



The Pakistan Credit Rating Agency Limited

Rating Report

SME Leasing Limited

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
12-Jun-2018	B+	B	Stable	Maintain	-
24-Jul-2017	B+	B	Stable	Maintain	-
10-Jan-2017	B+	B	Stable	Initial	-

Rating Rationale and Key Rating Drivers

SME Leasing Limited is a non-deposit taking small leasing company. The company is majorly owned by SME Bank Limited (long-term rating “B-” with developing outlook by PACRA). The ratings of SME Leasing are mainly driven by its stand-alone risk profile due to distressed position of parent bank. SME Leasing maintains a weak business and financial profile given higher quantum of non-performing portfolio, deteriorating equity base due to business losses, inadequate funding profile, and low liquidity. The management is currently focused to make recoveries from delinquent portfolio. In the recent period since 2015, the company while following a cautious approach has managed to build asset quality book; thus gradual reduction in losses is targeted. Although contained, higher operational expenses remained a drag and resultant losses caused equity erosion. Low funding base, currently limited to a financing facility provided by the parent bank – SME Bank, is a key constraint in improvement in business profile. However, the management is in discussions with relevant stakeholders to explore options to increase the funding base and/or lower its finance cost by conversion of existing facility to preference shares. Upon availability of required funding, the management expects fast-track turnaround in performance, enabling the company to generate profits, with a build up of good quality asset book. However, materialization of these efforts is yet to be seen.

The management’s efforts to curtail the operational losses are important to continue. Meanwhile, improvement in asset quality is crucial. Fresh injection of funds would be required to strengthen the company’s business profile; this would also have positive implication on the ratings. However, any material deterioration in existing risk profile of the company would negatively impact the ratings.

Disclosure

Name of Rated Entity	SME Leasing Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Non-Banking Finance Companies(Jan-17)
Related Research	Sector Study Modaraba & NBFCs(Apr-18)
Rating Analysts	Farheen Farooq farheen.farooq@pacra.com +92-42-35869504 Jhangeer Hanif jhangeer@pacra.com +92-42-35869504

SME LEASING LIMITED

Incorporated	2002
Major Business	Leasing
Legal Status	Listed
Head Office	Karachi

INDUSTRY SNAPSHOT

- NBFCs include 8 Leasing Companies.
- Intense competition from established financial institutions (FIs) owing to small network and similar nature of products being offered by these FIs.

OWNERSHIP

- SMEL is majority owned by SME Bank Limited (~73%). Remaining shareholding is distributed among financial Institution (7.57%), general public (14.72%), and insurance & other companies, corporate bodies and trust etc. (4.56%).

PRIVATIZATION

- Government of Pakistan is in the process of divesting its equity stake (~94%) in SME Bank along with the management control.
- A number of parties submitted their applications containing expression of interest and statement of qualifications on April 7, 2017. In response to the Pakistan commission, only five parties have submitted the statement of qualification that had obtained documents at the initial stage.
- Later Government targets to complete the process before June 30, 2017.
- SBP will conduct the fit and proper and after evaluation of potential investors a bid will be convened.
- State Bank of Pakistan has incentivized the transaction to provide support to the potential investors.
- SME bank was hopeful to complete the process of privatization till June 2018 regarding privatization transaction. Pre-bidding process was delayed further.
- The major highlight is the reduction of minimum capital requirement to PKR 6bln, that would be built in a staggered manner with the initial injection of PKR 2bln and PKR 1bln each year for the next 4 years.
- The bank will be granted a specialized banking license by SBP requiring to it to maintain majority at least 60% of exposure to SME and remaining 40% towards commercial and retail sector.

GOVERNANCE & MANAGEMENT

- The Board of Directors (BoD) comprises seven members, including the Chief Executive Officer. The BoD constitutes three nominees of SME Bank.
- Ms. Mehnaz Saleem – MBA is the chairperson of the board. She is an entrepreneur and serving as CEO at Terry Tex International.
- The board has made three committees namely Audit committee, Risk Management Committee and Human Resource & Remuneration Committee which are chaired by independent/non-executive directors.
- Mr. Mir Javed Hashmat is the CEO of the company. Mr. Hashmat has diverse experience of over 4 decades in financial institutions.
- Two management committees in place to monitor the company affairs namely; i) Disbursement Committee and ii) Waiver committee.

