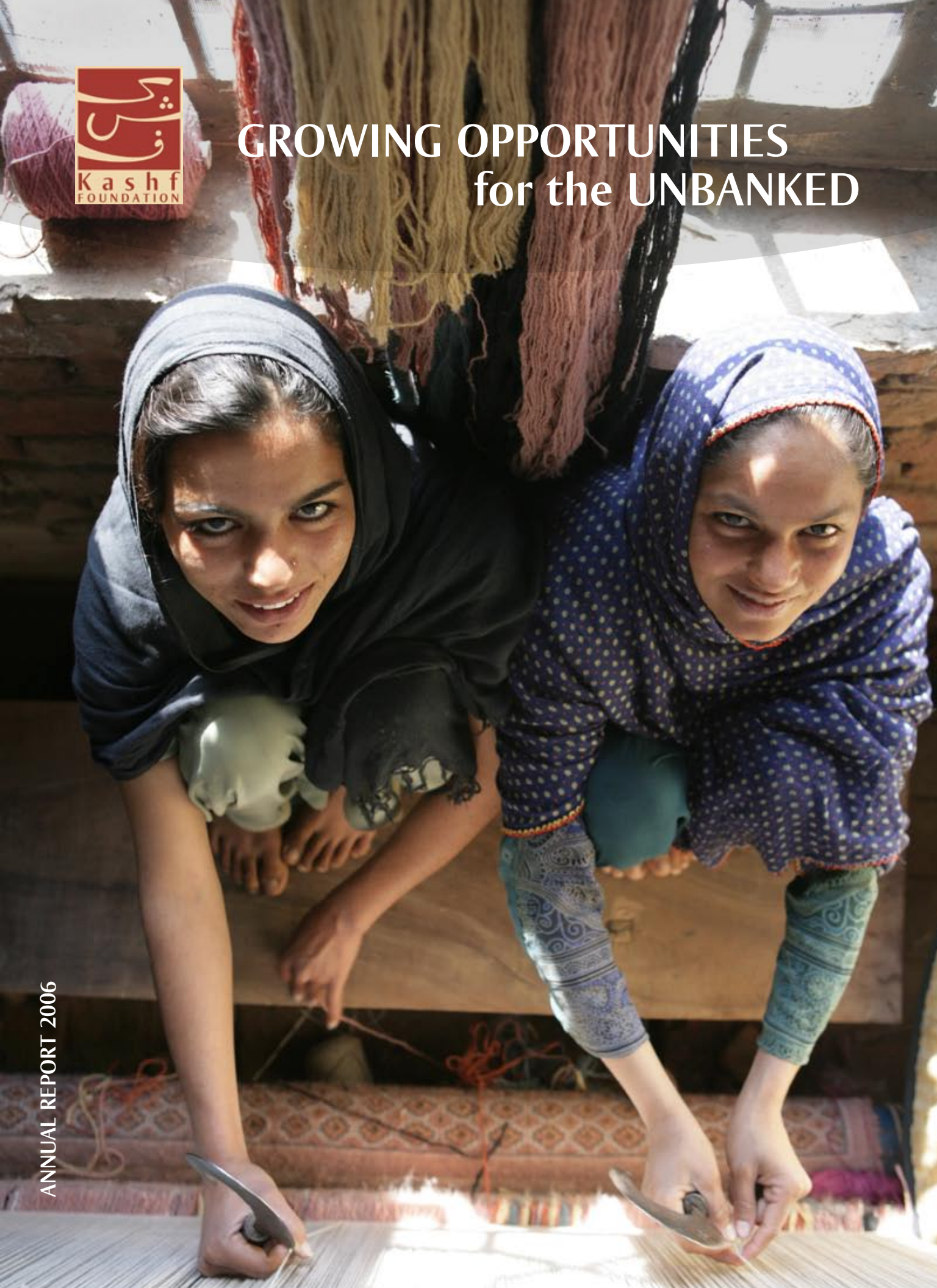




GROWING OPPORTUNITIES for the UNBANKED

ANNUAL REPORT 2006



At its inception in 1996, Kashf Foundation was the first specialized microfinance institution (MFI) in Pakistan. Furthermore, it was also the first MFI to achieve financial sustainability in 2003.

Kashf Foundation has continued to innovate by creating client-driven products, by demonstrating that women in Pakistan are active economic agents and by ensuring that poor households are bankable. Kashf Foundation remains committed to establishing sound business standards and to offering innovative pro-poor financial services.

This report provides a window of information into Kashf's rapidly growing family of clients, services, products and achievements for 2006.

Edited by: Aziz Omar, Nabeel Khan
Design and Layout: Sumaira Sagheer
Printed at:

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Contact Information:

19-Aibak Block
New Garden Town
Lahore, Pakistan
Tel: +92 (42) 111 981 981
Fax: +92 (42) 584 7816
www.kashf.org

GROWING OPPORTUNITIES for the UNBANKED



ANNUAL REPORT 2006

**Kashf's Vision**

Financial Services for All

Kashf's Mission

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.

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Foreword

The past few years have seen many critical developments in the microfinance sector in Pakistan; many new players including half a dozen microfinance banks have entered the market, commercial players have demonstrated greater interest in lending to viable practitioners, while branchless banking experiments are being conducted by MFIs. Keeping these trends in view, Kashf Foundation has a special role to play in promoting and building financial systems that work for the majority, especially women and demonstrating scale and sustainability.

The special focus for Kashf Foundation over the next five years is to ensure equity and efficiency – equity in terms of deepening outreach to rural markets, more remoter communities and gender accessibility to promote pro-women financial products and efficiency in terms of ensuring that loan servicing costs are low and transparent and that sound and ethical business practices are followed, especially when it comes to consumer protection and disclosure. Kashf Foundation will remain committed to bringing down operational costs by introducing new

technologies and deepening market infrastructure through innovations in new delivery methodologies that target rural communities.

Kashf Foundation will also push through the frontiers of microfinance by introducing graduation schemes that work with the ultra-poor, in order to help them achieve a credit worthy status. This will be coupled with building and streamlining new products that address the financial needs of the majority, including home improvement loans and health insurance products, while still maintaining a focus on achieving tremendous scale through accessing local financial markets.

Kashf Foundation will enhance its commitment to build an inclusive financial sector in Pakistan in the coming years. The Kashf family is expected to grow through the establishment of a microfinance bank which will promote the development of a domestic, deposit driven market in Pakistan, along with enhancing the breadth of financial services, especially in terms of offering deposit services to the poor. Through this model, Kashf hopes to demonstrate

“Kashf Foundation has a special role to play in promoting and building financial systems that work for the majority, especially women and demonstrating scale and sustainability.”

Roshaneh Zafar

that deposit services for the poor can be a viable option for microfinance institutions and can also be an effective tool for poverty alleviation.

Kashf Foundation's commitment to poverty alleviation and women's empowerment will remain a cornerstone of its future growth strategy. This will be coupled with a culture of meeting promises and striving for the highest ethical and moral standards, for the right culture undoubtedly breeds the right results.



Roshaneh Zafar
President





CEO's Message

Kashf Foundation began as an action research eleven years ago, inspired by a chance meeting between Roshaneh Zafar and Professor Muhammad Yunus. It was a pioneering effort as we were operating in a new market having little know-how of the intricacies of microfinance. The task was challenging and it took us three and a half years of hard work to reach our first 1000 clients. I clearly remember the joy and excitement of the day! The Foundation went onwards to reach the landmark figure of 100,000 clients in September 2006 making it quite unique from its peers. We marked the event by celebrating our ten year anniversary with our staff, members of the board, donors, supporters and colleagues from the microfinance community. For us, the event became even more significant due to the inspiring presence of Professor Yunus. This was indeed a great honour for Kashf.

In the year 2006, Kashf Foundation challenged itself and chartered new frontiers. We endeavored beyond the boundaries of the Punjab and announced our presence in Sindh province. Our detailed survey of Landhi, Malir and Korangi area, where

millions of fellow citizens live was an eye-opener to the horrific conditions in which people are compelled to survive. These areas are devoid of basic essentials like sanitation, drainage, health care and paved streets. Water is scarce and polluted. Four new branches have been opened in Karachi slums. Kashf is committed to improve the livelihood opportunities of the people of these areas.

This year we have inducted 60,000 new clients, opened 33 new branches and reached five new districts. The Kashf family also grew to include 523 new staff members. By the end of the year, Kashf was able to reach over 135,000 clients, adding 10,000 new clients every month in the last quarter. Client retention has improved appreciably with exit controlled at 10%. A new product was also introduced, the home improvement loan with positive feedback from the field.

Kashf Foundation has an abiding commitment to promoting learning. We feel passionately about developing a learning environment. We believe we have a tremendous



“Kashf Foundation has an abiding commitment to promoting learning....We believe we have a tremendous opportunity to build young people as talented professionals and responsible citizens with strong social values.”

