The Pakistan Credit Rating Agency Limited

Rating Report

Kashf Foundation

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
25-Sep-2021	A-	A2	Stable	Maintain	Yes
25-Sep-2020	A-	A2	Stable	Maintain	Yes
27-Sep-2019	A-	A2	Stable	Maintain	-
19-Jun-2019	A-	A2	Stable	Maintain	-
24-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Kashf Foundation is a renowned Microfinance Institution (MFI); it has been in operations since 1996. MFIs are governed by SECP regulations mainly NBFC (Establishment and Regulations) Rules, 2003, Non-Banking Finance Companies and Notified Entities Regulations 2008 and others. The key element is that MFIs are not permitted to mobilize deposits. While this provides funding constraints, it also delimits the boundaries of risk. Kashf Foundation is a not-for-profit organization. Hence, the source of funding comprises a) internal generation of profits, b) loans and c) grants. Second major source of funding is borrowings. The Foundation has diversified its borrowing to both local and foreign institutions and has issued a (PPTFC) of PKR 2bln with a green shoe option of PKR 1bln to fuel growth. Governance structure takes strength from the body of members and board of directors, who, in their own right, are reputable individuals. The induction process reflects alignment of the incumbent members to the institution itself, a self-propelling drive to contribute. The quality of board discussions is an evidence to this assertion. Kashf has stable and experienced senior management team which is supported by clear reporting lines as per a formalized organogram and satisfactory monitoring process. The ratings incorporate strong business profile of the Foundation demonstrated by continued enhancement in business volumes. GLP recorded good growth which led to enhanced mark up earned. Improved cost of funds resulted in uptick in spread. Strengthened non-mark up income supplemented the profitability despite higher provisioning expense being recorded. Maintaining asset quality intact remains essential, going forward. Meanwhile, the “Rating Watch” reflects the need to oversee the risk profile of the Institution against unavoidable challenges, particularly emanating from economic Implications in the wake of Covid-19, and its ramifications on the disposable income of the customer base. The impact of economic slowdown lately exacerbated by the global pandemic spread had cast a rippling effect on different sectors of the country. Microfinance industry is expected to absorb the impact as disbursement, recoveries and liquidity patterns were influenced.
The ratings are dependent on the foundation's aptness to sustain positive asset health indicators amidst growth in business volumes. The ratings would also monitor the impact of technological advancement on the operational and risk efficacy of the Foundation.

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Disclosure

Name of Rated Entity	Kashf Foundation
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-21),Criteria | Correlation Between Long-term & Short-term Rating Scales(Jun-21),Criteria | Rating Modifiers(Jun-21)
Related Research	Sector Study | Microfinance(Sep-20)
Rating Analysts	Sehar Fatima | sehar.fatima@pacra.com | +92-42-35869504

Profile

Structure Kashf Foundation is the first Microfinance Institution of the country. It is licensed by the Securities and Exchange Commission of Pakistan (SECP) under the Non-Banking Finance Companies Rules, 2003.

Background Kashf was established in 1996 and began operations as a Grameen replicator. It was incorporated with the SECP in 2007 as a public company limited by guarantee under Section 42 of the Companies Ordinance, 1984 (now Companies Act, 2017).

Operations Kashf operates at a national level with a network of over 325 branches. The Foundation extends small loans to the underprivileged communities with a maturity of less than or equal to one year. Most of the Foundation's portfolio is concentrated in urban areas of Punjab. The main product of the Foundation is the “Kashf Karobar Karza” loan which is provided to boost entrepreneurship in the country. Most of the Foundation's clientele is female.

Ownership

Ownership Structure Overall control of the foundation vests with 11 members. All members have deposited certain amount of guarantee in the Foundation as per the Companies Act, 2017 requirements.

Stability Kashf has a proper succession plan in place which is expected to remain unchanged, going forward.

Business Acumen Members of the Foundation are experienced professionals and have suitable skills to direct the Foundation in achieving its objectives.

Financial Strength The probability of the Foundation getting financial support from members is low since the Foundation is registered as a not-for-profit organization under section 42 of the Companies Ordinance 1984 (now Companies Act, 2017).

Governance

Board Structure Kashf has ten-member board of directors (BODs). Dr. Hafiz Ahmed Pasha is the chairman of the board.

Members’ Profile The board members have extensive experience in the sector. The Chairman - Dr. Hafiz Ahmed Pasha is a is the Dean of the School of Liberal Arts and Social Sciences at the Beaconhouse National University, Lahore, and Vice-Chairman of the Institute of Public Policy, Lahore.

