

State of Microfinance Investment

The MicroRate 2010 MIV Survey



July 2010

State of Microfinance Investment: The MicroRate 2010 MIV Survey was made possible by the generous support of:



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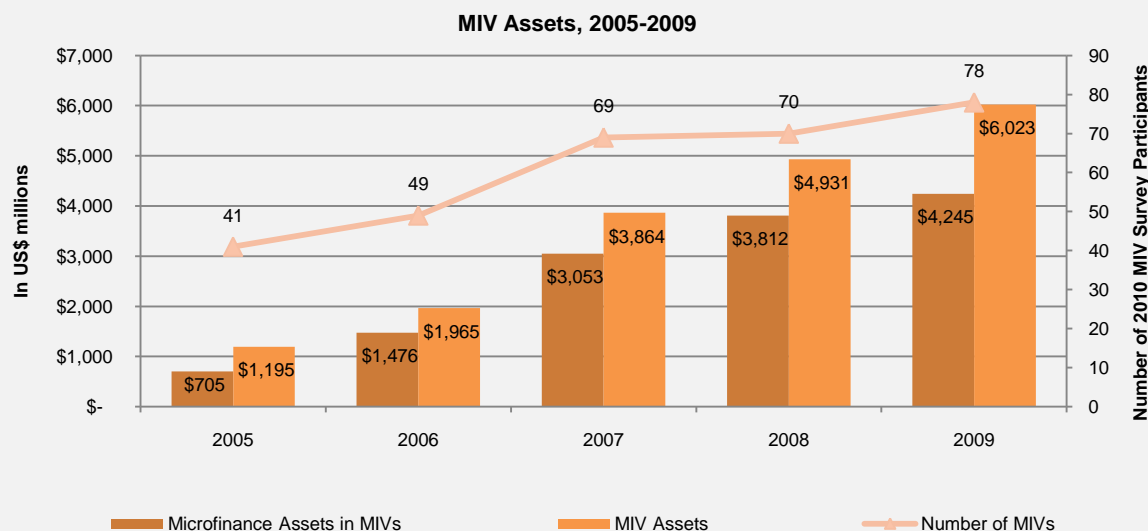
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Overview

Fueled by the attractiveness of the industry's social mission and strong performance of microfinance institutions (MFIs), MIVs grew rapidly over the last five years. In 2009, that growth slowed only marginally (to 22% from 28% in 2008). However, microfinance assets grew much more slowly than total MIV assets with the result that MIV liquidity increased dramatically. Interestingly, despite weak demand for funding from MFIs and against the backdrop of a worldwide recession, a number of new MIVs appeared during 2009. At the end of 2009, too many MIVs were chasing too few MFI lending opportunities.

The 2010 MIV Survey

MicroRate's 5th annual Survey of microfinance investment vehicles (MIVs) measures the development of a relatively new category of funds and other intermediaries that mobilize investments in rich countries and channel them to microfinance institutions (MFIs) in the developing world.

The assets of MIVs have grown from \$ 1.2 billion in 2005 to over \$ 6 billion at the end of 2009. It is one of the triumphs of development that such a large amount has been made available by investors

for on-lending to the poor in the slums of cities like Mumbai, Lima and Addis.

Of the 88 active MIVs identified by MicroRate as of December 31, 2009, 78 completed the Survey, resulting in an 89% response rate.

Total MIV assets grew 22% in 2009 to over \$6 billion. This was the lowest growth rate since MicroRate began tracking MIVs (2008: 28% growth to \$4.9 billion; and 2007: 97% growth to \$3.9 billion). The slow-down is dramatic, particularly when compared to the 97% growth rate in 2007. Nonetheless, it is remarkable that at a time of unprecedented stress and uncertainty in financial markets, MIVs were able to attract over \$1 billion in additional funding.