BUSINESS RISK

- SMEL is well diversified in different sectors. Public transport vehicle leads the pack by 28%.
- SMEL has a less decrease in non performing book as evident by NPL/ Gross finances ratio (CY17:64.1%, CY16:65.9%, CY15:66.1%). Major portion of this book is not provided leading to a potential drag on equity (Loss Provision/Impaired Lending: CY17:52.5%; CY16: 49.1%, CY15: 44.2%).
- On account of higher operating cost and continuous provisioning, SMEL has been incurring losses since 2009.
- Due to cautious approach of the management new disbursements since CY15 are performing well and no loan has been transferred to non-performing loans.
- In CY17, though SMEL managed to have provisioning reversals owing to recoveries, however, significant operating expenses continued to remain a drag on the company's performance.
- Going forward, SMEL intends to focus on its recoveries to expand its book through recovery.
- The quantum of loss has gone up from PKR 13mln in CY16 to PKR 22mln in CY17. This happened due to fall in bank's income and absence of other income in CY17.

FINANCIAL RISK

- SMEL's sole source of funding is a running finance facility of PKR 150mln from parent bank.
- SME bank has a restriction of not providing any funding more than 7.5% of its equity to related party (SMEL). Thus, SMEL's dependence on SME Bank remains very critical. However, SBP granted exemption to SMEBL from this requirement till June 2018.



The Pakistan Credit Rating Agency Limited

Financial Summary

SME Leasing Limited

BALANCE SHEET

	31-Dec-17	31-Dec-16	31-Dec-15
Assets			
Loans & Finances	21	19	21
Net Investment in Finance Lease	303	304	321
Operating Lease Assets	0	0	0
TFCs	0	0	0
Investments	0	0	4
Other Assets	154	180	222
Non-Performing Finances	297	321	358
<i>Less: Accumulated provision (specific/prudential)</i>	<i>(156)</i>	<i>(158)</i>	<i>(158)</i>
Total Assets	478	504	568
Liabilities			
Certificates of Investment	0	0	0
Security Deposits	212	220	241
Borrowings	111	106	131
Other Liabilities	21	21	21
Equity			
Total Equity	133	157	174
TOTAL LIABILITIES & EQUITY	478	504	568
INCOME STATEMENT			
Net Interest Revenue	16	19	10
Other Income	1	5	0
Operating Expenses	(41)	(38)	(37)
Pre-Provision Operating Profit	(24)	(14)	(27)
(Provision)/Reversals	1	1	6
Share of Profit of Associates	0	0	0
Net Income	(23)	(13)	(17)
Ratio Analysis			
Cost-to-Total Net Revenue	248%	197%	370%
Equity / Total Assets	28%	31%	31%
Impaired Lending / Gross Finances	64%	66%	66%
Loan Loss Provisions / Impaired Lending	25%	24%	23%

SME Leasing Limited

May-17



ENTITY CREDIT RATING SCALE & DEFINITIONS

Credit rating reflects forward-looking opinion on credit worthiness of underlying entity; 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. 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.	
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.		
AA	Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.		
AA-			
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.		
A			
A-			
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 or economic conditions are more likely to impair this capacity.		
BBB			
BBB-			
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.		
BB			
BB-			
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.		
B			
B-			
CCC	Very high 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.		
CC			
C			
D	Obligations are currently in default.		
Rating Watch	Outlook (Stable, Positive, Negative, Developing)	Suspension	Withdrawn
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. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled.	Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business or 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'.	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, a suspended rating should be considered 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, or e) the entity/issuer defaults.
Disclaimer: PACRA's rating is an assessment of the credit standing of an entity/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

Restrictions

- (3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
- (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)

Independence & Conflict of interest

- (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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