The Pakistan Credit Rating Agency Limited

Rating Report

SAFCO Microfinance Company (Private) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Mar-2024	BBB	A3	Stable	Maintain	-
28-Mar-2023	BBB	A3	Stable	Maintain	-
28-Mar-2022	BBB	A3	Stable	Maintain	-
23-Apr-2021	BBB	A3	Stable	Maintain	Yes
05-May-2020	BBB	A3	Stable	Initial	Yes

Rating Rationale and Key Rating Drivers

The rating reflects SAFCO Microfinance Company Private Limited's (SMCPL) transformation from a non-profit organization to a for-profit private company, a wholly-owned subsidiary of SAFCO Support Foundation (SSF). The prime focus of the company is to provide small, socially responsible financial services to low-income entrepreneurs. The loan portfolio consists of a total of 10 loan products mainly relating to the following segments; Enterprise, Livestock, Agriculture, SME, Personal, School Improvement, solar, housing, auto financing & Islamic financing.SMCPL, having been active since 2009, boasts an extensive presence throughout Sindh Province, comprising a network of 58 branches. These branches have played a crucial role in extending microfinance services to over 700,000 unbanked and low-income entrepreneurs, with a notable focus on supporting women entrepreneurs, who make up 59% of the beneficiary base. Moreover, SMCPL microfinance initiatives have significantly impacted rural communities, with 80% of its beneficiaries being smallholder farmers. The institution relies on diverse borrowing avenues, majorly from PMIC, along with some commercial bank, national and international lenders. The industry's loan portfolio requires prudent management mainly on the back of the consistent surge in the policy rate. However, going forward the impact of gross lending rate on the financial risk profile specifically on NPLs (Non-performing Loans) is being evaluated in due course of time. The restriction on the mobilization of deposits has demarcated and supplemented the risk absorption capacity while triggering the funding constraints. Despite the hyperinflationary environment and other microeconomic challenges specifically the consistent surge in KIBOR which ultimately elevated the cost of funds for MFIs, the portfolio at risk (PAR) > 30 days stood at 4.4% in 6MFY24 (FY23: ~4.3%) mainly on the back of the recoveries in the flood-impacted portfolios. As per the management accounts, the company's Gross Loan Portfolio (GLP), stood at ~PKR 3.7bln as of 6MFY24 (FY23: ~PKR 3.9bln). However, during 6MFY24, SMPCL recorded a sizeable improvement of ~58% in markup income, due to volumetric growth and improvement in spreads. SMCPL's witnessed a profit of ~PKR157mln in 6MFY24 (FY23: negative PKR 128mln). The same growth pattern is projected in the future as well; wherein the need to curb infection remains vital. SMCPL board is actively involved in making strategic choices and setting the direction of the company and the board ensures to follow the best practices of corporate governance. The Company has a stable and experienced senior management team which is supported by clear reporting lines as per a formalized organogram and a satisfactory monitoring process.

The ratings also incorporate the vulnerability in business due to low market share and limited geographical presence. The sustainability of positive performance indicators amidst business volume growth is critical for the Institution's ratings. The ratings will monitor the Institution's expansion and the impact of technological progress on its operational and risk efficacy. Therefore, sustaining growth momentum is vital for the Institution's future prospects.

Disclosure

Name of Rated Entity	SAFCO Microfinance Company (Private) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23),Methodology | Microfinance Institution Rating(Oct-23)
Related Research	Sector Study | Microfinance(Sep-23)
Rating Analysts	Sohail Ahmed Qureshi | sohail.ahmed@pacra.com | +92-42-35869504

Profile

Structure SAFCO Microfinance Company (Private) Limited (hereby referred to as "SMCPL" or ''Company'') was incorporated in May 2009 originally as a public company, limited by guarantee, but has now transformed into a private company limited by shares, and registered under Section 16 of the Companies Ordinance, 1984 (now Companies Act, 2017). It is licensed by the Securities and Exchange Commission of Pakistan, under the Non-Banking Finance Companies Rules, 2003.

