Planet Rating
THE GLOBAL MICROFINANCE RATING AGENCY

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FATEN, Palestine February 2006

Rating range

B- to B

Trend

Uncertain
The trend is "Uncertain" for FATEN due to the ongoing severe political and economic consequences related to the Israeli occupation as well as the uncertainty associated with the new Hamas-led Palestinian government's ability to govern effectively which can affect the growth potential and the quality of the loan portfolio.

- **Description of the institution**

Created by the international NGO Save the Children (SC) in January 1995, Palestine for Credit and Development (FATEN) is now an independent not-for-profit organization solely dedicated to providing micro-finance services to Palestinians following its spin-off from SC in March 1999. FATEN is headquartered in Ramallah in the West Bank. It offers both individual and group loans to its clients through a network of 12 branches throughout the West Bank and Gaza Strip. As of December 31, 2005, FATEN had 4,777 active loan clients, almost all of whom are women, with an outstanding portfolio of 8.9 M USD.

Performance indicators
(USD ***unless otherwise stated*****)**

	Dec. 2003	Dec. 2004	Dec. 2005
ACTIVITY			
Total number of staff	77	57	66
Total assets (K USD)	5,551	6,414	11,683
Loan portfolio (K USD)	1,261	2,383	8,944
Deposits (K USD)	28	39	32
Nb. of active borrowers	2,293	3,319	4,777
Nb. of savers	1,235	976	726
APR	See Annexes for details*		
PAR >30	2.3%	0.9%	1.6%
Write-off ratio	0.0%	0.0%	0.0%
Risk coverage ratio	0.0%	0.0%	0.0%
PERFORMANCE			
ROE	(8.0%)	(5.0%)	(0.0%)
Liabilities / Equity	11.4%	10.8%	14.6%
ROA	(7.2%)	(4.5%)	(0.0%)
Operational self-sufficiency	41.7%	67.4%	99.7%
Financial self-sufficiency	32.4%	57.0%	82.2%
Portfolio Yield	26.8%	28.8%	19.1%
Operating expense ratio	97.3%	47.1%	16.7%
Staff productivity	30	58	72
Funding expense ratio	0.0%	0.0%	0.0%
GROWTH			
Loan portfolio growth	129.6%	88.9%	275.2%
Savings portfolio growth	1.4%	37.6%	(18.1%)
Assets growth	1.7%	15.5%	82.1%

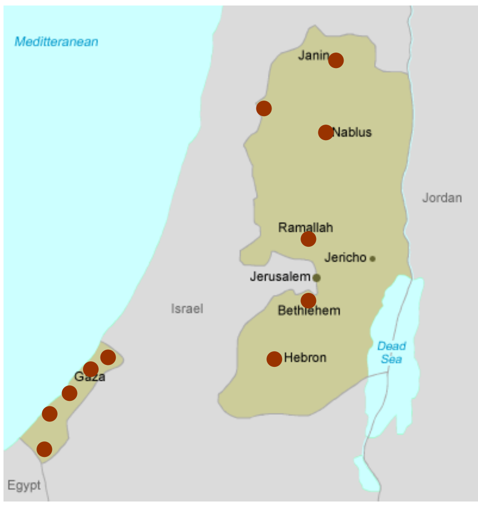
*Weighted portfolio APR is estimated around 30%

Evaluation summary
FATEN is arguably the strongest of all Palestinian MFIs. Nevertheless, FATEN needs to define a new Strategic Plan and to continue to grow top line revenues in order to sustain its fragile near-sustainability status.

Compliance to the existing IsDB's service agreement
Fully complied.

Improvements needed to reach minimum requirements on specific evaluation areas
- G: Draft and adopt a new Strategic Plan
- I: Provide better integration of existing MIS systems
- R: Better enforcement of basic lending policies and procedures
- A: Minimum requirements achieved
- F: Develop a comprehensive financing plan along with diversification goals
- E: Minimum requirements achieved

Strategic goals
- To provide Palestinian micro-entrepreneurs with sustained access to financial services
- To offer diverse credit products and other financial services
- To combine cost-efficient methodologies with exemplary client services
- To become financially sustainable institution
- To offer technical assistance to help in freeing the world from poverty



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Institutional presentation

Networks
FATEN is a member of the Palestine Microfinance Network and of the Microfinance Network of the Arab Countries (Sanabel Network).

Legal form, supervision and audit
Created by the international NGO Save the Children (SC) in January 1995, Palestine for Credit and Development (FATEN) is now an independent not-for-profit company solely dedicated to providing micro-finance services to Palestinians following its spin-off from SC in March 1999. FATEN is registered with the Ministry of Justice since July 1998, but is not supervised by banking authorities. Its legal status is quite unique being a more flexible non-profit company instead of the classical non-profit association.

Talal Abu-Ghazaleh & Co. has been appointed external auditors for the 2005 financial year under a three-year contract replacing Ernst & Young. The auditor only performed annual checks on the accounts and provided an unqualified opinion for 2005. Issues raised by the management letter are not considered material. Beside from formal annual audits, FATEN is subject to regular audits from SC and USAID – its largest funders.

FATEN's books of accounts are maintained in Jordanian Dinar (JOD) and transactions in other currencies are translated into JOD, but it uses USD as its reporting currency.

Ownership
FATEN is owned by its General Assembly (GA) made up of SC representatives and civil society members who subscribe to FATEN declared shares. SC technically owns 26% of declared shares, but is the owner of 64% paid-in shares due to other members having not paid their subscriptions. The GA in turn appoints a Board of Directors (BOD) to govern FATEN. SC is not represented on the BOD, but BOD members have been appointed or renewed with implicit SC approval.

Management team
The Managing Director (MD), Anwar Jayyousi, started with FATEN in March 2004. He has 17 years of experience in the banking and private sectors before coming to FATEN. He is assisted by an experienced Finance Manager who is with FATEN from the beginning and other managers in key departments of Operations and MIS.

