The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Microfinance Investment Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Jun-2022	AA	A1+	Stable	Maintain	Yes
25-Jun-2021	AA	A1+	Stable	Maintain	Yes
25-Jun-2020	AA	A1+	Stable	Maintain	Yes
27-Dec-2019	AA	A1+	Stable	Maintain	-
28-Jun-2019	AA	A1+	Stable	Maintain	-
31-Dec-2018	AA	A1+	Stable	Maintain	-
21-Jun-2018	AA	A1+	Stable	Maintain	-
24-Oct-2017	AA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of Pakistan Microfinance Investment Company Limited (PMIC) reflect its strong equity base, well-conceived business plan, and strong ownership structure. Pakistan Poverty Alleviation Fund (PPAF), Karandaaz Pakistan - funded by UK's Department for International Development (DFID) - and KfW, a German government-owned development bank – have contributed to the institution’s capital in addition to providing subordinated loans (PPAF, Karandaaz Pakistan & KfW). PMIC’s target market includes 42 institutions - 31 NBMFIs and 11 MFBs. Of these, the company has developed relationships with 21 MFIs and 4 MFBs and gross financing stood at PKR 25.4bln as of end-Dec’21. Cumulative provisioning witnessed a marginal uptick to PKR 1.24bln (end-Dec20: PKR 1.18bln). It is crucial to hold the asset quality, going forward. This is important, as multiple challenges surround the underlying microfinance universe, to which the company caters. Although on the credit concentration side, the risk remains high, the management is closely monitoring affairs in underlying microfinance players and is confident that the ensuing challenges would be managed. Going forward, high-interest rates along with the surge in inflation, and attrition in disposable income of end borrowers will require prudent management of affairs by the microfinance sector in the upcoming year. The Company's net revenue recorded a slight improvement of 5.4% while the net profitability inched up by 18.2%YoY, supplemented by an additional gain on derivatives. Rating Watch captures the heightened need to exercise vigilance on the exposures that the Company has taken. The proactive measures taken by the regulators and other concerning bodies have mitigated the potential damages much anticipated from the pandemic. Vigilance is required as the loan repayment cycle remains amid variants of the post-pandemic continue to re-emerge.

The ratings are dependent on maintaining portfolio quality. Upscaling of the Microfinance Products and stability in the experienced management team, the Company’s ability to sustain credit quality is considered important; maintaining a strong control environment remains central to the Company’s performance and hence the ratings.

Disclosure

Name of Rated Entity	Pakistan Microfinance Investment Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Financial Institution Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | DFIs(Jun-21)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Pakistan Microfinance Investment Company Limited (PMIC), incorporated in August 2016, is licensed to carry out Investment Finance activities as a Non-Banking Financial Company (NBFCs) under the NBFC Rules 2003 and NBFC Regulations 2008.

Background The establishment of PMIC is one of the key milestones in the National Financial Inclusion Strategy (NFIS) launched in May 2015. The National Financial Inclusion Strategy (NFIS) is targeted towards helping the poor segments of the society through financial inclusion.

Operations The business activities of PMIC can be divided into two categories; i) Financial solutions and ii) Microfinance plus products. The latter entails the design and implementation of new financing products in line with the needs of end clients, where PMIC is also providing grant funding for technical assistance.

Ownership

Ownership Structure PMIC was created by the Pakistan Poverty Alleviation Fund (PPAF) and Karandaaz Pakistan and the KfW, a German government-owned development bank.

Stability The ownership structure has remained stable since its inception.

Business Acumen The business acumen of sponsors is considered strong as these are associated with the same sector and share the same development mandate.

Financial Strength These strong sponsors strengthen the financial muscle of PMIC, enabling it to meet its objectives of enhancing liquidity of Microfinance sector.

Governance

Board Structure The board of PMIC comprises five members, including one representative of Karandaaz Pakistan and KFW Development Bank. There are two independent directors on the board including the chairman, providing additional independent oversight.

Members' Profile The board is chaired by Mr. Naveed A. Khan, a leading banker, having more than 30 years of experience of serving at various senior positions in the financial sector. Along with the PMIC, he is heading Sharmeen Khan Memorial Foundation (a charity organization) as the CEO. Prior to this, he served as President of Faysal Bank Limited and ABN Amro Bank Pakistan Limited and has served in senior management positions in the Bank of America, Pakistan. Mr. Naveed Goraya, representative of Karandaaz Pakistan, is also serving as Chief Investment Officer of Karandaaz Pakistan. Ms. Christine Eberhard is representing KfW on the board. Qazi Azmat Isa and Ali Raza Bhutta (PPAF Government Nominee) retired from board on Dec'21 and Jan'21 respectively. All the board members carry vast experience in diversified sectors.

