RATING REPORT

Mohammad Munir Mohammad Ahmed Khanani Securities Limited

REPORT DATE:
May 7, 2020

RATING ANALYSTS:
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RATING DETAILS		
Rating Category	**Initial Rating**	
	Long-term	**Short-term**
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*May 7, 2020*	

COMPANY INFORMATION	
Incorporated in March 2006	**External auditors:** Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants
Unlisted Public Limited Company	**Chairman of the Board:** Muhammad Farhan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Muhammad Munir Khanani
Mr. Muhammad Munir Khanani – 99.99%	

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Securities Firms Rating (June 2017) ***https://s3-us-west-2.amazonaws.com/backupsqlvis/docs/Securities%20Firms%20201706.pdf***

Mohammad Munir Mohammad Ahmed Khanani Securities Limited

OVERVIEW OF THE INSTITUTION

Mohammad Munir Mohammad Ahmed Khanani Securities Limited (MMMAKS) was incorporated in March 2006. The Company is a Trading Right Entitlement Certificate Holder of Pakistan Stock Exchange. Registered office is located at PSX, Karachi, Pakistan.

Financial statements of FY19 were audited by Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants.

Profile of Chief Executive Officer

Mr. Mohammad Munir Khanani is a seasoned professional with vast experience in the brokerage industry. He has served the Pakistan Stock Exchange diligently on various positions for many years; these positions include Director of Pakistan Stock Exchange, Chairman of Arbitration Committee of PSX, and Committee member of Margin Financing Product.

RATING RATIONALE

Mohammad Munir Mohammad Ahmed Khanani Securities Limited (MMMAKS) is principally engaged in provision of equity brokerage services to clients. The company has converted from private limited to public unlisted company in January 2020. Mr. Mohammad Munir Khanani is the majority shareholder of MMMAKS with 99.9% shareholding of the company. Currently, the brokerage house operates through its head office based in Karachi and 12 branches in different locations. Out of 12 branches, 7 are located in Karachi, 3 in Lahore, 1 in Islamabad and 1 in Hyderabad. Senior management team comprises professionals with significant experience within their respective domains. Employee turnover is on the lower side, with a large number of key personnel having been associated with the company for over ten years.

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 during 1HFY20. However, recent slowdown in economic activity in the light of coronavirus is expected to affect the performance of brokerage industry. Comfort is drawn from relief provided by regulatory bodies

Performance of the equity market has remained dismal over the past 2 fiscal years with dwindling trading volumes largely owing to economic slow-down, increasing interest rate environment and aggressive foreign selling. Decline in market volumes was more pronounced for ready market as compared to future market, where volumes remained stagnant. However positive investor sentiment resulting from improving macroeconomic indicators has led to recovery in 1HFY20. This is reflected in the table below, wherein volumetric growth in trades stood at 15% in 1HFY20 vis-à-vis 1HFY19. 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
Volume (Ready + Future) (In Billions)	100	58	55	31	36
Value (Regular) (In Billions)	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 14th 2019, when the SECP implemented a standard range/scale of brokerage commissions. This has certainly had a positive impact on 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.

Recent economic slowdown due to coronavirus is expected to affect the performance of brokerage firms. The impact of the same on the brokerage industry will be tested over time. Comfort is drawn from broad based regulatory relief for multiple sectors (including brokerage) provided by SBP and SECP and relief package provided by federal government to several industries.

Corporate governance and internal control framework is considered adequate

Board of Directors (BoD) at MMMAKS comprises five members, including two independent directors, who have been recently inducted on the BoD in order to ensure compliance with Trading and Clearing Broker license requirements under the new brokerage regime. Board is chaired by the CEO. In line with best practices, management may consider segregating resources for the positions of the CEO and Chairman of the Board. The BoD meets on a quarterly basis. Discussions in board meetings pertained to regulatory approvals, financial statements, growth strategy, scrutiny of loans and investments, and internal controls. Minutes of board meetings are brief and may be made more comprehensive. The company has recently formed Board Audit Committee (BAC) and, in line with best practices, the same is chaired by an independent director. Financial statements are audited by Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants Co., which is classified in 'Category A' of SBP's Panel of Auditors.

