

Rating

C- Minimum required

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.



Performance indicators (USD unless noted)

ACTIVITY	Dec 03	Dec 04	Dec 05	Aug 06
Total # staff	1	2	2	3
Total assets (UGX 000)	1,868	9,260	23,483	38,830
Loan portfolio	710	3,146	14,836	24,903
Outstanding dep.	514	4,239	11,892	9,198
# active borrowers	10	33	105	154
Number of savers	41	175	449	671
PAR 31-365	NA	NA	NA	4.0%
PAR > 365	NA	NA	NA	0.0%
Write-off ratio	0.0%	0.0%	0.0%	0.0%
Risk coverage ratio	NA	NA	NA	62.6%
FX 1 USD=	1,830	1,830	1,850	1,850

PERFORMANCE	Dec 03	Dec 04	Dec 05	Aug. 06
ROE	(7.8%)	6.2%	6.5%	37.6%
Liabilities / Equity	37.9%	199.6%	126.5%	115.0%
ROA	(5.6%)	2.5%	2.7%	17.2
OSS	90.3%	110.7%	106.6%	156.6%
FSS	85.1%	92.2%	95.8%	133.4%
Portfolio Yield	121.9%	52.8%	45.4%	57.8%
Op exp ratio	417.8%	58.5%	50.1%	42.4%
Staff productivity	10	17	53	51
Funding exp ratio	0.0%	0.1%	0.2%	3.9%
GROWTH				
Loan portfolio growth	NA	343.1%	376.8%	67.9%
Savings port growth	NA	724.7%	183.6%	(22.7)
Assets growth	-	395.6%	156.4%	65.4%

NOTE: Data not reliable

Karusacco, Uganda

October 2006

Description of the institution

Kahunge Rural Cooperative Savings and Credit Society (Karusacco) was registered in July 2003 by 45 Ugandans comprising local business people and professionals. It has received the financial and technical support of Uganda Cooperative Alliance (UCA), the UNDP-funded Private Sector Promotion Centre (PSPC), and the Microfinance Support Centre Ltd. (MSCL) and operates under the Uganda Cooperative Society Statute of 1991. As of August 2006, Karusacco manages a loan portfolio of 24,903 USD and serves approximately 154 borrowers using group and individual lending methodologies, as well as 671 depositors. It operates through a single office located in the Kahunge trading center, serving clients in nearby sub-counties of Kamwenge District and Nyantugo sub-county in Kyejojo District.

Evaluation summary

Karusacco is a small institution serving very rural clients based on an intimate understanding of the local market and clientele. The highly localized nature of its operations is its primary strength, in addition to relatively efficient and effective management and governance structures, and overall good risk awareness and management. However, the institution faces serious challenges in achieving its ambitious plans for growth outside its current area of operations, including a critical lack of accurate, reliable, timely financial and portfolio information, a shallow credit methodology that relies almost exclusively on client character, and an increasingly competitive market.

Improvements needed to reach minimum requirements on specific evaluation areas

- Institute systematic and regular data reconciliation to detect errors in both accounting and portfolio information in order to improve reliability of data and effectiveness of decision making.
- Improve internal audit procedures to include more detailed evaluation of operational risks, including client visits to detect potential fraud outside of HQ.

Strategic goals

The medium term goal of Karusacco is to significantly grow the savings and loan portfolio by mobilizing more clients outside of Kahunge trading centre. This growth should be attained through both new and existing products and active client mobilization activities.

Planet Rating

Plot 33 Lumumba Avenue
Murtala Courts, 6th floor
P.O. Box 36179
Kampala, Uganda
+256 (0)41 236 745
rating@planetrating.com
www.planetrating.com

Karusacco, Julius Akorinako - Chairperson

Kahunge Trading Centre
P.O. Box 1425
Kamwenge, Uganda
+256 (0)772 392 523
Karusacco@yahoo.com

▪ Institutional presentation

Networks

Karusacco is not currently a member of any international or national microfinance network. However, it is a member of the local Kamwenge District Microfinance Forum, and also receives technical and funding assistance from the Uganda Cooperative Alliance (see “Donations” below).

Ownership

Karusacco is a member-owned financial institution, and all clients are owners of the institution through share capital subscription. Members have a right to vote in the Annual General Meeting (AGM) and be elected to the governance organs (BoD and committees). To become a member, individuals, groups, and institutions must pay several fees, purchase share capital, and make a minimum deposit in the institution.

Legal form, supervision and audit

Karusacco was registered in July 2003 with certificate 6795 under the Uganda Cooperative Society Statute of 1991 and regulation of 1992. As a community-owned financial institution Karusacco is not subject to supervision by the Central Bank of Uganda (BoU). However, Karusacco is subject to basic reporting requirements by the local District Commercial Office, which is mandated to license and supervise all SACCOs in Kamwenge District. This local District Commercial Office has also audited Karusacco’s annual financial statements since inception. However, following the Uganda cooperative society statute of 1991 and regulation of 1992, the 2005 AGM appointed a Kampala-based audit firm, Team and Company, for the financial year ending December 31st, 2006.

Donations

Karusacco has received grants and soft funding from a variety of sources since its inception. These include a grant from Uganda Cooperative Alliance (UCA) in 2004 for 3.5 million UGX (1,900 USD) comprised of in-kind donations (office furniture, safe, and other items), funding for the renovation of the branch facilities, as well as a small subsidy towards the salary of the branch staff of 150,000 UGX (80 USD) per month. This grant is subject to specific reporting requirements and is thus accounted for in Karusacco’s financial statements as a no interest loan. However, this report considers these funds to be a grant, as our analysis deems it unlikely that the funds will need to be repaid. The institution has also received significant training on microfinance best practices from the GoU/UNDP PSPC and from the UCA.

