JSC Bank Constanta (Constanta)

Joint Stock Company

Tbilisi, Georgia

{second update} , August 2011

Credit Rating

Investment Grade			
	Above	α	α+
			α
			α–
		β	β+
			β
	Below		β–
		γ	γ+
			γ

	August 2008	January 2010	August 2011
RATING	β+	α–	α
RATING OUTLOOK*		*positive*	*positive*

Category	Grade		
	August 2008	January 2010	August 2011
Governance & strategic positioning	β+	α–	α
Organisation & Management	α–	α–	α–
Financial performance	β	β+	α–

Visit: 26-29 July 2011

M-CRIL:
Alok Misra alokmisra@m-cril.com
Gunjan Grover gunjan@m-cril.com
Tel: +91 124 230 9497
Fax: +91 124 230 9520

Constanta
Mr Levan Lebanidze
levan.lebanidze@constanta.ge
Tel: +995 32 401401

Structure

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Synopsis

- Constanta Bank's microfinance operations were **stated by Constanta Foundation** in 1997 by the current Chairperson Ms Tamar Lebanidze.
- The foundation started its operations with **grant support from Save the Children and later from USAID**
- Constanta received the **banking licence** from the National Bank of Georgia in July 2008 and acquired the microfinance operations of Constanta Foundation
- Till 2010, Constanta Foundation was the **majority shareholder** of the bank with 67.51% of the shareholding held by it through its wholly owned subsidiary LLC Constanta Plus.
- In 2011, the **Foundation sold its entire holding** and individual shareholders (promoters and senior management personnel) sold part shareholding to TBC Bank. TBC bank which is the second largest commercial bank in Georgia now holds 80% of Constanta bank's shareholding, while Oiko Credit holds 13.1% and remaining shares are held by 7 individual shareholders .
- With a change in the shareholding, Constanta now has **2 representatives of TBC bank on its supervisory board**.
- Constanta' **focus remains on providing access to finance to agriculture and small enterprises in remote areas of Georgia**. To gain efficiencies it has also ventured into providing other banking services
- In 2010, the bank received permission from the National Bank to mobilise deposits and has plans to significantly increase the share of deposits in its total source of funds (25% by end of 2012 and 45% by the end of 2014).

Synopsis

Main Performance Indicators					
	Dec-07	**Dec-08**	**Dec-09**	**Dec-10**	**June-11**
Gross Portfolio (GEL million)	42.9	57.7	53.1	69.1	85.2
Number of active borrowers	14,653	11,549	11,466	16,964	24,794
RoA	-3.2%	-6.2%	1.3%	2.8%	2.4%
Loan Portfolio Yield	36.2%	30.1%	30.9%	31.3%	31.5%
Other income / average assets (mainly penalty and bad debt recovery)	0.4%	1.5%	1.1%	4.1%	2.4%
Other fee income / average assets	0.0%	0.0%	0.0%	0.3%	0.4%
Portfolio at Risk (>60days)	0.0%	0.5%	1.3%	0.3%	0.2%
Operating Expense Ratio	28.9%	26.0%	20.1%	22.0%	21.3%
Average Loan Disbursed (GEL)	3,260	5,202	4,620	3,714	3,425
Borrowers per field staff	100	108	101	109	155

US $ = GEL1.665

In M-CRIL's opinion, Bank Constanta has the capacity to absorb additional loan funds for its planned growth. A rating update after one year is suggested to ascertain changes in the creditworthiness of the institution. This rating is valid, subject to no other significant changes in the organisational structure and external operating environment.

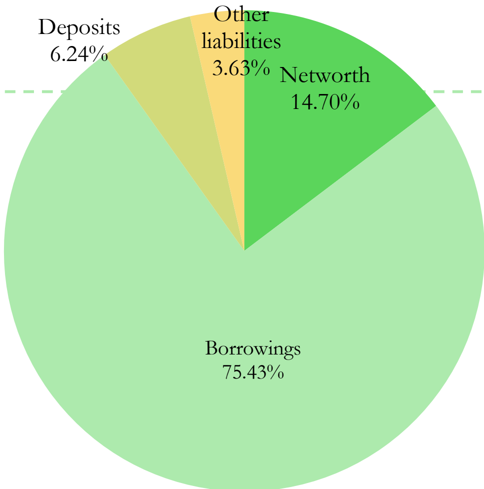
Strengths

- **Equity and Sub-debt** – A majority ownership of Bank TMC has paved the way for fresh equity infusions in future for the growth.
- **Diversified source of funds and increasing share of deposits** – the number of lenders has increased to 21 including many large microfinance funds. Constanta started accepting public deposits from 2010 (~6% of its total funds on 30 June 2011).
- **Loan appraisal and documentation** – Quality of loan appraisal was observed to be good. Details of cash flows, assets and loan history are analysed carefully. Loan utilisation checks (LUC) are done in all cases. Loan documentation is also well maintained.
- **MIS, accounting and financial policies** – Reporting is timely and real time. Proper data security systems are in place. Accounting policies are good.
- **Excellent portfolio quality** and profitable operations
- **Healthy Capital Adequacy Ratio** of 19.9% as on 31 December 2010. On 30 June 2011, the Tier 1 CAR declined to 16.6% while Tier 1&2 CAR was 22.0%.

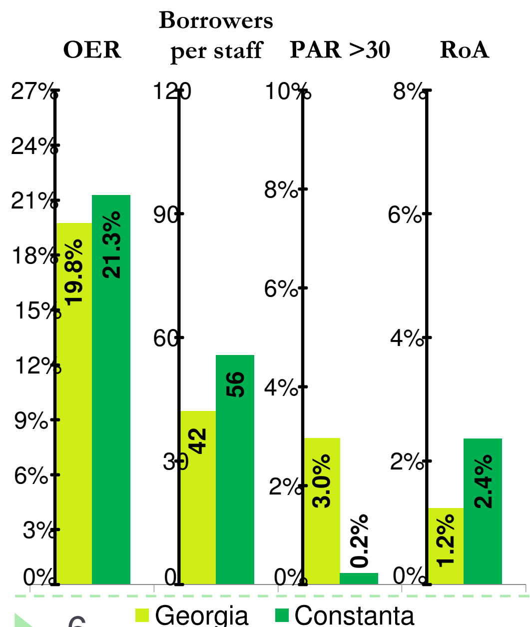
Issues

- **Less independent members on board and committees** – out of 5 board members, 3 represent shareholders while only one member is non-executive and non-shareholder member.
- **Internal audit frequency** – Internal audit of branches is carried out only once in a year which is inadequate. Many of the loans are of shorter than one year duration and may get left out of the ambit of internal audit. Strengthening audit is crucial in view of ambitious expansion plans and new services like ATM.
- **Low margins** – Despite a high yield (31.5%) and excellent portfolio quality, RoA is moderate (2.4%) on account of high operating expense ratio. With proposed expansion and increasing share of deposits, margins will be further stretched.
- **Performance appraisal of staff**– The HR department has not formalised the performance appraisal systems. With an increase in the size of bank, the current systems of appraisal based on feedback of seniors may not be adequate

Rating rationale



Comparison of Constanta's performance with MFIs in Georgia (data from MIX)



Experience and expertise of management in lending to agriculture - Constanta has gained experience in lending for agriculture and allied activities at remote locations where competition is relatively low and opportunities for growth are higher.

Growth prospects – Majority shareholding by TBC and grant of deposit taking license has allowed Bank Constanta to plan for higher growth - GEL599 million or USD360 million by end of 2014, CAGR of 77.5%. It plans to raise further equity and sub-debt from TBC bank

Good portfolio quality – A good set of systems for loan appraisal, good documentation, well trained branch staff and involvement of senior management in risk management has ensured an excellent portfolio quality.

