



The Pakistan Credit Rating Agency Limited

Rating Report

EFG Hermes Pakistan Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
28-Dec-2018	A-	A1	Stable	Maintain	-
30-Jun-2018	A-	A1	Stable	Maintain	-
23-Jun-2017	A-	A1	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The ratings reflect the company's association with an international financial services provider, EFG Hermes, and its emerging position in Pakistan's brokerage industry. Strong sponsor support, robust governance framework and internal control environment gives support to the ratings. The company has a well-designed organizational structure, with the senior management reporting to the respective heads at group level. Ongoing efforts have been put for full integration of the group's policies at company level. The company's research department has foreign alliance and is centralized in U.A.E. As a group policy, the company does not engage in proprietary trading which keeps the market risk low. Due to lackluster market performance in CY18, the company suffered a net loss of ~PKR 29mln in 9MCY18. The equity base of the company stood at ~PKR 201mln at end Sep-18, which gives modest capacity to absorb financial risk.

Improvement in profitability, continuous monitoring of risk related parameters and retention of key human resource will bode well for the company. Meanwhile, maintaining its competitive position in the industry through diversification and volume based enhancement in revenues is critical for ratings.

Disclosure

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



PROFILE

Legal Structure EFG Hermes Pakistan listed on Pakistan Stock Exchange (PSX) as a public limited company.

Background The company was incorporated on September 27, 1999, as a private limited company, under the name Invest and Finance Securities as. Later on, its converted into public unquoted company on November 27, 2006. It was listed on the Pakistan stock exchange on March 20, 2008. On 18 May 2017, an Egyptian Financial Services Group, EFG Hermes Frontier Holdings LLC, acquired 51% stake in the company.

Operations With its head office in Karachi, EFG Hermes Pakistan Limited's main activities of the company include brokerage, research and investment banking advisory.

OWNERSHIP

Ownership Structure EFG Hermes Pakistan Limited is a subsidiary of EFG Hermes Frontier Holdings LLC, which controls 51% stake in EFG Pakistan. The ultimate owner of the group is EFG Hermes Holding S.A.E (Egyptian Financial Group Hermes Holding Company). A group of professionals including the ex-CEO, owns around 27%, while the remaining stake is held by the general public.

Business Acumen EFG Hermes Holding S.A.E., established in 1984, is an Egyptian investment bank specializing in securities brokerage, asset management, investment banking and private equity. EFG Hermes is listed on the Egyptian Exchange (EGX) and London (LSE) Stock Exchange. EFG Hermes has offices in eleven countries including Pakistan and serve clients from the Middle East, North Africa, Europe and the United States.

Financial Strength EFG Hermes Holding S.A.E.'s equity stood at ~EGP 13.9bln (~USD 0.8bln) as at the end of CY17. The group made net profit of ~EGP 1.25bln (~USD 0.1bln) in CY17.

GOVERNANCE

Board Structure The board comprises fourteen members including the CEO. Six directors are key management personnel of the EFG Group.

Members' Profile Mr. Murad Ansari is the Chairman of EFG Pakistan and he is also the co-head of the MENA financials team of EFG Hermes Frontier Holdings LLC. He holds an MBA from Institute of Business Administration and carries sixteen years of professional experience in equity research and sales. All other board members are highly qualified and seasoned professionals.

Board Effectiveness EFG Pakistan has two board committees, namely i) Audit Committee and ii) HR and remuneration committee. TOR's for both committees are well defined. Audit committee meets on quarterly basis to review the financial statements and internal audit findings. Audit committee is chaired by an independent director.

Financial Transparency Internal audit function of EFG Pakistan is performed by the parent company. The company's external auditors are AGN Riaz Ahmad Saqib Gohar & Co, ranked under category "B" as per the SBP rankings. The auditor's issued an unqualified opinion on the financial statements of EFG Pakistan for the year ended CY17 and period ended 9MCY18.

MANAGEMENT

Organizational Structure For effective management integration, matrix reporting structure is in place. Key departmental heads have reporting line to respective functions at group level, in addition to reporting to the CEO. This structure provides better oversight while bringing broader exposure and experience to local operations.

Management Team The company's CEO resigned in the second half of CY18 and was replaced by Mr. Shahid Kamal as the acting CEO. Mr. Shahid Kamal (ACMA, FPFA) has diverse experience of more than a decade in risk management, internal audit and compliance. Mr. Ahmad Zakir Hafeez is the current CFO of the company. He has been associated with the company since 1999. Retention and removal of key management personnel is critical.

Effectiveness The management of the company continues its focus on streamlining the risk management architecture and internal control.

Control Environment EFG Hermes Pakistan has devised detailed policies, at group level, for operations, research, IT, trading and investment and risk among others. The risk department makes continuous efforts to minimize the company's exposures primarily to market risk, credit risk and liquidity risk.

BUSINESS RISK

Industry Dynamics CY18 started off with a bull with KSE-100 posting a positive cumulative return of ~4% in the first half of the year. After the general elections in July18, the political uncertainty minimized. However, the investors remained cautious due to falling central bank reserves and balance of payment crises, leading to KSE-100 posting a negative return of ~3% in the 3rd quarter of CY18. The overall trading volumes remained quite low in FY18 (FY18: 84mln, FY17: 140mln) as compared to the previous year. This has put undue pressure on income of all brokerage entities.

Relative Position The company remains one of the prominent players in the brokerage industry. In equity trading, the company enjoys ~5% market share.

Revenue The company's operating revenue mainly comprises equity brokerage income and inter-bank brokerage. During 9MCY18, equity brokerage income decreased by ~10% to ~PKR 89mln and operating expenses increased by ~2% to ~PKR 117mln as compared to same period last year.

