



GALT & TAGGART

CREATING OPPORTUNITIES

Microfinance sector overview

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KEY FINDINGS

STATUS QUO

- Despite facing a number of regulatory challenges in recent years, the MFO gross loan portfolio has sustained steady growth, with an 11.0% CAGR over 2019-24.
- The sector prioritizes consumer lending over business loans, mainly driven by high funding and hedging costs, leading to high interest rates on MFO loans.
- MFOs have limited access to GEL resources, yet they are required to issue loans in GEL. This FX mismatch necessitates hedging, further increasing the interest rates on MFO loans.

MICROBANK MODEL

- The status quo led to the initiation of new microbank model, serving as an intermediate structure between traditional banks and MFOs.
- The microbank model will enhance access to GEL resources, lowering funding costs. In addition, microbanks will be able to issue loans of up to GEL 1mn, compared to the current limit of GEL 100K.
- Reduced funding costs will lower interest rates. Besides, increased lending limits will enable microbank to offer more loans to the MSME sector.
- 3 MFOs are presently involved in the transition process, expected to finalize by the end of the year. At present, there are no other viable candidates in the market eligible for transfer to microbanks.



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MFO sector in Georgia

The MFO sector in Georgia primarily focuses on individual loans

MFO Gross loan portfolio, 2Q24

GEL 1.9bn

Individual clients

GEL 1.9bn (98.6%)

Legal entities
GEL 25mn
(1.4%)

Pawnshop loans
GEL 1.0bn (51.7%)

Consumer loans
GEL 0.6bn
(30.5%)

Others
GEL 7.5mn
(0.4%)

Trade & Service
GEL 0.2bn
(9.7%)

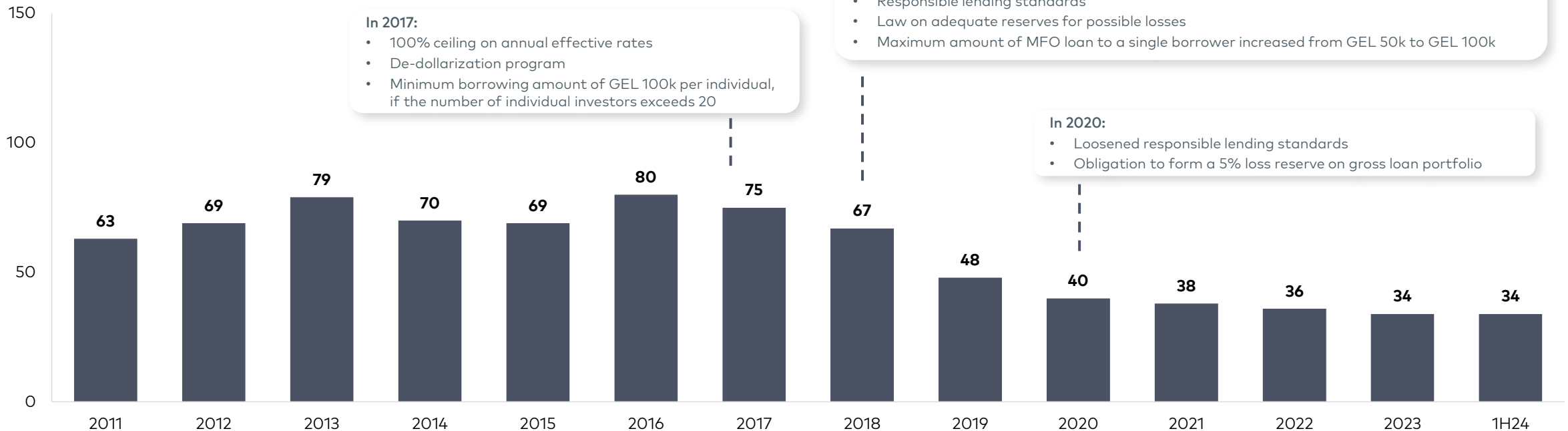
Agriculture
GEL 0.1bn
(6.4%)

Business loans

MFO sector in Georgia

The sector has faced a bunch of regulations, leaving only qualified players on the market

Number of MFOs

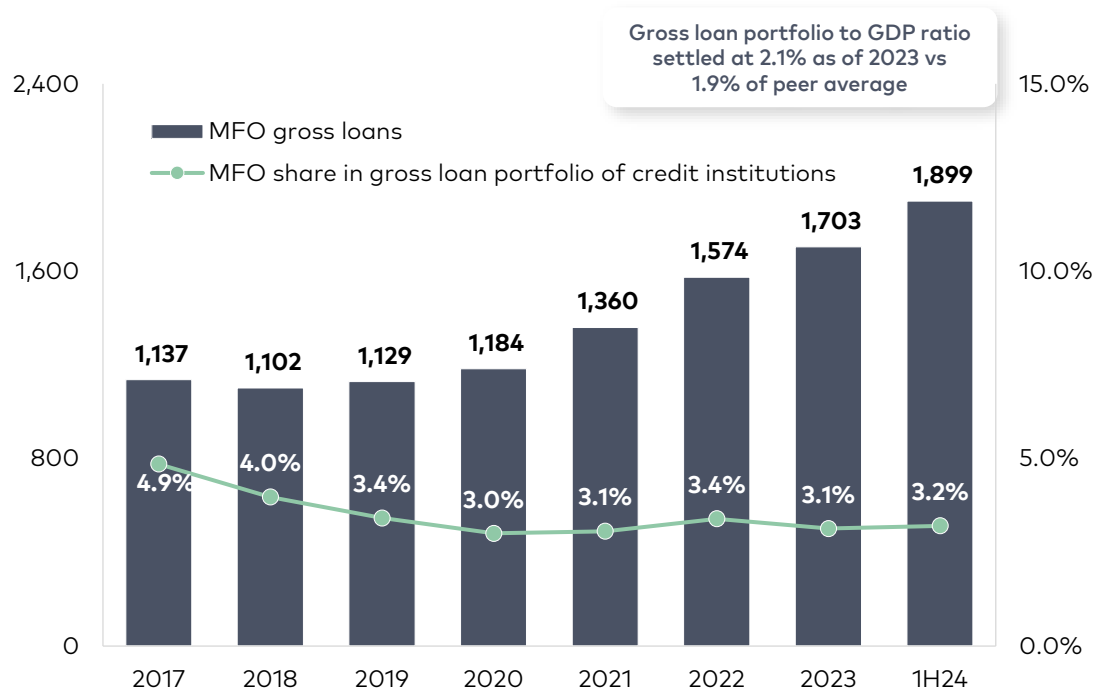


The MFO sector grew rapidly until 2017, but the stricter regulatory environment forced less qualified players (including online loan institutions) out of the market. By the 1H24, the number of active MFOs had dropped to 34, compared to 80 in 2016.