Good MIS, accounting and financial policies – The bank has employed well trained management team and has put in place good systems and policies for real time, effective and transparent reporting on operations and accounts. Systems for financial control are also strong.

Independent directors on Board – The number of board members has increased from 3 in 2010 to 5 in 2011 after the inclusion of 2 representatives of TBC Bank. However, Constanta has only 1 non-executive and non-shareholder member on its Board.

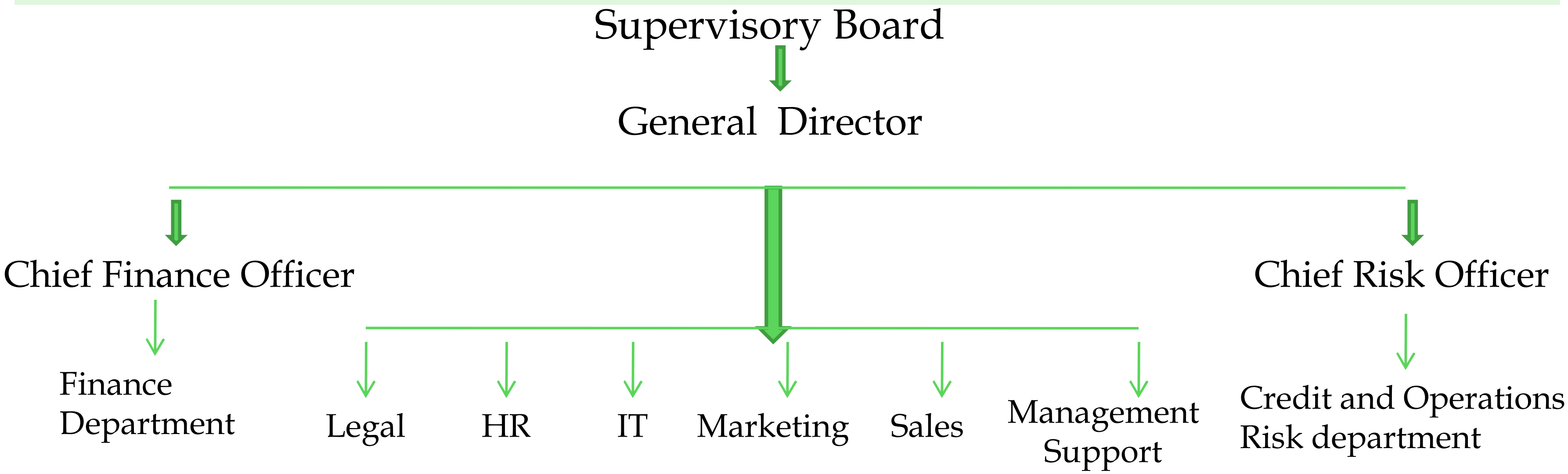
Low margins – Despite a reasonable yield of 31.5% and an excellent portfolio quality, it has a low return on assets at 2.4% for the first half of 2011. The operating expense ratio is high at 21.3% and in view of proposed branch expansion, it is likely to up putting pressure on margins. Increase in share of deposits (costlier than debt) will put further pressure on margins.

Audit: There is an imperative need to increase the audit frequency as well as have defined policy on client coverage during branch audit.

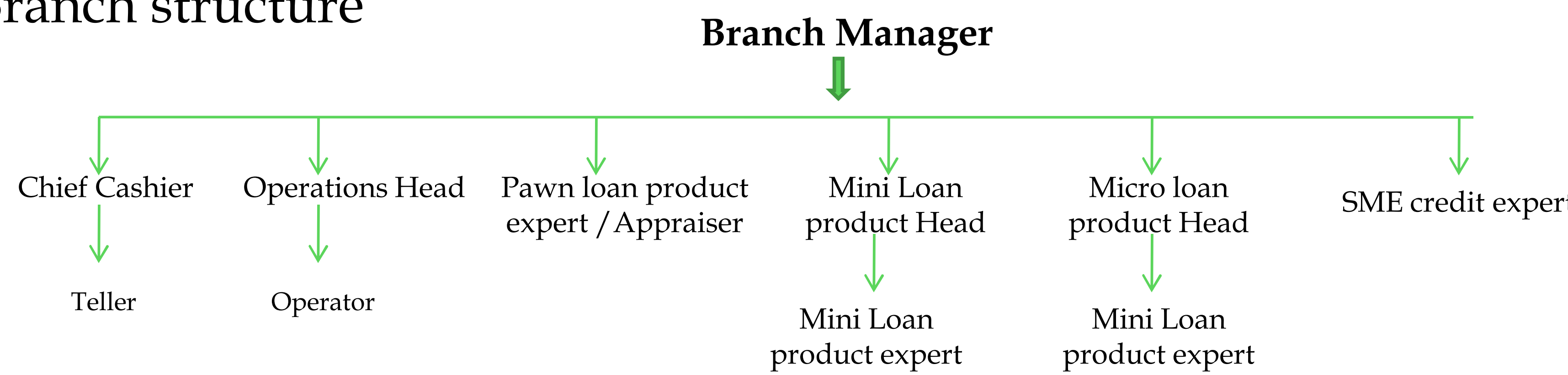
Introduction

- JSC Bank Constanta was promoted in October 1997 by Ms Tamar Lebanidze as Constanta Foundation, a not-for-profit organisation, to provide access to financial services to micro and small businesses.
- The foundation started its operations with grant support from Save the Children Fund and 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 agriculture and micro business.
- To comply with the requirement of a new Law on Microfinance Organisations in Georgia, Constanta Foundation transferred its operations to the newly established company, JSC Constanta by 31 December 2007.
- The foundation owned 67.51% of the shares of the company while the individual promoters held the remaining
- Constanta Foundation being a not for profit charitable institution decided to sell the shares of Constanta Bank to avoid any drift in its mission and conflict with the civil code which prohibits foundations from having entrepreneurial activity as primary activity. The shares were sold to TBC bank after deliberations by the promoters of Constanta. TBC Bank now holds 80% of the shares of Constanta Bank
- Constanta is now governed by a five member supervisory Board consisting of the Founder Chairperson Ms. Tamar Lebanidze, an independent professional Board member, two representatives of TBC Bank and one representative of Oiko Credit.
- The management is led by the General Director, Mr 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.
- The General Director together with the Chief Finance Officer and Chief Risk Officer form the Board of Directors (Executive).

