RATING REPORT

LSE Financial Services Limited

REPORT DATE:
November 20, 2019

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-1
Rating Outlook	*Stable*		*Stable*	
Rating Action	Reaffirm		Upgrade	
Rating Date	5th Nov'19		12th Dec'18	

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 – 75.9%	
Individuals– 18.8%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria *Non-Bank Financial Companies (Oct 2017)*
https://www.vis.com.pk/kc-meth.aspx

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: FY19: 2.1b; FY18: Rs. ***2.0****b; FY17: Rs. 1.7b*

Assets:FY19: Rs. 3.2b; FY18: Rs. 3.2b; FY17: Rs. 3.2b

Revenue: FY19: Rs. 184.3m; FY18: Rs. 139.2m; FY17: Rs. 110.6m

*Profit After Tax: FY19: Rs. 158.7m; 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 income generated through investment in margin trading system as a result of higher interest rates. The ratings also derive comfort from conventional investment policy leading to cautious business selection, sound capital structure, debt free balance sheet and strong liquidity profile. 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 building started generating rental income during FY18. The company 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 ground floor is currently retained by LSEFSL, however, the management plans to sell out the space once they are able to tap a reasonable client. However as per the current economic circumstances the plan is likely to materialize in the medium to long-term. Moreover during FY19, four parking spaces also started generating parking fee income. In addition, the company has long term equity investments (unquoted) in associated companies amounting to Rs 885.7m under equity method (FY18: Rs. 786.6mm) at end-FY19.

Overall conservative investment policy: 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) is capped at Rs. 400m (FY18: Rs. 400m) at end-FY19. During the period under review, there was no breach of internal policy. Further, LSEFSL invested Rs. 396.6m (FY19: Rs. 386.0m) in MTS, representing around 30% (FY18: 28%) of the total investment portfolio, at end-FY19.

With no one-time gain, bottom line was lower than preceding year: The core earnings of the company exhibited positive momentum amounting to Rs. 184.3m (FY18: Rs. 139.2m) during FY19 primarily on account of increasing benchmark rate scenario prevalent resulting in higher income earned through investment in margin trading system. Moreover, unrealized gain on equity shares of Pakistan Mercantile Exchange Limited (PMEX) amounting to Rs. 18.9m also contributed to higher core income earned during FY19. PMEX was an associate of the company based on common directorship; however due to retirement of the common director during the review period PMEX has now ceased to be an associate. On the contrary, the total income was recorded lower than the preceding year owing to Rs. 94.3m revaluation gain recorded during FY18 pertaining to spaces in South Tower given on 99 years financial lease. The fund management and operational fee was calculated at a rate of 2.0% (FY18: 2.0%) on closing net assets of the fund as per their audited accounts at end-FY19. The rental income, the main source of income generation, remained largely constant at Rs. 52.6m (FY18: Rs. 52.8m) during FY19. On the other hand, slight increase was witnessed in administration expenses mainly as an outcome of inflationary pressure leading to annual salary adjustments. Furthermore, the share of profit from associates under equity method was recorded slight higher at Rs. 131.4m (FY18: Rs. 127.3m) during FY19; however, the shareholding of LSEFSL in associates remain unchanged during FY19. Given the company'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 during FY18, therefore, the after tax profit for FY19 was recorded lower at Rs. 158.7m as compared to Rs. 344.3m in the previous year.

Strong capitalization and liquidity indicators: During FY19, the company's total assets remained unchanged at Rs. 3.2b (FY18: Rs. 3.2b) given there has been no change in business operations of the company. On the other hand, LSEFSL's equity base augmented as a result of internal capital generation. 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 full repayment of long-term debt, liquidity profile of the company improved sizably.

Stability at senior management level: There was no change at the helm of affairs with stability depicted at the senior management level during the review period. Going forward, stability in senior management is considered important for achievement of business prospects in the long-term. However, there was an enhancement in the Board of directors with the number of directors increased to nine from seven during FY19.

LSE Financial Services Limited **Annexure I**

BALANCE SHEET *(Rs. in millions)*	FY16	FY17	FY18	FY19
Property and Equipment	1,523	1,615	1,287	1,282
Investment in Associates	600	739	787	886
Investment Property	28	203	384	384
Short Term Investments	487	475	581	440
Other Assets	188	154	129	165
Total Assets	2,826	3,186	3,168	3,157
Borrowings	200	200	100	-
Trade and Other Payables	112	107	132	116
Deferred Taxation	43	63	150	97
Other Liabilities	249	307	49	33
Paid up Capital	1,283	1,283	1,283	1,283
Tier-1 Equity	1,477	1,739	2,047	2,141
Total Equity	2,222	2,509	2,816	2,911
INCOME STATEMENT	**FY16**	**FY17**	**FY18**	**FY19**
Total Revenue	110.2	110.6	139.2*	184.3
Fair Value Gain on Rev. of Inv. Property	-	174.7	163.1	-
Administrative Expenses	52.3	66.7	94.7	99.0
Share of Profit of Associates – net of tax	88.3	147.9	127.3	131.4
Profit (Loss) Before Tax	126.7	366.3	420.8	207.6
Profit (Loss) After Tax	79.2	328.2	345.4	158.7
RATIO ANALYSIS	**FY16**	**FY17**	**FY18**	**FY19**
Operating Margins (%)	34.9	39.7	32.0	46.3
Net Margins (%)	71.9	296.8	248.2	86.1
Current ratio (x)	1.49	4.2	3.7	4.1

Efficiency (%)	65.1	60.3	68.0	53.7
ROAA (%)	3.1	10.9	10.9	5.0
ROAE (%)	5.5	20.4	18.4	7.5
Debt to Equity Ratio (%)	27.4	21.7	5.0	-

** adjusted for one time fair valuation gain*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Annexure 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 — 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	(see table below)

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
05/11/2019	A	A-1	Stable	Reaffirmed
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	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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