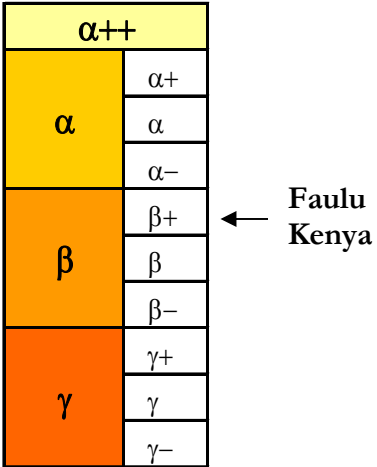
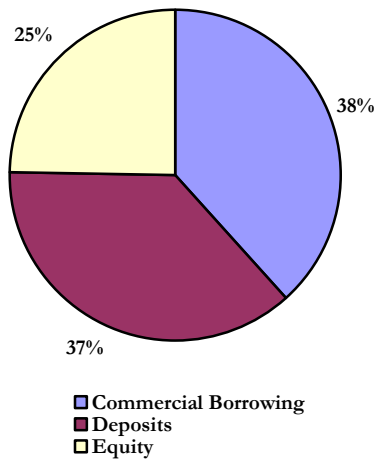


Faulu Kenya Limited – 3 rd Rating	KENYA
Limited Liability Company	Report as of December 2006
Contacts	Synopsis
<p>MicroRate: Craig Kirkwood Craig@MicroRate.com</p> <p>Benjamin Midberry Ben@MicroRate.com Tel: 011.703.243.5340 Fax: 011.703.243.7380</p>	<p>In 1991 Faulu Kenya was established as a lending project of the Food for the Hungry International (FHI) Kenyan country program. Now a limited liability company, Faulu Kenya's main shareholder, FHI, is based in the United States and is registered in Switzerland. Faulu Kenya is a faith based Christian organization and is one of the leading microfinance service providers in the country. This position is supported by the MFIs sizeable portfolio which grew by 65.9% to over \$19 million in 2006. Faulu Kenya makes mainly group loans and services around 68,000 clients.</p>
PERFORMANCE RATING	β+
Date of visit	February 2007
Date of previous rating	n.a.
Previous rating	n.a.
Forecast	Positive
Highlights	Highlights
 <p>The diagram shows a vertical scale of ratings from α++ at the top to γ- at the bottom. The scale is divided into four main sections: α (yellow), β (orange), γ (dark orange), and α++ (light yellow). Each section has three sub-ratings: α+, α, α-; β+, β, β-; γ+, γ, γ-. An arrow points from the text 'Faulu Kenya' to the β+ rating level.</p>	<p>POSITIVE</p> <ul style="list-style-type: none"> • Impressive return to profitability. • Good improvement in portfolio quality. • Strong management team. • Sufficient liquidity to manage short term growth. • A potentially large, well segmented market. <p>NEGATIVE</p> <ul style="list-style-type: none"> • Increased competition. • Less than optimum MIS. • Unregulated financial intermediation.
Main Performance Indicators	
	Dec'05 Dec'06
Gross Portfolio ('000's)	\$11,462.4 \$19,014.6
Number of active borrowers	39074 68434
ROE	2.0% 23.2%
Portfolio Yield	31.0% 33.8%
Portfolio at Risk	7.8% 3.2%
Operating Expense Ratio*	23.4% 20.1%
Average Loan Size	\$293 \$278
Borrowers per staff	187 222

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FAULU KENYA	KENYA	December 2006
Sources of Funding	Rating Rationale	



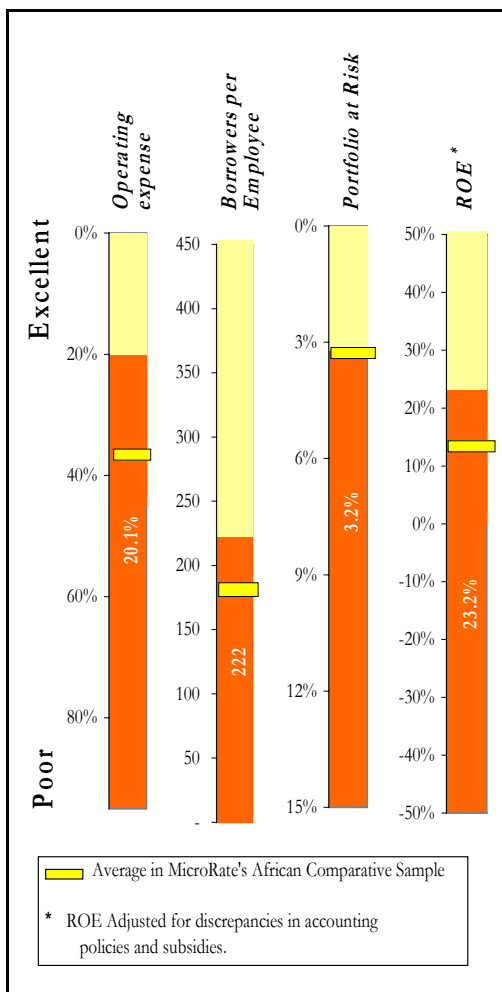
Faulu Kenya’s strong operational and financial improvements have poised it to become one of the leading microlenders in East Africa. An **excellent team of employees, managers and Board of Directors** has made the organization solidly efficient and productive. Its operation performance is complimented by a **keen sense of client needs and the flexibility to meet those needs**. (See page 4)

The organization has shown a **dramatic improvement in portfolio quality** in the past operating period driven by credit methodology tailored to its target client and improved internal controls. (pg. 5)

Faulu Kenya’s new CEO and her management team took the firm from operating losses in 2005 to healthy profits in 2006. **A turnaround of this magnitude has rarely been seen by MicroRate.** Faulu’s staff is equally impressive with low turnover and high operating efficiency and productivity. The Internal Audit and IT departments require further development. (pg. 6-8)

Faulu Kenya’s **Board of Directors is excellent, highly involved** and has positioned Faulu well. The firm has retaken its niche as a grassroots microfinance institution; its operations and strategy are aligned to solidify this position. (pg. 5, 8)

The institution’s structural and operational improvements were demonstrated in its **strong financial performance**. However, the institution still **lacks a stable track record** of financial performance. (pg. 9)



The operating expense ratio and ROE compared to all African MFIs rated by MicroRate with average loans < US\$500.

Country Overview



Macroeconomic Information	Dec 03	Dec 04	Dec 05	Dec 06
Annual Inflation	8.4%	11.6%	10.3%	14.5%
Exchange Rate per US\$	76.1	77.3	72.4	69.6
Annual Currency Devaluation	-1.2%	1.6%	-6.4%	-3.8%
Deposit Rate (Year Average)	2.1%	2.4%	5.1%	-

Source: International Finance Statistics

Over the last 4 years, Kenya has seen relative political and social stability, with Government actively supporting private sector development. As poverty eradication is a key issue on its agenda, support from Government has boosted MFI development. The Kenyan microfinance industry is poised for considerable change now that the Microfinance Act has been signed into effect (in late 2006). The central bank will be responsible for supervision and will legalise financial intermediation by microfinance institutions for the first time. However, despite opening a special department for rural microfinance, the department is not adequately staffed and supervision of microfinance institutions remains weak.

At the moment, there are only two players in the microfinance industry which are regulated: K-Rep and Equity Bank. Relative to other MFIs, these institutions are giants as they offer products and services for both traditional commercial banking clients and typical microfinance clients. As these institutions have built up good experience in mobilizing deposits, newly regulated MFIs will initially find it difficult to compete effectively.

Whilst these banks pose a threat to Faulu Kenya, the movement of mainstream banks into microfinance is of greater concern. Although this has been limited to local banks, international players (such as Barclays Bank) have started to move down scale. Not only do they offer salary loans, but unsecured micro-loans as well. Cumulatively, these commercial banks have significant critical mass. As such, MFIs will need to differentiate themselves and identify a market niche in which they can develop suitable competitive advantage.

Faulu Kenya understands this and so far has made good strides to position itself at the low end of the microfinance spectrum. Accompanying this strategy, the MFI has successfully extended its outreach into new geographical areas and segmented its market through its wide product range. This demand driven approach resulted in the institution reporting healthy growth rates since 2005.

Notwithstanding the threat of increased competition, there is still considerable scope to grow considering that around 56% of Kenya's population – 32 million - does not have access to formal financial services. Kenya's microfinance industry is also highly fragmented with around 3,500 microfinance providers and just as many SACCOs. Nearly all of these are small and operate in limited geographic areas. With almost 50% of Kenya's population concentrated in rural areas, it is expected that only 5 MFIs (K-REP, Equity Bank, Faulu Kenya, Kenya Women's Finance Trust ("KWFT") and SMEP)¹ are capable of targeting such clients given that they have the necessary infrastructure.

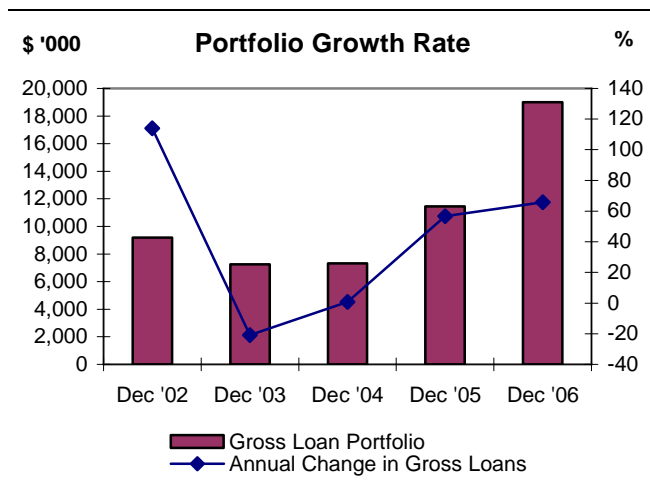
Overall, Faulu Kenya's main competitor remains KWFT (see *MicroRate rating dated March 2007*), since this institution targets the same market and operates in the same geographic areas.

¹ Source: Omar S. Nzomo - Unveiling Microfinance in Kenya

Microfinance Operations

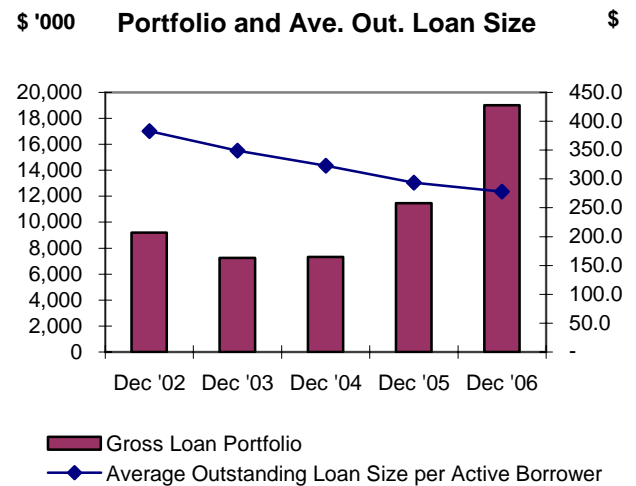
Main Indicators	31 Dec-02	31 Dec-03	31 Dec-04	31 Dec-05	31 Dec-06
Gross Loan Portfolio (000's)	\$9,187.9	\$7,262.5	\$7,315.8	\$11,462.4	\$19,014.6
Number of Active Borrowers	24,010	20,804	22,672	39,074	68,434
Asset Quality					
Portfolio at Risk / Gross Loan Portfolio	0.3%	15.3%	7.9%	7.8%	3.2%
Loan Loss Provision Expense / Average Gross Portfolio	1.6%	4.6%	1.4%	3.6%	0.9%
Loan Loss Reserves / Portfolio at Risk	585.7%	50.6%	70.1%	62.5%	91.2%
Write-offs / Average Gross Portfolio	0.5%	-	3.5%	2.3%	0.4%
Efficiency and Productivity					
Operating Expenses / Average Gross Loan Portfolio	21.8%	21.0%	27.6%	23.4%	20.1%
Cost per Borrower	\$69	\$77	\$93	\$71	\$57
Average Outstanding Loan Size	\$383	\$349	\$323	\$293	\$278
Number of Borrowers / Credit Officer	381	311	298	369	403
Number of Borrowers / Staff	185	147	151	187	222

Following three years of relatively stable growth, in 2005 Faulu Kenya's loan portfolio grew by a healthy 65.9% to \$19.0 million.



This sustained growth followed a deliberate contraction in the portfolio in 2003 as the MFI moved to improve portfolio quality (*see next section*). Whilst an aggressive expansion into the west of Kenya and along the coast saw client numbers more than triple to 68,000 (since 2004) this was also supported by a return to grassroots microfinance. As a consequence, Faulu Kenya is almost exclusively focussed on group loans.

This move downscale required the MFI to radically differentiate its product portfolio. This demand driven approach has been successful and the resultant volume growth more than offset the decline in the average outstanding loan size since 2002. As at December 2006, the average loan per active borrow reduced to \$278, from a high of \$383.



Faulu Kenya is good at making and recovering small, unsecured loans. They have developed a keen sense of their market, know their business, and have processes and systems that function well. This portfolio is managed through a nationwide network of twenty branches, divided into geographic zones. Area managers help to knit this far-flung network together, and ensure consistent application of credit policy.

The institution's primary product is a group loan which combines traditional village banking with solidarity lending. Clients are usually introduced into the microfinance programme with a traditional business loan known as Pamoja, which comprises nearly half (46.3%) of the loan portfolio.

The Wakulima (a loan to farmers) and the longer term Fanaka loan complement the product portfolio and together, they comprised 34.2% of the portfolio in December 2006.

The balance of the portfolio is heavily diversified, with around twenty loan variants offering longer term business loans, salaried loans, leased asset loans and loans to buy shares (amongst others).

Loan Products

	Pamoja	Wakulima	Fanaka
Loan type	Business	Agriculture	Business
Term	3-12 months	3-12 months	12-18 months
Int. rate*	15%-18%	20%	15%-18%
Int. type	Flat	Flat	Flat
Min loan	-	-	-
Max loan	\$1,400	\$2,800	\$7,000
Savings	25%	25%	25%
Portfolio %	46.3%	21.5%	12.7%

*Per annum

Groups are trained for up to 6 weeks, during which time an Executive Committee is elected. Most groups meet weekly, whereby loan disbursements, repayments and savings transactions are conducted. Good group formation is a key element of Faulu Kenya's success.

Typical of Grameen replicators, loan appraisal is done by clients, in that amounts are proposed and approved by the group itself, the group offers a joint and several guarantee and is self-selecting. This aligns interests such that only those members that are known by the others are approved by their peers for certain amounts.

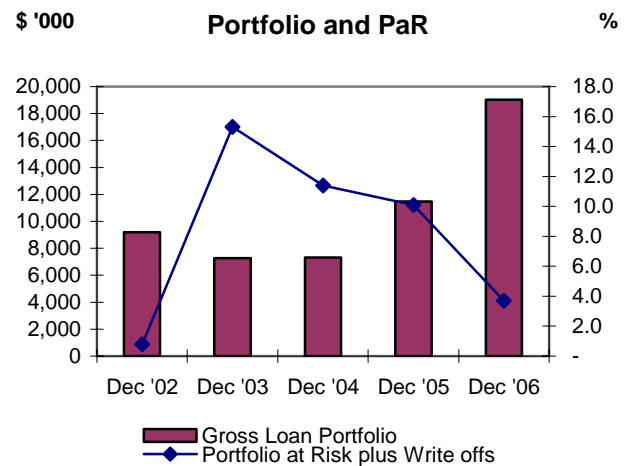
Before giving preliminary approval, group members visit each others' businesses. Payment capacity of each client is verified by a loan officer.

The competitive advantage of this credit technology in the Kenyan market is its ability to adapt to individual needs: an individual group member may pay down the loan more quickly and immediately receive a subsequent loan of a larger amount without waiting for others to complete their payments.

Overall, Faulu Kenya's ability to respond to client's needs is a major strength. Not only has this facilitated growth, but the drop out rate is relatively low. Client attrition is to be expected in a competitive group lending environment, but at current levels MicroRate is not yet concerned. What is worrying however, is the increase in multiple borrowing. Some clients are known to have up to 5 loans from Faulu Kenya and other MFIs, which strongly points to the danger of client-over indebtedness.

Portfolio Quality

In response to competition, Faulu Kenya's portfolio grew rapidly in 2002. In so doing, the MFI went rapidly upmarket and found itself in a niche with which it was not familiar. This combined with relatively poor branch monitoring resulted in a significant rise in PaR (over 30 days) to 15.3% (2002: 0.3%). Portfolio quality has since improved and in December 2006, PaR reduced to 3.2%. This is roughly in line with MicroRate's average for similar African MFIs.



In line with the lower PaR, write-offs as a percentage of the average portfolio declined to 0.4% (2003: 3.5%).

PAR plus write offs

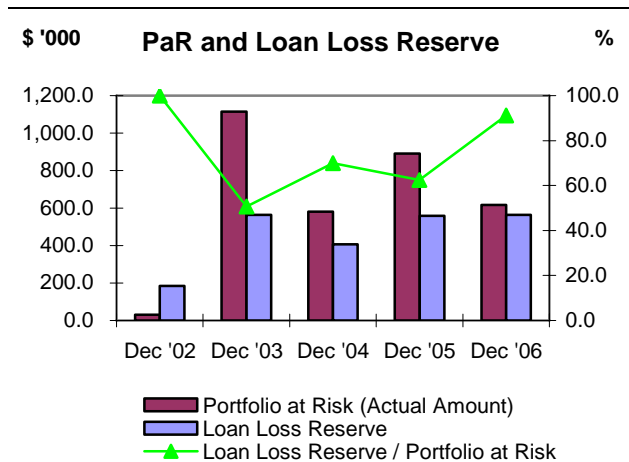
Portfolio Quality	December 2005	December 2006
Gross loan portfolio	\$11,462.4	\$19,014.6
Portfolio at risk	7.8%	3.2%
Write-offs/ Portfolio	2.3%	0.4%*
PaR plus write-offs	10.3%	3.6%

*Based on proposed write-off figures for the year.

This lower PaR is what one would expect from an institution where loans are backed by up to 50 members. The peer pressure mechanism is effective, and has been strengthened by good group training. However, arrears can be artificially lowered by "tapping" the Loan Savings Fund of an individual client. This is usually a matter of last resort (four consecutive missed weekly payments) and is not a preferred method of repayment.

On the whole, the improvement in portfolio quality can be attributed to a number of factors including:

- The implementation of effective approval processes and controls.
- The ability to track internal arrears (arrears by those clients whose payments had to be covered by others in the group) on an individual level. These data are very useful in screening out individual problem clients from subsequent loans.



Note: In 2002, the risk coverage ratio is shown as 100%, even though coverage was higher.

From a provisioning perspective, loan loss reserves to portfolio at risk increased, from a somewhat low 62.5% in 2005 to a fully adequate 91.2% in 2006. Although this is a comfortable level, it would be prudent, in MicroRate's judgement, if loan loss reserves fully covered portfolio at risk. This is particularly relevant given the high growth rates recorded since 2005 and the sizeable deposits held by the institution.

Organization and Management

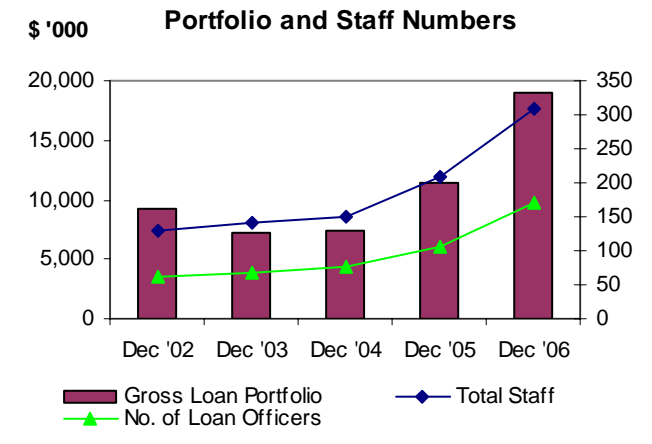
Faulu Kenya is headquartered in Nairobi and operates through a network of 20 branches. The Chief Executive Officer, Lydia Koros, has an abundance of commercial banking experience.

Over the last two years, the institution has made great strides in strengthening its capacity and boosting the competency of the management team. Senior managers are well qualified and have a good mix of banking and microfinance experience. The MFI displays good depth in management.

The executive management team resembles that of a commercial bank, and is predominantly made up of the following managers: Finance and ICT, Operations and

Business Development, Human Resources, Legal and a Chief Internal Auditor and Credit Administration.

Faulu Kenya recruits centrally and has grown its staff complement in line with the portfolio. As at December 2006, the institution had 308 staff, 170 of whom were loan officers.



Staff were found to be well trained and know their jobs well. However, there is a need to ensure regular and consistently applied training in the branches. Not only is this important to manage future growth, but also to improve the skills of middle management.

There is an incentive scheme in place which is based on a balanced scorecard system. Introduced by the incumbent CEO, loan officers can measure their performance and bonuses are paid out quarterly.

However, MicroRate believes that the targets set by management are too ambitious, which is preventing the majority of credit officers from receiving their bonuses. The problem is further compounded by the fact that the incentive scheme does not differentiate between areas (i.e. urban versus rural markets). These factors together can be counterproductive and could end up being demotivating.

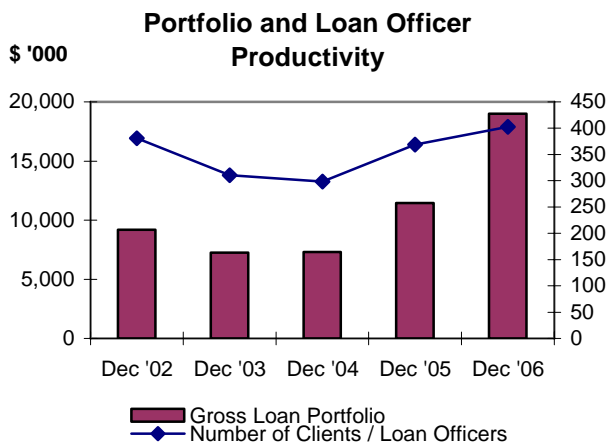
Despite this, staff turnover is low and this suggests a good working environment.

Staff Productivity

In terms of staff productivity, credit officers, on average, managed 403 borrowers, up from 367 in 2005. Even the lower of these two numbers is higher than

MicroRate's average for similar African MFIs (308). The higher productivity levels are quite an achievement, especially given that the number of credit officers has more than doubled since 2004.

The number of borrowers per staff followed the same trend and increased to 222 (2005: 186). This also remains well above the African average of 176.



Operating Efficiency

There is no doubt that highly productive staff contributed greatly to efficiencies. Faulu Kenya is efficient, reporting an operating expense ratio of 20.1%. For a village banking institution, this level of operating efficiency is good and even surpasses MicroRate's average for MFIs rated in both Africa and Latin America. The average operating expense ratio for African MFIs rated by MicroRate is 33.8%. In Latin America it is around 25.0%.

Furthermore, the good level of efficiency is confirmed by the cost per borrower trending markedly downwards over the past two periods, from \$92.6 to a review period low of \$57.1 in 2006.

Internal Controls

Faulu Kenya's internal controls are satisfactory and are strengthened by an Audit department of 3 individuals. At the moment, branches are visited at least once per year which is all that is possible given current capacity levels. In MicroRate's opinion, this is insufficient and the MFI would benefit greatly from an increase in capacity.

The Chief Internal Auditor has a wealth of experience with PricewaterhouseCoopers, the largest international accounting firm. In a relatively brief period, she has revived the internal audit function and is in the process of formalizing internal audit procedures. In addition, 8 committees are being created to identify weaknesses in various business areas.

This, together with strong process reviews of branch activities should continue to strengthen controls and

limit fraud. However, incidences of both client and staff initiated fraud have been reported.

Overall, MicroRate believes that internal controls will be enhanced by the implementation of the new MIS (*see below*). Whilst this will be a difficult task, it should also improve efficiencies (i.e. processes will be less time and labour intensive). Moreover, the technical capabilities of the audit department would benefit greatly by hiring staff with IT skills.

Management Information System

Faulu Kenya uses a loan tracking system known as Microbanker (a popular microfinance banking suite). Although this system is able to track most necessary data, it is inflexible and prone to error (due to the manual entry of data at head office).

It appears that one of the biggest limitations of the system is that it cannot consolidate all of its branch information into a single summarized report. As a result, the MIS cannot easily be modified and reporting is often inadequate. Currently, query reports have to be generated outside of the system using complementary, internally designed programmes. This makes customisation difficult and can hamper decision making capabilities. One example is that Microbanker can only generate a weekly ageing report. To generate an ageing analysis for a specific financial period is manual and takes time.

It is apparent that the MFI has outgrown Microbanker's capabilities and the need for more sophisticated banking software is tangible. Rapid growth has exacerbated the system's weaknesses and already the MIS is struggling to cope with the higher volumes of data. This is likely to increase the frequency of report mismatches (i.e. with the general ledger) which in the long run could add up to material amounts.

The MFI realises that the system needs to be replaced. The plan is to implement a new MIS by July 2007, which is ambitious. No software vendor has yet been identified, but the strategic plan allows for a 5 year rollout in which all branches will be interconnected.

Accounting System

Accounting at Faulu Kenya is centralised. The system is not integrated and financial reports are generated using Great Plains. Data are exported to the accounting software monthly and a consolidated report is generally available by the 10th of the following month.

Governance and Strategic Positioning

Faulu Kenya was incorporated as a company limited by shares in 1999 and is majority owned (70%) by Food for the Hungry International (“FHI”). The other 30% is owned by Faulu Kenya Trust. The Board of Directors, which meets quarterly, is comprised of 7 individuals, six of whom are Kenyan. The Chairman (also a director of FHI) has an extensive business background whilst the other members have an array of legal, accounting and business experience. The CEO holds an ex-officio position.

From MicroRate’s perspective it appears that the Board strikes a good balance between its social and commercial objectives. In terms of the latter, there are plans to enhance the capacity of the Board with banking and IT skills. This is to be encouraged, especially as the institution plans to transform into a regulated financial intermediary.

At the Board level there is also an executive, audit and risk management committee. These meet monthly, except for the executive committee which meets bi-monthly. Whilst this approach to risk management is necessary, a more formal framework would be desirable. This will become more urgent as the institution grows and regulatory demands increase.

As the institution prepares for transformation, the Board might consider putting in place a transformation committee. In MicroRate’s experience, the transformation process is often traumatic and one that requires the full weight of the Board.

Transforming into a regulated entity is possibly one of the biggest challenges the institution will face in the short term. Not only will Faulu Kenya have to stake large financial resources (the minimum capital requirements are KShs 60 million or \$750,000 equiv.) to meet central bank requirements, but the MFI will have to diversify its ownership structure (with a maximum shareholding of any one investor limited to 25%). Although the recent upward trend in profitability is encouraging, in Faulu Kenya’s case, attracting like-minded shareholders could be a difficult and lengthy process.

In addition, the transformation process will demand much time and effort from management. In this regard, it is imperative that proper structures are put in place to deal with this. Failure to do so could result in management’s focus being diverted away from operations, which could potentially undermine growth.

This said, there is definite need to transform. There is no doubt that Faulu Kenya can generate much needed

competitive advantage by mobilising deposits, which are a cheaper source of funding. Already the MFI is well positioned for transformation, with many staff and some structures already in place (legal, capital requirements etc). This is further supported by the institutions strong market position.

Faulu Kenya has developed a niche which it knows well. It has successfully segmented this market and developed its products accordingly. In so doing, the MFI has been able to grow horizontally (through volume) by offering smaller loans to the potentially large, low end microfinance market. This move has seen average loans sizes consistently decline whilst growth rates have been maintained at above 50%.

Financial Profile

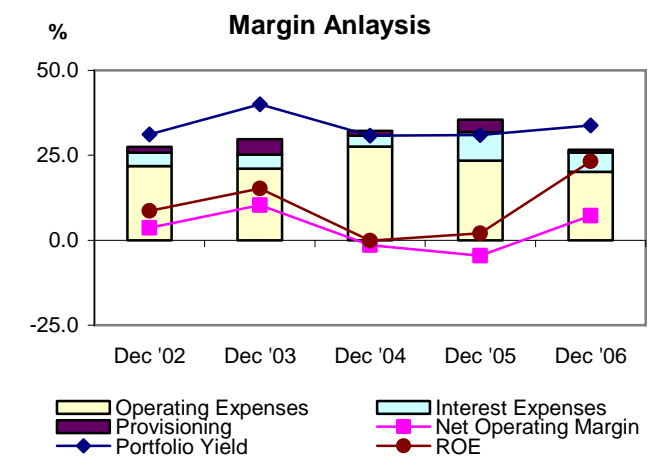
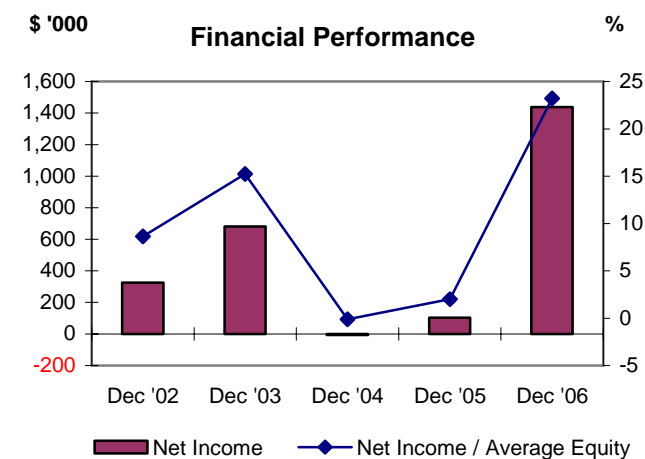
Financial Ratios	31 Dec-02	31 Dec-03	31 Dec-04	31 Dec-05	31 Dec-06
Capital Adequacy					
Debt / Equity	2.0	1.2	1.5	2.7	3.1
Asset Quality					
Portfolio at Risk / Gross Loan Portfolio	0.3%	15.3%	7.9%	7.8%	3.2%
Loan Loss Provision Expense / Average Gross Portfolio	1.6%	4.6%	1.4%	3.6%	0.9%
Loan Loss Reserves / Portfolio at Risk	585.7%	50.6%	70.1%	62.5%	91.2%
Write-offs / Average Gross Portfolio	0.5%	-	3.5%	2.3%	0.4%
Management					
Operating Expenses / Average Gross Loan Portfolio	21.8%	21.0%	27.6%	23.4%	20.1%
Number of Borrowers / Credit Officer	381	311	298	369	403
Number of Borrowers / Staff	185	147	151	187	222
Earnings					
Net income / Average Equity (ROE)	8.7%	15.2%	(0.1%)	2.0%	23.2%
Net income / Average Assets (ROA)	3.4%	6.0%	(0.1%)	0.7%	5.9%
Portfolio Yield	31.1%	40.1%	30.7%	31.0%	33.8%
Interest and Fee expenses / Average Gross Loan Portfolio	4.0%	4.2%	3.2%	8.4%	5.6%
Interest and Fee expenses / Average Funding Liabilities	6.1%	7.8%	6.4%	9.9%	6.0%
Liquidity					
Cash & Liquid Assets / Total Deposits	64.1%	67.1%	85.1%	101.6%	81.9%

MicroRate's Adjustment

MicroRate has shown income from the loan portfolio as "operating income", and income from investments as "non-operating income".

The benefits of Faulu Kenya's management restructuring began to feed through in 2006 as profit margins rose rapidly. With a healthy net income of \$1.4 million and a ROE of 23.2% the MFI is more than financially sustainable. This followed an operating loss of \$423,700 in 2005, where net income was boosted by non operating income of around \$555,000.

Interest and fee expenses as a percentage of the average portfolio reduced to 5.6%, down from a high 8.4% previously.



The low interest expense is attributable to the highly successful bond issue in 2005 which has funded much of Faulu Kenya's growth. As a consequence, total borrowings increased over 3 times to \$6.9 million. In 2006, total debt increased a further 58.8% to \$11 million, of which 34.5% relates to a revolving loan facility. As a result, debt funding exceeded deposits for the first time.

Although portfolio yield increased slightly to 33.8% in 2006 (2005: 31.0%), higher net operating margins were largely the result of lower provisions and funding costs.

The debt: equity ratio has consistently increased since 2003 and it now stands at 3.1:1. There is still scope to borrow in the short term, but if current growth rates continue, Faulu Kenya could reach the limits of its borrowing capacity relatively quickly. Becoming

regulated financial institution would remove this constraint.

Following the corporate bond issue, debt funding increased to 36.4% of total capital (equity plus liabilities) and further to 38.5% in 2006 (2004: 19.7%). This bond matures in 2010 and is unsecured. However, it is guaranteed (75%) by the French Development Agency up to a maximum principal amount of Euro 6 million. The issue is priced against the 91 day Treasury bill plus 0.5%. Faulu Kenya also pays 0.5% of the outstanding principal as guarantee fees quarterly.

The institution's 3 year revolving loan is held with Standard Chartered Bank. Approximately 90% of the facility had been utilised at December 2006 and is charged at an interest rate of 1% plus the Treasury bill rate. The MFI also manages a \$3.6 million overdraft facility which has not been drawn down.

All loans are denominated in local currency and hence there is no foreign exchange risk.

Although not strictly allowed, Faulu Kenya has benefited from the fact that it can intermediate its clients' savings. In 2006, these deposits amounted to a sizeable \$10.5 million. Currently, less than 20% (which is an internally imposed ceiling) of these deposits are tied up in the portfolio. Whilst this practice is risky for an unregulated institution, MicroRate is comforted by the fact that 81.9% of savings were covered by cash and liquid assets.

Overall, MicroRate has no immediate liquidity concern nor is there a mismatch between assets and liabilities in the short term.

Future Prospects

Despite good profits in 2006, the increasingly competitive Kenyan market will pose a significant challenge. Thus, it will be imperative that management focus on maintaining efficiencies, whilst managing portfolio growth (without a deterioration in portfolio quality).

Not only is this critical in preserving margins (especially as transformation will be expensive), but also in facilitating Faulu Kenya's future expansion plans.

Geographic expansion has worked well for the institution and is a strategy which the MFI will continue to employ. However, funding this expansion will prove to be the ultimate test and will require the right people, the right systems and a less labour

intensive operational structure. It is hoped that the new MIS will alleviate much of these problems and should facilitate healthy organic growth going forward.

This being said, funding will also be critical. Whilst the MFI is able to access the capital markets, funding the transformation initiative must also be addressed. At the moment there is a funding gap of approx \$4.3 million for capital expenditure. This sum is significant and at current profit levels, it is unlikely that the institution can absorb the costs internally. In MicroRate's opinion, it would be unwise to divert funds away from operations, as this could potentially place the institution at a competitive disadvantage.

Whilst transformation will be expensive, it is necessary to become regulated. Not only will this provide cheaper funding sources, but will allow the MFI to broaden its product range. The ultimate success of the MFI will depend on its ability to develop demand driven savings products, which compete effectively.

This cannot be overemphasized as already the savings market is dominated by the microfinance banks. Changing a client's mindset will also be difficult and will require more sophisticated marketing strategies. Not only will the MFI have to decide on a distribution strategy (for both credit and savings products), but developing effective communication channels will be critical as well.

Overall, Faulu Kenya is well placed to strengthen its market position further.

FAULU KENYA

(All amounts in USD '000s except as noted)

Income Statement for the year ended:	31-Dec-02	31-Dec-03	31-Dec-04	31-Dec-05	31-Dec-06
Interest and Fee Income	2,099.6	3,294.9	2,241.2	2,909.2	5,156.3
Interest and Fee Expense	(270.3)	(341.4)	(230.1)	(792.2)	(854.4)
Net Interest Income	1,829.2	2,953.4	2,011.1	2,117.0	4,301.9
Provision for Loan Loss	(110.8)	(376.7)	(103.1)	(342.5)	(132.8)
Net Interest Income After Provisions	1,718.5	2,576.8	1,908.0	1,774.5	4,169.1
Operating Expense	(1,470.3)	(1,730.0)	(2,013.3)	(2,198.2)	(3,070.1)
Net Operating Income	248.1	846.8	(105.3)	(423.7)	1,099.0
Other Income	203.2	167.1	133.0	555.3	350.5
Other Expenses	(4.8)	(29.2)	(19.8)	(0.0)	(11.3)
Extraordinary Items	-	-	-	-	-
Net Income Before Taxes	446.5	984.7	7.9	131.6	1,438.2
Taxes	121.1	304.8	14.2	28.5	-
Net Income	325.4	679.9	(6.3)	103.1	1,438.2
Balance Sheet as at:					
Cash and Banks	1,357.8	1,832.7	2,576.8	2,386.0	4,675.2
Temporary Investments	1,367.6	1,388.8	1,212.4	4,464.5	3,933.5
Net Loans	9,003.2	6,699.0	6,909.5	10,905.0	18,452.0
Gross Loans	9,187.9	7,262.5	7,315.8	11,462.4	19,014.6
<i>Performing Loans</i>	<i>9,156.3</i>	<i>6,148.1</i>	<i>6,735.8</i>	<i>10,570.6</i>	<i>18,397.6</i>
<i>Portfolio at Risk</i>	<i>31.5</i>	<i>1,114.4</i>	<i>580.0</i>	<i>891.8</i>	<i>617.0</i>
Loan Loss Reserve	184.7	563.6	406.3	557.4	562.6
Other Current Assets	247.1	354.3	404.3	473.1	754.8
Current Assets	11,975.7	10,274.8	11,102.9	18,228.6	27,815.6
Long Term Investments	72.0	24.0	120.6	128.9	225.3
Property and Equipment	114.5	125.6	740.5	908.8	954.5
Other Long Term Assets	46.8	61.5	101.4	272.0	70.1
Long Term Assets	233.3	211.1	962.4	1,309.7	1,249.9
Total Assets	12,209.0	10,485.9	12,065.3	19,538.3	29,065.4
Demand Deposits	-	-	-	-	-
Short Term Time Deposits	4,254.8	4,800.7	4,452.8	6,744.6	10,517.1
Short Term Funding Liabilities	3,585.7	396.2	2,285.7	-	3,787.7
Other Short Term Liabilities	324.1	412.0	454.7	535.8	539.8
Current Liabilities	8,164.6	5,608.9	7,193.2	7,280.4	14,844.6
Long Term Time Deposits	-	-	-	-	-
Long Term Funding Liabilities	-	-	-	6,908.9	7,183.9
Quasi - Capital Accounts	-	-	-	-	-
Other Long Term Liabilities	-	-	-	-	-
Long Term Liabilities	-	-	-	6,908.9	7,183.9
Capital	3,087.4	3,068.5	3,780.3	3,965.1	4,119.1
Retained Earnings	936.9	1,778.5	1,091.8	1,383.8	2,917.8
Other Capital Accounts	20.0	30.0	-	-	-
Equity	4,044.4	4,877.0	4,872.2	5,348.9	7,036.9
Total Liabilities & Equity	12,209.0	10,485.9	12,065.3	19,538.3	29,065.4
Key ratios:					
Asset Quality					
Portfolio at Risk / Gross Loan Portfolio (%)	0.3	15.3	7.9	7.8	3.2
Loan Loss Provision exp. / Average Gross Portfolio (%)	1.6	4.6	1.4	3.6	0.9
Loan Loss Reserves / Portfolio at Risk (%)	585.7	50.6	70.1	62.5	91.2
Write-offs / Average gross portfolio (%)	0.5	-	3.5	2.3	0.4
Efficiency and Productivity					
Operating Expenses / Average Gross Loan Portfolio (%)	21.8	21.0	27.6	23.4	20.1
Cost per borrower	68.9	77.2	92.6	71.2	57.1
Average outstanding loan size	382.7	349.1	322.7	293.4	277.9
Number of Borrowers per Staff (no.)	184.7	146.5	151.1	187.0	222.2
Number of Borrowers / Credit Officer (no.)	381.1	310.5	298.3	368.6	402.6
Operating Expenses / Net Interest and Other Income (%)	72.3	55.4	93.9	82.3	66.0
Profitability					
Net Income / Average Equity (%) (ROE)	8.7	15.2	(0.1)	2.0	23.2
Net Income / Average Assets (%) (ROA)	3.4	6.0	(0.1)	0.7	5.9
Portfolio Yield (%)	31.1	40.1	30.7	31.0	33.8
Net Interest Income / Average Gross Loan Portfolio (%)	27.1	35.9	27.6	22.5	28.2
Non Interest Income / Total Operating Income (%)	8.8	4.8	5.6	16.0	6.4
Financial Management					
Interest and Fee Expenses / Average Gross Portfolio (%)	4.0	4.2	3.2	8.4	5.6
Interest and Fee Expenses / Average Funding Liabilities (%)	6.1	7.8	6.4	9.9	6.0
Debt / Equity (1)	2.0	1.2	1.5	2.7	3.1
Total Capital / Risk Weighted Assets (%)	41.5	64.7	57.2	90.3	66.9
<i>Tier One Capital / Risk Weighted Assets (%)</i>	<i>41.5</i>	<i>64.7</i>	<i>57.2</i>	<i>39.4</i>	<i>33.1</i>
<i>Tier Two Capital / Risk Weighted Assets (%)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>50.9</i>	<i>33.8</i>
Cash and Liquid Assets / Total Deposits (%)	64.1	67.1	85.1	101.6	81.9
Cash and Liquid Assets / Liabilities to the Public (%)	33.4	57.4	52.7	94.1	58.0
Nominal Growth indicators					
Assets (%)	-	(14.1)	15.1	61.9	48.8
Loan Portfolio (%)	-	(21.0)	0.7	56.7	65.9
Shareholders Equity (%)	-	20.6	(0.1)	9.8	31.6
Deposits (%)	-	12.8	(7.2)	51.5	55.9
Net income (%)	-	108.9	n.a	n.a	1,295.1