RATING REPORT

Arif Habib Limited

REPORT DATE:
March 09, 2022

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	*March 09, 2022*		*Jul 26, 2021*	

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 – 69.44% General Public (Local & Foreign) – 25%	**Chief Executive Officer:** Mr. Muhammad Shahid Ali Habib

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria Methodology – Securities Firms Rating (July 2020)
https://docs.vis.com.pk/docs/SecuritiesFirm202007.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

RATING RATIONALE

Established in 2004, Arif Habib Limited ('AHL' or 'the Company') is a prominent brokerage and financial services company. 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 6 branches, one each in Lahore, Islamabad, Rawalpindi, Faisalabad, Multan and Peshawar. During the outgoing year, the company opened a new branch in Multan. Going forward, the management envisages of opening sales centers in interior Sindh, Punjab, and KPK along with industrial areas in Punjab to increase retail penetration in these untapped regions.

In FY21, AHL hold market share of 7.9% (FY20: 9.4%) and 2.3% (FY20: 3.4%) in the ready & future transactions respectively, in terms of volume. In terms of value, the Company's market share is 7.0% (FY20: 9.1%) and 1.3% (FY20: 2.7%) in the ready & future transactions respectively. Cumulatively, AHL's market share follows a downward trajectory with the same reported at 5.8% (FY21: 6.7%, FY20: 7.7%) in 1HFY22. The consistent decline in market share is targeted to be addressed by further penetrating in the retail segment through expansion of the company's distribution network. Improvement in market position in relation to peers is considered important from a ratings perspective. Currently, the company holds a 30% share in the Roshan Digital Account, highest in the market. In addition, AHL's investment banking arm is the leading transaction underwriter in the industry.

<u>Sector Update:</u>

PSX volumes witnessed a sizeable jump in the outgoing fiscal year. Thus, positively impacting the profitability profile of the brokerage industry.

PSX Data (Ready + Future)	FY18	FY19	FY20	FY21	HY22
Volume (In Billions)	58	55	68	166	74
Value (In Billions)	2,881	2,235	2,574	6,916	2,931

After two consecutive years of dismal trading activity, volumes of PSX rebounded with a year-on-year growth of 24% in FY20 and a sizeable jump of 144% in FY21. This increase in trading volumes was mainly due to an uptick in economic activity and sustained recovery following the ease of lockdown after first wave of Covid-19 while pandemic-induced market volatility and lower prevailing interest rates also attracted investors, thus supporting trading volumes. Decision of the GoP to enter into the IMF program further supported activity in the market. Accordingly, in tandem with trading volumes, brokerage revenues grew across the industry. This supported the profitability of brokerage companies, some of which had slipped into losses during the 3-year period FY17-19. During FY21, top sector performers comprised Technology, Cement, Banks, Fertilizer and Textile.

Finance and Investment Banking. He has served in leading positions at top local at international institutions.

While market activity improved in FY21, the same was subdued in 1HFY22 as a result of a spectrum of factors including higher trade deficit, inflation, tightening of the policy rate pressurizing leveraged companies and low participation due to delay in IMF's sixth review and transition from MSCI Emerging Markets to Frontier Markets. Index downside was contributed by selling in Technology, Oil & Gas Marketing companies and Refinery whereas investors preferred Banks, Fertilizer, and E&P companies.

Steps taken by SECP & PSX seem to be supportive with respect to ease of doing business and are expected to boost investors' confidence.

New regulations in the industry include SECP's capital market reforms, wherein small-sized brokerage houses shall not be allowed custody of customer's assets. Further, SECP has made a commission slab to a minimum of 3 paisa (or 0.15% of traded value) and maximum of 2.5% of traded value. This facilitated in promotion of a healthy competition and supported profitability profile of the brokerage sector. The number of Initial Public Offerings (IPOs), which dropped in FY20, was followed by 8 IPOs 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 on FY07. Inclusive of debt issuances, total capital raised during FY21 amounted to Rs. 31b.

SECP has simplified account opening process by allowing brokers to complete the whole process online. Moreover, the regulator is currently in the process of streamlining KYC & AML compliance regulations. Furthermore, PSX has launched several Exchange Traded Funds (ETF's) and Murabaha Share Financing (MSF), which allow investors access to lower cost asset management along with access to credit. Going forward, growth in overall economic indicators and major steps taken by SECP & PSX to boost investors' confidence will further increase the trading activity on PSX over next 2-3 years.

