

Rating

D+ Insufficient

Procedures are in place, but with failings, and certain problems are only partially addressed. There are medium-term risks for operations.



Performance indicators

(K UGS, unless otherwise stated)

	June 2004	June 2005	June 2006	Dec 2006*
ACTIVITY				
Total number of staff	3	3	5	5
Total assets (USD)	32,398	71,047	77,502	75,744
(K UGS)	62,755	122,769	141,131	135,279
Loan portfolio (USD)	18,932	35,300	40,490	49,267
Deposits (USD)	15,323	33,087	39,222	39,606
Nb. of active borrowers	133	142	125	149
Nb. of savers	515	594	707	782
APR	N/A	N/A	N/A	64%
PAR 31-365	N/A	N/A	31.5%	10.9%
Write-off ratio	0.0%	0.0%	1.7%	1.5%
Risk coverage ratio	N/A	N/A	36.4%	9.8%
PERFORMANCE				
ROE	27.5%	12.8%	4.4%	12.4%
Liabilities / Equity	1.25x	2.37x	1.97x	1.54x
ROA	11.8%	4.4%	1.4%	4.5%
OSS	135.7%	113.8%	111.6%	113.7%
FSS	131.3%	97.8%	105.6%	81.8%
Portfolio Yield	71.2%	66.6%	65.0%	56.1%
Operating expense ratio	51.1%	41.9%	44.1%	50.9%
Staff productivity	44	47	25	30
Funding expense ratio	10.4%	15.0%	9.3%	6.3%
GROWTH				
Loan portfolio growth	91.2%	66.3%	20.9%	19.3%
Savings portfolio growth	N/A	N/A	24.9%	-1.0%
Assets growth	61.3%	95.6%	15.0%	-4.1%
1 USD = xx UGS	1,937	1,728	1,821	1,786

*Dec 2006 financial data not audited

Mutara Development SACCO, Uganda

February, 2007

Description of the institution

Mutara Development SACCO is a members' credit and savings institution located at Mutara trading centre within Ruhinda County, approximately 7km from Ishaka town in Bushenyi district, western Uganda. It started as a private company in 1999, with support from the Ankole Private Sector Promotion Centre operating within Mutara, Mitooma and Kabira sub-counties and was originally intended to serve as a village bank. The institution later transformed to a public company limited by shares in March 2003 and registered formally as a credit and savings co-operative in May 2005. As at December 2006, its outstanding loan portfolio stood at 75.7 K USD while its savings deposits stood at approximately 39.6 K USD.

Evaluation summary

Mutara received an overall global rating of D+ based on its present attempts to gradually instill pro-active governance and operational structures that guide the institution's strategic direction, actively seek support (both financial and technical) and endeavor to improve the effectiveness of its key operations. Nevertheless persistent weaknesses, particularly regarding client appraisal, portfolio monitoring and delinquency management, continue to negatively impact on the institution's profitability. Additionally, increasingly high operational costs coupled with low client numbers and limited portfolio growth (both loan and savings) have reduced the efficiency levels of the SACCO. There is therefore an urgent need to address these key failings as a priority in order to achieve the institution's mission of becoming a self-sustaining financial institution providing a wide range of appropriate services to its clientele in an efficient manner.

Improvements needed to reach minimum requirements

- Develop a more in-depth planning mechanism that integrates all the institution's foreseeable requirements and is enhanced by a complementary budgeting process.
- Augment the existing MIS to ensure a more secure, reliable and adaptable system with the ability to adequately capture, process and store information in an efficient and timely manner.
- Institute, within the current credit methodology, concrete appraisal tools that comprehensively analyze key indicators such as the debt and repayment capacities of various categories of loan clients.
- Re-vamp the internal audit process to ensure that procedures and controls are consistently applied and periodically verified by a competent audit team.

Strategic goals

Mutara Development SACCO has set its sights on improving, and increasing, its financial services in the medium term before embarking on a longer term plan to expand its services beyond Ruhinda County to cover larger portions of Bushenyi district. It envisions itself as becoming one of the top self-sustaining and member-owned financial institutions within the district.

■ Institutional presentation

Networks

Mutara Development SACCO is a member of the Ankole Micro Finance Institution Association (AMFIA) and benefits substantially from its affiliation to the Ankole Private Sector Promotion Centre (APROCEL) through grants and technical assistance.

Ownership

Mutara is presently fully owned by a 600 plus strong shareholders/members' body and governed by a 9-member Board of Directors (BOD) in charge of formulating the institution's strategic direction. The present BOD was installed in May 2005 and is currently seeing out its initial 2-year term (although almost all of them sat on the previous Board prior to the institution's transformation into a SACCO) after which a third of them retire but may be re-elected provided they do not exceed the maximum limit of 6 years. The latter is done to ensure new board members gain from the valuable experience of old members. The Board reports to the members during the Annual General Meeting (AGM) and executes its duties through the Board committees on Loans, Human Resource Development and Finance; with a separately elected Supervisory committee undertaking internal audit operations. The BOD and management meet bi-monthly to review the institution's performance and direction.

