

## Azerdemiryolbank, Azerbaijan

Azerdemiryolbank (AzDB) was established in 1989 by the Azerbaijani State Railway Company (ASRC) as a limited liability company and then re-registered as a joint stock bank in 1992. After the exit of ASRC in 2003, international shareholders came in 2005 (EBRD) and 2007 (FMO). Initially involved only in corporate banking, AzDB has diversified since then into retail banking with micro, SME, consumer and mortgage finance. Microfinance was started in 2004 in partnership with the German Azerbaijan Fund and currently represents close to 10% of AzDB's portfolio. However, AzDB plans to considerably develop its microfinance activities in the coming years. As of March 2009, AzDB had an outstanding loan portfolio of 204 M USD and served 48,614 borrowers and 4,843 savers through a network of 30 branches and 2 units spread over the country.

### GIRAFE Rating

#### Rating

**B+**

#### Outlook

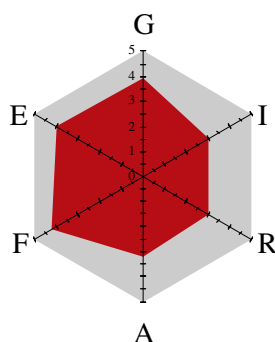
**Positive**

#### Date of the rating

**May 2009**

Valid until April, 2010

#### Rating per evaluation area



Governance – Information – Risk –  
Activities – Funding – Efficiency

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#### Rating highlights

- AzDB is a profitable institution with ROA and ROE of respectively 4.3% and 26.7% in 2008, a level that was successfully maintained during the first quarter of 2009. This profitability is fueled by adequate portfolio yield and revenue quality, economies of scale and better cost management. However, AzDB's profitability is now being hampered by higher credit risk (PAR 30 at 4.1% as of March 2009).
- The bank's governance and management have greatly improved over the past years with good support from the bank's main shareholders (EBRD, FMO and the Hajiyev family).
- AzDB benefits now from an experienced Supervisory Board (SB) and a skilled management team but the bank would gain from more regular SB meetings and a stronger staff for the management of the microfinance portfolio.
- Upcoming challenges for AzDB are to: 1) improve portfolio management, (especially for corporate and loans to entrepreneurs) to allow a better portfolio quality; 2) reinforce internal audit and; 3) successfully migrate to SAP Banking which should ease the bank's information generation process.

#### Outlook

The "Positive" trend is given based on the continuous efforts made by AzDB to enhance its governance, portfolio management, internal audit and MIS, which should lead to higher institutional, operational and financial performance.

#### Performance indicators

USD	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Assets	101,252,008	173,254,438	279,350,811	254,336,622
Loan portfolio	67,041,146	124,069,483	209,956,367	203,862,256
Active borrowers	12,079	25,043	53,914	48,614
Average outstanding loan per client	5,550	4,954	3,894	4,193
Outstanding deposits	54,661,464	74,389,349	102,975,031	78,373,864
Active savers	3,380	4,242	5,056	4,843
Staff	348	411	511	525
ROE	17.4%	25.0%	26.7%	25.4%
ROA (without donations)	3.3%	4.2%	4.3%	4.1%
Liabilities / Equity	5.39x	3.97x	4.97x	4.28x
Portfolio yield	22.1%	22.3%	24.0%	19.2%
Operating expense ratio	9.4%	7.9%	7.9%	7.7%
Funding expense ratio	10.0%	12.0%	10.2%	9.7%
Loan Loss Provision expense ratio	0.4%	1.2%	4.7%	0.0%
PAR 31-365	0.4%	0.5%	6.6%	4.1%
PAR > 365	0.0%	0.0%	0.0%	0.0%
Write-off ratio	0.4%	0.2%	0.4%	0.5%

Note: March 2009 figures are not audited and they are based on statutory accounting, not IFRS.

## Microfinance sector

The beginning of microfinance in Azerbaijan may be linked to the perestroika period, around the 1980s, when Soviet Authorities started providing loans to small businesses. Microfinance further developed with the arrival of international relief organizations around 1994, due to the humanitarian crisis following the war with Armenia over Nagorno-Karabakh. However, it was only from 1997 that traditional microfinance began when international NGOs such as FINCA and ADRA entered the sector. Over the past few years, the microfinance sector has evolved with remarkable growth in outreach, scale and increased competition among MFIs. The number of active borrowers has increased 6 fold since 2004 and the outstanding portfolio close to 10 times. In most recent years this has also led MFIs to expand outside of Baku into the rural areas which initially had been less served. Currently, MFIs serve around 320,000 clients throughout 60 of the 77 districts in the country, with an outstanding portfolio of around 550 M USD.

Microfinance services are offered through three types of institutions: commercial banks, non-bank financial institutions (NBFIs) and credit unions. AccessBank (a Bank) and Finca (an NBF) together dominated the market with a combined market share of 48% in active borrowers and 50% in outstanding loan portfolio. In total NBFIs make up about 50% of all clients, whereas banks account for 60% of the outstanding portfolio. Credit unions still play a limited role in the sector.

MFI	MFI Type	Active clients	%	Portfolio (M USD)	%
AccessBank	Bank	69,144	21.6%	208.1	37.6%
Bank Respublika	Bank	21,730	6.8%	24.9	4.5%
Parabank	Bank	14,462	4.5%	10.8	2.0%
<b>AzDB</b>	<b>Bank</b>	<b>10,766</b>	<b>3.4%</b>	<b>31</b>	<b>5.8%</b>
Others	Bank	21,330	6.7%	44.1	8.0%
<i>Sub-total</i>	<i>Banks</i>	<i>137,432</i>	<i>43.0%</i>	<i>319</i>	<i>59.0%</i>
Finca AZE	NBFI	83,817	26.2%	66.7	12.1%
Azercredit	NBFI	21,509	6.7%	17.1	3.1%
Normicro	NBFI	14,638	4.6%	14.3	2.6%
CrediAgro	NBFI	13,754	4.3%	50.9	9.2%
Viator	NBFI	9,751	3.1%	4.5	0.8%
FinDev	NBFI	6,086	1.9%	6.5	1.2%
Azeri Star	NBFI	5,973	1.9%	2.4	0.4%
Mikromaliyye	NBFI	4,150	1.3%	0.7	0.1%
Agrarcredit	NBFI	2,512	0.8%	21.0	3.8%
Komak Credit	CU	1,889	0.6%	1.5	0.3%
Nakhchivan Credit	NBFI	1,428	0.4%	1.5	0.3%
Agroinvest	CU	1,279	0.4%	2.6	0.5%
Others		15,113	4.7%	31.1	5.6%
<i>Sub-total</i>		<i>181,905</i>	<i>57.0%</i>	<i>221</i>	<i>41.0%</i>
<b>Total</b>		<b>319,337</b>	<b>100%</b>	<b>541</b>	<b>100%</b>

Source: AMFA Matrix (outstanding microfinance portfolio) for all MFIs expect for AzDB (loans to entrepreneurs) from Planet Rating, December 2008.

Banks are regulated by the National Bank of Azerbaijan (NBAR) under the Law on Banks and Banking Activities. Prudential ratios are in place for banks on areas such as capital adequacy, liquidity and provisioning. In the wake of the international financial crisis, the loan loss provision standards have been increased. Banks report monthly to NBAR and supervisory visits are done on a yearly basis. Although banks are to report on all outstanding loans to the Centralized Credit Register since August 2008, it is still unclear whether all banks have been complying with this new amendment to the regulation.

NBFIs are regulated under the same law but no prudential ratios have been set and NBFIs are restricted from taking deposits. NBFIs report quarterly to NBAR but supervision is generally weak. Since 2007, the NBAR has been working on a draft law for better regulation of NBFIs. If this law is approved, it should introduce prudential standards for NBFIs, more monitoring from the NBAR, options for NBFIs to accept collateral deposits and a formal access to the Centralized Credit Registry, amongst other improvements. The enactment of the law is not expected any time soon.

The Azerbaijan Micro-Finance Association (AMFA) has been in place since 2001, following the Microfinance Conference held in Baku. Its strength as an organization was tested in March 2009, when the NBAR issued a statute requesting that all NBFIs declare themselves non- or for-profit within ten days. Choosing the non-profit option would mean transformation to an NGO status limiting the possibility of raising equity in the future. MFIs choosing to be a for-profit entity would be subject to back taxes; the height of which was not specified. AMFA sent a formal response to the NBAR to postpone this request of status change until the Microfinance legislation was complete.

Around 95% of MFIs' funding resources come from foreign sources, as terms and rates have been better overall than those offered locally. In the local market, banks are reluctant to lend to NBFIs as they are often treated as competitors. MFIs may also finance their activities from other local sources like governmental funds, but terms and covenants are often strict.

To date the global economic recession has had limited impact on the credit risk levels in Azerbaijan, especially in the rural areas outside of Baku, as public spending has continued to fuel the economy (cf. Political and Economic Environment). However, the sector is not expected to remain fully immune during 2009.

## Political & economic environment

Economic growth (7.1 per cent) is slowing in 2009, slipping below 10 per cent for the first time since 2002. This is due to the decline of world prices for hydrocarbons, whose sales abroad represent 80 per cent of GDP and 90 per cent of exports. Volume growth has also been less spectacular than it was between 2003 and 2008, when production underwent a threefold increase. Oil-export revenues now allow the country to run very large external-account and fiscal surpluses that provide ample room for maneuvering, even in a context of falling hydrocarbon prices. The foreign debt that had financed oil installations has declined substantially. Inflation has, however, been a source of concern, bloated in 2008 by a massive increase in public spending earmarked for wages, infrastructure, and armament. The current decline of prices for oil products and food will likely foster a gradual easing of inflationary pressures.

The legal and regulatory framework has not been conducive to the emergence of a competitive private sector except for consulting services associated with hydrocarbon extraction. Although oil export revenues have nonetheless fostered the dynamism of services, telecommunications, transport, and construction, the local currency appreciation has choked off a private manufacturing sector suffering from a lack of competitiveness.

The conflict between Russia and Georgia during the summer of 2008 unnerved the operators of pipelines that carry Azerbaijani crude to Europe via Georgia. The risk of hostilities will likely deter investors from building new pipelines beyond the BTC (Baku, Tbilisi, and Ceyhan), the only one that has avoided transit via Russia. And although Russia's return to the region reduces the likelihood of a new war with Armenia in the near term, the lack of a conclusive settlement of the dispute over Nagorno-Karabakh continues to weigh on the regional geopolitical environment.

