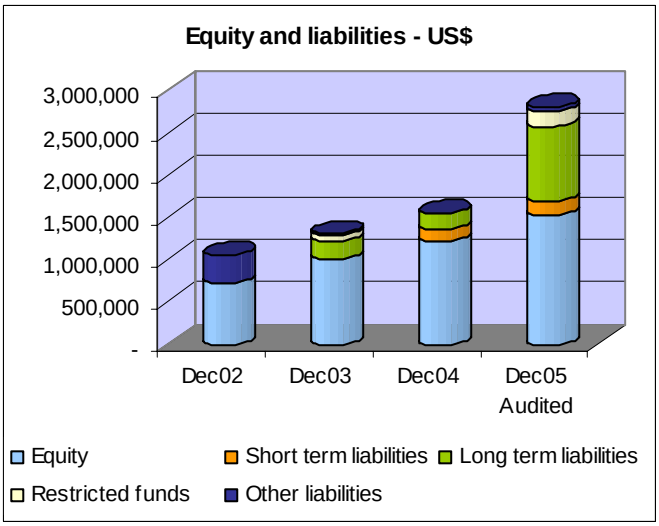
VisionFund CREDO Foundation – Georgia

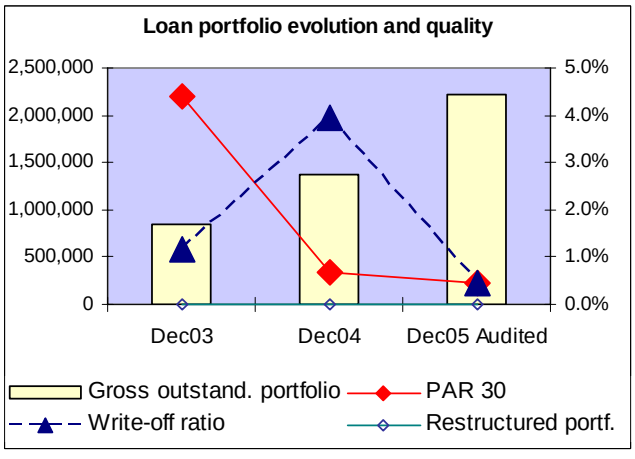
Final Rating	BB+
First rating	Validity: 1 year if no relevant changes in operations or within the operation context will happen. The final rating grade does not consider the political and economic context.
Previous rating: ---	

VisionFund CREDO Foundation started its micro-lending operations in 1997 under the former denomination of "Georgia's Entrepreneurs' Fund" (GEF), founded by World Vision International.
CREDO registered as local foundation in January 2005 and is owned by VisionFund International, a US-based private not-for-profit company wholly owned by World Vision Int'l.
CREDO is a microlending institution providing both urban and rural entrepreneurs with short and medium-term loans for working capital and fixed assets. It operates through five branches in Tbilisi, South and West Georgia.
Primarily financed by grants and soft loans from its founder, it has recently started to leverage its equity with soft debt.

Number	Dec03	Dec04	Dec05
Active borrowers	1,652	1,555	2,093
Active loans	892	1,351	1,972
Branches (hubs)	4	4	5
Total staff	35	40	51
Loan officers	13	16	17

Legal Form	Local Foundation
Inception year	1997
Area of intervention	Urban and rural
Credit methodology	Individual and group





Financial Indicators	Dec03	Dec04	Dec05 audited*
PAR 30	4.4%	0.7%	0.5%
Write-off ratio	1.2%	3.9%	0.4%
Restructured loans	0.0%	0.0%	0.0%
ROE	-8.9%	-0.6%	2.1%
AROE	-14.6%	-6.3%	-3.4%
Oper. Self-sufficiency (OSS)	81.5%	98.6%	105.3%
Fin. Self-sufficiency (FSS)	74.4%	87.3%	95.5%
Staff productivity (borrow.)	47	39	41
LO productivity (borrow.)	127	97	123
Operating expense ratio	56.7%	39.8%	33.4%
Funding expense ratio	1.0%	0.8%	2.8%
Provision expense ratio	3.2%	2.4%	0.8%
Portfolio yield	48.6%	40.0%	38.9%
Risk coverage ratio	71.3%	100.2%	101.9%
Cost of funds ratio	4.9%	3.6%	7.1%
Debt/Equity ratio	0.3	0.3	0.8

*Annualized indicators calculated over the period April-December

US$	Dec05 Audited
Average disbursed loan size	1,430
Gross outstanding portfolio	2,210,084
Total assets	2,809,076

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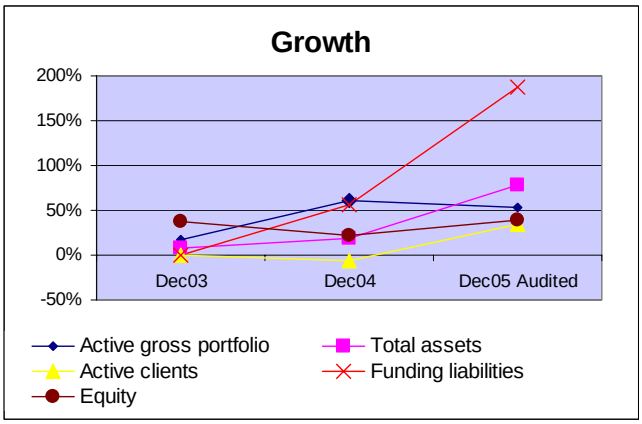
AREA	Risk factors	Relevance*
External environment and mkt. positioning	Growing competition in urban areas	Medium-high
	Uncertainties related to the new microfinance law	Medium-low
	Uncertainty on taxes	Medium-low
	Lack of a Credit Bureau for the microfinance sector	Medium
Governance, management and operations	Absence of a Financial Manager and concentration of top-managerial functions in the person of Deputy Director	Medium
	Work overload for the Deputy Director	Medium
	Lack of systematic approach to the assessment of staff's training needs	Medium
	Improvable internal control	Medium
Financial structure and ALM	Lack of experience with international commercial sources of funds	Medium-low
Financial and operational results	Profitability and sustainability not yet achieved	Medium-high
	Low efficiency and productivity	Medium

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

Strengths	Opportunities
→ Strong BoD → Good market positioning in rural areas → Products' development dedicated function → Good MIS → Excellent portfolio quality	→ Active membership in Association of Georgian Microfinance Organizations → Transformation into a shareholding company with clearer ownership

Final opinion

CREDO has achieved a sound level of consolidation and soundness in areas like governance, systems and loan portfolio management. Although the performance trends are positive and the portfolio quality is very high, CREDO is still facing low efficiency and has not yet achieved financial sustainability. Moreover, on one hand the growing competition, especially in urban areas, is putting downward pressure on the portfolio yield, and on the other hand, the financial expenses ratio will likely increase, because of the planned access to commercial borrowings. Other main issues regard the concentration of top-managerial positions in the person of the Deputy Director and an improvable system of internal control.



Branches ● and sub branch ● of CREDO

Other highlights

CREDO has been using the flat interest rate and the cash basis for its accounting. The external audit conducted on the last period (Apr-Dec05) has used the "effective interest method" to restate the financial statements (FS). Consequently, and given the non negligible differences between the audited and internal versions of FS, the profitability and sustainability analysis conducted on the audited FS shows significantly higher results than the ones given by the internal FS.

Benchmarking

CREDO's financial ratios (as of December 2005) reported below do not fully correspond to the ratios presented in the report, as they are calculated according to the *MicroBanking Bullettin* (MBB) methodology[1].

Financial ratios	CREDO Dec05 Audited	Crystal Fund Georgia Oct. 2005	ECA Medium broad	NGOs	Individual	Individual/ Solidarity
Gross Loan Portfolio gross loan portfolio adj for standardised write-offs (US$)	2,210,084	995,467	4,154,152	9,270,931	44,094,691	13,656,826
Average Loan Balance per Borrower on per capita GNI Average loan balance per borrower/ GNI per capita(%)	95%	55%	52%	44%	86%	68%
Portfolio at Risk> 30 Days oustanding balance of loans overdue> 30days/gross loan portfolio (%)	0.5%	4.6%	3.1%	2.9%	4.2%	4.5%
Adjusted Return on Equity AROE adj net operating income after taxes/avg tot equity (%)	-2.6%	10.7%	-4%	n. av.	8%	4%
Debt/ Equity Ratio adj.tot.liabilities/adj.tot.equity	0.8	0.9	n.av.	n.av.	6.9	4.2
Operating Expense/ Loan Portfolio (operating expense + In-Kind donations)/avg gross loan portfolio (%)	33.4%	26.1%	28.0%	35.9%	19.6%	29.0%
Borrowers per Loan Officer n. of active borrowers/n. of loan officers	123	123	164	280	238	269
Borrowers per Staff n. of active borrowers/n. of staff	41	57	90	155	114	137

ECA Medium broad, Eastern Europe and Central Asia, Gross Loan Portfolio (US$) 2 to 8 million, Avg. Balance per Borrower/ GNI per Capita ≥ 20% and ≤ 150%
All figures are referred to the MicroBanking Bulletin database updated as of Dec04 n.av. = not available
Crystal Fund's figures refer to Microfinanza's Rating as of October 2005 * The avg. loan balance has been calculated on available data for 2004.

- CREDO's portfolio is quite small compared to the peer group of Medium size MFIs of Eastern Europe and Central Asia and to all the remaining peer groups taken in consideration for the benchmarking analysis. On the other hand, the average loan balance per borrower is the highest.
- The portfolio quality is excellent and superior to all the peer groups, while profitability, efficiency and productivity present large room for improvement.

