The Pakistan Credit Rating Agency Limited

Rating Report

GuarantCo Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
18-May-2018	AAA	A1+	Stable	Maintain	-
29-Sep-2017	AAA	A1+	Stable	Maintain	-
13-Jan-2017	AAA	A1+	Stable	Maintain	-
13-Jan-2016	AAA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

GuarantCo Limited, an international Joint Venture development financial institution, is the local currency guarantee arm of the Private Infrastructure Development Group (PIDG). It is directly and indirectly owned by five highly rated sovereigns. Continuous sponsors support is evident from recent injections by Australian government's Department of Foreign Affairs (DFAT) and callable capital from the UK via PIDG. GuarantCo mainly operates in low income, below investment grade countries. Its objective is to facilitate flow of debt capital to projects having bearing on infrastructure and a positive long term impact by offering credit guarantees.
GuarantCo is cautiously building its guarantee portfolio with adequate emphasis on diversification: geographical, entity and sector. More than 60% of the company's portfolio is tilted to Africa, although GuarantCo is focusing to gain more exposure in Asia supported by their recently opened office in Singapore. There is almost 10% impairment in the quality of guarantee assets; improved from the last year. However, given the small size, this might be reflective of otherwise detailed and robust credit evaluation and monitoring framework.
The Company maintains good provision coverage. During CY17, a significant decrease in investment income was witnessed; though the overall return on investment is positive yet it is diminished on YoY basis. Recoveries from stressed portfolio supported bottom-line; enabling the company to post profit as opposed to continuous losses in prior years. Meanwhile, the sponsors gradually injected fresh funds to keep the company equipped with robust capitalization. A healthy treasury investment portfolio mainly comprising fixed income corporate bonds and US Treasury funded by its equity. Thus liquidity remained adequate along with sizable income stream. GuarantCo Management Company, a fully owned subsidiary of Cardano Development, is the fund manager responsible for GuarantCo's commercial operations. The contract has been assigned for relatively a longer period which is expected to help the management, to pursue a well-conceived strategy to achieve profitability in the near term. Nevertheless, the management's success in achieving its business objectives while capitalizing on its identified niche – infrastructure development remains to be seen.

GuarantCo's ratings are dependent on its robust ownership structure, well supported by implicit indeed demonstrated commitment by the sponsors. The Company's ability to achieve desired growth in its guarantee portfolio is important to pull off from bottom-line losses. Meanwhile, close monitoring of asset quality remains critical.

Disclosure

Name of Rated Entity	GuarantCo Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Non-Banking Finance Companies(Jan-17),Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17),Methodology | Bank Rating(Jun-17)
Related Research	Sector Study | Credit Guarantee Institutions(Apr-18)
Rating Analysts	Muneeb Rashid | muneeb.rashid@pacra.com | +92-42-35869504 Jhangeer Hanif | jhangeer@pacra.com | +92-42-35869504

GuarantCo Limited (GuarantCo) Profile	
Incorporated	2005
Major Business	▪ Joint Venture Financial Institution with international operations. The key objectives of establishing the entity are to, i) support infrastructure projects in low income countries via guarantee provisions which in turn, enable the said projects to raise debt financing and, ii) development of local financial debt markets. Thus, GuarantCo facilitates to bridge the funding gap that the local debt market would fail to meet due to capacity constraints, exposure limits and other covenants.
Legal Status	Unlisted
Registered Office	Mauritius

Industry Snapshot

Credit Guarantee Institutions (CGIs) facilitate lending by providing credit guarantees against the risk of default of issuers. These guarantees help these entities in raising debt from financial institutions. Thus CGIs are vital source of financial assistance to these entities. Globally, most CGIs are mandated to promote business, financial markets and infrastructure development activities mainly in less developed segments.

Ownership

- The ultimate ownership of GuarantCo lies with five governments – four of which (United Kingdom, Sweden, Switzerland, and Australia) own through PIDG, and the Netherlands maintains its stake through FMO.
- Shareholders are five highly rated sovereigns - United Kingdom (AA by Fitch), Switzerland (AAA by Fitch), Sweden (AAA by Fitch), and Australia (AAA by S&P) own 68%, 14%, 5%, and 2% respectively through the Private Infrastructure Development Group (PIDG) and Netherlands (AAA by Fitch) owns 11% through FMO.
- PIDG with consolidated strength of eight members is a donor financed trust while FMO is a development bank (51% owned by the Dutch government through Dutch Ministry of Foreign Affairs).
- Capital injections by sponsors on continuous basis signifying commitment to support.

Governance

- GuarantCo's seven-member BoD comprises qualified professionals with emerging and frontier market experience. The board comprises all non-executive directors.
- Ms. Yukiko Omura has replaced outgoing chairman Mr. Andy Bainbridge as the chairperson of the board since 1st January 2018. Ms. Yukiko Omura carries three decades of experience in multilateral development agencies and leading investment banks.
- Selection of the board is made by a public tender process. Board members are selected by a panel that has representatives from the donors.
- Close monitoring and oversight of management, guarantee portfolio, and investments is ensured through committees.

