

OJSC PASHA Bank

Interim condensed consolidated financial statements

30 June 2017

Contents

Report on Review of Interim Financial Information

Interim condensed consolidated financial statements

| | |
|--|---|
| Interim condensed consolidated statement of financial position..... | 1 |
| Interim condensed consolidated statement of profit or loss..... | 2 |
| Interim condensed consolidated statement of comprehensive income | 3 |
| Interim condensed consolidated statement of changes in equity | 4 |
| Interim condensed consolidated statement of cash flows | 5 |

Selected explanatory notes to the interim condensed consolidated financial statements

| | |
|---|----|
| 1. Principal activities..... | 6 |
| 2. Basis of preparation | 6 |
| 3. Changes in accounting policies..... | 7 |
| 4. Cash and cash equivalents | 7 |
| 5. Trading securities..... | 8 |
| 6. Amounts due from credit institutions | 8 |
| 7. Investment securities | 9 |
| 8. Loans to customers..... | 9 |
| 9. Investment property | 11 |
| 10. Other assets and liabilities | 11 |
| 11. Amounts due to banks and government funds..... | 12 |
| 12. Amounts due to customers | 12 |
| 13. Other borrowed funds | 13 |
| 14. Derivative financial instruments | 13 |
| 15. Debt securities issued | 13 |
| 16. Taxation | 14 |
| 17. Equity | 14 |
| 18. Commitments and contingencies | 14 |
| 19. Impairment losses on interest bearing assets and provision for guarantees and letters of credit | 16 |
| 20. Net fee and commission income | 17 |
| 21. Personnel, general and administrative expenses..... | 17 |
| 22. Fair values of financial instruments..... | 18 |
| 23. Related party disclosures | 20 |
| 24. Capital adequacy | 21 |



Ernst & Young Holdings (CIS) B.V.
Port Baku Towers Business Centre
South Tower, 9th floor
153, Neftçilar Ave.
Baku, AZ1010, Azerbaijan
Tel: +994 (12) 490 7020
Fax: +994 (12) 490 7017
www.ey.com/az

Ernst & Yanq Holdings (SiAyEs) Bi.Vi.
Port Baku Towers Biznes Mərkəzi
Cənub Qülləsi, 9-cu mərtəbə
Neftçilər prospekti, 153
Baku, AZ1010, Azərbaycan
Tel: +994 (12) 490 7020
Faks: +994 (12) 490 7017

Report on Review of Interim Financial Information

To the Shareholders and Board of Directors of
OJSC PASHA Bank

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of OJSC PASHA Bank and its subsidiaries, which comprise the interim condensed consolidated statement of financial position as at 30 June 2017 and the related interim condensed consolidated statements of profit or loss, comprehensive income, changes in equity and cash flows for the six-month period then ended, and selected explanatory notes (interim financial information). Management is responsible for the preparation and presentation of this interim financial information in accordance with IAS 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with IAS 34, *Interim Financial Reporting*.

Ernst & Young Holdings (CIS) B.V.

11 September 2017

Baku, Azerbaijan

Interim condensed consolidated statement of financial position

As at 30 June 2017

(In thousands of Azerbaijani manats)

| | Notes | 30 June 2017 (unaudited) | 31 December 2016 |
|---|--------|-----------------------------|------------------|
| Assets | | | |
| Cash and cash equivalents | 4 | 1,454,255 | 1,105,769 |
| Trading securities | 5 | 25,650 | 22,669 |
| Amounts due from credit institutions | 6 | 668,620 | 728,121 |
| Investment securities: | | | |
| - available-for-sale | 7 | 122,555 | 173,329 |
| - loans and receivables | 7 | 43,679 | 61,220 |
| Derivative financial assets | 14 | 2,897 | 984 |
| Loans to customers | 8 | 1,190,650 | 1,107,274 |
| Investment property | 9 | 4,757 | 1,654 |
| Property and equipment | | 12,690 | 12,809 |
| Intangible assets | | 56,643 | 55,067 |
| Current income tax assets | | 3,981 | - |
| Deferred income tax assets | 16 | 758 | 1,647 |
| Other assets | 10 | 26,884 | 19,302 |
| Total assets | | 3,614,019 | 3,289,845 |
| Liabilities | | | |
| Amounts due to banks and government funds | 11 | 312,896 | 330,294 |
| Amounts due to customers | 12 | 2,702,754 | 2,350,687 |
| Other borrowed funds | 13 | 45,354 | 51,473 |
| Debt securities issued | 15 | 28,901 | 18,705 |
| Derivative financial liabilities | 14 | 1,219 | 2,468 |
| Current income tax liabilities | | 808 | 12,436 |
| Deferred income tax liabilities | 16 | 14,503 | 8,446 |
| Provision for guarantees and letters of credit | 18, 19 | 1,949 | 6,959 |
| Other liabilities | 10 | 28,781 | 21,111 |
| Total liabilities | | 3,137,165 | 2,802,579 |
| Equity | | | |
| Share capital | 17 | 333,000 | 333,000 |
| Retained earnings | | 74,837 | 83,152 |
| Net unrealised losses on investment securities available-for-sale | | (63) | (1) |
| Foreign currency translation reserve | | 69,008 | 71,046 |
| Total equity attributable to shareholders of the Bank | | 476,782 | 487,197 |
| Non-controlling interests | | 72 | 69 |
| Total equity | | 476,854 | 487,266 |
| Total liabilities and equity | | 3,614,019 | 3,289,845 |

Signed and authorised for release on behalf of the Executive Board of the Bank:

Taleh Kazimov

Chairman of the Executive Board

Hayala Naghiyeva

Chief Financial Officer

11 September 2017



The accompanying notes on pages 6 to 21 are an integral part of these interim condensed consolidated financial statements.

