

Mikrofin

Bosnia and Herzegovina

April 2005

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

Global Rating

Rating: A
Trend: Uncertain

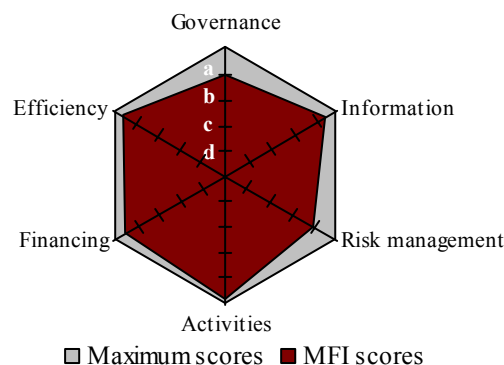
Mikrofin is a locally registered not-for-profit non-deposit taking Microcredit Organization started by CARE in 1997. Banja Luka-based Mikrofin targets low-income economically active non-bank clientele in Bosnia and Herzegovina. It is the largest Bosnian MFI as measured by portfolio outstanding with most of its assets concentrated in the Republika of Sprska. The institution currently offers three loan products based on an individual lending methodology. As of March 31, 2005, Mikrofin had an outstanding portfolio of over 23.3 million EUR, and was serving over 15,600 clients of all ethnic origins.

Rating Plus Summary

Environment	Favourable
Maturity	Mature: 8 years of operations
Scale	Large: Portfolio of 29 million USD (2004)
Target market	Broad: Avg. out. loan of 2,064 USD

Area Scores

G overnance	b
I nformation	a
R isk Management	a
A ctivities	a
F inancing and Liquidity	a
E fficiency and Profitability	a



ACTIVITY	Dec. 2002	Dec. 2003	Dec. 2004	PERFORMANCE	Dec. 2002	Dec. 2003	Dec. 2004
Total number of staff	60	79	94	ROE	31,4%	24,2%	24,5%
Total assets (EUR)	9 492 197	15 132 708	21 973 407	Liabilities / Equity	184,8%	141,2%	161,0%
(BAM)	18 564 839	29 596 551	42 975 590	ROA	9,7%	9,4%	9,7%
Loan portfolio (EUR)	9 116 646	14 553 093	21 329 755	Operational self-sufficiency	158,1%	163,4%	173,3%
Outstanding deposits (EUR)	0	0	0	Financial self-sufficiency	125,6%	135,5%	147,0%
Number of active borrowers	5 634	7 426	14 033	Portfolio Yield	29,3%	26,4%	23,9%
Number of savers	0	0	0	Operating expense ratio	14,3%	12,4%	9,7%
APR	27,9%	27,5%	24,2%	Staff productivity	94	94	149
PAR 31-365	0,0%	0,0%	0,2%	Funding expense ratio	3,4%	2,9%	3,4%
PAR > 365	0,0%	0,0%	0,0%	GROWTH			
Write-off ratio	0,1%	0,0%	0,0%	Loan portfolio growth	71,4%	59,6%	46,6%
Risk coverage ratio	48 163,5%	4 679,4%	874,0%	Savings portfolio growth	N/A	N/A	N/A
Exchange rate 1 EUR= xx BAM	1,96	1,96	1,96	Assets growth	66,6%	59,4%	45,2%

Notes:

(a) APR: Average annual effective rates for the whole portfolio for 2002-2004 are provided by Mikrofin. Calculated APRs by Planet Rating by product are: a) Individual loans (10,3% to 27,3% depending on grace period given); b) Start-Up Activities loans (24% to 32%) and Good Credit History loans (22% to 24%). APRs for agriculture loans are lower at around 17% to 21% if they were financed using USAID LAMP funds.
(b) For AROA and AROE comparisons, the peer group used is comprised of Mikrofin, EKI, Partner, Prizma, Sunrise, LOK Mikro, Sinergija Plus, Mi-Bospo and Benefit.

Rating Scale

Area Rating	Global Rating	Explanation
a	A+	Excellent
	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+	Good
	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+	Minimum required
	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	Insufficient
		Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.
e	E	Immediate risk of default or very insufficient
		There are immediate or underlying risks for operations or an unacceptable under performance.

Rating Plus: MicroBanking Bulletin categories for Eastern Europe & Central Asia

Scale (Outstanding portfolio USD)	Target Clientele (Avg. out. loan / GNP per capita)	Maturity (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 a % 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 sector in Bosnia and Herzegovina (BiH), launched after the end of war in 1997, is highly developed receiving support from the World Bank-financed Local Initiatives Project (LIP), international NGOs and development agencies such as KfW and USAID. Subsequent rounds of LIP financing targeting fewer and fewer MFIs have started the consolidation pressure within the sector. Although there were only a few takeovers and mergers completed to date, this consolidation trend, mirroring the parallel trend in the general banking sector, will intensify according to industry watchers. There are officially 46 registered MFIs, but most of the industry's outstanding portfolio is concentrated in the largest 10 MFIs amongst which Mikrofin holds the largest market share.

By the end of 2004, these 10 leading MFIs were serving around 100,000 clients, mainly in urban, but also increasingly in rural areas, with a total portfolio outstanding of around 100 million EUR, representing 20%+ growth both in terms of clients and portfolio size since 2003. Although portfolio quality remains strong, the entire sector is becoming concerned about the high level of client cross-indebtedness and the relative decline of guarantors' quality due to the fact that many guarantors also hold their own loans. Based on various loan officers' estimates from different MFIs, 20% to 60% of their clients also take loans from other sources. Bosnian MFIs must, therefore, offer more customized products in a timely fashion while strengthening risk management in order to maintain market position and portfolio quality.

Founded by CARE in 1997, Mikrofin is a not-for-profit and non-deposit taking institution registered with both entity governments allowing it to operate in both BiH entities under similar microcredit laws. The law is simple and provides for registration of specialized credit-only, non-government, non-profit institutions with minimal regulation and no formal government supervision. Efforts are underway to change the legal framework for MFIs, expand legal options and review the range of products that may be offered. A new microfinance law is expected to be adopted at the end of 2005.

Mikrofin received a global rating of A. This rating is based on Mikrofin's excellent operating and financial performance during the past three years during which it gained market and client shares in a competitive market to become the largest MFI in BiH in 2004 as measured by loan portfolio outstanding. Mikrofin excelled in many reviewed areas evidenced by its solid management team, efficient MIS systems, strong pricing and cost structure leaderships, outstanding portfolio quality, a diversified funding base and a very high productive asset ratio. Slight weaknesses are noted in areas of strategic planning, human resources management and internal audit.

The trend for the year to come is Uncertain. The uncertain trend is underpinned by the expected adoption of the new microcredit law and due to Mikrofin's desire to transform into a for-profit microcredit company. This planned transformation could have a number of internal (e.g. new products) and external (e.g. more regulations, tax obligations) consequences potentially impacting its market and profitability positions. While Mikrofin has strong management capacity, execution risks do exist. Internal trend is positive overall, but rising competition from commercial banks plus new microcredit law's undefined ramifications on Mikrofin result in a "Uncertain" trend rating.

Governance and decision making receives a score of: b

- ❑ The decision-making process at Mikrofin is straightforward and efficient. The competent fully localized Board of Directors guides the institution competently.
- ❑ Mikrofin has good planning processes and practices at all levels. Written Business Plan 2004-2007 lacks some details, however Mikrofin has been very successful with its unique, numerically oriented management style, thanks to frequent management team meetings.
- ❑ Mikrofin's market strategies are sound and relevant for its current market position in RS. It has yet to develop a clear Federation strategy given the possibility for it to either change/ redefine the market instead of continuing to pursue a more gradual expansion strategy.
- ❑ Downscaling and cost control have been successful strategies, but whether these two strategies will confer a sustainable competitive advantage in the long term is questionable, as many MFIs are also downscaling and as Mikrofin's cost structure seems to be already very low.
- ❑ Mikrofin has a solid management team led by a charismatic and driven Executive Director. Planned hiring of an HR Manager and a Legal Advisor is a welcome move that should strengthen overall management team.
- ❑ Human Resources functions work well, but many HR aspects could be formalized as Mikrofin grows in size. Middle management capacity needs to be further boosted.

Information management and systems receives a score of: a

- ❑ Internal-developed and integrated MIS are highly efficient and clearly a key enabler of Mikrofin's efficiency. The MIS Manager is technically competent and intimately knowledgeable of its MIS systems.
- ❑ No clear stand-alone IT strategy, but MIS systems are stable and working well. Any future development should be feasible given existing competencies. Mikrofin's internally-developed MIS could potentially benefit from an external audit.
- ❑ Updated and accurate loan information and reports are easily available and widely disseminated. Data security and integrity is good. More focus on customizing and summarizing data into consolidated reports would be useful.
- ❑ Accounting system and data are also of good quality and are well-maintained by a competent Finance Department.

Risk management receives a score of: a

- ❑ Operational risks are well identified and adequately framed by comprehensive and integrated procedures and policies. A competent Internal Auditor ensures adequate control of basic lending operational risks.
- ❑ Possible improvements include more resources for Internal Audit, systematic and regular audit of HQ functions and a direct reporting link to the Board of Directors.

Activities and services receive a score of: a

- ❑ Mikrofin's competitive position is secured for the next 12 months, however increased competition from MFIs and downscaling banks may erode Mikrofin's current leadership position in the medium-term.
- ❑ Having discontinued the group lending methodology, Mikrofin's individual lending methodology and products have been proven appropriate and efficient for the targeted clientele base.
- ❑ No formal diversification targets exist, but portfolio is well diversified with agriculture lending gaining market share. Formal targets could help with overall risk management.

- ❑ Exceptional portfolio quality with a PAR31 under 0.2%, a write-off ratio close to 0% for the past three years, and no rescheduled loans. This is due to its excellent client selection and monitoring systems along with the culture of zero tolerance for arrears.
- ❑ Risk coverage for potential loan loss is high based on existing high reserves and loan guarantee requirements.

Financing and liquidity receives a score of: a

- ❑ Solid funding structure as a result of diversified funding base and favourable funding mix made possible by strong track record of profitability and credible management.
- ❑ Remarkable ability to obtain loans from commercial funders and very skilful at building trust and support among its funding partners as evidenced by an increase in granted amounts and better financing terms over the past 2 years.
- ❑ No formal Asset Liability Management policy, but ALM risks are either well-managed or non-material.
- ❑ Mikrofin is leveraged at a low debt to equity ratio of 161%. It has additional debt capacity, but it is restrained because of lack of available fixed assets to be mortgaged.
- ❑ Liquidity management is not very sophisticated, yet it is quite effective given centralized and conservative liquidity management policy.
- ❑ Funds are disbursed quickly resulting in excellent deployment and optimization of assets. However this has also caused tight liquidity at times exacerbated by seasonal factors.

