RATING REPORT

Arif Habib Limited

REPORT DATE:
April 13, 2019

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA-	A-1	AA-	A-1
Rating Outlook	Stable		Stable	
Rating Date	*Apr 13, 2020*		*Jan 17, 2019*	

COMPANY INFORMATION

Incorporated in 2004	**External auditors:** Rehman Sarfaraz Rahim Iqbal Rafiq, Chartered Accountants
Listed Public Limited Company	**Chairman of the Board:** Mr. Zafar Alam
Key Shareholders (with stake 5% or more): Arif Habib Corporation Limited – 72.80% General Public (Local & Foreign) – 21.43%	**Chief Executive Officer:** Mr. Muhammad Shahid Ali Habib

APPLICABLE METHODOLOGY(IES)

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

Arif Habib Limited

OVERVIEW OF THE INSTITUTION

Arif Habib Limited (AHL) was incorporated in 2004 as a public joint stock company under the Companies Ordinance, 1984. AHL is registered with Securities & Exchange Commission of Pakistan (SECP) and holds Trading Rights Entitlement Certificate (TREC) granted by Pakistan Stock Exchange (PSX) Limited.

Profile of Chairman

Mr. Zafar Alam is a Non-Executive Director & Master's degree holder in Nuclear Physics and has over 33 years' experience in investment banking encompassing Origination, Trading, Sales and Asset Management in various financial centers around the globe. Mr. Zafar has a diverse experience across geographies and various aspects of finance, having worked in London, Singapore, Hong Kong and Dubai in Equities, Fixed Income and Asset Management.

Profile of CEO

Mr. Shahid Ali Habib carries a proven track record of establishing successful business organizations and turning around ventures into vibrant units. He has over 21 years of experience in the fields of Securities Brokerage, Banking, Asset Management, Corporate Finance and Investment Banking. He has served in leading positions at top local at international institutions.

RATING RATIONALE

Established in 2004, Arif Habib Limited (AHL) is a prominent brokerage and financial services company. AHL is listed on Pakistan Stock Exchange (PSX) with total equity of Rs. 2.5b (FY19: Rs. 2.9b, FY18: Rs. 3.2b) at end-Sep'19. The company is engaged in provision of equity and money market brokerage, interbank foreign exchange and corporate advisory services. AHL's operations run through its head office in Karachi along with 3 branches, one each in Lahore, Islamabad and Peshawar.

Rating Drivers

Brokerage industry continues to be affected by economic cycles. Declining trend in trading volumes over the last two years has impacted topline of the brokerage industry although recovery has been witnessed in past six months. Players with large proprietary books to witness losses on investment portfolio while corporate advisory income is also expected to be impacted.
Performance of the equity market has remained dismal over the past two fiscal years with dwindling trading volumes largely owing to economic slow-down 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 over last six months. Given tough market conditions and increasing regulatory & compliance requirements, 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. Going forward, focus of brokerage companies remains on cost rationalization, strengthening retail client base and focus on higher margin business. Nevertheless, brokerage sector outlook is expected to remain challenging; any sharp rise in Covid-19 infections and resultant decline in market volumes may impact profitability of brokerage companies. Moreover, quantum of impact of recently revised brokerage commission structure would be tracked by VIS.

Industry Data (Ready+ Future)	Volumes	Value
FY18	58,401,033,737	2,881,120,421,870
FY19	54,856,700,780	2,234,873,114,893
Growth	*-6%*	*-22%*
1HFY20	35,820,545,830	1,300,188,222,130
Growth	*15%*	*-0.3%*

Strong sponsor profile.
The assigned ratings continue to derive strength from AHL's sponsor profile, with majority stake held by Arif Habib Corporation Limited (AHCL). AHCL has sizeable shareholding in many different companies operating in diverse sectors such as fertilizers, securities & commodities brokerage, corporate advisory, asset management, cement, steel, wind power and real estate development sectors. Financial strength of AHCL is signified by its net worth of Rs. 22.5b as at end-1QFY20.

Prominent and improving market position; business strategy entails focus on domestic retail segment through strengthening of human resources and branch expansion.
AHL remains one of the prominent players in both equity and corporate advisory. Market share in terms of equity brokerage ~12% (FY18: 9%) and 10% (based on ready and future value) in equity trading during FY19 and 1HFY20 respectively. Sustenance of prominent market share has been on account of large block trades on both domestic and foreign counters, activity of new international broker dealer and opening a large number of new accounts. AHL's overall business strategy going forward is to focus on domestic retail individuals through strengthening of human resources and branch expansion. AHL expanded its business development and trading team in Peshawar in June'19 with plans to further

increase footprint in other cities of the country in the ongoing fiscal year.

Growing corporate advisory income remains a competitive edge and provides sustainability to overall revenues.
Brokerage revenue witnessed a decline during FY19 to Rs. 303m (FY18: Rs. 329m) due to lower investor activity and commission per share. However, given higher corporate advisory mandates during FY19, advisory and consultancy revenue increased by 72% to Rs. 376m (FY18: Rs. 218m) supporting overall operating revenue for the outgoing year. The company posted loss after tax of Rs. 62m during FY19 (FY18: Profit after tax of Rs. 536m) primarily being a function of capital losses and re-measurement losses on investment portfolio. However, the company was able to recoup its profitability by posting a profit after tax of Rs. 323m during 1HFY20 through unrealized gain on re-measurement of proprietary investment portfolio. Variation in total revenue stream would remain given the volatility in major revenues drivers, which include brokerage fees, capital gains and corporate advisory income.

