

RATING REPORT

Arif Habib Limited

REPORT DATE:

July 26, 2021

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	Jul 26, 2021		Apr 13, 2020	

COMPANY INFORMATION

Incorporated in 2004

External auditors: Rehman Sarfaraz Rahim Iqbal Rafiq,
Chartered Accountants

Listed Public Limited Company

Chairman of the Board: Mr. Zafar Alam

Key Shareholders (with stake 5% or more):
 Arif Habib Corporation Limited – 69.44%
 General Public (Local & Foreign) – 22.19%

Chief Executive Officer: Mr. Muhammad Shahid Ali Habib

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Securities Firms Rating (July 2020)

<https://s3-us-west-2.amazonaws.com/backupsqvis/docs/SecuritiesFirm202007.pdf>

Arif Habib Limited

OVERVIEW OF THE INSTITUTION RATING RATIONALE

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 33 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 21 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.

Established in 2004, Arif Habib Limited (‘AHL’ or ‘the Company’) is a prominent brokerage and financial services company. 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 5 branches, one each in Lahore, Islamabad, Rawalpindi, Faisalabad and Peshawar.

In FY20, the Company’s market share is 9.37% and 3.42% of the ready & future transactions respectively, in terms of volume. In terms of value, the Company’s market share is 9.1% and 2.7% of the ready & future transactions respectively. In addition, AHL’s investment banking arm is the leading transaction underwriter in the industry. AHL is listed on Pakistan Stock Exchange (PSX)

Sector Update

- After a dismal performance in FY18 & FY19, volumes of PSX rebounded with an increase of 32% in FY20, while further gaining momentum in 9M’FY21 (up 102% vis-à-vis SPLY).
- This increase in trading volumes in FY20 was mainly attributable to pandemic-induced market volatility. In 9M’FY21, the volumes remain elevated, being driven by lower benchmark rates and increasing in LSM post-July’20.
- Accordingly, in tandem with trading volumes, brokerage revenues grew across the industry. This supported the profitability of brokerage companies, some of which had slipped into losses during the 3-year period FY17-19.
- New regulations in the industry include SECP’s capital market reforms, wherein small-sized brokerage houses will now not be allowed custody of customer’s assets. Further, SECP has made a commission slab to minimum of 3 paise (or 0.15% of traded value) and maximum of 2.5% of traded value.
- PSX and NCCPL has also launched several Exchange Traded Funds (ETF’s) and Murabaha Share Financing (MSF) respectively, which allow investors access to lower cost asset management along with access to credit.
- PSX & SECP has introduced an alternative board namely Growth Enterprise Market (GEM), for listing of small companies.
- Moreover, SECP has simplified the account opening process and allowed the brokers to complete whole process online.
- Growth in overall economic indicators and the major steps taken by SECP & PSX to boost investors’ confidence will further increase the trading activity on PSX over the next 2-3 years.

Table 1: Industry Trading Metrics (Volume & Value) – Regular

	FY18	FY19	FY20	9M’FY20	9M’FY21
Volume (In Billions)	43	37	49	25	51
Value (In PKR’ Billions)	2,027	1,549	1,789	1,160	2,519

Rating Drivers

Strong sponsor profile

The assigned ratings 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.

Rating takes into account diversification in business risk profile

- AHL's assigned rating is supported by the diversification of operation revenues, which is superior to other brokerage companies. This diversification is illustrated in the table below.

Table 2: Diversification in operating revenue

	FY19	FY20	9M'FY20	9M'FY21	FY19	FY20	9M'FY20	9M'FY21
Brokerage Income	303	323	245	510	40%	50%	57%	50%
Advisory & consultancy	376	155	111	474	49%	24%	26%	47%
Dividend	88	167	72	32	11%	26%	17%	3%
Total (Rs. Mn.)	767	645	428	1,015				

- In absolute terms, AHL's topline came under pressure in FY20, mainly on account of subdued advisory & consultancy revenues; this was largely on account of lesser transactions concluded in the industry during this period. Conversely, the topline was supported by moderate growth in brokerage revenues and notably higher dividend revenues.
- In the brokerage business, the Company's revenue did depict modest growth, albeit the growth lagged peers, mainly as the market share attrition was noted. Conversely, however, on the back of strong growth in market volumes, wherein 9M'FY21 volumes already exceed full year FY20 volume, in combination with an improvement in market share, allowed the Company to post strong growth in brokerage revenue during this period.

