

**FIRST DAWOOD INVESTMENT BANK LIMITED (FDIB)****Ratings (December 2006)**

First Dawood Investment Bank Limited

	New	Previous
<b>Entity</b>		
Long term	A+	A+
Short term	A1	A1
<b>Secured TFCs</b>		
PKR 345mln	AA-	AA-

**Financial Data**

PKR (mln)

	30-Jun-06	30-Jun-05
Total Assets	8,063.8	6,628.2
Equity	972.4	698.4
Profit After Tax	113.9	53.6
ROE %	13.6	7.9
Debt/Equity* %	631.1	610.2

\*Excluding the effect of repo borrowings against government securities.

**Analysts**

Moin Khalid  
+92 42 5869504  
moin@pacra.com

Shahzad Saleem  
+92 42 5869504  
shahzad@pacra.com

**TFC Issue:**

FDIB has fully redeemed the first tranche of TFCs of PKR 253mln in September 2006. The bank currently has in issue TFCs worth PKR 345mln (second tranche), issued in July 2002. The instrument carries interest at 175bps + the SBP discount rate with a floor of 12.25% and a ceiling of 16.25%, payable semi-annually. The instrument is of a perpetual nature and have a call and put option exercisable at the end of every five years from the date of issue. The TFCs are secured by way of registered charge over all present and future assets and receivables of FDIB with a margin of 20%, providing adequate cushion to the TFC holders. The company is meeting its obligations towards TFC holders in a timely manner.

**Rating Rationale****Assessment**

- FDIB's ratings reflect the bank's sound asset quality and strong risk absorption capacity augmented by substantial amount of unrecognised reserves. While the improved profitability during FY06 was mainly an outcome of higher returns on equity investments, the ratings recognize the management's ongoing efforts at expanding and diversifying the revenue base through focusing on fee-based investment banking activities. Although contribution of fee-based income is showing a rising trend, given the increasing competition in the sector, it will take some time before a reasonable and stable revenue stream from these avenues could emerge.
- During FY06, FDIB's performance – measured in terms of ROE improved compared to the previous year, though it continued to remain lower than most peers. Despite sizeable growth in the financing portfolio, the net interest income registered a notable decline owing to pressure on spreads arising from sharp increase in borrowing cost. This was attributable to major portion of borrowings being on floating rates, as against a large portion of leases locked at fixed rates. Going forward, the management has increased its emphasis on writing new leases at floating rates, to manage the associated interest rate risk. During FY06, higher return on equity investments, as against sizeable revaluation deficit on equities and loss on disposal of government securities in the previous year, contributed significantly to the bottom line.
- Going forward, the contribution from financing operations is likely to remain constrained in the wake of increasing competition from commercial banks. Meanwhile, the management is focusing on diversifying the revenue base and has initiated wide array of investment banking activities, including trusteeship, underwriting, advisory services, issuing letter of comfort/guarantees and also money market brokerage operations. The contribution of fee income from these sources, albeit limited at present, has shown an encouraging trend especially in 1QFY07. However, since many of these initiatives are relatively an initial stage, the management's ability to convert these into stable revenue streams and timing and extent of contribution to the bottom line remain to be seen.
- The bank continues to maintain a strong asset quality, represented by a low proportion of NPLs in total finances. Meanwhile, there is sizeable amount of general provisioning against the impaired portfolio, thereby providing a cushion against potential loss. During the year, there has been an increasing focus on issuing letter of comfort/guarantees for augmenting the overall fee-based income. The associated risk is being managed by applying a careful selection and appraisal process, as is adopted for fund-based facilities, and ensuring adequate collateralisation.
- The exposure to the market risk is high due to sizable investments in non-strategic listed equity securities, close to the bank's equity base. The management is currently in the process of implementation of detailed Risk Management Guidelines, approved by the BoD for bringing greater discipline in the investment process and thus effective management of associated risks. Meanwhile, the bulk of the existing equity portfolio consists of liquid, fundamentally strong, and dividend paying shares. Further, a sizeable surplus on the investments classified as 'available for sale', albeit limited to some stocks, provides a cushion against any major adverse movements in the stock market.
- The equity base of the company registered a notable increase, attributable to a 33% right issue at a 50% premium, and retention of improved profit during FY06. The strong risk absorption capacity of the bank is further complemented by substantial amount of unrecognised appreciation in investment properties and investments in subsidiaries. The funding of FDIB mainly represents funds mobilized from financial institutions in the form of COIs and other credit lines. Despite rise in borrowing levels to support the expanding business levels, the financial leverage of the bank has been largely maintained due to corresponding increase in equity. Mobilization of additional funding during the year through short-term COIs led to reduction in the proportion of long-term funds in the total funding base. However, the management has recently secured adequate long-term credit lines from banks to reduce the tenor mismatch in assets and liabilities.

**Background**

- Dawood Leasing Company Limited, operating since 1995, was converted into First Dawood Investment Bank (FDIB) in 2004. Since then the company has undergone a paradigm shift, with investment banking gradually displacing leasing as the management's core focus, with further expansionary plans in the pipeline.
- FDIB, listed on the Karachi stock exchange, is sponsored by a branch of the reputable Dawood family, which is one of the largest business groups in Pakistan. The sponsoring family, with the experience of operating leasing modarabas and an asset management company, is further diversifying its operations through joint venture arrangements by setting up an Islamic Bank, Takaful Insurance and a wind power generation project. The increasing presence of the group in the financial sector is likely to strengthen the bank's franchise value and provide synergetic benefits. The Company's Chairman & Chief Executive, 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.