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REVIEW OF BANCO BANEX S.A.

Pursuant to Project 515 - 7227

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I. EXECUTIVE SUMMARY

A. Purpose of Review

The purpose of this study is to:

- review the portfolio and pipeline of projects of Banex Internacional S.A. to evaluate the respective
    * additionality
    * risk profile
    * financial soundness
    * development impact

- review Banex's credit process for promotion, analysis, approval, administration, and supervision insofar as this relates to the fulfillment of the terms of the loan contract with AID

- review the staffing and organizational structure at Banex to determine the extent to which it contributes to Banex's overall mission of development lending

- review the financial position at Banex to determine its profitability and its operational capability to sustain a market position within the private financial community

B. Methodology Used

The reviewer familiarized himself with background material and prior revisions of Banex. In the Banex revision, every credit file was reviewed to assess the effectiveness of credit initiation, analysis, and loan administration, as well as the strength of each credit and its suitability as development lending.

Meetings and discussions were held with all of the staffers of the Banex Development Unit, as well as other key management people within Banex. In addition, five of the Banex projects were visited, and brief discussions were held with key managers of these projects.

The Banex staff cooperated fully with the review and facilitated all of the information requested in a timely and expeditious manner.

C. Findings and Conclusions

portfolio

Banex s 6-30-87 AID funded long term portfolio of US$ 7.6 million in approvals and US$ 6.5 million in outstandings can be considered authentic developmental lending. The portfolio achieves additionality and a higher than commercial bank risk, even considering that the hypothetical commercial bank could have access to long term funding sources. The assessment for this higher than commercial risk is founded on the significant amount of start up projects financed, 14 of 21 relationships. Thus, it cannot be considered that every project achieves additionality, and it is not logical that every one should, but on the whole, the portfolio does achieve this effect.

Up to now the Banex development portfolio has been heavily weighted to the flower / plant / fern agricultural subsector where the analysis and follow up staff has achieved considerable market expertise. However, this has resulted in a lack of diversification of the portfolio. While there is an additional plant project approved but not yet disbursed. Banex management is now focusing in other areas to permit some diversification away from this subsector.

Banex management has maintained a controlled risk profile on the portfolio, maintaining a typical collateral coverage in the range of 90 to 100% with the collateral normally valued at a discount factor of about 20% below market. However, in the flower / plant / fern subsector, as well as in other agricultural loans, the collateral valuation has been steped each year to take into consideration the increasing value of the land and plantings as the project develops. This permits a higher degree of feasibility in consideration of projects.

Despite Banex's careful and measured analytical approach to developmental lending, there are eight of 21 problem relationships in the portfolio, with outstandings of US$ 2.2 million. This situation reaffirms the inherent higher risk in this type of portfolio.

The Banex management team has done a strong job of containing the risk of these problem loans by understanding the credit and the problems and exploring alternatives. The Banex staff has also been particularly helpful in pushing numbers and weighing options with the people of the various problem projects. The Banex people have demonstrated patience with these projects, and a willingness to structure as necessary (within prudent limits) in these situations.

Only three of these projects reflect serious problems at this time, and there are no write offs anticipated yet on this portfolio. Banex has sustained US$ 70,000 in losses on the development portfolio as the result of selling their equity position in two investments made earlier (as opposed to loans).

redit process

The Banex senior credit staffers, as well as all staffers in the Development Unit, appear to understand their mandate in terms of development lending. They also appear to have a good grasp of what there is in the market for developmental lending and, given their success so far in managing this portfolio, are being selective about future projects.

Our overall impression of the credit analysis capabilities of the Banex Development Unit is quite favorable. They do a good job of breaking the analysis down to critical variables to understand what drives the particular businesses, and the staff makes good use of microcomputers to perform intelligent sensitivity analyses for these projects.

The staff also performs a strong job of administration and follow up, which is so important in this type of lending. A Banex agronomist has an active call program, visiting all agricultural clients monthly, and the problem loans weekly. The result of his practical and frequent input is a close, hands on understanding of each of these credit situations which permits taking of action in a timely and anticipatory manner.

The remedial administration of the problem credits is also effective in that monthly reports are circulated up the approval chain where the most experienced credit staffers must approve of the strategies being followed. This assures that more people look into these situations that require greater care, and permits the institution to benefit from the accumulated credit expertise of its key people.

organization and staffing

The Banex organization is well organized with effective and professional leadership at the top and a delegated system of responsibility, which yields accountability within the portfolio management. This system was developed empirically over the years, which demonstrates that management may evolve in the right directions over time. This situation also reflects a serious and professional board of directors which permits management to manage, under established guidelines.

Credit committees exist within the Banex organization and appear to function properly. These ennance the operational effectiveness of Banex by permitting a smoother work flow within the organization, not requiring board input to virtually all credit decisions.

financial situation

The consolidated Banex financial situation is a strong one, with strong earnings and appropriate balance sheet relationships. In particular, the consolidated leverage of nearly 10 presents a solid capitalization while permiting appropriate returns on equity to situate Banex as a highly viable local financial institution and investment opportunity.

Banex management information systems track revenues from all profit centers, including the AID portfolio. However, Banex does not perform cost allocations to different departments so that accurate profitability figures per department are not available.