Table 3: Market Share

	Volume				Value			
	FY18	FY19	FY20	9M'FY21	FY18	FY19	FY20	9M'FY21
Market Share (Regular)	10.70%	13.05%	9.37%	13.83%	11.82%	16.20%	9.10%	10.78%
Market Share (Future)	3.35%	4.49%	3.42%	4.59%	2.34%	3.59%	2.71%	3.28%
Cumulative	8.83%	10.40%	7.66%	11.78%	9.03%	12.35%	7.15%	8.50%

- On the other hand, advisory & consultancy revenues also posted a 4-fold uptick, as IPOs picked pace in the market, and AHL was the lead underwriter in 3 out of 6 IPOs in FY21. In addition, the Company was Financial Advisor & Arranger to 6 debt transactions and 3 secondary offerings.
- Going forward, there are plans in place to grow the physical distribution network. Presently, the Company operates with 6 branches, which are planned to be grown to 10 over the next year.
- The Company's brokerage business is supported by its notable reliance on domestic retail investors, commission contribution from whom has increased notably over the past couple of years, in tandem with the uptick in domestic retail accountholders. Increase in reliance towards retail investors is viewed positively, as retail investors are generally more granular & sticky than institutional investors.
- Overall profitability of the company started to rebound in FY20 after posting a net loss in FY19.
- Profitability indicators have depicted notable improvement in 9M'FY21 as a result of which efficiency ratio depicted strong improvement. Overall profitability compares favorably to peers.

P&L Extract	FY18	FY19	FY20	9M'FY20	9M'FY21
Operating Revenue	656	767	645	428	1,015
Admin Expense	324	397	344	244	424
Finance Cost	185	218	362	300	104
Profit After Tax	536	(62)	60	(169)	1,587
ROAA*	9.6%	-1.1%	0.9%	NA	33.8%
ROAE*	16.9%	-2.1%	2.1%	NA	74.6%
Efficiency	67.7%	71.5%	95.9%	NA	49.6%

*Annualized

Adequate liquidity & capitalization profile; market risk remains high on account of large proprietary book

Liquidity Risk

- AHL's liquidity profile is considered adequate, in view of the current ratio consistently trending above 1x and standing at 2.2x as of Mar'21.
- Liquid assets (Cash + ST Inv.) stood at Rs. 3.5b at Mar'21 (FY20: Rs. 4.6b, FY19: 3.0b), of which 40% was cash & bank balances. Out of total short term investments of Rs. 2.1b at Mar'21, Rs 1.8b (60%) is invested in group companies.
- Excluding investment in group companies as strategic holdings, liquid asset coverage of total liabilities of the Company still stands above 1.3x as of Mar'21.

Credit & Market Risk

- AHL has gross trade debts of Rs. 1.1b and net trade debts of Rs. 200m. An amount of Rs. 920m pertained to legacy accounts that defaulted in 2008 financial crises, and which have been fully provisioned. Overall size of the trade debts is considered manageable, while a review of the ageing profile of trade debts is indicative of medium to low credit risk.
- AHL carries significant market risk on its books, as listed in the table below. As illustrated below, the portfolio is largely composed of real estate holdings and the Company's proprietary book.
 - The real estate portfolio comprises investment in plots of land and residential bungalows situated at Naya Nazimabad, Deh Manghopir, Gadap Town, Karachi as well as the investment in offices located in the building complex of ISE Towers REIT Management Company Limited and LSE Financial Services Limited. The valuation is undertaken by independent & qualified valuers. We have not noted any additional investment in this area during the period under review, with the increase mainly being attributable to capitalization of construction charges and general increase in fair value.
 - The property investment portfolio is a mix of Debt & equity securities. As of Mar'21, debt securities in the AHL's portfolio constituted 10% of the portfolio. Minimum credit rating of the issuers of these securities is the 'A' Band. The remaining portfolio includes investment in group Companies (62%) and other unrelated entities (28%).

