JSC MFO Swiss Capital Issuer Rating Report

B STABLE

Scope's credit view (summary)

The rating is driven by JSC MFO Swiss Capital's ('Swiss Capital') leading position among the largest Georgian microfinance organisations with a business model focused on consumer lending with a stable market share and a well-collateralised portfolio.

Swiss Capital's stand-alone rating of b is further supported by the strong profitability of its consumer lending. The company performed well relative to peers in the microfinance sector during an exceptionally difficult period due to the pandemic. Its ROAE and ROAA were respectively 16.5% and 7.5% in 2020 versus the sector's 9.3% and 3.2%.

Solvency and liquidity metrics continue to be reassuring. The capital adequacy ratio stood at 42.7% compared to the minimum requirement of 18% and the liquidity ratio amounted to 37.4% of total liabilities (+19 pp above the requirement) as of December 2020.

Swiss Capital is gradually embracing change in environmental, social and governance (ESG) factors and preparedness for digital transition (D), especially in the digital and governance area, though progress so far is not sufficient to differentiate the company and provide an uplift to the anchor rating of b-.

Outlook

The Outlook is Stable and reflects our view that Swiss Capital's performance will remain resilient in 2021. The expectation of an improving operating environment in Georgia further supports our views. We expect earnings to be sufficient to absorb potential credit losses.

Credit strengths

- One of the largest microfinance organisations in Georgia with a strong and stable market share.
- Strong profitability metrics with a solid track record in the recent past.
- Comfortable buffers to capital and liquidity requirements.

Credit weaknesses

- Weaker asset quality metrics compared to main peers.
- Heavy reliance on commercial bank funding could lead to a potential funding risk.

Positive rating-change drivers

- A refocus of lending towards lower-risk business (e.g. business loans) and less penetrated segments (e.g. agro loans); a market share increase that does not increase credit risk.
- A broader funding diversification policy that allows safer and more predictable funding inflows (e.g. customer deposits in case Swiss Capital gets a microbank license).

Negative rating-change drivers

- Downward pressure on profitability from increased cost of funding.
- Material deterioration in the portfolio's credit quality.

Ratings & Outlook

Issuer rating	B
Outlook	Stable

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Issuer profile

Founded in 2009 in Tbilisi and initially registered as PFS Holdings LLC, the company gained the status of microfinance organisation in 2011 and changed its name to JSC MFO Swiss Capital.

JSC MFO Swiss Capital is a Georgian microfinance organisation (MFO) operating exclusively in the domestic market where it lends to individuals, micro and small businesses.

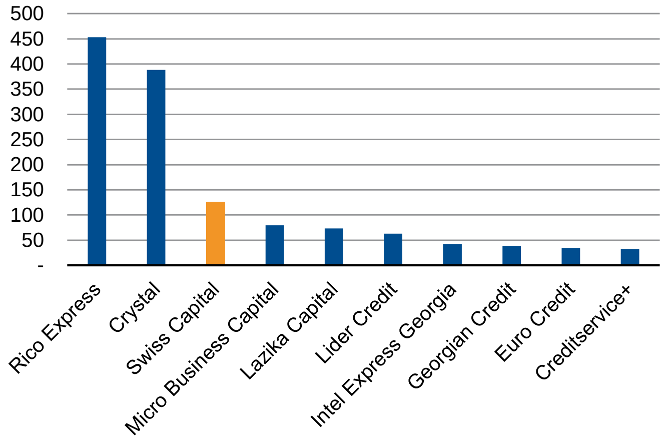
As of March 2021, the company employs 332 people in 20 branches in 7 different cities, including Georgia's largest cities.

One of the largest microfinance organisations in Georgia with a strong and stable market share

Swiss Capital is the third largest microfinance organisation in Georgia by total assets

The firm is the third largest microfinance organisation in Georgia, after Rico Credit and Crystal, with GEL 125.5m in total assets and an 8.9% market share in net loans as of March 2021.

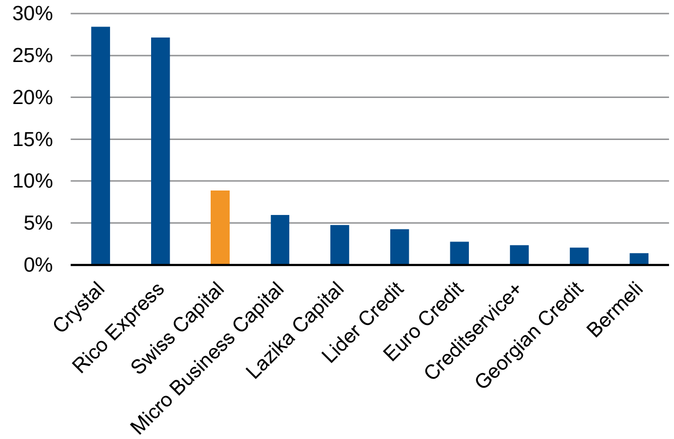
Figure 1: Georgian MFOs ranked by total assets (Q1 2021, GEL m)