Nevertheless, taking institutional relationships of 3.6% in operating expenses to average assets, and loading this further to 5% to take into account higher analysis and follow up costs on the development portfolio, we get a current approximate net spread of 4.5% (9.5% gross spread - 5% operating costs) on the development portfolio, before loan loss reserve allocations.

This dollar portfolio spread is lower than the overall Banex consolidated mostly local currency spread. But being in dollars, this dollar based spread presents a hedge on devaluation. This dollar spread can be considered a good one, (a solid net spread for a U.S. bank would be in the range of 2.5%) although Banex's loss experience on the portfolio is yet to be defined. Some losses on investments have been taken, but none yet on the loan portfolio.

It should be noted that as LIBOR rises, so will Banex's spread since revenues are tied to LIBOR while the cost of the funds is 2% fixed, in accordance with AID Washington policy. Thus if rates go up, Banex gets a windfall profit, at the expense of its clients who would be paying higher amounts of interest expense.

On the other hand, in a high interest rate environment Banex might need a larger spread to cover increased write offs of projects not able to withstand the increased interest costs, as occurred in the not too distant past.

compliance with the loan contract

Banex has complied with the requirements of the loan contract with AID both in spirit and in law. New negotiations with Banex are now underway, and one of the items on the agenda has been a tightening up of the development loan definition, to make more explicit the additionality concept.

II. FINDINGS

A. Portfolio Characteristics

Overview

At 6-30-87 Banex's AID dollar funded long term credit/investment portfolio consisted of 22 relationships for a total of US$ 7.6 million in approvals and US$ 6.5 million in outstandings. Twenty-one of these relationships are straight credits, while one relationship (Plantas Verdes) for US$ 95,000 remains a direct co-investment of Banex. An additional US$ 50,000 has been loaned to Plantas Verdes.

Of the loans, two (Bromelia and Costa Flor) for US$ 750,000 were initiated as co-investment but Banex's equity participation was sold (at a loss) during 1987. These two loans were sold as a result of problems with the credit and management's determination that Banex's position would best be managed as a creditor only, and since the operations of the Banex Trading Company affiliate, where the loans were booked, have been discontinued. Management is hoping to sell the remaining co-investment relationship, if a buyer can be found.

At this same time US$ 2.3 million in short term AID dollar funded facilities were booked, in accordance with the loan contract. An additional US$ 1.2 million was originally destined to the capital and activities of Banex Trading Company, thus completing the US$ 10.0 million of the private sector productivity project. This subsidiary is now being liquidated.

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A new amendment to the loan agreement is now being finalized betwen AID and Banex. This amendment will permit booking of short term obligations only on a phase out basis, establishing time limits for conversion of all AID bookings to long term development loans. Apparently, a sublimit of US$ 7.0 million is being set for 12-31-87. Given 6-30-87 long term outstandings of US$ 6.5 million and the recent new development credit approvals, and some disbursements, Banex should have no difficulty in complying with this December 31 target.

Portfolio Industrial Groupings

Of the 21 relationships with outstandings as of 6-30-87, 14 of these, representing US$ 4.8 million, was for new projects, while US$ 1.7 million was for expansion projects of existing operations. Fifteen of the relationships are agricultural, and mostly within the flowers / plants / ferns sub grouping. Banex lists seven industrial relationships, although one of these is tourism (Hotel Amstel) and another is arguably agricultural (Liga de la Caña) since the project was appended to an existing sugar mill. This leaves only five real industrial credits, with total 6-30-87 outstandings for a total of US$ 655,000.

These figures reflect a lack of diversification within the development portfolio. However, it appears that this situation has been intentional on the part of Banex management in view of the difficulty in finding appropriate industrial projects that fit within the provisions of the AID loan contract and in view of Banex's success so far in directing portfolio growth to the agricultural sector. Banex management apparently feels comfortable with the flowers / plants / ferns sub sector and, indeed, has built up some expertise in lending to it. However, a recent solid potential fern project was rejected on the grounds that Banex has sufficient exposure already in the fern subsector.

Structuring

The typical loan tenor of the term dollar portfolio is five years, although a couple of longer (macadamia) loans were found. Grace periods ranged from zero to four years, with one year being the median figure, and two years common.

These tenors appear appropriate, and flexible, in accordance with the needs of the particular projects. Except for the macadamia loans, which are already at the limits of what can be structured within this type of portfolio (7 years, 3 to 4 grace), there was no indication that tenors as structured [illegible]e inadequate for the needs of the projects.

Most loan pricing was LIBOR + 3%, plus commissions. This standard pricing is used since it is the maximum amount that the Central Bank will register for dollar loans taken by Costa Rican borrowers. The spread is a commercial one and is appropriate so as to refrain from subsidizing otherwise uneconomical projects.

This pricing allows for a generous spread given Banex's cost of funds, and helps compensate for the costly loan analysis and administration process necessary for developmencal lending. This strong spread also helps build up earnings and capital to withstand potential higher writeoffs from the developmental portfolio further down the road.

Additionality

AID appropriately focuses on "additionality" in analyzing a development portfolio. The basic concept here is wether a commercial bank would grant the same credit, and under the same terms. Refining this concept one step further, one can examine whether the hypothetical commercial bank would have granted the credit even with access to concessional funding sources.

Based on this viewpoint, the Banex AID funded long term portfolio essentially falls within these parameters, especially when considering the high number of start up and agricultural operations being financed. A commercial bank with matched funding sources would probably focus on expansion projects to existing customers, not to start up ventures. Commercial banks would not normally finance start up businesses due to the higher risk and a commercial bank's lack of development expertise and follow up capabilities, especially in the agricultural sector.

