JSC MFO Micro Business Capital Issuer Rating Report

NEGATIVE
B+

Scope's credit view (summary)

The B+ issuer credit rating on MBC reflects the following rating considerations:

- MBC ranks among the largest Georgian microfinance organisations (MFOs), with a business model mainly focused on collateralised micro and agro loans. Its market share has been resilient in recent years. MBC is considering applying for a microbank licence. In our view, such a licence would enhance the resilience of MBC's business model, further diversify its funding, reduce financing costs, and grant access to a larger potential market. However, this can only happen later and not before summer 2023 due to continuous delays in the implementation of the law.

- MBC's funding profile has benefited from its access to international financial institutions that offer funding in foreign currency, reducing its reliance on a few commercial banks. Foreign currency mismatch is material, however, with 50% of funding in US dollars and a small portion of foreign currency loans as of September 2022. Hedges are in place but their cost weighs on earnings: In 2021 they represented 20% of net revenue before foreign exchange costs.

- Profitability indicators worsened during the first half of 2022, driven by a trading loss on an open balance sheet position in US dollars and an increase in personnel expenses. The US dollar position was closed as of September 2022, alleviating some pressure on profitability.

- The pressure on profitability also caused a material decline in solvency metrics during the last 18 months. The capital adequacy ratio reached 21.6% at end-September 2022 (end-March 2022: 24.5%), although this is still 360 bp above the central bank's requirement. At the same time, MBC tightened its liquidity management. The liquidity ratio is 11 pp above the central bank's requirement, at around 29% as of September 2022.

- Asset quality metrics have remained sound compared to those of the company's main peers. At end-September 2022, loans past due by more than 30 days comprised 2% of gross loans (and about 63% are covered), while restructured loans comprised 1.7% of gross loans.

- MBC remains active in environmental, social and governance areas and preparing for the digital transition (ESG factor). It is especially strong in social and governance aspects. We acknowledge the role of microfinance organisations in empowering local communities, improving financial inclusion, developing the domestic economy, and increasing their relevance for its clientele.

One or more key drivers of the credit rating action is considered an ESG factor.

Outlook

The Negative Outlook reflects our view on the challenges MBC is facing given its more challenging operating environment, higher refinancing costs and their impact on profitability, tighter management of buffers above the minimum capital requirement, and a tighter liquidity position.

We could revise the Outlook to Stable if MBC's profitability, capital and liquidity metrics stabilised close to end-2020 levels, thereby sustainably improving buffers above the minimum solvency metrics.

We would lower the rating if, in the context of challenging operating conditions, MBC continued to operate under profitability pressure and with tight capital and liquidity positions.

Ratings & Outlook

Issuer rating	B+
Outlook	Negative

Lead Analyst

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

Team Leader

Marco Troiano, CFA
m.troiano@scoperatings.com

Scope Ratings UK Limited

52 Grosvenor Gardens
London SW1W 0AUR

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Issuer profile

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

It is an MFO operating only in the Georgian domestic market. It lends to micro and small business, self-employed individuals operating in trade, services, production and crafts, and households for mortgage and consumer purposes.

Georgian microfinance organisations are regulated by the National Bank of Georgia.

As of September 2022, the company employs 241 people in 17 branches in the main regions of Georgia.

Recent events

- *H1 2022 results:* MBC reported a net profit of GEL 81m, a decline of approximately 97% on a yearly basis. This material reduction was largely driven by significant losses deriving from trading in foreign currency (caused by the current foreign open balance sheet position on USD) and higher personnel expenses. The company’s top line (net interest income plus fee and commission income), however, rose by 5% YoY due to rapid volume growth during the year.
- *H1 2022:* Continuation of the expansion strategy with the opening of three new service centres during the first half of 2022.

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

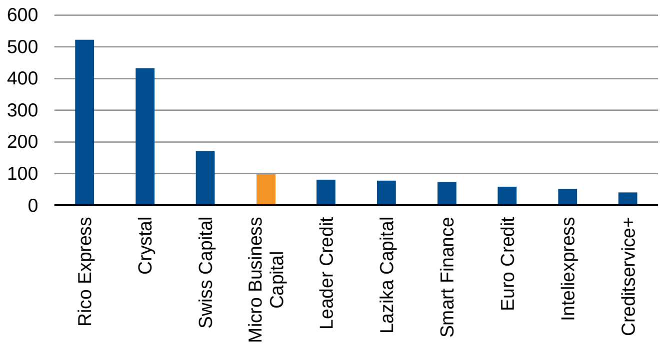
The "focused" business model assessment is driven by MBC's focus on business and agro loans, largely collateralised portfolio by real estate and vehicles which mitigates credit risk and an important market share in net loans within the sector but with a domestic focus only.

The "constraining" operating environment assessment reflects our view that Georgia is a small emerging market that still lags behind regional peers on most economic indicators, despite gradual improvements and reforms in recent years. The microfinance sector, in which MBC operates, represented only 3% of the total assets of Georgia's financial sector as of December 2021.

Fourth largest microfinance organisation in Georgia by total assets

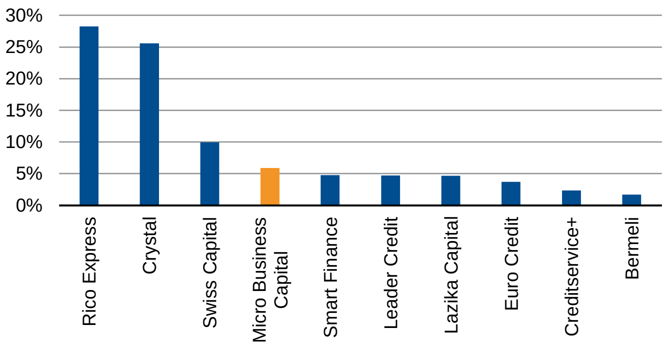
MBC is the fourth largest microfinance organisation in Georgia after Rico Express, Crystal and Swiss Capital. It has GEL 97m (roughly EUR 35m) in total assets and a 5.9% market share of net loans as of September 2022.

