

CREDIT OPINION

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Update

✓ Rate this Research

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Omega Funds Investment Ltd

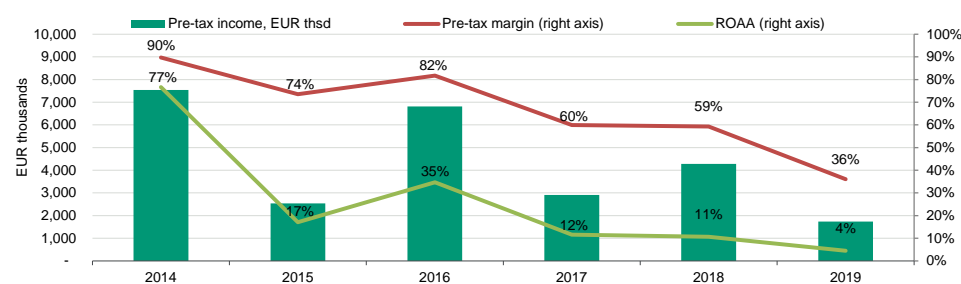
Annual update to credit analysis

Summary

We assign a B2 long-term issuer rating, with a stable outlook, to [Omega Funds Investment Ltd](#) (Omega). The rating is largely constrained by the company's small and undiversified franchise, with high concentration of business and revenue stream in few large customers, and key-man risk related to its shareholder. These concentrations render the company highly exposed to the operations of few large clients, making its earnings highly volatile. However, the rating is supported by Omega's ample capital buffer, robust liquidity position and sound profitability.

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
- » Highly volatile earnings

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 Funds Investment Ltd (Omega) is a small brokerage firm, with assets of about €18 million as of year-end 2019. 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 2019, Omega held financial instruments and cash on behalf of its clients with net market value of about €1.6 billion. The company recognises these amounts off balance sheet, based on IFRS and following its 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.

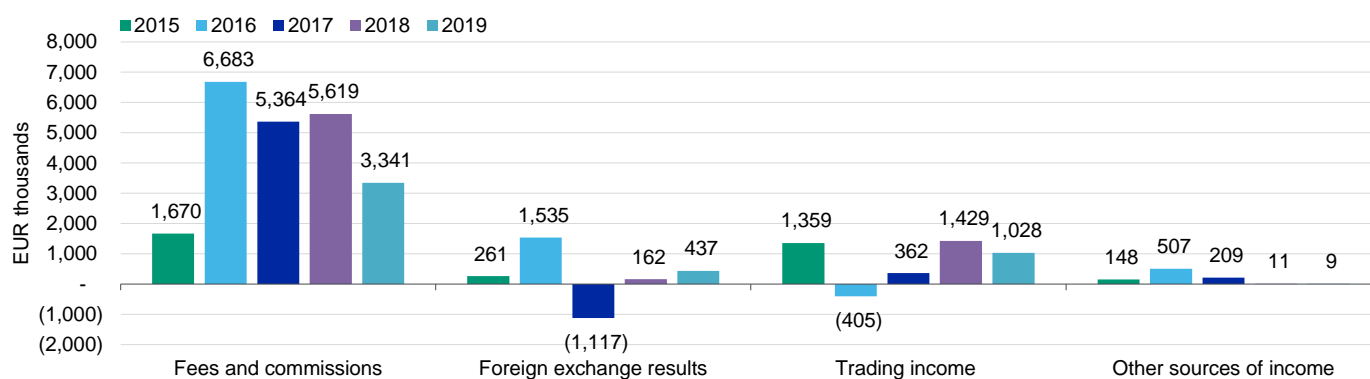
Detailed credit considerations

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

Omega is a relatively small brokerage firm, with pretax income of €1.7 million in 2019 (down from €4.3 million in 2018). 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

Omega's net financial result is highly volatile, largely because of volatile fee and commission income, which in turn depends on intensity and volume of client orders. In 2019, net revenue was weaker than a year earlier because of lower client activity. In addition, Omega

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reduced repo transactions, which also affected profit from deals on its own account. Concurrently, the company's operating expenses increased modestly by 5% from a year earlier, driven by staff costs, as well as professional fees and license expenses.

Omega's pre-tax margin has historically been strong, varying between 60% and 90%. In 2019, this margin shrank to 36%, but remained higher than the company's global peers. We assign a Pre-Tax Margin score of A2, given the recent revenue trends.

Based on management accounts for the first four months of 2020, we expect the company's revenue stream and bottom-line profitability to remain volatile through the rest of the year, given intense activity at its customers and the negative revaluation of its own position amid the dislocation of financial markets. 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 Caa3 because we give partial credit to our estimate of this metric based on interim management accounts, while the initial score penalises the company based on annual reporting.

