

RATING REPORT

LSE Financial Services Limited

REPORT DATE:

December 21, 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-1	A	A-1
Rating Outlook	Stable		Stable	
Rating Action	Reaffirmed		Reaffirmed	
Rating Date	21 Dec'21		17 Dec'20	

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 (with stake 5% or more):

Chief Executive Officer: Mr. Nafees Ahmad

Joint Stock Companies– 74.2%

Individuals– 18.1%

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 RATING RATIONALE

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. Nafees Ahmad has more than twenty-five years of experience in the financial sector, particularly in Corporate and Investment Banking, Project Management, and Business Development. He has worked as an Executive Director-Team Lead in GAT Consulting (Pvt.) Limited, and has been associated with Pak Oman Investment Company Limited as a Regional Head.

Financial Snapshot

Core Equity: end-FY21: Rs. 2.3b; end-FY20: 2.2b; end-FY19: Rs. 2.1b

Assets: end-FY21: Rs. 3.4b; end-FY20: Rs. 3.2b; end-FY19: Rs. 3.2b

Profit After Tax: FY21: Rs. 236.0m, FY20: Rs. 160.1m; FY19: Rs. 153.3m

Corporate Profile: Initially incorporated in October 1970 as a company limited by guarantee under the name of “Lahore Stock Exchange (Guarantee) Limited” followed by re-registration as a public company in 2012; the company ceased its stock exchange operations on January 11, 2016, subsequent to notification by Securities and Exchange Commission of Pakistan (SECP), dated August 25 2015, directing integration of the stock exchanges in Pakistan. Consequently, the Company was granted a license to operate as investment finance services company as a Non-Banking Financial Company (NBFC) by the SECP under the name of “LSE Financial Services Limited”. The registered office of the company is located in Khayaban-e-Aiwan-e-Iqbal, Lahore, Pakistan.

LSE Financial Services Limited has a unique business model encapsulating core revenue generation primarily through investment in Margin Trading System (MTS) of NCCPL and rental income from investment properties. Investment properties incorporate ownership in LSE Towers representing 25,018 square feet, and the company has entered into lease arrangements for lease of office spaces in North and South Towers. Other core earning avenues include income from financial assets, room maintenance services offered to tenants, fund and operational management fee, and software services. The company also holds investments in associates, namely The Pakistan Credit Rating Agency Limited (PACRA), Central Depository Company of Pakistan Limited (CDC), and National Clearing Company of Pakistan Limited (NCCPL), amounting to Rs. 1.12b which approximately accounts for one-third of the asset base. Income from the same has impacted net profitability positively on a timeline basis.

In accordance with Section 28b of NBFC rules, LSE Financial Services Limited was granted an exemption by SECP for three years to comply with the regulation to invest at least 70% of total assets in financing activities. The regulator relaxed the aforementioned regulation up to January 2019, and the company has applied for an extension on the same. LSE Financial Services Limited plans to liquidate shareholding in associates in a phased manner going forward and direct proceeds from realization of these investments towards financing activities including MTS, leases, and new lending products as approved by the Board of Directors.

During FY21, Mr. Nafees Ahmad was appointed as the Chief Executive Officer / Managing Director. His investment banking and lending experience is expected to bode well for LSEFSL given their strategy to build a financing portfolio. Also, Mian Muhammad Tariq Hassan has joined the company as an independent non-executive director.

Rating Drivers

Impact of revision in business plan entailing development of financing portfolio is yet to be seen.

The company is undergoing revision in business model entailing introduction of Term

Financing and Leasing Portfolio. Term Financing incorporates receivable financing, exposure in Sukuks and Term Financing Certificates (TFCs), and loan portfolios with short-term to long-term tenors. Leasing Portfolio consists of vehicles, equipment, and machinery; and the team has designed software for leasing product portfolio which is currently in mock testing phase. Also, the company is partnering with other financial institutions including banks and modarba companies to ensure sustainable operations. Exposure to credit risk emanating with loan portfolio will be mitigated through investments in liquid debt securities and extending financing to counterparties which are either backed by the Government of Pakistan (GoP) or encompass long-term and short-term credit ratings of at least “AA” and “A-1”, respectively, by PACRA or VIS. Furthermore, the company plans to launch an advisory business incorporating feasibility and research studies of public and private institutions, underwriting, syndication, debt restructuring, project financing, and advisory in mergers, acquisitions, and divestments. The company anticipates gradual build up in the financing portfolio in line with the recently approved credit policy.

In order to successfully implement new product lines, the company is also undergoing revisions in credit manuals, policies, and legal documents along with structural changes in compliance, legal, internal audit, and information technology departments. LSE Financial Services is also undertaking fresh hiring in marketing and risk departments to facilitate additions in the product portfolio.

Strong Internal Audit Function and sound IT infrastructure in place

The company has outsourced its Internal Audit function to M/s Kreston Hyder Bhimji & Co., Chartered Accountants, with quarterly and annually reporting to company’s board. Keeping pace with the development of information technology and desire to provide effective service to their customers, the company has invested in the latest information technology systems. Moreover, the company has earned ISO 9001:2015 certification for its quality management system.

Low Business Risk

Low business risk of the company incorporates conservative investment policy whereby the company holds investments in MTS of NCCPL, government backed treasury bills, and equity shares of Pakistan Merchantile Exchange (PMEX). While investing in MTS, company’s policy entails a cap of 25% investment in a single scrip to mitigate concentration risk; except TRG, where the limit is 10% given relatively volatile nature of the stock.