Interim condensed consolidated statement of profit or loss**For the six months ended 30 June 2017***(In thousands of Azerbaijani manats)*

| | Notes | For the six months ended 30 June (unaudited) | |
|--|-------|---|-----------------|
| | | 2017 | 2016 |
| Interest income | | | |
| Loans to customers | | 64,340 | 50,937 |
| Amounts due from credit institutions | | 47,444 | 5,708 |
| Investment securities | | 9,871 | 4,002 |
| Cash and cash equivalents | | 9,568 | 1,846 |
| Securities purchased under agreements to resell | | - | 12 |
| | | <u>131,223</u> | <u>62,505</u> |
| Trading securities | | 1,230 | 2,867 |
| | | <u>1,230</u> | <u>2,867</u> |
| Interest expense | | | |
| Amounts due to customers | | (50,975) | (13,081) |
| Amounts due to banks and government funds | | (5,623) | (4,862) |
| Debt securities issued | | (1,352) | - |
| Other borrowed funds | | (555) | (996) |
| Other | | - | (350) |
| | | <u>(58,505)</u> | <u>(19,289)</u> |
| Net interest income | | <u>73,948</u> | <u>46,083</u> |
| Provision for impairment losses on interest bearing assets | 19 | (6,576) | (13,507) |
| Net interest income after provision for impairment losses | | <u>67,372</u> | <u>32,576</u> |
| Net fee and commission income | 20 | 5,037 | 6,266 |
| Net gains from trading securities | | 1,794 | 1,918 |
| Net (loss)/gains from investment securities available-for-sale | | (21) | 7 |
| Net gains from foreign currencies: | | | |
| - dealing | | 23,850 | 30,100 |
| - translation differences | | 349 | 1,649 |
| - operations with foreign currency derivatives | | 2,673 | 104 |
| Other income | | 123 | 173 |
| Non-interest income | | <u>33,805</u> | <u>40,217</u> |
| Personnel expenses | 21 | (25,121) | (17,275) |
| General and administrative expenses | 21 | (13,838) | (18,620) |
| Depreciation and amortisation | | (3,670) | (3,300) |
| Reversal of provision/(provision) for guarantees and letters of credit | 19 | 5,010 | (53) |
| Non-interest expenses | | <u>(37,619)</u> | <u>(39,248)</u> |
| Profit before income tax expense | | <u>63,558</u> | <u>33,545</u> |
| Income tax expense | 16 | (13,234) | (9,129) |
| Net profit for the period | | <u>50,324</u> | <u>24,416</u> |
| Attributable to: | | | |
| - shareholders of the Bank | | 50,321 | 24,413 |
| - non-controlling interests | | 3 | 3 |
| | | <u>50,324</u> | <u>24,416</u> |

The accompanying notes on pages 6 to 21 are an integral part of these interim condensed consolidated financial statements.

Interim condensed consolidated statement of comprehensive income**For the six months ended 30 June 2017***(In thousand of Azerbaijani manats)*

| | Notes | <i>For the six months ended 30 June (unaudited)</i> | |
|---|-------|---|----------------|
| | | 2017 | 2016 |
| Net profit for the period | | 50,324 | 24,416 |
| Other comprehensive income | | | |
| <i>Other comprehensive income to be reclassified to profit or loss in subsequent periods</i> | | | |
| Unrealised (loss)/gain on investment securities available-for-sale | | (98) | 52 |
| Realised loss/(gain) on investment securities available-for-sale reclassified to the consolidated statement of profit or loss | | 21 | (7) |
| Net unrealised (loss)/gain in investment securities available-for-sale | 17 | (77) | 45 |
| Tax effect of net loss/(gain) on investment securities available-for-sale | 16 | 15 | (3) |
| Foreign currency translation difference | 17 | (2,038) | (1,109) |
| Net other comprehensive loss to be reclassified to profit or loss in subsequent periods | | (2,100) | (1,067) |
| Total comprehensive income for the period | | 48,224 | 23,349 |
| Attributable to: | | | |
| - shareholders of the Bank | | 48,221 | 23,346 |
| - non-controlling interests | | 3 | 3 |
| | | 48,224 | 23,349 |

The accompanying notes on pages 6 to 21 are an integral part of these interim condensed consolidated financial statements.

