RATING REPORT

Next Capital Limited

REPORT DATE:
April 10, 2019

RATING ANALYSTS:
Talha Iqbal
talha.iqbal@vis.com.pk

Muhammad Tabish
muhammad.tabish@vis.com.pk

RATING DETAILS				
	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	*April 10, 2019*		*March 19, 2018*	

COMPANY INFORMATION	
Incorporated in 2009	**External auditors:** KPMG Taseer Hadi & Co. Chartered Accountants
Public Limited Company	**Chairman of the Board:** Lt. Gen. Tariq Waseem Ghazi (Retd.)
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Muhammad Najam Ali
Mr. Muhammad Najam Ali ~ **27.5%**	
Mr. Adnan Afridi ~ **10.9%**	
Mr. Sarosh Tahir ~ **9.6%**	
MCB Bank Limited (Treasury) ~ **9.7%**	
Maple Leaf Cement Factory Limited ~ **7.5%**	
Mr. Arif Habib ~ **6.4%**	
Other Individuals ~ **23.1%**	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Securities Firms Rating (June 2017)
http://vis.com.pk/docs/Securities%20Firms%20201706.pdf

Next Capital Limited

OVERVIEW OF THE INSTITUTION

Next Capital Limited (NCL) was incorporated in 2009 under the Companies Ordinance 1984 as a public limited company. NCL is engaged in brokerage of equity, debt securities, commodities and forex in addition to provision of financial advisory services. The company is a member of Pakistan Mercantile Exchange Limited and holds a Trading Right Entitlement (TRE) certificate issued by the Pakistan Stock Exchange Limited (PSX).

External auditors are 'KPMG Taseer Hadi & Co. Chartered Accountants'. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan (SBP).

Profile of Chairman

General Tariq Waseem Ghazi (Ret.) is serving as a chairman of the Board. He was appointed as a secretary of Defense in May 2005 and has also served as chairman of the Civil Aviation Authority, the Fauji Foundation, Defence Housing Authorities, PIA Investments, and as chancellor of Foundation University, Islamabad. Presently, he serves on the boards of Sadiq Public School, Habib University and The Kidney Centre. Mr. Waseem Ghazi a MS degree in War Studies from the University of Islamabad and is a recipient of the Sword of Honour, two international, and fifteen service awards and Hilal-i-Imtiaz for his services

RATING RATIONALE

Incorporated in Dec'2009, Next Capital Limited (NCL) is about to complete a decade in the business of brokerage and advisory services. NCL caters primarily to equity broking services to domestic retail and high net worth (HNWI) clients, local institutions and foreign broker dealers along with limited presence in money market segment. Alongside, the company has a reputable market share in investment banking & corporate financial advisory business in Pakistan.

NCL, besides a head office based in Karachi, runs it retail operations through a branch in Lahore. The company, as part of cost rationalization strategy, merged operations of two branches in Lahore during ongoing year while PSX branch was shut down in FY18.

Key Rating Drivers:

Brokerage industry continues to be affected by economic cycles. Declining trend in trading volumes during FY18 and the ongoing year has impacted the topline of brokerage industry

Performance of the equity market has remained dismal over the last 22 months with trading volumes depicting a significant decline, largely owing to aggressive foreign selling, sizeable current account & rising fiscal deficit and slow-down in GDP growth. Average daily turnover of equity market stood at 101m shares in March'2019 and was at the lowest level over the last 6 years. Decline in ready market volumes during FY18 was more pronounced at around 96% for ready market as compared to future volumes where remained stagnant. 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. Players with large proprietary books have also witnessed losses given weak market performance.

Industry Data (Ready+Future)	Volumes in millions	Value in millions
FY17	100,345	4,756,168
FY18	58,401	2,881,120
Growth in FY18	*-42%*	*-39%*
1HFY19	31,182	1,304,415
Annualized growth in 1HFY19 vis-à-vis FY18	*7%*	*-9%*

Going forward, focus of brokerage companies is expected to remain on cost rationalization, increased portfolio diversification into derivatives and focus on higher margin business. Moreover, given low base effect of ready market volumes & growing volumes in the future segment and improved valuations post two consecutive years of decline in benchmark index, overall market volumes during FY20 are expected to be higher vis-à-vis FY19 and FY18.

Diversified revenue stream supports overall business risk profile. Given the challenging operating environment, management has enhanced focus on advisory services while further diversification is planned through investments in new ventures.

In the backdrop of increasing pressure on brokerage volumes, management has now enhanced focus on corporate finance and investment advisory (services covering Mergers & Acquisitions, IPOs and *to the country.*

Profile of CEO

Prior to forming NCL, Mr. Najam Ali served as CEO of JS Investments Limited and served twice as the Chairman of MUFAP. He was also the founding CEO of the Central Depository Company (CDC) and has served on the Board of Directors of Pakistan Oilfields Limited, Askari Bank Limited, KSE, and NCCPL. He is a member of the Institute of Chartered Accountants in England & Wales and Institute of Chartered Accountants of Ontario – Canada. He is a qualified Certified Public Accountant – USA and holds a Bachelor degree in Economics from the University of Michigan, Ann Arbor, USA. Mr. Ali has also attended and successfully completed the 'Advanced Management Program' at the world renowned Harvard Business School, USA. He is currently serving as a member of the Corporate Leaders Advisory Board of Institute of Business Administration (IBA).

Financial Snapshot

Net Equity: Dec 2018: Rs. 400.3m, June 2018: Rs. 394.7m

Net Revenue: HFY19: Rs. 97.8m, FY18: Rs. 241.1m

Debt & Equity Capital Raising). Further diversification in revenue streams is planned through new ventures.

