

Yehu Microfinance Trust, Kenya

Yehu Microfinance Trust started out as a project of the NGO Choice Humanitarian Kenya under the name Yehu Enterprise Support Services in 1998 and was independently registered as a Trust as of July 31, 2007. Yehu began its operations with the organizing of women's groups and facilitating their savings in Kwale District, Coast Province. The first loan was disbursed in 2000 and Yehu has since grown to a total of six branches including the recent opening of two branches in Mombasa. As of June 30, 2007 Yehu has 6,856 active savers and reaches 3,936 active borrowers through a single group loan product with a total loan portfolio of 398,661 USD.

GIRAFE Rating

Rating

D

Outlook

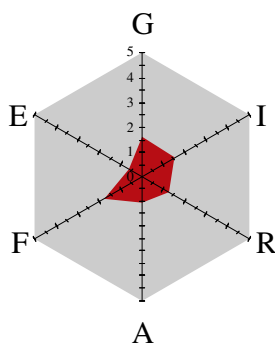
Positive

Date of the rating

August, 2007

Valid until July, 2008

Rating per evaluation area



Governance – Information – Risk –
Activities – Funding – Efficiency

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Rating highlights

- In August 2006, a professional CEO was appointed to head Yehu after which many critical improvements have been put in place, most notably stronger procedures with increased internal controls and improved portfolio management.
- Credit risk remains high even though PAR 31-365 has reduced from 37% (Dec. 2006) to 19% (Jun. 2007) and profitability remains low with ROA at (8.8%) in 2005, (26.8%) in 2006 and (18.2%) as of June 2007.
- Since 2006 Yehu has moved from its traditional rural focus in Coast Province to include urban areas and opened two branches in Mombasa.
- Yehu still faces challenges due to absence of the internal audit function, lapses in adherence to policy by branch staff and its MIS system where loan tracking and accounting data contain large unreconciled differences.

Outlook

The positive outlook for Yehu is based on yielding further results of improvements that have been set in motion including improved portfolio management and capacitating of branch staff, and on further improvements that are planned for such as strengthening the management team with a CFO, closer governance by a local board of directors and installation of an internal audit function. More determined action is still needed to improve information reliability, liquidity management and profitability.

Performance indicators

USD , unless otherwise stated	Dec. 2004	Dec. 2005	Dec. 2006	Jun. 2007
Assets	517,485	776,089	977,006	1,229,021
Growth	123.5%	40.5%	21.0%	20.2%
Loan portfolio	240,567	309,857	337,777	398,661
Growth	104.6%	20.7%	4.7%	12.8%
Outstanding deposits	137,483	252,119	386,322	469,156
Growth	63.8%	71.8%	47.2%	16.1%
Active borrowers	3,304	4,635	4,047	3,936
Active savers	5,254	6,340	6,781	6,624
Staff	42	41	48	52
ROE	(18.8%)	(9.2%)	(29.1%)	(20.4%)
ROA*	(18.2%)	(8.8%)	(26.8%)	(18.2%)
Liabilities / Equity*	0.03x	0.06x	0.12x	0.12x
Portfolio Yield	21.6%	23.9%	22.2%	25.8%
Operating expense ratio	55.3%	42.1%	50.7%	51.5%
PAR 31-365†	N/A	N/A	36.8%	19.0%
PAR > 365†	N/A	N/A	14.5%	7.5%
Write-off ratio†	0.0%	0.0%	9.3%	7.7%

*Ratios have been adjusted to exclude members' deposits from assets & liabilities.

†Based on data from Loan Performer, all other figures based on accounting data, see note in Information. 2007 PAR data is not fully reliable.

Microfinance sector

Many of the current market leaders in the microfinance industry were founded in the early eighties. Currently, the Kenyan microfinance industry contains two microfinance oriented banks (K-REP Bank and Equity Bank) that are regulated by the Central Bank of Kenya (CBK) under the Banking Act. Other regulated MFIs are cooperatives which are regulated by the Commissioner for Cooperative Development under the Co-operative Societies Act and are allowed to pursue member based financial intermediation. Other MFIs comprise Companies, NGOs and Trusts, are not regulated and are not allowed to pursue financial intermediation.

In December 2006 a new Microfinance Act was signed that will regulate deposit-taking financial institutions. The regulations under the act are still to be published by CBK. It is estimated that between three and five MFIs (KWFT, Faulu Kenya, Jamii Bora Trust, SMEP and KADET) will initially apply for a license. The act however, also leaves room for non-regulated, non-deposit taking financial institutions.

The financial sector however still has a lot of ground to cover as a recent study into the access to financial services in Kenya¹ showed that 38.4% of the total population is still excluded from financial services and that the vast majority uses informal groups rather than any kind of formal financial institution. The table below shows the percentage of the Kenyan population for each source of financial services:

Source	Rural %	Urban %	Male %	Female %	Total %
Bank	10.7%	25.1%	18.7%	10.1%	14.2%
Postbank	4.4%	9.3%	6.6%	4.7%	5.6%
SACCO	13.9%	10.5%	17.3%	9.2%	13.1%
MFI	1.5%	2.4%	1.6%	1.8%	1.7%
Informal groups	53.4%	42.1%	46.3%	54.6%	50.6%
Excluded	37.4%	41.6%	37.5%	39.3%	38.4%

Note: multiple responses are possible per column.

Notably only 1.7% of the population has used financial services from MFIs whereas 14.2% and 13.1% have used financial services from banks and cooperatives respectively. There are 3,767 licensed cooperatives that together are estimated to have 2.1 million clients, 1.48 billion USD in loan portfolio and 1.79 billion USD in deposits.² The larger cooperatives in Kenya are however more focused on salary loans to low- to middle-income clients in urban areas. Besides the cooperatives, the seven largest providers of microfinance services in Kenya are:

MFI	Savings accounts	Deposits (M USD)	Active borrowers	GLP (M USD)
Equity Bank	1,014,474	168	239,541	106
K-REP Bank	14,951	24	114,301	54
KWFT	n/a	13*	85,555	33
Faulu Kenya	n/a	11	68,434	19
Jamii Bora Trust	140,000†	4.1	60,000†	5.3
SMEP	n/a	3.5	24,090	6.6
KADET	n/a	2.2	16,575	3.7

Source: www.mixmarket.org 2006 data; * 2005 data; † estimate.

The current main donor support to the microfinance sector is coming from the Financial Sector Deepening project³ that focuses on the main challenges to further expand and strengthen the microfinance sector in Kenya: capacity building of MFIs, regulatory framework for cooperatives, rural finance, agricultural finance, SME finance and enhancing payments systems such as remittances and mobile phone banking.