Interim condensed consolidated statement of changes in equity**For the six months ended 30 June 2017***(In thousands of Azerbaijani manats)*

| | Attributable to shareholders of the Bank | | | | Total | Non-controlling interests | Total equity |
|--|--|---|--|---|----------------|---------------------------|----------------|
| | Share capital | Retained earnings (accumulated deficit) | Net unrealised gain/(losses) on investment securities available-for-sale | Foreign currency translation difference | | | |
| As at 31 December 2015 | 333,000 | 19,283 | (100) | 80,244 | 432,427 | 62 | 432,489 |
| Net profit for the six months ended 30 June 2016 (unaudited) | – | 24,413 | – | – | 24,413 | 3 | 24,416 |
| Other comprehensive income/(loss) for the six months ended 30 June 2016 (unaudited) | – | – | 42 | (1,109) | (1,067) | – | (1,067) |
| Total comprehensive income/(loss) for the six months ended 30 June 2016 (unaudited) | – | 24,413 | 42 | (1,109) | 23,346 | 3 | 23,349 |
| Dividends declared (Note 17) | – | (5,412) | – | – | (5,412) | – | (5,412) |
| As at 30 June 2016 (unaudited) | 333,000 | 38,284 | (58) | 79,135 | 450,361 | 65 | 450,426 |
| As at 31 December 2016 | 333,000 | 83,152 | (1) | 71,046 | 487,197 | 69 | 487,266 |
| Net profit for the six months ended 30 June 2017 (unaudited) | – | 50,321 | – | – | 50,321 | 3 | 50,324 |
| Other comprehensive loss for the six months ended 30 June 2017 (unaudited) | – | – | (62) | (2,038) | (2,100) | – | (2,100) |
| Total comprehensive income/(loss) for the six months ended 30 June 2017 (unaudited) | – | 50,321 | (62) | (2,038) | 48,221 | 3 | 48,224 |
| Dividends declared (Note 17) | – | (58,636) | – | – | (58,636) | – | (58,636) |
| As at 30 June 2017 (unaudited) | 333,000 | 74,837 | (63) | 69,008 | 476,782 | 72 | 476,854 |

The accompanying notes on pages 6 to 21 are an integral part of these interim condensed consolidated financial statements.

Interim condensed consolidated statement of cash flows**For the six months ended 30 June 2017***(In thousands of Azerbaijani manats)*

| | Notes | For the six months ended 30 June (unaudited) | |
|---|-------|---|------------------|
| | | 2017 | 2016 |
| Cash flows from operating activities | | | |
| Interest received | | 83,400 | 61,147 |
| Interest paid | | (19,747) | (17,367) |
| Fees and commissions received | | 11,103 | 9,477 |
| Fees and commissions paid | | (6,247) | (3,276) |
| Net realized loss on sale of investment securities available-for-sale | | (19) | (2) |
| Net realized loss from trading securities | | – | (739) |
| Realised gains less losses from dealing in foreign currencies and from operations with foreign currency derivatives | | 24,809 | 29,971 |
| Personnel expenses paid | | (24,513) | (13,561) |
| General and administrative expenses paid | | (12,895) | (18,583) |
| Other operating income received | | 125 | 776 |
| Cash flows from operating activities before changes in operating assets and liabilities | | 56,016 | 47,843 |
| <i>Net (increase)/decrease in operating assets</i> | | | |
| Trading securities | | (1,191) | (3,308) |
| Amounts due from credit institutions | | 80,013 | (91,577) |
| Loans to customers | | (93,432) | (31,205) |
| Other assets | | (2,337) | 1,482 |
| <i>Net increase/(decrease) in operating liabilities</i> | | | |
| Amounts due to banks and government funds | | (9,179) | (43,840) |
| Amounts due to customers | | 330,540 | (20,797) |
| Other borrowed funds | | (7,370) | (33,349) |
| Other liabilities | | (2,363) | (3,873) |
| Net cash from / (used in) operating activities before income tax | | 350,697 | (178,624) |
| Income tax paid | | (20,511) | (1,066) |
| Net cash from / (used in) operating activities | | 330,186 | (179,690) |
| Cash flows from investing activities | | | |
| Proceeds from sale and redemption of investment securities available-for-sale | | 374,008 | 40,118 |
| Proceeds from sale and redemption of investment securities – loans and receivables | | 46,488 | 47,412 |
| Purchases of investment securities available-for-sale | | (323,162) | (78,209) |
| Purchases of investment securities – loans and receivables | | (27,817) | (22,039) |
| Proceeds from sale of property, equipment and intangible assets | | – | 32 |
| Purchase of property and equipment and intangible assets | | (7,256) | (1,863) |
| Net cash from / (used in) investing activities | | 62,261 | (14,549) |
| Cash flows from financing activities | | | |
| Proceeds of debt securities issued | | 52,458 | – |
| Payment of debt securities issued | | (42,987) | – |
| Dividends paid | 17 | (58,636) | (5,412) |
| Net cash used in financing activities | | (49,165) | (5,412) |
| Effect of exchange rates changes on cash and cash equivalents | | 5,204 | 14,102 |
| Net increase/(decrease) in cash and cash equivalents | | 348,486 | (185,549) |
| Cash and cash equivalents, beginning | 4 | 1,105,769 | 1,021,306 |
| Cash and cash equivalents, ending | 4 | 1,454,255 | 835,757 |

The accompanying notes on pages 6 to 21 are an integral part of these interim condensed consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats)

1. Principal activities

OJSC PASHA Bank ("the Bank") was formed on 18 June 2007 as an open joint stock company under the laws of the Republic of Azerbaijan. The Bank operates under a banking licence issued by the Central Bank of the Republic of Azerbaijan ("CBAR") on 28 November 2007.

The Bank and its subsidiaries (together – "the Group") accept deposits from the public and extend credit, transfer payments, exchange currencies and provide other banking services to its commercial and private customers.

