MicroRating International

rating of Intean Poalroath Rongroeurng Ltd. (IPR)

Intean Poalroath Rongroeurng Ltd

Phnom Penh, Cambodia

Limited Company licensed as an MFI

September 2008

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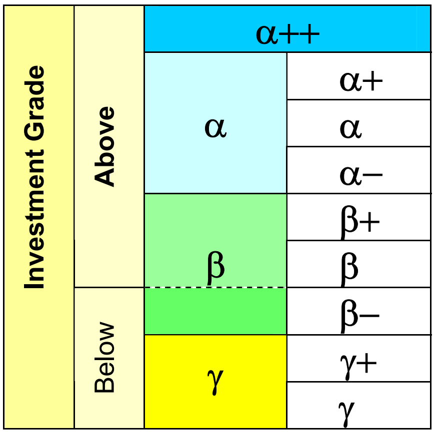
CREDIT RATING	β+
RATING OUTLOOK*	*positive*

*M-CRIL's viewpoint (positive, neutral or negative) of the future prospects of the organisation

Date of visit 17-19 September **2008**



Main Performance Indicators

	Dec-07	Sep-08
Gross portfolio (US$ mn)	1.75	3.74
Number of active borrowers	3,016	4,268
ROA	10.9%	10.8%
Portfolio yield	32.9%	35.9%
Portfolio at Risk> 60 days	0.58%	0.13%
Operating expense ratio	14.7%	16.8%
Average loan disbursed(US$)	691	822
Average loan o/s (US$)	582	876
Borrowers per field staff	232	171

Note: Figures for Sept. 08 are annualised

Synopsis

Intean Poalroath Rongroeurng Ltd (IPR Ltd) is a limited liability company established in August 2005 with its head office in Phnom Penh. It has performed moderately on management parameters and reasonably well on financial parameters. It has good portfolio quality despite a huge growth in portfolio. It has earned healthy profits since the beginning and has excellent capital adequacy which will allow it to leverage funds.

The Board of IPR has limited experience in microfinance except the General Manager (GM) and a weak second line of leadership. The staff is committed but requires significant training. The internal control and audit mechanisms are moderate. The organization is also exposed to high exchange risk as it borrows US dollars and disburses loans in three different currencies, Khmer Riel (26%), Thai Baht (19%) and US$ (54%). The future performance of IPR in a highly competitive microfinance market will largely depend on its ability to mobilise adequate on-lending funds.

A rating update after one year is suggested to ascertain changes in the creditworthiness of the institution. This rating is valid, subject to reasonable inflows of loan funds into the organisation and to no other significant changes in the organisational structure and external operating environment.

Highlights

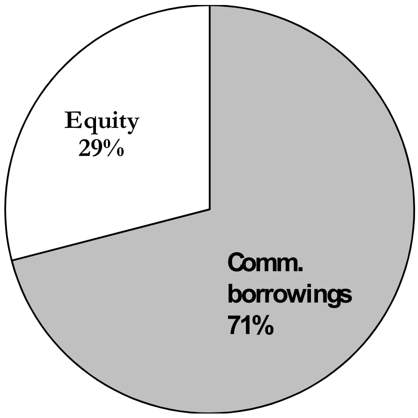
Positive

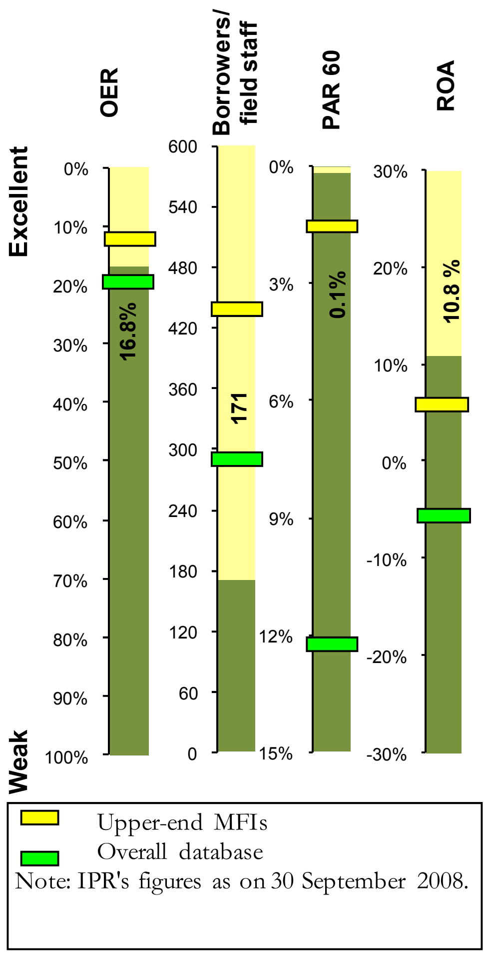
- High growth in portfolio
- Excellent portfolio quality
- Healthy capital adequacy
- Good performance on profitability and sustainability

Negative

- Limited experience of Board in microfinance
- Weak second line of leadership and staff quality
- High competition
- Moderate internal control and audit mechanisms
- Limited sources of funds
- Foreign exchange risk

Sources of Funding





Comparison of IPR performance with MFIs rated by M-CRIL

Rating Rationale

High growth in portfolio: IPR's portfolio has grown by 113% in the first nine months of the current financial year.

Excellent portfolio quality: The MFI has an excellent portfolio quality with PAR_{60} of 0.13% in September 2008 despite the high growth in portfolio.

Healthy capital adequacy: IPR has maintained a healthy capital adequacy position. Though it has declined over the last financial year, it was at 30.2% on 30 September 2008. This allows the organization to leverage loan funds.

Good performance on profitability and sustainability: IPR has sound financial performance with ROA of 10.8% and OSS of 155.6%. The operating efficiency has decreased slightly but was comfortable at 16.8% as on 30 September 2008.

Limited experience of Board in microfinance: All the Board members except the GM are either businessmen or rice millers and have no prior experience of microfinance. Hence their capability to provide strategic inputs is limited.

Weak second line of leadership: The second line of leadership is weak with the GM being in-charge of the organization. Since IPR recently reorganised its structure, most of the unit heads are new in the current positions and require time to acquaint themselves completely with their new responsibilities.

High degree of competition: The high degree of competition from other big MFIs operating in its operational area may force IPR to reduce interest rates in future, thus lowering profitability.

Moderate internal controls: The control systems at the field level are moderate. The frequency of field visits made by the BM is quite low. The Operations Manager is new and is still getting acquainted with the overall credit policy. The scope of the internal audit is limited to compliance on operational matters and it does not include financial and credit risk.

Weak performance on fund mobilisation: The future performance of IPR depends on its ability to mobilise external funds from various sources. This is otherwise limited to the Rural Development Bank of Cambodia and a couple of local investors. The organisation will need to mobilise both loans and equity from other sources.

Exposure to foreign exchange risk: IPR borrows in US$ and disburses loans to its clients in three different currencies, Khmer Riel (26%), Thai Baht (19%) and US$ (54%) and hence is exposed to a high degree of exchange risk.

Comparative Performance Highlights

Rating Grades

Category	September 2008
Governance & strategic positioning	β–
Organisation & Management	β+
Financial performance	β+
Overall	β+

Select indicators/ratios

Indicator/ratio	September 2008
1 Growth	
Loans outstanding (US$ mn)	3.74
Outstanding borrowings (US$ mn)	2.82
Active borrowers	4,268
Average loan size o/s (US$)	876
Number of loans disbursed during the period	5,751
Average amount disbursed during the period	822
2 Credit performance	
Portfolio at risk (>=30 days)	0.27%
Portfolio at risk (>=60 days)	0.13%
3 Efficiency and profitability	
Active clients per field staff	171
Active clients per staff	78
Net loans to total assets	91.9%
Operating expense ratio*	16.8%
Annual return on assets*	10.8%
Operating self-sufficiency	155.6%
Capital adequacy ratio	30.2%

Note: *Annualised figures

Country overview

Cambodia is a Southeast Asian country, bordering the Gulf of Thailand. The country has a history of invasions, wars and political unrest. After it gained independence from the French in 1953, the communist Khmer Rouge forces captured power in 1975. At least 1.5 million persons were either executed or killed due to forced labour during the Khmer Rouge regime. In 1978, the Cambodian army together with the Vietnamese army attempted to overthrow the Khmer Rouge, which started a 13-year period of civil war. The Paris Peace Accord in 1991 brought about the establishment of a democratically elected coalition government in 1998. Elections were again held in 2003, leading to the establishment of another coalition government in 2004.

In 1999, the first full year of peace in 30 years, the government made progress on economic reforms. From 2001 to 2004, the economy grew at an average rate of 6.4%, driven largely by an expansion in the garment sector and tourism. In 2005, exploitable oil and natural gas deposits were found beneath Cambodia's territorial waters, representing a new revenue stream for the government once commercial extraction begins in the coming years. However, the long-term development of the economy remains a daunting challenge. The Cambodian government continues to work with bilateral and multilateral donors, including the World Bank and IMF, to address the country's many pressing needs. The major economic challenge for Cambodia over the next decade will be fashioning an economic environment in which the private sector can create enough jobs to handle Cambodia's demographic imbalance. The population lacks education and productive skills with 74% still fully engaged in subsistence farming. However, in terms of the contribution of different sectors to GDP, agriculture contributes only 35%. Today, Cambodia is one of the poorest countries in the region: 36% of its 13.8 million citizens live below the national poverty line and 20% of the households are headed by a woman. Further, a weak social infrastructure – evident in the United Nations Development Programme's (UNDP) Human Development Index rank of 130 (out of 175) in 2003 – has meant that gender inequality, rural-urban regional disparities and poor health facilities continue to be significant hindrances to development.

The financial and banking sector were destroyed by the Khmer Rouge regime, which abolished money for a number of years. In the 1990s, Cambodia's banking sector went from a system limited to a single public bank to a two-tiered public banking system that separated the functions of the Central Bank from the Commercial Banks. The Royal Government of Cambodia (RGC) introduced banking regulations in 1999 and bank-restructuring programmes in 2000 and, as a result, a number of non-viable banks were liquidated. Today 17 banks remain in operation, including one state owned bank, three foreign bank branches, 10 local banks and three specialized banks (one of which is state owned). The government has liberalized interest rates, established reserve requirements, capped total exposure allowed to any one individual or client, and capped bank positions in foreign currency as a percent of the bank's net worth. However, with one exception – ACLEDA Bank – these banks are highly liquid, conservative and serve a narrow elite clientele.

Cambodia's financial sector is still at a rudimentary stage: the number of commercial banks is limited and effectively non-existent outside the capital city. With the exception of ACLEDA Bank (commercial bank) and the RDB (specialized bank) formal banks do not yet serve the poor. In this context, microfinance operators and the informal financial sector have been the de facto providers of financial services in rural areas. Currently there are at least 100 registered and unregistered lending bodies serving the rural population in Cambodia, including 16 licensed Microfinance Institutions (MFIs) and 24 registered rural credit operators. The main nine players in the microfinance market in Cambodia serve over 95% of the formal sector market.

National Bank of Cambodia (NBC) is responsible for regulating and supervising microfinance in Cambodia. The NBC has the authority to regulate, supervise, license and revoke licenses of MFIs, to issue prudential regulations and strengthen supervisory capacity.

Registration or licensing by NBC of microfinance providers is compulsory when operators meet one or more of the following conditions:

If engaged in	Registration by NBC	Licensing by NBC
Credit	Loan portfolio >= KHR 100 million (USD 25,000)	Loan portfolio >= KHR 1,000 million (USD 250,000) or >= 1,000 borrowers
Savings	Voluntary savings: >= KHR 1 million (USD 250) or >= 100 depositors	Voluntary savings >= KHR 100 million (USD 25,000) or >= 1,000 depositors

MFIs are required to be incorporated as limited liability companies or as cooperatives and require a minimum registered capital of approx US$62,500.

Microfinance operations

Main Indicators	31 Dec-2005	31 Dec-2006	31 Dec-2007	30 Sept-2008
Gross loan portfolio (US$ mn)	0.62	1.66	1.75	3.74
Active Borrowers	2,488	2,749	3,016	4,268
Branches	4	4	4	6
Asset Quality				
Portfolio at Risk (>60 days)/Gross Loan Portfolio	1.57%	0.52%	0.58%	0.13%
Loan Loss Reserve/Average Gross Portfolio	0.0%	0.51%	0.58%	0.23%
Efficiency and Productivity				
Operating Expenses/Avg. Gross Loan Portfolio	13.0%	12.8%	14.7%	16.8%
Cost per Borrower (US$)	44	57	91	86
Average Outstanding Loan size (US$)	248	605	582	876
Number of Borrowers/Total field staff	178	183	232	171
Number of Borrowers/Total staff	104	83	89	78

Exchange rates: 1US$ = KHR4,127 (2003); 1US$ = KHR4,035 (2004), 1US$ = KHR4,112 (2005), 1US$ = KHR4,057 (2006), 1US$ = KHR4,003 (2007)

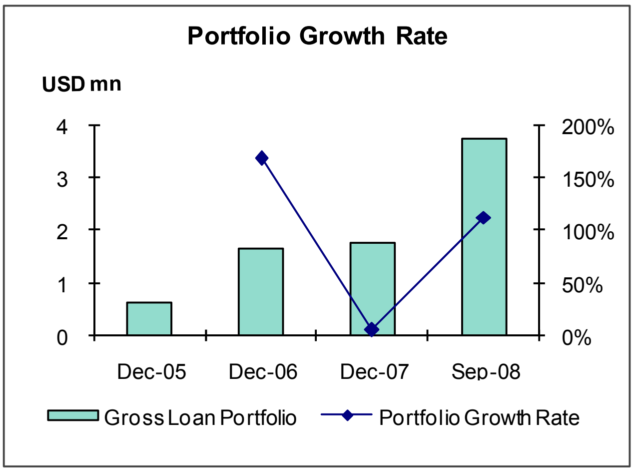
Intean Poalroath Rongroeurng Ltd (IPR) is the outcome of technological and capital constraints faced by the Federation of Cambodian Rice Millers Associations (FCRMA). The members of FCRMA were finding it difficult to export their milled rice to overseas markets as they were unable to meet international specifications for rice due to capital constraints. To overcome these constraints, IPR was created as a credit unit under the umbrella of the association by Mr Phou Puy and Mrs Hao Simorn in 2002.

In January 2005, the credit unit was registered with the National Bank of Cambodia (NBC) as a rural credit operator. As the volume of business increased, the unit was transformed into a private limited company, under the Ministry of Commerce in July 2005, with prior permission from FCRMA. Later, in August 2005, the company was granted an MFI licence by NBC. The company has its Head Office in Phnom Penh, the capital city of Cambodia. The two promoters (mentioned above) are the only shareholders of the company with 55% (Mr Phou Puy) and 45% (Mrs Hao Simorn) of the shares.

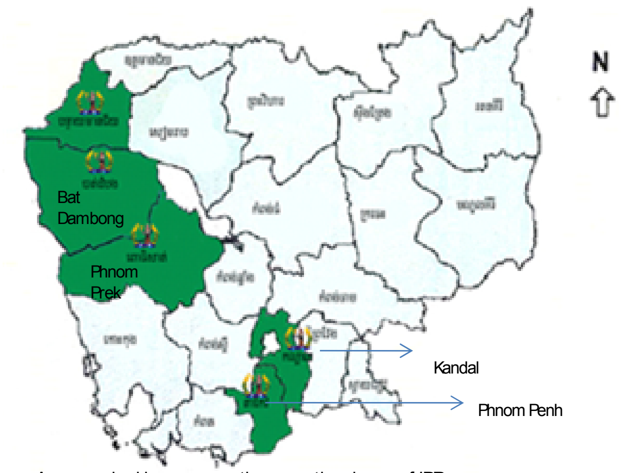
Unlike many other MFIs in Cambodia, IPR serves the lower economic segments. Initially, credit was provided only to the members (rice millers) of FCRMA. Later, since July 2005, the focus has been on poor farmers of the rural areas. The loan was disbursed in cash and in kind (seeds and fertilizers). However, since 2007onwards, only cash loans have been given and in three currencies: US dollar, Khmer riel (local currency) and Thai baht.

IPR operates through a network of six branches located in six provinces, namely Kandal, Takeo, Pursat, Battambong, Kampong Chhnang and Phnom Prek. Two of its branches are located in Battambong province while each of the other provinces has one branch covering more than one district. Kandal branch, located at the HO, is the oldest. IPR's operations covered 245 villages spread across 19 districts of five provinces on 30 September 2008.

IPR has four units: operations, finance, human resource (HR) & administration and. internal audit. Internal audit was formed in early 2006 and the administration & human resource unit was set up in January 2008. IPR is led by a General Manager (GM), who is assisted by the heads of the four departments. The head of finance is assisted by an accountant, a cashier and an MIS manager. At the branch level, the operations are led by Branch Manager (BM). The BM is supported by a Branch Assistant (BA) and 4-5 Credit Officers (COs). BA is responsible for handling cash as well as the MIS at the branch office. The COs are responsible for generating loan proposals, loan disbursement and collections. BM supervises the activities of COs as well as the BAs and manages cash.



In the last three years of operations, IPR's portfolio has grown almost 6 times from US$0.6 million in December 2005 to US$3.7 million on 30 September 2008 (as shown in the figure above). Portfolio growth slowed in 2007 as the company was in the process of setting up systems and procedures and on account of lack of funds. It had a total borrower base of 4,268 on 30 September 2008.



Areas marked in green are the operational area of IPR

Microfinance policies

IPR follows the individual lending methodology. It can extend loans to farmers (mainly rice growers) as well as micro-entrepreneurs, who have their own house. Almost all of its clients are farmers. All loans are collateralised and the loan size cannot be more than 35% of the market value of the collateral. Collateral consists of only immovable properties of the clients. The clients are also required to submit the original certificate of property ownership issued by the commune authority along with their identity card. IPR usually opens one branch in each province (except in Battambong province which has two branches).

Since the CO is responsible for generating loan proposals, he/she visits the prospective clients in the area assigned by the BM. The CO promotes the MF programme of IPR and fills the survey and appraisal forms which are then given to the BM along with all the necessary documents (ID card, certificate of property ownership). The BM checks the authenticity of the documents. Collateral is evaluated by the CO and then discussed with the BM who physically verifies collateral for loans above $1,000. If satisfied, the BM recommends the loan by filling the loan approval form. BM approves all loans less than $10,000 and for larger loans is approved by the loan approval committee, which consists of one member of BOD, GM and Operations Manager. Thereafter, the loan agreement/contract is prepared and signed by the client as well as the village/commune authority. The organization also requires a mortgage agreement for loans above US$10,000. However, the organization has not disbursed any loans above US$10,000 so far.

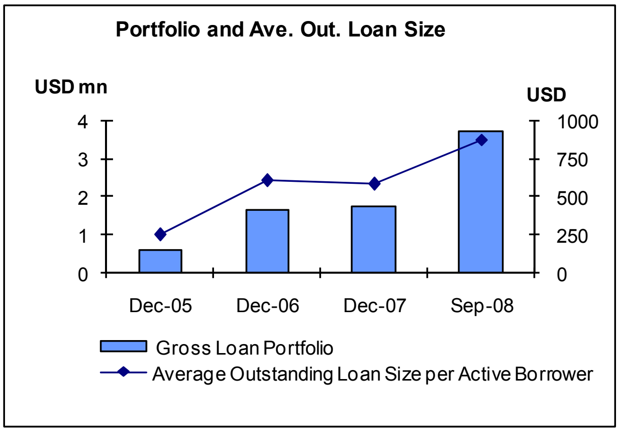
The loan amount is disbursed by the CO in cash at the client's home. For loan amounts greater than US$1,000 the BM & BA accompany the CO to the client's place for disbursement. For loan repayment, usually the CO visits the clients and collects payment. As per the credit policy, interest is collected first and principal is collected only at the end of the loan agreement. The client has three options in which to repay interest: monthly, 50% of the interest upfront and the rest paid either at mid-term or at the end of the contract. In case of overdues, the organization charges double the interest on the overdue amount from the day of overdue till the actual date of payment as penalty.

Loan products

The organization offers the following loan products to its clients:

Loan product	Purpose	Tenure	Loan size	Interest
Working capital loan	Agriculture and allied activities	1-12 months	<US$10,000	3%-3.5%
Investment loan	Agricultural equipment & assets	12 months to 24 months	>US$10,000	2%-3%

IPR charges 1% of the loan amount as loan commission fee for loan amount equal to or above $10,000. The purpose of the collateral is only to create pressure on clients since it cannot be forfeited and sold without court permission. Advance payment and foreclosure is allowed without penalty.



Saving products

IPR can mobilise savings from its members but does not have proper systems in place to do so. Consequently, it does not offer the savings product at present. As per NBC norms, IPR would also be allowed to mobilise savings from the public once it fulfils the minimum equity requirement of US$2.5 million.

Governance and strategic positioning

IPR has relatively weak performance on governance with a rating grade of β–. The Board members (barring Mr Hort Bunsong) are either businessmen or rice millers and their microfinance experience is limited to their association with IPR. The second line of leadership is also weak. IPR has performed moderately in mobilising funds from other financial institutions. High competitive pressure may force the MFI to lower interest rates in future, affecting profitability.

Governance structure

IPR has seven members on the Board including the two promoters. Most of the members are either businessmen or rice millers with no prior experience of microfinance. Mr Hort Bunsong, the GM is the most active Board member and is responsible for day to day functioning of the company and has been associated with the organization since inception. However, his experience in microfinance is also limited to his association with IPR.

The Board is required to meet twice in a year. The last Board meeting was held in December 2007. The Board has a Credit Committee and an Audit and Risk Committee. These committees assist the Board in policy issues with respect to credit risk, internal audit and overall operations of the company. The internal auditor reports directly to the Audit and Risk Committee. The GM updates the Board members on the progress of IPR's performance from time to time. In view of the growth of operations, the Board of IPR needs to be strengthened by inducting qualified and experienced professionals with diverse expertise to provide strategic inputs.

The management realises the lack of adequate MF experience on the Board and plans to restructure it by early 2009. However, appropriate people have not been identified yet. IPR also expects to have representatives of its potential investors on the Board.

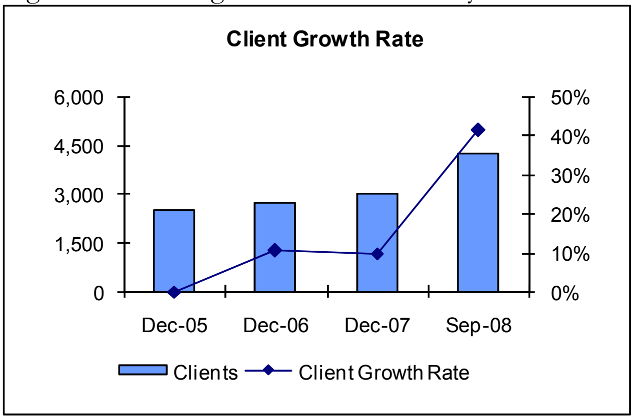
Operational and growth strategy

The organization will continue to follow the present operational/lending methodology. In order to increase organizational efficiency it is planning to hire a microfinance consultancy firm for advisory services and training of the staff on microfinance issues. However, no such agency had been identified at the time of the rating visit. It has plans to hire qualified and experienced professionals for its microfinance operations subject to the availability of funds and expansion.

In terms of expansion, IPR plans to open a new branch in Prey Veng province by mid-2009. However, in the long run it has plans to expand to other parts of Cambodia subject to the availability of funds. The organization is in the process of devising a new business plan for the next financial year as it has already over-achieved its plans for the current year.

IPR has hired a software professional to develop loan management software and is expected to install the software in all the branches by early 2009. The organization also plans to infuse an additional US$3 million as equity in the current financial year to fund its growth and expansion. The promoters of the company have committed additional $1 million equity by the end of the current financial year.

The number of borrowers has increased from 3,016 on 31 December 2007 to 4,268 on 30 September 2008, a growth rate of 55.3% (annualised). The high growth in client base (illustrated in the table below) is primarily because of the two new branches opened by the organization during the current financial year.



Fund mobilisation

IPR has a very limited lender base with only one institutional lender. Rural Development Bank (RDB) has been its source of funds since 2004. In its effort to widen its base, IPR received a loan from an individual, Mrs Ing Nungpin, a businesswoman in December 2007. However, to tide over the funds crisis and meet the clients' demand, IPR also obtained a loan from one of its Board members, Mr Veng Nandy, in March 2008. In the first nine months of the current year, IPR has obtained $0.4 million loan funds from RDB and received $1.2 million from Mr Veng and $0.4 million from Mrs Ing. The following table displays the borrowing details on 31 September 2008.

million $

Lender	Amount disbursed (till date)	Outstanding 30 Sept-08	Total interest rate
Rural Devt Bank	5.2	1.4	9.0%
Mrs. Ing Nungpin	1.0	0.25	14.2%
Mr. Meng Vandy	1.17	1.17	10.0%
Total	**7.37**	**2.82**	

In Cambodia, it is difficult to borrow from local financial institutions/banks. The local banks in Cambodia require huge collateral and as most of the MFIs have graduated from NGOs, they have limited resources to meet the collateral requirements of the commercial banks. Besides, the local banks focus on real estate and hence do not like to lend to MFIs. As a result, the MFIs are forced to explore sources like individuals and international lenders. However, borrowing from individuals is not a regular source of funds and loans from international banks are exposed to exchange risk.

To fund its growth plans, IPR is actively scouting for loans as well as equity. It has approached Incofin (Belgium), Planis (France), Seram Bank (South Korea), Emerging Market Consulting (USA) and Developing World Markets (USA) for funds. Seram Bank has shown interest in making an equity investment of $2 million. Though the regulations in the country require domestic investors to have a minimum 51% share in capital, IPR plans to retain at least 60% ownership. Consequently, subsequent to investment by foreign banks and institutions, funds would be infused by the Board.

Competition

The microfinance sector in Cambodia is quite competitive as there are many other MFIs operating there. Some of the major MFIs operating in Cambodia ACLEDA Bank, PRASAC and AMK are present in the operational area of IPR. Most of the other MFIs have many years of experience and pose stiff competition to IPR which has been operating for four years. Additionally it charges higher interest rates than its competitors to the same segment of clients. However, to deal with this, it has adopted a differential interest rate strategy in different provinces. IPR has a competitive edge in terms of flexibility in repayment of 50% of interest at the middle of the term or at the end of the term and the principal amount at the end of the term. Other MFIs require quarterly principal repayment which makes it difficult for clients to repay from their seasonal agricultural income.

Second line of leadership

The second line of leadership needs to be developed at IPR. The GM who is in-charge of the organization is a management professional with more than five years of experience in microfinance. He has developed a good understanding of the sector and is well versed in the issues facing the organization. Since IPR recently reorganised its organisational structure, most of the unit heads are new in their capacity. Consequently, they lack requisite experience.

The head of the operations unit joined IPR in March 2008 without any prior experience of microfinance and is still in the process of becoming acquainted with the credit policy of the organization. The head of the finance unit is a graduate in banking and finance with 5 years of experience in accounts and finance. She has been associated with the organization since October 2005. The head HR and Administration was responsible for internal audit till December 2007. The head of internal audit has been with IPR since 2003 but his capacity with respect to this function is limited.

Organisation and management

IPR has reasonable management performance with a grade of β+. This is primarily on account of inadequate internal control and audit, committed but moderate staff quality, reasonable MIS and accounting policies. However, it has standardised operations and well documented policies.

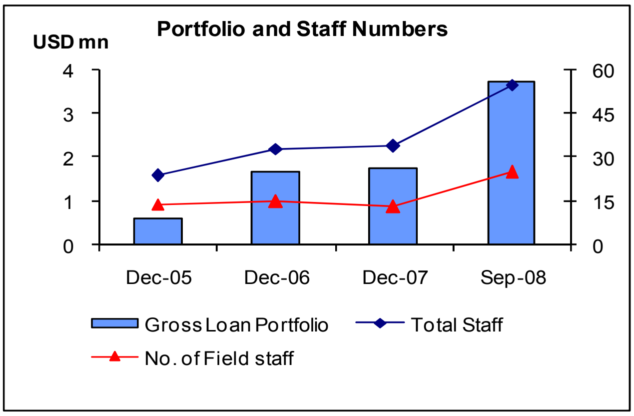
Human resource quality & management

IPR has total staff strength of 55 as on 30 September 2008. The HO staff is qualified but lacks requisite microfinance experience. The field staff, especially the COs have shown a high level of commitment but requires training with regard to loan appraisal and cash flow analysis. However, the staffs are well aware of the process and procedures of microfinance.

The HR and Administration department at IPR was created in January 2008. The recruitment of staff is entirely need based. For field staff, the process starts with the announcement of vacancies in the universities of the province followed by written test and personal interviews. These are conducted by a panel comprised of the Operations Manager, BM and HR manager. For unit heads at HO, the interview panel consists of two Board members and GM. The recruitment of HO staff is done internally through referrals from existing employees. For HO staff, experienced people with requisite skills are preferred. All the recruits join on probation for three months and are given a week's in-house and on-the-job training.

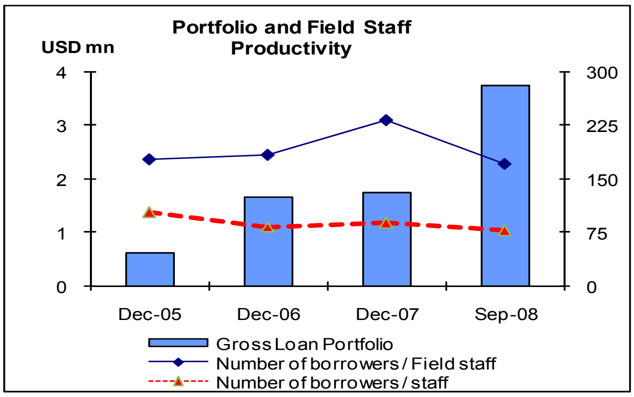
At the CO level, the training is need based and is primarily imparted by the BM. IPR plans to have regular in-house training programmes for its entire staff. The HO staffs, BMs and BAs are sent for external training organised by the Cambodian Microfinance Association (CMA). To develop its staff capacity, the company plans to hire an external agency to identify the weakness the human resource in IPR, assess its needs and provide training.

Staff salaries are mostly fixed with no incentive structures. However, the staffs are entitled to half yearly bonus, which is 25% of the basic salary. Staff salaries are low and are not at par with other MFIs. Due to the low salary structure, the organization is finding it difficult to hire qualified and experienced staff. However, it plans to bring the existing salary at par with other MFIs. Performance appraisal is done annually. As reported, staff attrition is low at present. The growth in total staff has been commensurate with growth in portfolio (see figure below). In order to support its expansion plans, IPR hired 21 staff in the nine months of the current year, mostly field staff. Consequently, the field staff to total staff ratio increased from 38% in December 2007 to 45% in September 2008. Despite this increase, it is much lower than the other MFIs who generally have this ratio in the range, 70-75%.



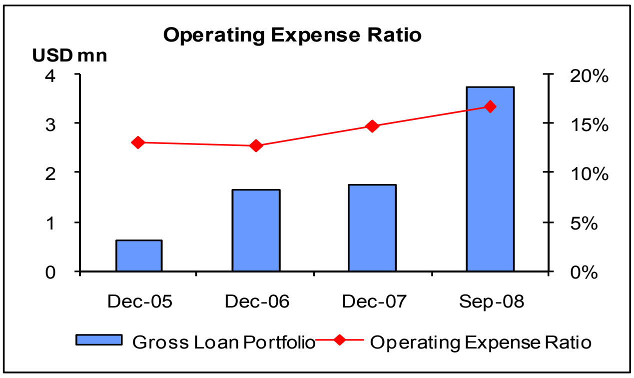
Staff productivity

Staff productivity at IPR is reasonable and has declined from 232 borrowers per field staff on 31 December 2007 to 171 in September 2008. The decline is primarily because of the increase in the number of field staff from 13 in December 2007 to 25 in September 2008, where as the number of borrowers has not increased in the same proportion during this period. A declining trend can be seen in total staff productivity (in the figure below) and is quite low at 78 borrowers per staff due to the low field staff to total staff ratio. As the operations of IPR are geographically scattered, the COs have to travel long distances, which results in high cost and considerable time spent on travelling. This reduces CO productivity.



Operating efficiency

The operating efficiency of IPR has decreased from 14.7% for 2007 to 16.8% (annualised) as on 30 September 2008, despite the high growth in portfolio. The decline in operating efficiency is primarily because of a huge loss incurred on exchange rate as compared to the gains of the last two financial years. Besides, travel expenses have also increased by 63.8% due to the opening of two new branches in the current year.



Accounting and MIS

The accounting systems and policies of IPR are good. It uses an accounting software called' Quick Book' (widely used across Cambodia). The branch sends loan disbursement, loan repayment and expense vouchers along with the summary sheet (having figures in three currencies) on a weekly basis to the accounts department. The finance unit at the HO verifies the vouchers and prepares branch wise weekly receipt and payments accounts. Thereafter, entries are made in the accounting software. Once the entries are posted, the transaction number is written against each one in the summary sheet, which makes it easier to track it later. It also prepares branch wise loan portfolio reports at the end of every week and ensures that the figures in Quick Book match the summary report.

The accounts are maintained in US dollars. IPR follows accrual accounting both for income and expenses. Depreciation is calculated on the straight line method. Since the organization is exposed to high degree of foreign exchange risk, it does not create any provision for the same and has no hedging arrangement. Provisional financial statements are prepared monthly while audited financial statements are prepared annually with a lag of 5 months. IPR does monthly reporting to NBC (central bank). As per these norms, IPR being a limited liability company is required to maintain 5% of its net worth as interest bearing statutory deposits with NBC.

For the loan loss reserve, IPR follows the NPA and investment provisioning norms of NBC, which classifies NPAs into different categories as follows:

NPA Category	Overdue duration (Working capital loan <US$10,000)	Overdue duration (Investment loan>US$10,000)	Reserve
Standard	1-30 days	1-30 days	0%
Sub Stdd	31-60 days	31-180 days	10%
Doubtful	61-90 days	181-360 days	30%
Loss	>91 days	>361 days	100%

The MIS at IPR is reasonable; however some discrepancy in the vouchers was observed during the branch visit. Currently MIS is manual; however a loan management (LMS) software has been under development for three months. LMS is expected to be ready for use by the end of 2008. The new software is being developed by a local programmer who lacks experience of developing software for microfinance. However, IPR has engaged this programmer after testing.

The software will be installed in HO and all the branches. LMS does not have the savings module but has the flexibility to add more features to its loan product module. In view of IPR's plans to mobilise deposits when it has fulfilled the minimum capital requirement, it will have to develop separate software for savings or upgrade the new software which will translate into additional time and money.

The disbursement and a copy of the reimbursement voucher received from the branches is the basis of the MIS. The entire information from the branches is consolidated at the HO along with client wise recovery details separately for the monthly interest and advance interest options. This report is prepared separately for different currencies. Thereafter, various customised reports are prepared when required by the management.

Tracking system for overdues

The tracking system for overdues is reasonable. At the branch level, the list of overdues is prepared monthly. The follow up process starts immediately when the loan becomes overdue. The BM visits the client's house along with the respective CO and tries to find out the reasons for non-payment. Some flexibility is allowed to the client if she agrees to repay the overdue amount on a later date, and such loan is not included in the overdue report. This is not a good practice as it does not reflect the true portfolio quality and PAR would be higher than is actually reported by the branches if these overdues were included. In case of wilful default, the village chief/commune authority assists the BM and CO in collection.

Internal control systems and audit

The internal control system at IPR is moderate. There is a good reporting structure at each level of the organization. The roles and responsibilities of staff at each level are clearly defined. However, the quality of the internal control in the field is moderate. The frequency of field visits made by the BM is quite low at 3-4 days in a month. This is mostly for the collection of overdues and verification of clients with loan size greater than US$1,000. The BM rarely makes any surprise visit to keep a check on the credit officers. Considering weak staff capacity at the field level and excessive reliance on COs for appraisal and evaluation of collateral, only a few field visits by the BM weakens the internal control mechanism and poses a risk to the portfolio. The Operations Manager being recently inducted in the organisation has also not made adequate branch visits.

The quality of internal audit at IPR is moderate with only one person involved in this critical function. The head of internal audit has been with the company for the last 5 years; initially as a CO and later as MIS officer. The internal audit functions under the direct supervision of the Audit & Risk sub-committee of the Board. The scope of audit is skewed towards compliance with financial and operational procedures and does not adequately focus on credit risk. Since the establishment of the internal audit unit in September 2006, each branch has been audited 3 times. The frequency of internal audit is quite low considering the small size of operations (6 branches) of IPR.

A branch is effectively audited for 3 days. The internal auditor spends 2 days at the branch office and 1 day in the field visiting clients at random. At the branch office, 15%-20% of records including the loan documents are checked; however the authenticity of the property ownership certificate is not verified with the village chief/commune authority. Client visits cover 5%-10% of the total and business viability of the client as well as correctness of appraisal done by the CO is assessed, in addition to the documents of the clients. However, the quality of such assessment is moderate. At the end, a draft report is prepared and submitted to the BM for his feedback. Later, a final report is prepared and submitted to the Audit Committee.

Financial planning and cash management

The financial planning system at IPR is reasonable to good. For the first time in 2008, a five year business plan was prepared with inputs from the branches. On the basis of discussion with various unit heads, financial projections are prepared for the whole organization with monthly disaggregation. The projections are prepared considering the return on equity required by the Board of Directors. However, IPR now has to revise its business plan as it has already surpassed its targets for this year.

Each branch sends in a monthly funds request on the basis of their expansion plan. Funds are transferred to the branches in consultation with the Operations Manager and GM. The first preference is given to the new branch followed by the branches which are in greater need of funds. For repayment to lenders, the Finance Manager prepares the expected recovery for all branches and informs the branch offices about the funds they need to remit to HO a month in advance. This helps the branches to disburse accordingly. As reported, IPR has not defaulted on any loan repayment.

Each branch as well as HO has a separate bank account with ACLEDA Bank. The funds are transferred internally to the respective branch accounts. Repayments from clients are usually deposited in the bank account on the same day or the next morning depending upon the situation. For large amounts, the BM is responsible for depositing cash in the bank or else the BA goes along with the CO for the purpose. There is no minimum or maximum limit for cash balances and no penalty is imposed for high balances. The organization does not have any cash insurance.

For cash withdrawal from the bank, there are two signatories at the HO as well as at the branches. For disbursement and repayment, the CO prepares disbursement and reimbursement vouchers (having serial numbers) with four copies one each for client and branch office and two for HO. At HO as well as in branches, the cash is kept in a one key safe and the keys are with the cashier. In branches the cashier is the BA. The average cash maintained at HO and the branch office are US$10,000 and US$2,000 respectively. Physical verification of cash is done on a weekly basis and cross checked with the cash book, both at the branches and HO, thereby enabling quick detection in case of fraud. No misappropriation of funds or fraud has been reported so far.

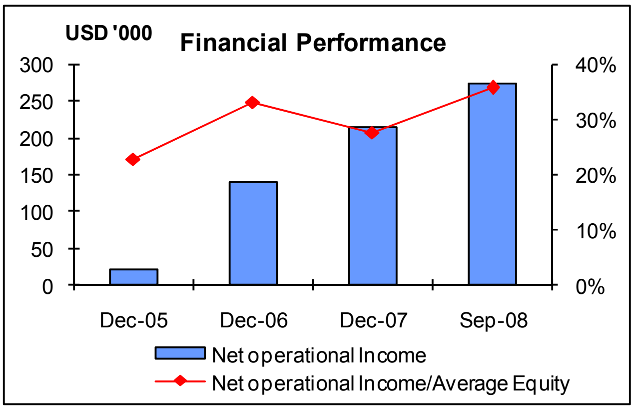
Quality of clients/member groups

The quality of the clients visited was good. The clients are well aware of the credit policy of the organization and are economically very active. They showed good performance on loan repayment and overall credit discipline.

Infrastructure

IPR has reasonable infrastructure for its operations. Fixed assets contribute around 4% of the total asset base as on 30 September 2008. Fixed assets mainly include, computers, office equipment and fixtures, vehicle, furniture and motorcycles for staff. The HO and four branches operate from rented premises.

Financial profile

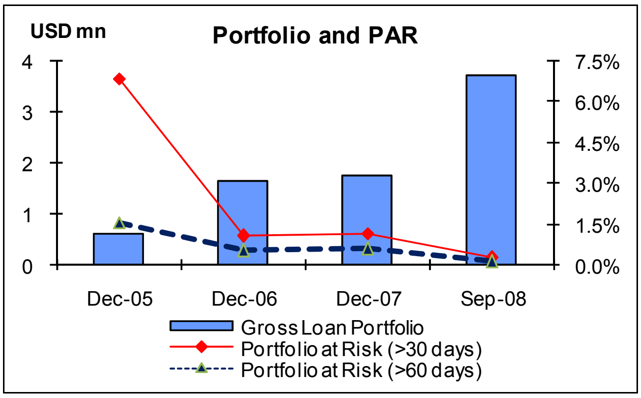


The financial performance of IPR is moderate with a rating grade of β+. This has resulted from healthy performance on profitability and sustainability. The organization has been making good profits since the beginning (see figure above). The yield has improved owing to improved portfolio quality. The operating efficiency has decreased slightly because of high exchange loss incurred by the organization. The OSS is well maintained and is at a comfortable stage even though it has declined over the past few years. The organization has maintained high ROA since the beginning. Besides, it has excellent capital adequacy. However, the performance has been restricted due to the absence of hedging arrangement against foreign exchange risk and limited lender base.

Financial Ratios	31 Dec-05	31 Dec-06	31 Dec-07	30 Sept-08
Capital Adequacy				
Risk Weighted Capital Adequacy ratio	22.9%	38.3%	48.1%	30.2%
Asset Quality				
Portfolio at Risk (>30 days)/ Gross Loan Portfolio	6.88%	1.08%	1.17%	0.27%
Portfolio at Risk (>60 days)/ Gross Loan Portfolio	1.57%	0.52%	0.58%	0.13%
Loan Loss Reserve/Portfolio at Risk	0.00%	97.25%	100.01%	173.34%
Loan Loss Provision Expense/Avg Gross Loan Portfolio	0.00%	0.85%	0.21%	0.15%
Management				
Operating Expenses/Average Gross Loan Portfolio	13.0%	12.8%	14.7%	16.8%
Number of Borrowers/Total field staff	178	183	232	171
Number of Borrowers/Total staff	104	83	89	78
Earnings				
Net operating income/Average Equity (ROE)	22.8%	33.1%	27.6%	35.8%
Net operating income/Average Assets (ROA)	3.1%	11.0%	10.9%	10.8%
Portfolio Yield	24.0%	31.6%	32.9%	35.9%
Financial Cost Ratio	10.2%	8.5%	6.8%	6.3%
Liquidity				
Cash & Liquid Assets/Total Current Assets	29.4%	15.0%	35.3%	3.5%
Cash & Liquid Assets/Total Assets	25.6%	13.9%	33.4%	3.3%

Credit performance and portfolio quality

The portfolio quality of IPR is good with PAR_{30} and PAR_{60} reported at 0.27% and 0.13% respectively as on 30 September 2008 as shown in the figure below. M-CRIL expects the PAR to be slightly higher than reported due to the lacunae in the reporting of overdues as explained earlier . However, the portfolio quality of the branches visited by the rating team was good.



IPR's portfolio is highly concentrated in agriculture, as the MFI lends only to farmers. This poses a significant degree of risk especially in view of the seasonal nature of agriculture, its dependence on rainfall and the absence of crop insurance in the country. The risk is compounded by the easy repayment feature of the company's loan products. To avoid this risk, IPR lends in the areas with high agriculture potential and good irrigation facilities with two-three crop cycles. IPR needs to diversify its portfolio to other sectors as has been done by other MFIs operating in the country.

Mobilisation of funds, equity & capital adequacy

IPR's limited lender base with RDB and two individual lenders has resulted in a total debt outstanding of $2.8 million on 30 September 2008 against $1.9 million on 31 December 2007, a significant increase of 48.5%. As indicated earlier, the financial institutions in Cambodia are not interested in lending to MFIs as they perceive it to be a risky proposition.

As per the NBC norms, the capital adequacy requirements for Limited Liability Companies have been revised from 20% to 15% in the current financial year. IPR's capital adequacy position has been excellent, even though it has declined over the past few years. The decline in the capital adequacy was primarily because of the significant increase in borrowings with no additional equity infusion.

Asset, liability & equity composition

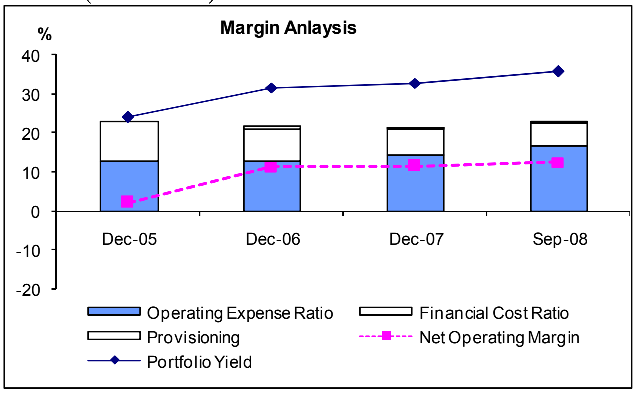
On 30 September 2008, the organization had deployed 92% of its total assets in loans, a high level. Its liquid assets were well maintained at 3% of the total and net fixed assets at 4%.

As on 30 September 2008, the total net worth accounted for 28.4% of the total assets, out of which equity capital accounted for 43.3% and reserves and surplus accounted for 56.7% of total net worth. Long term debt was 69.5% of the total assets on that date, a little higher than the 65.7% recorded at end 2007.

Profitability and sustainability

The organisation has performed extremely well on profitability and sustainability indicators. The yield on portfolio increased from 32.9% for 2007 to 35.9% (annualised) up to September 2008, primarily because of the improved portfolio quality. The financial cost ratio has marginally decreased from 6.8% for 2007 to 6.3% (annualised) for 2008, while the operating expense ratio increased from 14.7% to 16.8% (annualised) during the same period.

The Operational Self Sufficiency (OSS) was good at 155.3% for 2008, even though it has declined over the past few years. Return on Assets (RoA) and return on equity (RoE) are excellent at 10.8% (annualised) and 35.8% (annualised) for 2008.



IPR at present has no mechanism in place to hedge forex risk, which can substantially impact its profitability in the event of devaluation. To begin with, it can create an 'Exchange Risk Reserve Fund' with accretion from its annual surplus.

Future plans and prospects

IPR is a growing organization that has been operating for the last three years. IPR plans to continue focussing on expansion to increase its outreach in the near future. It has plans to open a branch in Prey Veng province by mid-2009 and another in high-potential Siem Reap province, a major tourist location on account of the Angkor Wat and other famous temples. In the long run it has plans to increase its outreach to other parts of Cambodia as well. The organization is in the process of devising a new business plan for the next financial year and is expected to be complete this by the end of October. For its expansion plan, IPR is making every effort to raise equity capital from foreign investors, in addition to the commitment by members of its Board. At the same time IPR is actively scouting for loan funds.

It is also planning to hire a microfinance consultancy firm for capacity building training of its staff (both management as well as field staff). For MIS, it has already hired a software professional to develop loan management software, which is expected to be installed by early 2009. In view of the present operations and the expansion plan, IPR has good prospects for the future.

Financial statements for IPR operations

Balance sheets (as on)

In USD

31-Dec-05	31-Dec-06	31-Dec-07		30-Sep-08
			Assets	
			Current assets	
301 580	297 106	964 582	Cash and bank	135 323
2 062	0	270	Interest receivable	103
25 100	25 100	25 100	Statutory deposits with NBC (central bank)	25 978
75 900	0	0	Staff loans	0
2 340	1 268	840	Other current assets	8 177
618 087	1 662 127	1 754 218	Gross loans outstanding	3 740 167
0	- 8 412	- 10 239	Loan loss reserve	- 8 741
618 087	1 653 715	1 743 979	Net loans outstanding	3 731 426
1 025 069	1 977 189	2 734 771	**Total current assets**	3 901 007
			Long term assets	
153 372	158 507	155 707	Net property and equipment	160 783
153 372	158 507	155 707	**Total long term assets**	160 783
1 178 441	**2 135 696**	**2 890 478**	**Total assets**	**4 061 790**
			Liabilities and Net worth	
			Current liabilities	
929	30 256	55 204	Expenses payable	84 350
0	38 016	53 935	Other current liabilities	782
929	68 272	109 139	**Total current liabilities**	85 132
			Long term liabilities	
0	1 400 000	1 400 000	Rural Development Bank of Cambodia	1 400 000
0	0	500 000	Individuals	1 422 000
1 000 000	1 400 000	1 900 000	**Total long term liabilities**	2 822 000
1 000 929	**1 468 272**	**2 009 139**	**Total liabilities**	**2 907 132**
			Net worth	
150 000	500 000	500 000	Share capital	500 000
7 252	27 512	167 424	Retained net surplus/(deficit)	381 339
20 260	139 912	213 915	Current net surplus/(deficit)	273 319
177 512	**667 424**	**881 339**	**Total net worth**	**1 154 658**
1 178 441	**2 135 696**	**2 890 478**	**Total liabilities and net worth**	**4 061 790**

Note: The financial statement for the financial year 2005 are a combined statement for IPR as a limited liability company since September 2005 and IPR as a rural credit operator from January to August 2005. (The financial Statement from January 2005 to August 2005 is unaudited.)

Income statements (for the year ending)

US dollars

31-Dec-05 (12 months)	31-Dec-06 (12 months)	31-Dec-07 (12 months)		30-Sep-08 (9 months)
			Income	
194 755	387 813	609 676	Interest on loan	782 972
8 668	765	2 783	Fee income	
11 595	50	0	Other income	457
0	1 456	3 603	Bank interest income	4 511
0	63 848	63 344	Foreign exchange gain	
215 018	**453 932**	**679 406**	**Total income**	**787 940**
			Financial costs	
86 435	104 350	127 625	Interest on borrowings	137 255
128 583	**349 582**	**551 781**	**Gross financial margin**	**650 685**
0	8 412	1 827	Provision for loan losses	(493}
0	2 062	2 000	Bad debts	3 697
128 583	**339 108**	**547 954**	**Net financial margin**	**647 481**
			Operating expenses	
26 178	62 198	135 949	Personnel expenses	131 520
6 648	10 724	15 432	Travel & Vehicle	25 275
5 000	19 000	19 000	Bank commission fees	10 422
1 712	12 250	12 113	Depreciation	12 135
0	5 580	4 000	Professional fees and training expenses	0
9 589	0	0	Exchange losses	101 563
61 340	47 710	87 359	Other administrative expenses	84 908
110 467	**157 462**	**273 853**	**Total operating expenses**	**365 823**
18 116	**181 646**	**274 101**	**Net surplus/(deficit)**	**281 658**
2 144	0	0	Non-operational income	0
	67	700	Non-operational expenses	0
18 116	**181 579**	**273 401**	**Profit before tax**	**281 658**
	41 667	**59 486**	**Tax expense/credit**	**8 339**
20 260	**139 912**	**213 915**	**Profit after tax**	**273 319**
			Reserves (deferred tax)	
20 260	**139 912**	**213 915**	**Current surplus/(deficit) transferred to balance sheet**	**273 319**

Note: For the financial year 2008, fee income is included in interest income

Notes to the financial statements

1. All loan portfolio income is recognised only when it is actually received (**cash basis**).
2. Financial costs (interest on borrowings, if any) and operating costs are calculated on an **accrual basis**.
3. Depreciation is calculated on a straight line method.
4. For loan loss provisioning and write-off, IPR follows the NBC guidelines as stipulated earlier in this report.
5. Assets and liabilities expressed in currencies other than US$ are converted into US$ at the rates of exchange quoted by NBC on the balance sheet date.

Glossary

1. Current repayment rate: Ratio of principal recovered (net of pre-payments) to the principal due for the last one year.
2. Portfolio at risk (PAR_{30}): Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 30 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. Net operating margin: Difference of (yield on portfolio+ yield on other income) and (financial cost ratio+ loan loss provisioning + interest loss provisioning) – also known as spread on portfolio
9. Average loan portfolio: This represents the average loan outstanding for the year computed on a monthly basis.
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 for the year. Adjustments have been made for subsidised cost of funds (w.r.t. 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
    M-CRIL Risk weights: 100% for all assets except the following: fixed assets & interest bearing deposits: 50%; cash 0%.
14. Return on assets: Ratio of operational income/(loss) to average total assets
15. Return on equity: Ratio of operational income/(loss) to average net worth

Abbreviations

AMK	Angkor Mikroheranhvatho (Kampuchea) Co Ltd
BM	Branch Manager
BA	Branch Assistant
BOD	Board of Director
CAR	Capital Adequacy Ratio
CEO	Chief Executive Officer
CO	Credit Officer
CMA	Cambodian Microfinance Association
EMI	Equated Monthly Instalment
FCR	Financial Cost Ratio
GM	General Manager
HO	Head Office
HR	Human Resource
IT	Information Technology
IPR	Intean Poalroath Rongroeurng Ltd
LLP	Loan Loss Provision
LLR	Loan Loss Reserve
M-CRIL	Micro-Credit Ratings International Ltd
MFI	Micro Finance Institutions
MIS	Management Information System
NBC	National Bank of Cambodia
NPA	Non Performing Assets
OER	Operating Expenses Ratio
OM	Operations Manager
OSS	Operational Self-Sufficiency
PAR_{30}	Portfolio at Risk (>=30 days)
RGC	Royal Government of Cambodia
RM	Regional Manager
ROA	Return on Assets
ROE	Return on Equity
RDB	Rural Development Bank