

## CREDIT OPINION

5 June 2019

Update

✓ Rate this Research

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# Omega Funds Investment Ltd

Update following ratings affirmation

## Summary

On 4 June 2019, we affirmed the local and foreign-currency B2 long-term and Not-Prime short-term issuer ratings of [Omega Funds Investment Ltd \(Omega\)](#). The outlook on the long-term ratings remained stable. The affirmation of Omega's ratings reflected our assessment of the company's ample capital cushion, strong liquidity profile and high profitability. The affirmation also took into account constraints associated with the company's (1) small and undiversified franchise, with high concentration of business and revenue stream on few large customers, and (2) key-man risk related to its shareholder.

Exhibit 1

### Omega's profitability is strong, but its earnings are highly volatile



Source: Omega's audited IFRS reports

## Credit strengths

- » Good capital buffer supported by sound profitability
- » Robust liquidity position

## Credit challenges

- » Small and undiversified franchise, resulting in concentrated business and revenue streams
- » Volatile earnings
- » Growing exposure to market risk

## Outlook

The B2 rating carries a stable outlook, reflecting our expectation that the company will maintain its current credit fundamentals over the next 12-18 months.

## Factors that could lead to an upgrade

- » Remarkable expansion in the company's franchise
- » Significant reduction in its single-name customer concentrations

## Factors that could lead to a downgrade

- » A significant increase in the company's leverage
- » A weakening of its liquidity profile
- » Loss of key customers, resulting in a significant scaling down of the company's activities and risk to the continuity of its business

## Profile

Omega is a small brokerage firm, with assets of EUR50 million as of end-2018 (end-2017: EUR21 million). Despite being domiciled in Limassol, Cyprus, Omega holds strong links with Russia via its shareholder, key customers and counterparties. Omega's principal activity is providing brokerage services to a handful of corporate clients.

As of year-end 2018, Omega held financial instruments and cash on behalf of its clients with net market value of EUR689 million (end-2017: EUR668 million). The company recognizes these amounts off-balance sheet, based on IFRS and following their auditors opinion. Omega is acting as a trustee in substance with respect to these assets and is not legally allowed to perform any operations with them at its own discretion.

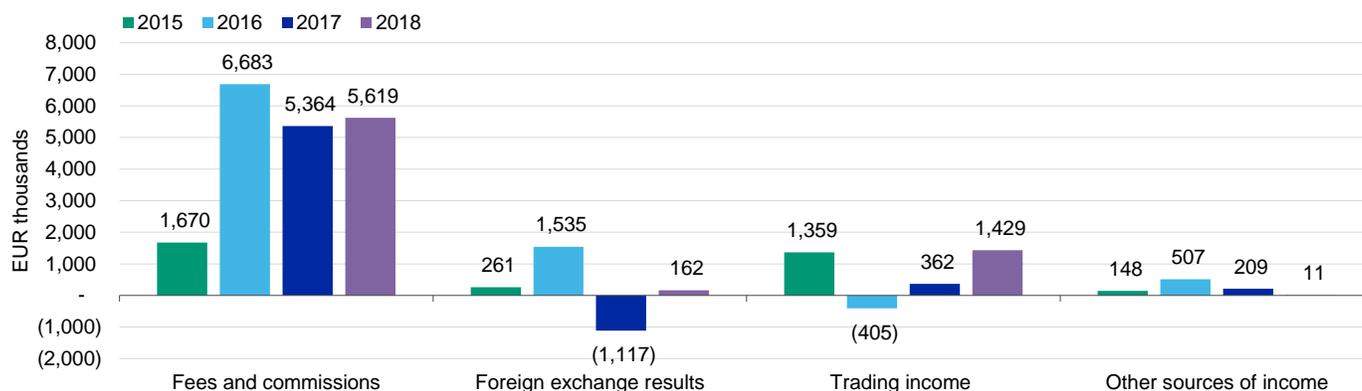
## Detailed credit considerations

### Scale and profitability: a small and highly concentrated franchise, which generates strong but highly volatile earnings

Omega is a relatively small brokerage firm, with pre-tax income of EUR4.3 million in 2018 (up from EUR2.9 million in 2017). Brokerage services to corporate clients mainly include operations with securities, and to a lesser extent, foreign-exchange transactions, primarily involving the Russian rouble, the US dollar and euro.

Exhibit 2

### Omega's revenue is dominated by fee and commission income



Source: Omega's IFRS reports

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Omega's 2018 financial results were stronger than that a year earlier, underpinned by increased revenue from repo transactions, as well as reported foreign-exchange profit related to positive revaluation of monetary asset and liabilities to euro. Concurrently, the company's operating expenses increased over 50% from a year earlier, mainly driven by expansion of its headcount. Additional outlays were partially related to IT, compliance and consulting services associated with the new EU regulations for securities companies coming into force in 2018. Omega's pre-tax margin has historically been strong, varying between 60%-90%. In 2018, this margin declined to 59%, but remained higher than the company's global peers. We assign Pre-Tax margin score of Aaa given expected trends.

