MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 July 2017

New Issue

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RATINGS

National Microfinance Bank Plc

Domicile	Tanzania
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.

Analyst Contacts

Christos Theofilou, CFA 357-2569-3004
AVP-Analyst
christos.theofilou@moodys.com

Savina R Joseph 357-2569-3045
Associate Analyst
savina.joseph@moodys.com

Constantinos Kypreos 357-2569-3009
VP-Sr Credit Officer
constantinos.kypreos@moodys.com

Jean-Francois Tremblay 44-20-7772-5653
Associate Managing Director
jean-francois.tremblay@moodys.com

Sean Marion 44-20-7772-1056
Managing Director - Financial Institutions
sean.marion@moodys.com

National Microfinance Bank Plc

Semiannual update

Summary rating rationale

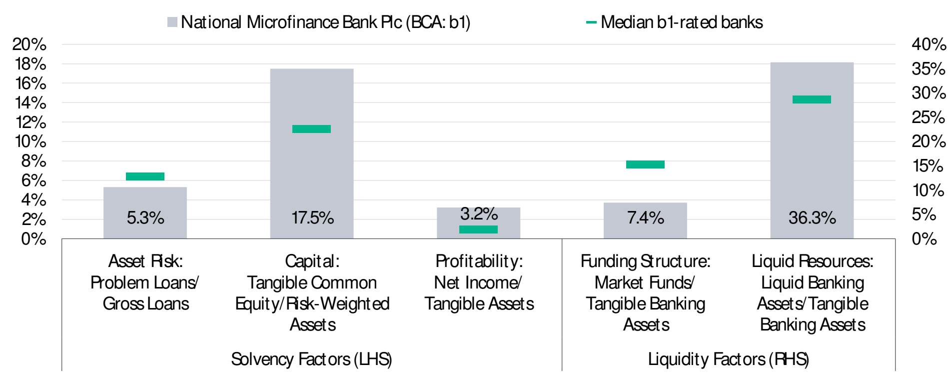
National Microfinance Bank Plc's (NMB) B1/Not-Prime local-currency deposit ratings capture the bank's standalone credit strength reflected in a b1 Baseline Credit Assessment (BCA).

The ratings reflect NMB's (1) solid capitalisation and profitability metrics, supported by the bank's retail-focused domestic franchise and beneficial association with Rabobank Netherlands (Aa2 stable, a2); (2) strong liquidity buffers and a retail-deposit-funded profile that has withstood the gradual reduction in government deposits; and (3) focus on salary-linked personal loans, which support the bank's asset-quality metrics.

At the same time, the ratings capture asset-quality risks for Tanzania's banks with weakening credit conditions following the government's austerity measures, higher interest rates and overall tighter credit availability for the country's borrowers.

We have also assigned a Ba3(cr)/Not-Prime(cr) Counterparty Risk (CR) Assessment and foreign-currency deposit ratings of B2/Not Prime, 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 are 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

» Strong profitability, supported by a solid domestic franchise

» High capitalisation buffers

» Retail deposit-based funding profile, with solid liquidity buffers

Credit challenges

» Tanzania's operating environment constrains NMB's ratings

» Asset-quality risks have risen, given weakening credit conditions

» Liquidity has tightened for the banking system following lower government deposits and austerity measures

Rating outlook

The outlook on NMB's ratings is stable. The stable outlook balances NMB's 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]

	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (TZS million)	4,938,280	4,563,231	3,888,668	3,287,175	14.5[4]
Total Assets (USD million)	2,264	2,113	2,244	2,071	3.0[4]
Tangible Common Equity (TZS million)	737,948	639,322	561,425	455,315	17.5[4]
Tangible Common Equity (USD million)	338	296	324	287	5.7[4]
Problem Loans / Gross Loans (%)	5.3	2.6	3.8	3.4	3.8[5]
Tangible Common Equity / Risk Weighted Assets (%)	17.5	17.9	17.7	16.7	17.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	19.0	9.5	12.7	11.4	13.1[5]
Net Interest Margin (%)	10.0	9.2	11.0	10.4	10.1[5]
PPI / Average RWA (%)	6.5	6.8	8.1	7.8	7.3[6]
Net Income / Tangible Assets (%)	3.2	3.3	4.0	4.1	3.6[5]
Cost / Income Ratio (%)	57.5	56.3	53.3	51.6	54.7[5]
Market Funds / Tangible Banking Assets (%)	7.4	5.9	5.4	5.1	5.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	36.3	39.9	42.6	45.2	41.0[5]
Gross Loans / Due to Customers (%)	75.7	69.9	67.4	63.8	69.2[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel II periods presented

