



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-Jun-2019	BMR1	-	Stable	Maintain	-
20-Dec-2018	BMR1	-	Stable	Maintain	
16-Jan-2018	BMR1	-	Stable	Initial	

Rating Rationale and Key Rating Drivers

The Rating reflects the company's very strong ownership profile and sponsor's business acumen. The rating incorporates the company's ability to retain its market share in lackluster equity market volumes. The leading position of the company in the country's brokerage industry emanates from an established franchise, longstanding relationship with a diverse customer base and strong market share. This is underpinned by its well-developed transactions execution and monitoring system, acclaimed research, strong control environment and 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. 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 margins have witnessed significant volatility.

The rating is dependent on upholding strong control and governance framework and continuous update of client servicing tools. Careful monitoring of risks, mainly market and liquidity risks and conflict of interest emanating from investment activities is crucial. The relatively constrained volumes in the market suppressed the profitability and managing any further contraction might be challenging.

Disclosure

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



Ownership

Ownership Structure Arif Habib Corporation (AHCL) 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. AHCL is the holding company of Arif Habib group.

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

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

Financial Strength Arif Habib Group had an equity size of ~PKR23bln as of March 2019.

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. Muhammad Sohail Salat, an independent director, ensuring good corporate governance. The HR & remuneration committee is chaired 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 account 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. The company 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 The Company'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 9MFY19.

Business Sustainability

Business Risk During first five months of CY19, KSE-100 posted a negative return of ~3%. Trading activity remained low on the back of negative market sentiments due to uncertainty on market performance in the backdrop of an economic slowdown, rising interest rate environment and consistent drag on IMF front. Concerns on upcoming budgetary measures remained in limelight. The overall trading volumes in first five months of CY19 remained low, (5MCY19: 88mln, CY18: 97mln, CY17: 102mln) as compared to previous years. This put pressure on income of all brokerage entities.

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 The commission/fee-based income stood at ~PKR 357mln in 9MFY19, (FY18: ~PKR 547mln, FY17: ~PKR 767mln). Operating expenses have seen a volatile trend, as a result, the trend for operating margins was as follows (3QFY19: 42%, FY18: 64%, FY17: 72%). Net Margins also witnessed a declining trend, (9MFY19: ~21%, FY18: ~98%, FY17: 115%).

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 The Company 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 9MFY19, liquid assets of AHL comprised ~0.15x of the total asset book ,(FY18: ~0.24x). AHL has cumulative bank lines of ~PKR 4.7bln available in case a need arises.

Financial Risk The company's Net Capital Balance for FY18 stood at ~PKR 920mln (FY17: ~PKR 1.7bln). The company finances its investments through short term debt and internally generated cash-flows.