Funding

Loan provider	Interest rate	Duration	Initial amount (UGX)	Initial amount (USD)	Out. as of Oct 06 (USD)
MSCL	13% PA	24 months	20 M	10,800	10,800

Management team

The management team consists of the single General Manager (GM), overseeing three staff: a single Loan Officer (LO), a cashier, and a guard. The GM was formerly a local businessman and holds a diploma in accounting. He has worked with Karusacco since the founding of the institution, on a volunteer basis until 2004. The GM has received additional training through the joint Government of Uganda (GoU)/United Nations Development Programme (UNDP) Private Sector Promotion Centre (PSPC).

Organization

- Until 2005 the GM conducted all day-to-day branch operations, from loan assessment to the accounting process. However, operations are now divided. The cashier accepts deposits and repayments, makes disbursements and prepares daily financial accounts, the LO selects clients, does loan analysis and monitoring/follow-up, and the GM trains and validates the work of the LO and cashier, mobilizes new members, and acts as the chief accountant.
- The 7-member Board of Directors (BoD) is elected every two years during the Annual General Meeting (AGM). The BoD plays both strategic and operational roles, defining goals and targets, developing policies and procedures, monitoring the management and financial performance of the SACCO, as well as approving some categories of loans.

Market penetration

Karusacco’s single office is located in Kahunge trading centre in Kamwenge district. From this office it serves member clients in Kahunge, Nkoma, Bwizi, Kamwenge, and Kicheche sub-counties in Kamwenge District and Nyantugo sub-county in Kyejojo District.

Products and services

Karusacco offers both credit and savings to members. The institution group as well as individual loans, although 83.7% of the loan portfolio is in individual loans. There are four loan products (business loans, school fees loans, asset acquisition loans and emergency loans) with amounts up to 2 million UGX¹ and duration up to 8 months. A fifth loan product, agricultural loans, is planned but has not yet been offered. All loan products carry a variety of additional fees, with the effective interest rates ranging

¹ Loans above 1 million UGX are only approved after at least 4 loan cycles.

between 48% and 126%. Some limited training is offered to individual group clients on loan use and business skills. The specific loan product parameters are as follows:

- Business loans for working capital are offered to individuals, groups, and institutions, at a rate of 3% declining and a term of 1-6 months with monthly repayments. Groups must include between 5 to a maximum of 50 members. Institutions include local health clinics and other local organizations. The GM estimates that 60% of the total portfolio is in business loans.
- School fees loans are offered mainly to school teachers at 3% declining for between 1-6 months. The borrower must have another source of income from a business or a salary.
- Asset acquisition loans are offered for income-generating assets (not consumer goods) at a rate of 4% flat for up to 8 months.
- Emergency loans are offered at 10% flat for up to two months with a single bullet payment that includes interest. These loans are intended primarily for the purchase of land.

Savings products include demand deposits which earn no interest (individual and joint savings accounts, and institutional accounts) and fixed deposits that earn 1.5% per month for the adult account and 0.5% per month for the “minor’s account.” The minimum term of a fixed deposit is 3 months, although term deposits can be withdrawn early by forfeiting interest. Finally, Karusacco also accepts school fees payments on behalf of local schools.

▪ Governance

Governance and Decision Making is rated “c”

Decision-making

- Overall, Karusacco has an inclusive decision making process, with harmony between the governance and management structures. The institution has a clear vision and mission with a focus on both social and sustainability goals.
- All strategic decisions and most operational decisions are made by the seven-member BoD based on management reports. Although this involvement does not currently impede operations due to the small scale of the institution and the highly available local board, it can limit Karusacco’s responsiveness to the operating environment. More devolution of operational decision-making to the management level and less reliance on the BoD would mitigate this risk.
- Because the BoD plays such a large role in operational decision-making, there is a risk that critical decisions could be made on wrong or outdated information. This

risk is exacerbated by slow reporting of portfolio and financial information.

- The BoD is very committed and involved, and the members are well-versed in the main internal issues. Meetings are very frequent (at least once per quarter by the constitution, but much more frequently in practice). Important agenda items receive adequate treatment during the meetings, with discussions formalized in detailed minutes. Moreover, the BoD is well-structured, with functioning subcommittees for loans and internal audit. There has been some turnover in both the executives (2 new members elected in 2005) and at the committee level through annual elections at the AGM, which serves to introduce new perspectives.
- There is strong communication between operational staff (meetings frequently throughout the week as necessary) and between the GM and the Board of Directors (BoD), eased by the small size of the operational team. The GM reports to the BoD at least quarterly and also attends all BoD meetings.
- The BoD members lack specific job experience in microfinance. However, the education level of the BoD members is relatively high, with all members holding at least a relevant diploma. This broader capacity has allowed the BoD to benefit from UNDP/GoU Private Sector Promotion Centre trainings on the necessary specific technical issues and microfinance best practices.
- The portfolio and financial reporting to the board is adequately detailed, and members have a good understanding of performance. However, delays in generating monthly reports mean that data is sometimes stale by one month or more, limiting its usefulness in decision-making.

