The Pakistan Credit Rating Agency Limited

SME LEASING LIMITED

	Initial Rating [Jan-17]
Long-Term	B+
Short-Term	B
Outlook	Stable

Report contents

JANUARY 2017

Profile &Ownership

- SME Leasing Limited (SMEL), incorporated in 2002, SMEL has a network of 6 branches spread across 6 cities. SMEL is Listed on Pakistan Stock Exchange.
- SMEL is majority owned by SME Bank Limited (~73.1%).
- SME Bank Limited (SMEBL), incorporated in October 2001, commenced commercial banking operations in 2005 with a network of 13 branches at end Sep16. PACRA has rated SMEBL at B/B in April 2016.
- During CY16, SME leasing was granted leasing license by SECP for three years.
- SMEL mainly lends in two categories i) loans and ii) finance leases.

Governance

- The Board of Directors (BoD) comprises seven members, including the Chief Executive Officer while one board position is vacant. The BoD constitutes two nominees of SME Bank and three independent directors.
- 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 two committees namely Audit committee and Human Resource Committee which are chaired by independent directors.

Management

- Mr. 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.

Risk Management

- Top 20 concentration in financing book is low (9MCY16: 8%; CY15: 8%)
- SMEL is well diversified in different sectors. Public transport vehicle leads the pack by 15%.
- SMEL has a significant non performing book as evident by NPL/ Gross finances ratio (9MCY16: 66.8%, CY15: 66.1%, CY14: 46.3.%). Sizeable portion of this book is not provided leading to a potential drag on equity (Loss Provision/Impaired Lending : 9MCY16: 45.2%, CY15: 44.2%, CY14 56.3%).

Performance

- 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 CY15 and 9MCY16, 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.

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 has granted exemption to SMEBL from this requirement till June 2017.
- Liquidity management and arrangement of finance other than RF line from SMEBL remains important.

RATING RATIONALE

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 negative 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 to reduce the quantum of loss. Moreover, in the recent period since 2015, the company while following a cautious approach has managed to build good asset quality book. Although contained, higher operational expenses remained a cause of loss, in turn, 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 to enable the company to grow its good assets and/or lower its finance cost by conversion of existing facility to preference shares. Although it may help in recovering from continuous losses, materialization of these efforts is yet to be seen.

KEY RATING DRIVERS

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.

Leasing

The Pakistan Credit Rating Agency Limited

Financials (Summary)

SME Leasing Limited

PKR mln

BALANCE SHEET	30-Sep-16	31-Dec-15	31-Dec-14	31-Dec-13
	9MCY16	CY15	CY14	CY13
Assets				
Loans & Finances	25	21	61	11
Net Investment in Finance Lease	302	321	442	368
Operating Lease Assets	-	-	-	-
TFCs	-	-	-	-
Investments	-	4	3	4
Other Assets	19	22	25	25
Non-Performing Finances	344	358	292	294
Less: Accumulated provision (specific/prudential)	(156)	(158)	(164)	(160)
Total Assets	**534**	**568**	**658**	**542**
Liabilities				
Certificates of Investment	-	-	-	0
Security Deposits	226	241	272	274
Borrowings	121	131	162	44
Other Liabilities	20	21	34	24
Equity				
Total Equity	167	171	188	200
TOTAL LIABILITIES & EQUITY	**534**	**568**	**658**	**542**
INCOME STATEMENT				
Net Interest Revenue	15	10	30	19
Other Income	4	0	0	2
Operating Expenses	(26)	(37)	(38)	(29)
Pre-Provision Operating Profit	(7)	(27)	(8)	(8)
(Provision)/Reversals	3	6	(2)	1
Share of Profit of Associates	-	-	-	-
Net Income	**(4)**	**(17)**	**(11)**	**(8)**
Ratio Analysis				
Cost-to-Total Net Revenue	171.3%	369.8%	128.5%	156.1%
Equity / Total Assets	31.3%	30.7%	28.9%	37.0%
Impaired Lending / Gross Finances	66.8%	66.1%	46.3%	57.8%
Loan Loss Provisions / Impaired Lending	45.2%	44.2%	56.3%	54.7%

STANDARD RATING SCALES & 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

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 or 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.** "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 Ratings

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.

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. 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.

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'.

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, a suspended 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, or e) the entity/issuer defaults.

Regulatory and Supplementary Disclosure	

Name of Rated Entity	SME Leasing Limited
Sector	Leasing
Type of Relationship	Solicited
Purpose of the Rating	Independent Risk Assessment
Related Criteria and Research	
Rating Methodology	Bank Rating Methodology
Sector Research	Leasing Sector - Viewpoint | Dec16
Rating Analysts	Aisha Khalid aisha@pacra.com (92-42-35869504) Rana Nadeem Nadeem@pacra.com (92-42-35869504)

Rating Team Statement

Rating Procedure

Rating is an opinion on relative credit worthiness of an entity or debt instrument. It does not constitute recommendation to buy, hold or sell any security. The rating team for this assignment does not have any beneficial interest, direct or indirect in the rated entity/instrument.

Disclaimer

Rating Shopping

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Surveillance

PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the rated entity/ issuer, the security arrangement, the industry etc, is disseminated to the market, in a timely and effective manner, after appropriate consultation with the entity/issuer

PACRA reviews all the outstanding ratings on annual basis or as and when required by any stakeholder (including creditor) or upon the occurrence of such an event which requires to do so

PACRA initiates immediate review of the outstanding rating(s) upon becoming aware of any information that may be reasonable be expected to result in any change (including downgrade) in the rating

Reporting of Misconduct

PACRA has framed and implemented whistle-blower policy encouraging all employees to intimate the compliance officer any unethical practice or misconduct relating to the credit rating by another employees of the company that came to his/her knowledge. The Compliance Officer reports to the BoD and SECP

Confidentiality

PACRA has framed a confidentiality policy to prevent abuse of the non-public information by its employees and other persons involved in the rating process, sharing and dissemination of the non-public information by such persons to outside parties

Where feasible and appropriate, prior to issuing or revising a rating, PACRA informs the issuer of the critical information and principal considerations upon which a rating will be based and provide the opportunity to clarify any likely factual misperception or other matter that PACRA would wish to be made aware of in order to produce a fair rating. PACRA duly evaluates the response. Where in a particular circumstance PACRA has not informed the entity/issuer prior to issuing or revising a rating, it informs the entity/issuer as soon as practical thereafter

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Probability of Default (PD)

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