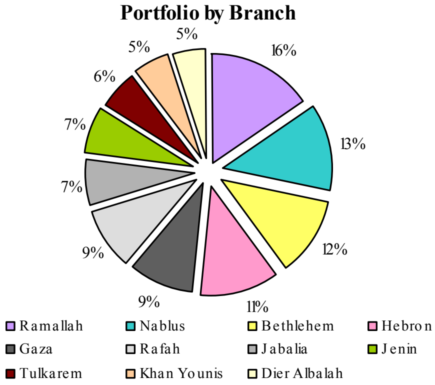
Donations
The institution has received donation commitments of 13.4 M USD from various sources channeled through SC, of which 10.7 M USD has been disbursed since 1999. 2.6 M USD of the 2.7 M USD of the un-disbursed amount is expected in 2006 from USAID.

Funding

Loan provider	Interest rate	Duration	Initial amount (USD)	Out. as of Dec. 2005 (USD)
IDB	0%	4 years	200,000	200,000

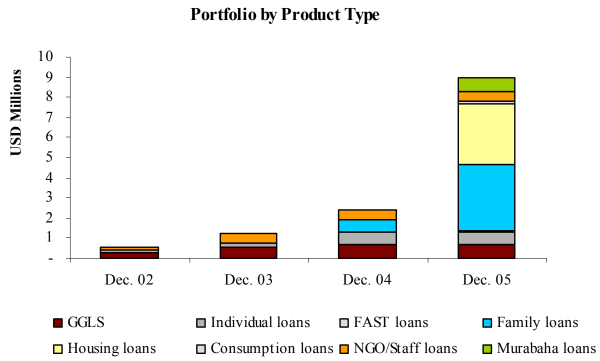
Organization
FATEN is headquartered in Ramallah in the West Bank. It offers both individual and group loans to its clients through a network of 12 branches throughout the West Bank (7 branches) and the Gaza Strip (5 branches) – one of the largest MFI networks in Palestine.

Market penetration
Thanks to its national network covering all key economic areas of West Bank and Gaza Strip, FATEN's market shares are estimated at 18% of total microfinance clients and 22% of total microfinance portfolio outstanding in 2005. FATEN is placed second among Palestinian MFIs based on active clients and third based on portfolio outstanding in 2005. As of December 31, 2005, 36% of its outstanding portfolio is located in Gaza and the rest in the West Bank reflecting more or less the population distribution of these Palestinian territories.



Products and services
See annexes for more details

FATEN has nine loan products covering a broad range of client needs. Amounts range from 70 USD to 15,000 USD and terms are up to 48 months, with a possible grace period of 3 months for housing loans. The average portfolio term is 24 months. Interest starts from 0.5% to 3.3% monthly flat. Clients are also charged various loan fees and are required to save within the group loan product. APRs range from 13% to 50%.



Governance

Governance and Decision Making is rated **"c"**

Decision-making
Thanks to knowledgeable BOD members and stakeholders, FATEN can boast having one of the strongest governance capabilities among Palestinian MFIs. FATEN receives strong guidance and backing from its BOD headed by a prominent university academic who is also a public policy consultant. The well-connected BOD Chairman is very involved in FATEN. Among the other all-volunteer, mostly academic/NGO BOD members, the degree of involvement varies. SC, FATEN's founder and single largest shareholder, is notably absent from the BOD, but does have considerable influence through periodic meetings with management and also acting as the main conduit for core funding from USAID and other technical assistance missions since the beginning.

Due to a constant unstable political climate, FATEN BOD has been acting quite conservatively (e.g. more as a custodian with a mission to safeguard the donated funds rather than a business owner taking calculated risks). The decision-making process at FATEN, while consensus-based and democratic, could be enhanced with SC represented not only at the General Assembly level, but also at the BOD level for its technical microfinance expertise. Similarly, the BOD composition could be more diverse (e.g. more private sector or business backgrounds) to provide different view points. Finally, FATEN has now attained the critical mass that would benefit from having specialized BOD committees (e.g. HR, audit, asset & liability management).

Planning
FATEN has been operating since 2002 without a Strategic Plan. While the institution continues to work reasonably well, the lack of a Strategic Plan has hindered an effective and timely decision-making process as management sometimes hesitate to make key decisions. While business planning is difficult due to the constant upheavals related to the Israeli occupation, it is important to have a Strategic Plan to provide a clear framework for decision-making and competency sharing between BOD and management.

FATEN does have a sensible Work Plan for 2006. 2006 projections done on Microfin forecast 25% growth in portfolio – quite reasonable and achievable given large demand. Without a clear Strategic Plan, FATEN has adopted a "wait-and-see" approach during a time when it could take bold decisions. This is particularly true when FATEN has to make difficult choices such as whether to continue its forecasted lending growth amid current political uncertainty. For now, FATEN BOD has instructed slow disbursement for the next few months as the new Government is being formed.

Thanks to its SC roots, FATEN has a good budget planning process along with efficient and regular tracking and monitoring of budget and activities. With regard to its product development process, FATEN has done a methodical job at research and launching of new products to suit various client needs. Nevertheless, this process could have been more strategic and coordinated so as not to have many products having practically identical features. See more details in Activities section.

Like many other Palestinian institutions, the planning process at FATEN has been influenced and in many cases determined by donors' money and their priorities. While the development aims are the same, FATEN is not yet strong enough to act as an equal partner. More independence can only be achieved with well-planned diversification of funding sources. Therefore, it is very much welcomed that a retreat of key stakeholders and management is being planned in the next few months to initiate the planning process with the view of drafting a new Strategic Plan.

Improvements needed to reach the minimum required
△ Draft a market-oriented and sensible Strategic Plan

Management Team
FATEN management is doing a good job considering the difficult operating environment. Following the departure of FATEN's first MD and a rather long (almost 2 years) period of interim leadership by the Finance Manager, FATEN BOD finally recruited an experienced former banker (Anwar Jayousi) to lead the institution – a nomination formally approved by SC. The new MD has succeeded in providing good consensual leadership and in creating a harmonious and cohesive team. Since his arrival, he also managed to streamline FATEN's cost structure and instill a more private sector focused style of management. His authority can be further strengthened to balance a more assertive BOD.

