



# Completion Report

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Project Number: 44060-024  
Loan Number: 3093  
September 2018

## Kazakhstan: Small and Medium Enterprise Investment Program (Tranche 2)

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**Asian Development Bank**

## CURRENCY EQUIVALENTS

Currency unit – tenge (T)

|        |   | <b>At Appraisal</b><br>(24 July 2013) | <b>At Project Completion</b><br>(28 December 2015) |
|--------|---|---------------------------------------|--|
| T1.00  | = | \$0.0065                              | \$0.0031   |
| \$1.00 | = | T153.17                               | T326.38  |

## ABBREVIATIONS

|          |   |  |
|----------|---|--|
| ADB      | – | Asian Development Bank                           |
| Baiterek | – | Baiterek National Management Holding JSC         |
| BCC      | – | Bank CenterCredit                                |
| CAGR     | – | compound annual growth rate                      |
| Damu     | – | Damu Entrepreneurship Development Fund           |
| DMF      | – | design and monitoring framework                  |
| EBRD     | – | European Bank for Reconstruction and Development |
| ESMS     | – | environmental and social management system       |
| FFA      | – | framework financing agreement                    |
| GAP      | – | gender action plan                               |
| IFRS     | – | International Financial Reporting Standards      |
| JSC      | – | Joint Stock Company                              |
| MFF      | – | multitranches financing facility                 |
| MFI      | – | microfinance institution                         |
| NBK      | – | National Bank of Kazakhstan                      |
| NIM      | – | net interest margin                              |
| NPL      | – | nonperforming loan                               |
| PFI      | – | participating financial institution              |
| S&P      | – | Standard & Poor's                                |
| SLA      | – | subsidiary loan agreement                        |
| SMEs     | – | small and medium-sized enterprises               |
| SPS      | – | Safeguard Policy Statement                       |
| SPV      | – | special purpose vehicle                          |
| TA       | – | technical assistance                             |
| TSB      | – | Tsesnabank                                       |

## NOTES

- (i) In this report, "\$" refers to United States dollars.

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## BASIC DATA

### A. Loan Identification

|    |   |  |
|----|---|--|
| 1. | Country                                       | Kazakhstan   |
| 2. | Loan number and financing source              | 3093, Ordinary Capital Resources                         |
| 3. | Loan title                                    | Small and Medium Enterprise Investment Program Tranche 2 |
| 4. | Borrower                                      | Entrepreneurship Development Fund (Damu)                 |
| 5. | Names of participating financial institutions | Bank CenterCredit, Tsesnabank                            |
| 6. | Amount of loan                                | \$122,000,000  |
| 7. | Project completion report number              | 1714   |

### B. Loan Data

|    |                               |   |
|----|-------------------------------|---|
| 1. | Appraisal                     |   |
|    | – Date started                | 11 December 2012                                      |
|    | – Date completed              | 24 July 2013  |
| 2. | Loan negotiations             |   |
|    | – Date started                | 11 November 2013                                      |
|    | – Date completed              | 27 November 2013                                      |
| 3. | Date of President's approval  | 13 December 2013                                      |
| 4. | Date of loan agreement        | 13 December 2013                                      |
| 5. | Date of loan effectiveness    |   |
|    | – In loan agreement           | 25 November 2014                                      |
|    | – Actual                      | 25 November 2014                                      |
|    | – Number of extensions        | 0   |
| 6. | Terminal date for commitments |   |
|    | – In loan agreement           | 28 December 2015                                      |
|    | – Actual                      | 28 June 2016  |
|    | – Number of extensions        | 1   |
| 7. | Loan closing date             |   |
|    | – In loan agreement           | 28 December 2015                                      |
|    | – Actual                      | 28 June 2016  |
|    | – Number of extensions        | 1   |
| 8. | Financial closing date        |   |
|    | – Actual                      | 9 November 2016                                       |
| 9. | Terms to the borrower         |   |
|    | – Interest rate               | 6-month London Interbank Offered Rate (LIBOR) + 0.40% |

- Maturity (number of years) 5
  - Grace period (number of years) 5
  - Repayment terms All principal to be repaid at maturity
10. Terms of relending (if any)
- Interest rate 7.00%
  - 5
  - Maturity (number of years) 5
  - Grace period (number of years) All principal to be repaid at maturity
  - Repayment terms
11. Interest rate for subloans Determined for each subloan by the participating commercial banks (average of 14%–15%)
12. Disbursements

## a. Dates

|   |   |                                     |
|---|---|-------------------------------------|
| <b>Initial Disbursement</b><br>26 November 2014 | <b>Final Disbursement</b><br>26 November 2014 | <b>Time Interval</b><br>0 months    |
| <b>Effective Date</b><br>25 November 2014       | <b>Actual Closing Date</b><br>9 November 2016 | <b>Time Interval</b><br>23.5 months |

## b. Amount (\$ '000)

| Category<br>Subloan        | Original<br>Allocation<br>(1) | Increased<br>during<br>Implementation<br>(2) | Cancelled<br>during<br>Implementation<br>(3) | Last<br>Revised<br>Allocation<br>(4=1+2-3) | Amount<br>Disbursed<br>(5) | Undisburse<br>d Balance<br>(6 = 4 - 5) |
|----------------------------|-------------------------------|--|--|--|----------------------------|--|
| Bank                       | 61,000                        | -  | -  | -  | 61,000                     | -                                      |
| CenterCredit<br>Tsesnabank | 61,000                        | -  | -  | -  | 61,000                     | -                                      |
| <b>Total</b>               | <b>122,000</b>                |  |  |  | <b>122,000</b>             |  |

**C. Implementation Data<sup>1</sup>**

1. Number of subloans 1,326
2. Sector distribution of subloans

| Sector                      | Projected | Actual<br>(T million) |
|-----------------------------|-----------|-----------------------|
| Industry (production)       | ...       | 3,187.56              |
| Services                    | ...       | 7,407.35              |
| Agriculture                 | ...       | 1,350.57              |
| Trade                       | ...       | 18,220.70             |
| Transport and Communication | ...       | 1,002.51              |
| Construction                | ...       | 1,439.48              |
| <b>Total</b>                |           | <b>32,608.17</b>      |

<sup>1</sup> As of 1 November 2017.



## 3. Size of subloans

| <b>Range</b>                  | <b>Number of Subloans</b> | <b>Aggregate Amount</b><br>(T million) |
|-------------------------------|---------------------------|--|
| Up to T999,999                | ...                       | 19.84                                  |
| From T1,000,000 to T1,999,999 | ...                       | 116.23                                 |
| From T2,000,000 to T4,999,999 | ...                       | 932.89                                 |
| Over T5,000,000               | ...                       | 31,539.21                              |
| <b>Total</b>                  | <b>1,326</b>              | <b>32,608.17</b>                       |

## 4. Other breakdown of subloans

| <b>Criteria</b>               | <b>Projected</b> | <b>Actual</b><br>(T million) |
|-------------------------------|------------------|------------------------------|
| Investments                   | ...              |                              |
| Working capital replenishment | ...              | 20,820.99                    |
| Refinancing                   | ...              | 3,005.89                     |
| Investments + working capital | ...              | 1.40                         |
| <b>Total</b>                  |                  | <b>32,608.17</b>             |

| <b>Criteria</b>                        | <b>Projected</b> | <b>Actual</b><br>(T million) |
|--|------------------|------------------------------|
| Loans issued outside Almaty and Astana | ...              | 21,220.17                    |
| Loans issued in Almaty and Astana      | ...              | 11,388.00                    |
| <b>Total</b>                           |                  | <b>32,608.17</b>             |

| <b>Criteria</b>                     | <b>Projected</b> | <b>Actual</b><br>(T million) |
|-------------------------------------|------------------|------------------------------|
| Loans issued to women entrepreneurs | ...              | 4,260.00                     |
| Loans issued to male entrepreneurs  | ...              | 28,348.17                    |
| <b>Total</b>                        |                  | <b>32,608.17</b>             |

| <b>Tenor</b>      | <b>Aggregate Number</b> | <b>Amount</b><br>(T million) |
|-------------------|-------------------------|------------------------------|
| Up to 1 year      | ...                     | 16,720.78                    |
| From 1 to 3 years | ...                     | 7,223.97                     |
| From 3 to 5 years | ...                     | 6,142.50                     |
| Over 5 years      | ...                     | 2,520.92                     |
| <b>Total</b>      | <b>1,326</b>            | <b>32,608.17</b>             |

## 5. Project performance report ratings

| <b>Implementation Period</b>              | <b>Ratings</b>                |                                |
|---|-------------------------------|--------------------------------|
|   | <b>Development Objectives</b> | <b>Implementation Progress</b> |
| From 1 July 2016 to 30 September 2016     | Potential problem             | Potential problem              |
| From 1 April 2016 to 30 June 2016         | Potential problem             | Potential problem              |
| From 1 January 2016 to 31 March 2016      | On track                      | On track                       |
| From 1 October 2015 to 31 December 2015   | On track                      | On track                       |
| From 1 July 2015 to 30 September 2015     | On track                      | On track                       |
| From 1 April 2015 to 30 June 2015         | Potential problem             | Potential problem              |
| From 1 January 2015 to 31 March 2015      | Potential problem             | Potential problem              |
| From 25 November 2014 to 31 December 2014 | On track                      | On track                       |

**D. Data on Asian Development Bank Missions**

| <b>Name of Mission</b>      | <b>Date</b>          | <b>No. of Persons</b> | <b>No. of Person-Days<sup>a</sup></b> | <b>Specialization of Members</b> |
|-----------------------------|----------------------|-----------------------|---------------------------------------|----------------------------------|
| Project Completion Review   | 3–7 October 2016     | 1                     | 5                                     | a                                |
| Midterm Project Review      | 14–18 September 2015 | 6                     | 24                                    | a, b, d, e, f, g                 |
| Loan Review                 | 12–21 May 2015       | 2                     | 18                                    | a, d                             |
| Loan Inception              | 13–17 October 2014   | 7                     | 28                                    | a, b, c, e, f, h                 |
| Special Loan Administration | 9–14 April 2014      | 4                     | 20                                    | a, a, i, c                       |

a = financial sector specialist, b = project analyst, c = economics officer, d = economist, e = gender specialist, f = environment specialist, g = social development specialist, h = staff consultant, i = treasury specialist.

Note: Staff of the Kazakhstan Resident Mission supported all missions.

<sup>a</sup> Some missions covered multiple projects. This column contains estimates of the number of person-days utilized for the tranche 2 project.

## I. PROJECT DESCRIPTION

1. On 29 September 2010, the Asian Development Bank (ADB) approved the Small and Medium Enterprise Investment Program in Kazakhstan, a multitranche financing facility (MFF) for \$500 million.<sup>1</sup> The investment program was designed to provide a financial intermediation loan to Damu Entrepreneurship Development Fund (Damu), guaranteed by the Government of Kazakhstan, to be onlent by participating financial institutions (PFIs) to small and medium-sized enterprises (SMEs). Limited access to medium-term credit was a key constraint in the development of SMEs, restraining their ability to exploit investment opportunities, increase employment, and contribute to sustainable growth. The investment program's expected impact was sustained job creation and economic growth, and the expected outcome was increased access by SMEs to medium-term credit on a sustainable basis.

2. The MFF was structured into three tranches each with specific DMF goals. The tranche 1 loan of \$150 million was signed on 21 September 2011, became effective on 28 September 2011, and closed on 27 June 2014; the loan, which was relent to three PFIs (Bank Center Credit [BCC], Kazkommertsbank, and Alliance Bank), was fully repaid in August 2016. The tranche 2 loan of \$122 million was signed on 29 October 2014, declared effective on 25 November 2014, and closed on 9 November 2016. The loan, whose maturity date is 15 October 2019, was relent in equal portions to BCC and Tsesnabank (TSB).<sup>2</sup> The tranche 3 loan of \$228 million was signed on 11 September 2015, declared effective on 9 October 2015, closed on 8 December 2017, and matures on 15 September 2020. It was relent to Delta Bank, Kazinvestbank, and TSB.

3. The expected impact of tranche 2 was sustained job creation and economic growth, and the expected outcome was increased access by SMEs to medium-term credit on a sustainable basis. Tranche 2's expected outputs were (i) medium-term financing to SMEs and (ii) improved financial sector outreach with focus on women entrepreneurs. Tranche 2 was categorized *financial intermediary* for environment and social safeguards.

## II. PROJECT DESIGN

### A. History

4. Damu is the state agency tasked with supporting the development of SMEs. It implements the government's credit programs for SMEs and provides nonfinancial support through information services, training, and consulting services. Prior to May 2013, the sole shareholder of Damu was the Samruk-Kazyna Sovereign Welfare Fund (Samruk-Kazyna). Ownership was transferred to Baiterek National Management Holding (Baiterek) on 22 May 2013. Damu is ultimately controlled by the Government of Kazakhstan and reports to the Ministry of National Economy.

5. In 2014, Damu obtained a rating of BBB+ (the same as the sovereign rating of Kazakhstan) from Standard and Poor's (S&P). From January 2015 to June 2017, S&P downgraded Damu in three steps to BB+ with a negative outlook, mirroring the country's sovereign rating downgrade. In September 2017, S&P affirmed its rating but changed its outlook

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<sup>1</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to the Republic of Kazakhstan for the Small and Medium Enterprise Investment Program*. Manila.

<sup>2</sup> The original amount of the tranche 2 loan requested by Damu and approved by the President was \$150 million equivalent in tenge. ADB. 2013. *Periodic Financing Request Report for Small and Medium Enterprise Investment Program Tranche 2*. Manila. The amount was subsequently reduced to \$122 million and the currency of the loan was changed from tenge to US dollars. Loan was sourced from ordinary capital resources.

to positive, reflecting increased confidence in the government's willingness to provide support, if needed, based on Damu's important role and strong link with the government.

## **B. Scope of Operations**

6. Damu provides support to Kazakh SMEs through four main instruments: (i) credit lines in local currency to SMEs through banks, microfinance institutions (MFIs), and leasing companies; (ii) interest rate rebates to eligible SMEs;<sup>3</sup> (iii) loan guarantees covering up to 85% of the eligible SME subloan amount; and (iv) nonfinancial support to SMEs through information and analytical services, training, and consulting.

## **C. Relationship with ADB and Other Lenders**

7. ADB, Damu, and the Government of Kazakhstan signed a framework financing agreement (FFA) for the MFF in September 2010. On 12 February 2014, the three parties signed an amendment to the FFA which (i) made minor revisions to the design and monitoring framework (DMF) and extended the end of expected implementation period from 2015 to 2018; (ii) confirmed that Damu can charge market-based margins on the subloans to PFIs; (iii) widened the range of permitted activities to be funded; and (iv) allowed ADB to extend foreign currency-denominated loans to Damu provided that acceptable hedging arrangements were in place.

8. ADB approved a second project with Damu, the Supporting Resilience of Micro, Small, and Medium-Sized Enterprises Finance Project, on 27 October 2016 in the amount of \$200 million.<sup>4</sup> The project was declared effective in November 2017 with the first disbursement in December 2017.

9. As of 31 December 2017, ADB was the only active foreign lender to Damu, with outstanding exposure at T72 billion, or 33% of Damu's total borrowings. All other Damu borrowings were from domestic sources, including T97 billion from its sole shareholder, Baiterek.

10. Starting in 2015, Damu issued guarantees totaling T50.2 billion to the European Bank for Reconstruction and Development (EBRD) in connection with loans by EBRD to BCC, Kassa Nova Bank, and KazMicroFinance (an MFI). In November 2016, Damu signed a €200 million financing agreement with the European Investment Bank; however, as of end June 2018, no disbursements had been made to Damu under this agreement.

## **D. Project Design and Formulation**

11. The Kazakh economy is highly dependent on large enterprises in the extractive industries; the contribution of SMEs to GDP is less than 20%. For more than 20 years, the government has recognized the importance of SMEs in supporting the country's long-term economic growth, creating employment, and generating innovation that can contribute to economic diversification. To help address the barriers faced by SMEs, in 2010 the government issued the *Roadmap for Business 2020* and the *Accelerated Industrial-Innovative Development of Kazakhstan*. Limited access to medium-term credit has been identified as one of the constraints to the development of SMEs. The government initially addressed this constraint by providing Damu with funds to make direct loans to SMEs from 1997 to 2009. Due to losses on these loans, Damu switched to

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<sup>3</sup> SMEs can claim interest rate rebates of 10% on capital investment loans and 7% on working capital loans.

<sup>4</sup> ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranchise Financing Facility to the Republic of Kazakhstan for the Small and Medium Enterprise Investment Program*. Manila.

providing credit facilities to partner banks starting in 2009. Under these facilities, partner banks extend loans to SMEs at the interest rate approved for each facility by the Ministry of National Economy.<sup>5</sup>

12. In the decade before the global financial crisis of 2007–2008, Kazakh banks used increasing amounts of foreign borrowings to fund their loan growth.<sup>6</sup> After they were cut off from international financial markets during the crisis, they contracted their activities, including SME lending. The situation was aggravated by an increase in problem loans from 7.1% in 2008 to 20.7% in 2011 and 19.5% in 2013, falling to 12.4% in 2014.<sup>7</sup> In 2014, Kazakhstan shifted to a floating exchange rate regime, which resulted in a 120% decline in the value of the tenge against the US dollar in 2014–2015. The exchange rate volatility led to (i) an increase in the percentage of foreign currency deposits, from 44% at the end of 2013 to more than 65% by the end of 2015;<sup>8</sup> and (ii) an increase in problem loans and a further contraction of banks' balance sheets (and loan portfolios) since commercial banks and their borrowers had significant unhedged foreign currency exposure. Bank loans contracted by 47% and SME loans fell by 22% during 2013–2015.