The Bank has four service points and two branches in Azerbaijan as at 30 June 2017 (31 December 2016: four service points and two branches) and two subsidiaries, JSC PASHA Bank Georgia located in the Republic of Georgia and PASHA Yatirim Bankasi A.Ş. (the "Subsidiaries") located in the Republic of Turkey.

The Bank's registered legal address is 15 Yusif Mammadaliyev Street, Baku, AZ1005, Azerbaijan.

As at 30 June 2017 and 31 December 2016, the following shareholders owned the outstanding shares of the Bank:

| <i>Shareholders</i> | <i>30 June 2017</i> (%) | <i>31 December 2016</i> (%) |
|---------------------|----------------------------|--------------------------------|
| Pasha Holding Ltd. | 60 | 60 |
| Ador Ltd. | 30 | 30 |
| Mr. Arif Pashayev | 10 | 10 |
| Total | 100 | 100 |

As at 30 June 2017 and 2016, the Bank is ultimately owned by Mrs. Leyla Aliyeva and Mrs. Arzu Aliyeva, who exercise joint control over the Bank.

PASHA Bank Georgia JSC, a wholly – owned subsidiary, is located in the Republic of Georgia, operating in the banking sector, with registered and paid up share capital of GEL 35,000 thousand as of 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 as at 30 June 2017. PASHA Bank Georgia JSC operates under a banking licence issued by the National Bank of Georgia (the "NBG") on 17 January 2013.

Legal address of the PASHA Bank Georgia JSC is 15 Rustaveli Street, Tbilisi, GE 0108, Georgia.

TAIB Yatirim Bank A.Ş. was incorporated in 1987 as an investment bank in Turkey with the permission of the Council of Ministers decision no. 6224 which allows the transfer of the banks' net profit after statutory liabilities and in case of liquidation the transfer of capital to foreign shareholders. On 27 January 2015, the Bank acquired 79.47% of the voting common shares of TAIB Yatirim Bank A.Ş. TAIB Yatirim Bank A.Ş. was renamed to Pasha Yatirim Bankasi A.Ş. at the registration of the Bank as shareholder. In March 2015, investment in share capital of the subsidiary was increased by TRY 175,000 thousand to TRY 255,000 thousand. As at 30 June 2017 and 31 December 2016, the Bank holds 99.92% voting common shares of PASHA Yatirim Bankasi A.Ş. with its head office located in Istanbul. The activities of the bank are regulated by the Central Bank of the Republic of Turkey (the "CBRT").

OJSC PASHA Bank and its Subsidiaries were consolidated in these financial statements.

2. Basis of preparation

General

These interim condensed consolidated financial statements for the six months ended 30 June 2017 have been prepared in accordance with International Accounting Standard ("IAS") 34 *Interim Financial Reporting*.

The Group is required to maintain their records and prepare their consolidated financial statements for regulatory purposes in Azerbaijani manat in accordance with International Financial Reporting Standards ("IFRS"). These interim condensed consolidated financial statements are prepared under the historical cost convention except for trading and available for sale securities and derivative financial instruments which have been measured at fair value.

These interim condensed consolidated financial statements are presented in thousand of Azerbaijani manats ("AZN") unless otherwise indicated. Transactions in currencies other than the AZN are treated as transactions in foreign currencies.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual consolidated financial statements, and should be read in conjunction with the Group's annual financial statements as at 31 December 2016.

(Figures in tables are in thousands of Azerbaijani manats)

3. Changes in accounting policies

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group's annual financial statements for the year ended 31 December 2016, except for the adoption of new Standards effective as of 1 January 2017. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The nature and the effect of these changes are disclosed below. Although these new standards and amendments apply for the first time in 2017, they do not have a material effect on the annual consolidated statements of the Group or the interim condensed consolidated financial statements of the Group. The nature and the impact of each new standard or amendment are described below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendment, entities are not required to provide comparative information for preceding periods. The Group is not required to provide additional disclosures in its condensed interim consolidated financial statements, but will disclose additional information in its annual consolidated financial statements for the year ended 31 December 2017.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact.

The Group applied the amendments retrospectively. However, their application has no effect on the Group's position and performance.

Annual improvements cycle – 2014-2016

Amendments to IFRS 12 Disclosure of Interests in Other Entities: Clarification of the Scope of Disclosure Requirements in IFRS 12

The amendments clarify that the disclosure requirements in IFRS 12, other than those in paragraphs B10-B16, apply to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale. The Group has adopted the amendments retrospectively. The amendments have no effect on the Group's financial statements.

4. Cash and cash equivalents

Cash and cash equivalents comprise:

| | <u>30 June 2017</u> <i>(unaudited)</i> | <u>31 December 2016</u> |
|--|---|-------------------------|
| Cash on hand | 155,652 | 114,917 |
| Current accounts with the CBAR, the NBG and the CBRT | 519,247 | 534,087 |
| Current accounts with other credit institutions | 78,463 | 91,145 |
| Time deposits with credit institutions up to 90 days | 700,893 | 365,620 |
| Cash and cash equivalents | <u>1,454,255</u> | <u>1,105,769</u> |

Current accounts with other credit institutions consist of non-interest bearing correspondent account balances with resident and non-resident banks in the amount of AZN 1,946 thousand (31 December 2016 – AZN 27,114 thousand) and AZN 76,517 thousand (31 December 2016 – AZN 63,733 thousand), respectively.