The MicroRate 2010 MIV Survey results also contain a note of caution: MIVs are finding it difficult to place the funds they are raising from investors. Less than half of the funding mobilized in 2009 ended up in microfinance. Most of the rest increased fund liquidity. The share of microfinance assets in total MIV assets fell from 78% to 71% during 2009.

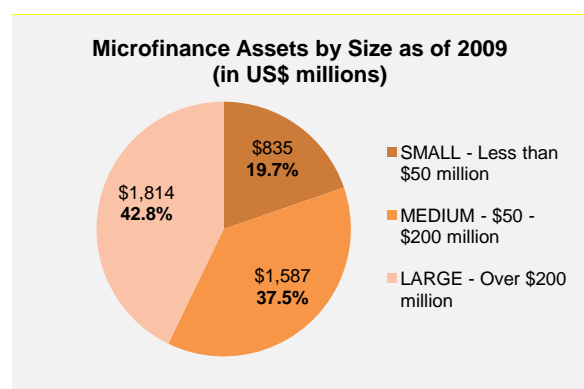
Eleven new MIVs were created in 2009 and 14 MIVs took part for the first time in this Survey.

As of December 31, 2009, MIVs held in aggregate 3,033 microfinance investments with an average investment size of \$1.4 million (2008: \$1.2

million). The average size of an equity microfinance investment increased 35% to \$2.3 million from \$1.7 million in 2008.

MIV Size

At the end of 2009, large MIVs (total assets of \$200 million or more) held approximately 43% of total microfinance assets, followed by medium MIVs (total assets of \$50-\$200 million) at 37% and small MIVs (total assets of less than \$50 million) at 20%.

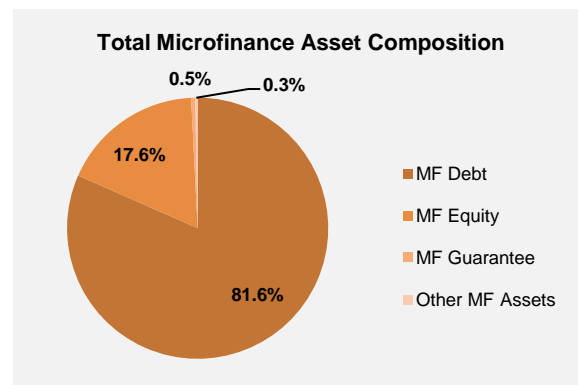


Over the last four years, there has been a shift in the asset base from small MIVs to large MIVs.

In 2009, the 5 large MIVs have a proportionally growing share of total microfinance assets (43% in 2009). The remaining share was divided between medium MIVs (17 representing 37%) and small MIVs (54 representing 20%).¹

MIV Asset Composition

The microfinance assets held by MIVs are primarily debt, as has been the case for the last five years. Of the microfinance assets held by MIVs, debt comprises approximately 81.6%, followed by equity at 17.6%, guarantees at 0.5% and other microfinance assets at 0.3%.



Debt as a proportion of total microfinance assets in MIVs decreased slightly from 85% in 2008. This may be attributed to the slowdown in demand for debt financing by MFIs. In light of the credit crunch, MFIs have been forced to scrutinize their client selection process and lending policies.

Microfinance equity assets as a percentage of total microfinance assets increased from 12.8% in 2008 to 17.6% in 2009. This growth can, in part, be attributed to the contraction in demand for loans from MFIs, and the increase in market value of equity investments in stocks like Compartamos, a Mexican MFI.

Of the 14 new participants in this year's Survey, five were pure equity funds. As loan demand slowed in 2009, MIV managers were increasingly attracted to equity investments and their upside potential. Over the past year, there has been speculation that several MFIs would go public – the most notable being SKS Microfinance Ltd., an Indian MFI.

