



The Pakistan Credit Rating Agency Limited

## ORIX MODARABA

	INITIAL [JAN-17]	REPORT CONTENTS
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JANUARY 2017

**Profile & Ownership**

- An Islamic financial institution, established in 1987
- Primarily engaged in financing of plant, machinery and vehicles through ijarah and musharika, and housing via musharaka
- Standard chartered bank (Pakistan) Limited, as part of its divestment strategy sold its 100% shares of Standard Chartered Services of Pakistan (Pvt.) limited and its 20% (direct & indirect) stake in Orix Modaraba to Orix Leasing Pakistan (OLP).
- Name of modaraba management company and modaraba changed to Orix Services Pakistan (Pvt.) Limited (OSPL) and Orix Modaraba respectively.
- Orix Leasing Pakistan Limited holds 20% ownership stake in OrixM through OSPL.
- Listed on Pakistan Stock Exchange

**Governance**

- BoD comprises six members including the CEO.
- Four board members are ex-officio nominees of OLP.
- During the year subsequent to the change in ownership apart from CEO five new board members joined the board.
- Chairman Shaheen Amin, CEO of OLP, has extensive experience of over 30 years.
- Board has made two committees namely Audit committee and Human Resource & Remuneration committee both chaired by an independent director.

**Management**

- Mr. Raheel Qamar Ahmad is CEO since 2011 and has over 25 years of experience in corporate and investment banking.
- Lean organizational structure with a professional management team.

**Risk Management**

- Comprehensive risk management systems in place.
- Financing book majorly comprise Ijarah (FY16: 77%; FY15: 77%).
- Ijarah portfolio dominated by corporate segment (90%) while diminishing musharika mainly comprises individuals (60%).
- High top 20 credit concentration in financing book (ijarah: 50%; diminishing musharika: 62%).
- NPLs as percentage of finances has improved owing to classification of loan of PKR 115mln as regular and recovery of PKR 26mln (FY16: 2.0%; FY14: 5.2%).

**Performance**

- During FY16, ORIXM's spread declined owing to decline in asset yield (FY16: 10.4%; FY15: 10.6%).
- Lesser ijarah rental and other income were the main reason of decrease in revenue however reversal of provisions helped the modaraba to register strong though decreased net income (FY16: PKR 173mln; FY15: 195mln).
- Going forward, the management intends to enhance its overall portfolio taking comfort from new sponsor's expansion strategy. In this regard SMEs would remain key focus in the near future. Moreover, management also plans to increase its share in diminishing Musharika to 40%.

**Financial Risk**

- ORIXM's funding mix consists of two main sources: (i) Certificates of Musharika (89%) and (ii) Musharika financing (11%).
- Diversified funding base as CoMs are mainly mobilized from individuals (78%) followed by corporates (22%).
- ORIXM has utilized 37% of the funding lines available from different FIs.
- Limited exposure to interest rate risk given the financing book and COMs linkage with floating rates.
- Higher concentration risk as top ten CoMs increased significantly to 38% in FY16 (FY15: 14%).
- Maintained leveraged capital structure despite reduction in COMs (Debt to Equity ratio: FY16: 2.7x; FY15: 2.7x)

**RATING RATIONALE**

ORIX Modaraba's acquisition by ORIX Leasing Pakistan Limited (OLP) been completed in FY16, wherein, OLP has acquired 100% stake in Modaraba's management company - now called ORIX Services Pakistan Limited (OSPL) - and 20% stake (direct and indirect) in ORIX Modaraba ORIXM). This acquisition while further strengthening the risk management framework of ORIXM is expected to benefit the Modaraba through established outreach and experience of parent, particularly in SME segment, which the management of Modaraba has identified as key growth driver.

On standalone basis, ORIX Modaraba enjoys sound financial profile emanating from low leveraging, managed liquidity, and sustained profitability. Moreover, good management quality, strong risk management systems, and control environment provide strength to ORIXM's profile. The Modaraba maintains its healthy performance - particularly asset quality and profitability. The management's new business strategy envisages volumetric growth in assets to improve its performance trends. The expected growth would be funded through mix of internal sources and debt. However, the management expects to maintain the leveraging pattern at comfortable level.

**KEY RATING DRIVERS**

The ratings are dependent on the management's ability to sustain its strong financial profile while ensuring stable profitability.

**INDUSTRY SNAPSHOT**

- 25 Modarabas
- Intense competition from established financial institutions(FIs) owing to small network and similar nature of products being offered by these FIs.
- Draft Regulations 2015, 2016 Draft Amendments in Modaraba Rules 1981, and 2016 Draft Modaraba Amendments Bill circulated by SECP.
- Restriction on issuance of COIs in Draft Modaraba Amendments Bill circulated by SECP.



