RATING REPORT

Allied Rental Modaraba

REPORT DATE:
May 11, 2021

RATING ANALYSTS:
Maham Qasim
Maham.qasim@vis.com.pk

RATING DETAILS

	Latest Rating	Previous Rating
Rating Category	Long-term	Long-term
Entity	A+	A+
Short-term	A-1	A-1
Rating Date	*June 11, '21*	*December 26, '19*
Rating Outlook	Stable	Stable

COMPANY INFORMATION

Incorporated in 2006	**External auditors:** A.F.Ferguson & Co., a member firm of Price Waterhouse Coopers (PWC)
Public Listed Company	**Chairman:** Mr. Syed Faisal Ali
Key Certificate holders (with stake 5% or more):	**Chief Executive Officer:** Mr. Murtaza Ahmed Ali
Allied Engineering and Services (Private) Limited – 69%	
Allied Engineering Management Company (Private) Limited – 20%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Modaraba Rating Scale

Allied Rental Modaraba

OVERVIEW OF THE INSTITUTION

Allied Rental Modaraba (ARM) was formed under the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 and the Rules framed there under and is managed by Allied Engineering Management Company (Private) Limited. ARM is listed on the Pakistan Stock Exchange.

Profile of the Chairperson

Syed Faisal Ali serves as the Chairman of ARM and Managing Director at Allied Engineering & Services (Pvt) Ltd. Mr. Faisal is also on the board of Allied Engineering Management Co. Pvt Ltd. He previously held the position of Finance Director of Pakistan Herald Publications Ltd

Profile of the CEO

Mr. Murtaza Ahmed Ali is the CEO of Allied Rental Modaraba. He is a fellow member of the Institute of Chartered Accountants of Pakistan (ICAP) and a qualified Cost & Management Accountant. He has got over 25 years of financial and business management experience of working in different industries.

Financial Snapshot

Total Equity: end-HY21: Rs. 5.3b; end-FY20: Rs. 5.4b; end-FY19: Rs. 5.3b; end-FY18: Rs.5.2b

Assets: end-HY21: Rs. 8.4b; end-FY20: Rs. 8.6b; end-FY19: Rs. 8.8b; end-FY18: Rs.9.0b

Profit After Tax:HY21: Rs. 159m; FY20: Rs. 228m; FY19: Rs. 383m; FY18: Rs. 395m

RATING RATIONALE

The ratings assigned to Allied Rental Modaraba (ARM) take into account the company being a wholly owned subsidiary of Allied Engineering & Services (Pvt) Limited (AESL); the latter is the market leader in generator rental business. The implicit support available from AESL, the authorized dealer of Caterpillar (CAT) products in Pakistan, remains a key rating driver. The ratings are underpinned by sound financial risk profile of the company emanating from relatively conservative capital structure, low leverage indicators, adequate liquidity and maintained asset quality with non-performing portfolio being fully provided. In the backdrop of improving power situation in the country, the management's business strategy envisages diversification from power business towards logistics and construction machinery segments. The profitability metrics exhibited slight deterioration owing to curtailed business operations leading to lower deployment of assets amid depressed economic environment in line with prevalent pandemic situation. Given the potential adverse impact on borrowers' repayment capacity due to COVID-19, management will be targeting cautious growth in ijarah assets going forward. Moreover stemming from asset consolidation strategy, debt mobilization is projected to be limited going forward. The ratings are dependent on the management's ability in sustaining its competitive positioning while keeping the financial profile intact.

Key Rating Drivers:

Enhanced focus on machinery and logistics segments as opposed power (gensets) segment in line with change in sector dynamics: The shrinking gap in demand and supply of electricity in line with improved energy production and grid availability over the course of last decade has reflected negatively on the demand prospects of gensets segment. Therefore, the management has decided to gradually streamline the revenue concentration in the gensets segment as a proactive strategy to avoid the dwindling demand of the segment impacting sustainability and profitability of the Modaraba. Although gensets continued to represent the largest proportion of Ijarah assets at 62% (FY19: 62%) the company continued its diversification towards the logistics and construction machinery segments through additions in both segments during the outgoing year. Since the last two fiscal years, ARM has reoriented itself to become a complete rental solution provider for all segments from power to logistics. ARM's current fleet size is around 1,300 units including 450 gensets, 340 inbound and outbound logistics vehicles, 250 infrastructure machines, 225 folk lifter machines and 35 cranes. Due to overall stagnation of the economy, slowdown of investments in infrastructure projects and slashed growth rate in all sectors of economy, ARM's investment remained subdued during the outgoing year and was recorded at Rs 317.0m as compared average of Rs. 1.3b per annum in the last four years.

