Micro-Finance Rating - Risk Assessment

VisionFund Cambodia Limited [VFC]

Phnom Penh, Cambodia

Rating grade	$\alpha-$ **alpha minus**	**Assessment**: Reasonable safety, good systems, Recommended
Visit dates: 18-22 February, 2006	**Operational head**: Mr Om Seng Bora	
Maximum validity of rating*: till February 2007		

Rating

VFC has a good performance on governance. A strong second line of leadership and linkages with World Vision (a well known development organisation) in a very competitive market are its major advantages. However, high dependence on a single source of finance is limiting its growth and is its major weakness.

VFC's managerial performance is good. Its strength is its excellent human resource, well-understood policies and participatory decision-making. However, its MIS is not yet standardised and information systems are cumbersome. Its Internal Audit system, though well laid out and comprehensive, has highly inadequate frequency.

In financial terms, VFC's high operating cost due to a large number of support staff and expensive managerial systems is a constraint in the competitive environment of Cambodia but its good portfolio quality as well as high capital adequacy are comforting factors from the lender's perspective. The overall financial performance is good.

In M-CRIL's view, on account of good overall performance and high capital adequacy, VFC can absorb - from all sources - loan funds of US$ 2,500,000 till February 2007.

A rating update after one year is suggested to ascertain changes in the creditworthiness and absorptive potential of the institution. **This rating is valid, subject to no other substantial inflows of loan funds into the organisation beyond the limits specified here** and to no other significant changes in the organisational structure and external operating environment.

For Micro-Credit Ratings International Ltd

Sanjay Sinha, Managing Director

***Validity** This rating is valid till the next loan proposal made by the MFI to any financial institution or till any other significant change in the structure of the loan programme or in its external environment. A **rating update** (comprehensive repeat rating) is recommended whenever such changes take place or at the end of **one year** from the date of the initial assessment, whichever is earlier. Any substantial additional information that becomes available could also result in a rating update or a rating review (revision of rating grade based on a desk analysis).

Liability The rating assigned is a professional opinion of the assessors and M-CRIL does not guarantee the information and cannot accept any legal responsibility for actions arising out of the recommendations made.

Category wise rating

Category	Rating grade[1]
A *Governance aspects*	α–
B *Managerial factors*	α–
C *Financial performance*	α
Overall	α–

Key Risk Factors

1 **Single source of finance:** VFC is the Cambodian subsidiary of Vision Fund International (VFI). VFI was promoted by World Vision, a large development organisation. At present, funds from various organisations belonging to the World Vision family are channelled through VFI. VFI further allocates these funds to its various subsidiaries according to its own fund allocation policies. For VFC, the only source of finance till now has been VFI. Due to this restricted source of finance, VFC has not been able to meet its portfolio targets of year 2005 (growth fell short by ~50%). Due to this limitation, VFC faces the risk of losing market share, in the highly competitive financial environment of Cambodia.

2 **Underdeveloped MIS and Internal Audit system:** The organisation's MIS is currently in transition from a manual to a computerised system. The software has been specified by VFI to maintain standardisation across its various subsidiaries, internationally. At present a mix of the old and the new system is being operated at the branches. The new system, apart from being highly expensive, does not offer the advantage of integrated accounting and MIS. With branch staff involved in maintaining both the old database as well as the new database, apart from maintaining accounting records, the level of complexity has increased, which increases the risk of error. Further, the Internal Audit department of the organisation has only two staff and a very inadequate frequency of branch audits, which increase the risks of errors and fraud.

3 **Foreign exchange risk:** Loans to VFC from VFI are in US Dollars while most of the loans from VFI to its clients are in the local currency. Though, the Cambodian economy has not faced inflationary conditions since 1999 and the currency is fairly stable, the organisation has assumed the additional risk of exchange rate fluctuation. Currency fluctuation losses during the year 2005 were high at US$39,000, which were even higher than the total interest expenses of the organisation.

Key Programme Strengths

Governance, experience and strategy	Management and operations	Financial
1 Linkages with 'World Vision' provides good brand and access to market 2 Experienced and qualified Board of Directors 3 Strong second line of leadership	1 Qualified and professional staff 2 Well documented policies 3 Well laid out plans	1 Good portfolio quality 2 High capital adequacy

[1] M-CRIL's grading sheet is attached at the end of the report.

Organisational Profile

Legal form	Years of m-f operation	Number of			
		Active borrowers	*Staff*	*Branches*	*Active borrowers/ staff member*
Limited liability company	5 years*	25,347	191	7	133

* Including 3 years of operations of MF programme of World Vision Cambodia (the parent organisation)

Microfinance programme: Operational highlights

Loan portfolio of MFI ('000 Riel, US$)	Cumulative loans disbursed by MFI ('000 Riel, US$)	Loan disbursed by MFI During the previous year	Average loan size from MFI to borrowers ('000 Riel, US$)
14,168,994	40,764,054	21,631,567	692
3.4 million	10.0 million	5.3 million	168

Key financial ratios

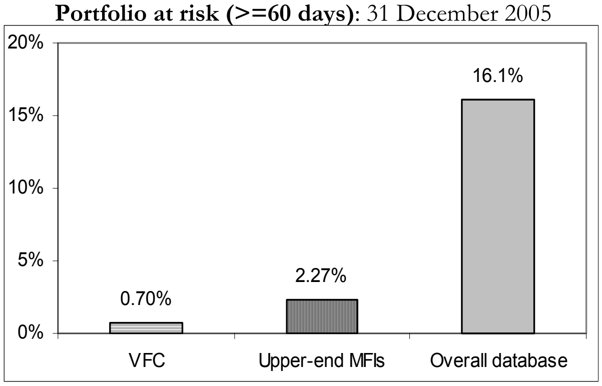
Portfolio at risk (>=60 days)	Current repayment rate	Risk weighted capital adequacy ratio	Weighted average cost of funds	Yield to APR ratio
0.7%	99.6%	81.4%	6.1%	99.5%
Yield on portfolio	**Other income to average portfolio**	**Financial cost ratio**	**Loan loss provisioning ratio**	**Operating expense ratio**
38.4%	0.6%	2.7%	1.3%	34.1%
Total income to average total assets	**Total expenses to average total assets**	**Return on average total assets**	**Operational self sufficiency**	**Financial self sufficiency**
32.5%	32.0%	0.6%	102.6%	92.2%

Notes

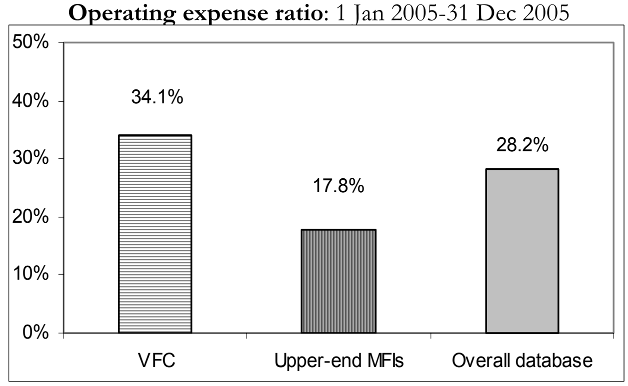
1 All figures are as on 31 December 2005.
2 The active borrowers' figure includes individual as well as group clients. On 31 December 2005, the MFI had 1,627 individual clients and 23,720 group clients in Village Banks and Solidarity Groups.
3 Other income includes mainly income from recovery of loans written off and penal charges from clients.
4 The organisation has provided a loan loss provisioning of 0.7% and has maintained a Loan Loss Reserve (LLR) of 0.4% of the outstanding portfolio on 31 December 2005. This is done as per the policy of National Bank of Cambodia and is based on ageing. The policy does not provide for any provision on good portfolio and portfolio with overdues upto 30 days. M-CRIL has, hence, provided additional provision to maintain a LLR of 1% of the total outstanding portfolio.
5 The ratio of repayment rate and PAR_{60} has been calculated from the MIS reports of VFC.
6 Capital adequacy is extremely high as almost all funds of VFC are owing to equity investment by Vision Fund International (Parent Company of VFC).
7 For calculation of FSS, market rate of interest is taken at 10% per annum (LIBOR +5%), since the organisation is obtaining loans in US Dollar. Inflation is taken at 4.0%.