Thanks to previous capacity building provided by SC and other TA providers along with on-the-job experience since 1995, FATEN has a strong and broad-based management team compared favorably to those of other Palestinian MFIs. Though very operationally-focused, FATEN management team has good cross-functional skills and thus reduces key-person risks. Strengths are found in core lending operations and product development with key areas for improvement in strategic product positioning, product marketing, funding and liquidity management.

Human resources
FATEN has good HR processes as evidenced by its knowledgeable lending staff. While the HR basics (e.g. recruitment of more qualified new staff and training them to best lending practices) are adequately addressed, FATEN could invest more time in loan staff capacity building, particularly in analyzing project cashflows. FATEN's uniform bonus policy could be better adjusted to taking into account the cost of living in its various offices. Also its performance management process could move beyond strictly numbers incorporating other aspects as skills and career development. As it grows in size, FATEN could benefit from having a dedicated HR function or department.

▪ Information

Information and equipment is rated **"b"**

Description of the MIS	
Equipment	▪ Fully computerized and modern equipment and software; two servers; SQL database; Internet connection through leased lines
Accounting	▪ Computerized, but not integrated with loan tracking system ▪ Able to generate monthly financial statements ▪ Frequent reconciliation of cash and loan portfolio balances ▪ Able to generate monthly analytical reports along with a scorecard
Portfolio information	▪ Al-Faten internally-developed loan tracking system ▪ Flexible and customized to its needs ▪ System has all required features and functionalities ▪ Able to generate all key portfolio reports

Management Information Systems
FATEN has a good and modern infrastructure (hardware and software) and competent IT staff of two. Its in-house developed "Al-Faten" loan tracking system is flexible and user friendly with capacity to absorb many products and variables. The systems work fine despite being non-integrated, although they would benefit from integration especially in avoiding having to re-entering data on separate Excel sheets and manually creating some management reports. With relevant access controls and adequate back up procedures, data security is assured with limited risks of data loss or manipulation. An IT user manual is being drafted. It would be also good to fully document program codes in case the MIS Specialist leaves.

"Al-Faten" has been sold to 4 different MFIs with FATEN IT staff providing technical support. While this might look internally as a reasonable leverage of existing IT capability, MIS sales and consulting revenues are small and definitely represent non-core businesses. FATEN needs to assess whether such revenues are fairly compensated for the long-term distraction on its staff and business. For example, IT staff could spend more time in the field to check/improve data entry skills in branches and connect the Ramallah branch to its main system/database, the later of which is not yet done. Finally, it would be useful for FATEN, along with its upcoming strategic planning process, to draft an IT development plan to forecast future IT needs.

Improvements needed to reach the minimum required
△ Provide better integration of existing MIS systems
△ Fully connect all branches and offices to central databases & systems

Information on activities
Thanks to its strong "Al-Faten" system capability, FATEN is able to generate accurate and reliable portfolio information with the capacity to generate various key ratios and data according to user needs. Reconciliation of loan balances is done frequently. Reports are easily obtained to enable tracking by product, client, branch or loan officer (LO). There is a good use of data in the institution in general.

Financial and accounting information
FATEN counts on a competent and experienced Finance Manager to oversee this important area. Relevant financial and accounting information can easily be obtained on demand. Reconciliation of cash and bank balances are done frequently. FATEN systems can generate accurate and complete financial statements on a monthly basis and are able to

fulfill reporting requirements for internal and external parties in a timely fashion. Financial analysis including useful scorecard and indicators is done providing good ability to track and monitor progress.

▪ Risks

Risk Management is rated **"b"**

Procedures and Internal Controls

Risk management at FATEN can be further improved by ensuring better compliance to existing policies and procedures. All basic procedures and internal controls are in place and are documented in various manuals. The loan procedures and policies are reasonably applied with some inconsistencies noted in various internal audit reports. The loan approval process, with different authority levels by amount and adequate segregation of duties, ensures (if well applied) systematic mitigation and control of lending risks consistent with good portfolio management practices. Limited cash risk exists although most loan transactions are made through banks.

Improvements needed to reach the minimum required

- △ Better compliance and enforcement of existing control procedures and lending rules

Internal Audit

FATEN adopts best practices in this critical area. Two knowledgeable Internal Auditors (IA) work efficiently following an annual audit plan approved by BOD to which they also report. Internal audit staff visits each branch at least twice a quarter. The quality of the audit reports is high as evidenced by relevant and detailed observations of gaps and inconsistencies along with practical recommendations for improvements. Some of the IA recommendations have not been followed through. Beside from IA work, comprehensive annual audit by external auditors and grant audits commissioned by donors like SC or USAID. These audits have not detected material gaps or weaknesses with regard to risk management.

Improvements needed to reach the minimum required

- △ Ensure that IA recommendations are swiftly implemented and followed up with potential bonus implications for non-compliance

▪ Activities

Activities: products and services is rated **"b"**

Marketing and competition

The microfinance market in Palestine is still young and has a dramatic growth potential. According to CGAP estimates, there are around 150,000 micro-enterprises needing microfinance services with only some 26,000 clients being served as of end of 2005.

The 10 local MFIs operate under various legal forms: one UN agency (UNRWA), two international NGOs (ANERA, CHF), one local program (GWLF), three local non profit NGOs (ASALA, ACAD, YMCA), one for non-profit NGO (FATEN), one network of cooperatives (PARC) and one for profit company (Al Amin). The banking sector has not been very active in the sector, with the exception of Bank of Palestine and more recently Al Rafah Bank (should start operations in April 2006). The Palestinian Banking Corporation is also involved in the industry although its loans tend to be oriented towards SME finance. One of the main issues at stake is the enactment of a new microfinance law that would ease microfinance operations for NGOs without needing to transform into banks. The EU has been very involved in the drafting of the new microfinance law. This process is expected to be long and the attitude of the new Palestinian Parliament and Government is not yet known.