Note: Georgian Credit's total assets as of December 2020

Source: NBG, Scope Ratings

Figure 2: Georgian MFOs ranked by market shares of net loans (Q1 2021)



Note: Georgian Credit's market share as of December 2020

Source: NBG, Scope Ratings

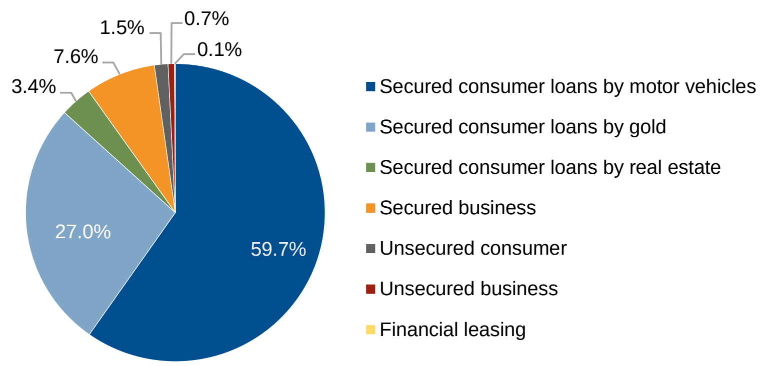
The Georgian MFO sector currently has 39 players, and it is highly concentrated, with the top 5 largest organisations holding 73% of total assets and 75% of the total net loan portfolio as of March 2021.

Swiss Capital's product offering includes secured consumer loans backed by motor vehicles, secured consumer loans backed by gold, secured consumer loans backed by real estate, secured micro and small business loans backed by motor vehicles or real estate, unsecured business loans and currency exchange. Since 2018, the company no longer offers unsecured consumer loans with remaining amount.

Secured consumer loans represented 90% of gross lending as of Q1 2021

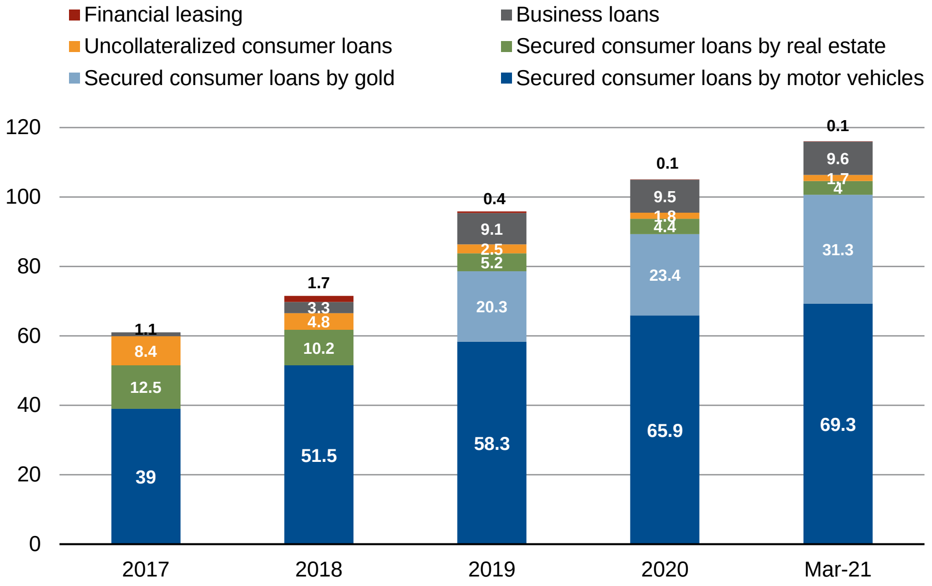
As of Q1 2021, the gross loan portfolio is composed of secured consumer loans backed by motor vehicles (60%) or by gold (27%), secured business loans (around 8%), secured consumer loans backed by real estate (3%), unsecured consumer loans (1.5%), unsecured business loans (0.7%) and financial leasing (0.1%).

Figure 3: Swiss Capital gross loan portfolio breakdown by product (Q1 2021)



Source: Company info, Scope Ratings

Figure 4: Swiss Capital gross loan portfolio breakdown by product (GEL m, 2017-Q1 2021)



Source: Company info, Scope Ratings

The weight of business loans has increased in recent years while the importance of secured consumer loans backed by real estate has materially decreased. Their contribution to total lending more than halved since 2018 due to more stringent regulation on LTV and payment-to-income (PTI) ratios and increased due diligence requirements. Uncollateralised consumer loans are expected to be withdrawn by 2022.

Swiss Capital's medium-term strategy focuses on i) secured consumer loans backed by motor vehicles, representing about half of total gross lending by 2023; ii) secured consumer loans backed by gold, reaching 30% of total gross lending by 2023; ii) significant growth in SME loans, representing 21% of total gross lending by 2023.

