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
20-Jun-2019	AAA	A1+	Stable	Maintain	-
28-Dec-2018	AAA	A1+	Stable	Maintain	-
13-Jun-2018	AAA	A1+	Stable	Maintain	-
14-Dec-2017	AAA	A1+	Stable	Maintain	-
14-Jun-2017	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. PKIC’s lending book shrunk 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. Strong equity base and minimal drag of NPLs on equity is a positive. 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 | 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 | DFIs(Jun-19)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Pakistan Kuwait Investment Company (Private) Limited was established in March 1979 as a joint venture between the Governments of Pakistan (GoP) and Kuwait. It is equally owned by GoP through the State Bank of Pakistan (SBP) and Government of Kuwait through Kuwait Investment Authority (KIA), representing their respective governments.

Background The Kuwait Investment Authority (KIA), an investment arm of the Government of Kuwait working under the Ministry of Finance, was established in 1982 as an independent legal entity.

Operations The objective of the Company is to profitably promote industrial investment in Pakistan. Despite being one of the oldest Joint Venture Financial Institutions (JVFI), Pak Kuwait has been following a strategy of limited credit expansion and skewed its operations with an increased focus towards money markets and equity investments.

Ownership

Ownership Structure It is equally owned by GoP through the State Bank of Pakistan (SBP) and Government of Kuwait through Kuwait Investment Authority (KIA), representing their respective governments.

Stability The ownership structure remained same since inception of the Company. It is likely to remain same in foreseeable future.

Business Acumen The business acumen of sponsors is considered strong.

Financial Strength The financial muscle of both sponsors is very strong.

Governance

Board Structure The overall control of the Company vests with six member board (BoD), having an equal representation from both governments. Board's Chairman is a representative of KIA.

Members' Profile The BoD members have extensive experience in the field of finance and investment management. This helps in providing useful insight in managing investments and guiding management in developing effective risk management policies and procedures.

Board Effectiveness The Board has formulated three committees, namely Audit Committee, Executive Committee and Risk Management Committee, to ensure smooth and effective monitoring of operations.

Financial Transparency KPMG Taseer Hadi & Co., Chartered Accountants, was the company's external auditors. They have given an unqualified opinion on the financials for the year ended December 31, 2018.

Management

Organizational Structure Pak Kuwait has an aligned organizational structure for operational efficiency. Company's main functions are classified as: Risk Management, Compliance, Investment Banking and Corporate Finance, Capital Market and Treasury, Finance, Internal Audit and Human Resource and General Support Services.

Management Team The Company's management team comprises well qualified and experienced individuals, having long association with the company. Mr. Mubashar Maqbool, Pak Kuwait's MD, has diversified experience in Development, Commercial and Investment Banking and is associated with the company since March 2019.

Effectiveness Pak Kuwait's complete operational set-up falls under the purview of the Managing Director. All department heads directly report to him, except for the Head of Internal Audit; reports to the Board Audit Committee and Head of Risk Management, reports to the Risk Management Committee of the board.

MIS The department heads monitor the performance of their departments on daily basis through different MIS reports being generated through system. They report the performance of their respective departments to the CEO on periodic basis.

Risk Management Framework Pak-Kuwait has developed and implemented various models and manuals to minimize the company wide risks. Risk Management Department comprehensively covers: development of measurement tools/models (e.g. Obligor Risk Rating (ORR), Facility Risk Rating (FRR), CAMEL rating model, and stress testing), establishment of credit and market risk limits, and formulation of policies and procedural manuals related to the overall risk management.

Business Risk

Industry Dynamics JVFI's witnessed slower growth (compared to last few years) in CY18 in terms of total assets and advances attributable to economic slowdown. Investment book majorly vested in government papers given investment's security. Industry's deposit base slimmed down and major reliance for funding remained on borrowings from money market. Going forward, to compete with other financial institutions (commercial banks primarily), the industry players need to build relatively unique products and services. Otherwise, JVFIs may get marginalized.

Relative Position The Company's market share in terms of advances inched down to 4% (CY17: 5%).

Revenues During CY18, interest earned witnessed uptick to stand at PKR 928mln (CY17: PKR 741mln) primarily due to increase in interest rates. Interest expense declined significantly due to lower borrowings and related costs.

Performance NIMR witnessed sizable increase to stand at PKR 862mln. Other operating income continued to supplement the profitability due to the stable share of PKR 2.9bln (CY17: PKR 2.1bln) in profit from associates. Cost to total net revenue decreased to 13% (CY17: 17%) primarily due to increase in total revenue. The provisioning expense stood at PKR 299mln (CY17: 64mln reversal). Hence, net profit stood at PKR 2.8bln (CY17: PKR 1.9bln), up 47% YoY.

Sustainability Going forward, the Company has planned higher disbursements to economically viable and technically feasible projects. Meanwhile, identifying new revenue streams via introduction of new products/services would be in focus.

Financial Risk

Credit Risk During CY18, the Company's loan book witnessed decline of 12% (CY17: decline 24%) to stand at PKR 2.7bln (CY17: PKR 3.0bln) - general industry wide phenomenon - economic slowdown resulting in delays in projects. Total assets witnessed uptick of 3% YoY (CY17: 1%) while advances contribute 9% (CY17: 11%) to total asset base. The Company's overall asset quality remained largely intact. NPLs to gross advances witnessed uptick to ~30% (CY17: 28%) attributable to decline in advances. Loan loss coverage ratio inched down to 96% (CY18) from 96% (CY17).