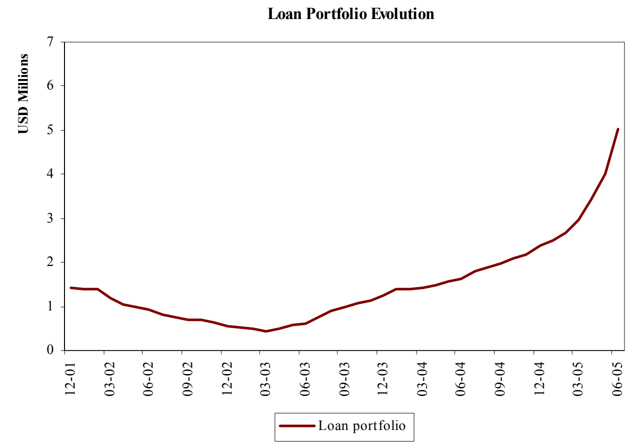
Palestine microfinance industry is still very dependent on grants and therefore many institutions have not developed yet a self-sufficiency perspective. Most MFIs, supported by grants, charge very low interest rates that do not allow other institutions concerned with self-sufficiency to compete effectively.

Dec 2005	Active borrowers	Out. balance (M USD)	Avg. out. balance (USD)	Number of offices
UNRWA	11,715	7.6	646	11
FATEN	4,777	8.9	1,493	12
CHF	3,738	12.5	3,346	8
ASALA	2,059	1.5	744	8
ACAD	1,383	3.1	2,237	6
YMCA	904	3.2	5,600	5
PARC	1,007	1.9	1,853	15
GWLF	330	N/A	N/A	1
ANERA	302	0.8	2,634	1

Source: CGAP

FATEN enjoys good reputation as a strong and well-funded MFI from its connections with SC and USAID. When compared to other MFIs, FATEN is considered very strong from a competitive standpoint due to a number of reasons including: large national network, strong ability to mobilize financial resources (clients of other MFIs sometimes have to wait for loans due to lack of liquidity), broader product range and stronger/clearer governance.

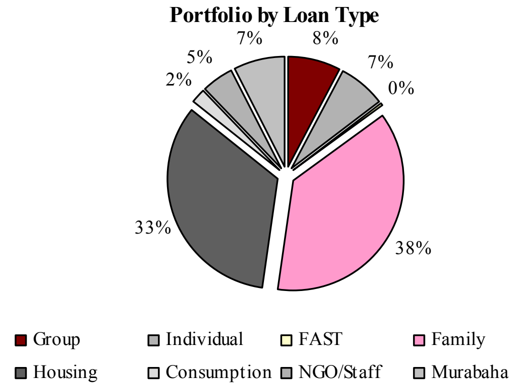
Portfolio Management



FATEN's portfolio has jumped significantly since 2004 following the disbursements of big grants. Its portfolio is managed by an experienced Operations Manager (OM) who was a former IA. FATEN has appropriate and flexible loan methodologies for its target clientele. Its portfolio management procedures came essentially from SC with adaptations made for the Palestinian context. The client selection and loan approval processes now seem to follow best practices with better client selection and follow up done after a PAR crisis in 2002. LOs are generally knowledgeable of lending risks, but more regular client visits and better compliance to lending rules would enhance overall portfolio management.

FATEN offers 9 different loan products covering a broad range of needs. It has plans to introduce more customized loans such as student and computer loans. While this broad product range highlights FATEN's strong product development capacity (although heavily influenced by USAID funding conditions), it would be beneficial to consider streamlining similar purpose loans into smaller number of all-purpose loans with more flexible terms to take into account various specific needs. More consideration given to profitability and administrative issues would enhance the existing product development process.

Portfolio diversification



FATEN has not defined clear portfolio diversification goals by sector nor its market positioning, except for its general desire to make more business loans and re-grow the group lending product to at least 25% of portfolio – group loan being its original/core product which over the years has dropped in favor of individual loans. Its move into individual loans and non-productive loans of larger sizes put it in direct competition with "downscaling" commercial banks, including a new well-capitalized microfinance competitor called "Alrafah Bank" to be launched shortly. While some FATEN's managers seem to have clear ideas of its competitive positioning, FATEN as an institution seems a bit unsure.

Portfolio quality

USD , unless otherwise stated	Dec. 2002	Dec. 2003	Dec. 2004	Dec. 2005
Loan portfolio	549,397	1,261,667	2,383,901	8,944,167
Change	(62.2%)	129.6%	88.9%	275.2%
Average outstanding loan	1,001,439	905,532	1,822,784	5,664,034
Number of active borrowers	1,737	2,293	3,319	4,777
Change	-	32.0%	44.7%	43.9%
Average outstanding loan per client	316	550	718	1,872
PAR >30	17.3%	2.3%	0.9%	1.6%
Write-off ratio	22.6%	0.0%	0.0%	0.0%

FATEN has succeeded in keeping its portfolio very healthy despite the difficult operating environment as evidenced by excellent PAR>30 of 1.6% as the end of 2005. This can be attributed to tighter client selection and loan approval procedures as well as the tougher collateral and guarantee requirements for loans. FATEN can go a step further by managing more actively its portfolio (e.g. intentionally or systematically direct more lending toward less-risky loans as measured by PAR and/or toward loans with higher risk-reward ratios) while balancing outreach considerations.

Bad portfolio is mostly concentrated in North West Bank and Gaza (80% of total PAR) reflecting the negative impact of the regions suffering most from the Israeli occupation. Like other MFIs, FATEN is growing more its portfolio in Central and South West Bank regions where economic conditions are relatively better. As more conservative conditions have improved its portfolio quality, the average loan size has more than tripled between 2004 and 2005, concentrating credit risks on a (relatively) smaller number of clients.

Given the low PAR achieved in an exceptionally difficult operating environment, one can also argue that FATEN can afford to take more risks. Its desire to provide more (typically smaller) group loans would go a long way toward this end. Again the issue here is one of lack of a clear strategy which will be defined this year.

Risk coverage

	Dec. 2003	Dec. 2004	Dec. 2005
Risk coverage ratio	259.5%	405.7%	197.4%

FATEN has clear and conservative loan loss provisioning, risk coverage and loan write-off policies. As shown on the above table, loan loss coverage ratio, while declining, is still more than adequate to cover potential losses. It is noted that FATEN, despite its write-off policy for late loans over 180 days, has stopped write-off since 2003 with BOD consent. FATEN needs to either respect its own write-off policy or to formally amend it should it think that the policy is no longer appropriate given the operating environment. This later option is much preferred than the existing non-compliance situation.

