

CredAgro – Azerbaijan

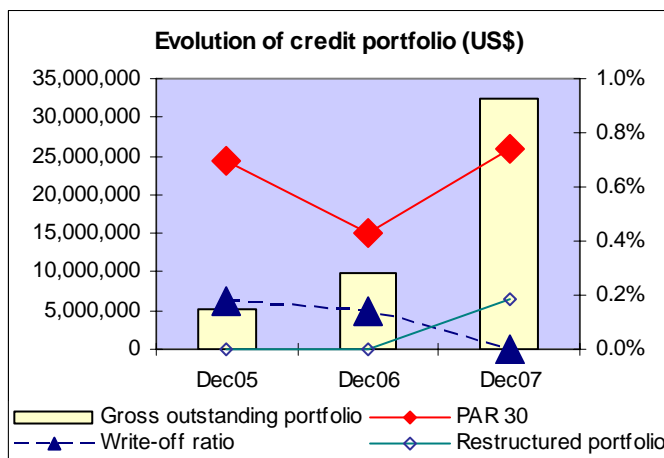
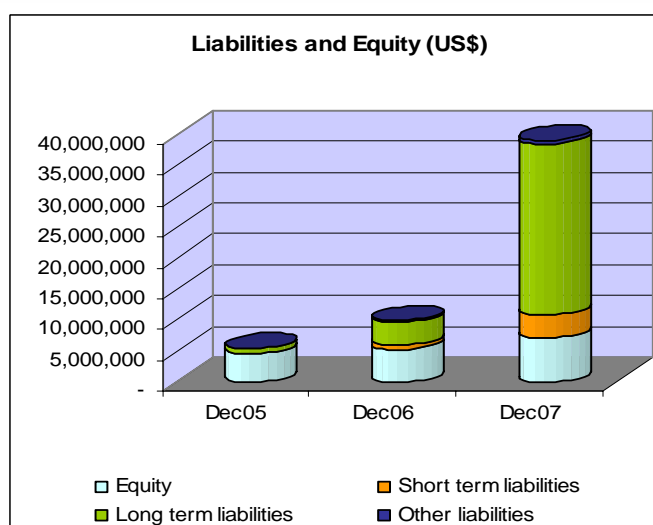
Final rating	A-
Second rating	<i>Validity:</i> 1 year if no relevant changes in operations or within the operation context will happen.
Previous rating: BBB May 2006	

CredAgro is a Non-Banking Credit Organization established in May 2000 in the framework of the Azeri Rural Credit project supported by USAID. ACDI/VOCA, channeling the USAID donations, has been constantly sustaining the development of CredAgro and in 2005 it was granted the property of CredAgro by USAID. With a widespread network of branches, CredAgro targets the upper end of the rural microfinance market, offering a well diversified range of individual products.

Since 2005 CredAgro has undergone a process of commercialization by increasingly leveraging the capital. At the moment, sustained by its impressive growth and confident in consolidated relationships with international investors, CredAgro is considering the opportunity to attract equity investors while transforming into a bank.

Legal form	Limited Liability Company
Inception year	2000
Network of reference	ACDI-VOCA
Area of activity	Rural
Credit methodology	Individual

Number	Dec05	Dec06	Dec07
Active borrowers	1,287	2,822	8,596
Branches	9	6	12
Total staff	53	68	139
Loan officers	15	19	57



US\$	Dec07
Average disbursed loan size	4,764
Gross outstanding portfolio	32,403,863
Total assets	39,090,827

Financial Indicators	Dec05	Dec06	Dec07
PAR 30	0.7%	0.4%	0.7%
Write-off ratio	0.2%	0.1%	0.0%
Restructured loans	0.0%	0.0%	0.2%
ROE	3.5%	8.1%	26.2%
AROE	-8.1%	-3.9%	8.2%
Oper. Self-sufficiency (OSS)	119.3%	147.0%	163.9%
Fin. Self-sufficiency (FSS)	73.0%	96.3%	122.4%
Staff productivity (borrow.)	27	42	62
LO productivity (borrow.)	86	149	151
Operating expense ratio	11.5%	10.4%	8.8%
Funding expense ratio	0.2%	2.7%	7.6%
Provision expense ratio	0.5%	1.0%	1.7%
Portfolio yield	22.3%	25.5%	29.0%
Risk coverage ratio	167.3%	303.5%	186.8%
Cost of funds ratio	1.8%	6.6%	7.9%
Debt/Equity ratio	0.2	0.9	4.4

CONTACTS

AREA	Risk factors	Relevance*
External environment	Increasing competition from banks	Medium
	Still lack of MF law	Medium-low
	High inflation and unexpected cost	Medium
	Lack of a credit bureau for microfinance institutions	Medium-low
Governance, management and operations	Weak Supervisory Board	Medium-high
	Improvable HR policy	Medium
	Lack of finance manager position	Medium
	Improvable internal control procedures at branch level	Medium-low
	Improvable liquidity management tools	Medium
	Lack of reconciliation report (internal vs audited financial statements)	Medium-low
Financial products and asset quality	Lack of cash handling	Medium
	High drop-out ratio and improvable drop out survey	Medium
	Portfolio concentration into bigger loans	Low
Financial structure and ALM	Improvable diversification of local financial partnerships	Medium-low
Financial and operational results	Improvable productivity	Medium-low

* 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.

<p>Strengths:</p> <ul style="list-style-type: none"> ➤ Impressive growth rate in 2007 ➤ Very good portfolio quality ➤ Institutional support from an international stakeholder (ACDI-VOCA) 	<p>Opportunities:</p> <ul style="list-style-type: none"> ➤ Transformation into a commercial bank ➤ Product diversification and market positioning
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Final opinion

In the last 18 months, CredAgro has impressively up-scaled its operations, having accessed to a variety of international and national sources of funds, while maintaining a very good portfolio quality and adequately reducing its exposure to currency risk. The support of a recognized international network such as ACIDI-VOCA is full and clearly represents a strength. The institution has started up the process of transformation into a commercial bank, which is definitely a crucial opportunity to consolidate its market positioning and its image.

The main challenges of CredAgro are the current weak governance structure given the reduced size of the Supervisory Board, the little availability of time of its current members and the lack of formal governance policies and of defined tools for the systematic assessment of the CEO. HR policies are improvable, in terms of career and succession planning, and this is exposing the institution to the risk of losing staff, also given the aggressive competition of banks. Finally, the current lack of a finance manager position, is an issue considering the higher level of complexity featured by CredAgro's financial structure.

Relevant changes respect to the previous rating

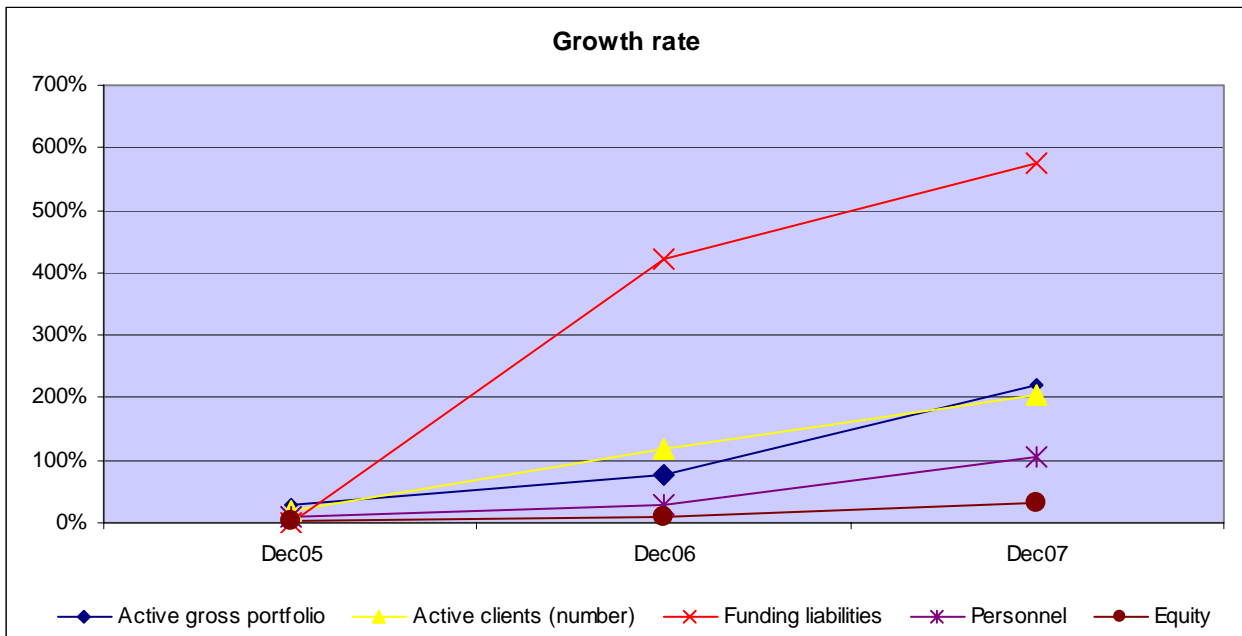
AREA	Relevant changes and comments	Trend
External Environment	<p>Legal framework is still uncertain, as the proposed microfinance law has not been approved yet and the efficiency of the existing credit bureau has not improved.</p> <p>Competition for CredAgro is growing, with some commercial banks becoming much more aggressive in micro and small enterprise lending.</p> <p>Unexpected increase in operating expenses due to loss of purchasing power and to the monopoly of Ministry of Extraordinary Affairs in certain areas.</p> <p>As for the government claims on international grants, the issue seems now quite clear and resolved, according to CredAgro management, after the "Assets Disposition" signed by USAID in favour of ACDI/VOCA</p>	Stable
Governance, management and operations	<p>The uncertainties of the ownership noticed in the previous rating, seem not existing anymore, being ACDI/VOCA now quite clear about the commercial and banking evolution of CredAgro and about its role within it. Since 2006 the access to commercial sources of funds has been wide and has led to an impressive growth.</p> <p>CredAgro has undertaken the first steps for a possible transformation process into commercial bank, with the realization of a feasibility analysis and the preparation of a business plan to be presented jointly to the request of transformation to the Central Bank. This would certainly represent an important enhancement of both the institutional status and in terms of consolidation of the market position.</p> <p>CredAgro governance structure has seriously weakened after one important member of the Supervisory Board (Mr. Azer Humbatov) has left in November 2007. No substitute so far has been identified neither introduced and there is no decision taken on that issue so far. The Supervisory Board currently results undersized (only 3 members) and lacking of specific banking, financial and auditing professional expertise, also affecting its capacity to directly supervise the internal audit function. Furthermore the current Supervisory Board members are quite busy people with limited availability.</p> <p>A written governance Policy Manual and a formalized CEO assessment methodology are still missing.</p> <p>At the management level, the MIS has been clearly improved and the IT department and policy have greatly evolved and consolidated.</p> <p>A full-fledge financial manager position is still missing. Human Resource policy has not been improved in terms of succession planning of crucial management positions and in terms of salary survey</p>	Slightly negative
Financial products and asset quality	<p>Diversification in credit products has improved with the introduction of consumer lending and express loans.</p> <p>In 2007, CredAgro outstanding portfolio has impressively grown compared to the previous years while maintaining a very good portfolio quality.</p> <p>Clients' drop-out monitoring has improved even if a more complete reporting (detailed description of reasons for drop-out, definition of strategies to be adopted, etc) is missing. Drop-out ratio, still high, is now 50.2% and it was 57% as of May 2006</p>	Positive