Source: Moody's Financial Metrics

Detailed rating considerations

Tanzania's operating environment constrains NMB's ratings

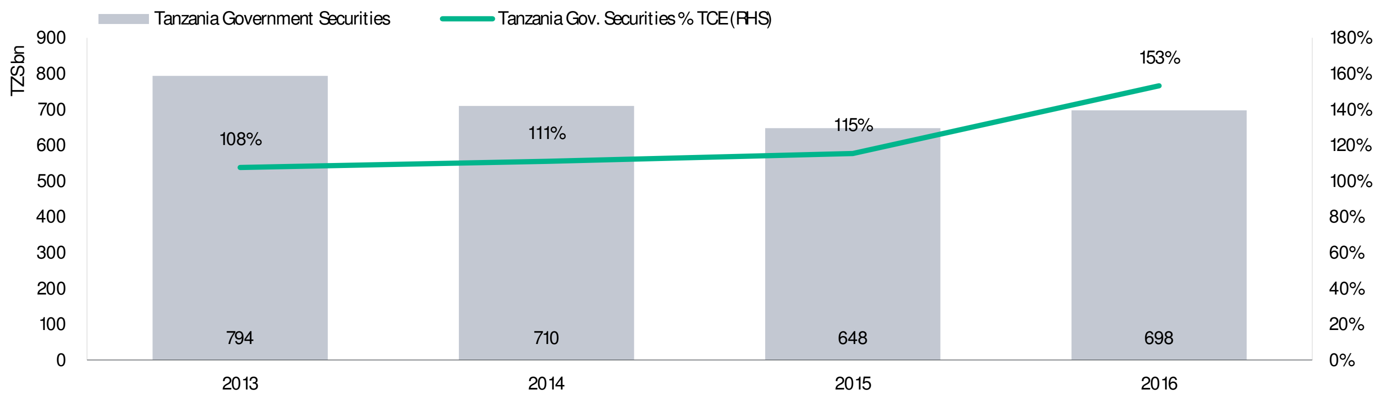
With NMB having 98% of its assets in Tanzania as of the end 2016, its asset quality remains susceptible to developments in the operating environment in Tanzania. Our Very Weak+ assessment of the operating environment reflects the country's rapidly expanding and fairly diversified economy, and low susceptibility to event risk. At the same time, the assessment captures the country's low institutional capacity, with an increasingly unpredictable policy environment that weighs on investor confidence.

Credit conditions for Tanzanian banks also reflect limitations in the quality of the credit information available, while these conditions have recently weakened due to a tighter fiscal policy, austerity measures, under-execution of capital spending, higher interest rates and tighter credit conditions for the country's borrowers. The tighter credit conditions follow a slowdown in lending, given the banks' tough liquidity conditions subsequent to the transfer of government deposits from the banking system to a single treasury account with the central bank. A stricter enforcement of tax collection is also exerting pressure on corporates that are faced with tightening liquidity.

NMB's credit profile is closely linked to the fiscal position of the Tanzanian government through the bank's high direct holdings of government securities at around 1x its tangible common equity, as Exhibit 3 shows.

