



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
01-Mar-2023	A-	A2	Developing	Downgrade	Yes
15-Apr-2022	A	A1	Negative	Maintain	Yes
28-Apr-2021	A	A1	Stable	Maintain	Yes
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

FINCA is categorized among mid-tier microfinance banks. The Bank reflects a presence across the province with 130 branches and around 13 districts. The ratings incorporate the 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 in establishing systems and controls. Currently, there are a few happenings underway that may result in a change in ownership in near future. Developing Outlook and Rating Watch indicates the expected change in ownership, in the medium term, as the possibility of the merger is being explored. During the last two years, attributable to consolidation going on, the footprint of the bank is largely sustained. Overall performance indicators reflected a deteriorated outlook amidst the economic slowdown lately exacerbated by the aftermaths of floods. Asset quality was also significantly impaired on account of the expiry of SBP’s deferment scheme period, with the majority portion being unprovided. Full recovery of the principal amount will remain essential to avoid a further dent in profitability. Markup earned and net markup income dropped consistently in line with GLP, during the last few quarters. Consequently, the bottom line of the Bank, during 9MCY22, reported a loss before taxation of PKR 728mln (CY21: PKR 1,514mln). Sponsor’s commitment to recouping the asset health and consolidating the Bank’s position within the stipulated time is an acute necessity. Revision in the rating incorporates the rising NPLs and write-offs along with the decline in profitability during the recent quarters. Also, the sizable decline in the equity base and deterioration in the CAR of the bank is concerning.

Since the projected outlook of the Bank indicates absorbing significant cash losses, timely yet matching sponsor support through equity injections is essential. The ratings are dependent upon the out-turn of management’s plans to steer the risk profile of the Bank toward an improved trajectory. Timely Sponsor Support is imperative.

Disclosure

Name of Rated Entity	FINCA Microfinance Bank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Microfinance Institution Rating(Jun-22),Methodology Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology Rating Modifiers(Jun-22)
Related Research	Sector Study Microfinance(Sep-22)
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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 a majority stake in the bank, through the dilution of Kashf Holdings' shares 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 Karza (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 Going forward, the shareholding of the bank may change in the near future as the merger of the bank is being explored.

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 The financial muscle of the sponsors is considered good.

Governance

Board Structure The Board comprises nine directors, including five representatives of FINCA Microfinance Cooperatief U.A., one representative of Kashf Holdings, and three independent directors.

Members' Profile The Board members have international exposure and carry diversified skillset. They have been associated with the microfinance industry for years.

Board Effectiveness The Board has four committees in place for oversight 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.

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 ending December 31st, 2021.

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 the performance of four departments is entirely overseen by the COO and one by the CFO.

Management Team Mr. Jahanzeb Khan - CEO - possesses 24 years of experience with one of the largest financial services institutions including JPMorgan Chase & Co., Blue Chip Management Consulting firm, Deloitte Consulting, and Telenor Microfinance Bank (Easypaisa). 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 timely decision-making.

MIS To support the decision-making of management, the MIS system generates detailed reports 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. The Risk Management Committee meets regularly to ensure that the risk profile of the bank remains within the Board's approved limit.

Technology Infrastructure The management has taken numerous steps toward 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 Microfinance Industry (MFI) comprises 50 microfinance providers including 30 microfinance institutions (MFIs). Active Borrowers continued the increasing trend as 8.5 million borrowers were achieved during CY22, an increase of 5.6% compared to CY21. Similarly, the GLP surpassed PKR 448bln during CY22, an increase of 26.1% compared to the GLP in CY21. The further analysis explains the major contribution to the growth of active borrowers and GLP was contributed by the MFB peer group where Mobilink MFB was at the top of the list due to the significant adoption of digital credit and greater outreach to the customer base. NBMFCs peer group also contributed to the increase by adding 94,000 active borrowers and PKR 2.6bln in GLP. In the case of MFBs, PAR > 30 days slightly increased to 5.3% (CY21: 5.2%). However, the PAR > 30 days of MFIs recovered to report at 4.1% in CY22 (CY21: 5.5%).

Relative Position The bank catered to around 2.5% of the borrowers of the industry (including MFIs, RSPs, and other projects), grabbing a 4.5% market share in terms of GLP as of end-Jun'22.

Revenue The bank earned a markup, during CY21, of PKR 5.1bln (CY20: PKR 8.6bln) - the majority portion (CY21: PKR 4.5bln, CY20: PKR 7.9bln) was earned from core operations. Net markup income clocked in at PKR 2.5bln (CY20: PKR 5.5bln). The primary reason for the decline is attributable to the consolidation of the advances book over the last three years. Non-mark up income recorded an increase to PKR 924mln (CY20: PKR 845mln). However, total income recorded attrition YoY to PKR 3.4bln (CY20: PKR 6.4bln). During 9MCY22, the total income clocked in at PKR 1.6bln.

Profitability The Bank declared a loss before tax of PKR 2.4bln in CY21 (CY20: PKR 1.3bln profit). The Bank's performance during the period wasn't sufficient to cover the expenses including operating and provisioning expenses. The net loss has been recorded at PKR 729mln and PKR 1.5bln for 9MCY22 and CY21 respectively.

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 more than 450,000 customers. 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 pandemic and recent floods have and 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 Micro-Enterprise loans (35%), followed by Livestock loans (32%), and Agri-Input loans (32%). During 9MCY22, the bank's infection ratio has inclined manifold to 16.8% (end-Dec'21: 14.8%) on account of the increase in absolute NPLs.