Political & economic environment

After several years of stagnation, the recovery underway since 2004 continued in 2006 despite the economic impact of the energy bill and the drought that affected farm and hydropower production during the early months of the year. While all economic sectors registered growth, agriculture, transport, telecommunications, and tourism were the most dynamic. Barring exogenous shocks, those trends should continue in 2007 underpinned by infrastructure modernization and active tax incentive policy. Meanwhile, the rapid increase of prices should ease barring exceptionally adverse weather or fiscal slippage.

With investment spending and domestic debt already straining the public sector balance, a marked increase in current public spending in the run-up to general elections end 2007 could thus negate the management efforts facilitated in past years by rising fiscal revenues. Export dynamism has moreover not sufficed to offset the rapid rise of imports (oil products and capital goods) thereby increasing the current account deficit. With moderate foreign debt, however, Kenya's financing needs have remained manageable.

The political context has been marked by the approach of elections (which could even be held earlier) that could heighten political and social tensions, and by an inadequate anti-corruption campaign, which has soured the country's relations with western financial backers

¹ Results of a National Financial Access Survey, The Steadman Group Research Division, July 2007. www.fsdkenya.org/finaccess

² CBK Annual Report 2006. <http://www.centralbank.go.ke/publications/annual/index.html>

³ A multi-donor project funded by DfID, SIDA and World Bank.

Strengths

- The regional integration underway within the East African Community will further strengthen Kenya's position and its attractiveness to investors.
- Improved infrastructure (transport, telecommunications, and financial services) will make it possible to exploit the potential of an already diversified economy more fully.
- That should facilitate gradually separating policy development from economic development.

Weaknesses

- Agriculture is still a key economic sector (25% of GDP), thus making most personal incomes vulnerable to weather conditions.
- Combating poverty, unemployment, and the AIDS pandemic continues to necessitate major efforts.
- The business climate and persistent corruption have damaged the country's image.
- High production costs have been hampering companies.
- The domestic debt burden (20% of GDP) has undermined public sector finances.

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

(USD millions)	2004	2005	2006 (e)	2007 (f)
Economic growth (%)	4.9	5.8	5.5	5.5
Inflation (%)	11.7	10.3	13.6	8.0
Public sector balance (%GDP)	-0.4	0.1	-4.4	-4.0
Exports	2,721	3,240	3,550	3,934
Imports	4,351	5,408	6,479	7,102
Trade balance	-1,630	-2,168	-2,929	-3,168
Current account balance (%GDP)	-2.2	-2.6	-4.6	-4.8
Foreign debt (%GDP)	42.1	34.8	29.2	28.8
Debt service (%G&S exports)	6.0	6.1	5.5	6.7
Foreign currency reserves (in months of imports)	3.3	3.2	3.7	3.4

Source: COFACE's Country Risk Ratings Guidebook 2006. (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

Yehu started its operations as a project of Choice Humanitarian Kenya an NGO registered under the NGO Act, under the name Yehu Enterprise Support Services (YESS). On July 31st 2007 Yehu Microfinance Trust has been independently registered as a Trust under Trustees Act, Chapter 167 of the Laws of Kenya. The assets and

operations of YESS have been transferred in its entirety to Yehu Microfinance Trust. As a Trust (nor before as an NGO) Yehu does not receive any formal supervision and is not regulated by the Central Bank of Kenya. As such Yehu is not allowed to pursue financial intermediation.

Separate audited accounts are available for YESS since 2001 and until 2005 YESS has been audited by Wambugu & Associates who provided unqualified opinions for all years. For the year 2006 YESS has been audited by Ruoro Kotut & Company who qualified their opinion for un-reconciled differences between accounting and loan tracking data on the loan portfolio.

Ownership

Choice Humanitarian Kenya (CHK) was founded by Choice Humanitarian, a United States based charity focused on poverty alleviation through sustainable village development. Since 2001 YESS has been governed by a five member Board of Directors (BOD) independent of the BOD of CHK of which four are representatives of Pope Foundation based in the US and one is the Country Director of CHK.

Yehu Microfinance Trust has been officially founded by Pope Foundation with an initial Trust Fund in the amount of 30 M KES (449 K USD). The new BOD of Yehu Microfinance Trust consists of one representative of Pope Foundation, the Country Director of CHK, one client representative, three local civil society leaders and the General Manager as an ex-officio board member.

Donations

To date Yehu has received a total of 60 M KES (0.9 M USD) in donations of which 48.9 M KES (0.7 M USD) is donated equity from Pope Foundation, a United States based charity. Yehu has also received 11.1 M KES (0.17 M USD) from Danish International Development Agency (Danida) focused on Tiribe and Samburu branches.

Funding composition

As of June 2007 Yehu's funding structure consists for 54% of donated equity and 39% of members deposits. The remaining 7% is made up of short and long term liabilities. To date Yehu has not yet attracted any borrowings. The member's deposits are however not used for on-lending but held in bank or fixed deposits.

Management team

The management team is composed of the Chief Executive Officer (CEO), Chief Operations Officer (COO), Accountant, Training Officer & Credit Controller (TOCC) and Administration Officer (AO). The TOCC is responsible

for training of staff and clients as well as overseeing branch compliance with policy and procedures. The Administration Officer is responsible for both human resource and IT management.

- The CEO, Adet Kachi, joined Yehu in August 2006. Previously he was Finance and Administration Manager (2.5 years) and Acting General Manager (1 year) of an MFI in Botswana. He holds a BSc in Agriculture from the University of Nairobi, Kenya (1990) and a MBA from De Montfort University, UK (2005).

Organization

The management team is based at the head office (HO) located in Mombasa together with support staff in the accounts and data processing units. The branches contain a Branch Manager (BM), a clerk and several Loan Officers (LO)⁴. Loans up to 40,000 KES are approved by branch managers where loans above that are approved at head office. All loan applications have to come to head office where disbursements are prepared.

Disbursements are made through local banks where clients pick up the money. For most client centers one or two of the members will deposit the collections in the banks themselves, although for some distant rural centers the LO takes the cash to the branch where the clerk will deposit the money in the bank.

Yehu uses a computerized MIS (Loan Performer (LPF) for its loan tracking as stand-alone units in its branches where databases are sent to HO weekly for consolidation. Where LPF has the capability of accounting this is not used by Yehu at present. Branches do not keep their own accounts but accounting slips are sent to HO weekly where a central, computerized accounting package (Quickbooks) is used.

Market penetration

Yehu operates through six branches and limits its area of operations to Coast Province in Kenya with Mombasa as the provincial capital. Its traditional area of operations has been Kwale District (South of Mombasa) where it currently has three branches in Mwambalazi, Mamba and Tiribe. In 2004 it opened a branch in Samburu with support from Danida. Since 2006 it has also started offering loans in urban areas with one branch opened in Likoni, Mombasa in 2006 and a second branch opened in Kisauni, Mombasa in 2007. For Coast Province Yehu's market share is estimated at 5% in terms of number of active borrowers.

