



The Pakistan Credit Rating Agency Limited

## Rating Report

### Arif Habib Limited | BMR

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#### Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
20-Dec-2018	BMR1	-	Stable	Maintain	
16-Jan-2018	BMR1	-	Stable	Initial	

#### Rating Rationale and Key Rating Drivers

Broker Management Rating of Arif Habib Limited (AHL) reflects its leading position in the country's brokerage industry emanating from an established franchise, deep relationship with a diverse customer base, and strong system share. This is underpinned by its well-developed transactions execution and monitoring system, acclaimed research, strong control environment, and good governance framework. The Company offers various value-added services to its clients including an online trading terminal, research portal, and mobile app. A strong IT infrastructure emplaced under the proper guidance of IT steering committee ensures uniform efficiency.

In addition to brokerage, AHL enjoys a distinct position in investment banking and advisory domain in Pakistan. This provides deeper penetration into client base. Credit risk – customer's receivables and funding – remain low. AHL has exposure to market risk due to its proprietary trading book. Related risks are managed through well-defined investment policy. Liquidity risk is supported by a firm commitment from the sponsor as well as the availability of banking lines of PKR ~4.7bln. In line with the capital market dynamics and lower trading volumes, AHL's profit has seen fluctuations in its operating income.

The rating is dependent on upholding strong control and governance framework, continues update of client servicing tools, and careful monitoring of risks - mainly market and liquidity risks, and conflict of interest - emanating from investment activities.

#### Disclosure

<b>Name of Rated Entity</b>	Arif Habib Limited   BMR
<b>Type of Relationship</b>	Solicited
<b>Purpose of the Rating</b>	Broker Management Rating Rating
<b>Applicable Criteria</b>	Methodology   Broker Management Rating(Jun-18)
<b>Related Research</b>	Sector Study   Brokerage & Security(Nov-18)
<b>Rating Analysts</b>	Shahzaib Khalid   shahzaib.khalid@pacra.com   +92-42-35869504



## Ownership

**Ownership Structure** Arif Habib Corporation (AHC) owns 65.52% stake in Arif Habib Limited (AHL), while rest is owned by the general public (21.95%), mutual funds (5.1%), foreign companies (1.26%) and others. AHC is the holding company of Arif Habib group (AHG).

**Stability** The company continues to enjoy strong support from the sponsoring family.

**Business Acumen** Arif Habib Group (AHG) has a diversified investment portfolio and has a presence in fertilizer, power, cement, steel, real estate, and financial segment.

**Financial Strength** AHG had an equity size of ~PKR30bln as of June 2018.

## Governance

**Board Structure** There are seven directors on the board, including the CEO Mr Muhammad Shahid Ali. Four members are non-executive and represent the parent company while two members are independent.

**Members' Profile** Mr. Zafar Alam is the current Chairman of the board, he has a master's degree in Nuclear Physics and possesses 31 years of international experience in investment banking. Mr. Muhammad Shahid Ali completed his MBA from IBA Karachi and carries over 19 years of experience in the fields of Securities Brokerage, Banking, Asset Management, and Investment Banking.

**Board Effectiveness** To support the board functions, AHL has established Audit and HR & remuneration committees. The audit committee is chaired by Mr. Ali Murtaza Kazmi, an independent director, ensuring good corporate governance. The HR & remuneration committee by Mr. Haroon Usman, a non-executive director.

**Financial Transparency** AHL has a robust and independent internal audit function. Russell Bedford Rahman Sarfaraz Rahim Iqbal Rafiq (RSRIR) are the external auditors of the company. The auditor's issued an unqualified opinion on the financial statements for the period ending FY18.

## Management

**Management Team** AHL has a well qualified and experienced team. The management staff turnover is low, indicating stability of the human resource.

**Organizational Structure** AHL has a functional organizational structure, with eight primary departments and six secondary departments. The primary departments include, i) international brokerage, ii) domestic brokerage, iii) interbank brokerage, iv) investment banking, v) compliance, vi) Marketing & business development, vii) IT and, viii) Online sales. Heads of the primary departments report directly to the CEO. Clear departmentalization offers efficient use of resources.

**Client Servicing** AHL offers multiple accounts opening mediums. Similarly, multiple channels, including a mobile app, are available to customers to execute and monitor their transactions. As soon as a trade is executed the client is notified via SMS and email. AHL has strong client reporting mechanism with account statements and market reports communicated to the clients on regular basis.

**Complaint Management** AHL has an adequate complaint management system in place, complaints can be made via e-mail, SMS, and calls. AHL has centralized complaint logging and attention-grabbing tools available.

**Extent Of Automation / Integration** Two database platforms installed with full integration between back and front office. The system has the ability to generate timely reports.

**Continuity Of Operations** AHL has a detailed disaster recovery plan to ensure the business continuity at the time of disaster. Moreover, backups are maintained at the DR site.