[1] The MBB adjusts financial data in order to uniform them among MFIs. Adjustments are made for: a) inflation, b) subsidies, c) loan loss provisions (*MBB*, Annex I: Notes on Adjustments and Statistical Issues).

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1. External Environment and CREDO's positioning

Institutional background

VisionFund CREDO Foundation started in 1997 under the denomination "Georgia's Entrepreneurs' Fund" (GEF), a small micro-lending project of World Vision Int'l in Tbilisi. As of January 2005[2], the institution registered as a Georgian microfinance foundation (CREDO), owned by VisionFund International, a US private not-for-profit organization specialized in microfinance and wholly owned by World Vision International. Since the beginning, CREDO has been greatly supported by World Vision with grants, soft loans, specialized technical assistance and training.

Context

Georgia's economy has been heavily suffering from the consequences of the break-up of the Soviet Union and the **civil conflicts** which soon arose in the two regions of Abkhazia and Ossetia. The structural reforms implemented by the Georgian government, although having had a stabilizing effect, were not completely adequate for supporting the economic recovery. Governance problems and political corruption led in 2003 to the **Rose Revolution** which provoked a regime change avoiding violence. The new government, expression of a heterogeneous big coalition, has taken decisive actions in combating corruption, restoring fiscal performance and accelerating the reform process. **Real GDP growth** has increased again in the last period. Year-on-year **inflation rate** increased in 2003 and 2004 but the trend has changed during 2005. As a result of measures implemented by the government to improve tax obedience, the demand on the national currency increased in Georgia, which led to the appreciation of Lari **nominal exchange rate** against the US Dollar, from an average of 2.19 in 2002 to 1.8 as of December 2005.

Sovereign risk[3]

Georgia	Foreign currency		Domestic currency	Rating Outlook
	Short term	Long term	Long term	
MOODY'S	n.av.	n.av.	n.av.	n.av.
S&P	B	B+	B+	Positive
Fitch	n.av.	n.av.	n.av.	n.av.

Georgia

Macroeconomic Indicators	Dec02	Dec03	Dec04	Dec05
Exch. rate in US$ (end of per.)	2.1	2.1	1.8	1.8
Exchange rate variation	1.5%	-0.7%	-12.0%	-1.8%
Inflation rate (end of period)	5.4%	7.0%	7.5%	6.2%
Inflation rate (average)	n.av.	4.8%	5.7%	8.3%
Deposit rate	9.8%	9.3%	7.2%	7.6%
Lending rate	31.8%	32.3%	31.2%	21.6%
Real GDP growth	5.5%	11.1%	6.2%	9.3% *
GDP per head (US$)	778	906	1,204	1,430

Font: Int'l Finance Statistics, EIU, Nat. Bank of Georgia. * Estimate NBG. n.av.=not available

Banking Sector

Georgian banking system includes 19 banks (12 foreign controlled). After having overcome the crisis in the mid 90s, when several banks went bankrupt, banking institutions have shown sustainable growth in deposits since 2000-2001. The year 2005 has witnessed an **increase in investments into the country's banking sector** and large banks became more active in

[2] It re-registered in March 2005 in compliance with a new amendment of the civil code on Microfinance Organizations.

[3] **Scales used: MOODY'S:** Long term - AAA, AA1, AA2, AA3, A1, A2, A3, Baa1, Baa2, Baa3 (Investment grade), Ba1, Ba2, Ba3, B1, B2, B3, Caa, Ca, C (Speculative grade); Short term - Prime-1, Prime-2, Prime-3 (Investment grade); Not Prime (Speculative grade); **S&P**: Long term - AAA, AA, A, BBB (Investment Grade); BB, B, CCC, CC (Speculative grade); SD (Selective Default); D (Default) - Rating from AA to CCC may be modified by a + or -; Short term - A-1(+), A-2, A-3 (Investment Grade); B, C (Speculative Grade); SD (Selective Default); D (Default) **Fitch:** Long term - AAA, AA, A, BBB (Investment Grade); BB, B, CCC, CC, C (Speculative grade); DDD, DD, D (Default) - Rating from AA to CCC may be modified by a + or -; Short term: F1, F2, F3 (Investment grade); B, C (Speculative grade); D (Default).

strengthening their market positioning and acquiring new market segments. Banks have become therefore more interested in mergers and acquisitions. Furthermore there has been an influx of foreign investments into some major Georgian banks (Bank of Georgia, United Georgian Bank, and Georgian Investbank, among others).

Regulation and Supervision

In February 2005 an **amendment of the Civil Code** allowed foundations and associations to re-register as microfinance organizations (MFOs) with the Ministry of Justice and legally lend to the poor. As the civil code establishes that microlending by an enterprise using its own resources (not-deposit-taking financial institution) is not subject to prudential regulation and supervision, the MFOs have few obligations at the moment. They only must publish their annual audited financial statements. The amendment of the Civil Code included a recommendation addressed to the National Bank of Georgia in order to draft a special law on "Microfinance Organizations Activities". The National Bank, together with several actors belonging to the international and national microfinance community, worked on the **draft of a law regulating microfinance organizations**, which should be approved by the Parliament within few weeks. The new law allows the **microfinance organizations to transform into commercial entities** (either LTD or Joint-Stock Companies), defines the activities which can be carried out[4] and establishes the maximum amount of a loan to one client equivalent to 15% of their charter capital. The draft law designates the **National Bank of Georgia (NBG) as the supervisory body for the microfinance sector**, but does not clearly define the content and modalities of the off-site and on-site supervision to be conducted. It leads to a certain degree of uncertainty on the burden and cost for the MFOs for concept of the NBG's supervision. The law being approved, microfinance organizations will have the opportunity to change their legal structure accordingly. By increasing the transparency (clearer ownership and external technical supervision of the National Bank) of the microfinance sector, the new law will potentially increase the inflow of local and foreign investments into the MFOs.

Microfinance Industry

Microfinance has been introduced in Georgia in 1997 by international donors such as World Vision, Save the Children and USAID. Since then, the sector has grown and substantially developed, now counting ten microfinance institutions, all of them registered as foundations. Constanta and FINCA are the biggest ones with respectively US$ 7m. and 7.4m. (Sep. 2005). **The market leader is Procredit**, a microfinance specialized bank founded in May 1999[5]. It is growing aggressively and has reached almost US$ 40m. as outstanding micro loan portfolio (< US$10,000) as of Dec. 2005. The Small Enterprise Lending Program Georgia (SELP), co-financed[6] by EBRD and TACIS is also supporting 3 commercial banks in downscaling their lending operations. These are the Bank of Georgia (BoG), the United Georgian Bank (UGB) and the Tbiluniversal (recently bought by the BoG). These banks are increasingly penetrating the market segment of micro and small loans, especially for amounts bigger than US$ 1,000. Other institutions operating in microfinance are small credit unions. Heritage of the past, they are rapidly decreasing in number (from 120 in 2003 to 50 as of 2004) and loosing market share. **The microfinance sector[7] is serving more than 60,000 clients**, while the potential market for microfinance is represented by about 200,000 borrowers, as estimated by Chemonics in 2003. Nevertheless, **competition in the sector is rapidly growing** in Georgia. A positive recent development in the microfinance industry has been the constitution of an association by five microfinance institutions, namely Crystal Fund, Constanta, CREDO, Finca and SBDF. The **Association of Georgian Microfinance Organizations (AGMO)** is currently acting to increase transparency in the microfinance sector. It has lobbied the government for the setting in place of the microfinance law. The challenge now is to go beyond and to carry out new activities like sector representation and lobbing, training and access to specialized

[4] They can provide lending products only, while are forbidden to collect savings.
[5] Former Microfinance Bank of Georgia.
[6] The support is given in terms of access to funds for on-lending and specialized technical assistance (IPC).
[7] For microfinance sector it is meant here the existing non-banking microfinance institutions providing microloans (BAI, BBK, Constanta, CREDO, Crystal Fund, DRC, FINCA, GRDF, SBDF, SDA) together with ProCredit Bank, whose portfolio is for about 30% composed of loans < US$ 10,000.

technical assistance. Despite the steps forward undertaken by the microfinance sector in Georgia there are still some issues which have to be addressed. A **Credit Bureau** has been recently created by the commercial banks (including ProCredit). **The microfinance institutions have not yet entered it**, but they are considering a certain degree of participation within approximately one year. Despite the existing informal exchange of information on clients among staff of different microfinance institutions, the absence of a Credit Bureau is a risk for CREDO, given the increasing competition especially in urban areas.

CREDO's market positioning

CREDO provides both urban and rural entrepreneurs with short and medium-term loans for working capital and fixed assets. Its five branches and one sub-branch operate in two main geographic areas of the country: South Georgia (Akhaltsikhe/Borjomi[8] and Akhalkalaki) and Western Georgia (Kutaisi and Batumi), other than Tbilisi, the capital city. **The most important competitors** for CREDO are **Procredit, FINCA, Constanta[9], Bank of Georgia and United Georgian Bank.** All of them are already operating or are entering the same regions covered by CREDO, which is facing with a growing and stronger competition especially in urban areas such as Tbilisi and Batumi. Competitors are getting increasingly aggressive also in terms of services and conditions offered and borrowers are benefiting from progressively lower interest rates and products differentiation.