(USD millions)	2006	2007	2008	2009(e)
Economic growth (%)	30.5	23.4	13.1	7.1
Inflation (%)	8.4	16.6	19.6	13.3
Public sector balance (%GDP)	-0.2	2.4	29.1	30.6
Exports	13,015	21,230	33,398	22,322
Imports	5,269	6,010	7,840	7,805
Trade balance	7,746	15,220	25,558	14,517
Current account balance (%GDP)	17.7	28.6	57.3	21.2
Foreign debt (%GDP)	28.2	22.3	19.2	17.5
Debt service (%G&S exports)	2.1	1.8	1.0	1.0
Foreign currency reserves (in months of imports)	2.8	3.5	5.8	5.6

Source: COFACE's Country Risk Rating Guidebook 2008. (e) estimates (f) forecasts. [Disclosure Statement](#): Data is provided with authorization from COFACE - a shareholder of Planet Rating.

COFACE Country Rating: C - A very uncertain political and economic outlook and a business environment with many troublesome weaknesses can have a significant impact on corporate payment behavior. Corporate default probability is high.

## Institutional presentation

### Legal form, supervision and audit

Azerdemiryolbank (AzDB) was established in 1989 by the Azerbaijani State Railway Company (ASRC) as a limited liability company and then re-registered as a joint stock bank in November 1992. It operates under a full banking license from the National Bank of Azerbaijan (NBAR). AzDB sends comprehensive weekly, monthly and quarterly reports to NBAR (including detailed statutory financial statements and key prudential ratios). The NBAR last visit was in October 2008 and the next one is scheduled for July 2009.

AzDB's financial year starts on January 1<sup>st</sup> and ends on December 31<sup>st</sup>. Its financial statements have been audited according to IFRS standards for the past thirteen years by PricewaterhouseCoopers (PwC) with unqualified opinions.

### Ownership

As of March 2009, the shareholding structure of AzDB is mostly split between the Hajiyev family (who has had strategic control since 1995<sup>1</sup>), EBRD and FMO who acquired new shares issued respectively in 2005 (25% + 1 share) and 2007 (10%). According to the shareholder agreement signed in November 2007, EBRD may exercise its put-option at the end of 2010. The Hajiyev family would have pre-emptive rights should EBRD choose to sell. During 2008, AzDB increased its authorized share capital and issued an additional 15 M ordinary shares. All issued shares were acquired by existing shareholders in proportion of their existing interest. As of Dec. 2008, AzDB's paid-up capital amounted to 17.8 M AZN (22.2 M USD), including 3.5 M AZN (4.4 M USD) of share premium.

Shareholders	Ordinary Shares (M)	%
Hajiyev Family	26.6	39.7%
EBRD	16.8	25.0%
FMO	6.7	10.0%
Amirjanov Roman Duniyali*	3.6	5.5%
Other individuals **	12.9	19.4%
Other corporate shareholders	0.3	0.4%
<b>Total</b>	<b>66.9</b>	<b>100.0%</b>

Note: \* AzDB's Chairman of the Executive Board; \*\* each of the other local individual shareholders have less than 5% of the shares.

<sup>1</sup> The Azerbaijani State Railway Company (ASRC) was the main shareholder of the bank until 1995 and sold its shares in 2003.

The shareholders are currently represented by a 5 member Supervisory Board (SB), whose chairman is from the Hajivev family and is elected for 4 years for renewable terms. Other seats are occupied by representatives of the two international shareholders (EBRD and FMO) and one minority shareholder. The fifth seat was recently appointed to an independent member who occupied senior management positions at EBRD and other international financial institutions. AzDB's Chairman of the Executive Board (CEO) attends also the SB meeting but has no voting rights. Members of the SB have professional background in banking and exercise supervisory controls over AzDB's management mainly through semi-annual meetings. Furthermore, they are responsible for the appointment of the Chairman of the Executive Board and its four Deputies. AzDB has established five sub-committees to support the SB, namely the Internal Audit, Credit, IT, ALM, and Risk Management committees.

## Funding composition

As of March 2009, AzDB's funding structure was comprised of 52% borrowings (of which 39% is renewable in the coming 12 months and the remaining 61% is due later) 31% deposits and 17% equity. The majority of borrowings are from international funders. 70% of funds were disbursed in USD, 21% in AZN and the remaining in other currencies (EUR). 36% of rates are floating, mostly based on LIBOR.

Outst. Borrowings (March 2009)	M AZN	M USD	%
EBRD *	21.8	27.0	22.9
Syndicate (Rosemount, BANIF)	12.8	16.0	13.5
BSTDB	7.1	9.0	7.6
ResponsAbility	8.0	10.0	8.5
SIFEM AG	5.6	7.0	5.9
FMO *	4.8	6.0	5.1
OFID	4.0	5.0	4.2
DEG	3.2	4.0	3.4
Rosemount Global	1.6	2.0	1.7
German Azerbaijan Fund	1.1	1.3	1.1
ICD	0.8	1.0	0.8
ING	2.4	3.0	2.5
VDK Spaarbank	1.6	2.0	1.7
Others (Microvest, MEDA)	1.6	2.0	1.7
<b>Sub-total International Borrowings</b>	<b>76.4</b>	<b>95.3</b>	<b>80.7</b>
Nat. Fund for Support Entrepreneurship	11.0	13.7	11.6
National Bank of Azerbaijan	3.6	4.5	3.8
Azerbaijan Mortgage Fund	2.1	2.6	2.2
Other local financial institutions	1.6	2.0	1.7
<b>Sub-total Local Borrowings</b>	<b>18.3</b>	<b>22.8</b>	<b>19.3</b>
<b>Total</b>	<b>94.7</b>	<b>118.1</b>	<b>100</b>

Note: \* related parties: FMO and EBRD are shareholders of AzDB.

AzDB also benefits from subordinated debts from DEG<sup>2</sup> of 3,773,160 AZN (4.5 M USD) disbursed in 2007 which matures in 2017 and more recently from FMO, maturing in 2019. Deposits are made up of individual and corporate savings.

<sup>2</sup> German development finance institution that is a member of KfW Bankengruppe.

## Donations

Since inception, AzDB has received in kind donations in the form of technical assistance from EBRD, SBFIC, USAID and IFC for purposes of strengthening the bank's corporate governance, front office activities, lending policy and control functions. Moreover, the bank has already secured donations for the implementation of its new MIS (SAP Banking) from EBRD (767 K EUR), FMO (500 K EUR) and DEG (200 K EUR) expected within the coming six months. Negotiations with other potential donors are on-going.

## Management team

The management team is composed by the Executive Board (EB) and the Senior management team. The EB includes the Chairman and four Deputy Chairmen.

- Mr. Amirjanov Roman Duniyali has been appointed since 1994 as the Chairman of the EB and has a long experience in banking and economics. Prior to becoming Chairman, he was Deputy Chairman of the EB. Mr. Duniyali graduated from the Azerbaijan Institute of National Economy.
- The Credit, Corporate Customers, Plastic Cards, and retail bank & branch network departments report to the Credit Deputy. The Strategic Development, Risk Management, IT, and Marketing & Business Development departments report to the Strategic Development Deputy. The International Relations, Treasury, Operational and Financial Control departments report to the International Relations Deputy. The Legal, Organizational, Problem Loans and Internal Security departments report the Legal Deputy.
- The HR department reports directly to the Chairman of the EB, who also supervises the unit for Prevention of legalization of Illegal acquired money and property and Internal Audit reports to the Board through the IA committee.

## Organization

AzDB is organized into three levels:

- The head office (HO), based in Baku, where all the management team is based. Loan amounts above branch limit and up to 100 K AZN (125 K USD) are approved by the Middle Credit Committee managed within the Credit Department based at the HO. Loan amounts ranging from 100 K AZN and up to 10% of the bank's total capital are approved by the Senior Credit Committee of the bank comprised of 2 Deputies of the Executive Board, the Credit Manager, Retail and Branch Network Manager, and Legal Manager. All loans that exceed 10% of the bank's capital must be approved by the SB based upon recommendation of the EB. Furthermore, all loans exceeding 250 K AZN require approval of the Risk Management Department.

- The branches are managed by Branch Managers (BM) who report to the Credit and Operational Managers based at the HO. BMs are supported by Accountants, Customer Service Advisors, and LOs. LOs managing a microfinance portfolio under the German Azerbaijan Fund (GAF)<sup>3</sup> are not currently supervised by BMs of their respective branch; they are under the supervision of Microfinance Managers working for the Credit Department at the HO, in cooperation with GAF consultants. BMs may approve loans up to their branch limit which is set based on branches size, years of existence and level of credit risk, which is revised on a yearly basis. Once loans are approved, amounts are transferred into clients' savings accounts or disbursed in cash when required by clients. Out of the 30 branches, 24 are involved in microfinance activities.
- Units are sub branches which offer all AzDB's products except loans. They are usually under the management of the nearest branch.

AzDB has been using an in-house MIS<sup>4</sup> for the management of its loan portfolio and savings. The MIS was developed by the current IT Manager of AzDB and is available in all branches and units of the bank which are connected to the HO through VPN. Accounting is managed on Excel, after data extraction from the MIS. Other services offered by AzDB (international transfers, remittances through Western Union, foreign exchange, etc) are managed on specific software which have no interface with AzDB's MIS. AzDB's server is based at the HO.

The microfinance portfolio funded by GAF is managed on AzDB's MIS and on a different system (Loan Workbench) provided by GAF. Loan Workbench has an interface with the bank's MIS and is connected to GAF's national server to allow GAF to keep track of its portfolio evolution.

