



The Pakistan Credit Rating Agency Limited

Rating Report

ORIX Modaraba

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
04-Mar-2021	AA	A1+	Stable	Maintain	-
04-Mar-2020	AA	A1+	Stable	Maintain	-
28-Aug-2019	AA	A1+	Stable	Maintain	-
26-Feb-2019	AA	A1+	Stable	Maintain	-
05-Nov-2018	AA	A1+	Stable	Maintain	-
19-Apr-2018	AA	A1+	Stable	Maintain	-
02-Aug-2017	AA	A1+	Stable	Maintain	-
14-Jan-2017	AA	A1+	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the extensive experience of ORIXM management in the financial services industry, stable assets quality, and adequate capital position necessary to manage the current scale of operations. ORIX Modaraba (ORIXM) enjoys a sound financial profile emanating from leveraging, managed liquidity, and sustained profitability. The Modaraba's operation with Orix Leasing provides synergistic impetus. Benefit is also derived in the form of strengthening with respect to risk management, providing established outreach and experience. The robust risk management systems and control environment provide strength to the Modaraba's profile.

The management's business strategy envisages growth in its assets financings, this was hampered by COVID-19 during the past year. While ramifications of this menace are still unfolding, the economic wheel has started rolling. This has been positively cushioned by steps taken by the regulatory and governing bodies including reduction in the interest rates.

The expected growth would be funded through a mix of internal sources and debt. However, the management expects to maintain the leveraging pattern up to a comfortable level.

The ratings are dependent on the ORIXM's ability to develop and sustain its business profile while ensuring stable profitability and financial metrics. Deterioration in respective business size and consequent margins, leading to erosion of profitability, and/or coverages will have negative impact on the ratings.

Disclosure

Name of Rated Entity	ORIX Modaraba
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology NBFC(Jun-20),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria Rating Modifier(Jun-20)
Related Research	Sector Study Modaraba & NBFCs(Apr-20)
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Profile

Structure ORIX Modaraba (ORIXM) is an Islamic Financial Institution listed on the Pakistan Stock Exchange.

Background ORIXM, incorporated in 1987, is managed by ORIX Services Pakistan (Private) Limited which is 100% owned by ORIX Leasing Pakistan Limited, a subsidiary of ORIX Corporation, Japan. ORIX Corp. has set up a number of specialized leasing companies providing a wide range of innovative financial products and services to clients in Japan and 38 different countries/regions across the world.

Operations The Modaraba is primarily engaged in the financing of plant, machinery, equipment, vehicles and housing finance under Islamic finance structures and operates from offices in Karachi, Lahore and Islamabad.

Ownership

Ownership Structure ORIXM is managed by ORIX Services Pakistan (Private) Limited which owns 10% certificates capital in ORIXM. ORIX Leasing Pakistan Limited (OLP) holds another 10% direct stake in ORIXM, making effective shareholding of OLP 20%. The rest 80% is held by the general public and financial institutions.

Stability ORIXM performs a succession planning session every three years and identifies successors for all critical roles. In this way, it provides continuity to leadership and avoids extended and costly vacancies for a key position. Successors that are identified in the session are equipped with all necessary training and assignments to enable them to take over the role.

Business Acumen ORIX Corp. was set up in Japan in 1964 as a leasing company. The scope of ORIX Corp's business today has widened considerably from the starting point of leasing, to include lending, investment, life insurance, banking, asset management, automobile, real estate, and environment and energy-related business.

Financial Strength OLP is majority owned by ORIX Corporation (49.6%). ORIX Corp., listed on the Tokyo and New York Stock Exchanges, is one of Japan's leading integrated financial services groups with operations spanning over 37 countries and regions around the globe as at December 31, 2020. The group has experience of 56 years of operations and has a total asset base of JPY 13.2trln and equity of JPY 3trln as at December 31, 2020.

Governance

Board Structure BoD comprises seven members including the CEO, out of which two are independent directors.

