RATING REPORT

Darson Securities Limited

REPORT DATE:
01 December, 2021

RATING ANALYSTS:
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RATING DETAILS		
	Initial Rating	
Rating Category	Long -term	Short -term
Entity	BBB+	A-2
Rating Outlook	Stable	
Rating Date	December 01, 2021	

COMPANY INFORMATION	
Incorporated on January 1998	**External auditors:** Muniff Ziauddin & CO Chartered Accountants
Public Unlisted Company	**Chairperson:** Mr. Muhammad Anwar Dar
Key Shareholders (with stake 5% or more):	**Director:** Mr. Muhammad Farooq Dar
Mr. Muhammad Farooq Dar – 37.6% Mr. Muhammad Anwar Dar – 19.3% Mr. Muhammad Ayan Dar – 13.1% Mr. Muhammad Hassan Dar – 13.1%	**CEO:** Mr. Malik Dil Awayz Ahmed

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria Methodology – Securities Firms Rating (July 2020) **http://vis.com.pk/kc-meth.aspx**

Darson Securities Limited

OVERVIEW OF THE INSTITUTION

Darson Securities Limited (DSL) is a public unlisted company which was incorporated in January 1998 under the Companies Ordinance 1984. DSL is a TREC holder of Pakistan Stock Exchange.

Profile of Chairman

Mr. Muhammad Anwar Dar is the chairman of a progressive business conglomerate, The Credence Group. The Group has a diversified portfolio and operates in the areas of financial services, stock trading, education, poultry feed & medicine and real estate.

Profile of CEO

Mr. Malik Dil Awayz Ahmed, CFA is a seasoned professional with association of over seventeen years in securities and commodities business. Mr. Ahmed has done his Master in Commerce with majors in finance from Hailey College of Commerce.

RATING RATIONALE

Darson Securities Limited ('DSL' or 'the Company') is engaged in provision of equity brokerage services mainly to domestic retail and institutional clients. Shareholding of the company is primarily vested within the Dar family. The Company has a total of 9 offices across Pakistan with its corporate office situated in Karachi.

Sector Update

- After a dismal performance in FY18 & FY19, volumes of PSX started to rebound with an increase of 32% in FY20, followed by historically high volumes in FY21. (Up 170% YoY).

Table 1: Industry Trading Metrics (Volume & Value) – Regular

	FY18	FY19	FY20	FY21
Volume (In Billions)	43	37	49	131
Value (In PKR' Billions)	2,027	1,549	1,789	4,781

- Accordingly, in tandem with trading volumes, brokerage revenues grew across the industry supporting industry profitability, wherein most companies had slipped into losses or posted mere breakeven during the 3-year period FY17-19.

- Increased underwriting activity was also noted, with Initial Public Offerings (IPOs) being concluded in FY21, raising a sum of Rs. 14b, which was the highest sum mobilized by corporates in 14 years, with the previous best being 12 transactions in FY07. Inclusive of debt issuances, total capital raised during FY21 amounted to Rs. 31b.

- With Pakistan's financial markets still being in their early stages - as derived from market depth and dearth of active investors – the brokerage industry is ripe for dynamic regulatory changes. SECP's regulatory changes, such as the standardization of brokerage commission slabs and division of brokerage industry by size with small-sized brokerage houses being prohibited from taking custody of client assets, were key measures towards industry growth. Additionally, SECP has digitized the account opening process and allowing individuals to open accounts online.

- Recently, PSX and NCCPL has launched several Exchange Traded Funds (ETFs) and Murabaha Share Financing (MSF) respectively, allowing consumer access to additional investment products at a lower asset management cost, along with access to credit. PSX & SECP has also introduced an alternative board namely Growth Enterprise Market (GEM), for listing of small companies.

- Lately, in Q1'FY22, we have noted a contraction in trading volumes, with the same dropping by 55% and 47%, in terms of volume and value respectively, vis-à-vis SPLY. VIS will continue to monitor emerging trends in industry activity on an ongoing basis.

Rating Drivers

Rating incorporates consistent improvement in market positioning and DSL's branch outreach

- DSL can be categorized as a small-sized brokerage company, accounting for ~4% of the market trade. As illustrated in the table below, the Company has posted consistent improvement in its market positioning during the past 3-year period.

Table 2: DSL Market Share (Ready Market)

	FY19	FY20	FY21
Volume	2.9%	3.3%	3.8%
Value	2.5%	3.1%	3.9%

- The improvement in market positioning is also reflected in the Company's clientele, wherein both domestic retail and domestic institutional clientele has posted strong uptick during the past 3-year period.

- At present, the Company does provide services to foreign retail clientele, which mainly pertains to expatriates. However, DSL is planning to develop a foreign desk in order to provide services to foreign corporates and individuals.

- Given the strong growth in brokerage industry volumes, in combination with DSL's improving market positioning, the Company's operating revenues grew notably.

Table 3: P&L Statement (Extract)

	FY19	FY20	FY21
Operating Revenue	**52**	**82**	**243**
Operating Expense	**55**	**89**	**234**
-Admin Expense	55	89	233
-Finance Cost	-	-	1
Net realized & unrealized gain on investments	**(26)**	**(6)**	**41**
Other Income	**3**	**12**	**22**
Profit After Tax	**(26)**	**(2)**	**71**
ROAA	***(6.8%)***	***(0.5%)***	***12.4%***
ROAE	***(7.6%)***	***(0.6%)***	***19.6%***
Efficiency	***98.6%***	***97.9%***	***91.6%***

- Diversification in revenue is low as equity brokerage income contributed >95% of the operating revenues of the Company during the past 3-year period, with the remaining income mainly emanating from dividends on proprietary book. In addition, the Company also generates 'Other Income' (OI), which has depicted healthy growth in recent years. Given the growth in business volumes, OI is likely to inch up going forward.