Senior management structure – (up to Head of Departments)



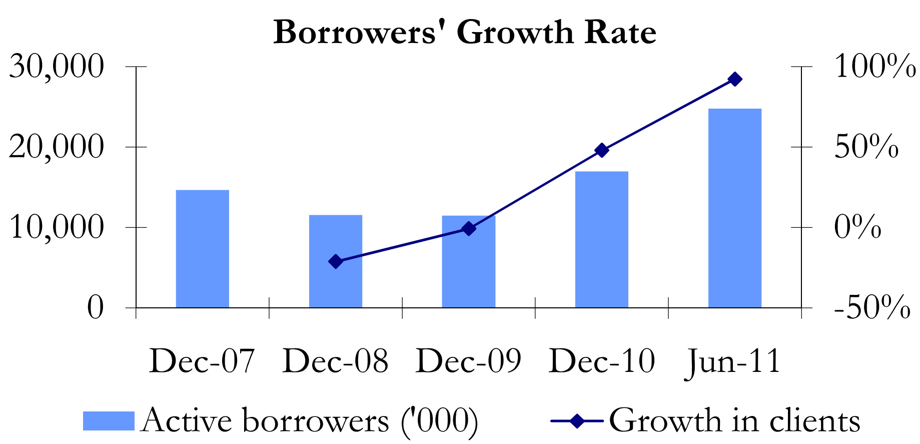
Branch structure

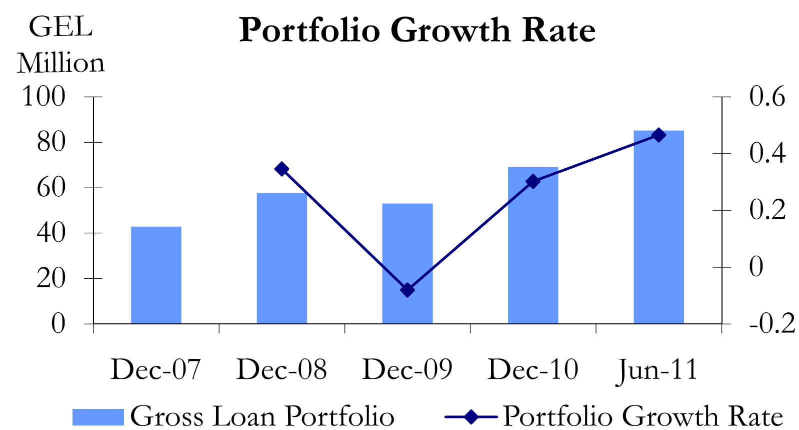


Contd..

- As on 30 June 2011, Constanta continues to operate from 21 branches. Branches are located 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. It plans to open 6 new branches in 2011, one was already set up at the time of the rating visit.
- All of its branches are located in cities; but its operations also extend to semi-urban and rural areas.
- After a decline in portfolio in 2009 following an adverse external environment due to war with Russia and global liquidity stress, Constanta registered a strong rebound with a loan growth rate of 30% in 2010 and 47% (annualised) for the first half of 2011. The number of borrowers increased even faster at a rate of 48% and 92% per annum resulting in reduction in the average loan size per borrower.

Existing branches of Constanta





Microfinance policies

- Constanta has a well laid out policy for sanction of loans. It lends in US$ as well as Georgian Lari. There are some differences in the product features among the loans in different currencies
- The Loan Officers at the branches verify the business of the applicant and then collect documents including financial statements and cash flow statement.
- A detailed cash flow analysis is required for higher loan sizes or seasonal loans.
- Loan sanctioning authorities are presented in the table

Loan sanctioning authority	US$ and Gel equivalent
Loan Managers	Upto 5,000
Branch Managers	5,001 – 15,000
Sales Department (Micro & Mini Credit Division)	15,001 – 30,000
Credit Risk Analyst (Head Office)	30,001 – 50,000
Head of Credit Risk Dept	50,001 – 70,000
Directors	70,001 – 100,000

- 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 mainly on a monthly basis and is in cash at the branches, however in certain branches agriculture loans have bullet repayment schedule.
- Loan utilisation checks are performed in all cases
- Considerable autonomy is provided to the Branch Managers to decide on the rate of interest and other loan terms considering clients' requirements and competitors' product features

Loan products features (List in Annex)

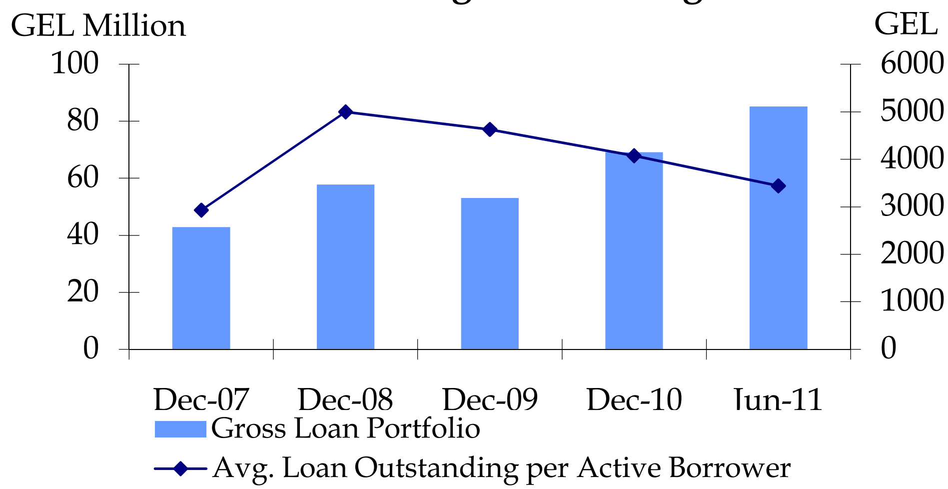
- Constanta has a wide range of loan products. Considerable flexibility is offered to the Branch Manager within safeguards to allow them to offer suitable features to the clients
- The Foundation started by offering group loans as its first loan product in 1997. However, after becoming a bank it decided to offer individual loans as was demanded by the clients. Consequently, Constanta introduced express loan/fast loan and discontinued group loans.

As a strategy, Constanta has increased its share of agriculture loans from 10% in 2009 to 22% in June 2011. Small business and express loans continue to be the major loan products. Another feature is an increase in the share of small size mini loans which has helped reduce the average loan size of Constanta

Product-wise distribution of loans

	Dec-09	Dec-10	Jun-11
Express	44%	31%	25%
Business	35%	36%	29%
Agro	10%	15%	22%
Mini	3%	10%	15%
Other	8%	8%	9%

Portfolio and Avg.Outstanding Loan Size



Loan products contd..

- Apart from its current loan products, Constanta will launch more loan products including consumer loans and mortgage with support from TBC Bank. These products will be launched in location where TBC bank is not present
- Currently SME loans are classified based on their size, however Constanta is planning to revamp its loan products with support from IFC to classify its products based on the nature of the business of the client
- Constanta provides a large window to its Branch Managers to decide on the rate of interest based in the competition. Branch Managers' incentive is based on the profitability of the branch which depends upon the volume of business and average yield earned. It was observed that some Branch Managers were not clear on the criteria to decide the rate of interest and it was difficult to understand the rationale of charging varied interest rates to different clients
- Constanta also plans to train its Branch Manager to implement the system of basing its interest rate on the risk assessment of the clients

Deposits

Deposits

- In 2010, Constanta received permission from the National bank of Georgia to take deposits from public. Earlier it was allowed to collect deposits only from institutions
- It has set aggressive targets for mobilising deposits. This is to reduce its dependence upon foreign institutional investors to reduce exposure to foreign currency risks and to reduce the impact of global liquidity conditions
- Being a new player, it pays relatively higher rate of interest on its deposit products.

