



The Pakistan Credit Rating Agency Limited

Rating Report

EFG Hermes Pakistan Limited | BFR

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Rating History

Dissemination Date	Rating	Outlook	Action	Rating Watch
23-Dec-2022	BFR 2+	Stable	Maintain	-
31-Mar-2022	BFR 2+	Stable	Initial	-

Rating Rationale

Factor	Comment
Ownership	EFGH is primarily owned by EFG Hermes Frontier Holdings LLC having ~51% ownership stakes, while ~44% are owned by individuals and institutions.
Governance	The board of directors comprises seven members including two independent directors, depicting a sound governance structure. Two board committees with independent representation are also present for added oversight.
Management and Client Services	The Company has a matrix organizational structure. The management comprises seasoned professionals reporting to their respective group heads. Client servicing is considered strong.
Internal Controls and Regulatory Compliance	A group internal audit function and international oversight ensures a strong control framework. Dedicated risk management and compliance department is also present.
Business Sustainability	Revenue from equity brokerage declined by ~48% in 9MCY22 as compared to SPLY. The performance is commendable in the backdrop of ~57% decline in market volumes.
Financial Sustainability	Trade receivables comprises merely ~5% of equity at end-Sep'22, signifying low credit risk. The market risk is considered low as EFGH does not engage in proprietary book investments.

Key Rating Drivers

The assigned ratings consider EFG Hermes Pakistan Limited's ('EFGH' or the 'Company') association with an established international financial services group "EFG Hermes". Leveraging foreign group expertise and oversight, EFGH provides exceptional research services to its clients. A robust multi-layer control framework is present through independent board representation, board committees, and group oversight. Despite CY22 being a challenging year for local equities, EFGH managed to contain the decline in traded volumes compared to the market and sustained its market share during 9MCY22. The continued sponsor support in the form of guaranteed loan arrangements of PKR 825mln provides comfort to the ratings. The sponsor reclassified its inter-company balances to enhance EFGH's equity by ~PKR 118mln. Going forward, the business environment is expected to remain challenging until clarity emerges on the economic front. The rating is dependent on sustainability and improvement in profitability from core income, increasing diversification of the topline, and maintaining market share. Meanwhile, upholding a strong control framework while effectively managing risks remains critical.

Disclosure

Name of Rated Entity	EFG Hermes Pakistan Limited BFR
Type of Relationship	Solicited
Purpose of the Rating	Broker Fiduciary Rating (BFR)
Applicable Criteria	Methodology Broker Fiduciary Rating(Jan-22)
Related Research	Sector Study Brokerage & Securities(Jan-22)
Rating Analysts	Afnan Iqbal afnan.iqbal@pacra.com +92-42-35869504

Profile

Background: EFG Hermes Pakistan Limited (EFGH), formerly Invest and Finance Securities Limited (IFSL) started its commercial operations in September 1999. The Company is a TREC Holder of the Pakistan Stock Exchange Limited.

Operations: EFGH primarily provides the services of equity brokerage. The brokerage clients are divided into three broad segments: i) Foreign ii) Institutions and iii) Retail/HNWIs.

Ownership

Ownership Structure: EFG Hermes Frontier Holdings LLC is the major shareholder having a 51% holding of EFG Hermes Pakistan. ~5% of shares are held by directors and the rest of ~44% of shares are owned by individuals and institutions.

Stability: EFG Hermes Frontier Holdings LLC is a 100% owned subsidiary of EFG-Hermes Holding S.A.E. The focus of EFG Hermes Frontier Holding LLC is to increase footprints and explore new opportunities in frontier markets of the world. EFG Hermes Holdings S.A.E. is an investment bank in the Middle East, North Africa (MENA), and Pakistan region.

Business Acumen: EFG, also known as the Egyptian Financial Group, became the first investment banking firm in Egypt when it was established by Dr. Mohamed Taymour in 1984. The company brought many investment strategies that were common to the west to Egypt as several of the firm's founders had Wall Street experience in corporate finance, sales & trading, and asset management; for example, Hermes established the first equity index in all of Egypt.

Financial Strength: The sponsors have adequate net worth and may inject capital into the Company with an increasing quantum of operations. The Holding Company earned ~\$53mln profit during 9MCY22, while its equity stood at ~\$787mln at end-Sep'22.