Management focus on streamlining the corporate structure with improving steps in IT and digitalisation

Swiss Capital has streamlined its corporate structure in 2020

Swiss Capital Group sold its subsidiaries LLC Swiss Capital Plus, LLC Swiss Capital Auto and LLC Swiss Capital Property at the end of 2020. We acknowledge and value positively the improvement in governance driven by streamlining and simplifying the company's structure.

The company has invested in operating systems, network infrastructure, staff training, certification and cybersecurity. A new customer IT platform is planned for June 2021, giving current and potential customers online access to all the company's services.

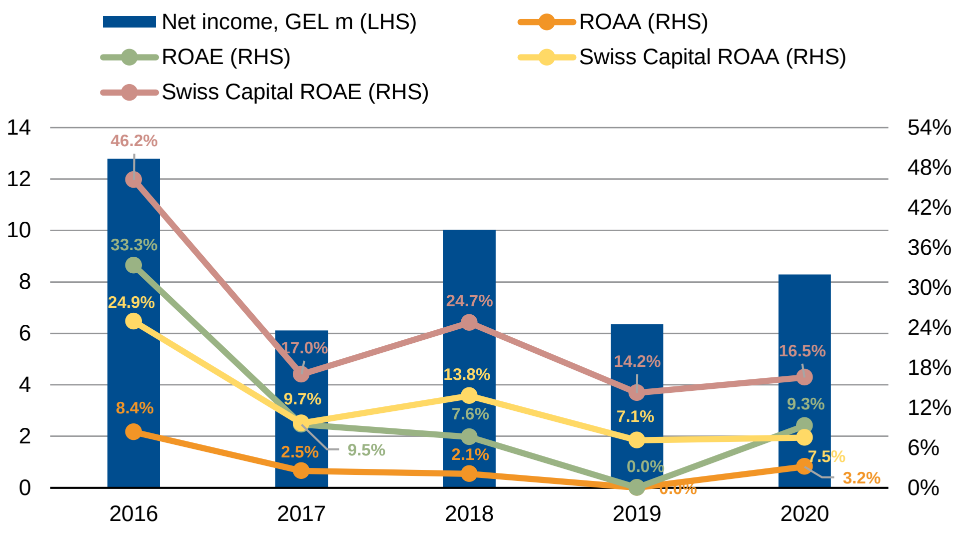
Very strong profitability metrics support the rating

Swiss Capital has displayed very solid profitability metrics in the past years, outperforming peers

Swiss Capital's interest income has been volatile in 2018 in 2019 due to the 50% interest rate cap imposed by regulators in late 2018. Profitability indicators improved in 2020 due to higher loan volumes, especially in auto loans (GEL +8.4m YoY), which benefit from a higher interest rate (roughly 40%) than the rest of the company's secured loans.

In 2020, Swiss Capital reported a 16.5% return on average equity (ROAE), a 7.5% return on average assets (ROAA) and a 32.8% net profit margin, outperforming the Georgian microfinance sector metrics which were characterised by high-single digits on the net profit margin (8.4%) and return on average equity (9.3%) and low-single digit returns on average assets (3.2%), as shown in Figure 5.

Figure 5: Profitability metrics, Swiss Capital vs MFO sector (GEL m, 2016-2020)

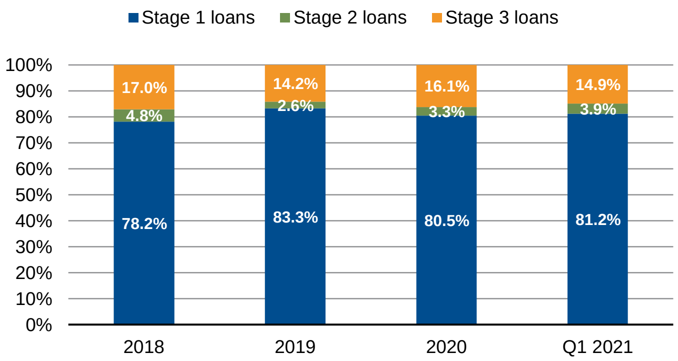


Source: Company info, NBG, Scope Ratings

Weaker asset quality metrics compared to main peers, remaining close to pre-pandemic levels

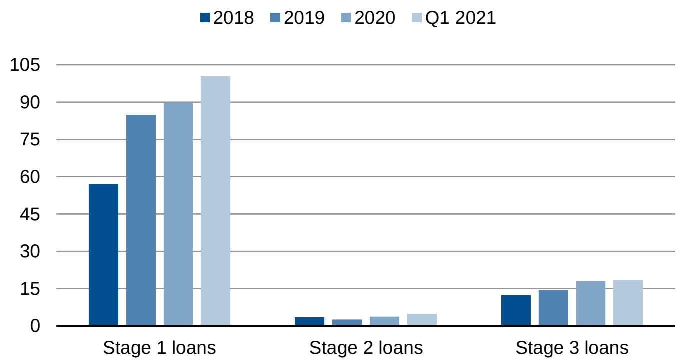
Swiss Capital focuses on collateralised lending, which as of March 2021 represented about 98% of the company's portfolio. Stage 2 and 3 loans mildly increased to 3.9% and 14.9% of total gross loans as of Q1 2021 versus 2.6% and 14.2% seen in 2019, mainly driven by loans collateralised by real estate, especially SME loans which experienced problems during the Covid-19 pandemic as business activity slowed down. Stage 3 coverage decreased to 55% in Q1 2021 vs around 57% in 2019.

