

MICROFINANCE

Sector Report – Sep'22

September'22

Research Report**Contents***Executive Summary**Outlook**Overview**Assets | GLP**Assets | Investments**Total Assets**Liabilities | Deposits & Borrowings**Capital Structure**Financial Performance**Ratio Analysis**Rating Curve**Bibliography***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 2QCY22 by ~13% against muted 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 is mainly due to an upward 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% 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, one of the key risks associated to the disaster is the risk of non-recovery from customers belonging to 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, floods calamity and rising fiscal and economic imbalances. FDI has also declined by ~26% in FY22 on a YoY basis.

Indicators	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

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 expense 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 GLP, MFBs have lent ~60% of their loan portfolio to Agri inputs and livestock, and they are most heavily impacted by the flash floods. 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 ~4,060 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, because just in the 1HCY22, the fresh NPLs rose to PKR~15,315mln, greater than what they used to be in CY20 when COVID-19 induced lockdown was at its peak. Considering rising inflation ahead, uncertainties to crop outputs, and the aftermath of the flood, the NPLs are expected to increase, going forward. Average Capital Adequacy of MFBs was recorded at around ~24% (excluding Advans, Sindh, and Pak Oman) in CY21. It is well above the regulatory requirement of ~15% providing sufficient cushion.

Overall Microfinance Sector has been undergoing successive 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 yet to unfold. In the absence of any regulatory relief, the credit quality of the sector is expected to take a further dig, especially 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, 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 the purpose of 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.

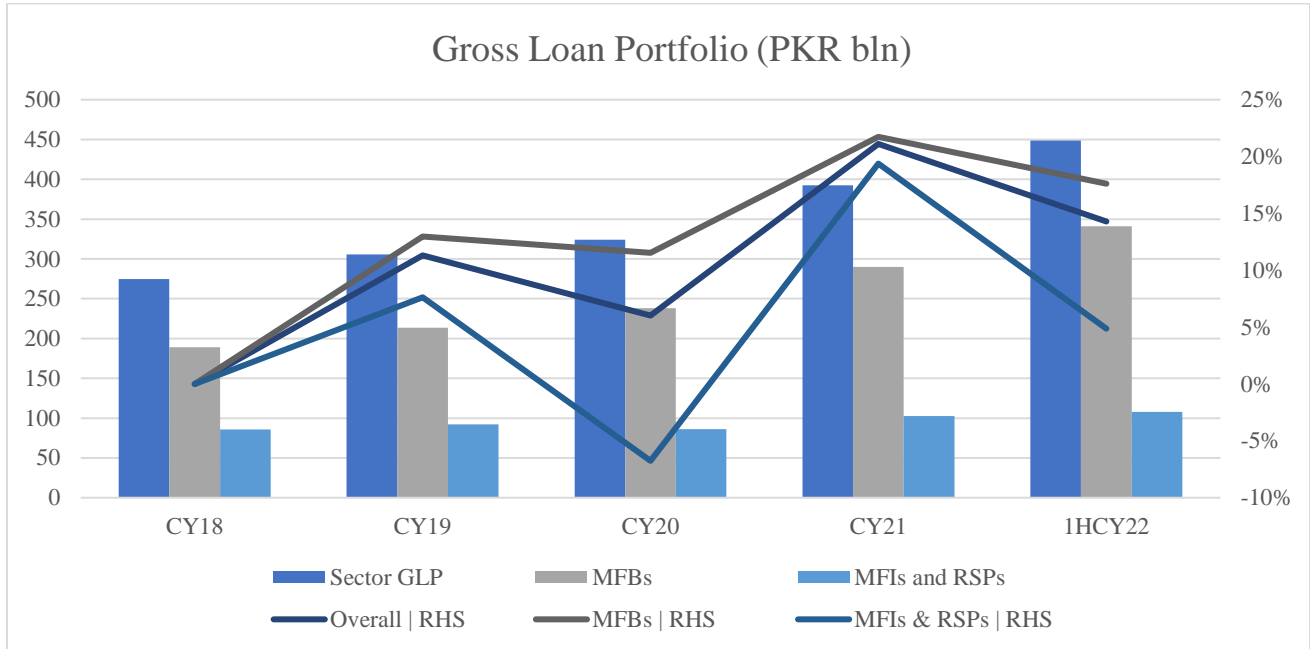
MFBs	Sponsors	GLP (PKR mln)	Market Share (GLP) - June'22
Khushhali	UBL: 29.7%, Rural Impulse Fund II S.A SICAV-FIS: 24.6%, responsAbility Global Micro and SME Finance Fund: 19.9%, Shorecap II Limited: 14.3%, Others: 11.7%	80,766	23.69%
Habib MFB	HBL: 50.5%, AKAM: 29.7%, JICA, 8.8%, AKRSP: 11.0%	74,637	21.89%
U MFB	PTCL: 100%	50,944	14.94%
Mobilink	Veon, G.T.A A.E: 100%	39,467	11.58%
NRSP	NRSP: 52.1%, Acumen: 16.02%, IFC: 16.02%, KfW: 16%	30,715	9.01%
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	5.91%
Telenor	Telenor Pakistan B.V: 55%, Alipay (Hong Kong) Holding Ltd. :45%	10,593	3.11%
APNA	UIG: 70%, Others: 30%	12,711	3.73%
Pak Oman	LOLC Pvt Ltd: 50.1%, Sultanate Oman: 33.2%, Pak Oman Inv. Co: 16.7%	5,584	1.64%
Advans	Advans SA SICAR: 100%	3,188	0.93%
Sindh MFB	Sindh Bank: 100%	1,190	0.35%
Total MFBs		340,966	76.00%
MFIs & RSPs		107,673	24.00%
Sector Total		448,639	100.00%

Note: ASA and Union Bank GLPs are included in the calculation of MFBs GLP.

