Kashf Foundation

Managing Director: Ms. Roshaneh Zafar

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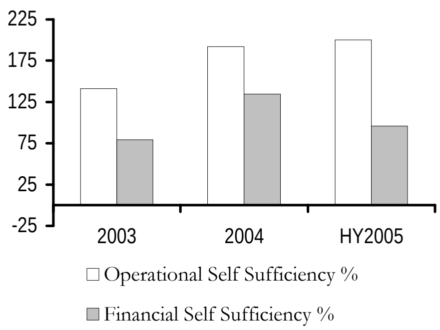
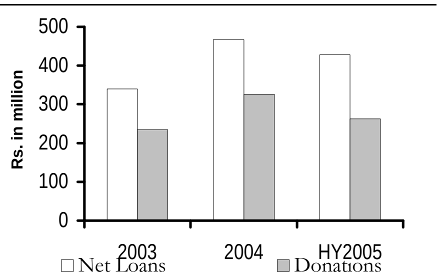
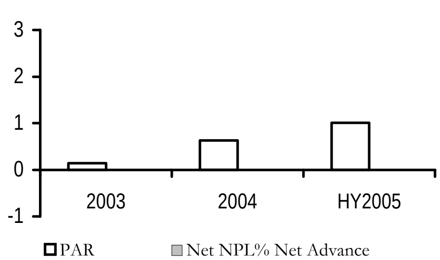
Category	Latest	Previous
Entity	BBB / A-3 *Oct. 27, '05*	BBB / A-3 *Sept. 13, '04*
Outlook	***Positive*** *Oct. 27, '05*	***Stable*** *Sept. 13, '04*

Key Financial Trends







Rating Rationale

Kashf Foundation (Kashf) was set up as a non-profit micro-finance institution (MFI), with the mission to alleviate poverty and empower the women in Pakistan. The Board of the Foundation has decided to change the legal structure of the institution from a society to a non-profit guarantee limited company under section 42 of the Companies Ordinance, 1984. Although the management had taken significant steps to ensure good governance including having a strong board and maintaining a high level of transparency, there was an absence of a protective regulatory layer. With change in the legal status, this area would be largely addressed and result in strengthening of the institution. The management expects conversion to be completed before the end of this year.

Kashf follows the group lending methodology which requires a highly decentralized operational network with each branch operating as an independent unit. Although, the operation is mainly focused on credit disbursements and collections, the institution also has a voluntary savings program and organizes other social advocacy programs. Over the years the institution has become both operationally (OSS) and financially self-sufficient (FSS) with low reliance on donor funds as the institution has demonstrated the ability to access and operate using commercial sources of funding. Kashf Foundation is among the few MFIs operating in Pakistan that are both operationally and financially self-sufficient with OSS and FSS at a level of 192% and 122% respectively during FY2004.

Kashf derives its strength from the quality of its management which has remained stable at the senior level. The board of directors also comprises individuals with experience in both the social and commercial sector.

Kashf has experienced substantial growth during the last three years with net loans increasing from Rs. 32.64m as at June 30, 2002 to Rs. 428.34m as at June 30, 2005. During this period, the NGO has increased its outreach while maintaining the quality of its loan portfolio, as infected portfolio constituted a very small proportion of total loans and total number of borrowers have increased to 70,929. The portfolio at risk (PAR) that stood at 1.01% as at June 30, 2005 is even lower than the general provision of 2% maintained by Kashf as loss reserves.

The resource base during this period has increased from Rs. 201.53m in 2002 to Rs. 851.53m as at June 30, 2005. With the loan portfolio constituting 50% of assets as at June 30, 2005, the remaining is largely deployed in liquid securities providing Kashf a high level of liquidity. Liquid assets constituted approximately 43% of assets while the NGO continues to be primarily funded by equity resulting in strong liquidity indicators. The tenor of loans is also short-term in nature, further supporting cash flows and liquidity.

