JSC MFO Micro Business Capital Issuer Rating Report

B STABLE

Scope's credit view (summary)

The B issuer rating reflects the following credit considerations:

The 'focused' business model assessment is driven by MBC's targeted strategy to provide mainly micro-loans for small businesses and agriculture; its portfolio largely collateralised by real estate and vehicles, which mitigates credit risk; and a stable market share in net loans with an exclusively domestic focus. The company has decided to apply for a microbank licence.

The 'constraining' operating environment assessment reflects the fact that Georgia is a small emerging market that still lags behind regional peers on some economic indicators (e.g. unemployment rate, GDP per capita), despite gradual improvements and reforms in recent years. We note that the MFO sector in Georgia still represents a small part of domestic financial assets (around 2% in 2022) and is less strictly regulated than the banking sector.

The 'developing' long-term sustainability assessment reflects MBC's adequate level of investment and attention to technology and digitalisation as well as its pioneer position in terms of CSR reporting. Nevertheless, the progress made so far is not yet a differentiating factor for the entity's credit profile.

The 'neutral' earnings capacity and risk exposures assessment reflect: i) a strengthened topline due to satisfactory loan growth and the closure of its open foreign exchange position, despite higher personnel expenses and persistently high hedging costs; and ii) historical low levels of cost of risk compared to its main peers.

The 'adequate' financial viability management assessment reflects a reduction on capitalization following a strategy of capital optimisation. The capital buffer to regulatory requirement started to decline in 2021 from what was previously viewed as comfortable. This was driven by i) the very limited retained earnings due to large losses deriving from foreign currency transactions in 2022 and ii) the decision to support the growth of the lending portfolio using the excess capital.

Outlook

The Stable Outlook reflects our view that MBC will continue to work on improving core profitability. MBC's medium-term strategy, which includes the possibility of becoming a microbank, requires an extended period to implement, execute and reach results.

What could move the rating up:

- A track record of sustained and consistent improvements in earnings capacity
- A material improvement in capital metrics and sound liquidity management

What could move the rating down:

- Further pressure on profitability due to a lower ability to generate sustained revenue, higher funding costs and/or higher impairment charges
- Material deterioration in the company's liquidity position as well as in its solvency metrics

Ratings & Outlook

Issuer rating	B
Outlook	Stable

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Bloomberg: RESP SCOP

Issuer profile

MBC was founded in Georgia as a joint stock company in December 2012.

It is a Micro Finance Organization (MFO) operating in the Georgian domestic market only. It lends to micro and small businesses, self-employed individuals operating in trade, services, production and crafts, and households for mortgage and consumer purposes.

Georgian MFOs are regulated by the National Bank of Georgia.

As of June 2023, the company employs 221 people in 17 branches in the main regions of Georgia.

Recent events:

- September 2023: MBC's August 2023 results reflected a satisfactory improvement of its bottom line, driven by better performance of its core income (including net interest income and fee income) and lower hedging costs.
- August 2023: MBC held its annual general shareholder meeting that led to the decision to apply for a microbank licence.
- 2022 results: MBC's net profit fell by about 75% YoY in 2022. driven by large losses deriving from trading in foreign currency due to a foreign open balance sheet position on USD that was closed in September 2022 and higher operating expenses (personnel and other expenses).
- December 2022: MBC issued its first bond for GEL 15m with a maturity of two years and a price of 3M TIBR + 450 bp.

Summary rationale for the rating construct

Step		Assessment	Summary rationale
STEP 1	Operating environment	Very supportive	• Small emerging economy that still lags behind regional peers on some macro indicators (e.g. unemployment rate, GDP per capita), despite gradual improvements and reforms in recent years • MFO sector is concentrated and only started to be regulated in 2017
		Supportive	
		Moderately supportive	
		Constraining	
		Very constraining	
	Business model	Very resilient	• Fourth largest MFO in Georgia • Application for Micro bank licence will enable greater business and funding diversification. • 6% share of MFO net loans, though marginal player in the broader Georgian market.
		Resilient	
		Consistent	
		Focused	
		Narrow	
	Mapping refinement	**High**	• Higher product diversification than some peers in the local MFO market
		Low	
	Initial mapping	**b/b+**	
	Long-term sustainability	Best in class	• MFOs' important role in developing the domestic economy • Company governance shows clear alignment of interests between shareholders and managers, indicating commitment to long-term value • Continual improvement in environmental initiatives and digitalisation
		Advanced	
		Developing	
		Constrained	
		Lagging	
	Adjusted anchor	**b**	
STEP 2	Earnings capacity & risk exposures	Very supportive	• Earnings materially lower than historical levels • Profitability metrics have improved in recent months due to volume growth and the closure of the open foreign exchange position • Sound asset quality metrics compared to most main peers, including a largely collateralised portfolio
		Supportive	
		Neutral	
		Constraining	
		Very constraining	
	Financial viability management	Ample	• Solvency metrics have stabilised but remain significantly lower than historical levels. Tighter buffer to capital requirement • Diversification of funding strengthened after MBC's bond issuance in December 2022 • Increasing financing from international institutions, contributing to long-term foreign currency funding and reducing the reliance on domestic banks
		Comfortable	
		Adequate	
		Limited	
		Stretched	
		At risk	
	Additional factors	Significant support factor	• No additional factor considered
		Material support factor	
		Neutral	
		Material downside factor	
		Significant downside factor	
	Standalone	**b**	
STEP 3	External support	Not applicable	
Issuer rating		**B**	

One of the largest microfinance organisations in Georgia by total assets, with an adequate and stable market share

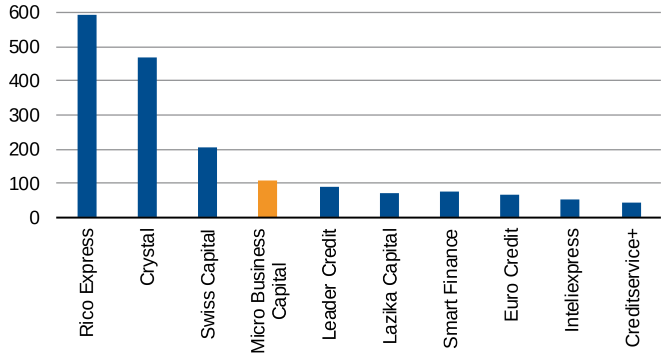
The 'focused' business model assessment is driven by MBC's focus on business and agricultural loans; its portfolio largely collateralised by real estate and vehicles, which mitigates credit risk; and a stable market share in net loans with an exclusively domestic focus. The company has decided to apply for a microbank licence.