Legal form, supervision and audit

Mutara underwent transformation from a public company limited by shares to a SACCO and subsequently registered as Mutara Development SACCO in May 2005 under the Co-operatives Statute (1991). The institution is therefore presently governed by the Co-operatives Regulations Act (1992). As a result, Mutara is obliged to provide bi-monthly activity reports and annual financial statements to Bushenyi's District Commercial Offices. The latter, under the mandate of the Ministry of Tourism, Trade and Industry, is responsible for monitoring and supervising the SACCO's activities as well as performing the external audit functions. Mutara is not liable to the central bank as it falls within the Tier IV category of financial institutions that are exempt from supervision by the Bank of Uganda.

Donations

Mutara received support in form of equipment during its start-up, from AMFIA and the UNDP/GoU/Netherlands funded APROCEL amounting to 6M UGS (USD 3,360).

Funding

Loan provider	Interest rate*	Duration	Initial amount	Initial amount (USD)	Outstanding amount
MSCL	13%	24 month	30 M UGS	17,360USD	10 M UGS

Management team

The present management team at Mutara comprises a Manager, Accountant and Senior Loans Officer. The Manager holds a bachelors degree in Economics while both the Accountant and Senior Loan Officer hold diplomas in Business studies. The management team is quite young at the institution with the manager having been hired in 2005 while the other two are no more than three years old at the institution. Prior to commencing his duties at Mutara, the manager underwent tailored training in operation of SACCOs at a nearby sister institution (Kyamuhunga SACCO) while the rest of the team has received training on the job.

Organization and market penetration

Mutara SACCO carries out the bulk of its operations within the sub-counties of Mutara, Mitooma and Kabira in Ruhinda County as well as Kitagata sub-county, all in Bushenyi district. At present the institution operates out of only one branch at the trading centre in Mutara. Target clientele comprise the farming communities, micro-entrepreneurs, business people, and civil servants from within the surrounding localities; the economic activities being mainly dairy farming, semi-commercial crop husbandry and related micro-enterprises such as produce marketing and processing.

Products and services

Products and services presently offered by Mutara include savings facilities for all active members as well as business, agriculture and school fees loans. The institution also operates school fees collection accounts.

Savings products comprise fixed and voluntary savings, with interest paid only on fixed deposits at a rate of 12% p.a. irrespective of the period or amount. There is also a minimum balance requirement of 10,000 UGS on all voluntary savings accounts.

Loans are offered to mini-groups (5-10 members) as well as individuals for periods of up to twelve months. The product range includes production loans (business and agriculture), consumption loans and school fees loans. All loans bear an interest rate of 4% per month on a declining balance and related fees include acceptance commission and processing fees (usually totalling up to 5% of the approved loan amount). Repayment periods vary from between 4-12 months although school fees loans do not exceed a 3-month period. The institution has a loan ceiling of 5 M UGS with amounts starting at UGS 50,000. Loan applicants are required to hold a minimum number of shares as loan approval is based on a shares: loan amount ratio of 1:7.

■ Governance

Governance and Decision Making is rated “c”

Decision making

- Mutara Development SACCO has a well outlined mission statement targeting the economic empowerment and bridging of the financial services gap among the target group. Related strategic objectives are set out in line with the above and form the backbone of the institution’s programs.
- + The present BOD has a rich mix of professionals with different academic backgrounds and experience including accounting, education and business among others. This BOD exercises adequate control over the institution owing to a clear understanding of its mandate and related governance principals.
- + The BOD maintains a cordial relationship with management through bi-monthly meetings, accompanied by performance reports, which enable informed and timely decision-making by the board in the best interest of the institution.
- There however remains a shortage of certain knowledge and experience on the board, specific to microfinance best practices, which are crucial to proper and successful operation of any microfinance institution.

Planning

- + The institution undertakes a detailed review of its business plan every two years and currently a new plan covering the period 2007 – 2009 is being finalized. The planning process involves input from major stakeholders (including the BOD and management) and covers key planning areas such as SWOT analysis reasonably well.
- The budgeting process is adequate for the size of the institution, including monthly budget tracking against actual expenditure that later feeds into the overall planning process.
- There is still room for better participation of the entire branch team, specifically the loan department, to enable the setting of realistic outreach and loan disbursement targets.
- In-depth analysis is still deficient in the planning process, particularly regarding financial projections (cash flow and portfolio growth) where the projected figures do not necessarily correspond to the institution’s growth strategies and operational targets.

Management team

- + Mutara has a small, relatively young, but nevertheless dedicated management team that is sufficiently qualified and competent despite their short span of experience. There is no key person risk as both the senior loan officer and the acting account have both rotated managerial duties during the period before the new manager was recruited.

- There is a clear pattern of authority and line of reporting that enables management to effectively communicate and implement action plans and follow-up on BOD decisions.
- However more training is required to augment the skills and performance of the team and make up for the shortage of experience, specifically in the areas of planning, financial analysis and projections as well as liquidity management.