NCL has a market share of around 5% with a retail client base of around 3,000 (Active: 449) clients, accounting for around one-half of equity brokerage income. On the brokerage front, management plans to further enhance contribution of retail brokerage income through increasing online customers. Retail brokerage remains a key focus area of the management. Given the challenging operating environment, management has no plans to expand branch network. Breakup of clients in a tabulated form is shown below:

Number of Clients	HY19	FY18	FY17
Foreign Institutions	7	9	5
Domestic Institutions	137	162	153
Domestic Individuals	449	643	711
Total	**593**	**814**	**869**

With respect to international institutional business, NCL has 7 broker dealers on its panel. Nevertheless, proportion of foreign brokerage income has declined significantly on a timelines basis due to shrinking trading volumes and lowered foreign investor's interest in the market. In view of the same, management has planned to directly reach out to end clients and a strategy in this regard is in place.

In line with sector trends, profitability profile has depicted weakening since last review; however, the Company posted profit during HFY19 on account of cost rationalization initiatives. Going forward, income from advisory services is projected to support earnings.

While earning profile of the company is largely characterized by equity brokerage commission, contribution from advisory division has increased over time. The company has a diversified revenue mix vis-à-vis similar rated peers. During FY18, recurring revenue declined significantly and was reported at Rs. 261.6m (FY17: Rs. 383.2m). The sizeable decrease is on account of lower brokerage revenue attributable to weak stock market volumes and decline in commission per share due to reduction in scrip prices. Advisory fee represents about one-third of NCL's total revenue. In absolute terms, advisory fees stood at Rs. 68.2m (FY17: Rs. 104.3m) during FY18 while its revenue share remained similar to prior year level. During HFY19, the advisory income was reported at Rs. 26.1m. Going forward, diversification in revenue base and corporate advisory pipeline is projected to support the profitability profile.

After depicting significant weakening in FY18, efficiency indicator has improved in HFY19 and stood at 87.5% (FY18: 98.1%; FY17: 70.3%). The improvement was on account of significant reduction in commission expense, finance cost and staff salaries. While the company reported profit before tax in FY18, overall net loss was incurred due higher taxation. During HFY19, the company posted a profit after tax of Rs. 5.6m (FY18: loss of Rs. 25.3m; FY17: profit of Rs. 103.0m). Going forward, the change in taxation regime from FTR to NTR would reduce the tax burden for the Company.

Weakening capitalization levels but leveraging profile has improved

Post FY17, equity base of the company has exhibited a declining trend on the back of loss incurred and dividend payout of Rs. 41.4m. Net equity stood at Rs. 400.3m (FY18: Rs. 394.7m; FY17: Rs. 465.1m) at end-HFY19. With repayment of Rs. 60.2m short term loan during HFY19, the company currently has no debt on balance sheet. This has resulted in improvement in leverage indicators. Exposure to market risk is also considered on the lower side given limited proprietary investments. Liquid assets in relation to total liabilities declined owing to sizeable decrease in cash and bank balance. Net capital balance at end-December'2018 at Rs. 202.2m was well in excess of regulatory requirement. Furthermore, NCL has also remained compliant with its overall underwriting limits.

Sound corporate governance framework

During the outgoing year, staff turnover was witnessed in sales and research function; however, vacant positions have been filled with qualified professionals. Board level governance is considered sound with requisite committees. Moreover, one-third board size is represented by independent directors.

Next Capital Limited Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**HFY19**
Trade Debts	67.8	428.8	134.0	227.8
Deposits and Prepayments	132.8	281.9	238.4	137.8
Long Term Investments in PSX Shares	40.1	41.2	31.7	21.8
Proprietary Book	-	15.4	12.1	12.1
Cash and Bank balances	339.4	269.7	127.0	106.9
Taxation *(Refundable)*	21.4	50.8	54.5	60.3
Total Assets	**658.6**	**1,143.9**	**697.3**	**649.6**
Trade and Other Payables	368.9	546.4	223.7	238.9
Long Term Loans	92.2	-	-	-
Short Term Loans – Unsecured	35.4	107.3	60.2	-
Total Liabilities	**496.5**	**653.7**	**287.0**	**243.6**
Net Worth	**162.1**	**465.1**	**394.7**	**400.3**
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**HFY19**
Operating Revenue	**163.6**	**353.7**	**241.1**	**97.8**
Administrative & Operating Expenses	164.3	239.4	240.1	94.7
Finance Cost	26.6	30.1	16.5	3.9
Profit Before Tax	(5.7)	140.0	4.8	10.2
Profit After Tax	**(16.1)**	**103.0**	**(25.3)**	**5.6**
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**HFY19**
Liquid Assets to Total Liabilities (%)	91.4%	80.7%	124.5%	93.6%
Liquid Assets to Total Assets (%)	68.9%	46.1%	51.2%	35.1%
Debt Leverage (x)	3.06	1.41	0.73	0.61
Gearing (x)	0.79	0.23	0.15	N/A
Efficiency (%)	103.0%	70.3%	98.1%	87.5%
ROAA (%)	-2.9%	11.4%	-2.8%	1.7%
ROAE (%)	-9.5%	31.6%	-5.6%	2.8%

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	Next Capital 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				
19-Jan-16	A-	A-2	Stable	Initial
19-Mar-18	A-	A-2	Stable	Reaffirmed
10-Apr-19	A-	A-2	Stable	Reaffirmed

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.
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. VIS is not an NRSRO and its ratings are not NRSRO credit ratings. Copyright 2019 VIS Credit Rating Company Limited. All rights reserved. Contents may be used by news media with credit to VIS.