MFO sector in Georgia

Despite regulations, the gross loan portfolio continued to grow and improve in quality, as reflected in lower risk ratios

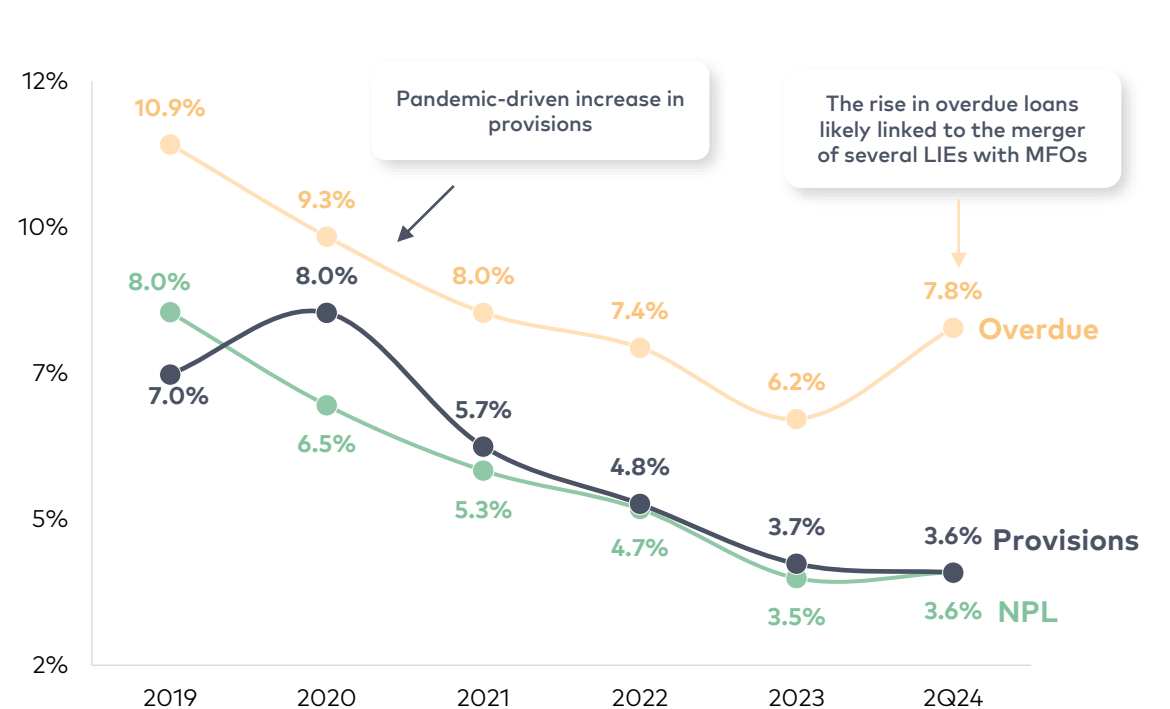
MFO gross loan portfolio, GEL mn



The MFO gross loan portfolio grew steadily with an 11.0% CAGR over 2019-24. The MFO share in the total gross loan portfolio of credit institutions has remained steady at approximately 3% during this period.

Source: NBG, Galt & Taggart
Note: NPL – past due by more than 30 days, LIE- Loan Issuing Entity

Key indicators evaluating the risk of MFOs' loan portfolios

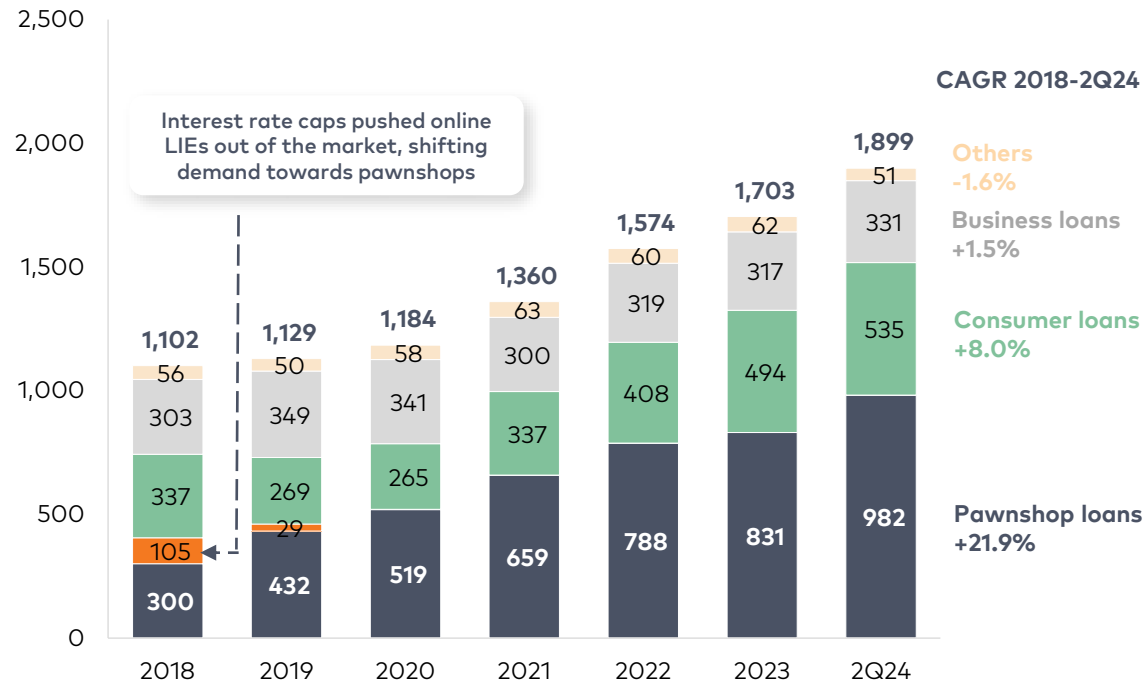


The regulations have improved the quality of MFO portfolio, evidenced in the downward trends in provisions, non-performing loans (NPLs), and overdue loans.