With an increase in total advances, net income from loan operations has increased significantly to Rs. 146.37m during the year ending December 31, 2004. The total return on advances during FY2004 stood at 39% providing Kashf sufficient room to absorb its operational costs that constitute 16% of the loan portfolio during FY2004. Being primarily funded by equity, financial charges were low. A large proportion of assets held as liquid securities are in the form of low yielding cash and term deposit receipts resulting in an overall average yield of 3% during the same period. In order to optimize returns, further diversification of investments in all asset classes and by issuers may be required. With increase in interest rate scenario, yield on the investment portfolio could increase and portfolio management would become particularly critical with the rising cost of funds.

Overview of the Institution

Kashf Foundation was set up in 1996 as a non-profit micro-finance organization, registered under the Societies Registration Act, 1860. It operates in the suburban areas of Lahore and surrounding small towns with a network of 35 branches. The total staff strength at Kashf increased from 243 employees to 275 with increase in number of loan officers from 111 to 173. Kashf primarily caters to women, using social collateral as security against loans extended JCR-VIS

Corporate Profile and Background

Kashf Foundation was registered as a non-profit organization in Lahore in 1996 under the Societies Registration Act 1860. The Foundation's mission is to alleviate poverty by providing quality and cost effective microfinance services to low income households especially women in order to enhance their economic role and decision making capacity. Kashf operates through 35 branches.

Kashf is represented on various forums, both at home and abroad; the foundation is a partner with the Grameen family along with the Schwab Foundation, an associate of the Women's World Banking Network, a member of the Pakistan Microfinance Network and a member of the State Bank of Pakistan's Consultative Group for Microfinance.

Kashf holds a five diamond status on the MIX (Microfinance Information Exchange) market website[1], an information portal of the World Bank for its level of disclosures.

Kashf also recently received AGFUND International Prize, 2005, by the Arab Gulf Program for United Nations Development Organizations.

As a part of the foundations efforts to improve the level of governance in the institution by operating in the regulated sector, the Board of the Foundation has decided to change the legal structure of Kashf from an NGO to a non-profit guarantee limited company under section 42 of the Companies Ordinance, 1984.

Operational Risks and Information Technology Systems

In order to minimize operational risks, the foundation has been deploying information technology systems throughout its branches, where a paperless environment with full connectivity is envisioned for 16 branches by year-end. Previously, documents at branches were prone to damage and theft, and in the absence of back-up copies and a lack of data security systems, inefficiencies in the system existed.

With the new system, modules for Loan and Saving Management, General Ledger and Security are being implemented. The operating environment is Oracle developer for both front-end and back-end, with 9 servers. The system is in the parallel run phase, which is expected to be completed by the end of this year. Information is received from the branches at the end of each day, while back-ups are maintained on tape drives and disks for data security.

The current system causes no delay in operations since branches have been delegated the responsibility of managing their respective portfolios. However, with an automated system, human error and operational risks are likely to reduce, and loan officers will have more time to spend in the field rather than dealing with credit administration.

Impact studies are also being conducted, where econometrists and anthropologists will be summoned in November to conduct a detailed study.

Manuals for financial risk management and credit risk management are in place, besides a human resource policy manual, a treasury manual and an operations manual. These documents are comprehensive and have been approved by the Board of Directors.

Lending Methodology

Kashf has adopted the group lending approach whereby responsibility for loan re-payment is also shared by the group members. This serves as social collateral for the loans thereby improving the credit quality of the group. This methodology however requires a high level of decentralization and strong level of standardized procedures and controls. Therefore each of Kashf's branches operate as an independent however identical unit in terms of procedures and policies. A single branch has approximately 4-6 loan officers, each managing 24 centers with 25 members each. The average number of borrowers per loan officers decreased from 508 to 390 as at December 31, 2004 due to a large number of new loan officers hired during the later part of the year. As per the lending methodology, one loan officer should

[1] www.mixmarket.org

cater to a maximum of 600 customers.

