

# AgroInvest

## Serbia and Montenegro

### June 2004

Rating scales and formulas may be found on the following page.

#### Global Rating

**A-; Positive Trend (Montenegro)**  
**B-; Uncertain Trend (Serbia)**

AgroInvest started as a microfinance program of World Vision, disbursing its first loan in September 1999. Given the different legal requirements in the two Republics, two distinct entities have been created: “AgroInvest NVO” in Montenegro and “World Vision Serbia and Montenegro” in Serbia, though in practice they share the same Board, management team, and operational methods. In May 2004, AgroInvest had a gross outstanding portfolio of 10.7 million EUR for 11,987 active borrowers.

#### Rating Plus Summary

|               |   |
|---------------|---|
| Environment   | Montenegro: Favorable<br>Serbia: Favorable infrastructure,<br>unfavorable legal / political environment |
| Maturity      | Young: almost 5 years of operations   |
| Scale         | Large: Portfolio of 13.1 million USD  |
| Target market | Broad: Avg. out. loan is 92.9% of<br>GNI/capita   |

#### Area Scores (Montenegro)

|  |          |
|--|----------|
| <b>G</b> overnance and decision making     | <b>b</b> |
| <b>I</b> nformation management and systems | <b>a</b> |
| <b>R</b> isk Management                    | <b>b</b> |
| <b>A</b> ctivities: products and services  | <b>a</b> |
| <b>F</b> inancing and liquidity            | <b>a</b> |
| <b>E</b> fficiency and profitability       | <b>a</b> |

#### Area Scores (Serbia)

|  |          |
|--|----------|
| <b>G</b> overnance and decision making     | <b>d</b> |
| <b>I</b> nformation management and systems | <b>a</b> |
| <b>R</b> isk Management                    | <b>b</b> |
| <b>A</b> ctivities: products and services  | <b>a</b> |
| <b>F</b> inancing and liquidity            | <b>d</b> |
| <b>E</b> fficiency and profitability       | <b>b</b> |

| Consolidated                         | FY 2001 | FY 2002 | FY 2003 | May 2004 |
|--------------------------------------|---------|---------|---------|----------|
| <b>ACTIVITY</b>                      |         |         |         |          |
| Total number of staff                | 22      | 53      | 61      | 71       |
| Total assets (K EUR)                 | 2,441   | 5,615   | 9,748   | 12,056   |
| Loan portfolio (K EUR)               | 2,003   | 4,774   | 8,361   | 10,749   |
| % portfolio in Montenegro            | 100%    | 74.4%   | 83.3%   | 82.1%    |
| Number of active borrowers           | 2,095   | 5,208   | 9,629   | 11,987   |
| Number of depositors                 | n/a     | n/a     | n/a     | n/a      |
| Annual effective interest rate       | 35.8%   | 35.8%   | 35.8%   | (a)      |
| PAR 31-365                           | 0.2%    | 0.2%    | 0.2%    | 0.2%     |
| PAR > 365                            | 0.0%    | 0.0%    | 0.0%    | 0.0%     |
| Write-off ratio                      | 0.2%    | 0.1%    | 0.1%    | 0.1%     |
| Risk coverage ratio                  | 1,077%  | 76.6%   | 51.3%   | 95.7%    |
| <b>Exchange rate</b><br>1 EUR= x YUN | 60.85   | 59.02   | 66.81   | 73.35    |

| Consolidated                 | FY 2001 | FY 2002 | FY 2003 | May (b) 2004 |
|------------------------------|---------|---------|---------|--------------|
| <b>PERFORMANCE</b>           |         |         |         |              |
| ROE                          | (2.1%)  | 8.7%    | 11.1%   | 20.0%        |
| Liabilities / Equity         | 15.8%   | 20.6%   | 50.3%   | 55.9%        |
| ROA                          | (2.4%)  | 7.3%    | 8.1%    | 13.0%        |
| Operational self-sufficiency | 91.2%   | 138.8%  | 138.5%  | 175.5%       |
| Financial self-sufficiency   | 47.8%   | 60.9%   | 87.5%   | n/a          |
| Portfolio Yield              | 28.7%   | 30.9%   | 31.3%   | 33.9%        |
| Operating expense ratio      | 29.8%   | 24.3%   | 22.0%   | 18.1%        |
| Staff productivity           | 95      | 98      | 158     | 169          |
| Funding expense ratio        | 0.5%    | 0.3%    | 1.0%    | 1.2%         |
| <b>GROWTH</b>                |         |         |         |              |
| Loan portfolio growth        | 291.0%  | 138.3%  | 75.2%   | 28.6%        |
| Asset growth                 | 316.1%  | 130.0%  | 73.6%   | 23.7%        |

(a) In late 2003, AgroInvest was required to partner with a bank to continue its operations, entailing additional costs for AgroInvest and subsequently the client. The resulting effective annual interest rate remains 35.8% in Montenegro but is now 40.5% in Serbia.

(b) May 2004 unaudited figures represent an eight-month partial year. Ratios were annualized for ease of comparison.

## Rating Scale

| Area Rating | Global Rating | Explanation   |
|-------------|---------------|---|
| a           | A+            | <b>Excellent</b>  |
|             | A             | The institution excels in the evaluation area and is a model for the sector. There is a long-term vision for continual improvement. There are no risks in the short and medium term for operations. Long-term risks are well managed and monitored. |
|             | A-            |   |
| b           | B+            | <b>Good</b>   |
|             | B             | Procedures are well developed, effective, and incorporate a long-term perspective. Some improvements could be made. Long-term risks are identified in the strategic plan.   |
|             | B-            |   |
| c           | C+            | <b>Minimum required</b>   |
|             | C             | Procedures are functional but with certain failings. There are minor risks in the medium term for operations, but these risks are being managed and monitored.  |
|             | C-            |   |
| d           | D             | <b>Insufficient</b>   |
|             |               | Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.  |
| e           | E             | <b>Immediate risk of default or very insufficient</b>   |
|             |               | There are immediate or underlying risks for operations or an unacceptable under performance.  |

## Rating Plus: MicroBanking Bulletin categories for ECA (Eastern Europe and Central Asia)

| Scale<br>(Outstanding portfolio USD) | Target Clientele<br>(Avg. out. loan / GNP per capita) | Maturity<br>(Years of operation) |
|--------------------------------------|---|----------------------------------|
| Large: > 8 million                   | Low-end: < 20% OR avg. out. loan ≤ 150 USD            | New: 1 to 3 years                |
| Medium: 2 to 8 million               | Broad: 20% to 149%                                    | Young: 4 to 7 years              |
| Small: < 2 million                   | High-end: 150% to 249%                                | Mature: over 7 years             |
|                                      | Small Business: 250 %                                 |                                  |

## Ratio Formulas

|                              |   |
|------------------------------|---|
| Personnel productivity       | Active borrowers / Total personnel (end of period)  |
| Loan officer productivity    | Active borrowers / Total Loan Officers (end of period)  |
| Return on assets             | ROA: Net operating income before donations / Average assets   |
| Adjusted return on assets    | AROA: Adjusted net operating income before donations / Average assets                               |
| Return on equity             | ROE: Net operating income before donations / Average equity   |
| Adjusted return on equity    | AROE: Adjusted net operating income before donations / Average equity                               |
| Leverage                     | Debt (savings + debts) / equity (end of period)   |
| Portfolio yield              | Portfolio revenue / 13-month average gross outstanding portfolio                                    |
| Operating expense ratio      | Operating expense / 13-month average gross outstanding portfolio                                    |
| Funding expense ratio        | Interest and fees paid on funding liabilities / 13-month average gross outstanding portfolio        |
| Cost of funds ratio          | Interest and fees paid on funding liabilities / Average funding liabilities (deposits + borrowings) |
| Loan loss expense ratio      | Net loan loss expense / 13-month average gross outstanding portfolio                                |
| Adjustment expense ratio     | Total adjustments / 13-month average gross outstanding portfolio                                    |
| Net portfolio as % of assets | Net outstanding portfolio / total assets (end of period)  |
| Operational self-sufficiency | Revenue from operations / (Financial expense + Loan loss expense + Operating expense)               |
| Financial self-sufficiency   | Revenue from operations / (Financial expense + Loan loss expense + Operating expense + Adjustments) |
| Risk coverage ratio          | Loan loss reserves / Portfolio at risk (31-365 days)  |
| Write-off ratio              | Loans written off / 13-month average gross outstanding portfolio                                    |

# Executive summary



The microfinance environment varies considerably in each entity of the Republic of Serbia and Montenegro given the distinct legal and economic environments as well as respective market sizes. Montenegro has a euro-based economy with a separate Central Bank, a limited market size given the small population, and a legal framework favorable to microfinance with supervision by the Central Bank. There are a couple of NGO providers as well as several banks that serve microentrepreneurs, although the products typically offered by banks are consumer loans. In Serbia, the vast market remains untapped given the inhospitable legal environment and the outright prohibition on lending by any entity other than a bank.

World Vision launched microfinance operations in 1999 in Montenegro and in 2001 in Serbia to serve and empower rural families through high-quality financial services. In Montenegro, AgroInvest takes the institutional form of an NGO whereas in Serbia the operations are conducted through a division of World Vision International (WVI), which has received recognition from the Ministry of Foreign Affairs. Serbia operations were not in compliance with the law initially but now are performed in partnership with a disbursing bank, although this institutional arrangement is not conducive to long-term sustainability of operations. In May 2004, AgroInvest has an outstanding portfolio of over 10.7 million EUR, 18% in Serbia and 82% in Montenegro, for its single Agroloan product to nearly 12,000 active borrowers.

## Overall summary:

- ❑ **Key strengths:** AgroInvest has developed a well-adapted credit methodology to suit the mountainous areas of Serbia and Montenegro, an ability to conduct microfinance in diverse and even difficult operating environments, strong portfolio quality, and solid financial performance.
- ❑ **Areas for improvement:** AgroInvest's governance could be improved to strengthen local Board and management, as the Executive Director is an expatriate and the Board dependent on WVI employees. AgroInvest also needs to develop skills in product innovation, as it has had only one loan product since inception.
- ❑ **Principal risks:** The principal risks for AgroInvest are the legal and political environment in Serbia, the limited market size in Montenegro, and regional political trends, notably with expected expansion to FYROM (Macedonia).

**AgroInvest operations in Montenegro received a final rating of A-. The trend is Positive** given the already strong financial performance and the absence of risks that would have a negative impact on performance over the next 12 months. Over the longer term, AgroInvest will need to ensure product innovation to keep growing in limited market with other suppliers of microcredit.

**AgroInvest operations in Serbia under WVI received a final rating of B-. The trend is Uncertain** given the uncertainty with regards to institutional transformation and access to funding over the next 12 months. If these issues are resolved, AgroInvest would be expected to achieve greater economies of scale and productivity to further improve its already solid performance. Serbia has a vast untapped market and AgroInvest has already proven the success of its credit methodology and overall operations in the area.

The area ratings are as follows:

**Governance and decision-making** received the rating **b** in Montenegro and the rating **d** in Serbia:

- ❑ The striking difference in the ratings for governance between the two entities is based on the different institutional forms resulting largely from the legal framework for microfinance. In Serbia, AgroInvest is only a representation of WVI therefore has no official local registration, statutes, or Board. In practice, the Board registered in Montenegro oversees operations in both entities. The planning process, management team, and human resource policies are otherwise virtually the same across entities.
- ❑ The Board serves an appropriate mission setting and supervisory role but is dependent on WVI staff in different countries and lacks significant banking and finance experience that may be necessary for a change in institutional form.
- ❑ The development of the latest business plan included for the first time the involvement of staff at various levels of the organization. The resulting plan attempts to address areas for improvement but the feasibility of further expansion in Serbia is contingent upon resolution of its institutional structure and financing issues and the expansion to FYROM (Macedonia) will require an important resource investment.
- ❑ The management team members are for the most part relatively new to their positions and are increasingly growing independent of the expatriate Executive Director who has already served in his position for five years. The team manages successfully the credit and financial operations.
- ❑ A dedicated HR Manager has managed human resource management since 2003 with a goal of making AgroInvest one of the best employers in the country. The policies are formalized and include incentive pay and thorough staff evaluations. In Serbia, the incentive pay has been problematic as staff is not able to reach the incentive goals due to lack of sufficient funding for operations.

**Information management and systems** received the rating **a** for both Montenegro and Serbia:

- ❑ AgroInvest's MIS serves its needs. The installation of eMerge with a Virtual Private Network prepares AgroInvest for a possible institutional transformation that requires an MIS with greater security and robustness, even if the benefits of a more powerful software will not accrue until all loans in the old software are repaid.
- ❑ AgroInvest has all the necessary portfolio information at the branch level daily and at the HQ level monthly. Through household surveys performed prior to starting operations in a village, AgroInvest has estimates of its market size and tracks its market penetration.
- ❑ The accounting and finance information is accurate and up-to-date with monthly statements. Upon recommendation of the external auditor, AgroInvest is monitoring financial performance by entity (Montenegro versus Serbia).

**Risk analysis** received the rating **b** for both Montenegro and Serbia:

- ❑ AgroInvest has adequate internal controls. Most procedures are clear and standardized, however certain policies, such as daily cash limits, are not clear to staff. AgroInvest only recently developed its manuals.
- ❑ AgroInvest has clearly identified major institutional risks. The internal audit function has made a promising start with an orientation towards improving operational performance, but has continued room for improvement.

**Activities: Products and Services** received the rating **a** for both Montenegro and Serbia:

- ❑ Using a well-adapted credit methodology that combines individual loan analysis with the efficiency gains of a village level representative, AgroInvest has successfully implemented its Agroloan product. AgroInvest has not yet developed any additional products. If AgroInvest expands to larger loan sizes, the cash-flow analysis would need to be refined.

- The PAR31 and write-off ratio of 0.2% and 0.1% respectively in 2003 and 2004 attest to the success in portfolio management. There are only minor variations by region.
- Credit risk coverage is appropriate, with nearly 100% of the PAR31 covered by provisions in May 2004 in addition to salary withholding guarantees for every loan.