Figure 6: Gross loan portfolio split by stages (% of gross loan portfolio, 2018-Q1 2021)



Source: Company info, Scope Ratings

Figure 7: Gross loan portfolio split by stages (GEL m, 2018-Q1 2021)



Source: Company info, Scope Ratings

Swiss Capital asset quality metrics remained close to pre-pandemic levels as of Q1 2021

Swiss Capital's past due loans>90 days ratio decreased to 13.5% as of Q1 2021, similar as seen in 2019 (13.2%), due to material loan growth during the first quarter of 2021.

However, asset quality indicators varied strongly depending on the type of collateral: While loans backed by motor vehicles displayed roughly 14% past due loans>90 days ratio with a 59% coverage as of March 2021, loans backed by real estate showed a 16% past due loans>90 days ratio with a 53% coverage and loans guaranteed by gold exhibited a 5% past due loans >90 days ratio with a coverage of 10%. Despite the legacy uncollateralised consumer portfolio reflects a 86% past-due loans>90 days ratio as of March 2021, this portfolio represents less than 2% of Swiss Capital's gross lending and currently holds a comfortable 87% coverage.

Nonetheless, current losses on the portfolio are very limited, with net write-offs decreasing to around 1% of the gross loan portfolio in 2020. Excluding 2018 where net write-offs peaked at 5% of the gross loan portfolio, they stood at around the 2% level in 2017 and 2019.

Swiss Capital's loan impairment charges have been significantly decreasing since 2018 due to a material decline in write-offs. However, Swiss Capital's cost of risk more than tripled in 2020, standing at 120bps, due to the current ongoing Covid-19 pandemic but is still lower than in 2017 and 2018, with the 2020 impairment/pre-impairment income ratio the lowest (18.7%) since 2017.

We consider the current level of profitability sufficient to manage Swiss Capital's weaker asset quality metrics.

Figure 8: Loan impairment charges breakdown (GEL m, 2017-2020)

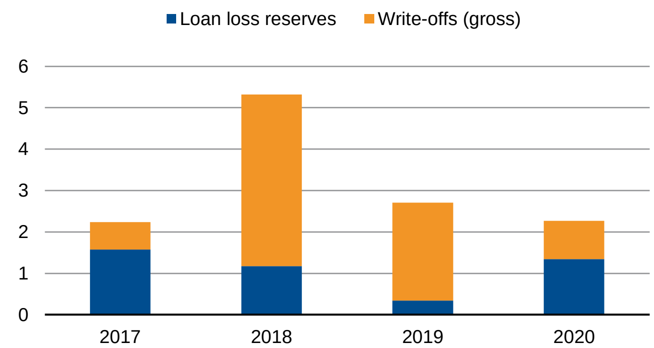
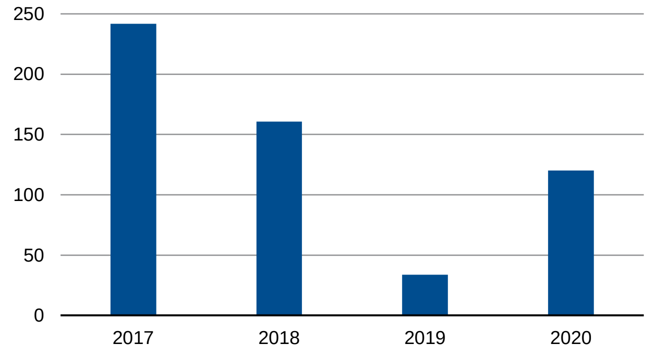


Figure 9: Loan loss reserves/gross loans (CoR, bps, 2017-2020)

