



Growth with quality – balancing risks and opportunities in microfinance



Growth always brings about change and change entails opportunities as well as risks. At BlueOrchard, we are well-placed to know that to be successful, a strong expansion in size and scope must be accompanied by the capacity to evolve with the environment while maintaining professional excellence. But not only have we grown and continue to do so, the microfinance industry as a whole is advancing, albeit at a somewhat slower pace than in previous years. Its progress can be measured in volume but also in the range and nature of services on offer, its geographic scope and the number and diversity of the actors that are involved.

Some fear that this impressive growth comes at a price, and that the brunt will be borne by those at the far end of the chain, the clients of microfinance. They argue that driven by excesses, the sector may lose sight of its primary aim, i.e. the socio-economic inclusion and consequent progress of those formerly marginalised. Investors worry about a rise in risky credits. There is talk of a "bubble" in the media.

We believe the present environment is one that raises the right reactions at an appropriate time: in many places, the microfinance industry's weight is now such that regulators, business partners and other influential players insist on rules and good practices that facilitate a healthy development of the microfinance industry. Furthermore, the financial crisis may prove to offer just the breather that was needed to consolidate the successes, to refocus on the priorities and to strengthen the basis for the future. All these adjustments will require a lot of serious efforts, clarity of purpose and a strong commitment for the long-term development. Only so will microfinance be able

to reach even deeper into the areas of exclusion at one end of the spectrum, and achieve integration into the formal economy at the other end.

As one of the most important microfinance investment managers world-wide, we know that we need to have an in-depth understanding of the risks in the current market environments and in our own portfolios to make our own contribution to the positive progress of the sector.

In this edition of the BlueNews, we have invited our director of risk management, David MacDougall, to explain how BlueOrchard goes about balancing risks and threats against the opportunities. We have also asked Fitch Ratings as a trusted observer of the industry to provide a comment on the assets that microfinance institutions can put towards the challenges that they are facing.

We wish you an interesting read.

Jean-Philippe de Schrevel, CEO
BlueOrchard Investments Sarl

Jean-Pierre Klumpp, CEO
BlueOrchard Finance S.A.

BlueOrchard's approach to appraising risks and opportunities



**By David MacDougall,
Director, Risk Management,
BlueOrchard Finance S.A.**

A risk manager's responsibilities are straightforward: anticipate potential risks early, identify potential risk mitigants and recommend policies to manage the risk. A simple example is the building in which a company is located. A risk manager would verify that an organization's office is covered with insurance to prevent losses in case of a hazard. Best practices, though, require extra consideration. Organizations should prepare to operate at times when their offices are not available or inaccessible. While the possibility seems remote, the risks are real. For example, many organizations are currently making contingency plans to continue operations in case of an influenza pandemic that would restrict their staff's possibilities to report to work. For an organization like BlueOrchard, risk management is deeply intertwined with its operations. BlueOrchard attracts investments and it has a duty to manage the funds prudently.

Risk management starts with staff selection. BlueOrchard's analytic staff includes people with

experience in microfinance and economic development and who possess regional expertise. Each speaks several languages. To keep the staff current on important trends, BlueOrchard invests in their development by in-house and external training on emerging issues in microfinance.

BlueOrchard's analysts review potential partner microfinance institutions for their adherence to the sector's mission and for their sustainability. They must represent a worthwhile investment by providing an adequate financial return as well as a convincing social performance. Over its 8 years of business, BlueOrchard has developed criteria that assist the analyst in a thorough examination of each partner. The analysis includes a visit to the microfinance institution, meeting senior and middle staff, seeing branch offices and talking to end clients.

The result of the research or due diligence is summarized in a detailed memo which is submitted to the internal credit committee for discussion and decision. The committee's members combine 80 years of financial experience. Once BlueOrchard has made a loan, it continues to monitor the credit monthly by collecting financial data, through regular telephone calls and annual visits.

Risk management takes on additional aspects when a loan is a part of a larger portfolio.

BlueOrchard establishes clear guidelines for the exposures in its funds. These include limits on the breadth of exposure to individual microfinance institutions and to countries. We continuously monitor and update these limits to account for events in the world and in the microfinance sector. These measures cannot eliminate risk but they help minimize adverse impacts of risks.