Efficiency and profitability receives a score of: a

- ❑ Mikrofin's profitability indicators are excellent especially in light of heightened competition and decreasing portfolio yield. The keys to success have been and continue to be its low cost structure derived from a disciplined approach to cost control, high staff productivity and efficient asset management.
- ❑ Effective interest rates and portfolio yields have been on a downward trend due to self-initiated decrease in interest rates in 2004.
- ❑ Lower portfolio yield would have hurt Mikrofin had it not been for its outstanding low cost structure and high staff productivity protecting its profit margins. Benefiting from economies of scale from growing portfolio, Mikrofin has consistently been able to reduce its operating expense ratio from 14.3% in 2002 to 9.7% in 2004.
- ❑ Excellent asset management is another key factor to understanding Mikrofin's high profitability. 95% of its total assets are deployed in an income-producing loan portfolio. There has also been a shift in portfolio composition from lower yielding Individual loans to higher yielding Start-Up Activities loans; the latter accounted for 17% of portfolio in 2004, up from 9% in 2003.

Financing needs:

- ❑ Mikrofin anticipates significant financing needs of 44,7 million BAM (22,8 million EUR) for the next three years, of which the majority of 2005 funding needs are already committed or in negotiation.
- ❑ Planet Rating believes that Mikrofin, being a solid institution, will have little difficulty in raising sufficient funds and executing its 2005-2007 Business Plan successfully.

Conflict of Interest Statement

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 sustainability of an institution. However, it is difficult for an institution that is young, operating in a challenging environment, or targeting hard-to-serve populations to achieve this level of sustainability. Rating Plus serves to clarify the institution's context.

Operating Context

Economic and Political Environment: Improving

Ranked 66 (out of 175 countries) in the UNDP 2004 Human Development Report, BiH is a post-conflict country transitioning to a free market economy. Much needs to be done to improve the regulatory environment and eliminate barriers to investment.

	Dec. 2002	Dec. 2003	Dec. 2004
Exchange rate: 1 EUR = X BAM	1.96	1.96	1.96
GDP/ capita (EUR)	1,556	1,642	1,732
Inflation	0.4%	0.6%	0.4%
BiH rating: Moody's			B3
:COFACE			D

Source: CBBH, Moody's, COFACE

- There is still too much over-lapping governing institutions in BiH. Laws are slow to pass, though some improvements have been made in the recent past. The adoption of the microfinance law has been delayed for over a year now. Macro-economic conditions are stable, but economic growth remains sluggish and unemployment remains extremely high, especially among youth (estimated at 60%+).
- The Central Bank of BiH has kept inflation low and the national currency (BAM) firmly pegged to the EUR for the past few years. This favourable economic climate and renewed trust have resulted in strong growth of deposits in domestic banks (+30%) and of overseas portfolio investment in BiH's stock exchanges.
- The Central Bank regulates banks and other financial companies, but does not yet regulate MFIs, which are currently overseen by entity governments.

Infrastructure: Favorable

Since the war, critical infrastructure has been rebuilt. Mikrofin communicates very efficiently with its branches and satellite offices via phone, email and Internet, but some roads are closed during winter due to snow causing occasional arrears.

Institutional Development (MBB Indicators)

Maturity: Mature; Scale: Large

- 8 years of operations (including years as a CARE project)
- Loan portfolio of 29 million USD
- Grants: 5,4 million USD since start up

Target clientele: Broad; Other Activities: No.

- Average loan outstanding is about 87.8% of GDP per capita (Dec. 2004) placing it in the Broad category as defined by the MBB.
- Mikrofin targets the middle and upper-end of the low-income non-banking client segment. Its three credit products apply individual methodology and serve mostly registered businesses (82% of loans issued in 2004).
- Mikrofin is downscaling into smaller loan sizes with its Start-Up Activities loan product and is expanding to rural areas. Agriculture lending is growing (mostly dairy and

livestock) under USAID LAMP and KFW Rural SMELP Credit Lines. All loan products are secured with guarantees. Mikrofin serves both men (65%) and women (35%).

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Acronyms



ALM	Asset and Liability Management
APR	Annual Effective Rate
BAM	Bosnia Official Currency
BiH	Bosnia and Herzegovina
BoD	Board of Directors
CGAP	Consultative Group to Assist the Poor
ED	Executive Director
EIR	Effective interest rate
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
FY	Fiscal Year (December 31 st)
HR	Human Resources
GNP	Gross National Product
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
IT	Information technology
KfW	German Development Bank
LAMP	Linking Agriculture Producers to Markets
LIP	Local Initiatives Microfinance Project
LO	Loan officer
MBB	MicroBanking Bulletin
MIS	Management Information System
MFI	Microfinance institution
MFC	Microfinance Centre for Central and Eastern Europe and the
NA	Not Applicable
NGO	Non Governmental Organization
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
RS	Republika of Srpska
SME	Small and medium sized enterprise
USAID	United States Agency for International Development
UNDP	United Nations Development Program
USD	United States Dollar

Institutional Presentation

Environment Bosnia and Herzegovina (BiH) is a post-conflict transitioning economy burdened by many over-lapping government levels reflecting political trade-off after the Dayton Agreement. There have been efforts to streamline certain government functions and ministries and reduce government expenses, but the process is slow and pain-staking due to inter-entity politics. Reforms have gone further on the Federation side reflected in its more dynamic economy, but unemployment is still very high especially among the youth (estimated 60%+) in both entities. Informal economy is estimated by various sources to be as high as 40% of overall economy.

The microfinance sector in BiH, launched after the end of war in 1997, is highly developed with support from the World Bank (WB) and international NGOs. The bulk of start-up funds to the sector have been channeled through the WB-financed Local Initiatives Project (LIP). In addition to numerous international development agencies, actors such as KfW and USAID have funded microfinance organizations (MFIs). Subsequent rounds of LIP financing targeting fewer and fewer MFIs have started the consolidation pressure within the sector. Although there were only few takeovers and mergers completed to date, this consolidation trend mirroring the parallel trend in the general banking sector will intensify according to industry watchers. There are officially 46 registered MFIs, but most of outstanding industry portfolio is concentrated among the largest 10 MFIs, where Mikrofin has the largest share.

Macroeconomic and banking reforms have been most advanced and represent top marks on BiH's scorecard. Competition in the banking sector has increased, especially with the entry of foreign-owned banks, and this has generally resulted in better product offerings and a decline in interest rates. It has also resulted in a swift consolidation of the sector, evidence by a decrease in the number of registered banks from 76 in 1997 to 35 in 2004. At the end of 2004, the banking system had over 9.4 billion BAM in assets. Many banks, especially foreign-owned ones, such as Raiffeisen Bank and Hypo-Alpe-Adria Bank, have started to lend to select MFIs on commercial terms. Some of these banks are also "downscaling" into top-tier MFI markets and thus increasing the competitive environment overall.

Mission Mikrofin's mission is "to provide appropriate financial services to economically active low-income people than can make a profit and make it possible for them to become economically independent". Mikrofin has a very clear commercial orientation and a business-like attitude.

Legal form and supervision Mikrofin is a not-for-profit and non-deposit taking institution registered with both entity governments allowing it to operate throughout BiH under similar microcredit laws. The law is simple and provides for registration of specialized credit-only, non-government, non-profit institutions with minimal regulation and no formal government supervision. Efforts are underway to change the legal framework for MFIs, expand legal options and review the range of products that may be offered. A new microfinance law is expected to be adopted at the end of 2005. A key proposed change is the possibility of MFIs to transform to for-profit finance companies presumably regulated, paying taxes, but with better ability to raise equity from private investors.

Ownership and External Support Registered as a MFI, Mikrofin has no shareholders and has never paid any dividends. All profits and cash donations are capitalized. Mikrofin's Board of Directors (BoD), made up of five voting members, is its highest decision-making body. These individuals, coming from different backgrounds and experiences, are deeply committed to Mikrofin, several of them

having been involved with Mikrofin for a number of years. The current BoD is presided by Mr. Aleksandar Dzombic – one of Nova Banka’s Executive Directors. Mikrofin’s Founder CARE has ceased all direct involvement in Mikrofin’s operations and has transferred all assets to Mikrofin. *(A list of BoD members is provided in the appendix.)*

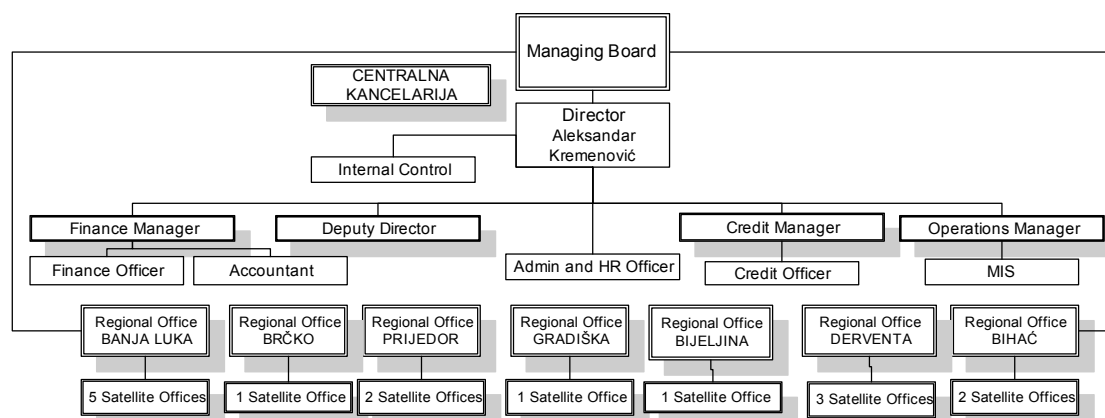
Services Mikrofin targets low-income economically active non-bank clients. Mikrofin technically offers four loan products (i.e. Individual loans, Start-up Activities loans, Good Credit History loans and Solidarity group loans), however it has more or less discontinued the group loan product as of the end of 2004. Individual loans dominate the portfolio at 79% as of the end of 2004 followed by Start-Up Activities loans at 17%. All loan disbursements and repayments are made at banks, except at its three largest branches in Banja Luka, Prijedor and Gradiska where transactions can be done in cash. Mikrofin serves both men (65%) and women (35%).

