

SME BANK LIMITED
Directors' Review on Operational Results for the nine months ended
September 30, 2011

We are pleased to present the operational results of SME Bank for the nine months ended September 30, 2011.

The Bank is operating with very narrow equity base of Rs 2.04 billion and is in dearth of sufficient liquidity to build its loan portfolio. Limited branch network is also one of the impediments in business expansion. Under these circumstances the smooth operation of Bank on self sustained basis hinders, yet management is striving hard to bring operations on self sustainable basis. Government of Pakistan taking cognizance of the situation allocated an amount of Rs 2.5 billion during annual budget 2010-11 for equity injection in to the Bank. However due to financial constraints at the level of government, the amount could not be released but an amount of Rs. 2.0 billion has been re allocated in the budget 2011-12.

Management of the Bank was changed during March 2011. New President & CEO is taking necessary measures to control losses and enhance profitability of the Bank. There are indications to believe that performance of the Bank has started to improve.

Financial Review

- Operating income of the Bank for the nine months ended September 30, 2011 is Rs 542 million as compared to Rs 503 million on September 30, 2010. The financial expenses have increased from Rs 276 million in Sep 2010 to Rs 324 million in Sep 2011 due to increase in deposit base from 2,029 million to Rs 2,806 million. The average cost of funds has increased from 9.88% to Rs 10.39% due to increase in term deposits and SBP discount rate. The administrative expenses have increased from Rs 384 million in Sep 2010 to Rs 406 million in Sep 2011 due to annual increments and price inflation.

The management has been able to grasp the trend of inflow to non performing loans. On the other hand, State Bank of Pakistan has allowed benefit of forced sale value of eligible collaterals/securities held against non performing loans. The bank opted for this benefit and resultantly requirement of provision against non performing loans has reduced by an amount of Rs 150 million during the quarter ended September 30, 2011.

However, limited branch network and narrow equity base remained major impediments in building loan portfolio to the level of sustainable operations. Resultantly, the Bank has incurred before tax loss of Rs 56 million as compared to before tax loss of Rs 290 million in the corresponding period of the year 2010.

Due to increase in deposit base of the Bank, the net borrowing from money market has reduced from Rs 1,361 million in Dec 2010 to Rs 785 million in Sep 2011. Net investment of the Bank stands at Rs.2,963 million, the major chunk of which is in government securities.

Paid Up Capital

- The Paid up Capital of the Bank remained at Rs 2.392 billion and the Bank continued to operate with less than the required minimum capital on the basis of exemption granted by State Bank of Pakistan. The Minimum Capital Requirement set by the State Bank requires the Banks to have Rs. 8.0 billion as paid up capital by the end of year 2011.

Disbursements & Recoveries

- During the period under review, the Bank has been able to make

disbursements of Rs 1,103 million and recoveries of Rs 435 million. On the other side due to low equity base, poor credit rating and uncertainty prevailing in the market about future of the Bank, the management continued to face difficulties in attracting new clients. However, gross outstanding portfolio of the Bank increased by Rs 68 million as compared to September 2010.

Interest Income and Expense

- Total income amounted to Rs 542 million (2010: Rs.502 million) of which treasury business generated Rs 268 million (2010: Rs. 211 million) while performance of SME lending operations generated Rs. 259 million (2010: Rs. 248 million). The income through recovery from old portfolio of defunct SBFC & RDFC ceased after 30th June, 2010 due to handing over of old portfolio to National Bank of Pakistan under an agreement of recovery sharing. However on the recommendation of present management, Board observed that, the agreement has caused loss to the Bank and has advised the management to take up with Ministry Of Finance for cancellation of the agreement.

- Mark up expense on account of customer deposits and money market borrowing have increased from Rs 276

million in Sep 2010 to Rs 324 million in Sep 2011 due to increase in the deposit base of the Bank. Average cost of funds has increased from 9.88% in Sep 2010 to 10.39% in Sep 2011 due to increase in term deposits and SBP discount rate. On the other hand, due to low credit rating, management has been facing great difficulties to attract large deposits from the public sector institutions because of policy of these institutions.

- Administrative Expenses of the Bank have increased from Rs 384 million in Sep 2010 to Rs 406 million in Sep 2011. The increase is attributable towards inflation and annual increment allowed to the employees.

- For the Bank to operate on self sustainable basis, injection of fresh equity and expansion of branch network

are of critical importance. Increase in equity base will help to improve performance and increase profitability of the Bank.

- We would like to place on record, our thanks to State Bank of Pakistan and other regulatory authorities for their continued support and guidance and the Shareholders for the trust and confidence reposed in us.