CREDO still maintains a very good positioning in rural areas and agricultural lending. Its main **comparative advantages** are related to the agricultural loan conditions (such as the flexible grace period) and methodology. A friendlier customer approach and a good reputation built in the rural areas are the other relevant advantages. **Main disadvantages** of CREDO are related to the lower access to funding and to the interest rates (calculated by the flat rates' method) charged on clients. The latter one has started to be perceived as a critical factor in an increasingly competitive microfinance environment, especially in some urban areas.

Main competitors

Institution	Products	Approx. avg. disbursed loan (US$)	Avg. Interest rate	Disbursement time	Guarantees
CREDO	Individual and group agricultural/urban, seasonal	1,430	1.2%-3% flat	3-5 days	moveable assets-mortgages- group-no collaterals
ProCredit Bank	Housing, consumer, business express, business micro, agro, corporate	1,625 (for loans below US$ 10,000)	1.5%-4% declining	2-10 days	no collateral - gold - movable assets - mortgages
Constanta	Group, individual urban, individual agricultural, seasonal	322	2%-4% declining	4-14 days	collateral - group solidarity
FINCA	Group urban / agricultural, individual, un-collateralized	614	2%-3% declining	7-21 days	no collateral
United Georgian Bank	Micro loans, express loans	n.av.	1.5%-3% declining	3-7 days	no collateral - movable assets - mortgages
Bank of Georgia	Group / individual urban, group for agriculture, un-collateralized	n.av.	1.3%-2.5% declining	2-8 days	no collateral - movable assets - mortgages

n. av. : not available

CREDO strongly focuses on the loan products' development based on a systematic follow up of the clients' needs (focus groups) and monitoring of the competitors. Nevertheless, **main competitors, bigger than CREDO, are growing fast and expanding throughout the territory, and enjoy at the moment a greater and cheaper access to funding**.

[8] Borjomi is the sub-branch of Akhaltsikhe.

[9] So far, Finca and Constanta have driven their attention and lending strategy to the lower stratum of CREDO potential clients, focussing the urban retail sector of micro entrepreneurs.

2. Governance and operational structure

Ownership and Governance

VisionFund CREDO Foundation is owned by VisionFund International, a US based private not-for-profit organization which is in the process of centralizing the ownership of all the microfinance institutions founded by **World Vision International**, a US-based NGO acting worldwide as a relief and development agency. The formal process of sale of CREDO from World Vision to VisionFund is still ongoing but the pace has been clearly set up.

Governance structure and functioning has been strengthened and developed in a sound way. The Board of Directors (BoD) counts with seven members, four are World Vision-related and the remaining three are not. The BoD members present an adequate background in banking and legal matters. The Board meets at least quarterly[10] and basic regulation for Board functioning is contained in CREDO's Charter. The communication and strategic support of the BoD to the CEO seem to be adequate and effective.

Board of Directors

Members	Charge	*Background and current profession*
Jason Evans	Chair	He is the representative of World Vision in Georgia. He has worked for several relief agencies in the Balkans and the Caucasus as well as Africa after a career in recostruction and engineering.
Nataly Mouravidze	Deputy	MBA from Oklahoma Univ., her professional expertises are related to the private sector development and TA for banks' downscaling. Her current position is Analyst at the EBRD in Georgia.
Tea Lortkipanidze	Member	Economist with an MBA from the London School of Business, she presents vast experience in the banking sector (Head of Credit Dep't in TBC Bank) in Georgia and is currently CEO of TBC Leasing.
Zurab Nikvashvili	Member	He presents vast experience in fiscal issues and knows well the financial sector in Georgia. He is partner of Assurance and Advisory Business Services (AABS) practice at Ernst and Young Georgia.
Vadim Usvitsky	Member	He started as a medical doctor but developed a business career, serving on the board of various MFIs and cooperatives in Russia. He is currently CEO of SEF Int'l, an MFI in Armenia.
Marina Yoveva	Member	With a long career in microfinance in the Caucasus and Balkans, she is currently acting as Regional Director for Microentreprises Development (WV) in Eastern Europe and Middle East. BoD of MFC.
Daniel Baertschi	Member	His professional experience is mainly in consulting services for development programs in different countries. He is now the International Programs Director for WV Switzerland.

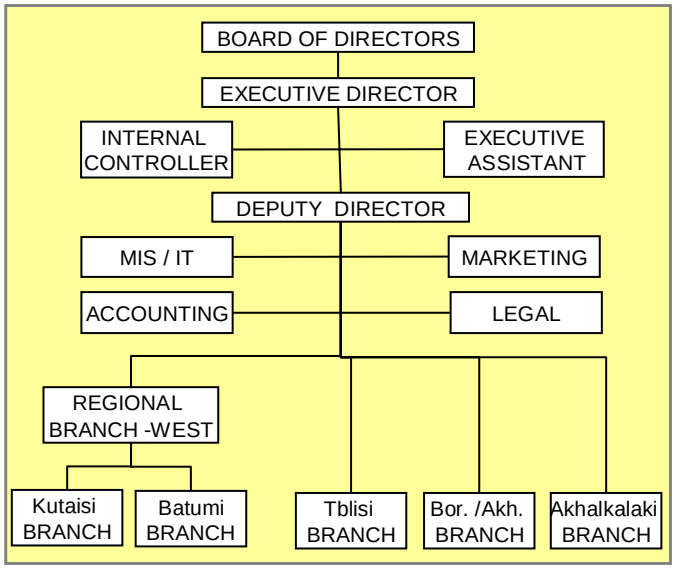
Organisation and structure

The headquarters are based in Tbilisi, in separate premises from the Tbilisi branch's physical office. Two other branches are located in Western Georgia[11] and other two in the South region.

[10] As some members are not residents, meetings can be held also by conference call.

[11] A Regional Manager has been recently appointed to supervise and coordinate the work of the two branches. Another Regional Manager for the two branches in South Georgia will also be appointed in the medium term.

The operational structure of the institution, partially decentralized, is functional to the current need of the institution. The branches are treated as cost and profit centres. Branch managers can approve loans up to US$ 5,000[12], which is more than triple the average disbursed loan of CREDO. While accounting data inputting is completely centralized in the HQs, all other administrative tasks are carried out at branch level by the accountant/MIS officer.



Human Resources

As of December 2005, CREDO's team is composed of 51 employees, out of which 17 are loan officers. The **staff allocation ratio (33%[13]) is low and it negatively affects the staff productivity of the institution.**

Personnel	Dec02	Dec03	Dec04	Dec05
Total	**27**	**35**	**40**	**51**
Loan officers	9	13	16	17
Other staff	18	22	24	34

The top management structure is composed by two staff: the CEO and the Deputy Director. Starting from January 2006 the **CEO** has been appointed also as CEO of AzerCredit (World Vision Azerbaijan). This is an uncommon organizational structure in the microfinance industry and could imply both advantages and disadvantages. The associated potential conflict of interests is mitigated by the belonging of the two MFIs to the same network. The CEO's main functions are related to the strategic guidance of the institution, to HR management and to fund raising.

The Operation Manager has been recently upgraded to the position of **Deputy Director**. He performs tasks related to the strategic support of the branches and the operational supervision,. including a random visit of 10% of the new clients to check the quality of loan assessment. As the Financial Manager left at the end of 2005, and the chief accountant is not ready yet to cover her position, he is also in charge of tasks of financial management (cash flows analysis, financial projections and ratios analysis). During the absence of the CEO, he performs the institutional representation. **The work overload for the Deputy Director is a risk factor for CREDO.** Also, the position of Financial Manager is now empty and CREDO is not planning to recruit a new person in the short run. It produces a risk of **concentration of top-managerial functions** in the person of Deputy Director. This risk will increase as soon as the institution's leverage grows.

Other managers at the head office level are the Marketing Manager (in charge of the products' development), the Chief Accountant[14], the Internal Controller and the MIS/IT Manager[15].

The general coordination of the staff training and hiring process is performed by the CEO, while the executive assistant at the HQs deals with personnel administration. Salaries are competitive in the microfinance sector. Moreover, the credit staff benefits from a performance-based bonus system, which has been working well so far. In general, the work climate seems good. On the other hand, **training is not based on a systematic assessment of staff's needs**. External training heavily depends on opportunities coming from World Vision regional network and MFC Poland. The not high level of staff turnover during 2005 (10%) as well as in the previous period confirms a good HR policy and management. Nevertheless, as the institution grows and a greater number of senior and management positions will be available, a more explicit career development policy and succession plan will be required.

[12] Lower amounts ceilings have been set up for younger branches.

[13] It includes however guards and cleaners.

[14] The Accounting Dep't is under restructuring: the Chief Accountant has been recently appointed and two new accountants have been hired.

[15] The MIS/IT Dep't is composed by one manager, one assistant and one intern. The Dep't is shared with World Vision Georgia.

Internal Control and operational risk management

The recently[16] appointed Internal Controller is in charge of systematically monitoring the deviances between planned and achieved, concerning mostly with financial operations. She is also in charge of the reporting for investors and donors[17]. An internal audit on clients, especially the biggest loans is also carried out by the deputy director and the regional manager.

Even if the exposure of CREDO to the operational risk is not high, as mitigated by the centralized and on-line MIS in place and by the fact that CREDO just manages gold and does not handle cash in its lending operations, a **strengthening of the position of Internal Controller is needed**.

Moreover, even if the BoD has already decided to strengthen the internal audit function, **nor Internal Auditor position** which reports directly to the BoD, neither any special Audit Committee of the BoD have been set up yet.

Concerning manuals and written procedures, the main ones are available and updated, except for the Financial / Accounting Manual (under revision) and the Internal Audit Manual (still missing).