Profitability Following the industry wide loss trend, the company suffered net loss of ~PKR 29mln in 9MCY18 (9MCY17: 25mln profit). The operating revenue was ~PKR 97mln in 9MCY18, which was unable to cover the administrative and general expenses of ~PKR 117mln.

Sustainability Going forward, the management intends to leverage its brand to capture maximum market share as activity in stock market picks up.

FINANCIAL RISK

Credit Risk EFG Hermes Pakistan has due diligence procedures in addition to its KYC, for the assessment of its client creditworthiness. The board has approved per party and per scrip limits, which are strictly adhered to by the management which minimizes the credit risk.

Market Risk In line with the EFG group's policy, the company does not engage in proprietary trading thus limiting the market risk exposure. Funds have been deployed in government securities and shares of PSX as per the requirement of Stock Exchanges (Corporatization, Demutualization and Integration) Act 2012.

Liquidity Risk The trade related assets are 0.3x of the trade related liabilities as at end Sep-18. The company retains the ability to borrow funds in the short term and liquidate investments in the financial assets if the need arises.

Coverages The company suffered net loss of ~ PKR 29 mln and has availed long-term loan of ~PKR 375 million due to which its coverage ratios are not satisfactory. EBITDA was -7.7x of the gross interest at end Sep-18 as compared to -12x at end Dec-17.

Capitalization The net capital balance of the company is ~PKR 441 million. The company can take exposure up to 25 times of its NCB.



The Pakistan Credit Rating Agency Limited

EFG Hermes Pakistan Limited

PKR Mln

BALANCE SHEET

	30-Sep-18 <i>Unaudited (9MCY18)</i>	31-Dec-17 <i>Audited (2HCY17)</i>	30-Jun-17 <i>Audited (FY17)</i>	30-Jun-16 <i>Audited (FY16)</i>
EARNING ASSETS				
1 Finances	99	178	76	-
2 Investments	317	259	616	88
	416	437	692	88
NON-EARNING ASSETS				
3 Cash and Bank Balances - Client funds	59	99	99	48
4 Trade debts	21	51	86	33
5 Advances, Deposits and Other receivables	154	191	197	72
6 Others (including Fixed Assets)	36	41	35	35
TOTAL ASSETS	686	820	1,109	276
7 Equity	201	240	256	192
8 Borrowings	378	472	718	6
Other Liabilities (Non-Interest Bearing)				
9 Trade Creditors*	72	73	90	46
10 Other Liabilities	35	36	46	32
TOTAL EQUITY & LIABILITIES	686	820	1,109	276

Proportionated for 9MCY18 and CY17

INCOME STATEMENT

	30-Sep-18 <i>Unaudited (9MCY18)</i>	31-Dec-17 <i>Audited (2HCY17)</i>	30-Jun-17 <i>Audited (FY17)</i>	30-Jun-16 <i>Audited (FY16)</i>
Fee Based Revenue				
11 Advisory	-	-	-	-
12 Brokerage	97	76	124	75
Operating Expenses				
13 Personnel Expenses*	(63)	(42)	(75)	(51)
14 Administrative Expenses*	(54)	(39)	(55)	(38)
Fee Based Income / (Loss)	(20)	(4)	(6)	(13)
Non Fee-Based Income				
15 Bank Deposits and others	-	-	-	-
16 Gain on Sale of Investments	10	4	56	3
17 Others	14	13	4	6
Total Operating Income / (Loss)	4	13	55	(5)
18 Financial Charges	(20)	(16)	(9)	(1)
Profit / (Loss) Before Tax	(16)	(3)	45	(6)
19 Taxes	(12)	(8)	(8)	(4)
Net Income	(29)	(11)	37	(10)

RATIO ANALYSIS

	30-Sep-18 <i>Unaudited (9MCY18)</i>	31-Dec-17 <i>Audited (2HCY17)</i>	30-Jun-17 <i>Audited (FY17)</i>	30-Jun-16 <i>Audited (FY16)</i>
CREDIT RISK				
20 Accounts Receivable / (Short Term Borrowings + Customer Advances + Accounts Payable)	28.9%	31.1%	56.4%	68.6%
LIQUIDITY RISK				
21 Trade Receivables / Trade Payables	0.3	0.7	1.0	0.7
22 Liquid Assets / Trade Related Liabilities	5.2	4.9	8.0	2.9
23 Liquid Assets / (Short term Borrowings + Advances from Customers + Accounts Payable)	5.2	2.2	4.7	2.9
COVERAGES				
24 EBITDA/Gross Interest	-7.7	-12.5	33.4	-54.7
25 FCFO/Gross Interest	-15.6	-66.8	19.5	-235.4
BUSINESS RISK				
26 Net Profit (before tax) Margin	n/m	n/m	36.7%	n/m
27 Trade Debtors	80.2%	81.2%	67.2%	89.9%
28 Operating Cost-to-Total Income	97.0%	85.9%	70.2%	106.1%
29 Net Fee based Income to Net Profit before Tax	123.8%	152.1%	n/m	227.7%
30 Net Profit (before tax) to Total Income	n/m	n/m	24.6%	n/m
31 Net Non-Earning Assets / Equity	116.7%	144.6%	145.1%	81.1%
FINANCIAL RISK				
32 Borrowings / Equity	187.8%	196.6%	280.5%	3.0%
33 NCB / Equity	-	188.2%	275.3%	28.2%

* *Proportionated in 9MCY18*

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		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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 surveil the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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

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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)
- (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)

Monitoring and review

- (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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