For and on Behalf of
Board of Directors




Chairman

SME Bank Limited
 Condensed Interim Unconsolidated Statement of Financial Position
 As at September 30, 2011

		(Un-audited) September 30, 2011	(Audited) December 31, 2010
	Note	(Rupees in '000)	
			Restated
ASSETS			
Cash and balances with treasury banks		205,349	227,980
Balances with other banks		4,296	9,091
Lendings to financial institutions	8	1,140,000	-
Investments	9	2,962,590	2,892,131
Advances	10	2,522,591	2,510,780
Operating fixed assets	11	115,923	109,854
Deferred tax assets		-	-
Other assets		227,452	255,807
		7,178,201	6,005,643
LIABILITIES			
Bills payable		48,556	40,505
Borrowings from financial institutions		1,924,891	1,360,622
Deposits and other accounts		2,806,090	2,225,822
Sub-ordinated loans		-	-
Liability against assets subject to finance lease		16,341	22,215
Deferred tax liabilities		-	-
Other liabilities		342,892	332,737
		5,138,770	3,981,901
NET ASSETS		2,039,431	2,023,742
REPRESENTED BY			
Share capital		2,392,507	2,392,507
Reserves		206,526	206,526
Unappropriated loss		(485,337)	(423,859)
		2,113,696	2,175,174
(Deficit)/ Surplus on revaluation of assets		(74,265)	(151,432)
		2,039,431	2,023,742

CONTINGENCIES AND COMMITMENTS

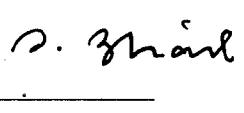
The annexed notes 1 to 16 form an integral part of these condensed interim unconsolidated financial information.


 CFO & Company Secretary


 President/Chief Executive


 Director


 Director


 Director

SME Bank Limited

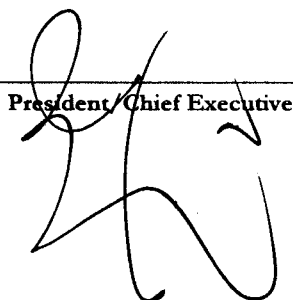
Condensed Interim unconsolidated Profit and Loss Account (Un-audited)

For the Nine months ended September 30, 2011

	Septmebr 30, 2011		September 30, 2010	
	For the Quarter ended	For the Nine months ended	For the Quarter ended	For the Nine months ended
	(Rupees in '000)			
Mark-up/ return/ interest earned	186,669	526,387	152,114	458,934
Mark-up/ return/ interest expensed	120,702	324,386	91,562	276,448
Net mark-up/ interest income	65,967	202,001	60,552	182,486
Provision against non-performing loans advances-net of reversal	10.4 (153,559)	(132,242)	34,316	144,602
Provision for diminution in the value of investments	-	-	-	(12,814)
Bad debts written off directly	(4)	396	213	391
	(153,563)	(131,846)	34,529	132,179
Net mark-up/ interest income after provisions	219,530	333,847	26,023	50,307
NON MARK-UP/ INTEREST INCOME				
Fee, commission and brokerage income	3,299	9,675	2,820	9,647
Dividend income	15	2,527	15	2,432
Income from dealing in foreign currency	-	-	-	-
Unrealized gain / (loss) on revaluation of investments classified as held for trading	-	142	-	415
Other income	1,398	3,331	29,488	31,053
Total non-markup/ interest income	4,712	15,675	32,323	43,547
	224,242	349,522	58,346	93,854
NON MARK-UP/ INTEREST EXPENSE				
Administrative expenses	136,991	413,602	121,115	373,451
Other provisions/ write offs	(10,875)	(8,053)	1,957	5,992
Other charges	-	48	(17)	4,267
Total non-markup/ interest expenses	126,116	405,597	123,055	383,710
(LOSS)/ PROFIT BEFORE TAXATION	98,126	(56,075)	(64,709)	(289,856)
Taxation - Current	1,912	5,403	1,697	4,850
- Prior years	-	-	-	306,353
- Deferred	-	-	-	-
	1,912	5,403	1,697	311,203
(LOSS)/ PROFIT AFTER TAXATION	96,214	(61,478)	(66,406)	(601,059)
Unappropriated loss brought forward	(581,551)	(423,859)	(741,501)	(206,848)
Loss available for appropriation	(485,337)	(485,337)	(807,907)	(807,907)
Basic/ Diluted (Loss)/ Earning per share (Rupees)	0.40	(0.26)	(0.28)	(2.51)

The annexed notes 1 to 16 form an integral part of these condensed interim unconsolidated financial information.


CFO & Company Secretary


President/Chief Executive


Director

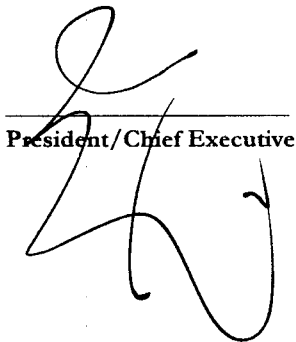
 
Director Director

SME Bank Limited
 Condensed Interim Unconsolidated Statement of Comprehensive Income (Un-audited)
 For the Nine months ended September 30, 2011

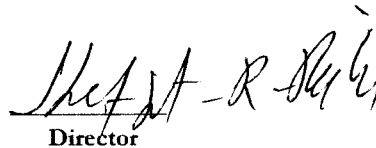
	September 30, 2011		September 30, 2010	
	For the Quarter ended	For the Nine months ended	For the Quarter ended	For the Nine months ended
	(Rupees in '000)			
Net (loss)/ profit after taxation	96,214	(61,478)	(66,406)	(601,059)
	<u>96,214</u>	<u>(61,478)</u>	<u>(66,406)</u>	<u>(601,059)</u>
Components of comprehensive income not reflected in equity				
Net change on remeasurement of available for sale investment to fair value	35,294	77,167	(7,054)	19,377
Total comprehensive (loss)/ income for the year	<u>131,508</u>	<u>15,689</u>	<u>(73,460)</u>	<u>(581,682)</u>


