RATING REPORT

Pak China Investment Company Limited (PCICL)

REPORT DATE:
June 28, 2021

RATING ANALYSTS:
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RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	Long-term	Short-term	Long-term	Short-term
Entity	AAA	A-1+	AAA	A-1+
Rating Outlook	Stable		Stable	
Rating Date	*June 28' 21*		*June 25' 20*	

COMPANY INFORMATION	
Incorporated in 2007	**External Auditors:** EY Ford Rhodes
Unlisted Public Company	**Chairman of the Board**: N/A
Key Shareholders (with stake 5% or more):	**Chief Executive Officer**: Mr. Wang Baojun
Government of Pakistan – 50%	
People's Republic of China – 50%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria: Government Supported Entities (July, 2020)
http://www.vis.com.pk/kc-meth.aspx

Pak China Investment Company Limited (PCICL)

RATING RATIONALE

The assigned ratings of Pak China Investment Company Limited (PCICL) incorporate implicit support of its two sovereign sponsors, Government of Pakistan (GoP) and People's Republic of China (PRC), with equal shareholding held through Ministry of Finance (MoF) and China Development Bank (CDB), respectively. PRC has an outstanding rating of 'A+' from an international credit rating agency. In the backdrop of challenging economic conditions and uncertainty posed by pandemic, disbursements were made in a highly cautious manner; the institution plans on following its conservative strategy by tapping listed and rated clients in the medium to long-term horizon. Overall, asset quality has exhibited slight downturn in line with non-performance of two clients; however, the same is not considered debilitating as the accounts are expected to be adjusted either by rescheduling or repayment by end of ongoing year. The ratings reflect restricted deferment allowed by the institution under central bank's regulatory relief framework; the deferred portfolio is one of the lowest amongst peers. The ratings are underpinned by strong capitalization, diversified revenue steam, sound liquidity, conservative risk appetite and efforts of the senior management to implement shareholders' strategic goals and vision.

Key Rating Drivers

Growth in credit portfolio despite onslaught of COVID-19: PCICL did not shift its lending focus solely towards portfolio consolidation and recovery activities despite stressed economic indicators owing to emergence of ongoing pandemic. Instead, the management continued with its cautious lending methodology with added adaptive maneuvers to curtail the heightened risk of repayment amid uncertain economic dynamics. During the rating review period, the institution focused on lending to rated clients mostly pertaining to investment grade category coupled with tapping listed entities given the regulatory disclosures enhance transparency. Therefore, PCICL was largely able to capitalize on its disbursement target; however, the total disbursement was shy of last year's numbers. On the other hand, the institution managed adequate recovery of principal during the outgoing year. Resultantly, Gross Loan Portfolio (GLP) exhibited growth of around 23%; new disbursements were majorly targeted towards public sector enterprises operating in coal mining along with in private sector companies with business interests in power, cement, textile, sugar, engineering and electronics. The company's advances portfolio is largely long-term in nature with average maturity of around 3 years; meanwhile 80% of the total lending is vested with the private sector. Sector-wise concentration revealed a decline in power, transport, cement, construction, whole sale & retail trade, financial and manufacturing while a growth was witnessed in textile, chemical & pharma, electronics and mining sectors in respect to gross loan portfolio during the outgoing year. Further, the management revised sector concentration limits with elimination of correlation of ceilings with institution's equity and replacing it with total exposure. Concentration in the advances portfolio remained on a higher side as top ten exposures on basis of total funded exposure accounted for 60% of gross advances at end-FY20.

Credit risk; asset quality indicators depicted deterioration on account of higher incidence of Non-Performing Loans (NPLs): NPLs were recorded higher owing to two clients pertaining to food sector (standalone) and power sector (syndicate) being classified during the period under review. The management is in negotiations with the power sector client and is hopeful that the customer will start servicing the payments in due course upon rectification of tariff related issues including base price setting. Secondly, the other client in food sector has had some internal liquidity issues which are now being mitigated by change in financial management structure. Under the new plan, results have already started to depict higher operational profits; therefore, as per negotiations with the client, payment of outstanding amounts supplemented with restructuring will start during the ongoing year. Moreover, as per the management, the institution has maintained a relatively clean portfolio as no classification was reported in disbursements made in the last three years starting Jan'18. Furthermore, NPLs pertaining to three vintage accounts have been fully provided. One client from energy sector was rescheduled during the outgoing year as the company's tariff was not approved by NEPRA. An understanding is expected to be reached with the client therefore, the account is projected to achieve

OVERVIEW OF THE INSTITUTION

Pak China Investment Company Limited (PCICL) was incorporated in 2007 as an unlisted public limited company. PCICL operates as a Development Financial Institution (DFI) under a joint venture agreement between its two sponsors i.e. Government of Pakistan (GoP) and People's Republic of China (PRC). The head office of the company is located in Islamabad while office is situated in Karachi.

