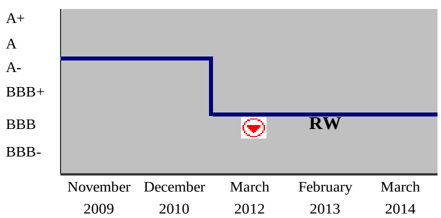
RATINGS (MARCH 2014)

FIRST PUNJAB MODARABA [FPM]

ENTITY	NEW	PREVIOUS
LONG TERM	BBB	BBB
SHORT TERM	A3	A3

FPM L.T. ENTITY RATING HISTORY



*RATING WATCH (RW) REMOVED
NEGATIVE OUTLOOK

FINANCIAL DATA

PKR (MLN)

	1HFY14*	FY13	FY12
Total Assets	1,413	1,568	1,911
Total Finances (Performing)	593	523	698
Net Non Performing Finances	320	552	600
Equity	45^	31^	143^
Profit / (Loss) after Tax	14	(111)	(168)
Equity/Assets (%)	2.3	1.1	6.7
Impaired lending/ Gross Finances (%)	59.7	66.6	59.2
Total Debt/Equity (times)	36.0	72.3	11.9

** Based on reviewed accounts for six months ended December 31, 2013*
^ Including surplus on revaluation of Fixed Assets

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RATING RATIONALE & KEY DRIVERS

- FPM's ratings reflect its strong association with the Bank of Punjab (BoP) - a bank majority owned by the Government of Punjab. This support is demonstrated in the form of provision of subsidized funding line through which most of Modaraba's assets are being funded. At the same time, the bank has instituted higher integration of modaraba's key functions into bank's respective departments. These initiatives are expected to help FPM in achieving break-even. The Modaraba's standalone performance is constrained owing to sizeable non-earning assets coupled with subdued business activities resulting in continuous losses. This while eroding the equity base has severely deteriorated the risk absorption capacity of FPM. Being cognizant of the situation, the management has geared up recovery efforts. The organizational structure has been realigned in line with focused business functions. However, the management's strategy to return to core profitability by building good quality asset book, while mobilizing additional funds, remains challenging.
- The ratings are dependent on continuing financial and operational support of the parent institution. Any weakening in the support from BoP would carry negative implications for the ratings.

ASSESSMENT

- During FY13, FPM’s performance continued to drag mainly on account of higher proportion of non-earning assets (~60%) in the total asset base. Modaraba’s net revenue remained under pressure owing to gap between income generating assets and return bearing liabilities. Sustained operating cost and continued provisioning expense, though significantly lower than previous year, resulted in net accounting loss of PKR 111mln (FY12: 167mln). Consequently, the Modaraba’s pure equity has deteriorated considerably (end-Jun13: PKR 18mln; end-Jun12: PKR 129mln). However, during 1HFY14, FPM managed to register PAT of PKR 14mln mainly on account of provisioning reversal.
- Going forward, the management intends to focus on a twofold strategy: (i) recovery of NPLs, and (ii) deployment of recovered funds in good quality financing portfolio. Given limited resources, FPM would continue to rely on the support of its parent bank – The Bank of Punjab (BoP), for the recovery of its NPLs. Meanwhile, cost reduction is also on FPM’s agenda for which it has reasonably reduced its HR strength. Moreover, it would remain solely dependent on its sponsor for the funding. Though, this funding would be available at favorable rate to support the operations, yet successful recoveries and building of good asset book would be critical for the Modaraba’s business revival, going forward. Currently, FPM has been restricted by SECP from issuing CoMs to third party until the business profile of FPM improves.
- FPM’s financing book (net of NPLs) continued to be dominated by ijarah (FY13: 54%; FY12: 60%) followed by morabaha (FY13: 37%; FY12: 35%) and diminishing musharaka (FY13: 9%; FY12: 5%). In terms of the asset mix of ijarah, during the review period, the portion of vehicles decreased in the total pie (FY13: 22%; FY12: 26%) as compared to plant & machinery (FY13: 78%; FY12: 74%). Diminishing musharaka funds plant & machinery whereas morabaha is working capital financing. In terms of sectoral mix, Electric goods sector appeared at the top (FY13: 19%; FY12: 15%) followed by Sugar (FY13: 17%; FY12: 20%), and Textile (FY13: 16%; FY12: 16%).
- The Modaraba’s asset quality continued to experience deterioration. This coupled with limited credit expansion resulted in higher impaired lending as percentage of finances (1HFY14: 60%; FY13: 67%; FY12: 59%). Moreover, owing to significant accumulated losses, potential drag on equity also stands very high (net NPLs/equity: 1HFY14: 10x; FY13: 31x; FY12: 5x).
- Previously, FPM has been funding its finances book through various means – morabaha, musharaka and certificate of musharaka (CoM). During FY13, FPM repaid all its non-sponsored funding. Thus, currently, both the CoMs and the musharika line are being provided by the parent bank and are expected to stay at the same level.
- Owing to continuously declining equity, FPM carries a significantly high leverage structure. Business losses in recent years have dented the equity base of the Modaraba and its risk absorption capacity. This is evident by the total debt/equity ratio (end-Dec13: 36x; end-Jun13: 72x; end-Jun12: 12x), significantly higher than the regulatory requirement (10 times).

PROFILE

- First Punjab Modaraba, established in 1992, is a perpetual multi-purpose Modaraba listed on all three bourses of the country. The management company, Punjab Modaraba Services (Pvt.) Limited (PMSL), holds ~ 40% stake in the Modaraba. PMSL is a wholly owned subsidiary of The Bank of Punjab (BoP). The bank operates a vast network of 312 branches at end-Sep13, mainly concentrated in Punjab. The Government of Punjab (GoPb) maintains majority stake in BoP (51%). It carries a long-term entity rating of 'AA-' from PACRA.
- The deputy CEO of BoP, Mr. Khalid Tirmizey, chairs the five-member Board of the Modaraba. Recently, Mr. Mehboob-ul-Hassan, an executive of BoP, has also joined the board. Apart from him, the remaining three board members also hold executive positions in BoP. Since December 2013, position of CEO is vacant and appointment of new CEO is in process.