Sadaf Abid

opportunity to build young people as talented professionals and responsible citizens with strong social values. Kashf employs a variety of strategies to promote its learning vision. The Kashf Learning Centre has become a hub for sharing of experiences and undertaking strategic sessions on customer care, management and leadership, personal effectiveness as well as business ethics and values. A total of 951 staff members were provided high quality training in the year. Orientation programmes for new staff were strengthened and the concept of developmental courses for building future managers was launched. In order to enhance analytical, strategic and risk management skills of staff, case study methodology has been actively encouraged.

Furthermore, Kashf Foundation aspires to be a trendsetter in promoting opportunities for women's development and leadership at all levels in the organization. Currently the Foundation has 42% female employees with 44% middle management positions held by women. We aim to improve these

trends and promote policies that encourage and support women to actively pursue their careers along with a work life balance.

In the coming years, Kashf Foundation is committed to increasing its outreach in Punjab and Sindh provinces. We aim to reach rural markets, more needy households along with innovating and leveraging on technology to reduce costs and improve customer experience. Through its financial services model, Kashf aspires to provide a platform to advance women's self confidence, esteem and overall economic well-being.

I would like to appreciate all those who help us in accomplishing our goals. My thoughts go to our president, board of directors, donors and supporters, our management team and valuable members of staff. Thank you for your passion, determination and belief in Kashf's mission.

Sadaf Abid
CEO

Organization Information

BOARD OF DIRECTORS

President Emeritus Mr. S. M. Zafar

Chairman Dr. Ishrat Hussain

Treasurer Mr. Asim Zafar

Secretary Ms. Mahbina Waheed

Director Mr. Khawar Ansari

Director Dr. Attiya Inayatullah

Director Ms. Rabia Khan

Director Mr. Ahmed Bilal Mehboob

Director Ms. Manizeh Bano

Director Mr. Farrukh Rizvi

Director Ms. Sadia Khan

Director Ms. Roshaneh Zafar

ORGANIZATION HEADS

President and Founder Ms. Roshaneh Zafar

Chief Executive Officer Ms. Sadaf Abid

Chief Financial Officer Mr. Khalid Kabeer

EXTERNAL AUDITORS

A.F. FERGUSON AND COMPANY

Chartered Accountants

LEGAL ADVISORS

Mandviwallah and Zafar Advocates

REGISTERED OFFICE

19 Aibak Block, New Garden Town, Lahore, Pakistan

LEGAL STATUS

Licensed under Section 42 of the Companies Ordinance 1984

2006 At a Glance

The year 2006 has been a year of both quantitative and qualitative growth.

- The number of Kashf's active clients crossed the 100,000 mark with the year closing at 135,797 clients, while Kashf's market share in Punjab continued to grow. Kashf is now in the top 5% of MFIs around the world in terms of outreach.
- Rs. 2.5 billion was disbursed this year resulting in a cumulative disbursement of Rs 5.6 billion and a cumulative clientele of 200,000 poor households.
- During 2006, a total of 228,594 loans were disbursed resulting in a 96% increase in portfolio, while portfolio quality continues to be excellent with PAR maintained at 0.08%.
- Field operations were introduced for the first time in the province of Sindh, thus expanding outreach from five districts in 2005 to 11 districts in 2006.
- Keeping its objective of rapid growth Kashf added 36 branches to last year's 33, resulting in a total of 69 branches and a team of 700 staff members.
- Impact assessment conducted this year has shown that Kashf's clients earn 51% more than non-clients.
- Kashf was able to achieve 100% automation in all its branches.
- Kashf's learning center for training existing and new staff was inaugurated in the year.
- Kashf celebrated its 10th year anniversary in Lahore with Professor Muhammad Yunus as the key note speaker.
- Dr Ishrat Hussain, ex-Governor State Bank of Pakistan, took over as Chairman of Kashf's Board.
- Kashf Foundation received CGAP's Financial Transparency merit award
- Kashf Foundation's client Robina Ishfaq and LO Nausheen Kanwal were winners in the Citibank-PPAF Micro Entrepreneurship Award competition.

Prof. Muhammad Yunus delivering the key-note speech at Kashf's 10 year anniversary



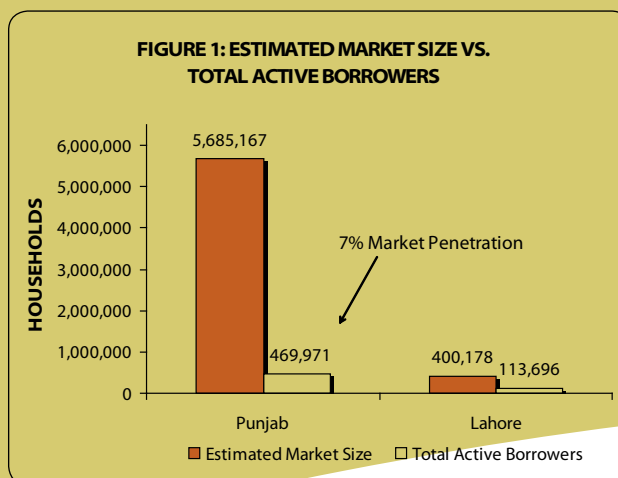


Kashf Foundation: An Inclusive Financial Services Model

Kashf Foundation provides sustainable microfinance services including microcredit, micro-insurance and social advocacy support to women from low income households in Pakistan. In other words, Kashf is targeting households who do not have prior access to formal financial services. The inclusive financial services model focuses on building economic self sufficiency amongst low income households through the provision of demand based, innovative products and via an efficient delivery

towns and sub-towns very rapidly. Kashf's current market share¹ of the Punjab market is estimated at 29%, while the overall penetration in the Punjab market for all MF providers is only 7%². Furthermore, the Lahore market is the most competitive in the country with 29% market penetration, while Kashf holds the majority market share of 57% in Lahore³.

Kashf has demonstrated both replicability and scalability over this period by commencing operations in the Sindh province. Its current set of products and services and delivery methodology were replicated in their entirety to meet the growing appetite for financial services in three major low income communities in Karachi i.e. Malir, Landhi and Korangi.



methodology, that combines simple procedures, quick turn around time and low cost operations.

Today, Kashf has an outreach of 135,797 clients who are being serviced through a network of 69 conveniently located branches, spread over 11 districts in two provinces of the country, making Kashf the 3rd largest MF provider in Pakistan. The model focuses on urban and peri-urban communities and has spread from large cities to small

¹ (Formula Calculation) Kashf Market Share: Kashf's Outreach in Punjab/ Total Industry Outreach in Punjab. Numbers for Outreach have been taken from the Micro Watch PMN, Issue 02: December 2006.

² (Formula Calculation) Market Penetration in Punjab = Total sector outreach in Punjab/ Potential Market in Punjab.

³ Potential Market in Punjab has been taken from the Kashf Foundation Publication "Market Analysis for Punjab 2006" and is calculated using two methodologies. One uses demographic indicators to assess the percentage of poor households in Punjab and the other involves Consumption expenditure from HIES, FBS 2003

Kashf's Services

"The impact of microfinance can be best seen through the children of clients, as each loan helps them towards a better future. It's not so much about today but about a sustainable tomorrow."

Professor Muhammad Yunus

The provision of sustainable microfinance services to the poor enables Kashf's clients to supplement their income by investing small loans in income generating activities and managing household cash flows through quick access to emergency loans. This translates into an increase in per capita income and enables households to acquire access to other resources including improved nutrition, schooling and healthcare which could have been unaffordable in other circumstances.

Innovation and client focus has helped Kashf evolve its product line to suit client needs and attract a greater number of clients to access financial services. In Pakistan, Kashf has been a pioneer in several areas. It was the first MFI to experiment with an insurance product, the only MFI to offer an emergency loan and to implement a home improvement loan pilot. Kashf has been at the forefront

of providing business solutions to meet the financial needs of small entrepreneurs - who are referred to as the "missing middle" of microfinance - through its Business Sarmaya loan. The Kashf approach also includes capacity building of communities through peer networks and focuses on creating awareness regarding social issues using interactive theatre and gender workshops. During this year, 86 theater performances were conducted which covered 14,875 clients and their spouses, along with the establishment of 4 gender councils in four different areas in order to address local needs on a proactive basis.

Table 1 below, briefly summarizes the main financial products offered by Kashf.

