RATING REPORT

FINCA Microfinance Bank Limited (FINCA MFB)

REPORT DATE:
April 30, 2021

RATING ANALYSTS:

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RATING DETAILS

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

COMPANY INFORMATION

Incorporated in 2008	**External auditors:** M/S KPMG Taseer Hadi & Co
Public Limited Company	**Chairperson of the Board**: Ms. Zarlasht Wardak
	Acting CEO: Mr. Shahid Hosain Kazi
Key Shareholders (with stake 5% or more):	
FINCA Microfinance Cooperatief U.A - 86.4%	
Kashf Holdings(Private) Limited – 5.2%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Micro-Finance Banks (June 2019)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Micro%20Finance%20201906.pdf

FINCA Microfinance Bank Limited

RATING RATIONALE

The assigned ratings of FINCA MFB incorporate association of the bank with FINCA Impact Finance., a global microfinance organization operating in 20 subsidiaries, including Pakistan. FINCA MFB continues to receive support from its parent through transfer of technical expertise emanating from FINCA's global experience. FINCA MFB has successfully embarked upon various IT initiatives, which are expected to bring operational efficiencies, going forward. The ratings take into account the currently manageable liquidity position of the bank coupled with improvement in capitalization indicators emanating from sizeable investment in risk free avenues as growth in micro-credit portfolio was limited amidst COVID-19. The ratings reflect slight downturn in the financial risk profile of the bank owing to higher incidence of non-performing loans leading to higher infection ratios; the same is a result of deterioration in sector dynamics prior to advent of COVID-19 pandemic. The downturn in asset quality has put a drag on the institution's profitability.

With the advent of global corona virus pandemic and the following lockdown, the microfinance borrowers and especially those in urban areas will have a further reduced capacity of meeting obligations. The ratings take into account SBP's relaxation on repayment terms for borrowers by giving a blanket extension of one year; however, VIS expects that the same will only stagger the infection ratios, which will eventually come forth by end-CY21. Going forward, ratings are dependent on achievement of projected growth plans while improving asset quality indicators, strengthening deposit profile and retaining buffer over regulatory capital requirement.

Organogram and Management Profile

FINCA has a horizontally spread organizational structure comprising thirteen departments. A total of six 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 three by the CFO. The Head of Internal Audit administratively reports to the CEO.

Department	CEO	COO	CFO
Business Development	Yes		
Information Technology		Yes	
Ops & Digital Transformation		Yes	
Human Resources	Yes		
Risk Management	Yes		
Finance			Yes
Legal & Corporate Affairs	Yes		
Administration & Procurement			Yes
Compliance & Internal Control	Yes		
Strategy & New Projects		Yes	
Internal Audit	Yes		
Marketing		Yes	
Treasury			Yes

Financial Risk Analysis

Credit Risk

Limited growth was achieved in the micro-credit portfolio during CY20 as a deliberate strategy of the bank amidst COVID-19 scenario. The gross loan portfolio is projected to remain unchanged in the on-going year owing to the prevalent economic condition amidst corona pandemic coupled with general downturn in microfinance dynamics. Management plans to slowly increase the GLP over the medium term, contingent upon on the economic situation. Going forward, management envisages growth in SME, SE and Gold portfolios with agricultural portfolio expected to remain at current levels. Individual lending continues to remain forte of the bank, while average loan ticket size continued to increase on a timeline basis. A larger ticket size continues to provide competitive advantage to FINCA over other MFBs in terms of lower operational cost incurred per individual loan initiated. Further, owing to progression of clients to successive loan cycles along with inflationary pressure and adequate cash flow assessment of clients , per party exposure does not constitute a significant risk. Credit risk emanating from microcredit portfolio exhibited a declining trend in CY20 due to relief provided by the SBP of deferment and restructuring. However, asset quality indicators witnessed weakening in 1QCY21. At end-Dec'20, around 58% of the net loan portfolio was deferred/re-scheduled under SBP relief, 47% of which

OVERVIEW OF THE INSTITUTION

FINCA Microfinance Bank Limited (FINCA MFB) previously Kashf Microfinance Bank Limited, was incorporated in June, 2008 as a public limited company under the New Companies Act 2017. The ultimate holding company of FINCA MFB is FINCA Impact Finance, a not-for-profit corporation incorporated in Washington D.C., U.S.

Profile of Acting CEO

Mr. Shahid Hosain Kazi possesses 22 years of banking experience in different institutions, departments, territories & jurisdictions and in various capacities, including in Leadership roles. Shahid's experience covers key banking functions such as Corporate & Retail Banking, Strategic Planning, Risk Management & International Business. He started his banking career with Emirates Bank in 1994. Over the years, he held senior positions at Bank Alfalah and Habib Metropolitan Bank (subsidiary of Habib AG Zurich). Most recently, he served for 4 years as "Group Head – Corporate & Transaction Banking" at Habib Metropolitan Bank. He holds an MBA in Banking & Finance from Institute of Business Administration (IBA) – Karachi.

