The Pakistan Credit Rating Agency Limited

Security & Management Services (Pvt.) Limited

	NEW [DEC-16]	PREVIOUS [DEC-15]
Entity		
Long Term	BBB	BBB+
Short Term	A3	A2
Outlook	Stable	Stable

REPORT CONTENTS

DECEMBER 2016

Profile

- SMS is one of the largest manned guarding security company in Pakistan, with guard force of 6,593. The guarding services of SMS can be broadly categorized into stationary guards, mobile patrol, VIP guards, executive protection services, escort and vehicles protection, reception services, route vehicles control, event security and security training. The company caters the needs of banks, corporates, government organizations and high profile clients, including US Embassy clos protection and UN Agencies.

Ownership

- SMS's ownership is considered strong. Mr. Ikram ul-Majeed Sehgal, the major shareholder of SMS, is one of the pioneers in the field of security services in the country. His Army background and representation on multiple local and international platforms related to security services provides SMS with a competitive edge. Mr. Zarrar Sehgal, the eldest son of Mr. Ikram ul-Majeed Sehgal, has been identified as the successor. He monitors group business at strategic level.

Governance & Management

- The board's size has increased to seven members from three. It is a family dominated Board, with room for improvement in terms of independent representation.
- The overall control of the company vests in seven member board of directors, including Mr. Ikram ul-Majeed Sehgal, who is the Chairman and CEO of the company. Mr. Zarrar Sehgal (Deputy Chairman), Ms. Kashmala Sehgal, Ms. Haya Sehgal and Ms. Nefer Sehgal joined the Board in FY16. The Board comprises six directors from the sponsoring family. The size of board commensurate with the operations of SMS.
- The management team comprises professionals with industry knowledge and proven track record. SMS has a team of experienced professionals, most of whom have been associated with the company for a long period. SMS's organizational structure is robust, with multiple tiers for check and balance

Performance

- The consolidation of business has increased the customer base of SMS. However, US Embassy contract still remains the major contributor to the revenue. This contract is based on open tender and is renewed after every 5 years. The renewal is upcoming in March, 2017. There is low risk of switching due to lengthy due diligence process.
- The revenue from manned guarding business has declined mainly due to loss of guarding contracts. The significant increase in operational cost and transfer of low value clients from WPPL has diluted the margins of SMS. At the same time, the hike in the operational costs has not yet been passed to the clients further impacting the margins. Consequently, the company incurred operating losses.
- Company's revenue witnessed hefty growth of 30.4% in FY16 (FY15:-4.1%), due to transfer of sizeable manned guarding business from WPPL. The revenue from manned guarding business has declined mainly due to loss of guarding contracts.
- SMS provides largely customized services to select clients having highly specialized security needs. This precludes competition to a large extent

Working Capital & Cash Flow

- The company receivables are mainly a function of its support to the associated concerns of the group. The total receivables from the associated companies witnessed an increase of 76% (FY16: PKR 430mln, FY15: PKR 329mln).
- The increase is mainly due to a loan of PKR 292mln to WWPL and other associated companies. The company's cashflows declined significantly owing to the loss incurred during the year, negatively impacting the coverages.

Capital Structure

- The company has a moderately leveraged capital structure (FY16: 27%, FY15: 22%).
- Total debt on SMS balance sheet is PKR 92mln as at end Jun-16. The increase in leveraging of the company is mainly due to further procurement of debt on its balance sheet for financing its provident fund liability.
- The management expects However, to manage the increasing inter-group borrowing there is a need for formal policy.

RATING RATIONALE

The restructuring at the group level resulted in a consolidation of man guarding business with SMS. There is softening in the margins owing to intense competition in the man guarding industry. At the same time the cost hike has not yet been passed to the clients, impacting current year profitability. The loss making man guarding segment of WPPL dominated the profitable high end contracts of SMS resulting in a negative bottom line for the company. The management is aiming the strategy to offload the loss making contracts and focus on high end profitable business cases. Meanwhile, efforts are underway to revise contract privacy upward. The company's efforts to capitalize on the Pathfinder Group's vision of offering a comprehensive set of security solutions through its dedicated companies would add value.

