

## FINCA Honduras – Honduras

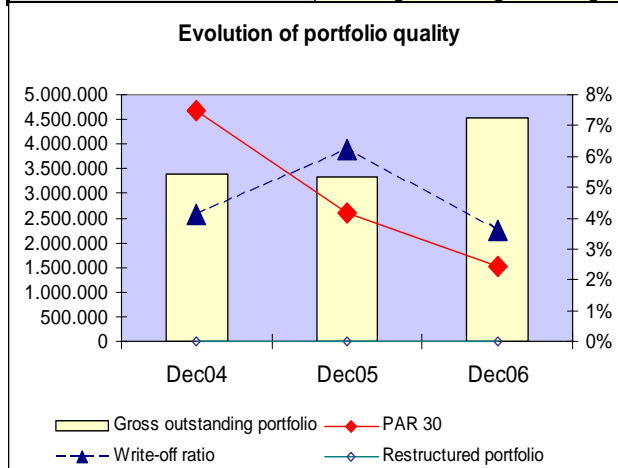
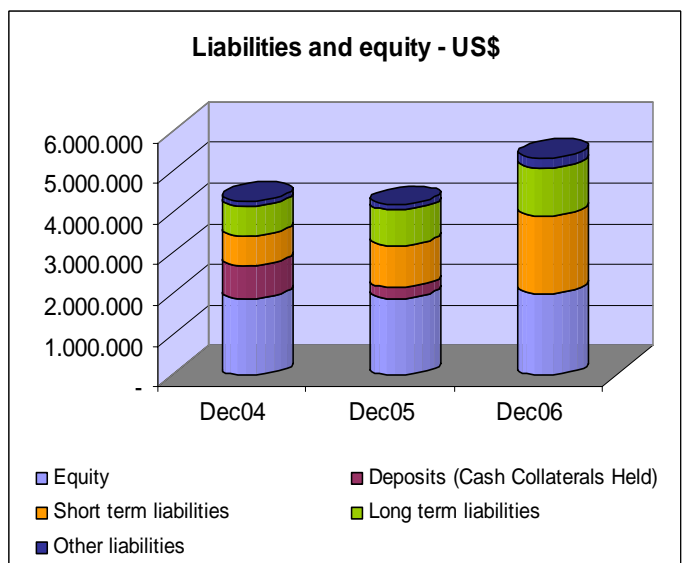
<b>Rating grade</b>	<b>BB</b>
<b>First rating</b>	Validity: 1 year if no relevant changes in operations or within the operational context will happen. The final rating does not consider the economic and/or political context.

FINCA Honduras is a non-profit Association created in 1990, specialized in microfinance and belonging to the FINCA International network. FINCA Honduras has 7 branches. Its main methodology is village banking for commercial activities in urban and rural areas, a product for which they are recognized at both the national and international level.

At the moment FINCA H. takes care of 16.084 borrowers and is part of REDMICROH, the national net of microfinance institutions in Honduras. It operates under the legal form of Private Organization of Development (OPD), which under Honduran legislation allows non-profit institutions to offer only credit services. FINCA Honduras has based its growth mainly on its equity and some local second tier banks (Fundación Coveloy y BCIE).

Number	Dec04	Dec05	Dec06
Active borrowers	16.938	14.581	16.084
Branches (hubs)	7	7	7
Total staff	126	107	104
Loan officers	80	56	54

<b>Legal Form</b>	Private Organization of Development (OPD)
<b>Starting Date</b>	1990
<b>Area of Activity</b>	Urban and Rural
<b>Credit Methodology</b>	Individual Lending, Group Lending and Village Banking



US\$	Dec06
Average disbursed loan size	317
Gross outstanding portfolio	4.526.134
Total assets	5.365.655

Financial Indicators	Dec04	Dec05	Dec06
PAR 30	7,5%	4,2%	2,4%
Write-off ratio	4,1%	6,2%	3,6%
Restructured loans	0,0%	0,0%	0,0%
ROE	6,1%	0,9%	5,5%
AROE	na	-8,9%	0,9%
Oper. Self-sufficiency (OSS)	105,8%	99,1%	103,8%
Fin. Self-sufficiency (FSS)	88,6%	90,2%	99,2%
Staff productivity (borrow.)	134	136	155
LO productivity (borrow.)	212	260	298
Operating expense ratio	42,0%	47,5%	45,8%
Funding expense ratio	3,6%	6,2%	7,9%
Provision expense ratio	6,7%	4,4%	3,4%
Portfolio yield - cash	52,8%	55,6%	58,3%
Risk coverage ratio	65,4%	77,3%	91,3%
Cost of funds ratio	6,4%	9,4%	12,7%
Debt/Equity ratio	1,3	1,3	1,7

na = no available

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The next table shows the main risk factors for the institution<sup>1</sup>

AREA	Risk factors	Relevance*
<b>External environment</b>	Strong competition in the market and uncertainty about a possible new entry of strong competitors	Medium
	Overindebtedness in the urban sector	Medium
<b>Governance, management and operations</b>	By-laws no updated and lack of a supporting code of rules	Medium-low
	High staff turnover	Low
	Delays in bank reconciliation	Medium
	Lack of a TI and MIS audit	Medium
	The MIS is not on line, weekly closing of consolidated accounts and some accounts don't square	Medium
<b>Financial products and asset quality</b>	Many documents to renew loans	Medium-low
	New mechanisms of collecting loans are slow and they are not entirely accepted by the staff of some branches	Medium-low
	High idle liquidity	Medium-low
	Portfolio quality to improve in 2 branches	Medium
<b>Financial structure and ALM</b>	Concentration in few commercial investors	Medium
	Limited treasury management	Medium
	Currency mismatch and currency risk	Medium-low
<b>Financial and operational results</b>	Low profitability and sustainability	Medium-high
	High operating expense ratio	Medium

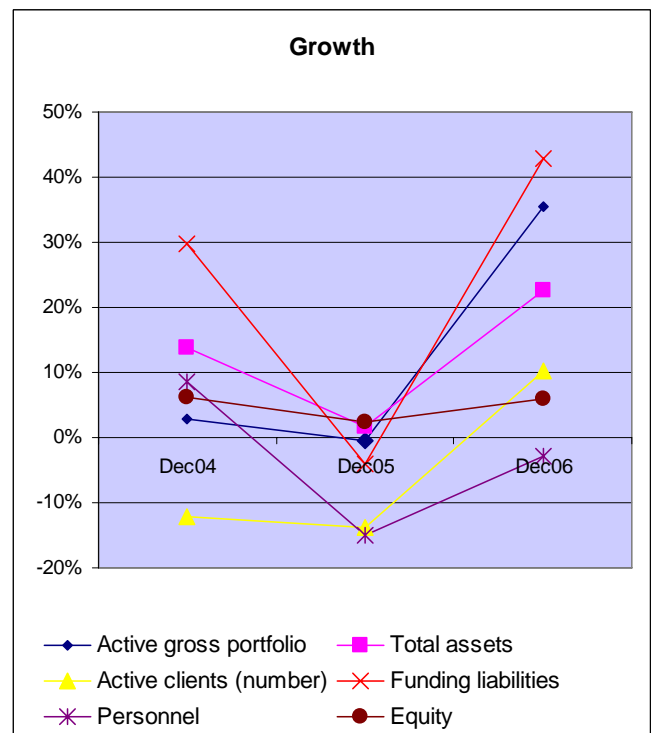
\* Relevance refers to the damage/loss brought about by negative events (associated to each risk factor) and to the probability that damage/loss eventually occurs.

<b>Strengths</b>
<ul style="list-style-type: none"> <li>▪ Strong Board of Directors and proactive in the support and monitoring of the management</li> <li>▪ Strong management team with a new institutional culture towards professionalism, efficiency and productivity</li> <li>▪ Leader in the Village Banking methodology</li> <li>▪ Good Internal Audit and internal control</li> <li>▪ Good portfolio quality</li> <li>▪ Member of FINCA International</li> </ul>

<b>Opportunities</b>
<ul style="list-style-type: none"> <li>▪ Transformation into a regulated institution and mobilization of saving deposits</li> <li>▪ New markets less saturated by the competition</li> <li>▪ Extension of the branch network</li> <li>▪ Access to new credit lines of international investors</li> </ul>

<sup>1</sup> See Chapter 8 for a detail with the “main measures adopted and/or will be adopted by the management” and our observations.

**● FINCA Honduras main branches**



**Final opinion**

Although in the last year there has been a positive trend of the indicators the most important risk factor for FINCA Honduras is related to the low levels of profitability and sustainability. In particular, the operating expense ratio is high. It is worthy to note that in 2006 much was invested to improve the credit process and the internal control structure. Until December 2005 FINCA Honduras had problems with productivity, image, portfolio quality and staff turnover. In January 2006 the CEO, was replaced with a new one, and since the new management the institution has strengthened its organizational structure. As of December 2006 the growth rate and the portfolio quality have improved demonstrating the new management’s approach to improving productivity, growth and achieving planned goals. Nevertheless, the portfolio quality can be improved in two areas. The institution presents a good equity structure situation and has room to improve its financial leverage. On the other hand there is a concentration in few commercial sources. The liquidity management, the bank reconciliations and the management information system present some weaknesses. Other risk factors are represented by an aggressively competitive market (and uncertainty represented by a possible entrance of new strong competitors). However it is important to mention the important support represented by Finca International.

## Benchmarking

All figures are referred to the MicroBanking Bulletin (MBB) database updated as of December 2005. FINCA Honduras 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<sup>2</sup>.

Financial Ratios	FINCA Honduras (Dic06)	FUNDAH MICRO (Dic06)	FINSOL (Sep06)	Fundación J. María Covelo (Mar06)	LA Medium	NGOs (FSS MFIs)	Village Banks (groups of ≥ 10 borrowers) (FSS MFIs)
<b>Gross Loan Portfolio</b> gross loan portfolio adj for standardised write-offs (US\$)	4.517.595	3.817.190	20.284.524	9.916.546	7.835.432	2.997.624	2.537.659
<b>Average loan balance per borrower / GNP per capita (%)</b>	23,7 **	31,0	96,7**	52 **	60,6	22,9	18,5
<b>Portfolio at Risk &gt; 30 Days</b> outstanding balance of loans overdue > 30 days / gross loan portfolio (%)	2,4%	4,7	4,8	4,8	5,3	2,1	2,3
<b>Adjusted Return on Equity AROE</b> adj net operating income after taxes / avg tot equity (%)	4,6%	47	14,5	7,7	5,3	4,1	2,3
<b>Debt/ Equity Ratio</b> adj.tot.liabilities/adj.tot.equity	1,6	3,7	2,1	1,4	3,0	1,4	1,3
<b>Operating Expense/ Loan Portfolio</b> (operating expense + In-Kind donations) / avg gross loan portfolio (%)	45,8%	33,0	16,6	27,5	11,5	29,1	38,4
<b>Borrowers per Loan Officer</b> n. of active borrowers / n. of loan officers	298	274	199	208	283	227	300

\* Fundación María Covelo (ratios as of Marzo 2006)      \*\* calculated on GDP per capita  
LA Medium, Latin America, Gross Loan Portfolio (US\$) 4 to 15 million

### Important issues of the benchmark

- The size of FINCA Honduras places it among the medium MFIs of Latin America;
- The AROE of FINCA Honduras is smaller than its competitors in Honduras and other peer groups;
- The portfolio at risk > 30 indicator is good and, in particular, is the best indicator compared to those of others MFIs in Honduras. On the other side it is in line respect to other peers groups considered in the *benchmarking*. It is worth noting that FINCA Honduras has a limited write-off ratio and it has not restructured loans;
- The operating expense ratio is the worst indicator compared to the peer groups; this indicates the need for improved institutional efficiency. Otherwise, the productivity per loan officer is better than other MFIs in Honduras and it is in line with the peer groups that represent the Village Banking methodology (methodology of FINCA). Finally, FINCA Honduras has the best outreach in depth in the *benchmarking*.
- The debt/equity ratio is in line with most of the peer groups and indicates that FINCA Honduras has a good level of equity and room for better financial leverage.