**Funding and Liquidity** received the rating of **a** in Montenegro and **d** in Serbia:

- The funding opportunities are severely limited in Serbia given the current institutional form as AgroInvest does not have an independent legal structure apart from WVI, resulting in the current funding shortages and a capital structure that is 91% financed by equity.
- In Montenegro, AgroInvest has had access to sufficient funding thus far and has a more diversified capital structure of 42% long-term liabilities from international sources such as KfW and Cordaid, albeit at concessional rates. Local banks have not expressed a willingness to lend to AgroInvest without physical collateral.
- Despite the multi-currency environment, there are no major ALM risks other than the devaluation of equity through inflation.
- Monthly cash-flow oversight is the responsibility of the branch manager and is therefore monitored closely. Longer-term projections on an institution-wide level could be more refined.

**Efficiency and Profitability** received the rating **a** in Montenegro and **b** in Serbia:

- The financial performance of Montenegro is stronger than that of Serbia given that operations have been in place longer in Montenegro and there is sufficient funding to use loan officer capacity, all leading to greater economies of scale.
- In both entities AgroInvest covers its costs with a healthy operational self-sufficiency. The high inflation adjustments drive down financial self-sufficiency to below 100%.

**Funding needs:**

- AgroInvest is seeking an additional 18 M EUR by end of 2006 for its operations in Montenegro, Serbia, and expansion into FYROM (Macedonia).
- Planet Rating believes that AgroInvest has strong operating methods and financial performance and a history of debt, even if at concessional rates. In funding decisions for Serbia, the investor will require additional due diligence to overcome legal challenges and the lack of a distinct institutional structure.

**The opinions expressed within this report are valid for one year after the rating mission. Beyond one year, or in case of a major change during this period affecting the institution's performance, that change due to the institution itself or its operating environment, Planet Rating does not guarantee the validity of the opinions contained herein, and recommends that a new rating evaluation be undertaken. Planet Rating cannot be held responsible for investments/financings that are made based on this report.**

# Rating Plus

The GIRAFE rating evaluates the financial sustainability of an institution regardless of its operating context (economic and political environment, infrastructure) or its development as measured by MicroBanking Bulleting (MBB) indicators such as maturity, scale, and target clientele. Rating Plus serves to highlight those internal and external impediments to achieving financial sustainability.

## Operating Context

|   | Sept. 2001 | Sept. 2002 | Sept. 2003 | May 2004 |
|---|------------|------------|------------|----------|
| <b>Economic and Political Environment:</b>          |            |            |            |          |
| <b>Favorable (Montenegro); Unfavorable (Serbia)</b> |            |            |            |          |
| Exchange rate: 1 EUR = X YUN                        | 60.85      | 59.02      | 66.81      | 73.35    |
| GNI/ capita (USD)                                   | 1,240      | 1,400      | 1,174      |          |
| Inflation estimate 1                                | 22%        | 27%        | 14%        |          |
| Inflation estimate 2                                | 39%        | 14%        | 14%        |          |
| Coface Rating                                       |            |            |            | D        |

Source: oanda.com / World Bank / IMF/ Coface

- Serbia and Montenegro is a lower middle-income country with GNI per capita of 1,174 USD. In 2003, GDP reached 15.6 billion USD, services accounting for 40% of GDP, industry for 36%, and agriculture for 24%. Agricultural land is fertile and arable, and the country is rich in natural and mineral waters.
- Between 1991 and 1999, the country suffered a severe economic decline, leaving a collapsed economy, a ruined financial sector, fragile institutions and increased vulnerability. It is now progressing towards a market economy despite ongoing political turmoil, with encouraging economic growth (5.5% in 2001 and 4% in 2002) and decreasing inflation (from 113% in 2000 and 39% in 2001, down to 14% in 2002).
- The wars with Bosnia and Croatia as well as the Kosovo conflict during the 1990's left Serbia and Montenegro with 450,000 refugees and 240,000 internally displaced persons. Approximately 10% of the population is below the poverty line although another third of the population could slip below poverty if the economic situation worsens.
- Microfinance in Montenegro is regulated by the Central Bank. In Serbia, only banks may legally provide loans, creating a highly unfavorable legal framework for MFIs.

### Infrastructure: Favorable

- Transportation infrastructure is adequate in the urban and rural areas of both Serbia and Montenegro. Travel in the mountains, where AgroInvest works, can be more challenging, especially during winter with snowfall.
- The telecommunications infrastructure is sufficient for MFIs to be able to work via telephone and leased lines for fluid data communication.

## Institutional Development (MBB Indicators)

### Maturity: Young Scale: Large

- AgroInvest began its activities in September 1999 and has therefore been operating for nearly 5 years. The loan methodology has been well mastered. Governance is still in the development stages, as is the management team.
- To achieve scale, AgroInvest benefited from donations (SIDA, CIDA, and to a lesser extent WV affiliates) for 5 million EUR and concessional loans for over 2.5 million EUR (KfW and Cordaid).

### Target clientele: Broad Other Activities: No

- AgroInvest provides credit only to rural microenterprises and families.
- Women now account for 70% of clients, which is higher than regional peers.
- AgroInvest is in the Broad category overall (20% to 120%) as the average outstanding loan as a % of GNI per capita is 92.9% in December 2003.
- Agriculture and agribusiness loans account for 93% of loans.

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# Acronyms



|       |  |
|-------|--|
| ALM   | Asset/Liability Management   |
| BoD   | Board of Directors   |
| BPRM  | Bureau for Population Refugees and Migration (United States)         |
| CIDA  | Canadian International Development Agency                            |
| EIR   | Effective interest rate  |
| EUR   | Euro   |
| FY    | Fiscal Year (October 1 <sup>st</sup> to September 30 <sup>th</sup> ) |
| FYROM | Former Yugoslav Republic of Macedonia                                |
| HQ    | Headquarters   |
| HR    | Human Resources  |
| GNP   | Gross National Product   |
| GDP   | Gross Domestic Product   |
| IAS   | International Accounting Standards                                   |
| IT    | Information technology   |
| KfW   | German Development Bank  |
| LO    | Loan officer   |
| LTS   | Loan Tracking System   |
| M     | Million  |
| MBB   | MicroBanking Bulletin  |
| MFI   | Microfinance institution   |
| MIS   | Management Information System  |
| NA    | Not Applicable   |
| NGO   | Non Governmental Organization  |
| PAR   | Portfolio at risk  |
| ROA   | Return on assets   |
| ROE   | Return on equity   |
| SC    | Save the Children  |
| SIDA  | International Development Cooperation Agency                         |
| SME   | Small and medium sized enterprise                                    |
| USAID | United States Agency for International Development                   |
| USD   | United States Dollar   |
| VA    | Village Association  |
| VC    | Village Council  |
| VPN   | Virtual Private Network  |
| WVI   | World Vision International   |
| YUN   | Yugoslav Dinar   |

# Institutional Presentation



*Political and economic environment* The highly complex political and economic history of Serbia and Montenegro results in distinctly different operating conditions for microfinance in each republic. Although one country, the Union of Serbia and Montenegro is composed of two republics and two semi-autonomous provinces in Serbia of Kosovo and Vojvodina. During the Milosovic period, Montenegro separated its economy so that it was not under control at the federal level (Republic of Yugoslavia). The resulting changes remain in Montenegro, including different central banks, currency (Euro versus Yugoslav Dinar), taxation systems, customs tariffs, and fiscal policy. The future harmonization of such policies remains uncertain, notably given Montenegro's aspirations to enter the European Union.

*Mission* AgroInvest combines its clear mission based on Christian values with a goal of long-term financial self-sufficiency. Its vision, "life for rural families in all its fullness" and its mission, "serving and empowering rural families through high-quality financial services" are very well known by all. To further support the social mission, branch bonuses are contingent upon the active client base reaching at least 60% women.

*Legal form and supervision* AgroInvest is legally two separate entities operating under two very different legal regimes, albeit in practice AgroInvest is managed as one organization.

**Montenegro:** As of December 2002, microfinance providers, if not already a bank, fall under supervision of the Central Bank. The authorizing decree was the result of lobbying by AgroInvest and other local actors. AgroInvest is subject to monthly reporting and periodic inspections. There are no stated prudential norms for AgroInvest, given that it may not provide savings, apart from a maximum leverage of 300% (debt/equity). MFIs are authorized to provide loans, leasing products, and consulting. Authorized maximum loan sizes are 8,000 EUR for individuals and 20,000 EUR for businesses.

**Serbia:** The general legal environment in Serbia is not stable and is not conducive to microfinance. Serbian law expressly prohibits non-banking structures from providing loans. Therefore, microfinance operations must pass through a registered bank and follow banking norms, such as an 18% reserve requirement (if not provided by the partner bank) and a 20% revenue tax. This problematic legal environment also greatly limits funding opportunities for MFIs.

AgroInvest initially operated independently of any banking structure when it launched services in Serbia in 2001. Through a donor, AgroInvest proposed an agreement with the Serbian government to approve its lending activities. Unfortunately, the government did not respond favorably and AgroInvest was required to cease disbursements for four months starting April 2003. AgroInvest developed a bank partnership and now offers loans in Serbia using a more costly but for now legally sanctioned method. The bank is party to the loan contract but bears no credit risk.

*Ownership* Given these striking differences in legal environments, the legal structure of AgroInvest is very different between Serbia and Montenegro even if in practice it is treated by staff and the founder, World Vision International (WVI), as one entity. WVI has an agreement with AgroInvest to preserve controlling majority of the Board (to nominate at least 51% of the Board) and to retain control of the assets.

**Montenegro:** AgroInvest NVO-Podgorica is a non-governmental organization, initially registered in 2000 and reregistered in May 2003 with the current name. The statutes are very basic to comply with legal requirements and enumerate that there is a Founder, a Board of Directors, a Supervisory Body (known as the Audit Committee), and a Managing Body (Executive Director). The minimum number of Board members is three and the Founder may appoint or dismiss any Board members. The current Board includes five voting members and the non-voting Executive Director.

**Serbia:** In Serbia, AgroInvest has received a letter from the Ministry of Foreign Affairs of Serbia and Montenegro recognizing World Vision International's presence as a humanitarian organization. AgroInvest is not registered as a local entity.

*Services* **Loan Product Features**

AgroInvest offers only one loan product, the Village Association (VA) Agroloan, from 250 EUR to 3,500 EUR (maximum of 1,500 EUR for a new client), with terms from 3 to 30 months (maximum of 18 months for new clients). AgroInvest developed the VA's to combine village banking and individual loan models. Clients form the VA and nominate respected members of the village to serve as community representatives, known as the Village Council. These village groupings are informal and serve uniquely to facilitate the work of loan officers (LOs), particularly in remote and less populated areas. The Village Council members provide assistance with marketing, client selection, loan monitoring, repayment collection and delinquency management.

| Loan Product Features            | VA Agroloan   |
|----------------------------------|---|
| Creation date                    | August 1999   |
| Minimum / Maximum loan amount    | 250 EUR / 1,500 EUR (first loan maximum)<br>3,000 EUR (maximum)   |
| % of total outstanding portfolio | 100%  |
| Nominal interest rate            | 18% (Montenegro)<br>20.4% (Serbia)  |
| Fees                             | Application fee (deducted when loan disbursed):<br>2.5% (Montenegro), 3.5% (Serbia);<br>Penalties 0.2% (calculated on the principal of that installment only) |
| Repayment frequency              | Monthly   |
| Term (without grace period)      | 3 months – 18 months (first loan)<br>– 30 months (subsequent loans)   |
| Grace period                     | Up to 6 months  |
| Guarantees                       | Two guarantors with bills of exchange and salary withholding  |
| Effective interest rate          | Montenegro: 35.8%<br>Serbia: 40.5%  |

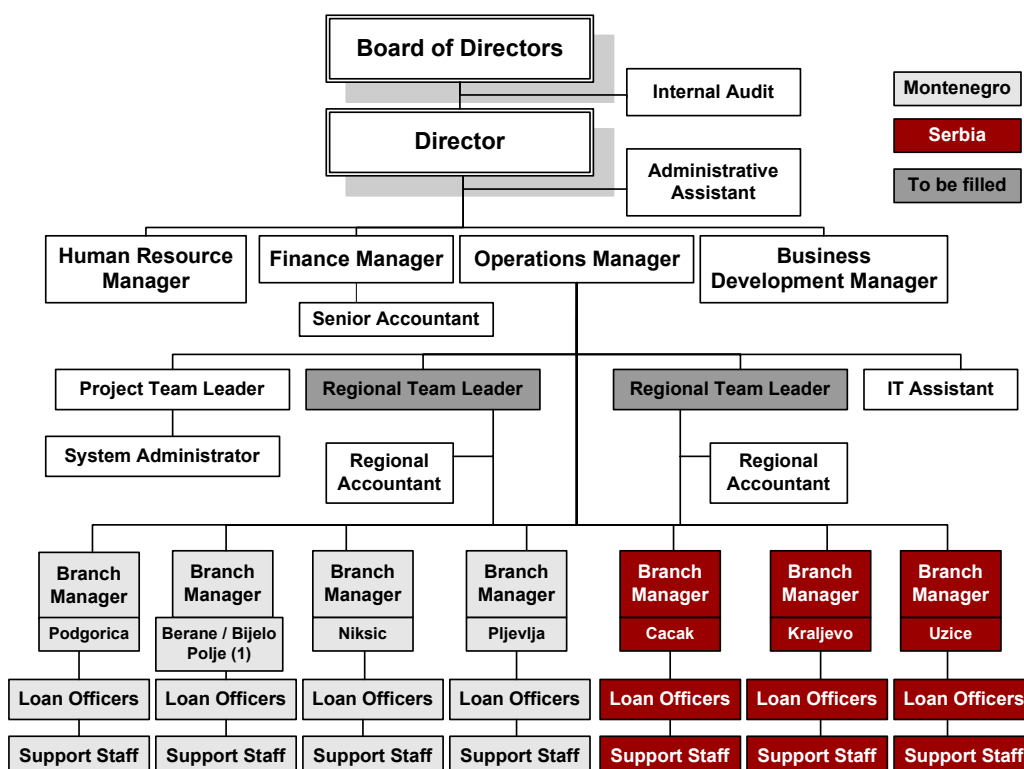
*Human resources and branches*

AgroInvest has its headquarters (HQ) in Belgrade, for the management team, an administrative office in Podgorica, Montenegro and eight lending offices, three in Serbia (Cacak, Uzice and Krajlevo) and five in Montenegro (Podgorica, Berane, Bijelo Polje, Niksic and the newly opened Pljevlja). All credit decisions and loan tracking data entry are decentralized to the branches. Accounting data is first treated at the branch level and then centralized. In addition to the branch level staff described below, the Village Associations play an integral role in service delivery,



totaling 170 at the end of 2003 (64 in Serbia and 106 in Montenegro). Each village typically groups around 150 households that share solidarity links, and are interrelated in terms of communications, road systems, businesses, family, education, and history.