TABLE 1: PRODUCT & SERVICES

| FEATURE | GENERAL LOAN | EMERGENCY LOAN | HOME IMPROVEMENT LOAN | BUSINESS SURMAYA LOAN | INSURANCE |
|-------------------------------|---|--|-------------------------------------|---|---|
| | (GL) | (EL) | (HIL) | (BSL) | |
| | "Growing Opportunities together!" | "Financial services whenever, wherever!" | "A better home for you!" | "Grow your business with Kashf!" | "We are with you always!" |
| Loan Purpose | Income generating | Consumption | Asset enhancement/ Home Improvement | Small & Medium Enterprise Development | Loan Insurance |
| Amount Per Loan | Rs 10,000 - Rs. 35,000 | Rs. 4,000 | Rs. 50,000 - Rs. 70,000 | Rs. 30,000 - 100,000 | 1.5% of loan size |
| Period Of Repayment | 1 year | 6 months | 4 years | 1-2 years | Linked to loan |
| Service Charge | 20% | 10% | 15% | 18% | None |
| Number Of Installments | 24 - Fortnightly | 12 - Fortnightly | 96 - Fortnightly | 12-24 monthly installments | Upfront Payment |
| Eligibility Criteria | Household income of Rs. 3000 - Rs. 10,000 | Must be an active GL client | Must be an active GL client | Business operational for a minimum of 2 years | Must be an active GL client or BSL client |

The Clients

Today Kashf has become a household name, trusted and relied upon by its female clients, as demonstrated by its rapidly growing outreach. The following graph shows an increase of nearly 77% in the number of total active clients served by the programme since last year, growing to 133,363 active clients in 2006 from 75,194 clients in 2005.

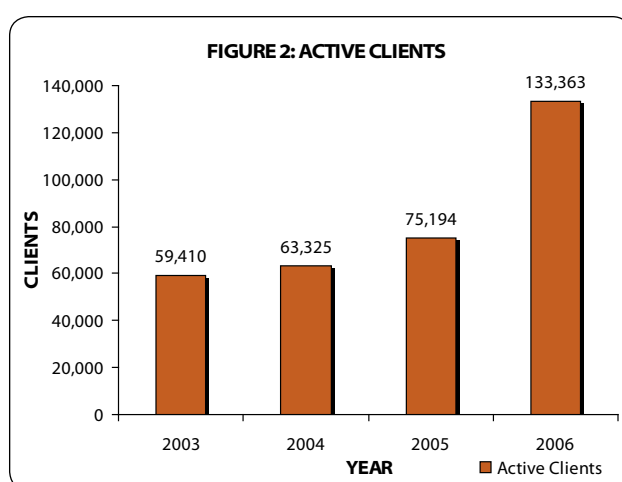


TABLE 2: GROWTH PATTERNS

| INDICATOR | 2003 | 2004 | 2005 | 2006 | % CHANGE |
|---------------------------|--------|--------|--------|---------|----------|
| Active number of clients | 59,418 | 63,325 | 75,194 | 133,363 | +77% |
| Dropouts | 5,259 | 16,387 | 15,778 | 13,383 | -15% |
| Client Attrition Rate (%) | 9 | 26 | 21 | 10 | |

Kashf's commitment to have a lasting impact on the lives of its clients by building a culture of integrity, team work and service has helped it to lower its client drop out and client attrition rate from 21% last year to 10% this year. As an organization, Kashf constantly strives towards improving customer care practices by inculcating valuable qualities such as tolerance, respect for others, discipline and punctuality amongst its staff. Kashf has achieved this by

articulating standards and guidelines which emphasise best practices in service delivery and by minimising policies that go against the institution's ethos of inclusivity and its core beliefs of ease of access and quality customer care.

By December 2006, Kashf had cumulatively provided Rs. 5.6 billion as loans to over 200,000 families. Kashf seeks to target the working poor who are particularly vulnerable to economic shocks. A typical Kashf client is 20-60 years of age. Her household consists of about 6 members, with an average per capita monthly income ranging from Rs. 500 (US\$8) to Rs 1,500 (US\$25) and is generally dependent on a single source of income to meet basic needs. In a majority of cases the single source of income is a vulnerable one with high seasonal variation.





Exhibit 1: Key Outcomes of Impact Assessment

Examining the effectiveness of Kashf in targeting the poor, we found that 90 percent of all its clients were living on less than \$1 a day. This is a commendable achievement that in spite of growing rapidly and attaining 100 percent operational and financial self-sufficiency, Kashf is reaching the 'very poor' people. The income of Kashf's mature clients is 51 percent higher than its new clients and this shows that Kashf is leading to poverty alleviation. Furthermore, the longer a client is associated with Kashf the higher their income is. Surprisingly, over 80 percent of both mature and new clients save and this is their main emergency coping mechanism. On the diet and health side, mature Kashf clients experience significantly less number of days when they have to eat less and have better access to health care.

Exhibit 2: Saima Baji's Road to Discovery

5 years ago, Saima's husband took some money to invest in a grocery store which turned bad and conditions worsened to such an extent that even affording a daily meal was difficult. Heavily indebted and frequently harassed by creditors, her husband was about to sell the house they owned. The economic tumult facing her household caused frequent disputes between her husband and her. She bore her husband 3 daughters and there was pressure on him to re-marry since Saima had not produced a male heir. "He used to be violent and abusive and at the time when I was pregnant with his second child he beat me really badly", admits a tearful Saima. It was at that juncture she realized that she had to fend for herself and her children and became an apprentice at a shop that did decorative work on clothes. The owner of the shop sublet part of the work to her and was impressed by her determination to change her economic situation. He instructed her to go to the city to attract potential buyers to increase the scope of her work and her income, but she could not since she didn't have the means to expand her work.

Saima later on heard about Kashf Foundation which advanced loans to women for the purpose of income generation. "A baji from Kashf came to our village and urged us to take loans to start our own business. Here was an organization that was advancing loans to us with no requirements when others turned their faces on us," exclaimed Saima. She went to the city from her rural locality in Ravi Rayon despite allegations from the neighborhood about her having a bad character. They told her husband to keep his wife in check however her husband had complete trust in her. Her first visit to the city

was full of fear and anxiety but she was able to get orders from the shopkeepers who praised her work. She started her business with a loan of Rs 4,000 to buy raw materials and gradually took higher loans as her scope of work increased. Saima saw her earning income rise from Rs 1,000 to Rs 3,000 per week on average.

With the income generated from her business she has been able to install electricity and gas within her house and also brought a TV. Her mother-in-law thinks highly of her and now believes that Saima is the best daughter-in-law she could wish for. Saima sends her 3 daughters to an English medium school, plus they go for tuition every afternoon, in addition to the regular school they attend. According to Saima she wants to give them a better future so that they should not undergo the same hardships she suffered and wants them to be well educated and married in a well-to-do household. All of this she says has been possible primarily due to Kashf and their belief in her that she could make a difference in her life.

5 years into the program she is currently taking a loan of Rs 20,000 and plans to expand her enterprise even further adding more labor and variety to her work." I currently employ around 35 women from the village and earn around 6,000 per week. People in the locality see me as a role model. Seeing my drive and passion has given other women from the locality the strength and the courage to venture into running their own enterprises."

