



The Pakistan Credit Rating Agency Limited

## Rating Report

### PAIR Investment Company Limited

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
26-Dec-2018	AA	A1+	Stable	Maintain	-
13-Jun-2018	AA	A1+	Stable	Maintain	-
18-Dec-2017	AA	A1+	Stable	Maintain	-
19-Jun-2017	AA	A1+	Stable	Maintain	-
23-Jun-2016	AA	A1+	Stable	Maintain	-

#### Rating Rationale and Key Rating Drivers

Development Financial institutions (DFIs) largely operate on turf common to commercial banks. Limited depth in participation towards development of long gestation projects, low funding base, and high competition become their key challenges. Joint Venture Financial Institutions are DFIs jointly conceived by the two sovereigns with primary objective of identifying and nurturing multiple development initiatives. Their ratings are mainly characterized by sovereign ownership, adequate standards of governance, and relatively conservative risk appetite.

The ratings assigned takes into account PAIR's ability to sustain its lending portfolio, in volumes. The lending portfolio quality is deteriorated by addition of some major groups into 'non-performing category' which impacted the overall performance. Management has created an adequate mix of sectors in advances. The capital and treasury division main focus of investment was Government securities, Equities, Sukuk & TFCs and funds. During the year, investment book declined; however provides comfortable cushion to the liquidity. Borrowing from financial institution remains the primary source of funding, while management's attention is required for enhancing the deposit base as it decreased with attrition of some major groups. Liquidity position and capitalization indicators remained stable. Going forward, PAIR is focusing on strengthening the credit portfolio by tapping new customers. Management is cognizant of the fact that they need to find new niche for growth and development, hence new avenues like SME segment, are being explored.

The ratings are dependent on the company's ability to sustain its financial profile while managing the associated risks encompassing active recovery of infected portfolio. Consistent efforts by the management to add further diversity to their portfolio and at the same time stability at CEO's position remains critical for the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	PAIR Investment Company Limited
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Financial Institution(Jun-18),Methodology   Criteria   Rating Modifier(Jun-18),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-18)
<b>Related Research</b>	Sector Study   DFI(Jun-18)
<b>Rating Analysts</b>	Sehar Fatima   sehar.fatima@pacra.com   +92-42-35869504

**The Pakistan Credit Rating Agency Limited**
**Profile**

**Structure** PAIR Investment Company Limited (PAIR), an equally owned joint venture between Pakistan and Iran, was incorporated in January 2007 and commenced operations as a Development Finance Institution (DFI) on May 29, 2007. The Ministry of Finance (MoF) manages the ownership interests of the Government of Pakistan, while Iran Foreign Investment Company (IFIC) represents the Government of Iran.

**Background** IFIC was incorporated in March 1998, and is entrusted with the objective of managing and expanding the Government of Iran's holdings abroad.

**Operations** PAIR's activities are largely bifurcated into fund-based and non-fund based, including financing for SME, large industrial and commercial projects, capital and money market operations and other investment banking activities.

**Ownership**

**Ownership Structure** PAIR Investment Company Limited (PAIR), an equally owned joint venture between Pakistan and Iran. The Ministry of Finance (MoF) manages the ownership interests of the Government of Pakistan, while Iran Foreign Investment Company (IFIC) represents the Government of Iran.

**Stability** The company's ownership structure is likely to stay same in foreseeable future.

**Business Acumen** The business acumen of Ministry of Finance (MoF) and Foreign Investment Company (IFIC) is considered good.

**Financial Strength** The financial strength of the sponsors is considered strong.

**Governance**

**Board Structure** The overall control of the company vests with six-member board of directors including the CEO and five non-executive directors. PAIR's board comprises three directors representing Pakistan and three directors representing Iran.

**Members' Profile** All the board members carry vast experience from diversified sectors. Mr. Zahoor Ahmad, nominated by MOF, was the Acting Chairman of the board till May'18. Mr. Arif Ahmed Khan – Secretary Finance – has been nominated as the new Chairman of the Board. With new Chairman being GoP nominee, new CEO nominations are under finalization by IFIC.

**Board Effectiveness** The board has formulated four board committees for effective monitoring. All board members attended the quarterly conducted board meetings. Minutes were detailed and well captured.