As on 30 June, some features of Constanta's deposits are as follows:

Duration	% share
<= 1 month	12.7%
> 1 <=3 months	3.4%
> 3 <=6 months	6.4%
> 6 <=12 months	63.2%
> 12 months	14.2%

Rate of interest	% share
5%	11.9%
6%	0.2%
7%	4.9%
8%	5.7%
9%	1.4%
10%	16.4%
11%	27.2%
12%	2.3%
13%	8.3%
14%	0.3%
15%	0.9%
16%	2.8%
17%	17.7%

Amount deposited	% share
1 - 1,000	4.1%
1,001 - 2,000	2.7%
2,001- 5,000	4.7%
5,001- 10,000	7.3%
10,001 - 20,000	9.6%
20,001- 30,000	7.7%
30,001- 40,000	2.4%
40,001- 50,000	4.4%
50,001 - 100,000	12.2%
> 100,000	44.9%

Other products and services

Apart from various loans and deposits, Constanta has launched various other banking services which are listed below. The revenue from these services has been a small proportion of Constanta's income so far (~4%)

- Currency Exchange
- Cash Delivery Service
- Money Transfers in tie-up with various international money transfer agencies
- Utility Payments
- Automated Teller Machines – testing phase

Apart from these, Constanta plans to enter into tie-ups with insurance companies for distribution of their products in the regions

Governance & Strategy

Governance structure
Operational growth & Strategy
Competition
Funding

Governance and strategy – *strong*

- Constanta has a strong performance on Governance and Strategy with grade of α. It has a highly experienced and professional Board, strong second line, experience and expertise in its target market segment and diverse sources of funds including deposits. The performance has improved on account of acquiring of majority shareholding of Constanta by TBC and possible synergies. The performance is restricted due to limited number of independent members on Board, a competitive business environment in a relatively small market size and country risk.

Board of Directors – *experienced and professional but limited number of independent Directors*

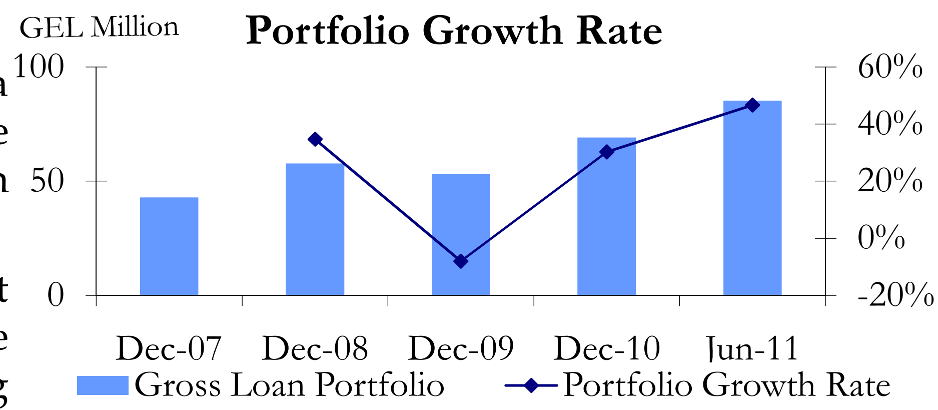
- Constanta has a highly experienced and professional Board. The Board now has five members after inclusion of 2 board members from TBC.
- Ms Tamar Lebanidze, the Founder of Constanta Foundation heads the Board.
- The other members of the Board include an independent Director Mr Giorgi Loladze, Chairman of the Supervisory Board of Georgian Stock Exchange
- Mr. Guillermo Salcedo, Deputy Director of Loans and Investments Department of Oikocredit
- Mr Badri Japharidze and Ms Nino Masurashvili representing TBC bank.
- The Board meets at least once every quarter 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 lacks non-executive and non-shareholder independent professional directors.
- The Supervisory Board has three committees - Audit Committee, Asset-Liability Committee and a Human Resource Committee. These committees are of two members each.

Operational growth and strategy

- After a decline in 2009 due to global liquidity crisis, Constanta registered a strong growth in 2010 and first half of 2011.
- With a change in ownership, Constanta is now more confident about raising equity and debt funds and has revised its plans recently. It plans to grow at a CAGR of ~77.5% for next 3 years (2012-14).
- There is no change in the operations and growth strategy of Constanta after the change in the ownership. It continues to target the regions which are not well served by commercial banks. The target market remains agriculture and micro businesses.
- The investment by TBC Bank was that of financial nature and has not resulted in any changes to the operations of Constanta. TBC will continue to serve the relatively better off sections of society instead of competing with Constanta by downscaling.
- Constanta got a boost by receiving the permission from the National bank of Georgia in 2010 to raise deposits from public. To reduce its dependence upon foreign institutional investors, Constanta has put a greater emphasis on raising the share of deposits in its source of funds. It plans to raise the share of deposits to 45% by the end of 2014 from the current 6.2%.
- Constanta also envisions a gradual reduction in circulation of dollars in Georgia which is currently 75% of the total currency circulation. To reduce its exposure as well as the exposure of its clients to foreign exchange fluctuation risks, it has given a greater emphasis on raising funds through deposits in local currency

Operational growth and strategy….cont.

- Constanta has diversified its product offerings but has kept its focus on agriculture and micro-enterprise loans as it believes that this sector has better resilience from economic downturns.
- Constanta has gained leadership in the segment among banks and microfinance institutions with its long experience and professional approach.
- Over the years, it has gradually reduced it average loan outstanding per client by increasing its lending to micro loans including micro agriculture loan, Express loans and Business loans



- While the loan portfolio has grown by a CAGR of 17% since December 2008, the increase in number of borrowers has been at the rate of 36% per annum.
- In geographical terms, Constanta has not increased the number of its branches since December 2008. It focused on improving efficiencies and was able to achieve break-even in 2009.
- Constanta has planned to add new branches in regions not yet covered by it. In 2011, it plans to add 6 new branches followed by more in 2012. This will put additional strain on its operating efficiencies but an increased scale may help it increase its margins from 2013 onwards.

Fund mobilization

- Constanta has a wide base of lenders. The number of lenders increased further in 2010 and 2011. Lenders include large and reputed microfinance funds. Constanta experienced a shortage of funds in 2008 and 2009 on account of the high country risk perception and global liquidity crisis, however, in 2010 the situation improved considerably.

Details of top 10 outstanding loans as on 30 June 2011 is given below:

Lender's Name	O/S as on 30-June 2011 (In GEL)	Currency	Rate of interest
TBC Bank (subordinated debt)	5,000,000	GEL	14.00%
BlueOrchard	4,000,000	USD	9.00%
Developing World Markets	4,000,000	USD	8.65%
Global Microfinance Facility	3,000,000	USD	7.30%
Oikocredit	2,493,400	GEL	12.75%
KCD microfinanzfond	2,000,000	USD	9.25%
KCD microfinanzfond	2,000,000	USD	7.25%
Selectum Sicav-Sif – BL Microfinance Sub-Fund	2,000,000	USD	7.75%
KCD Microfinanzfonds (FIS)	2,000,000	USD	7.25%
Microvest I, LP	2,000,000	USD	7.40%

Rate of interest on loans in local currency GEL are considerably higher than that of loan in USD. Of the total borrowed funds, 13% were in local currency as on 30 June 2011.

For the year 2011, Constanta required a total loan fund of GEL 34 million of which GEL 17 million was required for refinancing (GEL 5.3 million for the second half of 2011) for the and rest for growth. It is in talk with EBRD, Black Sea Trade and Development Bank and ADB for raising this fund.

Second line of management

- Constanta has a very strong second line of management, comprising of the CFO, CRO and other heads of the department. The senior management team is professionally educated, experienced and assumes leadership responsibilities of their respective teams.

Competition

- Most of the banks in Georgia such as Bank of Georgia and ProCredit have loan size of USD 3,000 or more. Constanta's Business and Enterprise loan with relatively higher loan size face competition from banks while its main product Mini and Mini Agri loan face competition from other microfinance institutions including FINCA, Credo and Lazika Capital.

- In future, however if banks decide to downscale further, the market segment of Constanta can become significantly more competitive and margins can come under pressure. With its majority shareholder TBC Bank, Constanta shares the understanding of not competing with each other. While Constanta will focus on remote regions with its smaller loan sizes, TBC offers its serves in urban centres and with bigger loan sizes.

