



The Pakistan Credit Rating Agency Limited

Rating Report

First Punjab Modaraba

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Sep-2021	A-	A2	Stable	Maintain	-
25-Sep-2020	A-	A2	Stable	Maintain	-
27-Sep-2019	A-	A2	Stable	Maintain	-
29-Mar-2019	A-	A2	Stable	Maintain	-
04-Dec-2018	A-	A2	Stable	Maintain	-
30-Jun-2018	A-	A2	Stable	Maintain	-
30-Dec-2017	A-	A2	Stable	Maintain	-
31-May-2017	A-	A2	Stable	Upgrade	-
28-Dec-2016	BBB+	A2	Positive	Maintain	-
13-Feb-2016	BBB+	A2	Stable	Maintain	-

Rating Rationale and Key Rating Drivers

The ratings reflect the strong patronage of the Modaraba; The Bank of Punjab (BoP) (Rated AA+ by PACRA). The topline decreased on account of decline in interest rates, however, the impact of said decline was in turn subsided by considerable fall in finance costs, providing comfort to the bottom-line for the period. In this regard, recovery of NPLs also helped. In order to mitigate the effect of accumulated losses, First Punjab Modaraba (FPM) intends to enhance its equity base through further injection of equity from the sponsor. The plan is at an advanced stage. The company has managed to sustain its earning assets, mainly lending book wherein vehicle financing contributed majorly. The key sponsor is committed for its support in the form of a sustainable funding base. The management is in the process of generating new avenues of business. A comprehensive business plan is under development, which shall be approved by BoP's board. The lending stagnated during COVID-19, as transportation sector, a niche of FPM, was severely impacted. From July 20 onwards, transportation sector picked up the pace which led to spiked lending levels in the quarter ending Sep'20. However, after the said quarter, lending levels of FPM showed the normal trend as that was before July'20, regardless of stability in the transport sector. The management's efforts to sustain and ultimately improve its business profile is expected to yield sustainable results; however, materialization is contingent upon the timely implementation. Support from sponsor is vital.

The ratings are dependent on relative positioning of the Modaraba in the sector and sustained asset quality of the new portfolio: achieving bottom line profitability is important. Meanwhile, any weakening in the financial profile or support from the sponsor could have negative implications.

Disclosure

Name of Rated Entity	First Punjab Modaraba
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Non-Banking Finance Companies Rating(Jun-21),Criteria Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria Rating Modifiers(Jun-21)
Related Research	Sector Study Modaraba & NBFCs(Apr-21)
Rating Analysts	Muhammad Noor Ul Haq noorulhaq@pacra.com +92-42-35869504

Profile

Structure First Punjab Modaraba (FPM), established in 1992, is a perpetual multi-purpose Modaraba listed on PSX. FPM is managed by Punjab Modaraba Services (Pvt) Ltd, a wholly owned subsidiary of The Bank of Punjab (BoP).

Background The Modaraba has remained successful in maintaining its growth trend by increase in total assets, certificate holder's equity and lending portfolio. On the basis of improved financial health and performance during last 5 years, the Registrar Modaraba SECP granted permission to raise funds from institutions through issuance of Certificates of Musharikhah (COMs).

Operations The Modaraba caters to corporate, commercial and individual customers through various modes of Islamic financing mainly Ijarah, Morabaha and Musharikhah. Musharikhah pertains to vehicles financing. Ijarah focuses on plant & machinery, vehicles and Home Decor Scheme. Morabaha targets raw material (working capital) financing for different sectors.

Ownership

Ownership Structure Punjab Modaraba Services (Pvt.) Limited (PMSL) holds ~39% stake in the FPM. PMSL is a wholly owned subsidiary of The Bank of Punjab (BoP). The general public has ~40% stake in FPM. The remaining shareholding is split amongst a number of financial institutions and corporate entities.

Stability Since FPM is managed by PMSL - fully owned subsidiary of BoP (in which Government of Punjab (GoPb) has majority stake). BoP and invariably GoPb stands behind the Modaraba as it has been providing financial assistance for the past many years.

Business Acumen The Board includes senior members from the management of BoP bringing with them strong business skill set which is critical for the sustainable success of the entity. The Modaraba stands to gain from the BoPs industry-specific working knowledge of lending and financing diverse set of customers and sectors across Pakistan.