Loan Product Features	Individual Loans	Start-up Activities	Good Credit History
Minimum / Maximum loan amount	1,500-30,000 BAM	500-5,000 BAM	Up to 10,000 BAM
% of total outstanding portfolio as of Dec. 31, 2004	78.7%	16.9%	4.4%
Nominal interest rate	12 to 18 %	18 % to 24 %	18 % to 20 %
Fees	1 to 2 %	2%	2%
Repayment frequency	Monthly		
Term (without grace period)	up to 36 months	up to 18 months	up to 18 months
Grace period	up to six months	no	no
Guarantees	Guaranties of companies, private persons, bill of exchange, mortgage, pledge on movable assets, (may require one or combination of two guaranties)	Guaranties of companies, private persons, bill of exchange, (may require one or combination of two guaranties)	Guaranties of companies, private persons, bill of exchange (may require one or combination of two guaranties)
Effective interest rate	13% to 19%	19% to 25%	19% to 21%

Source: Mikrofin

Human resources and branches

Mikrofin currently has a network of 7 main branches and 15 satellite offices covering a large portion of Republika Sprska (RS)’s territory and the Bihac region on the Federation side. It has plans to expand in the Federation territory in the next two years. The Senior Management Team is located in the headquarters in Banja Luka and expects a possible move this year should it finalizes the purchase of a new building in downtown Banja Luka. Operations are decentralized with most of client and credit decisions are taken at the individual branch level where the majority of Mikrofin’s 100+ staff members are located.



Human resources	Dec. 02	Dec. 03	Dec. 04
Number of branches and offices	14	19	22
Number of personnel	60	79	94
% Loan officers	58%	62%	62%
Turnover (exits/ period average number of personnel)	3.7%	4%	2.3%

External audit PriceWaterhouseCoopers has been Mikrofin's external auditor for the last three fiscal years (FY end is December 31st). Its accounts are compliant with and audited based on IFRS and CGAP disclosure guidelines. Mikrofin received all unqualified audit opinions for the same period. Financial information disclosure in financial statements is good both in terms of quantity and quality.

External supervision is limited to the external auditors annual missions, and reporting to LIP and other donors. The regulating ministries do not perform any operational control. External auditors apply international and microfinance standards, but do not visit branches (they rely on the internal auditor's visits) and do not directly report to the BoD.

Governance

Mikrofin is currently registered as a not-for-profit microcredit organization, but indicated its desire to transform to a for-profit limited liability microcredit company as soon as the new microcredit finance law is enacted. This planned transformation from a NGO to a private company will raise many ownership questions with the most important being: who will own the grants given to Mikrofin under its NGO status (7.8 million BAM as of 2004)? The risks linked to this planned transformation are not taken into account in this report. The new law will also impact other aspects of Mikrofin's operations and therefore its global risk profile, notably in key areas of governance, prudential supervision, reporting requirements, collateral requirements and income taxes.

Decision-making

The decision-making process at Mikrofin is straightforward and efficient. The competent fully localized¹ BoD guides the institution, approves key strategies and reviews performance results when it meets four times a year. All Board members are prominent, educated professionals coming from different backgrounds (i.e. doctor, lawyer, banker, businessman). They attend Board meetings regularly despite their busy work schedules. Their commitment is strong partially because Mikrofin is a prominent institution in the community, but also because Board members have known Mikrofin's Executive Director (ED) for a long time and have a close relationship with him. There is a risk that this friendship-enhanced loyalty may lessen should the current ED leave.

Board members receive high-quality quarterly management reports in advance of quarterly Board meetings². They are knowledgeable of the issues and challenges facing Mikrofin. While the Board's governance quality is considered good for Mikrofin's current NGO-type legal status, it will need to evolve in both composition and skills set should Mikrofin transform into a for-profit microcredit company in the future or expand its service range towards more sophisticated non-credit products. While Board members are all professionals capable of separating their various commitments, it should be noted that Mikrofin Board Chairman is one of Nova Banka's Executive Directors whose bank also provides credit facilities and other banking services to Mikrofin.

Planning

Relevance of the current strategy

Mikrofin has good planning processes and practices at all levels from corporate to branch and satellite offices and across all departments. There are daily meetings of top HQ-based managers at 8:30AM, monthly all-management meetings (HQ + branch managers) and annual meetings lasting 2-3 days to plan for various periods and activities. Mikrofin, more than other MFIs, is a numerically oriented institution where plans are always supported by many relevant numbers and are often (too) short in qualitative commentary and analysis. More discussions on

¹ CARE, Mikrofin's founder, has a non-voting presence on Board and therefore wields no material influence unlike the founders of other top BiH MFIs.

² These comprehensive reports cover all key client, portfolio, operational and financial data with accompanying comparative analysis against pre-approved budgets. Board members are generally happy with the frequency, the quality and the timeliness of management reports.

risks, competitive pressure and expansion plans would have been useful. Whereas discussions with the ED clearly demonstrate his command of the subjects, Mikrofin's written Business Plan 2004-2007 lacks concrete details and convincing explanations often expressed verbally.

Mikrofin is developing the following strategies for 2005-2007:

- ❑ Expand geographically, towards the Federation, and more into rural areas;
- ❑ Enlarge the products range (more flexibility under the new microcredit law);
- ❑ Develop strategic relationships with key funders and above all, local banks;
- ❑ Pursue strategic mergers and/or partnerships with other MFIs and banks;
- ❑ Transform into a for-profit limited liability company preceded by ownership clarification;
- ❑ Continue institutional and staff capacity building (recruitment of a HR manager and a lawyer, further strengthening of middle management...etc).

The above listed strategies are sound and relevant to Mikrofin's current market position in RS where it is strongest, but they lack details on whether and how fast Mikrofin aspires to be a national BiH player and on how aggressively it should act against established competition. Looking at the projected numbers, Mikrofin has set conservative targets of increasing active clients and portfolio by 50% and 74%, respectively by 2007 from 2004 levels. Being a top-ranking BiH institution by portfolio outstanding, it has yet to develop a clear Federation strategy given the possibility for it to either change/redefine the market instead of continuing to pursue a more gradual expansion strategy.

To face increased competition from banks and MFIs (refer to section A, on market analysis), Mikrofin has been going downstream with its Start-Up Activities loan created in March 2003 and continuing to tightly control costs. Based on 2004 portfolio and client data, and financial results, both of these operational strategies have been very successful. Whether these two strategies will confer a sustainable competitive advantage in the long term is questionable, as many MFIs are also downscaling and as Mikrofin's cost structure seems to be already very low.

Budgeting Process

Thanks to its excellent MIS systems and competent finance/accounting staff, budgeting process is one of Mikrofin's strong points. Its budgets are thoroughly detailed, realistic and are based on reasonable assumptions. Management at all levels is involved in setting up and monitoring the budgets. Results are closely compared and analyzed against budgets set by management in its monthly meetings and by the Board in its quarterly meetings. Using Mikrofin software, the institution generates detailed 2005-2007 financial projections based on reasonable assumptions. These projections are overall adequate for budgeting purposes, but some quarterly data details are not sufficiently updated.

Management Team

Skills and experience of management team

Mikrofin has very good management team. Like many MFIs, Mikrofin is led by a charismatic and driven ED. He inspires confidence, generates a good degree of corporate buy-in and acts as a good motivator for his team. Mikrofin's middle managers are competent operationally with their respective departments although none having yet the global view, command and presence of the ED. The ED represents a key-person risk which is somewhat mitigated by the fact that he has been with Mikrofin since the beginning and has shown strong long-term commitment to Mikrofin despite having received good offers to work elsewhere.

Mikrofin is well aware that it must continue to build its middle management team especially as the institution grows in size and complexity. We note with interest the creation of a new manager position called Operational Manager in January 2005 covering the areas of MIS, market research, product development and credit risk management including credit scoring. Mikrofin plans to hire a Human Resources (HR) Manager and a Legal Advisor to complete its Management Team in 2005. Mikrofin already has strong advantages of having educated, well-paid and committed managers who work well together. The next challenge is to build cross-functional abilities and systematic strategic mindset for all managers.

Executive Director: Aleksandar Kremenovic began his career in microfinance in 1997 in Employment and Training Foundation RS. He started with CARE-founded Mikrofin in 1998 as Mikrofin's Executive Director. He holds a Bachelor's degree of the Faculty of Economy of Banja Luka. He has taken numerous microfinance courses since joining Mikrofin and has been a Mikrofin trainer for MFC.

Organization of the management team

The management team is well-organized and their respective roles are well-defined. They appear to work cohesively under the strong leadership of the ED. The management structure is quite centralized in the HQ (decentralization of the credit decision process took place only two years ago). The current collegial decision-making structure and homogeneity of management profiles work well for Mikrofin. However future expansion into the Federation's territory together with more branches and offices overall and the changing nature of the competition would require adjustments in both management composition and skill set.

Human Resource Management

Organization of human resource management

There is currently no HR Manager, but for the time being the HR functions work quite adequately. There are Human Resources Manual, well-defined job descriptions as well as regular performance reviews. The ED is by default responsible for HR functions, but it is reported that 90% of this work is delegated down to respective Department's Managers and Branch Managers of field staff. As Mikrofin currently employs over 100 staff members, it is quite timely that it plans to hire a HR Manager to formalize the HR functions.

Skills management and performance evaluation

Performance evaluation process at Mikrofin is simple, but adequate enough. It is done quarterly for LOs, half year for all other staff and yearly for the Executive Director. Quite surprisingly, Mikrofin eliminated the variable bonus system for LOs in early 2005 citing employee complaints of unhealthy pressure. Staff members now receive a fixed amount replacing the bonus in form of a second monthly payment with a first monthly payment covering only salary. With good staff morale and competitive pay levels, it is not expected that this significant bonus change will be negative on LO productivity.

With regard to hiring new lending staff, Mikrofin gives its Branch Managers considerable autonomy. Once a LO is hired, efforts are focused on training him/her quickly to perform the required job well. Mikrofin does not have formal career plans. For lending staff, performance evaluation is mostly reduced to one benchmark (i.e. portfolio growth), which is too narrow a measure. With the creation of a formal HR Department, non-portfolio related objectives should be included in performance evaluation especially for management staff (e.g. training and development of staff under their supervision).

Information

Management Information System (MIS) and Equipment

Description of the MIS

Activity Information And Accounting	<ul style="list-style-type: none">• Internally developed MIS systems integrating both loan tracking and accounting functions.• Data is entered at the branch level, by the Admin/Finance officer: the officer enters disbursement/repayment either when clients come to the branch, before they meet with the cashier, or from the previous days' banks statements, for clients who use partner bank's tellers.• Data is sent daily to the HQ where it is consolidated. The Admin/Finance officers are in charge of data entry and of providing branch operational staff with information on their clients; the HQ is in charge of producing financial statements and activity reports.• Reconciliation of bank statements and MIS information is conducted daily at the HQ level.• The software generates numerous useful reports and the MIS team can export data to Excel and/or easily create new reports. All reports can be obtained the next day (after bank statements information is entered).• Financial statements are generated on a monthly basis, with provisions, depreciation and write off, available usually 10 days after the end of the month. A monthly financial analysis is performed, before and after adjustments.
Network	<ul style="list-style-type: none">• Server and LAN in each branch. Information sent to the HQ by email.• 58 computers, less than 2 years old.