Based on management accounts for the first quarter of 2019, we expect the company's revenue stream and bottom-line profitability to remain volatile through 2019, given remaining high concentrations on few large clients' operations, and increase in proprietary trading operations. Although Omega is steadily diversifying its revenue sources, the brokerage fees from concentrated customer base still dominate the company's operational income.

We adjust Omega's Pre-tax Margin Volatility score upwards to Ba1 from Ca because we give partial credit to our estimate of this metric based on quarterly management accounts, while the initial score penalises the company based on annual reporting.

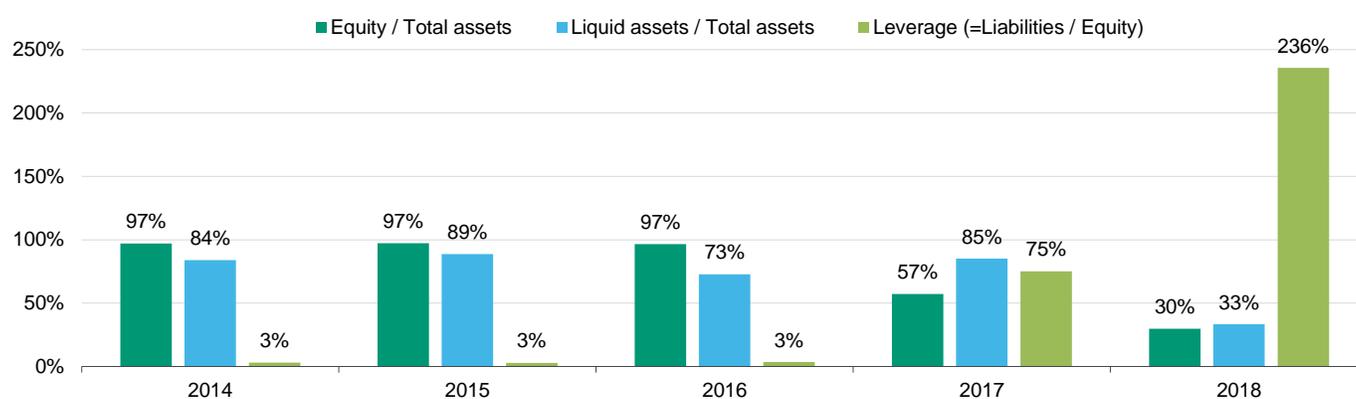
### Leverage and coverage: still good capital buffer, despite grown leverage; robust liquidity

Until end of 2016, Omega had operated at close to zero leverage and had its risky assets more than fully covered by an ample capital buffer. The company had no market debt issuance, but reported an increase in its liabilities in 2018 referred to repo transactions. Concurrently, Omega's equity-to-assets ratio declined to 30% at year-end 2018 from 57% a year before. Through 2018 Omega's leverage defined as liabilities/equity did not exceed 3 times on quarterly basis, which we consider as comfortable level. Most of repo transactions are short-term arbitrage trades with similar terms, in particular, underlying asset and tenor. Thus we see limited market risk, while the counterparty risk is mitigated via daily margining. We apply downward adjustments to two of three leverage and coverage ratio scores based on scenario analysis to better reflect the strength of Omega's financial profile.

Omega's credit profile could be exposed to downside risks in the event if management decides to further increase its leverage, which can result in higher exposure to market and credit risks as well as erosion of the company's liquidity profile. At the moment, Omega continues to benefit from robust liquidity buffer. Its liquid assets to total assets accounted for 33% at the end of 2018. Omega's securities portfolio is dominated by the Russian corporate and bank eurobonds of good credit quality and liquidity.

Exhibit 3

#### Omega has robust liquidity and good capital buffer



Source: Omega's annual reports

### Business profile and financial policy

We adjust Omega's Ba3 Adjusted Financial Profile score downwards by two notches to incorporate qualitative assessments pertaining to business diversification (-1 notch) and key-man risk (-1 notch).

In 2018, as well as in each of the preceding four financial years, more than 80% of Omega's fee and commission income was attributable to the company's three largest customers. This represents a very high single-name concentration in the company's revenue stream. Moreover,

Omega's boutique franchise highly depends on connections of its sole shareholder, rendering the company potentially vulnerable to any change in ownership or management.

### Operating environment

We assign a B2 score to Omega's Operating Environment, based predominantly (with a 70% weight) on the competitive dynamics and industry fundamentals of Russian brokerage companies.

