RATING REPORT

Pak-Gulf Leasing Company Limited (PGLC)

REPORT DATE:
September 01, 2021

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	A-	A-2	A-	A-2
Rating Outlook	Negative		Stable	
Rating Date	*September 01, 2021*		*July 07, 2020*	

COMPANY INFORMATION

Incorporated in 1994	**External Auditors:** M/s. Grant Thornton Anjum Rahman Chartered Accountants
Public Listed Company	**Chairman of the Board**: Mr. Sohail Inam Ellahi
Key Shareholders (with stake 5% or more):	**Chief Executive Officer**: Mr. Mahfuz ur Rehman Pasha
Mr. Pervez Inam – 15.58%	
Mr. Muhammad Ali Pervez – 14.26%	
Mr. Hassan Sohail – 14.26%	
Mr. Sohail Inam Ellahi – 9.66%	
Mr. Javed Inam Ellahi – 6.66%	
Unibro Industries Ltd – 5.91%	
Mr. Fawad S Malik – 5.32%	
Mid East Agencies (Pvt.) Ltd – 5.07%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria: Non-Bank Financial Companies (March 2020)
http://vis.com.pk/kc-meth.aspx

Pak Gulf Leasing Company Limited (PGLC)

OVERVIEW OF THE INSTITUTION

Pak-Gulf Leasing Company Limited (PGLC) was incorporated in 1994 as a public limited company and commenced operations from September 16, 1996. Financial statements for FY20 have been audited by M/s Grant Thornton Anjum Rahman Chartered Accountants

Profile of Chairman:

Mr. Sohail Inam Ellahi is the present CEO of Unibro Industries Limited. He has been associated with PGLC from the Company's inception and has also previously served as the Chief Executive Officer of PGLC. He is an Associate in Arts from Foothill College of the California Community Colleges, USA & holds a Bachelor of Science degree in Business Administration (Accounting) from San Jose State University in California, USA. He is a former Member of the Executive Committee of APTMA.

RATING RATIONALE

Pak-Gulf Leasing Company Limited ('PGLC' or 'the Company') is a prominent leasing company that has been an active institution in the Pakistani leasing sector for over the last twenty five years. Currently, the Company operates out of the head office in Karachi and a branch office located in Lahore.

PGLC is listed on Pakistan Stock Exchange. Shareholding pattern illustrates that majority interest is held by members of the Unibro Business Group and its associated companies.

Sector Update

- The NBFI/Modaraba Industry comprised 27 Modaraba companies (MoCo), 8 Leasing companies (LCs) and 4 Investment Finance Services companies (IFS).

Table 1: Key Financial Indicators – NBFI/Modaraba Industry (All figures in PKR' Millions, except for percentages)

	FY19				FY20			
	LCs	MoCo	IFS	Total	LCs	MoCo	IFS	Total
No. of Companies	**8**	**27**	**4**	**39**	**8**	**27**	**3**	**38**
Assets	10,577	54,084	30,580	**95,241**	10,807	51,585	27,785	**90,177**
Equity	5,319	20,997	10,953	**37,269**	5,366	18,743	12,205	**36,314**
Borrowings	1,293	16,928	12,281	**30,502**	1,178	16,387	8,454	**26,019**
Gearing	24%	81%	112%	**82%**	22%	87%	69%	**72%**
PAT	(115)	(1,315)	1,126	**(304)**	128	(2,098)	779	**(1,191)**
RoA	-1.1%	-2.4%	3.7%	**-0.3%**	1.2%	-4.1%	2.8%	**-1.3%**

Source: NBFI-Modaraba Association

- Overall industry asset base has depicted contraction on a timeline, mainly on account of adverse profitability and subdued growth in lending operations. Subsequent to reporting date (end-June'2020), the number of leasing companies in the industry has reduced as 4 leasing companies were debarred from operating as leasing companies by the SECP, on account of adverse financial conditions and non-fulfillment of minimum capital requirements.
- In March 2021, the Tax Laws (Second Amendment) Ordinance 2021 was introduced, in which tax exemptions available in clause 100 of Second Schedule of Income Tax Ordinance (ITO), to the modaraba industry was withdrawn. From a sector perspective, this will increase the tax burden Modaraba though it will have no impact on conventional leasing companies.
- Additional tax differences between the industry & tax authority include earlier measures by FBR to disallow maximum depreciation at the rate of 50% in first year of lease to 25% and imposition of Alternate Corporate Tax (ACT) of 17%. As a result, leasing companies have become subject to higher tax, whereas banks & modarabas are exempt from ACT.
- Amidst Covid-19, asset quality indicators of the industry have been impacted. Although a cumulative infection figure for the industry is not available, VIS has noted increase in infection in companies covered by VIS, while overall credit risk in the economy is considered elevated. As NBFIs/ Modarabas serve SME borrowers usually not covered by banks, the credit risk of the industry tends to be higher than the banking industry clientele.

