LAPO Microfinance Bank Limited

Final Rating Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

LAPO MICROFINANCE BANK LIMITED

Rating Assigned:

A-

A financial institution of good financial condition and strong capacity to meet its obligations.

Outlook: Stable
Issue Date: 5 September 2018
Expiry Date: 30 June 2019
Previous Rating: A-

Industry: Microfinance

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RATING RATIONALE

LAPO Microfinance Bank Limited's ('LAPO' or 'the Bank') rating reflects the Bank's strong market position, good capitalisation, good liquidity and funding profile. However, the rating is constrained by the rising level of impaired loans, increasing operating costs and the impact of low BVN compliance on loan disbursements and profitability. The rating is also tempered by the fragile but improving economy which continues to impact the quality of the Bank's loan portfolio.

Following a weak economic performance during the first half of 2017, the loan portfolio grew moderately by 6% to ₦55.5 billion as at 31 December 2017. As at same date, LAPO's portfolio-at-risk (PAR) to gross loans ratio increased to 7.9% from 5.8% in the prior year - higher than the regulatory threshold of 5%. Nonetheless, loan loss provisions remained adequate at approximately 93.3%. The rising level of impaired loans reflect the need to build a stronger credit risk management system – particularly origination and remedial management. As at 30 June 2018, the Bank's PAR to gross loans ratio had risen to 10.7% as the repayment capacity of a significant number of obligors remained weak, in light of the fragile macroeconomic climate.

Although LAPO's earnings profile was bolstered by the growth in the loan portfolio and favourable yields, profitability declined in 2017. Profitability was adversely impacted by a high cost profile and a rise in charge-offs as the volume of impaired loans increased. LAPO's cost-to-income ratio (CIR) increased to 77.7% (2016: 71%) while profitability indicators – pre-tax return on average assets (ROA) and average equity (ROE) declined to 8.8% and 38.6% respectively (2016 – ROA: 11.7%, ROE: 56.3%). Nevertheless, the Bank's profitability remained within industry standards. Owing to a rising cost profile and a sharp dip in earnings from loans & advances, profitability dropped further with annualised pre-tax ROA and ROE declining to 2.4% and 9.2% respectively as at 30 June 2018. Pre-tax earnings for the first half of 2018 dropped by 78% to

₦757 million in comparison to the corresponding period of the previous year. We expect the Bank's profitability to moderate in the near term given the adverse impact of low BVN compliance on loan disbursements as well as rising costs. However, this should normalise in the medium-term as the Bank's compliance improves. LAPO has now distributed about 200 BVN registration machines across its branches.

The Bank remains adequately capitalised for current business risks. As at 31 December 2017, LAPO's capital adequacy ratio (CAR) stood at 28% - significantly higher than the regulatory minimum for microfinance banks operating in Nigeria.

The funding profile largely relies on local currency borrowings as the Bank seeks to reduce foreign currency risk exposure. LAPO also continues to benefit from a wide pool of low-cost deposits, which has pushed the cost of funds lower. Weighted average cost of funds (WACF) stood at 6.75% in 2017 (2016: 7.1%) and dropped to 6.59% as at 30 June 2018. LAPO has also maintained a healthy liquidity position, with a liquidity ratio of 43.7% - higher than the regulatory benchmark of 20%.

Based on the aforementioned, we hereby maintain the '**A-**' rating assigned to LAPO Microfinance Bank Limited.

Strengths

- Strong market position
- Good capitalisation
- Good liquidity and funding profile
- Experienced and stable management team

Weaknesses

- Rising level of impaired loans
- High operating costs

Challenges

- Reducing operating expenses
- Improving remedial management to forestall further impairment in the loan portfolio
- Improving profitability beyond current levels
- Ensuring compliance to the BVN requirement and improving loan disbursements beyond prior volumes

Table 1: Financial Data

	FY2017	FY2016
Total assets & contingents	₦67.35 billion	₦62.7 billion
Total deposit liabilities	₦28.6 billon	₦27.6 billion
Net earnings	₦25.8 billion	₦23.1 billion
Pre-tax return on average assets	8.8%	11.7%
Pre-tax return on average equity	38.6%	56.3%

COMPANY PROFILE

LAPO Microfinance Bank Limited ('LAPO' or 'the Bank') commenced operations in 1987 as a subsidiary of Life Above Poverty Organisation (LAPO), a non-governmental organisation (NGO). The Bank was incorporated as a private limited liability company in 2007 and obtained a state microfinance banking license from the Central Bank of Nigeria (CBN) in 2010. The Bank has evolved to become a leading player within the microfinance space and is one of the eight national microfinance banks in Nigeria.

LAPO Microfinance Bank Limited has two key shareholders – LAPO NGO and Dr. Godwin Ehigiamusoe – who own 67.10% and 30.10% equity stake respectively. The remaining 3% is held by five Non-Executive Directors. The Bank is governed by a nine-member Board of Directors, which includes six Non-Executive Directors and three Executive Directors – including the Managing Director/CEO. LAPO has one independent director.

LAPO's operating strategy involves providing financial services to low-income households, micro-enterprises and small & medium scale enterprises. The Bank provides financial services to businesses in key sectors including trading, agriculture and education. LAPO operates via 483 branches in Nigeria with a head office located at LAPO Place, 18 Dawson Road, Benin City. The Bank's branches are spread across twenty eight (28) states including Edo, Lagos, Anambra and Rivers. During the year ended 31 December 2017, LAPO Microfinance Bank Limited had an average staff strength of 7,150 persons.

Table 2: List of Directors & Shareholding Structure

Current Directors		Shareholding
Dr. Osarenren Emokpae	*Chairman*	0.60%
Dr. Godwin Ehigiamusoe	*Managing Director/Chief Executive Officer*	30.10%
Mrs. Osaretin Demuren	*Non-Executive Director*	0.60%
Mr. Ede Osayande	*Non-Executive Director*	0.60%
Mr. Andrew Ejoh	*Non-Executive Director*	0.45%
Mr. Rene Azokly	*Non-Executive Director*	0.55%
Mrs. Hannatu Yaro Ahmed	*Non-Executive Director (Independent)*	Nil
Ms. Josephine Nwachukwu	*Executive Director*	Nil
Mrs. Faith Osazuwa Ojo	*Executive Director*	Nil

Table 3: Other Significant Shareholders

Shareholder	Shareholding
Life Above Poverty Organisation (LAPO)	67.10%

Business Structure

LAPO Microfinance Bank's operations are structured along seven core functions: Legal & Compliance, Risk Management, Corporate Planning & Strategy, Finance & Accounts, Corporate Services, Operations & IT and Internal Audit. The heads of these core units report to the Managing Director while the head of Internal Audit reports to the Board Audit Committee and through a dotted reporting line to the Managing Director.