	31-Mar-19 9MFY19	30-Jun-18 FY18	30-Jun-17 FY17	30-Jun-16 FY16
	Un-audited	Audited	Audited	Audited
A. EARNING ASSETS				
a. Finances				
1. Margin Trading System	-	-	-	-
2. Margin Financing	207	257	559	36
3. Ready Futures	-	94	344	-
	207	351	903	36
b. Investments				
1. Deposits with Banks - Client's Fund	422	662	789	283
2. Govt. Securities and Money Market Fund	-	-	-	-
2. Debt Securities & Income Funds	206	188	201	0
Other Investments	-	-	-	-
i) Related Party	1,862	1,141	1,445	1,093
ii) Listed Equity Investments	966	1,249	1,273	2,201
iv) Others	16	27	26	63
iii) Investment property	1,884	1,514	516	679
	5,357	4,780	4,251	4,319
Total Earning Assets	5,564	5,132	5,154	4,355
B. NON-EARNING ASSETS				
1. Cash and Bank Balances - Own Fund	16	25	43	23
2. Accounts Receivable	34	24	75	582
3. Advances, Deposits and Other receivables	905	246	370	541
4. Fixed Assets	48	46	51	62
	1,002	342	539	1,208
Non-Earning Assets	1,002	342	539	1,208
C. TOTAL ASSETS	6,566	5,473	5,693	5,563
D. Funding				
1. Commercial				
i) Advances from Customers	451	576	870	407
ii) Payables to Customers	34	115	34	465
	484	691	904	872
2. FIs				
i) Short-term Borrowings	2,872	1,473	1,408	1,881
ii) Current Maturity of Long Term Debt	-	-	-	-
iii) Long-term Borrowings	-	-	0	2
	2,872	1,473	1,408	1,883
Total Funding	3,357	2,163	2,313	2,755
E. Other Liabilities				
1. Due to Associates	-	-	-	-
2. Other Liabilities (staff gratuity, Accrued mark-up)	113	123	179	103
3. Provision for Taxation	-	-	-	-
	113	123	179	103
Other Liabilities	113	123	179	103
F. EQUITY				
1. Share Capital	660	550	550	550
2. Reserves:				
i. Statutory Reserve	-	-	-	-
ii. Capital Reserve	-	-	-	-
iii. Reserve for Bonus Shares	-	-	-	-
iv. Revenue Reserve	-	-	-	-
v. Unappropriated Profit	2,421	2,622	2,636	2,140
	2,421	2,622	2,636	2,140
Pure Equity	3,081	3,172	3,186	2,690
3. Surplus/(Deficit) on Revaluation of Investments	15	15	15	15
Total Equity	3,096	3,187	3,201	2,706
G. TOTAL LIABILITIES & EQUITY	6,566	5,473	5,693	5,563
H. CONTINGENT LIABILITIES				



Arif Habib Limited
INCOME STATEMENT
For the period ended

	31-Mar-19 9MFY19 Un-audited	30-Jun-18 FY18 Audited	30-Jun-17 FY17 Audited	30-Jun-16 FY16 Audited
1. Commission/Fee Based Revenue				
a. Advisory Fees*	142	218	365	252
b. Commission / Underwriting *	-	-	-	-
c. Brokerage	215	329	402	277
d. Others	-	-	-	-
	357	547	767	529
2. Operating Expenses				
a. Personnel Expenses*	(143)	(188)	(207)	(159)
b. Other Non-interest/Mark Up Expenses	(104)	(193)	(187)	(119)
	(247)	(381)	(394)	(277)
3. Brokerage Income / (Loss)	110	166	373	252
4. Non Fee-Based Income				
a. Finances	-	-	-	-
c. Dividend Income	72	110	91	61
d. Gain on Sale of Investments	120	5	895	(0)
e. Surplus/(Deficit) on Revaluation of Investments	(477)	5	(375)	162
f. Share of profit of subsidiaries/associates	-	-	-	-
g. Others	356	385	32	1
	70	505	643	224
5. Total Operating Income / (Loss)	180	670	1,017	476
6. Financial Charges	(131)	(185)	(138)	(166)
7. Other Income	63	167	263	146
8. Profit / (Loss) Before Tax	112	653	1,141	456
9. Taxes	(38)	(117)	(260)	(47)
10. Net Income	74	536	881	409
12. Unappropriated Profit / (Loss) Brought Forward	2,622	2,636	2,140	2,116
12. Adjustments	-	-	-	-
Available for Appropriations	2,696	3,172	3,021	2,525
13. Appropriations				
a. Statutory Reserve	-	-	-	-
b. Capital Reserve	-	-	-	-
c. Revenue Reserve	-	-	-	-
d. Cash Dividend	(165)	(550)	(385)	(385)
e. Bonus Dividend	(110)	-	-	-
	(275)	(550)	(385)	(385)
14. Unappropriated Profit/(Loss) Carried Forward	2,421	2,622	2,636	2,140



