



The Pakistan Credit Rating Agency Limited

Rating Report

Modaraba Al-Mali

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
27-Sep-2019	BBB+	A2	Stable	Maintain	YES
02-Apr-2019	BBB+	A2	Stable	Downgrade	-
22-Nov-2018	A-	A2	Stable	Maintain	-
29-Jun-2018	A-	A2	Stable	Maintain	-
26-Sep-2017	A-	A2	Stable	Maintain	-
20-Apr-2017	A-	A2	Stable	Maintain	-
20-Apr-2016	A-	A2	Stable	Maintain	-
09-Jun-2015	A-	A2	Stable	Maintain	-
30-Jun-2014	A-	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

Modaraba over the years has been trying to build a sustainable business model. With different attempts, the outcome is not yet materialized. The incumbent CEO has been working on a business plan, which with the auspices of the board, will be implemented. The development of this plan has been delayed. The relative operating environment has grown significantly. MAM has lagged in the relative peer universe having similar rating characteristics. The ratings draw comfort basically from the association of the Modaraba with Bankislami, via management Company (Bank Islami Modaraba Investment Limited). The ratings of Modaraba is reflective of its equity-based capital structure. Its financing book mainly comprises of Ijarah and Musharaka. Although the asset quality is fully maintained, as NPL's are fully provided (Loan Loss Provisions / Impaired Lending: 100%). The Modaraba is raising its income stream through renting out the available extra space from its office premises. The management would maintain largely equity-based capital structure; however, borrowing from the management company/sponsor bank would be an option available to the Modaraba.

The ratings are dependent on the management's ability to formulate a viable business plan and execute the business strategy to establish the modaraba on its footing. Maintaining healthy asset quality and its equity-based capital structure is important. The entity has been put on rating watch, given the parent of the management company intends to off-load its stake.

Disclosure

Name of Rated Entity	Modaraba Al-Mali
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	PACRA_Methodology_NBFC_FY19(Jun-19),PACRA_Criteria_LT ST Relationship_FY19(Jun-19),PACRA_Criteria_Rating Modifiers_FY19(Jun-19)
Related Research	Sector Study Modaraba & NBFCs(Mar-19)
Rating Analysts	Usama Liaquat usama.liaquat@pacra.com +92-42-35869504

Profile

Structure Modaraba Al-Mali (MAM) is a Non-Banking Islamic Financial Institution which got listed on the Pakistan Stock Exchange with a trading symbol of MODAM.

Background MAM was launched in 1987 as one of the pioneering modaraba to undertake financing business on the principles of Islamic shari'ah. BankIslami Pakistan Limited (BIPL) acquired 100% share capital of JS Finance Limited, the management company of the Modaraba, towards the end of FY07 and renamed it as BankIslami Modaraba Investments Limited (BMIL).

Operations MAM was previously engaged in the business of mobile tower lease and providing maintenance services to bank branches and other multinational companies across the country. This business line constituted the major income source for the Modaraba. However, lately, the Modaraba has sold its maintenance as well as mobile tower business and has lately focused on shari'ah compliant financing activities like Ijarah, Murabaha, diminishing Musharaka.

Ownership

Ownership Structure BankIslami Modaraba Investments Limited (BIML) has ~13% equity stake in MAM. BIML is a wholly owned subsidiary of Bank Islami Pakistan Limited (BIPL). The remaining certificate holding of MAM is distributed amongst NIT, NBFCs, joint stock companies, and individuals.

Stability MAM intends to book good quality assets in future through controlled leveraging of the balance sheet. It also plans to improve the fuel capacity of its fuel station in order to attend the growing demand. They primarily focus on SME sector and are hopeful of a positive result, however in case things go otherwise, the sector will be at a serious disadvantage against the banking industry.

