

RATING REPORT

Foundation Securities (Private) Limited

REPORT DATE:

January 29, 2024

RATING ANALYST:

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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		Rating Watch – Developing	
Rating Action	Upgraded		Maintained	
Rating Date	January 29, 2024		October 26, 2022	

COMPANY INFORMATION

Incorporated in 2005

External auditors: Grant Thornton Anjum Rahman

Private Limited Company

Chairman of the Board: Mr. Aziz Ikram

Key Shareholders (with stake 5% or more):

Chief Executive Officer: Syed Ahmad Abbas Zaidi

Askari Bank Limited – 51%

Fauji Foundation Pakistan ~49%

APPLICABLE METHODOLOGY (IES)

VIS Entity Rating Criteria Methodology – Securities Firms Rating

<https://docs.vis.com.pk/docs/SecuritiesFirm202007.pdf>

APPLICABLE RATING SCALE(S)

VIS Issue/Issuer Rating Scale:

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

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

Mr Aziz Ikram is the Chairman of the Board of FSL. Apart from his capacity as Chairman, he also holds the position at 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 25 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

Foundation Securities Private Limited (FSL) offers equity brokerage services with a limited presence in commodity segment and caters to domestic retail and institutions, high net worth individuals, and foreign broker dealers. Headquartered in Karachi, there are 4 branches located in Lahore Rawalpindi and Islamabad. At present, total staff strength stands at 95+ employees.

During FY23, a scheme of amalgamation of ASL with and into FSL was approved by the Board of directors of both Companies. Subsequently, the Scheme was sanctioned by Sindh High Court on March 13, 2023 and it was operationally completed on May 26, 2023. Consequently, the shareholding of Fauji Foundation has been diluted to 49.0% while 51.0% of the Company's shareholding has been allotted to Askari Bank Limited. Both are now sponsors of FSL.

FSL currently holds a 'Trading & Self-Clearing' brokerage license; however, management intends to acquire a 'Trading & Clearing' license following the merger with the increased capital to diversify its revenue base.

Sector Update

- During FY23, the brokerage sector faced significant challenges due to dwindling 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.

Table 1: Industry Trading Metrics – Regular

	FY19	FY20	FY21	FY22	FY23
Volume (In Billions)	37	49	131	73	47
Value (In PKR' Billions)	1,549	1,789	4,781	2,406	1,504

Securities earned him vast exposure to operations, risk, compliance, accounts and finance.

Key Rating Drivers:

Assigned ratings draw support from the strength of the Company's sponsors.

- Assigned ratings incorporate support from its sponsors. Askari Bank Limited (ASL), holding 51.0% of FSL's shareholding, is a scheduled commercial bank and is principally engaged in the business of banking as defined in the Banking Companies Ordinance, 1962. The Fauji Consortium, The Fauji Consortium: comprising of Fauji Foundation (FF), Fauji Fertilizer Company Limited (FFCL) and Fauji Fertilizer Bin Qasim Limited (FFBL) collectively owned 71.91 percent shares of the Bank. Fauji Foundation, on the other hand, holds 49.0% of FSL's shareholding and is one of Pakistan's biggest conglomerates with a diversified presence across business sectors well as a sizeable financial strength.

Shrinkage in brokerage revenue amid diminishing market volumes exerted pressure on the Company's bottom line in FY23, albeit an improvement is noted in 3MFY24.

- Similar to the preceding year, the Company's revenue has experienced contraction in FY23, with the operating revenue reducing to Rs.144.8m (FY23: Rs.226.3m).
- The Company's revenue mix is dominated by the Brokerage revenue, accounting for around 63% of the total revenue followed by 31.81% contribution from income from savings account. While contribution from brokerage revenue remains high, income from savings account has provided support to FSL's revenue base.
- The decline in the Company's revenue is primarily attributed to the drop in brokerage revenue in line with the industry trends. However, income from savings has recorded an increase vis-à-vis SPLY.

Table 2: Diversification in Total Revenue

	FY22	FY23	3MFY24	FY22	FY23	3MFY24
	PKR Mn.			%		
Brokerage Income	226.1	144.8	70.7	80.30%	62.46%	60.96%
Profit on Savings Account	44.5	73.8	34.3	15.81%	31.81%	29.57%
Others	11.0	13.3	11.0	3.89%	5.73%	9.47%
Total Revenue	281.6	231.9	116.0	100.00%	100.00%	100.00%

- This decrease in revenue has dragged the bottom line into losses in FY23. However, The Company's profitability profile depicted a rebound in 3MFY24 on the back of improvement in the Company's earning profile driven by the increase in Company's brokerage revenue as compared to the same period last year.
- Amid declining industry volumes, the Company's market share fell to 4.0% in FY23 (FY22: 4.7%). However, the same saw an uptick to 5.2% in 3MFY24. Going forward, sustaining overall market share will remain a key challenge in a highly competitive environment.
- The Company has a sizeable client base reaching 22k, with retail clients accounting for around 96% of the total client base. However, out of the total, 160 clients account for 66% of the total brokerage revenue generated by the Company.