**Risk Management Framework** AHL's risk management framework revolves around the risk committee. The committee is chaired by the company's Chairman, other members include the head of compliance, the CFO and risk officer/s. The main purpose of the committee is to monitor the risks faced by the company at all levels and enlist the observations for the senior management to review.

**Regulatory Compliance** Risk Management & Compliance Department ensures that all the regulatory requirements have adhered to. No observations were reported by the regulators in FY18.

## Business Sustainability

**Business Risk** CY18 started off with a bull with KSE-100 posting a positive cumulative return ~4% in the first half of the year. After the general elections in July 18, the political uncertainty minimized. However, the investors remained cautious due to declining central bank reserves and balance of payment crises, leading to KSE-100 posting a negative return of ~3% in the 3rd quarter of CY18.

**Business Profile** AHL remains a prominent player in equity broking, having a strong relationship with leading foreign broker/dealers. AHL's market share is steady at ~9%. However, the company's branch network is limited compared to other major players. It has a good mix of foreign, local institutional and high net worth individual clients. Retail penetration needs attention. Historically, AHL had a distinct edge over its competitor's by having a strong foothold in investment banking and advisory business, however, in recent times the competition is catching up. Investment book yields a substantial source of revenue, though volatile.

**Revenue And Profitability Analysis** In line with the market trend, the fee-based income of AHL shrank by 40% to ~PKR 86mln in 1QFY18 as compared to the same period last year, (FY18: ~PKR 547mln, FY17: ~PKR 767mln). Operating expenses have seen a volatile trend, as a result, the trend for operating margins was as follows (1QFY19: 2%, FY18: 41%). Non-fee-based income has also declined on YoY basis (FY18: ~PKR672mln, FY17: ~PKR 906mln).

## Financial Sustainability

**Credit Risk** AHL has developed due diligence procedures in addition to its KYC for the assessment of client creditworthiness. Applicable policies for leveraged products have been adopted and limits have been defined which are strictly monitored.

**Market Risk** AHL maintains a proprietary book for investment in different asset classes and all of the investments are properly managed and monitored according to AHL's investment policy. A proper dedicated team (including CEO) manages the investments. Cut-off limits have been defined and must be adhered to. Additionally, AHL has a firm commitment from its Sponsor to buy back strategic investment from short-term portfolio at a time of liquidity needs. The investment book has the risk of conflict of interest, though measures have been taken to mitigate it.

**Liquidity Profile** At the end of FY18, liquid assets of AHL comprised ~44% of the total asset book (FY 17 ~27%). AHL has cumulative bank lines of ~PKR 4.7bln available in case a need arises.

**Financial Risk** AHL's closing net capital balance (NCB) for FY18 stood at ~PKR 920mln (FY17: ~PKR 1.7bln). The company finances its investments through short-term debt and internally generated cash-flows.