Exhibit 3

High direct government exposure for NMB



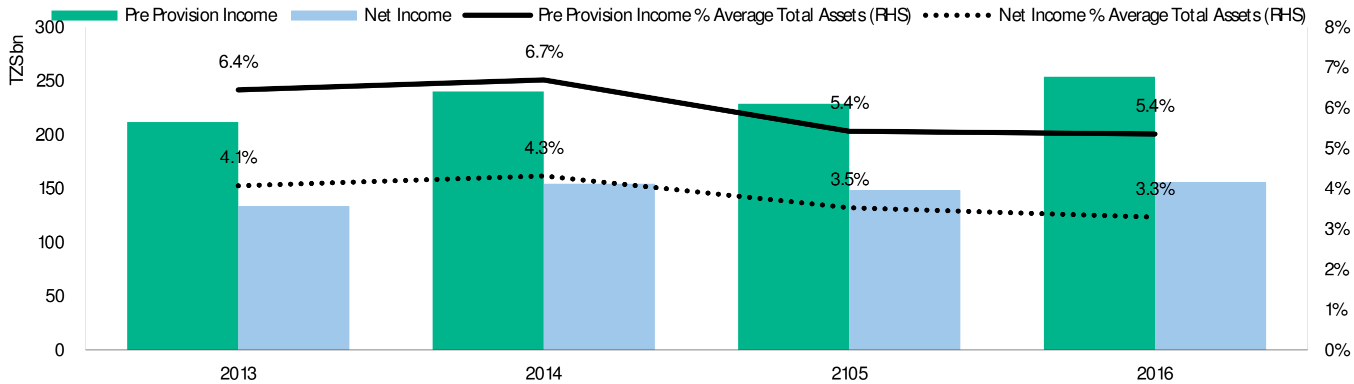
Sources: NMB's financial statements, Moody's Investors Service

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

We expect NMB's profitability to remain a credit strength, despite the recent drop, supported by the bank's solid retail-based domestic franchise, its beneficial association with Rabobank Netherlands and Tanzania's strong medium-term growth potential.

NMB's net income/tangible assets stood at a strong 3.2% in 2016, which compares favourably with the 0.9% b1-rated peer median, although lower than the 3.3% achieved in 2015 (see Exhibit 4). Pre-provision income/average total assets was a strong 5.4% in 2016 (2015: 5.4%), compared with the 2.2% for b1-rated peers. Profitability remains strong, supported by a high net interest margin of 10.0% in 2016 (2015: 9.2%), which has recently benefited from high interest rates on government securities, and 13% growth in gross loans. Unconsolidated profitability metrics reported in the first three months of 2017 were in line with those of 2016, with net interest income increasing 9.0% annually and loan-loss provisions consuming 12.5% of pre-provision income (8.9% in the first three months of 2016).

Exhibit 4
NMB's profitability metrics remain strong



Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

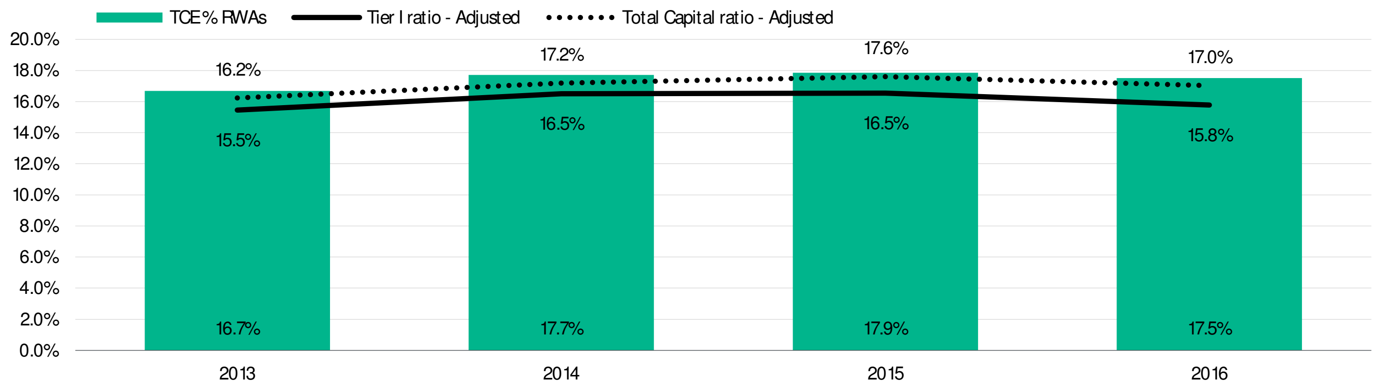
Profitability remains strong in spite of increased funding costs and investment spending, and higher loan-loss provisions. Loan-loss provisions increased to around 1.1% of average gross loans in 2016 (2015: 0.6%), while cost/income increased to 57.5% (2015: 56.3%). Higher expenses reflect NMB's significant ongoing investments in the IT platform, payments processing, staff and branch network expansion, although the bank already has implemented initiatives to improve efficiency.

