The Pakistan Credit Rating Agency Limited

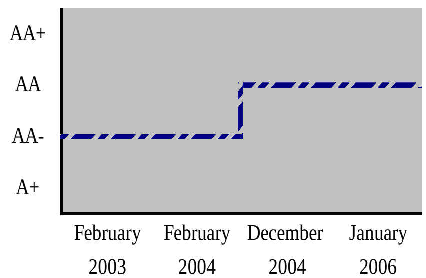
First Habib Modaraba (FHM)

Ratings (February 2006)

First Habib Modaraba

Entity	New	Previous
Long Term	AA	AA
Short Term	A1+	A1+

L.T Entity Rating – History



Financial Data

PKR (mln)

	30-June-05	30-June-04
Total Assets	2,657.1	2,131.8
Equity	825.2	420.99
Profit after Tax	101.8	71.28
ROA %	4.25	3.83
ROE %	16.33	17.36
Equity/Assets %	31.06	19.75

Analysts

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Rating Rationale

Assessment

- The ratings reflect the efficacy of FHM's business strategy and prudent risk management policies, which have enabled it to maintain outstanding asset quality while ensuring sustainability of performance, despite the increasingly competitive operating environment.
- FHM's improving trend of performance continued into 2005. Earnings benefited from volume growth, a slight widening in margins and strict control over operating costs. During FY05, the bottom line was also augmented by capital gains. However, ROE registered a slight decline owing to around two-fold increase in the equity base due to utilization of the right issue proceeds. The Modaraba's performance trend was maintained in 1HFY06 largely on the back of volume expansion and remained in line with targets for FY06.
- Going forward, FHM's performance is expected to remain robust although strong earnings may be constrained by pressure on margins amidst increasingly competitive pressures. To combat such pressures, the management plans on volume expansion, with increased focus on cement and energy sectors. The volume growth will be facilitated through increasing geographical outreach with the addition of one more branch in Lahore and three liaison offices each in Faisalabad, Rawalpindi and Korangi industrial area in Karachi during the current year.
- The Modaraba has demonstrated its ability to maintain infection-free lease portfolio over the years. The low risk profile reflects the Modaraba's effective risk management policies, both in terms of credit evaluation and monitoring. The lease portfolio, constituting around 77% of total assets, is balanced between plant & machinery and vehicles. The credit concentration decreased during the year with top 5 exposures comprising 20% of the total lease portfolio. Moreover, the potential risk is mitigated by the fact that these exposures are good quality credits that are performing well.
- The equity portfolio of FHM has increased by 35% till the end-1H06 but it still constitutes a modest 17% of the total equity at cost basis. The portfolio is mainly dominated by shares of group companies, which are liquid and offer a stable return. Moreover, the substantial surplus on revaluation of investments of PKR 908mln as at December 31, 2005, provides a cushion against unforeseen negative movement in the stock market in addition to augmenting the risk absorption capacity. Going forward, the management plans to continue trading in stocks on a selective basis in order to boost profitability.
- FHM's capital structure has significantly improved through 100% right issue. However, going forward, it would come to the previous years' level considering the management's plan of leveraged volume expansion, as partially reflected in 1H06. FHM's main source of funding remained COMs though the proportion has decreased; additional funding was obtained from banks through *morabaha* and *musharika* facilities. Going forward, the Modaraba is planning to issue *musharika* based term finance certificates. Owing to FHM's ability to generate funds through COMs, the availability of substantial unutilized credit lines and proposed *musharika* based TFC issue; it is not likely to face any funding constraints.

Support

- While the Habib Group (HG) has no contractual obligation to support FHM, owing to the close institutional linkage and use of the name 'Habib', in PACRA's view, support would be forthcoming, should it prove necessary.

Background

- First Habib Modaraba (FHM) is a Habib Group (HG) entity. The Habib Group (HG) is one of the largest business groups of Pakistan, with presence in most sectors of the economy, especially the financial sector, with two commercial banks incorporated in Pakistan (Bank Al-Habib and Metropolitan).
- Listed in 1985, FHM is a perpetual multipurpose modaraba. It is engaged primarily in the leasing business. Habib Modaraba Management Limited (HMML), with 38% stake, manages FHM.
- The board of directors of the Modaraba consists of experienced individuals mostly drawn from the financial sector. The current Chief Executive possesses over 40 years of experience in banking.