Rating Drivers

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. 21.13b as at end-1QFY22 (*1HY22: Rs. 23.0b*).

Growing corporate advisory income remains a competitive edge and provides sustainability to overall revenues. AHL plans to add sales centers to the company's distribution network in order to create awareness and capture the untapped demand in retail segment.

Brokerage revenue witnessed an increase during FY21 to Rs. 706m (FY20: Rs. 323m) due to higher investor activity in the market, commission per share supported by higher penetration in the growing retail and digital segment. The Company's brokerage business is supported by its notable reliance on domestic retail investors, commission contribution from whom has increased notably over the past couple of years, in tandem with the uptick in domestic retail accountholders. Increase in reliance towards retail investors is viewed positively, as retail investors are generally more granular & sticky than institutional investors. Going forward, there are plans in place to grow the physical distribution network.

Given higher corporate advisory mandates during FY21, advisory and consultancy revenue increased by 334% to Rs. 672m (FY20: Rs. 155m) supporting overall operating revenue for the outgoing year. The four-fold uptick was due to IPOs, listed and privately placed TFCs and Sukuks, M&As, PE placements and issuance of right shares. The company provided its services for listing of 6 IPOs in the outgoing year raising a total of Rs. 17b holding market share of 84% in the industry. In addition, the Company was Financial Advisor & Arranger to two debt issuances in the outgoing year. Management expects a Rs. 300m M&A transaction that will be reflected in end-June22's topline. Variation in total revenue stream would remain given the volatility in major revenues drivers, which include brokerage fees, capital gains and corporate advisory income. AHL's assigned rating is supported by the diversification of operation revenues, which is superior to other brokerage companies along with consistent growth in corporate advisory income. This diversification is illustrated in the table below.

	FY19	FY20	FY21	FY19	FY20	FY21
Brokerage Income	303	323	706	40%	47%	47%
Advisory & consultancy	376	155	672	49%	22%	44%
Dividend	88	167	114	11%	24%	8%
Mark-up on corporate debt securities	-	46	20	-	7%	1%
Total (Rs. Mn.)	**767**	**691**	**1512**			

Finance cost declined by 63% during FY21 due to lower quantum of debt employed. Due to a high proportion of increase recurring revenue as compared to a lower increase in operating expenses, efficiency (cost to recurring income) ratio of the company strengthened to 48.4% (FY20: 95.9%) in FY21. The company also posted higher profit after tax of Rs. 2,084m during FY21 (FY20: Rs. 60m) primarily being a function of higher brokerage revenue, capital gains and re-measurement profits on investment portfolio. Excluding the impact of one-off gains in the outgoing year, the net profit amounts to the tune of Rs. 518m in FY21. The company continued to sustain its profitability by posting a profit after tax of Rs. 758m during 1HFY22 through gains on investment portfolio. Going forward, profitability is expected to remain a function of stable equity brokerage income and growing advisory fees.

Adequate liquidity & capitalization profile; market risk remains high on account of large proprietary book and large direct exposure to equity market

Market Risk: AHL carries significant market risk based on the Company's portfolio comprising largely of real estate holdings and proprietary investments. The company has undertaken sizeable exposure in commercial and residential plots situated at Naya Nazimabad, Deh Manghopir, Gadap Towm, Karachi as well as the investment in offices located in the building complex of ISE Towers REIT Management Company Limited and LSE Financial Services Limited. Subsequently, long-term investments increased to Rs. 2.11b (FY20: 1.81b) at end-June'21 with the increase mainly being attributable to capitalization of construction changes and general increase in fair value. However, the same stood lower at Rs. 1.10b at end-Dec'21led by sale of 49 out of 60 real-estate plots resulting in lower assets for the period. According to the management, additional 20 plots will be added to AHL's investment portfolio and will be reflective in the company's books by end- Mar'22. Short-term investments of the company stood at Rs. 3.9b (FY21: 2.8b; FY20: 3.7b) at end-Dec'21.