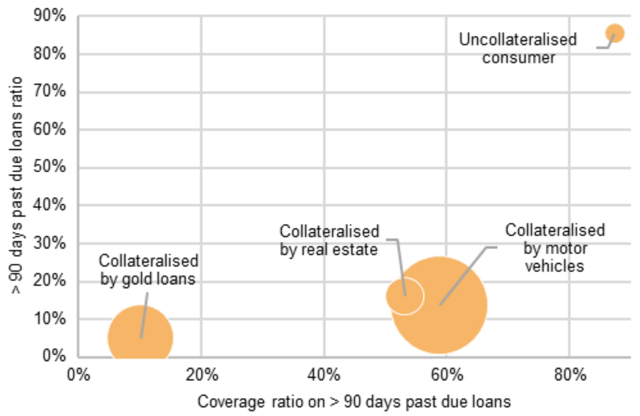


Source: Company info, Scope Ratings

Source: Company info, Scope Ratings

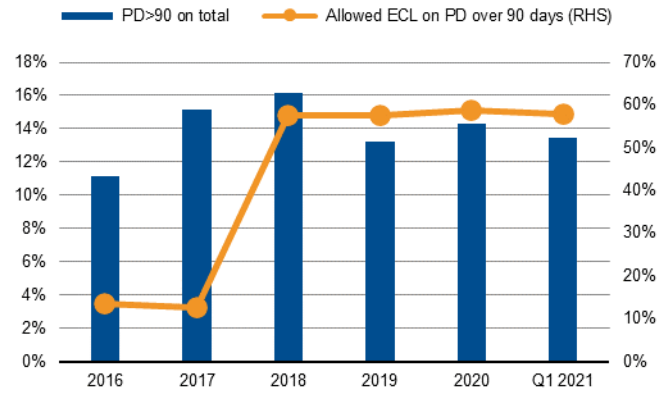
The change in provisioning rules under IFRS had a significant impact with the over 90 days past-due loans coverage ratio skyrocketing from 12.7% in 2017 to 57.5% in 2018.

Figure 10: Asset quality indicators disclosed by collateral (Q1 2021)



Note: Bubble size refers to gross loan volume
Source: Company info, Scope Ratings

Figure 11: Asset quality indicators, historical (2016-Q1 2021)



Source: Company info, Scope Ratings

Comfortable capital and liquidity position. However, heavy reliance on financial institutions' funding could lead to a potential funding risk

Swiss Capital currently holds ample buffers for both capital and liquidity requirements

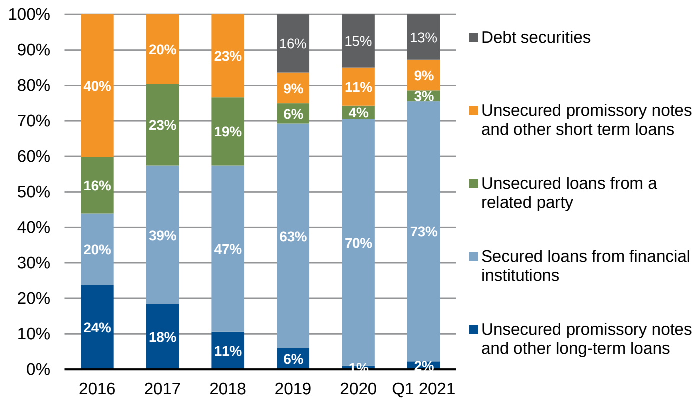
Solvency and liquidity metrics continue to be reassuring. The capital adequacy ratio stood at 42.7% compared to the minimum requirement of 18% and the liquidity ratio amounted to 37.4% of total liabilities (+19 pp above the requirement) as of December 2020.

Figure 12: Regulatory ratios (2018-2020)

	NBG requirement	2018	2019	2020
Capital Coefficient	Min 18%	55.3%	44.4%	42.7%
Liquidity Coefficient	Min 18%	47.7%	26.7%	37.4%
Property Investment Coefficient	Max 40%	3.9%	1.7%	2.0%
Investment Coefficient	Max 15%	11.5%	0.0%	0.0%
Insider Coefficient	Max 15%	0.3%	0.0%	0.0%
Pledged asset Coefficient	Max 90%	75.7%	116.4%	107.0%

Note: NBG set up a waiver on the pledged asset ratio to MFOs and plans to cancel or lighten as local bank loans are a main source of MFOs funding
Source: Company info, Scope Ratings

Figure 13: Funding structure (2016-Q1 2021)



