

## Hattha Kaksekar Limited (HKL) – Cambodia

Hattha Kaksekar Limited (HKL) HKL is a non-banking financial institution legally operating in Cambodia according to the mandate received by the National Bank of Cambodia (NBC) in 2001 and subsequently upgraded with the saving license obtained in early 2010. As of December 2010, there are 8 shareholders out of which 2 are international microfinance-specialized investors (Oikocredit and Triple Jump). HKL was established to serve low income population, with a specific focus on women and rural areas.

### FINAL RATING

# A-

Date Rating Committee : May 2<sup>nd</sup> 2011

Validity : 1 year if no relevant changes in operations or within the operational context occur.

### OUTLOOK

# Stable

Previous Rating : MicroFinanza Rating (2008): A

### RATING RATIONALE

#### FINANCIAL ANALYSIS AND CAPITAL ADEQUACY

HKL shows good and increasing performance results after having experienced a drop in 2009 due to the global economic turmoil. In 2010 the institution has demonstrated a sound pattern of portfolio growth coupled with an improved portfolio quality, even though some portfolio concentration is still present. Overall performance has however slightly declined if compared to the results achieved in 2007-2008. In order to ensure the expected growth for 2011 and 2012, the institution needs to boost the capital to maintain the CAR above the regulatory requirements. Within this perspective, HKL has already put in place a strategy through fresh capital injection and contracted subordinated debts.

#### GOVERNANCE, RISK MANAGEMENT AND QUALITATIVE RISK ANALYSIS

The institution relies on good ownership structure and on qualified BoD with a sound experience in microfinance. Top management team is skilled, while the organizational structure and HR management represent crucial areas that need to be strengthened to support the planned expansion, the product development and the saving mobilization plans. Financial risk management is also an area for improvement considering the increasing sophistication of the funding structure and the ALM. The risk of client over-indebtedness, partly due to a high competition, remains relevant in the whole sector and is exacerbated by the lack of a Credit Bureau.

Legal form	Limited Liability Company
Client typology	Micro, small and medium businesses
Year of inception	2001
Year of inception of the operations	1996
Regulator / Supervisor	National Bank Cambodia
Networks of reference	-
Area of intervention	Rural, peri-urban and urban
Credit methodology	Individual lending

Indicators	Dec08	Dec09	Dec10
Members (#)	48,852	47,835	57,070
Active borrowers (#)	44,467	41,110	47,952
Branches (#)	11	17	25
Total staff (#)	433	510	776
Loan officers (#)	210	249	394
Gross outstanding portfolio (US\$)	29,050,403	31,180,474	44,309,948
Total savings (US\$)	286,425	323,384	3,081,955
Total assets (US\$)	36,053,209	33,444,160	47,639,794

Financial Indicators	Dec08	Dec09	Dec10
PAR 30	0.5%	3.1%	0.9%
PAR 90	0.1%	2.9%	0.9%
Write-off ratio	0.1%	1.7%	1.6%
Restructured loans	0.0%	0.0%	0.0%
ROE	35.2%	15.5%	19.2%
ROA	7.2%	3.4%	4.4%
AROE	13.2%	14.0%	15.2%
Oper. Self-sufficiency (OSS)	149.7%	121.7%	127.9%
Fin. Self-sufficiency (FSS)	120.5%	120.3%	122.4%
Staff productivity (borrow.)	103	81	62
LO productivity (borrow.)	212	165	122
Operating expense ratio	11.4%	11.9%	13.7%
Funding expense ratio	9.0%	8.7%	7.6%
Provision expense ratio	0.3%	4.0%	1.2%
Portfolio yield	30.7%	28.9%	28.3%
Risk coverage ratio	131.5%	92.2%	184.0%
Cost of funds ratio	10.7%	9.4%	9.4%
Debt/Equity ratio	3.8	3.0	3.8
Capital adequacy ratio	20.9%	25.1%	20.8%

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## Main Risk Factors

AREA	Risk Factors	Relevance*	Key Points	Risk Mitigation
<b>1. External Context and MFI Positioning</b>	Client over-indebtedness	Medium-high	The microfinance sector in the country is characterized by an increasing trend of cross-indebtedness, which has been particularly identified in 2009 during the global economic	The CMA is active in promoting fair competition among members and MFIs are actively exchanging information.
	Lack of a credit bureau	Medium	Given the credit pollution in some areas, the credit bureau becomes of critical importance.	The CMA together with the Banking Association and the NBC have launched the preparatory phase for the
	High competition	Medium-high	Growing competition with similar offer and slow innovation in the product cross-selling.	Rural areas still presents unmet demand and lower SME might be a good market niche excluded from the banking sector.
	Limited cost-effectiveness of the collateral enforcement	Medium-low	House and land collateral not fully effective for debt recovery	-
<b>2. Governance, Organization and Operational Risk</b>	Flat organizational structure	Medium	The top management (COO and CFO) immediately below the CEO is not defined yet with a reporting coming from the departments centralized towards the CEO.	The CEO has assigned some responsibilities to the deputy CEO and his assistant to enhance them as centre of responsibility.
	Leadership and coaching skills to be enhanced at management level	Medium-low	Both top management (head of departments) and middle management show room for improvement in leadership in the decision making and in staff management considering the fast institutional growth.	The institution already includes regular meetings and delegation of power is gradually undertaken.
	Shortcoming in the HR management	Medium	Staff appraisal, training plan and recruitment process might be improved within a strategic framework. Incentive schemes and salary monitoring are areas to be addressed.	HR department has been split from the Administrative department and a new HR manager has been appointed.
	Head of Operation department overloaded	Medium-low	The operations department includes both credit and network management which, considering the current size, shows a certain overloading of multiple functions.	The Operations Department is nowadays under restructuring; a deputy Operations Manager will be appointed to oversee the branch network.
	Limited budgeting analysis and control function	Medium-low	Considering the volume of operations, analysis on the cost side (i.e. ABC analysis) is an area for improvement.	Since 4 months the institution has introduced the Financial control unit.

\* Relevance refers to the damage/loss brought about by negative events (associated to each risk factor) and to the probability that damage/loss eventually occurs.

AREA	Risk Factors	Relevance*	Key Points	Risk Mitigation
<b>2. Governance, Organization and Operational Risk</b>	Room for improvement in the risk management system	Medium	Risks are overall identified while monitoring and control are areas of improvement, especially within the financial risk management. ALM policies and procedures not fully detailed.	The institution has hired an external consultant to coach the risk management department.
	Shortcomings in the MIS	Medium	The branches data consolidation is time consuming. The software does not present the multicurrency facility. Shortcomings in reporting.	The Institution has just started the the process of installing a new software.
	Shortcomings in the assessment of the client repayment capacity	Medium-low	Assessment of clients do not include a cost structure on the clients business plan. The analysis on the agriculture loans is the same of other loans.	Loan officers and Chief Credit Unit together with BMs visit often the clients.
	Limited diversification of services	Medium-low	Products still do not bear a cross-selling approach as well as a consolidated package for the customer, in view of differentiating the spectrum offer from competitors.	Good flexibility of credit products
<b>3. Assets Structure Quality</b>	Concentration of cash and deposits in one bank	Medium-Low	54% of the total cash and deposits is placed at ACLEDA bank	Good reputation of ACLEDA bank, which has a capillary presence in HKL area of operations.
	High client drop-out ratio	Medium-low	Client drop-out is high and seems to be due for a limited share to competition. The accuracy of the drop-out formula presents scope for improvement	The client drop-out ratio is tracked by HKL and the reasons are analysed at branch and aggregate level
	Portfolio concentration in higher loan amounts	Medium	concentration of 14.3% of the total gross portfolio (above US\$ 5,000) in 1.7% of the total number of borrowers	Maximum portfolio share policy: 10% for US\$10,000-US\$20,000, 5% for >US\$ 20,000
	Lack of collateral diversification	Medium	The entire portfolio is backed by land and house collateral	There are legal constraints to recognize movable properties as collateral.
	Portfolio concentration in US\$	Medium-low	More than 80% of the portfolio is concentrated in US\$, creating a credit risk if the borrower cash flow is in a different currency	Widespread use of the US\$ in the Cambodian economy
	Small loan product bear the higher credit risk	Medium-low	Small loans show a lower portfolio quality in 2009 and 2010, possibly entailing a higher credit risk due to the strategy	Maximum portfolio share policy for small loans (US\$ 2,500-10,000) set at 50%

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AREA	Risk Factors	Relevance*	Key Points	Risk Mitigation
<b>4. Financial Structure and ALM</b>	Concentration of funding sources	Medium-low	The largest lender and the three largest lenders represent respectively 24% and 47% of the total liabilities as of Dec-10	22% of the total liabilities are due to the shareholders as of Dec 2010
	Concentration of time deposits	Medium-low	The holders of the 20 largest time deposits represent 64% of HKL time deposits and 14.7% of the total equity, indicating a certain concentration risk.	-
	Saving strategy effectiveness to be proved	Medium	Limited orientation to cross-selling to build a solid base of savers, key for liquidity. Time deposit bear a relatively high cost (interest rate 7.29% on average) and volatility.	The saving strategy may be reviewed in the short-medium term
	Basic liquidity management tools	Medium	Cash flow is partly fragmented. Gap analysis is not undertaken. With the introduction of savings the liquidity management becomes of critical importance.	Liquidity stands at acceptable levels. Limited volume of savings mobilized so far.
	Lack of a formalized contingency plan	Medium-low	Guidelines for a contingency plan becomes of critical importance considering the savings evolution.	Informally set with some players. On-going negotiation with ACLEDA bank for a credit PLAN.
<b>5. Financial and Operational Results</b>	Decreasing staff productivity	Medium	The higher growth pace of the staff no. compared to the growth of the operations entails a higher personnel expense ratio.	The new staff recruited in existing and new branches is expected to reach a higher productivity
	Constant downward of portfolio yield	Medium	The margin is decreasing along the years and may further reduce due to the market pressure and the SME strategy.	Some fee-based services (money transfer) have been introduced, but still limited.
<b>6. Business Plan and Financial Needs</b>	Lack of Consolidated Operational Plan	Medium-low	Lack of a consolidated operational plan including quantitative and qualitative objectives and responsibilities.	Departments are following an action plan based on specific timeframe.
	Lack of scenario analysis	Medium-low	Financial projections lack a scenario analysis, which is key under unexpected circumstances.	Projections elaboration follows a formalized decision making process.

\* Relevance refers to the damage/loss brought about by negative events (associated to each risk factor) and to the probability that damage/loss eventually occurs.

STRENGTHS	OPPORTUNITIES
<ul style="list-style-type: none"> <li>➤ Ownership structure and governance</li> <li>➤ Growing expertise of the management team</li> <li>➤ Large branch network</li> <li>➤ Portfolio quality</li> <li>➤ Capacity to attract funding</li> <li>➤ Profitability and sustainability</li> </ul>	<ul style="list-style-type: none"> <li>➤ Credit Bureau implementation</li> <li>➤ Unmet demand in the rural areas</li> <li>➤ Good demand from SME excluded from the banking sector</li> <li>➤ Saving mobilization</li> <li>➤ Recovery of the national economy</li> </ul>

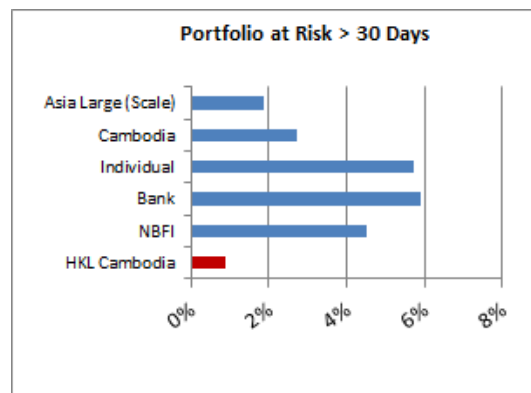
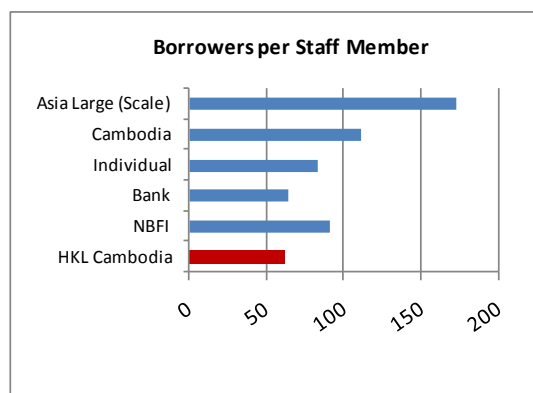
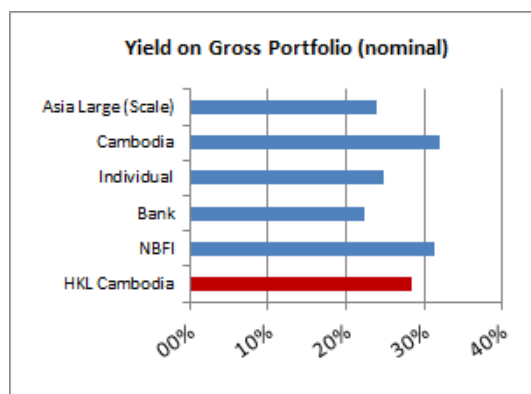
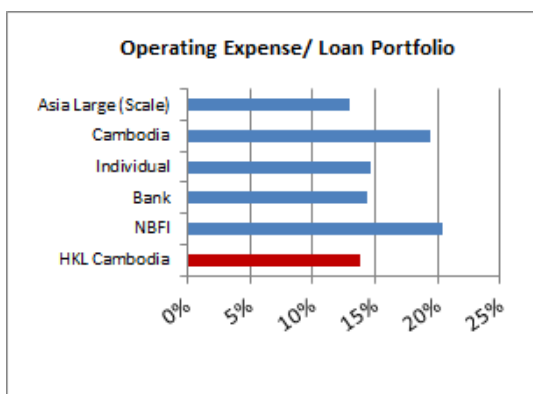
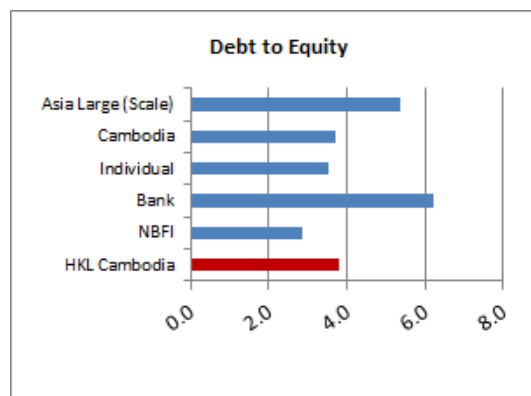
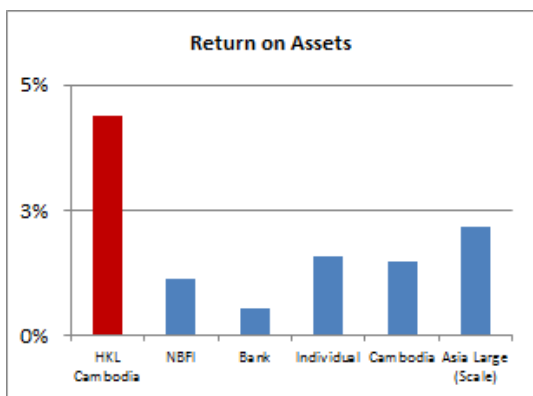
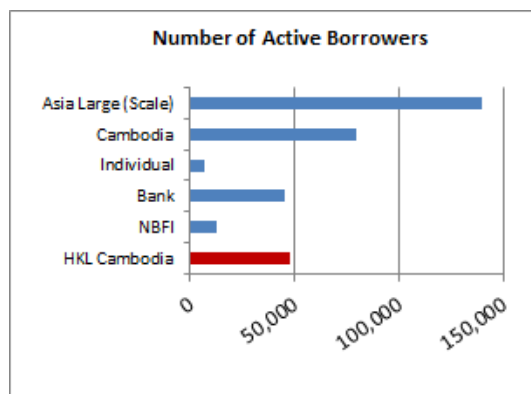
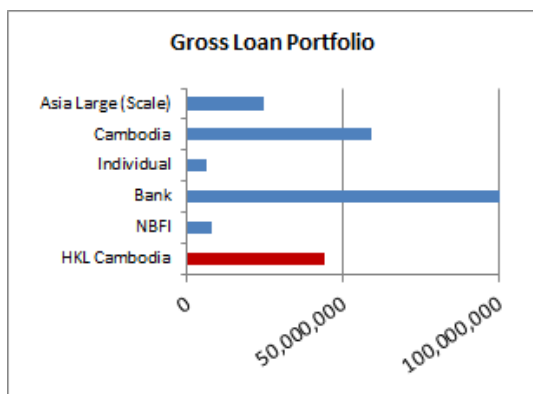
	Jan07-Dec07	Jan08-Dec08	Jan09-Dec09	Jan10-Dec10
<b>OUTREACH</b>				
Average disbursed loan size	725	823	934	1,122
Average outstanding balance	609	653	758	924
Average disbursed loan size on per-capita GDP	114.8%	103.2%	122.7%	137.1%
Average outstanding balance on per-capita GDP	96.4%	79.8%	99.7%	112.9%
Percentage of active borrowers women	72.2%	78.9%	77.4%	77.5%
<b>CROISSANCE (montant en devise nationale)</b>				
Growth of active gross portfolio	138.0%	105.1%	7.3%	42.1%
Growth of active borrowers	102.4%	91.2%	-7.5%	16.6%
Growth of active loans	102.4%	91.2%	-7.5%	16.6%
Growth of total assets	147.0%	120.4%	-7.2%	42.4%
Growth of staff	46.7%	74.6%	17.8%	52.2%
Growth of funding liabilities	205.3%	113.4%	-12.0%	49.8%
Growth of operating expenses*	na	84.4%	34.6%	45.3%
Growth of equity	50.9%	152.4%	11.4%	18.2%