In terms of additionality, there appears to be an exception for a small loan (US$ 75,000) to an established candy manufacturer (El Gallito) and exporter for the purchase of a computer. This loan was apparently done under the concept that the borrower exports a non traditional product, but in this case the borrower could have probably obtained this loan from a commercial bank that had longer term funds available.

Another industrial client (Hules Técnicos) which exports gaskets and rubber seals (non traditional exports) to the USA, and which

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presents strong earnings, could conceivably obtain commercial bank financing. But the size of the operation, and the relatively short existence of only 10 years, still reflecting high growth and "cash short" characteristics, probably still situates it within a "developmental" classification. In any event, AID could perhaps be more forgiving in this case because this particular operation is precisely the type of project that falls within AID guidelines for promotion of alternative and non traditional industrial and export capabilities within the country. This client is also being financed by the Private Investment Corporation.

Risk Profile

Because of the portfolio s composition as a developmental one, with numerous loans to new projects and with longer than commercial loan tenors, the risk profile is inherently higher than with a strictly commercial portfolio. There are many more "ifs," more things that can possibly go wrong, and more time for this to happen.

The portfolio, while of course reflecting a higher degree of risk than one of short term commercial and industrial credits, seems to reflect a profile or characteristic of a measured, or controlled risk. Management has apparently achieved this control through careful analysis, vigorous follow up, and a measured degree of loan support. This has permitted Banex to build up expertise in this type of developmental lending. This has especially been the case with the flower / plant / fern subsector.

The expertise built up in this subsector helps them understand and control further the new loans made, as well as the manage the existing ones. It also helps them be more selective about projects and facilitates their marketing efforts. They do not have to spend a great deal of time in looking at a project to determine if it is feasible, and seem to have a ready feeling for potential credits. Strategically, this puts management in a comfortable position since by virtue of their built up expertise, they have a good market understanding and don't have to spend a lot of time deciding on where they want to go with the portfolio.

As part of this risk control, Banex management looks at the collateral coverage on every loan. The typical coverage seen in the analyses has been in the range of 90 to 100% (several higher, few lower), with the collateral typically valued at a discount factor of about 20% from market. However, in projects of a construction or growth nature, such as flower, plant, fern, and macadamia projects, the collateral valuation is stepped each year to take into consideration the increasing value of the land and plantings as the project develops. This allows for a higher degree of feasibility in consideration of projects.

Development Impact (see annex)

Banex credit management periodically compiles for AID a listing of the development portfolio and includes information on the amount of project investment and the development impact (see attached annex). This is done by tracking estimated and actual employment and foreign exchange generation. We have discussed the preparation of this report with the person in charge and conclude that the figures appear to be accurate, so far as accuracy is possible, and that the numbers are compiled in a conscientious manner.

However, some explanations should be noted to possible distortions in the numbers. The total estimated project investment figure is for the finished project. The same logic applies to employment generation. For this reason, in the case of projects under development, actual investment and employment figures lag the total investment or generation figure, sometimes by a considerable margin.

So too with respect to the foreign exchange generation, although it should be noted that the last column is an accumulated number. It seems to us that a figure for annnual FX generation would be more helpful to permit measuring one year against the other.

The Hotel Amstel loan, one of the earlier ones made, reflects a high FX generation, and this is so because the number is four times the annual figure. On the other hand, while the Liga de la Caña loan envisioned generation of US$ 8[illegible],000 per year, there has been no generation because the project has been discontinued (although the debtor continues to make payements from its considerable other cash streams).

The Hotel Amstel figure is nearly half of the total amount for total accumulated foreign exchange generation so far, and may present some distortion in the sense that there is less of a

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cause and effect relationship between the project and FX generation. If the project would not have been done, the tourists could have stayed at another hotel. In this sense it is different from, say, a plant operation wherein if the project were not done, there would have been no FX generation from this source. There is thus no way to measure the true generation of this tourism loan, but some allowance should be made in interpretation of the total figure, especially since this particular project represents nearly 50% of reported foreign exchange generation.

However, total projected figures are consistent. And, in the Hotel Amstel case the projected FX generation is only 5% of the total. The Amstel figures also tend to stick out because it was one of the first loans made so that accumulated totals are significant within the totals.

Pipeline

The Banex Development Credit unit has about US$ 2 million in the pipeline for 1987. A considerable portion of this amount has been approved but not yet disbursed, while other projects look quite firm for approval. These projects include: Helechos Tropicales, US$ 500,000; Exporpac, US$ 400,000; Teneria Primenca, US$ 500,000; and Yuca Tica, US$ 500,000. The Helechos Tropicales project belongs to shareholders of another successful project currently financed by Banex.

Given the amount of this pipeline, it is likely that the conversion of short term dollar loans to the approximately US$ 3 million in additional long term development loans can be achieved

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within a reasonable time. We feel that these loans would be, if anything, stronger than the average existing portfolio since Banex has been able to build up a fairly strong expertise in analyzing and managing this type of loan, and this expertise can be brought to bear on the new loan proposals. From the development perspective, these loans would probably reflect at least the same approximate characteristics of the existing portfolio.