ASSETS

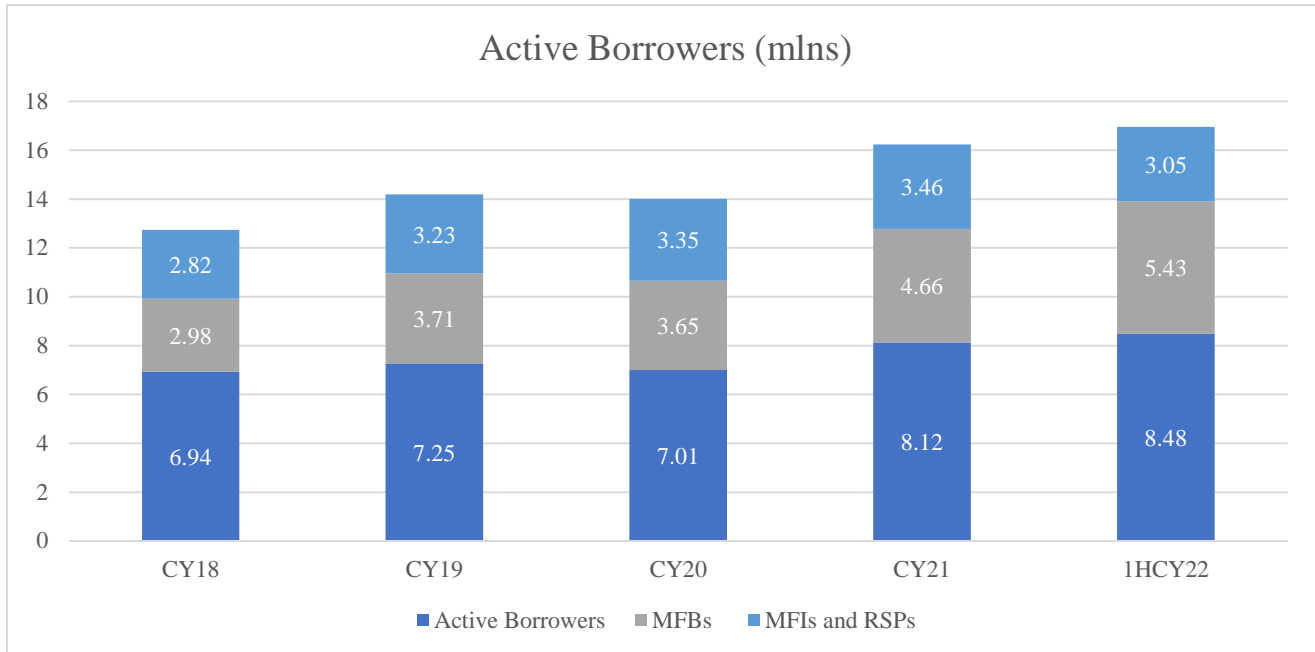
Gross Loan Portfolio | Peer Segments

Figure.1



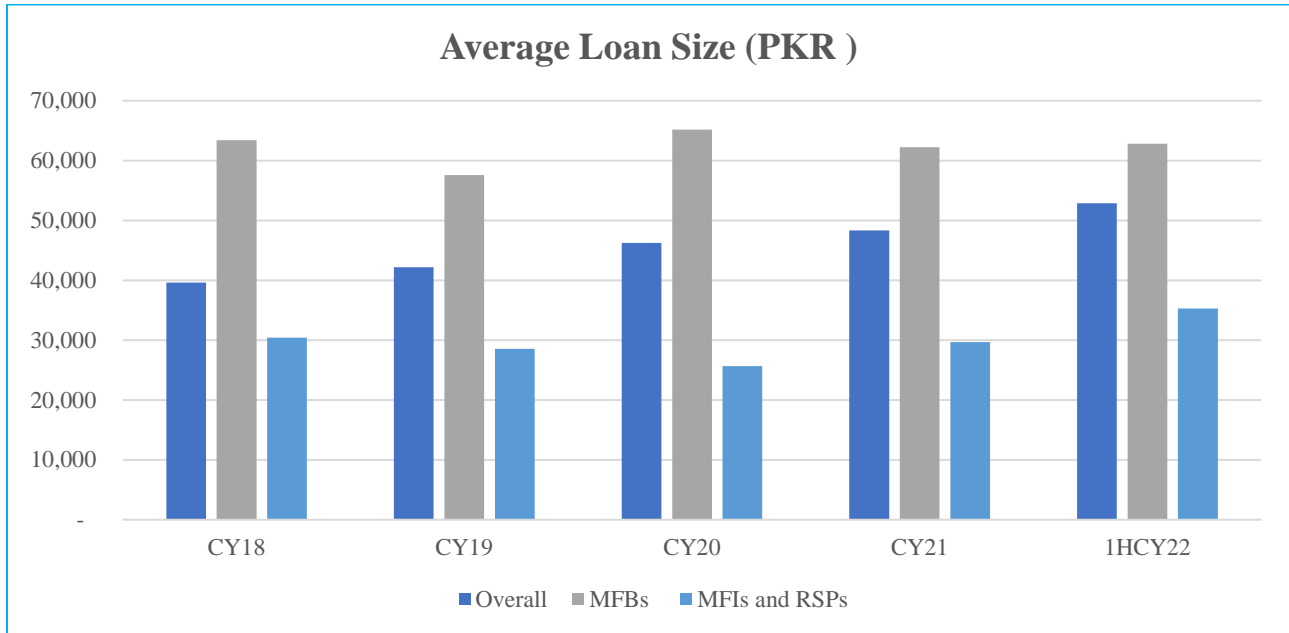
Active Borrowers and Loan Size | Peer Segments

Figure.2



Average Loan Size | Peer Segments

Figure.3

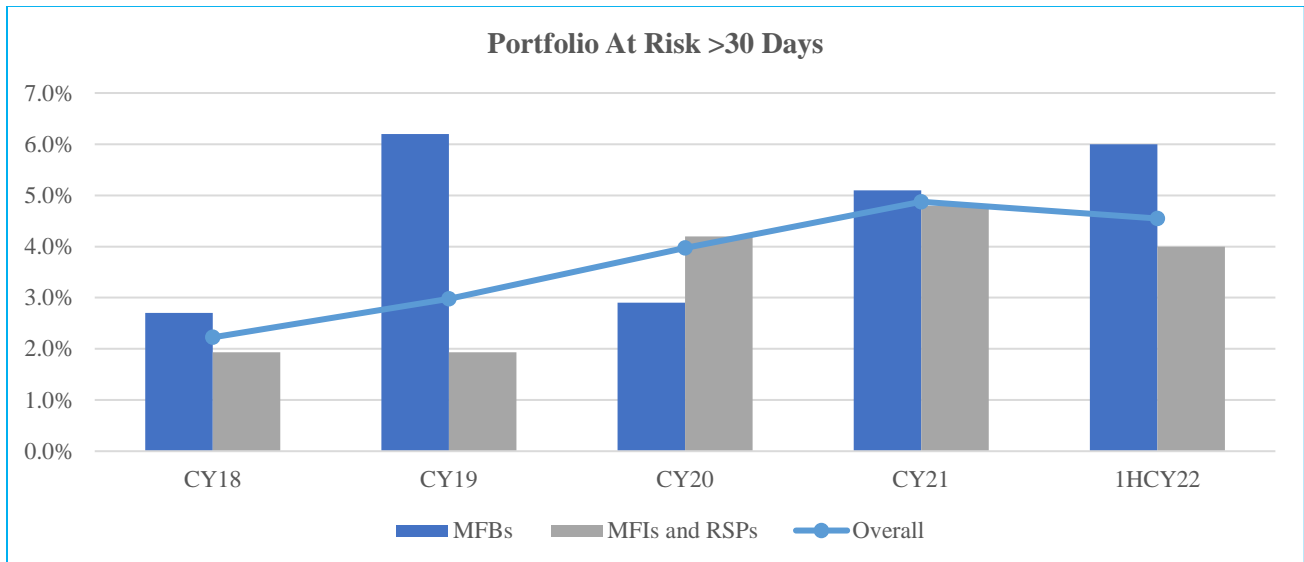


Historically, the sector’s growth rate slowed down but a healthy recovery was seen in CY21 where GLP posted a growth of ~21% YoY. Going forward, there are chances of restricted growth because of the recent flash flood, as it has a huge impact on the lower income tier of the society.

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

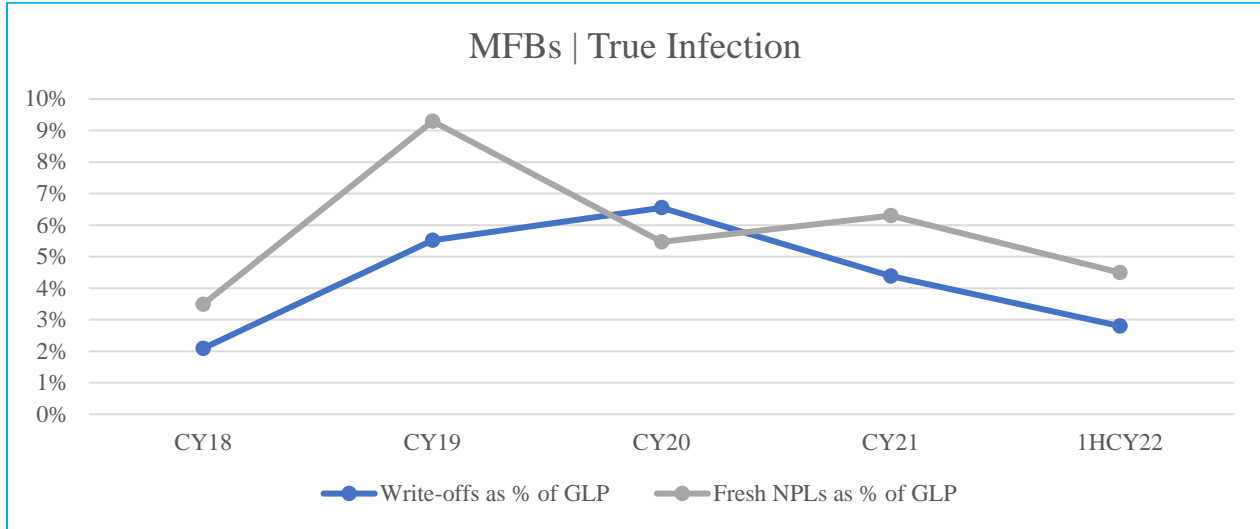
Asset Health | Peer Segments

Figure.4



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.

