MOODY'S
INVESTORS SERVICE

CREDIT OPINION
25 January 2017

New Issue

Rate this Research

**RATINGS**

**National Microfinance Bank Plc**

| | |
|---|---|
| Domicile | Tanzania |
| Long Term Debt | Not Assigned |
| Type | Not Assigned |
| Outlook | Not Assigned |
| Long Term Deposit | B2 |
| Type | LT Bank Deposits - Fgn Curr |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*

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# National Microfinance Bank Plc

First Time Rating

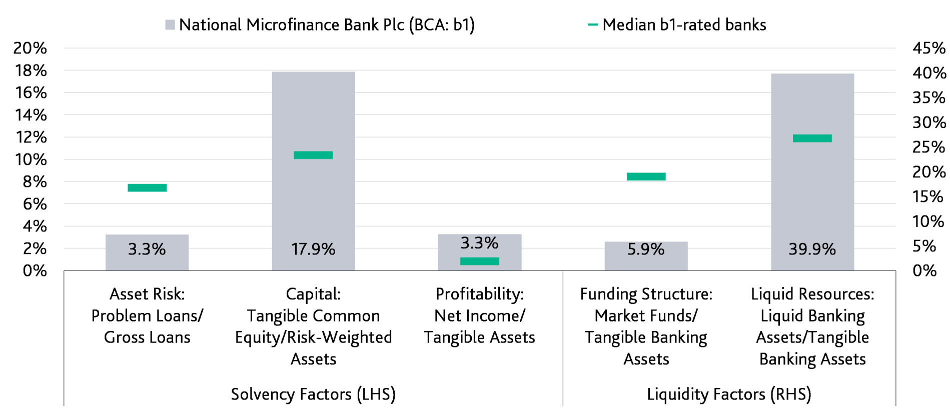
## Summary Rating Rationale

Moody's has assigned B1/ Not Prime global local currency deposit ratings to National Microfinance Bank Plc (NMB), which are in line with the bank's b1 baseline credit assessment (BCA). The ratings reflect NMB's (1) solid capitalization and profitability metrics, supported by its retail-focused domestic franchise and beneficial association with Rabobank Netherlands (Aa2 negative, a2), (2) strong liquidity buffers and a retail-deposit funded profile, that has withstood the gradual reduction of government deposits, and (3) relatively low non-performing loans that benefit from the solid performance of its salary-linked personal loans.

At the same time, the ratings capture (1) Tanzania's Very Weak + macro profile, including weaknesses in Tanzania's operating environment, including limitations in the quality of the credit information available for lenders and the country's low institutional capacity, according to global governance indicators, and (2) risks posed by high banking competition and lower potential growth in salary-linked loans and government-related business.

Moody's has also assigned a Ba3(cr)/ Not Prime(cr) Counterparty Risk (CR) Assessment, which are opinions of how counterparty obligations are likely to be treated if a bank fails and relates to a bank's contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities. Furthermore, Moody's has assigned a B2/ Not Prime rating foreign currency deposit ratings, which are constrained at a lower level to capture country specific foreign currency transfer and convertibility risks.

Exhibit 1
**Rating Scorecard - Key Financial Ratios**




Note: The problem loan and profitability ratios is the weaker of the average 3-year ratios and the latest reported ratios. The capital ratio is the latest reported figure. The funding structure and liquid asset ratios are the latest year-end figures.
*Source: Moody's Financial Metrics*

## Credit Strengths

» Profitability will remain a credit strength, supported by a solid domestic franchise

» HIgh capitalization buffers

» Asset quality metrics are supported by salary-linked personal lending focus

» Retail deposit-based funding profile with solid liquidity buffers

## Credit Challenges

» Ratings are constrained by Tanzania's Very Weak+ macro profile score

» Increasing banking competition and lower potential growth in government-related business poses risks

## Rating Outlook

The outlook on NMB's ratings is stable. The stable outlook balances NMB's overall solid financial fundamentals against risks in the overall operating environment.

## Factors that Could Lead to an Upgrade

Positive pressure could be exerted on NMB's ratings following an improvement in the country's operating environment, including the sovereign's credit profile.

