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
23-Sep-2023	A-	A2	Positive	Maintain	-
24-Sep-2022	A-	A2	Stable	Maintain	-
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

The rating emanates from the prominent profile of the Kashf Foundation (herein referred to as “The Foundation” or “the MFI”) in the Microfinance sector of Pakistan (herein referred to as "MFIs"). SECP is the Regulatory body for MFIs and they are governed through NBFC Rules, 2003 and NBFC Notified Entities Regulations, 2008. Kashf Foundation is a not-for-profit organization. The PAR(Portfolio at risk) of the MFI stood at 0.5% and has augmented the credit risk profile of the MFI. The rating takes comfort from a consistent upward-sloping growth trajectory in the GLP during a time span of three years. The Kashf Karobar Karza is their foremost product and predominately contributed to the markup earned and net profitability of the MFI. The MFI primary source of funding is borrowing with an optimal mix of local and foreign financing which also includes the issuance of PKR 2.5bln PPTFC bond to further augment their Gross Loan Portfolio (GLP) growth. The MFI has executed CCS (Cross-Currency Swaps) and FRAs (Forward Rate Agreements) to mitigate the foreign exchange risk in foreign borrowings. The optimization of operational costs with respect to their total disbursement of the portfolio has strengthened the profitability matrix coupled with spiral markup and non-markup income. The consistent appreciable growth in the net profitability of the Company during the time span of two years which ultimately beefed up the net equity levels provides comfort to the ratings of the Foundation. The liquidity profile of the Foundation remains one of the finest in the industry. The Board of the MFI is more of an advisory nature and all members, who, in their own right, are reputable individuals. The board is actively involved in making the strategic choices and setting the direction of the company and the board ensure to follow the best practices of corporate governance. The induction process reflects the alignment of the incumbent members to the institution itself, a self-propelling drive to contribute. The quality of board discussions is evidence of this assertion. The MFI has a stable and experienced senior management team which is supported by clear reporting lines as per a formalized organogram and a satisfactory monitoring process. The integration with the head office to assess the real-time status of recoveries and disbursements coupled with technological advancement has escalated the control environment. The restriction on the mobilization of deposits has demarcated and supplemented the risk absorption capacity while triggering the funding constraints. Despite the hyperinflationary environment and other microeconomic challenges specifically the consistent surge in KIBOR which ultimately elevated the cost of funds for MFIs, the portfolio at risk (PAR) > 30 days of MFIs has shown an improvement and reduced to 3.0% (4QCY22: 4.2%) mainly on the back of the recoveries in the flood-impacted portfolios. The industry's loan portfolio requires prudent management mainly on the back of the consistent surge in the policy rate. However, going forward the impact of gross lending rate on the financial risk profile specifically on NPLs (Non-performing Loans) is being evaluated in due course of time.

The outlook on the ratings is "positive" which reflects the prospective transition to the higher ratings. The essential elements are demonstration of robust capital adequacy, framework around liquidity position, and risk profiling of earning advances, amongst other things.

Disclosure

Name of Rated Entity	Kashf Foundation
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Microfinance Institution Rating(Jun-22),Methodology | Correlation Between Long-term & Short-term Rating Scales(Jul-23),Methodology | Rating Modifiers(Apr-23)
Related Research	Sector Study | Microfinance(Sep-22)
Rating Analysts	Muhammad Harris Ghaffar | harris.ghaffar@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 382 branches in 62 districts spread across all provinces of Pakistan. The Foundation extends micro and small loans to 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. Almost 100% of the Foundation's clientele is female.

Ownership

Ownership Structure The Foundation's ultimate authority resides in a committee of 10 members. each of whom has deposited a certain amount of guarantee in the Foundation with the stipulations of the Companies Act, 2017.

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 a 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 the Professor Emeritus of the Beaconhouse National University, Lahore, and a distinguished economist.

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

Transparency KPMG Chartered Accountants are the External Auditors of the foundation. They expressed an unqualified opinion on the financial statements for the year Ended June’22. 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. Moreover, the audit for the year ended June '23 is in process by A.F Ferguson & Co, Chartered Accountants.

Management

Organizational Structure Kashf operations are grouped under eleven departments. Functions are distributed among the 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 are seven-member management committees in place. Each department head ensures smooth operations of their department and reports to the Chief Executive Officer on pertinent matters.

MIS Integration of departments enhances management decision-making, with the CIB report system linked to Tasdeeq and Data Check Limited at Kashf Foundation.

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 Branchless Banking 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 During 1QCY23, the microfinance industry which includes MFIs, MFBs & RSP in Pakistan has shown a growth of 3.7% from 4QCY22 to 1QCY23 in terms of Gross Loan Portfolio (GLP). The GLP stood at PKR 509.6bln during 1QCY23 (4QCY24: PKR 491.3bln). The GLP portfolio of MFI reached PKR 88.528bln with an active borrower base of 2.3mln as of 1QCY23. Currently, in Pakistan, there are 24 dedicated Microfinance institutions primarily operating which provide specialized microfinance services. The portfolio at risk (PAR) > 30 days of MFI has shown an improvement and reduced to 3.0% (4QCY22: 2.0%) mainly on the back of the recoveries in the flood-impacted portfolios. The hyperinflationary environment has also impacted the MFI sector which is evident by a PKR 1.7bln surge in disbursements (1QCY23: PKR 31.8bln; 4QCY22: PKR 30.1bln) and PKR 3,282 hike in average loan size (1QCY23: PKR 59,628, 4QCY22: PKR 56,346). In the overall microfinance industry as of 1QCY23, HBL MFB is the market leader with a GLP of PKR 92.2bln followed by KBL PKR 89.1bln

