

RATING REPORT

Topline Securities Limited

REPORT DATE:

July 24, 2023

RATING ANALYSTS:

Shaheryar Khan Mangan

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RATING DETAILS

| Rating Category | Latest Rating | | Previous Rating | |
|-----------------|---------------|------------|-----------------|------------|
| | Long-term | Short-term | Long-term | Short-term |
| Entity | A | A-1 | A | A-1 |
| Rating Outlook | Stable | | Stable | |
| Rating Date | July 24, 2023 | | April 12, 2022 | |

COMPANY INFORMATION

| | |
|--|---|
| Incorporated in 2001 | External auditors: M/s Naveed Zafar Ashfaq Jaffery & Co. - Chartered Accountants |
| Public Unlisted | Chairman of the Board: Mrs. Sabahat Sohail |
| Key Shareholders (with stake 5% or more): | Chief Executive Officer: Mr. Mohammad Sohail |
| Mr. Mohammad Sohail – 70.91% | |
| Mr. Haroon Fattani – 22.3% | |
| Mr. Muhammad Amir Fattani – 6.8% | |

APPLICABLE METHODOLOGY(IES)

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

<http://vis.com.pk/kc-meth.aspx>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

<https://docs.vis.com.pk/docs/VISRatingScales.pdf>

Topline Securities Limited

OVERVIEW OF THE INSTITUTION

Topline Securities Limited (TSL) was incorporated under the Companies Ordinance 1984. The company is a TRE certificate holder of Pakistan Stock Exchange. The Company’s registered office is situated at Horizon Tower, Karachi.

Profile of CEO

Mr. Muhammad Sohail holds dual position of Chairman and CEO in the company. Mr. Sohail is an entrepreneur possessing approximately 26 years’ experience in capital markets including research and equity sales. Mr. Sohail holds an MBA degree and is a certified director from Pakistan Institute of Corporate Governance.

RATING RATIONALE

Topline Securities Limited (TSL) is engaged in the business of stock brokerage, commodity brokerage, underwriting, consultancy, book building, and advisory services. The majority Shareholding of the Company is primarily vested with Mr. Mohammad Sohail, who also serves as the Chief Executive Officer (CEO) of the company. The company provides both online and physical trading services to local and foreign clients.

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.

Key Rating Drivers:

Ratings take into account TSL’s client base

- TSL's client base is categorized into three segments: individuals, Corporates and foreign clientele, with individual clients dominating the Company's client base. In spite of low activities at PSX, foreign clients' share of the Company has seen an increase in total commission. The number of retail clients is showing an upward trajectory which is mainly attributed to the efforts laid out by the retail desk which has bode well for the Company's client base. In spite of the overall decline, the institutional clients continue to account for around 58% of the total brokerage income, underscoring their ongoing significance.
- TSL's brokerage revenue base represents a moderate concentration, with top 66 clients constituting around 50% of the total brokerage income.

Bottom line of the Company has come under pressure amid an economic slowdown in the country

Table 2: Revenue Diversification

| Diversification in Total Revenue | FY20 | FY21 | FY22 | FY20 | FY21 | FY22 |
|---|--------------|--------------|--------------|----------------|----------------|----------------|
| | PKR Mn. | - | - | % | - | - |
| Equity Brokerage - Institutional Client | 152.2 | 235.9 | 174.3 | 47.26% | 48.45% | 33.47% |
| - Individual Client | 63.6 | 140.9 | 124.7 | 19.75% | 28.94% | 23.94% |
| Income from Advisory Operations | 47.1 | 52.2 | 127.2 | 14.62% | 10.71% | 24.43% |
| Services rendered outside Pakistan | 7.5 | 1.6 | 0.9 | 2.33% | 0.33% | 0.17% |
| Total Operating Income | 270.4 | 430.5 | 427.1 | 83.95% | 88.44% | 82.02% |
| Bank Profit | 15.5 | 22.7 | 23.1 | 4.80% | 4.67% | 4.44% |
| Amortization of Government Treasury Bills | 1.6 | 9.8 | 35.3 | 0.50% | 2.01% | 6.78% |
| Dividend from Mutual Funds | 0.8 | 0.4 | 0.3 | 0.24% | 0.09% | 0.06% |
| Income from Margin Financing and MTS | 19.9 | 18.8 | 28.5 | 6.18% | 3.86% | 5.48% |
| Gain on Sale of Fixed Assets | 0.8 | 0.6 | 0.8 | 0.23% | 0.12% | 0.16% |
| Other Income | 13.2 | 3.9 | 5.6 | 4.09% | 0.81% | 1.07% |
| Total | 322.1 | 486.8 | 520.8 | 100.00% | 100.00% | 100.00% |

- In line with the industry trend, wherein brokerage volumes have contracted, brokerage income has registered a reduction in FY22 and subsequently in HY'FY23. Brokerage revenue posted a decline of 24% in FY22 to come in at Rs.250m (FY21: Rs.327m).
- Institution clients continue to account for a major chunk of the brokerage income, contributing around 58% of the brokerage revenue. Major decline in the brokerage revenue stem from institutional clients whereby it registered a decline of 24% in FY22 vis-à-vis the decline of 11% in the brokerage revenue from retail clients.
- While brokerage revenue has shown a decline, income from advisory operations has experienced a robust growth of 144% in FY22 reaching Rs.127m (FY21: Rs.52m). This increase has paved the way for an increased diversification, with the proportion of operating income derived from advisory operations surging to 31% (FY21: 13%).

