



The Pakistan Credit Rating Agency Limited

Rating Report

Kashf Foundation

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
24-Dec-2018	A-	A2	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Kashf Foundation is a renowned Microfinance Institution; 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. Profitability of the foundation is sanguine and hence integral generation of capital is occurring at a very good rate. Second major source of funding is borrowings. The foundation has diversified its sources of borrowings and has further plans to enmesh diversification therein. 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. Design of the not-for profit MFI itself is the right recipe for longevity. There are examples in the world around, providing assurance. The ratings incorporate strong business profile of the foundation demonstrated by continued enhancement in business volumes. Good management practices alongside proficient systems reflect the foundation's considerable experience in the rapidly growing microfinance sector. Asset quality persists to be sanguine on the backdrop of sound controls and recovery mechanism. A strategy is in place directed towards expanding the foundation's credit outreach to enhance its clientele as well as meet its disbursement targets. The foundation has been closely focusing on technological developments to uphold the growth with an integrated systems. Overall financial risk profile displays comfortable outlook.

The ratings are dependent on the foundation's aptness to sustain positive asset health indicators amidst growth in business volumes. Meanwhile, sustenance of improved margins are imperative. The ratings would also monitor the impact of technological advancement on the operational and risk efficacy of the foundation.

Disclosure

Name of Rated Entity	Kashf Foundation
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology Criteria Rating Modifier(Jun-18),Methodology Correlation Between Long-Term And Short-Term Rating Scale(Jun-18),Methodology MFI (Jun-18)
Related Research	Sector Study Microfinance Bank(Apr-18)
Rating Analysts	Nadeem Sheikh nadeem.sheikh@pacra.com +92-42-35869504

Profile

Structure Kashf Foundation (“Kashf” or “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 292 branches. The foundation extends small loans to under privileged community with a maturity of less than or equal to one year. Most of the foundation's portfolio is concentrated in Punjab. Main product of the foundation is “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, 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 to get 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 nine-member board of directors (BODs). Mr. Mueen Afzal is the chairman of the board.

Members' Profile The board members are cherished with extensive experience in the related sector. Mr. Mueen Afzal did his graduation from Punjab University and masters from Oxford University in 1963. He is a highly respected member of the Civil Services of Pakistan.

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.

Financial Transparency Deloitte Yousuf Adil Chartered Accountants are the External Auditors of the foundation. They expressed an unqualified opinion on the financial statements for the year Ended June'18. Internal Audit Department of the foundation reports directly to the Audit Committee. Compliance department is also in place which conducts regular inspection 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 an 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 no formal 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 Proper risk management policy to manage operational and credit risk is in place. 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 44 microfinance providers including 11 Microfinance Banks (MFBs), 17 Microfinance Institutions (NBMFCs), and 17 Rural Support Programmes (RSPs) and 9 others projects. MFI outreach hovers around ~6.7mln active borrowers at End-Sep18, representing market penetration of ~33% of the total potential market. MFIs are second to MFBs, representing 19% in total Gross Loan Portfolio (PKR ~254,612mln) and ~35% of active borrowers as at End-Sep18. The Microfinance Industry is accelerating on a growth trajectory with a YoY increase in industry gross loan portfolio (GLP) of over ~39%.

Relative Position Kashf is a relatively mid-tier player in the Microfinance sector. It is the one of the oldest players in the MFIs industry which has enabled it to develop a strong relationship with the borrowers. Kashf held ~4.5% of the market share in terms of GLP as at End-Sep18.

Revenue Kashf earned an interest income of PKR~3,401mln in FY18 with growth of ~43% YOY basis (FY17: PKR 2,382mln). The foundation earned PKR~992mln in 1QFY19. Revenue is growing due to enhanced business volumes.

Profitability The bank's business model emphasizes on keeping investments in non-earning assets as low as they could be to earn maximum returns from its asset base. During 1QFY19, Kashf's earning assets reflected ~91% of the total asset base (FY18: ~92%). The foundation posted a profit of PKR~821mln in FY18 (FY17: PKR~578mln) and PKR~271mln in 1QFY19. Going forward, spread is likely to be impacted by the increased policy rates.

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 a goodwill to attract potential clients. Customer centric business approach has been adopted. Going forward, rising interest rates amidst macro-economic instability would be a key challenge for Kashf, going forward.

Financial Risk

Credit Risk The foundation has properly designed loan approval and disbursement process. As mentioned earlier the loan approval process is de-centralized at branch level. Asset risk is low due to strong control & recovery mechanism. The infection ratio of the foundation as at End-Sep18 stands at ~0.3%.

Market Risk Market risk is expected to be impacted by the increased policy rates and macro instability in the country.

Funding The foundation's funding mix mostly constitutes long term loans from both local and foreign borrowers. All long term loans are floating rate liabilities. Total debt of the foundation as at End-Sep18 stood at PKR ~12,427mln.