<b>Orix Modaraba</b>	<i>PKR mln</i>			
<b>BALANCE SHEET</b>	<b>30-Sep-16</b>	<b>30-Jun-16</b>	<b>30-Jun-15</b>	<b>30-Jun-14</b>
	<b>1Q</b>	<b>Annual</b>	<b>Annual</b>	<b>Annual</b>
<b>Assets</b>				
<b>Finances</b>				
a) Musharika Financing	1,282	1,199	1,063	1,206
b) Investment in Ijarah Finance	3,591	3,638	3,539	4,195
c) Sukuks	-	-	-	-
Deposits with banks	359	217	248	124
Other Non Earning Assets	200	223	227	364
Non-Performing Finances	98	98	240	274
Less: Provision for Doubtful Receivables	(98)	(98)	(137)	(127)
Net Non-Performing Finances	-	-	103	147
<b>Total Assets</b>	<b>5,432</b>	<b>5,278</b>	<b>5,180</b>	<b>6,035</b>
<b>Liabilities</b>				
<b>Funding</b>				
a) Certificates of Mushariks	2,962	2,794	2,684	2,774
b) Morabaha Financing	-	-	-	-
c) Musharika Financing	278	328	478	1,041
d) Lease Rentals received in Advance	732	712	623	838
Other Liabilities	408	267	243	288
<b>Total Equity</b>	<b>1,052</b>	<b>1,176</b>	<b>1,153</b>	<b>1,094</b>
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>5,432</b>	<b>5,278</b>	<b>5,180</b>	<b>6,035</b>
<b>INCOME STATEMENT</b>				
Gross Revenue	108	468	587	655
Financial Charges	(53)	(223)	(313)	(386)
Other Income	9	27	66	35
Operating Expense	(33)	(113)	(103)	(95)
Pre-provision Profit	32	160	236	209
Provision for doubtful Receivables	2	33	(18)	(6)
Management Fee	(3)	(20)	(23)	(21)
<b>Net Income</b>	<b>30</b>	<b>173</b>	<b>195</b>	<b>182</b>
<b>Ratio Analysis</b>				
<b>Profitability Ratios</b>				
ROA	2.3%	3.2%	3.5%	2.8%
Cost-to-Total Net Revenue	50.6%	41.4%	30.4%	31.2%
<b>Capital Adequacy</b>				
Equity / Total Assets	19.4%	22.3%	22.3%	18.1%
<b>Funding &amp; Liquidity</b>				
Short Term Funding/Total Funding	80.4%	77.7%	84.4%	84.4%
<b>Loan Loss Coverage</b>				
Impaired Lending/Total Finances	2.0%	2.0%	5.2%	5.1%
Net Impaired Lending/Total Equity	9.4%	8.4%	20.8%	25.1%



## 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.

<b>LONG TERM RATINGS</b>		<b>SHORT TERM RATINGS</b>
<b>AAA</b>	<p><b>Highest credit quality.</b> Lowest expectation of credit risk.</p> <p>Indicate exceptionally strong capacity for timely payment of financial commitments.</p>	<p><b>A1+:</b> The highest capacity for timely repayment.</p> <p><b>A1:</b> A strong capacity for timely repayment.</p> <p><b>A2:</b> A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>A3:</b> An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>B:</b> The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.</p> <p><b>C:</b> An inadequate capacity to ensure timely repayment.</p>
<b>AA+</b> <b>AA</b> <b>AA-</b>	<p><b>Very high credit quality.</b> Very low expectation of credit risk.</p> <p>Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.</p>	
<b>A+</b> <b>A</b> <b>A-</b>	<p><b>High credit quality.</b> Low expectation of credit risk.</p> <p>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.</p>	
<b>BBB+</b> <b>BBB</b> <b>BBB-</b>	<p><b>Good credit quality.</b> Currently a low expectation of credit risk.</p> <p>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.</p>	
<b>BB+</b> <b>BB</b> <b>BB-</b>	<p><b>Moderate risk.</b> Possibility of credit risk developing.</p> <p>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.</p>	
<b>B+</b> <b>B</b> <b>B-</b>	<p><b>High credit risk.</b></p> <p>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.</p>	
<b>CCC</b> <b>CC</b> <b>C</b>	<p><b>Very high credit risk.</b></p> <p>“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.</p>	
<b>D</b>	<p>Obligations are currently in default.</p>	

**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.

**Disclaimer:** PACRA's rating is an assessment of the credit standing of an entity/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.



<b>Name of Rated Entity</b>	Orix Modaraba	
<b>Sector</b>	Modaraba	
<b>Type of Relationship</b>	Solicited	
<b>Purpose of the Rating</b>	Independent Risk Assessment	
<b>Related Criteria and Research</b>		
Rating Methodology	Non Banking Finance Companies Methodology	
Sector Research	Modaraba Sector - Viewpoint   Sep16	
<b>Rating Analysts</b>	Aisha Khalid <a href="mailto:aisha@pacra.com">aisha@pacra.com</a> (92-42-35869504)	Rana M. Nadeem <a href="mailto:nadeem@pacra.com">nadeem@pacra.com</a> (92-42-35869504)
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