**Financial Transparency** Board has set-up a three member Internal Audit Committee. M/s KPMG Taseer Hadi & Co., Chartered Accountants, external auditors of the Company have expressed an unqualified opinion in their audit report for the year ended December 31, 2017. The financial statements for the six months ending June 30th, 2018

**Management**

**Organizational Structure** Well-defined organizational structure to align its operations; entire operational set-up of the company falls under the purview of the Managing Director except for Internal Audit; who reports to the Board Audit Committee.

**Management Team** All the team members carry vast experience from diversified sectors. Mr. Hamid Eftekhari Kondelaji, CEO since Aug'17, has been nominated by IFIC and confirmed by the Ministry of Finance. Since Mr. Hamid was not granted work permit, therefore new CEO/MD has to be announced which is expected in the first quarter of CY19

**Effectiveness** To ensure effectiveness of the decision-making process, the management has setup eight committees: Asset and Liability Committee (ALCO), Management Committee (MANCOM), Investment Committee, IT Steering Committee, HR Committee, Central Credit Committee, Internal Control Monitoring Committee, and Market Risk Committee.

**MIS** The head of departments monitor the performance through real time based system generated reports that can accessed at any point of time.

**Risk Management Framework** Cognizant of the risk associated with operations, PAIR has developed and implemented various models and manuals to minimize the company wide risks.

**Business Risk**

**Industry Dynamics** DFI industry has grown with achieving a CAGR of 11% in the lending portfolio and 10% in funding, over a span of 5 years. Portfolio quality is improving with better risk monitoring and conservative lending. Going forward, to compete with the other financial institutions (commercial banks primarily), the industry players need to identify new niche for the expansion of DFIs operations.

**Relative Position** PAIR's market share stands at 7% in terms funding as well as lending base of JVFI industry's.

**Revenues** During 9MCY18, Company's markup earned decreased by 44% YOY ( 9MCY18: PKR 606mln; CY17: 1,405mln; 9MCY17: 505mln), on account of decrease in total earning assets, mainly investments. Company's markup expense is also inched up. Due to above mentioned factors, the Company reported a NIMR of PKR 277mln (CY17: PKR 658mln; 9MCY17: PKR 502mln).

**Performance** Company's other operating income declined owing to decrease in gains on sale of investments. Resultantly, company reported a total revenue of PKR 365mln (CY17: PKR 786mln; 9MCY17: PKR 594mln). Other operating expenses decreased by 22% on YoY. Hence, cost to total revenue ratio surged (9MCY18: 59%; CY17: ~45%; 9MCY17: ~47%). Provisioning expense of ~ PKR 120mln (CY17: PKR 67mln) further deteriorated the profits to stands at PKR 3mln (CY17: PKR 230mln; 9MCY18: PKR 278mln), 99% decline on YOY basis.

**Sustainability** Going forward, focus on strengthening the credit processes while tapping new customers. The liaison office in Tehran to facilitate cross border investments is taking time. Strengthening non-fund based revenues through new products for entering into new sectors.

**Financial Risk**

**Credit Risk** At 9MCY18, total earning assets (9MCY18: PKR 13.9bln, CY17: PKR 16.6bln) declined by 12% (decline of 5% in CY17) primarily driven by decline in investments. Gross advances increased by 11% (decline of 14% in CY17). In CY17, top three sector exposure are Textile (22%), Steel (14%) and Sugar (14%). Asset quality deteriorated significantly to 26% in 9MCY18 (CY17: 17%) of gross advances. Provisioning ratio declined to 59% (CY17: 91%) only because of sizable increase in non-performing advances.

**Market Risk** Investment in Government securities have decreased by 36% and comprises 83% of the net investment book of PAIR excluding debt instruments. The top sectors for equity investments remained Banks, Power, Cement and Fertilizer.

**Liquidity And Funding** ALCO is responsible for supervising interest rate risks and maturity mismatch management. Though liquid assets have declined (3QCY18: PKR 5.3bln; CY17: PKR 7bln, CY16: PKR 9bln) yet continue to provide comfortable cushion to borrowings and deposits (3QCY18: 86%; CY17: 91%, CY16: 109%). With expansion in funding base, maintaining the liquidity level would remain central for the company. Company's funding profile remained tilted towards borrowings (77%). Decline in deposits by (38%), mainly the decline in deposits from institutions.

**Capitalization** A strong equity base (3QCY18: PKR 9.2bln; CY17: PKR 9.3bln), mainly comprising Tier-I capital provides comfort to absorb the impact of any adverse macroeconomic performance related shocks. PAIR's capital adequacy remained above regulatory requirement (CY17: 59%, CY16: 76%).



## DFIs

### The Pakistan Credit Rating Agency Limited

### Financials (Summary)

#### PAIR Investment Company Limited

PKR mln

BALANCE SHEET	30-Sep-18	31-Dec-17	31-Dec-16	31-Dec-15
	9M	Annual	Annual	Annual
<b>Assets</b>				
<b>Earning Assets</b>				
Advances	4,507	4,549	5,114	3,110
Debt Instruments	4,351	4,324	2,901	2,647
- Total Finances	<b>8,858</b>	<b>8,873</b>	<b>8,015</b>	<b>5,757</b>
Govt Securities	3,742	5,803	7,868	14,851
Equity Investments	754	931	1,086	1,057
Investments in Associates & Subsidiaries	-	-	-	-
- Total Investments	<b>4,497</b>	<b>6,733</b>	<b>8,955</b>	<b>15,909</b>
Others	584	1,062	433	216
<b>Non Earning Assets</b>				
Non Earning Cash	50	37	64	46
Deferred Tax	254	261	238	260
Net Non Performing Finances	655	91	298	380
Fixed Assets & Others	612	628	596	654
<b>Total Assets</b>	<b>15,510</b>	<b>17,686</b>	<b>18,598</b>	<b>23,221</b>
<b>Liabilities</b>				
Certificates of Investment	1,131	1,814	2,080	1,891
Borrowings	5,023	6,371	6,550	11,652
<b>Interest Bearing Liabilities</b>	<b>6,153</b>	<b>8,185</b>	<b>8,630</b>	<b>13,543</b>
<b>Non Interest Bearing Liabilities</b>	<b>196</b>	<b>246</b>	<b>519</b>	<b>485</b>
<b>Equity</b>				
Total Equity	9,196	9,293	9,367	9,064
Revaluation Surplus	(36)	(37)	83	130
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>15,510</b>	<b>17,686</b>	<b>18,598</b>	<b>23,221</b>

#### INCOME STATEMENT

Interest/ markup earned	606	1,045	1,244	1,510
Interest/ markup expensed	(329)	(387)	(533)	(627)
<b>Net Interest/ markup revenue</b>	<b>277</b>	<b>658</b>	<b>710</b>	<b>883</b>
Other Income	88	129	53	360
Total revenue	<b>365</b>	<b>786</b>	<b>764</b>	<b>1,242</b>
Non Interest/ Non Markup expensed	(216)	(351)	(318)	(302)
Pre-provision Profit	149	435	445	940
Provision/ (Reversal)	120	67	(416)	17
Taxes	(26)	(138)	(258)	(326)
<b>Net Income</b>	<b>3</b>	<b>230</b>	<b>603</b>	<b>597</b>

#### Ratio Analysis

##### Performance

ROE	0.0% *	2.5%	6.5%	6.8%
Cost-to-Total Net Revenue	59.2%	44.7%	41.7%	24.3%
Capital Gains/ Total Revenue	19.0%	8.8%	0.7%	25.3%

##### Capital Adequacy

Equity / Total Assets	59.3%	52.5%	50.4%	39.0%
Capital Adequacy ratio as per SBP	58.1%	59.3%	76.4%	83.7%

##### Funding & Liquidity

Liquid Assets/ Deposits & Borrowings	86.2%	90.9%	108.7%	118.9%
Finances/ Deposits & Borrowings	155.0%	109.7%	96.3%	45.3%

##### Loan Loss Coverage

Loan Loss Provisions/ Impaired Lending	58.5%	90.5%	74.5%	70.8%
Net Impaired Lending/Total Equity	7.1%	1.0%	3.2%	4.2%

#### PAIR Investment Company Limited

Dec-18

[www.pacra.com](http://www.pacra.com)

## 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		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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.	<b>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	Obligations are currently in default.		



**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 surveil the opinion due to lack of requisite information.

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

**Disclaimer:** PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

### **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)
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- (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)

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