



**February 2008 Newsletter**  
**BlueOrchard Microfinance Securities 1**

Dear Investor:

In this newsletter, we provide an overview of the performance of BOMS1 and its 14 participating MFIs from January through December 2007<sup>1</sup>. Of note is the news on November 26th 2007 that KMB prepaid the full USD 7,250,000 BOMS1 loan. Since the acquisition of 75% of KMB's share capital in 2005 by Banca Intesa, the Bank has had increased access to cheaper funding and BOMS1 became a costly source of funding. This prepayment was accepted since KMB has also been moving away from a pure microfinance player to a universal commercial bank since its acquisition by Bank Intesa.

**Seventh Interest Payment: January 2008**

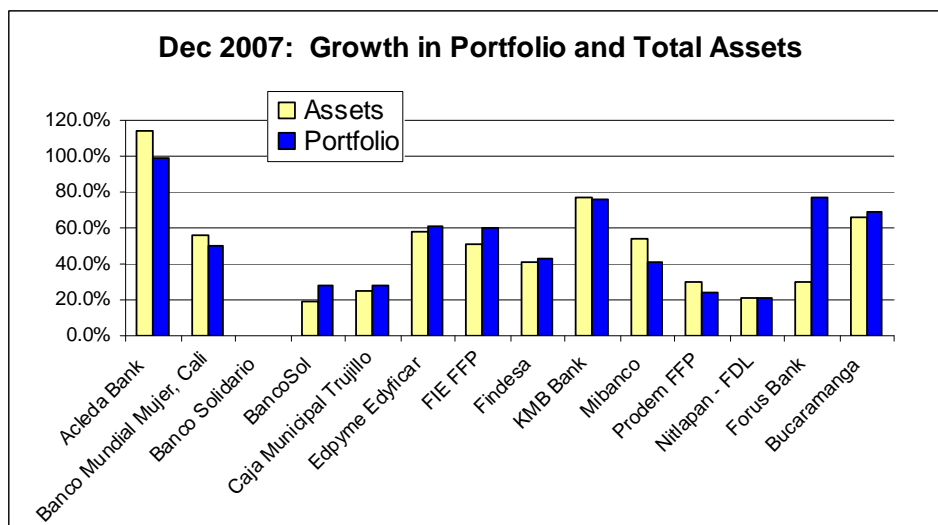
All 14 MFIs made their 15 January 2008 interest payments on schedule. Interest payments were subsequently disbursed to the Senior and Subordinated Noteholders on 31 January, 2008. Since the July 2004 closing, BOMS1 has made seven interest payments to investors.

**Investment Monitoring: The 14 MFIs:**

**(1) Asset and Portfolio Growth:**

In 2007, the combined total assets of the BOMS1 MFIs grew 45.54% to 4.90 billion USD while combined total portfolio grew 47.72% to 3.95 billion USD. These growth rates are slightly above the growth of assets and portfolio achieved in 2006, 41.67% and 37.57% respectively.

The MFIs with the highest asset growth in 2007 were Aceda Bank of Cambodia (113.7%) -- the MFI with the highest asset growth two years running – KMB Bank of Russia (77.2%), and Edpyme Edyficar of Peru (57.9%). Please see section 7 below for a profile of Edyficar. The MFIs with the strongest portfolio growth were Aceda Bank (98.8%), Forus Bank (77.11%) and KMB Bank of Russia (75.8%).



<sup>1</sup> Based on unaudited numbers self-reported by the MFIs through December 2007.