<p>Financial structure and ALM</p>	<p>Financial leverage has increased with a debt to equity ratio that has reached 4.5 (up from 0.2 in 2005). Nevertheless, if considering the effects of the back-to-back mechanism, the ratio is still well below 4, which is an acceptable level, also considering the institutional evolution perspectives and the likely enhancement of the level of equity.</p> <p>The institution is now systematically and adequately managing and monitoring its currency risk and the open position in US\$ has been reduced to 24% of total equity, down from 82% as of May 2006.</p> <p>CredAgro does not present, for the moment, a relevant exposure to interest rate risk given that all the borrowed funds except the ones from EBRD (representing 15% of total funding liabilities as of December 2007) bear fixed interest rates.</p>	<p>Positive</p>
<p>Financial and operational results</p>	<p>All indicators of financial and operational performance have improved in comparison to the last rating. Adjusted indicators have evolved from negative to positive values, as AROE shifts from -2.4% in 2006 to 11.3% in 2007 and AROA from -1.5% to 2.9%. FSS has been clearly consolidated, currently reaching a level well above 100% (128.4% as of December 2007). This is despite a relevant raise of the inflation rate especially in 2007, and the consequent financial adjustment.</p>	<p>Positive</p>
<p>Strategic objectives and future evolutions</p>	<p>CredAgro's business plan and financial projections have been produced for the period 2008-2010. Scenario and sensitivity analysis are now included in the business plan.</p> <p>A parallel business plan for the banking transformation is being completed in order to be presented to the Central Bank by the first quarter of 2008</p>	<p>Positive</p>

CredAgro HQ:
Baku

CredAgro branches:

- Absheron
- Ismayilli
- Jalilabad
- Masalli
- Guba
- Khacmaz
- Tovuz
- Mingachevir
- Zagatala
- Ganja
- Sheki
- Barda



Benchmarking

The benchmarking exercise includes a comparison of crucial indicators with selected peer groups. The figures stem from the MicroBanking Bulletin (MBB) database updated as of December 2005. CredAgro financial ratios indicated here do not fully correspond to the ratios presented in the report as they are calculated according to the *MicroBanking Bulletin* (MBB) methodology.¹

Financial ratios	CredAgro December 2007	ECA Medium High SME	ECA Large Non FI	ECA Large FI	Individual
Gross Loan Portfolio gross loan portfolio adj for standardised write-offs (US\$)	32,403,863	3,356,375	15,496,586	101,560,896	8,959,428
Average Loan Balance per Borrower on per capita GNI Average loan balance per borrower/ GNI per capita(%)	130.5%	336.2%	83.8%	170.2%	61.4%
Portfolio at Risk > 30 Days outstanding balance of loans overdue > 30days/gross loan portfolio (%)	0.7%	1.0%	0.8%	1.1%	2.3%
Adjusted Return on Equity AROE adj net operating income after taxes/avg tot equity (%)	6.4%	-0.6%	9.7%	10.2%	5.9%
Portfolio yield Financial Revenue from Portfolio/ Adjusted Average Gross Portfolio	29.0%	25%	27%	20%	30%
Debt/ Equity Ratio adj.tot.liabilities/adj.tot.equity	4.2	1.7	2.2	8.2	3.9
Operating Expense/ Loan Portfolio [operating expense + In-Kind donations]/avg gross loan portfolio (%)	8.8%	15.7%	15.6%	13.0%	16.4%
Borrowers per Loan Officer n. of active borrowers/n. of loan officers	151	65	167	210	205
Borrowers per Staff n. of active borrowers/n. of staff	62	32	104	56	94

All figures are referred to the MicroBanking Bulletin database updated as of December 2005

Important matters of the benchmarking

- CredAgro presents a bigger size of outstanding portfolio than all the peer groups excepted the ECA (Eastern Europe and Central Asia) Large Financial Intermediaries (FI)
- CredAgro's outreach in depth is better than ECA medium MFIs focussing on SME and than ECA Large FI.
- CredAgro presents the lowest portfolio at risk ratio bigger than 30 days
- CredAgro profitability, after financial adjustments, is still lower when compared to large institutions (both FI and non FI)
- CredAgro financial leverage is the highest among non FI institutions.
- CredAgro operating expense ratio is by far the lowest among the compared groups. Trend has been very positive if considering that in 2005 operating expense ratio was 11.5%
- As for productivity it is evident that CredAgro still has margins for improvement.

¹ The MBB adjusts the financial data to produce a common treatment for the effect of: a) inflation, b) subsidies, and c) loan loss provisioning and write-off (see *MBB*, Appendix I: Notes to Adjustments and Statistical Issues).

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1. External Environment and CredAgro positioning

Institutional background

CredAgro is a **Non-Banking Credit Organization** which was established in May **2000** as a limited liability company in the framework of the **Azeri Rural Credit project** supported by ACDI/VOCA. **ACDI/VOCA, channeling the USAID donations**, has been constantly sustaining the development of CredAgro, providing technical assistance for the capacity building, granting US\$ 3 million as loan capital and supporting the operating expenses of the institution over time. In 2005 USAID granted the ownership of CredAgro to ACDI/VOCA, which is currently the sole owner of the organization. Through a branch network covering more than 27 rayons of Azerbaijan, CredAgro targets the **upper end of the rural market**, partially **overlapping** with the **banks** which are **downscaling** their operations. Sustained by its impressive growth and confident in consolidated relationships with international investors, CredAgro is considering the opportunity to transform into a bank.

Political and macroeconomic context

The **political situation is stable** with Ilham Aliyev expected to remain in control of the political scene over the next period and winning a second term of office in October 2008. However, there is little prospect of a resolution of the conflict with Armenia over the disputed region of Nagorny Karabakh within the next future, as peace negotiations are likely to stall at least until elections in both countries are over (Azerbaijan and Armenia will each hold a presidential election in 2008).

Sovereign risk²

Azerbaijan	Foreign currency		Domestic currency	Rating Outlook
	Short term	Long term	Long term	
MOODY'S	P-2	Baa2	Ba2	Stable
S&P	na	na	na	na
Fitch	B	BB+	BB+	Stable

The macro-economic environment is positive and economic growth is rapid, mainly due to the booming oil sector and the development of the hydrocarbons industry, which have attracted huge foreign direct investment lasting recent years and leading to **robust growth in monetary aggregates**.

Azerbaijan

Macroeconomic Indicators	Dec04	Dec05	Dec06	Dec07
<i>Exchange rate in USD (end of period)</i>	0.98	0.92	0.87	0.85
<i>Exchange rate variation</i>	-0.4%	-6.3%	-5.1%	-3.0%
<i>Inflation rate (end of period)</i>	10.4%	7.4%	11.5%	19.7%
<i>Inflation rate (average of the period)</i>	6.7%	11.9%	8.3%	15.0%
<i>Deposit rate</i>	9.2%	8.5%	10.7%	11.4%
<i>Lending rate</i>	15.7%	17.0%	17.9%	19.2%
<i>Real GDP growth</i>	10.2%	24.3%	31.0%*	29.2%*
<i>GDP per head (USD)</i>	1,023	1,532	2,399	3,652

Source: International Finance Statistics, EIU. * Estimation

Real GDP growth has accelerated from 10.2% in 2004 to 31.0% in 2006, while base-period effects will result in a steady deceleration in real GDP growth from an

estimated 29.2% in 2007 to around 10.5% in 2009. GDP per head has tripled in 2007 compared to 2004.

Nevertheless, large inflows of oil export revenue, rapid credit growth and a comparatively loose fiscal policy have kept **year-on-year inflation in double digits** for more than a year, and this is expected to remain stable at least until the second half of 2009, although it should decelerate

² **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).

gradually from an estimated average annual rate of just over 15% in 2007 to around 10.5% in 2009.

Foreign-currency inflows from oil exports will **strengthen the Manat in both nominal and real effective terms in 2008-09**. The NBA will attempt to sterilise foreign-currency inflows through the sale of T-bills and the use of Azerbaijan's overseas oil fund, SOFAZ. However, the amount of short-term paper involved will be small. Azerbaijan's rate of inflation will remain high compared with the rates recorded by its trading partners. This will help to produce a real effective appreciation of the Manat of around 40% between the end of 2006 and the end of 2009.

Microfinance sector

As of December 2007 the **AMFA (Azerbaijan Micro-Finance Association) presents 24 microfinance institutions** out of which 8 represent downscaling commercial banks and 16 non-bank credit organizations. The combined portfolio³ is worth US\$ 384,140,533, reaching around 255,000 clients. These figures, compared to the data of December 2005 – total portfolio of US\$ 73 millions and 70,000 active clients - demonstrate the **rapid growth of the sector** and how it is becoming **increasingly competitive**.

The leading actor - with an outstanding portfolio worth US\$ 115 million - remains the **Microfinance Bank of Azerbaijan (MFBA)**, which has shown an impressive growth during the last years, passing from 5,724 active clients as of the end of 2005 to 46,653 clients as of December 2007, while the loan portfolio has correspondently increased by more than 5 times during the same period. The second actor, but the first in terms of number of clients reached, with 74,262 active clients as of December 2007, is **FINCA** while **CredAgro** is the third MFI by portfolio size, presenting an outstanding portfolio of US\$ 32 million and 8,595 clients.

The remaining market share is divided among smaller **MFIs, largely managed by international humanitarian organizations**, targeting micro and smaller enterprises in multiple regions of Azerbaijan.

Although the target market remains different for certain aspects, competition with commercial banks is rapidly increasing, especially in certain regions. Among the main banks offering microcredit services are **Bank of Baku, International Bank, Ata Bank and Bank Respublika**. Some are partner-banks of the GAF (German Azerbaijan Fund), a fund established in 2000 by the German Bank of Development (KfW) for the support of Azeri small and medium sized enterprises.

The role of the 30 **Credit Unions** operating in the country is limited both in terms of total number of clients and active portfolio. Moreover, their development as effective financial intermediaries is unlikely unless the legislation changes and allows them to collect deposits.

Finally, the possible **claim of the Azeri government** on the use and ownership of the capital granted to MFIs **does not raise further concern**, as soon as USAID has undertaken the asset disposition in favour of ACDI/VOCA, which has become the formal owner of the donated funds. This means that the government will not hinder the opening to equity investors, nor CredAgro will be asked to pay social and profit taxes retroactively.

Regulation and supervision

No considerable changes have occurred in the legal framework since the last rating. The **draft of Microfinance Law submitted by the National Bank to the Parliament is still under discussion**, but is likely to be approved by autumn 2008. Further important step will be constituted by the improvement of the regulatory and supervisory framework. This will entail drafting implementing regulations, establishing reporting requirements and training NBA staff for effective on-site and off-site supervision of MFIs.

The approval of the Microfinance Law will bring about a specially tailored legal framework, which triggers the introduction of dedicated prudential norms and a closer supervision performed by the National Bank over the organizations that will acquire a full for-profit status thus being allowed to collect savings (subject to specific requirements).

Supervision is carried out by the National Bank through reports (financial statements and portfolio classification) which MFIs are asked to submit quarterly.

³ The combined portfolio refers to AMFA members and non-members providing microfinance services.

According to the current regulation, all MFIs have to be legally registered as limited liability companies (LLC) and are required to pay profit taxes since 2005. However, thanks to their social orientation, they are currently **exempted by decree from paying social taxes**. Microfinance Institutions are not allowed to collect savings, unless they transform into banks.

CredAgro does not currently participate in the Credit Register (credit bureau set up by the National Bank of Azerbaijan in 2005), which is mainly including whose operations are concentrated in Baku. The Credit Register still presents inefficiencies and limited involvement of financial institutions, and given the increasing competition, this could represent a risk for potential clients' over-indebtedness. However, the MFI does not even systematically exchange information about clients with the credit organizations operating in the same areas. Given the increasing competition, this **represents a risk of over-indebtedness of clients** for the future.