VFC – financial overview

Portfolio at risk (>=60 days): 31 December 2005

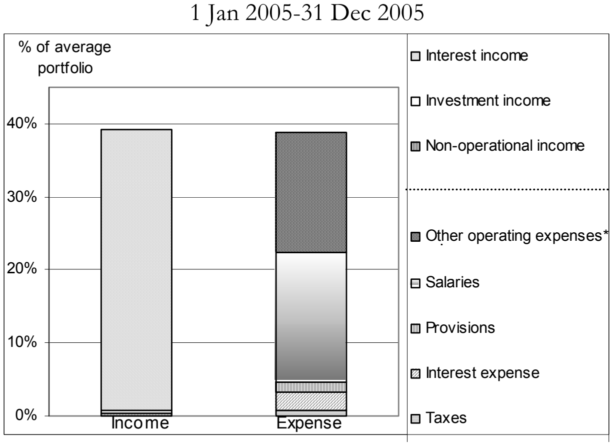


Operating expense ratio: 1 Jan 2005-31 Dec 2005

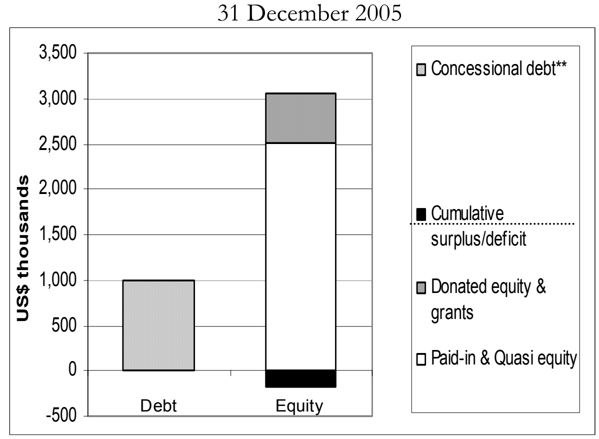


Note: 1. $n_{upper\text{-}end} = 10$ $n_{database} = 212$ (excuding outliers); Database figures as on 31 December 2004
2. Outliers and rated MFIs with no direct lending have been removed for analysis. Upper-end figures reflect top 10 MFIs.
3. The upper-end MFIs and overall database ratios represent simple averages for their respective samples.
4. The performance of either the Upper-end MFIs or all MFIs (overall database), do not necessarily reflect M-CRIL's rating standards.

Income and expense distribution:
1 Jan 2005-31 Dec 2005



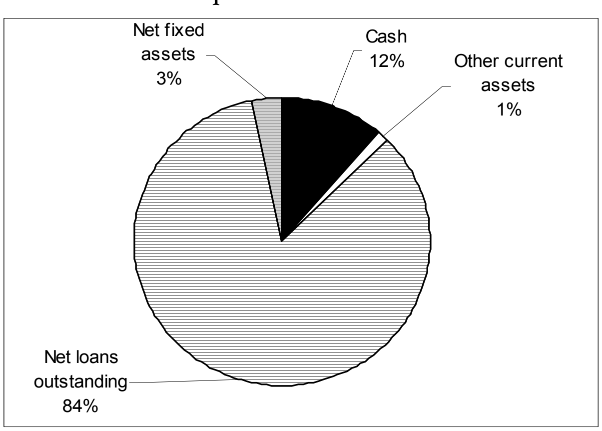
Debt and equity composition:
31 December 2005



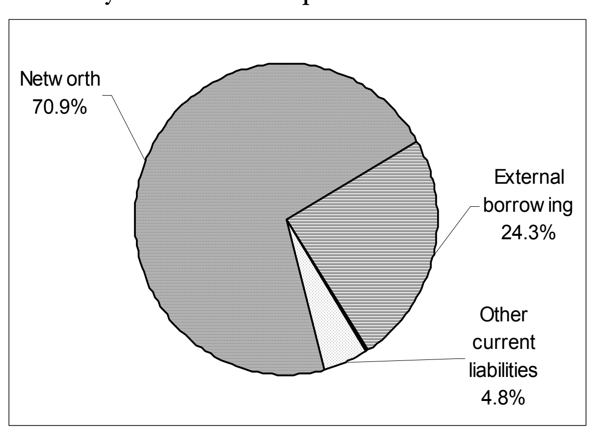
* Other operating expenses include travel, depreciation and administrative expenses

** Concessional debt is borrowing+comp.savings taken at < Bank PLR, voluntary savings taken at < bank deposit rates

Asset composition: 31 December 2005



Liability & net worth composition: 31 December 2005



Country Profile[3]

Cambodia is a Southeast Asian country, bordering the Gulf of Thailand, between Thailand (on the west), Vietnam (on the east), and Laos (on the north). Majority of the population believes in Buddhism and speaks Khmer language. The country has a parliamentary democracy.

Cambodia is one of the world's poorest nations; its economy is still suffering from the civil war that shattered the country during 1970s and 1980s. In 2005, its rank on Human Development Index of United Nations Development Programme was 130.

Subsistence farming employs 75% of the workforce. Conditions are ideal for the cultivation of its chief crop, rice, with availability of water from the Mekong River and a fertile soil. Corn, vegetables, fruits, peanuts, tobacco, cotton, and sugar palms are widely cultivated. Livestock raising (cattle, buffalo, poultry, and pigs) and extensive fishing are the other major economic activities.

After around 30 years of political instability and civil war during 1980s, peace efforts intensified in 1989 and 1991 with two international conferences in Paris, and a UN peacekeeping mission helped maintain a cease-fire. UN-sponsored elections in 1993 helped restore some normalcy. Norodom Sihanouk was reinstated as King. A coalition government, formed after national elections in 1993, brought renewed political stability. Cambodian economy grew by an average of 7.6% annually from 1987 until 1993 and then by about 4.5% annually during 1994-99. Growth remained about 5% from 2000 to 2004. The number of people living on less than one dollar per day declined from 36% in 1998 to 28% in 2005, according to the World Bank's estimate. Economic growth has been largely driven by expansion in the garment sector and tourism. Clothing exports were fostered by a US-Cambodian Bilateral Textile Agreement, which gave Cambodia a guaranteed quota of US textile imports. From January 2005, after the expiration of WTO Agreement on Textiles and Clothing, Cambodia-based textile producers are in direct competition with lower priced producing countries such as China and India.

The long-term development of the economy after decades of war remains a daunting challenge. The population lacks education and productive skills, particularly in the poverty-ridden countryside, which suffers from an almost total lack of basic infrastructure. Fear of renewed political instability and a dysfunctional legal system coupled with extensive government corruption discourage foreign investment.

The Cambodian government continues to work with bilateral and multilateral donors to address the country's many pressing needs. Donors including ADB and the World Bank, pledged $504 million in aid for 2005 on the condition that the Cambodian government begins taking steps to address rampant corruption.

The major economic challenge for Cambodia over the next decade will be fashioning an economic environment in which the private sector can create enough jobs to handle Cambodia's demographic imbalance. More than 50% of the population is 20 years or younger. In this scenario, microfinance is one of the areas that have attracted the attention of policy makers and the country has made significant progress in microfinance policy and regulation. The National Bank of Cambodia – the central bank – has been instrumental in bringing about regulatory changes that include the provision of a separate license for microfinance institutions.

[3] *Source: The CIA World Factbook, U.S. Department of State, Area Handbook of the US Library of Congress, http://worldfacts.us/Cambodia.htm*

1 Organisational background

VisionFund Cambodia Limited (VFC) was promoted by World Vision Cambodia (WVC), a well-known international, not-for-profit, development organisation. VFC was registered, as a commercial company with the Ministry of Commerce (MoC), in December 2003, and in the year 2004, it received MFI license from the National Bank of Cambodia. VFC took over the operations from an earlier microfinance programme of WVC, which was operational from 2001 with the name of Micro-Enterprise Development (MED) programme.

VFC inherits its Vision and organisational culture from its parent organisation WVC, which is a Christian company pursuing the goal to follow Christ's example in transforming the lives of poor and oppressed. VFC aims to complement WVC's work by providing access to affordable and stable financial services to the poor to generate jobs and assets creation for them. VFC's mission states " VisionFund Cambodia is a Christian company that provides financial services to help the poor liberate themselves from poverty."

The entire paid-up capital of VFC was owned by WVC, as a consideration of transfer of loan assets in December 2003. Later in March 2005, WVC transferred all the shares in VFC to a newly promoted organisation Vision Fund International (VFI), which is an umbrella organisation for all the microfinance institutions promoted by World Vision offices around the world. The table below shows their equity holdings in the VFC, as on 31 December 2004 and 31 December 2005.

Shareholders	31 December 2004		31 December 2005	
	Share capital (US$)	% of share capital	Share capital (US$)	% of share capital
World Vision International	757,891	100%	25	-
Mr Ray Sano (WVC's representative)	25			
Vision Fund International			757,891	100%
Total (US$)	**757,916**	**100%**	**757,916**	**100%**

Apart from the paid up share capital, VFC has loan capital grants (for lending purpose) and property and equipments grants (for fixed assets) from World Vision family organisations. The company has the option to convert these grants into share capital by increasing its capital registered with the Ministry of Commerce. The table below shows kind of grants, as on 31 December 2004 and 31 December 2005.

Purpose of grants	31 December 2004	31 December 2005
	Amount (US$)	Amount (US$)
Grant for on lending	796,571	1,752,016*
Grants for property and equipments	89,227	150,476
Grants for operational expenses	126,779	405,563
Total (US$)	**1,012,577**	**2,308,055**

*Organisation expects to receive grant of US$ 19,130 from WV during the year 2006

2 Microfinance operations

2.1 Background of microfinance operations

VFC's microfinance programme is five years old. Initially it was started as a programme of World Vision Cambodia with the purpose of providing financial services to the poor, who are facilitated under the Area Development Programmes (ADPs) of WVC (programmes focussing on the integrated development of an underdeveloped area). Later, in December 2003, WVC promoted VFC and transferred the programme to it.

