



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
26-Mar-2021	BBB+	A2	Developing	Maintain	YES
15-Apr-2020	BBB+	A2	Stable	Maintain	YES
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	-

#### Rating Rationale and Key Rating Drivers

Modaraba Al Mali, a subsidiary of Bank Islami Investments Limited (BIML), is a small sized player in the Modaraba Industry. The Modaraba enjoys patronage from its established sponsor, Bank Islami Pakistan Limited (BIPL). The formulation of a sustainable business plan had been a focal point of the Modaraba's management, in absence of which, Modaraba Al Mali is lagging behind, in comparison to its peers. A buyer had been sought for a considerable time period by the sponsors. This has borne fruit; a prominent business group has received the regulator's approval for the acquisition of the company. The approval with the Competition Commission of Pakistan (CCP) is pending, this is expected to be achieved within a short span of time.

The ratings take comfort in the equity based capital structure of the entity, indicating a low financial risk profile. The entity's financing book is mainly structured with Ijarah and Musharaka agreements, with assets quality being maintained, resulting in NPL's being fully provided (Loan Loss Provisions / Impaired Lending: 100%). The Modaraba is supplementing its revenue stream through renting out the available extra space from its office premises.

The ratings are dependent on the sustained risk profile. Development of new business strategy along-with its implementation would be important. Enhancement of asset base and equity-based capital structure is important. The entity has been put on rating watch, in lieu of the impending takeover by the new sponsors.

#### Disclosure

<b>Name of Rated Entity</b>	Modaraba Al-Mali
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   NBFC(Jun-20),Methodology   Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria   Ratings Transition(Jun-20)
<b>Related Research</b>	Sector Study   Modaraba & NBFCs(Apr-20)
<b>Rating Analysts</b>	Faraan Taimoor   faraan.taimoor@pacra.com   +92-42-35869504



## Profile

**Structure** Modaraba Al-Mali (MAM) is a Non-Banking Islamic Financial Institution which is listed on the Pakistan Stock Exchange.

**Background** MAM initiated its operations in 1987, as one of the pioneering modaraba to introduce Islamic Financing in the market. Bank Islami Pakistan Limited (BIPL) acquired 100% share capital of JS Finance Limited, the management company of the Modaraba, towards the end of FY-07 and renamed it as Bank Islami 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 focused on Shari'ah compliant financing activities like Ijarah, Murabaha, diminishing Musharaka.

## Ownership

**Ownership Structure** Bank Islami Modaraba Investments Limited (BIML) hold ~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 among a consortium of NIT, NBFCs, joint stock companies, and individuals.

**Stability** MAM initially has an intention to book good quality assets in future through controlled leveraging of the balance sheet. The Modaraba had an intention to improve its fuel station operations however current organizational plans aim towards sale of the fuel station. The Modaraba primarily focus on the 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 followed by an expansive branchless banking system. 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 307bln and advances of over PKR 134bln during FY-20 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** The CEO, Mr. Muhammad Sadiq Sheikh, has diverse banking 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 with minutes of the meetings being 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 through the year.

**Transparency**

## 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. The CEO oversees the direct operations of the Modaraba, with briefings given by the Head of each department, on a regular basis. 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 Management Committee, responsible for monitoring and running day to day operations of the 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 successfully implemented a customized financial software, designed in C Dot Net, to manage its routine business operations, comprising of accounts, finance, and administration modules. Periodic physical inspection is conducted in order to maintain strict control over the quality and quantity of tangible assets in the maintenance business.

**Risk Management Framework**

## Business Risk

**Industry Dynamics** The business environment in Pakistan remained challenging amidst COVID-19. Post-lockdown, the economy has revived as a result of growing appetite, particularly in corporate sector. Automobile sector has shown unprecedented growth ; disbursements in vehicles have augmented due to the low interest.

**Relative Position** Asset base of PKR 260mln and an equity base at PKR 241mln is relatively small compared to its competitors. MAM marks below the top 10 Modarabas. Its financing book mainly comprises of Ijarah and Musharaka. The company had previously disposed some of the vehicles from its Ijarah portfolio, and have continued to show dis-interest towards involvement in this function.