- It is pertinent to mention that DSL's business risk profile is lowered by the fact that its brokerage revenues are almost entirely (~99%) derived from domestic retail clientele, which has trended up on a timeline.

- Concentration, in terms of volumes traded, has also depicted consistent improvement. In FY21, 79 clients accounted for two-thirds of the Company's brokerage volume, a number that has increased from 31 in FY19 and 41 in FY20.

- Given the improvement in revenues, the Company was able to post a positive bottomline in FY21. Nevertheless, the Company's efficiency ratio remain on the higher side warrants improvement.

- Going forward, efforts to improve revenue diversification are on the anvil, with DSL recently acquiring an 'Offer to Consultant' license and developing a separate Corporate & Investment Banking function.

- Rating incorporates DSL's branch outreach, which spans across 7 cities. There are plans to further growth branch outreach in the short to medium term horizon.

Ratings incorporate Financial Risk Indicators of DSL, which are aligned with peers

Liquidity Risk

- DSL's liquidity risk profile is supported by quantum of liquid assets on the balance sheet, which amounted to Rs. 193m[1] as at Jun'21. As a percentage of assets & liabilities, liquid assets comprise 28% and 71% respectively.

Credit Risk

- Trade receivables stood at Rs. 105.7m as at Jun'21 which is 20% of the total current assets.

- 94% of the trade receivables are outstanding for a period of 0-14 days, depicting sound credit risk profile. Further, majority of the receivables are on account of in-house trades.

Market Risk

- The Company's proprietary book has grown in the last three years in proportion to equity, stood at 30% of the equity as of Jun'21 (Jun'20: 21%, Jun'19: 15%).

- The short term investments stood at Rs. 118.8m as at Jun'21, fully vested in listed equity securities.

- About a third of portfolio is invested in a single scrip, which is indicative of significant concentration and market risk exposure to a single scrip. In view of the same, proprietary operations, although limited, warrant a strictly defined investment policy, with narrower thresholds.

Sound capitalization indicators with low debt on balance sheet

- Equity (excluding revaluation surplus) has grown at a CAGR of 2% during the past 5-year period. As of Jun'17, the Company's equity stood at Rs. 400m, contributing 58% of the Company's asset base.

- In absolute terms, the Company's equity base stands on the lower side vis-à-vis peer median. Nevertheless, given size of the asset book and leveraging of less than 1, capitalization level is considered adequate at present. Nevertheless, given projected growth in business volumes and low level of internal capital generation capacity, external infusion may be warranted over the medium term horizon.

- The Company's capitalization profile is supported by lack of debt on the balance sheet, wherein gearing has historically remained nil, as indicated by an almost negligible level of finance cost YoY.

[1] Includes Cash & Short Term Investments

- Going forward, VIS will continue to track the growth in equity in tandem with business volumes, which is considered important from ratings purview.

Corporate Governance (CG) has room for Improvement

- Recently there have been changes at the Board level. Given the appointment of an independent director, number of directors on the Board has increased to 4. In contrast to CG best practices, Board composition leaves room for improvement, given lack of independent representation and gender diversification on the Board.

- Board sub-committees include an Audit Committee (AC), which includes 2 directors and an independent director.

- The Company's organizational structure includes 4 support/operation functions (Research, Marketing, Finance, 2 business functions (Sales, & Corporate Sales) and a control function i.e. Internal Audit & Compliance. As of Jun'21, the Company's staff strength stood at around 130.

- We have review the Company's policy framework, which is considered satisfactory.

FINANCIAL SUMMARY (amounts in PKR millions)				Appendix I
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**
Trade Debts	66	38	60	106
Long Term Investments	12	9	20	20
Short term Investments	71	50	68	119
Cash and Bank balances	38	49	86	75
Total Assets	403	365	465	689
Trade and Other Payables	47	35	121	269
Paid Up Capital	200	200	200	200
Net Worth (excluding revaluation surplus)	356	330	329	400
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**
Net Revenue	45	27	77	284
Brokerage Income	51	50	80	231
Dividend Income	2	2	3	3
Administrative Expenses	48	55	89	233
Finance Costs	0	0	0	1
Profit Before Tax	(4)	(25)	(0)	72
Profit After Tax	(10)	(26)	(2)	71
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**
Liquid Assets to Total Liabilities	233.5%	284.5%	127.2%	70.9%
Liquid Assets to Total Assets	27.2%	27.1%	33.1%	28.1%
Leverage	0.13	0.11	0.37	0.68
Gearing	-	-	-	0.01
Current Ratio (x)	7.00	6.30	2.68	2.00
Efficiency (%)	89.5%	98.6%	97.9%	91.6%
ROAA (%)	-2.4%	-6.8%	-0.5%	12.4%
ROAE (%)	-2.8%	-7.6%	-0.6%	19.6%

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

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	Darson 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.
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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				
01-December 2021	BBB+	A-2	Stable	Initial

Due Diligence Meetings Conducted

	Name	Designation	Meeting Date
1	Mr. Umair Ahmed	GM - Operations	September 23, 2021
2	Mr. Syed Hammad Ur Rehman	Head of Compliance	September 23, 2021
3	Mr. Yousuf Saeed	Head of Research	September 23, 2021