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 two million customers and a countrywide branch network. In addition, the bank has a management and technical service agreement with Rabobank, whereby it 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 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 and strengthening its internal capabilities to reach more customers. The bank's profitability should also benefit from the release of funds, following the reduction of the cash reserve ratio requirement from 10% to 8% in March 2017[1] and lower cost of funding due to lower competition for deposits in the country.

High capitalisation buffers

NMB's capital buffers support its solvency position and overall rating. The bank's tangible common equity is 17.0% of our adjusted risk-weighted assets[2] as of December 2016 (see Exhibit 5), compared with a 11.3% global median for b1-rated banks. We expect the capital adequacy ratios to drop following the inclusion of the market and operational risk-weighted assets[3], although the bank is expected to maintain levels higher than the domestic regulatory requirements of a core Tier 1 ratio of 10%, plus the 2.5% conservation buffer, and a total capital ratio of 12%, plus the 2.5% conservation buffer, effective August 2017.

Exhibit 5
Capitalisation to remain a credit strength, despite higher risk-weighted assets



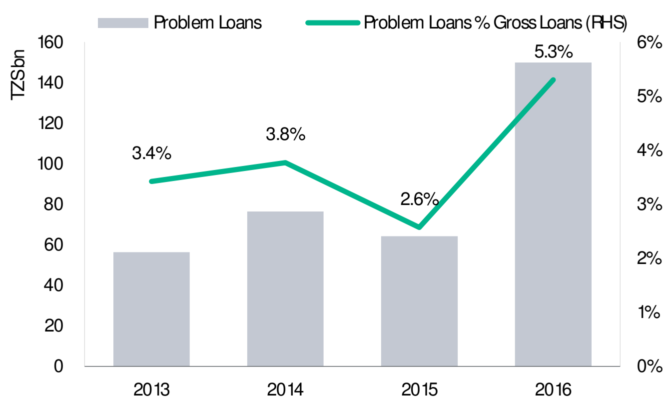
Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

In addition to the bank's internal capital generation that will support capital through strong profitability and moderate loan growth over the next 12-18 months, the bank is looking into other potential measures to boost capital above the internal minimum. The measures include revising its dividend policy downward or a capital increase either through a rights issue or a Tier 2 subordinated debt issue.

Asset-quality metrics are supported by salary-linked personal lending focus, but risks have risen

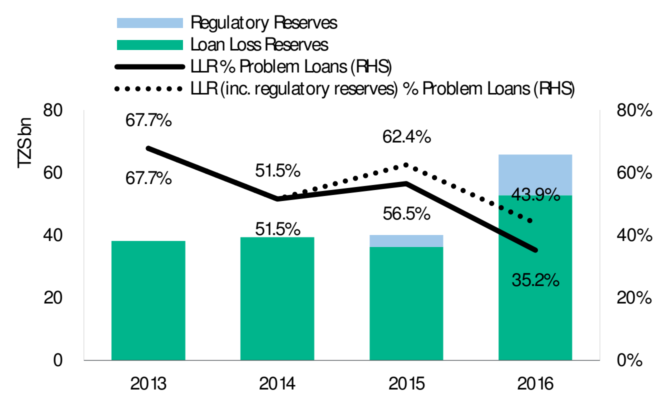
NMB's problem loan ratio of 5.3% as of the end of 2016 remains better than the 9.5% local system average reported for the same period and 6.4% for b1-rated global peers, despite a deterioration in 2016 (see Exhibit 6). The asset-quality deterioration in 2016 reflects a weakening in a few collateralised corporate exposures, given the challenging credit conditions (see above). As a consequence, NMB's provisioning coverage dropped to around 35% of problem loans by year-end 2016 (from 56% at year-end 2016 as Exhibit 7 shows), which we view as low. Nonetheless, the bank holds additional provisions in a regulatory reserve (part of Tier 2 capital) that increases the regulatory provisions to 44% of problem loans, while its strong profitability provides a strong buffer to absorb provisions, with problem loans at just 59% of pre-provision income.