Source: Company info, Scope Ratings

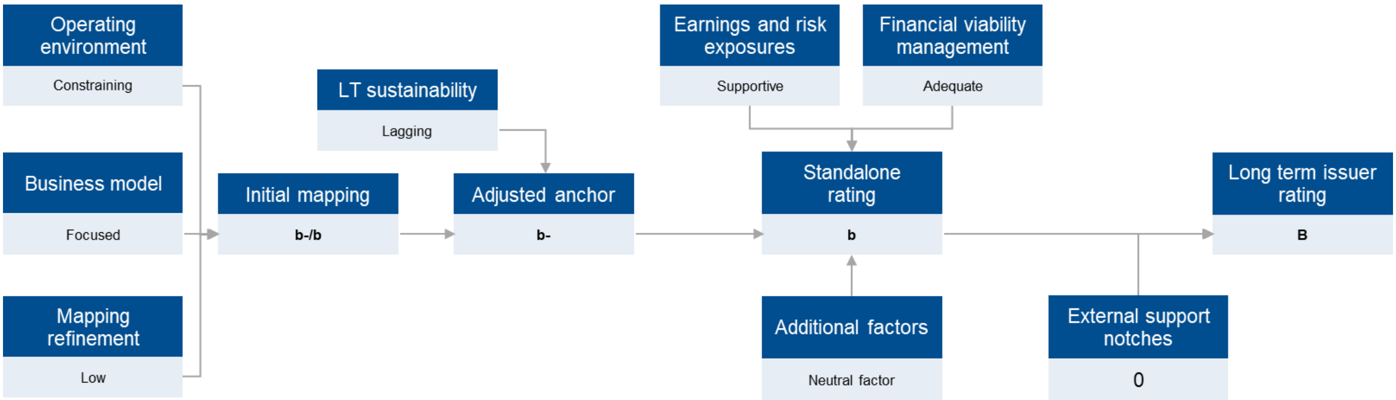
Georgian legislation bans microfinance organisations from receiving deposits and has continuously restricted borrowings from individuals (e.g. Minimum threshold of GEL 100k for borrowings from each individual when there are >20 individual investors) forcing Swiss Capital to modify its funding sources over time. In late March 2019, Swiss Capital issued a GEL 8m local corporate public bond maturing in September 2021.

Swiss Capital heavily relies on bank funding which could lead to a potential funding risk

Consequently, Swiss Capital funding sources have materially changed over the last recent years with secured lending from financial institutions as the largest contributor amounting to 73% of total lending as of Q1 2021 (vs 20% in 2016), followed by debt securities (13%), unsecured promissory notes and other short-term loans (9% vs 40% in 2016), unsecured loans from a related party (3% vs 16% in 2016) and unsecured promissory notes and other long-term loans (2% vs 24% in 2016).

Approximately 11% of Swiss Capital's funding is in USD as of December 2020 (vs 16% in 2019). Despite the GEL depreciation experienced in the last year, Swiss Capital has been able to manage the increasing FX mismatch in an adequate manner with the firm's cost of funding staying at an average of 14% in the last 5 years.

I. Appendix: Overview of the rating process

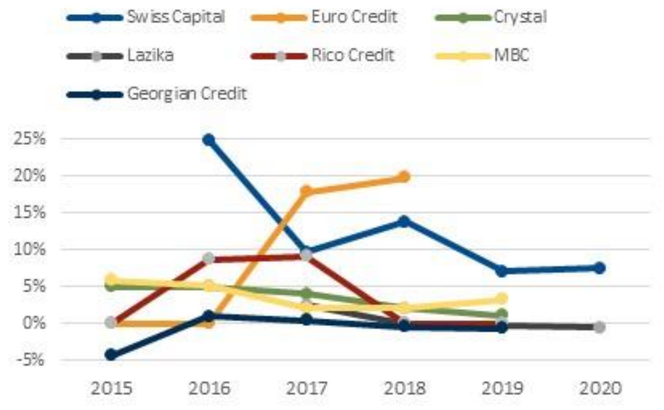


Step		Assessment	Summary rationale
STEP 1	Operating environment	Very supportive	• Small emerging market economy which is still trailing behind similar regional peers in most of the economic indicators despite the gradual improvements and reforms seen in the last years • The MFO market is concentrated and started to be regulated in 2017
		Supportive	
		Moderately supportive	
		Constraining	
		Very constraining	
	Business model	Very resilient	• Activities focused on the domestic market • Limited product range, focused on consumer and business loans • Strong and stable market share
		Resilient	
		Consistent	
		Focused	
		Narrow	
	Mapping refinement	High	• Lack of diversification is a constraint on the rating
		Low	
	Initial mapping	**b/b-**	
	Long-term sustainability	Best in class	• Governance has improved with the streamlining of the corporate structure • Improving steps in digitalisation • Lack of environmental policy
		Advanced	
		Developing	
		Lagging	
	Adjusted anchor	**b-**	
STEP 2	Earnings capacity & risk exposures	Very supportive	• Very strong profitability track record, outperforming MFO peers • Weaker asset quality metrics compared to main peers but currently remains close to pre-pandemic levels (2019) • Practically fully collateralised portfolio
		Supportive	
		Neutral	
		Constraining	
		Very constraining	
	Financial viability management	Ample	• Healthy buffers for both capital and liquidity requirements • Heavy reliance on financial institutions' funding which could lead to a potential funding risk
		Comfortable	
		Adequate	
		Limited	
		Stretched	
		At risk	
	Additional factors	Significant support factor	• No further considerations
		Material support factor	
		Neutral	
		Material downside factor	
		Significant downside factor	
	Standalone	**b**	
STEP 3	External support	Not applicable	
Issuer rating		**B**	