Planning

- Karusacco has a detailed 3-year business plan that includes market and institutional assessment, specific goals and targets, and trend analysis of key indicators. The plan also includes financial projections and defines concrete operational targets. HR needs are also clearly identified. This level of planning is very comprehensive relative to the size of the institution. Planning is also dynamic, with assumptions and targets reviewed regularly for relevance/viability and budgeting tracked for discrepancies against plans.
- The planning process has been significantly assisted through support from the PSPC advisor to the BoD (departed in 2004). It remains to be seen whether the GM and BoD have the capacity to manage the planning process on their own.
- However, some of the targets defined in the business plan are not realistic. For example, over the life of the plan, savings are anticipated to grow by more than 9 times, the loan portfolio is anticipated to grow by over 10 times and FSS is intended to be achieved by 2008. In

fact, growth of savings has declined sharply through August 2006. Even a revision of the Business Plan key targets appears overly ambitious (anticipated growth from 154 loan clients at August 2006 to 400 by year end).

- The business plan does not address some relevant risks. In particular, a stronger competitive analysis is necessary given the current competition in the immediate area of operations (numerous SACCOS in Kamwenge District including a competitor in Kahunge trading centre) and the possibility of new market entrants targeting the same or similar clientele. Also, the business plan does not specifically provide for an improvement in the MIS system to match the ambitious growth plans.

Management team

- + Karusacco's GM, the sole manager on the operational team, is motivated, knowledgeable, and committed to his job, and has relevant skills in accounting and finance. He has also benefited from numerous microfinance trainings offered by the UNDP/GoU, including records management, internal audit/control, and microfinance-specific financial accounting.
- With only one experienced manager, Karusacco faces significant key-person risk. The GM functions not only as the accountant but also as the de facto financial, administrative, operational, and HR manager. Although the LO and cashier can manage the office during a temporary absence of the GM, there is no true polyvalence within the institution.
- The GM lacks certain higher-level management skills, especially in the areas of planning and budgeting, which have largely been provided by outside consultants. He also needs to strengthen his financial analysis skills if the size and complexity of operations are to increase in line with the ambitious business plan.

Human resource management

- + Karusacco's HR management is jointly implemented by the GM and the BoD, with an appropriate focus on training and recruitment. Although there is no formal HR manual or BoD committee, short- and medium-term human resource needs have been systematically identified and budgeted for in the current Business Plan, including job descriptions.
- + The recruitment process is efficient and transparent. Staff positions have been openly competed through job postings in local papers. The process focuses on relevant qualifications as well as motivation, and has thus far resulted in the recruitment of quality staff. Interviews are conducted through an ad hoc recruitment committee composed of several BoD members with the GM.

- Relative to the size and age of the institution, the training of staff has been very complete. The BoD and GM view training as crucial in building the capacity of both the management and BoD members and all operational staff have benefited from UNDP/GoU PSPC trainings. However, more specialized training for the loan officer will be needed to bolster credit and client appraisal skills as Karusacco adds new riskier products and widens its area of operations (see "Activities" below).
- Staff job satisfaction is adequate, but the salary-scale is low. Although the BoD approved an improved salary scale with annual increases under the current Business Plan, this scale increase is contingent on reaching unrealistic financial performance targets (see "Planning" above). There is no current or planned loan officer incentive scheme.

Areas for improvement:

- * Devolve operational decision-making to Manager to allow more flexible and responsive decision-making.
- * Improve quality of reporting to BoD to increase effectiveness of decision-making.

Information

Information and equipment is rated "d"

Description of the MIS

Equipment	▪ Manual system.
Accounting	▪ Manual system. ▪ Financial statements (BS/IS) generated monthly
Portfolio and savings information	▪ Manual system ▪ Portfolio report generated monthly

Management Information System (MIS) and equipment.

- + Although entirely manual, Karusacco's MIS is well organized. The loan tracking, savings and accounting system uses ledger cards and till sheets that are well designed with appropriate checks to prevent errors or fraud: proper receipts, color coded system to track savings deposits and loan disbursements. A detailed chart of accounts has already been developed but not yet implemented (planned to be introduced by the end of 2006).
- The level of data security is insufficient. Back-up of critical accounting, loans/savings documents (member accounts book for example) is not done and presents a major risk of data loss in case of fire or theft. Simple steps could be taken to improve security, such as taking copies of key documents and storing them off premises.

Information on activities

- Portfolio reporting was previously quite basic, although a new format introduced by Karusacco in August 2006

with the assistance of UCA includes more detailed analysis, as PAR and efficiency and productivity ratios. This is new format also provides tracking by product type, which should improve trend analysis. Although the information necessary for portfolio monitoring (number of active clients, list of all loans and outstanding balances, gross portfolio outstanding) is theoretically available at the end of each month, delays in generating these reports mean that information is often out of date.

- Inefficiencies and inaccuracy in the time-consuming consolidation of portfolio information from various sources lead to some discrepancies in portfolio reports. For example, portfolio reports do not always reflect true loan balances or disbursed amounts due to time lags in updating the loan ledger cards. These inconsistencies make accurate monitoring difficult, including calculating reliable PAR indicators. The loan officer uses the loan contracts to monitor payments due, which is also a time consuming process.

Financial and accounting information

- Audited financial statements prepared by the Karusacco auditors contain numerous errors or inconsistencies in all years available and the balance sheet does not balance for 2005. This weakness has persisted due to limited checking of audited statements by the BoD and management.
- However, source documents generated by the GM for the annual consolidated statements are much more reliable and available on a monthly basis (trial balance, income statement). Using these documents, financial performance is tracked against projections, with tracking of budget discrepancies although deeper analysis of trends comparison to benchmarks is lacking.
- The consistency and efficiency of financial and accounting data need to be improved. In particular, steps must be taken to ensure consistent classification of accounting items (new Chart of Accounts will help this). The accounting process is also overly time consuming, resulting in significant delays that in some cases can impact the ability of management and the BoD to identify problems and take timely decisions.