Governance

Board Structure: The Company's Board of Directors (BoD) comprises seven members, which include two independent directors and four non-executive directors. The board is currently chaired by Mr. Murad Ansari, a non-executive director.

Members' Profile: The board members on average possess ~20 years of relevant experience. The board members are skilled and experienced to manage business operations efficiently. The presence of independent directors strengthens the governance framework.

Board Effectiveness: To ensure an effective control environment and compliance with reporting standards, the Company has constituted two board committees: i) Audit Committee, and ii) Human Resource and Remuneration Committee. Both the Audit and Human Resource committees are chaired by independent directors.

Transparency: Riaz Ahmad Saqib Gohar & Company Chartered Accountants are the external auditors of the company. They have expressed an unqualified opinion on the financial statements for CY21. The firm is QCR rated by ICAP and is in the B Category of SBP's panel of auditors.

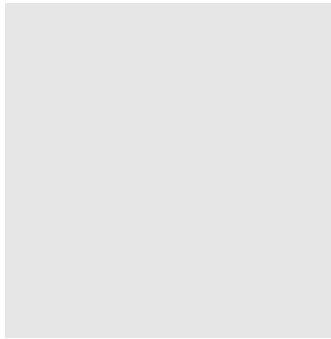
Management and Client Services

Organizational Structure: EFGH has a matrix organizational structure that highlights the roles and responsibilities of each individual. The functions of the Company are mainly divided into (i) Finance, (ii) Information Technology, (iii) Equity (Sales), (iv) Admin & HR, (v) Research, (vi) Regional Branch, (vii) Risk Management and Customer Services, (viii) Corporate Affairs and Compliance, (ix) Equity (Settlement), (x) Online Sales and (xi) International Sales. The management directly reports to the heads of departments at the group level.

Management Team: The CEO, Mr. Saad Iqbal, CFA has over 10 years of relevant experience. The CFO, Mr. Ahmad Zakir Hafeez holds MBA and has been associated with the Company since its inception. Mr. Shahid Kamal heading the secretarial and compliance department is an ACMA and also a Fellow Member of PIPFA.

Client Servicing: The Company has provided its customers with various channels, including a mobile app and online trading platform to facilitate the execution and monitoring of their transactions. The research department shares the relevant research with the clients on regular basis.

Complaint Management: EFGH has provided a guide for lodging complaints on its website and investors can lodge complaints through phone calls, SMS, Email, Website, and



by physical appearance. The customer service department looks after the complaint's resolution.

The extent of Automation / Integration: EFGH's trading system has a centralized real-time risk management system and allows for online trading. The core software functions include Equity Settlement, MM Settlement, Payroll, Accounting, and Risk Management. Furthermore, to facilitate its customers, EFGH is establishing a new tailor-made platform that will include an online trading system and a customized mobile app.

Continuity of Operations: The Company has a fully operational business continuity & disaster recovery location, which provides a robust structure for resuming all critical operations in the shortest possible time. The data about back-office records and back-office applications are backed up daily and secured in two separate locations.

Internal Controls and Regulatory Compliance

Risk Management Framework: EFGH has established Risk Management procedures for reviewing risk appetite, policies and controls put in place. EFG's internal audit function which is instrumental in mitigating risk is also based at the group level. EFGH has a separate Risk Manager and the policies are aligned at the group level.

Regulatory Compliance: EFGH's compliance department ensures that it is compliant with all the PSX requirements and SECP (Anti Money Laundering and Countering Financing of Terrorism) Regulations that pertain to its particular industry, as well as professional standards, accepted business practices, and internal standards.

Business Sustainability

Operating Environment: Pakistan's economy during CY22 has remained largely volatile. From international aspects such as the global recession and Russia-Ukraine war to the domestic political uncertainty and flash floods devastating a major part of the country, the investors have had no confidence in the market. Traded volumes have remained low which has affected the top line of the brokerage industry as a whole. Moving forward, political stability after elections may play a large factor in the possibility of stabilizing the market; however, the recent increase of policy interest rates may continue to deter investors towards safer fixed-income returns instead of the riskier equity market.

Performance: During 9MCY22, brokerage commission stood at ~PKR 94mln while during 9MCY21 it stood at ~PKR 181mln (CY21: ~PKR 241.6mln). Consequently, the Company reported a net loss of ~PKR 68mln during 9MCY22 as compared to a profit of ~PKR 30mln during 9MCY21.

