



MICROFINANCE

Sector Report – Sep'21

Sep'21

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~356bln - June'21, up by ~10% from PKR~324bln as at End-Dec'20. Almost equal growth of ~5% was observed in the 1st and 2nd Quarters of CY21.
- Among peer groups, MFBs continued to hold the highest share of the GLP - ~73%, while MFIs and RSPs collectively held the rest (June'21).
- Active borrowers increased to ~8mln – June'21, up by ~15% from ~7mln as at End-Dec'20. Among peer groups, MFBs accounted for ~58% 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 ~5.2% - June'21, up from ~3.7% as at End-Dec'20. Among peer groups, the highest to record infection were RSPs (~8.2%), though they hold a small system share. MFBs, holding the largest share in the pie, witnessed a weakened credit health with PAR>30 days increasing to ~4.5% - June'21 from ~2.9% as at End-Dec'20. The rise in NPLs is observed after the expiration of deferment/restructuring period in Mar'21. Meanwhile, MFIs recorded a marginal improvement registering PAR>30 days at ~4.1% - June'21 (~4.7% End-Dec'20).
- Overall fresh disbursements were recorded at PKR~214bln in 1HCY21. Disbursements have gradually picked up since lockdown restrictions across the country have relaxed. In CY20, disbursements dropped by ~6% YoY as compared to CY19.
- Deposit base of MFBs clocked in at PKR~378bln – June'21, up ~1.5% from PKR~373bln as at End-Dec'20. The sector's deposits grew sharply by ~40% in CY20, majorly on account of better rates offered by the MFBs to attract funds.
- Barring a few exceptions, the Sector's bottomline closed in positive in CY20. Some deterioration was reflected in 1HCY21 majorly on account of reduced credit quality.

SECTOR OUTLOOK: WATCH

CY20 has been a challenging year for the Microfinance Sector. A major risk that surfaced on the outbreak of COVID-19 was the risk of non-recovery from customers who underwent distressed financial situations due to lockdown and exceptional circumstances.

The Sector's resilience is, nonetheless, acknowledgeable as all players, including banks and Institutions, managed to sail through the storm. Regulator's support and relief initiatives had a big part to play. The problem, however, does not seem to be over yet. While the fear of lockdown subsides with increased vaccination drive, the overall economic indicators seem to be slipping off track as global and local demand recovery amid supply shocks are creating inflationary pressures. Current Account deficit is widening with an uptick in import bill, resultantly weakening the PKR against USD to historical low levels. The SBP has therefore, increased policy rate by 25bps in the MPC's latest meeting held on 20th Sep'21.

A summary of the macro-indicators is presented below:

	FY16	FY17	FY18	FY19	FY20	FY21	2MFY22
Average Inflation Rate (CPI)	2.90%	4.20%	3.90%	7.30%	10.70%	8.90%	8.40%
Average KIBOR	6.49%	6.11%	6.39%	10.43%	11.95%	7.43%	7.60%
Monetary Policy Rate (MPR)	6.04%	5.75%	5.95%	9.69%	11.75%	7.00%	7.00%
PKRV	6.34%	5.95%	6.26%	10.20%	11.79%	7.28%	7.45%
Average Exchange Rate	104.37	104.78	110.11	136.45	158.40	160.46	162.22
(USD mln)							
Current Account Balance	-4,961	-12,270	-19,195	-13,434	-2,970	-1,852	-2,290
Exports	21,972	22,003	24,768	24,257	22,536	25,630	4,601
Imports	41,118	48,001	55,671	51,869	43,645	53,785	11,406
Trade Balance	-19,146	-25,998	-30,903	-27,612	-21,109	-28,155	-6,805
Foreign Exchange Reserve	23,099	21,403	16,384	14,482	18,886	24,397	27,068

The Sector's key risk lies in maintaining its credit quality, especially after the expiration of loans deferments/restructuring period (Mar'21). Rising inflation can have an adverse impact on the repayment capacities of Microfinance borrowers. Moreover, it can elevate the already high administrative costs of the Microfinance players, impacting their profitability. Overall infection ratio of the Sector is growing – from ~3.7% in Dec'20 to ~5.2% in June'21. As per the SBP's data, almost ~1.7mln applications have been received and approved for deferment/restructuring till Mar'21, which amounted to a portfolio of PKR~121bln. This is almost ~46% of the MFBs GLP and ~34% of the overall Sector GLP.

GLP growth remained lackluster in CY20 (~6%). During 1HCY21, the growth picked up significantly and recorded at ~10%, reflecting improved situation. The deposit growth, however, displayed contrary outlook. Growth paced up in CY20 and almost muted in 1HCY21. Deposits are expected to record sluggish growth in CY21.

Barring exceptions, the Sector's performance remained satisfactory in CY20 and 1HCY21. Adequate loan loss provisions shielded against any major drag on equity. However, fresh NPLs are rising, which is a concern. Considering rising inflation ahead, uncertainties to crop outputs and weather conditions, the NPLs may increase, going forward.

The Sector's liquidity profile remains well covered. While MFBs are empowered to fund through deposits, MFIs have restricted funding avenues. Moreover, they do not possess Sponsor Financial Support. Liquidity risk is higher for MFIs specially the small players. There are ~25 MFIs and RSPs in the Sector. Most of the small MFIs and RSPs have GLP of less than PKR~5bln making it challenging for them to absorb high debt and administrative costs.

Average Capital Adequacy of MFBs was recorded around ~18% (excluding Advans, Sindh and Pak Oman) in CY20. Although, this is above the regulatory benchmark of ~15%, only a ~3% cushion is available to cover losses. Most of the large MFBs have CAR below ~20%.

Although the operational uncertainty due to the emergence COVID-19 has subsided to a large extent, the trickle-down effect of macro challenges and the systemic risks of the sector are expected to impact the risk profile of the sector. Therefore, the Sector continues to be placed on Watch.

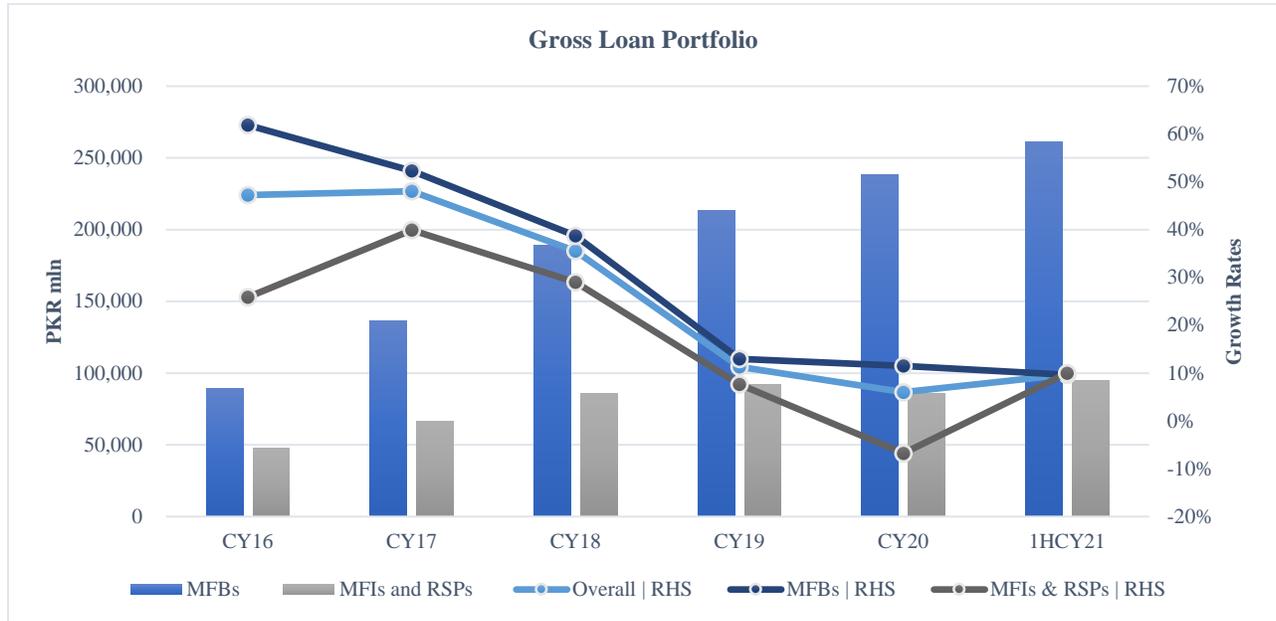
MICROFINANCE | AN OVERVIEW

- 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 hold the highest market share of ~73% in terms of GLP. For the purpose of this Sector Study, MFIs, RSPs and other Institutions are clubbed in 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.

