

MUTUAL FUND RATING METHODOLOGY

INTRODUCTION

Mutual fund industry in Pakistan is showing impressive growth. Its acceptance as a useful tool to deploy funds is on rise amongst both individual and corporate investors. However, at the same time, the increasing number of asset managers as well as funds has necessitated the need of an independent opinion on fund performance. Mutual fund rating, therefore, provides a useful yardstick to existing and potential investors and facilitates their investment decisions.

PROCESS OVERVIEW

PACRA follows a comprehensive approach to rate the two distinct ingredients of the mutual fund industry – asset managers and funds. These two are rated on separate scales. While the asset manager rating seeks to determine the professional capacity of asset managers, fund ratings focus on relative performance of mutual funds.

Every mutual fund investor has a distinct set of investment objectives and preferences. They all usually have unique risk-return perception and investment horizons that make it difficult to capture these preferences in a single yardstick for guiding investment decisions. PACRA Fund Rating (commonly referred to as *PACRA star rating*) attempts to address this investor need. The star rating provides an initial screening criterion to investors. The rating is a purely quantitative measure, avoiding any biases. It is based on historical returns of a fund relative to other funds in similar category. PACRA has defined different fund categories – each having distinct characteristics – and ratings of funds in a particular category are comparable. The rating methodology is designed in a manner that the star rating of a fund conveys a sense of how skillfully the fund has been managed; that is, the relative star ratings of two funds in a category should be affected more by manager skill than by market circumstances or events that lie beyond the fund managers' control. While the fund rating reflects the actual recorded performance, the likelihood of sustainability of performance – or improvement – can be judged from the rating of the manager of that fund.

DEFINING A CATEGORY

Fund categories define groups of funds whose constituents are similar in their risk factor exposures so that return comparisons are meaningful. Moreover, the observed return differences among funds relate primarily to security selection, or to variation in the timing and amount of exposure to different elements affecting the category. Each of these, over time, may be presumed to exercise a skill-related effect.

The following considerations apply while assigning a fund to a particular category:

- Funds are grouped by the type of investments that dominate their portfolios.

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- ***PACRA's Mutual Fund Rating Methodology***
- ***PACRA's Rating Actions***
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- In general, funds in the same category can be considered reasonable substitutes for the purposes of portfolio construction.
- Category membership of a fund is based on long-term portfolio composition philosophy for the fund as disclosed by its asset manager.

PACRA, after a detailed evaluation of mutual funds in Pakistan, has identified the following categories:

1. **Income Fund:** a fund that primarily invests in debt securities including money market instruments.
2. **Equity Fund:** a fund that primarily invests in equity securities.
3. **Balanced Fund:** a fund that carries a reasonable mix of equity and debt securities.
4. **Islamic Fund:** a fund that invests in *shariah* compliant instruments only.

The category of a particular fund will be established after evaluating its asset portfolio and in consultation with its asset manager. In case a particular fund is not being rated by PACRA, its category membership will be decided on the basis of the prospectus of the fund and public information available about its portfolio composition. The definition of a particular category can be narrowed down to generate a new category only if there are at least five funds to be included in the new category. Similarly, a new fund category can also be designed if a new class of assets, forming substantial portion of at least portfolios of five funds, is identified and is not covered by any of above categories.

MEASURING PERFORMANCE

PACRA considers both absolute and risk-adjusted performance. Absolute return refers to the appreciation or depreciation that a fund has achieved over a period of time and effectively this is what an investor takes home at the end. However, at the same time, the level of risk (extent of variability) that is involved with those returns is also important. Risk-adjusted return shows the trade-off investors make between risk and return. A combination of both absolute and risk adjusted performance is likely to provide investors a better measure to gauge historical performance of different funds.

