RATING REPORT

Pak China Investment Company Limited (PCICL)

REPORT DATE:
June 28, 2024

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 Action	*Reaffirmed*		*Reaffirmed*	
Rating Date	*June 28, 2024*		*June 26'23*	

COMPANY INFORMATION

Incorporated in 2007	**External Auditor:** *A. F. Ferguson & Co. Chartered Accountants*
Unlisted Public Company	**Chairman of the Board**: Mr. Wang Baojun
Key Shareholders (with stake 5% or more):	**Chief Executive Officer**: Mr. Hassan Raza
Government of Pakistan – 50%	
People's Republic of China – 50%	

**Board of Directors meeting held during CY23 in which statutory auditors for the CY 22 appointed. They will hold the office until conclusion of next AGM of the company.*

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria:
Government Supported Entities
https://docs.vis.com.pk/docs/Meth-GSEs202007.pdf
Financial Institutions Rating Methodology
https://docs.vis.com.pk/Methodologies%202024/Financial-Institution-v2.pdf

APPLICABLE RATING SCALE(S)

Rating Scales & Definitions:
https://docs.vis.com.pk/docs/VISRatingScales.pdf

Pak China Investment Company Limited (PCICL)

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 representative office is situated in Karachi.

Profile of Chairman

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 Practitioner. He has over 26 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

RATING RATIONALE

The assigned ratings of Pak China Investment Company Limited ('PCICL' or 'the Company') 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. CDB has an outstanding rating of 'A+' from an international credit rating agency. In the backdrop of challenging economic conditions disbursements are being made in a highly cautious and conservative manner. Th Institution has embarked upon an overall consolidation strategy with sole focus on listed, rated and blue-chip clients in the medium to long-term horizon. The ratings reflect timeline improvement in asset quality indicators given no new case of infection along with initiation of recovery from delinquent clients. However, there is room for improvement in the corporate governance environment as well as external reporting framework. In addition, the assigned ratings factor in PCICL's conservative risk appetite in terms of investment policy given no investment in long-term government securities coupled with restricted stock market exposure. Further, the ratings are underpinned by strong capitalization, sound profitability and liquidity profile, together with diversified revenue streams and efforts of the senior management to implement shareholders' strategic goals and vision.

Sector Update:

The financial sector in Pakistan has been navigating a challenging macroeconomic landscape. Despite facing headwinds such as high inflation, elevated interest rates, and geopolitical uncertainties, the sector has demonstrated resilience and adaptability in supporting economic stability. One of the important factors contributing to the sector's resilience has been its strong capitalization and liquidity. Banks and Development Financial Institutions (DFIs) in Pakistan remain well-capitalized. This ensures that they are equipped to absorb potential shocks and maintain financial stability. DFI's continued to face the challenge of lack of cheap sources of funding. Given limited good credit available in the market for deployment in a heightened credit risk environment, spreads remained under pressure. Consequently, investment portfolios were built up through leveraging the balance sheet for profitability uptick on volume growth.

The government's successful negotiation of the IMF's Stand-By Arrangement (SBA) program, culminating in a Staff-Level Agreement and disbursement of funds, has provided additional support to market confidence and exchange rate stability, with positive implications for the banking sector. In terms of monetary policy dynamics, the State Bank of Pakistan (SBP) has maintained a cautious stance, balancing the imperative of containing inflationary pressures while supporting economic growth. Even as headline inflation has moderated from peak levels, it remains elevated, prompting the SBP to retain the policy rate in the first half of 2024 and only reducing it by 1.5% in June 2024. This delayed rate cut reflects central bank's commitment to anchoring inflation expectations and safeguarding macroeconomic stability. We expect policy rate to reduce by another 1-1.5% by the end of 2024.

Looking ahead, the financial sector faces both challenges and opportunities. Continued vigilance in managing credit quality and liquidity risks will be vital, especially amidst evolving macroeconomic dynamics and policy uncertainties. Moreover, the sector's role in supporting the government's reform agenda, particularly in areas such as taxation, energy, and privatization of state-owned enterprises, will be critical in fostering sustainable economic growth and financial stability.

Development Bank (CDB).

Profile of CEO

Mr. Hassan Raza is an accomplished banker three decades of experience in various leadership roles with multinational and local banks. For the last seventeen years, he has been holding Group Executive / CEO level positions, locally and overseas. Previously, he was serving as Group Head, Corporate and Investment Banking, SME and Special Assets Management Group at Silk Bank Limited.