Correspondent Banks

LAPO Microfinance Bank Limited maintains corresponding banking relationships with a number of commercial banks including:

- United Bank for Africa (UBA) Plc.
- Standard Chartered Bank Nigeria Limited
- Zenith Bank Plc.
- Access Bank Plc.
- First Bank of Nigeria Limited

None of these banks had an equity stake in the Bank as at 30 June 2018.

Information Technology

LAPO's core banking application is Orbit-R, a centralised banking application developed by Neptunes Software. Orbit-R is primarily used for general ledger entries, loan transactions, transaction and risk management reporting. The application also supports the Bank's agency banking service. Over 500 of LAPO's agent bankers - also known as Agent Relationship Officers (AROs) - are connected to the Bank's application through palm-held devices used for daily transactions such as deposits and withdrawals. The Bank has a disaster recovery site located in the Lagos Annex Office. LAPO also has a data centre at the head office in Benin City comprising the hardware for the Bank's operations. The Bank issues debit cards profiled on Verve, MasterCard and Visa to its customers.

Business Strategy

LAPO Microfinance Bank Limited recently concluded a five-year strategy that commenced in 2013. Following the conclusion of this plan, the Bank has adopted a new five-year strategic blueprint covering the 2018 – 2022 period. The new plan has three focus areas - technology, product & service diversification and optimising staff productivity. Due to elevated costs attributable to branch maintenance, the Bank intends to leverage technology to penetrate the wide pool of potential clients. LAPO's agency banking service has witnessed significant growth, with an additional enrolment of over 300 agent bankers in 2017. Extending financial services to the rural economy and increasing penetration to other viable industries including educational services, agriculture and forestry– are also key considerations of LAPO's new strategic plan. The Bank currently serves over three million customers.

Track Record of Financial Performance

LAPO Microfinance Bank Limited remains the largest microfinance bank operating in Nigeria on the basis of total assets, earnings and pre-tax profits. Over the last three years, LAPO's total assets have grown at a compound annual growth rate (CAGR) of 19.3% to stand at ₦67.3 billion as at 31 December 2017. Growth in assets has been underpinned by substantial growth in the loan portfolio – which increased at a CAGR of 16.2% over the same period. Profitability indicators remained above industry standards during the three-year period, with an average pre-tax ROA and ROE of 10.4% and 49.5%. Nonetheless, the Bank's financial performance deteriorated in 2017, mainly due to a high cost profile and charge-offs emanating from the rising volumes of delinquent loans. Profitability ratios pre-tax ROA and ROE declined to 8.8% (2016: 11.7%) and 38.6% (2016: 56.3%) respectively.

Management Team

Dr. Godwin Ehigiamusoe is the Managing Director/ Chief Executive Officer of LAPO Microfinance Bank Limited. He has over 30 years' experience as a microfinance professional and established the Lift Above Poverty Organisation (LAPO) in 1987. Prior to establishing the LAPO NGO, Dr. Ehigiamusoe worked with the Edo State Government. He has a bachelor's degree in Sociology and a Master's degree in Sociology of Development from the University of Benin, Benin City. He also holds a Ph.D. in Political Science from Ambrose Alli University, Ekpoma and a Diploma in Cooperative Credit and Savings from the Federal Cooperative College, Ibadan. Dr. Ehigiamusoe has attended several professional courses at Harvard Kennedy School, Lagos Business School, IESE Business School and INSEAD Business School.

Other members of LAPO's senior management team include:

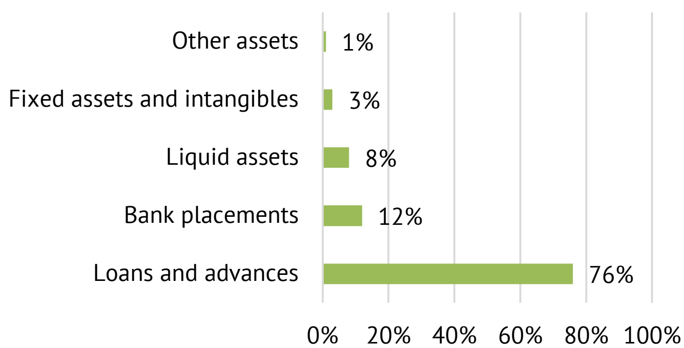
Mrs. Faith Osazuwa-Ojo	Executive Director – Head of Operations & IT
Mrs. Josephine Nwachukwu	Executive Director – Head of Corporate Planning & Strategy
Mr. Osadebamwen Elijah	Head, Corporate Services
Ms. Cynthia Ikponmwosa	Head, Corporate Secretariat, Legal & Compliance
Mrs. Gloria Bako	Head, Risk Management
Mr. Stanley Oriakhi	Chief Financial Officer

ANALYSTS' COMMENTS

ASSET QUALITY

As at 31 December 2017, LAPO Microfinance Bank Limited's total assets stood at ₦67.3 billion, representing a 7.4% growth over the prior year. Loans & advances remained the largest asset class on the Bank's balance sheet, representing 76% as at year-end. The balance comprised bank placements (12%), liquid assets (8%), fixed assets & intangibles (3%) and other assets (1%). LAPO's asset structure was relatively unchanged from the prior year.

Figure 1: Breakdown of Assets



LAPO's strategy for asset creation focuses on providing loans to low-income households and individuals. The Bank also serves micro, small and medium scale enterprises (MSMEs). LAPO provides either individual, group or business-related loans such as agriculture, housing and clean energy loans. Group loans are typically extended to a cluster of up to 40 individuals/members. The Bank's asset creation strategy facilitates a wider outreach to micro businesses that generally require relatively small loan amounts. Collectively, micro loans (individual and group loans) accounted for 90% of LAPO's loan portfolio as at reporting date (2016: 83%) while the loan book remains skewed towards trade and commerce – which is typical of microfinance institutions.