As they review the financial strength of the institutions, analysts also appraise the nature of their lending programs to gauge their social mission and their responsible behaviour. BlueOrchard continuously aspires to provide credible socio-economic returns on its investments and consequently runs a working group to ensure that we comply with the industry's best practices and more.

Risk management is most effective when the Board of Directors, senior management and staff fully understand and support established policies. This requires extra effort to communicate policies yet it can help prevent misunderstandings and errors. BlueOrchard's superior track record testifies to its organization-wide commitment to risk management.

Embroidery of wedding dresses, Panjshanbe market, Khujand (Tajikistan), April 2009



Naimajon Boboeva is 40 years old, married, and has 4 children between 5 and 20 years of age. She runs a sewing shop on the Panjshanbe market of Khujand and specialises in the rich hand-made embroidery of Tajik wedding dresses. Her husband prepares card board patterns for her based on traditional designs which she then stitches on the robes with a golden thread. Naimajon employs 9 women in her workshop which she mostly trained herself to the art. It takes about two weeks to realise a wedding dress, depending on the intricacy of the embroidery and the price varies between Tajik Somoni 200 to 400 (about EUR 30 to 60/USD

45 to 90), according to the importance of the work and the quality of the cloth. The workshop also makes the traditional head dresses worn by the brides. Naimajon took out a first loan with Imon International* in May 2000 for the amount of Tajik Somoni 120 (about EUR 19/USD 27) which allowed her to buy pieces of cloth and to launch her activity. Since then, she has regularly taken out other credits from Imon to develop her activity by renting a space at the market and by hiring and training additional staff. Her last credit was of USD 2500 for which she bought threads of 500 different colours and cloth, to be able to diversify her

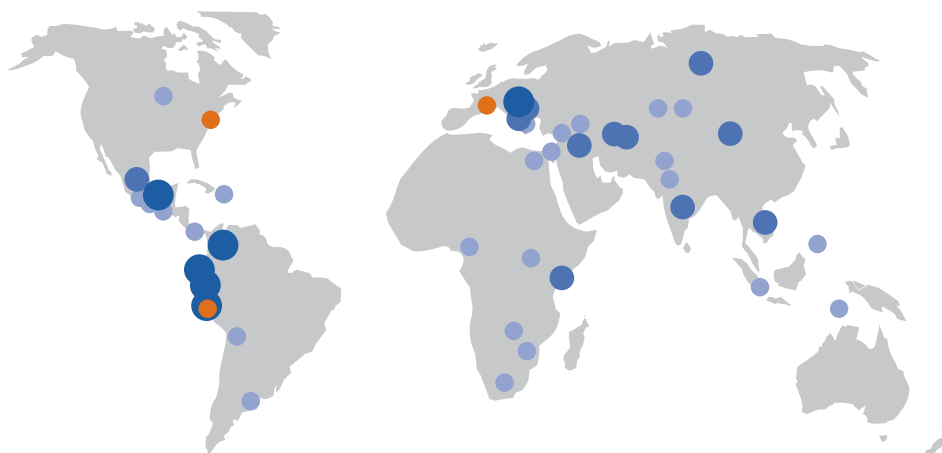
models. Thanks to the benefits of her sewing workshop, she was able to pay for the best available education for her children.

*IMON International's mission is to promote sustainable economic development and an improved quality of life in Tajikistan by insuring reliable access to financial services for the economically active members of the population. They are working to accomplish this by: providing small entrepreneurs with access to high quality financial products and services such as business loans, agro loans, consumer loans, and micro-loans. IMON International has 8 branch offices throughout Tajikistan and their clients work in many parts of the country's economic sector including trade, manufacturing, agriculture, and services. As of October 2008, IMON International had 27,802 active clients and a total portfolio of USD 28,405,549. Approximately 44% of these clients are women, 65% are from rural areas, and 60% are living under the poverty line. In addition, IMON International's portfolio accounts for 31% of all the microfinance clients in Tajikistan, according to AMFOT (the Association of Microfinance Organizations in Tajikistan).

In April 2009, IMON received an international rating of "A" from Microfinanza, a CGAP/World Bank certified rating agency. The rating means that IMON is operating professionally, the risks are minimal and all activities are properly tracked and managed.