As per the management, the targeted asset mix for ARM in the long-term is equal bifurcation (33%) amongst all three segments to aide revenue diversification. The machinery equipment includes machineries for road construction, coal & LNG based thermal plants and hydel power projects. Variety of equipment includes excavators, wheel loaders, motor graders, compactors, concreting equipment and other earth moving machinery. The initiation of mega infrastructure projects under China Pakistan Economic Corridor (CPEC) framework have resulted in an upsurge of utilization of construction machinery; the current fleet size is unable to meet the demand therefore considerable capital investment is projected in the aforementioned segment.

As per the management, currently 24 machines are deployed at the Basha Dam construction site. Going forward, the management plans to make capital investment of around Rs. 300.0m pertaining to logistics (Rs. 200.0m) and machinery segments (Rs. 100.0m) by end-FY21. On the other hand, no new investment is planned at this stage for any segment of the power rental business, both diesel and gas, as the present fleet size is enough to meet the current market demands. The modaraba is also continuously tapping new rental agreements for the transportation business with leading FMCGs and Oil Field Services companies to deploy its rental assets to more profitable segments of the business.

Reduced scale of operations; power and machinery segments majorly hit by economic slowdown: The gross (inclusive of provisional sales tax) and net ijarah rentals were recorded lower at Rs. 3.6b (FY19: Rs. 4.2b) and Rs. 3.3b (FY19: Rs. 3.7b) respectively during FY20 owing to overall slowdown in economic activity, emergence of COVID-19, imposition of lock down and devaluation of the currency making new imports significantly expensive. Power rental segment's contribution to revenue amounted to Rs. 1.3b (FY19: Rs. 1.6b) during the outgoing year; the decline is mainly attributable to overall lower deployment levels and completion of old long-term build-operate-transfer (BOT) projects. Cement and housing sectors generated sales for large engines segment, both gas and diesel. LNG availability and its rational tariff structure for the north customers has ensured better utilization of gas engines. As per the management, all long-term contracts continued with satisfactory payments except for one major heavy fuel oil (HFO) customer due to factory closure and resultant of no utilization of the HFO Units. However, during the ongoing both HFO units were sold by the management and gain was booked accordingly on disposal.

Rental sales of both inbound and outbound logistics segment continued its robust performance contributing almost half of total revenue at Rs. 1.6b (FY19: 1.6b) during FY20. Inbound logistics segment is growing at a steady pace, both in terms of new customers and new fuel efficient units with existing customers for deployment of forklifts, tractor trollies, reach stackers and other attachments to handle logistics within plant premises. Without compromising on quality of forklift units required for rental deployment, ARM has recently diversified its sourcing from Japanese to Chinese source, with almost 40% lower capital cost outlay. As per the management, the same would enhance market reach with better price realization and higher margins. Most of the inbound segment contracts are long term in nature with blue chip companies, handling plant and warehouse logistics on 24/7, 365-day basis. On the other hand, the outbound logistics segment once again crossed Rs.1.0b mark during FY20. The customer base for this segment mainly comprises of blue chip companies in the FMCG sector; Nestle, Engro, Pepsi Riaz Bottlers, Oil and Gas company, Schlumberger and many others.

CAT Machines and SANY Cranes rental segment remained stagnated due to lower infrastructure investment, lower GDP growth, COVID-19 impact in the later part of the current year and slowing down of CPEC projects. Revenue of this segment registered sales of Rs. 466.0m during FY20 as opposed to Rs. 518.0m in the preceding year. The major challenge of machine rental business is the payment cycle of the contractor. Payment by contractor is dependent on the recovery of his bills from the Government. Project delays are routine, except for CPEC projects where timely clearance of receivables is witnessed mostly. Although, major concentration of these units are deployed primarily with FWO and other ARMY contractors, timely recovery of receivables remains a challenge.

