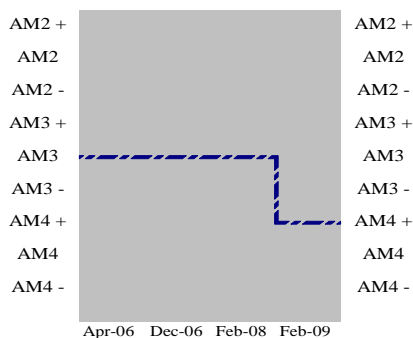


## ASSET MANAGER RATING (FEBRUARY 2009) DAWOOD CAPITAL MANAGEMENT (DCM)

## RATING RATIONALE AND KEY RATING DRIVERS

	New	Previous
Asset Manager	AM4 +	AM3



Funds	Size (mln)	
	Open-end	Dec'08 Dec' 07
1) Dawood Money Market Fund	532	3,442
2) Dawood Islamic Fund	377	382
<b>Closed-end</b>		
3) First Dawood Mutual Fund	528	754
	<b>1,437</b>	<b>4,578</b>

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- PACRA has downgraded Asset Manager Rating of Dawood Capital Management (DCM) to 'AM4+' (AM Four Plus) from 'AM3' (AM Three). The rating reflects relative weakness in asset management capabilities of the company, an outcome of limited development in support systems and fund management functions, vis-à-vis most of the industry peers who have shown marked improvement in their investment processes, and also demonstrated better ability to withstand the recent challenges in the industry. Due to weaknesses in fund policies and process, the performance and liquidity management of the company's premier fund was substantially impacted during the current crisis. The stressed financial profile of the sponsoring group - First Dawood Group - is likely to further constraint the management's efforts towards recovery in the near term.
- The rating depends on the management's ability to effectively revitalize its operations. Meanwhile stability in the senior management and strengthening of the fund management process and risk management systems would remain critical rating drivers.

## ASSESSMENT

- DCM, a First Dawood Group (FDG) company, started asset management business in 2003. While majority stake (56%) in DCM is held by FDG, with First Dawood Investment Bank (FDIB) holding 30% stake, NIT also holds 9% stake in the company. FDG in recent years have pursued increasing diversification in the financial sector. The group's interests include Islamic banking, asset management, brokerage, Islamic insurance and Modarabas. Currently non-banking financial companies (NBFC) are facing tough operating environment. Consequently, nearly all the companies of FDG have simultaneously come under pressure, including DCM, and are facing multiple challenges.
- The Board of DCM comprises seven members including the CEO – four representing the FDG mainly holding executive positions in group companies, one nominee of NIT and an independent director having extensive experience of the financial services sector. The CEO, Ms. Tara Uzra Dawood, a member of Dawood family, is a Harvard law graduate. Meanwhile, the company witnessed some turnover at the senior management level during 2008.
- After witnessing a peak of around PKR400bln in assets under management in Mar 08, the industry has reduced by more than half at present. While the constrained liquidity in the inter-bank market led to major redemption pressure in fixed income funds, as banks are the major investors in such funds, the downturn in capital markets eroded the value of investments in equity funds. A prolonged ban on redemption of units of equity related funds due to freezing of capital markets have impacted investors' confidence, mainly retail investors. The crisis has been aggravated by the decline in NAVs across the income fund category, and the failure on part of some asset managers in meeting the redemption requests in such funds. This is partly owing to the relatively nascent stage of the industry, which failed to maintain the distinction between income funds and money market funds. Consequently, a number of these funds ended up with a high proportion of investments in TFCs, an investment avenue that has increasingly become illiquid in the current scenario. This further impacted the asset managers' capacity to manage liquidity in the face of heavy redemption pressure.
- DCM also witnessed heavy redemption pressure, mainly in its premier fund, Dawood Money Market Fund (DMMF). Meanwhile, the company was unable to effectively manage the liquidity profile of DMMF, leading to suspension of redemption, which reflects the relative weakness in asset management capabilities of the company and limited development in the support functions and process. A part of this problem arises due to high portfolio allocation towards long maturity instruments (TFCs) that was not in line with the investor's risk profile. The current crisis has highlighted the need of the management attention towards matching the asset profile of the fund with that of the investor mix. The performance of the funds was also impacted due to the highest downward value adjustment among its peers on the TFCs portfolio. Resultantly, market standing of the asset manager was impacted and investor's confidence was tarnished.
- Challenges in the operating environment and pressure on capital and money markets are expected to put significant pressure on the prospects of DCM. Meanwhile, the company's ability to generate adequate revenues, which is a function of the total AUM, to support the requisite infrastructure and investment in further strengthening of support system is expected to remain subdued. Moreover, management efforts to develop and promote its investment schemes based on Dawood Money Market Fund – BABYFUND, SHAADIFUND, SAVINGSFUND, and LADIESFUND – to attract different classes of small investors, to date has achieved limited success. Going forward, early revival of the company during a tough operating environment would be an uphill task for the management.
- The investment management function of the company requires major strengthening. Meanwhile, there is reliance on group resources, which impacts company's relative independence. The input from the research department is very limited, due to which investment decisions are largely dependent on the experience of the Investment Committee (IC) members. The overall technology infrastructure requires further improvement with enhanced features of integration and controls. This would also be critical to ensure quality communication with unit holders at par with improving industry standards. The IC performs oversight of the risk management function and there is no separate resource dedicated for risk management and compliance function.