Savings Activities

USD, unless otherwise stated	Dec. 2003	Dec. 2004	Dec. 2005
Outstanding deposits	28,643	39,403	32,288
Change	1.4%	37.6%	(18.1%)
Number of savers	1,235	976	726
Change	5.0%	(21.0%)	(25.6%)
Average outstanding deposit per saver	23	40	44

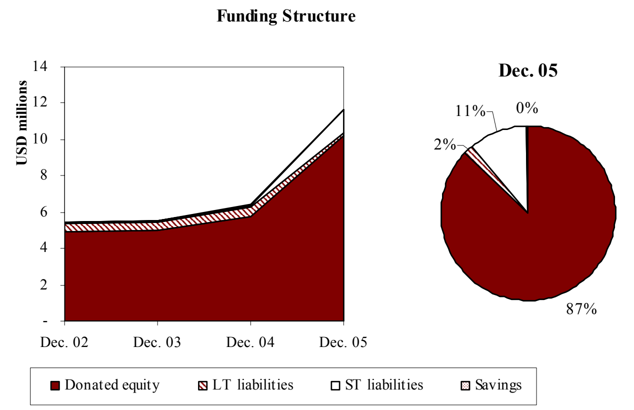
FATEN is not a deposit-taking institution. The above data refers to compulsory savings deposited mobilized within its solidarity groups. The table is provided for information purposes only.

▪ Financing and liquidity

Financing and liquidity is rated **"c"**

Financing Strategy

FATEN was created by SC from donations and it is still very dependent on donations until today for its funding. The positive side is these (often American-sourced) donations come in big amounts with tough monitoring conditions giving FATEN the cushion to work without the constant liquidity pressure often experienced by other MFIs. These donations also created heavy dependence on key donors (such as USAID) and renders the institution less active/aggressive at independent fund-raising as it should be.



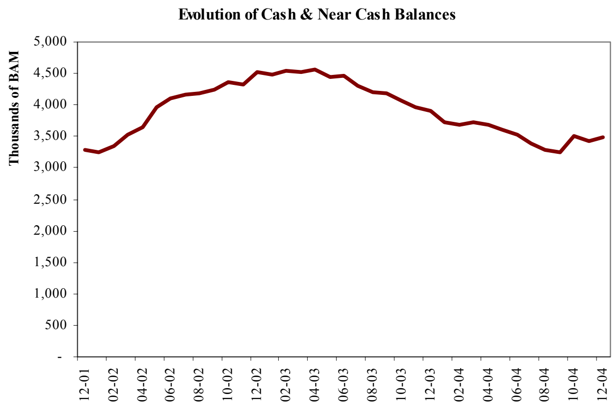
Until the IDB loan, FATEN was all-donation funded. The IDB funds are actually considered by some MFIs as equity or quasi-debt, given its very soft conditions. The good news is FATEN has excellent additional debt capacity given its (almost) leverage-free capital structure and strong comparative performance. It would be useful however for FATEN to diversify its funding base and gain track record as a borrower. Considering the tense political situation in Palestine, social rather than commercial investors are the most likely funding sources in the short and medium term with donation or soft funding expected to be available for a foreseeable future.

	Dec. 2003	Dec. 2004	Dec. 2005
Liabilities / Equity	11.4%	10.8%	14.6%

Asset and liability management
There are no formal ALM management policies nor there are real ALM risks within FATEN given its simple capital structure.

a) **Very limited maturity risk**: FATEN portfolio (except for the 200,000 USD IDB loan) is all funded by donations.
b) **Very limited FX risk**: All funding is in USD whereas most loans are also in USD.
c) **No interest rate risk:** No risk given interest-free funding base.

Liquidity management
FATEN kept significant cash and near cash (18.1% of assets as of Dec. 2005) on its balance sheet since 2001, despite a huge increases in portfolio size since 2003. This level is considered very high by normal liquidity standards. Part of the reason was its decision to be more prudent following the two periods of Intifada where it experienced huge increases in PAR. Part of the reason was the donor-driven funding process which resulted in big lump sums being disbursed (often late than planned) without taking fully into account FATEN's absorption capacity or existing disbursement plan.



While the cash trend is improving, there is more room for this present high cash level to be better and more efficiently deployed in the loan portfolio despite the required prudence given the political context. Nevertheless, this high liquidity level is unlikely to drop down significantly as FATEN has begun to slow down its lending since the election of the new government and the associated uncertainty. FATEN presently does mostly manual monthly liquidity projections, but its liquidity management practices are not as dynamic as they could be given the circumstances.

Improvements needed to reach the minimum required
△ Develop a comprehensive financing plan along with diversification goals
△ Develop a more dynamic liquidity management strategy in order to not keep too high cash or near cash levels on the balance sheets

▪ Efficiency and Profitability

Efficiency and Profitability is rated **"b"**

Profitability analysis	Dec. 2003	Dec. 2004	Dec. 2005
ROE	(8.0%)	(5.0%)	(0.0%)
Liabilities / Equity	11.4%	10.8%	14.6%
ROA	(7.2%)	(4.5%)	(0.0%)
Profit generation			
Operational self-sufficiency	41.7%	67.4%	99.7%
Portfolio Yield	26.8%	28.8%	19.1%
Operating expense ratio	97.3%	47.1%	16.7%
Staff productivity	30	58	72
Loan officer productivity	66	111	129
Average outstanding loan per client (USD)	550	718	1,872
Funding expense ratio	0.0%	0.0%	0.0%
Cost of savings	0.0%	0.0%	0.0%
Cost of liabilities	0.0%	0.0%	0.0%
Loan Loss Provision expense ratio	(22.1%)	(2.1%)	3.0%
PAR 30	2.3%	0.9%	1.6%
Write-off ratio	0.0%	0.0%	0.0%
Asset management			
Outstanding Loan Portfolio / Assets	21.4%	35.9%	74.2%
Non-portfolio income as a % of financial revenues	14.7%	5.0%	2.2%
Adjusted ratios			
Financial self-sufficiency	30.2%	[illegible]	82.2%101.5%
AROE	(13.2%)	(7.7%)	(3.0%)
AROA	(11.9%)	(7.0%)	(2.7%)

Overview of the profitability
FATEN is near to the operational sustainability status in 2005 and is expected to cross over the 100% mark in 2006. This is a result of a big increase in portfolio (+275% between 2004 and 2005) providing the necessary economies of scale to break-even.