Figure 1: Georgian MFOs ranked by total assets (Q3 2022, GEL m)



Source: NBG, Scope Ratings

Figure 2: Georgian MFOs ranked by market share of net loans (Q3 2022)



Source: NBG, Scope Ratings

Georgia has 37 MFOs and the sector is highly concentrated. The five largest MFOs hold 73% of total assets and 74% of total net loans in the sector as of September 2022. In terms of loan book composition, Crystal and MBC have high product diversification among the largest microfinance organisations in Georgia (Figure 4).

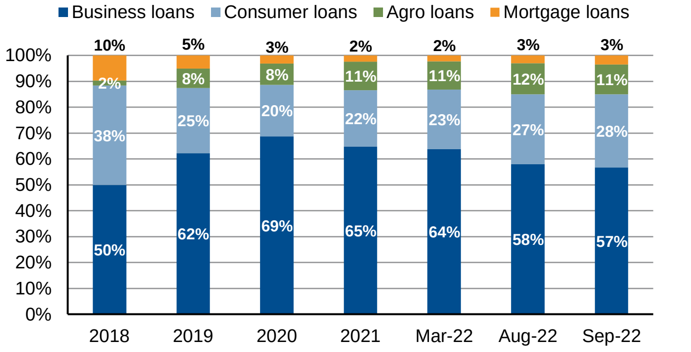
Microfinance organisations' assets represented 3% of the total Georgian financial system assets, compared to 96% for commercial banks as of December 2021 (Box A)

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: 57% of gross lending as of September 2022

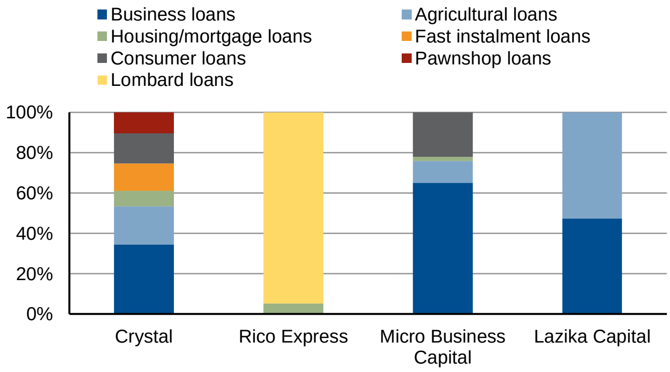
Most of MBC's lending consists of business loans, which represented 57% of gross loans as of September 2022 (Figure 3).

Figure 3: MBC's gross loan portfolio breakdown by product (2018-September 2022)



Source: Company data, Scope Ratings

Figure 4: Loan book composition among main Georgian MFOs by total loans (2021)



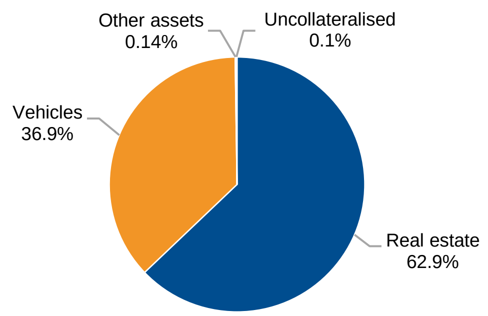
Source: Company data, Scope Ratings

In recent years, the share of business loans has far surpassed that of consumer and housing loans. This is due to a strategic focus on lower-risk borrowers as well as tighter regulation of loan-to-value and payment-to-income ratios. Since 2019, MBC has been growing its agro loan business by expanding into the rural areas of Georgia. We expect MBC to keep at least 70% of its portfolio in business and agriculture loans in the medium term in order to meet the requirement for microbank eligibility.

Practically the entire portfolio is collateralised

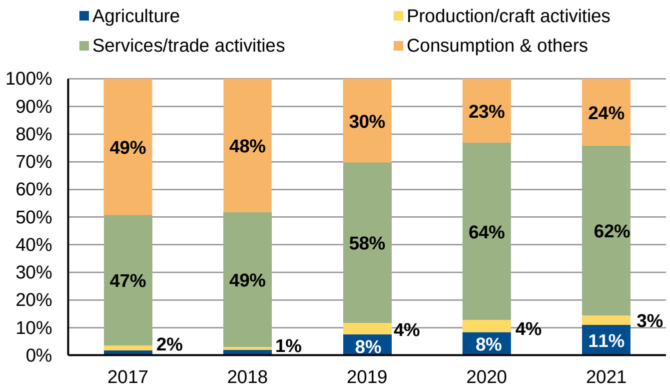
As of December 2021, over 99% of MBC's gross loans were collateralised by real estate (around 63%) or vehicles (around 37%), which we consider beneficial as it largely reduces the issuer's credit risk. MBC's internal controls and systems assess collateral quality as part of its loan approval process, which is divided into an inspection phase and a benchmarking phase.

Figure 5: MBC's gross loans by collateral (December 2021)



Source: Company data, Scope Ratings

Figure 6: MBC's gross loan by product (2017-2021)



Source: Company data, Scope Ratings

Agro loans constitute the cornerstone of MBC's medium-term strategy

MBC's short-term strategy until 2022 targets i) significant growth in agro loans to 16% of gross lending; ii) moderate growth in business loans to about 55% of gross lending; iii) temporary growth in consumer and other loans to 23% of gross lending; and iv) material expansion of the branch network across Georgia. We understand medium term strategy will be adapted depending on progress made with regards to the micro bank status eligibility.

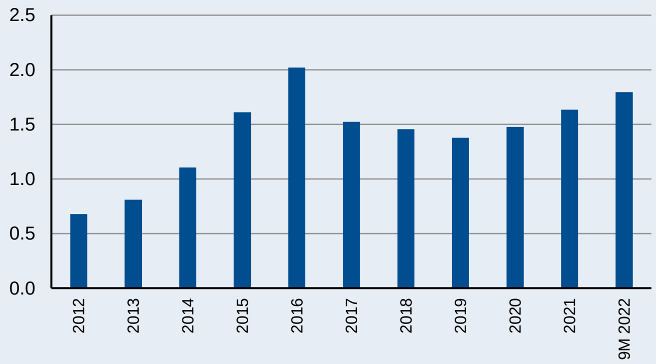
Box A: Overview of the role of microfinance organisations (MFOs) in Georgia

Microfinance organisations (MFOs) are gradually playing a more important role in the development of Georgia's financial sector and economy.