Several loans have been turned down, for apparently valid reasons. In two cases involving possible macadamia projects, technical analyses indicated that the land was not appropriate for macadamia in one case, and in the other there was insufficient confidence in the managerial and administrative capacities of the principals. Given the long term needs of this type of project in particular, these are sound credit reasons for turning down the projects.

Problem Loans

Despite Banex management's careful and measured analysis, 8 of the 22 relationships, with 6-30-87 outstandings of US$ 2.2 million (including US$ 90,000 in an equity investment) have been identified as problem loans, as is inevitable with a development portfolio where credit risk is inherently higher than for short term credits. Intensive follow up efforts have been maintained to manage these situations, which reflect varying degrees of severity. Only three of these reflect serious problems, and the experience gained in these more intensive remedial efforts have

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helped overall in terms of contributing to the in-house expertise and in permitting anticipation of where problems might arise in other credits.

Except for the remaining co-investment loan that may eventually be sold, at this time it does not appear likely that credit losses will be sustained on any of these problem projects, although the situation could deteriorate on a couple of them. But restructuring will probably be necessary on most of these. At the present time, therefore, no write offs are anticipated against the loan loss reserve.

Since most of the loans in the portfolio are still on grace periods, it is still too early to detect trends based on past due portfolio characteristics. But in any event Banex management does not rely on past due statistics to detect problems with this portfolio, relying instead on an active call program and vigorous follow up. This follow up is done weekly on the more serious credits, with visits by Banex s agronomist.

Losses on the portfolio so far have been for US$ 70,000, taken as the cost of getting out of the two equity investments mentioned so far. The amount of the investment sold on these two operations has been financed within the portfolio above. If the third equity investment (Plantas Verdes for US$ 95,000) could be sold, this would probably involve a partial loss as well.

B. CREDIT PROCESS

Target Marketing

In terms of the development portfolio and its future growth, the

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Banex target market definition is an implicit one, built up empirically from experience within their portfolio. No formal written document exists, but the Development Unit Head and his supervisors seem to have a strong, parallel grasp of what their developmental market is. The general manager, the credit assistant manager, the credit unit head, and the project analysis unit head appear to understand their mandate in terms of development lending. They have apparently carved their niche in this developmental sector, and are being somewhat selective about future projects.

In terms of this portfolio, Banex management has had the benefit of credit cross fertilization from its commercial portfolio. That is, some commercial clients, if they have a project, automatically bring it to Banex since they already have a working relationship. Conversely, for entirley new relationships, the commercial aspects of the business (letters of credit, export liquidations, Bolsa business, etc.) are of course channelled through the appropriate Banex unit / legal vehicle. This is one of Banex's advantages, as a private commercial bank, in doing development lending.

The Credit Process

Analysis of a credit institution's portfolio and its credit process are inseparable exercises, since it is the credit process itself which will, over the long run, determine the quality and focus of the credit portfolio. Any deficiencies in the process will likely result in weak credits or inappropriate positioning vis a vis other creditors. This focus is equally valid in terms of a developmental portfolio, since to achieve this portfolio, there must be a system and people capable of analyzing, structuring, documenting, and administering in accordance with this mandate.

analysis

Our overall impression of Banex's credit analysis capabilities is good. They seem to do a strong job of focusing on key variables and using common sense to analyze projected numbers, and to get behind the numbers to understand what drives them. The analysts focus on the big picture, putting things in perspective.

For example, on the Hules Tecnicos loan, where the financial figures of this local company are affected to a major extent by the policies of the mother company that markets the products in the USA (forcing the local operation to finance, at present, about ONE YEAR of sales as accounts receivable), Banex management analyzed the situation and decided to scale down the credit when the mother company would not provide sufficient financial information. The analytical staff also normally focuses, very appropriately for this type of project, on management's capabilities to direct the operation.

Project analysis cash flows are built from these key variables, focusing on sensitivity numbers as appropriate. The technical aspects of the numbers analysis are solid, utilizing cash budgets, funds flows, and projected financial statements.

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Microcomputers are used extensively to simplify the job.

However, in terms of the full project analysis, Banex could benefit from a more structured approach to presentation, thereby permiting a more concise and precise analysis while making sure that nothing has been left out. In particular, Banex should develop a one page loan approval summary form to facilitate understanding of total approvals, as to amounts and types of facilities, and to relate these to the company's net worth and to the amount of collateral support.

Because of the skill level built up within the department, the average time to process loan applications is very reasonable, taking normally two to four weeks (depending on the complexity) for the development projects. There were no complaints from clients in this regard.

administration

Since all loans are term loans with numerous covenants and clauses, there is a considerable amount of follow up work that has to be done for each credit. Administrative people perform these chores, following up on the progress of projects by obtaining financial and other information and by verifying maintenance of insurance coverage on assets pledged to Banex. Performance of periodic inspection on pledged assets are performed regularly, and close control is maintained on collection of interest and principal payments (though most loans are still on their respective grace periods).

These administrative efforts appear to be done in a fairly complete and conscientious manner, and are a key to the Banex sucess so far. Follow up of projects is invaluable to provide increased understanding of each particular business, and to provide insights on where things might go wrong and why. This is perhaps the most important element in managing this type of portfolio, and this is where experience is gained. Analyzing a project in theory is one thing, but seeing the project unfold in practice is another. Bridging this gap is of vital importance to understand future projects, or existing, newer ones. Banex has done a strong job in this critical area.

