MFO Rico Express LLC

Rating report

Issuer rating

B+

Outlook

Stable

Lead Analyst

Alvaro Dominguez Alcalde

a.dominguez@scoperatings.com

Related research

Scope affirms MFO Rico Express LLC's issuer rating at B+. Outlook is Stable, September 2024

Table of contents

Summary and Outlook

Rico Express' issuer rating of B+ reflects the following assessments:

- **Business model assessment: Focused (high).** Rico Express is the largest microfinance organisation in Georgia by total assets with a 28% market share on net loans within the domestic microfinance organisation (MFO) sector as of June 2024. Rico Express has a profitable business model focused on pawn loans secured by gold, precious metals and jewellery, as well as currency trading and international money transfers.
- **Operating environment assessment**: **Constraining (low).** Recent political tensions have not yet changed the economic outlook, but they remain an area of attention. The National Bank of Georgia supervises the MFO sector under a set of regulations that are less stringent than those for licensed banks.
- **Long-term sustainability assessment (ESG factor): Developing**. Rico Express has made significant improvements to its corporate governance framework over the past 18 months, ranging from management oversight and segregation of duties to strengthening and formalising its risk management framework.
- **Earnings and risk exposures assessment: Neutral**. Rico Express' profitability metrics are solid and historically better than the sector average. Interest income is by far the largest contributor to revenues and is an adequate first line of defence given the company's risk profile. The Stage 3 loan ratio is low (2.1% as of June 2024), given the relatively high risk of consumer loans, and has increased slightly as a result of the recent implementation of a more flexible write-off and loan recovery policy.
- **Financial viability assessment: Comfortable**. The company plans to maintain its conservative capital and liquidity ratios. While Rico Express operates with large buffers above the minimum capital requirement (capital ratio of 47% at end-June 2024), the liquidity position has been volatile recently as loan growth has been financed with own funds, putting pressure on the liquidity buffer, situation which has now been rebalanced to a comfortable liquidity ratio of 31% at end-August 2024. Bonds and promissory notes are the main funding sources for Rico Express, accounting for more than 80% of the total as of June 2024.

The Stable Outlook reflects Scope's view that the risks to the current rating are balanced.

The upside scenario for the rating and Outlook:

- A reduction in the company's risk profile, e.g. lower sensitivity to potential gold price volatility.

The downside scenarios for the rating and Outlook:

- Challenges to maintain some degree of business diversification, beyond pawn loans, for example in the event of more challenging business dynamics or economic conditions in the country.
- Pressure on earnings capacity, e.g. due to higher funding costs and/or higher impairment charges.
- A change in strategy or risk appetite, that significantly increases the firm's risk profile, such as tighter buffers above minimum capital or liquidity requirements.

Disclosure/warning

Rating drivers

Step	Rating drivers	Assessment				
STEP 1	Operating environment	Very constraining	**Constraining**	Moderately supportive	Supportive	Very supportive
	Low/High	*Low*			*High*	
	Business model	Narrow	**Focused**	Consistent	Resilient	Very resilient
	Low/High	*Low*			*High*	
	Initial mapping	**b**				
	Long-term sustainability	Lagging	Constrained	**Developing**	Advanced	Best in class
	Adjusted anchor	**b**				
STEP 2	Earnings capacity & risk exposures	Very constraining	Constraining	**Neutral**	Supportive	Very supportive
	Financial viability management	At risk / Stretched	Limited	Adequate	**Comfortable**	Ample
	Additional factors	Significant downside factor	Material downside factor	**Neutral**	Material upside factor	Significant upside factor
	Standalone rating	**B+**				
STEP 3	**External support**	Not applicable				
Issuer rating		**B+**				

Credit ratings

		Credit rating	Outlook
Issuer	**MFO Rico Express LLC**		
	Issuer rating	B+	Stable
	Short-term debt rating	S-4	Stable

