RATING REPORT

Rural Community Development Programmes

REPORT DATE:
July 16, 2020

RATING ANALYSTS:
Maham Qasim
Maham.qasim@vis.com.pk

RATING DETAILS

Rating Category	Latest Rating Long-term	Latest Rating Short-term	Previous Rating Long-term	Previous Rating Short-term
Entity Rating	BBB	A-3	BBB	A-3
Rating Date	*July 16, '20*		*February 8, '19*	
Rating Outlook	*Rating Watch Negative*		*Stable*	
Rating Action	*Maintain*		*Initial*	

COMPANY INFORMATION

Incorporated in 2016	**External auditors:** Grant Thornton Anjum Rahman
Company limited by guarantee	**Chairman:** Ms. Ayesha Gulzar
	Chief Executive Officer: Mr. Muhammad Murtaza

APPLICABLE METHODOLOGY(IES)

VIS Entity Rating Criteria : Non-Bank Financial Companies (March 2020)
https://www.vis.com.pk/kc-meth.aspx

Rural Community Development Programmes

OVERVIEW OF INSTITUTION

The company is primarily engaged in mobilizing funds for provision of microfinance services for mitigating poverty and promoting social welfare with the ultimate objective of poverty alleviation. The organization has presence in over 14 districts of Punjab and has divided its operations into 56 branches.

RATING RATIONALE

The assigned ratings of Rural Community Development Programmes (RCDP) take into account implicit support available from the parent organization, Rural Community Development society (RCDS) both on financial and technical fronts. The assigned ratings incorporate healthy growth in business operations, manageable asset quality, improved margins and sound profitability indicators. However, the operational performance of the institution has been slightly impacted by the rising credit impairment across the industry, with loss ratios exhibiting an increase. Given the economy is on a standstill with the onslaught of Covid-19 pandemic, the opportunities available for micro-credit borrowers for income generation have dampened, therefore VIS expects weakening of asset quality indictors going forward in line with escalated probability non-payment events.

Ratings factor in high leverage ratios given that growth observed in loan portfolio is primarily funded by higher quantum of both local and foreign denominated borrowings. The regulatory deferment of a portion of repayments against advances would impact the liquidity position of the institution, going forward, which to an extent may be mitigated by deferment of borrowing repayments; nevertheless, liquid assets in relation to borrowings remain low thus putting stress on liquidity indicators. In addition, in line with lock-down imposed by the government, the disbursement activities have been critically affected leading to the institution falling significantly short on its disbursement targets. Going forward, ratings will remain contingent upon meeting recovery targets, withholding asset quality and liquidity indicators while maintaining healthy disbursement activities to keep the organization afloat.

In 1998, RCDS was formed to provide integrated development services to the impoverished and neglected communities in Punjab, Pakistan. Subsequently to abide and comply with regulations, RCDS underwent a spin-off process and separated the microfinance and social development aspects; microfinance segment was taken into a new entity by the name of RCDP while the social development aspects were retained within RCDS in 2016. RCDP has a total branch network of 85 branches all of which are located in Punjab.

Rating Drivers:

Experienced board and management team, sponsor support remains strong: RCDP's senior management and board of directors are experienced professionals with considerable experience in the field of microfinance. The ratings also draw comfort from sponsor support received from RCDS both in terms of financial and technical assistance. Going forward, stability in management team will play a crucial role in materiliazation of growth objectives put forward by the institution.

Growth in microcredit portfolio: The overall gross portfolio exhibited positive momentum increasing to Rs. 5.7b (FY19: Rs. 5.0b; FY18: Rs. 3.2b) at end-HY20; the growth was a combined outcome of increase in both the number of active clients and the average loan size. There was a notable increase in the number of active borrowers, recorded higher at 151,894 (FY19: 139,163 FY18: 108,565) at end-HY20 on account of improved market penetration coupled with network expansion. Similarly, in line with progression of existing clients to successive cycles on the back of tested credit repayment history the average loan size of the institution also increased during the period under review; the same is likely to positively impact the profitability indicators going forward with improvement in productivity and efficiency given operating cost is spread across larger pool of advances. The following table depicts the breakup of size-wise composition of loans at end-HY20:

S. No.	Description	No. of Clients
1	Upto Rs. 30,000	15,138
2	Rs. 30,001 - Rs. 50,000	66,169
3	Rs. 50,001-Rs. 100,000	56,407

4	Rs. 100,001-Rs. 150,000	11,482
5	Rs. 150,001 -Rs. 350,000	2,640
6	Rs. 350,001 and Above	53

Credit and Enterprise Development (CED) and Business Enhancement Loan (BEL) continue to remain the main flagship products of the institution constituting around 63% of the total gross microcredit portfolio. During the period under review, RCDP introduced a new lending product for renewable energy; however disbursement under the same has remained almost negligible. As per the management, the product mix is likely to be dominated by CED and BEL during the rating horizon, given the management's focus continues to remain on group lending products. On the other hand, the proportion of enterprise loans in the portfolio mix is likely to improve given small scale businesses remain the primary source of livelihood of the consumers in the regions in which the organization operates.

More than 90% of the total GLP constituted group loans at end-HY20, meanwhile proportion of individual loans of the total portfolio remained limited. Recovery is easier in case of group loans due to peer pressure from group members or the guarantor of the loan. During FY19, RCDP made disbursement amounting to Rs. 9.5b, surpassing the target of Rs. 7.5b, against which recovery of Rs. 3.8b was made during the year. For FY20, the management had set a disbursement target of Rs. 10.7b against which an actual disbursement of Rs. 5.7b was made in line with onslaught of COVID-19 pandemic. As per the management, no disbursement has been made since the start of April as a result of lock down implemented by the government hindering disbursement efforts. Moreover, as a result of prevailing uncertain circumstances, RCDP has voluntarily curtailed disbursement operations and focused primarily on recoveries to protect the institution from heightened risk of non-payment given the income generation capacity of micro-credit borrowers has been severely impacted. Moreover, the disbursement target of Rs. 17.0b set for FY21 is highly unlikely to be achieved as the financial impact in the remaining months of calendar year will aggravate drastically as a result of corona coupled with locust attack in southern Punjab. Further, loan disbursement activities may also be hit due to hailstorm, heavy rain and flood during monsoon period, which is expected to begin in July'20. In addition, the growth in portfolio always remains contingent upon availability of funding from financial institution on a timely basis.

Increased credit risk: Credit risk emanating from microcredit portfolio indicated an increasing trend indicated by higher infection ratio; however the same still remains within manageable limits and is on a lower side vis-à-vis industry average. The reasons for credit risk not being at alarming levels include deployment of paperless loan approval, automated loan disbursement and payments collection system; this mechanism enables the management to maintain robust internal controls. Further, the predominant group lending at RCDP also assists in keeping repayment risk in check as recovery is easier in case of group loans due to peer pressure from group members or the guarantor of the loan. By end-HY20, non-performing loans (NPLs) increased to Rs. 143.7m (FY19: Rs. 49.2m; FY18: Rs. 19.5m), resultantly, gross infection was reported higher at 2.5% (FY19: 1.0%; FY18: 0.6%), while net infection amounted to 1.1% (FY19: 0.4%; FY18: 0.3%) at end-HY20. The management must continue to ensure prudent risk management, as borrowers comprise low-income households who can get stressed for liquidity even as a result of slightest volatility in circumstances. Investment avenues of the institution are restricted to term deposit receipts (TDRs) with a bank having a sound credit rating. Hence, overall credit risk originating from investment portfolio is considered limited. Going forward, asset quality indicators will remain key rating sensitivities; any notable change in the aforementioned factors can result in revision of ratings.

Lending methodology remained unchanged; with paperless environment and online appraisal system turnaround time has improved: The loan approval process is initiated by the loan officer who visits prospective customers to collect their information and then attaches all the required documents such as CNIC copy, photograph, etc. on the e-appraisal application. E-appraisal application is available on android operating system and can be installed in any android compatible phone or tablet. Additionally, a biometric device is used to collect thumbprint of client and a mobile data sim to ensure internet connectivity. Post completion of this stage, complete data of customer is accessed by the verification officer

(VO), who are deployed at every branch and supervised by Head Office. The responsibility of the VO is to ensure that the details of the guarantors and the customer are accurate, the loan will be used for the stated purpose and the borrower has sound repayment capacity. Based on his evaluation, the compliance officer provides his recommendation to the branch manager either to accept or reject the loan application. In case, the verification officer is not satisfied with the provided information, he can also send the application back to loan officer with his observations. Post feedback, the branch manager approves the loan, and sends a recommendation to area manager. The final approval is held with the Head of Operations located at the head office who reviews all applications that are accepted by the area managers. Despite induction of new loan officers (LOs) to meet requirements of growing business, active number of borrowers per loan officer increased on a timeline basis in line with significant growth in pool of borrowers.

Funding and Leverage Indicators: Given RCDP is a micro-finance institution with no access to consumer deposits; borrowings continue to remain the primary source of funding. In line with increase witnessed in the gross loan portfolio, borrowings of the institution were recorded higher at Rs. 4.2b (FY19: Rs. 3.9b; FY18: Rs. 2.7b) at end-HY20. The largest chunk of borrowings was acquired from Pakistan Microfinance Investment Company (PMIC). Presently, the funding by Pakistan Poverty Alleviation Fund (PPAF) is being continued through PMIC as the same is jointly setup by PPAF, Triple Jump, SIMA and other local commercial banks. Given the recent depreciation in rupee-dollar parity, the company faces risk on its foreign denominated borrowings, however, the company utilizes forward contracts in order to hedge this currency risk. To further mitigate the currency risk on foreign currency loans, going forward the company is considering replacing its foreign loans with domestic ones. The materialization of the same is yet to be ascertained over time. The break down of borrowings is presented in the table below:

(Rs. in millions)	**FY18**	**FY19**	**HY20**
Loan from Pakistan Microfinance Investment Company (PMIC)	2,012.5	2,900	2,790
Loan from Pakistan Poverty Alleviation Fund (PPAF)	91.4	-	-
Triple Jump	213.6	273.5	273.5
Demand Finance (HBL)	19.4	1.1	0.4
Demand Finance (UBL)	50.0	52.5	35
SIMA (Term Finance)	-	240.1	240.1
Rural Community Development Society	**-**	55.3	45.3
Total Long Term loans (including current maturity)	**2,441.8**	**3,522.5**	**3,384.3**
Running Finance Facility from HBL	99.1	104.2	99.7
Running Finance Facility from UBL	199.7	299.9	250.0
Demand Finance (NBP)	-	-	500.0
Total Short-term Borrowings	**298.8**	**404.1**	**849.7**
Total Borrowings	**2,685.7**	**3,926.6**	**4,234.0**

Given the institution's dependence on borrowings as the major source of funding, leverage indicators of RCDP have remained on the higher side. However, the same being reported slightly higher at end-FY19 in line with sizable increase in long-term funding procured; the same reverted to FY18's level at end-HY20 in line with augmentation of equity base. The institution's debt leverage and gearing were reported at 2.5x (FY19: 2.8x; FY18: 2.6x) and 2.4x (FY19: 2.6x; FY18: 2.4x) at end-HY20. Going forward once the corona pandemic subsides, disbursements are projected to increase substantially and therefore, borrowings are also expected to increase. As per management, the organization is in discussion with external parties for further borrowings. Being a non-deposit NBFC, the growth objectives of the institution are synced with availability of funding opportunities at all times.

Leverage indicators maintained despite quantum increase in borrowings: Capitalization indicators of the company have primarily been a function of growth in its lending portfolio. Given that RCDP is incorporated as a 'Limited by Guarantee Company', there is no share capital present. However, adjusting for internal capital generation, total equity of the institution (including subordinated loan from RCDS) increased to Rs. 1.8b (FY19: Rs. 1.5b; FY18: Rs. 1.2b) at end-HY20. Over the years, equity of the company increased primarily on the back of profit retention. In terms of capital adequacy, RCDP is comfortably placed; moreover the same presents sizable room for growth. In the medium to long-term the institution intends to convert into a bank to ease pressure on funding avenues; however, developments in this regard are yet to materialize.

Liquidity position depicts room for improvement: Given the institution has limited funding scope, majority of the available resources are vested in loan disbursements as growth in microcredit portfolio is management's priority, hence RCDP's liquidity profile has taken a dip during the period under review. The liquidity position depicts room for improvement and the same is likely to remain a rating concern for VIS going forward. In absolute terms, liquid assets stood lower at Rs. 614.8m (FY19: Rs. 601.5m; FY18: Rs. 857.5m) at end-HY20 primarily comprising cash and bank balances and term deposit receipts. Given the increase in quantum of borrowings, liquid assets in relation to total borrowings stood lower at 14.5% (FY19: 15.3%; FY18: 31.3%) at end-HY20.

Growth in bottom line: Profitability position of the institution has depicted upward trajectory as a result of volumetric growth in markup bearing assets. However, operating self-sufficiency ratio (OSS) has declined on a timeline basis in line with higher administrative expenses recorded vis-à-vis the recurring income; the same has been a function of management's strategy of enhancing market footprint of the institution by opening new branches. Nevertheless, the OSS ratio is still sizable and depicts considerable cushion as core income is sufficient to cover administrative expenses. RCDP's markup bearing assets comprise advances extended to customers and banks deposits. The total markup income was reported higher at Rs. 1.3b (FY18: Rs. 758.7m) during FY19; the same was recorded at Rs. 814.1m during HY20. Given that bank deposits constitute small proportion of overall markup bearing assets, majority of the markup income emanated from microcredit portfolio. Higher average quantum of advances and bank deposits resulted in improvement in total markup bearing income. Although there was no change in the pricing of loan portfolio during the period under review; the average return on markup bearing assets improved to 30.9% (FY19: 29.5%; FY18: 25.0%) during HY20 on account of growth in CED and BEL product portfolios entailing a higher markup charge at 20% as compared to other products having an markup charge of 15%.

Given the noticeable increase in average quantum of borrowings during FY19, markup expense increased to Rs. 511.5m (FY18: Rs. 221.0m); the same trend continued during HY20 with half-year expense recorded higher at Rs. 288.7m. Moreover as a result of increase in the prevailing benchmark rates in the last eighteen months, cost of funding also witnessed an increase to 14.5% (FY19: 15.3%; FY18: 9.8%) during HY20.In view of the respective movements in average return on markup bearing assets and average cost of funds, spreads of the company registered an increase and were reported higher at 16.2% (FY19: 14.2%; FY18: 15.2%). Going forward, management intends to continue mobilizing borrowings from financial donors, expected to involve a higher funding cost hence generating an adverse impact on spreads of the institution. VIS will continue to monitor movement in spreads during the rating horizon, ability to maintain the same at current levels will remain one of the key rating drivers.

There was considerable increase in administrative expenses on a timeline basis primarily pertaining to staff related costs, which were recoded higher as an outcome of additional hiring of employees to cater to growing business needs. Given the impending conversion to a microfinance bank, administrative expenses are projected to increase as the management will undertake additional staff hiring and focus on branch expansion to increase outreach. Accounting for other income and expenses, profit after tax of the company exhibited notable increase to Rs. 287.7m (FY19: Rs.362.0m FY18: 348.1m) during HY20. Improvement in profitability indicators was an outcome of increase in scope of operations with increase manifested in markup bearing income due to higher average markup bearing assets. Going forward, management projects the topline to outweigh the growth in expense base, thereby resulting in higher bottom-line.

Going forward, the impact of Covid-19 crisis on the overall economy and the financial sector would bring a shift in operating dynamics of the financial institutions in wake of sizable uncertainty prevalent. Further, the impact of curtailment of economic activity for a certain period of time and lower lending rate scenario may cause NIM compression, hence affecting the profitability of institutions. Maintaining conservative lending strategy to maintain asset quality and cost efficiencies would be important rating drivers going forward.

Rural Community Development Programme — Appendix I

FINANCIAL SUMMARY				*(amounts in PKR millions)*
BALANCE SHEET	**FY17**	**FY18**	**FY19**	**HY20**
Net Advances	2,009.0	3,039.3	4,786.0	5,403.5
Short term investments	306.0	106.0	106.0	206.0
Cash and bank balances	338.4	751.5	495.5	408.8
Total Assets	2,746.8	4,166.9	5,714.1	6,364.5
Sub-ordinated loan	75.4	54.9	55.3	45.3
Long Term loans (including current maturity and subordinated loan)	1,346.3	2,441.8	3,524.4	3,384.3
Short term borrowings	406.0	298.8	404.1	849.7
Total Liabilities	1,944.6	3,016.6	4,201.9	4,564.6
Total Equity	802.2	1,150.3	1,512.2	1,800.0
Total equity (including subordinated loans)	877.6	1,205.2	1,567.5	1,845.3
INCOME STATEMENT	**FY17**	**FY18**	**FY19**	**HY20**
Net Mark-up Income	355.0	537.7	738.1	525.4
Net Provisioning/ (Reversal)	35.6	54.2	91.9	32.5
Non-Markup Income	150.3	225.9	322.7	176.2
Administrative Expenses	233.7	405.4	633.5	400.7
Profit/ (loss) before Tax	262.0	348.1	362.0	287.7
Profit/ (loss) after Tax	262.0	348.1	362.0	287.7
RATIO ANALYSIS	**FY17**	**FY18**	**FY19**	**HY20**
Gross Infection (%)	0.3	0.5	1.00	2.50
Net Infection (%)	0.1	0.30	0.41	1.13
Spread (%)	15.9	15.2	14.2	16.8
OSS (%)	158.5	143.8	139.9	128.8
Net Worth % Total Assets (%)	31.9	28.9	27.4	29.0
Debt Leverage	2.4	2.6	2.8	2.5
Gearing	2.2	2.4	2.6	2.4
Liquid Assets to Total Borrowings (%)	36.8	31.3	15.3	14.5
CAR (%)	35.7	33.0	30.6	39.1
Return on Average Assets (%)	11.8	10.1	7.3	9.5
Current Ratio (x)	2.3	2.4	2.0	1.9

Productivity				
No. of Loan Officers (LOs)	245	382	627	698
No. of Branches	41	60	79	85
No. of Active borrowers	84,269	108,565	132,617	151,889
LO/Branch	6	7	8	8
Active borrowers/LO	344	284	212	218
Active borrowers/branch	2,055	1,809	1,679	1,789
Average loan size (in Rs.)	25,200	29,586	37,988	37,443

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Rural Community Development Programmes
Sector	Microfinance Institution
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: Entity				
16/07/2020	BBB	A-3	Rating Watch Negative	Maintained
02/08/2019	BBB	A-3	Stable	Initial

Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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