AgroInvest works with partner banks in both republics for disbursements, however in Serbia this is required for operations. In Montenegro, the partner bank is used simply to disburse the loans to limit the cash risk. Clients receive a document upon loan signature and must present this document with identification to the bank to receive the loan from the AgroInvest account. In Serbia, the bank is a legal party to the contract, which is signed by the client, World Vision (i.e. AgroInvest), and the bank. The bank therefore maintains a separate account for each client and tracks repayments by client, although it is AgroInvest staff and not the client that physically brings the cash to the bank for repayments.



(1) The sub-office Bijelo Polje has the infrastructure of a branch, but shares its Branch Manager with the Berane office

| Human resources                                      | Sept. 2001 | Sept. 2002 | Sept. 2003 | May 2004 |
|--|------------|------------|------------|----------|
| Number of branches                                   | 2          | 5          | 6          | 7        |
| Number of Village Associations                       | 50         | 113        | 170        | 197      |
| Number of personnel                                  | 22         | 53         | 61         | 71       |
| % Loan officers                                      | 72.7%      | 52.8%      | 49.2%      | 42.3%    |
| Turnover (exits/ period average number of personnel) | 0%         | 5.3%       | 1.8%       | 3%       |

*External audits* PriceWaterhouseCoopers was the external auditor FY 2000 (end of FY is September 30<sup>th</sup>) and after merger KPMG for FY 2001 and FY 2002. AgroInvest changed auditors for the FY 2003 audit to select Ernst and Young. The auditor produced consolidated reports in EUR as well as separate financial statements by republic in EUR. During the audit process the auditor sampled approximately 30 client files per branch to review. The auditors have all approved without reserve these financial statements, acknowledging that they give a fair picture, in all material

respects, of the financial position of the institution, and that they are in accordance with international accounting standards.

In 2003, AgroInvest received additional audits by several organizations: a CIDA program audit conducted by MEDA in March 2003, a CIDA financial audit by Deloitte & Touche in February 2003, a World Vision MEER audit conducted by the regional office in January 2003, a KfW financial audit conducted by GFA Management in August 2003, and a Central Bank of Montenegro audit in December 2003. None of these additional audits identified major weaknesses or inaccuracies.

*Competition* The legal environment largely determines the microfinance landscape, with competition becoming more noticeable in Montenegro but not yet in Serbia. Commercial banks are providing consumer loans that could serve as a substitute for microfinance loans in cases where a household member has a salary. ProCredit Bank offers products targeting the SME community throughout Serbia.

**Montenegro:** AgroInvest faces competition from another NGO, Alter Modus, and increasingly Opportunity Bank, a former NGO transformed to full-service bank that has a special agriculture line sponsored by KfW with interest rates to the client significantly lower than those of AgroInvest. Urban areas are not a target market for AgroInvest but are reportedly becoming saturated by other providers as Montenegro offers a limited market size.

**Serbia:** NGOs working with partner banks include MDF and Mikrofin (the latter the result of a merger among five smaller programs) initially funded to target specifically refugees. They are both smaller in scale than AgroInvest and operate predominantly in different geographic regions. The vast market therefore remains underserved.

# Governance and Decision Making

*As described in the Institutional Presentation, for legal purposes the governance of the Montenegro and Serbian offices is very different and thus has important implications for the long-term sustainability of operations in Serbia.*

## Decision-making

### Decision-making process

*Governance formalized in Montenegro and de facto in Serbia*

The Board is officially registered in Montenegro but is de facto overseeing Serbian operations, which are legally run as a representative office of WVI. In practice, AgroInvest has a clear separation of duties in the decision-making process between the Board, that meets quarterly and serves to oversee strategy, and a management team, that has the appropriate autonomy to conduct its day-to-day work. As is common for MFIs with an Executive Director in place since the MFI's founding, the Board may rely too heavily on the Executive Director. The Board makes decisions that are clearly in keeping with their mission of serving the financing needs of rural families. Per the statutes, requirements of the Board are very basic so most responsibilities are left for the Board and founder to decide.

*Board highly dependent on expatriate WV employees*

The Board has several skilled members but remains dependent on expatriate World Vision staff and would benefit from greater skill diversity. AgroInvest has now identified governance as an important issue to strengthen, as priority has been given to first developing the scale of AgroInvest operations in the context of a difficult operating environment. The Board is comprised predominantly of expatriates (three out of five members, the sixth member being the Executive Director without voting rights) who are World Vision staff in other countries, complemented by two local members. It is hoped that the number of members living locally will grow to four by the end of the year. The Board has a range of experiences, including law, religion, business, and development. The WVI regional microfinance director is both a member of the Board and the hierarchical supervisor of the AgroInvest Director, who is employed directly by WVI but paid for by AgroInvest, serving as a double check on the Executive Director's performance. The Board would benefit from more banking expertise, especially given that one of the possible institutional forms for the future is a banking structure.

*Institutional transformation could change nature of governance*

AgroInvest is actively investigating new institutional forms to strengthen local governance, increase access to external funds, and ensure long-term sustainability in Serbia. One solution under investigation to preserve strong ties to World Vision is the development of an AgroInvest International, which would be a holding entity under the Vision Fund, a structure created by the US-based WVI to help finance MFIs. This holding company would then consolidate the operations in the different regions, Serbia, Montenegro, and as anticipated, FYROM (Macedonia). The optimal legal structure of such a holding company is contingent upon the legal structure of each regional office, particularly in Serbia. The Executive Director is devoting much of his time investigating these various institutional forms, which entail different capital requirements and legally allowable funding sources.<sup>1</sup>

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<sup>1</sup> In Serbia, Savings and Credit institutions only have a 2M EUR capital requirement but may not receive donations or borrow in foreign currency, and only one license has been granted for such a structure over the last 12 years. The commercial bank structure would be more adapted but it may not receive donations and has a 10M EUR minimum capital requirement. A local (Serbian) NGO structure has numerous limitations for funding access. Banks in Montenegro require 5M in capital.

### **Management information**

#### *Regular and up-to-date management information*

AgroInvest provides the Board with accurate and up-to-date information on the financial and portfolio performance in addition to narrative reports from the Executive Director highlighting major risks and important issues for consideration. This information provides a clear picture of performance, with possible improvements in budgeting and projections.

## **Planning**

### **Relevance of the current strategy**

#### *Planning process being progressively decentralized*

The process of business plan development during the latest round involved the Board, for mission and vision definition, and field staff, for operational projections. The planning process in the past has been more centralized with the Executive Director, although he still manages the Microfin projections. This latest plan development process was an important learning process for the organization, upon which they hope to build for future annual updates.

#### *Feasible plan if Serbia "question" resolved*

The current strategic plan is feasible with one major caveat, that the Serbian legal problem can be resolved, opening the path to new financing and greater expansion in a large, unserved market. The Montenegro market has greater competition for a limited potential market; therefore the greatest growth opportunities are in Serbia. The basic goal is to grow to 25,000 clients (6,000 from existing markets, 9,500 from new markets) for a portfolio of 29 M EUR by yearend 2006 (from approximately 11 M EUR and 12,000 clients in May 2004.) These estimates are based on projected growth given the potential market of existing offices and planned expansion to southeastern Serbia and Macedonia. The locations of seven additional branch offices have already been identified. There are plans to develop one non-credit product as well. During the business planning process, AgroInvest took into account the MIS and human resource needs to meet its goals.

#### *Expansion to FYROM (Macedonia) anticipated*

An important aspect of AgroInvest's future plans, even if not quantified in the business plan projections, is a possible expansion into FYROM (Macedonia). AgroInvest has already done a microfinance assessment of the region, noting an appropriate economy for rural microcredit and a market need but a politically unstable environment. In the past, AgroInvest expected but subsequently cancelled a merger with another World Vision affiliate in Kosovo for several reasons. One of the issues not fully considered was ethnic relations and this will need to be carefully monitored for expansion in Macedonia. The goal is to open the first three branches in areas of mixed ethnic groups to gain credibility. Given strong ties to its sister organization in Bosnia, a potential collaboration in the future is also possible.

### **Budgeting Process**

#### *Budgeting process now more formalized*

The budgeting process has become significantly more formalized over the last year. The data on performance has always been available with great regularity, however the focus has been on retrospective analysis. In the past the budget variations have been up to 25% in certain cases. New procedures, duly recorded in a finance manual to be finalized soon, clarify all the procedures for budget management, authority levels, and budget updates.

#### *Some budgeting autonomy at the branch level*

The branch managers have a greater degree of autonomy than many other comparable institutions with regards to budgeting decisions. Per the branch bonus, a branch is responsible for its overall profitability but may choose how to spend money within basic guidelines. For example, a branch could choose to purchase an additional vehicle to increase the productivity of an existing officer as opposed to hiring a new loan officer if this was deemed more cost effective.

## Management Team

### Skills and experience of management team

#### *Management team covers basic areas*

The management team includes the Executive Director, Business Development Manager, Finance Manager, Human Resource Manager and Operations Manager. As discussed under Section I, the top IT staff is not available to serve as an IT manager and those duties are currently managed by the Operations Manager, a challenge during a major MIS transition. The Internal Auditor, based at headquarters, reports to the Board audit committee. The team has relevant professional experience for their respective positions, with the exception of the Business Development Manager, but this is complemented by prior experience working in MFIs (operation, internal audit) and with donors (USAID). Being part of the WVI network of over 40 MFIs worldwide, the management team benefits from information sharing and exchange trips, notably with EKI in neighboring Bosnia. The Executive Director and Business Development manager formerly worked there and others have performed exchange visits.

#### *Plans to strengthen operations management*

AgroInvest plans to hire more management staff for credit operations to meet increased needs in capacity and technical expertise. The Operations Manager, in his position for two months, supervises all branches. He has effectively been performing many of the Operational Manager tasks in his prior position as a regional leader.<sup>2</sup> Previously, there were two regional leaders, each supervising a region, but no Operations Manager. When activities develop in Serbia, it is expected that these two regional leaders will be hired to supervise the branches in their respective entities and serve a key relationship role with local government authorities and banks. Given the lack of product development expertise within the team, AgroInvest is also seeking to add a position that will focus on this topic.

### Organization of the management team

#### *To minimize key person risk with the expatriate Executive Director, development of management team a priority*

The management team functions are clearly distributed, with the Executive Director increasingly delegating responsibilities to the team. The expatriate Director has been with AgroInvest since it started in 1999. Although there is no formal departure date, it is expected that the Executive Director will stay at least through 2005. Therefore, the development of the management team is a stated priority for the organization. This is being developed through trainings, very detailed performance evaluations, and personal coaching by the Director. The job descriptions vary in level of detail but each manager knows his/her primary tasks now, and with more experience, the additional responsibilities for the future.

#### *Unique approach to branch management with “acting” managers*

Another unique feature of the organization of the management team is the strategy of “acting” branch managers. Expansion and staff promotion have created vacancies in branch manager positions. These positions are not necessarily filled with a permanent replacement immediately. Rather, AgroInvest will initially take employee requests to serve in these positions, including a senior management staff member as part of his/her management training. This practice promotes learning exchanges, is a tool to reduce possible fraud through staff rotation, serves as a test for promising new branch managers, and increases staff versatility. Although this practice could prove disruptive to the organizational structure, AgroInvest reports positive experiences. As the planning demands of branch managers become more complex, extended periods of time without a permanent branch manager could prove more difficult.

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<sup>2</sup> The current Operations Manager served as a loan officer, a branch manager, and a regional leader for a total of almost five years prior to being nominated to his current position.

## Human Resource Management

### Organization of human resource management

*HR position created in 2003; goal to be one of 100 best employers*

The position of HR Manager was created in February 2003 to handle all HR tasks in the context of expansion (recruitment, training plans, implementation of HR procedures and a salary grid). As a new position, a major part of the HR Manager's job has been to develop the institution's HR policies. A stated goal is to make AgroInvest one of the country's best 100 companies for employees. The current HR Manager is young and learning on the job but has sufficient skills, direct and regular staff contact, and a deep knowledge of the institution, having worked before as a client administrator in Montenegro. All administrative tasks relative to payroll are outsourced.

*Policies successful in building a committed staff*

AgroInvest has succeeded in building a motivated team through clear recruitment procedures, internal promotion of staff in key management roles, and on-going trainings. The emphasis on high quality performance is a notable characteristic at AgroInvest, based on clear skills management and performance reviews. One of the institution's key strengths is staff's strong sense of commitment to the organization. The improvements in HR Management (personnel policies, formulation of salary grid, etc.) should help reinforce that commitment if current dissatisfactions with remuneration in Serbia are addressed (see below).

### Skills management and performance evaluation

*Appropriate overall skills management with increased emphasis on management training*

HR procedures are appropriate, professional, and have grown more formalized since the creation of a dedicated HR Manager. Skill development of the management team and middle management is a primary focus and one of the greatest challenges. Field staff has sufficient skills.

