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
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. PMIC is distinctly positioned as an apex lending institution for the microfinance sector, in addition to its role to develop the sector and facilitate the evolution of the eco-system. PMIC's target market includes 37 institutions - 26 NBMFIs and 11 MFBs. Of these, the company has developed relationships with 20 MFIs and the loan portfolio stood at PKR~18bln as of end-Sep'18. The company was able to grow its lending portfolio and is maintaining its quality. Additionally, PMIC is in the process of developing lending relationships with MFBs and has already engaged one MBF. PMIC plans on expanding its microfinance lending portfolio to PKR~28bln by CY19. The company board has also approved Microfinance Plus initiatives targeted towards agri-value chains, enterprise development, micro-insurance, renewable energy, among others. Several pilot projects are underway. Funding sources comprise of subordinated loans from sponsors, and market borrowings; market-based funding is projected to comprise a sizable portion of the institution's overall funding, going forward. The company's operations have been designed on efficient lines with a strong control environment. Notable developments in the overall structure and risk environment alongside operational efficiencies are yielding healthy revenues. Going forward, the trend is expected to remain the same.

The ratings are dependent on the expanding loan portfolio while initiation of the Microfinance plus products, experienced 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. The sponsor support is a positive for the ratings.

Disclosure

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

Profile

Structure Pakistan Microfinance Investment Company Limited (PMIC), incorporated in August 2016, is licensed to carry out Investment Finance activities as a Non-Banking Financial Company (NBFCs) under the NBFC Rules 2003 and NBFC Regulations 2008. 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) Microfinance plus product. The company has initiated the process of providing different products under Microfinance plus product category.

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 The company's ownership structure is expected to remain same in foreseeable future.

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

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

Governance

Board Structure The board of PMIC comprises seven members, including one representative each of PPAF, Karandaaz Pakistan, KfW Development Bank and a Government Nominee. 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 except for government nominee.

Financial Transparency PMIC has engaged M/s KPMG Taseer Hadi & Co, an external auditors, A SBP panel member, who expressed an unqualified opinion for the year ended December 31, 2017.

Management

Organizational Structure PMIC organizational structure divided into nine departments namely; (i) Portfolio Management, (ii) Sector Development, (iii) Corporate finance and Investment Banking, (iv) Finance and Accounts, (v) Head Human Resource, (vi) Legal, (vii) Research and Strategy, viii) Risk Management & Compliance and (ix) Audit. All the departments reporting 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 21 years at senior level positions. The CFO, Mr. Fahad Asad, is a qualified Chartered Accountant with more than 16 years of post-qualification experience. He has been associated with PMIC since Nov'16. Key management personnel are qualified having diversified experience 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) Risk Committee. All committees includes CEO, CFO and the respective heads of departments. The meeting are conducted on required basis.

MIS The MIS reports could be generated at any point in time for monitoring daily, weekly, monthly or quarterly performance of the respective departments.

Risk Management Framework Cognizant of the risk associated with operations, PMIC has developed an on-lending criteria that is part of the credit origination process. Recently, 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 The Pakistan Microfinance Industry (MFI) continues the upward trajectory during last few years. The favorable macroeconomic conditions, launch of National Financial Inclusion Strategy and development of regulatory framework for Non-Banking financial Institutions by SECP have been the catalyst for MF industry growth. Pakistan Microfinance Industry comprises of 44 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (MFIs), 7 Rural Support Program (RSPs) and 9 others projects. Microfinance banks dominate the industry with a share in Gross Loan Portfolio of ~68%.

Relative Position Total Gross loan portfolio of Micro finance providers stands PKR 255bln in Sep-18 out of which PKR 18bln (~7%.) is contributed by Pakistan Microfinance Investment Company Limited.

Revenues With the growth in the business, the markup revenue increased to PKR 1.2bln during 9MCY18 from only PKR 701mln in Dec'17. Out of this total revenue ~70% is earned against the lending to microfinance institutions, other markup earned is from REPO transactions against T-Bills and PIBs and lastly profits on Term deposits certificates. PIMC's portfolio management income is almost zero on account of decline in portfolio with PPAF. Its services provide Financing & Investing Solutions as well as Microfinance plus products which consist of multiple services which will assist the company in multiple revenue streams.

Performance As its third year of operation, company's markup expense have increased more as compared to the markup income earned by the company (3QCY18: PKR 639mln; 2QCY18: PKR 378mln). Company's bottom line is also supported by other operating income of PKR 26mln (2QCY18: PKR 23mln; CY17: PKR 19mln) mainly from deposit accounts with the other banks and grant income from kfw development bank also contributed to the bottom line. However, administrative expenses have increased but remained below projected expenses. consequently, cost to revenue ratio stood at 38%. Management continuously rationalizing this cost as the company is growing its operations. Company booked general provision of PKR 91mln as the company maintained general provisions of 1% of outstanding financing portfolio. As a result, PMIC has managed to generate net income of PKR 187mln in Sep-18 (CY17: PKR 152mln; 5MCY16: loss PKR67mln). With the growth in business, it is expected that other operating income would also boost, providing additional cushion to bottom-line.