Board Effectiveness There are five sub-committees to assist the board, namely (i) Audit Committee, (ii) Credit, Program & Finance Committee (iii) Human Resource Committee (iv) Investment Committee and (v) Nomination Committee. Attendance during the meetings was good and minutes were properly documented.

Transparency EY ford Rhodes Chartered Accountants are the External Auditors of the foundation. They expressed an unqualified opinion on the financial statements for the year Ended June’21. The internal Audit Department of the foundation reports directly to the Audit Committee. The compliance department is also in place which conducts regular inspections of all relevant departments.

Management

Organizational Structure Kashf operations are grouped under nine departments. Functions are distributed among head office and branches. Core lending activities are carried out at the branch level.

Management Team The Foundation has a mix of diverse experience and skilled management. Ms. Roshaneh Zafar, the CEO, is one of the founding members of the Foundation having experience of over two decades. She is a renowned philanthropist and is assisted by an experienced management team.

Effectiveness The Foundation has a systematic decision-making process. There have seven members management committees in place. Each department head ensures smooth operations of their department and reports to the Chief Executive Officer on pertinent matters.

MIS Most of the departments are integrated which adds to effective decision making by the management.

Risk Management Framework A proper risk management policy to manage operational and credit risk is in place. A loan approval process is decentralized at the branch level. Recovery of all loans is being done through different agents.

Technology Infrastructure Kashf is continuously investing in its technological infrastructure to increase automation and efficiency in the departments which is a need of time in the microfinance industry. The increased automation would result in expediting the loan recovery process, providing good surveillance, and helping to keep its infection ratio in check.

Business Risk

Industry Dynamics Pakistan Microfinance Industry (MFI) comprises 32 microfinance providers, including 21 microfinance institutions (MFIs). Active Borrowers exceeded pre-COVID figures as 7.6 million borrowers were achieved during 3MCY21, an increase of 4% compared to 3MCY20. Similarly, the GLP surpassed PKR 340 billion during 3MCY21, an increase of 10% compared to the GLP in Q1 last year. The growth in active borrowers and GLP continues to be driven by the MFB peer group as they managed to add over 614,000 clients and PKR 11 billion in GLP. NBMFC peer group also contributed to portfolio growth with an addition of PKR 4.7 billion, led by Kashf and NRSP. The PAR>30 days increased from 3.7% to 4.5% as the infection ratio for MFBs rose from 3.3% to 4% and for NBMFCs from 4.9% to 5.6%.

Relative Position Considering the market share of ~5% in term of GLP of whole industry, the foundation is considered as a relatively mid-tier player in the Microfinance sector and one of the largest Microfinance Institution. It is one of the oldest players in the MFIs industry which has enabled it to develop a strong relationship with the borrowers.

Revenue Despite the challenging environment, Kashf was enabled to earn an interest income of PKR 5,001mln in FY21 with the decline of PKR 150mln YoY basis (FY20: PKR 5,151mln). This decline is mainly due to slight decrease in disbursement of portfolio in 2020-21 due to uncertain conditions due to COVID. Return on investment & bank deposits, clocked at PKR 633mln (FY20: PKR 626mln) whereas mark-up on micro-credit loan constitutes 87.7% of total interest income.

Profitability Kashf’s earning assets constitute 93% of the total assets, grew by 7.5% to earn maximum returns from its asset base. In 2021 the profitability of the company significantly increased by 267% to PKR 769mln as compared to (82.5%) in 2020 (PKR 210mln), reason of increase in profitability is mainly due to decrease in financial charges due to downward fluctuation in the policy rate.

Sustainability Kashf’s primary objective is to strengthen its market position with the ultimate aim of financial inclusion in the country. To achieve the stated objective, Kashf has diversified its products base on a timeline basis. For geographical penetration, the foundation has already developed goodwill to attract potential clients. A customer-centric business approach has been adopted. However, recovery from infected portfolio would remain one of the key challenges for Kashf, going forward.

Financial Risk

Credit Risk Kashf is one of the largest lenders in MFIs and has designed a decentralized loan approval and disbursement process at the branch level. To mitigate the asset risk the foundation has developed a strong control & recovery mechanism. Despite generally decelerated loan demand, Kashf maintained GLP at PKR 16,275mln as at end-Jun21 (FY20: PKR 13,830mln). The asset quality observed a witnessed incline in NPLs and clocked at PKR 604mln during FY21.