- Similarly, as result of an increase in the advisory income, the operating revenue in FY22 was reported on the higher side vis-à-vis FY21. Albeit the operating revenue in HY'FY23 has depicted a drop compared to SPLY.
- Income from margin finance has also shown an uptick which clocked in at Rs.29m in FY22 (FY21: 18.8m). Albeit their contribution to the operating revenue remains minimal.

Table 3: P&L Statement (Extract)

| Figures in PKR' Millions | FY20 | FY21 | FY22 | HY'FY23 |
|--------------------------|---------------|---------------|---------------|--------------|
| Operating Revenue | 240.2 | 400.0 | 406.6 | 142.8 |
| Administrative overheads | 170.1 | 227.3 | 239.4 | 105.5 |
| Financial charges | 10.8 | 6.3 | 8.6 | 5.0 |
| Other operating charges | - | - | - | - |
| Total operating expenses | 180.9 | 233.6 | 248.0 | 110.5 |
| Operating profit | 59.3 | 166.4 | 158.6 | 32.3 |
| Other income | 51.7 | 37.5 | 65.1 | 37.6 |
| Realized | 0.2 | 37.9 | 12.5 | 21.5 |
| Unrealized | 53.2 | 0.0 | 0.2 | 5.3 |
| Profit before tax | 164.3 | 241.7 | 236.5 | 96.7 |
| Taxation | 32.0 | 62.1 | 64.2 | 19.7 |
| Profit/(Loss) After Tax | 132.2 | 179.6 | 172.3 | 77.0 |
| ROAA | 13.45% | 15.27% | 11.95% | 9.9% |
| ROAE | 16.46% | 19.23% | 15.45% | 13.3% |

- With a small increase in the operating revenue, efficiency levels has depicted a slight improvement and continues to remain at moderate levels.
- TSL's profitability has noted a marginal decline in FY22. However, the profitability has been dented in H'FY23 whereby the profit after tax plummeted by 30% vis-à-vis SPLY which is mainly on account of a slowdown in market activity.
- The Company's other income largely emanates from the bank profit and government securities, which has shown a notable increase in FY22.
- Going forward, the brokerage revenue of the Company is expected to rebound in the near term given the expected resurgence in market volumes on the back of restoration of investor confidence following the stand by arrangement reached with IMF, consequently, the improvement is expected to reflect positively on the Company's profitability.

Financial risk indicators of TSL remained sound

Liquidity risk

- Liquid assets of the Company has plummeted in FY22 which have further slid down in HY'FY23. Nevertheless, liquid assets provides sizeable coverage to total liabilities, with liquid assets in relation to total liabilities standing at 269% and 162% in FY22 and HY'FY23 respectively.
- Current ratio of the Company was recorded at 3.8x in FY22. However, it contracted to 2.9x in HY'FY23, albeit remaining on the higher side.

Credit risk

Table 4: Asset Mix

| Figures in PKR' Millions | Jun'21 | Jun'22 | Dec'22 |
|--|--------|--------|--------|
| Non-Current Assets | | | |
| - Long-term Investments | 0 | 90.1 | 91.2 |
| - Others | 28.6 | 165.3 | 164.9 |
| Current Assets | | | |
| - Trade Debts | 467.2 | 333.7 | 433.1 |
| - Advances, Deposits, Prepayments etc. | 390.2 | 20.4 | 205.1 |
| - Short Term Investments | 175.8 | 464 | 518.8 |
| - Cash & Bank Balances | 253.9 | 343.4 | 271.1 |

- Trade debts of the Company includes receivables from margin financing, receivables from margin trading system, and receivables of murabaha share financing, cumulatively accounting for around 30% of the total current assets.
- With regard to the equity, trade debts of the Company account for around 36% of the equity as at Dec'22. Similarly, aging of the trade debts is considered satisfactory indicates low credit risk given that in 64% of the trade debts in FY22 are outstanding for up to five days while remainder are outstanding for more than days.

Market risk

- As at Dec'22, short investments as a percentage of equity stands at around 46%. However, the Company has a negligible exposure to market risk as its short investments are majorly parked in mutual funds, specifically in money market funds, and government securities, which primarily consist of treasury bills.
- Going forward, management has directed its strategy towards augmenting investments in mutual funds while reducing exposure in government securities. In spite of the same, market risk will remain minimal as the majority of the funds will be invested in money market funds.