Business model

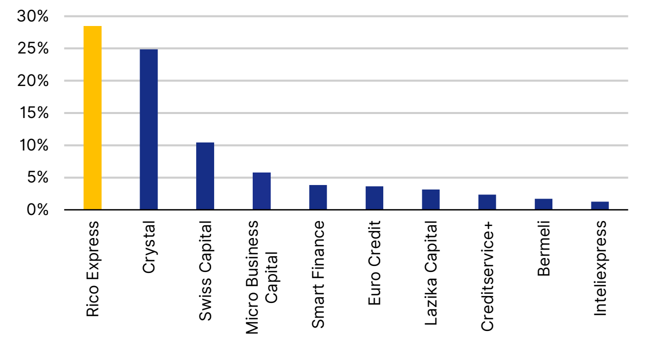
'Focused – high' business model assessment

Rico Express is the largest MFO in Georgia and the leading domestic player in the niche market of Lombard loans. It had total assets of GEL 642m (about EUR 216m) and a market share of 28% in terms of net loans as of June 2024.

Rico Express' business model is almost exclusively focused on pawn shop loans backed by gold and other precious metals. It also offers currency exchange services and international money transfers. The company's mortgage portfolio has been in run-off since 2017 after unfavorable changes in the property repossession regulations prompted Rico Express' decision to exit the market.

Rico Express' loan book is largely made of Lombard loans, which represented around 98% of gross loans as of December 2023. Geographic diversification is limited to its home country, although regional coverage is relatively high, with 37 regional branches out of total of 60.

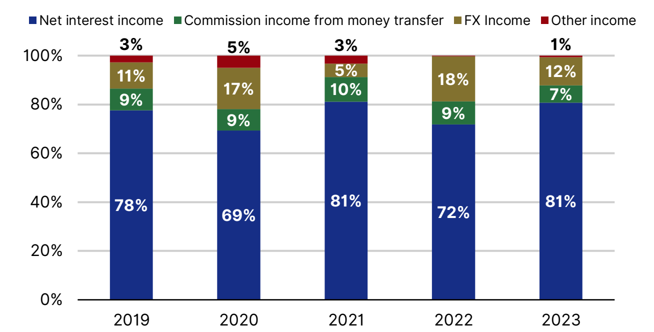
Figure 1: Georgian MFOs ranked by market share of net loans (Q2 2024)



Note: Data for Leader Credit are not publicly available.

Source: NBG, Company data, Scope Ratings

Figure 2: Rico Express' gross revenue breakdown (2019-2023)



Source: Company data, Scope Ratings

Rico Express offers small, short-term loans. There is no requirement to prove income, but collateral is set at maximum of 90% of the loan's value at origination. This strategy has made the company the leading MFO in Georgia. It has also resulted in a highly granular loan portfolio with an average loan amount of GEL 1,200 (about EUR 425) and an average maturity of 18 months.

Rico Express' main source of revenue is net interest income, accounting for around 78% on average for the last three years. The large amounts of foreign exchange income in 2022 and 2023 are largely due to an exceptional inflow of foreigners into the country.

Rico Express' medium-term strategy (2024-2026) is to: i) significantly increase Lombard loans; ii) continue to significantly reduce legacy mortgage loans; iii) expand the branch network throughout Georgia.

In our view, the medium-term plan is consistent with Rico Express' recent narrative and, overall, sensible. Most of the projections are in line with recent lending trends, as there is no deterioration in the economic environment or lending dynamics.

We expect that Rico Express will maintain its business focus and leading market share in this sector due to its strong franchise and well-developed expertise.