## Factors that Could Lead to a Downgrade

Negative pressure could be exerted on NMB's ratings if there is a deterioration in the overall operating environment leading to a weakening in the bank's overall financial fundamentals and credit risk profile.

## Key Indicators

Exhibit 2

**National Microfinance Bank Plc (Consolidated Financials) [1]**

| | 12-15[2] | 12-14[2] | 12-13[2] | Avg. |
|---|---|---|---|---|
| Total Assets (TZS million) | 4,576,513.0 | 3,888,668.0 | 3,287,175.0 | 18.0[3] |
| Total Assets (USD million) | 2,118.7 | 2,243.9 | 2,071.3 | 1.1[3] |
| Tangible Common Equity (TZS million) | 639,322.0 | 561,425.0 | 455,315.0 | 18.5[3] |
| Tangible Common Equity (USD million) | 296.0 | 324.0 | 286.9 | 1.6[3] |
| Problem Loans / Gross Loans (%) | 2.6 | 3.8 | 3.4 | 3.3[4] |
| Tangible Common Equity / Risk Weighted Assets (%) | 17.9 | 17.7 | 16.7 | 17.4[5] |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | 9.5 | 12.7 | 11.4 | 11.2[4] |
| Net Interest Margin (%) | 9.2 | 11.0 | 10.4 | 10.2[4] |
| PPI / Average RWA (%) | 6.8 | 8.1 | 7.8 | 7.6[5] |
| Net Income / Tangible Assets (%) | 3.3 | 4.0 | 4.1 | 3.8[4] |
| Cost / Income Ratio (%) | 56.7 | 53.3 | 51.6 | 53.8[4] |
| Market Funds / Tangible Banking Assets (%) | 5.9 | 5.4 | 5.1 | 5.4[4] |
| Liquid Banking Assets / Tangible Banking Assets (%) | 39.9 | 42.6 | 45.2 | 42.6[4] |
| Gross loans / Due to customers (%) | 69.9 | 67.4 | 63.8 | 67.0[4] |

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation

*Source: Moody's Financial Metrics*

## Detailed Rating Considerations

### RATINGS ARE CONSTRAINED BY TANZANIA'S VERY WEAK+ MACRO PROFILE SCORE

NMB's ratings are constrained by our assessment of Tanzania's Very Weak + macro profile. Tanzania's score captures the country's rapidly expanding and fairly diversified economy, and low susceptibility to event risk. Tanzania has significant future growth potential in every major sector of the economy, while Tanzanian banks benefit from a supply of stable, low-cost customer deposits and healthy liquidity buffers, which support their financial stability.

These strengths are, however, balanced against the relatively low wealth levels, widespread poverty and low institutional capacity according to global governance indicators. Tanzania's macro profile score also incorporates our view that credit conditions are affected by weaknesses in the quality of the credit information available for lenders and in the structuring of corporate loans, in particular the prevalence of working capital facilities to finance long-term financing needs.