Profile of Chairman

N/A

Profile of CEO

Mr. Wang holds degrees of Masters in Public Administration and Masters in Computer Science from China National School of Administration and Harbin Engineering University respectively. He is also a Qualified Accountant and Security Practitionerr. He has over 25 years' experience of working in Development Financial Institutions, with diversified exposure in the areas of Credit Management, Finance, Research, Information Technology and Planning. Before joining PCICL, he was Head of Australian Group as Senior Commissioner of China Development Bank (CDB).

Financial Snapshot

Tier-1 Equity: end-1QFY21- 17.5b; end-FY20: 17.4b; end-FY19: Rs. 16.6b; end-FY18: Rs. 15.3b

Net Profit: FY19:1Q21: Rs.92m; FY20: Rs. 773m; FY19: Rs. 760.1m; FY18: Rs. 618.8m performing status by end-FY21. PCICL has not recorded any write-off since FY11 and the same practice is to be followed during the rating horizon. Therefore, asset quality indicators depicted deterioration as gross and net infection increased on a timeline basis in line with higher incidence of NPLs despite growth in gross portfolio during the rating review period. Further, specific provisioning increased slightly; however, the same was lower relative to NPLs as the newly classified accounts pertained to other assets especially mentioned (OAEM) and substandard category entailing lower provisioning requirements.

PCICL's deferred portfolio represented around 8% of the performing advances at end-1QFY21; the same is on a lower side in comparison to peers. As per the management, none of the deferred clients is expected to default as markup payments are being serviced regularly. Given slight uptick in economic indicators along with successful vaccine rollout to mitigate severity of the pandemic, the management has projected a healthy disbursement target of Rs 5.0b with gross advances portfolio to increase to 13.5b at end-FY21. Projects in the pipeline largely pertain to power/energy sector involving credible names. Going forward apart from power, the management will majorly focus on cement, pharma and steel sectors. Moreover, given that the company's loan portfolio is skewed towards long-term loans, the management plans to enhance its focus on loans having relatively shorter tenure during FY21. In addition, PCICL also has initiated on tapping non-funded exposure market.

Sizable investment portfolio; credit and market risks are manageable: Investment portfolio of the bank exhibited a volatile trend with decline vested in the outgoing year owing to higher liquidity allocations to lending activities; however, the same increased by end-1QFY21. The increase, albeit minimal to FY19's level, was manifested in T-bills portfolio. PCICL has no investment in PIBs in line with institution's strategy of curtailing investment in longer tenure to avoid market and re-pricing risk exposure. However, the investment philosophy has its downside as the institution cannot capitalize on sizable capital gains in times of favorable discount rate movements. Investment in unlisted TFCs & Sukuks at carrying value was recorded higher during review period; however, given the return on these TFCs is pegged to market benchmark rate, interest rate risk arising from the same is considered manageable. Non-performing TFCs remained at prior year's level and were fully provided. Largest exposures in debt securities (including preference shares) pertained to financial sector constituting of gross debt investments in TFCs followed by investment in power sector, by end-FY20.

PCICL's equity market exposure increased during outgoing year in line with investment in initial public offerings (IPOs) of entities having business interests in steel, food processing and footwear; however, the proportion of the same to total investments remained minimal. As per the mandate, the institution is restricted in having exposure in secondary equity market transactions therefore the investment in stock market will remain insignificant. Investment in associates increased on a timeline basis; the same involves 5% equity investment each in Central Depository Company of Pakistan Ltd (CDC) and Pakistan Stock Exchange Ltd (PSX) and 9% in Deli JW Glassware Company Limited. All three companies are categorized as associates due to common directorship. As per the management, these strategic investments have been made keeping in view PCICL's long-term business plans besides expectation of recurring income. Credit risk emanating from investment portfolio has increased on a timeline basis as 58% of the investments are vested in sovereign securities at end-1QFY21 as compared to a higher proportion in FY19; however, the same stills remains manageable in the local context. Further, market risk is considered negligible given short-term nature of securities.

