The Pakistan Credit Rating Agency Limited

Rating Report

SAFCO Support Foundation

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
23-Apr-2021	BBB	A3	Stable	Maintain	YES
05-May-2020	BBB	A3	Stable	Initial	YES

Rating Rationale and Key Rating Drivers

SAFCO Support Foundation ('SAFCO' or the 'Foundation') is a Microfinance Institution (MFI) governed by the Securities & Exchange Commission of Pakistan under Section 42 of the Companies Act, 2017. The Foundation is licensed to operate under NBFC (Establishment and Regulations) Rules, 2003, Non-Banking Finance Companies and Notified Entities Regulations 2008. It has been in operations since 2009. The key element is that MFIs are not permitted to mobilize deposits, while they are also not backed by any stakeholder equity due to their status of "Companies Limited by Guarantee". These two elements, in combination, provide funding constraints, while they also delimit the boundaries of risk. SAFCO is a not-for-profit organization, hence, the source of funding comprises a) internal generation of profits, b) loans and c) grants. The Foundation's sanguine profitability culminates into integral capital generation at a decent rate. Second major source of funding is borrowings, for which the Foundation majorly relies on local avenues primarily including PMIC, with some portion of foreign lending too. Governance structure takes strength from the body of members and board of directors. The ratings also incorporate the vulnerability in business due to low market share and limited geographical presence. Under the current scenario, continuity of COVID-19 pandemic (penetration of third wave in Pakistan and internationally) will poise challenge to business and asset quality. However, due to sound management decisions, the Company is on track to surpass its past performance. The Institution's financial risk profile displays a comfortable outlook with fine profitability margins despite a fall in credit quality.

The ratings are dependent on the Foundation's aptness to sustain positive performance indicators amidst growth in business volumes. The ratings would also monitor the impact of technological progression on the operational and risk efficacy of the Foundation. Meanwhile, “Watch” reflects the need to oversee the risk profile of the Foundation against unavoidable challenges, particularly emanating from economic meltdown and repercussions due to Covid-19.

Disclosure

Name of Rated Entity	SAFCO Support Foundation
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | MFI (Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Microfinance(Sep-20)
Rating Analysts	Ahmad Saad Siddiqi | ahmad.saad@pacra.com | +92-42-35869504

Profile

Structure SAFCO Support Foundation (hereby referred to as "SSF" or ''Foundation'') was incorporated in May 2009 as a public company, limited by guarantee, registered under Section 42 of the Companies Ordinance, 1984 (now Companies Act, 2017). It is licensed by the Securities and Exchange Commission of Pakistan, under the Non-Banking Finance Companies Rules, 2003.

Background SSF originates from the Sindh Agricultural and Forestry Workers Coordinating Organization (SAFWCO), an NGO, established in 1986. After 25 years of delivering social development services and financial access to the destitute of rural Sindh, the Board of SAFWCO realized that technological and economic development has changed the scope of financial services, therefore they spun-off their microfinance activities into a separate entity i.e SSF.

Operations SSF operates at a provincial level with 50 branches in 10 Districts of the Sindh province, with over 515 employees. The Head office of the Foundation is located in Hyderabad. The loan portfolio consists of a total of nine loan products mainly relating to the following segments; Enterprise, Livestock, Agriculture, SME, Personal, School Improvement and lending specific to emergencies.

Ownership

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

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

Business Acumen The members are experienced, having suitable skills to guide the Foundation in the right strategic direction.

Financial Strength The probability of the Foundation to get financial support from members is low, since it is registered as a not-for-profit organization and the members do not receive monetary benefits out of the Foundation's profits.

Governance

Board Structure SSF has a 7 member Board of Directors. All directors are independent, providing objective oversight.

Members' Profile The Board members have extensive experience in the sector. Mr. Muhammad Ismail Kumbhar is the Chairman.

Board Effectiveness During FY20, 4 Board meetings were held. Attendance recorded during the meetings was good. The Board has 4 sub-committees; Audit Committee, Credit & Risk Committee, Human Resource Committee and the Social Performance Management Committee.

Transparency Deloitte Yousuf Adil Chartered Accountants, among the Big 4 audit firms, are the External Auditors of the Foundation. They expressed an unqualified opinion on the financial statements for the year Ended June'20. An internal audit department is in place, which reports to the Audit Committee.