Security

Thanks to automatic daily double back-ups (also done on CDs stored at banks), well-defined MIS user rights, passwords for computers and software (although they could be changed on a more frequent basis), audit trail and anti-virus software, the data is accurate and protected from unauthorized manipulation and from risk of loss. Mikrofin plans to buy a new and more powerful server for the HQ in order to replace the old one and to make sure the growing quantity of data may be adequately stored.

Ease of system use

The MIS is clearly a key enabler of Mikrofin's efficiency. Having been developed internally, it is entirely customized to the users' needs, both for data entry and for reporting purposes. The branch's Account/Finance officer enters data in real time, which automatically generates the reports used both by operational staff and administrative/management staff. Systems could be improved further by generating more complete and relevant reports (see below).

MIS plan and future improvements

There is no clear stand-alone IT strategy, which is not a major issue given that the MIS is already working well. The general goal is to continue to improve the software, including the development of a credit-scoring platform. As MIS systems have been stable for a year and the team is competent and flexible, any future development should be feasible, at least on the technical side, given existing competencies. Furthermore the existing databases (once stored on the new server) have large built-in capacity to accommodate forecasted growth for the next few years.

Skills of MIS Manager

The MIS Manager is technically competent and intimately knowledgeable of Mikrofin's systems. He assumes the roles of system administrator and programmer, in addition to performing everyday tasks of software development and maintenance. We have met only the MIS Manager, not the Operational Manager (also has some MIS responsibilities) who was on sick leave. The MIS Manager represents a key-person risk, as he is the only one to have mastered the program codes - although according to Mikrofin's ED, there are highly skilled computer persons in Banja Luka to replace him if needed. As the MIS system has been developed internally, it would be useful to have an external audit or to review it on a technical basis and determine whether it is necessary to document the program's logic and codes.

Information on Activities

Updated and accurate information is widely disseminated and easily available at all levels of the institution, but reports could be more structured to facilitate rapid analysis of figures. The MIS provides on-time, thoroughly detailed, daily updated information to internal and external clients. However many reports are often loaded with raw data and do not include any summary features nor comparison ratios that could allow for quick identification and analysis of problems. For instance, LOs receive many separate reports for list of defaulting clients, for PARs, loan loss ratios, growth...etc. It would have been more efficient to integrate many reports together into a single core performance report where fixed objectives are compared with results with some profitability indicators and comparisons with other LOs within and across branches.

Financial and Accounting Information

Information quality and financial analysis

Accounting information and financial statements are accurate and available every month by branch or on a consolidated basis. Financial analysis is performed on a monthly basis with financial adjustments. It could be further developed by analyzing performance (i.e. using more profitability indicators) at the regional/branch level, and at the product level, as Mikrofin operates in diverse regions and offers very different products.

Skills of Finance Department

The Finance Department is completely centralized at the HQ level, even though data entry is done at the branch level. This centralization, although different from other BiH institutions, seems to work adequately and efficiently. The 3-member HQ team works closely with the finance officer located at each of the branches. The Finance Manager -a Chartered Accountant- possesses all of the skills necessary to manage and improve the Finance Department. She has been with Mikrofin since 1998 including 4 years as a Chief Accountant before becoming Finance Manager in 2002.

Risk Management

Procedures and Internal Controls

Internal controls

Controls are well integrated into the daily procedures and guarantee an adequate management of operational risks.

- ❑ The updated Credit, MIS, Finance, Human Resources and Audit manuals, although their format could be improved, help to standardize procedures across branches. According to the internal auditor, procedures are well applied. Procurement procedures could be better formalized, in order to state formal purchasing decision limits.
- ❑ Credit decision-making of loans up to 10,000 BAM (i.e. the vast majority of loans) is decentralized at the branches, but satellites offices must report to their branch.
- ❑ The segregation of duties is adequate, both at branch and HQ levels, between lending decision, cash management and MIS data entry. This segregation of duties is furthermore strengthened by strictly defined MIS user rights.
- ❑ The budget is strictly monitored, both for activity levels and expenses.
- ❑ The institution reports that it has never faced/discovered any fraud.

Cash security

Loan disbursements and repayments are made mostly through banks, thereby ensuring the physical security of funds, but also in cash at the three biggest branches (Banja Luka, Prijedor and Gradiska) that are of sufficient size and can afford to pay for extra cashier staff. In these branches, an adequate segregation of duties³, strict safety procedures⁴ and cash limits ensure physical security of cash. Cameras are set up in these three branches, although their filming angles are not always the most useful ones.

Internal Audit

Risk identification

The Management Team and the Board have well identified strategic and operational risks, the most unpredictable risk being the market and competition (refer to section “A”). The system could be reinforced by stronger Board involvement in the internal audit process and work plan, since neither the internal nor the external auditors directly report to the Board. This would ensure a more regular update of the risks to be audited.

Internal audit

The internal auditor ensures the control of basic operational risks, even though some areas of his work could still be improved to better control HQ and client identification. The internal auditor is alone in auditing this 100-person team and 15,000 plus clients, but succeeds in visiting each branch 10 times a year (spending three hours to an entire day). He performs thorough audits of the branches, provides recommendations and monitors them. During most of his visits, he reviews between 10% to 20% of the loan files for loans approved within the past two months, but does not always meet with clients. He follows an annual work plan that

³ The cashier, who is the only staff member to take payments and disburse loans, does not have access to the MIS and does not issue receipts, which are directly produced by the MIS officer before the client goes and sees the cashier. Thus the cashier could neither create fictitious clients nor divert cash.

⁴ According to the internal auditor, these procedures are well applied in all branches.

is quite flexible⁵ and relevant. The procedures could benefit from more formalization: the audit manual is more theoretical than practical therefore is not sufficient to clearly explain audit procedures, and could not be used to train new audit staff. There is no list of audited/visited clients that would help in storing information on previous audit missions. Client monitoring recommendations could also be better stressed in the mission reports. No audit is performed at the HQ level.

⁵ It only sets up the number of days per type of activities, but does not set specific dates, there is no planning per branch.

Activities

Marketing and Competition

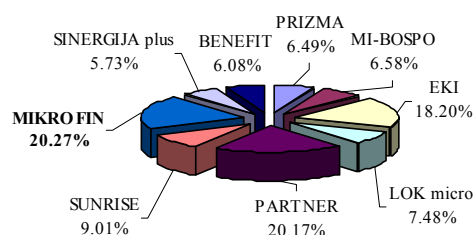
Market size is difficult to assess as the last census took place in BiH before the war. The World Bank estimated the total population to be 4.1 million in 2004. The BiH microfinance environment is highly competitive, notably in urban areas where MFIs have been operating for years and commercial banks are active. Some urban markets seem to be at or near saturation, therefore many MFIs (including Mikrofin) are seeking to expand their rural outreach. By the end of 2004, the 10 leading MFIs were serving around 100,000 clients, mainly in urban, but also increasingly in rural areas, with a total portfolio outstanding of about 100 million EUR. Although portfolio quality remains strong, the entire sector is becoming concerned about the high level of client cross-indebtedness and the relative decline of guarantors' quality (many guarantors also have loans and guarantee more than one loan).

In December 2004, Mikrofin became the largest MFI (20.27% market share) in BiH, with Partner closely behind (20.17%). Mikrofin arguably has the strongest market position in RS. Its presence in the Federation, while growing, is still limited in portfolio value and geographic coverage around the Bihac area in northwestern BiH (only 5% of the outstanding portfolio).

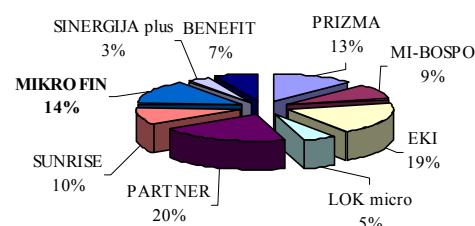
Mikrofin's management and staff identified strong MFI competition in the majority of towns and municipalities where Mikrofin has a presence with Partner and EKI as strongest competitors. Among commercial banks, ProCredit Bank BiH is a formidable competitor especially in larger towns. Mikrofin is a strong market player mainly because of its streamlined yet flexible credit products (i.e. three products only, but that can finance all types of activities), high loan amounts (up to 30,000 BAM or 15,300 EUR, the current legal limit), competitive pricing compared to other MFIs (APR of 24.2% in 2004), fast processing time (average of 5 days from initial client contact) and good service delivery (professionalism of its staff and clean bright conveniently-located client service offices).

Being a RS-dominated MFI with a small foothold in Bihac region, Mikrofin lacks a clear Federation market strategy. While Mikrofin's competitive position is secured for the next 12 months, several developments in both microfinance and general banking industries bring some concerns over the medium-term that might erode Mikrofin's current leadership position. The competition among top-tier MFIs is still somewhat "civilized" with no one aggressively "stealing" existing clients from other MFIs. As all top MFIs are expanding in each other's markets, one can ask how long this "civilized" competition will last. We are also aware that merger discussions have been taking place. A successful merger between any two major

Market Share by Portfolio Outstanding as of 12/2004



Market Share by Number of Active Clients as of 12/2004



players would create a strong competitor for Mikrofin unless Mikrofin conducts a proactive/preventive merger on its own.

A more worrying trend than MFI mergers is the “down-scaling” of commercial banks into Mikrofin’s low-income entrepreneurs niche. There is an excess of liquidity in BiH banks at this moment. Some local banks not able to compete with the top five foreign-owned local banks in corporate lending are now turning their attention to SME and micro-lending – the latter being Mikrofin’s niche market. Furthermore, Mikrofin will face stronger competition than in the past from ProCredit Bank BiH –a dynamic bank dedicated to SME and micro-lending. Based on current ProCredit Bank’s geographic coverage, it competes with 6 of the 7 Mikrofin branches/offices. Based on its corporate plan, ProCredit Bank will double its current 17-branch-and-office network by 2009. With cheaper funding base and broader range of products, ProCredit Bank has the capacity to seriously poach Mikrofin’s top-end clients. The question is not when, but how fast and how determined ProCredit Bank will be in doing so.