Operating environment

Focus on Rico Express' country of domicile: Georgia (BB/Stable)

Economic assessment:

- The Georgian economy is undergoing a strong recovery and has robust medium-run growth potential. Growth in recent years has been well above this trend rate, benefiting from strong services-sector exports, financial inflows, transit trade and arrivals of skilled workers from Russia, Belarus and Ukraine. After very strong real growth of 10.6% in 2021, 11.0% 2022, and 7.5% in 2023, growth is expected to remain strong at 7.5% this year before decelerating to 5.4% next year.
- Russia's invasion of Ukraine created significant economic uncertainties given the strong trade linkages of Georgia to the warring counterparties. So far, the economy has weathered the crisis exceptionally well.
- In addition, the economy is vulnerable to external shocks due to its small size, high dependence on external financing and high dollarization.
- The Georgian parliament adopted a new foreign-agent law in May 2024, which was a source of political tensions in the country. It remains to be seen to what extent prolonged political tensions could alter economic momentum in the country.

Key economic indicators	2021	2022	2023	2024E	2025F
Real GDP growth, %	10.6	11.0	7.5	7.5	5.4
Inflation (HICP), % change	9.6	11.9	2.5	1.6	2.9
Unemployment rate, %	20.6	17.3	16.4	13.5	13.0
Policy rate, %	10.5	11.0	9.5	7.5	7.0
Public debt, % of GDP	49	39	39	40	39
General government balance, % of GDP	-6.0	-2.6	-2.3	-2.6	-2.2

Source: Scope Ratings

Soundness of the Georgian financial sector:

- Commercial banks dominate the Georgian domestic financial sector, accounting for more than 90% of assets as of December 2023. Pension funds, insurance companies, MFOs and loan issuing entities (LIEs) together account for less than 10% of total assets.
- As of March 2024, about 34 MFOs were operating in Georgia. The sector comprises a diverse set of players, with some focusing on a selection of business products (e.g. Rico Express, Swiss Capital, Euro Credit) and others covering a broader product range (e.g. Crystal, Micro Business Capital)
- MFOs mainly provide consumer loans (over 80% of the total as of March 2024), followed by trade and services loans (10%) and agriculture and forestry loans (7%).
- The MFO sector is highly concentrated with the five largest MFOs holding around 75% of the sector's total assets and total net loans in March 2024. Since 2016, the number of active MFOs has more than halved. The consolidation has mainly been driven by the introduction of more demanding regulatory requirements. These include: i) a lending limit of up to GEL 200,000; ii) a minimum threshold for borrowing from individuals has been set at GEL 100,000 if there are more than 20 individual investors, in order to incentivise MFOs to shift to qualified investors; iii) a cap on the effective interest rate of 50% (down from 100%); iv) a minimum regulatory capital of GEL 1m; v) minimum capital and liquidity ratios (at 18% each); vi) the introduction of macroprudential policy tools such as maximum payment-to-income ratios and loan-to-value ratios.
- Recent reforms also include the development of a new regulatory framework for microbanks that is better aligned with the banking regulatory framework.

Banking system indicators	2019	2020	2021	2022	2023
ROAA, %	2.9	1.3	3.0	3.3	3.6
ROAE, %	20.3	10.2	22.1	22.8	24.8
Net interest margin, %	5.3	4.4	4.8	5.2	5.8
CET1 ratio, %	13.3	12.5	14.3	17.3	22.8
Problem loans/gross customer loans, %	4.3	5.4	3.9	3.1	2.6
Loan-to-deposit ratio, %	124.3	114.9	119.0	102.8	106.9

Source: SNL, Scope Ratings

Long-term sustainability (ESG-D)

'Developing' long-term sustainability assessment

Rico Express remains committed and active in environmental, social and governance areas and is investing in digitalisation.

Governance

Rico Express has significantly strengthened its corporate governance structure and framework over the last 12-18 months. Key milestones achieved in the company's corporate governance area include: i) the appointment of an independent member of the Supervisory Board with extensive experience in the domestic financial sector; ii) the appointment of a CFO with extensive experience in MFOs; iii) the establishment and quarterly meeting of an Audit and Risk Committee; iv) the creation and strengthening of the company's risk management framework based on a three line of defence model as well as the strengthening of the internal control systems led by the internal auditors.