TOTAL RETURN

PACRA calculates a fund's return for a given quarter as follows:

$$R = \frac{PE - PB + D +/- A}{PB} - RF$$

Where

- | | | |
|----|---|---|
| R | = | Total excess return for the quarter |
| PE | = | End of quarter NAV (net assets value) per share/certificate |
| PB | = | Beginning of quarter NAV per share/certificate |
| D | = | Cash distributions during the period |
| A | = | Adjustment on account of addition to capital at a value different from NAV (valid in case of closed-end mutual funds) |
| RF | = | Risk free rate – weighted average yield on 3-month treasury bills |

RISK-ADJUSTED RETURN

PACRA uses Sharpe Ratio – a technique developed by Nobel prize winning economist William Sharpe – to measure a fund’s risk adjusted return. Mathematically, Sharpe Ratio is the return generated over the risk free rate, per unit of risk. The ratio is calculated as follows:

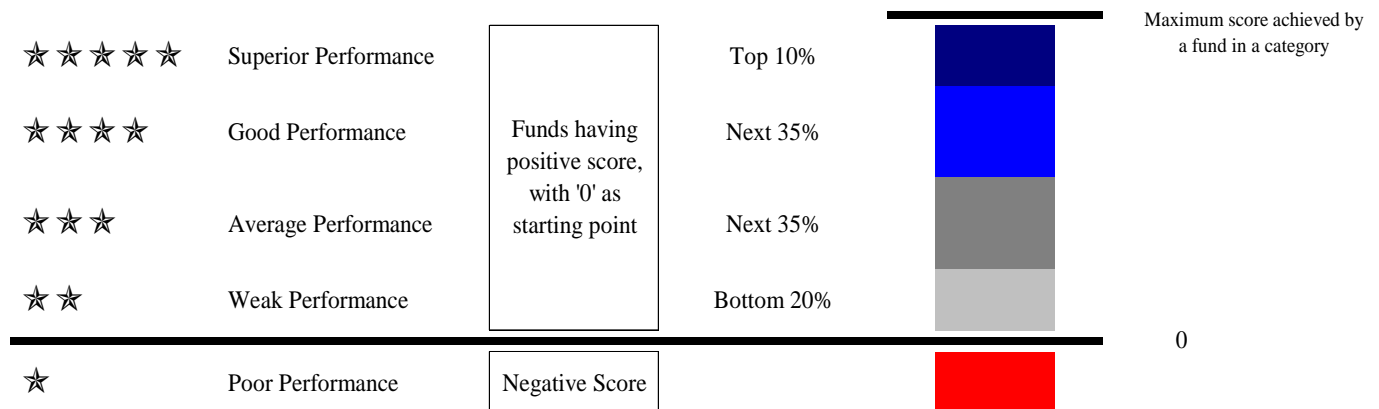
$$SR = \frac{R}{SD}$$

Where

R = Total excess return for the quarter (as explained above)

SD = Standard deviation of the fund. SD is computed using the trailing quarterly total return for the appropriate time period, which is either four quarters or twelve quarters.

PACRA calculates an overall quantitative score by combining these two equally weighted measures of historical performance. The star rating of a fund is then assigned according to the following distribution:



Other elements considered while calculating a score are as follows:

- Quarter of a year is used as a reference period to calculate performance.
- Funds are rated for up to two periods – the trailing four quarters (one year) and twelve quarters (three years) and simple average of quarterly returns in these periods is used to calculate final score.
- The score calculated on the basis of trailing four quarters performance counts 60% of the overall rating and the score based on trailing twelve quarters performance counts 40% of the rating.
- Funds with less than four quarter of performance history are not rated.

To summarise, the star rating is strictly a quantitative measure and funds are rated within their respective categories. The rating exercise measures performance of funds in a risk and return combination and then funds are ranked accordingly. It is important to note that a fund’s particular star rating is with reference to its category and consequently, ratings are comparable only in the same category.

PACRA RATING ACTIONS

September 26, 2005: PACRA Assigns IFS Rating to East West Insurance Company Limited

The Pakistan Credit Rating Agency (PACRA) has assigned an insurer financial strength (IFS) Rating of 'BBB' (Triple B) to East West Insurance Company Limited. The rating has been assigned a **positive** outlook. The rating denotes good capacity to meet policyholder and contract obligations.

The rating reflects EWI's satisfactory financial base, high solvency, sound liquidity position and a stable risk profile owing to effective and prudent underwriting practices being followed by management. At the same time, the rating also takes into account the company's weak profitability, attributable to higher level of operating expenses and modest investment income. However, the prospects for investment income have improved due to revamping of the investment portfolio. The management has also evolved a strategy for strengthening the core performance through curtailing costs and expansion in business volumes.