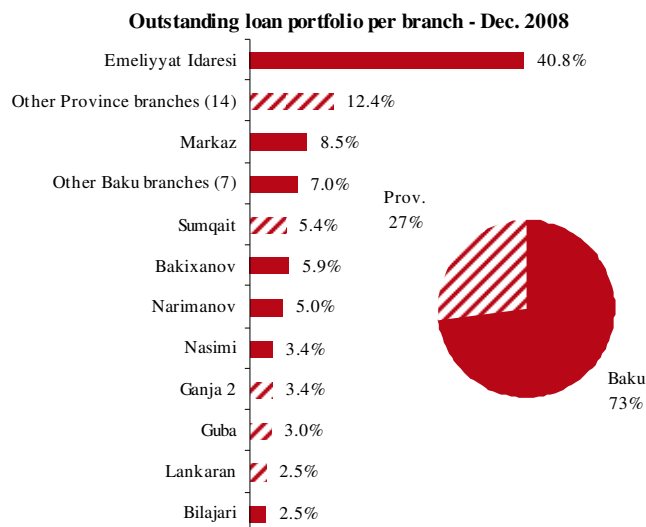
## Market penetration

AzDB has one of the largest (private bank) branch networks in Azerbaijan with 30 branches and 2 units in the country's capital, Baku, and other cities in the province of Azerbaijan. It also has 41 ATMs. Despite AzDB's will to improve its coverage outside of Baku, 73% of the bank portfolio is still concentrated in Baku where most economic activities take place. Among the banks operating in the country, AzDB is ranked 9<sup>th</sup> in terms of outstanding loan portfolio, 11<sup>th</sup> in

<sup>3</sup> The objective of the GAF is twofold - it should promote economic growth of private SME / self employed persons in Azerbaijan and it should help partner banks to expand their business activities especially with regard to SME

<sup>4</sup> Front office uses an Oracle based system and back office uses a Fox Pro based system.

terms of deposits (Dec. 2008) and 4<sup>th</sup> bank in terms of number of microfinance clients<sup>5</sup>.



## Products and services

AzDB offers corporate and retail loans which are meant to be collateralized above 150%. In addition, they include a 1% withdrawal fee and penalty fees varying from 0.1% to 1%. On average, AzDB's Effective Interest Rate (EIR) is estimated at 28%.

- Corporate loans (52% of the portfolio) are issued to companies in the trade, service, construction and manufacturing sectors. They are on average around 250 K AZN (304 K USD) and the loan amount cannot exceed 20% of bank's total equity. The loan term is on average 26 months and the interest rates charged are between 16% and 24% on a declining basis. Repayments are monthly, yearly or bullet payment and beneficiaries may obtain a grace period of up to 1 year. However, the ones under the National Fund for Support of Entrepreneurship (NFSE) may have a grace period for up to 3 years. Collaterals are comprised of real estate, inventory, equipments, letters of guarantee, etc. The EIR rate for corporate loans is estimated at 25%.
- Trading loans to entrepreneurs (retail) cover 19% of the portfolio and are on average 3,000 K AZN (3,650 USD) for around 1 year with a grace period of up to 6 months. Interest rates are between 22% and 28% declining basis. Repayments are similar to corporate loans and collaterals are comprised of real estate, residual inventory, deposits and guarantee. Microfinance loans are within this category of loans. The EIR for trading loans to entrepreneurs is estimated at 29%.
- Consumer loans (retail) cover 11.5% of the portfolio and are on average 600 AZN (730 USD) for an average length of 11 months and a declining interest rates

<sup>5</sup> AMFA

between 26% and 36%. Repayments are monthly and yearly. Collaterals are comprised of goods purchased and guarantee. The EIR is estimated at 38%.

- Auto loans (retail) cover 11.3% of the loan portfolio and have an average loan size around 11 K AZN (13 K USD). The loan length is on average around 12 months. Interest rates charged are between 19% and 27% (declining basis) and repayments are done on a monthly and yearly basis. Collaterals included cars purchased, real estate, third party. The EIR for auto loans is estimated at 29%.
- Plastic cards (retail) are on average around 3,200 AZN (3,900 USD) for an average length of 8 months. Interest rate is 25% declining and repayments are monthly, yearly or bullet payments. Collaterals include real estate, guaranty and deposits. The EIR is estimated at 28%.
- Mortgage loans (retail) are on average 40 K AZN (49 K USD) for an average length of 14 months, except the ones issued under the Azerbaijan Mortgage Fund line which have an average maturity of 20 years and sub-loans with average maturity of 15 years issued under the IFC mortgage line. Interest rates are between 4% and 25% declining basis with monthly and yearly repayments. Collaterals included properties, moveable assets, securities, deposits. The EIR for mortgage loans is estimated at 22%.

AzDB offers also demand and fixed term deposits, which are guaranteed for up to 30,000 AZN under the State Deposit Insurance Fund. The savings offering to retail clients was recently revamped into four attractive packages (Green, Red, Blue, and Yellow) with various interest rates and terms. AzDB also offers other services such as money transfers and foreign currency exchange.

## Networks

AzDB is member of the Association of Banks of Azerbaijan Republic, the Azerbaijan Microfinance Association (AMFA) and the Warsaw based Microfinance Center (MFC) for Central and Eastern Europe and NIS.

## ■ Governance

Governance and Decision making is rated “b”

### Decision making

The vision and mission are shared among shareholders. They have evolved since inception, especially with the arrival of two international socially-oriented shareholders (EBRD and FMO). The latter played a strong role in the institutional reform undergone over the last years, focusing particularly on corporate governance. The decision making process is now overall sufficiently efficient and transparent. Conflicts of interest are also adequately managed. The recent appointment of a fifth member in the SB, who is independent and experienced, should further strengthen the decision making process.

AzDB enjoys an experienced Supervisory Board (SB) with expertise in local and international banking, micro and SME finance (EBRD, FMO) and good networking in Azerbaijan from local shareholders, mainly the Hajiyev family. Strong inputs from new shareholders resulted, among other improvements, in a reorganized and more efficient structure to sustain growth, the introduction of the Risk Management department and the on-going acquisition of a new MIS. The SB is aware of most challenges faced by the bank and of its performance through regular, relevant and adequate reporting from sub-committees, semi-annual SB meetings and weekly meetings between the EB and the Chairman of the SB. As required by the law, many decisions (including non-strategic ones) are approved during the weekly meetings<sup>6</sup>, resulting in a time-consuming approval process. At the same time, the frequency of SB meetings (semi-annual) is not yet sufficiently optimal to discuss all strategic issues. In that regard and given the international profile of two of the SB members, the scope and frequency of these meetings could be streamlined, which is currently under discussion.

As a bank, the current legal status of AzDB is appropriate for conducting microfinance activities in Azerbaijan. Though complying with stricter regulation than other types of financial institutions such as NBFIs and credit unions, AzDB may be able to better compete in the microfinance sector thanks to a wider range of financial services (e.g. deposits) and greater sources of funding backed up by its strong local and foreign shareholders.

<sup>6</sup> Weekly meetings are held between the Executive Board and the chairman of the Supervisory Board. Other SB members approve decisions by mail.

## Planning

AzDB planning and budgeting process has greatly improved over the past three years and is currently at an acceptable level. The 2008-2010 business plan was designed on a participatory approach and based on a detailed and relevant analysis (economic forecasts, SWOT), which has allowed AzDB to identify steps needed to reach its objectives.

Overall, AzDB's objectives are ambitious and innovative (e.g. swift move into microfinance, new sophisticated MIS, expansion to the provinces) and are expected to be reached with the recruitment of new experienced staff (notably in the credit department) and the support from consultants (e.g. for the implementation of SAP banking) to complement in-house capacities. Furthermore, AzDB has put in place strategies to get the financial resources needed to execute main projects (cf. Funding Strategy).

The BP comes with three year financial projections according to three development scenarios (optimistic, normal, and pessimistic). Overall targets set by scenarios were quite optimistic which partially explained that 2008 financial projections were not met (e.g. -26% regarding outstanding loan portfolio). Following that gap and the impact of the international financial crisis in Azerbaijan, AzDB has decided to review its financial projections to be better in line with Azerbaijan's current economic situation<sup>7</sup>.

However, based on the analysis of the first quarter 2009, it can be said that end of this year financial projections may be difficult to reach, especially for microcredit. Although already revised to more realistic figures (58 M AZN instead of 70 M AZN), end-2009 objectives might not be reached due to delays in mobilizing proper staff and finalizing the update of the methodology. AzDB would also gain from establishing a more formal BP for its microfinance activities with more detailed financial projections and vision on how it will fit within AzDB's organizational structure.

AzDB has developed a detailed annual budget broken down on a monthly basis and adjusted when needed, after a variance analysis or changes in macro environment.

## Management team

AzDB benefits from an experienced and dynamic Executive Board comprised of four skilled top-managers and headed by a Chairman with good leadership skills. Furthermore, there is a succession plan in place.

The recent reorganization of the organizational structure of the bank, with the nomination of 16 department heads

<sup>7</sup> In terms of gross loan portfolio, +31% is planned vs. +80% and +60% during previous years.

(recruited or promoted), has reinforced Senior management who overall brings good support to the EB. This reorganization has also contributed to better performance and efficiency of the management team who has demonstrated good execution capacity. Most current improvements have taken place in the Credit department, which was recently reinforced with a Head and Deputy Head bringing good experience in SME and microfinance. The planned recruitment of a Microfinance Division Head and additional Branch microfinance Managers will be crucial to ensure an optimal development and monitoring of microfinance activities<sup>8</sup> given the fast planned growth and current challenges in the loan portfolio management.

The EM holds regular (weekly) formal and informal meetings. There are also weekly informal meetings between the EM and middle management which are eased by smooth communication among members.

## Human resource management

HR management has greatly improved over the past 3 years, thanks to the reinforcement of the HR department in 2006 with a new Manager and staff, quickly leading to the formalization of HR procedures, drop in staff turnover rates (from 18.7% in Dec. 2007 to 12.8% in Dec. 2008), and higher staff efficiency.

- Recruitments are transparent and handled in a professional manner (IQ test, background check). Job offers are designed with good benefit package to attract qualified staff to meet AzDB's overall operational and financial objectives.
- Most staff has received acceptable induction training (theoretical and/or practical) and may now benefit from valuable external refresher trainings. Historically insufficient, refresher trainings are now reinforced, especially for microfinance staff<sup>9</sup>.
- Staff appraisal is done according to employees' position (back and front office, LOs) based on quantitative and qualitative criteria, and satisfactory bonus systems are in place. However, the bonus systems for LOs could still be refined (cf. Loan Portfolio Management).

Overall, salary offered to staff is adequate when compared to market and employees have demonstrated a good morale and benefit from a friendly working environment.

<sup>8</sup> The Deputy Head of the Credit Department is in charge of microfinance but has other duties as Acting Branch Manager.

<sup>9</sup> The training from GAF was recently complemented by USAID modules for field staff. In-house training by the Credit Department is expected to bring staff to the required level to handle microfinance activities.