Its goal of reaching break-even in 2006 could however be in jeopardy if disbursement slows down significantly due to the BOD decision based on the current political situation. In this regard, FATEN BOD and to a lesser extent management are encouraged to better understand its cost structure and delivery model and their impact on the bottom line when they make portfolio-related decisions.

Efficiency
Thanks to a much larger near 9 M USD portfolio, productivity and efficiency ratios improved significantly as shown in the above table. Nevertheless, these productivity ratios are still low compared to international standards. FATEN can handle a lot more clients and achieve at least 50% increase in the portfolio (and in productivity ratios) based on the existing infrastructure.

Portfolio yield and effective interest rate
The portfolio yield has been dropping steadily to 19% in 2005 from 48% in 2002, partially due to competitive pressure and mostly to the introduction of lower yielding loan products such as family and housing loans – both dominating the current loan portfolio. FATEN has to monitor closely the overall portfolio yield to make sure it does not drop further as its near sustainability status is still very fragile. Efforts to grow the higher yielding group loans and reduce further the (extremely low priced) NGO/staff loans (5% of portfolio in 2005 compared to 40% in 2003) should help to stop this trend.

Operating expense ratio
Thanks to a much larger portfolio achieved in 2005, the operating expense ratio is now around the 17% mark. If FATEN concentrates on growing the portfolio from the existing branch network and increases

staff productivity, this ratio could improve much further and drop under 15%.

Funding expense ratio
The funding expense ratio is 0% given the fact that the institution is all donation or zero-interest funded. This ratio is expected to stay very low (below 3% on a blended basis) even if FATEN starts securing significant commercial funding.

Loan loss provision expense ratio
The loan loss provision expense is quite reasonable (within the Palestinian context) at 3% in 2005. However this ratio could increase significantly (e.g. double) if political and economic relations worsen between and Israel and Palestine.

Asset management
74% of assets are invested in the loan portfolio in 2005 which is better than before, but is low by acceptable international norms. Given its branch network, FATEN can quite easily bring this ratio above 80% and potentially above the 85% expected of well-performing MFIs.

Adjustments

Data in USD	**Dec. 2003**	**Dec. 2004**	**Dec. 2005**
Adjustment for the cost of funds = (a*b)-c	-	-	9,000
Average amount of borrowings (a)	-	-	100,000
Shadow price of borrowings (b)	9.0%	9.0%	9.0%
Interest expense on borrowings (c)	-	-	-
Adjustment for inflation = (d-e)*f	198,230	149,308	228,522
Avg. Equity (d)	4,962,084	5,385,622	7,990,788
Average fixed assets (e)	456,868	408,678	373,390
Inflation rate (f)	4.4%	3.0%	3.0%
Adjustment for in-kind donations*	-	-	-
Staff and technical assistance	-	-	-
Other	-	-	-
Adjustments for provisions	62,052	-	-
Loan losses	62,052	-	-
Total adjustments			
Net income before donations	(396,993)	(267,833)	(3,894)
Adjusted net income before donations	(657,275)	(417,141)	(241,416)
Adjusted net income before donations (USD)	(657,275)	(417,141)	(241,416)

Most adjustments have been made for inflation.

Annexes

Balance sheet		USD					Evolution			
FATEN	**Notes**	**Dec. 01**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**2002/2001**	**2003/2002**	**2004/2003**	**2005/2004**
ASSETS		**5,132,896**	**5,460,340**	**5,551,852**	**6,414,657**	**11,683,823**	**6.4%**	**1.7%**	**15.5%**	**82.1%**
Short Term Assets		**4,734,224**	**4,982,071**	**5,116,386**	**6,032,768**	**11,318,931**	**5.2%**	**2.7%**	**17.9%**	**87.6%**
Cash and Due from Banks		335,411	272,765	500,487	242,581	1,067,432	(18.7%)	83.5%	(51.5%)	340.0%
Short Term Investments		2,955,250	4,258,166	3,400,198	3,248,767	1,051,112	44.1%	(20.1%)	(4.5%)	(67.6%)
Short Term Net Loan Portfolio		1,340,558	427,567	1,187,623	2,300,459	8,668,356	(68.1%)	177.8%	93.7%	276.8%
Short Term Gross Loan Portfolio		1,453,481	549,397	1,261,667	2,383,901	8,944,167	(62.2%)	129.6%	88.9%	275.2%
(Loan Loss Reserve)		112,923	121,830	74,044	83,442	275,811	7.9%	(39.2%)	12.7%	230.5%
Interest Receivable		-	-	-	-	-	-	-	-	-
On loan portfolio		-	-	-	-	-	-	-	-	-
On investments		-	-	-	-	-	-	-	-	-
Accounts receivable and other assets	1	103,005	23,573	28,078	240,961	532,031	1,257,435	(72.7%)	758.2%	120.8%
Long term assets		**398,672**	**478,269**	**435,466**	**381,889**	**364,892**	**20.0%**	**(8.9%)**	**(12.3%)**	**(4.5%)**
Long Term Net Investments		-	-	-	-	-	-	-	-	-
Long Term Gross Loan Portfolio		-	-	-	-	-	-	-	-	-
Net Fixed Assets		398,672	478,269	435,466	381,889	364,892	20.0%	(8.9%)	(12.3%)	(4.5%)
Other Long Term Assets		-	-	-	-	-	(100.0%)	(100.0%)	-	-
LIABILITIES AND EQUITY		**5,132,896**	**5,460,340**	**5,551,852**	**6,414,657**	**11,683,823**	**6.4%**	**1.7%**	**15.5%**	**82.1%**
Liabilities		**463,065**	**519,942**	**568,083**	**627,182**	**1,489,723**	**12.3%**	**9.3%**	**10.4%**	**137.5%**
Short term liabilities		147,090	84,201	94,999	99,101	1,289,723	(42.8%)	12.8%	4.3%	1,201.4%
Demand Deposits		-	-	-	-	-	-	-	-	-
Compulsory Deposits		70,227	28,260	28,644	39,403	32,288	(59.8%)	1.4%	37.6%	(18.1%)
Short Term Time Deposits		-	-	-	-	-	-	-	-	-
Short Term Borrowings		-	-	-	-	-	-	-	-	-
Interest payable		-	10,543	45,883	35,641	-	-	335.2%	(22.3%)	(100.0%)
Accounts Payable and Other Short Term Liabilities	2	76,863	45,398	20,472	24,057	1,257,435	(40.9%)	(54.9%)	17.5%	5,126.8%
Long term liabilities		315,975	435,741	473,084	528,081	200,000	37.9%	8.6%	11.6%	(62.1%)
Long Term Time Deposits		-	-	-	-	-	-	-	-	-
Long Term Borrowings	3	-	-	-	-	200,000	-	-	-	-
Other Long Term Liabilities	4	315,975	435,741	473,084	528,081	-	37.9%	8.6%	11.6%	(100.0%)
Equity		**4,669,831**	**4,940,398**	**4,983,769**	**5,787,475**	**10,194,100**	**5.8%**	**0.9%**	**16.1%**	**76.1%**
Paid-In Capital		4,080	4,080	4,080	4,080	4,080	0.0%	0.0%	0.0%	0.0%
Donated equity		5,436,479	6,313,582	6,751,008	7,809,701	12,233,520	16.1%	6.9%	15.7%	56.6%
Retained earnings without donations and reserves		(770,728)	(1,377,264)	(1,771,319)	(2,026,306)	(2,043,499)	78.7%	28.6%	14.4%	0.8%
Current year		-	(606,535)	(394,055)	(254,987)	(17,191)	-	(35.0%)	(35.3%)	(93.3%)
Other equity accounts		-	-	-	-	-	-	-	-	-