The portfolio of 22 relationships is managed by the Development Unit Head, an account officer, and an agronomist. Other people within the credit department provide support, including the credit supervisors. This situation works out to 11 relationships per officer, which seems to be an appropriate number for this type of credit.

Most of the administrative credit and portfolio information and control is computerized, on line, and readily accessible through the terminal located within the credit department. The operations and data control areas make sure that the information is accurate. The information flow in general appears to be managed in a satisfactory manner.

In terms of managing the credit situations, credit files at Banex are secondary and apparently not used to centralize information. The portfolio appears to be managed from monthly printouts and credit reports. This is not necessarily bad, but greater use of the credit file as a management tool could be beneficial. In particular, Banex should develop a credit approval / summary form, to be updated at each credit revision. This form, with all existing facilities listed, should be the basis for updating computer records as to credit approvals.

The existing portfolio controls, and the credit staff's positive attitude toward them, combine to imbue a healthy anticipatory posture within the development portfolio. As a result, problem recognition can be achieved quicker, thus permitting greater options in terms of remedial management.

<u>remedial management</u>

The Banex staff keeps a close watch on the six problem credits, reviewing and visiting each such project at least monthly. Plans are devised, setting targets and deadlines for action to be taken.

This review is accomplished, appropriately, up the approval chain as well as within the unit. That is, the Credit Unit Head, the Bank Services Head, and the General Manager (all credit superiors of the Development Head) are all involved in reviewing and approving the monthly problem loan report. This ensures that the situation is being looked after, and brings to bear on each problem loan the added experience of the more senior credit people within the organization.

This close follow up cuts down on surprises, and also allows the Banex staff to be more useful, and more helpful, in suggesting possible cures to the clients involved. Indeed, in some cases the Banex staff almost perform the function of management consultants to their borower clients. This can be of considerable help to projects that have encountered problems since the expertise gained by the Banex staff may be helpful to overcome problems encountered in other projects.

The Banex staff has been patient with projects that have encountered problems, and been willing to restructure as necessary to get the project moving in the right direction. In one case in particular (Inversiones Palmetto) the Banex Development Unit Head performed his own in depth analysis of the project, which uncovered inefficient and hence unprofitable plantings of certain varieties. The numbers in the analysis convinced the principals that more productive varieties should be substituted for the former, and the new varieties have been planted.

C. ORGANIZATION AND STAFFING

The Banex organization is comprised of the following Costa Rican corporations: the holding company (Corporacion Banex, S.A.), the Banex bank (Banco Banex, S.A.), the Bolsa vehicle (Banex Valores, S.A.), and Banex Trading, S.A. (being liquidated). Additionally, the group includes the Panamanian subsidiaries: Banex Internacional, S.A. and Bantra (Panama) S.A. (the latter is also being liquidated). The AID dollar portfolio has been channelled through Banex Internacional (BISA) since this is a Panamanian company with accounting done in dollars.

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Banex (the bank) is managed by a general manager, to whom report three areas: Banking Services, Operations, and Bolsa. The first of these has responsibility over Marketing and Credit (including the Commercial and Development Units), the second over Accounting and Back Office Operations, Data Processing, Personnel, and International (shortly to be restructured under Banking Services), while the Bolsa Unit (through a separate company) handles all Bolsa operations.

The organization seems to be managed effectively and in a professional manner. Despite the difficulties of staffing in a thin market, Banex seems to have developed an effective management team. This has been achieved the hard way, by empirical development, and by a common sense attitude prevailing throughout the credit staff. Although the AID dollar portfolio is booked in BISA (the Panamanian subsidiary) manangement and administration of the portfolio is carried out b the Banex organization in San Jose..

Banex management manages credit, thus breaking with the Costa Rican mind set of a board of directors making all major decisions. While the board oversees policy, and approves the larger credits, a hands on mentality prevails within the organization from the general manager on down. Real credit delegations exist. and this has contributed to create an air of professionalism and accountability, which contributes to effective credit and risk management.

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Within the Development Unit, credites are handled by one of two officers, with support from an agronomist. This is a de facto account officer set up, and helps to nurture accountability within the unit. Close supervision and follow up, weekly for the more serious problem credits, and monthly reporting also contribute to this definition of responsibility. However, on the commercial side, Banex does not use the account officer system, managing instead with administrative reports to the unit head.

The credit committee has a delegated limit of Colones 5 million (approximately US$ 77,000) and is composed of the General Manager, the Banking Services Head, and the Credit Unit Head. Next in the approval chain is the Credit Comission, which has a delegated limit of Colones 10 million and is composed of the credit committee plus 3 designated directors. Approvals in excess of Colones 10 million must go to the full board.

While the threshold amount for full board approval may not seem high in dollar terms, it is high enough in local currency terms. However, for the AID portfolio only 5 of 20 relationships fall outside of full board approval. This is to be expected given the size of the projects, and their structuring in dollars.

D. FINANCIAL ANALYSIS

Systems for Financial Control

Banex has a satisfactory budgeting and management information process. Annual budgets are put together, breaking down the numbers on a monthly basis. These monthly numbers are compared to actuals to measure variances and determine the reasons for these

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variances. However, these efforts are revenue based, and no effort is made to allocate expenses. Apparently, this is due to the difficulty of finding an effective allocation method.

In terms of the financial statements, the operations staff also performs a satisfactory job of putting together the monthly figures. This is not easy because several corporations are involved, involving colon and dollar sets of books and figures. Extensive autimation of the system is evident, with most operations directly on line to the central computer.