As at 30 June 2017, the Group placed AZN 700,893 thousand in time deposits with one resident bank and two non-resident banks maturing through July 2017 with interest rates ranging between 1% and 12.01% p.a. (31 December 2016 – AZN 365,620 thousand matured in January 2017 with interest rates ranging between 0.4% and 14.30% p.a.).

*(Figures in tables are in thousands of Azerbaijani manats)***5. Trading securities**

Trading securities comprise:

| | 30 June 2017 <i>(unaudited)</i> | | 31 December 2016 | |
|---------------------------------|---|---------------------------|----------------------------------|---------------------------|
| | Nominal interest rate | Carrying value | Nominal interest rate | Carrying value |
| Bonds of financial institutions | 14.00% | 3,432 | 14.00% | 3,238 |
| Corporate bonds | 9.00%-12.09% | 22,218 | 9.00% | 19,431 |
| Trading securities | | 25,650 | | 22,669 |

As at 30 June 2017, the Group held securities of two resident entities (31 December 2016 – two) and one non-resident entity (31 December 2016 – none) amounting to AZN 25,650 thousand (31 December 2016 – AZN 22,669 thousand).

6. Amounts due from credit institutions

Amounts due from credit institutions comprise:

| | 30 June 2017 <i>(unaudited)</i> | 31 December 2016 |
|--|---|-------------------------|
| Time deposits with banks | 317,811 | 74,558 |
| Time deposit with the CBAR | 251,464 | 474,994 |
| Loans to banks | 31,426 | 93,727 |
| Obligatory reserve with the CBAR, the NGB and the CBRT | 46,579 | 47,007 |
| Restricted deposits | 22,212 | 38,742 |
| | 669,492 | 729,028 |
| Less: allowance for impairment (Note 19) | (872) | (907) |
| Amounts due from credit institutions | 668,620 | 728,121 |

As at 30 June 2017, time deposits with banks mature between July 2017 and December 2017 (31 December 2016 – between January 2017 and December 2017) and with interest rates ranging between 0.01% and 12.00% p.a. (31 December 2016 – between 0.5% and 15.00% p.a.).

As at 30 June 2017, time deposit with the CBAR represents deposit with maturity in September 2017. The deposit was placed from resources of one government entity (Note 12).

As at 30 June 2017, the Group had outstanding amount of AZN 31,426 thousand (31 December 2016 – AZN 93,727 thousand) of loans issued to three resident commercial banks (31 December 2016 – six resident commercial banks) with contractual maturity through December 2017 (31 December 2016 – June 2017) and interest rates ranging between of 15%-18% p.a. (31 December 2016 – between 3% and 22% p.a.).

Credit institutions in the Republic of Azerbaijan are required to maintain a non-interest earning cash deposit (obligatory reserve) with the CBAR at the level of 0.5% (31 December 2016 – 0.5%) and 1.0% (31 December 2016 – 1.0%) of the previous month average of funds attracted from customers by a credit institution in local and foreign currency, respectively. Credit institutions are required to maintain a mandatory interest earning cash deposit with the National Bank of Georgia at the level of 7% and 20% of the average of funds attracted from customers by a credit institution for the appropriate two-week period in GEL and foreign currencies, respectively (31 December 2016: 7% and 20% respectively). Credit institutions in the Republic of Turkey are required to maintain a mandatory interest earning cash deposit with the CBRT at the level of 4%-10.5% for TRY deposits and other liabilities according to their maturities (31 December 2016 – 4%-10.5%) and 5%-19% for foreign currency deposits and other liabilities according to their maturities (31 December 2016 – 4.5%-24.5%).

*(Figures in tables are in thousands of Azerbaijani manats)***7. Investment securities**

Investment securities available-for-sale comprises:

| | 30 June 2017 <i>(unaudited)</i> | | 31 December 2016 | |
|--|---|----------------------|-------------------------|----------------------|
| | Carrying value | Nominal value | Carrying value | Nominal value |
| Notes issued by the Central Bank of Azerbaijan Republic | 69,796 | 70,107 | 65,360 | 65,758 |
| Bonds of the Ministry of Finance of the Republic of Azerbaijan | 29,455 | 31,796 | 68,827 | 72,819 |
| Corporate bonds | 7,604 | 7,546 | 29,028 | 28,776 |
| Bonds of financial institutions | 4,896 | 4,911 | – | – |
| US Treasury bills | 4,291 | 4,255 | 7,002 | 6,988 |
| Notes issued by the Azerbaijan Mortgage Fund | 4,052 | 4,024 | – | – |
| Turkish Government Bonds | 2,461 | 2,415 | 3,112 | 3,064 |
| Investment securities available-for-sale | 122,555 | 125,054 | 173,329 | 177,405 |

Nominal interest rates per annum and maturities of these securities are as follows:

| | 30 June 2017 <i>(unaudited)</i> | | 31 December 2016 | |
|--|---|------------------------------|-------------------------|-------------------------------|
| | % | Maturity | % | Maturity |
| Notes issued by the Central Bank of Azerbaijan Republic | 11.44%-12.94% | July 17 | 14.34%-14.39% | January 2017 |
| Bonds of the Ministry of Finance of the Republic of Azerbaijan | 11.91%-18.96% | July 2017 – April 2018 | 2.49%-20.88% | January 2017 – December 2017 |
| Corporate bonds | 4.99%-10.86% | October 2021 – December 2021 | 4.97%-10.38% | October 2021 – December 2021 |
| Bonds of financial institutions | 2.52%-14.50% | July 2017 – September 2017 | 1.38%-11.84% | January 2017 – September 2017 |
| US Treasury bills | 1.80%-2.11% | December 2022 | – | – |
| Mortgage Fund | 3.00% | December 2037 | – | – |
| Turkey Government Bonds | 11.37% | July 2018 | 9.26%-10.64% | March 2017 – June 2017 |

