

Small and Micro Enterprise Programme, Kenya

Small and Micro Enterprise Programme (SMEP) was founded as the Small Scale Business Enterprise Programme of the National Council of Churches of Kenya (NCCCK) in 1975. The organization was registered in 1999 as an autonomous company limited by guarantee, with NCCCK as its sole guarantor. Through its network of 17 branches that create a near national coverage in Kenya, SMEP provides group and individual loans for small business, agriculture and consumption. As of March 2008, SMEP had a total of 33,161 clients of which 32,184 had a loan outstanding totaling a loan portfolio of 9.4 M USD.

GIRAFE Rating

Rating

C-

The GIRAFE methodology has been revised in January 2008. Changes do not affect the meaning of the grade. More info at www.planetrating.com

Outlook

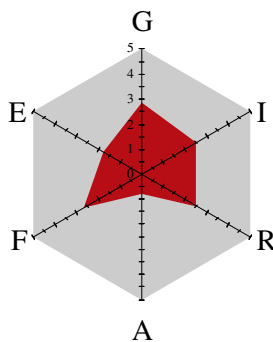
Stable

Date of the rating

April 2008

Valid until March 2009

Rating per evaluation area



Governance – Information – Risk –
Activities – Funding – Efficiency

Planet Rating Contact

Otto Wormgoor
owormgoor@planetrating.com
+256 414 236 745

MFI Contact

Phyllis Mbungu
info@smep.co.ke
+254 20 387 0162 / 205 5761

REF: OW/280508

Rating highlights

- Although SMEP has posted nominal positive ROA figures in the past four years between 0.0 to 1.5% the institution is not profitable after adjusting for the needed loan loss provision expenses to bring credit risk coverage to an adequate level.
- Credit risk has remained high although a slight improvement has been realized reducing PAR 31-365 from 22.2% in 2006 to 19.5% in 2007; PAR 365 however reduced from 14.7% to 4.5% partially as a result of a write-off ratio of 3.6%.
- The changes in the management team at the end of 2006 and 2007 have brought a positive change to SMEP instigating improvements in operations most of which are however still to bear their main fruits. Adequate preparations are being made for transformation into a regulated entity with the specific details and financial projections still to be finalized.
- The implementation of the MIS eMerge has been an important part of SMEP's growing process and will be a powerful tool in allowing SMEP to track and manage its portfolio more systematically.
- The main challenge for SMEP remains in improving portfolio quality which has received a temporary setback as a result of the post-election violence in Jan. 2008.

Outlook

The stable outlook reflects Planet Rating's opinion that even though significant improvements are underway and others are planned it will only be realistically possible for SMEP to bring credit risk, credit risk coverage and profitability within acceptable standards in the medium term especially given the setback due to the post-election violence.

Performance indicators

USD, unless otherwise stated	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008
Assets	7,806,769	8,632,169	9,297,720	12,233,496	12,669,550
Growth	67.9%	3.6%	3.5%	20.3%	4.0%
Loan portfolio	4,813,128	5,682,466	6,547,243	9,533,685	9,337,102
Growth	38.8%	10.6%	10.7%	33.2%	(1.7%)
Outstanding deposits	2,122,867	2,974,410	3,528,709	5,261,659	5,607,597
Growth	246.3%	31.3%	14.0%	36.4%	7.0%
Active borrowers	17,964	20,149	21,542	28,412	32,184
Active savers	20,599	21,633	24,090	30,240	33,161
Staff	88	94	106	128	126
ROE	0.0%	4.9%	2.1%	2.5%	6.4%
ROA	0.0%	1.5%	0.6%	0.7%	1.7%
Liabilities / Equity	2.35x	2.22x	2.26x	2.83x	2.89x
Portfolio Yield	30.2%	28.8%	28.3%	29.9%	26.3%
Operating expense ratio	25.8%	21.5%	23.4%	23.4%	22.0%
PAR 31-365*	n/a	n/a	22.2%	19.5%	30.2%
PAR > 365*	n/a	n/a	14.7%	4.5%	5.6%
Write-off ratio	0.0%	0.9%	0.0%	3.6%	0.0%

*PAR data prior to 2006 is based on the previous manual MIS and is not deemed 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 (2004) and are allowed to pursue member based financial intermediation. A new SACCO Societies Bill has been developed in 2007 but is still to be passed by parliament. Nevertheless MFIs which comprise Companies, NGOs and Trusts, are not regulated and are not allowed to pursue financial intermediation.

On December 30th 2006 a new Microfinance Act was enacted by parliament that will regulate deposit-taking financial institutions. The regulations under the act are to be published by CBK in May 2008. It is estimated that between three and five MFIs (KWFT, Faulu Kenya, Jamii Bora Trust, SMEP and KADET) will initially apply for a license. However, the act, also leaves room for non-regulated, non-deposit taking financial institutions.

A recent study on 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%

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 which together are estimated to have 2.1 million clients, 1.48 billion USD in loan portfolio and 1.79 billion USD in deposits.² However, it should be noted that the larger cooperatives in Kenya are more focused on salary loans to low- to middle-income clients in urban areas. Besides the cooperatives, the main providers of microfinance services in Kenya are:

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>

MFI	Active borrowers	GLP (M USD)	Savings accounts	Deposits (M USD)
Equity Bank	392,822	179	1,840,332	256
K-REP Bank*	114,301	54	14,951	24
KWFT	164,540	60	n/a	n/a
Jamii Bora Trust†	100,000	5.9	170,000	4.0
Faulu Kenya	90,339	25	n/a	13†
SMEP	30,240	9.5	n/a	5.3
KADET*	16,575	3.7	n/a	2.2

Source: www.mixmarket.org 2007 data; * 2006 data; † estimate.

Currently the main donor support for the microfinance sector is from the Financial Sector Deepening project³ which focuses on the main challenges to further stimulate 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.

Effects of the post-election violence

The post-election violence which erupted due to the contested elections held December 27th 2007 has affected the microfinance sector in Kenya. The direct effects of client's businesses being destroyed or displacement have had a varying impact on MFIs. Larger MFIs operating nationwide have been able to cope relatively well. Smaller MFIs operating in a localized area that was hardest hit by the tribal clashes (Kisumu, Eldoret, Northern Rift Valley and the main Nairobi slums of Kibera and Mathare) have been hit much harder and some stand to lose up to 40% of their portfolio.

More in general portfolio quality has deteriorated across the board as a result of the fact that: regular operations were not possible in the first two weeks of January 2008. The situation in Kenya has taken until February to become relatively stable, which created a backlog in client repayments that is slowly being reversed. The turmoil also has caused a general slow down of client's business limiting their repayment capacity and the tribal clashes have weakened group cohesion of intertribal groups reducing the effectiveness of group guarantees employed by many MFIs.

Political & economic environment

Kenya posted strong growth for the fourth straight year in 2007. Good weather conditions benefited agriculture as well as the forestry and fishing sectors. On a more fundamental level, the base of economic growth broadened thanks to the development of tourism and the intensification of trade within the East Africa Community. Those trends should continue in 2008 provided the post-elections tensions prove to lessen.

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

The economy has, however, been giving signs of overheating due to bottlenecks in transport and energy infrastructure. Rising despite the central bank's restrictive monetary policy, inflation should remain above the five percent target.

The good economic conditions coupled with prudent fiscal policy have only contributed modestly to the consolidation of public finances with privatization proceeds and tax revenues less than expected while debt service and investment spending undermined the budget. The fiscal deficit should moreover grow larger in 2008 due to the spending increase. The strong growth has moreover resulted in a widening of the current account deficit attributable to rising capital goods imports and the increasing cost of oil. The country's external financing needs nonetheless remain largely covered by incoming foreign direct investment. The country has ample and growing foreign exchange reserves.

Despite the progress made in improving the business environment, which allowed Kenya to be included in 2007 among the ten most reform-minded countries in Africa, the anti-corrupt campaign is still inadequate. The escalation of ethnic tensions in the wake of the hotly disputed December 2007 elections constitutes a critical risk for the stability of the country and the region.

