Micro-Credit Ratings International Limited

rating of a microfinance bank

JSC "Bank Constanta" | **Tbilisi, Georgia**

Joint Stock Company, first update | *January 2010*

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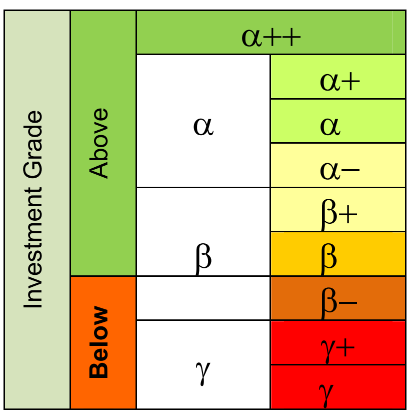
CREDIT RATING	α–
RATING OUTLOOK*	*positive*

*M-CRIL's viewpoint (positive, neutral or negative) of the future prospects of the organisation

Date of visit **18-22 January 2010**



Main Performance Indicators

	Dec-08	Dec-09
Gross Portfolio (GEL million.)	57.7	53.1
(US$ million)	34.2	31.4
Number of active borrowers	11,549	11,466
RoA	-6.2%	1.3%
Portfolio yield	28.5%	27.4%
Portfolio at Risk$_{30}$	0.87%	1.69%
Operating expense ratio	26.0%	20.1%
Average loan o/s (GEL)	5,000	4,631
Borrowers per field staff	108	101

Exchange rate used US$1= GEL1.69

Synopsis

Bank Constanta received a banking licence from the National Bank of Georgia in July 2008. It started microfinance as Constanta Foundation and has more than a decade's experience in microfinance. The bank has a professional and experienced Board, management and operations' staff. Its transformation to a bank has enabled it to deliver more financial products.

Constanta was not able to scale up its operations during 2008 and the first half of 2009 due to the Russian invasion and the global liquidity crunch. This resulted in a lower than expected staff productivity. Despite this, the management was able to achieve break-even in 2009 due to a reduction in its financial cost ratio and administrative expenses.

Constanta was able to manage its portfolio quality well during the challenging two years resulting from the Russian invasion which inflicted damage to life and property in Georgia. PAR$_{30}$ increased from 0.87% in Dec 2008 to 1.69% in Dec 2009. The external risks have now reduced significantly and the bank has grown well during the second half of 2009, its portfolio quality is also gradually improving. With the external environment becoming more conducive, the bank plans to introduce and expand non-credit financial services in 2010.

In M-CRIL's view, on account of a comfortable Capital Adequacy Ratio and portfolio quality, Constanta can absorb loan funds from commercial sources for on-lending. A rating update after one year is suggested to ascertain changes in the creditworthiness. This rating is valid, subject to no other significant changes in the organisational structure and external operating environment.

Highlights

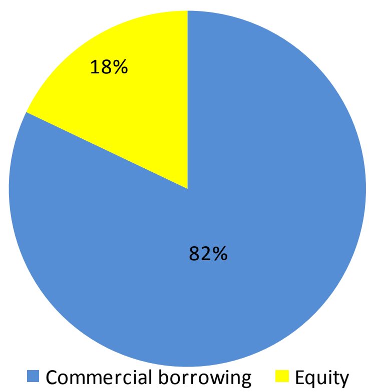
Positive

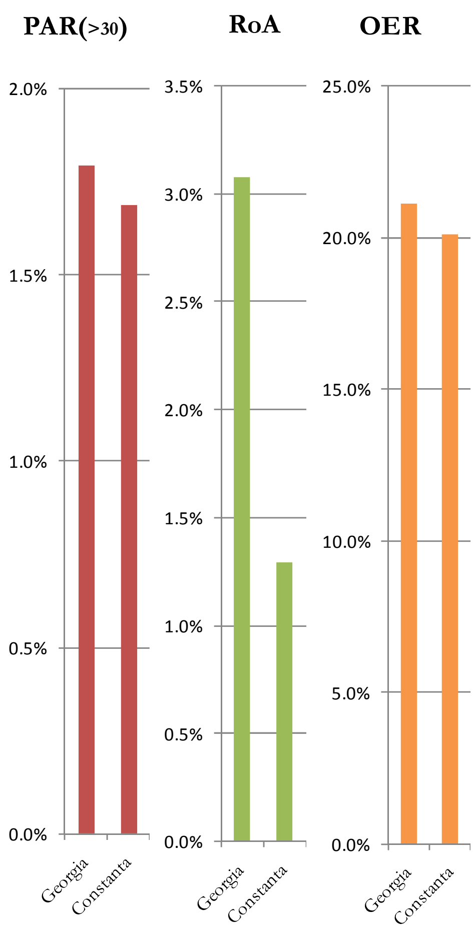
- Strong management, second line and operations staff
- Strong internal audit and control systems
- Good systems for overall risk management
- Healthy portfolio quality

Negative

- Small Board
- Intense competition
- Low staff productivity
- Low margins

Sources of Funding





Comparison of Constanta's performance with other MFIs in Georgia (*source: mix market*)

Rating Rationale

Strong senior and second line of management: Constanta has a professional and experienced senior management as well as second line of management. Staff members at all levels are well qualified, trained and experienced.

Strong internal control and audit mechanism: Constanta has a strong control team to check the utilisation of loans. It also has an internal audit team which is independent of management and audits all functions. A strong internal control environment is maintained by way of loan utilisation and collateral checks by the supervisory staff, control unit and internal audit staff.

Good risk management: Constanta has good risk management policies, systems and professionals. The risk management includes credit as well as financial risk management. The Operations Department has strict loan approval policies and a control division which makes surprise visits and client checks. The bank also has effective systems for managing its liquidity, Asset-Liability Matching (ALM), foreign exchange risk and interest rate volatility.

Good portfolio quality: Constanta's PAR_{30} increased from 0.87% in Dec 2008 to 1.69% in Dec 2009. It also restructured loans amounting to GEL700,000 (1.3% of the portfolio). This was due to the adverse external environment. Overall the bank has been able to maintain a reasonable portfolio quality.

Small Board: Though Constanta has a highly experienced and professional Board, it has only three members. Bringing in Board members from diverse professional backgrounds would strengthen it further.

Stiff competition: Constanta faces stiff competition from various MFOs and banks. Though the margins have increased, they are still under pressure. Being a new entrant in the banking sector, it faces tough competition from banks with respect to both loan and non-loan products. In 2009, Constanta's share in the bank credit market increased marginally from 0.96% to 1.02%. Its share in the bank credit market for loans under GEL100,000 was 2.85%.

Country risk: Constanta experienced a fund shortage in 2008 and 2009. Though the country risk has reduced significantly, the risk perception among external investors is still high.

Low staff productivity: Constanta has not been able to achieve its targeted growth in 2008 and 2009 due to the war and global recession. The loan portfolio and number of clients declined marginally in 2009 which hampered its plan to improve staff productivity.

Performance Highlights

Rating Grades

Category	Rating grade		Movement
	August 2008	January 2010	
Governance & strategic positioning	β+	α–	⇑
Organisation & Management	α–	α–	⇔
Financial performance	β	β+	⇑
Overall	β+	α–	⇑

Select indicators/ratios

Main Indicators	30 June-08	31 Dec-09
Gross Loan Portfolio (GEL million)	54.1	53.1
(US$ million)	32.0	31.4
Number of Active Borrowers	14,037	11,466
Risk Weighted Capital Adequacy ratio	19.9%	19.0%
Asset Quality		
Portfolio at Risk (>30 days)/Gross Loan Port.	0.3%	1.7%
Loan Loss Reserve/Gross Portfolio	2.1%	3.2%
Efficiency and Productivity		
Operating Expenses/Avg. Gross Loan Portfolio*	26.3%	20.1%
Cost per Borrower (GEL)*	916	880
Average Outstanding Loan Size (GEL)	3,856	4,631
(US$)	2,282	2,740
Number of Borrowers/Field staff	108	101
/Total staff	41	33

*: Ratios for both June 2008 and December 2009 are calculated on the basis of unaudited statements.
Exchange rate: US$1=GEL1.69 for all the years

Country overview

Georgia is a small country sharing borders with Russia, Azerbaijan, Armenia and Turkey. Georgia is divided into nine regions and has 69 districts.