Portfolio Management

Lending methodology

Having discontinued the group lending methodology based on clients’ preferences, Mikrofin’s individual lending methodology has proven to be efficient, the portfolio quality remains very high keeping the write off ratio minimal. The methodology relies on the following factors:

- ❑ Borrower selection based on a simple yet well-designed form that allows the analysis of any kind of activity (specific fields for the agriculture loans). The form include information on assets, liabilities, monthly cash flow for the previous month (without the loan, for the analysis to be conservative), detailed information on household income and expenses. Although the analysis is based only on one month, the seasonality can be analysed thanks to a simple table providing information on the typical performance per month.
- ❑ There is no automatic incremental increase in the loan amounts, the LOs and committees are cautious enough when deciding the amount to lend.
- ❑ Up to 2,000 BAM, monitoring the loan analysis is based on guarantees provided by the client; there is no compulsory field visit (4% of the active loans in Dec. 2004). This recent decision made a large, positive impact on costs with no material decrease in portfolio quality thus far.
- ❑ 90% of the credit decisions are made at the branch level, but with relevant limits and close supervision by HQ, 10% necessitate HQ approval due to loan approval limits.
- ❑ Flexibility to adjust interest rates for good clients and larger amounts.
- ❑ Frequent monitoring, made possible by decentralized “satellite offices”.
- ❑ Mobilization of strong collateral, usually covering more than 100% of the value of the loan.
- ❑ Effective delinquency management where the LO can contact the client very quickly and, if needed, utilize the client’s collateral.
- ❑ No rescheduling of loans.

The methodology could be further improved mainly by strengthening the analysis of cross-indebtedness and the monitoring of guarantors’ own debt capacity:

- ❑ Cross indebtedness is becoming a very important issue, above all for institutions like Mikrofin, serving clients who are more and more frequently approached by banks. Mikrofin does not use the credit bureau (too expensive and not complete) nor formal data exchange protocol with other MFIs to identify and black list some clients, though some informal consultations exist.

- ❑ Guarantors may have active loans themselves. In December 2004, one fifth of the guarantors were also active clients, thereby decreasing the quality of their guarantees⁶.
- ❑ Mikrofin would benefit from centralizing information on the prices of goods, especially agriculture products, and make it available to LOs.
- ❑ Legal recourse is not centralized. It is not yet an issue as very few legal recourses have been made.

Loan Officers' skills

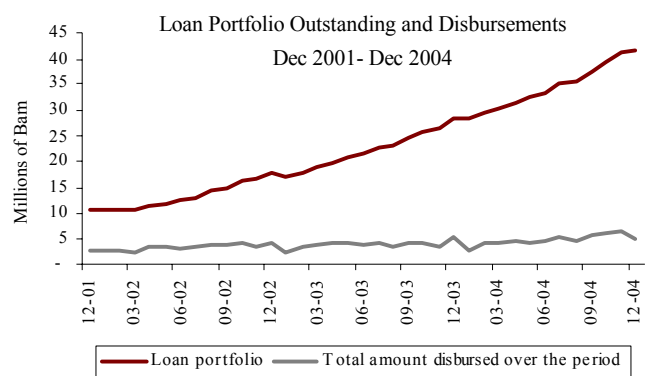
LOs typically have a university education and are screened for “good personality and work attitude/ethic”. LOs are trained on lending methodology, products, client selection and evaluation and MIS systems during the 3-month probation period with their branch manager and senior LOs. They are expected to become fully operational within 12 months. Due to good pay scales, supportive work environment and high unemployment in BiH, Mikrofin has a loyal and motivated lending team.

Global portfolio diversification rules

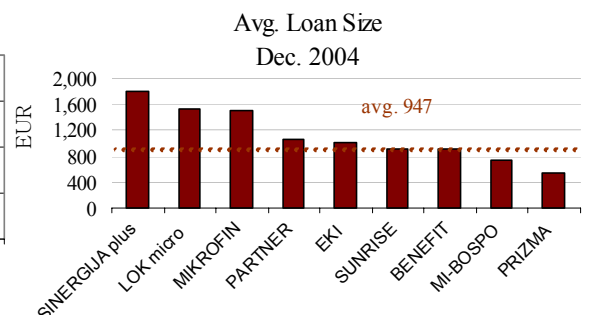
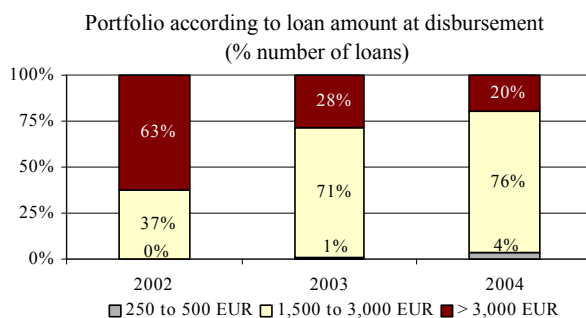
There are no formal diversification rules nor targets but the composition of the portfolio is closely monitored at the HQ level, during the frequent management team meetings. Mikrofin would benefit from conducting risk scenario analysis to develop prudential diversification targets in the future.

Composition and Evolution of the Portfolio

Mikrofin's loan portfolio experienced fast growth averaging 60% per annum in the past 3 years (71% in 2002, 60% in 2003, 47% in 2004). Most growth came from geographic expansion through the opening of new branches and offices. There is a clear but small seasonality in disbursements, as they are at their lowest in January and February each year due to winter conditions.

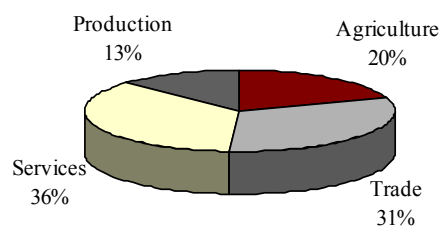


Average loan at disbursement slightly decreased (from 2,251 EUR in 2002 to 2,030 EUR in 2004) thanks to Mikrofin's downscaling efforts in rural areas. 76% of the loans disbursed in 2004 were between 1,500 EUR and 3,000 EUR. Nevertheless, Mikrofin still has one of the highest average loan sizes outstanding in BiH.



⁶ In case of default of the client, if the guarantor is himself a borrower, he may not be in a position to repay for the client; moreover, in most of the cases, LOs do not wish to push the guarantor to pay as they are afraid that he will no longer repay his own loan.

Outstanding Portfolio per type of activity
Dec. 2004

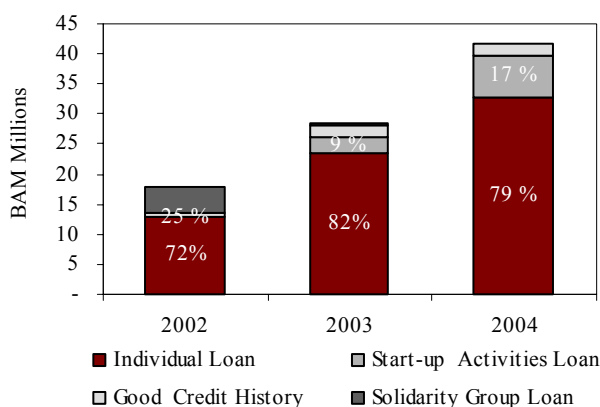


Mikrofin's portfolio is well diversified despite the lack of formal diversification rules, with agriculture share increasing every year (from 7% of the portfolio in 2002 to 20% in 2004), and trade decreasing (48% to 31%). The growing agriculture share is attributed to Mikrofin's participation in USAID LAMP and KFW Rural SMELP programs targeting farmers and its push into rural areas where agriculture predominates as the top economic activity.

Aside from the growing importance of agriculture in the portfolio, there is a marked increase in Start-Up Activities loans as a % of outstanding loans rising from zero in 2002 to 17% in 2004 and the disappearance of Solidarity Group loans, which made up a 25% of the portfolio in 2002. The fast rise in Start-Up Activities loans is explained by Mikrofin's downscaling efforts into rural areas. Please refer to

Section E for more discussions about profitability impact of Start-Up Activities loans' rise in the portfolio. *Please note that the % shown on the Portfolio by Product Type graph cover only the largest 2 products per each year in order to facilitate viewing.

Portfolio By Product Type



Portfolio at Risk (PAR)

Write-off Ratio

EUR , unless otherwise stated	Dec. 2002	Dec. 2003	Dec. 2004
Loan portfolio	9 116 646	14 553 093	21 329 755
Loan portfolio (BAM)	17 830 337	28 462 940	41 716 734
Evolution	71,4%	59,6%	46,6%
Average outstanding loan (BAM)	3164	3832	2972
Number of active borrowers	5 634	7 426	14 033
Evolution	27,5%	31,8%	89,0%
Average outstanding loan per client	1 618	1 960	1 520
% of GDP per capita	104,0%	119,4%	87,8%
Average amount disbursed	1 913	2 251	2 028
% of GDP per capita	122,9%	137,1%	117,1%
PAR 31-365	0,0%	0,0%	0,2%
PAR > 365	0,0%	0,0%	0,0%
Write-off ratio	0,1%	0,0%	0,0%
Risk coverage ratio ⁽¹⁾	48 163,5% ⁽¹⁾	4 679,4% ⁽¹⁾	874,0% ⁽¹⁾
PAR 31 net of loan loss provision / Equity	N/A	N/A	N/A

(1) Refer to the paragraph below (coverage by provisions)

Portfolio quality is very high, with PAR31 under 0.2%, a write-off ratio close to 0% for the past three years, and no rescheduled loans. There is no notable difference in portfolio quality between branches or products (agriculture and service loans with a PAR31 at 0.3% have the “highest” PAR). Like other Bosnian MFIs, Mikrofin rarely has long-term delinquency. The write-off ratio is very low, even though the write-off policy is conservative. Each month, Mikrofin writes off all loans over 150 days in arrears.

It is important to note that the rise in agriculture loans is not as risky as it was initially thought to be, as these loans are typically smaller and used for various activities, which produce regular revenues (e.g. livestock vs. crops). Moreover, farmers often have several income-producing activities at the same time thus not displaying expected higher risk than other loans (e.g. trade loans because of strong competition). Finally, Mikrofin dropped the requirement for field visits for all first-time loans under 2,000 BAM in late 2004 for cost-effectiveness reason. These smaller loans are also priced relatively higher which technically should compensate for higher risk profile. Nevertheless, thus far PARs have not changed for worse. This cost-saving measure needs to be monitored closely for potential portfolio quality implications.