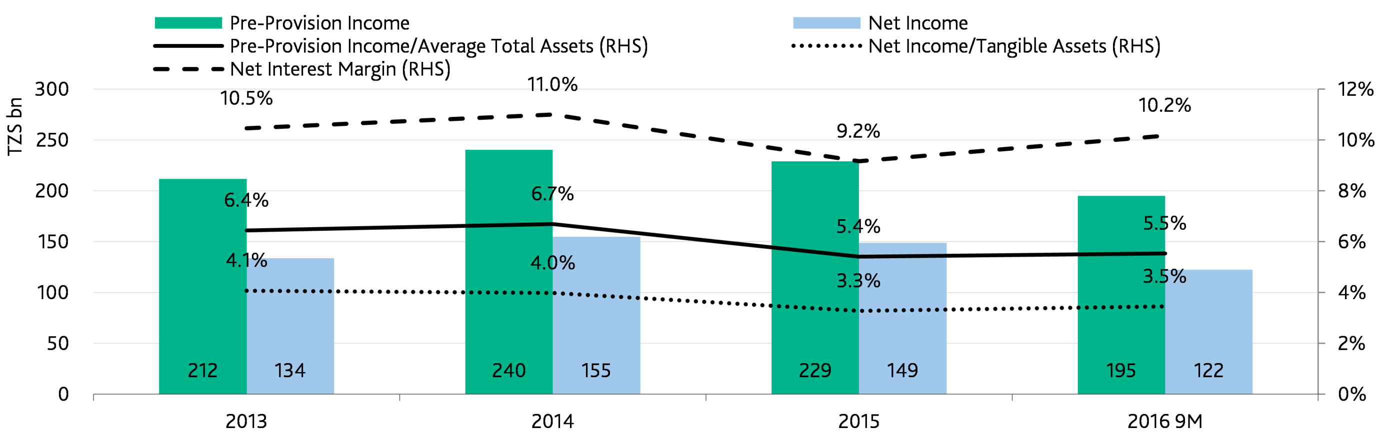
### PROFITABILITY WILL REMAIN A CREDIT STRENGTH, SUPPORTED BY A SOLID DOMESTIC FRANCHISE

We expect NMB's profitability to remain a credit strength supported by its solid retail-based domestic franchise, its beneficial association with Rabobank Netherlands (Aa2 negative, a2) and Tanzania's strong growth potential. This is spite of a slight weakening of profitability metrics due to higher funding costs and investment spending.

NMB's net income to tangible assets ratio stood at a strong 3.5% during the first nine months of 2016 (9M 2016), which compares favourably to the 0.8% b1-rated peer median, although lower than the 4.0% achieved during 2014 (exhibit 3). Pre-provision income to average total assets was a strong 5.5% in 9M 2016, compared to the 2.3% b1-rated peers, although lower than the 6.7% in 2014.

Exhibit 3

**NMB's Profitability Metrics Remain Strong, Despite Lower Margins**




*Source: National Microfinance Bank Plc Financial Statements, Moody's Financial Metrics*

The drop in profitability metrics primarily reflects the increase in the bank's cost of funding, following increased competition for customer deposits and the loss of low cost government deposits (see funding section). This has led to a reduction in net interest margins to 10.2% during 9M 2016 (2014: 11.0%), although margins remain high both by local and global standards. There was also an increase in expenses amid a significant ongoing investment in IT platform, payments processing, staff and branch network expansion. Accordingly, the cost-to-income ratio increased to 56.9% during 9M 2016, from 53.3% during 2014. Ongoing initiatives at the bank to improve efficiency are under way and are also expected to improve customer service, and strengthen internal capabilities to reach more customers.

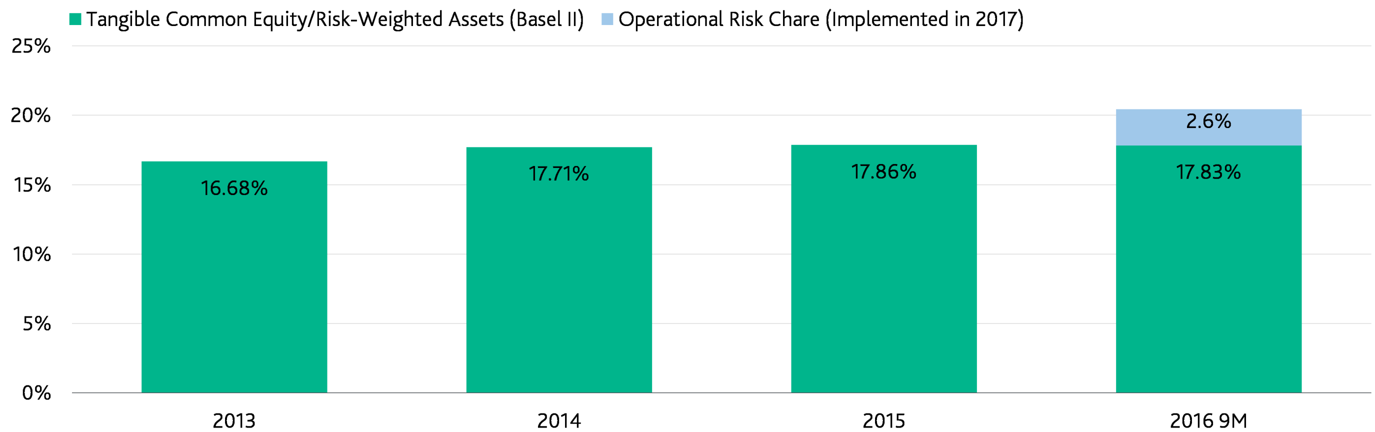
We expect profitability to remain a credit strength, supported by NMB's strong retail domestic franchise as one of the two largest banks in Tanzania with a 17% asset market share , over 2 million customers and a countrywide branch network. In addition, the bank has a management and technical service agreement with Rabobank Netherlands, whereby Rabobank recommends three senior management appointments (including the CEO), and supports the bank in technical areas, sharing expertise and know-how. The bank is also positioning itself to take advantage of Tanzania's strong growth potential by (1) diversifying and improving of its loan offering, leveraging its distribution network, and cross-selling to existing customers, (2) increasing its presence in the agricultural sector, and (3) diversifying and strengthening its service offering.