About the company: EWI commenced commercial operations as a general insurance company in 1983 and is currently listed on the Karachi Stock Exchange. The shareholding in the company is effectively held by Yunus family and all the members of the BoD, including the chief executive, belong to this family. The other major concern owned by the family is the Metropolitan Life Assurance Co. of Pakistan Ltd. The family also had the controlling interest in

Mybank Ltd. (previously Bolan Bank Ltd.), which it divested in Mar 04.

The company is writing various classes of general insurance business, and is the pioneer in the field of livestock insurance and recently extended coverage to loans against crops. The company has an extensive network of around 50 branches and agency offices spread across the country.

September 15, 2005: PACRA Assigns Rating to the Proposed TFCs of Bank Alfalah Limited

The Pakistan Credit Rating Agency (PACRA) has assigned a rating of **AA-** (Double A minus) to the proposed unsecured, subordinated term finance certificates issue of PKR 1,500mln by Bank Alfalah Limited. The rating denotes a very low expectation of credit risk emanating from a very strong capacity for timely payment of financial commitments.

The rating reflects the bank's well-conceived business strategy supported by an effective risk management system, helping the bank to maintain good asset quality despite its high growth mode in recent years. BAL's strategy encompasses continuing growth in business volumes through providing a wider spectrum of innovative financial products and solutions to an expanding client base. However, this growth is without compromising on the quality of the credit portfolio for which a well-designed, transparent risk management system is in place.

About the issuer - the bank: Bank Alfalah Limited (BAL), since its privatization in 1997, is majority owned by the Abu Dhabi Group. Pursuant to successful offer for sale of 20% shares by some of shareholders, the bank has been listed on the Karachi Stock Exchange in 2004. Bank Alfalah's business is governed by a low-margin high-volume philosophy. In recent years, the bank has shown aggressive growth in all areas of business including deposit mobilization, credit expansion and geographical outreach. BAL is the fifth largest bank in the country in terms of total assets with a network of 115 branches, including 15 Islamic branches at end-June 05.

About the TFC issue: The proposed unsecured subordinated TFCs would have a tenor of 8 years carrying mark-up at a floating rate of latest 6-month KIBOR plus 1.5%. Major principal redemption will be in three equal semi-annual installments commencing from the 84 th month of the issue.

September 07, 2005: PACRA Maintains Ratings of House Building Finance Corporation (HBFC)

The Pakistan Credit Rating Agency (PACRA) has maintained the long-term rating at 'A' (Single A) and the short-term rating at 'A1' (A One) of House Building Finance Corporation (HBFC). These ratings denote a low expectation of credit risk emanating from a strong capacity for timely payment of financial commitments.

HBFC's ratings reflect the Corporation's sound equity base signifying high-risk absorption capacity and strong underlying security against loans. Despite substantial proportion of overdue

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rentals, affecting performance from core financing operations, the cashflows remain strong to service financial commitments on timely basis owing to the distinctive funding arrangements with SBP. While these funds are being repaid gradually, the ongoing concerted efforts by the management for restructuring of the organization are expected to bring the requisite level of efficiencies and improvement in the Corporation's operations, by the time it has to rely on borrowings from the open market at competitive rates. A multidimensional reforms program is in various stages of implementation to make HBFC an efficient and proactive organization compatible with the increasingly competitive environment in the financial sector.

About the Corporation: The House Building Finance Corporation (HBFC) was established in 1952 under the HBFC Act, to provide financial facilities for the construction, reconstruction, repair and purchase of houses, particularly to the low and middle-income groups of the economy. The Government of Pakistan (GOP) and the State Bank of Pakistan (SBP) jointly hold the share capital of the Corporation.

The general direction and administration of the Corporation and its affairs is vested in the Board of Directors appointed by the GOP. HBFC has a large network of 60 offices spanning across the country, managed through 12 zones with headquarters at Karachi. The Corporation employs more than 1300 personnel.

Unlike other financial institutions engaged in housing finance, the bulk of the loan disbursements of HBFC are to low income group, and for construction of house, as against outright purchase and renovation. Under its new mission,

the HBFC aims to be the housing bank for Small & Medium Housing (SMH) finance.

