RATING REPORT

LSE Financial Services Limited

REPORT DATE:
December 13, 2018

RATING ANALYSTS:
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RATING DETAILS

	Latest Rating		Previous Rating	
Rating Category	**Long-term**	**Short-term**	**Long-term**	**Short-term**
Entity	A	A-1	A	A-2
Rating Outlook	*Stable*		*Stable*	
Rating Action	Upgrade		Reaffirmed	
Rating Date	12th Dec'18		31st Aug'17	

COMPANY INFORMATION

Incorporated in 2016	**External auditors:** M/s Kreston Hyder Bhimji & Co., Chartered Accountants
Company Limited by Shares	**Chairman of the Board:** Mr. Rashid Rehman Mir
Key Shareholders:	**Chief Executive Officer:** Mr. Sibghatullah Khalid
Key Shareholders (with stake 5% or more):	
Joint Stock Companies, Corporations and SMCs – 77.8%	
Individuals– 14.3%	

APPLICABLE METHODOLOGY(IES)

JCR-VIS Entity Rating Criteria *Non-Bank Financial Companies (Mar 2005)*
http://www.jcrvis.com.pk/Images/NBFC.pdf

LSE Financial Services Limited

OVERVIEW OF THE INSTITUTION

LSE Financial Services Limited was incorporated in January 2016 under the Companies Ordinance 1984. The company is licensed to carryout business of investment finance services under Non-Banking Finance Company (NBFC) rules.

Profile of the Chairman

Mr. Rashid Rehman Mir is a qualified Chartered Accountant and has over three decades of professional experience in audit, tax and management consultancy. He is currently serving as the Senior Partner at Rahman Sarfaraz Rahim Iqbal Rafiq Chartered Accountants.

Profile of the CEO

Mr. Muhammad Sibghatullah Khalid has over two decades of diversified experience and has worked on several assignments for microfinance institutions and banks, commercial banks, and manufacturing concerns in Pakistan and abroad.

Financial Snapshot

*Core Equity: FY18: Rs. **2.**0b; FY17: Rs. 1.7b*

Assets: FY18: Rs. 3.2b; FY17: Rs. 3.2b

Revenue: FY18: Rs. 139.2m; FY17: Rs. 110.6m

*Profit After Tax: FY18: Rs. 345.4**m;** FY17: 328.2m*

RATING RATIONALE

Ratings assigned to LSE Financial Services Limited (LSEFSL) reflect the company's low business risk appetite given its structured and unique business model coupled with increase in revenues stemming from higher investment in margin trading system. The ratings also derive comfort from conventional investment policy leading to cautious business selection, sound capital structure, minimal dependence on commercial borrowings and strong liquidity profile. The one-time revaluation gain recognition on financial lease of South Tower has contributed towards equity expansion. However, given the clearly articulated business strategy, the ratings remain constraint on account of limited growth potential in recurring revenues.

Low business risk profile supporting operating performance: LSEFSL's business model primarily entails low risk lease and rental operations of the North and South Tower. The South Tower, an eleven storey newly constructed building, against which lease money amounting Rs. 255.7m was received during FY17started generating rental income during FY18. The company has entered into a finance lease agreement for 99 years with corporate customers for leasing out floors and rooms of the building on commercial terms. During FY18, the remaining unsold spaces including fifth floor was leased out to a leading oil marketing company, one-third on fourth floor to National Clearing Company of Pakistan Limited (NCCPL) and mezzanine to Central Depository Company of Pakistan. The major impact of newly rented out spaces on revenue generation will be visible during the ongoing year. The ground floor is currently retained by LSEFSL, however, the management plans to rent out the space to a commercial bank or a multinational company. In addition, there are four parking spaces that will generate parking fee income, though nominal, going forward. Moreover, the company has long term equity investments (unquoted) in associated companies amounting to Rs 786.6m under equity method (FY17: Rs. 738.9m) at end-FY18.

Overall conservative investment policy; investment limit in MTS enhanced: The company has formulated an investment policy which is reviewed and approved by the Board every year. As per the internal policy, all investments made are managed by the investment committee and credit committee (CC) formulated by the Board of Directors. As per policy, investments in banks and DFIs can only be made in entities and their instruments rated 'AA/A-1' and above. However, the company cannot invest more than 40% of total funds or Rs. 50m, whichever is lower, as equity investment in financial institutions. LSEFSL can investment up to Rs. 20m in asset backed listed companies recommended by the CC and the Board. In addition, the investment in margin trading system (MTS) was capped at Rs. 400m (FY17: Rs. 200m) by end-FY18. There was no breach of internal policy limits during FY18. Further, LSEFSL invested Rs. 386.0m in MTS, representing around 28% of the total investment portfolio, at end-FY18.

