RATING REPORT

LSE Financial Services Limited

REPORT DATE:
February 14, 2023

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	*Rating Watch-Developing*		*Stable*	
Rating Action	Maintain		Reaffirmed	
Rating Date	February 14, 2023		December 21, 2021	

COMPANY INFORMATION

Incorporated in 2016	**External Auditors:** M/s Crowe Hussain Chaudhary & Co. Chartered Accountants
Company Limited by Shares	**Chairman of the Board:** Mr. Zahid Latif Khan
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Amir Zia
Modarba Al-Mali- 26%	
Joint Stock Companies- 47.8%	
Humera Muhammad Iqbal-11.2%	

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. Zahid Latif Khan is the Chairman. He is also the Chief Executive Officer of M/s Zahid Latif Khan Securities (Private) Limited. He also serves as Board member of other capital market institutions such as Islamabad Stock Exchange, Pakistan Mercantile Exchange Limited and NCEL Building Management Limited.

Profile of the CEO

Mr. Amir Zia is a Management Accountant and serves on the Board of Director of Assetplex Modaraba Investment Limited and represents as a non-executive Director of Modaraba Al-Mali. He previously served as the Group Chief Financial Officer of Treet Group of Companies.

RATING RATIONALE

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 and dividend income from associated investments. 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) - 36%, Central Depository Company of Pakistan Limited (CDC)-10%, and National Clearing Company of Pakistan Limited (NCCPL) - 23.5%, plus new investments in Pak General Insurance Company (10%) and Digital Clearing Company (9.94%). Strategic investments of Rs. 1.5b account for 41% of the asset base.

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, which has expired. In early 2022, Modarba Al Mali, specialized Islamic vehicle focusing on Islamic Venture Capital/Private Equity and Restructuring/Rehabilitation of companies having potential for revival, acquired 26% in LSE along with management control. With a new Board in place, comprising of 12 Directors including 3 independent directors, Mr. Amir Zia was on boarded as the new Chief Executive Officer. Mr. Amir Zia is a Management Accountant and serves on the Board of Director of Assetplex Modaraba Investment Limited and represents as a non-executive Director of Modaraba Al-Mali. He previously served as the Group Chief Financial Officer of Treet Group of Companies and has extensive financial management experience.

<u>Proposed Scheme of Demerger</u>

In the wake of diversifying the operating activities beyond the ambit of NBFC Rules and Regulations, a scheme of demerger has been proposed which is pending approvals from the authorities. Under this Scheme of Compromises, Arrangement and Reconstruction for Amalgamation / Demerger/Split LSE Financial Services Limited (LSEFSL)will be demerged with and into:

- LSE Ventures Limited (LVL)
- LSE Proptech Limited (LPL)

The second part of the demerger, involves the Amalgamation/ Merger of Data Textiles Limited, a public listed company currently on defaulters list with and into the newly created subsidiaries of LSEFSL, LSE Ventures Limited and LSE Proptech Limited, eventually converting LVL and LPL into listed entities.

LSE Ventures Limited (LVL)
The principal business of the Company is to make strategic & long-term investments and equity injection in other companies and undertakings in the form of equity, debentures, sukuks, commercial papers, hybrid instruments, warrants and any other type of shares or securities. Currently, the LVL is the wholly owned subsidiary of LSEFSL, however, post demerger LSEFSL will become the wholly owned subsidiary of LSE Ventures Limited (LVL). All strategic investments currently in LSEFSL will move into LVL.

LSE Proptech Limited (LPL)
The Company will develop, import, market, construct and maintain and offer software services for efficient real estate management and to provide online/ecommerce market places/networked warehouses and smart architectural, maintenance, safety, security and assurance solutions and eco-systems for buildings. On implementation of demerger, LVL will hold 30% of LPL while remaining 70% will be held by the shareholders of LVL. The property and its revenues currently parked in LSEFSL will be housed under LPL.

