The Pakistan Credit Rating Agency Limited

KASB MODARABA

	NEW [SEP-16]	PREVIOUS [SEP-15]
Long-Term	BBB+	BBB+
Short-Term	A2	A2
Outlook	Stable	Positive

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SEPTEMBER 2016

Profile &Ownership

- KASB Modaraba (KASBM) established in 1990, is a perpetual, multipurpose Modaraba with a network of 4 branches.
- The Modaraba, listed on Pakistan Stock Exchange is primarily engaged in financing through Ijarah, Morabaha, Musharaka, Diminishing Musharaka and Modaraba.
- Modarba's management company is KASB Invest (Private) Limited (KIPL).
- KIPL is majorly owned by Mr. Muzaffar Ali Shah Bukhari (43%) and Mr. Mahmood Ali Shah Bukhari (43%).
- KIPL has 50% stake in the Modaraba while BankIslami Pakistan Limited owns 22% and Sulaiman Ahmed Al-Hoqani has 16% stake in KASBM.

Governance

- BoD of KIPL comprises four members including the CEO of KASBM.
- Syed Waseem ul Haq Haqqie, a senior chartered accountant by profession, is the chairman of the board.
- Experienced BoD mainly comprising non-executive members.
- Audit and HR Committees are the two sub-committees, chaired by Mr. Farrukh Ansari (an independent director).

Management

- Rashid Siddiqui is the CEO since Sep-13.
- Mr. Siddiqui has over 35 years of experience in Development and Investment Banking, Corporate Finance, Leasing and Liability/Asset Management.
- Competent and experienced management team.
- Well defined organizational structure; 4 departments report to COO who in turn reports to the CEO.

Risk Management Framework

- Concentrated portfolio dominated by Diminishing Musharakah (~55.5%) and Morabaha (37.6%).
- Asset quality in existing credit portfolio is largely maintained, though the financing book has decreased (NPLs / Gross Finances: 9MFY16: 11.8%; FY15: 9.9%; FY14: 7.8%).
- However, non-performing loans are mostly provided (9MFY16: 83%), thus the potential drag on equity is low (Net NPLs / Equity: 9MFY16: 3.7%; FY15: 3.7 %; FY14: 4.9%).
- Diminishing Musharaka's top twenty exposures constitute 29% of the portfolio at end-9MFY16. Ijarah's top twenty customers' concentration stood at 100%.

Performance

- During 9MFY16, a reduction in earning assets caused a drop in Modaraba's gross revenue.
- Net revenue increased benefiting from a sizable decline in cost of funds.
- Rise in operating expenses due to increase in staff and branches during the year stagnated KASBM's profitability on a YoY basis (PAT: 9MFY16: PKR 2mln; 9MFY15: PKR 13mln).
- The restriction by SECP on KASBM on issuing new and/ or rolling over existing CoMs has impacted the gross revenue of the Modaraba as earning assets have reduced, also causing the management to amend its strategy and look for other sources of funding to meet its liquidity and business needs.
- Going forward, the management intends to focus on diminishing musharaka financing for automobiles and venture into various commodity based agri businesses.

Financial Risk

- Decline in Certificates of Musharakah (CoM) due to (i) SECP's verdict & (ii) as per management's strategy to reduce high cost CoMs.
- In the absence of any new borrowing and continued restriction, the CoMs by end FY17 would be at ~PKR 190mln.
- The Modaraba plans to raise new funding lines from banks; facility of PKR 150mln from JS Bank is in the process.
- Low leveraged capital structure; debt-to-equity ratio of 1.45x at end-9MFY16.
- The approval of draft regulations 2016 which restrict all Modarabas to raise CoMs would bring challenge for the Modaraba and the industry in terms of raising funding.

