RATING REPORT

Foundation Securities (Private) Limited

REPORT DATE:
May 25, 2021

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	Stable		Stable	
Rating Date	*May 25, 2021*		*April 22, 2020*	

COMPANY INFORMATION	
Incorporated in 2005	**External auditors:** Grant Thornton Anjum Rahman
Private Limited Company	**Chairman of the Board:** Brig. Sabir Ali (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 (July 2020)
https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/SecuritiesFirm202007.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. 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.

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 brokerage services with marginal presence in commodity segment. Presently, the company runs its operations through its 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.

Sector Update

- After a dismal performance in FY18 & FY19, volumes of PSX rebounded with an increase of 32% in FY20, while further gaining momentum in H1'FY21 (up 148% YoY).
- This increase in trading volumes was mainly due to an uptick in economic activity following the ease of lockdown in H1'FY20 while pandemic-induced market volatility and lower prevailing interest rates also attracted investors thus supporting trading volumes.
- 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 not be allowed custody of customer's assets. Further, SECP has made a commission slab to minimum of 3 paisa (or 0.15% of traded value) and maximum of 2.5% of traded value.
- PSX has also launched several Exchange Traded Funds (ETF's) and Murabaha Share Financing (MSF), 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)

	FY18	FY19	FY20	H1'FY20	H1'FY21
Volume (In Billions)	43	37	49	23	57
Value (In PKR' Billions)	2,027	1,549	1,789	820	2,118

Key Rating Drivers:

Rebound in trading volumes bodes well while lack of diversification in topline remains a rating constraint

Table 2: Revenue Breakup

Figures in PKR' Millions	FY19	FY20	H1'FY20	H1'FY21
Total Revenue (net)	**169**	**261**	**128**	**236**
- **Equity Brokerage Commission**	144	221	100	211
- **Profit on Saving Accounts**	17	41	21	19
- **Others**	2	(0)	7	6
Overheads	**192**	**200**	**94**	**154**
- **Administrative Expenses**	185	182	90	140
- **Finance Costs**	9	16	4	14

- Akin to the industry, FSL's revenues depicted strong growth of 55% and 84% during FY20 and H1'FY21 respectively. FSL's income is primarily derived from its equity brokerage activities. However, contribution in terms of income on saving accounts has increased.
- In FY20, FSL's market share came in at 6.4% (FY19: 6.7%). However, it dropped to 5.7% in H1'FY21.
- Given the industry-wide increase in trading volumes, the company's equity brokerage revenue grew by massive 53% and 112% during FY20 and H1'FY21 respectively.
- In contrast, FSL's administrative overheads remained intact; as a result the efficiency ratio has depicted notable improvement, albeit it remains aligned with the peers. (H1'FY21: 65.3%; FY20: 75.8%; FY19: 114.8%).
- As suggested by the improvement in efficiency ratio, FSL became profitable in FY20, posted a pre-tax profit of which came at Rs. 62.7mn in FY20 vis-à-vis a loss of Rs. 22.9mn in FY19.
- FSL's reliance on equity brokerage remains a business risk. Furthermore, even within the brokerage revenues, there is concentration, with the largest 1 & 5 clients constituting 17% and 22% of the aggregate, respectively. Excluding commissions from the top 5, client exposures are fragmented.
- However, a sizeable retail clientele, which accounts for about two-third of the brokerage income, is viewed as strength, while sustaining overall market share is a key challenge in highly competitive environment.

Table 3: Clientele Breakup

	Jun'18	Jun'19	Jun'20
Foreign Clients	32	32	32
Domestic Institutions	553	587	596
Domestic Individuals	12,745	12,662	12,930

- During FY20, the proportion of trading processed through the Institutional Delivery System (IDS) grew to 14%, in terms of volume (FY19: 8.4%). 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.

Rating is supported by strong internal capital generation and element of sponsor support

- On the back of improved profitability, FSL's equity base grew by 36% during the 1½ year period Jun'19-Dec'20.
- Given the volumetric uptick in brokerage business, the company's gearing & leverage has posted an uptick. Besides the proportionate uptick in client payables, the uptick in leverage was also partly contributed by a Rs. 300m short-term loan; this represents a running finance line to meet exposure

Table 4: Profitability & Capitalization (In PKR' Millions, unless stated otherwise)

	FY19	FY20	H1'FY21
Efficiency	115%	76%	65%
Profit before tax (PBT)	(22.9)	62.7	88.4
Net Equity	222	259	301
- **Paid-up Capital**	305	305	305
- **Accumulated Loss**	(105)	(62)	(4)
- **Surplus on Revaluation**	5.6	-	-
Gearing	0.70	0.17	1.16
Leverage	2.49	3.52	4.87

requirements.
- Being a majority owned subsidiary of Fauji Foundation, the rating assessment of FSL's continues to factor in an element of sponsor support.