Mr. Raza embarked on his banking journey in 1990's with Standard Chartered Bank, and over the years, he has worked with large local and foreign banks including UBL, HBL, National Bank of Pakistan, Bank of America and Habib Metropolitan Bank. During his affiliation with HBL, he also served as CEO of Habibsons Bank Ltd, London; a subsidiary of HBL Pakistan. An Aitchisonian he has obtained Master Degrees in Business Administration and Economics from reputed Universities.

Corporate Profile

Pak China Investment Company Limited ('PCICL' or 'the Company') was incorporated in Pakistan as a public limited Company in 2007. PCICL operates as a Development Financial Institution (DFI) under a Joint Venture (JV) agreement between the GoP and PRC; shares of PCICL are equally held by GoP through MoF and PRC through CDB. The Company has its head office in Islamabad while a representative office is located in Karachi.

PCICL was established to act as a bridge for promotion of bilateral trade and investment between the two countries and with an objective of financing economically viable and technically feasible projects. The Institution has played a vital role for economic development of Pakistan through active advisory role to attract Chinese investment in Pakistan and by providing wide range of financial services in infrastructure, industrial, agriculture, services, information technology, manufacturing and real estate sectors for over the last decade. As per the JV agreement between the two countries, PCICL shall consider financing on a priority basis in projects but not limited to those in which the Chinese and Pakistani investors collaborate and projects that are conducted by Chinese enterprises in Pakistan. Total staff strength of permanent employees of the institution stood at 52 (CY22: 50) at end-CY23.

Board of Directors

During the year in July 2023, the Ministry of Finance appointed Mr. Hassan Raza as the new Managing Director of the Company, while Mr. Jiang Ketao remained as the Deputy Managing Director. In this year, only one Board of Directors meeting was held on 25th October 2023, in which the 2021 accounts were finalized and auditors were appointed for 2022.. The statutory financials for the year ended 31 Dec 2022 has been initialed by statutory auditors.

Board of Directors	
Mr. Wang Baojun	Chairman
Mr. Hassan Raza	Member(Managing Director)
Mr. Jiang Ketao	Member(Deputy Managing Director)
Ms. Wang Li	Member
Mr. Amjad Mahmood	Member
Mr. Shahnawaz Mahmood	Member

Management Change

Mr. Hassan Raza took the office of Managing Director in July 2023. He is a distinguished banker with over 30 years of experience in various leadership roles across multinational and local banks, including UBL, HBK, NBP, Bank of America and Habib Metropolitan Bank. For the past 17 years, he has held Group Executive and CEO level positions both domestically and internationally. Before becoming the Managing Director of PCICL, he served as Group Head of Corporate and Investment Banking, SME, and Special Assets Management Group at Silk Bank Limited. An Aitchisonian, Mr. Raza holds Master's degrees in Business Administration and Economics and has completed the Cambridge Advanced Leadership Program at the University of Cambridge, Judge Business School, UK.

Risk Management

Scope of risk management department has remained the same, involving management of the overall risk profile of the Institution by monitoring all major risks encountered by the institution including credit, market & liquidity risk, operational risk. PCICL has developed an Operational Risk Management (ORM) Framework. The framework includes ORM Manual & Policy; the manual defines operational structure of ORMD, roles and responsibilities of the relevant personnel. It contains guidelines to conduct ORM workshop on annual basis, operational risk identification and assessment. Meanwhile, the policy includes ORM tools like Risk Control Self-Assessment (RCSA), Key Risk Indicators (KRI), incident management and data collection and scenario analysis. It also introduces risk mitigation tools to decrease the likelihood and impact of undesirable events. Under operational risk measurement, PCICL has decided to use Basic Indicator Approach (BIA) for calculating operational risk capital charge. Under BIA, PCICL is required to hold capital for operational risk equal to a fixed percentage of 15% of average positive annual gross income over the past three years. Furthermore, operational risk reporting guidelines have also been given to use operational loss reports, residual operational risk monitoring report, KRI reports along with control issue reporting and action plan. Additionally, testing procedure, spot checking and independent validation and verification by internal audit have also been explicitly defined in the manual.

Obligor risk-rating (ORR) model incorporating both qualitative and quantitative factors is used for credit risk assessment of each client. As per management, current portfolio is predominantly rated around the band of 2 and 3.

