

Institutional presentation

Legal form, supervision and audit

NMF is a not-for-profit organization officially registered with the Ministry of Social Affairs on October 15th, 2003, under the 2001 law n°1 on Private Associations and Enterprises. It was created to pursue a pilot project for lending activities initiated by the SFD in June 2002 and administered by it until 2003. Though it does not legally report to the SFD, NMF sends monthly monitoring reports to the SFD's Small and Micro Enterprise Development (SMED) unit.

Starting 2006, NMF's accounts are audited by Deloitte. From 2003 to 2005, they were audited by Dahman RSM, certified public accountants. The auditors have always certified the accounts without reserve. NMF's financial year starts on January 1st and ends on December 31st.

Ownership

As a foundation, NMF has no legal owners. It is governed by six out of its seven founders, who are all members of the Board of Trustees (hereafter referred to as Board of Directors or BOD) and have contributed to the initial paid-in capital¹. The BOD comprises the SFD as well as eminent local figures and ministers with business, legal, education, and administrative backgrounds. As per the founding statutes, BOD is to meet on a quarterly basis.

Paid-in capital, as of Dec. 2008	YER	USD	%
SFD	5,000,000	24,814	25%
Yemen Bank for Reconstr. and Dvlpmt	5,000,000	24,814	25%
Watani Bank for Trade and Investment	3,000,000	14,888	15%
Yemen and Gulf Bank	3,000,000	14,888	15%
Mr. Mohamed Abdo Saeed	3,000,000	14,888	15%
Mr. Hassan Mohamed Al Kabous	1,000,000	4,963	5%
Dr. Abdulkarim Al Iriani	100,000	496	0.5%
Mrs. Fatima Al Huraibi	50,000	248	0.2%
Total	20,150,000	100,000	100%

Since inception, the BOD is chaired by Dr. Abdulkarim Al Iriani, consultant for the President of the Republic of Yemen. Dr. Al Iriani holds a BSc and an MSc. in Agriculture from the University of Georgia (USA) and a Ph.D. in Biochemical Genetics from Yale University (USA).

Donations

NMF had received 84 M YER (416 K USD) of donations as of June 2009, mostly from the SFD through various trainings and consultancy works. In 2006, the Rockdale Foundation provided a conditional grant of 9.9 M YER (50 K USD)

¹ Under the form of grants, managed by NMF as paid-in capital though not legally recognized as such.

along with technical assistance and in-kind donations (computers). The Arab Gulf Organization also donated 8.8 M YER (44 K USD) for a branch opening in the Hajjah province.

Funding composition

NMF funds its activities through equity (33%), savings (14%), and borrowings (53%), out of which 36% are short term portion of long term loans. Equity is made of a majority of grants (68%), atop of paid-in capital (16%) and retained earnings (16%). All loans are in local currency and originate from the SFD with durations varying between 14 and 36 months. Until 2008, NMF benefited from subsidized lending rates (0%-7%).

Management team

The management team currently comprises the Executive Director (ED), the Operations Manager (OM), the Finance Manager (FM), the Human Resources (HR) Manager, and the IT Manager. It is supplemented by the Internal Audit (IA) Manager, who reports directly to the BOD.

The ED, Mr. Ahmed Al Zamzami, was formerly the SFD project officer in charge the initial lending activities and has headed NMF since inception. Mr. Al Zamzami holds a B.S. in Business Administration (Agribusiness option) from the California State University Fresno (CSUF). He has attended several international, regional and local microfinance trainings (Sanabel, Harvard Business School, etc.).

Organization

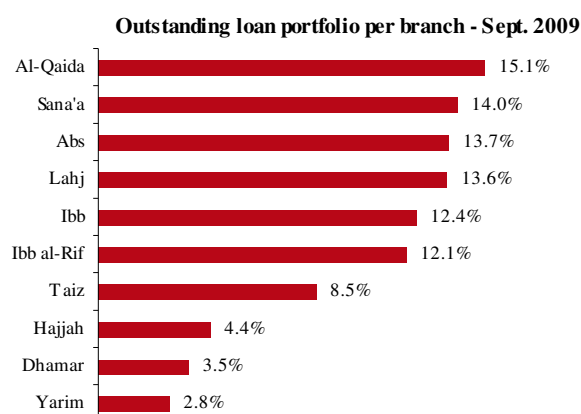
The headquarters in Sana'a comprise the entire management team while credit decisions are fully decentralized at the branch level. Each branch comprises a Branch Manager (BM), several Loan Officers (LOs), and a cashier who is also in charge of data entry. All transactions are done in cash. Loans are disbursed to each client individually by the cashier in the branches, while reimbursements are made in the field directly to the LO, who deposits the collected amount either in the branch or straight at the bank.

Similarly to other SFD-supported MFIs in Yemen, loan information is entered into Maeen, an Oracle-based software initially developed by a Technology Star, a local firm, and now freely provided by the SFD. NMF started using Maeen in 2007, but has also kept its former manual loan tracking system in place: the two systems will continue running in parallel until Maeen is completely reliable. NMF is presently upgrading its Maeen version, which should allow consolidating the branches individual databases by connecting them to HQ through a VPN network (with the exception of Abs where Internet is not yet available and that sends daily faxes to HQ). NMF relies on another Technology

Star software for accounting. The two systems are not integrated.

Market penetration

NMF operates through a network of 10 branches located in the South and North Western parts of Yemen. Competition has been historically virtually null and remains low everywhere.



Products and services

NMF presently offers four lending products. Administrative fees of 100 YER (0.5 USD) are collected on new loans and all loans bear an initial 1% death insurance fee².