na: not available



- Head Office
- Branches (see chapter 3 for details)

## Benchmarking <sup>1</sup>



<sup>1</sup> All figures of peer groups are referred to the MicroBanking Bulletin (MBB) and to the Microfinance Information Exchange (MIX) as of **December 2009**. The ratios of the rated MFI indicated here do not fully correspond to the ratios presented in the report as they are calculated according to the MBB methodology. The MBB adjusts the financial data to produce a common treatment for the effect of: a) inflation, b) subsidies, and c) loan loss provisioning and write-off (see MBB, Appendix I: Notes to Adjustments and Statistical Issues).

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## 1. External Context and MFI positioning

<b>Name of the MFI</b>	<b>Hattha Kaksekar Limited (HKL)</b>
<b>Legal Form</b>	Limited Liability Company
<b>Client typology</b>	Micro, small and medium businesses
<b>Year of inception</b>	1996 as NGO and transformed in 2001 in LLC
<b>Ownership</b>	See Chapter 2
<b>Audit Company</b>	KPMG (2008 - 2009) ; PricewaterhouseCoopers (Cambodia) Limited (2010)
<b>Rating Agency</b>	MicroFinanza Rating 2007; 2008
<b>Regulator / Supervisor</b>	National Bank Cambodia (NBC)
<b>Networks of reference</b>	Cambodia Microfinance Association (CMA)
<b>Area of Intervention</b>	Rural, peri-urban and urban clients
<b>Credit Methodology</b>	Individual lending

### 1.1 Institutional Background

HKL is a non-banking financial institution<sup>2</sup> legally operating in Cambodia according to the mandate received by the National Bank of Cambodia (NBC) in 2001 and subsequently, upgraded through the saving license obtained in early 2010.

HKL is operating in 15 provinces through a network of 29 branches, 15 sub-branches and 34 service posts and its lending activity is mainly devoted into the agriculture sector. The institution has been focusing on the upper low income population immediately above the low end market segment (mostly served with group loans) with a constant increase in the average disbursed loan size. Within this perspective, HKL offers individual loans defined as micro, small, medium and large credits, with the latter representing the intention of the institution to gradually cover also the SME market. As of December 2010 **HKL's outreach counts almost 48,000 active clients and active portfolio equal to US\$ 44.3 M.** Scaling up of operations has been enabled through both sound capitalization and attraction of borrowings from several international lending providers.

### 1.2 Country Risk: Political and Macroeconomic Context

After the 2008 general elections, the ruling Cambodian People's Party (CPP) confirmed its leading role in both central and local government with about 75% of total votes. CPP led by the prime minister, Hun Sen, will remain politically dominant over the 2011-12 forecast periods according to the EIU. Since taking full power over Cambodian affairs in 1998, the country's economy has grown at a remarkable rate despite outcries of corruption.

**Macro-economic performance recovered in 2010** after the serious setback in 2009 driven by poor exports of garments, smaller tourism receipts and weak inflow of FDI.

#### CAMBODIA

Macroeconomic Indicators	Dec07	Dec08	Dec09	Dec10
<i>Exchange rate in US\$ (end of period)</i>	3,999	4,077	4,165	4,222
<i>Exchange rate variation</i>	-1.4%	2.0%	2.2%	1.4%
<i>Inflation rate (average)</i>	7.4%	24.2%	0.6%	4.1%
<i>Inflation rate (end of period)</i>	14.0%	12.5%	5.3%	3.1%
<i>Deposit rate</i>	1.9%	1.9%	1.7%	1.3%
<i>Lending rate</i>	16.2%	16.0%	15.8%	15.6%
<i>Real GDP growth</i>	10.2%	6.7%	-2.0%	6.0%
<i>GDP per head (US\$)</i>	632	798	761	792

Source: International Finance Statistics, EIU

<sup>2</sup> HKL was established in 1996 as an NGO thanks to the initial support of OCS/OXFAM from Canada. HK NGO started its microfinance program in the Pursat province.

A rebound in tourism, cloth exports coupled with growth in agriculture contributed to a positive GDP growth of 6% in 2010. Industry (garment sector) played an important role in 2010, expanding by an estimated 11.6% (it had contracted in 2009). Tourism and agriculture followed with an increase respectively equal to 4.3% and 4.2%.

Bank lending to the private sector notably increased from 6.5% year on year at end-2009 to 27% in 2010, in line with the good economic performance. The riel appreciated by 1.4% against the US dollar over 2010.

In line with the recovery in domestic demand, inflation in 2010 averaged 4.0%, registering an increase vis-à-vis the low inflation levels in 2009. **30% of the population lived in poverty in 2007, with the majority of the poor and vulnerable living in rural areas.** There are indications that poverty has increased since 2007 as a result of sharply higher food prices in 2008 and the economic slowdown in 2009. A social protection strategy is expected to be launched this year, including programs such as free health care for the poor and the pilot testing of conditional cash.

**Forecasts for 2011 are positive and consolidating the 2010 figures.** GDP is projected to expand by 6.5% in 2011 and 6.8% in 2012. Growth in industry is projected at 10.8% in 2011, while construction by 3%. Offshore oil and gas production are planned to impact the GDP in 2012. Growth in services is expected to increase up to 5% in 2011.

Increase in prices will be triggered by the strengthening of domestic demand, generally expansionary fiscal policy, and higher global prices for food and fuel. Inflation is estimated to stand at 5.5% in 2011.

The high degree of dollarization of the economy (amounting to as much as 95% of currency in circulation) limits the effectiveness of monetary policy, which most likely should be tightened in response to the inflationary pressure.

Unexpected global economic weakness or sudden increase in oil prices could negatively impact on Cambodia's tourism and clothing exports and push up inflation. Tourism could also be affected by conflict on the border with Thailand.

### 1.3 Industry Risk: Financial System and Microfinance Sector

Microfinance in Cambodia began in the early 1990s with NGOs as first provider of microcredit to fill the gaps left by the banking sector. After the international recognition of a new Cambodian government in 1993, aid started to flow to the country and within the decade the initial experiments were transformed into a **sector led by profitable, regulated financial institutions.**

As of December 2010, there are **20 MFIs operating under licenses** from the National Bank of Cambodia (NBC) with operations in all 24 provinces of Cambodia. Cambodia Microfinance Association (CMA) regularly collects figures of 24 members. Overall, the Cambodian MF sector in Cambodia reached **1,217,371 borrowers** with a **total loan portfolio of US\$ 648 million.** The sector also serves **893,174 savers**, registering a 22% growth compared to 2009. 79% of savers are clients of ACLEDA Bank Plc., which has also the largest market share in the microfinance sector (34%). In terms of number of borrowers, as of December 2010 three institutions have reached more than 200,000 borrowers (AMK, ACLEDA and AMRET) and two more than 100,000 (PRASAC and VisionFund).

ACLEDA Bank Plc. has nearly US\$ 160 million in loans and 12 percent of the entire Cambodian banking systems' assets. Focusing on rural areas and small businesses, ACLEDA Bank has over fifty percent of the domestic microfinance market.

**After having registered a modest growth pace in 2009, microfinance portfolio has recovered good levels** passing from an increase of 12% y-o-y in 2009 to a more solid growth of 32% in 2010 even though lower than the one registered in 2008 (61%). Similarly, portfolio quality improved passing from a 4%-5% in 2009 to 1% in 2010. Alongside the increase of portfolio quality, **the risk of over-indebtedness has become an issue** with a phenomenon of multiple borrowings detected by MFIs. Cambodian practitioners stated a range between 10 and 30% of multiple borrowings in the areas

of operations. According to the data collected by the CMA, 8 provinces out of 24 have more than 9 lending providers (excluded ACLEDA Bank). As for HKL, only 11 out of 124 districts where HKL operates have 3 or less additional MFIs, while in the remaining districts more than 4 MFIs operate together with HKL. **Concentration of PAR results to be in Staung district (Kampong Tom) which sees the presence of 7 lenders.**

By the end of this year, the microfinance sector should have the credit bureau in place, which will be a partnership between IFC, NBC, CMA (with the 10% of shares) and the vendor itself (which has been already selected). Rules have not been designed yet.

Interest rates are gradually decreasing as well as operational margins of MFIs. Savings mobilization becomes of critical importance to lower the cost of funds, even though the licensed MFIs to collect savings are focusing the strategy on high interest rates on time deposits, which might exposes to some risk.

The microfinance sector in Cambodia appears to be split into two groups – those maintaining a focus on small-balance loans and outreach, and others working with a mixed product offering of micro- and SME-loans. Foreign borrowings still play a significant role in the MFI growth coupled with an increase in foreign equity injections. Specialized microfinance investors are relevantly present in the market, while local funding is still limited to some initiatives of ANZ bank.

Other issues remain to be addressed such as the fact that **land titles**, which are utilized by many MFIs as guarantee requirements, **are not fully available.**

CMA plays an important role in fostering local and international networks, promoting coordination and facilitating conflict resolution between institutions and promoting fair competition.

## 1.4 Regulatory Risk

In November 1999, NBC issued a **new law on banking and financial institutions**, followed in 2000 by a decree ('Prakas') **regulating the microfinance industry by licensing and registering major microfinance providers.** The prakas (2000 and 2002) marked **a shift towards the commercialization of microfinance (as limited liability company or cooperative) and its integration into the formal financial system** of Cambodia. Furthermore, on 18<sup>th</sup> December 2007, the National Bank issued a new Prakas regulating savings mobilization. Amongst the main requirements introduced by the decree, it is worth mentioning the need to have a minimum capital of US\$ 2.5 million and a liquidity ratio of 100%<sup>3</sup>.

Registered and licensed MFIs are submitted to a set of regulatory and supervisory provisions, out of which the main aspects are the following:

- **Licensing requirements:** a microfinance institution is required to be incorporated as a limited liability company or a cooperative.
- **Supervision:** registered MFIs need to submit quarterly reports including: financial statements, breakdown of loans/deposits by sector and currency; loan classification and delinquency ratio and network of branches and offices. No on site supervision is required for registered MFIs. Supervision activities are concentrated on licensed MFIs, which need to present monthly and annual reports including: audited financial statements, BOD annual report, statistics of staff and salaries; updated organization chart. Suspicious transactions should also be reported. Off-site supervision focuses on capital adequacy and loan performance. Yearly on-site supervision is planned for licensed MFIs.

The NBC has proven to be flexible and supportive towards the growing microfinance sector, **softening the capital adequacy (from 20% to 15% of total risk weighted**

<sup>3</sup> Calculated as liquid assets (cash in hand + deposit with NBC + deposit with banks + loans maturing in the next 30 days) over adjusted amount of deposits (25% of voluntary savings).

assets) and regulating the currency risk. In April 2008, the NBC implemented **new Charts Of Accounts** which is more similar to that of the banking sector. **HKL has implemented the new COA as a requirement to obtain the license for savings mobilization.**

**1.5 Local and Regional Risk: MFI Market Positioning**

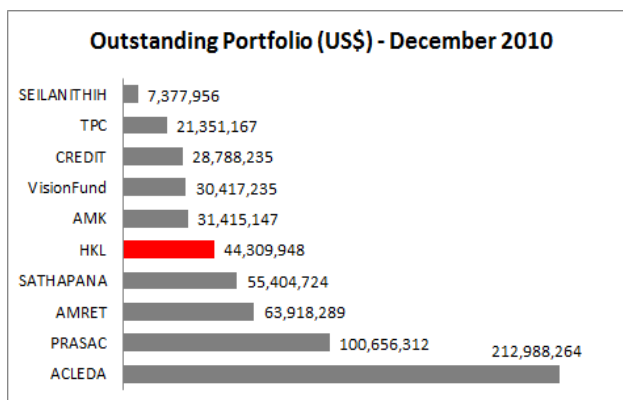
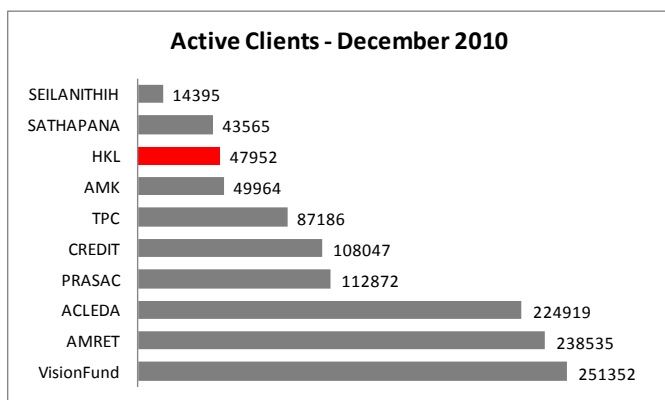
HKL is one of the major microfinance players in the country with a network of 29 branches, 15 sub-branches and 34 service posts located in 16 out of 24 provinces. The institution mainly operates in rural areas<sup>4</sup> targeting the market segment immediately above the poor population (mostly served through group loans) with a trend to expand the credit offer to lower SME market. This is reflected by a constant increase in the average loan size (see chapter 3).