Members' Profile Mr Shaheen Amin, Chairman, with an MBA degree from the University of Chicago and MS in Risk management from New York University, has been associated with Orix Leasing Pakistan since 1986. He is accompanied by other board members who are thorough professionals and carry experiences of managing business affairs in different sectors.

Board Effectiveness Three subcommittees on the Board exist; (i) Audit Committee, (ii) HR & Remuneration Committee and (iii) Risk Committee. Attendance recorded during the board and its sub-committee meetings was good and minutes of the meetings have been extensively documented.

Financial Transparency The financial statements of ORIXM for FY20 have been audited without any qualification by A. F. Ferguson & Co., Chartered Accountants. Furthermore, the Board has set up an effective internal audit function that reports independently to the Audit Committee regularly on compliance with critical policies and procedures and recommends amendments to these policies in line with the industry's best practices.

Management

Organizational Structure ORIXM has a well-defined organizational structure. Authorities and responsibilities are clearly and completely defined and it is ensured that the policies and procedures are understood throughout the organization.

Management Team CEO, Mr Raheel Qamar Ahmad, with an MBA degree from IIT, Chicago, possesses over 29 years of varied corporate and investment banking experience. In his prior roles, he headed the country's local corporate portfolio at Standard Chartered Bank and large regional corporate portfolios at United Bank Limited and Allied Bank. He has served as Chairman of the NBF and Modaraba Association of Pakistan and the Vice president of the Asian Financial Services Association. He is accompanied by a team of experienced management professionals.

Effectiveness There are four committees at the management level, i) Management Committee (MANCOM), ii) Asset and Liability Committee (ALCO), iii) Country's Operational Risk Committee (CORC) and iv) IT Steering Committee (ITSC). All the management committees are chaired by the CEO and include senior staff members that bring their vast experience in making strategies, business planning and in operations.

MIS Furthermore, the Company has implemented a number of policies and procedures, such as IT Security Policy and Business Continuity & and Disaster Recovery Plan, in order to mitigate the risks associated with the increasing use of information technology.

Risk Management Framework ORIXM manages and monitors risk exposure very prudently. ORIXM carries out extensive Credit & Due Diligence (decision making related) reviews both at the time of booking a new client and at every annual review of all relationships.

Business Risk

Industry Dynamics The business environment in the country remained challenging amidst COVID-19. The economy has uplifted, post lockdown as a result of growing appetite, particularly in corporate sector. Automobile sector has shown unprecedented growth as disbursements in saloon cars business have augmented due to the new interest rate regime.

Relative Position ORIXM is ranked in the top 5 modarabas on the Asset and Profitability base. Modaraba's performance during the year continued to be very strong, in spite of stiff competition with Islamic banks, as it booked fresh disbursements of PKR 1,244mln during 6MFY21.

Revenues ORIXM's gross revenue net of amortization of Ijarah assets decreased by 16.2% YoY from PKR 204mln to PKR 171mln. The decline was primarily driven by lower revenues from Diminishing Musharaka during 3MFY21. ORIXM's gross earning yield improved owing to a decrease in the cost of funds 3MFY21: 7.0% (FY20: 12.3%, FY19: 9.4%, FY18: 5.8%) on account of fall in interest rates.

Performance During 3MFY21, net income increased YoY by ~23% from PKR 22mln to PKR 27mln. The positive movement was the result of better portfolio mix and reduced financial charges.

Sustainability Modaraba's strategy is geared towards generating growth as the economy rebounds from COVID-19. The cornerstones of the strategy include (i) Expanding the DM portfolio, (ii) Stable and constant growth of the housing finance product and (iii) New business with High Net Worth customers.

Financial Risk

Credit Risk During 3MFY21, ORIXM's financing book comprised Ijarah 48.1% (FY20: 47.4% FY19: 50.7%, FY18: 60.7%) and Diminishing Musharaka 51.9% (FY20: 52.6% FY19: 49.3%, FY18: 39.3%). ORIXM's Ijarah portfolio consists of two equally distributed segments: (i) plant, machinery & equipment and (ii) vehicles. The Modaraba manages credit risks and its concentration through diversification of activities to avoid undue concentration of risk with individuals, groups or specific industry segments.