Credit Risk Coverage

Coverage by provisions

Similar to its BiH peers, Mikrofin has conservative provisioning ratios leading to high loan loss reserves providing a 870% risk coverage ratio at the end of 2004. This high coverage level is essentially due to the industry-wide requirement of a 2% provisioning ratio for healthy portfolio not normally found outside of BiH. Due to high reserves level, adjustments are not required and none have been made by Planet Rating. (*See detailed provisioning methodology in the appendix.*)

Coverage by guarantees

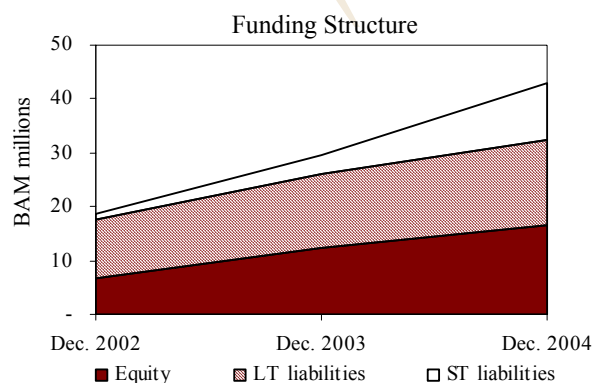
Mikrofin requires strong collateral and/or guarantees from its clients (although less stringent than banks' requirements). In March 2005, 98% of the active loans were covered by one or more guarantors, covering more than 100% of the loan amount, and 2% were covered by a guarantor and a mortgage. Since more than 80% of the outstanding portfolio is composed of loans for registered businesses, the guarantees tend to be stronger than for MFIs lending only to informal or unregistered businesses.

Financing and Liquidity

Financing Strategy

Description of the funding structure

Mikrofin has a solid funding structure as a result of a diversified funding base and a favourable funding mix. This is made possible by a strong track record of profitability and credible management. The story of the past three years is that of Mikrofin's remarkable ability to obtain loans from commercial funders and of their growing presence in its capital structure. Mikrofin has been very skilful at building trust and support among its funding partners as evidenced by both increasing amounts granted and better financing terms over the past 2 years.



Being a non-deposit taking MFI, Mikrofin funds its activities essentially with equity (38.3%) and debts (61.7%). Equity capital is made of retained earnings (8.6 million BAM) and of donations over the years (7.8 million BAM). Debt funding is made of short-term (40%) and long-term borrowings (60%). It is interesting to note that the proportion of short-term borrowing has substantially increased over the review period, but it is not as worrisome as a large part of the increase is attributed to the current portions of long-term loans.

Mikrofin has admirably succeeded in securing a good variety of funders from public and commercial sources which representing some of the who's who of MFI investors interested in Bosnia. Most remarkably, Mikrofin has managed to get conservative local commercial banks (3 thus far) to commit increasing credit exposure. Another good example is Austrian-owned Raiffeisen Bank BiH, which began to invest cautiously (1 million BAM loan, 1-year term, 8% interest rate) in October 2003 and has now committed to 4 million BAM on better terms (2 million BAM loan, 3-year term, EURIBOR + 5.9%) along with a separate 3 million KM short-term facility. In February 2005, Mikrofin signed a 1 million BAM, 8% on used amount, 1-year overdraft working capital facility with Hypo-Alpe-Adria Bank (a brand new funder).

Asset & Liability management

There is not a formal Asset Liability Management (ALM) policy at Mikrofin, but it has not had much negative impact on its ability to adequately manage ALM risks.

- Maturity risk is low as the average 14-month loan portfolio term is largely covered by the longer-term financing base, overdraft facility and retained earnings. Only 18% or 7.1 million BAM of Mikrofin 2004's portfolio is over 1 year compared to 60% or 26.5 million BAM of its funding base for the same period.
- Refinancing risk is minimal considering Mikrofin's continued strong performance, general stable macro-economic conditions and favorable liquidity situation.
- Interest rate risk is considered low despite a large portion of funding is based on variable EURIBOR because of: a) the pass-on clauses in loan contracts to end clients; b) the low

3.4% blended cost of capital thanks to soft loans from public funding sources; and c) the extremely low inflation levels witnessed in BiH in the last few years and continued conservative monetary policy practiced by BiH Central Bank.

- Foreign exchange risk is also considered low despite all lending is in BAM and borrowing is largely in foreign currencies due to: a) the existing pass-on clauses in loan contracts to end clients; and b) the stability of BAM-fixed link to the EUR which has not been changed since the introduction of the EUR.

Financing strategy

Mikrofin has an active yet simple funding strategy: increase exposure from existing lenders and obtain more commercial funding from a diversified investor base at reasonable cost. Based on funding results for the past 2 years, it has done a very good job. It has already secured a good portion of necessary funding for 2005. For the long-term, it largely counts on refinancing and expanding existing loans among public and social lenders. Mikrofin prefers to have fewer (3-5) large investors/lenders, but will have to work with more as most lenders have prudential concentration limits capping their exposure to Mikrofin and/or BiH in general.

Mikrofin is lowly leveraged at 161% debt to equity ratio for a financial institution. It has additional debt capacity, but it is now somewhat restrained because Mikrofin has already pledged all of its real estate assets and some portfolio assets for existing local loans. Mikrofin is planning to buy a larger building for its HQ operations and at the same time use it in the future as collateral to raise more funding. It is already in advanced negotiations with Hypo-Alpe-Adria Bank to finance this acquisition in the middle part of 2005. This is an interesting and cost-effective funding strategy for the long-term.

With the expected adoption of the new microcredit law and Mikrofin's desire to transform into a for-profit microcredit company, more funding avenues (e.g. private equity investors and investment funds) will be available. The key to access different types of investors from the existing ones is to clarify ownership issues (i.e. no one really owns Mikrofin at the moment) and to maintain its attractiveness as a potential investment target. Unfortunately, the ownership issues of Mikrofin and of MFIs in general will not be solved any time soon.

Liquidity Management

Cash-flow projections and resources optimization

Liquidity management is not very sophisticated, yet it is quite effective. With centralized and conservative liquidity management, Mikrofin never faced major liquidity crisis. Senior management work very closely together to reconcile and forecasts liquidity needs. Combined with advance forecasts and strong ability to raise funds, Mikrofin's liquidity position is usually adequate. There have been cases of clients waiting for loans, but delays tend to be seasonal in March when clients become active again after winter months and for not longer than 10 days. It now has an overdraft facility at Hypo-Alpe-Adria Bank to provide extra liquidity cushion.

It is Mikrofin's policy to disburse funds as quickly as possible into loans – a well understood and practiced policy at all management levels- resulting excellent deployment and optimization of assets (as evidenced in high portfolio as a percentage of total assets of about 95% in 2004), but also caused low liquidity levels often found in bank accounts and balance sheets. Mikrofin has 11 different banks accounts in 7 local banks, some of them opened due to donors' requirements. Cash management is sometimes restrained by donors' restrictive conditions in investing idle cash like LIP funds.

Efficiency and Profitability

Profitability Analysis	Dec. 2002	Dec. 2003	Dec. 2004
ROE	31,4%	24,2%	24,5%
Liabilities / Equity	184,8%	141,2%	161,0%
ROA	9,7%	9,4%	9,7%
Profit Generation			
Operational self-sufficiency	158,1%	163,4%	173,3%
Portfolio Yield	29,3%	26,4%	23,9%
Operating expense ratio	14,3%	12,4%	9,7%
Staff productivity	94	94	149
Loan officer productivity	161	152	242
Average outstanding loan per client (EUR)	1 618	1 960	1 520
Funding expense ratio	3,4%	2,9%	3,4%
Cost of liabilities	4,4%	4,4%	5,4%
Loan Loss Provision expense ratio	1,1%	1,0%	0,9%
Asset Management			
Outstanding Loan Portfolio / Assets	94,1%	94,2%	95,0%
Adjusted Ratios			
Adjustment expense ratio	4,9%	3,4%	2,5%
AROE	17,4%	16,3%	18,5%
AROA	5,4%	6,4%	7,3%
Financial self-sufficiency	125,6%	135,5%	147,0%
Adjusted operating expense ratio	14,3%	12,4%	9,7%
Adjusted funding expense ratio	8,2%	6,3%	5,9%
Adjusted loan loss provision expense ratio	1,1%	1,0%	0,9%

Overview of the profitability

By any standards, Mikrofin's profitability indicators are excellent especially in light of heightened competition and decreasing portfolio yield. For the past three years, its ROA stayed above 9.4% while ROE remained above 24.2% in the last 2 years. The key to Mikrofin's success has been and continues to be its low cost structure derived from a disciplined approach to cost control, high staff productivity and efficient asset management.

Portfolio yield and effective interest rate

Effective interest rates at Mikrofin have been on a downward trend due to self-initiated decrease of interest rates to clients in 2004. Over the review period, portfolio effective interest rates dropped significantly from 29.3% in 2002 to 23.9% in 2004. This downward trend is replicated in portfolio yields as Mikrofin has very low PARs and write-offs. Mikrofin reported that its interest rate leadership (i.e. lowest among MFIs) is an important marketing element of its client strategy. Mikrofin reported that its interest reduction has not been much followed by its competitors thus conferring it a strong competitive edge. It is noted however that Mikrofin's pricing is still higher than that of commercial banks.

Operating expense ratio

Lower portfolio yield would have hurt Mikrofin had not for its outstanding low cost structure and high staff productivity protecting its profit margins. Benefiting from economies of scale owing to a growing portfolio, Mikrofin has been able to consistently reduce its operating expense ratio from 14.3% in 2002 to 9.7% in 2004. This extraordinary low cost performance can be explained in three operational areas: a) disciplined cost management; b) high staff and systems productivity; c) streamlined products/processes allowing fast approvals ranging 3-7 days; and d) high percentage of productive assets combined with changing portfolio composition (explained further in the Asset management section).

There exists a pervasive cost-control culture and understanding of cost impact throughout the organization. Key decisions are typically accompanied advance planning and cost analysis. A new branch is opened only if it can have 2 million portfolio levels and can break even within a year. Similarly, Mikrofin managed to keep personnel costs as a percentage of administrative costs lower than its competitors (42.5% vs. 49.2%) despite paying among the highest salaries in the industry. Mikrofin has been able to compensate higher salaries with even higher staff productivity (+59% over 2003-2004). Not only the staff is motivated, they can also do their jobs well and fast because of Mikrofin's simple products/processes and efficient MIS systems. All of these factors combined with relative larger average loan size are giving Mikrofin a distinctive cost advantage and allowing it more room to reduce interest rates and reinforce its low cost leadership image among clients.

Funding expense ratio

Similar to its peers, Mikrofin benefits from low cost funding of 3.4% in 2004. This is as a result of soft loans from non-commercial institutions such as World Bank (LIP II), KfW (EFBH) and USAID (LAMP). As it grows in size, Mikrofin has been very successful at raising commercial funding which has already led to higher overall funding expense ratio and will continue to be higher for the long term. Mikrofin targets to keep its average cost of fund around 8% therefore providing considerable room for additional commercial debt in the funding mix.

Loan loss provision expense ratio

Loan loss provisions expense is low at about 1% of gross loan portfolio due to the extremely high quality of its loan portfolio. Had not for the required 2% provisioning requirement of the healthy loan portfolio -which increases naturally with portfolio growth- Mikrofin would have had substantially lower loan loss provisioning expenses.