Market Risk In CY18, Pak Kuwait's investment book stood at PKR 23.8bln (CY17: PKR 21.8bln), up 9% YoY. Analysis of investment book reveals that contribution by government securities inched up to 23% (CY17: 21%) while equity investments declined to 13% (CY17: 17%) of total investment book. In CY18, exposure in equity market declined to PKR 3.2bln (CY17: PKR 3.6bln).

Liquidity And Funding Over last few years, shift in exposure to government securities from equity investments decreased liquidity risk. The liquid assets (CY18: PKR 9.2bln, CY17: PKR ~9bln) continue to provide robust cushion to the borrowings and deposits of Pak Kuwait (CY18: 660%, CY17: 335%). During CY18, borrowings stood at PKR 1.4bln (CY17: PKR 2.6bln) while COIs increased to PKR 35mln (CY17: PKR 2.5mln). The management needs to improve its outreach in order to increase the funding base.

Capitalization The capital structure of the Company primarily comprises Tier-I capital. The company's capital adequacy remained strong at 42.55% (CY17: 41.26%), remaining well above regulatory requirement. Given the low risk profile of overall assets book, a large portion of capital is idle.

Pak Kuwait Investment Company (Private) Limited

Financial Summary

PKR mln

BALANCE SHEET	31-Dec-18	31-Dec-17	31-Dec-16
	Annual	Annual	Annual
Assets			
Earning Assets			
Advances	2,656	3,122	4,270
Debt Instruments	2,008	1,114	1,380
- Total Finances	**4,664**	**4,236**	**5,650**
Govt Securities	5,399	4,500	3,089
Equity Investments	3,211	3,648	3,930
Investments in Associates & Subsidiaries	15,197	13,660	12,807
- Total Investments	**23,807**	**21,808**	**19,826**
Others	1,081	2,496	2,650
Non Earning Assets			
Non Earning Cash	61	61	62
Deferred Tax	-	-	-
Net Non Performing Finances	42	44	152
Fixed Assets & Others	322	484	601
Total Assets	**29,977**	**29,129**	**28,941**
Liabilities			
Certificates of Investment	35	3	4
Borrowings	1,371	2,562	2,662
Interest Bearing Liabilities	**1,406**	**2,565**	**2,665**
Non Interest Bearing Liabilities	**2,022**	**1,757**	**1,588**
Equity			
Total Equity	26,382	24,128	22,822
Revaluation Surplus	167	679	1,865
TOTAL LIABILITIES & EQUITY	**29,977**	**29,129**	**28,941**

INCOME STATEMENT			
Interest/ markup earned	928	741	1,028
Interest/ markup expensed	(66)	(104)	(244)
Net Interest/ markup revenue	**862**	**637**	**784**
Other Income	3,534	2,403	3,787
Total revenue	**4,396**	**3,040**	**4,571**
Non Interest/ Non Markup expensed	(582)	(510)	(485)
Pre-provision Profit	3,814	2,530	4,086
(Provision)/ Reversal	(299)	64	43
Taxes	(747)	(743)	(676)
Net Income	**2,768**	**1,850**	**3,453**

Ratio Analysis			
Performance			
ROE	11.0%	7.9%	16.2%
Cost-to-Total Net Revenue	13.2%	16.8%	10.6%
Capital Gains/ Total Revenue	4.3%	3.0%	7.0%
Capital Adequacy			
Equity / Total Assets	88.0%	82.8%	78.9%
Capital Adequacy ratio as per SBP	42.6%	41.3%	39.8%
Funding & Liquidity			
Liquid Assets/ Deposits & Borrowings	659.9%	335.1%	275.3%
Finances/ Deposits & Borrowings	410.8%	211.9%	271.9%
Loan Loss Coverage			
Loan Loss Provisions/ Impaired Lending	96.2%	96.3%	90.4%
Net Impaired Lending/Total Equity	0.2%	0.2%	0.7%

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.

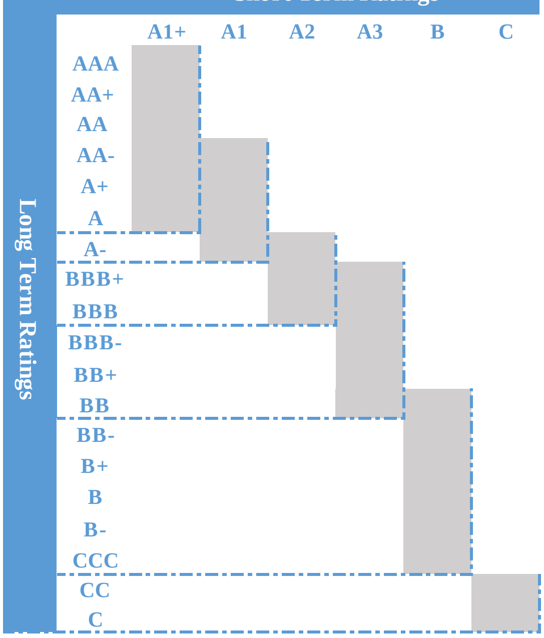
Long Term Ratings

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.

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