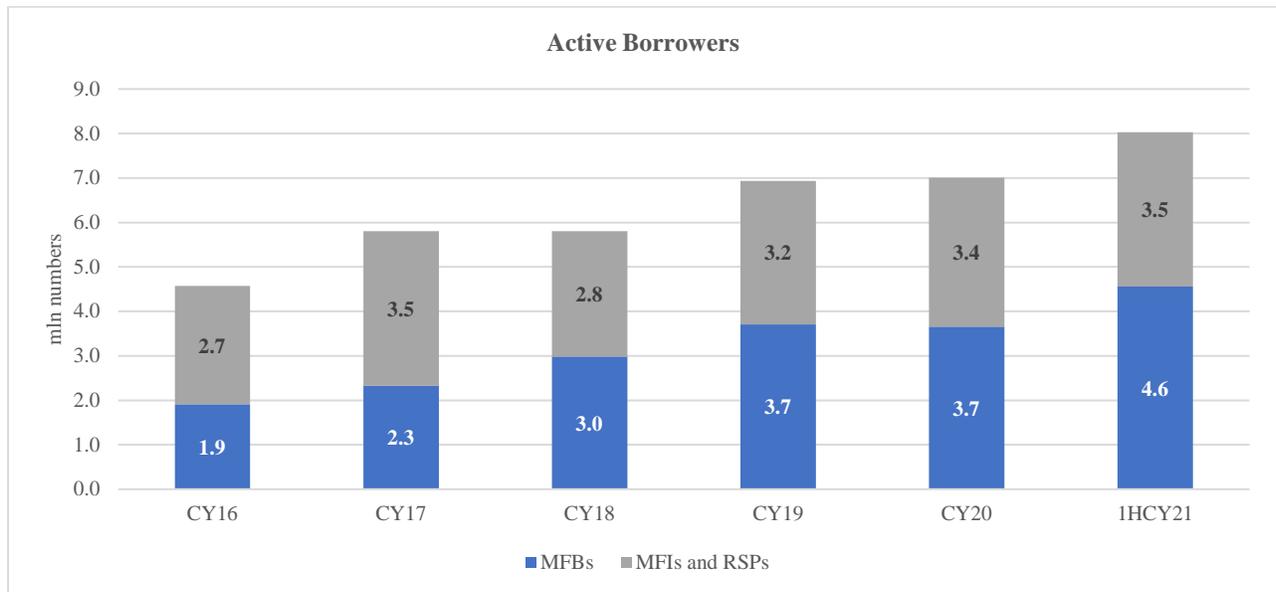
MFBs	Sponsors	GLP (PKR mln)	Market Share (GLP) - June'21
Khushhali	UBL: 29.7%, Rural Impulse Fund II S.A SICAV-FIS: 24.6%, responsAbility Global Micro and SME Finance Fund: 19.9%, Shorecap II Limited: 14.3%, Others: 11.7%	64,430	18.1%
The First MFB	HBL: 50.5%, AKAM: 29.7%, JICA, 8.8%, AKRSP: 11.0%	49,764	14.0%
U MFB	PTCL: 100%	34,751	9.8%
Mobilink	Veon, G.T.A A.E: 100%	31,086	8.7%
NRSP	NRSP: 52.1%, Acumen: 16.02%, IFC: 16.02%, KfW: 16%	29,740	8.4%
FINCA	FINCA Microfinance Cooperatief U.A. (FMC): 86.4%, Kashf Holdings: 5.2%, IFC: 4.9%, Triodos Fair Share Fund ("TFSF"): 2.7%	21,617	6.1%
Telenor	Telenor Pakistan B.V: 55%, Alipay (Hong Kong) Holding Ltd. :45%	11,944	3.4%
APNA	UIG: 70%, Others: 30%	11,022	3.1%
Pak Oman	LOLC Pvt Ltd: 50.1%, Sultanate Oman: 33.2%, Pak Oman Inv. Co. : 16.7%	4,279	1.2%
Advans	Advans SA SICAR: 100%	1,794	0.5%
Sindh MFB	Sindh Bank: 100%	689	0.2%
Total MFBs		261,116	73.4%
MFIs & RSPs		94,584	26.6%
Sector Total		355,700	100.0%

ASSETS

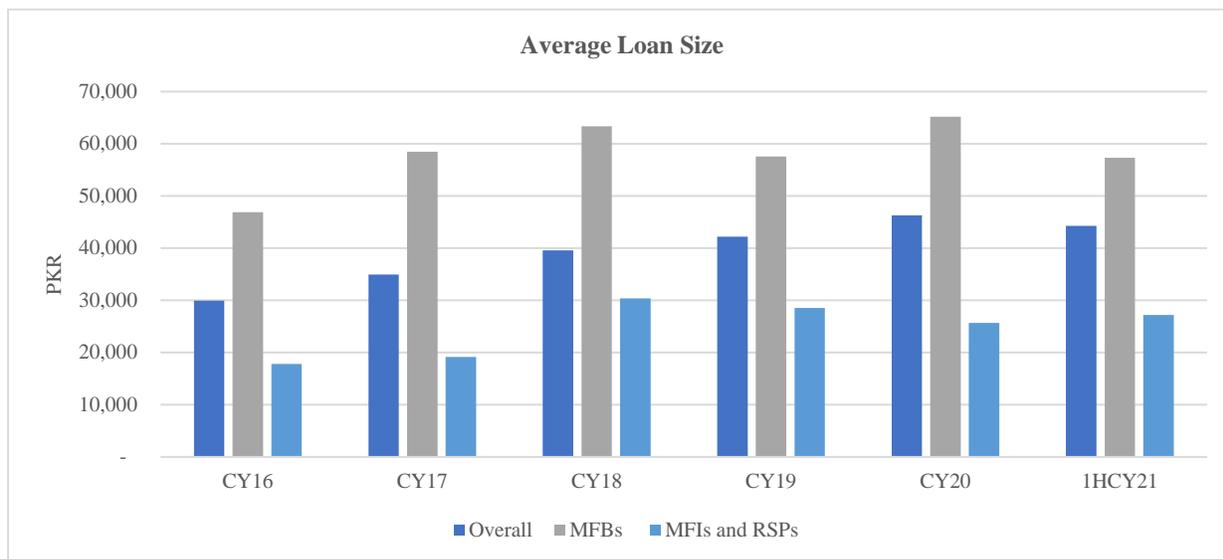
Gross Loan Portfolio | Peer Segments



Active Borrowers and Loan Size | Peer Segments



Average Loan Size | Peer Segments

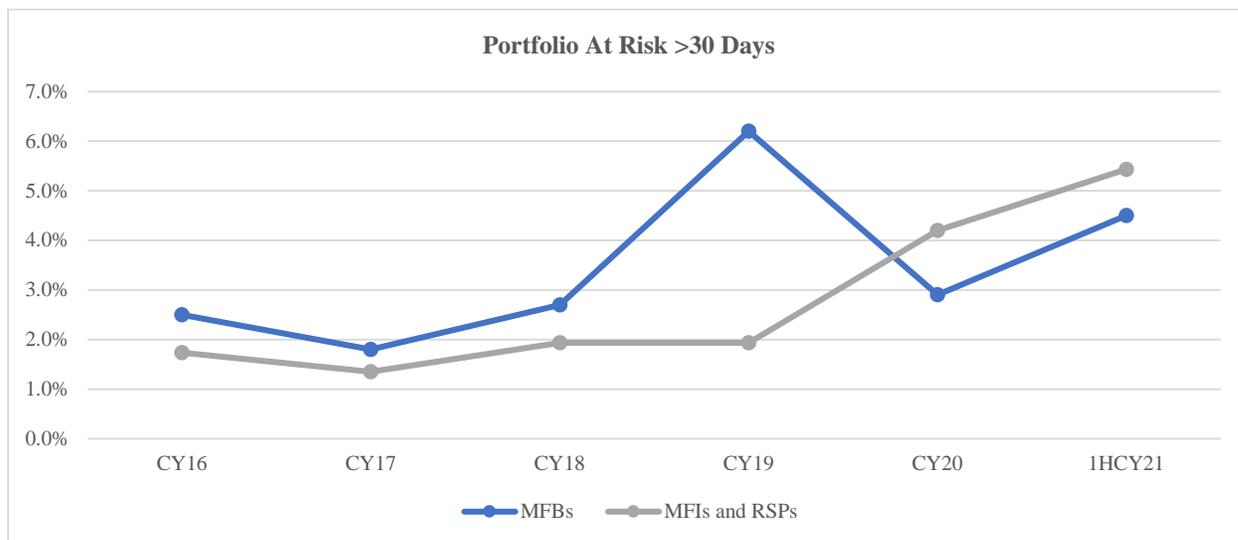


The growth rate of Sector’s GLP has been on a continuous decline since CY18.

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

The Sector’s GLP growth nosedived in CY20 owing to the expressing concerns of COVID-19 pandemic. However, a recovery of ~10% was observed in 1HCY21.

