

**FIRST GRINDLAYS MODARABA (FGM)****Ratings (February 2004)****First Grindlays Modaraba**

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

Financial Data

PKR (mln)

	30/6/2003	30/6/2002
Total Assets	2,105.7	2,466.2
Equity	720.7	695.4
Profit after Tax	175.0	172.4
ROA %	7.7	7.4
ROE %	24.7	25.2
Equity/Assets %	34.2	28.2

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Rating Rationale**Assessment**

- The ratings reflect FGM's demonstrated ability of sustaining its performance and low risk profile of assets portfolio, while maintaining its leading sector position, despite the increasingly competitive and somewhat difficult operating environment. The rating also takes into account the strong support factor drawn from FGM's affiliation with the Standard Chartered Group in Pakistan (SC).
- One of the most formidable challenges facing non-banking financial institutions (NBFI) at present is the increasing competition from commercial banks that are offering facilities to the corporate and industrial sectors on rates much lower than what the NBFIs can offer. Under the circumstances NBFIs are concentrating mainly on reducing the cost of funds and targeting volume growth. The management of FGM remained selective in writing business based on prudent credit and asset/liability management considerations. This resulted in lower level of business and reduced the book size. Nonetheless, the performance measured in terms of ROE and ROA was largely maintained on the back of maintained net revenue augmented by sizeable income on transfer of assets leased out embedded in other income. Meanwhile capital gains on sale of TFCs and recoveries from chronic cases provisioned in previous years also benefited the bottom line. In addition to efficient management of cost of funds, higher rate of return from Musharika arrangements- long term financing locked at higher rates- resulted in maintained spreads over the year. During the year the management revised its accounting estimates of the residual values of vehicles leased out under the commercial leasing scheme to represent more accurate valuation buttressing the net revenue of the Modaraba by PKR 10.4 mln. Except for the effect of office renovation expenses, that resulted in marginal increase in the costs to total net revenue ratio, the operating expenses of the Modaraba have largely been maintained. Despite the fact that leasing rates continue to come under pressure, the Modaraba's performance during 1H2004 is in line with its expected target of maintaining profitability at FY2003 level.
- Going forward, FGM while remaining conservative plans to increase its market share. Given its cost structure, effective risk management systems and ability to capitalize on the untapped client base of SC, FGM is well poised to achieve its targets. It will continue to concentrate on its core business of leasing while some diversification in product base will also be undertaken by offering Morabaha and Musharika products to the customers. The management also plans to introduce mortgage financing during FY2004.
- Consistent with the general trend in the leasing sector, there has been a significant increase in disbursement of motor vehicle leases during the year and the total leased assets portfolio is now dominated by motor vehicle leasing (FY03: 61% FY02: 45%), with the balance comprising plant and machinery. The management maintained sector diversity with maximum exposure in the pharmaceutical & chemical sector being less than 20%. The credit concentration increased during the year with top 10 exposures comprising 46% of the total portfolio. However, the potential risk is mitigated to a large extent by extending credit to good corporate clients, most of which have already established satisfactory business relationship with FGM as well as with SC.
- FGM has been able to maintain a high asset quality with non-performing leases constituting a nominal proportion of the total lease portfolio. In pursuance of its prudent provisioning policy, in addition to full provision for non-performing leases, FGM also carries a general provision against its exposure in retail lease portfolio. The outstanding asset quality is an outcome of a rigorous process of client identification, evaluation and post disbursement monitoring policies in addition to strong internal control systems.
- The certificates of Musharika (COM) have emerged as a stable source of funding for the Modaraba constituting around 48% of the total borrowing at end FY03. This has provided the Modaraba with stable medium-term funds and helped reduce the maturity mismatch risk. During FY2004, FGM plans to continue to mobilize funds through COMs and borrowings from financial institutions. Additionally, FGM continues to have access to ample unutilised credit line from SC and therefore have a very strong capacity for timely payment of financial commitments.

Support

- While SC has no contractual obligation to support FGM, close institutional linkage with SC strongly implies that support will be forthcoming, should it prove necessary.

Background

- Established in 1987, FGM is a perpetual, multi-purpose modaraba, listed on the Karachi and Lahore stock exchanges. It is primarily engaged in lease financing and operates from offices in Karachi, Lahore and Islamabad.
- Grindlays Services of Pakistan (Pvt.) Ltd – a wholly owned subsidiary of Standard Chartered Bank – manages the modaraba. Standard Chartered Bank is a London based international bank with a significant focus on emerging markets. It has a network of over 600 offices in 56 countries. It carries a long-term rating of "A+" by Fitch Ratings. In Pakistan, it is the largest foreign bank with 21 branches nationwide.
- During the year the Modaraba introduced new brand and logo to reflect its linkages to SCB Group, while the management is also in the process of changing the name of its management company to show its association with the group. The affiliation with SC continues to ensure access to quality clients and a useful marketing platform for FGM.
- The country manager of SC chairs the three member Board of the modaraba management company. The Managing Director appointed recently possesses over 15 years of experience in the banking sector, and enjoys complete operational autonomy.