Exhibit 6
Increased credit risk...



Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

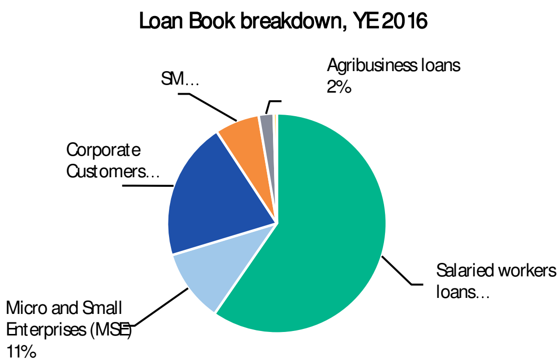
Exhibit 7
...with declining provisioning coverage



Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

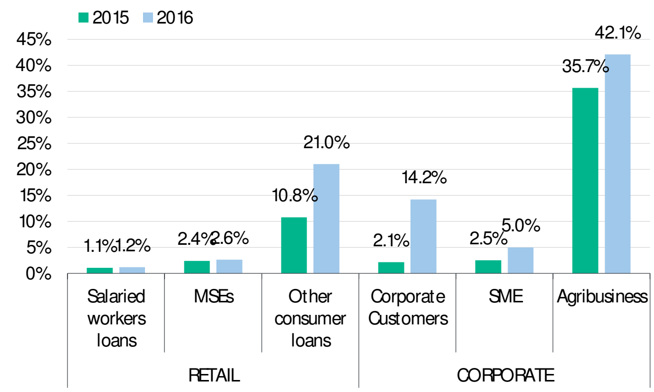
NMB's asset-quality metrics are better than those of its peers, supported by the bank's concentration in personal lending (in particular salary-linked lending, primarily to government employees), fairly low-risk appetite and adequate risk management processes (supported by its technical agreement with Rabobank). At year-end 2016, salary-linked loans accounted for 60% of the total, loans to large corporates 20%, and micro and small and medium-sized enterprises (MSME) loans 17% (see Exhibit 8). Asset quality was weaker in the corporate loan book, with a segment nonperforming loan (NPL) ratio of 14%, while the agribusiness NPL ratio reached 42% at year-end 2016. Positively, only 8% of loans were in foreign currency as of the year-end 2016, the majority were in exporting corporates.

Exhibit 8
Loan book breakdown



Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

Exhibit 9
NPL ratio by segment



Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

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 installments to a maximum of 50% of net salary.

