

**FIRST DAWOOD INVESTMENT BANK LIMITED (FDIB)****Ratings (February 2008)**

First Dawood Investment Bank Limited

	New	Previous
Entity		
Long term	A+	A+
Short term	A1	A1

Secured TFCs

PKR 345mln	AA-	AA-
PKR 345mln*	–	AA-

* Redeemed during FY07

Financial Data

PKR (mln)

	30-Jun-07	30-Jun-06
Total Assets	12,218.1	8,092.5
Equity	1,180.6	841.1
Profit After Tax	178.5	140.4
ROE %	16.5	14.8
Debt/Equity %	815.5	613.0

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TFC ISSUE:

FDIB issued a perpetual TFC of PKR 345mln in July 07, with a put option exercisable partial or whole, at 30 days notice prior to the Final Redemption Date (five years after issuance i.e. July 2012) and at the end of every five years thereafter, and with a call option exercisable in full on the same date but requiring 60 days notice. The TFC carries profit at a rate of 6 months KIBOR plus 165bps, payable semi-annually. The TFC is secured by way of first floating pari passu charge on leased assets and associated rental receivables of FDIB with a margin of 20%, providing adequate cushion to the TFC holders.

RATING RATIONALE AND KEY DRIVERS

- The ratings reflect FDIB's strong risk absorption capacity supplemented by substantial amount of unrecognised reserves. The ratings also recognize the volatility risk attached with the bank's profitability, an outcome of higher contribution of capital market operations towards the same. In the wake of intensifying competition in the sector, the management's ongoing efforts at expanding and diversifying the revenue base, and developing a prudent risk management and control environment are also taken into account. While fee-based income is showing growth, it will take some time before a sizeable and stable revenue stream from this source could emerge.
- The ratings are dependent on the management's ability to develop a diversified and sustainable revenue base, complemented by a strong risk management framework. Meanwhile, any material infection in the asset quality and/or decline in the contribution of core revenues would have negative implications for the ratings.

ASSESSMENT

- During FY07, RoE of the bank registered improvement on YoY basis both on a standalone basis and in comparison with peers. However, this was mainly a function of substantial return on its investment in equities. On the other hand, net interest revenue witnessed a decline owing to squeeze in spreads, attributable to intense competition in the financial industry that hindered effective deployment of funds and trimmed returns thereon. Although spreads are expected to remain under pressure, going forward, net interest revenue is likely to improve with targeted volume expansion. FDIB, with continued focus on investment banking activities, doubled its fee-based income, mainly consisting of guarantee commission and advisory fee. During 1QFY08, though the trend in performance of financing operations was maintained, growth in the bottomline slowed down due to lower contribution of capital gains owing to the sluggish trend in the capital market.
- FDIB, to achieve a sustainable income stream, intends to continue its focus on diversification of the revenue base, with emphasis on investment banking activities including underwriting and trusteeship. Although a conservative stance on the lease portfolio is likely to be maintained, a relatively higher proportion of growth in long-term finance is targeted. In the wake of intense competition from commercial banks in this regard, surplus liquidity, in the meantime, is expected to be deployed in capital market related finances and money market operations despite marginal returns available on these avenues. Another option available to the management is proprietary trading, which is capped on a cost basis at the level of equity base of the bank. Meanwhile, shareholders have given approval for an investment of around PKR 500mln into recent and upcoming initiatives of the group in the due course of time.
- There was a substantial increase in the classified portfolio of FDIB, emanating mainly from leases. While the management has enhanced recovery efforts, there is a sizeable amount of general provisioning against the impaired portfolio, providing a cushion against potential loss. Although the bank intends to continue with an increasing focus on issuing LoCs/LoGs, the associated risk is being managed by applying a careful selection and appraisal process usually followed for fund-based exposures.
- FDIB is exposed to a higher level of market risk emanating from sizeable investments in non-strategic listed equity securities, close to the bank's equity base. Although the bank has investment policy guidelines in place, risk of adverse movement in equities cannot be precluded altogether. Cognizant of the fact, a risk manager is recently hired at a senior management level as a group resource; he is expected to help in modernizing the overall risk management framework of FDIB. Meanwhile, the bulk of the existing equity portfolio consists of liquid, reasonably strong, and dividend paying shares. Furthermore, a sizeable surplus on the investments classified as "available for sale", albeit limited to some stocks, provides a cushion against any adverse movement in the stock market.
- FDIB, while following its high retention policy, made a 33% right issue at a 50% premium in the beginning of FY07. This has strengthened the already sound capital structure. The strong risk absorption capacity of the bank is further supplemented by substantial amount of unrecognised appreciation in investment properties. The bank mobilized funds from financial institutions in the form of COIs and other credits lines during the year. Consequently, FDIB experienced an upsurge in the financial leverage despite improvement in the equity base. Nevertheless, the associated financial risk remains manageable, especially given sizeable amount of liquid investments.

PROFILE

- Dawood Leasing Company Limited, operating since 1995, was converted into First Dawood Investment Bank (FDIB) in 2004. Since then FDIB has focused on developing alternative revenue resources, including fee-based income, to complement leasing business. Meanwhile, the bank has an investment of PKR 246mln in associates at end-Sept 07, accounted for using equity method of accounting since FY07.
- FDIB, listed on the Karachi stock exchange, is sponsored by a branch of the reputed Dawood family, which is one of the largest business groups in Pakistan. The bank's two subsidiaries – Guardian Modaraba Management (Pvt.) Limited and Providence Modaraba Limited – were merged with BRR Investment (Pvt.) Limited during the year, which is currently managing BRR Guardian Modaraba. Recently, the group has strengthened its standing in the financial sector by setting up an Islamic bank – Dawood Islamic Bank Limited – in cooperation with established financial sector entities and high net worth entrepreneurs of the Gulf region. Takaful Insurance and wind power project are in the offing. The company's Chairman and Chief Executive, Mr. Rafique Dawood, is an MBA from Harvard Business School with extensive business experience, and has held senior management positions with various family concerns both in Pakistan and abroad.