Considering these peculiarities, HKL’s main competitors are PRASAC, SATHAPANA and ACLEDA which occupy the same target market in the same areas where HKL operates. Agriculture remains a core sector for HKL and at the moment it gives some competitive advantages.

Thanks to a consolidation in the branding strategy, HKL’s franchise value is increasing even though PRASAC and ACLEDA Bank globally result to be more recognized. The upward trend in the pyramid might expose the institution to increasing competitive pressure especially with ACLEDA Bank.

The main competitive advantages of HKL are:

- No service charges applied
- Interest rate on time-deposits higher than ACLEDA
- Long term loan compared to MFIs



<sup>4</sup> Rural is defined as all areas outside Phnom Penh and all main provincial cities.

## 2. Governance, Organization and Operational Risk

### 2.1 Ownership and Governance

HKL's governance is generally good and leverages on international shareholders with strong reputation, expertise in microfinance as well as capacity to financially support the institution growth.

HKL is a limited liability company licensed by the Central Bank in 2001 as microfinance institution and afterwards upgraded in January 2010 as Micro-Deposit Taking Institution (MDI). Through the recent license, HKL can mobilize savings and deposits from the public.

The initial paid-in capital worth US\$ 77,850 was subscribed by four shareholders (HK NGO, HK Staff Association, SIDI and an individual). After CORDAID invested in HKL in 2003, three new shareholders joined the institution in 2008 (OikoCredit, Norfund and Triple Jump)<sup>5</sup> delineating the current shareholder composition.

December 2010

Ownership	Paid-in		Premium	% shares
	Amount	Shares		
CORDAID	188,700	1,887		6.95%
DY DAVUTH	55,500	555		2.04%
HKSA	208,600	2,086		7.68%
HKNGO	543,900	5,439		20.02%
NORFUND	384,300	3,843	403,515	14.15%
OIKOCREDIT	544,000	5,440	571,200	20.02%
SIDI	407,500	4,075	67,725	15.00%
TRIPLE JUMP	384,300	3,843	403,515	14.15%
<b>Total</b>	<b>2,716,800</b>	<b>27,168</b>	<b>1,445,955</b>	<b>100.00%</b>

HKL shareholder structure is in the process of being changed with the exit of CORDAID which sold its shares – in equal parts – to NORFUND and TRIPLE JUMP. The registration of the new shareholder structure is still under approval of the NBC. Besides, HKL shareholder's structure could change with the entrance of a new shareholder which will support the equity expansion of USD 5 Ml planned for 2011, which needed to face the expected growth of 40%. The new shareholder has not been identified yet. The entrance of the new shareholder will change the current share composition with HK NGO, HKSA and SIDI diluting their percentages.

#### Board of Directors (BoD)

Members	Charge	Background and current profession
<i>Mr. Erik Peter Geurts</i>	Chairman	Mr. Geurts has been recently appointed as Chairman and represents Triple Jump. He has extensive experience in microfinance and equity investments.
<i>Ms. Dominique Marcon</i>	Member	Ms. Marcon represents SIDI. She has thorough experience in microfinance and combines financial and social expertise.
<i>Mr. Hout Iengtong</i>	Member	Mr. Tong is the current CEO of HKL and founder of HKL. He represents the HKL NGO. He has extensive experience in management.
<i>Mr. Dy Davuth</i>	Member	Mr. Davuth is a private shareholder with experience in microfinance.
<i>MR. Christoffer Christensen-Roed</i>	Member	Mr. Christensen-Roed represents Norfund where he works as Investment Director. He has extensive banking and investment experience.
<i>Ms. Tahira Donkersloot</i>	Member	Ms. Tahira represents OIKOCREDIT where she works as equity investment officer. She has extensive banking experience.
<i>Mr. Lonh Hay</i>	Member	Mr. Hay worked with the National Bank of Cambodia for over 25 years and his last position before retiring was Deputy Director General and Advisor to the Governor.

Board of Directors' composition is adequate and well balanced between financial and

<sup>5</sup> The three new shareholders entered HKL capital paying a premium on each share. Indeed the initial nominal value of the shares was US\$ 100 while the newly subscribed shares were worth US\$ 205 including a premium of US\$ 105 per share.

**social orientation.** The General Manager (GM) - who represents the HK NGO – sits in the Board with voting right denoting a certain degree of concentration of power as he also acts as Chairman of HK NGO<sup>6</sup> Board of Trustees. However, the shareholders and BoD members are aware of a situation not properly in line with best practices and clear policies and procedures to avoid conflict of interest are in place. On the other hand, the presence of the CEO and HK NGO ensures a strong commitment in the activities of HKL as they represent the foundations of the institution. With a formalized and complete shareholder agreement, the BoD adequately regulates all the possible disputes and conflict of interest including the decision on borrowing from shareholders which at the same time are active lenders for the institution.

BoD meetings are held three times a year with a comprehensive analysis on the institutional development which benefits from a good communication flow – enabled by a satisfactory reporting – between the management and the BoD members. Committees at board level facilitate a pro-active feedback loop in the risk management framework as well proved in 2009 and at the beginning 2010 in concomitance with the global economic downturn. The Internal Audit Department reports to the BoD IA three times a year highlighting a good information and communication flow.

The CEO is formally and regularly evaluated on yearly basis.

## 2.2 Management and Decision Making

HKL relies on a committed management team which combines both growing expertise and deep knowledge of the microfinance context thanks to several years spent in this field.

**The decision making process is acceptable with a sufficient involvement of the key managers.** The CEO together with all the heads of department meet once a month and progress analysis is made based on extensive reporting. Nevertheless, the top management - especially the position immediately below the CEO - in our opinion, need to grow in terms of leadership and centre of responsibilities (see below), which would render more effective the delegation power.

This, in fact, exposes the institution to some key person risk – in the CEO position - which, given the size of the institution, need to be taken into consideration.

## 2.3 Organization and Structure

**Organizational structure is generally adequate** with an effective balance between decentralization and control which has so far ensured a sound growth. However, the institution has reached a critical size which would require some consolidation.

**HKL organizational structure still results to be rather flat** with a reporting line directly centralizing the majority of the information in the CEO position. The institution is aware of such a situation and has informally assigned to the Deputy Manager and to the Assistant to the General Manager the coordination of the financial and HR management and of the administrative, MIS and risk management respectively.

The HR department has been recently split from the administrative one and in November 2009 a risk manager has been appointed.

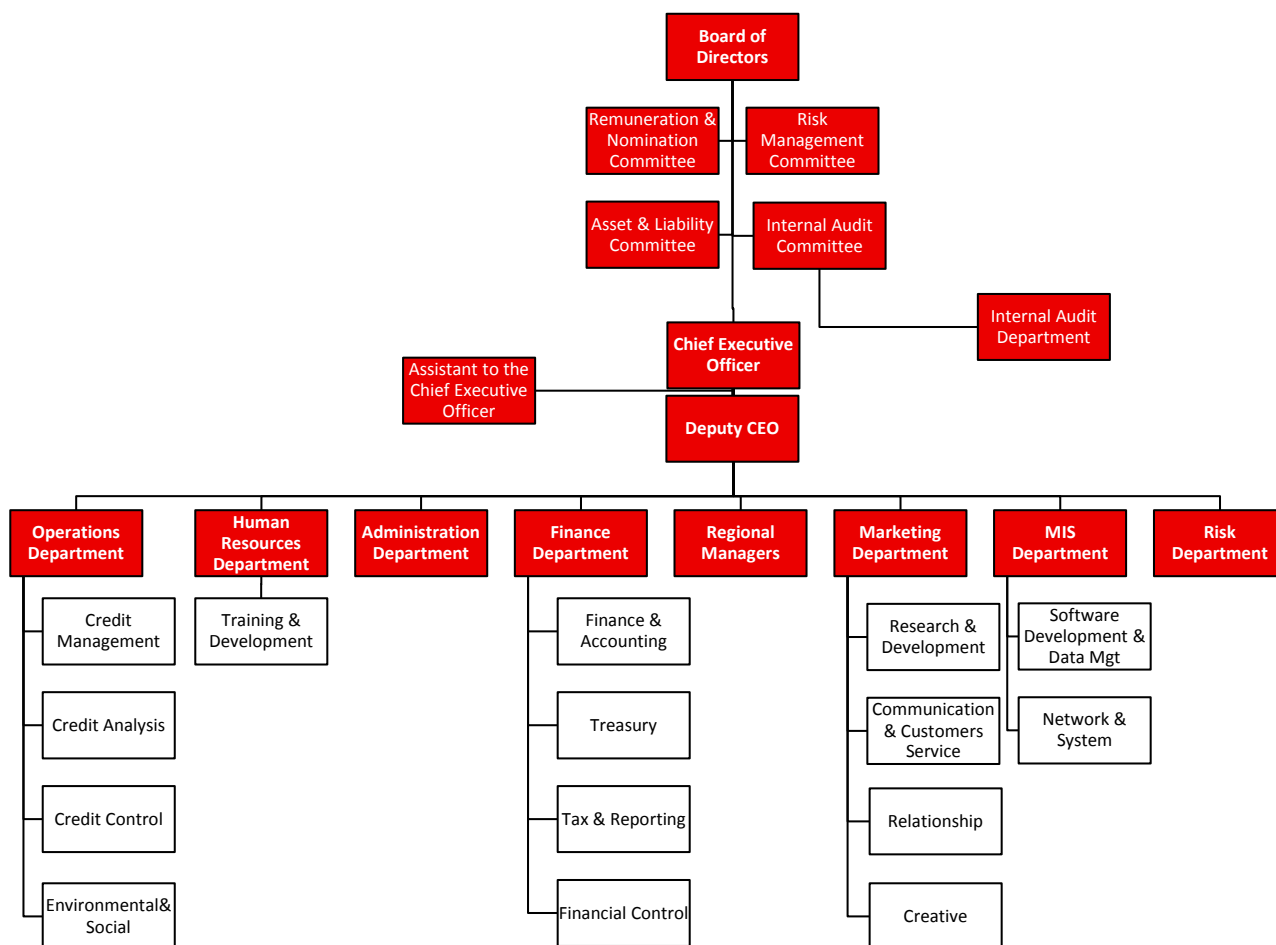
Overall, accountability infra-department is adequate, even though the credit department (and particularly the Head of the department) results to be overloaded with multiple functions as in particular it includes credit and network operational management.

The network operations formally report directly to the CEO highlighting a **lack of a key manager**, considering the size of the wide network. Branches are treated as cost centers and good communication flow is ensured by regular meeting in the branch and with the HQ. **Analysis for cost centers and profits (i.e. departments and products) is**

<sup>6</sup> HK NGO is the founder organization of HKL and currently it is only operating as investor in HKL without operations.

**quite basic.** The institution has recently introduced a Finance Control to improve this area.

The Legal Unit actively collaborates with the operations department in terms of supporting the delinquent loans’ recovery.



## 2.4 Human Resources (HR) and Staff Policy

**Human resources in HKL are characterized by an adequate level of expertise in the core business.** However, the new exposure on savings mobilization would require a consolidation of the financial and marketing skills both at top and middle management. Furthermore, the strategy to expand the SME lending would require credit staff to improve their credit analysis in this specific sector.

HR department has been just recently endowed with a dedicate HR Manager whom primary purpose is to focus on HR management rather than administrative (as mainly performed so far).

Staff enjoys an overall good commitment to the institution’s goals and frequent internal promotion demonstrates a feasible carrier development within the institution.

Staff turnover has decreased over the last three years, standing at 8% as of December 2010. The rapid growth in 2008 both in terms of portfolio (105%) and personnel (71%) has affected the turnover ratio.

As of December 2010, HKL’s human resource is composed of 786. Staff growth is in line with operations evolutions over the last three years. Given the business model, staff allocation ratio is adequate showing a good balance of the credit and other staff.

Personnel	Dec07	Dec08	Dec09	Dec10
<b>Total</b>	<b>248</b>	<b>433</b>	<b>510</b>	<b>776</b>
<i>Loan officers</i>	110	210	249	394
<i>Other staff</i>	138	223	261	382
<b>Staff allocation ratio</b>	<b>44.4%</b>	<b>48.5%</b>	<b>48.8%</b>	<b>50.8%</b>
<b>Staff turnover</b>	<b>21.6%</b>	<b>17.3%</b>	<b>12.5%</b>	<b>8.4%</b>

HR policies and procedures are adequately formalized. However, staff appraisal, training plan and recruitment process seem not to be included in a strategic framework, which nowadays is under the responsibility of the new HR manager. Among the main procedures, training plan is one of the priorities for HKL, considering the **fast growth and the need of quickly upgrading personnel**. At the time of the rating visit, the HR department was collecting feedback from a first training needs assessment.

Salary levels compared to the main competitors (mainly the top MFIs and ACLEDA) remain a challenge. A systematic mapping and monitoring on the salary level in the sector becomes of critical importance in order to face staff turnover. The incentive scheme based on quantitative parameters is not realistically achievable, limiting the motivation of the credit staff (only 13% of the credit staff receives a bonus based on its performance).

## 2.5 Risk Management, Internal Control and Internal Audit

### **Risk management approach can be improved given the size of the institution.**

Financial risk management represents an area for improvement considering the increased number of borrowings and the expansion of deposit saving accounts.

Risk management has been upgraded by a risk manager appointed in November 2009, who is in the process of strengthening the operational risk management thanks to the support of an external consultant. While credit risk management is adequately controlled and monitored, other financial risks and operational risks are not based on a risk culture approach yet. The financial Manager together with the risk manager needs to improve in this area. ALCO has been set up but monitoring and control are not fully effective yet (e.g. the institution still lacks appropriate tools).

**Internal control system is adequate.** Segregation of functions is in place at field level and the decentralization of credit decisions is well balanced by a good internal audit system. There is a limited cash handling in delinquent loan collection which exposed the institution to few fraudulent staff activity (characterized however by low relevance). The institution has drafted a fraud prevention manual, which is improvable especially in reference to the staff frauds contingency plan.

Overall, **processes and procedures are adequately formalized**, even though risk management and HR policies can be improved. Transactions are adequately formalized with cash limits appropriately defined.

**Internal Audit (IA) department is adequate.** The department is well staffed with regular visits conducted both a branch and HQ level (at least 4 times a year). Checks – which cover transaction, IT and accounting audit - and reporting are based on flow processing analysis, while the IA functions is not still oriented on preventive controls, but mostly limited in controls. Effectiveness on findings follow-up is regular tested.