Relative Position Considering the market share of ~5% in terms of GLP of the whole industry, the foundation is considered as a relatively mid-tier player in the Microfinance sector and one of the largest Microfinance Institutions. It is one of the oldest players in the MFI 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 10,590mln in FY23 with an incline of PKR 3,937mln YoY basis (FY22: PKR 6,653mln). This incline is mainly due to the significant increase in return on loans (FY23 PKR 9,056mln, FY22 PKR 6.653mln) Return on investment & bank deposits, clocked at PKR 9,056mln (FY22: PKR 646mln) whereas mark-up on micro-credit loans constitutes 85.5% of total interest income.

Profitability In 2023, the profitability of the company significantly increased to PKR 2,529mln (FY22: PKR 1,935mln), The reason for the increase in profitability is mainly due to a significant increase in the company's markup income.

Sustainability Kashf's key strategy is to expand its market presence and promote financial inclusion in the nation by diversifying products and establishing a positive reputation. However, loan recovery remains a significant ongoing challenge

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 26,663mln as at end-Jun23 (FY22: PKR 20,503mln). The asset quality observed a witnessed decline in NPLs and clocked at PKR 140mln during FY23 (FY22: PKR 313mln).

Market Risk The Foundation’s investment portfolio constitutes 13.2% of the total earning assets (FY21: 5.4%). The financial assets used for hedging in overall investments stood at 31.2% (FY21: 7.5%). Any upward fluctuation in policy rates will increase the financing cost of the Foundation as all local long-term borrowing carries a floating interest rate.

Funding Kashf has mobilized almost all funds from both local and foreign borrowers. The total debt of the foundation as of FY22 increased by 42% to PKR 33,415mln (FY22: PKR 23,510mln).

Cashflows & Coverages During FY23, with an upward movement in Kashf’s liquidity position. The Foundation’s liquid assets to borrowings ratio slightly declined to 43% as compared to 44% in FY22 on account of growth in borrowings to PKR 33,415mln (FY21: 23,510mln).

Capital Adequacy SECP has no minimum requirement for MFIs in terms of CAR ratio, unlike SBP which requires MFBs to maintain their CAR at 15%. Equity of the foundation stood at PKR 10,050mln as of FY23 (FY22: PKR 7,231mln) which is well above the required benchmark of Rs. 50 million as required by SECP.

PKR mln

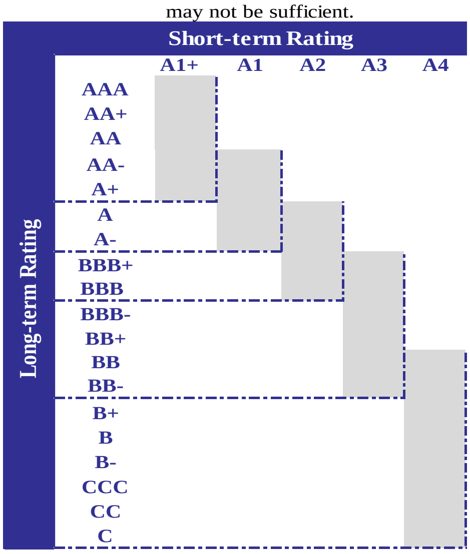
Kashf Foundation MicroFinance Institution	Jun-23	Jun-22	Jun-21
	12M	12M	12M
A BALANCE SHEET			
1 Total Finances - net	27,303	20,684	16,379
2 Investments	3,363	4,053	1,369
3 Other Earning Assets	10,747	6,270	5,853
4 Non-Earning Assets	4,651	1,301	1,326
5 Non-Performing Finances-net	(28)	(20)	88
Total Assets	46,036	32,287	25,016
6 Deposits	-	-	-
7 Borrowings	33,415	23,510	18,476
8 Other Liabilities (Non-Interest Bearing)	2,571	1,360	857
Total Liabilities	35,986	24,871	19,333
Equity	10,050	7,231	5,296
B INCOME STATEMENT			
1 Mark Up Earned	10,590	6,653	5,001
2 Mark Up Expensed	(4,653)	(2,664)	(2,022)
3 Non Mark Up Income	275	1,222	799
Total Income	6,212	5,212	3,778
4 Non-Mark Up Expenses	(3,559)	(3,090)	(2,522)
5 Provisions/Write offs/Reversals	(123)	(186)	(487)
Pre-Tax Profit	2,529	1,935	769
6 Taxes	-	-	-
Profit After Tax	2,529	1,935	769
C RATIO ANALYSIS			
1 Performance			
Net Mark Up Income / Avg. Assets	15.2%	13.9%	12.0%
Non-Mark Up Expenses / Total Income	57.3%	59.3%	66.7%
ROE	29.3%	30.9%	15.7%
2 Capital Adequacy			
Equity / Total Assets (D+E+F)	21.8%	22.4%	21.2%
Capital Adequacy Ratio	N/A	N/A	N/A
3 Funding & Liquidity			
Liquid Assets / (Deposits + Borrowings Net of Repo)	42.9%	44.3%	39.5%
(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	0.5%	1.5%	3.6%
Non-Performing Finances-net / Equity	-0.3%	-0.3%	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):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies 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 | Clause 11-(A)(p).
(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