Indicators	2005	2006	2007	2008	2009
Population (in million)	4.32	4.40	4.37	4.33	4.62
GDP growth, %	9.6	9.3	12.4	2.0	-4.9
Inflation, % (year end)	5.5	8.2	10.0	11.0	1.0
Current account balance, % GDP	-11.9	-15.9	-19.7	-16.6	-15.1
Balance of trade (US$ billion)	-1.6	-2.7	-3.9	N.A	N.A
Exchange rate (US$/GEL)	1.8	1.7	1.6	1.4	1.7

Georgia maintains diplomatic relations with Azerbaijan, Armenia and Turkey; however the increasing closeness of Georgia to the USA and EU in its effort to become a full member of NATO has strained Georgia's relations with Russia. The tension escalated well beyond the dispute over South Ossetia leading to an invasion by Russia in August 2008 resulting in widespread loss of life and property in Georgia.

Since the fall of the USSR, Georgia embarked on a major structural reform designed to move to a free market economy. However, under the impact of civil wars and the loss of preferential access to former Soviet Union markets and large budget transfers, output fell by 70% and exports by 90%. The World Bank and the International Monetary Fund were the first ones to offer financial help by granting a credit of US$206 million in 1995.

Since the early 2000s some visible positive developments have been observed in the Georgian economy. In 2006, real GDP growth rate reached 9.3%, making it one of the fastest growing economies in Eastern Europe. In 2007 also the country's growth was high at 12.4%. However, growth fell to 2.0% in 2008 and in 2009 GDP declined by 4.9%. Growth in 2008 and 2009 was impacted by war with Russia and global recession. The country is battling with a high unemployment rate and has a low median income compared to the European countries.

Due to the country's climate and topography, agriculture and tourism have been traditionally been the principal sectors of the economy. However agriculture is now replaced by services which form 62% of GDP, while the share of agriculture in 2009 fell to 12.1% of GDP. Its imports and exports both fell in 2009 to US$4.5 billion (US$6.3 billion in 2008) and US$1.77 billion (US$2.4 billion in 2008) respectively. Georgia is developing into an international transport and oil pipeline corridor on account of its strategic location. However tensions with Russia have led to an economic embargo and simultaneous discontinuation of financial links which acts as a major external impediment for Georgia's economy.

The economic collapse and increasing unemployment post-dissolution has resulted in citizens engaging increasingly in micro and small business activities. This is creating a market for the emerging microfinance (MF) industry. Among all the microfinance players listed on the Mix Market, ProCredit Bank is the leader with a dominant share of 77% while Bank Constanta follows with 8% market share. CREDO with 6% and FINCA with 4% in December 2008 are 3rd and 4th in terms of portfolio size. Other MFIs with small share include Lazika Capital, FinAgro, Crystal, ImerCredit, GeoCredit and Alliance Group. The potential of the MSME sector as well as growing demand led to commercial banks pursuing a down-scaling strategy. ProCredit Bank, especially established to serve this sector, leads the MF market and is the price driver. Competition in the Georgian microfinance sector is expected to be fiercer in future.

Commercial banks in Georgia are regulated by the National Bank of Georgia (NBG) which was constituted in the year 1995. NBG supervises and analyses the daily, monthly and quarterly reports sent by the banks. Quarterly reports are also available on NBG's website. NBG has formulated prudential requirements for banks which include:

Tier I Capital Adequacy Requirement - >8%
Total Capital Adequacy Requirement - >12%
Loan to an individual (insider) - <5% of the net worth
Total loans to all the insiders - <25% of the net worth

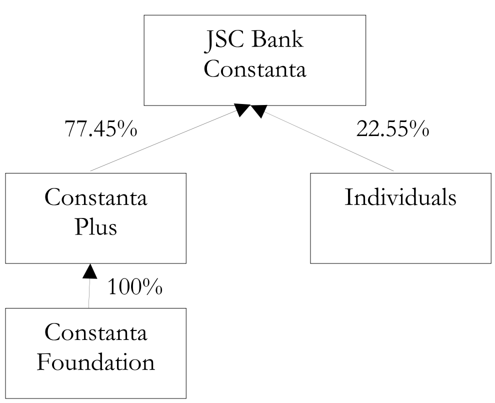
There are other such prudential restrictions to ensure good corporate governance and risk management practices among the commercial banks.

Sources:
www.worldbank.org
www.mixmarket.com
www.indexmundi.com/georgia
CIA World Factbook
World Economic Outlook Database 2008

Organisation Profile

JSC Bank Constanta (henceforth called Constanta) was promoted in October 1997 by Ms Tamar Lebanidze as Constanta Foundation, a not-for-profit organisation, to provide high quality microfinance services to micro and small businesses. The foundation started its operations with grant support from UNHCR through the Save the Children Fund, which was later supplemented by grant funding from USAID. Since then, Constanta Foundation has been associated with CARE, USAID, CGAP, Mercy Corps and DFID for various projects involving the provision of micro-loans to farm and off-farm businesses.

In order to comply with the requirement of the Law on Microfinance Organisations in Georgia which was adopted in July 2006 and amended in July 2007, Constanta started its operations as a Joint Stock Company (JSC) and transferred its operations to the newly established company by 31 December 2007. However as the law did not permit NGOs to be directly involved in business activity, Constanta Plus, a limited liability company was formed. LLC Constanta Plus is a 100% subsidiary of Constanta Foundation and owns 77.45 % of the shares of JSC Constanta. The remaining 22.55% of shares are owned by 7 individuals including the management and Board members of Constanta Foundation. Since receiving the bank licence from the National Bank of Georgia in July 2008, Constanta is also subject to banking supervision. Constanta can now raise deposits from registered institutions; however, it is yet to receive permission for mobilising savings from individuals.



Constanta serves more than 11,000 clients with a credit portfolio of around GEL 53 million as on 31 December 2009. All of its branches are located in cities; but its operations also extend to semi-urban and rural areas. Currently, Constanta operates through 21 branches in the Adjara, Shida Kartli, Kakheti, Imereti, Samegrelo, Kvemo kartli and Samtskhe Javakheti regions of Georgia. Six of these branches are located in Tbilisi, the capital city. In order to achieve greater efficiency, it has not added any new branch in 2008 and has closed one and opened one new branch in 2009. It does not plan to open any new branches in 2010 also.

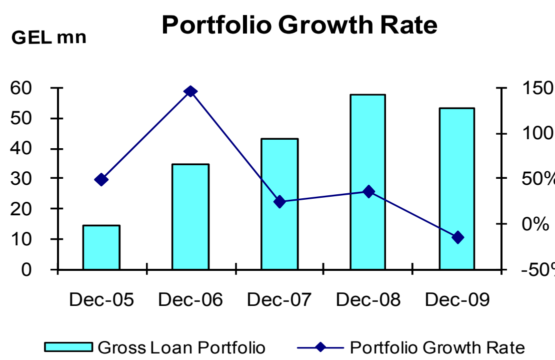
● Existing branches of Constanta

Constanta started micro-credit with lending to groups in urban areas. It diversified to individual lending at the end of 2001. In 2003, the organisation expanded its operations in rural areas when it launched an agricultural product. In addition to the wide range of loan products, Constanta also provides foreign exchange facilities, money remittances and other bank services. It is in the process of rolling out more services including credit/debit cards and ATMs.

Constanta is governed by a three member supervisory Board consisting of Tamar Lebanidze, also Executive Director (ED) of the Association of Georgian Microfinance institutions (AGMO), Giorgi Loladze, Chairman of the Georgian stock exchange and Irakli Kovzanadze, Chairman of Task Force of OECD and EBRD on Corporate Governance of Banks in Eurasia. The management is led by the General Director, Levan Lebanidze who joined as Program Manager in 2000 and became ED of the Foundation in 2004 and General Director of the Bank in 2008. He supervises the functioning of the key departments including HR, IT, Legal. The departments supervise the work of smaller units called Divisions. The General Director together with Operations and Finance Directors form the Board of Directors (Executive). Each branch is staffed by Loan Officers (LO), Loan Managers (LM), Heads of Credit Units (HCU) and Desk Officer (DOs) who are headed by a Branch Director who reports to the Board of Directors. The HCUs report to the Branch Director. The total staff strength of Constanta is 321.

Constanta's did not grow in 2009. This was mainly due to the negative impact of war and global liquidity crunch. In fact the portfolio declined from GEL57.7 million in December 2008 to GEL46.8 million in June 2009. It then increased to GEL53.1 million in

December 2009. Growth has been restricted deliberately to focus more on retaining portfolio quality. PAR(>30 days) increased during the year and touched a high of 2.7% in June 2009. The recovery in the growth rate during the second half of 2009 and normalcy of external environment suggest that growth in Constanta's portfolio is likely to be much better.