Background SMCPL, a subsidiary of SSF, a non-profit registered under section 42 of the Companies Act, is a for-profit private limited company registered with SECP under section 16 of the Companies Act 2017.SMCPL is licensed to provide investment and financial services under the regulatory framework of Non-Banking Finance Companies.

Operations SMCPL operates at a provincial level with 58 branches in 13 Districts of the Sindh province, with over 589 employees. The Head office of the company is located in Hyderabad. The loan portfolio consists of a total of ten loan products mainly relating to the following segments; Enterprise, Livestock, Agriculture, SME, Personal, School Improvement, Islamic loan, and lending specifically to emergencies.

Ownership

Ownership Structure SMCPL is majority-owned by SSF, which holds 99.99% of the company's shares. The remaining ownership is split between two individual shareholders, Mr. Muhammad Suleman and Mr. Muhammad Ismail Kumbhar.

Stability SMCPL has a proper succession plan in place which is expected to remain, going forward.

Business Acumen The member's extensive experience in the microfinance industry, coupled with their diverse skill sets, positions them well to navigate the complexities of the market and steer the company toward sustainable growth and success.

Financial Strength The probability of the company getting financial support from members is adequate since it is registered as a for-profit organization and the members receive monetary benefits out of the company's profits.

Governance

Board Structure SMCPL's Board of Directors comprises six members, with four acting as independent directors to ensure objective oversight. The remaining two directors hold nominated positions.

Members' Profile The Board members bring considerable expertise to the sector, notably Mr. Fazal Noor, the Chairman, who boasts 25 years of invaluable experience in agricultural education and sustainable development.

Board Effectiveness During FY23, many meetings were held. Attendance recorded during the meetings was good. The Board has 4 sub-committees; Audit Committee, Credit & Risk Committee, Human Resource Committee, and the Social Performance Management Committee.

Transparency Yousuf Adil Chartered Accountants (Category A as per SBP Panel) are the External Auditors of the company. They expressed an unqualified opinion on the financial statements for the year ended June'23. An internal audit department is in place, which reports to the Audit Committee.

Management

Organizational Structure SMCPL's operations are divided into nine departments, all reporting directly to the Managing Director, Mr. Syed Sajjad Ali Shah. The Internal Audit department is an exception, as it reports directly to the Audit Committee for independent oversight.

Management Team SMCPL boasts a diverse management team with a strong blend of experience and skills. At the helm, CEO Mr. Muhammad Suleman brings a wealth of knowledge, leveraging his 37 years of experience across various fields since joining the Foundation in 2014. The remaining members of the management team are similarly well-qualified, possessing a well-rounded skillset that complements Mr. Suleman's leadership.

Effectiveness The company has a systematic decision-making process. A management committee, having various functions, is in place. It is chaired by the MD and comprises all department heads.

MIS The MIS is integrated with all systems like Human Resource Management Systems, Financial Information Systems, and E-Appraisal. It provides effective information in order to aid quick decision-making and planning.

Risk Management Framework A proper risk management policy to manage operational and credit risk is in place. A loan approval process is embedded with respective approval limits enjoyed by each approving authority i.e., Branch Manager, Area Manager, Manager Operations, and Credit Committee.

Technology Infrastructure SMCPL is investing in its technological infrastructure to increase automation and efficiency in the departments.

Business Risk

Industry Dynamics During 1QCY23, the microfinance industry which includes MFIs, MFBs & RSP in Pakistan has shown a growth of 3.7% from 4QCY22 to 1QCY23 in terms of Gross Loan Portfolio (GLP). The GLP stood at PKR 509.6bln during 1QCY23 (4QCY24: PKR 491.3bln). The GLP portfolio of MFI reached PKR 88.528bln with an active borrower base of 2.3mln as of 1QCY23. Currently, in Pakistan, there are 24 dedicated Microfinance institutions primarily operating which provide specialized microfinance services. The portfolio at risk (PAR) > 30 days of MFI has shown an improvement and reduced to 3.0% (4QCY22: 2.0%) mainly on the back of the recoveries in the flood-impacted portfolios. The hyperinflationary environment has also impacted the MFI sector which is evident by a PKR 1.7bln surge in disbursements (1QCY23: PKR 31.8bln; 4QCY22: PKR 30.1bln) and PKR 3,282 hike in average loan size (1QCY23: PKR 59,628, 4QCY22: PKR 56,346).