13. The tranche 2 was designed as Financial Intermediation Loan (FIL) to address the shortage of domestically mobilized resources (including both deposits and the capital markets) for medium-term lending to SMEs in local currency.<sup>9</sup> Two Kazakh banks, BCC and TSB, were selected as the PFIs for tranche 2 based on their relatively good financial standing and strong commitment to develop SME lending. Tranche 2 aimed to deliver (i) medium-term financing to SMEs and (ii) improved financial outreach, with focus on women entrepreneurs. Other constraints to the development of SME finance like poor development of capital market, limited availability of lease financing to SMEs, Kazakh banks' reluctance to lend to SMEs (and prioritization of lending to corporate and state-owned enterprises) were out of the scope of tranche 2. The project was categorized as effective gender mainstreaming with two DMF output indicators (out of four) targeting promotion of gender equality. The project included comprehensive gender action plan (GAP). Appendix 3 includes more details on the project's gender features and the GAP implementation matrix.

### III. PROJECT IMPLEMENTATION

#### A. Lending Policies

14. As the operator of the government's SME support programs, Damu allocates funds in response to the government's sector preferences and geographic priorities. As of 1 July 2018,

<sup>5</sup> Under the FFA, the interest rate applicable to each subloan funded under the MFF is not prescribed by the Ministry of National Economy but is instead set by each PFI based on the borrower's creditworthiness and market conditions.

<sup>6</sup> These foreign borrowings included credit facilities provided by ADB to four banks through its non-sovereign lending window: (i) Alliance Bank (2006, \$100 million partial credit guarantee and \$50 million loan); (ii) BCC (2007, T6 billion loan funded by a private placement of a tenge-linked offshore bond); (iii) BTA Bank (2006, \$75 million loan); and (iv) Kazkommertsbank (2007, \$100 million partial credit guarantee). The loan to BCC and two partial credit guarantees to Kazkommertsbank and Alliance Bank were fully repaid. The loans to Alliance Bank and BTA Bank were restructured and had to be partially written off. ADB's current nonsovereign support to banks and SME development is limited to uncommitted, short-term trade-related credit guarantee facilities to BCC and TSB through the Trade Finance Program.

<sup>7</sup> National Bank of Kazakhstan. Indicators of Financial Sustainability. Available at [ww.nationalbank.kz](http://ww.nationalbank.kz). In 2017, the International Monetary Fund estimated that NPLs had increased to 40% of gross loans. International Monetary Fund. *Republic of Kazakhstan: 2017 Article IV Consultation- Press Release; and Staff Report*. 2017. Washington DC.

<sup>8</sup> Footnote 6.

<sup>9</sup> The tranche 1 loan and the subsidiary loan agreements with the PFIs were denominated in tenge. While the tranche 2 and tranche 3 loans and the related subsidiary loan agreements were denominated in US dollars, the PFIs hedged their US dollar exposure through swaps provided by NBK.

Damu had provided loans to 21 out of 33 commercial banks and five out of 638 MFIs. In accordance with its credit policy, which is approved by Baiterek, Damu sets a limit on its exposure to each partner institution. The limits are based on a rating model that takes into account the institution's capital, liquidity, profitability, asset quality, and access to funding. The maximum amount that Damu can extend to any single institution is capped at Damu's equity, although exceptions can be made on a case-by-case basis if permitted by Baiterek.

## B. Characteristics of Subloans

15. BCC and TSB relatively had a broad discretion on the characteristics of the subloans to be financed under tranche 2. Any Kazakh SME was eligible to receive a subloan provided that it was considered a SME<sup>10</sup> under the Law on Private Entrepreneurship and is not engaged in the activities identified in ADB's prohibited activities list. Subprojects to be financed by subloans had to be screened for environmental and social impact.<sup>11</sup> The subloan should be for business purposes, denominated in tenge, charge interest at a market rate, and have a repayment period no longer than 36 months if used for working capital, or 84 months if used for capital expenditures. At least 24% of the total principal amount of subloans were to be made to women entrepreneurs. No SME or group of related SMEs was permitted to borrow more than T550 million (the local currency equivalent of \$3 million at the time of tranche approval). The share of subloans used for refinancing should also not exceed 15%. BCC and TSB likewise, had to use their best efforts to ensure that at least 50% of the subloans were used for investment purposes and that at least 40% went to SMEs outside of Almaty and Astana.

16. As of the end of August 2016, BCC and TSB complied with all of the subloan requirements and targets with three exceptions: (i) TSB's share of refinancing loans exceeded the 15% cap by 4%; (ii) BCC and TSB both issued less than 50% of the subloans for investment purposes, with TSB missing the target by a much wider margin than BCC; and (iii) both banks issued less than 30% of the subloans to women entrepreneurs (Table 1). The PFIs reported that there is a high demand for SME loans. However, the existence of government subsidized lending programs such as those offered by KazAgroFinance<sup>12</sup> and Damu-Ondiris<sup>13</sup> affected their outreach efforts, particularly on potential clients with capital investment needs. Failure to meet the women's subloans target was partly due to the PFIs' insufficient experience in marketing of gender-tailored loans in the absence of ADB support.<sup>14</sup>

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<sup>10</sup> Differentiation between small and medium businesses is done based on number of employees and their annual asset values. For small businesses, number of employees should not exceed 50 people and assets value should not exceed 62,000 monthly calculation indexes (index used for accrual of pensions, fines, social benefits). For medium businesses, annual asset value must be more than 325,000 monthly calculation indexes, while the number of employees should be between 51 and 250 people

<sup>11</sup> The banks were required to submit semiannual environmental and social management reports; they complied with this requirement.

<sup>12</sup> State agency tasked to support agriculture sector in Kazakhstan. [http://www.kaf.kz/about/general\\_information/](http://www.kaf.kz/about/general_information/)

<sup>13</sup> This program supports SMEs in manufacturing sector by providing subsidized loans. For more details on this loan program please follow <https://damu.kz/upload/%D0%9F%D1%80%D0%B5%D0%B7%D0%B5%D0%BD%D1%82%D0%B0%D1%86%D0%B8%D1%8F%20%D0%94%D0%B0%D0%BC%D1%83%20%D0%9E%D0%BD%D0%B4%D0%B8%D1%80%D0%B8%D1%81%20ru.pdf>

<sup>14</sup> Another Kazakh bank, ForteBank, successfully implements a gender-tailored lending program under the EBRD Women in Business program. Unlike the loans made under the MFF, the EBRD loan is complemented by extensive technical assistance on (i) the development of sustainable credit mechanisms targeting women-led SMEs; and (ii) technical support for women-led SMEs in accessing know-how, nonfinancial business development services, and networking opportunities.

**Table 1: Compliance of Banks with Subloan Requirements and Targets (31 August 2016)**

| <b>Requirements</b>   | <b>Bank CenterCredit</b> | <b>Tsesnabank</b>  |
|---|--------------------------|--------------------|
| Used for business purposes only   | Yes                      | Yes                |
| Denominated in tenge  | Yes                      | Yes                |
| Priced at market-based interest rate  | Yes                      | Yes                |
| Repayment period of up to 36 months for working capital financing and up to 84 months for capital expenditure | Yes                      | Yes                |
| Share of loans for refinancing of not more than 15%   | Yes (7%)                 | No (19%)           |
| Subloan amount not more than T550 million   | Yes                      | Yes                |
| <b>Targets (Best Efforts Basis)</b>   |                          |                    |
| Share of loans issued for investment purposes of not less than 50%  | Not achieved (42%)       | Not achieved (21%) |
| Share of loans issued outside Almaty and Astana cities of not less than 40%                                   | Achieved (67%)           | Achieved (61%)     |
| Share of loans issued to women entrepreneurs of not less than 24% (on best effort basis)                      | Not achieved (14%)       | Not achieved (12%) |

SME = small and medium-sized enterprise.

Source: Reports submitted by Bank CenterCredit and Tsesnabank; audited project financial statements.

### **C. Implementation and Internal Operations of Subprojects**

17. Both PFIs received a loan of \$61 million in November 2014 and utilized the entire loan amount to make subloans before the closing date which occurred 13 months later. By 1 November 2017, the two PFIs had financed a total of 575 subborrowers on a cumulative basis through 2,226 subloans totaling T49.9 billion. BCC financed 342 subborrowers through 1,084 subloans totaling T26.9 billion, while TSB issued 1,142 loans to 234 subborrowers for a total of T23.0 billion. The average sub-loan size was T22.4 million and the average amount per sub-borrower was T86.7 million (T13.5 million average subloan size and T44.6 million per sub-borrower under tranche 1). The increase in the average subloan amount compared with tranche 1 is linked to the selection of PFIs, which target higher-end clientele. TSB targeted larger SME clients, thus its average loan size was T97.9 million, 24% higher than BCC (T79 million). At the same time, BCC had a larger share of loans for investment purposes, so the average loan tenor for SME loans issued by BCC was 33.1 months (23.1 months in TSB).

18. As of 1 November 2017, women entrepreneurs represented 32.8% of total borrowers, but because their subloans were much smaller than those received by men entrepreneurs, women entrepreneurs received only 13.1% of total subloans extended. Most of the subloans went to SMEs engaged in trade (55.3%), followed by services (24.4%), industry (7.4%), agriculture (3.9%), and mixed purposes (9%). Because more than half of the subloans were used by SMEs engaged in trade for working capital purposes, 49% of the subloans (by aggregate principal amount) had maturity of less than 1 year. 76% of the tranche 2 subloans were issued to SMEs located outside of Almaty and Astana. The subloans financed under tranche 2 resulted in the creation of 1,433 new jobs.

19. The average interest rates for the subloans issued under tranche 2 were higher than the average interest rates of subloans for all Damu programs, but slightly lower than the average rates for all local currency loans made to SMEs during the same periods (Table 2).

**Table 2: Average Interest Rates for Local Currency Loans Made to Small and Medium-Sized Enterprises, January 2015–October 2017**

| Date             | Average Interest Rate (%)            |  |   |
|------------------|--------------------------------------|--|---|
|                  | By BCC and TSB Using Tranche 2 Funds | By All Banks Using All Funding Sources | By All Banks Using Funds Provided by Damu |
| 31 October 2017  | 14.6                                 | 15.5                                   | ...                                       |
| 31 December 2016 | 14.4                                 | 16.7                                   | 13.3                                      |
| 31 December 2015 | 14.1                                 | 15.2                                   | 9.3                                       |

BCC = Bank CenterCredit, TSB = Tsesnabank.

(...) = no data available.

Sources: National Bank of Kazakhstan. 2017. *Statistical Bulletin*. <http://www.nationalbank.kz/cont/11tror14.pdf>; Damu Entrepreneurship Development Fund. 2017. Development strategy for 2014–2023; reports submitted by BCC and TSB.

## D. Organization and Operations of Damu

### 1. Organization, Management, and Staffing

20. Damu's sole shareholder is Baiterek. Key functions of the shareholder include approving Damu's charter, corporate governance code, dividend policy, external auditor, and annual financial statements.

21. The board of directors has seven members and is responsible for the general management of Damu's activities, including approving its corporate strategy and receiving reports from the internal audit department. Members of the board of directors participate in the work of the board committee on strategic and budgetary planning, the audit committee, and the committee on nomination and remuneration. The management board is the executive body of Damu and consists of eight members involved in daily management.

### 2. Personnel Administration

22. Damu had 371 staff members at the end of 2016. Staff turnover in 2016 was 13.7%. In the same year, 85 staff members were rotated and 253 received training.

### 3. Lending Operations

23. Damu focuses on lending to financial intermediaries (banks, MFIs, and leasing companies) for channeling to SMEs. From 2014 to 2017, Damu reported 8% growth in loans (compound annual growth rate) along with 93% growth in loans overdue 90 days due to the bankruptcies of KazInvestbank and DeltaBank. This increase in overdue loans was given provisions translating to a loan loss reserve of T24 billion, and an 81% coverage as of 31 December 2017. Consequently, net overdue loans to equity ratio was manageable at 5.6%.

### 4. Other Operations

24. In addition to its lending operations, Damu also issues loan guarantees which stood at T71 billion as at 31 December 2017. These guarantees were provided in support of (i) SME loans issued by partner banks; and (ii) EBRD loans to BCC, ForteBank, and Kazmicrofinance MFI (Appendix 5).



## E. Portfolio of Damu

25. At the end of 2017, Damu's major borrowers were 18 banks with outstanding exposure of T235 billion (97% of Damu's gross loan portfolio) (Appendix 5).

## F. Financial Statements and Ratios of Development Financial Institution, Damu

26. **Balance sheets.** From 2014 to 2017, Damu's assets increased by 14% and this was mostly finance by the increments in borrowings from domestic and external source (Appendix 5).

27. **Income statements.** Damu's profitability indicators demonstrated strong volatility from 2014–2017 period driven by gains and losses under FX derivatives (Appendix 5). On a positive side, income generation from Damu's core business (loans and guarantees) was satisfactory as evidenced by the growth in its net interest margin from 8% (2014) to 11% (2017).

28. **Key ratios.** Damu's financial position is satisfactory as evidenced by its strong capital position with capital adequacy ratio of 32%, manageable credit risk with net NPL to equity ratio of 5.6%, coupled with profitable operations and sufficient liquidity (Appendix 5).

## G. Covenants

29. The ADB loan agreement signed with Damu on 29 October 2014 requires Damu to ensure each PFI complies with the project-specific covenants. For tranche 2, ADB entered into separate project agreements with each PFI (both of which are also dated 29 October 2014), which included the same project-specific covenants as the loan agreement.<sup>15</sup> Capitalizing on lessons learned from tranche 1, ADB concluded project agreements with PFIs to ensure direct dialogue and better oversight over their performance.

30. The two PFIs were selected based on their commitment to expand SME lending portfolios and their compliance with the following eligibility criteria: (i) NBK prudential limits, or having an agreed action plan to do so; (ii) profitable for the most recently completed fiscal year, or having an agreed action plan to become profitable; (iii) NPL ratio of less than 10%, or having an agreed action plan to reduce NPL to that level; (iv) capital adequacy ratio (CAR) of at least 12% or having an agreed action plan to reach the required CAR level; and (v) a credit rating of at least B– issued by a credit rating agency, or another such rating acceptable to ADB.

31. ADB regularly reviewed compliance by the PFIs with the eligibility criteria as part of its review missions. Damu also reported to ADB changes to its shareholders structure or credit rating. From January 2014 to June 2017, both PFIs complied with most of the financial covenants. However, TSB has been in breach of the 12% CAR covenant since 2015. BCC likewise, had its NPL ratio above the 10% ceiling from the beginning, hence ADB agreed to remedial action plan to have it reduced to 13.4% by the end of 2015, 12.7% by the end of 2016, and 12.1% by the end of 2017. BCC failed to achieve its target in 2015 (14.7% vs. 13.4%) but was eventually on track by 2016 and 2017. BCC's delayed recovery was due to several factors including tax constraints

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<sup>15</sup> Project agreements signed with PFIs also included covenants on the financial performance (absent in loan agreement signed with Damu)

for bank write-offs,<sup>16</sup> slow court procedures, and the deferred operationalization of NBK's problem loans fund.<sup>17</sup>

**Table 3: Tsesnabank Compliance with ADB covenants, 2014–2017**

| Item  | 2014  | 2015 | 2016  | 2017  |
|---|-------|------|-------|-------|
| Compliance with NBK prudential limits           | Yes   | Yes  | Yes   | Yes   |
| Credit rating not below B– <sup>a</sup>         | B+    | B+   | B+    | B+    |
| Net profit of not below zero (T billion)        | 15.9  | 18   | 12.2  | 50.6  |
| NPL ratio of not of more 10% of gross loans (%) | 4.2%  | 3.8% | 4.6%  | 6.7%  |
| Total CAR of not below 12% (%)                  | 12.7% | 9.5% | 11.1% | 16.1% |

CAR = capital adequacy ratio, NBK = National Bank of Kazakhstan, NPL = overdue more than 90 days

<sup>a</sup> Standard & Poor's.

Sources: Damu Entrepreneurship Development Fund completion report; Tsesnabank's financial statements (audited and management accounts and audited project financial statements for 2016).

**Table 4: Bank CenterCredit Compliance with ADB covenants, 2014–2017**

| Item   | 2014  | 2015  | 2016  | 2017  |
|--|-------|-------|-------|-------|
| Compliance with NBK prudential limits        | Yes   | Yes   | Yes   | Yes   |
| Credit rating not below B– <sup>a</sup>      | B+    | B     | B     | B     |
| Net profit of not below zero (T billion)     | 0.9   | 1.9   | 5.4   | 28.8  |
| NPL ratio of not more 10% of gross loans (%) | 15.6% | 17.1% | 11.7% | 10.2% |
| Total CAR of not below 12% (%)               | 15.4% | 14.7% | 17.8% | 21.4% |

CAR = capital adequacy ratio, NBK = National Bank of Kazakhstan, NPL = overdue more than 90 days

<sup>a</sup> Standard & Poor's.

Sources: Damu Entrepreneurship Development Fund completion report; Bank CenterCredit financial statements (audited and management accounts, Standard & Poor's reports, and audited project financial statements for 2016).

32. As of 31 December 2017, Damu and PFIs complied with all other covenants in the loan and project agreements (Appendix 2).

#### IV. SUBLOAN IMPLEMENTATION

##### A. Loan Appraisal

###### 1. Distribution of Subloans

33. The actual distribution of the SME subloan portfolio did not deviate from expectations, apart from areas discussed in para. 16. The current SME loan distribution criteria set in the loan and project agreements are adequate to ensure increased access of SMEs to finance. No amendments were needed.

###### 2. Covenants

34. The relevant covenants in the loan agreement signed between ADB and Damu were adequate to regulate the use of tranche 2 funds, the selection of PFIs, and SME loan distribution.

<sup>16</sup> Until 1 January 2018, the Kazakh Tax Code had a clause establishing tax liability for a bank if it decides to write off a loan. A loan forego would imply a benefit to the sub-borrower, so (i) it is subject to income tax; and (ii) tax payment should occur at the source of the benefit generation, i.e., the bank was assumed to pay accrued income tax on behalf of such sub-borrower and later get reimbursement from the sub-borrower. Since it was almost impossible to obtain such reimbursement, Kazakh banks were reluctant to write off loans.