Notes:

1. Receivables from donors, prepayments & others
2. Employees pension fund, employees severance and others
3. IDB interest free loan
4. Provisions for employees' indemnity

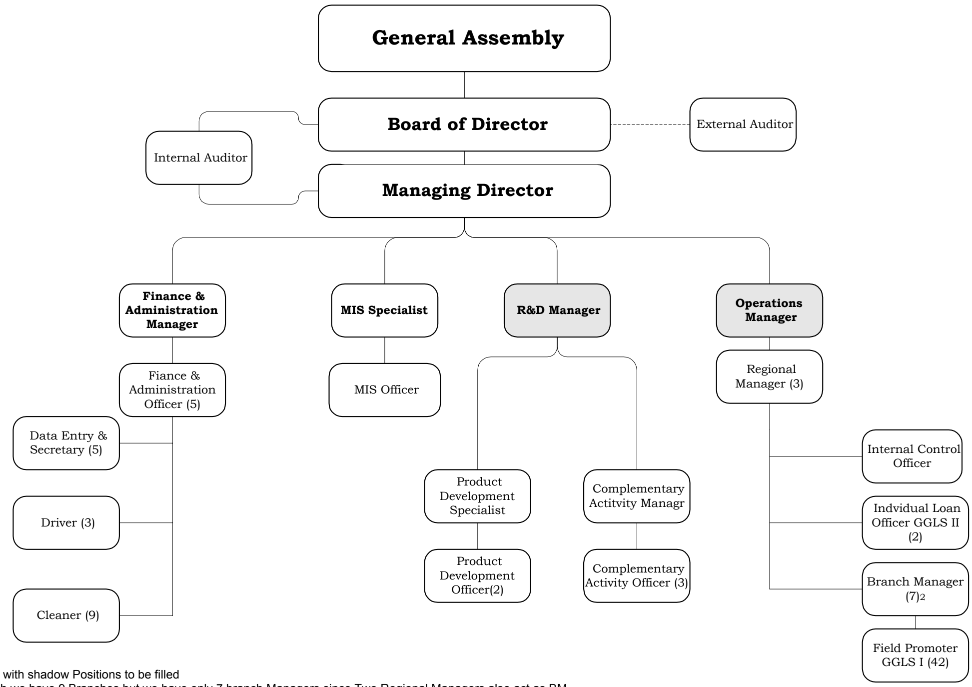
FATEN		USD				Evolution		
Income Statement	**Notes**	**Dec. 02**	**Dec. 03**	**Dec. 04**	**Dec. 05**	**2003/2002**	**2004/2003**	**2005/2004**
Financial Revenue (a)		**423,282**	**284,331**	**553,280**	**1,112,141**	**(0)**	**94.6%**	**101.0%**
Financial Revenue from Loan Portfolio		371,927	242,578	525,475	1,081,250	(34.8%)	116.6%	105.8%
Interest on Loan Portfolio		332,965	196,835	430,021	891,203	(40.9%)	118.5%	107.2%
Fees and Commissions on Loan Portfolio		20,934	23,754	61,148	185,372	13.5%	157.4%	203.2%
Penalty Revenue on Loan Portfolio		18,028	21,989	34,306	4,675	22.0%	56.0%	(86.4%)
Financial Revenue from Investments	1	51,355	41,753	27,805	24,534	(18.7%)	(33.4%)	(11.8%)
Other Operating Revenue		-	-	-	6,357	-	-	-
Financial Expense (b)		**-**	**-**	**-**	**-**	**-**	**-**	**-**
Interest paid on borrowings		-	-	-	-	-	-	-
Interest paid on deposits		-	-	-	-	-	-	-
Net Inflation Adjustment Expense		-	-	-	-	-	-	-
Other Financial Expenses		-	-	-	-	-	-	-
Financial income [c=a-b]		**423,282**	**284,331**	**553,280**	**1,112,141**	**(32.8%)**	**94.6%**	**101.0%**
Net Loan Loss provision expense (d)		**174,391**	**(199,724)**	**(37,475)**	**171,680**	**(2)**	**(1)**	**(6)**
Loan loss provision expense and write-off		246,859	(47,786)	9,398	192,455	(119.4%)	(119.7%)	1,947.8%
Recovery from Loans written off		72,468	151,938	46,873	20,775	109.7%	(69.1%)	(55.7%)
Operating expense (e)		**884,551**	**881,048**	**858,588**	**944,355**	**(0)**	**(0)**	**0**
Personnel Expense (includes fringe)		647,932	639,280	624,201	618,524	(1.3%)	(2.4%)	(0.9%)
Administrative Expense (non-staff operating expenses)		236,619	241,768	234,387	325,831	2.2%	(3.1%)	39.0%
Rent & utilities		63,507	53,341	47,962	56,908			
Depreciation and amortization		56,820	58,110	50,340	44,258	2.3%	(13.4%)	(12.1%)
Consulting fees		11,710	19,768	17,280	16,194	68.8%	(12.6%)	(6.3%)
Stationary & Office Supplies		12,158	12,442	11,110	9,227	2.3%	(10.7%)	(16.9%)
Transport		43,651	43,049	36,893	40,308	(1.4%)	(14.3%)	9.3%
Equipment Rental & Maintenance		9,869	7,869	20,799	7,161	(20.3%)	164.3%	(65.6%)
Communication		36,159	41,762	40,242	33,050	15.5%	(3.6%)	(17.9%)
Others		2,745	5,427	9,761	118,725	97.7%	79.9%	1,116.3%
Net Operating Income Before Taxes and Donations [f=c-d-e]		**(635,660)**	**(396,993)**	**(267,833)**	**(3,894)**	**(37.5%)**	**(32.5%)**	**(98.5%)**
Income Taxes (g)		-	-	-	-	-	-	-
Net Operating Income Before Donations [h=f-g]		**(635,660)**	**(396,993)**	**(267,833)**	**(3,894)**	**(37.5%)**	**(32.5%)**	**(98.5%)**
Non Operating Revenue (i)	2	29,125	2,938	12,846	12,206	(89.9%)	337.2%	(5.0%)
Non Operating Expense (including related taxes) (j)	3	-	-	-	25,503	-	-	-
Net Income Before Donations [k=h+i-j]		**(606,535)**	**(394,055)**	**(254,987)**	**(17,191)**	**(35.0%)**	**(35.3%)**	**(93.3%)**
Donations (l)		627,871	394,055	254,987	84,556	(37.2%)	(35.3%)	(66.8%)
Net Income (after Taxes and Donations) [m=k+l]		**21,336**	**-**	**-**	**67,365**	**(100.0%)**	**-**	**-**