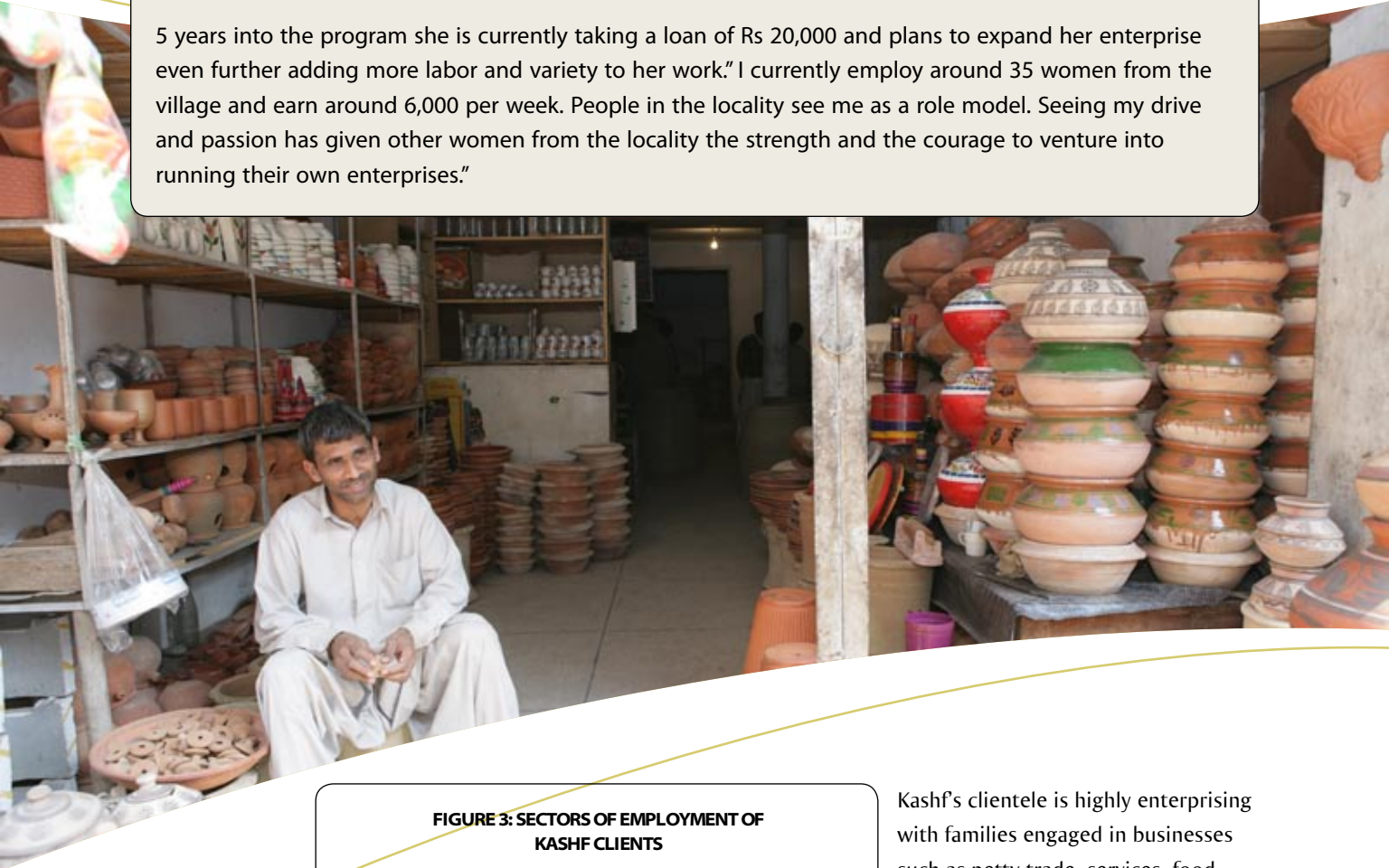
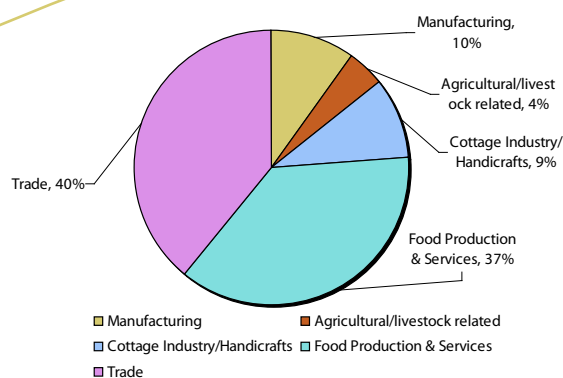
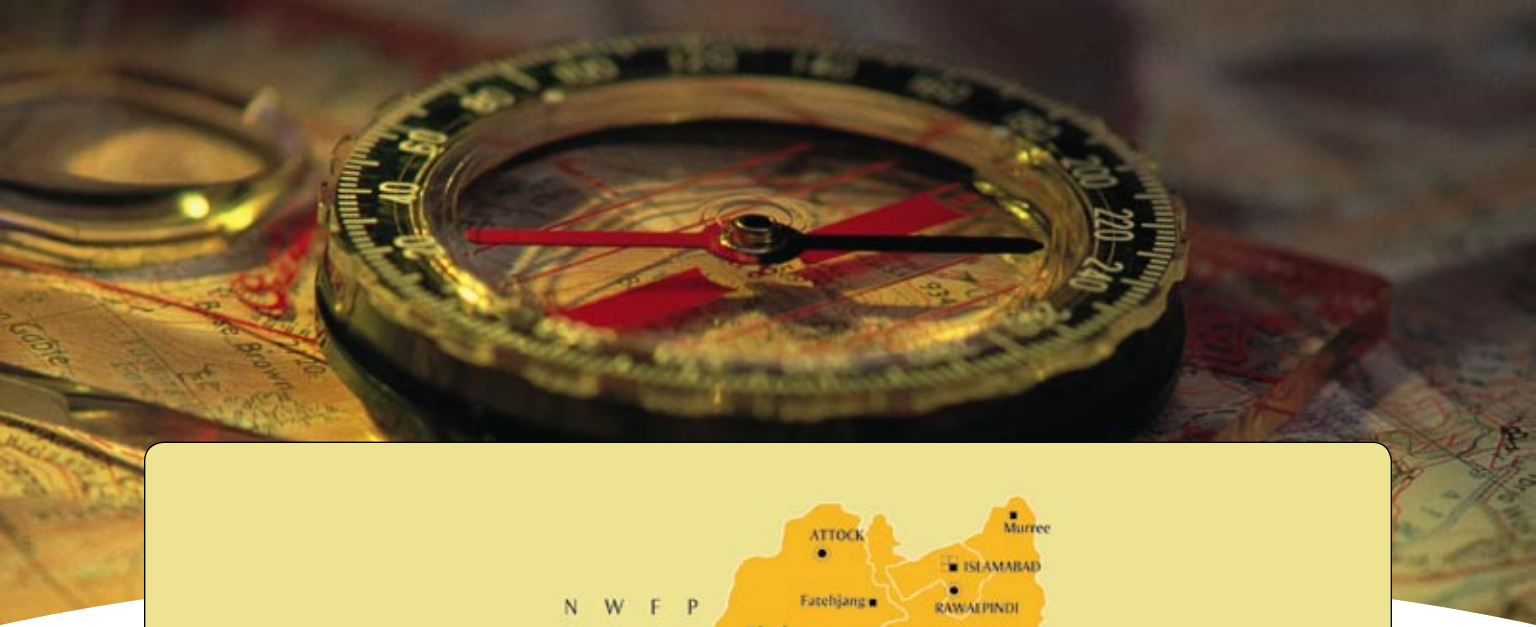


FIGURE 3: SECTORS OF EMPLOYMENT OF KASHF CLIENTS



Kashf's clientele is highly enterprising with families engaged in businesses such as petty trade, services, food processing, small manufacturing, cottage industries and small agro based activities. The given pie chart shows the different sectors in which Kashf's clientele are employed.



PUNJAB



Distribution Networks





Delighting the Customer

Kashf Foundation follows a very client centric approach that places its clients at the fore-front of all interactions. The organization firmly believes that it is client satisfaction which is the basis of institutional sustainability. Therefore, considerable effort goes into designing products to make them reflective of the clients' needs.

Kashf's loan products are based on the principles of affordability, accessibility, reliability and speed. Products are delivered at easily affordable rates and require no collateral. Delivery of the services at the doorstep of clients, along with conveniently located branches has made Kashf very accessible and close to its target market. Furthermore, the loan procedures facilitate clients by minimizing documentation and screening requirements.

IMPROVING PRODUCT OFFERINGS

Kashf continues to listen to its clients through several initiatives including customer satisfaction surveys, exit client surveys and regular impact evaluations. Over the years, one critical area that clients have raised concern over has been the loan size. Keeping this in view Kashf now offers

a range of loan sizes which begin at Rs 10,000 and are capped at Rs 50,000, thus reflecting the growing credit needs of clients as their businesses expand.

NEW PRODUCTS

Kashf also pursues a demand-based approach in designing new products and services. During this year, a home improvement loan pilot was started with key features such as no collateral requirement and minimal documentation, so as to reflect the general low level of property rights amongst Kashf's clientele. Kashf is also exploring the possibility of working with an insurance company to offer an affordable health insurance product to its clients, thus allowing them to hedge health related contingencies.

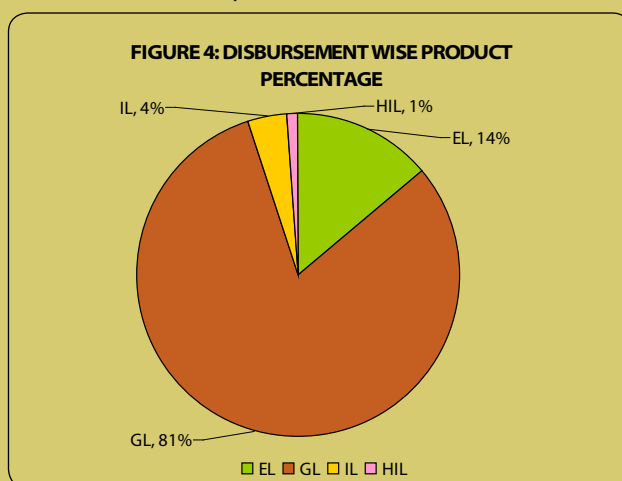
Products & Services

“The general loan helps us meet our financial needs for running businesses”

Razia Baji

LOAN PRODUCTS

Kashf provides a number of loan products to its clients including a General Loan (GL) for income generating activities, an Emergency Loan (EL) for consumption purposes, a Business Surmaya Loan (BSL) aimed at small and medium enterprises and a Home Improvement Loan (HIL) to cater for small home improvements in the household. The following graph highlights the product wise distribution of the various loan products:



GENERAL LOAN (GL):

The GL focuses on building and sustaining economic opportunities of poor households in order to achieve Kashf's over-arching goal of alleviating poverty. The GL is based on group collateral where a group of 25 women jointly insure each other against default. In light of Kashf's strong

commitment to customer care, center members have to wait only 7 days after their registration to get the first loan, while repeat clients can obtain a loan within 24 hours. The loans are advanced to female members of the household, where as the purpose of the loan is mutually decided by household members.

