RATING REPORT

Foundation Securities (Private) Limited

REPORT DATE:
April 4, 2019

RATING ANALYSTS:
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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	Negative		Stable	
Rating Date	*April 1, 2019*		*November 1, 2017*	

COMPANY INFORMATION	
Incorporated in 2005	**External auditors:** Grant Thornton Anjum Rahman
Private Limited Company	**Chairman of the Board:** Brig. Wajahat Nazir (Retd)
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Syed Ahmad Abbas Zaidi
Fauji Foundation Pakistan – 95.74%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Securities Firms Rating (May 2015)
http://www.vis.com.pk/Images/Securities%20methodology%201%20-2015.pdf

Foundation Securities (Private) Limited

OVERVIEW OF THE INSTITUTION

Foundation Securities Private Limited (FSL) was incorporated as a private limited company in January 2005, under the Companies Ordinance 1984. The company holds a Trading Right Entitlement Certificate (TREC) of Pakistan Stock Exchange (PSX) and is a member of Pakistan Mercantile Exchange (PMEX).

External auditors are 'Grant Thornton Anjum Rahman'. Auditors belong to category 'A' on the approved list of auditors published by the State Bank of Pakistan (SBP).

Profile of Chairman

Brig (Retd.) Wajahat Nazir is the Chairman of the Board of FSL. Apart from his capacity as Chairman, he is successfully promoting the interests of Fauji Foundation, the largest corporate/ welfare organization of Pakistan, both at national and international level, being Secretary Cerntral Board of Directors.

Profile of CEO & MD

Mr. Syed Ahmad Abbas Zaidi is currently serving as a CEO and MD of FSL. Mr. Zaidi has an experience of more than 14 years in equities related operations. His stint with international and local market names like ABN AMRO Equities, W.I Carr Indosuez Securities and First Capital Securities earned him vast exposure to operations, risk, compliance, accounts and finance.

RATING RATIONALE

Incorporated in 2005, Foundation Securities Private Limited (FSL) is a subsidiary of Fauji Foundation Pakistan. The group has strategic investments in various sectors including fertilizer, power, cement, infrastructure, banking, financial services, consumer goods, oil & gas and others. FSL is primarily engaged in retail and institutional equity broking services with marginal presence in commodity segment. Presently, the company runs its operations through a head office based in Karachi along with two branches in Lahore and Islamabad.

FSL has a strategic relationship with Macquarie Capital Securities Limited; an affiliate of global financial institution Macquarie Group. The partnering arrangement focus on in-bound and out-bound equity markets transactions besides other areas including mergers and acquisitions, and corporate finance advisory work.

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 topline of the brokerage industry.

Performance of the equity market has remained dismal over the last 22 months with trading volumes falling depicting a significant decline, largely owing to aggressive foreign selling, sizeable current account & rising fiscal deficit and slow-down in GDP growth. Decline in ready market volumes during FY18 and HFY19 was more pronounced for ready market as compared to future volumes where volumes 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.

PSX Data (Ready + Future)	Volumes (m)	Value (m)
FY17	100,345	4,756,168
FY18	58,401	2,881,120
% change in FY18	-42%	-39%
1HFY19	31,182	1,304,415
Annualized % change 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 expected entry of Pakistan in the IMF Programme, low base effect of ready market volumes & growing volumes in the future segment and improved valuations post almost two consecutive years of decline in benchmark index, overall market volumes during FY20 are expected to be higher vis-à-vis FY19 and FY18. Nevertheless, sector outlook is expected to remain challenging.

High business risk given low diversification in revenue streams and volatility associated with market volumes. Going forward, management plans to reactivate its commodity desk to diversify income streams.

As per industry estimates, average daily volumes of equity market dropped by around 50% during FY18 and remained at similar levels during HFY19. Company's market share has remained around 7%. FSL has a retail client base of over 13,000 (Active: 8,000) clients, accounting for around two-third of the brokerage revenue which reflects its focus on serving retail clients.

International institutional business has also witnessed a significant decline over time due to shrinking trading volumes and draining global investors' interest in the market. Presently, FSL has 3 broker dealers on its panel catering to 32 end clients.

Number of Clients	FY16	FY17	FY18	HY19
Foreign Clients	31	31	32	32
Domestic Institutions	507	541	553	570
Domestic Individuals	10,906	12,143	12,745	13,077

In contrast to equity market, trading volumes on commodity exchanges rose by 10.6% during FY18 with major increase in volumes traded for natural gas and platinum. In view of these trends, FSL's management intends to diversify revenue streams through reactivating its commodity desk and shifting its established client base towards this segment.

