



The Pakistan Credit Rating Agency Limited

Rating Report

Thardeep Microfinance Foundation

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Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
08-Apr-2020	BBB	A3	Stable	Initial	-

Rating Rationale and Key Rating Drivers

Thardeep Microfinance Foundation ('Thardeep' or the 'Foundation') is a Microfinance Institution (MFI) governed by the Securities & Exchange Commission of Pakistan under Section 42 of the Companies Ordinance, 1984 (now 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 2016, with early footprints as Thardeep Rural Development Programme (TRDP). 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. Thardeep 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 profitability culminates into integral capital generation at a decent rate. Second major source of funding is borrowings, for which the Foundation majorly relies on both local and foreign avenues including PMIC & SIMA. Governance structure takes strength from the sponsoring members who are also the board of directors. The foundation is relatively sound on technological grounds as it follows a complete paperless regime. While this is considered positive, the ratings also incorporate the concentration of business at regional level and vulnerability in business due to low market share. Therefore, credit risk remains high, as was reflected in Dec'19 higher Portfolio at Risk (PAR) owing to geographical concentration. Profitability margins, consequently, remained thin. Additionally, the growing impact of economic slowdown lately exacerbated by the global pandemic spread is further expected to deteriorate the overall risk profile of the Microfinance Sector, particularly with reference to the quality of assets and risk absorption capacity. Currently, the Institution's financial risk profile displays a comfortable outlook.

The ratings are dependent on the Foundation's aptness to sustain positive performance indicators amidst growth in business volumes. Meanwhile, the propensity of the business to guard itself against the current economic turmoil is imperative.

Disclosure

Name of Rated Entity	Thardeep Microfinance Foundation
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology MFI (Jun-19), Methodology Correlation Between Long-Term And Short-Term Rating Scale (Jun-19)
Related Research	Sector Study Microfinance (Sep-19)
Rating Analysts	Raniya Tanawar raniya.tanawar@pacra.com +92-42-35869504

Profile

Structure Thardeep Microfinance Foundation (hereinafter referred to as “Thardeep”) is a not for profit organization, registered under section 42 of the Companies Act., as a Microfinance provider, by Securities and Exchange Commission of Pakistan (SECP).

Background Thardeep Microfinance Foundation (Thardeep) has its origins since 1998 as community loans provider through a donor funded relief project which then became a Rural Support Programme (RSP). These loans were given out by Thardeep Rural Development Programme (TRDP) initially in Tharparkar, which extended to other districts of Sindh. In 2003, TRDP signed its first agreement with Pakistan Poverty Alleviation Fund (PPAF) and expands its operations, particularly its Microcredit portfolio, to more parts of Tharparkar and Umerkot Districts. By late 2016, TRDP’s Microcredit programme converted into an independent organisation.

Operations Thardeep operates at a district level with a network of over 82 branches. The foundation provides Microcredit to under privileged community with a maturity of less than or equal to one year. Most of the foundation's portfolio is concentrated in Tharparkar, Sindh. Foundation's clientele largely comprises female entrepreneurs with small businesses.

Ownership

Ownership Structure Thardeep has seven (7) founding members, including few nominated from TRDP, who, have no shareholding in the organisation.

Stability Since the ideology behind a not-for-profit organisation is community welfare therefore association of members is more of voluntary. Henceforth, succession planning is least expected in such foundation.

Business Acumen Thardeep members profile has experienced professionals with multifaceted skill set to direct the foundation in achieving its objectives.

Financial Strength As the foundation is a registered not-for-profit organization the probability to get financial support from members is low,

Governance

Board Structure Overall control vest in the seven members of the board with two female directors and an appropriate mix of Independent and non independent. Dr. Naseer Muhammad Nizamani is the Chairman of the board.

Members’ Profile The members profile of Thardeep's board is enriched with well-diversified experienced professionals, who have been involved in community based services previously. Dr. Naseer Muhammad Nizamani, is a highly qualified Physician with more than two (2) decades of experience in various renowned institutions including UNICEF & UNFPA.

Board Effectiveness There are three sub-committees, namely (i) Audit Committee, (ii) IT Committee and (iii) Human Resource Committee. Attendance during the meetings was good and minutes were properly documented.