## ■ Information

### Information is rated “b”

Overall, AzDB’s computational infrastructure is quite limited to meet the current needs of the bank in terms of portfolio and client growth, monitoring, and information flow. These weaknesses have already been identified by AzDB which is taking concrete steps to fix them.

The in-house MIS, developed by the IT department is able to produce broad key performance indicators for decision making and global portfolio monitoring. However, it is not yet sufficiently efficient in the generation of detailed information for the day to day operation of branches and a strict follow-up of the loan portfolio. The generation of detailed information is not systematic since it requires tedious and time-consuming manual intervention on Excel. For example, the MIS disallows a detailed follow-up by sub-category of loans<sup>10</sup> and an accurate estimation of PAR<sup>11</sup>. Because there are no interfaces between the MIS and other software (international transfers, foreign exchanges, remittances software), reconciliations are also time-consuming.

Overall, AzDB has implemented adequate security systems to secure its information and users have demonstrated an adequate software command.

- The MIS includes a tiered approval system and all branches are connected to the HO through secure VPN.
- The MIS is secured with the use of passwords which are frequently updated, and antivirus. Generator and UPS are also in place.
- Data is backed-up on three different servers (the central server and two computer-based servers) on a daily basis and off-site is done yearly in a branch located outside of Baku. AzDB would nevertheless gain from reinforcing the security access to the server room and making more regular off site backups.

In 2007, AzDB contracted an IT consulting firm to assess the weaknesses of its MIS and the bank’s current and expected needs. The software (SAP Banking) was chosen in a transparent manner and is expected to meet the needs of the bank. EBRD has been providing its expertise in this process and recently issued a call for tender for the implementation of the software, in three phases that might take over three years. The license, sufficient user rights and some hardware have already been purchased. In line with the implementation of SAP, AzDB has planned to strengthen its

<sup>10</sup> Data for different kinds of loans are grouped into one (e.g. loans to entrepreneurs).

<sup>11</sup> The current PAR is overestimated since it includes both principal and accrued interests (vs. only principal according to best practices). In addition, there is no standardized report on PAR by LO and number of days late.

connectivity infrastructure (from direct line to optic) and train related staff through an inventive system<sup>12</sup>.

Statutory financial statements are available on a daily basis for the bank as a whole and by branches on a monthly basis. IFRS accounting are available on a quarterly basis but the bank would gain from improving their quality. Yearly audit of financial statements are done according to IFRS. Adequate financial analysis is done after the generation of accounting information. Moreover, management makes a good use of it in the monitoring of the institution through profitability analysis by branch. Nonetheless, financial analysis is expected to be done more regularly once SAP is in place.

## ■ Risk Management

### Risk Management is rated “b”

#### Procedures and internal controls

AzDB has significantly improved its risk management over the last two years, with the establishment of a dedicated department within the reorganized structure. Currently, the Risk Management department is covering the main risks but would benefit from the formalization of policies in line with the risk map and the standardization of reporting formats. In this regard, the RM team will receive technical assistance from USAID in 2009.

AzDB’s current internal control system is satisfactory with formalized and up to date procedures, segregation of duties (back and front office), tiered loan approval system and hierarchical controls. However, for microcredit activities, sufficient compliance culture cannot be ensured in all branches yet due to the past insufficient involvement of AzDB’s management team in the management of microloans disbursed under GAF that led to weak supervision over LOs involved with GAF program. Aware of the situation and following some cases of negligence, AzDB’s management has been taking the right steps since January 2009 with the approval of all microloans by the credit department, the inspection of all branches (and decision to stop disbursements in the riskiest ones), the provision of refresher trainings, and the introduction of additional layers of checks. Moreover, procedures are currently being improved (e.g. with more clients’ visits) and should be disseminated soon.

AzDB undertakes regular data reconciliation between the MIS and different software used within the bank. This process ensures data reliability at the cost of time-consuming work on Excel.

<sup>12</sup> Employees will receive extra bonuses and discounts on interest rates on loans they take from AzDB. This is to encourage all staff to quickly master SAP once the system is in place.

Cash Security is adequate thanks to sufficiently conservative procedures (end-of-day cash count and collection, restricted access) and equipment (safes, locked doors, cameras). Ceilings for cash transit are defined according to the level of risk. As it is not required by the law, no cash count is performed for evening cash<sup>13</sup>. Cash security could still be improved, notably at the central safe level with more formalization of the approved visits and rotation in the team counting cash.

### Internal audit

Despite some good investments to enhance Internal Audit capacity in 2008, IA is not yet sufficiently staffed to cover main risks within AzDB. AzDB is aware of the necessity to widen the scope of its checks as initiated by the current IA Head in 2009 with the first audits of HQ departments. However, branches have not been sufficiently visited as they were only at 57% in 2008 and are planned to be checked at 76% in 2009 (vs. at least 100% best practice). While checks performed on corporate loans are comprehensive (100% of credit files), checks on credit to individuals are insufficient (little clients' visits and no tracking of the proportion of audited credit files). The IA head has a long experience in the bank but is still new in his IA position.

The IA department would benefit from updated policies providing clear guidelines and based on an independent mapping of risk<sup>14</sup>. IA reports ought to be less descriptive and more risk oriented. They currently do not mention the scope of checks performed (compared to objective), categorization and prioritization of findings, management response and a clear follow-up of previous recommendations (the register of recommendation is kept separately).

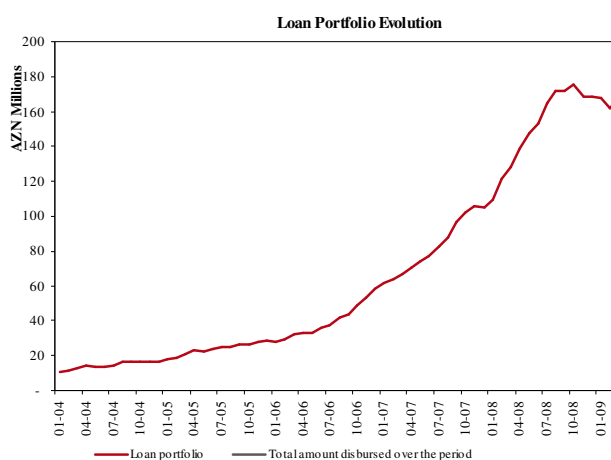
The institutional set-up guarantees the independence of the auditors that directly report to the Audit committee of the SB. A better reporting is nevertheless necessary to enhance the Audit Committee understanding of risks. Internal audits are supplemented by the support of external evaluations, audits (with management letters) and supervisory bodies' checks.

## Activities

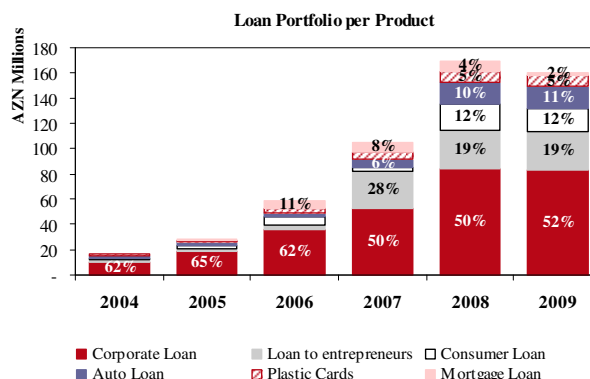
Activities: products and services is rated "b"

### Financial services evolution

Apart from a setback from August to February 2009 (7.7% decrease) as a consequence of the financial crisis, the loan portfolio has been growing by 79% on average since 2005 and peaked at +104% in 2006. This evolution is typical of the early stages of a retail lending activity in a context of high unmet demand. Over the years, the bank shows a steadily decreasing loan size per client (from 16,069 USD in 2004 to 4,193 USD in March 2009) reflecting the development of retail loans.



Portfolio growth is underpinned by the continued development of corporate loans<sup>15</sup>, take-off of the loans to entrepreneurs in 2007 (+933% notably microfinance loans<sup>16</sup>), and take-off of consumer loans, auto loans and plastic cards in 2008 (now representing a total of 27.8% of the portfolio). Mortgage loans, launched in 2006, still represent a small portion of the loan portfolio.



<sup>13</sup> Evening cash is the cash collected after 5pm. No disbursement is allowed after this time.

<sup>14</sup> So far, risks were identified by each department rather than by IA.

<sup>15</sup> 333 loans with an average outstanding size of 248,411 USD as of March 2009.

<sup>16</sup> Microcredits represented 47% of the loans to entrepreneurs in Dec. 08.

As of December 2008, the Savings Portfolio is made up at 77% of short and long time deposits and at 23% of demand deposit. Growing at an average pace of 50% since 2004 (with a peak to 161% in 2004), the savings portfolio is subject to seasonality at the end of each year as corporate clients involved in infrastructure projects receive payments from the government. The recent launch of four new attractive saving products for retail clients is expected to foster future growth.

## Financial services management

Overall, AzDB's portfolio management is satisfactory. However, improvements are needed to strengthen some of AzDB's credit methodologies and reinforce monitoring especially in the context of the current financial crisis. Aware of these weaknesses, mainly in microfinance and SME lending, AzDB has strengthened its Credit Department since the beginning of 2009. The Credit Manager is actively working on improving and streamlining the current credit methodologies, supervision and monitoring.

- The methodology for loans over 20,000 USD has been recently improved with the revision of the cash flow analysis model. Indeed, with the collaboration of an USAID consultant, AzDB has developed a more standardized and conservative credit model, taking more into account the client's indebtedness level. Furthermore, monitoring is well-ensured through a specific division within the Credit department.
- For loans below 20,000 USD, the bank is currently finalizing its own methodology based on the one developed by GAF as it recently took over the supervision of all its staff involved in managing the microfinance portfolio (previously managed by AzDB Microfinance Managers supervised directly by GAF consultants). AzDB would gain from better formalizing the appraisal of the clients' repayment capacity with, for example, the systematic use of the national credit bureau and the GAF's database for microloans. Further training to staff and increasing supervision are also undergoing.
- Based on higher risk on consumer lending, AzDB has developed further procedures to lower the credit risk on consumer loans, such as the use of insurance to guarantee repayments or require business partners (e.g. Samsung) to guarantee repayments of loans if clients default. The Bank has recently stopped the disbursement of consumer loans following the current difficult economic context.