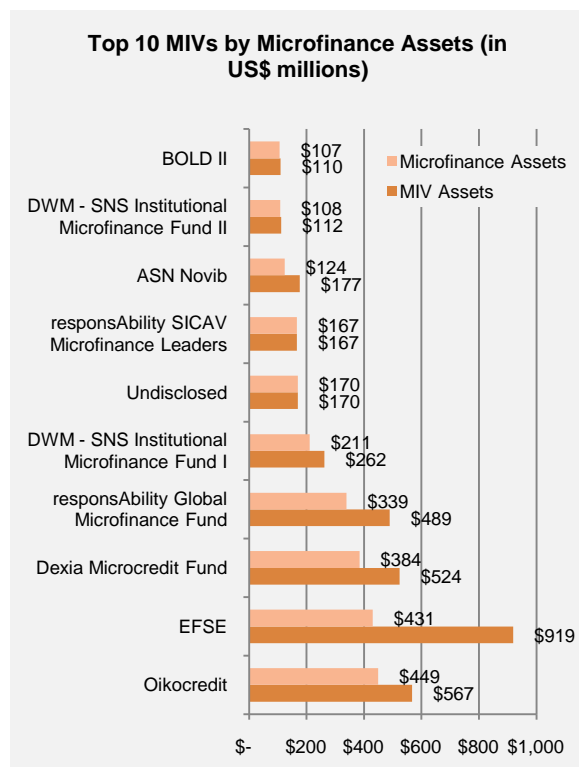
Microfinance guarantees as a proportion of total microfinance assets in MIVs also fell from 0.8% in 2008 to 0.5% in 2009, primarily due to a decrease in guarantees provided by the Global Commercial Microfinance Consortium, the largest provider of guarantees.

MIV investment in other MIVs increased. Of the 78 participants in the Survey, 20 MIVs disclosed investments in other MIVs of \$167 million, an increase of 10% from 2008.

¹ When summed according to size, the total number of MIVs is 76. As mentioned previously, data from 78 funds was included in this Survey; however, one fund manager manages three funds, yet reports data on a consolidated basis.

Top Ten MIVs by Microfinance Assets

The top 10 MIVs account for 59% of total microfinance assets held by MIVs. This percentage has declined annually since 2005 when the top 10 MIVs held 78% of total microfinance assets.



These top 10 MIVs grew by 9.4% in 2009 compared with a 22% growth in 2008. Eight of the top 10 MIVs have been in the top 10 for three consecutive years. The two newcomers are DWM's SNS Institutional Microfinance Fund II and one undisclosed participant.

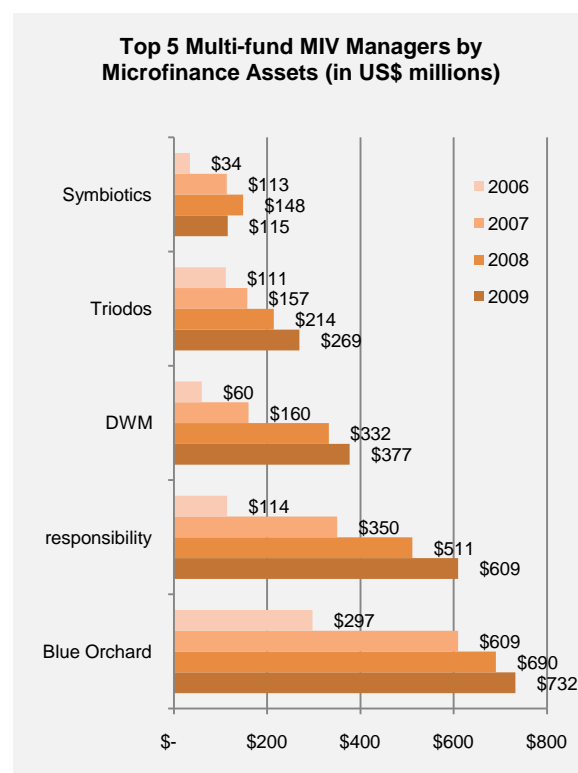
Several of the top 10 MIVs are managed by the same organization. Blue Orchard manages Dexia Microcredit and BOLD II Funds, responsAbility manages the Microfinance Leaders and Global Microfinance Funds, and Developing World Markets manages the SNS Institutional Microfinance Fund I and II.