Leverage and coverage: Good capital buffer and robust liquidity

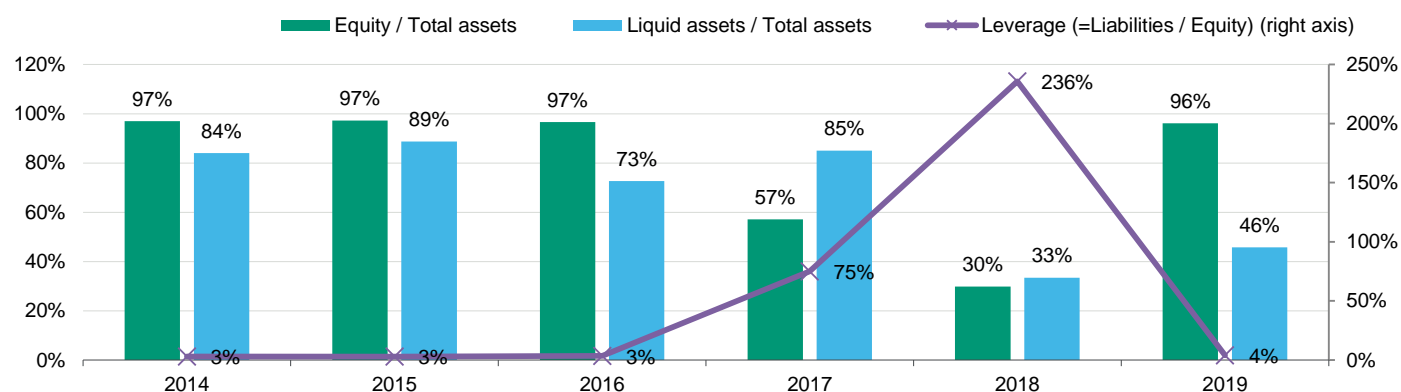
The company's leverage returned to single-digit range by year-end 2019 and amounted to 4% in terms of liabilities/equity following the contraction of repo transactions. Omega had no market debt issuance, but reported a drastic increase in its liabilities in 2017-18 referred to repos. Concurrently, Omega's equity-to-assets ratio declined to 30% as of year-end 2018 from 97% reported in 2014-16. Most of repo transactions were short-term arbitrage trades with similar terms, in particular, underlying asset and tenor. According to management accounts as of 30 April 2020, Omega's leverage remained broadly flat.

We believe that the company can increase leverage quickly, if needed, in case of attractive arbitrage deals. 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 drastically 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 its robust liquidity buffer. Its liquid assets accounted for 46% of total assets as of year-end 2019. As of 1 May 2020, the liquid buffer exceeded 60% of the company's assets. 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 IFRS reports

Business profile and financial policy

We adjust Omega's Ba3 Adjusted Financial Profile score downwards by one notch to incorporate qualitative assessments pertaining to business diversification. In the previous several 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.

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 it is for Cyprus, given the company's strong links with Russia via its sole shareholder Pavel Vashchenko; customers, many of which have Russian beneficiaries; trade of Russian securities and currency; and 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 before 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. However, none of these 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 a large number of small market participants operating in niche market segments and 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

Government support

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.

ESG considerations

In line with our general view for the securities industry, Omega has a low exposure to Environmental risks. See our [Environmental risk heatmaps](#) for further information.

In line with our general view for the securities industry, Omega has a low exposure to Social risks. See our [Social risk heatmaps](#) for further information.

Corporate governance is highly relevant for Omega, as it is to all securities companies. We adjust Omega's Ba3 Adjusted Financial Profile score downwards by one notch to incorporate qualitative assessments pertaining to key-man risk. Omega's boutique franchise highly depends on connections of its sole shareholder, rendering the company potentially vulnerable to any change in ownership or management. The corporate governance remains a key credit consideration given new emerging risks and continues to be a subject of our ongoing monitoring.

Methodology and scorecard

About Moody's Security Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement 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 November 2019. Please see the Rating Methodologies page on 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
Scale					
Pre-Tax Earnings (USD Million)	20%	-	-	Caa3	Revenue trend
Profitability					
Pre-Tax Margin	10%	-	-	A2	Revenue trend
Pre-Tax Margin Volatility	10%	-	-	Ba1	Other
Leverage and Coverage					
Debt/EBITDA	20%	-	-	Baa3	Stress resilience/susceptibility
(Retained Cash Flow-CapEx)/Debt	20%	-	-	Aaa	
EBITDA/Interest Expense	20%	-	-	Baa1	Stress resilience/susceptibility
Financial Profile Score	30%		A2	Baa2	
Operating Environment					
Russia	Factor Weights	Sub-factor Score	Score		
Macro Level Indicator	0%		Ba1		
Economic Strength	25%	baa2			
Institutions and Governance Strength	50%	ba3			
Susceptibility to Event Risk	25%	ba			
Competitive Dynamics and Industry Fundamentals	100%		B		
Home Country Operating Environment Score			B2		
	Factor Weights			Score	Comment
Operating Environment Score	70%			B2	
ADJUSTED FINANCIAL PROFILE				Score	
Adjusted Financial Profile Score				Ba3	
Financial Profile Weight	30%				
Operating Environment Weight	70%				
Business Profile and Financial Policy				Adjustment	Comment
Business Diversification				-1	very high concentration of few large customers
Opacity and Complexity				0	
Liquidity Management				0	
Corporate Behavior				-1	key-man risk
Total Business Profile and Financial Policy Adjustments				-2	
					Comment
Sovereign or parent constraint				Ba2	
Standalone Assessment Scorecard-indicated Range				B1 - B3	
Assigned Standalone Assessment					

Source: Moody's Investors Service

Ratings

Exhibit 5

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

Source: Moody's Investors Service

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