

## RATING REPORT

### Foundation Securities (Private) Limited

**REPORT DATE:**

April 22, 2020

**RATING ANALYSTS:**

Arsal Ayub, CFA

[arsal.ayub@vis.com.pk](mailto:arsal.ayub@vis.com.pk)

#### RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
<b>Entity</b>	A-	A-2	A-	A-2
<b>Rating Outlook</b>	Stable		Negative	
<b>Rating Date</b>	April 22, 2020		April 22, 2019	

#### COMPANY INFORMATION

<b>Incorporated in 2005</b>	<b>External auditors:</b> Grant Thornton Anjum Rahman
<b>Private Limited Company</b>	<b>Chairman of the Board:</b> Brig. Sabir Ali (Retd)
<b>Key Shareholders (with stake 5% or more):</b>	<b>Chief Executive Officer:</b> Syed Ahmad Abbas Zaidi
Fauji Foundation Pakistan – 95.74%	

#### APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Securities Firms Rating (June 2017)

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

**Foundation Securities (Private) Limited**

**OVERVIEW OF THE INSTITUTION      RATING RATIONALE**

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. Sabir Ali (Retd) is the Chairman of the Board of FSL. Apart from his capacity as Chairman, he also holds the position of Corporate Secretary of Fauji Foundation.

**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.

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 brokerage services with marginal presence in commodity segment. Presently, the company runs its operations through a head office based in Karachi along with 2 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 over the last 2 years has impacted topline of the brokerage industry although recovery has been witnessed in past six months.**

Performance of the equity market has remained dismal over the past 2 fiscal years with dwindling trading volumes largely owing to economic slow-down, rising benchmark rate and aggressive foreign selling. However positive investor sentiment resulting from improving macroeconomic indicators has led to recovery in 1HFY20. This is reflected in the table below, wherein volumetric trade in 1HFY20 stood 15% higher vis-à-vis SPLY. The relatively lower value trade is explained by the generally lower market pricing during this period.

**Table 1: Industry Trading Metrics (Volume & Value)**

	FY17	FY18	FY19	1HFY19	1HFY20
<b>Volume (Ready + Future) (In Billions)</b>	100	58	55	31	36
<b>Value (Regular) (In PKR’ Billions)</b>	4,756	2,881	2,235	1,304	1,300

Given tough market conditions, players with efficient and variable cost structure along with diversified revenue streams managed to remain profitable. On the other side, players with large proprietary books witnessed losses given weak market performance.

A positive development came into effect in October 14<sup>th</sup> 2019, when the SECP implemented a standard range/scale of brokerage commissions. This is expected to positively impact the revenue stream of brokers. However, in addition to increased revenues, the standardization of commission scale is expected to translate in an improvement in industry-wide quality standards, as previously several brokerage houses were charging very low commissions rates, which was adversely affecting competition and creating a disadvantage for market participants in the form of disparity in service standards.

**Asset allocations strategy is conservative with a small-sized proprietary book and sizable liquidity**

FSL's asset base dropped by 20% in FY19, which was mainly precipitated by the reduced trading volumes in the market. Following an increase in trading volumes in the latest period (1HFY20), the asset base grew by 49%, which was contributed in almost equal parts by higher trading volumes (52%) and increase in short term finance (45%).

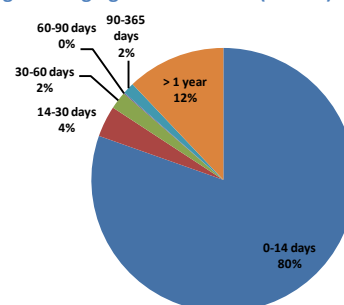
**Table 2: Asset Mix**

Figures in PKR' Millions	Jun'18	Jun'19	Dec'19
<b>Non-Current Assets</b>	<b>53.8</b>	<b>47.0</b>	<b>27.4</b>
- Long-term Investments	26.7	17.2	-
- Others	27.0	29.8	27.4
<b>Current Assets</b>	<b>913.8</b>	<b>727.7</b>	<b>1,123.8</b>
- Trade Debts	118.1	113.1	154.9
- Advances, Deposits, Prepayments etc.	135.5	152.4	230.3
- Proprietary Investments	0.4	0.3	45.0
- Cash & Bank Balances	551.8	333.1	583.2
- Taxation	98.2	117.1	110.4

FSL maintains a conservative asset allocation strategy, with about half the asset base being maintained in the form of cash & bank balances. Furthermore, the company has not taken part in proprietary equity operations, as the portfolio has remained minimal during the past few years. As of the end of the latest period (1HFY20), FSL had a proprietary book of Rs. 45m, which mainly included long term investments held previously transferred to short term (62%), and T-Bills (38%).