A comprehensive IT infrastructure is in place, which not only caters to the existing requirements satisfactorily but also has excess capacity to cater to additional workload with future growth in business. MMMAKS has an in-house IT department headed by a qualified resource. The company deploys a front office and a back office system. It is using SEAMS software (for Clearing and Settlement) developed by Micro Links as its back office system. This system has modules for financial accounting, settlements, AML/KYC and risk management of clients. MMMAKS also uses front office Risk Management System named Trade Cast/Trade Link & Seam, which is developed by the vendor Catalyst and Micro Links. This system is used to determine exposure limits for clients and generate alerts in case of any violations. Backup arrangements include a server at the head office premise on which real time backup is undertaken. Physical backup is also undertaken on hard drives at the end of the day; these hard drives are stored at owner's home. Another server is also placed at the owner's home on which data is transferred via internet at the end of each day. In case of any disaster, this alternate server can be switched on and any branch can act as a disaster recovery site.

An internal in-house audit function is also in place, which conducts internal audits and develops internal audit report at regular time intervals. Policy framework is also considered adequate as the company has requisite proprietary trading policy, employee trading policy, MTS/MFS policies and AML/KYC policies. Proprietary trading policy can be made more comprehensive with inclusion of risk management parameters.

Overall profitability has varied in line with industry performance with losses witnessed during FY18 and FY19, followed by subsequent improvement in HY20; the company has not depicted losses on operating basis during last three years

Brokerage commission and dividend income is core business of MMMAKS with contribution of more than 90% to total recurring revenues on a timeline basis. Brokerage commission includes equity brokerage and margin financing income. Equity brokerage income was reported at Rs. 50.2m (FY19: Rs. 75.2m; FY18: Rs. 105.3m; FY17: 204.7m) in HY20. Variation in equity brokerage is a result of fluctuation in market volumes of the company. In volumetric terms, the company reported a market share of 5.8% (FY18: 6.3%) in FY19. Over the last three fiscal years, share of equity brokerage revenue primarily emanated from retail clients (on average 99.9%) with commission income from institutions remaining relatively low (average 0.2%). The company has only 12 institutional clients, while its retail client base amounted to 9,997 at end-FY19.

The company has not posted any operating losses (recurring income less admin expenses and finance charges) during the last three years. Operating profitability was reported at Rs. 45.9m (FY19: Rs. 75.2m; FY18: Rs. 105.3m; FY17: Rs. 204.7m) in HY20. The following table depicts the movement in key components of operating profitability:

The company operates an equity investment portfolio, which amounted to Rs. 1.7b (FY19: Rs. 867.3m; FY18: Rs. 1.3b; FY17: Rs. 1.6b) at end-HY20. Overall profitability has depicted volatility largely on account of capital gains/losses on investment portfolio. Volatility of earnings is likely to be lower if investment portfolio is reduced and income is supported by stable sources of income such as financial advisory and underwriting.

Going forward, company's strategy is to continue focus on core business of equity brokerage and margin financing by increasing the quantum of retail clients and tapping more institutional clients. Full year impact of revised commission rates is expected to support profitability profile of the company. MMMAKS also has plans to establish a research department which will enable the company to increase its customer base through provision of research services. Limited reliance on investment portfolio and diversification of business activity will be crucial in sustaining a more robust earnings base, thereby offsetting downside risk emanating from the investment portfolio and providing support to the company's overall risk profile.

Capitalization profile has been supported by profit retention; leverage indicators have increased in HY20 with increase in business volumes

At end-HY20, total equity increased to Rs. 1.4b (FY19: Rs. 981.9m; FY18: Rs. 1.5b; FY17: Rs. 1.78b) on account of profit retention. The company has not paid any cash dividend over past three years; management plans to reinvest profits in business to grow it further. Total debt stood at Rs. 1.2b (FY19: Rs. 481.6m; FY16: Rs. 620.5m; FY17: Rs. 923.7m). Debt comprises only running finance (RF) facilities for meeting exposure and working capital requirements. Gearing and leverage have increased 0.85x (FY19: 0.49x; FY18: 0.41x; FY17: 0.51x) and 1.35x (FY19: 0.92x; FY18: 0.79x; FY17: 0.81x) respectively.