Business Acumen BIPL has prominent sponsors namely the JS Group (through Jahangir Siddiqui & Company Limited (JSCL), Mr. Ali Hussain and SAJ Capital Management Limited, Emirates NBD (through Dubai Bank PJSC), and Randeree family. BIPL has a network of 330 branches across Pakistan as at end- Sep18. Bank Islami is following a well-conceived business strategy of fast establishing itself as an active player in the niche Islamic banking segment.

Financial Strength MAM is owned by BIPL which has an asset base of over PKR 216bln and advances of over PKR 119bln as at CY18 and carries an adequate financial profile.

Governance

Board Structure MAM's Board of Directors comprises eight members, including the Chief Executive Officer (CEO). It constitutes seven nominees of BIPL, while the remaining one member is an independent director.

Members' Profile CEO, Mr Muhammad Sadiq Sheikh has experience of more than 4 decades in financial sectors.

Board Effectiveness The board has made two committees namely Audit committee and Human Resource & Remuneration Committee which are 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 The financial statements of MAM for FY18 have been audited without any qualification by M/S A.F Fergusons & Co. Chartered Accountants.

Management

Organizational Structure MAM has a well-defined organizational structure and its operations are divided into three departments mainly which are (i) Accounts, (ii) Credit/Recovery\ Operations, and IT\ Admin\ HR. All the departmental heads directly report to the CEO. All the departments, with the exception of recovery, are headed by Managers/ Deputy Managers, who possess adequate experience in their respective fields of operation.

Management Team There is currently one management committee in place, namely i) Management Committee, responsible for monitoring and running day to day operations of Modaraba.

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

MIS The Modaraba has implemented a customized financial application, designed in C # Dot Net, to manage its routine business operations, comprising accounts, finance, and administration modules. Periodic physical inspection is conducted to maintain strict control over the quality and quantity of tangible assets in the maintenance business.

Risk Management Framework The objective of FRM is risk mitigation and to monitor it prudently. The management has maintained good asset quality in its book. The Modaraba has fully provided all delinquent assets. The management expects the recovery to pick up, going forward, as settlement negotiations with some clients are underway.

Business Risk

Industry Dynamics Due to adverse political and economic indicators, there was slow economic growth in FY19. Owing to stiff competition with Islamic commercial banks, hike in interest rates and strict SECP policies, modarabas will remain under pressure. The modaraba sector contributed 0.18% of GDP. Asset base of this sector has grown over 72% since FY13, due to incorporation of new companies and mergers over the years that evolved into financially strong entities. The operating asset's allocation of most modarabas is skewed towards Ijarah, musharakah and murabaha financing.

Relative Position Asset base of PKR 267 mln is relatively low compared to competitors. MAM marks below the top 10 Modarabas. Its financing book mainly comprises of Ijarah and Musharaka. The company has disposed some of the vehicles from its Ijarah portfolio, which indicates a dis-interest in continuing this function. CAGR of 6% as at Dec-18 indicates very slow growth. The equity base at PKR 239 mln is also very less in comparison to peers.

Revenues Net revenue from Ijarah rentals dropped significantly from PKR 34 mln in to 7.7 mln in FY19. Income from operations was mainly through sale of fuel. Income from musharaka transactions increased from PKR 0.87 mln to 2.6 mln in FY19. Other sources were the rent from fuel station and office premises. Gross revenue decreased to 34 mln from 54 mln in FY19 owing to the slow down in leasing business. The net profit of the company also decreased sharply, FY19; 8.4mln (FY18: 11.5 mln) due to high interest rates which resulted in an increase in doubtful ijarah rentals.

Performance Interest rate scenario negatively affected the overall profitability of MAM, as there was no new lease disbursement made in the period under review. Earning assets increased by ~50%, on account of the revaluation of investment property which resulted in a PKR 4 mln surplus. Moreover, the operating expenses continued to remain a drag on the modaraba's performance.

Sustainability Over the past year, the CEO has been trying to build a sustainable business model, with different attempts made in the past, the outcome is yet to be seen. The success of this business plan is critical for survival of the modaraba.