The 'constraining' operating environment assessment reflects the fact that Georgia is a small emerging market that still lags behind regional peers on some economic indicators (e.g. unemployment rate, GDP per capita), despite gradual improvements and reforms in recent years. We note that the MFO sector in Georgia still represents a small part of domestic financial assets (around 2% in 2022) and is less strictly regulated than the banking sector.

Fourth largest microfinance organisation in Georgia by total assets

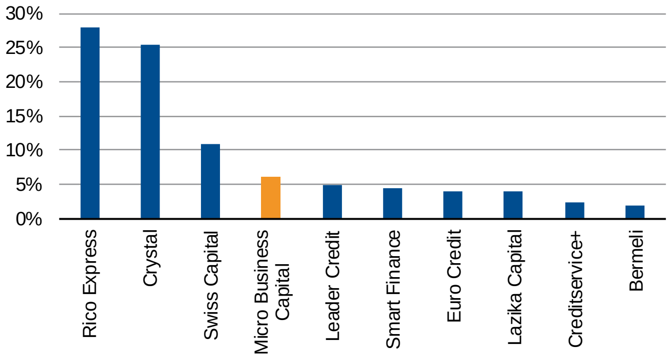
MBC is the fourth largest microfinance organisation in Georgia after Rico Express, Crystal and Swiss Capital. It has GEL 109m (roughly EUR 39m) in total assets and a 6% market share of net loans as of June 2023.

Figure 1: Georgian MFOs ranked by total assets (Q2 2023, GEL m)



Source: NBG, Scope Ratings

Figure 2: Georgian MFOs ranked by market share of net loans (Q2 2023)



Source: NBG, Scope Ratings

Georgia has 34 MFOs and the sector is highly concentrated. The five largest MFOs in Georgia hold 75% of total assets and total net loans in the sector as of June 2023. In terms of loan book composition, Crystal and MBC have high product diversification among (Figure 4).

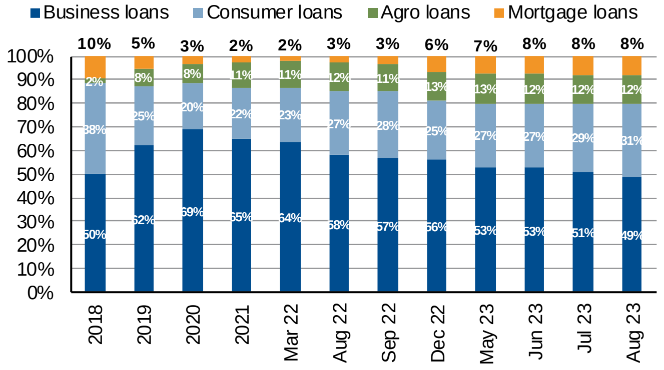
Microfinance organisations' assets represented about 2% of the total Georgian financial system assets as of December 2022 (Box A).

MBC's main financial products include trade and service loans, production and craft activity loans (business loans), consumer loans, agro loans and housing loans.

Business loans: 49% of gross lending as of August 2023

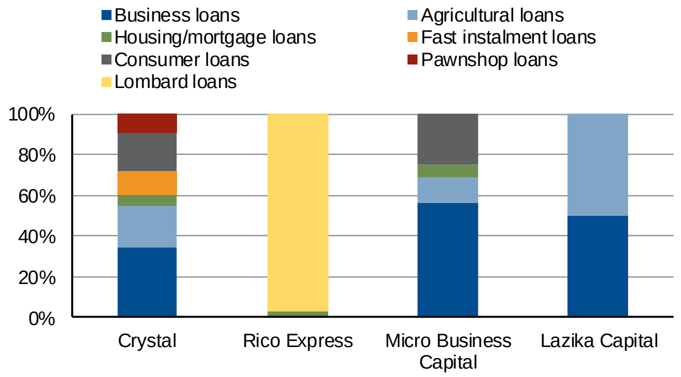
Most of MBC's lending consists of business loans, which represented 49% of gross loans as of August 2023 (Figure 3).

Figure 3: MBC's gross loan portfolio breakdown by product (2018-August 2023)



Source: Company data, Scope Ratings

Figure 4: Loan book composition among main Georgian MFOs by total loans (YE 2022)



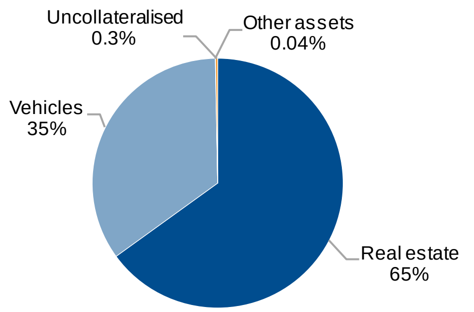
Source: Company data, Scope Ratings

MBC targets its growth mainly on business loans. This is due to the strategic focus on lower-risk borrowers as well as tighter regulation on loan-to-value and payment-to-income ratios. Since 2019, MBC has been growing its agro loan business by expanding into rural Georgia. Consumer lending has increased since 2022 due to a strong demand in the MFO market as well as its high profitability.

