The Pakistan Credit Rating Agency Limited

Rating Report

The First MicroFinanceBank Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2021	A+	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings assigned to The First MicroFinanceBank Ltd (FMFB) underpin the Bank's affiliation with Aga Khan Development Network and Habib Bank Limited (HBL) – one of the largest banks of the country. The First MicroFinanceBank Ltd (FMFB) has been able to devise a sound strategy and establish strong footprint over the years. The Bank held a 19% market share amongst the microfinance banks as at end-Sep`21 in terms of GLP, being second highest in the industry, which grew by 216 basis points on a YoY basis. The recent growth recorded in the GLP is a result of enhanced outreach secured by the Bank. The same growth pattern is projected in the future as well; wherein the need to curb infection remains vital. During 9MCY21, the Bank recorded sizable improvement in markup income, due to enhanced portfolio as well as investment book. Sustainable and improving the fee and commission income has been supplementing the profitability. The Bank's higher provisioning expense in 2020 is attributable to increased general provisioning to create additional cushion on rescheduled loans. The Bank enjoys sizable increase in net profitability. The investment book is vested in the government securities which adds to the liquidity side. Funding is majorly fueled through deposits where high contribution arises from saving and demand deposits. However, the concentration of the Top-20 deposits is tilted towards higher side. A high equity base provides cushion in the risk absorption capacity of the Bank. Capital Adequacy Ratio (CAR) was recorded at 18.6% as at end-Sep’21 amid equity injection by parent company, HBL, in form of the share capital through right shares issuance of Rs. 2b in the ongoing year. Risk management framework is supported by Loan Origination System which has been implemented in 120+ branches as at end-Sep’21 while branchless banking (FirstPay) has been commercially launched in 1QCY21. Under the current scenario COVID-19 pandemic has poised challenge to business and asset quality; guarding against the infection is of prime importance.

The ratings are dependent on the Bank’s ability to sustain and improve the current market position. Given the strong business acumen of the sponsors, a distinct focus is vested to continue leading the market with good asset quality. Meanwhile, the Bank’s propensity to protect its performance indicators is imperative.

Disclosure

Name of Rated Entity	The First MicroFinanceBank Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Microfinance(Sep-20)
Rating Analysts	Muhammad Fahad Iqbal | fahad.iqbal@pacra.com | +92-42-35869504

Profile

Structure The First MicroFinanceBank Ltd (FMFB), “the Bank”, was incorporated in 2002 as a nationwide microfinance bank; licensed by the State Bank of Pakistan.

Background The First MicroFinanceBank Ltd was established through a structured transformation of the credit and savings section of the Aga Khan Rural Support Programme (AKRSP), an integrated development programme to pioneer the microfinance sector in the country since 1982 in Gilgit-Baltistan and Chitral. The vision of the Bank was to alleviate poverty and target the social and economic well-being of the country by providing the opportunity to thousands of underprivileged households.

Operations The Bank is a fast-growing microfinance bank currently operating with a nationwide network of 213 locations, with its head office located in Islamabad. 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) Agri-Loan (ii) Livestock (iii) Micro-enterprise (iv) Housing and (v) Others.

Ownership

Ownership Structure The Bank is majorly owned by Habib Bank Limited (HBL) (71.43%), followed by Aga Khan Agency for Microfinance (AKAM) (17.15%), Aga Khan Rural Support Programme (AKRSP) (6.34%), and Japan International Cooperation Agency (JICA) (5.07%).

Stability Shareholding of HBL has increased in recent years. The ownership structure is expected to stay stable in the foreseeable future.

Business Acumen The business acumen of the Bank is considered strong due to its affiliation with HBL and AKAM.

Financial Strength Habib Bank Limited is renowned and one of the largest banks of Pakistan marking a strong footprint in the country. The Aga Khan Development Network (AKDN) is a group of development agencies with mandates that include the environment, health, education and many other areas.

Governance

Board Structure The Board comprises eight directors; which includes, four representatives of Habib Bank Limited, two representatives of Aga Khan Agency for Microfinance, one representative of Aga Khan Rural Support Programme and one representative from Japan International Cooperation Agency. The Board is chaired by Mr. Rayomond Kotwal – currently the Chief Financial Officer of HBL. He has over three decades of experience and has worked in senior finance roles with United Bank Limited, NIB Bank Limited, Citibank NA, Citi Cards Canada Inc., and ICI Pakistan Limited.

Members’ Profile All of the Board members are experienced professionals who carry diversified expertise as well as a strong technical skillset. The majority of the members have banking experience which is an added advantage. All of the members are heading different high-profile organizations.

Board Effectiveness The Board is sub-divided into five committees (i) HR Committee (ii) Risk Committee (iii) Audit Committee (iv) IT Committee and (v) Financial Inclusion Committee.