<sup>2</sup> 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).

## INDEX

<b>1. External environment and FINCA Honduras positioning.....</b>	<b>6</b>
Institutional Background.....	6
Macroeconomic and politic context.....	6
The microfinance sector.....	7
Regulation and Supervision.....	7
Market Positioning of FINCA Honduras.....	8
<b>2. Governance and organizational structure.....</b>	<b>9</b>
Ownership and governance.....	9
Management.....	10
Human Resources and Staff Policy.....	10
Organizational structure.....	11
Risk management and internal control structure.....	12
Accounting policies and procedures and external audit.....	12
Information Technology (IT) and Management Information System (MIS).....	12
<b>3. Financial Products.....</b>	<b>14</b>
Credit policies.....	14
Credit procedures.....	14
Guarantee policies.....	14
Savings policies.....	15
Other financial services.....	15
<b>4. Assets structure and quality.....</b>	<b>16</b>
Assets structure.....	16
Portfolio structure.....	16
Portfolio quality.....	17
<b>5. Financial structure and management.....</b>	<b>20</b>
Debt financing and savings mobilization.....	20
Assets and liability management.....	20
<b>6. Financial and operational results.....</b>	<b>22</b>
<b>7. Business plan and financial needs.....</b>	<b>24</b>
Strategic plan and operational plan.....	24
Financial projections.....	24
Financial needs and financing plan.....	24
<b>8. Details of the risk factors.....</b>	<b>25</b>
<b>Annex 1 – Financial statements.....</b>	<b>27</b>
<b>Annex 2 – Financial statements adjustments.....</b>	<b>29</b>
<b>Annex 3 – Financial Ratios.....</b>	<b>30</b>
<b>Annex 4 – Definition of ratios.....</b>	<b>32</b>
<b>Annex 5 – Guidelines for reporting and accounting.....</b>	<b>33</b>
<b>Annex 6 – Rating scale.....</b>	<b>35</b>

## 1. External environment and FINCA Honduras positioning

### Institutional Background

Finca Honduras is a non-profit Association in operation since 1990<sup>3</sup>, specialized in microfinance, and belonging to the FINCA International network. It is non-political, and was created in order to provide technical, financial and commercial assistance to organized groups of rural and urban poor areas, mainly of the artisan and farmer sector of the Republic of Honduras. FINCA Honduras has its headquarters in Tegucigalpa and has 7 branches. Its main methodology is Village Banking for commercial activities as well as production and services in urban and rural zones, products which are recognized at both a national and international level. Other products such as Solidarity Groups and Individual Lending are also offered by FINCA Honduras. At the moment FINCA Honduras takes care of 16.084 borrowers, and is a part of REDMICROH, the national network of microfinance institutions in Honduras. It operates under the legal form of OPD (Private Organization of Development) which under Honduran legislation allows the non-profit institutions to offer only credit services. FINCA Honduras has based its growth mainly on its equity and some national second-tier banks (Fundación Covelo y BCIE).

### Macroeconomic and politic context

The 27 of January 2006 the President of Honduras, Manuel Zelaya Rosales of the Liberal party (LP) began his mandate of four years. His party has not gained the simple majority at the National Congress

#### Sovereign Risk<sup>4</sup>

Honduras	Foreign currency		Domestic currency	Rating Outlook
	Short term	Long term	Long term	
<b>MOODY'S</b>	-	B2	B2	Estable
<b>S&amp;P</b>	nd	nd	nd	nd
<b>Fitch</b>	-	Ba2	Ba1	Estable

and will need the support of other parties in order to approve legislation. On the other hand, continuity in the 2006 and 2007 policies is anticipated, in agreement with the objectives established by the FMI aimed at poverty reduction (PRGF- *Poverty Reduction and Growth Facility*). Honduras will also benefit from the HIPC initiative (*High Indebted Poor Countries*), with the consequent cancellation of the external debt.

Honduras				
Macroeconomic Indicators	Dec03	Dec04	Dec05	Dec06
<i>Exchange rate in US\$ (end of period)</i>	17,7	18,6	18,9	18,9
<i>Exchange rate variation</i>	na	5,0%	1,4%	0,0%
<i>Inflation rate (end of period)</i>	6,8%	9,2%	7,7%	5,3%
<i>Deposit rate</i>	11,5%	11,1%	10,9%	9,3%
<i>Lending rate</i>	20,8%	19,9%	18,8%	17,4%
<i>GDP per head (US\$)</i>	969	1.015	1.103	1.188

Fuente: International Finance Statistics, EIU. na = no available

During 2003 the Honduran economy reverted the decreasing tendency of economic growth exhibited during the previous years, showing a growth of the PIB of the 11,41% in 2003, 13,93% in 2004 and 14,78% in 2005<sup>5</sup>. Inflation has diminished in 2005 and 2006, thanks to the relative exchange rate stability and a prudent monetary policy. In general, the **interest rates in the**

<sup>3</sup> Recognized by the Government of Honduras through resolution No. 181 – 90, 26<sup>th</sup> November 1990.

<sup>4</sup> **Rating scale: 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)

<sup>5</sup> PIB a precios corrientes. Fuente: Banco Central de Honduras.

**banking market** are still decreasing but they stay at a high level, nevertheless the *spread* in 2005 and 2006 has remained constant. On the other hand, in recent years the active interest rates in the market of the MSMEs have been reduced compare with those historically registered mainly due to increasing competition.

**Poverty and unemployment data** (63% of the population living under the line of poverty) have not seen positive variations. The exchange rate with the American dollar has remained constant in the last two years.

#### The microfinance sector

The microfinance market in Honduras is covered by certain organizations: OPDs<sup>6</sup>, OPDFs<sup>7</sup>, Financial Societies, Savings and Loan Cooperatives (SLCs) and Banks.

As for the market of banks and financial companies, the intervention of these in the market of the microfinance is limited, restricted mainly to FINSOL (dynamic financial company that mainly takes care of the sector of micro and small enterprise), the savings and loan association “La Popular” (part of the Group Covelo), and to some banks that have been created recently or are creating internal units to take care of the microfinance sector (e.g.: Banhcafé).

**An uncertainty exists in Honduras because of the new entry of Banco Procredit and Banco Azteca in the market**, which implies greater competition of costs and economies of scale. **REDMICROH** is the Microfinance Institutions National Network in Honduras, and includes the majority of the OPDs (ONG non-regulated microfinance institutions) and the new OPDFs (ONG regulated microfinance institutions). At the moment the network has 25 members. The biggest institutions are: Fundación Microfinanciera Covelo (that was the main promoter and founding of the network), ODEF, FUNED, Hermandad de Honduras, WRH, and FINCA y FAMA.

As for the Savings and Loan Cooperatives (SLCs), 76 SLCs are affiliated with the Federation of Savings and Loan Cooperatives of Honduras (**FACACH**)<sup>8</sup>. The biggest cooperatives of the sector (Sagrada Familia, Elga y Chorotega) grant mainly credit to the consumption. Only some of them are entering in the sector of the productive micro enterprise credit (20% of the COACs are considered around). The other cooperatives are small local cooperatives or closed cooperatives (serving the employees of a single company).

**Too much liquidity exists inside of the formal financial sector**, which has caused a greater positioning at banking level in the sector of micro and small company and in the consumption credit. This tendency could end as a problem of over-indebtedness, mainly in urban areas. There is access to a **public credit bureau** administered by the Banking Authorities of Honduras that includes banks and financial societies only and **two private credit bureaus** (*Trans Union* and *Infocom*) that include banks, financial societies and cooperatives also, giving suitable information. Also it is possible to emphasize that the **credit bureaus mentioned do not offer updated information of all clients**.

#### Regulation and Supervision

The banks (first and second tier), Financial Institutions, Savings and Loan Associations<sup>9</sup>, are regulated according to the norms of the National Commission of Banks and Insurances of Honduras (CNBS). The main law that handles this instance of control is the **Law of the Financial System**<sup>10</sup>. Other laws<sup>11</sup> and several circulars exist.

The National Congress of the Republic of Honduras established in November 2000 the **Regulating Law of the Private Organizations of Development specific for the microfinance sector**, in particular for the private Organizations of Development who are dedicated to financial activities for micro and small companies (OPDF). The National Commission of Banks and Insurances (CNBS),

<sup>6</sup> Private Organization of Development

<sup>7</sup> Private Organization of Financial Development

<sup>8</sup> [www.facach.hn](http://www.facach.hn)

<sup>9</sup> The only Savings and Loan Association is “La Popular”.

<sup>10</sup> Last version was published the 24 of September 2004. Source: CNBS.

<sup>11</sup> Law of reevaluation of assets, Norms to regulate the administration of the technologies of information and communications, Law about norms of accounting and audit, Law against the crime of washing assets, Law of insurance of deposits, Law of the National Commission of Banks and Insurances.

a regulating and supervising organ, has established the procedures for the constitution of an OPDF.

The Regulation for Savings and Loan Cooperatives is regulated according to the **Law of Cooperatives and the Regulation of Cooperatives**, being the Honduran Cooperative Institute (IHDECOOP) the controlling organ of the Honduran Cooperatives.

### Market Positioning of FINCA Honduras

From December 2006 FINCA Honduras, through its 7 branches in Tegucigalpa, Juticalpa, Choluteca, Comayagua, El Progreso, San Pedro Sula and La Entrada of Copán attends to 16,084 borrowers with credit (of which 13,405 are women). The 79% of its portfolio is concentrated in associative credit through the Village Banking methodology, 16% in Solidarity Groups and 5% in Individual Lending for commercial activities in rural and urban zones of the country. Individual Lending that FINCA offers is directed exclusively at the clients of the Village Banks that have grown their own business and need special attention by the institution.

One of the main competitive advantages of FINCA Honduras is the agility in renewing loans and the good attention it pays to the clients. The average loan amount is US\$ 374, which indicates its **concentration in the market of poor microenterprises**. As for 2007 it is planning the implementation of a pilot product for agriculture in one of its branches. It is also planning the introduction of a new credit product for successful clients of Village Banks.

**FINCA competition changes but it is strong at all of the branches.** The main competitors of FINCA Honduras are the OPD and OPDFs such as: ODEF, FAMA, Hermandad de Honduras,

#### Main competitors

Institution *	Coverage	Gross outst. Portfolio (US\$)	Borrowers	Credit methodology	Average loan balance (US\$)
<b>FINCA Honduras</b>	7 branches in 7 departments	3,1 mln	14.580	Bancos, Grupale Individual	213
<b>FAMA</b>	10 branches in 7 departments	4,3 mln	14.083	Village banking, Solidarity & Individual	305
<b>FUNDAHMICRO</b>	8 branches in 7 departments	2,5 mln	9.642	Village banking, Solidarity & Individual	255
<b>ODEF</b>	24 branches in 8 departments	8,8 mln	14.456	Village banking, Solidarity & Individual	611
<b>HDH</b>	11 branches in 7 departments	4 mln	8.068	Village banking, Solidarity & Individual	493
<b>PILARH</b>	5 branches in 4 departments	1 mln	3.080	Solidarity Group & Individual Lending	322
<b>FJMC</b>	27 branches in 9 departments	10,3 mln	16.753	Solidarity Group & Individual Lending	615

\* Source: REDCAMIF (October 2006), data as of June 2006

PILARH, Fundahmicro, Fundación Covelo. Additionally, there is competition from some local SLCs and some banks that offers consumer credit in urban areas.