### HIGH CAPITALISATION BUFFERS

NMB's capital buffers support its solvency position and overall rating. The bank's tangible common equity is estimated at 20.4% of risk-weighted assets as of September 2016, compared to a 10.4% global median for b1 rated banks, although the ratio is estimated to drop to around a still strong 17.8% if we include risk weighted assets for operational risks that will apply to Tanzanian banks from August 2017 (see exhibit 4). In calculating the ratio, we use Moody's standard adjustments whereby we risk-weight government securities at 100%.

Exhibit 4

**Capitalisation to Remain a Credit Strength, Despite Higher Operational RWAs**



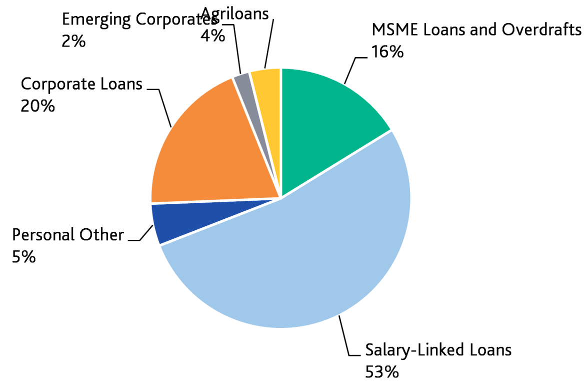

*Source: National Microfinance Bank Plc Financial Statements, Moody's Financial Metrics*

In addition to the bank's internal capital generation that will support capital through strong profitability and a moderate risk-weighted assets growth in the next 12-18 months, the bank is looking into potential other measures to boost capital above the internal minimum including revising its dividend policy lower or a capital increase either through a rights issue or a Tier II subordinated debt issue.

### ASSET QUALITY METRICS ARE SUPPORTED BY SALARY-LINKED PERSONAL LENDING FOCUS

NMB currently has fairly strong asset quality metrics, despite a deterioration during 2016, supported by its concentration in personal lending (in particular salary-linked lending, primarily to government employees), fairly low-risk appetite and adequate risk management processes, with Rabobank's influence. The bank estimates that by the end of 2016, salary linked loans will account for 53% of total, loans to large corporates for 20%, Micro and SME (MSME) loans for 16%, other personal loans for 5%, Agricultural loans for 4% and Emerging Corporate loans (smaller corporates) for 2%.