<sup>17</sup> <http://fpl.kz/ru>

### 3. Quality of Appraisal

35. Damu does not intervene in the appraisal of SME subprojects. PFIs does its own quality appraisal by analyzing the sub-borrower's capacity to generate sufficient cashflows to service the debt. Both PFIs also have established credit underwriting procedures, and overall, they were found to be acceptable.

#### B. Implementation

36. Overall, the project implementation was *satisfactory*. All the financed SME subprojects and sub-borrowers complied with ADB's selection criteria. The subprojects were also compliant with ADB's environmental and social safeguard policies.

## V. EVALUATION OF PROJECT PERFORMANCE

### A. Relevance

37. The project is rated *less than relevant*. However, SME support remains a top government and ADB priority considering the demand to further support SME access to financing.<sup>18</sup> The program also addressed gender-related issues by supporting women through launching public awareness campaigns with a focus on reaching women entrepreneurs and collecting and analyzing data on women entrepreneurs. Likewise, the PFIs selected complied with ADB's eligibility criteria as stated in ADB Operations Manual.<sup>19</sup>

38. There are several areas in the project design that can be improved to deliver better project results. The use of credit lines alone is not sufficient to address SME finance development. Tranche 2 addressed liquidity and currency-related issues but failed to resolve other sector constraints related to access to medium-term SME credit, e.g., banks' aversion to SME lending, the limited availability of lease finance for SMEs, the lack of domestic resources for medium-term SME credit, and the high regulatory burden on SMEs. Also, the use of commercial banks as the sole channel for onlending directed the lending focus to larger SMEs that could meet collateral requirements, thereby crowding out smaller SMEs. Microfinance organizations that cater to microenterprises in the lower market segment were not considered for tranche 2 financing.

39. DMF indicators should have been more closely aligned with the stated outcome and outputs. For instance, DMF output indicators were mostly linked to the disbursements volume rather than measuring delivery of medium-term financing to SMEs as envisaged by DMF. Another weakness of the current set of DMF outputs is that none of them stipulates improvements in sustainability of PFI's operations.

40. Gender-related output indicators in the DMF and criteria for SME loan distribution in project agreements signed with PFIs should be aligned with each other. For example, the DMF stipulates that at least 24% of sub-borrowers should be women entrepreneurs while the project agreements require at least 24% of SME loans to be disbursed to women entrepreneurs.

41. At the launch of the project, both PFIs had problems with the promotion of loans targeting women-led businesses. This is because of their limited experience in marketing such products

<sup>18</sup> Republic of Kazakhstan. 2010. Business Roadmap 2020 Astana; ADB. 2017. *Kazakhstan Country Partnership Strategy 2017–2021*. Manila.

<sup>19</sup> ADB. 2013. Financial Intermediation Loans. *Operations Manual*. OM D6/BP. Manila

(para 16). PFIs were tasked to launch new loan products, however, they did it on their own with no support from ADB and it led to slow disbursement to women entrepreneurs at the project launch.

## B. Effectiveness

42. The project is rated *less than effective*. The expected outcome of increased SME access to medium-term credit on a sustainable basis, measured by the increase in SME loans disbursed under Damu programs to T800 billion by the end of 2015, was achieved. By the end of 2015, Damu had onlent T908.6 billion to SMEs via banks, MFIs, and leasing companies. DMF output targets however, were not fully achieved.

43. Progress on the DMF output indicators is as follows:

- i. **Increase in the number of new SME loan accounts opened from 2,000 to 3,500 in 2013–2015, i.e., by 1,500 new accounts within 2 years.** By the end of 2015, the two PFIs had issued 994 SME loans with a parallel increase in new SME loan accounts, i.e., the performance target of 1,500 new SME accounts was not achieved. Non-delivery of the output indicator is explained by selection of PFIs focusing on large SME loans. As of 01 November 2017, PFIs on a cumulative basis have issued 2,226 SME loans.
- ii. **Increase in the SME loan portfolio in both PFIs from T33 billion to T60 billion in 2013–2015, i.e., by T27 billion within 2 years.**<sup>20</sup> By the end of 2015, both banks had financed 994 SME loans for T27.6 billion, i.e., the expected output was achieved. By 1 November 2017, both banks went further and have issued T49.9 billion loans.
- iii. **Increase in the percentage of women sub-borrowers from 10% in 2013 to at least 24% by the end of 2015.** At the end of 2015, women entrepreneurs represented 32.8% of the total number of SME borrowers and this output indicator was achieved. By 1 November 2017, this gender-related indicator increased to 34.2%.
- iv. **Increase in the share of loan applications from women entrepreneurs from 10% in 2013 to at least 30% by the end of 2015.** Neither Damu nor the PFIs collected data on the number of loan applications received from women entrepreneurs. Thus, assessment is not possible. Nonetheless, the increase in the number of women sub borrowers to more than 30% suggests that this output target has been met.

44. Tranche 2 also did not fully achieve its goal of providing medium-term credit to SMEs. Of the total loans issued, 49% of the sub-loans had tenor less than 1 year (para 18). This however, is a reflection of the current SME sector in the country, wherein medium to long-term loans are mostly sourced from the government subsidized SME lending programs.

## C. Efficiency

45. The project is rated *efficient*. Both PFIs liquidated the funds received by the original closing date of 28 December 2015. From 24 November 2014 to 28 December 2015, PFIs issued SME loans for T27.6 billion. Since then until 01 November 2017, PFIs disbursed additional T22.3 billion

<sup>20</sup> The current wording for this output indicator lacks clarity and should be read as an increase in SME loan disbursement volume, not an increase in the outstanding SME loan portfolio.

using cash proceeds from collections. Thus, a total of T49.9 billion SME loan has been disbursed under the program. This means that ADB funds had been recycled 2.25 times.

#### **D. Sustainability**

46. The project is rated *less than likely sustainable*. Both PFIs were in breach of financial covenants during the project implementation (para 31), although their financial position has already improved as of 31 December 2017. Both PFIs continue to have problems obtaining medium and long-term finance, except from the government; thus, undermining their capacity to grow sustainably. Damu also continue to charge a uniform margin of 4% to all PFIs despite their different risk profiles. The finance sector's operating environment remains difficult, and SME sector root constraints to medium-term SME credit (para. 13) have not yet been addressed. Outreach was also limited, with a focus on larger borrowers that met conventional collateral requirements. There was also no evidence that the project helped to establish the supply of SME lending at market rates, as loans under tranche 2 were provided at slightly lower interest rates than market (para. 19), while the government continued to provide interest subsidies to certain target groups, geographical locations, and sectors. There is no data available on the current performance of the SME projects financed under tranche 2, thus, assessment of the viability of the SMEs financed is not feasible. On a positive side, PFIs continued supporting SME sector even after project closure (para 45), suggesting a strong interest to further expand their SME portfolio.

#### **E. Development Impact**

47. The program's rating is satisfactory. During 2013–2016, the SME sector in Kazakhstan demonstrated significant positive dynamics. SME output increased to T16,867 billion and the share of the SME sector in gross domestic product reached 23.1% (compared to 16.7% in 2013) and this DMF impact indicator was achieved. Employment in the SME sector grew from 2.6 million people in 2013 to 3.1 million in 2016, and the share of the SME sector in overall employment reached 35.9% (30.1% in 2013). This means that implementation of this DMF impact indicator is on track. Outstanding loans to the SME sector grew from T1.3 trillion in 2013 to T3.0 trillion in 2016 and the share of SME loans in the aggregate loan portfolio of the Kazakh banking system reached 23.6% in 2016 (11.4% in 2013). This trend continued in 2017 and SME loans reached T3.1 trillion or 24.3% of the aggregate loan portfolio of the Kazakh banking system by the end of July 2017.

48. While it is difficult to determine the project's contribution to this growth, the financing of 2,226 SME subprojects and generation of 1,416 jobs (by the 1 November 2017) show incremental contribution to these results. Tranche 2 demonstrated better job creation than tranche 1: \$122 million under tranche 2 channeled to SMEs created 1,416 new jobs, which translates into \$86,000 spent per job created (\$93,516 under tranche 1). The better marginal job creation capacity of tranche 2 may be linked to the higher loan recycling ratio of 2.2 for tranche 2 compared with 1.5 for tranche 1. Most of the gender targets in the DMF were achieved, and social and environmental safeguards were complied with.

#### **F. Performance of Damu and the Participating Financial Institutions**

49. Damu's performance as executing agency is rated *satisfactory*. In general, Damu's internal processes were adequate to ensure good support for project implementation. Damu complied with the covenants in the loan agreement and coordinated well with ADB. Its financial performance is also *satisfactory* (Appendix 5). The PFIs' performance is rated *less than satisfactory* due to breach in some of the financial covenants (para 31 and Appendixes 6–7).

**G. Performance of ADB**

50. ADB’s performance is rated *satisfactory*. ADB regularly conducted review missions, met with representatives of government agencies and PFIs, and visited subproject sites. In its project completion report, Damu noted ADB’s timely assistance in providing clarification on various issues related to tranche 2’s implementation.

**H. Overall Assessment**

51. Overall, the project is rated less than *successful* because it was less than relevant, less than effective and less than likely sustainable.

52. The Gender and Development (GAD) approach of the project has been *successful*. It has brought economic opportunities to women by improving their access to finance. For succeeding programs, it is recommended to incorporate elements of support for women-led start-up businesses, development of more women-tailored financial products, and capacity building support to women in form of advisory support.

**Overall Ratings**

| <b>Criteria</b>           | <b>Rating</b>                |
|---------------------------|------------------------------|
| Relevance                 | Less than relevant           |
| Effectiveness             | Less than effective          |
| Efficiency                | Efficient                    |
| Sustainability            | Less than likely sustainable |
| <b>Overall Assessment</b> | <b>Less than successful</b>  |
| Impact                    | Satisfactory                 |
| Performance of Damu       | Satisfactory                 |
| Performance of ADB        | Satisfactory                 |

ADB = Asian Development Bank.  
Source: Asian Development Bank.

**VI. ISSUES, LESSONS, AND RECOMMENDATIONS**

**A. Issues and Lessons**

53. ADB should continue supporting the finance and SME sectors in Kazakhstan given the strong demand for SME finance and the government’s strong commitment to developing the SME sector. It is however recommended that ADB broaden its involvement to also address supply-side constraints to SME development (para 13), which will improve sustainability of the program. Subsequent financial intermediation loans should also consider combining policy-based loan and technical assistance to address non-liquidity constraints to SMEs’ access to finance.

54. Tranche 2 stimulated lending to the SME sector but its outreach was limited (para. 17). This suggests that PFIs were oriented towards larger loans rather than smaller SMEs. Microfinance institutions catering to lower-end SMEs should be considered as potential PFIs for succeeding programs (para 38).

55. DMF indicators lacked clarity and were not appropriate to assess the overall effectiveness of the project (para 39). For the succeeding projects, DMF should be better defined and have measurement metrics enabling assessment of sustainability of results. For instance, performance indicators on (i) improvement of loan maturity of SME loan portfolio (e.g. increase in share of sub-

loans with a tenor above 3 years) and (ii) improved sustainability of PFIs' operations (e.g. increase in domestically raised retail funding) might be a solution. The project's partial success in achieving DMF outputs (para 39) suggests that DMF formulation should be preceded by thorough study of the market. This will ensure that DMF goals take into account the existing structure of the market and behavior of the market participants. At the project inception, PFIs faced problems with disbursement of loans targeting women-led businesses (para 16). This demonstrates that introduction and use of new loan products should be supported through attached technical assistance.

## **B. Recommendations**

56. **Future monitoring.** The Kazakh banking system remains fragile, thus increased monitoring of Damu and the PFIs is needed. Quarterly reporting is likewise recommended instead of annually. Although quarterly reports are not audited, they still be an instrumental in improving monitoring quality over the project implementation

57. **Covenants.** The quality of the financial covenants in the project agreements signed with PFIs is not optimal and needs improvement. The existing covenant on the maximum NPL ratio does not relate the level of NPLs to capital. The introduction of a new covenant of net NPLs to capital would address this drawback as it would (i) ensure the PFI maintains adequate levels of provisions against NPLs relative to its equity; and (ii) prevent a deterioration in asset quality, leading to an impairment of capital. Other improvements would be a revision of the definition of NPLs by adding restructured loans<sup>21</sup> in the ratio definition. Reports on PFIs' financial performance and compliance with ADB covenants should be prepared on a consolidated basis to address deficiencies in the project agreements currently signed with PFIs— the current project agreement with TSB stipulates the submission of the financial statements on an unconsolidated basis despite TSB's significant investments in subsidiaries and associates.

58. **Further action or follow-up.** Tranche 2 is fully disbursed and onlent. Project implementation is on track and has reached most of its targets. To strengthen the monitoring of the performance of Damu and PFIs, it is recommended to implement the above recommendations in succeeding interventions.

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<sup>21</sup> Except when restructuring is linked to a change in the loan currency from foreign to local currency.

## DESIGN AND MONITORING FRAMEWORK

| Design Summary  | Performance Targets and Indicators  | Actual Status  |
|---|---|--|
| <p><b>Impact</b><br/>Sustained job creation and economic growth</p>                               | <p><b>By the end of 2018</b><br/>SME sector's contribution to gross domestic product doubled (baseline: T5.4 trillion in 2009)</p> <p>SME sector employment increased to 3.5 million (baseline: 2.1 million in 2009)</p>  | <p><i>On track.</i> By end 2016 SME output grew to T16.7 trillion and share of SME sector in GDP reached 23.1%<sup>a</sup></p> <p><i>On track.</i> By end 2016 total number employed in SME sector reached 3.1 million<sup>b</sup></p>   |
| <p><b>Outcome</b><br/>SMEs have increased access to medium term credit on a sustainable basis</p> | <p><b>By the end of 2015</b><br/>Under Damu programs, SME lending increased to T800 billion (baseline: T750 billion in 2013)</p>  | <p><i>Achieved</i><br/>In 2014-2015 Damu disbursed T908.6 billion to SME sector in Kazakhstan</p>  |
| <p><b>Output</b><br/>1. Medium-term financing to SMEs</p>   | <p><b>By the end of 2015<sup>d</sup></b><br/>SME loan accounts opened by PFIs increased to 3,500 (baseline: 2,000 accounts in 2013).</p> <p>SME loans by PFIs increased to T60 billion (baseline: T33 billion in 2013)</p> <p>At least 24% of PFI borrowers are women entrepreneurs (baseline: 10% in 2013)</p> | <p><i>Not Achieved</i><br/>By end 2015, both PFIs issued 994 SME loans and number of SME loan accounts increased by the same number.</p> <p>By end November 2017, both PFIs on a cumulative basis disbursed 2,226 SME loans with parallel increase in SME loan accounts.</p> <p><i>Achieved</i><br/>By end 2015 both PFIs have issued T27.6 billion loans to SMEs. By end November 2017, both PFIs on a cumulative basis disbursed T49.9 billion</p> <p><i>Achieved.</i> As of end 2015, 32.8% of the sub-borrowers were women entrepreneurs. As of end November 2017, share of women sub-borrowers was circa 34%.</p> |
| <p>2. Improved financial sector outreach, with a focus on women entrepreneurs</p>                 | <p><b>By the end of 2015</b><br/>At least 30% of SME loan applications received from women entrepreneurs (baseline: 10% in 2013)</p>  | <p><i>Unclear.</i> Neither Damu nor PFIs collect data on the loan applications received from women entrepreneurs.</p>  |



| Activities with Milestones  | Inputs                        |                         |
|---|-------------------------------|-------------------------|
| <p><b>1. Medium-term financing to SMEs</b></p> <p>1.1 Damu submits applications for withdrawal backed by matching drawdown/withdrawal requests from PFIs (July to September 2014)</p> <p>1.2 ADB lends USD to Damu which onlends to PFIs. PFIs enter into currency swap arrangements with NBK to get Tenge funds. (August-September 2014)</p> <p>1.3 PFIs onlend loans to SMEs (October 2014 to December 2015)</p> <p><b>2. Improved financial sector outreach, with a focus on women entrepreneurs</b></p> <p>2.1 Damu outreach activities to women entrepreneurs to raise awareness on availability and terms of financing, business development and other services of Damu (September 2014 to December 2015)</p> | Funding (in Tenge equivalent) |                         |
|   | ADB OCR loan                  | \$123.0 million         |
|   | Subborrowers                  | \$30.75 million         |
|   | <b>Total</b>                  | <b>\$153.75 million</b> |

ADB = Asian Development Bank, Damu = Damu Entrepreneurship Development Fund, GDP = gross domestic product, NBK = National Bank of Kazakhstan, OCR = ordinary capital resources, PFI = participating financial institution, SMEs = small and medium-sized enterprises, T = Kazakhstan tenge.

<sup>a</sup> Ministry of National Economy of the Republic of Kazakhstan. Committee on Statistics. [https://stat.gov.kz/faces/wcnav\\_externalId/homeNumbersSMEEnterprises?\\_afLoop=195525036906751#%40%3FafLoop%3D195525036906751%26\\_adf.ctrl-state%3Dslqtrn6m\\_50](https://stat.gov.kz/faces/wcnav_externalId/homeNumbersSMEEnterprises?_afLoop=195525036906751#%40%3FafLoop%3D195525036906751%26_adf.ctrl-state%3Dslqtrn6m_50)

<sup>b</sup> Ministry of National Economy of the Republic of Kazakhstan. Committee on Statistics. [https://stat.gov.kz/faces/wcnav\\_externalId/homeNumbersSMEEnterprises?\\_afLoop=195525036906751&\\_adf.ctrl-state=slqtrn6m\\_50&\\_afLoop=829026513558356#%40%3F\\_afLoop%3D829026513558356%26af%2BrLoop%3D195525036906751%26\\_adf.ctrl-state%3DI16g8vzo1\\_4](https://stat.gov.kz/faces/wcnav_externalId/homeNumbersSMEEnterprises?_afLoop=195525036906751&_adf.ctrl-state=slqtrn6m_50&_afLoop=829026513558356#%40%3F_afLoop%3D829026513558356%26af%2BrLoop%3D195525036906751%26_adf.ctrl-state%3DI16g8vzo1_4)

<sup>c</sup> Damu. Kazakhstan. Project Completion Report for KAZ: Tranche 2 -SME Investment Program. Unpublished.

