



The Pakistan Credit Rating Agency Limited

Rating Report

First Habib Modaraba

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Sep-2020	AA+	A1+	Stable	Maintain	-
26-Sep-2019	AA+	A1+	Stable	Maintain	-
27-Mar-2019	AA+	A1+	Stable	Maintain	-
22-Nov-2018	AA+	A1+	Stable	Maintain	-
30-Jun-2018	AA+	A1+	Stable	Maintain	-
30-Dec-2017	AA+	A1+	Stable	Maintain	-
23-Jun-2017	AA+	A1+	Stable	Maintain	-
30-Dec-2016	AA+	A1+	Stable	Maintain	-
07-Jan-2016	AA+	A1+	Stable	Maintain	-
09-Jan-2015	AA+	A1+	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect First Habib Modaraba's (FHM) strong business profile emanating from healthy asset base, sound asset quality and sustained profitability. The historical performance trend speaks volumes about the distinct position the FHM carries in the modaraba universe. Association with well-established sponsor i.e. Habib Metropolitan Bank, also provides comfort. The ratings takes into account good management quality and a strong control environment. The company witnessed profitability due to high interest rate regime while nurturing liquidity. FHM has managed to foster its devised strategy to beef-up its business volumes. This helped FHM to maintain its bottom-line performance by harnessing its asset quality, amidst COVID-19. FHM's capital provides strong support to the funding structure of the Modaraba, equally aided by Certificates of Musharaka (CoM). The overall capital structure shows an inclination towards leveraging.

Going forward, the management, intends to expand its outreach amidst the rebound in economy post COVID-19 while utilizing synergies from the parent's branch network.

The ratings are dependent on the management's ability to sustain its competitive positioning while ensuring stable profitability. The ratings also depend upon keeping its financial profile intact. Any significant change in its risk profile may adversely impact the ratings.

Disclosure

Name of Rated Entity	First Habib 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 First Habib Modaraba (FHM) is a Non-Banking Islamic Financial Institution and listed on the Pakistan Stock Exchange.

Background FHM, established in 1985, is a perpetual multipurpose modaraba engaged primarily in the Islamic mode of leasing business on the principles of Islamic shari'a. Habib Metropolitan Modaraba Management Company (Pvt.) Limited is the management company of Modaraba. FHM is one of the leading Modaraba in Modaraba industry in Pakistan with the title of most awarded Modaraba in Pakistan.

Operations FHM offers lease and diminishing musharaka financing primarily for plant & machinery and vehicles. During the year FY19, a window operation has started by the Modaraba in Habib Metro Bank branches to develop and offer Islamic financial products to the clients that demand such products.

Ownership

Ownership Structure HMMMCL, the management company, holds ~10% ownership stake in the Modaraba – as per the minimum regulatory requirement of 10%. The remaining certificate holding of FHM is dispersed amongst the corporates, individuals and others.

Stability FHM is gradually enhancing its business and growing financing assets size on sound footings. FHM intends to move forward cautiously and expand its business in prudent manner. FHM will also focus on revenue diversification, improve resource productivity and cost efficiency for sound and sustainable growth and profitability.

Business Acumen Apart from HMBL, the sponsor has a strategic stake in other sectors as well. Under the ownership of HMBL, FHM has achieved many milestones and has established a formidable position in the sector, which is a representation of a strong sponsor acumen.

Financial Strength FHM is owned by Habib Metro Bank Limited. HMBL, with an asset base of over PKR 908bln and advances of over PKR 292bln as at CY19, carries a strong financial profile.

Governance

Board Structure The size of FHM's board is six members. Except for the CEO, all board members are non-executive. The board of directors of FHM comprises of professionals having vast experience in banking and finance.

Members' Profile The CEO, Mr Muhammad Shoaib Ibrahim Chairman of NBFI & Modaraba Association of Pakistan is associated with the Modaraba since its inception. He has extensive working experience in Non-Banking Islamic Financial institutions for more than three decades.

Board Effectiveness The board has made two committees namely the Audit Committee and Human Resource Committee which is chaired by directors and minutes of the meetings are extensively documented. The performance of the board was evaluated as required under the regulations and effectively plays its oversight function through the various meetings held during the year.

Financial Transparency FHM 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. At present, EY Ford Rhodes Chartered Accountant are the auditor of First Habib Modaraba.

Management

Organizational Structure FHM is managed by a team of seasoned professionals who are associated with the Modaraba for long. Operations are divided into eight functional departments. All the departments reported to CEO except Internal audit that is also reported to the Audit Committee.

Management Team There are currently three management committees in place, namely, i) Credit Committee, ii) Market Investment Committee and iii) Assets and Liability Management Committee.

Effectiveness The management has developed a broad "Code of Conduct" which outlines HM's standard of conduct and the Modaraba's compliance with different stakeholder's expectations including certificate holders, employees, regulators and community at large.

MIS FHM has in-house developed ERP based MIS (ERP-I) for efficient and timely reporting. Current MIS can be classified into three categories on the basis of periodicity – Daily, Weekly and Monthly. FHM is shifting its process to dot net [.NET] applications, secured with the built-in Windows authentication.

Risk Management Framework Management of FHM continued to explore opportunities to achieve its strategic objectives while ensuring the proper implementation of RMF. FHM maintains a strong interdepartmental communication link on risk factors and encourages the culture of collaboration in decision-making amongst all departments.

