The Pakistan Credit Rating Agency Limited

Rating Report

Pakistan Microfinance Investment Company Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Jun-2021	AA	A1+	Stable	Maintain	YES
25-Jun-2020	AA	A1+	Stable	Maintain	YES
27-Dec-2019	AA	A1+	Stable	Maintain	-
28-Jun-2019	AA	A1+	Stable	Maintain	-
31-Dec-2018	AA	A1+	Stable	Maintain	-
21-Jun-2018	AA	A1+	Stable	Maintain	-
24-Oct-2017	AA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings of Pakistan Microfinance Investment Company Limited (PMIC) reflect its strong equity base, well-conceived business plan, and strong ownership structure. Pakistan Poverty Alleviation Fund (PPAF), Karandaaz Pakistan - funded by UK's Department for International Development (DFID) - and KfW, a German government-owned development bank – have contributed to the institution’s capital in addition to providing subordinated loans (PPAF, Karandaaz Pakistan & KfW). PMIC’s target market includes 41 institutions - 30 NBMFIs and 11 MFBs. Of these, the company has developed relationships with 21 MFIs and 3 MFBs and the loan portfolio stood at PKR 23.7bln as of end-Mar’21. The Company has adequate reserve coverage against non-performing loans, however, it is imperative to maintain the asset quality going forward. This is important, as multiple challenges surround the underlying microfinance universe, which the company caters to. For the time being, deferment would alleviate the infectious pressure on the asset quality, but beyond that, the recovery pattern of the underlying microfinance players needs to revive too, if not the historical peak, the optimum level at least to ensure the continued viability. This along with deferral in markup may impact profitability later this year. However, the management is closely monitoring affairs in underlying microfinance players and is confident that the ensuing challenges would be managed. The Company's net revenue improved YoY along with net profitability. The Company is focusing on Microfinance Funding sources comprised of subordinated loans from sponsors and commercial borrowings which have supported balance sheet growth. Rating Watch captures the heightened need to exercise vigilance on the exposures that the Company has taken in the wake of the COVID-19 Pandemic. COVID-19 is an ongoing challenge. While it has taken a toll on many businesses, its ramifications are still unfolding. The proactive measures are taken by the regulators and other concerning bodies have mitigated the potential damages much anticipated from this pandemic. As a result, the microfinance industry remained protected and posted record profits. Vigilance is required as the loan repayment cycle remains amid variants of the pandemic continue to re-emerge.

The ratings are dependent on maintaining portfolio quality. Upscaling of the Microfinance Products and stability in the experienced management team, the Company’s ability to sustain credit quality is considered important; maintaining a strong control environment remains central to the Company’s performance and hence the ratings.

Disclosure	
Name of Rated Entity	Pakistan Microfinance Investment Company Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | FI (Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | DFIs(Jun-20)
Rating Analysts	Muhammad Fahad Iqbal | fahad.iqbal@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 society through financial inclusion.

Operations The business activities of PMIC can be divided into two categories; i) Financial solutions and ii) Microfinance plus products. The latter entails the design and implementation of new financing products in line with the needs of end clients, where PMIC is also providing grant funding for technical assistance.

Ownership

Ownership Structure PMIC was created by the Pakistan Poverty Alleviation Fund (PPAF) (49%) and Karandaaz Pakistan — funded by UK's Department for International Development (DFID) (38%) — and the KfW, a German government-owned development bank (13%).

Stability The ownership structure has remained stable since its inception.

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

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

Governance

Board Structure The board of PMIC comprises six members, including one representative each of PPAF, Karandaaz Pakistan, and KfW Development Bank. There are two independent directors on the board including the chairman, providing additional independent oversight.

Members' Profile The board is chaired by Mr. Naveed A. Khan, a leading banker, carrying more than 30 years of experience at various senior positions. All of the board members are seasoned individuals carrying experience of more than 20 years.

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

Financial Transparency KPMG has expressed an unqualified opinion for the year ended December 31, 2020. PMIC as part of best practice has rotated KPMG as external auditors after 5 years of completion and has engaged EY Ford Rhodes as external auditors for the audit of the year 2021.