As at 31 December 2017, LAPO's loan portfolio stood at ₦55.5 billion, representing a 6% growth from the previous year. This represented a lower growth pace as business activities slowed in 2017 and a considerable number of the Bank's clients involved in trade-related activities experienced lower demand for their products due to the declining purchasing power of the populace. As at 30 June 2018, LAPO's loan book dropped moderately to ₦52 billion due to fewer disbursements, as a significant number of the Bank's clients were yet to be issued Bank Verification Numbers (BVNs). As a result, accounts with uncompleted BVN registrations were restricted from making withdrawals, thus moderating loan requests. In view of the improving, albeit fragile economy and the impact of low compliance to the BVN regulation, we do not expect a material growth in the loan portfolio in the near term.

The Bank's loan book remains well diversified with the top 20 obligors representing less than 1% of total loans. LAPO's portfolio is dominated by women, accounting for 74% of the loan portfolio as at 31 December 2017.

Figure 2: Breakdown of Loan Portfolio by Geographical Zone

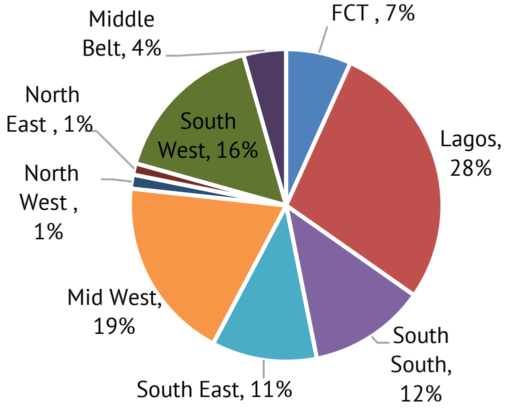
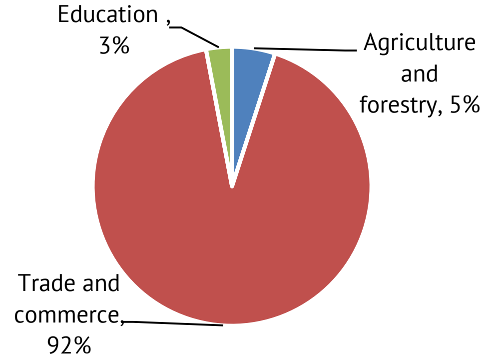


Figure 3: Breakdown of Loan Portfolio by Sector



LAPO's portfolio-at-risk (PAR) grew by 44.6% to ₦4.3 billion as at FYE 2017. This translated to a PAR to gross loans ratio of 7.8% - higher than the regulatory threshold of 5% for microfinance banks in Nigeria. LAPO's PAR to gross loans ratio was higher than NPF Microfinance Bank Plc. (NPF: 4.7%) but lower than Accion Microfinance Bank Limited (Accion: 11.6%). The rise in PAR was mainly due to the slowdown in economic activities which impaired the repayment capacity of small businesses – who form the bulk of LAPO's clientele. SME and agricultural loans accounted for 40% of the Bank's portfolio-at-risk as at FYE 2017.

The Bank's PAR to gross loans ratio would have been 8.6% had LAPO not written off ₦390.8 million in 2017 (2016: ₦19.7 million). LAPO's write-offs to average loan portfolio ratio of 0.7% was lower than NPF (1%) and Accion (7%). The Bank's write-off policy allows for loans that are more than 120 days past due to be written-off. A further review of the loan book also reveals that lost loans (loans over 91 days past due) accounted for 66% (2016: 56%). LAPO's management has indicated plans to recruit additional loan recovery personnel and carry out more engagements with community heads at strategic locations to help intensify recoveries. Cumulative loan loss provisions covered 93.3% of non-performing loans and was over 100% when we consider regulatory reserves.

Based on unaudited financial statements as at 30 June 2018, the Bank's PAR had increased by 28% to ₦5.6 billion with PAR to gross loans ratio at 10.7%. In our opinion, LAPO's asset quality requires improvement and reflects the need to strengthen credit risk management to forestall further impairment in the loan portfolio.

Figure 4: PAR/Gross Loans

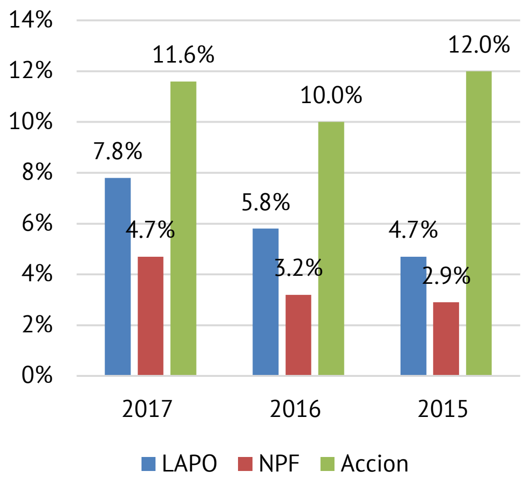
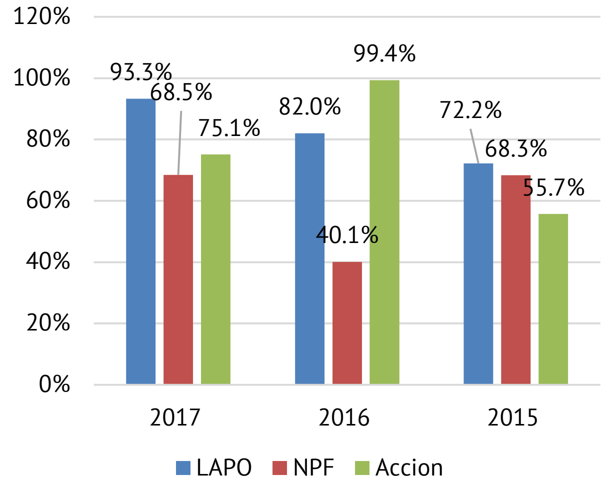


Figure 5: Loan Loss Provision Coverage Ratio



Risk Management

LAPO Microfinance Bank Limited operates a decentralised risk management function that is overseen by the Board of Directors through the Board Risk Management Committee ('BRMC'). The BRMC defines the Bank's overall strategic direction and tolerance for each risk element. The BRMC consists of three Executive Directors (including the Managing Director/CEO) and two Non-Executive Directors. The Executive Management Committee assists the BRMC in its oversight functions by reviewing the Bank's risk exposures, limits and controls. BRMC meets every quarter while the Management Risk Management Committee meets monthly. LAPO's Risk Management department is split into two units – Risk Management and Credit Management & Loan Recovery. Risk Management is responsible for managing the Bank's exposure to operational and reputational risk while the Credit Management & Loan Recovery unit manages credit risk.