Financial Assets (in 000's Rs.)	FY19	FY20	FY21
<u>Non-Current:</u>			
Pakistan Investment Bonds (PIBs)	0.0	52.3	0.0
<u>Current:</u>			
<u>Held-to-Maturity</u>			
Investment in Margin Trading System of NCCPL	396.6	370.0	462.5
Government Treasury Bills	24.6	25.9	25.5
<u>Held-for-Trading</u>			
Equity Shares of Pakistan Merchantile Exchange (PMEX)	18.9	18.9	19.1
Total	440.1	467.2	507.1

Although the company plans to expand investment portfolio going forward, business risk is expected to remain within manageable levels given its conservative investment policies.

Core earnings remained stagnant while share of profit from associates continued to provide impetus to the bottom-line

During FY21, core earnings of the company were reported at Rs. 130.1m (FY20: Rs. 137.4m), registering 5.4% dip on a YOY basis. Revenues from rental income from investment properties and contracts with customers based on room maintenance services, fund management, and software services witnessed minimal increase, however other income decreased mainly on account of lower ancillary income generated from renting parking space. Demand for the same declined due to COVID-19 lockdowns. Administrative and general expenses also depict 7% increase during FY21 vis-à-vis SPLY primarily on account of Punjab Workers' Welfare Fund (PWWF) provision accounted in FY21. Consequently, operating margins reduced to 27% (FY20: 48%) in the outgoing year. However, net profitability was largely supported by increase in share of profit from associates depicting significant increase of 78.7% to Rs. 243.7m (FY20: Rs. 136.3m) during FY21. Finance costs were minimal at Rs. 0.1m. As a result, net margins increased to 154% (FY20: 91%) in FY21. Going forward, realization of the company's business plan including buildup of financing portfolio and resulting income streams will remain important for ratings.

Strong liquidity profile and capitalization indicators

Liquidity profile of the company continue to remain strong with current ratio standing at 4.72x (FY20: 4.21x) during FY21, and is expected to remain on the higher side going forward with additions in portfolio investments.

Post adjustment of revaluation reserves, equity base of the company grew slightly to Rs. 2.3b (FY20: Rs. 2.2b) at end-FY21 on account of dividend payments amounting to Rs. 90m. Debt profile encapsulates conservative capital structure with minimal long term financing undertaken in FY21 for purchase and installation of 100 KW On-Grid Solar System under SBP's financing scheme of renewable energy projects. As a result, capitalization indicators continued to remain on the lower side with leverage and gearing levels standing at 0.12x (FY20: 0.12x) and 0.00x (FY20: 0.00x) at end FY21. Capitalization indicators are expected to remain low with projected profitability and minimal capex plan going forward.

LSE Financial Services Limited
Annexure I

BALANCE SHEET (in million PKR)	FY18	FY19	FY20	FY21
Property, Plant & Equipment	1,287.40	1,282.80	1,268.50	1,266.71
Investment Property	383.8	383.8	378.4	378.43
Investment Accounted for Using the Equity Method	796.1	883.0	996.3	1115.6
Financial Assets	551.7	440.1	467.2	507.1
Trade and Other Receivables	32.9	15.1	22.4	9.47
Cash and Bank Balances	52.6	106.8	69.7	79.8
Total Assets	3,177.4	3,153.8	3,249.2	3,406.9
Long Term Finances (including current maturity)	100	-	-	7.70
Trade and Other Payables	150.4	116.4	113.8	99.7
Other Liabilities	103	128	155	136
Total Liabilities	353.4	244.6	268.8	285.78
Paid Up Capital	1,282.80	1,282.80	1,282.80	1,282.84
Tier-1 Equity	2,046.80	2,129.70	2,189.10	2,344.93
Total Equity	2,823.9	2,909.3	2,980.5	3,121.2
INCOME STATEMENT	FY18	FY19	FY20	FY21
Projected Net Financial Income from New Product Portfolio				
Total Revenue	139.2	184.3	175.8	153.2
Gain on Recognition of Finance Lease	94.3	-	-	0
Fair Value Gain on Revaluation of Investment Property	163.1	-	-	0
Operating Profit	301.9	85.3	65.6	35.6
Share of Profit of Associate (Using Equity Method)-Net of Tax	127.3	124.1	136.3	243.7
Profit/(Loss) Before Tax	420.8	200.4	201.9	279.14
Profit/(Loss) After Tax	344.3	153.3	160.1	236.0
RATIO ANALYSIS	FY18	FY19	FY20	FY21
Operating Margin (%)	217%	62%	48%	27%
Net Margin (%)	247%	83%	91%	154%
Current Ratio (x)	3.66	4.06	4.21	4.72
Efficiency (%)	68%	54%	63%	77%
ROAA (%)	12%	5%	5%	7%
ROAE (%)	18%	7%	7%	10%
Gearing (x)	0.05	0.00	0.00	0.00
Debt Leverage (x)	0.17	0.11	0.12	0.12

ISSUE/ISSUER RATING SCALE & DEFINITIONS

Annexure III

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 IV			
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				
	21/12/2021	A	A-1	Stable	Reaffirmed
	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	5 th November'21	
	2	Mr. Noor Ul Haq	Risk Manager		