Notes:

1. Interests earned on term deposits of employee-related funds
2. MIS sales, consulting revenues and other non operating revenues
3. Expenses related to a lawsuit against SC occurred in 1998, put paid in 2005 after a court order

	Product 1	Product 2	Product 3	Product 4	Product 5	Product 6	Product 7	Product 8	Product 9
Name of the product	Group Guaranteed Lending & Saving (GGLS)	Individual Loan Phase I	Individual Loan Phase II	FAST Loan	Family Loan	Housing Loan	Consumption	NGO/Staff	Murabaha
Creation Date	1994	2000	2003	2000	2004	2005	2005	2002	2005
Client type (rural, urban, etc.)	All	All	All	Active client in GGLS and Phase one	All	All	All	FATEN Staff and NGO Staff	All
Authorised loan size (minimum and maximum)	200USD-1500USD	1000USD -5000USD	1000 USD - 3000 USD	Minimum loan size is 70USD and the maximum is 700USD or 50% or current active loan which is less	1000USD -15000 USD	1000USD- 15000USD	100 USD -1000 USD	1000 USD - 25000 USD	All FATEN Products can be disbursed according to Murabaha with the same requirements of the Products
Average disbursed loan size	430 USD	1565 USD	2083 USD	355 USD	4024 USD	6888USD	925 USD	6998 USD	
Authorised loan length (minimum and maximum)	6 -10 months	6-24 month	6-18 month	4 weeks	6 month-48 month	6 months- 48 months	1 month-12 months	1 month-48 months	
Average loan length	7 months	18	12month	4 weeks	24 month	36 month	12 months	36 months	
Grace period	no grace period	no grace period	no grace period	no grace period	no grace period	3 months optional grace period	No grace period	No grace period	
Collateral requirements and other conditions	Group guaranteed	Client Credit history in GGLS + postponed checks+ promissory notes	Postponed checks from transferred salary+ promissory note	Promissory note	Two transferred salary for loans above 5000 USD and one for loans below 5000 USD	Two transferred salary for loans above 5000 USD and one for loans below 5000 USD	Postponed Checks or Transferred salary	Staff Pension and Severance	
Repayment Schedule (ex. weekly, monthly)	Customer choose either by-weekly or Monthly	Monthly	Monthly	one payment after 4 weeks	Monthly	Monthly	Monthly	Monthly	
Nominal annualized interest rate	24%	18% for first loan and 15% for repeated loans	18% for first loan and 15% for repeated loans	48% monthly	8% loans below 5000 USD and 5.5% loans above 5000 USD (upfront for loans above 5000USD)	8% loans below 5000 USD and 6.5% loans above 5000 USD (upfront for loans above 5000USD)	12% for transferred salary and 18% for postponed checks	5% for FATEN staff and 7% for NGO staff	
Flat or declining ?	Flat	Flat	Flat	Flat	Flat	flat	Flat	Declining/ upfront	
Max APR (including fees, yearly)	40.04%	32.38% to 35.07%	27.28% to 29.94%	163.64%	13.81% to 15.7%	15.7% to 16.77%	31.71%	7.1%	0%
Fees and penalties	4.2USD	10 USD	50 USD	11 USD	50 USD loans 5000 USD and below loans above 5000 USD 1.5% of loan size	50 USD loans 5000 USD and below loans above 5000 USD 1.5% of loan size	no fees	no fees	
Major changes since creation (rate, size, term)	This product will be revised shortly in terms of loan size, loan duration, saving.	Fees	Loan duration	This product will be revised shortly in terms of duration and eligibility	Interest Rate, Loan Duration	Interest Rate	nothing	Interest rate	

Organizational chart



) Boxes with shadow Positions to be filled
:) Though we have 9 Branches but we have only 7 branch Managers since Two Regional Managers also act as BM