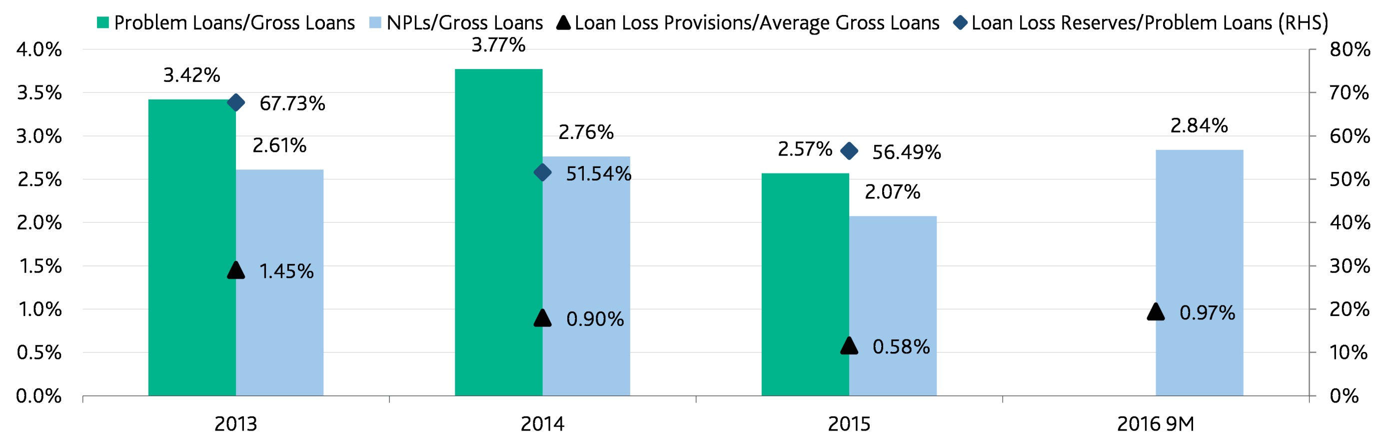
Exhibit 5
**Loan Book Breakdown by Segment**
**2016 Estimate**




*Source: National Microfinance Bank Plc Financial Statements, Moody's Financial Metrics*

Problem loans (including all loans overdue by 90 days) stood at 2.6% as of end-2015, which compare favourably with the b1-rated peer median of 7.4%. The provisioning coverage stood around 56%, with the bank holding additional provisions in a regulatory banking risk reserve and general banking reserve (which is part of Tier 2 capital), increasing the regulatory provisioning coverage to 95% of problem loans. As of September 2016, reported non-performing loans stood at 2.8% of gross loans, compared to 2.1% as of end-2015 (see exhibit 6).

Exhibit 6
**Asset Quality Metrics Remain Fairly Strong, Although It Weakened In 2016**




*Source: National Microfinance Bank Plc Financial Statements, Moody's Financial Metrics*

The asset quality deterioration in 2016 reflects a weakening in a few corporate exposures. The corporate sector has historically shown higher NPL volatility, with agriculture one of the most volatile sectors. A stricter enforcement of tax collection is also putting pressure on corporates that are faced with tightening liquidity. Positively, as of YE 2015, only 9% of loans are in foreign currency, the majority in exporting corporates, while NMB's top 10 group loans account for just 0.5x its shareholders equity.

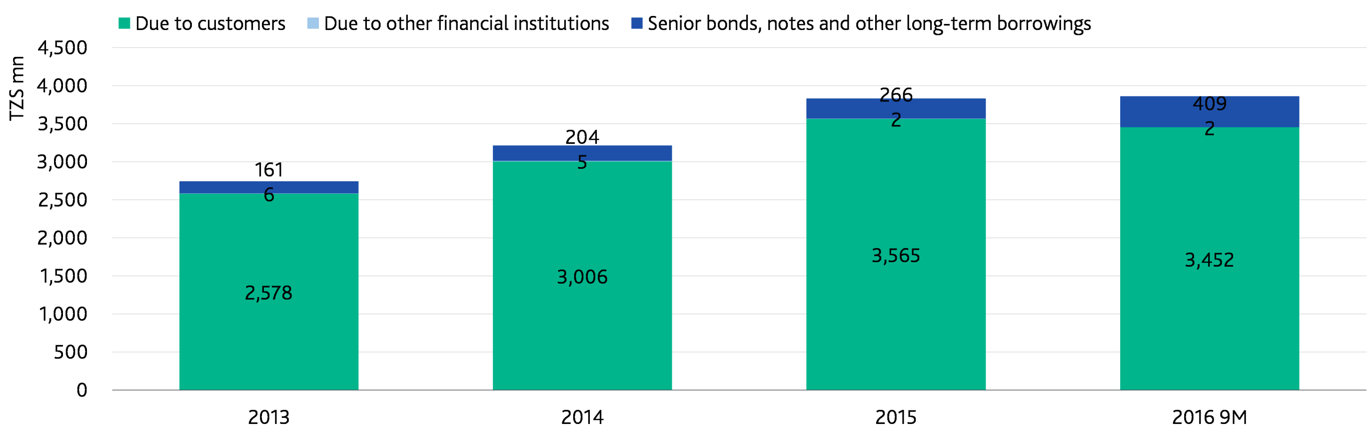
Consumer loan performance remains strong supported by the payroll deduction model, whereby loan repayments are taken directly from the employer (primarily government through a centralised process), and prior to the monthly salary being distributed, while the bank limits monthly instalments to a maximum of 50% of net salary.