Constanta's client numbers have been constantly decreasing since 2006. The decline in client numbers can be attributed to the strategy to phase out its "Group Loan" product. Some of its group loan clients were targeted by the competing banks. As a response, it introduced 'Express' loan and 'Mini' loan products, which have lower rate of interest and quicker disbursement process. This arrested the rate of decline from 2008 onwards. The decline rate fell from -25.3% in 2007 and -21.1% in 2008 to -0.72% in 2009. The number of borrowers is expected to rise as additional products are offered as a result of the banking licence.

Microfinance policies

Constanta lends to both women and men. Locations and areas are identified on the basis of market studies. Attractive markets are those with unmet demand or those partly covered by other microfinance service providers. The Loan Officer verifies the business of the applicant and then collects documents such as the profit and loss account, balance sheet and cash flow statement. A detailed cash flow analysis is required only for higher loan sizes or seasonal loans. This is followed by valuation and appraisal of collateral by the Branch Manager and Head of Credit Unit who have sanctioning authority for loans up to GEL20,000 (US$14,085). Applications for larger loans are forwarded to the HO for approval. At HO, loans over GEL20,000 and up to GEL30,000 can be approved by the team of two Credit Managers and the Credit Risk Manager (CRM). Loans over GEL30,000 and up to GEL50,000 can be approved by the Credit Risk Manager and the Operations Director, while loans over GEL50,000 can be approved only by the Board of Directors (Executive Board Committee) comprising of the General Director, Operations Director and Finance Director. The disbursements are made at the branch level by transferring money to the current account of the borrower. The process of loan application to disbursement takes 2-10 days. Repayment is on a monthly basis and is in cash at the branches.

<u>Loan products</u>

Constanta has a wide range of loan products. It started by offering group loans as its first loan product in 1997. However, in recent years competitors started offering individual loans without any collateral to the group clients of the Constanta. Consequently, Constanta introduced express loan/fast loan and has now discontinued group loans.

Product Category	Number of loans	Amount (31 December 2009)		% share in the total portfolio
		GEL million	US$ million	
Express	6,464	23,222	13,741	44%
Business	1,081	18,701	11,066	35%
Agro	1,434	5,357	3,170	10%
Mini	2,177	1,435	849	3%
Seasonal	42	512	303	1%
SME	2	239	142	0%
Consumption	45	111	66	0%
Staff loan	112	3,368	1,993	6%
Individual loan	6	51	30	0%
Overdraft		101	60	
Total Portfolio	11,363	53,095	31,417	

Exchange rate: US$1=GEL1.69

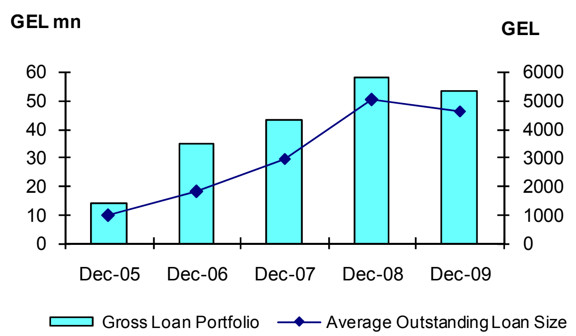
The share of the express loan product is growing and increased from 41.5% in December 2007 to 44% in December 2009 with a related phasing out of the group loans. The share of the earlier individual product is now almost zero.

A detailed description of loans is given in the table on the next page

Loan Product	Mini Loan	Mini Agricultural Loan	Express Loan	Business Loan	SME Loan	Agricultural Loan	Seasonal Loan
Time taken from the date of application	1 Day	1 Day	1 Day	3-5 Days	5-7 Days	3-5 Days	3-5 Days
Borrowers	Individual	Individual	Individual	Individual	Individual	Individual	Individual
Purpose	Micro Business	Agricultural	Small Business For working capital or fixed assets	Business For working capital or fixed assets	SMEs For working capital or fixed assets	Agricultural equipment/machinery , other necessary materials	For working capital, fixed assets and business expansion;
Loan size	GEL 60-600 USD 100-1,000	GEL 60-600 USD 100-1,000	GEL 1000-17,000 USD 600-10,000	GEL 1,000-17,000 USD 1,700-50,000	USD 50,001-170,000	GEL 1000-50000 USD 600-30000	USD 300-70000
Currency	GEL; USD	GEL; USD	GEL; USD	GEL; USD	USD	GEL; USD	USD
Annual Interest Rate	36%-48% (flat)	36%-48% (flat)	29%-48% (declining)	16%-48% (declining)-	16%-21% (declining)	23%-48% (declining)	21%-48% (declining)
Fees	2.5%	2.5%	2.3%-2.5%	2.3%-2.5%	0.5%-1%	1%-2.5%	1%-2.5%
Loan Duration (min. and max.)	12 months	12 months	12-36 months	3-60 months	3-60 months	3-60 months; flexible payment schedule and grace period	1-60 months; flexible payment option and grace period
Maximum Grace period	3 months	3 months	3 months	6 months	6 months	23 months	Flexible; based on business
Repayment frequency	Monthly	Monthly	Monthly	Monthly	Monthly	Flexible schedule	Flexible schedule
Collateral requirements & other conditions	Third party guarantee; Minimum 3 months of business experience	Third party guarantee; Minimum 3 months of business experience	Third party guarantee; Minimum 6 months of business experience	Collateral required (movable property, real estate on higher amounts) Minimum 6 months of business experience	Collateral required (real estate only) Minimum 6 months of business experience	Third party guarantee (up to 4,000 USD) and real estate; Minimum 24 months of business experience	Third party guarantee (up to 4,000 USD) and real estate; Minimum 1 season of business experience

The average outstanding loan size increased during the period 2005 to 2008 but stabilized thereafter. This increase was primarily due to a shift from group based micro lending to express business loans. The average outstanding loan size significantly increased from GEL969 (US$573) in December 2005 to GEL5,000 (US$2,959) in December 2008 and came down slightly to GEL4,631 (US$2,740) in December 2009. The average outstanding loan size now appears to have stabilised, as appears in the graph below.

Portfolio and Ave. Out. Loan Size



<u>Deposit products</u>

As of now, Constanta is authorised to collect deposits from institutions but not from individuals. It will be allowed to accept deposits from individual depositors only after the NBG has completed an assessment of the quality of its assets. According to the licence granted, Constanta is prohibited from accepting term and demand deposits from individuals unless the NBG specifically permits it. The bank can attract all kinds of deposits from companies; however it is relatively complicated at present. However, even after it obtains authorisation to collect deposits from individuals, the bank does not plan to raise any substantial funds in 2010 since the cost of deposits in the country is still high.

Governance and strategic positioning

Constanta has a reasonable performance on governance with a rating grade of $\alpha-$. A highly experienced and professional Board, strong second line, good vision and strategy to cope with competition, diverse sources of funds and good risk management practices have resulted in this performance. However, the competitive business environment, small market size and country risk have restricted the grade.

<u>Governance structure</u>

Constanta has a highly experienced and professional Board. However, the Board has only three members. Ms Tamar Lebanidze, the Founder of Constanta Foundation and the current Executive Director of AGMO heads the Board. The other members of the Board are Mr Giorgi Loladze, Chairman of the Supervisory Board of Georgian Stock Exchange and Mr. Irakli Kovzanadze, Chairman of Task Force of OECD and EBRD on Corporate Governance of Banks in Eurasia. The Board is required to meet quarterly and meets frequently to discuss strategic as well as operational issues. The members of the Board are from diverse professions and have rich experience of their respective fields. However, the Board could benefit by adding more members from diverse professional backgrounds.

After obtaining the banking license, Constanta has formulated an Audit Committee, Asset-Liability Committee and a Human Resource Committee in the Supervisory Board. These committees are of two members each. The bank plans to bring in equity investment from a reputed international investor. Subsequently it also plans to bring in more members to the Board. The addition of members on the Board will further strengthen the process of strategic decision making, systems and processes in the organisation.

<u>Operational and growth strategy</u>

Constanta's growth strategy has always been flexible and has responded to the prevailing situation. It adopted the group lending model but discontinued it in order to cope with growing competition from commercial banks. Over the years Constanta has diversified its product offerings and plans to continue its focus upon micro-enterprise loans as such enterprises have shown better resilience during the war and economic downturn. It plans to increase its lending of micro loans including micro agriculture loan, Express loans and Business loans

With a licence to operate as a bank, Constanta plans to continue to be microfinance focussed. However it plans to widen its spectrum by venturing into SME and corporate banking; albeit with an initial nominal exposure to this sector. The savings product would be a challenge during the current year on account of higher interest rates being offered by other banks. It plans to establish ATMs (Automated Teller Machines) and introduce cards in the current year. The launch of these new products and services was delayed due to the global recession and the war with Russia.