Areas for improvement:

- * Improve security of critical financial and accounting data to protect from fire, theft, or other potential losses.
 - * Conduct systematic and regular data reconciliation to detect errors and anomalies in order to improve data quality
-

Risk

Risk Management is rated “c”

Procedures and internal controls

- + The key operational staff have a good general understanding of financial and institutional risks, with the notable exception of competition risk. This includes the cashier, who plays a key role in the small control chain, as well as the General Manager. Karusacco has formalized important policies and procedures, including a relatively detailed Credit/Operational Manual. The credit policy has also been updated to reflect improved procedures, such as a recent restriction on members providing multiple personal guarantees on loans.
- However, other policies and procedures are less formalized. For example, some policies are contained only in the board minutes. Although these policies and procedures are well understood by the GM and communicated to the staff, they will need to be formalized as the operational staff grows.
- Due to the GM’s management of all finance and accounting procedures, there is limited separation of duties which could increase the risks of fraud. However, this risk is mitigated by the internal audit function which effectively checks head office financial procedures, including cash balances.
- Control procedures for savings are rigorous including specimen signatures and photograph checking. There are basic concentration risk policies in place (single loan should not exceed 3% of net assets) but no portfolio diversification procedures, either among products or by business activity. This kind of deeper risk analysis should be done given the growing number of products and the ambitious growth plans.
- + Adherence to the credit/operations policy is generally scrupulous. The lending policy also contains detailed rules on insider loans, which are meticulously followed. BoD members who borrow have been subjected to standard loan analysis and monitoring. However, the loan analysis is hampered by a relatively simplistic loan application form.
- Cash on the premises is well protected from theft in a heavy duty safe, with cash at the cashier window drawer limited to no more than 3,000,000 UGX at any time. There is a good segregation of duties for cash handling, with two persons required to open the safe. However, the cash in transit procedure is riskier: a single staff member travels by public transport to Fort Portal where the nearest Centenary Bank branch is located.
- The credit methodology does not provide for any specific oversight of clients other than by the LO, although the GM both trains and monitors the LO and also originates loans directly.

Internal audit

- ✦ The internal audit (IA) process is regular, with an audit performed at least three times per year and additional spot checks of cash balances at least three times per year. All visits are unannounced. The 3-member IA team, elected during the AGM, is large for a small organization. Members have relevant skills (accounting) but not previous experience in audit. The IA reports directly to the AGM as well as to the BoD, with meetings at least 3 times per year. Reports contain recommendations for follow up.
- Internal Audit procedures are not adequately formalized, resulting in incomplete identification and verification of risks. For example, the audit team only verifies compliance with procedures and cash balances and does not verify client files or visit the field to verify processes, procedures or check clients. This leaves a big opening for client or LO frauds to go undetected. This shortfall is due to a lack of proper identification of operational risks, not a lack of mandate to verify such risks.

Areas for improvement:

- ✦ Formalize credit and other operational procedures to improve consistency of their application
- ✦ Formalize and upgrade internal audit procedures to include client verification as an essential component of internal audit process.

Activities

Activities: products and services is rated “c”

USD , unless otherwise stated	Dec.03	Dec.04	Dec.05	Aug. 2006
Loan portfolio	710	3,146	14,836	24,903
Loan portfolio (KUGX)	1,299	5,7574	27,448	46,070
Evolution	NA	343.1%	376.8%	67.9%
Av. Out. loan portfolio	128	2,182	12,444	19,513
Active borrowers	10	33	105	154
Evolution	NA	230.0%	218.2%	46.7%
Average outstanding loan per client	70	94	141	162
Average amount disbursed	97	117	216	255
PAR 31-365	NA	NA	NA	4.0%
PAR > 365	NA	NA	NA	0.0%
Write-off ratio	0.0%	0.0%	0.0%	0.0%

Note: PAR and other portfolio data not reliable.

Marketing and competition

- ✦ Karusacco has good but eroding competitive advantages as a local community-owned financial institution, namely proximity to its rural client/owners. It has also

benefited from client loyalty, relatively well-adapted products and limited competition.

- However, the institution faces major challenges in new member mobilization (done by both manager, loan officer, and BoD members) real and growing competition in its rural market as rural banks and Micro Deposit taking Institutions (MDIs) such as CERUDEB, Stanbic, and UML expand their branch networks aggressively. Even in Kahunge Trading Centre Karusacco faces direct competition for its clientele from other similar SACCOS. Karusacco will need to develop a true marketing and competitive strategy to address this increasingly competitive market.
- The planned agricultural lending is clearly in demand but could be a risky way to grow the portfolio with its specific risks, longer terms, and larger loan amounts. This is especially true if Rural Producer Organizations (RPOs) are not well evaluated by the loan officer or loans are concentrated in one agricultural product.

