RATING REPORT

LSE Financial Services Limited

REPORT DATE:
December 17, 2020

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating Long-Term	Latest Rating Short-Term	Previous Rating Long-Term	Previous Rating Short-Term
Entity	A	A-1	A	A-1
Rating Outlook	*Stable*		*Stable*	
Rating Date	17th Dec'20		5th Nov'19	

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– 81.64%	
Individuals– 16.85%	

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria *Non-Bank Financial Companies (Mar 2020)*
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 (now Companies Act 2017). 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: end-FY20: 2.2b; end-FY19: Rs. 2.1b; FY18: end-Rs. 2.0b

Assets: end-FY20: Rs. 3.2b; end-FY19: Rs. 3.2b; end-FY18: Rs. 3.2b

Profit After Tax: FY20: Rs. 160.1m; FY19: Rs. 153.3**;** FY18: 344.3m

RATING RATIONALE

Ratings assigned to LSE Financial Services Limited (LSEFSL) incorporate company's low business risk appetite given its structured and unique business model. However, some revisions in business model has been made entailing introduction of MSME loans, development of credit department coupled with establishment of related operational policies and procedures. The risk associated with MSME loans is planned to be mitigated through liquid listed securities as collateral, with 35% to 50% margin. Core earnings of the company comprised revenue generation from various avenues while rental income, income from room maintenance and from financial assets constituting around two-third of recurring proportion of earnings, have remained largely stagnant. Around one-third of the asset base comprised investment in associates, income from the same has provided considerable support to the bottom line on a timeline basis. The ratings also derive comfort from conservative capital structure in absence of commercial borrowings and adequate liquidity.

Revision in business plan entailing launch of MSME loans in ongoing year: LSEFSL has launched a MSME loan product, namely Enterprise Expansion Financing (EEF) during 2QFY21. The loan product entails financing for business expansion against liquid listed securities as collateral, with 35% to 50% margin. Markup charged on these loans would be 3M KIBOR *plus* 4%. Loan size ranges from Rs. 0.5m to Rs. 5m, thereby servicing borrowers who are not catered by majority of commercial and microfinance banks. The company projects to disburse 44 loans for an amount of Rs. 110.5m by end-FY21. Funds for MSME loans would be provided through diversion of required amount from Margin Trading System (MTS) and available cash. To launch EEF, credit department has been established with hiring of staff while Credit Policy and Operational Procedural Manual have also been developed. The company has made arrangements for verification with Electronic Credit Information Bureau (eCIB) of State Bank of Pakistan (SBP) while establishment of link with NADRA for verification of clients is in progress.

Overall conservative investment policy: Investment policy is reviewed and approved by the board every year. As per the internal policy, all investments are managed by the investment business committee (IBC) and credit committee (CC) formulated by the Board of Directors. During FY20, LSEFSL invested in 3-year Pakistan Investment Bonds (PIBs) amounting Rs. 45.3m, carrying markup of 9% p.a. payable half yearly, maturing in September, 2022. As of June 30, 2020, market value of these PIBs was Rs. 52.3m. The company plans to liquidate these PIBs to pay dividend in FY21. Investment mix of financial assets is tabulated below:

Financial Assets (in million Rs.)	FY18	FY19	FY20
Non-Current:			
Pakistan Investment Bonds (PIBs)	0.0	0.0	52.3
Current:			
Held-to-Maturity			
Investment in Margin Trading System of NCCPL	386.0	396.6	370.0
Government Treasury Bills	165.7	24.6	25.9
Term Deposit Receipts (TDRs)	29.3	-	-

Held-for-Trading			
Equity Shares of Pakistan Mercantile Exchange (PMEX)	-	18.9	18.9
Total	**581.0**	**440.1**	**467.2**

Investment in Margin Trading System (MTS) of National Clearing Company of Pakistan Limited (NCCPL) remained capped at Rs. 400m. Anticipating decrease in markup rate, the company reduced MTS exposure by Rs. 200m in Mar'20; the said amount was invested in T-bills. However, upon maturity of T-bills on June 18, 2020, the amount was reinvested in MTS. While investing in MTS, the company has a policy not to invest more than 25% of its funds in one script to mitigate concentration risk; except TRG, where the limit is 10% given relatively volatile nature of the stock. Investment in associates accounted for using the equity method stood at Rs. 996.3m (FY19: Rs. 883m) at end-FY20. In accordance with equity method, carrying value of investments in associates has increased in line with adjustment of share of profit, other comprehensive income and revaluation surplus on PP&E, in proportion of shareholding in respective companies. Breakdown of investment is given below:

(in million Rs.)	PACRA	CDC	NCCPL
Carrying Value of Investment in Associates Accounted for Using Equity Method	83.2	504.1	409
% Shareholding	36.0%	10.0%	23.53%

As per management, after Integration of Stock Exchanges the SECP granted relaxation to company for three years with respect to compliance with section 28(b) of NBFC rules, which dictates that at least 70% of assets should be invested in financing services . Given the relaxation period has expired in Sep'19, the management intends to liquidate shareholding in associates in a phase wise manner as per business plan. Meanwhile, the company has also applied for further extension in relaxation of 28 (b) rule of NBFC from SECP, as the company has been granted NBFC license under special circumstances. The company projects to start liquidating these investments from FY23 and direct funds towards financial assets including MTS, MSME loans and wholesale lending. The management is also in the process of selling ground floor of the building and would invest the proceeds in Professional Clearing Member (PCM) in FY21 to the tune of Rs. 100m with a 15% shareholding along with the company's representation on its board.