Constanta does not plan to expand geographically until it has considerably improved its productivity. It plans to continue with the same number of branches for the year 2010. Due to the weak presence of commercial banks in the rural areas, Constanta plans to intensify its rural operations. In order to support its portfolio growth Constanta plans to mobilise equity from institutional investors which would help it raise debt. As already explained, Constanta does not plan to raise substantial deposits in the current year.

Fund mobilisation

Constanta has always had a wide base of lenders and donors including Oikocredit, Global Commercial Microfinance Consortium, Developing World Markets, EBRD, Dexia/Blue Orchard, Bank IM Bistum Essen, Credit Suisse, Triodos and Calvert. Despite this wide base, Constanta experienced a shortage of funds in 2008 and first quarter of 2009 on account of the high country risk perception, unstable political environment and global liquidity crisis. The funds crisis was more serious in 2008, and the organisation had to revise its business plan. In 2009, for the first half the loan portfolio shrunk due to the global liquidity crisis but in the second half the situation improved considerably.

The table below presents details of Constanta's current borrowings.

Lender	O/s on 31-12-09 (in $ '000)	Interest rate
OikoCredit	1,000	8.25%
OikoCredit	2,800	8.50%
Global Commercial MF	4,000	10.40%
EBRD	2,154	6.01%
Blue Orchard	4,000	9.00%
Developing World Markets	4,000	8.65%
Developing World Markets	750	11.80%
Dual Return Fund	500	9.50%
Dual Return Fund	250	9.75%
Dual Return Fund	1,000	9.90%
Dual Return Fund	1,000	9.90%
Finethic	500	9.50%
Finethic	500	9.75%
Calvert Social Investment Found.	500	8.25%
Credit Suisse	1,000	9.50%
Credit Suisse	500	9.90%
UMCOR	100	0.00%
Wallberg Invest S.A.	1,000	9.90%
Bank IM Bistum Essen	2,000	9.00%
Bank IM Bistum Essen	2,000	9.25%
Responsibility S.I.C.A.V	500	9.90%
EMF Microfinance Fund	1,000	8.75%
Total	**31,054**	**WACC-9.06%**

In addition to debt, Constanta plans to invite equity capital and is in negotiations with some international financial institutions. It plans to convert into an open company with dilution of the promoters' shareholding by increasing its capital by 15% to 20% in 2010. The crucial factors in mobilising equity investment relate to the price, the extent of control and the exit route. The equity mobilisation would increase the organisation's leveraging capacity. Constanta also plans to raise funds by an IPO and issue of bonds in the near future. These will be done after the markets sentiments revive once again to the pre 2007 levels.

Second line of leadership

Constanta has a strong second line of leadership with considerable experience in the banking sector. The Directors of various departments have years of relevant experience and have the skills to carry out their jobs efficiently and effectively.

Competition

Constanta faces stiff competition from various MFIs and banks operating in Georgia. The big non-bank players are FINCA, JSC MFO Crystal, VF Credo and Lazika Capital. In terms of share of clients, Constanta ranks third amongst the bank and non-bank MFIs; however due to comparatively high loan size offered by the banks, most of the banks are much ahead of Constanta in terms of volume. In terms of profitability only five banks including Constanta were profitable out of a total of 20 commercial banks in the country. For the year 2009, ROE of Constanta was second best among all the banks.

Competition with banks started when banks started pursuing a downscaling strategy in 2007. Consequently the Bank of Georgia, VTB and Bank Republic emerged in the microfinance market. Amongst the banks the main competitor is ProCredit Bank, the first commercial bank established to serve the MSME sector. It was in response to this competition that Constanta had to discontinue its group loan product and start individual lending. Today the Agriculture, Micro and SME sectors are the priorities of the bank's credit and growth strategy.

Constanta's core competence lies in its understanding of microlending on account of its 10 years of experience. Additionally promptness of services, client friendly approach, flexible and convenient terms and conditions are its strengths. Strong marketing and good positioning also helps the organisation to deal with the fierce competition. However for the same reason, it faces tough competition from banks with respect to savings mobilisation and other non-loan banking products in which it is a new entrant. Constanta has till now not invested much in the marketing of its non-credit services in order to keep its costs in control. However, it will need to grow the business volume of its branches to meet the increased overheads of banking.

Organisation and management

Constanta has good management performance with a grade of α-. This is on account of its professional and experienced staff, strong internal control systems, risk management practices, good credit appraisal systems and mechanism for tracking overdues. However the low productivity of staff is a major cause of concern.

Human resource quality & management

Constanta has qualified and experienced staff in its management cadre. Most of the department heads have experience of working in major commercial banks of Georgia.

Human resource management is formalised and the HR team consists of three executive members. However, Constanta's HR head position is currently vacant.

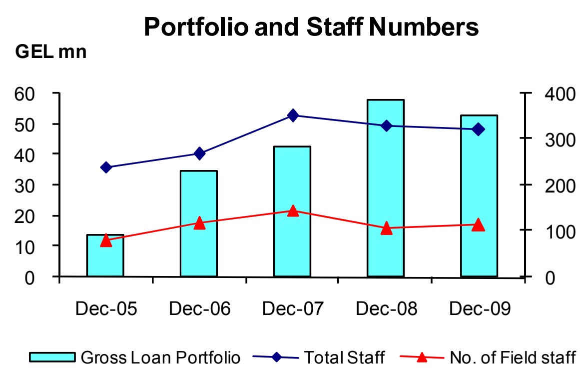
Short listed job applicants are invited for a written test which includes professional, IQ and IT tests followed by an interview. For top management positions, only an interview is conducted. Probation for various positions ranges from two to six months. The Loan Officers have to undergo two months of on-the-job training followed by two weeks of classroom training. Constanta prefers fresh recruits at the LO level and its own staff at the middle level.

Constanta has an in-house training team. Staff is regularly trained so as to equip them to meet the changes in the organisation. Due to inadequate staff and lack of training capacity most specialised training is conducted by an external agency. Few staff members were also deputed for exposure visits. As the staff base is expanding, it would be wise to further develop the training team to cater to the future capacity building requirements of the organisation, especially in the competitive market of Georgia.

The motivation levels of the staff are high and their salaries are commensurate with the other commercial banks. Attractive compensation by competitors was one of the main reasons for staff attrition in 2007. Staff attrition rate was high in 2008 at 33.7% mainly due to termination of 43 staff members (11.5%) on account of non-performance. The attrition rate declined to 16.6% in 2009 which, is still high. Among those who left the organisation in 2009, ~40% were with less than one year of experience with the bank.

The staff are provided a range of financial benefits up to GEL300 (US$ 177.5) for marriage, child birth or death of a close family member. Other initiatives to boost employee morale include training and promotion. Constanta also has a penalty in the form of no incentive for two months or no promotion for 4-8 months. Penalty is imposed on LO, HCU and BM for weak portfolio quality. For other staff, it is in the form of restrictions on salary increments and promotions. Performance appraisal is not very systematic and regular. However performance of the staff on parameters like numbers of clients, old and new clients, portfolio growth, portfolio at risk is assessed. There is no policy on regular transfer and transfers are usually made to fill up vacant positions or on request from the staff.

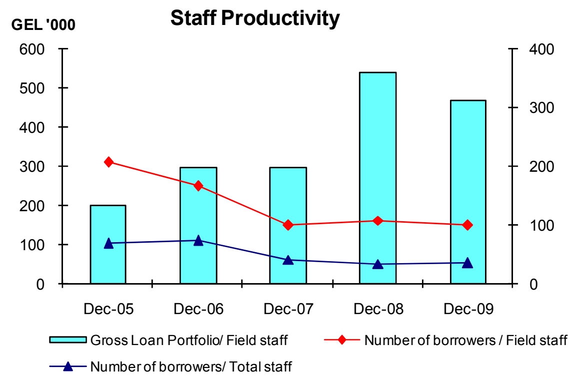
The field and total staff of Constanta increased with growth in its portfolio. The field staff (credit officers) considerably increased from 80 in December 2005 to 118 in December 2006 and further increased to 146 in 2007; however the number declined to 107 in 2008 as a result of termination of some staff members. In 2009 the number increased to 114. The number of administrative and support staff in the branches and HO increased from 150 in 2006 to 207 in 2007 and 225 in 2008 mainly on account of increased requirements in the accounting, finance and reporting sections after Constanta became a bank. In 2009, this number decreased to 207 again.



