

RATING REPORT

Sindh Modaraba

REPORT DATE:

June 30, 2020

RATING ANALYST:

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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	Jun 30, '20		Feb 22, '19	

COMPANY INFORMATION

Incorporated in 2015	External auditors: M/s Grant Thornton Anjum Rahman, Chartered Accountants (2019) Baker Tilly Mehmood Idress Qamar Chartered Accountants (2020)
Public Listed Modaraba	Chairman: Mr. Muhammad Bilal Shaikh
Key Certificate holders (with stake 5% or more): Sindh Modaraba Management Limited - 94.4%	Chief Executive Officer: Mr. M. Naimuddin Farooqui

APPLICABLE METHODOLOGY(IES)

VIS 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. Mubammad Bilal Sheikh is currently serving as the CEO of Sindh Leasing Company Limited (SLCL). Prior to joining SLCL he was President and CEO of Sindh Bank Limited. Mr. Sheikh is a seasoned banker with over 45 years of diversified experience in banking sector. He has headed several banks/financial institutions in the last 16 years.

Profile of CEO

Mr. M. Naim Faarooqui is a seasoned professional with over 33 years of experience in the financial services industry. Prior to joining Sindh Modaraba, he had served in the capacity of CEO in Sindh Leasing Limited and Sindh Bank Limited. He is an MBA from Texas Southern University, and also holds a Bachelor of Science Degree in Industrial Engineering from the University of Houston, USA

RATING RATIONALE

Sindh Modaraba (SM) is a wholly owned subsidiary of Government of Sindh (GoS) and is managed by Sindh Modaraba Management Limited (SMML). SM is primarily engaged in providing Sharaiah compliant financing facilities, including Ijarah, Diminishing Musharakah, Murabaha, Musharaka, Salam and Istisna financing, to customers. The Modaraba is listed on Pakistan Stock Exchange and its registered office is located in Karachi. The company operates through a network of two branches; one is located in Karachi and other is based in Lahore.

Key Rating Drivers:**Sound Sponsor Profile**

The assigned ratings incorporate sound profile of the sponsor, GoS, which owns approximately 94.4% of SM's certificates through SMML. The sponsor has demonstrated both technical and financial support for SM in the past. VIS expects sponsor support to materialize in future in case a need arises.

Cautious growth in financing portfolio will be targeted going forward due to economic impact of COVID-19 pandemic; managing asset quality remains the primary focus of the company

Due to conservative lending stance of the management, financing portfolio (in terms of outstanding principal) witnessed moderate decrease of 1.1% during FY19 vis-à-vis the preceding year. However, significant disbursements were undertaken during 9M'FY20, which resulted in an increase of 22.5% in financing portfolio to 815m at end-Q3'20. Growth was primarily a function of addition of new clients pertaining to textile, engineering, construction, energy and food sectors. GoS's Karachi intra-city and inter-city transport schemes projects have been cancelled; hence deposits of Rs.500m placed by GoS with SM for financing these projects were withdrawn. Diminishing Musharakah continues to represent a large chunk of financings followed by Ijarah. Client wise concentration risk persists as total client base is limited. However, with addition of new clients, management is focusing on reducing client-wise concentration as the portfolio growth progresses, going forward.

Given the management's strategy of maintaining a clean rather than a large portfolio, Non-performing loans on the books of the company remain minimal. At end'Q3'20, the company reported doubtful debts pertaining to two clients, one belonging to sugar sector and the other belonging to poultry sector. Management is actively working on recovering the same.

The impact of COVID-19 on the economy would make operating dynamics of the modarabas challenging. Regulatory relief measure granted by SECP to allow for delay of principal payments for one year to clients is expected to delay the impact of prevailing headwinds on portfolio asset quality indicators. However, exposure of SM to credit risk may be elevated due to significant impact of COVID-19 on already weak macroeconomic indicators. Given the economic slowdown and adverse impact on borrowers' repayment capacity due to COVID-19, the management will pursue cautious growth in financing portfolio going forward. Primary focus of the management will remain on maintaining a clean portfolio.