Market Risk Short-term investments as of end-Sep'22 declined to PKR 7.6bln (end-Dec'21: PKR 10.2bln). The investment book majorly comprise of government securities.

Funding The Bank's funding is majorly fueled through deposits (end-Sep'22: PKR 24,488mln, end-Dec'21: PKR 25,419mln) constituting 83.1% of the funding of the bank. The deposit base primarily consisted of time deposits (50.9%). The total borrowing stood at PKR 4,680mln (end-Dec21: PKR 5,181mln). The bank's advances-to-deposit ratio (ADR) increased to 80.4% (end-Dec'21: 74.1%), driven by an increase in the deposit base.

Cashflows & Coverages The liquidity profile declined during the period, as the bank's 'liquid assets as a % of deposits & short-term borrowings' ratio declined to 38.8% at the end-Sep'22 (end-Dec'21: 48.0%) driven by a 12.2% decrease in liquid assets.

Capital Adequacy The capital Adequacy ratio (CAR) stood at 16.07% as of end-Jun'22 (end-Dec'21: 15.3%). The bank's CAR has declined over the last two quarters and is not meeting the minimum regulatory requirement. The equity base is continuing the declining trend (end-Sep22: PKR 3bln, end-Dec21: PKR 3.7bln) as a consequence of accumulating losses.



PKR mln

**FINCA Microfinance Bank
Public Limited**

Sep-22	Dec-21	Dec-20	Dec-19
9M	12M	12M	12M

A BALANCE SHEET

1 Total Finances - net	17,031	16,774	20,811	21,425
2 Investments	7,692	10,230	6,449	6,244
3 Other Earning Assets	13	136	2,688	1,446
4 Non-Earning Assets	7,346	7,859	9,468	7,582
5 Non-Performing Finances-net	2,667	2,054	435	614
Total Assets	34,749	37,052	39,851	37,312
6 Deposits	24,488	25,419	26,083	23,911
7 Borrowings	4,680	5,181	5,511	5,553
8 Other Liabilities (Non-Interest Bearing)	2,546	2,714	3,014	3,129
Total Liabilities	31,715	33,315	34,607	32,594
Equity	3,034	3,738	5,243	4,716

B INCOME STATEMENT

1 Mark Up Earned	3,358	5,156	8,629	8,312
2 Mark Up Expensed	(2,419)	(2,623)	(3,039)	(2,998)
3 Non Mark Up Income	717	924	845	954
Total Income	1,657	3,457	6,435	6,269
4 Non-Mark Up Expenses	(2,897)	(3,607)	(3,824)	(4,168)
5 Provisions/Write offs/Reversals	(288)	(2,193)	(1,228)	(1,090)
Pre-Tax Profit	(1,527)	(2,342)	1,383	1,012
6 Taxes	798	820	(478)	(358)
Profit After Tax	(729)	(1,523)	905	653

C RATIO ANALYSIS

1 Performance

Portfolio Yield	20.0%	24.5%	38.6%	42.0%
Minimum Lending Rate	37.1%	40.7%	36.7%	38.1%
Operational Self Sufficiency (OSS)	67.8%	68.0%	113.2%	110.4%
Return on Equity	-28.7%	-33.9%	18.2%	14.9%
Cost per Borrower Ratio	N/A	N/A	N/A	N/A

2 Capital Adequacy

Net NPL/Equity	87.9%	54.9%	8.3%	13.0%
Equity / Total Assets (D+E+F)	8.7%	10.1%	13.2%	12.6%
Tier I Capital / Risk Weighted Assets	N/A	N/A	N/A	N/A
Capital Adequacy Ratio	N/A	N/A	N/A	N/A
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	-26.0%	-29.0%	10.5%	16.2%

3 Funding & Liquidity

Liquid Assets as a % of Deposits & Short term Borrowings	38.8%	48.0%	41.7%	39.7%
Demand Deposit Coverage Ratio	384.8%	454.4%	393.5%	426.2%
Liquid Assets/Top 20 Depositors	N/A	N/A	N/A	N/A
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	84.0%	83.1%	82.6%	81.1%
Net Advances to Deposits Ratio	80.4%	74.1%	81.5%	92.2%

4 Credit Risk

Top 20 Advances / Advances	0.0%	0.0%	0.0%	0.0%
PAR 30 Ratio	16.8%	14.8%	3.4%	4.7%
Write Off Ratio	0.0%	0.0%	0.0%	0.0%
True Infection Ratio	16.8%	14.8%	3.4%	4.7%
Risk Coverage Ratio (PAR 30)	22.7%	29.7%	41.2%	41.8%

Credit Rating

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	Very high credit quality. 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.
AA-	
A+	
A	High credit quality. 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.
A-	
BBB+	Good credit quality. 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.
BBB	
BBB-	
BB+	Moderate risk. 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.
BB	
BB-	
B+	
B	High credit risk. 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-	
CCC	Very high credit risk. Substantial credit risk "CCC" Default is a real possibility.
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



*The correlation shown is indicative and, in certain cases, may not hold.

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 some material identifiable event with indeterminable rating implications. 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 rating 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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults, or/and e) 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.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

- a) Broker Entity Rating
- b) Corporate Rating
- c) Debt Instrument Rating
- d) Financial Institution Rating
- e) Holding Company Rating
- f) Independent Power Producer Rating
- g) Microfinance Institution Rating
- h) Non-Banking Finance Companies Rating

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Rating Team Statements

(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)

Conduct of Business

(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 | Clause 11-(A)(p).

(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)

Monitoring and review

(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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