



The Pakistan Credit Rating Agency Limited

## Rating Report

### First Punjab Modaraba

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Sep-2019	A-	A2	Stable	Maintain	-
29-Mar-2019	A-	A2	Stable	Maintain	-
04-Dec-2018	A-	A2	Stable	Maintain	-
30-Jun-2018	A-	A2	Stable	Maintain	-
30-Dec-2017	A-	A2	Stable	Maintain	-
31-May-2017	A-	A2	Stable	Upgrade	-
28-Dec-2016	BBB+	A2	Positive	Maintain	-
13-Feb-2016	BBB+	A2	Stable	Maintain	-
13-Feb-2015	BBB+	A2	Stable	Upgrade	-
19-Mar-2014	BBB	A3	Stable	Maintain	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect the sustained performance and continuous support of the sponsor (The Bank of Punjab). The Modaraba has witnessed improvement in its standalone business profile exhibited in its performance trend; achieving profitability is a key highlight over the last couple of years, however, increase in finance cost curbed the effect of higher profitability. In order to propel growth, the Modaraba intends to widen its equity base either by internal generation and/ or by further injection of equity. The Modaraba managed to expand its earning assets, mainly lending book wherein vehicle financing contributed majorly. The key sponsor – The Bank of Punjab (BoP) – a bank majority owned by the Government of Punjab, continued its support in the form of a sustainable funding base. The management is in the process of generating new avenues of funding. By management endeavors, the infected portfolio is gradually reducing and further efforts are being made for recoveries. During FY20 further recoveries, as planned, are likely to support Modaraba’s performance in the future. The management’s efforts in particular to build strong financing book are expected to yield sustainable results; however, materialization is contingent upon the timely implementation.

The ratings are dependent on relative positioning of the Modaraba in the sector and sustained asset quality of the new portfolio: achieving bottom line profitability is important. Meanwhile, any weakening in the financial profile or support from the sponsor could have negative implications.

#### Disclosure

<b>Name of Rated Entity</b>	First Punjab Modaraba
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	PACRA_Methodology_NBFC_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
<b>Related Research</b>	Sector Study   Modaraba & NBFCs(Mar-19)
<b>Rating Analysts</b>	Muhammad Obaid   muhammad.obaid@pacra.com   +92-42-35869504



## Profile

**Structure** First Punjab Modaraba (FPM), established in 1992, is a perpetual multi-purpose Modaraba listed on PSX. FPM is managed by Punjab Modaraba Services (Pvt) Ltd., a wholly owned subsidiary of The Bank of Punjab (BoP).

**Background** The Modaraba has remained successful in maintaining its growth trend by increase in total assets, certificate holder's equity and lending portfolio. On the basis of improved financial health and performance during last 5 years, the Registrar Modaraba SECP granted permission to raise funds from institutions through issuance of Certificates of Musharikhah (COMs).

**Operations** The Modaraba caters to corporate, commercial and individual customers through various modes of Islamic financing mainly Ijarah, Morabaha and Musharikhah. Musharikhah pertains to vehicles financing. Ijarah focuses on plant & machinery, vehicles and Home Decor Scheme. Morabaha targets raw material (working capital) financing of different sectors

## Ownership

**Ownership Structure** Punjab Modaraba Services (Pvt.) Limited (PMSL) holds ~39% stake in the FPM. PMSL is a wholly owned subsidiary of The Bank of Punjab (BoP). The general public has ~40% stake in FPM. The remaining shareholding is split amongst a number of financial institutions and corporate entities.

**Stability** Since FPM is managed by PMSL - fully owned subsidiary of BoP (in which Government of Punjab (GoPb) has majority stake). BoP and invariably GoPb stands behind the Modaraba as it has been providing financial assistance for the past many years.

**Business Acumen** The Board includes senior members from the management of BoP bringing with them strong business skill set which is critical for the sustainable success of any entity. The Modaraba stands to gain from the BoPs industry-specific working knowledge of lending and financing diverse set of customers and sectors across Pakistan.

**Financial Strength** The Government of Punjab (GoPb) maintains majority stake in BoP (58%). While BoP has no contractual obligation to support FPM in a distressed situation, yet in the wake of deterioration in FPM's financial profile, the Bank has demonstrated its resolve to provide assistance to FPM by approving Musharikhah finance facility of PKR 1,405mln and roll over of Certificates of Musharika amounting to PKR 400mln.

## Governance

**Board Structure** FPM's Board of Directors (BoD) comprises six members including CEO. Excluding the CEO of FPM, all other members are non-executive and nominees from BoP. Mr. Umer Iqbal Sheikh, Head of Islamic banking BoP, joined the board of FPM. In Jan19, Mr. Khawaja Farooq Saeed, Independent Director, resigned from the board and the casual vacancy remains unfilled.

