FINANCIAL ANALYSIS

A. Selection of Participating Financial Institutions

1. Financial institutions in Uzbekistan may apply to be a participating financial institution (PFI) in the Small Business Finance Project if they (i) meet Asian Development Bank (ADB) due diligence requirements on financial analysis, financial management systems, and integrity due diligence; (ii) meet ADB requirements for environmental and social management systems; (iii) are willing and able to service the growth of rural and women-owned small businesses in line with the objectives of the project; (iv) comply with the regulatory prudential standards of the Central Bank of Uzbekistan (CBU) and Uzbekistan's laws and regulations on anti-money laundering and combating the financing of terrorism; and (v) comply with the covenants of other ADB projects and programs in which they are engaged (if any).

2. **Participating financial institutions' ability to support project objectives.** ADB selected Hamkorbank, Ipak Yuli Bank (IYB), Davr Bank, and UzbekLeasing International A.O. (ULC) as the PFIs. All PFIs have business strategies reflecting a strong track record and a commitment to serving rural and women-owned small businesses. Hamkorbank is fully privately owned. It has a strong regional footprint, with 95% of its loans booked outside the capital. It serves nearly 22,000 borrowers, including about 6,000 women, with an average loan size of $12,900. IYB, in which ADB holds 13.4% of the share capital, has 75% private ownership. Relative to Hamkorbank, IYB caters to the upper small business client segment, with 62% of its loans booked in the regions outside the capital and an average loan size of $54,100. Davr Bank, a local private bank, has a growing small business focus and aims to expand its lending outside the capital. It provides loans at an average size of $42,700. ULC is 49% privately owned. It is a leasing company with 72% of its leases booked outside the capital, with an average lease size of $117,000. Competition among lenders that use alternative strategies and distribution channels benefits small businesses. The PFIs have acceptable corporate governance, sound risk management practices, and transparent financial disclosure policies.

3. **Prudential regulations.** The CBU confirmed that by the end of 2015, all PFIs were in compliance with prudential and regulatory ratios including those relating to capital adequacy, liquidity, loan losses, open foreign currency positions. The regulatory capital adequacy ratio was increased from 10.0% to 11.5% effective 1 January 2016 as part of the adoption of Basel III standards. According to the CBU, further increases in the capital adequacy ratio are scheduled for 2017 (12.5%), 2018 (13.5%), and 2019 (14.5%) effective from 1 January of each year.

4. **ADB's financial covenants.** The selected PFIs comply with all ADB's financial covenants, as summarized in Table 1.

Table 1: Financial Covenant Compliance, 2015

Covenant	Ratio	Davr Bank	Hamkor bank	IYB	ULC
Return on average assets ratio (%)	≥ 1	6.6	3.8	2.3	10.3
Ratio of total nonperforming loans to total loans (%)	< 5	0.3	0.2	2.1	0.1
Maximum amount of risk on loans given to one insider (% of capital)	< 25	0.1	6.9	3.5	0.0

IYB = Ipak Yuli Bank, ULC = UzbekLeasing International A.O.
Source: Asian Development Bank staff.

5. The financial management assessment indicated that (i) all PFIs prepare their financial statements in accordance with International Financial Reporting Standards, (ii) each PFI has an

internal audit unit with an independent reporting structure, (iii) financial statements are audited by reputable internationally affiliated audit firms, (iv) formal risk management units exist, and (v) capital adequacy ratios are above regulatory requirements. ADB due diligence has identified weaknesses regarding internal audit, risk management, and accounting.

6. **Integrity due diligence**. All PFIs met the ADB's requirements on integrity due diligence, the results of which were endorsed by ADB's Office of Anticorruption and Integrity. In addition, the CBU confirmed compliance of all PFIs with national legal requirements related to anti-money laundering and/or combating the financing of terrorism.

7. **Environmental and social management system**. Hamkorbank and IYB have environmental and social management systems that satisfy ADB's Safeguard Policy Statement (2009). Davr Bank and ULC are required to establish environmental and social management systems that satisfy the Safeguard Policy Statement prior to loan disbursement to them.

B. Financial Analysis of Participating Financial Institutions

1. Hamkorbank

8. **Ownership.** Established in 1991, Hamkorbank is currently the only bank in Uzbekistan that has at least 30% foreign ownership (15% owned by the International Finance Corporation and 15% by the Netherlands Development Finance Company).

9. **Capital**. Hamkorbank's capital adequacy comfortably exceeds the regulatory prudential norms of the CBU, with its capital adequacy ratio (CAR) of 13.6% in 2015 well above the regulatory minimum of 10.0%. Hamkorbank raises capital through retained earnings and the issuance of new shares.

10. **Loan portfolio and asset quality.** Hamkorbank has a strong regional footprint, with 95% of its loans booked outside the capital. It serves nearly 22,000 borrowers with an average loan size of $12,900. Its loan book grew rapidly in 2014 and 2015, achieving 80% growth in 2014 and 41% growth in 2015. Loans to small businesses constituted 48% of Hamkorbank's total loans in 2015. Hamkorbank expects its small business loan book ($284 million in 2015) to grow at a compound annual growth rate of 25% by 2021, compared with 35% during 2012–2015. Hamkorbank's asset quality is sound, with a 0.2% nonperforming loan (NPL) ratio in 2015.[1] Its loan loss reserve (LLR) coverage remained satisfactory, representing 107.7% of NPLs in 2015.

11. **Profitability, funding, and liquidity**. Hamkorbank is highly profitable. Net income increased by 55% to $34 million in 2015 compared to 2014 fueled by its robust loan growth and a stable net interest margin of 7.4%. Return on assets (ROA) improved to 3.8% in 2015 from 3.7% in 2014 and its efficiency measured by a drop in the cost-to-income ratio from 69.7% in 2012 to 57.5% in 2015 improved as well. Hamkorbank sources 70% of its funding through deposits and supplements the remainder through foreign and domestic borrowings.

12. **Corporate governance**. Hamkorbank has a strong corporate governance structure in place, with seven independent directors out of nine directors on its supervisory board. All directors have solid financial sector experience. Board committees include the following: (i) risk management and internal audit, (ii) strategic planning and forecasting, and (iii) nomination and

[1] Loans with payments overdue by more than 90 days are considered nonperforming.

remuneration. The board is overseen by a commission comprised of three individuals representing shareholders. The two foreign shareholders have supported Hamkorbank to improve its corporate governance system.

13. **Risk management**. Hamkorbank's risk management function is adequate, with a strong risk management structure and well-defined policies and procedures. Its risk management department manages risk exposure and prudential limits supported by a dedicated information system. Hamkorbank conducts stress tests quarterly on liquidity, foreign exchange, interest rate, and credit risk.

2. Ipak Yuli Bank

14. **Ownership**. Incorporated in 1990, IYB is 75% owned by private and foreign shareholders. Since April 2013, ADB has held 13.4% of the bank's share capital. Another foreign shareholder, ECC-Bimas, holds 1.5% of the bank's share capital.

15. **Capital**. IYB's CAR was 12.6% as of 2015, down from 16.2% in 2013 but above the regulatory requirement of 10%. The decline reflects the increase of 90% in risk-weighted assets on the back of a growing loan book, compared with a 55% increase in total capital.

16. **Loan portfolio and asset quality**. Relative to Hamkorbank, IYB caters to the upper small business client segment, with 62% of its loans booked in the regions outside the capital and an average loan size of $54,100. Its small business loan portfolio ($271 million in 2015) comprised 78% of the total loan portfolio and is targeted to grow at a compound annual growth rate of 20% by 2021. With 40% of small business loans issued outside the capital, IYB plans to increase its rural coverage through expansion of a regional branch network and e-banking. The bank's portfolio quality is satisfactory, having improved from the end of 2013 (NPL ratio of 2.8% of gross loans) to the end of 2015 (NPL ratio of 2.1% of gross loans). LLR coverage of NPLs comprised a very comfortable 190.0% in 2015 and 215.4% in 2014, up from 124.7% in 2013.

17. **Profitability, funding, and liquidity**. IYB's profitability is strong, with an ROA of 2.3% and a return on equity (ROE) of 24.5% in 2015, supported by a solid net interest margin and fee-based earnings. Net income increased to $13 million in 2015 from $11 million in 2014. IYB has a stable funding profile, with customer deposits representing 80% of total funding and foreign borrowings representing 17% of total funding in 2015.

18. **Corporate governance**. IYB's board of directors has nine members, seven of which have prior banking, insurance, and investment services experience. The board supervises IYB's compliance with its internal policies and procedures. Board audit, risk management, remuneration, and corporate governance committees support the board functions. The head of the internal audit department reports to the audit committee, while the head of risk management reports to the chief executive officer.

19. **Risk management**. IYB's risk management is adequate. With support of ADB technical assistance, IYB has improved the scoring system for micro and consumer loans. In 2016, IYB plans to install data and credit management systems.

3. Davr Bank

20. **Ownership**. Davr Bank is a private bank incorporated in 2001. The shareholders are individual businessmen.

21. **Capital**. Davr Bank's CAR was 21.8% in 2015, down from 22.0% at the end of 2014. This reduction reflects only a 22% rise in total capital compared to a 71% rise in risk-weighted assets driven by the strong loan growth. Although Davr Bank forecasts an average CAR of 19.7% during 2016–2019 due to expected solid profitability and the issuance of new shares, its high growth strategy may put pressure on capital adequacy.

22. **Loan portfolio and asset quality**. Although it has a small market share of 0.3%, Davr Bank is expanding its micro and small enterprise loan portfolio. It provides loans at an average size of $42,700. Its small business loan book ($43.5 million in 2015) is expected to grow at a CAGR of 25% by 2021, compared with 58% during 2012–2015. Asset quality is satisfactory, with a NPL ratio of 0.3% and LLR coverage at 110% of NPLs in 2015.

23. **Profitability, funding, and liquidity**. Fueled by higher fee and commission income, Davr Bank recorded high profitability and efficiency in 2015, with an ROA of 6.6% and ROE of 33.0%. Net income increased to $4.7 million in 2015 from $3.3 million in 2012. Davr Bank sources its funding primarily through customer deposits, which made up 82.7% of total funding in 2015, and so far its funding is entirely in local currency.