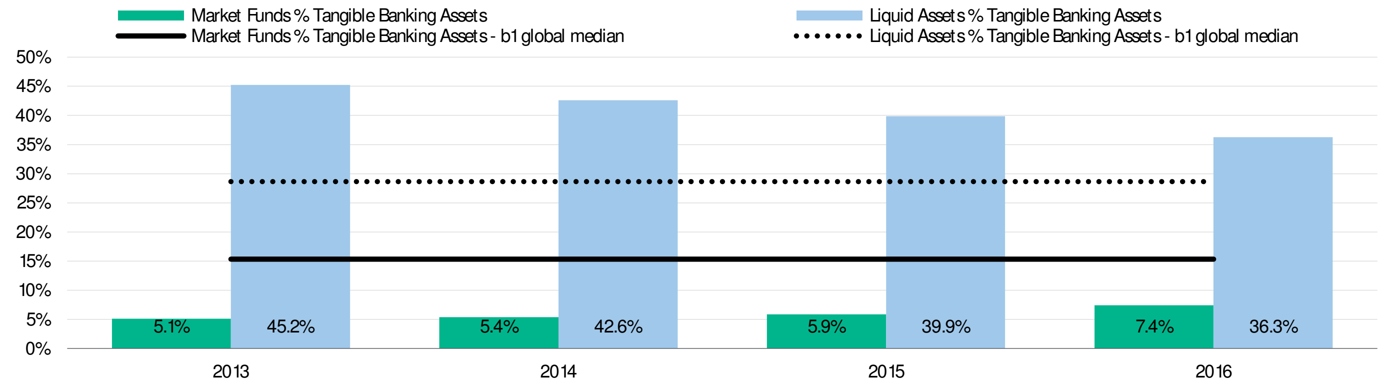
However, government austerity measures will continue to reduce compensation and benefits of government workers, and the pace of growth of this loan portfolio is expected to slow, which, in addition to increasing competition, forces the bank to diversify its loan book and service offerings. While this 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. 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 the bank to 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 mainly deposit funded, with deposits making up 91% of total funding as of December 2016. The bank's reliance on market funding remains low at 7.4% of tangible banking assets as of December 2016, compared with the global median for b1-rated banks of 15.3% (see Exhibit 10).

NMB also maintains solid liquidity buffers, with liquid banking assets at 36% of tangible banking assets as of December 2016, which compares favourably with the 29% median for b1-rated global peers. Unconsolidated customer deposits have grown by 1% in the first three months of 2017, while gross loans have contracted by 1%, supporting liquidity metrics through stable net loans/deposits of 73% (75% as of December 2016).

Exhibit 10
Liquidity metrics



Sources: National Microfinance Bank Plc Financial Statements, Moody's Investors Service

We estimate that retail deposits account for over half of total deposits, with NMB having one of the lowest cost of funding in the banking system. While government deposits continue to make up around 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.

To manage further government deposit withdrawals and continue to fund its loan growth, NMB is placing 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 improvement in its IT infrastructure. NMB also plans to diversify and expand 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.

Notching considerations

Affiliate support

NMB maintains a beneficial association with Rabobank through a management and technical services agreement, although we assume a low probability of affiliate support from Rabobank, which does not result in any rating uplift for NMB.

ARISE has been formed as a joint venture among Rabobank Netherlands (Aa2 negative, a2), Netherlands Development Finance Company (FMO, a Dutch development fund) and Norfund (a private equity company owned by the Norwegian Ministry of Foreign Affairs). ARISE will eventually hold all African subsidiaries and associates of the three entities, including a 35% stake in NMB (previously held by Rabobank). Rabobank's indirect stake will fall below 20%, with the remainder being held by FMO and Norfund.

Government support

NMB's B1 long-term local-currency deposit rating is based on its b1 BCA. We also believe there is a very high likelihood of government support in the event of 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 16%-18% in terms of domestic loans, deposits or 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 have assigned a B2 foreign-currency deposit rating to NMB, which is constrained at a lower level, capturing foreign-currency transfer and convertibility risks.

Counterparty Risk (CR) Assessment

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 to limit contagion, minimize losses and avoid disruption of critical functions.

Sources 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. The global medians quoted in the report are updated as of July 2017 and are calculated using the most recent full-year financial data for rated banks.

Bank-specific figures originate from banks' reports and Moody's Banking Financial Metrics. The full-year results for 2013-15 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 (published in June 2017).

About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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 11

National Microfinance Bank Plc

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

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	5.3%	caa1	↓	caa1	Expected trend	
Capital						
TCE / RWA	17.5%	ba3	↓	b1	Expected trend	
Profitability						
Net Income / Tangible Assets	3.2%	ba1	←→	ba1	Expected trend	
Combined Solvency Score		b1		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	7.4%	b1	←→	b1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	36.3%	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				0		
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 12

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

Endnotes

1 Tanzania's Banks Will Benefit from Central Bank's Lower Cash Reserve Requirement

2 In calculating the ratio, we use Moody's standard adjustments, whereby we risk-weight government securities at 100%.

3 Tanzanian Bank's Increased capital Requirements Are Credit Positive

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