Loan origination and disbursement are performed at the Bank's branches except for specialised loans such as SME and agricultural loans, which require additional evaluation by the Credit Management unit at LAPO's head office. Loan origination at the branches includes a number of steps:

- Client visits by the Client Support Officers (CSOs)
- Series of meetings for groups seeking facilities
- Completion of Know Your Customer documentation - including means of identification
- Verification of loan application forms and supporting documents – such as personal guarantees

The CSOs and the Credit Management unit perform preliminary analysis to assess the obligors' credit quality through cash flow analysis and credit score checks with the credit bureaus. The Credit Management unit performs preliminary analysis only for specialised loans such as SME and agricultural loans. We note that the cash flow analysis is done manually, with no specific internal credit grading model. Given the current scale of operations, we believe the Bank requires a more detailed credit assessment process.

Each of LAPO's regular, mega and super branches have credit committees that approve individual and group loans, while specialised loans are approved by the Management Credit Committee at the head office. The CSOs generate daily loan portfolio monitoring reports, which are reviewed by the branch managers. These reports are also generated daily by the Credit Management unit at the head office. Remedial management at LAPO is also under the purview of the Risk Management unit. For delinquent loans, the Bank keeps close contact with defaulting customers by issuing official warning letters between three days – two weeks of default, after which LAPO's CSOs and branch credit committees visit the clients and guarantors four weeks after, to begin recovery negotiations. The Bank currently has about 37 loan recovery officers and plans to engage more personnel to bolster recovery efforts as PAR continues to rise.

LAPO Microfinance Bank Limited's operational risk management is under the purview of both the Risk Management and the Internal Audit and Compliance units. The Internal Audit and Compliance unit is split into key functions – Corporate and IT audit and Internal Control. Corporate and IT audit ensure all systems are not compromised by malware and cyber-attacks while Internal Control performs reconciliations and audit of all branch operations. LAPO Microfinance Bank maintains an off-site archive, which enables the retention of data for up to six years. Internal Control uses an Audit Command Language (ACL), which enables real-time information transmission to the Bank's server and periodic checks on agency banking activities. Given the emerging risks relating to agency banking, LAPO has enhanced its operational risk management process by ensuring compliance to a number of criteria which helps mitigate the risk of fraud and theft. Prospective AROs are expected to have established business ventures registered with the Corporate Affairs Commission and are also required to have good community reputation.

In our opinion, the Bank's risk management processes are satisfactory. However, given the absence of an internal obligor credit grading system, we believe the credit evaluation process requires improvement.

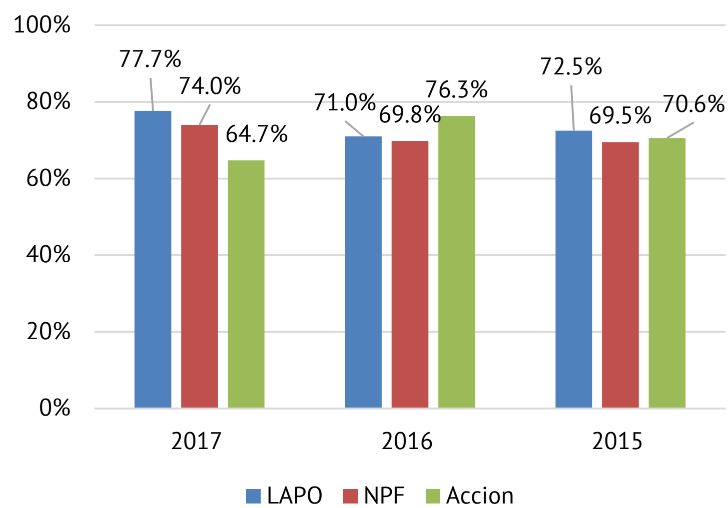
EARNINGS AND PERFORMANCE

LAPO Microfinance Bank Limited's earnings are derived from loans, advances, investment securities as well as fees and commissions from ancillary services. During the 2017 financial year, interest income grew by 13% to ₦30.1 billion, mainly driven by favourable yields on government securities in H1 2017. Interest income was also bolstered by the modest growth in the loan portfolio. Net revenue from funds remains the dominant source of earnings, remaining stable at 99% of net earnings.

Non-interest income increased by 22% to ₦255.8 million, upheld by ₦147 million earned from foreign currency bank placements. However, LAPO's interest expense on deposits increased by 36% while interest paid on borrowings marginally dipped by 2% as the Bank further diversified its funding base to include more domestic borrowings. Consequently, net interest margin (NIM) remained relatively unchanged from the prior year at 90.2%. In 2017, loan charge-offs increased by 65% to ₦1.6 billion as the volume of impaired loans increased. Charge-offs accounted for 5.3% of interest income (2016: 3.6%) but lower than the selected peers – NPF (7.1%) and Accion (11.7%).

LAPO's operating expenses rose by 22% to ₦20 billion in 2017 and was attributable to a spike in staff costs, repairs & maintenance and travelling expenses. Higher personnel expenses were as a result of staff recruitment, promotions and the upgrade of a number of functions – which led to salary increases during the year. Business development initiatives and branch maintenance costs were also principal reasons for the significant growth in operating expenses as LAPO opened additional 41 branches during the year. The rising cost profile translated to a higher cost-to-income ratio of 77.7% (2016: 71%). LAPO's CIR was higher than that of NPF (74%), Accion (64.7%) and the Bank's benchmark of 70%. However, LAPO's staff expenses to net earnings ratio of 39.6% was better than NPF (41.5%) but higher than Accion (33.1%). The Bank has outlined a number of initiatives to reduce operating costs such as reducing travel frequency for performance review meetings and placing a temporary embargo on recruitment. LAPO's CIR increased to 93.3% subsequent to year-end (for the six months to 30 June 2018) and was largely impacted by a drop in earnings. Nonetheless, we expect CIR to be moderated in the near term as initiatives to manage costs and grow revenue gain traction.

Figure 6: Cost-to-Income Ratio (CIR)



In 2017, LAPO's pre-tax profits declined by 14% to ₦5.7 billion, while profitability indicators – pre-tax return on average assets (ROA) and average equity (ROE) dropped to 8.8% and 38.6% respectively (2016 – ROA: 11.7%, ROE: 56.3%). Nonetheless, LAPO's ROE was higher than the selected peers – NPF & Accion – and the average return of 22% on 364-day Federal Government treasury bills in 2017. In our opinion, LAPO's profitability is good.