⁴ Within Yehu the term Community Credit Worker (CCW) is used.

Products and services

Yehu currently only offers one group loan product which includes mandatory savings based on the Grameen methodology. Loan amounts in rural/urban areas start at 5,000/10,000 KES (75/150 USD) and the maximum loan amount 250,000 KES (3,740 USD). The interest rate is 24% flat as of Oct. 2006, up from 20% flat previously, and a loan application fee of 150 KES is charged on each loan. The effective interest rate is 48% up from 40%. Members also pay a membership fee of 100 KES with annual renewal of 50 KES and 2% premium on each loan for insurance of death and permanent disability. Loans are guaranteed through a group guarantee and compulsory deposits of 30% of the loan amount. Voluntary deposits are also allowed. Deposits attract interest according to the interest Yehu earns from commercial banks minus a 1% administrative charge.⁵

Networks

Yehu is a member of the Association of Microfinance Institutions in Kenya (AMFI).

■ Governance

Governance and Decision Making is rated “d”

Decision-making

The decision-making at Yehu has been less than effective as in the past the BOD has been governing YESS from a distance (both literally as well as figuratively) which has allowed Yehu to struggle for a number of years. The recent move to hire a professional CEO (June 2006) has significantly strengthened the institution but direct governance has remained limited with quarterly meetings only and limited follow-up on decisions taken in previous meetings. Furthermore, this is also due to a lack of specific microfinance knowledge at the BOD level although the BOD does combine both skilled business people as well as people with a strong social development background.

With the new CEO in place the distant governance has also created an unbalance in the decision making process as the BOD has left much of the decision making powers with the CEO concentrating most of the decision making powers in this position. Also much of the initiatives for developing and implementing new and improved policies and procedures remain with the CEO.

Over the past year appropriate information has been provided to the BOD with brief monthly and more elaborate

⁵ Earned interest by Yehu and interest paid to clients on deposits does not pass through the income statement of Yehu except for the 1% admin charge.

quarterly reports. Unreliability of data however prevents full information to decision makers (see Information section).

As a project under Choice Humanitarian Kenya the institutional set-up has not been ideal although since 2001 YESS has kept separate books of accounts and has been governed by its own BOD independent from the BOD of CHK. The recent spin-off into Yehu Microfinance Trust strengthens the institutional set-up especially as a local BOD has been put in place. The new BOD of Yehu Microfinance Trust is expected to provide closer governance as a balance to the management but this needs to be proven over time. However, the new BOD also lacks key people with specific microfinance knowledge to add to the BOD members that have strong social development backgrounds.

Strategic Planning

Since early 2006 Yehu has changed its strategy from a true rural focus to a combined focus on the rural areas in Coast Province as well as on Mombasa. However, this strategic move was not underpinned by a thorough analysis but by a presumption that the high operating expenses in the rural areas should be cross-subsidized by lower operating expenses in the urban areas. In the short term however it has increased operating expenses as the number of branches has grown while the loan portfolio has only grown slightly.

Since inception no business plan has been in place which has disallowed Yehu to have a long term vision and has contributed to the continuing poor performance in the past. For 2007 a one year budget and action plan was prepared which includes basic performance targets for the branches. This one year plan does focus on the most urgent areas of strengthening necessary with an overall good focus on must-do activities that are urgently needed to strengthen the institution (improving portfolio quality, reducing costs and improving service delivery). One area that could have received more attention is data processing (see Information section). A business plan for the coming years 2008-2011 is planned to be developed in the second half of 2007.

The planning process was intentionally participatory including the management team and branch managers even though BMs were not ready for the task. This has resulted in capacitating of BMs (holding them accountable for their work) but has weakened the relevance of the plan. Throughout the institution there has been a better cost-awareness and a focus on reducing spending but to date this has not resulted in a significantly lower operating expense ratio (see Efficiency & Profitability section).

Management team

The management team is led by a professional CEO, however significant strengthening of the other management team members is necessary to move the institution through the changes ahead. The CEO does actively engage the management team members in planning and management of the change processes within Yehu giving them opportunity to give input to management process. Uptake of the space given could be greater and effective decision-making within the management team remains mostly with the CEO also due to the present skills gap with the other management team members.

A CFO is planned to be hired before the end of 2007 to strengthen the management team. Until the management team is significantly strengthened key-person risk will remain on the CEO. This has been partly mitigated by the BOD (Pope Foundation) through providing Yehu with a specific grant for a soft, long-term loan to the CEO for the purpose of buying a house and settling in Mombasa.

Human resource management

Yehu has a good recruitment process in place giving priority to internal promotion but when necessary hiring of external staff. Recently adequate on the job-training of new LOs has been introduced. Similarly a well developed staff evaluation process has recently been put in place (first half 2007) to monitor staff capacity at all levels. Further staff performance monitoring and guidance will benefit from the recently implemented incentive system (January 2007) although for some LOs in the poor performing branches the bonus will be difficult to achieve and can lead to demotivation, which could deteriorate their performance rather than improve it.

Staff training is a priority for Yehu and there is a continued capacitating of BMs and LOs through more strict management controls as well as organization wide seminars. This is necessary at Yehu in order to ensure equal and good understanding and application of policies and procedures throughout the institution. The function of Training Officer has been created for this task although this function also includes training of clients.

Yehu has faced significant staff turnover in the past and the staff turnover remains high. In the past year this has been mostly due to both firing of staff because of underperformance and/or fraudulent practices as well as below market remuneration of staff. The latter is an issue that is not yet being fully addressed by Yehu.

■ Information

Information is rated “d”

Yehu has adequate IT infrastructure and systems with computerized but separate management information systems in place for both accounting and loan/savings tracking. Quickbooks has been used since January 2004 and Loan Performer (LPF) came fully online in May 2006. The systems have greatly improved the availability of information as well as efficiency in data processing with data available on a timely basis. Yehu currently has limited internal capacity in place to adapt and/or improve IT systems and remains dependent on suppliers and contracted IT workers. For example the update of LPF software in April 2007 caused unreliability of newly entered data for some months and is yet to be fully resolved.⁶

Adequate back-up systems are in place for both LPF and Quickbooks with weekly back-ups but up-to-date anti-virus protection not fully streamlined throughout the institution. Data at branches is not stored securely but copies of essential data are sent to HO weekly.

Data reliability is hampered by significant un-reconciled differences between accounting and loan data which prevents full reliability of data and urgent reconciliation is necessary.

An excel sheet calculates all necessary performance indicators both for financial performance as well as performance of loans and savings activities on a monthly basis but this is not always timely available. Significant improvements have been made in the past year in using performance indicators for monitoring and managing performance, but unreliability of data partially restricts this. Two key areas however need strengthening:

- more detailed use of PAR data is needed to adequately monitor changes/improvements in portfolio quality;
- more focus is needed on monitoring income to understand and minimize the yield gap.