Geographical reach and diversification as a factor of stability

BlueOrchard has currently investments in more than 40 countries, working with over 125 microfinance institutions. The wide diversification of our portfolio is an important factor of stability and risk management. The reliability of our portfolio enables us to constantly expand our reach and our network of partnerships. We finance cooperatives, non-governmental organisations, rural banks, non-bank financial institutions, the microfinance sections of banks, apex institutions and second tier lending institutions, in emerging economies.



Situation as of December 2008, figures include both debt and equity placements

- BlueOrchard office
- <2% Countries in which there is exposure of up to 2% of aggregate managed portfolio. The figure for West Africa is regional.
- 2% to 7% Countries in which there is exposure of between 2 to 7% of aggregate managed portfolio
- 7%+ Countries in which there is exposure of more than 7% of aggregate managed portfolio

Key challenges for microfinance

By Sandra Hamilton and Mark Young,
Fitch Ratings

Fitch Ratings has argued that the current global economic crisis is exposing microfinance institutions (MFIs) to the risks of convergence, as the microfinance sector has become more integrated with the wider financial sector. Here we choose to focus on three critical challenges facing MFIs in this tougher operating environment, namely managing asset quality, deleveraging the balance sheet and strengthening corporate governance. We also touch on the issues of funding and, in particular, refinancing risk.

The global economic crisis has led to a strong shift in the two characteristics for which microfinance was hitherto renowned – fast loan portfolio growth and good asset quality. In 2009, MFIs are reporting much slower growth, or even a decline in outstanding loans, as well as weakening asset quality. How quickly and which MFIs recover from this will depend on several key factors:

- the strength of their underwriting standards, both historical and current;
 - the quality of management;
 - the quality of client management by loan officers;
 - the real nature of their loan products (for example, are there hidden consumer loans? Are they lending to micro entrepreneurs or small and medium enterprises? Do they use group or individual lending methodologies?).
- While funding also appeared a major challenge for MFIs, particularly in the second half of 2008, Fitch believes it is less of a constraint in 2009, despite the reduced availability of commercial wholesale funding, as this was partly replaced by funding from International Financial Institutions. While funding is available in smaller volumes and at higher costs, it appears to be sufficient at least to cover the moderate growth levels now being planned by MFIs for 2009-2010.

Many MFIs increased leverage during the good times, and are now having to manage a

de-leveraging process which highlights a critical long-term challenge for future growth. MFIs have limited internal capital generation – particularly given current profit pressures – and limited access to external sources of capital. Successful management of this challenge will renew pressure on MFIs to transform themselves into legal structures amenable to external capital investment.

Finally, a strengthening of corporate governance is vital to support MFIs in meeting the challenges of a tougher operating environment and, ultimately, of renewed growth. Attracting the talent and know-how to provide adequate internal control remains key to an MFI's future success.

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For further research on microfinance,
please visit www.fitchratings.com



A question to Maria Teresa Zappia, Managing Director, Investment Analysis Team

How have the recent financial and economic turmoil impacted microfinance institutions and how are they dealing with current risks?

Microfinance institutions (MFIs) have traditionally distinguished themselves through strong credit policies and procedures, and well trained loan officers. Hence dedicated technical assistance programs were focusing mainly on foreign exchange risk, liquidity management, treasury operations and asset and liabilities matching.

In the context of the global financial and economic crisis, the MFIs' performance was impacted by a combination of slower portfolio growth and a slight deterioration of the portfolio quality, which means that credit risk has increased and is back on the agenda.

The main reasons to this development are: firstly, an increased refinancing risk for MFIs, largely due to a temporary liquidity drought from the last quarter of 2008 to the first quarter of 2009; secondly, a high leverage, with a debt to equity ratio exceeding four to one; and thirdly, a fierce competition among the MFIs in certain markets.

As a result, MFIs are now focusing on the improvement of the credit risk, closely monitoring existing clients and thoroughly selecting new borrowers. Many have also concluded that busi-

ness finance has performed much better than consumer lending, and have therefore limited the proportion of the portfolio that was not earmarked for micro- and small entrepreneurs.

We see a couple possible outcomes of these recent developments: one is that the stricter credit policies would push for more lending to the existing credit-worthy borrower group; the other is that this would lead MFIs to explore new markets and products, extending the reach of MFIs and the financial inclusion of more remote clients.