The **main comparative advantages** of FINCA Honduras can be considered:

- Agility in delivery of loans (time of disbursement);
- Attention of the loan officers in the localities of the clients;
- Leader in the Village Banking methodology

The **main comparative disadvantages** of FINCA Honduras are:

- It can't collect savings and it can't provides other financial services because of its legal form;
- Credits with shorter term
- Limited network coverage

## 2. Governance and organizational structure

### Ownership and governance

Finca Honduras is a “Non-profit Civil Association” established in 1990. It belongs to the FINCA International network, an international network which offers technical support (methodologies, data processing and operations) and eventually effective guarantees for international funds.

In order to achieve its objectives and according to its By-Laws<sup>12</sup>, FINCA Honduras is managed by four organisms: FINCA International, a General Assembly, the Board of Directors and the CEO. The General Assembly is the supreme organ of the Foundation. The Board of Directors is the executive organ of the General Assembly resolutions, through the Administration, which will be in charge of the CEO. Nowadays the Board of Directors is integrated by six members (substitute members do not exist), in the positions of President, Vice-president, secretary, fiscal advisor and two vowels. The members are **professionals with a high academic profile, diversity of experience and knowledge of banking and finance, microfinance, regulation and control at the local, as well as regional and international levels**, a strength for FINCA Honduras.

#### Board of Directors

Members	Position	Background and current profession
Phillip C. Broughton	President	Master in Economics, 15 years in FINCA International, now Regional Director of FINCA for Latin America. Executive President in 6 programs of FINCA.
Rupert Wallace Scofield	Vice President	Master in Public Politics and Administration; Agriculture and Economics, more than 35 years of professional experience and more than 15 years in Finca International.
Hans Niehorster	Secretary	Bachelor of Commerce, 12 years as a member of the Board of Finca International, Honorary Consul of Portugal and Holland
José María Mendez Mariona	Fiscal advisor	Lawyer and notary with more than 20 years of experience as legal adviser. Member of the Board of Finca International and 7 programs of Finca
Rocael García	Member 1	Bachelor of Juridical and Social Science, with more than 30 years of international experience in credit unions, microfinanzas and commercial banks.
Gwen Marie Andreotti	Member 2	Master in Business Administration and now Human Resource & Business Director for Finca International, member of the Board for Finca in 5 countries

It is important to point out that the **By-Laws of Finca Honduras have not been updated** since 1990<sup>13</sup>, and currently there are differences between current practice and what it is written in the **By-Laws** (main source of Governance policies). Moreover, **no regulation exists** for the functions of each position of the Board of Directors and for settling other governance procedures and mechanisms.

The Board of Directors meets once a month on average, live or by teleconferences, as five of the six members live outside of Honduras.

<sup>12</sup> Document emitted in November of 1990.

<sup>13</sup> For example according to the By Laws the Board of Director should be integrated by 10 members.

FINCA has an **Internal Audit Department**, which reports directly to the Board of Directors and independently from the CEO. The person responsible of the Internal Audit Department presents monthly reports before the meetings of the Board of Directors.

The monthly information presented by the CEO and by the Internal Audit to the Board of Directors is complete and good.

It is important to point out that until December 2005 FINCA Honduras had problems of productivity, image, portfolio quality and staff turnover. **In January 2006 the CEO was replaced with a new one.** With this new election the Board of Directors wanted a change in the institutional culture towards increased professionalism and efficiency.

### Management

The Executive Director (**CEO**) of Finca Honduras is Gonzalo González, who began in January 2006. It is important to mention that during the management of the actual CEO, Finca Honduras has strengthened its organizational structure and the HR management, also establishing a good communication system.

Under the CEO there are the **Business Manager**, the **Financial/Operational Manager**, the **Human Resources Manager**, the **Information Technology Manager** and the **Credit Collection Manager**. Each one of these managers is responsible for its staff and its respective goals, which altogether form the operational plan of every year. The CEO supervises the performance of his managers, corroborating the fulfillment of their goals according to the strategic and operational planning and he is the connection to Finca International and the Board of Directors. In general **there is a good delegation of functions to the different managers.**

A point of note is that a Business Manager<sup>14</sup> was introduced in the second semester 2006 (before it was the CEO that concentrated this function). At the moment the CEO still covers the marketing function (nevertheless he has already planned to hire a new manager next year).

### Human Resources and Staff Policy

The **Human Resources Department** of FINCA Honduras is composed by three persons: the Manager, an assistant in charge of payroll and an assistant in charge of training.

The approach of the new management of FINCA Honduras consists of awarding the staff who fulfills the institutional goals. **In 2006 FINCA underwent a strong transition process** based on the strict evaluation of the field staff that involved a high **staff turnover**, 52%<sup>15</sup>. On the other hand, the CEO and the Human Resources Management think that now there is already a consolidated team, thus this trend will be reversed in 2007. It is worthy of note that in this process of transition there were no personnel legal cases. During our visit in the branches we found a good working environment and most of the staff share the objectives of the institution. However, formal surveys on the working environment have been planned to measure stress and personal satisfaction.

During last year FINCA H. focused on the development of a **new and aggressive incentive scheme**, to improve portfolio quality, raise productivity and more in general, the quality of the staff performance of the institution. The new incentive scheme for loan officer places FINCA Honduras as an institution with **attractive salary levels** in the Honduras microfinance market.

Selection, hiring and induction process has been improved. The performance evaluation of the staff takes place twice a year. The annual training plan for 2007 is still in process (there is not a percentage of the budget defined for the training). Formal replacement, career and succession plans don't exist but the institution is planning to introduce them in the medium term.

A payroll software is used currently and it will be integrated in the MIS in the medium term.

<sup>14</sup> The Business Officer is in charge of the institution commercial force, is the coordinator of the branches and remains in strict relation with Branch Managers, he follows the fulfillment of the goals and gives all the support and information needed from the headquarters for a good performance in every branch.

<sup>15</sup> During the last 2 years staff turnover was equally high (43% in 2004 and 54% in the year 2005) but this was a consequence of some problems in the human resources management.

As far as the **staff allocation ratio**, in the last two periods a 52% was obtained. This shows a healthy structure between loan officers and the rest of the staff<sup>16</sup>.

Personnel	Dec04	Dec05	Dec06
<b>Total</b>	<b>126</b>	<b>107</b>	<b>104</b>
Loan officers	80	56	54
Other staff	46	51	50
<b>Staff allocation ratio</b>	<b>63%</b>	<b>52%</b>	<b>52%</b>

Organizational structure

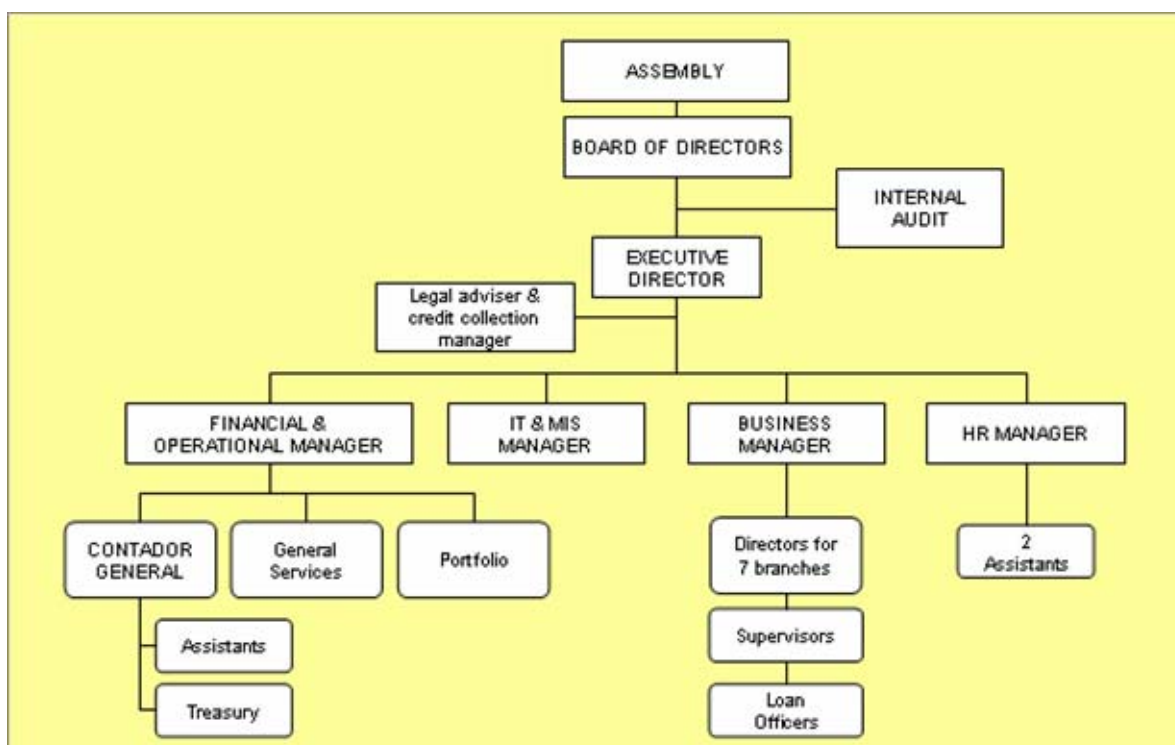
**The organizational structure of FINCA HONDURAS is efficient**, after a year of institutional adjustments and strengthening according to the positioning and expansion strategy in the Honduran market.

FINCA Honduras works with 7 branches and it is planning to open 3 new branches in 2007. The branches operate in a decentralized way. Each branch has a Director, a Supervisor, loan officers and administrative staff. **The credits approval is made in a decentralized way in every branch.** The Business Manager does not approve loans, he merely monitors the process. The branch administration checks the fulfillment of the procedures and generates the credit in the system.

The information flow between the business manager and the branch directors is systematic, even though it may differ in the formats from one branch to another.

**The administrative, accounting and financial management is centralized:** the branches do not manually generate accounting entries and do not elaborate their own balance and budget. The liquidity monitoring is centralized at the headquarters by the **Financial Manager**.

There are 2 central current accounts and every branch has got 3 bank current accounts (2 to disburse and one for the administrative costs). The **bank reconciliations** are carried out by the headquarters and, although it has been improved (there are no delays over 90 days) in respect to the last months, **there is an high concentration of data in need of reconciliation.** The financial manager is planning to open current accounts at branch level to improve bank reconciliation.



<sup>16</sup> The security and cleaning staff are hired in “outsourcing” since May 2006.

Risk management and internal control structure

The Board of Directors, CEO, and Financial Manager are responsible of risk management. There is not a specific risk department due to the small size of the institution. Nevertheless the internal audit department supports the Management in the risks identification activity.

The **internal control structure** of FINCA H. has been strengthened through the last year with the support of the Internal Audit Department and through the support of Finca International Network. In general, FINCA H. received the most important manuals and they have been updated. In particular, this year FINCA H. developed new manuals on internal control, credit and staff.

The **control structure** of the credit process, based on a hierarchic system of supervision (business manager, branch director and supervisor of the field staff) is adequate. Although a systematic control exists, there are instances of small frauds in some Village Banks. A planned measure is a higher rotation of the members of the board of directors in the Village Banks.

The **Internal Audit department** has a manager and 3 assistants. The manager and an assistant are almost permanently in the field, visiting the branches (at least 3 times a year) and their clients. One person is in charge of monitoring the operations and the accounting at the headquarters. If FINCA H. will expand further incorporating one or two more professionals for field work is planned. The Audit department counts with a new manual. The manual is based on the FINCA International experience. Internal Audit presents monthly reports to the Board of Directors of FINCA Honduras and when the BoD requires it attends the meetings to inform about particular situations. Additionally, he presents special reports to FINCA International (the Internal Audit regional department is based in Nicaragua).