Almost all of MBC's portfolio is collateralised

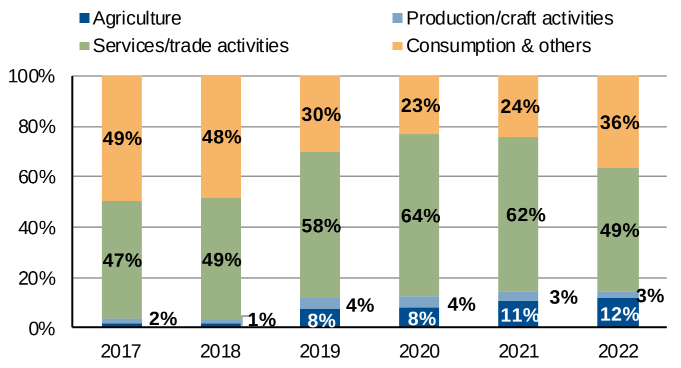
The vast majority of MBC loan portfolio is collateralised by either real estate or vehicles (Figure 5). The weighted average loan-to-value ratio for loans collateralised by real estate and by vehicles amounted to 38% and 51% respectively, as of December 2022. MBC's internal controls and systems assess collateral quality as a key part of its loan approval process.

Figure 5: MBC's gross loans by collateral (December 2022)



Source: Company data, Scope Ratings

Figure 6: MBC's gross loan by product (2017-2022)



Source: Company data, Scope Ratings

Becoming a microbank is the cornerstone of MBC's medium-term strategy

Due to the consolidation of the MFO market in Georgia, MBC has decide as a medium-term strategy to apply for the microbank licence to the National Bank of Georgia (NBG) and receive the microbank status. This will allow to i) start taking deposits by 2024; ii) become an important player in the microbank sector; iii) retain existing clients and attract new ones by enlarging its offer and range of financial products; and iv) access NBG's open market operations for liquidity support.

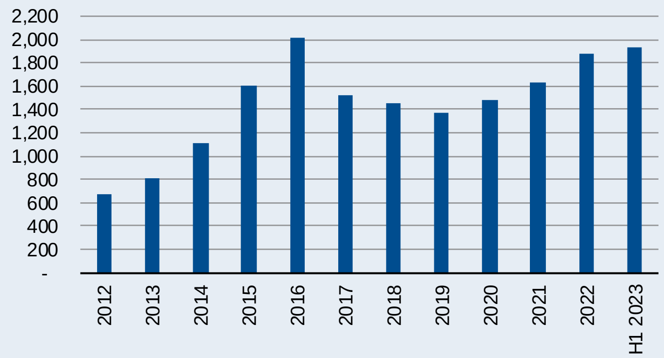
MBC will continue to access funding from International financial institutions (IFIs), growing its agricultural loan portfolio and improving efficiency to achieve a competitive size in the market.

Box A: Overview of the microfinance organisations (MFO) sector in Georgia

MFOs are playing an increasingly important role in the development of Georgia's financial sector and economy. Their key role is to provide loans and other financial services to people generally excluded from traditional banking channels, such as lower-income individuals, the self-employed, micro businesses and SMEs, helping them prosper and gain access to the financial system.

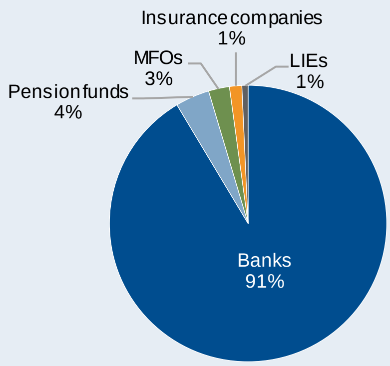
Although MFOs still only account for a very limited share of the Georgian financial system (about 2% as of December 2022), the sector's total assets have grown approximately threefold since 2012, reaching GEL 1.9bn as of June 2023.

Figure 7: Georgian MFO sector total assets (GEL bn, 2012-H1 2023)



Source: NBG, Scope Ratings

Figure 8: Georgian financial sector structure by total assets (2022)



LIEs: loan-issuing entity

Source: NBG, Scope Ratings

High mapping refinement

The combination of the operating environment ('constraining') and the business model ('focused') points to an initial mapping in the B category. Compared to domestic peers mapped in the same rating category, MBC benefits from a higher degree of product diversification (business loans, consumer loans, agricultural loans and mortgage loans), leading to refine the initial mapping to b/b+.

Box B: Focus on MBC's country of domicile: Georgia

Macroeconomic assessment – key credit considerations

- Georgia is a small, open and emerging market economy with a GDP per capita of USD 6,672 as of December 2022. Georgia is a net importer, with China as its largest trading partner (13% of total foreign trade turnover), followed by Azerbaijan (12%), Russia (12%), Armenia (11%) and Turkey (8%) in 2022. Its main exporting sectors as of end-2022 were manufacturing (33%), wholesale and retail trade (27%), and transport and storage (18%).
- Georgia's GDP grew by 3.8% over 2010-2020, more than neighbouring countries and several Eastern European states (3%). This was mainly driven by the government's economic reforms, which were tilted towards business-friendly policies (low taxes, free market-oriented economy), and by higher domestic consumption, higher exports and a significant rise in tourism.
- Credit weaknesses stem from continuous domestic political tension between the government and the opposition, structural unemployment, a highly dollarised banking system, a material dependence on tourism and historical geopolitical tensions with Russia due to the self-proclaimed independent regions of South Ossetia and Abkhazia.
- Georgia's weighted average unemployment rate rose to 20.6% in 2021 from 17.6% in 2019 due to the pandemic and lockdowns. Nonetheless, the job market has improved moderately in the last year, with unemployment decreasing to about 16.7% in June 2023, lower than in 2010-2018.
- The country's population is shrinking and is now below 3.7m from a peak of 5m in 1993, due to emigration to countries with better economic conditions.