Financial Strength The Government of Punjab (GoPb) maintains majority stake in BoP (58%). While BoP has no contractual obligation to support FPM in a distressed situation, yet in the wake of deterioration in FPM's financial profile, the Bank has demonstrated its resolve to provide assistance to FPM by approving Musharikhah finance facility of PKR 1,585mln and roll over of Certificates of Musharika amounting to PKR 413mln.

Governance

Board Structure FPM's Board of Directors (BoD) comprises seven members including CEO, all other members are non-executive and nominees from BoP. Mr. Umer Iqbal Sheikh, Head of Islamic banking BoP, joined the board of FPM. In Jan-19, Mr. Khawaja Farooq Saeed, Independent Director, resigned from the board and in place of him Miss Samina Afsar appointed as independent director.

Members' Profile Mr. Nadeem Amir is the CFO of BOP serving as BOD in FPM. He has more than 26 years of experience in banking sector. Two members are independent directors i.e. Mr. Imran Bashir and Ms. Samina Afsar. Mr. Imran Bashir is a practicing Chartered Accountant having over 21 years of experience and has set up his own practice whereas Ms. Samina is associated with leading telecom operator as marketing executive having over 15 years of experience.

Board Effectiveness FPM has constituted two board committees (Audit Committee and Human Resource & Remuneration Committee) to ensure rigorous monitoring of management's policies and entity's operations. Attendance recorded during the BoD and committee meetings was good and minutes have been properly documented.

Financial Transparency EY Ford Rhodes, Chartered Accountants, are the auditor of FPM and have expressed an unqualified conclusion on review of FPM's financial statements for 6MFY21. Meanwhile, ShineWing Hameed Chaudhry & Company is the auditor of the Punjab Modaraba Services (Pvt.) Limited, the management company of FPM.

Management

Organizational Structure The Modaraba has a lean organizational structure. The management team carries good experience profile but is relatively new with FPM. All department heads report directly to the CEO, with the exception of Internal Audit, which reports directly to the Audit Committee.

Management Team Mr. Aamir Malik, CEO of FPM, has more than two decades of experience, mainly at BoP. He has diversified experience of handling banking affairs covering Credit, Branch Banking, Foreign Trade, Recovery and SAM in different Management positions. The team includes a balanced mix of professionals who bring rich experience to the Modaraba.

Effectiveness The Modaraba has four committees at the management level for better functioning of its affairs; a) Credit Committee, b) Investment Committee, c) Asset and Liability Committee, and d) Management Committee. The Modaraba needs to focus on increasing the effectiveness of its management committees in order to monitor performance and assure adherence to the policies and procedures.

MIS FPM has acquired an online, centralized Financial Information System (FIS) Solution that has been custom developed in client / server application architecture that will help in managing the business processes easily and efficiently.

Risk Management Framework The Modaraba has implemented an Obligor Risk Ratings module (ORRs) in order to make prudent credit decisions while taking into account all related factors (industry positioning, ownership, management quality, management experience, obligor's historical conduct, facility structure etc).

Business Risk

Industry Dynamics COVID-19 has adversely impacted the performance of Modarabas owing to increase in overall credit risk, disruption in growth due to slowdown in economic activity and continuity of business operations. Nevertheless, Pakistan has been showing signs of economic recovery with a gradual commencement of dynamism. Further, the impact of tax amendments on the Modaraba sector, as per Finance Act 2021, remains yet to be seen.

Relative Position In terms of Assets, FPM comes in the top five Modarabas of Pakistan with an asset base at 9MFY21 of PKR 1.98bln i.e., ~6.4% of Financial Modaraba Market. The Modaraba commands further support from the fact that BoP owns ~39% and has provided and shall continue to lend support in case of need or financial distress.

Revenues Gross Revenue at 9MFY21 accumulated to PKR 93mln which is mainly driven by Musharaka income (52%) and Ijarah income – net of amortization (43%). Decrease in Gross Revenue (41% YoY) and 12% decrease in Ijarah assets has been observed from Mar-20 to Mar-21.

Performance Decrease in gross revenue was not translated to decrease in bottom-line as Company reported a net profit of PKR 5mln. Although PKR 19mln reversal of provision supported the bottom-line but significant decrease of 41% YoY in finance cost due to lower interest rates bolstered the profitability in Mar-21.