VFC is currently operational in 35 districts in seven provinces, where WVC's ADPs are operational. VFC operates through its seven branches, one each in seven provinces. As on 31 December 2005, it had 25,347 clients of which ~80% were women. In its five years of operations, the organisation has disbursed loans of ~US$10 million.

Till 2004, an expatriate was leading VFC as its General Manager (GM). However, from the year 2005, which is hailed as the year of sustainability and management localisation, the organisation is managed by the local Cambodian managers, while the earlier GM acts as a consultant and a non-executive Board member. GM is supported in decision-making by senior department heads namely, the Finance Manager, Operations Manager, Human Resource (HR) Manager and the IT Manager. Apart from these, there is an Internal Audit department. The Audit Manager is supposed to report to the Board of Directors.

At the branch level, there are Branch Managers (BM), Credit Supervisors (CS) and Credit Officers (CO). Administrative staff includes accountant, cashier and computer operators (data encoders). Regular field activities, i.e. loan disbursement and collections, are undertaken by COs and are supervised by the CSs. The CS has the responsibility of promoting new groups, identifying new clients, carrying out loan appraisal and following up overdues and bad loans.

The Board of VFC has eight members including the Consultant (earlier GM) and present GM as a non-voting member. GM is the only Executive Director. Five Board members are representative of World Vision family organisations. The Board members are highly qualified and have long years of experience in development and finance.

VFC has a decision making body called the Executive Team which is comprised of the Consultant, GM, Finance Manager, Operations Manager and HR Manager. All major operational decisions are taken by this Team.

The source of funding for VFC is World Vision and other related (partner) organisations. As mentioned earlier, the paid up share capital is completely owned by VFI. Other major source of funding is the grant support.

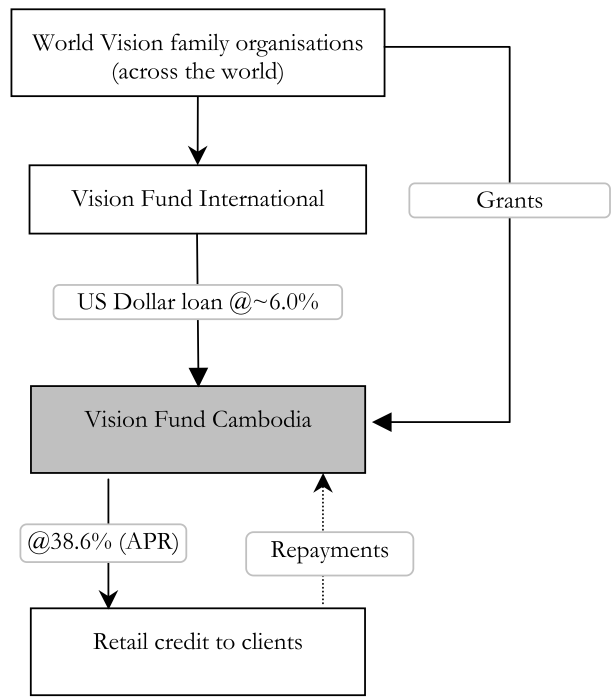
The organisation has also availed loan fund in US Dollar currency from is various World Vision family organisations; all the funds are routed through accounts of VFI. VFC has to make bullet repayment of all these loans and the loan term ranges from 2 years to 5 years.

Tenure and interest rate of all loans (from VFI) outstanding as on December 31, 2005

Date of Loan from VFI	Tenure (years)	Loan Amt. US$	Rate of Interest
9 March 2005	5	100,000	6.0%
30 June 2005	5	40,461	6.0%
11 July 2005	2	600,000	6.0%
5 September 2005	5	94,815	6.0%
21 November 2005	2	100,000	6.8%
29 December 2005	5	53,565	6.0%

Total		**988,841**	**Weighted average 6.1%**

The flow of funds to and from the organisation is as given in the following diagram:



2.2 Microfinance policies

VFC operates in and around WVC's ADP operational areas. Before opening up a new branch office, the Operations Manager of VFC discusses with Operations Manager of WVC to assess the feasibilities for branch opening by understanding the general profile of the area, economic potential, livelihood scenario and competition. Operations Manager also seeks possible supports like sharing of offices and information. Branch Manager meets the District Governor and Commune Authority to take permission and solicit their support. For selecting a village, Credit Supervisor is supposed to seek the support of local Commune Leader, who can help the organisation in recovery of overdues and scrutinising clients with loans from other MFIs.

VFC lends to Village Banks (VBs), Solidarity Groups (SGs) and Individual Loan (IL) clients. VB is a big group of 2 to 15 sub-groups, having ~5 members each. SGs are smaller groups of 3-5 individual members, with only one member from one household. VBs can also be looked as federations of SGs. As on 31 December 2005, VFC had 880 VBs with a total of 21,998 clients (an average of 25 members per Bank), 530 SGs with a total of 1,722 clients (an average of 3 clients per group) and 1,627 IL clients.

After identification of the potential clients, CS and CO give an orientation about VFC's loan products, loan sizes at various cycle, interest rate, repayment frequency, where to repay the loan and group guarantee requirements. After that, CO makes a home visit to make sure that the client actually deserves to receive the loan.

After getting satisfied about the quality of the Groups/Bank, CO gets the loan application prepared. CO submits the loan applications with a Family Information Sheet, an analysis of client's ability to repay to CS and to BM for their approval. In case the CS or the BM are not satisfied, they conduct Quality Check by making visits. After approval from BM, Branch Accountant posts the loan information for each individual client in the database. A loan agreement contract and repayment schedule is generated.

In case of Individual Loans, the organisation insists for a guarantor and collaterals worth at least 150% of the total loan amount. Assets value is based on the selling price.

While Group Loans are disbursed and their repayments are collected in the village meetings; in case of Individual Loans, organisation gives an incentive of lower interest rate if the client agrees to collect and repay loan at the branch office.

<u>Loan products</u>

VFC provides loans for various income generating activities including agriculture and micro-enterprises. Repayment schedule is flexible to the requirements of the borrowers.

Details of the loan products are given below:

For Village Banks

There are two loan products for VBs- Small Business Loans and Agriculture Loans

Loan details	Small Business Loan	Agriculture Loan
Currency	Riel and US$ (preferably US$)	Riel and US$ (preferably US$)
Loan size	First cycle: Riel 100,000 to 500,000 US$ 25 to125 Second cycle: Riel 100,000 to 700,000 US$ 25 to175 Third cycle: Riel 100,000 to 900,000 US$ 25 to225 Fourth cycle: same as third loan cycle	First cycle: Riel 80,000-400,000 US$ 20-100 Second cycle: Riel 80,000-600,000 US$ 20 to150 Third cycle: Riel 80,000-800,000 US$ 20 to200 Fourth cycle: same as third loan cycle
Interest rate	36% to 48% per annum on declining balance	36% to 48% per annum on declining balance
Loan term	3 months to 12 months	3 months to 12 months
Repayment	Option of monthly or fortnightly repayments. Loan repayment is in the same currency as that of loan disbursement.	1 For loans of more than Riel 500,000 (US$125), client has the option of making principal repayments in every 2, 3, 4, 5 or 6 months; interest though has to be repaid in monthly intervals. 2 For the clients with loan of less than Riel 500,000 (US$ 125), have an additional option (apart from options available to clients with loan size>US$ 125) to repay principal amount at the end of the loan term; interest is payable monthly.
Guarantee	Guarantee by group within VB	Guarantee by group within VB

For Solidarity Groups

There are three loan products for SGs- Small Business Loans, Agriculture Loans and Assets Creation Loans

Loan details	Small Business Loan (SBL)	Agriculture Loan (AL)	Assets Creation Loan (ACL)
Currency Loan size Interest rate Loan term	Riel and US$ (preferably US$) Riel 500,000-4,000,000 US$ 125-1,000 36% to 48% per annum on declining balance 3 months to 12 months	Riel and US$ (preferably US$) Riel 500,000-4,000,000 US$ 125-1,000 36% to 48% per annum on declining balance 3 months to 12 months	Riel and US$ (preferably US$) Riel 500,000-4,000,000 US$ 125-1,000 36% to 48% per annum on declining balance 3 months to 12 months
Repayment	Option of monthly or fortnightly repayments. One-month moratorium is allowable.	Client has the option of making principal repayments in every 3, 4, 5 or 6 months; interest has to be repaid monthly.	Client has the option of choosing repayments modes of as that of either SBL or AL.
Guarantee	Guarantee by SG members	Guarantee by SG members	Guarantee by SG members

For Individual loans

Individual loans are provided for Business, Agriculture and Asset creations.

