



The Pakistan Credit Rating Agency Limited

## Rating Report

### First Habib Modaraba

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Sep-2022	AA+	A1+	Stable	Maintain	-
23-Sep-2021	AA+	A1+	Stable	Maintain	-
25-Sep-2020	AA+	A1+	Stable	Maintain	-
26-Sep-2019	AA+	A1+	Stable	Maintain	-
27-Mar-2019	AA+	A1+	Stable	Maintain	-
22-Nov-2018	AA+	A1+	Stable	Maintain	-
30-Jun-2018	AA+	A1+	Stable	Maintain	-
30-Dec-2017	AA+	A1+	Stable	Maintain	-
23-Jun-2017	AA+	A1+	Stable	Maintain	-
30-Dec-2016	AA+	A1+	Stable	Maintain	-

#### Rating Rationale and Key Rating Drivers

The ratings reflect First Habib Modaraba's (FHM or the Modaraba) strong business profile, emanating from a healthy asset base, sound asset quality, and improved profitability. FMH documented robust performance for FY 2021-22, which was one of the best years in the operational history of FHM in terms of profitability and overall business growth. Additional comfort is derived from the Modaraba's affiliation with a renowned sponsor entity (Habib Metropolitan Bank). The presence of industry veterans in the management structure, along with the implementation of a robust internal control system, is considered pivotal in the operational efficiency of the Modaraba. Liquidity is being well maintained by investing in term deposits. FHM managed to sail through its devised strategy to beef up its business volumes to maintain its bottom-line performance by maintaining its asset quality. FHM's capital provides strong support to the funding structure of the Modaraba, equally aided by Certificates of Musharaka (CoM). The strong capital adequacy ratio portrays Modaraba's strong capital position. Moreover, new tax regulations will potentially aid Modarabas to furnish their equity base. Going forward, the management, while continuing with its growth strategy, intends to diversify its revenue streams through a diversified product portfolio and different business models. The Modaraba is evolving its long-term strategic vision to remain competitive in the increasingly complex financial landscape.

The ratings remain dependent on the management's ability to sustain its competitive positioning while ensuring stable profitability. The ratings also depend upon keeping its financial profile intact. Any significant change in its risk profile may adversely impact the ratings.

#### Disclosure

<b>Name of Rated Entity</b>	First Habib Modaraba
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Entity Rating
<b>Applicable Criteria</b>	Methodology   Correlation Between Long-term & Short-term Rating Scales(Jun-22),Methodology   Rating Modifiers(Jun-22),Methodology   Non-Banking Finance Companies Rating(Jun-22)
<b>Related Research</b>	Sector Study   Modaraba & NBFCs(Apr-22)
<b>Rating Analysts</b>	Muhammad Noor Ul Haq   noorulhaq@pacra.com   +92-42-35869504

## Profile

**Structure** First Habib Modaraba (FHM) has been established as a Non-Banking Islamic Financial Institution. The Company is listed on the Pakistan Stock Exchange, denoted by the trading symbol of "FHAM".

**Background** First Habib Modaraba was established in 1985 as a perpetual multipurpose modaraba, carrying out operations primarily in the Islamic mode of leasing business on the principles of Islamic Shari'a. Habib Metropolitan Modaraba Management Company (Pvt.) Limited is the management company of Modaraba.

**Operations** FHM offers Ijarah and Diminishing Musharika financing, primarily for plant & machinery and vehicles. In early FY19, the Modaraba engaged in window operations in Habib Metro Bank branches for the development and proposition of Islamic Financial to clientele to whom such investments show promise.

## Ownership

**Ownership Structure** The major shareholding of the Company is held by Habib Management Private Limited (54%), whereas 10% shareholding is held by the modaraba management company (Habib Metropolitan Modaraba Management Company). The remainder shareholding is distributed between various individuals, corporates, financial institutions and other parties.

**Stability** FHM is proceeding on a path of growth, in terms of business scale and size of financial assets on sound footings. A generally prudent approach is adopted by FHM in its prospective expansion plans.

**Business Acumen** Apart from HMBL, the sponsor has a strategic stake in other sectors as well. The ownership of HMBL has been deemed to be fruitful for FHM as it has succeeded in achieving many milestones and has developed a formidable position in the sector, which signifies a strong sponsor acumen.