Not all accounting practices follow international best practice:

- Write-off: loans are written-off from loan tracking data but to date no loans have been written off from accounting data, see note below.
- Interest earned/paid on members' deposits does not pass through the income statement.
- Loans written-off from the emergency fund do not pass through the income statement.

Note: Since December 2006 Yehu has consciously adopted a temporary Loan Loss Provisioning policy to stimulate LOs to clean up their portfolio.

⁶ As a result of this the PAR data for June 2007 is not fully reliable.

Currently specific loans are provisioned for 100% to be approved by management. As LPF does not have this function, the loans have been written-off in LPF reducing gross loan portfolio and PAR figures. However, to date the loans were not written-off from accounting data. No PAR data could be established for the gross loan portfolio as shown in accounting data. Therefore the following ratios in this report are based on the gross loan portfolio in LPF: PAR, write-off ratio, credit risk coverage ratio and PAR 31 net of loan loss provision / Equity. A standard Loan Loss Provisioning policy is expected to be put in place by the end of 2007.

■ Risk Management

Risk Management is rated “d”

Procedures and internal controls

Yehu has seen a significant improvement over the last year in developing adequate procedures and establishing internal controls that were virtually absent before. To date a new operational manual has been developed which is an all-in-one manual as a temporary step until more specific manuals will be developed. The manual contains the most basic procedures with adequate internal controls such as separation of duties and hierarchical limitation of powers as well as significant limitation of cash handling by staff.

The policy is new (June 2007) and is still to be fully introduced in the organization. Adherence to policy has been greatly increased in the past year but overall adherence to policy is still weak:

- Prevalent fraud cases have been considerably reduced but current controls do not yet fully prevent future potential cases of fraud; there is weak oversight of branch management which is especially necessary for rural branches due to the limited communication possibilities.
- Controls of LOs by branch management need to be strengthened in order to more closely monitor their operations.
- Significant training of LOs is needed on the newly developed policy and procedures.

The all-in-one manual still needs to be developed into more specific manuals such as: credit manual, accounting manual, HR manual, etc. The first manual to be recently developed is the internal audit manual (August 2007) but this one has not yet been put into practice.

Internal audit

Since inception the internal audit function has been absent in Yehu and only very limited checks have been carried out. However, since the second half of 2006 each branch has received multiple spot checks (semi-annually) by management team members and the Credit Controller. These spot checks have greatly contributed to the necessary increase in policy adherence within Yehu however they cannot be substituted for standalone, independent audit visits

by internal auditors that are not part of regular portfolio management.

The recent development of the IA manual is a good first step and an internal auditor is intended to be recruited before the end of 2007. Given the current weak adherence to policy and procedures within Yehu and its spread out branch network urgent installation of an internal audit unit is highly necessary. The developed IA manual adequately follows international best practice but could be strengthened in the areas of audit of management functions and to incorporate a global risk perspective of the institution.

There has been adequate support to internal controls by external auditors although the external audit by the previous auditors was weak. Yehu was slow to follow-up on recommendations on internal controls in the management letters of the 2004 & 2005 audits. The last audit has also provided good support for internal controls to Yehu and many of the recommendations have been implemented.

■ Activities

Activities: products and services is rated “d”

Market position

The microfinance market in Coast Province is not yet fully developed as the market penetration remains low and there is still a large untapped potential of microfinance clients. Hence, competition to date has remained relatively limited although some cross-indebtedness does occur, especially in Mombassa town. With this as a backdrop, Yehu has not yet been able to establish a strong market position and its market share in Coast Province has remained limited (estimated at 5%). Yehu has been able to penetrate the market in Mombasa relatively well where the Likoni branch is one of Yehu’s better performing branches.

Yehu’s main competitive advantage is its rural penetration in Kwale District, its lower starting loan sizes and client friendliness. The latter has however been compromised by fraudulent LOs in the past and long lead times for loan approval and savings withdrawals (on average above 14 days). On the other hand the fact that Yehu is more accommodating to clients when it comes to loan repayment does pose consequences for its portfolio quality.

To date the product offering has remained limited to one product although a second loan product – a school fees loan – has been developed and trial offerings will start in the second half of 2007. As Yehu expands and competition increases clearer competitive advantages for Yehu need to be established and it will have to further diversify its product offering.

Loan portfolio management

The credit methodology is adequately designed with elaborate group formation of clients and stepped loan disbursements (i.e. not all members from each group of five in the center receive a loan at the same time). The loan appraisal in the process is weak as it solely depends on the client’s information backed-up with information of group members and no home/business visit is conducted prior to loan disbursement. However, for loans over 40,000 KES a more stringent appraisal is done and verified by the BM.

The overall management of the portfolio at branch level is weak with delays in loan approval lead times and lacks follow-up on late loans with long delays before clients are visited. This situation is further exacerbated by the weak supervision capacity of BMs who on average are slow to catch up on the change process within Yehu and the more diligent portfolio management that is necessary. The incentive system for LOs & BMs, the visual posting of branch performance and weekly branch meetings with minutes sent to HO has increased the focus of branch staff on the key performance indicators.

However, full adherence to policy and procedures of branch staff remains weak which is in part due to their limited capacity as well as limited effective management of BMs and LOs respectively. Significant capacitating of branch staff is necessary especially in new operational procedures.

To control the poor portfolio quality loan disbursements to centers with a repayment rate below 95% have been stopped since October 2006. This, together with the write-off of loans, has resulted in a decline in active borrowers from 4,635 in Dec 2005 to 4,047 in Dec 2006. After a low in April 2007 with only 3,089 active borrowers the number has since increased to 3,936 as of June 2007. There is good potential for Yehu to increase its number of active borrowers as the number of dormant borrowers currently stands at 2,920. The loan portfolio has been steadily increasing due to an increase in average outstanding loan balance per borrower from 67 USD in Dec. 2005 to 101 USD as of June 2007.

Credit risk

The credit risk of Yehu remains high. Portfolio at risk was extremely high in the beginning of 2006 but has come down significantly during the year and even more in 2007. Current PAR levels however remain high (PAR 31-365: 19%, PAR>365 7.5%)⁷. The reduction in PAR is in part due to the ‘write-off’ of late loans as well as improvement of the portfolio itself.

⁷ The PAR data, write-off ratio and credit risk coverage are based on data from Loan Performer, see note in Information section.

The write-offs have been high in 2006 and in 2007 as a clean-up of the portfolio was necessary with write-off ratios at 9.3% and 7.7% respectively. Further write-offs can be expected as PAR > 365 stands at 7.5%. Write-offs are tracked separately in Loan Performer and reasonable recovery is made on loans written-off.

