

RATING REPORT

Sindh Modaraba

REPORT DATE:

June 29th, 2021

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A+	A-1	A+	A-1
Rating Outlook	Stable		Stable	
Rating Date	June 29 th , '21		June 30, '20	

COMPANY INFORMATION

Incorporated in 2015	External auditors: Baker Tilly Mehmood Idress Qamar Chartered Accountants
Public Listed Modaraba	Chairman: Mr. Waseem Mehdi Syed
Key Certificate holders (with stake 5% or more): Sindh Modaraba Management Limited - 94.36%	Chief Executive Officer: Mr. Zulfiqar Ali

APPLICABLE METHODOLOGY(IES)

JVIS Entity Rating Criteria: Non-Banking Financial Companies (March 2020)

<https://s3-us-west-2.amazonaws.com/backupsqvis/docs/NBFCs202003.pdf>

Sindh Modaraba (SM)

OVERVIEW OF THE INSTITUTION

Sindh Modaraba (SM) has been incorporated under the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980. The Modaraba started its operations in 2015 and is managed by Sindh Modaraba Management Limited (SMML).

Profile of Chairman

Mr. Mehdi is currently serving as the Chairman and Independent Director of SM. Mr. Mehdi has over 40 years of experience within Financial sector. He is also Independent Director and Chairman of the Board of Directors of Summit Bank. Mr. Mehdi holds Master Degree from Karachi University and Diploma in Banking (DAIBP from) Institute of Banking in Pakistan.

Profile of CEO

Mr. Zulfiqar Ali is a seasoned professional with over 25 years of diversified experience holding various senior positions within the Modaraba sector. Prior to his appointment as CEO, Mr. Ali served as the CFO and Company Secretary in SM from 2014 onwards. He is an associate member of ICMA Pakistan. Prior to joining SM, Mr. Ali was associated with Modaraba Al Mali and Bank Islami Modaraba Investments Ltd.

RATING RATIONALE

Sindh Modaraba (SM) is managed by Sindh Modaraba Management Limited (SMML), which in turn, is a wholly owned subsidiary of Government of Sindh (GoS). SM is engaged in providing Shariah compliant financing facilities to customers. The Modaraba is listed on Pakistan Stock Exchange and its registered office is in Karachi. And operates through a network of two branches, one located in Karachi and the other based in Lahore.

Key Rating Drivers:**Sound Sponsor Profile**

The key rating consideration is the sponsor profile of the Modaraba, GoS, which owns approximately 94.4% of SM's certificates through SMML. The remaining shareholding is vested within local individuals (5.28%), while the directors, CEO and their spouses own less than 1 percent. The sponsor has demonstrated both technical and financial support for SM in the past. VIS considers continued sponsor support a key factor for ratings.

Strengthening of management team lends support to planned growth in the future.

Significant changes have been observed in the senior management team and in the composition of Board of Directors in the ongoing fiscal year. Mr. Zulfiqar Ali has been elevated to the position of CEO (erstwhile served as CFO/Company Secretary in the organization) after replacing Mr. Naimuddin Farooqui. With the induction of Head of Risk Management and Head of Legal/SAM along with in-housing Internal Audit Department which was previously outsourced and expansion of Sales and Marketing Team, management aims to strengthen the Governance, Risk and Control environment to support planned growth in the future.

Portfolio growth remained depressed in 9M'21. Credit risk to remain elevated amid challenging economic environment.

Financing portfolio was reported lower at Rs. 712.6m (FY20: Rs. 791.9m; FY19: Rs. 666.7m) during 9MFY21. The decline was on account of challenging environment with the onset of COVID-19 and momentary slowdown in disbursements due to ongoing changes in senior management. Financing portfolio comprises primarily Diminishing Musharaka facility. Sector wise portfolio comprises mainly of sugar, chemical & allied and electronics sectors.

Non performing portfolio depicts increase on account of NPL accretion in poultry and retail segment affected due to COVID-19 led slowdown. Credit risk of the financing portfolio remains heightened due to sizable COVID deferrals allowed under the SECP's COVID relief measures, the outcome is which is yet to be seen. VIS expects provisioning burden to continue in the ongoing year. Going forward, management business strategy envisages growth in its financing portfolio on the back of unutilized equity at hand. However, maintenance of asset quality will remain key factor from ratings perspective.

