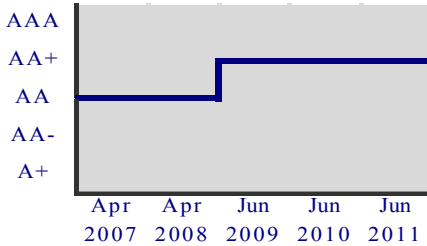


**RATINGS (JUNE 2011)**

**FIRST HABIB MODARABA [FHM]**

| ENTITY     | NEW | PREVIOUS |
|------------|-----|----------|
| LONG TERM  | AA+ | AA+      |
| SHORT TERM | A1+ | A1+      |

**FHM L.T. ENTITY RATING HISTORY**



**FINANCIAL DATA**

PKR (MLN)

|                       | 9MFY11* | FY10   | FY09   |
|-----------------------|---------|--------|--------|
| Total Assets          | 3,818   | 3,775  | 3,281  |
| Ijarah Assets         | 2,382   | 2,435  | 2,097  |
| musharika Assets      | 180     | 70     | 25     |
| Equity                | 2,020   | 2,037  | 1,971  |
| Gross Revenue         | 282     | 333    | 374    |
| Net Income            | 195     | 267    | 244    |
| ROE                   | 12.8 %  | 13.4 % | 12.5 % |
| ROA                   | 6.9 %   | 7.6 %  | 6.7 %  |
| Equity / Total Assets | 52.9 %  | 53.9 % | 60.1 % |

\* Based on un-audited accounts

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**RATING RATIONALE & KEY DRIVERS**

- The ratings denote FHM's sound risk absorption capacity emanating from a strong equity base. Moreover, the Modaraba has a healthy liquidity profile, as reflected in its sizeable investment book, yielding a stable dividend stream. FHM's risk-averse business strategy has enabled the Modaraba to sustain very strong asset quality despite continuing distressed economic conditions. Ijarah financing continues to remain FHM's strong forte, though the management is working to diversify its financing portfolio by taping hitherto unexplored potential areas of business. Meanwhile, FHM's association with the House of Habib remains a key factor.
- The ratings depend upon the management's strategy to successfully maintain a stable profit stream. The Modaraba's ability to sustain its very strong asset quality, despite continuing socio-political and economic challenges facing the country, is key driver of the ratings of FHM.

**ASSESSMENT**

- The Moderator's Ijarah portfolio (62% of total assets) is divided into two components: (i) plant, machinery & equipment (33%) and (ii) vehicles (67%). With regard to the sectoral mix, FHM's portfolio underwent a change during FY10, as exposure to chemicals & pharmaceuticals increased significantly to 28% (FY09: 17%), while exposures in other sectors witnessed a small decline on a relative basis. A similar mix was observed as at end-Mar11. Credit concentration declined marginally in terms of top five exposures (9MFY11: 20%, FY10: 21%) inline with efforts to reduce average exposure size.
- During 9MFY11, FHM witnessed an increase in its gross revenues, attributed to higher average Ijarah assets during the period, slightly supplemented by diminishing musharika financing. Accordingly, net revenue increased, despite a higher financial burden on account of relatively higher CoM base, which were utilized for funding the growth in Ijarah portfolio. Spreads were largely maintained on a comparable basis. During the period, dividend contribution in other income was low, expected to be complemented by end-FY11. Nevertheless, FHM was able to sustain its net income, despite a slight inflationary impact on its operating cost.

- Going forward, FHM intends to continue with its stance of conservative growth. While targeting quality customers, the Modaraba plans to manage risks emanating from continuing weakening in the macro-economic environment. FHM's competitive edge is its ability to quickly process financing requests of its premier clients. In terms of product mix, while Ijarah financing is expected to remain the Modaraba's strong forte, focus on diminishing musharika financing is expected to increase. Meanwhile, the management intends to offer Istisna – an Islamic pre-shipment financing mode to facilitate export oriented businesses – and have obtained requisite regulatory approval for the same. FHM intends to gradually enhance outreach through opening of new branches in cities where it did not have presence previously. The Modaraba had offices mainly located in Karachi and have recently opened new branches in Lahore and Islamabad.

- FHM follows a cautious strategy focusing on high credit quality customers. This translates into a very low asset impairment ratio. During FY10, the Modaraba recognized an impairment of PKR 4.2mln against Ijarah assets (FY09: PKR 13.9mln). At the same time, FHM recognized a reversal in provisioning as its recovery efforts materialized (PKR 5.8mln). During 9MFY11, while there was negligible impairment, the Modaraba further recovered a sizable portion (PKR 6.8mln) of remaining outstanding dues, with the balance (PKR 5.5mln) being rescheduled. Although fresh infection cannot be ruled out, NPL accretion is expected to remain limited given strong credit profile of FHM's clients.

- FHM has a sizable equity investment portfolio (PKR 1,131mln), constituting ~39% of the Modaraba's total equity as at end-Mar11. The portfolio is dominated by holdings in Habib Metropolitan Bank Limited (51%) and Bank Al-Habib Limited (47%). The Modaraba has substantial unrealized gain on its equity investments (9MFY11: PKR 895mln, FY09: PKR 856mln).

- FHM has a low leveraged capital structure with an equity-to-total-asset ratio of 53% at end-Mar11. The Modaraba obtains funding primarily in the form of Certificates of musharika (CoM), which constituted 96% of the total funding base (net of security deposits). These are mostly acquired from corporates (58%) and individuals (39%), and a small portion from financial institutions (3%). The proportion of individual certificate holders has increased on a YoY basis owing to efforts to diversify the Modaraba's CoM composition. This is accordingly reflected in a decrease in the top ten CoM holders concentration to 48% of the total certificate base from 56% last year.

**PROFILE**

- First Habib Modaraba, established in 1985 and listed on all the bourses of the country, is a perpetual multipurpose modaraba engaged primarily in the leasing business. FHM, managed by Habib Modaraba Management Company (Pvt.) Limited (HCML) is associated with House of Habib (HoH); this association is due to direct shareholding of Habib family members in HCML, which holds ~50% ownership stake in the Modaraba. Originating back to mid-nineteenth century, HoH is one of the largest business groups of Pakistan having presence in most sectors of the economy. HoH also owns a mid-sized bank of the country - Habib Metropolitan Bank Limited.

- The board of directors of FHM comprises five professionals having vast experience of banking and finance. The Managing Director, Mr. Muhammad Shoaib, Ex-Chairman of Modaraba Association of Pakistan, has been associated with the Modaraba since its inception. The management team is composed of seasoned professionals who have been associated with the Modaraba for a long period.