Profile of Chairman

The Board is chaired by Ms. Zarlasht Wardak who serves as regional director of FINCA Impact Finance. (Middle East & South Asia) and carries over 15 years of experience in executive financial management. Ms. Wardak holds a Bachelor of

Arts degree in International Business from South Western College in Kansas and Master of Science (MSc) degree in Peace Operations from George Mason University in Fairfax, Virginia. BoD comprise seasoned professionals carrying significant local and international experience of the microfinance sector including Ms. Roshaneh Zafar, MD, Kashf Foundation.

has been collected. Timely collection of outstanding due portfolio (principal and mark-up) is considered important from a ratings perspective. The management must continue to ensure prudent risk management as majority of the portfolio comprises agricultural & livestock based loans. Future trend with respect to asset quality indicators will continue to be tracked by VIS.

Liquidity

Liquidity profile of the bank is adequate; however high depositor concentration levels and higher advances to deposit ratio in comparison to peers remain a rating concern. Liquid assets carried on the balance sheet were reported at Rs. 10.9b (CY19: Rs. 9.5b) at end-CY20 mainly on account of increase in bank balances. As a result, cushion of liquid assets to total deposits and borrowings increased to 34.0% (CY19: 32%) at end-CY20. Around 60% (CY19: 66%) of liquid assets comprised investment in T-bills while remaining were deposit placements with SBP, NBP and other banks. Improvement in deposit profile (including depositor concentration and mix) remains a key focus area of the management. Deposits remained the primary funding source for the bank; deposit mix largely remained the same with term deposits comprising more than 50% of the deposit base. Depositor concentration improved at end-Dec'20 with top 50 depositors accounting for 31% (FY19: 34%) of total deposits; albeit remaining on the higher side. Subsequently, stickiness in deposits coupled with maintaining a broad based depositor base is required to mitigate the risk of large withdrawals.

Profitability

Despite a decline in mark-up spreads and disbursements during CY20, overall profitability of the bank improved primarily owing to higher income earned on bank deposits, decrease in administrative expense and one-off gain on disposal of fixed assets. As a result, Operational self-sufficiency (OSS) ratio increased to 114% (CY19: 111.0%) in line with lower operating expenses and higher NIM during CY20. With decrease in return on mark-up bearing assets offsetted by decrease in cost of funds, spread of the bank largely remained at prior year's level of 19.6% (CY19: 20.0%) during CY20. However, net mark-up income was reported higher at Rs. 5.6b (CY18: Rs. 5.3b) on the account of higher average mark-up bearing assets during CY20. Going forward the OSS is projected to rationalize owing to operational efficiencies primarily on the back of various IT initiatives, improved LO productivity and lower turnaround time. Accounting for taxation, net profit amounted to Rs. 904.7m (CY19: Rs. 653.4m). Going forward, profitability of the bank is projected to depict improvement in line with planned growth in loan portfolio over the medium term, improvement in deposit mix along with expected increase in benchmark rates.

Capitalization

Paid-up capital remained unchanged at Rs. 6.4b at end-CY20; however the total equity base augmented to Rs. 5.2b (CY19: Rs. 4.7b) on account of internal capital generation. Equity of the bank is in compliance with the minimum capital requirement of Rs. 1.0b stipulated for microfinance banks with nationwide operations. Net NPLs as a percentage of equity decreased to 11.5% (CY19: 16.7%) due to decline in NPLs at end-CY20. Dividend to the tune of Rs. 410m was paid during CY20. Capital Adequacy Ratio (CAR) of the bank increased to 20.9% (CY19: 19.8%) by end-CY20 due to range bound growth manifested in advances portfolio and relatively higher excess liquidity parked in risk free investments. Given growth plans over the medium term, sizeable internal capital generation would be required to maintain CAR above the minimum regulatory requirement. The same is likely to be attained if the deterioration in asset quality is countered effectively.