They play a key role providing 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.

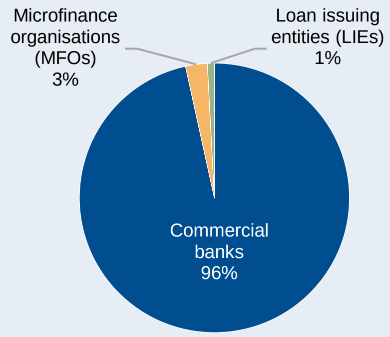
Although microfinance organisations still only account for a very limited share of the Georgian financial system (3% as of December 2021), the sector's total assets have grown approximately 2.5x since 2012, totalling GEL 1.8bn as of September 2022.

Figure 7: Georgian MFO sector total assets (GEL bn, 2012-9M 2022)



Source: NBG, Scope Ratings

Figure 8: Georgian financial sector structure by total assets (2021)



Source: NBG, Scope Ratings

Box B: National Bank of Georgia (NBG)'s draft bill on future framework for microbanks

The draft bill has been under discussion from 2021 and for now the only available financial highlights are as follow:

1) Minimum capital of GEL 10m
2) 70% of portfolio must be business or agriculture loans.
3) Loan limit up to GEL 1m

Box C: The economic and MFO operating environment in Georgia

Economic assessment - Key credit considerations:

- Georgia is a small, open, emerging market economy with a GDP per capita of USD 5,015 as of December 2021. It is a net importer, with Turkey as its largest trading partner (15% of total foreign trade turnover), followed by Russia (11.4%), China (10.3%), Azerbaijan (7.9%) and the US (5.7%) in 2021.
- For 2023, Scope anticipates lower GDP growth (4%) and a decrease in the unemployment rate (approx. 18%) and the inflation rate (6%)
- Georgia grew at an average pace of 3.9% during the 2010-2020 period, higher than the average of geographically close countries and several eastern European nations[1] (3%), mainly driven by the government's economic reforms. These have been tilted towards business-friendly policies such as low taxes and a free market-oriented economy, higher domestic consumption, higher exports and a significant rise in tourism.
- The job market situation in the country has improved moderately in the last two quarters, with the national unemployment rate decreasing to around 16% in Q3 2022, lower than the levels seen during the period 2010-2018
- With continuous high inflation, monetary policy continues to be tightened, with the policy rate standing at current levels until a clear trend of decreasing inflation is observed. The rising interest rates will bring material challenges in terms of higher cost of funding, lower margins due to the ongoing 50% regulatory interest rate cap and the consequent squeeze on household income due to persistent high inflation.
- Among factors constraining our assessment are continual domestic political tension between the government and the opposition, structural unemployment, a highly dollarised banking system, material dependence on tourism and historical geopolitical tensions with Russia due to the self-proclaimed independent regions of South Ossetia and Abkhazia.

Soundness of the Georgian financial sector - Key credit considerations:

- Commercial banks in Georgia play a major role in the domestic financial sector as they held approximately 97% of total financial sector assets as of December 2021. Within the non-banking sector, MFOs represent the largest segment, amounting to around 3% of total financial assets in 2021. Loan-issuing entities' (LIEs) contribution to the domestic financial sector is still very limited (<1% of total assets in 2021).
- After 2012, the Georgian microfinance sector has significantly accelerated, remaining in a positive trend until 2016. That year represented a tipping point when the sector started to downsize due to continual material regulatory changes, forcing more than half of players to exit the market (43 MFOs have left the market since 2016). There are 37 MFOs operating in Georgia as of June 2022.Despite 11 Georgian microfinance organisations leaving the market since 2020, total MFO assets increased around 9% YoY to about GEL 1.7bn, with net lending growing at a 13% rate to GEL 1.5bn as of June 2022. It is worth mentioning that the eight MFOs that left the microfinance market in 2020 and 2021 were among the smallest players.
- With regard to the whole domestic microfinance organisations market portfolio, consumer loans stood as the main contributor, representing 78% of the total portfolio as of June 2022, followed by trade and services loans (13%), agriculture and forestry loans (7%) and other loans (2%). It should be noted that consumer loans represented just 34% of the total portfolio in 2012, with agriculture and forestry loans (28%) and trade and services loans (27%) as the remaining contributors in the total portfolio that year.
- The microfinance organisation sector in Georgia was largely unregulated until 2017]. The main regulatory changes since then include: i) loans up to GEL 200,000 can only be issued and extended in GEL; ii) a minimum threshold of GEL 100,000 for borrowings from each individual when there are more than 20 individual investors; iii) effective interest rates capped at 50% from the previous 100%; iv) minimum regulatory capital of GEL 1m; v) implementation of minimum capital and liquidity coefficients of 18% each; vi) macroprudential policy instruments such as payment-to-income and loan-to-value ratios to encourage responsible lending practices; vii) development of a new regulatory framework for a new type of entity called a microbank.

Selected economic indicators	2019	2020	2021	2022F	2023F
GDP per Capita (USD'000)	4.6	4.2	5.0	NF	NF
Real GDP, % change	4.98	-6.76	10.36	9.60	4.00
Unemployment Rate, %	17.60	18.50	20.60	18.10	17.60
CPI, % change	4.84	5.22	9.57	11.60	6.00
Policy rate, %	9.00	8.00	10.50	11.00	9.50

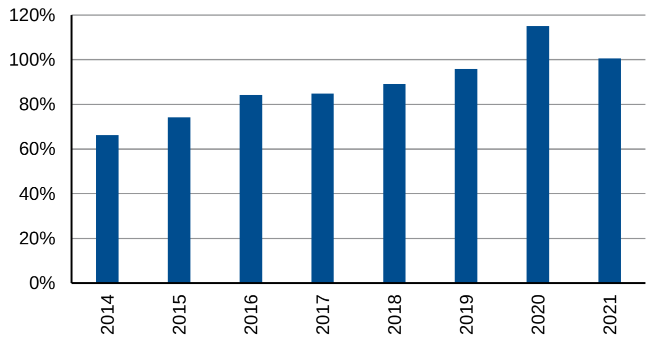
Source: SNL, Scope Macroeconomic Board's forecast, IMF, Scope Ratings
Note: NF stands for not forecasted.