Loan details	Business Loan (BL)	Agriculture Loan (AL)	Assets Creation Loan (ACL)
Currency Loan size Loan term Repayment Guarantee	Riel, Thai Baht and US$ (preferably US$) Riel 1,000,000-20,000,000 US$ 250-5,000 3 months to 18 months Option of monthly or fortnightly repayments. One-month moratorium is allowable. Property collateral of 150% of the loan amount and one guarantor	Riel, Thai Baht and US$ (preferably US$) Riel 500,000-4,000,000 US$ 125-1,000 3 months to 18 months Client has the option of making principal repayments in every 1, 2, 3 or 4 months; interest has to be repaid monthly. Property collateral of 150% of the loan amount and one guarantor	Riel, Thai Baht and US$ (preferably US$) Riel 500,000-4,000,000 US$ 125-1,000 3 months to 18 months Client has the option of choosing repayments modes of as that of either BL or AL. Property collateral of 150% of the loan amount and one guarantor

<u>Interest in case of Individual Loans</u>

	Interest rate	
Currency and Loan sizes	**Disbursement and collection at Client's house**	**Disbursement and collection at Branch Office**
<u>Riel</u> 1,000,000-5,000,000 5,000,100-20,000,000	 3.5% to 4% on declining balance 3.5% on declining balance	 3% to 3.5% on declining balance 3% to 3.5% on declining balance
<u>Thai Baht</u> 10,000-50,000 50,001-200,000	 3.5% to 4% on declining balance 3.5% on declining balance	 3% to 3.5% on declining balance 3% on declining balance
<u>US$</u> 250-1,500 1,501-5,000	 3.5% to 4% on declining balance 2.5% to 3.5% on declining balance	 3% to 3.5% on declining balance 2% to 3% on declining balance

Saving products

VFC does not offer saving products to its clients. In the year 2006, the organisation plans to offer a savings product to social responsible investors (non-clients). This would be a long-term deposit product that allows Cambodian residents to invest in VFC. This has been approved by the Board and would be offered to the public after VFI's approval.

Insurance products

At present (till completion of the rating visit), VFC does not offer any insurance product to its clients. However, it plans to offer micro-insurance products to its clients by mid of the year 2006.

VFC has conducted a market study on the overall demand for the life insurance product among its clients and has prepared a Business Plan.

The Ministry of Economy and Finance (MoEF) supports the organisation to pilot test the micro insurance services, even though the Ministry is currently in the process of drafting regulations to govern life insurance and micro-insurance sectors in Cambodia.

It is envisioned that VFC will initially have an insurance division within VFC to offer its life insurance product (for about one year) and would later spin this off into a separate micro-insurance company.

In the first year of launch of the insurance product, VFC plans to reach 5,000 clients, of the age group of 16 to 54 years, through its life insurance product, which would provide a cover of maximum US$350 (US$ 250 in the first three years of enrolment) to each insured. VFC has limited its liabilities by excluding death due to political and criminal reasons and has also limited the membership to those between the age of 16 to 54 years only. Benefits are also not payable in the event of death within 6 months of enrolment. It plans to have a Reserve Fund of US$250,000 for this programme from World Vision. The organisation plans to launch this product in September 2006, provided it gets the approval of MoEF.

3 Observations

3.1 Governance & strategy

VFC has shown good performance on governance with a grade of $\alpha-$. The grade reflects the organisation's experienced and qualified Board, strong second line of leadership, linkages with World Vision Cambodia, which helps it in growing its market base in a highly competitive microfinance sector of Cambodia. However, the performance is limited by its dependence on a single source of finance and slower than targeted growth due to this.

- Strategy for microfinance operations

  Governance: VFC has a highly experienced and professional Board. The members, eight in number, have long experience in development sector, finance and accounting. Five of the eight Board members are representative of World Vision, while one is a 'Professional' Director, Fellow from Australian Institute of Company Directors and an expert in finance and accounting. Another Board member is the CEO of a social enterprise while the eighth member (non-voting) of the Board is the GM. The Board meets once in each quarter. Board displays an active participation in monitoring of operations, formulation of business strategies and approval of policies and any changes therein. However, due to limited number of meetings (four in a financial year), Board does not oversee the findings and follow up on the findings of the Internal Auditor, who instead reports to the Operational Manager. This is the major weakness of the functioning of the Board.

To overcome its limitations, the Board had decided to create three committees, which include, "Leadership and Board Development Committee", "Evaluation and Audit Committee" and "Finance and Risk Committee". The committees have however not been formed till the rating visit for the want of required Board members. The Board is expected to fill certain vacant positions in 2006. "Evaluation and Audit Committee" is expected to review Internal Auditor's reports and actions taken upon the findings and to strengthen the overall controls. "Finance and Risk Committee" is supposed to review financial budgets and plans and to assist the Executive Team in raising funds and the "Leadership and Board Development Committee" is to be set to improve the effectiveness of the Board functioning. The committees would have selected Board members with required expertise and would have resource persons drawn from the management team.

<u>Second line of leadership</u>: In 2005, VFC's management was localised after being served by an expatriate as its General Manager for initial two years. The leadership was transferred by the Board on satisfaction of the leadership capabilities of the local senior management. Apart from having a competent local General Manager, VFC has the advantage of having a very strong senior management, part of the Executive Team, which comprises of the Operations Manager, Finance Manager and the HR Manager. Decision-making in the organisation is highly participatory and the Executive Team is involved in all major decision-making. The team meets once every month.

<u>Expansion</u>: VFC's growth in the last five years (including the earlier MED programme of WVC) has been reasonable in terms of clients, while the portfolio growth has been high.

Figure 1: Growth numbers

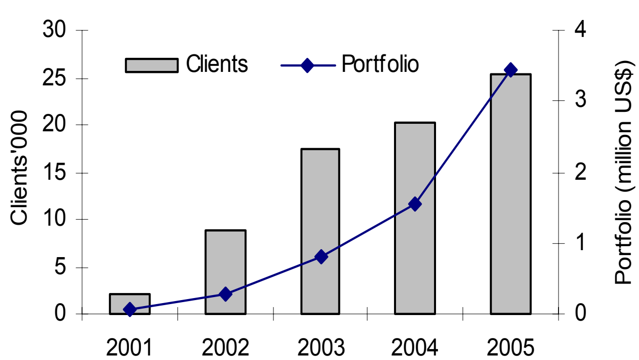
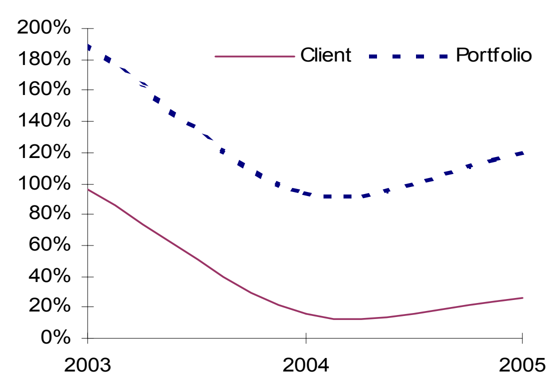


Figure 2: Growth rates

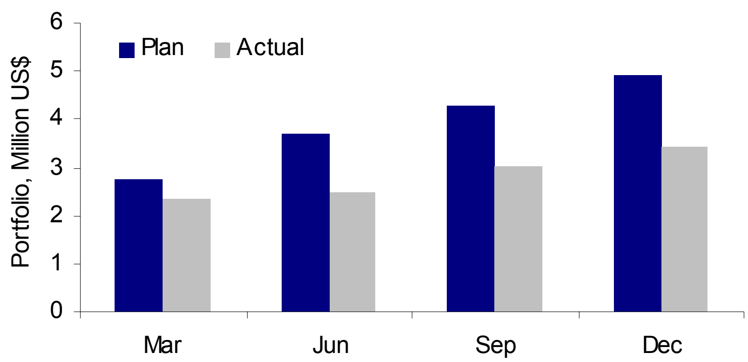


During the period 2003 to 2005, the number of clients has grown by 45.6% (in absolute terms this is an addition of around 7,934 clients in 2 years) while the portfolio has gone up by over 4 times (growth of 326%). Higher portfolio growth is mainly on account of increase in number of relatively larger size individual loans during the year.

VFC has the strategy of working in partnership with NGOs, engaged in development, which allows it to have higher probability of success, since the clients are also benefiting on income generation fronts.

The organisation has the advantage of operational support and established brand image of World Vision Cambodia, which provides it with the opportunity to expand faster in the highly competitive microfinance sector of Cambodia. The organisation has a strong Board and a very good management team; however, it fell substantially short of its clients and portfolio targets for the year 2005 due to shortage of funds and non-availability of it during the high demand period. Figure 3 shows the wide gap between the planned portfolio and the actual portfolio outstanding at four quarters of the year 2005. The organisation fell short of its portfolio outstanding targets by ~US$ 1.5 million (actual US$ 3.4 million as against planned US$ 4.9 million).