Internal Audit

The department consists of Head Internal Audit only, and the work comprises two main activities; pre audit and post audit. Pre audit involves the assessment of day-to-day activities and transactions. For post audit, there is an internal audit plan in place. As part of the post audit process, comprehensive audit of each department is conducted every year irrespective of the risk profile. During 2023, audit of several departments Special assignments are also conducted as and when required by the Company's management/Board Audit Committee.

Information Technology

IT department at PCICL has setup two data centers one at head office (HO) Islamabad and the other one is at branch office, Karachi. HO's data center hosts the primary domain controller server, database disaster recovery server and oracle database server for the applications. Windows server is used as the operating system with domain/network policies configured in compliance with the security policy of PCICL. All employees of the institution are assigned separate user IDs for accessing the network; these IDs are configured using the user management options in compliance with security policy of PCICL.

Backup of databases is taken thrice a day at HO for all the databases running at PCICL. Versions of changed and deleted files are kept for 15 days and can be restored during this period. Apart from daily backup, monthly, semi-annual and annual backups are also stored. These backups are restored periodically on test server to check the validity of the backup. The backup files are copied to disaster recovery servers at HO and branch office on periodic basis. In accordance to the regulatory requirement, backups are maintained for a period of 10 years. If required, specific backup can be further retained for undefined period. To enhance the current accessibility and availability of primary RTGS setup, a DR site for RTGS has been deployed at Islamabad office during the outgoing year which is now also fully functional.

Loan Approval Process

Loan approval process at PCICL remained unchanged during the rating review period. It comprises various steps including initial screening by CB&SME and RMG, and in-principle approval by DMD and MD. After that it is formally presented to the Credit Management Committee (CMC). CB&SME initiates the credit process by drafting a proposal after conducting an initial screening of potential corporate clients. Lastly, the proposal is presented to the CMC for final decision. CMC is the final approving authority and comprises MD, DMD, CFO and the Group Head RMG acts as an observer. For equity and financial institution exposures Head of Treasury is also a member of CMC. Disbursement of loans is carried out by the Credit Administration Department (CAD) while CB&SME & CAD are responsible for the post-disbursement monitoring of loans.

Strategic Initiatives

As per PCICL's mandate, JV signed between CDB and Ministry of Finance focuses on promoting Chinese investments; it is aimed at creating a blend of earnings from markup income, advisory income and investment income & capital gains using a three-pronged strategy focusing on commercial, Government/Public side and Chinese Initiative. The Private Equity Policy is in place explaining criteria of making investment, targeted sectors and other pertinent aspects of private equity investments

Financial Analysis

Asset & Investment Mix

The Company's assets decreased by 51%, from Rs 94,215 million in CY22 to Rs 45,921 million in CY23, due to significant reduction in investment portfolio, which declined primarily due to maturity of short-term borrowing deals with Banks, which were used to fund Treasury Bills. Investments dropped by 75% from Rs 73,441 million in CY22 to Rs 18,364 million in CY23. PCICL has consistently maintained a conservative investment approach, avoiding PIBs to limit exposure to market and re-pricing risks. This strategy paid off amid rising interest rates last year, as the Company avoided mark-to-market losses.

Table 1: Asset Mix

Figures in Millions	CY22	CY23	1Q24
Assets			
Cash and balances with treasury banks	93	58	145
Balances with other banks	3,313	4,339	4,289
Lending to financial institutions	99	1,886	3,796
Investments	73,441	18,364	26,420
Advances	16,198	19,688	18,568
Fixed assets	336	327	312
Intangible assets	0	5	4
Deferred tax assets	-	1	83
Other assets	735	1,254	1,392
Total Assets	**94,216**	**45,921**	**55,009**

The investment portfolio comprises of primarily short term T-Bills, which accounted for almost 48% of the total investment portfolio, indicating low credit risk due to the sizable proportion of government securities.

Investment in Term Finance Certificates (TFCs) and Sukkuks fell by ~4% in CY23, however as a proportion of total investments their share increased to 44% from 11% last year primarily due to decline in overall investment portfolio size. These TFCs and Sukuks include both listed and unlisted instruments, primarily issued by banks. During the year, the Company booked impairments against Khushhali Microfinance Bank Tier 1 instrument for Rs. 225m that was converted to equity, while added fresh Sukuk exposures in pharma sector.

Capital market investments accounted for only ~3% of the investment portfolio. PCICL is restricted to IPO transactions and avoids secondary market equity transactions, ensuring minimal stock market exposure. Additionally, PCICL holds equity stakes in Central Depository Company of Pakistan Limited (CDC), Pakistan Stock Exchange Limited (PSX), and Deli JW Glassware Company Limited (Deli), These strategic investments account for about 4.3% of total investment portfolio. While PSX and CDC investments grew in value, the Company continued to book revaluation losses against Deli JW Glassware Company Limited investment.