Sustainability Along with lending, PMIC will also provide additional service to MFBs and MFIs and may make equity and equity-linked investments as well. Financing organizations, other than MFIs and MFBs, could also be considered if such financing contributes to its mission. Management expects to close the year with a Gross loan portfolio of ~ PKR 22bln.

Financial Risk

Credit Risk During 9MCY18, Company was able to maintain its asset book with growth of 52% with maintained asset quality, backed by significant increase in loan given to Microfinane financial institutions. Going forward, company has also started lending to Microfinance banks.

Market Risk The treasury will operate as a profit centre, maintaining a treasury of PKR 1.1bln, along this. The funds are largely be invested in Commercial Banks rated "AAA" or in "AA" category . The company may invest in T-Bills and PIBs in foreseeable future.

Liquidity And Funding PMIC maintained a small portion of liquidity as the Liquid Assets / Deposits and Borrowings stands at 8.7% during 9MCY18 (CY17: 15.2%) as per company policy.

Capitalization PMIC has current equity of PKR 6.2bln sponsored by the three shareholders. Moreover, the subordinate loan from PPAF (up to PKR 11.5bln) and PKR 1.7bln from Karandaaz Pakistan. However, PMIC's internal capital generation is at 4.1% in Sep'18; expected to improve as the business expands and starts earning more.

The Pakistan Credit Rating Agency Limited

Development Financial Institution

Pakistan Microfinance Investment Company Limited	**Un-Audited**			PKR mln
BALANCE SHEET	**30-Sep-18**	**30-Jun-18**	**31-Dec-17**	**30-Jun-17**
	9M	**1H**	**Annual**	**1H**
Assets				
Lending to Financial Institutions				
1. Microfinance Institutions	18,124	16,671	11,496	4,159
2. Repurchase Agreement Lendings (Reverse REPO)	-	-	-	997
3. Others	-	-	-	-
	18,124	16,671	11,496	5,156
Other Earning Assets	1,050	1,250	950	2,326
Fixed Assets	28	30	31	26
Non-Earning Assets				
1. Cash and Bank Balances	22	328	67	104
2. Non-Performing Advances	-	-	-	-
3. Others	353	286	294	126
Total Assets	**19,577**	**18,565**	**12,837**	**7,737**
Borrowings	13,118	12,223	6,700	1,818
Other Liabilities (Non-Interest Bearing)	302	271	168	39
Equity	6,157	6,071	5,969	5,881
Total Liabilities & Equity	**19,577**	**18,565**	**12,837**	**7,737**
INCOME STATEMENT				
Net Interest / Mark Up Revenue	557	341	553	245
Other Operating Income/Loss	26	23	19	7
Total Revenue	**583**	**363**	**571**	**252**
Administrative and General Expenses	(222)	(154)	(271)	(118)
Pre-provision Profit	**361**	**209**	**300**	**133**
Provisions	(91)	(61)	(115)	(42)
Pre-tax Profit	**271**	**149**	**185**	**91**
Net Income	**187**	**101**	**152**	**64**
Ratio Analysis				
Performance*				
Cost-to-Total Revenue	38.0%	42.5%	47.5%	47.0%
ROE	4.1% *	3.4% *	2.6%	2.2%
NIMR (Net Interest/Mark-up Revenue) / Total Assets	3.9% *	4.3% *	5.9%	3.2%
Liquidity & Funding				
Liquid Assets / Deposits and Borrowings	8.7%	13.8%	15.2%	188.5%
Finances / Total Assets	91.5%	88.9%	88.7%	66.1%
Capital				
Equity / Total Assets	31.4%	32.7%	46.5%	76.0%
Capital formation rate [Net Profit-dividends / Opening Equity] * 100	4.1% *	3.4% *	2.6%	1.1%

** Annualised performance ratios*

Pakistan Microfinance Investment Company Limited

Dec-18

Rating Scale

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.

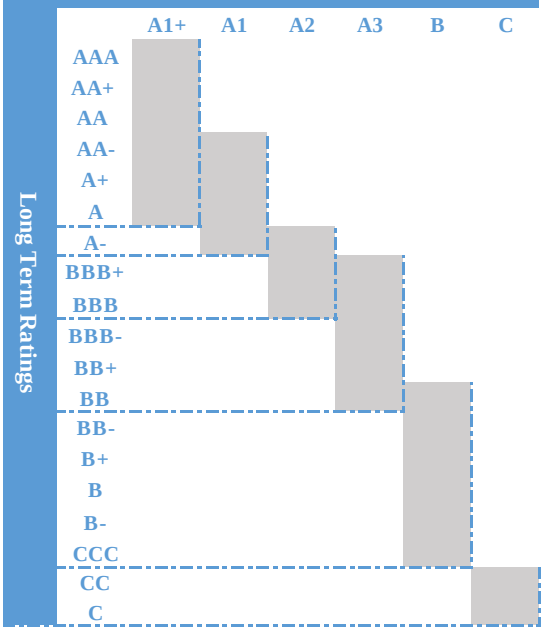
Long Term Ratings

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.

Short Term Ratings



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