The Pakistan Credit Rating Agency Limited

RATING REPORT

EFG HERMES PAKISTAN LIMITED

Formerly: Invest and Finance Securities Limited

	INITIAL [JUN-17]
Long-Term	A-
Short-Term	A1
Outlook	Stable

JUNE 2017

Profile

- EFG Hermes Pakistan Limited (EFGH), Formerly Invest and Finance Securities Limited (IFSL) started its commercial operations in September 1999.
- EFGH is a listed company on the Pakistan Stock Exchange (PSX).
- EFG Hermes Frontier Holdings LLC is the majority shareholder of EFGH holding 51% of the shares, 27% shares are held by a group of six individual investors and rest of 22% is free float.

Governance

- Board comprises seven directors. All the directors are Non-Executive. Four board members represent EFG Hermes Frontier Holdings LLC, two represent individual investors and one is an independent member.
- There are two committee at board level; i) Audit Committee and ii) HR and Remuneration Committee.
- Strong business acumen of board members due to local and international business exposure.

Management

- EFGH is headed by Mr. Muzzammil Aslam (CEO) since 2015. He has nearly 10 years of experience in the field of economics, research, business development and financial/capital markets.
- The company has a strong and experienced management team with a well-defined organizational structure to support the system.
- The functions of the company are mainly divided into: 1) Brokerage, 2) Treasury, 3) Research, 4) Operations, 5) Risk & Compliance and 6) Accounts.

Risk Management

- The Risk and Compliance department falls under the purview of Mr. Shahid Kamal who also acts as a company secretary.
- EFGH has a well-defined risk management system. Head of Risk & Compliance reports directly to the CEO.
- EFGH is not engaged in proprietary trading. The company exposure to credit risk is minimal by not offering any credit facilities to its customers.
- The company has outsourced its internal control to an audit firm.

Business Risk

- Brokerage income in 9MFY17 was PKR 85mln (9MFY16: PKR 50mln). This is mainly due to increasing market share, domestic and foreign, and higher volumes handled by company during the period.
- Meanwhile, increase of 43% (9MFY17: PKR 86.7 million) in operating and administration expenses kept the profitability of the company under pressure. The company marginally failed to achieve operational breakeven.
- The company reported profit after tax of PKR 25million in 9MFY17 compared to a loss of PKR 7million in 9MFY16, this was due to one off non-fee based income (PKR 35million) which emerged from off-loading 40% shares of PSX to strategic buyers.
- Management plans to capture 4% market by focusing on local retail and foreign clients by improving customer services and core software.

Financial Risk

- EFGH has a strong capitalization level with regulatory Net Capital Balance (NCB) stands at PKR 1 billion at end May-17. This gives EFGH the capacity to avail big orders.
- The company's liquid assets deteriorated to 1.60x of its trade related liabilities at end Mar-17 (1.91x end Dec-16) due to increase in payables to customers (T+2 settlement)

Research

- The company has centralized the research department base in Dubai. Both, local and international teams will report to Mr. Kato, who will lead the equity research team as head of equity.
- Under this structure reports are reviewed by a committee operating from Middle East branch. The committee is responsible to review and challenge the analyst's recommendation before publishing any report.
- Mr. Simon Kitchen will look after the Macro Economic Research and will operate through International office

RATING RATIONALE

The ratings incorporate EFG Hermes Pakistan Limited's (EFGH) (Formerly: Invest & Finance Services Limited) recent association with Cairo based financial sector holding group, EFG Hermes Holdings S.A.E. EFGH plans to capitalize on strong managerial, financial, and operational support from its sponsor. EFGH has well defined risk management and compliance systems to mitigate risks arising from uncertainties inherent in the retail-broking business. To further refine the policies and procedures, EFGH is in process to converge its practices to standards followed by its parent company. The ratings draw comfort from Company's policy that prohibits proprietary trading which limits the company exposure to market risk. Moreover, the company does not engage in Margin Financing System which minimizes the credit risk exposure. The company has adopted dynamic approach to build the market share and diversify client mix; i) relying on EFG relationship to build foreign client base – intended distinction and ii) attracting local customers through research, strong technology, and customer services. The company plans to launch an online application and revamp its software. EFGH has a centralized research department based in Dubai which covers local and international markets. The domestic team will work along with them.