- Recruitment is transparent with clear policies and procedures. Job openings are advertised via radio and newspaper ads in addition to internal promotion. The aim of the HR Manager is to match the right people and the right position, which sometimes results in very different positions filled by the same person (System Administrator was previously a Loan Officer and HR Manager a Client Administrator). Field knowledge is a priority; therefore the management team is required to act as a Branch Manager for six months.
- The salary grid is currently being redefined and is expected to include a base salary and then a range of coefficients for each position that are a function of the base salary.
- An additional bonus is split between branch employees to reward strong performance and a new individual bonus has been implemented for LOs' with "exceptional" productivity (i.e. above 420 clients).
- Staff is globally satisfied with overall compensation, but different factors have detracted from this satisfaction over the last few months. Serbian employees now have to pay the labor taxes that prior to March 2004 were not being paid. This nonpayment of taxes in the past was due to problems for AgroInvest to obtain a local tax ID number as an international organization. Serbia staff has therefore seen its net salary level decrease by 30%. In addition, funding shortages in Serbia make it more difficult for staff to achieve individual and branch level bonuses, leading to additional frustrations.
- The work contract offers additional benefits beyond the legal requirements, which are very similar in both entities. With the difference taxation calculations, Montenegro gross salaries are 10% greater than in Serbia.
- Each June, a performance review is being made in order to evaluate each employee's achievements with regards to his objectives, to draw attention to areas of improvement and identify needs for trainings. Objectives are defined on hiring, and each year adapted during the performance review.

- ❑ Other staff benefits include both internal and external trainings that account for 5% of all operational expenses in 2003. AgroInvest will need to be more strategic in its training plan to address management and middle management training needs.
- ❑ Annual gatherings organized twice a year offer employees an opportunity to spend time together for experience sharing and team building.

# Information Management Systems

## Management Information System (MIS) and Equipment

### Description of the MIS<sup>3</sup>

|                             |   |
|-----------------------------|---|
| <b>Infrastructure</b>       | <ul style="list-style-type: none"><li>• Virtual Private Network (VPN) for offices in Montenegro and a Wide Area Network throughout using ISDN; some computers are stand-alone.</li><li>• Sufficient computer stock at HQ and in the branches.</li></ul>   |
| <b>Accounting</b>           | <ul style="list-style-type: none"><li>• Software: Sun Systems: Off-the-shelf software with flexibility for producing data useful for analytic purposes in addition to accounting</li><li>• Data entry into the accounting system is restricted to the financial manager and senior accountant. Bookkeepers in each branch send in Excel their journal vouchers weekly to regional accountants for verification. The verified version is then posted to Sun System by the senior accountant.</li><li>• Information on loan disbursements and repayments is entered into the accounting system via the journal vouchers prepared at each branch. Data per client is not tracked in the accounting system.</li><li>• The cashier at the branch level checks daily cash balances and the regional accountant verifies this information weekly. Full statements are reconciled monthly.</li><li>• Financial statements are available on a monthly basis.</li></ul> |
| <b>Activity information</b> | <ul style="list-style-type: none"><li>• Software eMerge: Off-the-shelf software developed by Temenos recently installed in Montenegro in the first phase.</li><li>• Software: LTS: internally developed loan tracking software in Access and programmed in C++ installed in all branches.</li><li>• Staff in Serbia enters all data in the LTS. There is no consolidation of micro-level data but rather consolidation of summary statistics.</li><li>• Staff in Montenegro have recently begun entering data in the new eMerge database (common database for all Montenegro officers) but are also entering data in the LTS local database during the transition.</li><li>• Summary reports from the branches are sent monthly to HQ.</li></ul>  |

### Security

*Adequate computing security improving with software and infrastructure upgrades*

General computer security is appropriate and there are daily anti-virus updates using McAfee Anti-virus for networked computers. Stand-alone computers must use dial-up connections for such updates. The eMerge software has greater security than the in-house database, including an audit trail and access authority levels. For eMerge, the user must enter passwords at three levels, a dial-up password for the branch, a VPN connection password, and an individual eMerge password. The eMerge system backups are made to tape daily, with storage for one month. The VPN includes a Cisco router with firewall. Backups are also made to the server. Access to the accounting system is restricted to the senior accountant and the finance manager at present.

<sup>3</sup>Sun Systems was purchased by WVI and AgroInvest pays maintenance fees per the current five-year contract. eMerge was paid for by AgroInvest, albeit at a lower rate negotiated by WVI, and is under contract for maintenance renewable annually with payment of maintenance fees.

Given the nature of back-ups if performed according to policy, maximum data loss would be:

- eMerge data: one day
- In-house LTS data: one week
- Bookkeeping spreadsheets for journal vouchers: one week
- Sun Systems accounting data: weekly
- Staff computer files: weekly

#### **Ease of system use**

*Straightforward information flow; eMerge installation requires duplication during transition period*

The system of information flow is straightforward and easy for users. The recent introduction of eMerge in Montenegro has somewhat complicated that information flow during the transition period. eMerge was installed as part of a more global WVI initiative and to prepare AgroInvest in the event of an institutional transformation to an entity that has greater MIS security and flexibility demands. The data from the original LTS has not been transferred, therefore during the transition period there is double data entry, requiring additional staff.<sup>4</sup> The loans issued in the prior system will complete their cycle in the old software (loans on average 17.7 months in nominal terms but with shorter real terms when considering early repayment). The productivity benefits of the software will therefore not be fully available until all the loans are issued from eMerge and the final configurations to adapt eMerge to AgroInvest needs, such as customized reports, are completed.

#### **MIS plan and future improvements**

*MIS plan to install eMerge for Serbia operations*

As stated in the business plan, AgroInvest seeks to build a strong computing infrastructure. Expansion of eMerge to Serbia will occur next year. Another potential change over the next year is the delegation of accounting data entry to the branch level. This would require the installation of Sun Systems and significant training of bookkeeping staff.

#### **Skills of MIS managers**

*In-house MIS management team*

AgroInvest has in-house staff capable of designing basic programs for internal needs beyond the key programs of Sun Systems and eMerge, but given other obligations the team is not operating at capacity. There is a total staff of four, a Project leader for eMerge (on maternity leave), a System Administrator, an IT assistant (currently on a six-month Branch Manager rotation), and an IT Manager (on scholarship in the United States for the second of two years). It is expected that the IT Assistant will focus on Research and Development upon completion of his manager duties.

## **Information on Activities**

#### **Information quality**

*Regular and reliable portfolio information with detail available*

Using the old system, AgroInvest has daily repayment information at the branch level and monthly performance data at the headquarters level that is accurate and relevant. Data may be segregated by branch, LO, or village in addition to the monthly consolidated information. Ratios that are actively monitored include PAR by age, disbursements, outstanding figures, and a couple of impact statistics tracked in the MIS. With the introduction of eMerge system, consolidated data will require information from two separate loan tracking databases (eMerge and LTS).

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<sup>4</sup> Given challenges with data importing at another WVI regional MFI, the transfer of data from the old system to the new system was not supported.

*Market size information tracked, market research under development* Market information is based on village surveys for 10% of households conducted prior to initiating credit services in the village. This research helps determine market size. Further research on issues such as client satisfaction, client dropout, etc. is in the beginning phases, with a first client satisfaction study completed in the largest branch.

#### **Information dissemination**

Information is readily available at the branch level at all times and the monthly data are consolidated at headquarters. Monthly daylong branch and top management meetings facilitate information and experience sharing, including this data, across the organization. The goal of 100% intranet access will further facilitate information sharing.

## **Financial and Accounting Information**

#### **Information quality and financial analysis**

*Accurate financial information; external auditor recommended separate databases by region* The accounting information is regular and accurate and certified by the external auditor. The systems to produce accurate information are in place, with the challenge being the appropriate segregation of costs between Montenegro and Serbia operations. The existing system allows for clear identification of items by republic, however there are clearly some items that are easier to manage through Montenegro for legal reasons. To make this accounting information cleaner, the external auditor has suggested after the 2003 audit two entirely separate accounting databases.

*Appropriate financial analysis of performance* The department tracks all the key microfinance indicators for financial analysis. The configuration possibilities of Sun Systems allow the department to obtain data in analytically interesting ways, with some reports available by region, branch, funding source, loan officer, or village. Information on branch level profitability is used to estimate start-up costs, etc.

#### **Skills of finance department**

The finance department effectively manages the accounting needs of the institution and has an understanding of analytic nature of financial analysis. The financial manager uses Vision Executive, a report generating software, to develop adapted and analytically useful reports. The more sophisticated aspects of financial management related to Asset Liability Management have not been necessary to achieve profitable operations but could be further developed with staff.

# Risk Management

## Procedures and Internal Controls

### Internal Controls

AgroInvest has developed a strong internal control system given the nature of the credit methodology and operations. Procedure manuals were late to be developed but this is being resolved. Given the regularity and availability of data on staff productivity and portfolio performance, AgroInvest is able to identify and remedy potential areas of underperformance.

#### *Manuals only recently developed*

The development of manuals has arrived somewhat late at AgroInvest, although staff is aware of the key procedures. Manuals for credit and personnel procedures have recently been approved, with additional manuals in process for operations (very general), finance (very detailed), and IT. The finance manual is based on WVI standards with appropriate adaptations. Once the intranet is built, these manuals will be accessible online. The lack of sufficient clarity with regards to certain procedures was a key finding of the internal auditor prior to the development of more formal manuals. Some procedures deserve even further clarification, as for example cashiers were not always clear on the daily and overnight safe limits, although as a general rule they prefer to keep as little cash on hand as possible.

#### *Appropriate separation of duties to minimize fraud risks*

The segregation of duties effectively limits most risks of fraud and mistakes in operations. Portfolio diversification risks merit greater formalization (see Portfolio Management). LOs working with VC members select clients, the branch credit committee will approve loans, two persons meet the client to sign the disbursement papers (LO and either BM or another LO) and cash is physically disbursed by the bank per order submitted by the AgroInvest cashier. Repayments are recorded by both the VC member and the LO, and checked for cash totals by the cashier. The client administrator records transactions in the loan tracking system. Accounting information is generated at the branch but reviewed electronically by a regional accountant before data entry by the senior accountant. In small branches, the client administrator and cashier position may initially be combined, which is neither optimal nor detrimental from a risk management perspective.

#### *Village Councils have been effective, potential risks to monitor*

The Village Council members serve a key role in service delivery, however the relationship with AgroInvest is informal in nature and should be carefully monitored. There are no contracts or documents linking AgroInvest to these individuals or signed statements clearly explaining their responsibilities. Any village grouping is potentially susceptible to political influences and fortunately thus far AgroInvest has reported minimal problems. To prevent risks of reputation and any possible forms of organized fraud, the internal auditor could support the branches in Village Council monitoring.

### Liquidity security

#### *Risk exposure during cash transport, no incidents reported in five years of operations*

AgroInvest has some risk exposure with cash handling during transport and cash on hand in the offices, but has reported no problems in almost five years of operations. AgroInvest reported that cash-handling insurance was not available. In both republics, loans are disbursed at the bank and repaid to the VC member at his home the day before the official pay date.<sup>5</sup>

<sup>5</sup> VC members in different branches did not report to the rating team fear about holding cash in their homes given the low level of crime in the villages. Villages near the Niksic branch were noted by staff to have higher rates of robbery, therefore the branch team takes additional precautions and makes clear to the community that they do not keep cash.

AgroInvest therefore remains exposed during transport from the village to the branch (two employees if the collection amount exceeds 5,000 EUR) and from the branch to the bank (minimum of two employees). The cashier holds cash in a safe until the afternoon trip to the bank, which could involve transport of up to 50,000 EUR in the largest branch.

## Internal Audit

### Risk identification

*Institutional risks discussed openly, staff appreciate most operational risks*

The Executive Director and Board clearly identify the major risks, predominantly governance (Board development, management team/middle management strengthening) and the regulatory environment in Serbia, which results in funding shortages and suboptimal performance. Staff members appreciate generally operational risks but the internal audit function serves as the check on these procedures. The Board audit committee exists but could be more active (one member has no finance experience and the second member is a resident of Australia).

### Internal audit quality

*Adequate internal audit with goal to improve efficiency in addition to basic monitoring*

Internal audit is adequate for AgroInvest. The internal audit function was created in October 2002, reporting to the Board audit committee, to provide value-added services that would both monitor operations and improve efficiency. An audit schedule for the year is known by the management team upfront, whereas the branch to be audited receives notice one week prior to the visit. The auditor visits each branch at least once per year. Each branch audit typically lasts at least a week and focuses on a selection of the possible areas for audit. The internal auditor will do a random sample of at least 15 files and five visits, including delinquent clients. The auditor also reviews headquarters. Audit reports include recommendations and responses by the appropriate parties. These recommendations have been translated into policy improvements, notably by encouraging documentation of procedures in the form of manuals and improving cash security (ex. loans in Montenegro were previously disbursed in the villages instead of at the bank). Separate quarterly reports on more institutional-level risks are submitted to the Board.

*Promising start with improvements possible*

The audit function has made a promising start and over time would benefit from additional improvements. AgroInvest recently hired its third internal auditor, the first auditor having been promoted to a new position and the second having recently left the organization. Once this position has stabilized, the audit function will evolve even quicker. The number of client visits appears to be limited, especially given that often client monitoring is performed by the Village Council as opposed to the LO. Although the goal of the audit visits is not to “surprise” everyone, the general availability of the schedule at headquarters could reduce the effectiveness of the audits.

# Activities: products and services

## Marketing and competition

*Competition not an issue in the past, now a consideration in Montenegro*

Given the lack of competition, especially in Serbia, AgroInvest's products and marketing have been sufficient. As competition increases, notably in Montenegro given the limited market size, AgroInvest will need to be more strategic vis à vis its thinking with respect to competitors.

□ The marketing strategy, unique to AgroInvest in its service area, is on a village-by-village basis, with an initial gathering organized by AgroInvest in the community. It takes one month to inform the village and then select clients. The community representatives do ongoing marketing in the village informally. AgroInvest has a positive reputation in its service area and in older communities has a very high market share of rural households, sometimes greater than 50% of the targeted clientele.

*Competitive advantage with repayment collection in the village*

□ The loan methodology includes a couple of notable product advantages, notably the collection of repayments in the village and easier guarantee requirements than banks. Some other competitors also offer the grace period, as does AgroInvest.

□ AgroInvest does not compete on interest rates, as they are comparable to other NGOs but greater, in some cases significantly greater, than local banks.

□ The single loan product is for rural businesses and is capped at 3,000 EUR, thereby limiting the potential market. Other products, such as grouped loans for larger fixed assets purchases (e.g. tractor), housing loans or savings (if there is an institutional transformation) may be considered in the future.

