

RATING REPORT

Arif Habib Limited

REPORT DATE:

 October 9th, 2023

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	October 9 th , 2023		March 09, 2022	

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):
Chief Executive Officer: Mr. Muhammad Shahid Ali Habib

Arif Habib Corporation Limited – 69.44%

General Public (Local & Foreign) – 25%

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Securities Firms Rating (July 2020)
<https://docs.vis.com.pk/docs/SecuritiesFirm202007.pdf>
VIS Rating scale (2023)
<https://docs.vis.com.pk/docs/VISRatingScales.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

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 6 branches, one each in Lahore, Islamabad, Rahim Yar Khan, Faisalabad, Multan and Peshawar. Going forward, the management envisages of opening sales centers in interior Sindh, Punjab, and KPK along with industrial areas in Punjab to increase retail penetration in these untapped regions.

Sector Update

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

	FY18	FY19	FY20	FY21	FY22	FY23
Volume (In Billions)	43	37	49	131	73	47
Value (In PKR' Billions)	2,027	1,549	1,789	4,781	2,405	1,504

- During FY22, the brokerage sector faced significant challenges due to the poor overall economic situation, a global decline in commodity prices, and political uncertainty. As a result, investor's confidence was greatly impacted.
- After witnessing a significant surge in trading volumes in FY21, volumes have depicted a downward trajectory wherein the trading volumes declined by around 44% in FY22, followed by a further decline of around 35% in FY23.
- Accordingly, in tandem with trading volumes, brokerage revenues declined across the industry. This has dented the profitability of brokerage companies, some of which have slipped into losses. Additionally, low volume of IPOs resulting in reduced underwriting activity during FY22 also contributed to loss of revenue, during the year only three IPOs occurred raising a total of Rs.1.3b which is considered low as compared to FY21 whereby eight IPOs were witnessed raising over Rs.20.0b.
- Recently PSX has launched a new technologically advanced trading platform, called Designated Time Schedule (DTS), replaced by the old trading platform (KATS/Karachi Automated Trading System) due to hardware and software mismatch. The new system is expected to improve security features to better safeguard investors' data and resolve complaints about data leakages and theft.
- In order to further facilitate brokerage houses and traders, PSX has planned to launch 15 new Trading Right Entitlement Certificates (TREC) licenses which is expected to bring ease for brokers fulfilling minimum financial requirements and to offer trade execution services to retail, institutional and foreign clients along with becoming underwriters for right shares issue and act as agents for share buybacks.

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.

Key Rating Drivers

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. 19.96b as at end-9MFY23 (FY22: Rs. 23.8b).

Ratings take into account AHL’s diversified revenue base, however, the Company’s earning profile came under pressure amidst challenging macroeconomic environment during the year.

- In line with industry trend, wherein market volumes have contracted, AHL’s revenues also declined, during FY22 the Company’s recurring revenues declined to Rs. 1.1b (FY21 1.5b). However, the strength of AHL's assigned rating is underpinned by its operational revenue diversification which continues to remain superior to other brokerage firms despite subdued market activity during the year.
- The Company’s revenue mix remains dominated by its core brokerage income, however the Company’s advisory and consultancy income depicts declining trend on a timeline basis. During FY22, 46% (FY21 47%) of the Company’s revenue was generated through brokerage while 36% (FY21 44%) was generated through advisory and consultancy business. Remaining diversification of the Company’s revenue mix over the years is mentioned in the table below.

Total Operating Revenue (Rs. in m)	FY20	FY21	FY22	9MFY23	FY20	FY21	FY22	9MFY23
Brokerage and operating revenue	323	706	517	396	47%	47%	46%	35%
Advisory and consultancy fee	155	672	408	294	22%	44%	36%	26%
Dividend income	167	114	142	209	24%	8%	13%	19%
Markup on corporate debt securities	46	20	13	189	7%	1%	1%	17%
Markup on margin financing	-	-	52	39	0%	0%	5%	3%
	691	1,512	1,132	1,128				

- End-HFY23, the Company’s profitability profile also came under pressure on account of capital loss on and higher un-realized loss on re-measurement of investments. AHL incurred a loss of Rs. 153m (FY22 PAT Rs. 827m). Due to inflationary pressures, the Company’s finance cost also depicts increase on timeline basis which is also a drag on the Company’s profitability.
- The Company’s cost-to-income ratio however remains on the lower side, the Company’s augmented revenue base and portion from recurring other income continues to provide support to the Company’s operational risk.

Profitability Indicators (Rs. in m)	FY20	FY21	FY22	9MFY23
Total Recurring Income	736	1,589	1,210	1,161
Operating and Administrative Expenses	344	638	578	458
Finance Cost	362	132	197	463
Total Recurring Expense	706	769	775	921
Operating Efficiency (%)	47%	40%	48%	39%
Net Income	60	2,084	827	(153)
ROAA	1%	33%	11%	-3%
ROAE	2%	73%	21%	-7%

Ratings take into account AHL's growing client base

- AHL's client base witnessed a significant uptick during FY22, the Company remained focused towards expanding their geographical footprint through active participation in social events and increasing their number of sales centers across the country. During FY22 total number of clients amounted to 17,054 (FY21 10,807) while end-HFY23 total number of clients further grew to 18,557.
- AHL classifies its clientele into three groups: individuals, corporations, and foreign customers, with domestic institutional clients constituting the predominant portion of the company's customer base. In terms of revenue the Company maintains modest concentration risk on timeline basis. During FY22, revenues emanating from top 66 clients constituted 43% of the total revenue while end HFY23, the same was reported to be at 25%.
- The Company has also developed its own in-house integrated digital trading application enabling users to perform account opening and other various trading activities and services.