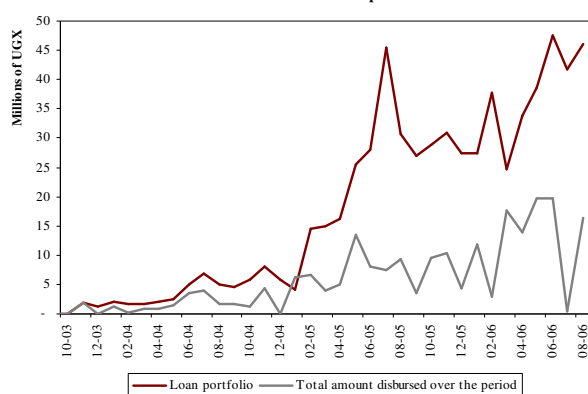
Portfolio Management

- Karusacco’s credit methodology relies on the high level of client knowledge and monitoring that is possible at the present scale of the institution. However, repayment capacity analysis is shallow, with loan decisions based largely on client character and income assessment through savings records (minimum 10% of the loan amount in savings). This method is adequately adapted to localized nature of Karusacco’s business but more rigorous analysis will be needed as the portfolio grows.
- Appropriate collateral and personal guarantees are taken as a secondary level of security. However, members can guarantee up to three loans, and can be borrowers themselves, which weakens the likelihood of effective guarantees in case of default.
- ✦ The loan approval process is efficient, as the GM can take decisions on loans up to 400,000 UGX and all Emergency Loans.
- ✦ The single LO is committed and motivated, and has a good knowledge of the portfolio. His analysis skills have been strengthened by ongoing training from the GM and by PSPC trainings. Good loan monitoring and follow up so far has helped to mitigate risk. Exposure to over-indebtedness risk is also well managed by systematic checking to see if clients have loans with other SACCOS in the region.
- Although client orientation and training in proper loan is conducted by the LO, it is relatively limited: two hours or less on the day of loan disbursement for individual clients. Training is more complete for group loans, it is still quite shallow and normally 2 days or less. This lack of complete training increases risk as the portfolio grows, particularly the risk of weak solidarity in group loans.

Quality of the portfolio

- Due to the imperfect portfolio data generation process, and potentially inaccurate loan aging until the 2006 introduction of the new more detailed UCA reporting format, PAR data for the period 2003 – 2005 may not be reliable. As such, no trend analysis of portfolio quality is possible.
- Although the PAR greater than one day of 6.9% through August 2006 is high by international standards, the lower PAR 31–365 of 4% for the same period indicates effective loan monitoring and recovery of overdue payments by the LO and is good by local and international standards. Karusacco’s PAR compares favourably with estimates of PAR obtained from nearby competitors, including SIDA SACCO with 10% (*Note: Planet Rating did not verify the accuracy of PAR data for competitors*).
- The GM estimates that school fee loans, the second largest part of the portfolio, represent the highest portion of total PAR (actual PAR data by product is not available). This is a result of weak credit analysis of salaried workers. This represents a real risk to portfolio quality if credit quality for this product is not improved.

Evolution of the loan portfolio



Portfolio composition and evolution

- + Karusacco’s portfolio has grown rapidly over the last three years (377% growth between 2004 and 2005). This strong growth is explained by the untapped demand for financial services in the rural market combined with Karusacco’s well adapted products, and the low base from which this growth has occurred.
- Nevertheless, the rate of loan portfolio growth has slowed in 2006, despite continuing growth in demand. This is at least partly due to erratic fluctuations in disbursements based on available funding (see Financing and Liquidity below) that makes managing portfolio growth difficult.

Portfolio diversification

- Karusacco’s business loan clients are involved in various economic activities, including petty trade, agricultural production, as well as services provision and salaried work. This lends a natural risk diversification in the portfolio, although the GM does follow a specific

diversification policy. This will be an important weakness if not more systematically addressed before the launch of agricultural lending, with its higher associated concentration risks.

Credit risk coverage

	Dec. 2003	Dec. 2004	Dec. 2005	June 06
Risk coverage ratio	NA	NA	NA	62.6%
PAR 31 net of loan loss provision / Equity	NA	NA	(3.3%)	2.1%

- Karusacco takes mandatory savings of at least 10% of the loan amount in addition to two account-holder co-signatories on each loan, and appropriate additional collateral (e.g. pledge of movable assets or property). In the event of a default, late payments can be extracted from the borrower’s savings account.
- However, it is unclear whether collateral agreements are legally enforceable (no land title taken for property, for example). In the case of group solidarity loans, the weak initial training of the groups reduces the efficacy of this risk coverage mechanism.
- Loan loss coverage is insufficient at around the 63% level. This is because Karusacco’s provisioning was based on arrears until 2005 which resulted in under provisioning. The current provisioning method, (10% less than 30 days late, 25% 31-60, 50% 61-90, 75% 91-120, and 100% > 120) is more conservative than the GIRAFE standard and is acceptable by international standards. Karusacco’s write-off policy allows loans to be written off after 1 year with the BoD’s permission, although no loans had been written off as of August 2006 as no loan has reached arrears of > 365.

Savings Activities

USD , unless otherwise stated	Dec. 2003	Dec. 2004	Dec. 2005	Aug. 2006
Total out. dep	514	4,239	11,892	9,198
Total outs dep (K UGX)	941	7,757	22,000	17,017
Evolution	NA	724.7%	183.6%	(22.7%)
% of comp savings	0.0%	0.0%	2.3%	36.1%
% of voluntary savings	100.0%	100.0%	97.7%	63.9%
Total nmb of depositors	41	175	449	671
Evolution	NA	326.8%	156.6%	49.4%
Avg dep bal per saver	12	24	26	14

- Although savings grew strongly from 2003 to 2005 there has been a sharp drop in the first eight months of 2006, particularly in voluntary savings. This drop does not appear to be primarily seasonal and could be the result of a client perception of weakness due to Karusacco’s recent liquidity constraints (see Liquidity Management). Such lack of confidence among depositors could present a serious risk if not managed carefully. This drop in

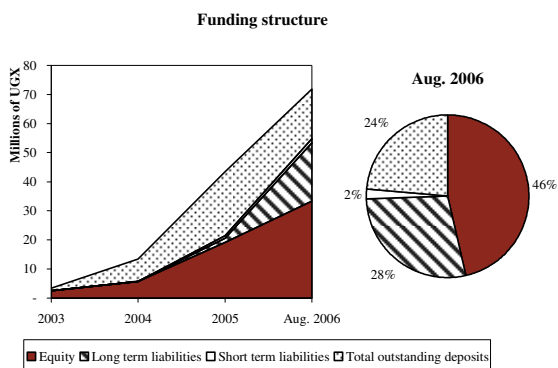
savings increases reliance on more expensive debt and equity funding for lending.

