been commercially launched in 1QFY21. With emergence of coronavirus the need for social distancing has further emphasized the importance of digital financial services. The bank is also strengthening its alternate delivery channels in alliance with HBL Konnect and UBL Omni.

The First MicroFinanceBank Limited (FMFB) Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*			
BALANCE SHEET	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**
Cash & balances with SBP and NBP	2,187	2,876	4,252
Balances with other Banks/NBFIs/MFBs	6,037	3,405	7,472
Net Investments	2,807	4,513	14,542
Net Financing	23,554	30,936	41,628
Other Assets	3,040	5,502	8,469
Total Assets	37,625	47,232	76,363
Total Deposits	31,129	38,404	61,726
Borrowings	-	-	2,021
Subordinated Debt	-	-	2,000
Other Liabilities	993	2,781	3,927
Paid-Up Capital	2,731	2,731	2,731
Tier-1 Equity	5,505	6,048	6,649
Net Worth	5,503	6,047	6,688
INCOME STATEMENT	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**
Net Mark-up Income	4,365	5,054	6,664
Net Provisioning / (Reversal)	251	853	1,567
Non-Markup Income	509	768	876
Operating Expenses	3,112	4,268	5,157
Profit Before Tax	1,511	701	815
Profit After Tax	1,000	533	575
RATIO ANALYSIS	**Dec 31, 2018**	**Dec 31, 2019**	**Dec 31, 2020**
Gross Infection (%)	0.9	3.5	2.8
Incremental Infection (%)	1.3	5.0	1.6
Provisioning Coverage (%)	32.7	33.6	29.9
Net Infection (%)	0.6	2.4	2.0
Net NPLs to Tier-1 Capital (%)	2.6	12.1	12.7
Capital Adequacy Ratio (%)	19.8	15.8	15.1
Cost of Funds (%)	6.7	10.5	10.4
Markup Spreads (%)	15.7	13.9	13.9
OSS (%)	129.9	108.1	107.0
ROAA (%)	3.1	1.3	0.9
ROAE (%)	20.0	9.2	9.0
Liquid Assets to Total Deposit & Borrowings (%)	35.4	28.1	41.2
Advances to Deposit Ratio (%)	75.7	80.6	67.4

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Annexure III
Name of Rated Entity	The First MicroFinanceBank Pakistan (FMFB)
Sector	Microfinance Bank (MFB)
Type of Relationship	Solicited
Purpose of Rating	Entity Ratings
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30/04/2021	A+	A-1	Rating Watch-Developing	Reaffirmed
30/04/2020	A+	A-1	Rating Watch-Developing	Maintained
25/03/2019	A+	A-1	Stable	Reaffirmed
30/04/2018	A+	A-1	Stable	Reaffirmed
31/10/2017	A+	A-1	Stable	Reaffirmed
28/04/2017	A+	A-1	Stable	Reaffirmed
28/04/2016	A+	A-1	Stable	Upgrade

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meeting/s Conducted

	Name	Designation	Date
1.	**Mr. Adil Abbasi**	Chief Financial Officer	26th March, 2021
2.	**Mr. Ali Raza Anjum**	Chief Operating Officer	26th March, 2021
3.	**Ms. Zehra Khalikdina**	Head Risk Management	26th March, 2021
4.	**Mr. Jalal Ahmad Shah**	Chief Information Officer	26th March, 2021
5.	**Mr. Muhammad Siddique**	Head Internal Audit	26th March, 2021
6.	**Mr. Salman Mehmood**	Head Rewards & HR Services	26th March, 2021