CredAgro's market positioning

Supported by a 222% growth rate registered during the last year, CredAgro **has strengthened its positioning in the market**, by expanding its areas of operations through the opening of four new branches located in Ganja, Shaki, Mingachevir and Barda rayons. At the same time, it has **widened its product offer while loosening some loan conditions** in order to be able to cope with fierce competition by correspondently adapting financial services to the demand of its target clientele. In this regard, CredAgro has actually rolled out the Express loan, a relatively short term and easily accessible loan, which is essentially designated for small businesses and consumption, whereas the maximum credit amount has been increased up to the 2% of the institutional equity. CredAgro is still attending the **upper segment** of the **rural** market of microfinance, although the portfolio allocation has quickly changed. In fact, the share of loan portfolio dedicated to the agricultural sector is decreasing in terms of percentage, while trade and consumer loans are progressively acquiring importance within CredAgro's market strategy. At the moment, the strongest competition is coming from the different banks operating respectively in the areas where CredAgro's branches are located. Some of them are pursuing **unfair competition** by issuing business loans in the name of consumer loans, in order to speed up loan procedures.

Main competitors, figures as of December 2007

Institution	Outstanding portfolio (US\$)	Products	Loan size (US\$)	Loan maturity	Interest rate	Active clients
CredAgro	32,281,102	individual	200 - 2% of equity	up to 48 months	25% - 36% annually	8,595
Agrar Credit	18,412,600	group and individual	1,000 - 100,000	up to 7 years	7% - 24% annually	2,825
FINCA	44,284,022	group and individual	50 - 30,000	up to 24 months	2.5% - 3.7% monthly	74,262
MFBA	114,537,415	individual	100 - 200,000	up to 36 months	1.5% - 3% monthly	46,653

On the other side, among the main non-banking competitors of CredAgro, there are **Agrar Credit**, providing agricultural loans and **Finca**, especially in the southern region.

As soon as banks are downscaling operations and progressively penetrating the microfinance sector, the fact that CredAgro operates through banks may represent **a risk of leaking valuable information to the competition**. In this regard, CredAgro is considering the possibility to shift to the cash system through the regional offices of the National Bank. Currently, branches endowed with security systems may keep cash up to AZN 1 million which confers CredAgro a certain margin of cash operations.

Commercial **banks are becoming quite aggressive in attracting MFIs' human resources** and this represents a relevant risk also for CredAgro.

The main **competitive advantages** of CredAgro's remains the following ones:

- Expertise in rural finance
- Transparency of operations
- Access not only for companies, but also for physical persons, to the leasing products

Nevertheless, the access to fresh resources has minimized the main **competitive disadvantages** observed during the last rating visit, while the cost of the services, however, has increased, being on average higher than the one charged by banks. Moreover, the time required for loan processing is longer in comparison to banks.

2. Governance and operational structure

Ownership and Governance

CredAgro is 100% owned by **ACDI/VOCA**, a US non-profit corporation, and it is incorporated in Azerbaijan as a limited liability company. Nevertheless, the future opportunity for CredAgro to transform into a bank has raised the need to **review the ownership issue** and opens to different solutions. In this regard, CredAgro may consider to re-register as a joint stock company in order to be able to apply for the banking license. At the same time, ACDI/VOCA is taking into consideration the possibility to create a commercial fund acting as financial arm, to which transferring the ownership of CredAgro in the next future. In this process, the institution will gradually open to equity investors with the aim at keeping a sound financial leverage while feeding its planned growth. In case of difficulties during the transformation process, CredAgro takes into consideration the option to merge with a local bank.

Since the last rating visit, the **Supervisory Board** of CredAgro has reduced in size due to the exit of Azer Humbatov. This has definitely weakened the governance structure as current BoD members do not present banking nor specific auditing and financial expertise, that represents a crucial lack in view of the future evolution of the institution. Out of the 3 members, the Chairman is resident abroad, what may complicate the communication flow. During the last year, board meetings took place 3 times versus four times foreseen by the internal procedures: however the quorum was met just twice.

In general, CredAgro presents a **weak governance**, characterized by a Supervisory Board which currently appears undersized in terms of number of members and lacking of more technical financial skills. Moreover, current Supervisory Board members are very busy people with quite limited possibilities to adequately participate to the supervisory and strategic role of the board. In this crucial and delicate transition phase that foresees the introduction of equity investors, these shortcomings may result particularly relevant. In this situation, the CEO plays an even more determinant role in the decision making process.

The Supervisory Board is still not organized into committees, nor it can count on an approved governance written manual.

Supervisory Board

Members	Charge	Background and current profession
Fred Smith	Chairman	Vice President for ACDI/VOCA in the Europe & Asia Division. Specialized in micro- small- and medium-sized enterprise (MSME) development with extensive experience in the design and implementation of technical assistance programs supporting MSME, micro and rural credit, and business development services.
Gulnara Hasanova	Member	General Manager of Aqua-Vita - TAJ company, a leading water production and distribution company in Azerbaijan. Currently enrolled in an MBA program with the Open University Business School of London. She holds a Master of Education degree.
Elchin Mammadov	Member	Resident Director of the Baku Office of Ledingham Chalmers law firm providing advisory services on all aspects of Azeri commercial law with emphasis in banking and finance, oil and gas, taxation and investment.

The **relationship between the ownership and the top management** has improved over the last year, and has come to a clear definition of the respective roles with a resolution of the issue on the growing commercial nature of CredAgro. ACDI/VOCA is currently supporting the transformation strategy of the institution with future possibilities to be a major shareholder of CredAgro within the framework of the fund creation.

Organisation and structure

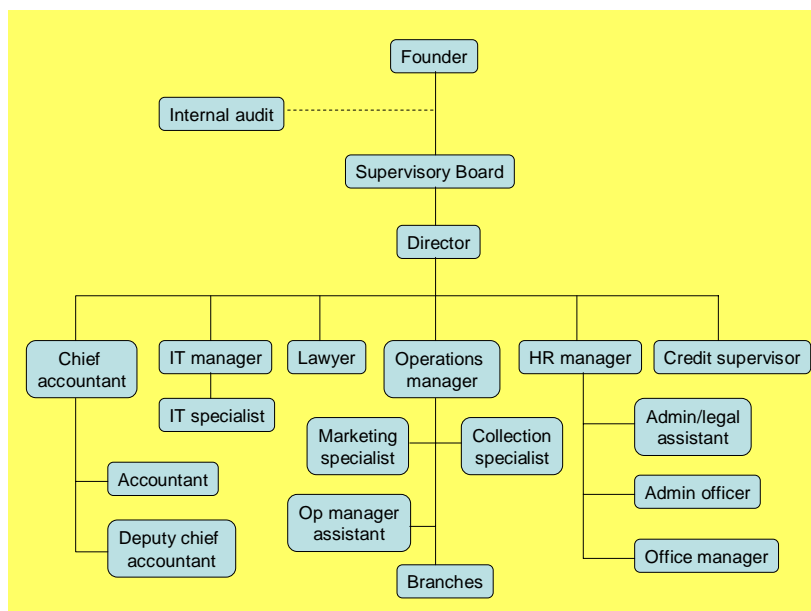
As part of the on-going decentralization process, CredAgro **organizational structure is rapidly expanding**, together with the branch network. According to the institutional strategy, two new branches will be opened within the current year. At the moment, CredAgro serves more than 27 rayons of Azerbaijan operating through 12 branches and 7 sub-offices. The branches and sub-offices are located in Absheron peninsula covering neighbouring districts, in the south – Jalilabad, Masalli branches with Lankaran and Bilasuvar sub-offices, in the west – Zagatala, Ismayilli and Tovuz branches with Goy-Chay, Qabala and Agstafa sub-offices, in the north – Khachmaz and Guba.

The objective is to progressively delegate responsibilities and decision-making power to branches until treating them as independent costs centres in order to improve their costs management capacity. To this purpose, CredAgro has **reviewed the loan approval levels** for the different credit committees, increasing the maximum amount that can be approved at the branch, regional and central levels⁴. Branches prepare monthly financial statements and the budget, but do not analyse profitability.

Since the last rating visit, CredAgro's **organizational chart has been strengthened** through the introduction of new key positions, like the IT manager and the credit supervisor, dedicated to inform directly the CEO on the sound functioning of the branches, which also includes the audit of the collaterals and the inspection on the final use of the loans. In addition, 6 branches have been endowed with a lawyer in charge of checking credit contracts and following the recovery of past due loans for the first two months after the due date. CredAgro's plan foresees the employment of a lawyer for each branch. Nevertheless, along with the growth of the institution and its leverage, a **specific financial manager position is still missing** and would be required in order to concentrate financial tasks and responsibility and develop more sophisticated financial management tools to soundly manage growth.

Human Resources

As of December 2007, CredAgro counts a total of 139 staff, out of whom 57 are loan officers. The staff allocation ratio (41%) has improved over the last year, reflecting the higher decentralization level reached by the institution. Given the aggressive



Personnel	Dec04	Dec05	Dec06	Dec07
Total	49	53	68	139
Loan officers	14	15	19	57
Other staff	35	38	49	82

⁴ Branches approve loans up to US\$ 5,000, the regional credit committee approves loans up to US\$ 20,000, the central credit committee approves loans bigger than US\$ 20,000. The Supervisory Council approves all loans exceeding 1% of the equity.

expansion strategy, CredAgro plans to hire 100 new staff within the current year; out of whom 3 people will be employed at the HQs level. The idea is to further strengthen the **management team**, which is **currently understaffed** in order to be able to manage the transformation process.

CredAgro's **management committee** is mostly coming from internal promotion and includes, besides the Director, the Operation Manager, the Chief Accountant, the HR Manager, the IT Manager and the Lawyer. Staff is generally adequately qualified and properly selected thanks to an **effective recruitment process** which is structured into different stages and interviews. Nevertheless, the HR department is facing some problems with prompt recruitment of staff, which may take around one month to hire new personnel with negative consequences on daily and planned operations. The difficulty is strongly linked to the specific context of the country with regard to the microfinance sector, which is characterized by scarcity of qualified staff and consequent **competition on human resources**. In comparison to previous years, however, the staff turnover ratio (7.9% during 2007) has improved. This may be the result of systematic staff satisfaction appraisals which are conducted by the HR manager in the branches, through individual interviews. During these visits, the manager also assesses the management of staff and the working environment. Anyway, **staff retention problems** may arise from the lack of formal career paths, which currently are comprehended in a draft version. Furthermore, a **succession plan is missing**, which clearly sets out the factors to be taken into account and the process to be followed in relation to retaining or replacing key persons. This planning, finalized to the identification and preparation of suitable employees through mentoring, training and job rotation, is becoming crucial, given the growth of the institution.

A good and systematic **evaluation system** of the staff is in place, which has been implemented at different levels with the purpose of defining training needs and salary levels. **Training** are accordingly scheduled on the basis of the results from yearly needs' analysis. Adequately projected training expenses are included into the budget. At the local level, CredAgro benefits from the membership of AMFA, which provides different training opportunities for its members, while some staff attended also external trainings organized by the Azerbaijani Banking Training Centre (ABTC).

In comparison to the last rating visit, efforts have been done in order to address the remuneration issue, by realizing adjustments to the **salary levels**. A preliminary survey on compensation levels has been conducted, although there is still room for improvement in order to fully adapt salaries to the market. The **incentive scheme has been recently revised and seems to be quite effective**.

Internal control and operational risk management

The **Internal Audit** department, which includes an Internal Auditor and an Internal Auditor officer, is independent from the management as it reports directly to the Supervisory Board on a quarterly basis. Over the last year it has consolidated its operations, following an annual plan, which scheduled two audits per branch and to the HQs. Audits are carefully undertaken and are adequate to the size of the institution. Nevertheless, along with the growth of CredAgro and the opening of new branches, the work load for the department may be unsustainable, requiring the employment of new staff.