List of Publicly Disseminated Ratings

Entity Ratings:

	Name of the Organisation	Type of Rating	Date of Notification MM/DD/YYYY	Rating Assigned		
				FS/FR/ AMR/DG	Long-Term	Short-Term
FINANCIAL SECTOR						
MUTUAL FUNDS / ASSET MANAGEMENT COS.						
1.	ABAMCO Limited	AMR ¹	06/30/2004	AM2	---	---
2.	Arif Habib Investment Management Limited	AMR	09/24/2004	AM2	---	---
3.	Atlas Asset Management Company Limited	AMR	10/27/2004	AM3	---	---
4.	BSJS Balanced Fund Limited	FR ²	05/17/2004	AA(f)	---	---
5.	National Investment (Unit) Trust – NIT	FR	09/15/2003	AA(f)	---	---
6.	Pakistan Income Fund (PIF)	FR	09/24/2004	A+(f)	---	---
7.	Pakistan Premier Fund (PPF)	FR	09/24/2004	AA(f)	---	---
8.	Pakistan Stock Market Fund (PSMF)	FR	09/24/2004	AA(f)	---	---
9.	Unit Trust Of Pakistan	FR	04/01/2004	AA(f)	---	---
DFIS / INVESTMENT COS. / BROKERAGE HOUSES						
1.	House Building Finance Corporation	Entity	08/31/2005		A	A1
2.	Investment Corporation of Pakistan (ICP)	Entity	03/04/2005		AA	A1+
3.	Jahangir Siddiqui & Company Limited	Entity	03/11/2005		AA+	A1+
4.	Jahangir Siddiqui Capital Markets Limited	Entity	06/25/2005		AA-	A1+
5.	Pakistan Industrial Credit & Investment Corporation Limited (PICIC)	Entity	06/30/2005		AA	A1+
6.	Pakistan Kuwait Investment Company (Pvt) Limited	Entity	06/23/2005		AAA	A1+
7.	Pak Libya Holding Company (Pvt) Limited	Entity	05/17/2005		AA-	A1+
MODARABAS						
1.	First Fidelity Leasing Modaraba	Entity	02/08/2005		A-	A2
2.	First Habib Modaraba	Entity	12/17/2004		AA	A1+
3.	First Punjab Modaraba	Entity	12/31/2004		A	A1
4.	Standard Chartered Modaraba (Formerly First Grindlays Modaraba)	Entity	12/22/2004		AA+	A1+
LEASING COMPANIES						
1.	Askari Leasing Limited	Entity	12/30/2004		A+	A1
2.	Network Leasing Corporation Limited	Entity	12/17/2004		BBB	A3
3.	Orix Leasing Pakistan Limited	Entity	01/12/2005		AA+	A1+
4.	Union Leasing Limited	Entity	12/22/2004		A+	A1

