The Pakistan Credit Rating Agency Limited

DEVELOPMENT FINANCE

RATINGS (SEPTEMBER 2011)
PAKISTAN CHINA INVESTMENT COMPANY LIMITED (PCICL)

	NEW	PREVIOUS
ENTITY		
Long Term	AA-	AA-
Short Term	A1+	A1+

FINANCIAL DATA
PKR (mln)

	1HCY11*	Dec-10	Dec-09
Total Assets	11,569	11,634	10,941
Equity	10,851	10,479	9,853
Net Income	307	560	514
ROA %	5.3	6.4	5.6
ROE %	5.7	5.5	6.2
Equity/ Total Assets %	93.8	90.1	90.1
SBP CAR (%)	101.3	96.5	120.0

**Based on unaudited accounts for the period ended June 30, 2011.*

ANALYSTS

Ahmed Ali Ehsan
+92 42 35869504
ahmed.ehsan@pacra.com

Rana M. Nadeem
+92 42 35869504
nadeem@pacra.com

RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect the sovereign ownership - governments of Pakistan and China - implying strong support. The ratings incorporate robust liquidity and sound equity base ensuring high risk absorption capacity. To improve overall risk profile of the company, the management intends to add short to medium term diverse exposures in fundamentally sound business sectors to its currently concentrated loan book. PCICL is eying establishing non-funded revenue stream, wherein it intends to offer itself as a critical conduit to Chinese companies operating in Pakistan. However, establishing diversified revenue streams while managing related risks in current economic environment would be challenging. Although the company recently experienced rise in classified advances, its asset quality still remains strong. Given the nascent stage of the company, the governance function is critical in setting the strategic direction.
- To ensure consistent improvement in overall operational framework, identification and retention of key management personnel remains critical. Sustaining strong asset quality while strengthening overall systems and controls would remain important to maintain healthy performance. At the same time, any politically motivated intervention in the company's affairs, impacting the governance standards, would negatively impact the ratings.

ASSESSMENT

- During 2010, PCICL's mark up income registered a considerable growth (19%) mainly due to increase in earning assets, further augmented by rising interest rates. However, spreads squeezed owing to high interest expenses incurred to finance arbitrage gains. Non funded income increased significantly (27%) on the back of gain on sale of investments (2010: PKR 199mln, 2009: PKR9mln). The overall profitability of the company also benefited from YoY lower provision expense. During 1HCY11, though company's non-funded income reduced significantly (95%), the profit witnessed a marginal increase of 7% as compared to same period last year on account of low interest cost as borrowings reduced significantly and low provision expense.
- Going forward, PCICL intends to gradually build a large portfolio of advances by targeting short to medium term diverse exposures, thereby reducing overall tenor of the portfolio and dilute its concentration risk. The company has highlighted the infrastructure projects (energy, transportation, telecommunication, and industrial and commercial infrastructure) and manufacturing sectors (including textile, sugar, leather and food processing) as potential avenues for the credit growth. Given the current difficult economic environment maintaining strong asset quality would be challenging. In order to enhance the revenue stream, management intends to concentrate on fee based income. Moreover, the company intends to facilitate Chinese investors to enhance bilateral business ties between both countries. In this regard, the management plans to establish China advisory department, maintain database to provide information to investors about economic indicators and regulatory framework of Pakistan and conduct seminars.
- The company's total finances stood at PKR 7,301mln at end-Dec-10. During 2010, PCICL has started diversifying its advances portfolio – top 5 sectors represent 83% concentration vis-a-vis 92% last year. The advances portfolio majorly comprises power sector (61%), storage (13%), fertilizer (8%), telecommunication (5%) and cement (4%). Although high power sector exposure mitigated to a certain extent due to GoP guarantee, limited number of clients exposes the company to concentration risk.
- The asset quality slightly deteriorated as NPLs increased (CY10: PKR 275mln, CY09: 200mln). Nevertheless, adequate provision (87%) has been charged by the company implying less relative adverse effect on the equity of the company, going forward.
- PCICL's investment portfolio declined considerably (2010: PKR 1,368mln, 2009: PKR 1,730mln) which represents 12% of total assets. The investment portfolio majorly comprises market treasury bills with the redemption period of six months to one year. The portfolio is not substantially exposed to interest rate risk due to short-term nature of securities.
- The company is in the process of establishing a sound Management Information Systems. In this regard, PCICL has implemented fixed assets and general ledger module of Sidat Hyder Financials. Moreover, it has deployed Santa Soft and Real Time Gross Settlement System for its treasury operations. The company is looking to acquire software for credit department. In this regard various presentations have been made by different vendors and it is expected that the software will be implemented by end-2011.
- PCICL has low leveraging with majority of its assets based on equity funding (Equity/Total Assets in1HCY11: 94%, CY10: 90%). As per joint venture agreement both partners have committed to contribute to enhance the equity base to US$ 200mln out of which US$ 134mln have been received. Going forward, while funding requirements are expected to remain lower owing to conservative growth stance, the company would gradually diversify its funding mix by issuing COIs.

PROFILE

- Pak-China Investment Company Limited (PCICL), an equal joint venture between the Government of Islamic Republic of Pakistan through Ministry of Finance (MoF) and Government of Peoples Republic of China through China Development Bank (CDB), was established in July 2007. The major objective of the company is to undertake financially viable projects to meet socio-economic development goals, while facilitating Chinese investment into Pakistan.
- The six-member board has equal representation of both the sponsor countries. However, the company has not been able to hold its BoD meetings on timely basis, impacting strategic direction setting as well. Both countries have representation at the top management level. The positions of Chairman of the Board and the Deputy Managing Director are nominated by Pakistan, whereas Vice Chairman of the Board and the Managing Director are appointed by China. Mr. Cao WenJiang, joining as Managing Director in May 2011, possesses extensive overseas experience in banking sector, while, Mr. Javed Mahmood, Deputy Managing Director, has a considerable experience in banking and power sectors.