Transparency A.F. Ferguson & Co. Chartered Accountants the external auditors of the Bank for the year ended 2020, expressed an unqualified opinion on the financial statements for the year ended December 31, 2020. The internal audit department directly reports to the audit committee creating an aspect of independence.

Management

Organizational Structure The Bank has a horizontally spread organizational structure comprising eleven departments; whereas, ten departments directly report to the CEO. Also, the reporting lines and job descriptions at each level are well defined.

Management Team Mr. Muhammad Amir Khan joined as CEO in June 2012 and he brings with him over 29 years of extensive experience in consumer and commercial banking with the Standard Chartered Bank, ABN AMRO Bank, and Royal Bank of Scotland. He also served as CEO of Mobilink Microfinance Bank (then Waseela Microfinance Bank). Mr. Adil Ali Abbasi is the CFO of the Bank and brings with him 18+ years of diversified experience.

Effectiveness The Bank has designated various management committees to manage and oversee operational efficacy.

MIS A comprehensive MIS system for reporting is in place to support the senior management in timely and effective decision-making. The Bank also has live dashboards, updated on a real-time basis for the management to gauge the overall performance every time.

Risk Management Framework The Bank has in place a separate Risk Management department to oversee various risks including credit, operational and market risks. The Risk Management Committee meets on monthly basis to ensure that the risk profile remains within BoD’s approved limit.

Technology Infrastructure The Bank's year-end 2020 was successfully carried out on the Core Banking System (CBS) where reports/dashboards were provided to stakeholders. The CBS was enhanced with various features and functionalities to keep it abreast with the evolving business and stringent regulatory requirements. CBS is housed in a state-of-the-art infrastructure maintained in a Tier-3 level data center housed at the Head Office.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises of 32 microfinance providers including 21 microfinance institutions (MFIs). During the Sep-21', Active Borrowers clocked at 8.2mln clients, depicting an increase of 2% QoQ and 20% compared to the same period last year. Consequently, the GLP surpassed PKR 365bln from PKR 355bln, a quarterly increase of 2.8% and 18% on a YoY basis.. Growth continues to be driven by MFBs as they added over 106,000 clients and 6.5bln in GLP. Mobilink Microfinance Bank remains the largest provider of microcredit in terms of clients with over 2mln borrowers, while Khushhali Microfinance Bank Limited is the largest provider in terms of GLP with over PKR 68bln.

Relative Position As at end-Sep’21, the Bank held 19% market share amongst the microfinance banks in terms of GLP, second highest in the industry.

Revenue Markup income of the Bank clocked in at PKR 11.4bln during CY20 (CY19: PKR 8.5bln), depicting sizable growth of 33.8% YoY, primarily attributable to the enhanced portfolio (microcredit loans). Portfolio yield stood at a robust 29.7% (CY19: 30.1%) whereas core spread stood at 21% (CY19: 20.6%). Net markup income grew by 31.8% (end-Dec'20: PKR 6.6bln, Dec'19: PKR 5bln). Net Mark up income in 9MCY21 is PKR 6.0bln (9MCY20: PKR 4.8bln).

Profitability During CY20, the Bank's non-markup expenses increased by 20.85% to PKR 5.1bln (CY19: PKR 4.2bln). Despite provisioning expense of PKR 1.6bln in CY20 (CY19: PKR 853mln), the Bank's net profitability improved to PKR 575mln (CY19: PKR 533mln). The profitability in 9MCY21 is in line with the improving trend to stand at PKR 590mln (9MCY20: PKR 422mln).

Sustainability The Bank has projected an increase in profitability and CAR in the future. Loan Origination System (LOS) has been implemented in 120+ branches by end- 3QFY21 while branchless banking (First Pay) has been commercially launched in 1QFY21. The Bank is strengthening its alternate delivery channels in alliance with HBL Konnect and UBL Omni.

Financial Risk

Credit Risk GLP of the Bank clocked in at PKR 43.4bln in CY20 (CY19: PKR 31.6bln). Total earning assets grew to PKR 82.7bln in Sep'21, attributable to an increase in investments and advances. Non-Performing loans increased to stand at PKR 3.3bln (end-Dec'20: PKR 1.2bln) – this had been an industry-wide trend. The PAR 30 ratio stood at 6.5% as at Sep’21 (end-Dec'20: 2.8%). The Bank also managed to prudently improve the coverage ratio to 83% as at end-Sep'21.

Market Risk The investment book clocked in at PKR 21bln as at end-Sep'21 (end-Dec'20: PKR 14.5bln) majorly vested with government securities. Investment book to total assets improved to 22.7% as at end-Sep'21.