The total number of GL loans disbursed increased by 78% from 74,922 loans in 2005 to 133,489 loans in 2006, leading to cumulative loans disbursed of 379,616, while GL outstanding grew by 89%. The massive increase in the number of disbursements this year has resulted in the opening of 36 new branches in new areas as well as deeper penetration in existing areas. Branch productivity standards have been adjusted upwards, with most branches having 6 loan officers (LO) and with most LOs handling 3 additional centers, i.e. each LO managing a portfolio of 675 clients on average. LO productivity increases have been made possible by direct investments in information technology via the introduction of an automated system in all branches.

The Average Loan Size (ALS) is an indicator for gauging the breadth of outreach of the program, that is,

TABLE 3A: GL PRODUCT INFORMATION

| PRODUCT : GL | 2005 | 2006 | CUMULATIVE |
|-----------------------------|---------------|---------------|---------------|
| GL Amount Disbursed (Rs.) | 1,093,546,433 | 2,030,972,183 | 4,743,688,166 |
| # of Loans Disbursed | 74,922 | 133,489 | 379,616 |
| GL Amount Outstanding (Rs.) | 707,210,691 | 1,338,923,784 | |
| Average Loan Size (ALS) | 14,595 | 15,214 | 12,496 |

“In a year there are occasions when one requires a loan for purposes other than business such as Eid and weddings. Last year I made my children’s Eid clothes from the chota qarza that Kashf gives us”

Rasheeda Baji

on average how effectively has the programme been able to target poor households. It is also relevant to measure the ALS as a percentage of the per capita GNP to determine the relative deepening of outreach; for the year 2006 the ALS was 31% of the per capita GNP, which shows Kashf’s continuing commitment to reaching out to poorer segments⁴.

EMERGENCY LOAN (EL):

The EL has been designed to provide credit to clients during financially volatile periods. Clients use EL to pay their children school fees, utility bills and all other unplanned petty expenditures. The product is seen to be client friendly and women friendly due to its ease of availability. Timely access to money gives women a sense of relief and comfort since they are able to meet immediate needs without having to borrow at exorbitant rates from traditional money lenders or having to request it from relatives and friends. The year 2006 saw the EL

grow by 91% to 92,627 loans up from 48,518 loans in 2005. The amount disbursed during the year increased from Rs. 138,703,909 in 2005 to Rs. 341,261,000 in 2006, implying an increase of 147% over the year. The reason for this growth could be attributed to flexibility of access in terms of clients being able to draw the EL twice in the year as opposed to only once.

BUSINESS SURMAYA LOAN (BSL):

Clients requiring loans below Rs 500,000 cannot obtain access to formal financial sources, since such amounts are still too small for commercial banks to lend. A quick estimate can show that the potential market for small enterprises is about 6 million with a negligible outreach to such entrepreneurs by the banking and the microfinance sector as a whole. Kashf targets fast moving small entrepreneurs through the BSL, the entire methodology of which is based on a credit scoring model. The BSL is advanced to clients with a minimum of 2 years running experience of their businesses and does not require stringent collateral. Generally the loan has a minimum processing time of less than 5 days.

The BSL was started in 2005 as a pilot project. The number of loans has grown more than 600% leading to a total of 2,478 loans advanced during 2006 in comparison with 326 loans in 2005. The total amount disbursed during 2006 was Rs. 97,745,000 considerably up from last year’s Rs 12,965,000. Growth over this period has resulted from modifying key product features and enhancing ease of access to clients by doing away with redundant assessment procedures and other requirements.

TABLE 3B: EL PRODUCT INFORMATION

| PRODUCT : EL | 2005 | 2006 | CUMULATIVE |
|-----------------------------|-------------|-------------|-------------|
| EL Amount Disbursed (Rs.) | 138,703,909 | 341,261,000 | 713,047,669 |
| # of Loans | 48,518 | 92,627 | 252,400 |
| EL Amount Outstanding (Rs.) | 60,371,242 | 107,502,593 | |
| ALS | 2,859 | 3,684 | 2,825 |

TABLE 3C: BSL PRODUCT INFORMATION

| PRODUCT : BSL | 2005 | 2006 | CUMULATIVE |
|------------------------------|------------|------------|-------------|
| BSL Amount Disbursed (Rs.) | 12,965,000 | 97,745,000 | 110,710,000 |
| # of Loans | 326 | 2,478 | 2,804 |
| BSL Amount Outstanding (Rs.) | 10,024,934 | 75,185,968 | |
| ALS | 39,770 | 39,445 | 39,483 |

⁴ The per capita GNP for the year 2006 is Rs 47,930, Pakistan Federal Bureau of Statistics, GNP at Current Factor Cost, Table 4

“With the help of Kashf, I shall be able to construct a room for my son who plans to get married this year. It gives me a sense of pride to give my son such a valuable gift for his marriage”

Jamila Baji

HOME IMPROVEMENT LOAN (HIL):

Kashf introduced the HIL in 2006, ever since home improvement and renovation were identified as key priorities by clients. The loan aims to increase the asset value of clients' homes and improve their living standards. Although seen as a non-productive loan, some clients have used it to make a room for the purpose of rental, while others have used it to provide a shed for their cattle. Also, some of Kashf's clients have saved rental costs by using the loan to construct basic structures on plots of land they previously owned.

The HIL works on the same group liability model where three to ten clients from the existing center form an HIL group and the responsibility of approval and repayment lies with the center. HIL has been designed with a longer repayment period and smaller installment amount, in order



The HIL has had 100% recovery due to its reliance on a solidarity lending approach, regular follow ups and strict enforcement of loan utilization solely for the purpose of home improvement.

TABLE 3D: HIL PRODUCT INFORMATION

| PRODUCT : HIL | 2006 | CUMULATIVE |
|----------------------------|------------|------------|
| HIL Amount Disbursed (Rs.) | 14,680,000 | 14,680,000 |
| # of Loans | 215 | 215 |
| Outstanding Amount (Rs.) | 13,888,564 | 13,888,564 |
| ALS | 68,279 | 68,279 |

NOTE: The loan amount disbursed and outstanding is only the principal amount

to make it easy for clients to continue accessing other loans from Kashf to meet their business and consumption needs. Since its inception in July 2006, a total of 215 loans have been disbursed resulting in a total of Rs. 14,680,000.



Other Services

CREDIT FOR LIFE INSURANCE:

Credit for life insurance has been a popular product amongst Kashf's clients, since economic upheavals are a regular part of their lives. Kashf was one of the pioneer organizations to introduce life insurance for poor clients in order to deal with emergency periods such as the death of a bread winner. This service is provided to the client and her spouse at a minimal premium. The insurance covers all outstanding loan balances plus a small burial payout at the time of the death of either party. This means that the family is able to cope with the consequences of such an event and faces no liabilities at that time. This is in stark contrast to the exploitative lending practices of the traditional money lender where the burden of repayment of the loan is transferred to the remaining family members.



TABLE 4: INSURANCE PRODUCT INFORMATION

| YEAR | NUMBER OF CUSTOMERS | PREMIUM COLLECTED (RS.) | NUMBER OF CLAIMS | CLAIMS PAID |
|-------|---------------------|-------------------------|------------------|-------------|
| 2006* | 138,724 | 88,455,694 | 567 | 3,465,000 |
| 2005 | 75,725 | 16,159,920 | 224 | 3,923,650 |
| 2004 | 64,576 | 8,259,410 | 455 | 6,691,385 |

* Data of 17 branches for a period of 4 months was unavailable



Financial Performance

Along with focusing on the scale and depth of outreach, Kashf Foundation has been able to successfully achieve and maintain financial sustainability and transparency, which are pivotal indicators for assessing the financial performance of microfinance institutions. The institution's long term viability is governed by its productivity, efficiency and returns which ensure that the organization employs cost effective methodologies and maintains a sustainable yield on portfolio.