Digitalisation

Rico Express has also improved in the area of digitalisation as the company has been involved in several key initiatives in recent months. Examples include: i) the partnership with Mastercard for the implementation of a debit card that will allow the automatic disbursement of loans in order to reduce the use of cash; ii) the partnership with Prinum for the future launch of a digital wallet by the end of 2024 where it will integrate Rico Western Union and Money Gram and Rico Express' clients will receive the money online without having to go to the company's offices; iii) the replacement of its former in-house accounting software with Alta software, considered the golden standard and used by most domestic banks and several MFOs.

Social and Environmental

Social factors do not represent a significant risk. As an MFO, Rico Express aims to support the financial development of its clients by offering tailor-made financial services. We note the company's intention to join national and international environmental initiatives or agreements in the future.

Figure 3: Long-term sustainability overview table[1]

	Industry level			Issuer level						
	Materiality			Exposure			Management			
	Low	Medium	High	Low	Neutral	High	Weak	Needs attention	Adequate	Strong
E Factor		◇			◇				◇	
S Factor	◇					◇			◇	
G Factor			◇			◇			◇	
D Factor			◇		◇				◇	

Source: Scope Ratings

[1] The overview table illustrates how each factor informs our overall assessment. Materiality refers to our assessment of the credit relevance of each factor for the banking industry. Exposure refers to what extent the bank is exposed to risks or benefits from opportunities compared to peers, given its business model and countries of operation. Management refers to how we view the bank's navigation through transitions.

Earnings capacity and risk exposures

'Neutral' earnings capacity and risks exposures' assessment

In contrast to the continued decline in the sector's bottom line between 2016-2019, which is the result of lower lending volume growth following the regulatory tightening, Rico Express has maintained solid profitability, and has not even reported a financial loss since 2011.

After a record year 2020, in which strong loan production drove revenue and profit growth, net income declined slightly in 2021. Revenues in 2021 were supported by strong loan volumes, NII and FX income, but higher operating expenses, higher hedging costs and lower gains on the sale of repossessed gold more than offset the positives.

For 2022, the microfinance organisation's net profit grew by approximately 27% year-on-year to GEL 52m (about EUR 18m), mainly driven by income stemming from foreign exchange trading due to an increase in foreign exchange currency transactions, supported by higher net interest income due to continued volume growth.

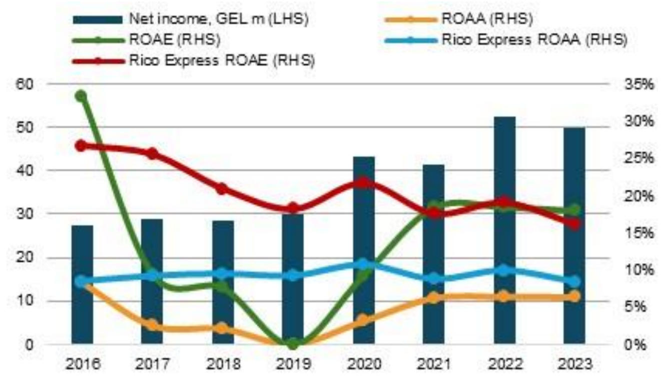
In 2023, the company's net profit decreased slightly by about 5% year-on-year to GEL 50m (about EUR 17m) as the extraordinary foreign exchange income generated in 2022 started to fade away in 2023, lower commission income from money transfers and higher operating expenses. However, net interest income increased by 14% in the year supported by continued volume growth.

Rico Express reported a net profit of GEL 25m for the first half of 2024, representing a slight increase compared to last year. Profitability in the first half of 2024 was supported by very strong loan volumes and good performance on NII as well as higher commission income, which were partially offset by higher operating expenses and lower income derived from foreign exchange operations.

Rico Express' three-year average net interest margin, net of hedging costs, was 11% as of December 2023. We note that revenues from other business lines, namely international money transfers and currency trading, have also performed well in recent years.