Organisation &Management

Human Resource
Staff Productivity
MIS & Accounting
Audit & Control
Overdue tracking
Financial planning
Client awareness

Organisation & Management - HR

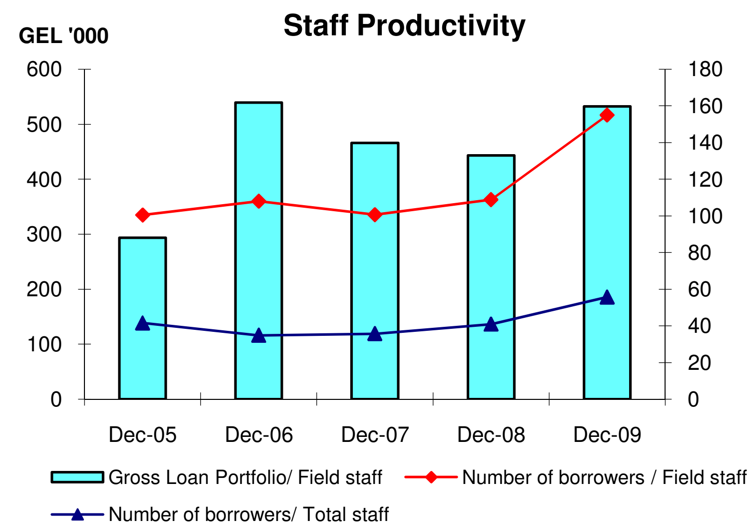
Constanta scores α– on management & systems on account of a good MIS, accounting and financial systems, good risk management practices and a good loan appraisal and documentation system. The grade is limited due to a moderate internal audit systems and low operating efficiency

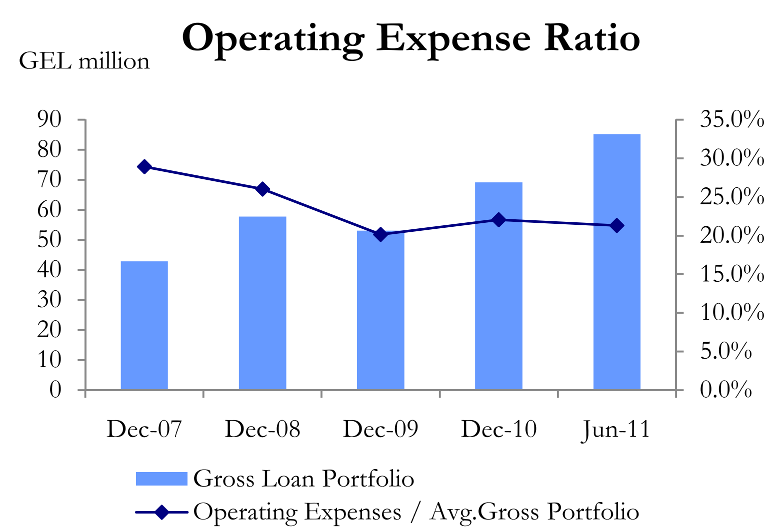
- **Human resource quality and management -** ***good***
- Constanta has a very well qualified and experienced management staff. Most of the head of department have experience of working in commercial banks.
- Human resource management is formalised and the HR team consists of three executive members. However, Constanta's HR head position is currently vacant.
- System for recruitments is well laid out. Applicants are screened by the HR department. Short listed job applicants are invited for a written test followed by an interview
- Probation period is up to 6 months
- For the field level jobs, recruitment are made at the level of the Field Officers and senior positions are filled mainly by promotions. For managerial positions, lateral placements are common.
- Induction of 3 days to 2 weeks is provided to the new recruits. SME loan officers have the longest training period while loan officers for Mini loan go through only a 3 day training
- The training department organises training programmes for other departments as well. A requirement for training is ascertained from the senior managers. Most specialised training is conducted by an external agency
- HR department currently does not have a formal system for performance appraisal of the staff. It relies on seniors feedback to decide promotions.
- Salaries at Constanta are comparable to that of other banks
- Branch Managers are provided incentive based on portfolio quality and branch profitability. Field officers are also provided performance linked incentives based on the volume of business and quality of portfolio
- Attrition rate declined in 2010 to 13.0% from 16.6% in 2009. However, for the first half of 2011, it was at a high of 11.4% (equivalent to an annualised 22.8%).

Staff productivity

- Staff productivity – *improved but still low*
  - Borrowers/field staff: increased from 101 as on 31 Dec 2009 to 155 as on 30 June 2011. The number of borrowers more than doubled during this period while the number of field officers increased by ~40%.
  - Borrowers/staff: also improved from 36 to 56. The number is still low. Constanta has a large number of administrative and support staff both at the Branch offices as well at the HO
  - However due to a decline in the average loan size, the amount of portfolio managed by field staff increased only by 14%.

- Operating efficiency - *low*
  - OER – still high despite improved staff productivity. Though borrower per staff improved, loan size became smaller. OER for first half of 2011 was high at 21.3% (annualised), lower than 22.0% for 2010 but higher than and 20.1% for 2009.





MIS and Accounting - *Good*

- Constanta uses a banking software (Ultra) for its MIS and accounting. 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 software works on a real time basis and is installed in all the 21 branches. The branches have internet connectivity through fibre optic channel or DSL. Back up of data is automatically stored in the server on a daily basis and also in a tape drive.
- The database stores the entire credit information and the administrator has the right to make changes if required. The quality of MIS reporting is good.
- Various reports as per the requirements of the National Bank of Georgia and various management departments are prepared regularly.
  - All income and expenses are recorded on accrual basis.
  - Depreciation is accounted on the written down value method.
  - Loans are written off when unpaid for more than 150 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 as incentives of the Branch managers are based on this.
  - The financial statements and other financial information are required to be submitted to the National Bank of Georgia on a daily, weekly, monthly, quarterly, semi-annually and annual basis. Various reports for lenders and other authorities are also generated

- Tracking system for overdues - *good*
  - Client is reminded over phone by the Loan Officer at the end of the due date. Loan Officer and Branch Manager visit the client and make efforts to collect the overdue loan.
  - Any loan overdue by more than 3 days is monitored by the Credit department. A letter 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.
  - However the legal process may extend up to 6-18 months and so it is not as effective.
  - In most of the cases collateral is not required to be liquidated and the client pays the settlement amount including the outstanding loan amount, interest on overdues, taxes and penalty in cash.
- Internal Audit - *moderate*
  - Constanta now has a 8 members audit team, headed by an experienced internal auditor who had earlier worked in a commercial bank.
  - Most of the team members have earlier worked in operations at branches
  - Earlier Constanta had a separate Control department which was merged with internal audit department in 2010
  - Internal audit frequency is once in a year. Considering the fact that a big proportion of loans are for a year or less, the frequency is inadequate.
  - All the branches and a few departments at the Head Office are audited. Audit of head office department has been recently started and the procedures are yet to be formalised
  - At the branches, auditors check various accounting records, vouchers and also visit a few clients. 5%-10% of the accounting records are checked, however, policies are not standardised and proportion of vouchers to be checked have not been set forth.
  - It was observed that in some cases, auditors make client verification over phone rather than visiting them, also policy on minimum number of clients to be visited in not clearly set forth.

