RATING REPORT

ASA Pakistan Limited

REPORT DATE:
April 29, 2021

RATING ANALYSTS:
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RATING DETAILS

Rating Category	Latest Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity Rating	BBB+	A-3	BBB+	A-3
Rating Date	*Apr 29, 2021*		*Apr 30, 2020*	
Rating Outlook	Stable		Rating Watch-Negative	

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

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 2020, ASA Pakistan operated out of 292 branches spread across Sindh and Punjab (Dec'19: 281). The company aims to improve socioeconomic condition of low income individuals through provision of microfinance facilities.

Business Update:

Conversion to a Micro Finance Bank (MFB)

- In October 2016, the company applied for an MFB license. ASA Pakistan completed the first step for obtaining MFB license by acquiring a No Objection Certificate (NOC) from 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, this was to be followed by an SBP inspection, which was previously expected to be carried out by July-September 2020. However, as a result of Covid-19 related lockdown, the inspection has remained delayed so far, albeit SBP is in close coordination with Compliance department and continuously monitoring company's performance. However, the actual inspection is expected to be conducted during May/ June 2021.
- As per management, all the pre-requisites for conversion to an MFB have been complied with.

Asset quality indicators continued to depict adverse movement in 2020

	Dec'19	Dec'20
Gross Advances	**9,739**	**10,291**
Gross Infection	**1.9%**	**4.0%**
- Stage 2	0.2%	1.0%
- Stage 3	1.7%	3.0%
Provisioning Coverage (Stage 2 & 3)	**56.6%**	**60.2%**
Net Infection (Stage 2 & 3)	**0.8%**	**1.6%**

- Gross advances grew by 5.7% in 2020, lower than industry uptick of 11%.
- The advances remain concentrated in small-ticket category. As of Dec'20, advances outstanding in up to 25k, 25k-50k and 50k-75k categories comprised 30% 58% and 11% of the portfolio respectively.
- In terms of geographical breakup, the portfolio remains the same with about a 70:30 split between Punjab & Sindh.
- As of Dec'20, 58% of the advances portfolio constituted loans which were in the loan cycle of 3 or more. This number has improved from 54% in the preceding year.
- 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.
- Given the pandemic-induced slowdown, credit risk across the industry stood heightened during the period. Nevertheless, given Covid-19 relief allowed by SBP, industry growth in NPLs actually stood at -32%, overall gross infection of the industry also falling to 3.3% vis-à-vis 5.3% previously. Translation of heightened credit risk in an increase in gross infection is likely to materialize by June'2021, as Covid-19 relief measures are rolled back.
- Conversely, ASA Pakistan's NPLs (Stage 2 & 3) grew by 1.2x and as a result gross infection of the portfolio increased to 4%. At this level, gross infection of the company stands on the higher side.
- Given significant credit loss expense (Rs. 385m) undertaken by the company, the provisioning coverage remained intact. Nevertheless net infection has risen, given higher net-NPLs. In addition to Stage 2 & 3 ECL allowance, the company is also maintaining general allowance on Stage 1 equaling 0.3% of the gross portfolio.

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.

Liquidity & Capitalization expected to be reinforced

- Liquid assets for the company primarily include cash and bank balances and amounted to Rs. 905m (Dec'19: Rs. 897m) as at Dec'20. Overall ratio of liquid assets to borrowings has remained at similar level and is considered to be on the lower side (Dec'20: 14.0%; Dec'19: 13.3%).
- The asset base is largely funded by both local and foreign denominated borrowings. As of Dec'20, two-thirds of the borrowings were foreign currency denominated
- ASA Pakistan's leverage ratio posted further improvement, dropping to 1.4x as of Dec'20 vis-à-vis 1.9x as of Dec'19. The consistent drop in leverage is attributable internal capital generation and retention.
- Liquidity & capitalization is expected to be reinforced through the planned equity infusion, subsequent to SBP inspection.

Profitability fell on account of higher credit impairment charge and administrative overheads

	Dec'18	Dec'19	Dec'20
Spreads	16.9%	23.2%	24.5%
OSS	**378.4%**	**419.4%**	**327.7%**
PAT	**1,159**	**1,383**	**949**

- The profitability indicators of ASA Pakistan were impacted by higher credit impairment charge and administrative overheads, which grew by 147% and 20% respectively. The major reason behind the increase in credit impairment is the change in socio economic conditions, which were impacted by Covid-19 nationwide. However, administrative overheads have been increased due to expense incurred for conversion to MFB.
- As a result the OSS measure has declined, albeit is still considered to be adequately high. Overall profitability indicators of the company compare favorably to the industry, which has remained in losses during the 2 year period (2019-2020).
- Going forward, spread is likely to constrict in line with the industry, while additional expected credit impairment will also weigh on the company's profitability.

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 Pakistan 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.

Rating is constrained by liquidity indicators and composition of borrowings

- ASA Pakistan's funding profile mainly constitutes commercial borrowing arrangements, as it does not have regulatory permission to raise deposits. With liquid assets, limited to 14% of the aggregate borrowings, the rating reflect low liquidity indicators of the company.
- Furthermore, with two-thirds of the borrowings being foreign currency denominated, there is also inherent currency risk. The company utilizes costly forward contracts in order to hedge this currency risk. There are plans to replace foreign loans with domestic ones, albeit these changes will materialize subsequent to conversion to an MFB.

The adverse movement in asset quality indicators has been noted and incorporated into our assessment

- The assigned rating incorporates the asset quality of the institution. Infection level has risen on a

timeline while credit risk in the economy is considered heightened on account of the economic challenges brought on by the pandemic.
- As per management, asset quality indicators depicted improvement in Q1'2021, as NPLs were slashed by about a third on the back of concerted recovery efforts.

As per management, pre-requisites for full conversion to an MFB have been concluded. Rating remains dependent on successful completion of conversion to MFB

- The management has concluded the pre-requisites, as required by the SBP, for full conversion to an MFB; these included documentation of policies & procedures.
- 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.

ASA Pakistan Limited — Annexure I

FINANCIAL SUMMARY			*(amounts in PKR millions)*
BALANCE SHEET	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**
Loans and advances - net	9,307	9,612	10,015
Total Assets	11,610	11,230	11,826
Borrowings	7,940	6,767	6,465
Paid up Capital	745	745	745
Net Worth	3,126	3,862	4,835
INCOME STATEMENT	**31-Dec-18**	**31-Dec-19**	**31-Dec-20**
Net Mark-up Income	2,897	3,012	2,935
Net Provisioning / (Reversal)	34	127	385
Non-Markup Income/(Loss)	127	142	117
Administrative Expenses	942	1,034	1,237
Profit before Tax	1,784	1,947	1,342
Profit after Tax	1,159	1,383	949
RATIO ANALYSIS		**31-Dec-19**	**31-Dec-20**
Gross Infection (%) (Stage 2 & 3)		2.5%	4.0%
Net Infection (%) (Stage 2 & 3)		1.5%	1.6%
Incremental Infection		NA	2.8%
Markup Spreads (%)		23.2%	24.5%
OSS (%)		419.4%	327.7%
Return on Average Assets (%)		12.1%	7.9%
Liquid Assets to borrowings (%)		13.3%	14.0%
Gearing (x)		1.8	1.3
Current Ratio (x)		2.8	2.9

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		
29-Apr-21	BBB+	A-3	Stable	Maintained
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.
Disclaimer	Information herein was obtained from sources believed to be accurate and reliable; however, VIS does not guarantee the accuracy, adequacy or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Kamran Hussain	CFO	March 31, 2021
Mr. Jawad	Head of Risk Management	