Human resource management

- + The institution has a detailed human resource policy that is currently being reviewed and revised. The latter clearly spells out, amongst other issues, the terms of service for all staff, recruitment and remuneration policies as well as performance review procedures.
- + The institution has hitherto shown commitment in following and implementing the above policies with a clear and transparent recruitment process as well as periodic and systematic salary and performance reviews for all staff.
- + The salary levels reflect those of the market conditions in the area although the present review is important to ensure staff retention and motivation while the staff training plan needs to be implemented and actively supported by the BOD.
- The existence of a staff-training policy within the Human resource manual is not complemented by a training budget or plan and is yet to be actively implemented.

Areas for improvement:

- * Develop a more comprehensive business plan complemented by an annual budget.
- * Train board members particularly in the areas of microfinance best practices, financial analysis and strategic planning.
- * Ensure that human resource policy is fully and actively implemented, in particular regarding staff training and periodic performance reviews.

■ Information

Information and equipment is rated “c”

Description of the MIS

- | | |
|-----------|---|
| Equipment | <ul style="list-style-type: none"> ■ Limited IT infrastructure; two desktop computers used by management team; no internal LAN or access to internet ■ Backup done on manager’s flash disk particularly information pertaining to financial operations, at least on a monthly basis |
|-----------|---|

Accounting	<ul style="list-style-type: none"> ▪ Manual accounting system is characterized by use of ledger and till sheets; no accounting software ▪ MS Excel used in data organization, sorting, simple analysis and financial report preparation. ▪ Accounting reports created at least once in two months.
Portfolio information	<ul style="list-style-type: none"> ▪ No portfolio management software in place; pre-designed sheets used in data collection. ▪ Performance analysis and indicators are computed, recorded and analyzed manually ▪ Related reports are prepared monthly, although delays of 1-2 weeks are common.

Management Information System (MIS) and equipment

- ✦ Mutara's MIS operations are principally manual; information is stored in physical files although the availability of some computer equipment and adequate computer skills at management level has enabled improved data assembling, analysis and storage.
- The manual system is quite stream-lined, especially in the accounting area, with check points to authenticate / validate and reconcile all accounting data being entered into the system.
- Nonetheless, there is potential risk of data loss or destruction through fire, theft or physical damage as paper files and client cards are neither duplicated nor stored in fire-proof or physically secure premises.
- Plans are underway to improve the present MIS in the medium-term, with the institution looking at a number of software programs.

Information on activities

- ✦ Mutara implemented proper portfolio aging and calculation of key performance indicators such as PAR (based on best practices) in the FY 2005-06. The latter form a key part of the reporting procedures to its main funding partner, MSCL, and are provided in monthly reports.
- The institution is able to generate quality and reliable information on its portfolio performance although the process still takes up to two weeks after the month's end due to the manual element of data processing.

Financial and accounting information

- Financial data, although timely and substantially reliable, has limited in-depth analysis that makes it only partially sufficient for institutional performance assessment and related decision-making.

Areas for improvement:

- ✦ Install a secure and reliable system to better protect information from loss or destruction, particularly for client files.
- ✦ Implement adequate financial analysis within financial reports and computerise information analysis to improve quality and timeliness of financial and activities data.

Risk

Risk Management is rated "d"

Procedures and internal controls

- ✦ The institution's formalized financial and credit policy documents incorporate concise internal control procedures related to their associated activities. They outline a clear segregation of duties as well as control, verification and reconciliatory processes for all cash related and loan transactions.
- All concerned board members and management staff demonstrates a clear understanding of the above internal controls and endeavour to consistently apply them. An isolated case in 2005 regarding approval of a 10M UGS loan by the credit committee (exceeding the set loan ceiling of the institution) highlighted the need to ensure complete enforcement of controls to prevent a re-occurrence of the same.
- Controls regarding the verification of "savings" clients' identity remain inadequate, particularly where photos are unavailable on pass-cards for transactions that involve routine use of thumb-prints.
- Cash is physically secure both at the branch and during transportation to and from the bank; the maximum cash limit at the branch is 10M and the institution has a cash insurance policy with Leeds Insurance Co. (nevertheless this limit has been knowingly exceeded on a few occasions).

Internal audit

- A voluntary Supervisory committee, charged with the internal audit function, is present and endeavors to carry out its duties as evidenced by a few Internal Audit reports to the board.
- The present committee is however largely deficient both in the experience and skill of performing general audit functions. This is further compounded by their lack of concrete awareness of the institution's key control guidelines and results in a clearly inadequate and poor audit system within the Mutara SACCO.
- Present external audits done by the Co-operatives Office do not add any quality to the internal audit function as they are incomprehensive and thus unable to identify potential flaws or authenticate financial the figures.

Areas for improvement:

- ✦ Institute a formalised induction process and operations manual for the supervisory committee to facilitate proper and complete functioning of the IA department.
- ✦ Develop more comprehensive client verification procedures to address present flaws among savings' clients.
- ✦ Seek better qualified external auditors to ensure that the internal audit process is complimented by the latter.