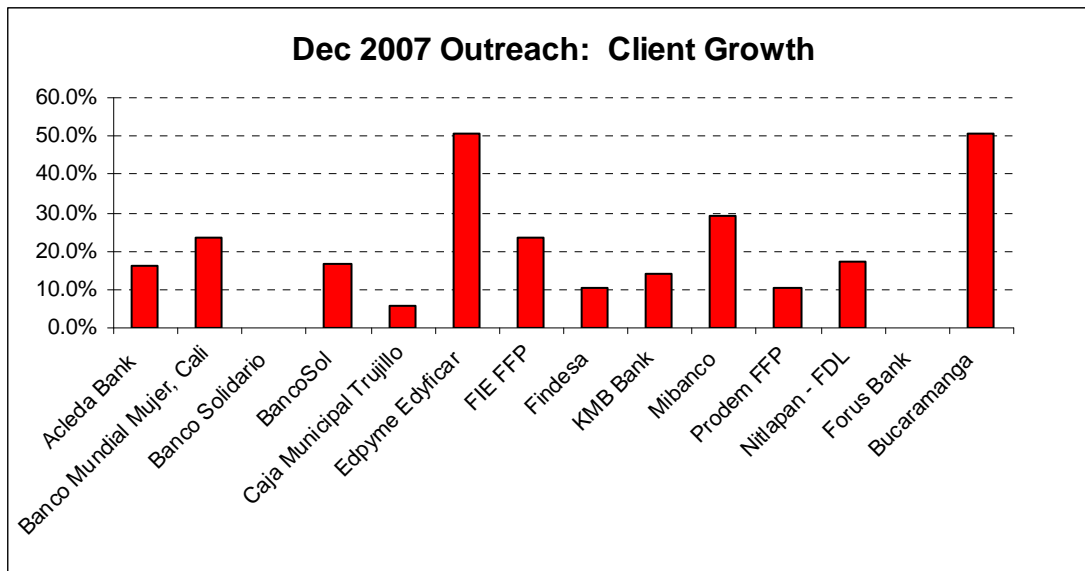
The MFIs with the slowest portfolio growth rate were Banco Solidario of Ecuador (-8.00%), FDL Nitlapan of Nicaragua (20.7%) and Prodem of Bolivia (23.8%). As mentioned in the August 2007 newsletter, the shrinkage in Banco Solidario's balance sheet is due principally to the sale of certain assets in its commercial lending portfolio in attempts to improve the Bank's profitability and portfolio quality.

**(2) Client Outreach:**

By 31 December 2007, over 1.70 million clients were being served by the MFIs in BOMS1, a 19.7% increase over last year.

This year's three fastest growing MFIs in terms of client outreach were Edyficar (50.7%), WWB Bucaramanga (50.5%) and Mibanco of Peru (29.1%). WWB Bucaramanga and Mibanco also lead in client growth in 2006.

The institutions experiencing the slowest client growth were: BancoSolidario of Ecuador (-8.3%), FORA/Forus Bank (-6.77%), and CMAC Trujillo (5.8%). As discussed below and in previous newsletters, FORA's transition into a commercial bank, Forus Bank, in 2006 has had an impact on the growth in loan portfolio and client outreach. Although losses in its SME portfolio lead Banco Solidario to restructure its operations and balance sheet in the past year, it remains the largest provider of microfinance services in Ecuador.



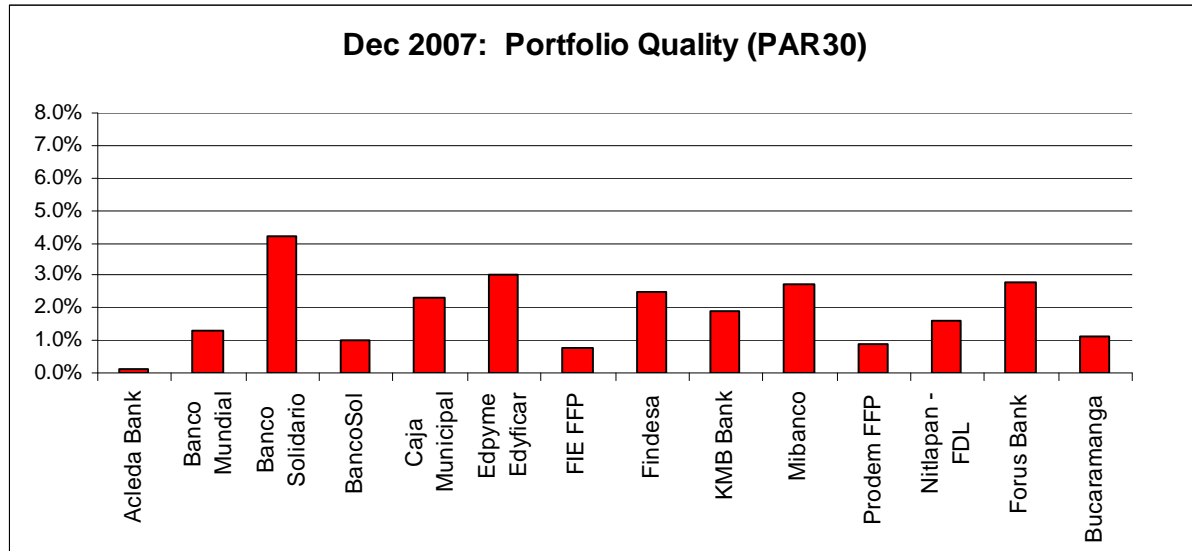
We will continue to monitor the client growth of the BOMS1 MFIs.