Accounting policy and procedures

Along the years under analysis (2003, 2004 and 2005), CREDO's internal financial statements have been prepared by using the method of flat interest rates and the cash basis for accounting. After transforming into an independent Georgian organization, CREDO has contracted the first external audit of its financial statements for the period April-December 2005[18]. They have been adjusted in order to incorporate the differences between the method currently used by CREDO and the method based on accrual basis and effective (declining) interest method for the recognition of interest income, as stated by the IAS 18 and the IAS 39. **These adjustments have provoked an increase of the gross outstanding portfolio by 10% and the interest revenues in the income statement by 15%**[19]. The present rating exercise has considered the not audited flat rate - cash basis financial statements of the last three fiscal years (2003, 2004 and 2005) to analyze consistent trends. Concerning the last period, profitability and sustainability analysis is made comparing ratios calculated both on the internal not audited financial statements (flat-cash) and on the audited ones (declining-accrual). The financial statements of 2003 and 2004 have been audited according to the WV standards (October 2003-September 2004 and October 2004-September 2005)[20]. It means that in the present report, the FS as of Dec03 is only partially audited, while the FS as of Dec04 has been audited with different dates.

Management Information System

The loan tracking system is a banking software adapted to microfinance institutions, E-Merge, which started working in the month of March 2005. All branches are in network and loan data are input daily by MIS officers in each branch. The accounting system, SUN, is centralized: data are input by the accounting dep't of the head office, not by branches. On weekly frequency, E-Merge data are integrated into SUN. Although the migration of data from Access to E-Merge, carried out manually during 2004 and 2005, put under pressure the institution, the gains in terms of security have been enormous. The reporting capacity also has been greatly improved. Some reports need still to be prepared manually, such as those ones related to loan disbursements. As E-Merge works exclusively on-line, the low connection speed to Internet provokes a certain degree of slowness in the processing of loan applications in some branches in the rural areas.

Given the current dimensions of the institution, back-ups and MIS security procedures are adequate.

[16] April 2006.

[17] She has been appointed as Internal Controller / Business Analyst of AzerCredit (MFI in Azerbaijan) for 4 days each month.

[18] After registering on January 24th 2005, the assets' transfer from GEF (World Vision project) to CREDO has been completed only by the ending of March during the same year.

[19] This is mainly due to the fact that the declining restatement assumes a distribution of interest and capital in the repaid installments of the loans disbursed during the period. This distribution concentrates the income in the first part of the repayment schedule (thus increasing the income from interests of the period under restatement), while the revenue in the case of flat interest calculation is more evenly distributed over the loan life-period (that can exceed the closing date of the period under consideration).

[20] External audits had been contracted by World Vision Georgia for all its operations (not only microcredit).

3. Lending operations

Financial products

CREDO only offers lending products, whose variety and flexibility of conditions make them tailored to different typology of clients and sector of business. The indirect provision (through strategic alliances) of non-lending products such as the micro-insurance, is under study.

Credit methodology

Credit products									
	Individual micro	**Individual small**	**Individual SME**	**Half-collateralized**	**Un-collateralized**	**Solidarity group**	**Individual village agriculture**	**Individual agriculture**	**Seasonal**
Credit methodologies	Individual	Individual	Individual	Individual	Individual	Solidarity group	Village Lending	Individual	Individual
Currency of the credit	US$	US$	US$	US$	US$	US$	US$	US$	US$
Type of interest	Flat	Flat	Flat	Flat	Flat	Flat	Flat	Flat	Flat
Min. interest rate (%)	2	1.5	1.17	2.2	2.5	n.av.	1.5	1.5	1.5
Max. interest rate (%)	3	2	1.67	2.5	3	3	3	3	3
Commissions	2 - 2.5% up-front	2 - 2.5% up-front	1.5 - 2% up-front	2 - 2.5% up-front	2.5% up-front	1 - 2% up-front	2 - 2.5% up-front	2 - 2.5% up-front	2 - 2.5% up-front
Min. credit amount (US$)	50	1,500	5,000	50	50	50	50	50	50
Max. credit amount (US$)	1,500	5,000	15,000	2,500	2,500	800	15,000	15,000	15,000
Max credit amount for the first loan (US$)	No Special Policy	No Special Policy	No Special Policy	No Special Policy	No Special Policy	No Special Policy	No Special Policy	No Special Policy	No Special Policy
Min. maturity (months)	2	4	4	4	4	4	4	4	4
Max. maturity (months)	18	24	24	18	18	12	36	36	24
Interests payments	Monthly	Monthly	Monthly	Monthly	Monthly	Twice a month	Monthly	Monthly	Monthly
Principal payments	Monthly	Monthly	Monthly	Monthly	Monthly	Twice a month	Monthly	Monthly	Monthly
Grace period (months)	For first loan: 1 month for principal	For first loan: 1 month for principal	For first loan: 1 month for principal	No grace period	No grace period	No grace period	Max. 6 months in one year for principal	Max. 6 months in one year for principal	Max. 8 months in one year for principal
Collaterals / guarantees	Collaterals covering min. 100% + min. 2 guarantors	Collaterals covering min. 100% + min. 2 guarantors	Collaterals covering min. 100% + min. 2 guarantors	Collaterals covering min. 50% + min. 2 guarantors	No collaterals, only min. 2 guarantors	Group solidarity	Collaterals covering min. 100% + min. 2 guarantors	Collaterals covering min. 100% + min. 2 guarantors	Collaterals covering min. 50% + min. 2 guarantors

The main lending methodology in use is the individual one, while the group loans represent a decreasing and minor share of total portfolio. The "individual village agriculture" product used a variant of the individual lending because of the active role of the "village's representative" in all the lending procedures. New products under testing is the consumer loan and the educational loan.

Old good clients in urban areas can access to discounts in the interest rate according to an incentive scheme to introduce new clients.

Credit policy

CREDO targets both physical persons and legal enterprises, both rural and urban areas, both agricultural and non-agricultural loans. Loan diversification is adequate to the level of competition present in the country. In response to some competitors which are relaxing their collaterals' requirements, CREDO has recently introduced half-collateralized and un-collateralized loan products. The mortgage is required only for loans > US$ 5,000, but exceptions for repeated clients are allowed.

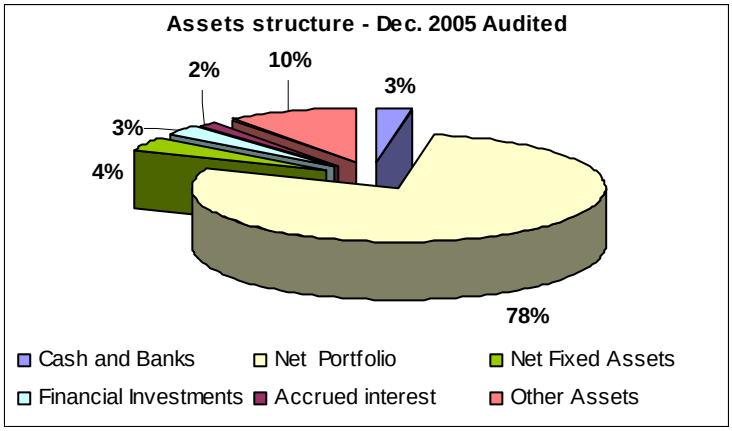
Procedures for loan issuing

In line with main competitors, the loan disbursement takes about 3-5 working days for new clients and even less for old ones. The assessment of the client's repayment capacity is made through a cash-flow analysis of the business; other revenues and expenses are also taken into account. The cash-flow form does not take into account the peculiarities of all the different businesses and sectors which are accessing to CREDO's services. Nevertheless, the loan assessment procedures are in general adequate and effective, as it is also demonstrated by the excellent portfolio quality.

4. Assets structure and quality

Assets structure

Along the year 2005, the net portfolio has represented on average about 83% of total assets, which is an adequate concentration of resources into the core business of the institution[21]. Yearly on yearly average liquidity (cash and banks plus financial investments) is worth about 5.4% in 2005 (it is 5.7% as of Dec.05), a sound level for a non-deposit-taking microfinance institution. Other assets[22] have sharply increased since August 2005 (because of receivable grants) and so induced a substantial but temporary decrease in the percentage of the net portfolio on total assets.



Portfolio structure

CREDO's loan portfolio is 98% composed of individual loans. Group loans percentage on total portfolio has decreased over time (19% as of Dec. 2003, 5% as of Dec. 2004) and will likely disappear in the next future.

Portfolio features	Jan03-Dec03	Jan04-Dec04	Jan05-Dec05 Non-audited	Apr05-Dec05 Audited
Gross outstanding portfolio (US$)	848,303	1,364,934	2,092,581	2,210,084
Growth of active gross portfolio	17.2%	60.9%	53.3%	53.7%
Avg. disbursed loan amount (US$)	1,298	1,357	1,430	-
Avg. disbursed loan / p.c. GDP	143.2%	112.7%	100.0%	-
Avg. disb. loan per borrower / p.c. GDP	-	-	92.0%	-
Average maturity (months)	9	11	10	10
Number of active borrowers	1,652	1,555	2,093	2,093
Number of active loans	892	1,351	1,972	1,972
% of active borrowers women	70.0%	72.0%	61.5%	61.5%
Drop-out ratio	-	30.9%	28.2%	-

The growth of the outstanding portfolio has been significant through the years, especially in 2004 and 2005. The number of active loans[23] has grown as well, but at a slightly lower pace, resulting in an increasing average disbursed loan size. However, due to the increase of the average GDP per-capita in the country, the loan size on per capita GDP has diminished over time. The percentage of women on total clients has diminished from 72.0% to 61.5% during 2005.