■ Activities

Activities: products and services is rated “d”

	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006
Loan portfolio (USD)	18,932	35,300	40,490	49,267
Loan portfolio (K UGS)	36,671	60,997	73,733	87,990
Change (%)	91.2%	66.3%	20.9%	19.3%
Av. outstanding gross loan portfolio	14,137	27,214	40,867	45,275
Nb. of active borrowers	133	142	125	149
Change (%)	18.8%	6.8%	(12.0%)	19.2%
Average outstanding loan per client	142	249	324	331
Average amount disbursed	164	304	429	367
PAR 31-365*	NA	NA	31.5%	10.9%
PAR > 365*	NA	NA	0.0%	0.0%
Write-off ratio	0.0%	0.0%	1.7%	1.5%

* PAR data not available for FY 2004 and 2005.

Marketing and competition

- Bushenyi district’s microfinance sector is highly competitive, particularly in urban the areas. There has been a sustained influx of formal financial institutions such as Centenary Rural Development Bank, Stanbic Bank, PRIDE-Uganda and UGAFODE among others. Nevertheless within the rural areas competition presently remains largely restricted to the SACCOs, most of which thrive on their proximity to the rural populace.
- Vis-à-vis its competitors, Mutara Development SACCO perceives its key strengths as the lower borrowing costs (overall) and prompt service delivery, particularly to the rural clientele. This perception remains questionable as most SACCOs in the area charge almost similar loan fees and even lower interest fees in some cases. Furthermore, the institution’s marketing remains vague with no clear strategies besides a few ad hoc responses to counter marketing campaigns by its competitors.
- The trend indicates that formal financial institutions like banks and MDIs are beginning to aggressively penetrate areas previously regarded as strongholds of the SACCOs. This is likely to erode the presently slack competitive advantages enjoyed by SACCOs including Mutara unless they adopt better and more comprehensive marketing techniques.

Credit methodology/Portfolio management

- ✚ Mutara Development SACCO has a formalized (and recently reviewed; 2006-2010) credit policy manual that clearly spells out the loan application, appraisal and approval procedures as well as requirements for the various loan products offered by the institution. All concerned staff displays adequate awareness of the above policies and endeavor to apply them.
- ✚ The institution has further benefited from an improved portfolio management methodology through its

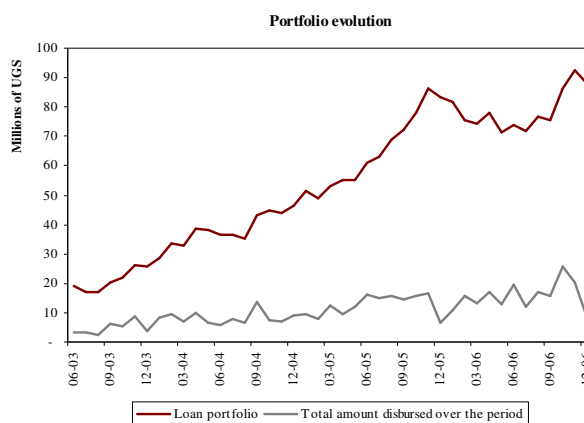
partnership with the Microfinance Support Centre Limited to which it reports bi-monthly. This has enabled better portfolio monitoring and delinquency tracking through the use of appropriate reporting tools.

- Delinquency management has improved as the institution has also recently adopted a strategy to utilize the services of court brokers to supplement the recovery efforts of the loan committee, particularly in the difficult cases involving loans above 2 M UGS.
- The loan officer’s has adequate appraisal and monitoring skills, experience as well as a good knowledge of the local area in which the institution operates.
- Nevertheless the present credit analysis methodology remains significantly weak in terms of analysis of viability and debt capacity of a business. Generally there is a stronger reliance on collateral and personal guarantors rather than client repayment capacity.

Quality of the portfolio

- Mutara does proper calculation of its PAR based on portfolio aging and standard best practices in microfinance. However the institution does not include rescheduled loans in the above indicator despite actively carrying out the practice particularly in 2006.
- PAR 31-365 went down to 10.9% in Dec. 2006 from 31.5% in June 2006 mainly as a result of loan rescheduling and write-off that catered for a combined 13.1% of the total portfolio as at Dec. 2006, although during 2006 the institution also endeavoured to implement tighter portfolio monitoring.
- PAR 31-365 remains reasonably high, despite write-off and loan re-scheduling in June 2006 indicating that portfolio management, particularly client appraisal and delinquency follow-up have to be improved.
- ✚ The institution has a formalized write-off policy that has been applied since the FY2005-06.

Portfolio composition and evolution



- Mutara’s portfolio grew steadily between 2003 - 2005 before experiencing a decline and unstable growth

trends during the FY2005/06. The latter was in part due to a reduction in the numbers of approved loans as well as poor portfolio performance that led to a number of loans being rescheduled and written off.

- The reduction in portfolio size as a result of slower disbursements experienced in Dec. 2005 was an effect of limited funds available for on-lending by the institution that had to be countered by accessing funding through MSCL. The same strategy is likely to be adopted following a similar scenario in Dec. 2007 (see Financing and liquidity).
- Overall Mutara’s portfolio is expected to experience a slow down in growth during the FY2006-07 and even a reduction in size should the institution fail to maintain its recently improved portfolio management techniques.