Overall liquidity position of the institution has remained strong: PCICL's liquidity position is considered sound in line with sizable quantum of investments carried on the books coupled with substantial cash balances. However, the same demonstrated a downward trend on a timeline basis with excess liquidity channelized towards lending activities as part of the growth strategy. Quantum of liquid assets (adjusted for repo) along with proportion of adjusted liquid assets to borrowings and deposits decreased on a timeline basis; however, despite the decline the institution is comfortably placed in terms of liquidity. Trend in borrowings exhibited slight volatility with decline in in the outgoing year; however, the same stood higher at end-1QFY21 mainly to fund higher investment in government securities. Further, the institution also obtained funding from private entity under certificates of investments (COI) during the outgoing year. Although advances are mainly funded through equity, long-term borrowings are availed to cover any financing gap. In addition, the institution has recently gotten a sizable long-term facility approved from one of the largest domestic commercial banks to add further cushion for meeting funding requests of clients.

Profitability maintained at prior years' level despite growth in scale of operations; the same is an outcome of declining benchmark rate scenario: The growth in average markup bearing assets in line with higher scale of operations did not reflect fully on profitability of the institution owing to higher average borrowings, shift in borrowing mix with increased tilt towards commercial borrowings entailing higher markup expense and reduction in policy rate. Further, a sizable dip in foreign exchange income on account of relatively stable exchange rate scenario also contributed unfavorably to profitability indicators. The impact of the aforementioned factors was largely diluted with sizable deduction in provisioning expense as the core income was recorded at prior year's level; subsequently efficiency ratio only increased slightly in line with increase manifested in operating expenses. Total markup income earned increased predominantly on back of higher average lending and investment portfolios. However, the yield on net advances decreased sizably owing to higher disbursement under SBP's TERF scheme where the spread of the intermediary institution is capped at 1.5% coupled with overall decline in market benchmark rates. Moreover, the markup income reaped on investments was recorded sizably higher during the outgoing year as a function of growth in investment book. However, a similar trend of declining yield on investments was witnessed as the yield on market treasury bills, constituting largest proportion of investment mix, reduced during FY20 in line with reduction in benchmark rates to cater to financial shocks to the economy amid COVID-19.

The institution is reporting negative spreads since the last two years as a combined outcome of inherent limitations of business model and operational phenomenon; the DFI is heavily funded by equity therefore, there is notable mismatch in yield on assets and cost of liabilities recorded. Further, the institution refrains from investment in PIBs entailing higher interest yield in comparison to T-Bills as longer tenure exposure in government securities portfolio is to be avoided to minimize market risk. In addition as per the management, the institution offloads T-bills before 15-20 days before maturity to capitalize on capital gains; in this process interest income becomes the part of capital gains. Hence, the aforementioned investment tactic leads to narrowing of yield on T-bill portfolio and spreads.

Non-interest income increased in FY20 mainly on account of higher capital gains on securities (recognized & unrecognized). Moreover, fee & commission income was also recorded higher on account of increase in credit related fee as the investment banking fees were recorded lower. Operating expenses, almost three-fourth of which comprised remuneration expenses increased as an outcome of annual salary increments along with slight increase in number of employees during the outgoing year to meet the requirements of growing business operations. Some increase was owing to adoption of IFRS 16, constituting recording of depreciation on right of use assets. Loan loss provisions booked by PCICL decreased sizably mainly on account of considerable reduction of impairment loss on investment in associate and available for sale portfolio. In line with reduction in provisions profit before tax stood slightly higher during the outgoing year.

Augmentation in core equity on back of profit retention: Equity base augmented on a timeline basis on account of profit retention. Risk Weighted Assets (RWAs) also increased on a timeline basis in line with overall higher RWAs pertaining to market and operational risk; however, risk weighted assets related to credit risk reduced in line with higher proportion of rated clients in the advance book. Total eligible capital was also reported higher at by end-1QFY21. Subsequently, owing to higher RWAs, Capital Adequacy Ratio (CAR) decreased slightly to 71.3% (FY20: 70.7%; FY19: 73.7%); however, the same is considerably higher than the minimum regulatory requirement and represents sizable room for growth for the institution. PCICL maintains one of the highest initial paid-up capital of Rs. 9.7b amongst all DFIs. The advance against issue of shares amounting to Rs. 9.7m will be adjusted with Ministry of Finance (MOF) against next tranche of equity injection.