Loans and receivables comprise:

| | 30 June 2017 <i>(unaudited)</i> | 31 December 2016 |
|--|---|-------------------------|
| Certificates of deposits of financial institutions | 17,180 | 17,686 |
| Bonds of financial institutions | 15,112 | 14,353 |
| Corporate bonds | 6,304 | 8,641 |
| Treasury bonds of the Ministry of Finance of Georgia | 5,176 | 20,674 |
| Less: allowance for impairment (Note 19) | (93) | (134) |
| Loans and receivables | 43,679 | 61,220 |

8. Loans to customers

Loans to customers comprise:

| | 30 June 2017 <i>(unaudited)</i> | 31 December 2016 |
|---|---|-------------------------|
| Legal entities | 1,094,151 | 1,046,055 |
| Individuals | 165,794 | 123,552 |
| Loans to customers (gross) | 1,259,945 | 1,169,607 |
| Less – allowance for impairment (Note 19) | (69,295) | (62,333) |
| Loans to customers (net) | 1,190,650 | 1,107,274 |

*(Figures in tables are in thousands of Azerbaijani manats)***8. Loans to customers (continued)**

A reconciliation of the allowance for impairment of loans to customers by class is as follows:

| | <i>Corporate lending</i> <i>30 June 2017</i> <i>(unaudited)</i> | <i>Individual lending</i> <i>30 June 2017</i> <i>(unaudited)</i> | <i>Total</i> <i>30 June 2017</i> <i>(unaudited)</i> |
|--|---|--|---|
| Individual impairment | (53,673) | (205) | (53,878) |
| Collective impairment | (10,048) | (5,369) | (15,417) |
| | <u>(63,721)</u> | <u>(5,574)</u> | <u>(69,295)</u> |
| Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance | <u>101,453</u> | <u>2,909</u> | <u>104,362</u> |
| | | | |
| | <i>Corporate lending</i> <i>31 December 2016</i> | <i>Individual lending</i> <i>31 December 2016</i> | <i>Total</i> <i>31 December 2016</i> |
| Individual impairment | (45,339) | (341) | (45,680) |
| Collective impairment | (12,750) | (3,903) | (16,653) |
| | <u>(58,089)</u> | <u>(4,244)</u> | <u>(62,333)</u> |
| Gross amount of loans, individually determined to be impaired before deducting any individually assessed impairment allowance | <u>93,196</u> | <u>3,242</u> | <u>96,438</u> |

Loans are made in the following industry sectors:

| | <i>30 June 2017</i> <i>(unaudited)</i> | <i>31 December 2016</i> |
|----------------------------------|---|-------------------------|
| Trade and services | 469,045 | 469,902 |
| Individuals | 165,794 | 123,552 |
| Manufacturing | 122,427 | 119,577 |
| Construction | 119,201 | 113,895 |
| Non-banking credit organizations | 116,892 | 125,530 |
| Mining | 75,974 | 64,622 |
| Agriculture and food processing | 63,028 | 48,438 |
| Energy | 41,136 | 13,782 |
| Transport and telecommunication | 39,151 | 43,671 |
| Leasing | 6,806 | 6,345 |
| Other | 40,491 | 40,293 |
| Total loans (gross) | <u>1,259,945</u> | <u>1,169,607</u> |

As at 30 June 2017, the Group granted loans to 6 customers (31 December 2016 – 6 customers) totalling AZN 320,795 thousand (31 December 2016 – AZN 299,486 thousand), which individually exceeded 5% of the Group's equity.

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- ▶ For commercial lending, charges over real estate properties, cash, securities, inventory and trade receivables;
- ▶ For retail lending, mortgages over residential properties.

Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

*(Figures in tables are in thousands of Azerbaijani manats)***9. Investment property**

In 2011, the Bank acquired land for the amount of AZN 2,000 thousand as investment property which is held for long-term appreciation in value. In 2017, the Bank reclassified two repossessed collaterals (office building and greenhouse area) in the amount of AZN 3,441 thousand to investment property which were given for operating lease. As at 30 June 2017, the fair value of investment property amounted to AZN 4,757 thousand (31 December 2016 – AZN 1,654 thousand). The Bank recognized impairment in the amount of AZN 684 thousand as of 30 June 2017 (31 December 2016 – AZN 346 thousand) due to decrease in recoverable amount.