From the **operational control** point of view, the new position of Credit Supervisor is supporting the on-going decentralization process, which requires a stronger control system. In this regard, the presence of a lawyer in each branch dedicated to the legal aspects of the credit procedures is a further factor of strength. At the branch level, with reference to the internal control system, a weak point is represented by the fact that bank statements are not sent to the HQs, with the result that double check is not performed. Also some lack of formalization of daily controls performed by the branch managers (especially concerning accounting and liquidity) has been noticed at branch level.

Accounting and external audit

Over the period of analysis (2005, 2006 and 2007) CredAgro's financial statements were **audited by Baker Tilly** and, as of December 2007, the auditors expressed an unqualified opinion on CredAgro's financial statements.

CredAgro's accounting policies and reporting **fully comply with IAS and International Financial Reporting Standards.**

Management Information System

CredAgro has made **significant improvements and investments** in this area with the aim at supporting the institutional growth with an adequate MIS while complying with the National Bank requirements in order to apply for the banking license. The current MIS called **ABS RS Bank** is a modular system composed of different core modules which are integrated to each other. In particular there are the loan tracking system, RS-Loans, the accounting module: RS-Retail covering retail banking and the RS-Incounting dealing with human resources, salary and fixed assets and finally the Deposit module referring to the liability side of the institution: deposits and borrowings. This last component has been developed 3 months ago only for what are the borrowings concerned. The MIS is permanently on-line and allows on-time information in all branches through ordinary internet connection. It is thought to easily manage operations of a middle-sized banking institution.

During the last year the IT department has been successful in designing macros finalized to fix errors at the data-entry stage. All main errors and bugs have been removed through patch-files and portfolio **data are** at the moment **fully reliable**. In addition, **limitations to access rights** and **stricter control procedures** have been implemented.

For what the portfolio and financial reporting is concerned, a higher level of flexibility has been achieved. The MIS currently allows the production of automatic and upon-request reports which fit the operational and managerial needs of an institution of this size. A weakness is represented by the fact that the MIS is not currently including a specific automatic reporting function for liquidity management (see also Chapter 5).

The **security system** in place is **excellent**, with adequate back-up policies and a very good energy power safe system. Moreover, regional offices and HQs are endowed with power diesel-generators. A disaster recovery system is in place. Further investments are planned for the current year in order to install an intranet system (VPM connection) which permits the connection in sub-offices where there is no internet access.

3. Lending operations

Financial products

Driven by increasing competitive pressure and supported by clients' feedbacks, CredAgro has **revised its range of products and the different loan conditions**. In 2007 the institution rolled out the Express loan which has been subsequently re-adapted to the demand of the target clientele. Its nature is similar to an emergency loan, usually conceived as support to the business. The small loan amount, the relatively short term and the higher accessibility level⁵ are compensated by a higher cost of the service (35.16% is the average interest rate calculated on an annual basis).

Credit methodology

	Credit products							
	Livestock	Crop	Trade	Processing	Other	Consumer	Leasing	Express
<i>Credit methodologies</i>	Individual	Individual	Individual	Individual	Individual	Individual	Individual	Individual
<i>Currency of the credit</i>	AZN/US\$	AZN/US\$	AZN/US\$	AZN/US\$	AZN/US\$	AZN/US\$	AZN	AZN/US\$
<i>Type of interest</i>	Declining balance	Declining balance	Declining balance	Declining balance	Declining balance	Declining balance	Declining balance	Declining balance
<i>Min. interest rate (%)</i>	26%	26%	25%	25%	25%	26%	25%	34%
<i>Max. interest rate (%)</i>	28%	28%	30%	30%	30%	36%	26%	36%
<i>Average interest rate (%)</i>	25.70%	25.83%	26.42%	26.10%	26.35%	33.25%	24.83%	35.16%
<i>Description of commissions</i>	1%	1%	1%	1%	1%	1%	1%	1%
<i>Min. credit amount (US\$)</i>	500	500	500	500	500	200	500	500
<i>Max. credit amount (US\$)</i>	2% of equity	2% of equity	2% of equity	2% of equity	2% of equity	50,000	2% of equity	5,000
<i>Max credit amount for the first loan (US\$)</i>	1% of equity	1% of equity	1% of equity	1% of equity	1% of equity	50,000	1% of equity	5,000
<i>Average credit amount (US\$)</i>	6,502	5,013	12,124	15,762	9,503	1,212	14,593	2,675
<i>Min. loan maturity (months)</i>	3	3	3	3	3	3	3	3
<i>Max. loan maturity (months)</i>	36	36	36	36	36	30	48	18
<i>Average loan maturity (months)</i>	19.5	19.5	19.5	19.5	19.5	13.5	25.5	10.5
<i>Periodicity of interests payments</i>	monthly	monthly	monthly	monthly	monthly	monthly	monthly	monthly
<i>Periodicity of principal payments</i>	according to cash flow	according to cash flow	according to cash flow	according to cash flow	according to cash flow	monthly	monthly/ according to cash flow	monthly/ according to cash flow
<i>Grace period (months)</i>	6 months	6 months	6 months	6 months	6 months	–	6 months	6 months
<i>Collaterals / guarantees</i>	real collateral	real collateral	real collateral	real collateral	real collateral	real collateral/ guarantee	real collateral	guarantee

With regard to other main changes introduced in the product offer, noteworthy is the **increase in the loan amount ceilings** with corresponding extension of the terms, which has involved all products. These adjustments reflect the general trend of the market and aim at increasing clients' retention rate through the satisfaction of upgraded clients' needs. At the same time, the **cost of the services has increased** twice during 2007, both in terms of commissions and interest rates. Nevertheless, the amount of rise is different for each product and generally reflects the demand of the market for that specific product and the related risk. In fact, the highest increases are observed in the consumption loan (8 point percentage) and in the crop loan (6 point percentage), whereas CredAgro has reduced the variability of the interest rate applied to the Leasing by establishing a smaller range (25% as the minimum interest rate and 26% as the maximum one). In future, CredAgro may think about a reduction of the financial cost, on the basis of banks' behaviours, in order not to lose competitiveness.

Given the liability structure of CredAgro, the amount of credit disbursed can be either in US\$ or in AZN depending on the request of the client and on the net open position limit of 25% of total

⁵ Only one guarantor is required, while loan officers analyses the repayment capacity of the client without producing cash flow statements in order to reduce loan processing time.

equity, determined by the management (50% according to ALM policy). Nevertheless, **the demand of AZN is rapidly increasing** among clients due to the depreciation of US\$, pushing CredAgro to break the position limit from time to time. This increases the overall risk exposure of CredAgro.

Lending procedures

CredAgro can rely on a **consolidated credit appraisal** process which is based on the **5C system**⁶; the estimated capacity to repay takes into account the projected cash flow of the business and of the family, including other financial obligations⁷. A business plan is prepared for each activity. Moreover, the applicant is required to fund at least 20% of the working capital or investment over the project's full repayment cycle. In case of Express loans, loan officers do not need to produce cash flow statements in order to speed up the disbursement process.

Compared to the last year, CredAgro did not succeed in reducing the loan processing time for collateralized business loans, which still lasts **two or three weeks**, mainly due to the time necessary for the collateral registration. Nevertheless, the process is more rapid for consumer, express and leasing loans.

CredAgro policy allows **rescheduling** loans in case of financial difficulty for the client if the new conditions can increase the probability of repayment. The decision of restructuring loans is taken by the central credit committee, which can approve special provisions on the restructured portfolio (separately tracked in the MIS).

Both before and after the disbursement of the loan, the **monitoring** of the client is systematic and satisfactory, carried out by the loan officer each 3 months through on-site visits. Moreover, branch managers personally monitor around 15 clients on a monthly basis, usually the ones with the biggest loans.

The **follow up of late loans** is effective, based on rapid reaction and close monitoring. After two months of delay, the case is passed to the lawyer who starts with the court procedure. Usually in a 3-month period the court takes a decision; however the sale of the collateral requires 6-12 months period time. In 2007, CredAgro has taken to court 24 problematic cases.

Collaterals and accessibility

Except for the **Consumer** loan and for the **Express** loan, which can be backed in some cases⁸ by the sole **guarantor** (one guarantor for amounts up to US\$ 3,000, two guarantors for higher amounts), the **other products** always require real collaterals (**pledge or mortgage**). In order to increase accessibility, CredAgro has reduced in 2007 the coverage ratio secured by the value of the **collateral**. In particular:

- For first-time borrowers, collateral must be valued by appraisal (at liquidation values) at not less than 150% of the value of the loan amount.
- If the assets are fully insured and a loss payable endorsement to CredAgro is filed, the ratio will be not less than 130% of the value of the loan amount.
- For borrowers who have established an excellent CredAgro repayment record on repeat loans, the ratio will be not less than 110% of the value of the loan amount.

⁶ Character, capacity, capital, conditions, collateral

⁷ Depending on the size of the business, loans can be issued also to clients with other financial obligations.

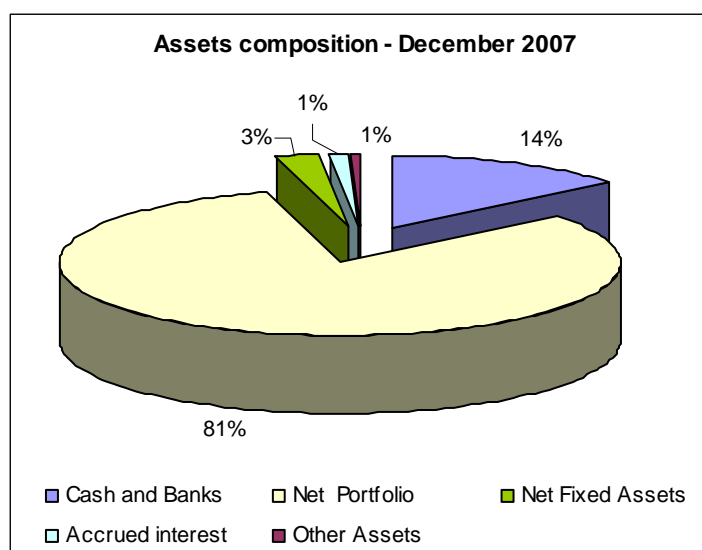
⁸ Depending on the 5C analysis of the loan officer, additional collateral may be required.

4. Assets structure and quality

Assets structure

As of December 2007, CredAgro's net portfolio represents 81% of the total assets maintaining a **good level of concentration of resources** in the core business.

Liquid assets in cash and banks are kept at an adequate level, 5,7% on average for the period January 2007-December 2007. The **much higher level of liquidity** at the end of the period (about 14%) **refers to the relevant amounts of borrowed funds received in November and December 2007** and not yet allocated in loan portfolio.



Portfolio structure

As of December 2007, CredAgro's outstanding portfolio stands at US\$ 32.4 million with 8,600 active borrowers. The biggest share of the credit portfolio is represented by trade loans and consumer loans: trade represents 44% of the total value and 11.6% of the total number of active clients, while consumer represents 28.6% of total value and 75.1% of total number of active clients. Compared to the previous rating, CredAgro's portfolio composition has significantly changed, with Consumer loan covering a big share of total outstanding portfolio. This shift may affect the compliance with the mission whose focus is to finance businesses in the rural areas.

