



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
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, deteriorating equity base due to business losses, inadequate funding profile and low liquidity. 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. Since March 2019 after the retirement of the CEO, an independent director is working as an acting CEO. 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 an existing facility to preference shares. The gap between the equity base and MCR has narrowed, to stay above MCR is critical. 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.

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	PACRA_Methodology_NBFC(Jun-19),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-19),Criteria Rating Modifier(Jun-19)
Related Research	Sector Study Modaraba & NBFCs(Mar-19)
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Profile

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

Background SME Leasing Limited (SLL) was incorporated in 2002 as a result of a 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 had a license from SECP to carry out leasing business. Thus, SLL is fully compliant with the minimum equity requirement of PKR 50mln.

Operations With a network comprising of a main office in Karachi and 5 branches situated in 5 cities across Pakistan, SME Leasing Limited is engaged in facilitating the small and medium size businessman, traders, professionals, and educationists to advise & support their financial needs (loans and finance lease). The company is exercising a very cautious approach in its business with the objective of minimizing the 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 Institutions (7.57%), the general public (14.24%), and insurance & other companies, corporate bodies, trust and 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. The GOP decided to privatize the bank and due diligence exercise was conducted. There has been progressing since then in this regard and they are confident to complete this procedure at the earliest.

Business Acumen The Federal Government through the Ministry of Finance occupies a ~94% stake in the parent company (SME Bank), therefore the sponsor's business acumen is considered good.

Financial Strength SLL is owned by SME Bank Limited and the Govt. of Pakistan is the major shareholder of the bank. Bank has an asset base of PKR 9.6bln as of Dec18 and equity of PKR (1.7) bln.

Governance

Board Structure The Board of Directors (BOD) comprises seven members, including the acting Chief Executive Officer. It constitutes three nominees of SMEBL. The remaining members are independent directors.

Members' Profile Acting CEO, Mr Abdul Waseem has experience of over 3 decades in banking and financial sectors. Prior to SLL, he has served at key positions at HBL and Askari Bank.

Board Effectiveness 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 and minutes of the meetings are 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 M/S Grant Thornton Anjum Rehman Chartered Accountants, as statutory auditors of the Company for the year 2019, the auditors have drawn attention towards the growing accumulated losses. This is serious observation and needs to be addressed.

Management

Organizational Structure SLL has a distinct organizational structure. There are five key departments wherein a clear line of responsibility is defined for each cadre.

Management Team There are currently two management committees in place, namely i) Credit Committee, ii) Waiver Committee. Credit Committee deals with disbursement and the waiver committee deals with recoveries and write-offs of loans.

Effectiveness The 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 an 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 Co regularly undergoes a process of continuously assessing and revising its risk management policies in line with changing market dynamics. The Committee reports regularly to the Board of Directors on its activities.

Business Risk

Industry Dynamics The business environment in the country remained challenging, measures taken by the Government towards economic stabilisation has impacted overall business sentiments. The slowdown in the economy has affected the demand for leasing. The transportation sector has been under strain and disbursements in commercial vehicle business were reduced. The cost of doing business has risen and investment finance companies continued to face stiff competition from banks.

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

Revenues The gross revenue from operations diluted (9MCY19: PKR 20mln; 9MCY18: PKR 24mln) due to the stagnant economic activities and higher policy rate. During the period 9MCY19, limited availability of funds adversely affected the writing of new business. The management has remained focused on recovery from its portfolio. Therefore the quantum of loss further increased to PKR 21mln (9MCY18: PKR 15mln).

Performance Asset quality indicators remained stressed with the majority of the portfolio being classified. On account of higher operating cost and continuous provisioning, SLL has been incurring losses since 2009. During nine month of CY19, though SLL managed to have provisioning reversals owing to recoveries, however, significant operating expenses continued to remain a drag on the company's performance.

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. Due to a cautious approach and limited availability of funds adversely affected the writing of new quality business. Meanwhile, the privatization of SME Bank will remain important.

Financial Risk

Credit Risk SLL's struggling to manage credit risk and its concentration through diversification of activities to avoid undue concentration of risk with corporations and specific industry segments. As at end-Sep19 Plant & Machinery share in total portfolio was the largest (~55%) followed by commercial vehicles (~19%) and others (~25%). In terms of sectoral distribution, SLL is diversified as Public Transport Vehicles leads the way by standing at 14%, Printing and Packaging 10%, while others hold with 76% share.

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.

Liquidity And Funding In CY13 SECP disallowed SLL to raise funds by issuing certificates of deposits mainly due to non-compliance with minimum equity requirements. Since then 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. The revised Prudential Regulation of SBP applicable from June 2015 has restricted the exposure of the bank to a related party to the extent of 7.5% of its equity.

Capitalization Due to continuous loss and a sustained number of high non-performing loans, leases and finances SLL's equity is eroding though at a slower rate lately. Resultantly it has a highly leveraged capital structure 9MCY19: 1.6 (CY18:1.3; CY17: 0.8).



The Pakistan Credit Rating Agency Limited

Financial Summary

PKR (mln)

SME Leasing Limited

BALANCE SHEET	30-Sep-19	31-Dec-18	31-Dec-17	31-Dec-16
	9MCY19*	CY18	CY 17	CY16
Assets				
Loans & Finances	29	29	20	19
Net Investment in Finance Lease	390	417	299	304
Operating Lease Assets	-	-	-	-
TFCs	-	-	-	-
Investments	-	-	-	-
Other Non Earning Assets	14	16	12	17
Non-Performing Finances	212	197	302	321
Less: Accumulated provision (specific/prudential)	(147)	(151)	(156)	(158)
Total Assets	499	509	478	505
Liabilities				
Certificates of Investment	-	-	-	-
Security Deposits	239	231	212	220
Borrowings	148	143	111	106
Other Liabilities	21	24	21	21
Equity				
Total Equity	90	112	133	157
TOTAL LIABILITIES & EQUITY	499	509	478	505
INCOME STATEMENT				
Net Interest Revenue	6	17	16	19
Other Income	0	0	1	5
Operating Expenses	(30)	(43)	(38)	(38)
Pre-Provision Operating Profit	(24)	(26)	(21)	(14)
(Provision)/Reversals	4	6	1	1
Share of Profit of Associates	-	-	-	-
Net Income	(20)	(21)	(20)	(13)
Ratio Analysis				
Equity / Total Assets	18%	22%	28%	31%
Impaired Lending / Gross Finances	44%	40%	65%	66%
Loan Loss Provisions / Impaired Lending	23%	23%	25%	24%

* Unaudited

SME Leasing Limited

Apr-20

Credit Rating Scale & Definitions

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 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.
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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

Disclaimer: PACRA’s ratings are an assessment of the credit standing of entities/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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