MFO sector in Georgia

The portfolio growth was mainly driven by an increase in pawnshop loans

MFO gross loan portfolio by sector, GEL mn



Pawnshop loans have increased at the fastest rate, driven by two main factors:

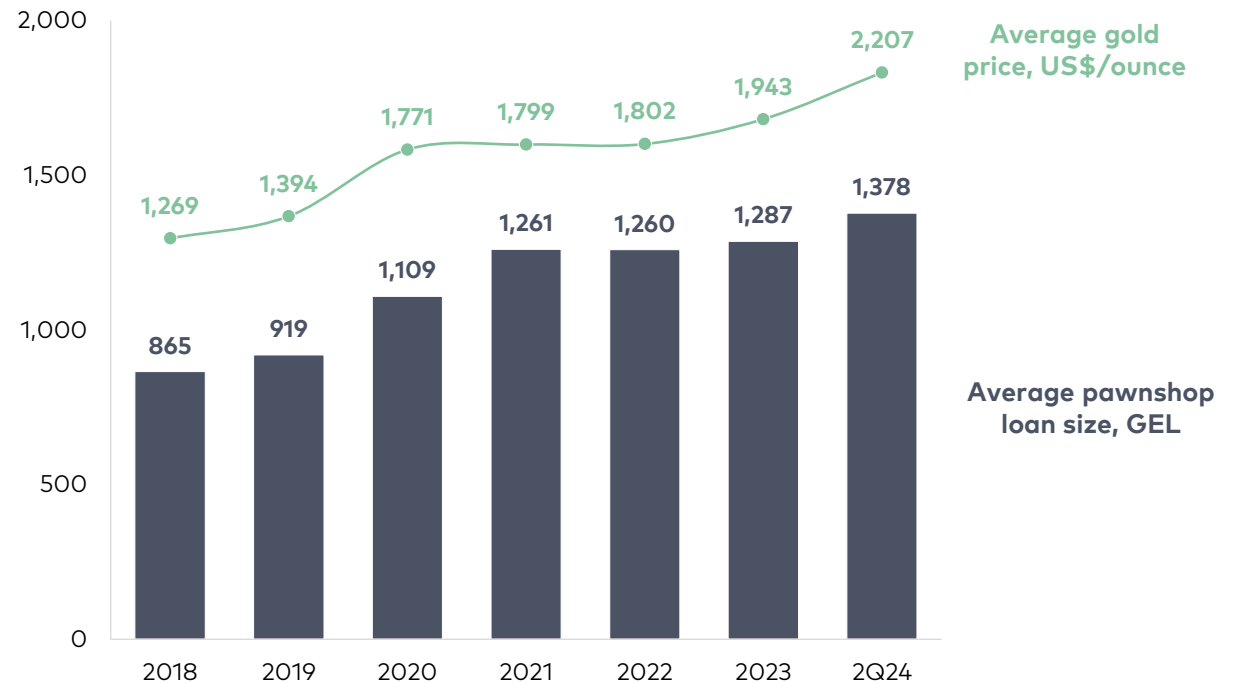
- 1) Increased number of clients previously using online loans
- 2) Increasing gold price

Source: NBG, Bloomberg, Galt & Taggart

Note: Consumer loans also include online loans and installments;

LIE- Loan Issuing Entity

Average pawnshop loan size and Gold spot price

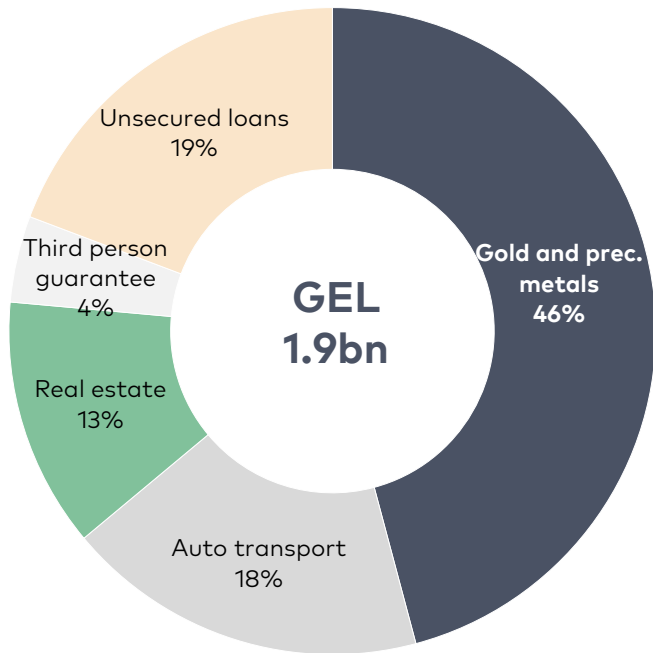


The average size of pawnshop loans has risen in line with global gold prices, recording a CAGR of 8.1% over 2018-24, vs a 9.7% CAGR for gold.