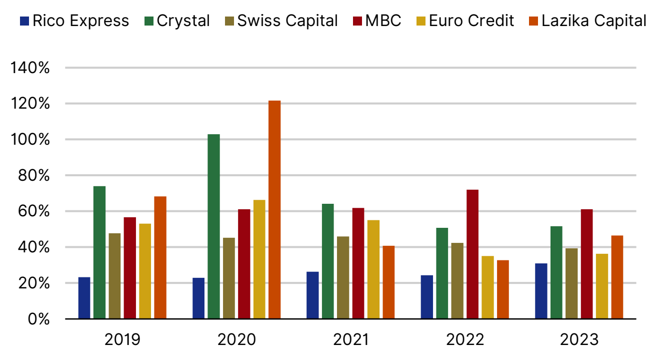
Operating expenses mainly comprise employee compensation. Operating expenses also include the cost of security and insurance cover for operations and gold storage, which is unique to Rico Express' business. Insurance cover for political violence and war, international conflict risk and robbery risk is also an important risk mitigant. Efficiency metrics are solid. The cost income ratio historically been between 20% and 30% and is lower than that of peers.

Figure 4: Profitability metrics vs MFO sector (IFRS, GEL m, 2016-2023)



Source: NBG, Company data, Scope Ratings

Figure 5: Main MFOs Cost to Income ratio (2019-2023)



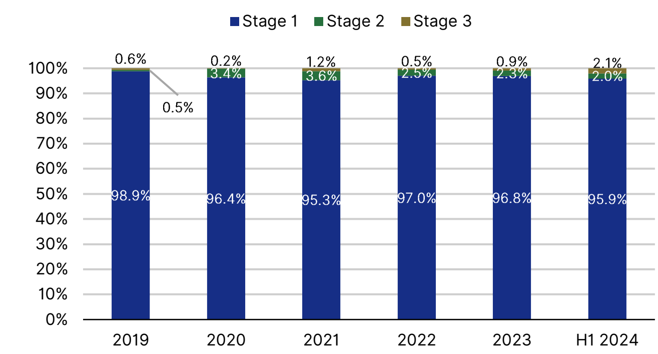
Source: Company data, Scope Ratings

Almost all of Rico Express' credit exposure consists of gold, silver and diamonds backed Lombard loans. The main underwriting policy is to ensure that collateral does not cover more than 90% of the loan value at origination. Collateral has a maximum maturity of 3 years.

The main underwriting standards for Lombard loans are as follows: i) maximum fixed amount at GEL 100,000; ii) initial maturity up to 1 year; iii) interest rate of the loan is fixed (18%); iv) collateral at no more than 90% LTV; v) loan amount cannot be more than 90% of the collateral value. There is no prepayment fee if the customer is willing to anticipate and prepay the loan, as this allows the company to re-engage again with the customer later in the year with a new loan or to provide a new loan with the same collateral at a value not exceeding 90% of the collateral value. This is also the main reason for the very low level of non-performing loans compared to both the sector and peers.

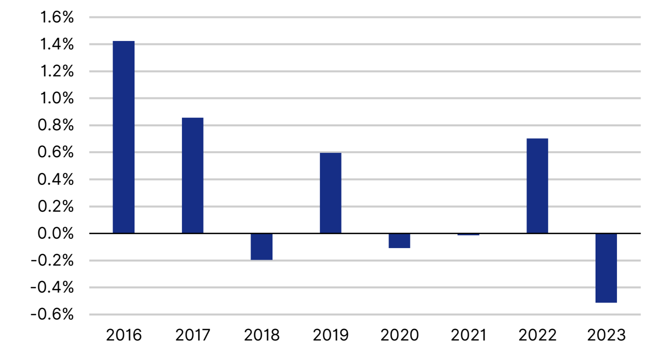
Operational risks associated with the management and storage of precious metals held as collateral are centralised. To ensure safe storage, these are transported daily to a central location, where they are audited and checked for discrepancies. The storage facility is considered 'best in class' and is insured by a local insurance company. To date, the company has not suffered any losses related to theft of precious metals. Operational risks have little potential for large losses given the insurance coverage, which we expect to remain key to operational risk management as the company maintains its focus on Lombard loans backed by precious metals.