Asset Health | Peer Segments

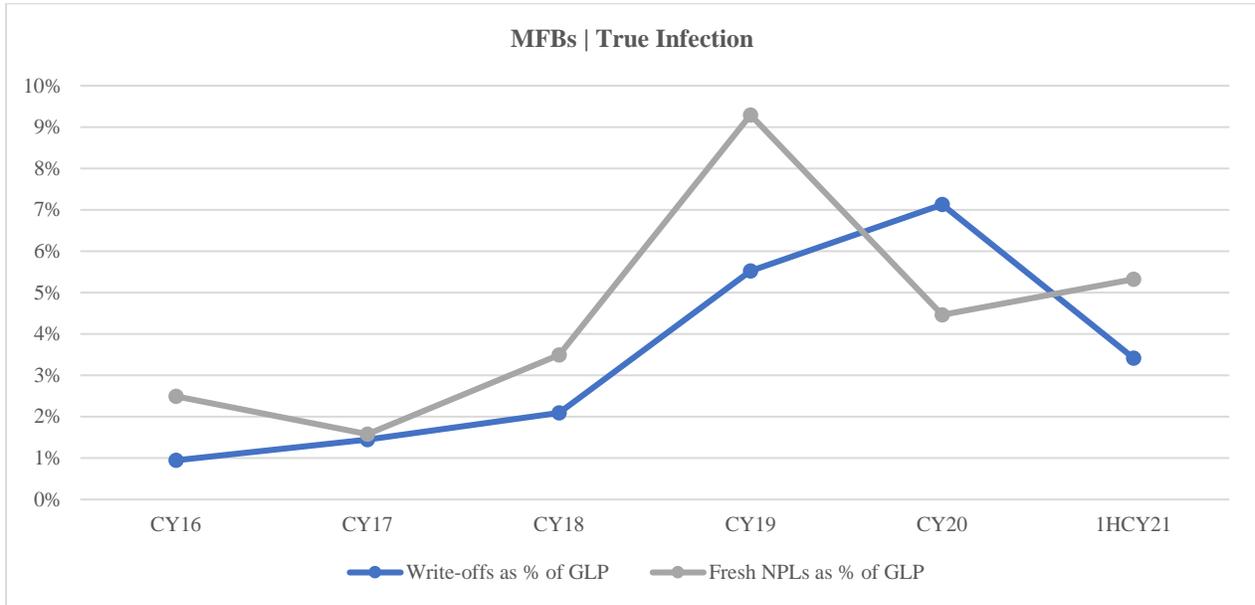


MFBs credit quality deteriorated significantly in CY19 with average PAR>30 days shooting up to ~6.2% from ~2.7% in CY18. Telenor MFB stood as the outlier, with its NPLs surging to ~21%. Barring Telenor, the Sector’s year end infection ratio clocked around ~3.5% in CY19.

In CY20, Telenor’s year-end NPL dropped to ~17% while average NPLs of top 5 MFBs (~59% Market share) diluted to ~1.7%, most likely on the backdrop of cautious disbursements and availing of SBP’s deferment scheme. This kept the credit quality in

check. CY21, however, strikes an alarm again, as Telenor’s NPLs rose back to ~22% while average NPLs of top 5 MFBs also slid up to ~3% in 1HCY21.

Average NPLs of MFIs and RSPs from CY16 – CY19 have remained range bound from 1% - 1.5%, a reflection of good credit controls. With the advent of COVID-19 in CY20, Infection ratio of MFIs and RSPs swelled to ~4.2%. This was expected since the liquidity level of MFIs does not encourage deferments and halted disbursements at large. The infection has continued to swell in 1HCY21, as deferments/restructuring period has expired. It is expected that MFIs infection will remain above ~5% at the end of CY21.

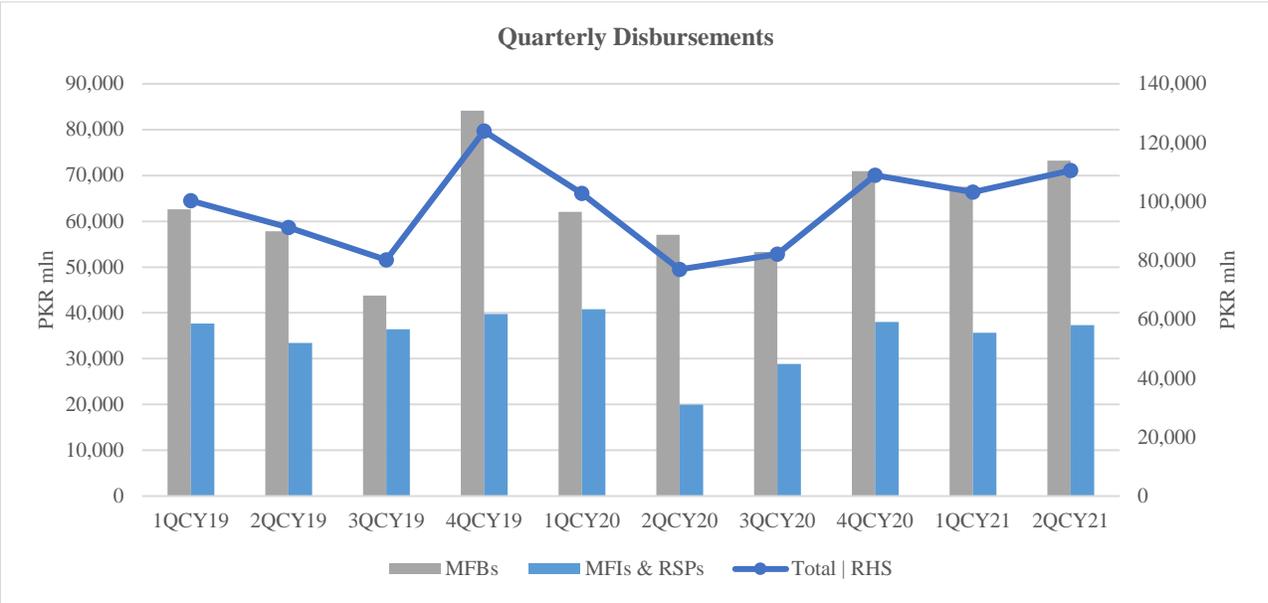
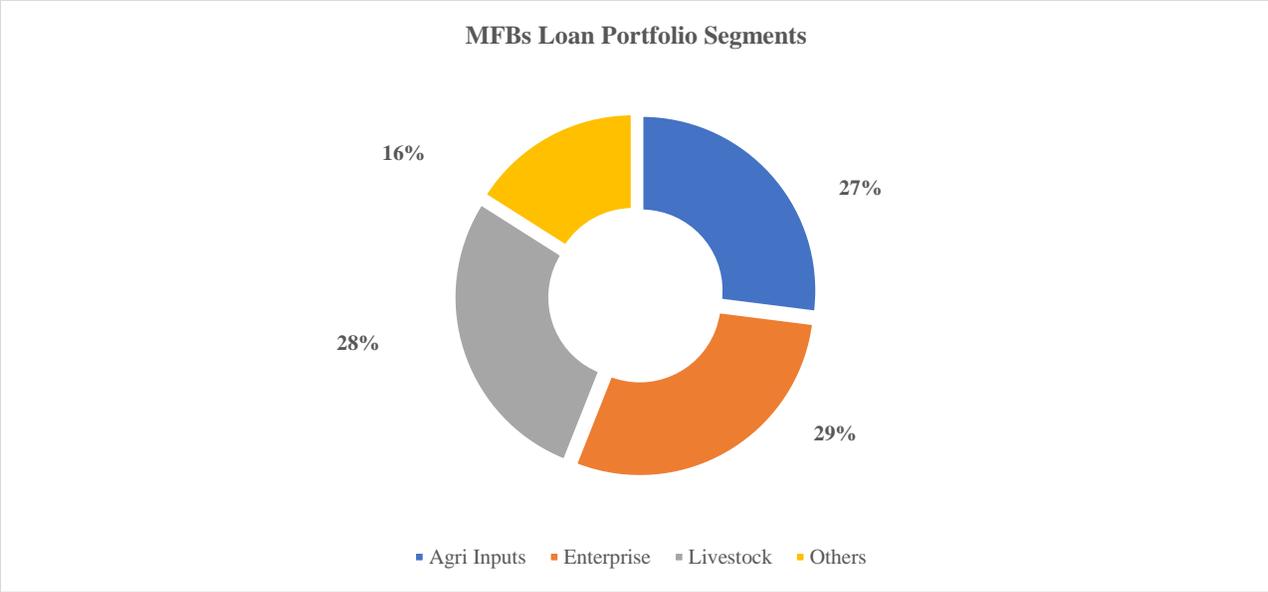


Fresh NPLs refer to the infection in the loans arising during a reporting period. These are determined based on the NPLs generated in a period and the write-offs charged during the period. In CY20, most of the anticipated bad loans were shielded by way of deferments &/or restructurings, therefore fresh NPLs were considerably low.

Following CY20, the fresh NPLs are on a rise again. Net NPL coverage was recorded at ~86% as at End-June’21. The ratio was above ~100% in CY20 due to the MFBs’ prudence to record provisions against anticipated deterioration. Considering the rising trend of fresh NPLs, the overall NPLs are expected to remain on the higher side as compared to pre-CY19 periods.

