



The Pakistan Credit Rating Agency Limited

Rating Report

First Habib Modaraba

Report Contents

1. Rating Analysis
2. Financial Information
3. Rating Scale
4. Regulatory and Supplementary Disclosure

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Sep-2021	AA+	A1+	Stable	Maintain	-
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	-

Rating Rationale and Key Rating Drivers

The ratings reflect First Habib Modaraba's (FHM or the Modaraba) strong business profile, emanating from healthy asset base, sound asset quality and sustained profitability. Additional comfort is derived from the Modaraba's affiliation with a renowned sponsor entity (Habib Metropolitan Bank). Presence of industry veterans in the management structure, along-with implementation of a robust internal control system, is considered pivotal in operational efficiency of the Modaraba. The historical performance trend speaks volumes about the distinct position FHM carries in the financial/non-financial modaraba universe. Post COVID, declining lending rates negatively impacted the topline, however, through addition of good quality financial assets and considerable financial charge reduction, the Modaraba secured a stable bottom-line for the period. FHM's capital provides strong support to the funding structure of the Modaraba, equally aided by Certificates of Musharaka (CoM). The strong capital adequacy ratio portray the Modaraba's strong capital position, should adverse circumstances arise. Going forward, the management intends to maintain its conservative growth strategy, as economic uncertainty is increasing due to resurgence of COVID. Further, withdrawal of tax exemptions under Finance Act, 2021, shall be a point of concern and may have negative repercussions prospectively.

The ratings remain 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 Non-Banking Finance Companies Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Transition and Default(Jun-21)
Related Research	Sector Study Modaraba & NBFCs(Apr-21)
Rating Analysts	Muhammad Noor Ul Haq noorulhaq@pacra.com +92-42-35869504

Profile

Structure First Habib Modaraba (FHM) is a Non-Banking Islamic Financial Institution and listed on the Pakistan Stock Exchange with a trading symbol of "FHAM".

Background First Habib Modaraba, established in 1985, with organizational objective as 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 Modarabas in the industry located in Pakistan, holding multiple awards in the industry.

Operations FHM offers Ijarah and Diminishing Musharika financing, primarily for plant & machinery and vehicles. In early FY19, the Modaraba engaged in window operations in Habib Metro Bank branches for the purpose of development and proposition of Islamic Financial to clientele to whom such investments show promise.

Ownership

Ownership Structure The shareholding of the Modaraba is 90.0% freely floated. As per the minimum regulatory requirement of 10.0% management holding, HMMMCL, the management company, holds 10% ownership stake in the Modaraba. A 54.2% stake in the Modaraba is held by Habib Management Private Limited, whereas the remaining stake of FMH is dispersed amongst the corporates, individuals and other entities.

Stability FHM is proceeding on a path of growth, in terms of business scale and size of financial assets on sound footings. A generally prudent approach is adopted by FHM in its prospective expansion plans.

Business Acumen Apart from HMBL, the sponsor has a strategic stake in other sectors as well. The ownership of HMBL has deemed to be fruitful for FHM as it has succeeded in achieving many milestones and has developed a formidable position in the sector, which signifies a strong sponsor acumen.

Financial Strength Habib Metro Bank Limited is the owner of FHM. HMBL, possesses an asset base of over PKR 1,017bln and advances of over PKR 312bln as at CY20, carrying a strong financial profile.

Governance

Board Structure The board of FHM is composed of six members, having two independent directors, two non-executive directors and one executive director i.e., CEO of the Modaraba. The board of directors of FHM comprises of professionals having vast experience in banking and finance sectors.

Members' Profile The Chairman of the Modaraba, Mr. Syed Rasheed Akhtar, is banking veteran, with a career spanning over 36 years. He has served in various senior management positions throughout his tenure, with prominent positions held in Bank Indosuez, Habib Bank AG Zurich, HBZ Bank Limited, South Africa.

Board Effectiveness The board has established two board level committees, namely; the Audit Committee and Human Resource Committee, chaired by respective directors. The board performance is stipulated as per SECP Regulations, and provides oversight effectiveness, observed through conduction of periodic meetings through the period.

Financial Transparency M/S EY Ford Rhodes is the External Auditor of FHM. They have expressed an unqualified opinion on the FHM's financial statements as at year-end 30 June 2020. The Audit Committee directly oversees the internal audit function, with review of financial statements and smooth progression of audit falling under its ambit.

Management

Organizational Structure General management of the company is based on a team of seasoned professionals who have served the Modaraba over a long tenure. The operations are divided into eight functional departments. The reporting lines of all departments converge towards the CEO, with Internal Audit being an exception, as it reports to the Audit Committee. There are currently three management committees in place, namely, i) Credit Committee, ii) Market Investment Committee and iii) Assets and Liability Management Committee.

Management Team The CEO, Mr. Muhammad Shoaib Ibrahim – former 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 spanning over more than three decades.

Effectiveness The management has developed a broad "Code of Conduct", which outlines FHM's standard of conduct and the Modaraba's compliance with different stakeholder's expectations including certificate holders, employees, regulators and community at large. All management committees conduct meetings on a periodic basis, with operational discussions being agenda of meetings.