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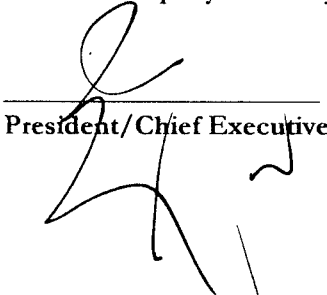
Condensed Interim Unconsolidated Cash Flow Statement (Un-audited)

For the Nine months ended September 30, 2011

	September 30, 2011	September 30, 2010
Note	(Rupees in '000)	
CASH FLOW FROM OPERATING ACTIVITIES		
(Loss)/ Profit before taxation	(56,075)	(289,856)
Less: Dividend income	(2,527)	(2,432)
	<u>(58,602)</u>	<u>(292,288)</u>
Adjustments for non-cash/ other items		
Depreciation	9,746	10,172
Amortization	1,148	1,173
Provision against non-performing loans and advances	(132,242)	144,602
Provision for impairment in value of investments	-	(12,814)
Net (Profit)/Loss on sale of fixed asset	(521)	(14,668)
Finance charges on leased assets	758	294
Other provisions/ write offs	(8,053)	5,992
Bad debts written off directly	396	391
	<u>(128,768)</u>	<u>135,142</u>
	<u>(187,370)</u>	<u>(157,146)</u>
(Increase)/ Decrease in operating assets		
Lendings to financial institutions	(900,000)	33,445
Advances	120,035	45,794
Other assets (excluding advance taxation)	36,407	239,606
	<u>(743,558)</u>	<u>318,845</u>
Increase/ (Decrease) in operating liabilities		
Bills payable	8,051	1,793
Borrowings from financial institutions	564,269	(307,785)
Deposits	580,268	(173,782)
Other liabilities (excluding current taxation)	17,416	(51,085)
	<u>1,170,004</u>	<u>(530,859)</u>
	<u>239,077</u>	<u>(369,160)</u>
Income tax paid	(12,664)	(4,101)
Net cash flow used in operating activities	<u>226,413</u>	<u>(373,261)</u>
CASH FLOW FROM INVESTING ACTIVITIES		
Net (investments)/de-investment in available-for-sale securities	(193,292)	221,130
Net (investments)/de-investment in held-to-maturity securities	200,000	53,360
Dividend income	2,527	2,432
Investments in operating fixed assets	(17,230)	(4,724)
Sale proceeds of property and equipment disposed-off	788	15,125
Net cash flow from/(used in) investing activities	<u>(7,207)</u>	<u>287,323</u>
CASH FLOW FROM FINANCING ACTIVITIES		
Payment of lease obligations	(6,632)	(3,678)
Net cash flow from financing activities	<u>(6,632)</u>	<u>(3,678)</u>
Increase in cash and cash equivalents	<u>212,574</u>	<u>(89,616)</u>
Cash and cash equivalents at beginning of the year	<u>237,071</u>	<u>271,074</u>
Cash and cash equivalents at the end of period	<u><u>449,645</u></u>	<u><u>181,458</u></u>

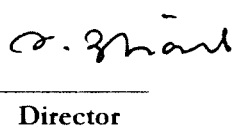
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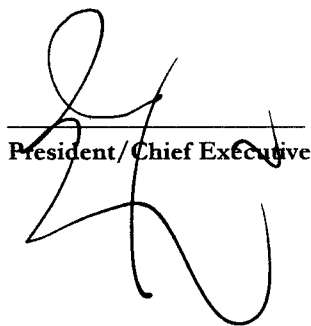

Director

SME Bank Limited
 Condensed Interim Unconsolidated Statement of Changes in Equity (Un-audited)
 For the Nine months ended September 30, 2011

	Share Capital	Statutory reserve	Unappropriated loss	Total
	(Rupees in '000)			
Balance as at January 1, 2010	2,392,507	206,526	(206,848)	2,392,185
Payable to Industrial Credit for Rural Women transferred to unappropriated Loss (note 12)	-	-	30,851	30,851
Balance as at January 1, 2010 - Restated	2,392,507	206,526	(175,997)	2,423,036
Net Loss for the period	-	-	(601,059)	(601,059)
Transfer to statutory reserve	-	-	-	-
Balance as at September 30, 2010 - Restated	2,392,507	206,526	(777,056)	1,821,977
Net Profit for the period from October 10 to December 31, 2010	-	-	353,197	353,197
Balance as at December 31, 2010 - Restated	2,392,507	206,526	(423,859)	2,175,174
Net loss for the period	-	-	(61,478)	(61,478)
Transfer to statutory reserve	-	-	-	-
Balance as at September 30, 2011	2,392,507	206,526	(485,337)	2,113,696

The annexed notes 1 to 16 form an integral part of these condensed interim unconsolidated financial information.


 CFO & Company Secretary


 President/Chief Executive


 Director

 
 Director Director

SME Bank Limited

Notes to the Condensed Interim Unconsolidated Financial Information (Un-audited)

For the quarter ended September 30, 2011

1. GENERAL INFORMATION

- 1.1 SME Bank Limited (the Bank) is a public limited company incorporated in Pakistan on October 30, 2001 under the Companies Ordinance, 1984 having its registered office at 40-Jang Building, A.K. Fazal ul Haq road, Blue area, Islamabad. The Bank obtained its business commencement certificate on April 16, 2005 which became effective from the date of its issue. The Bank is now a Scheduled Commercial Bank engaged in the business of banking with the primary objective to support and develop Small and Medium Enterprise (SME) sector in Pakistan by providing necessary financial assistance and business support services on sustainable basis. The Bank is operating through a network of 13 Commercial banking branches. Based on the latest credit rating report dated June 30, 2011 issued by JCR-VIS Credit Rating Company Limited, credit rating of the Bank was BBB (triple B) in the long term and A-3 (A three) in the short term.