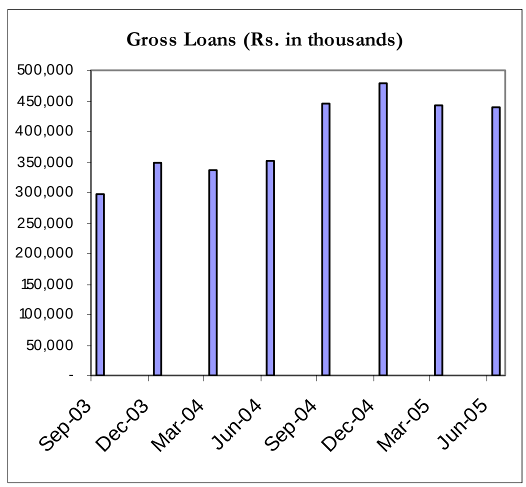
Kashf mainly targets women who may then utilize the loan proceeds either for self-employment or to support a micro-enterprise for male family members. Clients are selected in accordance with a set profile, which comprises women who are unlikely to shift localities, have permanent establishments and a household income ranging between Rs. 3.5-6K per month. While the repayment capacity of loanees is not formally assessed, character references are obtained before disbursement. Each member of the group is initially verified and photographs and copies of NIC are taken for future reference. The loan officer, branch manager, and area manager, each go in the field to evaluate every customer in terms of their repayment ability by way of informal discussion and by reference checks. Once all verifications are complete the loan amount is disbursed through cheques to each customer in the group. Loan limits assigned are small and increased only after successfully repaying the entire loan amount.

Loans are primarily unsecured with no physical collateral and no personal guarantee and therefore carry a higher risk of complete loss upon default. Group lending allows for peer pressure being utilized as a disciplinary tactic. A member of the center is designated as the center manager, who takes responsibility of the group's timely repayments and collection of installment proceeds. Installments are payable on a fortnightly basis, a day prior to each fortnightly center meeting. Mandatory attendance of 80% ensures frequent interaction with every client. Installments collected are deposited at the Kashf branch. A copy of the deposit slip is submitted to the LO when the center meeting is held on each repayment date and the next deposit slip is filled and given to the Center Manager by the LO for the next payment. The cashier at the branch has also been instructed not to accept an installment if it is not being paid in full. This may cause delays in payments arriving in the HO account, but dampens misappropriation risk. To preclude the possibility of collusion of any form, portfolios handled by LOs are interchanged every 6 months. The company had also planned frequent relocation from branches to counter this risk, however relocation of staff to other localities is proving difficult to achieve.

By shifting responsibility of collection to a member of the borrowing group and treating disbursements and repayments from a group collectively rather than as individual transactions, peer pressure is intensified in case of non-payment. The foundation also saves on the cost of commuting between households and collecting dues through its LOs. Social collateral obtained is strictly enforced. In case of non-payment, members of the group are required to meet the shortfall in the group's due installment.

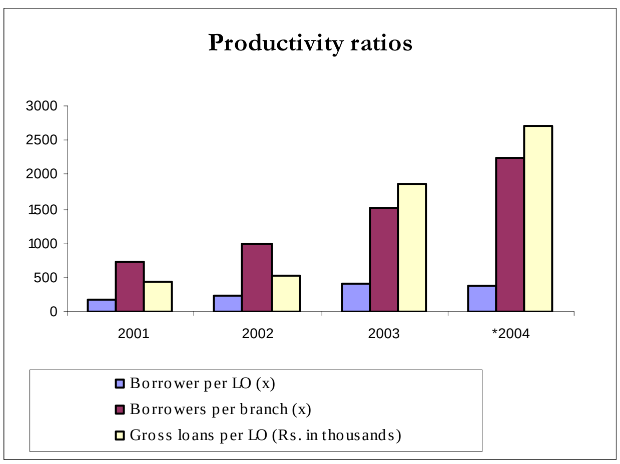
Financial Analysis

The loan portfolio registered substantial growth during the period FY2002-FY2004 with net loans increasing from Rs. 32.64m as at June 30, 2002 to Rs. 467m as at December 31, 2004. However, the loan growth has tapered subsequent to the year-end with net advances decreasing to Rs. 428m as at June 30, 2005.



