FINANCIAL ANALYSIS

A. Selection Criteria for Participating Financial Institutions

1. The participating financial institutions (PFIs) were selected based on (i) their strategic fit with the project; (ii) satisfactory financial strength, e.g., capital adequacy, management and governance, asset quality, earnings and liquidity, financial management and internal control systems, integrity and environmental and social management systems; and (iii) compliance with the prudential requirements of the National Bank of Kazakhstan and Kazakhstan's laws and regulations on combating money laundering and the financing of terrorism (AML/CFT). Additional PFIs may participate if the Asian Development Bank (ADB) is satisfied that they meet the above eligibility criteria.

2. **Strategic fit with the project's objectives**. The project will leverage the rural footprint of Bank CenterCredit (BCC), Nurbank, and to some extent Bank Kassa Nova (BKN), all of which currently have more than 50% of their loans to micro, small, and medium-sized enterprises (MSMEs) in rural areas. BCC is strong in the small-business segment, serving over 2,500 small borrowers with an average loan size of $80,000. BCC displays good financial performance, an acceptable risk profile, and good corporate governance. In addition, International Finance Corporation is a reputable shareholder of BCC, supporting good credit culture and responsible finance policies. Bank Kassa Nova (BKN), originally a microfinance organization (MFO), retains its micro and small focus, with 3,100 small business clients and an average loan of less than $30,000 equivalent. Bank of Astana (BOA) and Nurbank are small banks and have recently begun to target MSMEs. The three MFOs—Bereke, Asian Credit Fund (ACF), and KazMicroFinance (KMF)—focus on the smallest borrowers, operate mainly in rural areas, and have a good track record of working with women's businesses. Competition among lenders that use alternative strategies and distribution channels benefits small businesses and their financing needs.

3. The PFIs prepare annual financial statements in accordance with International Financial Reporting Standards, audited by reputable audit firms. They have passed integrity due diligence and comply with AML/CFT regulations. Prior to the first disbursement to each PFI, environmental and social management systems that satisfy ADB's Safeguard Policy Statement 2009 must be in place. Project agreements will reflect these commitments and specify ADB's eligibility criteria.[1]

[1] In addition to the central bank's prudential ratios, ADB set the following financial eligibility criteria to be reconfirmed by each PFI before each disbursement. Banks: (i) a ratio of net nonperforming loans (overdue more than 90 days less loan loss reserves) to total regulatory capital of less than 25%; and (ii) net profit generated in the most recently completed fiscal year. MFOs: (i) a capital adequacy ratio of no less than the higher of 30% over NBK's prudential requirement or 15%; (ii) a leverage ratio not exceeding the NBK's prudential requirement less 30%; (iii) a ratio of net nonperforming loans (overdue more than 30 days less loan loss reserves) to total equity of less than 10%; and (iv) net profit generated in the preceding fiscal year.

Selected financial performance indicators of Participating Financial Institutions (2015)

Item	BOA	BCC	BKN	NRB	ACF (MFO)	Bereke (MFO)	KMF (MFO)
Assets (T billion)	224	1,442	80	321	1	5	44
ROAA	0.9	0.2	1.2	0.1	5.2	1.4	4.2
Net NPLs to total capital (%)[a]	-10.9	-5.3	6.3	-9.2	-0.16	0.5	3.9
Debt:Equity for MFOs	-	-	-	-	2.8:1	0.4:1	3.4:1

ACF = Asian Credit Fund, BOA = Bank of Astana, BCC = Bank CenterCredit, BKN = Bank Kassa Nova, KMF= KazMicroFinance, MFO = microfinance organization, NPL = nonperforming loan, NRB = Nurbank, ROAA = return on average assets

[a] Defined as loans past due more than 90 days for banks and past due more than 30 days for MFOs, less loan reserves, over regulatory capital.

Source: Consultants' due diligence report based on questionnaires from participating financial institutions, central bank data, and entities' audited financial statements.

B. The Participating Financial Institutions

1. Bank CenterCredit

4. Established in 1988, BCC ranked fifth bank by asset size in 2015 in Kazakhstan. It focuses on retail and MSME lending, supported by 136 branches. The micro segment includes loans of up to T150 million ($440,000); small enterprises, up to T450 million ($1.34 million); and medium-sized enterprises, up to T1,500 million ($4.47 million). MSME loans grew by 16% (2015) representing 24% of all loans. BCC serves 2,500 clients, with an average loan size of $80,000 equivalent, of which 45% are located in the two largest cities. In the current context, its MSME loans are expected to grow at 1% annually (2016–2018).

5. Bakhytbek Baiseitov holds 31.3% of shares, and Kookmin Bank (incorporated in the Republic of Korea) holds 30.0%, followed by International Finance Corporation (10.0%). BCC is overseen by a supervisory board and a management board, each composed of six experienced bankers. The audit department has 28 staff reporting directly to the supervisory board. The risk management department has 90 staff, of which 30 are engaged in loan workout. Core banking and information technology systems are currently being upgraded with the support of the parent bank Kookmin.