CREDO monitors the retention rate on a monthly basis. It is very active in monitoring its clients' needs through focus groups. The drop out ratio calculated on a yearly basis confirms the good achievements of the institution (28.2% in 2005).

[21] As of December 2005, CREDO's net portfolio represents 78% of total assets, as shown in the graph.

[22] Since December 2005 it also includes accrued interests on loans.

[23] It is worth to note that the number of active borrowers is higher than the number of active loans because of group loans.

The loan portfolio seems adequately diversified as far as the sectors of activities financed by CREDO are concerned; even though trade represents the largest share, the other three sectors together cover for almost half of the outstanding portfolio as of December 2005.
Although, according to the plans, the agricultural portfolio will grow rapidly in the next years, the balancing among sector of business will remain under sound levels.
CREDO's outstanding portfolio is also adequately diversified among branches and geographic regions in the country (see second table below).

December 2005 - Audited

By sector	outstanding portfolio (US$)	% of outst. portfolio
Agriculture	476,730	21.6%
Production	241,855	10.9%
Service	349,484	15.8%
Trade	1,142,015	51.7%
TOTAL	**2,210,084**	**100%**

Loan portfolio quality

Portfolio quality is excellent with a consolidated PAR30 worth 0.5% as of December 2005[24]. A remarkable **improvement has been clearly achieved since the year 2004**. Loan restructuring, although allowed and regulated, is not commonly practiced. The write-off ratio has been significant (3.9%) only during 2004 for loans disbursed in previous years. The setting up of the new MIS and the fine-tuning of lending procedures have notably contributed to these positive trends.

Portfolio Quality Indicators	Jan03-Dec03	Jan04-Dec04	Jan05-Dec05 Not audited	Apr05-Dec05 Audited
Consolidated PAR30	**4.4%**	**0.7%**	**0.49%**	**0.47%**
31-60	0.8%	0.2%	0.07%	0.06%
61-90	1.3%	0.1%	0.13%	0.12%
91-180	2.3%	0.4%	0.29%	0.28%
181-365	0.0%	0.0%	0.00%	0.00%
>365	0.0%	0.0%	0.00%	0.00%
Arrears rate (> 1 day)	6.0%	0.7%	0.79%	0.75%
Restructured portfolio	0.0%	0.0%	0.0%	0.0%
Provision expense ratio	3.2%	2.4%	0.8%	0.8%
Loan loss reserve ratio	3.1%	0.7%	0.5%	0.5%
Risk coverage ratio (30 days)	71.3%	100.2%	101.9%	101.9%
Write off ratio	1.2%	3.9%	0.73%	0.43%

The risk coverage ratio (>30 days) has always been higher than 100% in 2004 and 2005. In addition, considering that the non-performing portfolio is partly covered by the gold requested as collateral, **the risk of loan losses is adequately controlled**.

The analysis of portfolio quality by branch shows a substantial equilibrium, being Akalkalaki, the newest agency, the best one and Batumi the worst. In the latter case, the main reason is linked to the unwillingness to repay of some identified clients.

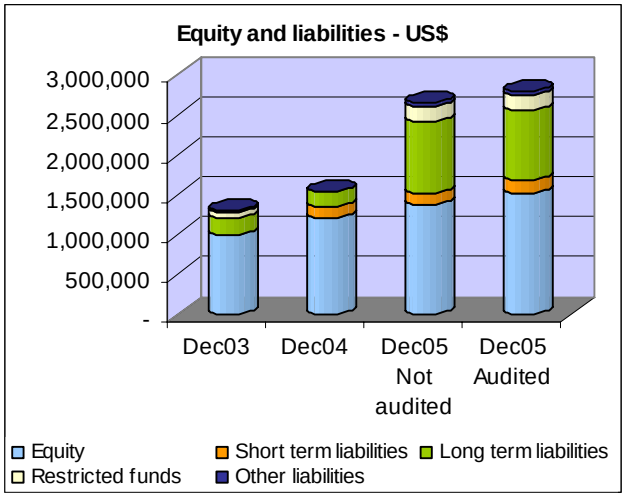
December 2005 - Not audited

Branch	outstanding portfolio (US$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR > 30 weighted
Tbilisi	468,217	22.4%	18.8%	0.2%	0.0%
Kutaisi	778,310	37.2%	33.8%	0.4%	0.2%
Batumi	351,628	16.8%	16.5%	0.8%	0.1%
Samtskhe-Djavakheti	447,784	21.4%	29.5%	0.7%	0.1%
Akalkalaki	46,641	2.2%	1.3%	0.0%	0.0%
TOTAL	**2,092,580**	**100%**	**100%**		**0.5%**

[24] The differences between the audited and non-audited balance sheets are insignificant.

5. Financial structure and ALM

As of December 2005, **the debt to equity ratio stands at a low level (0.8[25])**, as CREDO's access to external funding has been limited to loans received from the World Vision network. A rapid increase in the leverage of the institution is expected, as its planned growth will be mostly financed by debt.

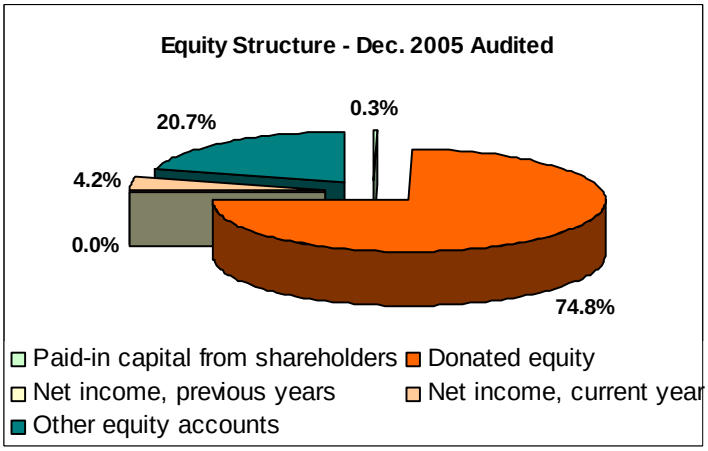


Liabilities and equity structure

CREDO does not collect public savings, so its funding liabilities are represented only by external borrowings. These are mostly (84%) long term liabilities, at yearly interest rates ranging from 5 to 7% in US$, below the international commercial rates. All loans, both short and long term ones, proceed from the network of the founder.

The loan from the local Bank of Georgia, taken in 2005 to face a temporary shortage of funds, represents the only experience with a commercial source of funding. It was a short term loan (6 months) completely paid back before the end of the year, and not renewed because very expensive (17% per annum).

Since the beginning of 2006, mainly thanks to the CEO's skills for fund raising, CREDO has started leveraging from international commercial investors specialized in microfinance.



As of December 2005, total equity is slightly more than US$ 1.5m., with a large share represented by donated capital. The retained earnings of previous years are worth 0.0% in the audited F.S., because the auditors make the assumption that Apr.-Dec. 2005, the period which has been audited, is CREDO's first period of operations. The retained earnings from previous years, which have been actually produced, have been included in "other equity account", worth 20.7% of total equity. While the equity-related **capitalization strategy has been based on external donations so far**, CREDO aims at generating positive net incomes starting from 2006, but better results may be more likely produced in 2007.

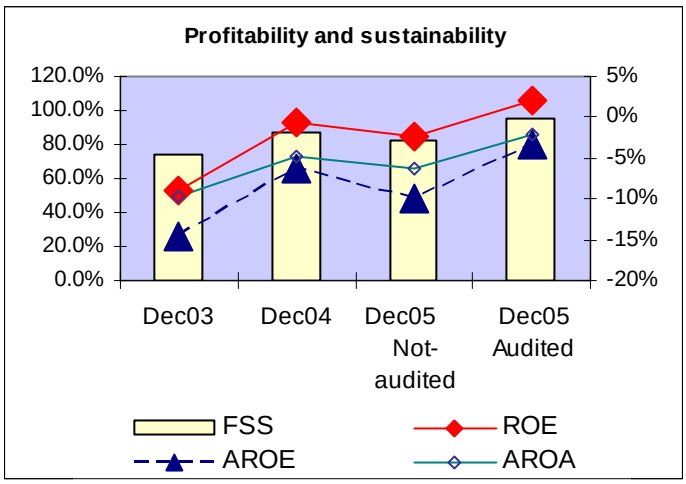
Assets and Liabilities Management

The current ratio is very high (11 as of December 2005). The loan portfolio is mostly (84%) short term and the funding liabilities, as already mentioned, are mostly long-term. CREDO **is not exposed to any maturity mismatch risk**. Most assets are indexed to the US$ and almost all the liabilities are denominated in US$, which is the functional currency adopted by CREDO. Therefore, the institution **is only limitedly vulnerable to currency risk**: the negative net position in US$ is worth of 11.1% of total assets. This risk is partially mitigated by the unlikelihood of a strong appreciation of the GEL. The **interest rate risk is also limited**, because the interest rate associated with the funding liabilities, proceeding from W.V. network, should not change. However,

[25] It is worth 0.9 in the internal not audited balance sheet as of Dec. 2005.

CREDO's credit portfolio bears a fixed interest rate, which can lead to the increase of the interest risk along with the access to commercial borrowings.
The liquidity management tools used by the institution are not sophisticated but, given its size, operations and financial structure, they meet the current needs of the institution.
The increasing exposition to different and new international investors can put the institution under some pressure, especially as far as the reporting capacity is concerned.