Figure 5 shows that operational self-sufficiency, which highlights the ability of the programme to cover all operational costs from its income, decreased since last year from 180% to 154% in 2006. Financial self-sufficiency (FSS) which is a more stringent measure to assess self-sufficiency net of any subsidy slightly declined to reach 110% in 2006. The decline in both indicators has resulted from Kashf's aggressive growth plan and the opening of 36 new branches which will become fully productive in 2007; however, this trend has been offset by a growth in the portfolio of 96% over the past year along with a substantial increase in income from loans, which grew at 80% over the previous year.

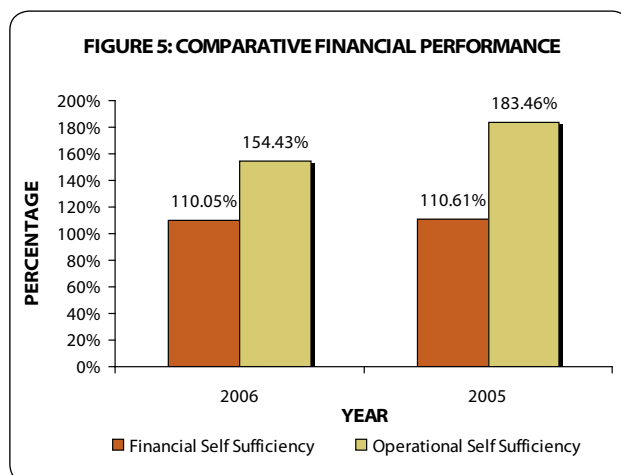


TABLE 5: SELF-SUFFICIENCY TREND

| INDICATOR | 2006 | 2005 |
|------------------------------|---------|---------|
| Financial Self Sufficiency | 110.05% | 117.21% |
| Operational Self Sufficiency | 154.43% | 180.20% |

Simultaneously, Kashf Foundation has been successful in incorporating an innovative, flexible and decentralized approach in order to manage expansion and outreach efficiently, to raise branch productivity and to improve client screening and targeting, thus enhancing the long term sustainability of the organization. Figure 7 on the following page shows that efficiency indicators have kept in line with

annual projections, while both ratios have deteriorated over the period 2005 to 2006. In addition to new branches being opened, other aspects that have impacted on efficiency include an increase in the overall personnel expenses of 103% and administrative expenses of 131% over the year.

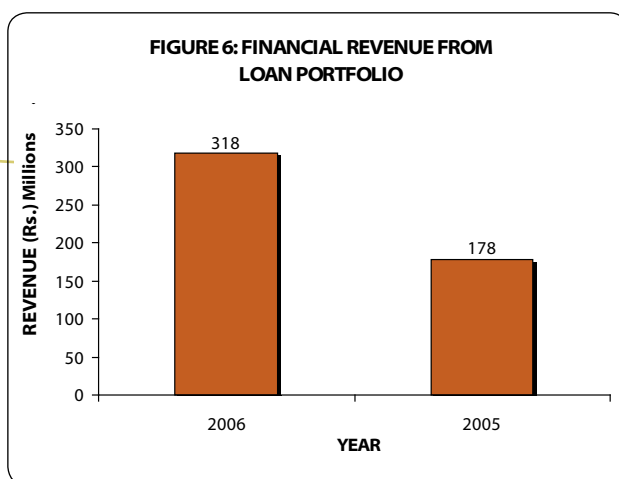


TABLE 6: FINANCIAL REVENUE FROM LOAN PORTFOLIO

| INDICATOR | 2006 | 2005 |
|---------------------------------------|-------------|-------------|
| Financial Revenue from Loan Portfolio | 317,932,503 | 178,391,492 |

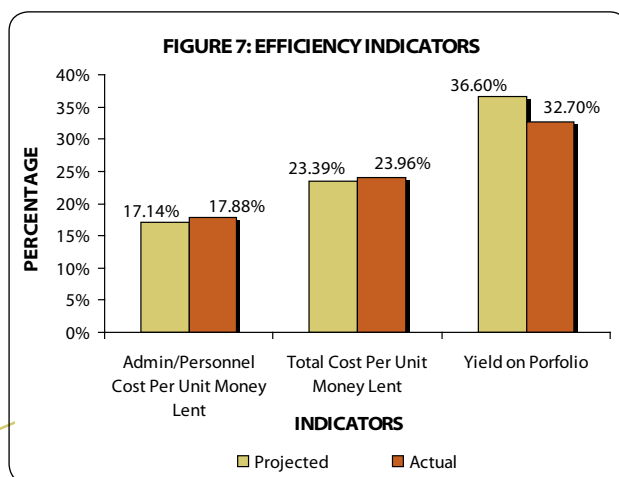


TABLE 7: RETURN ON ASSET

| INDICATORS | PROJECTED | ACTUAL |
|--|-----------|--------|
| Admin/Personnel Cost Per Unit Money Lent | 17.14% | 17.88% |
| Total Cost Per Unit Money Lent | 23.39% | 23.96% |
| Yield on Portfolio | 36.60% | 32.70% |

Furthermore, the yield on portfolio, which is a primary measure for determining the ability of the institution to generate income from its loan portfolio, has been lower than projected yield. The gap in the yield has primarily resulted from delays in processing loans of repeat clients, an aspect which was closely reviewed over the last year and several policy changes were introduced to overcome this issue. The policy changes included introducing flexible center sizes, simplifying approval procedures for repeat clients and closely monitoring repeat centre disbursements.

Portfolio at Risk (PAR) measured at 1 day late, has improved from 0.32% to 0.11% over this year despite a massive increase in the total amount disbursed by Rs 2.5 billion. This emphasizes that no new overdue was experienced in 2006 and recovery was maintained at 100% through out the period.

The adjusted return on total assets (AROA) reflects the capacity of the programme to apply its assets to generate income, while the adjusted return to equity (AROE) measures the return that the programme can provide to private investors, in case it was a for-profit entity with shareholding.

Overall, the factors contributing to profitability include portfolio yield, asset yield, operating cost, financial cost, and loan loss cost ratios. As earlier mentioned over the year, operating costs and financial costs increased while yield was a little lower than projected. As a result,

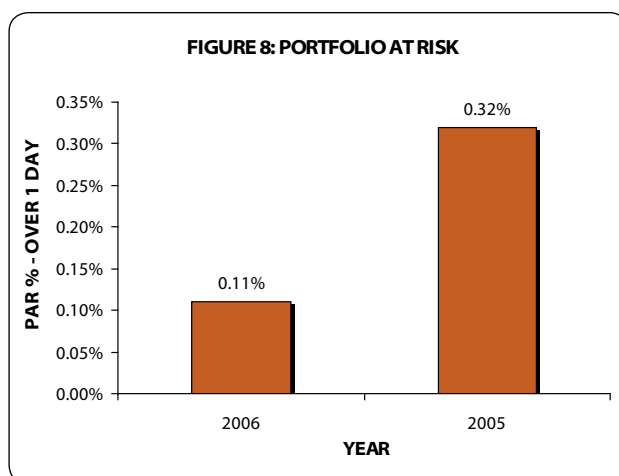


TABLE 8: PAR, EFFICIENCY & ADMINISTRATIVE COST

| INDICATOR | 2005 | 2006 | STATUS |
|---|-------------|---------------|----------|
| Outstanding-GL/EL (Rs) | 764,404,951 | 1,445,134,542 | +89% |
| Outstanding-BSL (Rs) | 10,024,934 | 75,185,968 | +650% |
| Total Outstanding (Rs) | 774,429,885 | 1,520,320,510 | +96% |
| PAR at 1 day late | 0.32% | 0.11% | Improved |
| Recovery rate % | 100% | 100% | Constant |
| Total Cost per unit of money lent | 21% | 24% | Declined |
| Admin/Personnel cost per unit of money lent | 16% | 18% | Declined |

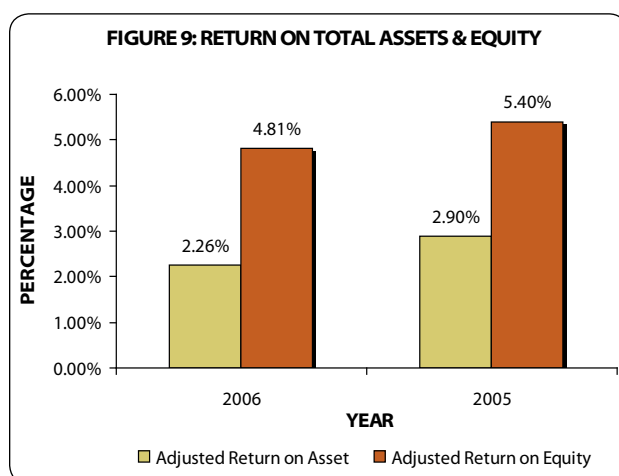



TABLE 9: RETURN ON ASSET & EQUITY

| INDICATOR | 2006 | 2005 |
|---------------------------|-------|-------|
| Adjusted Return on Asset | 2.26% | 2.90% |
| Adjusted Return on Equity | 4.81% | 5.40% |

both AROA and AROE declined. The AROA was at 2.26% and AROE at 4.81% in 2006, as can be seen in Figure 9.