Ratings draws support from Company's sound capitalization indicators given low gearing and leverage levels

Table 5: Capitalization

| Figures in PKR' Millions | FY21 | FY22 | HY'FY23 |
|------------------------------|-------|---------|---------|
| Total Equity | 998.7 | 1,120.8 | 1,197.8 |
| - Paid-up Capital | 150.0 | 150.0 | 150.0 |
| - Total Reserves | 848.7 | 970.8 | 1,047.8 |
| Short term Borrowings | - | 95.0 | 22.2 |
| Long term Borrowings | - | - | - |
| Total Liabilities | 319.5 | 307.2 | 488.0 |
| Gearing (x) | 0.0x | 0.08x | 0.02x |
| Leverage (x) | 0.3x | 0.3x | 0.4x |

- Equity of the Company has increased in tandem with the profits which have clocked in at Rs.1,198m in HY'FY23 (FY22: Rs.1,120m; FY21: Rs999m).
- Company's short term borrowings witnessed a drawdown of Rs.95m in order to provide funding for working capital requirement. However, it reduced to Rs.22m in HY'FY23. Nonetheless, gearing and leverage indicators have remained sound, with gearing and leverage recorded at 0.08x and 0.27x respectively in FY22 and in H'FY23 it stood at 0.02x and 0.41x respectively.

Governance framework is considered sound

- The board of directors is composed of 7 directors which bodes well for the Company. The Company also has a female representation on the board.
- The Company has recently added an independent director on the board. Following this development, the number of independent directors has increased to two.
- There are 4 board committees established for oversight; audit committee, HR and remuneration committee, nomination committee and risk management committee.

| FINANCIAL SUMMARY | | <i>(amounts in PKR millions)</i> | | | | Appendix I |
|--|--|----------------------------------|----------------|----------------|----------------|----------------|
| <u>BALANCE SHEET</u> | | Jun'19 | Jun'20 | Jun'21 | Jun'22 | Dec'22 |
| Trade Debts | | 190.3 | 227.041 | 467.16 | 333.7 | 433.1 |
| Deposits and Prepayments | | 301.1 | 97.9 | 389.9 | 19.7 | 204.1 |
| Short Term Investments | | 18.0 | 277.5 | 175.8 | 464.0 | 518.8 |
| Cash and Bank balances | | 382.7 | 405.5 | 253.9 | 343.4 | 271.1 |
| Total Assets | | 931.5 | 1,034.8 | 1,318.2 | 1,427.5 | 1,685.8 |
| Trade and Other Payables | | 191.0 | 164.7 | 308.6 | 208.3 | 463.6 |
| Long Term Loans | | - | - | - | - | - |
| Short Term Loans | | - | - | 10.6 | 95.0 | 22.2 |
| Total Liabilities | | 194.3 | 165.5 | 319.5 | 307.2 | 488.0 |
| Paid up Capital | | 150 | 150 | 150 | 150 | 150 |
| Net Worth | | 737.1 | 869.4 | 998.7 | 1,120.8 | 1,197.8 |
| <u>INCOME STATEMENT</u> | | FY19 | FY20 | FY21 | FY22 | HY'FY23 |
| Operating Revenue | | 203.3 | 240.2 | 381.2 | 406.6 | 142.8 |
| Operating Expenses | | 168.1 | 170.1 | 227.3 | 239.4 | 105.5 |
| Finance Cost | | 6.3 | 10.8 | 6.3 | 8.6 | 5.0 |
| Profit Before Tax | | 84.8 | 164.3 | 241.7 | 236.5 | 96.7 |
| Profit After Tax | | 64.2 | 132.2 | 179.6 | 172.3 | 77.0 |
| <u>RATIO ANALYSIS</u> | | FY19 | FY20 | FY21 | FY22 | HY'FY23 |
| Liquid Assets to Total Liabilities (%) | | 351.2% | 470.1% | 250.3% | 266.4% | 161.9% |
| Liquid Assets to Total Assets (%) | | 73.3% | 75.2% | 60.7% | 57.3% | 46.9% |
| Current Ratio (x) | | 4.71 | 6.15 | 4.04 | 3.82 | 2.93 |
| Debt Leverage (x) | | 0.26 | 0.19 | 0.32 | 0.27 | 0.41 |
| Gearing (x) | | - | - | 0.01 | 0.08 | 0.02 |
| Efficiency (%) | | 75.4% | 63.3% | 54.0% | 55.8% | 0.0% |
| ROAA (%) | | 6.8% | 13.5% | 15.3% | 11.9% | 9.9% |
| ROAE (%) | | 9.1% | 16.5% | 19.2% | 15.5% | 13.3% |

| REGULATORY DISCLOSURES | | | | Appendix II | |
|---|---|----------------------------|-------------------------|-----------------------------|----------------------|
| Name of Rated Entity | Topline Securities 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 | | | | |
| | 24-July-23 | A | A-1 | Stable | Reaffirmed |
| | 12-Apr-22 | A | A-1 | Stable | Upgrade |
| | 19-Mar-21 | A | A-2 | Stable | Upgrade |
| | 24-Apr-20 | A- | A-2 | Positive | Maintained |
| | 18-Jan-19 | A- | A-2 | Stable | Reaffirmed |
| | 19-July-17 | A- | A-2 | Stable | Reaffirmed |
| | 22-Mar-16 | A- | A-2 | 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 | S. No | Name | Designation | Date | |
| | 1. | Mr. Khalid Mehmood | CFO & Company Secretary | 20 th June, 2023 | |