6. BCC's capital adequacy ratio (CAR) has declined from 16.0% (2012) to 14.2% (2015) because of high loan loss provisions. The loan book was T1,039 billion ($3.1 billion) in 2015, of which 20% denominated in foreign currency. Asset quality declined in 2015 as the nonperforming loan (NPL) ratio rose from 12.7% to 13.7%, but improved to 8.0% in March 2016 and is fully covered by provisions with an adequate ratio of net NPLs to total regulatory capital of –5.3% (2015). Since 2012, BCC improved asset quality through loan restructuring, disposition of collateral, and write-offs.[2] Retail and trade account for 60% of NPLs. Profits are low, with a return on average assets (ROAA) of 0.2% (2015).

2. Bank of Astana

7. Established in 2008, BOA ranked 19th by asset size (2015). It focuses on retail and SME lending through eight branches. It increased MSME loans by 40%, which now represent 63% of

[2] Write-offs increased in 2015, supported by tax deductibility. While asset quality remains weak, BCC can be considered conservative. Rating agencies observe that BCC has recognized risks related to the weaker economy, has lower exposure to foreign currency loans (20%) than its peers, and most such loans are classified as problem assets.

its loan book (2015). It serves 370 clients with an average loan size of $90,000. BOA classifies micro-enterprise loans as up to T35 million ($100,000) and small-enterprise loans as up to T350 million ($1 million). Loans outside of Almaty and Astana represented 15% of the loan book, and were mainly in trade and service. BOA is increasing its business with agricultural cooperatives and expanding it to include leasing. It is investing in mobile applications to support origination of loans to SMEs and financial technology start-ups. It estimates an annual 25% MSME loan growth for 2016–2018.

8. BOA is controlled by Tokhtarov Olzhas Tanirbergenovich, who owns 68% of the share capital. BOA is governed by a six-member board of directors and a four-member management board of experienced bankers. BOA's risk management function includes a board risk committee and a 15-staff risk management unit. BOA uses an internal credit rating system, limiting branch approval authority to T5million ($15,000). The compliance department covers AML compliance and reports suspicious transactions to the financial intelligence unit. The audit department conducts audits based on a risk-based audit plan and reports directly to the board of directors.

9. BOA's capital adequacy was moderate with a CAR of 13.9% (2015). Its loan book was T139 billion ($410 million), of which 30% was denominated in foreign currency. Given high loan growth at a compound annual growth rate of 93% (2012–2015), the NPL ratio dropped from 14.2% in 2013 to 3.4% in 2015. NPLs are fully covered by loan loss reserves, and the ratio of net NPLs to total regulatory capital stands at a robust –10.9% (2015). BOA's funding risk is substantial—the 20 largest depositors represent 41% of liabilities (2015). Loan concentration improved but remains high, with the 20 largest exposures representing 62% of loans. Profitability declined in 2015: the ROAA fell to 0.9% (from 1.3% in 2014).

3. Bank Kassa Nova

10. Established in 2009 and ranked 29th by assets (2015), BKN is a very small bank focusing on MSMEs via 23 branches. Its loan book stood at T58.4 billion ($173 million) in 2015, with 25% in foreign currency. MSME loans up to T300 million ($894,000) represent 74% of BKN's loan book, serving 3100 small and micro businesses, with an average loan size of $41,000. Around 50% of such loans are to rural borrowers and 50% to women borrowers. BKN estimates a moderate annual MSME loan growth of 10% in 2016–2018.

11. BKN is fully owned by JSC Nova Leasing, which is controlled by Bulat Utemuratov, who holds 85% of the share capital. As a former senior civil servant with close links to the President of Kazakhstan he is a politically exposed person. ADB integrity due diligence classified the risks as low. BKN has a 17-staff risk management unit, which is considered satisfactory for its business. An internal control unit covers AML/CFT and reports any suspicious transactions. The internal audit department reports directly to the board of directors.

12. BKN's CAR was reported at a satisfactory 21.5% (2015). While well above prudential limits, the CAR is expected to drop in 2016–2018 because of credit growth and narrowing margins, and because loan loss provisioning requirements limit the recapitalization through retained earnings. Asset quality deteriorated as the NPL ratio increased to 3.2% (2015) from 0.9% (2013), and only 47% of NPLs are covered by reserves. The ratio of net NPLs to regulatory capital stood at a significant 6.3% (2015). Profitability (1.2% ROAA) is reported adequate, but expected to decline with increasing loan loss provision requirements. Deposits represent 82% of liabilities and are highly concentrated as the top 10 depositors hold 56%.

4. Nurbank

13. Founded in 1992, Nurbank is ranked 14th by assets and operates through 16 branches. The loan book was T259 billion ($770 million) in 2015, of which 18% was denominated in foreign currency. While MSME loans represented only $177 million or 23% of total loans in 2015, Nurbank plans to expand its MSME business by establishing SME units in each branch and putting in place an MSME lending process.[3] In 2015, it served 790 MSME customers, with an average loan size of $51,000. Around 75% of loans were issued outside of Almaty or Astana in 2015. Nurbank forecasts annual MSME lending growth of 20% in 2016–2018.