Subsequent to year-end, the Bank's profitability indicators declined with annualised pre-tax ROA and ROE falling to 2.4% and 9.2% respectively as at 30 June 2018. This was mainly due to a high cost profile and muted earnings from loans & advances. Pre-tax earnings for the first half of 2018 dropped by 78% to ₦757 million in comparison to the corresponding period of the previous year. The dip in earnings was a result of lower loan disbursements made during the period given that a number of LAPO's clients had not been issued BVNs. LAPO has now distributed over 200 registration machines across its branches to drive compliance with the regulation. Nevertheless, we expect profitability to dip significantly in the near term.

Figure 7: Pre-tax return on average assets (ROA)

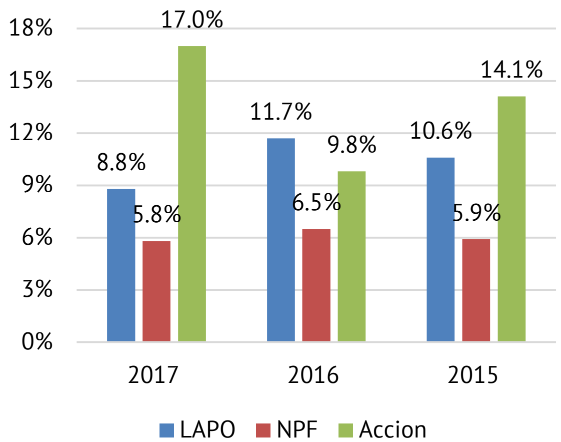
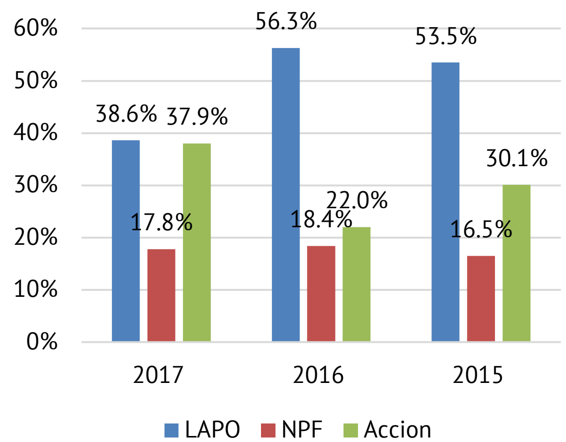


Figure 8: Pre-tax return on average equity (ROE)

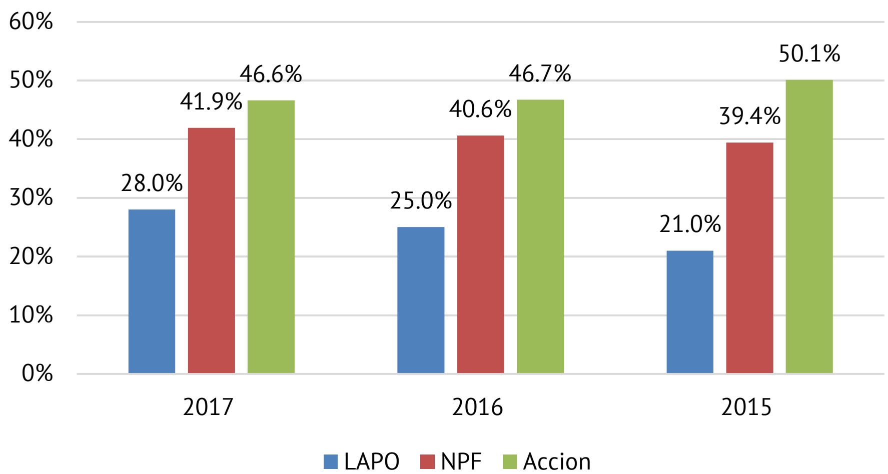


Capital & Leverage

As at 31 December 2017, LAPO Microfinance Bank Limited had fully paid-up share capital of ₦2 billion. As at the same date, total shareholders' funds stood at ₦16.1 billion – significantly higher than the regulatory minimum of ₦2 billion for national microfinance banks. Core capital increased by 18.5% and was largely supported by earnings accretion. LAPO plans to shore up capital in the medium-term through a private placement.

As at reporting date, the Bank's Capital Adequacy Ratio (CAR) stood at 28% and was above the regulatory minimum of 10%, though much lower than the selected peers – NPF (41.9%) and Accion (46.6%). In our opinion, the Bank's capitalisation is good for its current business risks.

Figure 9: Capital Adequacy Ratio (CAR)

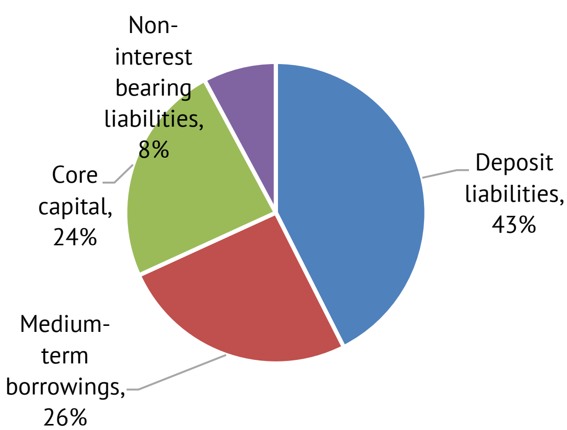


LIQUIDITY & FUNDING

LAPO Microfinance Bank Limited is predominantly funded by equity, deposit liabilities and borrowings from a number of Nigerian and foreign financial institutions – including development finance institutions.

LAPO's strategy for liability generation is to utilise stable deposits from regular savings to drive asset creation. The Bank requires its borrowers to be regular customers to qualify for a loan. As at 31 December 2017, LAPO's deposit liabilities stood at ₦28.6 billion, 3.5% increase over the prior year. Savings accounts remained the dominant source of deposits and accounted for 94% of the Bank's total deposit liabilities. The deposit base also remains well diversified with the top 20 depositors accounting for only 3% of the Bank's total deposit liabilities as at 31 December 2017.