However government austerity measures will continue to reduce compensation and benefits of government workers and the pace of growth of this loan portfolio is expected to slow, which in addition to increasing competition, forces the bank to diversify its loan and service offerings. While this will likely lead to weaker asset quality, amid an increasing contribution from higher-risk segments like agriculture and MSME, we expect the process to be gradual given the bank's fairly low risk appetite and strict controls, while in the long-term increased diversification will support the bank's franchise growth potential. By 2020, the bank expects to reduce consumer lending to around 50%, while increasing MSME and agriculture to 30%.

## RETAIL FOCUSED DEPOSIT BASED FUNDING PROFILE WITH SOLID LIQUIDITY BUFFERS, DESPITE LOSS OF GOVERNMENT DEPOSITS

While we have seen a liquidity tightening for NMB and the overall banking system (following the loss of government deposits and austerity measures weighing on private sector liquidity and deposits), we expect that the bank will maintain a deposit funded profile and solid liquidity buffers, supported by its leading retail domestic franchise and ongoing focus on alternative distribution channels. NMB is majority deposit funded with deposits making up 89% of total funding as of September 2016 (see exhibit 7). Despite an increase in market funding to 9% of tangible banking assets as of September 2016, the bank's reliance on market funding remains low (the global median for b1-rated banks is 19%).

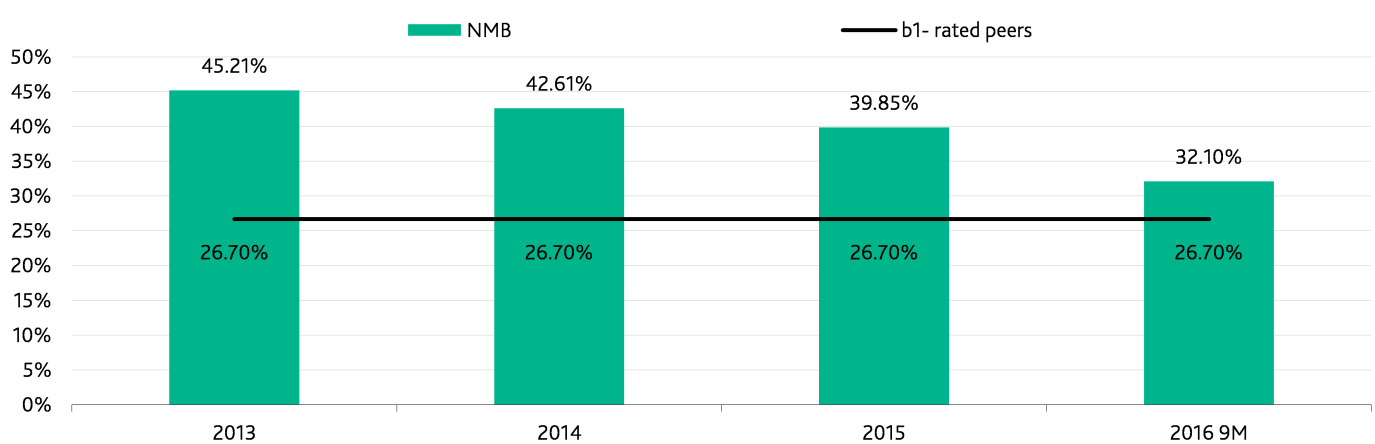
Exhibit 7
**Funding Breakdown of NMB**




*Source: National Microfinance Bank Plc Financial Statements, Moody's Financial Metrics*

NMB also maintains solid liquidity buffers, with liquid banking assets at 32% of tangible banking assets as of September 2016. Despite the recent drop from 40% as of end-2015, liquidity metrics compare favourably with the 27% median for b1-rated global peers (exhibit 8).