Staff productivity

The staff productivity of Constanta is low and is on a decreasing trend in terms of number of borrowers. The number of borrowers per field staff reduced from 225 in December 2004 to 101 in December 2009. The total staff productivity, measured by Clients per staff, in December 2009 was mere 36. Constanta had plans to increase this productivity in 2008 and 2009 but due to restricted growth, it remained low. With respect to average portfolio outstanding per field staff, the productivity increased from GEL120,000 in 2004 to

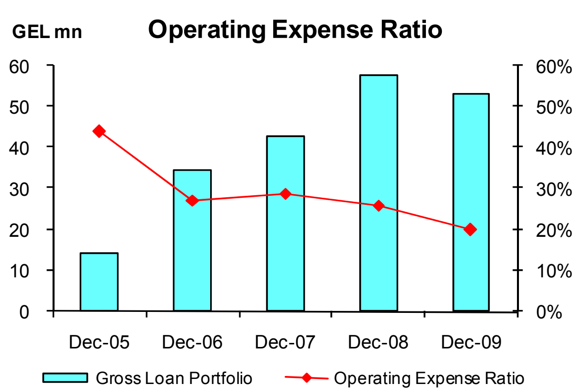
GEL294,000 in 2007 and considerably to GEL465,743 in 2009.



The prime reason for the low client productivity of staff is the policy of posting 4-6 LOs even in newly established branches. The average field staff per branch was 7 in December 2007 which reduced to 5.4 in December 2009 resulting in a slight increase in field staff productivity. In addition to this, the high number of administrative and support staff at every branch resulted in low productivity. To deal with the existing low levels of productivity, the management terminated the services of non-performing staff in 2007 and 2008.

Operating efficiency

The OER was very high at 52.7% in 2004 but since then has declined to 20.1% for the year ending December 2009. As compared to 2008, the expenses on salaries declined by 19%, administrative expenses declined 15% and total operating expenses declined by 24%. Correspondingly, the loan portfolio declined by only 5%. This resulted in an improvement in the OER and consequently margins of the bank. This is explained in detail in the financial section.



With an increase in scale and freeze on the numbers of branches and staff, the productivity is expected to improve further. As a result OER is expected to decline further and at a higher rate.

Accounting and MIS

All income and expenses are recorded on accrual basis. Loan loss reserve is created on the basis of ageing analysis. Depreciation is accounted for on a monthly basis on the written down value method. Loans are written off when unpaid for more than 180 days. The branches are treated as profit centres and online accounting of branches is done. HO administrative costs and cost of funds are allocated to the branches. Performance of the branches is carefully analysed in quarterly management reports.

Constanta now uses an integrated banking software called “Alta Bank 2005”. It has a well qualified and experienced IT head and team. The software has strong security features and is capable of generating all standard banking reports.

The database stores the entire credit information and the administrator has the right to add products and make any other changes if required. The software works on a real time basis and is installed in all the 21 branches. The quality of MIS reporting is good.

The branches are on-line connected with a centralised SQL server at HO. There are two servers at HO and on failure of one of the server; the branches automatically get connected to the second server. Branches are well connected by fibre channel and DSL. However occasional cases of connectivity breakdown are observed in the branches and mobile connectivity is used as a back up in such a situation. Back up of data is automatically stored in the server on a daily basis and also in a tape drive.

Reporting is done according to the requirements of the National Bank of Georgia and Income Tax authority. Apart from the mandatory regulatory reporting, reports are generated to analyse various financial risks as well to do comparative performance analysis.

The financial statements and other financial information are required to be submitted to the National Bank of Georgia on a daily, biweekly, monthly, quarterly, semi-annually and annual basis. Tax declarations are made to the government tax department on a monthly and annual basis. Other information is prepared for lenders and vendors and submitted to them as per their requirements. Variance reports are prepared monthly and sent to branches. On a quarterly basis, the financial statements of the branches are discussed with the BM.

Tracking system for overdues

The tracking system of overdues is good. Any loan overdue by more than 3 days is monitored by the credit head. In case of non-repayment, on the 3rd day from the due date an official note is sent asking the client to visit the branch. After 30 days of non-repayment from the due date the case is forwarded to the Legal Department.

The last resort is to file a legal suit against such clients. However the legal process may extend up to 6-18 months. Constanta has so far not lost any case against its clients; however, there are many cases pending for more than a year. In most of the cases collateral is not liquidated and the client pays the settlement amount including the outstanding loan amount, interest on overdues, taxes and penalty in cash.

Internal control systems

Constanta has two parallel systems of operations audit. It has an internal audit (IA) team of 5 members. These consist of members with combination of operations and accounting skills. The team is headed by an experienced professional with banking experience.

The internal audit format includes policy, operational and financial compliance in addition to collateral and loan utilisation checks. Fixed assets and inventory purchases as well as cash audit are also included in these visits. The audit is conducted on a sample basis and covers roughly 10% of the portfolio and 5% of the total clients in a branch. The duration of the visit is 1-3 weeks by 2-4 persons depending upon the size of the branch and issues discovered. The IA team also audits the HO departments and reports directly to the Supervisory Board.

Apart from the Internal Audit, the operation's department also has a six member control unit established specially for the purpose of control of loan disbursement and overdues. Regular visits, 2-3 times a year are made to the branches which are of 2 weeks duration. The visiting team consists of 2-4 members and at least 30% of overdue clients are visited. Assessment of LO's capability and integrity is also done. The Report is sent to the BM and subsequently to the Credit risk Manager. The report is finally submitted to the Board of Directors. Special visits by the controlling team are conducted if any serious issues are observed by the internal audit team.

Financial planning

Constanta has prepared a five year strategic business plan for the period 2009-2013 in the beginning of the year 2009. The plan will be updated for the period 2010-14, in the current year. The plans explicitly states deliverables for every department. The plan is quite rigorous and shows the projected growth of the organisation in terms of operational area, portfolio and clients. The plan is revised every year and is based upon market forces and competitor analysis. A master budget is prepared annually on the basis of the business plan.

Request for funds by branches are sent in the morning to the Treasury Manager (TM). The Bank has established cash collections service division and funds are sent physically by secured vehicles.

Branches have limits with respect to cash, liquidity and treasury and the treasury department monitors compliance with these limits by branches. The limits assigned are different for every branch and revised from time to time. Such a system ensures strong financial planning. Any idle cash at HO is put in other banks at inter-bank rates.

Quality of clients

Based on the client visits, the quality of clients seemed to be good in terms of awareness and repayment performance. The level of satisfaction amongst the client is high mainly due to the quality of service and personal approach of the staff. Despite stiff competition, duplication is avoided by information sharing through the credit bureau.

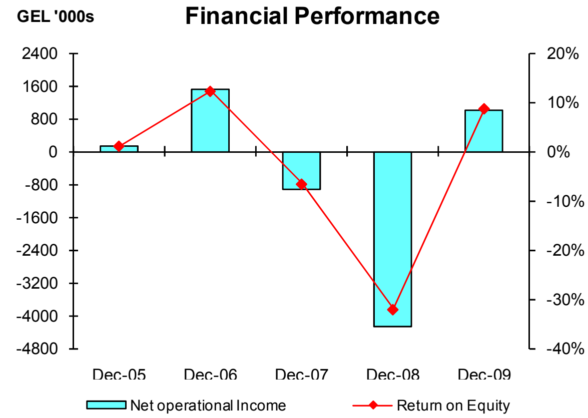
Infrastructure

Constanta has adequate infrastructure for its operations. Fixed assets mainly include, computers, office equipment, furniture and fixtures and vehicles. The HO operates from rented premises while some of the branches operate from the bank's own premises. After transformation to a bank, 19 branches were renovated in 2007 and 2008. Cash safes and security measures were installed as per the statutory requirements.

In order to develop a branch infrastructure with the best standards of a commercial bank and with a common brand, Constanta made heavy investments in fixed assets in 2007. The fixed assets increased to 12% of the total assets in 2008 and were 11.0% of the total assets as on 31 December 2009.

Financial profile

Constanta's performance on financial parameters is reasonable with a rating grade of β+. This is an improvement over the last rating by one notch. The bank achieved profitability even though it was marginal. This was mainly due to control on personnel and administrative costs, reduction in FCR and reduction in loan loss provisioning requirements. The capital adequacy position of the organisation is comfortable at 19.0%. It has been able to maintain its capital adequacy ratio above the statutory requirement. However, with a moderate to high country risk perception among the lenders, the bank will need to maintain its capital high by introducing more equity. Constanta has maintained a good portfolio quality even during the difficult times and has been able to improve margins.



As is apparent from the above figure, the profitability dipped sharply immediately after becoming a bank in 2008, but the bank again achieved break-even in 2009. Yield reduced sharply from 46.6% in 2005 to 33.8% in 2007 due to the change in composition of the portfolio. The group loan product had a high yield and formed 34% of the total portfolio in 2006. The reduction in the share of the group loan product sharply reduced profitability as the change in the portfolio mix was coupled with price wars waged by Constanta's competitors forcing the organisation to lower its own lending rate of interest.