Banking System	2017	2018	2019	2020	2021
ROAA (%)	2.82	2.66	2.85	1.35	3.00
ROAE (%)	19.84	18.57	20.26	10.14	21.87
Net Interest Margin (%)	5.81	5.99	5.30	4.41	4.77
CET1 ratio (%)	9.46	13.89	13.27	12.53	14.33
Problem Loans/ Gross Customer Loans (%)	2.29	4.82	3.65	5.56	3.89

Source: SNL, Scope Ratings

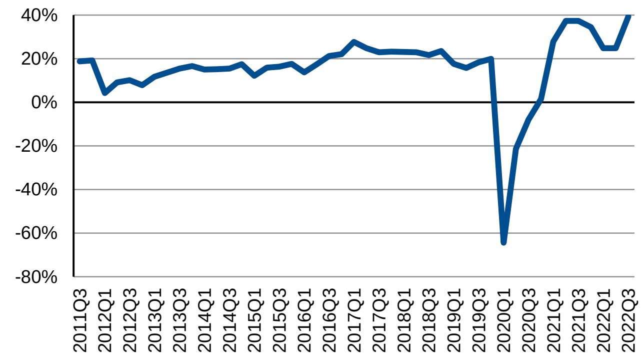
[1] Countries included in the sample: Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Georgia, Kazakhstan, North Macedonia, Russian Federation, Turkey, Turkmenistan, Ukraine, Uzbekistan

Figure 9: Georgian banking sector assets as a % of GDP (2014-2021)



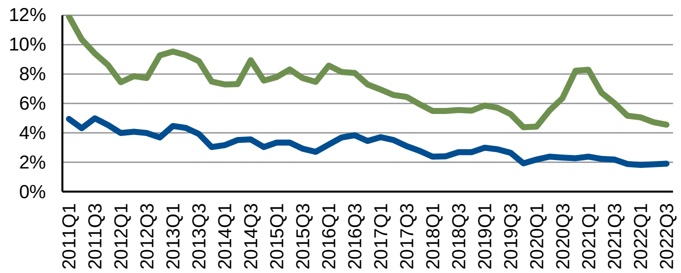
Source: NBG, Scope Ratings

Figure 10: Georgian commercial banks' RoE (Q3 2011-Q3 2022)



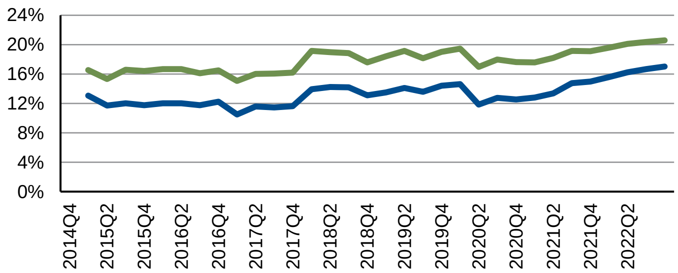
Source: NBG, Scope Ratings

Figure 11: Georgian commercial banks' NPLs (Q1 2011-Q3 2022)



Source: NBG, Scope Ratings

Figure 12: Georgian commercial banks' capital adequacy metrics (Q4 2014-Q3 2022)



Source: NBG, Scope Ratings

Positive and well-aligned governance model with continual improvement in social factors, digitalisation and IT

The "developing" long-term sustainability assessment reflects MBC's continuous investment and attention in technology and digitalisation during the recent past as well as being one of the pioneers in terms of CSR reporting. Nevertheless, the progress made so far is not yet a differentiating factor for the entity's credit profile.

We consider governance (G) and digital (D) transition factors to generally be the most relevant credit factors for financial institutions. Environmental (E) and social (S) factors are gaining momentum, with the E factor having much more precise expectations in relation to climate risk.

Social and digital factors have improved in recent years

The role of MFOs to empower local communities, improve financial inclusion and develop the domestic economy weighs positively on MBC's rating and it is already captured in our business model assessment.

One of the first in the Georgian MFO sector to include a CSR report

Unlike most of its domestic peers, MBC has been publishing a CSR report since 2019 and taking its first steps into the ESG area, with a clear emphasis on social factors.

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

Recent years have seen MBC make major investments in technological development, digital services, new software, licences, cybersecurity, and online and external channels. The company's Alta software is considered one of the most sophisticated banking software packages in Georgia, enabling it to reduce operational risks and provide transparent reporting.

Declining profitability metrics while asset quality indicators remained strong compared to main peers

The "neutral" earnings capacity and risk exposures assessment reflect: i) MBC's worsening earnings capacity driven by larger hedging costs and losses deriving from trading in foreign currency and higher personal expenses. The entity's profitability bounced back after its open position on USD was closed in September 2022, ii) its historically low levels of asset quality compared to its main peers.

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

Operating income increased during 2016-19, driven by significantly higher loan volumes. In 2017, increased expenses hit the bottom line. Profitability indicators worsened in 2020 as a result of higher hedging costs, provisions and expenses that could not be offset by the increase in net interest income, especially from business loans (up GEL 9.7m YoY).