MFO sector in Georgia

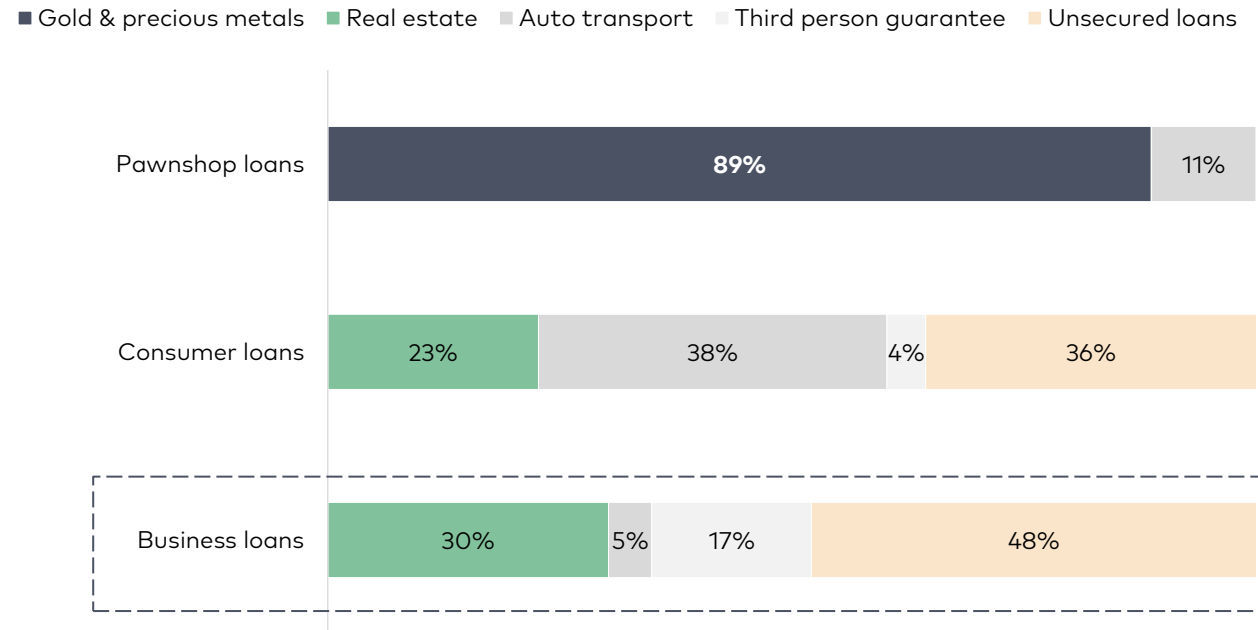
Pawnshop loans are fully collateralized, lifting the overall sector soundness

Distribution of loan portfolio by collateral, 2Q24



Pawnshop loans are almost entirely collateralized by gold, consumer loans by auto transport.

Distribution of loan types by collateral

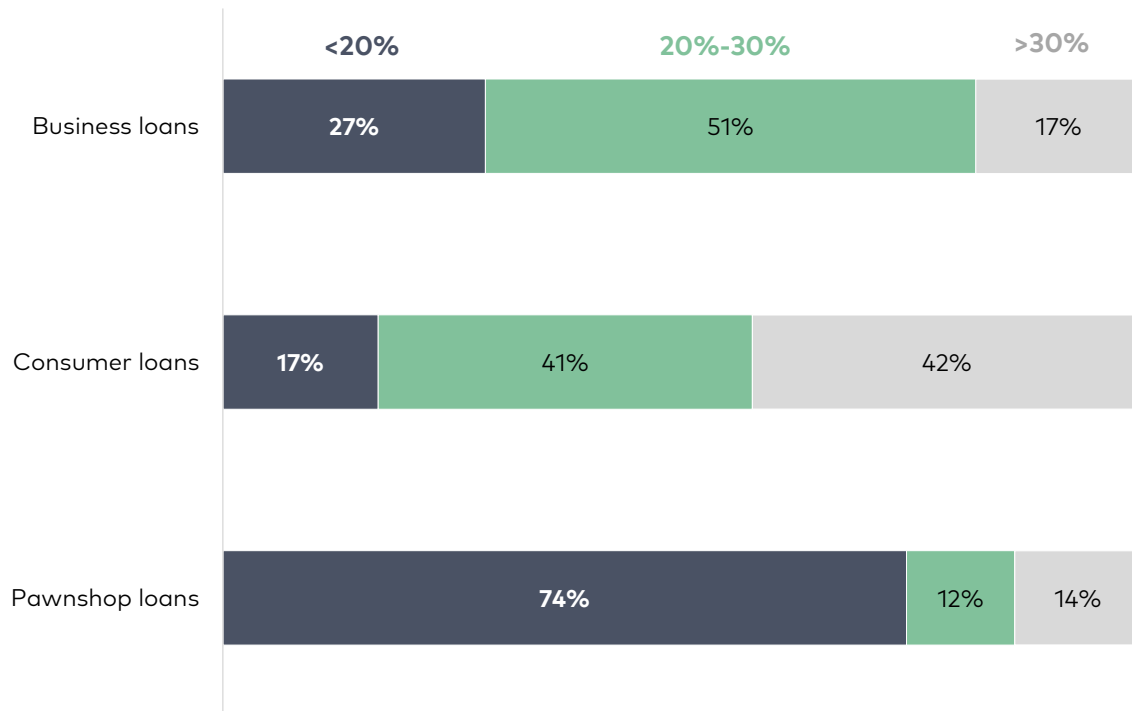


In contrast, business loans are typically unsecured, as they often lack sufficient assets to offer as collateral.

MFO sector in Georgia

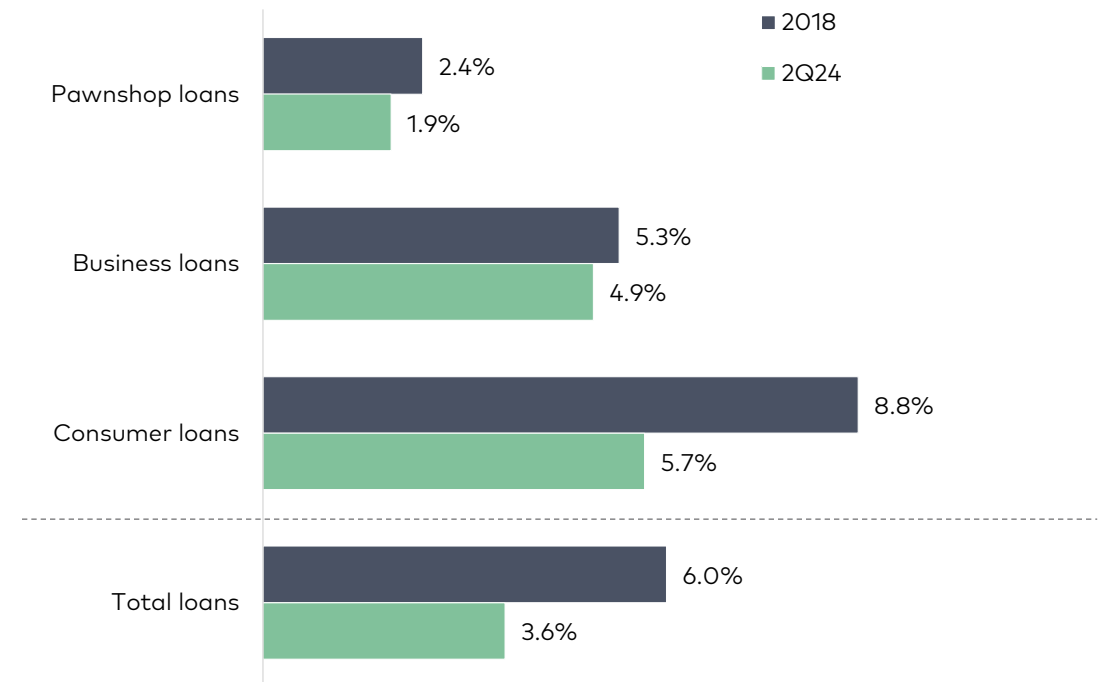
Unlike pawnshop loans, most business loans are uncollateralized, bearing higher risk and resulting in high interest rates