Financial Ratios	31 Dec 05	31 Dec 06	31 Dec 07	31 Dec 08	31 Dec 09
Capital Adequacy					
Risk Weighted Capital Adequacy Ratio	80.3%	37.6%	30.9%	17.5%	19.0%
Asset Quality					
Portfolio at Risk (>30 days)/ Gross Loan Portfolio	1.20%	0.54%	0.43%	0.87%	1.69%
Loan Loss Reserve/Gross Portfolio	2.9%	2.7%	2.0%	3.2%	3.2%
Management					
Operating Expenses/Average Gross Loan Portfolio*	43.9%	27.2%	28.9%	26.0%	20.1%
Number of Borrowers/Total field staff	207	166	100	108	101
Number of Borrowers/Total staff	69	73	42	35	36
Earnings*					
Net operating income/Average Equity (RoE)	0.6%	8.5%	-14.2%	-31.3%	7.7%
Net operating income/Average Assets (RoA)	0.8%	4.4%	-0.8%	-6.2%	1.29%
Portfolio Yield	46.6%	38.6%	34.0%	28.5%	27.4%
Other income/Average Portfolio	8.8%	6.4%	2.7%	3.0%	4.6%
Financial Cost Ratio	2.2%	10.9%	13.3%	10.1%	8.9%
Interest and fee expense/Average funding liabilities	5.4%	10.9%	11.3%	10.0%	8.2%
Liquidity					
Cash & Liquid Assets/Total Assets	1.4%	0.4%	2.9%	3.5%	3.1%

Credit performance and portfolio quality

The portfolio quality of Constanta remains good even though the PAR_{30} increased to 1.69% as on 31 December 2009 compared to 0.87% on 31 December 2008. Constanta restructured loans amounting to GEL700,000 (1.3% of the portfolio) in 2009. This decline is attributable to loss of life and property during the war and a slowdown in the economic activity in 2008 and early 2009 due to the global recession.

Distribution of PAR_{30} on the basis of loan sizes as on 31 December 2009 is as follows:

As on 31 December 2009

Loan amount range USD	PAR > 30 (USD)	PAR > 30 (%)
Up to 500	628	0.07%
501 to 20,000	443,547	2.19%
20,001 to 30,000	69,978	1.25%
30,001 to 50,000	17,137	1.03%
More than 50,000	Nil	0.00%
Total	**531,289**	**1.69%**

As can be observed, PAR is not unusually high in any of the loan size segments. PAR was observed to be highest in Gori branch which was affected by the war with Russia. This region was occupied by the Russian troops for some weeks which led to an exodus of people and interruption of business activities. The region has a good agricultural potential and is identified by Constanta for providing agriculture loans primarily to apple growers.

As on 31 December 2009

Activities	Amount GEL mln	Share of Portfolio
Trade	31.1	58.6%
Agriculture	5.4	10.1%
Production	4.0	7.6%
Services	5.7	10.7%
Others (including staff loans)	6.9	13.1%

The portfolio is reasonably diversified as can be seen from the above table. The share of the portfolio in trade reduced from 60.8% as on 31 December 2007 to 58.6% in 2009. The share of agriculture increased from 8.2% in December 2007 to 10.1% in December 2009. Considering Constanta's plans to intensify its operations in rural areas where banks are usually not present, the share of agriculture loans in the total portfolio is expected to rise in future.

In addition to the diversification, the organisation also reduces portfolio risk by accepting collateral. Nearly 37% of the loan outstanding is backed by property mortgages. This is higher than the 31% recorded in the previous rating in June 2008. With the rapid increase in the share of the express loan in total portfolio, which is provided without any collateral, the unsecured loans will tend to increase. The organisation will need to constantly upgrade its skills in the loan appraisal process mainly with respect to projecting the cash flows of the express loan clients and his/her repayment capacity and measuring the risks. The branch staff will need to be trained further to base interest rates on risk measurement.

Mobilisation of funds, liability & equity composition

Constanta always had a wide base of lenders and donors. Despite the wide base, Constanta experienced a major shortage of funds in 2008 and first quarter of 2009. High risk perception, unstable political environment in the country and recession during 2008 and 2009 were the reasons for this fund crunch.

The capital adequacy of the organisation has been decreasing since 2004. With no debt funds in 2004, CAR was exceptionally high at 100.5% but it reduced to 30.9% in December 2007 and further to 19.0% in December 2009. The CAR is still more than the statutory requirement of 12%. High country risk perception will necessitate Constanta to maintain a relatively higher CAR to comfortably leverage commercial funds.

Asset composition

The gross loan portfolio was roughly 90% of the total asset base in December 2005 which reduced to 67.6% in December 2007. However the share of loan assets to total assets has improved in subsequent years and was at 80.5% as on 31 December 2009. Cash and bank balances formed 3.1% of the total assets in December 2009 and cash and bank balance including short term dues from banks formed 7.8% of the total assets, which is reasonable.

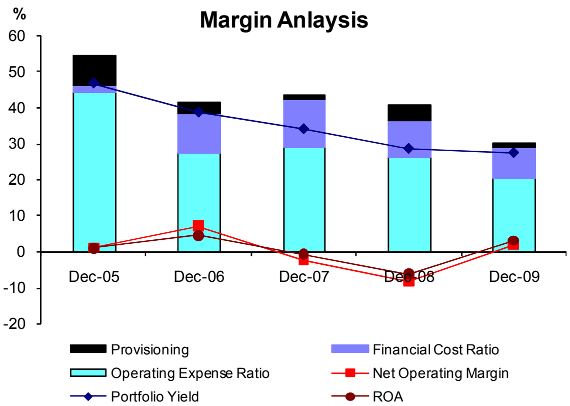
ALM

Constanta classifies and compares its assets and liabilities in monthly buckets upto the first three months. Beyond three months and upto one year the classification is at quarterly intervals. Beyond one year the classification is done yearly. For the short term (upto one year). Constanta's ALM is comfortable and its assets in each bucket are higher than the liabilities.

Foreign Exchange Match

Constanta has 79.1% of its total assets in US Dollar while 81.8% of its funds are in US Dollars. The gap is very limited and does not pose much risk. It does not have any significant exposure in other foreign currencies.

Profitability and sustainability



Future plans and prospects

Constanta was not able to perform well on profitability and sustainability indicators till 2008 due to the strategic change in the portfolio mix In 2008, it also had to increase loan loss provisioning to meet the regulatory requirements. However in 2009, it put a control on its expenses and there was a lower requirement for provisioning. This led to regaining of profitability.

Constanta plans to continue to be a microfinance focussed bank. However it plans to widen its spectrum by venturing into SME and corporate banking; albeit with an initial marginal exposure to this sector. It also plans to increase the share of other services in its revenues. It has already introduced money transfers/remittances foreign exchange and other retail banking services. It plans to introduce ATMs, credit cards and other corporate banking services in the current year.

Constanta does not plan to expand geographically until it has considerably improved its productivity. The number of branches in 2010 will remain same. Constanta plans to intensify its operations in rural areas where presence of other commercial banks is limited.

In order to support its portfolio growth Constanta plans to mobilise funds by raising equity capital from an institutional investor. In the long run it would like to raise funds from the public by way of deposits, bonds and IPO of equity shares.