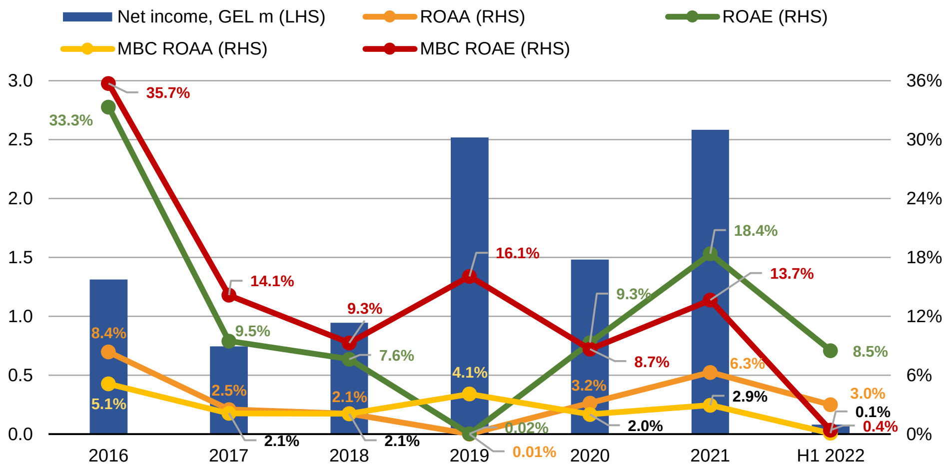
MBC's profitability metrics bounced back in 2021, showing a better bottom line than pre-pandemic levels (2019). The material increase in 2021 was driven by positive performance in net interest income, which rose by a quarter due to an increase in volume growth during the year. Other factors supporting positive annual profitability included an increase in fee and commission income and lower impairments.

Profitability indicators deteriorated sharply in H1 2022, mainly driven by FX losses

MBC's net profit fell by 97% YoY in H1 2022. Although core income (net interest income plus fee and commission income) rose by 5% YoY driven by rapid volume growth during the year, the company's operating income was hit by large losses deriving from trading in foreign currency. These losses were almost three times larger than those in H1 2021 due to a current foreign open balance sheet position on USD. Higher personnel expenses, up 37% YoY, also contributed to the deterioration in the bottom line.

Due to the losses explained above, MBC's return on average equity was 0.4%, its return on average assets was 0.1%, and its net profit margin was 1% in H1 2022. These are below the sector averages of 8.5%, 3% and 34.4% respectively.

Figure 13: Profitability metrics, MBC vs MFO sector (IFRS, GEL m, 2016-H1 2022)



Source: Company data, NBG, Scope Ratings

Former open balance sheet position has been closed, enhancing bottom line

As of September 2022, the open balance sheet position in USD was closed, with a consequent positive effect on MBC's bottom line. Net income bounced back to profitability under Georgian accounting standards, amounting to around GEL 86k after two consecutive quarters of reported losses.

We acknowledge the improvement on MBC's bottom line after the closure of its USD open balance sheet position. However, we still expect a challenging return to the historical high levels of profitability because of the uncertain economic outlook in Georgia that could lead to lower lending volumes, rising cost of funding which could still put pressure on MBC's margins going forward.

Asset quality

Low asset quality metrics compared to main peers

Most asset quality indicators remained strong. However, we see a slight deterioration of loans more than 30 days past due that increased to 2% of gross loans, from 1.7% in March 2022, while coverage on loans more than 30 days past due declined. Total loans past due rose to 3.6% of gross loans in September 2022, from 3% in March 2022.

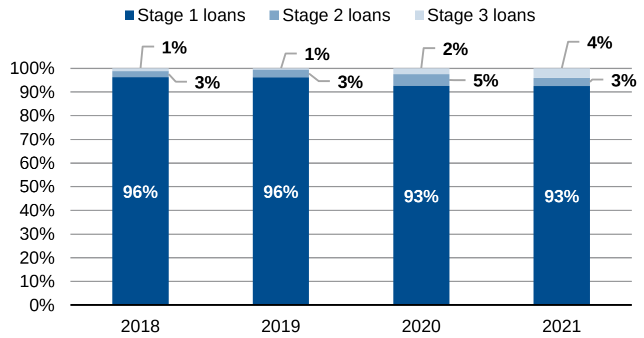
As of September 2022, coverage on all past-due loans was around 34% and around 63% on loans more than 30 days past due, versus 39% and 69% respectively as of March 2022. MBC's restructured loans amounted to 1.7% of gross loans in September 2022, versus 2.4% in March 2022. The reserve coverage ratio of Stage 3 loans decreased to 42% in 2021 versus 44% in 2020.

Restructurings stemming from the Covid-19 crisis caused Stage 3 loans to increase to 4% of gross loans as of December 2021, versus 2% in 2020 (Figure 14).

Current portfolio losses are limited. Net write-offs were 1.2% of gross loans in September 2022, down from 2.6% in March 2022 and 1.6% in 2021.

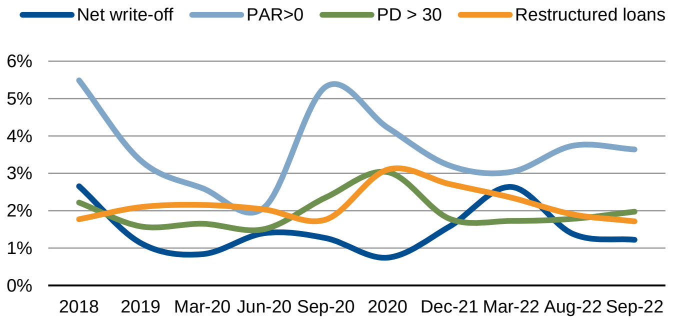
The practically entire proportion of its lending portfolio being collateralised and moderate risk in its business mix are supportive of MBC's asset quality in the medium term.

Figure 14: Gross loan portfolio by stage (%, 2018-2021)



Source: Company data, Scope Ratings

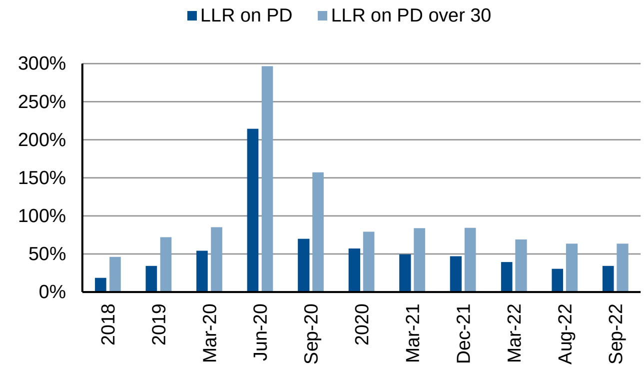
Figure 15: Asset quality metrics (%, 2018-September 2022)