Internal Audit carries out controls on the fulfillment of legal and fiscal obligations.

Internal audit has not carried out controls on individual credits yet (but it is planned for 2007) and it is important to point out that **there is no specialized audit of IT and MIS**.

Accounting policies and procedures and external audit

The Financial Manager prepares the Financial Statements of FINCA Honduras, which are based on the generally accepted accounting principles. The manager is also studying the implementation process for chart of accounts and rules of the regulated financial institutions by the National Commission of Banks and Insurances (CNBS). The last **external audits** have been carried out by the International Firm Deloitte, and are in an annual base. The opinion of the auditor is without exceptions (it is just mentioned that the interests gained on loans are registered under the cash/basis principle, which is a comprehensive base but different from the generally accepted accounting principles).

Information Technology (IT) and Management Information System (MIS)

The **department** includes one manager and one assistant, and together they are in charge of administrating the database, the network and the communication with the company of Guatemala which provided the MIS. Considering that the MIS used is provided by a foreign company, this company is the one in charge of the development and the personalization of the system.

The **SIEM system**, developed by MFSI (Microfinance Solution Inc.) of Guatemala, is used by several programs of FINCA at the international level. It is a software managed by a reliable institution. Specifically, it is the support and technical development that is made on line from Guatemala and which could be cause of delays and errors in the production of the reports of the institution. In particular, FINCA H. still has two problems MFSI has not solved: **some accounting reports and outstanding of loans don't square**. Because of these problems FINCA H. always needs to reconstruct the balances. A new version of the MIS will be implemented in the coming months and FINCA H. hopes to overcome these problems.

**SIEM** has the accounting and portfolio<sup>17</sup> modules integrated. The portfolio reports produced for the loan officers at the branches is reliable and good.

The system is based on a SQL Server and it is installed in each one of the branches. The information is sent by the branches every week by Internet. **The system is not on-line. There is a**

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<sup>17</sup> Another module as "saving" is not active because FINCA Honduras cannot catch savings and "budget" is not being used in its totality. All these attributes of the present system will be evaluated for the growing process of FINCA Honduras.

**weekly closing of consolidated accounts** but FINCA H. is working to achieve a daily closing of consolidated accounts. The data processing between the branches and the headquarters is slow and sometimes stops. This involves delays in the process of consolidation of the data. Besides, there are electricity problems in some branches and there are not invertors or electric current generators. FINCA H. is planning an audit in order to understand electricity problems.

At the moment FINCA H. counts on **a single server<sup>18</sup> at central level** (which is not in a restricted access), nevertheless it is planning the implementation of a contingency plan as the installation of another server in a different office. However, Finca H. has adequate backup policies (3 backups, of which 2 are external, one remains in the head office, and one is taken to a bank) and most of the computers can replace the server. On the other side **there is not a back-up procedure in the branches.**

There are adequate security procedures (double system of passwords, firewalls, etc.).

It is important to mention that FINCA H. is working on a plan formulation to improve the MIS and its technology to expand services and to put the branches on-line.

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<sup>18</sup> In the branches the computers are used as servers.

### 3. Financial Products

FINCA is the historical leader of the Village Banking methodology. FINCA H. concentrates in the 79% of the total portfolio in the village banking methodology. FINCA H. has incorporated other credit methodologies: Solidarity Groups and Individual Credit, but these represent a limited percentage (16% and 5% respectively) of the total portfolio as of December 2006.

#### Credit policies

FINCA Honduras directs its credit products at microentrepreneurs with commercial, production and services activities in rural and urban zones in Honduras. The credit products of FINCA Honduras are developed to adapt to the requirements of the microentrepreneur and to the competition. The competitive advantages in the market are the speed in the loan disbursement and the client confidence.

**Village Banking (VB)** with an average term of five months is addressed to microentrepreneurs with a high rotation in their commercial activities and it is based on solidarity guarantees. **Solidarity Group** is directed to a more dispersed population of microentrepreneurs, with activities that requires bigger funds. In general, FINCA H. does not intend to again promote this methodology, with which it had a bad experience. **Individual Lending** is directed at the outstanding clients of the Village Banks whose funding necessities have increased, which is known as “*graduation of clients*”. FINCA H. is planning to diversify its products in answer to their client’s requirements. In 2007 the agriculture loan will be tested in one of the branches as a pilot product. FINCA H. is also considering the introduction of new types of credit with the clients of the Village Banks.

#### Credit procedures

Loan officers carry out the group organizational process, complete the information of the loan application, analyze the repayment capacity of the clients and their guarantees and consult in the credit bureau the loan records of the new clients. Once they have completed this process, the loan applications are analyzed by the credit committee of the branch, which meets frequently. Branch directors are constantly implementing new initiatives that allow more rapid credit disbursements, awarding fidelity of their clients (credit disbursement up to 24 hours for good previous clients). For new clients the credit disbursement period can change depending on various factors, such as the distance, frequency of the training meetings (for Village Banks), etc..

Branches are coping with the demand of the clients **to reduce the number of signatures and the documentation that clients must present, at least for repeated good clients**. FINCA H. is planning to carry out a study to improve the loan renewal process for good past clients.

The loan officer carries out the first follow-up of the fulfillment of the payments. After the director of the branch supports the loan officer in the follow-up of the delinquency loans by carrying out visits and notifications. Finally, in case of negative results, help to collect late loans is requested to the legal office that supports FINCA Honduras. The legal office has a legal consultant<sup>19</sup> as manager of collection and 3 legal collectors who share the territory<sup>20</sup>. During our visits in the branches we detected some people not satisfied with the new structure of collecting loans mainly due to the slow process. In general, the new collection mechanisms still have not been accepted by the staff in the offices and the management is examining the new mechanisms of collecting loans.

#### Guarantee policies

As for Village Banking methodology solidarity guarantees are requested to the members of the Group and the same applies to the Solidarity Group methodology. Nevertheless credit officer or the administrative committees sometimes also use pledges if it is necessary. As for the individual credits, pledges or guarantors are requested.

<sup>19</sup> This consultant supports FINCA Honduras with all the legal subjects.

<sup>20</sup> A legal executive covers Choluteca, another executive covers Tegucigalpa, Juticalpa y Comayagua, while the last executive covers San Pedro Sula, Copan y Progreso.

Savings policies

FINCA Honduras does not have savings products, although previously it collected savings through a guarantee fund. To fulfill banking commission requirements, savings were given back to the clients in 2005.

The Village Banking methodology provides incentive for the organized groups to save as a strategy to reach self-sufficiency and to back their credits. These savings are deposited in recognized financial institutions.

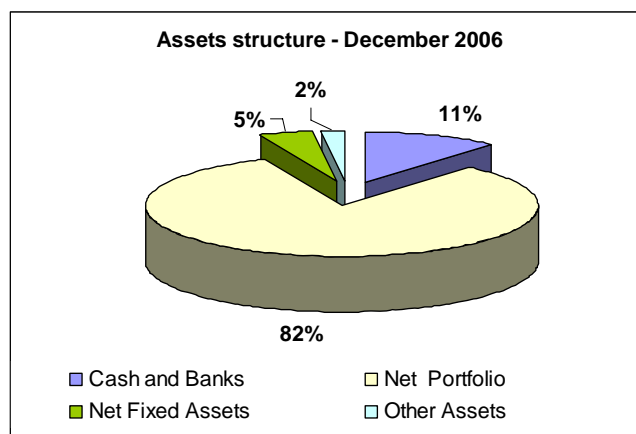
Other financial services

At the moment FINCA Honduras does not offer other financial products.

## 4. Assets structure and quality

### Assets structure

As of December 2006, the **net outstanding portfolio is 82%** of the total assets, which is considered a good concentration in the core business of the institution. The level of **liquidity (cash and banks) is prudential and reaches 11%** of the total assets. In general, FINCA H. throughout the present year has maintained a liquidity level between 10% and 16% with lower levels than those previously registered in 2004 and 2005. Nevertheless the idle liquidity remains at high levels. It is important to point out that the institution has never taken advantage of short term financial investments in the last 3 years, and this activity could help to lower the level of idle liquidity. The **net fixed assets** are 5% of the total assets, while **other assets** represents 2,2% of the total assets.



### Portfolio structure

As of December 2006, the gross outstanding portfolio reaches **US\$ 4.526.134 with 16.084 active clients<sup>21</sup>**. In 2005 the portfolio growth rate was negative while in 2004 was very weak. In 2006, with the change of the Executive Director, the credit portfolio has begun to grow again and as of December 2006 the growth rate was 35,6%, showing the new management approach towards productivity and growth.

Portfolio features	Jan04-Dec04	Jan05-Dec05	Jan06-Dec06
Gross outstanding portfolio (US\$)	3.405.976	3.338.969	4.526.134
Banco Comunal	2.781.494	2.724.447	3.546.968
Crédito Solidario	437.145	489.074	745.919
Crédito Individual	187.337	125.448	233.248
Gross outstanding portfolio (national currency)	63.462.878	63.090.490	85.522.210
Growth of active gross portfolio	2,8%	-0,6%	35,6%
Average disbursed loan amount (US\$)	206	283	317
Av. disbursed loan size on per capita GDP	20%	26%	27%
Average maturity (months)	5	5	6
Number of active borrowers	16.938	14.581	16.084
Number of active loans	16.938	14.581	16.084
% of active borrowers women	85,0%	84,3%	83,3%
Drop-out ratio	na	73,3%	40,4%
Drop-out ratio adjusted	na	61,8%	34,2%
Drop-out ratio Village Banks	na	45,8%	31,2%

The **average disbursement loan amount** is US\$ 317 as of December 2006, while the **average disbursement loan size on per capita GDP** is 27%. **Women represent more of 83,3% of the total clients**. These indicators demonstrate an excellent level of reach in the credit service depth of FINCA Honduras.

<sup>21</sup> 991 Village Banks (one Village Bank has on average 15 clients), 384 Solidarity Groups (one Solidarity Groups has on average 3 clients), 158 Individual Loans.

It can be observed that **the Village Banking methodology has the greater share of the total portfolio with 78,4%**. The solidarity group represents 16,5% of the total portfolio, but this one is a methodology that has not been promoted. The individual lending methodology has the lowest percentage because it is only used with good clients who graduate in the Village Banks.

The **adjusted drop-out ratio<sup>22</sup> of the clients stands at a medium-high level (34,2% as of December 2006) even though it has improved**

**compared to the last year (61,8% as of December 2005)**. The drop-out ratio of the village banks is 31,2% as of December 2006 (45,8% as of December 2005). The analysis of the client drop-out is carried out informally, and drop-out is due to different reasons: no-renewal of loans to the clients who have been in arrears, clients who take a resting period and clients who went with the competition. The institution is aware of the risk and it has planned to carry out a client satisfaction study in order to detect and measure the main exit reasons of the clients.

