

Microfinance Sector

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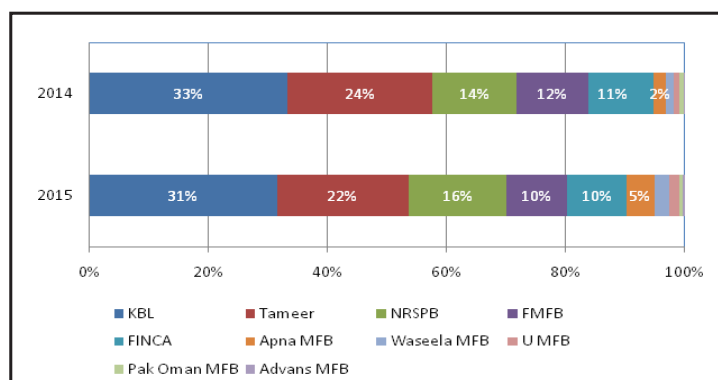
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The microfinance sector has become a significant player in providing access to credit to the largely underserved low income population of the country, over the past decade. Large unsatisfied demand opportunities, an enabling regulatory environment and increasing interest of both domestic and foreign investors have been the main drivers for the healthy development of the sector. Today the sector is characterized by institution having strong ownership profile, enhanced geographical presence, sound asset quality and profitability indicators alongside increasing branchless banking penetration.

In terms of gross microcredit portfolio, Khushhali Bank Limited (KBL) remained the largest provider of microcredit with a market share of 31% among Microfinance Banks (MFBs), followed by Tameer Microfinance Bank Limited (22%) and NRSP Bank (16%). Gross microcredit portfolio grew by over 50%; growth is characterized by increasing number of borrowers as well as gradual progression of the same to subsequent higher loan cycle. Deposit base, while somewhat concentrated, have also depicted steady growth though average deposit balances have fallen significantly. To back growing operations, sponsor support in the form of fresh equity injection has been mostly witnessed. Key indicators of the sector displaying growth over the last half decade are provided in the table below:

Microfinance Banks - Key Indicators	2015	2011
Number of branches/Unit	788	441
Number of Active Borrowers	1,458,633	846,956
Gross Microcredit Portfolio (Rs. M)	55,697	15,434
Average Loan Balances (Rs.)	38,184	18,223
Number of Depositors	10,654,221	1,337,864
Value of Deposits (Rs. Millions)	63,089	13,908
Average Deposit Balance (Rs.)	5,922	10,396

Market Share

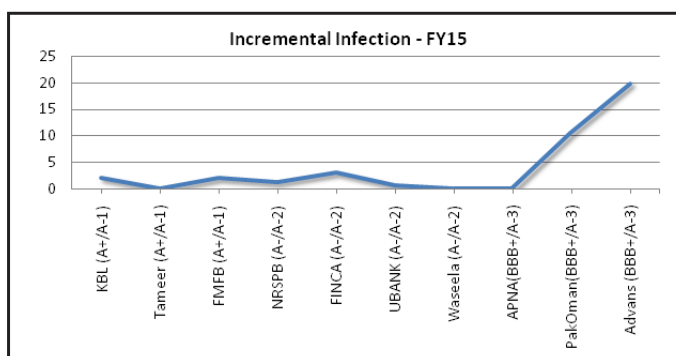


Product Portfolio

Lending under group methodology continues to dominate the overall microcredit portfolio though the sector participants prefer individual lending for Micro Small and Medium Enterprises (MSME) and secured segments. Major sectors in the microcredit portfolio include trade, agriculture, live-stock/poultry, services and small scale manufacturing. To keep pace with the borrowers increasing loan requirement, the sector has gradually increased the average loan size. At end-FY15, average loan balance of the sector stood at Rs. 38,184 (FY11: Rs. 18,223) while average disbursement size has increased by around 25% over the last five years. Being well below the regulatory limit of Rs. 150,000, large space for growth is available here.