Market Risk The Foundation’s investment portfolio constituting 5.4% of the total earning assets (FY20: 9.3%). There are no financial assets utilized for hedging in overall investments in FY21 (FY20: PKR 540mln). Any upward fluctuation in policy rates will increase the financing cost of the foundation as all local long-term borrowing carry a floating interest rate. Kashf has the policy to hedge all foreign currency exposures, which is beneficial for the foundation, in the current environment.

Funding Kashf has mobilized mostly all funds from both local and foreign borrowers. Total debt of the foundation as at FY21 slightly increase by 2.7% to PKR 18,311mln (FY20: PKR 17,829mln). An upward moment in advances to borrowings ratio to 89% from 75% is due to enhancement in recent disbursements owing to soften lockdown as virus caseload drops.

Liquidity During FY21, with a downward movement in Kashf’s liquidity position. The Foundation’s liquid assets to borrowings ratio remained low at 39% as compared to 47% in FY20. In FY20 Kashf has increased the liquidity to Asset ratio upto 35% from 25% due to uncertain conditions in the country due to COVID. In FY 21 Kashf has intentionally bring down the liquidity to asset ratio close to benchmark of 25%.

Capital Adequacy SECP has no minimum requirement for MFIs unlike SBP which require MFBs to maintain their CAR at 15%. Equity of the foundation stood at PKR 5,295mln as at FY21 (FY20: PKR 4,391mln).

Kashf Foundation Listed Public Limited	Jun-21 12M	Jun-20 12M	Jun-19 12M
A BALANCE SHEET			
1 Total Finances - net	16,379	13,830	14,212
2 Investments	1,369	3,656	3,210
3 Other Earning Assets	5,853	5,787	2,531
4 Non-Earning Assets	1,326	1,635	999
5 Non-Performing Finances-net	88	(317)	(75)
Total Assets	25,016	24,590	20,877
6 Deposits	-	-	-
7 Borrowings	18,476	19,154	15,769
8 Other Liabilities (Non-Interest Bearing)	857	883	734
Total Liabilities	19,333	20,038	16,502
Equity	5,296	4,518	4,328
B INCOME STATEMENT			
1 Mark Up Earned	5,001	5,151	4,681
2 Mark Up Expensed	(2,022)	(2,641)	(1,722)
3 Non Mark Up Income	799	737	430
Total Income	3,778	3,247	3,389
4 Non-Mark Up Expenses	(2,522)	(2,578)	(2,127)
5 Provisions/Write offs/Reversals	(487)	(459)	(68)
Pre-Tax Profit	769	210	1,194
6 Taxes	-	-	-
Profit After Tax	769	210	1,194
C RATIO ANALYSIS			
1 Performance			
Net Mark Up Income / Avg. Assets	12.0%	11.0%	16.8%
Non-Mark Up Expenses / Total Income	66.7%	79.4%	62.8%
ROE	15.7%	4.7%	32.6%
2 Capital Adequacy			
Equity / Total Assets (D+E+F)	21.2%	18.4%	20.7%
Capital Adequacy Ratio	N/A	N/A	N/A
3 Funding & Liquidity			
Liquid Assets / (Deposits + Borrowings Net of Repo)	39.5%	51.0%	36.9%
(Advances + Net Non-Performing Advances) / Deposits	N/A	N/A	N/A
Demand Deposits / Deposits	N/A	N/A	N/A
SA Deposits / Deposits	N/A	N/A	N/A
4 Credit Risk			
Non-Performing Advances / Gross Advances	3.6%	1.9%	0.4%
Non-Performing Finances-net / Equity	1.7%	-7.0%	-1.7%

Credit Rating

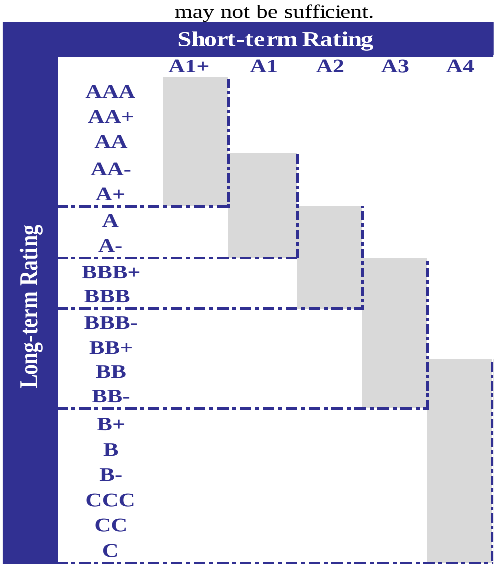
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities

a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments

a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information