Financial Risk

Credit Risk Earning assets (83% of total) are divided into segments: (i) non-financing including a) gasoline station (31% of Total earning assets), b) investment property (34%), c) deposits with banks (22%), and (ii) financing book (13%). During FY19, Gasoline station earned 263 mln from sale of fuel and 1.6mln from rent of station. There is no change in equity base. The credit risk exposure of modaraba is mainly from Ijarah & Musharakah financing book. Higher profit rates in FY19, ranging from 3%-10% also improved earnings. Stable stream of income and significant growth of assets indicate towards the ability to set off liabilities and absorb impairment.

Market Risk MAM focuses on core financing business and has no exposure to equity/debt investment. Consequently, it is exposed to minimal market risk.

Liquidity And Funding MAM is allowed to mobilize deposits from the public, but does not plan to do so as it currently has ample funds. The income is exempt from tax provided it distributes 90% of its profits to its certificate holders after making appropriation for statutory reserves. Moreover, refunds amounting to PKR 29mln are due, which is an additional benefit for the modaraba. MAM paid dividend of PKR0.5 per certificate in 1HFY19 amounting total to PKR 9.2 mln, which represents commitment to fulfill liabilities.

Capitalization MAM has an equity-based capital structure as evident from its equity to total assets ratio i.e 90% as at FY19 (FY18: 86%), thus it is exposed to minimal credit default risk.

**MODARABA****Modaraba Al-Mali***PKR(mln)*

BALANCE SHEET	30-Jun-19	30-Jun-18	30-Jun-17	30-Jun-16
	FY19	Annual	Annual	Annual

Assets**Earning Assets**

Ijarah Finance	10	18	57	106
Other Earning Assets	195	117	89	76
Non Earning Assets	43	46	43	38
Non-Performing Finances	30	58	58	56
<i>Less: Accumulated provision (specific/prudential)</i>	(30)	(58)	(58)	(56)
Total Assets	267	196	196	219

Liabilities

Total Funding	10	11	18	44
Other Liabilities	17	17	16	16

Equity

Total Equity	167	168	162	160
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INCOME STATEMENT

Gross Revenue	12	15	13	12
Total Net Revenue	17	23	18	19
Operating Expenses	8	11	10	15
Net Income	8	12	7	5

Ratio Analysis

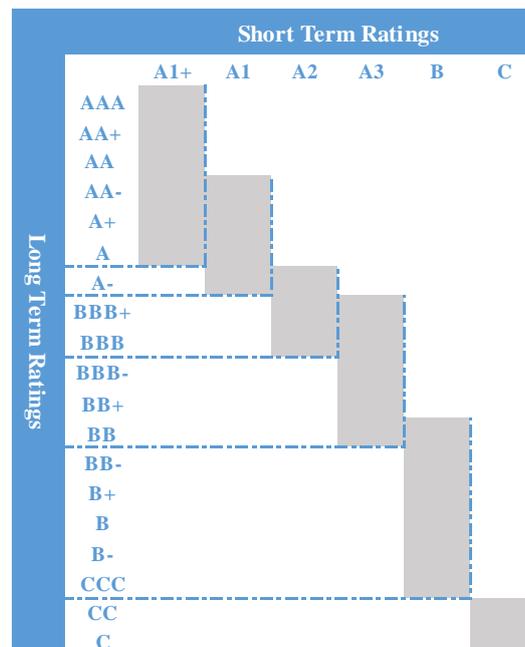
Cost-to-Total Net Revenue	44.7%	44.8%	58.3%	77.6%
Equity / Total Assets	89.6%	85.9%	82.7%	72.7%
Impaired Lending / Gross Finances	50.4%	64.0%	47.3%	34.5%
Loan Loss Provisions / Impaired Lending	100%	100%	100%	100%

Unaudited*Sep-19**

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	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
AA+ 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.	A1	A strong capacity for timely repayment.
A+ 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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
BBB+ 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
BB+ BB 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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
B+ 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.	C	An inadequate capacity to ensure timely repayment.
CCC CC C	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.		
D	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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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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