As of March' 24, the Company has been building its T-Bill portfolio which remains exposed to low credit risk as well as low market risk as investment holdings remains mostly short term. Some impairments were noted against Sukuk holdings primarily in Steel exposures. Nevertheless, overall credit risk of the portfolio remains manageable. Moving forward, management plans to maintain a conservative investment strategy, focusing on short-term government securities amidst weak macro-economic conditions and interest rate uncertainty.

Table 2: Investments

Investments - In Millions	CY22	CY23	1Q24
T-Bills	63,585	9,034	17,171
Shares - Listed Companies	219.5	161.2	317
Debt Securities – Listed	5,486	5,330	5,303
Debt Securities – Unlisted	2,934	2,667	2,529
Preference Shares – Listed	392.4	375	357
Commercial Paper	-	-	-
Pakistan Stock Exchange Limited	324	404	355
Central Depository Company	323	357	353
Deli JW Glassware Company Limited	176	35	35
Total	**73,440**	**18,364**	**26,420**

Advances

The Company's gross advances increased by 22%, rising from Rs 17,506 million in CY22 to Rs 21,410 million in CY23. These advances primarily comprise of Long Term financing which accounts for 68% of the Loan portfolio while advances related to Running Finance accounted for 19.3% and short-term advances 12.6%. However, gross advances declined by 5.5% to Rs 20,244 million in 1QCY24.

The Company provides advances across various sectors. The Textile sector represents the largest exposure in Funded Advances at 20.21%, followed by the Power, Gas, Water, and Sanitary sector at 19.13%, and the Mining and Quarrying sector at 10.75%. PCICL continues to prioritize top-tier blue-chip clients, as well as CPEC-related projects. Consequently, the concentration in the advances portfolio remains high. The top 10 exposures accounted for 58.31% of the total funded exposure.

Asset Quality:

Asset quality indicators have improved on a timeline as depicted by decline in gross and net infection. The Gross Infection has improved from 8.7% in CY22 to 6.9% in CY23 while Net Infection has declined from 2.7% in CY22 to 0.4% in CY23. Infection improvement was a result of lower non-performing loans, which reduced from Rs 1,529 Million to Rs 1,471 Million at CY23 as well as increase in gross advances portfolio. The Company has enhanced efforts to recover bad loans and was successful in making some recoveries in FY23.

The Specific Provisioning Coverage has improved from 70.9% in CY22 to 94.8% in CY23 as a result of higher provisions booked during the year as well as decline in the Non-Performing Loans. Total Company proactively built additional provisioning (ECL) to take up the total provisioning coverage to 113.9% at end March 2024. Non-Performing Loans as a percentage of Tier 1 Equity stood at 7.7% at Mar'24 indicating improvement from 9.6% in CY22.

	CY22	CY23	1QCY24
Non-Performing Loans- In Millions	1,529	1,471	1,471
Gross Infection	8.7%	6.9%	7.3%
Net Infection	2.7%	0.4%	0.3%
Specific Provisioning Coverage	70.9%	94.8%	95.8%
Total Provisioning coverage	85.52%	117.14%	114%

Funding & Liquidity

The overall liquidity profile of the institution is sound as evidenced from liquid assets to total deposits and borrowings recorded at 92% in CY23 and 112% at end 1QCY24, although this is lower than previous years when sizable treasury operations funded by secured borrowings provided liquidity support. With the deleveraging of the balance sheet, liquid investment and corresponding secured borrowings declined.

Given PCICL as a DFI is a secondary market borrower with deposits only restricted to certificate of investments (COIs), the liquidity risk arising from withdrawals is almost non-existent. The COIs decreased to Rs. 346 Million at end CY23 as opposed to Rs. 1.5 billion at CY22. Going forward, given cautious growth planned for the asset book, we do not expect deposits to increase.

While Liquidity Coverage ratio is not applicable on DFIs, the Company maintained it at heathy levels of 1242%. Net Stable Funding Ratio was maintained at 124% in FY23.