Rating Drivers

Proposed demerger to impact balance sheet size

In FY22, with the new shareholders coming in, a rights issue for Rs. 513m was subscribed which boosted paid up capital of LSEFSL to Rs. 1.79b. However, overall equity increase to Rs. 3.4b (FY21: Rs. 3.12b) was relatively lower due to sizable dividend payout of Rs. 301m in FY22. Going forward, once the demerger scheme is implemented, expected to be sanctioned by the year end and to be completed within the next 4-5 months, the balance sheet size of LSEFSL shall reduce as majority of the assets including the strategic investments of Rs. 1.5b and property asset of Rs. 1.2b shall move into LVL and LPL respectively. Post demerger equity base shall reduce to ~ Rs. 100m, limiting business operations and impacting overall competitive position of the Company.

While Company will move towards compliance, augmentation of revenue streams will be important

With the completion of the proposed demerger, the Company is expected to be compliant with the NBFC regulations. However, revenue streams will become limited. Currently, revenue mix include 30% from Margin Trading System (MTS)investment, 45% from rental business, 12% from fund management and about 6% from investment income. In addition, Rs. 179m was received as dividends from investment in associates in FY22. However, with the proposed demerger, revenues will primarily be generated from MTS investments, the size of which will also reduce given the reduced equity on the books. In addition to concentration risk, revenues will remain exposed to volatility in MTS business, which remains a function of capital market activity and interest rate movement. Going forward, augmentation of balance sheet footing and revenue streams will become important for the Company to maintain its competitive position.

BALANCE SHEET (in million PKR)	FY20	FY21	FY22	Q1'23
Property, Plant & Equipment	1,268.50	1,266.71	1,278.43	1,293.38
Investment Property	378.4	378.43	378.76	378.43
Investment Accounted for Using the Equity Method	996.3	1115.61	1146.98	1198.24
Financial Assets	467.167	507.29	845.16	0.00
Trade and Other Receivables	22.4	9.47	15.43	19.00
Cash and Bank Balances	69.7	79.82	94.89	25.52
Total Assets	3,249.20	3,406.94	3,868.64	3,884.69
Long Term Finances (including current maturity)	-	7.70	7.79	7.31
Trade and Other Payables	113.8	99.65	103.30	114.12
Total Liabilities	268.8	285.78	377.16	309.35
Paid Up Capital	1,282.80	1,282.84	1,795.98	1,795.98
Tier-1 Equity	2,189.10	2,344.93	2,716.91	2,757.98
Total Equity	2,980.50	3,121.15	3,491.48	3,575.34
INCOME STATEMENT	FY20	FY21	FY22	Q1'23
Net Financial Income from New Product Portfolio				
Total Revenue	175.8	153.18	174.89	64.52
Gain on Recognition of Finance Lease	-	0	0	0
Fair Value Gain on Revaluation of Investment Property	-	0	0	0
Operating Profit	65.6	35.55	12.53	0.08
Share of Profit of Associate (Using Equity Method)-Net of Tax	136.3	243.69	202.02	26.40
Profit/(Loss) Before Tax	201.9	279.14	214.09	26.39
Profit/(Loss) After Tax	160.1	235.98	157.27	41.74
RATIO ANALYSIS	FY20	FY21	FY22	Q1'23
Operating Margin (%)	48%	27%	8%	NA
Net Margin (%)	91%	154%	90%	NA
Current Ratio (x)	4.21	4.72	5.06	6.10
Efficiency (%)	63%	77%	93%	NA
ROAA (%)	5%	7%	4%	NA
ROAE (%)	7%	10%	6%	NA
Gearing (x)	0.00	0.00	0.00	0.00
Debt Leverage (x)	0.12	0.12	0.14	0.11

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				
14/02/2023	A	A-1	Rating Watch-Developing	Maintained
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.
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Due Diligence Meetings Conducted

	Name	Designation	Date
1	Mr. Ghulam Mustafa	Chief Financial Officer	Nov 16, 2022
2	Mr. Amir Zia	Chief Executive Officer	