Figure.5

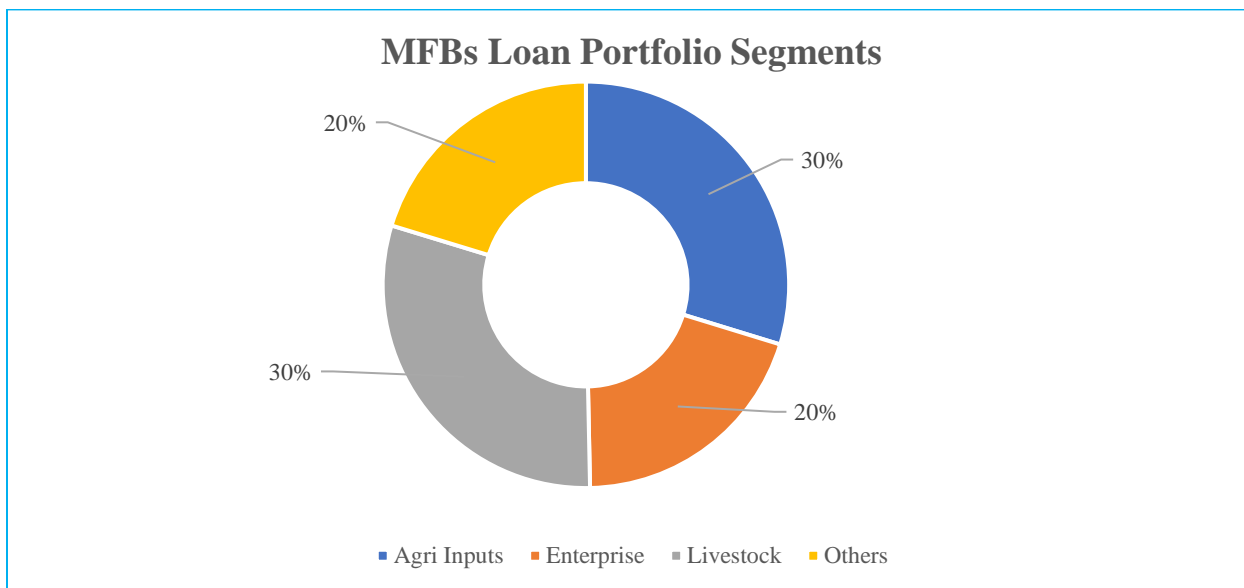


Overall financial parameters of microfinance banks have remained under stress during the last couple of years mainly due to slow economic growth, uptick in inflation, unexpected rains and pest attacks, issues pertaining to crop yield and pricing, and unexpected decrease in livestock particularly in Sindh due to untimely rains. Following CY21, the fresh NPLs are on a rise again. Net NPL coverage was recorded at ~73% as of End-June'22. The ratio was above ~100% in CY20 due to the MFBs' prudence to record provisions against anticipated losses, coverage ratio has dropped significantly.

MFBs Loan Portfolio Segments:

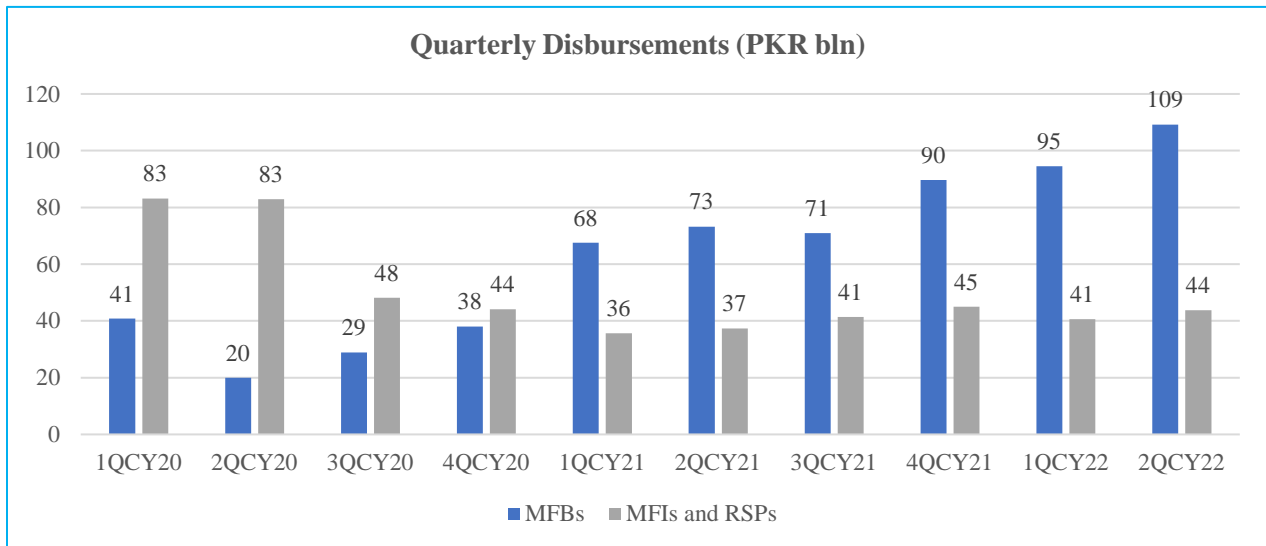
The loan book of MFBs is collectively concentrated around ~60% in livestock and crop lending wherein cash cycles of the borrowers are critical for undisruptive repayments.

Figure.6



Quarterly Disbursements

Figure.7

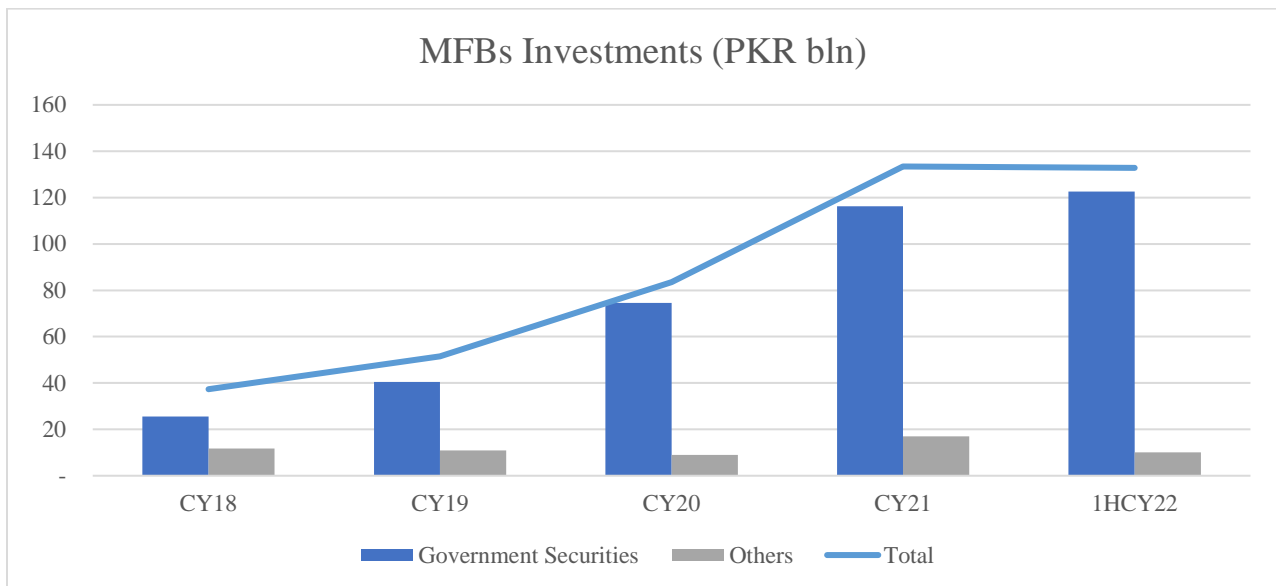


OTHER ASSETS:

Investments | MFBs

MFBs' Investments are generally dominated by Government Securities majorly in short-term T-Bills. During CY21, while GLP showed growth, the Investments also grew by a robust ~60% clocking in at PKR~133bln as of End-Dec'21 (PKR~84bln as of End-Dec'20). The increase was led by MFB increasing its holding of low-risk government papers capitalizing on the government's demand to meet budgetary needs from domestic resources. Investments in government securities continue to show growth with each passing year and there is a high probability of an increase in investment in government securities as to hedge against expected rise in NPLs.

Figure.8

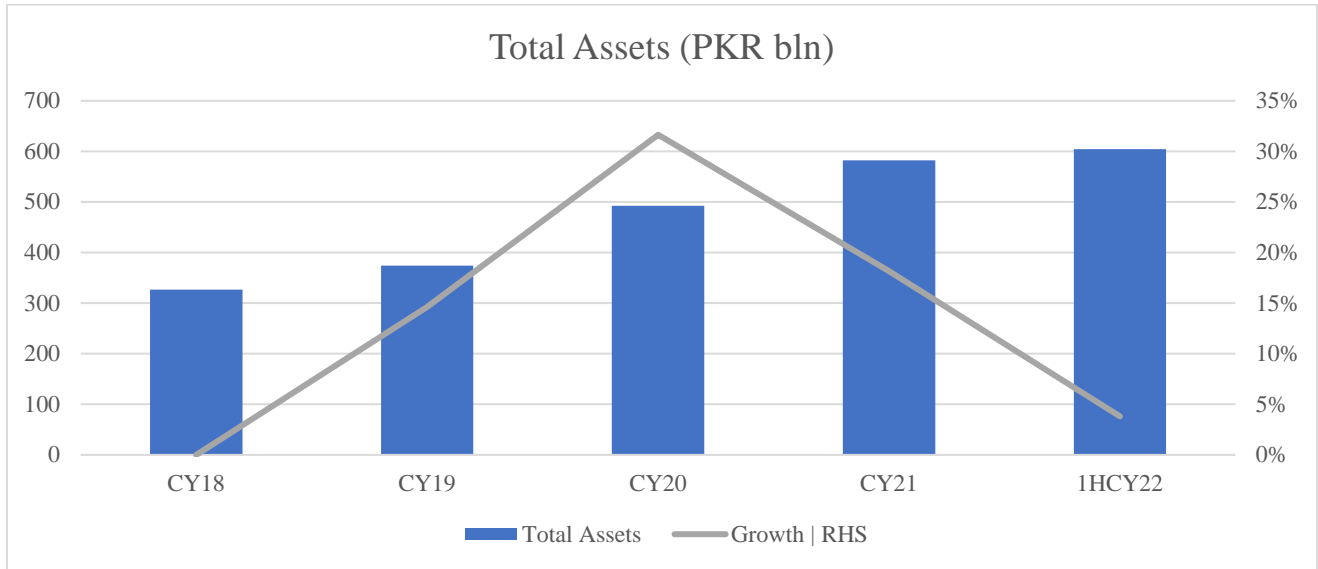


Total Assets:

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. The growth in total assets during CY21 mainly came on the back of increases in advances and investments. However, some increase in borrowings was also necessary to finance the assets’ growth; borrowings increased by PKR ~32 billion ~120% over the year.

Figure.9



LIABILITIES | DEPOSITS & BORROWINGS

Figure.10

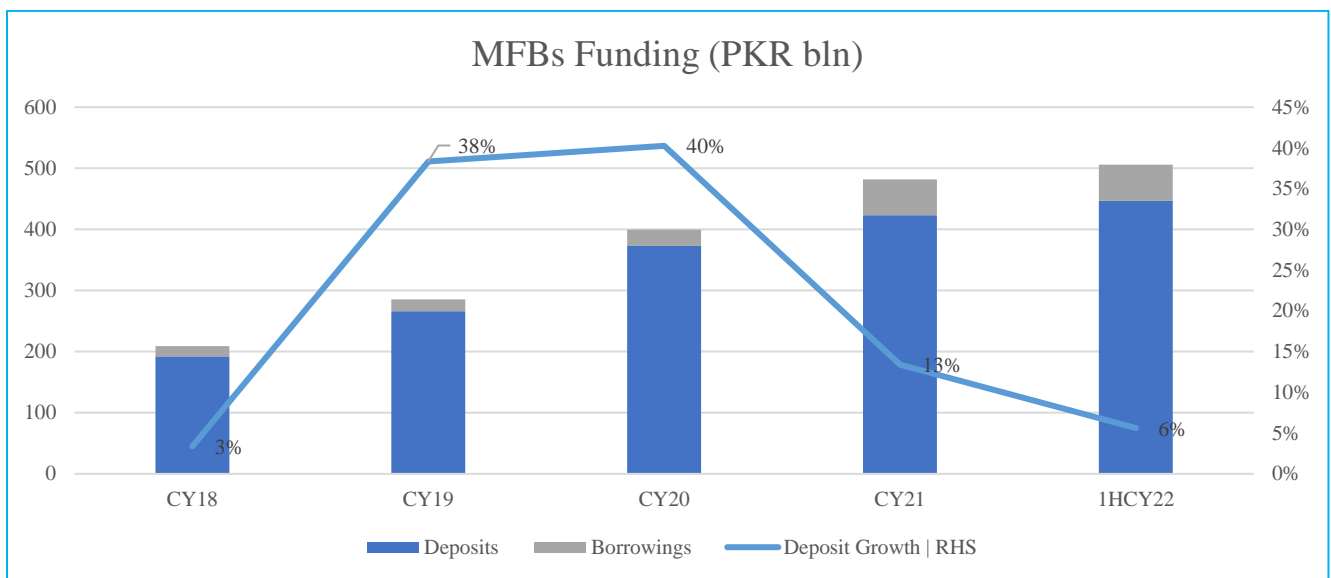
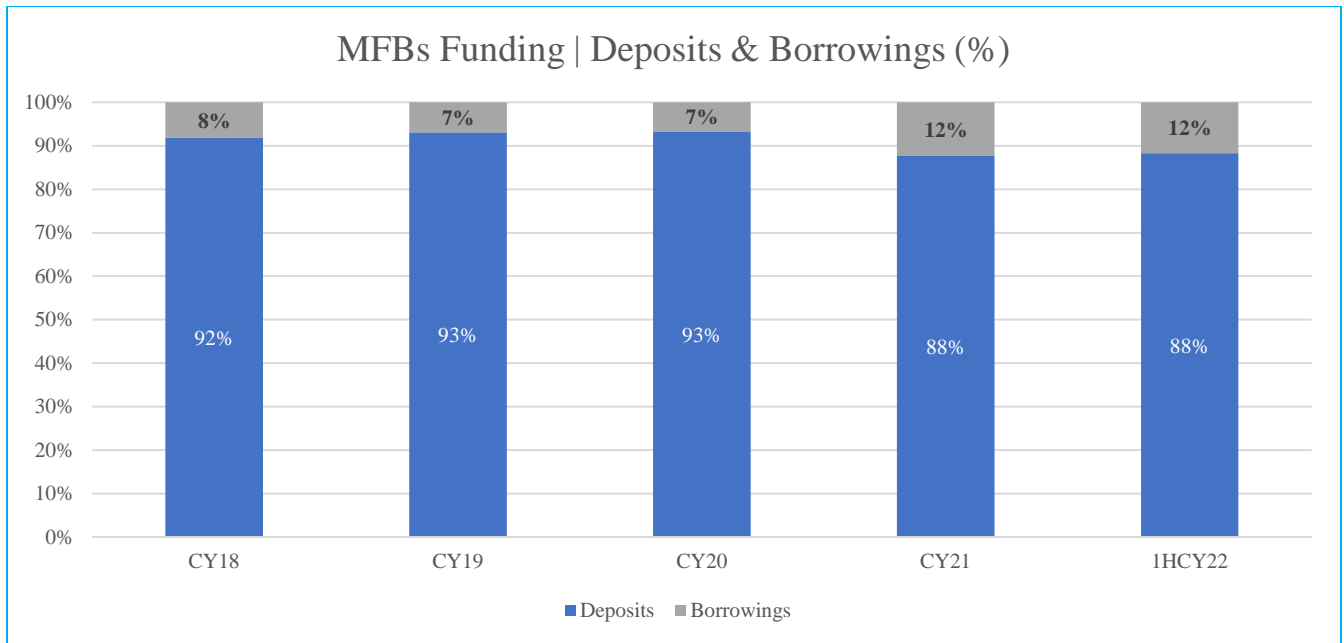


