Kashf Foundation

Chairman: Dr. Ishrat Hussain; President: Ms. Roshaneh Zafar

June 17, 2008

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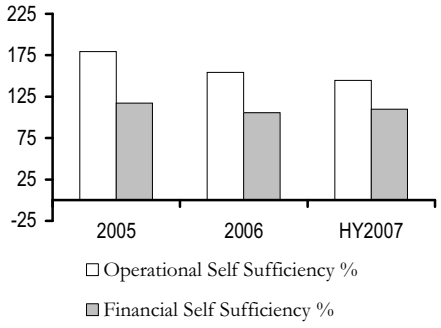
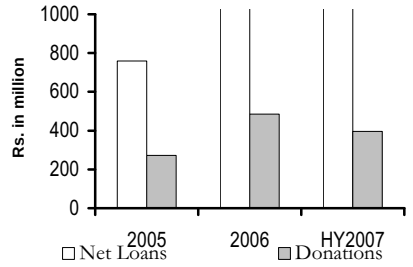
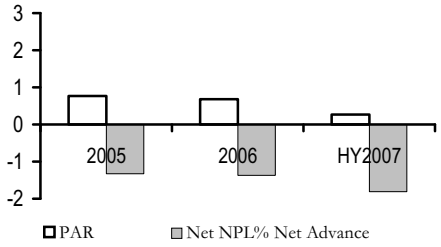
Category	Latest	Previous
Entity	BBB+/A-3	BBB+/A-3
	Apr 3, '08	*Jun 20, '07*
TFC-1	A	A
Rs. 720m	*Apr 3, '08*	*Jun 20, '07*
Outlook	***Stable***	***Positive***
	Apr 3, '08	*Jun 20, '07*

Key Financial Trends







Rating Rationale

Kashf Foundation (KF) ventured into microfinance in 1996. While the foundation operates in the absence of complete supervisory regime, unlike the MFIs operating in the regulated sector, it has adopted sound governance practices on a voluntary basis and financial disclosures are also considered adequate. Integral to the business strategy of KF is achieving its social mission of alleviating 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. The management and Board of Directors actively monitor progress against defined targets.

In the outgoing year, the foundation has embarked upon an aggressive, growth-oriented financial plan, while maintaining sound asset quality indicators. This has exemplified in the asset base which has increased rapidly to Rs. 4.06b (FY06: Rs. 2.0b) as at December 31, 2007. Of this, lending operations remain the primary focus of the organization The total loan portfolio stood at Rs. 3.08b as at year end FY07 (FY06: Rs. 1.54b) Aggregate infection has remained low, with PAR-30 at less than 1% of the loan portfolio. In spite of the rapid growth projected, KF has envisaged that PAR-30 will be maintained at less than 2% of the gross portfolio.

While maintaining controls and asset quality against the backdrop of rapid growth is critical, KF is considered to be well poised to take upon this challenge in view of its tested lending methodology and tailor-made software which ensures effective monitoring. The accuracy and timeliness of information generated by the MIS is considered sound. The foundation has extended geographical outreach by venturing into the province of Sindh. Credit cultures are unique across provinces on account of differences in entrepreneurial activity, economic profile, etc. While the amount of portfolio stemming from branches in Sindh is still small, asset quality indicators within this geographical segment will be keenly monitored as the size of this portfolio increases.

Funding sources have been diversified with the issue of a privately placed TFC over the last year. As of December 31, 2007, total borrowings amounted to Rs. 2.40b (FY06: Rs. 893.28m) while additional long term funding is also being raised to support the growth in loan portfolio. The ability of the foundation to call for equity funding is restricted on account of its legal structure, as being a non-profit guarantee limited company; KF does not have shareholders who may contribute capital in times of stress. Net worth of the institution has nevertheless enhanced over the years to Rs. 1.46b (FY06: Rs. 944.61m) on account of donated funds and surplus generated from operations. Debt leverage is projected to be maintained at under 5x over the rating horizon.

Both operational and financial self-sufficiency ratios have improved relative to 2006. Profitability indicators are healthy even after taking into account the high level of overheads innate to the microfinance business. Net profit amounted to Rs. 429.40m (FY06: Rs. 211.80m) for the outgoing year. As the proportion of market based borrowings increases in the funding mix, the cost of funds is likely to go up. However, cost of doing business on a per unit basis indicates an improvement in profitability indicators over time.

Overview of the Institution

Kashf Foundation was set up in 1996 as a micro-finance organization. Recently, the organization has changed its legal status to a non profit guarantee limited company and, as such, will now operate with a non profit organization and a microfinance bank. The foundation operates with a network of 154 branches as of December 31, 2007. It primarily caters to women, offering both group and individual loan products JCR-VIS

Microfinance Overview

Microfinance has played a critical role in alleviating poverty worldwide. There is mounting evidence from all corners of the globe, exemplifying that access to financial services helps the poor build up income, enhance resources and reduce vulnerability to crisis that are part of their daily lives.

Recognizing the impact of microfinance services on poverty alleviation and social mobilization, the Government of Pakistan accelerated its efforts towards establishing strong foundations for microfinance institutions that operate under the realm of the State Bank of Pakistan (SBP). The first microfinance bank was set up in 2000, followed quickly by the promulgation of an entirely separate regulatory framework for SBP licensed MFIs - the Microfinance Ordinance.[1]

Subsequent growth in the microfinance industry has been consistent, attributed largely to the outreach of various MFBs and MFIs. As of December 2007, the Pakistan Microfinance Network (PMN) reported 30 members, the break up of which is given below:[2]

Category	Number of operators
Microfinance Bank	6
Microfinance Institution	5
Rural Support Programs	5
Non Governmental Organizations	12
Commercial Financial Institutions	2

With particular reference to Kaashf Foundation (KF), the organization is amongst the largest providers of micro credit. In terms of number of active borrowers, KF accounts for 20.1% of the national market share as of December 31, 2007.

[1] Pakistan Microfinance Overview 2006 – a publication of the Pakistan Microfinance Network
[2] MicroWatch Jan-Dec –a publication of the Pakistan Microfinance network

Corporate Profile

KF began operations in 1996 as an MFI to provide credit, saving and micro-insurance to households that have lacked formal access to the financial market. The foundation focuses on lending to women, with the aim of alleviating poverty through gender empowerment and improving access to financial credit.

Change in Legal status

While the organization was initially registered as a society, it changed its legal status last year to a non profit guarantee limited company registered under the Companies Ordinance 1984. The sponsors of KFL have also decided to establish presence in the formal sector by setting up a micro-finance bank, whereby KF will maintain majority stake through a holding company.

Profile of Top Management and Board

The foundation has a 10-member Board of Directors. Board composition reflects independence from management, and the ability to fairly and objectively reflect the interests of all stakeholders. In terms of board composition, board members possess a diversity of skills and market knowledge so they can critically evaluate management initiatives and performance.

This blend of professionals has played a strong role in influencing the foundation's ability to transform its mission into a successful and sustainable business venture. The organization has placed strong emphasis on governance related matters on a voluntary basis.

The Board of Directors is chaired by Dr. Ishrat Hussain who was the former governor of the State Bank of Pakistan and currently heads the National Commission for Government Reform. In his capacity as the Director of Central Asian Republics at the World Bank, Dr. Hussain was the pioneer of several World Bank initiatives on microfinance. He has also played an instrumental role in the promulgation of the Microfinance Ordinance in Pakistan.

KF also has Mr. Steve Rasmussen acting as an advisor to the Board. Mr. Rasmussen is the lead Microfinance Specialist for the South Asian Region for World Bank. He has extensive experience in microfinance across Pakistan and South Asia, including serving as Chief Executive Officer of the Pakistan Microfinance Network.

The President of the organization is Ms. Roshenah Zafar. Ms. Zafar has worked with the World Bank as a development research associate as well as an array of civil society organizations in the country. She established the Kaashf Foundation in 1996 after a chance meeting with Dr. Yunus – the founder of Grameen Bank in Bangladesh. Many of the founding principles and values of KF have been inspired from the Grameen bank.

The CEO of the company is Ms. Sadaffe Abid who has also worked for the World Bank in the field of education. She joined KF in 1997. Since then, she has worked in various capacities as a research analyst, Chief Operating Officer and subsequently as Chief Executive Officer.

With the exception of the Head of Human Resources, the core management team has been associated with the organization since its early years. While stability of the management team has been KF's forte, allowing for the rapid growth, development of a formal management succession policy may also be taken up by the Board to have a strong second-tier management as well, that can evolve with KF.

Human Resources

The Head of Human Resources joined KF in September 2007. Ms. Kiran Kashif holds a PGD in Human Resource Management from Punjab University. She has also attended HR courses at the Lahore University of Management Sciences and has over 13 years of experience in her field.

Human resource management can be a significant challenge for KF, as it will have to hire and train new staff very quickly to meet the demands of the growing organization. In addition, new staff is often entrusted with considerable responsibilities, given the decentralized nature of KF's operations. Accordingly, the management will have to ensure that there is an organized hiring, training & promotion process, and employees are incentivized adequately to ensure that staff turnover is measured and controlled.

The recruitment process for loan officers has recently been centralized and all hiring decisions are now made at the HO. For hiring at the branch level, candidates for mostly entry level jobs are identified. Loan officers must at least possess a BA Degree for group loan branches and a B Com Degree for individual loan branches. Greater emphasis is also being placed upon computer competency so that employees possess the right combination of skills from the onset. After induction, orientation training is held for 6 months, subsequent to which employees are placed on a rotational program. After a trainee LO has received confirmation, he is assigned to a branch.

Each branch includes a combination of old and new staff so that fresh recruits can benefit from the experience of their peers. To avoid collusion, branch employees are usually placed at a location, other than their area of residence. In addition, all branch employees are rotated once every 2 years and the portfolio is also shuffled amongst loan officers. Often this rotation exercise is linked to employee promotion.

As at June 30, 2007, the organization had total staff strength of 1289 employees. Most of the employee base is represented by loan officers in the field. Turnover is also highest at the field level. During the six months ended June 2007, 93 people left the organization of which 72 were loan officers. The management is looking to revise salary packages and training programme so as to provide greater solidity at the branch level.

Training

KF has a multi-tier training programme catering to the specific requirements of the field staff as well as

the management located at the HO. The training courses are designed, after incorporating feedback from various departments, internal audit and the GESA (Gender, Empower and Social Advocacy) unit. All employees attend workshops geared towards 'gender sensitivity' that primarily deal with social issues.

In addition, orientation and refresher courses are also conducted for trainees and existing staff employed at the branch level. The training programs cover a wide range of topics such as company ethics, customer care, fraud management, communication and negotiation skills.

Internal audit

The internal audit team, which reports directly to the audit committee, was recently constituted. The Head of department is Mr. Ghulam Haider Chaudhry, who is a CA finalist and an MBA in Finance. The department comprises 14 people, including an assistant manger and 6 audit teams.

Each audit team makes 20-25 visits each year, ensuring that all branches are audited at least once a year. Risky branches are paid bi-annual visits. Each branch audit lasts up to 8 days and involves a multitude of activities including observational studies, sample testing and client interviews.

A branch is classified as high, medium or low risk based on its calculated scoring. The score is calculated using a grading sheet developed in-house by the audit department. This scoring is based on 4 sources of risks namely credit risk, cash risk, documentation risk and human resource risk, each source incorporating a multitude of qualitative and quantitative dimensions. The final score is a culmination of individual grades, assigned to each source of risk.

While the audit plan has been laid out in detail, complete implementation may be constrained by the lack of sufficient HR resources in the department. Accordingly, further hiring is on the anvil. In its initial reviews, the audit department has highlighted various documentation related issues and cost over runs at branches, which are being addressed by the management.

Risk Management

Managing risks on a holistic basis is considered as an important requirement for a financial institution. This activity is currently housed within the finance department and the present focus is limited to liquidity and interest rate risk management. Credit risk management will be taken up next. Scope may be extended to include operational risk, given KF's decentralized operations and rapid growth rate.

Managing the constant inflow of high volume small payments to ensure effective utilization of funds is at the root of liquidity management. As per policy, the liquidity generated from the system is used in funding new loans while the foundation has also obtained running finance lines by collateralizing its investment portfolio.

Loan disbursement and collection procedures are an important aspect of credit risk management. Given the higher volume of cash transactions, the process of disbursing and collecting loans is vulnerable to both human error and fraud. KF has reduced the vulnerability to such risks by making all disbursements through cheques. All recoveries are deposited by the client in the bank, while premiums and savings are mobilized from members in cash, which can be a potential source of risk.

Product Lines

There are 4 main product lines at KF namely General Loan (GL), Emergency Loan (EL), Home Improvement Loan (HIL) and Business Surmaya Loan (BSL). With the exception of BSL, loans are disbursed following a group lending methodology.

The GL is offered to a group of 25 women, referred to as a Centre, with the primary security being social collateral. Although the loan is provided to female members of the household, the choice of economic activity is the mutual decision of the family. The loan is repayable fortnightly over a period of 1 year at the rate of 20% (including service charges).

The EL can be availed by GL clients during times of economic distress. The loan allows clients to meet unexpected health or education needs, without affecting the viability of their business. Clients can avail up to two EL during the year of a maximum amount of Rs. 4000/-. The loan is repayable at 20% p.a over six months in fortnightly installments. These loans are partially secured by compulsory, non-remunerative deposits kept at the branch.

The HIL was introduced in 2006 and is available to clients who have completed two loan cycles of GL. The loan is geared at renovation and reconstruction of houses and thereby improves the client's living standards. The loan size ranges from Rs. 50,000 - Rs. 70,000 and is repayable over 4 years in equal fortnightly installments.

The BSL is an individual loan that ranges from Rs. 20,000 to Rs. 50,000 in the first loan cycle and may double to Rs. 100,000 in subsequent loan cycles. The BSL is only offered to clients with a minimum business continuity of 2 years, who own their place of residence, and have no other collateral requirements. A guarantor is also required to provide collateral for the BSL. The initial loan cycle is repaid over 1 year in monthly installments; however, succeeding cycles involve more flexible repayment schedules.

The loan repayment schedule serves as an effective monitoring tool. It is also important to ensure that quasi-automatic loan increase policies maintain adequate control over the borrower's indebtedness. For this purpose, a review of the borrower's capacity to take loan is undertaken prior to disbursement of each new loan.

Insurance is provided for up to 1.5% of the loan amount. Premium rates are based on 2% of loan amount for disbursements of Rs. 20,000 and 1% for larger amounts. In case of death or permanent disability, insurance provides cover against funeral charges in addition to the outstanding loan amount.

It is not unusual for a borrower to have more than one loan outstanding at one time. With the lack of a central nationwide data base, it is however not possible to determine the indebtedness of borrowers with complete accuracy.

Lending methodologies

Group lending

Group lending is based on a simple, standardized procedure that relies on social collateral as the primary security. To ensure that the system works effectively, considerable autonomy and decision making authority is delegated at the branch level. The method has been progressively improved by the organization, ensuring consistently low infection in assets.

Under the group lending methodology, clients are solicited by loan officers using door to door marketing. Loan officers (LO) usually work on an individual basis although a trainee LO may be paired with a more experienced associate. LOs are well versed with product features and loan processing requirements.

Once a potential client has been identified, a loan application, encompassing the personal and financial information of the client/household is filled out. Additional information to verify the information given on the application is also sought. Clients are identified using their CNIC, where unavailable, a unique reference ID is assigned to the client.

The loan is initially processed by the loan officer and subsequently handed over to the credit committee. The latter constitutes the branch manager and loan officers. Once a loan has been approved, a check is given to the client, which can be enchased at the designated bank branches.

As the loan is repayable fortnightly, centre meetings are also held twice a month. A manager, selected from amongst the centre, is responsible for collecting money and depositing it at the bank, prior to the centre meeting. To facilitate collection, a sub-committee, comprising 5 women from the centre is also formed. Each sub committee leader will collect money from their Centre and submit it to the Centre leader. At the meeting the loan officer collects the

deposit slips. Cash will only be accepted at the Centre meetings in exceptional circumstances.

A single LO will handle up to 27 centres as meetings are held 5 days a week. Everyday 3 centre meetings are conducted, making it 15 centre meetings in a week. This ensures that a LO is able to complete all 27 centre meetings within a fortnight.

Individual lending

The individual lending methodology places greater emphasis on financial analysis and the viability of the individual's business. The loan application form is a more comprehensive questionnaire including information of the applicant, his/her spouse and the loan guarantor. It also includes detailed information pertaining to the business financials including an analysis of the client's ability to generate income on a weekly and monthly basis. Seasonal variations are also given due consideration. Family expenses and the cost of running the business are also taken into account to ensure that the disposable income of the applicant is sufficient to meet debt obligations in a timely fashion.

Once all the information has been collected, ratios analysis is undertaken to assess the profitability and cash generating ability of the client's business. The proposal is presented to the credit committee that comprises the BM and LO. The credit committee checks the accuracy of the financial analysis and makes decisions on the basis of defined parameters. Thereafter, a loan approval decision is made. As in the case of group lending, disbursement is done using cheques. Collections are made in cash at the branch. Audit findings have highlighted instances where clients were extended loans larger than what they should qualify for on account of either omitted or under-estimated costs, indicating the need to place greater emphasis on the training of LOs in undertaking the requisite financial analysis.

Although the individual methodology mandates the existence of a guarantor, the financial viability of the guarantor is of less importance. There are defined benchmarks for this, but they are not being strictly abided.

Branch Network

A key factor in assessing the performance of the microfinance organization is its customer outreach. KF has, thereby, placed considerable focus on expanding its network of branches.

The current operational region is divided into 20 zones with approximately 5 to 7 branches in each area. The branch network is concentrated in Lahore and surrounding regions within the Punjab province, which collectively constitutes 16 zones. Considerable competition exists as several other microfinance organizations are also active in the region. Recently, the foundation has ventured into Sindh. Here, KF has established 23 branches.

Both the degree and nature of competition varies from district to district. In most cases, differentiating factors include loan size, requirement of fortnightly/monthly meetings, individual/group lending methodology and time taken for credit disbursement. In some areas, state-owned or state influenced operators may enjoy unique positioning on account of low interest charge on loans.

In addition to loan processing and data entry, branches collect premium, client deposits and loan payments. As at December 31, 2007, the foundation had 154 branches (HY07: 115; FY06: 72) and 295,396 customers (HY07: 208,825; FY06: 136,015). This includes up to 15 branches specifically dedicated to the BSL portfolio. Each branch is headed by a branch manager and includes 4-6 loan officers and one cashier. The latter is also responsible for data input in the management information system.

Information Systems

The management information system deployed at the branch level is called 'Miracle Worker'. The software was developed in Oracle by the IT team of KF, which has been associated with the organization for several years.

Once all the applications for the day have been received, they are entered into the system by the data

input officer at the branch and automatically transferred to the HO, at day-end. The system generates a random, unique ID for each client.

As the system has been programmed in-house, it caters specifically to the needs of KF. Appropriate checks and balances are in place, ensuring that integrity of the data is maintained. In addition to active client data, client history (including that of previous customers) is also maintained in the system.

'Miracle Worker' also includes report generation features. A daily and weekly activity sheet is created by the branches and submitted to the HO. In addition, the system can also be used to search for client data on the basis of selected parameters, facilitating managerial decision making. The system also enables daily monitoring of collection and disbursement activities by the senior management.

Adequate arrangements have also been made for back-ups as these are maintained both at on and off site locations on a regular basis.

Financial Analysis
Credit Risk

From FY2003 onwards, the resource base of Kashf Foundation has registered rapid growth to Rs. 2b as at December 31, 2006, translating into a CAGR of 37% over the 4 year period. Growth momentum was sustained over the outgoing year, as the asset base grew to Rs. 2.53b by June 2007 and further to Rs. 4.06b by December 31, 2007. The primary focus of the organization has remained on lending operations as the outstanding loan portfolio increased to Rs. 2.1b by June 2007 and further to Rs. 3.19b by December 2007 (FY06: Rs. 1.54b).

Product wise Loan portfolio (Rs. in mn)			
Product line	**HY'07**	**Dec'06**	**Dec'05**
GL	1679.55	1339.02	707.53
EL	147.21	107.61	60.38
HIL	25.64	13.89	-
BSL	199.01	75.43	10.02
Total	**2051.41**	**1535.95**	**777.93**

As exemplified in the product wise break up given above, the GL product continues to be the main constituent accounting for 82% of the gross loan portfolio. The Home Improvement Loan and the Business Surmaya Loan are more recent additions to the portfolio, constituting 1% and 10% of the gross loan portfolio, respectively.

Growth in the overall loan portfolio is attributed to both enhanced customer outreach as well the gradual progression of existing customers into larger loan cycles. The number of active borrowers has seen a persistent rise from 75,550 to 208,825 as at HY07, translating into an average loan size of Rs. 9,823.58 (FY05: Rs. 10,296.89). The fall over the one and half year period is attributed to the increase in number of customers, whereby new customers are disbursed relatively smaller amounts. As of June 30, 2007, 48.42% of the outstanding group loan portfolio, amounting to Rs. 896.85m (FY06: 573.79m), is attributed to customers in the initial loan cycle. Another 38.93% of the portfolio amounting to Rs. 721.11m (FY06: Rs. 660.26m) is represented by customers in the second to fourth loan cycle. The remaining 12.65% (FY06: 15.51%) of the portfolio is represented by subsequent loan cycles.

As the individual loan product is a recent addition, 80.27% of its portfolio as at HY07 is represented by customers in the initial loan cycle. This translates to an amount of Rs. 159.01m (FY06: Rs. 60.92m). The remaining portfolio, spread over customers in the second and third loan cycles, amounts to Rs. 39.27m (FY06: Rs. 14.51m).

Geographically, the loan portfolio remains concentrated in Lahore and the surrounding suburban regions. There are a total of 104 (FY06: 61) branches in Punjab, divided into 16 regions (FY06: 10 regions). This collectively represents 95% (FY06: 99%) of the outstanding group loan portfolio. The organization has only recently entered into the Sindh region. As of June 30, 2007, the organization has 11 (FY06: 4) branches in Sindh, representing 4% (FY06: 1%) of the outstanding loan portfolio.

Geographical Break up				
Region	**HY07**		**FY06**	
	%	**Amount (Rs.)**	**%**	**Amount (Rs.)**

Punjab	96%	1.96b	99%	1.52b
Sindh	4%	87.37m	1%	12.27m
Total	100%	2.05b	100%	1.54b

Going forward, the management plans to further reduce concentration in Punjab as more branches are opened in other parts of the country. By the end of 2007 the o/s loan portfolio grew to Rs. 3.19b, spread over 154 branches including 23 branches in the Sindh region. Microfinance activity has so far being concentrated in Punjab and predominantly in the Lahore region, on an industry wide basis.

With business momentum remaining strong over FY07, the company has hired additional loan officers to handle the larger volume of business. As at June 30, 2007, the number of LOs had increased to 565 (FY06: 372; FY05: 184). The outstanding portfolio and borrower/LO indicators have shown a marginal decline in the interim as the organization has undertaken fresh hiring, though these levels are expected to optimize, going forward. The foundation will need to retain focus on retaining its experienced staff and expedite training of new staff. High turnover at the branch level may prove to be a serious impediment to the planned expansion in business volumes.

	HY07	**FY06**	**FY05**
No. of LO	565	372	184
No. of branches	115	72	34
LO/Branch	5	5	5
Active Borrower/LO	370	366	410
Active Borrower/branch	1816	1889	2221

**figures have been rounded.*

As at June 30, 2007, NPLs stood at Rs. 5.63m (FY05: 1.05m), resulting in PAR-30 of 0.27% (FY05: 0.14%). Furthermore, PAR-30 infection was maintained at less than 1% by the end of 2007. As a matter of prudence, KF does not reschedule loans and has progressively improved its collection procedures in order to keep a tight control over incidence of non performance within the portfolio. As a result, PAR-30 has consistently been retained at less than 1% of the asset base. Although considerable growth has been projected within the portfolio over ensuing years, the organization has envisaged that PAR-30 will be retained at less than 2% of the outstanding portfolio.

Liquidity Risk

KF has relied on a variety of funding sources to finance its resource base. Historically, the organization has enjoyed strong support from multilateral organizations such as PPAF, Citi-OPIC and the Grameen Foundation. During the initial stages, growth and infrastructure development was largely financed through subsidized funding. Subsequently, strong operating performance also allowed KF to tap commercial avenues of funding.

Greater capital markets participation is only part of the challenge of increasing the availability of microfinance. While MFIs have largely lacked access to mainstream capital markets investors, there has nevertheless been a growing trend towards capital markets transactions on a global basis. Unlocking these sources of capital requires greater disclosures and transparency in financial reporting from MFIs. The level of financial transparency by KF is acknowledged by a 5-diamond status enjoyed by the organization on the MIX Market. In addition to having issued privately placed Term Finance Certificates over the last year, the organization is also in the process of raising additional long-term funds to fuel growth in loan portfolio.

Total borrowings as of December 31, 2007 amounted to Rs. 2.40b (FY06: Rs. 987.60m). Funding requirements over the outgoing year were met primarily through the Pakistan Poverty Alleviation Fund, while some funds borrowings were also outstanding against Grameen Foundation and the Accumen Fund. The primary purpose of these loans has been to finance the company's lending operations.

KF also utilized a short term running finance facility that is secured against the investment portfolio. The facility limits were increased over FY06 to Rs. 300m (FY05: Rs. 200m) and furthermore to Rs. 500m over FY07. Against this, KF utilized an average balance of Rs. 194.80m (FY06: 130.84m) during 2007.

KF has also issued secured and privately placed TFCs, amounting to Rs. 720m. The TFC is secured by a first pari passu charge on all present & future receivables as well as cash & bank balances, with a 25% margin. In addition to this, 25% of the principal amount is secured by way of an irrevocable standby letter of credit from Citibank, NA. The TFC issue carries profit at the rate of 3-month KIBOR plus 245 bps.

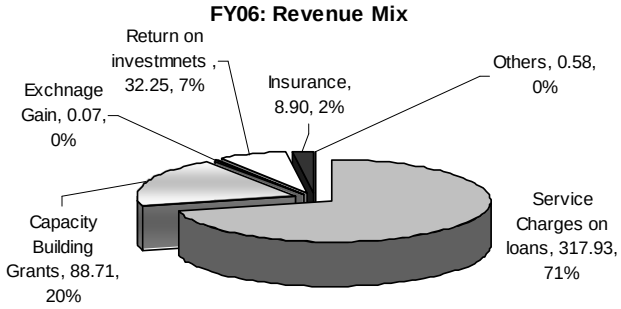
Over subsequent years, growth is expected to remain highly leveraged; as the company plans to capitalize on its long standing relations with local and international donor agencies. Funding requirements are estimated at Rs. 4.5b for FY08, against which KF is considering various commercial loan facilities. Given the robust operating performance over the past couple of years, the company is also considering credit proposals from reputable organizations such as BlueOrchard.[3]

The investment portfolio has grown from Rs. 114.85m in FY06 to Rs. 142.67m by the end of FY07. The portfolio comprises a mix of government securities and TDRs/TFCs issued by various commercial banks and as such, are a source of liquidity for the company. However, members' savings do not constitute a major source of liquidity. As of December 31, 2007, these amounted to Rs. 12.7m (FY06: Rs. 8.06m).