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.

Risk Management Framework Management of FHM continued to explore opportunities to achieve its strategic objectives while ensuring 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 private sector borrowing from banks increased by 34.0% during 9MFY21 which is witnessing that, economic activities of this year are better than the pre-COVID period of FY20. The large-scale manufacturing (LSM) sector has also shown good growth during 9MFY21. However, worsening 3rd wave of Covid-19 pandemic and a spike in inflation rate, remained immediate challenge for the economy.

Relative Position FHM is well abreast of the economy and adopts risk mitigation strategies in a timely manner. In terms of market coverage, FHM possesses 20.7% of the modaraba market share and 35.6% of the financial modaraba market share, based on assets of PKR 11,013mln at March-21.

Revenues The key revenue generators have witnessed a decline, as Diminishing Musharaka witnessed a decline of 26.5%, comprising of PKR 207.1mln (9MFY21: PKR 572.8mln; 9MFY20: PKR 779.8mln) and Ijarah Agreements declining at 53.6% on a YoY basis (9MFY21: PKR 66.2mln; 9MFY20: PKR 142.7mln). A total revenue of PKR 659mln was achieved during 9MFY21, with contribution mix being gross Musharakah Financing at 86.9% and Ijarah Agreements at 10.0% of total gross revenue.

Performance The financial performance has remained stable. A direct hit by falling revenues was absorbed by decreased financial costs (9MFY21: PKR 297.5mln; 9MFY20: PKR 619.7mln) which, all other expenses remaining stable, provided comfort to the bottom line of the Modaraba, resulting in a Profit After Tax of PKR 256.6mln. The stable performance of the Modaraba is further indicated by its stable return on assets (9MFY21: 3.10%; 9MFY20: 3.14%).

Sustainability With low risk profile customers being targeted, the Modaraba plans to manage risks, while strengthening its risk management framework. In terms of sector, the Modaraba intends to 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.

Financial Risk

Credit Risk FHM credit risk is primarily managed through a comprehensive credit policy, which is pre-approved by the Board of Directors (BoD). The Modaraba has decreased its stake in government investments, reducing its Term Deposit Musharaka (TDM) from PKR 500mln in 9MFY20 to PKR 318.5mln in 9MFY21. Further, the financing mix of FHM is concentrated in three sectors, namely; i) Pharmaceutical ii) Services iii) Food & Allied.

Market Risk The Modaraba has developed a comprehensive investment policy which contains provisions for the activities of the overall investment portfolio as well as per scrip exposure. FHM's investment portfolio continues to be dominated by (AA category) rated Meezan Bank and Soneri Bank (TDMs). Furthermore, during 9MFY21, the equity investments have increased as funds are redirected towards equity investments aimed at well reputed companies.

Liquidity And Funding The Modaraba has issued COMs for 3 months, 6months, and 1 year time period. However, overall portfolio is tilted towards 3 months maturity, which depicts market confidence on the Modaraba. The option to avail additional finances in case of any adverse event is available from the group bank. The liquidity position of the Modaraba is as; Liquid Assets / Total Funding ratio (9MFY21: 12.4%; 9MFY20: 20.8%). The Modaraba obtains primary funding from Certificates of Musharika (CoM).

Capitalization FHM has a CAR of 32.0% at 9MFY21 (9MFY20: 31.8%), portraying the Modaraba's strong position, should adverse circumstances arise. FHM's substantial growth in asset base would need 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 financing portfolio.



First Habib Modaraba

BALANCE SHEET	30-Mar-21	30-Jun-20	30-Jun-19	30-Jun-18
	9MFY21	FY20	FY19	FY18
Assets				
Investments (Others)	374	268	317	255
Equity	294	188	242	255
Debt	80	80	75	-
Finances	9,986	8,722	9,679	8,499
Other Earning Assets	765	667	839	1,288
Net Non-Performing Advances	-	-	-	-
Total Non-Earning Assets	263	255	288	237
Total Assets	11,013	9,913	11,124	10,279
Liabilities				
COMs	6,353	5,280	6,149	5,593
Lease rentals received in advance	258	372	481	502
Other Liabilities	689	628	857	624
Equity				
Equity (including surplus on revaluation)	3,714	3,634	3,637	3,560
Total Liabilities & Equity	11,013	9,913	11,124	10,279

INCOME STATEMENT

Net Revenue	362	488	418	383
Other Operating Income/Loss	7	15	14	15
Total Revenue	420	613	502	434
Administrative and General Expenses	(55)	(71)	(60)	(48)
Pre-provision Profit	301	460	369	327
Provisions	-	-	-	-
Pre-tax Profit	257	317	320	290
Net Income	257	317	320	290

Ratio Analysis

Performance				
ROA	3.1% **	3.0%	3.0%	3.1%
Coverages				
Liquid Assets / Total Funding	12.4%	17.7%	19.0%	28.2%
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

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
--	---

Disclaimer: PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. Contents of PACRA documents may be used, with due care and in the right context, with credit to PACRA. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

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)

Proprietary Information

(23) All information contained herein is considered proprietary by PACRA. Hence, none of the information in this document can be copied or, otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's prior written consent