Risk Management

As the sector is characterized by growing competition, an increasing appetite for risk taking has become evident; thus placing significant importance on risk management systems of the organizations. As per a recent survey finding, natural disasters are considered to be the biggest risk faced by the microfinance sector while competition is considered to be the fastest emerging risk. Asset quality indicators of MFBs have remained strong, reflected by manageable incremental infection rates. While being diversified on a per counterparty basis, the sector remains prone to natural calamities and other economic conditions which may adversely impact borrowers across the board in large clusters. Risk pertaining to natural calamity is further aggravated in view of the non-availability of any meaningful insurance coverage.



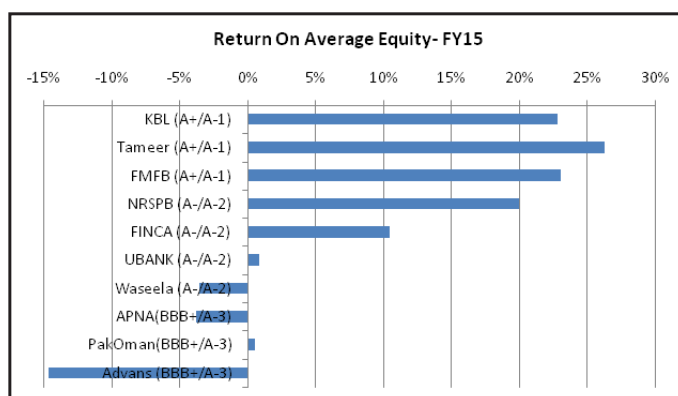
Funding

Given the increasing appetite for credit, availability of liquidity will continue to play a critical role in supporting future growth. While some MFBs have adequate deposits to fund their microcredit portfolio, others have relied on commercial borrowings to meet growing demand of liquidity. Microfinance credit guarantee facility has also played a key role in providing access to commercial funding sources. Moderate to high concentration levels in deposit base while being of concern, also requires a corresponding liquidity cushions to be maintained on balance sheet. Moderation in deposit concentration and granularity of their volumes would remain to be a function of the maturity profile of the MFBs, going forward.

Profitability

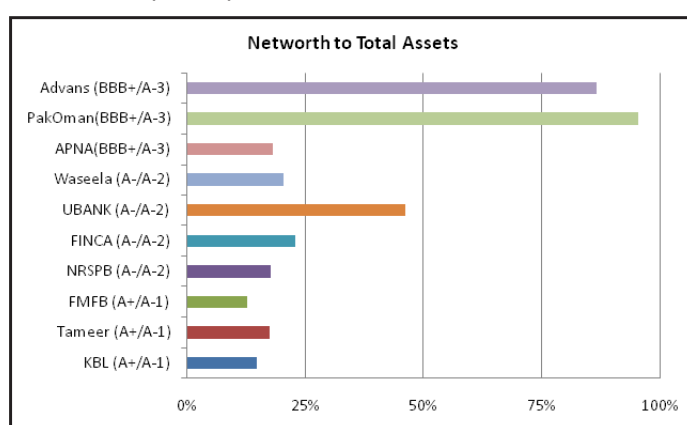
Revenues of the sector have continued their upward trend owing to volumetric growth in the microcredit portfolio. Decline in benchmark rates positively reflected on the spreads in the sector as loan products are largely fixed rate while deposit rates are linked to benchmark rates. To an extent the high return on micro credit portfolio, affords MFBs the flexibility to offer better return on deposits; in part, this advantage is however off-set by the high level of overheads experienced by institutions.

Nonetheless, overheads have gradually rationalized while the sector participants are also aiming to digitalize branch banking services which will further improve operational efficiencies. Out of the 10 MFBs, 7 posted profitable results during 2015; amongst these, consistency of profitable results has yet to be established by some. Given the differences in deployment of assets in lending activities, return metrics vary considerably across sector participants, with return on average equity ranging from -15% to 26%.



Net worth

The net worth of MFBs for the period ranges from Rs. 487m to Rs. 4b. Capital Adequacy Ratio also varies significantly across sector participants.