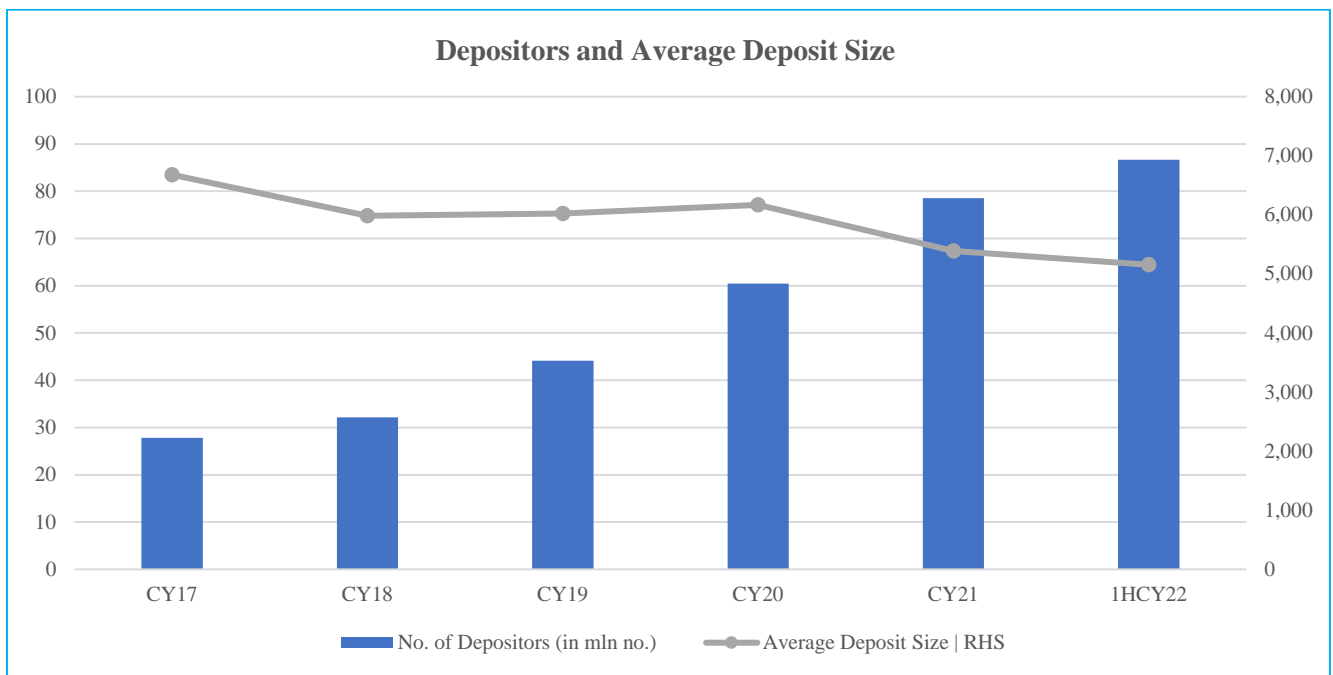
Figure.11



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.

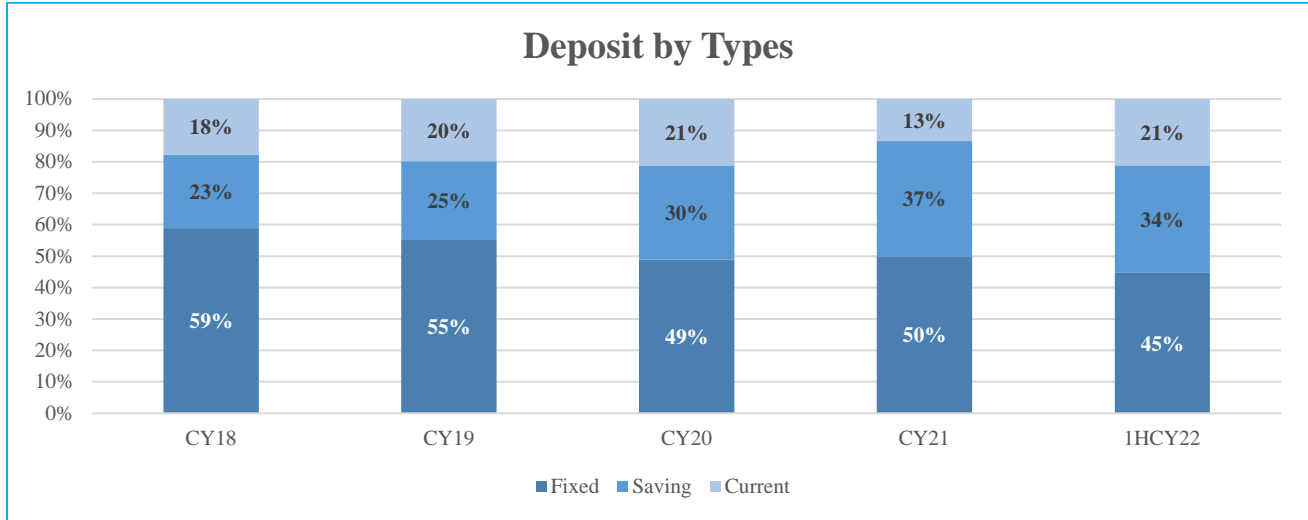
The deposit base of MFBs was recorded at PKR~447bln as of End-June'22 (PKR~423bln as of End-Dec'21). The Sector's deposits grew by ~6% in 1HCY22. This was majorly driven by Current Accounts (~95% growth) and Savings Accounts (~16% growth). Current Account savings grew on the back of increased branchless banking deposits. Meanwhile, growth in SA came on account of better saving rates offered by MFBs to attract more funds.

Figure.12



The total number of MFBs Deposit Accounts as at End-June'22 was recorded at ~87mln (~79mln as at End-Dec'21). The average deposit size decreased from PKR~6,167 in CY20 to PKR~ 5,389 CY21. However, in 1HCY22, the number of depositors increased by ~10% while deposits in value terms registered an increase of ~6% at End-June'22.

Figure.13



The MFBs Deposit Mix is inclined towards Fixed deposits and Saving Accounts (SA) collectively making ~79% of the deposit base as at End-June'22.

