2010 Annual report

MEF
Microfinance
Enhancement
Facility

Content

The Mission
The Fund

THE MISSION

Initiated by KfW Entwicklungsbank ("KfW") and International Finance Corporation ("IFC"), a member of the World Bank Group, co-managed by three leading private investment managers (BlueOrchard Finance S.A., Cyrano Management S.A. and responsAbility Social Investments AG), Microfinance Enhancement Facility S.A., SICAV-SIF ("MEF") was setup in February 2009 as a USD 500 million facility to provide short and medium-term financing to microfinance institutions ("MFIs") facing difficulties in securing financing as a result of the global financial crisis and, in particular, the 2008/2009 liquidity crisis.

Recognised as a unique vehicle for the microfinance industry, MEF has an important signalling effect and contributes to the stabilisation of the microfinance sector. As demonstrated by the crisis situations in Bosnia and Herzegovina, Nicaragua, and most recently India, the crises in the microfinance industry are ongoing. In times of uncertainty, a vehicle that can respond quickly and decisively, such as MEF, can provide a stable source of funding.

As a complement to existing sources of funding, MEF focuses on providing liquidity that the market does not offer. MEF is a flexible vehicle structured to meet the needs of MFIs, without crowding out private sector initiatives.

As a demand oriented fund, seeking to respond to the needs of the market and of individual MFIs, it opens the possibility to provide financing to more than 100 microfinance institutions in up to 40 countries and to support lending to as many as 60 million low-income borrowers in many of the world's poorest countries.

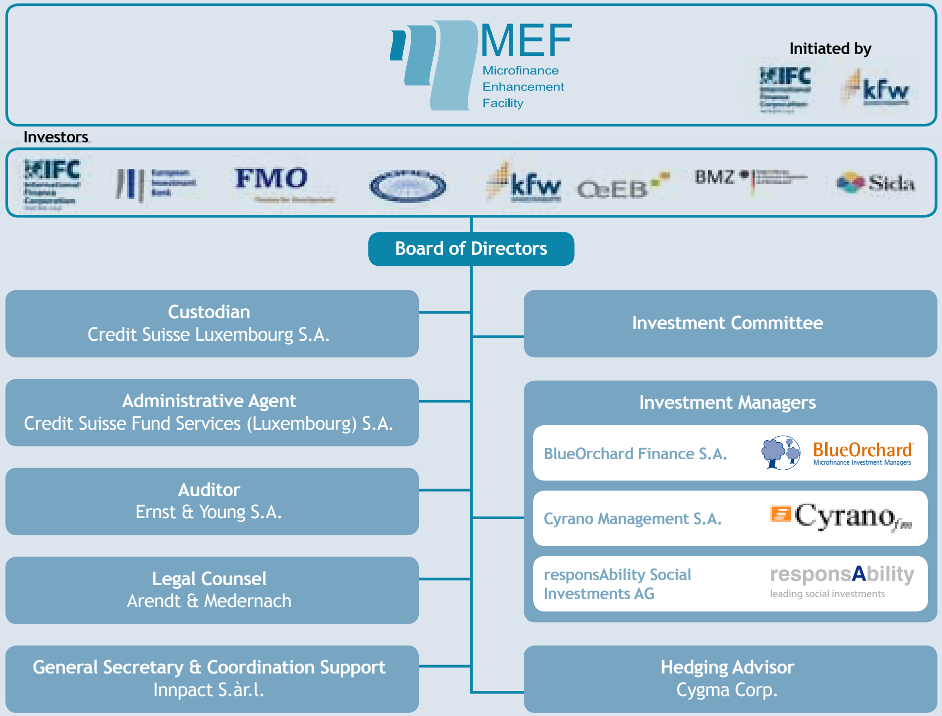
The investment managers are lead by MEF's Investment Committee, convening on a monthly basis and composed of reputable professionals of the microfinance industry, Mr. Syed Aftab Ahmed, Mr. Karlo de Waal, and Mr. Klaus Pfeiffer.

THE FUND

MEF aims to support economic development and prosperity globally through the provision of additional development finance to micro-enterprises, via qualified financial institutions.

In pursuing its development goal MEF observes principles of sustainability and additionality, combining development and market orientations.