Portfolio features	Jan05-Dec05	Jan06-Dec06	Jan07-Dec07
Gross outstanding portfolio (US\$)	5,258,421	9,765,546	32,403,863
Livestock	944,243	825,418	1,684,555
Crop	288,589	362,629	640,544
Trade	2,518,650	4,270,342	14,242,266
Processing	282,355	512,538	857,727
Other	764,550	1,125,889	2,495,654
Consumer	430,197	2,152,730	9,258,616
Leasing	0	254,705	1,810,153
Express	0	260,283	1,414,343
Gross outstanding portfolio (local currency)	4,830,386	8,509,697	27,390,985
Growth of active gross portfolio	28.7%	76.2%	221.9%
Average disbursed loan amount (US\$)	5,463	4,421	4,764
Av. disbursed loan size on per capita GDP	357%	184%	130%
Average maturity (months)	11	9	10
Number of active borrowers	1,287	2,822	8,596
% of active borrowers women	8.5%	21.5%	25.0%
Drop-out ratio	37.9%	36.8%	50.2%

CredAgro's portfolio **growth rate has been impressive for year 2007** (222% as for the value and 205% as for number of active borrowers) and it was already quite good in 2006. This is indeed the result of massive access to international (and national) commercial sources of funds and of the installed capacities to manage that evolution.

The **average disbursed loan size** has slightly increased since 2006 and **substantially reduced since 2005**, despite the relevant increase of inflation in the last two years. This is also reflected in the outreach in depth indicator (average disbursed loan size/GDP pro-capita) which, as of December 2007, is 130%, down from 357% in 2005. In that regard, a relevant raise of the GDP

per-capita has to be considered as well. The increased outreach in depth and reduced average loan size is mainly linked to the very rapid growth of consumer lending product within the portfolio of the institution.

Even if reduced compared to the previous rating, the level of the **drop-out ratio** is still high (50.2%) and there are clear margins of improvement in CredAgro's policies and procedures for the survey and management of clients' loyalty. A full-fledge systematic analysis and reporting, which includes the explanation of the reasons behind clientele drop-out and consequent strategies to be adopted, is still missing at CredAgro.

December 2007

Loan product	% of outst. portfolio	% of number of active clients	PAR >30 days	PAR > 30 weighted	PAR >1 day	PAR > 1 weighted
<i>Livestock</i>	5.2%	2.5%	0.7%	0.04%	2.2%	0.1%
<i>Crop</i>	2.0%	1.3%	3.5%	0.07%	5.7%	0.1%
<i>Trade</i>	44.0%	11.6%	0.7%	0.29%	2.7%	1.2%
<i>Processing</i>	2.6%	0.5%	3.1%	0.08%	3.1%	0.1%
<i>Other</i>	7.7%	2.6%	1.3%	0.10%	6.2%	0.5%
<i>Consumer</i>	28.6%	75.1%	0.5%	0.14%	2.5%	0.7%
<i>Leasing</i>	5.6%	1.2%	0.1%	0.01%	4.7%	0.3%
<i>Express</i>	4.4%	5.2%	0.3%	0.01%	4.0%	0.2%
TOTAL	100.0%			0.7%		3.1%

As for the breakdown of the portfolio by sector, **the share of agricultural portfolio** (livestock plus

December 2007

By amount (US\$)	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR > 30 weighted
<i>0-3,500</i>	6,731,781	20.8%	72.6%	0.2%	0.0%
<i>3,501-10,000</i>	7,351,607	22.7%	18.3%	1.1%	0.2%
<i>10,001 - 20,000</i>	4,916,337	15.2%	4.4%	0.9%	0.1%
<i>20,001-30,000</i>	4,082,539	12.6%	2.2%	0.6%	0.1%
<i>30,001+</i>	9,321,598	28.8%	2.6%	0.8%	0.2%
TOTAL	32,403,862	100%	100%		0.7%

crop), whose higher risk is also reflected by the higher level of PAR, has decreased from the previous rating (from 19.6% as of May 2006 to 7.2% as of December 2007), mainly compensated by the growth of the share in consumer lending.

In terms of portfolio structure by credit amount, as of December 2007, 55% of the outstanding portfolio is composed of loans bigger than US\$ 10,000 (it was 45%

Branch	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR > 30 weighted
<i>Absheron</i>	5,433,611	16.8%	7.7%	1.8%	0.3%
<i>Ismayilli</i>	2,571,320	7.9%	11.6%	1.1%	0.1%
<i>Jalilabad</i>	3,450,936	10.6%	10.9%	0.5%	0.1%
<i>Masalli</i>	5,453,781	16.8%	15.1%	0.2%	0.0%
<i>Guba</i>	2,661,978	8.2%	8.4%	1.1%	0.1%
<i>Khacmaz</i>	3,672,578	11.3%	15.6%	0.5%	0.1%
<i>Tovuz</i>	3,874,898	12.0%	9.9%	0.9%	0.1%
<i>Mingachevir</i>	128,660	0.4%	0.1%	0.0%	0.0%
<i>Zagatala</i>	2,423,659	7.5%	15.3%	0.1%	0.0%
<i>Ganja</i>	1,548,856	4.8%	3.5%	0.0%	0.0%
<i>Sheki</i>	1,183,585	3.7%	1.8%	0.0%	0.0%
<i>Barda</i>	0	0.0%	0.0%	0.0%	0.0%
TOTAL	32,403,862	100%	100.0%		0.7%

as of May 2006), and 28.8% of portfolio consists of loans bigger than US\$ 30,000. Such a structure is showing **CredAgro’s growing focus on targeting SMEs** which is much more evident than other MFIs in Azerbaijan. The augmented concentration of outstanding portfolio into bigger loans (one third into the > US\$ 30,000 loan category) is increasing the exposure of the institution to portfolio quality risks.

Portfolio distribution among CredAgro’s branches does not show any particular problem of concentration, as no branch reaches a share bigger than 20% of total outstanding portfolio neither out of the total number of active borrowers.

Loan portfolio quality

CredAgro **portfolio quality has been maintained at very good levels**, with a consolidated PAR30 of 0,7%, no write-off and a restructured portfolio of 0,2% as of December 2007.

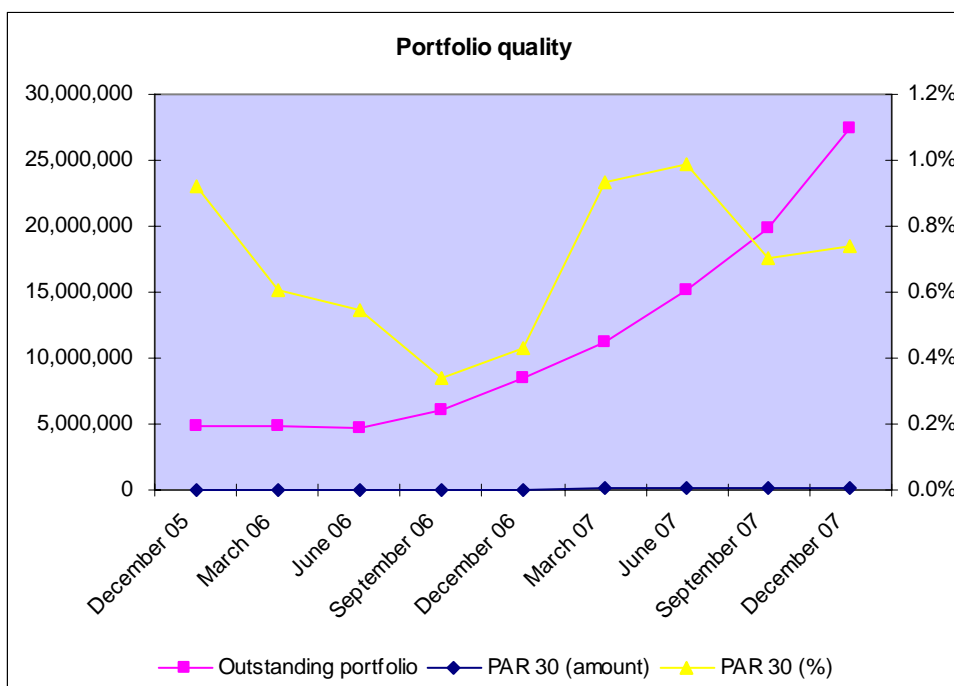
Despite the very strong growth in the last year and a half, PAR30 has never been higher than 1%.

Portfolio Quality Indicators	Jan05-Dec05	Jan06-Dec06	Jan07-Dec07
Consolidated PAR30	0.7%	0.4%	0.7%
31-60	0.3%	0.0%	0.2%
61-90	0.1%	0.1%	0.1%
91-180	0.0%	0.2%	0.2%
181-365	0.3%	0.1%	0.2%
>365	0.0%	0.0%	0.0%
Arrears rate (> 1 day)	0.8%	0.3%	0.4%
Restructured portfolio	0.0%	0.0%	0.2%
Provision expense ratio	0.4%	1.0%	1.7%
Loan loss reserve ratio	1.2%	1.3%	1.4%
Risk coverage ratio (30 days)	167.3%	303.5%	186.8%
Write off ratio	0.2%	0.1%	0.0%

nd = no disponible

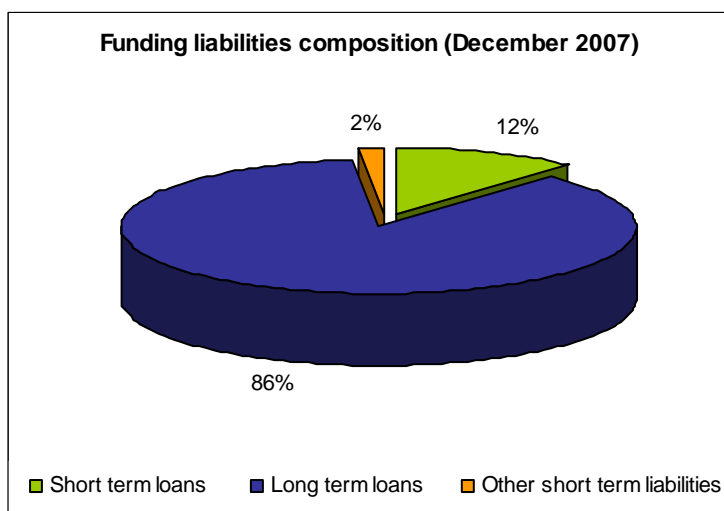
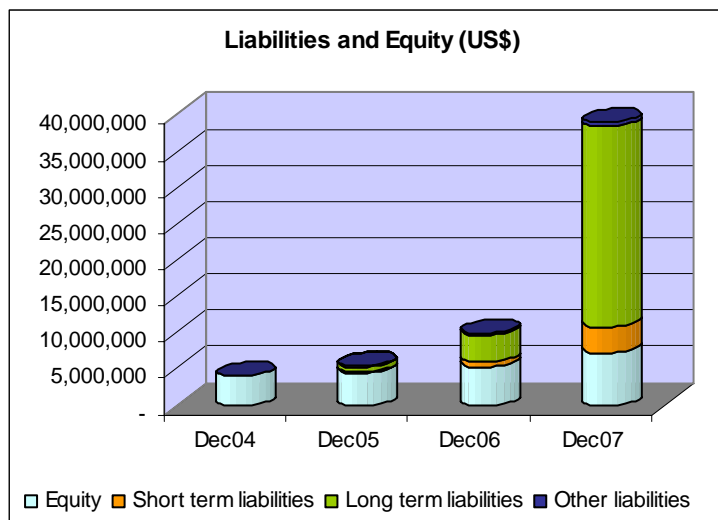
Risk coverage is at sound levels being almost 190% as of December 2007. Moreover, considering that a significant part of the portfolio is backed by collaterals, the risk of loan losses is well managed.

The portfolio breakdown analysis shows that **there is no relevant concentration of credit risk** in any particular category: by branch, Absheron presents the highest PAR30, which is 1.8% (bit only 0.3% if weighted); by product/sector, crop has the biggest risk in absolute terms (also turning very low when the PAR30 is weighted) and by loan size, the category US\$ 3,500-10,000 has the highest PAR30, even if it is only 1.1% (0.2% if weighted).