Interest rate ranges by loan types



MFO business loans are mostly issued at a minimum 20% interest rate.

MFO reserves for possible losses by type of loan

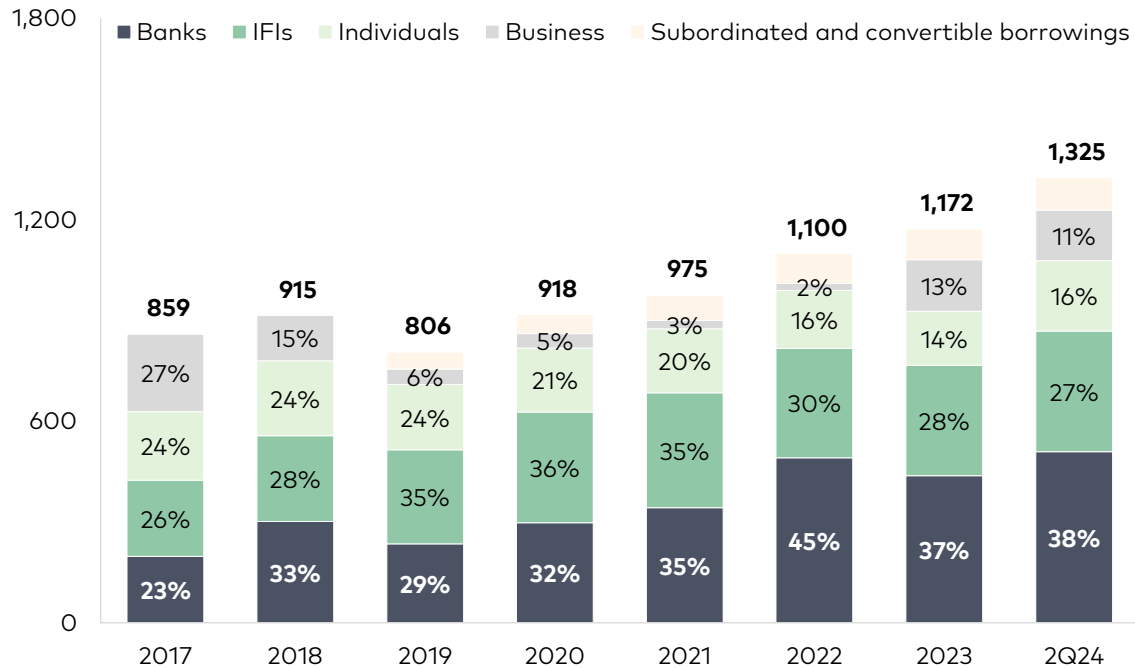


The relatively high riskiness of business loans is also expressed in higher reserves, standing at 4.9% as of 2Q24, as they typically consist of clients who do not qualify for bank financing.

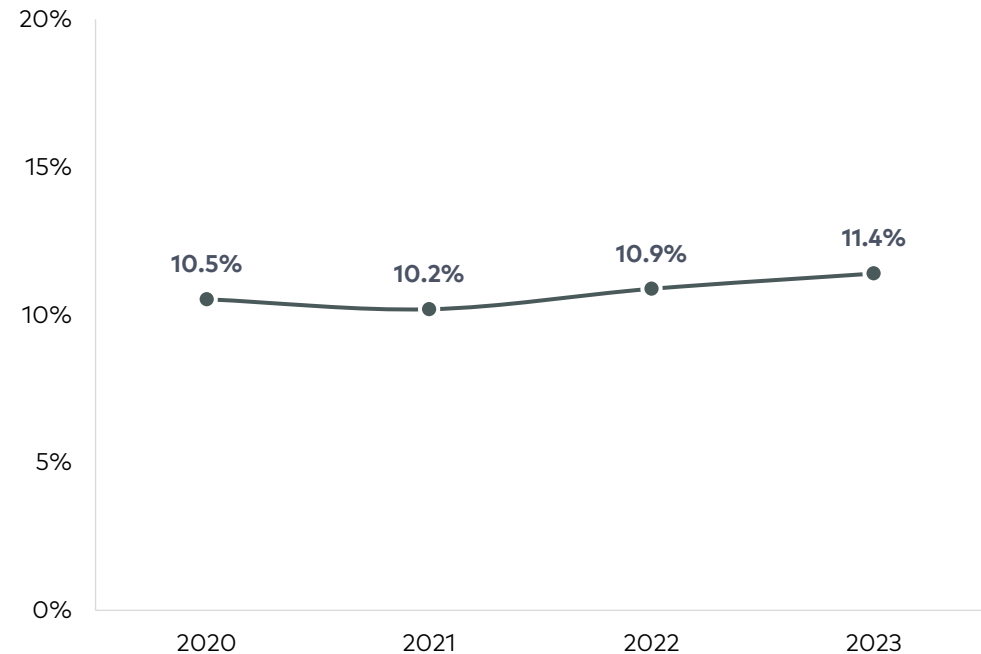
MFO sector in Georgia

High interest rates on MFO loans are linked to high funding and hedging costs

MFO total borrowings by funding source, GEL mn



Average cost of funds of MFOs



MFOs primarily obtain funding from banks and IFIs, however the share of alternative funding sources such as bonds and promissory notes, has been increasing in recent years.

The cost of funds for MFOs is c. 2-3x higher than that of large banks, but relatively closer to the figures of smaller-sized banks.

