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-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

SAFCO Microfinance Company (Private) Limited ('SMCPL' or the 'Company') is a Microfinance Institution (MFI) governed by the Securities & Exchange Commission of Pakistan under Section 16 of the Companies Act, 2017. The company is licensed to operate under NBFC (Establishment and Regulations) Rules, 2003, Non-Banking Finance Companies, and Notified Entities Regulations 2008. It has been in operation since 2009. The key element is that MFIs are not permitted to mobilize deposits, this element provides funding constraints. SAFCO is a for-profit organization, hence, the source of funding comprises a) Shareholders' equity, b) loans, and c) Internal generation of profits. The company's profitability culminates in integral capital generation at a decent rate. The second major source of funding is borrowings, for which the company majorly relies on local avenues primarily including PMIC, with some foreign portion. The ratings also incorporate the vulnerability in business due to low market share and limited geographical presence. Recently, the company has enhanced GLP, leading to an improvement in markup earned. However, total income declined on account of the exchange losses and higher costs of borrowing and remained stagnant at PKR 468mln at the end-June'22 (FY21: PKR 492mln). The Quantum of NPLs has increased on a YoY basis, where the company prudently recorded higher provisions to provide a cushion against the current and potential NPLs. Provisioning against NPLs along with higher non-markup expenses caused net profitability to dilute.

The Institution's financial risk profile displays a stable outlook with fine profitability margins despite a fall in asset quality. Going forward, the sustainability of profits along with asset quality are key essentials.

Disclosure

Name of Rated Entity	SAFCO Microfinance Company (Private) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology | Rating Modifiers(Jun-22)
Related Research	Sector Study | Microfinance(Sep-22)
Rating Analysts	Sehar Fatima | sehar.fatima@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 originates from the Sindh Agricultural and Forestry Workers Coordinating Organization (SAFWCO), an NGO, established in 1986. After 25 years of delivering social development services and financial access to the destitute of rural Sindh, the Board of SAFWCO realized that technological and economic development has changed the scope of financial services, therefore they spun off their microfinance activities into a separate entity i.e., SMCPL.
Operations SMCPL operates at a provincial level with 58 branches in 12 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 nine loan products mainly relating to the following segments; Enterprise, Livestock, Agriculture, SME, Personal, School Improvement, and lending specifically to emergencies.

Ownership

Ownership Structure Overall control of the Company vests with 3 Shareholders i.e. SSF & 2 individual members. SSF is a major shareholder of 99.9% in SMCPL.
Stability SMCPL has a proper succession plan in place which is expected to remain, going forward.
Business Acumen The members are experienced, having suitable skills to guide the company in the right strategic direction.
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 has a four-member Board of Directors. Two directors are nominees and the rest two are independent, providing objective oversight.
Members' Profile The Board members have good experience in the sector. Mr. Ismail Khumbar, the Chairman, possesses 22 years of experience in agricultural education and sustainable development.
Board Effectiveness During FY22, five board 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'22. An internal audit department is in place, which reports to the Audit Committee.

Management

Organizational Structure SMCPL operations are grouped under nine departments. All departments, report to Mr. Syed Sajjad Ali Shah, the MD, except in the case of the Internal Audit Department which directly reports to the Audit Committee.
Management Team The management has a mix of diverse skills and experience. Members of the management team are adequately qualified and possess a well-rounded set of skills.
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 Pakistan Microfinance Industry (MFI) comprises 50 microfinance providers including 30 microfinance institutions (MFIs). Active Borrowers continued the increasing trend as 8.5 million borrowers were achieved during CY22, an increase of 5.6% compared to CY21. Similarly, the GLP surpassed PKR 448bln during CY22, an increase of 26.1% compared to the GLP in CY21. The further analysis explains the major contribution to the growth of active borrowers and GLP was contributed by the MFB peer group where Mobilink MFB was at the top of the list due to the significant adoption of digital credit and greater outreach to the customer base. NBMFCs peer group also contributed to the increase by adding 94,000 active borrowers and PKR 2.6bln in GLP. In the case of MFBs, PAR > 30 days slightly increased to 5.3% (CY21: 5.2%). However, the PAR > 30 days of MFIs recovered to report at 4.1% in CY22 (CY21: 5.5%).
Relative Position SMCPL is a relatively small player in the Microfinance sector. Active borrowers in FY22 increased by 16%, to 123,778 compared to 105,909 in FY21. As of End-FY22, the company held ~1% of the market share in terms of active borrowers (active borrowers of the industry are 8.5mln) and the market share of ~0.8% in terms of the Gross Loan Portfolio of the whole industry.
Revenue SMCPL earned a net markup income of PKR 571mln in FY22, depicting an increase of 30% as compared to the corresponding period (FY21: PKR 439mln). The Company's business strategy emphasizes maintaining some investments in the form of term deposits and bank deposits. Included in net markup revenue is the PKR 85mln made from these investments.
Profitability During FY22, earning assets reflect 91% of the total asset base (FY21: 91%). Non-mark-up expenses witnessed an increase to PKR 398mln. The provisioning expense of PKR 35mln was written. The bottom-line of the Institution recorded a substantial decrease clocking in at PKR 63mln during FY22 (FY21: PKR 111mln).
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. The GLP as of end-June'22 amounted to PKR 3,674mln (End-June'21: PKR 2,463mln). The non-Performing Loans ratio as of end-Jun'22 stood at 4.4% (End-Jun'21: 6.0%).
Market Risk The investment book of the company comprises Short Term Deposit Receipts (various banks) amounting to PKR 496mln as of End-Jun'22 (End-Jun'21: PKR 274mln).
Funding The company 's funding mix comprises long-term loans from both local (74%) and foreign financial institutions (26%). Total long-term borrowing of SMCPL as of end-Jun'22 stood at PKR 4,284mln (FY21: PKR 3,200mln). Borrowing from PMIC constitutes 65% of the total long-term borrowings of the company.
Cashflows & Coverages SMCPL's liquidity position declined during FY22 as the liquidity ratio (Liquid Assets / (Borrowings + Borrowings net of Repo)) stood at 27.2% (FY21: 42.7%). The decrease in liquidity position is led by a reduction in liquid assets by 14.6% to PKR 1,166mln (FY21: PKR 1,366mln). SMCPL will have to assess its liquidity position and improve it by the placement of more funds in liquid assets to meet unexpected demands.
Capital Adequacy SECP has no minimum requirement for NBFI, unlike SBP which requires MFBs to main 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. The total funds and reserves as of end-Jun'22 stood at PKR 923mln (FY21: PKR 863mln).

