RATING REPORT

ASA Pakistan Limited

REPORT DATE:
May 4, 2020

RATING ANALYSTS:
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RATING DETAILS				
Rating Category	**Latest Rating**		**Previous Rating**	
	Long-term	**Long-term**	**Long-term**	**Short-term**
Entity Rating	BBB+	A-3	BBB+	A-3
Rating Date	*Apr 30, 2020*		*Apr 30, 2019*	
Rating Outlook	Rating Watch-Negative		Stable	

COMPANY INFORMATION	
Incorporated in 2008	**External auditors:** Ernst & Young Ford Rhodes Chartered Accountants
Unlisted Public Limited Company	**Chairman of the Board:** Mr. Dirk Machgielis Brouwer
Key Shareholders (with stake 5% or more):	**Chief Executive Officer:** Mr. Saeed Uddin Khan
ASA International – 99.9%	

APPLICABLE METHODOLOGY(IES)
Methodology: Micro Finance Banks (June 2019)
https://www.vis.com.pk/kc-meth.aspx

ASA Pakistan Limited

OVERVIEW OF THE INSTITUTION

In March 2008, ASA Pakistan Limited (ASA Pakistan) was incorporated as an unlisted public limited company. It is licensed to operate as a microfinance institution (MFI) under Company's Ordinance, 1984

Profile of Chairman
Mr. Dirk Machgielis Brouwer co-founded ASA International in 2007 and has since as its Executive Director and Chief Executive Officer. Prior to 2007, he had a distinguished career in investment banking spanning over 20 years.

Profile of CEO
Mr. Saeed Uddin Khan brings with him 33 years of diversified and senior management experience in Conventional as well as Islamic Banking in different banks and financial institutions. He holds MBA degree from IBA, Karachi. He also holds diploma in Banking (DAIBP) and PGD as well as NIBAF, SBP Certification in Islamic Banking, beside short as well as extensive training within and outside Pakistan. Mr. Khan brings with him a rich knowledge of strategic planning, retail banking, product and brand development, corporate financing, risk management, budgeting, MIS etc, in addition to that he also possesses hands on exposure of SME/Retail Lending.

RATING RATIONALE

ASA Pakistan Limited (ASA Pakistan) is a subsidiary of ASA International. It is a for-profit, non-depository Microfinance Institution, operating as a lending company and regulated by the Securities and Exchange Commission of Pakistan. As on December 2019, ASA Pakistan operated out of 281 (2018: 270) branches spread across Sindh and Punjab. The company aims to improve socioeconomic condition of low income individuals through provision of microfinance facilities. It is licensed to operate on a nationwide basis, however, currently functions in Sindh and Punjab.

Since last review, key change at senior management level was appointment of Mr. Saeed Uddin Khan as Chief Executive Officer (CEO) in place of Mr. Md. Farid Ahmed.

Key Rating Drivers:

Experienced board and management team; sponsor support remains a credit strength.
ASA Pakistan's senior management and board of directors are experienced professionals with considerable experience in the field of microfinance. The ratings also draw comfort from ASA Pakistan's more than decade spanning experience in the microfinance sector. ASA continues to receive financial and technical assistance from ASA International Holding (ASAI). ASAI is backed by ASA International Group Plc, a microfinance company, listed on London Stock Exchange, UK.

NOC has been obtained from SBP for conversion to MFB; IT has been revamped.
In October 2016, the company applied for an MFB license; approval of the same is awaited from regulator. ASA Pakistan completed the first step for obtaining MFB license; the company received a No Objection Certificate (NOC) by SBP in January 2020. The approval was based on the SBP's assessment of the quality of proposal of the proposed MFB. As per standard procedure, management awaits the SBP inspection, which is expected to be carried out in July-September 2020, following which, the company expects to obtain the MFB license. In accordance with regulatory requirements for MFBs, as per management, around 70% of requirements have been complied with. Key developments include implementation of the new ASA Core Banking System alongside hiring of new resources and reorganization of the information technology department. Going forward, ratings are dependent upon conversion of the institution into a regulated entity in the ongoing year; given that business volumes have grown substantially over time desiring the entity to remain in a more robust regulatory regime.

Asset quality indicators have deteriorated in 2019; infection levels could further rise due to Covid-19 crisis.
In 2019, gross loan portfolio of the company increased by only 4% to Rs. 9.7b (2018: Rs. 9.4b). Flagship product of the company remains its smaller ticket sized loans. ASA Pakistan lends on an individual basis, collections / recoveries are made in groups in order to ensure 100% recoveries. The group is also helpful in identifying potential clients and collecting critical credit intelligence which ultimately ensure 100% loan recoveries. Clients are not required to pay loan installment any other client but they facilitate collection efforts through providing information. Since ASA Pakistan reported fresh Non-Performing Loans (NPLs) amounting to Rs. 90.8m; gross infection increased to 2.1% (2018: 0.4%); however, infection levels remained low vis-à-vis industry average. Management has attributed rise in NPLs to operational issues. Management expects gross infection to be restricted under 2% over 2020.