FINCA Microfinance Bank (FINCA MFB) Appendix I

FINANCIAL SUMMARY - FINCA	*(amounts in PKR millions)*			
BALANCE SHEET	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Cash and Bank Balances with SBP and NBP	1,639.2	1,595.5	1,572.1	1,612.7
Balances with other Banks and/NBFIs/MFBs	2,489.5	1,642.7	2,849.1	1,893.9
Lending to Financial Institutions	0.0	0.0	0.0	0.0
Total Investments	3,827.5	6,244.5	6,448.9	7,350.2
Net Advances	20,580.5	22,038.8	21,246.1	21,012.4
Operating Fixed Assets	1,748.3	3,131.1	2,445.0	2,306.0
Other Assets	1,970.6	2,613.4	5,171.4	5,274.8
Total Assets	**32,279.8**	**37,311.9**	**39,850.9**	**39,606.6**
Total Deposits	23,741.8	23,911.3	26,082.8	25,962.4
Borrowings	3,318.5	4,752.9	4,710.5	4,636.0
Subordinated Debt	0.0	800.0	800.0	800.0
Other Liabilities	1,187.1	3,129.4	3,014.1	2,968.3
Tier-1 Equity	4,030.0	4,714.6	5,243.0	5,242.5
Net Worth	4,032.4	4,718.3	5,243.5	5,239.9
Paid Up Capital	6,348.9	6,348.9	6,348.9	6,348.9
INCOME STATEMENT	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Net Mark-up Income	4,702.9	5,314.4	5,589.8	1,153.9
Net Provisioning / (Reversal)	434.9	1,089.6	1,228.4	500.8
Non-Markup Income	801.9	954.5	845.4	201.0
Operating Expenses	3,489.9	4,167.7	3,790.9	867.1
Profit Before Tax	1,579.9	1,011.6	1,416.0	-12.9
Profit after tax	956.5	653.4	904.7	-5.2
RATIO ANALYSIS	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**	**31-Mar-21**
Gross Infection (%)	1.9%	4.7%	3.4%	6.3%
Incremental Infection (%)	3.0%	7.2%	4.6%	3.7%
Provisioning Coverage (%)	73.5%	41.8%	41.2%	46.9%
Net Infection (%)	1.5%	3.7%	2.9%	4.3%
Net NPLs to Tier-1 Capital (%)	7.3%	16.7%	11.5%	16.8%
Capital Adequacy Ratio (%)	15.9%	19.8%	20.7%	NA
Cost of Funds (%)	8.2%	10.3%	9.8%	8.7%
Markup Spreads (%)	19.9%	20.0%	19.6%	15.1%
OSS (%)	126.3%	111.3%	114.2%	97.1%
ROAA (%)	3.3%	1.9%	2.3%	-0.1%
ROAE (%)	26%	15%	18%	-0.4%
Gearing (x)	NA	NA	NA	NA
Current Ratio (x)	NA	NA	NA	NA
Advances to Depost Ratio	88.3%	94.0%	82.6%	83.4%
Liquid Assets to deposits & borrowings (%)	29.4%	32%	34%	35%

Added Information- COVID-19 Restructuring as per SBP's notification

	31-Dec-19	**31-Dec-20**	**31-Mar-21**
Total Rollover Portfolio (Rs. in b)		12.2	NA
Deferred Portfolio		NA	NA
Restructured Portfolio		NA	NA
Rollover Portfolio to Net Advances (%)		58%	NA
Current Cash Recovery (%)		59%	64%
Amount Recovered (Rs. in b)		5.7	NA
Amount to be Recovered (Rs. in b)		6.5	NA
Write off (Rs. in b)	0.94	1.37	0.16
Write off to GLP (prior to write-off) (%)	4.0%	6.0%	0.8%

Provisioning to Total Income (%)	13.1%	14.2%	27.5%
Provisioning to Profit After Tax (%)	166.3%	135.5%	-9615.7%
Provisioning to Gross Loan Portfolio (%)	4.8%	5.7%	9.3%
Provisioning to Net Advances (%)	4.9%	5.8%	9.5%
Mark-up Accrued (Rs. in b)	2.0	4.6	NA
Mark-up Accrued to Net Interest Income (%)	38%	82%	NA

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	FINCA Microfinance Bank (FINCA MFB)
Sector	Micro Finance Bank (MFB)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-Apr-20	A	A-1	Rating Watch Developing	Reaffirmed
30-Apr-20	A	A-1	Rating Watch Developing	Maintained
30-Apr-19	A	A-1	Stable	Reaffirmed
23-Apr-18	A	A-1	Stable	Reaffirmed
31-Oct-17	A	A-1	Stable	Reaffirmed
27-Apr-17	A	A-1	Stable	Reaffirmed
09-Jan-17	A	A-1	Stable	Upgrade
26-April-16	A-	A-2	Positive	Reaffirmed
30-April-15	A-	A-2	Positive	Maintained
30-April-14	A-	A-2	Stable	Upgrade
30-April-13	BBB+	A-3	Stable	Upgrade
09-May-12	BBB-	A-3	Rating Watch - Developing	Downgrade
29-April-11	BBB	A-3	Rating Watch - Developing	Maintained

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 Meetings Conducted

	Name	Designation	Date
1	Mr. Ghulam Qadir	CFO	07/08- April- 2021
2	Mr. Rao M. Qaiser	Head Business Development	07-April-2021
3	Mr. Asghar Hussain	Head Strategy	07-April-2021
4	Ms. Nuvin Jatala	Head IT	08-April-2021
5	Ms. Maryam Waqar	Acting Head Internal Audit	08-April-2021