**Revenues** Net revenue from Ijarah rentals have vanished as a source of income in the Bi-Annual Financials (6HFY-21: PKR 0; 6HFY-21: PKR 0.14mln). Income from operations was mainly through sale of fuel contributing an amount of PKR 5mln. Income from Musharaka transactions decreased from PKR 1.3mln (6MFY-20) to PKR 0.65mln (6MFY-21). Other sources were the rent from fuel station and office premises. Gross revenue increased to PKR 7.97mln in 6MFY-21 against PKR 7.15mln in 6MFY-20 owing to the gradual-pacing in leasing business. The net profit of the company elevated to some extent, mainly on the back of reduction in operating expenses, (6MFY-21: PKR 5.01mln; 6MFY-20: PKR 3.46mln).

**Performance** Interest rate scenario negatively affected the overall profitability of MAM, as there was no new lease disbursement made in the period under review.

**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 contingent divestment by the parent company will prove to be a crucial factor in determining future business plans.

## Financial Risk

**Credit Risk** Earning assets (87% of total) are divided into segments: (i) non-financing including a) gasoline station (26% of Total earning assets), b) investment property (28%), c) deposits with banks (28%), and (ii) financing book (4%). During 6MFY-21, Gasoline station earned revenues of PKR 119mln from sale of fuel. There is no change in equity base. The credit risk exposure of modaraba is mainly from Ijara & Musharkah financing book. Stable stream of income and gradual growth of assets indicate ability to set off liabilities.

**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, tax refunds of approximately PKR 26mln are due, which is an additional benefit for the modaraba.

**Capitalization** MAM has an equity-based capital structure as evident from its equity to total assets ratio i.e. 93% as at 6MFY-21 (FY-20: 91%), thus it is exposed to minimal credit default risk.

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

<b>BALANCE SHEET</b>	<b>31-Dec-20</b>	<b>30-Jun-20</b>	<b>30-Jun-19</b>	<b>30-Jun-18</b>
	<b>1HFY21*</b>	<b>FY20</b>	<b>FY19</b>	<b>FY18</b>
<b>Assets</b>				
<b>Earning Assets</b>				
Ijarah Finance	4	20	10	18
Other Earning Assets	215	205	195	117
Non Earning Assets	34	36	43	46
<b>Total Assets</b>	<b>260</b>	<b>272</b>	<b>267</b>	<b>196</b>
<b>Liabilities</b>				
Total Funding	4	8	10	11
Other Liabilities	16	16	17	17
Surplus on Revaluation of Investments	67	67	73	1
<b>Equity</b>				
Total Equity	<b>174</b>	<b>182</b>	<b>167</b>	<b>168</b>
Total Liabilities & Equity	<b>260</b>	<b>272</b>	<b>267</b>	<b>196</b>
<b>INCOME STATEMENT</b>				
Gross Revenue	8	11	12	15
Total Net Revenue	12	11	17	23
Operating Expenses	6	7	8	11
Net Income	<b>5</b>	<b>4</b>	<b>8</b>	<b>12</b>
<b>Ratio Analysis</b>				
Cost-to-Total Net Revenue	53.3%	61.0%	44.7%	44.8%
Equity / Total Assets	92.5%	91.3%	89.6%	85.9%
Impaired Lending / Gross Finances	0.0%	65.1%	50.4%	64.0%
Loan Loss Provisions / Impaired Lending	100%	100%	100%	100%

**Mar-21**

**Credit Rating**

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Scale	Long-term Rating Definition
AAA	<b>Highest credit quality.</b> Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+	
AA	<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.
AA-	
A+	
A	<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.
A-	
BBB+	
BBB	<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.
BBB-	
BB+	<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.
BB	
BB-	
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-	
CCC	
CC	<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.
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><b>Entities</b></p> <ul style="list-style-type: none"> <li>a) Broker Entity Rating</li> <li>b) Corporate Rating</li> <li>c) Financial Institution Rating</li> <li>d) Holding Company Rating</li> <li>e) Independent Power Producer Rating</li> <li>f) Microfinance Institution Rating</li> <li>g) Non-Banking Finance Companies (NBFCs) Rating</li> </ul>	<p><b>Instruments</b></p> <ul style="list-style-type: none"> <li>a) Basel III Compliant Debt Instrument Rating</li> <li>b) Debt Instrument Rating</li> <li>c) Sukuk Rating</li> </ul>
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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.
- (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)

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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)
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- (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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