6. Financial and operational results



Profitability and sustainability have not been yet fully achieved. The trend analysis, conducted on the internal not audited financial statements (based on flat interest rate and cash basis) shows an important improvement in 2004, while the trend is negative in 2005, mainly to the decrease of portfolio yield, the increase of financial expenses and the establishment of a new branch.

As of Dec. 2005, the audited and the not audited financial statements show quite different financial results[26].
On one side, the internal financial statements for the period Jan.05-Dec.05 show negative results both in profitability (ROE worth -2.4% and ROA -1.5%) and sustainability (OSS 95.4%). Adjusted ratios are also reflecting these results (AROE -10.0%, AROA -6.2%, FSS 82.8%).
On the other side, the same ratios calculated on the audited financial statements for the period Apr.05-Dec.05 are positive (ROE 2.1%, ROA 1.2%, OSS 105.3%) and become negative only after the consideration of the cost related to the inflation[27] (AROE -3.4%, AROA -2%, FSS 95.5%).

Given that the ratios calculated on the audited FS have been annualized (since the audit period is only 9 months), **more consistent conclusions on trends and profitability/sustainability results will be drawn starting from the next year.**

The **portfolio yield** has decreased sharply from 2003 to 2005 and **will likely follow a downward path along the next year**, mostly because of the discounts on the interest rates for those urban clients who introduce new clients to the institution. On the other hand, CREDO is planning to slightly increase the upfront fee, but has not taken yet the final decision on it.
Even though the efficiency has improved remarkably during the period under consideration, **the operational expense ratio is still quite high** especially considering that the main lending methodology is the individual one with a quite large average disbursed loan. LOs productivity and staff **productivity** (measured in number of active borrowers) also are **not satisfactory**. The planned growth for 2006 will likely allow CREDO to obtain some gains in terms of efficiency and productivity.
However, the financial expense ratio will increase because of growing leverage and increasing access to commercial borrowing.
So far, the margin for CREDO has been negative if we consider the not audited financial statements or very limited in the case of audited ones. Considering that the provision expense ratio has been maintained at very low levels, thanks to the excellent portfolio quality, CREDO is facing an important challenge regarding its sustainability and profitability. A more aggressive strategy to improve efficiency and productivity is needed in the short run to be able to face the growing competition.

[26] See chapter 2: accounting policy and procedures.
[27] See annex 2 for details on adjustments to the financial statements.

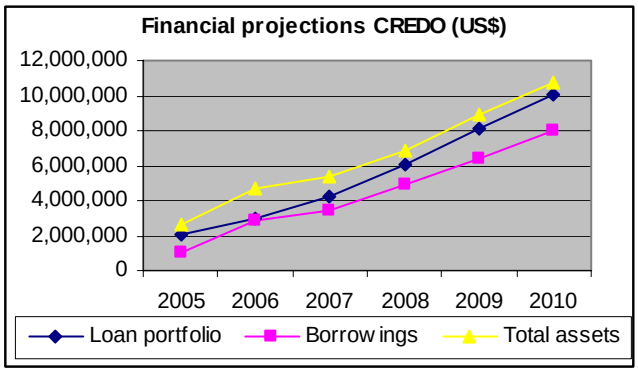
Financial Indicators	Jan03-Dec03	Jan04-Dec04	Jan05-Dec05 Not audited	Apr05-Dec05 Audited
Operat. expense ratio (avg.gross portf.)	**56.7%**	**39.8%**	**35.8%**	**33.4%**
Staff allocation ratio	37.1%	40.0%	33.3%	33.3%
Loan officer productivity (borrowers)	127	97	123	123
Loan officer productivity (amount)	65,254	85,308	123,093	130,005
Branch productivity (amount)	212,076	341,234	418,516	442,017
Cost per loan lent	328	256	257	n. av.
Cost per borrower	248	295	330	330
Funding expense ratio*	**1.0%**	**0.8%**	**2.6%**	**2.8%**
Provision expense ratio	**3.2%**	**2.4%**	**0.8%**	**0.8%**
Portfolio yield (gross portfolio)	**48.6%**	**40.0%**	**37.2%**	**38.9%**

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

7. Strategic objectives and financial needs

Strategic objectives and evolution

As indicated in the Business Plan 2006-2010, CREDO plans to increase the loan portfolio up to US$ 10.1m. as of Dec. 2010, almost five times the current level (Dec. 2005).



According to the projections, the leverage will increase progressively from the current 0.9 up to more than 3 as of Dec. 2010.

OSS is supposed to reach 100% as of Dec. 2007 and to increase over time. Profitability and sustainability analysis however have been carried out only on the conservative "flat rate cash basis hypothesis", namely the not audited financial statements.

In the short run, CREDO foresees a yearly on yearly **growth rate of the outstanding portfolio worth about 42% as of December 2006**. A new satellite office will be opened in the area of influence of Kutaisi branch. The main strategy to face the growing competition is the identification of niches like the rural areas and the agricultural lending, generally less attractive for the stronger competitors like Procredit and other commercial banks. Tourism lending also represents a strategic niche for expansion.

As soon as the new draft law will be approved, main challenge will regard the transformation into a limited liabilities or a joint stock company. On a hand the first legal status is very easy to manage and to constitute, but on the other hand a joint sock company is much more attractive for external equity investors.

Financial needs

The institution is shifting towards a more commercial funding strategy, opening to additional sources other than World Vision network. **CREDO's financial needs for 2006 are worth US$ 1.5m**., which is under negotiation with the following institutions:

- VisionFund Int'l for additional US$ 0.75m.
- Symbiotics for US$ 0.5m.
- Novib for US$ 0.3m.

Other sources, such as Blue Orchard, Triodos and EBRD have been already contacted.
The fundraising strategy seems to be adequate to feed the planned growth.

8. Details of the risk factors

According to our analysis, the main **risk factors** of CREDO are the following ones:

AREA	Risk factors	Relevance*	Main measures implemented and/or to implement in the short term	Observations
External environment and mkt. positioning	***Growing competition in urban areas***	**Medium-high**	Products' development based on constant monitoring of clients' needs and competitors' offer	Especially in Tbilisi and Batumi / Main competitors are bigger than CREDO and rely on more and cheaper funds
	Uncertainties related to the new microfinance law	**Medium-low**	-	The draft law, not yet approved, does not define content and modalities of the supervision of the NBG on the Microfinance Organizations
	Uncertainty on taxes	**Medium-low**	A tax expert has been recently appointed in the Accounting Department	Tax authorities could provoke changes in the tax burden for the institution
	Lack of a Credit Bureau for the microfinance sector	**Medium**	Lobbying through AGMO / Informal exchange of information among MFIs	The non-banking MFIs do not participate in the Credit Bureau recently created by the commercial banks
Governance, management and operations	***Absence of a Financial Manager and concentration of top-managerial functions in the Deputy Director***	**Medium**	The recently promoted Chief Accountant is acquiring skills of financial management	The Financial Manager left in November 2005 and the DD relieved her functions
	Work overload for the Deputy Director	**Medium**	-	The DD deals with the credit and financial management and partly with internal audit and institutional representation
	Lack of systematic approach to the assessment of staff's training needs	**Medium**	-	Training supply is mostly based on external upcoming opportunities
	Improvable internal control	**Medium**	A position of Internal Controller has been recently set up.	Not yet consolidated Internal Controller / Incomplete Manuals / Lack of Internal Auditor
Financial structure and ALM	***Lack of experience with international commercial sources of funds***	**Medium-low**	The only experience has been a short term commercial loan from a local bank for funding shortage during 2005	Reporting capacity and financial management under pressure
Financial and operational results	***Profitability and sustainability not yet achieved***	**Medium-high**	Trends are slightly positive in the last 3 years / CREDO is planning to increase the up-front fee	Financial expense ratio will grow, while portfolio yield could be forced to decrease because of competition
	Low efficiency and productivity	**Medium**	The planned growth will generate some economies of scale	Decreasing but still high operational costs / low productivity and low staff allocation ratio

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

Annex 1 - Financial statements

CREDO				
Balance sheet (US$)	**Dec03**	**Dec04**	**Dec05 Not audited**	**Dec05 Audited**
ASSETS				
Cash and bank deposits	326,544	71,464	80,836	78,984
Short term financial assets	-	-	80,000	80,000
Net outstanding portfolio	821,651	1,355,779	2,082,099	2,199,602
Gross outstanding portfolio	848,303	1,364,934	2,092,581	2,210,084
Performing portfolio	810,927	1,355,801	2,082,290	2,199,793
Portfolio at risk > 30 days	37,376	9,133	10,291	10,291
(Loan loss reserve)	26,652	9,155	10,482	10,482
Accrued interest	-	-	-	45,210
Other short term assets	96,595	42,326	289,931	284,969
Total short term assets	**1,244,790**	**1,469,569**	**2,532,866**	**2,688,765**
Long term financial assets	-	-	-	-
Net fixed assets	65,780	85,943	120,310	120,311
Other long term assets	-	-	-	-
Total long term assets	**65,780**	**85,943**	**120,310**	**120,311**
Total assets	**1,310,570**	**1,555,512**	**2,653,176**	**2,809,076**
LIABILITIES and EQUITY				
LIABILITIES				
Sight deposits	-	-	-	-
Short time deposits	-	-	-	-
Short term loans	-	144,000	149,500	162,000
Other short term liabilities	17,732	1,093	48,474	62,196
Total short term liabilities	**17,732**	**145,093**	**197,974**	**224,196**
Long term time deposits	-	-	-	-
Long term loans	218,000	195,000	899,875	887,375
Other long term liabilities	-	-	-	-
Restricted funds	75,000	-	170,000	170,000
Total Long term liabilities	**293,000**	**195,000**	**1,069,875**	**1,057,375**
Total liabilities	**310,732**	**340,093**	**1,267,849**	**1,281,571**
EQUITY				
Paid-in capital from shareholders	-	-	5,000	5,000
Donated equity	847,331	980,155	1,133,582	1,142,585
Quasi-capital	-	-	-	-
Reserves	-	-	-	-
Total retained earnings	152,507	220,865	232,346	63,795
Net income, previous years	86,525	154,160	220,865	-
Net income, current year	65,982	66,705	11,481	63,795
Other equity accounts	-	14,399	14,399	316,125
Total equity	**999,838**	**1,215,419**	**1,385,327**	**1,527,505**
Total liabilities and equity	**1,310,570**	**1,555,512**	**2,653,176**	**2,809,076**