Business Risk

Industry Dynamics The reduction in economic activity amidst COVID-19 led to uncertainty for the sector. Post June, pick up of economy coupled with strong auto sales, is expected to provide welcome relief.

Relative Position FHM is well abreast of the economy and adopts risk mitigation strategies to perform in timely manners. The performance remained satisfactory despite low discount rates and pressure on profit margin. The year under review was a year of increased challenges for businesses with political uncertainty and several other economic issues. However, despite these issues including highly competitive market and intense competition with market players particularly with Islamic commercial banks, FHM has made satisfactory performance.

Revenues During 9MFY20, the revenue from operations increased to PKR 436mln compared to the same period last year PKR 370mln due to significant increase in share income of profit from diminishing musharaka. However, in terms of disbursement FHM disbursed Rs.3.183 billion as compared to disbursement of Rs.4.108 billion of corresponding period of last year. Due to low disbursement the size of financing book has also reduced to Rs.9.425 billion from Rs.9.630 billion of same period of last year. The bottom line also improved by ~11% from PKR 239mln in 9MFY19 to PKR 266mln in 9MFY20 on account of increase in other income.

Performance During 9MFY20, interest rate scenario affected the overall profitability of the financial industry, so as FHM. The earning assets decreased by ~6.9% especially on account of assets given on lease. The net interest revenue increased by 18% (9MFY20: PKR 436mln; 9MFY19: PKR 370mln).

Sustainability Going forward, FHM intends to continue with its conservative growth stance. While targeting quality customers, the Modaraba plans to manage risks while strengthening its risk management framework. In terms of sector Modaraba will focus on the following sectors; i) Food & Allied Products ii) Services iii) Energy & Power iv) Pharmaceuticals v) Steel and Cement vi) Healthcare and vii) Education. In terms of product mix, focus would be on diminishing musharaka.

Financial Risk

Credit Risk FHM manages its credit risk by a comprehensive credit policy as approved by the Board of Directors (BoD). The overall exposure remained concentrated towards pharmaceuticals (FY20: 20%; FY19: 17%; FY18: 14%) followed by services (FY20: 17%; FY19: 19%; FY18: 21%) and food & allied (FY20: 11%; FY19: 9%; FY18: 9%).

Market Risk Modaraba has a detailed investment policy which defines limits for overall investment portfolio as well as per scrip exposure. The policy also outlines detailed criteria for selection of any investment opportunity. FHM's investment portfolio continues to be dominated by (AA category) rated Meezan Bank and Soneri Bank (TDRs). Furthermore, during 9MFY20, the Modaraba also has a small investment book of listed stock, comprising 11% of FHM's equity, signifying low risk.

Liquidity And Funding Modaraba has issued COMs for 3 months, 6months, and 1 year time period. However, overall portfolio is tilted towards 3months maturity, which depicts market confidence on the Modaraba (9MFY20: 93%; FY19: 93%) of the total COMs. The option of reverting to group bank for added liquidity is also available in dire circumstances. After maturing of GoP Ijarah Sukuks, the liquidity position is as; Liquid Assets / Total Funding ratio (9MFY20: 21%; 9MFY19: 9%). The Modaraba obtains funding from Certificates of Musharika (CoM). Corporates dominate the CoM mix (FY20: 89%) followed by Individuals (FY20: 6%) and Trusts (FY20: 5%).

Capitalization FHM capital structure shows an inclination towards leveraging as evident by equity-to-total-asset ratio of 32% at 9MFY20 (9MFY19: 30%). FHM's substantial growth in asset base would have to be financed through either fresh equity injection or borrowed funds. This is prominent by an increase in the funding base by the Modaraba to increase the musharaka portfolio.

**First Habib Modaraba**

BALANCE SHEET	31-Mar-20	30-Jun-19	30-Jun-18	30-Jun-17
	9MFY20*	FY19	FY18	FY17
Assets				
Investments (Others)	303	317	255	279
Equity	217	242	255	279
Debt	86	75	-	-
Finances	9,426	9,679	8,499	6,733
Other Earning Assets	700	839	1,288	1,214
Net Non-Performing Advances	-	-	-	-
Total Non-Earning Assets	576	288	237	141
Total Assets	11,005	11,124	10,279	8,367
Liabilities				
COMs	6,180	6,149	5,593	3,914
Lease rentals received in advance	454	481	502	366
Other Liabilities	800	857	624	615
Equity				
Equity (including surplus on revaluation)	3,570	3,637	3,560	3,472
Total Liabilities & Equity	11,005	11,124	10,279	8,367

INCOME STATEMENT

Net Revenue	351	418	383	389
Other Operating Income/Loss	15	14	15	18
Total Revenue	436	502	434	440
Administrative and General Expenses	(52)	(60)	(48)	(44)
Pre-provision Profit	321	369	327	344
Provisions	-	-	-	-
Pre-tax Profit	266	320	290	305
Net Income	266	320	290	295

Ratio Analysis

Performance				
ROA	3.2% **	3.0%	3.1%	3.8%
Coverages				
Liquid Assets / Total Funding	20.8%	19.0%	28.2%	38.1%
Loan Loss Coverage				
Impaired Lending / Gross Finances	0%	0%	0%	0%
Loan Loss Provisions / Impaired Lending	100%	100%	100%	100%

* Unaudited

**Annualized

First Habib Modaraba

Sep-20

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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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