Planet Rating
THE GLOBAL MICROFINANCE RATING AGENCY

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GIRAFE Mikrofin, BiH August 2006

Rating

A+	**Excellent**
A	The institution excels in the evaluation area and is a model for the sector. There is a long-term vision for continual improvement. There are no risks in the short and medium term for operations. Long-term risks are well managed and monitored.
A-	
B+	
B	
B-	
C+	
C	
C-	
D	
E	

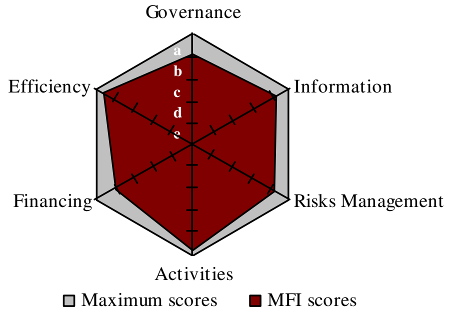
Trend

Positive	Given Mikrofin's desire to transform into a for-profit company, it will face many challenges associated with the new legal status. Despite this fact, Mikrofin has demonstrated a strong planning and execution capacity which will likely to ensure continued internal operational stability and good performance.
Stable	
Uncertain	
Negative	

Performance indicators
(K EUR, *unless otherwise noted*)

	Dec. 2003	**Dec. 2004**	**Dec. 2005**	**Jun. 2006**
ACTIVITY				
Total number of staff	79	94	112	143
Assets	15,133	22,400	32,959	38,872
Assets (K BAM)	29,597	43,810	64,462	76,028
Loan portfolio	14,553	21,329	29,846	36,748
Active borrowers	7,426	14,033	20,399	23,725
APR	See note below.			
PAR 31-365	0.0%	0.2%	0.2%	0.3%
PAR > 365	0.0%	0.0%	0.0%	0.0%
Write-off ratio	0.0%	0.0%	0.0%	0.0%
Risk coverage ratio	4,680%	56.8%	67.4%	71.9%
PERFORMANCE				
ROE	24.2%	24.6%	20.1%	19.7%
Liabilities / Equity	141.2%	153.2%	204.1%	224.9%
ROA	9.4%	9.9%	7.2%	6.3%
OSS	163.4%	180.1%	160.0%	153.5%
FSS	124.5%	147.1%	132.4%	125.8%
Portfolio Yield	26.4%	23.9%	20.8%	19.9%
Operating expense ratio	12.4%	9.7%	8.9%	8.2%
Staff productivity	94	149	182	166
Funding expense ratio	2.9%	3.4%	4.0%	4.5%
GROWTH				
Portfolio growth	59.6%	46.6%	39.9%	23.1%
Asset growth	59.4%	48.0%	47.1%	17.9%
EUR/BAM	**1.96**	**1.96**	**1.96**	**1.96**

Note: As of June 2006, weighted average APR is of 19.4%, and new product APRs range from 16.5% to 22%. Please see Annexes for APR by product.



▪ Description of the institution

Mikrofin is a not-for-profit and non-deposit taking institution that started its activities in 1997, under the World Bank's Local Initiatives Project (LIP). The founder, CARE, has ceased all direct involvement in 1999. Mikrofin has been operating as a local microfinance organization since 2002. Through a network of 33 branches and satellite offices, it serves clients in the Northern part of BiH, mainly in Republika Srpska (RS), both in urban and rural areas. Its loan products range from 500 to 30,000 BAM (255-15,300 EUR), and are designed for small businesses, agriculture as well as housing. As of June 2006, Mikrofin had an outstanding portfolio of over 36 M EUR, serving 23,725 clients.

▪ Rating summary

The MFI has been assigned / received a global rating of A.

This rating reflects Mikrofin's solid management team, good track record of managing fast growth, sound portfolio management practices, excellent portfolio quality, low cost structure and good profitability. This rating also recognizes Mikrofin's market and pricing leadership positions which represent valuable competitive advantages over other BiH MFIs. The biggest challenges ahead for Mikrofin are to plan for its transformation into a for-profit MFI, to upgrade its governance structures to fit the new legal status and to become a truly national BiH player either through further expansion into the Federation side of BiH or a merger with an existing MFI.

Rating Trend

This grade has been given with a **Stable** trend. This trend is underpinned by our assessment that Mikrofin will continue to grow its franchise throughout BiH despite growing competition with other MFIs. Its disciplined approach to expansion, its excellent execution capacity and its ability to line up solid financing partners are expected to keep Mikrofin the number #1 BiH MFI for the next 12 months despite the upcoming transformation challenges.

▪ Financing needs

Mikrofin anticipates funding needs of 25 M EUR over the next 2 years. Given Mikrofin's forecasted profitability, good borrowing track record and reasonable risk profile, it can expect to have continued access to both local and international funding to finance its expansion and transformation.

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▪ Microfinance sector

The microfinance sector in Bosnia and Herzegovina (BiH), launched in 1996 with UNHCR pilot project in Tuzla, is highly developed with support from the World Bank (WB) and international NGOs. The bulk of start-up funds to the sector have been channelled through the WB-financed Local Initiatives Project (LIP). Through various rounds of LIP funding, the WB has been able to dictate conditions through its Eligibility Criteria and thus heavily influenced the way many MFIs are managed. Numerous international donors have funded microfinance organizations (MFIs) and provided valuable technical assistance. The 10 largest MFIs, having adopted most industry best practices, are among the strongest MFIs in Eastern Europe. There is a pressure to consolidate the 55 registered MFIs into 4-5 strong players mirroring the parallel trend in the general banking sector. Although there have been informal talks about mergers, there is not yet an industry-wide sense of urgency to translate words into actions. BiH MFIs have yet to experience “real pain” (e.g. slower growth, deteriorating portfolio quality) to trigger them into serious merger/takeover talks. One of the biggest obstacles to industry consolidation is that top MFI management, used to manage their own MFIs their own way to consider potentially different, possibly reduced roles in larger merged MFIs. Another obstacle is the allocation of management staff positions following any mergers.

After years of waiting and hoping, both BiH entities’ parliaments have adopted the new microfinance law (the FBH Parliament adopted it on August 30th, 2006 whereas the RS Parliament did it on June 14th, 2006). The attention is now shifted to the upcoming drafting of the new bylaws by entities’ Banking Agencies and their possible application in early 2007. BiH MFIs will be given time, up to July/September 2007 to comply with the new law. The new law will provide existing MFIs two choices: non-profit foundation status or for-profit shareholder company status – both options non-deposit taking, an activity reserved to banks. The two main differences between these two options are: 1) minimum capital requirement (500,000 BAM or 250,000 EUR for a company and 50,000 BAM or 25,000 EUR for a foundation); and 2) maximum loan size (50,000 BAM or 25,000 EUR for a company and 10,000 BAM or 5,000 EUR for a foundation). The law authorizes MFI mergers and acquisitions and outlines clear reporting requirements. The Law on Enterprises will also apply to newly transformed MFI companies including the requirement to pay income taxes. The MFIs will be licensed and supervised by each entity’s Banking Agency which is a step forward in terms of supervision of the sector which is presently regulated by Ministry of Finance in RS, and by Ministry of displaced persons and refugees in FBiH. Regulation is however expected to be lighter than those applied to banks given the absence of deposit taking risks.

The BiH microfinance sector is now entering an interesting phase of development where MFI managers and their Boards will have to decide soon which transformation option to take. It is expected that the vast majority of BiH MFIs will transform into for-profit companies for the following reasons: 1) most have sufficient capital which was built up from capitalized donations and retained earnings; 2) all have been extending loans exceeding 10,000 BAM (i.e. if they choose the foundation status they will have to give up substantial number of existing clients; and 3) the company status will allow the opening of the capital structure to investors which in turn reinforces their capacity to compete in the future (i.e. additional funds to finance expansion and product development). Several MFIs are in discussion with potential domestic and foreign investors to secure their participation as strategic equity partners. Mergers discussions are expected to accelerate and to be more serious than before. It is likely that one or more MFIs will announce a merger within the next 6 months. The BiH microfinance sector is firmly heading toward consolidation and further commercialization. Most commercial banks, led by Raiffeisen Bank BiH and with the notable exception of ProCredit Bank BiH, have chosen to get involved in the microfinance sector indirectly by financing MFI portfolio growth. As of June 30th, 2006, the local banks and insurance firms provided about 76 of the 136 M BAM in outstanding exposure on commercial terms to BiH MFIs.

▪ Political and economical environment

Since the 1995 Dayton Agreement, the country has made substantial progress in a context characterized by the presence of a peacekeeping force, a waiving of debts, and conclusion of agreements with the IMF. GDP has tripled, exports have increased tenfold, introduction of a fixed exchange rate regime made it possible to stabilize inflation, and public sector finances have partly recovered.

The economy continued to grow at a robust rate in 2005, reflecting the steadiness of manufacturing and exports. A slight economic upturn is expected in 2006 as a result of investments made in infrastructure and the industrial sector. The financial and economic situation has nonetheless remained shaky. The unemployment and poverty rates have been high, the savings rate very low, and production has not yet returned to its pre-war level. Robust domestic demand, spurred by a credit boom, has caused imports to rise and kept the current account deficit at levels difficult to sustain in the medium term just when international aid has been declining.

Politically, the situation has not completely calmed down. Although the Dayton Agreement certainly pacified the country, it also sanctioned political division and ethnic segregation. However, on the tenth anniversary of the agreement, and under international pressure, Bosnian leaders accepted a revision of the peace treaty intended to strengthen the central government. Meanwhile, the European Union announced the start of negotiations on a stabilization and association agreement.

COFACE Country Rating: D

USD millions	2003	2004	2005	2006
Economic growth (%)	4	5.7	5.4	5.7
Inflation (%)	0.6	0.4	1	1.9
Public sector balance (%GDP) (*)	-6.6	-4.8	-3	-2
Exports	1,296	1,664	2,072	2,434
Imports	3,816	4,496	5,195	5,541
Trade balance	-2,520	-2,832	-3,123	-3,107
Current account balance (%GDP)	-17.8	-17.3	-16.8	-15.2
Foreign debt (%GDP)	57.1	55.2	52.7	49.4
Debt service (%Exports)	5.2	4.3	4.5	4.7
Foreign exchange reserves (import months)	5.2	6	5.3	5.1

Source: COFACE's Country Risk Ratings Guidebook 2006. 2005 data is estimated and 2006 forecasted. (*) Excluding grants.

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

▪ Institutional presentation

Networks
Mikrofin is a member of AMFI (the local association of MFIs in BiH) and Warsaw-based MFC (the Microfinance Centre for Central and Eastern Europe and NIS).

Ownership
Registered as a MFI, Mikrofin has no shareholders and has never paid any dividends. All profits and cash donations are capitalized. Mikrofin's Board of Directors (BOD), made up of five voting members, is its highest decision-making body. These individuals come from different backgrounds and are deeply committed to Mikrofin, several of them having been involved with Mikrofin for a number of years. The current BOD is presided by Mr. Aleksandar Džombić, the current RS Minister of Finance. Mikrofin's founder CARE has ceased all direct operational involvement and has transferred all assets to Mikrofin.

Management team
The Management Team is located at Banja Luka Head Office. Operations are decentralized as most of credit decisions are made at the branch level. The institution is led by its Executive Director (ED) surrounded by a well-rounded top management team.

Donations
Mikrofin received 7.8 M BAM (4 M EUR) of donations since its inception. Most of the funds came from CARE, UNHCR, LIP and RS' Development and Employment Fund.

Legal form, supervision and audit
Mikrofin is a not-for-profit and non-deposit taking institution, registered with both entity governments allowing it to operate throughout BiH. Recent changes in the legal framework (cf. Microfinance sector) will provide opportunity to transform, presumably into a microfinance company, with reporting requirements to the Banking Agency, and a new legal status subject to Companies' law.

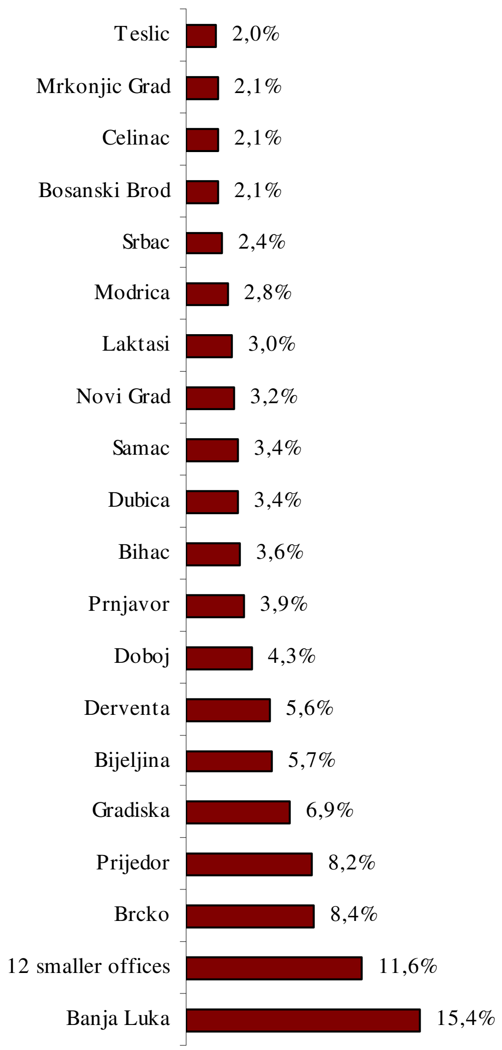
PriceWaterhouseCoopers (PwC) has been Mikrofin's external auditor for the past four years. PwC provided an unqualified opinion for the 2005 financial statements which are audited in accordance to international accounting standards (IAS and IFRS).

Market penetration
Mikrofin has established a network of 9 main branches and 24 satellites offices, heavily covering all the Northern part of BiH's territory. It has expanded east and west of HQ towards FBH, and remains so far the largest Bosnian MFI. Its stated ambition is to become a national player within a few years.

Products and services
For more details about the products, please see Annexes.

Mikrofin has recently conducted a major change in its loan products, by restructuring existing products (Individual loan and Good credit history loans merge into Loan for Entrepreneurs), and introducing housing and agriculture loans. It currently offers four main products, three of which are related to the loan purpose. Fast loan consists of small loans, disbursed regardless of the activity and requiring minimal guarantees (none for loans up to 2,000 BAM). Except for the three biggest branches, all disbursements and repayments are made through banks so Mikrofin's branches and offices do not handle any cash.

Portfolio by region - June 2006



▪ Governance

Governance and Decision Making is rated **« a »**

Decision-making

Mikrofin is guided by a clear vision and is highly focused on dual goals of outreach and financial sustainability. BOD members, managers and staff are animated by a strong desire to remain the #1 microfinance service provider in BiH. Mikrofin's clear vision coupled with its strong ambition resulted in a highly disciplined and organized MFI. The decision-making process at Mikrofin is accordingly good and clear, but it still suffers from several structural weaknesses previously identified (i.e. all-volunteer BOD not acting as owners and deferring to management for key initiatives, BOD validates proposed strategies but does not lead…etc.).

Mikrofin BOD does meet regularly, discusses relevant subjects and receives key operational and financial data. While the BOD is involved and knowledgeable of key issues, it is not yet fully informed of the new microfinance law and its implications. The BOD is however keen to back the company transformation idea even if the bylaws are still being drafted. It believes in the management's case that the company transformation is the right strategic decision for Mikrofin. BOD Chairman (also RS Minister of Finance) is still officially part of the BOD, but he has not attended meetings in 2006. No major changes are expected regarding BOD composition or its way of conducting business until transformation. The BOD Audit Committee exists, but it is not active. Comprehensive meeting minutes are being kept.

Mikrofin plans to transform as soon as the bylaws are published and as early as January 2007. The upcoming transformation process is inherently risky, but it should provide Mikrofin with the tools/resources to stay competitive and remain the market leader. The Company status will attract private investors who will bring both money and technical assistance critical to the success of any transformation. In this regard, Mikrofin has recently signed the first debt transaction with a convertible option with EBRD– a first among BiH MFIs. It has begun to negotiate a shareholders' agreement framework with EBRD. It is also in discussions with other potential equity partners to provide it with alternatives. Mikrofin is well positioned for the upcoming transformation even of a concrete plan still needs to be drafted and execution risk is a factor.

Planning

The planning process at Mikrofin is simple, yet systematic, participative and effective. The current Strategic Plan (SP) 2006-2008 addresses relevant subjects, but it could be more detailed on areas such as market strategy and research, non-credit products, diversification, risk management, etc. Mikrofin will need a new and more specific SP when transformation is decided with more details on new governance structure, dividend policy, strategic alliances, etc.

Mikrofin's 2006-2008 financial projections are ambitious, but they look achievable. The key assumptions are realistic, although the loan loss provisioning projections could be more conservative. Similarly projected taxes paid projected look low. Mikrofin displays good budget planning process as well as efficient budget tracking and monitoring. Deeper financial analysis can be done in order to provide even better management decision-making.

Management team

Mikrofin benefits from a strong and effective leadership under the well-respected ED. Its senior management team (SMT) has been significantly broadened and strengthened. Many management positions have been created and filled by competent professionals. The new Operations Manager was a BOD member and a commercial banker. He is in charge of branch and office daily management. The credit and network expansion aspects are handled by the Credit Manager – a function typically combined with that of the Operations Manager at other MFIs. New HR Manager, Financial Control Manager (handling investors' relations) and Market Research Manager complete the well-rounded team bringing more skills and competencies to the SMT.

Mikrofin management has a good understanding of key challenges, communicates well and succeeded in creating a positive mindset and morale among staff. The decision-making process is collegial, but the ED is still the decisive decision-maker. Following the SMT's enlargement, key-person risk at the ED level has been lowered. The ED is still quite involved in operational matters, but the process of enhanced delegation of responsibilities and empowerment of managers is underway. Some managers still have further room for growth and the work organization could be enhanced (e.g. market research and product development could be more prominent, HR function with training component be boosted, rethink credit organization and supervision for the expansion scenario, risk management functions after transformation, more involvement for the IT Manager in the product development process, etc.).

While the SMT has become larger, its cohesiveness and effectiveness continue to be good through strong leadership, clear allocation of responsibilities, good coordination and regular meetings. This SMT is one of the strongest MFI management teams among BiH MFIs and represents a good management platform for future transformation.

Human resource management

HR functions at Mikrofin have been strengthened and formalized as evidenced by the creation of the new HR Manager position, the newly updated HR Manual and the new HR information management system. Good existing HR recruitment processes are largely unchanged, while a simple staff training program has been established. In general, there is a good team spirit and morale fostered by a number of team building events and training workshops. Mikrofin provides competitive salaries and incentives that are aligned with corporate objectives. Mikrofin can improve on formalizing certain HR aspects like salary scales and management performance reviews. On the subject of potential transformation, there is a general staff buy-in of the idea even if most staff needs further information on how it will or won't affect them and in which ways.

	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Total number of staff	79	94	112	143
% Credit officers	62%	62%	63%	68%
Turnover	4%	5%	9%	3%

▪ Information

Information and equipment is rated **« a »**

Description of the MIS	
Equipment	▪ Modern equipment (hardware and software) ▪ HP servers, SQL database ▪ LAN, Internet connection in all branches to HQ ▪ Information sent to HQ by email; most offices do not have direct connection for offices to HQ due to slow local ADSL capability, daily consolidation of the central database. ▪ No Intranet, shared folders provide access to key docs
Accounting	▪ Self-developed software integrated with loan tracking ▪ Centralized accounting ▪ Daily reconciliation of portfolio information ▪ Monthly financial statements detailed by branch, with allocation of the HQ expenses.
Portfolio information	▪ Self-developed software integrated with accounting ▪ Numerous and detailed reports available on demand

Management Information System (MIS) and equipment

Compared to the last rating, there have been no major changes to the MIS. The MIS continues to work correctly and efficiently. A new control module has been added to the MIS allowing the Internal Auditor (IA) to insert comments following his field visits. Database security continues to be good with key servers being kept in a separate locked air-conditioned room. Data security standards (password controls, defined access controls, updated anti-virus software, regular backup…etc.) are high and are being consistently applied. Mikrofin's IT team was reinforced following the hiring of a second IT staff last October 2005 which provides more technical and programming back-up previously not available. Data entry at very small offices is done by LOs, but there are relevant checks in place at the regional level to ensure data accuracy and reliability. Given current MIS systems' capability and flexibility, Mikrofin should be able to handle the IT challenges related to the planned transformation.

Information on activities

Portfolio data quality is high. High standards of timely, accurate, reliable and relevant portfolio information are being met. Highly detailed portfolio data can be obtained by branch or product and all necessary reports can be generated on demand in real time. There is a good understanding and use of key information throughout the organization.

Financial and accounting information
Similar to portfolio data, financial and accounting data is of high quality, easily available and very detailed. The Finance Department is staffed by experienced and competent personnel. There is regular tracking of budgets and relevant analysis of variances. Reporting standards and capability are excellent.

External audit & accounting policy change
Mikrofin produced IFRS accounts in 2005 which include its new compliance to IAS 18 and 30. Mikrofin's external auditors PwC provided an unqualified opinion for its 2005 accounts. IAS 18 requires that Mikrofin recognizes fee income over the duration (on an accrued basis) of the loans instead of recognizing them immediately per prior practice. IAS 30 takes issue with the over-provisioning done by Mikrofin and its BiH peers (i.e. 2% of loan healthy portfolio) which resulted in lower income. A compromise has been found to allow Mikrofin to continue this provisioning policy (as required by local authorities) while complying with IAS 30. The over-provisioning amount is now classified as a reserve account within the equity section of the balance sheets.

Internal audit
Mikrofin has a good understanding of strategic, operational and financial risks thanks to strong Internal Audit (IA) Department, recently reinforced with one additional staff and a dedicated car. The IA Manual is updated, and now better suited for training and daily operations. A relevant though brief work plan with quantitative goals is available at the beginning of the year: controls on operational and financial transactions are frequent, and the number of client visits has been raised from 2% to 10% following a major fraud discovered within an important competitor. A newly developed IT application records controls type and frequency. IA reports include clear recommendations and are submitted to ED on a monthly basis, with a summary at year end. Yet, IA reports could be more detailed and systematic, especially regarding the follow up of suggested corrective actions.

There is no thorough audit of IT (but mitigated by checks by various internal system users) and top management functions. IA Department should be further strengthened by reporting straight to a planned and dedicated BOD Audit Committee. External supervision is limited to the external auditors' annual missions, and reporting to LIP and other investors/donors. The regulating ministries do not perform any operational control.

▪ Risks

Risks Management is rated **« a »**

Procedures and internal controls
Mikrofin's standardized procedures are thoroughly documented in the recently updated Credit, MIS, Finance, Human Resources and Audit manuals. Controls are well integrated into the daily procedures and guarantee an adequate management of operational risks. Across branches, staff has a very good compliance culture. Credit decision-making of loans up to 10,000 BAM (still the vast majority of loans) is decentralized at the branches, but satellites offices must report to their branch. The segregation of duties is adequate between lending decision, disbursement and MIS data entry, both at branch and HQ levels, though less in satellite offices (but there are checks and verification in place to mitigate this risk). This segregation of duties is furthermore strengthened by strictly defined MIS user rights.

Cash risk is limited as loan disbursements and repayments are done through banks, except for the three biggest branches (Banja Luka, Prijedor and Gradiska) that are of sufficient size and can afford to pay for extra cashier staff. In these branches, an adequate segregation of duties, strict safety procedures, cash limits, as well as cameras, ensure physical security of cash. There is no cash management in satellites offices.

▪ Activities

Activities: products and services is rated **« a »**

Marketing and competition
The BiH microfinance sector is highly competitive, mostly in urban areas where MFIs have been operating for years and commercial banks are active, but also increasingly in rural areas. The overall market demand is still expanding, but growth rates have slowed down with an increasing number of clients having loans at more than one institution. By the end of June 2006, the 14 largest MFIs were serving over 150,000 clients. The microfinance portfolio outstanding is estimated around 180 M EUR. This is in addition to the commercial banks' microfinance portfolio with the largest share attributed to ProCredit Bank BiH with over 25,000 micro-credit clients and an estimated portfolio of over 55 M EUR in June 2006.

The major ongoing trends are:
- MFIs going aggressively into rural areas providing agriculture-related loans;
- MFIs extending loan terms longer to around 36 months (until the new law allows longer terms);
- MFIs looking at product diversification directly (e.g. housing loans) or in partnerships with other financial institutions (e.g. selling insurance products, indirect

really taken off for any MFIs);

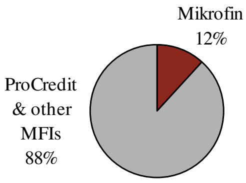
mobilizing deposits, but these non-core activities have really taken off for any MFIs);
- Certain commercial banks "down-scaling" into the top 10% of MFI largest clients. The latter trend is partially explained by excess local liquidity forcing commercial banks to look for new markets.

All MFIs have been facing more aggressive competition from ProCredit Bank who has been fast expanding its office network and hiring a lot of new staff. With a cheaper funding base (access to savings) and a broader range of products, ProCredit Bank has started to poach top-end MFI clients. Thus far, MFIs have been mostly relying on word-of-mouth and fast quality service to gain and retain clients. Although industry portfolio quality remains strong overall, there are signs that the BiH microfinance sector is becoming more "normal" as evidenced by increasing portfolio-at-risk and write-offs recorded at some MFIs as the results of increased industry competition and client over-indebtedness.

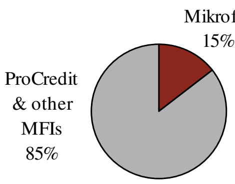
Market positioning and strategy

Among BiH MFIs, Mikrofin continues to be the market leader, both in terms of portfolio outstanding and number of active clients: between 2003 and 2005, its market share increased from 8% to 15% and from 5% to 12%, respectively. It currently offers the lowest interest rates in BiH, which results in the lowest portfolio yield. Mikrofin holds strong competitive advantages such as faster and simpler procedures than some of its competitors, more flexible collateral requirements, ability to do second loans for certain clients and certain older cycle loans with typically lower interest rates. It enjoys a good reputation.

Market share by Number of Active clients – December 2005



Market share by Gross loan portfolio – December 2005



Mikrofin has reorganized the management of its credit operations in order to speed up the response to market changes and deal with Mikrofin's product development lagging behind other MFIs. Branch Managers (BMs) now report directly to the new Operations Manager (OM) who was a former BOD member and an experienced banker who has worked on RS' WB projects for several years. His tasks include network coordination, portfolio monitoring and control as well as marketing and advertisement. The Credit Manager (CM), now free of daily tasks of running the branch/office network, focuses on network expansion and product development in addition to his existing credit approval responsibilities. As Mikrofin expands more toward FBH, it will have to rethink the organization and supervision of its operations and credit committees which are now still centralized in Banja Luka – quite far away for its senior credit staff to participate physically in such credit committees (for larger loans) should Mikrofin expand south towards Sarajevo and Mostar.

Mikrofin recently hired a R&D Manager to carry out market research with improved tools and techniques. As a result, in 2006, Mikrofin was able to adapt its existing products and launch new ones to better suit the market needs, and conducted major changes to its loan products, in terms of category, term and conditions. So far, marketing and promotion activities were mainly done through basic channels, such as word-of-mouth or brochures distribution, along with some radio and printed ads. A more sophisticated communication plan needs to be put in place, if the transformation takes place and expansion goes to more saturated areas in the FBH. Mikrofin counts on its reinforced operational team to stay ahead of market trends and to maintain its leading market position.

Credit methodology

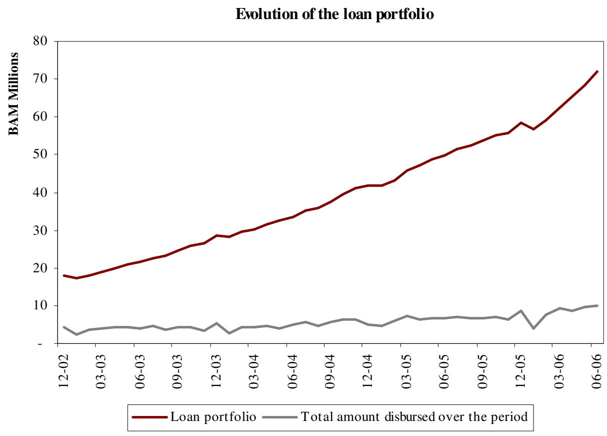
Mikrofin credit methodology proved to be both efficient and adapted to the BiH market as evidenced by its strong growth rate and its ability to maintain excellent portfolio quality. With time and experience, it decided to become more flexible (e.g. fewer requirements for small amounts and second cycles, certain clients can have a second loan), allowing faster disbursements while credit discipline is maintained, through highly standardized processes and good compliance culture.

Mikrofin lending staff is well-trained, motivated and knowledgeable of appropriate credit risks' analysis. The credit risk analysis is adequate, and mainly based on the client's character/reputation, his/her cash flows assessment, as well as the quality of the guarantors. The introduction of the new products has not drastically modified the existing credit methodology, although new application forms and specific analysis questions have been added for them. Existing good practises are kept in place: detailed business analysis is included when needed and follow-up is frequent and systematic with regular visits to clients eased by its decentralized branch/office network. Response to delinquency continues to be rapid, systematic and rigorous.

Awareness of increased exposure to client cross and over-indebtedness led Mikrofin to use more data from the Credit Bureau, though LOs use it mainly for new clients only. Despite several years of double digit growth, there are no major issues for now given existing strong demand and internal credit discipline. The institution needs to keep a close monitoring on Fast and Housing loans (which are quite different in risk nature from its core productive loans that it already masters well), as well as second loans to the same clients, and clients/guarantors' indebtedness and credit capacity situation.

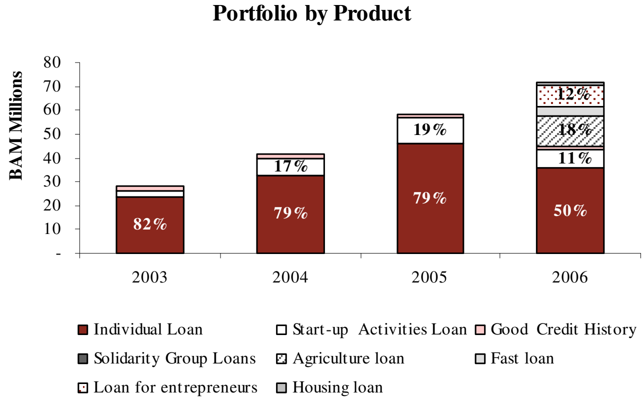
Mikrofin is exposed to a minor operational risk due to its rapidly growing activity, and notably to the hiring of 35 new employees between January and June 2006. Nevertheless, this risk is reduced by systematic training, well documented procedures and frequent internal controls. LOs typically have a university education and are screened for "good personality and work attitude / ethic". They are well trained (3-month probation period, fully operational within 12 months), with a good knowledge of their region and market. They are committed to Mikrofin and highly motivated, due to competitive pay scales and supportive work environment. BMs have a clear vision of their role of supervision and support, and providing both consistency and quality controls.

Portfolio Evolution



Due to the strong market demand and aggressive expansion through both new openings and higher market penetration rate of the existing offices, Mikrofin's loan portfolio is experiencing high growth, averaging almost 50% per year during the past 3 years (60% in 2003, 47% in 2004, and 40% in 2005). This growth remains strong in 2006 (+23% as of June 2006 from end 2005) reflecting growth in both existing products and new ones (e.g. fast and housing loans). Number of offices increased from 19 in 2003 to 31 in June 2006: these recent office openings now account for 14% of total portfolio.

Mikrofin's portfolio continues to be dominated by productive loans to small businesses. Former "Individual loan" and "Good credit history loan" were transformed into the new "Loan for Entrepreneurs". The noticeable growing importance of agriculture share in the portfolio led to the creation of a dedicated "Agriculture loan", which encountered good success and accounted for 17.8% of total portfolio in June 2006 since it was launched in February 2006. Solidarity Group loans were all reimbursed in 2005, and have been removed from the product mix. Truly new products (e.g. fast and housing loans) now account for a combined 7.9% – a rapid progression given the fact that they were launched only in April 2006.



Portfolio quality

K EUR, unless otherwise stated	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Loan portfolio	14,553	21,329	29,846	36,748
Loan portfolio (K BAM)	28,463	41,717	58,374	71,873
Evolution	59.6%	46.6%	39.9%	23.1%
Avg. outstanding loan port.	11,218	17,509	25,362	32,311
Number of active borrowers	7,426	14,033	20,399	23,725
Evolution	31.8%	89.0%	45.4%	16.3%
Average outstanding loan per client	1,960	1,520	1,463	1,549
% of GDP per capita	119.4%	84.6%	74.6%	78.9%
Average amount disbursed	2,251	2,027	1,966	2,002
% of GDP per capita	137.1%	112.9%	100.2%	102.0%
PAR 31-365	0.0%	0.2%	0.2%	0.3%
PAR > 365	0.0%	0.0%	0.0%	0.0%

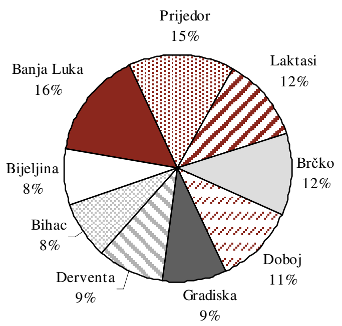
Despite fast growth and increased competition, Mikrofin managed to keep an excellent portfolio, and has been maintaining its PAR > 31 at less than 0.3% since 2002. This great performance is due both to a good client's selection and to strict portfolio management procedures. It is noted that new products such as Fast and Housing loans do not have yet a sufficient PAR track record to clearly see whether their inclusion in the portfolio will materially alter Mikrofin's traditional excellent portfolio quality. Having said that, Mikrofin's portfolio quality is unlikely to deteriorate markedly because of these new products thanks to its existing tight portfolio management practices and rapid response to any delinquency. There is no loan rescheduling.

Fast loan is priced relatively more than other products (higher interest rate of about 3% in APR terms, no grace period, shorter term) to compensate the higher risk profile. It is appreciated by clients because it requires neither field visits nor guarantors for amounts up to 2,000 BAM (1,023 EUR): first adopted at the end of 2004 for cost-effectiveness reason, this procedure proved not to affect negatively portfolio quality, since most Fast loans are issued either to existing clients or to salaried ones.

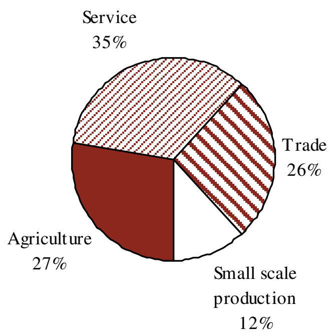
Portfolio diversification

Mikrofin has a very good geographical coverage in western RS. Its presence in the FBH is growing, though still limited in portfolio value and geographic coverage around the Bihać region in north-western BiH. Most recent expansion reached Tuzla in FBH (north-eastern BiH) and surrounding municipalities, and future plans include farther areas such as Sarajevo and Mostar.

Portfolio by Branch



Portoflio breakdown - Dec. 2005



The above portfolio breakdown by type of activity further confirms the appropriate diversification of Mikrofin's portfolio. Its composition has not significantly changed since 2004, but is expected to be further strengthened by the new products launched in 2006. There still are neither formal diversification rules nor targets by sector or product, but there is a proper monitoring of the portfolio composition at HQ level. Agriculture lending at Mikrofin is mostly for dairy production and pig/cattle husbandry where Mikrofin gained experience through its participation to the USAID LAMP program. The Fast and Housing loans have induced a real product diversification and their shares are expected to grow in the future as Mikrofin has been able to secure longer resources to finance housing loans and due to the fast loans' popularity.

Mikrofin has no policy regarding exposure limit, but in 2005, the largest borrowers (30,000 BAM loans) represented only 3% of the portfolio outstanding.

Credit risk coverage

	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Risk coverage ratio	4,679.5%	56.8%	67.4%	71.9%
PAR 31 net of loan loss provision / Equity	(4.7%)	0.3%	0.2%	0.3%

As of December 2005, compliance with IAS 30 (cf. section I) drastically lowers the risk coverage ratio below the 100% limit. Yet, it remains acceptable given that the "excess" loan loss reserve was simply transferred to the equity account. The industry-wide legal requirement of a 2% provisioning ratio for healthy portfolio still applies: as previously accounted, it had lead to a 2004 risk coverage ratio over 800%, and reflected Mikrofin's conservative provisioning policy. Despite having more flexible (i.e. lower) collateral requirements for certain loans, the collaterals (e.g. bill of exchange, administrative salary ban, etc.) and guarantees usually cover more than 100% of the value of the loan. Contractual legal enforcement in BiH has also improved to provide better protection of lenders' rights.

Write-off

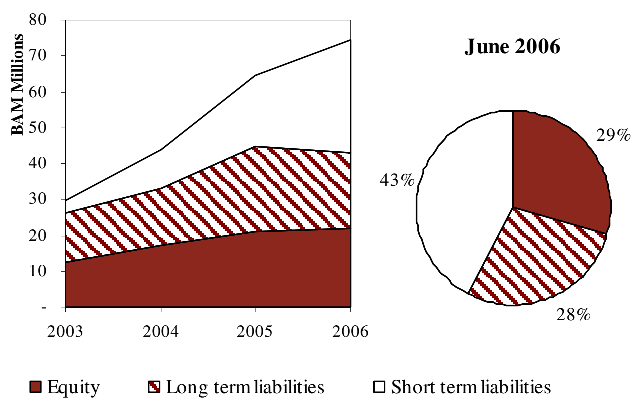
	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Write-off ratio	0.03%	0.03%	0.05%	0.03%

Write-off ratio has been minimal due to excellent portfolio quality, and is not expected to increase given Mikrofin's rigorous portfolio management. Individual loans continue to be the riskiest product consistently representing over 90% of the write-offs over the years. Like other Bosnian MFIs, Mikrofin rarely has long-term delinquency. Loans over 150 days in arrears are written off on a monthly basis.

▪ Financing and liquidity

Financing and liquidity is rated **« a »**

Funding structure



	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Liabilities / Equity	1.4x	1.5x	2x	2.2x

Capital structure & Leverage

Being a non-deposit taking MFI, Mikrofin funds its activities essentially with equity (29%) and debts (71%). Mikrofin remains moderately leveraged at 2.2x as of June 2006. Its leverage is expected to increase significantly when the new 8 M EUR EBRD loan (its largest ever) is fully disbursed. Debt funding is made of short-term (43%) and long-term borrowings (28%): the proportion of short-term borrowing has substantially increased over time, but it is not worrisome as the major part of the increase is attributed to current portions of long-term loans (which are typically refinanced or renewed). Equity capital is made of retained earnings (14.2 M BAM) and of donations accumulated over the years (7.8 M BAM).

ALM risks

There still is no formal Asset Liability Management (ALM) policy, but ALM risks are generally manageable for Mikrofin for now. A formal risk management policy should be developed if Mikrofin opts for transformation.

Interest Mismatch	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Funding expense ratio	2.9%	3.3%	3.9%	4.4%
Portfolio yield	26.4%	23.2%	20.5%	19.5%

Floating rate liabilities As of June 30, 2006	Outstanding amount (BAM)	Rate
Liabilities in EUR		
EFSE	5,867,490	5.3%+EURIBOR
EFSE-HL	782,332	4.65%+EURIBOR
Dexia	2,933,745	6%+EURIBOR
KfW	2,021,057	EURIBOR
Liabilities in BAM		
Hypo Banka	3,215,072	5.5%+EURIBOR
Raiffeisen	666,667	5.5%+EURIBOR
Raiffeisen	333,333	5.4%+EURIBOR
Total	**15,819,697**	

Mikrofin is exposed to interest rate risk as 31% of its debt (15.8 M BAM) is on floating rate basis. This risk is real especially as the underlying EURIBOR benchmark has moved up significantly since mid-2005 (2.1% in mid-2005 compared to 3.6% in October 4, 2006, albeit quite below the peak of 5.29% in November 2000). While this risk is marginally compensated by debts with no spread (e.g. KfW loan). Mikrofin has no hedging policy nor has tried to intentionally borrow only fixed rate loans, but it would be timely to think about this issue and set up limits to better manage and minimize the downside risk.

Maturity Mismatch	K BAM	
As of June 30, 2006	Portfolio	Liabilities
Short term up to 12 months	49,696,834	35,253,280
Long term >12 months	22,175,899	17,371,011
Total	**71,872,733**	**52,624,291**

Maturity risk is limited, as Mikrofin's average portfolio term is of 18 month, while substantial part of its borrowings is on a long term basis (5 years on a weighted average basis). Long term products, such as Agriculture (22-month average) or Housing loans (25-month average), may raise the average portfolio length as their share in the portfolio grows, but increased long-term funding base (e.g. ICO-AECI 10-year loan, KfW 5-year loans, and EBRD), retained earnings and overdraft facilities should compensate the additional risk. Looking ahead, there will be no legal limit on loan amount and terms if transformation is adopted: maturity risk will then need to be closely monitored and managed.

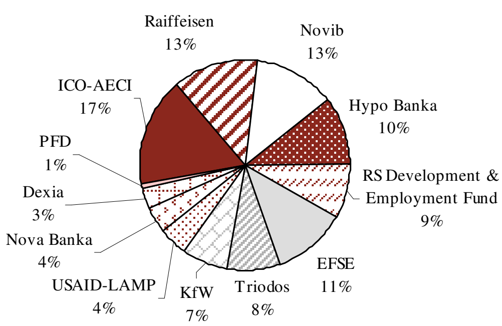
FX Mismatch	BAM	EUR	USD
As of June 30, 2006			
Liabilities by currency	16,629,567	32,881,831	3,112,893
Portfolio by currency	70,435,278	-	-

Mikrofin is exposed to FX risk despite BAM / EUR fixed peg that has not changed since EUR introduction. Although BiH governments seem to prudentially manage the economy, internal or external shocks can change this currency peg. This risk is contractually transferred to the client, but a severe devaluation would test its limits. Again as Mikrofin looks forward toward transformation, ALM risks will have to become an important item for management consideration.

Financing strategy

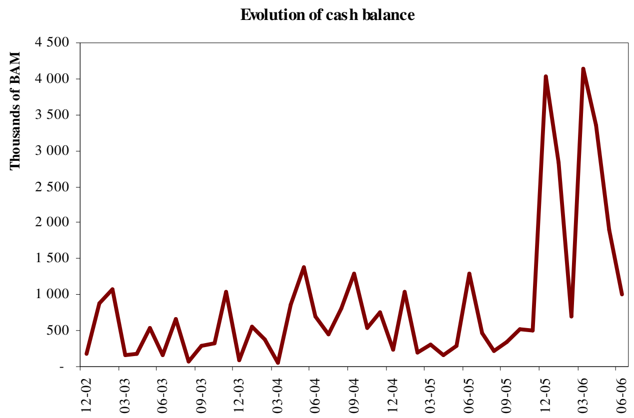
As a result of a diversified investor base and funding mix, Mikrofin has achieved a solid funding structure. It has a good anticipation of funding needs. This is made possible by a dynamic funding strategy and a historic profitability. Over the years, Mikrofin has built an excellent credit track record and negotiation abilities, allowing the institution to benefit from competitive and longer resources. As a result, commercial funders have a growing presence in its capital structure, and EBRD recently agreed on issuing a 8 M EUR loan with a convertible option.

Loan providers 2002-2006



While Mikrofin is more leveraged than its ECA peers (2.2x and 0.8x, respectively), it still has important additional debt absorption capacity due to its rapid expansion. Yet, and despite having EBRD as a potential equity investor, Mikrofin is still working to define a clear strategy for its capital structure, as well as suitable investors' profiles. Given a favourable risk-return profile, Mikrofin should be an attractive target for many equity investors.

Liquidity management



Liquidity management is not very complex, yet it is quite efficient. As shown in the above graph, Mikrofin's policy is to disburse funds as quickly as possible into loans. Good daily, monthly and yearly projections allow appropriate anticipation of funding needs. Yet, data and tools still need to be integrated in order to get the global picture faster. Cash flow is updated on a monthly basis, but not always based on the business plan projections. Only global previsions for the whole organization are available. For the first time in late 2005, Mikrofin is experiencing liquidity excesses following large foreign loan disbursements (e.g. EFSE loan disbursed in late 2005). These levels have dropped due to its high capacity to absorb and deploy funds thanks to the fast expansion of the network. Despite higher absolute cash positions, the cash to assets ratios remain very reasonable. Mikrofin can gain by working closer with its lenders to match disbursements with funding needs. Upon transformation, long term and more detailed liquidity management plans are needed however to better manage liquidity.

▪ Efficiency and Profitability

Efficiency and Profitability is rated « **a** »

Profitability analysis	**Dec. 2003**	**Dec. 2004**	**Dec. 2005**	**Jun. 2006**
ROE	24.2%	24.6%	20.1%	19.7%
Liabilities / Equity	1.4x	1.5x	2x	2.2x
ROA	9.4%	9.9%	7.2%	6.3%
Profit generation				
Operational self-sufficiency	163.4%	180.1%	160.0%	153.5%
Portfolio Yield	26.4%	23.9%	20.8%	19.9%
Operating expense ratio	12.4%	9.7%	8.9%	8.2%
Staff productivity	94	149	182	166
Loan officer productivity	152	242	287	245
Average outstanding loan per client (EUR)	1,960	1,520	1,463	1,549
Funding expense ratio	2.9%	3.4%	4.0%	4.5%
Cost of liabilities	4.4%	5.4%	5.7%	6.1%
Loan Loss Provision expense ratio	1.0%	0.2%	0.1%	0.3%
PAR 31-365	0.0%	0.2%	0.2%	0.3%
Write-off ratio	0.0%	0.0%	0.0%	0.0%
Asset management				
Outstanding Loan Portfolio / Assets	94.2%	95.1%	90.4%	94.3%
Non-portfolio income as a % of financial revenues	0.0%	0.0%	0.0%	0.0%

Overview of the profitability

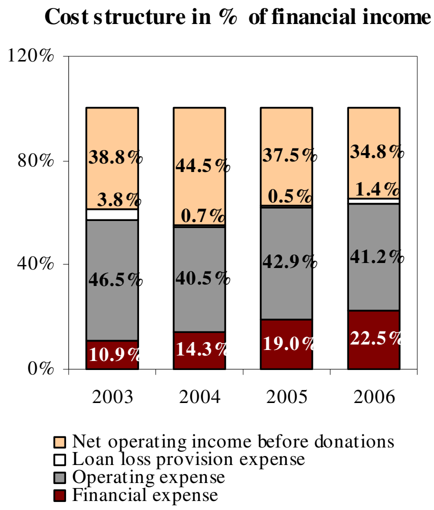
Mikrofin is a profitable institution as measured by OSS, ROA and ROE indicators. The key to Mikrofin's success continues to lie in its low cost structure derived from a disciplined approach to cost control, high staff productivity and efficient asset management. Nevertheless, while remaining at an excellent level, profitability indicators have been decreasing due to lower portfolio yield and higher cost of funds partially compensated by better efficiency driving down operating costs.

Portfolio yield

There is no material yield yap between Mikrofin's portfolio yield of 19.9% and its average portfolio APR of 19.4%. Decreasing yield over the years reflects reduced interest rates offered to clients rather than a bad quality portfolio, as evidenced by an excellent PAR > 31 and write-off ratios, and excellent loan loss provision expense ratio. High competition from banks like ProCredit Bank BiH is expected to maintain pressure on interest rates, potentially driving portfolio yield further down.

Operating expense ratio

Mikrofin's operating expense ratio is excellent, kept below 10% since 2004, and still decreasing despite network expansion, and high property and IT investments. This extraordinary low cost performance can be explained by: a) a disciplined cost management; b) streamlined processes allowing fast loan approvals; c) high percentage of productive assets; and d) high staff and systems productivity, still growing overall, despite a small decrease in 2006 (due to 35 newly hired employees).



Funding expense ratio

Funding expense ratio has been increasing over the years due to both increased leverage level and increased access to higher priced commercial loans. Nevertheless, at 4.5% as of June 2006 this ratio is still quite low thanks to availability of soft loans. The trend is however upward and could be lead to a blended cost of 6% over the next 18 months.

Asset management

Excellent asset deployment is another key factor in understanding Mikrofin's high profitability. Over 90% of its total assets are transformed into productive (income-producing) loan portfolio (94.3% as of June 2006).

Adjusted performance

Details concerning the specific adjustments are included in the annexes

Mikrofin is financially self-sufficient after GIRAFE adjustments. There is no loan loss provisioning adjustments. On an adjusted basis, AROE is still strong at 11.6% in 2006, while AROA becomes lower than its Balkan's peers (6.4%), though still higher than the industry average (1.9%). The shadow cost of funds was lowered from 12% in 2002 to 10% in 2003 and 9.2% in 2005 to take into account the fact that Mikrofin was able to access better priced funds.

	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Adjustment expense ratio	5.1%	3.0%	2.7%	2.9%
AROE	12.3%	17.7%	13.1%	11.6%
AROA	4.8%	7.1%	4.7%	3.7%
Financial self-sufficiency	124.5%	147.1%	132.4%	125.8%

Profitability outlook

Profitability outlook is positive, but it is expected that profitability levels might decrease due to ongoing expansion expenses, planned transformation expenses, rising funding costs and continued competitive pressure on margins, yet compensated by continued high asset quality, expected higher productivity and continued cost control discipline.

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.

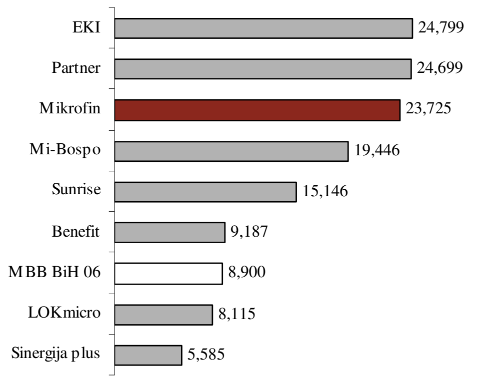
▪ Benchmarking

Classification	
Area	Bosnia and Herzegovina
LIP peer group	Mikrofin, EKI, LOKmicro, Mi-Bospo, Partner, Sinergija plus, Sunrise, Benefit
MBB peer group	BENEFIT, EKI Microcredit Institution, LIDER, LOKmicro, MI-BOSPO, Mikra, Mikro ALDI, MIKROFIN, Partner, Prizma, SinergijaPlus, Sunrise, Women for Women

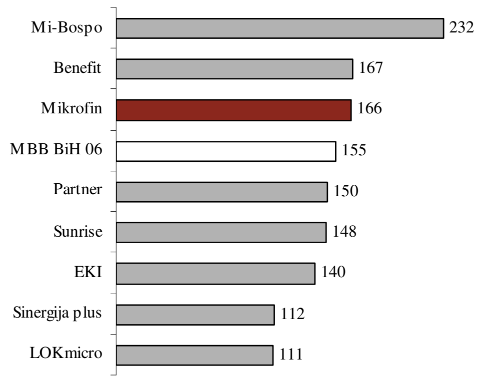
Source: LIP, June 2006; MiX, October 2006.

Mikrofin compares favourably to its BiH and MBB ECA peers in almost all indicators shown hereafter.

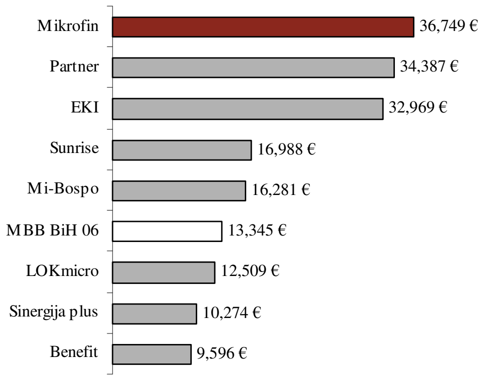
Number of active clients



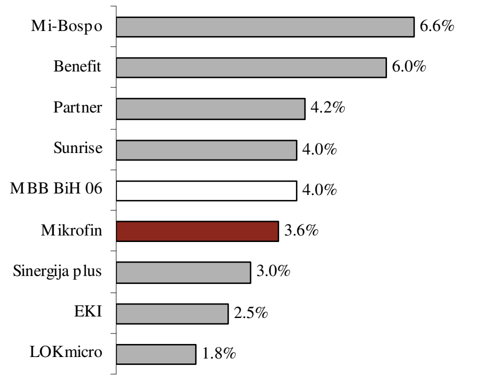
Staff productivity



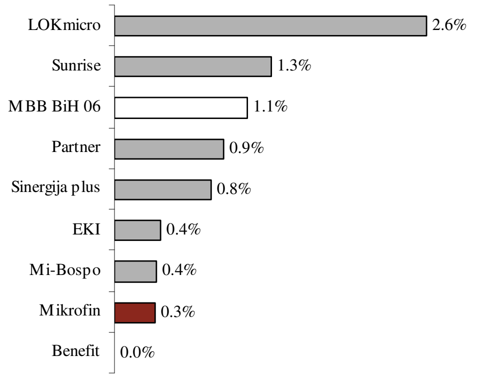
Gross loan portfolio



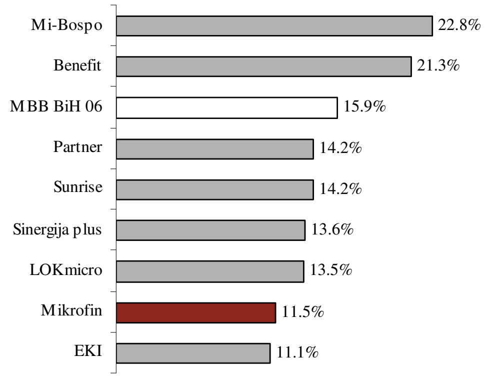
Adjusted Return on Assets



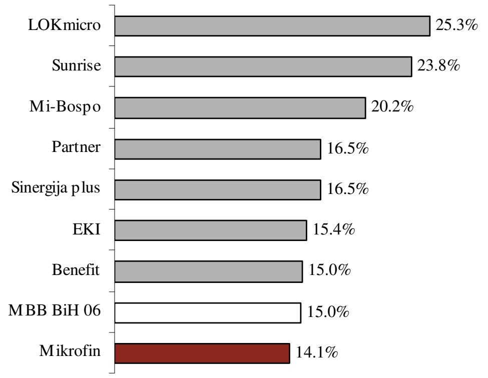
PAR > 30 days



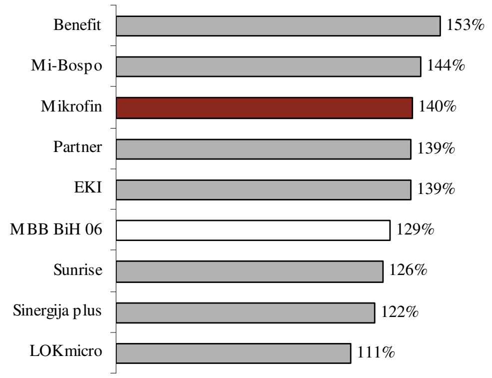
Adjusted Return on Equity



Operational efficiency



Operational Self-sufficiency



Annexes

Acronyms

ALM	Asset/Liability Management
BOD	Board of Directors
EBRD	European Bank for Reconstruction and Development
EFSE	European Fund for South-Eastern Europe
EU	European Union
EUR	Euro
EURIBOR	Euro Interbank Offered Rate
FI	Financial intermediary
FY	Fiscal Year (Jan. 1st to Dec. 31st)
HQ	Headquarters
HR	Human Resources
GNP	Gross National Product
GDP	Gross Domestic Product
IAS	International Accounting Standards
IFC	International Finance Corporation
IT	Information technology
KfW	German Development Bank
LIBOR	London Interbank Offered Rate
LO	Loan officer
MIS	Management Information System
MFI	Microfinance institution
MFC	Microfinance Center for Central and Eastern Europe and the Newly Independent States
NA	Not Applicable
NGO	Non Governmental Organization
PAR	Portfolio at risk
ROA	Return on assets
ROE	Return on equity
SME	Small and medium sized enterprise
USAID	United States Agency for International Development
UNDP	United Nations Development Program
USD	United States Dollar

Formulas and ratios

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

Notes to the financial statements

General notes to financial statements per CGAP Disclosure Guidelines

0 The MFI follows the CGAP disclosure guidelines.

1 The financial statements presented include a balance sheet, income statement, and accompanying notes.

2 The financial statements provided include 4 years of data.

3 Segment Reporting for Multiservice Microfinance Institutions: not applicable.

4 Portfolio reporting

4.1 Loan loss provision expense: expenses related to actual or anticipated loan losses are shown separately from other expenses in the income statement ("loan loss expense").

4.2 The loan loss reserve is shown as a negative asset in the balance sheet. It is calculated each December by the finance manager according to the methodology described in the table.

Provisioning methodology	Rate
Healthy portfolio	2%
Rescheduled	n.a.
less than 30 days	10%
31 – 60	30%
61 – 90	50%
91 – 120	70%
121-150	90%
more than 151 days	100%
over 365 days	100%
Write-off amount	100% after 150 days

4.3 Loans are written off every month from the loan loss reserve and the loans outstanding.

4.4 The following table reconciles these movements:

BAM	Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006
Loan loss reserve, January 1st	357,200	7,091	58,009	95,956
+ Loan loss provision expense	248,071	61,768	62,452	181,344
- Provision reversal	14,502	-	-	82,761
- Loans written off during the year	7,327	10,850	24,505	21,342
Loan loss reserve, year end	**583,442**	**58,009**	**95,956**	**173,197**

4.5 Accrual vs. Cash accounting: according to IAS 18, the MFI started accruing interest in December 2004;

5 Portfolio quality

5.1 Indicators: Portfolio quality and the calculations of such are displayed in the tables in Section A and the calculations are based on standard portfolio at risk calculation of: (outstanding loan principal for loans in arrears over X days)/(total portfolio outstanding).

5.2 Renegotiation of loans: the MFI does not refinance nor reschedule loans.

5.3 Insider loans: the MFI does not allow employees to borrow funds.

6 Donations

6.1 Revenue from donations is shown separately from income generated by operations in the income statement.

6.2 Current period donations: not applicable.

6.3 Donations accounting methodology: Grants for operations to be used in the current operating period are recorded in the income statement. Grants for fixed assets were recorded directly in the balance sheet with amortization of such assets passing through the income statement. Grants for loan funds are recorded directly in the balance sheet. Please note that the financial statements disclosed in this report have been modified for presentation to better reflect donations.

6.4 In-kind donations: Please refer to the Appendix on Adjustments for details on in-kind donations that Planet Rating has identified.

6.5 Cumulative amount of all prior period donations: Donations since 1997 are detailed in the table below.

Donor	**Amount BAM**	**Purpose**
Care International	3,363,151	Portfolio
UNHCR	1,166,474	Portfolio
DEF	1,156,948	Portfolio
META	925,703	Training and Equipment
DEF	670,277	Equipment and operating costs
UNHCR	336,299	Equipment and operating costs
USDA	174,810	Equipment and operating costs
Delphi	6,669	Staff training
Total	**7,800,330**	

7 Details of liabilities

7.1 Loans that account for more than 10% of total liabilities are listed in a table at the end of the report.

7.2 Deposits: not applicable as it is not allowed by law.

8 Other significant Accounting Policies

8.1 Depreciation of fixed assets: The depreciation of fixed assets on a flat basis using the following schedule:

Asset Class	**Useful Life**	**Rate**
Computers and other equipment	3 years	33.33%
Vehicles	5 years	20%
Furniture	8 years	12.5%
Buildings	10-25 years	4%-10%

8.2 Inflation accounting: none.

8.3 Currency mismatch: please refer to the F area for more information on potential mismatch.

8.4 Accounting treatment of unrealized gains or losses due to foreign currency fluctuations: none.

Adjustments

	Dec. 2003	**Dec. 2004**	**Dec. 2005**	**Jun. 2006**
Adjustment for the cost of funds = (a*b)-c	**1,095,828**	**992,103**	**1,189,523**	**733,614**
Average amount of borrowings (a)	14,440,542	21,566,016	34,238,382	46,737,018
Shadow price of borrowings (b)	12.0%	10.0%	9.2%	9.2%
Interest expense on borrowings (c)	637,037	1,164,499	1,960,408	1,416,289
Adjustment for inflation = (d-e)*f	**24,928**	**26,624**	**158,606**	**170,322**
Avg. Equity (d)	9,395,940	14,786,148	19,248,941	22,301,062
Average fixed assets (e)	1,086,583	1,474,091	1,626,011	2,263,131
Inflation rate (f)	0.3%	0.2%	0.9%	1.7%
Adjustment for in-kind donations	**-**	**-**	**-**	**-**
Staff and technical assistance	-	-	-	-
Other	-	-	-	-
Adjustments for provisions	**-**	**-**	**-**	**-**
Loan losses	-	-	-	-
Other risks	-	-	-	-
Other adjustments	**-**	**-**	**-**	**-**
Total adjustments	**1,120,756**	**1,018,727**	**1,348,129**	**903,936**
Net income before donations	2,271,957	3,635,427	3,871,317	2,196,197
Adjusted net income before donations	1,151,201	2,616,700	2,523,188	1,292,260
Adjusted net income before donations (EUR)	**588,600**	**1,337,898**	**1,290,085**	**660,722**

Mikrofin		BAM					EUR				Evolution		
Balance sheet	**Notes**	**Dec. 2002**	**Dec. 2003**	**Dec. 2004**	**Dec. 2005**	**Jun. 2006**	**Dec. 2003**	**Dec. 2004**	**Dec. 2005**	**Jun. 2006**	**2004/2003**	**2005/2004**	**2006/2005**
ASSETS		**18,564,839**	**29,596,551**	**43,809,924**	**64,461,887**	**76,027,828**	**15,132,476**	**22,399,658**	**32,958,839**	**38,872,411**	**48.0%**	**47.1%**	**17.9%**
Short Term Assets			**28,238,480**	**42,219,813**	**62,733,839**	**73,163,476**	**14,438,106**	**21,586,648**	**32,075,303**	**37,407,891**	**49.5%**	**48.6%**	**16.6%**
Cash and Due from Banks			92,760	230,831	4,037,417	1,001,123	47,427	118,022	2,064,299	511,866	148.8%	1,649.1%	(75.2%)
Short Term Investments			-	-	-	-	-	-	-	-	-	-	-
Short Term Net Loan Portfolio	1	17,473,137	27,879,498	41,658,725	58,278,280	71,699,535	14,254,561	21,299,768	29,797,211	36,659,390	49.4%	39.9%	23.0%
Short Term Gross Loan Portfolio		17,830,337	28,462,940	41,716,734	58,374,236	71,872,733	14,552,870	21,329,427	29,846,273	36,747,945	46.6%	39.9%	23.1%
(Loan Loss Reserve)		357,200	583,442	58,009	95,956	173,198	298,309	29,660	49,062	88,555	(90.1%)	65.4%	80.5%
Interest Receivable			203,947	286,008	378,150	-	104,276	146,234	193,345	-	40.2%	32.2%	(100.0%)
On loan portfolio	2		203,947	286,008	378,150	-	104,276	146,234	193,345	-	40.2%	32.2%	(100.0%)
On investments			-	-	-	-	-	-	-	-	-	-	-
Accounts receivable and other assets			62,275	44,249	39,992	462,818	31,841	22,624	20,448	236,635	(28.9%)	(9.6%)	1,057.3%
Long term assets			**1,358,071**	**1,590,111**	**1,728,048**	**2,864,352**	**694,371**	**813,011**	**883,537**	**1,464,520**	**17.1%**	**8.7%**	**65.8%**
Long Term Net Investments			-	-	-	-	-	-	-	-	-	-	-
Long Term Gross Loan Portfolio		-	-	-	-	-	-	-	-	-	-	-	-
Net Fixed Assets		815,094	1,358,071	1,590,111	1,661,910	2,864,352	694,371	813,011	849,721	1,464,520	17.1%	4.5%	72.4%
Other Long Term Assets			-	-	66,138	-	-	-	33,816	-	-	-	(100.0%)
LIABILITIES AND EQUITY			**29,596,551**	**43,809,924**	**64,461,887**	**76,027,828**	**15,132,476**	**22,399,658**	**32,958,839**	**38,872,411**	**48.0%**	**47.1%**	**17.9%**
Liabilities			**17,323,551**	**26,510,629**	**43,263,301**	**52,624,291**	**8,857,391**	**13,554,669**	**22,120,175**	**26,906,373**	**53.0%**	**63.2%**	**21.6%**
Short term liabilities			3,421,948	10,613,016	19,751,776	31,531,191	1,749,614	5,426,349	10,098,923	16,121,642	210.1%	86.1%	59.6%
Demand Deposits		-	-	-	-	-	-	-	-	-	-	-	-
Compulsory Deposits		-	-	-	-	-	-	-	-	-	-	-	-
Short Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-	-
Short Term Borrowings		625,327	3,095,365	10,237,451	18,830,174	30,039,236	1,582,635	5,234,326	9,627,715	15,358,817	230.7%	83.9%	59.5%
Interest payable	3	30,941	78,486	-	478,526	337,282	40,129	-	244,666	172,450	(100.0%)	-	(29.5%)
Accounts Payable and Other Short Term Liabilities			248,097	375,565	443,076	1,154,673	126,850	192,023	226,541	590,375	51.4%	18.0%	160.6%
Long term liabilities			13,901,603	15,897,613	23,511,525	21,093,100	7,107,777	8,128,320	12,021,252	10,784,731	14.4%	47.9%	(10.3%)
Long Term Time Deposits		-	-	-	-	-	-	-	-	-	-	-	-
Long Term Borrowings			13,901,603	15,897,613	23,511,525	21,093,100	7,107,777	8,128,320	12,021,252	10,784,731	14.4%	47.9%	(10.3%)
		11,258,788											
Other Long Term Liabilities			-	-	-	-	-	-	-	-	-	-	-
Equity		**6,518,880**	**12,273,000**	**17,299,295**	**21,198,586**	**23,403,537**	**6,275,085**	**8,844,989**	**10,838,665**	**11,966,038**	**41.0%**	**22.5%**	**10.4%**
Paid-In Capital			5,000	5,000	5,000	5,000	2,556	2,556	2,556	2,556	0.0%	0.0%	0.0%
Donated equity		3,648,525	7,130,688	7,800,330	7,800,330	7,800,330	3,645,863	3,988,245	3,988,245	3,988,245	9.4%	0.0%	0.0%
Retained earnings without donations and reserves			5,137,312	8,659,630	12,225,771	14,160,752	2,626,666	4,427,599	6,250,937	7,240,278	68.6%	41.2%	15.8%
Current year			2,271,957	3,780,300	3,899,292	2,256,512	1,161,633	1,932,837	1,993,676	1,153,736	66.4%	3.1%	(42.1%)
Other equity accounts	3		-	834,335	1,167,485	1,437,455	-	426,589	596,926	734,959	-	39.9%	23.1%

Notes:

1) Difference with 2004 and 2005 audited data is due to accrued interest, representing 0.7% and 0.6% respectively, here recorded separately in Interest Receivable on loan portfolio;

2) Accrued interest not yet calculated for the 2006 partial year;

3) 2005 data is deferred income from loan fees, reclassified in compliance with IAS 18;

4) Equity account created by reclassifying loan loss reserve in compliance with IAS 30.

Mikrofin Income Statement	Notes	BAM Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006	EUR Dec. 2003	Dec. 2004	Dec. 2005	Jun. 2006	Evolution 2004/2003	2005/2004	2006/2005
Financial Revenue (a)		**5,853,142**	**8,171,775**	**10,320,036**	**6,302,595**	**2,992,664**	**4,178,162**	**5,276,551**	**3,222,465**	**39.6%**	**26.3%**	**(38.9%)**
Financial Revenue from Loan Portfolio		5,784,221	8,168,584	10,317,872	6,300,202	2,957,425	4,176,531	5,275,444	3,221,242	41.2%	26.3%	(38.9%)
Interest on Loan Portfolio		5,230,104	7,203,736	9,302,714	5,759,874	2,674,110	3,683,212	4,756,402	2,944,977	37.7%	29.1%	(38.1%)
Fees and Commissions on Loan Portfolio		541,755	952,187	995,083	528,422	276,995	486,845	508,778	270,178	75.8%	4.5%	(46.9%)
Penalty Revenue on Loan Portfolio		12,362	12,661	20,075	11,906	6,321	6,473	10,264	6,087	2.4%	58.6%	(40.7%)
Financial Revenue from Investments		-	-	-	-	-	-	-	-	-	-	-
Other Operating Revenue		68,921	3,191	2,164	2,393	35,239	1,632	1,106	1,224	(95.4%)	(32.2%)	10.6%
Financial Expense (b)		**637,037**	**1,164,499**	**1,960,408**	**1,416,289**	**325,712**	**595,399**	**1,002,341**	**724,137**	**82.8%**	**68.3%**	**(27.8%)**
Interest paid on borrowings		637,037	1,164,499	1,960,408	1,416,289	325,712	595,399	1,002,341	724,137	82.8%	68.3%	(27.8%)
Interest paid on deposits		-	-	-	-	-	-	-	-	-	-	-
Net Inflation Adjustment Expense		-	-	-	-	-	-	-	-	-	-	-
Other Financial Expenses		-	-	-	-	-	-	-	-	-	-	-
Financial income [c=a-b]		**5,216,105**	**7,007,276**	**8,359,628**	**4,886,306**	**2,666,952**	**3,582,763**	**4,274,210**	**2,498,328**	**34.3%**	**19.3%**	**(41.5%)**
Net Loan Loss provision expense (d)		**225,294**	**58,360**	**56,718**	**91,174**	**115,191**	**29,839**	**28,999**	**46,617**	**(74.1%)**	**(2.8%)**	**60.7%**
Loan loss provision expense and write-off		233,569	61,768	62,452	98,583	119,422	31,581	31,931	50,405	(73.6%)	1.1%	57.9%
Recovery from Loans written off		8,275	3,408	5,734	7,409	4,231	1,742	2,932	3,788	(58.8%)	68.3%	29.2%
Operating expense (e)		**2,718,854**	**3,313,489**	**4,431,593**	**2,598,935**	**1,390,128**	**1,694,160**	**2,265,838**	**1,328,814**	**21.9%**	**33.7%**	**(41.4%)**
Personnel Expense (includes fringe)		1,729,410	2,076,951	2,659,497	1,566,222	884,233	1,061,928	1,359,779	800,797	20.1%	28.0%	(41.1%)
Administrative Expense (non-staff operating expenses)		989,444	1,236,538	1,772,096	1,032,713	505,895	632,232	906,058	528,018	25.0%	43.3%	(41.7%)
Depreciation and amortization		156,216	220,434	290,586	188,354	79,872	112,706	148,574	96,304	41.1%	31.8%	(35.2%)
Consulting fees/ training and technical assistance		-	-	-	-	-	-	-	-	-	-	-
Advertisement and entertainment		121,261	188,806	180,847	102,230	62,000	96,535	92,466	52,269	55.7%	(4.2%)	(43.5%)
Cost of bank charges		108,896	176,870	337,585	173,178	55,678	90,432	172,604	88,545	62.4%	90.9%	(48.7%)
Maintenance of fixed assets		111,682	43,796	97,187	34,104	57,102	22,393	49,691	17,437	(60.8%)	121.9%	(64.9%)
Rent		96,441	87,591	120,144	79,469	49,310	44,785	61,429	40,632	(9.2%)	37.2%	(33.9%)
Transport		68,283	84,235	110,267	76,964	34,913	43,069	56,379	39,351	23.4%	30.9%	(30.2%)
Stationary		64,311	61,701	77,216	42,742	32,882	31,547	39,480	21,854	(4.1%)	25.1%	(44.6%)
Communication		62,033	82,615	96,110	59,885	31,717	42,240	49,140	30,619	33.2%	16.3%	(37.7%)
Other		200,321	290,490	462,154	275,787	102,423	148,525	236,296	141,008	45.0%	59.1%	(40.3%)
Net Operating Income Before Taxes and Donations [f=c-d-e]		**2,271,957**	**3,635,427**	**3,871,317**	**2,196,197**	**1,161,633**	**1,858,764**	**1,979,373**	**1,122,897**	**60.0%**	**6.5%**	**(43.3%)**
Income Taxes (g)		-	-	-	-	-	-	-	-	-	-	-
Net Operating Income Before Donations [h=f-g]		**2,271,957**	**3,635,427**	**3,871,317**	**2,196,197**	**1,161,633**	**1,858,764**	**1,979,373**	**1,122,897**	**60.0%**	**6.5%**	**(43.3%)**
Non Operating Revenue (i)		-	144,873	27,975	60,315	-	74,072	14,303	30,839	-	(80.7%)	115.6%
Non Operating Expense (including related taxes) (j)		-	-	-	-	-	-	-	-	-	-	-
Net Income Before Donations [k=h+i-j]		**2,271,957**	**3,780,300**	**3,899,292**	**2,256,512**	**1,161,633**	**1,932,837**	**1,993,676**	**1,153,736**	**66.4%**	**3.1%**	**(42.1%)**
Donations (l)		3,482,163	669,643	-	-	1,780,402	342,383	-	-	(80.8%)	(100.0%)	-
Net Income (after Taxes and Donations) [m=k+l]		**5,754,120**	**4,449,943**	**3,899,292**	**2,256,512**	**2,942,035**	**2,275,220**	**1,993,676**	**1,153,736**	**(22.7%)**	**(12.4%)**	**(42.1%)**

Mikrofin	Product 1	Product 2	Product 3	Product 4	Product 5	Product 6	Product 7
Name of the product	Individual Loan	Start-up Activities Loan	Good Credit History	Fast Loan	Loan for Entrepreneurs	Loan for Agriculture	Housing Loan
Creation Date	March 2003	March 2003	March 2003	April 2006	2006	February 2006	April 2006
Client type (rural, urban, etc.)	urban, rural, production, trade, services, agriculture	urban, rural, production, trade, services ,agriculture	urban, rural, production, trade, services, agriculture	n.a.	services, trade, and small scale production	agriculture production	housing
Authorized loan size (minimum and maximum)	BAM 1,500-30,000	BAM 500-5,000	up to BAM 10,000	BAM 500 - 5,000	BAM 1,500 - 30,000	BAM 1,000 - 30,000	BAM 500 - 30,000
Average disbursed loan size	7,884	1,851	4,311	1,982	8,082	3,594	4,300
Authorized loan length (minimum and maximum)	up to 36 months	up to 18 months	up to 18 months	up to 36 months	up to 36 months	up to 36 months	up to 36 months
Average loan length	19 month	13 months	14 months	16 months	20 months	22 months	25 months
Grace period	up to 6 months	no	up to 3 months	no	up to 6 months	up to 9 months	no
Collateral requirements and other conditions	Guaranties of companies, private persons, bill of exchange, mortgage, pledge on movable assets (depending on the loan amount and loan term MIKROFIN requires one or two of these guaranties)	Guaranties of companies, private persons, bill of exchange (depending on the loan amount and loan term MIKROFIN requires one or two of these guaranties)	Guaranties of companies, private persons, bill of exchange (depending on the loan amount and loan term MIKROFIN requires one or two of these guaranties)	No guarantors for amounts up to BAM 2,000 and repayment term up to 18 months; 1 guarantor for amounts from BAM 2,001 to 5,000	1 guarantor either legal or natural person for the amounts up to BAM 20,000; 1 guarantor, legal person, for the amounts between BAM 20,001 and 30,000	no guarantee for loans up to BAM 3,000; 1 guarantor either legal or natural person for loans from BAM 3,001 to 5,000; 2 guarantors either legal or natural persons for loans above BAM 5,000; pledge, mortgage	no guarantee for loans up to BAM 2,000 & term up to 18 months; 1 guarantor for loans up to BAM 2,000 & term above 18 months; 1 guarantor, legal or natural, for loans up to BAM 20,000; 1 guarantor legal for loans up to BAM 30,000
Repayment Schedule (ex. weekly, monthly)	monthly	monthly	monthly	monthly	monthly	monthly	monthly
Nominal annualized interest rate	16% to 18%	18% to 24%	18% to 20%	18% to 20%	16% to 18%	15% to 16%	16% to 20%
Flat or declining ?	declining	declining	declining	declining	declining	declining	declining
APR	17% to 21%	22% to 28%	21% to 23%	21% to 23%	17% to 20%	16% to 17%	17% to 22%
Fees and penalties	1% to 2 %	2%	2%	2%	1% to 2%	1%	1% to 2%
Major changes since creation (rate, size, term)	Created in 1998, with loan amount connected to loan cycle until 2000; in March 2003, interest rate decreased, loan amount and terms were modified; product stopped in December 2005	In March 2003, interest rate decreased depending on the loan amount and term; product stopped in December 2005	In March 2003, interest rate decreased depending on the loan amount and term; product stopped in December 2005				

Financing sources

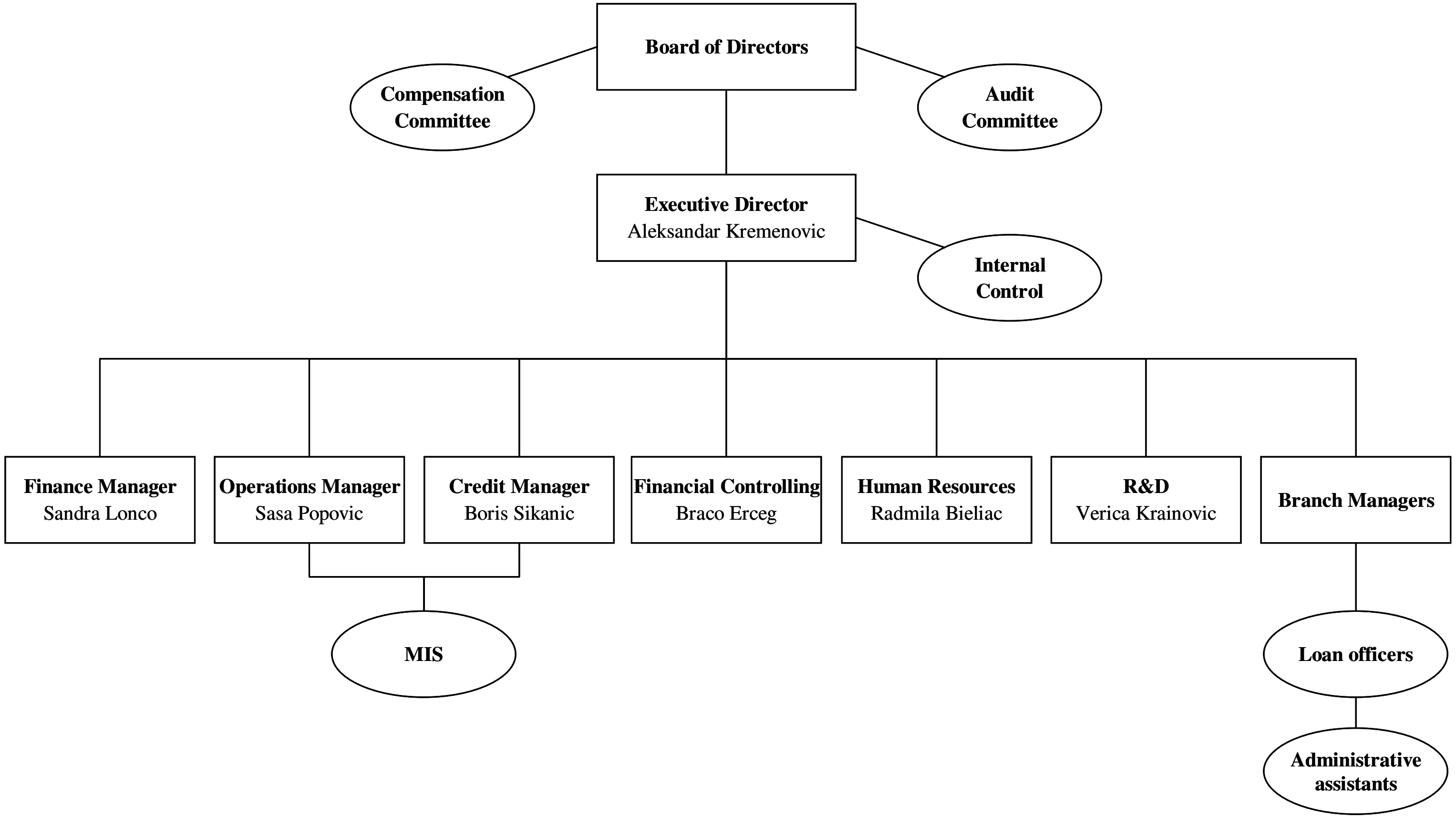
As of June 30, 2006

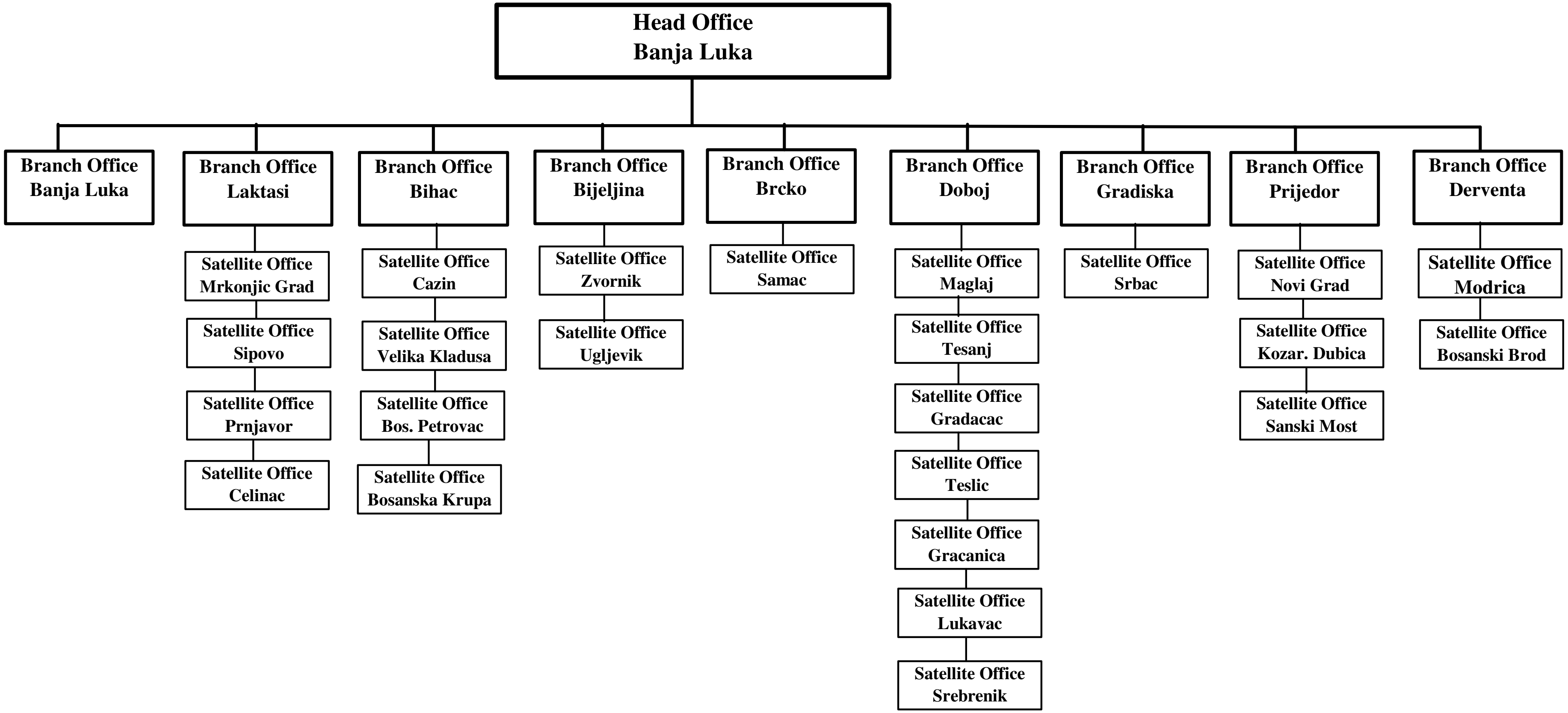
Loan Provider (Source)	Currency	Contracted Amount (BAM)	Outstanding Amount (BAM)	Outstanding Amount (USD)	Outstanding Amount (EUR)	Interest Rate	Maturity
HYPO BANKA (1)	BAM	1,000,000	-			7.7%	20.02.2007
HYPO BANKA	BAM	2,000,000	1,221,866			EURIBOR+5,5%	01.04.2008
HYPO BANKA	BAM	3,000,000	1,993,206			EURIBOR+5,5%	01.06.2008
HYPO BANKA	BAM	1,200,000	1,200,000			7.0%	15.09.2006
FOND - RS DEF	EUR	6,037,647	6,037,647		3,087,000	5.0%	15.03.2017
KFW	EUR	977,915	293,375		150,000	EURIBOR	30.09.2007
KFW	EUR	977,915	326,037		166,700	EURIBOR	30.09.2007
KFW	EUR	977,915	325,940		166,650	EURIBOR	30.09.2007
KFW	EUR	977,915	488,958		250,000	EURIBOR	30.09.2008
KFW	EUR	977,915	586,749		300,000	EURIBOR	31.03.2009
NOVA BANKA	BAM	2,000,000	2,000,000			7.0%	23.12.2006
NOVA BANKA	BAM	1,000,000	1,000,000			7.0%	30.11.2006
RAIFFEISEN	BAM	1,000,000	1,000,000			7.3%	20.10.2006
RAIFFEISEN	BAM	1,000,000	1,000,000			7.3%	28.11.2006
RAIFFEISEN	BAM	1,000,000	1,000,000			7.3%	09.03.2007
RAIFFEISEN	BAM	1,000,000	666,667			EURIBOR+5,5%	21.05.2007
RAIFFEISEN	BAM	1,000,000	333,333			EURIBOR+5,4%	01.04.2008
RAIFFEISEN	BAM	2,000,000	2,000,000			7.3%	29.09.2006
RAIFFEISEN	BAM	2,000,000	2,000,000			7.3%	18.04.2007
TRIODOS	EUR	977,915	977,915		500,000	8.0%	01.10.2006
TRIODOS	EUR	2,738,162	2,738,162		1,400,000	8.0%	01.05.2007
TRIODOS (2)	EUR	1,955,830	-		-	7.5%	01.07.2008
DEXIA	EUR	733,436	1,466,873		750,000	EURIBOR+6%	20.01.2007
DEXIA	EUR	488,958	488,958		250,000	EURIBOR+6%	16.06.2007
DEXIA	EUR	977,915	977,915		500,000	EURIBOR+6%	16.06.2007
NOVIB	EUR	8,801,235	4,889,576		2,500,000	7.5%	31.07.2008
LAMP	USD	3,112,893	3,112,893	2,000,000		0.0%	25.06.2006
EFSE	EUR	5,867,490	5,867,490		3,000,000	EURIBOR+5,3%	31.03.2009
EFSE-HL	EUR	1,955,830	782,332		400,000	EURIBOR+4,65%	30.09.2009
ICO-AECI	EUR	11,734,980	5,867,490		3,000,000	5.0%	15.12.2015
PFD	EUR	488,958	488,958		250,000	5.0%	15.05.2009
Total		**69,960,823**	**51,132,337**	**2,000,000**	**16,670,350**		

(1) Overdraft facilities

(2) Disbursed after June 30

Organizational chart




Head Office Banja Luka
Branch Office Banja Luka
Branch Office Laktasi
Satellite Office Mrkonjic Grad
Satellite Office Sipovo
Satellite Office Prnjavor
Satellite Office Celinac
Branch Office Bihac
Satellite Office Cazin
Satellite Office Velika Kladusa
Satellite Office Bos. Petrovac
Satellite Office Bosanska Krupa
Branch Office Bijeljina
Satellite Office Zvornik
Satellite Office Ugljevik
Branch Office Brcko
Satellite Office Samac
Branch Office Doboj
Satellite Office Maglaj
Satellite Office Tesanj
Satellite Office Gradacac
Satellite Office Teslic
Satellite Office Gracanica
Satellite Office Lukavac
Satellite Office Srebrenik
Branch Office Gradiska
Satellite Office Srbac
Branch Office Prijedor
Satellite Office Novi Grad
Satellite Office Kozar. Dubica
Satellite Office Sanski Most
Branch Office Derventa
Satellite Office Modrica
Satellite Office Bosanski Brod