



The Pakistan Credit Rating Agency Limited

# KASB MODARABA RATING REPORT

	<b>NEW [Nov-17]</b>	<b>PREVIOUS [MAY-17]</b>
Long-Term	BBB+	BBB+
Short-Term	A2	A2
Outlook	Stable	Stable

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NOVEMBER 2017

## Profile & Ownership

- KASB Modaraba (KASBM) established in 1990, is a perpetual, multipurpose Modaraba with a network of 1 head office and 3 branches.
- The Modaraba, listed on Pakistan Stock Exchange is primarily engaged in financing through Ijarah, Morabaha, Musharaka, Diminishing Musharaka and Modaraba.
- Modaraba'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 & Management

- BoD of KIPL comprises four members including the CEO of KASB Modaraba.
- Syed Waseem ul Haq Haqqie, is the chairman of the board, a senior chartered accountant by profession.
- Aftab Afroz Mahmoodi is the CEO since Mar-17. He has over all 32 years of experience with 22 years in the financial sector. He is supported by a Competent and experienced management team.
- Well defined organizational structure; 4 departments' reports to the respective heads who in turn reports to the CEO. Head of Internal Audit reports to the Audit Committee/Board.

## Risk Management Framework

- Concentrated portfolio dominated by Diminishing Musharakah (~39.5%) and Morabaha 38.7%) at end-Jun17.
- Asset quality in existing credit portfolio is somehow increased, though the financing book has decreased (Impaired lending / Gross Finances: FY17: 20.0%; FY16: 10.7%; FY15: 9.9%).
- However, non-performing loans are mostly provided (3MFY18: 87%; FY17: 86%), thus the potential drag on equity is low (Net NPLs / Equity: FY17: 3.3%; FY16: 3.6%).
- Diminishing Musharaka's (DM) top twenty exposures constitute 31% of the portfolio at end-FY17. Ijarah's top twenty customers' concentration stood at 7%.
- During 3MFY18, Modaraba financing book skewed towards Morabaha as compared to DM FY17 (40%), DM (37%), Modaraba (14%), and Ijarah (9%). Modaraba total assets stands at PKR 350mln.

## Performance

- During 3MFY18, a reduction in earning assets, Modaraba's gross revenue declined prominently (3MFY18: PKR 49mln; FY17: PKR 65mln; 3MFY17: PKR35mln).
- Lower gross revenue further leads to lower net revenue (3MFY18: PKR13mln; FY17: PKR 60mln; 3MFY17: PKR 91mln) despite the lower financial cost.
- Modaraba managed admin expenses, but KASBM's profitability on a YoY basis stood at (PAT: 3MFY18: PKR 1mln; FY17: PKR 5mln; 3MFY17: PKR 2mln).
- 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. Further Modaraba is making efforts to recover its receivable and to negotiate for the funding lines.

## 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 3MFY18 are at ~PKR 73mln (FY17: PKR 100mln).
- The Modaraba plans to raise new funding lines from banks; facility of PKR100mln from JS Bank is in the process from which 63mln has been already utilized by it.
- Low leveraged capital structure; debt-to-equity ratio of 0.33x at end-FY17 which is a depiction of maturing COM's.

## RATING RATIONALE

The ratings reflect KASBM's adequate financial profile emanating from low-leveraged capital structure, depicting maturing COM's. The Modaraba continues to remain profitable, albeit miniscule. In FY16, SECP restricted KASBM from raising new CoMs. This decision is subject to reconsideration depending on the performance of the Modaraba in FY17 but still pending with SECP. Owing to this restriction, KASBM has experienced contraction in its COMs (3MFY18: PKR 73mln; FY17: PKR 100mln; FY16: PKR 425mln). KASBM has religiously met all the maturities of COM's. The Modaraba witnessed squeeze in its assets, with a consequent impact on performance of the Modaraba. Liquidity is being well managed. However, the management's ability to establish a stable and continuous non-deposit funding stream would be demonstrated over a longer horizon. Moreover, good asset quality provides comfort. Modaraba is making continuous efforts to recover its receivable and negotiating for more funding lines. To meet the funding challenge though, the management is also controlling its cost structure within bound. Moreover, the management intends to follow cautious growth stance with continued focus on asset quality by cost cutting. Modaraba more focus is towards more funding lines from banks and search for new businesses for Modaraba to survive.