Financial statements of Constanta*

Balance sheets

31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08			31-Dec-09
GEL	GEL	GEL	GEL	Assets	GEL	GEL
			-			
				Current assets		
27 000	26 000	159 000	2 437 000	Cash		1 983 777
188 000	212 000	1 712 000	51 000	Bank		30 860
			250 000	Financial assets/derivatives		
	108 000	267 000	367 000	Net intangibles		586 940
	55 000	182 000	29 000	Inventories and stock		
			2 041 000	Due from Banks		3 131 878
318 000		496 000		Tax paid in advance		
	21 000		540 000	Deferred tax		60 134
40 000	133 000	206 000	34 000	Tax settlements other than income tax		
		41 000	263 000	Other assets		1 507 621
37 000	210 000	263 000		Debtors		
			54 000	Short term investments		
		1 270 000		Receivable from sale of shares		
				Loans outstanding		
14 123 000	34 739 000	42 885 000	57 746 000	Gross loans outstanding after write-off	53 094 730	
469 000	957 000	849 000	1 823 000	(Loan loss reserve)	1 718 958	
13 654 000	33 782 000	42 036 000	55 923 000	Net loans outstanding		5 13 75 772
14 264 000	**34 547 000**	**46 632 000**	**61 989 000**	**Total current assets**		**5 86 76 983**
				Long term assets		
				Long term investments	64 000	
	16 867 000	9 309 000		Deposits with banks		
1 409 000	1 756 000	7 484 000	8 465 000	Gross property and equipment		
1 409 000	1 756 000	7 484 000	8 465 000	Net property and equipment	7 251 980	
1 409 000	**18 623 000**	**16 793 000**	**8 465 000**	**Total long term assets**		**7 315 980**
15 673 000	**53 170 000**	**63 425 000**	**70 454 000**	**Total Assets**		**65 992 964**
				Liabilities and Networth		
				Current liabilities		
35 000	20 000	170 000		Trade payables		
			1 122 000	Deposits/Current Accounts		1 002 739
		5 000		Accrued interest		794 479
	369 000	499 000		current income tax		
		62 000		deferred income tax		
	31 000	116 000		Tax payable other than income tax		
	42 000	97 000	257 000	Other current liabilities		424 129
35 000	462 000	949 000	1 379 000	Total short term debt		0
35 000	**462 000**	**949 000**	**1 379 000**	**Total current liabilities**		**2 221 347**
				Long term liabilities		
4 080 000	39 451 000	44 743 000	57 544 000	Bank loan		52 350 574
		2 762 000		Other borrowings		
4 080 000	39 451 000	47 505 000	57 544 000	Total long term debt		52 350 574
4 080 000	**39 451 000**	**47 505 000**	**57 544 000**	**Total long term liabilities**		**52 350 574**
4 115 000	**39 913 000**	**48 454 000**	**58 923 000**	**Total Liabilities**		**54 571 921**
				Net worth		

			15 675 000	Equity	15 675 850	
1 450 000	2 097 000	2 097 000		Donation		
		1 247 000		Asset revaluation reserve		
		2 471 000		Minority interest		
10 043 000	10 108 000	11 165 000		Retained earnings	- 5 137 318	
65 000	1 052 000	- 2 009 000	- 4 144 000	Current year profit/loss	882 510	
11 558 000	**13 257 000**	**14 971 000**	**11 531 000**	**Total net worth**		**11 421 042**
15 673 000	**53 170 000**	**63 425 000**	**70 454 000**	**Total Liabilities and Net Worth**		**65 992 964**

*: Balance sheet for 2005, 2006 and 2007 are of Constanta Foundation. For December 2008 and December 2009, Balance sheet is for JSC Bank Constanta

The differences in the retained earnings as on 31 December 2009 at GEL(-5,137,318) and profit of year 2008 at GEL(-4,143,432) is due to the differences in the regulations of the National Bank of Georgia from that of IFRS which is enforced by the auditors of the bank. While the financial statements for 2009 are unaudited, 2008 statements are audited and comply with IFRS principles.

Income statements for the year ending

In GEL

31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-07			31-Dec-09
GEL	GEL	GEL	GEL	**Income**	GEL	GEL
4 796 000	8 419 000	12 584 000	14 563 000	Interest on loans to customers	13 736 404	
7 000	752 000	1 465 000	288 000	Interest from banks	112 790	
27 000	10 000		8 000	Interest on investments	3	
677 000	907 000			Administrational fees		
104 000	261 000	822 000	808 000	Penalties, Commission and fee	1 740 985	
	100 000		572 000	Foreign exchange gain	223 889	
		41 000		Insurance		
100 000	97 000	124 000	151 000	Bad debts recovered		
21 000	29 000	29 000		Other income	324 496	
5 732 000	**10 575 000**	**15 065 000**	**16 390 000**	**Total income**		**16 138 566**
				Financial costs		
169 000	2 263 000	4 717 000	5 030 000	Interest on borrowings	4 438 270	
8 000	21 000	19 000		Interest on overdraft		
45 000	92 000	173 000	101 000	Commission		
			119 000	Interest on deposits	60 677	
5 510 000	**8 199 000**	**10 156 000**	**11 140 000**	**Gross financial margin**		**11 639 619**
- 1 081 000	488 000	- 108 000	1 823 000	Provision for losses	548 114	
1 939 000	252 000	483 000	322 000	Write off		
4 652 000	**7 459 000**	**9 781 000**	**9 995 000**	**Net financial margin**		**11 091 506**
				Operating expenses		
2 572 000	3 499 000	5 162 000	6 560 000	Personnel expenses	5 328 087	
1 220 000	1 978 000	4 123 000	3 880 000	Administrative expenses	3 276 747	
91 000	134 000	252 000	342 000	Travelling	174 391	
257 000	292 000	792 000	1 558 000	Depreciation	1 283 112	
380 000	29 000	379 000	923 000	Other expenses	23 518	
4 520 000	**5 932 000**	**10 708 000**	**13 244 000**	**Total Operating expenses**		**10 085 855**
132 000	**1 527 000**	**- 927 000**	**- 4 249 000**	**Net Surplus/Deficit**		**1 005 651**
		250 000		Loss on sale and revaluation of assets		89 076
16 000		308 000		Foreign Exchange translation loss		14 646
			35 000	Provision for losses on other operations		47 998
		61 000		Gain/(Loss) on security trading		- 10 741
			31 000	Other financial expenses		
			369 000	Loss on financial assets-at fair value		
			19 000	Gain on sale/revaluation of assets		
116 000	**1 527 000**	**- 1 424 000**	**- 4 684 000**	**Profit before tax (PBT)**		**843 189**
51 000	475 000	585 000	- 540 000	Tax expense/credit		- 39 321
65 000	**1 052 000**	**- 2 009 000**	**- 4 144 000**	**Profit after tax (PAT)**		**882 510**

*: Income statement for 2005, 2006 and 2007 are of Constanta Foundation. For 2008 and 2009 Income statement is for JSC Bank Constanta

Balance sheets in US$

31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08			31-Dec-09
US$	US$	US$	US$	**Assets**	US$	US$
			-			
				Current assets		
15,976	15,385	94,083	1,442,012	Cash		1,173,833
111,243	125,444	1,013,018	30,178	Bank		18,260
-	-	-	147,929	Financial assets/derivatives		-
-	63,905	157,988	17,160	Net intangibles		347,302
-	32,544	107,692	17,160	Inventories and stock		-
-	-	-	1,207,692	Due from Banks		1,853,182
188,166	-	293,491	-	Tax paid in advance		-
-	2,426	-	319,527	Deferred tax		35,582
23,669	78,698	121,893	20,118	Tax settlements other than income tax		-
-	-	24,260	155,621	Other assets		892,083
21,893	124,260	155,621	-	Debtors		-
-	-	-	31,953	Short term investments		-
-	-	751,479	-	Receivable from sale of shares		
				Loans outstanding		
8,356,805	20,555,621	25,375,740	34,169,231	Gross loans outstanding after write-off	31,417,000	
277,515	566,272	502,367	1,078,698	(Loan loss reserve)	1,017,135	
8,079,290	19,989,349	24,873,373	33,090,533	Net loans outstanding		30,399,865
8,440,237	**20,442,012**	**27,592,899**	**36,679,882**	**Total current assets**		**34,720,108**
				Long term assets		
				Long term investments		37,870
-	9,980,473	5,508,284	-	Deposits with banks		-
33,728	1,039,053	4,428,402	5,008,876	Net property and equipment		**4,291,113**
833,728	**11,019,527**	**9,936,686**	**5,008,876**	**Total long term assets**		**4,328,982**
9,273,964	**31,461,538**	**37,529,586**	**41,688,757**	**Total Assets**		**39,049,091**
				Liabilities and Networth		
				Current liabilities		
20,710	11,834	100,592	-	Trade payables		
-	-	-	663,905	Deposits/Current Accounts		**593,337**
-	-	2,959	-	Accrued interest		**470,106**
-	218,343	295,266	-	current income tax		
-	-	36,686	-	deferred income tax		
-	18,343	68,639	-	Tax payable other than income tax		
-	24,852	57,396	152,071	Other current liabilities		**250,964**
20,710	273,373	561,538	815,976	Total short term debt		**0**
20,710	**273,373**	**561,538**	**815,976**	**Total current liabilities**		**1,314,407**
				Long term liabilities		
2,414,201	23,343,787	26,475,148	34,049,704	Bank loan		30,976,671
-	-	1,634,320	-	Other borrowings		
2,414,201	23,343,787	28,109,467	34,049,704	Total long term debt		30,976,671
2,414,201	**23,343,787**	**28,109,467**	**34,049,704**	**Total long term liabilities**		**30,976,671**