Shrinkage in bottom line during the outgoing year, a direct outcome of decline in revenues: The compounded strain on the economy in line with rupee evaluation, pandemic

outbreak and high policy rate resulted in stagnation of new contracts and price increments for ARM, therefore the profit for the outgoing year was recorded lower at Rs. 227.5m (FY19: Rs. 382.9m). Given different segments were impacted at varying levels, diversification of rental portfolio ensured that the company maintained healthy positive bottom line. The contribution of power, logistics and machines segments was recorded at 39% (FY19: 43%), 47% (FY19: 43%) and 14% (FY19: 14%) respectively during FY20. The operating expenses were rationalized to Rs. 2.6b (FY19: Rs. 2.9b) with major reduction manifested in repairs and employee related expenses during the outgoing year; the same is in line with decline in sales revenues along with stringent control measures adopted by the management. Repairs and maintenance expense went down to Rs. 289.6m during FY20 as compared to Rs. 424.6m in the previous year due to reduced deployment levels and lower consumption of machine hours at customer sites. Gross margins exhibited positive momentum, increasing to 25.3% (FY19: 23.9%) during FY20; the improvement was attributed to decrease in depreciation expense to Rs. 517.1(FY19: Rs. 719.1m) as assets reached their residual values, lower investment during the year and maturity of some of long-term BOT contracts. On the contrary, administration expenses increased to Rs. 247.5m (FY19: Rs. 235.0m) although salaries & wages remained unchanged; the increase was mostly on account of change in accounting policies that require depreciation expenses to be charged on right of use assets as well. As per the prudential regulations applicable to the Modarabas', provision against potential ijarah losses amounted to Rs. 96.8m (FY19: Rs. 103.3m) owing to lower levels of receivables at end-FY20. As per the management, machine rentals relatively take higher recovery periods and are subject to release of funds to their contractors from either Provincial/Federal Governments or other such contracting bodies. Moreover, finance cost was also recorded slightly higher at Rs. 300.2m (FY19: Rs. 288.4m) due to increase in average benchmark rates during FY20. In addition, other income stood lower at Rs. 28.2m (FY19: Rs. 104.9m) in line with reduced gain on disposal of assets amounting to Rs. 23.9m reaped during the outgoing year in comparison to gain of Rs. 99.8m recorded during FY19.

Profitability indicators improved slightly despite stagnant revenues during HY21: The declining trend in sales could not be rescued fully during the ongoing year given challenging economic conditions and overall stagnation of the business subsequent to ongoing pandemic. ARM's topline was recorded almost at prior year's corresponding period at Rs. 1.7b (HY20:Rs. 1.74m) during HYFY21; sales in the power generation segment geared up by 8.7% during 2QFY21 compared to corresponding period last year due to improved overall deployment of smaller units and maintenance of rental contracts for megawatt segment; the power segment continues to maintain its lead in terms of profitability. Further, sales from construction machines and cranes segment improved significantly by 24% and contributed around Rs. 123.0m (2QFY20: Rs. 99.0m) in 2QFY21. Infrastructure construction and CPEC projects have picked pace; ARM is currently working on major projects of Skurdu Road, Thar Coal and Jamshoro Power Plant and Mityari Lahore Transmission Line. In addition, the sector presents opportunities for the future in the wake of new DAM projects of Daimer Basha, Dasu and Mohmand. As per the management, the company is in negotiation with all major contractors, including FWO and Chinese contractors to identify their needs and accordingly develop machine rental fleet.

The operation and maintenance expenses increased slightly to Rs. 1.4b (HY20: Rs. 1.35b) in line with fleet vehicles running cost raised by 25% due to overall higher transportation cost. On the other hand, salaries and wages were recorded lower at Rs. 402.9m (HY20: Rs. 459.3m) owing to steps taken by management that had an offsetting effect of upward revision in minimum wage by the Government during HY21. Subsequently in line with increase in operating expenses despite slight dip in revenues coupled with greater contribution of machine business entailing

lower margins vis-à-vis power rentals, margins reduced to 20.5% during HY21. Further the administration expenses also stood higher at Rs. 131.0m (HY20: Rs. 120.4m) primarily due to increase in depreciation expense. On the other hand, finance cost went down on account of reduced interest rate scenario prevalent during the concerned period. In addition, provision against ijarah losses were also recorded lower at Rs. 11.8m (HY21: Rs. 51.2m) being in compliance with the prudential regulations. As a result of controlled financial and provision expenses, ARM reported higher profit of Rs. 158.5m during HY21 as compared to Rs. 149.1m in the corresponding period of FY20. Going forward, deployment level of rental fleet and support in revenues from logistics and construction projects will remain key rating drivers.