**Financial Strength** Habib Metro Bank Limited is the sponsor of FHM. HMBL, possesses an asset base of over PKR 1,224bln and advances of over PKR 398bln as of CY21, carrying a strong financial profile

## Governance

**Board Structure** The board of FHM is structured with six members, composed of two Independent Directors, three non-executive directors and one executive director, the CEO of the Modaraba. The board of directors of FHM comprises professionals having vast experience in the banking and finance sectors.

**Members' Profile** The position of board Chairman has been held by Mr. Syed Rasheed Akhtar, a reputed professional of the banking industry, possessing professional experience of over 36 years. He has served in various senior management positions throughout his tenure, with prominent positions held in Bank Indosuez, Habib Bank AG Zurich and HBZ Bank Limited, South Africa.

**Board Effectiveness** The board has established two board-level committees, namely; the Audit Committee and Human Resource Committee, chaired by independent directors. The board performance is stipulated as per SECP Regulations and provides oversight effectiveness, observed through the conduction of periodic meetings.

**Financial Transparency** M/s. EY Ford Rhodes, Chartered Accountants are the External Auditor of FHM. They have expressed an unqualified opinion on the FHM's financial statements for FY21.

## Management

**Organizational Structure** A lean organization has been implemented by the Company, with reporting lines ultimately converging towards the CEO of the Company, the Internal Audit department being an exception as it reports directly to the Audit Committee. The management team comprises seasoned and loyal professionals. There are currently three Management Committees in place, namely, i) Credit Committee, ii) Market Investment Committee and iii) Assets and Liability Management Committee.

**Management Team** The Modaraba is led by Mr. Shoaib Ibrahim as the Chief Executive Officer. He is a veteran of the Non-Banking Islamic Financial industry, being the previous chairman of the NBFIs and Modaraba Association, with a career spanning over 30 years.

**Effectiveness** The management has developed a broad "Code of Conduct", which outlines FHM's standard of conduct and the Modaraba's compliance with different stakeholders' expectations including certificate holders, employees, regulators and the community at large. All management committees conduct meetings periodically, with operational discussions being the agenda of meetings.

**MIS** FHM has in-house developed ERP-based MIS (ERP-I) for efficient and timely reporting. Current MIS can be classified into three categories based on periodicity – Daily, Weekly and Monthly.

**Risk Management Framework** Management of FHM continued to explore opportunities to achieve its strategic objectives while ensuring proper implementation of RMF. FHM maintains a strong interdepartmental communication link on risk factors and encourages a culture of collaboration in decision-making amongst all departments.

## Business Risk

**Industry Dynamics** The business environment in the country remained challenging, and measures taken by the Government toward economic stabilization have impacted overall business sentiments. Due to adverse economic indicators in recent periods, the scenario has turned into a gloomy outlook. The transportation sector has also been under strain and disbursements in the vehicle business were conservatively reduced, however gradual revival of the sector seems imminent. The cost of business has risen and NBFCs continue to face stiff competition from banks

**Relative Position** First Habib Modaraba has established itself as one of the leading players in the Modaraba industry, acquiring a share of ~27% based on total assets.

**Revenues** The recovering economy boded positively for the key revenue generators of the Company, as Income from lease financing observed growth of 6% on a YoY basis (FY22: PKR 138mln; FY21: PKR 129mln, 9MFY22: PKR 111mln; 9MFY21: PKR 66mln) whereas Income from Diminishing Musharakah financing observed growth of 79% on a YoY basis (FY22 PKR 1,424mln; FY21: PKR 796mln, 9MFY22: PKR 897mln; 9MFY21: PKR 572mln). Total income of PKR 518mln was achieved during 9MFY22 (FY21: PKR 607mln), with the contribution mix being gross Musharaka Financing at 89% and lease financing at 11% of total gross revenue.

**Performance** Stability continues to be depicted in the financial performance of the Company. In line with the growing topline, the financing costs grew in proportion, in addition to other costs which remained in line. Further, as per the recent regulation change, the Company has paid tax expenses of PKR 113mln in the recent period, leading to a profit of PKR 382mln for the period ended FY22. The stable performance of the Modaraba is further indicated by its stable return on assets (9MFY22: 2.5%; FY21: 3.3%; FY20: 3.0%).

**Sustainability** Given its strong risk management framework, business is conducted with low-risk customers. In terms of market segmentation, Modaraba intends to focus on the following sectors; i) Food & Allied Products ii) Services iii) Energy & Power iv) Pharmaceuticals v) Steel and Cement vi) Healthcare and vii) Education. Further, Modaraba intends to enhance market reach in new cities and add sound customer base.

