The Pakistan Credit Rating Agency Limited

FIRST PUNJAB MODARABA

	NEW [FEB-15]	PREVIOUS [MAR-14]
Long-Term	BBB+	BBB
Short-Term	A2	A3
Outlook	Stable	Stable

FEBRUARY 2015

RATING ANALYSES (FEBRUARY 2015)

FIRST PUNJAB MODARABA (FPM)

RATING RATIONALE:

- The ratings of FPM reflect demonstrated commitment of key sponsor – The Bank of Punjab (BoP) – a bank majority owned by the Government of Punjab. Currently, all assets of the modaraba are funded through subsidized loan extended by BoP; all other credit obligations are paid off. This led to significant reduction in funding cost. Meanwhile, higher integration of modaraba's operations with the bank resulted in lower operating costs. Overall performance of the modaraba is improving, and is expected to achieve breakeven from core operations within FY15. The management, while expediting recovery efforts, is targeting careful expansion in loan book. Herein, focus is diminishing musharaka for vehicles and assets for medium-sized borrowers. However, building quality asset book while mobilizing required funding would remain challenging.

KEY RATING DRIVERS

- The ratings are dependent on successful execution of the management's strategy to strengthen its core operations to ensure profitability. Meanwhile, any weakening in the support from the sponsor could have negative implications.

- **Asset Mix:** FPM's financing book (net of NPLs) is dominated by morabaha (FY14: 45%; FY13: 37%) followed by diminishing musharika (FY14: 35%; FY13: 9%) and ijarah (FY14: 20%; FY13: 54%). In terms of the asset mix of ijarah, the portion of vehicles increased in the total pie (FY14: 28%; FY13: 19%) as compared to plant & machinery (FY14: 72%; FY13: 81%). Diminishing musharaka funds plant & machinery whereas morabaha is a working capital financing. In terms of sectoral mix, Electric goods sector appeared at the top (FY14: 17%; FY13: 19%) followed by Textile (FY14: 15%; FY13: 16%) and Chemicals (FY14: 14%; FY13: 12%). However, top five sectors showed a significant concentration constituting 70% of the total book.
- **Asset Quality:** FPM's high credit risk is reflected in its top twenty customer concentration. Ijarah's top twenty exposures constitute 95% of the portfolio as at 1QFY15. Meanwhile there are only twenty five and nine parties in Morabaha and Musharika financing respectively.
- In the absence of fresh disbursements, impaired lending as a percentage of finances went up despite a decline in NPLs (1QFY15: 75%; FY14: 73%; FY13: 67%). Moreover, owing to significant improvement in business performance, potential drag on equity has reduced (net NPLs/equity: 1QFY15: 5x; FY14: 6x; FY13: 31x).
- **Investment:** FPM has an investment portfolio worth 1.5% of its asset base at end-Sep14. This includes room, corporate membership and unquoted shares of Lahore Stock Exchange.
- **Performance:** During FY14, despite reduction in earning assets, higher asset yield helped the Modaraba in maintaining its gross revenue. Furthermore, reduced cost of funding, due to subsidized financing by the parent bank, resulting in lower financial charges led to breakeven in terms of net revenue. Meanwhile FPM managed to register pre-provision operating profit of PKR 6mln in FY14 as against loss of PKR 81mln in FY13 mainly on account of: (i) gain on sale of fixed assets, and (ii) reduced administrative cost. Reversal in provisioning expense of PKR 56mln due to recovery in non performing book helped the Modaraba achieve profit before tax of PKR 59mln in FY14 as against loss of PKR 111mln in FY13. During 1QFY15, continued provisioning reversal resulted in profitable bottomline.
- **Strategy:** Going forward, the management intends to enhance its share of Diminishing Musharika in the total financing book. This is expected to bring stability in the earnings. Furthermore, target clientele would be middle tier customer which would help in bringing down per party concentration. Meanwhile, continued focus on recovery of NPLs would remain management's top priority. Furthermore, in order to bring diversity in the earnings, FPM intends to offer brokerage services. Moreover, it would remain 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 quality asset book would be critical for the Modaraba's business revival, going forward. FPM intends to approach the SECP to remove restrictions from issuing CoMs due to improvement in its business profile.
- **Funding:** The Modaraba has availed a Musharikah finance facility of PKR 873 from its parent bank – BOP as at end-Sep-14 (approved limits of PKR 1,060mln). Furthermore, as against another available financing facility of PKR 300mln by BOP, FPM has issued CoMs of PKR 100mln as at end-Sep-14.
- **Capital Structure:** FPM carries a moderately leveraged structure. Improved business performance in FY14 has strengthened the equity base of the Modaraba resultantly its risk absorption capacity. This is evident by the significant reduction in the Modarab's total debt/equity ratio (1QFY15: 10x; FY14: 11x; FY13: 72x), which showed significant reduction.
- **Profile:** First Punjab Modaraba (FPM), established in 1992, is a perpetual multi-purpose Modaraba listed on all three bourses of the country. The Modaraba caters to corporate, commercial and individual customers through various modes of Islamic financing mainly ijarah, morabaha and musharaka.
- **Governance and Management:** FPM's Board of Directors (BoD) comprises six members including the CEO of FPM. The deputy CEO of BOP, Mr. Khalid Tirmizey, chairs the Board. Recently, Mr. Khwaja Farooq Saeed, a retired Justice of Lahore High Court, has also joined the board. The remaining four board members hold executive positions in BOP. During FY14, Mr. Aamir Malik was appointed the Chief Executive Officer of FPM. He has over 22 years of experience working at The Bank of Punjab and has diversified experience of handling banking affairs covering Credit, Branch Banking, Foreign Trade, Recovery and SAM in different Management positions. All department heads report directly to the CEO, with the exception of Internal Audit, which reports directly to the board audit committee.