Multi-fund MIV Managers

For the first time in the survey's history, a multi-fund MIV manager, Blue Orchard, crossed the \$1 billion mark for total assets under management (AUM) followed by responsAbility at \$0.8 billion. In fact, Blue Orchard managed approximately 17% of total MIV assets covered in MicroRate's annual MIV Survey.

Microfinance assets held by the top five multi-fund managers increased by 11.1% over 2008, consistent with the growth in microfinance assets held by all managers, which was 11%. The top 5 multi-fund managers have consistently accounted for 50% of microfinance assets in 2008 and 2009.

In 2009, Triodos had the highest growth rate among managers (47%), followed by Developing World Markets (DWM) at 43%. Since 2006, DWM's microfinance assets had a compound annual growth rate of 84.5%, making it the fastest growing manager. responsAbility had a 75% compound annual growth rate over the same period.



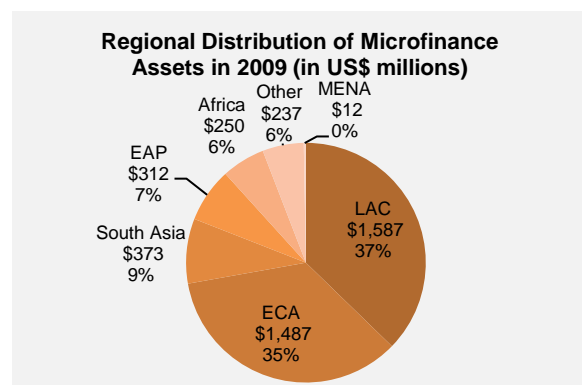
New and existing managers continue to create funds, some of which have specific regional or

country focuses such as Caspian Advisors, which manages the Indian Financial Inclusion Fund.

Faced with rapidly rising liquidity, in early 2010 responsAbility, the second largest MIV manager, suspended the acceptance of new funds in the responsAbility Global Microfinance Fund, an MIV that had been open to retail investors.

Geographic Distribution

In 2009, MIVs held more assets in Latin America and the Caribbean (LAC, 37%) than in Eastern Europe and Central Asia (ECA, 35%). This reversed the position in 2008, when ECA captured 43% of the market while LAC had only 35%. Investors are shying away from ECA during the financial crisis and moving back into the more mature LAC market.

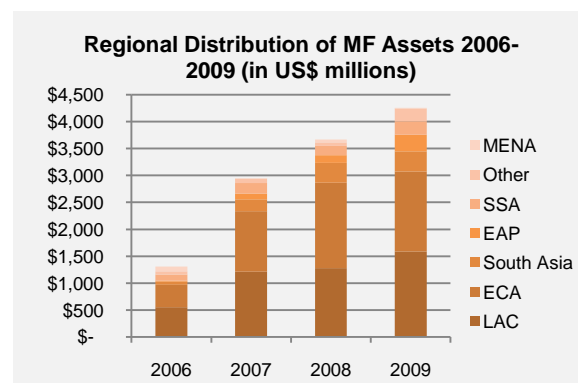


Combined, LAC and ECA continue to dominate MIV portfolios, comprising 72% of all microfinance investments.

There was no growth in microfinance investments in South Asia over 2008. Although two fund managers, Blue Orchard and responsAbility increased their exposure in the Region, Oikocredit reduced its South Asian portfolio by over 50%.

Investment in Sub-Saharan Africa (SSA), representing 6% of total microfinance assets, grew at an astonishing rate of 45% in 2009. The large growth of investment in SSA during 2009 can in part be attributed to Oikocredit's increase in investments in the region by approximately 300%. Both SSA and South Asia had strong growth over a four year period, most notably South Asia,

which has achieved a compound annual growth rate of 82% from 2006 to 2009.



The strongest regional growth in microfinance investments in 2009 was in East Asia and the Pacific (EAP) which grew by 124%, albeit from a very small base. Triodos and Oikocredit have scaled up investments in this region over the last several years.

MIVs reduced their investments in the Middle East and North Africa (MENA) region to less than 1% of total microfinance investments during 2009. Two MIVs that had a combined share in 2008 of 90% in the MENA market drastically reduced their investments.

MFI Demand

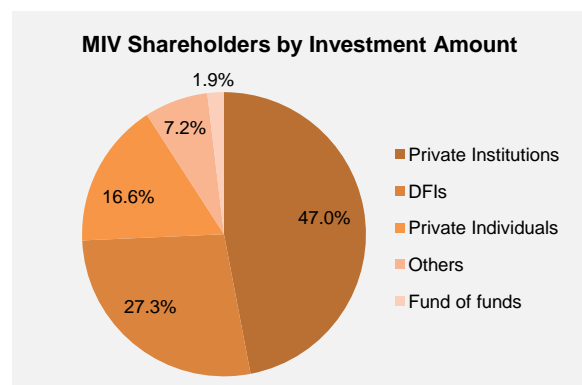
During 2009, there was a noticeable shift in the borrowing preferences of MFIs. Due to the increased availability of low-rate, local funds, as well as the risks associated with borrowing in hard currency, MFIs have turned to local funding. Typically, MFIs will first try to obtain funding locally and only turn to MIVs if reasonably priced local funding is insufficient.

At a time when many MFIs have scaled back their growth, this has led to a disproportionate drop in demand for loans from MIVs. A sample of MicroRate MFIs² grew 22% during 2009 compared to 49% in 2007 before the financial crisis.

² Based on a sample of 33 MFIs from MicroRate's Latin America & Caribbean portfolio tracked from 2007 to 2009.

Investor Demand

Investor demand remained strong in 2009, despite the effects of the global recession. MIVs raised more money from investors than they were able to place with MFIs. Investors remain optimistic about microfinance compared to other investment opportunities.



Based on investor profile data provided by 75% of participants, private institutional investors³ provided the largest share of investment in MIVs both by number of investors and amount invested, financing 47%, a slight increase over 2008. Public institutions' investment also increased slightly, to 27% of MIV assets. Over the last year, public development finance institutions (DFIs) increased their investments in MIVs from \$809 million to \$876 million. DFIs launched two new fund facilities managed by Blue Orchard and responsAbility.

In mid 2009, when it was evident that investor interest in MIVs continued to be strong and MFI funding demand had slowed, DFIs began disbursing one of the two funding facilities, the "Microfinance Enhancement Facility (MEF)". This \$500 million facility was created by IFC and KfW in late 2008 to assure MFIs of continued funding when it was feared that credit markets

would seize up. The announcement of the MEF succeeded in calming the fears of the microfinance industry, however by the time disbursements began in May 2009, MIVs already suffered from a glut of funding. There is little doubt that the late disbursement of the MEF has contributed to the present situation, where many MIVs are struggling to cope with excess liquidity.

Forty-seven of the participating MIVs projected additional microfinance investments of over \$2 billion during 2010 despite a decrease in demand for funding from MFIs. This looks promising when compared with the 2009 MIV Survey, where MIVs estimated growth of \$0.7-\$1 billion. The question remains, will MFIs' demand for MIV funding increase in 2010?

Cooling Off Period – Opportunities to Reflect

The increase in funding of MIVs by private investors and DFIs in 2009, coupled with decreased funding demands from MFIs, has resulted in an oversupply of funds. Although MIV managers have increased equity investments as loan demand dropped off, the growth in microfinance equity has only compensated to a limited extent.

At the end of 2009, MIVs held over \$1 billion in liquid assets (17% of MIV assets) compared to \$459 million in 2008 (10% of MIV assets). At the end of 2008, MIVs built up liquidity in anticipation of large redemption requests, which did not materialize to any significant degree. The unprecedented increase in liquidity in 2009 reflects the difficulty in placing funds in creditworthy MFIs and the decreasing absorptive capacity of the MFI sector.

Measures such as responsAbility's hold on accepting new funds, liquidity has now reached what MicroRate believes to be unsustainable levels. The pressure to disburse funds, coupled with the decrease in investment opportunities, could lead to a deterioration of portfolio quality as managers find themselves under increasing pressure to reduce liquidity. Many MIV investors view their investments in a socially responsible investment context and feel the need to have their

³ Investors in MIVs are broken down into the following types by MicroRate:

Private Institutions- Commercial Investors, banks, pension funds, etc.

Development Finance Institutions- Public institutions, International Financial Institutions, etc.

Private Individuals - High-net-worth, retail, etc.

Others - NGOs, Foundations and Investors with religious affiliations

Fund of Funds- Investments made in other MIVs

investments placed in MFIs versus in cash positions where they achieve no social impact.

The recession has sent shock waves through the global financial system yet, thus far, only a few MFIs have been affected. It will take time to determine what effects the crisis has on MFIs and their clients as microfinance institutions are less connected to international capital markets. Thus far markets that are isolated from the global capital markets have been impacted less and have proven more resilient. The verdict on the correlation and counter-cyclical of microfinance with regards to other investment alternatives is yet to be determined.

Recognizing the need to compete with local sources of capital, MIVs have started lending in local currencies. This has been facilitated by hedging facilities which decrease MIV exposure to exchange rate volatility. Three facilities in particular have emerged to mitigate foreign exchange risk including one hedging intermediary, MFX Solutions, and two currency hedging funds, TCX, which utilizes MFX Solutions to hedge investment to MFIs, and Cygma, which as of June 2010 had not yet started operations. Viable hedging facilities covering exotic currencies are a milestone in the development of the MIV industry.

The Future of the Industry

As a result of the global financial crisis, MIVs have built up unsustainable levels of liquidity. MIVs are now under pressure to relax their lending standards in order to reduce liquidity

MicroRate believes the current cooling off period could be considered a blessing in disguise. In 2007, just before the crisis erupted, MIVs had grown by nearly 100%. This was not sustainable. The drop in demand for funding in 2009 could be seen as an opportunity for MIVs to strengthen their operations and focus on delivering the products and services that microfinance institutions truly require.

Even though many MIVs expect demand to recover rapidly, it is likely that in 2010 the industry will continue to grow, at a slower, more sustainable pace than in the past.

To view the 2010 Microrate MIV Survey presentation, please visit, www.microrate.com.

APPENDIX I: DEFINITION OF AN MIV

MicroRate defines an MIV as an independent investment vehicle, which satisfies the following three criteria:



1. The vehicle must be an independent legal entity for intermediation of capital (i.e. independent of the MFIs being funded).
 - MFI holding companies such as ProCredit Holdings are excluded from this *Survey*.
2. Vehicle must have or be open to multiple private investors.
 - MIVs which are only sponsored by development agencies or government bodies and are not set up collectively with private investors or open to them are excluded.
 - An investment vehicle supported *only* by donors does not qualify as a MIV.
 - Examples include Grameen Foundation, Omidyar Tufts Microfinance Fund, Deutsche Bank Start Up Fund and Deutsche Bank Microcredit Development Fund.
 - Vehicles that accept *both* donor and investment capital, like MicroCredit Enterprises, are considered MIVs.
3. The investment vehicle must focus on investing in microfinance.

APPENDIX II: GLOBAL MIV LIST AS OF DECEMBER 31, 2009

2010 MIV Survey Participants

1. Aavishkaar Goodwell India Microfinance Development Company
2. Access Bank Bond I
3. ACCION Gateway Fund LLC
4. ACCION International Global Bridge Fund
5. ACCION International Latin American Bridge Fund
6. ACCION Investments in Microfinance SPC
7. Advans SA Sicar (formerly, La Fayette Investissement)
8. Africap Microfinance Investment Company Ltd.
9. ALTERFIN
10. Antares Equity Participation Fund
11. ASN Novib Fund
12. BBVA Codespa Microfinance Fund
13. Bellwether Microfinance Fund Private Limited
14. Blue Orchard Loans for Development 2006-1
15. Blue Orchard Loans for Development SA (BOLD II)
16. Blue Orchard Microfinance Securities 1
17. Blue Orchard Private Equity Fund (BOPEF)
18. Calvert Foundation
19. Catalyst Microfinance Investors
20. Consorzio Etimos SC
21. DWM Microfinance Equity Fund
22. DWM - XXEB
23. Developing World Markets DWM Microfinance Fund I
24. Development International Desjardins FONIDI
25. Dexia Microcredit Fund
26. Dignity Fund (Fund closes in 2010)
27. Dual Return Fund (SICAV)
28. Dutch Microfinance Fund
29. Elevar Equity Fund II
30. Envest Microfinance Cooperative
31. European Fund for Southeast Europe
32. FINCA Microfinance Fund B.V.
33. Global Commercial Microfinance Consortium
34. Global Microfinance Equity Fund
35. Global Partnerships Microfinance Fund 2005
36. Global Partnerships Microfinance Fund 2006
37. Global Partnerships Microfinance Fund 2008
38. Gray Ghost Microfinance Fund LLC
39. Hivos Triodos Fund Foundation
40. Investisseur et Partenaire Pour le Developpement
41. Impulse Microfinance Investment Fund NV
42. Incofin CVSO
43. India Financial Inclusion Fund
44. LocFund
45. LokMicro
46. Luxembourg Microfinance Development Fund
47. MicroAccess Trust 2007
48. MicroCredit Enterprises
49. Microfinance Loan Obligation Compartment LC
50. Microfinance Loan Obligations SA Compartment Opportunity Eastern Europe 2005-1
51. Microfinance-Invest. Nr 1
52. MicroVentures Investments SCA, SICAR
53. MicroVentures spa
54. Microvest I, LP
55. MicroVest II
56. Minlam Microfinance Offshore Master Fund, LP
57. MLC Frontiers LLC
58. MV Microfin Pvt Ltd (MicroVentures India)
59. Nowergian Microfinance Initiative Frontier Fund
60. Nowergian Microfinance Initiative - NMI Global Fund
61. Oikocredit Ecumenical Development Co-op Society
62. PGGM
63. responsAbility Global Microfinance Fund
64. responsAbility SICAV (Lux) Microfinanz Fonds
65. responsAbility SICAV (Lux) Microfinance Leaders
66. Rural Impulse Fund S.A.
67. Saint Honore Microfinance
68. Sarona Risk Capital Fund and Sarona Risk Capital Fund 1 LP (formerly, MEDA)
69. ShoreCap International
70. Solidarite Internationale pour de Developpment et l'Investissement
71. SNS Institutional Microfinance Fund I
72. SNS Institutional Microfinance Fund II
73. Societe Cooperative Fonds International de Garantie (FIG)
74. Triodos -Doen Foundation
75. Triodos Fair Share Fund
76. Triodos Microfinance Fund
77. Unitus Equity Fund LP
78. Working Capital for Community Needs, Inc

MIVs that chose not to participate in the 2010 MIV Survey

1. Aavishkar
2. Balkan Financial Sector Equity Fund
3. CredSud spA
4. Cyrano Management
5. Finethic Microfinance Fund
6. Kolibri Kapital ASA
7. LokCapital
8. Wallberg



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