¹ Asset Manager Rating

² Fund Rating



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	Name of the Organisation	Type of Rating	Date of Notification		Rating Assigned	
			MM/DD/YYYY	FS/ FR/ AMR/DG	Long-Term	Short-Term
BANKING COMMERCIAL						
1.	AlBaraka Islamic Bank (Pakistan Branches)	Entity	06/27/2005		A-	A1
2.	Askari Commercial Bank Limited	Entity	06/09/2005		AA+	A1+
3.	Bank Al Habib Limited	Entity	06/15/2005		AA	A1+
4.	Bank Alfalah Limited	Entity	06/09/2005		AA	A1+
5.	The Bank of Punjab	Entity	06/14/2005		AA-	A1+
6.	Dawood Bank Limited	Entity	05/05/2005		BBB-	A3
7.	First Women Bank Limited	Entity	06/29/2005		AA	A1+
8.	KASB Bank Limited	Entity	05/05/2005		BBB+	A2
9.	Metropolitan Bank Limited	Entity	06/10/2005		AA+	A1+
10.	MCB Bank Limited (Formerly Muslim Commercial Bank Limited)	Entity	05/18/2005		AA	A1+
11.	NDLC-IFIC Bank Limited	Entity	07/20/2005		A+	A1
12.	Prime Commercial Bank Limited	Entity	06/27/2005		A+	A1
13.	Saudi Pak Commercial Bank Limited	Entity	06/13/2005		BBB	A3
14.	Soneri Bank Limited	Entity	03/18/2005		AA-	A1+
15.	Union Bank Limited	Entity	06/25/2005		AA-	A1+
BANKING INVESTMENT						
1.	Atlas Investment Bank Limited	Entity	12/22/2004		A+	A1
2.	First Dawood Investment Bank Limited (Formerly Dawood Leasing Company Limited)	Entity	02/03/2005		A+	A1
3.	First International Investment Bank Limited	Entity	12/22/2004		A	A1
4.	Jahangir Siddiqui Investment Bank Limited	Entity	03/22/2005		A+	A1
5.	Orix Investment Bank Limited	Entity	12/29/2004		A	A1
5.	Trust Leasing & Investment Bank Limited	Entity	11/12/2004		AA-	A1+
INSURANCE COMPANIES						
1.	East West Insurance Company Limited	IFS ³	09/21/2005	BBB	---	---
2.	Habib Insurance Company Limited	IFS	09/21/2004	A	---	---
3.	International General Insurance Company of Pakistan Limited (IGI)	IFS	06/23/2004	AA	---	---
4.	Muslim Insurance Company Limited	IFS	09/23/2004	A	---	---
5.	New Jubilee Insurance Company Limited (NJI)	IFS	09/27/2004	AA	---	---
REAL ESTATE DEVELOPERS & PROJECTS						
1.	Eden Developers (Pvt) Limited	DG ⁴	07/01/2004	PE2	---	---
INDUSTRIAL CORPORATES						
TEXTILE						
1.	Azgard Nine Limited (Formerly Legler Nafees Denim Mills Limited)	Entity	02/24/2005		A	A1
2.	Nishat Mills Limited	Entity	03/01/2005		A+	A1

³ Insurer Financial Strength Rating

⁴ Developer Grading



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Name of the Organisation	Type of Rating	Date of Notification	Rating Assigned			
			MM/DD/YYYY	FS/ FR/ AMR/DG	Long-Term	Short-Term
SUGAR & ALLIED						
1.	Al-Abbas Sugar Mills Limited	Entity	02/17/2005		A	A1
FUEL & ENERGY						
1.	Attock Petroleum Limited (APL)	Entity	11/14/2004		AA	A1+
2.	Attock Refinery Limited (ARL)	Entity	03/02/2005		AA-	A1+
3.	National Refinery Limited (NRL)	Entity	04/27/2005		AAA	A1+
4.	Pak-Arab Refinery Company Limited (PARCO)	Entity	12/30/2004		AAA	A1+
5.	Pakistan State Oil Company Limited (PSO)	Entity	10/20/2004		AAA	A1+
TRANSPORT & COMMUNICATION						
1.	Pakistan Mobile Communications (Pvt) Limited (Mobilink)	Entity	09/23/2004		AA-	A1
2.	WorldCall Communications Limited	Entity	03/04/2005		A+	A1
CHEMICAL & PHARMACEUTICALS						
1.	Engro Chemical Pakistan Limited	Entity	04/05/2005		AA-	A1+
PAPER & BOARD						
1.	Packages Limited	Entity	05/24/2005		AA	A1+
MISCELLANEOUS						
1.	Tri-Pack Films Limited	Entity	05/23/2005		A+	A1



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Term Finance Certificates (TFCs) Ratings:

Sr. No.	Issuer Name	Amount PKR mln	Date of Notification (MM/DD/YYYY)	Issue Date (MM/DD/YYYY)	Rating Assigned
1.	Al-Abbas Sugar Mills Limited (<i>Privately Placed</i>)	350.00	02/17/2005	07/03/2003	A+
2.	Al-Noor Sugar Mills Limited	203.66	04/15/2005	10/31/2000	A2*
3.	Askari Commercial Bank Limited – I	1,500.00	06/09/2005	02/04/2005	AA
4.	Askari Commercial Bank Limited – II (<i>Proposed</i>)	1,500.00	06/09/2005	<i>To be issued</i>	AA
5.	Atlas Investment Bank Limited – I	200.00	12/22/2004	09/27/2000	AA-
6.	Atlas Investment Bank Limited – II	100.00	12/22/2004	08/16/2001	AA-
7.	Azgard Nine Limited	2,000.00	02/25/2005	09/20/2005	A+
8.	Bank Al Habib Limited	1,350.00	06/15/2005	07/16/2004	AA-
9.	Bank Alfalah Limited – I	650.00	06/24/2004	12/21/2002	AA-
10.	Bank Alfalah Limited – II	1,250.00	08/26/2004	11/24/2004	AA-
11.	Bank Alfalah Limited – III	1,500.00	09/02/2005	<i>To be issued</i>	AA-
12.	Chanda Oil & Gas Securitization Company Limited – Securitised	1,000.00	06/08/2004	02/16/2005	A
13.	Engro Chemical Pakistan Limited (2 nd Tranche)	1,000.00	04/05/2005	07/06/2002	A1+*
14.	First Dawood Investment Bank Limited (<i>Formerly Dawood Leasing Company Limited</i>) (1 st Tranche)	253.05	02/03/2005	09/21/2001	AA-
15.	First Dawood Investment Bank Limited (<i>Formerly Dawood Leasing Company Limited</i>) (2 nd Tranche)	345.00	02/03/2005	07/27/2002	AA-
16.	First International Investment Bank Limited (M-Series)	57.04	12/22/2004	09/01/2001	A1*
17.	Gulistan Textile Mills Limited	320.67	03/31/2005	09/05/2001	A-
18.	Jahangir Siddiqui & Company Limited – TFCs-I	500.00	03/11/2005	04/18/2003	AA+
19.	Jahangir Siddiqui & Company Limited – TFCs-II	500.00	03/11/2005	12/23/2004	AA+
20.	Jahangir Siddiqui & Company Limited – TFCs-III (<i>Proposed</i>)	500.00	06/20/2005	<i>To be issued</i>	AA+
21.	Maple Leaf Cement Factory Limited	250.00	01/10/2005	07/20/2002	A+
22.	MCB Bank Limited (<i>Formerly Muslim Commercial Bank Limited</i>)	1,600.00	05/18/2005	08/10/2002	AA-
23.	Network Leasing Corporation Limited	100.00	12/17/2004	10/08/2000	A2*
24.	Orix Leasing Pakistan Limited (2 nd Tranche)	758.00	01/12/2005	08/01/2002	AA+
25.	Prime Commercial Bank Limited	800.00	06/27/2005	02/12/2005	A