## Portfolio Management

*Highly effective and adapted credit methodology*

### **Lending methodology**

AgroInvest has developed a highly effective credit methodology that meets the needs of small rural and agricultural loans while leveraging the assistance of community members. The focus on mountain communities was a strategic decision because of the greater solidarity in villages, the lack of other service providers of proximity, and the social mission to target a poorer population. The clever use of the Village Council improves the quality of client selection, assists in marketing, and greatly increases LO capacity, for a very modest fee starting after six months of service.

**Borrower selection:** Borrower selection is appropriate for the smaller loan sizes, although would need more sophistication for larger loans beyond the current products. All clients are reviewed by the Village Council member and via home visits by the LO for debt capacity analysis. The information is appropriate for smaller loans but not sufficiently detailed for larger loans. Debt coverage of the potential loan payment based on past revenues must be of approximately 1.45, although the manual does not specify the exact range required. The Credit Committee, including the branch manager and one or two other LOs, in addition to the presenting LO, will make the final decision on approval and loan amount. Restrictions on client selection for those with a history of delinquency, if for an acceptable reason, have been lightened to increase client retention.

**Portfolio monitoring:** Village Council members assist greatly in portfolio monitoring as they see the client at least once per month for repayment. LOs then collect repayments from the

Village Council and must subsequently return to the office with the cash, thereby limiting the time to visit clients with no repayment problems. Client monitoring is expected within the first month after loan disbursement and once in the nine following months, although these visits are not always documented.

**Delinquency management:** Delinquency management is swift, as the Village Council knows the day prior to the collection date who has not yet paid and may take action immediately. If the payment has not yet been paid when the AgroInvest LO arrives at the village, the LO will take immediate action to contact the client and to apply pressure on the loan guarantors. Per the procedures, the penalty is 0.2% of the principal portion of the late installment. In practice, this is only applied if it is believed that non-payment is due to client unwillingness.

#### **Loan Officers skills**

*Loan officers have sufficient skills*

Overall, loan officers have sufficient skills to conduct their work. They have clear knowledge of the microentrepreneurs' market and are familiar with local prices for animal purchase, animal feed, production per square meter of greenhouse, etc. They are somewhat less familiar with non-agricultural businesses given their relative infrequency in the portfolio. The largest loan amount is 3,000 EUR and if a loan officer is not as strong in analysis at these higher levels, at a minimum the client already has a credit history with AgroInvest in previous cycles before reaching this amount.

#### **Portfolio diversification**

*Portfolio diversification procedures to formalize*

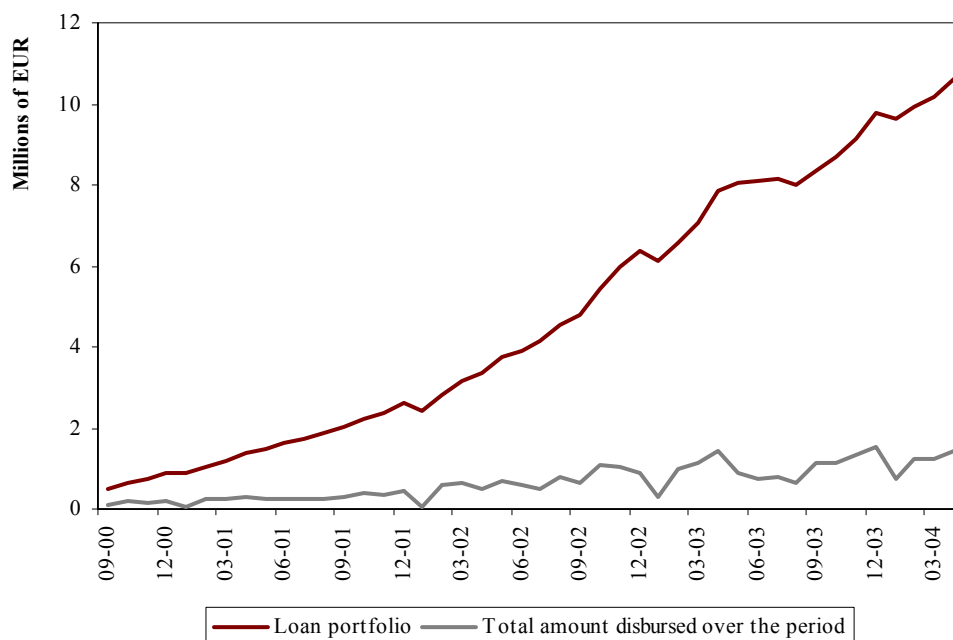
Given the homogeneity of the target clientele and product offering, AgroInvest would benefit from more clear guidelines on portfolio diversification. The coverage of areas in both Serbia and Montenegro does facilitate geographic diversification and to a lesser extent business types. Clients are subject to economic trends in neighboring countries. For example, the pig market experienced a significant dip in prices at one point given regional trends and this is one of the principal activities financed in Serbia. The policy currently under consideration is to limit the portfolio of any branch to no greater than 50% invested in the same "business" as defined by their categories (animal husbandry, greenhouse, etc.). The highest concentration at present being in cattle, although the concentration is less than 50% in any given branch. This definition of "business" is not detailed enough to know risk by product, as the category greenhouse could cover tomatoes, paprika, etc. that are subject to different market risks.

## Portfolio at risk (PAR)

### Write-off ratio

| EUR<br>(unless specified in local currency) | Sept. 2001 | Sept. 2002 | Sept. 2003 | May 2004   |
|---|------------|------------|------------|------------|
| Loan portfolio                              | 2,003,009  | 4,774,023  | 8,361,911  | 10,749,489 |
| % Change                                    | 291.0%     | 138.3%     | 75.2%      | 28.6%      |
| Average outstanding portfolio               | 1,230,285  | 3,240,858  | 6,976,776  | 9,555,700  |
| Number of active borrowers                  | 2,095      | 5,208      | 9,629      | 11,987     |
| % Change                                    | 185.0%     | 148.6%     | 84.9%      | 24.5%      |
| Average outstanding loan per client         | 956        | 917        | 868        | 897        |
| % of GNI per capita                         | 68.3%      | 68.6%      | 92.9%      | n/a        |
| Average amount disbursed                    | 1,350      | 1,386      | 1,409      | 1,450      |
| % of GNI per capita                         | 96.4%      | 103.8%     | 150.7%     | n/a        |
| PAR 31-365                                  | 0.2%       | 0.2%       | 0.2%       | 0.2%       |
| PAR > 365                                   | 0.0%       | 0.0%       | 0.0%       | 0.0%       |
| Write-off ratio                             | 0.2%       | 0.1%       | 0.1%       | 0.1%       |

Loan portfolio evolution



*Strong portfolio growth over last several years; mild seasonal dips*

AgroInvest's portfolio has grown at a strong pace over the last several years, at decreasing growth rates (291% in 2001 down to 75% in 2003). Notable seasonal dips in disbursements occur in January during the Orthodox holiday season. The extended dip in disbursements in mid 2003 is attributable to the legal problems with Serbia operations, as AgroInvest was required to cease disbursements to comply with the law. Although the portfolio is predominantly in agriculture, these loans are typically repaid monthly with grace periods only offered in exceptional cases. The loans are not used for seed and therefore less susceptible to strong variations by season.

*Overall average loan sizes relatively constant*

The dynamics of the Agroloan product have not changed substantially over the last several years. The average outstanding loan declined modestly from 956 EUR in 2003 to 897 EUR in 2004. The average disbursed loan has increased modestly from 1,250 EUR in 2003 to 1,450 EUR in 2004.

EUR in 2004. The competing influences of expansion, with smaller loan sizes, and maturity of existing clients, with larger loan sizes, appear to cancel each other out.

| May 2004 Data (EUR)                                   | Consolidated | Serbia | Montenegro |
|---|--------------|--------|------------|
| Outstanding loan portfolio                            | 10,749,489   | 18%    | 82%        |
| Number of active borrowers                            | 11,987       | 19%    | 81%        |
| Total amount disbursed over the period <sup>(a)</sup> | 9,844,100    | 22%    | 78%        |
| Number of loans disbursed <sup>(a)</sup>              | 6,790        | 21%    | 79%        |
| Average amount disbursed <sup>(a)</sup>               | 1,450        | 1,516  | 1,432      |
| PAR < 30 days   | 0.8%         | 0.4%   | 0.9%       |
| PAR 31-365 days                                       | 0.2%         | 0.3%   | 0.2%       |

(a) Data for the eight-month period Oct. 03 through May 04.

*Strong portfolio quality in both regions*

Overall portfolio quality has remained steady and strong, with a consolidated 0.2% PAR31-365 and a write-off ratio between 0.1% and 0.2% over the last several years. There are mild differences by region, noting that the Montenegro operations have a preponderant impact on many portfolio indicators with 82% of the outstanding portfolio. The PAR 1-30 days in Montenegro at 0.9% is more than double that of Serbia, however the trend reverses for the PAR31-365 as it is higher in Serbia at 0.3%, than Montenegro at 0.2%. Given that repayments occur in the first two to three weeks of the month, LOs have an opportunity for one to two weeks to pursue delinquent clients prior to the month-end statistics. The PAR in Serbia is reportedly related in part to the lack of sufficient funds to meet disbursement demands of existing and new clients. Sometimes client repayment problems are related to delays in salary payments by local companies or dairy cooperatives.

## Credit risk coverage

### Coverage by provisions

|  | Sept. 2001      | Sept. 2002 | Sept. 2003 | May 2004 |
|--|-----------------|------------|------------|----------|
| Risk coverage ratio                        | 1,077.6%        | 76.6%      | 51.3%      | 95.7%    |
| PAR 31 net of loan loss provision / Equity | > 100% coverage | 0.0%       | 0.1%       | 0.0%     |

*Standard loan loss provision methodology*

AgroInvest has a standard loan loss provisioning requirement. Please refer to the Notes to Financial statements for further details on the provisioning methodology. The drop in the risk coverage ratio of 1,077.6% in 2001 to 76.6% in 2002 is due to the change in policies, as in 2001 there was a general 2% provision on the entire portfolio, which was reduced to provisions for specific risk on late loans. In Serbia, AgroInvest must dedicate an 18% reserve for all outstanding loans,<sup>6</sup> although these amounts are not part of the loan loss provision illustrated above.

### Coverage by guarantees

*Guarantees for moral pressure; salary withholdings enforceable*

AgroInvest has flexible guarantees that serve a moral pressure role but could, if necessary, be executable in court. The two co-signers may not reside in the same household as the client, may not be AgroInvest clients with an outstanding loan, and must be a salaried employee. They sign a promissory note, with authorization for salary withholding, and a bill of exchange (mjenica).

## Savings Activities

AgroInvest is prohibited by law from savings collection.

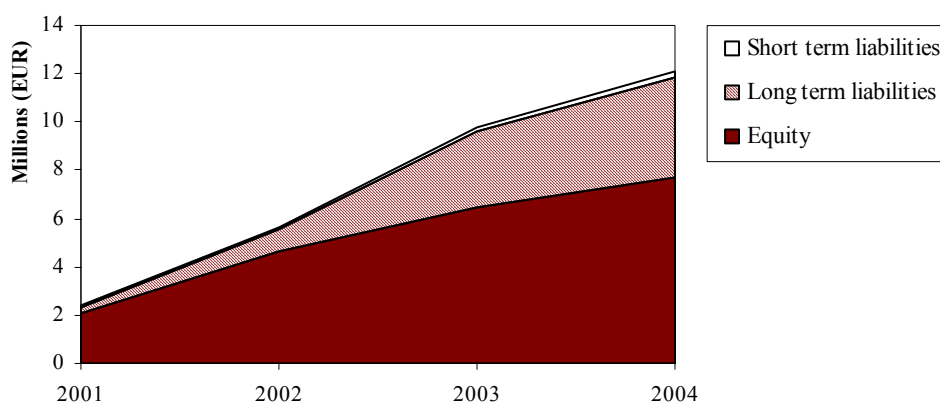
<sup>6</sup> The law requires all banks to have an 18% reserve requirement and the partner bank working with AgroInvest in Serbia has in turn imposed such a requirement on the outstanding loan amounts.

# Financing and liquidity

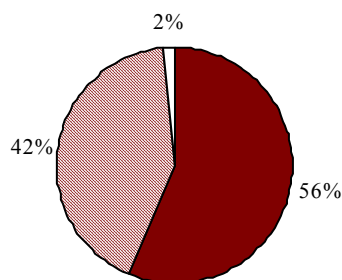
## Financing Strategy

### Description of the funding structure

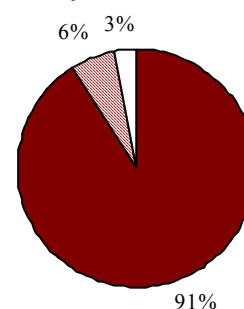
#### Funding structure: consolidated



#### May 2004 / Montenegro



#### May 2004 / Serbia



*Donated equity from CIDA, SIDA, WV, and BPRM, positive retained earnings and long-term borrowings*

In May 2004, AgroInvest is funded 64% by equity and 34% by long-term borrowings at concessional rates (average 5%), with short-term liabilities accounting for less than 2%. AgroInvest does not collect savings. Long-term borrowings have become an increasingly important source of funds, growing from 8.5% in 2001 to 34% of assets in May 2004. AgroInvest has positive retained earnings since 2001, accounting for more than 34% of all equity in 2004; thereby enabling the institution to finance part of its growth by itself. International donors are the World Vision network, CIDA, SIDA and BPRM, and lenders at concessional rates are KfW, Cordaid and World Vision (See appendices for all details relative to these loans, grants and donations).

*Borrowings only available for Montenegro*

The funding structure per region in May 2004 reflects the different legal environments. Serbia may not have any borrowings to finance its activities whereas Montenegro's capital structure is more than 40% in borrowings.

#### Asset & Liability Management Procedures

AgroInvest does not face major risks related to its asset/liability structure. Long-term liabilities and equity represent more than 90% of total assets, which largely cover the portfolio of shorter average duration.<sup>7</sup> Dealing with two currencies renders accounting more

<sup>7</sup> The average nominal loan term is approximately 17.7 months, and incorporating repayments the real loan term is on average less than 13 months.