Core earnings remained largely stagnant while share of profit of associate provided impetus to the bottom line: The core earnings were recorded at Rs. 175.8m (FY19: Rs. 184.3m) during FY20. Rental income on investment properties decreased to Rs. 46m (FY19: Rs. 52.6m) mainly on account of renewal of rental agreement with Pakistan Stock Exchange (PSX) at a lower rate in order to retain PSX given its significance among other major clients. The management organized open house events to attract clients for renting or lease out the vacant spaces during the outgoing year. However, given premium rents charged by LSEFSL amid high competition and economic slowdown, the prospects of additional rental income remain low, as per management. Revenue from MTS was recorded higher at Rs. 48.9m (FY19: Rs. 43.8m) owing to higher average return earned on investment, despite some reduction in MTS exposure in Mar-Jun'20. Average return on MTS during FY20 was 15% (FY19: 11%). Revenue from room maintenance services remained at Rs. 21.8m (FY19: Rs. 21.6m). Fund management fee amounting Rs. 18m (FY19: Rs. 17m) pertained to fee charged at rate of 2.0% (FY19: 2.0%) on closing net assets of the funds. Unrealized gain on equity shares of Pakistan Mercantile Exchange (PMEX) was nil (FY19: Rs. 18.9m) as no change in value was recorded in FY20. Income from financial assets recorded at amortized cost/under effective interest rate method was Rs. 20.5m (FY19: Rs. 19.5m) in FY20. Miscellaneous income was higher at Rs. 22.3m (FY19: Rs. 7.2m) on account of amount received on re-measurement of office areas of rented property.

Administrative expenses increased slightly to Rs. 110.3m (FY19: Rs. 99m) mainly as a result of annual salary adjustments and increase in board meeting fee expenses in line with higher number of meetings conducted during the review period. Share of profit of associate accounted for using the equity method (net of tax) was recorded higher at Rs. 136.3m (FY19: Rs. 124.1m) during the outgoing year while percentage holding in associates remained the same. Accounting for taxation, net profit was recorded at Rs. 160.1m (FY19: Rs. 153.3m) during FY20. While recurring revenue and equity base have witnessed a limited growth over the years, change in business strategy is expected to support earnings on a long-term horizon.

Strong capitalization and liquidity indicators: Equity increased slightly to Rs. 2.2b (FY19: Rs. 2.1b) by end-FY20 on back on partial retention of profits. Cash dividend paid during FY20 was recorded higher at Rs. 102.6m (FY19: Rs. 64.1m). Revaluation surplus on property, plant and equipment was Rs. 786.4m (FY19: Rs. 779.6m) at end-FY20. Capitalization is considered strong despite modest increase in core equity given debt free balance sheet. Liquid assets were recorded at Rs. 536.9m (FY19: Rs. 546.9m). The management plans to build alliances with Chemonics International and Pakistan Credit Guarantee Company Limited (PCGC) in order to access subsidized borrowings mainly for wholesale lending starting from FY24.

Corporate governance: There were no changes at the board and senior management level during the review period. The board comprised nine members including one female director.

LSE Financial Services Limited Annexure I

BALANCE SHEET (in million PKR)	FY18	FY19	FY20
Property, Plant & Equipment	1,287.4	1,282.8	1,268.5
Investment Property	383.8	383.8	378.4
Investment Accounted for Using the Equity Method	796.1	883	996.3
Financial Assets	581	440.1	467.2
Trade and Other Receivables	32.9	15.1	22.4
Cash and Bank Balances	52.6	106.8	69.7
Other Assets	43.6	42.2	46.7
Total Assets	3,177.4	3,153.8	3,249.2
Long Term Finances (including current maturity)	100	-	-
Trade and Other Payables	150.4	116.4	113.8
Other Liabilities	103	128.1	155
Total Liabilities	353.4	244.6	268.8
Paid Up Capital	1,282.8	1,282.8	1,282.8
Tier-1 Equity	2,046.8	2,129.7	2,189.1
Total Equity	2,823.9	2,909.3	2,980.5
INCOME STATEMENT	FY18	FY19	FY20
Total Revenue	139.2	184.3	175.8
Gain on Recognition of Finance Lease	94.3	-	-
Fair Value Gain on Revaluation of Investment Property	163.1	-	-
Operating Profit	301.9	85.3	65.6
Share of Profit of Associate (Using Equity Method)-Net of Tax	127.3	124.1	136.3
Profit/(Loss) Before Tax	420.8	200.4	201.9
Profit/(Loss) After Tax	344.3	153.3	160.1
RATIO ANALYSIS	FY18	FY19	FY20
Operating Margin (%)	216.9	61.8	47.7
Net Margin (%)	247.4	83.2	91.1
Current Ratio (x)	3.66	4.06	3.73
Efficiency (%)	68.0	53.7	62.7
ROAA (%)	12.2	5.3	6.2
ROAE (%)	18.2	7.3	7.6
Gearing (x)	0.05	0.0	0.0
Debt Leverage (x)	0.17	0.11	0.12

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					Appendix III
Name of Rated Entity	LSE Financial Services Limited (Formerly, Lahore Stock Exchange Limited)				
Sector	Non-Bank Financial Companies (NBFCs)				
Type of Relationship	Solicited				
Purpose of Rating	Entity Ratings				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
			RATING TYPE: ENTITY		
	17/12/2020	A	A-1	Stable	Reaffirmed
	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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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Ghulam Mustafa	Chief Financial Officer	November 13, 2020	