MFBs Loan Portfolio Segments:

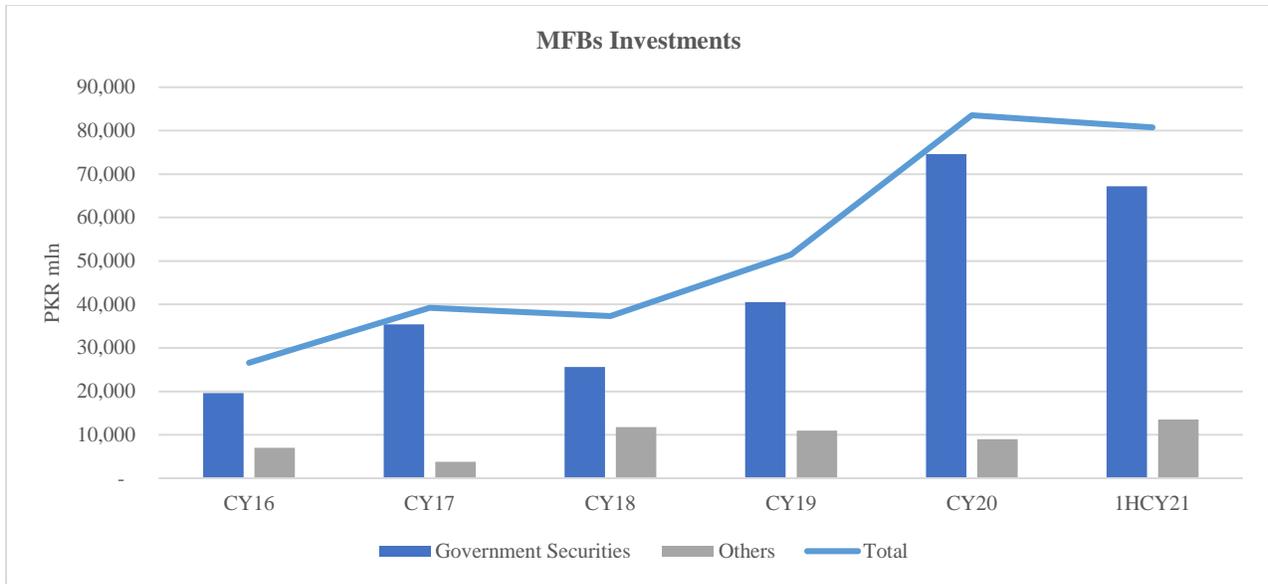
Based on the data of 5 MFBs (NRSP, APNA, Telenor, FINCA and Advans), the loan book of the sector is fairly diversified in Agri, Livestock, Enterprise and others, with each category having less than 30% concentration in the MFBs’ loan mix.



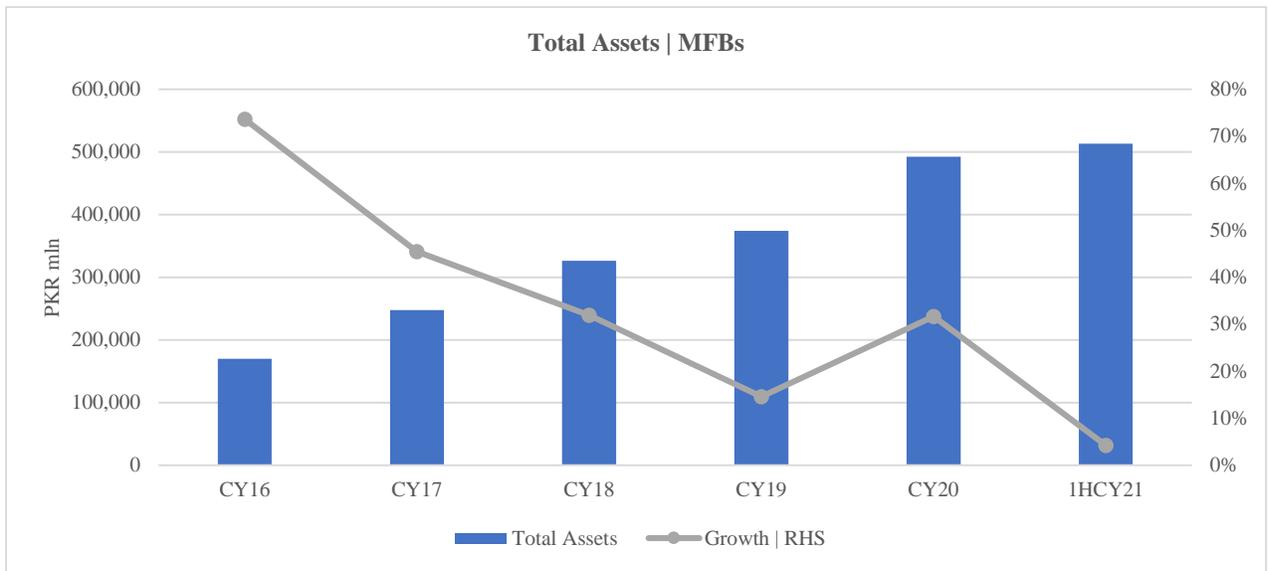
OTHER ASSETS:

Investments | MFBS

MFBS' Investments are generally dominated by Government Securities majorly in short term T-Bills. During CY20, while GLP witnessed a muted growth, the Investments grew by a record ~62% clocking in at PKR~82bln as at End-Dec'20 (PKR~51bln as at End-Dec'19). The increase was led by a rise in Government Securities in order to secure better returns. Investments dropped slightly to PKR~81bln in 1HCY21.

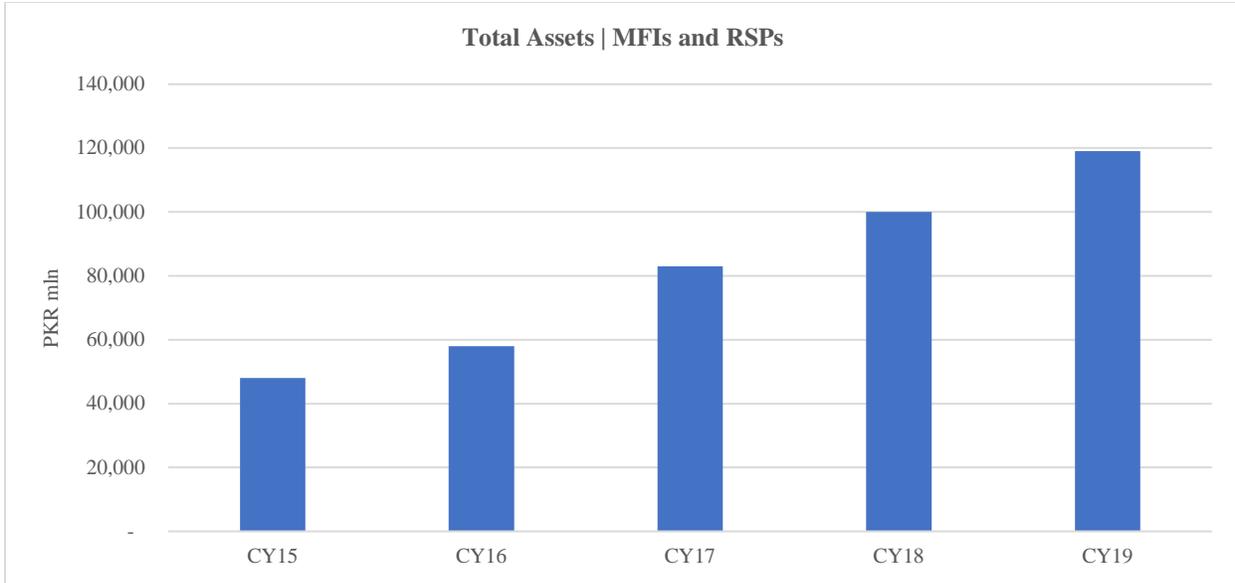


Total Assets:



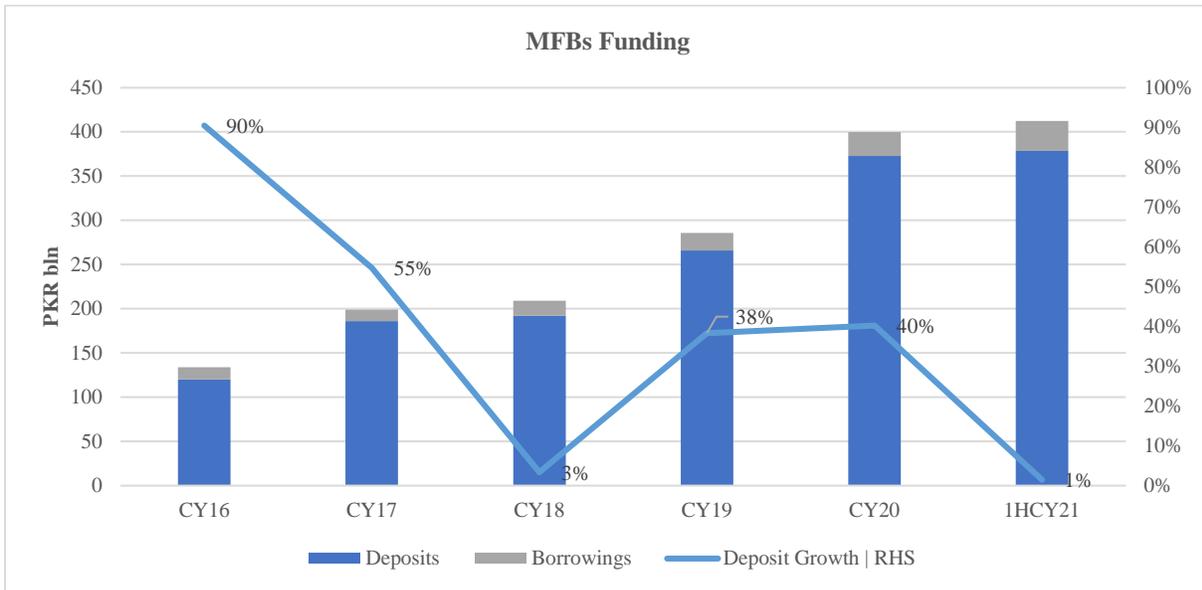
The total Asset base of MFBS has crossed half a trillion clocking in at PKR~513bln as at June'21. Almost 70% of the MFBS' assets are deployed in Advances and Investments, which implies that the sector has at minimum ~70% earning assets on its books.

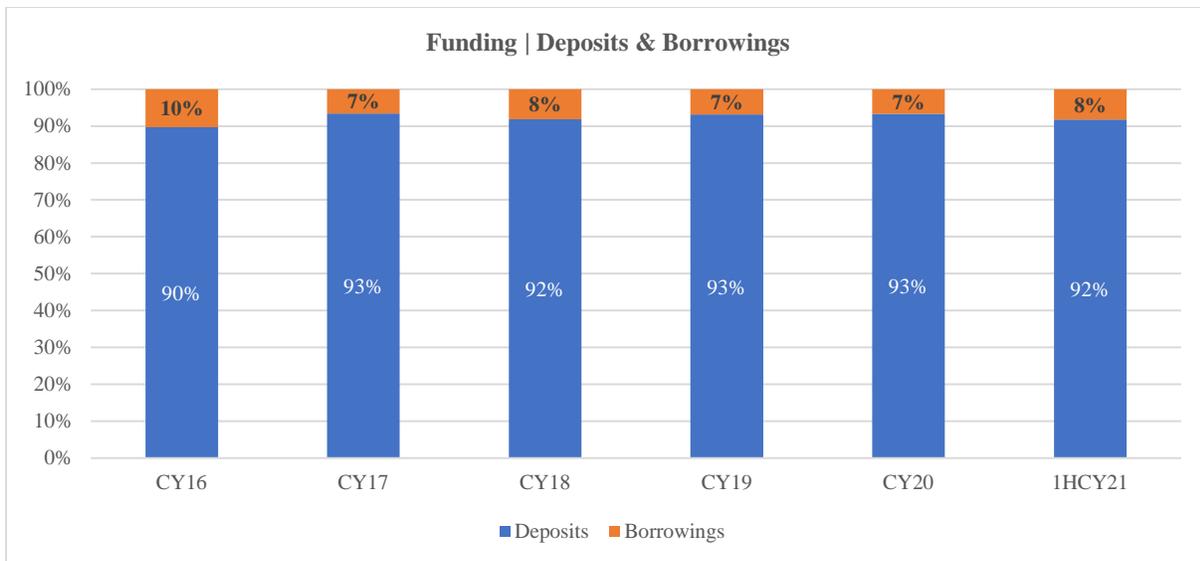
The Sector's footing has sharply increased in the past decade due to a wide potential to grow. The momentum of growth is gradually softening now. An average CAGR of above ~35% in GLP from CY16 – CY20 is a testament of the Sector's robust growth in the past.



Source: PMN Annual Report | Pakistan Microfinance Review

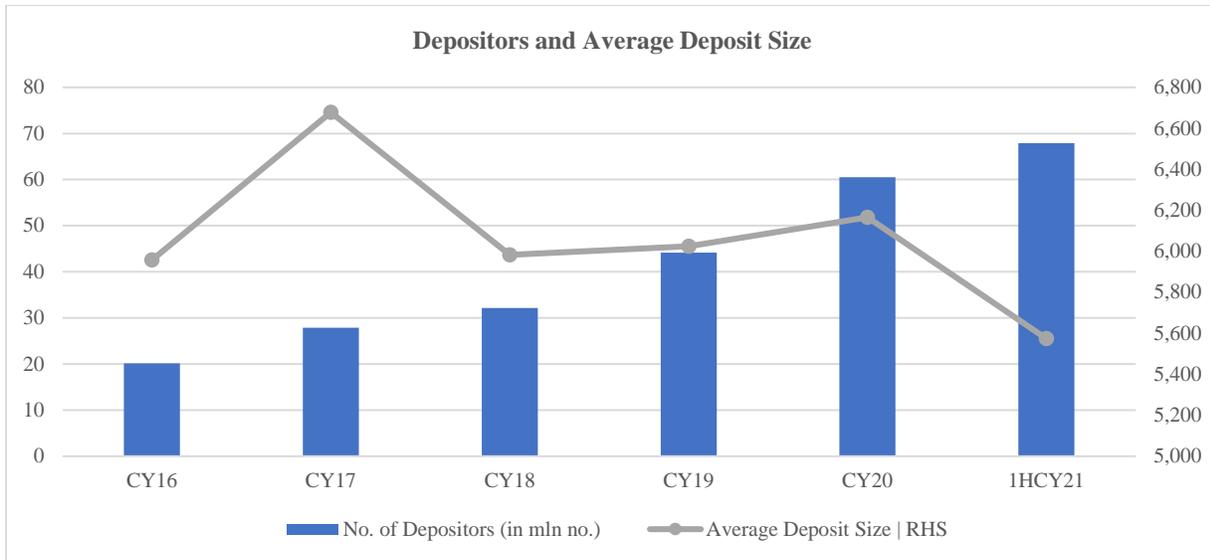
LIABILITIES | DEPOSITS & BORROWINGS



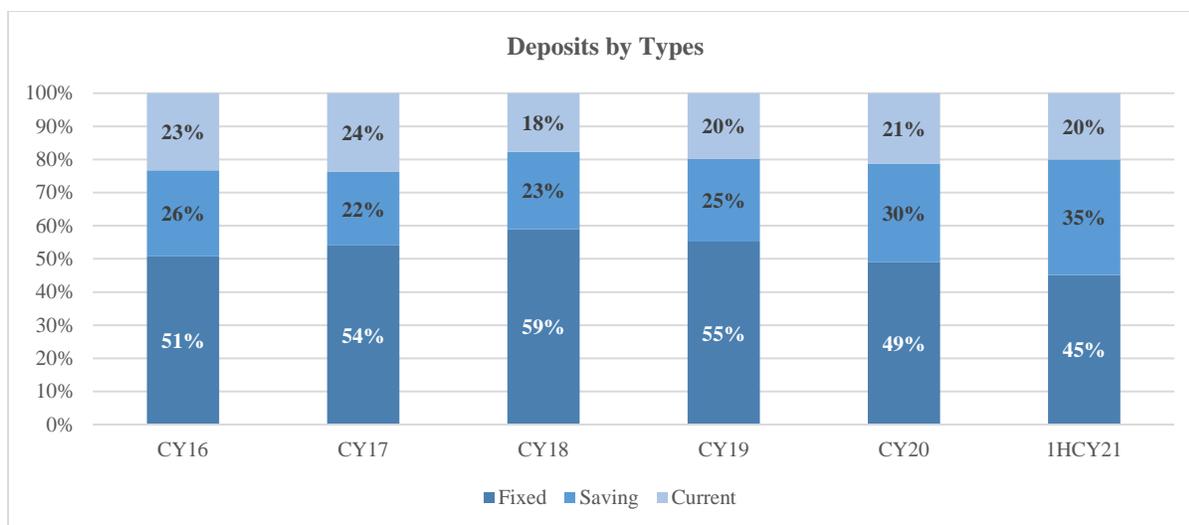


Total funding of MFBS was recorded at PKR~412bln as at End-June'21 (PKR~400bln as at End-Dec'20), of which ~92% pertained to deposits and ~8% constituted borrowings.

The deposit base of MFBS was recorded at PKR~378bln as at End-June'21 (PKR~373bln as at End-Dec'20). Growth rate of the Sector's deposits from CY16 – CY20 averaged around ~46%. An interesting dimension to the Sector's deposit growth was that despite of the outbreak of COVID-19 in CY20, the deposits closed at a wholesome growth of ~40% at End-Dec'20. This was majorly driven by Saving Accounts (~67% growth) and Current Accounts (~51% growth). Growth in SA came on account of better saving rates offered by MFBS to attract more funds. Meanwhile, current accounts grew on the back of increased BB deposits.