14. JP Finance Group, owned by Rashid Sarsenov, controls 84% of the share capital. Nurbank is governed by a three-member supervisory board and a seven-member management board. Except for the chairman, who is the son of the owner of Nurbank, all management board members have strong banking experience. Nurbank has a strong risk management department with 73 staff, including a workout and recovery department with 94 staff. The audit unit follows an annual risk-based audit plan covering all functions of the bank, including branches, and reports directly to the supervisory board. A compliance department carries out AML and CFT functions.

15. With a CAR of 17.6% (2015), Nurbank is moderately capitalized. Asset quality remains poor although the NPL ratio dropped to 23% in 2015, from 33% in 2013, mainly through extensive write-offs and asset recoveries, as well as transfer of problem loans to a special-purpose vehicle. While Nurbank has substantial exposure to the real estate and construction segments and significant restructured loans, NPLs are reasonably covered by reserves. The ratio of net NPL to regulatory capital stood at a solid –9.22%, while Nurbank's profitability is marginal (ROAA of only 0.1% in 2015).

5. Asian Credit Fund – Microfinance Organization

16. Founded in 1997, ACF has four branches and 25 offices across five regions. With a small loan book of T1,919 billion ($5.6 million) and an average loan size of $375 (2015), ACF is targeting subsistence-oriented activities in agriculture. It has close to 15,000 borrowers, and 96% of its loans are outside of the two major cities.

17. The international microfinance network Mercy Corps (50.5%) and Base of Pyramid Asia (47.6%) are the controlling shareholders. ACF has a five-member board and a four-member management. Typical for many MFOs, risk management is not separated from lending. However, since risk is being managed at the head office while loan approvals are made at the branches, a possible conflict of interest is effectively mitigated. An internal control person manages AML/CFT duties and reporting. Internal audit is carried out by one person and supervised by the head of audit of Mercy Corps' subsidiary in Kyrgyzstan.

18. ACF reported an excellent asset quality with an NPL ratio (30 days) of 0.8% (2015). With NPLs fully covered by provisions, the ratio of net NPLs to equity was solid at –0.16%. Profitability is adequate with a 5.2% ROAA (2015) but retained earnings remain limited.

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[3] Nurbank defines the micro and small business segment by exposures up to T300 million ($880,000), and the medium-sized business segment by exposures up to T3 billion ($8.8 million).

6. Bereke – Microfinance Organization

19. Bereke, founded in 2003, has three branches in the eastern region. It has a strong gender and subsistence orientation with an average loan size of $945. Its loan book is very small at T973 million ($2.9 million) and with 4,215 borrowers, all outside of the two major cities.

20. The main owners are Zhumagul Khairlybayeva, Balgaisha Assyrbekova and Raushan Musina, each holding 25% of the shares.[4] Bereke has a four-member board of directors and a seven-member management board. Similar to ACF, risk management is integrated in the credit department at head office while credit origination is carried out at the branches. The risk managers are responsible for meeting NBK's AML/CFT requirements, and basic know-your-customer policies and procedures are in place. This internal control function is carried out by the internal auditor.

21. NPLs were low at 2.9% in 2015. NPLs are almost fully covered by provisions, bringing the ratio of net NPLs to equity to 0.5%. Profitability is low and declining—ROAA at 1.5% (2015)— and will constrain internal capital and loan growth.

7. KazMicroFinance – Microfinance Organization

22. Founded in 2006, KMF is the microfinance market leader in Kazakhstan with 18 branches and 84 sub-branches. It has a strong rural footprint and a focus on serving women and low-income clients. KMF's loan book grew by 24% during 2015, reaching T35.1 billion ($103 million). The number of clients increased by 18% to more than 151,000 in 2015, with an average loan size of $682. All KMF clients are outside the two major cities.

23. The main shareholder is KMF-Demeu (62.5%), which is fully owned by ACDI/VOCA, an American microfinance network. ResponsAbility Management (10%), and Triodos (13.6%) are other significant shareholders. KMF has a five-member supervisory board and a four-member management board. The supervisory board is responsible for controlling risks, supported by the risk committee, audit committee, credit committee, and asset–liability management committee. Risk management policies are reviewed regularly. The audit unit follows an annual risk-based audit plan and reports directly to the supervisory board. The risk unit is responsible for compliance with AML/CFT requirements.

24. NPLs were at a low 2.4% in 2015. However, loan loss provisions are low and consequently the ratio of net NPLs to equity was 3.9%. Given its low loan loss provisions, KMF reports a high albeit declining profitability—the ROAA of 4.2% (2015) is down from 8.1% (2014). Business loans represent 55% of the loan book, followed by agriculture (29%). Group loan products comprise 54% of total loans. KMF expects annual loan growth of 20% for 2016–2018.

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[4] The remaining 25% of the shares is in the hands of 10 individuals, senior management and staff of the institution, each holding 2.5%.