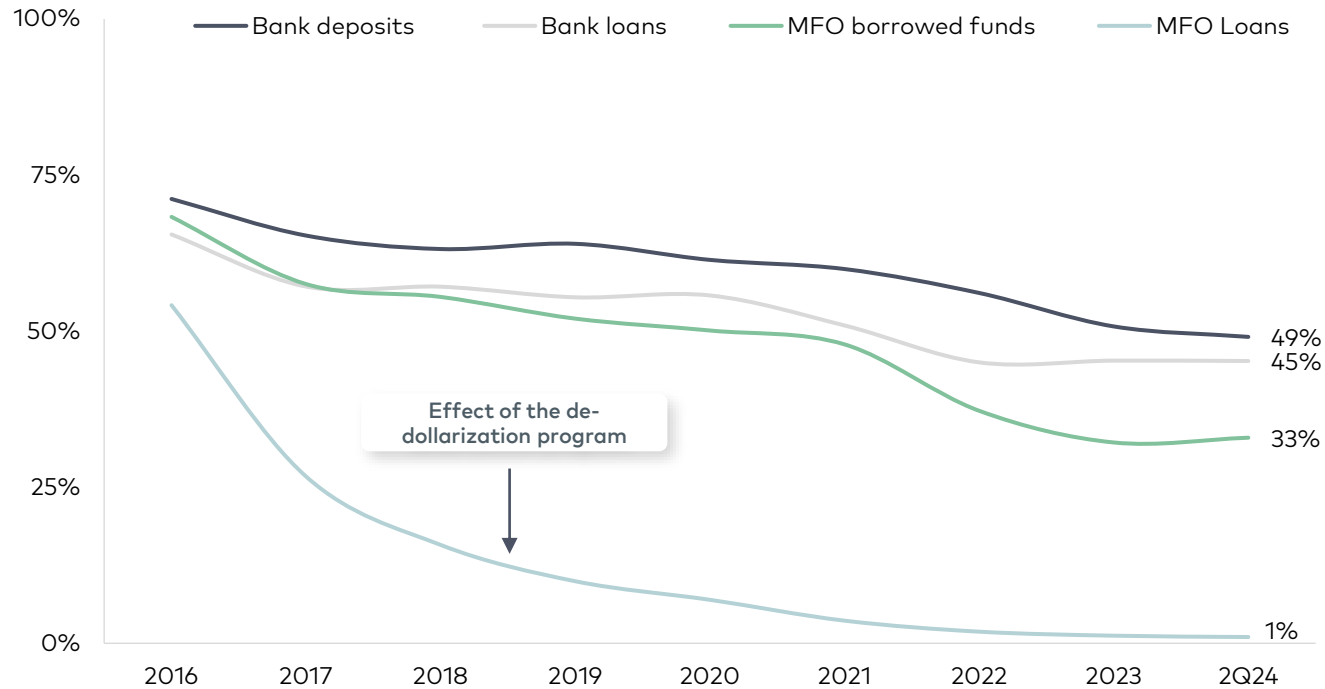
Source: NBG

Note: Costs of funds do not include hedging costs (i.e. swap fees etc.)

MFO sector in Georgia

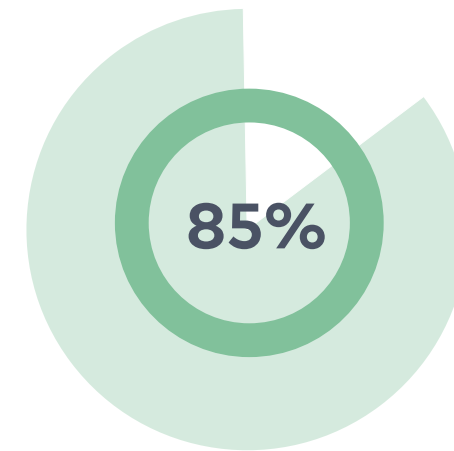
Hedging is essential to manage FX risks, as 33% of MFO borrowings are in FX while the entire loan portfolio is in GEL

FX share in Bank loan and deposit portfolio vs MFO loan portfolio and borrowed funds



32% of MFO borrowed funds are in FX while MFOs can only lend in GEL, exposing them to currency risk. In contrast, banks benefit from natural hedging due to having both FX funding and an FX loan portfolio.

Share of hedged FX liabilities, 1H24

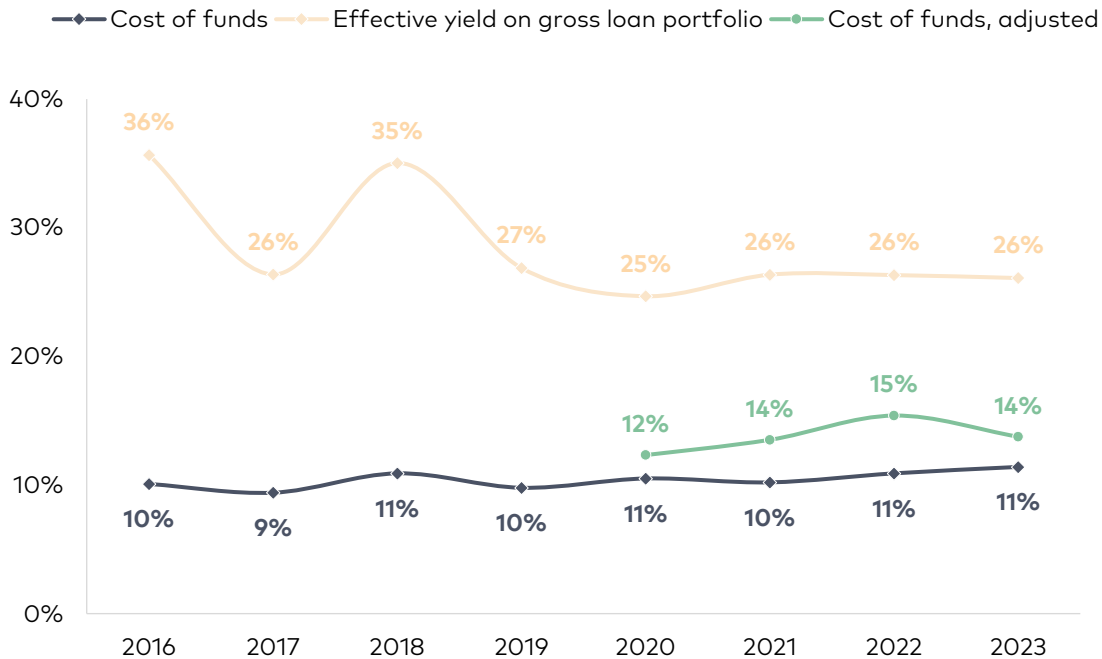


85% of MFO FX liabilities are hedged through swaps, however the high hedging costs further burden MFOs, diminishing their overall competitiveness in the market.