CREDO				
Income Statement (US$)	**Jan03-Dec03**	**Jan04-Dec04**	**Jan05-Dec05 Not audited**	**Apr05-Dec05 Audited**
Interest & commissions received on loans	351,331	449,762	613,639	532,487
Financial revenue from investment	2,950	896	3	509
Other financial revenues	-	12,294	1,517	-
A) Financial revenue	**354,281**	**462,952**	**615,159**	**532,996**
Interest paid on borrowings	7,458	8,952	43,486	38,748
Interest paid on savings	-	-	-	-
Interest paid on mortgage	-	-	-	-
Other financial expenses	-	-	3,322	2,358
Inflation adjustment	-	-	-	-
B) Financial expenses	**7,458**	**8,952**	**46,808**	**41,106**
Gross financial margin (A - B)	**346,823**	**454,000**	**568,351**	**491,890**
Loan loss provision	23,350	26,639	13,394	11,619
Net financial margin	**323,473**	**427,361**	**554,957**	**480,271**
Other operating revenue	4,871	13,120	6,532	4,098
Personnel expenses	225,581	227,238	305,074	236,625
Administrative expenses	184,333	219,806	286,241	220,535
C) Operating expenses	**409,914**	**447,044**	**591,315**	**457,160**
Net operating income	**- 81,570**	**- 6,563**	**- 29,826**	**27,209**
Extraordinary revenue	-	-	-	-
Extraordinary expense	-	-	-	-
Net income before donations, before tax	**- 81,570**	**- 6,563**	**- 29,826**	**27,209**
Taxes	-	-	-	7,527
Net income before donations	**- 81,570**	**- 6,563**	**- 29,826**	**19,682**
Donations in cash	147,552	78,100	48,328	48,328
Revenue not from the operations	-	7,168	1,979	1,979
Expenses not from the operations	-	12,000	9,000	6,194
Net income	**65,982**	**66,705**	**11,481**	**63,795**

Annex 2 – The adjustments to the financial statements

The financial statements in Annex 1 are the result of **standard reclassification**. They are based on internal financial statements, except for the F.S. for the period Apr-Dec05, which have been audited according to international standards.

Financial statements have been then adjusted to allow a comparison with other institutions which use a different logic of presentation of the information and to evaluate the level of sustainability of the institution at market conditions and prices.
The main adjustments normally are:

- adjustment for the accrued interest on delinquent loans > 90 days
- elimination of subsidies (donations in kind[28] and soft loans[29])
- provisions are calculated with a standard formula[30]
- adjustments for inflation
- adjustments for write-offs

CREDO does not accrue active interests on loans. The audited financial statements (Apr05-Dec05) do accrue interests but not on past due loans, thus related adjustments are not required.
A small adjustment for subsidy on the cost of funding liabilities is always required, except for the Audited F.S. Apr.05-Dec.05[31].
The inflation adjustment is the most important adjustment, which reduces the net income in each period.

Adjustments (US$)	Jan03-Dec03	Jan04-Dec04	Jan05-Dec05 Non-audited	Apr05-Dec05 Audited
Reversal of accrued interest on non-perf loans	-	-	-	-
Subsidized cost of fund adjustment	667	5,296	5,263	-
- Interest rate used (national currency)	24.2%	23.4%	16.2%	16.1%
- Interest rate used (foreign currency)	4.4%	5.1%	7.0%	7.2%
Inflation adjustment	41,581	57,509	94,491	52,788
- Inflation rate used	4.8%	5.7%	8.3%	4.6%
Loan loss provision adjustment	-	-	-	-
In-kind subsidy adjustment	-	-	-	-
Total variation of net income	42,248	62,805	99,754	52,788

[28] Donations in kind are valorized and added to operational expenses.
[29] In the income statement it is registered the value of the difference between financial costs of the institutions and financial cost evaluated at the market rate. In particular, in the case of loans in local currency, it is considered 75% of the average lending rate in the national market (IFS Line 60P). In the case of loans denominated in foreign currencies (US$ and Euro), it is considered the average value of LIBOR 1 year plus 3%.
[30] Provisions are calculated according to the following formula:

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

[31] Libor 1 year has increased progressively during 2005, so the avg. value for the period Apr-Dec.05 is a bit higher than the avg. for the entire year.

Annex 3 - Financial ratios

CREDO (US$)	Jan03-Dec03	Jan04-Dec04	Jan05-Dec05 Not Audited	Apr05-Dec05 Audited
PROFITABILITY				
Return on Equity (ROE)	-8.9%	-0.6%	-2.4%	2.1%
Adjusted Return on Equity (AROE)	-14.6%	-6.3%	-10.0%	-3.4%
Return on Assets (ROA)	-6.8%	-0.5%	-1.5%	1.2%
Adjusted Return on Assets (AROA)	-9.8%	-4.8%	-6.2%	-2.0%
Operational self-sufficiency (OSS)	81.5%	98.6%	95.4%	105.3%
Financial self-sufficiency (FSS)	74.4%	87.3%	82.8%	95.5%
Profit Margin	-22.7%	-1.4%	-4.8%	5.1%
LOAN PORTFOLIO QUALITY				
Portfolio at risk (PAR30)	4.4%	0.7%	0.49%	0.47%
Arrears rate (> 1 day)	6.0%	0.7%	0.79%	0.75%
Restructured loans	0.0%	0.0%	0.00%	0.00%
Provision expense ratio	3.2%	2.4%	0.81%	0.85%
Loan loss reserve ratio	3.1%	0.7%	0.50%	0.47%
Risk coverage ratio (30 days)	71.3%	100.2%	101.85%	101.85%
Write-off ratio	1.2%	3.9%	0.73%	0.43%
Adjusted write-off ratio	1.1%	4.0%	0.70%	0.43%
EFFICIENCY AND PRODUCTIVITY				
Staff allocation ratio	37.1%	40.0%	33.3%	33.3%
Loan officer productivity (borrowers)	127	97	123	123
Loan officer productivity (amount)	65,254	85,308	123,093	130,005
Staff productivity (borrowers)	47	39	41	41
Staff productivity (amount)	24,237	34,123	41,031	43,335
Branch productivity (amount)	212,076	341,234	418,516	442,017
Operating expenses ratio (average gross portf.)	56.7%	39.8%	35.8%	33.4%
Operating expenses ratio (average assets)	34.0%	32.5%	29.6%	28.6%
Cost per loan lent	328	256	257	n. av.
Cost per borrower	248	295	330	330
Personnel expenses ratio (average gross portf.)	31.2%	20.2%	18.5%	17.3%
Admin. expenses ratio (average gross portfolio)	25.5%	19.6%	17.4%	16.1%
ASSETS/LIABILITIES MANAGEMENT				
Portfolio yield (gross portfolio)	48.6%	40.0%	37.2%	38.9%
Portfolio yield (gross portfolio) - accrued	48.6%	40.0%	37.2%	38.9%
Funding expense ratio*	1.0%	0.8%	2.6%	2.8%
Cost of funds ratio*	4.9%	3.6%	6.9%	7.1%
Provision for inflation (average gross portfolio)	0.0%	0.0%	0.0%	0.0%
Adjusted provision for inflation (av. gross port.)	5.7%	5.1%	5.7%	3.9%
Current ratio	70.20	10.13	10.98	10.39
Liquidity over total assets	24.9%	4.6%	3.0%	2.8%
Debt/equity ratio	0.31	0.28	0.92	0.84
Equity multiplier	1.3	1.3	1.9	1.8
Capital adequacy ratio	76.3%	78.1%	52.2%	54.4%

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

** When required, the ratios have been calculated on 9 months and then annualized.

OUTREACH				
Average disbursed loan size	1,298	1,357	1,430	n.av.
Average outstanding balance	951	1,010	1,061	1,121
Average disbursed loan size on per-capita GDP	143.2%	112.7%	100.0%	n.av.
Average outstanding balance on per-capita GDP	105.0%	72.9%	74.2%	78.4%
Percentage of active borrowers women	70.0%	72.0%	61.5%	n.av.