Financial Transparency BDO Ebrahim & Co are the External Auditors of Thardeep. The auditors are on the QCR list as well as categorised - 'A' on the list of SBP approved auditors. They expressed an unqualified opinion on the financial statements for the year Ended June' 19.

Management

Organizational Structure Thardeep has a decentralised organisation structure where the decision-making power is distributed, and the sections and divisions have different degrees of independence.

Management Team Thardeep has a mix of diverse experience and skilled management. Mr. Sono Khangharani, the CEO, is one of the founding members having an experience of over three decades. Mr. Sono's professional career started in late 1982 as a teacher (lecturer) in Agriculture University Tando Jam Sindh, Mr Sanjai, a finance professional ably looks after the Risk & Compliance aspects of the business. All members are associated with Thardeep since its inception.

Effectiveness The foundation has a systematic decision making process. Each department head ensures smooth running of their department and they meet Chief Executive Officer to discuss material matters.

MIS The departments are integrated which helps in effective decision making. For a way forward, Thardeep is in the process of establishing a proper ERP system within the organisation and is currently in collaboration with Aritech.

Risk Management Framework There exist a separate Risk & Compliance Department where every risk oriented factor is being catered. Compliance department also conducts regular inspection of all relevant departments on monthly/quarterly basis. Internal Audit Department exists that reports directly to the Audit Committee.

Technology Infrastructure Thardeep has a profound technological stature in place, which gives an edge to the foundation. Sophisticated automated system processes established throughout the organisation with paperless environment. There is an Electronic Financial information System (e-FIS) that is used for efficient generation of money transactions. Furthermore, Thardeep has acquired cloud hosting service from an international vendor Microsoft Azure.

Business Risk

Industry Dynamics Industry Dynamics Pakistan Microfinance Industry comprises 41 microfinance providers including 11 Microfinance Banks (MFBs), 15 Microfinance Institutions (MFIs), 6 Rural Support Programmes (RSPs) and 9 other projects. As at 6MFY20, the overall industry borrowers stood at ~7.3mln out of which MFIs constitute ~2.5mln active borrowers, representing ~34% of the total market. The industry Gross Loan Portfolio (GLP) clocked at PKR ~305,743mln out of which MFIs represent 20% i.e. PKR ~60,363mln

Relative Position Thardeep is a relatively small-tier player in the Microfinance sector. Sponsors has presence in the same domain since 1998. Thardeep has the highest GLP and holds ~1% of the market share in terms of GLP as at Dec'19 and relies on internal capital and external borrowing to finance its portfolio. Currently, Thardeep has around 172K active borrowers at 6MFY20. Thardeep has geographical presence in 19 districts.

Revenue Thardeep earned an interest income of PKR~1,123mln in FY19 with exceptional growth of ~42% YOY basis (FY18: PKR~789mln). Revenue is growing (6MFY20; PKR 680mln) due to increased business volumes i.e. active borrowers.

Profitability Thardeep's profits stood at PKR 53mln in FY19 (FY18: PKR 155mln), lower on account of exchange losses. The spread is likely to reduce due to increased policy rate as Thardeep is not intending to transfer the impact of increase in borrowing cost to borrowers.

Sustainability Thardeep's management has a growth-centric approach through market penetration by way of expansions. Management has a devised plan to achieve its objectives. Geographical limitation and high interest rates amidst macro-economic instability would be a key challenge for Thardeep,

Financial Risk

Credit Risk There is a systematic process in place that is properly designed and decentralised, at branch and area level, for loan approvals and disbursements. Low asset risk due to strong control & recovery mechanism however, Credit risk remains high, as reflected in Dec'19, higher Portfolio at Risk (PAR), owing to geographical concentration. Thardeep’s PAR stood at ~2% during FY19 (FY18: ~0.7%). The GLP, as at FY19, stood at PKR ~3.9bln. Infection ratio of Thardeep is at par with industry average; End-6MFY20 rose to ~1.5% (FY19: 1.2%). The product mix largely comprises lending to Livestock (~35%), Agriculture (~4%) and Enterprises (~38%).