Relative Position SMCPL is a relatively small player in the Microfinance sector. Active borrowers in FY23 stood at 120,416 compared to 123,778 in FY22. As of End-FY23. Considering the market share of ~1% in terms of GLP of the whole industry, the foundation is considered as a relatively small player in the Microfinance sector. The company has developed a strong relationship with the borrowers.

Revenue During 6MFY24, the company earned a net markup income of ~PKR 349mln (FY23: ~PKR 442mln; FY22: ~PKR 571mln). The Company's business strategy emphasizes maintaining some investments in the form of term deposits and bank deposits. Notably, within the 6MFY24 period, about ~PKR 63mln of the net markup income was generated from investments like term deposits and bank deposits, reflecting a strategic emphasis on maintaining such investments.

Profitability During 6MFY24, the non-mark-up expenses were recorded at PKR 580mln (FY23:~PKKR 398mln; FY22:~PKR 342mln). The provisioning expense of PKR 8mln was written in 6MFY24 (FY23: ~PKR 75mln; FY22: ~PKR 7mln). The bottom line of the Institution recorded a substantial increase clocking in at PKR 157mln during 6MFY24 (FY23: nagative128mln; FY22: PKR 63mln).

Sustainability SMCPL's primary objective is to further strengthen its market position in the industry. To achieve the stated objective, the company is developing new finance products.

Financial Risk

Credit Risk The company has set an authority matrix at the branch, area, region, and HO level, depending on the loan size. Further, a Credit Committee is in place as the apex body to approve the highest slab of loan size or conflicting issues. During 6MFY24, the GLP amounted to PKR 3.4bln (FY23:~PKR 3.7bln; FY22: ~PKR 3.6bln). The true infection ratio as of 6MFY24 was recorded at 4% (FY23: 6% ; FY22: 4%)

Market Risk The investment book of the company comprises Short Term Deposit Receipts (various banks) amounting to PKR 125mln as of 6MFY24 (FY23:~PKR 462mln; FY22: ~PKR 546mln).

Funding Total long-term borrowing of SMCPL as of 6MFY24 stood at PKR 3.9bln (FY23: ~PKR:4.5bln; FY22: ~PKR 4.2bln). Long-term borrowings comprise approximately 62% of the total debt as of FY23.

Cashflows & Coverages During FY23, SSF's current ratio stood at a robust 2.22, reflecting a strong liquidity position.

Capital Adequacy SECP has no minimum requirement for NBFI, unlike SBP which requires MFBs to maintain their CAR at 15%. Apart from any regulatory requirement to meet minimum ratios, the company has to satisfy the covenants of loans. The company must comply with those covenants. During 6MFY24, the total funds and reserves stood at PKR 776mln (FY23: PKR~618mln; FY22: ~PKR 923mln).