Liquidity position is sound: The liquidity profile of the company was adequate in view of sizable cash flows in relation to long-term outstanding obligations. Funds flow from operations decreased to Rs. 428.4m (FY20: Rs. 869.2m; FY19: Rs. 1.2b) in HY21 in line with decline in revenues. However, with subsequent decline in borrowings, FFO to total debt was substantial and was recorded almost at pre-pandemic levels during the period under review. Going forward, according to the management, cash flows are expected to improve on account of increase in sales supported by improvement in sector dynamics in line with mega projects falling under CPEC framework. Ijarah receivables exhibited a declining trend on a timeline basis; the same in respect to rental income were also recorded lower at 29.5 %(FY20: 33.4%; FY19: 33.4%) at end-HY21. On the other hand, the aging analysis of rental receivable (ijarah rentals and operation and maintenance income receivable) showed slight deterioration as receivables amounting to Rs. 241.9m (FY19: Rs. 194.9m) were overdue for more than six months; the same accounted for 17.5% (FY20: 13.4%) of the total receivables at end-HY20. The overdue receivables have been fully provided for therefore pose no risk to asset quality going forward.

Maintained capitalization levels: Capitalization levels largely remained at pre-pandemic levels in line with profit distribution to the certificate holders. Moreover, in line with reduced level of borrowings over the years, leverage indicators have further improved on a timeline basis. ARM's management has a philosophy of maintaining gearing levels at conservative levels; therefore, gearing and debt leverage stood low at 0.34x (FY20: 0.36x; FY19: 0.45x) and 0.58x (FY20: 0.61x; FY19: 0.66x) at end-HY21. The expansion in operating assets was largely kept on hold given the prevailing market dynamics. Similarly, there are currently no plans of mobilizing any external funding from any institution given significant availability of equity. Ability to maintain leverage at moderate levels while pursuing growth related objectives will remain critical to ratings.

Allied Rental Modaraba (ARM) Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*	
BALANCE SHEET	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**	**31-Dec-20**
Cash and Bank Balances	307.4	91.2	50.6	92.9	153.5
Ijarah Rentals Receivable	987.9	1,334.1	1,235.6	1,100.3	999.6
Ijarah Assets	6,059.7	6,732.9	6,434.7	6,120.3	5,981.1
Total Assets	8,361.0	9,036.5	8,829.0	8,634.3	8,422.0
Creditors, Accrued & Other Liabilities	590.5	625.3	821.6	1,050.2	1,002.3
Borrowings*	2,837.8	3,044.0	2,414.6	1,937.2	1,800.7
Paid Up Capital	1,755.0	2,000.0	2,200.0	2,200.0	2,200.0
Equity	4,658.6	5,150.5	5,333.5	5,351.7	5,343.6
INCOME STATEMENT	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**	**31-Dec-20**
Rental Income	3,001.0	3,574.1	3,694.3	3,299.1	1,694.5
Operation and Maintenance Income	115.3	122.1	127.4	132.3	69.4
Total Income	3,116.3	3,692.2	3,821.7	3,431.4	1,763.9
Operating Expenses	2,277.0	2,758.4	2,907.1	2,562.2	1,402.8
Gross Profit	839.3	937.8	914.6	869.2	361.1
Finance Costs	169.4	246.7	288.4	300.2	87.2
Profit (Loss) Before & After Tax	457.9	395.1	382.9	227.5	158.5
RATIO ANALYSIS	**30-Jun-17**	**30-Jun-18**	**30-Jun-19**	**30-Jun-20**	**31-Dec-20**
Gross Margin (%)	28.0	25.4	23.9	25.3	20.5
Net Margin (%)	14.7	10.7	10.0	6.6	9.0
FFO (Rs. In Millions)	1,349.5	1,069.9	1,178.4	891.0	428.4
FFO to Total Debt (x)	0.48	0.35	0.49	0.46	0.48
Current Ratio (x)	1.09	1.23	1.10	1.42	1.16
Gearing (x)	0.60	0.59	0.45	0.36	0.34
Leverage (x)	0.77	0.75	0.66	0.61	0.58
ROAA (%)	5.9	4.4	4.3	2.6	3.7
ROAE (%)	10.1	7.7	7.3	4.3	5.9

***** excluding off balance sheet financing*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Allied Rental Modaraba
Sector	Modaraba
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2021 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.
Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
11-June-21	A+	A-1	Stable	Reaffirmed
26-Dec-19	A+	A-1	Stable	Reaffirmed
31-Dec-18	A+	A-1	Stable	Reaffirmed
02-Oct-17	A+	A-1	Stable	Reaffirmed
28-Dec-15	A+	A-1	Stable	Reaffirmed
29-Dec-14	A+	A-1	Stable	Reaffirmed
30-Jul-13	A+	A-1	Stable	Upgrade

Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Mohammad Saad	CFO	5th April 2021
2	Mr. Yousaf	Financial Controller	5th April 2021