Market share witnessed upward trend during FY22

- Despite challenging macroeconomic environment the Company was able to increase its market share in the ready transaction market during FY22. In terms of volume, the Company's market share increased to 8.8% (FY21 7.9%) and 8.4% in terms of value (FY21 7.0%). Growth momentum continued end-HFY23 and market share increased to 12.5% and 12.7% in terms of volume and value respectively.
- The Company's market share also witnessed improvement both in terms of future transaction volume and value. During FY22, the Company's market share in future transactions substantially improved to 24.6% (FY21 2.3%) in terms of volume and 14.9% (FY21 1.3) in terms of value. However, end-HFY23 future transaction share market volumes declined consequently leading the Company's market share to decline to 5.6% and 4.3% in terms of volume and value respectively.

Adequate liquidity & capitalization profile; however market risk remains high on account of large proprietary book:Liquidity & Credit Risk:

- The Company's liquidity profile is considered adequate, total liquid asset base of the Company amount to Rs. 6.3b (FY21 5.5b) providing 1.7x (FY21 1.6x) times coverage to total liabilities of Rs. 3.7b (FY21 3.5b).
- End-HFY23, total liabilities of the Company increased to Rs. 5.4b and liquid asset base declined to Rs. 6b hence liquidity coverage deteriorated to 1.3x times.
- AHL's liquidity profile is also supported in view of the current ratio maintenance above 1x and standing at 1.8x as of Mar'23.
- 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 have increased on a timeline basis, however, the ageing is considered satisfactory.

Capitalization:

- The Company's debt profile continues to be largely short term in nature. During FY22, total debt increased to Rs. 2.45b further increasing to Rs. 3.1b end-HFY23. Capitalization indicators also depict an increase, gearing ratio witnessed increased on timeline basis, during FY22, gearing stood at 0.47x (FY21 0.28x) further increasing to 0.66x end-HFY23. Leverage ratio also increased to 0.73x (FY21 0.70x) during the year, while the same increased to 0.97x end-HFY23 on account of increase in total debt and total liabilities on timeline basis.
- Increase in gearing and leverage ratio is attributable to conversion of investment property to developmental REIT schemes, going forward, the company aims reduce pressure on gearing and leverage with future fund inflows from the project developmental REIT projects.

Market Risk:

- The company has undertaken sizeable exposure in commercial and residential plots 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.
- AHL carries significant market risk based on the Company's portfolio comprising largely of real estate holdings and proprietary investments. During FY22, the Company's short-term investments investment portfolio significantly increased to Rs. 5.3b (FY21 2.7b) subsequently increasing the Company's market risk to 1.02x times of equity (FY21 0.55x). Increase in the Company's proprietary book is also attributable to sizeable exposure in TFCs on timeline basis.

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. As per the investment policy in place, the Company can invest up to 35% of its equity in a particular security. The company has complied with its investment policy in the review period.

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 (BHRRRC), 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	FY21	FY22	9MFY23
Trade Debts	24	31	157	240	166	365
Long Term Investments + Investment Property	1,534	1,880	1,805	2,105	1,738	1,011
Short term Investments	2,679	2,411	3,724	2,747	5,273	4,837
Cash and Bank balances	687	627	806	2,674	1,068	1,148
Total Assets	5,473	5,642	6,869	8,472	8,986	9,153
Trade and Other Payables	563	638	795	1,790	1,120	1,200
Long Term Loans	1	-	838	30	20	4
Short Term Loans - Secured	1,473	1,909	1,836	1,369	2,432	3,080
Total Debt	1,474	1,909	2,674	1,400	2,452	3,084
Paid Up Capital	550	660	594	594	653	653
Net Worth (excluding revaluation surplus)	3,172	2,902	2,833	4,952	5,186	4,641
<u>INCOME STATEMENT</u>						
Net Operating Revenue	1,051	480	707	3,078	1,670	812
Brokerage Income	329	303	323	706	517	396
Advisory and consultancy fee	218	376	155	672	408	294
Dividend Income	110	88	167	114	142	209
Operating & Administrative Expenses	(324)	(397)	(344)	(638)	(578)	(458)
Finance Costs	(185)	(218)	(362)	(132)	(197)	(463)
Profit Before Tax	653	12	129	2,393	970	(68)
Profit After Tax	536	(62)	60	2,084	827	(153)
<u>RATIO ANALYSIS</u>						
Liquid Assets to Total Liabilities	147.2%	111.5%	126.0%	157.4%	167.8%	133.4%
Liquid Assets to Total Assets	61.5%	53.9%	66.0%	64.6%	70.7%	65.5%
Leverage	0.72	0.94	1.27	0.70	0.73	0.97
Gearing	0.46	0.66	0.94	0.28	0.47	0.66
Current Ratio (x)	1.70	1.36	1.53	1.80	1.90	1.79
Efficiency (%)	43%	46%	47%	40%	48%	39%
ROAA (%)	9%	-1%	1%	27%	9.5%	-1.7%
ROAE (%)	17%	-2%	2%	41%	16.8%	-3%

*Annualized

REGULATORY DISCLOSURES						Appendix II
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	
	<u>RATING TYPE: ENTITY</u>					
	9-Oct-23	AA-	A-1	Stable	Reaffirmed	
	09-Mar-22	AA-	A-1	Stable	Reaffirmed	
	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	N/A					
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. For conducting this assignment, analyst did not deem necessary to contact external auditors or creditors given the unqualified nature of audited accounts and diversified creditor profile.					
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Due Diligence Meetings Conducted	Name		Designation	Date		
	1	Mr. Muhammad Taha Siddiqui	Company Secretary & CFO	04-Apr-2023		