Market, credit and liquidity risks are considered manageable.

Market Risk: MMMAKS maintains an investment portfolio which is regularly monitored by Mr. Muhammad Munir Khanani (Chairman). Market risk is considered to be on the higher side given the sizeable investment portfolio in relation to equity at end-HY20. However, management has set a limit of 1.0x for its proprietary book in relation to its equity in the revised investment policy. Subsequently, actions have been undertaken to comply with this limit during the ongoing year.

Credit Risk: MMMAKS has satisfactory due diligence procedures and policies available in addition to mechanism of clients' credit analysis. Risk limits for clients have been built internally in the systems and strict adherence is observed with these limits. All the institutional client trades are done through IDS. Trade debts ageing depicts room for improvement with approximately 30% of total receivables outstanding for more than 1 year at end-FY19 but the company has adequate collateral against these receivables. Hence, credit risk is considered manageable.

Liquidity Risk: Net Capital Balance (NCB) of the brokerage was reported at Rs. 670m at end-FY19 and stood above regulatory requirement. Liquidity risk is on the lower side.

Mohammad Munir Mohammad Ahmed Khanani Securities Limited — Appendix I

FINANCIAL SUMMARY				(amounts in PKR millions)
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**HY20**
Trade Debts	943.1	659.6	439.8	838.5
Advances, deposits and other receivables	84.6	60.0	60.2	106.5
Short term investments	1,571.8	1,321.3	867.3	1,745.3
Cash and bank balances	505.3	512.8	382.7	534.9
Property and Equipment	14.5	35.7	30.4	29.0
Long term investment	41.2	23.4	-	-
Total assets	3,333.5	2,713.5	1,881.5	3,354.2
Long Term Loans	-	-	-	-
Short Term Loans - Secured	923.7	620.5	481.6	1,210.6
Trade payables	533.1	557.5	404.6	692.9
Accrued markup	22.7	14.8	13.5	26.2
Total Liabilities	1,479.5	1,192.8	899.6	1,929.7
Issued, subscribed and paid up capital	395.1	395.1	395.1	395.1
Equity (excluding revaluation surplus)	1,828.9	1,518.5	981.9	1,424.5
Equity (including revaluation surplus)	1,854.0	1,520.7	981.9	1,424.5
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**HY20**
Commission, dividend and other income	290.8	193.8	165.6	111.5
Capital (Loss)/ gain on investments	886.1	(334.4)	(481.2)	141.3
Impairment loss on TREC	(39.9)	(2.5)	-	-
Total Revenue	1,136.9	(143.1)	(315.6)	252.8
Administrative expenses	(57.2)	(60.6)	(60.9)	(31.8)
Other income/(expenses) - net	(57.6)	11.8	21.0	4.9
(Diminution)/Appreciation in short term investments	(185.5)	28.6	(109.0)	273.5
Financial charges	(176.3)	(48.5)	(73.9)	(38.6)
Profit before Tax	660.4	(211.7)	(538.4)	460.8
Taxation	(118.9)	(107.0)	(27.4)	(18.2)
Profit after Tax	541.4	(318.8)	(565.8)	442.6
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**HY20**
Liquid Assets to Total Liabilities (%)	140.4%	153.8%	139.0%	118.2%
Liquid Assets to Total Assets (%)	62.3%	67.6%	66.4%	68.0%
Leverage (x)	0.81	0.79	0.92	1.35
Current Ratio (x)	2.17	2.20	2.03	1.71
Gearing (x)	0.51	0.41	0.49	0.85
Efficiency (%)	78.8%	54.0%	76.6%	60.5%
ROAA (%)	N/A	-10.5%	-24.6%	33.8%
ROAE (%)	N/A	-19.0%	-45.3%	73.6%

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	Mohammad Munir Mohammad Ahmed Khanani Securities 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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Due Diligence Meetings Conducted	see table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
07/05/2020	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

S.No	Name	Designation	Date
1.	Mohammad Munir Khanani	CEO	March 5, 2020
2.	Abdul Hadi Khanani	Head of Operations	March 5, 2020
3.	Abdul Razzak	CFO	March 5, 2020