Total Number of MFBS Deposit Accounts as at End-June'21 was recorded at ~68mln (~60mln as at End-Dec'20). Average loan size hovered around PKR~6,000 in CY19 and CY20. However, in 1HCY21, number of deposit accounts increased by ~12% while deposits in value terms registered a modest increase of ~1% resulting in a lower average loan size of PKR~5,600 as at End-June'21.



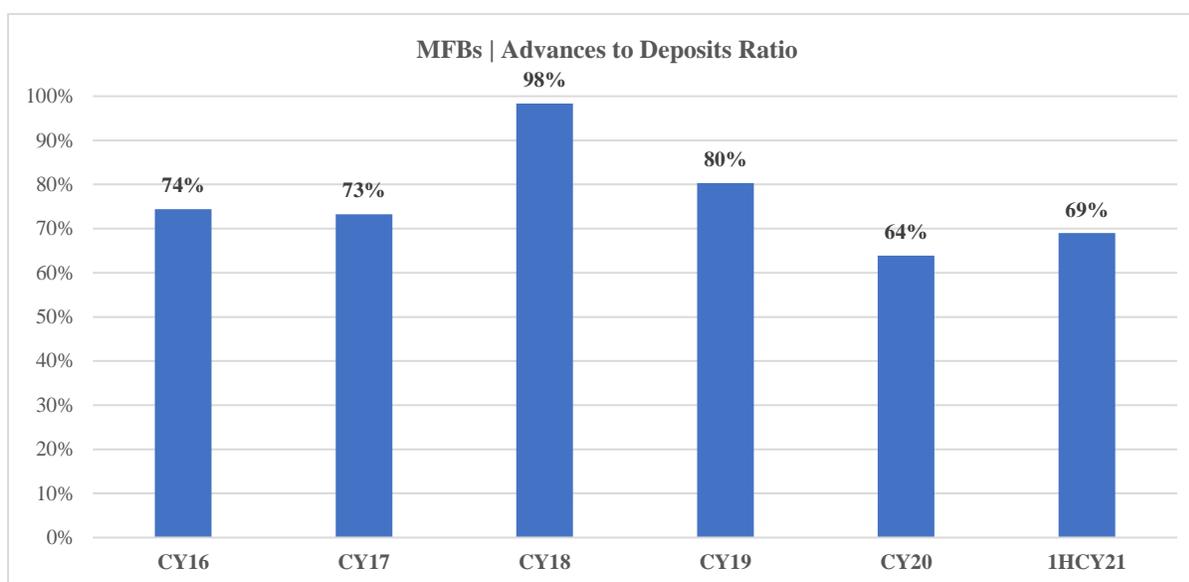
The MFBs Deposit Mix is inclined towards Fixed deposits and saving deposits (SA) collectively making ~80% of the deposit base as at End-June'21. The SA share has grown from ~26% of the deposits in CY16 to ~35% in 1HCY21, while Fixed deposits have reduced from ~51% (CY16) to ~45% (1HCY21).

CASA accounted for ~55% of the total deposit base as at End-June'21. This mix is very similar to the deposit segmentation in commercial banks, wherein average CASA ranges around ~50%. Deposits make up ~82% of the MFBs' total liabilities.

While CASA share is high, the share of CA remains low, despite having 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 on the basis of 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. MFBs involved in digital banking, including Telenor, Mobilink, U Bank and FINCA, have impressively increased their customer outreach on the branchless banking (BB) front. However, the share of BB deposits in value terms still remains nominal.

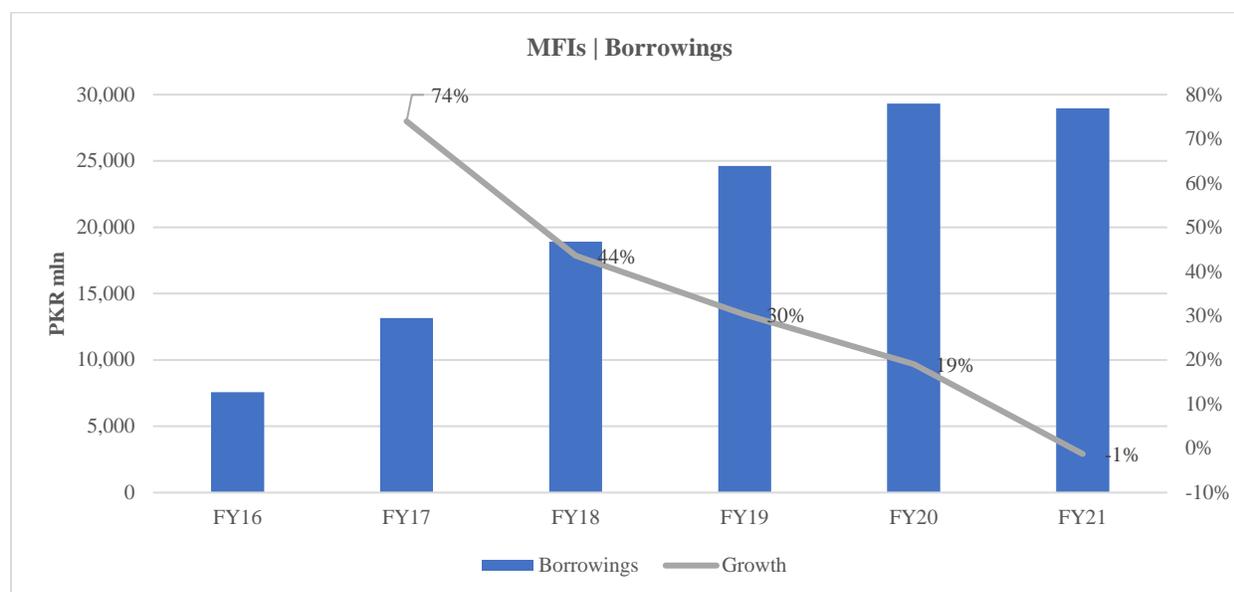
MFBs | Advances to Deposits Ratio (ADR):



ADR of the MFBs (CY16 – 1HCY21) 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 deposit base experienced an uptick in growth. A sharp increase of ~62% in MFBs' investments corroborates to the reduced ADR.

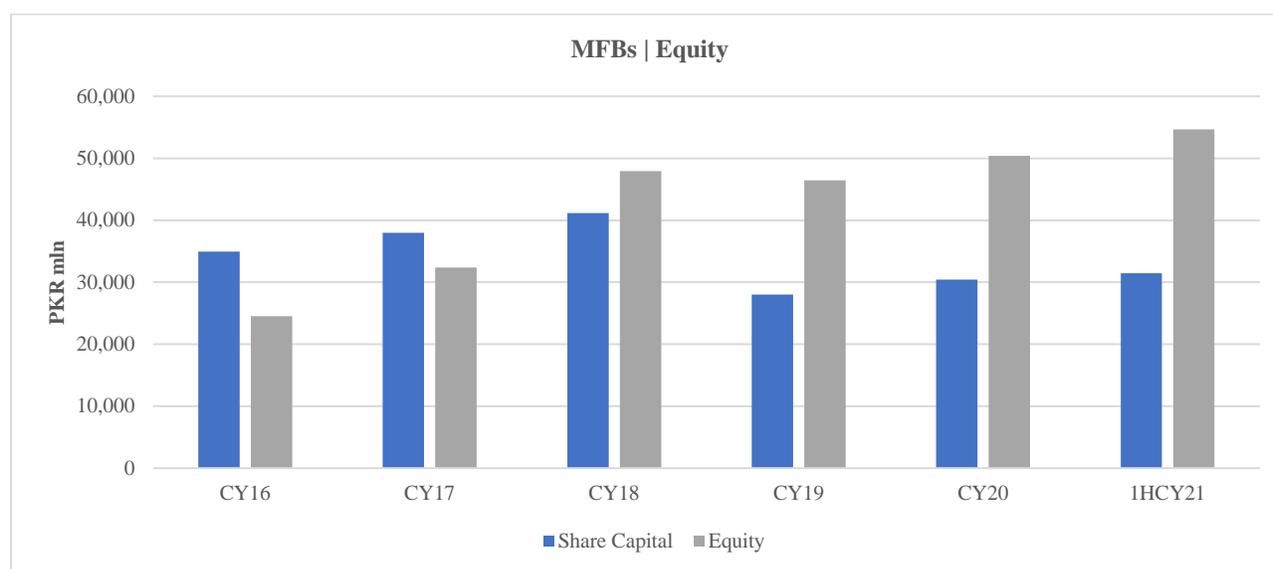
In 1HCY21, the ADR seems to be converging towards its average. Surprisingly, there has been almost negligible expansion in the sector's deposits in 1HCY21 (~1%), while MFBs GLP grew by ~10%. A negative growth of ~7% and 5% was recorded for fixed and current deposits respectively, while only saving accounts grew by ~19% in 1HCY21.