Funding The Bank's funding is majorly fueled through deposits (end-Sep'21: PKR 75.2bln, end-Dec'20: PKR 61.7bln), where the major contribution arises from saving and demand deposits. Concentration of the Top-20 deposits is tilted towards higher side. The total borrowing recorded a slight uptick to stand at PKR 4.5bln (end-Dec'20: PKR 4bln). The Bank's advances-to deposit ratio (ADR) improved to 65% (end-Dec'20: 67.4%) attributable to a higher increase in deposits.

Cashflows & Coverages

Capital Adequacy Capital Adequacy Ratio (CAR) stood at 15.05% as at end-Dec'20 (end-Dec'19: 15.8%), above the regulatory requirement. Equity base recorded a robust increase to PKR 9.2bln (end-Dec'20: PKR 6.7bln). Capital Adequacy Ratio (CAR) as at end-Sep'21 was improved to18.6%.

PKR mln

First Microfinance Bank Unlisted Public Limited	Sep-21 9M	Dec-20 12M	Dec-19 12M	Dec-18 12M
A BALANCE SHEET				
1 Total Finances - net	48,382	42,207	30,508	23,643
2 Investments	21,049	14,542	4,513	2,807
3 Other Earning Assets	9,994	8,170	3,856	6,392
4 Non-Earning Assets	12,574	12,024	7,926	4,871
5 Non-Performing Finances-net	571	(579)	429	(88)
Total Assets	92,571	76,363	47,232	37,625
6 Deposits	75,260	61,726	38,404	31,129
7 Borrowings	4,520	4,021	-	-
8 Other Liabilities (Non-Interest Bearing)	3,560	3,927	2,781	993
Total Liabilities	83,340	69,675	41,185	32,122
Equity	9,231	6,688	6,047	5,503
B INCOME STATEMENT				
1 Mark Up Earned	10,488	11,404	8,522	6,047
2 Mark Up Expensed	(4,432)	(4,740)	(3,468)	(1,683)
3 Non Mark Up Income	865	876	768	509
Total Income	6,922	7,540	5,822	4,874
4 Non-Mark Up Expenses	(4,466)	(5,157)	(4,268)	(3,112)
5 Provisions/Write offs/Reversals	(1,626)	(1,567)	(853)	(251)
Pre-Tax Profit	830	815	701	1,511
6 Taxes	(241)	(241)	(168)	(511)
Profit After Tax	590	575	533	1,000
C RATIO ANALYSIS				
1 Performance				
Portfolio Yield	28.0%	29.7%	30.1%	31.1%
Operational Self Sufficiency (OSS)	107.4%	106.6%	107.7%	129.3%
Return on Equity	9.9%	9.0%	9.2%	20.0%
Cost per Borrower Ratio	1.0%	1.0%	0.9%	0.9%
2 Capital Adequacy				
Net NPL/Equity	6.2%	-8.7%	7.1%	-1.6%
Equity / Total Assets (D+E+F)	10.0%	8.8%	12.8%	14.6%
Capital Adequacy Ratio	18.6%	15.0%	15.8%	19.8%
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	11.8%	9.5%	9.7%	22.2%
3 Funding & Liquidity				
Liquid Assets as a % of Deposits & Short term Borrowings	45.3%	41.7%	28.1%	35.4%
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	94.3%	93.9%	100.0%	100.0%
Net Advances to Deposits Ratio	65.0%	67.4%	80.6%	75.7%
4 Credit Risk				
Top 20 Advances / Advances	0.0%	0.0%	0.0%	0.0%
PAR 30 Ratio	6.5%	2.8%	3.5%	0.9%
Write Off Ratio	1.9%	1.3%	1.8%	0.7%
Risk Coverage Ratio (PAR 30)	82.9%	148.0%	61.3%	141.3%

Credit Rating

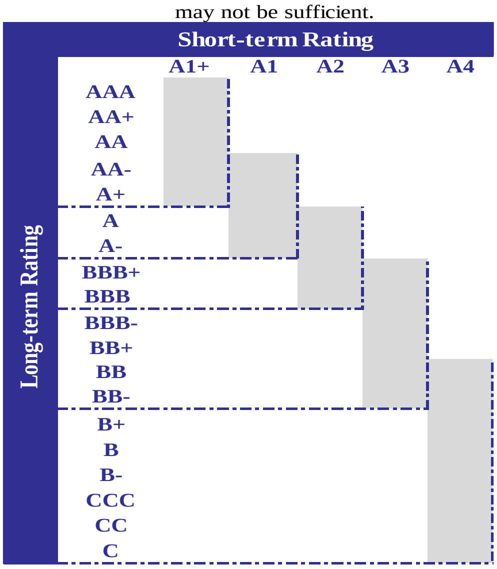
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

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

Short-term Rating

Scale	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
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 surveill 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):

Entities

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

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

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

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(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.
(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)

Independence & Conflict of interest
(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)
Proprietary Information