The increase in portfolio over the later half of FY2004 is attributable to both, an increase in average loan size that has increased from Rs. 5,100 / borrower as at May 2004 to Rs. 6,900 / borrower as at December 31, 2004 and an increase in active borrowers that increased to 67,552 from 62,971 during the same period. The tapering off of the loan portfolio can be attributed to closing of three branches and a decrease in outstanding balances as repayments are made by existing clients while disbursements were slower during the same period. Total number of active borrowers however continued to increase to 70,929 as at June 30, 2005.

As per the credit policy at Kashf, each loan officer manages approximately 24 centers with 25 members each resulting in a total number of 600 borrowers per loan officer. A new loan officer is to be added if the number of borrowers increases from this internal benchmark to mitigate operational risks with managing large number of clients. The borrower per loan officer increased from the year 2001 to its highest point during FY2003. However with a rapid increase in total number of loan officers during FY2004, the number of borrowers/loan officer, has decreased to 390 as at December 31, 2004. It is the NGO's group lending methodology that allows a loan officer to manage such a large number of borrowers. The following table indicates trend in some of the productivity ratios of Kashf.



The two main loan products offered by the foundation are General loans (GL) and Emergency loans (EL). The former serve the purpose of financing income-generating activities. Procurement of loans is fast and easy, and obtaining a GL is compulsory in order to be a Kashf client. The minimum initial loan is Rs. 6,000, which may go up to Rs. 10,000 depending on reputation, credibility, sustainability and repayment capacity of the borrower; based on performance and repayment capacity, loan limits may be increased by Rs. 1,000 to Rs. 4,000 for every successive loan cycle. The maximum GL loan amount ranges from between Rs. 20,000 to Rs. 25,000 depending on the area and branch. These loans are payable in 24 installments over one year. The portfolio outstanding in this category is Rs. 446.33m as at December 31, 2004, increased over Rs. 323.44m outstanding as at December 31, 2003.

Emergency loans are categorized to finance consumption needs of borrowers. Clients are eligible for these loans if they are active Kashf clients. Loans are repayable in 11 installments. These loans range from Rs. 2,000 to Rs. 4,000, depending on the area and branch. Kashf has also obtained credit insurance that offers coverage to the outstanding credit balance and pays burial expenses in case of death of a client.

Going further, the organization plans to introduce home improvement loans, hire purchase, and is also conducting research on the option of introducing pension savings. Personal loans have recently been introduced, though the portfolio is as yet, small and the institution is deliberating upon substantial focus on these loans in future. Credit assessment procedures for personal loans differ significantly from group lending methodology and human and operational systems will require adaptation.

Kashf has maintained the quality of its credit portfolio with only a marginal increase in portfolio at risk from previous year. Its portfolio at risk stood at 0.63% as at December 31, 2004 with overdues greater than 30 days amounting to Rs. 2.98m on a gross basis. This level of infection is even less than the 2% provision maintained by Kashf as reserves against bad debt. Performance during the first six months has also been satisfactory with PAR at 1.01% as at June 30, 2005.

However owing to Kashf's operations being primarily concentrated in Lahore and its vicinity, there exists risks by virtue of geographical concentration in the loans portfolio. Further, competition from other MFIs is starting to emerge with Kashf clientele being the primary target owing to their credit performance history. Although such a scenario might increase the business acquisition cost for Kashf, it also indicates realization of mission for the Foundation which is to provide credit access to the micro borrowers. This might also allow Kashf to explore new geographical areas, decreasing its current level of geographical concentration and cultivating a better credit culture within borrower pocket.

By virtue of the institution still being largely funded by equity, the available liquid assets in hand constituting 37% of borrowings and 158% of current liabilities as well as the short-term nature of advances, there exists low level of liquidity risk.

Funding Sources

Kashf continues to be primarily equity financed with equity constituting 60% of total resource base as at December 31, 2004. Initial capital of the foundation was provided through donations for various purposes including infrastructure development and lending activities. As at December 31, 2004, total donations (equity) stood at Rs. 325.58m while another Rs. 178.5m of total equity have been earned through internal profit generation over the years. Kashf being a non-profit institution retains all its profits thereby steadily improving its level of capitalization.