In terms of the provisions of the State Bank of Pakistan BSD circular No. 7 of 2009, the Bank was required to increase its paid up capital (net of losses) as at December 31, 2011 up to Rs. 8 billion. The State Bank of Pakistan (SBP) has granted exemption from meeting the enhanced Minimum Capital Requirement and the Bank is allowed to operate with minimum paid up capital (net of losses) of Rs. 2 billion till privatization of the Bank.

1.2 Amalgamation of defunct RDFC and SBFC

The Federal Government promulgated the Regional Development Finance Corporation (RDFC) and Small Business Finance Corporation (SBFC) Amalgamation and Conversion Ordinance, 2001 (the Ordinance 2001) setting forth the mechanism of amalgamation of defunct RDFC and SBFC. Both these entities were Development Financial Institutions (DFIs). In pursuance of the Ordinance 2001, Finance Division, Ministry of Finance issued an Order (SRO (1) 2001) dated December 29, 2001 setting forth the scheme of amalgamation of RDFC and SBFC with the Bank effective January 1, 2002. Pursuant to this scheme entire assets and liabilities of defunct RDFC and SBFC as at December 31, 2001 were transferred to the Bank at fair value. These two institutions stand dissolved and ceased to exist effective January 1, 2002. The Bank allotted its shares to the share holders of defunct RDFC and SBFC in proportion to their shareholding therein based on the fair value of net assets of defunct RDFC and SBFC on December 31, 2001.

2. BASIS OF PRESENTATION

This condensed interim unconsolidated information is presented in condensed form in accordance with approved accounting standards as applicable in Pakistan for Interim Financial Reporting. This condensed interim unconsolidated financial information does not include all of the information required for full financial information and should be read in conjunction with the financial statements of the Bank for the year ended December 31, 2010.

3. STATEMENT OF COMPLIANCE

- 3.1 This condensed interim unconsolidated financial information of the Bank for the nine months ended September 30, 2011 is unaudited and has been prepared in accordance with the requirements of the International Accounting Standard 34 - Interim Financial Reporting and the requirements of BSD Circular Letter No. 2 dated May 12, 2004 and provisions of and directives issued under the Companies Ordinance, 1984, the Banking Companies Ordinance, 1962 and the directives issued by the Securities and Exchange Commission of Pakistan (SECP) and the State Bank of Pakistan (SBP). In case where requirements differ, the provisions of and directives issued under the Companies Ordinance 1984 and the Banking Companies Ordinance, 1962, and the directives issued by SECP and SBP have been followed.

Accounting standards, amendments and interpretations to such standards that are mandatory for accounting periods beginning on or after January 01, 2011 which are either not relevant or considered to have no significant effect on these financial statements or disclosures thereof, are not listed in this condensed interim unconsolidated financial information.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies and methods of computation adopted in the preparation of this condensed interim financial information are the same as those applied in the preparation of the financial statements for the year ended December 31, 2010, except for the inclusion of the following:

SMEBL Employees Empowerment Trust

On August 14, 2009, the Government of Pakistan (GoP) launched Benazir Employees' Stock Option Scheme ("the Scheme") for employees of certain State Owned Enterprises (SOEs) and non-State Owned Enterprises where GoP holds significant investment (non-SOEs). The scheme is applicable to permanent and contractual employees who were in employment of these entities on the date of launch of the Scheme, subject to completion of five years vesting period by all contractual employees and by permanent employees in certain instances.

The Scheme provides for a cash payment to employees on retirement or termination based on the price of shares of respective entities. To administer this scheme, GoP shall transfer 12% of its investment in such SOEs and non-SOEs to a Trust Fund to be created for the purpose by each of such entities. The eligible employees would be allotted units by each Trust Fund in proportion to their respective length of service and on retirement or termination such employees would be entitled to receive such amounts from Trust Funds in exchange for the surrendered units as would be determined based on market price for listed entities or breakup value for non-listed entities. The shares relating to the surrendered units would be transferred back to GoP.

The scheme also provides that 50% of dividend related to shares transferred to the respective Trust Fund would be distributed amongst the unit holder employees. The balance 50% dividend would be transferred by the respective Trust Fund to the Central Revolving Fund managed by the Privatisation Commission of Pakistan for payment to employees against surrendered units. The deficit, if any, in Trust Funds to meet the re-purchase commitment would be met GoP.

The Scheme, developed in compliance with the stated GoP policy of empowerment of employees of State Owned Enterprises need to be accounted for by the covered entities, including the Company, under the provisions of amended International Financial Reporting Standards 2 Share Based Payments (IFRS 2). However, keeping in view the difficulties that may be faced by the entities covered under the Scheme, the Securities & Exchange Commission of Pakistan on receiving representations from some of entities covered under the Scheme and after having consulted the Institute of Chartered Accountants of Pakistan vide their letter Ref: CAIDTS/PS&TAC/2011-2036 dated February 02, 2011 has granted exemption to such entities from the application of IFRS 2 to the Scheme.