Areas for improvement:

- *Deepen credit methodology beyond character assessment and weak collateral guarantees to include more detailed evaluation of business viability.
- *Focus on savings mobilization, particularly term deposits, to maintain a sufficient liquidity cushion for growth in lending activities.

■ **Financing and liquidity**

Financing and liquidity is rated “d”



Financing strategy

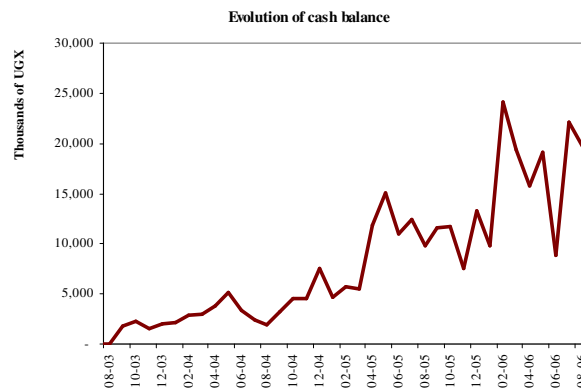
- Karusacco is largely financed by share capital and retained earnings, with the remaining half of the capital structure comprised almost equally of savings and debt. This capital structure is good given the young age of the institution. Moreover, given the high level of profitability of the institution (on an unadjusted basis) the equity base should continue to grow. With low leverage, Karusacco has excellent additional debt capacity.
- Although deposits are close to a quarter of the overall capital structure, most client savings are in demand rather than in term deposits. This means that the growth in the deposit funding base has not been commensurate with loan growth, leading to a growing reliance on soft loans to finance the lending activities. This ultimately increases dependence on external resources, which is not the goal of community-owned cooperative institutions.
- The planning for funding needs is not very dynamic, with an ongoing reliance on MSCL for external loans, and little planning for external funding needs.

Asset and liability management

Asset and liability management (ALM) risks are currently limited:

- + **Very low interest rate risk:** although loan providers’ interest rates are reviewed every year, the current interest margin is sufficient to cover potential interest rate increase.

- + **Limited maturity risk:** Mostly equity and long term liabilities fund short term loans to clients. The one exception are term deposits, which must be matched to assets of compatible maturity.
- + **No FX risk:** Karusacco has not borrowed or issued loans in foreign currency.



Liquidity management

- Liquidity management is a major challenge for Karusacco. No liquidity projections are done, resulting in tight liquidity in the past due to fast loan growth and low term savings. Fast assets deployment results in low cash balances when liquidity is available for on-lending, erratic liquidity means that debt financing is used to meet short term funding needs.
- With unstable savings rates and the client’s ability to withdraw term deposits early without interest, Karusacco faces some liquidity risk to meet client withdrawal demands. Cash reserves to ensure the ability to meet client withdrawal demands are based on a fixed amount rather than a percentage, which exposes the institution to some liquidity risk.

Areas for improvement:

- *Improve liquidity management through better projections of liquidity needs.
- *Establish a coherent plan in advance to proactively access external funding to ensure adequate liquidity to fund growth. Diversify funding sources to ensure availability of funding when needed.

■ **Efficiency and Profitability**

Efficiency and Profitability is rated “c”

Profitability analysis	Dec. 2003	Dec. 2004	Dec. 2005	Aug. 2006
ROE	(7.8%)	6.2%	6.5%	37.6%
Liabilities / Equity	37.9%	137.1%	126.5%	115.0%
ROA	(5.6%)	3.0%	2.9%	17.2%
Profit generation				
Op. self-sufficiency	90.3%	110.8%	106.6%	156.6%
Portfolio Yield	121.9%	52.8%	45.4%	57.8%

Op. expense ratio	417.8%	58.4%	50.1%	42.4%
Staff productivity	10	17	53	51
Loan officer productivity	NA	NA	NA	154
Avg out. loan client (USD)	70	94	141	162
Funding expense ratio	0.0%	0.1%	0.2%	3.9%
Cost of savings	0.0%	0.0%	0.0%	0.6%
Cost of liabilities	NA	NA	0.0%	9.1%
LLP expense	0.0%	0.0%	2.7%	2.2%
PAR 31-365	0.0%	0.0%	0.0%	4.0%
Write-off ratio	0.0%	0.0%	0.0%	0.0%
Asset management				
Out LP / Assets	38.0%	42.9%	61.7%	62.5%

Overview of the profitability

Unadjusted profitability has grown impressively since Karusacco launched operations, reaching 37.6% for the first 8 months of 2006 with an impressive ROA as well. Low leverage gives Karusacco excellent debt capacity, and the ability to increase profitability even more by using low cost refinancing to fund growth of the portfolio. Future profits will also depend on maintaining cost control and the quality of the portfolio. Karusacco compares very favorably in terms of both ROA and leverage with its Micro Banking Bulletin peer groups (East African MFIs and Cooperatives).