AzDB has an adequate delinquency management policy with responsibilities clearly split between the Credit and Problem Loan department staff. However, delinquency management could be improved by ensuring compliance in all branches, better information quality (cf. section "I") and a bonus system taking more into account portfolio quality. Aware of these flaws, management has taken good initiatives:

reinforced controls, sanctions, and disbursements stopped in some branches (e.g. Sabunchu, Sumqayit and Shamaxi) to focus on delinquency management.

## Credit risk

AzDB's overall credit risk has significantly increased over the past two years but it stands currently at an acceptable level. PAR 30-365 was at 4.1% as of March 2009, 6.6% in Dec. 2008 and 0.5% in Dec. 2007. The high increase between 2007 and 2008 was notably due to a high increase in the PAR 30-365 of corporate loans and loans to entrepreneurs.

- The PAR increase for corporate loans (PAR 30=8.3% in Dec. 2008 vs. 0.1% in 2007) can be more directly related to the effect of the crisis on manufacturing, construction, trade and services (which accounted for 90% of total corporate loans as of Dec. 2008), and the higher portfolio concentration.
- The PAR increase for loans to entrepreneurs (at 6.5% as of Dec. 2008 vs. 1.3% in 2007) mostly stems from the microfinance portfolio. For the microfinance portfolio under GAF, PAR 30 increased to 5.7% in March and 7% in April (and even up to 12.1% and 15.2% in Sabunchu and Sumqayit branches<sup>17</sup>). The current level, much higher than microfinance medians in Azerbaijan (1.49% in March 2009<sup>18</sup>) in the ECA region in 2007 (1.2%), can be attributed to loan portfolio management issues. Measures to stop this increase are expected to yield results only in the medium term.
- PAR 30-365 for plastic cards, consumer and auto Loans has recently increased to 4%, 1.1% and 3.7% in Dec. 2008.

PAR over 365 days increased to 0.5% in March 2009. This amount remains low despite the fact that AzDB has not written-off any loans in recent years due to adequate collection mechanisms. AzDB's write off policy<sup>19</sup> is in line with local and IFRS standards.

Rescheduling mechanisms are well monitored with adequate levels of approval in place. However, in wake of the financial crisis rescheduling has become more frequent and represented 7.1% as of March 2009 and 6.9% in 2008 vs. 0.3% in 2007. This ratio was exceptionally high in 2008 mainly due to the rescheduling of corporate and loans to entrepreneurs.

<sup>17</sup> PAR information at this level of detail is not fully reliable because not reconciled with the total loan portfolio. PAR for non-GAF microfinance portfolio is not available.

<sup>18</sup> Median calculated based on figures reported to AMFA as of March 2009.

<sup>19</sup> Write offs are made on a case by case basis by management, depending on the likelihood to recover past due amounts.

Other factors that could potentially further increase credit risk are well-mitigated thanks to clear rules monitored by the Credit and Risk Management department, regarding: 1) connected lending (at 0.5% in Dec. 2008), 2) sector concentration (capped by policy at 25%<sup>20</sup>), 3) concentration on consumer lending (it covers with auto loans 22.1% of the portfolio) and 4) borrower concentration (no borrower had loan balances in excess of 10% of net assets as of Dec. 2008).

## Credit risk coverage

AzDB's credit risk coverage is satisfactory.

- As of Dec. 2008, anticipated losses (PAR 30) are sufficiently covered at 80.3% by the loan loss provision (IFRS). As of March 2009, the provision sufficiently covers anticipated losses at 102.7%.
- The value of collaterals covered 140%<sup>21</sup> of the past due loans as of December 2008. Main collaterals are real estate (57%), movable properties (27%) and other assets (14%). Most collaterals are registered and can be used efficiently in front of the court. Even though they are not registered for business loans below 10 K AZN and consumer loans, the latter is also covered by merchant partners, at 50% or 100%. In addition, AzDB uses clients' fixed term and demand deposits<sup>22</sup> as collateral.
- Most of consumer loans are usually insured by business partners (e.g. Samsung) or insurance to cover the outstanding loan portfolio purchased for a fee of 3% of the loan amount.

## Funding and liquidity

Funding and liquidity is rated "a"

### Capitalization and funding strategy

AzDB is capitalized above minimum requirements, both in terms of regulatory core and total CAR, respectively at 13.7% (vs. 6% min) and 19.2% (vs. 12% min.) as of March 2009<sup>23</sup>. Sufficient capitalization has been achieved thanks to historic good internal capital generation, timely arrival of new shareholders in equity in 2005 and 2007 and recourse to subordinated debt.

Compliance with minimum capital requirements should be ensured for the years to come. In the short term, thanks to the planned capitalization of incomes at the end of S1 2009

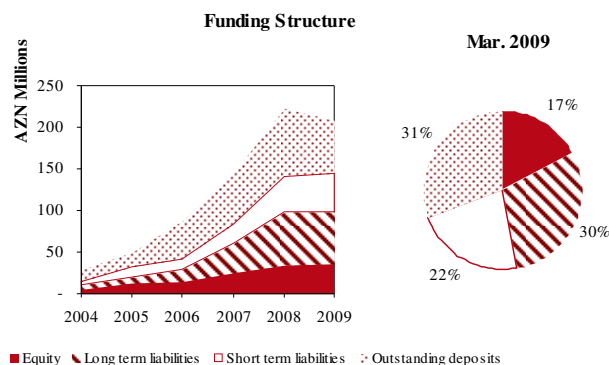
<sup>20</sup> Main sectors of activities are manufacturing (16.7%), trade (15%), service (10%), construction (9.9%) and agriculture (4.9%).

<sup>21</sup> Using the fair value of collaterals as stated in 2008 AFS.

<sup>22</sup> However, AzDB is not yet able to precise the exact amount of cash collaterals as its MIS records them as voluntary savings.

<sup>23</sup> The ratios presented here are those calculated according to the NBAR's requirements. Calculations in accordance with the requirements of the Basle Accord yield a core CAR of 20.3% and a total CAR of 22.4%.

(AzDB is exempted from tax in 2009 and 2010), and the attraction of an additional subordinated debt (FMO) in a context of slower growth planned for 2009. In the medium term, thanks to shareholders satisfied with AzDB's good ROE level (above 20% since 2007) and capacity to improve its overall performance. EBRD and FMO are committed to support the bank and EBRD could remain in the bank after 2010<sup>24</sup> as well.



Funding needs were estimated at 106.8 M USD for 2009. For the coming six months, 20% are already secured and 30% are in advanced stage of negotiations (including 20 M USD senior loan from EBRD). Although funding needs are frequently updated, AzDB would gain in visibility if this process was streamlined so that all relevant departments share similar information.

AzDB has a sound debt funding strategy, consisting in attracting an equivalent share of international borrowings and local deposits. AzDB recently revamped and widely-advertised its retail deposits, which have since yielded positive growth. The deposit insurance system, covering individuals' deposits up to 30,000 AZN, might foster the depositors' confidence. On the borrowings side, the active communication and good relationship with fund providers, close follow-up of covenants (and re-negotiation when needed) is expected to allow sufficient roll out of current borrowings. As some funds were cancelled at the end of 2008 due to the international crisis, AzDB is now further diversifying its funding sources (e.g. with a syndicated loan), which is expected to enhance its negotiation power.

## Liquidity risk

The treasury department is well organized and staffed with experienced professionals with the required skills to ensure an adequate liquidity management. The overall efficiency of the department is nevertheless hampered by the time-consuming work required to compensate for the MIS flaws.

<sup>24</sup> EBRD would therefore not necessarily use its put option. Refer to the ownership section of the institutional presentation.

The design of the funding structure reduces the risk of not being able to renew or replace maturing liabilities. Maturity risk is sufficiently monitored and anyhow limited with quick and current ratios above 100% as of Dec. 2008. The funding structure remains indeed simple to manage with limited demand deposit and moderate deposit concentration. Funding could be nevertheless more diversified to avoid paying funds at a higher cost as it happened at the early stage of the financial crisis in Q4 2008.

AzDB has kept adequate level of cash during the crisis with a Liquid to Asset Ratio (LAR) at 16.9% in Dec. 2008 and demand deposits largely covered by cash. The contingency plan designed during the crisis has proved useful in this regard. LAR was maintained over 15% during the crisis as required by the funders' covenants. Even though covenants were softened, liquidity levels are still kept high (LAR around 11% in March 2009) as the bank expects important loan repayments during the year (e.g. 16 M USD or 6.3% of assets in Sept. 2009). To avoid having too much idle liquidities, AzDB may have recourse to overnight deposits (so far up to 5 M AZN).

## Market risk

Market risks are managed daily by AzDB's treasury department and reviewed monthly during the treasury committee. As of March 2009, potential losses resulting from AzDB's exposure to market risks would not have significant effects on its profitability.

- AzDB's FX open position is in compliance with NBAR's requirements. The most significant open positions are on USD at (9.6%), resulting from the shrinking availability of funds in local currency during the crisis. This open position is despite the disbursements of loans in USD and EUR, where a significant depreciation of the AZN could have an impact on credit risk. The bank has also recourse to swaps for hedging, however to a limited extent given their limited availability in Azerbaijan.
- The aggregated open position on floating interest rates is significant (short 86.8% on the bank's equity), particularly on LIBOR (short 83.8%). However, an increase of 100 basis points in LIBOR would only decrease the ROA by 0.14 points to 3.9%.

## Efficiency and Profitability

Efficiency and Profitability is rated "b"

### Profitability analysis

AzDB has progressively improved its profitability with an ROA increasing from 3.3% in 2006 to 4.3% in 2008, over ECA benchmarks (2.6% in Dec. 2007). This performance was fueled by adequate portfolio yield and revenue quality,

economies of scale and further cost management. AzDB's ROE closely follows the same pattern than ROA, reaching 26.7% in Dec. 2008. However, AzDB's profitability has started to be hampered by higher credit risk (cf. Activities).

The high increase in credit risk in 2008 has affected the portfolio yield (24% in 2008) as evidenced by the widening gap with the theoretical EIR (estimated at around 28%). AzDB's portfolio yield nevertheless increased over the years resulting from the increase in interest rates for most of its products<sup>25</sup>.

AzDB enjoys a good revenue quality, generating 82% of its revenues from its lending activities. The bank benefits from a growing brand thanks to the strengthening of the marketing department and better communication with clients on AzDB's reliability and support from international shareholders. Furthermore, AzDB has one of the largest private bank branch networks in the country. Its microfinance market share is nevertheless small (3.4%). Further growth is expected in the untapped provinces on the microfinance and retail segment. AzDB's interest rates, including microfinance ones, are generally sufficiently competitive.

AzDB's other revenues are generated from interest and fee income from investments (5.5%) and other revenues (12.2%). They have contributed to AzDB's good total revenue ratio of 29.2% in Dec. 2008.

Despite high increase in administrative costs (related to branch expansion and personnel expense) over the past 3 years, AzDB's cost structure is adequate as shown by its decreasing operating expenses ratio from 9.4% in 2006 to 7.9% in 2008. This trend was stimulated by better cost management, economies of scale and higher staff productivity<sup>26</sup>.

As of result of the recent growth in credit risk, the loan loss provision expense ratio increased significantly between 2007 and 2008, from 1.2% to 4.7%. On the other hand, AzDB's funding expense ratio has been stable around 10% over the past years (10.2% in 2008). The peak in 2007 is explained by the high leverage during the year before the issuance of new shares in Q4 2007. With the current international financial crisis, the funding expense ratio is expected to further increase.

AzDB has had a satisfactory asset optimization, standing consistently above 70% since 2006 and at 73.4%<sup>27</sup> in 2008.

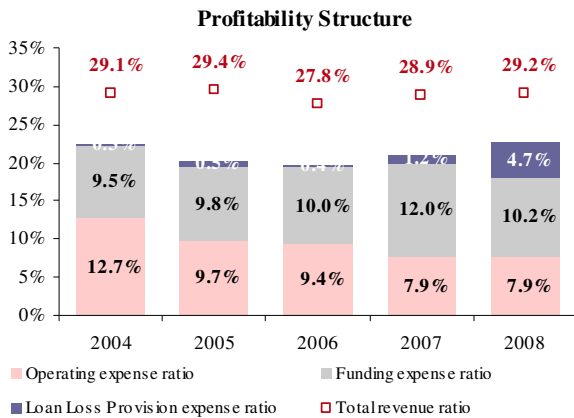
<sup>25</sup> Interest rates on corporate loans went from 18-19 to 22%, consumer from 30% to 36%, loans to entrepreneurs from 30% to 36%.

<sup>26</sup> Staff productivity increased from 12 to 60 between 2006 and 2008. This trend was partially the result of increasing retail lending.

<sup>27</sup> Taking into consideration the compulsory cash reserve set at the NBAR.

This level is explained by AzDB’s conservative policy to keep a cash cushion equivalent to 15% of its assets (cf. Liquidity Management section).

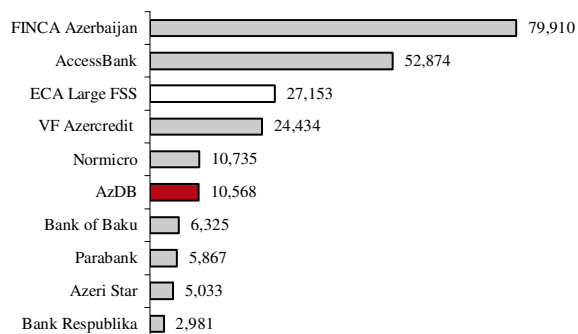
AzDB’s profitability outlook over the next year is stable. Despite AzDB’s capacity to promptly adjust its interest rates and plans to introduce new attractive products, any increase in profitability is likely to be hampered by weaker portfolio quality and rising funding costs.



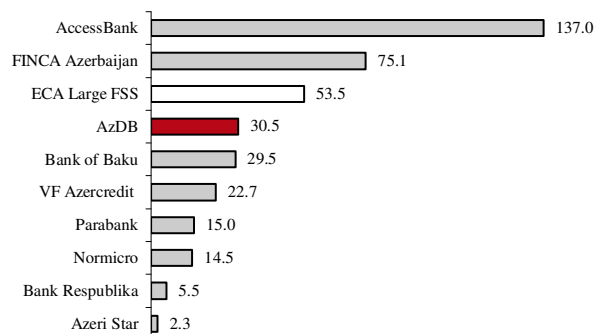
*The opinions expressed within this report are valid for one year after the rating mission. Beyond one year, or in case of a major change during this period affecting the institution’s performance, that change due to the institution itself or its operating environment, Planet Rating does not guarantee the validity of the opinions contained herein, and recommends that a new rating evaluation be undertaken. Planet Rating cannot be held responsible for investments/financings that are made based on this report.*

## Benchmarking

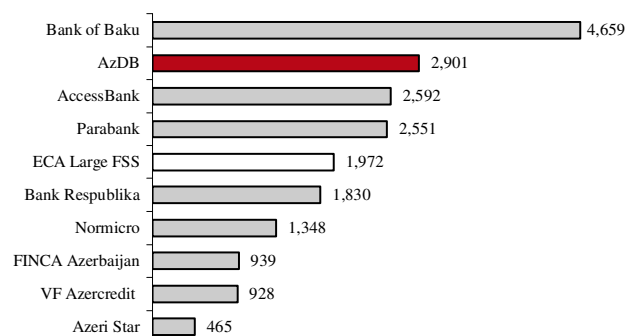
Active borrowers



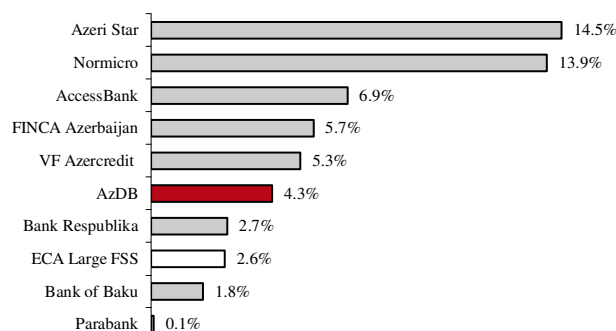
Loan portfolio (M USD)



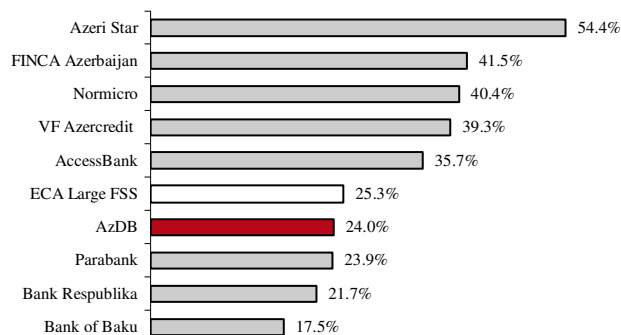
Average outstanding loan per client (USD)



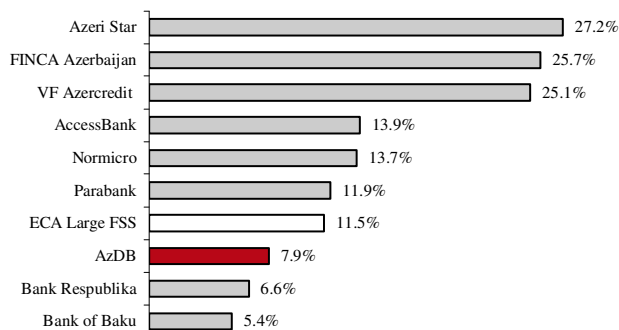
ROA



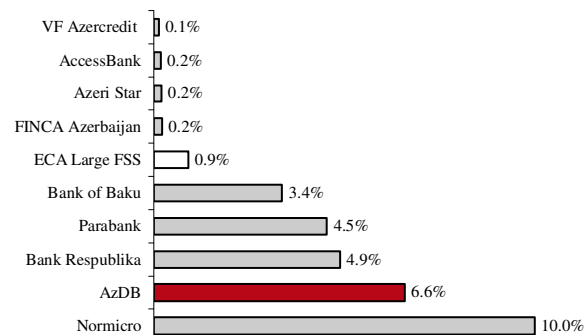
Portfolio yield



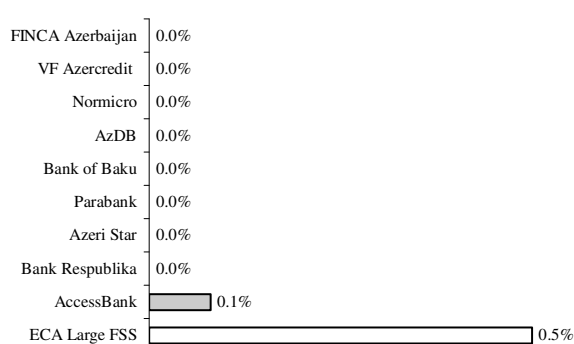
Operating expense ratio



PAR 31-365



Write-off ratio



Note: AzDB's outstanding loan portfolio and active borrowers are only based on the bank's activities on SME, MSE and microfinance loans.

Sources: Planet Rating (AzDB as of March 2009 for outstanding loan portfolio and active borrowers and as of December 2008 otherwise); AMFA Matrix (outstanding loan portfolio and active borrowers of other microfinance providers as of March 2009); Audited financial statements for the ROE and portfolio yield of Bank of Baku (2007), PARABANK (2007) and Bank Respublika (2008); Mixmarket (other benchmarks of other microfinance providers as of Dec. 2008; 2007 MBB benchmarks for ECA Medium FSS).