Sector Developments

Some of the key sector developments that took place in the year 2015 include:

- Introduction of prudential regulations for non-bank microfinance providers by the Security and Exchange Commission of Pakistan (SECP);
- The capital adequacy framework for MFBs was revised in line with international best practices and Basel Capital Framework;
- SBP directed MFBs to cap their aggregate loan exposure against security of gold at 35%; the banks have to comply with this regulation by June, 2017;
- MFBs allowed direct membership of cheque clearing house;
- With commencement of province level operations by Sindh Microfinance Bank, total number of MFBs increased to 11’;
- APNA Microfinance Bank, a Sindh based provincial MFB, was awarded license to operate nationwide.

Future Outlook

While the microfinance sector has grown at a fast pace in the recent years, its share in the financial sector of the country remains small. Nonetheless, the sector is expected to play a pivotal role in increasing financial inclusion, livelihood creation and sustainable economic growth. Growth outlook on the sector remains positive the lead here would be taken by those having sound risk assessment policies and infrastructure strength for greater access to funding sources. Growth by itself may however, not necessarily continue to drive ratings upwards in the sector.

Credit ratings assigned by JCR-VIS are considered to be comparable across sectors. Our assessment endeavors to position each company that JCR-VIS rate, vis-à-vis any other company in the rated universe, thereby maximizing the utility of ratings for the common investors by providing a single yardstick for assessing the creditworthiness of any institution. While assessing the ratings, sector related risks are taken into account in addition to firm specific risks. In the present overall economic conditions and specific factors of the microfinance industry, JCR-VIS believes that ratings of MFBs are expected to remain stable within the foreseeable future.

SECTOR OVERVIEW

	Khush-ali Bank	Tameer MFB	First MFB	NRSP Bank	FINCA	U MFB	Wa-seela	Apna MFB	Pak Oman MFB	Advans MFB
Ratings	A+/A-1	A+/A-1	A+/A-1	A-/A-2	A-/A-2	A-/A-2	A-/A-2	BBB+/A-3	BBB+/A-3	BBB+/A-3
Outlook	Stable	Stable/ RW	Stable	Positive	Positive	Stable	Stable	Positive	Stable	Stable
Rating Company	JCR-VIS	JCR-VIS /PACRA	JCR-VIS	JCR-VIS	JCR-VIS	JCR-VIS	PACRA	PACRA	JCR-VIS	JCR-VIS
Amounts in Rs. millions										
Total Assets	26,696	21,058	12,187	14,307	8,452	2,271	4,896	5,670	1,127	563
Microcredit Portfolio	17,246	12,125	5,526	8,999	5,419	913	1,350	2,566	359	181
Deposits	15,583	15,678	9,661	7,255	6,057	1,065	3,197	4,547	25	15
Net Worth	3,951	3,690	1,544	2,544	1,933	1,048	999	1,030	1,074	487
Profit/Loss After Tax	824	852	312	460	167	8	-39	-29	6	-78
Number of Active Clients	520,517	287,285	176,738	258,444	90,804	22,254	27,225	n/a	16,334	2,173
Average Loan Size (Rs.)	33,409	42,418	31,615	35,154	59,888	41,022	49,313	n/a	24,130	42,279
Number of Branches	128	66	151	67	100	38	41	69	24	4
Incremental Infection (%)	2.0	-	2.0	1.2	3.0	0.6	-	-	10.6	19.8
Cost of Funds (%)	7.7	5.5	6.2	8.1	9.2	6.0	2.4	7.4	1.1	3.6
Liquid Assets to Total Deposits & Borrowings (%)	28.8	43	55.0	38.5	29.3	81.9	87.4	48.6	26.4	1,468.8
Capital Adequacy Ratio (%)	20.5	37	23.7	20.9	30.5	88	43.5	29.8	156.9	145.7
Net Worth to Total Assets (%)	14.8	17.5	12.7	17.8	22.9	46.2	20.4	18.2	95.3	86.5
Spreads (%)	19.2	17.2	14.0	14.9	21.9	9.6	9.6	8.7	16.0	7.8
Return on Average Equity (%)	22.8	26.2	23.0	19.9	10.4	0.8	-3.6	-3.8	0.5	-14.7

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