

UNION LEASING LIMITED (ULL)

RATINGS (APRIL 2007)

UNION LEASING LIMITED

| | NEW | PREVIOUS |
|---------------|-----|----------|
| ENTITY | | |
| Long Term | A+ | A+ |
| Short Term | A1 | A1 |

FINANCIAL DATA

PKR (mln)

| | 30-Jun-06 | 30-Jun-05 |
|------------------|-----------|-----------|
| Total Assets | 4,262.2 | 4,455.4 |
| Equity | 507.0 | 542.2 |
| Profit after Tax | 0.3 | 84.1 |
| ROA % | 0.01 | 2.04 |
| ROE % | 0.07 | 16.71 |
| Equity/Assets % | 11.9 | 12.2 |

ANALYSTS

Susan S. Sharaf
+92 42 586 9504
susan@pacra.com

Moin Khalid
+92 42 586 9504
moin@pacra.com

ASSESSMENT

- The company's ratings reflect its strong association with Standard Chartered Bank of Pakistan Limited (SCBPL). SCBPL, rated AAA by PACRA, owns 66% stake in the company and nominees from the bank's professional staff dominate ULL's BOD. The new management is in the process of formulating a business strategy for the company. However, on a standalone basis, ULL has experienced substantial weakening of its financial profile as reflected by deterioration in core performance, erosion in asset quality, and, in turn, depleted risk absorption capacity.
- ULL's lease portfolio declined by around 5% during FY06 due to lower lease disbursements during the period. Meanwhile, in addition to switching to floating rate structure for all new leases, the company re-priced a large portion of its existing lease portfolio to manage the impact of higher interest rates. Although this strategy provided some support to the company's spreads, ULL could not fully avert the pressure and spreads declined to below 2%, leading to significant reduction in net interest revenue. However, the major setback to ULL's profitability was in the form of higher provisioning required against substantially increased portfolio of impaired leases that led to pre-tax loss for the period. The loss was masked by a reversal of an almost equivalent amount of deferred tax liability.
- During 1H FY07, the company's lending operations were almost discontinued and the finances portfolio has further declined to PKR 3bln by end-Dec 2006 (down by around 20%). At the same time, spreads have gone down further, resulting in substantial decline in net interest revenue. However, the major factor contributing to the substantial loss was provisioning against non-performing leases.
- The management is currently considering various options as to future business model to be followed by ULL. These options include a) merge ULL with SCBPL, b) continue with existing scope of operations c) convert ULL into a micro finance institution, or d) convert ULL into an asset management company. The management intends to finalize the strategy within FY07 and plans to start implementing the same in the following year. In this regard, the company would immensely benefit from its association with SCBPL. The company has access to global network of Standard Chartered and depending on the selected strategy, it would be in a position to adopt such business model implemented elsewhere alongwith related risk management framework. In the intervening period, lending operations would remain largely discontinued.
- ULL's asset quality has deteriorated substantially with impaired lending representing around 16% of the total portfolio at end-Dec 06 (FY06: 10%, FY05: 5%, FY04: 4%). Although a modest level of deterioration was observed in FY05, the weakening credit quality of the loan book was revealed subsequent to detailed evaluation of the portfolio by the new management. With gradual repayment of good quality loans, the proportion of relatively weak credit is increasing in the total loan book, particularly given the fact that fresh disbursements are limited. The new management has used subjective – indeed stringent – criteria to identify impaired portfolio. Hence, further material erosion in asset quality on account of impairment is unlikely. ULL has substantially enhanced the provision coverage (52% at end-Dec 06) at the expense of significant erosion in the company's equity. Meanwhile, the management has geared up recovery efforts and is hopeful of considerable success in this regard.
- Despite reduction in overall asset base, ULL's capital structure has weakened substantially due to reduction in its equity base (End-Dec 06 Equity/assets: 9%). Given limited volume expansion, further deterioration in capital structure is not expected except for any material impairment in the loan book, though unlikely.

KEY RATING DRIVERS

- These ratings are dependent on continuing strong support from SCBPL. Meanwhile, in case it is decided not to merge ULL with SCBPL, the strategy to establish itself in its identified business with related time line, while overcoming existing constraints of weak asset quality and capital structure, would be critical.

PROFILE

- Union Leasing Limited (ULL), incorporated in October 1993, is listed on all the three stock exchanges of the country. SCBPL, subsequent to its acquisition of Union Bank Limited, acquired control of ULL in the second half of 2006. The new CEO, Mr. Syed Ali Azhar Naqvi, who has recently joined Union Leasing, is a seasoned banker with a diversified national and international experience. Prior to joining ULL, he was managing an independent consultancy firm mainly focusing on financial institutions. Mr. Badar Kazmi, the CEO of SCBPL, is the new chairman of ULL.
- SCBPL – around 99% owned subsidiary of Standard Chartered Bank, UK (SCB) – is Pakistan's sixth largest bank, in terms of assets, and has a network of 116 branches across Pakistan. While SCB is a London based international bank with a significant focus on emerging markets. It has a network of over 1,400 branches (including subsidiaries, associates and joint ventures) in over 50 countries.