



Thaneakea Phum Cambodia

Phnom Penh, Cambodia

Rating grade	α— alpha minus	Assessment: Recommended, reasonable safety excellent systems
Visit dates: 14 – 19 July, 2003	Operational head: Ms Elizabeth Abrera, CEO	
Maximum validity of rating*: till 31 July, 2004		

Rating

TPC has performed well on governance/strategy, management and financial indicators. A negative return on average total assets due to a high operating expense ratio (OER) and substantial concentration of the portfolio in agriculture reduce the otherwise strong performance of the MFI.

In M-CRIL's view, on account of overall good performance, portfolio quality and significant scope to expand in existing operational areas, TPC can absorb – from all sources – loan funds of US\$1 million (Kh Riel 4,000 Million) over the next one year for on-lending to its borrowers.

However, since the high OER has an adverse impact on the MFI's sustainability, any disbursement of loan funds should be contingent upon TPC presenting an action plan to bring down the ratio from the present level of 49.8% to less than 35% over the next one year.

A rating update after one year is suggested to ascertain changes in the creditworthiness and absorptive potential of the institution. **This rating is valid, subject to no other substantial inflows of loan funds into the organisation beyond the limits specified here** and to no other significant changes in the organisational structure and external operating environment.

- for Micro-Credit Ratings International Ltd

Sanjay Sinha, Managing Director

***Validity** This rating is valid till the next loan proposal made by the MFI to any financial institution or till any other significant change in the structure of the loan programme or in its external environment. A **rating update** (comprehensive repeat rating) is recommended whenever such changes take place or at the end of **one year** from the date of the initial assessment, whichever is earlier. Any substantial additional information that becomes available could also result in a rating update or a rating review (revision of rating grade based on a desk analysis).

Liability The rating assigned is a professional opinion of the assessors and M-CRIL does not guarantee the information and cannot accept any legal responsibility for actions arising out of the recommendations made.

Category wise rating

<u>Category</u>	<u>Rating grade¹</u>
A <u>Governance aspects</u>	α-
B <u>Managerial factors</u>	α-
C <u>Financial performance</u>	α-
Overall	α-

Key Risk Factors

- 1 **High exposure to agriculture:** The largely rural operations of TPC notwithstanding, the share of agriculture in the portfolio (60%) is very high. With agriculture being largely rainfed and underdeveloped, this high exposure to a single sector of the economy could potentially lead to large losses due to crop failure.
- 2 **Refinancing of older loans:** The general loan product of TPC has flexible loan terms which allows the borrowers to make a one time repayment at the end of the loan cycle. A fresh loan can be sanctioned to borrowers only once the earlier loan is settled. However, in a few cases the rating team observed that the next loan was released within four to seven days of the repayment of the earlier loan. Since this re-lending does not necessarily coincide with the crop harvest – when farmers could reasonably be expected to have the cash to make bullet repayments – this practice could lead to the “ever-greening” of a part of the portfolio and substantial loan loss at some point in the future.

Key Programme Strengths

Governance, experience and strategy	Management and operations	Financial
<ul style="list-style-type: none"> ✓ Very experienced board members ✓ Strong emphasis on credit discipline ✓ Ability to draw on the experience of CRS as managers and also lessons from the field 	<ul style="list-style-type: none"> ✓ Stable and qualified staff resources ✓ Reasonably strong and disciplined Village Banks ✓ Strong internal, financial control and planning systems ✓ Strong accounting system ✓ Good system for tracking overdues 	<ul style="list-style-type: none"> ✓ Good repayment history ✓ Very high capital adequacy ratio ✓ Good resource mobilisation for on-lending

¹ M-CRIL’s grading sheet is attached at the end of the report.



TPC Assessment

Organisational Profile

Legal form	Years of m-f Operation	Number of				
		Active borrowers	Members	Staff	Branches	Active borrowers/ staff member
Limited liability company	9	29,459	39,555	142	10	206

Microfinance programme: Operational highlights

Client savings (KhR million)	Outstanding borrowings of MFI (KhR million)	Loan portfolio of MFI (KhR million)	Cumulative loans disbursed by MFI (KhR million)	Average loan size from MFI to borrowers (KhR)
872.3 US\$223,660	Nil	7,041.7 US\$1,805,600	37,929.5 US\$9,725,000	3,000,000 US\$770

Key financial ratios

Portfolio at risk (≥ 60 days)	Cumulative repayment rate	Risk weighted capital adequacy ratio	Subsidy dependence index	Yield to APR ratio
2.7%	99.1%	89.3%	28.8%	96.4%
Yield on portfolio	Other income to average portfolio	Financial cost ratio	Loan loss provisioning ratio	Operating expense ratio
46.3%	3.2%	1.7%	0.9%	49.8%
Total income to average total assets	Total expenses to average total assets	Return on average total assets	Operational Self Sufficiency	Financial Self Sufficiency
33.5%	35.4%	-1.9%	94.6%	83.2%

Notes

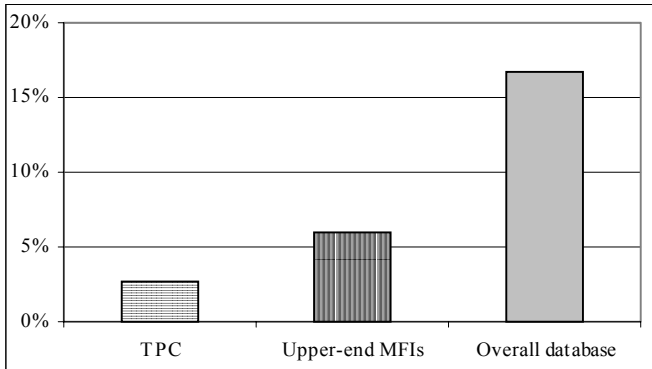
- 1 All figures above pertain to the organisation's micro-finance programme as on 30 June 2003.
- 2 The operations of TPC comprise 39,555 clients in a total of 966 village banks and 5,082 groups. The number of active borrowers is 29,459.
- 3 All staff members of TPC are full-time and are dedicated only to the microfinance programme.
- 4 The ratios of repayment rate and portfolio at risk have been calculated on the basis of an examination of all loan accounts (borrowers to MFI level), cross verification from office ledgers and during field visits to groups and examination of other office records. The methodology used to measure such ratios is a function of the data with the organisation and the quality of that data.



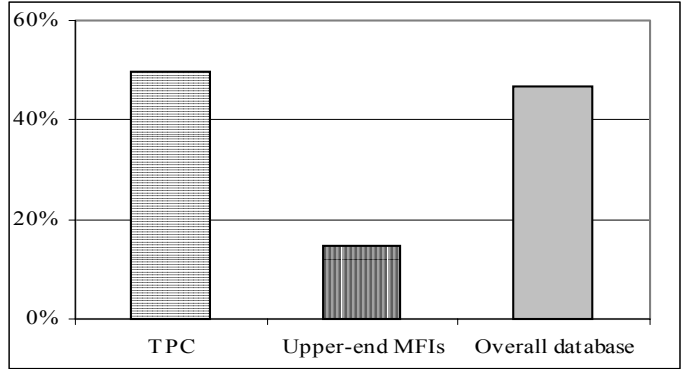
TPC Assessment

TPC – financial overview

Portfolio at risk (>=60 days): 30 June 2003

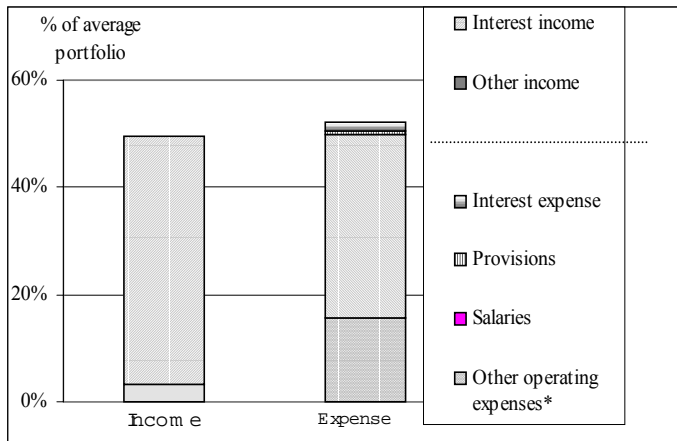


Operating expense ratio: 1 July 2002-30 June 2003



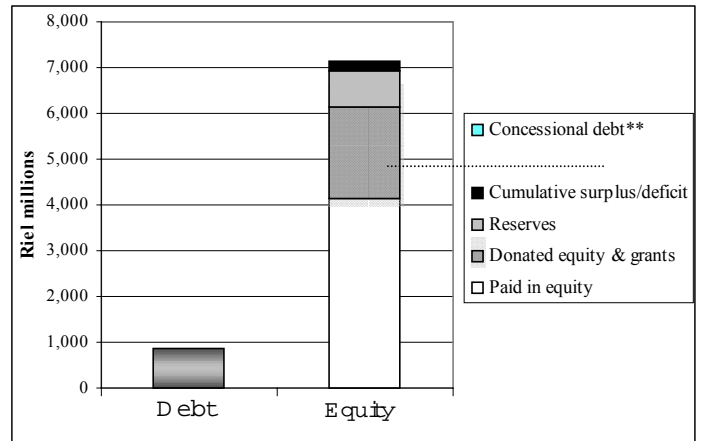
- Note:** 1. $n_{upper-end} = 9$ $n_{database} = 86$; Database updated as on 28 February 2003.
 2. Outliers and rated NGOs with no direct lending have been removed for analysis. Upper-end figures reflect MFIs with top 10% scores.
 3. The upper-end MFIs and overall database ratios represent simple averages for their respective samples.
 4. The performance of either the Upper-end MFIs or all MFIs (overall database), do not necessarily reflect M-CRIL's rating standards.

Income and expense distribution:
1 July 2002-30 June 2003



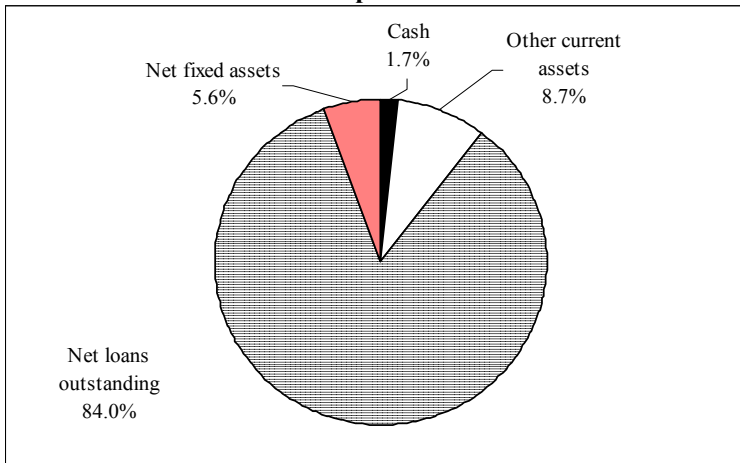
* Other operating expenses include travel, depreciation and administrative expenses

Debt and equity composition:
30 June 2003

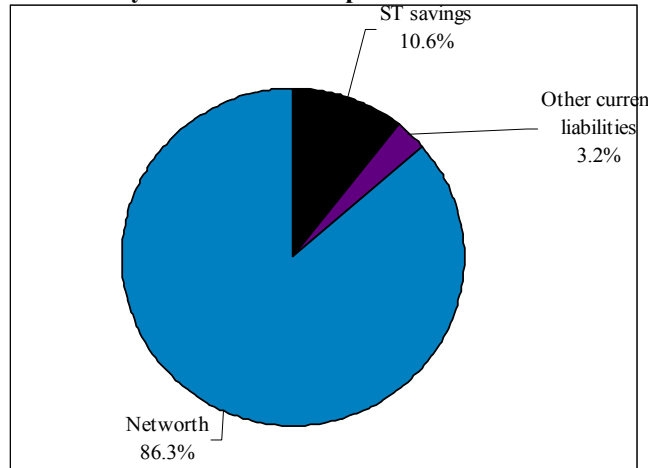


** Concessional debt is borrowing+comp.savings taken at < Bank PLR +50 basis points, & voluntary savings taken at < bank deposit rates

Asset composition: 30 June 2003



Liability & net worth composition: 30 June 2003



Country Profile

Cambodia lies at the heart of the Indochina peninsula, bordered by Thailand to the west, Laos to the north and Viet Nam to the east. Cambodia is a Khmer speaking Buddhist country, which is governed by a parliamentary democracy and a constitutional monarchy. It is one of the poorest countries in the world (ranks 130 out of 173 countries on the human development ranking of the United Nations Development Programme). Subsistence farming employs 75% of the workforce, with the Mekong River providing fertile, irrigated fields for rice production. Well over half of Cambodia is forested. Cambodia has suffered a long period of political and economic upheavals during the 1970s and 1980s, and it was only in the 1990s that some semblance of peace and economic stability returned to the region.

After the period of political turmoil, the revival of Cambodia's economy, was heavily dependent on international institutions – the Asian Development Bank, the World Bank, the European Union and others have been the largest contributors to the country's development. With the exception of one year, Cambodia's overall economic and financial performance, since the late 1980s has been generally positive. The economy grew by an average of 7.6% annually from 1987 until 1993 and then by about 4.5% annually during 1994-99. Economic growth in recent years has been supported by the continued expansion of exports, especially of the garments sector (15%), tourism (41% increase in visitors) and agriculture (5% growth of rice production and 6% for other crops). The exchange rate has been fairly stable, averaging around 3,900 Riels to US\$1 over the last three years.

The improvement of the overall economic situation also reflects changes in the weight of different contributing sectors. The services sector leads the way with 43% of the national GDP, while agriculture has gone down to 37% and industry has increased to 20%. The garment industry alone now employs some 100,000 workers, mainly young women. The informal sector, especially small enterprise trade and services, has expanded significantly, allowing for the employment of a large labour force that the formal market could not absorb. It is expected that this favourable outlook will continue to benefit microfinance as the economy tries to catch up with its ASEAN neighbours.

In this scenario, microfinance is one of the areas that have attracted the attention of policy makers and the country has made significant progress in microfinance policy and regulation. The National Bank of Cambodia – the central bank – has been instrumental in bringing about regulatory changes that include the provision of a separate license for microfinance institutions. This has increased the incentive for MFIs to become professionally managed and operated, sustainable institutions.



1 Organisational background

Thaneakea Phum, Cambodia (TPC) was registered in 2002 as a limited liability company under Cambodian law. Catholic Relief Services (CRS) holds 90% of the equity of the company and others hold the remaining 10%. The present operations of TPC are an offshoot of the Thaneakea Phum Programme (TPP), a rural credit and savings programme launched by CRS in 1994 with the goal of increasing the income and quality of life of poor rural Cambodian families by providing women access to uncollateralized loans for productive activities using the village banking methodology. TPP operated primarily poverty alleviation programmes in Cambodia as a wholesale institution with six partner local NGOs but also operated two of its own branches offering retail services to clients. The present structure of TPC is the result of a merger of operations and transformation of two CRS branches along with two of its NGO partners that agreed to spin off their credit programmes to become part of the licensed micro-finance institution.

TPC is now focused entirely on microfinance activities. It has a five-member board consisting of three representatives of CRS, one independent member and one representative of the staff. The three board members are senior staff of CRS and have very long experience in development and finance related functions. The external board member is a retired official from the National Bank of Cambodia and has more than twenty years of experience in banking and finance. The fifth member, the staff representative, is elected democratically through secret ballot. The current staff member on the Board is a Branch Manager who has five years of experience in banking and microfinance.

2 Microfinance operations

2.1 Background of microfinance operations

The credit operations of the erstwhile TPP started in 1994 initially in retail lending. However, by 1999 the changing legal environment for microfinance forced CRS/TPC and its LINGO partners to discuss the institutional options that would strengthen the programme's long term viability and sustainability. It was this that led to the merger and transformation of the programme into a locally incorporated MFI.

TPC is presently working in 1,026 villages in 45 districts of Cambodia. These districts are spread across eight provinces. It has outreach to 39,555 members of whom 29,459 were borrowers on 30 June 2003. The organisation works through nine branches, and has a total of 142 staff, 131 at the branches and 11 at the head office

TPC's operations are led by its Chief Executive Officer, Ms Elizabeth Abrera. Ms Abrera is also the Regional Technical Adviser for CRS in their South-East Asia and Pacific Regional Office. A Deputy Chief Executive Officer, a Chief Operating Officer (COO) and a Chief Financial Officer (CFO) assist the CEO. The COO is the head of operations and all the Branch



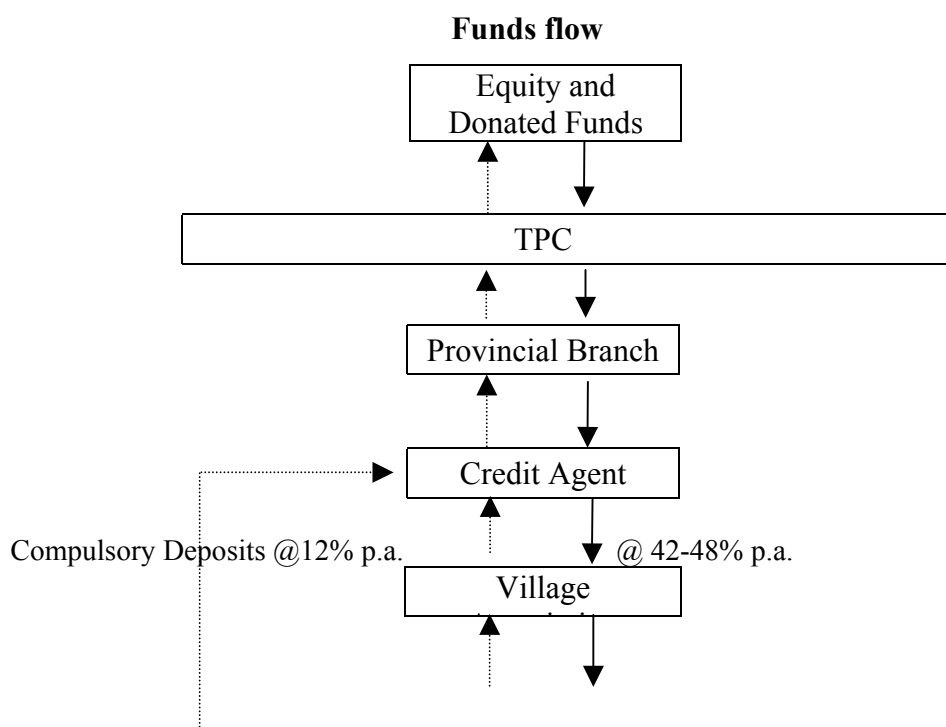
TPC Assessment

Managers report to him. He is responsible for product development and human resource development as well as operations. The CFO is responsible for financial, administration and MIS related matters. There is also a team of three internal auditors based at the head office, reporting to the Chief Executive and the Board directly. At the branches, operations are led by the Branch Managers (BMs). Each BM is assisted by a Credit Manager and a team of 8-9 field staff who are called Credit Agents (CAs). There are also a number of other support staff at the branches - including a cashier, a bookkeeper, an MIS clerk, driver and cleaner. The CAs handle field operations and are rotated frequently within the service area of a branch and at times across branches as a result of transfers and/or promotions.

Being a subsidiary of CRS and an offshoot of one of its programmes, TPC was funded from CRS private funds as well as by grants from the United States Agency for International Development, the McKnight Foundation and Development Capital. So far, TPC has not obtained loan funds from any source. The details of funds received from the donors are

Source of funds	Cumulative amount (US\$)
Catholic Relief Services	1,075,000
USAID	2,980,000
McKnight Foundation	316,000
Development Capital	60,000
Total	4,431,000

The flow of funds for on-lending is depicted in the following diagram. The broken arrows indicate repayments of loans or deposit of savings.





TPC Assessment

Association

Individual Clients

2.2 Microfinance policies

The organisation's operations follow the Village Banking model of Latin America. It is similar to the model of Bangladesh's Grameen Bank. Here a number of small groups – each with three to seven members form a village bank that is very similar to the centre of the Grameen model. All the group members essentially belong to the same village. Groups elect leaders also to be part of the decision-making of the village bank. Normally a Village Bank (VB) has 30-60 members affiliated to it through the groups. Each Credit Agent is responsible for 10-12 VBs. Each branch of TPC has approximately 5-12 CAs. The role of the VB is to approve loan applications, prepare loan contracts, monitor loan utilisation and follow-up repayments and bad debts. The CA also functions as the cashier of the VB and holds overall responsibility for the performance of the VB.

TPC has a clearly laid out process for village selection and group formation. The process begins with the visit of the Credit Agent to the new village where he tries to ascertain the potential credit demand. This is ascertained on the basis of a formal demographic survey of the village. Once the results of the survey meet the prescribed requirements of TPC, permission from the local authority is sought to start operations in the area. Following the approval of the local authorities, branch operations are started with a branch manager, some credit agents and an accountant. As the scale of operations at the branches grows, the number of support and field staff is increased. Once a member is enrolled with the VB following a client survey, he/she is given training on the basic principles of microfinance. The training is followed by an assessment of the member to determine eligibility to receive a loan from TPC.

TPC has a clearly laid out process for opening branches and a policy of not starting operations where another MFI is already working. An in-house team undertakes a provincial survey for this purpose. This process takes from one to two months depending on the size of the province, its population, the number of districts and communes as well as its distance from the Head Office. The survey report and feasibility study is reviewed by the COO and CEO and then presented to the Board for approval if the proposed branch appears to have the potential to be viable and feasible. Once approval of the Board is secured, discussions with local authorities are initiated for obtaining permission to open a branch and operate in the area.

Savings products

TPC has a compulsory savings product, wherein the member must deposit 5-10% of the loan



TPC Assessment

amount borrowed as security. Members receive interest at 12% per annum on the deposited amount. The deposited amount varies by loan product with the Thaneakea Phum Loan requiring a deposit of 5% of the borrowed amount, whereas the Solidarity Group Loan and Market Loans require 10%. Special Loans have no savings requirement. The amount deposited under the compulsory saving cannot be withdrawn until the loan is fully repaid.

TPC has recently introduced a voluntary savings product. Here the deposits can be withdrawn at the convenience of the member, who receives interest on the monthly balance at 8% pa. However this product has not yet attracted the attention of many members.

Loan products

Loan type	Delivery channel	Loan size	Repayment terms	Other conditions
TP Loan	Loan is disbursed individually to members of the group	Initially up to US\$62.50 (KhR250,000)	The repayment period and term are flexible and decided between the VB/CA, approved by the BM and Credit Manager. The repayment period is either monthly or at the end of the cycle. The loan term varies from 4 to 12 months. Principal can be paid at end of the cycle but interest is payable at least monthly.	The interest rate is 48% per annum on end of cycle (EOC) principal payment and 42% per annum on amortized interest and principal repayment based on declining balance. Appraisal is conducted by the CA if the loan amount is more than KhR300,000. A repeat loan is sanctioned after reviewing the repayment history and business assessment of the client.
Solidarity Group Lending	Disbursed individually to members of the group with good repayment records and flourishing businesses	Upto US\$300 (KhR1.2 million)	Loan to be collateralised or covered by two financially able guarantors. Interest and principal to be repaid within 12 months on a monthly basis.	Meant for relatively bigger businesses and enterprises. Interest charged is 42% per annum on declining balances.
Market Loans	Disbursed individually to members of groups that do business	Those with market stalls eligible for	Flexible repayment terms between 4 to 12 months	Interest rate 42% per annum if client pays at TPC office or 48% per month when collected by the Credit Agent at the



TPC Assessment

	in public markets of major rural towns and Phnom Penh	higher first loans; those with no permanent stalls entitled to first loans between KhR 3-500,000		market stall; principal and interest amortized either daily, weekly or monthly
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3 Observations

3.1 Governance and strategy

TPC performs well on governance and strategy with a grade of $\alpha-$. This good grade reflects its sound strategy at the policy level and good performance in operations. The organisation has an experienced and relatively active Board. The presence of a staff representative on the Board has helped to enhance staff participation in policy formation. All the products introduced by TPC are good in terms of their market competitiveness and repayment performance. However, a design flaw in one of its most important products results in some risk of refinancing.

➤ Strategy for microfinance operations

TPC shows overall strong performance on strategic aspects. The operations are fully focused on microfinance, with TPC adopting a relatively fast growth strategy for operations. In terms of geographical coverage, the organisation has a moderate level of concentration. It covers about 32% of the villages in the project area, and within the villages, it covers about 18% of the households under its operations. TPC has done well to restrict its geographical spread in the areas where other MFIs are already working. This has helped in avoiding the risk of cross-financing between MFIs.

One of the issues of concern is the high client dropout rate. Over the last year and half, there has been a net dropout of about 12% of clients from its fold. Given the nature of the products of TPC, this appears to be very high. Another area of concern is the design of its end of cycle (EoC) product. TPC does not have a policy on the number of days after which it would allow the release of the next cycle of loan. The rating team observed that in a number of cases the next cycle of loan was released within five days of repayment of the earlier cycle. Though the extent of this could not be ascertained definitely, this type of product design could hold the risk of “ever-greening” (perpetual refinancing).

➤ Experience in microfinance

TPC is relatively young as an organisation as it was registered in 2001 as an MFI. However it draws from the experience of its erstwhile entity, TPP and of its parent, Catholic Relief Services (CRS). All its board members have very rich experience in the area of banking, finance and development. The current chairman of the organisation, was involved in the early phases of starting microfinance operations in Cambodia. This means he has good appreciation of operational issues. Another board member who has long years of experience with the Cambodian central bank, is actively involved in operations. She regularly attends monthly staff meetings as a special invitee. The employee representative brings an additional operational perspective into the policy formulation of the organisation.

3.2 Managerial factors

TPC shows good performance on management with a grade of $\alpha-$. This primarily results from its very good MIS, sound accounting policies and practices at the HO level, and an effective audit and inspection system.

➤ Human resource quality and management

TPC has adequately qualified and committed staff for the microfinance programme. Though the staff dropout rate has been an area of concern, it has improved over the last one year. Over the last two years, there has been an emphasis on recruiting local skilled professionals at relatively higher positions. While this is a welcome step towards grooming local talent for taking up higher responsibilities, TPC would do well to ensure quality recruitment at these levels. Owing to the use of senior staff drawn from the ranks of CRS, the transfer of skills to field staff in the use of the village banking model is effective. However, staff exposure to other microfinance implementation and training programmes is quite limited.

➤ Accounting and MIS

The MIS at TPC is very good. All the branches and the head office are equipped with the Micro-Banker software. This has been installed after a proper trial run for about six months at both the branches and at the head office.

At the village bank level, Credit Agents (CAs) and group leaders are given the responsibility of maintaining records. All the transactions at the village bank level are recorded by two persons and the CA brings the records to the branch. Here all the transactions are recorded in the software. This recording forms the basis for the MIS of the organisation. The software can generate all the required and relevant reports at the required periodicity. At the end of every month, a compact disk containing all the software files is sent to the head office from the branches. The data is consolidated at the head office. Further, such relevant reports as portfolio quality, arrears, progress on expansion, client drop-outs are generated for the whole organisation with a branch wise break-up. However, there are some problems with the software that raise a question mark over its effectiveness. For example, the report on arrears is not accurate as it considers the head office sanction of loan as disbursement. As there is always going to be a time lag between the sanction and release of funds, the reports related to arrears may not be accurate.

The software also works as the platform for the accounting system. The records brought from the village bank and fed into the system function as the input for the accounts. The software has all the features that are required for accounting and generates accounting reports. However, due to virus/bugs the generation of monthly financial statements has not been possible at the branch level. As is the case with MIS report generation, the data being sent from the branches is also used as the basis for the compilation and consolidation of accounts at the HO level. It is here that all the relevant accounting and financial reports are generated. These reports can be generated with a branch wise break-up which facilitates analysis. These reports



TPC Assessment

include monthly profit and loss accounts, receipt and payments and month-end balance sheets.

➤ Tracking system for overdues

The systems for tracking arrears at TPC are adequate. The use of Micro-Banker for MIS and accounts ensures that overdues are detected immediately. The daily entry of the records into the system is essential for this kind of system to work effectively. The CAs in coordination with the Branch Manager and other branch staff ensure that the transactions at the village bank level are reported regularly and data is fed into the system on a daily basis. The software can produce reports of overdues at any time. The report records the genesis of the loans along with the due date and amount overdue for the respective client along with his past record. The same report can also be generated at the HO level once the diskette from the branch is sent there. Moreover, the financial control systems monitor recoveries realised and the amounts due on a weekly basis. These serve as an additional check on arrears.

➤ Financial planning and control systems

TPC has strong financial control systems. At the branch level, daily cash reconciliation is undertaken and accounts are closed by mid-afternoon every day. Similar levels of check are prevalent at the head office. Monthly cross checks of member-wise loan outstanding, with branch loans outstanding are undertaken.

To support the internal control function, TPC has a team of three internal auditors. The internal audit team functions independently and reports directly to the Chief Executive and the board. It visits the branches once in four months and spends close to one week at every branch. The internal audit reports cover all aspects of financial control and monitoring. The draft report of the internal audit is shared with the respective branch and Branch Managers and Credit Managers are together asked to provide explanations on the issues raised by the internal audit team. If necessary, disciplinary action is taken by the CEO in consultation with the Chief Operating Officer. The internal audit team also needs to make presentations at board meetings to apprise the board about its functioning. Another control mechanism operates through surprise field and monitoring visits conducted by the COO and the Deputy CEO and through the enforcement of a strong culture of staff discipline.

The CAs at the village banks make loan disbursements; cash for this purpose is provided at the respective branch office. There is a proper system for the verification of cash disbursement by the Branch Manager and the Credit Manager.

In terms of planning, TPC uses cash flow statements for projecting future growth in operations. The annual budgeting exercise is undertaken at the head office based on revenue and cost estimates received from the branches. Accordingly, physical targets are provided to the branches to meet the MFI's growth plans.

Operational cash flow planning at TPC also appears to be very effective but seems somewhat costly. Every Friday, branches report their cash position to the head office,



TPC Assessment

along with their weekly fund requirements, based on their disbursement and operational expense requirements. The cash is transferred to the branches through the respective branches of commercial banks where TPC has its accounts. Each of these cash transactions costs the organisation around 0.15% of the value of the transaction subject to the amount being more than KhR18,000 (US\$4.50).

➤ Decision making

The operations manual of the organisation has standardised the decision-making process of the organisation. This facilitates the smooth conduct of routine field operations along with monitoring and reporting. There is also a system of holding periodic meetings of Branch Managers and the COO to introduce clarity on implementation issues. The board, in consultation with the Chief Executive, takes the policy decisions.

➤ Infrastructure

TPC has an adequate infrastructure base for its microfinance operations (total value of fixed assets of TPC amounts to KhR464.9 million on 30 June 2003). This accounts for nearly 6% of the total asset base of the organisation. All the branches and head office operate through rented accommodation and are located at an approachable place. The other fixed assets like computers, furniture and vehicles are adequate for the present scale of operation. The current level of infrastructure is adequate and is being employed effectively for the overall operations of the microfinance programme.

3.3 Financial performance

The financial performance grade of TPC is good at $\alpha-$. Though the organisation has not done well on profitability and sustainability, its credit record, portfolio quality, capital adequacy, liquidity and financial coverage are good.

➤ Credit performance and portfolio quality

TPC has excellent credit performance. Its cumulative repayment rate was 99.1% and PAR₆₀ was 2.7% on 30 June 2003. The strong credit culture at the field level and zero tolerance for any arrears results in this high performance. The excellent recovery performance is also a result of being able to use member savings to settle pending loan balances in the few cases where recovery becomes an issue.

Also, in a few exceptional cases, where a member has taken a loan and, due to a disaster/calamity situation, finds it difficult to repay the loan, a second loan is issued to the member as a special loan, before the member is actually eligible for another loan. However, such cases are few and the overall recovery performance of the organisation is excellent. The main area of concern is the perceived refinancing of general TPC loans that are repaid at the end of the cycle. The rating team found quite a few instances of fresh loans being sanctioned to borrowers, within four to seven days of repayment of older loans. This was discussed in **Section 3.1**.



TPC Assessment

TPC provides loans for different production and consumption activities, though it does not track the utilisation of the funds. However, based on the observations made in the field, and interaction with its staff at branches and head office, the rating team concludes that more than 60% of its portfolio lies in agriculture with animal husbandry, micro-enterprises, petty businesses, consumption and health, accounting for the remaining 40% of the portfolio. Considering that only a small part of the service area of TPC is under the Mekong river basin and most of the agriculture in the service area is rain-fed, this high exposure to agriculture is a matter of concern.

➤ Asset, liability and equity composition

The asset composition of TPC is good with more than 85% of its total assets deployed in loans. On liabilities, the organisation has relied mainly on paid in and donated equity from CRS. The grant funds from its parent body have been used for different operational and investment activities. The worldwide network of CRS has helped it to mobilise funds from a number of donor organisations – listed in the table in **Section 2**. In addition, TPC mobilises funds from its members as compulsory deposits. This amounts to nearly 11% of the total liabilities of the organisation. Due to its heavy reliance on donated and paid in funds its net worth is high and the risk weighted capital adequacy ratio is very good at 89.3%.

➤ Sustainability and profitability

The organisation's financial sustainability in terms of its profitability is not good. It has a negative return on average total assets (-1.9%). Similarly the Operational Self-Sufficiency (OSS) ratio is also sub-optimal at 94.6% due to a very high operating expense ratio (49.8%). The high level of expenses is primarily due to a substantial salary outlay which is more than 34% of the average annual portfolio. The presence of two expatriates in the senior management of the organisation when taken into account (currently subsidized by CRS) has added significantly to the salary bill. The operating expense ratio would come down to 42% if the salary of these managers could be paid at local rates. Similarly, the return on average total assets would become positive (1.6%) if local managers could be found to replace the expatriate staff. The Subsidy Dependence Index (SDI) is not too bad at 28.8% due to a high yield on portfolio (46.3%). Financial Self-Sufficiency is also reasonable at 83.3%, which results from the reliance on equity and donated funds in a (currently) low inflation economy. The yield to APR ratio is also very good at 96.4%, because of the organisation's high recovery rate.

4 Conclusions



TPC Assessment

Strengths	Weaknesses
<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✓ Very experienced board members ✓ Strong emphasis on credit discipline ✓ Ability to draw on the experience of CRS in terms of senior managers and also lessons from the field <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✓ Stable and qualified staff resources ✓ Reasonably strong and disciplined VBs ✓ Strong internal, financial control and planning systems ✓ Strong accounting system ✓ Strong system for tracking overdues <p><u>Financial</u></p> <ul style="list-style-type: none"> ✓ Good repayment history ✓ Very high capital adequacy ratio ✓ Good resource mobilisation for on-lending 	<p><u>Organisational</u></p> <ul style="list-style-type: none"> ✗ Thin spread over the operational area <p><u>Managerial</u></p> <ul style="list-style-type: none"> ✗ Errors in the calculation of overdues ✗ High transaction costs of handling cash <p><u>Financial</u></p> <ul style="list-style-type: none"> ✗ Limited diversification of portfolio ✗ Very high operating expense ratio

5 Creditworthiness

TPC has achieved a rating grade of *alpha minus* ($\alpha-$).² In terms of creditworthiness this implies **reasonable safety**. Its performance on all the three components of the rating is good, though there are some areas that require attention from the management. Being an off-shoot of a development focussed organisation has led to the lack of an adequate focus of the organisation on profitability and sustainability. This is the major reason for TPC still making losses after more than eight years microfinance operations. However, with strong fundamentals like high yield on portfolio, good credit discipline and decent portfolio quality, the overall creditworthiness of TPC will increase if corrective measures are taken in time.

In M-CRIL's view, on account of significant institutional presence, overall good performance, and good portfolio quality, TPC can absorb – from all sources – loan funds of US\$1 million (KhR4,000 million) over the next one year for on-lending to its borrowers.

Though TPC has commitments of grant funds to cover its operational losses, M-CRIL believes that the disbursement of loan funds to the organisation should be contingent upon it presenting an action plan to reduce its operating expense ratio to less than 35% over the next one year.

² The Rating Grade given measures performance on the rigorous standards established by M-CRIL. The assessment uses an instrument designed specifically for the conditions and nature of MFIs operating in Asia and is comparable with other ratings done by M-CRIL in this region.



Financial statements for TPC's Operation

Balance Sheet - as on 30 June 2003

<u>Assets</u>	<u>Khmer Riel</u>	<u>Khmer Riel</u>	<u>US \$</u>	<u>US \$</u>
			US\$= 4,000 Riel	
<u>Current assets</u>				
Cash in hand and bank		140,360,159		35,990
Balance with NBC		18,000,000		4,615
Interest bearing deposits		633,571,785		162,454
Prepayments & other advances		39,970,612		10,249
Advance profit tax		10,075,617		2,583
Due from Debtors		16,754,820		4,296
<u>Loans outstanding</u>				
Gross loans outstanding	7,041,719,063		1,805,569	
(Loan loss reserve)	(101,024,714)		(25,904)	
Net loans outstanding		6,940,694,349		1,779,665
Total current assets		7,799,427,342		1,999,853
<u>Long term assets</u>				
Net property and equipment	464,952,058		119,218	
Total long term assets		464,952,058		119,218
Total Assets		8,264,379,400		2,119,072
<u>Liabilities and Network</u>				
<u>Current liabilities</u>				
Client savings – compulsory		872,266,862		223,658
Deferred Revenue		210,572,381		53,993
Suspense, Clearing & Interbranch accounts		3,744,132		960
Taxes payable		5,753,302		1,475
Accrued expenses & provisions		42,444,368		10,883
Total current liabilities		1,134,781,045		290,969
<u>Net worth</u>				
Paid up equity	3,230,244,745		828,268	
Hybrid Capital Investment	897,382,130		230,098	
Translation Reserve	(2,985,868)		(766)	
Reserve & Appropriation	801,872,362		205,608	
Donated equity	2,021,292,595		518,280	
Retained net surplus/(deficit)	308,777,488		79,174	
Current net surplus/(deficit)	(126,985,097)		(32,560)	
Total net worth		7,129,598,355		1,828,102
Total Liabilities and Net Worth		8,264,379,400		2,119,072



TPC Assessment

Income Statement: Statement from 1 July 2002 – 30 June 2003

<u>Income</u>	<u>Riel</u>	<u>Riel</u>	<u>US \$</u>	<u>US \$</u>
Interest and fees on loans	2,093,528,233		536,802	
Other income 1 (registration & fees)	120,494,365		30,896	
Other operating income	23,956,371		6,143	
Foreign Exchange Gain	462,156		119	
Total income		2,238,441,125		573,959
<u>Financial costs</u>				
Interest on member savings	74,777,622		19,174	
Gross financial margin		2,163,663,503		554,786
Provision for loan losses	38,894,490		9,973	
Net financial margin		2,124,769,013		544,813
<u>Operating expenses</u>				
Salaries	1,543,280,645		395,713	
Travel	92,206,067		23,643	
Depreciation	122,864,876		31,504	
Administrative/office expenses	493,402,522		126,513	
Total Operating expenses		2,251,754,110		577,373
Net Surplus/Deficit		(126,985,097)		(32,560)

Adjustments:

TPC draws on the resources of Catholic Relief Services in terms of two senior personnel. This has been reflected in the adjustments. The value of adjustments for in-kind donations thus computed is estimated at KhR315 million for the year ending 30 June 2003. Thus, after all adjustments, the loss for the year ending 30 June 2003 is KhR126.9 million and the adjusted return on average assets is – 1.9%.



Notes to the financial statements

1. The Financial Statements have been estimated for the microfinance operations and represent an approximate picture. This has involved, appropriate modifications to the existing financial statements using data gathered and assumptions made during the rating exercise and also allocations based on an estimation of the degree of use of overall fixed assets and the value of the total staff time being spent on microfinance activities. Such modifications can result in differences between the income statement and balance sheet prepared by the organization itself and the statements presented above.
2. Income includes interest income, fees and earnings from other microfinance related services offered by the MFI rated. All loan portfolio related income is recognised only when it is actually received (**cash basis**). Grants allocated to the organisation's microfinance programme are treated as donated equity in the balance sheet (and not regarded as operational income).
3. Financial costs (interest on borrowings and savings, if any) and operating costs are calculated on an **accrual basis**. Loan loss provisioning expense and the corresponding balance sheet entry (loan loss reserve) has been computed based on the quality of the portfolio.

Glossary

1. Cumulative repayment rate
Ratio of cumulative principal recovered (net of pre-payments) to the cumulative principal due till the date of measurement.
2. Portfolio at risk (PAR₆₀)
Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date.
3. Yield on portfolio
The interest income on loans divided by the average loan portfolio for the year.
4. Other income to average portfolio
Total income other than from the interest on loans divided by average portfolio.
5. Financial cost ratio
Total interest expense for the year divided by the average portfolio.
6. Loan loss provisioning ratio
Total loan loss provisioning expense for the year divided by the average portfolio.
7. Operating expense ratio
Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio.
8. Average loan portfolio
This represents the average loan outstanding for the year computed on a monthly basis.
9. Subsidy Dependence Index
The Subsidy Dependence Index broadly measures the net subsidies received as a proportion of the income of the organisation. A higher ratio indicates that there is a higher level of dependence on subsidies. Subsidies can be in the form of grants and savings deposits/ borrowings at a rate lower than market rate. Computation of subsidies is done with respect to the market rate of interest.
10. Average total assets
This represents the average total assets for the year calculated on an annual basis.
11. Operational Self-Sufficiency
Ratio of total income to total costs for the year.
12. Financial Self-Sufficiency
Ratio of total income to total adjusted expenses. Adjustments have been made for subsidised cost of funds (w.r.t. the market interest rate), equity (w.r.t. inflation) and in-kind donations.
13. Risk weighted capital adequacy ratio
Ratio of networth to risk weighted assets (Risk weights: 100% for all assets except the following: fixed assets & interest bearing deposits: 50%; cash 0%).



Projected Cash Flows and Financial Statements for five years

- The following assumptions and projections - derived from the limited information available from the organisation on its future financial projections – are tentative in nature. These **should not be viewed in isolation nor be regarded as a basis for investing in the future** - only the main risk rating report provides an opinion on investments.
- All assumptions are based on the data gathered during the rating exercise and the savings and credit methodology used by the organisation.

1 Basic Assumptions

(see also Notes to Cash Flow Projections below)

For the year ending:	30-Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Members	39,355	44,000	50,000	55,000	60,000	65,000
Savings per member/year	220	24,000	27,000	30,000	36,000	40,000
Yield on average portfolio	46.3%	46.3%	46.3%	46.3%	46.3%	46.3%
Interest paid on savings	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%
Cost of external funds	0.0%	6.0%	6.2%	6.3%	6.3%	6.4%
Repayment rate from groups	99.1%	99.5%	99.5%	99.0%	99.0%	99.0%
Loan loss reserve ratio	1.4%	1.5%	1.5%	1.5%	1.5%	1.5%
Number of active loanees/loan a/cs	24,459	31,000	35,500	41,500	47,000	51,000
Number of loans disbursed		27,331	30,850	36,175	40,775	43,950
Average loan size to borrowers (in Khmer Riel)	1,200,000	1,200,000	1,350,000	1,500,000	1,800,000	2,000,000



TPC Assessment

2 Projected balance sheets

(in million Khmer Riel)

As on:	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Assets						
Cash balance & other current assets	859	567	340	418	749	603
Loans outstanding	7,042	18,260	22,954	30,192	40,664	51,346
Loan loss reserve	-101	-274	-344	-453	-610	-770
Net loans outstanding	6,941	17,986	22,610	29,739	40,055	50,576
Net fixed assets	465	1,318	2,537	3,633	4,620	5,508
Total Assets	8,264	19,871	25,486	33,790	45,424	56,686
Liabilities and Net Worth						
External borrowings	0	4,000	7,668	13,671	21,173	27,011
Member savings	872	1,542	2,405	3,525	5,048	6,884
Other liabilities	263	259	259	259	259	259
Donations and equity	6,948	12,948	12,948	12,948	12,948	12,948
Retained surplus/deficit	309	182	1,123	2,207	3,387	5,996
Current surplus/deficit	-127	941	1,084	1,180	2,609	3,589
Net worth	7,130	14,071	15,155	16,335	18,944	22,533
Total Liabilities and Net Worth	8,264	19,871	25,486	33,790	45,424	56,686

3 Projected Income Statements

(in Million Kh Riel)

For the year ending:	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Income						
Interest	2,094	5,852	9,533	12,293	16,389	21,282
Other income	145	159	175	193	212	233
Total Income	2,238	6,012	9,708	12,485	16,601	21,515
Expenses						
Financial	75	305	637	1,086	1,695	2,311
Loan loss provision	39	173	70	109	157	160
Depreciation	123	146	282	404	513	612
Operating expenses (excl. depreciation)	2,129	4,446	7,635	9,707	11,627	14,843
Total Cost	2,365	5,071	8,624	11,306	13,992	17,926
Surplus/Deficit	-127	941	1,084	1,180	2,609	3,589



TPC Assessment

4 Projected Cash Flow Statements

(in Million Kh Riel)

For the year ending:	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Inflows					
Opening cash	859	567	340	418	749
External borrowings	4,000	5,000	9,000	13,500	15,000
Repayments from members	18,644	32,768	41,700	55,452	72,519
Grants	6,000	0	0	0	0
Member compulsory savings deposits	744	959	1,245	1,692	2,040
Interest income	5,852	9,533	12,293	16,389	21,282
Other income	159	175	193	212	233
Total Inflow	36,258	49,001	64,770	87,663	111,823
Outflows					
Disbursement	29,862	37,463	48,938	65,925	83,200
Repayments to lenders	0	1,332	2,997	5,998	9,163
Withdrawals of savings deposits	74	96	125	169	204
Operating expenses (excl. depr.)	4,446	7,635	9,707	11,627	14,843
Interest paid on borrowings	160	400	730	1,180	1,596
Interest paid on savings	149	237	356	514	716
Fixed assets purchase	1,000	1,500	1,500	1,500	1,500
Total Outflow	35,692	48,662	64,352	86,914	111,221
Net cash balance	567	340	418	749	603

5 Key projected performance ratios

For the year ending:	Jun-03	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
Operational self-sufficiency	95%	118.6%	112.6%	110.4%	118.6%	120.0%
Return on average assets	-1.9%	6.7%	4.8%	4.0%	6.6%	7.0%
Operating expense ratio	49.8%	36.3%	38.4%	38.1%	34.3%	33.6%
Average outstanding/borrower (Kh Riel)	287,899	414,998	459,087	548,937	677,742	789,936
Portfolio growth rate	164.0%	159.3%	25.7%	31.5%	34.7%	26.3%
Savings to total assets	10.6%	7.8%	9.4%	10.4%	11.1%	12.1%
Risk weighted capital adequacy ratio	89.3%	75.5%	63.5%	51.8%	44.7%	42.3%



TPC Assessment

6 Notes to the projections

1. The Operating expense ratio is based on current levels and is projected based on changes in overall productivity and growth in staff, branches and portfolio.
2. Estimated external borrowings are subject strictly to performance based on the findings of this microfinance capacity assessment (credit rating).
3. Number of active loan accounts relative to membership is based on the current and historical relationship and projected growth trends.
4. Average loan size to members increases by 10-15% every year.
5. Net group level savings/member increases at the rate of 5-10% per year and it is conservatively assumed that per member low interest bearing saving deposits and high interest bearing saving deposits remain equal.
6. Repayment from members is taken based on assuming that for each of the first four months of every year, 5% of annual disbursement takes place; disbursement for the remaining eight months is 10% of annual disbursements. Repayments are calculated after factoring in the loans outstanding of last year and the repayment rate for the current year.
7. Interest income is taken as [yield on portfolio*average portfolio for the year]. Yield movements are projected to increase over time to levels closer to the effective interest rate of the organisation. For TPC the yield remains same for the next five years.
8. Other income is the income that the organisation earns on investments and registration and fee income and increases by 10-12% every year.
9. Disbursements are taken as the [number of loans disbursed during the year*average loan size to borrowers].
10. Estimates on growth in outreach and demand for loans from the organisation have been made based on current growth levels and future expansion potential and capacity. Increase in members is taken at rates between 10-25% per year.
11. Repayments to lenders ranges from 25-50% of last year-end's outstanding debt depending on the expected source of funds and the present and future expected liability structure.
12. Interest paid is taken as the [average cost of external funds * the average external borrowing liability figure].
13. Fixed assets purchase is estimated based on likely requirements of the organisation and is taken at levels between Riel 1.0-1.5 billion per year.
14. In the projections the net worth figure includes donations and equity, retained surpluses and current surplus.



M-CRIL's Microfinance Rating Symbols

M-CRIL Grade	Description
$\alpha+++$ alpha triple plus $\alpha++$ alpha double plus $\alpha+$ alpha single plus	Highest safety, excellent systems ➤ most highly recommended Highest safety, very good systems ➤ most highly recommended Very high safety, good systems ➤ highly recommended
α alpha $\alpha-$ alpha minus $\beta+$ beta plus β beta	High safety, good systems ➤ highly recommended Reasonable safety, good systems ➤ recommended Reasonable safety, reasonable systems ➤ recommended, needs monitoring Moderate safety, moderate systems ➤ acceptable, needs improvement to handle large volumes
$\beta-$ beta minus $\gamma+$ gamma plus γ gamma	Significant risk, poor to moderate systems ➤ acceptable only after improvement Substantial risk, poor systems ➤ needs considerable improvement Highest risk, poor systems ➤ not worth considering