Liquidity Kashf's liquidity position improved during 1QFY19 as liquidity ratio stood at 23% at end 1QFY19 as compared to 20% in FY18. The improvement in liquidity position is being led by increase in cash and bank balance during the period.

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 ~3,057mln as at End-Sep18.


Kashf Foundation

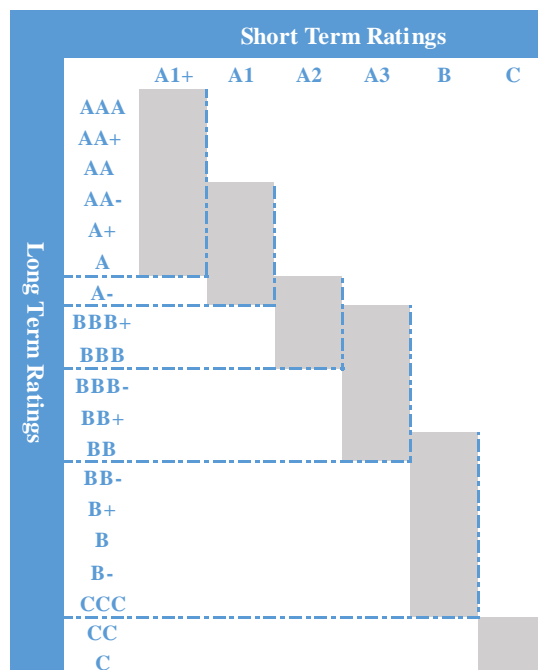
PKR Million

BALANCE SHEET	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
Earning Assets				
Advances	11,266	10,237	7,189	4,720
Investments	94	94	81	206
Deposits with Banks	2,342	1,635	1,847	1,152
Lending to Financial Institutions	1,044	1,036	752	422
	14,747	13,002	9,869	6,499
Non Earning Assets				
Non-Earning Cash	125	85	93	74
Net Non-Performing Finances	176	151	91	58
Fixed Assets & Others	1,463	1,151	916	770
	1,765	1,387	1,100	902
TOTAL ASSETS	16,511	14,389	10,969	7,401
Interest Bearing Liabilities				
Borrowings	12,427	10,798	8,316	5,461
	12,427	10,798	8,316	5,461
Non Interest Bearing Liabilities				
	765	579	429	336
TOTAL LIABILITIES	13,192	11,376	8,744	5,797
EQUITY (including revaluation surplus)	3,266	2,995	2,165	1,569
Deferred Grants	53	17	60	35
Total Liabilities & Equity	16,511	14,389	10,969	7,401
INCOME STATEMENT	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
Interest / Mark up Earned	992	3,401	2,382	1,957
Interest / Mark up Expensed	(330)	(1,068)	(644)	(562)
Net Interest / Markup revenue	662	2,333	1,738	1,395
Other Operating Income	41	242	216	179
Total Revenue	704	2,575	1,954	1,574
Other Income	26	(54)	(88)	30
Non-Interest / Non-Mark up Expensed	(440)	(1,635)	(1,259)	(887)
Pre-provision operating profit	289	886	608	716
Provisions	(18)	(64)	(30)	25
Pre-tax profit	271	821	578	742
Taxes	-	-	-	-
Net Income	271	821	578	742
Ratio Analysis	30-Sep-18	30-Jun-18	30-Jun-17	30-Jun-16
Performance				
ROE	37%	35%	35%	54%
Cost-to-Total Net Revenue	63%	63%	64%	56%
Provision Expense / Pre Provision Profit	6%	7%	5%	-4%
Capital Adequacy				
Equity/Total Assets	19%	19%	18%	18%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	0.3%	0.3%	0.3%	0.3%
Loan Loss Provisions / Non-Performing Advances	420%	399%	348%	327%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	21%	17%	24%	26%
Intermediation Efficiency				
Asset Yield	29%	30%	29%	30%
Cost of Funds	11%	11%	9%	10%
Spread	17%	19%	20%	20%
Outreach				
Branches	292	291	260	187
Kashf Foundation				
Dec-18				

Credit Rating Scale & Definitions

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 Ratings		Short Term Ratings	
AAA	Highest credit quality. Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments	A1+	The highest capacity for timely repayment.
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.	A1	A strong capacity for timely repayment.
AA		A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
AA-		A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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.	B	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
A		C	An inadequate capacity to ensure timely repayment.
A-			
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.		
BBB			
BBB-			
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.		
BB			
BB-			
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.		
B			
B-			
CCC	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.		
CC			
C			
D	Obligations are currently in default.		



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, a) some material identifiable event and/or b) deviation from expected trend. 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 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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, e) the entity/issuer defaults, or/and f) PACRA finds it impractical to surveil the opinion due to lack of requisite information.

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

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(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

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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.
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- (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)
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- (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)

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