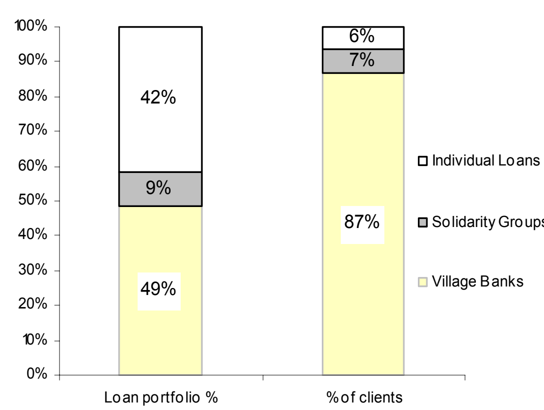
Figure 3: Portfolio outstanding, Plan Vs Actual in 2005



Apart from non-receipt of funds from the lender, the organisation also suffers from its liquidity policy, which requires it to maintain atleast 10% idle cash balance. The Board in its meeting held on 21st November 2005 referred the liquidity of 14% as low. The organisation maintained a very high average liquidity of 11.5% during the year 2005. Further, the terms of repayment to its lenders does not match well with the repayments made by its own clients. The repayments to its own lenders are bullet repayments, which necessitates it to save funds over a period to repay.

In terms of geographic spread, since VFC was promoted for the purpose of providing financial services to the poor, who are serviced by the Area Development Programmes of WVC, VFC's operations are spread across seven provinces of Cambodia in and around WVC's operations. All the branch offices share the premises with WVC offices. VFC is benefited by the presence of WVC in the region. It is easier for VFC's staff to get knowledge of economic activities in the region and client's financial needs. VFC is

Figure 4: Shares of Portfolio and client distribution



also benefited by the established brand image of WVC. In terms of coverage within the provinces covered, VFC's focus being on poor, most of its clients are in the interiors and rural areas where other MFIs have less presence. The organisation's clients are scattered and some are served far from the branch offices, which increases the cost of its operations. Loans to poor are mainly through VBs and loan size is small. The organisation has, however, done well to have a sizable proportion of its portfolio in relatively larger size individual loans, which helps it keep reasonable efficiency levels in terms of portfolio outstanding. Figure 4 gives a view of the proportion of portfolio and clients covered by different lending models. As the figure shows, while Village Banks have 87% of the total clients, they have only 49% of the total portfolio outstanding. Individual loan clients are only 6% of the total clients but because of their higher loan size, they have 42% of the total portfolio outstanding. The organisation has the strategy of keeping its overall operational costs low by offering relatively bigger sized Individual Loans. VFC plans to have ~50% of its portfolio in Individual Loans while having ~78% of total clients in Village Banks by the end of five year (year end 2010).

Competition: VFC faces stiff competition from a number of MFIs working in all the provinces where it is working, especially in the urban centres. However, most of its operations are in rural areas targeting very poor, some of these areas are not well reached by the other MFIs. The organisation's competitive edge is its linkages with WVC, which helps it easily identifying the market and an established brand of WVC helps it in increasing its clientele.

Presently, the interest rates charged by VFC are comparable to those of other MFIs, however, any reduction in the interest rate by the competitors could cause trouble to the organisation, since its operational costs are high and return on assets is low. As a competitive strategy, VFC offers flexible loan terms to its clients. In case of individual loans and SG loans, loan repayment terms are easy. Loan for business purpose is given a one-month moratorium, clients with loan for agriculture purposes have the option to repay principal amount even in half yearly breaks. Clients with loan for Asset Creation have the wide option of choosing the repayment schedule of that of Business loans or Agriculture Loans. Since most of the loans for business purpose involve some Asset Creation; the clients have the advantage of repaying principal amount as per their convenience.

Experience: The microfinance programme was originally started by WVC as a MED programme. Later a separate commercial company was formed and business was transferred to it. The WVC team has five years of microfinance experience in Cambodia. Presently VFC has a complete focus on microfinance. Its staff and Board have long years of collective experience in development, finance and accounting. However, so far VFC has worked on grants, equity and loans from the parent organisation and other family organisation; it lacks experience in mobilising commercial borrowings.

Plans: Within the next five years, VFC plans to have an outreach of ~1,10,000 clients and a portfolio of US$ 20.7 million. It plans to establish 1,400 Village Banks, ~25,000 Individual Loan clients, 2,600 solidarity groups and 160 Association Loans[4], which would allow the poorer micro entrepreneurs to access services from VFC. The organisation plans to enter into strategic alliances with other development organisations that would need microfinance services, similar to WVC. It has already started discussions with Plan International, an NGO

[4] Association Loan will be a wholesale loan product, which will be designed in 2007 to serve Farmers/or Small Business Associations

working in Cambodia.

The organisation plans to introduce insurance product in 2006, as discussed earlier. It would start this product after receipt of a Reserve Fund of US$250,000 from WV and approval from the Government. Considering that the claims in the first year would be limited, due to clause for not providing benefits in the event of death within six months of enrolment, Reserve Fund of US$ 250,000 plus the first year premium of ~US$70,000 would be sufficient to meet liabilities arising out of death of even 26% of its clients (1,292 clients) in the second half of the first year, which is unlikely. Hence, with this plan, the risk of loss to the organisation in the year 2006 is negligible.

3.2 Managerial factors

VFC has displayed good performance on managerial factors with a grade of $\alpha-$. This grade is on account of the organisation's professionally qualified human resource, well documented and communicated policies and participatory decision-making. The overall performance is limited by its yet to be standardised MIS, cumbersome processes and inadequate strength of Internal Audit system.

- Human resource quality and management

VFC has a young, professional and dedicated managerial and field staff team. Senior management is well qualified in management, finance and accounting. The organisation has systematic training and induction system for all staff members. HR department has a Capacity Building team of three: a Capacity Building Coordinator and two trainers. HR department assesses the staff performance through a 360° performance appraisal system; the requirement of training needs and prepares a training calendar for the next year. At present, there is no incentive system based on the staff performance, but the HR department has recently introduced an incentive system based on various parameters such as portfolio outstanding, clients and portfolio quality. The system is yet to be approved by the Board.

The organisation has an elaborate support staff structure at both Head Office as well as at branch level, which has scope for optimisation. At present, it has 84 support staff members out of the total staff of 189, which is very high. Number of support staff is high mainly because of cumbersome information systems. Following is some detail of the support staff engaged in mainly managing the information systems in the branches.

Support staff in 7 branches	Number of staff
Accountants (including their assistants)	15
Data Encoders	10
Cashiers	7
Admin assistants	5
Total	**37**

The table shows that on an average more than 5 staff members are engaged in maintaining information system. Apart from these, Credit Supervisors and the Branch Managers also spend their time in supervising these systems. The main reason for cumbersome processes is duplication and excessive information gathering, some of which is not analysed and used by the organisation.

For handling cash, accounts and data entry, VFC has created three different positions viz. Cashier, Accountants and Data encoders. In some of the efficient MFIs around the world, much of the data entry work is done by the Credit Officers themselves. This form of staff structure appears to be inefficient.

Large number of support staff is one of the main reasons for the organisation's low clients to staff ratio (133). The other main reason being, overstaffing due to higher planned growth for the year 2005, which was not met due to failure to secure required funds on time from VFI, which is the only lender of VFC.

- Accounting and MIS

VFC has a reasonable accounting system. Vouchers support all transactions. Debit and Credit vouchers are separately maintained for all transactions. Accounting system is not integrated with the MIS. Accounting reports at the branches are prepared on MS Excel and are then integrated at the HO in accounting software called Sun System. All the transactions are entered daily into the system, cash is reconciled everyday and a cash count sheet is prepared. Branches are treated as separate profit centres and monthly performance reports are prepared, which include portfolio performance, Balance Sheet and a Profit and Loss account.

The organisation has adapted the policy for providing loan loss reserves and write-offs as prescribed by the National Bank of Cambodia. The policy provides for provisioning on portfolio with overdues of more than 30 days, however the provisioning as per this policy does not seem to be adequate and some provision on standard portfolio should also be provided.

The MIS of VFC is in the phase of transition. Till 2004, the organisation used an MS Access based software for recording loan disbursement information and generating repayment schedule for the clients, however this software does not record collection details and hence can not give reports on portfolio quality, which is to be gathered from the accounting records. In 2005, the organisation installed new software 'E-Merge', which is a sophisticated on-line system, normally used by banking companies. This software was installed as per the requirement of VFI, which has the policy to standardise the systems across all its subsidiaries worldwide. This software has 'C' Program as its front-end, 'J' base as its Back-end and uses Windows 2000 as the platform. It has a centralised database and branch offices make online data-entries in the central database located at the HO. This allows the users at HO to have a real time access to the branch data.

Most of client's data is still in the old database (~70%) and for the new clients, new software E-Merge is used. In some cases even new cases are entered into the old database by the branch staff since the new system is more time consuming. With the new cases entered in it, the old database would need to be maintained till the tenure of the new cases comes to an end.