MFI's | Borrowings:



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

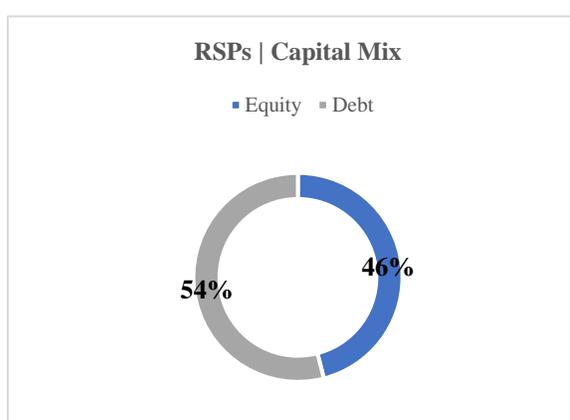
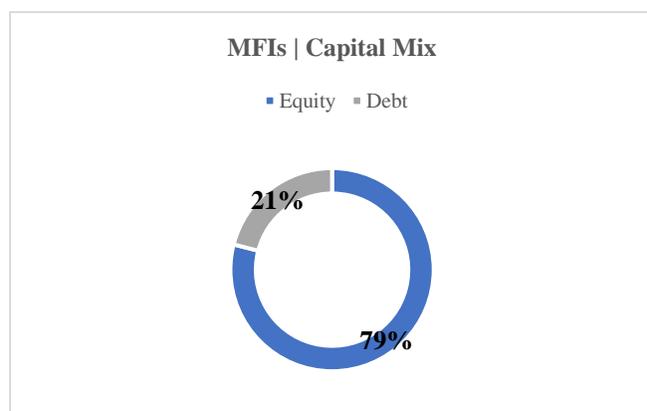
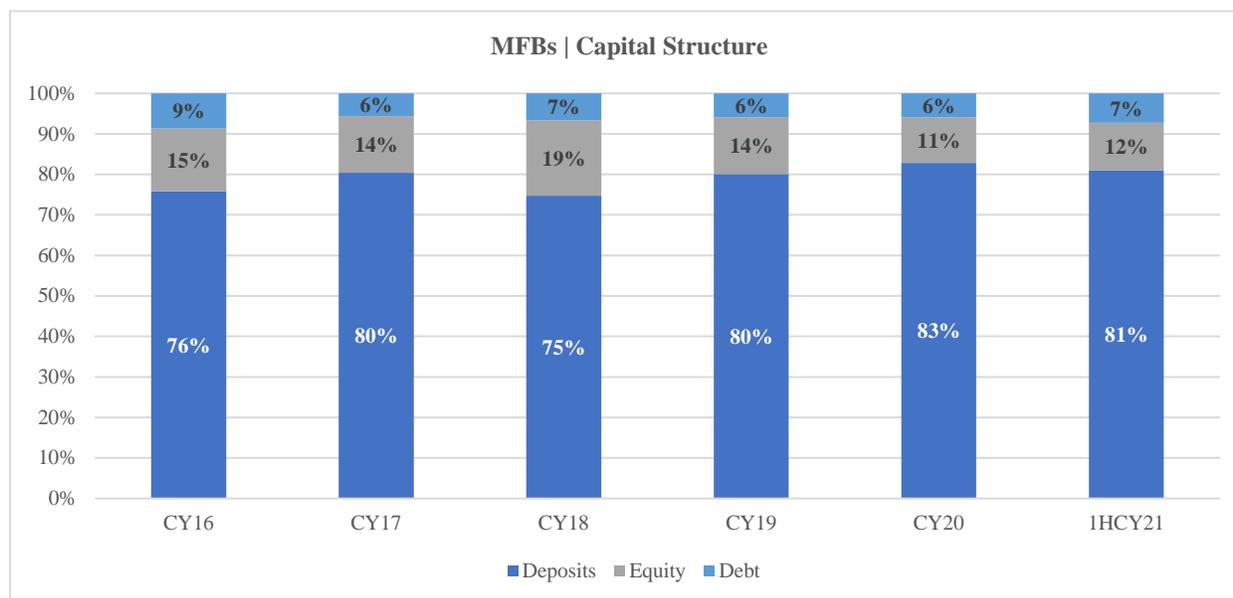
CAPITAL STRUCTURE



Total Equity of the MFBs Sector was recorded at PKR~55bln as at End-June'21 (PKR~50bln as at End-Dec'20), up ~8%. The Sector's equity represents ~11% of its total assets. Gross Loans advanced are approximately 5 times of the Equity, while deposits attracted are a multiple of 7.

NPLs >30 days as a percentage of Equity were recorded at ~22% as at End-June'21. However, net NPLs or actual drag on equity remained low at ~3% since the Sector is well covered with provisions, around ~86% of the NPLs.

CAPITAL MIX



Capital Adequacy Ratios		
MFBs	CY19	CY20
Khushhali	19.1%	19.6%
The First MFB	16.0%	15.0%
U MFB	16.7%	21.7%
Mobilink	24.0%	
NRSP	15.0%	16.0%
FINCA	20.0%	21.0%
Telenor	25.0%	19.0%
APNA	11.7%	11.8%
Pak Oman	84.0%	65.0%
Advans	32.0%	38.0%
Sindh MFB	77.0%	98.0%
Average	31%	33%

MFBs' Average CAR was recorded at ~33% in CY20 (~31% in CY19). Excluding the small sized banks (Advans, Pak Oman and Sindh MFB), the Sector's average CAR drops to around ~18%.

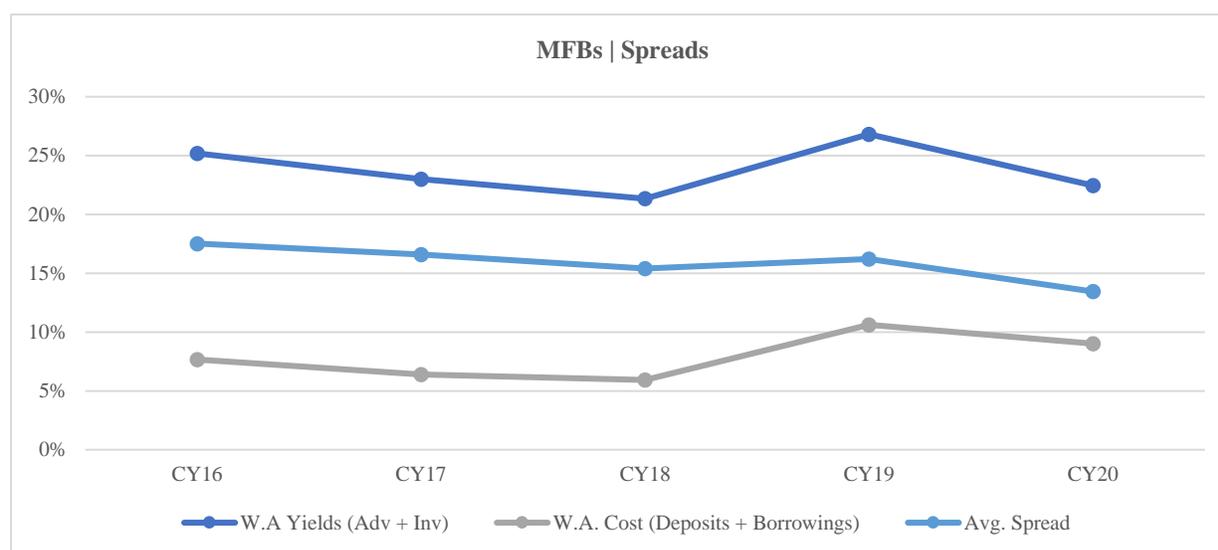
FINANCIAL PERFORMANCE:

Operating Performance	CY16	CY17	CY18	CY19	CY20	1HCY21
<i>MBFs / PKR mln</i>						
Mark-up/Return/Interest Earned	24,740	35,658	50,401	66,026	75,333	31,606
Mark-up/Return/Interest Expensed	6,750	11,299	15,845	26,674	30,972	13,046
Net Mark-up / Interest Income	17,990	24,360	34,556	39,353	44,361	18,560
Administrative expenses	14,582	27,499	35,879	47,104	48,524	22,116
Profit / (Loss) before taxation	4,799	8,388	6,621	-9,957	-3,071	-2,995
Profit / (Loss) after taxation	3,168	5,293	3,893	-11,663	-5,602	-3,353
EPS	1.5	2.3	1.5	-2.5	-0.4	-0.3

Overall performance of MFBs reflected some pressure due to the unprecedented crisis in CY20 and 1HCY21. Telenor MFB reflected an anomaly, with a high net loss of PKR~5bln in 1HCY21 (PKR~11bln in CY20, and PKR~16bln in CY19). The sector's bottomline turns positive when excluding TMFB. In CY20, the Sector added almost PKR~32bln to its investment portfolio funded through additional PKR~107bln deposits. This fostered the growth of NIMR in value terms. However, as a % of Mark-up income, NIMR continues to record at ~60%. 1HCY21 reflected no growth on deposits, primarily on account of rationalizing deposit holding cost.