*Maturity and exchange rate risks limited*

complicated but does not introduce significant risk at present. The Yugoslav Dinar was previously linked to the Deutsche Mark, and has not fluctuated considerably against the EUR, thus preventing major exchange variations since most liabilities are denominated in Euros. Furthermore, the bulk of the loan portfolio is in Montenegro (82%) where the currency is the Euro. Legally, all operations in Serbia must be conducted in Yugoslav Dinar.<sup>8</sup> The only currency risk borne by AgroInvest is with borrowed funds denominated in USD, although the EUR is currently stronger and the remaining 101,250 USD were reimbursed in May 2004. Both borrowings and loans to clients are fixed rate.

**Financing Strategy**

*Problematic shortage of funds to finance Serbia operations*

Given the importance of finding sufficient financing for planned growth for Serbia, AgroInvest created the position of Business Development Manager in October 2003. The financing strategy for AgroInvest's Serbia operations is essentially limited to grant funds given the current legal status as a representation of an international NGO. The lack of sufficient financing is a problem for operations in existing branches. However, Montenegro has not experienced funding shortages and may borrow up to 300% of equity.

*Strategy to exhaust remaining donor funds and increase borrowings*

The current strategy is to explore all donor funding remaining, particularly with existing donors including the Swedish Development Agency and the Dutch Embassy. Small grants from World Vision support offices are also being pursued but would not be a source of portfolio funding. The goal is to obtain 5 M EUR in 2005 and 6 M EUR in 2006. AgroInvest has not identified other donors working actively in the area with sufficient budgets to help finance the Serbia operations. AgroInvest hopes to continue working with existing lenders and to identify new international sources, as local banks seek hard collateral such as property as a condition for a loan.

## Liquidity Management

**Cash-flow projections**

*Short-term cash monitored at branch level*

Annual cash-flow projections based on the portfolio growth underlying the business plan have been generated with Microfin for the next three years. These budgeting plans will be revised on a quarterly basis to meet more precisely the institution needs. These basic long-term projections could be more refined and understood at the branch level.

*Long-term cash-flow projections to refine*

Cash-flow projections for short-term cash-flow needs are monitored on a monthly basis at the branch level, as the branch is responsible for ensuring sufficient funds to meet all loan and branch expense obligations. Several tools are in place to ensure efficient day-to-day cash management, such as disbursements plans prepared in advance by LOs, forecasts of daily repayments calculated for each bank account by the LTS, and budgets including monthly plans for operating expenses. Branches will take the initiative to contact other branches to borrow from each other to meet short-term needs during the month.

**Resources optimization**

*Minimal idle resources*

Given that client demand exceeds supply, AgroInvest does not have excess liquidity in general. The only exception is in Serbia, where the bank partner disbursing loans has required that AgroInvest maintain an 18% reserve requirement as cash in the bank. This reserve requirement is required of banks in Serbia and was essentially passed on to AgroInvest.

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<sup>8</sup> In the past, Serbian loan contracts were denominated in EUR but paid in the Yugoslav Dinar equivalent as calculated on each payment date. Now, all Serbian transactions must be performed in Dinar but some clients continue to pay in EUR, which must be physically converted to Dinar by AgroInvest prior to depositing repayments at the bank. The Dinar transactions are converted daily to EUR in the accounting system at the bank daily exchange rate.

# Efficiency and Profitability

| <b>Profitability analysis</b>       | <b>2001</b> | <b>2002</b> | <b>2003</b> | <b>May 2004<sup>(a),(b)</sup></b> |
|-------------------------------------|-------------|-------------|-------------|-----------------------------------|
| ROE                                 | (2.1%)      | 8.7%        | 11.1%       | 20.0%                             |
| Liabilities / Equity                | 15.8%       | 20.6%       | 50.3%       | 55.9%                             |
| <b>Montenegro</b>                   | n/a         | n/a         | 67.5%       | 77.5%                             |
| <b>Serbia</b>                       | n/a         | n/a         | 9.6%        | 10.3%                             |
| ROA                                 | (2.4%)      | 7.3%        | 8.1%        | 13.0%                             |
| <b>Montenegro</b>                   | n/a         | n/a         | n/a         | 13.0%                             |
| <b>Serbia</b>                       | n/a         | n/a         | n/a         | 13.1%                             |
| <b>Profit generation</b>            |             |             |             |                                   |
| Operational self-sufficiency        | 91.2%       | 138.8%      | 138.5%      | 175.5%                            |
| <b>Montenegro</b>                   | n/a         | n/a         | 155.4%      | 177.0 %                           |
| <b>Serbia</b>                       | n/a         | n/a         | 103.8%      | 170.5%                            |
| Portfolio Yield <sup>(c)</sup>      | 28.7%       | 30.9%       | 31.3%       | 33.9%                             |
| <b>Montenegro</b>                   | n/a         | n/a         | n/a         | 31.4%                             |
| <b>Serbia</b>                       | n/a         | n/a         | n/a         | 45.6%                             |
| Operating expense ratio             | 29.8%       | 24.3%       | 22.0%       | 18.1%                             |
| <b>Montenegro</b>                   | n/a         | n/a         | n/a         | 16.3%                             |
| <b>Serbia</b>                       | n/a         | n/a         | n/a         | 26.8%                             |
| Staff productivity                  | 95          | 98          | 158         | 169                               |
| Loan officer productivity           | 131         | 186         | 321         | 400                               |
| <b>Montenegro</b>                   | n/a         | n/a         | n/a         | 441                               |
| <b>Serbia</b>                       | n/a         | n/a         | n/a         | 287                               |
| Average out. loan per client (EUR)  | 956         | 917         | 868         | 897                               |
| Funding expense ratio               | 0.5%        | 0.3%        | 1.0%        | 1.2%                              |
| <b>Montenegro</b>                   | n/a         | n/a         | n/a         | 1.5%                              |
| <b>Serbia</b>                       | n/a         | n/a         | n/a         | 0.0%                              |
| Cost of liabilities                 | 4.6%        | 1.9%        | 3.9%        | 3.7%                              |
| Loan Loss Provision expense ratio   | 2.8%        | (1.1%)      | 0.1%        | 0.8%                              |
| PAR 31-365                          | 0.2%        | 0.2%        | 0.2%        | 0.2%                              |
| Write-off ratio                     | 0.2%        | 0.1%        | 0.1%        | 0.1%                              |
| <b>Asset management</b>             |             |             |             |                                   |
| Outstanding Loan Portfolio / Assets | 80.3%       | 84.9%       | 85.7%       | 89.0%                             |
| <b>Montenegro</b>                   | n/a         | n/a         | 91.2%       | 94.8%                             |
| <b>Serbia</b>                       | n/a         | n/a         | 66.0%       | 70.0%                             |
| Investment income / Revenues        | 0.0%        | 0.0%        | 0.0%        | 0.0%                              |
| <b>Adjusted ratios</b>              |             |             |             |                                   |
| Adjustment expense ratio            | 30.1%       | 29.0%       | 13.5%       | n/a                               |
| AROE                                | (24.1%)     | (19.0%)     | (5.7%)      | n/a                               |
| AROA                                | (26.8%)     | (16.0%)     | (4.2%)      | n/a                               |
| Financial self-sufficiency          | 47.8%       | 62.1%       | 87.5%       | n/a                               |

(a) Data for May 2004 is based on an eight-month period from October 2003 through March 2004. A simple annualization of relevant ratios was performed for ease of comparison.

(b) In FY 2004, Serbia invoiced 12,500 EUR per month to Montenegro to cover a part of HQ costs. In May 2004, a cumulative installment was made for one year. Planet Rating adjusted the financial statements for the calculation of profitability ratios to give a more realistic picture, given that the period presented is only an 8-month period and not 12. In the future, those installments will be more frequent, either monthly or quarterly.

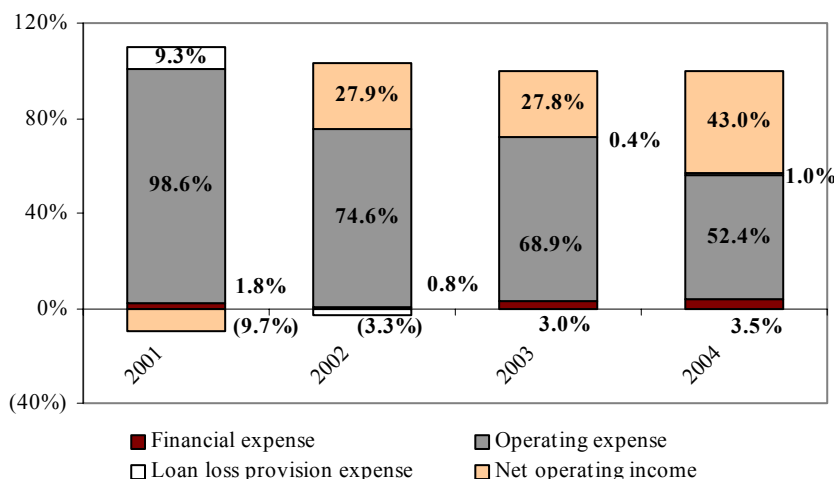
(c) Note that figures by region are based on beginning/end of period portfolio amounts while overall portfolio yield is based on the more accurate monthly portfolio data.

## Overview of the profitability

*Increasingly profitable operations*

AgroInvest is a profitable institution since FY 2002 with an operational self-sufficiency of 138.5%.<sup>9</sup> In comparison with its peer group as defined by MBB<sup>10</sup>, AgroInvest has a similar level of operational self-sufficiency (134% for the peer group), although data for the partial year 2004 reveal even stronger performance with an operational self-sufficiency of 175.5%.

Cost structure in % of financial income



*Increases in ROA, ROE, and leverage*

In FY 2003, AgroInvest had an ROE at 11.1% and an ROA at 8.1%, before adjustments for high inflation and costs of funds (see later section on adjustments). With the significant increase in leverage, from 15.8% in 2001 to 55.9% in 2004, there is a notable increasing difference between ROA and ROE (from 7.3% and 8.7% in Sept. 2002 to 13% and 20% in May 2004 annualized).

*Montenegro operations significantly more profitable; higher leverage*

Montenegro operations have the basis for greater profitability than Serbian operations for a number of reasons, including greater access to funding and subsequently higher productivity and additional years of operation. Planet Rating estimates indicate that the two regions have approximately the same annualized ROA in 2004, 13%, although Montenegro is paying financing costs, while Serbia is not, and a greater share of HQ costs. The difference in leverage between the two entities is driven by the legal framework. Since Montenegro allows for borrowings, its debt/equity ratio is up to 77.5% in 2004 while Serbia's ratio is only 10.3%.<sup>11</sup>

## These profitability results are based on the following factors:

*Stable portfolio yield, differences by region due to bank partnership in Serbia*

### Portfolio yield and effective interest rate

Average portfolio yield is above 30% and remained stable over the years, thanks to low delinquency. Interest rates were stable in both entities at 1.5% flat per month until end of FY

<sup>9</sup> These ratios take into account only income generated from operations. AgroInvest has also received non-negligible donations excluded from these ratios (233,464 EUR in FY 2002 and 229,779 EUR in FY 2003).

<sup>10</sup> The Microbanking Bulletin N°9, July 2003, peers group ECA comprised of BESA, PSHM (Albania), Kamurj (Armenia), FINCA-AZE (Azerbaijan) MI-BOSPO, EKI, Mikra, Mikrofin, Partner, Prizma, Sunrise, Women for Women (Bosnia and Herzegovina), NOA (Croatia), Constanta (Georgia), ACF, KCLF (Kazakhstan), KEP (Kosovo), BTF, FINCA-KGZ (Kyrgyzstan), XAC (Mongolia), AgroInvest (Montenegro), FM (Poland).

<sup>11</sup> Note that this amount is greater than 0% because there are liabilities on the balance sheet other than borrowings.

2003, when AgroInvest raised rates in Serbia to 1.7% to compensate for the additional cost of issuing loans through a bank partner. AgroInvest's rates are similar to those charged by its NGO competitors in Serbia and Montenegro but somewhat higher than those charged by its peer group, 25.6%, and considerably higher than its bank competitors. AgroInvest plans to lower interest rates in the future per its strategic plan. The annual effective interest rate in May 2004, which includes administrative fees of 2.5% in Montenegro and 3.5% in Serbia, is 35.8% and 40.5% respectively.

#### **Operating expense ratio**

*Operating expense ratio continues to trend downward; slightly higher than peers*

The operating expense ratio as a percent of the outstanding portfolio has continually declined over time, from 29.8% in FY 2001 down to 22% in Sept. 2003, and even lower to 18.1% in 2004 based on simple annualization estimates. This trend is attributable to increasing average gross loan portfolio, resulting in greater economies of scale, and increased productivity. This ratio is a little higher than the ECA Large peer group at only 16.4%, although lower than the all ECA peer group at 34%, presumably due to its relatively younger age in the ECA Large peer group, less well-off clientele, and lack of strong competition to drive down interest rates.

*Productivity improvements also driving improvements in operating expense ratio*

Productivity increases have further driven improvements in the operating expense ratio. Overall staff productivity has increased from 95 end of FY 2001 to 169 May 2004 and LO productivity from 131 to 400 over the same period. This is considerably higher than peers with 151 clients per LO. The Village Council payments serve to increase LO productivity significantly. The average size of the Village Associations is increasing, rendering them more productive (from 42 clients on average in 2001 to 60 in 2004.) Additionally, the LOs have significant administrative help by other branch staff.

*Productivity higher in Montenegro*

Montenegro's longstanding operations, high market penetration, and sufficient funding result in higher LO productivity, on average 441 in Montenegro vs. 287 in Serbia. The lack of portfolio funding is the leading reason why productivity is lower in Serbia, leaving excess loan officer capacity.

Operating expenses are broken out into the following categories:

- ❑ Staff expense represents around 60% of the total operational expenses, which is typical for an MFI. This includes all salaries, per diem and the not insignificant benefits. The Village Council expenses could be likened to "salaries" given their support role to LOs, and total 5% of operating costs in 2003.
- ❑ Governance costs should be noted, including the cost of an expatriate international director and transport for international Board members.
- ❑ Other costs linked to staff are trainings, a priority given to improving staff skills, representing 5% of operating costs in 2003.
- ❑ Depreciation is less than 5% of all operating expenses as AgroInvest rents its facilities.
- ❑ Required partner bank fees in Serbia are a new cost, although compensated in part by higher interest rates. In May 2004, Serbia generates 23.3% of all financial revenues but accounts for 56.3% of all bank fees.

