The Pakistan Credit Rating Agency Limited

Rating Report

Thardeep Microfinance Foundation

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
30-Sep-2020	BBB	A3	Stable	Maintain	YES
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. 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 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 Jun'20 higher Portfolio at Risk (PAR) owing to geographical concentration. Hike in NPLs led to net provisioning expense being recorded; maintaining asset quality intact remains essential. Higher provisioning expense significantly impacted the profitability. However, post June recoveries picked up pace. Rating Watch encompass ramifications emerging from Covid-19 outbreak and nationwide lockdown imposed for few months. Covid-19 had posed challenges to the microfinance sector, almost all segments of the economy, were negatively impacted. Meanwhile, for mitigating the affect of Covid-19, the central bank has taken well-tailored and comprehensive actions including reduction in key policy rates and deferment of repayment obligations for a defined period. Most of the urban workforce is employed by micro and small enterprises that rely on either informal credit or credit through microfinance institutions (MFIs). Moreover, the urban flooding in Sindh further enhanced challenges for some players in the sector.

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-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Microfinance(Sep-19)
Rating Analysts	Muhammad Noor ul Haq | noorulhaq@pacra.com | +92-42-35869504

Profile

Structure Thardeep Microfinance Foundation (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 Tharparker, 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 planing 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.

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 Pakistan's Microfinance Industry comprises 38 microfinance providers including 11 Microfinance Banks, 17 Microfinance Institutions (MFIs), 6 Rural Support Programmes and 4 other projects. As at end-Mar20, the total number of industry borrowers stood at ~7.3mln (FY19: ~7.1mln) out of which MFIs constituted ~2.4mln active borrowers (FY19: ~2.3mln), representing 33% of the total market. The Industry Gross Loan Portfolio (GLP) clocked in at PKR~308,557mln (FY19: PKR ~293,695mln), out of which MFIs represented 20%. Amid economic uncertainty, a slump in growth within the industry is noted. The locust attack in various parts of Punjab and Sindh coupled with the urban flooding are expected to have an impact on the credit health of entities. The outbreak of the pandemic Covid-19, has added further uncertainty in the industry.

Relative Position Thardeep is a relatively small-tier player in the Microfinance sector and holds ~1% of the market share in terms of GLP as at Jun'20. Thardeep relies on internal capital and external borrowing to finance its portfolio. Currently, Thardeep has around 172K active borrowers with a geographical presence in 19 districts.

Revenue In response to the Covid-19 pandemic and subsequent nationwide lockdowns, Thardeep witnessed a significant dip in its growth momentum. The gross interest income of the foundation increased by 8.4% to PKR 1,218mln in FY20 as against the exceptional growth of 42.5% (FY19: PKR 1,123mln) in FY19. However, the foundation was largely able to resume its growth of revenue during last quarter of FY20; which is grew by 21.5%.

Profitability The net surplus of PKR 54mln in FY19 turned into a net deficit of PKR 211mln owing to higher provisioning charge of PKR 211mln during FY20. Moreover, margins have taken a major hit due to rising finance costs along with worsening credit health.

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 going forward.

Financial Risk

Credit Risk Thardeep's operations remain focused on low and middle income self- employed borrowers, who are relatively more vulnerable to economic cycles. Given the ongoing economic slowdown credit health of the portfolio has worsened in line with the industry behavior. Credit risk remains high, as reflected in higher Portfolio at Risk (PAR), owing to geographical concentration. Given the economic uncertainty, the management has exercised restraint with regards to fresh disbursement in order to curb further deterioration of credit health; which is reflected in GLP PKR 3.6bln During FY20. Whereas the infection ratio of Thardeep significantly rose to 7.8%.

Market Risk Higher finance cost of the foundation as all local long term borrowing carry floating interest rate and highly competitive market find it difficult to pass on the impact of higher cost of funds. However, Thardeep has a policy to hedge all foreign currency exposures, which is beneficial for the foundation in 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 FY20 reduced to PKR 5.1bln (FY19: PKR5.6bln) while the advances to funding ratio also fell to 68% (FY19: 73%), due to the recent pause in disbursement.