Figure 6: Rico Express asset quality breakdown by loan staging (2019-H1 2024)



Source: Company data, Scope Ratings

Figure 7: Rico Express' cost of risk (2016-2023)



Source: Company data, Scope Ratings

Financial viability management

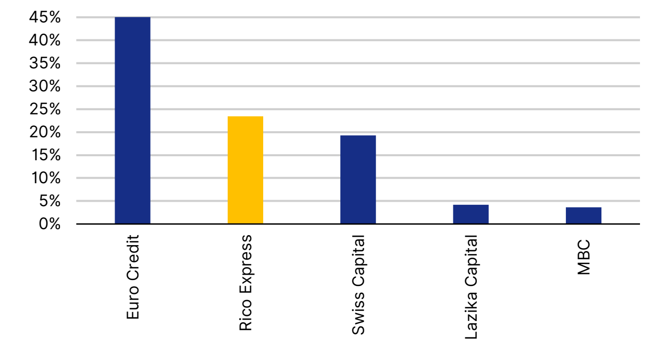
'Comfortable' financial viability management assessment

Capitalisation metrics have been historically high and above those of peers. As of June 2024, Rico Express had a comfortable buffer to the minimum requirements, with a capital adequacy ratio of 47% (equity to assets), well above the required 24%.

The high level of capitalisation and the use of equity to support growth (average payout of around 22% over the last five years) are in line with the strategy of keeping margins high and limiting reliance on bank funding to support growth.

Rico has a solid liquidity buffer, with a ratio of about 31% as of August 2024, after the reinvestment of GEL 25m via subordinated debt out of the GEL 35m dividend paid. This is above its regulatory minimum of 25%. The liquidity ratio is lower than the peak of 54% in December 2020, when Rico increased its liquidity reserves in response to pandemic related uncertainty but is in line with historical levels.

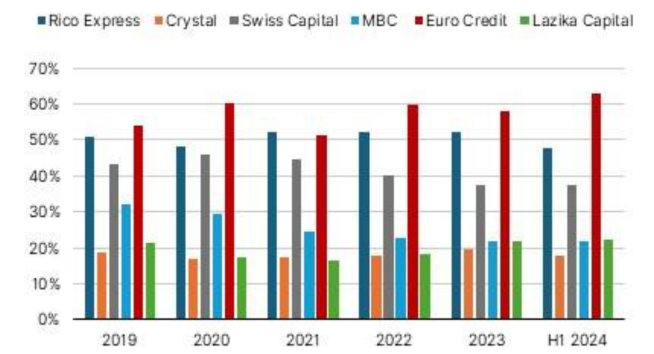
Figure 8: Buffer to capital adequacy ratio requirement (NBG, H1 2024)



Note: Capital adequacy ratio = Equity/Assets for MFOs that do not report their CAR in quarterly reports.

Source: Company data, Scope Ratings

Figure 9: Main MFOs' capital adequacy ratio (2019-H1 2024)



Source: SNL, Scope Ratings

Liquidity consists mainly of cash on hand and current accounts with banks totaling GEL 63m as of June 2024, covering 25% of the short-term promissory notes and bonds issued. Liquidity increased to GEL 71m as of August 2024.

Funding is moderately diversified by type and counterparty: as of June 2024, Rico Express' funding consists of 42% of bonds, 40% of promissory notes and 18% of funds from local commercial banks. Funding from domestic commercial banks comes from a mix of large, medium and small Georgian banks.

Promissory notes have been part of the funding strategy since the early years, allowing better management of interest rate fluctuations and better matching of the relatively short-term loan portfolio.