**(3) Portfolio quality:**

The average PAR30 (the percentage of the MFIs' portfolio at risk past 30 days) for the MFIs was 1.85% an improvement over last year's average PAR30 of 2.12% an on par with 1.75% at December 2005. 13 of the 14 MFIs ended the year with a PAR30 of 3.0% or less while BancoSolidario had a PAR30 of 4.2%.

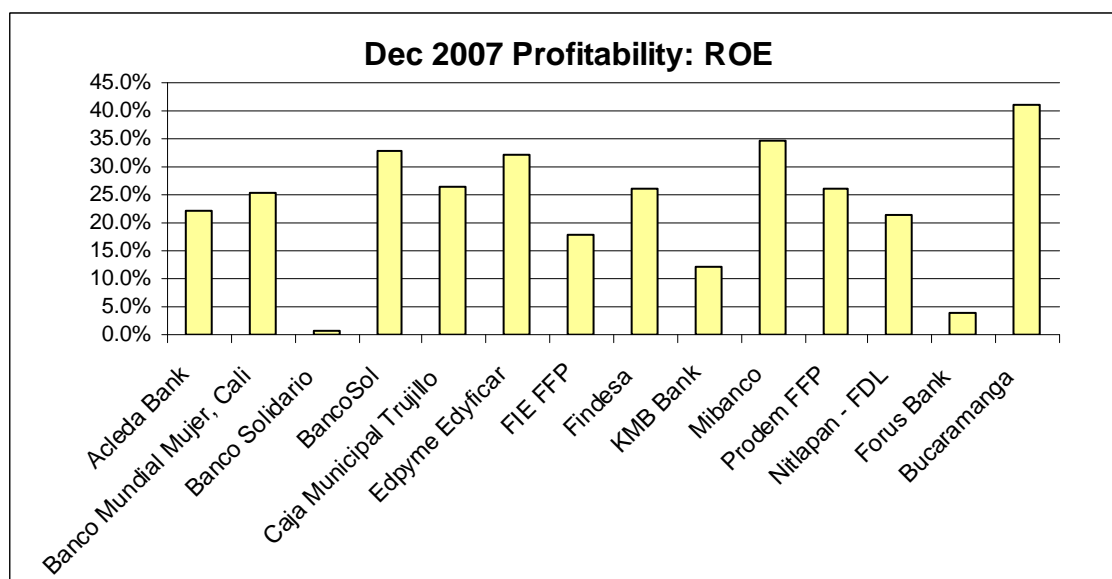


As the PAR calculation can be influenced by the speed of growth of the portfolio and write-offs, it can not be relied on as a sole measurement of portfolio quality.



**(4) Profitability:**

The MFIs in BOMS1 continue to show strong profitability; in 2007, they generated an average ROA of 3.23% (3.47% in 2006) and an average ROE of 23.06% (23.45% in 2006). The MFIs with the highest ROE were WWB Bucaramanga (50.5%), Mibanco (34.6%) and BancoSol of Bolivia (32.7%). This is the third straight year that WWB Bucaramanga has been the top performer.





## **(5) Global Economic and Political Environment**

Global financial markets have been volatile over the past several months, precipitated in particular by the decline in value of US sub prime and other mortgage securities and the decline in US housing prices that is associated with it. This has led to, downgrades of structured debt products of many kinds and contagion to other credit markets. In January, the US Federal Reserve responded to tightening credit markets and recessionary fears by reducing the key fed funds rate by 125 bps, 75 bps in an unexpected announcement and 50 bps at the scheduled FOMC meeting. Central banks in several developed countries also took coordinated action to ease liquidity as credit crunch conditions began to jeopardize the proper functioning of credit markets. The structured product market has been the hardest hit; CDO issuance has nearly ceased in many asset classes.

Emerging markets asset classes have been relatively resilient to the overall financial market turmoil. While spreads have widened for sovereign debt in tandem with other global credit markets, the strong economic fundamentals of many regions has meant that many local markets have continued to show positive results.

For the microfinance sector specifically, the impact of the credit crunch has been muted to date. The institutions themselves continue to perform extremely well, as indicated in previous sections, and have not suffered deteriorations in their portfolio quality. Obtaining financing to fund their rapid growth, however, has potentially become more challenging as global liquidity conditions tighten, and we are closely monitoring the refinancing risk of the MFIs, particularly for those with high leverage. The diversity of funding sources for microfinance institutions, which includes international lenders, development banks, local banks, bond markets and depositors, mitigates this risk significantly. The “double bottom line” motivation of many investors to microfinance is also helpful in maintaining liquidity to the sector.

The following are brief updates of the BOMS1 countries experiencing material change in their political, economic or microfinance environment:

### **Bolivia**

The election of leftist President Evo Morales was viewed with concern by many in the microfinance sector because of the possibility of populist-inspired interventions by the government that could lead to defaults by clients and MFIs.

To date, however, this has not been the case as no interest rate caps have been introduced and MFIs continue to achieve healthy growth with strong portfolio quality. Moreover, President Morales has not been able to consolidate power and faces strong opposition to many of his proposed policies. In November, there were some violent clashes between the government and opposition supporters followed by several regions (4 of 9) declaring themselves autonomous. Tensions have since subsided and the MAS administration has met with the regional governors to settle their differences. It is unclear how these discussions will progress, but the outlook appears much better than in November. Concessions from both sides are likely and the constitution will ultimately go to a national referendum. Political demonstrations, and violence, remain a possibility but a civil war is very unlikely and the country seems to be functioning unabated.

With regards to the microfinance industry, the Bolivian Banking Superintendency did not approve the acquisition of Prodem by the Banco Industrial de Venezuela, a state owned bank. This news was welcomed by most practitioners as this acquisition would have added uncertainty to the market since the Venezuelan bank’s intentions were unclear.



## **Ecuador**

The current political situation in Ecuador is characterized by an unusual concentration of power in the Executive Branch. President Rafael Correa was able to pass a referendum to create a Constituent Assembly in which his party eventually obtained 90 of its 130 seats. This assembly has the mandate to re-write the constitution and has temporarily dissolved congress. In tandem to this political maneuvering, there has been a clear deterioration of the economy; economic growth in the second half of 2007 was a worrisome 1.4%. End of year GDP growth figures have been revised downward to a mediocre 2% which is significantly lower than the 3.9% and 6.0% growth rates registered in 2006 and 2005, respectively.

More specifically regarding the microfinance sector, the 5-5-5 government program (loans of USD 5,000 for 5 years at a 5% interest rate targeting the productive sector) has had virtually no impact on the market thus far, although it could eventually effect the credit culture of borrowers as the program has experienced massive defaults. Thus far the government has disbursed about USD 70 million, but PAR 30 is said to be about 40%. As a result, apparently USD 280 million that had been allocated to this program, has been diverted to the subsidy of agriculture inputs, gas, etc.

In other news for the microfinance sector, the interest rate ceilings that were set in mid-2007 have been increasing as each month's ceiling is based on the previous month's average. Thus, the subsistence microfinance ceiling rate has gone from 41% to 46% leaving the MFIs in BOMS1 with more than a sufficient margin to operate sustainably.

## **(6) MFI Updates**

### **Banco Solidario**

BancoSolidario's loan book and balance sheet has been showing improvement following a difficult 2006 when the bank wrote off a sizeable volume of non-performing assets. Banco Solidario's portfolio quality has improved significantly; PAR 30 has gone down from 6% in January 2007 to 4.6% in January 2008). In 2007, the bank experienced a decrease in revenues due to the interest rates ceilings imposed by the Ecuadorian Central Bank. The immediate effect is seen in its December 2007 financial statements (ROA 0.1% and ROE 0.7%) as the law prohibits institutions from charging upfront commissions. The net effect of the change to accrued interest in lieu of upfront fees will only be evident after a complete portfolio rotation, which will occur in July 2008. The interest rate ceilings have been set at levels (20% to 46% depending on the loan amount) at which Banco Solidario can sustainably operate; its overall portfolio yield remained stable throughout 2007 at 28%. Thus, BancoSolidario expects to close the year 2008 with a much healthier net profit of USD 1 million, compared to USD 241,000 (unaudited) in 2007.

### **Forus**

Forus Bank successfully closed its first year of operation as a commercial bank. Total portfolio increased by 76% year-on-year to USD 65 million. The bank experienced some client drop-out during the first nine months of the year due to its transformation into a new legal entity and related new requirements such as additional documentation and increased bank fees. In response to these new challenges, Forus has designed new products requiring less documentation, introduced a money transfer system and increased direct cash operations with cash vaults installed in most branches. Portfolio quality remains good although Forus operates in a more difficult environment than a year ago. The competition from commercial banks, especially from the State-owned Sberbank, and the boom in consumer lending in Russia has entailed a change in credit culture and increased overindebtedness of clients. Forus has



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therefore strengthened its risk management and procedures, hired a new Head of internal audit, introduced new positions for ex-ante and ex-post controls in each branch and changed its bonus policy. Also, as of December 2007, Forus' write off policy will comply with standard banking practices; all loans with delinquency of more than 180 days are written off which explains the strong increase in write-offs as of December 2007.

### **(7) Featured MFI : Edpyme Edyficar, Peru**

Edyficar is an "Edpyme" (Empresa de Desarrollo de la Pequeña y Micro Empresa) registered under the Banking Act (2002), Law N° 26702, and is under the supervision of the "Superintendencia de Bancos y Seguros" (SBS). This microfinance institution grew out of a CARE Peru program and has been providing microfinance loans since 1985. In 1998 the Edpyme was created. CARE Peru is the largest shareholder with 84% of the shares; the remaining shares are owned by Microvest 8%, individuals, and employees.

The Edpyme's activity is lending to micro, small and medium sized businesses, as well as to individuals for housing loans. Edyficar participates in "Mivivienda" a national program supporting the rehabilitation and construction of houses. As of December 2007, Edyficar had a total of USD 152 million in total assets and USD 128 million in portfolio. With 137,000 active clients, Edyficar is the largest Edpyme in Peru and the second largest MFI in terms of microfinance clients.

Edyficar has a strong governance with an active board made up of nine professional representing the shareholders and independent members. Headquartered in Lima, Edyficar has 17 branches throughout Peru and is represented in most major cities. Edyficar has 722 employees of which more than half are loan officers. With an average loan size of USD 862, Edyficar participates primarily in microfinance compared to municipal savings and loans companies and microfinance banks which have a significant portion of their portfolio in SME loans.

2007 was an excellent year for Edpyme Edyficar as it took advantage of favorable macroeconomic conditions in Peru. In a year when Peru's GDP grew over 7%, Edyficar was able to grow its portfolio 61% and its number of clients 50%. Edyficar's solid portfolio performance is especially impressive given the strong competition it faces. Portfolio at risk above 30 days was 3% in December 2007 compared to 3.5% one year earlier. Financial performance was also strong with an ROA of 5.4% and ROE of 32.3% (in USD).

2007 was also a pioneering year for Edyficar as it issued its first capital markets issuance with a partial credit guarantee from the IFC. The approximately USD 50 million program was rated AA- by Apoyo, a Peruvian rating agency. Edyficar is the only second Peruvian MFI to issue bonds in the capital markets (after MiBanco) taking advantage of the highly liquid Peruvian pension funds.

2008 should be another important year for Edyficar as growth prospects continue to be strong in microfinance and the economy in general. Edyficar has also applied for a license as a non-bank finance company, which will allow Edyficar to accept deposits and issue commercial paper. At the same time, 2008 will also be a year of increased competition as many of Peru's large commercial banks are entering the microfinance arena after seeing specialized MFIs enjoys financial success over the years. These banks will likely pursue a market niche with a higher average loan size than Edyficar.



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## **(8) Looking Ahead**

BlueOrchard expects continued growth and profitability for the participating MFIs in 2008. We will continue to keep investors apprised of any material changes to the institutions in the BOMS1 portfolio or the environments in which they operate, and remain available to answer any questions you may have.

Sincerely yours,

The BlueOrchard Team

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