

## Poverty Eradication and Community Empowerment, Ethiopia

Poverty Eradication and Community Empowerment (PEACE) was set up as a Share Company in 1999 and begun operations in August 2000. Its operations span 3 regional states of Ethiopia namely Amhara, Oromia and the Southern Nations and Nationalities Peoples Regional States (SNNPRS). In total, PEACE operates 14 branches mainly in the rural areas with a clear focus on women as the target market. PEACE offers both loan and savings products and as at 31 December 2006, outstanding loans stood at 2.9 M USD with 19,260 active clients.

### GIRAFE Rating

Rating

**B-**

Outlook

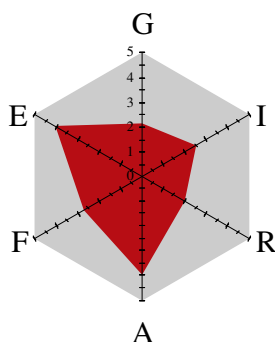
**Stable**

Date of the rating

**September 2007**

Valid until August 2008

Rating per evaluation area



Governance – Information – Risk –  
Activities – Funding – Efficiency

#### Planet Rating Contact

Alex Kalimugogo

[akalimugogo@planetrating.com](mailto:akalimugogo@planetrating.com)

+256 414 236 745

#### MFI Contact

Tezera Kebede, Executive Director

[peace@ethionet.et](mailto:peace@ethionet.et)

+251 11 652 5541

REF: AK/081007

#### Rating highlights

- Excellent portfolio quality thanks to appropriate client selection, thorough appraisal and quick delinquency management (PAR>31 of 0.3% as at Dec. 2006).
- Very high profitability (ROE and ROA of 34.5% and 9.4%, respectively at end 2006) underpinned by both strong cost control and important under-investments.
- Good competitive posture based on a robust local demand; excellent growth potential, but faster growth will greatly stretch current HR and MIS capacity.
- Competent senior management, but middle management team needs serious boost in both number and capacity building; staff turnover is still a major issue.
- Vulnerable to fraud and compliance risks due to insufficient internal audit resources and skills set; current set up does not guarantee necessary independence.
- Important key-person risk at the MIS developer level (i.e. one-man operation, no local technical support) in addition to inadequate MIS infrastructure.
- Low risk, but underdeveloped capital structure; no material ALM risks; funding sources are still mostly concessional; yet to develop a coherent funding strategy.

#### Outlook

- Stable profitability outlook based on expectations of continued tight portfolio management practices and cost controls; future sustainable growth will depend on PEACE's ability to make much-needed investments in MIS, HR and Risk Management despite the potential short-term negative, but limited impact on profitability.

#### Performance indicators

| USD , unless otherwise stated | Dec. 2003 | Dec. 2004 | Dec. 2005 | Dec. 2006 | Jun. 2007 |
|-------------------------------|-----------|-----------|-----------|-----------|-----------|
| Assets                        | 872,327   | 1,275,170 | 2,209,422 | 3,211,928 | 3,463,490 |
| Growth                        | 25.7%     | 46.7%     | 71.5%     | 51.3%     | 9.3%      |
| Loan portfolio                | 588,758   | 869,780   | 1,795,929 | 2,983,327 | 3,249,443 |
| Growth                        | 53.9%     | 48.2%     | 104.4%    | 72.9%     | 10.4%     |
| Outstanding deposits          | 134,389   | 217,114   | 396,403   | 661,198   | 767,451   |
| Growth                        | 53.7%     | 62.1%     | 80.7%     | 73.7%     | 17.6%     |
| Active borrowers              | 5,428     | 7,766     | 13,728    | 19,260    | 19,809    |
| Active savers                 | 5,896     | 8,458     | 14,369    | 20,552    | 21,489    |
| Staff                         | 41        | 61        | 68        | 77        | 84        |
| ROE                           | (6.5%)    | 16.2%     | 1.1%      | 34.5%     | 35.7%     |
| ROA                           | (2.7%)    | 7.0%      | 0.4%      | 9.4%      | 10.0%     |
| Liabilities / Equity          | 1.37x     | 1.27x     | 2.60x     | 2.73x     | 2.41x     |
| Portfolio Yield               | 16.8%     | 30.6%     | 16.9%     | 22.4%     | 22.0%     |
| Operating expense ratio       | 20.5%     | 18.6%     | 12.8%     | 8.5%      | 6.8%      |
| PAR 31-365                    | 0.2%      | 0.1%      | 0.0%      | 0.3%      | 0.6%      |
| PAR > 365                     | 0.0%      | 0.1%      | 0.1%      | 0.1%      | 0.1%      |
| Write-off ratio               | 0.0%      | 0.0%      | 0.0%      | 0.0%      | 0.0%      |

## Microfinance sector

The Ethiopian microfinance sector is relatively young but has grown rapidly in recent years. Informal microfinance (including informal group-based credit associations) and NGO credit programs have existed for many years. In 1996 the Government introduced a legal framework intended to professionalize the industry and encourage sustainability through the Proclamation 40/1996. In addition to a minimum capital requirement, reporting requirements and annual inspection by the National Bank of Ethiopia (NBE), the law specifically endorses deposit mobilization, which is a primary source of funds for the sector. Although the law presented some limitations at inception, much progress has been made to improve it, like the liberalization of interest rates on loans, the softening of the cap of loans (established first at 5,000 ETB, around 550 USD) and the possibility to offer loan products different from group loans. In this context, Ethiopian MFIs have made impressive strides in their financial and operational performance with a focus on increased efficiency and sustainability.

As of December 2006, 28 MFIs licensed by the NBE served approximately 1.5 million clients through more than 500 branches and sub-branches and account for 3% of total financial sector assets. However, the industry is heavily concentrated in six large MFIs affiliated to regional governments. These MFIs are among the largest in Africa - the largest, ACSI, serving as many as 500,000 borrowers - and representing over 80% of both sector assets and total clients. The remaining MFIs, with a few exceptions, are generally linked to indigenous or international NGOs. Savings and Credit Cooperative Organizations (SACCOs) also play a large role in the provision of financial services. The approximately 700 SACCOs operating in Ethiopia are usually urban, employee-based cooperatives<sup>1</sup>.

In general, Ethiopian MFIs serve both urban and rural areas. Although the outreach of the government-supported MFIs is broader, NGO MFIs and new WOCCU-supported rural SACCOs have made efforts to increase rural outreach. The range of products offered by regulated MFIs is limited, but some government supported MFIs have begun to offer products other than credit and savings, including payment and remittance services. Government-supported MFIs also offer agricultural input supply loans using government credit lines. These loans have been criticized by international donor and NGO partners as constituting inappropriate government influence in competition.

Both bilateral and multilateral donor agencies are active in the Ethiopian microfinance sector, offering funding and technical assistance. Donors include the World Bank, the EU, IFAD, ADB, UNDP and SIDA. In addition, international NGOs provide technical assistance and funding, including CARE, Save the Children, Catholic Relief Services. The sector has been strongly supported in the previous years by the Rural Financial Intermediation Program (RUFIP), financed by IFAD, ADB, Development Bank of Ethiopia and Government of Ethiopia. The program includes a package of almost 95 M USD broken down in various components of capacity building, grants, equity and credit funds for a period of seven years. The industry benefits from a very dynamic national network organization, the Association of Ethiopian Microfinance Institutions (AEMFI), which serves as a channel for policy dialogue and a driver of industry transparency.

Despite the rapid growth of the Ethiopian microfinance sector and the large scale of the dominant MFIs, there is still a huge gap between supply and demand. Access to finance is still primarily through informal means. Current estimates indicate that microfinance providers meet just 10-12% of demand, and rural areas, which constitute more than 80% of the 70 million Ethiopians, are particularly underserved<sup>2</sup>. Other challenges include the ongoing reliance on and influence of the Government on the largest institutions and the heavy concentration of the industry in these institutions. The remaining market remains fragmented among smaller and weaker MFIs. The regulatory framework still has some scope to improve: loan loss provisioning methods are not very conservative, accounting standards are not sufficiently regulated and supervisory visits tend to concentrate only on the largest institutions. Finally, the lack of liberalization of the financial markets means that foreign participation and direct lending from foreign sources in MFIs is forbidden, leading to growth limitations for private institutions. The current negotiation for the entrance of Ethiopia in the World Trade Organization (WTO) is expected to solve this problem.

| Name         | Active clients   | Outs. portfolio (M USD) | Outs. deposits (M USD) |
|--------------|------------------|-------------------------|------------------------|
| ACSI         | 515,686          | 75.3                    | 40.1                   |
| DECSI        | 392,693          | 82.1                    | 22.0                   |
| OCSSCO       | 181,403          | 25.5                    | 9.1                    |
| OMO          | 106,460          | 12.5                    | 5.6                    |
| ADCSI        | 83,000           | 15.6                    | 4.8                    |
| PEACE        | 19,260           | 2.98                    | 0.66                   |
| Others       | 238,911          | 28.9                    | 7.8                    |
| <b>Total</b> | <b>1,518,153</b> | <b>239.9</b>            | <b>89.4</b>            |

Source: AEMFI, data as of December 2006

<sup>1</sup> *Short Study on Microfinance, Ethiopia*. February 2003, background documents country strategy 2003-2007, Jennefer Sebstad.

<sup>2</sup> *Regulating Microfinance in Ethiopia*, Gobezi: 2005.

## Political & economic environment

After the high agriculture production of 2005, growth maintained a reasonable level in 2006, but was still insufficient to reduce the widely spread poverty (Ethiopia was ranked 170 out of 177 countries in the 2006 Human Development Index of UNDP). Additionally, the various infrastructure works launched in rural areas (roads, electricity) have contributed to boost the economy and should enable the development of the country in the long run. The economy remains very vulnerable to climate hazards, reducing the capacity to forecast for 2007. Inflation remains high and the national balances are heavily negative. Social and capital investments impact the public budget and State companies, while the tax base is still very narrow. The dramatic increase of exports (coffee, oleaginous, gold) is however inferior to that of imports (mainly oil). Although debt cancellations granted within the HIPC and MDRI frameworks will reduce the financing needs of the country, these will remain high and will need to be covered by international cooperation. However, the political evolutions could threaten international support. The domestic situation is characterized by the consequences of the strong repression of post-electoral demonstrations in June and November 2005, which led to the decapitation of opposition and the revival of ethnic pressure in various regions. In addition to that, the border disagreement with Eritrea is not resolved, and there is a risk that the war will resume. Since the summer of 2006, the risk of a generalized conflict in the Horn of Africa has increased with the deterioration of the situation in Somalia, where Ethiopian military support to the provisional government has triggered war declarations from Islamic militias that control most of the Somalia territory.

**Country Rating:** C - A very unsteady political and economic environment could deteriorate an already bad payment record.

| (USD millions)                                      | 2004   | 2005   | 2006<br>(e) | 2007<br>(f) |
|---|--------|--------|-------------|-------------|
| Economic growth (%)                                 | 11.1   | 8.8    | 5.2         | 5.4         |
| Inflation (%)                                       | 8.6    | 6.8    | 10.5        | 8.0         |
| Public sector balance<br>(%GDP)                     | -10.2  | -10.7  | -10.7       | -11.1       |
| Exports   | 600    | 818    | 1,044       | 1,139       |
| Imports   | 2,587  | 3,633  | 4,047       | 4,215       |
| Trade balance                                       | -1,987 | -2,815 | -3,033      | -3,076      |
| Current account balance<br>(%GDP)                   | -10.9  | -15.8  | -13.1       | -10.8       |
| Foreign debt (%GDP)                                 | 76.0   | 53.8   | 47.4        | 14.7        |
| Debt service (%G&S<br>exports)                      | 11.4   | 6.9    | 2.8         | 2.8         |
| Foreign currency reserves (in<br>months of imports) | 5.0    | 4.2    | 3.1         | 3.3         |

Source: COFACE's Country Risk Ratings Guidebook 2007. (e) is estimated and (f) forecasted.

Disclosure Statement: Data is provided with authorization from COFACE - a shareholder of Planet Rating.

## Institutional presentation

### Legal form, supervision and audit

PEACE MFI was established in 1999 by an NGO called Agri-Services Ethiopia (ASE), following a proclamation by the Ethiopian Government which banned NGOs from extending financial outreach services. PEACE is registered as a Share Company and a non-bank financial institution (NBF) under the terms of Proclamation 40/1996. The supervisory body of PEACE is the National Bank of Ethiopia (NBE) through its Micro-Finance Supervision Department. Such supervision includes the adherence to regulatory norms, monthly, quarterly and yearly reporting, and inspection visits. NBE presented a comprehensive inspection report on December 6 2005. PEACE was audited by Degefa Lemesa & Co. between 2002 and 2005. The accounts were certified with unqualified opinions for all years. Currently, PEACE is audited by TAY & Co.

### Ownership

PEACE is owned by ASE and fourteen other individuals, most of whom have links with ASE. PEACE has a subscribed and paid up capital of 400,000 ETB and 200,000 ETB respectively. It is noted that all shareholders waived ownership rights to PEACE as an entity and thus can only transfer shares (not sell) to other local parties or individuals of similar (social) goals.

### Donations

Donations since 2000 amount to 9 M ETB and originate mainly from Netherlands Organization for Development Cooperation (NOVIB), Ethio-Italy Arsi Bale Rural Development Project (ABRDB), ASE and Rural Finance Intermediation Program (RUFIP). NOVIB has been the principal source of donations contributing 7.3 M ETB between 2000 and 2006. RUFIP contributed 0.09 M ETB in donations, while ABRDB and ASE contributed 1.1 M ETB and 0.4 M ETB, respectively.

### Funding composition

Long-term concessional loans from RUFIP (funded by World Bank, Africa Development Bank and IFAD) and NOVIB together make up 38% of the total funding structure as at end of June 2007. As at the end of December 2006, long-term loans from RUFIP amounted to 6.5 M ETB to be paid back in 12 years at an interest rate of 6%. NOVIB lent 4.3 M ETB in loans to be paid back in 3 years at an interest rate of 8%. PEACE pays back NOVIB by sending installments to other NOVIB-supported Ethiopian NGOs, therefore respecting NBE's prohibition from remitting hard

currency outside Ethiopia. PEACE also has access to a revolving fund from ABRDB amounting to 2.66 M ETB.

## Management team

The current management team of PEACE consists of the Executive Director (ED), the Finance and Administration Manager (FAM) and the Operations Manager (OM). The post of OM had been vacant for a few months in 2007 but a replacement was identified and hired in September 2007. The ED, Tezera Kebede, joined PEACE in 2000 in his current position and has extensive practical experience in the MFI sector. Prior to joining PEACE, he worked as a Branch Manager of Wisdom MFI in Ethiopia. M. Kebede has a Bachelor of Economics Degree from Addis Ababa University and an Associates Bachelors Degree in Microfinance from Uganda Martyrs University. He is currently pursuing an MBA from Indira Gandhi Open University. M. Kebede has also undertaken a number of short-term courses and is a certified trainer of the CGAP course “Skills for Microfinance Managers”.

## Organization

PEACE currently operates 14 branches outside the Head Office (HO). Operations are mainly concentrated at the branch offices while the HO serves as a consolidation and controlling point for transactions and operations. Each branch employs a Branch Manager (BM) who is assisted by a cashier, one accountant and at least one loan officer (LO). LOs in some branches are assisted by field assistants (FA). Each branch operates both a savings and a current accounts in the nearest available commercial bank to the branch. HO uses these bank accounts to monitor liquidity at branch level and also to effect cash transfers, when shortfalls occur. Operational procedures restrict handling of cash to the cashier in presence of the LO for loan related transactions. BMs are limited to endorsing credit of up to 1,500 ETB, above which the loan committee involving HO personnel must be consulted.

For accounting and loan tracking, a manual MIS is used for branches without electricity. Others use a computerized MIS called Total Microfit Solution (TMS), a locally-developed software used by a number of MFIs. Computerized branches run their own stand alone databases, save weekly data on flash disks and send them on a monthly basis to HO for consolidation. TMS depends on manual entry of primary data into Excel sheets before importing data into the database. Some reports are generated directly by TMS. Others are generated manually on Excel from TMS data.

## Market penetration

PEACE has operations in 3 major provincial states of Ethiopia targeting the rural clientele and women. PEACE currently operates 14 branches: Mollalle, Kuy, Bereh Aleletu, Zefne, Gasara, Dello Sebro, Ginir, Melliyyu Burka, Robe-Goba, Amaro Kelle, Bekoji, Adaba, Enebsesar and Bale. The closest branch is 45 km from HO in Addis Ababa. PEACE plans to open a further 2 branches in the near future. PEACE is currently ranked 5<sup>th</sup>.

## Products and services

PEACE offers both loan and savings products to its clients. There are 2 loan products namely, agriculture loan and the non-agriculture loan. Both loan products are group loans and are based on the solidarity-group principle. The agriculture loan, which currently accounts for about 80% of the total portfolio, carries an interest rate of 18% (flat) and a maximum term of one year. Loans come with bullet repayments with monthly interest accrual. Loans range between 150 ETB and 20,000 ETB. The non-agriculture loan product is similar in terms of loan term and minimum and maximum borrowing amounts. Interest, however, is 15% (flat) and payments are amortized monthly. Clients are required to pay an upfront fee of 2% and credit is guaranteed by the group. In some instances, collateral is held in addition to the group guarantee (particularly for larger loans). Average portfolio effective interest rate (APR) for agriculture and non-agriculture loans is 22% and 39% respectively, both with an average term of 10 months. As at end of Dec. 2006, average outstanding loan balance was 1,413 ETB.

The savings products include mandatory savings, regular voluntary savings and institutional savings. Mandatory savings are required for loan clients and constitute 10% of the loan value. They mainly serve to mitigate default risk and are accessible after the loan has been fully serviced. Regular voluntary savings, on the other hand, require group loan members to make regular contributions of their choice to a savings account during the term of the loan. This is also partly to cover default risk, but also serves as a basis on which to assess creditworthiness of a client. Institutional saving mainly targets cooperative organizations in the rural areas. All savings products carry an interest rate of 5%. As at Dec. 2006, Mandatory loans constituted 50% of the total savings, compared to 45% for regulatory savings and just under 5% for institutional savings. Clients do not have access to their mandatory savings until the end of the loan term, but can access their regulatory savings progressively as they service the loan. Clients are generally encouraged to physically deposit their savings at the branch offices or through their group leaders.

## Networks

PEACE is a member of the Association of Ethiopian Microfinance Institutions (AEMFI). It is also a member of the Microfinance African Institutions Network (MAIN).

## ■ Governance

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Governance and Decision Making is rated “c”

### Decision-making

Despite being a share company, PEACE still looks, feels and operates very much like an NGO. It has a shared socially-oriented mission and vision with its BOD and shareholders although it is also focused on sustainability. Among the 15 shareholders, ASE clearly is the most influential shareholder and remains supportive of PEACE’s overall strategy. While BOD composition is diverse in background, it is quite homogeneous by nature as most members have ASE links. It has no truly independent directors, and it would benefit from commercial banking or private sector experience on the BOD to provide different perspectives and more finance-oriented guidance to increasingly complex sets of issues.

PEACE BOD holds more regular meetings than before, is more involved and has participative and consensus-based decision-making. Nevertheless, BOD’s oversight is still very operational in nature and is focused on past results. PEACE would benefit from more strategic discussions of institutional and financial issues (e.g. organizational structure, management capacity, ALM risks). There are no specialized BOD Committees (such as Audit) which can provide a closer oversight over key operational risks.

Due to legal requirements, PEACE will need to secure new shareholders soon and increase its paid-in capital from 200,000 ETB to an authorized capital base of 400,000 ETB. Despite a general preference for social local investors, PEACE has yet to develop a clear and credible strategy in this regard. While BOD has delegated management to take a lead on this issue, this is an example of a key issue that the BOD needs to get more involved in to achieve desired results in a timely manner which again underlines the need to make the BOD composition evolve to provide management with the necessary high level support.

### Planning

PEACE needs a Strategic Plan (SP) as the current Business Plan (BP) is too operational in nature to address upcoming market and institutional challenges of the organization. The SP should address long-term vision, conduct deep SWOT analysis, define key strategies and goals, address key risks and mitigants, set performance standards, study future HR and infrastructure needs, make resource allocations, define

capital structure and financing strategies. The current BP discusses the past and immediate short term future, but it could be more specific and action-oriented. Notably it could elaborate more on key strategic matters such as setting market share, business and product development, portfolio quality standards, productivity/efficiency measures and define key investment projects (e.g. IT, branding, marketing, promotion).

Together with the BP, PEACE developed Microfin-generated projections for the next 3 years. Growth assumptions are reasonably conservative. The projections are however based on some unrealistic cost structure assumptions (e.g. too low cost of borrowed funds, staffing and salary levels, equipment investments, etc.). PEACE has a simple but efficient budgeting and tracking process that covers all branches and the HO.

### Management team

PEACE is competently led by the ED backed by the FAM. They are knowledgeable, experienced and committed to the institution. The key person risk on the ED remains nevertheless high due to important management staff turnover (caused in part by low salaries). The new OM Manager just started and he will likely take some time to become fully effective given his lack of direct experience in microfinance.

Besides the ED, FAM and OM, the middle management team is thin for an institution of its size. All positions are present on the organizational chart, however, the organizational structure is not yet optimal. The functions of IT, Internal Audit and HR need much more prominence given their strategic importance to a fast growing organization like PEACE, but also because of the ongoing weaknesses in these areas. Generally speaking, PEACE needs to boost its management ranks externally and further build the capacity and provide specialist training (e.g. internal auditor) to those currently employed. The BMs are well trained and motivated, but PEACE needs a comprehensive strategy to promote them in order to give them a career path as well as boosting the middle management at the HO.

### Human resource management

Basic HR procedures and policies are in place along with adequate recruitment practices. PEACE has no formal HR Department at this stage and HR issues are not given enough attention thus far. It needs to anticipate turnover risks rather than reacting to departures. It hired consultants to perform the review of its organizational structure, job evaluation, grading and salaries, roles that might, perhaps, have been done internally, if the HR function had more prominence.

Following the consultants' work and recommendations, PEACE approved a 37% salary adjustment in 2006 which did not stop the former OM from leaving in 2007. While its benefits levels seem competitive within the industry, it remains to be seen whether further salary adjustments made in 2007 (eroded by high inflation context) will be enough to attract key skills set and retain qualified staff. Apart from salaries, PEACE also runs the Championship Cup to identify and reward excellent branches. This type of initiative would be even more effective if PEACE could make it part of a comprehensive performance management program that includes motivation, training and improving the working environment.

## ■ Information

Information is rated "c"

PEACE has reasonable MIS infrastructure and processes to produce reasonably reliable and timely data in order to manage its current loan and saving activities. Nevertheless, PEACE is not well positioned to handle future growth due to MIS systemic weaknesses and limitations; and general under investment in its MIS infrastructure.

The computerized TMS system did not deliver as much efficiency gains as expected. Excel is still being used as the main interface for branches to consolidate data to the central HO database. This causes some work duplication and the report generation process is somewhat slow and partially manual. Another TMS limitation is its Access database which is not appropriate for large transaction volumes at PEACE. It is not clear whether or when the developer will transition it to a higher capacity database such as SQL. PEACE has also reached a point where it needs to invest in a dedicated modern server to house its databases.

Security of the MIS and data remains inadequate. Passwords to access TMS are not changed regularly and there is no off-site backup provision. The physical security of hardware and data is undermined by lack of a fire-proof, locked up and air conditioned room. PEACE is also exposed to short-term operational risk as the sole France-based developer of TMS offers no local technical support or access to source codes. Further more, no contingency plans are in place in the event of his non-availability. The current MIS officer is competent to run and maintain the system, but his role is operationally oriented. PEACE lacks a strategic IT view and an appropriate IT plan despite its importance to the operations. Given the traditional under-investment in the IT area, PEACE needs to considerably boost its investments (in both equipment and HR) in order to keep up with the fast pace of growth of the organization.

Information quality is generally reasonable in terms of reliability and timeliness, with exception to some errors in the savings data. Portfolio reports are relevant and backed by appropriate analysis at both branch and HO levels. Updating of the savings ledger, however, was in some instances done without double checks, which makes savings data vulnerable to manipulation and fraud. Accounting and financial data is generally reliable and timely. Accounting data is consolidated and reconciled on a monthly basis. There are some concerns, however, over some of the accounting standards employed, specifically on the treatment of depreciation and inflation. Asset depreciation rates did not conform to industry and statutory standards and inflation was not provided for in the audited financial statements. This discrepancy, however, seems to be a general sector weakness in Ethiopia. This could lead to inflated asset base and operating position.

## ■ Risk Management

Risk Management is rated "c"

### Procedures and internal controls

The current procedures and internal controls are appropriate and conform to the general practice of MFIs. The procedures have been formalized and documented into various manuals including the Internal Audit and the Operations manuals. Most manuals, however, have not been updated since 2000 and, in the case of recently updated manuals, some branches did not possess them. Adherence to procedures is generally reasonable although at branch level there were some discrepancies. Loan disbursement and collection, for instance, is the responsibility of the cashier, however, some cases in which this duty was delegated to the LO were noted.

Controls at PEACE are characterized by good separation of duties and tasks. Each branch employs a BM, a cashier, an accountant (or two) and LOs, which ensures an adequate series of checks and balances, despite resulting in a heavy back office. While PEACE has no history related to physical theft of cash, cash security is inadequate. Transportation of cash between various points of transaction poses some risk, as there is no insurance policy in place and the cash is transported by relatively insecure means (motorcycle or public buses).

### Internal audit

PEACE is vulnerable to non-compliance and fraud risks due to a severe lack of resources in the Internal Audit (IA) function. There has been chronic and persistent understaffing in the IA function and PEACE currently employs only one IA, who is expected to cover all 14 branches and over 19,000 clients. Further more, efficiency is inhibited by the

remote and random location of branches and, consequently, several upcountry branches have not been audited in the past year. Further, in 2006 the IA went on maternity leave and her role was filled in by various HO staff. While such an intervention is better than none, it is not tenable as the IA role calls for a certain level of independence from management. This situation calls for more urgency in staffing the IA function and re-focusing its activities to a more risk-oriented approach in order to maximize impact.

The current set up does not allow the IA the full independence as the IA currently reports to the ED without any BOD involvement. Although there is an open line of communication with the BOD, there are no dedicated IA meetings. As such, it is difficult to provide necessary oversight, a role that a BOD Audit Committee would ordinarily contribute to. The IA reports are generally below standard and lack relevant scope and detail. The reports need to be based on a comprehensive annual IA plan, focused and prioritized on the risks faced by the organization. The external audit reports as well as the inspection reports by NBE have been helpful in pointing out weaknesses at PEACE, however, there is no formalized and systematic process to follow up on recommendations.

## ■ Activities

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Activities: products and services **is rated “b”**

### Market position

PEACE has achieved a competitive position in the Ethiopian MFI sector through a focus strategy that targets rural low-income women. It has experienced significant growth during the past 5 years and the market still has a high level of unmet demand. Faster growth is possible, however, PEACE does not possess an optimal service delivery model and infrastructure to exceed current growth rates prudently and efficiently. The present branch network is randomly scattered and several branches are remotely located, making cost optimization and supervision difficult. An alternative model being considered is to have regional branches that act as service hubs in order to benefit from a higher level of efficiency and closer supervision.

Ranked 5<sup>th</sup>, PEACE enjoys good competitive advantages in its service regions based on quick turnaround of loans and slightly lower pricing than its non-government backed competitors (See Benchmarking). While these advantages are not sustainable in the long run, they permit PEACE to easily gain new clients given the huge unmet demand. Its product range is narrow as the market is essentially undersupplied and there is no immediate pressure to diversify. The products are competitively priced and despite higher pricing than some direct competitors, demand

remains high. PEACE plans to recruit a Planning and Product Development Manager in the near future and this will help to spur product development, market research, branding and other marketing activities.

### Loan portfolio management

PEACE employs an appropriate group credit methodology that is suitable for its targeted rural clientele. Credit decisions are essentially character-based backed by solidarity group guarantees. The client management system greatly relies on and is reinforced by the strong support from local administrative structures which helps out in the delinquency management process. PEACE's portfolio management system is highly efficient thanks in large part to built-in delegation of various group management tasks to group leaders who select members and pre-authorize individual loan sizes within the range set by PEACE. Delinquency management and general follow up is also channeled through the group leaders and this form of group pressure is highly effective in rural settings. LOs maintain a high level of communication with group leaders to monitor group performance. LOs generally have the required skills and know-how to manage their portfolios and there is a high level of knowledge about the operational procedures. LOs and FAs would, however, benefit from refresher training on client and credit management to avoid complacency that could emanate from repeat clients, which make up a significant portion of the loan portfolio of PEACE.

Overall, PEACE's portfolio growth has been impressive albeit largely attributed to the high level of demand for financial services in Ethiopia. Portfolio composition, nevertheless, remains dominated by agriculture loans (80%) and average loan size has not changed significantly over the years. While there are no specific portfolio diversification targets, PEACE now lends more to non-agriculture clients (20% of portfolio). All these issues will become important in the future when the market becomes more competitive.

### Credit risk

PEACE has so far maintained an excellent track record in terms of the portfolio quality, with PAR 31-65 at less than 1% since inception of the organization. This is attributed to its stringent lending policies and procedures which explicitly discourage and penalize rescheduling and defaulting on loan payments. Furthermore, PEACE has effectively used the local administrative structures to its advantage to enhance delinquency management measures in addition to sharing information regarding credit risk with provincial authorities and other local MFIs to minimize over-indebtedness risk. Compulsory savings also played a crucial role in helping PEACE maintain an excellent portfolio quality. Somewhat surprisingly, both loan products exhibit similar PAR levels

which could signal some potential concentration risk as many clients appear to be involved in similar forms of agriculture, which makes up over 80% of the total portfolio. The risk is even more apparent given that Ethiopia is prone to droughts.

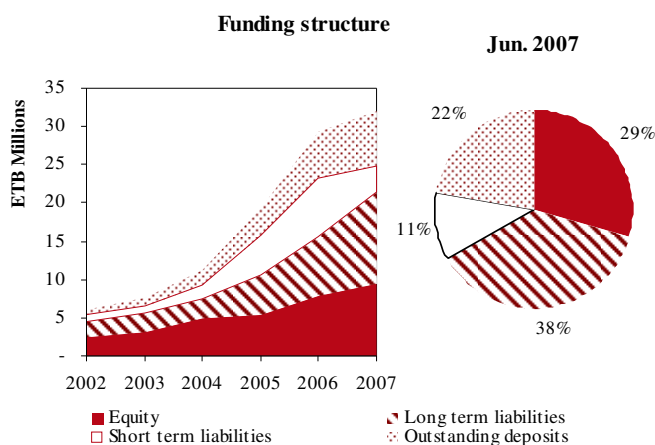
PEACE's provisioning policy has loosened up slightly in recent years and credit risk coverage was 90% as at 31 Dec. 2006. Nevertheless, this credit risk coverage level remains adequate due to the cover provided by the mandatory savings and regular voluntary savings. On paper, PEACE adopts an aggressive write off policy, whereby default loans over 180 days are written off. In reality, there have been very few write-offs over the years both because of its excellent portfolio quality but also because PEACE has not been in total compliance with its own write-off policy as there is PAR beyond 365 days (fortunately small) that remains on the balance sheet.

### Savings activities

As expected, savings volume growth has mirrored that of the loan portfolio (see Performance Indicators) given the continued predominance of compulsory savings and of regular voluntary savings, which have elements of the compulsory savings in its defined amounts and regularity. Savings mobilization is still a low risk and secondary element of PEACE's activities given the lack of an internal champion and a clear strategy. This activity has very good potential and could have had a higher priority for PEACE especially in light of its important contribution to PEACE's funding base. However, given the current weaknesses in internal controls and information systems, savings would be exposed to considerable risks.

## ■ Funding and liquidity

Funding and liquidity is rated "c"



## Capital Structure & Leverage

PEACE is transitioning from an NGO-type capital structure dominated by equity, to a more commercial-like structure as demonstrated by the progressive increases in long-term debt. PEACE is well capitalized with equity representing a solid 29% of the funding structure. Its capital structure remains conservative with a liability to equity ratio of 2.4x as at June 2007. Its debts are essentially concessional loans from NOVIB and RUFIP. Savings, while growing, still play a secondary role as a funding source. Given its reasonable risk profile, recent good track record and good growth prospects, PEACE has some additional debt capacity which is however constrained by local laws and limited risk appetite of the local banks.

## Asset & Liability Management

Maturity risk is low as portfolio is predominantly funded by retained earnings, donations and long-term concessional loans. There is no interest rate risk (no floating rate financing) and no FX risks as PEACE cannot transact in hard currency due to NBE limitations.

## Funding strategy

PEACE traditionally relied on ASE-initiated socially-oriented funders (i.e. NOVIB, ABRDP). Since becoming a Share Company, it started to borrow from RUFIP, but ongoing growth has put stress on securing more capital to support medium-term growth. While the need to diversify funding sources is clear, PEACE has yet to develop a coherent and comprehensive funding strategy. This is not helped by the fact that local banks only lend with heavy collateral requirements (120%) and that MFIs cannot borrow and pay in hard currency from international lenders. While these constraints make the fund raising tasks harder, PEACE should look into other alternatives such as guarantees. As mentioned previously, savings can play a bigger part in funding if PEACE invests more in the saving infrastructure, personnel and products. Another avenue is to increase its capital base, but this will be somewhat difficult and is unlikely to attract large sums due to its inherent unattractiveness (no dividends allowed at this stage).

## Liquidity management

Basic and regular cash flow projections are done to manage cash at PEACE. Liquidity risk is low, but PEACE will need to manage liquidity tighter and in a more systematic way if truly voluntary savings (as opposed to the current regular voluntary savings which entail an element of mandatory savings in that clients choose the amount that they will be depositing regularly and must commit to it) become a significant source of funding.

## ■ Efficiency and Profitability

Efficiency and Profitability is rated “a”

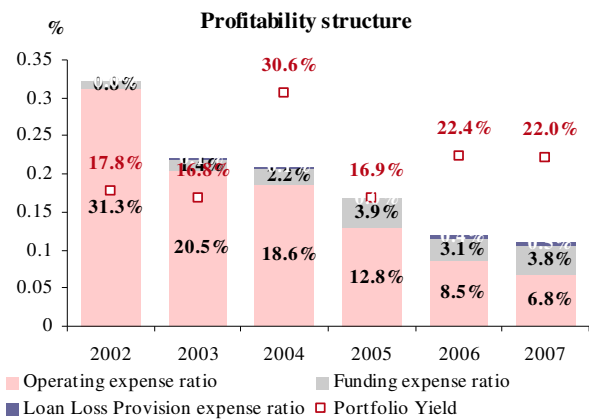
### Profitability analysis

PEACE has exhibited an overall positive pattern of profitability during the past 5 years, except for a dip in 2005 explained partly by a shift from a cash-based to an accrual-based accounting method for income recognition during the period. In 2006, there was a significant recovery in all the profitability indicators and interim results for 2007 suggest that a more stable trend is setting in. While all the profitability indicators have shown an increase since 2005, increasing ROA, as an indicator, masks a trend of underinvestment in fixed assets as reflected by the declining trend of net fixed assets on the balance sheet which is also mirrored by a high 93% portfolio to assets ratio in 2007.

PEACE’s portfolio yield has been slightly trending down over the years to stay somewhat competitive with the subsidized rates given by its government-backed competitors. Its current 22% portfolio yield is below the industry average and offers some additional margin to increase interest rates (or fees) on loan products. There is no material gap between its portfolio yield and its estimated portfolio APR of 23%. In terms of operating costs, PEACE has achieved a remarkable level of efficiency as reflected by the continuous decline in the operating expense ratio, which was 8.5% as at December end 2006. This has been achieved partly due to the credit methodology in place, which delegates a significant portion of the loan appraisal and management tasks to the group leaders. This is reflected by the declining trend in cost per borrower and the increasing level of LO productivity during the past 5 years. The benchmark indicators reveal that, among its peers, PEACE has the lowest operating expense ratio (excluding government-owned MFIs). This very low level of operating expense ratio is also underpinned by past and ongoing under-investment in equipment (thus very low asset depreciation levels) and personnel (see HR section). It will be difficult to maintain such a cost level if PEACE truly wants to prepare well for the future by making previously mentioned investments.

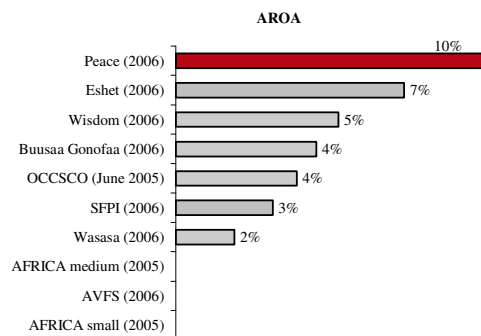
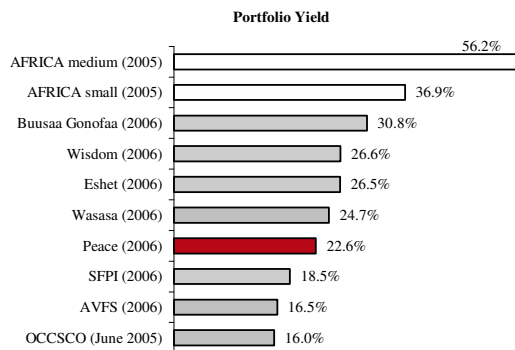
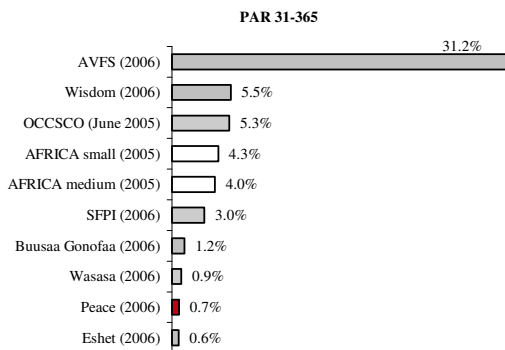
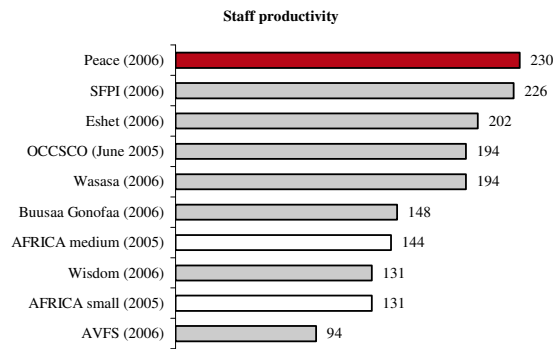
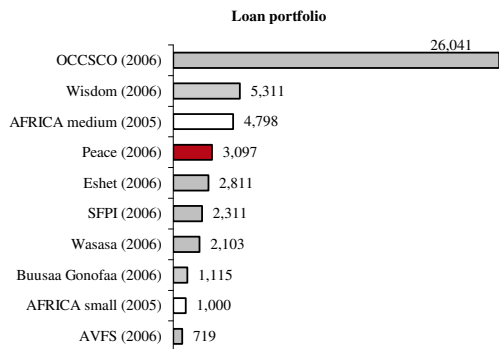
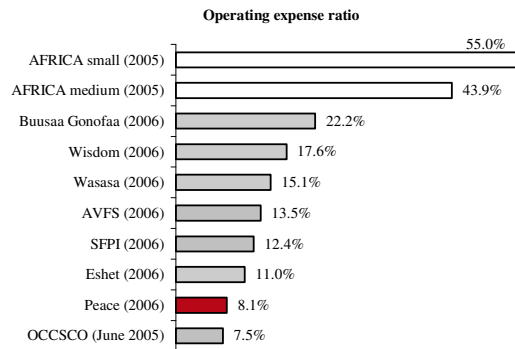
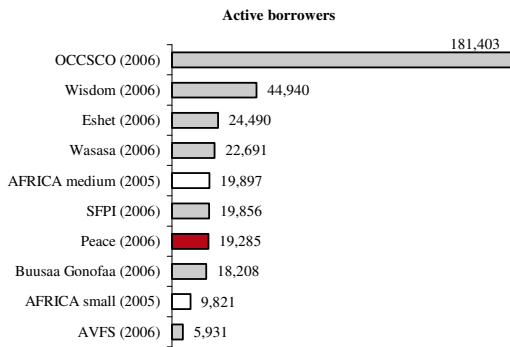
The funding expense ratio of PEACE has been gradually increasing over the years and this reflects the gradual transformation of its capital structure from an NGO-oriented one to an NBFi-oriented one, whereby it is depending less on grants and more on loans (although still quite concessional) and savings. Loan loss expenses have been minimal thanks to excellent portfolio quality although this could potentially go higher to provide better risk coverage ratios currently at only 85% of PAR31.

The profitability outlook is positive for PEACE subject to certain conditions. PEACE is expected to maintain its good track record in managing the portfolio and in keeping low operating expenses. Nevertheless, profitability in the future could be affected by the current level of underinvestment in both assets and human resources. To manage the high pace of growth, PEACE needs to invest in considerable infrastructure in information and risk management systems, both of which are essential for efficiency and sustainable profitability growth. To sustain future growth, PEACE is not expected to depend on concessional loans perpetually (i.e. NBE might relax overseas borrowing rules in the next years) and this could also have a significant impact on the current low funding expense ratio. Savings could therefore be expected to play a major role in funding the portfolio in the future but this would require PEACE to invest further in saving infrastructure and personnel.



*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.*

## Benchmarking



Source: The Mix Market

MFIs: Africa Village Financial Services (AVFS), Wisdom MFI, Oromia Credit & Savings Company (OCSSCO), Specialised Financial and Promotional Institution MFI (SFPI), Busaa Gonfaa, Wasasa, Eshet.

MBB Peer groups; benchmarks 2005 (medians)

## ■ Performance indicators

Data in USD, unless otherwise stated

| Loan Portfolio                                       | Dec. 2003 | Dec. 2004 | Dec.2005   | Dec. 2006  | Jun. 2007  |
|--|-----------|-----------|------------|------------|------------|
| Loan portfolio                                       | 588,758   | 869,780   | 1,795,929  | 2,983,327  | 3,249,443  |
| Loan portfolio (ETB)                                 | 5,192,843 | 7,697,556 | 15,732,340 | 27,207,938 | 30,024,854 |
| Evolution  | 53.9%     | 48.2%     | 104.4%     | 72.9%      | 10.4%      |
| Average outstanding loan                             | 487,126   | 685,088   | 1,261,590  | 2,335,112  | 3,033,304  |
| Active borrowers                                     | 5,428     | 7,766     | 13,728     | 19,260     | 19,809     |
| Evolution  | 29.5%     | 43.1%     | 76.8%      | 40.3%      | 2.9%       |
| Average outstanding loan per client                  | 108       | 112       | 131        | 155        | 164        |
| % of GDP per capita                                  | 101.3%    | 105.0%    | 121.4%     | 149.6%     | 160.6%     |
| Average amount disbursed per loan                    | 856       | 822       | 896        | 1,073      | 1,177      |
| % of GDP per capita                                  | 757.2%    | 632.1%    | 583.0%     | 635.7%     | 580.5%     |
| Rescheduled loans                                    | 0.0%      | 0.0%      | 0.0%       | 0.0%       | 0.0%       |
| PAR 31-365   | 0.2%      | 0.1%      | 0.04%      | 0.3%       | 0.6%       |
| PAR > 365  | 0.0%      | 0.1%      | 0.1%       | 0.1%       | 0.1%       |
| Write-off ratio                                      | 0.0%      | 0.0%      | 0.0%       | 0.0%       | 0.0%       |
| Risk coverage ratio                                  | 66.0%     | 94.0%     | 102.7%     | 90.1%      | 84.8%      |
| PAR 31 net of loan loss provision / Equity           | 0.1%      | 0.0%      | (0.0%)     | 0.1%       | 0.3%       |
| Savings  | Dec. 2003 | Dec. 2004 | Dec.2005   | Dec. 2006  | Jun. 2007  |
| Outstanding deposits                                 | 134,389   | 217,114   | 396,403    | 661,198    | 767,451    |
| Outstanding deposits (ETB)                           | 1,185,314 | 1,921,456 | 3,472,488  | 6,030,126  | 7,091,247  |
| Evolution  | 53.7%     | 62.1%     | 80.7%      | 73.7%      | 17.6%      |
| Mandatory savings (%)                                | 48.9%     | 45.4%     | 50.8%      | 50.3%      | 49.6%      |
| Voluntary savings (%)                                | 51.1%     | 48.3%     | 45.1%      | 45.7%      | 46.4%      |
| Active savers  | 5,896     | 8,458     | 14,369     | 20,552     | 21,489     |
| Evolution  | 21.6%     | 43.5%     | 69.9%      | 43.0%      | 4.6%       |
| Average outstanding deposit per saver                | 23        | 26        | 28         | 32         | 36         |
| Mandatory  | 16        | 18        | 26         | 24         | 20         |
| Voluntary  | 12        | 12        | 12         | 15         | 17         |
| Staff  | Dec. 2003 | Dec. 2004 | Dec.2005   | Dec. 2006  | Jun. 2007  |
| Total number of staff                                | 41        | 61        | 68         | 77         | 84         |
| % Credit officers                                    | 19.5%     | 19.7%     | 16.2%      | 15.6%      | 17.9%      |
| Turnover   | n/a       | 3.9%      | 15.5%      | 11.0%      | 3.7%       |
| Profitability Analysis                               | Dec. 2003 | Dec. 2004 | Dec.2005   | Dec. 2006  | Jun. 2007  |
| ROE  | (6.5%)    | 16.2%     | 1.1%       | 34.5%      | 35.7%      |
| Liabilities / Equity                                 | 1.37x     | 1.3x      | 2.6x       | 2.7x       | 2.4x       |
| ROA  | (2.7%)    | 7.0%      | 0.4%       | 9.4%       | 10.0%      |
| Portfolio Yield                                      | 16.8%     | 30.6%     | 16.9%      | 22.4%      | 22.0%      |
| Operating expense ratio                              | 20.5%     | 18.6%     | 12.8%      | 8.5%       | 6.8%       |
| Cost per borrower                                    | 18        | 16        | 12         | 10         | 10         |
| Staff productivity                                   | 132       | 127       | 202        | 250        | 236        |
| Loan officer productivity                            | 679       | 647       | 1,248      | 1,605      | 1,321      |
| Average outstanding loan per client (USD)            | 108       | 112       | 131        | 155        | 164        |
| Funding expense ratio                                | 1.4%      | 2.2%      | 3.9%       | 3.1%       | 3.8%       |
| Cost of savings                                      | 1.6%      | 2.5%      | 2.7%       | 2.6%       | 5.5%       |
| Cost of liabilities                                  | 2.2%      | 2.1%      | 4.4%       | 3.6%       | 5.4%       |
| Loan Loss Provision expense ratio                    | 0.1%      | 0.1%      | 0.0%       | 0.4%       | 0.5%       |
| PAR 31-365   | 0.2%      | 0.1%      | 0.04%      | 0.3%       | 0.6%       |
| Write-off ratio                                      | 0.0%      | 0.0%      | 0.0%       | 0.0%       | 0.0%       |
| Outstanding Loan Portfolio / Assets                  | 67.4%     | 68.1%     | 81.2%      | 92.5%      | 93.3%      |
| Revenue from investment as a % of financial revenues | 4.8%      | 1.7%      | 2.3%       | 0.6%       | 0.2%       |
| Liquidity  |           |           |            |            |            |
| Loans to deposits                                    | 438.1%    | 400.6%    | 453.1%     | 451.2%     | 423.4%     |
| Liquidity / Total assets (LAR)                       | 25.8%     | 21.3%     | 16.1%      | 5.0%       | 5.2%       |
| Exchange rate 1 USD= xx ETB                          | 8.8       | 8.9       | 8.8        | 9.1        | 9.2        |

| PEACE<br>Balance sheet                            | Notes | ETB              |                   |                   |                   |                   | USD            |                  |                  |                  |                  | Evolution     |                |              |               |
|---|-------|------------------|-------------------|-------------------|-------------------|-------------------|----------------|------------------|------------------|------------------|------------------|---------------|----------------|--------------|---------------|
|   |       | Dec.<br>2003     | Dec.<br>2004      | Dec.<br>2005      | Dec.<br>2006      | Jun.<br>2007      | Dec.<br>2003   | Dec.<br>2004     | Dec.<br>2005     | Dec.<br>2006     | Jun.<br>2007     | 2004/2003     | 2005/2004      | 2006/2005    | 2007/2006     |
| <b>ASSETS</b>                                     |       | <b>7,693,923</b> | <b>11,285,258</b> | <b>19,354,534</b> | <b>29,292,786</b> | <b>32,002,644</b> | <b>872,327</b> | <b>1,275,170</b> | <b>2,209,422</b> | <b>3,211,928</b> | <b>3,463,490</b> | <b>46.7%</b>  | <b>71.5%</b>   | <b>51.3%</b> | <b>9.3%</b>   |
| <b>Short Term Assets</b>                          |       | <b>7,201,655</b> | <b>10,800,000</b> | <b>18,941,955</b> | <b>28,850,684</b> | <b>31,589,913</b> | <b>816,514</b> | <b>1,220,339</b> | <b>2,162,324</b> | <b>3,163,452</b> | <b>3,418,822</b> | <b>50.0%</b>  | <b>75.4%</b>   | <b>52.3%</b> | <b>9.5%</b>   |
| Cash and Due from Banks                           |       | 1,984,092        | 2,400,442         | 3,116,111         | 1,452,502         | 1,660,606         | 224,954        | 271,236          | 355,720          | 159,266          | 179,719          | 21.0%         | 29.8%          | (53.4%)      | 14.3%         |
| Short Term Investments                            |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |
| Short Term Net Loan Portfolio                     |       | 5,186,820        | 7,686,726         | 15,716,046        | 27,104,078        | 29,850,627        | 588,075        | 868,557          | 1,794,069        | 2,971,938        | 3,230,587        | 48.2%         | 104.5%         | 72.5%        | 10.1%         |
| Short Term Gross Loan Portfolio                   |       | 5,192,843        | 7,697,556         | 15,732,340        | 27,207,938        | 30,024,854        | 588,758        | 869,780          | 1,795,929        | 2,983,327        | 3,249,443        | 48.2%         | 104.4%         | 72.9%        | 10.4%         |
| (Loan Loss Reserve)                               |       | 6,023            | 10,830            | 16,294            | 103,860           | 174,227           | 683            | 1,224            | 1,860            | 11,388           | 18,856           | 79.8%         | 50.5%          | 537.4%       | 67.8%         |
| Interest Receivable                               |       | -                | 675,139           | 52,469            | 233,607           | 4,010             | -              | 76,287           | 5,990            | 25,615           | 434              | -             | (92.2%)        | 345.2%       | (98.3%)       |
| On loan portfolio                                 |       | -                | 675,139           | 52,469            | 233,607           | 4,010             | -              | 76,287           | 5,990            | 25,615           | 434              | -             | (92.2%)        | 345.2%       | (98.3%)       |
| On investments                                    |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |
| Accounts receivable and other assets              |       | 30,743           | 37,693            | 57,329            | 60,497            | 74,670            | 3,486          | 4,259            | 6,544            | 6,633            | 8,081            | 22.6%         | 52.1%          | 5.5%         | 23.4%         |
| <b>Long term assets</b>                           |       | <b>492,268</b>   | <b>485,258</b>    | <b>412,579</b>    | <b>442,102</b>    | <b>412,731</b>    | <b>55,813</b>  | <b>54,831</b>    | <b>47,098</b>    | <b>48,476</b>    | <b>44,668</b>    | <b>(1.4%)</b> | <b>(15.0%)</b> | <b>7.2%</b>  | <b>(6.6%)</b> |
| Long Term Net Investments                         |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |
| Long Term Gross Loan Portfolio                    |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |
| Net Fixed Assets                                  |       | 449,768          | 429,758           | 368,179           | 408,802           | 357,231           | 50,994         | 48,560           | 42,030           | 44,825           | 38,661           | (4.4%)        | (14.3%)        | 11.0%        | (12.6%)       |
| Other Long Term Assets                            | 2     | 42,500           | 55,500            | 44,400            | 33,300            | 55,500            | 4,819          | 6,271            | 5,068            | 3,651            | 6,006            | 30.6%         | (20.0%)        | (25.0%)      | 66.7%         |
| <b>LIABILITIES AND EQUITY</b>                     |       | <b>7,693,923</b> | <b>11,285,258</b> | <b>19,354,534</b> | <b>29,292,786</b> | <b>32,002,644</b> | <b>872,327</b> | <b>1,275,170</b> | <b>2,209,422</b> | <b>3,211,928</b> | <b>3,463,490</b> | <b>46.7%</b>  | <b>71.5%</b>   | <b>51.3%</b> | <b>9.3%</b>   |
| <b>Liabilities</b>                                |       | <b>4,450,830</b> | <b>6,313,235</b>  | <b>13,979,658</b> | <b>21,448,289</b> | <b>22,619,872</b> | <b>504,629</b> | <b>713,360</b>   | <b>1,595,851</b> | <b>2,351,786</b> | <b>2,448,038</b> | <b>41.8%</b>  | <b>121.4%</b>  | <b>53.4%</b> | <b>5.5%</b>   |
| Short term liabilities                            |       | 2,126,278        | 3,866,554         | 8,701,938         | 13,695,647        | 10,641,801        | 241,075        | 436,899          | 993,372          | 1,501,716        | 1,151,710        | 81.8%         | 125.1%         | 57.4%        | (22.3%)       |
| Demand Deposits                                   |       | 606,068          | 1,048,659         | 1,707,825         | 2,997,917         | 3,572,158         | 68,715         | 118,493          | 194,957          | 328,719          | 386,597          | 73.0%         | 62.9%          | 75.5%        | 19.2%         |
| Compulsory Deposits                               |       | 579,246          | 872,797           | 1,764,663         | 3,032,209         | 3,519,088         | 65,674         | 98,621           | 201,446          | 332,479          | 380,854          | 50.7%         | 102.2%         | 71.8%        | 16.1%         |
| Short Term Time Deposits                          |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |
| Short Term Borrowings                             | 3     | 815,571          | 1,815,571         | 4,899,644         | 6,993,598         | 2,665,571         | 92,468         | 205,149          | 559,320          | 766,842          | 288,482          | 122.6%        | 169.9%         | 42.7%        | (61.9%)       |
| Interest payable                                  |       | 77,200           | 117,307           | 302,094           | 616,063           | 882,375           | 8,753          | 13,255           | 34,486           | 67,551           | 95,495           | 52.0%         | 157.5%         | 103.9%       | 43.2%         |
| Accounts Payable and Other Short Term Liabilities |       | -                | 12,220            | 27,712            | 55,860            | 2,609             | 5,464          | 1,381            | 3,163            | 6,125            | 282              | (74.6%)       | 126.8%         | 101.6%       | (95.3%)       |
| Long term liabilities                             |       | 2,324,552        | 2,446,681         | 5,277,720         | 7,752,642         | 11,978,071        | 263,555        | 276,461          | 602,479          | 850,070          | 1,296,328        | 5.3%          | 115.7%         | 46.9%        | 54.5%         |
| Long Term Time Deposits                           |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |
| Long Term Borrowings                              |       | 1,058,000        | 2,058,000         | 4,600,392         | 6,503,535         | 10,831,562        | 119,955        | 232,542          | 525,159          | 713,107          | 1,172,247        | 94.5%         | 123.5%         | 41.4%        | 66.5%         |
| Other Long Term Liabilities                       | 4     | 1,266,552        | 388,681           | 677,328           | 1,249,107         | 1,146,509         | 143,600        | 43,919           | 77,321           | 136,963          | 124,081          | (69.3%)       | 74.3%          | 84.4%        | (8.2%)        |
| <b>Equity</b>                                     |       | <b>3,243,093</b> | <b>4,972,023</b>  | <b>5,374,876</b>  | <b>7,844,497</b>  | <b>9,382,772</b>  | <b>367,698</b> | <b>561,811</b>   | <b>613,570</b>   | <b>860,142</b>   | <b>1,015,452</b> | <b>53.3%</b>  | <b>8.1%</b>    | <b>45.9%</b> | <b>19.6%</b>  |
| Paid-In Capital                                   |       | 200,000          | 200,000           | 200,000           | 200,000           | 200,000           | 22,676         | 22,599           | 22,831           | 21,930           | 21,645           | 0.0%          | 0.0%           | 0.0%         | 0.0%          |
| Donated equity                                    |       | 4,215,625        | 5,279,738         | 5,625,690         | 5,787,370         | 5,787,370         | 477,962        | 596,581          | 642,202          | 634,580          | 626,339          | 25.2%         | 6.6%           | 2.9%         | 0.0%          |
| Retained earnings without donations and reserves  |       | -                | (507,715)         | (450,814)         | 1,857,127         | 3,395,402         | (132,940)      | (57,369)         | (51,463)         | 203,632          | 367,468          | (56.7%)       | (11.2%)        | (511.9%)     | 82.8%         |
| Current year                                      |       | (185,852)        | 664,815           | 56,903            | 2,282,440         | 1,538,280         | (21,072)       | 75,120           | 6,496            | 250,268          | 166,481          | (457.7%)      | (91.4%)        | 3,911.1%     | (32.6%)       |
| Other equity accounts                             |       | -                | -                 | -                 | -                 | -                 | -              | -                | -                | -                | -                | -             | -              | -            | -             |

Notes: 1) 2007 figures are not based on audited accounts, which we have not yet received; 2) Deferred cost on lease of MIS Software; 3) Loans from Novib and Arsi Bale project. 4) Deferred income from grants

| PEACE<br>Income Statement                              | Notes | ETB              |                  |                  |                  |                  | USD             |                |                |                |                | Evolution       |                |                 |                |
|--|-------|------------------|------------------|------------------|------------------|------------------|-----------------|----------------|----------------|----------------|----------------|-----------------|----------------|-----------------|----------------|
|  |       | Dec. 2003        | Dec. 2004        | Dec. 2005        | Dec. 2006        | Jun. 2007        | Dec. 2003       | Dec. 2004      | Dec. 2005      | Dec. 2006      | Jun. 2007      | 2004/2003       | 2005/2004      | 2006/2005       | 2007/2006      |
| <b>Financial Revenue (a)</b>                           |       | <b>762,253</b>   | <b>1,929,938</b> | <b>1,908,694</b> | <b>4,848,801</b> | <b>3,090,642</b> | <b>86,423</b>   | <b>218,072</b> | <b>217,887</b> | <b>531,667</b> | <b>334,485</b> | <b>153.2%</b>   | <b>(1.1%)</b>  | <b>154.0%</b>   | <b>(36.3%)</b> |
| Financial Revenue from Loan Portfolio                  |       | 719,827          | 1,857,107        | 1,864,660        | 4,766,783        | 3,082,637        | 81,613          | 209,843        | 212,861        | 522,674        | 333,619        | 158.0%          | 0.4%           | 155.6%          | (35.3%)        |
| Interest on Loan Portfolio                             |       | 585,831          | 1,658,121        | 1,452,444        | 4,110,796        | 2,651,338        | 66,421          | 187,358        | 165,804        | 450,745        | 286,941        | 183.0%          | (12.4%)        | 183.0%          | (35.5%)        |
| Fees and Commissions on Loan Portfolio                 | 1     | 130,195          | 194,343          | 406,523          | 635,501          | 409,327          | 14,761          | 21,960         | 46,407         | 69,682         | 44,299         | 49.3%           | 109.2%         | 56.3%           | (35.6%)        |
| Penalty Revenue on Loan Portfolio                      |       | 3,801            | 4,643            | 5,693            | 20,486           | 21,972           | 431             | 525            | 650            | 2,246          | 2,378          | 22.2%           | 22.6%          | 259.8%          | 7.3%           |
| Financial Revenue from Investments                     | 2     | 36,856           | 32,821           | 43,932           | 27,899           | 7,164            | 4,179           | 3,709          | 5,015          | 3,059          | 775            | (10.9%)         | 33.9%          | (36.5%)         | (74.3%)        |
| Other Operating Revenue                                |       | 5,570            | 40,010           | 102              | 54,119           | 841              | 632             | 4,521          | 12             | 5,934          | 91             | 618.3%          | (99.7%)        | 52,957.8%       | (98.4%)        |
| <b>Financial Expense (b)</b>                           |       | <b>60,184</b>    | <b>135,141</b>   | <b>428,427</b>   | <b>652,893</b>   | <b>530,562</b>   | <b>6,824</b>    | <b>15,270</b>  | <b>48,907</b>  | <b>71,589</b>  | <b>57,420</b>  | <b>124.5%</b>   | <b>217.0%</b>  | <b>52.4%</b>    | <b>(18.7%)</b> |
| Interest paid on borrowings                            |       | 29,349           | 61,542           | 291,044          | 418,530          | 365,664          | 3,328           | 6,954          | 33,224         | 45,891         | 39,574         | 109.7%          | 372.9%         | 43.8%           | (12.6%)        |
| Interest paid on deposits                              |       | 30,835           | 73,599           | 137,383          | 234,363          | 164,542          | 3,496           | 8,316          | 15,683         | 25,698         | 17,808         | 138.7%          | 86.7%          | 70.6%           | (29.8%)        |
| Other Financial Expenses                               |       | -                | -                | -                | -                | 356              | -               | -              | -              | -              | 39             | -               | -              | -               | -              |
| <b>Financial income [c=a-b]</b>                        |       | <b>702,069</b>   | <b>1,794,797</b> | <b>1,480,267</b> | <b>4,195,908</b> | <b>2,560,080</b> | <b>79,600</b>   | <b>202,802</b> | <b>168,980</b> | <b>460,078</b> | <b>277,065</b> | <b>155.6%</b>   | <b>(17.5%)</b> | <b>183.5%</b>   | <b>(39.0%)</b> |
| <b>Net Loan Loss provision</b>                         |       | <b>5,438</b>     | <b>4,808</b>     | <b>5,464</b>     | <b>94,299</b>    | <b>71,207</b>    | <b>617</b>      | <b>543</b>     | <b>624</b>     | <b>10,340</b>  | <b>7,706</b>   | <b>(11.6%)</b>  | <b>13.6%</b>   | <b>1,625.8%</b> | <b>(24.5%)</b> |
| Loan loss provision expense and write-off              |       | 5,438            | 4,808            | 5,464            | 94,299           | 71,207           | 617             | 543            | 624            | 10,340         | 7,706          | (11.6%)         | 13.6%          | 1,625.8%        | (24.5%)        |
| <b>Operating expense (e)</b>                           |       | <b>882,483</b>   | <b>1,125,174</b> | <b>1,417,900</b> | <b>1,819,169</b> | <b>950,593</b>   | <b>100,055</b>  | <b>127,138</b> | <b>161,861</b> | <b>199,470</b> | <b>102,878</b> | <b>27.5%</b>    | <b>26.0%</b>   | <b>28.3%</b>    | <b>(47.7%)</b> |
| Personnel Expense (includes fringe)                    |       | 412,318          | 543,648          | 715,888          | 958,285          | 502,274          | 46,748          | 61,429         | 81,722         | 105,075        | 54,359         | 31.9%           | 31.7%          | 33.9%           | (47.6%)        |
| Administrative Expense (non-staff operating expenses)  |       | 470,165          | 581,526          | 702,012          | 860,884          | 448,319          | 53,307          | 65,709         | 80,138         | 94,395         | 48,519         | 23.7%           | 20.7%          | 22.6%           | (47.9%)        |
| Depreciation and amortization                          |       | 195,726          | 210,648          | 164,583          | 96,408           | 78,700           | 22,191          | 23,802         | 18,788         | 10,571         | 8,517          | 7.6%            | (21.9%)        | (41.4%)         | (18.4%)        |
| Consulting fees  |       | -                | -                | 20,758           | 77,455           | 8,118            | -               | -              | 2,370          | 8,493          | 879            | -               | -              | 273.1%          | (89.5%)        |
| Rental costs   |       | 9,153            | 15,628           | 55,870           | 77,981           | 45,990           | 1,038           | 1,766          | 6,378          | 8,551          | 4,977          | 70.7%           | 257.5%         | 39.6%           | (41.0%)        |
| Travel costs   | 3     | 141,632          | 142,993          | 173,904          | 287,639          | 122,781          | 16,058          | 16,157         | 19,852         | 31,539         | 13,288         | 1.0%            | 21.6%          | 65.4%           | (57.3%)        |
| Communication and training                             |       | -                | 56,250           | 92,207           | 135,101          | 81,895           | -               | 6,356          | 10,526         | 14,814         | 8,863          | -               | 63.9%          | 46.5%           | (39.4%)        |
| Audit fees   |       | 8,970            | 8,971            | 9,775            | 7,500            | 1,316            | 1,017           | 1,014          | 1,116          | 822            | 142            | 0.0%            | 9.0%           | (23.3%)         | (82.5%)        |
| Insurance  |       | 37,131           | 39,671           | 66,777           | 53,981           | 32,923           | 4,210           | 4,483          | 7,623          | 5,919          | 3,563          | 6.8%            | 68.3%          | (19.2%)         | (39.0%)        |
| Office costs   |       | 38,353           | 44,173           | 52,836           | 59,184           | 15,031           | 4,348           | 4,991          | 6,032          | 6,489          | 1,627          | 15.2%           | 19.6%          | 12.0%           | (74.6%)        |
| Utilities and maintenance                              |       | 19,766           | 20,787           | 6,314            | 15,082           | 33,873           | 2,241           | 2,349          | 721            | 1,654          | 3,666          | 5.2%            | (69.6%)        | 138.9%          | 124.6%         |
| Others   |       | 19,434           | 42,405           | 58,988           | 50,553           | 27,692           | 2,203           | 4,792          | 6,734          | 5,543          | 2,997          | 118.2%          | 39.1%          | (14.3%)         | (45.2%)        |
| <b>Net Operating Income Before Taxes and Donations</b> |       | <b>(185,852)</b> | <b>664,815</b>   | <b>56,903</b>    | <b>2,282,440</b> | <b>1,538,280</b> | <b>(21,072)</b> | <b>75,120</b>  | <b>6,496</b>   | <b>250,268</b> | <b>166,481</b> | <b>(457.7%)</b> | <b>(91.4%)</b> | <b>3,911.1%</b> | <b>(32.6%)</b> |
| <b>Net Operating Income Before Donations [h=f-g]</b>   |       | <b>(185,852)</b> | <b>664,815</b>   | <b>56,903</b>    | <b>2,282,440</b> | <b>1,538,280</b> | <b>(21,072)</b> | <b>75,120</b>  | <b>6,496</b>   | <b>250,268</b> | <b>166,481</b> | <b>(457.7%)</b> | <b>(91.4%)</b> | <b>3,911.1%</b> | <b>(32.6%)</b> |
| Non Operating Revenue (i)                              |       | -                | -                | -                | -                | -                | -               | -              | -              | -              | -              | -               | -              | -               | -              |
| Non Operating Expense (including related taxes) (j)    |       | -                | -                | -                | -                | -                | -               | -              | -              | -              | -              | -               | -              | -               | -              |
| <b>Net Income Before Donations [k=h+i-j]</b>           |       | <b>(185,852)</b> | <b>664,815</b>   | <b>56,903</b>    | <b>2,282,440</b> | <b>1,538,280</b> | <b>(21,072)</b> | <b>75,120</b>  | <b>6,496</b>   | <b>250,268</b> | <b>166,481</b> | <b>(457.7%)</b> | <b>(91.4%)</b> | <b>3,911.1%</b> | <b>(32.6%)</b> |
| Donations (l)  |       | 915,866          | 1,064,114        | 345,951          | 187,174          | -                | 103,840         | 120,239        | 39,492         | 20,523         | -              | 16.2%           | (67.5%)        | (45.9%)         | (100.0%)       |
| <b>Net Income (after Taxes and Donations) [m=k+l]</b>  |       | <b>730,014</b>   | <b>1,728,929</b> | <b>402,854</b>   | <b>2,469,614</b> | <b>1,538,280</b> | <b>82,768</b>   | <b>195,359</b> | <b>45,988</b>  | <b>270,791</b> | <b>166,481</b> | <b>136.8%</b>   | <b>(76.7%)</b> | <b>513.0%</b>   | <b>(37.7%)</b> |

Notes: 1) Application and passbook fees; 2) Interest on savings; 3) Traveling per diem and car running costs

## ■ Formulas

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

## ■ Rating scale

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