Due to the Georgia's larisation programme since 2017, the share of foreign currency loans (US dollars and euros) in Rico Express' portfolio has fallen to just 3% in 2023, from 53% in 2017. This programme has reduced the sector's need to access foreign currency funding. However, Rico Express, like many in the MFO sector, continues to access foreign currency funding, mostly in US dollars, to take advantage of favourable rates. As of December 2023, 30% of total funding is denominated in foreign currency (related to the promissory notes). We view positively Rico Express' strategy to fully hedge its liabilities via currency swaps to mitigate currency risk. However, hedging also represents an increasing cost that adds to the cost of funding. The latter has averaged 3.5% over the past five years (5.6% for 2023).

However, the potential impact related to foreign exchange risk has diminished since 2017, as Rico Express has reduced its reliance on foreign exchange funding by more than half (down 40pp on total funding since December 2017).

Financial appendix

I. Appendix: Selected financial information – MFO Rico Express LLC

	2019	2020	2021	2022	2023
Balance sheet summary (GEL '000)					
Assets					
Cash and cash equivalents	63,473	115,464	69,923	109,530	101,168
Amounts due from credit institutions	0	4,639	1,549	0	0
Derivative financial assets	0	0	0	825	642
Loans to customers (Net)	264,702	305,997	366,416	425,849	467,716
Current income tax asset	0	883	0	0	0
Right-of-use assets	1,889	5,695	6,829	5,667	5,290
Property and equipment	14,229	16,072	15,284	16,340	16,127
Intangible assets	31	57	154	475	831
Deferred income tax asset	0	0	0	0	0
Other assets	5,371	11,745	22,842	16,511	18,111
Total assets	**349,695**	**460,552**	**482,997**	**575,197**	**609,885**
Liabilities					
Derivative financial liabilities	426	2,178	358	0	0
Promissory notes issued	109,882	112,590	121,448	115,263	100,937
Current income tax liabilities	99	0	1,095	2,093	2,900
Borrowed funds	55,164	113,584	95,444	132,944	42,189
Lease liability	1,967	5,670	7,014	5,039	4,644
Deferred income tax liability	377	2,027	2,765	4,081	3,991
Other liabilities	2,754	4,277	4,565	15,233	10,279
Total liabilities	**170,669**	**240,326**	**232,689**	**274,653**	**294,633**
Charter capital	1,584	1,584	1,584	1,584	1,584
Retained earnings	177,442	218,642	248,724	298,960	313,668
Total equity	**179,026**	**220,226**	**250,308**	**300,544**	**315,252**
Total equity and liabilities	**349,695**	**460,552**	**482,997**	**575,197**	**609,885**
Income statement summary (GEL '000)					
Net interest income	44,816	47,298	57,788	67,314	76,562
Expected credit loss reversal/(charge)	-1,583	330	51	-3,016	2,411
Net commission income from money transfers	4,935	6,064	7,204	8,481	6,877
Currency trading	6,477	9,171	9,908	32,160	17,794
Foreign currency derivatives	-918	-2,525	-5,046	-19,189	-7,995
Other income	1,951	8,409	1,349	3,807	2,097
Personnel expenses	-9,565	-11,371	-13,638	-16,915	-22,139
Other expenses	-9,873	-6,925	-8,856	-10,086	-12,169
Profit before income tax expense	**36,240**	**50,451**	**48,760**	**62,556**	**63,438**
Income tax expense	-6,421	-7,209	-7,484	-10,154	-13,668
Profit for the year	**29,819**	**43,242**	**41,276**	**52,402**	**49,770**
Other comprehensive income	0	0	0	0	0
Total comprehensive income for the year	**29,819**	**43,242**	**41,276**	**52,402**	**49,770**