**Members' Profile** Chairman of the board – Mr. Khalid Tirmizey, former Deputy CEO, has been appointed as Acting President, with effect from December 7, 2018, until a new President is appointed. He has over 42 years of experience working at several leading commercial banks. Before joining BOP he worked as the Deputy CEO for Faysal Bank and was part of the management team that spearheaded the bank's rapid growth in the banking sector.

**Board Effectiveness** FPM has constituted two board committees (Audit Committee and Human Resource & Remuneration Committee) to ensure rigorous monitoring of management's policies and entity's operations. Attendance recorded during the board and its committees' meetings was good and minutes have been properly documented.

**Financial Transparency** EY Ford Rhodes, Chartered Accountants, is auditor of FPM and have expressed an unqualified conclusion on review of FPM's financial statements for 6MFY19. Meanwhile, ShineWing Hameed Chaudhry & Company is the auditor of the Punjab Modaraba Services (Pvt.) Limited, the management company of FPM.

## Management

**Organizational Structure** The Modaraba has a lean organizational structure. The management team carries good experience profile but is relatively new with FPM. All department heads report directly to the CEO, with the exception of Internal Audit, which reports directly to the Audit Committee.

**Management Team** Mr. Aamir Malik, CEO of FPM, has more than two decades of experience, mainly at BOP. He has diversified experience of handling banking affairs covering Credit, Branch Banking, Foreign Trade, Recovery and SAM in different Management positions. The team includes a balanced mix of professionals who bring rich experience to the Modaraba.

**Effectiveness** The Modaraba has four committees at the management level for better functioning of its affairs; a) Credit Committee, b) Investment Committee, c) Asset and Liability Committee, and d) Management Committee. The Modaraba needs to focus on increasing the effectiveness of its management committees in order to monitor performance and assure the adherence to the policies and procedures.

**MIS** FPM has acquired an online, centralized Financial Information System (FIS) Solution that has been custom developed in client / server application architecture that will help in managing the business processes easily and efficiently.

**Risk Management Framework** The Modaraba has implemented an Obligor Risk Ratings module (ORRs) in order to make prudent credit decisions while taking into account all related factors (industry positioning, ownership, management quality, management experience, obligor's historical conduct, facility structure etc.)

## Business Risk

**Industry Dynamics** Due to reduction in industry spreads and adverse economic indicators in recent period, the scenario has turned to a gloomy outlook. Considering present economic situation and stiff competition with Islamic commercial banks, it is expected that business activities during the current year will slightly remain under pressure as the political uncertainty took its toll on overall business sentiments.

**Relative Position** In terms of Assets, FPM comes in the top five Modarabas of Pakistan with an asset base at Mar19 of PKR 2.12bln (Jun18: PKR 1.99bln). The Modaraba commands further support from the fact that BoP owns ~39% and has provided and shall continue to lend support in case of need or financial distress.

**Revenues** Gross Revenue of PKR 176mln is mainly driven by Musharaka income (67%) and Ijarah income – net of amortization (26%). Increase in Gross Revenue (36% YoY) is contributed by 70% increase in Ijarah income, underpinned by healthy 70% YoY increase in Ijarah assets.

**Performance** Increase in gross revenue was not translated in increase in bottom-line as Net income of the company decreased by 48% YoY from PKR 29mln in FY18 to PKR 15mln in FY19. Although PKR 13mln reversal of provision supported the bottom-line but 61% YoY increase in finance cost due to high interest rates deteriorated the profitability.

**Sustainability** Increasing interest rates are putting a dent in the profitability as the cost of financing for the highly leveraged Modaraba will continue to rise in the near future more than the asset yield earned. Going forward, FPM intends to continue with its cautious approach, While targeting quality customers. In terms of product Modaraba will focus on the transport (private and commercial vehicles) which currently represents ~85% of finances.

## Financial Risk

**Credit Risk** FPM's financing book is dominated by Musharikhah (FY19: 66%; FY18: 78%) followed by Ijarah (FY19: 28%; FY18: 19%) and Morabaha (FY19: 7%; FY18: 4%). Non-performing finances stood 42% of Gross finances with a relatively low coverage (36%) as compared to its peers. Non-performing finances have been fully provided for.

**Market Risk** Modaraba focuses primarily on core financing business and has no exposure to equity/debt investment. Consequently, FPM is not exposed to market risk

**Liquidity And Funding** The Modaraba has availed a Musharikhah finance facility of PKR 1,224mln from its parent bank – BOP as at end-Jun-19 against approved limit of PKR 1,405mln. Against another available financing facility of PKR 400mln by BOP, FPM has fully availed that facility by issuing CoMs. Furthermore, after approval of SECP for collecting deposits with the limit of PKR 200mln, FPM has collected deposits from Corporate customers amounting to PKR 45mln.