Ministry of Finance (MOF) Government of Pakistan (GoP) executed a "Deed of Trust" on 10th day of June 2010 for creating and regulating a trust known as the SMEBL Employees Empowerment Trust (the trust) and vest the same in a Board of Trustees. According to Para 2 sub para (1b) of the Deed of Trust, 12% shares of the Bank out of the total shareholding of GoP are to be transferred by MOF to the trust. Management has requested MOF for transfer of 12% shares out of the GoP shareholding in the Bank and forward Share Transfer Deed duly signed by the competent authority.

The Ministry of Finance (GoP) has not yet transferred its investment to the trust and accordingly the impact of exemption from IFRS 2 cannot be quantified at this stage.

5. ACCOUNTING ESTIMATES

The basis for accounting estimates adopted in the preparation of this condensed interim unconsolidated financial information are the same as those applied in the preparation of the financial statements of the Bank for the year ended December 31, 2010.

6. FINANCIAL RISK MANAGEMENT

The financial risk management objective and policies adopted by the Bank are consistent with that disclosed in the financial statements of the Bank for the year ended December 31, 2010

7. FINANCIAL RESTRUCTURING AND GOING CONCERN ASSUMPTION

7.1 The Government of Pakistan (GoP) assisted by Asian Development Bank (ADB) is working on SME Sector Development Programme (SME SDP). Loan agreement for this programme between GoP and ADB and project agreement between ADB, SBP, Small and Medium Enterprise Development Authority (SMEDA) and the Bank have been signed on February 10, 2004. This programme, apart from other aspects on policy matrix relating to SME sector of Pakistan, also envisages restructuring of SME Bank Limited. Salient features of the restructuring of the Bank are given below:

- i) Adjustment of accumulated balances due from SBP on account of its share in profits and losses of the Bank against credit lines provided by SBP;
- ii) Payment of Rs 3 billion to SBP before January 1, 2004 against outstanding credit lines and conversion of balance of remaining credit lines into a loan repayable in full by June 30, 2006;

- iii) Raising the paid-up capital to Rs 1,100 million by issuing additional shares to GoP;
- iv) The Ministry of Finance (MoF) shall ensure that SBP's shareholding in the Bank is terminated through the purchase of SBP held shares at nominal value by shareholders or otherwise;
- v) 100% provision to be made against non performing financial assistance extended by the defunct RDFC and SBFC prior to January 1, 2002 which provision to be adjusted against SBP credit lines. SBP will recover this amount from proceeds of ADB loan to GoP;
- vi) Reduction in the number of recovery branches, staff rationalization through Voluntary Separation Scheme (VSS), human resource audit and hiring of new professional staff on merit;
- vii) Reimbursement by GoP of costs related to VSS launched for all regular employees;
- viii) SBP to issue a banking license to the Bank on compliance with all conditions of restructuring and applicable SBP regulations. The commercial banking operations will be separate from the recovery operations of the defunct RDFC and SBFC portfolio and the two operations will be run as independent units within the Bank; and
- ix) Privatization of the Bank by June 2006.

7.2

Current status of the above referred financial restructuring is given below:

- i) Accumulated balances of Rs 3,275.752 million due from SBP on account of its share in profits and losses of the Bank have been adjusted against credit lines provided by SBP;
- ii) Rs. 7,393 million has been paid to SBP since 2003, to fully adjust the loan liability.
- iii) Paid-up capital has been increased to Rs. 2,393 million by issue of 73,502,453 additional shares of Rs 10 each to GoP without right issue in 2004, issue of 40,000,000 additional shares of Rs 10 each to GoP without right issue in 2005, issue of 50,000,000 additional bonus shares of Rs 10 each to GoP without right issue in 2006 and issue of 39,250,700 additional shares of Rs. 10 each to GoP without right issue in 2007. Proceeds against issue of additional shares in 2004 were paid by GoP to SBP against the Bank's loan balance due to SBP;
- iv) Provision of Rs 1,283.196 million against non performing financial assistance extended by the defunct RDFC and SBFC was adjusted against credit lines of SBP in 2003;
- v) VSS was approved by the Board of Directors of the Bank on November 7, 2003. 707 employees were relieved under the scheme upto December 31, 2005 and the aggregate reported cost for 707 employees was Rs. 1,764.268 million, which has been received by the bank by March 31, 2007;
- vi) Human resource technical audit has been completed and report has been submitted to the Bank;

- vii) Banking license was issued by SBP on September 13, 2004 and the Bank has started banking operations after the issue of certificate for commencement of banking business by SBP on April 16, 2005;
- viii) Privatization Commission (PC) has constituted a transaction committee which is represented by members from the Privatization Commission, State Bank of Pakistan, Ministry of Finance and the Bank. Privatization Commission has approved M/s BMA Capital as Financial Advisors for the Bank and due diligence exercise for the privatization of the Bank has been carried out in the year 2008;
- ix) No further progress has been made on the privatization of the Bank.

7.3

Further restructuring of SME Bank:

In compliance to the decisions taken during meeting at Ministry of Finance dated September 14, 2009 following actions have been undertaken.