FSL's trade debts have increased on a timeline basis, in absolute terms, albeit proportionally (to the asset base) it remains at similar level. The gross debtors as of Dec'19 stood at Rs. 175mn (Jun'19: Rs. 133mn; Jun'18: Rs. 135mn) and provisioning against the same stood at 11%. The aging of the gross debtor profile is presented in figure 1. It is pertinent to mention that the amount outstanding for longer than 1 year has almost entirely been provisioned.

**Figure 1: Aging of Trade Debts (Dec'19)**



**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.**

FSL's income is primarily derived from its equity brokerage activities. However, given the sizable increase in cash balances, the contribution in terms of income on saving accounts has increased.

**Table 3: Revenue Breakup**

Figures in PKR' Millions	FY18	FY19	1H'FY19	1H'FY20
<b>Total Revenue (net)</b>	<b>202</b>	<b>169</b>	<b>99</b>	<b>129</b>
- Equity	188	144	86	100
- Profit on Saving Accounts	8	23	12	26
- Others	6	2	1	3
<b>Overheads</b>	<b>225</b>	<b>192</b>	<b>103</b>	<b>92</b>
- Administrative Expenses	215	185	98	90
- Finance Costs	9	9	4	4
- Others	0	(2)	1	(2)

In FY19, FSL's market share remained close to ~7%<sup>1</sup>. Given the industry-wide drop in trading volumes, the company's equity brokerage revenues shrunk by 46% in FY18, followed by another 23% contraction in FY19. Following resumption in industry trading activity in 1HFY20, brokerage revenues posted an improvement.

In view of the top line shrinkage, administrative expenses were also lower mainly on account of lower trading volumes and absence of any variable staff bonuses, as the company went into losses. Resultantly, the pre-tax losses of the company remained commensurately low at Rs. 23mn.

<sup>1</sup> Calculated in terms of Regular Market Volumes (Excl. Future Market Volumes)

FSL's significant reliance on equity brokerage operations remains a business risk. However, the sizable retail clientele, which accounts for about two-thirds of the brokerage commissions, is viewed as strength. Brokerage income depicts some concentration with the largest 1 & 5 clients constituting 14% and 22% of the aggregate respectively. Excluding commissions from the top 5, client exposures are fragmented. In FY19, the proportion of trading processed through the Institutional Delivery System (IDS) stood at 3% & 8% in terms of volume and value respectively.

**Table 4: Clientele Breakup**

	Jun'17	Jun'18	Jun'19
<b>Foreign Clients</b>	31	32	32
<b>Domestic Institutions</b>	541	553	587
<b>Domestic Individuals</b>	12,143	12,745	12,662

Cognizant of the sizable reliance on equity brokerage operations, diversification in revenue streams has been on management's agenda. However progress in this regard has been slow.

**Back to back losses during the 2-year period (FY18-FY19) have resulted in equity erosion.**

Given drop in equity brokerage volumes, the company's efficiency ratio worsened in FY18, albeit depicted some recovery in FY19. As a result of the losses in FY18, and 52% dividend payout on prior year profit, the company's equity dropped by 36%. Despite incurring additional losses in FY19, the impact on equity was lessened by transfer of fair value of long-term loan from parent company. The same was gauged to be Rs. 16.6m as the loan term was extended for 2½ year period, and interest cost on the extended period was waived off by the parent company.

**Table 5: Profitability Indicators (In PKR' Millions, unless stated otherwise)**

	FY18	FY19	1HFY20
<b>Efficiency</b>	115%	103%	75%
<b>Net Profit (Loss) (after tax)</b>	(56.3)	(18.2)	25.8
<b>RoAA</b>	-5%	-2%	5%
<b>RoAE</b>	-20%	-8%	22%

Given the increase in short term financing and client deposits, during 1HFY20, the company's gearing & leverage have both increased. As a result, the leverage indicator stands higher than the peer group median.

**Table 6: Capitalization (In PKR' Millions, unless stated otherwise)**

	Jun'18	Jun'19	Dec'19
<b>Net Equity</b>	230.2	222.1	243.5
- <b>Paid-up Capital</b>	304.6	304.6	304.6
- <b>Accumulated Losses</b>	(90.7)	(104.7)	(61)
- <b>Surplus on Revaluation</b>	16.2	5.6	-
<b>Gearing</b>	0.7x	0.7x	1.3x
<b>Leverage</b>	3.2x	2.5x	3.7x

The rating assessment of FSL takes into account an element of sponsor support. Furthermore, FSL's conservative asset deployment strategy is also a positive rating determinant. As of Dec'19, liquid assets in relation to liabilities stood at 66.1%.