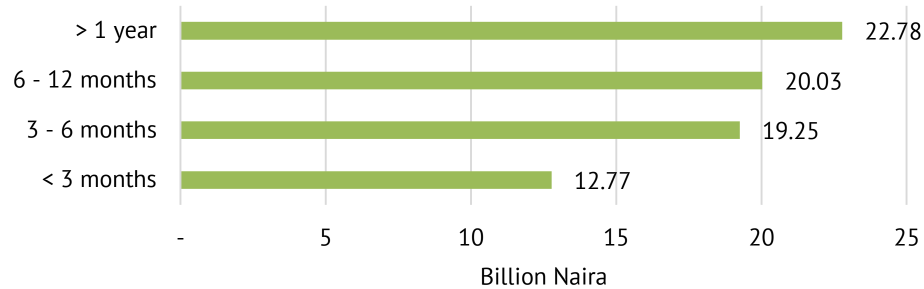
Figure 10: LAPO's Funding Base



As at 31 December 2017, LAPO's total borrowings stood at ₦17.2 billion, representing a 7% increase over the prior year, largely on account of additional local currency borrowings of ₦8.2 billion, including the ₦3.15 billion five-year unsecured bond. The bond is the first series in a ₦20 billion debt issuance programme. We note that LAPO's funding structure has changed materially, with foreign borrowings accounting for only 18% of the Bank's borrowings (2016: 46%). The Bank has adopted this strategy to reduce exposure to foreign exchange risk and expects to pay the outstanding foreign debt of ₦1.3 billion by Q4 2018. LAPO's funding mix translated to a lower weighted average cost of funds (WACF) of 6.75% in 2017 (2016: 7.1%). WACF dropped to 6.59% as at 30 June 2018. We expect the Bank's funding costs to remain unchanged in the near term given its huge low-cost deposit base, upheld by the growing ancillary services such as agency banking. LAPO's funding profile is expected to remain skewed towards local currency borrowings with a medium-term plan to shore up capital through a private placement.

LAPO maintained a healthy liquidity profile with a liquidity ratio (liquid assets to total LCY deposits) of 43.7% as at 2017 FYE – well above the regulatory minimum of 20%. The liquidity profile was also supported by investments in treasury bills – which accounted for 9% of the Bank's deposit liabilities and within the regulatory requirement of 5% - 10%. However, a gap analysis reveals mismatches across the various maturity buckets, resulting in a cumulative asset and liability mismatch of ₦22.8 billion. Nevertheless, the Bank's borrowings and the ability to refinance through wholesale funding provides adequate buffer.

Figure 11: Cumulative Liquidity Gap Analysis – 2017 Financial Year End



OWNERSHIP, MANAGEMENT & STAFF

LAPO Microfinance Bank Limited is a private limited liability company licensed by the Central Bank of Nigeria to provide microfinance services in Nigeria. The Bank is closely held by two main shareholders – LAPO NGO and Dr. Godwin Ehigiamusoe. A nine-member Board of Directors, chaired by Dr. Osarenren Emokpae, governs LAPO's activities. The Board comprises three Non-Executive Directors (including one independent director) and three Executive Directors. The Board of Directors has four standing committees:

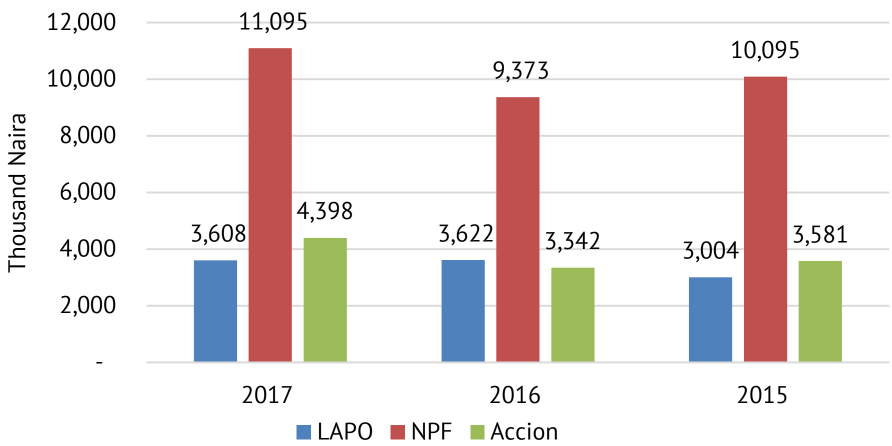
- Risk Management Committee
- Finance and General Purpose Committee
- Audit Committee
- Environmental, Social and Governance (ESG) Committee

Dr. Godwin Ehigiamusoe is the Managing Director/Chief Executive Officer who has over three decades of microfinance experience. The Managing Director is supported by a well-experienced six-member senior management team – which includes two Executive Directors. LAPO Microfinance Bank Limited is expected to undergo a number of governance changes in the short to medium-term. The Bank intends to create a role of a Deputy Managing Director and appoint a new Managing Director by 2019.

LAPO's staff strength as at 31 December 2017 stood at 7,150 persons, a 12% increase over the prior year. The Bank's staff strength has continued to grow following business expansion through branches and other functions such as technology. Management personnel accounted for less than 1% of total staff while non-management staff accounted for the balance.

In 2017, the Bank embarked on a staff productivity exercise which entailed staff promotions, conversion and merging of key roles. This exercise resulted in a significant rise in staff costs, which amounted to ₦10.2 billion, a 23% increase over the prior year. Net earnings per staff remained stable at ₦3.6 million but lower than NPF (₦11.1 million) and Accion (₦4.4 million). LAPO's net earnings per staff remained sufficient to cover staff costs per employee approximately 2.5 times (2016: 2.8 times). LAPO's efficiency indicator – operating expenses to average gross loan portfolio – increased slightly to 40% as at 31 December 2017 (2016: 35%) but compared less favourably to selected peers – NPF (25%) and Accion (20%). Due to the prevailing macroeconomy, which we believe may constrain asset creation in the near term, we expect this indicator to remain high.

Figure 12: Staff Productivity - Net Earnings per Staff



In our opinion, LAPO Microfinance Bank Limited's management is well experienced and we consider staff productivity to be satisfactory.

OUTLOOK

Nigeria's economic recession which lasted for five quarters between 2016 and 2017 adversely impacted several industries – with microfinance being highly vulnerable to economic shocks. Accordingly, LAPO witnessed a tough year in 2017, as the slowdown in business activities negatively impacted the Bank's operations. In 2017, profitability came under pressure as the cost of operations spiked while the Bank incurred higher impairment charges from the rising level of delinquency. LAPO's profile was nonetheless characterised by adequate capitalisation and a good liquidity & funding profile.

