RATING REPORT

Arif Habib Limited

REPORT DATE:
January 18, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Outlook	Stable		Stable	
Rating Date	*Jan 17, 2019*		*Nov 24, 2017*	

COMPANY INFORMATION

Incorporated in 2004	**External auditors:** Rehman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants; reappointed for FY19.
Listed Public Limited Company	**Chairman of the Board:** Mr. Zafar Alam
Key Shareholders (with stake 5% or more): Arif Habib Corporation Limited – 65.5% General Public (Local & Foreign) – 22.0%	**Chief Executive Officer:** Mr. Muhammad Shahid Ali Habib

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria Methodology – Securities Firms Rating (May 2015)
http://www.jcrvis.com.pk/Images/Securities%20methodology%201%20-2015.pdf

Arif Habib Limited

OVERVIEW OF THE INSTITUTION

Arif Habib Limited (AHL) was incorporated in 2004 as a public joint stock company under the Companies Ordinance, 1984. AHL is registered with Securities & Exchange Commission of Pakistan (SECP) and holds Trading Rights Entitlement Certificate (TREC) granted by Pakistan Stock Exchange (PSX) Limited.

Profile of Chairman

Mr. Zafar Alam is a Non-Executive Director & Master's degree holder in Nuclear Physics and has over 32 years' experience in investment banking encompassing Origination, Trading, Sales and Asset Management in various financial centers around the globe. Mr. Zafar has a diverse experience across geographies and various aspects of finance, having worked in London, Singapore, Hong Kong and Dubai in Equities, Fixed Income and Asset Management.

Profile of CEO

Mr. Shahid Ali Habib carries a proven track record of establishing successful business organizations and turning around ventures into vibrant units. He has over 20 years of experience in the fields of Securities Brokerage, Banking, Asset Management, Corporate Finance and Investment Banking. He has served in leading positions at top local at international institutions.

RATING RATIONALE

Established in 2004, Arif Habib Limited (AHL) is a prominent brokerage and financial services company. AHL is listed on Pakistan Stock Exchange (PSX) with total equity of Rs. 3.2b. The company is engaged in provision of equity and money market brokerage, interbank foreign exchange and corporate advisory services. AHL's operations run through its head office in Karachi along with 2 branches, one each in Lahore and Islamabad. Staff strength company was reported at 109 (FY17: 100) as at end-June 2018.

Rating Drivers

Brokerage industry continues to be affected by economic cycles. Declining trend in trading volumes during FY18 and ongoing year has impacted the topline of brokerage industry.
Political uncertainty due to elections, aggressive foreign selling, rising current account deficit and expected slow-down in GDP growth has translated into dismal performance of the benchmark index over the last 18 months. Resultantly, market volumes have posted a noticeable decline during the period. Going forward, market volumes over the short-term are expected to remain under pressure given rising interest rates and risk of rupee depreciation as the country negotiates a new IMF program. Given the operating environment, players with efficient and variable cost structures focusing on high margin business and diversification in revenue streams are expected to fare better vis-à-vis peers.

Strong sponsor profile.
The assigned ratings continue to derive strength from AHL's sponsor profile, with majority stake held by Arif Habib Corporation Limited (AHCL). AHCL has sizeable shareholding in many different companies operating in diverse sectors such as fertilizers, securities & commodities brokerage, corporate advisory, asset management, cement, steel, wind power and real estate development sectors. Financial strength of AHCL is signified by its net worth of Rs. 30.5b as at end-1QFY19.

Prominent market position; business strategy has been aligned to focus on HNWIs and institutions through strengthening of human resources, sales team reorganization, branch expansion and relationship management.
AHL remains one of the prominent players in both, equity and corporate advisory domain with a market share of ~9% (based on ready and future value) in equity trading. However, retail clientele is on the lower side vis-à-vis other large and medium sized brokerage houses. AHL's overall business strategy has been aligned to focus on growing High Net Worth Individuals (HNWI) and institutional business through strengthening of human resources, sales team reorganization, branch expansion and relationship management. Business development and trading team has been expanded in Lahore and Islamabad with once branch being set up in Peshawar.

With respect to international institutional business, AHL has five exclusive broker dealer relationships. Since last review, the company has become local partner of a notable international brokerage firm.

Sizeable corporate advisory income remains a competitive edge and provides sustainability to equity brokerage revenue; however, variation in revenue stream would remain given volatility in the two major revenues drivers, capital gains and corporate advisory.
Profit after tax decreased by ~40% to Rs. 536.3m (FY17: Rs. 880.5m) in FY18. In line with market trend, the decline is attributed to reduction in fee-based income to Rs. 546.6m (FY17: Rs. 767.3m) comprising equity brokerage income (FY18: Rs. 328.5m; FY17: Rs. 402.2m) and corporate advisory & money market (FY18: Rs. 218.0m; FY17: Rs. 365.1m). Corporate advisory fees remained a function of execution of number of mandates. Overall profitability was supported by significant unrealized gain on re-measurement of investment property.

Non-fee based income over FY18 also declined to Rs. 282.2m (FY17: Rs. 1,249.0m) primarily because sizeable capital gain on sale of short term (ST) investments of Rs. 895.2m was booked in FY17 compared to Rs. 5.2m in FY18. Moreover, decline in profitability was offset by sizeable gain on re-measurement of investment property of Rs. 385.0m (FY17: Rs. 32.3m) booked as the company revalued its residential and commercial plots of land located in Naya Nazimabad project based on valuation carried out by an independent external party. Variation in total revenue stream would remain given the volatility in major revenues drivers, which include brokerage fees, capital gains and corporate advisory income.