**Corporate Governance Infrastructure**

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 the period under review, except for the change in CEO/MD which was noted in the prior review. Board level governance of the company is considered sound; however, room for improvement exists in terms of Board size and independent directors. In order to enhance control systems, Internal Audit has been segregated and outsourced, whilst the internal function overseeing controls, is now focused on Compliance & Risk Management.

**Foundation Securities (Private) Limited**
**Appendix I**

<b><u>BALANCE SHEET</u></b>	<b>Jun'17</b>	<b>Jun'18</b>	<b>Jun'19</b>	<b>Dec'20</b>	
Trade Debts	294.3	118.1	113.1	154.9	
Deposits and Prepayments	235.4	135.5	152.4	230.3	
Long Term Investments	41.2	26.7	17.2	-	
Proprietary Book	2.1	0.4	0.3	45.0	
Cash and Bank balances	813.2	551.8	333.1	583.2	
Taxation	97.0	98.2	117.1	110.4	
<b>Total Assets</b>	<b>1,529.7</b>	<b>967.8</b>	<b>774.8</b>	<b>1,151.2</b>	
Trade and Other Payables	805.3	565.9	383.8	580.7	
Long Term Loans	255.0	55.0	38.4	38.4	
Short Term Loans – Secured	100.0	100.0	118.0	286.5	
<b>Total Liabilities</b>	<b>1,181.3</b>	<b>737.5</b>	<b>552.7</b>	<b>907.7</b>	
Paid-up Capital	<b>304.6</b>	<b>304.6</b>	<b>304.6</b>	<b>304.6</b>	
Net Equity	<b>348.4</b>	<b>230.2</b>	<b>222.1</b>	<b>243.5</b>	
<b><u>INCOME STATEMENT</u></b>					
	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>1H'FY19</b>	<b>1H'FY20</b>
Brokerage Income	347.0	187.7	143.8	85.8	99.6
Consultancy Service	-	0.7	0.5	-	-
Research	-	0.5	0.7	0.7	-
Commodities	1.6	1.1	0.2	0.1	0.0
Profit from Saving Accounts	13.2	8.1	23.3	12.3	25.7
<b>Operating Revenues</b>	<b>362.3</b>	<b>198.2</b>	<b>168.5</b>	<b>99.0</b>	<b>125.4</b>
Administrative Expenses	278.2	215.1	185.2	98.1	90.4
Finance Cost	19.4	9.4	8.5	4.0	3.8
<b>Profit Before Tax</b>	<b>113.4</b>	<b>(22.7)</b>	<b>(22.9)</b>	<b>(4.7)</b>	<b>36.8</b>
<b>Profit After Tax</b>	<b>96.1</b>	<b>(56.3)</b>	<b>(18.2)</b>	<b>(5.5)</b>	<b>25.8</b>
<b><u>RATIO ANALYSIS</u></b>					
	<b>FY17</b>	<b>FY18</b>	<b>FY19</b>	<b>1H'FY20</b>	
Liquid Assets to Total Liabilities (%)	68.8%	74.8%	60.3%	66.1%	
Liquid Assets to Total Assets (%)	53.2%	57.0%	43.0%	52.1%	
Current Ratio (x)	1.3	1.3	1.5	1.3	
Debt Leverage (x)	3.4	3.2	2.5	3.7	
Gearing (x)	1.0	0.7	0.7	1.3	
Efficiency (%)	82.1%	113.1%	114.8%	75.1%	
ROAA (%)	7.0%	(4.5%)	(2.1%)	5.4%*	
ROAE (%)	32.6%	(20.0%)	(8.5%)	22.5%*	
<b>*Annualized</b>					

### 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](http://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](http://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](http://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**

<b>Name of Rated Entity</b>	Foundation Securities (Private) Limited				
<b>Sector</b>	Brokerage				
<b>Type of Relationship</b>	Solicited				
<b>Purpose of Rating</b>	Entity Rating				
<b>Rating History</b>	<b>Rating Date</b>	<b>Medium to Long Term</b>	<b>Short Term</b>	<b>Rating Outlook</b>	<b>Rating Action</b>
	<b>RATING TYPE: ENTITY</b>				
	22-April-2020	A-	A-2	Stable	Maintained
	1-April-2019	A-	A-2	Negative	Maintained
	1-Nov-2017	A-	A-2	Stable	Initial
<b>Instrument Structure</b>	N/A				
<b>Statement by the Rating Team</b>	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.				
<b>Probability of Default</b>	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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<b>Due Diligence Meetings Conducted</b>	<b>Name</b>	<b>Designation</b>	<b>Date</b>		
	Mr. Owais Ahmed	Accounts Manager	April 10, 2020		