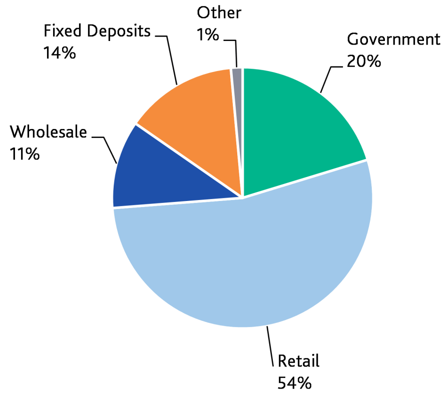
Exhibit 8
**Liquidity Metrics**




*Source: National Microfinance Bank Plc Financial Statements, CRDB Bank Plc Financial Statements, Moody's Financial Metrics*

Retail deposits make up 54% of total deposits (exhibit 9), with NMB having a lower cost of funding than the banking system. While government deposits continue to make up 20% of deposits these have come down over the past few years, amid the government's initiatives to manage excess liquidity more efficiently. As part of these initiatives, government agencies are transferring their excess balances out of the banking system and into the Bank of Tanzania. While NMB's funding profile remains a credit strength this has led to an increase in the cost of funding, as zero cost government deposits have been replaced with more costly private sector fixed-term deposits.

Exhibit 9
**Deposit Breakdown**
**September 2016**




*Source: National Microfinance Bank Plc Financial Statements, Moody's Financial Metrics*

In order to manage further government deposit withdrawals and continue to fund its loan growth, NMB is placing an increased emphasis on deposit mobilisation across all business units, with a focus on improving its service levels (through network convenience, offering advice, properly structuring products, and increased market segmentation) and improving and expanding its electronic payment solutions and transactional banking offering (to complement its strong collections capabilities), supported by improvements in its IT infrastructure. NMB also plans to diversify and lengthen its funding structure to include domestic bond issuances (it already issued a retail bond in May 2016) and continue to source funding from development finance institutions, while the bank is also looking into securitising its salary-linked personal loan book.

## Notching Considerations

### AFFILIATE SUPPORT

NMB maintains a beneficial association with Rabobank through a management and technical services agreement. We note however Rabobank's intention to reduce its 35% minority stake in NMB, following the creation of a Joint Venture with FMO (a Dutch development fund) and Norfund (a private equity company owned by the Norwegian Ministry of Foreign Affairs) that will hold all African subsidiaries and associates of the three entities, including NMB. The new joint venture will continue to hold a 35% stake in NMB, although Rabobank's indirect stake will fall to below 20%, with the remainder being held by FMO and Norfund. We expect NMB to continue to benefit from a similar management and technical service agreement with the joint venture.

Based on the above, we assume a 'low' probability of affiliate support from Rabobank, which does not result in any rating uplift for NMB.

### GOVERNMENT SUPPORT

NMB's B1 long-term local currency deposit rating is based on its b1 baseline credit assessment. We also believe there is a 'very high' likelihood of government support in the event of a stress, based on (1) authorities track record of supporting banks in times of stress, (2) the government's 32% direct shareholding in the bank, and (3) NMB's systemic importance as the second largest bank in Tanzania (with market shares of around 16%-18% in terms of domestic loans/ deposits/ assets). Despite our assessment of a 'very high' probability of government support, the bank does not benefit from any rating uplift due to the government's limited capacity to provide support.

We assign a B2 foreign-currency deposit rating to NMB, which is constrained at a lower level capturing foreign currency transfer and convertibility risks.