GROWTH (amount in US$)				
Growth of active gross portfolio	17.2%	60.9%	53.3%	53.7%
Growth of active borrowers	0.1%	-5.9%	34.6%	n.av.
Growth of active loans	16.6%	51.5%	46.0%	n.av.
Growth of total assets	7.8%	18.7%	70.6%	77.6%
Growth of staff	29.6%	14.3%	30.0%	n.av.
Growth of funding liabilities	n.av.	55.5%	209.6%	187.5%
Growth of operating expenses	n. av.	9.1%	32.3%	n.av.
Growth of equity	37.9%	21.6%	14.0%	39.5%

All the growth ratios regarding the period Apr05-Dec05 have been calculated on 9 months. n. av. = not available

Annex 4 - Definitions

	Description of the ratio	Formula
Profitability	**Return on equity (ROE)**	Net income before donations / Average equity
	Adjusted return on equity (AROE)	Adjusted net income before donations / Average equity
	Return on assets (ROA)	Net income before donations / Average assets
	Adjusted return on assets (AROA)	Adjusted net income before donations / Average assets
	Operational self-sufficiency (OSS)	(Financial revenue + Other operating revenue) / (Financial expenses + Loan loss provision expenses + Operating expenses).
	Financial self-sufficiency (FSS)	(Adjusted financial revenue + Other operating revenue) / (Adjusted financial expenses + Adjusted loan loss provision expenses + Adjusted operating expenses)
	Profit margin	Net operating income / operating revenue
Portfolio quality	**Portfolio at Risk (PAR30)**	Portfolio at Risk > 30/ Average gross portfolio
	Provision expense ratio	Loan loss provision expenses / Average gross portfolio
	Loan loss reserve ratio	Accumulated reserve / Gross portfolio
	Risk coverage ratio (>30 days)	Accumulated reserve / Portfolio at risk >30 days
	Write-off ratio	Write-off of loans / Average gross portfolio
Efficiency and productivity	**Staff allocation ratio**	Loan officers / Total staff
	Loan officer productivity – Borrowers	Number of active borrowers / Number of loan officer
	Loan officer productivity – Amount	Gross portfolio / Number of loan officer
	Staff productivity – Borrowers	Number of active borrowers/ Number of staff
	Staff productivity – Amount	Gross portfolio / Number of staff
	Operating expenses ratio	Operating expenses / Average gross portfolio
	Cost per borrower	Operating expenses / Number of borrowers
	Administrative expenses ratio	Administrative expenses / Average gross portfolio
	Personnel expenses ratio	Personnel expenses / Average gross portfolio
Financial management	**Portfolio yield**	Interest income from portfolio / Average gross or net portfolio
	Funding expense ratio	Interests and fee expenses on funding liability / Average gross portfolio
	Cost of funds ratio	Interest expenses on funding liability / Period average funding liability
	Current ratio	Short term assets / Short term liability
	Debt/Equity ratio	Total liability / Equity
	Capital adequacy ratio	Total equity / Total assets
Outreach	**Average disbursed loan size**	Amount issued in the period / Number of issued loans
	Average disbursed loan size on per-capita GDP	Average disbursed loan size / Per-capita GDP

Other definitions:

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

Operating expenses: Personnel expenses + Administrative expenses

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

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

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

Annex 5 - Guidelines of reporting and accounting

Financial statements

CREDO does not provide non-financial services, so its financial statements reflect exclusively the results of its financial activities. The Fiscal Year runs from January 1 to December 31. Since April 2005, CREDO prepares its own financial statements separately from World Vision Georgia. The functional currency is US$, but CREDO is planning to move to Lari, national currency, during 2007.

Loan loss provision and write-offs

CREDO sets the loan loss reserve on monthly basis, calculating the cost of provision according fixed percentages calculated on ageing categories of the portfolio at risk (outstanding balance of past due loans). The calculation is made automatically by the MIS. The cost of the provision is recorded into the income statement and is cumulated into the loan loss reserve in the balance sheet.
CREDO writes-off bad loans when they are late > 120 days and the chances to recover them are low.

Ageing portfolio at risk	% provision
1 - 30 days	10%
31 - 60 days	25%
61 - 90 days	50%
91 - 120 days	75%
> 120 days	100%

Accrued interests

The audited F.S. Apr-Dec05 accrue active interests on loans and financial investments and the passive interests on funding liabilities. CREDO 's policy however is to use flat interest rate on cash basis along 2006, while turning to IFRS only since 2007.

Ratios of portfolio quality

CREDO reports data on portfolio at risk and arrears in the correct way. The standard portfolio quality ratio used is PAR 30 in the reporting and PAR 1 in the F.S. (non-performing loan portfolio).

Restructured loans

Although CREDO's policy allows for restructuring loans, it is not a commonly-used practice.

Insider loans

CREDO does not allow the disbursement of loans to the staff and BoD members. On the other hand, loans to staff and Directors' relatives are allowed and regulated.

Donations and in-kind subsidies

Donations for loan capital and fixed assets are registered directly into the equity, while those ones for operating expenses are registered in income statement. CREDO has not received any in-kind subsidies.

Donations received (US$)

Year	Amount	Destination	Source
2003	240,000	Loan capital	CIDA
	55,000	Loan capital	World Vision Canada
Sub-total	**295,000**		
2004	150,000	Loan capital	SOROS
	21,500	Loan capital	BDI Funds
Sub-total	**171,500**		
2005	297,402	Loan capital	Chemonics Int'l (USAID)
	16,314	Investments	Chemonics Int'l (USAID)
	48,328	Operating expenses	Chemonics Int'l (USAID)
	33,134	Investments	World Vision Georgia
	843,817	Loan capital	World Vision Georgia
	10,813	Loan capital	NRC
	1,932	Investments	GMSE
Sub-total	**1,251,740**		
TOTAL	**1,718,240**		

Details of funding liability

December 2005

Funding liabilities

Source	Currency (in which the loan is due)	Outstanding Balance (US$)	Outstanding Balance Short term (US$)	Outstanding Balance Long term (US$)
World Vision Canada	US$	59,375	47,500	11,875
VisionFund International 1	US$	375,000	0	375,000
World Vision MEERO 1	US$	15,000	0	15,000
World Vision MEERO 2	US$	100,000	50,000	50,000
World Vision MEERO 3	US$	48,000	0	48,000
VisionFund International 2	US$	375,000	0	375,000
World Vision MEERO 4	US$	77,000	52,000	25,000
TOTAL		**1,049,375**	**149,500**	**899,875**

December 2005

Funding liabilities features

Source	Loan amount (US$)	Disbursement date	Maturity date	Principal repayments	Interest repayments	Interest rate
World Vision Canada	95,000	15/02/2004	15/02/2007	Quarterly	Quarterly	5.00%
VisionFund International 1	375,000	11/07/2005	30/06/2007	Maturity	Quarterly	6.00%
World Vision MEERO 1	15,000	05/07/2005	05/01/2007	Maturity	Quarterly	4.00%
World Vision MEERO 2	100,000	07/09/2005	07/06/2007	Quarterly	Quarterly	6.00%
World Vision MEERO 3	48,000	21/10/2005	21/04/2008	Quarterly	Quarterly	6.00%
VisionFund International 2	375,000	08/11/2005	30/06/2007	Maturity	Quarterly	7.00%
World Vision MEERO 4	77,000	15/12/2005	15/04/2007	n.av.	Quarterly	6.00%

Other accounting policy

CREDO is adopting the flat interest rate on a cash basis. Only starting from the period Apr.05-Dec.05 the external auditors have restated the F.S. using the effective interest rate method on an accrual basis. CREDO will likely adopt the declining interest rates and accrual basis since 2007.
Fixed assets are depreciated using the straight-line system, with the estimated useful life of each class of asset as a basis.
CREDO does not consider the effect of the inflation in the financial statements.

Exchange rate variations and assets and liability denominated in foreign currency

Transactions are made both in US$ and Lari. The conversion into US$ is undertaken using the official daily exchange rate issued by the Central Bank.
Foreign currency transactions are adjusted at the end of the year and the gains/losses for currency fluctuations are listed in the administrative expenses under the item “currency exchange loss / gain”.

December 2005 - Not Audited

US$	US$*	Local currency	Total
Assets	**2,351,505**	**301,671**	2,653,176
Cash and banks	43,796	37,040	80,836
Financial assets	80,000	0	80,000
Portfolio	2,082,099	0	2,082,099
Fixed assets	120,310	0	120,310
Other assets	25,300	264,631	289,931
Liabilities	**2,646,972**	**6,204**	2,653,176
Loans	1,219,375	0	1,219,375
Other liabilities	42,270	6,204	48,474
Capital	1,385,327	0	1,385,327
NET POSITION	**-295,467**	**295,467**	**0**

Exch.rate GEL/US$: 1.7925

Annex 6 - Rating Scale

Rating grade	Definition
AAA	Extremely strong capacity to meet its financial obligations. Excellent operations. Very stable and highly unlikely to be adversely affected by foreseeable events.
AA	Very strong capacity to meet its financial obligations. Very good operations. Stable and unlikely to be adversely affected by foreseeable events.
A	Strong capacity to meet its financial obligations. Very good operations. Stable even if it could be affected by major internal or external events.
BBB	Adequate capacity to meet its financial obligations. Good operations. Quite stable even if it could be affected by significant internal or external events.
BB	Limited vulnerable capacity to meet its financial obligations. Adequate operations. Quite stable even if it could be affected by internal or external events.
B	Partially vulnerable capacity to meet its financial obligations. Sufficient operations. Not completely stable and vulnerable to internal or external events.
CCC	Vulnerable capacity to meet its financial obligations. Basic operations. Potentially unstable and vulnerable to external or internal events.
CC	Highly vulnerable capacity to meet its financial obligations. Poor operations. Potentially unstable and vulnerable to external or internal events.
C	Very high vulnerable capacity to meet its financial obligations. Very poor operations. Unstable and very vulnerable to external or internal events.
D	Not able to meet its financial obligations. Insufficient operations. Very unstable and completely vulnerable to external or internal events.

The rating grade can be corrected with a + or – sign, which implies a slight positive or negative variation respect to the main grade.