PKR mln

SAFCO Microfinance Company (Private) Limited	Jun-22	Jun-21	Jun-20	Jun-19
	12M	12M	12M	12M
A BALANCE SHEET				
1 Total Finances - net	3,674	2,463	2,143	2,389
2 Investments	546	274	210	350
3 Other Earning Assets	683	1,079	764	293
4 Non-Earning Assets	469	410	481	446
5 Non-Performing Finances-net	(1)	(35)	(74)	(107)
Total Assets	5,371	4,191	3,524	3,371
6 Deposits	-	-	-	-
7 Borrowings	4,284	3,200	2,657	2,621
8 Other Liabilities (Non-Interest Bearing)	160	128	120	105
Total Liabilities	4,444	3,328	2,777	2,726
Equity	923	863	747	645
B INCOME STATEMENT				
1 Mark Up Earned	948	693	823	610
2 Mark Up Expensed	(376)	(254)	(329)	(228)
3 Non Mark Up Income	(103)	53	38	110
Total Income	468	492	532	491
4 Non-Mark Up Expenses	(398)	(342)	(373)	(335)
5 Provisions/Write offs/Reversals	(7)	(40)	(57)	(54)
Pre-Tax Profit	63	111	102	101
6 Taxes	-	-	-	-
Profit After Tax	63	111	102	101
C RATIO ANALYSIS				
1 Performance				
Portfolio Yield	26.7%	28.8%	35.7%	31.1%
Minimum Lending Rate	25.0%	25.8%	32.5%	31.1%
Operational Self Sufficiency (OSS)	106.1%	115.7%	110.6%	109.2%
Return on Equity	7.1%	13.8%	14.7%	17.0%
Cost per Borrower Ratio	3,214.1	N/A	N/A	N/A
2 Capital Adequacy				
Net NPL/Equity	-0.1%	-4.0%	-9.9%	-16.6%
Equity / Total Assets (D+E+F)	17.2%	20.6%	21.2%	19.1%
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]	7.3%	14.9%	15.8%	18.6%
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	0.4%	0.2%	0.3%	0.0%
PAR 30 Ratio	4.4%	6.0%	2.5%	0.8%
Write Off Ratio	0.0%	0.0%	0.0%	0.0%
True Infection Ratio	4.4%	6.0%	2.5%	0.8%
Risk Coverage Ratio (PAR 30)	100.8%	122.2%	233.9%	658.2%

Credit Rating

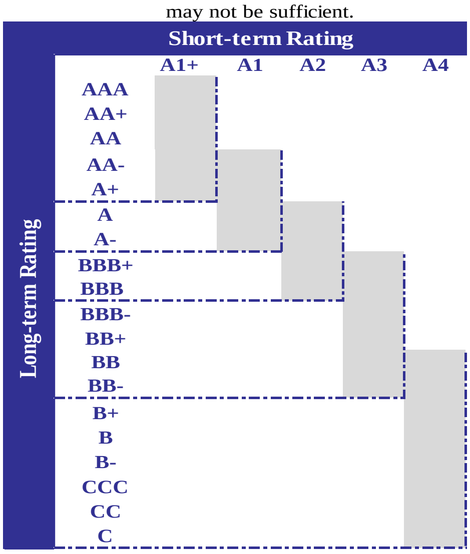
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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 | 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