Portfolio diversification

- Mutara SACCO does not have a specific portfolio diversification policy. It has attempted to vary the nature and composition of its target clientele in addition to the economic activities supported (as spelt out in its credit policy).
- The institution avails production and consumption loans to groups and individuals that include salaried employees, business people, farmers and micro-entrepreneurs. The institution also has a policy in place to prevent the risk of over-exposure to a single borrower.
- There remains a need to clearly assess the levels of risk involved within each category of clients and economic activity to avoid over-concentration of risk in one particular area.

Credit risk coverage

	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006
Risk coverage ratio (%)	N/A	N/A	36.4	9.8
PAR 31 net of loan loss provision / Equity (%)	(0.0)	(8.4)	31.1	16.3

- The credit risk coverage is poor at only 9.8% despite the existence of a provisioning policy, contained within the institution’s credit manual.
- Although the above policy spells out a provisioning methodology based on proper aging of the loan portfolio, there is no provision for rescheduled loans (a practice that was actively carried out by the institution in the FY2005/06).
- The institution also has in place a systematic application of guarantors and collateral to cover loans, particularly production loans. The use of collateral, particularly fixed assets, in the recovery of defaulted loans has been successful to a larger extent although a few cases have proven difficult in the past. Consequently, court brokers were recently contracted to ease the above.

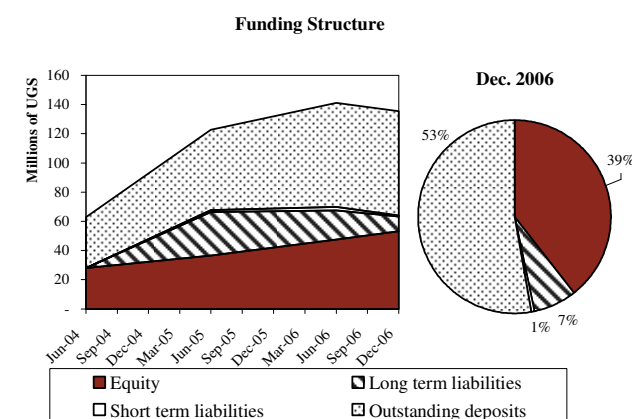
Savings Activities

	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006
Outstanding deposits (USD)	NA	33,087	39,222	39,606
Outstanding deposits (k UGS)	NA	57,173	71,422	70,736
Change (%)	NA	NA	24.9%	(1.0%)
Number of depositors	515	594	707	782

- Mutara’s outstanding deposits have grown over the last three years albeit at a declining rate. This trend is likely to continue as the level of deposits drops further, unless the institution embarks on a savings mobilization campaign. The latter will soon become a necessity with the increasingly competitive microfinance sector in the region which will necessitate more aggressive marketing to attract new clients (and retain old ones).
- The continued decline in fixed deposits (down to 20.6% of total outstanding deposits in Dec. 2006, from 26.3% in June 2006) means that Mutara is steadily losing its principal source of stable funding which will no doubt have a negative effect on the institution’s ability to grow its loan portfolio (as earlier mentioned). There is need to encourage more fixed deposits to ensure the portfolio growth is not hampered by limited availability of reliable funding (see Financing and liquidity below).

Financing and liquidity

Funding and liquidity is rated “c”



	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006
Liabilities / Equity	1.25x	2.37x	1.97x	1.54x

Financing strategy

- + Mutara’s capital structure displays diversified mix of funding sources for its activities including outstanding client deposits that comprise 53%, equity at 39% and long term borrowings at 7% as at Dec. 2006.
- + The institution has maintained a good relationship with its main funding partner MSCL since accessing a 30 M UGS loan in May 2005 and at the time of this report another loan worth 20M UGS had just been acquired

from the same lender which is likely to further strengthen its capital structure and afford more funding options.

- The institution is lowly leveraged, at approximately 1.5x its equity as of December 2006; this is expected to increase after the successful negotiation for additional funding from MSCL.
- The reducing levels of fixed deposits (which stood at 11% in Dec. 2006) highlight the need for Mutara to reinvigorate this typically stable source of funding and avoid a potential over-dependency on external loans.

Asset and liability management

Asset and liability management (ALM) risks are present but remain limited.

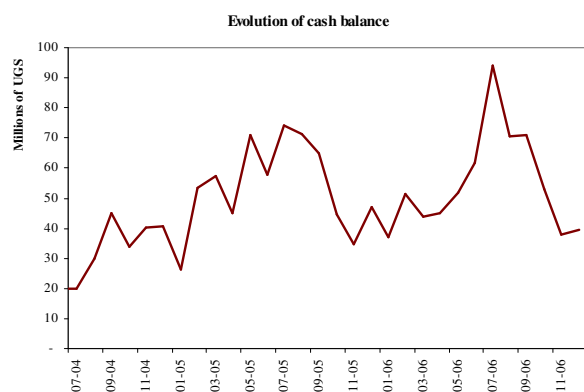
- **Limited but present maturity risk:** A greater portion of Mutara's funding is derived from outstanding client deposits (predominantly volatile short term demand deposits). This poses a potential maturity risk as the average portfolio term is 8 months. Nevertheless, the institution continues access long-term loans (24 months) from MSCL, thus considerably reducing maturity risks.