- Group loans are the historical core product and represent 94% of the September 2009 portfolio. They were initially developed based on the ASA lending methodology and with the support of an ASA consultant. They require 200 YER (1 USD) of compulsory savings to be collected beforehand, then along with each installment³. They are intended for groups of 5 to 25 women, with solidarity mechanisms systematically linked to 5 of them. Amounts range from 5,000 to 200,000 YER (25 to 990 USD), with an average disbursed loan of 102,500 YER (508 USD). Terms range from 6 to 12 months, with an average of 9. Repayment may be done on a weekly or on a monthly basis, and grace period is allowed for the first one. Annual interest rate is of 24% flat, equivalent to an effective interest rate (EIR) of 45% to 48% without the cost of savings. When counting such cost, EIR goes up, varying between 50% and 70%.
- Individual loans have the exact same characteristics (amounts, range, rate), but require guarantees (salaried or commercial guarantor, collateral). They represent 2% of the September 2009 portfolio.
- Seasonal loans were introduced in 2005 for existing clients, but they are currently stopped. Their amounts ranged from 10,000 to 50,000 YER (50 to 250 USD), for

² For annual loans, 0.5% for semi-annual ones.

³ The client may choose to save larger amounts, but NMF does not account them separately.

terms from 1 to 3 months, with 30,000 YER (150 USD) on average over 2 months.

- Gold loans started in 2007 and are individual loans backed by gold assets covering 130% of the loan value. Amounts range from 10,000 to 600,000 YER (50 to 3,000 USD), with terms from 3 to 30 months. Disbursed loans averaged 305,000 YER (1,500 USD) over 16.5 months. Interest rate is of 1.6% on a flat monthly basis. They represent 4% of the September 2009 portfolio.

A 10% rate is served on active borrower's savings, and 5% on others. In most cases, clients choose not to earn such interest, usually prohibited by Islamic rules (*riba*⁴).

Fraud

In mid 2006, NMF discovered a 12 M YER (60 K USD) fraud involving a loan officer in its Taiz branch. The case has been filed in court, which has issued an order in favor of NMF. The remaining amount to be collected is of 6.9 M YER (34 K USD)⁵.

At the same time, NMF also discovered that several loans were handed to a single member in a group of its Yarim branch. Following the project failure, the group defaulted by 800 K YER (4 K USD)⁶.

Networks

NMF is part of the recently created National Microfinance Network (NMN) of Yemen, which its ED presently chairs. It is also a member of Sanabel, the network of MFIs of the Arab world.

Governance

Governance and decision making is rated "c"

Decision making

- + The vision and mission are shared among key decision makers.
- NMF status is that of an NGO and is not the most suitable legal set up as it prevents it from taking voluntary savings and from raising capital.
- It plans to transform under the new law dating March 2009 and allowing microfinance banks with a minimum capital of 500 M YER (2.5 M USD) to be established.
- + Information sent to BOD is relevant, complete, and easily available, thus allowing sound decisions to be made on time.

⁴ *Riba* refers to capital gains without counterpart. It is considered as usury by Islamic economic jurisprudence as it was formerly the case in the Christian world.

⁵ 2.5% of the portfolio or 5.6% of equity as of June 2009.

⁶ 0.3% of the portfolio or 0.6% of equity as of June 2009.

- + BOD members are all prominent Yemeni businessmen and political figures with diversified experiences. They show good implication and provide valuable legal and operational support when needed.
- Though some of them are in regular contact with the ED, they are usually very busy and unable to attend the quarterly meetings.
- Meetings are thus held only once to twice a year, which is insufficient to ensure: 1) that strategic decisions are actually made on time; and 2) a systematic and efficient control over the implementation of the decisions.
- BOD has delegated part of its monitoring role to the SFD that initially created the programs and is also a BOD member. Respective responsibilities were assigned in a BOD meeting and are briefly document in the minutes (SFD supervises while BOD agrees on policies and contracts). But as the BOD often relies on the SFD opinion, the resulting decision making process could still be more efficient, notably in order to provide diversified opinions.
- The SFD being all of a BOD member for NMF, a BOD member for other MFIs⁷, a lender, a training organizer, and a loan tracking system provider, potential conflicts of interests could arise, especially as long as there are no clearly written rules in that regard.
- Being aware of this issue, the SFD has an exit strategy, which it started implementing by withdrawing from the trainings, now falling under the responsibility of the Yemeni network.

Planning

- Since 2005, NMF has 5-year strategic plans in place, with the latest going from 2009 to 2013.
- + Plans are updated annually and followed upon on a regular basis, with reports sent to BOD.
- + The planning process is participatory and follows a bottom-up approach, with objectives broken by LO, chosen by them and clearly displayed and followed upon in the branches, thus ensuring a strong staff buy-in.
- The 2010 plan is not yet drafted, but should include a transformation option.
- + The current plan comprises ambitious yet realistic goals (+100% to reach 21,000 clients in 2009), as well as a thorough analysis of the market and institutional strength and weaknesses.
- NMF has regularly lagged behind schedule in meeting its goals.
- This is notably to due to a cautious growth approach with a focus on institutional capacity building (staff and HQ), leading to a voluntarily reduced growth when credit risks rises (e.g. 2007 negative growth following the 2006 fraud, two branches not opened in 2009).

⁷ The SFD is notably chairing the BOD of Aden Microfinance Foundation.