Source: Company data, Scope Ratings

II. Appendix: Selected financial information – MFO Rico Express LLC

Earnings and profitability	2019	2020	2021	2022	2023
Yield on gross loans (%)	20.5%	19.7%	20.3%	20.2%	21.6%
Net Interest Margin (Net of hedging costs) (%)	13.4%	10.5%	12.0%	9.0%	12.1%
Cost of funding (%)	6.4%	6.9%	10.0%	15.6%	22.8%
Net interest income % operating income	77.6%	69.3%	81.2%	71.8%	80.8%
Net fees & commissions % operating income	8.9%	8.8%	10.1%	9.5%	7.0%
FX income % operating income	10.7%	16.9%	5.4%	18.4%	11.5%
Pre-tax income / Average assets	11.2%	12.5%	10.3%	11.8%	10.7%
Pre-tax income / Average equity	22.1%	25.3%	20.7%	22.7%	20.6%
Cost income ratio (%)	23.8%	22.8%	26.3%	25.2%	30.1%
Total impairments % pre-impairment income	16.0%	-0.8%	-0.1%	5.4%	-5.1%
Total impairments % gross loans	2.1%	-0.1%	0.0%	0.7%	-0.5%
Total impairments & gold repossession % gross Loans	2.7%	1.0%	0.6%	0.8%	-0.4%
Return on average assets (%)	9.2%	10.7%	8.7%	9.9%	8.4%
Return on average equity (%)	18.2%	21.7%	17.5%	19.0%	16.2%
NBG covenants	**2019**	**2020**	**2021**	**2022**	**2023**
Leverage ratio (Equity % Assets)	51.2%	47.8%	51.8%	52.3%	51.7%
Liquidity ratio (%)	29.6%	53.7%	33.5%	NA	80.5%
Pledged assets to equity ratio (%)	77.8%	57.5%	49.3%	NA	17.3%
Funding and liquidity	**2019**	**2020**	**2021**	**2022**	**2023**
Funding in GEL % total funding	43.7%	54.6%	52.6%	63.4%	70.4%
Funding in foreign currency % total funding	56.3%	45.4%	47.4%	36.6%	29.6%
Short-term funding % total funding	66.6%	49.8%	56.0%	46.4%	37.0%
Long-term funding % total funding	33.4%	50.2%	44.0%	53.6%	63.0%
Promisory notes % total funding	66.4%	49.3%	55.9%	46.4%	70.5%
Financial liabilities % equity	92.4%	103.7%	86.8%	82.6%	45.4%
Cash and cash equivalents % promisory notes	57.8%	102.6%	57.6%	95.0%	100.2%
Liquid assets % total assets	18.2%	25.1%	14.5%	19.0%	16.6%
Asset mix, quality and growth	**2019**	**2020**	**2021**	**2022**	**2023**
Net loans % assets	75.7%	66.4%	75.9%	74.0%	76.7%
Stage 3 loans % gross loans	0.6%	0.2%	1.2%	0.5%	0.9%
Stage 3 loans % tangible equity and reserves	1.0%	0.3%	1.7%	0.8%	1.3%
Coverage ratio on stage 3 loans (%)	25.3%	11.1%	14.2%	41.0%	3.9%
Gross loan growth (%)	22.0%	15.5%	19.8%	17.0%	9.1%
Asset growth (%)	17.4%	31.7%	4.9%	19.1%	6.0%
Capital and Shareholder's distribution	**2019**	**2020**	**2021**	**2022**	**2023**
Dividend payout ratio	2.3%	4.7%	27.1%	4.1%	70.4%
Adjusted Capitalisation Ratio (deducted intangible assets, other assets and property & equipment)	48.6%	46.3%	50.2%	50.7%	49.5%
Gross debt / Tangible equity	92.2%	102.7%	86.7%	82.7%	86.8%

Source: Company data, Scope Ratings

Analyst

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

Team Leader

Marco Troiano, CFA
+44 77 69320373
m.troiano@scoperatings.com

Applied methodology

Financial Institutions Rating Methodology, February 2024

Scope Ratings UK Limited

52 Grosvenor Gardens
London SW1W 0AU
Phone: +44 20 7824 5180
scoperatings.com

Bloomberg: RESP SCOP
info@scoperatings.com
Scope contacts

Disclaimer