MFO sector in Georgia

Despite high funding and hedging costs, the sector maintains high profitability

Microfinance sector profitability indicators

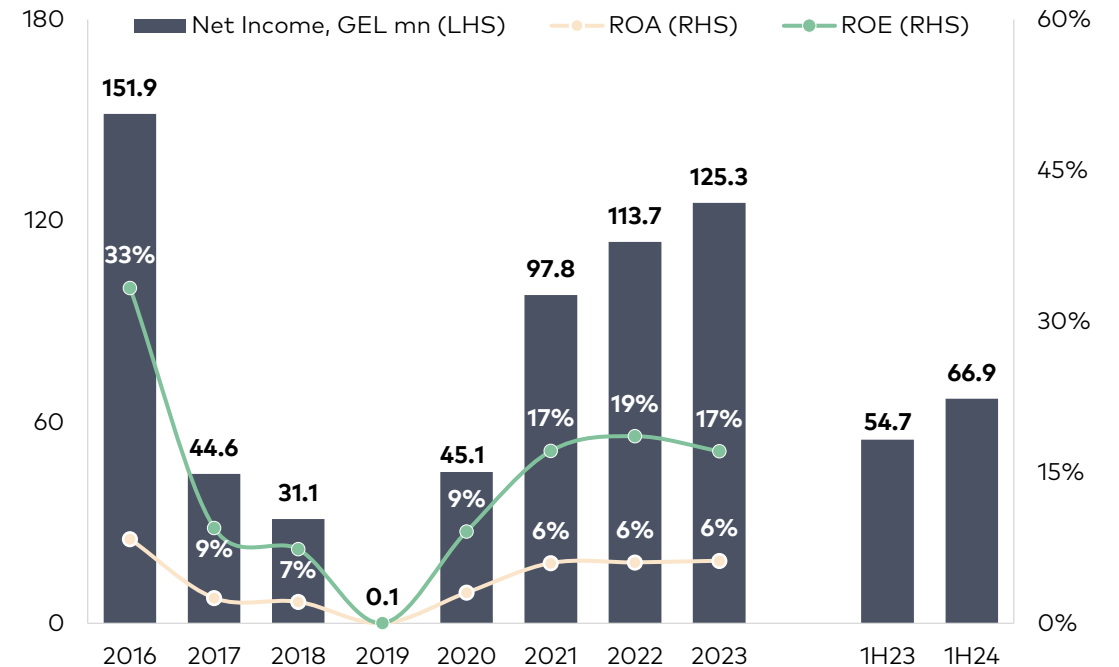


Regulations have reduced yields on the gross loan portfolio, which, along with high hedging costs, have narrowed MFOs' spreads, though they remain higher than those of systemic banks.

Source: NBG, Galt & Taggart

Note: Adjusted cost of funds includes swap expenses, Effective yield includes net fee and commission income

Microfinance sector profitability



Reduced yields, coupled with high operating costs, have pressured profitability since 2016. However, strong portfolio growth since the pandemic, along with stability in yields and cost of funds, has led to improved profitability post-pandemic, with ROE and ROA reaching 17% and 6%, respectively, as of 2023.



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FUTURE OUTLOOK

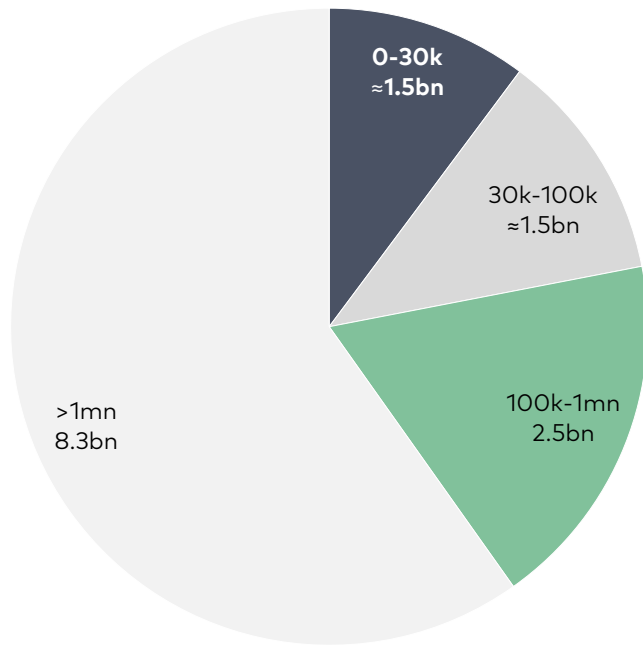
Microbank model will lower funding costs, leading to higher exposure to business loans

		MFO	VS	Microbank
BENEFITS	Loan limits	Up to GEL 100K		Up to GEL 1mn
	Taking deposits	No right		Up to GEL 30K
	NBG GEL resources	No access		Access
	Client accounts	No ability		Able
REQUIREMENTS	Business loans	No requirement		Minimum 50% share in total portfolio (70% after 2 years)
	Supervisory capital	Min. GEL 1mn		Min. GEL 10mn

FUTURE OUTLOOK

Microbanks will be able to receive deposits up to GEL 30K, however this may not be the optimal choice