- i) VSS offered to the regular employees of the Bank in November 2009, wherein 139 employees opted for VSS offered vide Circular No. HO/HR&SD/2009/5385 dated October 15, 2009. These employees have been relieved at a total cost of Rs. 661 million with effect from November 14, 2009;
- ii) The Old portfolio of defunct RDFC & defunct SBFC has been transferred to National Bank of Pakistan with effect from 1st July 2010. Consequently all the recovery offices and recovery booths have been closed. However, staff of the recovery offices have been advised to continue to maintain and keep the safe custody of records and assets including loan files, security documents, books of accounts, vehicles, furniture/fixture and other assets till handing over of all the relevant records to the concerned institution; and
- iii) Government of Pakistan have allocated an amount of Rs. 2 billion in the annual budget 2011-12 for equity injection into the Bank.

7.4

Going concern assumption

During the period, the Bank has incurred a net loss of Rs. 61 million resulting in accumulated losses of Rs. 485 million (December 31, 2010: Rs. 424 million) as of balance sheet date. The Government of Pakistan (GoP), hold 94% shares of the Bank through Ministry of Finance (MoF). The Government has made a budget allocation to provide further equity contribution. The Bank's management therefore believes that GoP will provide further equity contribution to the Bank and therefore the going concern assumption is an appropriate basis to prepare these financial statements.

SME Bank Limited

Notes to the Condensed Interim Unconsolidated Financial Statements (Un-audited)

For the Nine months ended September 30, 2014

8	LENDINGS TO FINANCIAL INSTITUTIONS	Note	(Un-audited)	(Audited)
			September 30, 2011	December 31, 2010
	Call money lendings		240,000	-
	Others (Clean Lending)		900,000	-
			<u>1,140,000</u>	<u>-</u>

8.1 These lendings carry markup rate ranging between 11% to 14% per annum and have maturity period upto 4 months

9 INVESTMENTS

	Held by the bank	Given as collateral	Total
	(Rupees in '000)		
As at September 30, 2011 (Un-audited)	<u>1,080,451</u>	<u>1,882,139</u>	<u>2,962,590</u>
As at December 31, 2010 (Audited)	<u>1,531,177</u>	<u>1,360,954</u>	<u>2,892,131</u>

9.1 INVESTMENTS BY TYPES:

Available-for-sale securities

Market Treasury Bills (MTBs)	584,666	470,671	1,055,337
Pakistan Investment Bonds (PIBs)	252,308	1,489,725	1,742,033
Fully paid ordinary shares/mutual funds	46,427	-	46,427
Term Finance Certificates (TFCs)	19,560	-	19,560
	<u>902,961</u>	<u>1,960,396</u>	<u>2,863,357</u>

Held-to-maturity securities

Letter of placement (LOP)	-	-	-
Term Deposit Receipts (TDRs)	-	-	-
Certificates of Investments (COIs)	762	-	762
	<u>762</u>	<u>-</u>	<u>762</u>

Investment in subsidiary

SME Leasing Limited	215,457	-	215,457
Investments at cost	<u>1,119,180</u>	<u>1,960,396</u>	<u>3,079,576</u>
Less: Provision for diminution in value of investments	<u>(42,721)</u>	<u>-</u>	<u>(42,721)</u>
Investments net of impairment	<u>1,076,459</u>	<u>1,960,396</u>	<u>3,036,855</u>
Surplus/(deficit) on revaluation of Available-for-sale-securities	<u>3,993</u>	<u>(78,258)</u>	<u>(74,265)</u>
Total Investments at market value	<u>1,080,451</u>	<u>1,882,139</u>	<u>2,962,590</u>

	Note	(Un-audited) September 30, 2011	(Audited) December 31, 2010
(Rupees in '000)			
10. ADVANCES			
Loans, cash credits, running finances, etc- In Pakistan			
Extended by:			
Defunct SBFC	10.1	4,392,516	4,406,468
Defunct RDFC	10.1	509,185	540,039
SME Bank Ltd		2,567,697	2,687,773
Due from ex-employees	10.1	21,031	21,153
Due from employees		175,012	185,124
		<u>7,665,441</u>	<u>7,840,557</u>
Net investment in finance lease - In Pakistan	10.1	1,253	1,253
Advances - gross		<u>7,666,694</u>	<u>7,841,810</u>
Provision for non-performing advances - specific	10.4	(5,144,103)	(5,331,030)
Advances - net of provision		<u>2,522,591</u>	<u>2,510,780</u>

10.1 Assignment of Non-Performing Loan (NPL) portfolios of defunct SBFC & RDFC to National Bank of Pakistan (NBP)

The Board through its resolution by circular No.10/circ/33 dated March 08, 2010 duly endorsed by the members in their meeting dated May 20, 2010 has approved the transfer and assignment of the non-performing loan portfolios of defunct RDFC and SBFC to NBP on the basis of deferred transfer price. Subsequently transfer and assignment agreement was executed between SME Bank Limited and National Bank of Pakistan at Karachi on July 01, 2010 (Effective date). According to the agreement, the transferor (SME) and the acquirer (NBP) acknowledge, declare and confirm the transfer, assignment and vesting of all rights, interests, privileges, title, powers and remedies in favour of the acquirer with respect to:

- the non-performing loans, collateral and the debtors;
- all agreements, deeds, instruments and other documents relating to the non-performing loans, debtors and collateral and to which the transferor is, or legally deemed to be, a party or a beneficiary;
- all legal proceedings by and against the transferor with respect to the non-performing loans, the debtors and collateral, which may be pending before any court, tribunal, arbitrator or authority, without being subject to any liabilities of the transferor to any person.

The agreed transfer price is an amount equal to 50% of the net recoveries or 25% of the gross recoveries which ever is higher in first two anniversaries and 50% of the net recovery from 2nd anniversary.