Profile of CEO:

Mr. Mahfuz-ur-Rehman Pasha served as an Officer of the Inland Revenue Service of the Federal Government of Pakistan for 30 years, before retiring in 2011, in BPS-21. He took up the position of CEO of PGLC in 2013. Mr. Pasha holds a B.Sc. (Electrical Engineering) degree from the University of Peshawar and a Diploma in Elementary German Language. He is an Associate Member of the Institute of Engineers, Pakistan (IEP) and a Certified Director from the Pakistan Institute of Corporate Governance (PICG). He currently serves as a Director on the Boards of Kaghan Development Authority, National Power Parks Management Company (Private) Limited. Mr. Pasha is also a former Chairman & a Member of the Executive Committee of the NBFI & Modaraba Association of Pakistan.

Business Update : PGLC

- In the leasing industry, subsequent to the regulator debarring a few companies, there are only 4 operational leasing companies. Of these, PGLC is the only privately-owned leasing company.
- During the period under review, we noted contraction in the Company's asset base, as leasing operation in 9M'FY21 remained subdued. Nevertheless, this was partly because of seasonality of lease underwriting, much of which materializes in the last quarter.

Table 2: Balance Sheet Extract (Rs. in Millions)

	Jun'19	Jun'20	Mar'21
Assets *	**1,873.8**	**1,844.8**	**1,383.2**
- *Investment in Finance Lease**	1,611.1 (86%)	1,483.3 (80%)	1,155.3 (84%)
- ***Equity***	**666.4**	**657.3**	**628.0**
- ***Debt***	**859.8**	**793.8**	**425.1**
o *Short Term*	414.3	344.6	115.0
o *Long Term*	50.0	29.2	108.3
o *CoIs*	392.3	404.2	190.1
o *Lease Liabilities*	3.2	15.9	11.7
- ***Other Liabilities***	**255.4**	**301.4**	**236.8**

- The asset quality indicators have been adversely affected, as a large-sized exposure went into litigation. The recent uptick in infection is mainly on account of 2 leases that have gone under litigation of healthcare & media industry clients. As per management, the Company will most likely reverse the provisioning undertaken on this exposure, as and when the legal proceedings are settled and/or otherwise recoveries are done out of the court.

Table 3: Asset Quality Indicators

	Jun'19	Jun'20	Mar'21
Gross Infection	4.2%	17.8%	24.1%
Provisioning Coverage	61.6%	37.0%	71.4%
Net Infection	4.3%	19.0%	28.8%

- As of Jun'20, major sector exposures of leasing operations pertained to Energy Oil & Gas (16.3%), Services (11.0%), Healthcare (9.1%), Food Tobacco & Beverage (7.8%), Media & Entertainment (7.5%) and Chemic Fertilizer & Pharmaceutical (7.3%).
- Overall concentration in the financing portfolio remains on the higher side, with top 10 counterparties comprising more than 65% of the leasing portfolio. As per management, client concentration is mainly a result of the Company's selective underwriting strategy.
- Given the subdued growth in leasing, significant portion of the available credit lines were kept unutilized as of Mar'21. As a result, the Company's gearing was notably lower at 0.68 (Jun'20: 1.21; Jun'19: 1.29).
- The Company uses credit lines from commercial banks to meet funding requirements, as and when they arise. As of Mar'21, the Company had credit lines available of up to Rs. 550million.
- Part of the Company's funding comes from Certificate of Investments (CoIs), the quantum of which has reduced on a timeline. It is pertinent to mention that majority (~88%) of these issuances are held by related parties. Maturity tenure of these securities ranges from 3 months to 36 months.

- Liquid assets on the balance sheet include portfolio of sovereign securities, maintained as a 15% reserve on CoIs as required by regulator.

Table 4: Liquidity Indicators (All figures in PKR' Millions, except for percentages)

	Jun'19	Jun'20	Mar'21
Cash & Bank Balances	16.4	114.8	19.5
Sovereign Securities	60.5	61.5	31.8
Units of National Investment Trust	3.0	3.0	3.8
Liquid Assets	**79.9**	**179.3**	**55.2**
Liquid Assets to Liabilities	**7.2%**	**16.4%**	**8.3%**

- In FY20, PGLC's spread came under pressure, as benchmark rate during the period was notably higher. For leasing companies, higher rate of borrowing implies lower spread, as there is limited room to further increase yield on markup bearing assets. As SBP started easing benchmark rates in Q4'FY20, much of the benefit of this lower rate materialized in 9M'FY21, as reflected in the table below.

Table 5: PGLC Spreads

	FY19	FY20	9M'FY21
Yield on Markup Bearing Assets	**14.0%**	**15.8%**	**17.4%***
- *Lease Portfolio*	14.1%	15.9%	17.7%*
- *Investment Portfolio*	10.9%	14.9%	8.6%*
Cost of Borrowings	**9.4%**	**13.8%**	**7.1%***
Spread	**4.6%**	**2.0%**	**10.3%**

- The improved spreads positively affected the operating profit in 9MFY21, which was almost twice the operating profit for corresponding period last year. The improvement is also illustrated from the change in efficiency ratio for the period. As also illustrated in the table below, the improvement in efficiency ratio also emanated from expense rationalization measures. However, the Company went into losses on account of sizable provisioning it had to take.