Key economic indicators	2020	2021	2022	2023F	2024F
GDP per capita (USD'000s)	4.2	5.0	6.8	NF	NF
Real GDP, % change	-6.8	10.4	10.2	7.5	6.1
Unemployment rate, %	12.0	13.6	11.6	17.1	16.8
CPI, % change	5.2	9.6	11.9	NF	NF
Policy rate, %	8.00	10.50	11.00	9.50	7.50
General government debt, % of GDP	60	49	49	37	38

NF: not forecasted

Source: Scope Ratings, SNL

Soundness of the banking and MFO sector – key credit considerations

- The Georgian domestic financial sector is dominated by commercial banks, accounting for over 90% of assets. Pension funds, insurance companies, MFOs and loan-issuing entities account for less than 10% of total assets.
- As of June 2023, 34 MFOs operate in Georgia. The sector comprises a diverse set of players, some concentrated in specific products like Rico Express and others covering a broader product range.
- MFO loans include consumer loans, representing 80% of the total as of June 2023, followed by trade and services loans (11%), agriculture and forestry loans (7%) and other types (2%).
- The share of consumer loans has been growing: in 2012 they made up just 34% of the total portfolio, with agriculture and forestry loans (28%) and trade and services loans (27%) as the remaining contributors to the portfolio.
- The MFO sector is highly concentrated: the five largest MFOs hold 75% of total assets and total net loans of the sector as of June 2023. Since 2016, the number of active MFOs has more than halved due to continual, material regulatory changes largely introduced from 2017 onwards.
- Key regulations introduced since 2017 include: i) loans up to GEL 200,000 can only be issued and extended in GEL; ii) minimum threshold of GEL 100,000 for borrowings from each individual when there are more than 20 individual investors; iii) higher cap on the effective interest rate to 50% from 100%; iv) minimum regulatory capital of GEL 1m; v) minimum capital and liquidity coefficients of 18% each; vi) macroprudential policy instruments such as payment-to-income and loan-to-value encouraging responsible lending practices; and vii) development of a new regulatory framework for new entities defined as microbanks.

Banking system indicators	2018	2019	2020	2021	2022
ROAA, %	2.7	2.9	1.3	3.0	3.3
ROAE, %	18.6	20.3	10.2	22.3	23.3
Net interest margin, %	6.0	5.3	4.4	4.8	5.2
CET1 ratio, %	13.9	13.3	12.5	14.3	17.1
Problem loans/gross customer loans, %	4.8	3.6	5.6	3.9	3.0
Loan-to-deposit ratio, %	117.5	124.3	114.9	118.1	102.7

ROAE: return on average equity
CET1: Common Equity Tier 1
NF: not forecasted

Source: Scope Ratings, SNL

Adequate governance model, continuous investment in digital capabilities to strength its market positioning and strengthening its social impact

The 'developing' long-term sustainability assessment reflects MBC's continuous investment and attention to technology and digitalisation as well as its pioneer position in terms of CSR reporting. Nevertheless, the progress made so far is not yet a differentiating factor for the entity's credit profile.

Figure 9: Exposure and management of key ESGD factors[1]

Source: Scope Ratings

Governance

MBC's governance model is adequate compared to peers. All members of top management hold shares in the company, indicating a commitment to the company's long-term value.

The company's current shareholder structure would likely not change if it became a microbank. However, some minor common and/or preferred stock (1%-2% range) might be distributed to existing shareholders due to a slight change in capital requirements.

The company has a clear strategy in terms of transparency and social impact. For the second year in a row, MBC has won the Transparency Bartas Honorary Award within the category of small and medium business as a result of its quality of reporting and transparency. It also received the Global Banking and Finance Review Awards in the category of 'Best Microfinance Company Georgia 2022' and 'Non-Banking Financial Institution Brand of the Year Georgia 2022'.

Digital capabilities

MBC has been making major investments in technological development, digital services, new software, licences, cybersecurity, and online and external channels. The company uses third party software from Alta software, which is a leading financial software provider in Georgia, counting all major Georgian banks among its customers. The transformation to a microbank will require further investment, but execution risk is mitigated by the software provider's established banking expertise. For MBC, the IT transition will consist in the implementation of core banking modules, including IFRS accounting, real-time gross settlements, the SWIFT platform, as well as deposit modules and internet banking. We do not consider these requirements and IT changes a disruption for the strategy as the entity is actively managing the process.

Environmental factors

Unlike most of its domestic peers, MBC has been publishing a corporate social responsibility report since 2019. In the past year, MBC has been involved in different initiatives and events focused on the environment and sustainability. Examples include participating in the panel discussion of the impact-oriented investment conference Impact in Neighbourhood and attending the first working meeting of Sustainable Development Goals Innovations Accelerator at Caucasus University.

[1] The overview table illustrates how each factor informs our overall long-term sustainability assessment. The materiality table shows how we view the credit relevance of each factor for the industry at large. The exposure table shows how we see the issuer's degree of exposure to each ESG-D factor. The management table shows how we view the issuer's management of these exposures.

Social factors

The role of MFOs in empowering local communities, improving financial inclusion and developing the domestic economy weighs positively on MBC's strategy and it is already captured in our business model assessment.

MBC has been active in several initiatives and events focused on the social factor. Examples include participating in the United Nations Women's Organization meeting in Baku, taking part in the study tour in Oslo organised by the United Nations' Women Georgia and attending the UN Global Compact Network's event among others.

MBC joined the United Nations Women's Empowerment Principles in 2019. The company is also a member of United Nations Global Compact and United Nations Women.

Improving earnings capacity, although weaker than historical levels; asset quality indicators remain resilient

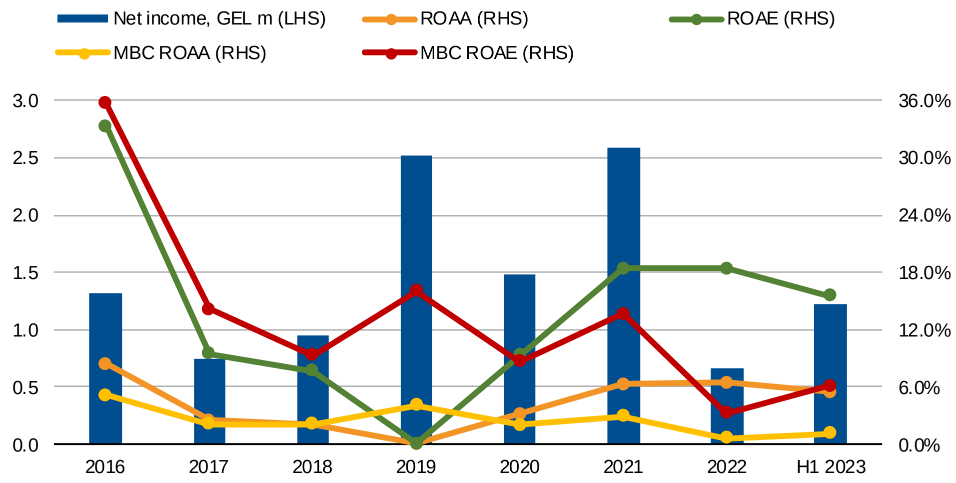
The 'neutral' earnings capacity and risk exposures assessment reflect: i) a strengthened topline due to satisfactory loan growth and the closure of its open foreign exchange position, despite higher personnel expenses and persistently high hedging costs; and ii) historical low levels of cost of risk compared to its main peers.