- Internal Control - *reasonable*
  - Apart from the Internal Audit, the Credit department verifies the details of loans and clients from the MIS and look for the cases of policy violations in loan disbursements
  - Regular visits are made by the managers of various departments such as Accounts, IT, Credit and Sales to monitor the activities at the branches.
- Cash management - *good*
  - Request for funds by branches are sent to the Treasury department. 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. Any idle cash at HO is put in other banks at inter-bank rates.
- Financial Planning – *good*
  - The finance department prepares various reports on a monthly basis to ensure proper Asset Liability Management. It monitors and manages mismatches in duration, currency and interest rates mismatch in various assets and liabilities.
  - After the change in the shareholding pattern, Constanta has revised its growth plans and has drafted a new business plan. The plan is for the period 2011-14.
  - Business plan is revised every year and is based upon market forces and competitor analysis. Variance analysis is performed by the Finance department each quarter.

- Quality of clients - *good*
  - The quality of clients was observed to be good in terms of awareness and repayment performance.
  - The level of satisfaction amongst the client was good and clients appreciated the quality of service provided to them. In most cases, service quality was mentioned as the reason for choosing Constanta over other banks.
  - Despite stiff competition, duplication is avoided by information sharing through the credit bureau.
- Infrastructure - *adequate*
  - Constanta has adequate infrastructure for its operations.
  - It has adequate IT hardware for its current requirements, though in future it plans to enhance the safety feature by having a backup facility and remote disaster centre.
  - ATMs at all the branches are installed and are working well- testing phase with staff
  - It has vehicles with safety features to transfer cash to and from branches
  - Proper office equipment, furniture and fixtures and vehicles are available at all the offices. Cash safes and security measures are installed as per the statutory requirements.
  - The HO operates from rented premises while some of the branches operate from the bank's own premises.
  - Total fixed assets have not increased proportionately after 2008 since no new branche has been added. The proportion of fixed assets in total assets dropped from 12% in 2008 to 6.26% (excluding intangible assets) in June 2011. In 2011 and next 2-3 years, the fixed assets will increase with establishment of new branches.

Financial Profile

Profitability and Margins
Portfolio Quality
Asset & Liability composition
ALM

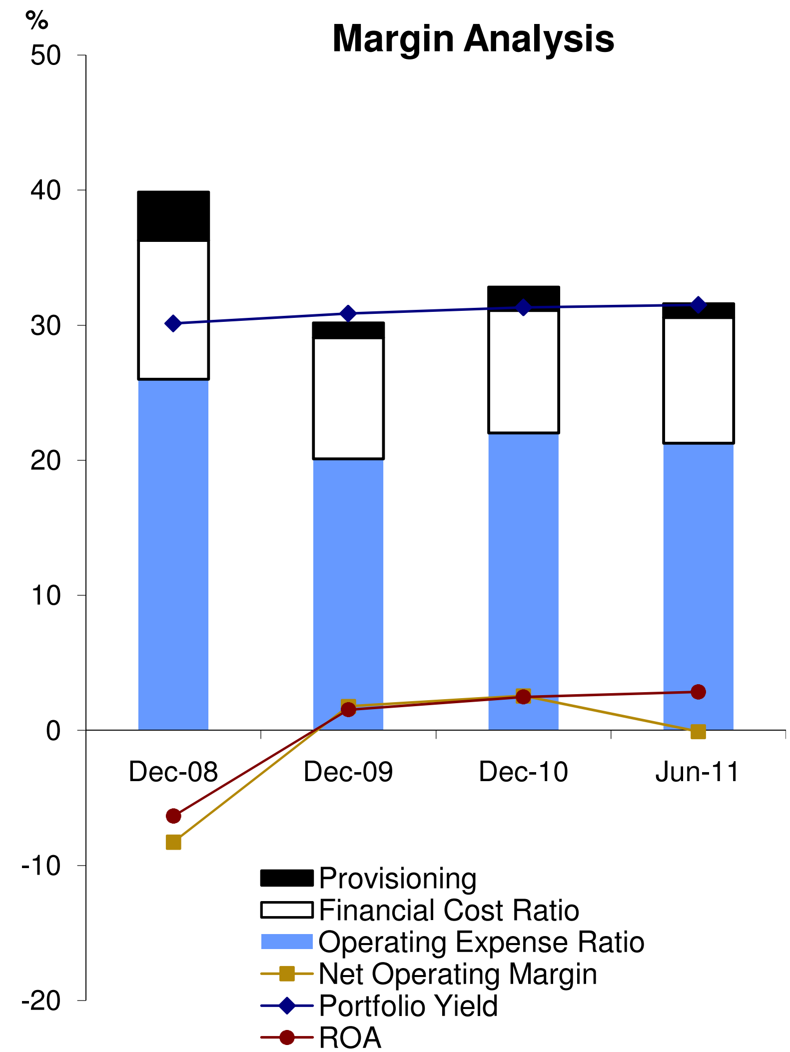
Key Indicators

- **Constanta** has a grade of α– on financial parameters

Financial Ratios	31-Dec-08	31-Dec-09	31-Dec-10	30-June-11
Capital Adequacy				
Risk Weighted Capital Adequacy Ratio (Tier I)	17.5%	18.9%	19.9%	16.6%
Risk Weighted Capital Adequacy Ratio (Tier I+II)	17.5%	18.9%	19.9%	22.0%
Asset Quality				
PAR (>60 days)/ Gross Loan Portfolio	0.5%	1.3%	0.3%	0.2%
Loan Loss Reserves/Portfolio at Risk (>60 days)	622%	243.88%	352.62%	601.25%
Loan Loss Reserves/Gross loan Portfolio	3.16%	3.24%	1.23%	0.98%
Loan Loss provision/Average Gross Portfolio	3.6%	1.1%	1.7%	1.0%
Management				
Operating Expenses/Average Portfolio	26.0%	20.1%	22.0%	21.3%
Number of Borrowers/Field Staff	108	101	109	155
Earnings				
Net operating income/Avg Equity (RoE) after tax	-31.3%	7.4%	15.5%	14.6%
Net operating income/Avg Assets (RoA) after tax	-6.2%	1.3%	2.8%	2.4%
Portfolio Yield	30.1%	30.9%	31.3%	31.5%
Financial Cost Ratio	10.3%	9.0%	9.1%	9.3%
Other fee income/Average assets	0.0%	0.0%	0.3%	0.4%
Other income/Avg assets (penalty, bad debt recovery, forex)	1.5%	1.1%	4.1%	2.4%
Operating Self Sufficiency	79.9%	107.1%	109.4%	112.6%
Liquidity				
Cash & Liquid assets / Total Assets	3.9%	3.1%	7.3%	14.0%

Profitability & Margins

- Constanta has been profitable since 2009 and its RoA (after tax) increased from 1.3% in 2009 to 2.4% during the current year(January-June). The profitability increase is on account of slight increase in portfolio yield and other income and almost similar OER over the years. Yield on portfolio was 31.5% for the period January-June 2011 as compared to 31.3% for 2010.
- Shareholding by TBC and provision of sub ordinate debt has boosted the CAR (Tier I+II) to 22.0% as on 30 June 2011.
- Operating Self-Sufficiency (OSS) was comfortable at 112.6% during January-June 2011.
- Plans for branch expansion will increase the OER in the short to medium run (till branches mature) putting downward pressure on margins. Increased share of deposits (at a cost higher than borrowings) coupled with NBG reserve requirements for deposits will further squeeze the margins.
- Income from sources other than loan is still very low. Constanta needs to increase its fee based income to improve profitability