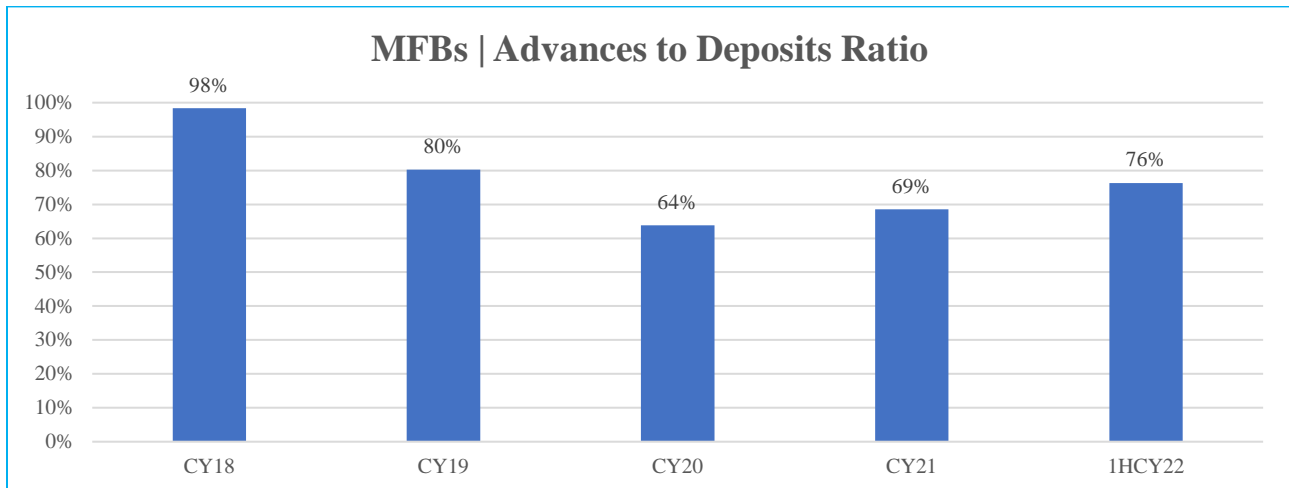
CASA accounted for ~55% of the total deposit base as at End-June'22. This mix is very similar to the deposit segmentation in commercial banks, wherein the average CASA ranges around ~50%. Deposits make up ~80% of the MFBs' total liabilities.

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. The share of BB deposits in value terms remains nominal.

MFBs | Advances to Deposits Ratio (ADR)

Figure.14

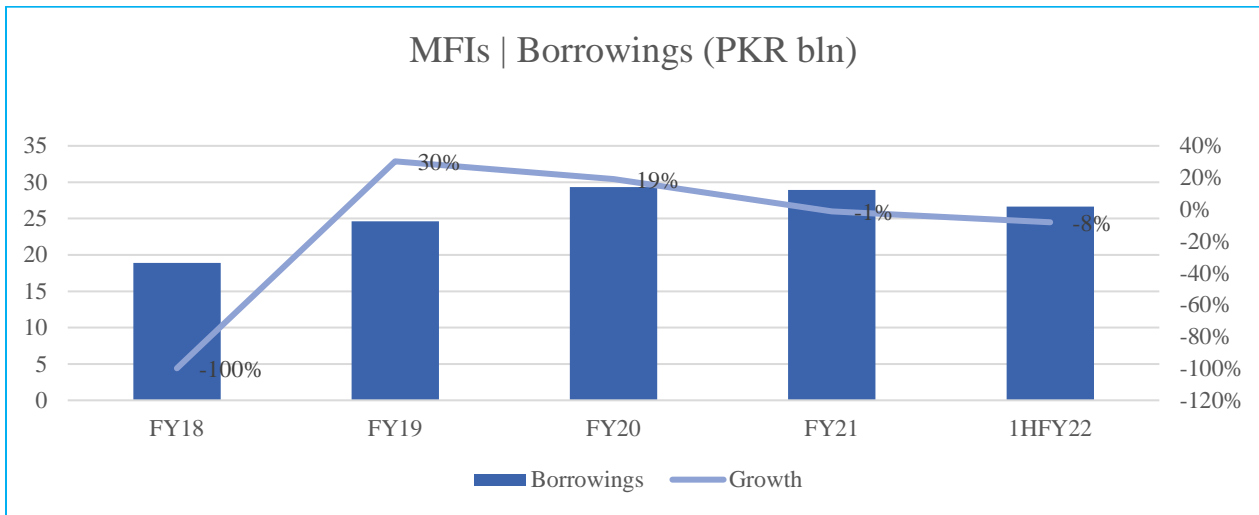


ADR of the MFBs (CY18 – 1HCY22) averages around ~77%. The range has been broad from an exorbitantly high ~98% ADR in CY18 to as low as ~64% in CY20. CY20's ADR dropped dramatically for obvious reasons of muted lending while the deposit base experienced an uptick in growth.

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.