Kashf has also accessed commercial sources of borrowings in addition to borrowings from various development finance institutions. Of the total borrowings amounting to Rs. 306.68m as at December 31, 2004, Rs. 129.9m was outstanding against a credit line of Rs. 450m by Pakistan Poverty Alleviation Fund (PPAF), Rs. 21.19m against Grameen Foundation, Rs. 8.92m against Acumen Fund and Rs. 139.16m against a running finance line from a local commercial bank. With the decrease in net advances during this year, total borrowings have also decreased to Rs. 269.9m. However Kashf continues to have credit lines of Rs. 750m from PPAF and Rs. 150m from a local commercial bank respectively. This allows room for additional growth. Kashf could further benefit from diversification in commercial sources of funding rather than relying on fewer relationships.

Profitability

With a substantial increase in loan portfolio during FY2004, income from financing has increased to Rs. 146.37m yielding an average return on advances of 39%. However, owing to the low interest rate scenario prevailing then, resulting in sizeable placements in term depository receipts at low interest rates, average return on mark-up bearing earning assets was low at 21.7% during the same period.

This level of return on earning assets is sizeable for maintaining profitability given the current level of operating expenses that constitute 16% of the loan portfolio and cost of funding being 2.28% during FY2004. These financials have allowed Kashf to be both operationally and financially self-sufficient during the year ending December 31, 2004, with OSS and FSS[2] ratios at a level of 192% and 122.4% respectively.

With the increase in interest rate scenario subsequent to year end 2004, return on placements with financial institutions is likely to increase allowing Kashf to counter the corresponding increase in the cost of borrowings. Even if Kashf was to maintain its average return on lending portfolio at the current level and maintain its quality of loan portfolio, the level of profitability is likely to improve in the increasing interest rate scenario JCR-VIS

[2] Calculation for FSS has been made with the assumption of a cost of borrowing at 11% and inflation at 6.5% during FY2004.

Year	2004**	2003	2002	2001	* Median
Reporting Period		12	12	12	12
Key performance indicators					
Profitability					
Operational self-sufficiency (%)	192.32	121.12	94.74	73.24	80.75
Financial self-sufficiency (%)	122.4	74.97	57.19	58.42	70.92
Return on net advances (%)	38.91	35.65	55.19	40.45	16.68
Operative efficiency (%)	15.95	27.22	63.23	73.08	21.6
Asset Quality					
Portfolio at Risk (%)	0.63	-	-	-	5.21
Capitalization					
Equity % Assets	60.6	37.3	40.6	58.6	45.69
Capital Adequacy (%)	86.01	70.2	109.3	118.0	
Liquidity Ratios:					
Liquid assets% total borrowings	100.19	99.1	148.8	353.8	
Loans% Total borrowings	152.33	64.8	30.8	142.6	
Productivity Ratios:					
Active borrowers per LO (x)	390	408	245	172	248
Gross Oustanding portfolio per LO (Rs. in thousands)	2770	1873	516	445	2,023
Active borrowers per branch (x)	1732	1511	982	722	811

* Median includes all members of the Pakistan MicroFinance Network, Performance Indicators Report December 2004