KEY RATING DRIVERS

The rating of the company is dependent upon its ability to retain the high end profitable contracts. The company's ability to successfully revamp its business strategy to sustain pressure on margins of guarding business and generates profits remains important.

INDUSTRY

Security services industry in Pakistan is in the development stage. In contrast to global practices, it is segmented with over 400 companies. Of these, only 217 are registered with All Pakistan Security Agency Association (APSAA). It is a strategically important industry, employing over 2000,000 individuals and a major source of employment for retired law enforcement personnel. The target market for the industry is mainly banks, corporate businesses and foreign missions. There is high geographical concentration, whereby most of the established security agencies are based in major cities only. The industry with two major segments – manned guarding (80%) and cash business (20%) is following an oligopolistic stance where there are dominant players in both segments.

PKR mln

Security & Management Services (Pvt.) Limited

	30-Jun-16	30-Jun-15	30-Jun-14
BALANCE SHEET	**Annual**	**Annual**	**Annual**
Non-Current Assets	**161**	**169**	**227**
Current Assets	**684**	**550**	**465**
Trade Receivables	97	76	175
Due from Associates	430	329	211
Others	157	145	78
Total Assets	**845**	**719**	**692**
Debt	**100**	**100**	**24**
Long-term (Incl. Current Maturity of long-term debt)	100	100	24
Other Liabilities	480	267	407
Shareholder's Equity	**265**	**352**	**261**
Total Liabilities & Equity	**845**	**719**	**692**
INCOME STATEMENT			
Turnover	**1,847**	**1,416**	**1,477**
Gross Profit	175	254	243
Net Income	**(28)**	**91**	**55**
EBITDA	17	148	112
FCFO	(11)	137	105
RATIO ANALYSIS			
Performance			
Turnover Growth	30.4%	-4.1%	13.0%
Gross Margin	9.5%	17.9%	16.4%
Net Margin	-1.5%	6.4%	3.7%
Leverage (Total Debt/Total Debt+Equity)	27.4%	22.1%	8.5%
Coverages			
Interest Coverage (FCFO/Gross Interest)	-0.7	18.9	23.2
Debt Coverage (FCFO/Gross Interest+CMLTD+Uncovered Total STB)	-0.5	9.4	3.7

The Pakistan Credit Rating Agency Limited

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 Issuer — Security & Management Services (Pvt.) Limited
Sector — Security
Type of Relationship — Solicited

Purpose of the Rating — Independent Risk Assessment

Rating History

Date	Long Term	Short Term	Outlook	Action
31-Dec-16	BBB	A3	Stable	Downgrade
31-Dec-15	BBB+	A2	Stable	Maintain
29-Apr-15	BBB+	A2	Stable	Initial

Related Criteria and Research

Rating Methodology — Corporate Rating Methodology

Rating Analysts

Rai Aman Zafar
aman.zafar@pacra.com
(92-42-35869504)

Rai Umar Zafar
rai.umar@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
PACRA maintains principle of integrity in seeking rating business.
PACRA has used due care in preparation of this document. Our information has been obtained directly from the underlying entity and public sources we consider to be reliable

but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information.
Conflict of Interest
PACRA, the analysts involved in the rating process, and members of its rating committee do not have any conflict of interest relating to the credit rating done by them
The analysts involved in the rating process do not have any interest in a credit rating or any of its family members has any such interest
The analysts and members of the rating committees including the external member members have disclosed all the conflict of interest, including those of their family members, if any, to the Compliance Officer PACRA
The analysts or any of its family members do not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This is, however, not applicable on investment in securities through collective investment schemes. PACRA has established appropriate policies governing investments and trading in securities by its employees
PACRA may provide consultancy/advisory services or other services to any of its clients or to any of its clients' associated companies and associated undertakings that is being rated or has been rated by it. In such cases, PACRA has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities
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 ii) fee mandate - signed with the payer, which can be different from the entity
PACRA ensures that the credit rating assigned to an entity or instrument should 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
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
Prohibition

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