**Capitalization** Despite positive bottom-line, owing to reserve build up, equity declined by 1% from PKR 203mln at Jun18 to PKR 201mln at Jun19. FPM carries a leveraged structure - the total debt/equity ratio lies at 8.5x at Jun19 (FY18: 7.9x).



First Punjab Modaraba

PKR mln

BALANCE SHEET	30-Jun-19	30-Jun-18	30-Jun-17	30-Jun-16
	FY19	FY18	FY17	FY16

**Assets**

<b>Finances</b>				
1. Morabaha	83	41	44	76
2. Musharaka	836	865	850	410
3. Ijarah	350	206	160	180
Other Earning Assets	77	79	71	35
Other Non-Earning Assets	277	216	163	117
Non-Performing Finances	931	1,030	1,059	1,092
Less: Provision for Doubtful Debts	(338)	(348)	(378)	(383)
Net Non Performing Finances	592	681	681	709
Less: Suspended Income	(92)	(95)	(95)	(100)
<b>Total Assets</b>	<b>2,124</b>	<b>1,993</b>	<b>1,874</b>	<b>1,427</b>

**Liabilities**

<b>Funding</b>				
1. Certificate of Musharaka	446	400	400	100
2. Morabaha	-	-	-	-
3. Musharaka	1,258	1,212	1,118	969
4. Security Deposits	136	113	119	141
Other Liabilities	83	65	45	41

**Equity**

Total Equity	201	203	192	177
<b>Total Liabilities &amp; Equity</b>	<b>2,124</b>	<b>1,993</b>	<b>1,874</b>	<b>1,427</b>

**INCOME STATEMENT**

Gross Revenue	176	130	121	73
Financail Charges	(150)	(94)	(80)	(58)
Other Income	18	10	10	5
Operating Expenses	(39)	(35)	(29)	(22)
Pre-Provision Operating Profit/(Loss)	5	11	22	(2)
Provisions for Doubtful Debts / Reversals	13	20	5	25
Management Fee	-	(3)	(3)	(2)
Profit Before Taxes	18	28	24	21
<b>Net Income</b>	<b>15</b>	<b>29</b>	<b>28</b>	<b>28</b>

**Ratio Analysis**

**Profitability Ratios**

ROA	1%	1%	2%	2%
Cost-to-Total Net Revenue	-88%	-77%	-57%	-111%

**Capital Adequacy**

Equity / Total Assets	9%	10%	10%	12%
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**Funding & Liquidity**

Short Term Funding/Total Funding	28%	26%	28%	14%
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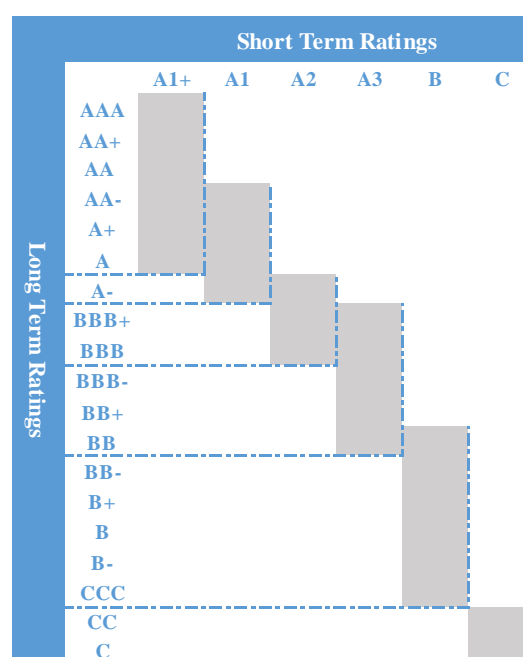
**Loan Loss Coverage**

Impaired Lending/Gross Finances	42%	48%	50%	62%
Net Impaired Lending/ Equity (%)	2.94	3.35	3.55	4.01

## Credit Rating Scale & Definitions

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.

Long Term Ratings		Short Term Ratings	
<b>AAA</b>	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	<b>A1+</b>	The highest capacity for timely repayment.
<b>AA+</b> <b>AA</b> <b>AA-</b>	<b>Very high credit quality.</b> 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.	<b>A1</b>	A strong capacity for timely repayment.
<b>A+</b> <b>A</b> <b>A-</b>	<b>High credit quality.</b> 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.	<b>A2</b>	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<b>Good credit quality.</b> 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.	<b>A3</b>	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
<b>BB+</b> <b>BB</b> <b>BB-</b>	<b>Moderate risk.</b> 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.	<b>B</b>	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
<b>B+</b> <b>B</b> <b>B-</b>	<b>High credit risk.</b> 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>C</b>	An inadequate capacity to ensure timely repayment.
<b>CCC</b> <b>CC</b> <b>C</b>	<b>Very high credit risk.</b> 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.		
<b>D</b>	Obligations are currently in default.		



**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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) 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.

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(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

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- (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)

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- (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.
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- (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)

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- (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)

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- (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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