



FIRST DAWOOD INVESTMENT BANK LIMITED (FDIB)

Ratings (January 2009)

First Dawood Investment Bank Limited

	New	Previous
Entity		
Long term	A-	A+
Short term	A2	A1
Secured TFC		
PKR 345mln	A	AA-
Outlook	Negative	-

Financial Data

PKR (mln)

	30-Jun-08	30-Jun-07
Total Assets	11,064.2	12,362.6
Equity	1,388.2	1,274.5
Profit After Tax	113.7	188.5
ROE %	8.9	16.6
Debt/Equity %	611.7	755.4

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TFC ISSUE:

FDIB issued a privately placed TFC of PKR 345mln in Sept 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%.

RATING RATIONALE AND KEY DRIVERS

- The ratings of FDIB reflect deteriorating financial profile of the bank, an outcome of high leverage and greater reliance on short-term borrowings. In the prevailing tightened money market and an overall cautious stance by most lenders, coupled with high interest rates, the bank’s financial risk has increased significantly. The liquidity risk is further exacerbated as a portion of company’s investment portfolio has experienced significant erosion in its value. Meanwhile, the risk of further deterioration in asset quality, arising from both funded and non-funded exposures, has also increased. Also the performance, including the risk absorption capacity, has been impacted by continuing pressure on spreads in financing operations, loan impairment losses and revaluation losses from higher exposure in equity market.
- Nevertheless, the management of the bank, cognizant of the challenges faced by the bank, is exploring various options to revive the bank’s operations, the major being the injection of fresh equity into the bank. The ratings carry negative outlook. Failure to achieve tangible progress on these plans in the near term could result in further downward adjustment in the ratings.

ASSESSMENT

- Investment banking industry in Pakistan is undergoing a challenging phase, and most entities in the industry have lately experienced significant deterioration in credit profiles and access to funds. Meanwhile, various macro economic challenges faced by the entire economy have severely impacted the operating environment for the investment banking industry.

- Likewise, FDIB performance and financial profile has been dented by these events. During the year, there was a notable shrinkage in the financing portfolio mainly leasing business due to competitive pressure faced by the bank. Meanwhile, spreads squeezed as asset yield could not match the pace of escalation in the cost of borrowing in the current rising interest rate scenario. Consequently, the bank’s dependence on placement and equity market operations for revenue generation increased. The performance of the bank came under pressure due to downslide in the equity market towards the end of FY08. Profitability was further dampened on account of high provisioning against rising trend in asset impairment. While contribution from fee-based income, mainly guarantee commission, witnessed an increasing trend, the risk assumed in the current difficult credit environment remains higher. 1Q FY09 proved to be a difficult period for the bank as it reported operating loss, mainly attributable to deficit on the stock market portfolio and continuing pressure on spreads.

- Prospects of FDIB have come under pressure attributable to shrinkage in the financing portfolio and pressure on spreads. Moreover, managing the asset quality and finding business growth avenues would be major challenges. At the same time, higher exposure of the bank to equity market operations is expected to result in significant revaluation losses from the ongoing downslide in the equity market. These factors could lead to the erosion of the capital of the bank. Meanwhile, access to economical sources of funding would remain a cause of concern particularly over the short-term. Nevertheless, management of the bank, cognizant of the challenges faced by the bank, is exploring various options to revive bank’s operations, the major being the injection of fresh equity into the bank. However, the success of these initiatives remains to be seen.

- There was a substantial increase in the classified portfolio of the bank (Impaired lending to gross finances FY08: 27.5%, FY07: 12.7%) mainly emanating from long-term finances, placements and margin financing. Meanwhile, the proportion of uncovered NPLs to equity has increased signifying higher potential drag on the risk absorption capacity. The bank also has sizeable off balance sheet exposures in the form of guarantees. However, the associated risk is expected to outweigh return in case of a guarantee call.

- FDIB exposure to equity market, close to the bank’s equity base, exposes the bank to high level of market risk. Significant revaluation losses from equity market operations could severely impact the risk absorption capacity of the bank. Meanwhile, tight market conditions, making bank’s TFC portfolio almost illiquid, have further intensified the liquidity risk.

- The bank’s funding base comprises a mix of bank borrowings and certificate of deposits, with a larger proportion of the former. FDIB made significant short-term borrowings during the year, whereas the assets were mainly long-terms, producing a maturity mismatch. Moreover, current economic scenario has made funding inaccessible in the interbank bank market. Although, currently the bank is adequately capitalized, ensuing losses could significantly dampen the capital base, necessitating the urgent need for injection of equity.

PROFILE

- Dawood Leasing Company Limited, operating since 1995, was converted into First Dawood Investment Bank (FDIB) in 2004. Since then FDIB has made efforts in developing alternative revenue resources, including fee-based income, to complement leasing business.

- FDIB, listed on the Karachi stock exchange, is sponsored by a branch of the reputed Dawood family. First Dawood Group in recent years have pursued increased diversification in the financial sector including Islamic banking, asset management, brokerage business, Islamic insurance and Modaraba. Currently non-banking financial companies (NBFC) are facing tough operating environment. Consequently, all the companies of First Dawood Group have simultaneously come under pressure and are facing multiple challenges.

- The seven members BoD, comprises majority representation of First Dawood Group and nominees of National Investment Trust and State Life Insurance Corporation. The company’s Chief Executive and Chairman, 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.