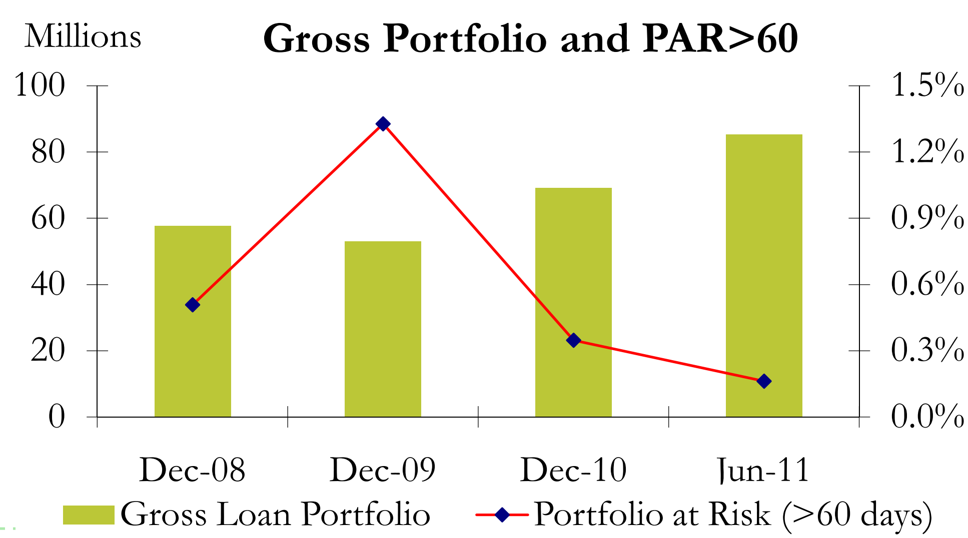


Portfolio Quality

- Credit performance and portfolio quality – *good*
  - Constanta has been able to maintain a healthy portfolio quality despite substantial jump in portfolio as reflected by PAR>1 day at 0.7% on 30 June 2011. The policy of writing off all loans overdue for more than 150 days also helps in showing a good portfolio quality. Constanta has written of 3.83%, 2.26% and 0.42 % of portfolio during 2009, 2010 and 2011 (January –June). Higher write off in 2009 was on account of disruption due to Russian invasion.
  - The portfolio composition remains varied both geographically and sector wise reducing the covariant risk. Sector wise, agriculture, production, service and trade account for ~95% of portfolio, with trade having highest share of 47%. Geographically, the biggest branch Gori (in terms of portfolio) has a share of 6.5% in total portfolio.

Portfolio distribution 30 June 2011

Sector	% Portfolio
Agriculture	22.06%
Production	13.70%
Services	11.22%
Trade	47.39%
Others	5.63%



Asset & liability composition

- Borrowings, 75.43%; net worth 14.70%, Deposits, 6.24% and Other liabilities, 3.63% constitute the total source of funds on 30 June 2011. Going ahead, with introduction of additional service like ATMs, Constanta plans to substantially increase the share of deposits. While replacement of borrowings with deposits has cost implications, considering the exclusive reliance on foreign sources for borrowings, it seems a good strategy.
- On the asset side, while historically Constanta had ~80% of assets as loans, it has fallen to 75% on 30 June 2011. Reason being, higher reserve requirements of NBG on deposits. It has also to keep a buffer as NBG stipulations keep changing quickly. Fixed assets are 6.26% of total assets as on 30 June 2011. Being a bank with better infrastructure than a conventional MFI, the level is reasonable.
- In its business plan, Constanta has planned for a Debt-Equity ratio of 5.9, which is reasonable.

ALM

- Constanta has a comfortable asset liability match on maturity duration. It has a positive gap of more than 90% in assets and liabilities maturing in next one year. A shorter duration of its loans has helped it in maintaining this positive gap. This shows that Constanta has the potential to raise relatively low cost short term deposits
- Over 76% of the total funds were expressed in USD which was matched exactly by the assets in USD. As a policy, Constanta allocates funds to branches for on-lending based on its source currency. In future the bank plans to gradually increase the share of local currency.

Financial Statements of JSC Bank Constanta

Balance Sheets in GEL as on

	31-Dec-07	31-Dec-08	31-Dec-09	31-Dec-10	30-Jun-11
ASSETS					
Current assets					
Cash	159,000	2,437,000	1,983,777	2,528,000	3,975,769
Compulsory reserves with NBG	1,712,000	51,000	30,860	3,016,000	10,893,492
Financial assets/derivatives		250,000		625,000	1,000,000
Inventories and stock	182,000	29,000			
Deposits in correspondent accounts	9,309,000	2,041,000	3,131,878	2,029,000	1,513,180
Tax paid in advance	496,000				
Deferred tax		540,000	60,134	50,000	1 35 769
Tax settlements other than income tax	206,000	34,000			
Other assets	41,000	263,000	1,507,621	268,000	2,967,722
Debtors	263,000				396,039
Short term investments	1,270,000	54,000			
Loans outstanding					
Gross loan outstanding (Retail)	**42,885,000**	**57,746,000**	**53,094,730**	**69,123,000**	**85,234,255**
Loan loss reserve	(849,000)	(1,823,000)	(1,718,958)	(847,000)	(831,323)
Net loans outstanding	**42,036,000**	**55,923,000**	**51,375,772**	**68,276,000**	**84,402,932**
Total current assets	**55,674,000**	**61,622,000**	**58,090,043**	**76,792,000**	**10 52 84 903**
Long term assets					
Intangible assets	267,000	367,000	586,940	731,000	675,019
Other assets			64,000	193,000	445,929
Net property and equipment	7,484,000	8,465,000	7,251,980	7,299,000	7,100,012
Total long term assets	**7,751,000**	**8,832,000**	**7,902,920**	**8,223,000**	**8,220,960**
Total Assets	**63,425,000**	**70,454,000**	**65,992,963**	**85,015,000**	**113,505,863**

LIABILITIES AND NET WORTH					
Current liabilities					
Trade payables	170,000				
Deposits/Current Accounts		1,122,000	1,002,739	1,906,000	7,084,153
Accrued interest	5,000		794,479		1,519,105
Short term loans	499,000				1,636,790
deferred income tax	62,000				87,634
Tax liability	116,000				100,535
Other current liabilities	97,000	257,000	424,129	369,000	778,445
Total current liabilities	**949,000**	**1,379,000**	**2,221,347**	**2,275,000**	**11,206,662**
Long term liabilities					
Long term debt					
Borrowed funds - loans	44,743,000	57,544,000	52,350,574	67,227,000	80,617,594
Other borrowings	2,762,000				
Subordinate Debt					4,995,100
Total long term liabilities	**47,505,000**	**57,544,000**	**52,350,574**	**67,227,000**	**85,612,694**
Net worth					
Share Capital		15,675,000	15,675,850	17,406,000	17,405,850
Donations	2,097,000				
Asset revaluation reserve	1,247,000				
Minority Interest	2,471,000				
Retained net surplus/(deficit)	11,165,000		(5,137,318)	(3,986,000)	(1,892,578)
Current net surplus/(deficit)	(2,009,000)	(4,144,000)	882,510	2,093,000	1,173,234
Total net worth	**14,971,000**	**11,531,000**	**11,421,042**	**15,513,000**	**16,686,506**
Total Liabilities and Net Worth	**63,425,000**	**70,454,000**	**65,992,963**	**85,015,000**	**113,505,863**

Income Statements for the period:

	Jan-Dec-07	Jan-Dec-08	Jan-Dec-09	Jan-Dec-10	Jan-Jun-11
Income					
Interest on loans to customers	12,584,000	14,563,000	13,736,404	18,643,037	11,757,263
Interest from banks	1,465,000	288,000	112,790	108,053	18,449
Other interest income/interest on investments		8,000	3		
Other fee income				216,203	221,207
Admin fee	822,000	808,000	1,740,985	256,963	212,737
Penalties and fine				1,088,966	625,364
Foreign exchange gain		572,000	223,889	252,623	113,811
Insurance	41,000				
Bad debts recovered	124,000	151,000		1,044,048	433,069
Other income	29,000	19,000	324,496	68,405	34,900
Total operational income	**15,065,000**	**16,409,000**	**16,138,566**	**21,678,298**	**13,416,800**
Financial costs					
Interest on borrowings	4,717,000	5,030,000	4,438,270	54 67 621	34 39 048
Interest on overdraft	19,000				
Commission	173,000	101,000			
Interest on deposits		119,000	60,677	626	93 307
Gross financial margin	**10,156,000**	**11,159,000**	**11,639,619**	**1 62 10 051**	**9,884,445**
Provision for loan losses	(108,000)	1,823,000	548,114	1,047,606	391,169
Write-off	483,000	322,000			
Net financial margin	**9,781,000**	**9,014,000**	**11,091,506**	**15,162,445**	**9,493,276**

<u>Operating expenses (retail)</u>					
Personnel expenses	5,162,000	6,560,000	5,328,087	7,034,035	4,302,544
Administrative expenses	4,123,000	3,880,000	3,276,747	4,341,331	2,583,225
Travelling	252,000	342,000	174,391	527,607	374,153
Depreciation	792,000	1,558,000	1,283,112	1,258,605	671,377
Other expenses	379,000	923,000	23,518	133,823	150,081
Total Operating expenses	**10,708,000**	**13,263,000**	**10,085,855**	**13,295,401**	**8,081,380**
Net Surplus/Deficit (Before tax)	**(927,000)**	**(4,249,000)**	**1,005,651**	**1,867,044**	**1,411,896**
Loss on sale and revaluation of assets	(250,000)		(89,076)		223
Foreign Exchange translations loss	(308,000)		(14,646)		
Provision for losses on other operations		(35,000)	(47,998)		
Gain/(Loss) on security trading	61,000		(10,741)		
Other financial expenses		(31,000)			
Loss on financial assets-at fair value		(369,000)			
Grants				641,868	
Income tax	(585,000)	540,000		(415,076)	(238,885)
Net Surplus/Deficit (after tax)	**(2,009,000)**	**(4,144,000)**	**843,189**	**2,093,836**	**1,173,234**

Abbreviations & Glossary

ABBREVIATIONS

APR	Annual Percentage Rate
CEO	Chief Executive Officer
CRM	Credit Risk Manager
GEL	Georgian Lari (currency of Georgia)
HO	Head Office
HR	Human Resource
JSC	Joint Stock Company
LLC	Limited Liability Company
LT debts	Long Term debts
M-CRIL	Micro-Credit Ratings International Ltd
MFI	Micro Finance Institution
MIS	Management Information System
OER	Operating Expenses Ratio
OSS	Operational Self Sufficiency
PAR_{60}	Portfolio At Risk (greater than 60 days)
PAT	Profit after tax
PBT	Profit before tax
RoA	Return on Assets

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 (>0days)): Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 1 day 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

Annexes

Profile of the Board

	Board Member	Position on Board	Experience	Year joined
1	Ms Tamar Lebanidze	Chairperson	Worked for Save the Children USA, MSF/Medicines Sans Frontiers/ Holland, Spartacus International Has 12 years experience at the Institute of Physiology, Georgian Academy of Science and 2 years teaching experience	Nov 2007
2	Mr. Giorgi Loladze	Member	Chairman of the Georgian Stock Exchange since 1999. CEO of a Brokerage Company Caucasus Capital Group	Nov 2007
3	Mr. Guillermo Salcedo	Member	Deputy Director of Loans and Investments Department of Oikocredit	Sep 2010
4	Mr. Badri Japharidze	Member	Chairman of “TBC-TV”, TBC Kredit, Vice-Chairman of the supervisory board of “TBC-Bank	July 2011
5	Ms. Nino Masurashvili	Member	Deputy General Director at TBC bank responsible for Retail and SME	July 2011

Loan Products

Loan Product	Mini Loan	Mini Agricultural Loan	Express Loan	Business Loan	SME Loan	Agricultural Loan
Borrowers	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
Loan size	60 - 1700 USD 100 - 3000 GEL	60 - 1700 USD 100 - 3000 GEL	1701 - 10000 USD 3001 - 7000 GEL	1701 - 30 000 USD	30 001 - 200 000 USD 50 000 - 300 000 GEL	1701 - 30 000 USD 3001 - 10 000 GEL
Currency	USD; GEL	USD; GEL	USD; GEL	USD	USD; GEL	USD; GEL
Annual Interest Rate (declining)	34-70%	34-70%	23% - 48%	16 - 48%	14 - 48%	22% - 68%
Admin Fees	2.5% -3.5%	2.5% -3.5%	2.3% - 2.5%	1 - 2.3 %%	0.3 - 1.0%	1.0 - 2.5 %
Loan Duration (min. and max.)	3 - 24 month	3 - 24 month	3 - 36 month	3 - 60 month	3 - 84 month	3 - 60 month
Maximum Grace period	3 month	3 month	3 month	6 month	6 month	23 month
Repayment frequency	1 per month	1 per month	1 per month	1 p/m	1 p/m	1 per month
Collateral requirements & other conditions	Guarantor	Guarantor	Guarantor; movable property; real property;	real estate	real estate	Guarantor; movable property; real property;

Other loan products with small proportion of portfolio

Loan Product	Seasonal Loan	Pawn Shop	Student loan	SMS Loan	Deposit Secured Loans	Employee overdraft
Borrowers	Individual	Individual	Individual	Individual	Individual	Individual
Purpose	For working capital, fixed assets and business expansion;					
Loan size	1200 - 30 000 USD	50 -3000 USD 100 - 5000 GEL	100 - 2000 USD	60 - 600		
Currency	USD	USD; GEL	USD	USD	USD; GEL	GEL
Annual Interest Rate (declining)	22% - 48%	42% (Flat)	18 - 24%	55%	Deposit's Annual interest plus 4%	24%
Admin Fees	1.0 - 2.5 %	0.5 - 1.0%	2%	2.50%	0	0
Loan Duration (min. and max.)	3 - 60 month	3 - 12 month	3 - 12 month	3 - 18 month		
Maximum Grace period	11 month	0	0	0	0	0
Repayment frequency	1 p/m	1 p/m	1 p/m	1 p/m	1 p/m	1 p/m
Collateral requirements & other conditions	Guarantor; movable property; real property;	Juvelry	Guarantor			

M-CRIL rating grades

M-CRIL Grade	Description
α+	Strong governance, excellent systems and healthy financial position. Without a foreseeable risk ➢ Most highly recommended
α	Good governance, excellent/good systems, healthy financial position ➢ Highly recommended
α–	Good governance, good systems and good financial performance; Low risk, can handle large volumes ➢ Recommended
β+	Reasonable performance, reasonable systems. Reasonable safety but may not be able to bear an adverse external environment and much larger scale ➢ recommended, needs monitoring
β	Moderate systems. Low safety ➢ acceptable only after improvements are made on specified areas
β–	Weak governance, weak systems. Significant risk ➢ not acceptable but can be considered after significant improvements
γ+	Weak governance, poor quality systems. High risk ➢ needs considerable improvement
γ	Weak governance, poor systems, weak financial position. Highest risk ➢ not worth considering

In addition, a 'Positive' outlook given by M-CRIL suggests that the institution is expected to improve its rating in one year period to one higher notch, 'Neutral/Stable' suggests that the institution is likely to retain its rating till the end of one year from the rating, and 'Negative' outlook suggests that it is expected that the institution will lower its rating performance by one notch in one year period.