Profitability of AID portfolio

These systems measure the revenue generation of all profit centers, including the Development Unit. However, because the system measures only revenues and not costs, Banex does not have profitability figures for the AID portfolio. However, by measuring the operating expense structure of the consolidated Banex organization, we can calculate an approximation of the profitability of the AID portfolio.

Assuming a LIBOR figure of 8%, and considering the normal 3% spread plus commissions, total revenue generation on the portfolio would be about 11.5% (commissions on the long term portfolio are only on new loans and restructurings, therefore we allocate only 0.5%). Taking into account the cost of these AID funds of 2% then results in a gross spread of 9.5%.

The consolidated figure for operating expenses to average assets (see annex) has been 3.6%. If we take this same figure as a base and conservatively increase it to 5% to compensate for added follow up expenses, we then get a net spread of 4.5% on the Banex portfolio (9.5% - 5%, before loan loss provisions. This net spread will rise if LIBOR rises, as it has recently, because the revenues are tied to this fluctuating base figure while the costs of the money (paid to AID) are fixed. However, if LIBOR should drop, so will this spread.

It should be here noted that this spread is sensitive not only to actual shifts in LIBOR, but also for the duration of the change. For example, LIBOR hovered around 7% for a substantial part of this year and only recently has it climbed to the present figure between 8% and 9%. Hence although LIBOR is presently 8%, the noted spread will not necessarily be achieved for the year because of the previous levels maintained for about seven months.

Banex management feels that the risk mimization fund cost should be reduced from this spread, but this dollar fund remains on Banex's books, generating dollar income. And, Banex will perceive FX gains on this fund as the Costa Rican colon is periodically devalued. So although Banex does not have use of the funds, the asset is reported on the Banex consolidated books and is therefore not really expensed. Also, this asset does not require much in terms of management time so that the dollar revenue generated therefrom is almost all a net figure (i.e., not reduced by costly loan management expenses).

The net spread figure on the AID dollar portfolio above is less than the overall spread on consolidated Banex assets (mostly local currency denominated) of 6.5% as depicted on the annexed

Banex financial statements. This net spread on assets is composed of income from operations less interest expenses, compared to average assets. So the AID portfolio, according to these calculations, produces about half the earnings level of the rest of the Banex assets.

The AID loan of US$ 10 million is important to Banex, and at June 30 represented 19.4% of total consolidated assets at a conversion rate of C. 61.75. Assuming a net spread of 4.0% on this portfolio for these first six months (Banex probably makes a higher spread on the short term portion because of lower analysis and administrative costs), and an average portfolio of US$ 9 million (which includes about US$ 2 million short term), Banex s earnings on the dollar portfolio of about US$ 180,000 constituted about 23% (at assumed C. 61.00 average FX rate) of Banex consolidated operating income before provisions.

Consolidated Financial Analysis

The Banex consolidated figures present healthy earnings and appropriate balance sheet relationships. The current return on average assets of 2.5% is good, as is the return on average equity figure of 27% and the net spread on average assets of 6.5%. While we do not have comparative figures for Costa Rican private banks, we would venture to say that most any private banker in Costa Rica would be happy with these numbers.

The Banex liabilities to equity relationship is appropriate, registering a leverage of close to 10. This presents an adequate capitalization profile of 9.4% of assets, which is stronger than the average U.S. bank (around 7%). This characteristic financial institution leverage situation thus permits the strong return on equity figure and situates Banex as a more than viable local investment opportunity.

The Banex loan loss reserve, at 1.7% of assets (¢. 54 million; close to US$ 900,000), appears adequate. The AID loan contract requires a reserve of 1%, so the actual number is almost twice what is required overall.

It is interesting to note that on a consolidated basis Banex currently pays no Costa Rican income taxes. This is due in part to the significant dollar based short term investments. For these U.S. investments, Banex receives interest income net of tax liabilities. For the Costa Rican operations, the losses of some companies (Banex Trading included) help compensate for earnings elsewhere. And, the Panama operations are essentially tax free.

E. COMPLIANCE WITH TERMS OF THE LOAN CONTRACT

The original AID loan agreement was signed with Banco Banex in September of 1981. In February 1984 a novation was signed substituting Banex Internacional as the debtor, with the guarantee of the parent Corporacion Banex. The pertinent obligations of the new borrower are as follows:

* establish a loan guarantee fund

  This has been established with Banker's Trust in New York, with purchases of securities on a quarterly basis. Banex must deposit into this fund 3% of AID outstandings (for the

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first 10 years, 2 % thereafter). At 12-31-86, the risk minimization total was C. 47.6 million, equivalent to US$ 803,000, or 8% of the original loan.

In March of this year, Banex s external auditor prepared a study of AID sourced outstandings on the Banex books to determine whether the amount of the risk minimization fund was correct. This report was sent to AID and confirmed that the fund at that time was overfunded by US$ 90,575.82.

* maintain a minimum 1% bad debt reserve

  The bad debt reserve for Banex, on a consolidated basis, at 12-31-86 was C. 29.4 million, or 1.45% of the consolidated portfolio. At 6-30-87 the figure was 1.70%.

* not pay dividends in excess of 18% of capital

  No dividends were paid from 1986 financial results.

* not use AID funds to pay operating expenses

  AID funds have all been loaned out.