Finance cost increased by 18% during FY19 due to increase in benchmark rates. Decrease in recurring revenue outpaced reduction in expenses (which included compensation incurred for investment in human capital), as a result, efficiency (cost to recurring income) ratio of the company weakened to 71.5% (FY18: 67.7%) in FY19. Going forward, profitability is expected to remain a function of gains/losses on investments, equity brokerage income and advisory fees.

Liquidity profile is adequate while capitalization levels have weakened; market risk remains high on account of large proprietary book.
Market Risk: AHL has undertaken sizeable exposure in commercial and residential plots situated at Naya Nazimabad; as a result of which long-term investments increased to Rs. 1.85b (FY19: Rs. 1.88b; FY18: 1.53b) at end-Sept'19. Short term investments of the company stood at Rs. 2.4b (FY19: 2.4b; FY18: Rs. 2.7b) at end-Sept'19. A major chunk of the investment portfolio pertains to investment in group companies and proprietary investments. With large direct exposure to equity market, market risk is considered to be on the higher side.

Liquidity Risk: Liquid assets in relation to total liabilities decreased to 116% (FY19: 122%; FY18: 148%) at end-Dec'19 on account of slight reduction in proprietary book and lower deposit against exposure margin; while the same being supported by higher cash & bank balances. Portfolio of liquid assets was supported by higher deposit against exposure margin at end-FY19. Liquid assets are sufficient in relation to current liabilities of the company.

Credit Risk: AHL has due diligence procedures in addition to its KYC, for the assessment of its client creditworthiness. Applicable policies for leveraged products have been adopted and limits have been defined which are strictly monitored. Trade debts have increased on a timeline basis; however their ageing is considered to be manageable.

Debt profile is entirely short term in nature. Debt leverage has slightly weakened on a timeline basis to 1.07x (FY19: 0.94x; FY18: 0.72x); while gearing levels improved at end-Dec'19 after increasing during FY19 being reported at 0.64x (FY19: 0.66x; FY18: 0.46x) at end-Dec'19. Weakening in overall debt leverage was on account of higher utilization of short term borrowings and declining equity base due to losses on investment portfolio. Going forward, the company aims to follow a conservative strategy with projected reduction in debt levels. Net Capital Balance (NCB) has declined on a timeline basis; however solvency position remains adequate.

Experienced management team and adequate control framework.
Management team at AHL comprises seasoned professionals with considerable financial services sector experience and remained stable since last review. Ratings also incorporate adequate control framework implemented at the company. Board approved underwriting and investment policies are present. However, following board approvals, certain breaches in limits stipulated in the investment and underwriting policy were observed during the outgoing year. Going forward, compliance with limits is important given the current rating levels.

Sound corporate governance framework.

Board of directors at AHL includes members carrying vast experience in the financial services sector. No change was witnessed in the board composition during the outgoing year. Two independent directors are present on the board. Two committees, namely Board Audit Committee (BAC) and Board Human Resource & Remuneration Committee (BHRRC), are also present at board level in order to ensure effective oversight.

FINANCIAL SUMMARY (amounts in PKR millions)	Appendix I			
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**1HFY20**
Trade Debts	75	24	31	51
Long Term Investments+ Investment Property	542	1,534	1,880	1,883
Short term Investments	3,264	2,679	2,411	2,510
Cash and Bank balances	833	687	627	1,202
Total Assets	5,693	5,473	5,642	6,208
Trade and Other Payables	850	563	638	1,129
Long Term Loans	2	1	-	52
Short Term Loans - Secured	1,408	1,473	1,909	1,858
Total Debt	1,410	1,474	1,909	1,910
Paid Up Capital	550	550	660	594
Net Worth (excluding revaluation surplus)	3,186	3,172	2,902	2,994
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**1HFY20**
Total Revenue	1,411	1,051	480	659
Brokerage Income	402	329	303	157
Advisory and consultancy fee	365	218	376	59
Dividend Income	91	110	88	47
Operating & Administrative Expenses	(386)	(324)	(397)	(157)
Finance Costs	(138)	(185)	(218)	(226)
Profit Before Tax	1,141	653	12	346
Profit After Tax	881	536	(62)	323
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**1HFY20**
Liquid Assets to Total Liabilities	165.1%	148.0%	121.8%	116.3%
Liquid Assets to Total Assets	72.2%	61.8%	58.8%	59.9%
Leverage	0.78	0.72	0.94	1.07
Gearing	0.44	0.46	0.66	0.64
Cash Flow from Operations	648	804	(469)	710
Current Ratio (x)	2.04	1.70	1.36	1.34
Efficiency (%)	54%	68%	72%	NA
ROAA (%)		10%	-1%	11%
ROAE (%)		17%	-2%	22%

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	Arif Habib 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				
	13-Apr-20	AA-	A-1	Stable	Reaffirmed
	17-Jan-19	AA-	A-1	Stable	Reaffirmed
	24-Nov-17	AA-	A-1	Stable	Reaffirmed
	29-Nov-16	AA-	A-1	Stable	Reaffirmed
	24-Jun-15	AA-	A-1	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**	
	1	Mr. Saad Bin Ahmed	Head of Sales	19-Feb-2020	
	2	Mr. Muhammad Taha Siddiqui	Company Secretary & CFO	19-Feb-2020	