2,434,911	**23,617,160**	**28,671,006**	**34,865,680**	**Total Liabilities**		**32,291,078**
				Net worth		
	-	-	9,275,148	Equity	9,275,651	
857,988	1,240,828	1,240,828	-	Donation		
-	-	737,870	-	Asset revaluation reserve		
-	-	1,462,130	-	Minority interest		
5,942,604	5,981,065	6,606,509	-	Retained earnings	(3,039,833)	
38,462	622,485	(1,188,757)	(2,452,071)	Current year profit/loss	522,195	
6,839,053	**7,844,379**	**8,858,580**	**6,823,077**	**Total net worth**		**6,758,013**
9,273,964	**31,461,538**	**37,529,586**	**41,688,757**	**Total Liabilities and Net Worth**		**39,049,091**

Exchange rate used for conversion US$ 1 = GEL 1.69

Income statements for the year ending

In US$

31-Dec-05	**31-Dec-06**	**31-Dec-07**	**31-Dec-08**			**31-Dec-09**
US$	US$	US$	US$	**Income**	US$	US$
2 837 870	4 981 657	7 446 154	8 617 160	Interest on loans to customers	81 28 050	
4 142	444 970	866 864	170 414	Interest from banks	66 740	
15 976	5 917		4 734	Other interest income/interest on investments	2	
400 592	536 686			Administrational fees		
61 538	1 54 438	4 86 391	4 78 107	Penalties, Commission and fee	10 30 169	
			11 243	Gain on sale/revaluation of assets		
	59 172		3 38 462	Foreign exchange gain	1 32 479	
		24 260		Insurance		
59 172	57 396	73 373	1 51 000	Bad debts recovered		
12 426	17 160	17 160		Other income	1 92 009	
33 91 716	**62 57 396**	**89 14 201**	**97 71 118**	**Total income**		**95 49 447**
				Financial costs		
1 00 000	13 39 053	27 91 124	29 76 331	Interest on borrowings	26 26 195	
4 734	12 426	11 243		Interest on overdraft		
26 627	54 438	1 02 367	59 763	Commission		
			70 414	Interest on deposits	35 903	
32 60 355	**48 51 479**	**60 09 467**	**66 64 609**	**Gross financial margin**		**68 87 349**
- 6 39 645	2 88 757	- 63 905	10 78 698	Provision for losses	3 24 328	
11 47 337	1 49 112	2 85 799	1 90 533	Write off		
27 52 663	**44 13 609**	**57 87 574**	**53 95 379**	**Net financial margin**		**65 63 021**
				Operating expenses		
15 21 893	20 70 414	30 54 438	38 81 657	Personnel expenses	31 52 714	
7 21 893	11 70 414	24 39 645	22 95 858	Administrative expenses	19 38 904	
53 846	79 290	1 49 112	2 02 367	Travelling	1 03 190	
1 52 071	1 72 781	4 68 639	9 21 893	Depreciation	7 59 238	
2 24 852	17 160	2 24 260	5 46 154	Other expenses	13 916	
26 74 556	**35 10 059**	**63 36 095**	**78 47 929**	**Total Operating expenses**		**59 67 962**
78 107	**9 03 550**	**- 5 48 521**	**- 24 52 550**	**Net Surplus/Deficit**		**5 95 060**
		1 47 929		Loss on sale and revaluation of assets		52 708
9 467		1 82 249		Foreign Exchange translation loss		8 666
			20 710	Provision for losses on other operations		28 401
		36 095		Gain/(Loss) on security trading		- 6 356
			18 343	other financial expenses		
			2 18 343	Loss on financial assets-at fair value		
68 639	**9 03 550**	**- 8 42 604**	**- 27 09 947**	**Profit before tax (PBT)**		**4 98 929**
30 178	2 81 065	3 46 154	- 3 19 527	Tax expense/credit		- 23 267
38 462	**6 22 485**	**- 11 88 757**	**- 23 90 420**	**Profit after tax (PAT)**		**5 22 195**

Exchange rate used for conversion US$ 1 = GEL 1.69

*: Income statement for 2005, 2006 and 2007 are of Constanta Foundation. For 2008 and 2009, Income statement is for JSC Bank Constanta.

Notes to the financial statements

1. Constanta Foundation was registered as a not for profit microfinance organisation on 31 January 1997. In November 2007, JSC Constanta was formed as a joint stock company. On 8 July 2008, JSC Constanta received license from National Bank of Georgia to operate as a bank.
2. Financial statements for 2005 and 2006 are prepared for Constanta Foundation. Statements for 2007 are consolidated financial statements for Constanta Foundation, Constanta Plus and JSC Constanta. All significant intra-group transactions, balances, income and expenses are eliminated on consolidation. While the statements for 2008 represents statements of JSC Bank Constanta only. Based on agreement Constanta Foundation has sold all its assets and liabilities to JSC Constanta at book value.
3. Both income and expenses are recognised on an accrual basis.
4. Intangibles include software, patent and licenses.
5. LLR is created on the basis of ageing analysis. M-CRIL has not made any adjustments as LLR is created appropriately.
6. Loans are written off after 180 days.
7. Amortization of intangible assets and depreciation of fixed assets are calculated on straight-line basis at given rates: buildings (5%), furniture and equipment (20%), vehicles (20%), other (20%) and intangible assets (10%).

Glossary

1. Current repayment rate: Ratio of principal recovered (net of pre-payments) to the principal due for the last one year.
2. Portfolio at risk (PAR_{30}): Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 30 days to the total loans outstanding on a given date.
3. Yield on portfolio: The interest income on loans divided by the average loan portfolio for the year.
4. Other income to average portfolio: Total income other than from the interest on loans divided by average portfolio.
5. Financial cost ratio: Total interest expense for the year divided by the average portfolio.
6. Loan loss provisioning ratio: Total loan loss provisioning expense for the year divided by the average portfolio.
7. Operating expense ratio: Ratio of salaries, travel, administrative costs and depreciation expenses to the average loan portfolio.
8. Net operating margin: Difference of (yield on portfolio+ yield on other income) and (financial cost ratio+ loan loss provisioning + interest loss provisioning) – also known as spread on portfolio
9. Average loan portfolio: This represents the average loan outstanding for the year computed on a monthly basis.
10. Average total assets: This represents the average total assets for the year calculated on an annual basis.
11. Operational Self-Sufficiency: Ratio of total income to total costs for the year.
12. Financial Self-Sufficiency: Ratio of total income to total adjusted expenses for the year. Adjustments have been made for subsidised cost of funds (w.r.t. market interest rate), equity (w.r.t. inflation) and in-kind donations.
13. Risk weighted capital adequacy ratio: Ratio of networth to risk weighted assets
    M-CRIL Risk weights: 100% for all assets except the following: fixed assets: 50%; cash 0%.
14. Return on assets: Ratio of operational income/(loss) to average total assets
15. Return on equity: Ratio of operational income/(loss) to average net worth

Abbreviations

BM	Branch Manager
CAR	Capital Adequacy Ratio
CARE	Christian Action Research and Education
CGAP	Consultative Group to Assist the Poor
DFID	UK Department for International Development
DSL	Digital Subscriber Line
EBRD	European Bank for Reconstruction and Development
EMI	Equated Monthly Instalment
EU	European Union
FCR	Financial Cost Ratio
FSS	Financial Self-Sufficiency
GEL	Georgian Lari
GD	General Director
HCU	Head of Credit Unit
HO	Head Office
IA	Internal Audit
IDB	International Development Bank
IMF	International Monetary Fund
IPO	Initial Public Offer
IT	Information Technology
JSC	Joint Stock Company
LLC	Limited Liability Company
LLP	Loan Loss Provision
LLR	Loan Loss Reserve
LO	Loan officer
M-CRIL	Micro-Credit Ratings International Ltd
MFI	Micro Finance Institutions
MFO	Micro Finance Organisations
MIS	Management Information System
MSME	Micro, Small and Medium Enterprises
NATO	North Atlantic Treaty Organisation
NBFC	Non Bank Finance Company
NGO	Non Governmental Organisation
OECD	Organization for Economic Cooperation and Development
OER	Operating Expenses Ratio
OSS	Operational Self-Sufficiency
PAR_0	Portfolio at Risk (>=0 days)
RoA	Return on Assets
RoE	Return on Equity
TM	Treasury Manager
UNDP	United Nations Development Programme
US	United States
USAID	United States Agency for International Development

Validity This rating is valid till the next loan proposal made by the MFI to any financial institution or till any other significant change in the structure of the loan programme or in its external environment. A **rating update** (comprehensive repeat rating) is recommended whenever such changes take place or at the end of **one year** from the date of the initial assessment, whichever is earlier. Any substantial additional information that becomes available could also result in a rating update or a rating review (revision of rating grade based on a desk analysis).

Liability The rating assigned is a professional opinion of the assessors and M-CRIL does not guarantee the information and cannot accept any legal responsibility for actions arising out of the recommendations made.

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