

RATING REPORT

Adam Securities Limited

REPORT DATE:

21 September, 2021

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Stable		Stable	
Rating Date	September 21, 2021		September 17, 2020	

COMPANY INFORMATION

Incorporated on June 08, 2001	External auditors: M/s Baker Tilly Mehmood Idrees, Chartered Accountants
Public Unlisted Company	Chairperson: Mr. Muhammad Umair
Key Shareholders (with stake 5% or more):	Director: Mr. Noman Abdul Majeed Adam
Mr. Noman Abdul Majeed Adam – 98.86%	CEO: Mr. Muhammad Aftah Haji Ghani

APPLICABLE METHODOLOGY(IES)

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

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

Adam Securities Limited

OVERVIEW OF THE INSTITUTION

RATING RATIONALE

Adam Securities Limited (ASL) is a public unlisted company which was incorporated in June 2001 under the Companies Ordinance 1984. ASL is a TREC holder of Pakistan Stock Exchange.

Profile of Chairman Director & Sponsor

Mr. Noman Abdul Majeed is the Director of the company with over 10 years of experience in Stock Market, International Markets and Commodities Market. He is the head of Securities Brokerage Division of the company as well. Mr. Noman holds a graduate degree from University of Karachi.

Profile of CEO

Mr. Muhammad Aftab Haji Ghani is post graduate in Islamic Banking and Finance from University of Karachi and has an experience of above 28 years in banking sector. Previously, he has served as Manager Islamic Window and AVP in United Bank Limited from February 2011 to October 2020.

Adam Securities Limited (ASL) is engaged in provision of equity brokerage services mainly to domestic retail and institutional clients. Shareholding of the company is primarily vested within the family represented by one individual. The company operates through its head office in Karachi.

Sector Update

- After a dismal performance in FY18 & FY19, volumes of PSX started to rebound with an increase of 32% in FY20, followed by historically high volumes in FY21. (Up 170% YoY).
- 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 be prohibited from taking custody of client assets. Further, SECP has standardized brokerage commission slab to minimum of 3 paise (or 0.15% of traded value) and maximum of 2.5% of traded value.
- The number of Initial Public Offerings (IPOs), which dropped in FY20, was followed by 8 IPOs in FY21, raising a sum of Rs. 14b, which was the highest sum mobilized by corporates in 14 years, with the previous best being 12 transactions om FY07. Inclusive of debt issuances, total capital raised during FY21 amounted to Rs. 31b.
- 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	FY21
Volume (In Billions)	43	37	49	131
Value (In PKR’ Billions)	2,027	1,549	1,789	4,781

Rating Drivers

Improving trend in profitability has continued in FY21. We have noted growth in revenue from non-brokerage commission stream, albeit there is room for further improvement in revenue diversification.

- ASL's market share inched down to 11.62% during FY21 from 12.67% in FY20. However, given the increase in industry trading volume, discussed above, the company's brokerage volume was notably higher. .
- Brokerage commission remained the core revenue stream for the company, with an average of 94% operating revenue earning from the same.
- Concentration in brokerage commission is diversified between domestic retail and institution, wherein domestic retail consist of 58% while remaining is earned from local institutions. Commission from international clients is negligible.
- During FY20, ASL has earned Rs. 1.2m from commodity commission which discontinued in the year under review.
- The company has received an underwriting license and expecting a sustainable revenue from investment banking deals in future. In FY21, ASL booked revenue of Rs.2.4m from the same. Management is expecting this revenue streamline to grow during FY22 on the back of increasing number of IPO's and corporate and investment banking activities in the industry.
- Overall client concentration remained high depicting increased business risk.
- Number of clients continued to increase with a growth in individuals' clientele both in retail and international segment.
- Higher concentration in brokerage commission implies higher business risk emanating from the volatility in market trading volumes. Sustainable diversification in the operating revenue is important from ratings perspective.

Diversification in Operating Revenue	FY19	FY20	FY21	FY19	FY20	FY21
	Pkr Mn.			%		
Commission Income	39.1	31.8	146.0	93.8%	90.4%	96.7%
Dividend Income	1.3	2.2	2.6	3.0%	6.2%	1.7%
Commodity Income	-	1.2	-	-	3.4%	-
Investment Banking	1.3	-	2.4	3.2%	-	1.6%
Total	41.7	35.2	150.9	100%	100%	100%

- Excluding capital gains on ready-future trading, the company's efficiency ratio has remained above 100% during the last 3 years including FY21, despite adding other recurring revenue streams in operating income. (FY21: 124%, FY20: 136%). However, capital gains have depicted a recurring trend, which is mainly because all these trades are hedged by future sell options. Incorporating 85% of the capital gains into recurring income, the company's efficiency stood comfortable at 43% (FY20: 50%).