The data encoders enter any new group or clients, loan disbursement details and repayment details. A repayment schedule is generated which is handed over to the COs. Disbursement and repayments are recorded both in the MIS as well as the accounting system. In case of repayment default, a voucher entry is recorded by the Accountant to classify the portfolio as per aging of the overdue. In case the client's data is in the new system, repayment is recorded and repayment schedule is automatically amended; however if the data is in the old database, repayment schedule is to be amended manually.

Branches send all the accounting information to HO each month by e-mails. Head Office prepares consolidated as well as branch-wise reports and sends it back to the branches.

The new system suffers from certain limitations. The staff finds it cumbersome and a hindrance to provide faster service to its clients and still prefers to use the old system. The reports generated by the system are too many and are not utilised by the users. It was found that despite obvious errors in monthly branch reports, neither HO nor the branch staff had corrected them. The system is highly expensive too. Apart from having high infrastructure requirements like lease-line connectivity at the branch offices, modern servers etc, it has increased the requirement of data- encoder staff at the branch offices. Since the accounting is not integrated with the MIS, the requirement of accountants has not reduced and data duplication has increased, which has chances of errors.

Following table gives an overview of the costs involved with the new system.

Cost of fixed assets	US$
E-Merge software Installation	25,000
Lease-line equipments	23,673
Servers (year 2005)	12,925
Servers (planned for 2006)	30,000
Total	**91,598***

*To be depreciated in 3 years

Yearly operational costs	US$
E-Merge repairs and maintenance	8,000
E-merge license fee*	9,840
Lease-line equipment maintenance	3,000
Internet service fee	10,560
Lease-line fee*	55,002
Salary of data-encoders (assumed @$100/month for staff of 10)	12,000
Depreciation for 2005*	20,532
Total	**118,934**

*Cost for 7 branches and would increase with increase in number of branches
**Depreciation in 2006 would be higher by US$10,000, with an additional investment of US$ 30,000 in servers.

Total operational cost for the year 2005 is approx. US$ 119,000 which is 13.6% of the total operating expenses or 4.6% of the average portfolio (out of OER-34.1%, 4.6% is contributed by the new system). These costs do not include cost of providing training on the new system to the staff and the time spent on tackling bugs and dip in business volumes because of additional staff time consumed.

- <u>Tracking system for overdues</u>

VFC has <u>reasonable systems for tracking overdues</u>. The accounting system differentiates portfolio on an ageing basis and generates list of the clients with overdues. The Monthly Progress Reports provide details of overdues at the branch level. For the clients in the new system (E-Merge), this information is available at any point in time, as the MIS is able to generate reports immediately after the collections for the day has been entered. Overdues are tracked by the COs and, in case the CO is not able to collect, the CS makes efforts.

- Financial planning and control systems

VFC has a reasonable planning and a moderate control system. The organisation has prepared a five-year strategic Business Plan for the period 2006-10. The Plan shows the projected growth of the organisation in terms of operational area, portfolio and clients. It also shows the organisation's plans to introduce new products including savings and micro-insurance. Apart from an organisational Plan, each branch prepares its own Plan in consultation with the Operations Manager, which is broken down into expected monthly performances and is reviewed every month with the actual performance.

Cash planning at HO and Branch level is moderate. Branches send their requirements for cash to the HO as per their disbursement plans for the month and expected repayments. However, the branches do not review cash requirements, which results in very high cash balances and leads to poor utilisation of available funds. In fact, the organisation does not feel it important to have low cash balances with the branches and is rather concerned about reducing transaction costs in transfer of funds. Apart from ordinary cash management the organisation has a poor liquidity policy. As per the Board policy the organisation is required to maintain idle cash balances of at least 10%. After the rating visit, the organisation plans to reduce its idle cash balances from present 10% to 5%.

The overall control systems of VFC are moderate. There is the system of comparing the actual performances with planned, however, due to large amount of details involved; analysis is not carried out effectively. Also, the organisation lacks a system of incentive and disincentives based on the performance.

The internal audit system is moderate. The audit team had only two members at the time of rating visit. The organisation normally has four staff in its audit department. The Department Head has just left the organisation, though he engages himself partly. Audit team is expected to visit each branch once in every six months for the purpose of internal audit. The scope of audit is wide and it covers all financial and operational policy issues. There is a mechanism of giving report to the branch and asking its response. The auditors also look at the variances in the performances as compared to the targets and past period data.

As per the policy, the auditors are expected to report to the Board of Directors, however, owing to limited meetings and time spent by the Directors, reporting is done to the Operations Manager. The organisation has planned to form an Audit Committee of the Board, which would review the functioning of the Internal Auditors. The Board took this decision in April 2005 but till the rating visit in Feb 2006, the committee was not formed. Further, the present strength of the department is highly inadequate, the organisation plans to increase it to five in the year 2006. At present, as per the policy, the frequency of the audit is very low: once in every six months; and due to reduced strength of the team, even this is not complied with.

Apart from the Internal Audit, the organisation is audited by the National Bank Of Cambodia to assess the policies and capacities of the organisation apart from assessing the prudence of various management decision made during the year. World Vision International also audits the organisation once in every three years. The last such audit was done in July 2004.

- Quality of clients/member groups

  Visited member groups and individual clients showed good performance on overall discipline and credit culture. The clients were aware of the interest rates and policies and procedures of VFC. The meeting of clients are conducted efficiently. The records of the visited groups and individual clients were updated and documents were in accordance with organisational policies.

- Infrastructure

  VFC has adequate infrastructure at HO, as well as, at branch level. The organisation had an infrastructure base of US$131,789 as on 31 December 2005, which is 3.2% of its total assets. This includes computer hardware and software, vehicles, furniture and fixtures at branches and the Head Office. All branches, sub-branches and Head Office share premises with WVC on a rental basis. The current level of infrastructure is adequate in the overall management of the microfinance programme. The organisation plans to invest another US$30,000 in new servers for its MIS in the year 2006.

3.3 Financial performance

The financial performance grade of VFC is good at α. The grade is on account of its excellent portfolio quality and repayment rate. It has achieved operational sustainability at the end of the year 2005. It has a very high capital adequacy, which is comforting for the lenders. However, the organisation has a very high operating expense ratio, high idle funds and an under-leveraged equity, which are its major financial weaknesses.

- Credit performance and asset quality

  VFC has an excellent portfolio quality with PAR_{60} at 0.7% and current repayment rate of 99.6% as on 31 December 2005. Good repayment rate is also reflected in its high Yield to APR ratio of 99.5%. The organisation's portfolio quality is after a write-off of portfolio of US$ 13,180 during the year, which is 0.4% of its year-end gross portfolio. Organisation follows a provisioning and write-off policy, as prescribed by the National Bank of Cambodia.

  It provides provisions as per the following rates:

For loans with a loan term of less than or equal to one year

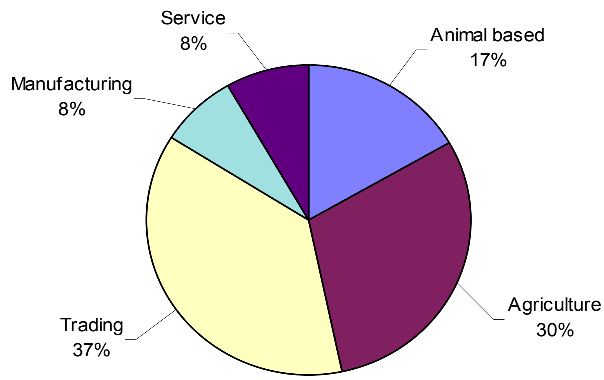
Portfolio with overdues (days)	Provisioning
1-30	Nil
30-60	10%
60-90	30%
>90	100% (written-off at the end of each half year)

For loans with a loan term of more than one year

Portfolio with overdues (days)	Provisioning
1-30	Nil
30-180	10%
180-360	30%
>360	100% (written-off at the

	end of each half year)

VFC's loan portfolio is very well diversified. The pie chart below shows the portfolio diversification across various sectors. Within these broad sectors, clients have taken loans for various purposes.



- <u>Mobilisation of funds</u>

So far VFC has mobilised money only from World Vision family organisation, channelled through VFI. Its external borrowings are US$988,841 from VFI at an average interest rate of 6.1%. Though the loans are at a concessional rate of interest of 6%, the loans are in US Dollars and the organisation has to bear the loss of local currency depreciation. In the year 2005 it suffered a loss of US$ 38,674 on account of currency depreciation, which was more than its total interest cost. Most of the organisation's funds (56.7% of the total liabilities) are in the form of grants. The equity owned by VFI constitutes 18.6% of the total liabilities. However, to meet the requirements of its planned growth, VFC would require external commercial borrowings. The organisation wishes to avail loan from local lenders and has recently availed the services of a consultant from AusAid, who is supporting it with resource mobilisation and brand building. However, it would be able to raise funds only after getting approval from VFI.