<sup>d</sup> Indicators refer to PFI portfolio funded through tranche 2 of the project. Baselines are taken from tranche 1.

<sup>e</sup> Reporting dates are set as 1 April and 1 September.

## STATUS OF COMPLIANCE WITH LOAN COVENANTS

### Loan 3093–KAZ: Small and Medium Enterprise Investment Program – Tranche 2 Status of Compliance as of 1 November 2017

| Covenant  | Reference in Loan Agreement | Status of Compliance   |
|---|-----------------------------|--|
| <b>Article II. The Loan</b>   |                             |  |
| ADB agrees to lend to the Borrower from ADB's ordinary capital resources an amount of one hundred twenty-two million (\$122,000,000,000).   | Section 2.01                | In compliance.<br><br>Amount of \$122 million is fully disbursed.  |
| The Borrower shall relend all of the Loan proceeds to PFIs. To this end, upon effectiveness of the Loan Agreement, the Borrower shall submit signed applications for withdrawal to fund Subloans for each of the relevant PFIs.   | Section 2.01 (a)            | In compliance.<br><br>Damu has channeled \$122 million to two PFIs, which fully on lent received funds in SME loans. |
| Each application for withdrawal shall contain, among other things, the following information:<br>(i) the PFI to whom the Loan proceeds will be relent; and<br>(ii) the amount requested to be withdrawn from the Loan Account.  | Section 2.01 (b)            | In compliance.   |
| The principal amount of the Loan withdrawn from the Loan Account shall be repayable in full to ADB by 10 a.m. (Almaty time) on the Final Repayment Date.  | Section 2.02                | Not yet applicable.  |
| The Borrower shall pay to ADB interest on the principal amount of the Loan withdrawn and outstanding from time to time at a rate for each Interest Period equal to the sum of (i) LIBOR; and (ii) 0.60% as provided by Section 3.02 of the Loan Regulations less a credit of 0.20% as provided by Section 3.03 of the Loan Regulations. | Section 2.03 (a)            | In compliance.<br><br>Interest payments are done in time and in full volume.   |
| Interest and other charges on the loan shall be payable to ADB semiannually by 10 a.m. (Almaty time) on 15 April and 15 October in each year, commencing on 15 April 2015   | Section 2.03 (b)            | In compliance.<br><br>No delays with payments from Damu.   |
| The Borrower shall pay a commitment charge of 0.15% per annum. Such charge shall accrue on the full amount of the Loan (less amounts withdrawn from time to time) commencing 60 days after the date of this Loan Agreement.   | Section 2.04                | In compliance.   |
| The Borrower may at any time request any of the following Conversions of the terms of the Loan in order facilitate prudent debt management:<br>(i) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding from a  | Section 2.05 (a)            | In compliance.<br><br>This option has not been yet used.   |

| Covenant  | Reference in Loan Agreement     | Status of Compliance   |
|---|---------------------------------|--|
| (ii) Floating Rate to a Fixed Rate, or vice versa; and the setting of limits on the Floating Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Floating Rate.  |                                 |  |
| Any conversion requested pursuant to subsection (a) hereinabove that is accepted by ADB shall be considered a "Conversion", as defined in Section 2.01(6) of the Loan Regulations, and shall be effected in accordance with the provisions of Article V of the Loan Regulations and the Conversion Guidelines.  | Article II.<br>Section 2.05 (b) | In compliance.<br><br>This option has not been yet used.               |
| For each portion of a Subloan prepaid by a PFI under the relevant SLA, the Borrower shall make a corresponding prepayment under this Loan Agreement promptly in accordance with the provisions of Section 3.05 of the Loan Regulations. For the avoidance of doubt, any prepayment notice given by the Borrower and endorsed by the Guarantor in accordance with Section 3.05 of the Loan Regulations shall be irrevocable. ADB agrees to confirm to the Borrower an acceptable date of prepayment and the amounts that will become due and repayable under the Loan Agreement by 10 a.m. (Almaty time) on such date of prepayment not later than 15 days before such date of prepayment. | Section 2.06                    | Not yet applicable. No prepayments so far.                             |
| All payment and repayment obligations of the Borrower are independent of the timely and due performance by PFIs of similar obligations under the SLAs and shall be fulfilled by the Borrower solely in accordance with the provisions of this Loan Agreement. The Borrower shall indemnify ADB for any costs, expenses, charges or fees incurred as a result of the Borrower's failure to perform any of its payment or repayment obligations in a timely manner in accordance with this Loan Agreement. Such indemnity amount shall be treated as a charge on the Loan which shall be payable by the Borrower upon demand by ADB.  | Section 2.07                    | In compliance.   |
| <b>Article III. Description of Project; Use of Proceeds of the loan</b>   |                                 |  |
| The Project for which the Loan is made is the financing by the Borrower of Qualified SME Subprojects through Subloans to PFIs and SME Loans to Qualified SME Borrowers in accordance with the terms of this Loan  | Section 3.01                    | In compliance.<br><br>All funds are onlent to qualified SME borrowers. |

| Covenant   | Reference in Loan Agreement | Status of Compliance |
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| Agreement, the Project Agreements, relevant SLAs and SMELAs.   |                             |                      |
| Except as ADB may otherwise agree, the proceeds of the Loan shall be used only for the purpose of the Project and shall be applied exclusively to the cost of Goods, Works and consulting services and other items of expenditure required to be carried out in Qualified SME Subprojects. For each withdrawal application submitted by the Borrower hereunder, the amount of ADB financing under the Project is 100% of the total amount requested by the Borrower under such withdrawal. | Section 3.02 (a)            | In compliance.       |
| Except as ADB may otherwise agree, all Goods, Works and consulting services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 1 to this Loan Agreement.   | Section 3.02 (b)            | In compliance.       |
| The Loan Closing Date for withdrawals from the Loan Account for the purposes of Section 9.02 of the Loan Regulations shall be one year and sixty (60) days from the date of this Loan Agreement or such other date as may be agreed between the Borrower and ADB.  | Section 3.03                | In compliance.       |
| <b>Article IV. Subloans</b>  |                             |                      |
| The Borrower shall enter into an SLA with each PFI, which provides, among other things, for the relending of the proceeds of the Loan to such PFI for the carrying out of the Project, and the rights of the Borrower and ADB with respect thereto. Correspondingly, the Borrower shall ensure that such PFI enters into a Project Agreement with ADB.   | Section 4.01 (a)            | In compliance.       |
| Each SLA shall be in the form and on terms and conditions acceptable to ADB, and shall be without prejudice to, and without limitation on, the obligations of the Borrower under this Loan Agreement, subject to the foregoing, and except as ADB may otherwise agree, each SLA shall (i) provide that the principal repayment schedule for each Subloan shall match the principal payment   | Section 4.01 (b)            | In compliance.       |
| In addition to the matters set forth in subsection (b) hereinabove, each SLA shall also provide that, within 30 calendar days of each PFI's receipt of the Subloan proceeds from the Borrower ("Swap Execution Period"), such PFI shall have executed, on terms and conditions acceptable to ADB, a currency swap with the NBK pursuant to which NBK shall have provided Tenge to such PFI in exchange for the Dollar proceeds of such   | Section 4.01 (c)            | In compliance.       |

| Covenant  | Reference in Loan Agreement | Status of Compliance |
|---|-----------------------------|----------------------|
| <p>Subloan; <i>provided, however,</i> that the foregoing shall not be required to the extent that such PFI has, no earlier than 30 days prior to the date of this Loan Agreement, executed such a currency swap with NBK on terms acceptable to ADB. Subject to the proviso in the foregoing sentence, in the event such currency swap has not been executed by such PFI within the Swap Execution Period, it shall be an event of default under the relevant SLA, and the Borrower shall prepay the portion of the principal amount of the Loan corresponding to such Subloan in accordance with the provisions of Section 2.06 above.</p>   |                             |                      |
| <p>If any currency swap for a Subloan referred to in subparagraph (c) hereinabove (whether entered into before or after the date of this Loan Agreement) is terminated prior to repayment of the Loan in full, (i) Damu shall promptly notify ADB of such termination and (ii) the applicable PFI shall have 30 days from the date of such termination to replace such currency swap with another currency hedging instrument (such as a new currency swap, foreign exchange forward contract(s), other hedging instruments, etc.) on terms acceptable to ADB. In the event that such PFI fails to enter into such a replacement currency hedging instrument on terms acceptable to ADB within such 30-day period, Damu shall, at the written request of ADB, prepay in full the portion of the principal amount of the Loan corresponding to such Subloan in accordance with Section 3.05 of the Loan Regulations.</p> | Section 4.01 (d)            | In compliance.       |
| <p>The Borrower shall promptly and effectively exercise its rights under each SLA and, whenever legally permissible, SMELA in accordance with the standards of a prudent lender and in such manner as to protect the interests of the Borrower and ADB and to accomplish the purposes of the Loan.</p>  | Section 4.02 (a)            | In compliance.       |
| <p>No rights or obligations under the SLA shall be assigned, amended, abrogated or waived nor any modifications or changes to any SLA shall be made or otherwise agreed by the Borrower without the prior consent of ADB.</p>   | Section 4.02 (b)            | In compliance.       |
| <b>Article V. Particular Covenants</b>  |                             |                      |
| <p>The Borrower shall carry out the Project and conduct its business with due diligence and efficiency and in conformity with applicable sound banking, administrative, financial, and business practices.</p>  | Section 5.01 (a)            | In compliance.       |

| <b>Covenant</b>  | <b>Reference in Loan Agreement</b> | <b>Status of Compliance</b> |
|--|------------------------------------|-----------------------------|
| The Borrower shall, promptly as required, take all action within its powers to maintain its corporate existence, to carry on its operations and to acquire, maintain and renew all rights, properties, powers, authorization, licenses and privileges which are necessary in the carrying out of the Project or in the conduct of its business.  | Section 5.01 (b)                   | In compliance.              |
| In the carrying out of the Project and in the conduct of its business, the Borrower shall perform all the obligations set forth in Schedule 2 to this Loan Agreement.  | Section 5.01 (c)                   | In compliance.              |
| The Borrower shall furnish to ADB, or as the case may be shall cause to be furnished to ADB, all such reports and information as ADB shall reasonably request, as part of the reports and information referred to in Section 7.04(a) of the Loan Regulations, concerning the (a) administration, operations and financial condition of the PFIs; and (c) SLAs, Qualified SME Borrowers, Qualified SME Subprojects, and SME Loans. All reports and information provided to ADB by the Borrower or by the PFIs (at the request by the Borrower) for purposes of compliance with the eligibility criteria for the Qualified SME Borrowers and the Qualified SME Subprojects will be provided in reliance on the relevant Qualified SME Borrowers' representations and adequate due diligence by the PRIs concerned.   | Section 5.02                       | In compliance.              |
| The Borrower shall (i) maintain separate accounts and records for the Project; (ii) prepare an annual consolidated Statement of Utilization of Funds for the Project in accordance with accounting standards acceptable to ADB; (iii) have such consolidated Statement of Utilization of Funds to be audited annually by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with international standards for auditing or the national equivalent acceptable to ADB; (iv) as part of each such audit, have the auditors prepare a report (which includes the auditors' opinion on the consolidated Statement of Utilization of Funds, use of the Loan proceeds as well as on the use of the procedures for the imprest fund and statement of expenditures) and a management letter (which sets out the deficiencies in the internal control of the Project that were identified in the course of the audit, if any, as well as any significant | Section 5.03 (a)                   | In compliance.              |

| Covenant   | Reference in Loan Agreement | Status of Compliance |
|--|-----------------------------|----------------------|
| <p>weaknesses identified by the auditor based on a review of the Borrower's internal controls over PFI monitoring as outlined in the Borrower's "Manual on Monitoring of Programs" and attached to the audit terms of reference); and (v) furnish to ADB, no later than 6 months after the end of each fiscal year to which they relate, copies of such audited consolidated Statement of Utilization of Funds, audit report and management letter, all in the English language, and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request.</p>  |                             |                      |
| <p>ADB shall disclose the annual audited consolidated Statement of Utilization of Funds and the opinion of the auditors thereto within 30 days of the date of their receipt by posting them on ADB's website.</p>  | Section 5.03 (b)            | In compliance.       |
| <p>In addition to the annual audited consolidated Statement of Utilization of Funds referred to in subsection (a) hereinabove, the Borrower shall (i) provide its annual financial statements prepared in accordance with International Financial Reporting Standards; (ii) have its financial statements audited annually by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB, in accordance with international standards for auditing or the national equivalent acceptable to ADB; and (iii) furnish to ADB, no later than 1 month after approval by the relevant authority, copies of such audited financial statements in the English language and such other information concerning these documents and the audit thereof as ADB shall from time to time reasonably request.</p> | Section 5.03 (c)            | In compliance.       |
| <p>The Borrower shall enable ADB, upon ADB's request, to discuss the consolidated Statement of Utilization of Funds and the financial statements for the Borrower and its financial affairs where they relate to the Project with the auditors appointed by the Borrower pursuant to subsections (a)(iii) and (c) hereinabove, and shall, authorize and require any representative of such auditors to participate in any such discussions requested by ADB. This is provided that such discussions shall be conducted only in the presence of an authorized officer of the Borrower, unless the Borrower shall otherwise agree.</p>   | Section 5.03 (d)            | In compliance.       |

| <b>Covenant</b>  | <b>Reference in Loan Agreement</b> | <b>Status of Compliance</b> |
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| The Borrower shall cause PFIs to enable ADB's representatives to inspect, any Qualified SME Borrower, any Qualified SME Subproject, the Goods and Works, and any relevant records and documents maintained by the Borrower and the PFIs (at the request by the Borrower) concerning the Project.   | Section 5.04                       | In compliance.              |
| The Borrower shall promptly take all action, including the provision of funds, which shall be necessary on its part to enable the PFIs to perform its obligations under the Project Agreements, and shall not take or permit any action which would interfere with the performance of such obligations.  | Section 5.05                       | In compliance.              |
| <b>Article VI. Effectiveness</b>   |                                    |                             |
| The following are specified as additional conditions to the effectiveness of this Loan Agreement for the purposes of Section 10.01(f) of the Loan Regulations: (a) the SLAs, each in the form and substance acceptable to ADB, shall have been duly executed and delivered on behalf of, and shall have become legally binding upon, the relevant PFIs and the Borrower, and all conditions precedent to their effectiveness, other than, if applicable, a condition requiring the effectiveness of this Loan Agreement, shall have been fulfilled; and (b) each PFI has established as ESMS acceptable to ADB and appointed designated staff that are trained in implementing the ESMS for screening prospective Qualified SME Subprojects. | Section 6.01                       | In compliance.              |
| The following is specified as an additional matter, for the purposes of Section 10.02(d) of the Loan Regulations, to be included in the opinion or opinions to be furnished to ADB: the SLAs between the Borrower and each of the PFIs referred to in Section 6.01 hereinabove have been duly authorized or ratified by, and executed and delivered on behalf of, the Borrower and each of these PFIs, and are legally binding upon the Borrower and these PFIs in accordance with its terms.  | Section 6.02                       | In compliance.              |
| A date 30 days after the date of this Loan Agreement is specified for the effectiveness of the Loan Agreement for the purposes of Section 10.04 of the Loan Regulations.   | Section 6.03                       | In compliance.              |
| <b>Article VII. Miscellaneous</b>  |                                    |                             |
| The Chairperson of Management Board of the Borrower is designated as representative of the Borrower for the purposes of Section 12.02 of the Loan Regulations.   | Section 7.01                       | In compliance.              |



| Covenant   | Reference in Loan Agreement | Status of Compliance               |
|--|-----------------------------|------------------------------------|
| <b>SCHEDULE 1. Procurement of Goods, Works and Consulting Services</b>   |                             |                                    |
| <p><u>General</u><br/>The Borrower shall cause the PFIs to ensure that all Goods, Works, and consulting services to be financed out of the proceeds of the Loan shall be procured in accordance with ADB procurement policy, which is embodied in relevant provisions of the Procurement Guidelines and the Consulting Guidelines; except that the requirement that the proceeds of ADB financing can be used only for procurement of Goods, Works and consulting services supplied from and produced in member countries of ADB is not applicable. The use by Qualified SME Borrowers of international competitive bidding procedures under the Project shall be encouraged where the amount of a Qualified SME Subproject investment is unusually large.</p> | Section 1                   | No data received on non-compliance |
| <p><u>Industrial or Intellectual Property Rights</u><br/>(a) The Borrower shall cause the PFIs to ensure that all Goods and Works procured by each Qualified SME Borrower (including without limitation all computer hardware, software and systems, whether separately procured or incorporated within other goods and services procured) do not violate or infringe any industrial property or intellectual property right or claim of any third party.</p>  | Section 2 (a)               | As above.                          |
| <p>(b) The Borrower shall cause PFIs to ensure that all contracts entered into by each Qualified SME Borrower for the procurement of Goods and Works contain appropriate representations, warranties and, if appropriate, indemnities from the contractor or supplier with respect to the matters referred to in subparagraph (a) hereinabove.</p>   | Section 2 (b)               | As above.                          |
| <p>(c) The Borrower shall cause PFIs to ensure that all ADB-financed contracts entered into by each Qualified SME Borrower with consultants contain appropriate representations, warranties and, if appropriate, indemnities from the consultants to ensure that the consulting services provided do not violate or infringe any industrial property or intellectual property right or claim of any third party.</p>   | Section 2 (c)               | As above.                          |