Management

Organizational Structure SSF operations are grouped under nine departments. All departments, report to Mr. Syed Sajjad Ali Shah, the MD, except in case of the Internal Audit Department which directly reports to the Audit Committee.

Management Team The management has a mix of diverse skills and experience. Mr. Muhammad Suleman, the CEO, is with the Foundation since 2014. He has a vast working experience of 35 years in different fields. Other members of the management team are adequately qualified and possess a well rounded set of skills.

Effectiveness The Foundation has a systematic decision making process. A management committee, having various functions, is in place. It is chaired by the MD and comprises all department heads

MIS The MIS is integrated with all systems like Human Resource Management System, Financial Information System and E-Appraisal. It provides effective information in order to aid quick decision-making and planning.

Risk Management Framework A proper risk management policy to manage operational and credit risk is in place. Loan approval process is embedded with respective approval limits enjoyed by each approving authority i.e. Branch Manager, Area Manager, Manager Operations and Credit Committee. 80% of the recovery takes place through Alternate Delivery Channels such as Easy Paisa, HBL Konnect and Jazz Cash, while the rest is done through credit officers.

Technology Infrastructure SSF is investing in its technological infrastructure to increase automation and efficiency in the departments. Further increase in automation would result in expediting the loan recovery process, providing good surveillance and keeping the infection ratio in-check.

Business Risk

Industry Dynamics Pakistan's Microfinance Industry comprises 39 microfinance providers including 12 Microfinance Banks, 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes and 4 other projects. As at end-Dec'20, the total active borrowers of the industry stood at 7.0mln (FY20: 6.9mln), which shows a marginal increase of 1.4%. However, the restrictions are being lifted only in a phased manner and the degree of relaxations vary across regions depending upon the severity of covid-19 pandemic. The Industry Gross Loan Portfolio (GLP) clocked in at PKR 324,155mln (FY20: PKR 299,948mln). The surge in active borrowers and GLP continues contributed by the MFB peer group, which added over 170,000 clients and over PKR 115,000mln of GLP. The PAR>30 days decreased from 4.8% to 3.7% as the infection ratio for MFBs declined from 5% to 3.3% whereas it increased for the MFIs from 4.2% to 4.9%.

Relative Position As at 6MFY21, the Foundation held 1% (FY20: 1%) of the market share in terms of active borrowers. Considering this and the market share of 1% in terms of GLP of the whole industry, the Foundation is considered as a low tier player in the Microfinance sector.

Revenue SSF earned gross interest income of PKR 378mln in 6MFY21, depicting a decline of 2% as compared to corresponding period (6MFY20: PKR 399mln). Net markup income of the Company increased slightly by 1% to PKR 253mln (6MFY20: PKR 249). Non markup income of the Company also took a hit, amounting to PKR 35mln (6MFY20: PKR 82mln), representing a decline of 57%.

Profitability In 6MFY21, the Foundation posted a net surplus of PKR 109mln (6MFY20: PKR 125mln). Pressure on the bottom-line was mainly attributed to rise in provisions expense to PKR 27mln (6MFY20: PKR 3mln), as a result of higher NPLs.

Sustainability SSF's primary objective is to further strengthen its market position in the industry. To achieve the stated objective, the Foundation is developing new finance products. It is to be noted that footprints in the rural areas of Sindh were already present due to the presence of SAFWCO, which has been operating as an NGO. Fluctuating policy rates and deteriorating economic environment, especially in the wake of epidemic spread, will be the key challenge for the Foundation, going forward.

Financial Risk

Credit Risk The Foundation has set an authority matrix at the branch, area, region and HO level, depending on the loans size. Further, a Credit Committee is in place as the apex body to approve the highest slab of loan size or conflicting issues. The GLP as at End-Dec'20 amounted to PKR 2,497mln (End-June'20: PKR 2,189mln). The Non-Performing Loans ratio as at End-Dec'20 stood at 3.8% (End-June'20: 2.5%). The loan book is fairly diversified, with most concentration in Enterprise (46%), followed by Livestock (43%), Agriculture (6%) and Personal lending (3%).

Market Risk Market risk is expected to be impacted by the monetary policy and macro instability in the country. High policy rates will increase the financing cost of the Foundation. The investment book of the Foundation comprises short term Term Deposit Receipts (various banks) amounting to PKR 184mln as at 6MFY21 (FY20: PKR 257mln).