In line with investment in HR and expansion in business & support teams (especially in retail segment), compensation expenses increased by 14%. However, commission to traders (variable component) declined by 29%. Finance cost increased by 33% due to higher utilization of borrowing lines. Decrease in recurring revenue outpaced reduction in expenses (which included compensation incurred for investment in human capital), as a result, efficiency ratio of the company weakened to 67.7% (FY17: 48.7% (adjusting for donation expense)) in FY18. Effective tax rate reduced to 18% (FY17: 23%) on account of variation in realized capital gains.

1QFY19 witnessed a major decline of 68% in market traded volumes and 24% in market traded values compared to same period last year. Resultantly, AHL's brokerage and investment banking division posted lower revenue of Rs. 85.5m (1QFY18: Rs. 141.8m). Going forward, profitability is expected to remain a function of gains/losses on investments, equity brokerage income and advisory fees.

Liquidity profile is adequate while capitalization levels are considered strong; market risk remains high on account of large proprietary book.
Market Risk: In FY18, AHL acquired investment property amounting to Rs. 859.1m in plots of land and residential bungalows situated at Naya Nazimabad; as a result, long-term investments increased to Rs. 1,533.9m (FY17: Rs. 541.5m) at end-June 2018. Short term investments of AHL stood at Rs. 2.5b (FY18: Rs. 2.6b; FY17: Rs. 3.3b) as at end-1QFY19. A major chunk of the investment portfolio pertains to investment in group companies (39% of investment portfolio) and proprietary investments (42% of investment portfolio) with around one-tenth of the portfolio comprising ready future transactions. Remaining investments including exposure in debt instruments of highly rated counter parties. With large direct exposure to equity market, market risk is considered to be on the higher side.

Liquidity Risk: Liquid assets in relation to total liabilities decreased to 94.2% (FY17: 117.6%) on account of reduction in proprietary book and lower cash & bank balances. Liquid assets are more than sufficient to account for current liabilities of the company.

Credit Risk: AHL has due diligence procedures in addition to its KYC, for the assessment of its client creditworthiness. Applicable policies for leveraged products have been adopted and limits have been defined which are strictly monitored. Trade debts are low and their ageing is considered to be manageable.

Debt profile is entirely short term in nature. Debt leverage has decreased on a timeline basis to 0.72x (FY17: 0.78x; FY16: 1.06x) while gearing ratio has also reduced to 0.46x (FY17: 0.44x; FY16: 0.70x). Maximum gearing level remained in line with the specified benchmarks. Net Capital Balance (NCB) has improved on a timeline basis and stands considerably above the minimum regulatory requirement, thereby denoting an adequate solvency position.

Experienced management team and adequate control framework.
Management team at AHL comprises seasoned professionals with considerable financial services sector experience and remained stable since last review. Ratings also incorporate adequate control framework implemented at the company. Board approved underwriting and investment policies are present. However, following board approvals, certain breaches in limits stipulated in the investment and underwriting policy were observed during the outgoing year. Going forward, compliance with limits is important given the current rating levels.

Sound corporate governance framework.

Board of directors at AHL includes members carrying vast experience in the financial services sector. No change was witnessed in the board composition during the outgoing year. Two independent directors are present on the board. Two committees, namely Board Audit Committee (BAC) and Board Human Resource & Remuneration Committee (BHRRC), are also present at board level in order to ensure effective oversight.

FINANCIAL SUMMARY (amounts in PKR millions) — Appendix I

BALANCE SHEET	**30-Jun-18**	**30-Jun-17**	**30-Jun-16**
Trade Debts	24.5	74.8	582.3
Long Term Investments	1,533.9	541.5	741.3
Short Term Investments	2,678.8	3,263.8	3,294.3
Cash and Bank balances	686.8	832.8	306.2
Total Assets	5,473.4	5,693.0	5,563.3
Trade & Other Payables	562.8	870.0	407.0
Long Term Loans	-	-	-
Short Term Loans - Secured	1,472.6	1,408.0	1,880.7
Total Liabilities	2,286.1	2,491.2	2,857.8
Total Equity	3,187.3	3,201.1	2,705.5
INCOME STATEMENT	**30-Jun-18**	**30-Jun-17**	**30-Jun-16**
Equity Brokerage Income	328.5	402.2	277.2
Capital Gain/(Loss) on Sale of Investments	5.2	895.2	(0.5)
Advisory Income	218.0	365.1	252.1
Other Income	167.5	262.7	146.3
Administrative Expenses	324.4	386.3	267.9
Finance Cost	184.8	138.5	165.9
Profit Before Tax	653.0	1,140.9	456.0
Profit After Tax	536.3	880.5	409.5
RATIO ANALYSIS	**30-Jun-18**	**30-Jun-17**	**30-Jun-16**
Market Share (Volume) (%)	8.8%	6.6%	n/a
Market Share (Value) (%)	9.0%	6.1%	n/a
Liquid Assets to Total Liabilities (%)	97.5%	117.6%	39.8%
Liquid Assets to Total Assets (%)	40.7%	51.5%	20.4%
Leverage (x)	0.72	0.78	1.06
Gearing (x)	0.46	0.44	0.70
Efficiency (%)	67.7%	48.7%	60.8%
ROAA (%)	9.6%	16.1%	8.5%
ROAE (%)	16.9%	29.9%	15.2%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: JCR-VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.jcrvis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details. www.jcrvis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Arif Habib Limited
Sector	Brokerage
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
17-Jan-19	AA-	A-1	Stable	Reaffirmed
24-Nov-17	AA-	A-1	Stable	Reaffirmed
29-Nov-16	AA-	A-1	Stable	Reaffirmed
24-Jun-15	AA-	A-1	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	JCR-VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
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