Lower interest rates and provisioning charges will be a drag on profitability.

Despite a surge in provisioning charges (237x times increase) in FY20, profitability for the year increased to Rs. 107.9m (FY19: Rs. 81.2m) on the back of higher interest income earned on deployment of excess cash. However, in the ongoing year, with the sharp decline in interest rates (625bps reduction in the policy rate), the returns have been impacted. Total income for 9MFY21 stood lower at Rs. 105.4m (9MFY20: Rs. 140.2m). Also, the operating expenses were higher

during the ongoing fiscal year due to cost related to hiring and revamping of the management team. Resultantly, the Net Profit stood at Rs. 59.7m (9MFY21: Rs. 97.2m) during 9MFY21. With the recent change in Modarba regulations outlining more stringent classification criteria, we expect provisioning burden to increase going forward. Materialization of targeted growth in financing portfolio while maintaining asset quality together with cost control will remain crucial for ratings.

Sound liquidity profile and capitalization indicators

During the year, subordinated and interest free loan of Rs. 500m was extended to the Modaraba from the sponsor which boosted capitalization indicators. This was set off against support extended by Government of Sindh last year for the Intra city transport scheme which was later shelved and subsequently the funds transferred to sponsor as directed by GoS. Given the uptick in equity, no borrowings or deposits have been mobilized. Adequate cushion in equity exists for deployment in support of future growth. Liquid assets were recorded at Rs.898m as at 9M'21 mainly comprising of cash in hand and short term investments.

Sindh Modaraba (SM)
Appendix I

FINANCIAL SUMMARY				
<i>(amounts in PKR millions)</i>				
BALANCE SHEET	FY18	FY19	FY20	9M'21
Ijarah Rentals Receivable	6.8	0.0	-	0.2
Ijarah Assets	61.3	10.5	7.2	5.3
Current portion-Diminishing Musharaka	208.4	249.1	270.8	336.3
Long term portion-Diminishing Musharaka	407.0	407.1	514.0	370.9
Total Financing portfolio	676.7	666.7	791.9	712.6
Short Term Investments	130.0	160.0	-	320.0
Cash and bank balances	670.7	788.6	883.7	578.1
Total Assets	1,569.4	1,639.3	1,706.2	1,648.7
Creditors, Accrued & Other Liabilities	524.6	570.7	90.6	34.1
Lease Key Money	28.7	5.3	5.0	5.0
Total liabilities	553.5	576.2	96.2	39.7
Paid up Capital	450.0	450.0	450.0	450.0
Equity	1,015.8	1,063.0	1,610.0	1,608.9
INCOME STATEMENT				
Income from Diminishing Musharaka	55.0	92.4	101.9	61.2
Income from Ijarah financing	10.7	4.7	0.8	0.5
Income from Murabaha finance	0.5	-	-	-
Income from Bank deposits	14.2	15.9	83.3	34.4
Term Deposit Receipts	8.4	12.0	2.1	9.4
Operating Expenses	28.9	32.1	39.2	36.2
Other income	1.0	0.6	3.4	0.1
Profit/ (Loss) Before Tax	52.4	81.2	107.9	59.7
Profit/ (Loss) After Tax	52.4	81.2	107.9	59.7
RATIO ANALYSIS				
Current Ratio (x)	2.0	2.1	12.2	31.8
Efficiency (%)	32.3%	25.6%	20.9%	34.3%
Gearing (x)	-	-	-	-
Leverage (x)	0.5	0.5	0.1	0.0
ROA (%)	4.0%	5.1%	6.4%	4.7%
ROE (%)	5.2%	7.8%	8.1%	4.9%

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix II

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	Sindh Modaraba				
Sector	Modaraba				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
	<u>RATING TYPE: ENTITY</u>				
	06/29/2021	A+	A-1	Stable	Reaffirmed
	06/30/2020	A+	A-1	Stable	Reaffirmed
	02/22/2019	A+	A-1	Stable	Reaffirmed
	12/29/2017	A+	A-1	Stable	Reaffirmed
	01/16/2017	A+	A-1	Stable	Initial
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.				
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Due Diligence Meetings Conducted	S. No	Name	Designation	Date	
	1	Mr. Zulfiqar Ali	Chief Executive Officer	June 18, 2021	