Adequate returns in past years compared to peers, although this trend has reversed

Since 2016, MBC's profitability has been volatile: after ups and downs in parallel with the company's growth in 2016-2019 it has suffered in 2020 from the impacts of limited portfolio growth and increasing hedging costs, and in 2022 from losses on foreign currency trading related to an open USD FX balance sheet position.

Despite a weak performance in the first months of 2023 due to higher provision expenses and lower credit recoveries caused by understaffing issues, MBC's profitability metrics have improved satisfactorily over the following months, almost doubling in August 2023 the year-end 2022's bottom line. This improvement was driven by i) an encouraging performance in its core income (net interest income and fee income), which rose by 15% due to larger volume growth; and ii) lower hedging costs caused by the progressive interest rate cuts by the NBG.

Figure 10: Profitability, MBC versus MFO sector (IFRS, GEL m, 2016 to H1 2023)



Note: Metrics for half-year have been annualised
Source: NBG, Company data, Scope Ratings

Cost of risk has been one of the main sources of bottom-line volatility. The cost of risk peaked in June 2020 at 8.8%. This was due to the NBG requiring 5% of general provisions raised on the loan portfolio, though this declined to 2.6% because the regulator acknowledged MBC's lower risk profile compared to peers. MBC's cost of risk has materially decreased since then and stood at 2.5% as at August 2023. We expect MBC's cost of risk to continue declining in 2023 and 2024, stabilising around the levels seen in H2 2022, due to the improvement already seen in loan recoveries once the temporary shortage of key workers was fixed.

Improving profitability during the first eight months of 2023 due to volume growth and lower hedging costs

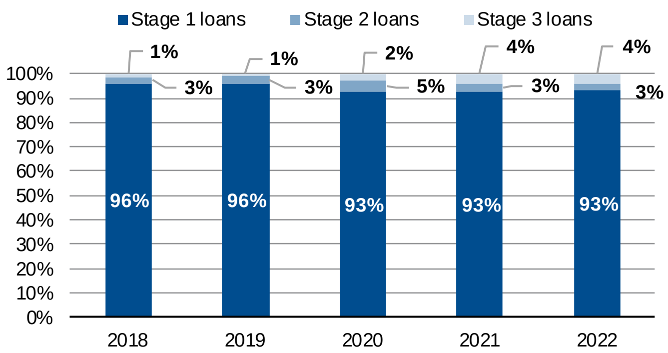
We expect this positive trend to continue and provide some relief in terms of earning capacity by YE2023, as the objective to become a microbank will require stability of earnings. However, we note the significant gap of MBC in term of profitability compared to peers. In NBG's generally accepted accounting principles standards, MBC's annualised return on average equity was 6.1% and its annualised return on average assets was 1.1% in June 2023. These are below the annualised sector averages of 15.5% and 5.5% respectively.

Adequate asset quality metrics compared to its main peers

After some volatility due to the Covid-19 pandemic, asset quality has reached a certain stabilization (Figure 12). In August 2023, total past due loans decreased to 2.7% of gross loans, from 3.4% in December 2022; loans past due > 30 days decreased to 1.4% (from 1.8%) and restructured loans amounted to 1.2% of gross loans (from 1.6%).

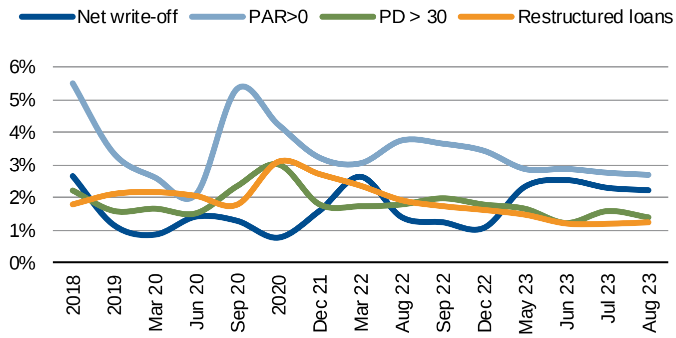
Due to the large portion of collaterised loans in the portfolio, MBC's loan losses are limited. Net write-offs represented 2.2% of gross loans in August 2023, up from 1% and 1.6% in 2022 and 2021, respectively. We expect these losses to decrease and stabilise in the near future to around 2% due to a normalisation of the speed for collections, after the temporary shortage of employees was fixed earlier this year.

Figure 11: Gross loan portfolio by stage, under IFRS accounting standards



Source: Company data, Scope Ratings

Figure 12: Asset quality metrics according to Georgian local GAAP (% over gross loans)



PAR: portfolio at risk, PD: past due
Source: Company data, Scope Ratings

Adequate funding profile and liquidity; capital optimization strategy has resulted in lower buffer above requirements compared to historical levels

The 'adequate' financial viability management assessment reflects the change in capitalisation strategy with an optimisation through lower buffer to requirement compared to the past.

Tighter buffer to capital requirement

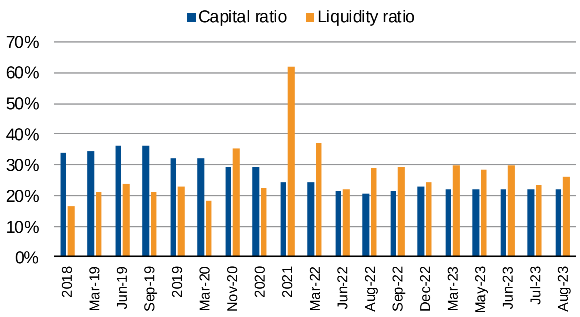
Solvency metrics stabilised in 2023 after some volatility due to amortisations of subordinated loans and extension of its maturity to strengthen capital ratios. Compared to the period 2018-2021 where MBC's loan growth was still contained, capital is now optimised with what is in our view a moderate buffer to minimum requirements, considering the nature of the business. As of August 2023, MBC's capital adequacy ratio is 22%, 4 pp above the central bank's requirement and 3 pp above the financial institutions covenant requirement.