Liquidity Thardeep's liquidity position deteriorated during FY20 as the liquidity ratio stood at 25% as compared to 28% in FY19. This is mainly due to a significant drop in cash and bank balances as at End-FY20.

Capital Adequacy Unlike for Microfinance Banks, SECP has no minimum requirement for Microfinance Institutions, with respect to CAR. The total funds and reserves of the foundation as at end-Jun20 amounted to PKR 232mln (end-Jun19: PKR 444mln).

Thardeep Microfinance Foundation

PKR Million

BALANCE SHEET	30-Jun-20	30-Jun-19	30-Jun-18	30-Jun-17
Earning Assets				
Advances	3,476	4,137	3,448	2,333
Investments	982	839	675	213
Deposits with Banks	173	461	386	40
	4,631	**5,436**	**4,509**	**2,586**
Non Earning Assets				
Non-Earning Cash	90	265	33	8
Net Non-Performing Finances	(4)	(27)	(22)	(27)
Fixed Assets & Others	883	666	332	147
	970	**904**	**342**	**128**
TOTAL ASSETS	**5,601**	**6,340**	**4,851**	**2,714**
Interest Bearing Liabilities				
Borrowings	5,083	5,610	4,337	2,420
	5,083	5,610	4,337	2,420
Non Interest Bearing Liabilities	286	286	120	55
TOTAL LIABILITIES	**5,368**	**5,896**	**4,458**	**2,475**
EQUITY (including revaluation surplus)	232	444	393	238
Deferred Grants	-	0	1	1
Total Liabilities & Equity	**5,601**	**6,340**	**4,851**	**2,714**

INCOME STATEMENT	30-Jun-20	30-Jun-19	30-Jun-18	30-Jun-17
Interest / Mark up Earned	1,218	1,123	789	363
Interest / Mark up Expensed	(790)	(525)	(325)	(130)
Net Interest / Markup revenue	**427**	**599**	**464**	**233**
Other Operating Income	2	26	102	-
Total Revenue	**430**	**625**	**566**	**233**
Other Income	207	237	52	20
Non-Interest / Non-Mark up Expensed	(598)	(752)	(448)	(238)
Pre-provision operating profit	39	110	169	15
Provisions	(251)	(56)	(14)	(33)
Pre-tax profit	(211)	54	155	(18)
Taxes	-	-	-	-
Net Income	**(211)**	**54**	**155**	**(18)**

Ratio Analysis	30-Jun-20	30-Jun-19	30-Jun-18	30-Jun-17
Performance				
ROE	-63%	13%	49%	-8%
Cost-to-Total Net Revenue	139%	120%	79%	102%
Provision Expense / Pre Provision Profit	636%	51%	8%	222%
Capital Adequacy				
Equity/Total Assets	4%	7%	8%	9%
Loan Loss Coverage				
Non-Performing Advances /Gross Advances	2.4%	1.0%	0.0%	0.0%
Loan Loss Provisions / Non-Performing Advances	104%	165%	3764%	0%
Funding & Liquidity				
Liquid Assets / Deposits and Borrowings	25%	28%	25%	11%
Intermediation Efficiency				
Asset Yield	24%	23%	22%	14%
Cost of Funds	15%	11%	10%	5%
Spread	9%	12%	13%	9%
Outreach				
Branches	82	82	60	-

Credit Rating

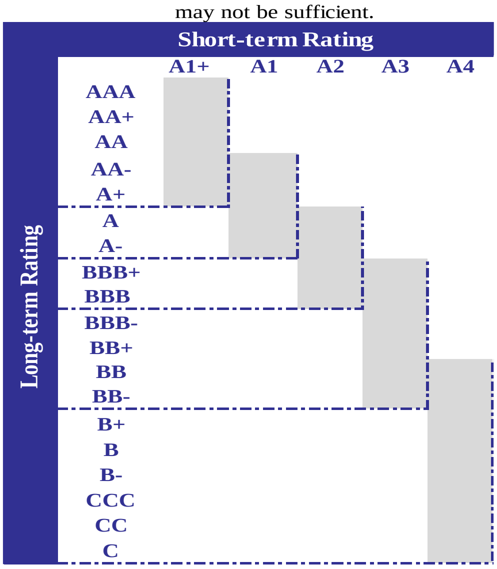
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

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