P&L Extract	Jun'19	Jun'20	Mar'21
Long Term Investments – Subsidiaries	88	82	82
– Other Entities	66	45	59
Investment Property	1,726	1,678	1,808
Short Term Investments	2,411	3,827	2,113
Total	4,292	5,632	4,061

Debt profile

Balance Sheet Extract	FY18	FY19	FY20	9M'FY20	9M'FY21
Investment property	1,374	1,726	1,678	1,699	1,808
Shor term investment	2,679	2,411	3,827	2,680	2,113
Cash	687	627	806	840	1,424
Total Assets	5,473	5,642	6,893	5,890	6,408
Total equity	3,172	2,909	2,767	2,428	4,451
LT loan (Inc. current maturity)	1	-	838	348	29
ST loan	1,473	1,909	1,836	2,180	283
Total Liabilities	2,286	2,725	3,626	3,162	1,957
Current ratio	1.70	1.36	1.52	1.27	2.23
Gearing	0.46	0.66	0.97	1.01	0.07
Leverage	0.72	0.94	1.19	1.26	0.44

- Total financing taken by the company has notably declined, as a result of which we have noted significant drop in gearing & leverage.
- In view of the same, capitalization profile of the company has depicted improvement on a timeline.

Experienced management albeit control framework warrants improvement.

- Management team at AHL comprises seasoned professionals with considerable financial services sector experience and remained stable since last review.
- Although there is an investment policy in place, the ranges defined in the methodology warrant a review, given that at present the Company can invest up to 35% of its equity in a single scrip. As of Mar'21, AHL's investment in a single group company (Fatima Fertilizer) was in breach of the aforementioned limit. In line with the investment policy, the Company has taken an approval from the Board for this breach.

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			
<u>BALANCE SHEET</u>	FY18	FY19	FY20	9MFY21	
Trade Debts	24	31	157	200	
Long Term Investments+Investment Property	1,534	1,880	1,805	1,948	
Short term Investments	2,679	2,411	3,827	2,113	
Cash and Bank balances	687	627	806	1,424	
Total Assets	5,473	5,642	6,893	6,408	
Trade and Other Payables	563	638	795	1,398	
Long Term Loans	1	-	838	29	
Short Term Loans - Secured	1,473	1,909	1,836	283	
Total Debt	1,474	1,909	2,674	312	
Paid Up Capital	550	660	594	594	
Net Worth (excluding revaluation surplus)	3,172	2,902	2,767	4,427	
<u>INCOME STATEMENT</u>	FY18	FY19	FY20	9MFY20	9MFY21
Total Revenue	1,051	480	707	308	2,311
Brokerage Income	329	303	323	245	510
Advisory and consultancy fee	218	376	155	111	474
Dividend Income	110	88	167	72	32
Operating & Administrative Expenses	(324)	(397)	(344)	(244)	(424)
Finance Costs	(185)	(218)	(362)	(300)	(104)
Profit Before Tax	653	12	129	(139)	1,835
Profit After Tax	536	(62)	60	(169)	1,587
<u>RATIO ANALYSIS</u>	FY18	FY19	FY20	9MFY20	9MFY21
Liquid Assets to Total Liabilities	147.2%	111.5%	140.7%	180.7%	
Liquid Assets to Total Assets	61.5%	53.9%	67.2%	55.2%	
Leverage	0.72	0.94	1.19	0.44	
Gearing	0.46	0.66	0.97	0.07	
Current Ratio (x)	1.70	1.36	1.52	2.23	
Efficiency (%)	68%	72%	96%	50%	
ROAA (%)	9%	-1%	1%	34%	
ROAE (%)	17%	-2%	2%	75%	

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

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: 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.vis.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.vis.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.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'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.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when 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				
	26-Jul-21	AA-	A-1	Stable	Reaffirmed
	13-Apr-20	AA-	A-1	Stable	Reaffirmed
	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	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.				
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meetings Conducted		Name	Designation	Date	
	1	Mr. Muhammad Taha Siddiqui	Company Secretary & CFO	07-Jul-2021	