The Pakistan Credit Rating Agency Limited

Rating Report

SME Leasing Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Apr-2022	B-	A4	Negative	Maintain	Yes
06-Apr-2021	B-	A4	Negative	Downgrade	Yes
06-Apr-2020	B	B	Negative	Maintain	Yes
30-Sep-2019	B	B	Negative	Maintain	Yes
16-May-2019	B	B	Negative	Downgrade	Yes
29-Nov-2018	B+	B	Negative	Maintain	Yes
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 leasing Company and is majorly owned by SME Bank Limited. SME Leasing maintains a weak business and financial profile given the higher quantum of a non-performing portfolio, continuously depleting equity base, now almost eroded, due to business losses, inadequate funding profile and low liquidity. The equity has gone below the Minimum Capital Requirement. The management has been trying to boost the profitability to bring sustainability to SME Leasing but funding constraint remained a major obstacle in converting the Company into a profit-making institute. Mr. Asghar Maqsood has been working as acting CEO from July 2020 to Dec 2021 and as the full time CEO since January 2022. During CY21, the Company recovered PKR 83mln of which PKR 51mln pertained to chronic NPLs and also disbursed new loans of PKR 18mln from the recoveries. 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 through fresh equity injection. Upon availability of required funding, the company expects a turnaround in performance, enabling the company to generate profits, with a build-up of good quality asset book. However, a materialization of these efforts is yet to be seen. Further, enhancement in equity levels is drastically required.

The company’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 a 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 Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Modaraba & NBFCs(Apr-21)
Rating Analysts	Muhammad Noor Ul Haq | noorulhaq@pacra.com | +92-42-35869504

Profile

Structure SME Leasing Limited (SLL) is a Non-Banking Financial Institution which is listed on the Pakistan Stock Exchange in 2006 with a trading symbol of SLL.

Background SLL was incorporated in 2002 as a result of demerger of the leasing division of SME bank and a subsidiary company of SME Bank Limited. In July 2016, subsequent to management's decision to continue as a non-deposit taking company, SLL obtained a license from SECP to carry out leasing business.

Operations With a network of 6 branches situated in 6 cities across Pakistan, SLL is engaged in facilitating the small and medium size business man, traders, professionals, and educationists to advise & support their financial needs (loans and finance lease). The company is excercising a very cautious approch in its business with the objective of minimizing risk of default. The company has also been managing its expenses in order to curtail its losses to the minimum possible. The core objective of the company is to extend lease and working capital financing facilities to small and medium enterprises of the country.

Ownership

Ownership Structure SLL is majorly held by SME Bank, which constitutes 73.14% shareholding. Remaining shareholding is distributed among financial Institution (7.57%), general public (14.24%), and insurance & other companies, corporate bodies and trust etc. (4.88%).

Stability SLL is primarily dependent on the running finance facility of the SME Bank Limited although the Bank itself is in a dire condition and incurring losses since 2009. The respective factors indicate the existence of a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern.

Business Acumen The Federal Government through Ministry of Finance occupies ~94% stake in the parent company (SME Bank). The Bank has the requisite skill set which is necessary for sustainable success of any entity.

Financial Strength SLL is owned by SME Bank Limited and the Govt. of Pakistan is the major Shareholder of the Bank. Bank has asset base of PKR 9.9bln as at Dec-20 (Dec-19: PKR 10.2bln).

Governance

Board Structure The Board of Directors (BOD) comprises seven members, including the CEO. It constitutes of three nominees of SMEBL and three independent directors. The board also has the representation of one female director.

Members' Profile The CEO, Mr. Asghar Maqsood has experience of over 25 years in leasing industry and has been associated with SLL for over 20 years. Prior to SLL he has served at First Leasing Corporation Ltd.

Board Effectiveness The board has made five committees namely Audit committee, Risk Management Committee, Human Resource & Remuneration Committee, Procurement Committee and Nomination Committee which are chaired by independent/non-executive directors and minutes of the meetings are well documented. The performance of the board was evaluated as required under the regulations and effectively plays its oversight function through the various meetings held during the year.

Financial Transparency The Board of SLL has appointed BDO Ebrahim & Co., Chartered Accountants, as statutory auditors of the Company for the year 2021, the auditors have drawn attention towards the growing accumulated losses. This is a serious observation and needs to be addressed.

Management

Organizational Structure SLL has a distinct organizational structure. There are seven key departments who report directly to CEO namely; (i) Finance (ii) Compliance (iii) Credit Admin Department (iv) Legal Affairs Department (v) HR & Administration Department and (vi) Operations Department and (vii) Risk Department.

Management Team There are currently three management committees in place, namely (i) Credit Committee, (ii) Waiver Committee and (iii) Management Committee. Credit Committee deals with disbursement and Waiver Committee deals with recoveries and write offs of loans.

Effectiveness Function of the management committees are clear and well defined to adequately accomplish the goals and objectives set out by the board and higher management. Further, it oversees to ensure that appropriately designed internal control framework is in place and routinely tested to address top risks.

MIS SLL lends mainly to the corporate & SME segment. This requires in-depth credit evaluation and effective monitoring as most of the small corporates and SMEs lack extensive control system. The absence of publicly available information makes the credit evaluation process more challenging.

Risk Management Framework The board of directors is responsible for establishing and monitoring risk management framework. Various sub-committees of the board and management are involved in ensuring effective implementation of the risk management policies. The company regularly undergoes a process of continuously assessing and revising its risk management policies in line with changing market dynamics.

Business Risk

Industry Dynamics The business environment in Pakistan remained challenging. The current political environment caused uncertainty, particularly in corporate sector. Automobile sector has shown unprecedented growth; disbursements in vehicles have augmented due to the stable interest rate regime.