## 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 taking new funding lines and tapping new stable avenues of funding to improve business profile is important.

## INDUSTRY SNAPSHOT

- Industry comprises 25 Modarabas.
- Intense competition from established financial institutions (FIs) owing to small network and similar nature of products being offered by these FIs.
- SECP grants authorization to float two new Modaraba of PKR 800mln.



<b>KASB MODARABA</b>				
				<i>PKR mln</i>
<b>BALANCE SHEET</b>	<b>30-Sep-17</b>	<b>30-Jun-17</b>	<b>30-Jun-16</b>	<b>30-Jun-15</b>
<b>Assets</b>				
<b>Finances</b>				
1. Morabaha	142	150	267	313
2. Musharaka	-	-	-	31
3. Ijarah	28	32	53	35
4. Modaraba	49	51	54	23
5. Diminishing Musharaka	131	153	316	354
6. Finance Lease	-	-	0	0
Other Earning Assets	88	84	112	148
Other Non-Earning Assets	116	116	85	64
Non-Performing Finances	96	97	83	83
Less : Provision for Doubtful Debts	(84)	(84)	(69)	(69)
Net Non Performing Finances	13	13	14	14
<b>Total Assets</b>	<b>567</b>	<b>600</b>	<b>901</b>	<b>983</b>
<b>Liabilities</b>				
<b>Funding</b>				
1. Certificate of Musharaka	73	100	425	530
2. Security Deposits	10	10	12	6
Other Liabilities	91	98	75	61
<b>Equity</b>				
Total Equity	392	391	389	385
<b>Total Liabilities &amp; Equity</b>	<b>567</b>	<b>600</b>	<b>901</b>	<b>983</b>
<b>INCOME STATEMENT</b>				
Gross Revenue	9	65	116	137
Financail Charges	(3)	(21)	(51)	(66)
Other Income	8	16	26	15
Operating Expenses	(13)	(61)	(77)	(73)
Pre-Provision Operating Profit/(Loss)	<b>1</b>	<b>(1)</b>	<b>13</b>	<b>13</b>
Provisions for Doubtful Debts				-
Management Fee	(0)	(0)	(1)	(2)
Profit Before Taxes	1	5	8	11
<b>Net Income</b>	<b>1</b>	<b>5</b>	<b>8</b>	<b>11</b>
<b>Ratio Analysis</b>				
<b>Profitability Ratios</b>				
ROA	0.4%	0.8%	0.9%	1.0%
Cost-to-Total Net Revenue	95.2%	101.6%	85.5%	85.1%
Net Non-Earning Assets / Assets net of Non-Interest Liabilities	17.6%	16.6%	2.9%	3.7%
Net Non-Earning Assets / Equity	23.9%	24.0%	6.2%	9.0%
<b>Capital Adequacy</b>				
Equity / Total Assets	69.2%	65.3%	43.2%	39.2%
<b>Funding &amp; Liquidity</b>				
Short Term Funding/Total Funding	65.0%	60.3%	55.4%	55.4%
Top 20 Deposits / Total Deposits	99.6%	80.0%	80.0%	64.3%
<b>CREDIT RISK</b>				
Impaired Lending/Gross Finances	21.6%	20.0%	10.7%	9.9%
Net Impaired Lending/ Equity	3.2%	3.3%	3.6%	3.7%
Top 20 Performing Advances / Total Advances	76.6%	76.6%	68.3%	57.4%

KASB Modaraba

Nov-17

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## 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.

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

<p><b>Outlook (Stable, Positive, Negative, Developing)</b> 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’.</p>	<p><b>Rating Watch</b> 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.</p>	<p><b>Suspension</b> 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.</p>	<p><b>Withdrawn</b> 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</p>
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Regulatory and Supplementary Disclosure

Rated Entity

Name of Rated Entity

KASB Modaraba

Sector

NBFC & Modaraba

Type of Relationship

Solicited

Purpose of the Rating

Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
10-Nov-17	BBB+	A2	Stable	Maintain
26-May-17	BBB+	A2	Stable	Maintain
23-Sep-16	BBB+	A2	Stable	Maintain
23-Sep-15	BBB+	A2	Positive	Initial

Methodology:

Non-Banking Financial Institution Methodology

Sector Research:

NBFCs & Modaraba - Viewpoint - Mar17

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Rating Team Statement

Rating Procedure

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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.

Probability of Default (PD)