## 2.6 Information Technology (IT) and Management Information System (MIS)

**HKL MIS/IT's capacity is limited considering the volume of operations and the capillary network.**

MicroBanker is the current system for loan tracking and accounting management which is fully decentralized at branch level through 42<sup>7</sup> databases dislocated in the branches. Weekly (for portfolio) and monthly (for FSs) reconciliations are quite time-consuming and not completely safe as performed in Excel. The saving module is quite rigid, which also hampers the upgrading of the saving methodology. Reporting capacity is adequate through customized template in Excel facilitated by the Support Loan Application (SLA) installed.

Back-ups are regularly and systematically kept in HQ and outside (under the responsibility of the CEO). At branch level, information is burned in CDs and weekly submitted to the HQ.

HKL is moving towards a corporate banking system, which has been tentatively identified. By 2012, the roll out of the system is expected with a budget already discussed of USD 1.2 Ml. Connectivity remains an area to be tested.

## 2.7 Supervision Compliance, Contingencies, External Audit and Accounting Policies

Accounting policies are adequate and almost in line with International Accounting Standards.

Over the period of analysis (2008 and 2009) HKL's financial statements were **audited by KPMG. Auditors expressed a fair opinion on the Financial statements** for all the periods of analysis. HKL accounting policies and reporting are compiled according the **Cambodian Financial Reporting Standards** and and the guidelines of the National Bank of Cambodia. The functional currency is expressed in USD.

The institution is supervised by the NBC and liquidity, solvency and net open position in foreign currency should be maintained on a daily basis and reported to the NBC on a monthly basis. **The institution has not encountered compliance problems so far.**

For 2010 the institution's FSs have been audited by PricewaterhouseCoopers (Cambodia) Limited. The final report at the time of the rating visit was not published yet.

## 2.8 Credit Products and Policies (Annexe 6)

HKL offers individual loans through 4 products according their loan size range (see annex 6 for details). Repayment conditions are flexible and clients might opt for a monthly, balloon or semi-balloon (where interests are paid monthly) amortizations. All loans can be disbursed in KHR, THB or USD even though the latter have lower interest rates by 0.5% on a monthly basis. Loans do not have any service charge, but are linked to monthly compulsory savings. However, the institution is planning to phase out the compulsory saving and gradually replace them through voluntary saving accounts in order to be aligned with competitors. In general, loans bear a monthly interest rates ranging between 2 and 3.5% according to the size. Pre-repayments are allowed with 50% interest charged if the pay off occurred in the first three months of the credit lifespan.

Overall, **the credit offer is still limited considering the level of competition** (especially triggered by top MFIs and ACLEDA Bank). Products such as housing and consumption might be launched by 2011 even though the no timeframe has been defined yet.

Large loans are increasing and specialized loan officer are currently dedicated. HKL plans to expand the SME lending even though a specific credit has not been tailored.

Loan to employees (management and staff) are offered with favourable conditions, including housing credits. Terms are formalized in the credit manual and interest rates range between 10-12% (for management) and 11-15-6% (for staff).

<sup>7</sup> Branches might have up to three databases according to the three currencies used (USD, KHR, THB).

As many competitors, HKL request for almost all the portfolio land title as collateral. Soft land titles are the most common among clients, even though duplicated copies are quite common, exposing the institution to risk of multiple borrowings.

Only 19% of loans are secured by “hard” land titles while the remaining loans are secured by semi-official land titles.

Portfolio is therefore strongly concentrated in one type of collateral, whose enforcement is quite long, while the institution did not experience cases so far. The Marketing department is exploring the opportunity to deal with also movable property as collateral.

## 2.9 Credit Procedures

Credit procedures are included the credit manual, even though the different loan processes’ formalization and detail are areas of improvement.

**Disbursement procedures are globally effective.**

Clients’ ability to repay the loan is adequately analysed although between 1,000 and 2,500 the cost-revenue analysis is not sufficiently detailed.. Limits to level of credit risk by product, by repayment frequency, by sector are given.

Loan approvals are well decentralized at sub-branch (up to USD 2,500), branch (up to USD 5,000) and head office (up to USD 20,000) and credit committee composed of senior staff in the field cross-checks the clients’ capacity to repay, even though without formalized meetings.

Loan processing and disbursement time is rapid, that is 2 days for micro and small loans and 3 days for medium loans. The application process is smooth. Loan transactions are carried out at the branches, limiting the cash handling only on collection of delinquent credits.

Client **monitoring** undertaken after disbursement is adequate with periodical visit and a system of control ensured by the presence of loan supervisor (in the big branches) and the credit chief unit. Within two weeks use of the loan should be checked according to a formalized procedure. **Follow up on late loans is acceptable** and based on close monitoring of delinquent clients. However, delinquency management need to be better formalized within the credit manual.

## 2.10 Savings and Other Financial Services (Annexe 6)

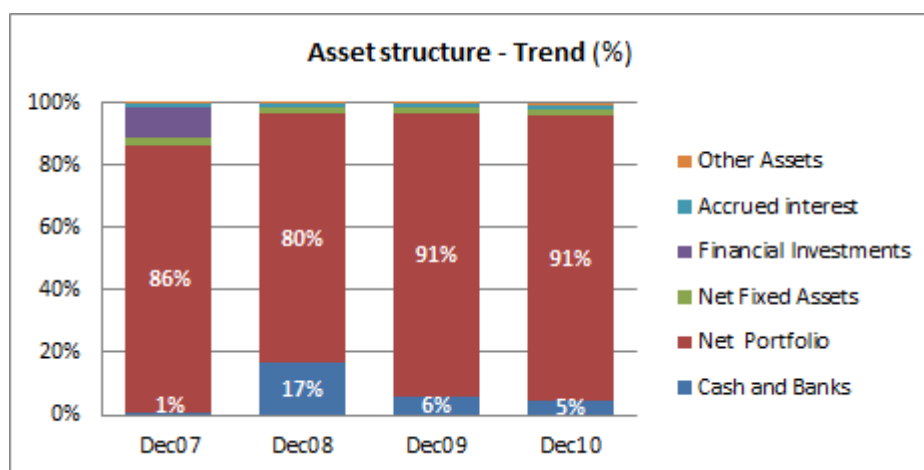
Since January 2010, HKL is legally allowed to mobilize savings from the public. Product offer variety is adequate for the current volume of deposits. However, the institution still has to leverage its network, especially in reference with saving accounts (they account only 3% of the total savings). As of December 2010, 97% of the deposit accounts are compulsory savings linked to loans, even though HKL is planning to phase them out. High-income time deposits mobilized amount for 48% of total outstanding saving balance. This type of product allows clients to earn interest on a monthly basis, while the fixed capitalized time deposits (which have not been offered in 2010) allow clients to earn interests at the end of deposit term. VIP Savings have been launched only recently and are especially aimed at Phnom Penh clients who deposit a considerable high amount and a special customer care will be dedicated to them. Planned deposits can be accumulated throughout the term of the deposit agreement.

Overall, interest rates on time deposits are higher than those offered by banks and competitive with MDIs. This exposes the institution to an increasing cost of funds and higher volatility vis-à-vis a financial resource which should be less volatile and less expensive.

### 3. Assets Structure and Quality

#### 3.1 Assets Structure

The concentration of the assets in the net loan portfolio is good and shows a positive trend, reaching 91.5% as of December 2010, and 92.9% on average during 2010. The liquidity level is prudential as compared to the still limited saving mobilization, in compliance both with the NBC limit and the internal policy<sup>8</sup>. The excess liquidity registered during 2009 (16.6% on average, 24% as of March and June) is due to the gap between the demand of credit, reduced by the global crises, and the loans received from lenders based on previous agreements. The strategy to manage the excess liquidity focused on placements in banks, with an acceptable yield<sup>9</sup>. 54% of the total cash and banks is placed at ACLEDA bank, reflecting the large network of the bank but also representing a concentration risk.



#### 3.2 Portfolio Structure, Seasonality and Concentration Risk

After the extremely high levels registered in 2007 and 2008, the growth of the gross loan portfolio dropped to 7.3% in 2009 as a result of the lower demand, while recovering a high pace in 2010 (42%)<sup>10</sup>. The portfolio growth in 2009 was possible in spite of the total assets' contraction (-7.2%) and thanks to the significant reduction of the liquidity level. The lower growth in the number of borrowers (16.6% in 2010) is reflected in the increasing average loan size. The micro loans share of the portfolio has been constantly decreasing from 30% in 2008 to 26% in 2009 and 21% in 2010.

Portfolio Features	Jan07-Dec07	Jan08-Dec08	Jan09-Dec09	Jan10-Dec10
<b>Gross outstanding portfolio (US\$)</b>	<b>14,165,336</b>	<b>29,050,403</b>	<b>31,180,474</b>	<b>44,309,948</b>
Micro	4,690,247	8,726,039	8,021,868	9,186,187
Small	4,632,675	9,232,460	11,163,525	16,188,248
Medium	4,842,414	11,091,905	10,999,809	16,068,189
Large	0	0	995,273	2,867,324
<b>Growth of gross portfolio (US\$)</b>	<b>138.0%</b>	<b>105.1%</b>	<b>7.3%</b>	<b>42.1%</b>
<b>Av. disbursed loan amount (US\$)</b>	<b>725</b>	<b>823</b>	<b>934</b>	<b>1,122</b>
<b>Av. disbursed loan size/GDP pc</b>	<b>115%</b>	<b>103%</b>	<b>123%</b>	<b>137%</b>
<b>Number of active borrowers</b>	<b>23,253</b>	<b>44,467</b>	<b>41,110</b>	<b>47,952</b>
<b>% of active borrowers women</b>	<b>72.2%</b>	<b>78.9%</b>	<b>77.4%</b>	<b>77.5%</b>
<b>Drop-out ratio</b>	<b>46.0%</b>	<b>48.2%</b>	<b>60.6%</b>	<b>43.1%</b>

Discontinuing the group loan methodology in 2009 contributed to the drop in the number of active borrowers (-7.5%), as well as to the client drop-out ratio peak of

<sup>8</sup> Liquid assets / 25% total voluntary savings > 50% according to the NBC, and > 120% according to HKL policy.

<sup>9</sup> Average yield worth 3.58%.

<sup>10</sup> According to updated information received after the visit to the institution, the portfolio and the borrowers grew respectively by 16% and 6% in the first quarter 2011.

60.6%. Client drop-out is high<sup>11</sup> over all the periods and seems to be mainly due to resting and in some cases competition. The higher loan amount exposes HKL to an increasing risk of competition from ACLEDA bank, partly reflected in the client drop-out rate. The client drop-out ratio is tracked by HKL, even if the accuracy of the formula may be improved<sup>12</sup>, and the reasons are analysed at branch and aggregate level.

HKL depth of outreach is intermediate in terms of poverty profile of the borrowers, as confirmed by the average disbursed loan size/GDP pc (137% in 2010). HKL mainly operates in areas with a high concentration of microfinance providers, suggesting a **moderate financial inclusion** of the segment without access to formal financial services. The expected decrease in the micro loans is likely to reduce the share of target population among the clients (low income). However, the **large rural coverage, female outreach, the prevalence of productive activities (81%) financed and of micro-entrepreneur loans (58%)** are currently in line with the social mission.

The product diversification is satisfactory<sup>13</sup>, even if the growing share of small and medium loans (37% of the outstanding portfolio each), with larger credit exposure per borrower, increases the concentration risk. The concentration of 14.3% of the total gross portfolio (above US\$ 5,000) in 1.7% of the total number of borrowers, coupled with some room for improvement in the loan repayment analysis (see chapter 2), represents a factor of higher credit risk.

The composition of the portfolio by sector and district is adequate, without significant concentrations, and in line with the risk limits approved by the BoD. The seasonality impact of the agricultural cycle on the loan portfolio is marginal thanks to the mitigation effect of other sectors, particularly trade. However, the share of agriculture portfolio has been increasing from 27% in 2008 and 2009, to 34% in 2010 (40% is the maximum set by the BoD). The share of portfolio financing non-productive activities (Household expenses) is 13% as of December 2010.

**The concentration in US\$ denominated portfolio (83%)** generates some credit risk due to the possible different currency of the borrower activities<sup>14</sup>. The risk is mitigated by the widespread use of the US\$ in the Cambodian economy.

### 3.3 Portfolio Quality and Credit Risk

With a PAR30 worth 0.9%, the **portfolio quality has recovered good standards** in 2010<sup>15</sup>, after the deterioration experienced in 2009 due to the global crisis, also thanks to the increased growth pace in 2010. However, the concentration in the older ageing categories together with the higher write-off ratio in 2009 and 2010 indicate larger loan recovery difficulties in the last two years.

<sup>11</sup> MIS over-estimates new clients, including the existing clients who pass to a different currency or from a sub-branch to a branch.

<sup>12</sup> Considering as drop-outs the clients who do not renew the loan within one month may be too short to reflect the real drop-out.

<sup>13</sup> Policy on maximum portfolio shares: 50% small (US\$ 2,500-10,000), 10% medium (US\$ 10,000-20,000) and 5% large (> US\$ 20,000). The remaining share is represented by micro loans.

<sup>14</sup> Even if the borrower can choose between KHR, US\$ and THB, the lower interest rate for loans larger than US\$ 1,000 in US\$ compared to KHR may represent an incentive towards US\$ denominated loans, regardless of the borrower activity.

<sup>15</sup> According to updated information received after the visit to the institution, PAR30 and PAR90 slightly improved to respectively 0.75% and 0.71% as at March 2011.

Portfolio Quality Indicators	Jan07-Dec07	Jan08-Dec08	Jan09-Dec09	Jan10-Dec10
<b>PAR 1</b>	0.3%	0.9%	3.1%	0.9%
<b>Consolidated PAR30</b>	<b>0.2%</b>	<b>0.5%</b>	<b>3.1%</b>	<b>0.9%</b>
<b>Consolidated PAR90</b>	<b>0.1%</b>	<b>0.1%</b>	<b>2.9%</b>	<b>0.9%</b>
31-60	0.1%	0.3%	0.1%	0.0%
61-90	0.0%	0.1%	0.1%	0.0%
91-180	0.0%	0.1%	0.7%	0.1%
181-365	0.0%	0.0%	2.0%	0.3%
>365	0.0%	0.0%	0.2%	0.4%
<b>Arrears rate (&gt; 30 days)</b>	0.1%	0.2%	2.3%	0.8%
<b>Restructured portfolio</b>	0.0%	0.0%	0.0%	0.0%
<b>Provision expense ratio</b>	0.8%	0.3%	4.0%	1.2%
<b>Loan loss reserve ratio</b>	1.1%	0.7%	2.8%	1.7%
<b>Risk coverage ratio (30 days)</b>	501.4%	131.5%	92.2%	184.0%
<b>Write off ratio</b>	0.0%	0.1%	1.7%	1.6%

The main reasons for the higher delinquency in 2009 are the lower income of the clients, affected by the business failure and loss of jobs, coupled with excessive debt borrowed from multiple sources in some cases. The **risk of client over-indebtedness** in Cambodia is **relevant**, especially in some districts, and may be the reason for the higher PAR especially in the Staung branch. On the other hand the higher portfolio quality in 2010 has been achieved through the improved loan recovery in the older branches with the larger PAR (Pursat, Staung, Siem Reap), as well as to the lower PAR in the new branches. In spite of the good progress made in 2010, three branches still account for 38% of the portfolio amount at risk as of December 2010: Pursat, Dangkor and Battambang.