December 2006

Loan product	% of outst. portfolio	PAR >30 days	PAR 30 weighted
<i>Village Banking</i>	78,4%	2,0%	1,6%
<i>Solidarity Group</i>	16,5%	3,7%	0,6%
<i>Individual Lending</i>	5,2%	4,7%	0,2%
<b>TOTAL</b>	<b>100,0%</b>		<b>2,4%</b>

#### Portfolio quality

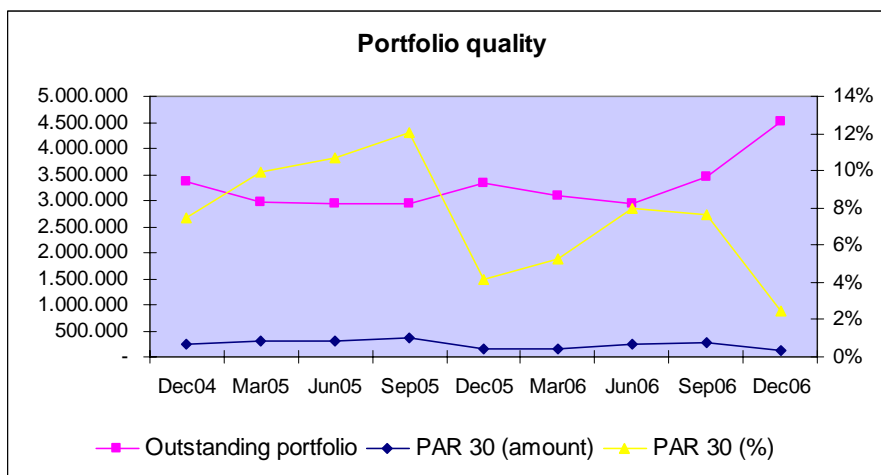
**The quality portfolio in 2006 has shown great improvement** in respect to the previous years. The principal reason was the change of the management at the beginning of 2006. This has transmitted to all the staff a new proactive approach towards the credit follow/up and collection, and the respect of the proposed goals. Besides, in the Honduran microfinance sector, the portfolio quality indicators have improved in 2006, due to an improvement of the political and macroeconomic conditions. If we compare FINCA H. with the other OPDs and OPDFs, the result is that FINCA H. has the best portfolio quality. However, we must notice that the main methodology used by FINCA is the village banking methodology and that the portfolio quality still leaves room for improvement with respect to the *benchmarking* in Latin America.

Portfolio Quality Indicators	Jan04-Dec04	Jan05-Dec05	Jan06-Dec06
<b>PAR 1</b>	31,6%	25,4%	9,3%
<b>Consolidated PAR30</b>	<b>7,5%</b>	<b>4,2%</b>	<b>2,4%</b>
31-60	2,9%	1,7%	1,0%
61-90	1,6%	0,6%	0,6%
91-180	1,7%	1,3%	0,7%
181-365	1,3%	0,5%	0,2%
>365	0,0%	0,0%	0,0%
<b>Arrears rate (&gt; 1 day)</b>	<b>13,4%</b>	<b>9,4%</b>	<b>4,6%</b>
<b>Arrears rate (&gt; 30 days)</b>	<b>3,9%</b>	<b>2,7%</b>	<b>1,3%</b>
<b>Restructured portfolio</b>	<b>0,0%</b>	<b>0,0%</b>	<b>0,0%</b>
<b>Provision expense ratio</b>	<b>6,7%</b>	<b>4,4%</b>	<b>3,4%</b>
<b>Loan loss reserve ratio</b>	<b>4,9%</b>	<b>3,2%</b>	<b>2,2%</b>
<b>Risk coverage ratio (30 days)</b>	<b>65,4%</b>	<b>77,3%</b>	<b>91,3%</b>
<b>Write off ratio</b>	<b>4,1%</b>	<b>6,2%</b>	<b>3,6%</b>

As of December 2006, **the ratio of portfolio at risk greater than 30 days (PAR 30) is 2,4%** (4,2% as of December 2005 and 7,5% as of December 2004). Besides, the structure of PAR 30 shows that the higher percentage is concentrated in the first months. Also the **write-off ratio** has continued to improve and as of December 2006 is 3,5% (6,2% as of December 2005). The next

<sup>22</sup> The drop-out ratio is measured as (number of active clients at the beginning of the period + number of new (first time) clients entering during the period – number of active clients at the end of the period) / (number of active clients at the beginning of the period). In the adjusted drop-out ratio it is necessary to pull out clients written-off during the period.

year this ratio should be lower, due to the improvement in the methodology, monitoring and collection of the loans. FINCA Honduras does not have **restructured loans**.



In the chart it is necessary to indicate 2 points worth considering:

1. The strong portfolio growth has been ongoing since June 2006. In this case we have to remember that a portfolio with an increasing trend of growth could hide problems of future arrears<sup>23</sup>.
2. Both in 2005 and in 2006, the improvement of the PAR ratios in the September – December trimester, is due principally to the annual write off of one portion of the portfolio (it’s important to notice that in 2006 the write-off was half of the previous year). On the other hand, an important trend change is shown in the June – September trimester: in 2005 there is a strong growth of the arrears, while in 2006 there is a decreasing trend, which confirms an improvement in the methodology, monitoring and collection of loans.

The **risk coverage ratio (30 days)** reaches 91,3% as of December 2006, which is an **acceptable level of protection** according to the prudential international standards in microfinance.

The **analysis of portfolio by branch** does not show particular concentrations. The highest percentage of outstanding portfolio (20,3%) and of number of clients (24,9%) on the total are both in the branch of Choluteca. As for delinquency, **the agencies of Tegucigalpa and Copan show the highest ratios of CeR30** (respectively 6,7% and 6,6%). The delinquency in Tegucigalpa is due to problems related to the strong competition and to some problems of over-indebtedness in the market, while Copan is a particular area with a weak culture of payment. Both in Copan and in Tegucigalpa branches directors were changed at the end of 2006. The other agencies maintain a good portfolio quality.

December 2006

Branch	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR 30 weighted	Write-off ratio
Tegucigalpa	389.852	8,6%	11,0%	6,7%	0,6%	2,2%
Comayagua	849.661	18,8%	14,2%	0,4%	0,1%	0,2%
Copan	805.264	17,8%	14,3%	6,6%	1,2%	0,8%
Choluteca	920.525	20,3%	24,9%	0,9%	0,2%	0,7%
San Pedro Sula	499.833	11,0%	12,2%	2,2%	0,2%	0,2%
Progreso	670.353	14,8%	15,2%	0,2%	0,04%	0,4%
Juticalpa	390.646	8,6%	8,2%	1,69%	0,146%	2,2%
<b>TOTAL</b>	<b>4.526.134</b>	<b>100%</b>	<b>100%</b>		<b>2,4%</b>	

<sup>23</sup> On the other hand a portfolio with a decreasing trend accentuates the difficulties of the portfolio quality.

The **individual lending presents the highest arrears** (CeR30 of 4,7%) while the village banking methodology presents the lowest arrears (CeR30 of 2%), confirming the expectations.

The credit portfolio by amount disbursed does not show particular concentration of the arrears, while the credit portfolio by term shows a higher concentration of arrears in the range between 7 – 9 months, which especially represent individual loans of graduated clients.

## December 2006

By amount (US\$)	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR 30 weighted
< 212	581.477	12,8%	33,9%	2,9%	0,4%
212 - 529	1.912.741	42,3%	49,6%	2,7%	1,2%
529 - 1.058	919.980	20,3%	11,1%	2,0%	0,4%
> 1.058	1.111.937	24,6%	5,4%	2,0%	0,5%
<b>TOTAL</b>	<b>4.526.134</b>	<b>100%</b>	<b>100%</b>		<b>2,4%</b>

## December 2006

By term	outstanding portfolio (US\$)	% of outst. portfolio	% number of borrowers	PAR > 30 days	PAR 30 weighted
< 6 meses	3.234.196	71,5%	86,3%	2,3%	1,7%
7 - 9 meses	648.964	14,3%	9,2%	4,0%	0,6%
> 9 meses	642.975	14,2%	4,5%	1,4%	0,2%
<b>TOTAL</b>	<b>4.526.134</b>	<b>100%</b>	<b>100%</b>		<b>2,4%</b>

## 5. Financial structure and management

As of December 2006 the **debt/equity ratio of FINCA Honduras was 1,66**, which is an adequate capital structure. The institution has the opportunity to leverage its equity.

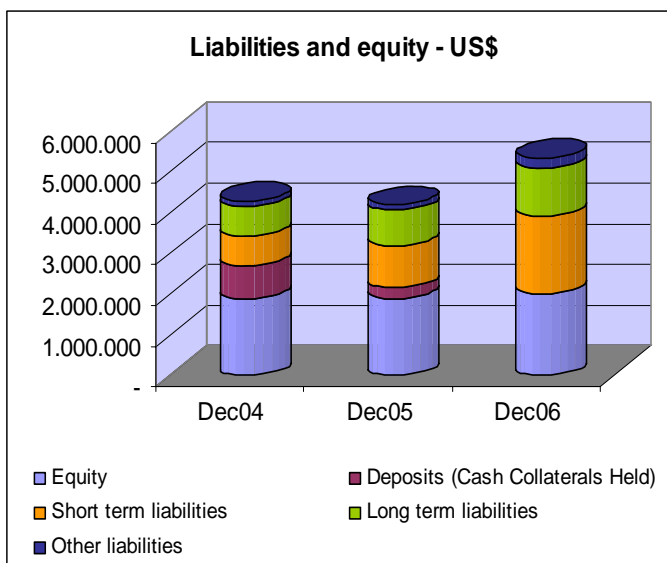
### Debt financing and savings mobilization

As of December 2006 **FINCA Honduras liabilities are US\$ 3,4 millions**, 57% is represented by short term loans, 35% by long term loans, and 8% by other liabilities.

All borrowed loans are commercial and **the cost of fund ratio is 12,7%** as of December 2006. Three investors concentrate 83,6% of the total borrowed funds, (just Fundación Covelo has 57,7%), which is a **risk of concentration of the funding liabilities in few sources**. The management is aware of this risk. FINCA cannot mobilize savings because of its legal form. Previously FINCA H. used to collect savings through a “guaranty fund” but in order to fulfill the banking commission rules, savings were given back to the clients in 2005. Savings remain as an opportunity in case of the transformation of FINCA Honduras in a regulated institution.

### Assets and liability management

**As of December 2006 there are no maturity gaps** in respect to the analyzed ranges (see table below), this shows a low liquidity risk for the institution. As of December 2006 **the currency ratio is 2,36** maintaining a similar level in respect to the previous periods (2,58 as of December 2005). Besides, FINCA keeps a conservative position with **prudential liquidity levels** (between 10% and 16% of the total asset) and has opened some credit lines with BCIE and Fundación Covelo.



### December 2006

Source	%
CORDAID	14,8%
Banco Atlantida	7,8%
Proyecto Copan N.	8,6%
BCIE	11,1%
Fundación Covelo	57,7%
<b>TOTAL</b>	<b>100%</b>

### December 2006

US\$	30 days or less	31-90 days	91-180 days	181-365 days	1-5 years	Total
<b>Total assets</b>	<b>1.727.603</b>	<b>2.241.942</b>	<b>1.133.783</b>	<b>70.953</b>	<b>191.374</b>	<b>5.365.655</b>
Cash and banks	593.286	-	-	-	-	593.286
Investments	-	-	-	-	-	-
Net portfolio	1.109.146	2.218.291	1.098.306	-	-	4.425.743
Fixed assets	5.016	10.032	15.048	30.096	182.334	242.526
Other assets	20.155	13.619	20.429	40.857	9.040	104.100
<b>Total liabilities and equity</b>	<b>308.893</b>	<b>374.412</b>	<b>516.798</b>	<b>969.665</b>	<b>1.178.571</b>	<b>3.348.340</b>
Deposits	-	-	-	-	-	-
Loans	55.129	374.412	516.798	969.665	1.178.571	3.094.575
Other liabilities	253.765	-	-	-	-	253.765
<b>Net position</b>	<b>1.418.710</b>	<b>1.867.530</b>	<b>616.984</b>	<b>- 898.712</b>	<b>- 987.197</b>	<b>2.017.315</b>
<b>Acumulated</b>	<b>1.418.710</b>	<b>3.286.240</b>	<b>3.903.225</b>	<b>3.004.513</b>	<b>2.017.315</b>	

It is important to mention that FINCA Honduras is also interested in applying to an emergency liquidity fund of Costa Rica (*Emergency Liquidity Facility, ELF*). Finally, Finca Honduras can count on the international support of FINCA International as last resort.