5. Financial structure and ALM

CredAgro’s financial structure, as of December 2007, presents a strong increasing of the financial leverage given the wide access to several international (mainly) commercial borrowings, started in 2005 but impressively increased in 2006 and 2007. Between 2006 and 2007 the **debt to equity ratio** has increased more than four times, reaching, as of December 2007, up to 4.44. Nevertheless, if considering the effects of the **hedging mechanism against currency risk** (back to back mechanism agreed with the local bank Texnika Bank, see below), the debt to equity ratio is 3.7, which is an acceptable level, also considering the institutional evolution perspectives and the likely enhancement of the level of equity.



CredAgro’s business and financial plan for the period 2008-2010 show a reduction of the debt to equity ratio below 3 by 2010.

Liabilities and equity structure

As of December 2007, the total value of CredAgro funding liabilities is worth of US\$ 31.3 million, of which the majority are long term commercial loans (more than 80% of the total funding liabilities), which are mainly coming from a **variety of international investors** and from a local bank (Texnika Banka).

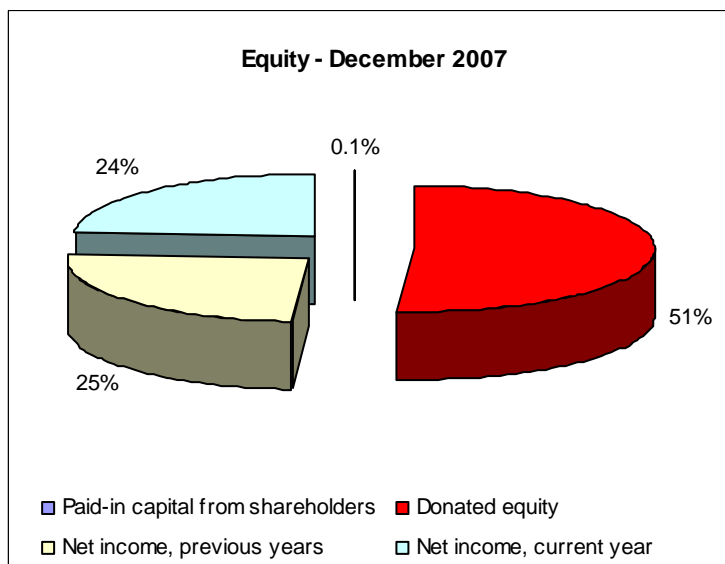
CredAgro has demonstrated high capacity to attract international funding resources and to develop good and

long-standing relationships with international and national stakeholders.

This has also been facilitated by the institutional support provided by its founder and owner, ACIDI-VOCA.

As for local financial partners, a **tight relationship has been developed, in the last years, with Texnika Bank**, both for the treasury management and for other services (back to back currency hedging system, overdraft). Diversification of local financial partners could be improved by CredAgro in order to have alternatives in case of problems and to keep a more neutral image positioning respect to the banking system.

As of December 2007, **total equity**, is about **US\$ 7.2 million**, half of it



resulting from the grants for loan capital received, along the years, by ACDI/VOCA. The accumulated retained earnings already represent half of the equity value.

CredAgro is aware about the need of increasing its **capitalization** level in order to keep sustaining the ambitious growth path undertaken and its **strategy** is to access, in the short and medium run, to equity or quasi-equity. According to the conservative scenario of the financial modeling, CredAgro foresees to reach more than US\$ 10 million of total equity by the end of 2008 and up to US\$ 50 million by the end of 2010. However, should CredAgro's strategy to transform into a commercial bank be confirmed after application to the National Bank, the capital strategy will be adapted to the needs identified within the new bank's business plan and to the newly introduced capital standards by the National Bank of Azerbaijan (minimum capital for a commercial bank is fixed to 10 million AZN). The institution is strongly oriented to have a property structure which include, beside ACDI/VOCA, a big international investor, a big local investor (i.e. a local bank) and reserve some shares to staff as well.

Assets and Liabilities Management

In the last two years, CredAgro has improved its ALM policies and tools, also thanks to some specialized consulting (i.e ABTC). This is mainly true for **foreign exchange risk management**, given the hedging mechanism agreed with Texnika Bank which is based on a back to back system bearing quite good conditions (the net cost of the back to back is about 1,5% over the hedged amounts). As for **liquidity management, this is improvable in terms of automation of monitoring and reporting** (the MIS is not currently including a specific automatic reporting function on liquidity). An ALCO normally meets every month and includes the top management plus one member of the Supervisory Board. Nevertheless the Supervisory Board member with finance skills, that used to participate to the ALCO, has recently left the Board (see Chapter 2) and has not been replaced so far.

Even if liquidity/maturity risk monitoring and management at CredAgro is still quite basic (i.e. no maturity gap analysis is been conducted), the institution does not currently present a liquidity risk in any of the aging categories. Moreover the current ratio is maintained at adequate levels (3.7 as of December 2007) although it registers a clearly decreasing trend (it was 10.5 as of December 2006).

Amounts in AZN

December 07	30 days or less	31 to 90 days	91 to 180 days	181 to 365 days	1 to 5 years	Other	Total
Total assets	865,003	400,027	1,220,710	7,068,702	22,097,966	1,391,069	33,043,477
Cash and banks	791,365						791,365
Investments					3,849,486		3,849,486
Outstanding portfolio	73,638	400,027	1,220,710	7,068,702	18,248,480		27,011,557
Net fixed assets						878,580	878,580
Other assets						512,489	512,489
Total liabilities	0	481,821	1,056,625	1,608,887	23,343,151	481,520	26,972,004
Deposits							0
Loans		481,821	1,056,625	1,608,887	23,343,151		26,490,484
Other liabilities						481,520	481,520
Net position	865,003	-81,794	164,085	5,459,815	-1,245,185	909,549	6,071,473
Cumulative liquidity risk	865,003	783,209	947,294	6,407,109	5,161,924	6,071,473	

CredAgro **does not present, for the moment, a relevant exposure to interest rate risk** given that all the borrowed funds except the ones from EBRD (representing 15% of total funding liabilities as of December 2007) bear fixed interest rates. Moreover CredAgro would be formally allowed (according to the contracts signed with borrowers) to redefine the interest rates during the loan life (even if this has never occurred). The institution is liabilities-sensitive for aging category 31-90 days and assets-sensitive for all the remaining time brackets. If market interest rates fall, this would have a negative impact on CredAgro's net interest income in all the assets-sensitive categories and a positive impact in the liabilities-sensitive categories.

A more detailed and systematic monitoring of the maturity structure by aging categories (gap analysis) would allow the institution to more appropriately monitor the financial risks such as liquidity risk and interest rate risk.

December 2007

US\$	US\$*	Euro	Other currencies	Local currency	Total
Assets	24,923,000	0	0	14,167,828	39,090,828
Cash and banks	871,730			65,647	937,377
Financial assets	4,553,988				4,553,988
Portfolio	19,252,134			12,702,891	31,955,025
Fixed assets				1,039,371	1,039,371
Other assets	245,148			359,918	605,067
Liabilities	26,674,952	0	0	5,233,251	31,908,203
Deposits					-
Loans	26,280,000			5,058,559	31,338,559
Other liabilities	394,952			174,692	569,644
NET POSITION	-1,751,952	0	0	8,934,577	7,182,625

* Exchange rate AZN/US\$: 0.85

Concerning **foreign exchange risk**, CredAgro still presents, as of December 2007, a negative net position in US\$ of about US\$ 1.7 million, that is about 24% of total equity, which is much lower than May 2006 (when it was worth US\$ 3.9 million, being 82% of total equity). This is because the institution has increased the liabilities denominated in US\$ and has reduced the percentage of the loan portfolio denominated in US\$ (also thanks to the back to back mechanism introduced), representing now 61% of the total outstanding portfolio against 87% as of May 2006. This trend has also led to eliminate foreign exchange losses in 2007.

6. Financial and operational results

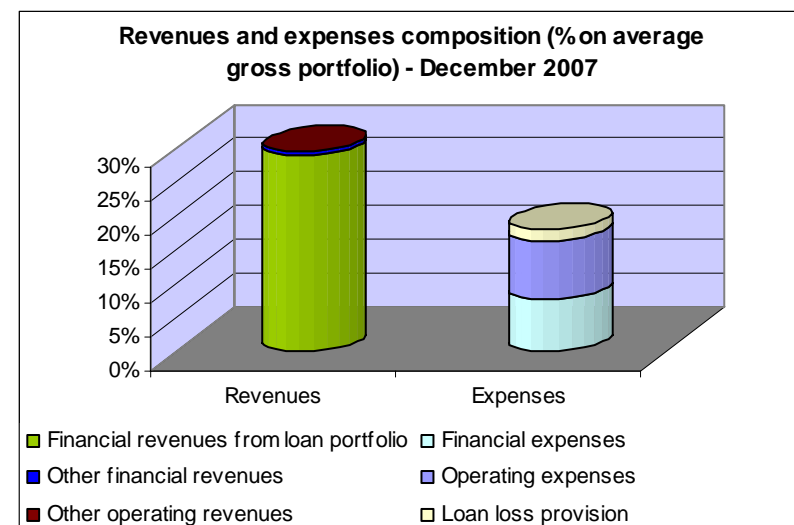
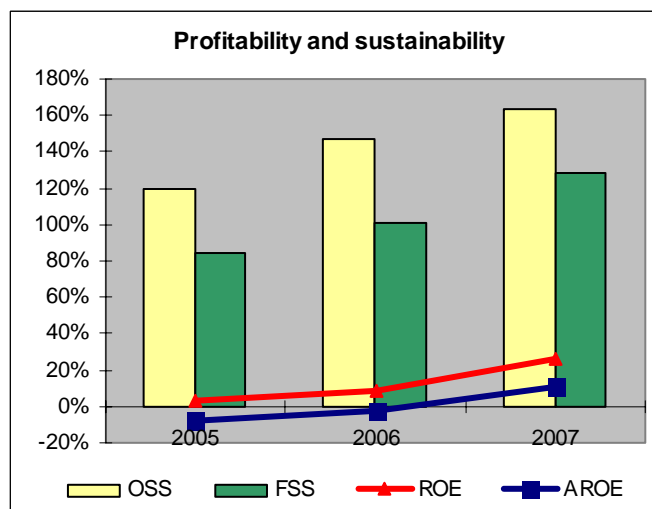
The analysis of the financial performance of CredAgro is based on the audited financial statements for years 2005, 2006 and 2007.

CredAgro shows a **positive trend of profitability and sustainability** and as of December 2007, ROE has reached 26.2% up from 8% in 2006 and 3.5% in 2005. ROA, as of December 2007, is 8.1%, being 5.8% in December 2006 and 3.2% in 2005. OSS has raised from 119% in 2005 to 164% in December 2007.

Adjusted indicators have evolved from negative to positive values, as AROE shifts from -3.9% in 2006 to 8.2% in 2007 and AROA from -2.5% to 2.1%. **FSS has been clearly consolidated**, currently reaching a level well above 100% (122.4% as of December 2007).

This is despite a relevant raise of the inflation rate especially in 2007, and the consequent financial adjustment.

The main reasons of the positive trend in profitability are the higher portfolio yield (29% as of



December 2007, up from 22.3% as of December 2005), linked to the **increase of active interest rates and of loan commissions** defined by the institution in 2007, and the **improvement of efficiency**, clearly reflected by the reduction of the operating expense ratio from 11.5% in 2005 to 8.8% as of December 2007. The average effective interest rate has increased also because of the relevant growth, as a percentage of the portfolio, of the consumer and express loans which are more expensive.

As for efficiency, CredAgro has started benefiting from economies of scale as the size of its gross outstanding portfolio has grown more than six times since December 2005. The rather low operating expense ratio is the expression of the **excellent level of efficiency** reached by CredAgro.

Financial Indicators	Jan05-Dec05	Jan06-Dec06	Jan07-Dec07
Operating expenses ratio (aver. gross portf.)	11.5%	10.4%	8.8%
Staff allocation ratio	31.9%	27.9%	41.0%
Loan officer productivity (borrowers)	86	149	151
Loan officer productivity (US\$)	350,561	513,976	568,489
Branch productivity (US\$)	876,404	1,627,591	2,700,322
Cost per loan lent	411	258	194
Cost per borrower	427	337	291
Funding expense ratio	0.2%	2.7%	7.6%
Provision expense ratio	0.5%	1.0%	1.7%
Portfolio yield (gross portfolio)	22.3%	25.5%	29.0%

Productivity has also **clearly improved since 2005**, both in terms of number of active borrowers per loan officer and of cost per loan lent and cost per borrower.

The increase of **funding expense** ratio, from 0.2% in 2005 to 7.6% for the period January 2007-December 2007, reflects the wide access to commercial sources of funds of CredAgro and the relatively high cost of the back-to-back scheme. Given the even wider future access to commercial funds by CredAgro, the incidence of funding expenses will keep growing

Overall, CredAgro has demonstrated its capacity to perform an impressive growth while maintaining high quality standards. This has allowed the institution to greatly benefit from economies of scale which are compensating the necessary increase of financial costs. The good market positioning and product diversification have permitted to increase yields leading to a consolidation of institutional profitability. The current **wide margins** are putting the institution in the condition to adequately face possible future downward pressures on market interest rates due to increasing competition.

7. Strategic objectives and financial needs

Strategic objectives and strategies

The business plan available and analyzed during the previous rating exercise was covering the period 2007-2009, and it has been updated with a new version covering the period 2008-2010.

The goals stated within the business plan have been so far fulfilled with respect to both the quantitative projections and the qualitative objectives. In the first case plans for portfolio growth, portfolio quality, as well as profitability, efficiency and productivity, have all been fulfilled. CredAgro has also achieved the planned goals related to structural expansion, product diversification, operating system (and MIS especially) improvement.

The **business plan 2008-2010** includes financial projections (developed in Microfin) according to a conservative and aggressive scenario. The table below is showing the evolution of the main financial items according to the **conservative scenario**. Credit portfolio is projected to grow at a pace of 50% to 60% a year and to reach more than AZN 100 million (AZN 125 million for the aggressive scenario) and about twenty thousand active clients by 2010. Debt to equity is planned to gradually reduce below 3, this meaning the attraction of equity investors (and subordinated debts) while keeping accessing to borrowed funds at commercial rates. As for profitability, net income projected for 2008 is worth AZN 2.6 million up from AZN 1.4 million obtained as of December 2007.

Projected key financial indicators	2007 (actual)	2008	2009	2010
<i>Net portfolio (AZN)</i>	27,011,559	43,091,838	69,104,315	105,787,092
<i>Growth of portfolio</i>	221.9%	59.5%	60.4%	53.1%
<i>Number of active clients</i>	8,596	11,213	17,324	21,193
<i>Clients drop-out ratio</i>	50.2%	57.0%	50.0%	50.0%
<i>Total equity (AZN)</i>	6,075,496	10,693,636	20,537,458	40,044,235
<i>Debt to equity ratio</i>	4.44	4.77	3.86	2.97
<i>Operating expense ratio</i>	8.8%	10.0%	9.3%	7.8%

Overall the financial projections for the period 2008-2010 appear to be adequate and consistent with the last evolutions and with the institution's capabilities.

The most important declared strategic objective of CredAgro for the next years is the **transformation into a bank**. The management is working on an alternative business plan for banking transformation to be presented to the central bank jointly with the application for the banking license. For that purpose, has contracted a consultant from the Azerbaijan Banks Training Center (ABTC) in order to undertake a feasibility study, a valuation of CredAgro and to provide support on the new business plan. ACDIVOCA and some international stakeholders, like EBRD, KfW, IFC, DWM, among others, have expressed their interest to be involved, as equity investors, within CredAgro's transformation process into a bank.

Given the evolution, the operational context and the market positioning of CredAgro, the evolution into a bank appears to be a correct strategy for the consolidation of the institution in the coming years.

Financial needs

Overall the **funding strategy of CredAgro has been very effective** so far and has led to a strong growth. CredAgro will keep accessing commercial debt from the main microfinance investors (i.e. BlueOrchard, DWM, OikoCredit, Symbiotics, GMF, MicroVest, etc) even if it will also have to rise equity or quasi-equity in order to maintain and reduce the financial leverage ratio.

8. Details of the risk factors

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

AREA	Risk factors	Relevance*	Main measures implemented and/or to implement in the short term	Observations
External environment	<i>Increasing competition from banks</i>	Medium	CredAgro institutional strategy is to proceed to a transformation into commercial banks and the feasibility study and business plan preparation have already been started	Direct competition on the same target (consumer loans, SME loans) and on human resources (stealing staff). Risk of leaking valuable information through clients' bank accounts
	<i>Still lack of MF law</i>	Medium-low	The transformation into commercial bank will sort this out	Uncertainties related to humanitarian status of CredAgro and to the process of transformation into commercial bank
	<i>High inflation and unexpected cost</i>	Medium	–	Unexpected increase in operating expenses due to loss of purchasing power and monopoly of Ministry of Extraordinary Affairs in certain areas
	<i>Lack of a credit bureau for microfinance institutions</i>	Medium-low	Good credit appraisal process which mitigates risk of overindebtedness	CredAgro is not participating to the banks Credit Register because banks credit portfolios are highly concentrated in Baku while the bulk of CredAgro's operations is in the regions
Governance, management and operations	<i>Weak Supervisory Board</i>	Medium-high	Potential new board members have been interviewed and CredAgro expects to have two additional board members in place in April 2008	The Board is currently undersized (just 3 members); lacking of financial professional expertise (especially for internal audit) and members of the board are busy people. Lack of governance written policies and formalized methodology of CEO evaluation
	<i>Improvable HR policy</i>	Medium	–	Lack of succession plan. Not in-depth and systematic salary survey. Especially in view of the employment of 100 new staff
	<i>Lack of finance manager position</i>	Medium	CredAgro's short term strategy envisages to strengthen the finance department with the introduction of a treasurer/ALM officer	A Chief Accountant position is covering some of the typical financial manager functions. The increasing complexity of CredAgro liability side requires a dedicated manager position
	<i>Improvable internal control procedures at branch level</i>	Medium-low	–	Some lack of formalisation of daily controls and responsibilities (daily cash and accounting controls performed by the branch managers are not formalized in a written and signed declaration)
	<i>Improvable liquidity management tools</i>	Medium	The IT department is working for the development of a liquidity management module	A liquidity management module is not integrated in the MIS and liquidity/cash-flow monitoring is held through an Excel sheet)
	<i>Lack of reconciliation report (internal vs audited financial statements)</i>	Medium-low	–	Control over accounting items reclassification and reconciliation with auditors reports is improvable

* 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.

AREA	Risk factors	Relevance*	Main measures implemented and/or to implement in the short term	Observations
<i>Financial products and asset quality</i>	<i>Lack of cash handling</i>	Medium	The transformation into commercial bank would eliminate such a risk	CredAgro is not currently issuing loans in cash directly to clients, but through the banks. Given the growing competition from banks, the institution is exposed to the risk given by direct contacts between CredAgro's clients and the banks
	<i>High drop-out ratio and improvable drop out survey</i>	Medium	-	Drop-out ratio is still high (50.2% as for 2007). Drop-out ratio is constantly calculated and monitored even if a more complete and detailed reporting on the reasons of clients' drop-out and on the strategies to be put in place is missing
	<i>Portfolio concentration into bigger loans</i>	Low	Older clients have graduated to bigger loans	28.8% of outstanding portfolio is composed of loans bigger than US\$ 30,000
<i>Financial structure and ALM</i>	<i>Improvable diversification of local financial partnerships</i>	Medium-low	CredAgro is also working, mainly for treasury management, with other local banks depending on availability of branches. It is also starting to access to other financial services (i.e. credit lines) from alternative banks	CredAgro mainly works with one local bank (Texnica Bank) as for treasury and other financial services (i.e. back-to-back, overdraft, etc). Diversification of local financial partners could be improved by CredAgro in order to have alternatives in case of problems and to keep a more neutral image positioning respect to the banking system.
<i>Financial and operational results</i>	<i>Improvable productivity</i>	Medium-low	Since 2005 the trend has been clearly positive	Number of active borrowers per loan officer could still be increased especially if considering the reduction of average disbursed loan size since 2005

* 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

CredAgro			
Balance sheet (US\$)	Dec05	Dec06	Dec07
ASSETS			
<i>Cash and bank deposits</i>	125,492	83,502	5,490,180
<i>Short term financial assets</i>	-	-	-
<i>Net outstanding portfolio</i>	5,192,862	9,638,643	31,954,997
<i>Gross outstanding portfolio</i>	5,258,421	9,765,546	32,403,863
<i>Performing portfolio</i>	5,219,229	9,723,729	32,163,511
<i>Portfolio at risk > 30 days</i>	39,192	41,817	240,351
<i>(Loan loss reserve)</i>	65,559	126,903	448,865
<i>Accrued interest</i>	41,583	86,484	378,380
<i>Other short term assets</i>	9,560	28,627	227,900
Total short term assets	5,369,496	9,837,257	38,051,457
<i>Long term financial assets</i>	-	-	-
<i>Net fixed assets</i>	131,111	207,942	1,039,369
<i>Other long term assets</i>	-	-	-
Total long term assets	131,111	207,942	1,039,369
Total assets	5,500,607	10,045,199	39,090,827
LIABILITIES and EQUITY			
LIABILITIES			
<i>Sight deposits</i>	-	-	-
<i>Short time deposits</i>	-	-	-
<i>Short term loans</i>	20,030	720,000	3,723,333
<i>Other short term liabilities</i>	87,055	197,377	564,883
Total short term liabilities	107,086	917,377	4,288,216
<i>Long term time deposits</i>	-	-	-
<i>Long term loans</i>	800,000	3,780,000	27,615,227
<i>Other long term liabilities</i>	-	55,119	-
<i>Restricted funds</i>	-	-	-
Total Long term liabilities	800,000	3,835,119	27,615,227
Total liabilities	907,086	4,752,496	31,903,443
EQUITY			
<i>Paid-in capital from shareholders</i>	4,924	5,190	5,351
<i>Donated equity</i>	3,368,938	3,551,418	3,661,074
<i>Quasi-capital</i>	-	-	-
<i>Reserves</i>	-	-	-
<i>Total retained earnings</i>	1,219,660	1,736,095	3,520,959
<i>Other equity accounts</i>	-	-	-
Total equity	4,593,521	5,292,704	7,187,384
Total liabilities and equity	5,500,607	10,045,200	39,090,827

CredAgro			
Income Statement (US\$)	Jan05-Dec05	Jan06-Dec06	Jan07-Dec07
<i>Interest & commissions received on loans</i>	968,059	1,695,522	5,479,584
<i>Financial revenue from investment</i>	-	-	53,801
<i>Other financial revenues</i>	-	-	51,565
A) Financial revenue	968,059	1,695,522	5,584,950
<i>Interest paid on borrowings</i>	7,189	177,856	1,427,403
<i>Interest paid on savings</i>	-	-	-
<i>Interest paid on mortgage</i>	-	-	-
<i>Other financial expenses</i>	287,279	220,679	8,877
<i>Inflation adjustment</i>	-	-	-
B) Financial expenses	294,468	398,536	1,436,280
Gross financial margin (A - B)	673,591	1,296,986	4,148,670
<i>Loan loss provision</i>	20,773	65,124	319,757
Net financial margin	652,818	1,231,863	3,828,912
<i>Other operating revenue</i>	8,746	3,361	16,326
<i>Personnel expenses</i>	306,139	396,657	1,097,188
<i>Administrative expenses</i>	197,133	295,274	563,970
C) Operating expenses	503,272	691,931	1,661,158
Net operating income	158,292	543,292	2,184,080
<i>Extraordinary revenue</i>	-	-	-
<i>Extraordinary expense</i>	-	-	-
Net income before donations, before tax	158,292	543,292	2,184,080
<i>Taxes</i>	949	134,020	509,516
Net income before donations	157,343	409,272	1,674,563
<i>Donations in cash</i>	53,635	41,097	51,945
<i>Revenue not from the operations</i>	-	-	-
<i>Expenses not from the operations</i>	-	-	-
Net income	210,978	450,370	1,726,508

Annex 2 - Financial statements adjustments

The financial statements in Annex 1 are the result of **standard reclassification**. They are expressed in US\$, using the exchange rates published by IFS (International Financial Statistics). The figures are based on audited financial statements for the three period analyzed.

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 with market conditions. The main adjustments normally are:

- adjustment for the accrued interest on delinquent loans
- elimination of subsidies (donations in kind⁹ and soft loans¹⁰)
- provisions are calculated with a standard formula¹¹
- adjustments for inflation
- adjustments for write-off¹²

The financial adjustments applied to CredAgro refer to **inflation** and **subsidized cost of funds**. Given the sudden raise of inflation in 2007, the relative adjustment for the last periods is quite relevant, affecting the adjusted net income and therefore the adjusted profitability ratios and FSS ratio.

The cumulative effect of the adjustments reduces the net income in all the periods.

Adjustments (US\$)	Jan05-Dec05	Jan06-Dec06	Jan07-Dec07
Reversal of accrued interest on non-perf loans	-	-	-
Subsidized cost of fund adjustment	21,604	45,377	191,665
- Interest rate used (national currency)	12.8%	13.4%	14.4%
- Interest rate used (foreign currency)	7.0%	8.3%	8.1%
Inflation adjustment	333,617	563,008	966,508
- Inflation rate used	7.4%	11.5%	16.8%
Loan loss provision adjustment	-	-	-
In-kind subsidy adjustment	-	-	-
Total variation of net income	355,220	608,386	1,158,173

⁹ Donations in kind are valorized and added to operational expenses.

¹⁰ 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 EUR), it is considered the average value of LIBOR 1 year plus 3%.

¹¹ Provisions are calculated according to the following formula:

Portfolio:	1-30 days	10%	Restructured loans	0-30 days	50%
	31-60 days	30%		> 30 days	100%
	61-90 days	50%			
	>90 days	100%			

¹² Loans past due more than 180 days are written-off.

Annex 3 - Financial ratios

CredAgro (US\$)	Jan05-Dec05	Jan06-Dec06	Jan07-Dec07
PROFITABILITY			
<i>Return on Equity (ROE)</i>	3.5%	8.1%	26.2%
<i>Adjusted Return on Equity (AROE)</i>	-8.1%	-3.9%	8.2%
<i>Return on Assets (ROA)</i>	3.2%	5.8%	8.1%
<i>Adjusted Return on Assets (AROA)</i>	-7.3%	-2.5%	2.1%
<i>Operational self-sufficiency (OSS)</i>	119.3%	147.0%	163.9%
<i>Financial self-sufficiency (FSS)</i>	73.0%	96.3%	122.4%
<i>Profit Margin</i>	16.2%	32.0%	39.0%
LOAN PORTFOLIO QUALITY			
<i>Portfolio at risk (PAR30)</i>	0.7%	0.4%	0.7%
<i>Arrears rate (> 1 day)</i>	0.8%	0.3%	0.4%
<i>Restructured loans</i>	0.0%	0.0%	0.2%
<i>Provision expense ratio</i>	0.5%	1.0%	1.7%
<i>Loan loss reserve ratio</i>	1.2%	1.3%	1.4%
<i>Risk coverage ratio (30 days)</i>	167.3%	303.5%	186.8%
<i>Write-off ratio</i>	0.2%	0.1%	0.0%
<i>Adjusted write-off ratio</i>	0.5%	0.3%	0.4%
EFFICIENCY AND PRODUCTIVITY			
<i>Staff allocation ratio</i>	31.9%	27.9%	41.0%
<i>Loan officer productivity (borrowers)</i>	86	149	151
<i>Loan officer productivity (amount)</i>	350,561	513,976	568,489
<i>Staff productivity (borrowers)</i>	24	42	62
<i>Staff productivity (amount)</i>	111,881	143,611	233,121
<i>Branch productivity (amount)</i>	876,404	1,627,591	2,700,322
<i>Operating expenses ratio (average gross portf.)</i>	11.5%	10.4%	8.8%
<i>Cost per loan lent</i>	411	258	194
<i>Cost per borrower</i>	427	337	291
<i>Personnel expenses ratio (average gross portf.)</i>	7.0%	6.0%	5.8%
<i>Admin. expenses ratio (average gross portfolio)</i>	4.5%	4.4%	3.0%
ASSETS/LIABILITIES MANAGEMENT			
<i>Portfolio yield (gross portfolio)</i>	22.3%	25.5%	29.0%
<i>Funding expense ratio*</i>	0.2%	2.7%	7.6%
<i>Cost of funds ratio*</i>	1.8%	6.6%	7.9%
<i>Current ratio</i>	9.64	10.53	3.69
<i>Liquidity over total assets</i>	2.3%	0.8%	14.0%
<i>Debt/equity ratio</i>	0.20	0.90	4.44
<i>Equity multiplier</i>	1.2	1.9	5.4
<i>Capital adequacy ratio</i>	83.5%	52.7%	18.4%

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

OUTREACH

<i>Average disbursed loan size</i>	5,476	4,421	4,764
<i>Average outstanding balance</i>	4,086	3,461	3,770
<i>Average disbursed loan size on per-capita GDP</i>	357.5%	184.3%	130.5%
<i>Percentage of active borrowers women</i>	8.5%	21.5%	25.0%

GROWTH (amount in national currency)

<i>Growth of active gross portfolio</i>	28.7%	76.2%	221.9%
<i>Growth of active borrowers</i>	20.3%	119.3%	204.6%
<i>Growth of active loans</i>	20.3%	119.3%	204.6%
<i>Growth of total assets</i>	24.7%	73.2%	277.5%
<i>Growth of staff</i>	8.2%	28.3%	104.4%
<i>Growth of funding liabilities</i>	0.0%	420.6%	575.6%
<i>Growth of equity</i>	4.4%	9.3%	31.7%

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/ 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
	Drop-out ratio	(Number of clients at the beginning of the period + Number of new clients - Number of clients at the end of the period) / Number of clients at the beginning of the period
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 (gross portfolio)	Interest income from portfolio / Average gross or net portfolio
	Cost of fund ratio	Interest expenses on funding liabilities / Period average funding liabilities
	Funding expense ratio	Interests and fee expenses on funding liabilities / Average gross portfolio
	Current ratio	Short term assets / Short term liabilities
	Debt/Equity ratio	Liabilities / 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 liabilities: Liabilities 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).

Annex 5 - Guidelines of reporting and accounting

Financial statements

CredAgro does not provide non-financial services; its financial statements reflect exclusively the results of its financial activities. Financial statements are audited by a local company (Baker Tilly).

Loan loss provision and write-offs

CredAgro sets the loan loss reserve on monthly basis, as the sum of fixed percentages of the portfolio categories shown in the table.

Portfolio classification	% provision
Satisfactory loans	1%
Watch loans	10%
Unsatisfactory loans	30%
Doubtful loans	60%
Loss loans	100%

The branches make a draft classification of portfolio based on quantitative and qualitative indicators, which is then confirmed by the Credit Committee and reviewed by the internal auditor.

The cost of the provision is recorded into the income statement and is cumulated into the loan loss reserve in the balance sheet.

CredAgro writes-off doubtful loans when they are late > 180 days after the approval of the SC.

CredAgro has been regularly writing off loans in the last years; however, the amounts written of in a 12 months period have never exceeded 0.2% of the average gross portfolio (2005), while it has been 0.1% in 2006 and 0.0% 2007.

Insider loans

The table shows the situation of the loans borrowed by the top management and the staff as of

December 2007

Insider loans (US\$)	Outstanding balance	Loan term	Interest rate	Collateral	PAR > 1 day
Board	–	–	–	–	–
Management	43,007	35 months	13%	–	0%
Staff	213,311	25 months	13%	–	0%

December 2007.

Donations

Donations for loan capital are put in balance sheet (equity), while donations for operating expenses are registered in income statement. As shown in the table below, between 2005 and 2007

Donations received (US\$)

Year	Amount	Destination	Source
2005	50,709	Grant loan capital	USAID through ACDIVOCA
	48,685	Investment (e.g. grant financing or donation of property, vehicles, computers)	USAID through ACDIVOCA
Sub-total	99,394		
2006	26,000	Direct grant for operating expenses, (e.g. management and training/TA costs)	ABAD
Sub-total	26,000		
2007	24,000	Direct grant for operating expenses, (e.g. management and training/TA costs)	ABAD
	20,167	Investment (e.g. grant financing or donation of property, vehicles, computers)	USAID through ACDIVOCA
	17,882	Direct grant for operating expenses, (e.g. management and training/TA costs)	EBRD
Sub-total	62,049		
TOTAL	187,443		

CredAgro received some donations from ACDI/VOCA USAID and from ABAD (USAID network).

Details of funding liability

December 2007

Loans borrowed					
Source	Currency (in which the loan is due)	Outstanding Balance (US\$)	Outstanding Balance Short term (US\$)	Outstanding Balance Long term (US\$)	Agreement, kind of product and collateral
REAAL Ieven	US\$	2,000,000	0	2,000,000	Loan agreement
Finetic microfinance	US\$	500,000	500,000	0	Loan agreement
Dual Return Fund	US\$	250,000	250,000	0	Loan agreement
Credit Suisse	US\$	500,000	500,000	0	Loan agreement
Oikocredit Fund	US\$	500,000	250,000	250,000	Loan agreement
Oikocredit Fund	US\$	480,000	240,000	240,000	Loan agreement
ASN Novib Funds	US\$	1,000,000	0	1,000,000	Loan agreement
GMF	US\$	4,000,000	0	4,000,000	Loan agreement
EBRD	US\$	800,000	400,000	400,000	Loan agreement
Dexia Micro Fund	US\$	1,000,000	0	1,000,000	Loan agreement
Dexia Micro Fund	US\$	1,000,000	0	1,000,000	Loan agreement
SICAV (lux)	US\$	1,000,000	1,000,000	0	Loan agreement
Blue Orchard Finance	US\$	2,000,000	0	2,000,000	Loan agreement
EBRD	US\$	3,000,000	0	3,000,000	Loan agreement
ASN Novib Funds	US\$	1,500,000	0	1,500,000	Loan agreement
DWM asset manad	US\$	4,000,000	0	4,000,000	Loan agreement
Sicav 2	US\$	1,000,000	333,333	666,667	Loan agreement
DWM	US\$	1,000,000	0	1,000,000	Loan agreement
Finetic microfinance	US\$	750,000	250,000	500,000	Loan agreement
Texnikabank	AZN	1,764,706	0	1,764,706	Loan agreement (back to back scheme)
Texnikabank	AZN	1,000,000	0	1,000,000	Loan agreement (back to back scheme)
Texnikabank	AZN	1,176,471	0	1,176,471	Loan agreement (back to back scheme)
Texnikabank	AZN	611,765	0	611,765	Loan agreement (back to back scheme)
Texnikabank	AZN	477,647	0	477,647	Loan agreement (back to back scheme)
TOTAL		31,310,588	3,723,333	27,587,255	

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.