RATIO ANALYSIS

	31-Mar-19 9MFY19 Un-audited	30-Jun-18 FY18 Audited	30-Jun-17 FY17 Audited	30-Jun-16 FY16 Audited
A. PERFORMANCE				
1. ROE	3.1%	31.7%	51.2%	21.5%
a Net Profit Margin	20.7%	98.1%	114.8%	77.4%
b Asset Turnover	7.1%	18.8%	25.1%	13.5%
c Financial Leverage	212.1%	171.7%	177.8%	205.6%
2. Net Profit (before tax) Margin	31.4%	119.5%	148.7%	86.2%
3. ROA	1.2%	9.6%	15.6%	7.4%
4. Personnel Expenses-to-Total Operating Income	79.5%	28.0%	20.4%	33.4%
5. Personnel Expenses-to-Fee Income	40.1%	34.4%	27.0%	30.0%
6. Cost-to-Fee Income	57.9%	36.2%	27.9%	36.8%
7. Cost-to-Total Operating Income	137.3%	56.8%	38.7%	58.3%
8. Taxes / Pre-Tax Profit	34.2%	17.9%	22.8%	10.2%
9. Net Non-Earning Assets / Assets net of Non-Interest Liabilities	13.8%	4.1%	6.5%	20.2%
10. Net Non-Earning Assets / Equity	28.7%	6.9%	11.2%	40.9%
B. WORKING CAPITAL				
1. Accounts Receivable / (Short Term Borrowings + Customer Advances + Accounts Payable)	1.0%	1.1%	3.2%	21.1%
B. FINANCIAL EXPOSURE				
1. Investments / Equity	160.2%	129.9%	108.7%	150.0%
2. Equities / Total Capital	121.6%	83.7%	61.6%	65.9%
3. Short Term Proprietary Investments / Equity	31.4%	39.4%	40.0%	81.8%
4. Fixed Income / Total Capital	6.7%	5.9%	6.3%	0.0%
5. NCB / Equity	0.0%	29.0%	55.7%	35.4%
C. LIQUIDITY				
1. Trade Related Assets / Trade Related Liabilities	0.07	0.04	0.08	0.67
2. Liquid Assets / Total Assets	0.15	0.24	0.24	0.50
3. Liquid Assets / Trade Related Liabilities	2.10	1.88	1.54	3.22
4. Liquid Assets / (Short term Borrowings + Advances from Customers + Accounts Payable)	1.16	1.28	1.21	1.70
6. Liquid Investments / Equity	0.31	0.39	0.40	0.82
D. COVERAGE RATIOS				
1. EBITDA/Gross Interest	1.66	1.87	10.19	2.51
2. FCFO/Gross Interest	0.45	(2.87)	9.24	1.59
3. TCF/Gross Interest	0.46	(2.25)	9.24	1.59
4. FCFO/Gross Interest+CMLTD	0.45	(2.87)	9.24	1.59
5. FCFO/Gross Interest+CMLTD+Uncovered Short Term Borrowings	0.45	(2.87)	9.24	1.59
6. TCF/Gross Interest+CMLTD+Uncovered Short Term Borrowings	0.46	(2.25)	9.24	1.59
<i>Debt Payback Analysis</i>				
7 Long-term Debt/FCFO	0.00	0.00	0.00	0.00
8 Total Debt / FCFO	49.18	(2.77)	1.10	7.13
E. CAPITAL ADEQUACY				
1. Equity / Total Assets	46.9%	58.0%	56.0%	48.4%
2. Total Equity (including surplus on revaluation) / Total Assets	47.2%	58.2%	56.2%	48.6%
3. Total Debt / Equity	92.8%	46.2%	44.0%	69.6%
4. Dividend Payout Ratio	223.5%	102.6%	43.7%	94.0%
F. GROWTH				
1. Total Assets	20.0%	(3.9%)	2.3%	-
2. Equity	(2.9%)	(0.4%)	18.4%	-
3. Brokerage Revenue	(34.7%)	(18.3%)	45.1%	-
4. Asset Yield	1.3%	9.8%	13.5%	-

BROKER MANAGEMENT RATING SCALE

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

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- (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)
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- (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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