Management

- Management of guarantee portfolio is outsourced to GuarantCo Management Company Limited (GMCL), a fully owned subsidiary of Cardano Development. Treasury investment book is subcontracted to PIMCO and Fidelity.
- Mr. Lasitha Perera; the CEO took over the position in Jan-17. He is an experienced investment banker directly associated with the company since 2009. He is assisted by an experienced team.

Risk Management

- Diverse high credit risk guarantee portfolio focused towards countries below investment grade as per mandate.
- Current portfolio is spread across fifteen countries and nine sectors. The current portfolio size as at end-Dec17 stood at USD 579.3mln (end-Dec16: USD 456.4mln) depicting an increase of ~27% on YoY basis.
- As at end-Dec17, the company's country wise exposure is concentrated towards Nigeria (Dec17: 24%; Dec16: 30%) followed by India (Dec17: 18%, Dec16: 19%), and Gabon (Dec17: 11%; Dec16: nil).
- During CY17, the overall quality of asset book remained manageable (Infection ratio - CY17: 9.9%; CY16: 17.2%, CY15: 13.1%).
- The company prudently maintained its high provisioning against the non performing book (CY17: 100%, CY16: 100%, CY15: 100%).

Performance

- GuarantCo's revenue source comprises two streams: (i) guarantee income (fees received from its clients on the committed guarantees) and (ii) income on its investment portfolio.
- During CY17, on account of higher volumes, guarantee revenue continued to rise registering a YoY growth of 28% (CY16: 23%).
- Significant cost savings in administrative and general expenses coupled with lower provisioning expense on the back of cash receipts enabled the company to post net income of USD ~5mln (CY16: Net Loss of USD ~3mln).
- Improvement in quality of underperforming portfolio – a major challenge.
- Almost half of GuarantCo's revenue comes from Africa as per its mandate. Additional focus on Asia going forward, supported by expanding outreach. Target of increasing the guarantee portfolio to USD 1bln by end-2020.

Capital & Funding

- Strong liquidity profile (Liquid assets/ Gross guarantees – CY17: 82.6%; CY16: 90.6%; CY15: 99.2%).
- Sound capitalization level as evident by capital to guarantee portfolio ratio of 1.1x at end-Dec17 (end-Dec16: 1.2x).
- Callable-capital facility by DFID and a standby facility by FMO is available. The USD 30mln facility by FMO, which was finalized in CY16, upon utilization, will be converted into debt. Additionally, the USD 50mln (GBP 40mln) facility provided by UK (DFID), is signed by DFID and has been made available for utilization under the GuarantCo's funding agreement in 2017.

GuarantCo Limited

Balance Sheet	31-Dec-17	31-Dec-16	31-Dec-15
	CY17	CY16	CY15
ASSETS			
Earning Assets			
1. Deposits with Banks	48,716	46,250	41,927
2. Investments	222,132	213,442	213,289
Trade and other receivables	20,698	13,712	3,805
Deferred expenses	135	-	1,657
Deferred Tax	-	-	48
TOTAL ASSETS	**291,681**	**273,404**	**260,727**
LIABILITIES			
Current Liabilities			
1. Derivative Financial Instruments	503	-	7,475
2. Trade and other payables	5,299	2,688	4,964
3. Provision - Guarantee payable	10,083	10,194	7,276
Deferred Income	4,103	4,855	3,039
EQUITY			
TOTAL EQUITY	271,693	255,668	237,973
TOTAL LIABILITIES & EQUITY	**291,681**	**273,404**	**260,727**

INCOME STATEMENT	31-Dec-17	31-Dec-16	31-Dec-15
Guarantee Revenue	10,505	8,207	6,692
Investment Income	4,165	6,380	6,635
Fund Manager Fee & Administrative expenses	(10,825)	(11,377)	(9,910)
Grant expense	(1,395)	(850)	(418)
Operating Profit	(1,715)	(4,019)	(3,636)
Provisions w.r.t guarantees	3,897	(2,114)	(6,375)
Net Finance Income	4,165	6,380	6,635
Taxation	(247)	(59)	(79)
Net Income	**5,023**	**(3,286)**	**(6,051)**

RATIO ANALYSIS	31-Dec-17	31-Dec-16	31-Dec-15
Ratio Analysis			
Profitability Ratios			
1. ROE	1.9%	-1.3%	-2.5%
Liquidity Ratios			
1. Liquid Assets/Gross Guarantees	82.6%	90.6%	99.2%
2. Liquid Assets/Equity	99.7%	101.6%	107.2%
Guarantee Loss Coverage			
1. Stressed Assets Coverage Stressed Assets Coverage (Provisions/Stressed Assets)	84.6%	82.4%	44.1%
2. Infection Ratio (Impaired Guarantees / Gross Guarantees)	9.9%	17.2%	13.1%
Capital Adequacy			
1. Equity/Total Assets	96.5%	97.1%	93.9%
2. Equity/Gross Guarantees	82.9%	89.2%	92.5%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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 Ratings

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 or 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.** "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 Ratings

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 conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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 or 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'.

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, a suspended rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

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.
(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 | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(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 | 18-(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 | 18-(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-(f-VII)
Proprietary Information
(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent