

**Listed Microfinance Institutions' Shareholder Valuations and Their Stocks'
Results – Notes on Results to Date**

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Introduction

Microfinance Institutions (MFIs) need equity capital to support their purpose – the provision of financial services to poor people in emerging economies – in a financially-sound way.

In order to reach large numbers of the poor, the amounts of equity capital required is considerable and is commonly estimated to exceed the volume that charitable-giving (through grants and equity-like financing) can provide, even on a country-by-country basis.

This need for equity capital in volume, and the financial success of many leading MFIs, is driving two further trends – 1) the increasing involvement of commercially-oriented equity investors in the ownership of MFIs, and 2) the use of public equity markets by qualified MFIs, to raise new capital and to give investors convenient means to buy-into and sell-out of such MFIs.

Given the relatively small asset size of most MFIs, even those with share-ownership structures, public equity markets have not been a funding option and may not be for the foreseeable future. Such MFIs necessarily rely on founders' equity, 'investor angels' equity, and venture capital/private equity funds' equity. In such cases, estimating financial returns and changes to Shareholder Value must necessarily rely on historical accounting data and investors' projections thereon. The WSAS MFI Shareholder Value Index series' (WSAS MFI SVIX) results for example are based entirely on the aggregate changes in a portfolio of MFIs' Shareholder Values arising from historical book value information and from cash flows to and from individual MFIs' investors.¹

¹ For details, please see “The WSAS Microfinance Institutions Shareholder Value Indexes: Methodology, Definitions, and Practices”, at www.wallstreetadvisorservices.com/the_wsas_mfi_shareholder_value_index_series .

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But as more and more leading MFIs use public markets for new capital and/or for listing opportunities, the question naturally arises about how incorporating MFIs' publicly-quoted share prices might affect WSAS' measurement of changes to MFI Shareholder Values.

This Note looks at the results of shares from the 4 publicly-listed MFIs currently covered in the WSAS MFI SVIX series – Banco Compartamos (Mexico), Financiera Independencia (Mexico), Equity Bank (Kenya), and SKS Microfinance (India), with a view to illustrating how shareholder value in financial terms can differ significantly under the two valuation options, and why the WSAS MFI SVIX methodology is the better option.

To jump ahead, we conclude that such shares so far have not demonstrated enough liquidity to make public share prices satisfactory substitutes to the pricing method used by WSAS for the WSAS MFI SVIX series. However, since some significant ownership transfers take place at 'market prices', such as initial public offerings and post-offering sales on the stock exchange, market prices are incorporated in index results.

if the liquidity improves and if more MFIs take the public listing route and also develop liquid markets for their shares, WSAS will develop some hybrid way to measure changes to MFI Shareholder Value that more consistently includes publicly-quoted share prices.

Performance Features of the Listed MFIs' Shares – The Metrics Defined

WSAS looked at MFIs' share price performance across 3 metrics:

- * *Implied returns to investors*, as measured by change in share prices over time (in local currency terms);
- * *valuations paid*, as measured by share price multiples to book value per share (P/BV); and
- * *demonstrated liquidity*, as measured by volumes of shares traded relative to the total shares issued by the companies.

The charts at the end of this Note provide quick visuals on how stock prices have moved over time (adjusted for splits and cash dividends paid out), and of the volume of trading underlying these price movements.

Implied returns consist of the potential or 'paper' gains/losses which investors could have achieved, assuming they bought in at initial public offering prices (or in the case of Equity Bank, at the stock's first actual closing price) and held their shares through-out the periods examined. This is a big (and commonly used) assumption in stock market evaluations. Of course, a big reason to list shares is to give investors opportunities to buy and sell (and repeat this process ad infinitum) as they view relative value. It's an axiom of investing that 'how much one enjoys the ride, depends on when one gets in and out of the ride'. The rollercoasters are illustrated in each of the price charts. WSAS MFI SVIX valuations for public offerings assumes that one gets in at the start of the ride, and stays on.

Valuations paid, the P/BV multiple, traces the evolution of the MFI's publicly-quoted share price relative to its historical book value per share. As can be readily seen in the tables, there is no constant relationship between these two variables – public opinion about the 'right' share price,

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relative to recorded book values, obviously moves around quite a bit. But it is clear that these opinions consistently remained well above historical book values.

Demonstrated liquidity, the final metric covered here, links the volume of shares traded over the period of a year to the number of shares outstanding at the end of the year. A company's stock is generally considered to be liquid when orders to buy or sell in volume do not materially affect the price. The less liquid a company's stock is, the less relevant the market price is considered to be. Of course, that means the stock's clearing price may be either higher or lower than the quoted market price. A seller caring to sell a big position may have to take a price well below the prices achieved on small volumes, while a party interested in buying a big stake may have to offer much more than prices on small volumes.

Implied Returns & Valuations – MFI Data

This section looks at details of the implied returns investors in MFI stocks have witnessed over time, and includes the changes in Shareholder Value by the MFIs' respective 'investor vintages' measured under the WSAS MFI SVIX methodology.

Each table presented also notes the Price to Book Value ratio (P/BV(x)) in effect at the time – scaling the stock's closing price at Dec. 31 with the company's book value per share at that same date. All measurements were made in local currency terms.

Basic Data for Compartamos Banco (Mexico) – the initial public offering (IPO) was completed in mid-April 2007, offering 20% of its existing shares at MEX 40.04/share. No new capital was raised by the company; all proceeds went to existing shareholders (= WSAS MFI SVIX's Investor Vintage 2005; IV 2005), which was the principal source for that Investor Vintage's 315% gain in shareholder value in 2007. IV 2005 continues to own 80% of the company, as far as can be determined from public sources.

The IPO created the company's "Investor Vintage 2007", which paid approximately 12.7x book value to the IV 2005 shareholders and thereby, under the WSAS MFI SVIX methodology, suffered an immediate, significant decrease in shareholder value (-92%) that has slowly been recouped through Compartamos' operational results.

Measured by changes to the stock price, however, IV 2007 can be said to have increased its value by 76% from IPO to the end of 2009, assuming a buy-and-hold strategy.

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Compartamos (Mexico) Information Category	From IPO to end 2007	For the Year ending 12/31/2008	For the Year ending 12/31/2009	Cumulative Change from inception to end- 2009
Change in Stock Price (%)	18%	-41%	179%	76%
IV 2005 – SVIX method	315%	13%	15%	441%
IV 2007 - SVIX method	-89%	49%	44%	-76%
Market P/BV (x) at year-end	8.86	3.64	6.96	

Basic Data for Financiera Independencia (Mexico) – FINDEP made its IPO on Oct. 31, 2007, offering 136 million shares to the public, so that 20% of the capital of the company would be publicly held. Of the shares offered to the public, 2/3 were sold by existing shareholders, and 1/3 represented new shares raising new capital for the company.

According to FINDEP's offering memorandum, new investors suffered an immediate dilution of value from the offering price of MEX 24.00/share, to post-offer book value per share of MEX 3.16 (-87%) after considering cash added to book value from the primary shares offered.

As FINDEP had two MFI SVIX Investor Vintages (IV2005 and IV2006) preceding the IPO which created its Investor Vintage 2007, the table below is a little different from that of Compartamos as it includes FINDEP's IV 2006's results.

FINDEP (Mexico) Information Category	From IPO to end 2007	For the Year ending 12/31/2008	For the Year ending 12/31/2009	Cumulative Change from inception to end- 2009
Change in Stock Price (%)	-22%	-61%	112%	-35%
IV 2005 – SVIX method	126%	-31%	16%	79%
IV 2006 – SVIX method	170%	154%	*	585%
IV 2007 - SVIX method	-86%	40%	12%	-77%
Market P/BV (x) at year-end	5.89	3.13	4.67	

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IV 2006 bought a 20% stake in FINDEP in 2006, and its 2007 SVIX-method result partially reflects its 'rebound' from the buy-in cost, as well as its benefits from the IPO. It was bought out during 2008 by the principal shareholders (IV 2005) and through company stock repurchases. IV 2005's SVIX method decline in value in 2008 reflects their costs in buying out IV 2006.

Basic Data for Equity Bank (Kenya) – EQBank listed all its shares on the Nairobi Stock Exchange on August 7, 2006, via a process called an "introduction". No capital was raised and no shares were sold in an IPO; shares simply became available to trade, meaning existing shareholders were provided a means to liquidate positions and the public could buy-in via the stock market. Consequently, no identifiable new "Investor Vintage" was created at the time of the listing. Other Investor Vintages that are shown bought into the company via negotiated deals.

Equity Bank (Kenya) Information Category	From Introduction to end 2006	For the Year ending 12/31/2007	For the Year ending 12/31/2008	For the Year ending 12/31/2009	Cumulative Change from Introduction to end-2009
Change in Stock Price (%)	-16%	224%	0% ^{1/}	-5%	158%
IV 2005 – SVIX method	49%	385%	32%	23%	1,073%
IV 2007 – SVIX method		-66%	33%	24%	-45%
IV 2008 - SVIX method			-74%	24%	-67%
Market P/BV (x) at year-end	5.72	3.64	3.31	2.28	

1/ This is not a mistake. Please see the chart for actual price movements

EQBank reports in its annual reports that the percentage of total shares in the hands of public was 31% (end-2007), 34.8% (end-2008), and 37.1% (end-2009). In combination with reports on holdings by other significant investors, this indicates a slow but steady trend by some of the management to selling their shares in the public market. In a deal closed in June 2008, EQBank bought Uganda Microfinance Ltd. in an all-share deal for about 3% of EQBank's shares, accounting for most of that year's increase in EQBank's shares in public hands.

An institutional investor in EQBank sold out its 15 million shares, 4.05% ownership position, in a transaction registered at the stock exchange on Dec. 30, 2008.

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Basic Data for SKS Microfinance Ltd. (India) – As SKS made an IPO in India only very recently, on July 28, 2010, after adding a number of new investors through private equity deals earlier in 2010, it is too early to draw much from its experience. But, as SKS's issue has been extremely high-profile and seems likely to continue to be so, it is worth noting the facts to date and updating the facts in the future.

The IPO was issued at INR 985/share, for about 23.3% of the company's shares outstanding post-issue. Of this amount, 10.3 percentage points were a new issue of common stock (= creating 7.445 mn. new shares and adding INR 7.33 billion to book value), and 13 percentage points (= 9.35 mn. shares) were offered to the public by existing shareholders (providing them a cash-out of INR 9.21 billion).

The stock issue price was approximately 5.8 times FY2010 book value per share, and 3.8 times the company's book value per share post-issue (including new cash in the company's book value). The stock was listed in India on August 16, and closed that day at INR 1,086.50/share (= 4.19 x P/BV). As the chart for its share price movements shows, valuations generally moved up at least until its management issues became public on October 4, 2010, when the company dismissed its CEO.

The Missing Metric – Demonstrated Liquidity

So far, the report has presented information about stock price movements and relative valuation resulting from stock prices and the WSAS MFI SVIX valuations for Investor Vintages. The point being that the two approaches lead to very different results, at least in terms of implied returns over the same periods. But there is no clear reason from the results only to prefer one valuation approach to the other. The strongest argument for using the WSAS MFI SVIX methodology in such cases arises from the 'missing metric' – demonstrated liquidity (or rather, the general lack thereof).

There are strong arguments for using publicly-quoted share prices to value any investor's position in a company, not least of which is the 'mark-to-market' accounting best practice. But, there are allowable exceptions to marking-to-market, when circumstances indicate a real market may not exist for an investor's position. Liquidity constraints are one of the most commonly accepted reasons allowing alternative valuation methods to be used.

To date, with the exception perhaps of Compartamos, the listed MFIs' shares show low liquidity levels, both in absolute terms (volumes traded) and in relative terms (volumes traded, relative to shares outstanding). The limited liquidities of the shares is somewhat further obscured by the fact that shares' trading data aggregated over some time periods is commonly boosted by 'churning' around the immediate listing dates and by 'spikes' involving transactions which are registered at the stock exchange, while actually being negotiated off-exchange.

The charts at the end of the report offer pictures of the widely-varying degrees of absolute volumes traded by each MFI's shares, over the course of years; the table below summarizes annual trends in relative liquidity.

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MFI Shares' Trading Characteristics - Relative Liquidity

	2006	2007	2008	2009	2010 (to end-Sept.)
MFI shares for:					
Equity Bank	5%	14%	15%	7.5%	14%
Compartamos		41%	32%	46%	31%
FINDEP		11%	15%	9%	5%

As the table shows, only Compartamos has demonstrated stock trading activity over the course of a year much higher than one might expect from a single private equity, negotiated ownership transaction.

While Equity Bank's shares have been consistently among the top five most traded shares at the Nairobi Stock Exchange, that marketplace is widely acknowledged to be one of the leading 'frontier markets', in good part because of its low overall liquidity.

It remains to be seen how actively traded SKS Mircofinance's shares will be.

Conclusions

The WSAS MFI Shareholder Value Index series undertake to measure the changes to shareholder value which investors in MFI equity shares experience over time. The approach we use to measure changes in shareholders' value relies on accounting data and on cash flows to and from investors, which can include cash from subscriptions by the public.

Given that stock market valuations so far have been between 2x-9x book values, using stock market prices in the WSAS MFI SVIX would not only change individual MFIs' valuations, they would greatly increase the weight of these MFIs in the Index series, would likely add to the volatility of results, and would generally distort the Indexes' results.

As the great majority of MFIs eligible for the WSAS MFI SVIX Index series are unlikely to have shares quoted in public markets any time soon, and as most of the few listed MFIs which are constituents of the WSAS MFI SVIX haven't demonstrated consistent liquidity to justify using their share prices to value changes in shareholder value, WSAS will continue to use its current valuation methodology.

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Source; www.yahoo.com/finance, 10-14-2010

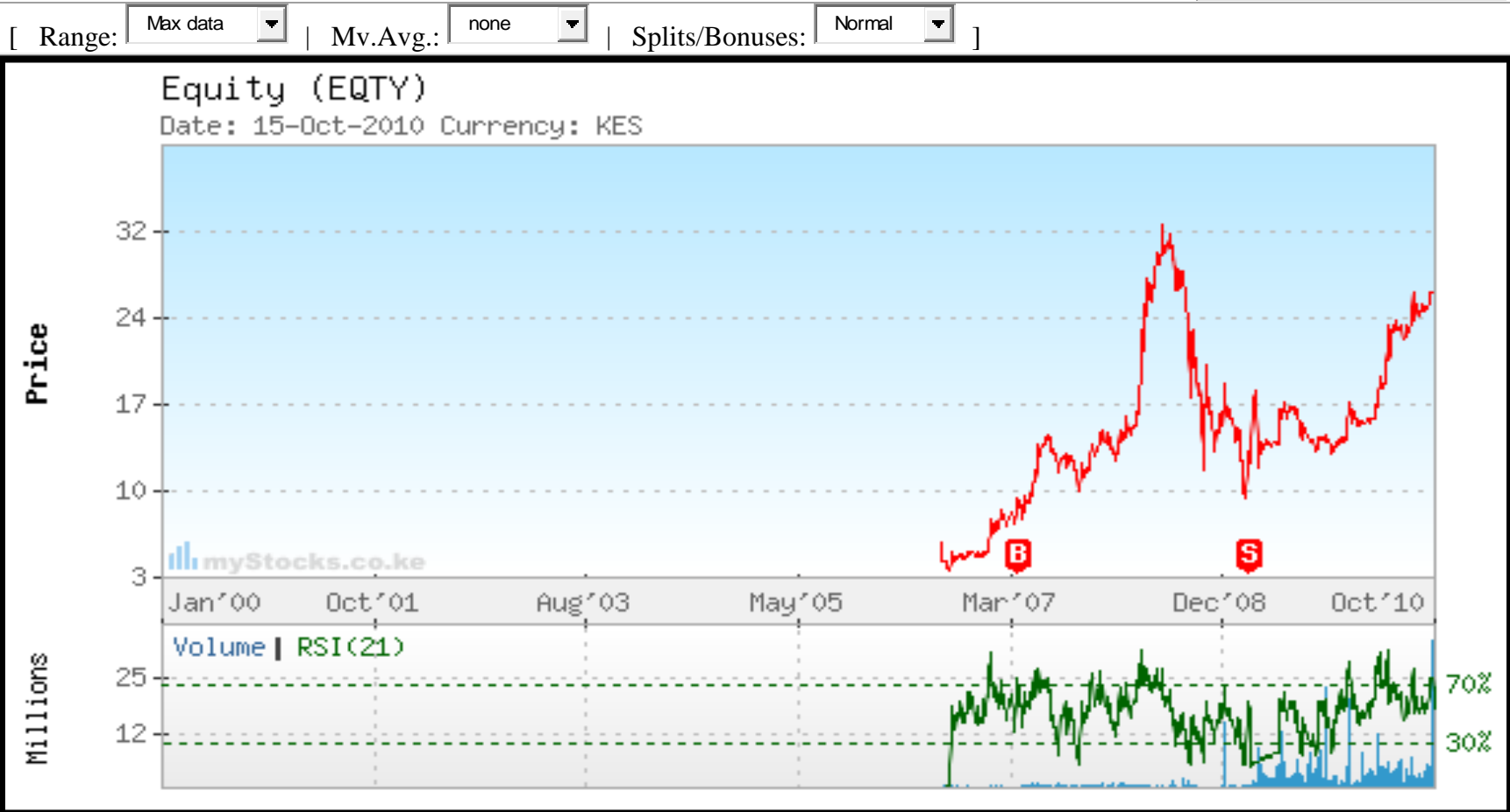
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Source; www.yahoo.com/finance ; 10-14-2010

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Source: www.mystocks.co.ke, 10-15-2010

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Source: <http://finance.yahoo.com/q/bc?s=SKSMICRO.NS&t=3m&l=on&z=1&q=1&c=> 10-15-2010

(Note: SKS Microfinance's shares trade at 2 Indian exchanges – The Bombay Stock Exchange & the National Stock Exchange. Volume shown here is for NSE trading only.)

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The WSAS MFI Shareholder Value Indexes – Introduction

The WSAS MFI Shareholder Value Indexes (WSAS MFI SVIX) are the first consistent measures of changes over time in the value of shareholders' investments in the equity of a broad sample of microfinance institutions (MFIs). The WSAS MFI SVIX are designed to provide institutional investors such as pension funds, foundations, and endowments, as well as fund managers and researchers in general, with much-needed benchmarks of MFI shareholder value performance. The WSAS MFI SVIX results approximate what investors achieved in the past, and provide the basis for accumulating historical performance characteristics of the niche asset category, MFI equity.

The WSAS MFI SVIX annual series are value-weighted, that is, they are created by combining the changes of shareholder value into one series and then indexing the changes from the base period.

Readers should refer to the formal methodology statement, "The WSAS MFI Shareholder Value Indexes: Methodology, Definitions, and Practices" for a complete description. The Methodology is available from the WSAS website, at http://wallstreetadvisorservices.com/the_wsas_mfi_shareholder_value_index_series

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WSAS is a small consultancy specializing in innovations in financial information services, for emerging markets and socially responsible investing. Founder and President Peter Wall has over 20 years' experience in developing and marketing financial information services with International Finance Corporation (IFC), FTSE International, and most recently, Microfinance Information Exchange, Inc. (MIX).

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