Market Risk Modaraba focuses primarily on the core financing business and has adopted appropriate policies to minimize its exposure to market risk. Moreover, ALCO and group treasury use different parameters to monitor the market risk performance of ORIXM's funding base.

Liquidity And Funding ORIXM's funding mix comprises of two main sources: (i) Certificates of Musharaka (77%), and (ii) Musharaka (23%). Its exposure to interest rate risk is limited, given its Ijarah and Musharaka financing portfolio is linked with floating rates. During the period, ORIXM's liquidity profile held relatively steady (liquid assets to total debt ratio: 3MFY21: 19.7%; FY20: 20.3%).

Capitalization ORIXM has a leveraged financial profile (equity to total assets ratio: 3MFY21: 16%; FY20: 16%). In line with the net profitability of the Modaraba, the positive trend is reflected in dividend outflow.



The Pakistan Credit Rating Agency Limited

Financials (Summary)

Orix Modaraba

PKR mln

BALANCE SHEET	30-Sep-20	30-Jun-20	30-Sep-19	30-Jun-19	30-Jun-18
	3MFY21	FY21	3MFY20	FY19	FY18
Finances					
a) Musharika Financing	2,723	2,766	2,813	3,053	2,482
b) Investment in Ijarah Finance	2,532	2,632	3,020	3,140	3,833
Deposits with banks	923	932	447	332	386
Other Non Earning Assets	343	452	330	410	240
Non-Performing Finances	525	555	170	112	97
Less: Provision for Doubtful Receivables	(105)	(90)	(87)	(81)	(85)
Net Non-Performing Finances	419	465	82	32	12
Total Assets	6,939	7,246	6,692	6,966	6,953
Funding					
a) Certificates of Musharika	3,629	3,872	2,786	2,786	3,127
b) Morabaha Financing	-	-	-	-	-
c) Musharika Financing	1,083	1,240	1,765	1,934	1,636
d) Advance Lease Rentals & Security Deposit	624	600	658	685	763
Other Liabilities	514	360	415	401	279
Total Equity	1,088	1,174	1,069	1,160	1,148
TOTAL LIABILITIES & EQUITY	6,939	7,246	6,692	6,966	6,953
INCOME STATEMENT					
Gross Revenue	171	867	204	669	431
Financial Charges	(86)	(599)	(150)	(448)	(246)
Other Income	5	65	10	73	90
Operating Expense	(44)	(180)	(39)	(157)	(144)
Pre-provision Profit	46	152	24	137	132
Provision for doubtful Receivables	(15)	(10)	-	4	2
Management Fee & W.W.F.	(3)	(15)	(3)	(15)	(14)
Net Income	27	127	22	126	120
RATIO ANALYSIS					
Profitability Ratios					
ROA	1.5% *	1.8% *	1.3% *	1.8%	1.9%
Cost-to-Total Net Revenue	49.3%	54.2%	61.4%	53.5%	52.2%
Capital Adequacy					
Equity / Total Assets	15.7%	16.2%	16.0%	16.7%	16.5%
Funding & Liquidity					
Short Term Funding/Total Funding	80.6%	80.0%	73.5%	70.2%	70.8%
Loan Loss Coverage					
Impaired Lending/Gross Finances	9.1%	9.3%	2.8%	1.8%	1.5%
Net Impaired Lending/Total Equity	48.2%	47.3%	15.9%	9.7%	8.4%

**annualized*

Orix Modaraba

Mar-21

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.

Scale	Long-term Rating Definition
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	
CC	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.
C	
D	Obligations are currently in default.

Scale	Short-term Rating 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 conditions.
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 surveil 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):

<p>Entities</p> <ul style="list-style-type: none"> 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 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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)

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