Funding The Foundation's funding mix comprises long term loans from both local (83%) and foreign financial institutions (17%). Total debt of SSF as at 6MFY21 stood at PKR 2,497mln (FY20: PKR 2,614mln). Borrowing from PMIC constitutes 73% of the total debt of the Foundation.

Liquidity SSF's liquidity position has declined during 6MFY21 as the liquidity ratio (Liquid Assets/Borrowings) stood at 18.6%% at Dec'20 (FY20: 33%). The decrease in liquidity position is led by decrease in surplus cash and bank balances.

Capital Adequacy SECP has no minimum requirement for MFIs to maintain the Capital Adequacy Ratio (CAR) at a certain level, unlike MFBs. The total funds and reserves as at 6MFY21 stood at PKR 815mln (FY20: PKR 714mln).

PKR mln

SAFCO Support Foundation Public Company Limited by Guarantee	Dec-20 6M	Jun-20 12M	Jun-19 12M	Jun-18 12M
A BALANCE SHEET				
1 Total Finances - net	2,681	2,446	2,739	1,782
2 Investments	-	-	-	-
3 Other Earning Assets	464	787	293	449
4 Non-Earning Assets	435	351	446	313
5 Non-Performing Finances-net	(91)	(65)	(107)	(57)
Total Assets	3,488	3,519	3,371	2,487
6 Deposits	-	-	-	-
7 Borrowings	2,497	2,614	2,621	1,722
8 Other Liabilities (Non-Interest Bearing)	135	161	105	221
Total Liabilities	2,632	2,775	2,726	1,943
Equity	856	743	645	544
B INCOME STATEMENT				
1 Mark Up Earned	378	696	610	341
2 Mark Up Expensed	(125)	(331)	(228)	(102)
3 Non Mark Up Income	35	106	110	86
Total Income	288	471	491	324
4 Non-Mark Up Expenses	(152)	(371)	(335)	(214)
5 Provisions/Write offs/Reversals	(27)	(2)	(54)	(30)
Pre-Tax Profit	109	98	101	80
6 Taxes	-	-	-	-
Profit After Tax	109	98	101	80
C RATIO ANALYSIS				
1 Performance				
Net Mark Up Income / Avg. Assets	14.4%	10.6%	13.0%	11.6%
Non-Mark Up Expenses / Total Income	52.6%	78.7%	68.3%	65.8%
ROE	27.3%	14.1%	17.0%	16.1%
2 Capital Adequacy				
Equity / Total Assets (D+E+F)	24.6%	21.1%	19.1%	21.9%
Capital Adequacy Ratio	N/A	N/A	N/A	N/A
3 Funding & Liquidity				
Liquid Assets / (Deposits + Borrowings Net of Repo)	18.6%	33.1%	16.3%	30.4%
(Advances + Net Non-Performing Advances) / Deposits	N/A	N/A	N/A	N/A
Demand Deposits / Deposits	N/A	N/A	N/A	N/A
SA Deposits / Deposits	N/A	N/A	N/A	N/A
4 Credit Risk				
Non-Performing Advances / Gross Advances	3.8%	2.5%	0.8%	1.1%
Non-Performing Finances-net / Equity	-10.6%	-8.8%	-16.6%	-10.5%

Credit Rating

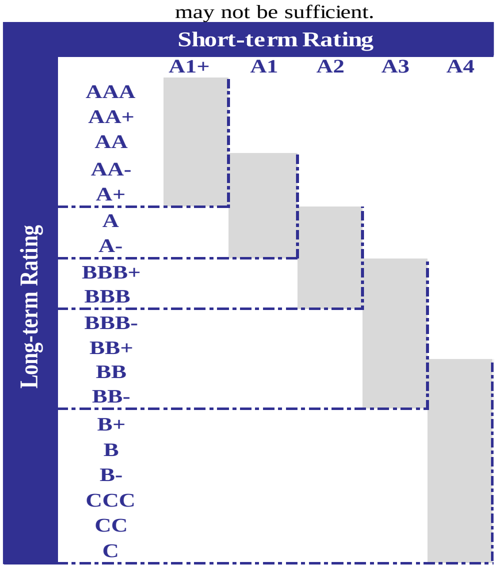
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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