Strengths

- Kenya's relatively diversified economy has benefited from the growth of the construction and telecommunications sectors.
- An emerging middle class has underpinned consumption and fostered greater diversification of production.
- The regional integration under way within the East Africa Community has enhanced Kenya's role in the region and its attractiveness to investors.
- The influx of foreign direct investment, since 2005 has underpinned an increase in medium-term potential.

Weaknesses

- Agriculture remains a crucial sector of the economy, generating 25 per cent of GDP and providing a livelihood for the majority – 85 per cent – of the population whose incomes are thus vulnerable to weather conditions.
- A shortage of infrastructure and its deteriorated condition have impeded growth with the road network and port facilities still inadequate and electricity production limited.
- An extensive mobilization of resources will be necessary to stem not only the poverty that afflicted 46 per cent of the population in 2006 but also unemployment and an AIDS pandemic in sharp decline but still affecting six per cent of the population.

- Persistent corruption and violence have damaged Kenya's image and have had a negative impact on international aid.

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.

(USD millions)	2005	2006	2007(e)	2008(f)
Economic growth (%)	5.8	6.1	6.4	6.5
Inflation (%)	10.3	14.5	6.9	7.2
Public sector balance (%GDP)	0.1	-2.1	-3.9	-5.1
Exports	3,455	3,502	3,760	4,152
Imports	5,602	6,768	7,602	8,210
Trade balance	-2,147	-3,266	-3,842	-4,058
Current account balance (%GDP)	-0.8	-2.4	-3.7	-5.1
Foreign debt (%GDP)	32.3	30.3	30.9	34.6
Debt service (%G&S exports)	4.4	5.7	5.9	5.1
Foreign currency reserves (in months of imports)	3.9	4.3	4.9	4.8

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

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

Institutional presentation

Legal form, supervision and audit

Small and Micro Enterprise Programme (SMEP) was founded as the Small Scale Business Enterprise Programme of the National Council of Churches of Kenya (NCCK) in 1975. The organization was registered in 1999 as an autonomous company limited by guarantee. SMEP is currently in the process of establishing a company limited by shares (SMEP MFI Ltd.) to enable it to become a Micro-Deposit Taking Institution regulated by the Central Bank of Kenya (CBK). At present SMEP is not regulated by CBK.

SMEP has been audited by Deloitte & Touche Kenya since its beginnings. Although SMEP does not follow the microfinance best practice of changing audit firms every three years, Deloitte's audit teams are changed each year in order to provide a more independent opinion on the institution and the state of its Financial Statements. Deloitte has not qualified its opinion on the audited financial statements for the years under review. The financial year of SMEP starts on January 1st and ends December 31st.

Ownership

SMEP only has one guarantor which is the National Council of Churches of Kenya (NCCK). The exact shareholding

structure for SMEP MFI Ltd is still to be determined and the shares have been allocated equally among SMEP and five individuals representing NCKK; three of which are present board members of SMEP. SMEP MFI Ltd. initially will not adhere to the maximum percentage of ownership of 25% by any one party and is intending to use the four year grace period to diversify its ownership base.

The Board of Directors (BoD) of SMEP is elected by NCKK's executive committee, and is comprised of seven members (bankers, lawyers, an economist, and a CPA). Terms are for three years but are renewable. Several members have held their position since the establishment of the company in 1999. The BoD only has one committee at present which is the transformation committee to guide the process of regulation by CBK.

Donations

Since inception, SMEP has received over 128 M KES (1.7 M USD) in donations. 66 M KES (1.0 M USD) was received from USAID in the form of a bank guarantee that was converted into a donation at the end of the period. Other donations originate from various international organizations destined for working capital and technical assistance. Since end of 2004 SMEP has not received any donations. In November 2007 a funding contract was signed with the Micro Enterprise Support Programme Trust (MESPT) focused on the development of individual loan products for a total value of 6.1 M KES (94 K USD).

Funding composition

As of December, 2007, SMEP's funding structure is comprised of equity (25%), debt (30%) and compulsory deposits (43%). Debt comes from local investors which include Cooperative Bank (79 M KES), MESPT (61 M KES) and Jitegemee Trust (13 M KES).

SMEP also participates in two Government of Kenya initiatives to provide financial services to Women and Youth for which SMEP has contracted 60 M KES under the Women Fund and 7 M KES under the Youth Fund⁴. To date 20 M KES and 1.7 M KES have been disbursed under these two funds respectively. The funds carry an interest rate of only 1% per annum (declining) and the interest rate to clients is capped at 8% per annum (flat).⁵

⁴ Youth is defined between the ages of 18 and 35.

⁵ To minimize the effect of low repayments, which is common when clients know the funds originate from government, SMEP only makes these loans available to clients as their first loan. Subsequent loans are provided only under the normal conditions of SMEP.

Management team

The management team is composed of a CEO, Operations Manager (OM), Financial Manager (FM), IT Manager, HR Manager and Internal Auditor (IA). After the previous CEO left in September 2006 Phyllis Mbungu, who was the Finance Manager was appointed as acting CEO and was fully appointed in November 2006. The Internal Auditor became the new Finance Manager as of July 2007. In August 2007 a new Internal Auditor was recruited. In the same period also a new Operations Manager started in December 2006.

- Phyllis Mbungu has worked with NCKK since 1987 as an accountant and joined SMEP in 1999 as the Chief Accountant (which is now the position of Finance Manager). Ms. Mbungu holds a Bachelor of Commerce, with a double major in Accounting and Business Administration and Management from Daystar University in Kenya.

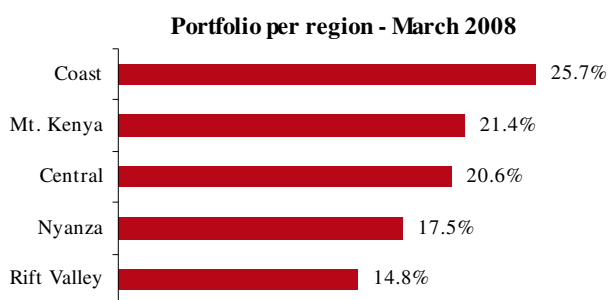
Organization

SMEP currently houses its management team and administrative operations in its Head Office (HO) in Nairobi. SMEP's branches are comprised of a Branch Manager (BM), Loan Officers (LOs) and an IT Assistant. IT assistants are in charge of entering client information into the MIS for loan approval, which is done by the BM for loans under 150,000 KES (2,336 USD), the OM for loans under 500,000 KES (7,787 USD), and the CEO for loans over 500,000 KES. Loan evaluation forms and contracts are all sent to the HO by courier, where the finance department reviews the forms and emits the checks necessary for loan disbursement. Contracts, chattels and title deeds are kept at the HO. Loan collection is done directly through deposits in banks (KCB or Cooperative Bank). In the case of business loans, money is collected during group meetings, upon which a member of the group signs a receipt and deposits the funds in the closest bank. SMEP has plans to introduce regional offices in the next years, including a regional manager with increased autonomy for decision-making and loan approval.

For loan tracking SMEP uses eMerge by Temenos of Switzerland. It was purchased in 2006 and became fully functional in September 2007, although data harmonization is still in process, see Information section. While 90% of branches are connected via internet (DSL or wireless), the IT department has plans to connect the remaining 10% during 2008. Accpac is used for accounting purposes and is not integrated with the MIS. The IT department is developing an interface to facilitate the transfer of the data between the two systems which should be operational by mid 2008.

Market penetration

SMEP operates through a network of 17 branches and 10 Satellite Offices (that respond directly to the nearest branch). The branches provide a near national coverage in Kenya and cover the principal populated areas of the country. Nairobi (central Kenya) has traditionally been SMEP's largest area but has been overtaken in 2007 by the coast region and in 2008 also by Mt. Kenya region. The outstanding portfolio per region is shown in the graph below.



Products and services

SMEP offers 4 principal loan products, with the lead product being business loans. SMEP offers loans only in KES, and charges interest rates on a flat basis at 20% per annum. Apart from interest, SMEP charges loan insurance for 2% the value of the loan and a Loan Administration Fee (LAF) of 1% the value of the loan. To take out a loan, clients must have 10-25% of the loan value in compulsory savings.

- **Business Loans:** Created in 1999 under the community bank methodology for rural and urban clients. Loan terms vary between 3-24 months. Loan amounts vary from 5,000 KES (78 USD) - 1 M KES (15,600 USD). Payments are made weekly in group meetings, with a grace period of up to 2 weeks.
- **Agricultural Loans:** Created in 2006 under the community bank methodology for rural clients. Loan terms vary between 3-12 months, with an average of 9 months. Loan amounts vary from 5,000 KES (77.9 USD) – 200,000 KES (3,110 USD), with an average of 50,000 KES (779 USD). The principal is repaid in a single bullet payment at the end of the loan term; interest payments are made weekly in group meetings with a grace period of 2 weeks.
- **Special Loans:** These are complementary loans given to members of community banks with outstanding business loans, and are destined for school fees, emergencies, business expansion, livestock, household assets and purchase of shares of an IPO on the Nairobi Stock Exchange. Loan amounts vary from 5,000 KES to 300,000 KES (4,672 USD). Loan terms vary from 3-12 months. Payments are made weekly at the same time as the business loan.
- **Individual Loan:** Created in 2007 for clients graduating from established community banks. Loan amounts vary from 100,000 KES (1,557 USD) to 3 M KES

(46,722 USD). Loan terms vary from 3-24 months, with an average of 12 months. Payments are made weekly.

The group loan products are backed by savings and group guarantees, as well as collateral for loan amounts over 150,000 KES (2,336 USD). Individual loans are backed by savings and collateral only. The business, special and individual loans have an effective interest rate of 45% on average. For agricultural loans the effective interest rate is 25% on average.

Networks

SMEP is a member of the Association of Microfinance Institutions of Kenya (AMFI) as well as the International Network of Alternative Financial Institutions (INAFI) Africa, where Phyllis Mbungu is currently the Vice President of the Board.

■ Governance

Governance and Decision making is rated “c”

Decision making

SMEP was founded with a clearly established social mission, shared among its shareholders and understood to be complementary with sustainability and profitability. Given the current regulatory environment, the legal set up is adequate. SMEP's decision to transform into a regulated company limited by shares under the new microfinance law will allow it to capture savings from the public, and is being adequately prepared for with the creation of a transformation committee to guide this process. Nonetheless, while future shareholder options have been explored, the final governance and shareholding structures are yet to be determined as well as the exact process of transformation. Given the high cost associated to upgrading branches SMEP is planning to take a gradual approach to move branches one by one to the new, regulated entity. This mode of transfer is in principal acceptable to CBK and the exact details are currently being worked out by SMEP.

Thanks to quarterly board meetings with reliable and ample information available, the board has generally been able to make timely strategic decisions in SMEP's best interests. However, the decision to mobilize voluntary deposits (among its own clients only) and on-lend compulsory deposits has not been in the best interest of the institution, and has exposed SMEP to risk of intervention by CBK.⁶

⁶ As an unregulated entity SMEP is not allowed to collect voluntary deposits nor intermediate compulsory deposits and is therefore at risk of intervention by CBK. Given current and historic practice in Kenya intervention is unlikely as a result of the intermediation of compulsory deposits. However, there is no history of un-regulated entities collecting voluntary deposits in Kenya and risk of intervention for this fact is higher. However, the amount

The decision-making process would be strengthened with a more critical analysis by management and the inclusion of more financial indicators in the reports to the BoD (such as PAR, ROA, etc.) that would permit a more in-depth analysis of the current financial situation. The board could also benefit from additional committees (e.g. audit committee) to increase the speed with which decisions can be taken.

The profiles of board members boast a variety of backgrounds (lawyer, economist, banker, CPA, etc), allowing for a diversity of well-founded opinions and analyses. The board's capacity, and the planned inclusion of a member with experience in legal transformation, provides it with sufficient expertise to guide the institution in the transformation process. Follow-up of board decisions in each meeting is consistent and allows for their effective implementation.

Planning

SMEP's current Strategic Plan (SP) identifies the principal objectives and strategies for growth in the next five years, with a thorough analysis of the current external and internal environment as well as the main challenge (regulation) facing the institution in the coming years. However, the plan fails to address certain key elements such as credit risk, competitive advantages, and financing strategies. The SP is translated into an annual Business Plan, through a participatory planning process, but has yet to be prepared for 2008.

The SP includes projections for portfolio as well as basic financial ratios through 2012. However, the projections only include cash flow statements without the related income statements and balance sheets. Furthermore, the projections are based on an extrapolation of 2007's growth data and for example do not contemplate theoretical interest income on loans versus actual income.

Given the plans to initiate the process of transformation during 2008, the planning regarding the specific operational and administrative elements is still incomplete, in areas such as:

- The management of new company and transfer of assets from SMEP to SMEP MFI Ltd.
- The process of branch transformation and planning of which branches to transfer when.
- Detailed financial projections for the balance sheet and Income Statements for both SMEP and SMEP MFI Ltd.
- Potential effects of the provisioning policy on institutional profitability, see Credit Risk Coverage below.

of voluntary deposits has remained limited and as of March 2008 stands at 1.4 M KES (21,352 USD) for 1,590 clients and comprises only 0.2% of total assets.

Similar to the financial projections in the SP also the budget for 2008 is only composed of a cash flow statement (backed by a narrative on the main assumptions made), which limits its use in monitoring. There is however adequate budget follow-up for the budget that is available.

Management team

SMEP's management team has been consolidated within the past year, and currently includes members with appropriate capacities and experience for their positions. The change in leadership has been well received at the various levels of the organization, and the open-door policy is positively perceived by personnel. Although the team is newly formed, it has established positive relationships with the various stakeholders (CBK, funders, other strategic partners) and demonstrated dynamism and proclivity to change.

After a year of constitution, the team has demonstrated efforts to address key institutional risks and challenges (especially credit risk). Monthly meetings with BMs and constant communication allow for the swift flow of information and implementation of decisions. The impact of these decisions is encouraging but still limited as a result of the recent political unrest that has intervened in various expected improvements. The key-person risk at SMEP is mitigated through collective decision-making on key issues and the permanence of the BoD as well as the Branch Managers (BM).

Human resource management

Human resources are managed professionally under a HR manager, who administers administrative aspects as well as key strategic elements such as recruitment, evaluation, and staff retention. SMEP has shown a good capacity to retain its personnel with a low turnover since 2005 (7.7% in 2007). The increase in staff turnover during 2006 (18%) can be attributed to the exit of CEO and Operations Manager which triggered the departure of other staff.

The procedures for staff recruitment have been effective in identifying personnel with appropriate skills for their positions. Induction is fairly standardized, with a week in HQ and 2-3 months of field training for LOs. Annual staff evaluations have yet to be utilized to their full capacity to identify opportunities for training, especially in key technical areas such as credit risk management. However, a skills evaluation is currently underway for the planned transformation to a formal deposit-taking financial institution. Nonetheless, the current incentive scheme for field staff is limited to annual performance-based bonuses and would be strengthened with the use of monthly or quarterly incentives based on portfolio quality.

Staff morale at all levels is high, thanks to an adequate salary scheme, clearly perceived career path and good level of communication within the team, and regulation is a specific source of motivation.

■ Information

Information is rated “c”

The MIS of SMEP is relatively efficient and cost-effective. The recently implemented MIS (eMerge) is appropriate for current activities and scalable for the institution’s projected growth and regulation⁷. The accounting package is adequate for SMEP but the fact that the two systems are not integrated reduces operating efficiencies. The branches are on-line connected to HO but connectivity has not been optimal. SMEP is currently working on a more reliable connection. SMEP has the basic internal capacity to manage the system. MIS systems support is adequate, thanks to a local maintenance provider (Delisys) and this will be strengthened with the opening of a Temenos office in Nairobi.

Data security is ensured by frequent back-ups stored on- and off-site, automatically updated anti-virus protection, password protection and user profiles. However, the system would be strengthened with product configurations including pre-established interest rates to prevent manual errors or potential fraud. Paper data security is only partly adequate as loan contracts are stored centrally at HO but not in a secure way.⁸ Collateral documents (logbooks, title deeds) are stored securely in a safe at HO.

The process of data transfer to the new MIS and its verification has required more time than expected and is at present 85% complete. This process, combined with severe operating delays during the post-election violence, has meant that SMEP still does not have a fully reliable or complete view of the current loan portfolio. This situation should be ameliorated before the end of May 2008.

Although portfolio reports per product, branch and LO are available within the system, they have yet to be fully utilized at the branch level. The time lag in data entry and lack of training has meant that the use of system-generated information is still limited for day to day portfolio management.

In management as well as in reporting to stakeholders (BoD and funders, principally) portfolio analysis would be

⁷ eMerge and its more sophisticated version T24 are currently used by several regulated and non-regulated Kenyan financial institutions, including Kenya Commercial Bank, Commercial Bank of Africa, K-Rep, KWFT, and FAULU.

⁸ A copy of the loan contract remains at the branch but these are not always copies of the fully filled and signed contract.

facilitated with the reporting of PAR as a percentage of portfolio instead of a gross amount in KES. The use of financial indicators in MT and BoD reports would strengthen institutional analysis and decision-making, and should be improved with use of the SEEP Reporting Framework. Branches are managed as profit-centers, assuming the costs of the HO⁹ and allowing them to be analyzed according to their individual profitability.

■ Risk Management

Risk Management is rated “c”

Procedures and internal controls

Policies and procedures are adequately documented in frequently updated manuals although they remain relatively brief. The current policies and procedures contain sufficient internal controls with adequate separation of tasks and limitation of powers. While centralization at HO of all disbursements does allow for strong internal controls and increased prevention of fraud, it significantly reduces efficiency and customer service (i.e. time for loan disbursement). Increased decentralization would improve efficiency but would require stronger middle management and a stronger internal audit function. The creation of a position dedicated to risk identification and management will be important as the organization grows and transforms into a regulated deposit-taking entity with more inherent risks.

There is basic compliance by branch staff to the policies and procedures but this would benefit further from stronger supervision of BMs from HO and supervision of LOs by BMs. There is a need to more closely supervise the adherence to portfolio management procedures (see Activities). Similarly, stronger procedures need to be put in place regarding tracking of collateral documents within SMEP (at branch and HO levels) to avoid potential misuse as well as possible loss of the documents.

Bank reconciliation is done sufficiently frequent but unresolved items are not cleared sufficiently fast. Reconciliations between eMerge and Accpac are handled adequately but remain time consuming without an appropriate interface as well as differences in accounting (e.g. disbursement date of loans). The current delay between check emission in Accpac and eMerge has required the use of a special account for “Checks in Transit” and a grace period of 2 weeks for their conciliation. An interface for integration between the MIS and accounting system is currently being developed to facilitate this process.

⁹ HO costs are distributed according to disbursed loan volume.

Internal audit

The Internal Audit (IA) function has a wide scope covering both operational risks at the HO and branch level. However, its span should further include other risks such as liquidity risk, reputation risk and legal/regulatory risk, given the upcoming challenges for SMEP. The IA department has sufficient skills to adequately carry out its task, but lacks actual man-power to be able to do a sufficient number of audits given the extent and geographical spread of the branches. However, the planned addition of a third staff member as well as the purchase of audit software is expected to increase capacity by mid-2008, but with the expected growth of SMEP and upcoming transformation more staff will be needed.

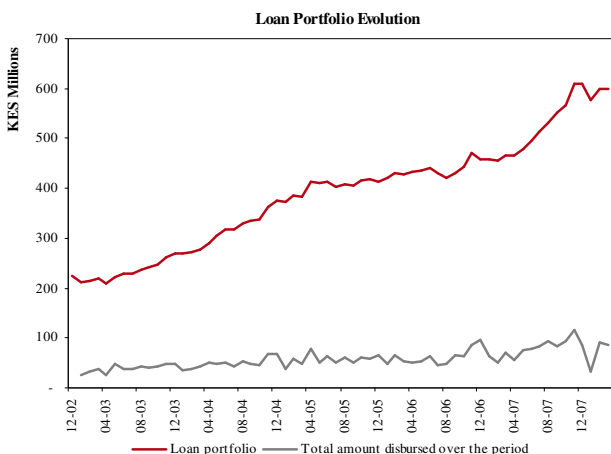
The present institutional set-up guarantees the needed independence of the IA department, and there is an open communication between the IA manager and the board as well as the CEO. However, the supervision of internal controls has not been complemented by the work of external auditors, who have concentrated on a review of the financial statements but not on operational and credit risks.

Activities

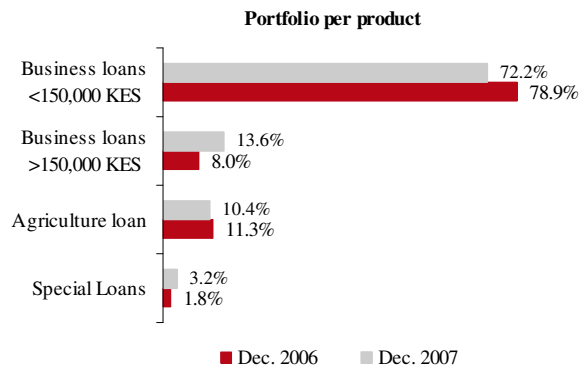
Activities: products and services is rated “e”

Evolution and composition of the portfolio

SMEP’s portfolio has witnessed a steady growth in 2003 and 2004 but 2005 and 2006 showed slow growth with growth rates only just above 10%. In 2007 the growth rate picked up again and a 33% increase was noted for the year. The growth in number of clients follows the same trend.



The portfolio has maintained a similar composition between 2006 and 2007. The main change is the reduction of the business loans with loan amounts under 150,000 KES (2,336 USD) in favor of business loans over 150,000 KES. The special loans almost doubled in their percentage of total loan portfolio but remain limited at 3.2%. In 2008, SMEP has plans to increase the proportion of agricultural loans.



Loan portfolio management

SMEP has adequately designed credit methodologies but they are not uniformly applied across all branches leading to sizeable differences in branch performance. Areas that would require further optimization within the credit methodologies are the repayment structure for agricultural loans as these currently have a singly bullet payment at the end, and a further deepening of the cash flow analysis for individual loans. For the individual loans dedicated loan application forms requiring a more detailed appraisal are currently being developed.

The main area where implementation of the credit methodology varies across branches is the loan appraisal for the group loans. The loan appraisal depends mainly on group approval and it is common that after the first loan LOs do not perform another business appraisal themselves. To partly remedy this SMEP has started offering refresher trainings to groups in 2007 on group management. However, it is necessary for SMEP to increase the level of loan appraisal in order to take better informed credit decisions to be able to evaluate decisions taken by the groups themselves.

In 2007 a significant number of special loans have been added to the product offering. While these have been effective in fostering client loyalty, training on these new products to LOs has been limited, reducing the roll out of the products and the adequate implementation by LOs.

To date delinquency management and follow-up has not been sufficiently rigorous to ensure good portfolio quality. Much of the delinquency management is left to the groups, with little involvement by the LO or a legal entity. This could be a good process however LOs are not sufficiently rigorous to ensure the group to pay SMEP prior to the group resolving the issue internally. In part, this situation has historically come from the manual management of portfolio at risk, which underestimated the real situation of portfolio quality but has come to light with the introduction of eMerge. However, at present LOs will only know their PAR at the end of the month, but do not track it on a daily or weekly basis. Management has increased focus to improve

portfolio quality in 2007 and as of January 2008 SMEP has introduced a new policy denying loan disbursement to groups with arrears which is expected to put a further emphasis on portfolio quality to both LOs and groups. The effect cannot be fully evaluated given the short term that this policy has been in place as well as the recent events in Kenya.

Credit risk

Credit risk has remained high at SMEP. For the past two years, SMEP has maintained a PAR 30 of above international norms (PAR 30 at 36.9% and 24.0% as of Dec. 2006 and Dec. 2007 respectively).¹⁰ PAR31-365 has however reduced only marginally from 22.2% to 19.5%. The main reduction took place in PAR 365 which reduced from 14.7% to 4.5%, partly as a result of a write-off of 18.4 M KES (287 K USD). Due to the post-election violence PAR levels have increased as of March 2008 with PAR31-365 rising to 30.2% and PAR 365 to 5.6%.

The business loans follow the main PAR trend of the loan portfolio. The only product to increase PAR31-365 from 2006 to 2007 are the special loans with ratios increasing from 16.6% to 26.5%. Agricultural loans on the other hand have seen a more significant reduction with PAR31-365 reducing from 40.3% to 23.1%.

Given its initial positive financial result of close to 19 M KES for FY07 SMEP has decided to use this to write-off 18.4 M KES of its past due loans. This write-off is however not backed by a clear write-off policy and SMEP is still to develop and implement a proper write-off policy. SMEP is currently in the process of developing policies to monitor the written-off loans and their recoveries.

In 2008, SMEP decided to offer rescheduling of loans for clients directly affected by the post-election violence (looting, burning, etc). No loans had yet been rescheduled as of March 2008.

Limits on concentration in specific geographic areas and/or economic sectors are not yet developed. Concentration risk is expected to be low given the geographic spread and diversity of client activities. Furthermore, agricultural loans at present only comprise 11% of the portfolio.

Credit risk coverage

The present loan loss provision methodology of SMEP (a standard 3% provision of the total loan portfolio) has increased since 2006 (when this was just 2%) however it does not lead to an adequate provisioning level given SMEP's level of PAR. The credit risk coverage of PAR 30

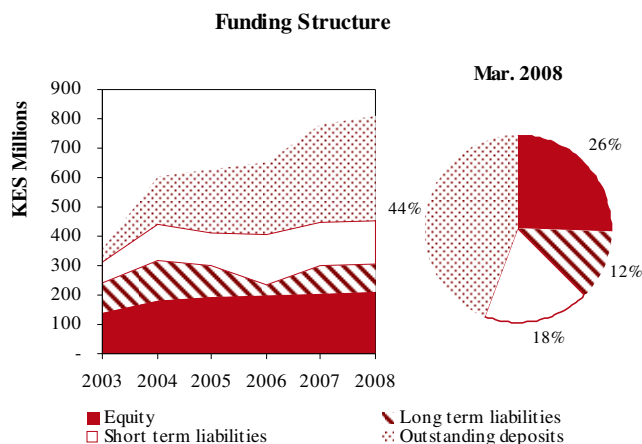
¹⁰ Data prior to December 2006 was based on the previous manual MIS. The PAR data contained therein is not deemed reliable.

has been low in the past and as of December 2007 stood at a low 12.5%. The low provisioning levels result in the fact that PAR 30 net of loan loss provision as a percentage of equity stands at 62.8% as of December 2007. If SMEP would apply a proper loan loss provisioning policy this would mean a one time expense of 65 M KES (1.0 M USD) as of December 2007.¹¹

Furthermore, SMEP is at present not able to fully utilize the group guarantee as evidenced by the high PAR of group loans. Compulsory deposits do provide additional coverage and the larger loans are adequately covered by chattel or other hard collateral.

Funding and liquidity

Funding and liquidity is rated "c"



Capitalization and funding strategy

SMEP is adequately capitalized with a capital adequacy ratio of 31.8% as of December 2007. However, if SMEP would apply a proper loan loss provisioning policy it would mean a one time expense of 65 M KES (1.0 M USD) as of December 2007 which would drop its CAR to 21.7%. A CAR of 21.7% is still adequate for SMEP but it will limit its further growth without an additional capital injection or significant reduction of its PAR.

There is currently an adequate diversification of funding sources and SMEP has identified funding needs for the coming year. SMEP has good relationships with national and international funders. Sufficient negotiation skills are present within SMEP to negotiate funding contracts with favorable conditions. As a result, a significant part of the funding needs for 2008 are already contracted or in advanced stages of negotiation.

¹¹ As a result of the increasing PAR levels as of March 2008 the provisioning expense needed to come to an adequate provisioning level has risen to 90 M KES (1.4 M USD).

However, for the years beyond 2008 the total volume of funding is known but there is still little analysis on the specific volume of each type of funding that SMEP will need, i.e. deposits, debt and equity. The search for equity investments is only in its initial stages and at present SMEP has only discussed with one of its present funding partners to provide a convertible loan.

Liquidity risk

At present, the instruments used by SMEP for liquidity management are limited to only short term cash-flow projections (weekly/bi-weekly). Longer term, updated cash-flow projections are not available and larger payments (e.g. loan repayments to investors) are monitored separately through Excel spreadsheets.

SMEP's liquidity levels have been low and as of December stood at only at 0.7% covering only 0.5 months of operating expenditures. At present SMEP has only a limited availability of overdrafts but can make use of several draw down facilities if needed. Liquidity risk is further mitigated by a large buffer of T-Bills and Fixed Deposits although this would mean forfeiting the revenue on these investments.

Maturity risk is low at SMEP given the large portion of its equity and long term debt as well as the fact that the deposits are not callable by clients until they finish their loans. The current ratio as of December 2007 is around 150%. However, maturity risk is not actively managed by SMEP.

SMEP has not set an exact prudential guideline for itself what percentage of deposits it needs to keep in liquid assets or short term investments but aims for roughly half. As of December 2007 this ratio stood at 42%. It is expected that this is sufficient to meet demands from clients whose savings are callable.

Market risk

Although SMEP does not have any formal mechanisms in place to measure its level of exposure to market risks, the current funding structure has effectively mitigated these. Foreign exchange risk is not present as all assets and liabilities are in KES only. Interest rate risk is also limited as 25% of debt is on fixed interest rate and the other 75% of debt (representing an 80% of Tier 1 capital) is linked to the base rate of the different investors which have been stable in recent years and are only changeable in case of macroeconomic changes.

■ Efficiency and Profitability

Efficiency and Profitability is rated “d”

Profitability analysis

SMEP has posted positive ROA figures varying between 0% and 1.5% since 2003. However, these figures have been distorted by the institution's significant under-provisioning policy, see 'Activities' section above. Adjusting profits for the appropriate provisioning expenses in 2007, the ROA reduces to negative (7.7%). One of the most significant limitations to SMEP's profitability has been the significant yield gap as a result of poor portfolio quality. While the theoretical effective interest rate is roughly 43%, the actual yield has been between 27.5% and 30% in the past years.

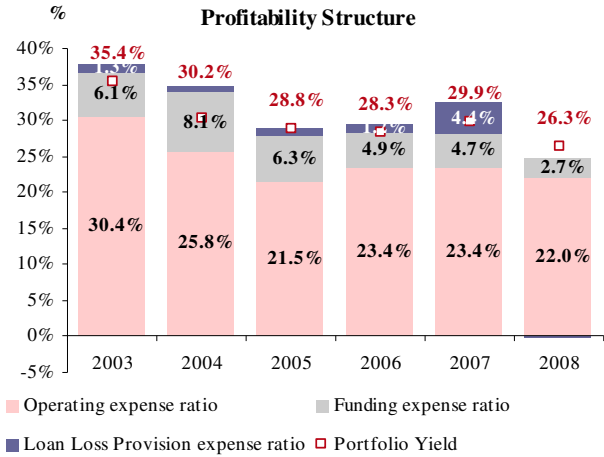
SMEP's current revenue quality is moderate. Its principal competitive advantages in the Kenyan microfinance market are its long period of existence and product diversity. On the other hand its interest rates are slightly higher as compared to its main competitors. Although many new products have been introduced in 2007, mainly the special loans, not all have been quickly received (e.g. the individual loan product). SMEP has not been active in carrying out market studies or developing a marketing strategy in the past years, necessary to achieve the growth planned for the next five years. Regulation will be a strategic advantage for SMEP to position itself in the market as a formal deposit-taking entity.

Meanwhile, the operating expense ratio has decreased over the past five years (from 30.4% in 2003 to 23.4% in 2007). This remains slightly lower than its peers (27.8% for East Africa) as a result of an above average level of staff productivity reaching 236 in 2007.

The funding expense ratio has seen a declining trend as the cost of debt has reduced as a result of reduced cost of funds as well as a reducing percentage of debt in the funding structure, which was replaced by the cheaper member's deposits. The loan loss provision expense has remained artificially low over the past years and does not represent actual figures (see “Activities” section).

SMEP's profitability outlook is not positive per se as it will have to make significant expenses to bring up the loan loss provisioning levels to acceptable standards. Even though SMEP shows a positive ROA for the first three months of 2008, these figures do not take into account the needed loan loss provision expenses for the deterioration of portfolio quality that took place as a result of the post-election violence. The main challenge for SMEP to become profitable is the improvement of its portfolio quality. This will also help to increase portfolio yield (and close the yield gap) which will provide some room to adjust interest rates to stay in line with its competitors. Healthy portfolio growth

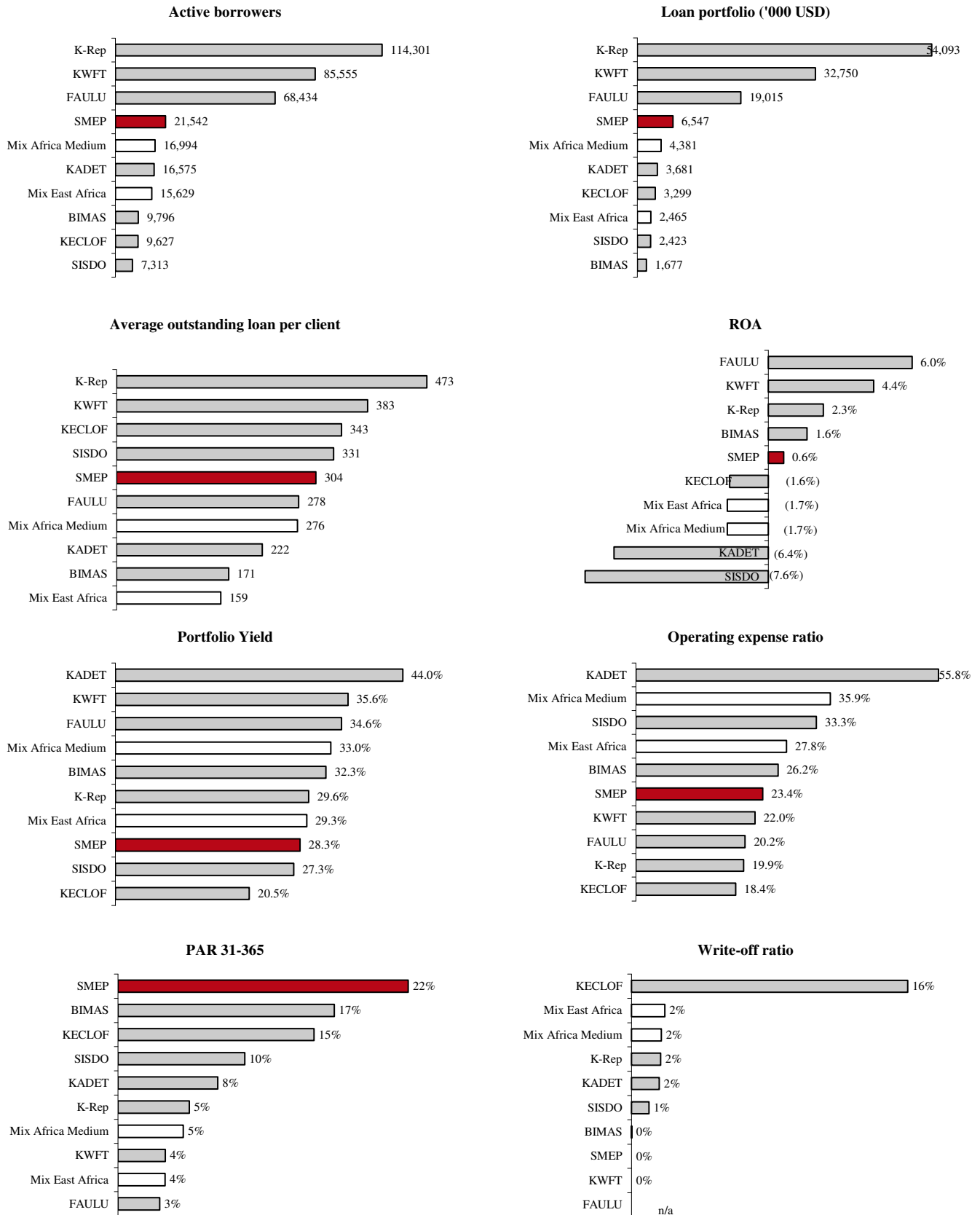
will allow SMEP to achieve economies of scale. Transformation into a regulated entity should support the growth strategy and allow its funding expense ratio to decrease as a consequence of less expensive funding sources (i.e. savings). However, regulation will require major investments (systems, HR, office upgrades), that SMEP will have to bear in the next few years, likely to result in an increased level of operational costs.



Note: Figures are not adjusted for loan loss provision expenses.

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



Sources: SMEP, KECLOF, SISDO Planet Rating own data, others: www.mixmarket.org. All data as of Dec. 2006 except KADET (2006-09).

■ Performance indicators

Data in USD, unless otherwise stated

	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008
Loan Portfolio					
Loan portfolio evolution					
Loan portfolio	4,813,128	5,682,466	6,547,243	9,533,685	9,337,102
Loan portfolio (KES)	373,980,037	413,683,508	457,959,008	609,870,503	599,535,317
Evolution	38.8%	10.6%	10.7%	33.2%	(1.7%)
Average outstanding loan	4,005,133	5,523,738	6,221,816	7,983,226	9,249,977
Active borrowers	17,964	20,149	21,542	28,412	32,184
Evolution	10.3%	12.2%	6.9%	31.9%	13.3%
Average outstanding loan per client	268	282	304	336	290
% of GDP per capita	53.1%	47.5%	44.1%	36.9%	31.2%
Average amount disbursed per loan	n/a	n/a	648	754	773
% of GDP per capita	n/a	n/a	94.0%	82.9%	83.0%
Portfolio quality					
Rescheduled loans	0.0%	0.0%	0.0%	0.0%	0.0%
PAR 31-365*	n/a	n/a	22.2%	19.5%	30.2%
PAR > 365*	n/a	n/a	14.7%	4.5%	5.6%
Write-off ratio	0.0%	0.9%	0.0%	3.6%	0.0%
Credit risk coverage					
Risk coverage ratio (PAR 30)	n/a	n/a	8.2%	12.5%	8.5%
PAR 31 net of loan loss provision / Equity	n/a	n/a	77.8%	62.8%	94.0%
Savings					
Outstanding deposits	2,122,867	2,974,410	3,528,709	5,261,659	5,607,597
Outstanding deposits (KES)	164,946,774	216,537,035	246,822,050	336,588,699	360,063,780
Evolution	246.3%	31.3%	14.0%	36.4%	7.0%
Mandatory savings (%)	100.0%	100.0%	100.0%	99.7%	99.6%
Voluntary savings (%)	0.0%	0.0%	0.0%	0.3%	0.4%
Active savers*	20,599	21,633	24,090	30,240	33,161
Evolution	26.5%	5.0%	11.4%	25.5%	9.7%
Average outstanding deposit per saver*	103	137	146	174	169
Mandatory	103	137	146	173	168
Voluntary	-	-	-	13	13
Staff					
Total number of staff	88	94	106	128	126
% Credit officers	43.2%	48.9%	48.1%	50.0%	51.6%
Turnover	8.1%	9.9%	18.0%	7.7%	4.7%
Profitability analysis					
ROE	0.0%	4.9%	2.1%	2.5%	6.4%
Liabilities / Equity	2.35x	2.22x	2.26x	2.83x	2.89x
Capital adequacy ratio	44.9%	44.6%	41.0%	31.8%	32.4%
ROA	0.0%	1.5%	0.6%	0.7%	1.7%
Profitability structure					
Portfolio Yield	30.2%	28.8%	28.3%	29.9%	26.3%
Operating expense ratio	25.8%	21.5%	23.4%	23.4%	22.0%
Cost per borrower	57	59	68	66	63
Staff productivity	204	214	203	222	255
Loan officer productivity	473	438	422	444	495
Average outstanding loan per client (USD)*	268	282	304	336	290
Funding expense ratio	8.1%	6.3%	4.9%	4.7%	2.7%
Cost of savings	1.7%	2.5%	1.4%	1.5%	0.0%
Cost of liabilities	11.1%	8.9%	8.8%	9.1%	6.8%
Loan Loss Provision expense ratio	0.7%	0.9%	1.2%	4.4%	(0.1%)
PAR 31-365*	n/a	n/a	22.2%	19.5%	30.2%
Write-off ratio	0.0%	0.9%	0.0%	3.6%	0.0%
Resource optimization					
Outstanding Loan Portfolio / Assets	60.4%	64.5%	68.3%	75.6%	71.5%
Revenue from investment as % of financial revenues	6.0%	7.9%	4.7%	5.2%	0.0%
Liquidity					
Cash to demand deposits	n/a	n/a	n/a	463.0%	366.3%
Liquidity / Total assets (LAR)	2.8%	14.2%	2.2%	0.7%	0.6%
Exchange rate 1 USD= xx KES	77.7	72.8	69.9	64.0	64.2

* The PAR data prior to the 2006 end of year data is based on the previous manual MIS and is not deemed reliable.

SMEP Income Statement	Notes	KES					USD					Evolution			
		Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008	05/04	06/05	07/06	08/07
Financial Revenue (a)		107,739,679	128,978,895	134,693,654	167,236,166	41,155,566	1,386,611	1,771,688	1,925,657	2,614,288	640,953	19.7%	4.4%	24.2%	(75.4%)
Financial Revenue from Loan Portfolio		94,030,750	115,962,595	123,005,325	152,560,213	38,989,418	1,210,177	1,592,893	1,758,554	2,384,869	607,217	23.3%	6.1%	24.0%	(74.4%)
Interest on Loan Portfolio		75,607,135	94,141,769	100,913,548	122,736,476	33,261,211	973,065	1,293,156	1,442,718	1,918,655	518,007	24.5%	7.2%	21.6%	(72.9%)
Fees and Commissions on Loan Portfolio		17,987,708	20,342,730	20,066,100	27,816,843	5,728,207	231,502	279,433	286,876	434,842	89,211	13.1%	(1.4%)	38.6%	(79.4%)
Penalty Revenue on Loan Portfolio		435,907	1,478,096	2,025,677	2,006,894	-	5,610	20,304	28,960	31,372	-	239.1%	37.0%	(0.9%)	(100.0%)
Financial Revenue from Investments		6,472,667	10,146,393	6,325,297	8,625,408	-	83,303	139,374	90,430	134,835	-	56.8%	(37.7%)	36.4%	(100.0%)
Other Operating Revenue	1	7,236,262	2,869,907	5,363,032	6,050,545	2,166,148	93,131	39,422	76,673	94,584	33,735	(60.3%)	86.9%	12.8%	(64.2%)
Financial Expense (b)		25,164,535	25,493,970	21,311,993	23,825,928	3,970,911	323,868	350,192	304,688	372,454	61,843	1.3%	(16.4%)	11.8%	(83.3%)
Interest paid on borrowings		23,333,507	20,630,472	17,953,792	19,519,585	3,970,911	300,303	283,386	256,678	305,136	61,843	(11.6%)	(13.0%)	8.7%	(79.7%)
Interest paid on deposits		1,831,028	4,863,498	3,358,201	4,249,100	-	23,565	66,806	48,011	66,423	-	165.6%	(31.0%)	26.5%	(100.0%)
Net Inflation Adjustment Expense		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other Financial Expenses		-	-	-	57,243	-	-	-	-	895	-	-	-	-	(100.0%)
Financial income [c=a-b]		82,575,144	103,484,925	113,381,661	143,410,238	37,184,656	1,062,743	1,421,496	1,620,969	2,241,833	579,110	25.3%	9.6%	26.5%	(74.1%)
Net Loan Loss provision expense (d)		2,312,475	3,742,197	5,183,362	22,716,836	(146,089)	29,762	51,404	74,104	355,117	(2,275)	61.8%	38.5%	338.3%	(100.6%)
LL prov. expense and write-off		2,449,631	4,110,924	5,568,490	22,825,636	(140,039)	31,527	56,469	79,610	356,817	(2,181)	67.8%	35.5%	309.9%	(100.6%)
Recovery from Loans written off		137,156	368,727	385,128	108,800	6,050	1,765	5,065	5,506	1,701	94	168.8%	4.4%	(71.7%)	(94.4%)
Operating expense (e)		80,194,128	86,378,040	101,853,286	119,627,520	32,598,373	1,032,099	1,186,512	1,456,153	1,870,055	507,684	7.7%	17.9%	17.5%	(72.8%)
Personnel Expense (includes fringe)		48,454,466	53,769,200	61,075,145	68,053,114	18,152,806	623,610	738,588	873,165	1,063,827	282,710	11.0%	13.6%	11.4%	(73.3%)
Admin. Expense (non-staff op. expenses)		31,739,662	32,608,840	40,778,141	51,574,406	14,445,567	408,490	447,924	582,988	806,227	224,974	2.7%	25.1%	26.5%	(72.0%)
Depreciation and amortization		3,513,287	3,251,149	5,526,812	8,138,775	2,143,686	45,216	44,659	79,014	127,228	33,386	(7.5%)	70.0%	47.3%	(73.7%)
Consulting fees		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Rent, utilities & communication		5,568,310	5,766,780	5,956,235	7,607,772	3,009,900	71,664	79,214	85,154	118,927	46,876	3.6%	3.3%	27.7%	(60.4%)
Office costs		9,304,484	8,806,199	7,415,138	8,480,127	1,900,541	119,749	120,964	106,011	132,564	29,599	(5.4%)	(15.8%)	14.4%	(77.6%)
Travel and transport		4,009,764	4,058,826	4,061,558	4,432,690	950,643	51,606	55,753	58,066	69,293	14,805	1.2%	0.1%	9.1%	(78.6%)
Bank charges		3,204,116	3,832,686	5,445,937	4,664,190	1,257,200	41,237	52,647	77,858	72,912	19,579	19.6%	42.1%	(14.4%)	(73.0%)
Loan insurance		2,400,000	1,928,979	1,970,980	2,631,335	-	30,888	26,497	28,178	41,134	-	(19.6%)	2.2%	33.5%	(100.0%)
Audit & legal fees		1,648,805	2,253,391	2,397,123	3,150,381	961,475	21,220	30,953	34,271	49,248	14,974	36.7%	6.4%	31.4%	(69.5%)
Transformation costs	2	-	-	5,551,070	10,119,887	3,424,216	-	-	79,361	158,197	53,328	-	-	82.3%	(66.2%)
Others		2,090,896	2,710,830	2,453,288	2,349,249	797,907	26,910	37,237	35,074	36,724	12,427	29.6%	(9.5%)	(4.2%)	(66.0%)
Net Operating Income Before Taxes and Donations [f=c-d-e]		68,541	13,364,688	6,345,013	1,065,882	4,732,371	882	183,581	90,712	16,662	73,701	19,399%	(52.5%)	(83.2%)	344.0%
Income Taxes (g)		-	4,182,178	2,268,816	(3,900,535)	1,419,711	-	57,448	32,436	(60,974)	22,110	-	(45.8%)	(271.9%)	(136.4%)
Net Operating Income Before Donations [h=f-g]		68,541	9,182,510	4,076,197	4,966,417	3,312,660	882	126,133	58,276	77,637	51,591	13,297%	(55.6%)	21.8%	(33.3%)
Non Operating Revenue (i)		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Non Operating Expense (including related taxes) (j)		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Income Before Donations [k=h+i-j]		68,541	9,182,510	4,076,197	4,966,417	3,312,660	882	126,133	58,276	77,637	51,591	13,297%	(55.6%)	21.8%	(33.3%)
Donations (l)		42,647,668	-	-	-	-	548,876	-	-	-	-	(100.0%)	-	-	-
Net Income (after Taxes and Donations) [m=k+l]		42,716,209	9,182,510	4,076,197	4,966,417	3,312,660	549,758	126,133	58,276	77,637	51,591	(78.5%)	(55.6%)	21.8%	(33.3%)

Notes: 1) Includes management fee for MEDP paid by DANINDA, 2) Includes meetings held, eMerge costs, consultancy costs

SMEP	Notes	KES					USD					Evolution		
		Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Mar. 2008	06/05	07/06	08/07
Balance sheet														
ASSETS		606,585,974	628,421,894	650,346,242	782,577,573	813,511,833	7,806,769	8,632,169	9,297,720	12,233,496	12,669,550	3.5%	20.3%	4.0%
Short Term Assets		579,466,652	602,226,419	613,538,790	743,368,426	775,980,091	7,457,743	8,272,341	8,771,500	11,620,566	12,085,035	1.9%	21.2%	4.4%
Cash and Due from Banks		17,273,726	89,533,942	14,231,916	5,158,515	5,021,704	222,313	1,229,862	203,468	80,640	78,208	(84.1%)	(63.8%)	(2.7%)
Short Term Investments		185,426,180	100,718,005	150,393,913	136,242,440	174,967,916	2,386,437	1,383,489	2,150,117	2,129,784	2,724,932	49.3%	(9.4%)	28.4%
Short Term Net Loan Portfolio		366,500,436	405,346,183	444,053,193	591,574,389	581,379,242	4,716,865	5,567,942	6,348,437	9,247,675	9,054,341	9.5%	33.2%	(1.7%)
Short Term Gross Loan Portfolio		373,980,037	413,683,508	457,959,008	609,870,503	599,535,317	4,813,128	5,682,466	6,547,243	9,533,685	9,337,102	10.7%	33.2%	(1.7%)
(Loan Loss Reserve)		7,479,601	8,337,325	13,905,815	18,296,114	18,156,075	96,263	114,524	198,805	286,011	282,761	66.8%	31.6%	(0.8%)
Interest Receivable		346,031	1,149,904	-	-	-	4,453	15,795	-	-	-	(100.0%)	-	-
On loan portfolio		-	-	-	-	-	-	-	-	-	-	-	-	-
On investments		346,031	1,149,904	-	-	-	4,453	15,795	-	-	-	(100.0%)	-	-
Accounts receivable and other assets	1	9,920,279	5,478,385	4,859,768	10,393,082	14,611,229	127,674	75,253	69,478	162,468	227,554	(11.3%)	113.9%	40.6%
Long term assets		27,119,322	26,195,475	36,807,452	39,209,147	37,531,743	349,026	359,828	526,220	612,930	584,516	40.5%	6.5%	(4.3%)
Long Term Net Investments		-	-	-	-	-	-	-	-	-	-	-	-	-
Long Term Gross Loan Portfolio	2	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Fixed Assets		23,404,068	21,435,908	34,885,727	37,796,704	36,427,411	301,211	294,449	498,746	590,850	567,317	62.7%	8.3%	(3.6%)
Other Long Term Assets	3	3,715,254	4,759,567	1,921,725	1,412,443	1,104,332	47,815	65,379	27,474	22,080	17,199	(59.6%)	(26.5%)	(21.8%)
LIABILITIES AND EQUITY		606,585,974	628,421,894	650,346,242	782,577,573	813,511,833	7,806,769	8,632,169	9,297,720	12,233,496	12,669,550	3.5%	20.3%	4.0%
Liabilities		425,320,347	433,297,947	451,146,098	578,411,012	604,612,902	5,473,878	5,951,895	6,449,842	9,041,901	9,416,180	4.1%	28.2%	4.5%
Short term liabilities		286,288,221	325,887,183	415,818,664	484,642,041	508,278,530	3,684,533	4,476,472	5,944,780	7,576,075	7,915,878	27.6%	16.6%	4.9%
Demand Deposits		-	-	-	1,114,212	1,371,007	-	-	-	17,418	21,352	-	-	23.0%
Compulsory Deposits		164,946,774	216,537,035	246,822,050	335,474,487	358,692,773	2,122,867	2,974,410	3,528,709	5,244,241	5,586,245	14.0%	35.9%	6.9%
Short Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-	-	-
Short Term Borrowings		113,490,879	104,294,391	159,946,952	140,401,030	137,111,703	1,460,629	1,432,615	2,286,693	2,194,793	2,135,364	53.4%	(12.2%)	(2.3%)
Interest payable		488,324	-	575,833	20,699	-	6,285	-	8,232	324	-	-	(96.4%)	(100.0%)
Accounts Payable & Other Short Term Liabilities		7,362,244	5,055,757	8,473,829	7,631,613	11,103,047	94,752	69,447	121,147	119,300	172,918	67.6%	(9.9%)	45.5%
Long term liabilities		139,032,126	107,410,764	35,327,434	93,768,971	96,334,372	1,789,345	1,475,423	505,061	1,465,826	1,500,302	(67.1%)	165.4%	2.7%
Long Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-	-	-
Long Term Borrowings		139,032,126	107,410,764	35,327,434	93,768,971	96,334,372	1,789,345	1,475,423	505,061	1,465,826	1,500,302	(67.1%)	165.4%	2.7%
Other Long Term Liabilities		-	-	-	-	-	-	-	-	-	-	-	-	-
Equity		181,265,627	195,123,947	199,200,144	204,166,561	208,898,932	2,332,891	2,680,274	2,847,879	3,191,595	3,253,371	2.1%	2.5%	2.3%
Tier 1 Capital		181,265,627	195,123,947	199,200,144	204,166,561	208,898,932	2,332,891	2,680,274	2,847,879	3,191,595	3,253,371	2.1%	2.5%	2.3%
Paid-In Capital		-	-	-	-	-	-	-	-	-	-	-	-	-
Donated equity		128,145,328	128,145,328	128,145,328	128,145,328	128,145,328	1,649,232	1,760,238	1,832,039	2,003,208	1,995,722	0.0%	0.0%	0.0%
Retained earnings without donations and reserves		53,120,299	66,978,619	71,054,816	76,021,233	80,753,604	683,659	920,036	1,015,840	1,188,388	1,257,648	6.1%	7.0%	6.2%
Tier 2 Capital		-	-	-	-	-	-	-	-	-	-	-	-	-
Subordinated debt		-	-	-	-	-	-	-	-	-	-	-	-	-
Other equity accounts		-	-	-	-	-	-	-	-	-	-	-	-	-

Notes: 1) Includes staff loans, 2) It was not possible for SMEP to establish the long-term portion of the loan portfolio, 3) This includes only the long term portion of staff loans

■ Formulas

Return on assets (ROA):	Net operating income before donations / Average assets
Return on equity (ROE):	Net operating income before donations / Average equity
Leverage:	Debt (savings + debts) / Equity (end of period)
Capital Adequacy Ratio (CAR)	Total Capital / Risk weighed assets
Portfolio yield:	Portfolio revenue / Average gross outstanding portfolio
Operating expense ratio:	Operating expense / Average gross outstanding portfolio
Staff productivity:	Active borrowers / Total personnel (end of period)
Funding expense ratio:	Interest and fees paid on funding liabilities / Average gross outstanding portfolio
Cost of savings ratio:	Interest and fees paid on deposits / Average deposits
Cost of borrowings ratio:	Interest and fees paid on borrowings / Average borrowings
Loan loss provision expense ratio:	Net loan loss provision expense / Average gross outstanding portfolio
Adjustment expense ratio:	Total adjustments / Average gross outstanding portfolio
Net portfolio as a % of assets:	Net outstanding portfolio / Total assets (end of period)
Risk coverage ratio:	Loan loss reserve / Portfolio at risk (31-365 days)
Write-off ratio:	Loans written off / Average gross outstanding portfolio
Liquid Asset Ratio (LAR):	Cash and due from banks / Total assets
Quick ratio (one month):	Assets maturing within one month / Liabilities maturing within one month
Current ratio:	Assets maturing within one year / Liabilities maturing within one year

■ 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-	Current institutional, operational and financial performances are satisfactory when compared to industry standards.	
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.	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.	INVESTMENT GRADE
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.	
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	SPECULATIVE INVESTMENT
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	
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.	TECHNICAL ASSISTANCE REQUIRED
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.	