KEY RATING DRIVERS

The rating is dependent on the company's ability to generate sustainable organic revenue and achieve breakeven at operational level. Moreover, building a decent market share in the highly competitive brokerage industry is crucial. Realizing the synergies of international parentage and building up a sustainable foreign business will remain imperative for EFGH.

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EFG Hermes Pakistan Limited

BALANCE SHEET	31-Mar-17	30-Jun-16	30-Jun-15	30-Jun-14
	9M FY17	FY16	FY15	FY14
	Audited	*Audited*	*Audited*	*Audited*
EARNING ASSETS				
Finances	0	0	0	0
Investments	88	84	435	346
	88	**84**	**435**	**346**
NON-EARNING ASSETS				
Cash and Bank Balances	179	48	130	28
Trade debts	66	33	17	151
Advances, Deposits and Other receivables	82	34	65	40
Others (including Fixed Assets)	89	77	50	65
TOTAL ASSETS	**504**	**276**	**696**	**631**
Equity	248	192	457	868
Borrowings	36	7	0	331
Other Liabilities (Non-Interest Bearing)				
Trade Creditors	127	49	414	24
Other Liabilities	93	28	27	18
TOTAL EQUITY & LIABILITIES	**504**	**276**	**898**	**1,241**

INCOME STATEMENT	31-Mar-17	30-Jun-16	30-Jun-15	30-Jun-14
	9M FY17	FY16	FY15	FY14
	Audited	*Audited*	*Audited*	*Audited*
Fee-Based Income				
Fees	0	1	0	0
Commission	0	0	0	16
Brokerage	85	75	86	75
Others	0	0	2	5
Operating Expenses	**(87)**	**(89)**	**(72)**	**(69)**
Brokerage Income / (Loss)	**(2)**	**(13)**	**16**	**27**
Non Fee-Based Income	**36**	**7**	**95**	**179**
Total Operating Income / (Loss)	**34**	**(6)**	**111**	**206**
Financial Charges	(2)	(1)	(5)	(7)
Other Income / (Loss)	1	1	44	2
Profit / (Loss) Before Tax	**33**	**(6)**	**150**	**200**

RATIO ANALYSIS	31-Mar-17	30-Jun-16	30-Jun-15	30-Jun-14
	9M FY17	FY16	FY15	FY14
	Audited	*Audited*	*Audited*	*Audited*
Performance				
Net Profit Margin	30%	(13%)	157%	200%
Cost-to-Fee Income	102%	118%	82%	72%
Capital				
Overdue Accounts Receivable / Total Accounts Receivable	0%	0%	0%	0%
Overdue Accounts Receivable /(Short Term Borrowings + Accounts Payable)	0%	0%	0%	0%
Accounts Receivable / (Short Term Borrowings + Customer Advances + Accounts Payable)	0%	0%	0%	185%
Exposure				
Investments / Equity	40%	44%	95%	40%
Liquidity				
Trade Related Assets / Trade Related Liabilities	0%	0%	49%	2,585%
Liquid Assets / (Short term Borrowings + Advances from Customers + Accounts Payable)	125%	175%	126%	94%
Liquid Investments / Equity	40%	44%	95%	40%
Coverages				
EBITDA/Gross Interest	25	(1)	24	27
FCFO/Gross Interest	15	(11)	21	25
FCFO/Gross Interest+CMLTD+Uncovered Short Term Borrowings	(25)	1	(24)	(27)
Total Debt (excluding Covered Short Term Borrowings) / FCFO	1	(1)	0	2
Capital Adequacy				
Equity / Total Assets	43%	70%	51%	70%
Total Debt / Equity	15%	4%	0%	38%

CREDIT RATING
SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long Term Ratings

Rating	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments.
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short Term Ratings

A1+: The highest capacity for timely repayment.

A1:. A strong capacity for timely repayment.

A2: A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.

A3: An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

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'.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating Watch may accompany Outlook of the respective opinion.

Suspension
It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn
A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults., or/and f) PACRA finds it impractical to surveill the opinion due to lack of requisite information