+ Limited interest rate risk: Mutara's main funder uses fixed interest rates on its loans, although bi-annual reviews are done based on the prevailing inflation rate in the country. Infrequently, very marginal changes may occur as a result of changes in inflation although the short term nature of Mutara's portfolio potentially allows it to re-adjust its loan pricing accordingly.

+ No FX risk: Mutara has not borrowed or issued any loans in foreign currency.

Liquidity management

- Besides having a policy on minimum liquidity reserves, Mutara's other liquidity management practices are ad hoc and neither formalized nor based on comprehensive cash flow projections.
- The institution experiences erratic liquidity levels and resource optimization remains poor. Limited funding has twice been blamed for slow disbursements despite periods of high liquidity and occasional idle cash.



Efficiency and Profitability

Efficiency and Profitability is rated "d"

Profitability analysis	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006*
ROE	27.5%	12.8%	4.4%	12.4%
Liabilities / Equity	1.25x	2.37x	1.97x	1.54x
ROA	11.8%	4.4%	1.4%	4.5%
Profit generation				
Operational self-sufficiency	135%	113%	111%	113%
Portfolio Yield	71.2%	66.6%	65.0%	56.1%
Operating expense ratio	51.1%	41.9%	44.1%	50.9%
Staff productivity	44	47	25	30
Loan officer productivity	133	142	125	149
Avg out loan/ client (USD)	142	249	324	331
Funding expense ratio	10.4%	15.0%	9.3%	6.3%
Cost of savings	9.8%	15.0%	4.4%	14.0%
Cost of liabilities	0.0%	0.0%	15.5%	13.7%
LLP expense ratio	0.0%	6.5%	8.9%	(0.8%)
PAR31 – 365	0.0%	0.0%	31.5%	10.9%
Write-off ratio	0.0%	0.0%	1.7%	1.5%
Asset management				
Out LP / Assets	58.4%	47.2%	46.3%	64.4%
Non-portfolio income as a % of financial revenues	0.0%	0.0%	0.0%	0.0%

*Dec. 2006 figures are pre-tax and devoid of a number of "end-year" financial calculations; profitability data is not reliable as is.

Overview of the profitability

Mutara's overall profitability shows a declining trend over the last three years (with both ROE and ROA indicating steady declines). This is expected to continue into the FY2006/07 albeit the Dec. 2006 figures, considering that the latter's net operating incomes are pre-tax and depreciation was not even indicated for the period.

Portfolio yield and effective interest rate

Mutara's average effective interest rate lies around 64% and its steadily declining portfolio yield currently stands at 56.1%. The above indicates a substantial yield gap that is progressively increasing thus highlighting a poorly performing portfolio as evidenced by the arrears rates and amount of re-scheduled loans over the last six months.

Operating expense ratio

The OER continued to increase into the FY2006/07 and is considerably high, currently lying at 50.9%. This figure illustrates the institution's failure to control and reduce operating costs (including personnel and administrative) despite achieving both productivity and asset deployment gains.

Funding expense ratio

At 6.3% Mutara's FER is determined fundamentally by its external borrowings and to a lesser extent by the amounts of outstanding deposits (specifically the short-term fixed deposits), both of which make up its funding liabilities. The current funding ratio is shortly expected to increase as the institution is in the latter stages of acquiring another 20 M UGS loan from MSCL.

Loan loss provision expense ratio

Mutara adopted and actively implemented a proper provisioning methodology in 2006 which explains the sudden increase in the LLP ratio. Nevertheless the Dec. 2006 figure is understated as the previously adopted policy was not properly adhered to, which was in turn resulted in the particularly low credit risk coverage ratio. The LLP ratio is expected to be substantially higher under the correct provisioning, especially if both the re-scheduled and late loans are properly provisioned for.

Asset management

Mutara's asset management improved during the first half the FY2006/07 with the institution's assets in its loan portfolio increasing from 46.3% to just over 64%. This level is considerably good for a SACCO but can be improved, and sustained, through more systematic and effective asset deployment mechanisms (particularly liquidity management) as only about 4.6% of the total asset base is tied up in fixed assets.

Profitability outlook

Mutara's profitability outlook is by and large negative based on the trends in key profitability and efficiency indicators. The continued decline in portfolio yield (margin pressure) combined with the steadily increasing OER, if not reversed, will lead to decline in profitability. Furthermore, the LLP ratio, if correctly employed is expected to be higher and further increase as a result of the poor portfolio performance. Overall, unless the institution embraces and actively implements the recently adopted portfolio and delinquency management techniques (in addition to adopting better cost controls) it is highly unlikely that this outlook will change for the better.

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

Factors	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+ 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.