The risk coverage ratio is appropriate in all the periods, with the exception of 2009. The entire portfolio is backed by land and house collateral. The **limited collateral diversification** and the **difficult access to collateral** due to the legal constraints<sup>16</sup> hamper the loan recovery cost-effectiveness.

By sector	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR > 30 weighted
<i>Trade</i>	15,366,331	34.7%	25.7%	1.0%	0.4%
<i>Service</i>	4,603,955	10.4%	8.3%	0.7%	0.1%
<i>Agriculture</i>	15,186,867	34.3%	47.4%	0.8%	0.3%
<i>Other</i>	9,152,795	20.7%	18.6%	0.9%	0.2%
<b>TOTAL</b>	<b>44,309,948</b>	<b>100%</b>	<b>100%</b>		<b>0.9%</b>

No particular credit risk concentration is observed in the portfolio breakdown by sector, districts and loan term. However, the Khampong Chang branch seems to show more difficulties than the average in controlling the portfolio quality and achieving the critical size for sustainability.

<sup>16</sup> Multiple certificates of land issued by local authorities, lengthy and expensive legal processes.

Branch	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR > 30 weighted
HEAD OFFICE	348,566	0.8%	0.1%	0.00%	0.00%
PURSAT	2,169,961	4.9%	7.6%	2.66%	0.13%
STAUNG	1,028,475	2.3%	3.5%	2.60%	0.06%
SIEM REAP	3,870,414	8.7%	6.2%	0.81%	0.07%
STENG SEN	2,365,553	5.3%	6.9%	0.00%	0.00%
BANTEAY MEANCHEY	3,834,562	8.7%	7.8%	0.20%	0.02%
PHNOM PENH	2,338,809	5.3%	2.3%	0.38%	0.02%
KAMPONG CHAM	3,168,060	7.1%	9.1%	0.53%	0.04%
BATTAMBANG	2,921,149	6.6%	6.1%	1.58%	0.10%
KHAMPONG CHANG	584,411	1.3%	2.3%	3.07%	0.04%
TAKEO	1,840,054	4.2%	4.5%	0.15%	0.01%
PREY VENG	1,831,210	4.1%	3.9%	0.42%	0.02%
DANGKOR	2,339,149	5.3%	3.2%	2.10%	0.11%
TBONG KHMUM	1,229,176	2.8%	3.1%	2.01%	0.06%
DAUN PENH	1,716,346	3.9%	2.3%	1.68%	0.06%
TAKHMAO	2,089,013	4.7%	3.9%	0.35%	0.02%
SORTNIKUM	885,852	2.0%	2.6%	0.81%	0.02%
CHIKRENG	920,821	2.1%	3.0%	0.86%	0.02%
POIPET	2,054,423	4.6%	3.8%	0.23%	0.01%
SVAYRIENG	695,321	1.6%	1.5%	0.00%	0.00%
POUK	1,061,278	2.4%	2.4%	1.77%	0.04%
BARAY	2,069,067	4.7%	7.4%	0.41%	0.02%
BAKAN	1,517,455	3.4%	3.6%	0.91%	0.03%
MEMUT	1,024,546	2.3%	2.2%	0.10%	0.00%
MUK KAMPUL	406,279	0.9%	0.7%	0.40%	0.00%
<b>TOTAL</b>	<b>44,309,948</b>	<b>100%</b>	<b>100%</b>		<b>0.9%</b>

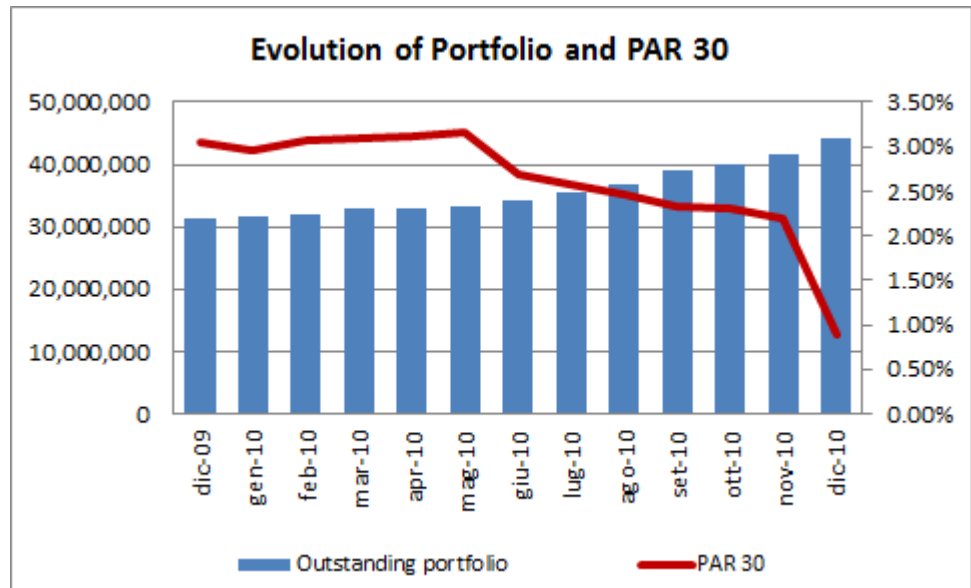
  

By term	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR > 30 weighted
0 - 6 months	231,870	0.5%	1.3%	0.2%	0.0%
6 - 12 months	10,477,417	23.6%	57.8%	0.9%	0.2%
12 - 24 months	27,218,887	61.4%	38.1%	1.1%	0.7%
> 24 months	6,381,775	14.4%	2.8%	0.0%	0.0%
<b>TOTAL</b>	<b>44,309,948</b>	<b>100%</b>	<b>100%</b>		<b>0.9%</b>

The portfolio share allocated to large loans is still limited (6.5% as of Dec 2010), mitigating the risk due to loan amounts larger than US\$ 10,000. However, the small loan product proved to bear the highest risk in times of crises (PAR30=4.4% as of Dec 2009), and still shows a lower portfolio quality, indicating that the strategic orientation towards small loans may gradually increase the credit risk.

Loan Product	% of outst. portfolio	% no. of borrowers	PAR > 30 days	PAR > 30 weighted	PAR > 1 day	PAR > 1 weighted
Micro	20.7%	57.8%	0.9%	0.2%	0.9%	0.2%
Small	36.5%	29.5%	1.2%	0.4%	1.2%	0.5%
Medium	36.3%	12.2%	0.7%	0.3%	0.7%	0.3%
Large	6.5%	0.5%	0.0%	0.0%	0.0%	0.0%
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>		<b>0.9%</b>		<b>0.9%</b>

The increasing PAR>30 along loan cycles (0.4% first, 1.1% second, 1.2% third, 1.5% >third) may be related to a less accurate repayment capacity analysis of repeated clients to issue larger loan amounts.



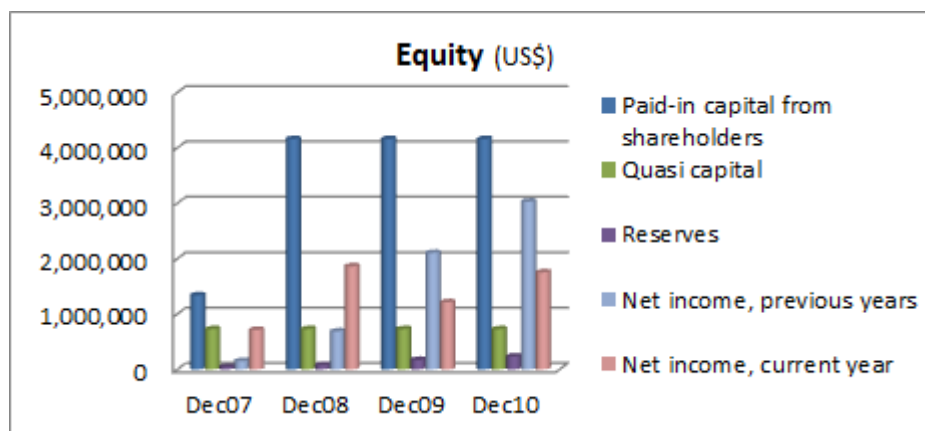
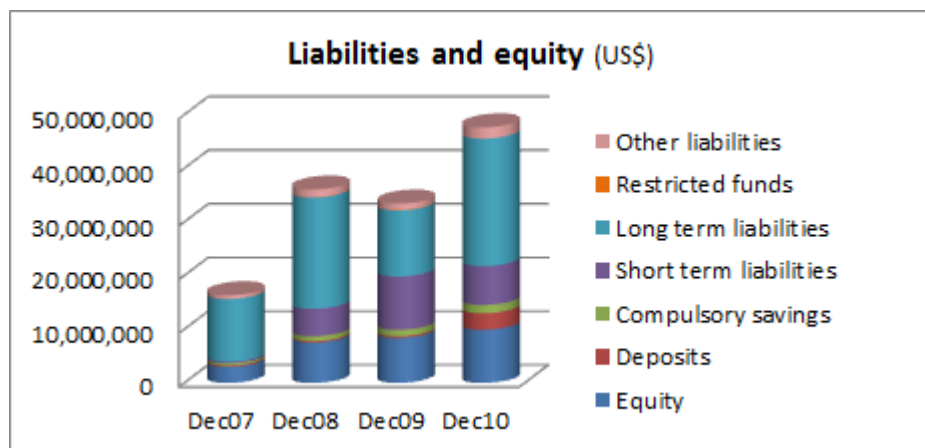
The analysis of the monthly performance evolution during 2010 shows a constant decreasing trend of the PAR 30. The portfolio growth plays a large role in the evolution of the PAR30 (see graph), due to the lower inherent likelihood of young loans to fall into arrears. Despite the positive trend, the PAR volatility is not ruled out due to the persisting risk of client over-indebtedness in the market and the indicator sensitivity to the changes in the growth pace.

## 4. Financial Structure and Assets and Liabilities Management

### 4.1 Equity and Solvency Risk

Considering the company risk profile, HKL solvency is considered overall satisfactory, showing a proactive capacity to accompany the growth of funding and absorb unexpected losses. HKL shows an **acceptable capital adequacy** as of December 2010, with CAR worth 17.1% according to the NBC criteria<sup>17</sup>, in line with the legal requirement (minimum 15%) but below the risk limit set by the BoD (20%). The Equity to Assets ratio shows similar levels at the end of 2008 and 2010 (20.9% and 20.8%) while the peak registered in 2009 (25.1%) reflects the decrease of total liabilities (-12%) due to the slowdown of the operations. After the last capital injection in 2008, the equity growth has been mainly supported by the capitalization of 80% of the net income. The pay-out ratio for the owners has been equal to 20% in 2007 and 2008, in line with the internal dividend policy. The projected growth for the coming years generates the **need of a new capital injection**.

The Tier 1 and Tier 2 capital increase strategy (5Ml in 2011) is adequate and it is based on subordinated loans, injection from existing shareholders as well as new shareholders. The majority of the current shareholders demonstrate commitment to support the capitalization of HKL. Triple Jump, Oikocredit and Norfund, accounting for the 55.3% of the total shares as of Dec 2010<sup>18</sup> agreed to inject new capital to maintain their share, while the other shareholders’ participation (HKNGO, SIDI, HKSA and Mr. Dy Davuth) may be diluted. A subordinated debt worth 2Ml was received in January 2011 from Triple Jump<sup>19</sup>. Discussions are on-going for the negotiation of a subordinated loan from a current lender and for the evaluation of some proposals from new potential shareholders.



<sup>17</sup> The NBC calculation of CAR does not include the net income of the year in the total equity before the audit of FFSS.

<sup>18</sup> In the first quarter of 2011 Triple Jump and Norfund agreed to equally divide and acquire the Cordaid share (6.95%).

<sup>19</sup> The equity already includes subordinated debts from HKNGO US\$415,743 and MEF/AFD US\$ 313,576.

## 4.2 Liabilities and Concentration Risk

HKL demonstrated the capacity to attract sufficient funding over the last years. The decrease of total liabilities by 12% in 2009 is due to the reduced need of funding resulting from the operations slowdown.

In spite of the adequate number of current lenders, the current structure of funds presents some concentration, with the largest lender representing 24% and the three main lenders represent 47% of the total liabilities as of Dec 2010. This may increase the complexity of the liabilities management for the MFI, especially in times of crisis. Borrowing from shareholders (22% of the total liabilities as of Dec 2010) acts as a positive factor to ensure the availability of funds; basic practices to manage the related conflict of interest are adopted by the BoD.

The slight concentration in long term liabilities (63% as of December 2010) and the marginal share of subsidized loans (2.8%, from NSD and Kiva) provide an appropriate funding composition. 68% of the borrowings carries an interest rate comprised between 7.1% and 9%, and 13% carries an interest rate higher than 9%, confirming the commercial nature of the majority of liabilities. Only 15% and 3% of the loans borrowed bear interests between 2.9% and 7%, or lower than 2.9%. The cost of funds maintained a constant level over the last two years; the expected decrease in the level of interest rates in the future may be counterbalanced by the possible increase of subordinate debts as a capitalization strategy.

The client savings still represent a marginal share of funding liabilities (8.2% as of December 2010), even if their growth has been fast starting from the second quarter of 2010, above HKL expectations. The concentration of savings in short term deposits (49%) is in line with the strategic focus on fixed deposits through attractive interest rates, while the lower amount of demand deposit (18%) may reflect the limited network and services as compared to the banks. Compulsory savings account for 33% of the total savings as of December 2010, and are expected to gradually decrease in the future. The holders of the 20 largest time deposits represent 64% of HKL time deposits and 14.7% of the total equity, indicating a concentration risk. The effectiveness of the current focus of the saving strategy on time deposit, bringing a relatively high cost (interest rate 7.29% on average) and volatility, will need to be proved in the future.

## 4.3 Assets and Liabilities Management (Liquidity Risk and Market Risk)

The ALCO<sup>20</sup> monthly meetings constitute a positive factor for the management of the funding, liquidity and foreign currency risks, including a monitoring and alert system for the liquidity and foreign currency limits set by the NBC. However, the absence of a finalized manual and the vacancy of the risk manager may currently reduce the ALCO effective risk management.

Overall, the building of the risk management culture is in process in HKL, showing a positive evolution over the last years. However, the **financial risk policies and tools show some room for improvement** considering the increasing complexity of HKL operations.