Source: Company data, Scope Ratings

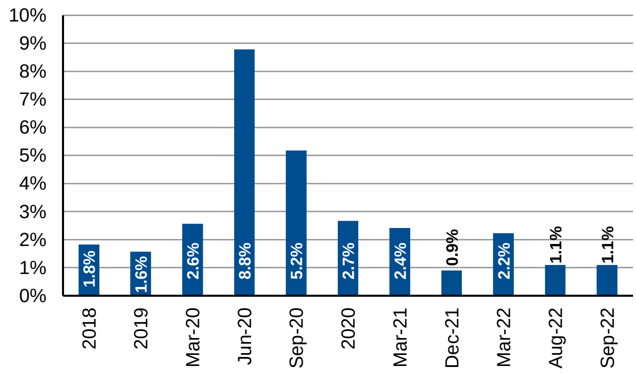
Cost of risk peaked at 8.8% in June 2020. This was due to the National Bank of Georgia requiring 5% of general provisions raised on the loan portfolio. This requirement was then lowered to 2.6% after the central bank acknowledged MBC's lower risk profile compared to peers. MBC's cost of risk has materially decreased since June 2020 and stood at 1.1% as of September 2022.

Figure 16: Coverage on past-due loans (2018-September 2022)



Source: Company data, Scope Ratings

Figure 17: Provision expenses (included on foreclosed loans) to gross loans (cost of risk, %, 2018-September-2022)



Source: Company data, Scope Ratings

Diversified funding profile with still comfortable capital and liquidity positions, however with tighter capital buffer above the requirements compared to historical levels

The "comfortable" financial viability management assessment reflects our view that historically MBC has shown solid capital levels. However, capital buffer to regulatory requirement has started to decline significantly since 2021 due to the losses reported during the first half of 2022 and to support the growth of the lending portfolio.

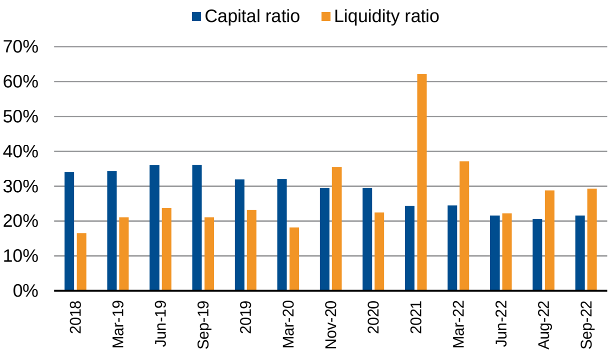
Tighter buffer to capital requirement

We note that solvency metrics declined during the first eight months of 2022 due to the continuous amortization of its subordinated loans and the one-off impact of the open balance sheet position in USD. As of September 2022, MBC held a moderate buffer to minimum capital requirements, with a capital adequacy ratio of 21.6% (3.6 pp above the central bank's requirement and 2.6 pp above the financial institutions covenant requirement). We expect MBC's capital ratio to mildly improve in the medium term along with bottom line profitability.

Despite MBC's liquidity ratio having continually declined since December 2021 to about 29% (11 pp above the requirement) as of August 2022, the ratio is still above the levels seen during the 2018-2020 period. Under the National Bank of Georgia's regulation, MFOs must hold at least 18% of cash against debt maturing within six months.

The temporary spike in MBC's liquidity ratio (Figure 18) in 2021 was driven by funds received from an international financial institution at the end of the year. The ratio then fell from its peak during the first few months of 2022 due to several funding maturities.

Figure 18: MBC's capital and liquidity ratio (2018-September 2022)



Source: Company data, Scope Ratings

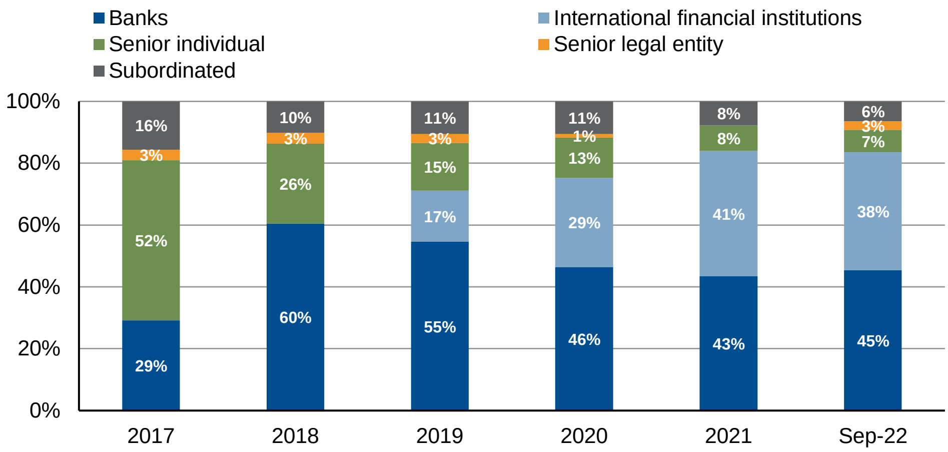
Figure 19: Regulatory ratios (2018-September 2022)

	NB requirement	2018	2019	2020	2021	Mar-22	Jun-22	Aug-22	Sep-22
Capital coefficient	Min 18%	34.1%	31.9%	29.5%	24.3%	24.5%	21.6%	20.5%	21.6%
Liquidity coefficient	Min 18%	16.5%	23.2%	22.5%	62.2%	37.1%	22.2%	28.8%	29.3%
Property investment coefficient	Max 40%	13.1%	13.2%	13.0%	14.3%	15.7%	14.9%	14.6%	14.1%
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%	108.3%	128.0%	119.1%	116.4%

Source: Company data, Scope Ratings

MBC has had to diversify its funding since 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) We view positively the increasing reliance on international financial institutions funding as it brings more diversification to the company's funding sources adding foreseeable and safe long-term funding.

Figure 20: MBC's funding structure (2017-September 2022)



Source: Company data, Scope Ratings

As of September 2022, most major Georgian banks are providing secured lending to MBC. International financial institutions have become increasingly important, lending around GEL 28.8m to MBC. This figure represents around 38% of its funding as of September 2022 (Figure 20).