Asset management

Good asset management is another key factor in understanding Mikrofin's high profitability. 95% of its total assets are deployed in productive (income-producing) loan portfolio. Furthermore, there has been a significant shift in portfolio composition from lower yielding Individual loans (APRs of 10,3% to 27,3%) to higher yielding Start-Up Activities loans (APRs of 24% to 32%). Start-Up Activities loans accounted for 17% of portfolio in 2004 up from 9% in 2003. We are of the view that Mikrofin stands to benefit strongly if it integrates more systematically the notion of product profitability into its staff objectives and into performance management.

Adjusted performance

Details concerning the specific adjustments are included in the annexes.

On an adjusted basis, both AROA and AROE are still remarkably strong at 7.3% and 18.5%, respectively in 2004. As measured by adjusted profitability, Mikrofin outperformed its MFI peers by a wide margin as the local group average 2004's AROA and AROE were only at 3.6% and 9.1%, respectively. Please see note b on the cover page for peer's group data.

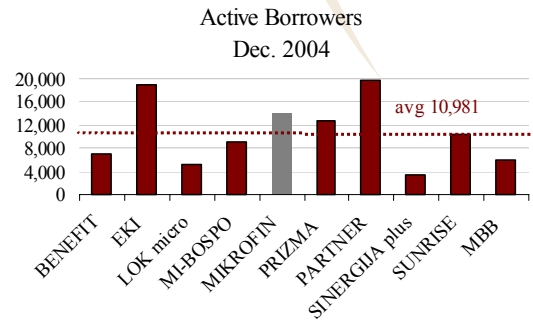
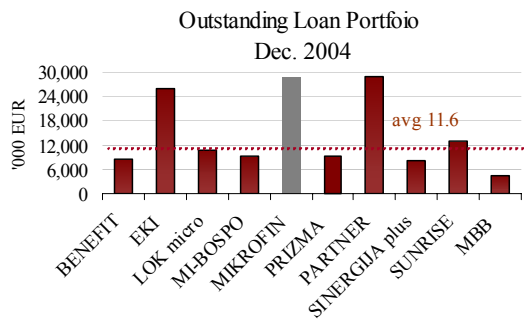
Evolution of profitability

Mikrofin has been remarkable at maintaining high profitability over the past three years. Increased competition and higher commercial funding cost should put pressure on the profitability levels in the future. Based on factors mentioned throughout the report, it is expected that Mikrofin will continue to have superior profitability levels compared to its peers due to its low cost structure. It will also be able to sustain better pricing pressure should commercial banks go aggressively for low-income clientele.

Benchmarking

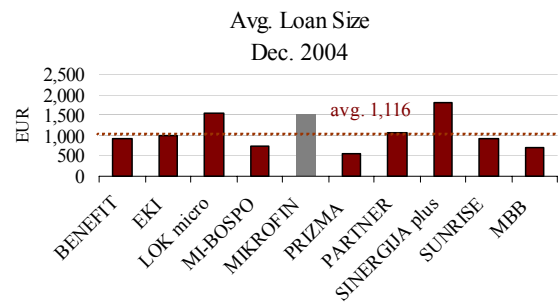
Mikrofin was compared to the following groups:

- ❑ MBB peer group “ECA” consisting of 20 MFIs in Eastern Europe and Central Asia.
- ❑ 7 BiH MFIs funded by World Bank’s LIP II plus Prizma. Note: These MFIs represent a wide range of institutions, lending methodologies and market focus making direct comparison difficult. Comparison to its peers is made nevertheless to provide an idea how Mikrofin is performing in the market place.

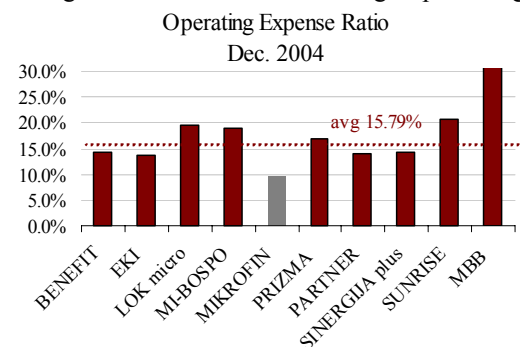
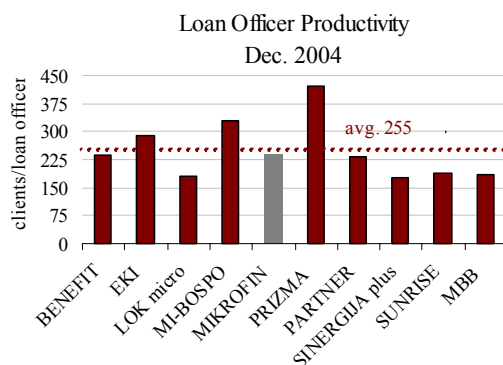


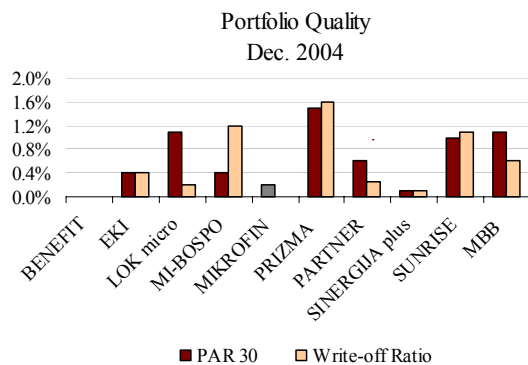
Mikrofin compares well with its peers and often outperforms them in most indicators. Its outstanding loan portfolio is higher than the BiH sample average owing mainly to successful geographic expansion and typical higher loan average of the preferred individual lending methodology (average US\$2,064 vs. US\$1,519 for BiH peers). Its loan portfolio size is also significantly higher than MBB per group for the ECA region where group lending methodology is still largely used. Strong institutional capacity has allowed Mikrofin to absorb rapid client expansion as evidenced by nearly 200% increase in active borrowers between 2002 and 2004.

Mikrofin’s average loan size is significantly superior to MBB ECA regional competitors consistent with its strategy to target low-income non-poor clientele requiring larger loan sizes. The institution is, however, beginning to downscale in smaller loans to enlarge its customer base.



After years of investment in its systems and fine-tuning of its operations, Mikrofin started to reap economies of scale. Highly efficient operations and good staff productivity have allowed Mikrofin to attain an operating expense ratio that is considerably lower than the average for the BiH and MBB ECA samples especially considering that it has abandoned the group lending methodology.

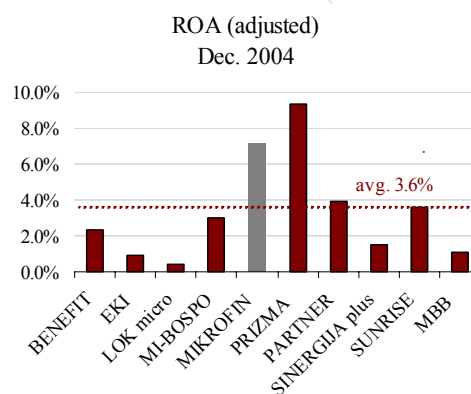




Mikrofin presents exceptional performance in terms of portfolio quality as measured by PARs and write-off ratios. This is due to its excellent client selection and monitoring systems along with the culture of zero tolerance for arrears. It has also a methodical and effective way to follow up on delinquency that is further enhanced by the quality of its loan guarantors.

Mikrofin's adjusted ROA outperformed the two peer groups despite having comparatively lower portfolio yield and increasingly higher commercial funding cost. This impressive performance is a combination of four factors:

- ❑ A high level of productivity
- ❑ Efficient deployment of capital into income-generating assets; low level of fixed assets. Mikrofin has amazing 95% of all assets in interest-earning loan portfolio!
- ❑ Rapidly growing portfolios and clientele base resulting in economies of scale
- ❑ Larger loan sizes



Appendices

Financial Statements and Notes

General notes to financial statements per CGAP Disclosure Guidelines

Mikrofin's financial statements generally follow the CGAP disclosure guidelines.

1. Financial statements include balance sheet, income statement, cashflow statement and accompanying notes.
2. The financial statements provided include prior years data.
3. Segment Reporting for multi-service Microfinance Institutions: not applicable
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. It is calculated each month when it occurs by the finance manager according to the methodology described in the table.
- (3) Loans are written off every month when it occurs from the loan loss reserve and the loans outstanding.

Provisioning Methodology			
Aging	% Provision	(% outstanding balance)	
Healthy			2 %
0 to 30 days			10 %
31 – 60			30 %
61 – 90			50 %
91 – 120			70 %
121 - 150			90 %
> 150			100 %
Write off			After 150 days

- (4) The following table reconciles these movements:

	Dec. 2002	Dec. 2003	Dec. 2004
Loan loss reserve, January 1 st	209 044	357 200	583 442
+ Loan loss provision expense for the year	159 296	233 569	319 752
+ Loan loss provision expense	164 892	248 071	319 752
- Provision reversal	5 596	14 502	-
- Loans written off during the year	11 140	7 327	10 850
Loan loss reserve, December 31st	357 200	583 442	892 344

- (5) Accrual vs. Cash accounting: Mikrofin recognizes interest income and expenses 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) Renegotiation of loans: Mikrofin does not refinance/reschedule loans.
- (3) Insider loans: Mikrofin does not allow employees to borrow funds.

6. Donations

- (1) Revenue from donations is shown separately from income generated by operations in the income statement.
- (2) Donations accounting methodology: Grants are recognized as income in the current operating period whenever there is reasonable assurance that Mikrofin will comply with the conditions attaching to them (if any) and that grants and that are recorded in the income statement. Grants for fixed assets are recorded as long-term accruals on the balance sheet and released to the income statement in the same manner of depreciation of the related fixed assets is charged to the income statement. Please note that the financial statements disclosed in this report have been modified for presentation to better reflect donations.

- (3) Current period 2004 donations:

Donors	Amount Received (BAM)
META	113,995
META	67,729
META	82,937
CARE	404,980

- (4) In-kind donations: Please refer to the Appendix on Adjustments for details on in-kind donations that Planet Rating has identified.
- (5) Cumulative amount of all prior period donations: The amount is available (refer to the “equity from donations” line in the balance sheet).

7. Details of liabilities

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

Loan Providers	Interest Rate	Capital outstanding 2004 (BAM)
LID	5%	5,326,131
KfW	EUROBOR	3,553,097
Raiffeisen Bank	8%	3,333,333
DEXIA	EUROBOR +6% (6. 5%)	3,227,120
TRIODOS	8%	2,933,745
USAID LAMP	0%	2,525,184
NOVIB	8%	2,444,788

- (2) Deposits: not applicable as it is not allowed by law.