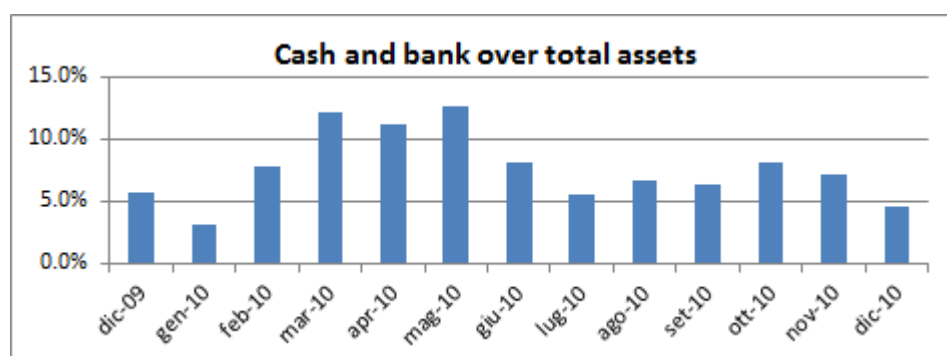
**The liquidity management tools currently in place are quite basic:** the cash flow analysis at global level is partly fragmented, and the minimum cash limit is set at the same amount for all the branches based on the historic data. Moreover, the cash flow projections are affected by the frequent loan prepayment and the demand exert a constant pressure towards longer loan terms. The risk involved is mitigated by the acceptable liquidity level so far, even if more accurate tools will be critical with the saving mobilization. **The risk related to the lack of a formalized contingency plan**, of primary importance considering the savings evolution, is partly mitigated by the informal guidelines set with some lenders and the on-going negotiation with ACLEDA bank for a credit line. **The tools to monitor the currency risk are adequate**, while **tools for the interest rate risk and sensitivity analysis are not available yet.**

<sup>20</sup> Composed of: Deputy GM, Finance manager, Operation manager, Assistant to GM.

FX Risk - Dec 2010 (US\$)	KHR	THB
Assets	5,334,754	3,101,126
Liabilities	4,693,846	3,103,458
Net position	640,908	-2,332
Net position / Equity	6.5%	-0.02%
Exchange rate US\$/KHR	4053	
Exchange rate US\$/THB	30.02	

**HKL is currently exposed to a limited currency risk.** Considering that the functional currency of HKL is the US\$, the analysis is focused on the KHR and THB. The net positions in KHR and THB have been quite limited so far (6.5% and -0.02% of total equity as of December 2010). In spite of the denomination of equity in US\$, HKL is subject to the NBC prudential limits for the open position in US\$. After the long open position in US\$ registered in 2009, above the limit set by the NBC<sup>21</sup>, the position has been normalized in December 2009 thanks to a loan in US\$ received by one of the shareholders. In general, the strategy adopted for the currency risk management consists in seeking for the balance between assets and liabilities in each currency, including disbursing loans in US\$, KHR and THB.

**The liquidity and maturity risks are currently limited:** according to the static analysis, the negative net position for the period 31 to 90 days is small (total assets / total liabilities worth 0.83) and the cumulative net position up to 90 days is positive. However, the analysis of the monthly share of liquidity over total assets shows some volatility (see graph); a more accurate analysis of the savings behavior will be crucial for the appropriate liquidity management in the future.



The floating rate of some borrowings (10.2% of funding liabilities), together with the fixed rate of the loans issued to clients, generates some **interest rate risk** (liability sensitive up to 90 days); however, the risk relevance is considered low<sup>22</sup> and it is mitigated by the overall good balance between short and long assets and liabilities.

Interest rate risk, Dec 2010, US\$	30 days or less	31 to 90 days	91 to 180 days	181 to 365 days	1 to 5 years	Non interest sensitive	Total
<b>Total assets</b>	1,677,378	936,294	3,048,490	13,239,549	26,584,477	2,884,988	48,371,177
Cash and banks	1,176,240	0	0	0	0	991,411	2,167,651
Investments (*)	0	0	0	0	0	5,552	5,552
Outstanding portfolio	501,138	936,294	3,048,490	13,239,549	26,584,477	0	44,309,948
Net fixed assets	0	0	0	0	0	897,363	897,363
Other assets	0	0	0	0	0	990,663	990,663
<b>Total liabilities</b>	2,283,081	1,129,609	1,812,723	5,017,771	23,311,985	4,173,861	37,729,030
Deposits	1,225,101	537,011	179,765	1,119,942	20,135	1,548,787	4,630,742
Loans	1,057,980	592,598	1,632,958	3,897,829	23,291,850	548,861	31,022,075
Other liabilities	0	0	0	0	0	2,076,213	2,076,213
<b>Net position</b>	-605,703	-193,315	1,235,767	8,221,778	3,272,491	-1,288,873	10,642,146
<b>Cumulative net position</b>		-799,018	436,750	8,658,528	11,931,019	10,642,146	21,284,293

<sup>21</sup> Limit set by NBC: (Open currency position on each foreign currency +index loans)/Net worth = Not exceed +/-20%.

<sup>22</sup> The impact on 1year net interest rate sensitive income due to +-200bps interest rate shift is worth 0.48% of equity.

## 5. Financial and Operational Results

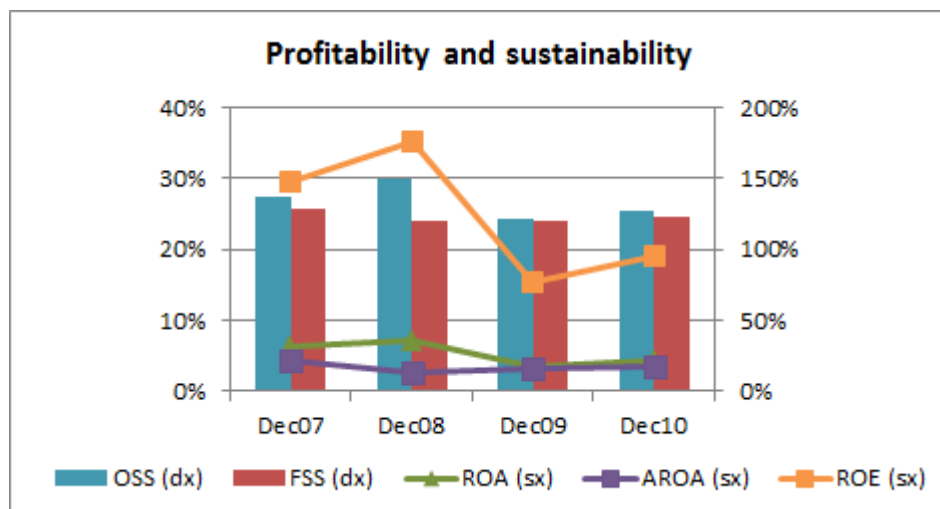
### 5.1 Profitability and Sustainability

The financial performance analysis is based on the annual audited financial statements for the years 2007, 2008 and 2009, and on the internal financial statements for 2010.

**HKL profitability level is very good**, with ROA and ROE worth 4.4% and 19.2% in 2010. Despite the drop in 2009, ROA and ROE was standing at good levels registering a 15.5% and 3.4% respectively. Profitability and sustainability show a similar trend in the last years. The decrease of OSS from 150% in 2008 to 122% in 2009 was mainly due to the lower concentration of the assets in loan portfolio as well as to the portfolio quality decrease, affecting the provision expenses and the portfolio yield. Lower provision expense and portfolio allocation in 2010 play a key role in the improvement of OSS of the last period.

**The adjusted results confirm the full sustainability of HKL** (see annex 5 for more details). The main adjustment applied accounts for the inflation in the country, which registered a high peak in 2008 and decreased significantly the high unadjusted performance of 2008. FSS and AROA are worth 122% and 3.4% respectively, with a slight improvement compared to 2009 (120% and 3.2%).

HKL currently shows a good capacity to generate revenues and cover the expenses. The challenges for the future profitability are related to the constant downward pressure on the active interest rates, the uncertainties about the cost of funds (especially linked with the savings strategy) evolution and the staff productivity. Product diversification (including effective cross-selling between saving and credit products) and potentially fee based services are areas to be addressed in order to maintain good levels of profitability, which can be put under pressure by the organization consolidation (e.g. new MIS).



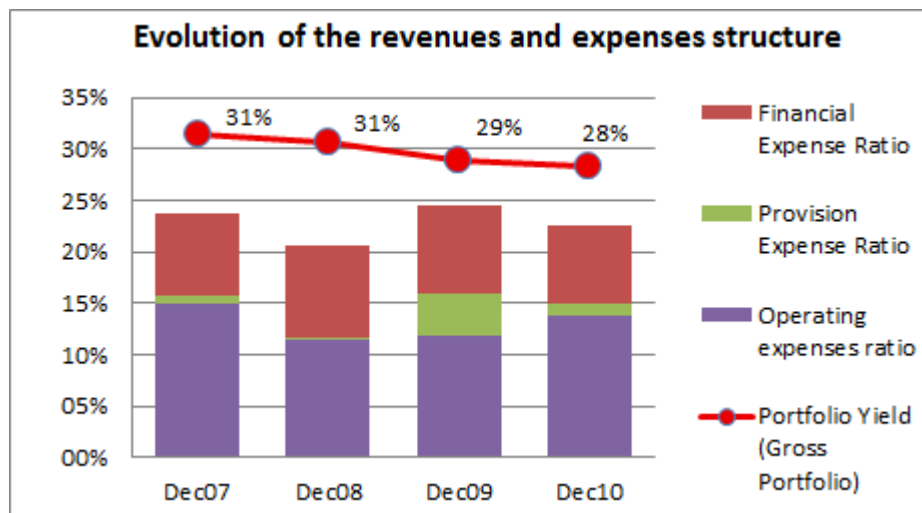
### 5.2 Revenues and Expenses Structure and Margins

The portfolio yield shows a constant decreasing trend over the last years, reflecting the pressure of market competition<sup>23</sup> and the decrease of the micro loan share, with a higher yield, on the total portfolio (from 30% in 2008 to 26% in 2009 and 21% in 2010). The portfolio yield drop in 2009 is also due to the lower portfolio quality, which negatively affect the provision expense ratio (from 0.3% in 2008 to 4% in 2009).

After a constant decrease from 2007 to 2009, and despite the increase in the loan size, the operating expense ratio increased in 2010, mainly due to the increase in administrative expenses and the lower staff productivity. The operating expense ratio still registers an acceptable level in 2010 (13.7%)

<sup>23</sup> A slight decrease of the interest rates on loans from US\$ 1,000 to US\$ 10,000 was applied in 2010.

The higher administrative expense ratio registered in 2010 (5.7%, compared to 4.8% in 2008 and 4.1 in 2009) is due to the jump of the cost of marketing, rent and equipment entailed by the branding strategy for the saving mobilization. The increasing trend in the personnel expense ratio over the last two years (from 6.6% in 2008 to 7.8% in 2009 and 8.1% in 2010) is mainly the result of the higher growth pace of the number of staff (35% on average in 2009 and 2010) compared to the growth of the operations.



The **decreasing productivity** in 2009 and 2010 both in terms of number of borrowers and portfolio amount represents a **challenge** for HKL, even if the impact on efficiency is lower due to the increasing loan size. The performance (122 borrowers per loan offices) is below the internal objective (150) and the international benchmark (see page 4). The reasons can be partly identified in the intensive recruitment of new staff in existing and new branches, which has not yet reached full productivity levels.

Performance Indicators	Jan07-Dec07	Jan08-Dec08	Jan09-Dec09	Jan10-Dec10
Operating expenses ratio (average assets)	13.5%	10.1%	9.7%	12.4%
Operating expenses ratio (aver. gross portf.)	14.9%	11.4%	11.9%	13.7%
Staff allocation ratio	44.4%	48.5%	48.8%	50.8%
Loan officer productivity (borrowers)	211	212	165	122
Loan officer productivity (amount)	128,776	138,335	125,223	112,462
Staff productivity (borrowers)	94	103	81	62
Staff productivity (amount)	57,118	67,091	61,138	57,100
Branch productivity (amount)	1,573,926	2,640,946	1,834,146	1,772,398
Cost per borrower	85	75	79	113
Cost per member	71	69	70	94
Average disbursed loan size	725	823	934	1,122
Funding expense ratio*	8.0%	9.0%	8.7%	7.6%
Provision expense ratio	0.8%	0.3%	4.0%	1.2%
Adjusted provision inflation (avg. gross port.)	1.4%	5.0%	0.1%	1.0%
Portfolio yield (gross portfolio)	31.4%	30.7%	28.9%	28.3%
Other financial products yield	0.1%	0.1%	0.7%	0.0%
Other products yield	0.5%	0.1%	0.2%	0.3%

\* exchange rate variations are not included in the calculation of the ratio

The cost of funds stands at 9.4% in 2009 and 2010, lower than the levels registered in 2008 and 2007, in line with the interest rates' evolution in the financial markets. In spite of the constant cost of funds over the last two years, the funding expense ratio decreases in 2010 to 7.6% due to the higher growth of the average gross portfolio from 2009 to 2010 compared to the average liabilities<sup>24</sup>.

The impact of the saving collection on the cost of funds is not yet visible due to the

<sup>24</sup> The concentrated growth of liabilities at the end of 2010 explains the compatibility with the higher leverage as of Dec 2010.

limited volume mobilized. However, considering the fixed costs entailed, the saving mobilization strategy is challenged by the market conditions, with the banks' competitive advantage in sight deposits and the high level of passive interest rates currently recognized by the market on term deposits<sup>25</sup>.

The margin left on portfolio yield after the operating, funding and provision expense ratios is still adequate (5.8%), even adjusting for the inflation provision (1%). However, the margin shows a decreasing trend along the years and it is subject to a risk of further reduction as the market pressure and the HKL SME strategy will push the portfolio yield downward. Preserving adequate margins will depend on HKL capacity to improve the productivity level and control the operating expenses, while maintaining a good quality of portfolio and proving an effective funding strategy.

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<sup>25</sup> HKL offers interest rates on fixed deposits from 3 to 11.2%, in line with the local market. The average (un-weighted) interest rate on time deposits (49% of the total deposits as of Dec 2010) is 7.29%, for voluntary savings (18% of the total deposits) is 3.57%, while no interest is paid on compulsory savings (33% of the total, discontinued in Jan 2011).

## 6. Business Plan and Financial Needs

### 6.1 Strategic and Operational Plan

The current business plan is updated and covers the years 2011-2015.

The following are the main strategic guidelines included in the Business Plan:

- Enlarging the current branch network and maintain a sustained growth;
- Achieving saving mobilization;
- Improving existing products and introduce new ones;
- Improving the MIS, the HR management and financial management;
- Becoming a commercial bank by 2014.

The business plan is **overall complete**, including a detailed institutional assessment, market analysis, and a description of the main assumptions.

**Expansion in 2011** includes the opening of three new branches and the upgrading of 5 sub-branches in full-fledged branches. Clients are expected to reach 72,560 by FY 2011 (141,329 by 2015).

The feasibility of **mobilizing saving** at 50% of loan portfolio (9% as of Dec 2010 or USD 9.3 Ml) and reducing the funding expenses to 6% by 2015 will need to be proved by the new saving strategy and the evolution of the interest rates in the market.

A clear strategy to become a **commercial bank** by 2014 has not been identified yet; the feasibility and success of the transformation is influenced by the evolution of the sector, including the local MFIs and banks' approach towards M&A.

The set of strategic tools, including the strategic plan and a detailed budget, may be further improved by a **consolidated operational plan** including a complete set of quantitative and qualitative objectives by area of responsibility.