Table 6: P&L Extract

	FY19	FY20	9M'FY20	9M'FY21
Net Spread Income	147.7	141.1	104.0	144.2
Other Income	18.1	10.3	7.0	7.7
Recurring Income	**165.9**	**151.4**	**111.0**	**152.0**
Administrative Expenses	**78.8**	**68.0**	**54.5**	**43.6**
Efficiency	*47.5%*	*44.9%*	*49.1%*	*28.7%*
Operating Profit	**86.8**	**83.3**	**56.5**	**108.4**
Provisioning Charge	*15.6*	*61.7*	*48.8*	*133.7*
Provisioning Burden	*18.0%*	*74.1%*	*86.3%*	*123.4%*
Profit (Loss) Before Tax	**71.2**	**21.6**	**7.7**	**(25.4)**
Profit (Loss) After Tax	**64.4**	**10.9**	**7.6**	**(22.9)**

Key Rating Drivers:

PGLC's Operational Track Record

The assigned rating take into account the operational track record of the Company, which has been in the leasing business for a period of more than 25 years. VIS has an outstanding rating of

'A-/A2' for PGLC, being reaffirmed since 2015, after being upgraded from BBB+ in 2014.

Ratings take into PGLC's debt & liquidity profile

- The ratings reflect PGLC's gearing, which has been maintained close to 1.2x historically. Even though the same was notably reduced as of Mar'21, as per management the stronger leasing growth in Q4 implied that gearing has reverted to historical level. Nevertheless, it remains within acceptable threshold.

- In addition, we have also noted a drop in reliance on CoIs. With much of the CoIs being held by related parties and reduction in quantum of the same, the maturity mismatch risk is lower on a timeline.

- Liquid assets on the balance cover roughly 8% of the liabilities. However, these remain comfortable in comparison to current liabilities.

Asset quality indicators have depicted an adverse trend and will be closely monitored by VIS on a timeline

PGLC's asset quality indicators have depicted an adverse trend and as of Mar'21, the infection stood on the higher side. As per management, they have taken adequate provisions in Q4, in addition to an FSV benefit, on account of the strong collateralization of non-performing exposures. The management remains focused on recouping these losses.

Improvement in operating profit has been incorporated into the assigned rating
On the back of expense rationalization measures and improved spreads, PGLC's operating profits have depicted notable improvement. Nevertheless, given adverse movement in asset quality, the provisioning burden is likely to remain on the higher side.

Pak Gulf Leasing Company Limited (PGLC) Appendix I

FINANCIAL SUMMARY (amounts in PKR millions)				
BALANCE SHEET		**Jun'19**	**Jun'20**	**Mar'21**
Total Investments		63	65	36
Net Investment in Leases*		1,611	1,483	1,155
Total Assets*		1,874	1,845	1,383
Borrowings		857	793	425
COI		392	404	190
Paid Up Capital		253.7	253.7	253.7
Tier-1 Equity		666	657	628
Net Worth		759	750	721
**** Net of Investment in Finance Lease***				
INCOME STATEMENT	**FY19**	**FY20**	**9M'FY20**	**9M'FY21**
Net Mark-up Income (excludes finance cost)	148	141	104	144
Other Income	18	10	7	8
Operating Expenses	79	68	54	44
Operating Profit	87	83	57	108
Provisioning Charges	(16)	(62)	(49)	(134)
Profit (Loss) Before Tax	71	22	8	(25)
Profit (Loss) After Tax	64	11	8	(23)
RATIO ANALYSIS		**FY19**	**FY20**	**9M'FY21**
Gross Infection (%)		4.2%	17.8%	24.1%
Provisioning Coverage (%)		61.6%	37.0%	71.4%
Net Infection (%)		4.3%	19.0%	28.8%
Efficiency (%)		*47.5%*	*44.9%*	28.7%
ROAA (%)		2.5%	0.4%	-
ROAE (%)		8.7%	1.4%	-
Current Ratio (x)		1.34	1.53	1.66

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES — Appendix III

Name of Rated Entity	Pak Gulf Leasing Company Limited (PGLC)
Sector	Non-Bank Financial Institution (NBFC)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	See table below
Instrument Structure	N/A
Statement by the Rating Team	VIS, 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(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	See table below

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
01-Sep-21	A-	A-2	Negative	Reaffirmed
30-Jun-20	A-	A-2	Stable	Reaffirmed
22-Apr-19	A-	A-2	Stable	Reaffirmed
30-Jan-18	A-	A-2	Stable	Reaffirmed
30-Dec-16	A-	A-2	Stable	Reaffirmed
27-Nov-15	A-	A-2	Stable	Reaffirmed
25-Sep-14	A-	A-2	Stable	Upgrade
06-Apr-13	BBB+	A-3	Stable	Reaffirmed

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Mahfuz-ur-Rehman Pasha	CEO	July 26, 2021
Mr. Khalil Anwer Hassan	Advisor	July 26, 2021
Mr. Suleman Chaggla	CFO	July 26, 2021