The Structure



Board of Directors

Board of Directors (as at 31 December 2010)
Mr. Roland SILLER, Chairman
Ms. Monika BECK
Ms. Andrea HAGMANN
Mr. Tassilo HENDUS
Mr. Martin HOLTMANN
Ms. Mamta SHAH

Investment Committee

Investment Committee (as at 31 December 2010)
Mr. Klaus PFEIFFER, Chairman
Mr. Syed Aftab AHMED
Mr. Karlo DE WAAL

Letter of the Chairman

It is with great pleasure that I introduce to you the 2010 Annual Report for the Microfinance Enhancement Facility.

The Microfinance Enhancement Facility was created in February 2009 as a response to the global financial crisis to provide short and medium term financing to MFIs that were encountering difficulties in securing financing, despite continued strong performance of those MFIs.

2010 was a challenging year in the microfinance sector, as demand for funding decreased and the credit profile of many MFIs deteriorated. The MEF, while continuing to offer liquidity to the market, increasingly focused on managing the risk of its portfolio.

In 2010, MEF increased its diversification and entered into hedging relationships in order to increase its local currency capability.

In this report, we have highlighted two microfinance institutions, the Agricultural Cooperative Bank of Armenia and Finca Kyrgyzstan that have partnered with the MEF and also the story of a chicken farmer, client of Mikrofin in Bosnia and Herzegovina.

The success of the Fund can be measured not only in the millions of dollars that have been disbursed and the number of MFIs and their clients that have been reached, but also in the important signalling effect it has in the market. We have made several investments in Nicaragua and Bosnia and Herzegovina, two countries that have experienced crisis in their microfinance sectors. In these countries, the Fund invested in strong MFIs, with strong portfolio quality and profitability compared to their peers.

The coming year will once again be challenging. As noted with the recent developments in India, there is a continued need for a fund such as the MEF, which offers stabilisation to the market and serves as a catalyst for continued development of the financial sector.

MEF and its mission enjoy wide support from development finance institutions across the globe. With over USD 300 million in undrawn commitments, the Fund is able to react quickly in order to offer liquidity in times of crisis.

On behalf of the Board, I would like to thank MEF's investors, stakeholders and partner institutions as wess as their commitment to the Fund's mission.

Mr. Roland Siller
Chairman of the Board of Directors

Supported by Three Investment Managers

BlueOrchard Finance S.A.

BlueOrchard Finance S.A. provides innovative financial instruments and solutions for placements in microfinance, bridging the gap between capital markets and microfinance institutions. This includes initial identification of, and due diligence on, microfinance institutions, as well as continuous monitoring and reporting on their activities and portfolios. BlueOrchard Finance S.A. manages the relationship with all the parties involved and strictly adheres to the investment policies and guidelines of its clients. BlueOrchard believes in creating value through solid long-term relationships by providing debt and equity to microfinance institutions in all stages of their development. It shares their mission to provide financial services to those who have few resources and are excluded from mainstream financial services.

BlueOrchard®
Microfinance Investment Managers

Portfolio MEF - BlueOrchard

Portfolio managed as at 31 December 2010		
Portfolio	USD	% total MEF portfolio
	36,903,959	36%

Supported by Three Investment Managers

Cyrano Management S.A.

Cyrano Management S.A. is a pioneer fund manager specialized in the microfinance industry in emerging markets.

Cyrano has developed a rigorous loan methodology to analyze in-situ and monitor on a monthly basis the qualitative and quantitative risks of all portfolio MFIs. Its key strengths are its loan methodology and risk monitoring. Cyrano managed the first credit fund for MFIs in Latin America (LA-CIF), created the only mezzanine fund in microfinance (Solidus) and one of the most successful and solvent global funds (GMF).

Portfolio MEF - Cyrano

Portfolio managed as at 31 December 2010		
Portfolio	USD	% total MEF portfolio
	30,500,000	30%

Supported by Three Investment Managers

ResponsAbility Social Investment AG

With assets under management of more than USD 1 billion, responsAbility Social Investments AG is one of the world's leading social investment companies. Its areas of focus include microfinance, SME financing, fair trade, and independent media. responsAbility's investment solutions give people in developing and emerging economies access to markets, information, and other services crucial to their development; they enable private and institutional investors to earn a financial return while at the same time making a positive social impact.

Founded in 2003, responsAbility operates as an independent asset manager. Its shareholders are renowned Swiss financial institutions, a social venture capital company, and responsAbility's own employees.

responsAbility
leading social investments

Portfolio MEF - ResponsAbility

Portfolio managed as at 31 December 2010		
	USD	% total MEF portfolio
Portfolio	33,882,978	34%

A facility enhancing MFIs

Key Figures
as at 31 December 2010

Portfolio in detail

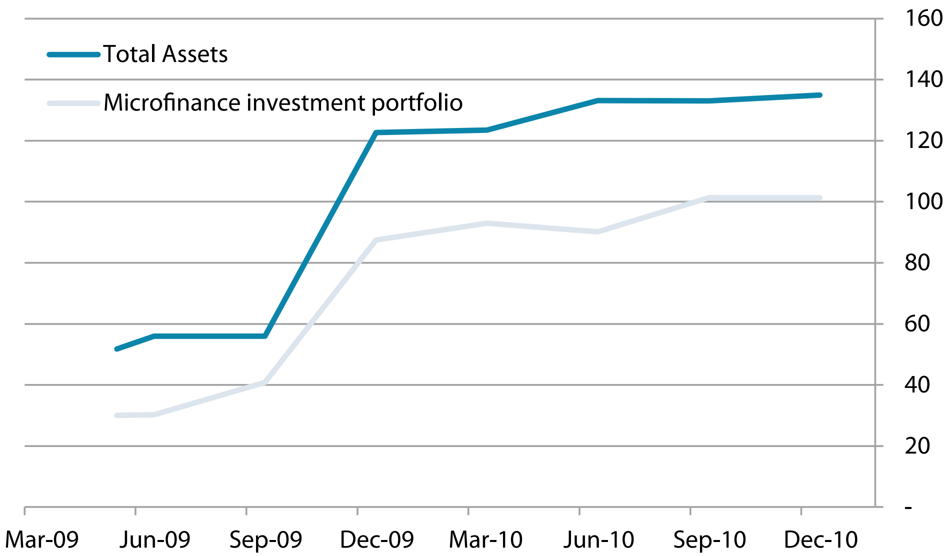
	December 2010	Cumulative disbursements
Microfinance investment portfolio	USD 101.3 MM	USD 116.0 MM
Short term investments	USD 33.6 MM	-
Total Assets	USD 134.9 MM	-
Microfinance portfolio as a % of total assets	75%	-
Number of MFIs	21	22
Number of loans	31	34
Number of countries	10	10

A facility enhancing MFIs

Key Figures

as at 31 December 2010

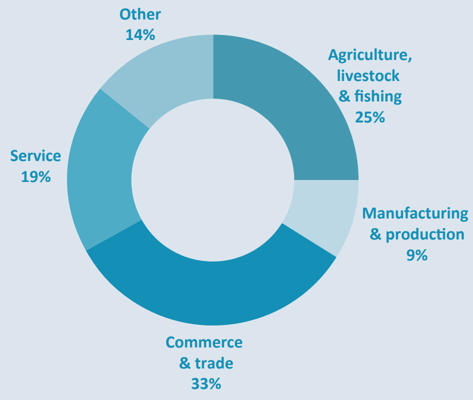
Portfolio evolution since launch



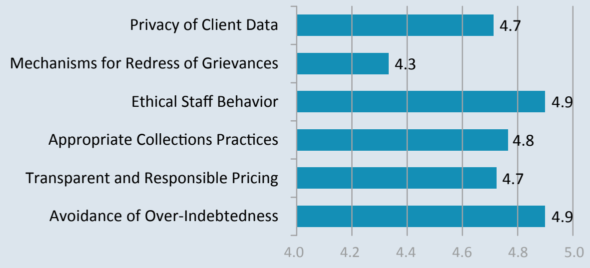
A facility enhancing MFIs

Impact Indicators
as at 31 December 2010

Sector Distribution of Portfolio



Level of adherence to Client Protection Principles
(self reported)



Microfinance Institutions Reach

Borrowers reached	
Total, number:	61,859
Women, %:	48%
Rural, %:	52%
Loans	**Number**
Average loan balance (USD):	2,808
Client Type	**Percentage of portfolio**
Microfinance:	51%
SME:	35%
Mortgage:	3%
Consumer:	9%
Other:	2%
Product Type:	**MFIs offer microfinance through**
Direct loans:	87%
Group guaranteed loans:	31%
Other:	4%

Adherence to social and environmental criteria

Adherence to Client Protection Principles	
MFIs having formally adopted	81%
Adherence to exclusion list	
Violations of the exclusion list	none

Activity Reports

BlueOrchard 2010 Activity Report

2010 is widely regarded as a period of transition and consolidation in the microfinance market. The economic and financial crises have led to economic recession in many countries and have impacted the clients of Microfinance Institutions. However, during the second half of 2010 the industry has shown some signs of recovery: the majority of regions have experienced a stabilisation of the portfolio quality and a return to moderate growth.

BlueOrchard Finance followed the sector's developments closely and combined its efforts of portfolio monitoring and portfolio expansion contributing to the MEF portfolio growth during the year. The main developments of the BlueOrchard Finance pool were reflected in the disbursement of a total of seven loans, the addition of two new clients and one new country, and the expansion of the geographical coverage to seven countries.

We have been even more selective than in the past in building partnerships with existing and new clients, but we were nevertheless able to provide crucial support to microfinance institutions operating in very challenging markets. In particular, we are proud of the support provided by MEF to some of the leading institutions in Nicaragua at a time in which international microfinance investment vehicles and development financial institutions had significantly curtailed their financing in the country.

2011 promises to be a year of steady recovery, renewed growth and dynamism in the microfinance industry. As we endeavour to meet the evolving liquidity needs of MFIs, together with MEF we have identified several areas to further extend our outreach in new and still underserved countries.

Activity Reports

Cyrano 2010 Activity Report

MARKET REVIEW

As the global economy began to improve in 2010, the general trend for MFIs worldwide was an increase in portfolio growth rates, improvements in portfolio quality and increased margin generation due to reductions in provision expenses and increased efficiency. These trends were more pronounced in institutions with proactive management that had implemented adequate measures at the beginning stages of the crisis. For many MFIs, existing treasury and increases in deposits were sufficient to satisfy funding needs. An excess of funding destined for top-tier MFIs continues to put pressure on interest rates despite no substantial improvements in risk among those MFIs. As seen in 2010, the microfinance industry remains exposed to country and political risk in addition to financial risk. In light of these risks, Cyrano has placed increasing focus on risk mitigation and all MFIs managed by Cyrano for the MEF are in a solid financial position as of December 2010.

MARKET OUTLOOK

The global crisis has demonstrated that MFIs with solid financial performance need to restructure financial liabilities in order to minimize maturity and currency mismatch, implying that some senior debt or deposits should be replaced with new and more adequately tailored senior debt. With MEF's goal of offering new and innovative products to the market, the increased access to hedging mechanisms and the ability to extend local currency loans up to five year terms, will allow the Fund to continue offering additionality to the market for the foreseeable future.

Activity Reports

responsAbility 2010 Activity Report

DECOUPLING OF EMERGING MARKETS

By contrast with rich industrial nations, the powerful growth seen by emerging markets and developing countries in 2010 was extremely well underpinned and looks set to continue in 2011. The global financial and economic crisis had little impact on developing countries and emerging markets. Unlike their counterparts in the industrialized West, these countries have not had to shoulder structural burdens such as high unemployment and debt, which means their potential for growth remains high.

MICROFINANCE BACK ON PATH TO GROWTH

In line with the strong performance of developing and emerging economies, the microfinance industry has managed to bounce back from the global financial and economic crisis fairly quickly. Demand for microcredit on the part of borrowers was already picking up again in the second half of 2009, and gathered further pace in 2010.

Clients Stories

The Agricultural Cooperative Bank of Armenia

The Agricultural Cooperative Bank of Armenia (ACBA) was established in Armenia in 1995 to initially finance small and medium size agricultural enterprises and individuals. In 2006 Credit Agricole S.A. of France made an equity investment in ACBA and the bank was renamed and reorganized into ACBA Credit Agricole Bank CJSC. Credit Agricole is the largest shareholder with 28% of the shares, while the other main shareholders are ten agricultural cooperative regional unions. As of December 2010, ACBA has over 119,300 loans outstanding, of which over 75% of the borrowers are in rural areas, and an average outstanding loan balance of US$ 2,373.

Armenia was severely impacted by the global financial crisis due to significant decreases in (I) trade with Russia and other major trading partners, (II) foreign investment and (III) remittances – which account for 20% of GDP – from the Armenians in Russia, US and Europe. As a result, GDP decreased by 14.4% in 2009 and the Armenian Dram was devalued by over 20% on March 3, 2009.

In keeping with its track record of conservative financial policies and a strong management team, ACBA had implemented a variety of preventive measures both before and during the crisis. As a result of these proactive measures, the impact on the bank was minimal despite the economic turmoil that gripped the country. As of the end of 2009, the portfolio at risk greater than thirty days (PAR>30d) was only 1.3% and this was over protected by provisions. By December 2010 PAR>30d had decreased to under 1%. ACBA maintained strong profitability during the crisis, along with low leverage and high levels of liquidity.

As a sign of its confidence in the bank, MEF extended a US$ 15m loan to ACBA in October 2009. During the first nine months of 2009, in US Dollar terms senior debt had decreased by over 10%, but increased by nearly 11% in the six months following MEF's loan. While not the only factor, we believe that MEF's loan had an important signaling effect on the market.

Clients Stories

Chickenfarming in Lukavica

Bozdar is 54 years old and owns a chicken farm in Lukavica, near Sarajevo (Bosnia and Herzegovina). He took a first loan of KM 5'000 (about EUR 2'500) in 2002 to buy 480 chickens and to start a small chicken-raising business. In 2008, Bozdar's flock of chickens has doubled. Income was not always stable and food prices had gone up considerably, so this additional activity was helping Bozdar and his family of four people to make ends meet. The eggs are sold to local markets and Bozdar also sells some chickens to a nearby factory. Since his first loan, Bozdar has borrowed regularly from Mikrofin to buy grains for the birds and acquire new equipment. One of the credits borrowed helped him to restore the barn, whose renovations cost him KM 20'000 (about EUR 10'000). These improvements were necessary to better control the temperature and insulate the building during the winter. Currently, Bozdar's loan with Mikrofin is helping him finance half of the purchase of a new flock of chickens.

Clients Stories

Finca Kyrgyzstan

FINCA Kyrgyzstan was established in 1995 as a credit program of FINCA International Inc. to provide financial services to the lower client segment in rural areas and micro entrepreneurs in peri-urban and urban communities. In 2003, the program incorporated as a joint stock company and transformed into a formal, non-deposit-taking Micro Credit Company (MCC), licensed by the National Bank of the Kyrgyz Republic (NBKR). Since several years, it plans transformation into a bank, but due to regulatory restrictions and a difficult environment the process was continuously delayed. However, until mid-2011 FINCA Kyrgyzstan targets to finally submit the banking license application to the central bank. The MFI is wholly owned by FINCA International Inc. and fully integrated into its network under the supervision of the FINCA Eurasia Hub based in the Ukraine.

FINCA Kyrgyzstan is the largest MFI in terms of loan portfolio and the second largest in terms of micro clients in the countryThe large nationwide network is one of the main competitive advantages of FINCA Kyrgyzstan, as it allows reaching clients living in more remote and underserved areas.

The inter-ethnical conflict in the Osh province in 2010 affected about 8 branches of that and neighboring provinces. Mainly the Osh and the Alay branches were affected, with a rise in the percentage of loans in arrears, called portfolio at risk, in mid-July 2010 to over 50% and over 12%, respectively. However, in only two weeks FINCA was able to bring the situation under control by bringing portfolio at risk levels back to normal. Loans from affected clients were refinanced, peaking 5% of gross loan portfolio as of Aug 2010. Nevertheless, refinanced portfolio rapidly decreased again in the following months. This shows that FINCA, as the overall Kyrgyz microfinance sector, was fairly resistant to the Osh conflict. Especially the good debt payment culture in the Kyrgyz Republic and the seriousness with which clients were treating the critical situation helped the MFIs to maintain a good portfolio quality.

Clients Stories

Finca Kyrgyzstan

Nonetheless, when the inter-ethnical conflict arose in mid-2010 international lenders stopped lending to the sector leading to liquidity constraints by the sector in the following months. Even though, some lenders started granting loans again by the end of 2010, cautiousness and restrictions remained among international microfinance investment vehicles and development finance institutions. responsAbility reopened the country for investments in November 2010 after elections were held in October, but reached its internal exposure limits for the Kyrgyz Republic in general and FINCA Kyrgyzstan in particular in other funds under management. Seeing additional demand from the MFI, the MEF renewed and increase its exposure to FINCA Kyrgyzstan to avoid liquidity constraints.