We expect MBC's capitalisation strategy to remain optimising resources and supporting growth, also under the scenario of becoming a microbank. We would expect therefore a steady trend of organic capital generation as the business growths.

MBC's liquidity ratio showed some volatility since 2021 due to the tight conditions for refinancing coupled with costly hedging for funds in FX. The management improved liquidity targeting a reduction on funding costs taking advantages of windows of better rates. As of August 2023, the liquidity ratio is 26% (8 pp above the requirement), still above the levels seen over 2018-2020. Under the National Bank of Georgia's regulation, MFOs must hold at least 18% of cash against debt maturing within six months.

We should expect that under the scenario of MBC to become a microbank, liquidity will be easier to manage as deposits would provide additional long-term resources.

Figure 13: MBC's capital and liquidity ratios, Georgian Local GAAP



Source: Company data, Scope Ratings

Figure 14: Regulatory ratios, Georgian Local GAAP

	NB requirement	2018	2019	2020	2021	Mar-23	Jun-23	Jul-23	Aug-23
Capital coefficient	Min 18%	34.1%	31.9%	29.5%	24.3%	22.2%	22.0%	21.9%	22.0%
Liquidity coefficient	Min 18%	16.5%	23.2%	22.5%	62.2%	29.9%	29.7%	23.6%	26.1%
Property investment coefficient	Max 40%	13.1%	13.2%	13.0%	14.3%	14.0%	13.3%	13.0%	12.7%
Investment coefficient	Max 15%	0%	0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Insider coefficient	Max 15%	0%	0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pledged asset coefficient	Max 90%	205.8%	209.8%	175.7%	106.0%	84.7%	83.3%	77.1%	82.0%

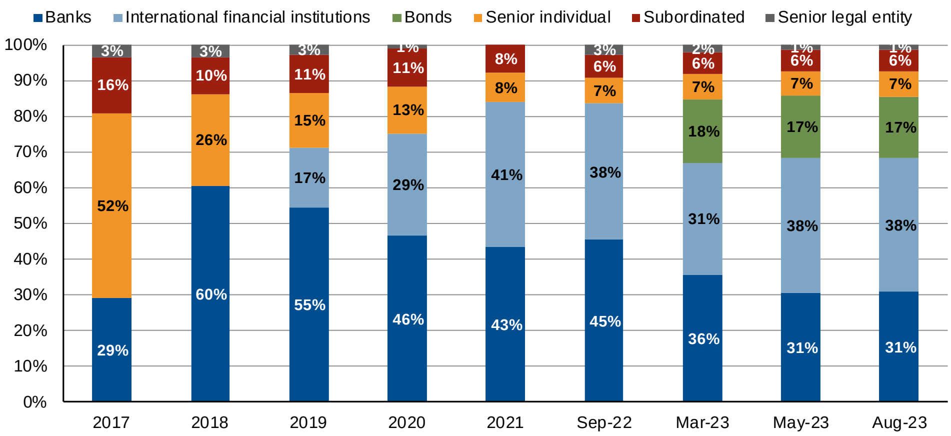
Source: Company data, Scope Ratings

MBC has had to diversify its funding from 2017, when Georgian legislation began prohibiting MFOs from taking deposits and limited individual borrowings to above GEL 100,000 (the minimum threshold for borrowings and an investor base of more than 20 individuals). Since then MBC has been able to reduce its dependence on funding from domestic banks and enlarged its funding access to international financial institutions.

As of August 2023, most major Georgian banks provide secured funding to MBC. International financial institutions have become the most important funding source, with around 38% of total funding as of August 2023. In addition, MBC's was able to issue its first corporate bond in December 2022, for an amount of GEL 15m and tenor 2-years, to partially replace borrowing from commercial banks, diversifying further its funding structure.

We consider that obtaining a microbank licence will enable MBC to take deposits and receive funds in domestic currency. Combined with the issuance of bonds in domestic currency, we believe this will represent an important milestone to diversify funding and reduce funding costs.

Figure 15: MBC's funding structure



Source: Company data, Scope Ratings

Foreign currency risk

Due to the Georgian government's larisation programme, which started in 2017, the share of US dollar loans in MBC's portfolio fell to just 2% in 2022 from 35% in 2017. In terms of liabilities, there is a significant foreign currency mismatch given that 47% of longer-term funding is in US dollars as of August 2023. We view positively the fact that MBC now hedges all its liabilities via domestic bank swaps or back-to-back loans to avoid any potential foreign exchange risk.

Figure 16: MBC's funding structure (2020-August 2023)

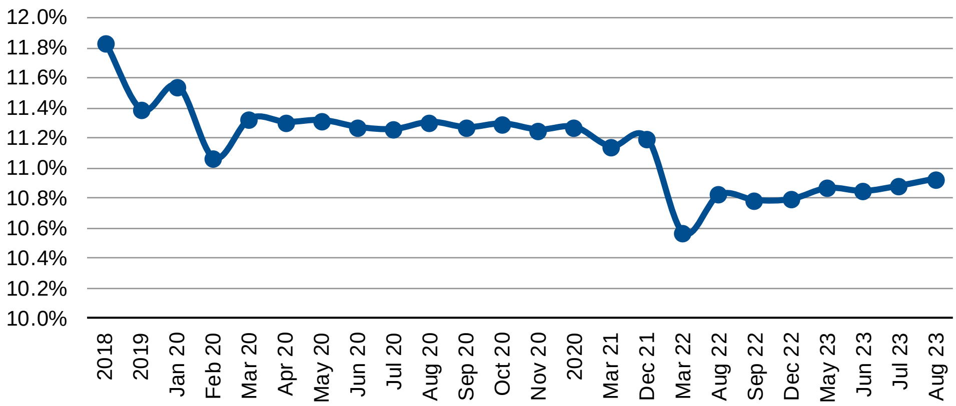
	Dec 2020		Aug 2023	
Currency	Average interest rate	% of outstanding in GEL	Average interest rate	% of outstanding in GEL
EUR	5.5%	0%	3.3%	0%
GEL	13.7%	47%	14.4%	53%
USD	7.4%	53%	6.6%	47%

Source: Company data, Scope Ratings

Pricing on EUR and US dollar funding has improved since December 2020, with the company slightly reducing its reliance on US dollars (down from 53% to 47%). However the FX volatility observed in 2022 and first half of 2023 increased hedging costs, which were equivalent to 22% of net revenue before foreign exchange income in 2022. MBC expects these costs to decrease in 2023 and 2024 as the company has not recently been borrowing in foreign currency, focusing only on domestic currency, whose policy rate has been continuously decreasing since May 2023.