Concentration risk is not monitored and no portfolio diversification rules have been set in place. However, concentration risk is expected to be low due to a dual focus on urban and rural areas and diverse nature of businesses of the clients.

Credit risk coverage remains low at 24.4% (Dec. 2006) and 31.5% (June 2007) as the high loan loss provision expenses have mainly been eaten-up by the write-offs. The loan loss provisioning policy does not follow international best practice as loans are provided for only on an individual basis for the full 100% as requested by independent branches and approved by management resulting in irregular loan loss provisioning.

Otherwise loans are protected through group guarantees and mandatory savings of clients (30% of loan amount). Where enforcement of these guarantees has improved over the past year they can be further strengthened with increased capacity of LOs.

Savings

Compulsory savings are requested as collateral for loans but members are also allowed to save more than the minimum required. Yehu does not track these 'voluntary' savings separately. Over the past three years savings have grown faster than the loan portfolio and total deposits currently are 118% of the loan portfolio. However, neither previously as a NGO and currently as a Trust is Yehu allowed to pursue financial intermediation and savings are kept in bank and fixed deposits.

■ Funding and liquidity

Funding and liquidity is rated "d"

The funding structure is typical of an NGO-MFI with significant donated equity making up the majority of the assets. The members' deposits are collected but not used for on-lending increasing the level of equity in effective assets to 89% as of June 2007.

Asset & Liability Management

ALM risks are very limited for Yehu as the institution does not face interest rate risk or FX risk. Maturity risk is limited but not monitored by Yehu. Sufficient cash is available to cover savings withdrawals as liquidity levels are relatively

high but liquidity levels are not based on analysis of savings activities. Vice versa the term of the loan portfolio is easily covered by the equity.

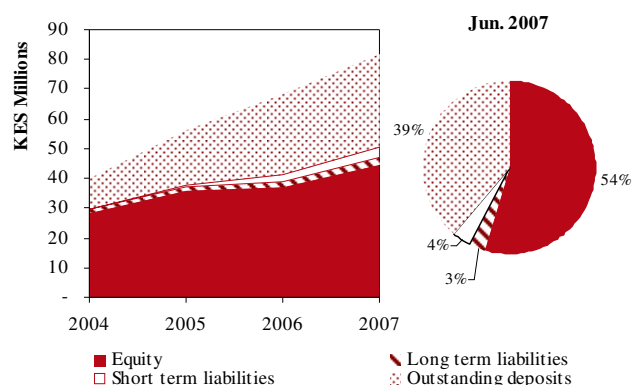
Funding strategy

Yehu currently has no funding plan in place to meet its funding needs. Diversification of sources of funding is necessary as Yehu is solely dependent on its main donor: Pope Foundation. A start has been made with a first loan of 10 M KES (150,000 USD) from the Micro Enterprise Support Programme Trust in Kenya which is in its final stages of contracting.

Liquidity management

No effective liquidity management is in place and no cash flow projections are made. Cash management and allocation among different accounts has recently been improved but does need further strengthening. There is limited risk of illiquidity as cash buffers, even excluding savings, have remained relatively high at Yehu. On the other hand optimization of resources is low and only recently further optimization has taken place depositing part of members' deposits in fixed deposits. Further optimization is possible.

Funding structure



■ Efficiency and Profitability

Efficiency and Profitability is rated "e"

Profitability analysis

Yehu is currently not profitable and the figures also do not show a positive trend with a negative return on assets in 2005 of (8.8%), (26.8%) in 2006 and (18.2%) in the first half of 2007. Return on equity follows a similar trend as leverage is low and steady.

The two main reasons for the negative returns are:

- The effective interest rate (40% until Oct. 2006 and 48% since) is not sufficient to cover the current operating expense ratio, let alone loan loss provision expenses.

Either Yehu needs to create significant economies of scale or otherwise further increase its interest rates to match income with its costs.

- A significant yield gap exists with yield varying between 22-26% over the years. The main reason for this yield gap is the large percentage of non performing loans in its portfolio but income has also been missed because of frauds.

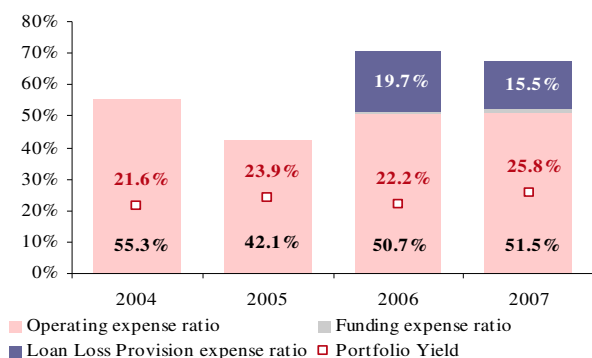
The operating expense ratio is showing a stable trend as reduction in efficiencies (staff productivity) and increased cost per borrowers are off-set by an increasing average outstanding loan amount. The reduction in efficiency and increase in cost per borrower is mostly due to the reducing number of active borrowers in the past year and a half while the operating structures expanded with the opening of two new branches.

The funding expense ratio has been negligible due to low borrowings with only interest paid on a relatively small overdraft. The high loan loss provision expenses in 2006 and 2007 are the main drivers behind the drop in ROA and given current credit risk coverage levels further LLP expenses can be expected. Further optimization of assets is necessary for Yehu to improve its ROA as loan portfolio as a percentage of assets has declined from 59.7% in 2005 to 46.1% in Dec. 2006 and 40.9% in June 2007.⁸

The profitability outlook for Yehu is uncertain. The yield gap is expected to reduce with increasing portfolio quality and increased internal controls but a more in-depth cost and pricing analysis is necessary to come to a financially sustainable operating mode for Yehu. Furthermore the loan loss provision expenses are expected to remain high and the funding expense ratio is expected to come into play as Yehu is attracting debt. On the positive side efficiency indicators do seem to have reached their lowest point and are again on an upward trend opening prospects for Yehu to reduce its operating expense ratio.

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.

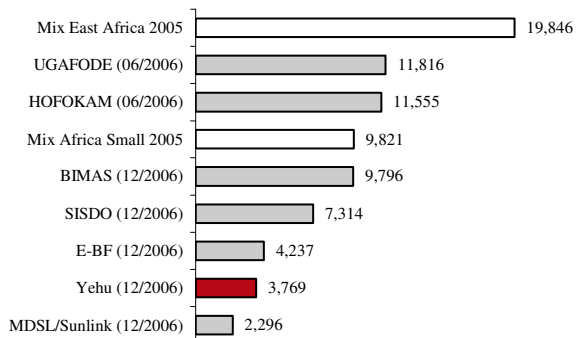
Profitability structure



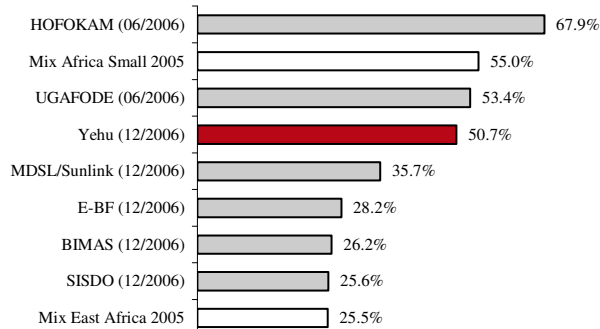
⁸ These ratios are adjusted to exclude member deposits from assets. The unadjusted ratios are 39.9% (Dec. 2005), 27.9% (Dec. 2006) and 25.0% (June 2007).

Benchmarking

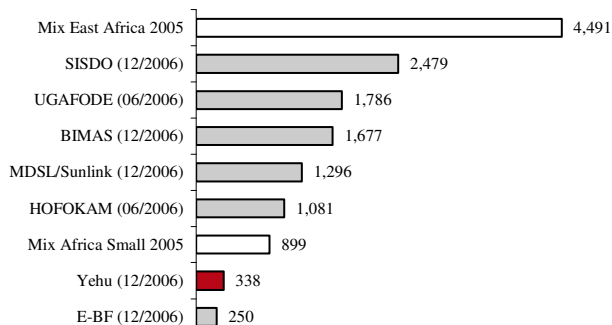
Active borrowers



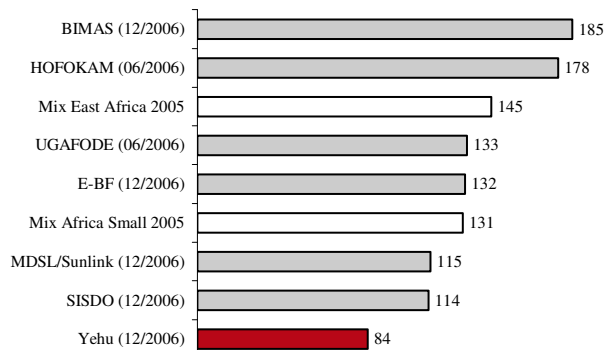
Operating expense ratio



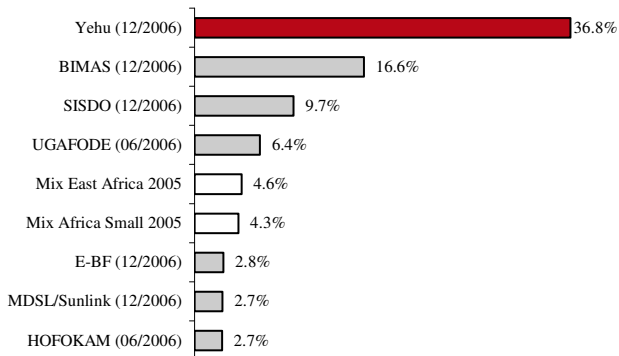
Loan Portfolio ('000 USD)



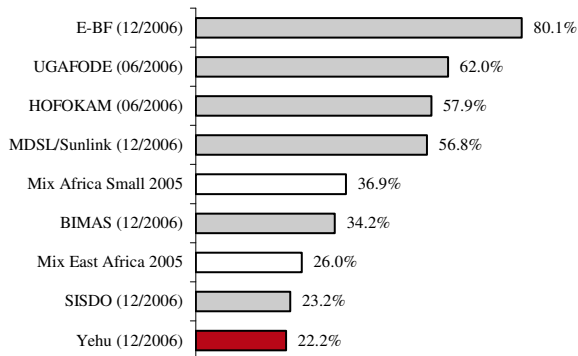
Staff productivity



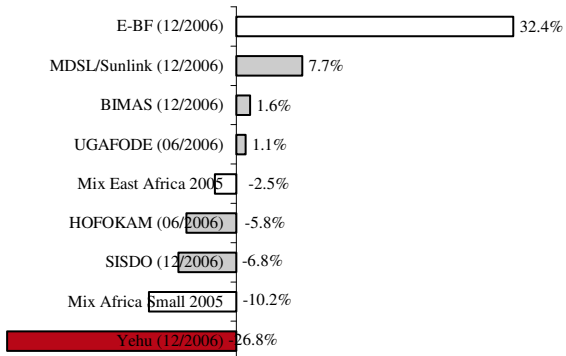
PAR 31-365



Portfolio Yield



ROA



Source:

www.mixmarket.org for MBB data and E-BF, MDSL, BIMAS, SISDO
Yehu, Ugafode (Uganda) and HOFOKAM (Uganda) is Planet Rating data.

■ Performance indicators

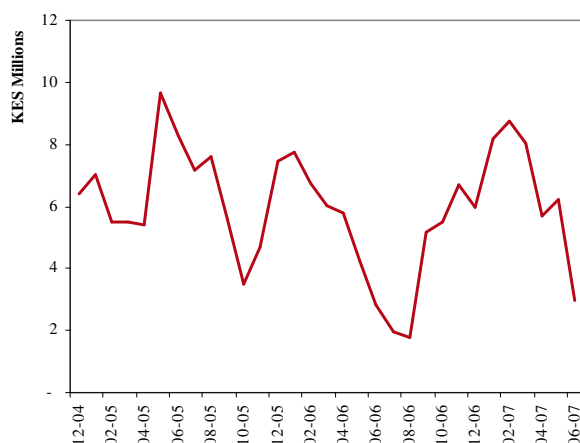
Data in USD, unless otherwise stated

Loan Portfolio	Dec. 2004	Dec. 2005	Dec. 2006	Jun. 2007
Loan portfolio	240,567	309,857	337,777	398,661
Loan portfolio (KES)	18,692,065	22,557,607	23,626,424	26,647,762
Evolution	104.6%	20.7%	4.7%	12.8%
Average outstanding loan portfolio	179,063	281,903	330,137	376,061
Active borrowers	3,304	4,635	4,047	3,936
Evolution	N/A	40.3%	(12.7%)	(2.7%)
Average outstanding loan per client	73	67	83	101
% of GDP per capita	17.2%	14.8%	17.7%	20.5%
Average amount disbursed per loan	107	122	156	183
% of GDP per capita	21.2%	21.0%	22.3%	23.0%
Rescheduled loans	0.0%	0.0%	0.0%	0.0%
PAR 31-365†	N/A	N/A	36.8%	19.0%
PAR > 365†	N/A	N/A	14.5%	7.5%
Write-off ratio†	0.0%	0.0%	9.3%	7.7%
Risk coverage ratio†	0.0%	0.0%	24.4%	31.5%
PAR 31 net of loan loss provision / Equity†	N/A	N/A	20.0%	9.9%
Savings				
Outstanding deposits	137,483	252,119	386,322	469,156
Outstanding deposits (KES)	10,682,406	18,354,255	27,022,013	31,359,855
Evolution	63.8%	71.8%	47.2%	16.1%
Active savers	5,254	6,340	6,781	6,624
Evolution	N/A	20.7%	7.0%	(2.3%)
Average outstanding deposit per saver	26	40	57	71
Staff				
Total number of staff	42	41	48	52
% Credit officers	50.0%	43.9%	45.8%	48.1%
Turnover	45.5%	16.9%	20.2%	8.0%
Profitability analysis				
ROE	(18.8%)	(8.5%)	(29.2%)	(20.6%)
Liabilities / Equity*	0.03x	0.05x	0.12x	0.12x
ROA*	(18.2%)	(8.8%)	(26.8%)	(18.2%)
Portfolio Yield	21.6%	23.9%	22.2%	25.8%
Operating expense ratio	55.3%	42.1%	50.7%	51.5%
Cost per borrower	30	26	41	49
Staff productivity	79	113	84	76
Loan officer productivity	157	258	184	157
Average outstanding loan per client (USD)	73	67	83	101
Funding expense ratio	0.0%	0.1%	0.5%	0.7%
Cost of savings	0.0%	0.0%	0.0%	0.0%
Cost of liabilities	6.1%	10.3%	8.9%	6.4%
Loan Loss Provision expense ratio	0.0%	0.0%	19.7%	15.5%
Outstanding Loan Portfolio / Assets*	63.3%	59.7%	46.1%	40.9%
Revenue from investment as a % of financial revenues	0.2%	0.1%	1.3%	0.0%
Loans to deposits	174.7%	120.7%	87.6%	83.5%
Liquidity / Total assets (LAR)*	24.2%	24.4%	24.4%	22.2%
Exchange rate 1 USD= xx KES	77.7	72.8	69.9	66.8

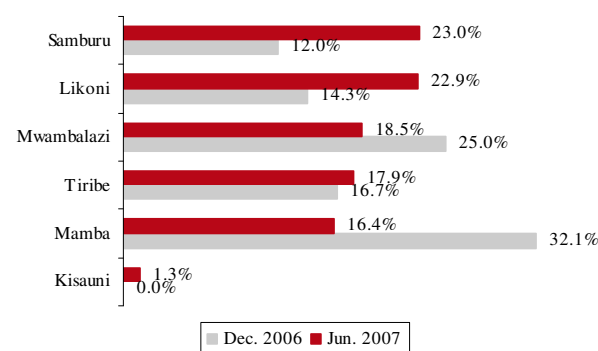
* Ratios have been adjusted to exclude members' deposits from assets & liabilities.

† Based on data from Loan Performer, all other figures based on accounting data, see note in Information. 2007 PAR data not fully reliable.

Evolution of cash balance



Outstanding Loan Portfolio per Branch



Yehu Microfinance Trust		KES				USD				Evolution		
Income Statement	Notes	Dec. 2004	Dec. 2005	Dec. 2006	Jun. 2007	Dec. 2004	Dec. 2005	Dec. 2006	Jun. 2007	2005/ 2004	2006/ 2005	2007/ 2006
Financial Revenue (a)		3,381,233	5,690,014	5,749,357	4,338,882	43,517	78,160	82,196	64,911	68.3%	1.0%	(24.5%)
Financial Revenue from Loan Portfolio		2,999,853	4,906,915	5,119,554	3,241,882	38,608	67,403	73,192	48,500	63.6%	4.3%	(36.7%)
Interest on Loan Portfolio		2,999,853	4,906,915	5,119,554	3,241,882	38,608	67,403	73,192	48,500	63.6%	4.3%	(36.7%)
Fees and Commissions on Loan Portfolio		-	-	-	-	-	-	-	-	-	-	-
Penalty Revenue on Loan Portfolio		-	-	-	-	-	-	-	-	-	-	-
Financial Revenue from Investments		5,120	6,524	74,103	-	66	90	1,059	-	27.4%	1,035.9%	(100.0%)
Other Operating Revenue		376,260	776,575	555,701	1,097,000	4,842	10,667	7,945	16,412	106.4%	(28.4%)	97.4%
Financial Expense (b)		2,656	16,566	108,738	84,283	34	228	1,555	1,261	523.8%	556.4%	(22.5%)
Interest paid on borrowings		2,656	16,566	108,738	84,283	34	228	1,555	1,261	523.8%	556.4%	(22.5%)
Interest paid on deposits		-	-	-	-	-	-	-	-	-	-	-
Net Inflation Adjustment Expense		-	-	-	-	-	-	-	-	-	-	-
Other Financial Expenses		-	-	-	-	-	-	-	-	-	-	-
Financial income [c=a-b]		3,378,577	5,673,448	5,640,619	4,254,599	43,482	77,932	80,641	63,651	67.9%	(0.6%)	(24.6%)
Net Loan Loss provision expense (d)		-	-	4,545,380	1,949,591	-	-	64,983	29,167	-	-	(57.1%)
Loan loss provision expense and write-off		-	-	4,545,380	1,949,591	-	-	64,983	29,167	-	-	(57.1%)
Recovery from Loans written off		-	-	-	-	-	-	-	-	-	-	-
Operating expense (e)		7,695,344	8,647,221	11,702,019	6,469,608	99,039	118,781	167,299	96,788	12.4%	35.3%	(44.7%)
Personnel Expense (includes fringe)		4,207,296	5,001,434	5,851,596	3,405,026	54,148	68,701	83,658	50,941	18.9%	17.0%	(41.8%)
Administrative Expense (non-staff operating expenses)		3,488,048	3,645,787	5,850,423	3,064,583	44,891	50,079	83,641	45,847	4.5%	60.5%	(47.6%)
Depreciation and amortization		389,341	300,886	951,505	601,726	5,011	4,133	13,603	9,002	(22.7%)	216.2%	(36.8%)
Marketing		-	-	215,584	50,065	-	-	3,082	749	-	-	(76.8%)
Rent & utilities		287,982	427,096	1,124,752	712,914	3,706	5,867	16,080	10,665	48.3%	163.3%	(36.6%)
Stationary & printing		777,286	499,831	838,437	619,341	10,004	6,866	11,987	9,266	(35.7%)	67.7%	(26.1%)
Travel costs		1,542,879	1,701,113	2,138,376	639,055	19,857	23,367	30,571	9,561	10.3%	25.7%	(70.1%)
Accounting services		227,361	-	-	-	2,926	-	-	-	(100.0%)	-	-
Training		9,991	282,708	234,669	104,060	129	3,883	3,355	1,557	2,729.6%	(17.0%)	(55.7%)
Audit fee		139,200	174,000	174,000	174,000	1,792	2,390	2,488	2,603	25.0%	0.0%	0.0%
Bank charges		71,714	118,660	101,753	83,798	923	1,630	1,455	1,254	65.5%	(14.2%)	(17.6%)
Others		42,294	141,492	71,347	79,623	544	1,944	1,020	1,191	234.5%	(49.6%)	11.6%
Net Operating Income Before Taxes and Donations [f=c-d-e]		(4,316,767)	(2,973,773)	(10,606,780)	(4,164,601)	(55,557)	(40,849)	(151,641)	(62,304)	(31.1%)	256.7%	(60.7%)
Income Taxes (g)		-	-	-	-	-	-	-	-	-	-	-
Net Operating Income Before Donations [h=f-g]		(4,316,767)	(2,973,773)	(10,606,780)	(4,164,601)	(55,557)	(40,849)	(151,641)	(62,304)	(31.1%)	256.7%	(60.7%)
Non Operating Revenue (i)		-	-	-	-	-	-	-	-	-	-	-
Non Operating Expense (including related taxes) (j)		-	-	-	-	-	-	-	-	-	-	-
Net Income Before Donations [k=h+i-j]		(4,316,767)	(2,973,773)	(10,606,780)	(4,164,601)	(55,557)	(40,849)	(151,641)	(62,304)	(31.1%)	256.7%	(60.7%)
Donations (l)		-	-	-	-	-	-	-	-	-	-	-
Net Income (after Taxes and Donations) [m=k+l]		(4,316,767)	(2,973,773)	(10,606,780)	(4,164,601)	(55,557)	(40,849)	(151,641)	(62,304)	(31.1%)	256.7%	(60.7%)

Yehu Microfinance Trust Balance sheet	KES				USD				Evolution			
	Notes	Dec. 2004	Dec. 2005	Dec. 2006	Jun. 2007	Dec. 2004	Dec. 2005	Dec. 2006	Jun. 2007	2005/ 2004	2006/ 2005	2007/ 2006
ASSETS		40,208,580	56,499,285	68,338,507	82,151,545	517,485	776,089	977,006	1,229,021	40.5%	21.0%	20.2%
Short Term Assets		36,535,753	52,251,567	58,642,647	74,274,066	470,216	717,741	838,389	1,111,171	43.0%	12.2%	26.7%
Cash and Due from Banks		12,843,688	22,590,114	31,527,491	22,248,940	165,298	310,304	450,735	332,853	75.9%	39.6%	(29.4%)
Short Term Investments		5,000,000	5,335,274	5,550,686	22,828,880	64,350	73,287	79,356	341,529	6.7%	4.0%	311.3%
Short Term Net Loan Portfolio		18,692,065	22,557,607	19,081,044	20,542,569	240,567	309,857	272,793	307,325	20.7%	(15.4%)	7.7%
Short Term Gross Loan Portfolio		18,692,065	22,557,607	23,626,424	26,647,762	240,567	309,857	337,777	398,661	20.7%	4.7%	12.8%
(Loan Loss Reserve)		-	-	4,545,380	6,105,193	-	-	64,983	91,336	-	-	34.3%
Interest Receivable		-	-	-	-	-	-	-	-	-	-	-
On loan portfolio		-	-	-	-	-	-	-	-	-	-	-
On investments		-	-	-	-	-	-	-	-	-	-	-
Accounts receivable and other assets	1	-	1,768,571	2,483,426	8,653,677	-	24,294	35,504	129,463	-	40.4%	248.5%
Long term assets		3,672,827	4,247,718	9,695,861	7,877,480	47,269	58,348	138,618	117,850	15.7%	128.3%	(18.8%)
Long Term Net Investments		-	-	-	-	-	-	-	-	-	-	-
Long Term Gross Loan Portfolio		-	-	-	-	-	-	-	-	-	-	-
Net Fixed Assets		3,672,827	4,247,718	9,695,861	7,877,480	47,269	58,348	138,618	117,850	15.7%	128.3%	(18.8%)
Other Long Term Assets		-	-	-	-	-	-	-	-	-	-	-
LIABILITIES AND EQUITY		40,208,580	56,499,285	68,338,506	82,151,545	517,485	776,089	977,006	1,229,021	40.5%	21.0%	20.2%
Liabilities		11,604,269	20,665,732	31,297,566	37,460,294	149,347	283,870	447,448	560,421	78.1%	51.4%	19.7%
Short term liabilities		10,838,132	19,199,200	29,283,737	35,037,926	139,487	263,725	418,657	524,182	77.1%	52.5%	19.6%
Demand Deposits		-	-	-	-	-	-	-	-	-	-	-
Compulsory Deposits		10,698,932	18,689,530	26,979,148	31,896,845	137,695	256,724	385,709	477,190	74.7%	44.4%	18.2%
Short Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-
Short Term Borrowings	2	-	321,490	2,124,769	3,135,261	-	4,416	30,377	46,905	-	560.9%	47.6%
Interest payable		-	-	-	-	-	-	-	-	-	-	-
Accounts Payable and Other Short Term Liabilities		139,200	188,180	179,820	5,820	1,792	2,585	2,571	87	35.2%	(4.4%)	(96.8%)
Long term liabilities		766,137	1,466,532	2,013,829	2,422,368	9,860	20,145	28,791	36,240	91.4%	37.3%	20.3%
Long Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-
Long Term Borrowings		-	-	-	-	-	-	-	-	-	-	-
Other Long Term Liabilities	3	766,137	1,466,532	2,013,829	2,422,368	9,860	20,145	28,791	36,240	91.4%	37.3%	20.3%
Equity		28,604,311	35,833,553	37,040,941	44,691,252	368,138	492,219	529,558	668,600	25.3%	3.4%	20.7%
Paid-In Capital		-	-	-	-	-	-	-	-	-	-	-
Donated equity	4	31,736,936	41,939,951	51,356,409	63,171,320	408,455	576,098	734,220	945,069	32.1%	22.5%	23.0%
Retained earnings without donations and reserves		(3,132,625)	(6,106,398)	(14,315,468)	(18,480,069)	(40,317)	(83,879)	(204,662)	(276,469)	94.9%	134.4%	29.1%
Current year		(4,316,767)	(2,973,773)	(10,606,780)	(4,164,601)	(55,557)	(40,849)	(151,641)	(62,304)	(31.1%)	256.7%	(60.7%)
Other equity accounts		-	-	-	-	-	-	-	-	-	-	-

Notes: 1) For June 2007 this includes a 6.7 M KES loan to the General Manager (see Governance section); 2) Overdraft facility which in the audited financial statements is shown as a negative asset; 3) Death insurance fund; 4) No clear track record exists to track donations since inception. Donations are likely to be higher and retained earnings is likely to be lower.

■ Formulas

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

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