Since certain clauses of portfolio transfer agreement have not been implemented including issuance of notices to the borrowers of defunct RDFC and SBFC etc, the outstanding portfolio relating to defunct RDFC and SBFC stands recognized in the financial statements of the Bank.

Although the Board through its resolution by circular No.10/circ/33 dated March 08, 2010 duly endorsed by the members in their meeting dated May 20, 2010 had approved the transfer and assignment of non performing portfolio of defunct SBFC & RDFC to NBP on the basis of deferred transfer price however on assumption of charge, the new management of the Bank has re-visited and re-analyzed the whole transaction and observed that clauses of agreement signed with NBP are detrimental to SME Bank's interests and causing financial loss to the Bank. The management therefore recommended the cancellation of transfer and assignment agreement to the Board of Directors in its 64th meeting dated May 16, 2011. The Board has in principle agreed with the management recommendation and advised the management to convey its views along with legal opinion, NBP recovery performance and Board's pronouncement for revocation of agreement to Ministry of Finance to arrange retrieval/restoration of old portfolio to SME Bank in the interest of recovery of public funds.

The management is accordingly taking suitable steps for cancellation of transfer and assignment agreement with National Bank of Pakistan. However since the portfolio transfer agreement dated 1st July 2010 with NBP has not formally been cancelled, the amount recovered by the Bank from the borrowers of defunct RDFC and SBFC has been recognized as liability to NBP.

10.2 NET INVESTMENT IN FINANCE LEASE	(Un-audited) September 30, 2011				(Audited) December 31, 2010			
	Not later than one year	Later than one and less than five years	Over five years	Total	Not later than one year	Later than one and less than five years	Over five years	Total
	(Rupees in '000)							
Lease rentals receivable	973	-	-	973	973	-	-	973
Residual value	280	-	-	280	280	-	-	280
Minimum lease payments	1,253	-	-	1,253	1,253	-	-	1,253
Financial charges for future periods	-	-	-	-	-	-	-	-
Present value of minimum lease payments	1,253	-	-	1,253	1,253	-	-	1,253

10.3 Advances include Rs. 5,614,965 thousands (2010: 5,646,099) which have been placed under non-performing status as detailed below:

Category of Classification	September 30, 2011			Provision Required	Provision Held
	Classified Advances				
	Domestic	Overseas	Total		
	(Rupees in '000)				
Substandard	78,412	-	78,412	968	968
Doubtful	52,362	-	52,362	1,832	1,832
Loss	5,484,191	-	5,484,191	5,141,303	5,141,303
	5,614,965	-	5,614,965	5,144,103	5,144,103

10.4 Particulars of provision against non-performing advances

	(Un-audited) September 30, 2011			(Audited) December 31, 2010		
	Specific	General	Total	Specific	General	Total
	(Rupees in '000)					
Opening balance	5,331,030	-	5,331,030	5,221,053	-	5,221,053
Amounts written off	(54,438)	-	(54,438)	(13,399)	-	(13,399)
Provision of transferred portfolio	(247)	-	(247)	(712)	-	(712)
Charge/(Reversals)						
Charge for the year	10,242	-	10,242	165,164	-	165,164
Reversals	(142,484)	-	(142,484)	(41,076)	-	(41,076)
	(132,242)	-	(132,242)	124,088	-	124,088
Closing balance	5,144,103	-	5,144,103	5,331,030	-	5,331,030

10.4.1 The State Bank of Pakistan (SBP) has amended the Prudential Regulation vide BSD Circular No. 1 of 2011 dated October 21, 2011 in relation to provision for loans and advances, thereby allowing benefit of Forced Sale Value (FSV) of pledged stocks, mortgaged commercial and residential properties held as collateral and plant & machinery under charge against non performing advances. The bank opted for this benefit, and provisions against Non Performing Loan (NPL) are provided at prescribed rate after considering FSV of the subjected collateral. Accordingly requirement of provision against NPLs has reduced by an amount of Rs. 150.6 million during the quarter.

10.4.2 Particulars of provisions against non-performing advances	(Un-audited) September 30, 2011			(Audited) December 31, 2010		
	Specific	General	Total	Specific	General	Total
	(Rupees in '000)					
In local currency	5,144,103	-	5,144,103	5,331,030	-	5,331,030
In foreign currencies	-	-	-	-	-	-
	5,144,103	-	5,144,103	5,331,030	-	5,331,030

SME Bank Limited

Notes to the Condensed Interim Unconsolidated Financial Statements (Un-audited)

For the Nine months ended September 30, 2011

		(Un-audited) September 30, 2011	(Audited) December 31, 2010
		(Rupees in '000)	
11. OPERATING FIXED ASSETS			
Capital work-in-progress	11.1	716	716
Property and equipment	11.2	112,985	107,646
Intangible assets	11.3	2,222	1,492
		<u>115,923</u>	<u>109,854</u>

		(Un-audited) September 30, 2011	(Audited) December 31, 2010
		(Rupees in '000)	
11.1 Capital work-in-progress			
Advances to suppliers and contractors for:			
- Computer Equipment		716	716
- Software		716	716
		<u>716</u>	<u>716</u>

		(Un-audited) September 30, 2011	(Audited) December 31, 2010
		(Rupees in '000)	
11.2 Property and equipment			
Book value at the beginning of the period/year	11.2.1	107,646	103,955
Cost of additions during the period		15,352	17,545
Book value of the deletions during the period/year		(267)	(457)
Depreciation charge during the period/year		(9,746)	(13,397)
Book value at the end of the period/year		<u>112,985</u>	<u>107,646</u>

11.2.1 This includes cost of land measuring 500 square yards in sector G-7 and 4666.66 square yards situated in sector G-5/2 was originally allotted to SBFC and RDFC respectively. CDA required payment of Rs. 3.367 million for transferring the plot in the name of the Bank. However, on receiving draft of the required amount, CDA returned the same requiring payment of market value in view of proposed privatization of the Bank. The payment has been accounted for as addition in 2007 as the matter is being pursued by the Bank with CDA.