National Bank of Georgia worked to develop a regulatory framework for microbanks in 2021.

A draft of the Georgian law on the activities of microbanks was published in March 2022 and approved by Parliament in September 2022. Licensed microbanks would be allowed to collect deposits from individuals. In July 2022, MBC confirmed that it intends to apply for a microbank license.

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 4% in 2021 from 35% in 2017. There is a significant foreign currency mismatch given the 50% of longer-term funding in US dollars as of September 2022. We view positively MBC fully hedging all its liabilities via domestic bank swaps or back-to-back loans to avoid any potential short-term risk.

Pricing on euro and US dollar funding has improved on average since December 2020, with the company slightly reducing its reliance on US dollars (down 200 bps since December 2020).

Figure 21: MBC's funding and average interest rate split by currency (December 2020 vs August 2022)

	Dec 20		Sep 22	
Currency	Average interest rate	% of outstanding in GEL	Average interest rate	% of outstanding in GEL
EUR	5.5%	0%	3.3%	0%
GEL	13.8%	48%	14.6%	50%
USD	7.6%	52%	6.0%	50%

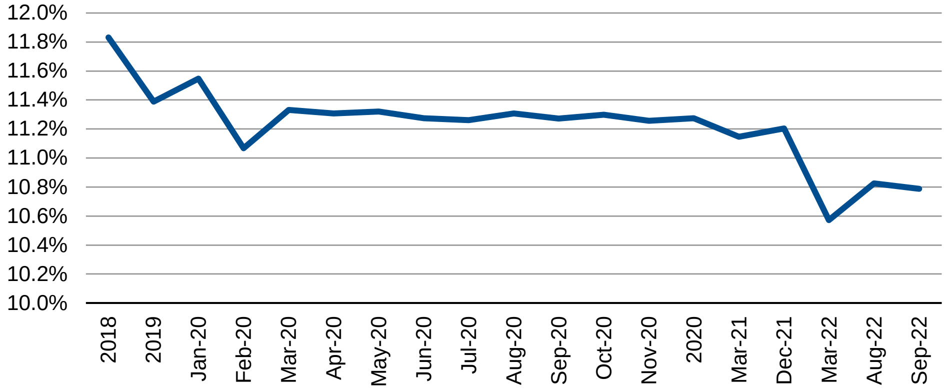
Source: Company data, Scope Ratings

Foreign exchange volatility has increased hedging costs, which were equivalent to 20% of net revenues before foreign exchange income in 2021. In 2022, MBC expects these high costs to persist due to increasing interest rate on US dollar borrowings from international financial institutions.

We consider that obtaining a license in the future microbank project will enable MBC to take deposits and receive funds in domestic currency. Combined with the use of alternative sources of funding (e.g. issuance of bonds in domestic currency), we believe this will represent an important milestone in reducing the company's balance sheet mismatch and consequent hedging costs.

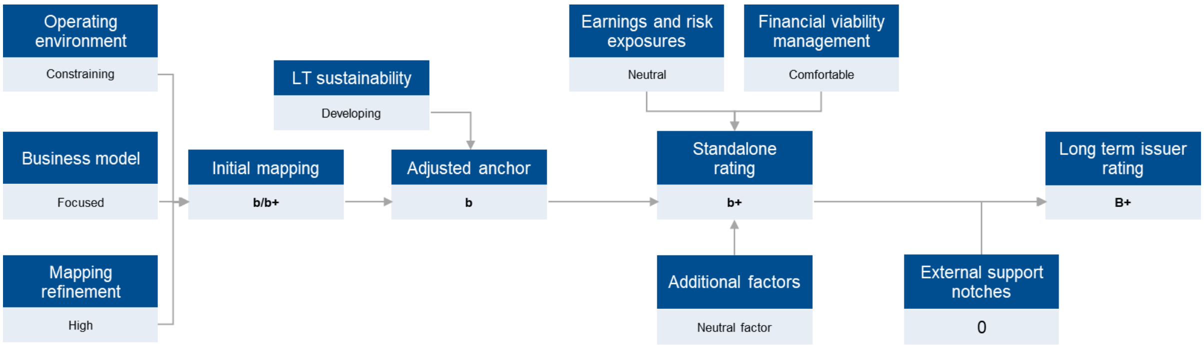
MBC's cost of funding remained fairly stable during the period between March 2020 and December 2021, amounting to an average of 11.3% after a drop in 2019 and volatility in Q1 2020. Lower interest rates on US dollar financing helped MBC drive down its cost of funding during Q1 2022, to 10.6% as of March 2022. However, this downward pattern has reversed lately due to higher interest rates on GEL and US dollar financing. MBC's cost of funding has thus increased to 10.8% as of September 2022.

Figure 22: MBC's cost of funding (2018-September 2022)



Source: Company data, Scope Ratings

I. Appendix: Overview of the rating process



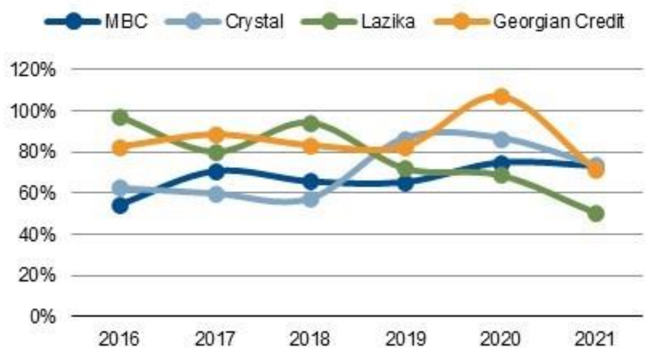
Step		Assessment	Summary rationale
STEP 1	Operating environment	Very supportive	• Small emerging market that still lags behind regional peers on most economic indicators, despite gradual improvements and reforms in recent years. • MFO market is concentrated and started to be regulated in 2017.
		Supportive	
		Moderately supportive	
		Constraining	
		Very constraining	
	Business model	Very resilient	• All-domestic activities • Well-diversified business model focused on growing micro and agro loans • Stable market share
		Resilient	
		Consistent	
		Focused	
		Narrow	
	Mapping refinement	High	• Higher product diversification than peers
		Low	
	Initial mapping	**b/b+**	
	Long-term sustainability	Best in class	• MFOs' role to develop 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	
		Lagging	
	Adjusted anchor	**b**	
STEP 2	Earnings capacity & risk exposures	Very supportive	• Some elements of earnings volatility but good asset quality metrics compared to main peers, including largely collateralised portfolio
		Supportive	
		Neutral	
		Constraining	
		Very constraining	
	Financial viability management	Ample	• Solvency metrics continue to decline. Comfortable but tighter buffer to capital requirement • Increasing financing from international institutions, contributing to safe and stable long-term foreign currency funding and reducing reliance on a few commercial 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+**	