Board Effectiveness The board has formulated three board committees for effective monitoring. During the year, eight board meetings were conducted for the purpose of developing strategy on timely basis. Attendance remained strong during all the meetings.

Financial Transparency The external auditors, EY Ford Rhodes, has expressed an unqualified opinion for the year ended December 31, 2021.

Management

Organizational Structure PMIC organizational structure divided into nine departments namely; (i) Portfolio Management, (ii) Sector Development, (iii) Corporate finance and Investment Banking, (iv) Finance and Accounts, (v) Human Resource, (vi) Legal, (vii) Research and Strategy, viii) Risk Management & Compliance and (ix) Audit.

Management Team Mr. Yasir Ashfaq is the CEO of the company and is leading the Company since August 2017. He has more than 25 years of experience in commercial & investment banking, development and microfinance sector. He is a Fellow Member of ICMA and also has a Master's in Economics from University of Sydney.

Effectiveness To ensure effectiveness of the decision-making process, the management has setup three committees: i) Asset and Liability Committee (ALCO), ii) Management Committee (MANCOM), and iii) Risk Committee. All committees include CEO, CFO and the respective heads of departments.

MIS The Company's core ERP system is SAP which caters to business functionalities, reporting and GL transactions.

Risk Management Framework PMIC's enterprise risk management framework serves as a comprehensive document that outlines the risk profile and aids in implementation of PMIC's business strategy vis-à-vis strategic challenges to achieve overall objectives of the company and determination of the risks undertaken in relation to the company's risk capacity.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises of 42 microfinance providers including 31 microfinance institutions (MFIs). During CY21, active borrowers of the industry exceeded pre-COVID figure to 8.1 million borrowers after recording growth of 16% compared to CY20. Similarly, the GLP surpassed PKR 393 billion during CY21, an increase of 21% compared to CY20. The growth in active borrowers and GLP continues to be driven by the MFB peer group as they managed to add over one million clients and PKR 52 billion in GLP. NBMFC peer group also contributed to portfolio growth with an addition of PKR 16.7 billion. In case of MFBs, PAR > 30 days increased to 5.1% (CY20: 3.3%) on account of expiration of loan deferment period allowed by SBP. However, the PAR > 30 days of MFIs recovered to report at 2.9% in CY21 (CY20: 4.7%).

Relative Position PMIC has been established as an apex institution for the microfinance industry.

Revenues During CY21, markup revenue declined to PKR 2.8bln (CY20: PKR 3.2bln) attributable to prevailing declined key policy rate in CY21. Further segregation reveals that 86.8% of this total revenue is earned against lending to microfinance institutions (core operations of PMICL). The asset yield slightly declined to clock at 10.5% in CY21 (CY20: 12.7%). As at Mar-22, PMIC earned mark up revenue of PKR 986mln, an increase by 50.2% YoY.

Performance The Company's markup expense declined and clocked in at PKR 1.77bln in CY21 (CY20: PKR 2.2bln). Net mark up remained largely same at PKR 1.0bln. Net profitability is supported by other operating income of PKR 101mln primarily through MTM gain on derivative (CY21: PKR 79mln). Non-mark up expenses inched up. Consequently, cost to revenue ratio stood at 34.8% (CY20: 32.4%). After deduction of provisioning expense (CY21: PKR 61mln, CY20: PKR 144mln), net profitability enhanced to PKR 477mln (CY20: PKR 403mln). During 1QCY22, mark up income stood at PKR 987mln and net profitability improved to PKR 144mln.

Sustainability Along with lending, PMIC will also provide additional services to MFBs and MFIs and may make equity and equity-linked investments as well. Financing organizations, other than MFIs and MFBs, could also be considered if such financing contributes to its mission.

Financial Risk

Credit Risk PMIC's gross financing to financial institutions amounts to PKR 25.4bln as at end-Dec21 (end-Dec20: PKR 23.5bln). The top five lenders include; i) Kashf Foundation (19%), ii) Rural Community Development Program (14%), iii) JWS Pakistan (13%), iv) Thardeep Microfinance Found (13%), and v) SAFCO Support Foundation (10%) as at end-Dec'21. Despite these lenders being credible, diversification will assist managing concentration as 68% of top-10 is with five institutions.