- + Institutional and operational projects needed to carry out the strategic plan are well identified (IT migration, branch opening, procedures update, funding strategy etc.).
- The time needed to achieve them has been underestimated, with some projects taking much longer than expected due to both internal and external factors (e.g. IT, power cuts, arising reporting issues with the Maeen roll out, low frequency of BOD meetings, etc.).
- Significant growth is expected to resume once the IT system is fully in place, as it allows a closer performance monitoring.
- Financial projections are available but need to be updated as the 2009 plan is now outdated.
- They presently include only one scenario.
- They are closely monitored but the related budget is not updated during the year.

Management team

- + Starting Q3 2009, NMF management team is complete with the main functions staffed (HR, Finance, Operations, IA, IT).
- + Each department has a sound understanding of its role and activities and is headed by a knowledgeable top manager, assisted by middle managers with identified deputies for each department.
- Both could benefit from further technical training in their respective domains as little training has been provided at HQ level in the past few years.
- Until September 2009, management meetings were ongoing but informal. They are not scheduled every week to ensure the most optimal communication, knowledge sharing, and collective decision making within the team. Only 2 formal meetings were documented so far.
- + Tasks are clear and there is a clear will of team work and taking the institution a step further. This in turn mitigates key-person risk in running the operations.
- Some departments have however been under-staffed from time to time (e.g. Operations, IT).
- The strategic vision, drive, and experience in all domains are still concentrated at the ED level.
- The team's ability to execute plans still needs to be demonstrated as it has been hampered by the delays in the IT system roll-out.
- + When needed, it has nevertheless properly adjusted to arising operational risks.

Human resource management

- + HR are professionally administered within NMF (job descriptions, salary scales, contracts for every staff, etc.).
- + Recruitment process is transparent and ensures the most qualified staff is selected.

- At all levels (HQ and field), NMF suffers from the wider issue of poorly qualified human resources in Yemen.
- Despite a 3-month introductory training as well as other ongoing ones for field staff, additional training is still needed to fully compensate an initially very low qualification level.
- Training is less frequent at HQ level, mainly due to a low budget (only covering transportation and accommodation costs for field staff).
- So far, the majority of trainings have been provided by the SFD with trainers' fees fully covered, which has generating a strong reliance on SFD trainings and a less dynamic approach in case NMF needs are not met (e.g. 3 out of 9 for 2009).
- + Evaluations are conducted twice a year and comprise a mix of quantitative and qualitative factors, ensuring a regular improvement and assessing training needs.
- + Bonuses computed monthly and paid quarterly are linked to growth and PAR, thus providing proper incentives for goals to be reached.
- Though staff morale is generally good, NMF suffers from a relatively high turnover (up to 13% in the past years).
 - Turnover is particularly high during probation periods, as it proves difficult to find qualified and keen on working staff. Exit interviews are conducted but did not show issues on which NMF could significantly improve⁸. It is to be noted that turnover is commonly high in the MENA region, especially amongst female LOs.
- + Salaries are reasonable per Yemeni standards, notably when compared to similar organizations. For HQ staff, they are set according to experience, background, and the nature of the job. For field staff, they are calculated according to both productivity (clients) and risk (PAR).
 - They are still lower than the private sector, potentially leading to a lower retention level.
 - Despite all outstanding loans being checked upon an LO departure and a transition plan made, portfolio transfer policy is not yet fully efficient and PAR is relatively higher for departing LOs. NMF requires each LO to provide a guarantor upon recruitment, which proves efficient but might requires time.
- Provide in-depth technical training at HQ level and systematically document management minutes to mitigate key-person risk.
- Provide additional training for field staff.

Information

Information is rated "c"

- + NMF has evolved from a manual to the Maeen computerized loan tracking system, which is provided free of charge and effectively running since 2009.
- It has required a lengthy deployment process (several years), in part due to development issues and limited vendor support.
 - For now, the two systems still run in parallel as Maeen is not yet stable. A new version is being installed and future ones are expected to be integrated with accounting.
- + Loan tracking information provided by the system is accurate, which was NMF's clear priority upon migration.
 - Automatically generated reports are not yet properly working or accurate (25% of the available reports effectively available, wrong totals, etc.). Standard reports do not always suit NMF specific needs.
 - These issues are expected to be solved by year-end, with the help of the SFD.
 - With the exception of Abs where Internet is not available (13% of the portfolio as of June 2009), the branch databases are in the process of being centralized in order to allow an automatic consolidation into a single master database stored at the HQ.
 - In the meantime, consolidated information still requires lengthy consolidation and reconciliation processes and is only available on a monthly basis. Also, some useful information is not easily available and requires customized and lengthy queries (e.g. PAR by product).
- + NMF is the only MFI in Yemen to have accessed to the source code and was able to improve the system independently.
 - The source code of the latest version has already been requested.
- + The new IT Manager, in place since June 2009, has a sound understanding of databases and programming and has been instrumental in accelerating the roll-out process.
- + The system includes various user profiles and restricted accesses allowing: 1) a proper process guaranteeing data reliability to be designed (e.g. only the IT department is entitled to change information); and 2) an adaptable access to information for each user (LO, BM, HQ, etc.).
- + Since mid 2009, electronic data is properly secured through regular back-ups firewall, up-to-date anti-virus software, etc. thus limiting data loss to less than one day. Accounting information back-up is done on a daily basis.

Areas for improvement

- Increase the frequency of BOD meetings to ensure decisions are made on time and properly followed upon.
- Draft clear written rules on SFD involvement in the decision-making process.
- Improve the forecasted time needed to carry out projects and include several scenarios in the business plan to enhance reactivity in case a change is needed.

⁸ Main reasons include marriage for female LOs or jobs found within the public sector.

- + Paper files are properly stored in metallic cabinets in the branches.
- + Financial statements are available on a monthly basis, at global and branch levels.
- + Financial analysis is in place through the SEEP and SMED monthly reports. At branch level, it allows the management to allow new disbursements or not.
- It could still be further refined in order to support broader management decisions (e.g. product cost analysis or enhanced HQ expenses allocation to the branches).