**On the other hand the liquidity management is improvable** especially as for the management of idle liquidity. Short-term financial investments have never been done, and there is no management of the liquidity by daily cash flow. In general **there is a lack of sophisticated monitoring and management of liquidity tools**. There is not an Investments Committee nor an Assets and Liabilities Committee (ALCO). Their establishment would be important, especially in case of the transformation of FINCA Honduras into a regulated financial institution. The Management is aware of this weakness and has planned the creation of an ALCO and the use of short-term financial investments as a priority.

**There is a currency mismatch of US\$ 459.020, represented by the loan in US dollars received from CORDAID.** However **the currency risk has a medium-low relevance** due to the forecasted stability of the macro indicators. The management has decided not to take any particular measures to mitigate the currency risk<sup>24</sup>.

**The interest rate risk is low** because the credit portfolio of FINCA Honduras has a high rotation (average term 5-6 months), while only the 36% of the total of liabilities are composed of short-term loans.

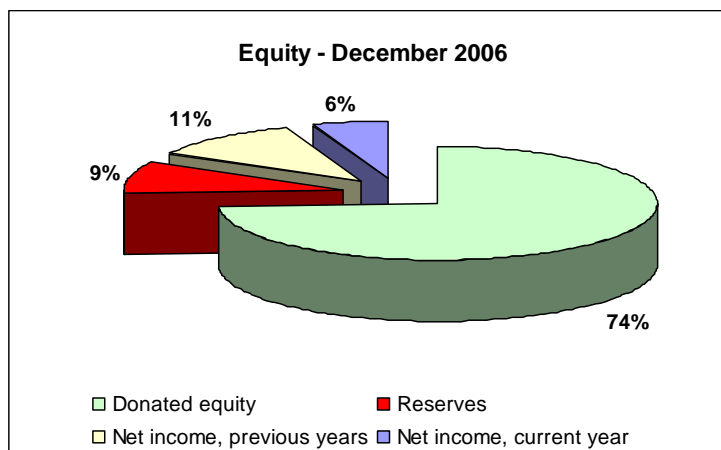
**December 2006**

US\$*	US\$	Local currency	Total
<b>Assets</b>	0	5.365.655	5.365.655
Cash and banks	0	593.286	593.286
Financial assets	0	0	-
Portfolio	0	4.425.743	4.425.743
Fixed assets	0	242.526	242.526
Other assets	0	104.100	104.100
<b>Liabilities</b>	459.020	2.889.319	3.348.340
Deposits	0	0	-
Loans	459.020	2.635.555	3.094.575
Other liabilities	0	253.765	253.765
<b>NET POSITION</b>	<b>-459.020</b>	<b>2.476.336</b>	

\* Exchange rate Lempira / US\$: 18,9

Equity

As of December 2006 the equity of FINCA Honduras comes to US\$ 2 million and it has grown (in Lempiras) 6% in 2006. The donated equity represents 74% of the total, while the reserves 9%. FINCA Honduras has a **strategy of capitalization through retained earnings**. The **net profit of this year** represents 6% of the total equity, while the retained earnings of the last years represent 11% of the total equity.



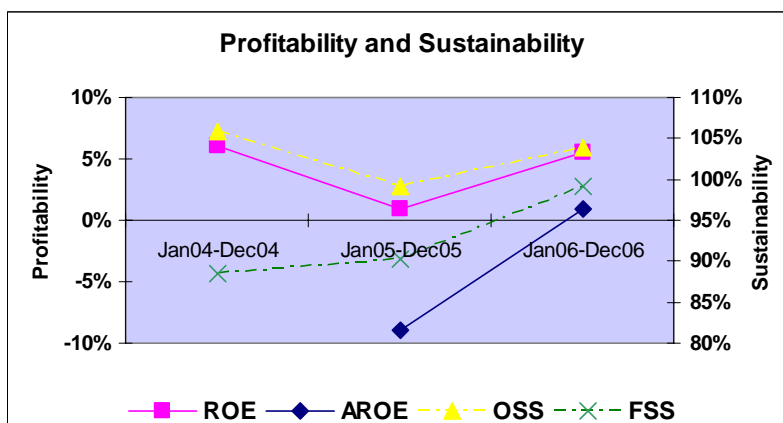
<sup>24</sup> Besides the Honduran market does not offer specific products to hedge the institution against currency risk.

## 6. Financial and operational results

The indicators of **profitability and sustainability** have improved in respect to last year when they had deteriorated. On the other hand, as of December 2006 these indicators are still to be improved.

As of December 2006 **ROE is 5,5%** (0,9% in December 2005), while **ROA is 2,5%** (0,4% in December 2005). It is important to mention that **extraordinary revenues** have slightly improved the profitability in all periods. As of December 2006 the **operational self-sufficiency (OSS) is 103,8%** (99,1% in December 2005) which is still a low level.

The **adjusted profitability and sustainability indicators** present an improving trend but they still remain at **low levels**. As of December 2006 **AROE is 0,9%**, **AROA is 0,4%**, while **financial self-sufficiency (FSS) is 99,2%**. The improvement in the adjusted indicators until the level reached as of December 2006 is due mainly to the improvement of the portfolio quality and the reduction of the inflation rate (that causes a reduction of the adjusted provision).



Financial Indicators	Jan04-Dec04	Jan05-Dec05	Jan06-Dec06
Operating expenses ratio (aver. gross portf.)	42,0%	47,5%	45,8%
Staff allocation ratio	63,5%	52,3%	51,9%
Loan officer productivity (borrowers)	212	260	298
Loan officer productivity (amount)	42.575	59.624	83.817
Branch productivity (amount)	486.568	476.996	646.591
Cost per loan lent	28	44	46
Cost per borrower	69	94	101
Funding expense ratio*	3,6%	6,2%	7,9%
Provision expense ratio	6,7%	4,4%	3,4%
Adjusted provision for inflation (av. gross portf.)	5,1%	4,1%	2,7%
<b>Portfolio yield (gross portfolio)</b>	<b>52,8%</b>	<b>55,6%</b>	<b>58,3%</b>

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

As of December 2006 the **operating expenses ratio is 45,8%** which is a high level (47,5% in December 2005 and 42% in December 2004), even though the gross portfolio has increased and the loan officer productivity has improved (298 clients). In fact, **cost per borrower** has increased up to US\$ 101 as of December 2006 (US\$ 94 in December 2005 and US\$ 69 in December 2004). This is due mainly to the increased administrative costs for improving the internal control structure and to the increased staff costs (new staff with experience, increase of the salary and aggressive incentive scheme to improve portfolio quality). As for the **staff allocation ratio** in the past 2 years FINCA has maintained a good balance (52%). The management of FINCA Honduras has invested in new staff, credit process and internal control improvements, which have lead to an improvement of portfolio quality and productivity indicators and should lead to good financial and operational results in the coming year.

The **funding expenses ratio is increasing (7,9% in December 2006** respect to 6,2% as of December 2005), due to the increasing share of liabilities with commercial costs. On the other hand, **the provision expense ratio has been decreasing (3,4% in December 2006** with respect to 4,4% in December 2005) due to the improvement in the portfolio quality.

**Portfolio yield is 58,3% in December 2006** and it has increased compared to last year (56,6% as of December 2005), due mainly to a decreased percentage of delinquent loans. Nevertheless this trend indicates an aggressive competition where Finca Honduras works doesn't exist yet.

**At the moment a good margin to cover the structure of the financial and operational expenses of the institution does not exist.** FINCA could not absorb possible increases in delinquent loans, financial expenses or inflation. Besides, it is important to point out that aggressive market competition for FINCA H. could lead in the medium term to decreased interest rates, which could create pressure on the margins.

Nevertheless if we evaluate the performance of the last semester, FINCA Honduras has improved portfolio quality, efficiency and productivity indicators. The institution seeks to replicate the performance levels reached in the last semester 2006 and wants to improve its efficiency through:

- A further improvement of the portfolio quality and of the staff productivity
- Individualized payments using a banking note
- A greater leverage through savings mobilization and the diversification of new financial resources by taking advantage of economies of scale.

## 7. Business plan and financial needs

### Strategic plan and operational plan

The **Strategic Plan of FINCA Honduras** presents a good analysis of the external context (market and competitors) and of the same institution, with the identification of general objectives and the strategy to achieve them. It is important to indicate that in the objectives of the Strategic Plan for 2010 FINCA aims at reaching more than 32.000 clients.

The **Operational Plan 2007** has specific objectives to implement the strategy, activities, people in-charge and dates of realization.

Some of the main goals for 2007 include:

- more than 21.000 clients through 7 branches, and penetration of 3 new geographic areas. Need of 12 additional loan officers.
- US\$ 5 million in outstanding portfolio
- less than 3% of CeR30
- diversification in credit products offered
- improvement in technology, human resources and marketing.

It is important to point out that the management of FINCA Honduras takes a strict follow-up of the Annual Operational Plan and as for 2006 most of planned activities have been fulfilled.

### Financial projections

The **financial projections** are prepared and regularly updated in Microfin by the Financial Manger. In 2007 the expected portfolio growth is 39%, while the growth of the number of borrowers is 40%.

The debt-equity ratio goes from 1,7 in December 2006 to 2,2 in December 2007 which indicates a better financial leverage of FINCA H. which will allow it to fund its growth. **ROE** increases to 8,7% in 2007 (as of December 2006 it was 5,5%) and the OSS (operational sustainability) increases up to 124,13% (as of December 2006 is 103,8%) due mainly to a

Some proyected ratios (US\$)	Dec 06	Dec 07 *
Portfolio yield (gross portfolio)	58,3%	47,4%
Operating expenses ratio (aver. gross portf.)	45,8%	32,1%
Funding expense ratio*	7,9%	7,8%
Provision expense ratio	3,4%	2,5%
Return on Equity (ROE)	5,5%	8,7%
Debt/equity ratio	1,7	2,2

\* Source: MICROFIN updated as of February 2007

greater disbursement of loans, productivity increases, and portfolio quality improvement (in particular a decreased write-off ratio). In order to decrease the portfolio yield from 58,3% to 47,4%, the efficiency must improve greatly (the operating expenses ratio decreases from 45,8% to 32,1%).

### Financial needs and financing plan

Based on the growth objectives, the **financial needs** of FINCA for 2007 are **US\$ 1 million**. The planned growth and the funding sources to cover the financial needs for 2007 are achievable, above all considering the excellent results of the last semester of 2006. At the moment FINCA H. is negotiating some credit lines with 3 banks.

It is important to remember the opportunity to also fund the growth through the savings collection in case of the transformation of FINCA Honduras into a regulated financial institution and supervised by the National Commission of Banks and Insurance (CNBS)<sup>25</sup>.

<sup>25</sup> There is a feasibility study of the transformation of FINCA Honduras into a regulated institution.