### 6.2 Financial Projections

Projected Financial Indicators	2010	2011	2012	2013	2014	2015
ROE	19.2%	11.99%	12.07%	12.06%	12.57%	12.83%
ROA	4.4%	3.04%	3.08%	3.07%	3.12%	2.99%
Oper. Self-sufficiency (OSS)	127.9%	126.91%	123.27%	123.05%	123.48%	123.20%
Debt/Equity ratio	3.8	2.58	3.23	2.72	3.31	3.27
Saving balance / gross portfolio	9.0%	16%	20%	30%	40%	50%
Operating expenses ratio (avg. portf.)	13.7%	14.7%	13.6%	13.3%	12.6%	12.3%
Loan officer productivity (borrowers)	122	150	149	150	152	154
Cost of funds ratio*	9.4%	8.6%	9.6%	9.1%	9.2%	8.9%
Portfolio yield (gross portfolio)	28.3%	26.5%	25.7%	25.0%	24.3%	23.6%

\* exchange rate variations are not included in the calculation of the ratio

The financial projections appear to be overall realistic and mainly based on prudential assumptions.

In spite of the high and growing competition, the sustained growth planned (40% for 2011 and 30% annually from 2012 to 2015) may be possible due to the rural expansion and product diversification strategy. The decrease in the projected portfolio yield and the conservative PAR assumptions<sup>26</sup> reflect the increasing competition in the market, together with the SME penetration strategy. As a result, the planned profitability is lower on average than the result achieved in 2010 (ROE and ROA equal to 12.3% and 3.3% over the five years period), but good in absolute terms. Debt to equity is kept under 4 over all the periods; the drop in 2011 is due to the expected capital injection.

The financial projections exercise currently lacks a scenario analysis, which is a key

<sup>26</sup> PAR 30 equal to 2.5% on average during the 5 projected years (compared to 0.9 as of Dec 2011).

strategic tool for a proactive management under unexpected circumstances.

### **6.3 Financial Needs and Funding Plan**

HKL is considered to have the capacity to attract sufficient funding for the planned growth.

The funding needs for 2011 are estimated at US\$ 17 MI, out of which around US\$ 6 MI are expected as public savings (which however are planned to reach 9.3MI according a first analysis). The US\$ 11MI new borrowings from lenders are under negotiation with the Spanish Microfinance Program and Norfund. The funding plan from 2012 onward is based on a mix of fixed and floating interest loans, from existing and new lenders, aiming at decreasing the cost of funds and extending the term.

The strategy of attracting larger loans from lenders willing to establish a long term funding relation with HKL is a positive factor for meeting funding needs, even if it could increase the funding concentration risk.

The additional liabilities to be absorbed generate the need of 5MI new capital injection in 2011. The capitalization strategy is adequate and it is based on subordinated loans, injection from existing shareholders as well as new shareholders (see chapter 4 for more details).

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**Annex 1 – Financial Statements**


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<b>Balance sheet (US\$)</b>	<b>Jan07-Dec07</b>	<b>Jan08-Dec08</b>	<b>Jan09-Dec09</b>	<b>Jan10-Dec10</b>
<b>ASSETS</b>				
<i>Cash and bank deposits</i>	98,132	6,013,239	1,945,176	2,167,651
<i>Short term financial assets</i>	1,545,420	0	0	4,000
<i>Net outstanding portfolio</i>	14,015,162	28,847,051	30,303,544	43,578,566
<i>Gross outstanding portfolio</i>	14,165,336	29,050,403	31,180,474	44,309,948
<i>Performing portfolio</i>	14,135,386	28,895,736	30,229,192	43,912,416
<i>Portfolio at risk &gt; 30 days</i>	29,950	154,667	951,282	397,533
<i>(Loan loss reserve)</i>	150,174	203,352	876,930	731,382
<i>Accrued interest</i>	243,067	472,798	475,938	699,473
<i>Other short term assets</i>	55,351	45,829	55,010	65,483
<b>Total short term assets</b>	<b>15,957,132</b>	<b>35,378,917</b>	<b>32,779,668</b>	<b>46,515,173</b>
<i>Long term financial assets</i>	1,552	1,552	1,552	1,552
<i>Net fixed assets</i>	397,128	582,860	582,654	897,363
<i>Other long term assets</i>	0	89,880	80,286	225,706
<b>Total long term assets</b>	<b>398,680</b>	<b>674,292</b>	<b>664,492</b>	<b>1,124,621</b>
<b>Total assets</b>	<b>16,355,812</b>	<b>36,053,209</b>	<b>33,444,160</b>	<b>47,639,794</b>
<b>LIABILITIES and EQUITY</b>				
<b>LIABILITIES</b>				
<i>Sight deposits</i>	124,370	174,222	199,312	814,497
<i>Compulsory savings</i>	398,854	907,814	1,183,230	1,548,787
<i>Short time deposits</i>	135,396	112,203	124,072	2,267,458
<i>Short term loans</i>	300,000	5,105,782	9,962,985	7,230,225
<i>Other short term liabilities</i>	700,858	1,418,713	1,214,964	2,076,213
<b>Total short term liabilities</b>	<b>1,659,478</b>	<b>7,718,734</b>	<b>12,684,563</b>	<b>13,937,180</b>
<i>Long term time deposits</i>	0	0	0	0
<i>Long term loans</i>	11,714,147	20,748,401	12,330,000	23,791,850
<i>Other long term liabilities</i>	0	0	0	0
<i>Restricted funds</i>	0	60,184	42,192	0
<b>Total Long term liabilities</b>	<b>11,714,147</b>	<b>20,808,585</b>	<b>12,372,192</b>	<b>23,791,850</b>
<b>Total liabilities</b>	<b>13,373,625</b>	<b>28,527,319</b>	<b>25,056,755</b>	<b>37,729,030</b>
<b>EQUITY</b>				
<i>Paid-in capital from shareholders</i>	1,339,700	4,162,755	4,162,755	4,162,755
<i>Donated equity</i>	0	0	0	0
<i>Quasi-capital</i>	729,319	729,319	729,319	729,319
<i>Reserves</i>	44,704	80,464	173,648	234,429
<i>Total retained earnings</i>	868,463	2,553,352	3,321,683	4,784,261
<i>Net income, previous years</i>	153,259	689,664	2,106,067	3,029,935
<i>Net income, current year</i>	715,204	1,863,688	1,215,616	1,754,326
<i>Other equity accounts</i>	0	0	0	0
<b>Total equity</b>	<b>2,982,186</b>	<b>7,525,890</b>	<b>8,387,405</b>	<b>9,910,764</b>
<b>Total liabilities and equity</b>	<b>16,355,811</b>	<b>36,053,209</b>	<b>33,444,160</b>	<b>47,639,794</b>

<b>Income Statement (US\$)</b>	<b>Jan07-Dec07</b>	<b>Jan08-Dec08</b>	<b>Jan09-Dec09</b>	<b>Jan10-Dec10</b>
<i>Interest &amp; commissions received on loans</i>	2,879,518	6,760,983	8,240,556	10,157,897
<i>Financial revenue from investment</i>	8,229	27,450	212,404	10,445
<i>Other financial revenues</i>	40,997	17,007	19,738	77,335
<b>A) Financial revenue</b>	<b>2,928,744</b>	<b>6,805,440</b>	<b>8,472,698</b>	<b>10,245,677</b>
<i>Interest paid on borrowings</i>	726,147	1,969,897	2,458,915	2,671,903
<i>Interest paid on savings</i>	5,510	9,568	12,352	67,995
<i>Interest paid on mortgage</i>	0	0	0	0
<i>Other financial expenses</i>	1,223	0	0	0
<i>Inflation adjustment</i>	0	0	0	0
<b>B) Financial expenses</b>	<b>732,880</b>	<b>1,979,465</b>	<b>2,471,267</b>	<b>2,739,898</b>
<b>Gross financial margin (A - B)</b>	<b>2,195,864</b>	<b>4,825,975</b>	<b>6,001,431</b>	<b>7,505,779</b>
<i>Loan loss provision</i>	75,099	68,353	1,149,389	438,986
<b>Net financial margin</b>	<b>2,120,765</b>	<b>4,757,622</b>	<b>4,852,042</b>	<b>7,066,793</b>
<i>Other operating revenue</i>	43,771	31,004	63,540	120,112
<i>Personnel expenses</i>	597,273	1,453,369	2,214,148	2,892,481
<i>Administrative expenses</i>	769,113	1,065,799	1,177,325	2,036,078
<b>C) Operating expenses</b>	<b>1,366,386</b>	<b>2,519,168</b>	<b>3,391,473</b>	<b>4,928,560</b>
<b>Net operating income</b>	<b>798,150</b>	<b>2,269,458</b>	<b>1,524,109</b>	<b>2,258,346</b>
<i>Extraordinary revenue</i>	11,263	0	0	0
<i>Extraordinary expense</i>	0	0	0	0
<b>Net income before donations, before tax</b>	<b>809,413</b>	<b>2,269,458</b>	<b>1,524,109</b>	<b>2,258,346</b>
<i>Taxes</i>	173,401	472,201	326,485	511,919
<b>Net income before donations</b>	<b>636,012</b>	<b>1,797,257</b>	<b>1,197,624</b>	<b>1,746,427</b>
<i>Donations in cash</i>	79,192	66,431	17,992	7,900
<i>Revenue not from the operations</i>	0	0	0	0
<i>Expenses not from the operations</i>	0	0	0	0
<b>Net income</b>	<b>715,204</b>	<b>1,863,688</b>	<b>1,215,616</b>	<b>1,754,326</b>

## Annex 2 – Financial Statements' Adjustments

The financial statements in Annex 1 are the result of standard reclassification and they are based on the annual audited financial statements for the years 2007, 2008 and 2009, and on the internal financial statements for 2010.

**Financial statements have been adjusted** in order to make them comparable to financial reporting and performances of institutions using different accounting standards and operating in different environment and to evaluate the level of sustainability of the institution with market conditions.

The main adjustments include:

- Accrued interest on delinquent loans > 90 days.
- Subsidies: donations in kind<sup>27</sup> and soft loans<sup>28</sup>.
- Provisions (calculated with a standard formula<sup>29</sup>).
- Inflation.

Adjustments (US\$)	Jan07-Dec07	Jan08-Dec08	Jan09-Dec09	Jan10-Dec10
<b>Reversal of accrued interest on non-perf loans</b>	0	0	0	0
<b>Subsidized cost of fund adjustment</b>	0	0	0	0
- Interest rate used (national currency)	12.1%	12.0%	11.9%	11.7%
- Interest rate used (foreign currency)	8.1%	6.1%	4.6%	3.9%
<b>Inflation adjustment</b>	<b>132,048</b>	<b>1,105,713</b>	<b>40,617</b>	<b>362,259</b>
- Inflation rate used (average in the period)	7.4%	24.2%	0.6%	4.3%
<b>Loan loss provision adjustment</b>	0	0	45,274	0
<b>In-kind subsidy adjustment</b>	0	0	0	0
<b>Total variation of net income</b>	<b>132,048</b>	<b>1,105,713</b>	<b>85,891</b>	<b>362,259</b>

<sup>27</sup> Donations in kind are valorized and added to operational expenses.

<sup>28</sup> In the income statement it is registered the value of the difference between financial costs of the institutions and financial cost evaluated at the market rate. In particular, in the case of loans in local currency, it is considered 75% of the average lending rate in the national market (IFS Line 60P). In the case of loans denominated in foreign currencies (US\$ and Euro), it is considered the average value of LIBOR 1 year plus 3%.

<sup>29</sup> Provisions are calculated according to the following formula:

Portfolio at risk:	1-30 days	10%	Restructured loans	0-30 days	50%
	31-60 days	30%		> 30 days	100%
	61-90 days	50%			
	>90 days	100%			

### Annex 3 – Financial Ratios

	Jan07-Dec07	Jan08-Dec08	Jan09-Dec09	Jan10-Dec10
<b>PROFITABILITY</b>				
Return on Equity (ROE)	29.5%	35.2%	15.5%	19.2%
Adjusted Return on Equity (AROE)	20.9%	13.2%	14.0%	15.2%
Return on Assets (ROA)	6.3%	7.2%	3.4%	4.4%
Adjusted Return on Assets (AROA)	4.4%	2.6%	3.2%	3.4%
Operational self-sufficiency (OSS)	136.7%	149.7%	121.7%	127.9%
Financial self-sufficiency (FSS)	128.9%	120.5%	120.3%	122.4%
Profit Margin	26.9%	33.2%	17.9%	21.8%
<b>LOAN PORTFOLIO QUALITY</b>				
Portfolio at risk > 30 days (PAR 30)	0.2%	0.5%	3.1%	0.9%
Portfolio at risk > 90 days (PAR 90)	0.1%	0.1%	2.9%	0.9%
Restructured loans	0.0%	0.0%	0.0%	0.0%
Provision expense ratio	0.8%	0.3%	4.0%	1.2%
Loan loss reserve ratio	1.1%	0.7%	2.8%	1.7%
Risk coverage ratio (30 days)	501.4%	131.5%	92.2%	184.0%
Write-off ratio	0.0%	0.1%	1.7%	1.6%
Adjusted write-off ratio	0.0%	0.1%	1.6%	1.6%
<b>EFFICIENCY AND PRODUCTIVITY</b>				
Staff allocation ratio	44.4%	48.5%	48.8%	50.8%
Loan officer productivity (borrowers)	211	212	165	122
Loan officer productivity (amount)	128,776	138,335	125,223	112,462
Staff productivity (borrowers)	94	103	81	62
Staff productivity (amount)	57,118	67,091	61,138	57,100
Branch productivity (amount)	1,573,926	2,640,946	1,834,146	1,772,398
Operating expenses ratio (average gross portf.)	14.9%	11.4%	11.9%	13.7%
Operating expenses ratio (average assets)	13.5%	10.1%	9.7%	12.4%
Cost per loan lent	47	47	69	89
Cost per borrower	85	75	79	113
Cost per member	71	69	70	94
Personnel expenses ratio (average gross portf.)	6.5%	6.6%	7.8%	8.1%
Admin. expenses ratio (average gross portfolio)	8.4%	4.8%	4.1%	5.7%
<b>ASSETS/LIABILITIES MANAGEMENT</b>				
Portfolio yield (gross portfolio)	31.4%	30.7%	28.9%	28.3%
Portfolio yield (gross portfolio) - accrued	31.4%	30.7%	28.9%	28.3%
Other financial products yield	0.1%	0.1%	0.7%	0.0%
Other products yield	0.5%	0.1%	0.2%	0.3%
Funding expense ratio*	8.0%	9.0%	8.7%	7.6%
Cost of funds ratio*	10.3%	10.7%	9.4%	9.4%
Provision for inflation (average gross portfolio)	0.0%	0.0%	0.0%	0.0%
Adjusted provision for inflation (av. gross port.)	1.4%	5.0%	0.1%	1.0%
Current ratio	1.7	3.0	1.4	1.4
Liquidity over total assets	0.6%	16.7%	5.8%	4.6%
Liquidity + investments over total assets	10.1%	16.7%	5.8%	4.6%
Liquidity over total savings + other short term liabilities	10.2%	352.7%	126.4%	42.0%
Debt/equity ratio	4.5	3.8	3.0	3.8
Capital adequacy ratio	18.2%	20.9%	25.1%	20.8%