FSL's revenues remain dependent on inherent volatile nature of equity market. Losses observed in FY18 and HFY19. Quantum of losses has reduced during HFY19 due to cost rationalization initiatives.

Over the years, revenue base of the company has largely comprised commission income from equity brokerage; indicating significant reliance on market volumes. During FY18, operating revenue declined significantly and was reported at Rs. 211.8m (FY17: Rs. 360.5m). The sizeable decrease in revenue was on account of lower trading volumes and commission charged per share due to reduction in value of shares traded.

On the cost front, FSL has undertaken various stringent cost control measures including a) reduction in administrative expenses b) trimming HR costs c) closing Gulshan branch and merging its operations with PSX branch. However, cost-income ratio weakened to 107.4% (FY18: 112.6%; FY17: 82.5%) during HFY19 vis-à-vis FY17 levels as decline in operating revenues was higher than operating costs. During HFY19, the company reported a loss before tax of Rs. 4.7m (FY18: loss of Rs. 22.7m; FY17: profit of Rs. 113.9m). Going forward, achieving planned diversification in revenue base and operating cost rationalization is considered important for improvement in profitability profile.

Declining equity size on account of accumulated losses and dividend paid. Capitalization levels and liquidity indicators have also depicted a weakening trend.

Equity base of the company has depicted a declining trend on account of increase in accumulated losses and dividend declared for the year FY17 which were paid out in FY18. Net equity amounted to Rs. 216.1m (FY18: Rs. 230.2m; FY17: Rs. 348.4m) at end-HFY19. Total debt carried on balance sheet amounted to Rs. 155m (FY18: Rs. 155m; FY17: Rs. 355m) at end-HFY19. Long term loan of Rs. 200m was repaid in September'2017 due to reduced requirements of exposure deposits owing to lower trading volumes. Exposure to market risk is limited given no proprietary investments on balance sheet. Liquid assets in relation to total liabilities decreased to 59.8% (FY18: 74.8%; FY17: 69.0%) at end-HFY19 on account of decline in cash and bank balance over time.

Corporate governance structure.

Management team at FSL comprises professionals who are well versed with the brokerage industry. There has been no significant change witnessed in senior management team during 2018 and the ongoing year. Board level governance of the company is considered sound; however, room for improvement exists in terms of board size and independent directors. Internal Audit function needs to be segregated from Compliance & Risk Management function.

Foundation Securities (Private) Limited — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY16**	**FY17**	**FY18**	**1HFY19**
Trade Debts	252.6	294.3	118.1	145.1
Deposits and Prepayments	193.5	235.4	133.7	139.2
Long Term Investments	31.1	41.2	26.7	18.0
Proprietary Book	3.6	2.1	0.4	0.4
Cash and Bank balances	609.4	813.2	551.8	351.1
Taxation	59.2	97.0	98.2	111.8
Total Assets	**1,199.4**	**1,529.7**	**968.0**	**803.7**
Trade and Other Payables	730.3	805.3	566.2	430.4
Long Term Loans	200.0	255.0	55.0	55.0
Short Term Loans – Secured	-	100.0	100.0	100.0
Total Liabilities	**957.8**	**1,181.3**	**737.8**	**587.6**
Net Worth	**241.6**	**348.4**	**230.2**	**216.1**
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**1HFY19**
Brokerage Income	273.1	348.8	202.1	86.0
Consultancy Service	0.02	-	0.7	-
Research	-	-	0.5	0.7
Operating Revenue	**298.1**	**360.5**	**211.8**	**96.4**
Administrative Expenses	252.3	278.2	228.4	98.1
Finance Cost	23.6	19.4	9.4	4.0
Profit Before Tax	32.3	113.9	(22.7)	(4.7)
Profit After Tax	**20.7**	**96.6**	**(56.3)**	**(5.5)**
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**1HFY19**
Liquid Assets to Total Liabilities (%)	64.0%	69.0%	74.8%	59.8%
Liquid Assets to Total Assets (%)	51.1%	53.3%	57.1%	43.7%
Debt Leverage (x)	4.0	3.4	3.2	2.7
Gearing (x)	0.8	1.0	0.7	0.7
Efficiency (%)	91.7%	82.5%	122.6%	107.4%
ROAA (%)	1.7%	7.1%	(4.5%)	(1.4%)
ROAE (%)	8.6%	32.7%	(19.5%)	(5.1%)

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	Foundation Securities (Private) Limited
Sector	Brokerage
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	see table below
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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Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
1-Nov-2017	A-	A-2	Stable	Initial
1-April-2019	A-	A-2	Negative	Maintained