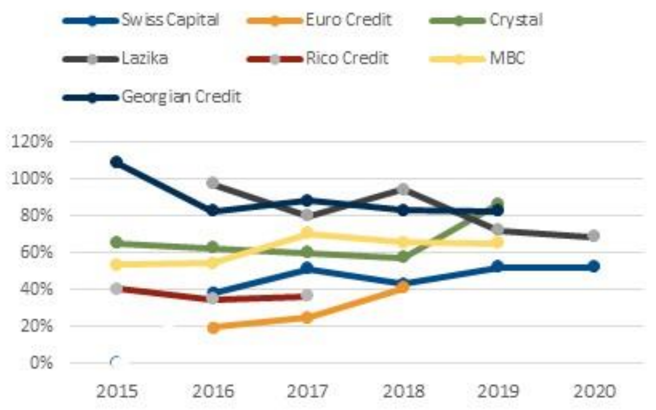
II. Appendix: Peer comparison

Rating on average equity (%)

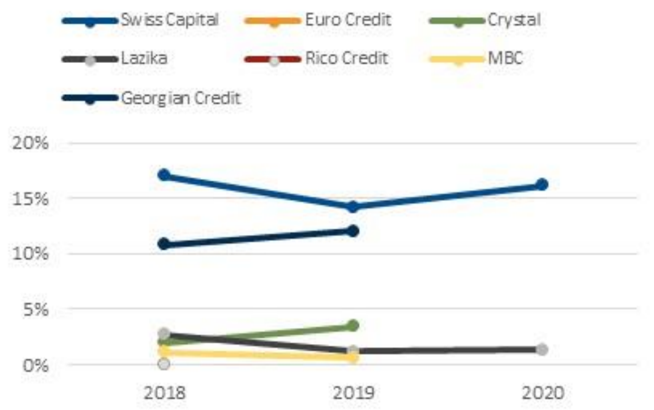
Return on average assets (%)



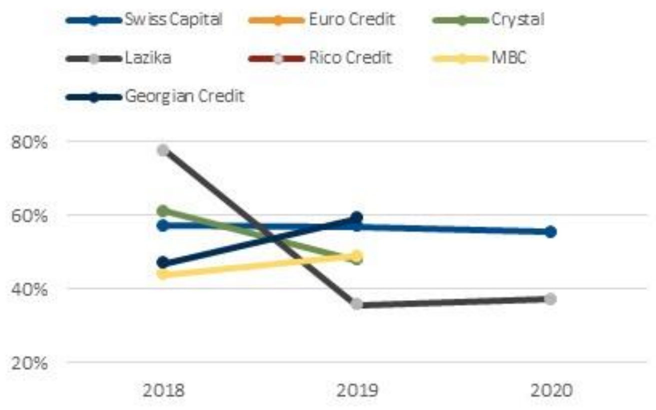
Cost-to-income ratio (%)



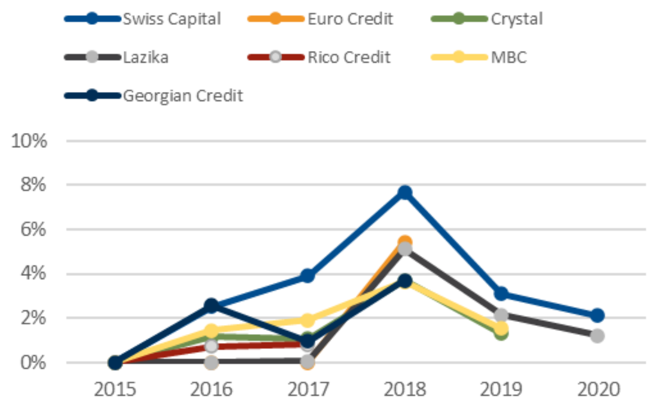
Stage 3 ratio (%)



Stage 3 coverage ratio (%)



Loan-loss provisions/average total gross loans (%)



National peers: Swiss Capital, Micro Business Capital, Crystal, Lazika Capital, Georgian Credit, Euro Credit, Rico Credit