Management

Organizational Structure PMIC's organizational structure is divided into eight departments namely; (i) Portfolio Management, (ii) Sector Development, (iii) Corporate finance and Investment Banking, (iv) Finance and Accounts, (v) Human Resource, (vi) Legal and Procurement, vii) Risk & Compliance (including research) and (viii) Audit. All the departments report to CEO except for the 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 a CEO after one year. Mr. Yasir carries an overall experience of more than 22 years at senior-level positions. He is a Fellow member of ICMA and also has a Master's in Economics from the University of Sydney. The previous CFO, Mr. Fahad Asad, has left PMIC and Mr. Safwat Khalid, a Fellow member of ICAP, has joined as a new CFO in April-21. He has 20+ years of experience mainly in Banking & Financial Services sector.

Effectiveness To ensure the effectiveness of the decision-making process, the management has set up three committees: i) Asset and Liability Committee (ALCO), ii) Management Committee (MANCOM), and iii) Management Risk Committee. All committees include the CEO and relevant heads of departments. The meetings are conducted on a required basis.

MIS The Company's core ERP system is SAP which caters to business functionalities and GL transaction recording.

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

Business Risk

Industry Dynamics Pakistan Microfinance Industry comprises 46 microfinance providers including 11 Microfinance Banks (MFBs), 30 Microfinance Institutions (MFIs), 5 Rural Support Programme (RSPs) and 9 other projects. As at 1QCY21, the overall industry borrowers stood at ~7.6mln, an increase of 3.8% compared to the prior year

Relative Position The GLP surpassed PKR 340bln, an increase of 9.4%. The growth in active borrowers and GLP continues to be driven by the MFB peer group as they managed to add over 614,000 clients and PKR 11bln in GLP.

Revenues During CY20, markup revenue slightly declined to PKR 3.2bln (CY19: PKR 3.6bln). Further segregation reveals that 90.5% of this total revenue is earned against lending to microfinance institutions (core operations of PMICL). The asset yield slightly declines to clock at 12.7% in CY20 (CY19: 15.5%).. Markup revenue in 1QCY21 is PKR 656mln (1QCY20: PKR 1bln).

Performance The Company's markup expense has slightly declined to clock in at PKR 2.2bln in CY20 (CY19: PKR 2.4bln). Company's bottom line is also supported by other operating income of PKR 19mln in CY20 mainly due to grant income from KFW development bank. Administrative expenses have slightly decreased. Consequently, the cost to revenue ratio stood at 32.4%. Management continuously rationalizing this cost as the company is growing its operations. PMIC booked provision of PKR 144mln as the company maintained general provisions of 1.9% of outstanding financing portfolio. As a result, PMIC has managed to generate a net income of PKR 403mln in CY20 (CY19: PKR 39mln). Net income in 1QCY21 is PKR 56mln (1QCY20: PKR 157mln) With the growth in business, it is expected that other operating income would also boost, providing additional cushion to bottom-line. The profits are expected to keep up the growth trajectory as financing would continue to rise while borrowings would remain on the lower end.

Sustainability Along with lending, PMIC will also provide additional services 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.

Financial Risk

Credit Risk The net lending to financial institutions amounts to a total PKR 23.5bln as at end-Dec20 and PKR 23bln as at Mar21. The top five lenders include; i) Kashf Foundation (14.83%), ii) Rural Community Development Program (12.08%), iii) JWS Pakistan (10.02%), iv) Thardeep Microfinance Found (9.31%), and v) SAFCO Support Foundation (8.66%) in Mar21. Despite these lenders being credible, the management needs to diversify its portfolio as almost 55.7% of lending is to the main 5 major financial institutions. The management has derived the policy to record General provision at 1% of the targeted Gross Loan Portfolio. Among the top 10 portfolios, only 5 entities are rated and they constitute 47.09% of the top 10 exposure. As far as the overall portfolio is concerned they constitute only 3 banks consisting of 7% of the total portfolio.