LAPO's growth plans for 2018 is focused on key strategic areas including technology, product & service diversification and staff productivity. Though the Bank has no significant branch expansion plans in the near term, LAPO plans to leverage agency banking service to achieve a good customer outreach. Despite the plan to have achieved a wider customer base of 10 million customers by 2020, we expect core lending business to remain skewed to trade and commerce – an essential business focus for microfinance banks. LAPO intends to keep funding costs low by growing low-cost deposit liabilities and accessing more local currency borrowings. Plans to shore up capital through a private placement is also in the offing.

As a result of the recovering but fragile economy, we expect asset quality may remain under pressure in the near term. In our view, the Bank would also need to strengthen credit risk management to curtail further impairment in the loan book. Nonetheless, we expect capitalisation, liquidity and funding will remain adequate. We hereby attach a '**stable**' outlook to the rating of LAPO Microfinance Bank Limited. This is based on our expectations that the issues with BVN compliance and the adverse impact on loan disbursements will be resolved by year-end 2018.

FINANCIAL SUMMARY

LAPO MICROFINANCE BANK						
BALANCE SHEET AS AT	**31-Dec-17**		**31-Dec-16**		**31-Dec-15**	
	=N='000		**=N='000**		**=N='000**	
ASSETS						
Cash & equivalents	365,348	0.5%	226,524	0.4%	84,833	0.2%
Government securities	2,693,877	4.0%	2,178,354	3.5%	1,334,877	2.5%
Stabilisation securities		1.7%		0.9%		0.6%
Quoted investments						
Money market placements	1,153,096	1.7%	588,554	0.9%	303,761	0.6%
LIQUID ASSETS	4,212,321	7.97%	2,993,432	5.71%	1,723,471	3.9%
Balances with Nigerian Banks	8,316,179	12.3%	6,737,440	10.7%	5,024,634	9.6%
Balances with banks outside Nigeria						
TOTAL PLACEMENTS	8,316,179	12.35%	6,737,440	10.74%	5,024,634	9.6%
Direct loans and advances - Gross	55,475,273	82.4%	52,326,870	83.4%	44,455,587	84.8%
Less: Cumulative loan loss provision	-4,061,341	-6.0%	-2,471,240	-3.9%	-1,503,750	-2.9%
Direct loans & advances - net	51,413,932	76.3%	49,855,630	79.5%	42,951,837	82.0%
Advances under finance leases - net						
TOTAL LOANS - NET	51,413,932	76.34%	49,855,630	79.49%	42,951,837	82.0%
		3.1%		16.1%		31.2%
Interest receivable						
Interest paid in advance						
Other prepayments	786,217	1.2%	648,712	1.0%	478,261	0.9%
Tax recoverable						
Other accounts receivable	279,121	0.4%	211,669	0.3%	240,016	0.5%
Deferred losses						
TOTAL OTHER ASSETS	1,065,338		860,381	1.37%	718,277	1.4%
Property, plant & equipment - for own use	2,212,557	3.3%	2,021,898	3.2%	1,546,852	3.0%
Goodwill & other intangible assets	128,058	0.2%	252,401	0.4%	433,822	0.8%
TOTAL FIXED ASSETS & INTANGIBLES	2,340,615	3.48%	2,274,299	3.63%	1,980,674	3.8%
TOTAL ASSETS	**67,348,385**	**100.0%**	**62,721,182**	**100.0%**	**52,398,893**	**100.0%**

LAPO MICROFINANCE BANK						
BALANCE SHEET AS AT	**31-Dec-17**		**31-Dec-16**		**31-Dec-15**	
	=N='000		**=N='000**		**=N='000**	
CAPITAL & LIABILITIES						
Share capital	2,000,000	3.0%	1,994,627	3.2%	1,985,256	3.8%
Share premium						
Statutory reserve	3,977,828	5.9%	3,482,006	5.6%	2,910,332	5.6%
Exchange difference reserve						
Irredeemable preference shares						
Other non-distributable reserves						
Revenue reserve	10,157,498	15.1%	8,140,347	13.0%	5,356,420	10.2%
TIER 1 CAPITAL (CORE CAPITAL)	16,135,326	24.0%	13,616,980	21.7%	10,252,008	19.6%
		18.5%		32.8%		29.5%
Revaluation surplus						
Redeemable preference shares						
Other long-term borrowings	14,143,348	21.0%	9,580,263	15.3%	2,345,945	4.5%
TIER 2 CAPITAL	14,143,348	21.0%	9,580,263	15.3%	2,345,945	4.5%
Other Long term Foreign borrowings	3,123,965	4.6%	6,566,706	10.5%	8,244,670	15.7%
Demand deposits						
Savings deposits	26,858,478	39.9%	25,828,954	41.2%	24,703,603	47.1%
Time deposits	1,793,683	2.7%	1,843,265	2.9%	1,002,180	1.9%
Inter-bank takings						
TOTAL DEPOSIT LIABILITIES - LCY	28,652,161	47.2%	27,672,219	54.6%	25,705,783	64.8%
Customers' foreign currency balances						
TOTAL DEPOSIT LIABILITIES	28,652,161	47.2%	27,672,219	54.6%	25,705,783	64.8%
Interest payable					57,087	0.1%
Unearned interest & discounts						
Taxation payable - deferred	139,287	0.2%	122,242	0.2%	101,281	0.2%
Taxation payable - current	3,266,806	4.9%	3,291,163	5.2%	2,095,495	4.0%
Dividend payable						
Other accounts payable	1,888,492	2.8%	1,871,609	3.0%	3,596,624	6.9%
TOTAL OTHER LIABILITIES	5,294,585	7.9%	5,285,014	8.4%	5,850,487	11.2%
TOTAL CAPITAL & LIABILITIES	**67,349,385**	**100.0%**	**62,721,182**	**100.0%**	**52,398,893**	**100.0%**

