DEVELOPMENT FINANCE

The Pakistan Credit Rating Agency Limited

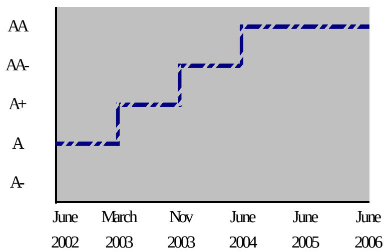
Pakistan Industrial Credit & Investment Corporation Limited

Ratings (June 2006)

Entity*	New	Previous
Long term	AA	AA
Short term	A1+	A1+

** The ratings have been placed on a RatingWatch pending outcome of the expected merger with PICIC Commercial Bank Limited.*

LT Entity Rating – History



Summary Data

(PKR million)

	31-Dec-05	31-Dec-04
Total Assets	40,489.4	31,715.4
Total Equity	8,518.8	6,701.8
Accumulated profit / (loss)	1,384.0	12.5
Net Income	2,227.3	1,636.3
ROA %	6.2	5.8
ROE %	29.3	32.8
Adjusted Equity / Total assets %	23.4	24.3

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Rating Rationale

Assessment

- PICIC's ratings reflect the Corporation's maintained risk absorption capacity supported by well diversified income streams from stable and sustainable sources, and the largely maintained relative positioning among the larger financial sector entities. Though having made substantial contribution to the Corporation's profitability in recent years, income from capital market operations will remain vulnerable to volatility risk emanating from fluctuations in the stock market. The renewed focus on core business operations is expected to lend further stability to the income stream. At the same time, the sustainability of PICIC's performance trends is contingent on the ability to improve spreads on lending operations as these remain considerably lower than those of commercial banks. The proposed merger with PICIC Commercial Bank Limited (PCBL) is expected to redress this relative disadvantage. However, the terms of merger and the timing of its consummation remain to be finalized. At this stage, therefore, Corporation's prospects are clouded by a degree of uncertainty. Consequently ratings remain on RatingWatch.
- During FY2005, despite a 49% YoY increase in advances backed by the increased geographical presence, PICIC's NIMR was substantially lower on a YoY basis. The primary reason for this was considerably reduced spreads emanating from the higher cost of funds during 2005. Furthermore, as already expected, the contribution from reversal of suspense income against regularized NPLs was substantially lower. However, as a consequence of suitable equity portfolio selection and deft trading, the Corporation earned sizable income in the shape of both dividends and capital gains. As a result, and backed further by better control over the admin and general expenses, the Corporation managed a 29% YoY increase in pre-tax profits. The declining trend in the NIMR has continued during 1Q2006, which, alongwith incremental provisions against classified loans emanating from the change in FSV weightage criteria lead to declining earning prospects as net income represented only about half of the 2005 level on a pro-rata basis. However, the management expects to make up for the shortfall in the ensuing months on account of substantial contributions from reversal of provisions against some classified loans. The recent re-profiling of a considerable portion of the deposit base is also expected to have favourable implications for spreads. Meanwhile, the continuation of consistent dividend yields both on strategic and other equity investments is expected to help reduce the relative dependence on unsustainable sources.
- With a substantial increase in the capital market activity, particularly since FY2003, the effective management of market risk has steadily gained special significance for PICIC as the Corporation is exposed to a higher degree of volatility risk. The management has in place effective risk management measures such as capping of non-strategic investments, limits of trading activity and stop-loss limits to contain the market risk. Furthermore, around PKR 1bln as unrealised surplus on these investments as of 1QE06 provides a cushion against any unexpected price erosion in future.
- The bank's asset quality in terms of net impaired lending as a percentage of equity continues to improve on a YOY basis. This is a function of, primarily the enhanced equity, and some recoveries made during the year. While fresh infections have been limited, the delinquent portfolio is adequately collateralised, largely by way of equitable mortgage of property. The rise in the market values of the underlying assets over recent years provides a further cushion against the potential risk of loss. The expected settlement of some delinquent cases, currently under negotiations, is also expected to have a positive impact on the asset quality. Meanwhile, the corporation is reviewing and upgrading its risk management system for credit evaluation and monitoring.
- Despite a record payout of 85% during 2005, the Corporation's equity base witnessed a net increase of around 16% during the 15 months up till 1Q06. Meanwhile, the funding base grew by around 43% during the same period. The incremental growth in funding base during 2005 was largely contributed by deposits, as a result of which, their proportion vis-à-vis borrowings within the funding mix continued to increase. Some high-cost deposits shed during 1Q06 were by and large substituted by borrowings in order to rationalize the overall cost of funds. However, the change is only expected to be temporary, and the management expects to largely achieve the (75:25) deposits/borrowings composition by the end of the current year. Going forward, the current capital structure allows the Corporation ample room for further growth, while enhanced recovery from the loan portfolio would continue to augment resources.
- Merger of the subsidiary PCBL with the corporation is in process. The merger is likely to impact the organization positively, in terms of lower expected cost of funds as well as diversification of operations.

Profile

- Pakistan Industrial Credit & Investment Corporation Limited (PICIC) was established in 1957. Being the largest DFI in the country in terms of total assets and a branch network of 45 as of 1Q06, the Corporation's primary activities encompass term financing for industrial and commercial activities, merchant banking operations, capital market operations, leasing and consumer financing. PICIC engaged in asset management consequent to the acquisition of management rights of ICP mutual funds – Lot 'B' and ICP SEMF (subsequently renamed as PICIC Investment Fund and PICIC Growth Fund respectively). These are now being managed through a new Asset Management Company wholly owned by the Corporation. PICIC also ventured into the general insurance business by forming PICIC Insurance Limited, a wholly owned subsidiary, wherein the Corporation has recently resolved to reduce its holding to 30% and distribute the remaining 70% among PICIC's existing shareholders in order to comply with the SBP specified pre-conditions for the proposed merger with its other subsidiary, PCBL.
- Among the shareholders, public sector corporations have the strongest presence followed by the general public and private institutions. The chief executive, who has been in this position since 1996, is an experienced banker and has been principally instrumental in the turnaround of the organization in the last few years.

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