* not make loans in excess of US$ 250,000, without AID approval

  All loans above this amount have been duly approved by AID.

* maintain at least 50% of the credit portfolio long term

  At 6-30-87, US$ 6.5 million were outstanding on a long term basis, representing 65% of the US$ 10 million loan. As mentioned, the contract is being renegotiated. Among other things, this change will increase the percentage of long term loans that should be funded with the US$ 10 million.

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III. CONCLUSIONS

Banex has complied with its mandate of development lending, compiling a portfolio that achieves additionality and a higher than commercial bank risk, even considering that the hypothetical commercial bank could have access to long term funding sources. However, on the collateralization of this portfolio, Banex has been somewhat conservative and could perhaps take on greater risk in this area. With projects already approved but not yet disbursed, and with other projects in the pipeline, it appears that the existing portfolio trajectory will continue.

The credit process at Banex, so important to maintain as sound a development portfolio as possible, is strong. The Banex credit staff has done a good job of analyzing and structuring this portfolio, achieving control and an anticipatory posture through vigorous and intelligent follow up of the projects. This allows the credit staff to manage the portfolio and permits more options in remedial efforts with the more difficult loan situations that are bound to arise in this type of portfolio. The staff should be commended for their fine efforts.

The present organizational structure at Banex is appropriate to manage this portfolio, and, apparently, to manage the other banking and financial businesses within the Banex umbrella as well. This organizational structure, with delegated management authority, contributes to the effective management of the AID portfolio by imbueing accountability and defined responsibilities within the risk asset management system. The structure also permits an appropriate and efficient use of human resources as senior credit staffers, those with the most experience, are part of the approving chain of command.

The consolidated Banex financial results and position situate it comfortably as a viable financial investment in the local market. Banex has a profile of its own, independent of AID concessionary funding. This allows Banex to project itself with credibility as an independent financial institution, with staying power and sustainability in the market.

IV. RECOMMENDATIONS

For Banex

Banex should immediately adopt a loan approval summary form for all credits, both for control and administration purposes. As it is now, it is necessary to dig through the credit files to find out what has been approved, when, to whom, and under what conditions. While the analysis staff may have this information in their heads, this is inappropriate.

All financial institutions should have such a form to recommend a credit, and most do, to define clearly what has been approved and under what conditions, and to document approvals. While board resolutions now provide this function, these resolutions are too cumbersome and do not normally include all the pertinent information. The Credit Approval Summary form should include:

* the name of the company and its location
* its ownership structure, in one line (not a detailed list)
* client category (i.e., industry, agriculture, etc.)
* net sales, total assets and total capital (for purposes of comparing to the amount of total credit approvals, not for financial analysis)
* date of recommendation and approval
* date of credit revision to be made
* total credit approval in thousands, including existing facilities
* present outstandings, if any, and under what facilities
* amount of increase or decrease in total credit facilities
* brief description of credit facilities, including major

terms (if a term loan with numerous conditions, the term loan summary should be attached to the C.A. Summary)

* a listing and brief description, noting the value, of all collateral and support taken for new and existing credits
* a space for the initials of the account executive and other members of the credit committee, and the board members recommending and approving the credit
* a brief, two page maximum, credit remarks section appended outlining the major risks and the reasons for approving the credit (this would be a summary of the project analysis)

For AID

Banex has been effective in implementing development policies and managing a development portfolio. If AID wishes to channel additional resources into the Costa Rican economy for these purposes, careful consideration should be given to Banex.

BANEX CONSOLIDATION - Comparative Financial Statements

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millions of C.R. colones	audited 12-31-85	audited 12-31-86	internal 6-30-87
RATIOS (* annualized)			
return on avg. assets %	N.A.	2.41	2.49 *
return on avg. equity %	N.A.	27.52	27.05 *
return on avg. securities %	N.A.	22.46	23.90 *
net spread on avg. assets %	N.A.	6.43	6.49 *
oper. exp. / avg. assets %	N.A.	3.59	3.57 *
risk min. fund / AID debt %	8.06	8.03	12.89
loans / funded debt	N.A.	1.55	1.79
liabilities / equity	10.96	10.07	9.68
loan loss reserve / portfolio %	1.74	1.45	1.70
BALANCE SHEET			
cash	152.4	336.3	448.9
marketable securities	217.8	296.9	260.4
risk minimization fund	43.5	47.6	79.9
Liquid Assets	413.7	680.8	789.2
loans, net	1362.9	1994.7	2063.1
receivables & other	65.5	125.0	159.7
Normal Risk Assets	1428.4	2119.7	2222.8
investments & other	137.2	59.8	68.4
fixed assets, net	91.7	106.3	106.7
Illiquid Assets	228.9	166.1	175.1
Total Assets	2071.0	2966.6	3187.1
	======	=======	=======
certificates of investment	663.1	1130.5	1452.8
loans payable	1039.2	1283.9	1153.4
other payables	195.5	284.3	282.5
Total Liabilities	1897.8	2698.7	2888.7
common stock	132.8	161.7	179.9
excess paid in capital + adjust.	8.9	14.0	12.8
retained earnings	31.5	92.2	105.7
Total Net Worth	173.2	267.9	298.4
Liabilities + Net Worth	2071.0	2966.6	3187.1
	======	=======	=======
INCOME STATEMENT			
interest on marketable sec	32.6	57.8	33.3
interest + commissions on loans	233.9	324.4	191.7
commissions on banking services	32.7	60.4	31.3
earnings on foreign exchange	7.2	5.0	7.3
Income from Operations	306.4	447.6	263.6
interest & commissions on loans	88.8	133.5	64.3
interest on cert. of investment	94.0	152.1	99.4
operating expenses	80.9	90.5	54.9
Total Expenses	263.7	376.1	218.6
other income	2.6	2.9	2.4
Operating Income	45.3	74.4	47.4
less: loan loss provision	14.7	7.7	6.3
less: provisions	5.3	6.0	2.8

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EXHIBIT #3

COMPANY	OWNERSHIP	LOAN AMOUNT (000's$)	AMOUNT DISBURSED	AMOUNT PAST DUE (000'S$)	TERM (yrs)	DATE	PROJECT	PRODUCT	EXPORT MARKET	TOT.PROJ INVESTM. (000'S$)	ACC.INV TO DATE (000'S$)	TOT.EST. EMP. GENERAT.	EMPLOYM. GENERATION TO DATE	EST.GEN. FX/YR (000'S$)	ACCUM.FX GEN.TO DATE (000'S$)
AGRICULTURAL															
Cia. Agricola Myristica	U.S.	125	125	0	5	15-Mar-83	EXP	Spices	U.S.	500	379	19	19	120	125
Daniel Lester, Richard Roach, Dan Gardiner	U.S.	750	600	0	7	16-Dec-85	EXP	Macadamia	U.S.	2,396	2,027	75	50	1,596	0
Inversiones Palmeto Ltda.	Costa Rica	215	215	30.7	5	12-Jul-85	NEW	Orn.Plants	U.S.	395	380	12	15	222	105
Flores del Irtaru S.A.	Costa Rica	370	370	0	5	20-Aug-85	NEW	Flowers	U.S.	600	1,088	60	59	384	453
Berger y Raigosa Agroind.	Colombia/Venezuela	384	200	0	7	27-Sep-85	NEW	Macadamia	U.S.	551	548	17	15	350	0
Helechos Expreso S.A.	U.S./Costa Rica	450	372	0	5	30-Sep-85	NEW	Leatherleaf	Europe	1,333	1,240	50	43	792	225
Helechos Internacionales	U.S.	160	160	0	5	13-Dec-85	EXP	Leatherleaf	Europe	833	708	35	30	684	540
Flores del Volcan CRP	Costa Rica/Panama	170	170	2.6	5	13-Dec-85	NEW	Flowers	U.S.	332	369	25	31	180	42
Flores y Follajes Tirol	U.S./Costa Rica	350	338	0	5	3-Jun-86	NEW	Flowers	U.S.	809	814	60	52	460	160
Green Helechos S.A.	U.S./Costa Rica	600	600	0	5	7-Aug-86	NEW	Leatherleaf	Europe	1,885	1,400	150	74	1,279	0
. cel S.A.	Costa Rica/Germany	460	295	0	5	29-Sep-86	EXP	Leatherleaf	Europe	817	830	35	26	516	14
Plantas Reales S.A.	Costa Rica/Germany	600	600	0	5	26-Aug-86	NEW	Leatherleaf	Europe	1,363	1,280	90	100	1,200	402
San Miguel Growers	U.S. (1)	250	250	0	-	28-Ago-85	New	Bromelias	U.S.	1,310	1,111	41	55	722	96
Inv. Costa Flor S.A.	Israel (2)	500	500	0	-	28-Ago-85	New	Flowers	U.S.	1,500	1,300	18	60	370	65
INDUSTRIAL															
El Gallito Industrial Ltda.	Costa Rica	75	75	0	5	6-Jun-84	EXP	Chocolates	US/others	75	75	0	0	0	0
Hotel Amstel S.A.	Holland	500	500	0	5	15-Jun-83	NEW	Tourism		1,050	1,294	59	59	797	550
Liga Agricola e Industrial de la Caña de Azucar	Costa Rica	500	500	0	5	14-Aug-85	NEW	Alcohol	U.S.	500	500	12	12	800	0
C.R. Yates S.A.	Costa Rica	250	250	6	5	15-Nov-85	EXP	Yachts	U.S.	451	451	42	39	980	245
Desarrollo de Exp. S.A.	Nicaragua	80	80	0	5	9-Apr-86	NEW	Fiber Glass	U.S.	367	491	42	39	669	468
Hules Técnicos S.A.	Costa Rica	500	250	20	5	19-Dec-85	EXP	Rubber	U.S.	250	250	39	51	1,576	1,101
Industrias Textiles Rose	U.S.	195	0	0	5	17-Jun-87	NEW	DrawBack	U.S.	546	0	100	0	0	0
CO-INVESTMENT															
Plantas Verdes, S.A.	U.S. (3)	145	145	2	-	11-Set-85	New	Orn.Plants	U.S.	270	250	20	17	160	65
TAL		7,629	6,595	61.30						18,133	16,785	1,001	646	13,857	4,734

(1) BANTRA's participation was originally for US$250.000, it was sold for US$200.000.

(2) BANTRA's participation was originally for US$200.000, it was sold for US$180.000. The additional US$300.000 correspond to BANTRA's and OMNI's subordinated debt for US$150.000 each one.

(3) It includes stock capital investment for US$95.000 and a direct loan for $50.000.