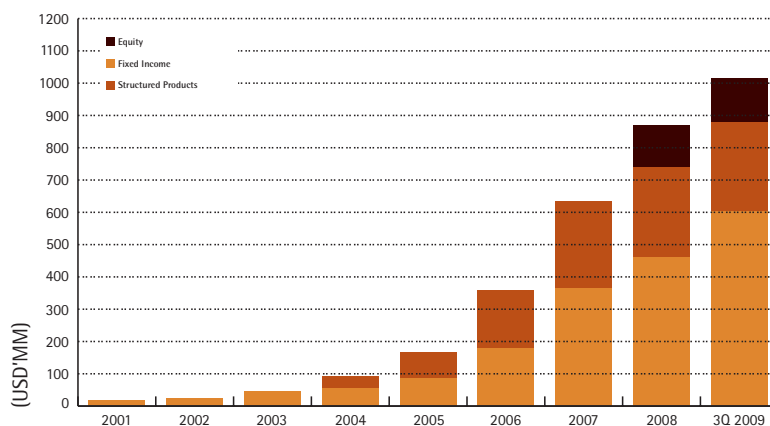
Interestingly, some Bolivian MFIs are moving already in the second direction by developing innovative lending techniques and products in new areas of the country.

The scope of BlueOrchard's investments

Table showing the growth of BlueOrchard assets under management since inception from March 2001 to September 2009.

General overview

- As of 30 September 2009, BlueOrchard companies manage total assets of over USD 1 billion.
- Since inception in 2001 to 30 September 2009, BlueOrchard Finance S.A. has disbursed more than 800 loans totalling USD 1.1 billion to 192 MFIs.
- Since its inception at the end of 2007, BlueOrchard Investments has made 8 equity investments amounting to USD 44 million.



The socio-economic profile of micro-creditors

- The average loan size made by BlueOrchard Finance S.A.'s partner MFIs to micro-entrepreneurs is USD 1,530 as of 30 September 2009.
- More than half of the clients of our partner MFIs are women (56%).
- Nearly half of the MFIs' clients are rural micro-entrepreneurs (43 %).
- About one in four works in agriculture (23%).
- Over two thirds of the loans in our partner MFIs' portfolios are dedicated to micro-entrepreneurs.
- The vast majority of the loans are granted to individuals (compared to group loans).

The following charts show the characteristics of BlueOrchard's fund portfolios taken together in terms of social indicators: the gender participation

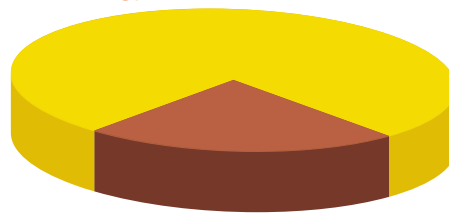
in our partner MFIs' loan portfolios, the types of activities financed by these MFIs, the location of the micro-entrepreneurs, what part the different services and products of the MFIs take and what methodology is followed by the MFIs. The figures are based on a breakdown of active borrowers of the MFIs in BlueOrchard's global portfolio as of 30 September 2009.

Gender



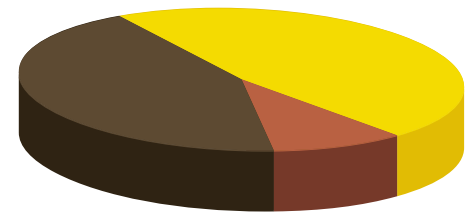
- Female 56%
- Male 41%
- Legal Entities 3%

Methodology



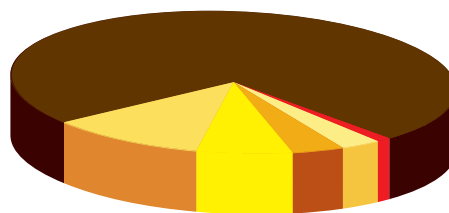
- Individual loans 77%
- Group loans 23%

Location



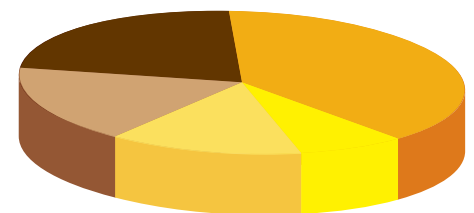
- Urban 47%
- Semi-urban 10%
- Rural 43%

Products



- Microcredit loans 74%
- SME loans 7%
- Consumption 11%
- Education / Health / Emergency 1%
- Housing 3%
- Other products 4%

Activities



- Agriculture 23%
- Manufacture 8%
- Trade 39%
- Services 17%
- Other 14%

Short news

BlueOrchard was chosen to manage the **Microfinance Growth Fund for Latin America and the Caribbean** announced by President Obama in April 2009 and set up by U.S. Government's Overseas Private Investment Corporation and the Inter-American Development Bank. *Read more on www.blueorchard.com.*

A study by OnValues for the World Microfinance Forum Geneva shows that **European pension funds are set to increase their investment in microfinance**.

Read more on www.microfinanceforum.org.

Events

(a non-exhaustive selection of events on microfinance to which BlueOrchard participates)

Beijing (China), 27-28 October 2009 – The China Association of Microfinance's 5th annual conference and microfinance forum. Melchior de Mural, Geert Roosen and Myriam Djari will represent BlueOrchard.

Arlington, VA (USA), 4-7 November 2009 – SEEP Network Annual Conference. Ann Miles, Managing Director and head BlueOrchard's US office will be representing the company.

Amsterdam, (NL), 11 November – The Future of ESG integration. Cees Van Gessel, BlueOrchard Advisor, will represent the company.

Paris (France), 18 November 2009 – Conférence Annuelle MicroFinance 2010 – Jean-Pierre Klumpp will speak on risk, liquidity and currency management in microfinance.

Frankfurt (Germany), 19 November 2009 – IFC Euro Finance Week – Jean-Pierre Klumpp will speak on "Supporting jobs through credit to small business and low-income borrowers".

St. Petersburg (Russia) – 17-19 November 2009 – Russian Microfinance Center Conference – Julie Hubert-Moulin and Vincent Oswald will represent BlueOrchard.

Luxemburg, 24-26 November 2009 – European Microfinance Week – Maria Teresa Zappia will take part in the workshop on social performance measurement and reporting.

Geneva (Switzerland), 1-2 December 2009 – Shorex Wealth Management Forum – Jean-Pierre Klumpp will be speaking on microfinance as a socially responsible and sustainable investment opportunity.

Berlin (Germany), 3-4 December 2009 – KfW Financial Sector Development Symposium – Jean-Pierre Klumpp will be representing the company.

Singapore, 26-27 January 2010 – Microfinance Investments in Asia – Jean-Philippe de Schrevel and Jean-Pierre Klumpp will be speaking at the event.

BlueOrchard's Microfinance investment vehicles – facts and figures

Dexia Micro-Credit Fund – BlueOrchard's flagship commercial investment fund designed to refinance microfinance institutions (MFIs) specialised in financial services to micro-entrepreneurs in emerging markets. It represents 51.6% of the portfolio managed by BlueOrchard. Inception date: September 1998.

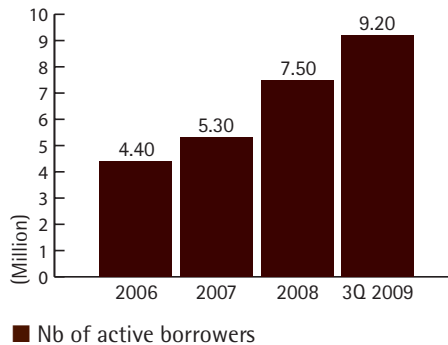
Figures in USD as of 30 September 2009

Net Asset Value USD	531 million
Average outstanding loan size to MFI USD	2 million
Loan average maturity	15.6 months
Number of loans outstanding:	188
Number of MFIs with outstanding loans:	98
Number of countries in which there are outstanding loans:	34
Local currencies delivered in the fund: (Colombian peso, Mexican peso, Peruvian nuevo sol, Philippine peso, Russian rouble, Thai baht).	6
17% of the loans made from this fund are made in local currency swapped in USD	

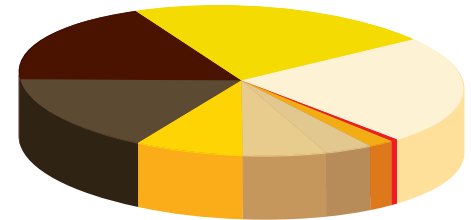
Figures in USD as of 30 September 2009

Share value	ROI Year-todate 2009	
USD	16,894.0	2.17%
CHF	12,170.6	1.74%
EUR	12,998.3	2.31%

Growth of active borrowers (micro-entrepreneurs) in MFIs served with the DMCF



Regional distribution in % of the NAV as of 30 September 2009



South America	22.0%
Eastern Europe	18.7%
Russia, Central Asia and Caucasus	15.7%
Central America and the Caribbean	5.9%
East Asia and the Pacific	7.9%
South Asia	3.8%
Africa	1.9%
North Africa & Middle East	0.4%
Liquidities and equivalent	23.7%

Saint-Honoré Microfinance Fund – The fund is co-managed by BlueOrchard Finance and Edmond de Rothschild Asset Management. It invests in a variety of microfinance institutions including apex institutions. Inception date: November 2005.

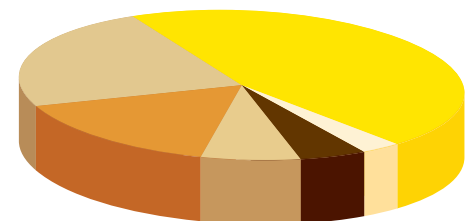
Figures in EUR as of 30 September 2009

Net Asset Value:	9.97 million
Portfolio maturity:	15 months
Number of loans outstanding:	9
Number of MFIs with outstanding loans:	8
Number of countries in which there are outstanding loans:	6

Share value	ROI 2009
EUR 5,550.7	2.6%

Eastern Europe	23.0%
Russia, Central Asia and Caucasus	5.0%
Central America and the Caribbean	7.2%
East Asia and the Pacific	3.1%
Western Europe	15.7%
Liquidities and equivalent	45.9%

Regional distribution in % of the NAV as of 30 September 2009



BBVA Codespa Microfinance fund – A fund used for loans to MFIs in Latin America. BlueOrchard advises BBVA on these investments. Inception date: October 2006.

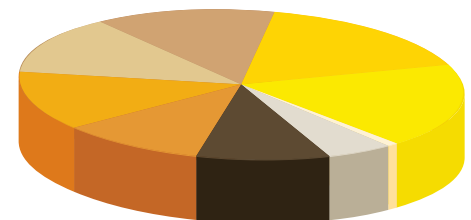
Figures in EUR as of 30 September 2009

Net Asset Value:	27.65 million
Portfolio maturity:	15 months
Number of loans outstanding:	23
Number of MFIs with outstanding loans:	19
Number of countries in which there are outstanding loans:	9
54% of the loans made from this fund are made in local currency	

Share value	ROI 2009
EUR 10,880.50	0.93%

Nicaragua	18.8%
Peru	13.4%
Guatemala	9.7%
Paraguay	10.1%
Ecuador	16.6%
Honduras	12.5%
Mexico	13.1%
Dominican Republic	5.2%
El Salvador	0.6%

Regional concentration as % of the portfolio as of 30 September 2009



Microfinance Enhancement Facility (MEF)

–The fund was established in 2009 in response to the global credit crisis to refinance loans to well-established MFIs. MEF was founded by the International Finance Corporation and KfW

Entwicklungsbank. BlueOrchard Finance is one of the co-managers of the fund, together with Cyrano Management and responsAbility Social Investments.

Figures in EUR as of 30 September 2009

Net Asset Value:	12.37 million
Portfolio maturity:	19 months
Number of loans outstanding:	4
Number of MFIs with outstanding loans:	4
Number of countries in which there are outstanding loans:	4

BlueOrchard Microfinance Securities 1, LLC (BOMS 1 – 2004/2005) – The world's first international structured microfinance product created by BlueOrchard with two partners offered US private and institutional investors an opportunity to acquire notes collateralised by MFI debt obligations. The deal was closed in two tranches (2004 and 2005).