Profitability

PCICL's profitability profile has exhibited positive trajectory during the outgoing year as the total income has increased by 61% from Rs 3,193 Million in CY22 to Rs 5,130 Million in CY23. The increase in total income has been due to both an increase in the Net Markup/ Interest Income and the Non Markup/Interest income. The Net Markup/interest Income has increased by 73% from Rs 2,376 Million in CY22 to Rs 4,109 Million in CY23. The increase in the interest income resulted from higher spreads on the back of higher interest rates as well as portfolio growth. The Non-Markup/Interest Income has increased by 25% from Rs 817 Million in CY22 to Rs 1,022 Million in CFY23, attributable primarily to an increase in Foreign Exchange Income and Unrealized Gain on Securities. However, fee and commission income recorded a decline due to limited investment advisory opportunities. Operating expenses and provisions charge increased in CY23 however remained relatively constrained, resulting in sizeable increase in profit after tax of 88% to Rs 2,495 Million in CY23. Efficiency depicts an improving trend over time.

Capitalization

The Company has strong capitalization buffers in place. Despite increase in risk weighted assets by 11.32% Y/Y to Rs. 31.043b (CY22: Rs. 28.613b) at end-CY23 due to an increase in the credit risk related risk weighted assets, sizeable profitability uptick supported equity increase. The Capital Adequacy Ratio increased from 55.46% in CY22 to 59.45% in CY23. CAR is strong and considerably higher than the minimum regulatory requirement of 11.5% and represents sizable room for growth for the institution. In addition, PCICL's CAR compares favorably to peers. The impact of IFRS 9 adoption was also relatively small having no significant impact on CAR levels. We expect capitalization levels to remain strong over the rating horizon.

Pak China Investment Company Limited (PCICL) **Appendix I**

FINANCIAL SUMMARY						(Amounts in PKR Millions)
BALANCE SHEET	**2019**	**2020**	**2021**	**2022**	**2023**	**1Q'2024**
Total Investments	19,241	15,464	12,587	73,441	18,364	26,420
Advances	9,291	11,550	15,842	16,198	19,688	18,568
Total Assets	33,400	31,231x	37,742	94,215	45,921	55,009
Borrowings	16,119	12,903	14,694	72,178	22,740	30,690
Deposits & other accounts	-	512	4,750	1,503	371	275
Paid-Up Capital	9,697	9,697	9,697	9,906	9,906	9,906
Tier-1 Equity	16,627	17,134	17,841	19,371	21,641	22,260
Net Worth	16,632	17,304	18,047	19,616	21,776	22,321
INCOME STATEMENT	**2019**	**2020**	**2021**	**2022**	**2023**	**1Q'2024**
Net Mark-up Income	1,713	1,439	1,468	2,376	4,109	1,103
Net Provisioning / (Reversal)	472	117	263	469	370	84
Non-Markup Income	301	336	379	817	1,022	121
Non Markup/interest Expenses	476	492	534	604	768	221
Profit (Loss) Before Tax	1,066	1,166	1,049	2,119	3,992	919
Profit (Loss) After Tax	760	773	708	1,325	2,495	620
RATIO ANALYSIS	**2019**	**2020**	**2021**	**2022**	**2023**	**1Q'2024**
Gross Infection (%)	9.89%	13.55%	9.66%	8.73%	6.87%	7.27%
Specific Provisioning Coverage	59.7%	39.9%	51.9%	70.9%	94.8%	95.8%
Total Provisioning Coverage (%)	74.71%	48.05%	64.62%	85.52%	117.14%	114%
Net Infection (%)	4.2%	8.6%	4.9%	2.7%	0.4%	0.3%
Net NPLs to Tier-1 Capital (%)	2.76%	6.92%	5.07%	2.80%	0.41%	0.32%
Capital Adequacy Ratio (C.A.R (%))	73.66%	70.68%	62.44%	55.46%	59.45%	55%
ROAA (%)	2.28%	2.39%	2.05%	2.01%	3.56%	5%
ROAE (%)	4.57%	4.56%	4.01%	7.03%	12.05%	11%

Pak China Investment Company Limited (PCICL) Appendix II

REGULATORY DISCLOSURES	Appendix II
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile. Copyright 2024 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
		RATING TYPE: ENTITY		
28-June -24	AAA	A-1+	Stable	Reaffirmed
26-June-23	AAA	A-1+	Stable	Reaffirmed
23-June-22	AAA	A-1+	Stable	Reaffirmed
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 06, 2024
2	Mr. Abbas Athar Hamadani	Group Head Corporate Banking	June 06, 2024
3	Syed Nabeel Abbas	Head of Treasury	June 06, 2024
4	Mr. Armughan Ahmed	CFO/Acting CRO	June 06, 2024