MFBs | Borrowings

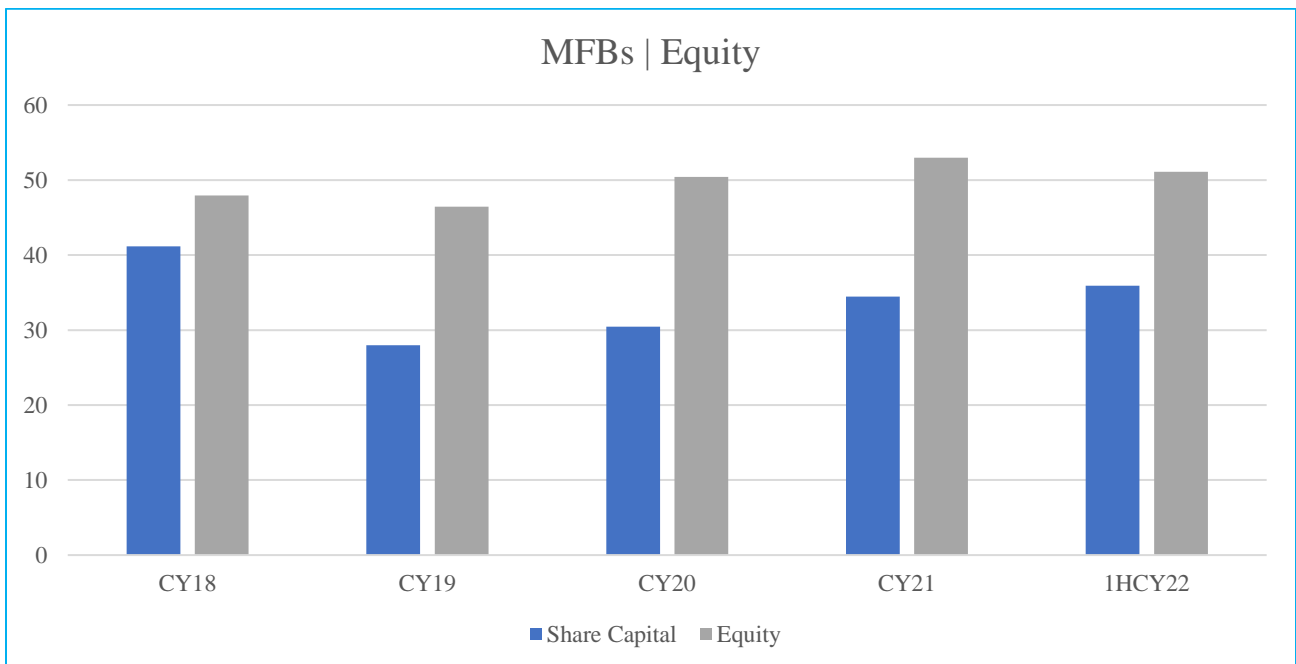
Figure.15



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

CAPITAL STRUCTURE

Figure.16

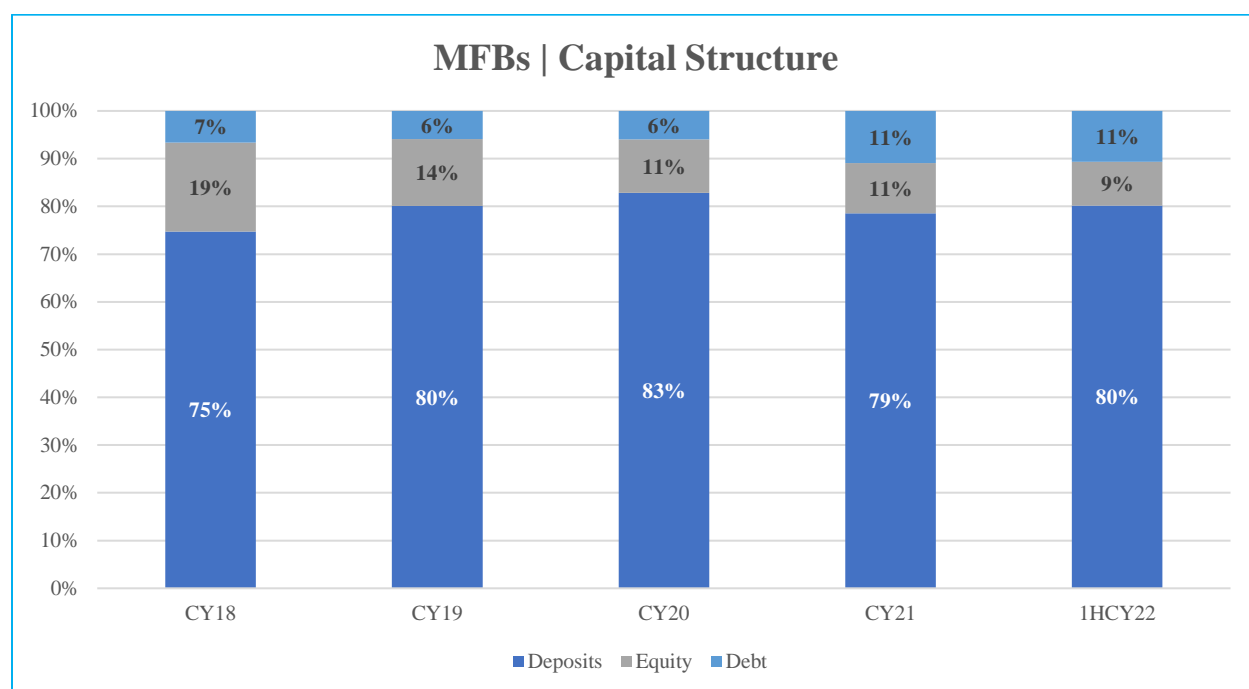


Total Equity of MFBs Sector was recorded at PKR~51bln as at End-June'22 (PKR~57bln as at End-Dec'21), down ~10%. The Sector's equity represents ~8% of its total assets. Gross Loans advanced are approximately 9 times the Equity, while deposits attracted are a multiple of 10.

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 ~73% of the NPLs.

CAPITAL MIX

Figure.17



Capital Adequacy Ratios (CAR):

Figure.18

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 CY21 (~31% in CY20). Excluding the small-sized banks (Advans, Pak Oman, and Sindh MFB), the Sector's average CAR drops by around ~7%. CAR falls due to faster growth in asset base (including growth in lending portfolio) as compared to eligible capital. Sponsors of a few loss-making institutions have fulfilled their commitment by injecting further equity to meet the capital requirement and support their operations.

FINANCIAL PERFORMANCE:

Figure.19

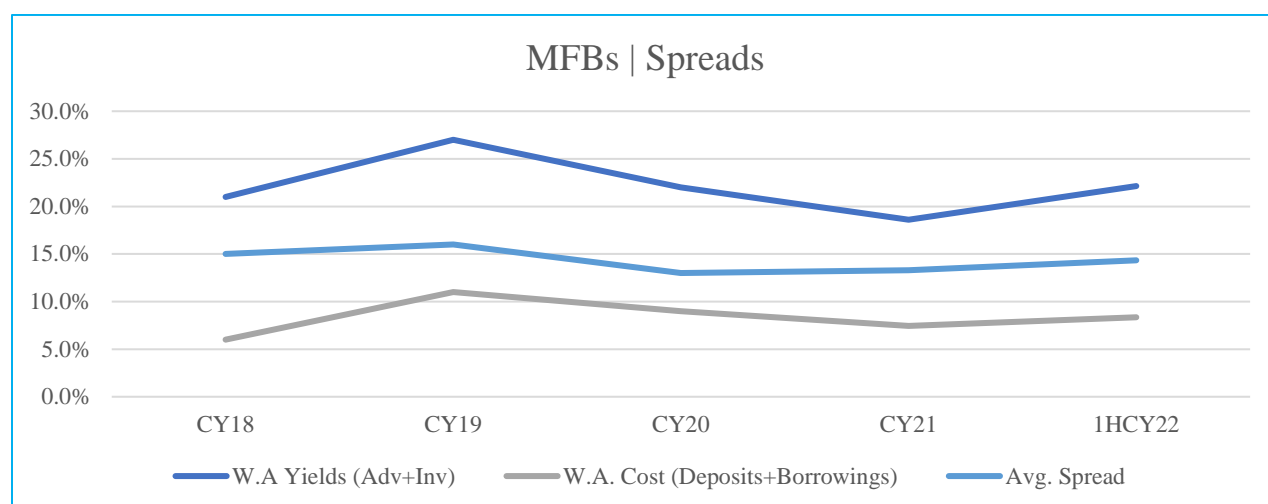
Operating Performance	CY18	CY19	CY20	CY21	1HCY22
<i>MFBS / PKR mln</i>					
Mark-up/Return/Interest Earned	50,401	66,026	75,333	67,790	66,597
Mark-up/Return/Interest Expensed	15,845	26,674	30,972	21,620	31,366
Net Mark-up / Interest Income	34,556	39,353	44,361	46,170	35,230
Administrative expenses	35,879	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

The bottom line of MFBS went negative because of high administrative and provisioning costs, which can be seen through operational self-sufficiency (ratio of financial revenues to all expenses) a decline from ~81.9% in CY20 to ~76.8% in CY21. Telenor MFB is another anomaly, with a high net loss of PKR~11bln in CY21. 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.

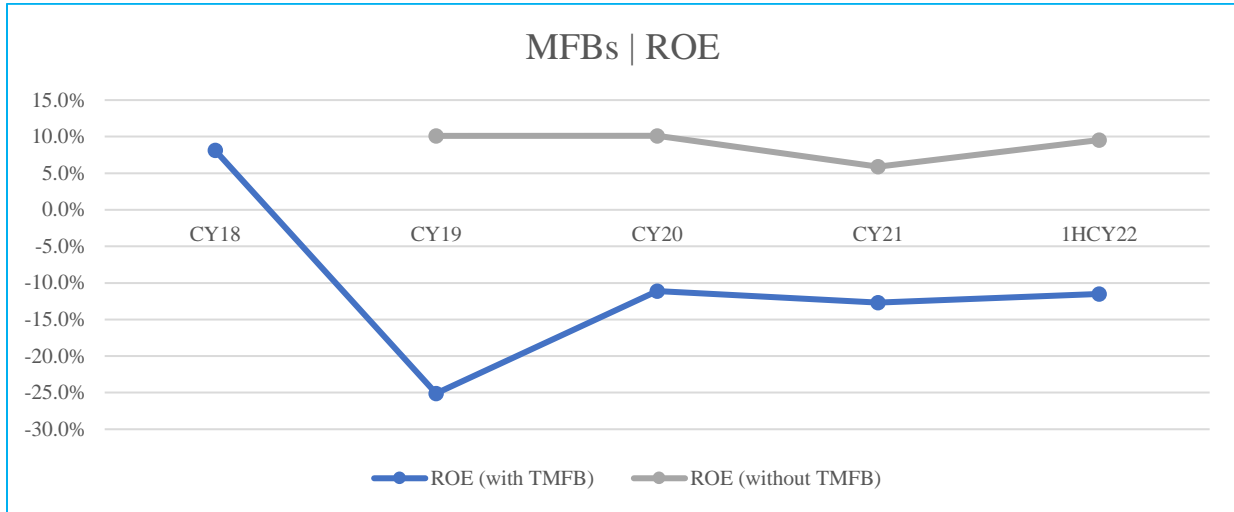
Figure.20



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:

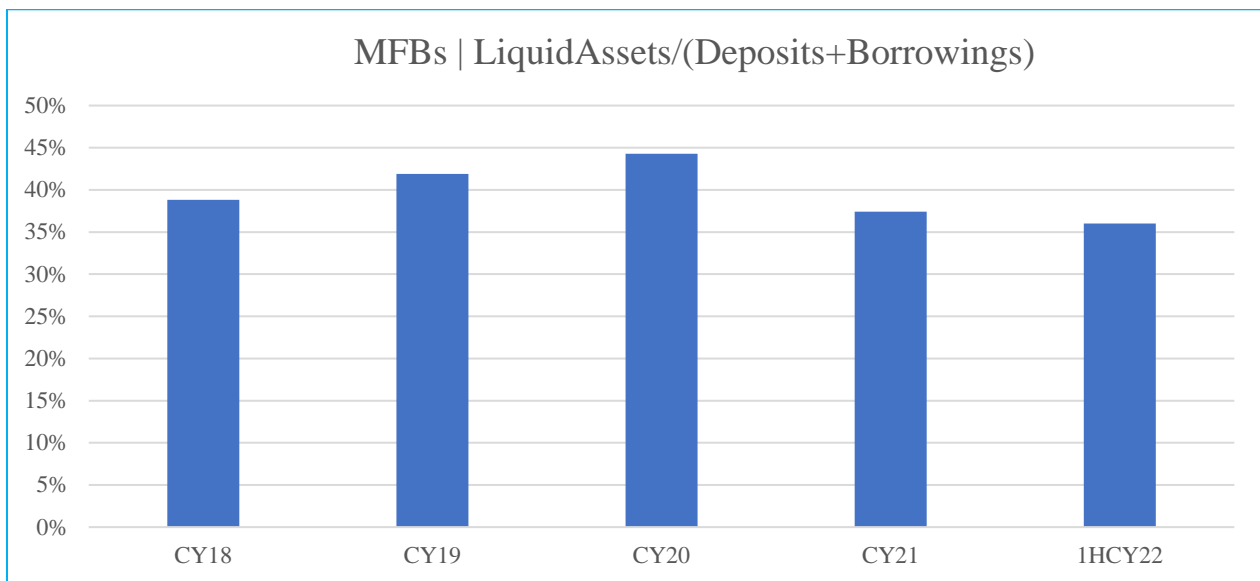
Figure.21



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 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.

Figure.22



RATING CURVE

Figure.23

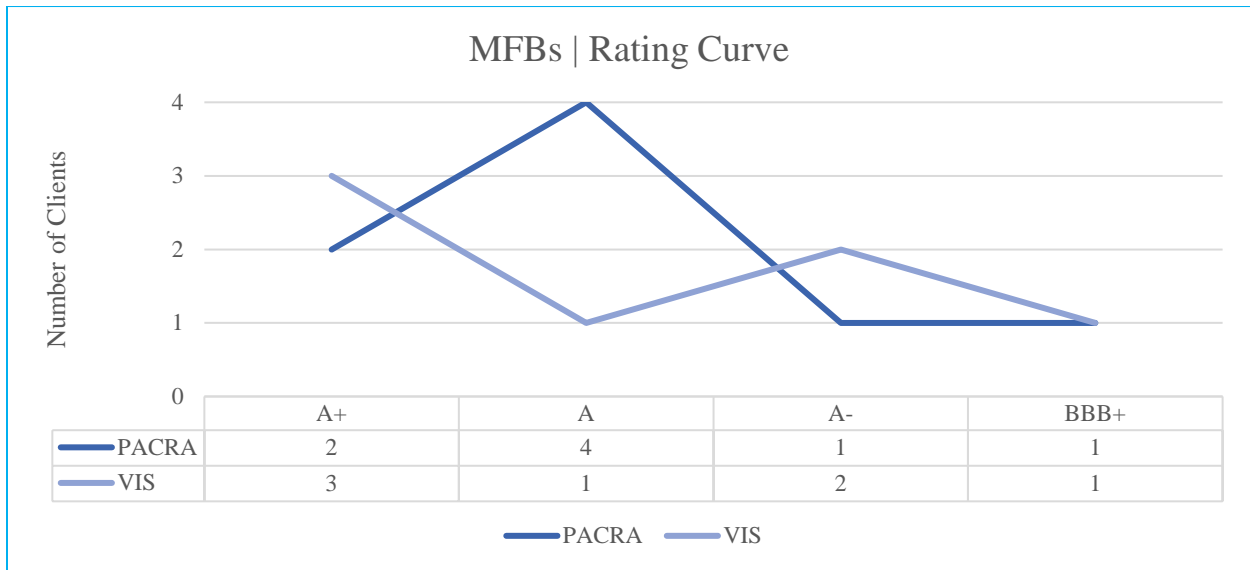
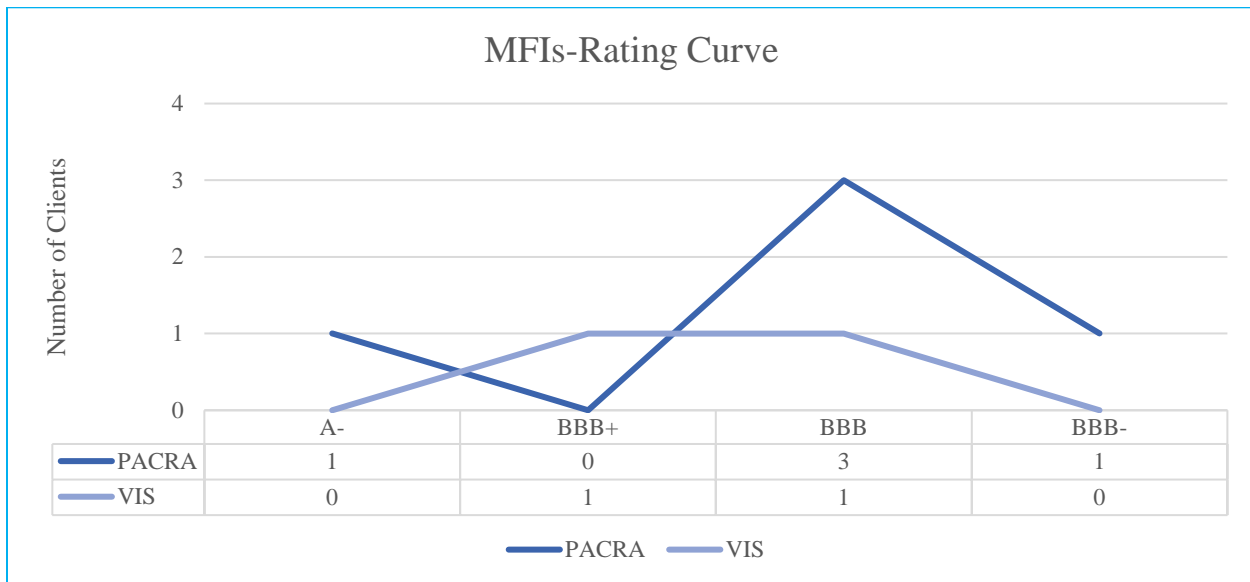


Figure.24



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