Figures in USD as of 30 September 2009*

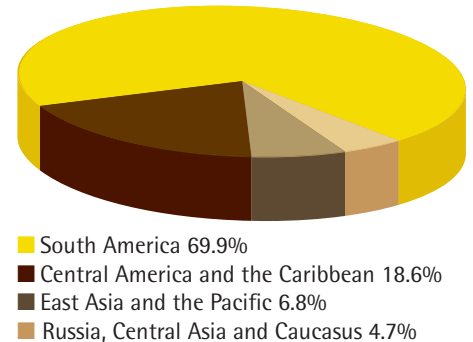
Total Assets:	81.1 million
Portfolio:	74.0 months
Number of loans outstanding:	16
Number of MFIs with outstanding loans:	13
Number of countries in which there are outstanding loans:	7

* unaudited

Yield:

OPIC Notes:	4.45%
A Notes:	4.94%
B Notes:	6.10%
C Notes:	8.27%

Regional distribution as % of the portfolio as of 30 September 2009



BlueOrchard Loans for Development 1 (BOLD 1 – 2006) – A second collateralised debt obligation closed in April 2006 with Morgan Stanley and FMO (the Netherlands Development Finance Company) as partners.

Figures in USD as of 30 September 2009*

Total Assets:	100.8 million
Portfolio:	96.7 million
Number of loans outstanding:	21
Number of MFIs with outstanding loans:	21
Number of countries in which there are outstanding loans:	13

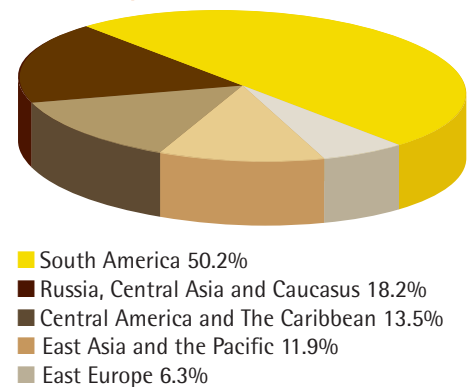
32.6% of the loans made from this fund are made in local currency

* unaudited

Yield:

A1 notes:	Euribor € 3M + 0.75%
A2 notes:	5.59%
A3 notes:	6.02%

Regional distribution as % of the portfolio as of 30 September 2009



BlueOrchard Loans for Development 2 (BOLD 2 – 2007) – A third collateralised debt obligation closed in May 2007 with Morgan Stanley and FMO (the Netherlands Development Finance Company) as partners. Like its predecessors, BOLD 2 finances non-guaranteed loans to a diversified portfolio of MFIs. Part of the loans is in local currencies, with exchange rate risks being covered by derivative products. The senior tranches A (USD 44 million) and B (USD 16 million) were rated by Standards & Poors and received respectively AA and BBB scores.

Figures in USD as of 30 September 2009*

Total Assets:	111.4 million
Portfolio:	106.7 million
Number of loans outstanding:	21
Number of MFIs with outstanding loans:	20
Number of countries in which there are outstanding loans:	11

34% of the loans made from this fund are made in local currency

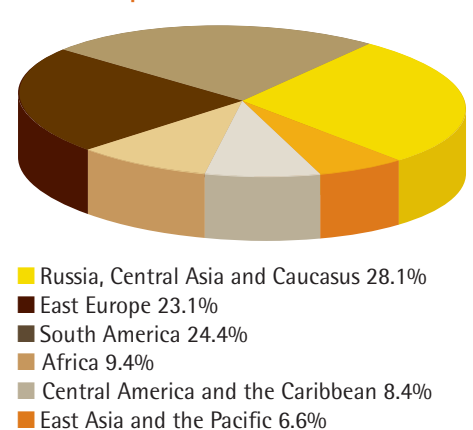
* unaudited

Yield:

A notes:	5.61%
B notes:	6.16%
C notes:	7.73%*

* WA of combined fixed and floating rate.

Regional distribution as % of the portfolio as of 30 September 2009



BlueOrchard Private Equity Fund

The BlueOrchard Private Equity Fund is a SICAV registered in Luxemburg in December 2007. The Fund seeks to forge long-term partnerships with microfinance organisations across the world. It acquires minority stakes in their capital

while playing an active governance role by sharing international experience, information, networks, knowledge and taking active part at board level. It is committed to achieve strong tangible social returns along with market financial returns.

Figures in USD as of 30 September 2009

Total Assets (committed capital):	133.3 million
Total investment disbursed:	44 million
Number of equity direct investments:	8

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