PKR mln

SAFCO Microfinance Company (Private) Limited	Dec-23	Jun-23	Jun-22	Jun-21
	6M	12M	12M	12M
A BALANCE SHEET				
1 Total Finances - net	3,440	3,744	3,674	2,463
2 Investments	125	462	546	274
3 Other Earning Assets	746	519	683	1,079
4 Non-Earning Assets	781	683	469	410
5 Non-Performing Finances-net	137	(23)	(1)	(35)
Total Assets	5,229	5,386	5,371	4,191
6 Deposits	-	-	-	-
7 Borrowings	3,933	4,534	4,284	3,200
8 Other Liabilities (Non-Interest Bearing)	520	234	160	128
Total Liabilities	4,453	4,768	4,444	3,328
Equity	776	618	923	863
B INCOME STATEMENT				
1 Mark Up Earned	820	1,068	948	693
2 Mark Up Expensed	(471)	(627)	(376)	(254)
3 Non Mark Up Income	7	84	(103)	53
Total Income	356	526	468	492
4 Non-Mark Up Expenses	(207)	(580)	(398)	(342)
5 Provisions/Write offs/Reversals	8	(75)	(7)	(40)
Pre-Tax Profit	157	(128)	63	111
6 Taxes	-	(0)	-	-
Profit After Tax	157	(128)	63	111
C RATIO ANALYSIS				
1 Performance				
Portfolio Yield	40.1%	24.6%	26.7%	28.8%
Minimum Lending Rate	35.5%	32.8%	24.2%	25.8%
Operational Self Sufficiency (OSS)	122.9%	89.9%	102.4%	115.7%
Return on Equity	45.2%	-16.6%	7.1%	13.8%
Cost per Borrower Ratio	3,387.4	4,716.8	3,214.1	N/A
2 Capital Adequacy				
Net NPL/Equity	17.6%	-3.8%	-0.1%	-4.0%
Equity / Total Assets (D+E+F)	14.8%	11.5%	17.2%	20.6%
Tier I Capital / Risk Weighted Assets	N/A	N/A	N/A	N/A
Capital Adequacy Ratio	N/A	N/A	N/A	N/A
Capital Formation Rate [(Profit After Tax - Cash Dividend) / Equity]	50.9%	-13.9%	7.3%	14.9%
3 Funding & Liquidity				
Liquid Assets as a % of Deposits & Short term Borrowings	N/A	N/A	N/A	N/A
Demand Deposit Coverage Ratio	N/A	N/A	N/A	N/A
Liquid Assets/Top 20 Depositors	N/A	N/A	N/A	N/A
Funding Diversification (Deposits/(Deposits+Borrowings+Grants))	0.0%	0.0%	0.0%	0.0%
Net Advances to Deposits Ratio	N/A	N/A	N/A	N/A
4 Credit Risk				
Top 20 Advances / Advances	0.5%	0.5%	0.4%	0.2%
PAR 30 Ratio	3.8%	5.5%	4.4%	6.0%
Write Off Ratio	0.0%	0.0%	0.0%	0.0%
True Infection Ratio	3.8%	5.5%	4.4%	6.0%
Risk Coverage Ratio (PAR 30)	0.0%	110.7%	100.8%	122.2%

Credit Rating

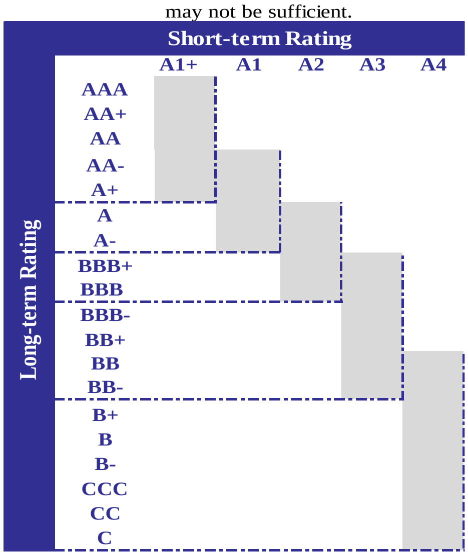
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

Rating Team Statements

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**

i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions

(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business

(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report | Clause 11-(A)(p).
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest

(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review

(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 17-(a)
(19) PACRA reviews all the outstanding ratings periodically, on annual basis; Provided that public dissemination of annual review and, in an instance of change in rating will be made; | Chapter III | 17-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 17-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument;| Chapter III | 17-(d)

Probability of Default

(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past; | Chapter III | 14-3(f)(vii)

Proprietary Information