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-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 a 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). First tranche of subordinated loan from KfW for Renewable Energy Project amounting to € 5mln (total € 15mln) is now expected in July-20, which will further augment the capitalization of the institution. PMIC is distinctly positioned as an apex lending institution for the micro finance sector, in addition to its role to develop the sector and facilitate the evolution of the eco-system. PMIC's target market includes 42 institutions - 31 NBMFIs and 11 MFBs. Of these, the company has developed relationships with 21 MFPs and 3 MFB and the loan portfolio stood at PKR 24bln as of end-Mar'20. A standalone infection has emerged in the recent period which has been fully provided. It is crucial to hold the asset quality, going forward. This is important, as multiple challenges surround the underlying microfinance universe, which the company caters too. For the time being, deferment would alleviate the infectious pressure on the asset quality, but beyond that, recovery pattern of the underlying microfinance players need to revive too, if not the historical peak, optimum level at least to ensure the continued viability. This along with deferral in markup may impact profitability in the upcoming year. However, the management is closely monitoring affairs in underlying microfinance players and is confident that the ensuing challenges would be managed. Covid-19 has posed challenges to the sector, as all segments of the economy, worldwide and domestically, are getting negatively impacted. The ramifications would continue to unfold, warranting vigilance and timely actions where needed. To hold asset quality is of utmost importance in the wake of pending risks to the customer universe. The company's profitability took hit in 2019 due to one exposure, though rebounded in 1QCY20. The company is focusing on Microfinance Funding sources comprises, subordinated loans from sponsors and commercial borrowings which have supported balance sheet growth. The company's operations have been designed on efficient lines with a good control environment. Rating Watch captures the heightened need to exercise vigilance on the exposures that the company has taken in the wake of Covid-19 Pandemic.

The ratings are dependent on maintaining portfolio quality. Up scaling 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 | MFI (Jun-19),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria | Rating Modifier(Jun-19)
Related Research	Sector Study | DFIs(Jun-20)
Rating Analysts	Abdul Wahab | abdul.wahab@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. The objective of the company is to provide funding to microfinance providers to promote financial inclusion in Pakistan in order to alleviate poverty and contribute to the sector's development. The Company operates through its head office in Islamabad.

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. It aims to enhance formal financial access to 50% of the adult population and increase proportion of women with access to a formal account to 25% by 2020.

Operations The business activities of PMIC can be divided into two categories; i) Financial solutions and ii) Sector Development initiatives. The latter entails 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) (49%) and Karandaaz Pakistan — funded by UK's Department for International Development (DFID) (38%) — and the KfW, a German government-owned development bank (13%).

Stability ownership structure has remained stable since 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 for the Micro finance sector.

Governance

Board Structure The board of PMIC comprises six members, including one representative each of PPAF, 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, carrying more than 30 years of experience at various senior positions. All of the board members are seasoned individuals carrying experience of more than 20 years.

Board Effectiveness The board has formulated three board committees for effective monitoring. Attendance remained strong during all the meetings.

Financial Transparency PMIC has engaged M/s KPMG Taseer Hadi & Co, as external auditors, a SBP panel member, who expressed an unqualified opinion for the year ended December 31, 2019.

Management

Organizational Structure PMIC's organizational structure is divided into eight departments namely; (i) Portfolio Management, (ii) Sector Development, (iii) Corporate finance and Investment Banking, (iv) Finance and Accounts, (v) Human Resource, (vi) Legal and Procurement, vii) Risk & Compliance (including research) and (viii) Audit. All the departments report to CEO except for internal audit who also reports to the BoD.

Management Team Mr. Yasir Ashfaq is the CEO of the company. He was serving as the COO in past, since August 2016 but appointed as CEO after one year. Mr. Yasir carries an overall experience of more than 22 years at senior level positions. The CFO, Mr. Fahad Asad, is a qualified Chartered Accountant with more than 18 years of experience. He has been associated with PMIC since Nov'16. Key management personnel are qualified having diversified experience and this is a positive for the organization.

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) Management Risk Committee. All committees include CEO and relevant heads of departments. The meetings are conducted on required basis.

MIS The company is in the process of implementing SAP - ERP, which will automate operations and further strengthen controls.

Risk Management Framework Cognizant of the risk associated with business, PMIC has developed an on-lending criteria that is part of the credit origination process. PMIC has developed an AML/CFT policy and procedures to prevent, detect and report any suspicious transactions and a due diligence mechanism is designed before entering into any business transaction.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises of 42 microfinance providers including 11 microfinance banks (MFBs). MFI outreach hovers around ~7.2mln active borrowers at End-Dec19, representing market penetration of ~35% of the total potential market. MFBs dominate the Microfinance sector, representing ~70% in total Gross Loan Portfolio (PKR 213,712mln) and 49% of active borrowers at end Dec'19. The Microfinance Industry is heading towards a growth trajectory with a YoY increase in industry gross loan portfolio of ~40%. The industry is increasing its inclination towards digital banking side, with new entrants to emerge in this segment, going forward.

Relative Position Total Gross loan portfolio of Micro finance providers stands PKR 213.71 bln in Dec-19 out of which PKR 24 bln (11.2%) is contributed by Pakistan Microfinance Investment Company Limited.

Revenues During CY19, markup revenue increased to PKR 3.6bln (3MCY20: PKR 1bln; CY18: PKR 1.7bln;). Further segregation reveals that 89% of this total revenue is earned against lending to microfinance institutions in CY19, where as in 3MCY20, this rtio was 90%. (core operations of PMICL).