24. **Corporate governance**. The supervisory board is comprised of five members with adequate qualifications in the financial sector. Board members are elected for 1-year term. The supervisory board has six committees: audit, investment, human resources, credit, risk management, and assets and liability management. The head of the internal audit department reports directly to the audit committee of the supervisory board. The head of the risk management department reports to the chief executive officer. Deposits are the bank's primary funding source, making up 82.7% of total funding as of the end of 2015.

25. **Risk Management**. Davr Bank's risk management capacity is evolving with the development of risk management procedures. The bank is planning to purchase advanced risk management software and improve its risk management function through the hiring and training of qualified staff.

4. UzbekLeasing International A.O.

26. **Ownership**. Incorporated in 1996, ULC is the third-largest lessor in Uzbekistan. Its shareholders are the National Bank of Uzbekistan for Foreign Economic Activity (41.6%), Malayan Banking (19.7%), and Uzbek-Oman Investment Company (38.7%).

27. **Capital**. ULC's CAR in 2015 was a robust 40.9%, allowing enough room for growth and a cushion against credit losses. In 2015, ULC raised capital through the issuance of new shares.

28. **Loan portfolio and asset quality.** ULC's leasing finance is mostly booked in the regions outside Tashkent (72%), with an average deal size of $117,000. Almost 90% of finance leases are provided to small and medium-sized enterprises, with 44% of leases extended to small businesses engaged in manufacturing. About 10% of ULC's lease portfolio is disbursed to women-owned businesses. ULC's lease portfolio is expected to grow by an average annual rate of 35%, increasing from $45.7 million in 2015 to $140 million in 2019. ULC's asset quality is strong, with an NPL ratio of 0.1% and LLR at 100% in 2015.

29. **Profitability, funding, and liquidity.** ULC's profitability is high, with an ROA of 10.3% and ROE of 27.7% in 2015 resulting from its high net interest margin and its high pricing power. Borrowings from its shareholders and from international financial institutions constitute 75% of total funding. Its net income has increased almost six times since 2012 and increased by 81.2% in 2015 compared to 2014. The company's cost-to-income ratio decreased steadily from 86.1% in 2012 to 47.2% in 2015 as a result of improved efficiency.

30. **Corporate governance.** The company has developed detailed regulations for its supervisory and management boards. The roles and responsibilities of board each member are clearly defined. The supervisory board meets every quarter and special meetings are held more frequently in order to approve transactions above $600,000. The supervisory board consists of five members with extensive track records in the banking sector. Board members are elected at the general meeting of shareholders for 1-year terms. The board has an audit committee.

31. **Risk management.** ULC is regulated by the Ministry of Finance. Its risk management system was developed with support of the European Bank for Reconstruction and Development and the International Finance Corporation. There is high key-man risk, as key functions in the company are staffed by only one or a few specialists. ULC is planning to hire more qualified risk management staff. Currently, ULC does not back up its information technology system off-site; however, it is planning to establish an off-site backup system in the second half of 2016.

C. Financial Projections

32. The financial projections prepared by the PFIs for 2016–2021 estimate an annual growth of eligible loans of 22% reaching SUM6.0 trillion, up from SUM1.8 trillion. The increase indicates an estimated demand for eligible loans of SUM4.2 trillion. The loan amount of $100 million represents 21% of the estimated demand for eligible loans. The indicative financial performance ratios are summarized in Table 2, showing an expected satisfactory performance of the PFIs.

Table 2: Participating Financial Institutions, Indicative Financial Performance Ratios (%)

Year	2013 (actual)	2014 (actual)	2015 (actual)	2016 (projected)	2017 (projected)	2018 (projected)	2019 (projected)	2020 (projected)	2021 (projected)
Ipak Yuli Bank									
CAR	16	14	12.6	12	13	14	15	15	15
ROAA	2	2	2.3	2	2	2	2	2	2
NPL	3.6	1.5	2.1	1.5	1.5	1.3	1.2	1.1	1.1
Hamkorbank									
CAR	20	15	13.6	14	14	15	16	16	16
ROAA	4	4	3.8	4	4	4	4	4	4
NPL	0.2	0.6	0.2	0.6	0.6	0.5	0.5	0.6	0.6
Davr Bank									
CAR	33	22	21.8	20	19	19	20	20	20
ROAA	11	8	6.6	6	6	6	6	6	6
NPL	0.1	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4
UzbekLeasing International A.O. [a]									
CAR	40	29	40.9	39	38	35	34	32	31
ROAA	9	10	10.3	9	9	9	10	10	10
NPL	1.9	0.9	0.1	2.2	2.2	2.2	2.2	2.2	2.2

CAR = capital adequacy ratio, NPL = nonperforming loan, ROAA = return on average assets.
Note: Loans with payments overdue by more than 90 days are considered nonperforming.
[a] CAR of the leasing company is defined as capital to total assets.
Source: Medium-term Business Development Plans of participating financial institutions.