Sustainability Decreasing finance cost has helped the Company by lowering major cost. Going forward, FPM intends to continue with its cautious approach, while targeting quality customers. In terms of customer base, the Modaraba will focus on the transport (private and commercial vehicles) which currently represents ~85% of finances. The management is in the process of generating new avenues of business, for which a comprehensive business plan is under development, to enhance the standalone profitability of the Modaraba prospectively.

Financial Risk

Credit Risk FPM's financing book is dominated by Musharakah of PKR 1.65bln at Mar-21 (Jun-20: PKR 1.71bln). Short term funding is 62% of the total funding. Gross finance is 98% of the total deposits and borrowings which results in mismatch of lending and deposits relationship.

Market Risk Modaraba focuses primarily on core financing business and has no exposure to equity/debt investment. Consequently, FPM is not exposed to market risk.

Liquidity And Funding The Modaraba had availed a Musharikhah finance facility of PKR 1,585mln from its parent bank – BoP as at Mar-19 against approved limit of PKR 1,585mln. Against another available financing facility of PKR 600mln by BOP, FPM has fully availed that facility by issuing CoMs. Furthermore, after approval of SECP for collecting deposits with the limit of PKR 200mln, FPM has collected deposits from corporate customers.

Capitalization Due to lower profitability and owing to reserve build up, equity remained almost stagnant at PKR 142mln at Mar-21 (Jun-20: PKR 149mln). FPM carries a leveraged structure - the total debt/equity ratio lies at 12x at Mar-21 (Jun-20: 11x).



First Punjab Modaraba

PKR mln

BALANCE SHEET	31-Mar-21	30-Jun-20	30-Jun-19	30-Jun-18
	9MFY21	FY20	FY19	FY18
Assets				
Finances				
1. Morabaha	262	274	75	41
2. Musharaka	619	548	814	841
3. Ijarah	447	479	335	206
Other Earning Assets	128	102	101	99
Other Non-Earning Assets	396	501	355	219
Non-Performing Finances	293	648	880	1,030
Less : Provision for Doubtful Debts	(87)	(340)	(339)	(348)
Net Non Performing Finances	207	308	541	681
Less: Suspended Income	(77)	(92)	(92)	(95)
Total Assets	1,981	2,120	2,130	1,993
Liabilities				
Funding				
1. Certificate of Musharaka	1,014	1,014	446	400
2. Morabaha	-	-	-	-
3. Musharaka	632	693	1,258	1,212
4. Security Deposits	54	145	141	113
Other Liabilities	139	119	93	65
Equity				
Total Equity	142	149	193	203
Total Liabilities & Equity	1,981	2,120	2,130	1,993
INCOME STATEMENT				
Gross Revenue	93	195	173	130
Financail Charges	(90)	(208)	(150)	(94)
Other Income	14	9	14	10
Operating Expenses	(29)	(37)	(39)	(35)
Pre-Provision Operating Profit/(Loss)	(13)	(42)	(2)	11
Provisions for Doubtful Debts / Reversals	19	(2)	9	20
Management Fee	-	-	-	(3)
Profit Before Taxes	6	(43)	7	28
Net Income	5	(43)	6	29
Ratio Analysis				
Profitability Ratios				
ROA	0%	-2%	0%	1%
Cost-to-Total Net Revenue	-177%	898%	-106%	-77%
Capital Adequacy				
Equity / Total Assets	7%	7%	9%	10%
Funding & Liquidity				
Short Term Funding/Total Funding	100%	100%	28%	26%
Loan Loss Coverage				
Impaired Lending/Gross Finances	18%	33%	42%	49%
Net Impaired Lending/ Equity (%)	1.45	2.06	2.81	3.35

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	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
AA-	
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.
A-	
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 and in economic conditions are more likely to impair this capacity.
BBB-	
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.
BB	
BB-	
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.
B-	
CCC	Very high credit risk. 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.
CC	
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>Entities</p> <ul style="list-style-type: none"> a) Broker Entity Rating b) Corporate Rating c) Financial Institution Rating d) Holding Company Rating e) Independent Power Producer Rating f) Microfinance Institution Rating g) Non-Banking Finance Companies (NBFCs) Rating 	<p>Instruments</p> <ul style="list-style-type: none"> a) Basel III Compliant Debt Instrument Rating b) Debt Instrument Rating c) Sukuk Rating
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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)

Conduct of Business

- (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)
- (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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