8. Other significant Accounting Policies

- (1) Depreciation of fixed assets: The depreciation of fixed assets on a flat basis using the following schedule:

Asset Class	Useful Life	Depreciation Rate
Computers and other equipment	3 years	33.33%
Vehicles	5 years	20%
Furniture	8 years	12.5%
Buildings	10-25 years	4%-10%

- (2) Inflation accounting: none
- (3) Currency mismatch: please refer to the F area for more information on potential mismatch.
- (4) Accounting treatment of unrealized gains or losses due to foreign currency fluctuations: none.

Specific notes to the financial statements

- Loans to employees in 2002 (stopped afterwards), rent advance
- Borrowings details are given in the F area and in the CGAP format notes
- Debt toward employees and suppliers
- Borrowings details are given in the F area and in the CGAP format notes

MIKROFIN Balance sheet	Notes	BAM				EUR			Evolution	
		Dec. 2001	Dec. 2002	Dec. 2003	Dec. 2004	Dec. 2002	Dec. 2003	Dec. 2004	03/02	04/03
ASSETS		11 143 537	18 564 839	29 596 551	42 975 590	9 492 197	15 132 708	21 973 407	59%	45%
Short Term Assets			17 749 745	28 238 480	41 385 479	9 075 440	14 438 327	21 160 384	59%	47%
Cash and Due from Banks			174 551	92 760	219 614	89 248	47 428	112 289	-47%	137%
Short Term Investments			-	-	11 217	-	-	5 735	-	-
Short Term Net Loan Portfolio		10 194 487	17 473 137	27 879 498	40 824 390	8 934 010	14 254 780	20 873 499	60%	46%
Short Term Gross Loan Portfolio		10 403 531	17 830 337	28 462 940	41 716 734	9 116 646	14 553 093	21 329 755	60%	47%
(Loan Loss Reserve)		209 044	357 200	583 442	892 344	182 636	298 314	456 255	63%	53%
Interest Receivable			28 890	203 947	286 009	14 771	104 278	146 236	606%	40%
On loan portfolio			28 890	203 947	286 009	14 771	104 278	146 236	606%	40%
On investments			-	-	-	-	-	-	-	-
Accounts receivable and other assets	1		73 167	62 275	44 249	37 410	31 841	22 625	-15%	-29%
Long term assets			815 094	1 358 071	1 590 111	416 757	694 381	813 023	67%	17%
Long Term Net Investments			-	-	-	-	-	-	-	-
Long Term Gross Loan Portfolio			-	-	-	-	-	-	-	-
Net Fixed Assets		781 890	815 094	1 358 071	1 590 111	416 757	694 381	813 023	67%	17%
Other Long Term Assets			-	-	-	-	-	-	-	-
LIABILITIES AND EQUITY			18 564 839	29 596 551	42 975 590	9 492 197	15 132 708	21 973 407	59%	45%
Liabilities			12 045 959	17 323 551	26 510 629	6 159 096	8 857 527	13 554 877	44%	53%
Short term liabilities			787 171	3 421 948	10 613 016	402 480	1 749 641	5 426 432	335%	210%
Demand Deposits			-	-	-	-	-	-	-	-
Compulsory Deposits			-	-	-	-	-	-	-	-
Short Term Time Deposits			-	-	-	-	-	-	-	-
Short Term Borrowings	2	1 074 445	625 327	3 095 365	10 237 451	319 730	1 582 659	5 234 406	395%	231%
Interest payable			30 941	78 486	130 376	15 820	40 130	66 661	154%	66%
Accounts Payable and Other Short Term Liabilities	3		130 903	248 097	245 189	66 931	126 852	125 365	90%	-1%
Long term liabilities			11 258 788	13 901 603	15 897 613	5 756 615	7 107 886	8 128 445	23%	14%
Long Term Time Deposits			-	-	-	-	-	-	-	-
Long Term Borrowings	4	7 214 026	11 258 788	13 901 603	15 897 613	5 756 615	7 107 886	8 128 445	23%	14%
Other Long Term Liabilities			-	-	-	-	-	-	-	-
Equity		2 627 117	6 518 880	12 273 000	16 464 961	3 333 102	6 275 182	8 418 530	88%	34%
Paid-In Capital			5 000	5 000	5 000	2 556	2 556	2 556	0%	0%
Donated equity		1 188 055	3 648 525	7 130 688	7 800 331	1 865 490	3 645 919	3 988 307	95%	9%
Retained earnings without donations and reserves			2 865 355	5 137 312	8 659 630	1 465 055	2 626 706	4 427 666	79%	69%
Current year			1 435 690	2 271 957	3 515 720	734 068	1 161 651	1 797 587	58%	55%
Other equity accounts			-	-	-	-	-	-	-	-

MIKROFIN Income Statement	Notes	BAM						Evolution	
		Dec. 2002	Dec. 2003	Dec. 2004	Dec. 2002	Dec. 2003	Dec. 2004	03/02	04/03
Financial Revenue (a)		3 908 665	5 853 142	8 310 052	1 998 499	2 992 710	4 248 927	50%	42%
Financial Revenue from Loan Portfolio		3 856 092	5 784 221	8 168 584	1 971 619	2 957 471	4 176 595	50%	41%
Interest on Loan Portfolio		3 396 064	5 230 104	7 189 241	1 736 407	2 674 151	3 675 857	54%	37%
Fees and Commissions on Loan Portfolio		457 090	541 755	966 682	233 710	276 999	494 264	19%	78%
Penalty Revenue on Loan Portfolio		2 938	12 362	12 661	1 502	6 321	6 474	321%	2%
Financial Revenue from Investments		1 193	-	-	610	-	-	-100%	-
Other Operating Revenue		51 380	68 921	141 468	26 271	35 239	72 333	34%	105%
Financial Expense (b)		444 066	637 037	1 164 499	227 051	325 717	595 408	43%	83%
Interest paid on borrowings		444 066	637 037	1 164 499	227 051	325 717	595 408	43%	83%
Interest paid on deposits		-	-	-	-	-	-	-	-
Other Financial Expenses		-	-	-	-	-	-	-	-
Financial income [c=a-b]		3 464 599	5 216 105	7 145 553	1 771 449	2 666 993	3 653 519	51%	37%
Net Loan Loss provision expense (d)		149 386	225 294	316 344	76 381	115 193	161 747	51%	40%
Loan loss provision expense and write-off		159 296	233 569	319 752	81 448	119 424	163 489	47%	37%
Recovery from Loans written off		9 910	8 275	3 408	5 067	4 231	1 743	-16%	-59%
Operating expense (e)		1 879 523	2 718 854	3 313 489	961 000	1 390 149	1 694 186	45%	22%
Personnel Expense (includes fringe)		1 146 485	1 729 410	2 058 588	586 197	884 247	1 052 555	51%	19%
Administrative Expense		733 038	989 444	1 254 901	374 802	505 902	641 631	35%	27%
Depreciation and amortization		103 267	156 216	220 434	52 800	79 873	112 708	51%	41%
Consulting fees		-	-	-	-	-	-	-	-
Advertisement and entertainment		99 239	121 261	169 277	50 741	62 001	86 551	22%	40%
Cost of bank charges		90 364	108 896	176 870	46 203	55 678	90 434	21%	62%
Maintenance of fixed assets		44 010	111 682	43 796	22 502	57 103	22 393	154%	-61%
Rent		78 574	96 441	87 592	40 175	49 310	44 786	23%	-9%
Transport		44 928	68 283	101 029	22 972	34 913	51 656	52%	48%
Stationary		35 150	64 311	69 314	17 972	32 882	35 440	83%	8%
Communication		47 944	62 033	82 615	24 514	31 717	42 241	29%	33%
Others		189 562	200 321	303 974	96 923	102 424	155 422	6%	52%
Net Operating Income Before Taxes and Donations [f=c-d-e]		1 435 690	2 271 957	3 515 720	734 068	1 161 651	1 797 587	58%	55%
Income Taxes (g)		-	-	-	-	-	-	-	-
Non Operating Income		-	-	-	-	-	-	-	-
Donations (l)		2 460 470	3 482 163	669 643	1 258 038	1 780 429	342 388	42%	-81%
Net Income (after Taxes and Donations) [m=k+l]		3 896 160	5 754 120	4 185 363	1 992 106	2 942 080	2 139 975	48%	-27%

Adjustments

The following adjustments were applied:

- ❑ Adjustment for inflation: to neutralize the effect of inflation on equity and fixed assets.
- ❑ Adjustment for cost of funds: to estimate the cost that the institution would pay if using commercial financing. This adjustment accounts for the cost savings received from donated funds or soft loans.
- ❑ Adjustments for in-kind donations: none.
- ❑ Adjustments to provisions in compliance with the international standards fixed by the MicroBanking Bulletin for the sake of homogenization: none.

Data in BAM	Dec. 2002	Dec. 2003	Dec. 2004
Adjustment for the cost of funds = (a*b)-c	624 072	688 605	808 791
Average amount of borrowings (a)	10 086 293	14 440 542	21 566 016
Shadow price of borrowings (b)	10,6%	9,2%	9,2%
Interest expense on borrowings (c)	444 066	637 037	1 164 499
Adjustment for inflation = (d-e)*f	15 098	49 856	51 580
Avg. Equity (d)	4 572 999	9 395 940	14 368 981
Average fixed assets (e)	798 492	1 086 583	1 474 091
Inflation rate (f)	0,4%	0,6%	0,4%
Adjustment for in-kind donations	0 -	0 -	0 -
Staff and technical assistance			
Other			
Adjustments for provisions	0 -	0 -	0 -
Loan losses	-	-	-
Other risks			
Other adjustments	0	0	0
Total adjustments	639 170	738 461	860 371
Net income before donations	1 435 690	2 271 957	3 515 720
Adjusted net income before donations	796 520	1 533 496	2 655 349
Adjusted net income before donations (EUR)	407 260	784 076	1 357 679

Board of Directors Members

Name	Position on Board	Education	Current Employment	Date elected to Board
Aleksandar Džombić	President	Graduate Economist	NOVA BANKA Executive Director Bijeljina, Branch Office Banja Luka	August 2001
Jelena Todić	Vice President	Graduate Lawyer	Independent practice of law, Banja Luka	August 2001
Saša Popović	Member	Graduate Economist	Zepter Komerc Banka Executive Director Banja Luka	August 2001
Damir Trivić	Member	Graduate Economist	Private Owned Company PP PRIMEX Banja Luka	August 2001
Nebojša Milanović	Member	Doctor, specialized in internal medicine	Internal Clinic of Clinical Centre in Banja Luka	August 2001