Liquidity profile and leverage indicators compare less favorably in comparison to peers.
Liquid assets for the company primarily include cash and bank balances and amounted to Rs. 896.9m (2018: Rs. 1.5b) at end-2019. With decline in liquid assets, liquidity profile of the company deteriorated; liquid assets as a proportion of borrowings declined to 13.3% (2018: 19.0%) at end-

2019. Moreover, gross loans were largely funded by both local and foreign denominated borrowings mobilized by the company, during 2019. Given the recent depreciation in rupee-dollar parity, the company faces significant risk on its foreign denominated borrowings, however, the company utilizes forward contracts in order to hedge this currency risk. To further mitigate the currency risk on foreign currency loans, going forward the company is considering replacing its foreign loans with domestic ones. Progress in this regard will need to be seen over time. Gearing and debt leverage ratios of the company improved to 1.8x (2018: 2.5x) and 1.9x (2018: 2.7x) at end-2019. As per management, borrowings will continue to remain the major source of funding of the company till the MFB license is received.

Despite higher finance cost, profitability levels also improved on the back of net exchange gain, volumetric growth in advances and maintained administrative expenses.
Profitability levels of the company amounted to Rs. 1.4b (2018: Rs. 1.16b) in 2019. Profit after tax was higher than the prior year given net exchange gain, volumetric growth in advances and maintained administrative expenses. However, growth trend in profitability is expected to slow down due to lag in disbursements and growth in administrative expenses. Nonetheless, operating self-sufficiency ratio of the company depicted further improvement from 378.4% in 2018 to 419.4% in 2019. The same depicts considerable cushion as core income is more than sufficient to cover administrative expenses. Ability to maintain these performance metrics will be a key rating driver.

Capitalization indicators remained sound on a timeline basis; management expects these levels to improve given planned equity injection in view of the ongoing conversion to a MFB.
Capitalization indicators of the company have primarily been a function of growth in its lending portfolio. After conversion into a MFB, additional equity injection is expected from ASAI to increase the paid up capital of ASA Pakistan to Rs. 1.5b, which is above the regulatory requirement of Rs. 1.0b for a microfinance bank operating at a national level. During 2019, the company maintained high dividend payout at 50.6% (2018: 47.5%). Management has put dividend payout on hold until conversion to MFB which will support equity levels.

Going forward, the Covid-19 crisis and its impact on the economy and the financial sector would make the operating dynamics of the banks in general uncertain. The impact of curtailment of economic activity for a certain period of time and lower lending rate scenario may cause NIM compression, thereby impacting the profitability of bank. Maintaining conservative lending strategy to maintain asset quality and cost efficiencies would be important rating drivers going forward.

ASA Pakistan Limited Annexure I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**
Loans and advances - net	7,323	9,307	9,612
Total Assets	9,889	11,610	11,230
Borrowings	7,100	7,940	6,767
Paid up Capital	745	745	745
Net Worth	2,528	3,126	3,862
INCOME STATEMENT	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**
Net Mark-up Income	2,474	2,897	3,012
Net Provisioning / (Reversal)	7	34	127
Non-Markup Income/(Loss)	(227)	(137)	96
Administrative Expenses	734	942	1,034
Profit before Tax	1,544	1,784	1,947
Profit after Tax	1,215	1,159	1,383
RATIO ANALYSIS	**31-Dec-17**	**31-Dec-18**	**31-Dec-19**
Gross Infection (%)	0.28%	0.4%	2.1%
Net Infection (%)	0.16%	0.3%	0.8%
Markup Spreads (%)	29.60%	16.90%	23.2%
OSS (%)	305.30%	378.40%	419.43%
Return on Average Assets (%)	15.70%	10.76%	12.11%
Liquid Assets to borrowings (%)	30.90%	19.00%	13.3%
Gearing	2.8	2.5	1.8
Current Ratio	4.7	2.5	2.8

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix 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	ASA Pakistan Limited (APL)
Sector	Micro Finance
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
30-Apr-20	BBB+	A-3	Rating Watch-Negative	Maintained
30-Apr-19	BBB+	A-3	Stable	Reaffirmed
16-Aug-18	BBB+	A-3	Stable	Reaffirmed
6-June-17	BBB+	A-3	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	• Mr. Tufail Rajper – Head of Business • Mr. Jawwad Ali – Head of Risk Management • Mr. Muhammad Kamran Hussain – Chief Financial Officer