* Short-term rating



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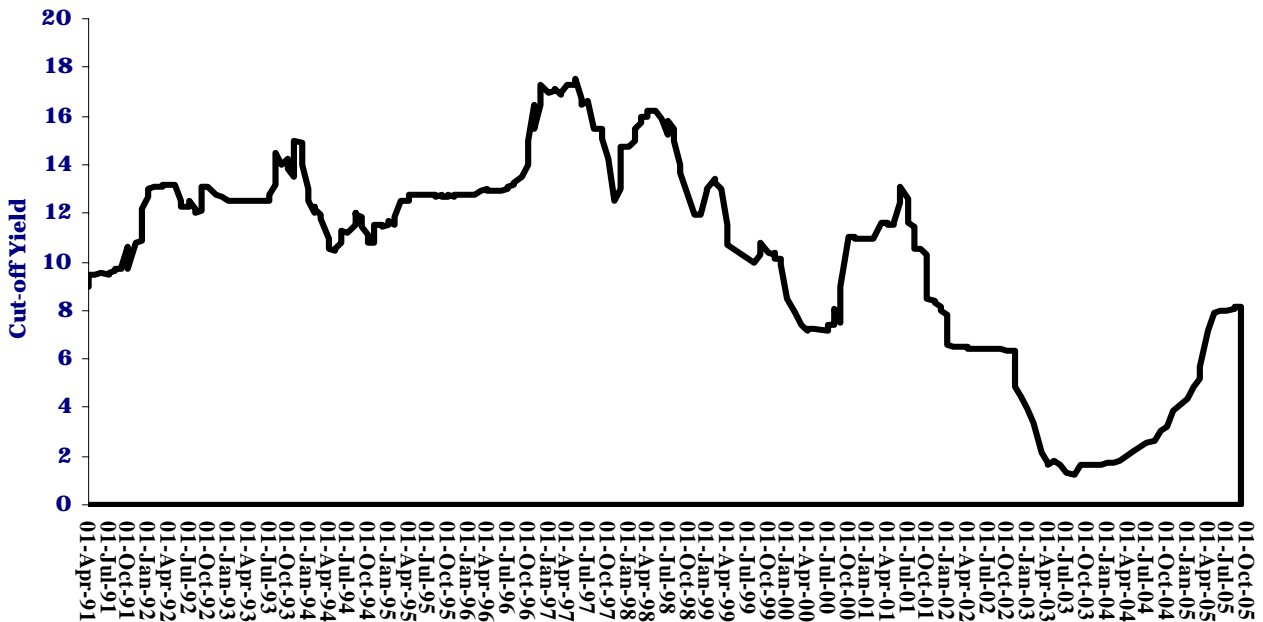
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26.	Securetel SPV Limited – (Securitized)	850.00	11/26/2004	04/27/2003	A
27.	Shahmurad Sugar Mills Limited	230.00	04/15/2005	05/21/2002	BBB
28.	Soneri Bank Limited	1,200.00	03/18/2005	05/05/2005	A+
29.	Sui Southern Gas Company Limited (1 st Tranche)	1,000.00	01/06/2005	06/01/2001	AA
30.	Sui Southern Gas Company Limited (2nd Tranche)	1,250.00	01/06/2005	06/11/2002	AA
31.	Trust Leasing & Investment Bank Limited – 1 st Tranche	250.00	11/12/2004	06/03/2003	AA
32.	Trust Leasing & Investment Bank Limited – 2nd Tranche	375.00	11/12/2004	07/18/2004	AA
33.	Trust Leasing & Investment Bank Limited – 3rd Tranche (Proposed)	375.00	06/17/2005	To be issued	AA
34.	Union Bank Limited – I	750.00	06/25/2005	12/21/2002	A+
35.	Union Bank Limited – II	750.00	06/25/2005	01/20/2004	A+
36.	Union Bank Limited – III (Proposed)	1,000.00	06/25/2005	To be issued	A+
37.	Union Leasing Limited	357.10	12/22/2004	04/20/2002	A1+*
38.	WorldCall Communications Limited	350.00	03/04/2005	10/01/2002	AA-

INTEREST RATE TRENDS

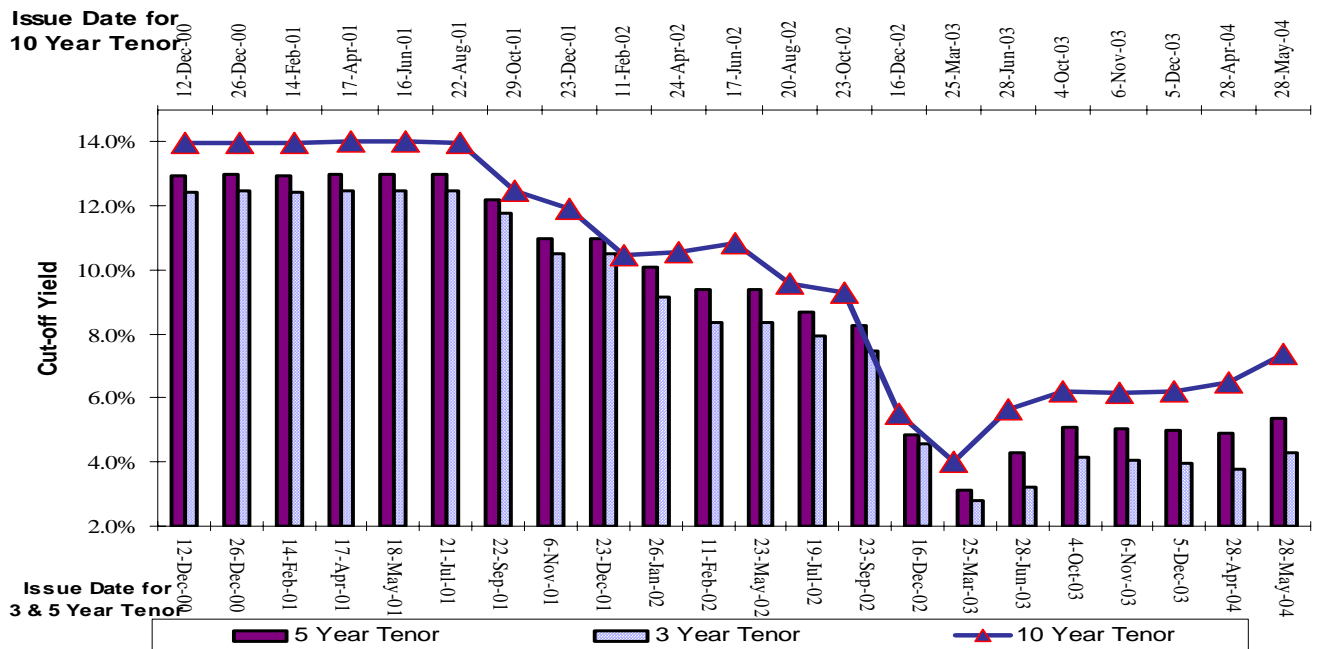
Short Term: (Treasury Bills)