The Pakistan Credit Rating Agency Limited

**Arif Habib Limited**

PKR Mn

<b>BALANCE SHEET</b>				
	<b>30-Sep-18</b>	<b>30-Jun-18</b>	<b>30-Jun-17</b>	<b>30-Jun-16</b>
	<i>Un-audited</i>	<i>Audited</i>	<i>Audited</i>	<i>Audited</i>
<b>EARNING ASSETS</b>				
1 Finances	262	351	903	36
2 Investments	4,391	4,337	3,576	4,319
	<b>4,653</b>	<b>4,688</b>	<b>4,479</b>	<b>4,355</b>
<b>NON-EARNING ASSETS</b>				
3 Cash and Bank Balances - Client funds	378	469	718	23
4 Trade debts	95	24	75	582
5 Advances, Deposits and Other receivables	218	246	370	541
6 Others (including Fixed Assets)	47	46	51	62
<b>TOTAL ASSETS</b>	<b>5,391</b>	<b>5,473</b>	<b>5,693</b>	<b>5,563</b>
7 Equity	3,172	3,187	3,201	2,706
8 Borrowings	1,507	1,473	1,408	1,883
<b>Other Liabilities (Non-Interest Bearing)</b>				
9 Trade Creditors	588	691	904	872
10 Other Liabilities	124	123	179	103
<b>TOTAL EQUITY &amp; LIABILITIES</b>	<b>5,391</b>	<b>5,473</b>	<b>5,693</b>	<b>5,563</b>
<b>INCOME STATEMENT</b>				
	<b>30-Sep-18</b>	<b>30-Jun-18</b>	<b>30-Jun-17</b>	<b>30-Jun-16</b>
	<i>Un-audited</i>	<i>Audited</i>	<i>Audited</i>	<i>Audited</i>
<b>Fee Based Revenue</b>				
11 Advisory*	34	218	365	252
12 Brokerage*	52	329	402	277
<b>Operating Expenses</b>				
13 Personnel Expenses*	(41)	(188)	(207)	(159)
14 Administrative Expenses*	(43)	(137)	(179)	(106)
<b>Fee Based Income / (Loss)</b>	<b>2</b>	<b>222</b>	<b>381</b>	<b>264</b>
<b>Non Fee-Based Income</b>				
15 Bank Deposits and others	-	-	-	-
16 Gain on Sale of Investments	89	5	895	(0)
17 Others	102	610	3	354
<b>Total Operating Income / (Loss)</b>	<b>192</b>	<b>838</b>	<b>1,279</b>	<b>618</b>
18 Financial Charges	(27)	(185)	(138)	(166)
<b>Profit / (Loss) Before Tax</b>	<b>165</b>	<b>653</b>	<b>1,141</b>	<b>452</b>
19 Taxes	(15)	(117)	(260)	(47)
<b>Net Income</b>	<b>149</b>	<b>536</b>	<b>881</b>	<b>406</b>
<b>RATIO ANALYSIS</b>				
	<b>30-Sep-18</b>	<b>30-Jun-18</b>	<b>30-Jun-17</b>	<b>30-Jun-16</b>
	<i>Un-audited</i>	<i>Audited</i>	<i>Audited</i>	<i>Audited</i>
<b>CREDIT RISK</b>				
22 Accounts Receivable / (Short Term Borrowings + Customer Advances + Accounts Payable)	4.5%	1.1%	3.2%	21.1%
<b>LIQUIDITY RISK</b>				
23 Trade Receivables / Trade Payables	0.16	0.04	0.08	0.67
24 Liquid Assets / Trade Related Liabilities	5.52	4.76	4.18	4.20
25 Liquid Assets / (Short term Borrowings + Advances from Customers + Accounts Payable)	1.55	1.52	1.63	1.33
<b>BUSINESS RISK</b>				
26 Net Profit (before tax) Margin	191.6%	119.5%	148.7%	85.4%
27 Fee Based Income to Total Income	31.1%	47.0%	46.1%	59.9%
28 Operating Cost-to-Total Income	30.4%	27.9%	23.2%	30.0%
29 Net Fee based Income to Net Profit before Tax	1.2%	34.0%	33.4%	58.5%
30 Net Profit (before tax) to Total Income	59.7%	56.2%	68.5%	51.2%
31 Net Non-Earning Assets / Equity	19.4%	20.8%	32.3%	40.9%
<b>FINANCIAL RISK</b>				
32 Borrowings / Equity	47.5%	46.2%	44.0%	69.6%
33 NCB / Equity	-	28.9%	55.5%	35.2%

\* Proportionated in 1QFY19

**BROKER MANAGEMENT RATING SCALE**

SYMBOL	DEFINITION	
<b>BMR 1A</b>	<b>Excellent</b>	Excellent regulatory compliance, control environment, and financial management; governance and risk management frameworks are extremely effective; HR, IT, and customer services are strongly proactive.
<b>BMR 1++ BMR 1+ BMR 1</b>	<b>Strong</b>	Strong regulatory compliance, control environment, and financial management; governance and risk management frameworks are highly effective; HR, IT, and customer services are highly proactive.
<b>BMR 2++ BMR 2+ BMR 2</b>	<b>Sound</b>	Sound regulatory compliance, control environment, and financial management; governance and risk management frameworks are effective; HR, IT, and customer services are proactive.
<b>BMR 3++ BMR 3+ BMR 3</b>	<b>Adequate</b>	Adequate regulatory compliance, control environment, and financial management; governance and risk management frameworks are satisfactory; HR, IT, and customer services are adequate.
<b>BMR 4++ BMR 4+ BMR 4</b>	<b>Inadequate</b>	Inadequate regulatory compliance, control environment, and financial management; governance and risk management frameworks need improvements; HR, IT, and customer services are insufficient.
<b>BMR 5</b>	<b>Weak</b>	Weak regulatory compliance and business practices.

**SURVEILLANCE AND VALIDITY OF THE RATING**

PACRA shall not keep the Broker Management Rating under constant surveillance. The rating will be reviewed at least once every six months. Any material happening during a period that may warrant a revision of rating will be incorporated in the following review.

**OUTLOOK (STABLE, POSITIVE, NEGATIVE, DEVELOPING)**

Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. ‘Stable’ outlook means a rating is not likely to change. ‘Positive’ means it may be raised. ‘Negative’ means it may be lowered. Where the trends have conflicting elements, the outlook may be described as ‘Developing’.

**WITHDRAWN**

A rating is withdrawn on a) termination of rating mandate, or b) cessation of underlying entity.

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### **Rating Team Statements**

(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

### **2) Conflict of Interest**

- i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
- ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
- iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

### **Restrictions**

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
- (5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

### **Conduct of Business**

- (6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
- (7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
- (8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
- (9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
- (11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

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- (12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA's opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
- (13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
- (14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
- (15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
- (16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
- (17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

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- (18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
- (19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
- (20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
- (21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)

### **Probability of Default**

(22) PACRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA's transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA's Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(F-VII)

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