■ Annexes

MUTARA DEV'T SACCO Income Statement	UGS				USD				Evolution		
	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006	2005/2004	2006/2005	2006/2006
Financial Revenue (a)	22,851,750	33,898,332	51,686,679	25,862,900	11,797	19,617	28,384	14,481	10.5%	44.1%	(43.2%)
Financial Revenue from Loan Portfolio	19,485,075	31,336,207	48,399,280	22,628,200	10,059	18,134	26,578	12,670	3.1%	60.1%	(43.6%)
Interest on Loan Portfolio	15,401,200	25,007,900	36,236,500	17,085,200	7,951	14,472	19,899	9,566	1.7%	55.1%	(44.9%)
Fees and Commissions on Loan Portfolio	3,508,425	5,946,547	12,162,780	5,249,800	1,811	3,441	6,679	2,939	27.6%	119.9%	(32.4%)
Penalty Revenue on Loan Portfolio	575,450	381,760	-	293,200	297	221	-	164	(100.0%)	-	-
Financial Revenue from Investments	-	-	-	-	-	-	-	-	(100.0%)	-	(100.0%)
Other Operating Revenue	3,366,675	2,562,125	3,287,399	3,234,700	1,738	1,483	1,805	1,811	37.1%	(0.7%)	(39.6%)
Financial Expense (b)	2,850,850	7,030,750	6,884,557	2,542,016	1,472	4,069	3,781	1,423	19.9%	8.5%	(44.4%)
Interest paid on borrowings	-	-	3,870,157	1,029,166	-	-	2,125	576	(85.4%)	(100.0%)	-
Interest paid on deposits	2,850,850	6,765,850	2,757,700	1,247,850	1,472	3,915	1,514	699	86.9%	15.8%	(40.7%)
Net Inflation Adjustment Expense	-	-	-	-	-	-	-	-	-	-	-
Other Financial Expenses	-	264,900	256,700	265,000	-	153	141	148	104.9%	(2.1%)	(84.8%)
Financial income [c=a-b]	20,000,900	26,867,582	44,802,122	23,320,884	10,326	15,548	24,603	13,058	8.4%	52.9%	(42.9%)
Net Loan Loss provision expense (d)	-	3,049,891	6,631,801	(308,000)	-	1,765	3,642	(172)	-	-	-
Loan loss provision expense and write-off	-	-	3,049,891	6,631,801	-	-	1,765	3,642	-	-	-
Recovery from Loans written off	-	-	-	308,000	-	-	-	172	-	-	-
Operating expense (e)	13,990,750	19,711,015	32,814,900	20,512,187	7,223	11,407	18,020	11,485	55.9%	11.5%	(40.1%)
Personnel Expense (includes fringe)	5,543,100	8,788,050	14,218,850	10,266,750	2,862	5,086	7,808	5,748	40.4%	21.2%	(33.0%)
Administrative Expense (non-staff operating expenses)	8,447,650	10,922,965	18,596,050	10,245,437	4,361	6,321	10,212	5,737	78.7%	0.3%	(50.2%)
Depreciation and amortization	751,300	838,775	2,020,108	-	388	485	1,109	-	55.4%	29.7%	(27.3%)
Consulting fees	360,000	543,200	422,400	140,000	186	314	232	78	26.9%	28.1%	(100.0%)
Stationary	1,525,250	533,750	1,654,950	2,300,450	787	309	909	1,288	9.6%	(22.7%)	(100.0%)
Rent	1,200,000	1,200,000	1,200,000	500,000	620	694	659	280	14.1%	(33.3%)	(100.0%)
General Office Expenses	1,068,100	1,397,950	6,041,850	2,757,850	551	809	3,318	1,544	(90.0%)	(100.0%)	-
Membership Fees	671,900	914,000	205,000	311,250	347	529	113	174	(28.6%)	57.1%	(100.0%)
Seed Capital Application	1,349,100	1,609,950	-	100,000	696	932	-	56	(1.1%)	0.0%	(100.0%)
Insurance & Recovery Costs	768,450	1,326,040	4,335,842	1,834,487	397	767	2,381	1,027	6.3%	5.9%	(100.0%)
AGM	458,950	984,300	948,850	1,409,400	237	570	521	789	(94.9%)	193.9%	(100.0%)
Others	294,600	1,575,000	1,767,050	892,000	152	911	970	499	571.5%	(0.3%)	(26.3%)
Net Operating Income Before Taxes and Donations [f=c-d-e]	6,010,150	4,106,676	5,355,421	3,116,697	3,103	2,377	2,941	1,745	1,745	(1,524.4%)	(57.4%)
Income Taxes (g)	-	-	3,512,764	-	-	-	1,929	-	-	-	-
Net Operating Income Before Donations [h=f-g]	6,010,150	4,106,676	1,842,657	3,116,697	3,103	2,377	1,012	1,745	(110.2%)	(1,524.4%)	(57.4%)
Non Operating Revenue (i)	-	-	-	-	-	-	-	-	-	-	-
Non Operating Expense (including related taxes) (j)	-	-	-	-	-	-	-	-	-	-	-
Net Income Before Donations [k=h+i-j]	6,010,150	4,106,676	1,842,657	3,116,697	3,103	2,377	1,012	1,745	(110.2%)	(1,524.4%)	(57.4%)
Donations (l)	-	-	-	-	-	-	-	-	-	(64.8%)	(100.0%)
Net Income (after Taxes and Donations) [m=k+l]	6,010,150	4,106,676	1,842,657	3,116,697	3,103	2,377	1,012	1,745	(27.3%)	140.6%	(64.5%)