| Covenant   | Reference in Loan Agreement | Status of Compliance |
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| <b>SCHEDULE 2. Execution of Project; Financial Matters</b>   |                             |                      |
| <u>Implementation Arrangements</u><br>1. As the Project Executing Agency, the Borrower shall be responsible for overall implementation, including utilization and disbursement of the Loan proceeds. The Borrower shall ensure that the Project is implemented in accordance with the detailed arrangements set forth in the FAM. Any subsequent change to the FAM shall become effective only after approval of such change by the Borrower and ADB. In the event of any discrepancy between the FAM and this Loan Agreement, the provisions of the Loan Agreement shall prevail. | Section 1                   | In compliance.       |
| 2. The Borrower shall cause each PFI to: (a) bear the credit risk associated with the SME Loans made by it to Qualified SME Borrowers under the Project; and (b) independently determine the creditworthiness of each Qualified SME Borrower and the terms and conditions of the related SME Loans, in accordance with international best practices for lending or otherwise providing credit through financial leasing to SMEs (includes determination of margins and associated fees, security taken and proper legal documentation).  | Section 2                   | In compliance.       |
| <u>Eligibility Criteria for PFIs</u><br>3. The Borrower shall cause each PFI to comply with the following eligibility criteria. In the event, however, of any non-compliance by such PFI with any of the following eligibility criteria, the Borrower shall cause such PFI to notify ADB of such non-compliance within the time period indicated in paragraph 2 of the Schedule to the respective Project Agreements:  | Section 3                   | In compliance.       |
| (a) comply fully with capital adequacy ratios and prudential limit guidelines set by the agency responsible for banking and financial supervision in Kazakhstan or have an agreed action plan to do so;  | Section 3 (a)               | In compliance.       |
| (b) have a credit rating of at least "B-" issued by a credit rating agency or have such other rating acceptable to ADB (provided that such rating shall not be two or more notches lower than the then current rating of the relevant PFI as of the date of this Agreement, unless the rating downgrade is an automatic downgrade as a result of   | Section 3 (b)               | In compliance.       |

| Covenant  | Reference in Loan Agreement | Status of Compliance  |
|---|-----------------------------|---|
| the downgrading of the sovereign rating of the Guarantor).  |                             |   |
| (c) be profitable for its most recently completed fiscal year or have an agreed action plan to become profitable. For purposes of the foregoing, profitability refers to profit after tax;  | Section 3 (c)               | In compliance.  |
| (d) have a ratio of non-performing loans (NPLs) less than 10% or have an agreed action plan to reduce NPLs to that level. For purposes of the foregoing, non-performing loans shall mean loans overdue by more than 90 days and shall include, at a minimum, principle and accrued interest; and  | Section 3 (d)               | Partially in compliance:<br>-As of end June 2017, Tsesnabank was in compliance with NPLs at 4.7% of gross loans.<br>- As of end June 2017 Bank CenterCredit is breach with NPLs at 10.7% of gross loans |
| (e) maintain a ratio of total capital to risk-weighted assets of not less than 12% or have an agreed action plan to attain such ratio. For purposes of the foregoing, such ratio shall be calculated in accordance with Kazakhstan statutory requirements.  | Section 3 (e)               | In compliance.  |
| 4. Each SLA shall provide that it shall be an event of default under such SLA if the relevant PFI shall have either (i) failed to comply with the terms of any agreed action plan between such PFI and ADB in respect of attaining compliance with any of the eligibility criteria described in paragraph 3 above or (ii) failed to come to agreement with ADB on such an action plan within 60 days after ADB has become aware that such PFI has ceased to be compliant with any of the eligibility criteria described in paragraph 3. In the event that there is failure by a PFI to either (a) comply with the terms of any such action plan or (b) enter into any such action plan within the time period specified above, the Borrower shall inform ADB and the Borrower and ADB shall agree on the course of action for such PFI. | Section 4                   | In compliance.  |
| <u>Change of Control of PFIs</u><br>Each SLA shall provide that it shall be an event of default under such SLA if any change in control (as such term shall be defined in the applicable SLA) of the relevant PFI will, in Damu's sole discretion, either (a) have a material adverse effect on such PFI's operations or financial performance, or (b) entail a change in such PFI's business strategy not conducive to achieving the objectives of the Investment Program. The Borrower shall, and shall cause each PFI to, promptly notify ADB of the occurrence of any   | Section 5                   | In compliance.  |

| Covenant   | Reference in Loan Agreement | Status of Compliance |
|--|-----------------------------|----------------------|
| change in control of such PFI and, if requested by ADB, the Borrower shall promptly exercise its rights under the applicable SLA in respect of such change in control.   |                             |                      |
| <u>Eligibility Criteria for Qualified SME Borrower</u><br>The Borrower shall cause PFI to ensure that each Qualified SME Borrower:<br>(a) is a small and/or medium enterprise according to the definition stipulated in the Law on Private Entrepreneurship of the Republic of Kazakhstan; and   | Section 6 (a)               | In compliance.       |
| (b) is not engaged in any prohibited investment activity listed in the attachment to this Schedule.  | Section 6 (b)               | In compliance.       |
| <u>Eligibility Criteria for Qualified SME Subproject</u><br>The Borrower shall cause PFIs to ensure that Qualified SME Subprojects shall be for activities that:<br>(a) are not included in the list of prohibited investment activities set out in the attachment to this Schedule; and   | Section 7 (a)               | In compliance.       |
| (b) comply with the environmental safeguards set out in paragraphs 10 to 12 of this Schedule.  | Section 7 (b)               | In compliance.       |
| <u>SME Loans</u><br>The Borrower shall cause each PFI to ensure that:<br>each SME Loan:<br>(i) is used by a Qualified SME Borrower to (A) acquire fixed assets, (B) modernize existing fixed assets, (C) finance working capital, and/or (D) subject to subparagraph (b) below, finance existing loans with the specific purpose to acquire/modernize fixed assets and/or finance working capital; | Section 8 (a-i)             | In compliance.       |
| (ii) is denominated in Tenge;  | Section 8 (a-ii)            | In compliance.       |
| (iii) has a market-based interest rate; and  |                             | In compliance.       |
| (iv) subject to subparagraph (b) below, has a repayment term as follows: (A) in the case of financing for working capital – up to 36 months; and (B) in the case of financing for acquisition and modernization of fixed capital assets – up to 84 months, <i>provided</i> , that such PFI shall be required to use its own funds to the extent the  | Section 8 (a-iii)           | In compliance.       |

| Covenant   | Reference in Loan Agreement | Status of Compliance |
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| <p>repayment term of such SME Loan extends beyond the principal repayment date of the Subloan to such PFI. For the avoidance of doubt, any principal amount of an SME Loan repaid may, subject to the terms of this subparagraph (a), be used by such PFI to make additional SME Loans;</p>  |                             |                      |
| <p>(i) at any given time, no more than 15% of the aggregate amount of the Subloan to such PFI is applied to the financing of existing loans of such PFI for Qualified SME Subprojects originally made using funds other than the proceeds of the Loan and (ii) the remaining repayment term of any such existing loan shall not be more than 12 months at the time it is financed using the proceeds of the Subloan. For the avoidance of doubt, such PFI shall ensure that the eligibility criteria for those Qualified SME Borrowers and Qualified SME Subprojects (which includes the use of the ESMS to screen these Qualified Subprojects) have been met;</p> | Section 8 (a-iv)            | In compliance.       |
| <p>(ii) at any given time, no more than 15% of the aggregate amount of the subloan to such PFI is applied to the financing of existing loans of such PFI for qualified SME subprojects originally made using funds other than the proceeds of the Loan and (ii) the remaining repayment term of any such existing loan shall not be more than 12 months at the time it is financed using the proceeds of the Subloan. For the avoidance of doubt, such PFI shall ensure that the eligibility criteria for those Qualified SME Borrowers and Qualified SME subprojects (which includes the use of the ESMS to screen these qualified subprojects) have been met</p> | Section 8 (b)               | In compliance.       |
| <p>at any given time, no Qualified SME Borrower or group of affiliated persons (as such term shall be defined in the applicable SLA) shall</p>   | Section 8 (c)               | In compliance.       |

| Covenant   | Reference in Loan Agreement | Status of Compliance  |
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| have outstanding borrowings, either individually from the PFI or collectively from all the financial institutions (including the PFI) to which the Borrower may lend money under the Investment Program for the same purpose as the SME Loan, of more than T550,000,000 using funds made available by ADB under the Investment Program;  |                             |   |
| Such PFI uses its best efforts to cause that:<br>(i) at least 50% of the aggregate principal amount of the SME Loans made by it under the project are used by for investment purposes and<br><br>(ii) at least 40% of the aggregate principal amount of the SME Loans made by it under the Project are provided to SMEs located outside of Almaty and Astana cities; and   | Section 8 (d)               | Partially achieved<br>As of 31 August 2016, 42% and 21% of the SME subloans issued by Bank CenterCredit and TsesnaBank were issued for investment purposes. This is below desired 50%<br><br>67% and 61% of the SME subloans issued by Bank CenterCredit and TsesnaBank were issued outside Almaty and Astana cities. |
| such PFI uses its best efforts to cause that (i) at least 30% of the aggregate number of SME Loan applications received by such PFI under the Project, and (ii) at least 24% of the aggregated number of SME Loans made by such PFI under the Project, are from or to, as applicable, the following:<br>(A) SMEs with a minimum of 50% women ownership; or<br>(B) SMEs with management controlled by women.                      | Section 8 (e)               | In Compliance.  |
| <u>Qualified SME Subprojects (Screening, Categorization, and Environmental and Social Assessment and Planning)</u><br>The Borrower shall cause the PFIs to ensure that before any proposed subproject is approved to be a Qualified SME Subproject for financing:<br>(a) the PFIs have appointed designated staff for project implementation particularly for financial management and reporting, and monitoring and evaluation; | Section 9 (a)               | In compliance   |
| (b) the ESMS is used to screen and categorize the significance of potential environmental, indigenous peoples or involuntary resettlement impacts associated with such subproject; and   | Section 9 (b)               | In compliance   |
| (c) an EMP is prepared for proposed subprojects as required pursuant to the ESMS.  | Section 9 (c)               | In compliance   |
| The Borrower shall cause the PFIs to ensure that each proposed subproject does not   | Section 10                  | In compliance   |

| Covenant   | Reference in Loan Agreement | Status of Compliance |
|--|-----------------------------|----------------------|
| involve any: (a) involuntary resettlement or indigenous peoples impacts within the meaning of the SPS; (b) environmental impacts which can be categorized as Category A, in each case within the meaning of the SPS; or (c) activity referred to in paragraph 7(a) of this Schedule.   |                             |                      |
| Without limiting paragraph 10(a) of this Schedule, the Borrower shall cause the PFIs to ensure that in respect of any proposed subproject that involves the acquisition or transfer of any interest in land, such acquisition or transfer is between willing parties and not under eminent domain.   | Section 11                  | In compliance        |
| <u>Environment</u><br>The Borrower shall cause the PFIs to ensure that the preparation, design, construction, implementation, operation and decommissioning of each Qualified SME Subproject comply with (a) all applicable laws and regulations of the Republic of Kazakhstan relating to environment, health, and safety; (b) the ESMS; (c) the EARF; and (d) all measures and requirements set forth in the respective EMP, and any corrective or preventative actions set forth in a Safeguards Monitoring Report. | Section 12                  | In compliance        |
| <u>Human and Financial Resources to Implement Safeguards Requirements.</u><br><br>The Borrower shall cause the PFIs to ensure that (a) necessary budgetary and human resources are made available to fully implement the ESMS; and (b) each qualified SME Borrower makes available necessary budget and human resources to fully implement the EMPs as required  | Section 13                  | In compliance        |
| The Borrower shall cause the PFIs to do the following:<br>(a) submit semi-annual Safeguards Monitoring Reports to the Borrower for compilation and timely submission by the Borrower to ADB;   | Section 14 (a)              | In compliance        |
| (b) if any unanticipated environmental and/or social risks and impacts arise during any Qualified SME Subproject implementation, promptly inform the Borrower and ADB of the occurrence of such risks or impacts, with detailed description of the event and proposed corrective action plan; and  | Section 14 (b)              | In compliance        |
| (c) report to the Borrower and ADB any actual or potential breach of compliance  | Section 14 (c)              | In compliance        |

| Covenant  | Reference in Loan Agreement | Status of Compliance |
|---|-----------------------------|----------------------|
| with the measures and requirements set forth in the EMP, promptly after becoming aware of the breach.   |                             |                      |
| <u>Disbursement</u><br>Except as ADB may otherwise agree, the Loan proceeds shall be disbursed in accordance with the Loan Disbursement Handbook.   | Section 15                  | In compliance        |
| <u>Gender</u><br>The Borrower shall cause the PFIs to ensure that: (a) the gender action plan as referred to in Schedule 5 to the FFA is duly implemented under the Project; (b) adequate resources are allocated for the implementation of the plan; and (c) key gender outcome and output targets are monitored and achieved.   | Section 16                  | In compliance        |
| <u>Labor Standards</u><br>The Borrower shall cause the PFIs to ensure that the core labor standards (as set out in the relevant conventions of the International Labor Organization) and applicable laws and regulations of the Republic of Kazakhstan, including workplace occupational safety norms, are complied with during Qualified SME Subproject implementation.  | Section 17                  | In compliance        |
| <u>Good Governance and Anticorruption</u><br>The Borrower and PFIs shall comply with ADB's Anticorruption Policy (1998, as amended to date) and acknowledge that ADB, consistent with its commitment to good governance, accountability, and transparency, reserves the right to investigate directly, or through its agents, any possible corrupt, fraudulent, collusive, or coercive practices relating to the Project. The Borrower shall cause each PFI to: (a) ensure that all contracts financed by ADB utilizing the proceeds of the Loan include provisions specifying the right of ADB to audit and examine the records and accounts of the PFIs and the Qualified SME Borrowers as they relate to the Project; and (b) cooperate fully with any such investigation and to extend all necessary assistance, including providing access to all relevant books and records, for the satisfactory completion of any such investigation. | Section 18                  | In compliance        |
| <u>Anti-Money Laundering and Financing of Terrorism</u><br>The Borrower shall cause each PFI to ensure: (a) compliance with applicable laws and regulations of the Borrower on combating money laundering and financing of terrorism and that Loan proceeds are not   | Section 19 (a)              | In compliance        |



| Covenant  | Reference in Loan Agreement | Status of Compliance |
|---|-----------------------------|----------------------|
| used, directly or indirectly, in money laundering or financing of terrorism;  |                             |                      |
| (b) implementation of internal control procedures to prevent violation of subparagraph (a) hereinabove; and   | Section 19<br>(b)           | In compliance        |
| (c) that the Borrower and ADB are promptly informed if there is any violation or potential violation of subparagraph (a) hereinabove. In the event that ADB informs a PFI of its concern that there has been such an alleged violation, the PFI shall (i) cooperate in good faith with ADB and its representatives so that ADB can determine whether such a violation has occurred; (ii) respond promptly and in reasonable detail to any query from ADB; and (iii) furnish documentary support for such response upon ADB's request. | Section 19<br>(c)           | In compliance        |

## GENDER EQUALITY ANNEX

### I. Narrative analysis

1. To maximize the impact of the project, Gender and Development (GAD) strategy was developed focusing on (i) medium-term financing to women and (ii) improved financial sector outreach to women entrepreneurs. The project design was highly relevant as it aimed to meet the needs of women entrepreneurs and support Damu in improving its data-base and deepen analysis of its programs through adoption of the gender aspect. The project had a positive impact on the lives of women, especially in rural areas of Kazakhstan, by providing access to finance and improved opportunities for women's involvement in business.

2. The project was categorized as effective gender mainstreaming—two out of four DMF output indicators targeted promotion of gender equality. The project is rated *successful* in delivering gender equality results with all GAP's targets achieved (table A3.1).

### II. PFIs

3. All PFIs met and exceeded target of 24% of sub-borrowers being women – as of end December 2015 and end December 2017, women represented 32.8% and 34% of sub-borrowers. With improved access to credit, women got better opportunities for entrepreneurial skills building and involvement in income-generation activities.

4. Both PFIs (Tsesna Bank and Bank Credit Center) report on the strong interest from women in the program. PFIs' participation in the program was explained by their acknowledgment of the women potential in the entrepreneurship - women are recognized to run the business on par with the men. Banks collect sex-disaggregated information and data on loan performance. PFIs mention that women are more disciplined borrowers in terms of servicing the loans.

5. Representatives of the banks indicated on the existing societal stereotypes on the role of women, which the main challenge for women to start business. PFIs believe that women - targeted approach is important. PFIs suggest that this approach should also include components on development of women tailored products, financial literacy programs for women and advisory support for women entrepreneurs.

### III. Women beneficiaries

6. The figures show that the number of women borrowers exceeded the target of 24% and by end December 2017, women represented 34% share of sub-borrowers.

**Box 1.**

Gulmaiara, 46, from Pavlodar region of Kazakhstan is in carpet trading business. She received T15 million loan from Bank Credit Center to expand her business. She mentioned that her engagement in business brought financial independence and more confidence.

Saule, 50, from Koshetau region, used the credit (amount is not disclosed) to purchase a building for kindergarten. Since she has invested in the building, now she feels more confident. Saule considers her involvement with business very satisfying and she seeks for continuous improvement of her business skills. She attends various events and would like to see more opportunities to interact and exchange ideas with other women entrepreneurs.

Gaukhar, 41, Almaty, was able to access funds through a credit line of KZT 45 million which she used to repair and refit premises for kids' training center. The training offered in these 400 square meter premises include classes in English, speed reading and mental arithmetic. She has plans to refit the second floor of the building as a fitness center in the future. The business she runs increased her self-esteem.

7. Under an ADB regional technical assistance project, two knowledge products—a publication and a video—are being developed on successful cases of women's entrepreneurship.<sup>1</sup> These include women entrepreneurs who received subloans financed under the tranche 2 project.

8. Future SME support projects in Kazakhstan should include components on development of women-tailored banking products and support of women-led start-up businesses.