## 8. Details of the risk factors

According to our analysis, the **major risk factors** for FINCA HONDURAS, are the following:

AREA	Risk factors	Relevance*	Main measures implemented and/or to implement in the short term	Observations
<i>External environment</i>	<i>Strong competition in the market and uncertainty about a possible new entry of strong competitors</i>	Medium	Products diversification, salaries and incentive schemes improved	Banco Procredit y Banco Azteca (consumer credit) have planned to start the operations in Honduras in the next months
	<i>Overindebtedness in the urban sector</i>	Medium	FINCA Honduras uses a Credit Bureau. Redmicroh (lobby) is helping to mitigate the risk. FINCA H. has a good diversification of the portfolio among branches and Tegucigalpa has got the lowest percentage	Over liquidity in the formal financial market and banks are lending more and more to the MSMEs and credit consumer sectors. Credit Bureau have not a complete and updated information
<i>Governance, management and operations</i>	<i>By-laws no updated and lack of a supporting code of rules</i>	Medium-low	Members of the Board are good and recognized professionals, have a good reputation image and the mechanisms and rules of governance have been used since many years	By-laws are the main source of information to evaluate the governance of the institution. A supporting internal code of rules could improve the transparency and confirms the best practices
	<i>High staff turnover</i>	Low	In 2006 there was a strong transition process based on the strict evaluation of the staff on results. As a consequence there was an high staff turnover.	Staff turnover in 2006 was 52%. We expect that this ratio will be much lower in 2007
	<i>Delays in bank reconciliation</i>	Medium	The Chief Financial Officer is planning to open a current account in every branch to collect loans payments and to improve bank reconciliation	Even if there are some improvements in the last months (no delays above 90 days) there is an high concentration of data to reconcile
	<i>Lack of a TI and MIS audit</i>	Medium	The internal audit wants to negotiate a TI & MIS external audit in 2007	-
	<i>The MIS is not on line, weekly closing of consolidated accounts and some accounts don't square</i>	Medium	FINCA H. is working to achieve a daily closing of consolidated accounts. Moreover, they are working on a plan formulation to improve the MIS and its technology to expand the services and to put the branches on-line	It is worthy to say that the data sent by some branches to the headquarters is slow and sometimes stops. This involves delays in the process of consolidation of the data.

AREA	Risk factors	Relevance*	Main measures implemented and/or to implement in the short term	Observations
<i>Financial products and asset quality</i>	<i>Many documents to renew loans</i>	Medium-low	They are planning to carry out a study to improve the process of loans renewal to good clients	Of course to ask many documents to the clients it seems that the IMF has got very strict controls
	<i>New mechanisms of collecting loans are slow and they are not entirely accepted by the staff of some branches</i>	Medium-low	The management is examining the new mechanisms of collecting loans	During our visit in the branches we detected some people not satisfied with the new structure of collecting loans
	<i>High idle liquidity</i>	Medium-low	The institution wants to create an ALCO and they are planning some short term financial investments	The institution has never taken advantage from short term financial investments
	<i>Portfolio quality to improve in 2 branches</i>	Medium	The branch directors were changed at the end of 2006	The branches of Tegucigalpa and Copan show the highest PAR30
<i>Financial structure and ALM</i>	<i>Concentration in few commercial investors</i>	Medium	Management is aware of the risk	High concentration in 3 sources and just Foundation Covelo represents 58% of the total sources
	<i>Limited treasury management</i>	Medium	It is planned to build a weekly cash-flow and an ALCO will be established	Limited tools to monitor and manage the liquidity
	<i>Currency mismatch and currency risk</i>	Medium-low	Management is aware, it has analyzed the risk and the stability of the macroeconomics indicators and it has decided not to take particular measures	The currency mismatch is US\$ 459.020 (loan from CORDAID)
<i>Financial and operational results</i>	<i>Low profitability and sustainability</i>	Medium-high	Portfolio quality, staff productivity improved, leverage, etc., by keeping operating expenses ratio at the same level	Good trends of the performance ratios in 2006 due to the increasing productivity and the portfolio quality improvement
	<i>High operating expense ratio</i>	Medium	Management has invested a lot in new professional staff and to improve credit and internal control processes. These measures should improve financial and operational results in 2007	The ratio "cost per borrower" has an increasing trend due to the increasing personnel costs (new professionals and incentives) and administrative costs (controls improved)

\* 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

FINCA HONDURAS			
Balance sheet (US\$)	Dic04	Dic05	Dic06
<b>ASSETS</b>			
Cash and bank deposits	757.020	750.780	593.286
Short term financial assets	-	-	-
Net outstanding portfolio	3.239.116	3.231.909	4.425.743
Gross outstanding portfolio	3.405.976	3.338.969	4.526.134
Performing portfolio	3.150.860	3.200.392	4.416.148
Portfolio at risk > 30 days	255.117	138.577	109.986
(Loan loss reserve)	166.860	107.060	100.391
Accrued interest	-	-	-
Other short term assets	122.302	114.139	103.171
<b>Total short term assets</b>	<b>4.118.438</b>	<b>4.096.828</b>	<b>5.122.200</b>
Long term financial assets	-	-	-
Net fixed assets	242.475	279.062	242.526
Other long term assets	3.731	2.912	929
<b>Total long term assets</b>	<b>246.206</b>	<b>281.974</b>	<b>243.455</b>
<b>Total assets</b>	<b>4.364.644</b>	<b>4.378.802</b>	<b>5.365.655</b>
<b>LIABILITIES and EQUITY</b>			
<b>LIABILITIES</b>			
Overdraft *	65.552	166.783	-
Short time deposits	828.587	249.014	-
Short term loans	714.662	1.034.174	1.916.004
Other short term liabilities	120.884	139.906	253.765
<b>Total short term liabilities</b>	<b>1.729.684</b>	<b>1.589.877</b>	<b>2.169.769</b>
Long term time deposits	-	-	-
Long term loans	747.240	883.392	1.178.571
Other long term liabilities	-	-	-
Restricted funds	-	-	-
<b>Total Long term liabilities</b>	<b>747.240</b>	<b>883.392</b>	<b>1.178.571</b>
<b>Total liabilities</b>	<b>2.476.924</b>	<b>2.473.269</b>	<b>3.348.340</b>
<b>EQUITY</b>			
Paid-in capital from shareholders	-	-	-
Donated equity	1.480.170	1.459.615	1.497.927
Quasi-capital	-	-	-
Reserves	155.058	152.905	176.566
Total retained earnings	252.492	293.013	342.823
Net income, previous years	140.946	248.985	231.040
Net income, current year	111.546	44.028	111.783
Other equity accounts	-	-	-
<b>Total equity</b>	<b>1.887.719</b>	<b>1.905.532</b>	<b>2.017.315</b>
<b>Total liabilities and equity</b>	<b>4.364.644</b>	<b>4.378.802</b>	<b>5.365.655</b>

\* originated during the last day of the month to cover payments (e: credits were prepared in the 31st of every month and then were disbursed the 1st or 2nd of the following month) this caused in the accounting an overdraft. By recommendation of the External Audit, they were reclassified in liabilities not to show negative balance in assets. This accounting practice stopped in 2006.

<b>FINCA HONDURAS</b>			
<b>Income Statement (US\$)</b>	<b>Ene04-Dic04</b>	<b>Ene05-Dic05</b>	<b>Ene06-Dic06</b>
<i>Interest &amp; commissions received on loans</i>	1.577.062	1.734.127	1.971.117
<i>Financial revenue from investment</i>	-	-	-
<i>Other financial revenues</i>	1.581	2.419	10.802
<b>A) Financial revenue</b>	<b>1.578.643</b>	<b>1.736.546</b>	<b>1.981.919</b>
<i>Interest paid on borrowings</i>	85.713	177.607	267.810
<i>Interest paid on savings</i>	22.626	15.004	-
<i>Interest paid on mortgage</i>	-	-	-
<i>Other financial expenses</i>	1.406	4.980	42
<b>B) Financial expenses</b>	<b>109.745</b>	<b>197.590</b>	<b>267.852</b>
<b>Gross financial margin (A - B)</b>	<b>1.468.898</b>	<b>1.538.956</b>	<b>1.714.067</b>
<i>Loan loss provision</i>	200.823	137.158	114.618
<b>Net financial margin</b>	<b>1.268.075</b>	<b>1.401.798</b>	<b>1.599.450</b>
<i>Other operating revenue</i>	77.904	63.531	21.581
<i>Personnel expenses</i>	925.515	1.062.275	981.207
<i>Administrative expenses</i>	329.686	419.091	566.741
<b>C) Operating expenses</b>	<b>1.255.201</b>	<b>1.481.366</b>	<b>1.547.948</b>
<b>Net operating income</b>	<b>90.778</b>	<b>16.037</b>	<b>73.082</b>
<i>Extraordinary revenue</i>	20.812	33.729	34.545
<i>Extraordinary expense</i>	45	125	-
<b>Net income before donations, before tax</b>	<b>111.546</b>	<b>17.566</b>	<b>107.628</b>
<i>Taxes</i>	-	-	-
<b>Net income before donations</b>	<b>111.546</b>	<b>17.566</b>	<b>107.628</b>
<i>Donations in cash</i>	-	26.462	4.155
<i>Revenue not from the operations</i>	-	-	-
<i>Expenses not from the operations</i>	-	-	-
<b>Net income</b>	<b>111.546</b>	<b>44.028</b>	<b>111.783</b>

## Annex 2 – Financial statements adjustments

The financial statements in Annex 1 are the result of a **standard reclassification of audited financial statements**; figures are expressed in American Dollars.

**Financial statements have been adjusted** to allow a comparison with other institutions which use a different logic of presentation of information and to evaluate the level of sustainability of the institution with market conditions.

The main adjustments normally are:

- adjustments for the accrued interest on delinquent loans (more than 90 days);
- elimination of donations in kind.
- elimination of soft loans<sup>26</sup>;
- provisions are calculated with a standard formula<sup>27</sup>;
- adjustments for inflation;
- adjustments for write off<sup>28</sup>.

FINCA Honduras has been affected all these years by the adjustment of the **inflation**. The loan loss provision adjustment had affected only in the past years, and the subsidized cost of fund adjustment only in 2004.

The net income is reducing in all considered periods.

Adjustments (US\$)	Ene04-Dic04	Ene05-Dic05	Ene06-Dic06
Reversal of accrued interest on non-perf loans	-	-	-
Subsidized cost of fund adjustment	77.836	-	-
- Interest rate used (national currency)	14,9%	14,1%	13,1%
- Interest rate used (foreign currency)	5,1%	7,0%	8,3%
Inflation adjustment	152.394	126.663	89.853
- Inflation rate used	9,2%	7,7%	5,3%
Loan loss provision adjustment	74.576	52.885	-
In-kind subsidy adjustment	-	-	-
<b>Total variation of net income</b>	<b>304.806</b>	<b>179.548</b>	<b>89.853</b>

<sup>26</sup> In the income statement it is registered as 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 credit rate in the national market (IFS Line 60P). In the case of loans denominated in foreign currencies (US\$ and euro), it is considered the average value of Libor 1 year plus 3%.

<sup>27</sup> 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%			

<sup>28</sup> The delinquent portfolio of more than 180 days is canceled.

## Annex 3 – Financial Ratios

In the present report we have calculated the indicators in a quarterly basis for the years 2004 and 2005 and in a monthly basis for 2006 (which has showed a strong portfolio growth, mainly in the second semester) because the period average is much more significant.