Overall, despite rapid growth Kashf has managed to maintain and sustain its financial sustainability, efficiency and profitability over this year and to match its performance with global benchmarks. Given its tremendous growth this year, Kashf has joined a small group of MFIs that have achieved considerable scale, i.e. only 5% of the MFIs reporting on the MIX market have achieved more than 100,000 clients and above⁵. Kashf continues to pioneer improvements in financial performance and in setting high standards for sustainability for the MF sector in Pakistan.

⁵ 40 out of 717 MFIs ranked against the indicator of outreach have more than 100,000 clients each.



Kashf is always aiming for high standards to improve quality and its commitment to excellence.

Corporate Governance

Kashf is always aiming for high standards to improve quality and its commitment to excellence. In keeping with this spirit, the legal status of Kashf Foundation was changed from a Society registered under the Societies Registration Act 1860, to a not-for-profit (NPO) company under section 42 of the Companies Ordinance 1984. The change in the legal status does not alter the mission or the vision of the Foundation in any way.

Kashf also posts its financial and non financial data on the MIX market. The MIX market is a global, web-based, microfinance information platform. Kashf was given a 5 diamond status on the MIXMARKET website. This signifies the highest standards of disclosure of quality information. Kashf is the only non-banking MFI to achieve this level of transparency and disclosure among a total of 98 such programs. Given its continuing emphasis on financial transparency, Kashf was also considered eligible for the “transparency award” by CGAP, and has also received a high ranking certification from the Pakistan Centre for Philanthropy.

Supporters

The Foundation would like to thank the following organizations for their continuing generosity and commitment:



Acumen Fund is a non-profit global venture fund that uses entrepreneurial approaches to solve the problems of global poverty. Investments focus on delivering affordable, critical goods and services – like health, water and housing – through innovative, market-oriented approaches.



Consultative Group to Assist the Poor (CGAP) is a consortium of 33 public and private development agencies working together to expand access to financial services for the poor in developing countries. It is a resource center for the entire microfinance industry supporting innovative products and delivery mechanisms, cutting edge technology and providing novel solutions to the challenges of expanding microfinance.



The Department for International Development (DFID) is the part of the UK Government that manages Britain's aid to poor countries and works to get rid of extreme poverty. In addition to its work as a bilateral donor to individual countries, 43% of total DFID development assistance funding goes through multilateral agencies.



Grameen Foundation (GF), a global 501(c)(3) non-profit organization works to replicate the Grameen Bank microfinance model around the world through a global network of partner microfinance institutions. Grameen Foundation's mission is to empower the world's poorest people to lift themselves out of poverty with dignity through access to financial services and to information.



Pakistan Microfinance Network (PMN) is a network of organizations engaged in microfinance and dedicated to improving the outreach and sustainability of microfinance services in Pakistan. The network has built greater awareness among policy makers, launched comprehensive capacity building initiatives, and established standards and benchmarks for transparency in MFIs.



The Pakistan Poverty Alleviation Fund (PPAF) represents an innovative model of public private partnership. Sponsored by the Government of Pakistan and funded by the World Bank and other leading donors the PPAF provides financial and non-financial support to civil society organizations on a long-term basis.



SHOREBANK INTERNATIONAL

Founded in 1973, **Shorebank International (SBI)** is America's first and leading community development bank. A pioneer in profitably lending to underserved urban and rural communities, ShoreBank has grown to \$2 billion in assets and has affiliates across the United States and international consulting projects around the world.



Women's World Banking's mission is to expand the economic assets, participation and power of low-income women entrepreneurs by helping them access financial services and information. It supports a global network of more than 50 microfinance institutions and banks in 29 countries throughout Africa, Asia, Eastern Europe, Latin America and the Middle East, offering them a full menu of advisory services and veteran leadership in the mission to bring financial empowerment to poor women entrepreneurs.

A. F. FERGUSON & CO.

A member firm of

PRICEWATERHOUSECOOPERS 

A. F. Ferguson & Co.
Chartered Accountants
505, 5th Floor, Alfalah Building
P.O. Box 39, Shahrah-e-Quaid-e-Azam
Lahore, Pakista.
Telephone: (042) 6285078-85
Fax: (042) 6285088
E-mail: ferguson@brain.net.pk

AUDITOR'S REPORT TO THE MEMBERS OF THE FOUNDATION

We have audited the annexed balance sheet of Kashf Foundation as at Decemeber 31, 2006, the related statement of income and expenditure, cash flow statement and statement of changes in funds together with the notes forming part thereof (hereinafter referred to as the "financial statements") for the year ended.

It is the responsibility of the Foundation's management to establish and maintain a system of internal control and prepare and present the financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining on a test basis, evidence supporting the amounts and disclosure in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by the management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements present fairly in all material respects the financial position of Kashf Foundation as at December 31, 006 and its surplus for the year then ended on the basis of accounting policies described in note 3 to the financial statements.


Chartered Accountants

Lahore, May 11, 2007

KASHF FOUNDATION

BALANCE SHEET AS AT DECEMBER 31, 2006

| | Note | 2006 Rupees | 2005 Rupees |
|---|------|--------------------|--------------------|
| Assets | | | |
| Cash and bank balances | 4 | 285,632,295 | 254,159,792 |
| Investments | 5 | 114,848,299 | 149,771,763 |
| Micro-credit loan portfolio | 6 | 1,499,416,837 | 758,358,057 |
| Advances, deposits, prepayments and other receivables | 7 | 40,445,091 | 19,257,231 |
| Operating fixed assets | 8 | 58,316,669 | 46,343,145 |
| Assets subject to finance lease | 9 | 5,351,035 | 2,292,849 |
| | | 2,004,010,226 | 1,230,182,837 |
| Liabilities | | | |
| Finances under mark-up arrangements | 10 | 94,414,833 | 167,259,417 |
| Members' security deposits | 11 | 8,063,948 | 6,394,401 |
| Creditors, accrued and other liabilities | 12 | 63,024,547 | 30,425,781 |
| Liabilities against assets subject to finance lease | 13 | 4,202,053 | 1,716,942 |
| Borrowings | 14 | 893,281,607 | 404,803,757 |
| Capacity Building grants | 15 | (3,585,208) | 14,292,838 |
| | | 1,059,401,780 | 624,893,136 |
| Contingencies and commitments | 16 | | |
| Net Assets | | 944,608,446 | 605,289,701 |
| Represented by | | | |
| Donated funds | | 364,814,228 | 249,824,557 |
| General funds | | 566,450,902 | 353,315,823 |
| Grants related to fixed assets | | 11,477,432 | 1,864,906 |
| Far value reserve | | 1,865,884 | 284,415 |
| | | 944,608,446 | 605,289,701 |


CHAIRMAN


TREASURER

KASHF FOUNDATION

STATEMENT OF INCOME AND EXPENSE FOR THE YEAR ENDED 31, 2006

| | Note | 2006 Rupees | 2005 Rupees |
|---|------|--------------------|--------------------|
| Service charges on micro-credit loans to members | | 317,932,503 | 178,391,492 |
| General and administrative expenses | 17 | (166,630,404) | (85,582,347) |
| Seminar, workshop, research and staff training expenses | | (7,257,950) | (2,034,354) |
| Loan loss provision | 6.5 | (16,957,940) | (7,600,072) |
| | | (190,846,294) | (95,216,773) |
| | | 127,086,209 | 83,174,719 |
| Capacity building grants recognised as income | 15 | 86,704,117 | 18,399,560 |
| Other grants recognized as income | | 2,001,250 | - |
| Other income | 18 | 41,724,630 | 26,278,538 |
| Exchange gain | | 73,519 | 275,220 |
| | | 130,503,516 | 44,953,318 |
| Financial Charges | 19 | (42,094,238) | (19,064,971) |
| | | 215,495,487 | 109,063,066 |
| Donations | | (2,001,250) | (2,338,753) |
| Community training expenses | 20 | (1,696,839) | (166,137) |
| Surplus for the year | | 211,797,398 | 106,558,176 |
| Portfolio at risk | | 0.11% | 0.27% |
| Adjusted Return on Assets (AROA) | | 2.26% | 2.90% |
| Adjusted Return on Equity (AROE) | | 4.81% | 5.40% |
| Operational self-sufficiency | | 154.43% | 180.20% |
| Financial self-sufficiency | | 110.05% | 117.21% |
| Active loan clients | | 136,012 | 75,520 |