Portfolio yield and effective interest rate

Although it is not possible to compare Karusacco's effective and actual yields, the high effective interest rates on all products, but particularly the shorter term loans, are a key driver of Karusacco's strong growth in profitability over just 3 years of operations. Short term emergency loans, for example, carry an effective interest rate of over 126%.

Operating expense ratio

+ Operating costs are currently following a notable downward trend, and OSS is already well above 100%. Although operating costs are likely to rise again in the medium term as the institution expands, particularly into more rural areas with new products such as agricultural lending, Karusacco should continue to benefit from economies of scale (higher staff productivity, increased repeat loan clients) in the near to medium term.

Funding expense ratio

+ The funding expense of Karusacco remains extremely low thanks to the exclusive use of soft financing, equity, and savings to fund operations. Although this ratio is rising, the increase is unlikely to pose a serious risk in the near to medium term given the wide interest margin on the loan products.

Loan loss provision expense ratio

- Loan loss provision expense has been uniformly low since 2003, but this is partly due to the fact that loan loss provisioning was not calculated correctly and provisions were not made until 2005.

+ However, the good quality of the portfolio has kept this expense low through 2006.

Asset management

Karusacco's fast deployment of assets, driven by the intense demand from loan clients, contributes to a high ratio of assets in the income-earning loan portfolio.

Areas for improvement:

* Take advantage of low leverage ratio to increase profits by accessing external funds to increase loan portfolio growth as needed.

■ Appendices

KARUSACCO Balance sheet	Notes	UGX				USD				Evolution		
		Dec 03	Dec 04	Dec 05	Aug. 2006	Dec 03	Dec 04	Dec 05	Aug. 2006	2004/2003	2005/2004	2006/2005
ASSETS		3,419,151	16,945,916	43,442,949	71,836,306	1,848	9,160	23,483	38,830	395.6%	156.4%	65.4%
Short Term Assets		3,299,151	16,811,916	40,406,128	66,199,485	1,783	9,088	21,841	35,784	409.6%	140.3%	63.8%
Cash and Due from Banks		2,000,000	11,055,232	13,291,478	19,737,878	1,081	5,976	7,185	10,669	452.8%	20.2%	48.5%
Short Term Investments		-	-	-	1,549,000	-	-	-	837	-	-	-
Short Term Net Loan Portfolio		1,299,151	5,756,684	26,814,650	44,912,607	702	3,112	14,494	24,277	343.1%	365.8%	67.5%
Short Term Gross Loan Portfolio (Loan Loss Reserve)		1,299,151	5,756,684	27,446,734	46,070,112	702	3,112	14,836	24,903	343.1%	376.8%	67.9%
Interest Receivable		-	-	-	1,157,505	-	-	-	626	-	-	83.1%
On loan portfolio		-	-	-	-	-	-	-	-	-	-	-
On investments		-	-	-	-	-	-	-	-	-	-	-
Accounts receivable and other assets	1	-	-	300,000	-	-	-	162	-	-	-	(100.0%)
Long term assets		120,000	134,000	3,036,821	5,636,821	65	72	1,642	3,047	11.7%	166.3%	85.6%
Long Term Net Investments		-	-	-	200,000	-	-	-	108	-	-	-
Long Term Gross Loan Portfolio		-	-	-	-	-	-	-	-	-	-	-
Net Fixed Assets		120,000	134,000	3,036,821	5,436,821	65	72	1,642	2,939	11.7%	2,166.3%	79.0%
Other Long Term Assets		-	-	-	-	-	-	-	-	-	-	-
LIABILITIES AND EQUITY		3,419,151	16,945,916	43,442,949	71,836,306	1,848	9,160	23,483	38,830	395.6%	156.4%	65.4%
Liabilities		940,551	11,288,884	24,260,634	38,416,571	508	6,102	13,114	20,766	1,100.2%	114.9%	58.3%
Short term liabilities		940,551	11,288,884	22,860,634	18,416,571	508	6,102	12,357	9,955	1,100.2%	102.5%	(19.4%)
Demand Deposits		940,551	7,756,884	21,500,134	10,875,071	508	4,193	11,622	5,878	724.7%	177.2%	(49.4%)
Compulsory Deposits		-	-	500,000	6,141,500	-	-	270	3,320	-	-	1,128.3%
Short Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-
Short Term Borrowings	2	-	3,532,000	-	-	-	1,909	-	-	-	(100.0%)	-
Interest payable		-	-	-	-	-	-	-	-	-	-	-
Accounts Payable and Other Short Term Liabilities	3	-	-	860,500	1,400,000	-	-	465	757	-	-	62.7%
Long term liabilities		-	-	1,400,000	20,000,000	-	-	757	10,811	-	-	1,328.6%
Long Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-
Long Term Borrowings		-	-	1,400,000	20,000,000	-	-	757	10,811	-	-	1,328.6%
Other Long Term Liabilities		-	-	-	-	-	-	-	-	-	-	-
Equity		2,478,600	5,657,032	19,182,315	33,419,735	1,340	3,058	10,369	18,065	128.2%	239.1%	74.2%
Paid-In Capital		2,225,000	5,150,000	12,760,000	20,400,000	1,203	2,784	6,897	11,027	131.5%	147.8%	59.9%
Donated equity		-	-	-	-	-	-	-	-	-	-	-
Retained earnings without donations and reserves		253,600	507,032	6,422,315	13,019,735	137	274	3,472	7,038	99.9%	1,166.6%	102.7%
Current year		(96,400)	253,432	811,215	6,597,420	(52)	137	438	3,566	(362.9%)	220.1%	713.3%
Other equity accounts		-	-	-	-	-	-	-	-	-	-	-