#### **Funding expense ratio**

*Low cost of funds*

AgroInvest finances its portfolio mainly with donations and borrowings at concessional rates, 3.5% KfW, 6% Cordaid, and 5% World Vision versus an estimated 15% market rate. These lower cost sources have kept down the institution's cost of funds. The funding expense ratio slightly increased from 0.5% in 2001 to 1.0% in 2003 with a stable cost of liabilities around 4% the last couple of years. These costs are all attributable to loans for Montenegro.

### **Loan loss provision expense ratio (cost of risk)**

The loan loss provision expense ratio decreased from 2.8% in 2001 to 0.1% in 2003, after a change in loan loss provisioning policy from a general 2% provision to a standard specific risk provision policy. The write-off ratio remains low throughout the period, never exceeding 0.2%.

### **Asset management**

*Requirement in Serbia for 18% reserve*

Outstanding loan portfolio represents more than 85% of AgroInvest's assets, given the low level of fixed assets and a policy that branch liquidity should not exceed 5% of portfolio exclusive of operational costs. Nevertheless, the legal framework in Serbia requires an 18% reserve for loans, which the partner bank does not cover. The allocation of assets in Serbia is therefore by definition less efficient.

### **Adjusted performance**

*Details concerning the specific adjustments are included in the annexes.*

*Inflation adjustment significant*

AgroInvest figures were adjusted for cost of funds (20% of adjustments) and inflation (80% of adjustments). The loan loss provisioning policy was considered sufficient and the in-kind donations received by WVI network membership are compensated by AgroInvest's costs as serving as the local WVI representation. The results are a lower AROE and AROA, -5.7% and -4.2% respectively in 2003, versus positive adjusted returns for AgroInvest peers. The very high inflation rate drives the difference in adjusted results.

### **Evolution of profitability**

*Profitability expected to continue with greater economies of scale despite expansion costs*

AgroInvest projections anticipate continued profitability with a lower operating expense ratio and lower interest rates. Funding costs should rise with additional and potentially higher rate liabilities. Although significant expansion is expected, analyses reveal that a new branch covers its own operating costs within five months or less. The increasing tax burden, on Serbian revenues and salaries, new product development costs, travel and communication expenses, and expansion into new countries will need to be closely monitored to ensure that AgroInvest meets its targets.

# Appendices

## Financial statements and notes

### General notes to financial statements per CGAP Disclosure Guidelines

The financial statements and additional data provided by AgroInvest are sufficient to produce financial statements that comply with CGAP Disclosure Guidelines. Data provided for May 2004 are from internal financial statements. Other data are from audited financial statements.

1. The Financial Statements presented include a balance sheet, income statement, and accompanying notes.
2. The financial statements provided include 3.5 years of data.
3. AgroInvest only offers financial services, therefore no non-financial services are included in this statement.
4. Portfolio reporting
  - (1) Loan loss provision expense: expenses related to actual or anticipated loan losses are shown separately from other expenses in the income statement (“loan loss expense”).
  - (2) The loan loss reserve is shown as a negative asset in the balance sheet. The Finance Manager calculates the amount each month according to the methodology described in the table.
  - (3) Loans are written off monthly from the loan loss reserve and the loans outstanding

| Provisioning methodology |   |
|--------------------------|---|
| Aging                    | Provision<br>(% of outstanding balance)       |
| < 30 days                | 10.0%   |
| 31-60                    | 25.0%   |
| 61-90                    | 50.0%   |
| 91-120                   | 75.0%   |
| 121-180                  | 100.0%  |
| Write off                | Monthly Loans are written off after 180 days. |

- (4) The following table reconciles these movements:

|                               | Sept. 2001 | Sept. 2002 | Sept. 2003 |
|-------------------------------|------------|------------|------------|
| LL reserve, beginning of year | 928        | 43,196     | 5,754      |
| LL expense during the year    | 44,899     | 0          | 10,398     |
| Reversal of provision         | 0          | 33,846     | 0          |
| Write-off of delinquent loans | 2,631      | 3,585      | 9,459      |
| LL reserve, end of year       | 43,196     | 5,754      | 6,693      |

- (5) Interest income and expense are recognized on an accrual basis.
5. Portfolio quality
  - (1) Indicators: Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).
  - (2) Renegotiations of loans: the MFI doesn't refinance nor reschedule loans.
  - (3) Insider loans: the MFI doesn't allow employees to borrow funds.
6. Donations
  - (1) Revenue from donations is shown separately from income generated by operations in the income statement.
  - (2) September 2003 donations:

| Donors      | Amount Received | Restrictions and Comments  |
|-------------|-----------------|--|
| CIDA Canada | 554,842         | Funds to be used for financing microcredit activities in the areas defined by the Petra Agreement (Montenegro and Serbia). AgroInvest has to retain at least five years as of the project termination date and provide at CIDA's request all relevant records (narrative activity, financial Requests for funding, IS, BS, PR, OIR), documents and |

| Donors       | Amount Received | Restrictions and Comments   |
|--------------|-----------------|---|
| WV Canada    | 319,580         |   |
| WV US        | 153,800         |   |
| WV Australia | 124,529         |   |
| SIDA Sweden  | 2,212,062       | Development of new branches, growth in number of clients (50% from April 2002 to March 2003) and in size of portfolio, OSS of 130%, market research for Macedonia, training of staff (LOs and Accounting staff), institutional assessment |
| BPRM         | 226,456         | Improve incomes and reduce employment in rural villages in northern Montenegro that host or hosted displaced persons from Kosovo and refugees from Croatia and Bosnia and disburse 50% of loans to women                                  |
| CIDA Canada  | 1,135,409       | AgroInvest has to retain at least five years as of the project termination date and provide at CIDA's request all relevant records (narrative activity, financial Requests for funding, IS, BS, PR, OIR), documents and statements.       |

- (3) Donations accounting methodology: Grants for operations to be used in the current operating period are recorded in the income statement. Grants for fixed assets were recorded directly in the balance sheet with amortization of such assets passing through the income statement. Grants for loan funds are recorded directly in the balance sheet. Please note that the financial statements disclosed in this report have been modified for presentation to better reflect donations.
- (4) In-kind donations: Please refer to the Appendix on Adjustments for details on in-kind donations that Planet Rating has identified. In the case of AgroInvest, the benefits received by being affiliated with World Vision are compensated by the costs incurred by AgroInvest to represent World Vision in Serbia for non-microfinance related activities.
- (5) Cumulative amount of all prior period donations:

|                               | 2001             | 2002             | 2003             |
|-------------------------------|------------------|------------------|------------------|
| CIDA Canada                   | 550,073          | 554,843          | 554,842          |
| WV Canada                     | 133,739          | 133,739          | 319,580          |
| WV US                         | 98,068           | 153,803          | 153,800          |
| WV Australia                  | 82,860           | 113,747          | 124,529          |
| SIDA Sweden                   | 664,613          | 1,906,540        | 2,212,062        |
| BPRM                          | 226,456          | 226,456          | 226,456          |
| CIDA Canada                   |                  | 685,534          | 1,135,409        |
| Grant for credit operations   | 305,853          | 233,464          | 229,729          |
| <b>TOTAL (as shown in BS)</b> | <b>2,061,663</b> | <b>4,008,126</b> | <b>4,956,407</b> |

## 7. Details of liabilities as of September 2003

- (1) Loans that account for more than 10% of total liabilities.

| Loan Providers              | Terms  | Capital outstanding September 2003 |
|-----------------------------|--|------------------------------------|
| <b>World Vision Germany</b> | Loan provided for a period of three years, no interest is to be charged.   | 15,339                             |
| <b>World Vision Canada</b>  | Interest is 5% of the unpaid balance. Loan is 100 000 USD, repayments to be made in USD, agreement starting April 1, 2003 for 12 months with a grace period of 12 months. For three years following the end of the implementation phase of the grant (March 31, 2004 to April 20, 2007) AgroInvest will submit semi-annually complete financial reports.                             | 34,864                             |
| <b>KfW Germany</b>          | Maturity dates of two installments in June 2007 and December 2007 and annual interest rates of 3,00 % payable on half-year basis. To support the transition activity in Montenegro trough promotion of rural areas conducted by farms.   | 1,450,000                          |
| <b>KfW Austria</b>          | Maturity dates of two installments in June 2007 and December 2007 and annual interest rates of 3,00 % payable on half-year basis. To support the transition activity in Montenegro trough promotion of rural areas conducted by farms.   | 500,000                            |
| <b>Cordaid Holland</b>      | Payable in seven semi-annual months installments payable on November and May, starting in November 2004. Interest rate 6%. Amount to be invested for microcredit targeted at poor rural households in Central and Northern Montenegro and Central Serbia. Loan portfolio without any arrears worth 100% of the loan amount (presentation of a list of loans subject to this clause). | 600,000                            |

- (2) Deposits: AgroInvest doesn't offer saving products.

## 8. Other significant Accounting Policies

- (1) Interest income and expense and other operating income and expenses are recognized on an accrual basis. Fee income relates to loan-processing fees, which are calculated as 2.5% - 3.5% of the disbursed loan amount, and it is automatically deducted from the loan amount at disbursement. Other financial income relates to penalty fees (1.5% of disbursed loan amount) charged for contract termination before due date.
- (2) Depreciation of fixed assets: The depreciation of fixed assets on a flat basis using the following schedule:

| Asset Class  | Useful Life | Depreciation Rate |
|--|-------------|-------------------|
| All fixed assets except vehicles<br>(data processing equipments) | 3years      | 33.33%            |
| Vehicles   | 5 years     | 20%               |

- (3) Inflation accounting: none
- (4) Currency mismatch: please refer to the F area for more information on potential mismatch.
- (5) Accounting treatment of unrealized gains or losses due to foreign currency fluctuations: Financial statements are expressed in Euros, which is the official currency in the Republic of Montenegro, whereas the official currency in the Republic of Serbia is the Yugoslav Dinar. Accounting Laws of the Republic of Montenegro and the Republic of Serbia prescribes that reporting currencies are Euro and Dinar, respectively.

Assets and liabilities denominated in foreign currencies are translated into EUR at the average official exchange rate ruling at the balance sheet date. Gains and losses, resulting from the foreign currency transactions are included in the income statement for the year as gain and losses.

## Specific notes to the financial statements

### Income statement

1. Including gains due to foreign currency transactions.
2. Including international salaries / per diem and benefits, paid by World Vision International and invoiced to AgroInvest.
3. Staff costs: in accordance with local regulations and tax legislation, the Organization is obliged to pay payroll tax and employee benefits through contributions (for health insurance, retirement benefits and unemployment scheme). Taxes and contribution are charged to the employee and to the employer.
4. Note that the unaudited figures for 2004 by region for “other administrative expenses” as provided by AgroInvest were modified by Planet Rating. AgroInvest transferred funds from Montenegro to Serbia to cover HQ costs for 12 months, while the period of this Income Statement is only 8 months, therefore to more cleanly analyze profitability by entity an adjustment was made such that the amount transferred between the two entities was the equivalent of 8 months HQ charges. Additionally, AgroInvest considered this a donation to Serbia whereas Planet Rating considered this an offset to expenses.
5. Grant for credit operations are shown in the IS and added in the BS to the donated equity.
6. Current year net income shown in BS is exclusive of operations donations.

### Balance sheet

7. Different legal frameworks in Serbia and Montenegro result in distinct funding possibilities thus strategy among others things. Separate financial statements are therefore being provided for a better understanding of entities' operations (details are available in domain E)
8. Loans granted by “World Vision International Serbia and Montenegro”, Belgrade, to individuals located in Serbia from October 1, 2002 to March 31, 2003 were not in accordance with the Law on Banks and other financial institutions of the Republic of Serbia, which prescribes that only banks are authorized to approve loans on the territory of the Republic of Serbia. World Vision International Serbia and Montenegro”, Belgrade, signed the contract with Meridian Bank A.D, Novi Sad at September 2003 to process and approve loans to individuals through the Bank.
9. Cash and cash equivalents include cash and deposits with the banks. This also includes the 18% reserve requirement for the portfolio in Serbia.
10. Net commercial loans are stated at their initial amount net of specific provision potential loan losses. Gross loans and loan loss reserve are also presented in the BS
11. Receivables from WV international and other assets and prepaid expenses
12. Tangible assets are stated at their historical costs value net of accumulated depreciation, which is calculated on a straight-line basis over estimated useful lives. Fixed assets items that cost less than 1,000 EUR (FY2003) and 500 EUR (FY2002) are recognized as expenditures in the profit and loss account.
13. Details of long terms borrowings can be found in the notes above.
14. Details of donated equity are presented in the notes above. Please note that the financial statements disclosed in this report have been modified for presentation to better reflect donations: grants for operations to be used in the current operating period are recorded in the income statement and added to the donated equity in the balance sheet.