Source: Company info

III. Appendix: Selected financial information – JSC MFO Swiss Capital

	2016	2017	2018	2019	2020	Q1 2021
Balance sheet summary (GEL '000)						
Assets						
Cash and cash equivalents	2,154	5,048	6,464	5,197	8,888	9,004
Financial instruments at fair value through profit or loss	1,809	0	0	0	0	0
Loans to customers	46,320	60,906	62,124	90,113	98,159	109,966
Financial leasing	0	0	1,524	307	77	69
Other assets	963	758	473	334	840	1,198
Property and equipment	1,326	1,258	893	732	864	1,086
Intangible assets	518	470	383	329	307	277
Right-of-use asset	0	0	0	5,517	5,717	5,867
Current income tax asset	0	780	0	63	413	19
Deferred tax asset	563	861	1,981	1,627	1,347	1,344
Investments in subsidiaries	1,366	919	717	0	0	0
Total assets	**55,019**	**71,000**	**74,559**	**104,219**	**116,612**	**128,830**
Liabilities						
Borrowed funds	20,267	31,858	31,076	50,788	55,887	63,178
Financial instruments at fair value through profit or loss	0	0	0	0	159	0
Current income tax liability	745	0	424	0	0	6
Other liabilities	498	785	378	6,767	6,865	9,460
Total liabilities	**21,510**	**32,643**	**31,878**	**57,555**	**62,911**	**72,644**
Share capital	4,175	4,175	4,175	4,175	4,175	4,175
Share premium	2,068	2,068	2,068	2,068	2,068	2,068
Retained earnings	27,266	32,114	36,438	40,421	47,458	49,942
Total equity	**33,509**	**38,357**	**42,681**	**46,664**	**53,701**	56,185
Total liabilities and equity	**55,019**	**71,000**	**74,559**	**104,219**	**116,612**	**128,829**
Income statement summary (GEL '000)						
Interest income	23,531	28,448	34,519	28,199	30,516	7,998
Interest expense	-2,940	-3,493	-4,135	-5,102	-7,573	-1,894
Net interest income	20,591	24,955	30,384	23,097	22,943	6,104
Other income	2,002	1,193	1,245	2,241	2,461	711
Net loss on financial instruments at fair value through profit or loss	863	-1,204	-351	99	-102	105
Operating income	**23,456**	**24,944**	**31,278**	**25,437**	**25,302**	**6,920**
Personnel expenses	-3,629	-5,920	-6,340	-6,607	-7,260	-1,732
Operating and administrative expenses	-5,336	-6,861	-7,172	-6,724	-5,899	-1,645
Total expenses	-8,965	-12,781	-13,512	-13,331	-13,159	-3,377
Pre-provision income	**14,491**	**12,163**	**17,766**	**12,106**	**12,143**	**3,543**
Loan impairment charge	-1,133	-2,234	-5,322	-2,705	-2,265	-410
Impairment of investment in subsidiaries	-308	-447	-202	-717	0	0
Foreign exchange loss, net	2,144	-1,884	-440	-445	-155	-104
Profit before income tax	**15,194**	**7,598**	**11,802**	**8,239**	**9,723**	**3,029**
Income tax expense	-2,408	-1,491	-1,775	-1,886	-1,429	-397
Net profit for the year	**12,786**	**6,107**	**10,027**	**6,353**	**8,294**	**2,632**

Source: Company info, Scope Ratings

IV. Appendix: Selected financial information – JSC MFO Swiss Capital

Earnings and profitability	2016	2017	2018	2019	2020	Q1 2021
Yield on gross customer loans (%)	47.9%	43.5%	47.1%	27.5%	27.2%	NA
Yield on net customer loans (%)	50.8%	46.6%	55.4%	31.1%	30.9%	NA
Cost of funding (%)	14.5%	11.0%	13.3%	9.2%	12.9%	NA
Net interest income/ operating income (%)	87.8%	100.0%	97.1%	90.8%	90.7%	88.2%
Cost/ income ratio (%)	38.2%	51.2%	43.2%	52.4%	52.0%	48.8%
Impairment on financial assets / pre-impairment income (%)	7.8%	18.4%	30.0%	22.3%	18.7%	11.6%
Loan loss provision/ average gross loans (%)	2.5%	3.9%	7.7%	3.1%	2.1%	NA
Return on average assets (%)	24.9%	9.7%	13.8%	7.1%	7.5%	2.2%
Return on average equity (%)	46.2%	17.0%	24.7%	14.2%	16.5%	5.0%
NBG covenants	**2016**	**2017**	**2018**	**2019**	**2020**	**Q1 2021**
Capital adequacy ratio (%)			55.3%	44.4%	42.7%	NA
Liquidity ratio (%)			47.7%	26.7%	37.4%	NA
Pledged assets to equity ratio (%)			75.7%	116.4%	107.3%	NA
Asset mix, quality and growth	**2016**	**2017**	**2018**	**2019**	**2020**	**Q1 2021**
Net loans / assets (%)	84.2%	85.8%	83.3%	86.5%	84.2%	85.4%
Net loan growth (%)	17.6%	31.5%	2.0%	45.1%	8.9%	12.5%
Stage 3 loans / total gross loans (%)			17.0%	14.2%	16.1%	NA
Stage 3 coverage ratio (%)			57.1%	56.9%	55.4%	NA
PD>90 days / total gross loans (%)	11.1%	15.2%	16.1%	13.2%	14.3%	14.3%
Expected credit loss, PD>90 days (%)	13.6%	12.7%	57.5%	57.6%	58.7%	58.7%
Write-offs – recoveries / Stage 3 (PD90 for 2017)		11.2%	35.3%	13.1%	8.4%	NA

Source: Company info, Scope Ratings

Note: Ratio calculations

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 payables with maturity more than 6 month)

e) Return on average assets (ROAA, %) = Net income / Average assets

f) Return on average equity (ROAE, %) = 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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