Omega is domiciled in Cyprus. Therefore, we take into account the fact that the company benefits from being subject to EU standards of regulation and supervision, as executed by the Cyprus Securities and Exchange Commission. However, we believe the Russian operating environment is more relevant for Omega than that of Cyprus, given the company's strong links with Russia via its (1) sole shareholder Pavel Vashchenko; (2) customers, many of which have Russian beneficiaries; (3) trade of Russian securities and currency; and (4) other counterparties (for example, brokers and banks), many of which are domiciled in Russia.

The operating environment limits Omega's financial profile and results in a Ba3 Adjusted Financial Profile score, compared with a Baa2 score prior to the consideration of the operating environment.

### Macro-Level Indicator

Russia's Ba2 Macro-Level Indicator score reflects the country's moderate (+) economic strength and low (+) institutional strength with high (-) susceptibility to event risk. That said, neither of the indicators has any weighting in the scorecard because these scores are higher than the Competitive Dynamics and Industry Fundamentals score.

### Competitive dynamics and industry fundamentals

We assign a B score to the Competitive Dynamics and Industry Fundamentals of both Russian and Cyprus-based securities industry service providers. Entry barriers are low in both countries, resulting in (1) a large number of small market participants, operating in niche market segments; and (2) relatively low industry concentration. In recent years, the exit of large foreign banks from the Russian market has benefited domestic companies, although at the same time, state-owned banks and their subsidiaries have increased their presence significantly, maintaining the strong competitive pressure on smaller firms.

In addition, Russian brokers, as well as Cyprus-based brokers servicing Russian clients, remain subject to the heightened risk of adverse secular changes, given, in particular, the vulnerability of Russia's capital markets to the uncertainty around international sanctions.

### Support and structural considerations

Omega is not a systemic entity either in Cyprus or in Russia, and therefore, we estimate a low probability of government support, resulting in no additional uplift to the company's rating.

### Methodology and scorecard

#### About Moody's Security Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Overall, the scorecard-calculated standalone assessment range for Omega is B1-B3. The company's assigned B2 standalone assessment is in the middle of the range, indicating that there is no strong upward or downward pressure on Omega's rating, consistent with its stable outlook.

### Methodologies

The principal methodology used in these ratings was Securities Industry Service Providers, published in June 2018. Please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

## Rating methodology and scorecard factors

Exhibit 4

### Omega Funds Investment Ltd

Financial Profile	Factor Weights	Historic Ratio	Initial Score	Assigned Score	Key driver #1	Key driver #2
<b>Scale</b>						
Pre-Tax Earnings (USD Million)	20%	-	-	<b>Caa3</b>	Revenue trend	
<b>Profitability</b>						
Pre-Tax Margin	10%	-	-	<b>Aaa</b>	Cost trend	
Pre-Tax Margin Volatility	10%		Caa3	<b>Ba1</b>	Other	
<b>Leverage and Coverage</b>						
Debt/EBITDA	20%	-	-	<b>Ba1</b>	Stress resilience/susceptibility	
(Retained Cash Flow-CapEx)/Debt	20%	-	-	<b>Aaa</b>		
EBITDA/Interest Expense	20%	-	-	<b>Baa1</b>	Stress resilience/susceptibility	
Financial Profile Score	<b>30%</b>		<b>A2</b>	<b>Baa2</b>		
<b>Operating Environment</b>						
<b>Russia</b>						
	<b>Factor Weights</b>	<b>Qualitative Scale</b>	<b>Score</b>			
Macro Level Indicator	0%		Ba2			
Economic Strength	25%	Moderate +				
Institutional Strength	50%	Low +				
Susceptibility to Event Risk	25%	High -				
Competitive Dynamics and Industry Fundamentals	100%		B			
Home Country Operating Environment Score			B2			
	<b>Factor Weights</b>			<b>Score</b>	<b>Comment</b>	
<b>Operating Environment Score</b>	<b>70%</b>			<b>B2</b>		
<b>ADJUSTED FINANCIAL PROFILE</b>				<b>Score</b>		
<b>Adjusted Financial Profile Score</b>				<b>Ba3</b>		
Financial Profile Weight	30%					
Operating Environment Weight	70%					
<b>Business Profile and Financial Policy</b>				<b>Adjustment</b>	<b>Comment</b>	
Business Diversification				-1	very high concentration on few large customers	
Opacity and Complexity				0		
Liquidity Management				0		
Corporate Behavior				-1	key-man risk	
<b>Total Business Profile and Financial Policy Adjustments</b>				<b>-2</b>		
					<b>Comment</b>	
<b>Sovereign or parent constraint</b>				<b>Ba2</b>		
<b>Standalone Assessment Range</b>				<b>B1 - B3</b>		
<b>Assigned Standalone Assessment</b>				<b>B2</b>		

Source: Moody's Financial Metrics

## Ratings

Exhibit 5

Category	Moody's Rating
<b>OMEGA FUNDS INVESTMENT LTD</b>	
Outlook	Stable
Issuer Rating	B2
ST Issuer Rating	NP

Source: Moody's Investors Service

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