- <u>Asset, liability and equity composition</u>

Loan portfolio of VFC constitutes 84.3% of the total assets, which is reasonable, while idle funds were 11.5% of the total assets as on 31 December 2005. The high idle funds are due to the policy of the organisation to maintain a minimum liquidity of 10%, which is very high considering that the organisation does not accept savings from its clients. Idle funds should ideally be at 3% to 4%. Over the year, the organisation had an average monthly idle funds of 11.5%. This shows that significant proportion of the funds were unemployed during the year even though the organisation was short of its funds requirements.

On the liability side, net worth comprised 70.9% of total liabilities. The net worth of VFC is high as most of its funds are from grants. Due to such high net worth, the organisation had a very high capital adequacy of 82.0% as on 31 December 2005. This also shows the inability of the organisation in leveraging its net worth to access external commercial funds.

- <u>Profitability and Sustainability</u>

There has been a significant improvement in VFC's profitability and sustainability over the past year. During the year 2005, the organisation succeeded in having a positive return on assets. The organisation had a RoA of 0.6% for the year 2005. Its OSS was 102.6%, while the FSS was 92.2%. FSS was lower because of dependence on loan at a concessional rate.

The organisation could make profit because of its high yield of 38.4%, even though its OER is very high at 34.1%. With a high OER, it faces the risk of loss in case interest rate fall due to competitive pressures. The organisation's staff efficiency at 133 borrowers/staff member is low, though the efficiency of its field staff (Credit Officers) at 246 borrowers/CO is reasonable. Salaries and office expenses are two major components of operating expenses constituting 52.2% and 36.6% of total operating expenses, respectively.

4 Conclusions

Strengths	Weaknesses
Organisational and Strategy ✓ Professional and experienced Board ✓ Strong second line of leadership ✓ Linkages with WVC, advantage of its brand	Organisational and Strategy ✗ Over dependence on single source of finance ✗ Elaborate staff structure
Managerial ✓ Qualified, professional and dedicated staff ✓ Well documented and communicated policies ✓ Good infrastructure	Managerial ✗ Cumbersome information system, MIS in transition. ✗ Inadequate frequency of internal audit ✗ Low client per staff ratio
Financial ✓ Good portfolio quality ✓ High capital adequacy ✓ High Yield to APR	Financial ✗ High operating expenses ✗ High idle funds ✗ Very low financial leverage

5 Creditworthiness

VFC has achieved a rating grade of ***alpha minus (α–)***.[5] In terms of creditworthiness, this implies **reasonable safety**. VFC's performance on all the parameters, especially on financial parameters is good. Its major strengths are a professional Board, strong second line of leadership, good quality managerial and field staff and an excellent portfolio quality. From the commercial lenders' perspective, a very high capital adequacy is a big comforting factor, even though it reflects organisation's major weakness in not being able to leverage external commercial borrowings. Its major financial weakness is its high OER, due to excessive support staff and expensive information systems. In the highly competitive MF environment of Cambodia, the organisation could face difficulty if it is not able to leverage its operational advantage of having linkages with WVC because of lack of availability of funds at the right time and also, if it is not able to cope with the pressure of falling interest rates due to its high OER.

In M-CRIL's view, on account of good overall performance and high capital adequacy, VFC can absorb - from all sources - loan funds of US$ 2,500,000 till Feb 2007.

[5] The Rating Grade given measures performance on the rigorous standards established by M-CRIL. The assessment uses an instrument designed specifically for the conditions and nature of MFIs operating in Asia and is comparable with other ratings done by M-CRIL in this region.

Financial statements for VFC

Balance Sheet

As on 31 Dec 2004		as on 31 Dec 2005	
US$	**Assets**	US$	US$
	Current assets		
177,556	Cash in hand and bank		468,929
350,000	Short-term deposits		30,000
28,205	Other current assets		6,709
	Loans outstanding		
1,564,321	Gross loans outstanding	3,445,767	
(15,643)	(Loan loss reserve)	(34,457)	
1,548,678	Net loans outstanding		3,411,310
2,104,439	**Total current assets**		**3,916,948**
	Long term assets		
58,456	Net property and equipment	131,789	
58,456	**Total long term assets**		**131,789**
2,162,895	**Total Assets**		**4,048,737**
	Liabilities and Networth		
	Current liabilities		
6,007	VB Client security deposits		605
258,417	Payable –WVC		4,183
65,816	Other current liabilities		189,740
	Short term debt		
-	Total short term debt		-
330,240	**Total current liabilities**		**194,528**
	Long term liabilities		
	Long term debt		
223,475	VFI concessional loan	988,841	
223,475	Total long term debt		988,841
223,475	**Total long term liabilities**		**988,841**
	Net worth		
757,916	Paid up equity	757,916	
796,571	Grant for loan (lending)	1,752,016	
89,227	Grant for property and equipments	150,476	
121,501	Grant for operational expenses	344,528**	
	Exchange loss on Net worth	(1,103)	
(2,907)	Retained net surplus	(156,035)	
(153,128)	Current net surplus	17,570	
1,609,180	**Total net worth**		**2,865,368**
2,162,895	**Total Liabilities and Net Worth**		**4,048,737**

**Excluding tax on grants for operational expenses

Income Statement – for the year ending

31 Dec 2004		31 Dec 2005	
US$	**Income**	US$	US$
494,531	Interest and fees on loans	983,371	
3,391	Interest on investments	10,320	
289	Recovery of bad debts	1,205	
4,004	Other income (penalty charged on overdues)	4,462	
502,215	**Total income**		**999,358**
	Financial costs		
	Interest on borrowings	29,970	
	Currency fluctuation losses	38,674	
502,215	**Gross financial margin**		**930,714**
17,838	Provision for loan losses	31,994	
484,377	**Net financial margin**		**898,720**
	Operating expenses		
367,988	Salaries	455,548	
32,871	Travel	62,659	
24,814	Depreciation	35,627	
225,218	Administrative/office expenses	319,594	
650,891	**Total Operating expenses**		**873,428**
(166,514)	**Net Surplus/Deficit**		**25,292**
13,386	Non-operational income	11,291	
	Non-operational expenses	1,194	
(153,128)	Profit before tax (PBT)		35,389
	Tax*		17,819
(153,128)	**Profit after tax (PAT)**		**17,570**

* Grants for operational expenses and tax on these grants have been excluded. Grants for operational expenses, net of tax, have been directly taken to the Balance Sheet

Notes to the financial statements

1. Incomes are taken on cash basis and expenses on accrual basis
2. Interest expenses do not appear in 2004, since the loan in 2004 was without interest and was later in 2005 concerted into Grant for loan.
3. Grants are not taken as income. Tax on grants for operational expenses (20% on profit after taking into consideration grants for operational expenses) have been adjusted with the grants and have gone straight to the Balance Sheet.
4. Other current assets include receivables, advances and pre-paid expenses.
5. Other income is penal charges on clients for making delayed payments.
6. Additional provision for loan losses is provided by M-CRIL to maintain LLR of 1%. This is more than LLR maintained by VFC as per NBC's guidelines, which does not provide for provision on good portfolio, while M-CRIL as a conservative policy provides provision even on portfolio with no overdues. Write-offs of US$13,180 were made during the year.
7. Non-operational income is recovery of loans written off under the MED programme of WVC. Non-operational expenses include loss on sale of fixed assets.

Glossary

1. Current repayment rate
   Ratio of current principal recovered (net of pre-payments) to the principal due during the period.
2. Portfolio at risk (PAR_{60})
   Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date.
3. Yield on portfolio
   The interest income on loans divided by the average loan portfolio for the year.
4. Other income to average portfolio
   Total income other than from the interest on loans divided by average portfolio.
5. Financial cost ratio
   Total interest expense for the year divided by the average portfolio.
6. Loan loss provisioning ratio
   Total loan loss provisioning expense for the year divided by the average portfolio.
7. Operating expense ratio
   Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio.
8. Average loan portfolio
   This represents the average loan outstanding for the year computed on a monthly basis.
9. Average total assets
   This represents the average total assets for the year calculated on an annual basis.
10. Operational Self-Sufficiency
    Ratio of total income to total costs for the year.
11. Financial Self-Sufficiency
    Ratio of total income to total adjusted expenses for the year. Adjustments have been made for subsidised cost of funds (w.r.t. market interest rate), equity (w.r.t. inflation) and in-kind donations.
12. Risk weighted capital adequacy ratio
    Ratio of net worth to risk weighted assets (Risk weights: 100% for all assets except the following: fixed assets & interest bearing deposits: 50%; cash 0%).

Projected Cash Flows and Financial Statements for five years

- The following assumptions and projections - derived from the limited information available from the organisation on its future financial projections – are tentative in nature. These **should not be viewed in isolation nor be regarded as a basis for investing in the future** - only the main risk rating report provides an opinion on investments.
- All assumptions are based on the data gathered during the rating exercise and the credit methodology used by the organisation.