Data in USD, unless otherwise stated

## ■ Performance indicators

	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
<b>Loan Portfolio</b>					
<b>Loan portfolio evolution</b>					
Loan portfolio	29,182,687	67,041,146	124,069,483	209,956,367	203,862,256
Loan portfolio (AZN)	28,616,542	58,419,655	104,838,713	168,175,050	167,778,637
Growth	71.8%	104.1%	79.5%	60.4%	(0.2%)
Active borrowers	8,029	12,079	25,043	53,914	48,614
Growth	? 659.6%	50.4%	107.3%	115.3%	(9.8%)
Average outstanding loan per client	3,635	5,550	4,954	3,894	4,193
% of GDP per capita	239.5%	231.3%	135.6%	75.0%	83.0%
Average amount disbursed per loan	2,132	4,797	6,140	5,560	n.a
% of GDP per capita	140.4%	199.9%	168.1%	107.1%	n.a
<b>Portfolio quality</b>					
Rescheduled loans	n.a	0.4%	0.3%	6.9%	7.1%
PAR 31-365	n.a	0.4%	0.5%	6.6%	4.1%
PAR > 365	n.a	0.0%	0.0%	0.0%	0.0%
Write-off ratio	0.0%	0.4%	0.2%	0.4%	0.5%
<b>Credit risk coverage</b>					
Risk coverage ratio (PAR 30)	n.a	447.9%	392.0%	80.3%	102.7%
PAR 31 net of loan loss provision / Equity	(6.8%)	(5.5%)	(5.7%)	6.5%	(0.5%)
<b>Savings</b>					
Outstanding deposits	18,581,481	54,661,464	74,389,349	102,975,031	78,373,864
Outstanding deposits (AZN)	18,221,000	47,632,000	62,859,000	82,483,000	64,501,690
Growth	25.4%	161.4%	32.0%	31.2%	(21.8%)
Voluntary savings (%)	100.0%	100.0%	100.0%	100.0%	100.0%
Cash collateral (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Active savers	2,679	3,380	4,242	5,056	4,843
Growth	? 96.1%	26.2%	25.5%	19.2%	(4.2%)
Average outstanding deposit per saver	5,434	11,852	15,441	17,287	15,986
Voluntary savings	5,434	11,852	15,441	17,287	15,986
Cash collateral	-	-	-	-	-
<b>Staff</b>					
Total number of staff	298	348	411	511	525
% Credit officers	12.8%	17.8%	22.9%	27.8%	26.9%
Turnover	12.9%	20.4%	18.7%	12.8%	1.4%
<b>Profitability analysis</b>					
ROE	18.1%	17.4%	25.0%	26.7%	25.4%
Liabilities / Equity	3.04x	5.39x	3.97x	4.97x	4.28x
Core capital adequacy ratio	18.5%	14.9%	24.5%	20.8%	20.3%
Total capital adequacy ratio	25.7%	19.7%	34.8%	27.9%	22.4%
ROA	4.1%	3.3%	4.2%	4.3%	4.1%
ROA (without donations)	4.1%	3.3%	4.2%	4.3%	4.1%
<b>Profitability structure</b>					
Total revenue ratio	29.4%	27.8%	28.9%	29.2%	34.5%
Portfolio yield	20.6%	22.1%	22.3%	24.0%	19.2%
Operating expense ratio	9.7%	9.4%	7.9%	7.9%	7.7%
Cost per borrower	290	345	300	271	319
Staff productivity	27	35	61	106	93
Loan officer productivity	211	195	266	380	345
Average outstanding loan per client (USD)	3,635	5,550	4,954	3,894	4,193
Funding expense ratio	9.8%	10.0%	12.0%	10.2%	9.7%
Cost of savings	8.3%	6.7%	9.4%	10.4%	8.5%
Cost of borrowings	3.0%	4.9%	7.5%	7.3%	7.9%
Loan Loss Provision expense ratio	0.5%	0.4%	1.2%	4.7%	0.0%
PAR 31-365	n.a	0.4%	0.5%	6.6%	4.1%
Write-off ratio	0.0%	0.4%	0.2%	0.4%	0.5%
<b>Resource optimization</b>					
Outstanding Loan Portfolio / Assets	56.0%	65.1%	70.3%	71.2%	76.9%
Revenue from investment as a % of financial revenues	8.7%	7.5%	6.2%	6.3%	0.0%
<b>Liquidity</b>					
Cash to demand deposits	334.7%	138.0%	142.1%	159.8%	121.6%
Liquidity / Total assets (LAR)	23.4%	17.2%	15.9%	16.9%	10.6%
Current ratio (1 year)	123.7%	110.1%	127.0%	131.2%	133.4%
Exchange rate 1 USD= xx AZN	1.0	0.9	0.8	0.8	0.8

Note: Cash collaterals are included within voluntary savings as the split between voluntary savings and cash collaterals is not available due to MIS limitations.

## ■ Financial statements – AZN

Income Statement (AZN)	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Interest and fee income on loan portfolio	3,211,000	4,825,000	8,490,000	18,010,000	35,733,513	7,950,110
Interest and fee income on investments	388,000	459,000	687,000	1,193,000	2,392,000	-
Interest and other financial expenses	1,463,600	2,294,000	3,831,000	9,681,000	15,180,000	4,038,194
Net inflation adjustment expense	-	-	-	-	-	-
Net foreign exchange income (expense)	-	-	-	-	-	-
<b>Net financial income</b>	<b>2,135,400</b>	<b>2,990,000</b>	<b>5,346,000</b>	<b>9,522,000</b>	<b>22,945,513</b>	<b>3,911,916</b>
Fees and commissions on other financial services	-	-	-	-	-	20,174
Other operating income	889,800	1,596,000	1,507,000	4,196,000	5,305,487	6,361,188
Operating expenses	1,968,400	2,280,000	3,630,000	6,354,000	11,704,000	3,186,752
<i>Personnel expenses</i>	861,600	1,014,000	1,771,000	3,514,000	7,001,000	1,677,151
<i>Administrative and other expenses</i>	749,800	905,000	1,326,000	2,018,000	3,712,000	918,163
<i>Depreciation</i>	357,000	361,000	533,000	822,000	991,000	591,438
Non operating income (net)	-	-	-	-	-	(4,898,384)
<b>Gross operating income</b>	<b>1,056,800</b>	<b>2,306,000</b>	<b>3,223,000</b>	<b>7,364,000</b>	<b>16,547,000</b>	<b>2,208,142</b>
Net loan loss provision expense	43,000	118,000	141,000	979,000	6,932,000	-
<b>Net operating income</b>	<b>1,013,800</b>	<b>2,188,000</b>	<b>3,082,000</b>	<b>6,385,000</b>	<b>9,615,000</b>	<b>2,208,142</b>
Extraordinary income (net)	-	-	-	-	-	-
<b>Net income before tax</b>	<b>1,013,800</b>	<b>2,188,000</b>	<b>3,082,000</b>	<b>6,385,000</b>	<b>9,615,000</b>	<b>2,208,142</b>
Income Tax	321,400	571,000	810,000	1,480,000	1,721,000	-
<b>Net income before donations</b>	<b>692,400</b>	<b>1,617,000</b>	<b>2,272,000</b>	<b>4,905,000</b>	<b>7,894,000</b>	<b>2,208,142</b>
Donations	-	-	-	-	-	-
<b>Net Income</b>	<b>692,400</b>	<b>1,617,000</b>	<b>2,272,000</b>	<b>4,905,000</b>	<b>7,894,000</b>	<b>2,208,142</b>

Balance Sheet (AZN)	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
<b>ASSETS</b>	<b>28,467,600</b>	<b>49,589,000</b>	<b>88,231,000</b>	<b>146,400,000</b>	<b>223,760,000</b>	<b>209,319,040</b>
Liquid assets	7,928,200	11,605,000	15,132,000	23,227,000	37,714,000	22,221,031
Net loan portfolio	15,930,467	27,776,542	57,438,655	102,878,713	159,285,050	161,070,806
<i>Gross loan portfolio</i>	16,655,267	28,616,542	58,419,655	104,838,713	168,175,050	167,778,637
<i>(Loan loss reserve)</i>	724,800	840,000	981,000	1,960,000	8,890,000	6,707,831
Interest receivable	133	28,458	491,345	1,311,287	5,145,950	3,334,565
Financial investments	298,400	949,000	1,245,000	1,760,000	1,399,000	1,107,445
Net fixed assets	3,088,200	7,618,000	7,879,000	10,107,000	12,376,000	13,490,538
Intangible assets	51,600	56,000	26,000	36,000	100,000	94,700
Other assets	1,170,600	1,556,000	6,019,000	7,080,000	7,740,000	7,999,956
<b>LIABILITIES AND EQUITY</b>	<b>28,467,600</b>	<b>49,589,000</b>	<b>88,231,000</b>	<b>146,400,000</b>	<b>223,760,000</b>	<b>209,319,040</b>
<b>Liabilities</b>	<b>22,871,200</b>	<b>37,321,000</b>	<b>74,433,000</b>	<b>120,923,000</b>	<b>190,145,000</b>	<b>173,477,214</b>
Demand deposits	3,313,200	3,467,000	10,964,000	16,349,000	23,595,000	18,279,987
Time deposits	11,222,800	14,754,000	36,668,000	46,510,000	58,888,000	46,221,703
Cash collateral	-	-	-	-	-	-
Borrowings	8,008,800	17,407,000	24,485,000	50,950,000	99,081,000	97,445,161
Subordinated debt	-	-	-	3,974,000	3,852,000	3,773,160
Other liabilities	326,400	1,693,000	2,316,000	3,140,000	4,729,000	7,757,203
<b>Equity</b>	<b>5,596,400</b>	<b>12,268,000</b>	<b>13,798,000</b>	<b>25,477,000</b>	<b>33,615,000</b>	<b>35,841,827</b>
Core capital	5,596,400	8,841,000	10,450,000	20,718,000	27,920,000	35,841,827
<i>Paid-in capital</i>	3,883,800	7,544,000	7,687,000	14,832,000	17,832,000	17,494,630
<i>Donated equity</i>	-	-	-	-	-	-
<i>Retained earnings</i>	1,712,600	1,297,000	2,763,000	5,886,000	10,088,000	18,347,196
Other equity accounts	-	3,427,000	3,348,000	4,759,000	5,695,000	-

Off Balance Sheet Accounts	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Portfolio under management	-	-	-	-	-	-
Written-off loans under collection	-	-	-	-	-	-
Guarantees	4,771,200	5,102,600	13,418,000	18,787,000	22,164,000	n.a

Balance Sheet Averages	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Gross loan portfolio	15,446,634	23,395,838	38,482,736	80,934,545	148,973,810	165,937,329
Assets	27,542,300	39,028,300	68,910,000	117,315,500	185,080,000	216,539,520
Deposits	14,248,900	16,378,500	32,926,500	55,245,500	72,671,000	73,492,345
Borrowings and subordinated debt	5,601,900	12,707,900	20,946,000	39,704,500	78,928,500	102,075,660
Equity	5,368,200	8,932,200	13,033,000	19,637,500	29,546,000	34,728,413

Note: March 2009 financial statements are not audited and were done based on statutory accounting, not IFRS