MUTARA DEV'T SACCO Balance sheet	UGS				USD				Evolution		
	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006	Jun. 2004	Jun. 2005	Jun. 2006	Dec. 2006	2005/2004	2006/2005	2006/2006
ASSETS	62,755,881	122,769,490	141,131,965	135,279,039	32,398	71,047	77,502	75,744	95.6%	15.0%	(4.1%)
Short Term Assets	58,199,894	117,252,478	135,235,061	128,941,135	30,046	67,854	74,264	72,195	101.5%	15.3%	(4.7%)
Cash and Due from Banks	19,838,473	57,835,542	61,678,183	39,467,726	10,242	33,470	33,871	22,098	191.5%	6.6%	(36.0%)
Short Term Investments	-	-	100,000	100,000	-	-	55	56	-	-	0.0%
Short Term Net Loan Portfolio	36,671,421	57,947,936	65,279,457	87,054,770	18,932	33,535	35,848	48,743	58.0%	12.7%	33.4%
Short Term Gross Loan Portfolio (Loan Loss Reserve)	36,671,421	60,997,827	73,733,200	87,990,800	18,932	35,300	40,490	49,267	66.3%	20.9%	19.3%
Interest Receivable	-	3,049,891	8,453,743	936,030	-	1,765	4,642	524	-	177.2%	(88.9%)
On loan portfolio	-	-	-	-	-	-	-	-	-	-	-
On investments	-	-	-	-	-	-	-	-	-	-	-
Accounts receivable and other assets	1,690,000	1,469,000	8,177,421	2,318,639	872	850	4,491	1,298	(13.1%)	456.7%	(71.6%)
Long term assets	4,555,987	5,517,012	5,896,904	6,337,904	2,352	3,193	3,238	3,549	21.1%	6.9%	7.5%
Long Term Net Investments	-	-	-	-	-	-	-	-	-	-	-
Long Term Gross Loan Portfolio	-	-	-	-	-	-	-	-	-	-	-
Net Fixed Assets	4,555,987	5,517,012	5,896,904	6,337,904	2,352	3,193	3,238	3,549	21.1%	6.9%	7.5%
Other Long Term Assets	-	-	-	-	-	-	-	-	-	-	-
LIABILITIES AND EQUITY	62,755,881	122,769,490	141,131,965	135,279,039	32,398	71,047	77,502	75,744	95.6%	15.0%	(4.1%)
Liabilities	34,907,317	86,351,250	93,722,068	82,059,913	18,021	49,972	51,467	45,946	147.4%	8.5%	(12.4%)
Short term liabilities	34,907,317	56,351,250	73,722,069	72,059,916	18,021	32,611	40,484	40,347	61.4%	30.8%	(2.3%)
Demand Deposits	20,067,317	41,529,709	52,610,842	55,511,952	10,360	24,033	28,891	31,082	107.0%	26.7%	5.5%
Compulsory Deposits	-	-	-	-	-	-	-	-	-	-	-
Short Term Time Deposits	14,840,000	13,534,000	18,812,000	15,732,000	7,661	7,832	10,331	8,809	(8.8%)	39.0%	(16.4%)
Short Term Borrowings	-	-	-	-	-	-	-	-	-	-	-
Interest payable	-	-	-	-	-	-	-	-	-	-	-
Accounts Payable and Other Short Term Liabilities	-	1,287,541	2,299,227	815,964	-	745	1,263	457	-	78.6%	(64.5%)
Long term liabilities	-	30,000,000	19,999,999	9,999,997	-	17,361	10,983	5,599	-	(33.3%)	(50.0%)
Long Term Time Deposits	-	-	-	-	-	-	-	-	-	-	-
Long Term Borrowings	-	30,000,000	19,999,999	9,999,997	-	17,361	10,983	5,599	-	(33.3%)	(50.0%)
Other Long Term Liabilities	-	-	-	-	-	-	-	-	-	-	-
Equity	27,848,564	36,418,240	47,409,897	53,219,126	14,377	21,075	26,035	29,798	30.8%	30.2%	12.3%
Paid-In Capital	16,365,000	22,768,000	35,813,000	40,329,000	8,449	13,176	19,667	22,581	39.1%	57.3%	12.6%
Donated equity	4,900,000	6,000,000	6,000,000	6,000,000	2,530	3,472	3,295	3,359	22.4%	0.0%	0.0%
Retained earnings without donations and reserves	6,010,150	4,245,343	1,823,468	3,116,697	3,103	2,457	1,001	1,745	(29.4%)	(57.0%)	70.9%
Current year	6,010,150	4,106,676	1,842,657	3,116,697	3,103	2,377	1,012	1,745	(31.7%)	(55.1%)	69.1%
Other equity accounts	573,414	3,404,897	3,773,429	3,773,429	296	1,970	2,072	2,113	493.8%	10.8%	0.0%