The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Kuwait Investment Company (Pvt.) Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
13-Jun-2018	AAA	A1+	Stable	Maintain	-
14-Dec-2017	AAA	A1+	Stable	Maintain	-
14-Jun-2017	AAA	A1+	Stable	Maintain	-
06-May-2016	AAA	A1+	Stable	Maintain	-
06-May-2015	AAA	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 benefit from the company's strong financial profile emanating from robust risk absorption capacity and sound liquidity. Despite increasing credit offtake in the country, PKIC’s lending book did not expand much following a prudent lending and risk management approach. The management is cognizant of the opportunities and is contemplating an appropriate strategy. Nonetheless, the build-up of strategic equity investments in different companies provides a strong and stable income stream in the shape of dividends; hence, comforting the net profits. The company has focused on treasury operations where it is enhancing its participation in money market. The liquidity profile of the institution remains comfortable with access to financial institutions to support its treasury and lending operations. Going forward, the management, while continuing to prudently increase its advances book, would focus on non-fund based revenue stream.

The ratings are dependent on the management's ability to sustain its financial profile while managing the associated risks. Management’s efforts to diversify its operations, finding a new niche for growth, while sustaining its profitability would remain critical.

Disclosure

Name of Rated Entity	Pakistan Kuwait Investment Company (Pvt.) Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Correlation between long-term and short-term rating scale(Jun-17),Methodology | Criteria Modifiers(Jun-17),Methodology | Bank Rating(Jun-17)
Related Research	Sector Study | DFI(Jun-18)
Rating Analysts	Muhammad Shahzad Saleem | shahzad@pacra.com | +92-42-35869504

Pakistan Kuwait Investment Company (Pvt.) Limited (PKIC) Profile	
Incorporated	1979
Major business lines	The objective of the company is to profitably promote industrial investment in Pakistan.
Legal status	Private Limited Company
Head Office	Karachi

Industry Snapshot

- 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

Profile and Ownership

- **Status:** Pakistan Kuwait Investment Company (Pvt.) Limited (PKIC) is an equally owned joint venture between Pakistan and Kuwait. State Bank of Pakistan (SBP) manages the ownership interests of the Government of Pakistan, while Kuwait Investment Authority (KIA) represents the Government of Kuwait. The governments of Kuwait and Pakistan have been rated “Aa2” and “B3” respectively, with a stable outlook, by Moody’s in 2018.
- **Background:** Kuwait Investment Authority has primarily investments in real estate, private equity, public equity, fixed income and alternative investment markets across the globe.
- **Operations:** PKIC has been following a strategy of limited credit expansion with an increased focus towards capital and money markets. Consequently, it has developed a good and diversified portfolio of strategic and equity investments.

Governance

- **Board Structure:** The overall control of the company vests with six-member board of directors including the CEO and five non-executive directors having equal representation from both governments.
- **Members Profile:** All the board members carry vast experience from diversified sectors. The Chairman of the board, Mr. Abdullah Abdulwahab Al-Ramadhan, a representative of KIA, has extensive experience in the field of finance and investment management.
- **Board Effectiveness:** The board has formulated three board committees for effective monitoring. All board members attended five board meetings conducted during the year. Minutes were detailed and well captured.
- **Financial Transparency:** Board has set-up a three member Audit Committee that reports to the Board. M/s KPMG Taseer Hadi & Co., Chartered Accountants, the external auditors of the Company have expressed an unqualified opinion in their audit report for the year ended December 31, 2017.

Management

- **Organizational Structure:** Well-defined organizational set-up of the company falls under the purview of the Managing Director except for Internal Audit and Risk Management Heads; who reports to the Board Audit Committee and Board Risk Management Committee respectively.
- **Management Team:** All the board members carry vast experience from diversified sectors. Mr. Mansur Khan, CEO is associated with the company since Feb'14, carries over 30 years of diversified experience in the banking and development sector locally and abroad.
- **MIS Reporting:** The department heads monitor performance on daily basis through different MIS reports being generated through system and report to the CEO on periodic basis.

Risk Management

- **Operational Risk:** Cognizant of the risk associated with operations, PKIC has installed and implemented various models and manuals to minimize the company wide risks.
- **Credit Risk:** Despite 24% and 10% decrease YOY in company’s loan book in CY17 and 1QCY18 respectively, total assets increased slightly by 1% in CY17 and 3% in 1QCY18 on account of its investment book. Advances portfolio was passively managed (15% decline in gross advances). In CY17, top three sector exposure are Textile (54%), Power (14%) and Petroleum (10%). Asset quality remained intact with impaired portfolio forming 27% of gross advances in CY17 (CY16: 26%) and 1QCY18 of total lending and fully provided for loan losses in CY17 and 1QCY18.
- **Market Risk:** Investment in Government securities stood at 21% in CY17 and 5% in 1QCY18 of company’s entire investment book. Within the government securities PIBs and T-Bills have weightage of 20% and 80% respectively in CY17. Whereas in 1QCY18, 100% investment was made in PIBs. The top sectors for equity investments remained Banks and Power. Despite consistent competition in the banking industry, Meezan Bank after tax profit grew by 14% (CY17: PKR 6.3bln). Given strategic nature and healthy performance of majority of the investments, market risk is considered manageable. However, Company is planning to sell off its investment in Pakistan Kuwait Takaful Company Limited.

Business Risk

- **Performance:** Marked 5% share in the lending portfolio of JVFI industry, while it has been able to tap 29% of the JVFI industry's funding base. Net markup revenue declined by 19% YOY in CY17, on back of lower spreads on lending to corporate clients. However, in 1QCY18, net markup revenue remain stable. Other operating income witnessed increase in 1QCY18 mainly due to the stable share in profit from associates. With an increase in admin expenses, the cost to net revenue increased to 17% in CY17 and 13% in 1QCY18. Above challenges led to a decline in net profit by 46% in CY17 and clocked in at PKR 1,850mln. However, profits inclined by 4% in 1QCY18 and clocked in at PKR 868mln.
- **Sustainability:** Going forward, focus will be on strengthening the credit processes while tapping new customers. Strengthening non-fund based revenues through new products for entering into new sectors.

Financial Risk

- **Liquidity:** Assets and Liabilities Committee is responsible for supervising interest rate risks and maturity mismatch management. Liquid assets have inclined (CY17: PKR 9bln and 1QCY18: PKR 5bln), thus provide comfortable cushion to borrowings and deposits. With expansion in funding base, maintaining the liquidity level would remain central for the company.
- **Funding:** Company’s funding profile remained tilted towards borrowings (100%). Deposits remain stable; with COI concentration with one group only.
- **Capital:** A strong equity base (CY17: PKR 24bln and 1QCY18: PKR 24bln), mainly comprising Tier-I capital provides comfort to absorb the impact of any adverse macroeconomic performance related shocks. PKIC’s capital adequacy 41% remained above regulatory requirement.

Pakistan Kuwait Investment Company (Pvt.) Limited

PKR mln

BALANCE SHEET	31-Mar-18	31-Dec-17	31-Mar-17	31-Dec-16	31-Dec-15
	1Q	**Annual**	**1Q**	**Annual**	**Annual**
Assets					
Earning Assets					
Advances	3,024	3,166	3,527	4,314	4,997
Debt Instruments	1,506	1,114	1,383	1,380	1,438
- Total Finances	**4,530**	**4,280**	**4,910**	**5,694**	**6,435**
Govt Securities	938	4,500	4,972	3,089	6,645
Equity Investments	3,556	3,648	4,025	3,930	3,865
Investments in Associates & Subsidiaries	14,065	13,660	12,975	12,807	10,194
- Total Investments	**18,559**	**21,808**	**21,972**	**19,826**	**20,704**
Others	6,306	2,495	1,880	2,650	21
Non Earning Assets					
Non Earning Cash	61	61	61	62	64
Deferred Tax	-	-	-	-	-
Net Non Performing Finances	-	1	108	108	117
Fixed Assets & Others	721	484	426	601	1,026
Total Assets	**30,177**	**29,129**	**29,357**	**28,941**	**28,367**
Liabilities					
Certificates of Investment	3	3	4	4	180
Borrowings	2,520	2,562	2,639	2,662	6,247
Interest Bearing Liabilities	**2,523**	**2,565**	**2,643**	**2,666**	**6,427**
Non Interest Bearing Liabilities	**2,333**	**1,757**	**2,104**	**1,588**	**1,324**
Equity					
Total Equity	24,496	24,128	23,156	22,822	19,727
Revaluation Surplus	825	679	1,454	1,865	889
TOTAL LIABILITIES & EQUITY	**30,177**	**29,129**	**29,357**	**28,941**	**28,367**

INCOME STATEMENT					
Interest/ markup earned	191	741	190	1,028	1,229
Interest/ markup expensed	(25)	(104)	(26)	(244)	(365)
Net Interest/ markup revenue	**165**	**637**	**164**	**784**	**864**
Other Income	1,034	2,403	823	3,787	2,620
Total revenue	**1,199**	**3,040**	**987**	**4,571**	**3,484**
Non Interest/ Non Markup expensed	(159)	(520)	(92)	(443)	(545)
Pre-provision Profit	1,041	2,520	895	4,128	2,939
Provision/ (Reversal)	3	73	133	0	(435)
Taxes	(175)	(743)	(194)	(676)	(676)
Net Income	**868**	**1,850**	**834**	**3,453**	**1,828**

Ratio Analysis					
Performance					
ROE	14.3%	7.9%	14.5%	16.2%	9.6%
Cost-to-Total Net Revenue	13.2%	17.1%	9.3%	9.7%	15.6%
Capital Gains/ Total Revenue	11.6%	3.0%	6.9%	7.0%	10.1%
Capital Adequacy					
Equity / Total Assets	81.2%	82.8%	78.9%	78.9%	69.5%
Capital Adequacy ratio as per SBP	40.6%	41.3%	40.3%	39.8%	38.9%
Funding & Liquidity					
Liquid Assets/ Deposits & Borrowings	191.7%	335.1%	355.8%	275.3%	168.3%
Finances/ Deposits & Borrowings	224.7%	211.9%	238.6%	271.9%	125.4%
Loan Loss Coverage					
Loan Loss Provisions/ Impaired Lending	100.0%	99.9%	92.3%	93.0%	92.8%
Net Impaired Lending/Total Equity	0.0%	0.0%	0.5%	0.5%	0.6%

The Pakistan Credit Rating Agency Limited

ENTITY CREDIT RATING SCALE & DEFINITIONS

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

Long Term Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ **AA** **AA-**	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ **A** **A-**	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ **BBB** **BBB-**	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances or economic conditions are more likely to impair this capacity.
BB+ **BB** **BB-**	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ **B** **B-**	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business, and economic environment.
CCC **CC** **C**	**Very high credit risk.** "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

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

C: An inadequate capacity to ensure timely repayment.

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

Outlook (Stable, Positive, Negative, Developing)
Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business or financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, a suspended rating should be considered withdrawn.

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

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term “family members” shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers’ associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst’s area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
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