10. Other assets and liabilities

Other assets comprise:

| | 30 June 2017 (unaudited) | 31 December 2016 |
|--|---|-------------------------|
| Other financial assets | | |
| Settlements on money transfers | 9,273 | 5,598 |
| Clearance cheque accounts | 7,616 | 2,048 |
| Accrued commission receivable on guarantees and letters of credit | 467 | 338 |
| Other | 15 | 101 |
| | <u>17,371</u> | <u>8,085</u> |
| Other non-financial assets | | |
| Deferred expenses | 3,402 | 3,394 |
| Repossessed collateral | 2,053 | 5,280 |
| Other prepayments | 2,030 | 1,017 |
| Prepayments for acquisition of property, equipment and intangible assets | 1,986 | 1,362 |
| Taxes, other than income tax | 42 | 164 |
| | <u>9,513</u> | <u>11,217</u> |
| Other assets | <u>26,884</u> | <u>19,302</u> |

As at 30 June 2017, clearance cheque accounts consist of receivables from other banks for which cheques stand as collateral.

As at 30 June 2017, deferred expenses of AZN 274 thousand (31 December 2016 – AZN 816 thousand), related to the long term prepayment for the rent of the service points located in Baku and AZN 872 thousand (31 December 2016 – 1,487 thousand) related to long term software support.

Other liabilities comprise:

| | 30 June 2017 (unaudited) | 31 December 2016 |
|--|---|-------------------------|
| Other financial liabilities | | |
| Clearance cheque accounts | 7,616 | 2,048 |
| Settlements on money transfer | 3,536 | 3,464 |
| Accrued expenses | 882 | 535 |
| Accrued commission payable on guarantees and letters of credit | 27 | – |
| Other | 524 | 175 |
| | <u>12,585</u> | <u>6,222</u> |
| Other non-financial liabilities | | |
| Payable to employees | 14,070 | 13,715 |
| Deferred income | 789 | 731 |
| Other provision | 127 | 132 |
| Taxes, other than income tax | 102 | 94 |
| Other | 1,108 | 217 |
| | <u>16,196</u> | <u>14,889</u> |
| Other liabilities | <u>28,781</u> | <u>21,111</u> |

*(Figures in tables are in thousands of Azerbaijani manats)***11. Amounts due to banks and government funds**

Amounts due to banks and government funds comprise:

| | <u>30 June 2017</u> <i>(unaudited)</i> | <u>31 December 2016</u> |
|--|---|-------------------------|
| Loans from the National Fund for Support of Entrepreneurship | 111,663 | 99,906 |
| Short-term deposits from banks | 97,029 | 90,136 |
| Long-term deposits from banks | 78,292 | 67,287 |
| Amount due to Azerbaijan Mortgage Fund | 7,178 | 4,826 |
| Loans from the CBAR and NBG | 5,124 | 41,676 |
| Amount due to IT Development Fund | 4,506 | 5,013 |
| Correspondent accounts with other banks | 9,104 | 21,450 |
| Amounts due to banks and government funds | <u>312,896</u> | <u>330,294</u> |

As at 30 June 2017, the Group had loans received from the National Fund for Support of Entrepreneurship amounting to AZN 111,663 thousand (31 December 2016 – AZN 99,906 thousand), maturing through August 2026 (31 December 2016 – through August 2026), and bearing interest rate of 1.0% p.a. The loans were acquired for the purposes of assistance in gradually improving entrepreneurship environment in Azerbaijan under the government program. The loans have been granted to local entrepreneurs at interest rate of 6% p.a. (31 December 2016 – 6% p.a.).

As at 30 June 2017, the Group received short-term funds from five non-resident commercial banks (31 December 2016 – six) comprising AZN 97,029 thousand (31 December 2016 – AZN 90,136 thousand) maturing through August 2017 (31 December 2016 – August 2017) and with interest rates ranging between 11.9% and 14.65% p.a. (31 December 2016 – 1.60% and 12.00% p.a.).

As at 30 June 2017, the Group received long-term funds from two resident commercial banks (31 December 2016 – one) comprising AZN 78,292 thousand maturing through May 2018 with interest rates of 2.00 and 3.5% p.a. (31 December 2016 – AZN 67,287 thousand maturing through February 2018 with interest rate of 2.00%).

As at 30 June 2017, the Group had loans refinanced from the Azerbaijan Mortgage Fund amounting to AZN 7,178 thousand (31 December 2016 – AZN 4,826 thousand), maturing through December 2040 (31 December 2016 – through December 2040) and bearing interest rate of 4.0% p.a.

As at 30 June 2017, the Group had loans received from the CBAR and NBG amounting to AZN 5,124 thousand (31 December 2016 – 41,676 thousand), maturing through November 2017 (31 December 2016 – through November 2017) with interest rates ranging between 3.5% and 7% p.a. (31 December 2016 – 3.5% and 7% p.a.).

As at 30 June 2017, the Group had loans refinanced from the IT Development Fund amounting to AZN 4,506 thousand (31 December 2016 – AZN 5,013 thousand), maturing through December 2021 (31 December 2016 – through December 2021) and bearing interest rate of 1.0% p.a.

12. Amounts due to customers

The amounts due to customers include the following:

| | <u>30 June 2017</u> <i>(unaudited)</i> | <u>31 December 2016</u> |
|---|---|-------------------------|
| Demand deposits | 1,468,321 | 998,925 |
| Time deposits | 1,234,433 | 1,351,762 |
| Amounts due to customers | <u>2,702,754</u> | <u>2,350,687</u> |
| Held as security against guarantees issued (Note 18) | 9,403 | 8,123 |

Included in time deposits is a deposit attracted at market rate from one government entity of AZN 239,959 thousand maturing through September 2017.