1 Basic Assumptions

(see also Notes to Cash Flow Projections below)

For the year ending:	***Dec-05***	**Dec-06**	**Dec-07**	**Dec-08**	**Dec-09**	**Dec-10**
Clients	*25,347*	35,000	50,000	70,000	90,000	110,000
No of Depositors	-	100	2,000	4,000	6,000	8,000
Savings/depositor per year	-	70	70	120	140	150
Interest paid on savings	-	7.0%	7.0%	7.0%	7.0%	7.0%
Yield on average portfolio	*38.4%*	38.0%	37.0%	36.0%	35.0%	35.0%
Cost of external funds	*6.1%*	9.3%	10.0%	9.9%	10.1%	10.3%
Repayment rate from groups	*99.6%*	99.0%	98.5%	98.0%	98.0%	97.5%
Loan loss reserve ratio	*1.0%*	1.5%	1.5%	2.0%	2.0%	2.5%
Average loan size to borrowers	*168*	200	220	240	260	280

2 Projected balance sheets

US$ in thousands

As on:	*Dec-05*	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Assets						
Cash balance	*469*	437	496	524	703	901
Other current assets	*37*	54	80	120	162	207
Loans outstanding	*3,446*	5,071	7,510	11,222	15,168	19,417
Loan loss reserve	*-34*	-76	-113	-224	-303	-485
Net loans outstanding	*3,411*	4,995	7,397	10,998	14,865	18,932
Net fixed assets	*132*	225	340	432	506	565
Total Assets	***4,049***	**5,711**	**8,314**	**12,074**	**16,235**	**20,605**
Liabilities and Net Worth						
External borrowings	*989*	2,547	4,834	6,985	10,071	12,123
Member savings	*1*	7	145	576	1,207	1,920
Other liabilities	*194*	211	237	277	319	364
Donations and equity	*3,004*	3,023	3,023	3,917	3,917	4,915
Retained surplus/deficit	*-156*	-138	-77	75	319	721
Current surplus/deficit	*18*	61	152	244	402	562
Net worth	*2,865*	2,946	3,098	4,237	4,638	6,197
Total Liabilities and Net Worth	***4,049***	**5,711**	**8,314**	**12,074**	**16,235**	**20,605**

3 Projected Income Statements

US$ in thousands

For the year ending:	*Dec-05*	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Income						
Interest	*983*	1,618	2,327	3,372	4,618	6,053
Other income	*16*	24	35	52	70	90
Total Income	***999***	**1,642**	**2,362**	**3,424**	**4,689**	**6,143**
Cost						
Financial	*69*	193	415	653	976	1,285
Loan loss provision	*32*	42	37	112	79	182
Depreciation	*36*	56	85	108	126	141
Operating costs (excl.depr.)	*838*	1,277	1,633	2,242	3,001	3,827
Total Cost	***974***	**1,569**	**2,169**	**3,115**	**4,182**	**5,435**
Non operational income	*11*	5	1	1	1	1
Non operational expenses	*1*	2	3	4	5	5
Tax	*18*	15	39	62	101	141
PAT to balance sheet	***18***	**61**	**152**	**244**	**402**	**562**

4 Projected Cash Flow Statements

US$ in thousands

For the year ending:	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Inflows					
Opening cash	469	437	496	524	703
External borrowings	2,300	4,300	3,850	5,400	7,000
Repayments from members	5,375	8,561	13,087	19,454	26,551
Grants and Equity	19	0	895	0	997
Member savings deposits	7	140	480	840	1,200
Interest income	1,618	2,327	3,372	4,618	6,053
Other income	24	35	52	70	90
Non-operational income	5	1	1	1	1
Total Inflow	**9,817**	**15,802**	**22,233**	**30,908**	**42,595**
Outflows					
Disbursement	7,000	11,000	16,800	23,400	30,800
Repayments to lenders	742	2,014	1,699	2,313	4,948
Withdrawals of savings deposits	1	2	49	209	487
Operating expenses (excl. depr.)	1,277	1,633	2,242	3,001	3,827
Interest paid on borrowings	189	409	628	914	1,176
Interest paid on savings	4	5	25	62	109
Fixed assets purchase	150	200	200	200	200
Non-operational expenses	2	3	4	5	5
Tax	15	39	62	101	141
Total Outflow	**9,380**	**15,305**	**21,709**	**30,205**	**41,693**
Net cash balance	**437**	**496**	**524**	**703**	**901**

5 Key projected performance ratios

For the year ending:	*Dec-05*	Dec-06	Dec-07	Dec-08	Dec-09	Dec-10
Operational self-sufficiency	*103%*	104.7%	108.9%	109.9%	112.1%	113.0%
Return on average assets	*0.6%*	1.3%	2.2%	2.4%	2.8%	3.1%
Operating expense ratio	*34.1%*	31.3%	27.3%	25.1%	23.7%	22.9%
Average outstanding/borrower (US$)	*136*	145	150	160	169	177
Portfolio growth rate	*120.3%*	47.2%	48.1%	49.4%	35.2%	28.0%
Savings to total assets	*0.0%*	0.1%	1.7%	4.8%	7.4%	9.3%
Risk weighted capital adequacy ratio	*81.4%*	57.1%	40.5%	37.4%	30.4%	31.9%

6 Notes to the projections

1. The Operating expense ratio is based on current levels and is projected based on changes in overall productivity and growth in staff, branches and portfolio.
2. Estimated external borrowings are subject strictly to performance based on the findings of this microfinance capacity assessment (credit rating).
3. Cost of external funds goes up sharply with the organisation availing loans at a commercial rate from other lenders. It comes down marginally in 2008, due to receipt of concessional loans from VFI. This is as per the Business Plan prepared by VFC.
4. Non-operational income is on mainly account of recovery of bad loans, written off by WVC before transferring assets to VFC. This income is not expected to continue beyond 2006. 2007 onwards, non-operational income includes fees from visitors only. Non-operational expenses include loss on sale of fixed assets.
5. Equity and donations have been assumed to be coming from VFI into the organisation as per the Business Plan of the organisation.
6. Average loan size to members has been assumed to be going up as the organisation has plans to increase proportion of Individual Loan in its total portfolio in future.
7. Interest income is taken as [yield on portfolio*average portfolio for the year]. Yield is projected to be going down with an increase in competition in future.
8. Organisation plans to introduce savings products for social investors (non-client) and small voluntary savings in future. Number of depositors is as estimated by the organisation. Interest rate has been kept constant at 7%.
9. Other income is the income from penalty that the organisation charges from client on delay in repayment and also includes recovery of bad debts. Other income is projected to increase in proportion of the portfolio based on 2005 figure.
10. Disbursements are taken as the [number of loans disbursed during the year*average loan size to borrowers].
11. Estimates on growth in outreach and demand for loans from the organisation have been made based on the organisation's own business plan.
12. Interest paid is taken as the [average cost of external funds * the average external borrowing liability figure].
13. The tax has been calculated as 20% of the surplus, which is the current tax rate.
14. Insurance product is not taken into projection, as it would be a separate division.

7 List of abbreviations

ACL	Assets Creation Loan
ADB	Asian Development Bank
ADP	Area Development Programme
AL	Agriculture Loan
APR	Annual Percentage Rate
BM	Branch Managers
CO	Credit Officer
CS	Credit Supervisor
FSS	Financial Self Sufficiency
GM	General Manager
HO	Head Office
HR	Human Resource
IL	Individual Loan
LLP	Loan Loss Provisioning
LLR	Loan Loss Reserve
LT debts	Long Term Debts
M-CRIL	Micro-Credit Ratings International Ltd
MED	Micro Enterprise Development
MFI	Micro Finance Institution
MIS	Management Information System
MoC	Ministry of Commerce
MoEF	Ministry of Economy and Finance
NBC	National Bank of Cambodia
OER	Operating Expenses Ratio
OSS	Operational Self Sufficiency
PAR_{60}	Portfolio At Risk (greater than 60 days)
PAT	Profit After Tax
PBT	Profit Before Tax
PLR	Prime Lending Rate
RoA	Return on Assets
SBL	Small Business Loan
SG	Solidarity Group
VB	Village Banks
VFC	VisionFund Cambodia
VFI	Vision Fund International
WTO	World Trade Organisation
WVC	World Vision Cambodia

M-CRIL's Microfinance Rating Symbols

M-CRIL Grade	Description
α+++ alpha triple plus	Highest safety, excellent systems ➢ most highly recommended
α++ alpha double plus	Highest safety, very good systems ➢ most highly recommended
α+ alpha single plus	Very high safety, good systems ➢ highly recommended
α alpha	High safety, good systems ➢ highly recommended
α– alpha minus	Reasonable safety, good systems ➢ recommended
β+ beta plus	Reasonable safety, reasonable systems ➢ recommended, needs monitoring
β beta	Moderate safety, moderate systems ➢ acceptable, needs improvement to handle large volumes
β– beta minus	Significant risk, poor to moderate systems ➢ acceptable only after improvement
γ+ gamma plus	Substantial risk, poor systems ➢ needs considerable improvement
γ gamma	Highest risk, poor systems ➢ not worth considering