		(Un-audited) September 30, 2011	(Audited) December 31, 2010
		(Rupees in '000)	
11.3 Intangible assets			
Book value at the beginning of the period/year		1,492	3,055
Cost of additions during the period		1,878	-
Book value of the deletions during the period/year		-	-
Amortization charge during the period/year		(1,148)	(1,563)
Book value at the end of the period/year		<u>2,222</u>	<u>1,492</u>

SME Bank Limited

Notes to the Condensed Interim Unconsolidated Financial Statements (Un-audited)

For the Nine months ended September 30, 2011

12. At the time of amalgamation of RDFC and SBFC with the Bank, an amount of Rs. 30.851 million was included in other liabilities. Pursuant to the Board of Directors decision dated March 05, 2011, this amount has been taken to equity restating the comparative figures. This has resulted in decrease in accumulated loss of the Bank as at January 01, 2010 by Rs. 30.851 million with corresponding decrease in liabilities by the same amount.

	(Un-audited) September 30, 2011	(Audited) December 31, 2010
	(Rupees in '000)	
13. CONTINGENCIES AND COMMITMENTS		
13.1 Transaction-related contingent liabilities		
Guarantees in favour of:		
Government	130,430	71,156
Others	95,260	90,411
13.2 Other Contingencies		
a) Claims not acknowledged as debt from various borrowers for loss sustained due to non-disbursement.	24,972	24,972
b) Damages claim by borrower for delay in recording repayments received from borrower, not acknowledged as debt.	49,800	49,800
c) Damages claim by Ravi Securities (Pvt) Limited and Taas Securities (Pvt) Limited, not acknowledged as debt.	23,800	23,800
d) Tax demands of Rs. 612.707 million raised by the Income Tax Authorities related to VSS staff cost (tax year-2005) has been decided in favour of the Bank. However tax authorities has filed appeal before ATIR against the decision of the Income Tax Commissioner. Based on tax advisors' opinion, management strongly believes and expects favourable outcome and therefore no provision has been provided for this effect in the financial statements.	612,707	612,707
e) Adjustment of loan guarantee against borrowing from IDBP repaid in prior years, disputed by IDBP.	-	9,939
f) Back benefits and claims of staff/employees under litigation.	109,820	90,800
	<u>1,046,789</u>	<u>973,585</u>
13.3 Commitments in respect of forward lending		
Commitments to extend credit	245,975	243,700
13.4 Commitments for the acquisition of operating fixed assets	2,213	680
13.5 Commitments against repo/reverse repo transactions		
Purchase and resale agreements	-	33,445
Sale and repurchase agreements	1,875,017	1,371,750
	<u>1,875,017</u>	<u>1,405,195</u>
13.6 Other commitments		
Undrawn facilities	333,488	201,747
13.7 Bills for collection		
Payable in Pakistan	616	2,076

14. RELATED PARTY TRANSACTIONS

The Bank has a related party relationship with its subsidiary- SME Leasing Limited (SMEL), its directors, executive officers and employees' funds.

Details of balances outstanding at quarter end and transactions with related parties are as follows:

	(Un-audited) September 30, 2011	(Audited) December 31, 2010
	(Rupees in '000)	
Balances outstanding		
SME Leasing Limited :		
Investment in subsidiary	215,457	215,457
Loan to SMEL	86,477	114,657
Receivable from SMEL	1,894	2,435
Liability against assets subject to finance lease	3,165	8,212
Investment in TFC's issued by SMEL	-	25,000
Deposit balance of SMEL	2,380	10,006
Interest income on loan to SMEL	13,656	8,524
Repayment of loan	2,705	99,368
Repayment of interest on loan	13,488	8,503
Payment received against TFC's	25,000	25,000

Principal terms of loan to SMEL

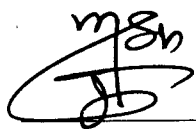
Year	Amount (Rupees '000)	Term	Interest rate	Repayment	Number of installments
2010	131,000	3 Years, Reviewable 6 monthly	3 months Kibor + 3 %	RF	-

15. CORRESPONDING FIGURES

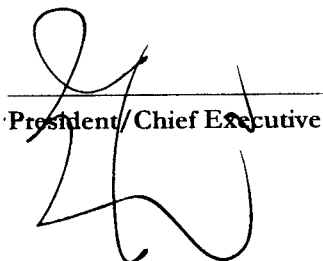
Comparative information has been re-classified/re-arranged in these financial statements, wherever necessary to facilitate comparison.

16. DATE OF AUTHORIZATION

These financial statements were authorized for issue by the Board of Directors of the Bank on October 27, 2011.



CFO & Company Secretary



President/Chief Executive



Director



Director

Director