Relative Position SLL is ranked in top 5 leasing companies on the basis of Assets. SLL's performance during the year continued to be weak due to the higher administrative & finance costs and stiff competition from other Islamic non-banking financial institutions.

Revenues The gross revenue from operations slightly diluted (CY21: PKR 21.3mln; CY20: PKR 21.6mln) due to the stagnant economic activities and lower policy rate compared to last year. During CY21, limited availability of funds adversely affected the writing of new business.

Performance Net Loss of the Company for the year decreased by 77% YoY to PKR 13.4mln. This came on back of reversal of provisions against potential lease losses and loans due to recovery of PKR 51mln from chronic NPLs.

Sustainability Going forward, SLL intends to focus on its strategy of recoveries from its portfolio and writing new good quality leases with the target of minimum default. With recent increase in policy rate compared with last year low interest rate, SLL foresees a challenging period ahead before the economy settles down.

Financial Risk

Credit Risk The SLL's policy is to enter into financial contracts in accordance with the internal risk management policies and the requirements of the NBFC's Rules and Regulations. SLL is struggling to manage credit risk and its concentration through diversification of activities to avoid undue concentration of risk with corporations and specific industry segments.

Market Risk SLL is focusing on core financing business and has no exposure to equity/debt investment. Consequently, SLL is exposed to interest rate and other price risk only. Further, the company manages the market risk by monitoring exposure on marketable securities by following internal risk management policies and regulations laid down by the SECP.

Liquidity And Funding The main source of funding is dependent on the running finance facility granted by the holding company. The funding line availed from holding company/parent bank amounts to PKR 150mln.

Capitalization Due to continuous loss and a sustained number of high non-performing loans, leases and finances SLL's equity is eroding at a faster rate lately. Resultantly it has a highly leveraged capital structure CY21: 29.7 (CY20: 11.1, CY19: 2.8, CY18: 1.7).

PKR mln

SME Leasing Limited	Dec-21	Dec-20	Dec-19	Dec-18
Listed Public Limited	12M	12M	12M	12M
A BALANCE SHEET				
1 Total Finance-net	430	507	562	595
2 Investments	-	-	-	-
3 Other Earning Assets	-	0	0	0
4 Non-Earning Assets	18	21	23	17
5 Non-Performing Finances-net	(101)	(122)	(103)	(103)
Total Assets	347	406	482	509
6 Funding	324	361	381	374
7 Other Liabilities	16	25	23	24
Total Liabilities	340	386	405	397
Equity	7	20	77	112
B INCOME STATEMENT				
1 Mark Up Earned	21	22	27	31
2 Mark Up Expensed	(18)	(22)	(22)	(14)
3 Non Mark Up Income	0	0	0	0
Total Income	3	0	4	17
4 Non-Mark Up Expenses	(44)	(44)	(44)	(44)
5 Provisions/Write offs/Reversals	28	(14)	5	6
Pre-Tax Profit	(13)	(57)	(35)	(21)
6 Taxes	(0)	(0)	(0)	(0)
Profit After Tax	(13)	(58)	(36)	(21)
C RATIO ANALYSIS				
1 PERFORMANCE				
a Non-Mark Up Expenses / Total Income	1518.2%	11344.8%	1074.1%	256.3%
b ROE	-102.7%	-119.3%	-37.8%	-19.1%
2 CREDIT RISK				
a Gross Finances (Total Finance-net + Non-Performing Advances + Non-Performing Debt Instruments) / Funding	144.7%	151.1%	158.5%	172.0%
b Accumulated Provisions / Non-Performing Advances	359.8%	419.4%	337.8%	314.9%
3 FUNDING & LIQUIDITY				
a Liquid Assets / Funding	1.0%	0.5%	0.2%	1.6%
b Borrowings from Banks and Other Financial Institutes / Funding	0.0%	0.0%	0.0%	0.0%
4 MARKET RISK				
a Investments / Equity	0.0%	0.0%	0.0%	0.0%
b (Equity Investments + Related Party) / Equity	0.0%	0.0%	0.0%	0.0%
5 CAPITALIZATION				
a Equity / Total Assets (D+E+F)	1.9%	4.8%	16.0%	21.9%
b Capital formation rate (Profit After Tax + Cash Dividend) / Equity	-68.5%	-74.8%	-32.0%	N/A

Credit Rating

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.

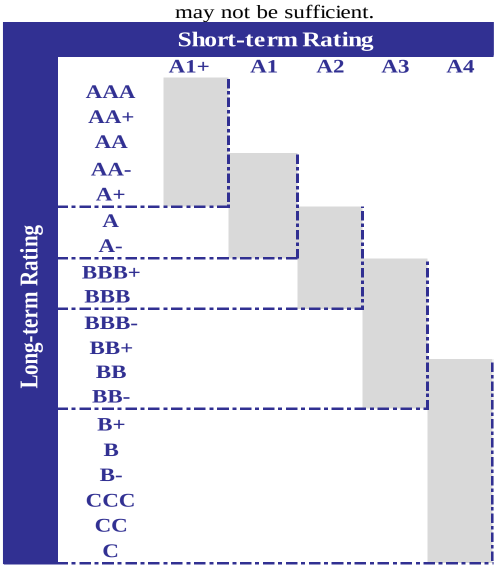
Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
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.
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.
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.
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+ 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.
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.

Short-term Rating

Scale	Definition
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
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.

Short-term Rating



**The correlation shown is indicative and, in certain cases, may not hold.*

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 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.

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) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

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

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.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure

(Credit Rating Companies Regulations,2016)

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)

Proprietary Information