Pak China Investment Company Limited (PCICL) Annexure I

FINANCIAL SUMMARY *(amounts in PKR millions)*					
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**FY20**	**1QFY21**
Total Investments	13,848.1	9,976.2	19,241.5	15,657.9	17,748.2
Net Advances	7,900.0	7,620.2	9,291.2	11,550.1	11,407.3
Lending to Financial Institutions	-	-	-	1,150.0	-
Cash & Balances	2,195.4	1,615.8	4,054.6	2,258.3	3,160.9
Other Assets	477.4	550.1	812.9	792.7	743.8
Total Assets	24,420.9	19,762.2	33,400.2	31,409.0	33,060.2
Borrowings	9,576.9	4,180.7	16,119.3	12,902.9	14,641.6
Deposits & other accounts	-	-	-	512.4	512.4
Other Liabilities	175.5	220.3	651.7	511.5	330.8
Paid-Up Capital	9,116.4	9,116.4	9,696.6	9,696.6	9,696.6
Tier-1 Equity	14,668.3	15,278.3	16,627.3	17,399.1	17,491.3
Net Worth	14,668.6	15,361.3	16,632.0	17,482.3	17,575.3
INCOME STATEMENT					
Net Mark-up Income	954.4	1,082.4	1,713.0	1,439.2	287.4
Net Provisioning / (Reversal)	(70.7)	225.6	471.9	116.9	2.4
Non-Markup Income	276.8	405.0	262.9	284.3	(67.5)
Share of Profit in Associates	46.6	36.5	38.1	51.6	24.5
Operating Expenses	378.1	386.4	476.3	491.8	117.7
Profit Before Tax	969.8	911.8	1,065.8	1,166.5	129.1
Profit After Tax	670.6	618.8	760.1	773.2	92.28
RATIO ANALYSIS					
Gross Infection (%)	3.7	10.0	9.9	13.6	13.7
Provisioning Coverage (%)	100.0	48.8	59.7	39.9	39.9
Net Infection (%)	0.0	5.4	4.2	8.6	8.7
Cost of funds (%)	5.9	3.6	13.0	10.1	6.8
Markup Spreads (%)	0.8	2.9	(0.4)	(0.4)	0.3
Net NPLs to Tier-1 Capital (%)	N/A	2.7	2.4	5.8	5.8
Capital Adequacy Ratio (CAR) (%)	93.7	87.3	73.7	70.7	71.3
Efficiency (%)	28.2	27.7	31.3	32.1	45.3
ROAA (%)	2.9	2.8	2.9	2.4	1.1
ROAE (%)	4.7	4.1	4.8	4.5	2.1
Liquid Assets to Deposits & Borrowings (%)	199.4	296.5	113.4	91.3	84.3

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Pak China Investment Company Limited (PCICL)
Sector	Development Finance Institution (DFI)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	

Rating History:

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
28-June-21	AAA	A-1+	Stable	Reaffirmed
25-June-20	AAA	A-1+	Stable	Reaffirmed
21-June-19	AAA	A-1+	Stable	Reaffirmed
20-June-18	AAA	A-1+	Stable	Reaffirmed
30-June-17	AAA	A-1+	Stable	Reaffirmed
28-June-16	AAA	A-1+	Stable	Reaffirmed
24-June-15	AAA	A-1+	Stable	Initial

Due Diligence Meetings Conducted:

	Name	Designation	Date
1	Syed Mehar Ali Shah	Financial Controller	June 10, 2021
2	Mr. Abbas Athar Hamadani	Group Head SME & Corporate Finance	June 10, 2021
3	Mr. Tariq Mehmood	Group Head Investment Banking	June 10, 2021
4	Mr. Nabeel Abbas	Head of Treasury	June 10, 2021
5	Ms. Yasmin Akbar	Group Head Risk Management	June 10, 2021
6	Mr. Armughan Ahmad	CFO	June 10, 2021
7	Mr. Saeed	Head Internal Audit	June 10, 2021