Strategy: The Company is focusing on enhancing its Retail Clientele by improving its technology integration as well as its social media presence, while the hiring of additional resources for technological advancement is also under consideration.

Financial Sustainability

Credit Risk: The majority of the credit exposure is with customers, brokers, and other financial institutions. The Company controls its credit risk through a variety of reporting and control procedures, including establishing credit limits based on a review of the counterparties' financial conditions. The Company monitors collateral levels regularly and requests changes in collateral levels as appropriate if considered necessary.

Market Risk: EFGH, as a policy, does not engage in proprietary equity investments, thus limiting the impact of market risk. The Company invests its excess funds in government securities.

Liquidity Risk: The current assets of EFGH stood at ~PKR 1,251mln at end-Sep'22 as compared to current liabilities of ~PKR 272mln. The Company retains the ability to borrow funds in the short term and liquidate investments in the financial assets if the need arises.

Capitalization: The Company has availed a long-term loan of ~PKR 825mln which is secured against the financial guarantee by the parent company. During the quarter that ended Sep'22, the parent company reclassified its inter-company receivable balance, increasing the equity of EFGH by ~PKR 118mln, and as a result, the equity of EFGH stands at ~PKR 207mln at end-Sep'22.

PKR mln

EFG Hermes Pakistan Limited	Sep-22	Dec-21	Dec-20	Dec-19
	9M	12M	12M	12M

A BALANCE SHEET

1 Finances	88	80	41	13
2 Investments	911	841	416	396
3 Other Earning Assets	11	11	11	11
4 Non-Earning Assets	293	385	394	341
5 Non-Performing Finances-net	-	-	-	-
Total Assets	1,304	1,317	862	762
6 Funding	873	825	440	620
7 Other Liabilities (Non-Interest Bearing)	224	329	286	11
Total Liabilities	1,097	1,154	726	631
Equity	207	163	136	131

B INCOME STATEMENT

1 Fee Based Income	93	242	172	123
2 Operating Expenses	(144)	(196)	(158)	(167)
3 Non Fee Based Income	74	45	43	51
Total Operating Income/(Loss)	23	90	57	8
4 Financial Charges	(78)	(44)	(40)	(45)
Pre-Tax Profit	(55)	47	16	(37)
5 Taxes	(12)	(18)	(15)	(11)
Profit After Tax	(68)	29	2	(48)

C RATIO ANALYSIS

1 Business Sustainability

Pre Tax Margin	-60.0%	19.3%	9.5%	-30.1%
EBITDA/ Revenue	28.9%	39.8%	33.0%	6.4%
Profit / (Loss) Before Interest & Taxes / Total Assets	1.7%	6.9%	6.6%	1.0%

2 Financial Sustainability

Total Investments / Equity	440.2%	515.2%	305.7%	303.2%
NCB / Equity	392.6%	527.9%	276.2%	281.7%
LCB/ Total Equity	392.6%	523.2%	276.2%	281.7%
(Cash & Cash Equivalents + Government Securities) / Total Assets	86.7%	86.1%	81.8%	82.1%
Total Debt / Equity	421.7%	505.7%	323.9%	342.5%

Broker Fiduciary Rating Scale & Definitions

An independent opinion on the quality of management and client services and sustainability of operations

Scale	Definition
BFR 1	Very Strong. Very Strong quality of management, client services and very high likelihood of sustaining operations.
BFR 2++ BFR 2+ BFR 2	Strong. Strong quality of management, client services and high likelihood of sustaining operations.
BFR 3++ BFR 3+ BFR 3	Good. Good quality of management, client services and above average likelihood of sustaining operations.
BFR 4++ BFR 4+ BFR 4	Adequate. Adequate quality of management, client services and average likelihood of sustaining operations.
BFR 5	Weak. Weak quality of management, client services and weak likelihood of sustaining operations.

<p>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'.</p>	<p>Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. 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 rating outlook of the respective opinion.</p>	<p>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.</p>	<p>Withdrawn A rating is withdrawn on a) termination of rating mandate, b) cessation of underlying entity, c) the rating remains suspended for six months, or/and d) PACRA finds it impractical to surveil the opinion due to lack of requisite information.</p>	<p>Harmonization A change in rating due to revision in applicable methodology or underlying scale.</p>
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Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

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- 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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- (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 | Clause 11-(A)(p).
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- (10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
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- (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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- (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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