\* exchange rate variations are not included in the calculation of the ratio

## Annex 4 – Definitions

	Description of the ratio	Formula
Profitability	Return on Equity (ROE)	Net income before donations / Average equity
	Adjusted Return on Equity (AROE)	Adjusted net income before donations / Average equity
	Return on Assets (ROA)	Net income before donations / Average assets
	Adjusted Return on Assets (AROA)	Adjusted net income before donations / Average assets
	Operational Self-sufficiency (OSS)	(Financial revenue + Other operating revenue) / (Financial expenses + Provision expenses + Operating expenses)
	Financial Self-sufficiency (FSS)	(Adjusted financial revenue + Other operating revenue) / (Adjusted financial expenses + Adjusted loan loss provision expenses + Adjusted operating expenses)
	Profit Margin	Net operating income / operating revenue
Portfolio Quality	Portfolio at Risk (PAR30)	Portfolio at Risk > 30/ Gross outstanding portfolio
	Provision Expense Ratio	Loan loss provision expenses / Average gross portfolio
	Loan Loss Reserve Ratio	Accumulated reserve / Gross portfolio
	Risk Coverage Ratio (>30 days)	Accumulated reserve / Portfolio at risk >30 days
	Write-off Ratio	Write-off of loans / Average gross portfolio
Efficiency and Productivity	Staff Allocation Ratio	Loan officers / Total staff
	Loan Officer Productivity – Borrowers	Number of active borrowers / Number of loan officer
	Loan Officer Productivity – Amount	Gross portfolio / Number of loan officer
	Staff Productivity – Borrowers	Number of active borrowers/ Number of staff
	Staff Productivity – Amount	Gross portfolio / Number of staff
	Operating Expenses Ratio	Operating expenses / Average gross portfolio
	Cost per Borrower	Operating expenses / Average number of borrowers
	Administrative Expenses Ratio	Administrative expenses / Average gross portfolio
	Personnel Expenses Ratio	Personnel expenses / Average gross portfolio
Financial Management	Portfolio Yield	Interest income from portfolio / Average gross portfolio
	Funding Expense Ratio	Interests and fee expenses on funding liabilities / Average gross portfolio
	Cost of Funds Ratio	Interest expenses on funding liabilities / Average funding liabilities
	Current Ratio	Short term assets / Short term liabilities
	Debt/Equity Ratio	Total liabilities / Equity
	Equity / Assets ratio	Total equity / Total assets
	Capital Adequacy Ratio	Total equity / Total risk weighted assets
Outreach	Average Disbursed Loan Size	Amount issued in the period / Number of issued loans
	Average Disbursed Loan Size Per-C. GDP	Average disbursed loan size / Per-capita GDP

**Other Definitions:**

**Funding Liability:** Liability that finance the loan portfolio and the cash investments necessary to manage the loan portfolio

**Operating Expenses:** Personnel expenses + Administrative expenses

**Recovery from Write-off Ratio:** Income from write-off (payments received from loan already written-off) / Average gross portfolio

**Restructuring of Delinquent Loans:** includes rescheduling loans (extending the term of the loan or relaxing the schedule of required payments) and refinancing loans (paying off a problem loan by issuing a new loan).

**Drop-out Ratio:** calculated as follows: (number of active clients at the beginning of the period + number of new (first time) clients entering during the period – clients written off during the period – number of active clients at the end of the period) / (number of active clients at the beginning of the period).

## Annex 5 – Main Guidelines on Reporting and Accounting

<b>Financial Statements</b>	The audited financial statements are prepared in accordance to the National Bank of Cambodia (NBC), the Cambodian Accounting Standard. HKL does not provide non-financial services, thus its financial statements reflect only the results of financial activities.																																			
<b>Accounting Policy for the Accrued Interest</b>	HKL uses accrual basis accounting principle. Accrued interest income and expense is recognized according to the International Accounting Standard																																			
<b>Loan Loss Provision and Write-Offs</b>	<p>HLK loan loss provisioning policy is based on the policy of the NBC. The specific provision for bad and doubtful loans is made on loans that are identified as non-performing, according to the number of days overdue (different parameters for short and long term loans). The specific provision is calculated as a percentage of the loans outstanding at the time the loan is classified, excluding accrued interest, and is charged as an expense. Interest on nonperforming loans is not accrued. In addition to the specific provision, an additional general provision for bad and doubtful loans is made at the rate of 1.5% of total loan outstanding (2009).</p> <p>Loans are written off to the income statement when the loans remain unpaid after 90 days for loans with maturities of one year or less and after 360 days for loans with maturities of more than one year. Loans written off are removed from the outstanding loan portfolio and from the provision for bad and doubtful loans. An uncollectible loan or portion of a loan classified is written off when, in the judgment of the management, there is no prospect of recovery, after taking into consideration the realisable value of the collateral, if any.</p>																																			
<b>Restructured Loans</b>	The head office’s credit committee approves the loan restructuring if the client shows the intention to repay and still generates some income. The condition for restructuring is that the decrease in the repayment capacity is due to natural phenomenon or global crisis in the area, accident, fire, death of a family member, or war (not the downward of the business cash flow). No special provision is made. As of December 2008, 2009 and 2010 there are no active restructured loans.																																			
<b>Insider Loans</b>	<p>Insider loans are given at favorable interest rate.</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="7" style="text-align: left; padding-left: 20px;">December 2010</th> </tr> <tr> <th style="text-align: left; padding-left: 20px;">Insider loans (US\$)</th> <th style="text-align: center;">Outstanding balance</th> <th style="text-align: center;">Loan term</th> <th style="text-align: center;">Interest rate</th> <th style="text-align: center;">Collateral</th> <th colspan="2" style="text-align: center;">PAR &gt; 1 day</th> </tr> </thead> <tbody> <tr> <td style="padding-left: 20px;"><b>Board</b></td> <td style="text-align: center;">-</td> <td style="text-align: center;">-</td> <td style="text-align: center;">-</td> <td style="text-align: center;">-</td> <td colspan="2" style="text-align: center;">-</td> </tr> <tr> <td style="padding-left: 20px;"><b>Management</b></td> <td style="text-align: center;">502,903,130</td> <td style="text-align: center;">24</td> <td style="text-align: center;">10%-12%</td> <td style="text-align: center;">Land and house</td> <td colspan="2" style="text-align: center;">0.0%</td> </tr> <tr> <td style="padding-left: 20px;"><b>Staff</b></td> <td style="text-align: center;">1,585,696,693</td> <td style="text-align: center;">36</td> <td style="text-align: center;">11%-15.6%</td> <td style="text-align: center;">Land and house</td> <td colspan="2" style="text-align: center;">0.0%</td> </tr> </tbody> </table>	December 2010							Insider loans (US\$)	Outstanding balance	Loan term	Interest rate	Collateral	PAR > 1 day		<b>Board</b>	-	-	-	-	-		<b>Management</b>	502,903,130	24	10%-12%	Land and house	0.0%		<b>Staff</b>	1,585,696,693	36	11%-15.6%	Land and house	0.0%	
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<b>Off-balance Sheet Items</b>	HKL does not present off balance sheet items																																			
<b>Donations</b>	<p>Donations received in cash:</p> <ul style="list-style-type: none"> <li>- US\$ 66,431 in 2008;</li> <li>- US\$ 17,992 in 2009;</li> <li>- US\$ 7,900 in 2010</li> </ul>																																			

## Funding Liabilities

Loans borrowed (December 2010)					
Source	Currency	Outstanding Balance (US\$)	Outstanding Balance ST (US\$)	Outstanding Balance LT (US\$)	Agreement, kind of product and collateral
Alterfin	USD	1,000,000	1,000,000		Credit line
Alterfin	USD	1,000,000	1,000,000		Credit line
Alterfin	USD	500,000		500,000	Credit line
BlueOrchard	USD	2,000,000		2,000,000	Credit line
BlueOrchard	USD	1,000,000		1,000,000	Credit line
DWM	USD	2,000,000		2,000,000	Credit line, collateral 100% of
DWM	USD	1,500,000		1,500,000	Credit line, collateral 100% of
DWM	USD	3,000,000		3,000,000	Credit line, collateral 100% of
GRAMEEN CREDIT	USD	2,000,000		2,000,000	Credit line
Incofin	USD	500,000		500,000	Credit line
Incofin	USD	1,500,000	1,500,000		Credit line
NSD	USD	500,000		500,000	Credit line, 2.7604% interest
OIKOCREDIT	USD	989,143		989,143	Credit line, collateral 100% of
OIKOS	USD	130,000		130,000	Credit line
PlanIS	USD	1,500,000		1,500,000	Credit line
PlanIS	USD	500,000		500,000	Credit line
Symbiotics	USD	1,000,000		1,000,000	Credit line
Symbiotics	USD	1,000,000		1,000,000	Credit line
Symbiotics	USD	500,000		500,000	Credit line
Triple Jump	USD	700,000	700,000		Credit line
Triple Jump	USD	1,282,484		1,282,484	Credit line
KIVA	USD	548,861	548,861		Revolving fund, 0% interest rate
BlueOrchard	THB	522,946		522,946	Credit line
DWM	THB	1,057,980	1,057,980		Credit line, collateral 100% of
Symbiotics	THB	552,924		552,924	Credit line
Symbiotics	THB	537,269		537,269	Credit line
Norfund	KHR	2,091,784		2,091,784	Credit line
OIKOCREDIT	KHR	394,769	394,769		Credit line, collateral 100% of
OIKOCREDIT	KHR	1,213,916		1,213,916	Credit line, collateral 100% of
<b>TOTAL</b>		<b>31,022,075</b>	<b>6,201,610</b>	<b>24,820,465</b>	

## Annex 6 – Financial Products

Credit Products	Micro	Small	Medium	Large
<i>Credit Methodology</i>	Individual	Individual	Individual	Individual
<i>Currency of the credit</i>	USD,THB,KHR	USD,THB,KHR	USD,THB,KHR	USD,THB,KHR
<i>Type of interest</i>	Declining Balance	Declining Balance	Declining Balance	Declining Balance
<i>Min. interest rate (% monthly)</i>	2.9%	2.3%	1.9%	1.5%
<i>Max. interest rate (% monthly)</i>	3.0%	2.5%	2.0%	2.0%
<i>Average interest rate (% monthly)</i>	2.95%	2.40%	1.95%	1.75%
<i>Description of commissions</i>	-	-	-	Loan Fee
<i>Min. credit amount (US\$)</i>	Up to 50	1,000	2,500	10,000
<i>Max. credit amount (US\$)</i>	1,000	2,500	10,000	1% of company's networth
<i>Max. credit amount - 1st loan (US\$)</i>	No limitation	No limitation	No limitation	No limitation
<i>Average credit amount (US\$)</i>	525	1,750	6,250	40,000
<i>Min. loan maturity (months)</i>	3	3	3	3
<i>Max. loan maturity (months)</i>	15	24	36	36
<i>Average loan maturity (months)</i>	9	14	19.5	19.5
<i>Periodicity of interests payments</i>	Monthly	Monthly	Monthly	Monthly
<i>Periodicity of principal payments</i>	Monthly	Monthly	Monthly	Monthly
<i>Grace period (months)</i>		-	-	-
<i>Collaterals / guarantees</i>	Land, house and guarantor	Land, house and guarantor	Land, house and guarantor	Land, house and guarantor
<i>Obligatory savings</i>	USD 1 per installment	USD 3 per installment	USD 5 per installment	USD 5-10 per installment

Savings Products	COMPULSORY	SAVINGS	VIP SAVINGS	PLANNED	TIME DEPOSITS (Fixed-capitalized)	TIME DEPOSITS (High Income)
<i>Currency</i>	KHR,USD,THB	KHR,USD,THB	KHR,USD,THB	KHR,USD,THB	KHR,USD,THB	KHR,USD,THB
<i>Min. interest rate (%)</i>	-	2.5%	2.7%	3.0%	3.0%	3.0%
<i>Max. interest rate (%)</i>	-	4.0%	4.5%	9.0%	11.0%	11.2%
<i>Average interest rate (%)</i>	-	3.3%	3.6%	6.0%	7.0%	7.1%
<i>Commissions</i>	-	-	-	-	-	-
<i>Min. accepted balance (USD)</i>	1	5	1,000	10	50	50
<i>Term (months)</i>	Upon loan maturity	-	-	3,6,12,18,24 months	1,3,6,12 months	1,3,6,12 months
<i>Average term</i>	-	-	-	12 months	6 months	6 months
<i>Interest repayments frequency</i>	Monthly	Monthly	Monthly	Monthly, End of period	End of period	Monthly
<i>Penalty in case of anticipated withdrawal (USD)</i>	3	3	3	Convert to Saving interest rate	25 or negotiation	25 or negotiation

## Annex 7 – Rating Scale

The final rating grade does not consider the Country Sovereign Rating Risk, but it takes into account the effects of the political and economic context on MFI's performance.

Grade	Definition
AAA+ AAA AAA-	<i>Excellent operations and performance. Exposure to risks is minimum and risks are very well monitored and managed. Very stable and highly unlikely to be adversely affected by foreseeable events.</i>
AA+ AA AA-	<i>Very strong operations and performance. Exposure to risks is minimum and risks are very well monitored and managed. Stable and unlikely to be adversely affected by foreseeable events.</i>
A+ A A-	<i>Very good operations and performance. Exposure to risks is minimum and risks are well monitored and managed. Stable even if it could be affected by major internal or external events.</i>
BBB+ BBB BBB-	<i>Good operations and performance. Exposure to risks is limited and risks are quite well monitored and managed. Quite stable even if it could be affected by significant internal or external events.</i>
BB+ BB BB-	<i>Adequate operations and performance. Exposure to risks is limited and risks are monitored and managed. Stable even if it could be affected by internal or external events.</i>
B+ B B-	<i>Sufficient operations and performance. The institution is exposed to some risks and they are sufficiently monitored and managed. Not completely stable and vulnerable to internal or external events.</i>
CCC+ CCC CCC-	<i>Basic operations and performance. The institution is exposed to some risks even if they are in part monitored and managed. Potentially unstable and vulnerable to external or internal events.</i>
CC+ CC CC-	<i>Very basic operations and performance. Exposure to risks and weak capacity to monitor and manage the risks. Potentially unstable and vulnerable to external or internal events.</i>
C+ C C-	<i>Poor operations and performance. Relevant exposure to risks and poor capacity to monitor and manage the risks. Potentially unstable and vulnerable to external or internal events.</i>
D	<i>Very poor operations and performance. Relevant exposure to risks and very poor capacity to monitor and manage the risks. Unstable and very vulnerable to external or internal events. Risk of default.</i>

**OUTLOOK** indicates the direction a rating is likely towards to move over a one year period

**POSITIVE** Probable upgrade

**STABLE** It is not likely to change

**NEGATIVE** Probable downgrade

The information used in the current rating has been partly provided by the institution subject to the evaluation process and partly collected during the meetings with the head executives. The analysis is based on audited financial statements and other official sources. MicroFinanza Rating cannot guarantee the reliability and integrity of the information, as it does not conduct auditing exercises, and therefore does not bear responsibility for any mistake or omission coming from the use of such information. The rating has to be considered as an external and independent opinion and it has not to be considered as a recommendation to realize investments in a specific institution.