9. Table A3.1 provides additional information on gender action plan implementation results.

**Table A3.1: Gender Action Plan Implementation Matrix and Results**

| Activities   | Indicators and Targets                                    | Status Update as of 01 January 2016   |
|--|---|---|
| <b>Output 1: Medium-term financing to SMEs</b>   |   |   |
| 1.1 Damu continues to collect sex disaggregated data on number of borrowers; loan accounts opened; new jobs created; amount of loan in Tenge; purpose of loan; business sector of borrowers, and analyzes the data semi-annually to produce monitoring data on loan type, amount (etc.) by sex | Database is updated monthly and analyzed twice per year   | <i>On track.</i> Damu maintains the data base of beneficiaries and differentiates information based on different indicators, including gender. The indicators include: program name, bank, region, name, sex, marital status, date, loan term/duration, amount approved, amount disbursed, grace period (if any), interest rate, effective interest rate, purpose of credit, region, sector, subsector, number on new jobs/employment created.<br>The data is analyzed quarterly and submitted to the National Commission for Women's Affairs and Family and Demographic Policy and the Ministry of Economy |
| 1.2 Damu adds an indicator in its sex disaggregated MIS on loan performance  | Periodic reports on SME loan portfolio performance by sex | <i>On track.</i> Damu collects information on performing and not performing loans. The Information Analytical Department annually prepares a report on the development of SMEs  |

<sup>1</sup> ADB. 2016. *Technical Assistance for Strengthening Gender-Inclusive Grow in Central and West Asia*. Manila.

| Activities  | Indicators and Targets  | Status Update as of 01 January 2016   |
|---|---|---|
| <p>(payment timeliness/delinquency, satisfactory repayment/bad loans)</p> <p>1.3 Damu (and PFIs) targets at least 24% of borrowers to be women entrepreneurs</p>  | <p>At least 24% of borrowers are women entrepreneurs by end 2015 (baseline: 10% in 2013)</p>  | <p>in Kazakhstan and its regions. The latest annual report of Damu includes sex-disaggregated information on entrepreneurs.</p> <p><i>Achieved.</i> As of the end of 2015, 33% of borrowers were women entrepreneurs. (As of the end of 2017, the percentage had increased to 34%.)</p>   |
| <b>Output 2: Improved financial sector outreach, with a focus on women entrepreneurs</b>  |   |   |
| <p>2.1 Damu outreach activities to women entrepreneurs to create more effective demand for finance and raise awareness on availability and terms of financing, business development and other Damu services</p> | <p>At least 30% of all applications are received from women entrepreneurs (baseline: 10% in 2013)</p> <p>Evidence of advertisements, targeted information (Damu's Entrepreneurship Service Centers, women associations), radio or TV slots at times when all Damu's programs, including women's programs are transmitted.</p> | <p><i>Achieved.</i> Neither Damu nor PFIs collect data on number of loan applications received from women entrepreneurs. However, as per Damu, as of 01.01.2016 the share of women borrowers was 32.8% and this might indicate that the 30% for loan applications received from women entrepreneurs might have been reached.</p> <p><i>On track.</i> Information on programs focused on support of female entrepreneurship was widely disseminated through Damu's Entrepreneur's Service Centers and Mobile Entrepreneurship Service Centers in all regions of the country. The video records prepared by Damu in Russian and Kazakh languages have been transmitted in all regions on the channel 24.kz. Video records were also transmitted on the TV -screens in Entrepreneurs Service Centers' waiting rooms. In addition, video records have been transmitted in public transport in Almaty. Billboards have been placed in the regions. Information on the programs for women entrepreneurs is also promoted on the main web-site of Damu <a href="https://www.damu.kz/en/">https://www.damu.kz/en/</a></p> <p>Programs focused on support of female entrepreneurship in Kazakhstan received wide coverage in the mass media:<br/> <a href="http://fin.mandp.kz/kredit-woman/">-http://fin.mandp.kz/kredit-woman/</a><br/> <a href="https://pandaland.kz/articles/mamam-o-mamah/obrazovanie-i-karera/delovye-zhenshhiny-kazahstana-realno-li-raskrutit-svoj-biznes">-https://pandaland.kz/articles/mamam-o-mamah/obrazovanie-i-karera/delovye-zhenshhiny-kazahstana-realno-li-raskrutit-svoj-biznes</a><br/> <a href="http://mamaspace.kz/zhenshhiny-v-kazaxstanskom-biznese-mogut-mnogoe/">-http://mamaspace.kz/zhenshhiny-v-kazaxstanskom-biznese-mogut-mnogoe/</a><br/> <a href="http://www.akorda.kz/ru/osnovnie-napravleniya-nacionalnoi-komissii/uchastie-zhenshin/komissiya-po-delam-zhenshchin-info/razvitie-zhenskogo-predprinimatelstva">-http://www.akorda.kz/ru/osnovnie-napravleniya-nacionalnoi-komissii/uchastie-zhenshin/komissiya-po-delam-zhenshchin-info/razvitie-zhenskogo-predprinimatelstva</a><br/> <a href="http://www.akorda.kz/ru/osnovnie-napravleniya-nacionalnoi-komissii/uchastie-zhenshin/komissiya-po-delam-zhenshchin-">-http://www.akorda.kz/ru/osnovnie-napravleniya-nacionalnoi-komissii/uchastie-zhenshin/komissiya-po-delam-zhenshchin-</a></p> |

| Activities   | Indicators and Targets  | Status Update as of 01 January 2016   |
|--|---|---|
| <p>2.2 Damu analyzes, uses and disseminates the results of the survey on gender issues in the SME sector (under Tranche 1, report dated May 2013) to PFIs</p>  | <p>Evidence that Damu has informed its own business support programs in response to the results of the survey on gender issues.</p> | <p><a href="http://info/bolee-treti-kazahstanskogo-vvp-sozdayut-zhenshchiny">info/bolee-treti-kazahstanskogo-vvp-sozdayut-zhenshchiny</a></p> <p>-</p> <p><a href="https://www.youtube.com/watch?v=qV65ozMWsfo">https://www.youtube.com/watch?v=qV65ozMWsfo</a></p> <p>-</p> <p><a href="https://www.youtube.com/watch?v=8eSiUqr1zzw">https://www.youtube.com/watch?v=8eSiUqr1zzw</a></p> <p>-</p> <p><a href="https://www.youtube.com/watch?v=7hyW9S1ev2Y">https://www.youtube.com/watch?v=7hyW9S1ev2Y</a></p> <p>-<a href="https://kapital.kz/business/48344/zhencshiny-aktivnee-prihodyat-v-biznes.html">https://kapital.kz/business/48344/zhencshiny-aktivnee-prihodyat-v-biznes.html</a></p> <p><i>On track.</i> Tranche 1 analysis and lessons learned from it, has helped Damu to integrate gender indicator in its programs and analysis. The latest survey which is used for planning the work of Damu is also gender sensitive and contains data and analysis on women entrepreneurs</p> <p><a href="https://www.damu.kz/kz/poleznaya-informatsiya/Damu_BOOK_ENG_inet.pdf">https://www.damu.kz/kz/poleznaya-informatsiya/Damu_BOOK_ENG_inet.pdf</a></p> <p>Such reports are important for Damu in evaluating and analyzing its programs</p> <p>Damu shared the results of the Tranche 2 with PFIs and the Ministry of National Economy. Damu disseminates analysis not only for ADB projects but also for other programs (e.g. government or donor-funded). Damu has expanded the data-base and tracks the development of women's entrepreneurship in the country on a regular basis. This analysis has strengthened Damu's and PFIs' interest in working with women entrepreneurs.</p> |
| <p>2.3 Damu discusses with each PFI the possibility to improve products (e.g. Working Capital Loans, Term Loans, Equipment Financing, Letters of Credit) and services (mobile or internet banking) for women entrepreneurs</p> | <p>At least one feasible action agreed by each PFI to engage women clients</p>  | <p><i>On track.</i> Damu discussed with the PFIs possibility of launching joint loan programs tailored to women entrepreneurs and cooperation modalities (e.g. Damu informs women clients on the loan products available at PFIs and supports potential sub-borrowers in communication with banks). Bank Center Credit in cooperation with Damu launched loan product tailored for women entrepreneurs 'Women in business'</p> <p>(<a href="https://www.bcc.kz/product/programma-kreditovaniya-dlya-individualnykh-predprinimateley/">https://www.bcc.kz/product/programma-kreditovaniya-dlya-individualnykh-predprinimateley/</a>).</p> <p>TsesnaBank also launched loan product tailored to women entrepreneurs. (<a href="https://tsb.kz/corporates/credits_smb/state_support/1027">https://tsb.kz/corporates/credits_smb/state_support/1027</a>).</p>   |

| Activities | Indicators and Targets | Status Update as of 01 January 2016  |
|------------|------------------------|--|
|            |                        | <p>To attract women-entrepreneurs “Tsesnabank” applies different methods: round tables with women-entrepreneurs in the regions, open days at district branches, call-up of potential clients, etc. On March 8 (International Women’s Day), employees of branches visited potential women customers to congratulate them on this occasion. The dissemination of handouts with the terms of the programs is also widely used.</p> <p>“Bank CenterCredit’ JSC also informs possible women clients on the financial products available through its client network, regional branches, different public events.</p> |

## STATISTICAL INFORMATION ON SUBLOANS

**Table A4.1: Loans Disbursed by Participating Financial Institutions Under Tranche 2 Through 1 November 2017**

| Participating Financial Institution | Amount Disbursed (T million) | Share of Amount Disbursed (%) | Number of Borrowers | Number of Loans | Average Loan amount (T million) | Average Loan term (months) | Weighted Average Interest Rate (%) |
|-------------------------------------|------------------------------|-------------------------------|---------------------|-----------------|---------------------------------|----------------------------|------------------------------------|
| BCC                                 | 26,956                       | 54                            | 342                 | 1,084           | 78,8                            | 33.1                       | 14.5                               |
| TSB                                 | 22,917                       | 46                            | 234                 | 1,142           | 97,9                            | 23.1                       | 14.7                               |
| <b>Total</b>                        | <b>49,873</b>                | <b>100</b>                    | <b>575</b>          | <b>2,226</b>    | <b>86,7</b>                     | <b>28.5</b>                | <b>14.6</b>                        |

BCC = Bank CenterCredit, TSB = Tsesnabank.

Source: Damu.

**Table A4.2: Distribution of Subloans by Maturity, 1 November 2017**

| Term         | Amount Disbursed (T million) | Share (%)  | Number of Borrowers | Number of Loans | Average Loan Amount (T million) | Average Loan Tenor (months) | Weighted Average Interest Rate (%) |
|--------------|------------------------------|------------|---------------------|-----------------|---------------------------------|-----------------------------|------------------------------------|
| Up to 1 year | 24,547                       | 49         | 188                 | 1,331           | 130.6                           | 9.8                         | 14.5                               |
| 1–3 years    | 12,345                       | 25         | 196                 | 507             | 62.9                            | 28.5                        | 14.7                               |
| 3–5 years    | 8,909                        | 18         | 199                 | 314             | 44.8                            | 55.2                        | 14.9                               |
| 5–7 years    | 4,072                        | 8          | 42                  | 74              | 96.9                            | 83.3                        | 14.0                               |
| <b>Total</b> | <b>49,873</b>                | <b>100</b> | <b>575</b>          | <b>2,226</b>    | <b>86.7</b>                     | <b>28.5</b>                 | <b>14.6</b>                        |

Source: Damu.

**Table A4.3: Distribution of Subloans by Sector, 1 November 2017**

| Sector                               | Amount Disbursed (T million) | Share (%) | Number of Borrowers | Number of Loans | Average Loan amount (T million) | Average Loan Tenor (months) | Weighted Average Interest Rate (%) |
|--------------------------------------|------------------------------|-----------|---------------------|-----------------|---------------------------------|-----------------------------|------------------------------------|
| Information and communication        | 52                           | 0.1       | 4                   | 5               | 13                              | 16.3                        | 14.0                               |
| Construction                         | 2,126                        | 4.3       | 38                  | 95              | 56                              | 21.2                        | 14.7                               |
| Wholesale and retail trade           | 27,562                       | 55.3      | 226                 | 1,243           | 122                             | 19.3                        | 14.5                               |
| Accommodation and food services      | 1,362                        | 2.7       | 17                  | 45              | 80                              | 51.8                        | 14.5                               |
| Operations with real estate          | 2,385                        | 4.8       | 36                  | 55              | 66                              | 47.4                        | 14.6                               |
| Administrative and support services  | 1,605                        | 3.2       | 15                  | 24              | 107                             | 48.4                        | 14.7                               |
| Health and social services           | 2,023                        | 4.1       | 24                  | 71              | 84                              | 70.0                        | 14.5                               |
| Arts, entertainment and recreation   | 225                          | 0.5       | 4                   | 5               | 56                              | 46.2                        | 15.6                               |
| Provision of other types of services | 1,517                        | 3.0       | 50                  | 66              | 30                              | 50.0                        | 14.8                               |

| <b>Sector</b>                                   | <b>Amount Disbursed (T million)</b> | <b>Share (%)</b> | <b>Number of Borrowers</b> | <b>Number of Loans</b> | <b>Average Loan amount (T million)</b> | <b>Average Loan Tenor (months)</b> | <b>Weighted Average Interest Rate (%)</b> |
|---|-------------------------------------|------------------|----------------------------|------------------------|--|------------------------------------|---|
| Agriculture, forestry and fishery               | 1,939                               | 3.9              | 20                         | 89                     | 97                                     | 38.6                               | 14.1                                      |
| Mining industry and related activities          | 42                                  | 0.1              | 2                          | 3                      | 21                                     | 41.9                               | 14.0                                      |
| Water supply, sanitation and waste management   | 22                                  | 0.0              | 1                          | 3                      | 22                                     | 24.5                               | 14.0                                      |
| Financial services                              | 2,184                               | 4.4              | 11                         | 171                    | 198                                    | 18.4                               | 15.2                                      |
| Professional, scientific and technical services | 266                                 | 0.5              | 12                         | 35                     | 22                                     | 25.9                               | 14.1                                      |
| Transport and warehouses                        | 2,264                               | 4.5              | 53                         | 96                     | 43                                     | 42.2                               | 15.3                                      |
| Education                                       | 535                                 | 1.1              | 14                         | 24                     | 38                                     | 60.8                               | 14.3                                      |
| Industry  | 3,705                               | 7.4              | 62                         | 193                    | 60                                     | 27.3                               | 14.4                                      |
| Activities at household levels                  | 58                                  | 0.1              | 3                          | 3                      | 19                                     | 25.4                               | 19.0                                      |
| <b>Total</b>                                    | <b>49,873</b>                       | <b>100.0</b>     | <b>575</b>                 | <b>2,226</b>           | <b>86,736</b>                          | <b>28.5</b>                        | <b>14.6</b>                               |

Source: Damu.



## SUMMARY OF FINANCIAL PERFORMANCE OF DAMU

1. Damu was established in 1997 as a public development institution to support small and medium enterprise (SME) development. Its main activity is lending to SMEs and microfinance organizations through commercial banks and leasing companies, using both Damu's own and borrowed funds. In addition to lending, Damu provides nonfinancial support for SMEs in the form of information and analytical services, training, and consulting. Damu has 16 regional offices, with its headquarters based in Almaty.

2. Prior to May 2013, the sole shareholder of Damu was Samruk-Kazyna Sovereign Welfare Fund (Samruk-Kazyna).<sup>1</sup> Ownership was transferred to the Baiterek National Management Holding JSC (Baiterek), which was established in May 2013 to acquire Damu and other development and financial institutions previously held by Samruk-Kazyna. Damu is ultimately controlled by the Government of Kazakhstan, and reports to the Ministry of National Economy.

3. Between 2014–2017, Damu's balance sheet grew by 13% from T223 billion to T 320 billion on the back of funding from parent company and from Asian Development Bank (ADB). The borrowed funds were invested in:

- a. loan book (net) growing at 8% (CAGR 2014–2017), all denominated in local currency. As of end 2017 loan book (net) accounted for T219 billion or 69% of total assets;
- b. liquid assets which grew by 14% (CAGR 2014–2017) to T57 billion or 18% of total assets as of end 2017.

4. As of end 2017 Damu's liabilities were concentrated with ADB (T72 billion) and BaiTerek & Samruk Kazyna (T97 billion) representing 33% and 44% of total borrowings. ADB is the only foreign lender to Damu and in 2015–2016 ADB was also the largest lender with 60% and 52% share in total borrowings.

**Table A5.1: Growth indicators, 2014–2017**  
(T million)

| Year                 | 2014    | 2015    | 2016    | 2017    | CAGR  |
|----------------------|---------|---------|---------|---------|-------|
| Liquid assets        | 37,995  | 50,280  | 87,808  | 56,820  | 14%   |
| Loan portfolio (net) | 172,865 | 247,011 | 205,386 | 219,384 | 8%    |
| Total borrowings     | 124,495 | 235,269 | 223,870 | 203,003 | 18%   |
| Total equity         | 83,143  | 95,173  | 98,705  | 101,148 | 7%    |
| Total assets         | 223,054 | 355,306 | 349,434 | 319,913 | 13%   |
| Profit after tax     | 4,141   | 15,655  | 5,593   | 4,113   | -0.2% |

CAGR = compound annual growth rate

Source: 2014-2017 audited financial statements

### A. Loan Portfolio

5. In 2014–2017, Damu's gross loan portfolio grew from T177 billion to T243 billion (Table A5.2). Damu has two main loan products:

<sup>1</sup> Samruk-Kazyna is a holding company for the government's interest in over 400 natural resource, power, telecommunication, infrastructure, and other companies. Samruk-Kazyna has a Standard & Poor's credit rating of BBB+/A-2, which is the same as the sovereign rating of the Republic of Kazakhstan.

- a. Loans to banks, which total T235 billion and represent 97% of all loans; thus, Damu's credit risk is strongly linked to the creditworthiness of the Kazakh banking sector.
- b. Direct loans to Kazakh SMEs and MFIs, which total T8 billion and account for the remaining 3% of all loans; the majority of these are loans to SMEs issued by Delta Bank and transferred to Damu after Delta Bank become insolvent.

**Table A5.2: Loan portfolio breakdown by loan type, 2014–2017**  
(T million)

| Year                      | 2014           | %           | 2014           | %           | 2016           | %           | 2017           | %           | CAGR       |
|---------------------------|----------------|-------------|----------------|-------------|----------------|-------------|----------------|-------------|------------|
| Loans to banks            | 174,283        | 98%         | 248,202        | 99%         | 219,521        | 99%         | 235,272        | 97%         | 11%        |
| Loans to MFIs             | 1,354          | 1%          | 1,139          | 0.5%        | 947            | 0.4%        | 970            | 0.4%        | -11%       |
| Direct loans to SMEs      | 1,785          | 1%          | 1,678          | 1%          | 1,622          | 1%          | 6,947          | 3%          | 57%        |
| <b>Gross loans</b>        | <b>177,422</b> | <b>100%</b> | <b>251,019</b> | <b>100%</b> | <b>222,091</b> | <b>100%</b> | <b>243,188</b> | <b>100%</b> | <b>11%</b> |
| Loan loss reserves        | 4,557          |             | 4,008          |             | 16,705         |             | 23,804         |             | 73%        |
| <b>Net loan portfolio</b> | <b>172,865</b> |             | <b>247,011</b> |             | <b>205,386</b> |             | <b>219,384</b> |             | <b>8%</b>  |

CAGR = compound annual growth rate, MFIs = microfinance institutions, SME = small and medium enterprise  
Source: 2014-2017 audited financial statements

6. All loans are in Kazakh tenge and hence do not expose Damu and its borrowers to foreign exchange risk.
7. In terms of maturity, 80% of outstanding loans as of end 2017 had maturity above 1 year.
8. In addition to its lending operations, as of the end of 2017 Damu has a portfolio of guarantees totaling T71 billion, or around 29% of its loan portfolio (Table A5.3). There are two types of guarantees:
  - a. Guarantees issued directly in support of SME loans, which increased by 38% from 2014 to 2017—from T10 billion to T25 billion.
  - b. Guarantees issued in support of loans by the European Bank for Reconstruction and Development (EBRD) loans to three banks (Bank CenterCredit [BCC], ForteBank, and Kassa Nova Bank) and one microfinance institution (KazMicroFinance [KMF]). These guarantees increased by 85% from 2015 to 2017—from T27 billion to T45 billion.
9. Quality of the issued guarantees is reported as satisfactory.

**Table A5.3: Guarantees issued by Damu, 2014–2017**  
(T million)

| Year                     | 2014         | 2015          | 2016          | 2017          | CAGR             |
|--------------------------|--------------|---------------|---------------|---------------|------------------|
| EBRD loans               | 0            | 27,220        | 40,903        | 45,282        | 18% <sup>a</sup> |
| SME support              | 9,621        | 17,340        | 23,069        | 25,413        | 38%              |
| <b>Guarantees, total</b> | <b>9,621</b> | <b>44,620</b> | <b>63,972</b> | <b>70,695</b> | <b>94%</b>       |

CAGR = compound annual growth rate, EBRD = European Bank for Reconstruction and Development, SME = small and medium enterprise

<sup>a</sup> For 2015–2017 period only.

Source: 2014-2017 audited financial statements

## B. Asset Quality

10. From 2014 to 2016, the quality of Damu's loan portfolio significantly deteriorated, with loans overdue more than 90 days reaching T33 billion, or 15% of gross loans (Table A5.4). However, the percentage of such loans declined to 12% in 2017. Loan loss provisions increased more than five times over four years: they totaled 81% of loans overdue more than 90 days as of the end of 2017. The unprovisioned amount of 19% constituted a relatively low 5.6% of Damu's equity.

**Table A5.4: Loan book quality, 2014–2017**  
(T million and %)

| Year                        | 2014    | 2015    | 2016    | 2017    | CAGR |
|-----------------------------|---------|---------|---------|---------|------|
| Non-performing loans (NPLs) | 4,615   | 4,435   | 33,411  | 29,434  | 93%  |
| Gross loan Portfolio (GLP)  | 177,422 | 251,019 | 222,091 | 243,188 | 8%   |
| Loan Loss Provisions (LLPs) | 4,557   | 4,008   | 16,705  | 23,804  | 54%  |
| NPLs – GLP ratio            | 3%      | 2%      | 15%     | 12%     |      |
| LLPs – NPLs ratio           | 99%     | 90%     | 50%     | 81%     |      |
| Net NPLs – equity ratio     | 0.1%    | 0.4%    | 16.9%   | 5.6%    |      |

CAGR = compound annual growth rate, NPLs = overdue loans over 90 days, GLP=gross loan portfolio, LLPs=loan loss provisions

Source: 2014–2017 audited financial statements

11. The decline in loan portfolio quality suggests that Damu may have loosened its underwriting standards. However, Damu's underwriting was made more difficult because of the local conditions. First, under Kazakh bank regulation, the amount of loans considered overdue does not include accrued interest and loans to subsidiaries. Second, unlike in many other countries, loan restructuring does not usually result in downward re-classification and does not require the creation of additional provisions and capital charges. Third, Kazakh banks often agree to exchange problem loans, with the transferee bank recording the loans as newly issued, "normal" loans.

## C. Capital Adequacy

12. Over 2014–2017, Damu's equity grew from T83 billion to T101 billion, driven by retained earnings (Table A5.5). Its leverage ratio ended at 32%, down 5% from 2014.

**Table A5.5: Capitalization levels, 2014–2017**  
(T million)

| Year                 | 2014    | 2015    | 2016    | 2017    | CAGR |
|----------------------|---------|---------|---------|---------|------|
| Equity               | 83,143  | 95,173  | 98,705  | 101,148 | 7%   |
| Assets               | 223,054 | 355,306 | 349,434 | 319,913 | 17%  |
| Equity- assets ratio | 37%     | 27%     | 28%     | 32%     |      |

CAGR= compound annual growth rate

Source: 2014–2017 audited financial statements

## D. Earnings and Profitability

13. Damu's profitability has been variable over 2014–2017, as profits on currency derivatives caused profits to soar in 2015 as the value of the tenge declined by half (Table A5.6). However, income generation from its core business has been helped by an increase in Damu's net interest margin from 8% in 2014 to 11% in 2017.

**Table A5.6: Profitability indicators, 2014–2017**  
(T million and %)

| Item                     | 2014  | 2015   | 2016  | 2017  |
|--------------------------|-------|--------|-------|-------|
| Net profit (after tax)   | 4,141 | 15,656 | 5,593 | 4,113 |
| Net interest margin      | 7.7%  | 5.4%   | 10.4% | 11.3% |
| Return on average assets | 3.6%  | 5.4%   | 1.6%  | 1.2%  |
| Return on average equity | 9.8%  | 17.6%  | 5.8%  | 4.1%  |
| Cost–income ratio        | 50.4% | 19.8%  | 21.3% | 31.2% |

Source: 2014-2017 audited financial statements

## E. Funding, Liquidity and exposure to foreign exchange risks

14. The Fund's liquidity is adequate with no maturity gaps in any time bucket as of the end of 2017, as the repayments on the loans mirror the repayment structure of the borrowings. Broad liquid assets (cash and cash equivalents, placements with banks, and liquid securities) accounted for T35 billion and they covered short-term liabilities of 30 days by 5.3 times. On the negative side, Damu's funding is very much concentrated with funding from ADB and Baiterek accounting for 78% of total borrowings. Damu actively uses derivatives to hedge FX exposure related to its loans from ADB. As of the end 2017, Damu had small short FX gap of T1.5 billion, or 1.5% of equity.

**Table A5.7: Liquidity and FX gap indicators, 2014–2017**  
(%)

| Item                                    | 2014 | 2015  | 2016  | 2017   |
|---|------|-------|-------|--------|
| Liquid assets to total assets           | 17%  | 14%   | 25%   | 18%    |
| Liquid assets to short-term liabilities | 201% | 181%  | 390%  | 535%   |
| FX gap - equity ratio                   | 2.6% | 30.8% | 19.8% | (1.5%) |

( ) = negative value

Source: 2014- 2017 audited financial statements

15. Table A5.8 and A5.9 summarize Damu's balance sheet and income statements.

**Table A5.8: Balance sheet, 2014–2017**  
(T million)

| Item                     | 2014           |             | 2015           |             | 2016           |             | 2017           |             | CAGR       |
|--------------------------|----------------|-------------|----------------|-------------|----------------|-------------|----------------|-------------|------------|
| Customer loans, net      | 172,865        | 77%         | 247,011        | 70%         | 205,386        | 59%         | 219,384        | 69%         | 10%        |
| Liquid assets            | 37,995         | 17%         | 50,280         | 14%         | 87,808         | 25%         | 56,820         | 18%         | 17%        |
| Fixed assets, net        | 2,657          | 1%          | 3,206          | 1%          | 2,739          | 1%          | 2,497          | 1%          | -2%        |
| Other assets             | 9,536          | 4%          | 54,808         | 15%         | 53,501         | 15%         | 41,212         | 13%         | 80%        |
| <b>Total Assets</b>      | <b>223,054</b> | <b>100%</b> | <b>355,306</b> | <b>100%</b> | <b>349,434</b> | <b>100%</b> | <b>319,913</b> | <b>100%</b> | <b>16%</b> |
| Total borrowings         | 124,495        | 56%         | 235,269        | 66%         | 223,870        | 64%         | 203,003        | 63%         | 22%        |
| Other liabilities        | 15,416         | 7%          | 24,864         | 7%          | 26,860         | 8%          | 15,762         | 5%          | 1%         |
| <b>Total Liabilities</b> | <b>139,911</b> | <b>63%</b>  | <b>260,133</b> | <b>73%</b>  | <b>250,729</b> | <b>72%</b>  | <b>218,765</b> | <b>68%</b>  | <b>20%</b> |
| Common stocks            | 73,755         | 33%         | 73,755         | 21%         | 73,755         | 21%         | 73,755         | 23%         | 0%         |
| Retained earnings        | 9,388          | 4%          | 21,418         | 6%          | 24,950         | 7%          | 27,393         | 9%          | 54%        |
| <b>Total Equity</b>      | <b>83,143</b>  | <b>37%</b>  | <b>95,173</b>  | <b>27%</b>  | <b>98,705</b>  | <b>28%</b>  | <b>319,913</b> | <b>100%</b> | <b>71%</b> |

Source: 2014–2017 audited financial statements

**Table A5.9: Income Statement, 2014–2017**  
(T million)

| Item                                      | 2014          | 2015          | 2016          | 2017          |
|---|---------------|---------------|---------------|---------------|
| Interest Income                           | 12,551        | 19,431        | 35,546        | 34,797        |
| Interest Expense                          | (5,062)       | (7,102)       | (8,773)       | (7,630)       |
| <b>Net Interest Income</b>                | <b>7,489</b>  | <b>12,329</b> | <b>26,773</b> | <b>21,167</b> |
| Net fee and commission income             | 2,530         | 2,154         | 2,785         | 4,158         |
| <b>Net interest and commission Income</b> | <b>10,018</b> | <b>14,482</b> | <b>29,558</b> | <b>31,325</b> |
| Gains / Losses on FX derivatives          | 1,461         | 44,056        | (7,777)       | (16,771)      |
| Foreign Exchange Revaluation              | (57)          | (1,225)       | 2,034         | 2,157         |
| Other Income                              | (1,230)       | (32,418)      | 395           | 333           |
| <b>Total Income</b>                       | <b>10,192</b> | <b>24,896</b> | <b>24,211</b> | <b>17,045</b> |
| Operating expenses                        | (5,142)       | (4,941)       | (5,157)       | (5,312)       |
| Asset impairment provisions               | 498           | (298)         | (11,610)      | (6,527)       |
| <b>Pre-tax income</b>                     | <b>5,549</b>  | <b>19,657</b> | <b>7,444</b>  | <b>5,206</b>  |
| Income tax                                | (1,407)       | (4,002)       | (1,851)       | (1,093)       |
| <b>Net Income</b>                         | <b>4,141</b>  | <b>15,656</b> | <b>5,593</b>  | <b>4,113</b>  |

Source: 2014- 2017 audited financial statements

## F. Summary

16. **Strengths.** Damu's strengths are:
- i. It has strong capital adequacy levels.
  - ii. Its ownership by the state has resulted in a credit rating at the level of the sovereign rating, as a result of a high probability of government support in case of an emergency.
  - iii. It has strong liquidity levels.
17. **Key risks.** Damu's risks include:
- i. Around two-thirds of its assets are loans to Kazakh banks, which are weakly supervised by the National Bank of Kazakhstan.
  - ii. Two creditors—Baiterek and ADB—account for almost all of its liabilities.
  - iii. Its net earnings fluctuate depending on gains and losses from foreign exchange derivatives.
  - iv. The occurrence of problem loans, especially in the period from 2015–2017, suggest that underwriting and monitoring could be improved.

## SUMMARY OF FINANCIAL PERFORMANCE OF TSESNA BANK

1. TsesnaBank (TSB) was founded in 1992 and by end 2017 it was one of market leaders in Kazakhstan:
  - a. 3<sup>rd</sup> largest bank by assets with market share of 8.6%
  - b. 3<sup>rd</sup> largest bank by customer loans with market share of 10.6%
  - c. 3<sup>rd</sup> largest bank by customer accounts & deposits with market share of 9% servicing 259,000 individuals and 56,000 legal entities via 22 branches and 146 sub-branches
2. TSB has an especially strong market position in the Northern and Central Kazakhstan with a market share of 35.4% in loans and 20.0% of customer deposits. As of the end of 2017, 75.2% of the bank's outstanding loans were disbursed in these regions.
3. As of the end of 2017, TSB complied with all prudential norms established by the National Bank of Kazakhstan (NBK). In May 2018, Standard & Poor's assigned the bank a credit rating of B+ with a negative outlook.
4. As of end 2017, TSB's ownership structure consists of:

**Table A6.1: Ownership structure, 31 December 2017**

| Shareholder's name         | Place of registration/<br>citizenship | Ownership share, % |
|----------------------------|---------------------------------------|--------------------|
| Tsesna Financial Holding   | Kazakhstan                            | 62%                |
| Mr. Uandykov Chingiz       | Kazakhstan                            | 9%                 |
| TOO ApparatKZ <sup>b</sup> | Kazakhstan                            | 7%                 |
| TOO KINESIOKZ <sup>c</sup> | Kazakhstan                            | 5%                 |
| Other shareholders         |                                       | 16%                |

Source: 2017 audited financial statement

5. In April 2017, TSB (as part of a consortium also including Tsesna Financial Holding and Bakytbek Baiseitov) acquired a 29.6% ownership stake in Bank CenterCredit. However, it disposed of this stake in March 2018. TSB's subsidiaries as shown in its latest annual financial statements are shown in Table A6.2.

**Table A6.2: Subsidiaries and investment in associates, 31 December 2017**

| (%)                |                         |   |                    |
|--------------------|-------------------------|---|--------------------|
| Company name       | Country of registration | Sector                                    | Ownership share, % |
| Bank Center Credit | Kazakhstan              | banking                                   | 30%                |
| Plus Bank          | Russia                  | banking                                   | 100%               |
| Tsesna Garant      | Kazakhstan              | Insurance                                 | 100%               |
| Tsesna Capital     | Kazakhstan              | Brokerage                                 | 100%               |
| Tsesna OUSA        | Kazakhstan              | Management of<br>the distressed<br>assets | 100%               |

Source: 2017 audited financial statements

6. Financial statistics for TSB for the last four years are set forth in Table A6.3

**Table A6.3: Growth indicators, 2014–2017**  
(T million)

| Year                 | 2014      | 2015      | 2016      | 2017      | CAGR |
|----------------------|-----------|-----------|-----------|-----------|------|
| Loan portfolio (net) | 1,060,249 | 1,589,510 | 1,718,928 | 1,808,797 | 19%  |
| Customer deposits    | 1,003,402 | 1,437,271 | 1,666,392 | 1,677,388 | 19%  |
| Total borrowings     | 191,372   | 349,761   | 288,137   | 235,230   | 7%   |
| Total equity         | 105,021   | 125,516   | 165,897   | 219,578   | 28%  |
| Total assets         | 1,321,495 | 1,956,593 | 2,260,037 | 2,291,110 | 20%  |
| Net profit           | 15,904    | 18,063    | 12,157    | 50,601    | 47%  |

GAGR = compound annual growth rate

Source: 2014-2017 audited financial statements

## A. Loan Portfolio.

7. From 2014 to 2017, the bank's loan portfolio grew by 22%, from T1.1 trillion to T1.9 trillion (Table A6.4). The main driving force behind this growth was a 29% increase in the volume of loans to small and medium enterprises, which represented 73% of loans as of end of 2017 (compared to only 60% in 2014). Loans to corporate and retail clients also both grew, but at compound annual rates averaging of less than 10%.

**Table A6.4: Loan book breakdown by client type, 2014– 2017**  
(T million)

|                    | 2014             |             | 2015             |             | 2016             |             | 2016             |             | CAGR       |
|--------------------|------------------|-------------|------------------|-------------|------------------|-------------|------------------|-------------|------------|
| Corporate Loans    | 278,947          | 25%         | 402,992          | 24%         | 310,698          | 17%         | 355,627          | 18%         | 8%         |
| SME loans          | 670,139          | 60%         | 1,085,582        | 64%         | 1,348,403        | 72%         | 1,448,879        | 73%         | 29%        |
| Retail loans       | 160,704          | 14%         | 202,846          | 12%         | 203,725          | 11%         | 187,279          | 9%          | 5%         |
| <b>Gross loans</b> | <b>1,109,789</b> | <b>100%</b> | <b>1,691,420</b> | <b>100%</b> | <b>1,862,826</b> | <b>100%</b> | <b>1,991,785</b> | <b>100%</b> | <b>22%</b> |

CAGR =compound annual growth rate, SME =small and medium enterprise

Source: 2014- 2017 audited financial statements

8. TSB enjoys long-term funding from Damu, the Development Bank of Kazakhstan, KazAgro, Agrarian Credit Corporation, and the Asian Development Bank (ADB). As a result, the share of its loans with a maturity longer than 1 year increased from 52% in 2014 to 80% in 2017.

