



Investment Promotion Booklet, January 10, 2011

accelerating social investments



*This booklet¹ is prepared by
Microenterprise Development Fund
to attract IFIs for investment promotion
in Armenian leading microfinance institution*

¹ The booklet is purposefully prepared in A5 format, hence, for the best view of it, it is recommended to print it in A5 format.

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EXECUTIVE SUMMARY

MDF presents significant upside opportunity for entry by a foreign institutional investor.

- MDF is an MFIF (Microfinance Investment Fund) and an MFI (Microfinance Institution) at the same time, in a sense that it both invests in microfinance industry and attracts external funds from other MIFIs to support its activities, hence accelerating its inorganic growth.

- With assets of about 15 mln USD and clients of about 12,500 all over Armenia, MDF fosters micro-entrepreneurship by providing loans to micro and small entrepreneurs, with 60% of its loan portfolio allocated in rural areas.

- In 2010, the gross loan portfolio reached \$9.4 million (2009: \$8.6 million).

- Major transformation, including transfer of portfolio and experienced staff has successfully moved the provision of microfinance services from MDF to KAMURJ and put its operations under the regulation of the Central Bank of Armenia. In addition, the transformation has opened a wide range of new opportunities for partnerships, debt and equity financing, as well as for developing and offering a wide spectrum of new financial and non financial services.

- Armenia is ranked *21st freest among the 43 countries in the Europe region*, and its score puts it above the world and regional averages.

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This document is for use by IFIs considering entry/expansion into the Armenian microfinance market. It is designed to address the main issues of interest to potential partners, backed by quantitative data. Readers are encouraged to contact the Microenterprise Development Fund (MDF) staff listed on page 3 for any queries.

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MDF PROFILE

Microenterprise Development Fund (MDF) is an Armenian non-for profit organization that has been founded in 2000, as a result of merger of two microfinance projects run by ***Save the Children Federation Inc (280K USD initial capital)*** and ***Catholic Relief Services (190K USD initial capital)***. The ultimate purpose of this merger was to create a single unit professional microfinance institution that clients of both programs could have relied in the long-run. Since then, MDF has passed through several and significant phases of institutional transition and structural changes, by delightfully passing all the challenges on its way through. The success factors were MDF's core values and its strong commitment to them, which are *Customer satisfaction, Commitment to mission, Quality and Competitive Products, Excellence, Teamwork, Professionalism and Accountability*.

As of today, with assets of about 15 mln USD and clients of about 12,500 all over Armenia, MDF fosters micro-entrepreneurship by providing loans to *micro and small entrepreneurs*, with 60% of its loan portfolio allocated in rural area.

MDF continuously improves and diversifies its services to ensure institutional growth, client retention, and increased customer loyalty and satisfaction with all aspects of the fund's operations. For this reason, MDF has founded (2010) a Universal Credit Organization called KAMURJ (full ownership over its subsidiary), to separate *financial services* from its core *non-financial services*. By doing so, MDF aims to reach a unique synergy effect, serving its clients two-handed.

Poor clients, without adequate capacities to make productive investments, would require access to non-financial services in addition to those of financial nature. These services may take the form of training to build specific skills like marketing and financial management and promotion of economic opportunities specifically suited for the local context.

The non-financial services provided by MDF include but are not limited to *Technical assistance (TA), Advisory services (AS) and Small grants (SG)*, inimitably tailored for its clientele groups.

The TA component will support farmers to have access to new farming technologies, seeds, small equipment and different input suppliers with proven reputation. The TA efforts will also help small farmers to access and utilize resources from various donors, particularly by helping them in writing business plans, proposals, budgeting and basic accounting.

The AS component will encourage access and use of new farming and processing technologies and innovative approaches, advise seasonal planning, marketing and establishing cooperation of farmers.

The SG component will encourage new and ecologically sound farming, to cope with unstable cash flows, risks associated with weather, dealing with perishable products, etc. Small grants will be provided to a limited number of farmers who find borrowing the first loan too costly/risky to start a new and innovative farming initiative.

COMPANY DATA

MDF continued to maintain its position as one of the leading Microfinance institutions on the Armenian market during 2010. It increased its total asset base in 2010 by 1 % to \$ 12.5 million (2009: \$12.3 million) after a slight decline in 2009.

Gross loan portfolio in 2010 was \$9.4 million (2009: \$8.6 million). This relatively small increase was because the Fund was more cautious in lending during the whole 2010. As a result, the Fund generated less interest income from loans to customers.



2010 was profitable for MDF². There was a net income after tax of more than \$1.3 million (2009: \$1.2 million).

The Fund continued to strengthen its distribution channels by closing the year 2010 with 9 branches and sub-branches. The total number of employees at MDF³ as of 30 December 2010 was 129.

Over the last ten years MDF has continuously done well in terms of overall financial performance. It has a track record of continuous growth in terms of customer base, loan portfolio and widespread representation in regions of Armenia.

² Consolidated, including the financials of Kamurj UCO LLC

³ including those of KAMURJ UCO LLC



MDF has been well capitalized since its operation in 2000, with capital to total assets ratio varying from 75-95% for that period of time of operation.

Financing structure



The financing structure has mainly been capital intensive, i.e. there is big room for leverage. The Fund currently has two institutional lenders, namely Incofin (Belgium) and PlaNIS, Planet Finance Group (France) with total of 2.1 mIn USD initial borrowing. The Debt to equity has been steadily low for the last 6 years, as described on the chart.

Efficiency



Since 2003, the operating expenses over the loan portfolio has dropped sharply 50 to roughly 10%, which is mainly due to enhanced efficiency practices introduced at the Fund during the mentioned period. The low ratio also indicates the steady growth of the loan portfolio over the last 6 years.

Productivity



*Personnel allocation ratio*⁴ has dropped from 70% to roughly 35% over the past 6 years, which is basically explained by the increase of the administration (marketing, monitoring, and treasurers) and the support staff.

Loans per loan officer ratio has more than doubled over the past 6 years, which is a result of productivity increase of loan officers: higher rates of penetration per loan officer, faster loan tracking practices.

For more on MDF-Kamurj's financial performance, efficiency and productivity figures, please visit The MixMarket⁵ by the following address www.mixmarket.org/mfi/kamurj.

⁴ Number of Loan Officers / Number of Personnel

⁵ The MixMarket is a global, web-based, microfinance information platform. It provides information to sector actors and the public at large on microfinance institutions (MFIs) worldwide, public and private funds that invest in microfinance, MFI networks, raters/external evaluators, advisory firms, and governmental and regulatory agencies.

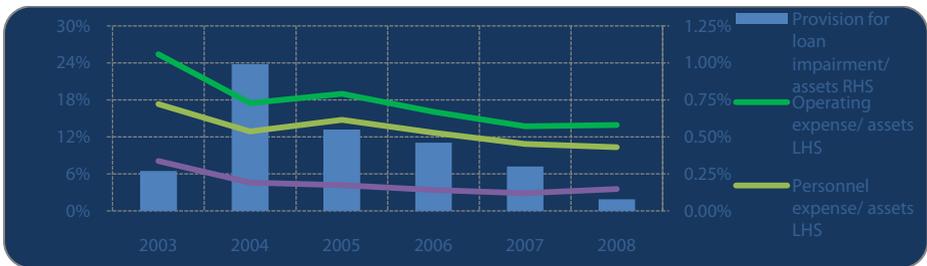
INVESTMENT STRATEGY AND THE REPORTING

MDF invests in microfinance throughout its sole subsidiary KAMURJ UCO, on a well diversified basis. Most investments take the form of short to medium-term loans with fixed interest rates, and specifically tailored to our clients' business and financial needs. No equity investments are made so far.

For the last 10 years MDF had lent to micro and small entrepreneurs creating a unique synergy effect based on a strong group cohesion mechanism.

The business model has proved to be the right path to excel.

The well diversified portfolio with provisions for loan impairment (to assets) topping up to 1% (2004), with current similar ratio of 0.5% *only*, is the quantitative measure of the statement above.



The *group lending methodology* anchors the investment strategy, with clear guidelines for MDF (KAMURJ UCO) lending. The loan portfolio is comprised of about 12,500 borrowers, with average loan of about 700 USD.



MDF is an MFIF (Microfinance Investment Fund) and an MFI (Microfinance Institution) at the same, in a sense that it both invests in microfinance industry and attracts external funds from other MIFIs to support its activities, hence accelerating its inorganic growth.

MDF that has been in existence since 2000, has been in good partnership with international financial institutions and is suitable for investors who want to achieve both social benefits and a financial return. The fund offers interesting possibilities of diversification and is designed for private and institutional investors with a medium to long-term investment horizon. To this regard, MDF is aiming for long term growth in value and is keen to get engaged in new partnerships with Microfinance Investment Funds and other investors having ambitions to expand in Armenian Microfinance industry.

MDF's capacity to report on financial returns and social performance makes the Fund more responsible and transparent to its investors. In addition, the financial performance reports, published monthly/quarterly/annually, provide transparent information about performance and the development of social benefits.

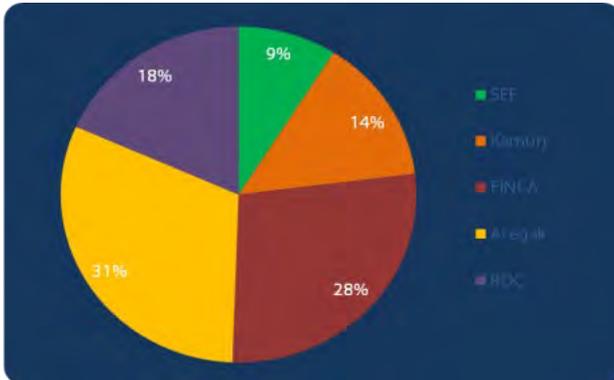
MDF has solid reputation of a reliable partner working with IFIs and for the time being, it has in force contracts with two IFIs, namely with Incofin and PlaNIS, with principal amounts of borrowings/loans of \$1,5 mln/\$.6mln respectively.

KAMURJ UNIVERSAL CREDIT ORGANIZATION LLC

Since October 2010 a new page in MDF’s history was turned on. The microfinance arm of MDF was transferred to the newly created KAMURJ Universal Credit Organization LLC, where MDF is the sole shareholder. This major transformation, including transfer of portfolio and experienced staff has successfully moved the provision of microfinance services from MDF to KAMURJ and put its operations under the regulation of the Central Bank of Armenia. In addition, the transformation has opened a wide range of new opportunities for partnerships, debt and equity financing, as well as for developing and offering a wide spectrum of new financial services. The MDF financial products have been revised and improved according to the new trends and demands in the Armenian microfinance market. Constantly hearing clients and putting maximum innovation and efforts to achieve their satisfaction has been a corner stone of KAMURJ strategy. As a result, a good number of new loan products are already offered by KAMURJ, which was not possible with MDF due to the country regulation limitations for non-profit foundations. Client feedback and advancing both group and individual services are well balanced between KAMURJ’s social goals and financial performance.



The institutional transformation from a non for-profit to for-profit was well perceived by the management and staff, strongly supported by developing and offering a unique set of well balanced career, monetary/non-monetary incentives and opportunities to the transferred staff, who adequately appreciated the transition with a great level of enthusiasm and dedication to excel and grow.



Kamurj has a strong presence and operational infrastructure and throughout the country. Its branch structure is constantly expanding to reach additional families in need, particularly in the remote areas. As of 2010, KAMURJ had around 14% of market shares among microfinance providers in the country, such as FINCA, Aregak, SEF, etc. serving

urban micro-entrepreneurs and low-income rural families.

KAMURJ has developed its Strategic Business Plan outlining the main areas of growth and scaling up, cooperation and service development for the period of 2011 – 2014. The Plan also defines the strategy and financial needs of KAMURJ for each year of the period to achieve the outlined goals and objectives. Supporting value-chain services to low-income families, by playing an active role in the chain, is particularly incorporated into the Plan and a new intervention, which is an innovative, important and efficient strategy for covering wide range needs of the target population, particularly in rural and underserved areas. This approach is also a key to maintain highly efficient financial performance of the institution. The main projections reflected in the Strategic Business Plan (both in USD and Armenian Drams) are presented in the table below

KAMURJ is firmly positioned to maintain the mission of MDF and serve the same target group – low income families in urban and rural settings of Armenia, empowering them to alleviate poverty and encouraging their efforts in improving their economic and social wellbeing.

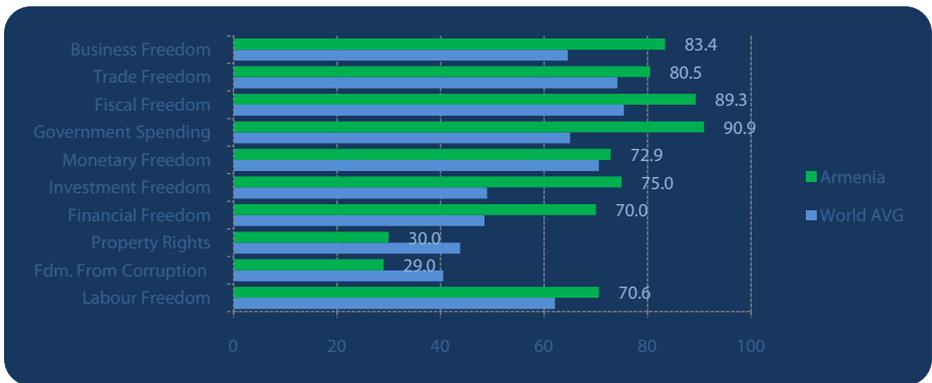
Overall financial performance



THE INVESTMENT CLIMATE IS WELCOMING

Armenia has implemented substantial economic reforms in many parts of its economy over the past decade, making considerable gains in income growth and poverty reduction while maintaining macroeconomic stability.

According to The Heritage Foundation⁶ Armenia's economic freedom score is 69.2, making its economy the 38th freest in the 2010 Index. Armenia is ranked 21st freest among the 43 countries in the Europe region, and its score puts it above the world and regional averages.



Business Freedom 83.4 | AVG 64.6

The freedom to start, operate, and close a business is well protected under Armenia's regulatory environment. Starting a business takes an average of 15 days, compared to the world average of 35 days. Obtaining a business license requires about the world average of 18 procedures and less than the world average of 218 days. Closing a business is easy.

Trade Freedom 80.5 | AVG 74.2

Excise taxes and fees, inadequate infrastructure, unpredictable customs valuation, inefficient customs administration, weak enforcement of property rights, import monopolies, and corruption add to the cost of trade. Fifteen points were deducted from Armenia's trade freedom score to account for non-tariff barriers.

Fiscal Freedom 89.3 | AVG 75.4

Low tax rates and moderate government

⁶ <http://www.heritage.org/index/country/armenia>

spending contribute to an impressive degree of Fiscal freedom. The VAT and corporate and personal income tax rates are all 20% (the max). In 2010, overall tax revenue as a percentage of GDP was 16.5 percent.

Government Spending 90.9 | AVG 65.0 Total government expenditures, including consumption and transfer payments, are low. In the most recent year, government spending equaled 17.4 percent of GDP.

Monetary Freedom 72.9 | AVG 70.6 Inflation in Armenia is relatively low, averaging 3.9 percent between 2002 and 2009. Relatively stable prices explain most of the monetary freedom score.

Investment Freedom 75.0 | AVG 49.0 By law, foreign and domestic investors are accorded equal rights in establishing businesses in nearly all sectors of the economy. There are no restrictions or controls on foreign exchange accounts, invisible transactions, or current transfers, and there are no repatriation requirements. The government maintains several incentives, such as tax holidays, for foreign investors. By law, foreign investments cannot be expropriated except in extreme cases of a natural or state emergency, upon a decision by the courts, and with compensation.

Financial Freedom 70.0 | AVG 48.5 Armenia has accelerated the pace of legal and regulatory reform in order to restructure its financial sector. The government has embarked on privatization and regulatory reform that includes adopting international accounting standards. The state no longer has a stake in any bank, and all 21 are privately owned. Financial-sector infrastructure has been enhanced through improved market transparency. However, the banking sector, which accounts for over 90 percent of total financial-sector assets, still suffers from insufficient long-term funding and market segmentation. Capital markets and insurance are not fully developed. There are no limitations on conversion and transfer of money or repatriation of capital and earnings. The securities market has a legal framework in place but remains small.

Property Rights 30.0 | AVG 43.8 Armenian law provides substantial protection for intellectual property rights and is in compliance with the WTO's Trade Related Aspects of Intellectual Properties (TRIPS) Agreement. The government has increased enforcement of IPR laws.

Fdm. from Corruption 29.0 | AVG 40.5 As is the case with many former-Soviet countries, corruption is perceived to be widespread. In recent years, however, the government has introduced a number of significant reforms to combat this problem. Armenia ranks 109th out of 179 countries in Transparency International's Corruption Perceptions Index for 2008, a decline from 2007.

Labor Freedom 70.6 | AVG 62.1

Armenia's labor market operates under relatively flexible employment regulations. The non-salary cost of employing a worker is moderate, and dismissing a redundant employee is relatively simple.

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