<b>FINCA HONDURAS (US\$)</b>	<b>Ene04-Dic04</b>	<b>Ene05-Dic05</b>	<b>Ene06-Dic06</b>
<b>PROFITABILITY</b>			
<i>Return on Equity (ROE)</i>	6,1%	0,9%	5,5%
<i>Adjusted Return on Equity (AROE)</i>	na	-8,9%	0,9%
<i>Return on Assets (ROA)</i>	3,0%	0,4%	2,5%
<i>Adjusted Return on Assets (AROA)</i>	-5,0%	-3,8%	0,4%
<i>Operational self-sufficiency (OSS)</i>	105,8%	99,1%	103,8%
<i>Financial self-sufficiency (FSS)</i>	88,6%	90,2%	99,2%
<i>Profit Margin</i>	5,5%	-0,9%	3,6%
<b>LOAN PORTFOLIO QUALITY</b>			
<i>Portfolio at risk (PAR30)</i>	7,5%	4,2%	2,4%
<i>Arrears rate (&gt; 1 day)</i>	13,4%	9,4%	4,6%
<i>Restructured loans</i>	0,0%	0,0%	0,0%
<i>Provision expense ratio</i>	6,7%	4,4%	3,4%
<i>Loan loss reserve ratio</i>	4,9%	3,2%	2,2%
<i>Risk coverage ratio (30 days)</i>	65,4%	77,3%	91,3%
<i>Write-off ratio</i>	4,1%	6,2%	3,6%
<b>EFFICIENCY AND PRODUCTIVITY</b>			
<i>Staff allocation ratio</i>	63,5%	52,3%	51,9%
<i>Loan officer productivity (borrowers)</i>	212	260	298
<i>Loan officer productivity (amount)</i>	42.575	59.624	83.817
<i>Staff productivity (borrowers)</i>	134	136	155
<i>Staff productivity (amount)</i>	27.032	31.205	43.521
<i>Branch productivity (amount)</i>	486.568	476.996	646.591
<i>Operating expenses ratio (average gross portf.)</i>	42,0%	47,5%	45,8%
<i>Operating expenses ratio (average assets)</i>	33,6%	35,9%	36,0%
<i>Cost per loan lent</i>	28	44	46
<i>Cost per borrower</i>	69	94	101
<i>Personnel expenses ratio (average gross portf.)</i>	31,0%	34,1%	29,0%
<i>Admin. expenses ratio (average gross portfolio)</i>	11,0%	13,4%	16,8%
<b>ASSETS/LIABILITIES MANAGEMENT</b>			
<i>Portfolio yield (gross portfolio)</i>	52,8%	55,6%	58,3%
<i>Funding expense ratio*</i>	3,6%	6,2%	7,9%
<i>Cost of funds ratio*</i>	6,4%	9,4%	12,7%
<i>Adjusted provision for inflation (av. gross portf.)</i>	5,1%	4,1%	2,7%
<i>Current ratio</i>	2,38	2,58	2,36
<i>Liquidez sobre activo total</i>	17,3%	17,1%	11,1%
<i>Debt/equity ratio</i>	1,31	1,30	1,66
<i>Capital adequacy ratio</i>	43,3%	43,5%	37,6%

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

**OUTREACH**

<i>Average disbursed loan size</i>	206	283	317
<i>Average outstanding balance</i>	201	229	281
<i>Average disbursed loan size on per-capita GDP</i>	20,3%	25,7%	26,6%
<i>Average outstanding balance on per-capita GDP</i>	19,8%	20,8%	23,7%
<i>Percentage of active borrowers women</i>	85,0%	84,3%	83,3%

**GROWTH (amount in national currency)**

<i>Growth of active gross portfolio</i>	2,8%	-0,6%	35,6%
<i>Growth of active borrowers</i>	-12,3%	-13,9%	10,3%
<i>Growth of active loans</i>	-12,3%	-13,9%	10,3%
<i>Growth of total assets</i>	13,8%	1,7%	22,5%
<i>Growth of staff</i>	8,6%	-15,1%	-2,8%
<i>Growth of funding liabilities</i>	29,8%	-4,1%	42,8%
<i>Growth of operating expenses</i>	16,2%	19,7%	4,5%
<i>Growth of equity</i>	6,3%	2,4%	5,9%

## Annex 4 – Definition of ratios

	Description of the ratio	Formula
<b>Profitability</b>	<b>Return on equity (ROE)</b>	Net income before donations / Average equity
	<b>Adjusted return on equity (AROE)</b>	Adjusted net income before donations / Average equity
	<b>Return on assets(ROA)</b>	I Net income before donations / Average assets
	<b>Adjusted return on assets (AROA)</b>	Adjusted net income before donations / Average assets
	<b>Operational self-sufficiency (OSS)</b>	(financial revenue + other operating revenue)/ (Financial expenses + Loan loss provision expenses + operating expenses)
	<b>Financial self-sufficiency (FSS)</b>	(Adjusted financial revenue + other operating revenue)/ (Adjusted financial expenses + adjusted loan loss provision expenses + adjusted operating expenses)
	<b>Profit margin</b>	Net operating income/ operating revenue
<b>Portfolio quality</b>	<b>Portfolio at risk</b>	Portfolio at risk > 30/Gross portfolio
	<b>Provision expense ratio</b>	Loan loss provision expenses/Average gross portfolio
	<b>Loan loss reserve ratio</b>	Accumulated reserve/ Gross portfolio
	<b>Risk coverage ratio(&gt;30 days)</b>	Accumulated reserve/ Portfolio at risk > 30 days
	<b>Write off ratio</b>	Write off of loans/ Average gross portfolio
<b>Efficiency and productivity</b>	<b>Staff allocation ratio</b>	Loan officers/ total staff
	<b>Loan officer productivity-borrowers</b>	Number of active borrowers/ Number of loan officer
	<b>Loan officer productivity-amount</b>	Gross portfolio/ Number of loan officer
	<b>Staff productivity – borrowers</b>	Number of active borrowers/ Number of staff
	<b>Staff productivity – amount</b>	Gross portfolio/ Number of staff
	<b>Operating expenses ratio (on gross portfolio)</b>	Operating expenses/ Average gross portfolio
	<b>Operating expenses ratio (on assets)</b>	Operating expenses/ Average assets
	<b>Cost per borrower</b>	Operating expenses/ Average number of borrowers
	<b>Administrative expenses ratio</b>	Administrative expenses/ Average gross portfolio
	<b>Personal expenses ratio</b>	Personnel expenses/ Average gross portfolio
<b>Financial management</b>	<b>Portfolio Yield (gross portfolio)</b>	Interest income from portfolio/ Average gross or net portfolio
	<b>Financial expenses ratio</b>	Financial expenses/ Average gross portfolio
	<b>Funding expense ratio</b>	Interest expenses on funding liabilities/ Period average funding liabilities
	<b>Current ratio</b>	Short term assets/ short term liabilities
	<b>Liquidity ratio</b>	Available funds/ total short term deposits
	<b>Debt/equity ratio</b>	Liabilities/ Equity
	<b>Capital adequacy ratio</b>	Total equity/ Total assets
<b>Outreach</b>	<b>Average disbursed loan size</b>	Amount issued in the period/ Number of issued loans
	<b>Average disbursed loan size on per-capita GDP</b>	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 for reporting and accounting

### Financial Statements

The financial statements of FINCA Honduras reveal the consolidated activity of the institution, are prepared in local currency (Lempiras) and are made under the cash method (accounting in cash amounts).

### Loan loss provision and write off

The policy for loan loss provision of FINCA Honduras is the following:

Aging portfolio in arrears	% provision
0 days	1%
1 - 30 days	1%
31 - 60 days	25%
61 - 90 days	50%
91 - 180 days	75%
> 180 days	100%

All the credits 180 days late and after all the administrative requests for their recovery have finished, the cases are transferred to the legal department to proceed with the legal recovery and ask the authorization to the Board of Directors for the write off of the provisions.

### Accrued interests

FINCA has a prudential policy to register the accrued interests.

### Restructured loans

FINCA has not restructured delinquent loans mainly because there is a strict policy of restructured loans and only in special cases.

There is not a particular provision policy.

### Insider loans

There is no policy and insider loans are not disbursed.

### Donations

The greater part of the received donations by FINCA Honduras are for the loan fund capital and at the moment of reception is placed in the income statement, then at the end of the period is capitalized in the equity.

Year	Amount	Destination	Source
2006	4.155	Loan Fund	Fundación Atkinson
	129.407	Operating Expenses	Finca International
<b>Sub-total</b>	<b>133.562</b>		
2005	26.462	Loan Fund	Proyecto FINLANDIA/MAFOR
<b>Sub-total</b>	<b>26.462</b>		
<b>TOTAL</b>	<b>160.023</b>		

### Exchange rate variations and assets and liabilities in foreign currency

The value of the items originally denominated in US\$ is converted using the exchange rate as of the day's date. Gain and losses are registered in the monthly income statement.

### Other accounting policy

Fixed assets are depreciated using the straight-line system, with the estimated useful life of each class of assets as a basis according to the local law.

FDL does not consider the effects of inflation in the financial statements.

### Loans

## December 2006

Loans borrowed				
Source	Currency (in which the loan is due)	Outstanding Balance (US\$)	% total	Agreement, kind of product and collateral
CORDAID	US\$	459.020	14,8%	Loan - Portfolio
Banco Atlantida	Lempira	242.566	7,8%	Loan - Portfolio
Proyecto Copan N.	Lempira	264.617	8,6%	Loan - Portfolio
BCIE	Lempira	136.543	4,4%	Credit line - Portfolio
BCIE	Lempira	68.271	2,2%	Credit line - Portfolio
BCIE	Lempira	15.665	0,5%	Credit line - Portfolio
BCIE	Lempira	121.724	3,9%	Credit line - Portfolio
Fundación Covelo	Lempira	66.154	2,1%	Credit line - Portfolio
Fundación Covelo	Lempira	344.003	11,1%	Credit line - Portfolio
Fundación Covelo	Lempira	185.232	6,0%	Credit line - Portfolio
Fundación Covelo	Lempira	132.309	4,3%	Credit line - Portfolio
Fundación Covelo	Lempira	132.309	4,3%	Credit line - Portfolio
Fundación Covelo	Lempira	158.770	5,1%	Credit line - Portfolio
Fundación Covelo	Lempira	105.847	3,4%	Credit line - Portfolio
Fundación Covelo	Lempira	138.924	4,5%	Credit line - Portfolio
Fundación Covelo	Lempira	92.616	3,0%	Credit line - Portfolio
Fundación Covelo	Lempira	66.154	2,1%	Credit line - Portfolio
Fundación Covelo	Lempira	99.232	3,2%	Credit line - Portfolio
Fundación Covelo	Lempira	132.309	4,3%	Credit line - Portfolio
Fundación Covelo	Lempira	132.309	4,3%	Credit line - Portfolio

Funding liabilities features					
Source	Loan amount (US\$)	Disbursement date	Maturity date	Principal repayments	Interest repayments
CORDAID	595.000	16/12/03	03/11/09	SEMESTRAL	QUARTERLY
Banco Atlantida	264.617	29/11/06	29/11/07	MONTHLY	MONTHLY
Proyecto Copan N.	264.617	02/08/06	30/07/08	SEMESTRAL	QUARTERLY
BCIE	136.543	07/11/06	02/06/08	QUARTERLY	QUARTERLY
BCIE	341.357	14/09/05	02/04/07	QUARTERLY	QUARTERLY
BCIE	39.163	13/12/05	02/07/07	QUARTERLY	QUARTERLY
BCIE	121.724	21/07/06	02/06/08	QUARTERLY	QUARTERLY
Fundación Covelo	66.154	19/12/06	19/12/08	QUARTERLY	MONTHLY
Fundación Covelo	344.003	18/12/06	18/12/08	QUARTERLY	MONTHLY
Fundación Covelo	185.232	13/12/06	12/12/08	QUARTERLY	MONTHLY
Fundación Covelo	132.309	23/11/06	21/11/08	QUARTERLY	MONTHLY
Fundación Covelo	132.309	20/11/06	20/11/08	QUARTERLY	MONTHLY
Fundación Covelo	158.770	23/10/06	23/10/08	QUARTERLY	MONTHLY
Fundación Covelo	105.847	18/10/06	17/10/08	QUARTERLY	MONTHLY
Fundación Covelo	158.770	25/09/06	25/09/08	QUARTERLY	MONTHLY
Fundación Covelo	105.847	27/09/06	27/09/08	QUARTERLY	MONTHLY
Fundación Covelo	105.847	29/03/06	28/03/08	QUARTERLY	MONTHLY
Fundación Covelo	158.770	23/03/06	23/03/08	QUARTERLY	MONTHLY
Fundación Covelo	264.617	12/12/05	12/12/07	QUARTERLY	MONTHLY
Fundación Covelo	264.617	06/12/05	06/12/07	QUARTERLY	MONTHLY

## Annex 6 – Rating scale

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