Capitalization indicators and liquidity profile are healthy

Capitalization indicators of SM are considered sound as the company has not mobilized any interest bearing debt. There are currently no plans of mobilizing any external funding from any

institution given significant availability of equity. During FY20, SM has obtained further Rs. 500m as subordinated interest free loan from SMML. This loan is repayable at the discretion of SM. The same is classified as a part of the equity. Liquidity profile of the company is manageable given the sizeable proportion of liquid assets in relation to total liabilities.

Profitability is expected to remain under pressure due to decreasing interest rate scenario

Profitability of SM witnessed increase on account on increasing interest rates during FY19. Sizeable growth in financing portfolio along with increasing interest rates continued to further growth profitability during 9M¹FY20. Efficiency ratio has also remained at manageable levels for the company over the years. Going forward, it is expected that the impact of curtailment of economic activity for a certain period of time, higher business risk in the borrower portfolio and lower lending rate scenario may result in pressure on profitability profile of the company in the medium to long term rating horizon. Conservative lending strategy to maintain asset quality and cost efficiencies would be important rating drivers going forward.

Corporate governance framework is satisfactory

The ratings reflect presence of adequate corporate governance framework at SM. Board of Directors (BoD) and senior management include seasoned professionals. BoD includes seven members, out of which two are independent directors. In line with best practices, a female director is also present on the Board. Five board committees also exist to maintain effective oversight. Policy framework of SM is considered adequate.

Sindh Modaraba (SM)
Appendix I

FINANCIAL SUMMARY		<i>(amounts in PKR millions)</i>			
<u>BALANCE SHEET</u>	30-Jun-17	30-Jun-18	30-Jun-19	31-Mar-20	
Ijarah Rentals Receivable	3.5	6.8	0.01	-	
Ijarah Assets	136.4	61.3	10.5	7.8	
Current portion of Diminishing Musharaka	76.1	208.4	249.1	293.7	
Long term portion of Diminishing Musharaka	419.1	407.0	407.1	514.0	
Short Term Investments	-	130.0	160.0	-	
Advances, prepayments and other receivables	17.7	70.0	20.4	-	
Cash and bank balances	370.8	670.7	788.6	856.4	
Total Assets	1,028.6	1,569.4	1,639.3	1,700.9	
Creditors, Accrued & Other Liabilities	12.0	524.6	570.7	95.8	
Borrowings	-	-	-	-	
Lease Key Money	32.8	28.9	5.3	5.0	
Total liabilities	44.9	553.5	576.2	101.4	
Paid up Capital	450.0	450.0	450.0	450	
Equity	983.7	1,015.8	1,063.0	1,599.5	
<u>INCOME STATEMENT</u>	30-Jun-17	30-Jun-18	30-Jun-19	31-Mar-20	
Income from Diminishing Musharaka	23.3	55.0	92.4	72.9	
Income from Ijarah financing*	12.2	10.7	4.7	0.6	
Income from Murabaha finance	-	0.5	-	-	
Income from Bank deposits	19.6	14.2	15.9	64.6	
Term Deposit Receipts	-	8.4	12.0	2.1	
Operating Expenses	24.1	28.9	32.1	28.3	
Other income	0.5	1.0	0.6	0.6	
Profit/ (Loss) Before Tax	26.3	52.4	81.2	97.2	
Profit/ (Loss) After Tax	26.3	52.4	81.2	97.2	
<u>RATIO ANALYSIS</u>	30-Jun-17	30-Jun-18	30-Jun-19	31-Mar-20	
Current Ratio (x)	18.5	2.0	2.1	11.6	
Efficiency (%)	43.4%	32.3%	25.6%	20.2%	
Gearing (x)	-	-	-	-	
Leverage (x)	0.05	0.5	0.5	0.1	
ROA (%)	2.6%	4.0%	5.1%	7.8%**	
ROE (%)	2.7%	5.2%	7.8%	9.7%**	

*Income adjusted for ijarah depreciation

**Annualized

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>				
	06/30/2020	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. Faraz-uz-Zafar	Manager Risk Management & Compliance	June 25, 2020	