** Kashf changed its financial year-end from June to December.

Year	**2004****	**2003**	**2002**	**2001**
Reporting Period	**12**	**12**	**12**	**12**
Rs. in millions				
Balance Sheet Items				
Total Cash And Cash Equivalents	67.71	289.46	6.64	5.88
Total Investments	239.57	27.74	151.31	40.07
General Loans	*446.33*	*189.37*	*32.30*	*16.98*
Consumption Loans	*32.82*	*18.55*	*0.74*	*1.72*
Gross Advances	**479.15**	**207.91**	**33.04**	**18.70**
Less:	12.03	0.42	0.40	0.18
Bad Debts not provided	*0.05*	*0.05*	*0.05*	*0.04*
Specific provision	*11.98*	*0.37*	*0.35*	*0.14*
Net Advances	**467.12**	**207.49**	**32.64**	**18.52**
Operating fixed assets	40.79	9.68	7.15	6.47
Other Assets	16.57	6.23	3.79	2.04
Total Assets	**831.76**	**540.59**	**201.53**	**72.98**
Share Capital	0.00	0.00	0.00	0.00
Donated equity-opening balance	205.61	53.75	28.75	5.62
Donations capitalized during the year(working capital & F. Assets)	57.1	82.71	25.00	23.13
Donations recognized as income during the year	62.87	35.01	20.68	13.55
Donated equity	**325.58**	**171.47**	**74.43**	**42.30**
General Reserves-beginning balance	107.62	28.39	14.00	6.53
Net Operating Profit (Excluding grant income) transferred during the year	70.89	1.57	-6.29	-6.08
General Reserves-ending balance	**178.51**	**29.96**	**7.71**	**0.45**
Total Equity	**504.09**	**201.43**	**82.14**	**42.75**
Member's saving account	7.61	7.55	1.32	2.44
Long term loans	30.12	14.59	11.15	6.99
Current portion of long term loans	129.92	297.96	93.67	3.55
Short term loan	139.02	0.00	0.00	0.00
Total Borrowings	**306.67**	**320.10**	**106.14**	**12.99**
Working capital & capacity building grant funds	2.20	8.57	9.31	15.32
Other liabilities	18.8	10.50	3.95	1.92
Total Liabilities	**327.67**	**339.17**	**119.40**	**30.23**
Balance Sheet Check	0.00	0.00	0.00	0.00

Year	2004**	2003	2002	2001
Reporting Period	**12**	**12**	**12**	**12**
Rs. in millions				
Income Statement Figures				
Interest income	**157.66**	**49.08**	**18.18**	**6.73**
Service charges on micro-credit loans to members	*146.31*	*42.80*	*14.12*	*5.19*
Interest on investment	*11.3*	*1.14*	*0.30*	*0.05*
Interest on saving account	*0*	*5.13*	*3.76*	*1.49*
Financial expenses	**16.66**	**9.70**	**2.27**	**0.47**
Net Finance Income	**141.00**	**39.38**	**15.91**	**6.26**
Insurance income	1.22	2.07	0.00	0.00
Other Income	0.25	0.97	0.15	0.13
Core non-interest, op income	**1.48**	**3.05**	**0.15**	**0.13**
Exchange gains/(losses)	-0.29	(0.69)	(0.97)	0.33
Volatile non-interest op income	**(0.29)**	**(0.69)**	**(0.97)**	**0.33**
Total non-int, op income	**1.18**	**2.36**	**(0.83)**	**0.46**
Total Revenues (Operating & Non-operating income)	**142.18**	**41.73**	**15.08**	**6.73**
Operating expenses	61.4	32.79	16.36	9.48
Personnel Expense	*38.79*	*20.32*	*9.96*	
General & Admin expenses	*22.38*	*12.41*	*6.32*	*9.38*
Seminar, workshop & research expenses	*0.22*	*0.06*	*0.07*	*0.10*
Training exp- staff & Community	2.23	4.43	3.16	2.41
Basic Earning	**78.55**	**4.51**	**(4.44)**	**(5.16)**
Total Provisions/write offs	(4.53)	(0.03)	(0.32)	(0.13)
Net operating profit / (loss)	**74.03**	**4.48**	**(4.76)**	**(5.29)**
Cash Donations	62.87	35.01	20.68	13.55
Gross Profits Dastkaari	2.16	1.51	0.96	0.41
Dastkaari Project expenses	(5.82)	(3.22)	(1.86)	(1.22)
Other Income	0.52	0.00	0.00	0.02
Total Non-operational Income/Expense	**59.74**	**33.30**	**19.78**	**12.76**
Profit before taxation	**133.76**	**37.78**	**15.03**	**7.47**
Provision for taxation	0.00	1.20	0.65	
Net profit	**133.76**	**36.58**	**14.38**	**7.47**