### COUNTERPARTY RISK ASSESSMENT

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than expected loss and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities. The CR Assessment takes into account the issuer's standalone strength as well as the likelihood of affiliate and government support in the event of need, reflecting the anticipated seniority of these obligations in the liabilities hierarchy. The CR Assessment also incorporates other steps authorities can take to preserve the key operations of a bank, should it enter a resolution.

NMB's CR Assessment is positioned at Ba3 (cr), one notch above the Adjusted BCA, reflecting our view that its probability of default is lower than that of deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

### SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

Unless noted otherwise, we have sourced data relating to system-wide trends and market shares from the central bank. Bank specific figures originate from banks' reports and Moody's Banking Financial Metrics. Full year results for 2013-2015 are based on NMB's consolidated financial statements, while we use NMB's quarterly unconsolidated financial statements as a proxy for the performance of the consolidated entity. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document: "Financial Statement Adjustments in the Analysis of Financial Institutions" (https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_187419 ) published on 12 February 2016.

### ABOUT MOODY'S BANK SCORECARD

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed.

As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Methodology and Scorecard Factors

Exhibit 10

**National Microfinance Bank Plc**

| **Macro Factors** | | |
|---|---|---|
| **Weighted Macro Profile** | **Very Weak +** | **100%** |

| **Financial Profile** | | | | | | |
|---|---|---|---|---|---|---|
| **Factor** | **Historic Ratio** | **Macro Adjusted Score** | **Credit Trend** | **Assigned Score** | **Key driver #1** | **Key driver #2** |
| Solvency | | | | | | |
| Asset Risk | | | | | | |
| Problem Loans / Gross Loans | 3.3% | b3 | ↓ | b3 | Expected trend | |
| Capital | | | | | | |
| TCE / RWA | 17.9% | ba3 | ←→ | ba3 | Expected trend | |
| Profitability | | | | | | |
| Net Income / Tangible Assets | 3.3% | ba1 | ←→ | ba1 | Expected trend | |
| Combined Solvency Score | | b1 | | b1 | | |
| Liquidity | | | | | | |
| Funding Structure | | | | | | |
| Market Funds / Tangible Banking Assets | 5.9% | b1 | ←→ | b1 | Extent of market funding reliance | |
| Liquid Resources | | | | | | |
| Liquid Banking Assets / Tangible Banking Assets | 39.9% | b2 | ↓ | b2 | Expected trend | |
| Combined Liquidity Score | | b1 | | b1 | | |
| Financial Profile | | | | b1 | | |
| Business Diversification | | | | 0 | | |
| Opacity and Complexity | | | | 0 | | |
| Corporate Behavior | | | | 0 | | |
| Total Qualitative Adjustments | | | | 0 | | |
| Sovereign or Affiliate constraint: | | | | | | |
| Scorecard Calculated BCA range | | | | ba3-b2 | | |
| Assigned BCA | | | | b1 | | |
| Affiliate Support notching | | | | -- | | |
| Adjusted BCA | | | | b1 | | |

| **Instrument class** | **Loss Given Failure notching** | **Additional Notching** | **Preliminary Rating Assessment** | **Government Support notching** | **Local Currency Rating** | **Foreign Currency Rating** |
|---|---|---|---|---|---|---|
| Counterparty Risk Assessment | 1 | 0 | ba3 (cr) | -- | Ba3 (cr) | -- |
| Deposits | 0 | 0 | b1 | -- | B1 | B2 |

*Source: Moody's Financial Metrics*

## Ratings

Exhibit 11

| Category | Moody's Rating |
|---|---|
| **NATIONAL MICROFINANCE BANK PLC** | |
| Outlook | Stable |
| Bank Deposits -Fgn Curr | B2/NP |
| Bank Deposits -Dom Curr | B1/NP |
| Baseline Credit Assessment | b1 |
| Adjusted Baseline Credit Assessment | b1 |
| Counterparty Risk Assessment | Ba3(cr)/NP(cr) |

*Source: Moody's Investors Service*

REPORT NUMBER 1053089

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