9. Contingent liabilities (i.e., guarantees, letters of credit, and undrawn loan commitments) do not represent a significant credit risk. As of the end of 2017, they stood at T207.5 billion. Their quality is reported as satisfactory.

## B. Asset Quality

10. Over the period from 2014 to 2017, TSB experienced a 30% increase in loans more than 90 days overdue (from T47 billion to T133 billion). T133 billion constitutes 6.7% of its gross loan portfolio, which is well below the average ratio for banks of 10.7%. The volume of overdue loans increased because of a slowdown in the Kazakh economy and because the 50% devaluation of the tenge in the first half of 2015. Its relatively good well-performing loan book is partially explained by the bank's concentration in SME lending, which demonstrated better resilience to macroeconomic shocks compared to the corporate sector. The bank's provisioning policy is quite conservative. In response to the deterioration of the quality of its loan book quality, TSB increased

its loan loss provisions at a compound annual growth rate of 58% (Table A6.5). Its provisions are now equal to 138% of its loans overdue more than 90 days.

**Table A6.5: Loan Portfolio Quality, 2014–2017**  
(T million and %)

| Item                                | 2014      | 2015      | 2016      | 2017      | CAGR |
|-------------------------------------|-----------|-----------|-----------|-----------|------|
| Overdue loans over 90 days (NPLs)   | 46,725    | 64,472    | 86,265    | 132,659   | 30%  |
| Gross loan Portfolio (GLP)          | 1,109,789 | 1,691,420 | 1,862,826 | 1,991,785 | 24%  |
| Loan Loss Provisions (LLPs)         | 49,540    | 101,910   | 143,898   | 182,988   | 58%  |
| NPLs – GLP ratio                    | 4.2%      | 3.8%      | 4.6%      | 6.7%      |      |
| LLPs - NPLs ratio                   | 106%      | 158%      | 167%      | 138%      |      |
| LLPs - NPLs ratio                   | 95%       | 73%       | 85%       | 57%       |      |
| Net NPLs - Regulatory Capital ratio | (2%)      | (22%)     | (29%)     | (15%)     |      |

(-) = negative value

CAGR = compound annual growth rate, NPLs= non-performing loans, GLP = gross loan portfolio, LLPs = loan loss provisions

Source: 2014- 2017 audited financial statements.

11. As of the end of 2017, 93% of the bank's loans were secured by collateral (mainly real estate). However, especially for loans made in rural areas, it might be difficult for TSB to liquidate some of the collateral in the event of default due to the absence of a functioning real estate market.

### C. Capital Adequacy

12. In October 2017, TSB joined NBK's program on Financial Sector Stability and NBK invested T100 billion in TSB's 15-year subordinated convertible bonds (Tier 2 capital). This resulted in an increase in the bank's total capital adequacy ratio from 11.1% at the end of 2016 to 16.1% at the end of 2017 (Table A6.6).

**Table A6.6: Capital Adequacy, 2014–2017**  
(T million and %)

| Year                 | 2014      | 2015      | 2016      | 2017      |
|----------------------|-----------|-----------|-----------|-----------|
| Tier 1 capital       | 93,011    | 123,181   | 159,900   | 208,008   |
| Tier 1 & 2 capital   | 155,050   | 166,783   | 199,439   | 316,645   |
| Risk-weighted assets | 1,219,404 | 1,760,450 | 1,800,393 | 1,902,538 |
| CAR Tier 1           | 7.6%      | 6.9%      | 8.9%      | 10.5%     |
| CAR Tier 1 & 2       | 12.7%     | 9.5%      | 11.1%     | 16.1%     |

Source: 2014-2017 audited financial statements

### D. Earnings and Profitability

13. TSB operates on a financially sustainable basis (Table A6.7).

**Table A6.7: Profitability and Efficiency, 2014–2017**  
(T million and %)

| Item                     | 2014   | 2015   | 2016   | 2017   |
|--------------------------|--------|--------|--------|--------|
| Net Income               | 15,904 | 18,063 | 12,157 | 50,601 |
| Net interest margin      | 5.1%   | 4.7%   | 5.0%   | 4.2%   |
| Return on average assets | 1.4%   | 1.1%   | 0.6%   | 2.2%   |
| Return on average equity | 18.3%  | 15.7%  | 8.3%   | 26.3%  |
| Cost-income ratio        | 44.0%  | 38.9%  | 44.1%  | 31.9%  |

Source: 2014-2017 audited financial statements.



## E. Funding and Liquidity

14. From 2014 to 2017, TSB's customer deposits grew by 19% to T1.7 trillion, or 81% of total liabilities. Most of growth in deposits was from retail clients, partially as a result of migration of clients from troubled Kazakh banks such as Delta Bank, Kazinvestbank, and RBK Bank. The share of retail deposits in the bank's total deposits increased from 27% in 2014 to 47% in 2017.

15. Borrowings accounted for 11.3% of TSB's liabilities as of the end of 2017. Mostly of the borrowings are from government agencies such as Agrarian Credit Corporation, Damu, and KazAgro.

16. TSB's liquidity position is satisfactory, though it deteriorated somewhat compared to 2014 (Table A6.8).

**Table A6.8: Liquidity and Funding Ratios**

| Item   | (%)  |      |      |      |
|--|------|------|------|------|
|  | 2014 | 2015 | 2016 | 2017 |
| Liquid assets - total assets ratio                               | 12%  | 11%  | 14%  | 9%   |
| Liquid assets - short-term liabilities of 30 days and less ratio | 74%  | 63%  | 67%  | 43%  |
| Liquid assets - current deposits ratio                           | 119% | 13%  | 108% | 55%  |
| Gross loans – deposits ratio                                     | 111% | 18%  | 112% | 119% |
| Deposits - total liabilities ratio                               | 82%  | 78%  | 80%  | 81%  |

Source: 2014-2017 audited financial statements

17. During the past four years, TSB's open foreign currency positions remained comfortably less than the prudential limit of 20% for commercial banks. As of the end of 2017, TSB reported an open position of T35 billion, or around 10% of regulatory capital (Table A6.9).

**Table A6.9: Net Open Foreign Currency Position**

| Item   | (T million)  |               |              |               |
|--|--------------|---------------|--------------|---------------|
|  | 2014         | 2015          | 2016         | 2017          |
| \$   | 8,064        | 15,622        | 783          | 29,640        |
| EUR  | 94           | 64            | 266          | 244           |
| RUR  | 145          | 859           | 8,695        | 4,972         |
| Other currencies   | 92           | 146           | 126          | 149           |
| <b>Open currency position, total</b>                     | <b>8,394</b> | <b>16,692</b> | <b>9,870</b> | <b>35,005</b> |
| <b>Open currency position - regulatory capital ratio</b> | <b>5%</b>    | <b>10%</b>    | <b>5%</b>    | <b>10%</b>    |

\$= US dollar, EUR = Euro, RUR = Russian Ruble

Source: 2014-2017 audited financial statements

18. TSB's balance sheet and income statement for the past four years are summarized in Tables A6.10 and A6.11.

**Table A6.10: Balance sheet, 2014– 2017**  
(T million)

| Balance sheet item             | 2014             |             | 2015             |             | 2016             |             | 2017             |             |
|--------------------------------|------------------|-------------|------------------|-------------|------------------|-------------|------------------|-------------|
| Customer loans, net            | 1,060,249        | 80%         | 1,589,510        | 81%         | 1,718,928        | 76%         | 1,808,797        | 76%         |
| Liquid assets and securities   | 164,522          | 12%         | 208,908          | 11%         | 305,352          | 14%         | 199,308          | 15%         |
| Fixed assets, net              | 26,112           | 2%          | 44,314           | 2%          | 48,065           | 2%          | 47,928           | 2%          |
| Other assets                   | 70,612           | 5%          | 113,861          | 6%          | 187,692          | 8%          | 235,077          | 7%          |
| <b>Total Assets</b>            | <b>1,321,495</b> | <b>100%</b> | <b>1,956,593</b> | <b>100%</b> | <b>2,260,037</b> | <b>100%</b> | <b>2,291,110</b> | <b>100%</b> |
| Total deposits                 | 1,003,402        | 76%         | 1,437,271        | 73%         | 1,666,392        | 74%         | 1,677,388        | 71%         |
| Total borrowings               | 191,372          | 14%         | 349,761          | 18%         | 288,137          | 13%         | 235,230          | 12%         |
| Other liabilities              | 21,701           | 2%          | 44,045           | 2%          | 139,611          | 6%          | 158,914          | 9%          |
| <b>Total Liabilities</b>       | <b>1,216,474</b> | <b>92%</b>  | <b>1,831,077</b> | <b>94%</b>  | <b>2,094,140</b> | <b>93%</b>  | <b>2,071,532</b> | <b>92%</b>  |
| Common stocks                  | 59,070           | 4%          | 59,042           | 3%          | 88,828           | 4%          | 90,927           | 4%          |
| Retained earnings and reserves | 45,952           | 3%          | 66,474           | 3%          | 77,069           | 3%          | 128,885          | 4%          |
| <b>Total Equity</b>            | <b>1,321,495</b> | <b>100%</b> | <b>1,956,593</b> | <b>100%</b> | <b>2,260,037</b> | <b>100%</b> | <b>2,291,110</b> | <b>100%</b> |

Source: 2014-2017 audited financial statements

**Table A6.11: Income Statement, 2014–2017**  
(T million)

| Income statement item                     | 2014          | 2015          | 2016           | 2017           |
|---|---------------|---------------|----------------|----------------|
| Interest Income                           | 111,898       | 127,243       | 197,164        | 201,831        |
| Interest Expense                          | (54,879)      | (62,899)      | (110,338)      | (121,224)      |
| <b>Net Interest Income</b>                | <b>57,019</b> | <b>64,344</b> | <b>86,826</b>  | <b>80,607</b>  |
| Net fee and commission income             | 7,606         | 6,138         | 11,800         | 13,730         |
| <b>Net interest and commission Income</b> | <b>64,625</b> | <b>70,482</b> | <b>98,626</b>  | <b>94,337</b>  |
| Other Income                              | 12,899        | 20,862        | 15,081         | 81,485         |
| <b>Total Income</b>                       | <b>77,524</b> | <b>91,344</b> | <b>113,707</b> | <b>175,822</b> |
| Operating expenses                        | (34,105)      | (35,507)      | (50,192)       | (56,037)       |
| Asset impairment provisions               | (22,657)      | (32,240)      | (49,050)       | (56,912)       |
| <b>Pre-tax income</b>                     | <b>20,762</b> | <b>23,597</b> | <b>14,465</b>  | <b>62,873</b>  |
| Income tax                                | (4,858)       | (5,534)       | (2,308)        | (12,272)       |
| Net Income                                | 15,904        | 18,063        | 12,157         | 50,601         |

( ) = negative.

Source: 2014-2017 audited financial accounts

## F. Summary

### 19. Strengths. TSB has:

- i. Satisfactory asset quality and financial performance.
- ii. A focus on SME and retail clients which provides solid risk diversification and has helped ensure steady profitability.

### 20. Key risks. TSB has:

- i. A risk that nonperforming loans may increase as a result of aggressive growth in the period from 2014 to 2016, including loans denominated in foreign currency to borrowers without foreign currency earnings.
- ii. Low liquidity.

## SUMMARY OF FINANCIAL PERFORMANCE OF BANK CENTERCREDIT

### A. Performance Overview

1. Bank CenterCredit (BCC) was incorporated and started operations in 1988. In 2013, BCC was the fourth largest bank in Kazakhstan. However, in the succeeding years, its growth slowed and its rank according to total assets declined to seventh.
2. In April 2017, a consortium of investors (Tsesnabank, Financial Holding Tsesna, and existing shareholder and Kazakh businessman Bahytbek Baiseitov, acquired 41.9% of BCC from Kookmin Bank of Korea. Mr. Baiseitov also purchased 10% of the shares of BCC from International Finance Corporation (IFC). The shareholders of the bank as disclosed in its latest annual financial statements are set forth in Table A7.1.<sup>1</sup>

**Table A7.1. Ownership structure, 31 December 2017**  
(%)

| Shareholder's name | Percentage |
|--------------------|------------|
| B.R. Baiseitov     | 43.9%      |
| JSC Tsesnabank     | 29.6%      |
| Others             | 26.5%      |
| Total              | 100.0%     |

Source: 2017 audited financial statements

3. As of the end of 2017, BCC had 19 branches and two subsidiaries (Table A7.2).

**Table A7.2. Subsidiaries an investment in associates, 31 December 2017**  
(%)

| Company Name   | Country of Operation | Ownership Percentage | Main Activity                   |
|----------------|----------------------|----------------------|---------------------------------|
| LLP BCC-SAOO   | Kazakhstan           | 100%                 | Management of distressed assets |
| JSC BCC Invest | Kazakhstan           | 95.2%                | Brokerage & dealer activity     |

Source: 2017 audited financial statements

4. From 2014 to 2017, net loans increased by only 0.2%, while deposits increased by 20.9% (Table A7.3). Profits increased dramatically in 2017 as a result of the accounting treatment of the bank's subordinated bonds purchased by the National Bank of Kazakhstan (NBK). The bank complies with the prudential norms established by NBK.

**Table A7.3: Growth indicators, 2014 -2017**  
(T million)

| Indicators                       | 2014      | 2015      | 2016      | 2017      |
|----------------------------------|-----------|-----------|-----------|-----------|
| Total Assets                     | 1,106,295 | 1,442,411 | 1,362,251 | 1,330,498 |
| Net Loans                        | 829,402   | 891,980   | 818,742   | 831,251   |
| Total Liabilities                | 1,020,816 | 1,356,231 | 1,262,986 | 1,201,615 |
| Deposits                         | 808,296   | 1,060,078 | 1,053,902 | 976,952   |
| Borrowings                       | 117,880   | 181,548   | 109,649   | 98,791    |
| Debt Securities and Subordinated |           |           |           |           |
| Bond                             | 84,874    | 88,776    | 78,142    | 92,782    |
| Total Equity                     | 85,479    | 86,180    | 99,265    | 128,883   |
| Net Profit                       | 967       | 1,941     | 5,361     | 28,871    |

Source: 2014-2017 audited financial statements

<sup>1</sup> In March 2018, TsesnaBank sold its stake in BCC.

5. As of the end of 2017, corporate loans represented 55% of the bank's gross loan portfolio, while retail loans had a share of 28.5% and loans to micro, small, and medium enterprises had a share of 16.5%.

6. As of the end of 2017, BCC's loans overdue by more than 90 days totaled T97.4 billion, or 10.2% of its gross loan portfolio (Table A7.3). Loan loss provisions grew to T114 billion in 2017.

**Table A7.3: Loan Portfolio Quality, 2014–2017**  
(T million and %)

| Item                                | 2014    | 2015      | 2016    | 2017    |
|-------------------------------------|---------|-----------|---------|---------|
| Overdue loans over 90 days (NPLs)   | 151,912 | 178,086   | 103,737 | 94,753  |
| Gross loan Portfolio (GLP)          | 971,931 | 1,039,441 | 889,209 | 930,656 |
| Loan Loss Provisions (LLPs)         | 148,995 | 151,326   | 93,454  | 113,851 |
| NPLs – GLP ratio                    | 15.6%   | 17.1%     | 11.7%   | 10.2%   |
| LLPs - NPLs ratio                   | 98%     | 85%       | 90%     | 120%    |
| Net NPLs - Regulatory Capital ratio | 2%      | 16%       | 6%      | (8%)    |

(-) = negative value

CAGR = compound annual growth rate, NPLs=overdue loans over 90days, GLP = gross loan portfolio, LLPs = loan loss provisions

Source: 2014- 2017 audited financial statements.

7. BCC's funding base consist mostly of customer deposits (81% of liabilities as of end 2017). Most of the deposits are retail (53%).

8. In October 2017, BCC joined National Bank of Kazakhstan's (NBK) program on Financial Sector Stability. The purchase by NBK of BCC's subordinated bonds resulted in a significant improvement in the bank's capital adequacy ratios (Table A7.4).

**Table A7.4: Capital Adequacy Ratio, 2014 – 2017**  
(T million and %)

| Capital Adequacy                      | 2014    | 2015      | 2016      | 2017      |
|---------------------------------------|---------|-----------|-----------|-----------|
| Total Regulatory Capital (Tier 1 & 2) | 142,764 | 163,263   | 179,968   | 229,419   |
| Risk Weighted Assets                  | 929,135 | 1,111,246 | 1,012,140 | 1,070,556 |
| Capital Adequacy Ratio (Tier 1 & 2)   | 15.37%  | 14.69%    | 17.78%    | 21.4%     |
| Capital Adequacy Ratio (Tier 1)       | 9.40%   | 8.02%     | 10.00%    | 13.3%     |

Source: 2014-2017 audited financial statements

9. BCC finished 2017 with net profit after tax of T29 billion, which is 538% improvement compared to 2016 results. This is mainly due to accounting treatment of NBK's investments in BCC's subordinated bonds.

10. BCC generated enough revenues to support operations and even provide for the allocation for loan loss reserves. Revenues however, included significant accruals for impaired loans which if not recognized would result in a negative bottom-line.

11. Overall, BCC's concentration on recovery coupled with its low reliance on external funding afforded the bank to maintain sufficient liquidity buffers to assets which stood at 26.3% as of end 2017.

**B. Overall Conclusion**

12. BCC's financial condition is similar to the condition of most banks in Kazakhstan. It has a significant volume of problem loans while capital and earnings are constrained by the need to continue to increase loan loss provisions.

**C. Summary**

13. **Strengths.** BCC has:

- i. An established market position in the SME and retail segments.
- ii. Sufficient liquidity buffers with a low reliance on external funding.

14. **Key risks.** BCC has:

- i. Weak asset quality.
- ii. Weak loss absorption capacity given its modest profits.