Market Risk Market risk is linked yet impacted by the monetary policy and macro instability in the country. High policy rates will increase the financing cost of the foundation as all local long term borrowing carry floating interest rate. Thardeep has a policy to hedge all foreign currency exposures, which is beneficial for the foundation, in the current environment.

Funding The foundation’s funding mix mostly constitutes long term loans from both local and foreign borrowers. Total debt of the foundation as at FY19 rose to PKR ~5.6bln (FY18: PKR~4.3bln) while for 6MFY20 it amounted PKR 4.8bln.

Liquidity Thardeep’s liquidity position improved during FY19 as the liquidity ratio stood at 13% as compared to 10% in FY18. However, this ratio dropped during 6MFY20 to 4% which is a significant drop. Thardeep needs to assess its liquidity position and improve it by placement of more funds in liquid assets to meet unexpected demands.

Capital Adequacy As at Dec'19, the Capital to GLP ratio stood at ~11.5% (FY19: ~11%), which was considered adequate in with respect to the peers. Unlike MFBs, the MFIs are not regulated to maintain a certain CAR percentage at 15%. Equity of the foundation stood at PKR~445mln as at Dec'19.



Thardeep Microfinance Foundation

PKR Million

BALANCE SHEET	31-Dec-19	30-Jun-19	30-Jun-18	30-Jun-17
Earning Assets				
Advances	3,945	4,137	3,448	2,333
Investments	856	839	675	213
Deposits with Banks	125	461	386	40
	4,925	5,436	4,509	2,586
Non Earning Assets				
Non-Earning Cash	62	265	33	8
Net Non-Performing Finances	(67)	(27)	(22)	(27)
Fixed Assets & Others	669	666	332	147
	664	904	342	128
TOTAL ASSETS	5,589	6,340	4,851	2,714
Interest Bearing Liabilities				
Borrowings	4,821	5,610	4,337	2,420
	4,821	5,610	4,337	2,420
Non Interest Bearing Liabilities				
	323	286	120	55
TOTAL LIABILITIES	5,144	5,897	4,458	2,475
EQUITY (including revaluation surplus)	445	444	393	238
Deferred Grants	0	0	1	2
Total Liabilities & Equity	5,589	6,341	4,851	2,715

INCOME STATEMENT	31-Dec-19	30-Jun-19	30-Jun-18	30-Jun-17
Interest / Mark up Earned	681	1,123	789	363
Interest / Mark up Expensed	(413)	(525)	(325)	(130)
Net Interest / Markup revenue	268	599	464	233
Other Operating Income	2	26	102	-
Total Revenue	269	625	566	233
Other Income	58	237	52	20
Non-Interest / Non-Mark up Expensed	(266)	(752)	(448)	(238)
Pre-provision operating profit	61	110	169	15
Provisions	(60)	(56)	(14)	(33)
Pre-tax profit	1	54	155	(18)
Taxes	-	-	-	-
Net Income	1	54	155	(18)

Ratio Analysis	31-Dec-19	30-Jun-19	30-Jun-18	30-Jun-17
Performance				
ROE	1%	13%	49%	-8%
Cost-to-Total Net Revenue		120%	79%	102%
Provision Expense / Pre Provision Profit	98%	51%	8%	222%
Capital Adequacy				
Equity/Total Assets	8%	7%	8%	9%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	1.4%	1.0%	0.0%	0.0%
Loan Loss Provisions / Non-Performing Advances	221%	165%	3764%	0%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	22%	28%	25%	11%
Intermediation Efficiency				
Asset Yield	37%	23%	22%	14%
Cost of Funds	23%	11%	10%	5%
Spread	14%	12%	13%	9%
Outreach				
Branches	82	82	60	-

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+ 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.	A1	A strong capacity for timely repayment.
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.	A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial 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.	A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
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	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.
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.	C	An inadequate capacity to ensure timely repayment.
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.		



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.

Disclaimer: PACRA's ratings are an assessment of the credit standing of entities/issue in Pakistan. They do not take into account the potential transfer / convertibility risk that may exist for foreign currency creditors. PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

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

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- (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)

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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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