Table 3: P&L Extract

	FY21	FY22	FY23	3MFY24
Operating revenue	476	226	145	71.0
Administration and distribution expenses	(306)	(226)	(229)	(84)
Operating profit	170	0.5	(84)	(13)
Financial charges	(19)	(9)	(12)	(0.2)
Other income	50	55	87	45
(Loss)/ Gain from quoted securities	0	(0.3)	0	0
Unrealized (loss)/ (gain) on re-measurement	17	(16)	(4)	0.7
Profit before tax	216	30	(12)	33
Taxation	(55)	(14)	(1)	(12)
Profit after tax	161	16	(13)	21

- On the operational front, FSL's efficiency noted an improvement, coming in at 72.3% in 3MFY24 (FY23: 98.4%, FY22: 80.3%). This is attributed to higher recurring revenue led by the increase in brokerage revenue.
- Going forward, assigned ratings will weigh on the Company's improvement in earnings and profitability profile as well as sustaining the market share.

Financial risk indicators are considered adequate.
Liquidity Risk:

- FSL maintains a conservative asset allocation strategy wherein more than half of its asset base is in the form of cash and bank balances.
- The liquid assets of the Company provide sufficient coverage against its total liabilities, with liquid assets to total liabilities standing at 1.15x as of Sept'23 (Jun'23: 0.98x, Jun'22: 0.87x).
- Similarly, the liquidity profile also draws support from the current ratio of 1.65x as of Sept'23 (Jun'23: 1.85x, Jun'22: 1.57x).

Credit Risk:

- FSL's credit risk is primarily derived from its trade debts, which stood at Rs.222.5m as of Sept'23 (Jun'23: Rs.212.7m, Jun'22: Rs.123.8m). Given that ~54% of receivables fall within one day to ten days as of Sept'23, the Company's ageing profile is considered manageable.

Market Risk:

- The Company maintains a small proprietary book, with short term investments at Rs.10.7m as of Sept'23 (Jun'23: Rs.10.1m, Jun'22: Rs.12.8m). Moreover, short term investments to equity ratio is recorded at 1.6%, reflective of a minimal market risk (Jun'23: .1.5%, Jun'22: 3.8%).

Capitalization:

- Following the amalgamation of ASL into FSL, the equity including revaluation gains saw an increase to Rs754.4m as of Jun'23 (Jun'22: Rs.364.7m). However, the equity excluding revaluation gains stands at Rs.673.8m as of Jun'23 (Jun'22: Rs.364.7), which then increased to Rs.695m as at Sept'23 on the back of increase in the Company's profitability.

- The Company has a Nil gearing as of Sept'23 (Jun'23: Nil, Jun'22: 0.15x) given no debt on its book while the leverage ratio stood at 1.16x as of Sept'23 (Jun'23: 0.95x, Jun'22: 1.68x).

Governance framework is considered adequate.

- At present, the Company's board consists of three members, representing two board committees. Increasing the same may improve the overall governance framework of the Company as well as paving the way for more enhancing its board committees.

Foundation Securities (Private) Limited
Appendix I

BALANCE SHEET	FY21	FY22	FY23	3MFY24*
Operating Fixed Assets	16.3	16.8	257.5	260.0
Trade Debts	161.1	123.8	212.7	222.5
Deposits and Prepayments	272.3	230.4	200.6	97.4
Proprietary Book	29.9	13.7	10.1	10.7
Cash and Bank balances	812.3	518.9	616.8	917.6
Taxation	68.4	64.8	79.0	75.4
Total Assets	1,364.5	976.6	1,391.5	1,582.9
Trade and Other Payables	915.3	549.4	622.7	805.4
Long Term Loans (<i>Incl. current maturity</i>)	49.5	55.0	-	-
Short Term Loans – Secured	-	-	-	-
Total Liabilities	967.4	613.0	637.0	807.3
Paid-up Capital	304.6	304.6	576.0	576.0
Net Equity (Excluding Revaluation Surplus)	397.1	365.1	673.8	695.0
<u>INCOME STATEMENT</u>				
Brokerage Revenue	476.5	226.3	144.8	71.0
Other Income	50.3	55.0	87.4	45.3
Recurring Revenues	526.8	281.3	232.3	116.2
Administrative Expenses	306.0	225.8	228.6	84.0
Finance Cost	19.0	8.9	11.5	(0.2)
Profit Before Tax	216.4	30.4	(11.6)	32.7
Profit After Tax	161.3	15.9	(12.5)	21.1
<u>RATIO ANALYSIS</u>				
Liquid Assets to Total Liabilities (%)	87.1%	86.7%	98.4%	115.0%
Liquid Assets to Total Assets (%)	61.7%	54.4%	45.1%	58.7%
Current Ratio (x)	1.39	1.57	1.82	1.65
Debt Leverage (x)	2.44	1.68	0.95	1.16
Gearing (x)	0.12	0.15	-	-
Efficiency (%)	58.1%	80.3%	98.4%	72.3%
ROAA* (%)	12.7%	1.4%	-0.9%	6.6%
ROAE* (%)	49.2%	4.2%	-2.2%	14.8%

*Unaudited Accounts

REGULATORY DISCLOSURES				Appendix II	
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				
	29/Jan/2024	A	A-2	Stable	Upgraded
	26/Oct/2022	A-	A-2	RW - Developing	Maintained
	24/Jan/2021	A-	A-2	RW - Developing	Maintained
	25/May/2021	A-	A-2	Stable	Reaffirmed
	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.				
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Due Diligence Meeting Conducted	Name	Designation	Date		
	Mr. Zahid Ali Khan	CFO & Company Secretary	17-Jan-2024		