LAPO MICROFINANCE BANK						
INCOME STATEMENT FOR THE YEAR ENDED	**31-Dec-17**		**31-Dec-16**		**31-Dec-15**	
	=N='000		**=N='000**		**=N='000**	
Interest income	30,088,806	99.2%	26,669,311	99.2%	19,408,496	99.2%
Interest expense	-2,959,890	-9.8%	-2,767,416	-10.3%	-2,052,841	-10.5%
Loan loss expense	-1,587,371	-5.2%	-961,622	-3.6%	174,570	0.9%
NET REVENUE FROM FUNDS	25,541,545	84.2%	22,940,273	85.3%	17,530,225	89.6%
FOREIGN EXCHANGE	147,068	0.5%			31,273	0.2%
COMMISSIONS	4,741	0.0%	3,839	0.0%	14,336	0.1%
FEES & OTHER INCOME	103,949	0.3%	205,104	0.8%	106,953	0.5%
NET EARNINGS	25,797,303	85.0%	23,149,216	86.1%	17,682,787	90.4%
STAFF COSTS	-10,204,476	-33.6%	-8,291,467	-30.8%	-6,624,042	-33.9%
DEPRECIATION EXPENSE	-906,318	-3.0%	-933,120	-3.5%	-723,458	-3.7%
OTHER OPERATING EXPENSES	-8,937,627	-29.5%	-7,207,431	-26.8%	-5,472,150	-28.0%
OPERATING EXPENSES	-20,048,421	-66.1%	-16,432,018	-61.1%	-12,819,650	-65.5%
PROFIT (LOSS) BEFORE TAXATION	5,748,882	18.9%	6,717,198	25.0%	4,863,137	24.9%
TAX (EXPENSE) BENEFIT	-1,839,670	-6.1%	-2,170,443	-8.1%	-1,572,076	-8.0%
		-14.4%		38.1%		17.2%
PROFIT (LOSS) AFTER TAXATION	3,909,212	-1.5%	4,546,755	55.0%	3,291,061	34.0%
NON-OPERATING INCOME (EXPENSE) - NET						
STATUTORY RESERVE	-495,822	-1.6%			-411,383	-2.1%
CAPITAL REDEMPTION						
PROPOSED DIVIDEND	-1,396,239	-4.6%	-1,191,154	-4.4%	-979,805	-5.0%
SCRIP ISSUES						
OTHER APPROPRIATIONS			-571,674	-2.1%		
RETAINED PROFIT	2,017,151	-7.8%	2,783,927	48.5%	1,899,873	26.9%
RETAINED PROFIT B/FWD	8,140,347		5,356,420		3,456,547	
RETAINED PROFIT C/FWD	10,157,498		8,140,347		5,356,420	
GROSS EARNINGS	30,344,564	100.0%	26,878,254	100.0%	19,561,058	100.0%

KEY RATIOS	31-Dec-17	31-Dec-16	31-Dec-15
PROFITABILITY & EARNINGS			
Net interest margin	90.2%	89.6%	89.4%
Loan loss expense/Interest income	5.3%	3.6%	0.0%
Operating expenses/Net earnings	77.7%	71.0%	72.5%
Return on average assets	8.8%	11.7%	10.6%
Return on average equity	38.6%	56.3%	53.5%
Gross earnings/Total assets & contingents (average)	46.7%	46.7%	42.5%
EARNINGS MIX			
Net revenue from funds	99.0%	99.1%	99.1%
Commissions	0.0%	0.0%	0.1%
Fees & other income	0.4%	0.9%	0.6%
EFFICIENCY INDICATORS			
Operating expenses/average loan portfolio	39.6%	35.4%	33.9%
Adjusted operating expenses/average loan portfolio	37.8%	33.4%	32.0%
Personnel expenses/average loan portfolio	20.2%	17.9%	17.5%
LIQUIDITY & FUNDING			
Total loans - net/Total lcy deposits	71.0%	80.8%	93.7%
Liquid assets/Total lcy deposits	43.7%	35.2%	26.3%
Demand deposits/Total lcy deposits	0.0%	0.0%	0.0%
Savings deposits/Total lcy deposits	93.7%	93.3%	96.1%
Time deposits/Total lcy deposits	6.3%	6.7%	3.9%
ASSET QUALITY RATIOS			
PERFORMING LOANS (₦'000)	51,121,225	49,314,920	42,373,580
NON-PERFORMING LOANS (₦'000)	3,640,169	455,546	2,082,007
Non-performing loans /Total loans - Gross	7.8%	5.8%	4.7%
Loan loss provision/Total loans - Gross	7.3%	4.7%	3.4%
Loan loss provision/Non-performing Total loans	93.3%	82.0%	72.2%
Risk-weighted assets/Total assets & contingents	93.6%	94.8%	95.9%
CAPITAL ADEQUACY & LEVERAGE RATIOS			
Adjusted capital/risk weighted assets	28%	25%	24.2%
Tier 1 capital/Adjusted capital	100%	100%	81%
Total loans - net/Adjusted capital	3.21	3.73	4.37
Core capital unimpaired by losses (₦'000)	16,135,326	13,616,980	10,252,008
STAFF INFORMATION			
Average number of employees	7,150	6,392	5,886
Staff cost per employee (₦'000)	1,427	1,297	1,125
Net earnings per staff (₦'000)	3,608	3,622	3,004
Staff cost/Net earnings	39.6%	36%	37%
Staff costs/Operating expenses	50.9%	50%	52%

RATING DEFINITIONS

Aaa	A financial institution of impeccable financial condition and overwhelming capacity to meet obligations as and when they fall due. Adverse changes in the environment (macro-economic, political and regulatory) are unlikely to lead to deterioration in financial condition or an impairment of the ability to meet its obligations as and when they fall due. In our opinion, regulatory and/or shareholder support will be obtained, if required.
Aa	A financial institution of very good financial condition and strong capacity to meet its obligations as and when they fall due. Adverse changes in the environment (macro-economic, political and regulatory) will result in a slight increase the risk attributable to an exposure to this financial institution. However, financial condition and ability to meet obligations as and when they fall due should remain strong. Although regulatory support is not assured, shareholder support will be obtained, if required.
A	A financial institution of good financial condition and strong capacity to meet its obligations. Adverse changes in the environment (macro-economic, political and regulatory) will result in a medium increase in the risk attributable to an exposure to this financial institution. However, financial condition and ability to meet obligations as and when they fall due should remain largely unchanged. In our opinion, shareholder support should be obtainable, if required.
Bbb	A financial institution of satisfactory financial condition and adequate capacity to meet its obligations as and when they fall due. It may have one major weakness which, if addressed, should not impair its ability to meet obligations as and when due. Adverse changes in the environment (macro-economic, political and regulatory) will result in a medium increase in the risk attributable to an exposure to this financial institution.
BB	Financial condition is satisfactory and ability to meet obligations as and when they fall due exists. May have one or more major weaknesses. Adverse changes in the environment (macro-economic, political and regulatory) will increase risk significantly.
B	Financial condition is weak but obligations are still being met as and when they fall due. Has more than one major weakness and may require external support, which, in our opinion, is not assured. Adverse changes in the environment (macro-economic, political and regulatory) will increase risk significantly.
C	Financial condition is very weak. Net worth is likely to be negative and obligations may already be in default.
D	In default.

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