Planet Rating – Karusacco – October 2006

KARUSACCO Income Statement	Note	UGX				USD				Evolution		
		Dec 03	Dec 04	Dec 05	Aug. 2006	Dec 03	Dec 04	Dec 05	Aug 06	2004/2003	2005/2004	2006/2005
Financial Revenue (a)		896,400	2,615,700	13,033,018	18,252,675	485	1,414	7,045	9,866	2	398.3%	40.0%
Financial Revenue from Loan Portfolio		289,700	2,132,800	10,459,700	13,903,175	157	1,153	5,654	7,515	636.2%	390.4%	32.9%
Interest on Loan Portfolio		53,700	1,428,800	7,234,250	9,650,275	29	772	3,910	5,216	2,560.7%	406.3%	33.4%
Fees and Commissions on Loan Portfolio		236,000	588,000	2,367,750	3,758,900	128	318	1,280	2,032	149.2%	302.7%	58.8%
Penalty Revenue on Loan Portfolio		-	116,000	857,700	494,000	-	63	464	267	-	639.4%	(42.4%)
Financial Revenue from Investments		-	-	-	-	-	-	-	-	-	-	-
Other Operating Revenue	1	606,700	482,900	2,573,318	4,349,500	328	261	1,391	2,351	(20.4%)	432.9%	69.0%
Financial Expense (b)		-	2,568	52,690	932,284	-	1	28	504	-	1,951.8%	1,669.4%
Interest paid on borrowings		-	-	-	649,998	-	-	-	351	-	-	-
Interest paid on deposits		-	-	-	93,534	-	-	-	51	-	-	-
Net Inflation Adjustment Expense		-	-	-	-	-	-	-	-	-	-	-
Other Financial Expenses		-	2,568	52,690	188,752	-	1	28	102	-	1,951.8%	258.2%
Financial income [c=a-b]		896,400	2,613,132	12,980,328	17,320,391	485	1,413	7,016	9,362	191.5%	396.7%	33.4%
Net Loan Loss provision expense (d)		-	-	632,084	525,421	-	-	342	284	-	-	(0)
Loan loss provision expense and write-off		-	-	632,084	525,421	-	-	342	284	-	-	(16.9%)
Recovery from Loans written off		-	-	-	-	-	-	-	-	-	-	-
Operating expense (e)		992,800	2,359,700	11,537,029	10,197,550	537	1,276	6,236	5,512	1%	4%	(0)
Personnel Expense (includes fringe)	2	-	790,000	3,060,000	4,173,700	-	427	1,654	2,256	-	287.3%	36.4%
Administrative Expense (non-staff op expenses)		992,800	1,569,700	8,477,029	6,023,850	537	848	4,582	3,256	58.1%	440.0%	(28.9%)
Depreciation and amortization		-	-	274,179	-	-	-	148	-	-	-	(100.0%)
Consulting fees		-	-	-	-	-	-	-	-	-	-	-
Transportation		285,000	561,300	1,380,000	2,071,000	154	303	746	1,119	96.9%	145.9%	50.1%
Printing and stationary		277,400	664,300	1,800,200	1,420,000	150	359	973	768	139.5%	171.0%	(21.1%)
Advertising and publicity		81,800	150,500	374,400	336,700	44	81	202	182	84.0%	148.8%	(10.1%)
Training		34,000	31,800	389,200	-	18	17	210	-	(6.5%)	1,123.9%	(100.0%)
Entertainment		149,600	76,800	464,450	-	81	42	251	-	(48.7%)	504.8%	(100.0%)
AGM Expenses		-	-	440,300	591,200	-	-	238	320	-	-	34.3%
Rent		10,000	80,000	300,000	200,000	5	43	162	108	700.0%	275.0%	(33.3%)
Others	3	155,000	5,000	3,054,300	1,404,950	84	3	1,651	759	(96.8%)	60,986.0%	(54.0%)
Net Operating Income Before Taxes and Donations [f=c-d-e]		(96,400)	253,432	811,215	6,597,420	(52)	137	438	3,566	(362.9%)	220.1%	713.3%
Income Taxes (g)		-	-	-	-	-	-	-	-	-	-	-
Net Operating Income Before Donations [h=f-g]		(96,400)	253,432	811,215	6,597,420	(52)	137	438	3,566	(362.9%)	220.1%	713.3%
Non Operating Revenue (i)		-	-	-	-	-	-	-	-	-	-	-
Non Operating Expense (including related taxes) (j)		-	-	-	-	-	-	-	-	-	-	-
Net Income Before Donations [k=h+i-j]		(96,400)	253,432	811,215	6,597,420	(52)	137	438	3,566	(362.9%)	220.1%	713.3%
Donations (l)	4	350,000	-	5,103,500	-	189	-	2,759	-	(100.0%)	-	(100.0%)
Net Income (after Taxes and Donations) [m=k+l]		253,600	253,432	5,914,715	6,597,420	137	137	3,197	3,566	(0.1%)	2,233.8%	11.5%

Formulas and ratios

- 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

Rating Scale

Factor s	Area Rating	Global Rating	Explanation
4 to 5	a	A+ A A-	Excellent 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.
3 to 4	b	B+ B B-	Good 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.
2 to 3	c	C+ C C-	Minimum required 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.
1 to 2	d	D	Insufficient Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.
0 to 1	e	E	Immediate risk of default or very insufficient There are immediate or underlying risks for operations or an unacceptable under performance.