GEL-denominated term deposits by ranges, Jul-24

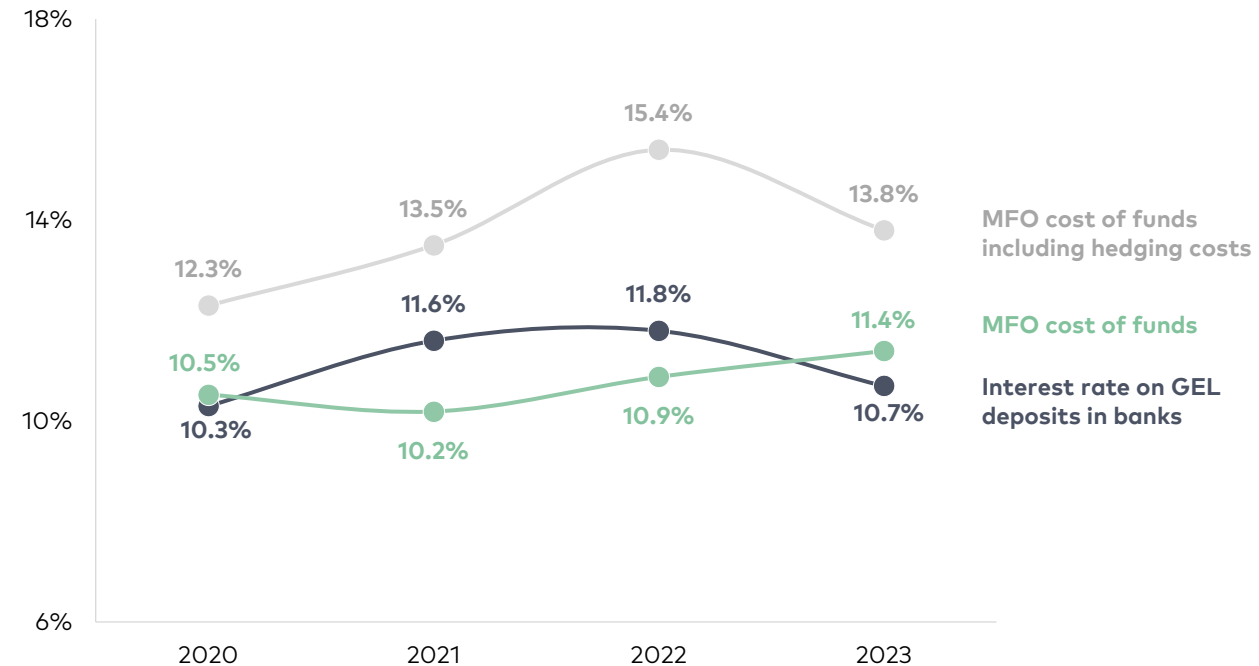


The Microbank status will enable current MFOs to access a potential funding source of GEL 1.5bn, through deposits. This is a current total size of GEL-denominated term deposits within the 0-30k GEL range.

Source: NBG, Galt & Taggart

Note: Term deposits include those of individuals and businesses

Cost of funds for MFOs vs interest rate on GEL deposits in banks

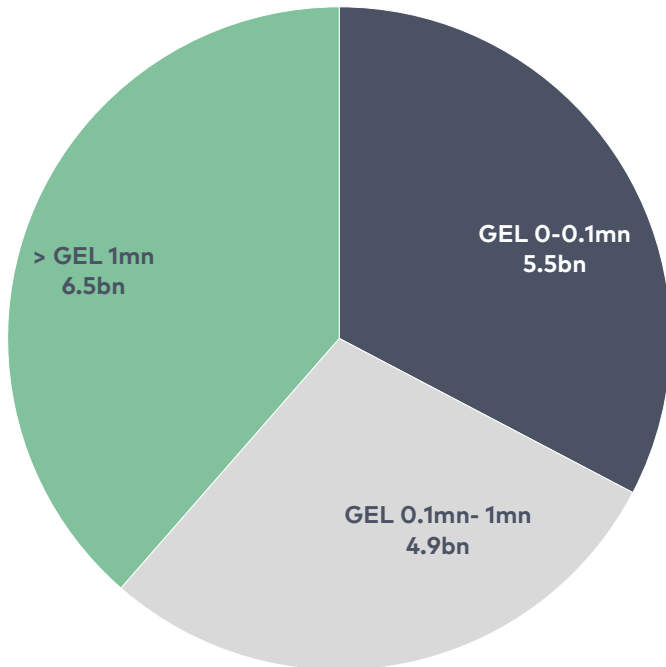


Given the current interest rates on GEL deposits in banks, microbanks will need to offer at least 11% to remain competitive, which is relatively lower than current cost of funds for MFOs including hedging costs. However, it is unlikely that deposits will become the major funding source in the near future.

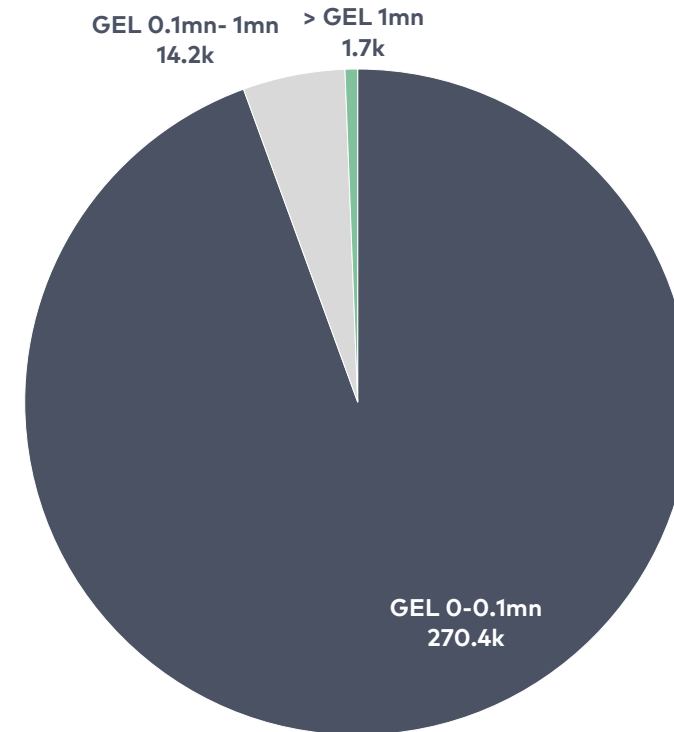
FUTURE OUTLOOK

Microbanks will be able to issue loans up to GEL 1mn, providing an additional GEL 4.9bn lending opportunity

GEL-denominated business loans by ranges, Jul-24



Number of GEL-denominated business loans by ranges, Jul-24





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