Areas for improvement

- Stabilize the loan tracking system by accessing its source code and fixing the remaining bugs.
- Increase efficiency in producing information.
- Enhance financial analysis to support decision making.

▪ Risk management

Risk management is **rated “c”**

Procedures and internal controls

- + Though some of them would require an update, written procedures are in place for all departments and are reasonably well observed. Procedures were last updated in 2008, after weaknesses were identified.
- + Following the 2006 fraud, internal controls were reinforced, notably through more frequent visits to clients (100% of new clients for BM, random spot checks for the Operations, 10% of client visits for IA). This is instrumental in limiting major operational risks (ghost loans, several loans being collected by a single person, frauds on behalf of LOs).
- + Limitation of power (credit committees) and hierarchical controls (BM, OM) are in place, and poor performance is usually addressed (from warning to firing staff when needed).
- Yet, basics of internal controls are not all implemented, and separation of tasks is not ideal (e.g. LO approve loans and handle cash reimbursement in the field, cashier is in charge of data entry).
- This is partially mitigated by processes ensuring data is reliable, such as daily reconciliations of the LOs portfolio, monthly reconciliation of bank statements and cash movements (daily for branches where it is possible), as well as frequent field visits to reconcile NMF's accounts with clients passbooks. Related risks have also significantly decreased since the loan tracking system is in place.
- Being aware of the remaining risk, NMF is about to sign an agreement with the Post Office to have all reimbursements made directly through their tellers.
- Cash risk exists as LOs often transport cash or gold (field to branch or branch to bank).

- No insurance is in place in that regard, but Yemeni culture decreases the assault risk against females.
- + Procedures in place also partially mitigate this risk as: 1) two persons are required to deposit cash at bank, usually driven by a known external driver; 2) no cash kept overnight in the branch; 3) two keys are needed to open the safes in the branches (BM and cashier).

Internal audit

- + IA 2009 plan covers all branches (at least once a year) as well as HQ functions (HR, Finance, IT). This plan is expected to be fully implemented by year-end, thus contributing to limiting major operational risks.
- + It includes client visits (10%) and files check (40% to 50%), based on a random sampling that takes into account the credit risk level of each branch.
- + The IA Manager has been in place for a year and has a good understanding of microfinance risks as well as a strong desire to improve.
- IA still needs to cover other microfinance risks (reputation, financial, legal risks, etc.): those are in the process of being included in the updated manual. IA could also be more pro-active in its approach (e.g. anticipate potential risks, set limits).
- Additional technical training might be needed in that regard.
- IA reports evolved over time from being too detailed to presenting a summary of the main risks on a yearly basis.
- + They comprise good recommendations, which are properly followed upon, as well as suggestions to improve procedures.
- Yet, recommendations are not prioritized according to the risk level, nor a short summary included in each IA report.
- + IA department is staffed with three persons, which is presently sufficient to cover the operations scope. In order to keep the same coverage, this number is expected to increase once NMF resumes growth.
- + IA reports straight to BOD in the organization structure.
- In practice, given the BOD's unavailability, IA reports to the ED, which does not guarantee enough independence nor allow a proper coverage of the ED function.
- + Internal controls are supplemented by external audits with recommendation letters, and by SFD punctual audits (including client visits and exhaustive branch audits by SFD's own IA department).

Areas for improvement

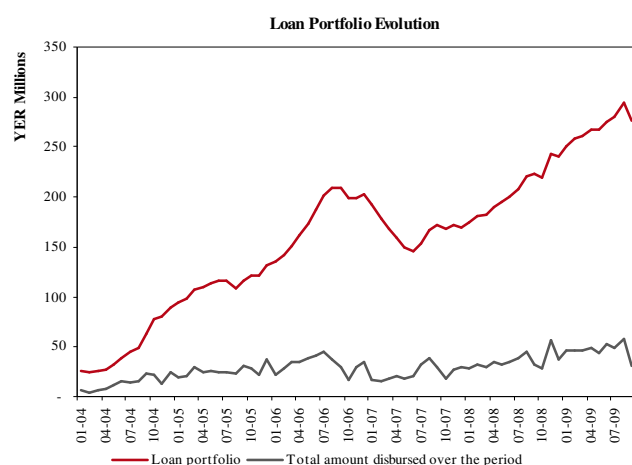
- Improve task segregation and limit cash risk.
- Provide technical training to the IA department, notably in order to cover all microfinance risks.
- Include clearly prioritized recommendations in the IA reports.

■ Activities

Activities: products and services is rated “c”

Financial services evolution

After three years of steady growth, NMF's loan portfolio dropped by -17% in 2007, following the frauds discovery and the subsequent in-depth portfolio audit. Growth resumed in 2008 (+42%), but the 2009 increase is likely to be lower, though still significant at +15% as of September 2009. This is notably due to the ongoing checks related to the loan tracking system, which revealed some inconsistencies in the branch reporting earlier in the year.



Financial services management

- + NMF credit methodology has evolved over time and is now reasonably well designed. Group loans still represent the bulk of the portfolio (94% as of September 2009) while the group guarantee proves effective, notably thanks to sound procedures including: four meetings explaining the process; visits at the client's home conducted by both the LO and the BM; assessment of the business and household expenses and revenues; guarantees effective in sub-groups of five within larger groups of up to twenty five; relatives requiring different guarantors; client picture taken; black-list checked upon; guarantor required when needed; individual loans requiring a commercial or a salaried guarantor).
- It could still be further fine-tuned to better avoid poorly performing clients. For instance, the fields related to the repayment capacity analysis need to be re-introduced as they are not presently included in the loan tracking system (vs. existing in the manual forms).
- The repayment capacity criterion is not conservative enough, with the loan installment potentially equaling the net revenue. Besides, there are no penalties on late repayments, and especially not for gold loans, which are less risky but still induce a relatively weaker on-time repayment culture.

- + Delinquency management is decentralized in the branches, with support from HQ provided as needed.
- Some of its rules could still be clearer (e.g. when to contact HQ, send a letter, transfer to court, etc.).
- + Capitalizing on past experiences, NMF now closely monitors its portfolio. This is expected to remain once significant growth has resumed.
- LOs are trained to gain the appropriate skills, but NMF still suffers from the difficulty to find qualified staff, which is a widely spread issue in Yemen. As a result, skills differ from one LO to another, notably regarding repayment capacity assessment.
- BM closely supervises the LOs, but further attention will be needed in periods of fast growth.

Credit risk

- Since 2006, credit risk level has been higher than internationally accepted norms and than regional peers. PAR 30 has stabilized between 3% and 4% in 2007 and 2008 (3.3% in 2007, 3.5% in 2008) whereas it stood at 2.7% worldwide and 1.9% in the MENA region⁹.
- Following the loan tracking system deployment, PAR 30 appeared to be as high as 9.7% as of June 2009. This was mainly the result of lengthy data entry in some branches (Taiz), but also LO departure in some others (Sana'a) or clients moving abroad (Abs). Loans to men were stopped in Q3 2009, as they proved riskier. As a result, PAR 30 has dropped back to 4.8% as of September 2009.
- + A write-off policy for all loans late by over 365 days was adopted in early 2009.
- Write-off has also been above international and regional standards in 2007 and 2008 (5.3% and 2.3% respectively vs. 1.1% internationally and 0.5% for MENA). It stood at 2.2% as of September 2009. Such levels, up from 0%, are essentially fraud-related.
- Though lengthy, recovery is expected to be good as fraud cases are filed in court.
- + The new incentive scheme sets the PAR limit at 3% (vs. 8% previously), which has also been instrumental in decreasing the 2009 credit risk level.
- PAR per product is not yet available to conduct further analysis.
- + Rescheduling is not allowed and there are neither loans to staff nor to their close family, except for gold loans, providing they are granted by another LO.
- Portfolio concentration by sector and region is regularly followed upon, but there are no specific rules to limit exposure on specific areas. Besides, some information is only available for disbursed loans, which could blur the actual risk level.

⁹ Source: MicroBanking Bulletin, 2007 benchmarks.

Credit risk coverage

- + Credit risk coverage is good, with loan loss reserve historically covering over 100% of the PAR 90.
- It did not historically cover 100% of the PAR 30 and went down from 89% as of December 2008 to 77% in June 2009.
- + It increased to 111% of the PAR 30 as of September 2009.
- + The compulsory savings and death insurance provide extra financial guarantees.
- + When taking into account the death insurance reserve, it becomes largely sufficient at 238% of the PAR 30 as of December 2008.
- + Gold loans, which are of higher amounts (up to three times, with a maximum of 600,000 YER or 3,000 USD vs. 200,000 YER or 1,000 USD for group loans), are covered up to 130% with gold collateral.

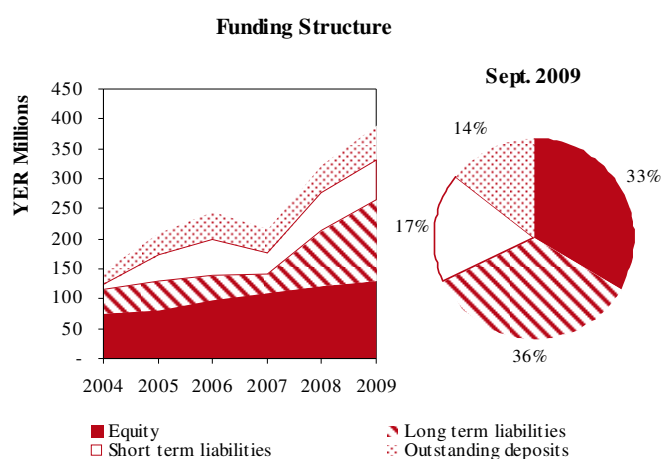
Areas for improvement

- Fine-tune the lending methodology where needed.
- Further improve LO skills and delinquency management to reduce then stabilize the credit risk level.

Funding and liquidity

Funding and liquidity is rated “c”

Capitalization and funding strategy



- + Funding needs are fully covered for 2009.
- Funding needs for 2010 are not yet available, but will be included in the updated business plan.
- + Leverage is still low (2.0x as of September 2009) and minimal capital requirements are largely met (CAR above 75% as of September 2009 vs. minimum required of 25% for young NGOs). Leverage goes further down when adjusted to include the unearned grants, leaving much room for additional commercial loans.

- + Communication with the SFD, the sole fund provider so far, has proven good with regular and transparent reporting, notably through the use of SEEP and SMED reports. Over the years, NMF has built itself an excellent repayment history.
 - Additional negotiation skills will be needed upon graduation to other fund providers.
 - So far, NMF has initiated a few contacts with international investors, but has not yet been into advanced talks with of them.

Liquidity risk

- + The Finance department is well organized.
- Turnover has been high for the FM position.
 - The present FM has been in place for only one month but has been in the microfinance industry since 2004.
- + Liquidity risk is low given the large amount of available cash, made up of clients’ savings and SFD outstanding loans. LAR stands at over 20% since December 2008 and cash covers a full year of operating expenses (vs. 10% and a minimum of 3 months respectively).
 - Although extra cash is invested in short term deposits, liquidity could be better managed, notably in order to optimize the use of available resources.
- + Savings are very conservatively managed and virtually not invested in the portfolio. Deposit withdrawal coverage is largely sufficient at over 100% (vs. 15% as per prudential norms).
 - For legal reasons, as NMF is not entitled to collect savings, compulsory and voluntary savings are not accounted separately, thus preventing their optimal management.
- Funding structure is not diversified enough, with the SFD being the only fund provider and doing so at an increasing cost.
 - Contacts have already been initiated with some international investors (e.g. Grameen-Jameel, Kiva) as well as local banks in that regard. If needed, the SFD is keen on providing additional funding support.
- Cash flow projections are not closely monitored.
 - This does not generate any extra liquidity risk given the available cash, but would become necessary in case of growth, especially if coupled with various external sources of funding.

Market risk

- + NMF is not exposed to market risks as all its assets and liabilities are on a fixed rate basis and labeled in YER.
 - Once contacts are established with international investors, it will be instrumental to have an exposure policy in place.

Areas for improvement

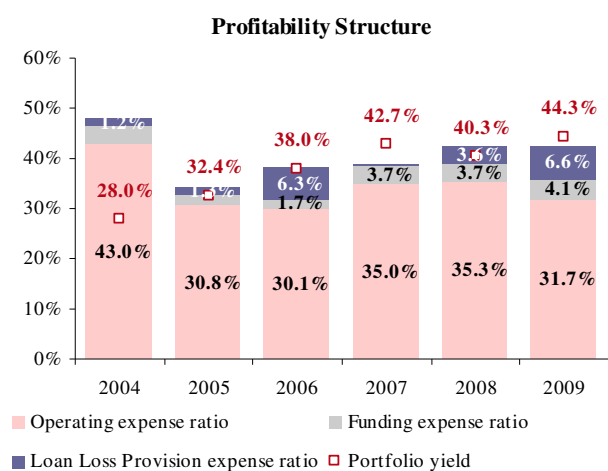
- Develop a funding strategy and diversify the funder base.
- Put in place liquidity management procedures.
- Optimize liquidity management and monitor cash flows.
- Design a market risk exposure policy.

Efficiency and profitability

Efficiency and profitability is **rated “c”**

Profitability analysis

- + NMF has been a profitable institution ever since it broke even in 2005, with an ROA and ROE respectively standing at 4.2% and 2.7% as of December 2008. When excluding donations, ROA is of 1.1%.
- + This has been possible as NMF has sufficient latitude in defining a sustainable interest rate.
- ROA with and without donations respectively stood at 3.4% and 3.1% as of September 2009, as NMF received less donations. ROE stood at 8.9%. These levels exclude interest to be paid on savings.
- Financial revenue fluctuates as the former manual system did not allow a proper accounting of interest on savings (averaged at 7.5% and adjusted at year-end, often given back by clients).
- This has been sorted out with the loan tracking system, which comprises a field specifying whether a client wishes to earn interest on its savings or not.



- + NMF is presently the Yemeni leader in terms of microfinance. It has enjoyed limited competition so far.
- The rapid growth of Amal Bank, which started its operations in 2009¹⁰, could constitute a potential threat in some regions, notably Ibb, Taiz, Sanaa, together representing 47% of NMF's portfolio as of September 2009.
- + NMF's brand is presently better known.

¹⁰ Amal Bank plans on reaching 100,000 clients within 5 years.

- Yet, it will need to conduct a deeper analysis of market and competition and, if needed, fine-tune the range of its services to adapt it to the actual demand.
- + This is presently done through yearly client satisfaction surveys, as well as a cautious product development process that includes client needs assessment, pilot testing and evaluation prior to launching.
- Operating expenses have increased in 2007 and 2008 as growth was slowed and extra time was spent on institutional capacity building. They go back slightly above their 2005-2006 level of 30% in 2009.
- They are expected to go further down due to efficiency gains once the IT system is in properly running.
- This, in turn, should compensate for the increasing cost of financial resources (from 1.7% in 2006 when most loans were subsidized, to 4.1% in 2009).
- Loan loss provision expenses significantly increased to 10.2% in June 2009, as the migration to Maen showed arrears in the Abs branch. Such arrears were decreased by September 2009, but loan loss provision expense still stands fairly high at 6.6%.
- Resources are not efficiently invested in the portfolio, with a historically low deployment ratio, standing at 68% as of September 2009.
- + NMF profitability outlook is positive, based on the significant potential efficiency gains once the loan tracking system is properly running, as well as the expectation that loan loss provisioning expenses will decrease over time, as reinforced control further improve credit risk level.

Political & economic environment

Start-up of liquefied-gas production has spurred the economy

The decline of oil production continued to undermine economic growth in 2008. With purchasing power reduced by soaring staple commodity prices, private consumption suffered despite subsidy increases. Public sector investment, focused mainly on the gas liquefaction project, underpinned the economy. The start-up of a liquefied gas production line in the 2009 second quarter will result in an acceleration of GDP growth albeit moderate with the fall of oil prices and fiscal revenues forcing the government to reduce investment spending. Some projects included in a Poverty Reduction Program partly supported by international aid could be postponed in consequence. Easing inflation will improve household purchasing power. Private consumption could, however, be affected by the slowdown of transfers from emigrants employed in Gulf countries whose economies will slump due to the drop in oil earnings.

Widening twin deficits

Oil resources are the main component of government revenues and export earnings. Despite the start-up of a first liquefied gas production line in the second quarter, the fall of hydrocarbon prices will widen the fiscal and current account deficits in 2009. The decline of fuel and staple-foodstuff prices will facilitate reducing spending on subsidies and thereby limiting the fiscal deficit. But with the social tensions and the extent of poverty in the country, the government has little leeway to discontinue subsidies entirely. As regards external accounts, currency earnings will be limited as a result of the fall of barrel prices and decline of emigrant worker transfers. The drop in imports, attributable to the fall of raw-material and staple-foodstuff prices, could pave the way for reducing the current account deficit. In these conditions financing needs will grow. In a context of international crisis and aversion to risk on the part of investors and banks, the country will likely be able to count on increased aid from friendly countries.

Strengths

- The country enjoys political and financial backing by the international community, which promised USD five billion in aid in November 2006 to finance development and poverty-reduction projects.
- The production start-up in 2009 of a natural gas liquefaction factory will breathe new life into the economy.
- Foreign debt constitutes a limited constraint thanks to relief granted by the Paris Club.
- Transfers from expatriate workers consolidate the invisibles balance.

Weaknesses

- The economy remains dependent on oil revenues that are in decline due to depletion of reserves.
- Political instability and poverty impede the structural adjustments needed to facilitate the transition to a post-oil economy.
- Insecurity, bureaucracy, corruption, and a lack of professional skills undermine the business environment.
- The financial system is still relatively underdeveloped.
- The country is dependent on food-product imports with agriculture devoted to qat production.

COFACE Country Rating: C – A very uncertain political and economic outlook and a business environment with many troublesome weaknesses can have a significant impact on corporate payment behavior. Corporate default probability is high.

COFACE Business Climate Rating: D – The business environment is very difficult. Corporate financial information is rarely available and when available usually unreliable. The legal system makes debt collection very

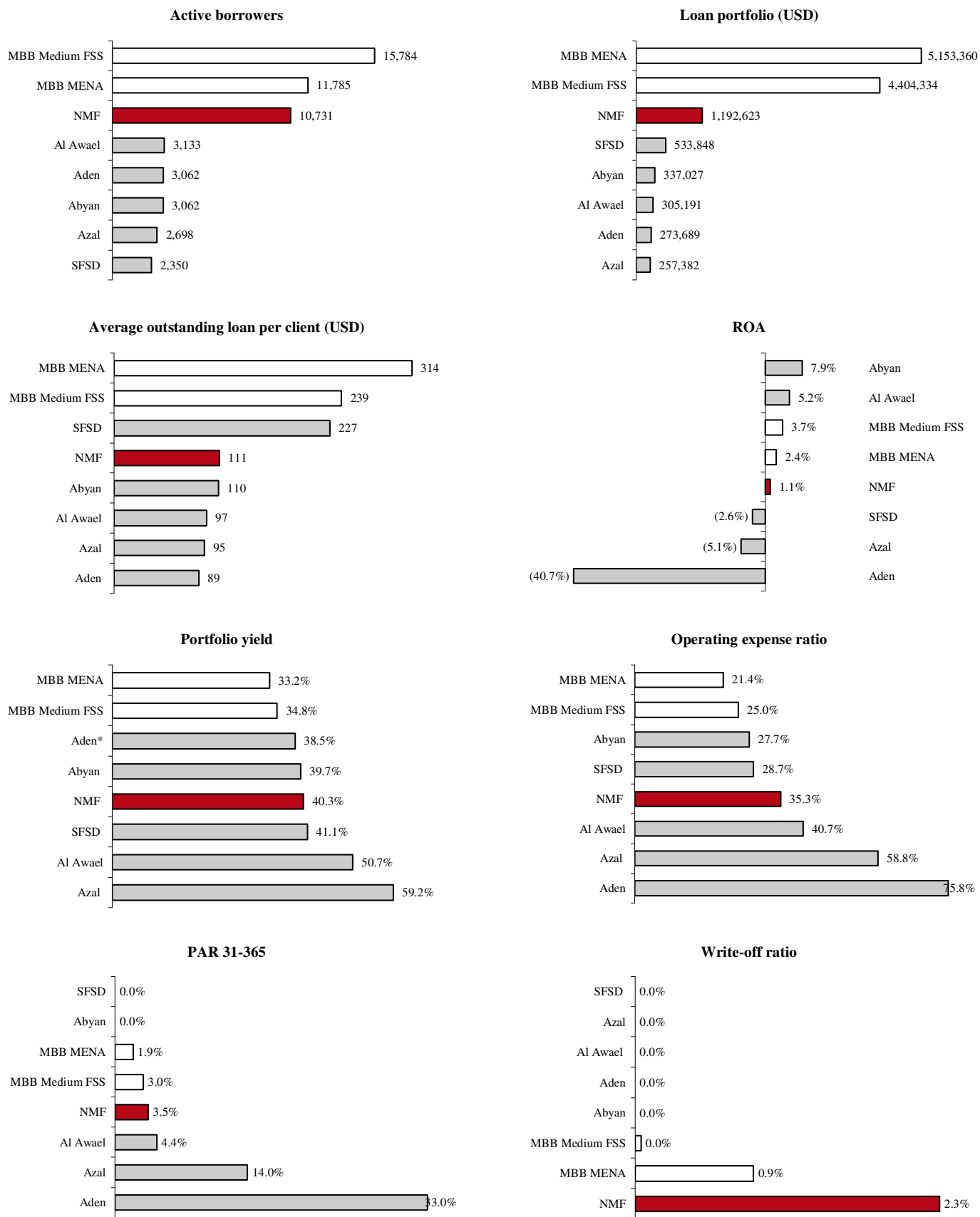
unpredictable. The institutional framework has very serious weaknesses. Intercompany transactions can thus be very difficult to manage in the highly risky environments rated D.

USD billions	2006	2007	2008 (e)	2009 (f)
Economic growth (%)	3.2	3.5	3	5
Inflation (%)	18.2	12.5	18	7.7
Public sector balance (%GDP)*	0.8	-6	-7	-13.7
Exports	6.9	7.1	8.8	6.3
Imports	5.9	7.7	9.3	8.8
Trade balance	1	-0.6	-0.5	-2.5
Current account balance (%GDP)	0.3	-1.3	-1.7	-4.5
Foreign debt (%GDP)	1.3	-6.1	-6	-14.1
Debt service (%G&S exports)	28.6	26.7	22.8	23.4
Foreign currency reserves (in months of imports)	3.6	4.2	3.4	4.5

* Excluding grants. (e) estimates (f) forecasts. Source: COFACE Country Risk Rating Guidebook 2009. Disclosure Statement: Data is provided with authorization from COFACE - a shareholder of Planet Rating.

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: MiX, MFI, Planet Rating; data as of December 2008. *Aden's portfolio yield as of June 2009.

■ Formulas

Return on assets (ROA):	$\text{Net operating income} / \text{Average assets}$
ROA (without donations):	$\text{Net operating income before donations} / \text{Average assets}$
Return on equity (ROE):	$\text{Net operating income before donations} / \text{Average equity}$
Leverage:	$\text{Liabilities} / \text{Equity (end of period)}$
Capital adequacy ratio:	$\text{Capital} / \text{Risk weighted assets (end of period)}$
Total revenue ratio:	$\text{Total revenue} / \text{Average gross outstanding portfolio}$
Portfolio yield:	$\text{Portfolio revenue} / \text{Average gross outstanding portfolio}$
Operating expense ratio:	$\text{Operating expense} / \text{Average gross outstanding portfolio}$
Cost per borrower:	$\text{Operating expense} / \text{Active borrowers (end of period)}$
Staff productivity:	$\text{Active borrowers} / \text{Total personnel (end of period)}$
Funding expense ratio:	$\text{Interest and fees paid on funding liabilities} / \text{Average gross outstanding portfolio}$
Cost of savings:	$\text{Interest and fees paid on deposits} / \text{Average deposits}$
Cost of borrowings:	$\text{Interest and fees paid on borrowings} / \text{Average borrowings}$
Loan loss provision expense ratio:	$\text{Net loan loss provision expense} / \text{Average gross outstanding portfolio}$
Write-off ratio:	$\text{Loans written off} / \text{Average gross outstanding portfolio}$
Risk coverage ratio:	$\text{Loan loss reserve} / \text{Portfolio at risk} > 30 \text{ days}$
Cash to demand deposits:	$\text{Instantly available liquid assets} / \text{Demand deposits (end of period)}$
Current ratio (1 year):	$\text{Short term assets} / \text{Short term liabilities (end of period)}$

■ Rating scale

Rating	Rating summary	
A++	Current institutional, operational and financial performances are optimal. There is no downside risk in the short-term. Medium and long-term plans are well-designed, execution capacity is excellent and goals are very likely to be achieved. Short and medium term risks are minimal and/or well-managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should only minimally affect the institution's financial condition given its high resilience.	INVESTMENT GRADE
A+	Current institutional, operational and financial performances are excellent when compared to industry standards.	
A	Medium and long-term plans are well-designed, execution capacity is very good, and goals are very likely to be achieved. Short and medium term risks are minimal and/or well managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should have a limited impact on the institution's financial condition given its ability to quickly adjust its strategies and/or take corrective actions.	
A-	Medium and long-term plans are well-designed, execution capacity is very good, and goals are very likely to be achieved. Short and medium term risks are minimal and/or well managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should have a limited impact on the institution's financial condition given its ability to quickly adjust its strategies and/or take corrective actions.	
B++	Current institutional, operational and financial performances are satisfactory when compared to industry standards.	INVESTMENT GRADE
B+	Medium and/or long-term plans are adequately designed, execution capacity is good and goals are likely to be achieved. Short and medium term risks are low and/or well managed. Areas for improvements have been identified and are being addressed. Changes in the economic, political or social environment might have an impact on the institution's financial condition that should however remain moderate.	
B	Medium and/or long-term plans are adequately designed, execution capacity is good and goals are likely to be achieved. Short and medium term risks are low and/or well managed. Areas for improvements have been identified and are being addressed. Changes in the economic, political or social environment might have an impact on the institution's financial condition that should however remain moderate.	
B-	Current institutional, operational and financial performances are close to industry standards. Short and medium term risks are moderate but are not fully addressed. Most areas for improvements have been identified, but medium and long term plans miss one or several critical elements, execution capacity is uneven and some goals are unlikely to be achieved. The institution is vulnerable to major changes in the economic, political or social environment.	TECHNICAL ASSISTANCE REQUIRED
C++	Current institutional, operational and financial performances are below comparable industry standards. Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
C+	Current institutional, operational and financial performances are below comparable industry standards. Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
C	Current institutional, operational and financial performances are below comparable industry standards. Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
C-	Current institutional, operational and financial performances are below comparable industry standards. Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	TECHNICAL ASSISTANCE REQUIRED
D	High risk: Important weaknesses in operational and financial areas result in high institutional vulnerability and potential risk of default. Performance is very poor in several important evaluation areas.	
E	Immediate risk of default: Existing operational and/or financial and/or strategic weaknesses create an outstanding risk of default. Performance is very poor in most evaluation areas.	