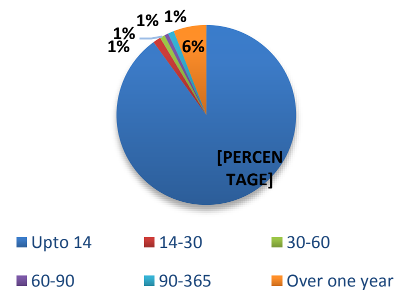
Conservative asset allocation with small-sized proprietary book translates in low liquidity risk

Table 5: Asset Mix

Figures in PKR' Millions	Jun'19	Jun'20	Dec'20
Non-Current Assets	**47.0**	**27.1**	**26.2**
- Long-term Investments	17.2	-	-
- Others	29.8	27.1	26.2
Current Assets	**727.7**	**1,144.1**	**1,742.0**
- Trade Debts	113.1	291.2	345.6
- Advances, Deposits, Prepayments etc.	152.4	54.8	341.6
- Proprietary Investments	0.3	41.6	20.9
- Cash & Bank Balances	333.1	638.6	940.3
- Taxation	117.1	106.6	93.6

- FSL's asset base increased by 51% in FY20, in line with the uptick in brokerage volume. The growth in asset base was also contributed by the mobilization of debt in H1'FY21 and high profit retention.
- FSL maintains a conservative asset allocation strategy, with more than half the asset base being maintained in the form of cash and bank balances. As such, the company had almost entirely liquidated its proprietary investment portfolio as of Jun'19. During the period under review, the company did partake in proprietary investment operations, albeit these remain limited to 4% of asset base as of Jun'20 and 1% of asset base as of Dec'20. The short term investments amounting to Rs. 20.9m as at Dec'21 consisted of listed equity securities.
- 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 ageing of trade debts of the company is indicative of low credit risk.

Figure 1: Aging of Trade Debts (Dec'20)



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

BALANCE SHEET	Jun'18	Jun'19	Jun'20	Dec'20
Trade Debts	118.1	113.1	291.2	345.6
Deposits and Prepayments	135.5	152.4	54.8	341.6
Long Term Investments	26.7	17.2	-	-
Proprietary Book	0.4	0.3	41.6	20.9
Cash and Bank balances	551.8	333.1	638.6	940.3
Taxation	98.2	117.1	106.6	93.6
Total Assets	**967.8**	**774.8**	**1,171.2**	**1,768.2**
Trade and Other Payables	565.9	383.8	854.2	1,046.6
Long Term Loans	55.0	38.4	43.9	48.1
Short Term Loans – Secured	100.0	118.0	-	300.0
Total Liabilities	**737.5**	**552.7**	**912.1**	**1,467.2**
Paid-up Capital	**304.6**	**304.6**	**304.6**	**304.6**
Net Equity	**230.2**	**222.1**	**259.0**	**301.0**

INCOME STATEMENT	FY18	FY19	FY20	1H'FY20	1H'FY21
Brokerage Income	187.7	143.8	207.2	99.6	211.1
Consultancy Service	0.7	0.5	0.4	-	0.9
Research	0.5	0.7	-	-	-
Commodities	1.1	0.2	-	0.0	-
Profit from Saving Accounts	3.1	17.3	40.6	21.3	19.4
Operating Revenues	**193.1**	**162.7**	**248.3**	**121.0**	**231.4**
Administrative Expenses	215.1	185.2	182.0	90.4	139.8
Finance Cost	9.4	8.5	15.9	3.8	14.0
Profit Before Tax	(22.7)	(22.9)	62.7	36.8	88.4
Profit After Tax	**(56.3)**	**(18.2)**	**40.3**	**25.8**	**67.0**

RATIO ANALYSIS	FY18	FY19	FY20	1H'FY21
Liquid Assets to Total Liabilities (%)	74.9%	60.3%	74.6%	65.5%
Liquid Assets to Total Assets (%)	57.1%	43.0%	58.1%	54.4%
Current Ratio (x)	1.35	1.41	1.32	1.23
Debt Leverage (x)	3.20	2.49	3.52	4.87
Gearing (x)	0.67	0.70	0.17	1.16
Efficiency (%)	113.1%	114.8%	75.8%	65.3%
ROAA (%)	(4.5%)	(2.1%)	4.1%	9.1%*
ROAE (%)	(19.5%)	(8.1%)	16.8%	47.8%*
*Annualized				

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	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**	
	RATING TYPE: ENTITY					
	25-May-2021	A-	A-2	Stable	Maintained	
	22-April-2020	A-	A-2	Stable	Maintained	
	1-April-2019	A-	A-2	Negative	Maintained	
	1-Nov-2017	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	**Name**	**Designation**	**Date**			
	Mr. Owais Ahmed	Accounts Manager	March 18, 2021			