Market Risk The treasury will continue to operate as a profit center while ensuring availability of sufficient funds as per business requirement. The company has a conservative investments policy, whereby funds are either parked in government securities or highly rated counter parties. PMIC's investment book witnessed sizable increase YoY (end-Dec21: PKR 839mln, end-Dec20: PKR 289mln). Further analysis reveals PKR 238mln in PIBs while PKR 600mln in TFCs of banks.

Liquidity And Funding Funding base of the company (end-Dec21: PKR 18.7bln, end-Dec20: PKR 16.8bln) mainly comprising of borrowing from shareholders and financial institutions. The liquid assets as percentage of Borrowings stood at as at end-Dec21: 28.0% (Dec20: 21.1%). During 1QCY22, the overall liquidity has witnessed a decline and recorded at ~21%.

Capitalization The equity base of the company witnessed increase to PKR 7.3bln as at end-Dec21 (end-Dec20: PKR 6.8bln) sponsored by the three shareholders.

Pakistan Microfinance Investment Company Limited

PKR mln

BALANCE SHEET	30-Mar-22	30-Dec-21	31-Dec-20	31-Dec-19
	3M	Annual	Annual	Annual
Assets				
Lending to Financial Institutions				
1. Microfinance Institutions	25,156	24,624	22,800	23,140
2. Repurchase Agreement Lendings (Reverse REPO)	-	-	1,725	-
3. Others	36	56	-	-
	25,192	24,681	24,525	23,140
Other Earning Assets	3,604	3,227	1,627	2,108
Fixed Assets	116	128	37	74
Non-Earning Assets				
1. Cash and Bank Balances	353	2,019	212	806
2. Non-Performing Advances	760	760	747	721
3. Others	561	293	274	343
Total Assets	**30,586**	**31,107**	**27,422**	**27,192**
Borrowings	22,166	22,224	19,094	18,772
Other Liabilities (Non-Interest Bearing)	1,102	1,704	1,635	2,133
Equity	7,317	7,180	6,693	6,286
Total Liabilities & Equity	**30,586**	**31,107**	**27,422**	**27,192**
INCOME STATEMENT				
Net Interest / Mark Up Revenue	336	1,019	1,054	1,247
Other Operating Income/Loss	(16)	100	19	29
Total Revenue	**320**	**1,119**	**1,073**	**1,276**
Administrative and General Expenses	(97)	(389)	(348)	(401)
Pre-provision Profit	**223**	**730**	**725**	**874**
Provisions	(18)	(61)	(144)	(807)
Pre-tax Profit	**205**	**669**	**581**	**68**
Net Income	**140**	**477**	**403**	**39**
Ratio Analysis				
Performance				
ROE	7.6%	13.3%	6.2%	0.6%
ROA	1.8%	1.6%	1.8%	0.2%
Cost-to-Total Revenue	30.3%	34.8%	32.4%	31.5%
Net Non-Earning Assets / Equity	8.1%	11.0%	5.4%	8.1%
NIMR (Net Interest/Mark-up Revenue) / Total Assets	1.1%	6.2%	3.9%	5.1%
Asset Yield	3.7%	10.5%	12.7%	15.5%
Liquidity & Funding				
Liquid Assets / Deposits and Borrowings	20.8%	28.0%	21.1%	16.5%
Finances / Total Assets	80.7%	77.8%	87.9%	83.9%
Capital				
Equity / Total Assets	23.9%	23.1%	24.4%	23.1%

Credit Rating

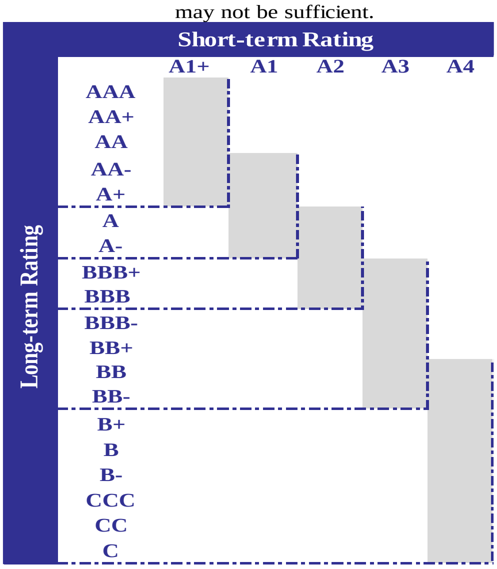
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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):

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

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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 | 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