CHAIRMAN


TREASURER

KASHF FOUNDATION

CASH FLOW STATEMENT FOR THE YEAR ENDED 31, 2006

| | Note | 2006 Rupees | 2005 Rupees |
|---|------|----------------|----------------|
| Cash flow from operating activities | | | |
| Surplus for the year | | 211,797,398 | 106,558,176 |
| Adjustments for: | | | |
| Depreciation on operating fixed assets | | 4,432,275 | 3,322,820 |
| Depreciation on leased assets | | 1,175,306 | 259,953 |
| Capacity building grants recognized as income | | (86,704,117) | (18,399,560) |
| Other grants recognized as income | | (2,001,250) | - |
| Financial charges | | 42,094,238 | 19,064,971 |
| Loss/(gain) on disposal of fixed assets | | 162,920 | (16,610) |
| Fixed assets written off | | - | 134,789 |
| Provision against doubtful receivables | | 1,280,161 | 557,951 |
| Loan loss provision | | 16,957,940 | 7,600,072 |
| | | (22,602,527) | 12,524,386 |
| Surplus before working capital changes | | 189,194,871 | 119,082,562 |
| Effect on cash flow due to working capital changes | | | |
| (increase) in loan portfolio | | (758,016,720) | (298,783,933) |
| (increase) in advances, deposits, prepayments and other receivables | | (22,468,021) | (3,301,001) |
| Increase in creditors, accrued and other liabilities | | 28,013,930 | 11,987,452 |
| Increase/(decrease) in members' security deposits | | 1,669,547 | (1,216,511) |
| | | (750,801,264) | (291,313,993) |
| Cash generated from operations | | (561,606,393) | (172,231,431) |
| Financial charges paid | | (37,509,402) | (18,129,906) |
| Net cash used in operating activities | | (599,115,795) | (190,361,337) |
| Cash flow from investing activities | | | |
| Fixed capital expenditure | | (16,674,069) | (9,956,894) |
| Sales proceeds from disposal of fixed assets | | 105,350 | 929,156 |
| Lease rentals paid | | (1,748,381) | (835,860) |
| Proceeds from/(payments for) investments - net | | 46,504,933 | (27,729,401) |
| Net cash from/(used in) Investing activities | | 28,187,833 | (37,592,999) |
| Cash flow from financing activities | | | |
| Donated funds | | 116,990,921 | (6,300,015) |
| Capacity building grant funds | | 68,826,071 | 31,561,431 |
| Grant related to fixed assets | | 10,950,207 | 363,895 |
| Proceeds from borrowings - net | | 488,477,850 | 244,760,200 |
| Net cash from financing activities | | 685,245,049 | 270,385,511 |
| Net increase in cash and cash equivalents | | 114,317,087 | 42,431,175 |
| Cash and cash equivalents at the beginning of the year | | (3,099,625) | (45,530,800) |
| Cash and cash equivalents at the end of the year | 21 | 111,217,462 | (3,099,625) |

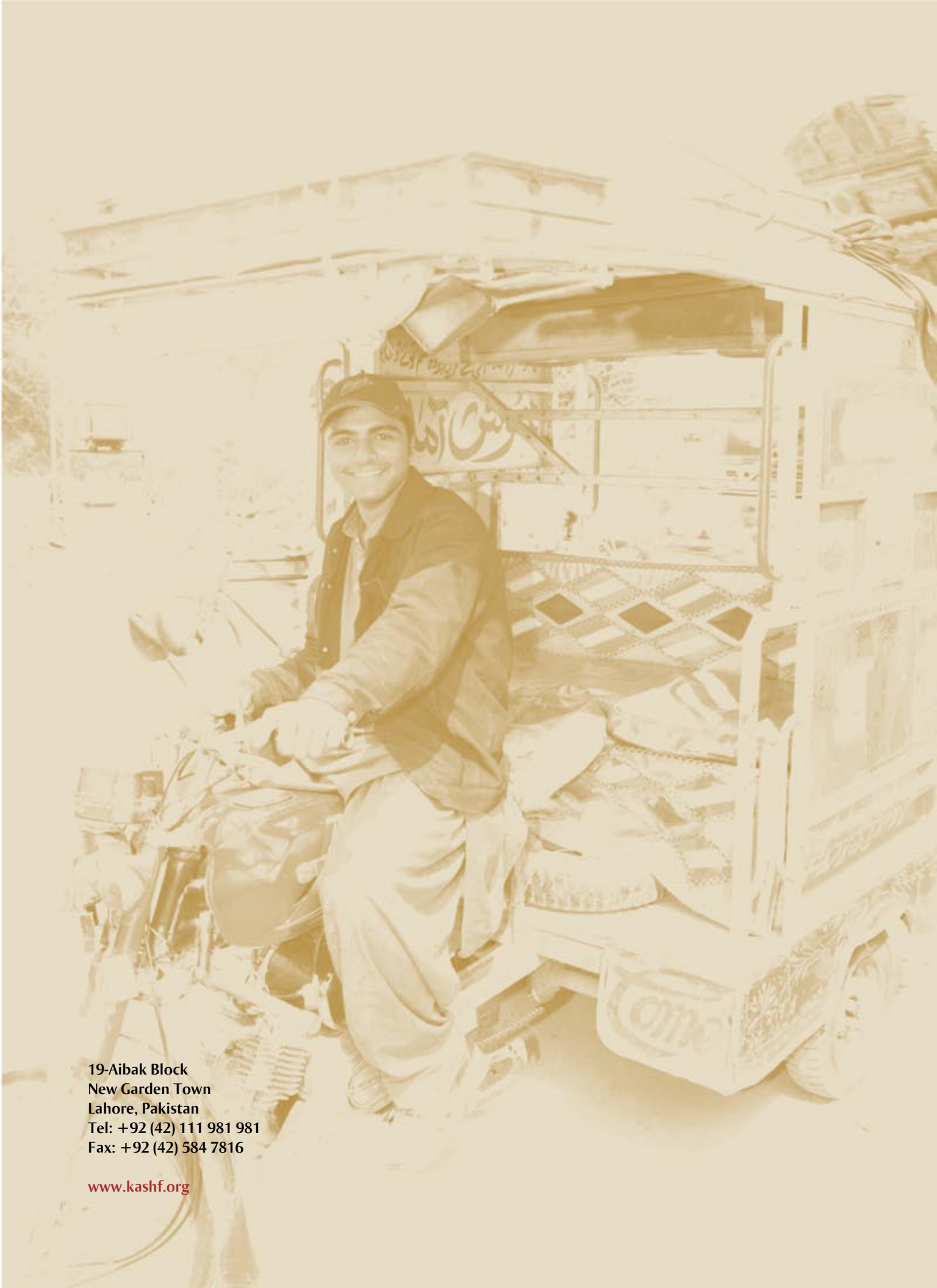
KASHF FOUNDATION

STATEMENT OF CHANGES IN FUNDS FOR THE YEAR ENDED 31, 2006

| | Donated funds | General funds | Grants related to fixed assets | Fair value reserve | Total |
|---|---------------|---------------|--------------------------------|--------------------|--------------|
| | Rupees | Rupees | Rupees | Rupees | Rupees |
| Balance as at January 1, 2005 | 263,112,581 | 242,383,329 | 1,949,913 | - | 507,445,823 |
| Grants received during the year | 7,945,947 | - | 363,895 | - | 8,309,842 |
| Donated funds transferred to Enterprise Development | (11,977,454) | | | | (11,977,454) |
| General funds utilized during the year | (5,331,101) | | | | (5,331,101) |
| Interfund transfer | (3,925,416) | 3,925,416 | | | - |
| Surplus for the year | - | 106,558,176 | - | - | 106,558,176 |
| Grants related o fixed assets utilized during the year | | 448,902 | (448,902) | | - |
| Fair value gain during the year on available for sale investments | | | | 284,415 | 284,415 |
| Balance as at January 1, 2006 | 249,824,557 | 353,315,823 | 1,864,906 | 284,415 | 605,289,701 |
| Grants received during the year | 813,291 | - | - | - | 813,291 |
| Transferred from capacity building grant funds | 116,177,630 | - | 10,950,207 | - | 127,127,837 |
| Funds utilized during the year | (2,001,250) | - | | | (2,001,250) |
| Surplus for the year | - | 211,797,398 | - | - | 211,797,398 |
| Grants related o fixed assets utilized during the year | | 1,337,681 | (1,337,681) | | - |
| Fair value gain during the year on available for sale investments | | | | 1,581,469 | 1,581,469 |
| Balance as at December 31, 2006 | 364,814,228 | 566,450,902 | 11,477,432 | 1,865,884 | 944,608,446 |


CHAIRMAN


TREASURER



19-Aibak Block
New Garden Town
Lahore, Pakistan
Tel: +92 (42) 111 981 981
Fax: +92 (42) 584 7816

www.kashf.org