Performance PMIC's mark-up expenses have increased significantly ~158% during CY19 to PKR 2.4bln due to increase in key policy rate (3MCY20: PKR 699mln; CY18: PKR 926mln). The Company's bottom line is supported by other operating income of PKR 29mln (CY18: PKR 17mln) primarily due to grant income. Though, Administrative expenses increased by ~11% and cost to revenue ratio improved to 31.5% (3MCY20: PKR 29.5%; CY18: 38%) attributable to enhanced total revenues. Management is continuously rationalizing cost structure as the company is growing its operations. PMICL booked two provisions, a general provision of PKR 86mln as the company maintained general provisions of 1% - 1.5% of outstanding financing portfolio and a specific provision of PKR 720.6mln. Whereas, in 3MCY20, PMICL booked a specific provision of PKR 4mln only. Due to significant increase in finance cost and provision, PMIC has managed to generate profit after tax of PKR 39.3mln in CY19 (3MCY20: PKR 157mln CY18: PKR 277mln).

Sustainability PMIC will introduce innovative and customized products and solutions for the micro finance sector which will also diversify the risk profile of the company.

Financial Risk

Credit Risk By end-Mar-20, Company's asset book has been decreased by a minor ~0.36% due to slight decrease in net financing because of increased provisioning expense. Although total loan given to Micro finance financial institutions have increased by~1%. Going forward, company has also started lending to Micro finance banks.

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. Investment policy of the company is silent on the duration of portfolio with reference to the market risk appetite of the company.

Liquidity And Funding PMIC maintains sufficient funds in liquid assets (Bank/ Government securities) and at the end Dec-19 the liquid asset ratio significantly improved to 14.5%, where as in Mar-20, ratio decreased to 9.1% (CY18: 6.2%) (Liquid asset/ (Borrowing)

Capitalization PMIC has an equity base of PKR 6.4bln sponsored by the three shareholders. Moreover, subordinate loan from PPAF of PKR 9.3bln and PKR 2.8bln from Karandaaz Pakistan also support capitalization. PMIC's internal capital generation significantly reduced to 0.6% in CY19 due to decrease in profitability, but in 3MCY20, this ratio again improved to 10% (CY18: 4.6%); this is expected to further improve as the business expands.

The Pakistan Credit Rating Agency Limited

Development Financial Institution

Pakistan Microfinance Investment Company Limited

PKR mln

BALANCE SHEET	31-Mar-20	31-Dec-19	31-Dec-18	31-Dec-17
	3M	Annual	Annual	Annual
Assets				
Lending to Financial Institutions				
1. Microfinance Institutions	24,052	23,861	20,764	11,496
2. Repurchase Agreement Lendings (Reverse REPO)	-	-	-	-
3. Others	-	-	-	-
	24,052	23,861	20,764	11,496
Other Earning Assets	2,241	2,094	825	950
Fixed Assets	64	74	27	31
Non-Earning Assets				
1. Cash and Bank Balances	221	806	56	67
2. Non-Performing Advances			-	-
3. Others	515	357	414	294
Total Assets	**27,093**	**27,192**	**22,087**	**12,837**
Borrowings	19,924	20,013	15,489	6,700
Other Liabilities (Non-Interest Bearing)	725	892	353	168
Equity	6,444	6,286	6,245	5,969
Total Liabilities & Equity	**27,093**	**27,192**	**22,087**	**12,837**
INCOME STATEMENT				
Net Interest / Mark Up Revenue	325	1,247	813	553
Other Operating Income/Loss	-	29	17	19
Total Revenue	**325**	**1,276**	**830**	**571**
Administrative and General Expenses	(97)	(401)	(315)	(271)
Pre-provision Profit	**228**	**874**	**515**	**300**
Provisions	(4)	(807)	(116)	(115)
Pre-tax Profit	**224**	**68**	**399**	**185**
Net Income	**158**	**39**	**277**	**152**
Ratio Analysis				
Performance				
Cost-to-Total Revenue	29.8%	31.5%	38.0%	47.5%
ROE	9.9%	0.6%	4.5%	2.6%
NIMR (Net Interest/Mark-up Revenue) / Total Assets	1.2%	4.6%	4.7%	5.9%
Liquidity & Funding				
Liquid Assets / Deposits and Borrowings	12.4%	14.5%	6.2%	15.2%
Finances / Total Assets	84.9%	86.6%	93.0%	88.7%
Capital				
Equity / Total Assets	23.8%	23.1%	28.3%	46.5%
Capital formation rate [Net Profit-dividends / Opening Equ	10.0%	0.6%	4.6%	2.6%

Rating Scale | Corporate

2019

Credit Rating Scale & Definitions

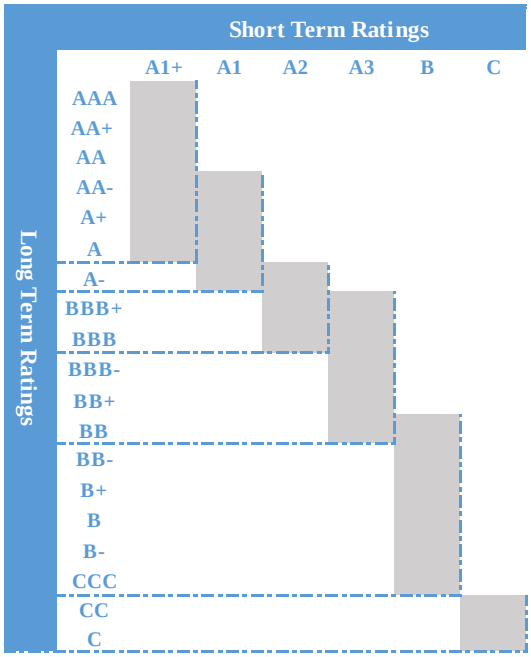
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term 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 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 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.



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) 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.

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