Currently, the property investment portfolio is a mix of Debt & equity securities. As of Dec'21, debt securities in the AHL's portfolio constituted 4% of the portfolio. Minimum credit rating of the issuers of these securities is the 'A' Band. The remaining portfolio includes investment in group Companies (31%) and other unrelated entities (65%).With large direct exposure to equity market, market risk is considered to be on the higher side.

P&L Extract	Jun'20	Jun'21	Dec'21
Long Term Investments – Subsidiaries	82	82	82
– Other Entities	45	55	44
Investment Property	1,678	1,969	976
Short Term Investments	3,724	2,747	3,902
Total	***5,529***	***4,853***	***5,004***

Liquidity Risk: Liquid assets in relation to total liabilities increased (1HY22: 190%; FY21: 157%) on a timeline basis on account of lower debt drawdown, increase in proprietary book and support by higher cash & bank balances. AHL's liquidity profile is considered adequate, in view of the current ratio consistently trending above 1x and standing at 2.3x as of Dec'21.

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 due to delay in payment from foreign and investment banking transactions. However, the ageing is considered satisfactory.

Capitalization: Debt profile is largely short term in nature. Debt leverage has improved on a timeline basis to 0.60x (FY21: 0.70x; FY20: 1.27x) at end-Dec'21. Despite improvement in gearing levels at end- June'21, the same slightly increased (1H22: 0.31x; FY21: 0.28x) at end-Dec'21. Improvement in overall debt leverage was on account of lower utilization of short term borrowings and inclining equity base due to gains on investment portfolio. Going forward, the company aims to follow a conservative strategy with projected reduction in debt levels.

Net Capital Balance (NCB) has increased on a timeline basis and was reported significantly higher at Rs. 3.99b (FY21: Rs.1.91b) at end-Dec21; however solvency position remains adequate. At half year-end '22, paid-up capital was reported higher at Rs. 653m (FY21: Rs. 594m; FY20: Rs. 594m) on account of issuance of bonus shares. Going forward, capitalization indicators are expected to further strengthen in lieu of conservative capital structure and projected growth in equity base through profit retention.

Experienced management albeit control framework warrants improvement.

Management team at AHL comprises seasoned professionals with considerable financial services sector experience and remained stable since last review. As per the investment policy in place, the Company can invest up to 35% of its equity in a particular security. The company has complied with its investment policy in the review period.

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	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Trade Debts	24	31	157	240	341
Long Term Investments+Investment Property	1,534	1,880	1,805	2,105	1,101
Short term Investments	2,679	2,411	3,724	2,747	3,902
Cash and Bank balances	687	627	806	2,674	1,866
Total Assets	5,473	5,642	6,869	8,472	8,172
Trade and Other Payables	563	638	795	1,790	1,159
Long Term Loans	1	-	838	30	19
Short Term Loans - Secured	1,473	1,909	1,836	1,369	1,550
Total Debt	1,474	1,909	2,674	1,400	1,569
Paid Up Capital	550	660	594	594	653
Net Worth (excluding revaluation surplus)	3,172	2,902	2,833	4,952	5,116
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Total Revenue	1,051	480	707	3,078	1,184
Brokerage Income	329	303	323	706	275
Advisory and consultancy fee	218	376	155	672	323
Dividend Income	110	88	167	114	55
Operating & Administrative Expenses	(324)	(397)	(344)	(638)	(287)
Finance Costs	(185)	(218)	(362)	(132)	(76)
Profit Before Tax	653	12	129	2,393	851
Profit After Tax	536	(62)	60	2,084	758
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**HY22**
Liquid Assets to Total Liabilities	147.2%	111.5%	126.0%	157.4%	190.4%
Liquid Assets to Total Assets	61.5%	53.9%	66.0%	64.6%	71.1%
Leverage	0.72	0.94	1.27	0.70	0.60
Gearing	0.46	0.66	0.94	0.28	0.31
Current Ratio (x)	1.70	1.36	1.53	1.80	2.27
Efficiency (%)	68%	72%	96%	48%	51%
ROAA (%)	9%	-1%	1%	33%	18%
ROAE (%)	17%	-2%	2%	73%	30%
**Annualized*					

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				
	09-Mar-22	AA-	A-1	Stable	Reaffirmed
	26-Jul-21	AA-	A-1	Stable	Reaffirmed
	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. Muhammad Taha Siddiqui	Company Secretary & CFO	16-Feb-2022	