RATING RATIONALE

The ratings reflect KASBM's adequate financial profile emanating from low-leveraged capital structure and reasonable diversity in the income stream translating into moderate profitability. In FY16, SECP has restricted the KASBM from raising new CoMs. This decision is subject to reconsideration depending on the performance of the Modaraba in FY16. Owing to this restriction, KASBM has experienced contraction in its COMs. Although the Modaraba has managed it from in-house cash holdings, squeeze in assets was witnessed as the Modaraba has yet to raise funds from other sources. Meanwhile, the squeeze in business volumes is impacting the performance of the Modaraba. However, liquidity is being well managed. Moreover, good asset quality provides comfort.
To contain the funding challenge, the management is in the process of securing funding from sources other than deposits. However, the management's ability to establish a stable and continuous non-deposit funding stream is yet to be seen. The management intends to follow cautious growth stance with continued focus on asset quality. Diminishing Musharaka and agri based business are likely growth drivers.

KEY RATING DRIVERS

The ratings are dependent on the management's ability to arrest the declining trend, indeed restore its profitability level. Vigilance in liquidity management remains important. Meanwhile, tapping new stable avenues of funding to improve business profile is important.

Financials (Summary)

KASB MODARABA *PKR mln*

BALANCE SHEET	31-Mar-16	30-Jun-15	30-Jun-14	30-Jun-13
	9MFY16	FY15	FY14	FY13
Assets				
Finances				
1. Morabaha	233	313	395	627
2. Musharaka	0	31	80	84
3. Ijarah	17	35	72	47
4. Modaraba	25	23	36	84
5. Diminishing Musharaka	344	354	399	424
6. Finance Lease	0	0	1	1
Other Earning Assets	295	148	208	197
Other Non-Earning Assets	102	64	100	38
Non-Performing Finances	83	83	83	83
Less : Provision for Doubtful Debts	(69)	(69)	(69)	(69)
Net Non Performing Finances	14	14	14	14
Total Assets	**1,030**	**983**	**1,306**	**1,516**
Liabilities				
Funding				
1. Certificate of Musharaka	558	530	925	1,152
2. Security Deposits	5	6	8	9
Other Liabilities	85	61	83	90
Equity				
Total Equity	384	385	288	265
Total Liabilities & Equity	**1,031**	**983**	**1,306**	**1,516**
INCOME STATEMENT				
Gross Revenue	93	137	166	213
Financail Charges	(41)	(66)	(97)	(133)
Other Income	12	15	8	5
Operating Expenses	(58)	(73)	(51)	(62)
Pre-Provision Operating Profit/(Loss)	**203**	291	322	413
Provisions for Doubtful Debts		-	-	(69)
Management Fee	(0)	(2)	(3)	-
Profit Before Taxes	2	11	24	(46)
Net Income	2	**11**	**24**	**(46)**
Ratio Analysis				
Profitability Ratios				
ROA	0.3%	1.0%	1.7%	-2.9%
Cost-to-Total Net Revenue	90.2%	85.1%	65.6%	73.0%
Net Non-Earning Assets / Assets net of Non-Interest Lia	3.5%	1.9%	2.6%	-2.7%
Net Non-Earning Assets / Equity	8.6%	4.5%	11.2%	-14.3%
Capital Adequacy				
Equity / Total Assets	37.2%	39.2%	22.1%	17.5%
Funding & Liquidity				
Short Term Funding/Total Funding	55.1%	55.4%	83.4%	96.3%
Loan Loss Coverage				
Impaired Lending/Gross Finances	11.8%	9.9%	7.8%	6.2%
Net Impaired Lending/ Equity	3.7%	3.7%	4.9%	5.4%

STANDARD RATING SCALES & 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

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
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.
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.
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 or economic conditions are more likely to impair this capacity.
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+ **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.
CCC **CC** **C**	**Very high 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.

Short Term Ratings

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.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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, a suspended 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, or e) the entity/issuer defaults.

Regulatory and Supplementary Disclosure

Rated Entity	
Name of Rated Entity	KASB Modaraba
Sector	Modaraba
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
23-Sep-15	BBB+	A2	Positive	Initial

Methodology:

Sector Research: Modaraba - Viewpoint - Sep16

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Rating Team Statement

Rating Procedure

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