6-Month Treasury Bills Cut-Off Yield



Long Term: (PIBs)

Rates for 3, 5 & 10 Year Tenor



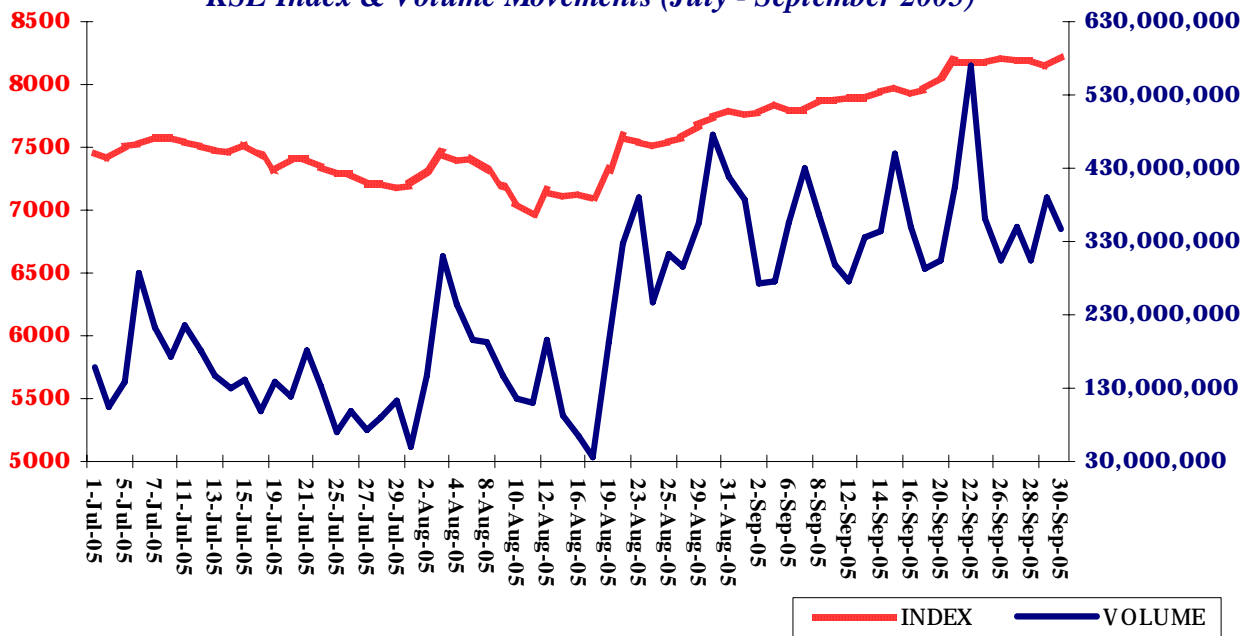
KIBOR:

KIBOR (6-Month Average Ask Rate)



KSE-100 Index:

KSE Index & Volume Movements (July - September 2005)





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