Sizable gain on recognition of finance lease, augmented bottom line: Positive impetus in earnings was witnessed during FY18 primarily owing to Rs. 94.3m revaluation gain pertaining to spaces in South Tower given on 99 years financial lease; the gain was realized over the construction cost amounting to Rs. 286.7m. Adjusting for one-time gain, total revenue still exhibited upward trajectory in line with higher income earned on investment made in MTS coupled with higher fund management fee charged to Members Contribution Fund, Investors Protection Fund and TREC Holders' Contribution Fund. The fund management and operational fee was calculated at a higher rate of 2.0% (FY17: 1.5% to 2.0%) on closing net assets of the fund as per their management accounts at end-FY18. The rental income, the main source of income generation, has continued to increase, though nominally, on a timeline basis.

Further, LSEFSL's bottom line was substantially supported by fair value gain of Rs. 163.1m on revaluation of office spaces in North and South Tower held by the company for rental income generation and capital appreciation. On the other hand, increasing trend witnessed in administration expenses was mainly a function of higher depreciation charge on building and electric fittings and some provisioning expense booked against doubtful receivables. The share of profit from associates under equity method was recorded lower at Rs. 127.3m (FY17: Rs. 147.9m) during FY18; however, the shareholding of LSEFSL in associates remain unchanged during FY18. Given gain on finance lease together with positive momentum in core business operations, the profitability indicators improved during FY18 as compared to preceding year.

Strong capitalization and liquidity indicators: During FY18, the company's total assets increased slightly and the increase was mainly manifested in higher investment in MTS and associates along with higher fair value of investment property. On the contrary, property, plant and equipment declined by end-FY18, as an outcome of lease out of office spaces in the South Tower for 99 years. The increase in assets was mainly funded by higher equity base. The company's already low reliance on commercial borrowings was further streamlined with repayment of loan facility amounting to Rs. 100.0m. In line with higher funds parked in liquid avenues along with partial repayment of long-term debt, liquidity profile of the company improved considerably with liquid assets representing 6.3x (end-FY17: 2.7x) of the total borrowings at end-FY18.

Frequent changes at senior management level: There has been a change at the helm of affairs with Mr. Sibghatullah Khalid replacing Mr. Farid Malik as the CEO of the company during FY18; Mr. Sibghatullah Khalid had joined the company in July'18. Going forward, stability in senior management is considered important for achievement of business prospects in the long-term.

LSE Financial Services Limited **Annexure I**

BALANCE SHEET *(Rs. in millions)*	FY16	FY17	FY18
Property and Equipment	1,523	1,615	1,287
Investment in Associates	600	739	787
Investment Property	28	203	384
Short Term Investments	487	475	581
Other Assets	188	154	129
Total Assets	2,826	3,186	3,168
Borrowings	200	200	100
Trade and Other Payables	112	107	132
Deferred Taxation	43	63	103
Other Liabilities	249	307	49
Tier-1 Equity	1,477	1,739	2,016
Total Equity	2,222	2,509	2,784
INCOME STATEMENT	**FY16**	**FY17**	**FY18**
Total Revenue	110.2	110.6	139.2*
Fair Value Gain on Rev. of Inv. Property	-	174.7	163.1
Administrative Expenses	52.3	66.7	94.7
Share of Profit of Associates – net of tax	88.3	147.9	127.3
Profit (Loss) Before Tax	126.7	366.3	420.8
Profit (Loss) After Tax	79.2	328.2	345.4
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**
Operating Margins (%)	34.9	39.7	32.0
Net Margins (%)	71.9	296.8	248.2
Efficiency (%)	65.1	60.3	68.0
ROAA (%)	3.1	10.9	10.9

ROAE (%)	5.5	20.4	18.4
** adjusted for one time fair valuation gain*			

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure II

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: JCR-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.jcrvis.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.jcrvis.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.

'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.jcrvis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when JCR-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 — Annexure III

Name of Rated Entity	LSE Financial Services Limited (Formerly, Lahore Stock Exchange Limited)
Sector	Non-Bank Financial Institution (NBFC)
Type of Relationship	Solicited
Purpose of Rating	Entity Rating

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
12/12/2018	A	A-1	Stable	Upgrade
31/08/2017	A	A-2	Stable	Reaffirmed
04/07/2016	A	A-2	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	JCR-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.
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