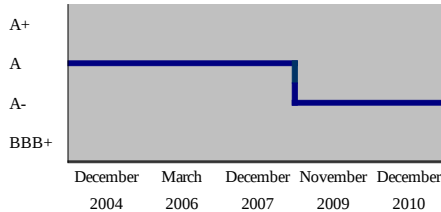


RATINGS (DECEMBER 2010)
FIRST PUNJAB MODARABA [FPM]

ENTITY	NEW	PREVIOUS
LONG TERM	A-	A-
SHORT TERM	A2	A2
OUTLOOK	Negative	-

FPM L.T. ENTITY RATING HISTORY

FINANCIAL DATA

PKR (MLN)

	Jun-10	Jun-09
Total Assets	2,665.1	3,046.0
Net Non performing finances	874.6	442.9
Equity	370.0	363.0
Profit after tax	7.0	(90.8)
ROA (%)	2.0	(21.9)
ROE (%)	0.3	(2.7)
Equity/ Assets (%)	13.9	11.9
Impaired lending/ gross finances (%)	55.5	18.1
Total debt/ Equity (%)	497.5	613.9

ANALYSTS

Aahyan Mumtaz
 +92 42 35869504
 aahyan.mumtaz@pacra.com

Rai Umar Zafar
 +92 42 35869504
 rai.umar@pacra.com

RATING RATIONALE & KEY DRIVERS

- The ratings reflect FPM's association with an established medium sized bank – The Bank of Punjab – facilitating multi-faceted support to the Modaraba. FPM has witnessed steep decline in its asset quality, which has impacted its performance due to sizeable income suspension and provisioning expenses. Nevertheless, the Modaraba's operations are still above the break-even sustenance level. The management is persisting in its efforts of business consolidation while curtailing further delinquencies and expediting the recovery procedure.
- The outlook on the ratings is negative, given substantial deterioration in FPM's standalone financial profile. The ratings are dependent on the successful execution of the management's strategy to consolidate its operations, in-turn developing a profitable revenue stream. Meanwhile, any weakening in the perceived support from the sponsoring bank would carry negative implications for the ratings.

ASSESSMENT

- FPM experienced a slowdown in revenue growth during FY10. This was mainly an outcome of subdued expansion in FPM's finances portfolio. In the wake of surge in the company's non-performing lending portfolio, a sizeable portion of Ijarah and Morabaha income was suspended, impacting the reported gross revenues of the Modaraba. However, FPM experienced lower financial charges as utilization of funding lines as well as related cost decreased. Meanwhile, the Modaraba booked a one-time capital gain on divestment of its investment portfolio. These factors mitigated the decline in gross revenue. Loan loss provisioning expense remained the same as last year even though impaired lending grew exponentially, on account of FSV provisioning benefits availed by the Modaraba, in-turn enabling FPM to report a marginally positive bottom line for the year. During 1QFY11, FPM reported a loss of PKR 28.6mln, driven by higher provisioning as the impaired portfolio ages. Going forward, provisioning expenses are expected to rise as a large portion of the non-performing portfolio remains un-provided for.
- The Modaraba intends to continue concentrating on consolidation of business, with focus towards recoveries and reduction in the cost of funds. The consolidation is aimed to arrest the rising trend in NPLs, while improving profitability. In addition, the Modaraba intends to prudently broaden its finances book. During FY11, PKR 700mln worth of new business – mostly Ijarah financing – is targeted by the management largely maintaining the current sectoral mix. While remaining cautious towards consumer financing, FPM's focus on Ghar Sawaro Scheme is expected to remain limited. On the funding side, the Modaraba intends to increase the proportion of CoMs in its funding mix by targeting ~PKR 400mln worth of certificate issue. This is likely to be directed towards institutional investors.
- In terms of sectoral mix, the textile and sugar sectors continued to lead the segment exposures constituting 19.7% and 15.0% of the total advances portfolio respectively at end-FY10 (Textile: 24.9%, Sugar: 18.5% at end-FY09). Meanwhile, there was a reasonable increase in exposure to defensive industries such as pharmaceuticals and consumables, as well as a higher proportion of exposure in the chemical sector.
- The Modaraba's asset quality deteriorated significantly during FY10, with NPLs surging to PKR 874mln. This was mostly due to weakened economic fundamentals impacting its borrowers while some bad loans were a product of lapses in the credit evaluation process. Accordingly, the impaired lending to gross finances ratio witnessed an alarming increase. Going forward, the management is observing marginal accounts while actively pursuing recovery on a case to case basis. This was reflected in 1QFY11, which saw a slight decrease in the company's impaired lending portfolio. Further, recovery efforts are expected to be boosted by a possible PKR 180mln inflow during FY11 as progress on a major litigation unfolds. On this front, FPM is supported by BoP in terms of resource sharing as certain major names are common between the two. Nevertheless, a small quantum of further infection is anticipated, observing certain watchlist accounts whereby probability of delinquency is high.
- The Modaraba's funding mix comprises mostly Musharaka financing lines (~41%) as well as Certificate of Musharaka (~32%). As a result of liquidity crunch emanating in FY09, a high degree of reliance was placed on its parent, the Bank of Punjab for the acquisition of funds. Musharaka financing, in entirety, is extended by BoP, while the bank also holds 43% of CoMs issued. The Modaraba, leveraging BoP's branch network, plans to increase the proportion of CoMs in its funding mix as it provides a less costlier avenue for funding.
- FPM has a highly leveraged capital structure. Although absolute debt levels have decreased in comparison to last year, attributed to sizing down of the lending portfolio, the gearing level is still high. Equity augmentation through retained earnings has remained limited over the years owing to cash dividend payouts to fulfil the statutory requirement for tax exemption. Hence, any material growth in assets would primarily be a function of leveraging. Given the pressure of profits and the Modaraba's growth plans, a sizeable improvement in the capital structure cannot be expected for the foreseeable future.

PROFILE

- First Punjab Modaraba (FPM), established in 1992, is a perpetual multi-purpose Modaraba listed on all three bourses of the country. The management company of FPM, Punjab Modaraba Services (Pvt.) Limited (PMSL), holds over 39% stake in the Modaraba. PMSL is a wholly owned subsidiary of The Bank of Punjab (BoP). The bank, majority owned by the government of Punjab, carries a very strong financial profile as reflected by its long-term entity ratings of 'AA-' (Double A minus), though the outlook is negative [assigned by PACRA].
- The deputy CEO of BoP, Mr. Khalid Tirmizey, chairs the five-member Board of the Modaraba. The CEO, Mr. Khaqan Hasnain Ibrahim, is an MBA and possesses above 30 years of diversified experience in financial management. Of the remaining three board positions, two are reserved for executive members of BoP while the other is an independent member. To further add value in the area of risk management, Mr. Abdul Razzaq, Chief Risk Officer of BoP, has been inducted onto the BoD.