Market Risk The treasury continues to operate as a profit center while ensuring the availability of sufficient funds as per business requirements. The Company has a conservative investments policy, whereby funds are either parked in government securities or highly rated counterparties. The investment policy of the company is silent on the duration of the portfolio with reference to the market risk appetite of the company

Liquidity And Funding PMIC maintains sufficient funds in liquid assets (Bank/ Government securities) and the liquid assets as a percentage of Deposits and Borrowings of the Company as at end-Dec20: 21.1% (Dec19: 16.5%). The percentage stood at 19.9% as at end-Mar21.

Capitalization PMIC has current equity of PKR 6.7bln in CY20 sponsored by the three shareholders. Moreover, the subordinate loan from PPAF (up to PKR 8.4bln) and PKR 2.8bln from Karandaaz Pakistan and KfW (PKR 879mln) is strengthening the capital. A broader equity base would enhance the borrowing ability of the company as well. Equity in 1QCY21 stood at PKR6.8bln. In the future, Company will further explore the sponsor loans and other funding sources.

Pakistan Microfinance Investment Company Limited

PKR mln

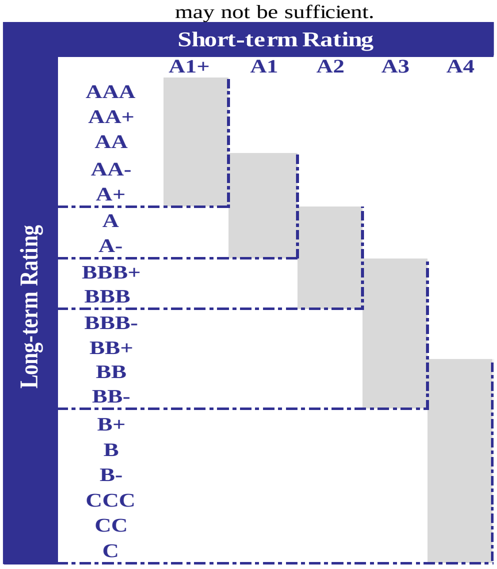
BALANCE SHEET	30-Mar-21	31-Dec-20	31-Dec-19	31-Dec-18
	3M	Annual	Annual	Annual
Assets				
Lending to Financial Institutions				
1. Microfinance Institutions	22,349	22,800	23,140	20,764
2. Repurchase Agreement Lendings (Reverse REPO)	1,380	1,725	-	-
3. Others	-	-	-	-
	23,729	24,525	23,140	20,764
Other Earning Assets	1,676	1,627	2,108	825
Fixed Assets	48	37	74	27
Non-Earning Assets				
1. Cash and Bank Balances	126	212	806	56
2. Non-Performing Advances	747	747	721	-
3. Others	294	274	343	414
Total Assets	**26,620**	**27,422**	**27,192**	**22,087**
Borrowings	19,470	20,237	19,915	15,390
Other Liabilities (Non-Interest Bearing)	400	492	990	452
Equity	6,749	6,693	6,286	6,245
Total Liabilities & Equity	**26,620**	**27,422**	**27,192**	**22,087**
INCOME STATEMENT				
Net Interest / Mark Up Revenue	262	1,054	1,247	813
Other Operating Income/Loss	(53)	19	29	17
Total Revenue	**209**	**1,073**	**1,276**	**830**
Administrative and General Expenses	(89)	(348)	(401)	(315)
Pre-provision Profit	**120**	**725**	**874**	**515**
Provisions	(15)	(144)	(807)	(116)
Pre-tax Profit	**106**	**581**	**68**	**399**
Net Income	**56**	**403**	**39**	**277**
Ratio Analysis				
Performance				
Cost-to-Total Revenue	42.6%	32.4%	31.5%	38.0%
ROE	3.4%	6.2%	0.6%	4.6%
NIMR (Net Interest/Mark-up Revenue) / Total Assets	3.9%	3.9%	5.1%	4.7%
Liquidity & Funding				
Liquid Assets / Deposits and Borrowings	19.9%	21.1%	16.5%	5.7%
Finances / Total Assets	87.5%	87.9%	83.9%	93.0%
Capital				
Equity / Total Assets	25.4%	24.4%	23.1%	28.3%
Capital formation rate [Net Profit-dividends / Opening Equ	3.4%	6.4%	0.6%	4.8%

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):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk 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.
(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