## ■ Financial statements – USD

Income Statement (USD)	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Interest and fee income on loan portfolio	3,274,526	4,920,457	9,742,942	21,313,609	44,611,127	9,659,915
Interest and fee income on investments	395,676	468,081	788,387	1,411,834	2,986,267	-
Interest and other financial expenses	1,492,556	2,339,384	4,396,374	11,456,805	18,951,311	4,906,676
Net inflation adjustment expense	-	-	-	-	-	-
Net foreign exchange income (expense)	-	-	-	-	-	-
<b>Net financial income</b>	<b>2,177,646</b>	<b>3,049,154</b>	<b>6,134,955</b>	<b>11,268,639</b>	<b>28,646,084</b>	<b>4,753,239</b>
Fees and commissions on other financial services	-	-	-	-	-	24,513
Other operating income	907,404	1,627,575	1,729,401	4,965,680	6,623,579	7,729,269
Operating expenses	2,007,342	2,325,107	4,165,710	7,519,527	14,611,735	3,872,117
<i>Personnel expenses</i>	878,646	1,034,061	2,032,362	4,158,580	8,740,325	2,037,851
<i>Administrative and other expenses</i>	764,634	922,904	1,521,689	2,388,166	4,634,207	1,115,630
<i>Depreciation</i>	364,063	368,142	611,659	972,781	1,237,203	718,637
Non operating income (net)	-	-	-	-	-	(5,951,864)
<b>Gross operating income</b>	<b>1,077,708</b>	<b>2,351,621</b>	<b>3,698,646</b>	<b>8,714,793</b>	<b>20,657,928</b>	<b>2,683,040</b>
Net loan loss provision expense	43,851	120,334	161,809	1,158,580	8,654,182	-
<b>Net operating income</b>	<b>1,033,857</b>	<b>2,231,287</b>	<b>3,536,837</b>	<b>7,556,213</b>	<b>12,003,745</b>	<b>2,683,040</b>
Extraordinary income (net)	-	-	-	-	-	-
<b>Net income before tax</b>	<b>1,033,857</b>	<b>2,231,287</b>	<b>3,536,837</b>	<b>7,556,213</b>	<b>12,003,745</b>	<b>2,683,040</b>
Income Tax	327,759	582,297	929,539	1,751,479	2,148,564	-
<b>Net income before donations</b>	<b>706,098</b>	<b>1,648,990</b>	<b>2,607,299</b>	<b>5,804,734</b>	<b>9,855,181</b>	<b>2,683,040</b>
Donations	-	-	-	-	-	-
<b>Net Income</b>	<b>706,098</b>	<b>1,648,990</b>	<b>2,607,299</b>	<b>5,804,734</b>	<b>9,855,181</b>	<b>2,683,040</b>

Balance Sheet (USD)	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
<b>ASSETS</b>	<b>29,030,797</b>	<b>50,570,059</b>	<b>101,252,008</b>	<b>173,254,438</b>	<b>279,350,811</b>	<b>254,336,622</b>
Liquid assets	8,085,050	11,834,591	17,365,160	27,487,574	47,083,645	27,000,037
Net loan portfolio	16,245,633	28,326,068	65,915,372	121,749,956	198,857,740	195,711,793
<i>Gross loan portfolio</i>	16,984,772	29,182,687	67,041,146	124,069,483	209,956,367	203,862,256
<i>(Loan loss reserve)</i>	739,139	856,618	1,125,775	2,319,527	11,098,627	8,150,463
Interest receivable	135	29,021	563,857	1,551,819	6,424,407	4,051,720
Financial investments	304,303	967,775	1,428,735	2,082,840	1,746,567	1,345,620
Net fixed assets	3,149,296	7,768,713	9,041,772	11,960,947	15,450,687	16,391,905
Intangible assets	52,621	57,108	29,837	42,604	124,844	115,067
Other assets	1,193,759	1,586,784	6,907,276	8,378,698	9,662,921	9,720,481
<b>LIABILITIES AND EQUITY</b>	<b>29,030,797</b>	<b>50,570,059</b>	<b>101,252,008</b>	<b>173,254,438</b>	<b>279,350,811</b>	<b>254,336,622</b>
<b>Liabilities</b>	<b>23,323,679</b>	<b>38,059,351</b>	<b>85,417,719</b>	<b>143,104,142</b>	<b>237,384,519</b>	<b>210,786,408</b>
Demand deposits	3,378,748	3,535,590	12,582,052	19,347,929	29,456,929	22,211,405
Time deposits	11,444,830	15,045,890	42,079,412	55,041,420	73,518,102	56,162,459
Cash collateral	-	-	-	-	-	-
Borrowings	8,167,245	17,751,377	28,098,462	60,295,858	123,696,629	118,402,383
Subordinated debt	-	-	-	4,702,959	4,808,989	4,584,642
Other liabilities	332,857	1,726,494	2,657,792	3,715,976	5,903,870	9,425,520
<b>Equity</b>	<b>5,707,118</b>	<b>12,510,708</b>	<b>15,834,290</b>	<b>30,150,296</b>	<b>41,966,292</b>	<b>43,550,215</b>
Core capital	5,707,118	9,015,909	11,992,196	24,518,343	34,856,429	43,550,215
<i>Paid-in capital</i>	3,960,636	7,693,249	8,821,437	17,552,663	22,262,172	21,257,145
<i>Donated equity</i>	-	-	-	-	-	-
<i>Retained earnings</i>	1,746,482	1,322,660	3,170,760	6,965,680	12,594,257	22,293,070
Other equity accounts	-	3,494,799	3,842,093	5,631,953	7,109,863	-

Off Balance Sheet Accounts	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Portfolio under management	-	-	-	-	-	-
Written-off loans under collection	-	-	-	-	-	-
Guarantees	4,865,592	5,203,549	15,398,210	22,233,136	27,670,412	n.a

Balance Sheet Averages	Dec. 2004	Dec. 2005	Dec. 2006	Dec. 2007	Dec. 2008	Mar. 2009
Gross loan portfolio	15,752,227	23,858,696	44,161,965	95,780,526	185,984,782	201,624,945
Assets	28,087,192	39,800,428	79,079,642	138,834,911	231,061,174	263,109,988
Deposits	14,530,797	16,702,529	37,785,747	65,379,290	90,725,343	89,298,111
Borrowings and subordinated debt	5,712,727	12,959,311	24,037,182	46,987,574	98,537,453	124,028,749
Equity	5,474,403	9,108,913	14,956,392	23,239,645	36,886,392	42,197,343

Note: March 2009 financial statements are not audited and were done based on statutory accounting, not IFRS.

## ■ Formulas

Return on assets (ROA):	$\text{Net operating income} / \text{Average assets}$
ROA (without donations):	$\text{Net operating income before donations} / \text{Average assets}$
Return on equity (ROE):	$\text{Net operating income before donations} / \text{Average equity}$
Leverage:	$\text{Liabilities} / \text{Equity (end of period)}$
Capital adequacy ratio:	$\text{Capital} / \text{Risk weighted assets (end of period)}$
Total revenue ratio:	$\text{Total revenue} / \text{Average gross outstanding portfolio}$
Portfolio yield:	$\text{Portfolio revenue} / \text{Average gross outstanding portfolio}$
Operating expense ratio:	$\text{Operating expense} / \text{Average gross outstanding portfolio}$
Cost per borrower:	$\text{Operating expense} / \text{Active borrowers (end of period)}$
Staff productivity:	$\text{Active borrowers} / \text{Total personnel (end of period)}$
Funding expense ratio:	$\text{Interest and fees paid on funding liabilities} / \text{Average gross outstanding portfolio}$
Cost of savings:	$\text{Interest and fees paid on deposits} / \text{Average deposits}$
Cost of borrowings:	$\text{Interest and fees paid on borrowings} / \text{Average borrowings}$
Loan loss provision expense ratio:	$\text{Net loan loss provision expense} / \text{Average gross outstanding portfolio}$
Write-off ratio:	$\text{Loans written off} / \text{Average gross outstanding portfolio}$
Risk coverage ratio:	$\text{Loan loss reserve} / \text{Portfolio at risk} > 30 \text{ days}$
Cash to demand deposits:	$\text{Instantly available liquid assets} / \text{Demand deposits (end of period)}$
Current ratio (1 year):	$\text{Short term assets} / \text{Short term liabilities (end of period)}$

## ■ Rating scale

Rating	Rating summary	
A++	Current institutional, operational and financial performances are optimal. There is no downside risk in the short-term. Medium and long-term plans are well-designed, execution capacity is excellent and goals are very likely to be achieved. Short and medium term risks are minimal and/or well-managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should only minimally affect the institution's financial condition given its high resilience.	INVESTMENT GRADE
A+	Current institutional, operational and financial performances are excellent when compared to industry standards.	
A	Medium and long-term plans are well-designed, execution capacity is very good, and goals are very likely to be achieved. Short and medium term risks are minimal and/or well managed. Long-term risks are adequately monitored and anticipated. Changes in the economic, political or social environment should have a limited impact on the institution's financial condition given its ability to quickly adjust its strategies and/or take corrective actions.	
A-		
B++	Current institutional, operational and financial performances are satisfactory when compared to industry standards.	INVESTMENT GRADE
B+	Medium and/or long-term plans are adequately designed, execution capacity is good and goals are likely to be achieved. Short and medium term risks are low and/or well managed. Areas for improvements have been identified and are being addressed. Changes in the economic, political or social environment might have an impact on the institution's financial condition that should however remain moderate.	
B		
B-	Current institutional, operational and financial performances are close to industry standards. Short and medium term risks are moderate but are not fully addressed. Most areas for improvements have been identified, but medium and long term plans miss one or several critical elements, execution capacity is uneven and some goals are unlikely to be achieved. The institution is vulnerable to major changes in the economic, political or social environment.	SPECULATIVE INVESTMENT
C++	Current institutional, operational and financial performances are below comparable industry standards. Short and medium term risks are moderate-high but are not fully addressed. Most areas for improvements have been identified, but medium and long-term plans miss one or several critical elements, execution capacity is weak and many goals are unlikely to be achieved. Most management processes and systems are in place but need to be refined or updated. The institution is vulnerable to major changes in the economic, political or social environment	
C+		
C-		
D	<b>High risk:</b> Important weaknesses in operational and financial areas result in high institutional vulnerability and potential risk of default. Performance is very poor in several important evaluation areas.	TECHNICAL ASSISTANCE REQUIRED
E	<b>Immediate risk of default:</b> Existing operational and/or financial and/or strategic weaknesses create an outstanding risk of default. Performance is very poor in most evaluation areas.	