SME Bank Ltd
small business - Big opportunities

SME BANK LIMITED

UN CONSOLIDATED FINANCIAL STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2016

DIRECTORS' REPORT TO THE SHAREHOLDERS

We are pleased to present the 15th annual report of SME Bank Limited with the audited accounts and auditors' report thereon for the year ended December 31, 2016.

Economic Review

The onset of 2017 has mainly seen positive vibes coming out of the Pakistan Economy. This has not happened overnight and has been the effect of structural reforms and prudent monetary and fiscal policies. Growth accelerated in Pakistan in Fiscal Year 2016 due to these policies, sharply lower oil prices, and improved security, outpacing earlier growth forecast despite a major crop failure. Inflation and the current account deficit were lower than expected, while foreign exchange reserves strengthened and the budget deficit shrank. During the period under review (CY16), due to further abatement in inflationary pressures (average inflation of 3.76%), State Bank of Pakistan (SBP) reduced the policy rate by a cumulative 75 bps in CY 16 followed by a 350 bps reduction in CY15. SBP in its policy statement highlighted:

(i) improvement in the macroeconomic conditions;
(ii) better law and order situation; and
(iii) Positive growth prospects underpinned by investment under China Pakistan Economic Corridor (CPEC).

Supportive provisions from the International Monetary Fund, the World Bank and the Asian Development Bank also assisted the foreign exchange reserves to reach an all-time high of USD 23 billion, providing an effective import cover of 5 months and stability to the local currency.

Worsening liquidity situation and banks' insatiable appetite for risk free securities crowded out private sector and advances only posted a meagre growth of 5.1% in CY16.

Banks are facing challenges in keeping the balance between profitability and liquidity management as the market is short by an average of Rs 850 billion, which is injected by the SBP through OMOs on a weekly basis.

As far as the interest rate scenario is concerned, we do not see the reversal in the monetary policy in the short to medium term. With a plethora of positive developments at the macro level engineered by the current finance team, the Government has enough space to bolster the economy through easy monetary policy.

Operational Highlights

The Bank is operating with paid capital of Rs 2.39 billion since 2007. State Bank has granted exemption to meet the requirement of minimum paid up capital of Rs 10 billion by June 30, 2017. Shareholders in their meeting on October 7, 2009, advised to recapitalize the bank by increasing its paid-up capital and management has approached Ministry of Finance for the same. The Board noted that in view of impending privatization of the Bank, SBP's constraints on business expansion, and very narrow equity base of less than Rs 2 billion, it is a challenge to operate the bank on self sustainable basis.

In view of restrictions placed by State Bank of Pakistan there was no change in branch network during the year 2016 and the Bank continued to operate with 13 commercial banking branches and five recovery offices.

Interest Rate Scenario

SBP discount rate at the beginning of the year 2016 was 6.50 percent. During the year the net decrease in discount rate was 0.25 percent to bring the discount rate to 6.25 percent at year end. The change in discount rate also affects KIBOR for different tenors and income of the bank as compared to previous year.

Credit Rating

Bank was assigned a long term as well as short term credit rating of B (Single B) by PACRA credit rating agency on April 14, 2016. The credit rating company has expressed that growth in the bank's operations is restricted due to delay in injection of additional equity into the bank; that although the management is taking measures to improve business functions, operational sustainability is dependent upon equity injection by the primary sponsor.

Operational Results

In the backdrop of narrow equity base and shortage of funds, management has been able to meet day to day liquidity needs and maintenance of statutory liquidity requirements (SLR) set by the State Bank of Pakistan. Despite enormous pressure of liquidity crunch, loans and advances portfolio stood at Rs 2,996 million. During the year under review income from SME lending operations decreased by an amount of Rs 111.305 million. The cost of deposits and borrowing increased by an amount of Rs 4.924 million. The average cost of deposits decreased to 5.94% as compared to 7.13% in 2015.

The bank has booked before tax loss of Rs 457 million during the year 2016 as compared to before tax loss of Rs 275 million in 2015, and Net loss of Rs 199 million as compared to Net loss of Rs 282 million in 2015. The reason for incurring losses were due to pending privatization, restructuring, limited outreach, inadequate level of equity and economic condition. In future, we expect to decrease the losses by enhancing revenues and reducing volume of our Non-performing loans.

During the year 2016, the bank reversed net provision of Rs 2.102 million against non-performing loans as against reversal of provision of Rs 63 million in 2015. Loans and advances on account of the bank's lending operation were Rs 2,995 million in 2016 to Rs 2,990 million in 2015.

The ongoing energy crises seriously dampened the business activities in the country to a great extent, which in turn affected the repayment capacity and behaviour of the bank's borrowers but despite these hindrances the management of the bank made persistent efforts to reduce the non-performing loans of the bank resulting in decrease from Rs 611 million on December 31, 2015 to Rs 514 million on December 31, 2016.

The deposits of the bank has been increased by Rs. 459 million and stand at Rs 5,229 million as on December 31,2016 as compared to last year Rs. 4,770 million as on December 31,2015.

Bank has investment of Rs. 215.46 million in SME Leasing Limited (SMEL) which is carried in these financial statements at Rs. 128,495 million and has outstanding running finance exposure of Rs. 126,580 million at the balance sheet date. The company during the year has mainly focused on internal cash generation through recoveries of non-performing loans and investing them to build-in the fresh healthy portfolio. The company has managed to disburse Rs. 98 million against fresh leases out of its recoveries totaling to Rs. 145 million and also managed to finance its operating expenses to some extent. Market value of its share has witnessed some inclination and stood at Rs 3.69 per share