Although total equity has grown to Rs. 944.61m (FY05: Rs. 605.29m) at year end FY06 and subsequently to Rs. 1.46b by December 31, 2007, the proportion of equity in funding mix is projected to decrease as the organization leverages itself. Debt leverage is presently 1.9x and is projected to remain under 5x over the rating horizon.

Profitability

As the primary focus of the organization continues to be on its lending operations, the bulk of revenues also stem from the loan portfolio. Service charges on the outstanding loan portfolio have almost doubled to Rs. 317.93m (FY05: Rs. 178.39m). The company has also booked Rs. 86.70m (FY05: Rs. 18.40m) of its capacity building grants as income, providing strong impetus to the overall revenue base. Although the investment portfolio declined to Rs. 114.85m (FY05: Rs. 149.77m), income thereon has increased to Rs. 32.25m (FY06: 15.53m). The revenue mix for FY06 is exemplified in the chart below:



Overall, the revenue of KF increased by more than 100% to Rs. 448.43m (FY05: Rs. 223.34m). This momentum was sustained over the 2007, as the total revenue base more than doubled to Rs. 928.28m.

With rapid growth registered in the resource base, management expenses including administrative, personnel and training costs have also increased to Rs. 175.59m in FY06 (FY05: Rs. 87.78m) and amounted to Rs. 269.90m over the year ended December 31, 2007. Most of this increase has manifested within HR related costs, attributed to the increase in both outreach and staff strength.

Although an increase in overheads is a natural function of growth within the organization, overheads accounting for 42.31% (FY05: 42.97%) of the revenue base and 10.91% (FY05: 8.45%) of the asset base, have by and large been maintained at prior year levels. Furthermore, analyzing cost of doing business on a per unit basis indicates an improvement in profitability indicators projected over ensuing years. This is because overheads are expected to be distributed over a progressively larger network.

Cost Analysis (Rs. in millions)

[3] BlueOrchard Finance S.A. is manager of the Dexia Micro-Credit Fund & responsAbility Global Microfinance Fund. BlueOrchard caters to the financial needs of microfinance institutions, globally.

	FY'07	FY06	FY05
Total Expenses*	269.9m	175.59	87.78
Cost/LO	0.37	0.47	0.43
Cost/branch	1.75	2.44	2.58
Cost/borrower	0.0009	0.0013	0.0012

** operating expenses*

Financial expenses have inclined as the proportion of market based borrowings increased in the funding mix. This trend is expected to continue. For FY06, financial expenses amounted to Rs. 42.09m, increasing to Rs. 156.96m over 2007 as proceeds from privately placed TFCs were drawn down.

KF maintains 2% general provisioning against the net outstanding micro-credit loan portfolio. Charge for 2007 was higher at Rs. 69.17m on account of the growth in loan portfolio (FY06: Rs. 16.96m).

After considering all expenses, net profit increased over FY06 to Rs. 211.80m (FY05: Rs. 106.56m), translating into an ROAA of 13.1% (FY05: 10.3%) and ROAE of 27.6% (FY05: 19.2%). Profitability trends have been sustained over the outgoing year, with the company having posted a net profit of Rs. 429.40m. Sustained profitability is also indicated by the financial and operational self sufficiency which stood at 144% and 172%, respectively as at December 31, 2007. Given the aggressive expansion planned over the next couple of years, however, growth in expenses will need to be kept under check as it may hamper profitability and subsequently the company's ability to meet projected targets. JCR-VIS