P&L Extract	FY18	FY19	FY20	FY21
Operating Revenue	77.2	40.3	35.2	148.6
Operating Expense	90.3	77.6	89.0	208.2
-Admin Expense	86.9	75.3	82.8	192.1
-Finance Cost	3.4	2.3	6.3	16.2
Net realized & unrealized gain on investments	34.2	52.1	120.3	358.1
Profit After Tax	17.6	43.9	98.5	336.8
ROAA	2.1%	5.5%	10.6%	28.7%
ROAE	3.2%	7.8%	17.1%	45.1%
Efficiency	81%	113%	136%	124%

Financial risk profile remains manageable

Liquidity Risk

- Historically, current ratio of the company remained above 2x while at end-FY21, current ratio stood at 3.35x, which is considered adequately high.
- ASL has Rs. 896m of Cash and Short term investment as at Jun'21 which converted to 2.4x of the total liabilities and 69% of the total assets.

Credit Risk

- Trade receivables stood at Rs.29.6m which is 2% of the total current assets.
- 70% of the trade receivables are lying in the band of 10 days, depicting sound credit risk profile of the company.

Market Risk

- Traditionally, ASL runs a small proprietary book which has started to increase in FY20 and further grew in FY21. As at Jun'21, short term investments has increased to Rs. 786m converting it into 60% of the total assets. (Rs. 25m in money market, remaining in listed equities)
- As per management, market risk emanating from the proprietary trading portfolio of Rs. 786m, is largely hedged by future sell options, which cover roughly 85% of the trading book.

Sound capitalization structure with low leveraging and high profit retention

- Capitalization structure draws strong support from internal cash generation as total equity of the company grew to Rs. 913.2m as at Jun'21 compared to Rs. 591.4m last year.
- Gearing and Leverage indicators remained low to come at 0.20x and 0.41x as at Jun'21.

Corporate governance framework is adequate

Board of Directors comprises 4 members including a female director. An independent director, Mr. Muhammad Umair is also present as Chairman to the Board. A risk management committee and audit committee have been constituted at the Board level.

FINANCIAL SUMMARY (amounts in PKR millions)		Appendix I		
<u>BALANCE SHEET</u>	FY18	FY19	FY20	FY21
Trade Debts	17	40	7	30
Long Term Investments	30	22	8	8
Short term Investments	121	93	312	786
Cash and Bank balances	37	127	416	110
Total Assets	787	813	1,047	1,304
Trade and Other Payables	77	87	447	174
Short Term Loans	-	55	-	179
Paid Up Capital	250	265	265	265
Net Worth (excluding revaluation surplus)	558	562	586	908
<u>INCOME STATEMENT</u>	FY18	FY19	FY20	FY21
Total Revenue	111	92	156	507
Brokerage Income	76	39	32	146
Commodity Income	-	-	1	-
Advisory and consultancy fee	8	1	-	2
Dividend Income	2	1	2	3
Administrative Expenses	87	75	83	192
Finance Costs	3	2	6	16
Profit Before Tax	71	52	106	347
Profit After Tax	18	44	98	337
<u>RATIO ANALYSIS</u>	FY18	FY19	FY20	FY21
Liquid Assets to Total Liabilities	74.3%	91.0%	159.8%	238.4%
Liquid Assets to Total Assets	20.1%	27.1%	69.5%	68.7%
Leverage	0.38	0.43	0.78	0.41
Gearing	0.00	0.10	0.00	0.20
Current Ratio (x)	3.37	3.11	2.19	3.35
Efficiency (%)	81.0%	112.9%	136.1%	123.6%
ROAA (%)	2.1%	5.5%	10.6%	28.7%
ROAE (%)	3.2%	7.8%	17.1%	45.1%

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: 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	Adam 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
	<u>RATING TYPE: ENTITY</u>				
	06-September 2021	A-	A-2	Stable	Reaffirmed
	17-September 2020	A-	A-2	Stable	Upgrade
	18-February-2020	BBB+	A-2	Stable	Upgrade
	26-July-2019	BBB	A-3	Stable	Upgrade
	30-March-2018	BBB-	A-3	Stable	Upgrade
	31-October-2017	BB+	A-3	Stable	Upgrade
	03-April-2017	BB	A-3	Stable	Reaffirmed
	30-Dec-2015	BB	A-3	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	Meeting Date	
	1	Mr. Noman Abdul Majeed Adam	Director	August 30, 2021	
	2	Mr. Muhammad Rizwan Haroon	Chief Financial Officer	August 30, 2021	