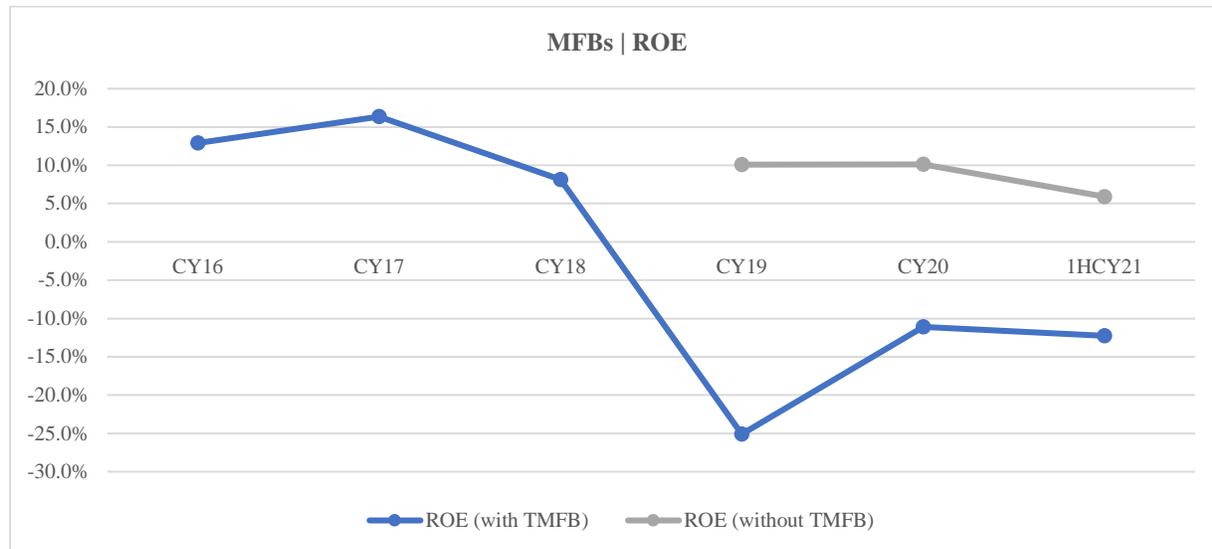
RATIO ANALYSIS

Note: Ratio Analysis is based on PACRA Rated Universe only. The ratios may vary on 100% population.



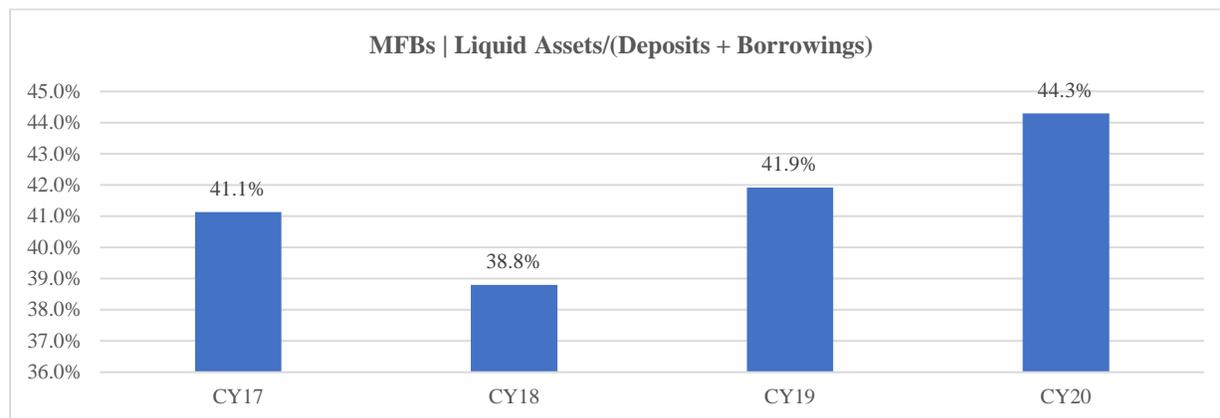
In CY20, the MFBs focus was inclined towards secure investments, rather than in lending, in order to reduce risk of loss amid COVID-19 crisis. This resulted in weighted average yields dropping from ~27% to ~22%. Average spread of the banks, therefore, reduced to ~13% from ~16% in CY19. However, low interest rates on the other hand provided relief to the cost of funds to certain extent.

RETURN ON EQUITY:

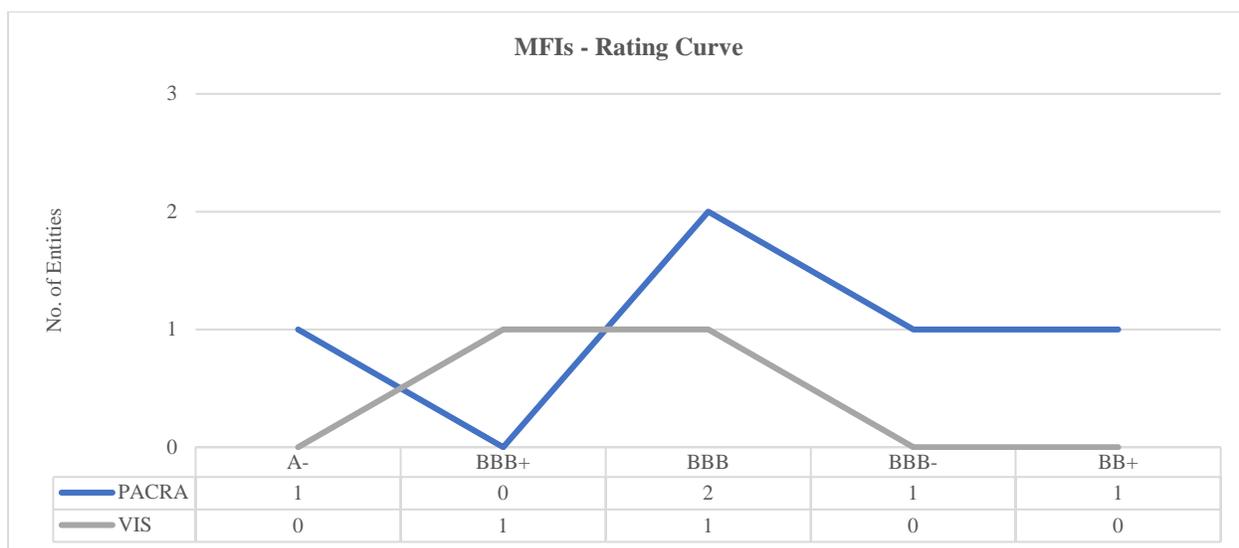
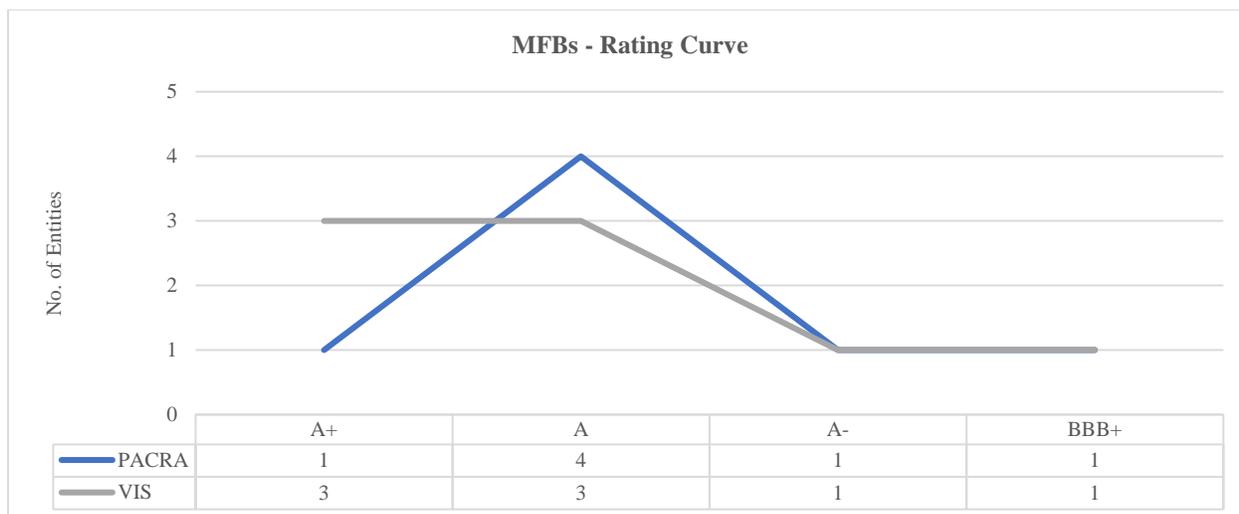


LIQUIDITY:

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 ~42%. During CY20, liquidity profile improved to ~44% (~42% in CY19) on account of a rise in liquid assets, particularly placed in short term secured investments.



RATING CURVE



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