## Financial Risk

**Credit Risk** FHM credit risk is primarily managed through a comprehensive credit policy, which is pre-approved by the Board of Directors (BoD). The Modaraba has decreased its investments in debt instruments, reducing its Term Deposit Musharaka (TDM) and directing funds into Sukuks. Further, the financing mix of FHM is concentrated in three sectors, namely; i) Pharmaceutical ii) Services iii) Food & Allied.

**Market Risk** The Modaraba has developed a comprehensive investment policy that contains provisions for the activities of the overall investment portfolio as well as per scrip exposure. FHM's investment portfolio continues to be dominated by highly rated entity investments, along-with subtle exposure to Sukuk investments and TDMs.

**Liquidity And Funding** The Modaraba has issued COMs for 3 months, 6 months, and 1-year periods. However, the overall portfolio is tilted towards 3 months maturity, which depicts market confidence in the Modaraba. The option to avail of additional finances in case of any adverse event is available from the group bank. The liquidity position of the Modaraba is as; Liquid Assets / Total Funding ratio (9MFY22: 3.0%; FY21: 9.2%; FY20: 11.5%). The Modaraba obtains primary funding from Certificates of Musharika (CoM).

**Capitalization** FHM has a CAR of 33% in FY21, portraying Modaraba's strong position, should adverse circumstances arise. FHM's substantial growth in asset base would need to be financed through either fresh equity injection or borrowed funds. This is prominent by an increase in the funding base by the Modaraba to increase the financing portfolio.



**First Habib Modaraba  
Listed Public Limited**

*PKR mln*

*PKR mln*

*PKR mln*

*PKR mln*

**Mar-22**

**Jun-21**

**Jun-20**

**Jun-19**

**9M**

**12M**

**12M**

**12M**

**A BALANCE SHEET**

1 Total Finance-net	14,901	10,705	8,696	9,804
2 Investments	395	303	188	242
3 Other Earning Assets	346	697	666	838
4 Non-Earning Assets	219	267	253	232
5 Non-Performing Finances-net	193	151	110	8
<b>Total Assets</b>	<b>16,053</b>	<b>12,123</b>	<b>9,913</b>	<b>11,124</b>
6 Funding	11,432	7,701	5,817	6,997
7 Other Liabilities	751	593	462	491
<b>Total Liabilities</b>	<b>12,183</b>	<b>8,294</b>	<b>6,280</b>	<b>7,487</b>
<b>Equity</b>	<b>3,870</b>	<b>3,828</b>	<b>3,634</b>	<b>3,637</b>

**B INCOME STATEMENT**

1 Mark Up Earned	1,009	972	1,332	1,009
2 Mark Up Expensed	(569)	(423)	(765)	(543)
3 Non Mark Up Income	77	58	47	36
<b>Total Income</b>	<b>518</b>	<b>607</b>	<b>613</b>	<b>502</b>
4 Non-Mark Up Expenses	(163)	(202)	(194)	(174)
5 Provisions/Write offs/Reversals	(48)	(41)	(102)	(8)
<b>Pre-Tax Profit</b>	<b>306</b>	<b>363</b>	<b>317</b>	<b>320</b>
6 Taxes	(40)	-	-	-
<b>Profit After Tax</b>	<b>266</b>	<b>363</b>	<b>317</b>	<b>320</b>

**C RATIO ANALYSIS**

**1 PERFORMANCE**

a Non-Mark Up Expenses / Total Income	31.6%	33.3%	31.7%	34.7%
b ROE	9.2%	9.7%	8.7%	8.8%

**2 CREDIT RISK**

a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	130.3%	139.0%	149.5%	140.1%
b Accumulated Provisions / Non-Performing Advances	N/A	N/A	N/A	N/A

**3 FUNDING & LIQUIDITY**

a Liquid Assets / Funding	6.5%	13.1%	14.7%	15.6%
b Borrowings from Banks and Other Financial Institutes / Funding	6.5%	0.6%	0.0%	0.0%

**4 MARKET RISK**

a Investments / Equity	10.2%	7.9%	5.2%	6.7%
b (Equity Investments + Related Party) / Equity	10.2%	7.9%	5.2%	6.7%

**5 CAPITALIZATION**

a Equity / Total Assets (D+E+F)	24.1%	31.6%	36.7%	32.7%
b Capital formation rate (Profit After Tax + Cash Dividend) / Equity	9.3%	10.0%	8.7%	N/A

**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)

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- 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 | Clause 11-(A)(p).
- (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)
- (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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