MBC's cost of funding remained fairly stable between March 2020 and December 2021, with an average cost of 11.3%. Lower interest rates on US dollar financing helped MBC drive down its cost of funding during 2022, to 10.6%. However, this downward pattern has reversed slightly due to higher interest rates on GEL and US dollars. MBC's cost of funding has thus increased to 10.9% as of August 2023. We expect that the funding coming from deposits should provide some stability in funding cost, however, the price to capture and maintain a stable base of deposits is a challenge for a new player as a microbank in our view.

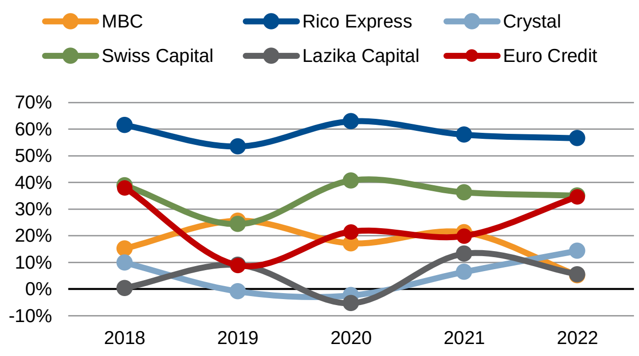
Figure 17: MBC's cost of funding (2018-August 2023)



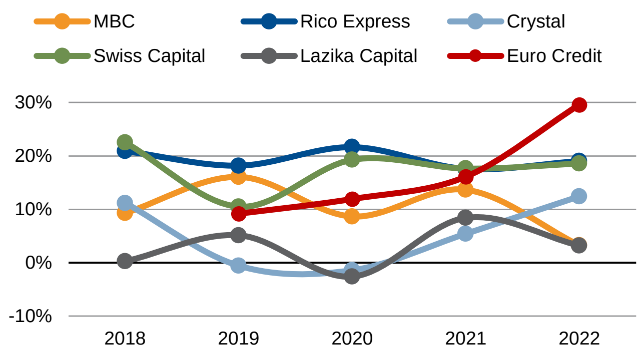
Source: Company data, Scope Ratings

I. Appendix: Peer comparison

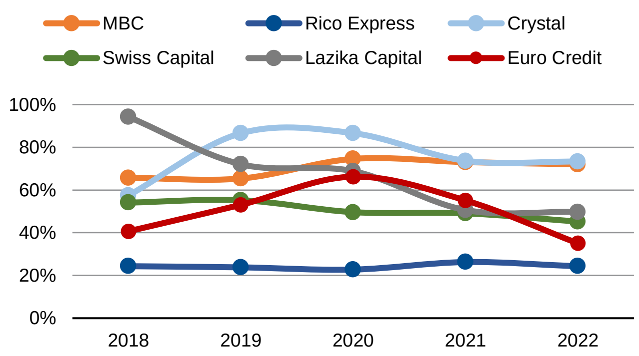
Net profit margin (%)



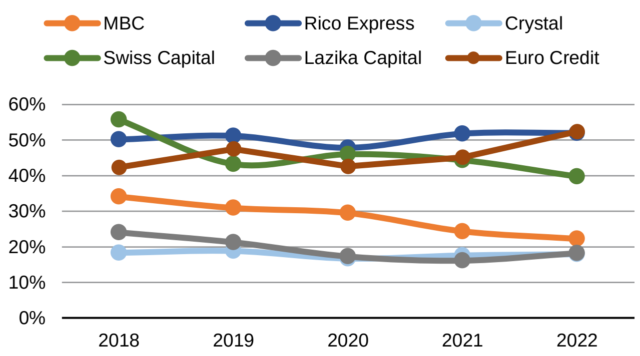
Return on average equity (%)



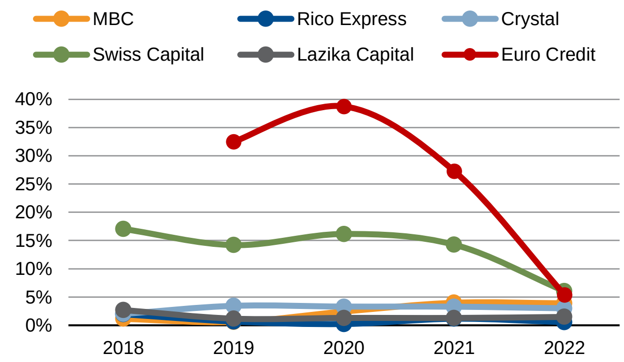
Cost-to-income (%)



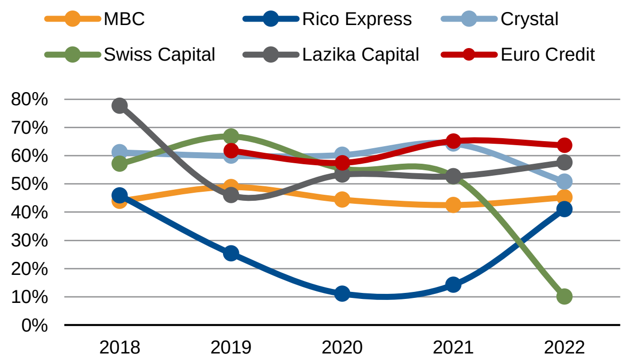
Capital adequacy ratio (%)



Stage 3 ratio (%)



Stage 3 coverage ratio (%)



Note: Figure for Euro Credit's return on average equity for 2018 was not included due to a large positive number disrupting the chart. Return on average equity for Euro Credit for 2018 amounted to about 89%.