II. Appendix: Peer comparison

Net profit margin (%)

Return on average equity (%)

Cost-to-income (%)



Capital adequacy ratio (%)

Stage 3 ratio (%)

Stage 3 coverage ratio (%)

National peers: Crystal, Lazika Capital, Georgian Credit

Note: Figures for Georgian Credit's net profit margin and RoAE for 2020 have not been included due to large negative numbers that disrupted both charts. Net profit margin and RoAE for Georgian Credit for 2020 amounted to -788% and -86% respectively.

Source: Company information

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

	2018Y	2019Y	2020Y	2021Y	H1 2022
Balance sheet summary (GEL '000)					
Assets					
Cash and cash equivalents	1,771	3,046	2,673	13,879	7,170
Loans to customers	48,348	58,219	66,858	72,817	85,033
Property and equipment	1,933	2,262	2,404	2,880	2,823
Intangible assets	236	262	237	327	332
Deferred tax assets	346	194	356	394	394
Right-of-use assets	0	4,483	4,050	5,328	6,326
Current tax assets	0	0	0	0	0
Other assets	1,020	1,391	1,624	1,545	1,388
Total assets	**53,654**	**69,857**	**78,202**	**97,170**	**103,466**
Liabilities					
Subordinated borrowings and other borrowed funds	38,429	48,084	54,928	70,146	75,151
Subordinated debt	0	0	0	0	0
Lease liabilities	0	4,700	4,947	5,941	6,733
Current tax liability	186	19	0	0	0
Other liabilities	370	355	765	790	1,415
Total liabilities	**38,985**	**53,158**	**60,640**	**76,877**	**83,299**
Share capital	2,185	2,200	2,225	2,250	2,250
Share premium	852	900	996	1,117	1,117
Preference shares	7,347	7,347	7,347	7,347	7,347
Retained earnings	4,285	6,252	6,994	9,579	9,452
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**	**20,167**
Total liabilities and equity	**53,654**	**69,857**	**78,202**	**97,170**	**103,466**
Income statement summary (GEL '000)					
Interest income	11,284	14,080	15,858	20,123	10,485
Interest expense	-4,172	-4,971	-6,290	-7,270	-3,891
Net interest income	7,112	9,109	9,568	12,853	6,594
Fee and commission income	1,293	1,658	1,647	1,923	1,170
Net foreign exchange income/(loss)	-458	-853	-3,776	1,356	1,782
Net (loss)/ income from trading in foreign currency	-213	480	1,955	-3,515	-4,395
Operating income	**7,734**	**10,394**	**9,394**	**12,617**	**5,151**
Impairment losses on debt financial assets	-1,523	-554	-748	-458	264
Personnel expenses	-2,988	-4,187	-4,238	-5,836	-3,352
General administrative expenses	-2,095	-2,605	-2,773	-3,388	-1,982
Profit before income tax	**1,128**	**3,048**	**1,635**	**2,935**	**81**
Income tax expense	-182	-528	-152	-350	0
Profit for the year	**946**	**2,520**	**1,483**	**2,585**	**81**

Note: H1 2022 interim unaudited report

Source: Company information, Scope Ratings

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

Earnings and profitability	2018	2019	2020	2021	H1 2022
Yield on gross loans (%)	22.9%	23.9%	23.1%	26.8%	24.1%
Cost of funding (%)	10.9%	10.3%	11.5%	10.4%	10.4%
Net interest income/ operating income (%)	92.0%	87.6%	101.9%	101.9%	128.0%
Net fees & commissions/ operating income (%)	16.7%	16.0%	17.5%	15.2%	22.7%
FX income / operating income (%)	-5.9%	-8.2%	-40.2%	10.7%	34.6%
Trading income / operating income (%)	-2.8%	4.6%	20.8%	-27.9%	-85.3%
Cost/ income ratio (%)	65.7%	65.3%	74.6%	73.1%	103.6%
Impairment on financial assets / pre-impairment income (%)	57.5%	15.4%	31.4%	13.5%	144.3%
Loan loss provisions / average gross loans (%)	2.0%	1.4%	2.7%	3.1%	2.4%
Return on average assets (%)	2.1%	4.1%	2.0%	2.9%	0.0001%
Return on average equity (%)	9.3%	16.1%	8.7%	13.7%	0.0004%
NBG covenants	**2018**	**2019**	**2020**	**2021**	**H1 2022**
Capital adequacy ratio (%)	34.1%	31.9%	29.5%	24.3%	21.6%
Liquidity ratio (%)	16.5%	23.2%	22.5%	62.2%	22.2%
Pledged assets to equity ratio (%)	205.8%	209.8%	175.7%	106.0%	128.0%
Asset mix, quality and growth	**2018**	**2019**	**2020**	**2021**	**H1 2022**
Net loans/ assets (%)	90.1%	83.3%	85.5%	74.9%	82.2%
Past due > 30 / tangible equity & reserves (%)	18.6%	11.1%	29.4%	28.0%	11.9%
Past due > 30 / total gross loans (%)	2.7%	1.7%	3.0%	1.8%	1.7%
Loan loss allowance for stage 2 & 3 loans / Past due > 30	34.4%	30.3%	35.1%	40.3%	NA
Net loan growth (%)	44.5%	20.4%	14.8%	8.9%	17.4%

Note: H1 2022 interim unaudited report

Source: Company information, 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

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer