

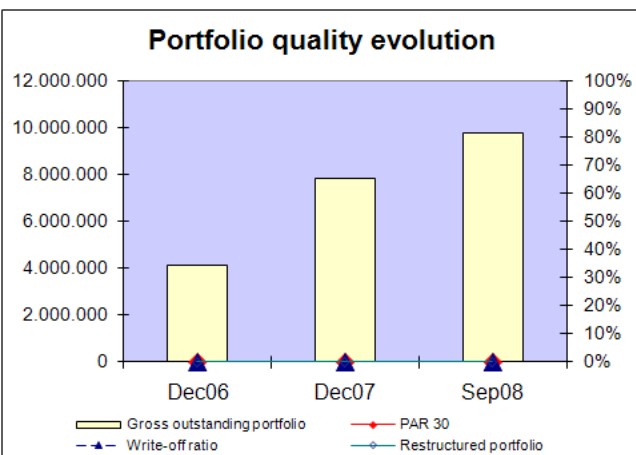
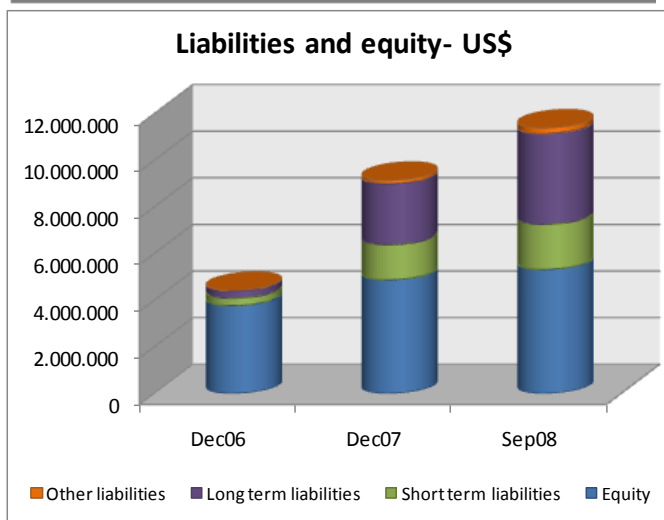
## Frontiers – Kyrgyzstan

<b>Final rating</b>	<b>BBB</b>
<b>2<sup>nd</sup> rating</b>	<i>Validity:</i> 1 year if no relevant changes in operations or within the operation context will happen. The final rating grade does not consider the political and economic context.
<b>Previous rating: BBB (July 2007)</b>	

Registered in July 2003 under the framework of the Central Asia (CA) MicroFinance Alliance (CAMFA) project, the Micro Lending Company (MLC) Frontiers begun its operation as pure second tier lending institution in the middle of 2004 with an initial capital of US\$ 3,4 M. In order to fulfill its mission, which consists in supporting the growth and expansion of the non-bank financial institution community in CA, Frontiers is at the moment providing lending services in three countries, namely Kyrgyzstan, Tajikistan and Kazakhstan. As of September 2008 the second tier MLC has 51 active clients and an outstanding portfolio worth about US\$ 9.8 M. Since the last rating in June 2007 Frontiers has managed to build partnerships with several international lenders and to importantly increase its financial leverage, with a debt to equity ratio reaching 1.14 as of September 2008.

<b>Legal Form</b>	2 <sup>nd</sup> tier MCC
<b>Inception year</b>	2003
<b>Area of intervention</b>	Urban/Rural
<b>Credit methodology</b>	Individual

Number	Dec06	Dec07	Sep08
Active borrowers	31	43	51
Active loans	51	79	97
Branches (hubs)	0	0	0
Total staff	9	9	11
Loan officers	3	3	4



US\$	Sep08
Average disbursed loan size	127,003
Gross outstanding portfolio*	9,775,726
Total assets	11,394,927

\*Less accrued interests and commissions received

Financial Indicators	Dec06	Dec07	Sep08
PAR 30	0.0%	0.0%	0.0%
Write-off ratio	0.0%	0.0%	0.0%
Restructured loans	0.0%	0.0%	0.0%
ROE	2.4%	6.4%	8.2%
AROE	-2.9%	-14.0%	-16.7%
Oper. Self-sufficiency (OSS)	130.9%	128.6%	121.3%
Fin. Self-sufficiency (FSS)	87.4%	67.6%	73.7%
Staff productivity (borrow.)	3	5	5
LO productivity (borrow.)	10	15	15
Operating expense ratio	6.6%	5.6%	6.0%
Funding expense ratio	0.9%	3.1%	4.8%
Provision expense ratio	0.0%	0.0%	0.0%
Portfolio yield - cash	14.7%	15.0%	17.1%
Risk coverage ratio	na	na	na
Cost of funds ratio	6.3%	9.2%	9.1%
Debt/Equity ratio	0.2	0.9	1.1

na: not applicable

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AREA	Risk factors	Relevance*
<i>External environment</i>	Political and economical instability	Medium
	Competition in human resources	Medium
	International financial crisis	Medium-high
	Regulatory risk	Medium
<i>Governance, management and operations</i>	Key person risk	Low
	No presence of the BoD in the region	Medium
	Some shortcoming in the MIS	Medium-low
	Incomplete internal audit function	Low
<i>Financial products and asset quality</i>	Issues in diversifying lending products	Low
	Concentration of portfolio in few clients	Medium
	On-site monitoring post disbursement to be strenghten	Medium-low
	Credit crunch	Medium
<i>Financial structure and ALM</i>	Interest rate risk	Medium-low
	Incomplete ALM policies and tools. No risk management framework	Medium-low
	Currency risk	Medium
	Shortage of funds	Medium-high
<i>Financial and operational results</i>	Provision cost not included in IS	Medium-low
	Profitability and sustainability still consolidating	Medium-low
	Improvable efficiency and productivity	Medium
<i>Strategic objectives</i>	Some shortcoming in the business plan	Medium-low

\* Relevance refers to the damage/loss brought about by negative events (associated to each risk factor) and to the probability that damage/loss eventually occurs.

Strengths	Opportunities
<ul style="list-style-type: none"> <li>• <i>Strong and committed founder;</i></li> <li>• <i>Existing partnership with several domestic and international actors;</i></li> <li>• <i>Good knowledge of the market reached;</i></li> <li>• <i>Young and motivated management and staff.</i></li> </ul>	<ul style="list-style-type: none"> <li>• <i>Expansion in new countries within the NIS;</i></li> <li>• <i>Existing unmet demand for credit in the countries reached;</i></li> <li>• <i>Participation of international investors into Frontier's equity;</i></li> <li>• <i>Transformation in a deposit taking microfinance institution.</i></li> </ul>

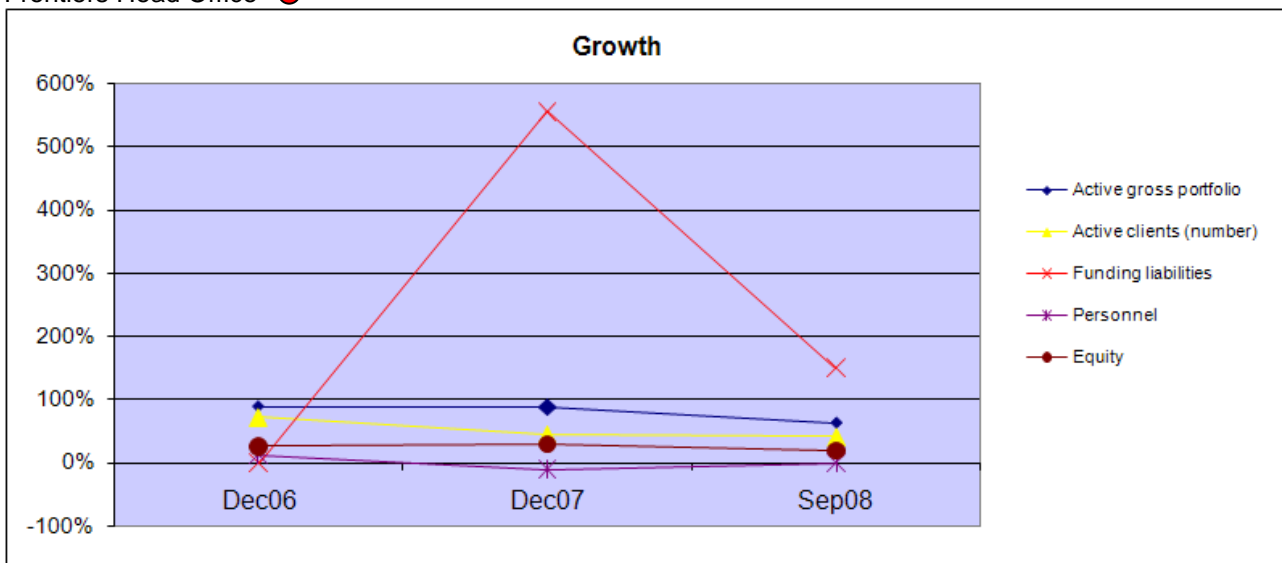
## Relevant changes respect to the previous rating

AREA	Relevant changes and comments	Trend
<b>External Environment</b>	<p>Since the previous rating Kyrgyzstan has been affected by a serious economic slowdown associated with strong inflationary pressures, which have impacted on the microfinance sector in terms of overall portfolio quality and capacity to grow. At the same time, the international financial crisis has influenced Frontiers access to funding, triggering a certain shortage of funds. On the other end, the credit crunch has eased the competition posed to Frontiers by international microfinance vehicles (MIV).</p> <p>The decision of the National Bank of the Kyrgyz Republic (NBKR) not to let Micro Credit Companies lend in US\$ has firstly slowed down the second tier institution's operations. On the positive side, there have been changes in terms of taxation, which will allow Frontiers to be more fiscally efficient and to introduce a proper policy for loan loss provisioning.</p>	<b>Stable/Negative</b>
<b>Governance, management and operations</b>	<p>In terms of governance the only major change affecting Frontiers has been the resigning of the only local member of the BoD, which negatively influences the effectiveness of the governance decision making. Positive change is the strengthening of the management team, with the recent introduction of the position of CFO and the personal development of the current Credit Manager, which are progressively mitigating the existing key person risk.</p> <p>Over the 3<sup>rd</sup> quarter of 2007 Frontiers has been affected by a rather high staff turnover (33%), demonstrating the high competition for specialized human resources. The first 9 months of 2008 have been characterized by a much lower staff turnover, thanks to salary increase and the introduction of mortgage and consumer loans to staff. The MIS has remained unchanged compared to last rating and confirms some weaknesses in terms of portfolio tracking and reporting. The institution was at the time of the rating visit in the process of purchasing a new MIS, which will allow a more efficient tracking of loan portfolio and financial structure.</p>	<b>Stable/Positive</b>
<b>Financial products and asset quality</b>	<p>Compared to the previous rating, Frontiers' product offer to 1<sup>st</sup> tier MFIs has not changed, and the institution still disburses one main type of loan, aimed at financing clients' portfolio for on-lending. The lending products Frontiers introduced in 2007 are still only seldom requested by existing and potential clients, and only 2 TA loans were outstanding as of September 2008.</p> <p>The limitation imposed by the NBKR to the disbursement of loans in US\$ has surely made Frontiers' product offer less attractive for clients outside Kyrgyzstan. At the same time, the recent agreement with Asian Universal Bank (AUB), Demir Bank and Eskhata Bank mitigate the risk of clients dropping out because of the cost associated with receiving, converting and hedging Kyrgyz Soms in other countries.</p> <p>Since June 2007 Frontiers' portfolio shows a lower concentration into few borrowers (34% lent to the largest 5 borrowers). On the other end, the increasing average loan per client, the slightly worsening borrowers' average portfolio quality (Frontiers portfolio quality remains excellent), and the client base composition including more Credit Unions, trigger a certain augment in the credit risk associable to its portfolio.</p>	<b>Stable</b>

<p><b>Financial structure and ALM</b></p>	<p>Since the previous rating Frontiers has continued to increase its financial leverage, and as of September 2008 the financial structure is almost equally composed of loans from international lenders and capital from the only shareholder, ACDI/VOCA. The increased access to external borrowings much quicker than the increase in capital has triggered a significant augment in the debt/equity ratio from 0.54 as of September 2007 to 1.14 as of September 2008, which however leaves wide room for further financial leverage. The attraction of new loans has increased Frontiers diversification of funding liabilities, which now counts on 5 different investors. Liabilities maturity structure remains favourable, with 64% of outstanding loans showing long term maturity. The capital structure has remained practically unchanged with ACDI/VOCA still the only owner of Frontiers, while a further small capital infusion and retained earnings have brought about an increase in the equity base. ALM has improved with the introduction of new tools for the monitoring of currency and maturity net positions, interest rate risk, and a new better format for cash flow analysis was being developed at the time of the rating visit. The relaxed currency risk mitigation policy has brought about a relevant 63% US\$ short position on equity as of September 2008, which has rapidly resulted in significant FX losses. Frontiers reacted shortly afterwards using SWAP contracts with AUB to significantly limit the short open position.</p>	<p><b>Stable</b></p>
<p><b>Financial and operational results</b></p>	<p>The performance of Frontiers follows an uneven pattern since the last rating. ROE has somehow improved since 6.5% as of June 2007 to the current 8.22% mainly thanks to the increased leverage coupled with higher portfolio yield. At the same time, ROA has slightly decreased from 5.4% y-o-y in June 2007, firstly to 5.05% over 2007 and subsequently to 4.22% over the period October 2007-September 2008. The worsening of ROA has been triggered by the decreasing concentration of assets into the loan portfolio (see chapter 4) and the increase in the operating and funding expenses ratio. FX losses contributed to the diminishing performances. In terms of adjusted performance, AROE and AROA reach negative results over the period October 2007 – September 2008 (-16.67% and -8.9%) due to the strong increase in inflation affecting Kyrgyzstan over the last two years. Frontiers' efficiency, after improving from December 2006 to December 2007, worsens over the last period of analysis due to augmenting salaries and inflation pushing upward administrative expenses. At the same time productivity slightly improves, though still showing room for further betterment.</p>	<p><b>Stable</b></p>
<p><b>Strategic objectives and future evolutions</b></p>	<p>Frontiers, also due to exogenous factors, has not achieved some of the objectives set in 2007, especially in terms of financial performances, portfolio diversification and the implementation of the new MIS. At the same time, portfolio and liabilities growth targets have been overachieved, and a more aggressive plan has been build for the next three years, which could however be hampered by the current international credit crunch.</p>	<p><b>Stable</b></p>



Frontiers Head Office ●



### Final opinion

Frontiers is a well-performing second tier microcredit company which has been rapidly growing thanks to the development of long term partnerships with international investors and a significant potential market. The consolidation of the organizational structure has greatly reduced the existing key person risk. Although the BoD is very committed it still lacks local representatives. While the loan portfolio quality ratios show excellent figures, the worsening position of some client MFIs is increasing the associated credit risk. In regards to Frontiers' financial structure, the application of hedging mechanisms is recently lowering the currency risk, which was seriously undermining Frontiers' performances. Sustainability and profitability are standing at adequate levels, while the respective negative adjusted ratios are reflecting the high inflation in the country. The financial leverage leaves wide room for external funding, though the current financial crisis could slow down funds attraction. The new provisions by the National Bank of Kyrgyzstan, which allows the Institution to only lend in local currency, hampers its competitiveness in the markets outside Kyrgyzstan. At the same time, due to the current credit crunch, the overall competition by international investors has somehow decreased.

## Benchmarking

The “second tier” peer group is composed of apex institutions previously rated by MicroFinanza Rating Srl. Due to heterogeneity of the nature and operations of these institutions, some of the ratios might not be fully comparable. Moreover the number of institutions is limited and some of the apex microfinance institutions are at an early stage of development.

Financial Ratios	<i>MCC Frontiers September 08</i>	Second tier
Gross Loan Portfolio * (US\$)	9,775,726	7,286,071
Number of borrowers	51	40
PAR 30 (%)	0.0%	1.9%
Return on Equity ROE (%)	8.2%	5.1%
Adjusted Return on Equity AROE (%)	-16.7%	-5.7%
Return on Assets ROA (%)	4.2%	4.1%
Portfolio yield (%)	17.1%	15.3%
Real Portfolio yield (%)	-6.3%	7.5%
Funding expenses ratio (%)	4.8%	2.6%
Operating expense ratio (%)	6.0%	7.4%
Debt to Equity ratio	1.1	0.6
Productivity per staff - amount (US\$)	888,702	595,378
Productivity per staff - borrowers	5.3	2.1
Cost per unit of money lent (%)	0.1%	7.1%

\* Gross Loan Portfolio is less accrued interests and received loan commissions

- Frontiers has a slightly bigger portfolio thanks to the growth achieved since the previous rating.
- The company presents very good portfolio quality as a result of the strong financial analysis and monitoring of clients
- Due to higher debt to equity ratio and portfolio yield, and better efficiency, ROE is higher than the benchmark, while ROA stands at the same level
- The adjustments are heavier for Frontiers due to the high inflation affecting Kyrgyzstan over the last year
- Portfolio yield is slightly higher than the benchmark
- Frontiers performs better than the peer group in terms of productivity and efficiency.