Achievement of Market-Friendly Initiatives and Results Program
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AMC Business Plan Review 2004

Final Report

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Annex I AMC Business Plan Report 2004

AMC Microfin – (CD included with this report)

SUMMARY REPORT

In accordance with the Scope of Work, the consultant spent two days reviewing the Business Plan prepared by senior management of AMC:

The Business Strategy of the Business Plan:

Senior management has adopted a strategy of growing the loan portfolio through increasing the productivity of loan officers to a reasonable case load of 120 clients per loan officer and an increase in the loan size in the JD 3,000- JD 8,000 range[1]. This strategy is quite reasonable, although the following issues should be considered:

(i) AMC is focusing on the Amman, Irbid, and Zarqa governorates, which are the most competitive banking/microfinance geographic areas in the Jordanian market. The Updated Credit Demand Survey (October 2002) indicates that the effective demand in the governorates for loans in the JD 3,000-8,000 range is about JD 20.56 million. If 20% of those wishing to borrow proved to be not creditworthy, the creditworthy effective demand would be about JD 16.5 million. With a projected loan portfolio outstanding of JD 2.8MM (Running Project and Household loans) in FY 2007, AMC would have to achieve a market share of 16.9% of the current demand.

If market demand were to grow at 5% p.a. over the next four years, this would equal a 14% market share of future demand. This looks challenging. It is suggested that management review the aforesaid survey and cross check this data with the loan officers concerned, to identify exactly where their potential client base is within these governorates.

(ii) Paragraph 1.3 notes that the portfolio growth will be driven more by an increase in the loan size rather than by an increase in the case load per loan officer. The microfin model indicates, however, that the loan size declines slightly from JD 3,116 for FY 2003 to JD 2,938 for FY 2007. Conversely the caseload per loan officer increases from 65 for FY 2003 to 107 in FY 2007.

(iii) AMC is extending loans to start-up businesses, which are considered high risk by most lenders. With a maximum exposure to these loans, though, of JD 69,000, and its ample loan loss reserve, AMCs risks are limited.

(iv) AMC projects that 65% of the future portfolio growth will come from car loans, with this product's loan portfolio growing from JD 167,000 in FY 2003 to JD 1,875,000 in FY 2007. Most lenders, when appraising these loans, rely heavily on the borrower's job security, and their ability to recover their loan through adequate collateral resulting from the discount of the car's resale value to the loan outstanding. A lot of emphasis also is placed on the borrower's current

[1] Para. 7.16 mentions JD 3,000-8,000, para 19.2 says JD 5,000-10,000; and para 8.5 notes JD 3,000-10,000.

debt service ratio, which will be hard to ascertain correctly in the absence of a functioning credit bureau. This loan portfolio also would be extremely vulnerable to an increase in the cost of oil, resulting from a non-renewal of the short term agreements with the UAE, Kuwait and Saudi Arabia. These factors place considerable importance on the thoroughness of the credit appraisal undertaken by the loan officer, and on close supervision by senior management of both the individual credits and the overall portfolio.

The Projected Results of the Business Plan:

(i) AMC has borrowed from the Wholesale Funding Facility (WFF) (in August 2002). This borrowing could result in AMC being eligible to receive a distribution of capital from the WFF at the time of its dissolution, as is alluded to in para. 19.3. If this is the case, the receipt of these cost- free funds needs to be factored into the projections.

(ii) As noted in the business plan, AMC derives a considerable advantage from its cheap weighted average cost of funds. If the AMIR grant and the MOP loans are costed at the market rate of 8% (para. 14.10), the cost of funds would increase by JD 913,000 over the five year period. This would result in an accumulated loss over the five year period, and delay annual profitability until FY 2005, other things being equal.

(iii) The sharp jump in profitability between FY 2003 and FY 2004 appears primarily to be the result of the increase in the caseload per loan officer , which rises from 65 loans to 86 loans respectively. With the relatively recent introduction of the start-up, household and car loan products, a more gradual build-up in the caseload would help limit future non-performing loans resulting from lack of familiarity with the new products on the part of the loan officers.

(iv) The operational and administrative costs per employee are projected to rise about 14% over the five year period of the projections. It is noted, though, that the other operational expenses at both the program and administration levels remain fixed for FY 2005-2007, and fall between FY 2003 and FY 2004. Whilst good budget control is to be applauded, some allowance should be made for an increase in these costs over time.

Issues with the Microfin Model:

(i) The Balance Sheets for the five year projections do not balance. The difference appears to arise due to the inclusion in the opening balance sheet in the financial statements tag of the Microfin program of a loan from the MOP of JD 1,250,000; which is excluded from the opening balance sheet in the Model Set-Up page of Microfin. This difference needs to be corrected.

(ii) The projections carry forward for each year a current liability of JD 216,000. By their nature, these are obligations that should be paid within the following 12 months. Treating these items as being paid will impact both the liquidity of AMC and incur an annual finance charge of about JD 17,000 p.a.

(iii) The business plan in paragraph 14.2 undertakes sensitivity analysis regarding the impact of the "cost free" grant funds. The adjusted operational sustainability ratios, however, appear to be misrepresented, and should be reviewed.

(iv) The financial sustainability ratio, as reported in the Income Statement Analysis Microfin printout, records the financial sustainability ratio as being superior to the operational sustainability ratio for years FY 2004-FY2007. This is counterintuitive, and needs to be checked[2].

(v) The business plan would benefit from the identification of potential risks, and a discussion of how these risks are to be handled, facing AMC as it moves forward. These risks would include an increase in the oil/petrol/gasoline prices (the effect on the car loans) and the impact of a sharp rise in interest rates by the CBJ as a result of a drop in aid levels from the U.S.

(vi) It is suggested that profitability models be prepared for the branches in Zarqa and Irbid to assure that they become profitable within a 2-3 year period.

[2] There is a strong correlation between these ratios and the sensitivity analysis noted in (iii) above.