| AGROINVEST   |          | EUR   |                 |                  |                  | % Change         |               | Serbia        |                | Montenegro     |                  |                  |
|--|----------|-------|-----------------|------------------|------------------|------------------|---------------|---------------|----------------|----------------|------------------|------------------|
| Income Statement   |          | Notes | Sep. 2001       | Sep. 2002        | Sep. 2003        | May. 2004        | 2002/<br>2001 | 2003/<br>2002 | Sept. 2003     | May. 2004      | Sept. 2003       | May. 2004        |
| <b>Financial Revenue (a)</b>                                     |          |       | <b>372,355</b>  | <b>1,054,399</b> | <b>2,230,089</b> | <b>2,198,737</b> | <b>183%</b>   | <b>112%</b>   | <b>547,760</b> | <b>513,279</b> | <b>1,682,329</b> | <b>1,685,456</b> |
| Financial Revenue from Loan Portfolio                            |          |       | 352,710         | 1,000,116        | 2,181,963        | 2,159,297        | 184%          | 118%          | 535,888        | 503,252        | 1,646,074        | 1,656,043        |
| Interest on Loan Portfolio                                       |          |       | 284,726         | 844,104          | 1,903,401        | 1,891,469        | 196%          | 125%          | 480,673        | 427,215        | 1,422,728        | 1,464,253        |
| Fees and Commissions on Loan Portfolio                           |          |       | 67,984          | 156,012          | 278,562          | 267,828          | 129%          | 79%           | 55,215         | 76,037         | 223,346          | 191,790          |
| Penalty Revenue on Loan Portfolio                                |          |       | -               | -                | -                | -                | -             | -             | -              | -              | -                | -                |
| Financial Revenue from Investments                               |          |       | -               | -                | -                | -                | -             | -             | -              | -              | -                | -                |
| Other Operating Revenue  | 1        |       | 19,645          | 54,283           | 48,126           | 39,440           | 176%          | (11%)         | 11,872         | 10,027         | 36,255           | 29,413           |
| <b>Financial Expense (b)</b>                                     |          |       | <b>6,614</b>    | <b>8,287</b>     | <b>66,390</b>    | <b>77,152</b>    | <b>25%</b>    | <b>701%</b>   | <b>1,634</b>   | <b>-</b>       | <b>64,756</b>    | <b>77,152</b>    |
| Interest paid on borrowings                                      |          |       | 6,614           | 8,287            | 66,390           | 77,152           | 25%           | 701%          | 1,634          | -              | 64,756           | 77,152           |
| Other Financial Expenses   |          |       | -               | -                | -                | -                | -             | -             | -              | -              | -                | -                |
| <b>Financial income [c=a-b]</b>                                  |          |       | <b>365,741</b>  | <b>1,046,112</b> | <b>2,163,699</b> | <b>2,121,585</b> | <b>186%</b>   | <b>107%</b>   | <b>546,126</b> | <b>513,279</b> | <b>1,617,573</b> | <b>1,608,304</b> |
| Net Loan Loss provision expense (d)                              |          |       | 34,670          | (35,272)         | 8,028            | 22,877           | (202%)        | (123%)        | 197            | 4,928          | 7,831            | 17,949           |
| Loan loss provision expense and write off                        |          |       | 34,670          | (33,846)         | 10,398           | 24,406           | (198%)        | (131%)        | 197            | 4,928          | 10,201           | 19,478           |
| Recovery from Loans written off                                  |          |       | -               | 1,426            | 2,370            | 1,529            | -             | 66%           | -              | -              | 2,370            | 1,529            |
| Operating expense (e)  |          |       | 367,127         | 786,726          | 1,535,696        | 1,153,031        | 114%          | 95%           | 525,859        | 296,104        | 1,009,838        | 856,926          |
| Personnel Expense (includes fringe)                              | 2, 3     |       | 230,623         | 483,189          | 910,931          | 520,804          | 110%          | 89%           | 349,156        | 154,599        | 646,040          | 366,205          |
| Administrative Expense (non-staff operating Expenses)            |          |       | 136,504         | 303,537          | 624,765          | 632,227          | 122%          | 106%          | 176,703        | 141,505        | 363,798          | 490,721          |
| Depreciation and amortization                                    |          |       | 19,530          | 38,272           | 71,435           | 56,322           | 96%           | 87%           | 22,195         | 14,366         | 49,239           | 41,956           |
| Consulting fees  |          |       |                 | 5,269            | 6,366            |                  | -             | 21%           |                |                |                  |                  |
| Village Council payments   |          |       |                 |                  | 84,264           |                  | -             | -             |                |                |                  |                  |
| Other  | 4        |       | 116,974         | 259,996          | 462,700          | 575,905          | 122%          | 78%           | 154,508        | 127,139        | 314,559          | 448,765          |
| <b>Net Operating Income Before Taxes and Donations [f=c-d-e]</b> |          |       | <b>(36,056)</b> | <b>294,658</b>   | <b>619,975</b>   | <b>945,677</b>   | <b>(917%)</b> | <b>110%</b>   | <b>20,070</b>  | <b>212,247</b> | <b>599,904</b>   | <b>733,429</b>   |
| Income Taxes (g)   |          |       | -               | -                | -                | -                | -             | -             | -              | -              | -                | -                |
| Net Operating Income Before Donations [h=f-g]                    |          |       | (36,056)        | 294,658          | 619,975          | 945,677          | (917%)        | 110%          | 20,070         | 212,247        | 599,904          | 733,429          |
| Non Operating Revenue (i)  |          |       | -               | -                | -                | -                | -             | -             | -              | -              | -                | -                |
| Non Operating Expense (including related taxes) (j)              |          |       | -               | -                | -                | -                | -             | -             | -              | -              | -                | -                |
| Net Income Before Donations [k=h+i-j]                            |          |       | (36,056)        | 294,658          | 619,975          | 945,677          | (917%)        | 110%          | 20,070         | 212,247        | 599,904          | 733,429          |
| Donations (l)  | 5        |       | 305,853         | 233,464          | 229,729          | 79,555           | (24%)         | (2%)          | -              | 79,555         | 229,729          | -                |
| <b>Net Income (after Taxes and Donations) [m=k+l]</b>            | <b>6</b> |       | <b>269,797</b>  | <b>528,122</b>   | <b>849,704</b>   | <b>1,025,232</b> | <b>96%</b>    | <b>61%</b>    | <b>20,070</b>  | <b>291,802</b> | <b>829,633</b>   | <b>733,429</b>   |

| AGROINVEST  |       | EUR Consolidated |                  |                  |                   | Serbia           |                  | Montenegro       |                  | % change consolidated |               |
|---|-------|------------------|------------------|------------------|-------------------|------------------|------------------|------------------|------------------|-----------------------|---------------|
| Balance sheet                                     | Notes | Sept. 2001       | Sept. 2002       | Sept. 2003       | May 2004          | Sept. 2003       | May. 2004        | Sept. 2003       | May. 2004        | 2002/2001             | 2003/2002     |
| <b>ASSETS</b>                                     | 7,8   | <b>2,441,921</b> | <b>5,615,933</b> | <b>9,748,194</b> | <b>12,056,778</b> | <b>2,113,129</b> | <b>2,744,001</b> | <b>7,640,736</b> | <b>9,312,774</b> | <b>130.0%</b>         | <b>73.6%</b>  |
| <b>Short Term Assets</b>                          |       | <b>2,355,442</b> | <b>5,461,634</b> | <b>9,532,821</b> | <b>11,830,552</b> | <b>2,044,119</b> | <b>2,670,047</b> | <b>7,494,372</b> | <b>9,160,503</b> | <b>131.9%</b>         | <b>74.5%</b>  |
| Cash and Due from Banks                           | 9     | 394,225          | 667,389          | 1,157,588        | 1,062,359         | 642,885          | 744,148          | 514,703          | 318,208          | 69.3%                 | 73.5%         |
| Short Term Investments                            |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| Short Term Net Loan Portfolio                     | 10    | 1,959,813        | 4,768,269        | 8,355,218        | 10,726,767        | 1,394,318        | 1,915,284        | 6,960,900        | 8,811,483        | 143.3%                | 75.2%         |
| Short Term Gross Loan Portfolio                   |       | 2,003,009        | 4,774,023        | 8,361,911        | 10,749,489        | 1,394,515        | 1,919,854        | 6,967,396        | 8,829,635        | 138.3%                | 75.2%         |
| (Loan Loss Reserve)                               |       | 43,196           | 5,754            | 6,693            | 22,722            | 197              | 4,570            | 6,496            | 18,152           | (86.7%)               | 16.3%         |
| Interest Receivable                               |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| On loan portfolio                                 |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| On investments                                    |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| Accounts receivable and other assets              | 11    | 1,404            | 25,976           | 20,015           | 41,426            | 6,916            | 10,615           | 18,769           | 30,812           | 1,750.1%              | (22.9%)       |
| <b>Long term assets</b>                           |       | <b>86,479</b>    | <b>154,299</b>   | <b>215,373</b>   | <b>226,226</b>    | <b>69,010</b>    | <b>73,954</b>    | <b>146,364</b>   | <b>152,271</b>   | <b>78.4%</b>          | <b>39.6%</b>  |
| Long Term Net Investments                         |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| Long Term Gross Loan Portfolio                    |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| Net Fixed Assets                                  | 12    | 86,479           | 154,299          | 215,373          | 226,226           | 69,010           | 73,954           | 146,364          | 152,271          | 78.4%                 | 39.6%         |
| Other Long Term Assets                            |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| <b>LIABILITIES AND EQUITY</b>                     |       | <b>2,441,921</b> | <b>5,615,933</b> | <b>9,748,194</b> | <b>12,056,778</b> | <b>2,113,129</b> | <b>2,744,001</b> | <b>7,640,736</b> | <b>9,312,774</b> | <b>130.0%</b>         | <b>73.6%</b>  |
| <b>Liabilities</b>                                |       | <b>332,879</b>   | <b>961,032</b>   | <b>3,264,027</b> | <b>4,322,731</b>  | <b>184,916</b>   | <b>255,274</b>   | <b>3,079,107</b> | <b>4,067,456</b> | <b>188.7%</b>         | <b>239.6%</b> |
| <b>Short term liabilities</b>                     |       | 125,144          | 39,532           | 133,690          | 227,258           | 14,291           | 84,649           | 119,393          | 142,605          | (68.4%)               | 238.2%        |
| Short Term Borrowings                             |       | -                | -                | 87,161           | 81,566            | -                | -                | 87,161           | 81,566           | 22.2%                 | (38.1%)       |
| Interest payable                                  |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| Accounts Payable and Other Short Term Liabilities |       | -                | 39,532           | 46,529           | 145,692           | 14,291           | 84,649           | 32,232           | 61,039           | (68.4%)               | 17.7%         |
| <b>Long term liabilities</b>                      |       | 207,735          | 921,500          | 3,130,337        | 4,095,473         | 170,625          | 170,625          | 2,959,714        | 3,924,851        | 343.6%                | 239.7%        |
| Long Term Borrowings                              | 13    | 207,735          | 676,838          | 2,600,203        | 3,565,339         | -                | -                | 2,600,203        | 3,565,339        | 225.8%                | 284.2%        |
| Other Long Term Liabilities                       |       | -                | 244,662          | 530,134          | 530,134           | 170,625          | 170,625          | 359,511          | 359,512          | -                     | 116.7%        |
| <b>Equity</b>                                     |       | <b>2,109,042</b> | <b>4,654,901</b> | <b>6,484,167</b> | <b>7,734,047</b>  | <b>1,928,213</b> | <b>2,488,727</b> | <b>4,561,629</b> | <b>5,245,318</b> | <b>120.7%</b>         | <b>39.3%</b>  |
| Paid-In Capital                                   |       | -                | -                | -                | -                 | -                | -                | -                | -                | -                     | -             |
| Donated equity                                    | 14    | 2,061,663        | 4,008,126        | 4,956,407        | 5,049,194         | 1,952,938        | 2,190,230        | 2,779,409        | 2,779,409        | 94.4%                 | 23.7%         |
| Retained earnings (no donations and reserves)     |       | 47,379           | 635,701          | 0                | 1,479,430         | (27,833)         | 321,467          | 1,736,998        | 2,412,925        | -                     | -             |
| Current year                                      |       | (36,056)         | 294,658          | 0                | 619,975           | 17,589           | 349,301          | 832,116          | 675,930          | 1,241.7%              | 132.7%        |
| Other equity accounts                             |       | -                | 11,074           | 48,330           | 30,019            | 3,108            | (22,970)         | 45,222           | 52,984           | (917.2%)              | 110.4%        |

## Adjustments

Data in EUR

|   | Sep. 2001      | Sep. 2002      | Sep. 2003      |
|---|----------------|----------------|----------------|
| <b>Adjustment for the cost of funds</b>               | <b>14,918</b>  | <b>58,056</b>  | <b>185,925</b> |
| Average amount of borrowings                          | 143,548        | 442,287        | 1,682,101      |
| Shadow price of borrowings (a)                        | 15.0%          | 15.0%          | 15.0%          |
| Interest expense on borrowings                        | 6,614          | 8,287          | 66,390         |
| <b>Adjustment for inflation = (H + I - A - L) * N</b> | <b>355,136</b> | <b>880,627</b> | <b>753,858</b> |
| H. Avg. Equity  | 1,685,925      | 3,381,971      | 5,569,534      |
| M. Average fixed assets                               | 71,670         | 120,389        | 184,836        |
| N. Inflation rate (a)                                 | 22.0%          | 27.0%          | 14.0%          |
| <b>Adjustment for in-kind donations</b>               | <b>0</b>       | <b>0</b>       | <b>0</b>       |
| a. Staff and technical assistance                     |                |                |                |
| b. Other  |                |                |                |
| <b>Adjustments for provisions</b>                     | <b>0</b>       | <b>0</b>       | <b>0</b>       |
| Loan losses   |                |                |                |
| Other risks   |                |                |                |
| <b>Other adjustments</b>                              |                |                |                |
| <b>Total adjustments</b>                              | <b>370,054</b> | <b>938,683</b> | <b>939,783</b> |
| Net income before donations                           | (36,056)       | 294,658        | 619,975        |
| Adjusted net income before donations                  | (406,110)      | (644,025)      | (319,808)      |

(a) The shadow price of borrowings is a rough estimate, as AgroInvest does not have access to local bank funds. These rates are lower than the inflation rates obtained from a different source. By measure of prudence, Planet Rating maintained the more conservative inflation estimates.

The following adjustments were applied:

- ❑ The adjustment for inflation is performed to account for the effect of inflation on equity and fixed assets.
- ❑ Adjustment for cost of funds is performed to estimate the cost that the institution would pay if using commercial financing instead of concessional rate loans. In the case of AgroInvest, all loans are at concessional rates and were therefore adjusted.
- ❑ Adjustments for in-kind donations: AgroInvest does benefit from several in-kind donations by being part of the World Vision, such as exchange visits. At the same time, AgroInvest has incurred costs, notably management staff time, to serve as the World Vision representative in Serbia. In the future, AgroInvest will likely be paid for its services to World Vision
- ❑ Adjustments to provisions are performed to better compare AgroInvest to its peers and adjust for cases of inadequate provisioning. In this case, the provision policy was sufficient and no adjustment was performed.