

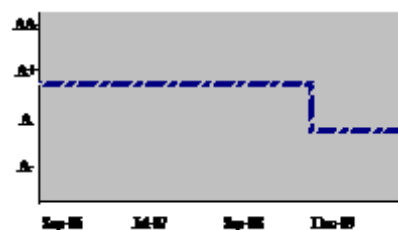


**RATINGS (JANUARY 2010)**

**KASB SECURITIES LIMITED (KSL)**

	NEW	PREVIOUS
<b>ENTITY</b>		
Long-term	A	A+
Short-term	A1	A1
<b>TFC - Secured, privately placed</b>		
PKR500mln	A+	AA-
Outlook	-	Positive

**LONG TERM RATING HISTORY**



**FINANCIAL DATA**

PKR (mln)

	30-Sep-09*	31-Dec-08
Total Assets	2,473	2,255.3
Equity	1,087.1	1,198.4
Net Income	(190.3)	4.7
ROE (%)	(22.2)	0.37
ROA (%)	(10.73)	0.17

\* Based on unaudited results for 9 months

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**TFC ISSUE**

KSL has issued a secured TFC of PKR 500mln in June 2007 for a tenor of five years, carrying profit at the rate of 6-month KIBOR plus 190bps, payable semi-annually, with no floor and no cap. The major principal will be redeemed in three equal semi-annual installments (33.3% each), starting from June 2011. The TFC has *Call Options* exercisable in full at any time after 1 year on a coupon date, at 30 days notice at a premium of 0.50% on the outstanding face value. The instrument is secured by way of first ranking pari passu charge on all present and future current assets as well as first ranking charge on present and future fixed asset, with 25% margin.

**RATING RATIONALE AND KEY DRIVERS**

- The ratings of KSL recognize the suppressed socio-economic environment in Pakistan, which has pressurized stock markets' performance and resultantly lower brokerage volumes. In addition, the ratings take into account dent on KSL's risk absorption capacity, mainly due to significant impairment in equity investments and a substantial rise in doubtful receivables. Simultaneously, the ratings factor in the management's plan to engage in proprietary trading, though the resulting exposure to market risk would be limited due to KSL's proven capital market experience and cap on size of the trading book. Nevertheless, the ratings draw comfort from KSL's strong presence in the equity broking business, an outcome of its established franchise supported by an advanced technology infrastructure and extensive research skills. Meanwhile, association with Bank of America Merrill Lynch (BAML) is also a key rating factor.
- The ratings are dependent on the company's ability to manage its business risk, emanating from inherently highly volatile nature of brokerage volumes. At the same time, improvement in overall risk management framework would remain vital. Meanwhile, any prolonged downturn in stock market leading to a decline in brokerage business is likely to have negative implications for the ratings.

**ASSESSMENT**

- Substantial deterioration witnessed in the socio-economic fundamentals of Pakistan during FY09 that impacted the stock market's performance, and in turn lowered brokerage volumes. The KSE 100 index, which had experienced remarkable growth over the past few years, declined sharply, resulting in imposition of a temporary floor on the index, thus limiting trading volumes. However, market players having stable alternative sources of revenues, low fixed cost structures, proactive managements, and sound risk management systems were better able to withstand the difficult operating environment.
- In line with the market dynamics, KSL's brokerage revenues declined significantly in the recent period. However, with weakening of certain key players, it managed to increase its market share (Sep09:7%; Sep08: 5%). Given that KSL had sizeable proprietary equity investments, the demise of stock market further impacted the bottom line, as KSL had to recognize a significant loss (Sep09: PKR83mln; Sep08: 94mln) on its equity investments portfolio. KSL, like various other market players also participated in financing the stock market positions of certain clients. After imposition of floor on stock exchange and significant erosion in values, a few of KSL's trade debtors failed to honor margin calls, resulting in doubtful receivables. Consequently, its profitability further deteriorated on account of provisioning against doubtful debts (Sep09: PKR100mln; FY08: PKR154mln), in turn, eroding its risk absorption capacity.
- Going forward, KSL would focus on sustaining its lately enhanced market share and increase the proportion of retail investors, particularly high net worth individuals. In this regard, it plans to expand branch network while attracting additional clients through its online trading system – KASB Direct, which commands a market trading position. Moreover, the company plans to strengthen its money market and fixed income instruments broking divisions, while exploring the commodities exchange to diversify its revenue streams. Nevertheless, in such a difficult operating environment, management's success to improve its overall performance would be challenging.
- KSL historically had a sizeable equity investment portfolio – strategic group linked investments and stock market portfolio. While not being engaged in active trading, the intentions were to gradually offload the portfolio and invest the proceeds in low risk earning assets. However, lately KSL's management has started active proprietary trading. This shift in stance will lead to increased market risk. KSL's management, cognizant of the increased risk profile, has devised an investment policy. The policy has specified investment parameters and placed certain limits on these investments.
- KSL has adequate risk management systems, but the recent stock market crisis has highlighted the need for further strengthening. At the same time, regulator's initiatives to discourage risk prone market financing products would further assist in mitigating credit risk.
- KSL continues to enjoy its long established relationship with Merrill Lynch, lately merged into Bank of America. KSL's research team, known for its quality research work, benefits from its regular liaison with BAML in addition to continuous enhancement of analytical skills through training. Meanwhile, KSL has a strong technology infrastructure which is expected to help the company to bring in further efficiency in its overall operations.
- KSL's equity has eroded on account of losses emanating from revaluation losses and provisions. Consequently its volume handling ability has also been impacted. However, it continues to draw comfort from stand-by lines of credit available from various financial institutions.

**PROFILE**

- KASB Securities Limited (KSL) is a successor to brokerage business started by Mr. Khadim Ali Shah Bukhari (Late) in mid fifties, corporatized in 1991 as Khadim Ali Shah Bukhari & Company Limited. KSL, listed on the KSE since Aug08, is majority owned subsidiary (77%) of KASB Bank Limited. The KASB group is contemplating changes in holding structure of its various companies that may result in transfer of KSL's ownership from the bank. The company operates through its branches in four cities, Karachi, Lahore, Islamabad and Rahim Yar Khan.
- KSL's seven-member board includes three executive directors. The current CEO, Mr. Farrukh H. Sabzwari, an MBA, joined the company in Jan05 and holds around 15 years of experience in investment banking and broking businesses. A team of experienced professionals supports him.

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