National peers: Rico Express, Crystal, Swiss Capital, Lazika Capital, Euro Credit

Source: Company data, Scope Ratings

II. Appendix: Selected financial information – JSC MFO Micro Business Capital

	2018Y	2019Y	2020Y	2021Y	2022Y
Balance sheet summary (GEL '000)					
Assets					
Cash and cash equivalents	1,771	3,046	2,673	13,879	6,778
Loans to customers	48,348	58,219	66,858	72,817	90,241
Property and equipment	1,933	2,262	2,404	2,880	2,785
Intangible assets	236	262	237	327	407
Deferred tax assets	346	194	356	394	137
Right-of-use assets	0	4,483	4,050	5,328	5,511
Current tax assets	0	0	0	0	267
Other assets	1,020	1,391	1,624	1,545	4,109
Total assets	**53,654**	**69,857**	**78,202**	**97,170**	**110,235**
Liabilities					
Subordinated borrowings and other borrowed funds	38,429	48,084	54,928	70,146	84,214
Subordinated debt	0	0	0	0	0
Lease liabilities	0	4,700	4,947	5,941	5,348
Current tax liability	186	19	0	0	0
Other liabilities	370	355	765	790	719
Total liabilities	**38,985**	**53,158**	**60,640**	**76,877**	**90,281**
Share capital	2,185	2,200	2,225	2,250	2,255
Share premium	852	900	996	1,117	1,136
Preference shares	7,347	7,347	7,347	7,347	7,464
Retained earnings	4,285	6,252	6,994	9,579	9,099
Accumulated deficit	0	0	0	0	0
Current year profit/loss	0	0	0	0	0
Total equity	**14,669**	**16,699**	**17,562**	**20,293**	**19,954**
Total liabilities and equity	**53,654**	**69,857**	**78,202**	**97,170**	**110,235**
Income statement summary (GEL '000)					
Interest income	11,284	14,080	15,858	20,123	22,684
Interest expense	-4,172	-4,971	-6,290	-7,270	-8,273
Net interest income	7,112	9,109	9,568	12,853	14,411
Fee and commission income	1,293	1,658	1,647	1,923	2,268
Net foreign exchange income/(loss)	-458	-853	-3,776	1,356	4,821
Net (loss)/ income from trading in foreign currency	-213	480	1,955	-3,515	-8,658
Operating income	**7,734**	**10,394**	**9,394**	**12,617**	**12,842**
Impairment losses on debt financial assets	-1,523	-554	-748	-458	-853
Personnel expenses	-2,988	-4,187	-4,238	-5,836	-6,947
General administrative expenses	-2,095	-2,605	-2,773	-3,388	-4,034
Profit before income tax	**1,128**	**3,048**	**1,635**	**2,935**	**1,008**
Income tax expense	-182	-528	-152	-350	-351
Profit for the year	**946**	**2,520**	**1,483**	**2,585**	**657**

Source: Company data, Scope Ratings

III. Appendix: Selected financial information – JSC MFO Micro Business Capital

Earnings and profitability	2018	2019	2020	2021	2022
Yield on gross loans (%)	22.9%	23.9%	23.1%	26.8%	24.3%
Cost of funding (%)	10.9%	10.3%	11.5%	10.4%	9.8%
Net interest income/ operating income (%)	92.0%	87.6%	101.9%	101.9%	112.2%
Net fees & commissions/ operating income (%)	16.7%	16.0%	17.5%	15.2%	17.7%
FX income / operating income (%)	-5.9%	-8.2%	-40.2%	10.7%	37.5%
Trading income / operating income (%)	-2.8%	4.6%	20.8%	-27.9%	-67.4%
Cost/ income ratio (%)	65.7%	65.3%	74.6%	73.1%	85.5%
Impairment on financial assets / pre-impairment income (%)	57.5%	15.4%	31.4%	13.5%	45.8%
Loan loss provisions / average gross loans (%)	2.0%	1.4%	2.7%	3.1%	3.8%
Return on average assets (%)	2.1%	4.1%	2.0%	2.9%	0.6%
Return on average equity (%)	9.3%	16.1%	8.7%	13.7%	3.3%
NBG covenants	**2018**	**2019**	**2020**	**2021**	**2022**
Capital adequacy ratio (%)	34.1%	31.9%	29.5%	24.3%	22.8%
Liquidity ratio (%)	16.5%	23.2%	22.5%	62.2%	24.5%
Pledged assets to equity ratio (%)	205.8%	209.8%	175.7%	106.0%	66.4%
Asset mix, quality and growth	**2018**	**2019**	**2020**	**2021**	**2022**
Net loans/ assets (%)	90.1%	83.3%	85.5%	74.9%	81.9%
Past due > 30 / tangible equity & reserves (%)	18.6%	11.1%	29.4%	28.0%	40.2%
Past due > 30 / total gross loans (%)	2.7%	1.7%	3.0%	1.8%	1.8%
Loan loss allowance for stage 2 & 3 loans / Past due > 30	34.4%	30.3%	35.1%	40.3%	39.9%
Net loan growth (%)	44.5%	20.4%	14.8%	8.9%	23.9%

Source: Company data, Scope Ratings

Note: Ratio calculation

a) Yield on gross loans (%) = interest income/total gross loans to customers

b) Cost of funding (%) = interest expense/total borrowings

c) Capital adequacy ratio (%) = (total equity - asset revaluation reserve - intangible assets - investments in subsidiaries) / (total assets - asset revaluation reserve - intangible assets - investments in subsidiaries)

d) Liquidity ratio (%) = cash and cash equivalents/(total liabilities - debts maturing after six months)

e) Return on average assets (%) = net income/average assets

f) Return on average equity (%) = net income/average equity

g) Profit margin (%) = net income/gross financial margin

h) Leverage (%) = debt/equity

i) Stage 3 ratio (%) = Stage 3 loans (or past due over 90 days)/total gross loans

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