MEF Annual report 2010

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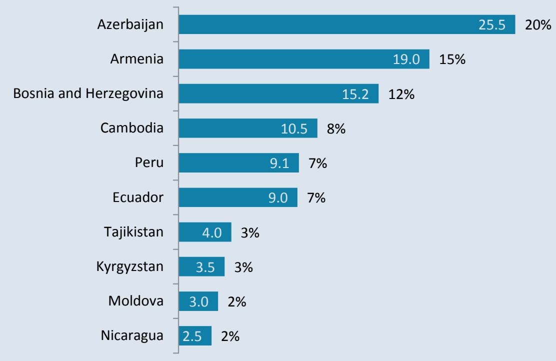
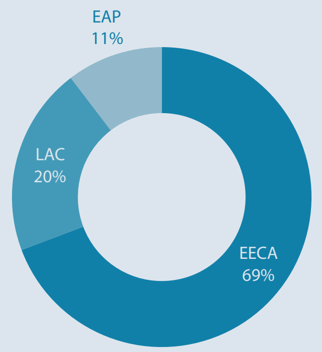
The Portfolio

as at 31 December 2010

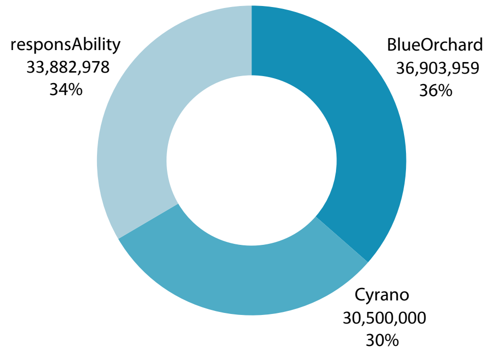
Country distribution
Microfinance investment portfolio - Equivalent USD MM



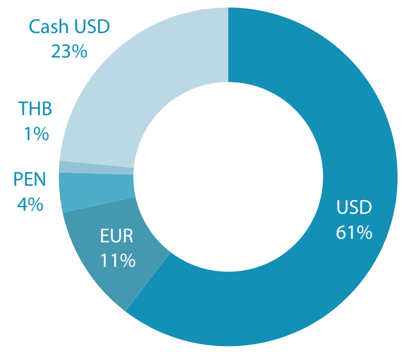
Regional distribution in %
Microfinance investment portfolio



Investment Manager distribution in %
Microfinance investment portfolio - Equivalent USD



Currency distribution in %
Total portfolio



The Investors

Balance Sheet *

ASSETS	as at 31 December 2010	as at 31 December 2009
Loans to MFIs	101,286,937	91,607,640
Current assets	33,621,072	31,817,467
of which : Cash & cash equivalent	31,653,639	30,537,210
Other assets	13,582	204,986
Total Assets	**134,921,591**	**123,630,093**

LIABILITIES	as at 31 December 2010	as at 31 December 2009
Current liabilities	4,131,160	847,611
of which : Cash & cash equivalent	3,355,164	276,000
Accruals and deferred income	---	378,306
Total Liabilities	**4,131,160**	**1,225,917**
Net Assets	**130,790,431**	**122,404,176**

*in USD

*Income Statement **

INCOME	2010	2009 [(1)]
Interest on loans	6,761,676	2,301,598
Upfront fees	659,690	82,422
Other income	116,167	5,679
Total Income	**7,537,533**	**2,389,699**

EXPENSES	2010	2009
Management fees	(1,207,314)	(1,334,447)
Legal, advisory and audit fees	(291,415)	(241,125)
Administration, custodian and domiciliation fees	(193,593)	(89,631)
Other expenses	(916,812)	(448,496)
Total Expenses	**(2,609,134)**	**(2,113,699)**

NET OPERATING RESULTS	2010	2009
Net income from investments	4,928,399	276,000
Net realized and unrealized gains/losses on foreign exchange	(1,091,351)	(495,649)
Net realized and unrealized gains/losses on swaps	(84,230)	1,344
Value adjustments relating to loans	(1,801,599)	(50,549)
Net increase/decrease in Net Assets as result of operations for the year/period	**1,951,219**	**(268,854)**

MOVEMENT IN CAPITAL	2010	2009
Subscription of shares	9,790,200	122,949,030
Redemption of shares	---	---
Advance of dividend	(3,355,164)	(276,000)
NET ASSETS AT THE END OF THE YEAR/PERIOD	**130,790,431**	**122,404,176**

[(1)] from 5 February 2009 to 31 December 2009

*in USD as at 31 December 2010

Microfinance Enhancement Facility SA, SICAV-SIF

5, Rue Jean Monnet
L-2180 Luxembourg

Investment Managers:

- BlueOrchard Finance S.A.
  32 rue de Malatrex
  1201 Geneva Switzerland
- Cyrano Management S.A.
  Calle Bolivar # 472 / Ofic. 702 - 703
  Miraflores Lima 18 Peru
- responsAbility Social Investments AG
  Josefstrasse 59 8005 Zurich
  Switzerland

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