*(Figures in tables are in thousands of Azerbaijani manats)***12. Amounts due to customers (continued)**

An analysis of customer accounts by economic sector follows:

| | 30 June 2017 (unaudited) | 31 December 2016 |
|----------------------------------|---|-------------------------|
| Manufacturing | 578,147 | 542,550 |
| Individuals | 511,357 | 532,932 |
| Investment holding companies | 480,414 | 449,016 |
| Trade and services | 434,662 | 372,380 |
| Transport and communication | 222,614 | 90,276 |
| Mining | 153,949 | 25,238 |
| Construction | 137,824 | 166,766 |
| Insurance | 64,598 | 46,254 |
| Hotel business | 41,760 | 42,478 |
| Public organizations | 24,978 | 25,474 |
| Agriculture | 17,534 | 10,454 |
| Non-banking credit organizations | 10,736 | 22,315 |
| Energy | 2,807 | 3,232 |
| Other | 21,374 | 21,322 |
| Amounts due to customers | 2,702,754 | 2,350,687 |

As at 30 June 2017, customer deposits included balances with five (31 December 2016 – five) largest customers comprised AZN 1,240,117 thousand or 46% of the total customer deposits portfolio (31 December 2016 – AZN 1,100,919 thousand or 47% of the total customer deposits portfolio).

13. Other borrowed funds

As at 30 June 2017, other borrowed funds included balances with four (31 December 2016 – four) foreign banks amounting to AZN 45,354 thousand (31 December 2016 – AZN 51,473 thousand), maturing through April 2021 (October 2017 – through April 2021) and bearing interest rates ranging between 6.17% and 7.62% p.a. (31 December 2016 – between 1.48% and 3.75% p.a.). These unsecured borrowings are for trade finance of import operations (letters of credit) of the customers of the Group.

14. Derivative financial instruments

The Group enters into derivative financial instruments for trading purposes. The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts.

| | 30 June 2017 (unaudited) | | | 31 December 2016 | | |
|---|---|--------------------|------------------|----------------------------|-------------------|------------------|
| | Notional amount | Fair values | | Notional amount | Fair value | |
| | | Asset | Liability | | Asset | Liability |
| Foreign exchange contracts | | | | | | |
| Options domestic | 2,080 | – | (1,124) | 2,162 | – | (990) |
| Forwards and swaps – foreign | 34,039 | 260 | (95) | 26,441 | 320 | (983) |
| Forwards and swaps – domestic | 20,000 | 2,637 | – | 37,316 | 664 | (495) |
| Total derivative assets/ (liabilities) | | 2,897 | (1,219) | | 984 | (2,468) |

15. Debt securities issued

In 2017, PASHA Yatirim Bankasi A.S. had issued three short-term bonds denominated in TRY one of which was redeemed as at 30 June 2017. The carrying amount of the bonds amounted to AZN 28,901 thousand as at 30 June 2017 (31 December 2016 – AZN 18,705 thousand).

*(Figures in tables are in thousands of Azerbaijani manats)***16. Taxation**

The corporate income tax expense comprises:

| | 2017 (6 months) (unaudited) | 2016 (6 months) (unaudited) |
|--|--|--|
| Current tax charge | (5,950) | (8,454) |
| Deferred tax charge | (7,269) | (678) |
| Less: deferred tax recognized directly in other comprehensive income | (15) | 3 |
| Income tax expense | (13,234) | (9,129) |

17. Equity

As at 30 June 2017 and 31 December 2016, the Bank's authorized, issued and fully paid capital amounted to AZN 333,000 thousand comprising of 10,000 ordinary shares with a par value of AZN 33,300 per ordinary share. Each ordinary share entitles one vote to the shareholder.

On 23 May 2016, General Shareholders Meeting declared dividends totalling AZN 5,412 thousand which was paid in June 2016.

On 25 April 2017, General Shareholders Meeting declared dividends totalling AZN 58,636 thousand which was paid in May 2017.

Foreign currency translation reserve

Foreign currency translation reserve is used to record exchange difference arising from the translation of the financial statements of foreign subsidiaries.

Unrealised gains (losses) on investment securities available-for-sale

This reserve records fair value changes on available-for-sale investments.

18. Commitments and contingencies**Operating environment**

Azerbaijan continues economic reforms and development of its legal, tax and regulatory frameworks as required by the market economy. The future stability of the Azerbaijan economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

In 2015 as a result of significant drop in crude oil prices, Azerbaijani manat devalued against the US dollar from AZN 0.7862 to AZN 1.5500 for 1 USD. Following this devaluation, the Central Bank of the Republic of Azerbaijan announced floating exchange rate. During first half of 2017 the exchange rate of Azerbaijani manat against US dollar continued to fluctuate in the range between AZN 1.7020 and AZN 1.9200.

These events resulted in worsening of liquidity in the banking system and much tighter credit conditions. There continues to be uncertainty regarding economic growth, access to capital and cost of capital which could adversely affect the Group's future results and financial position and business prospects in a manner not currently determinable. Such adverse impacts could include deterioration of the quality of the loan portfolio, with increases in non-performing loans and decreases in loan collateral values, and losses on investment securities

Azerbaijani government announced plans to accelerate reforms and support to banking system in response to current economic challenges.

The Group's Management is monitoring these developments in the current environment and taking precautionary measures it considered necessary in order to support the sustainability and development of the Group's business in the foreseeable future.

(Figures in tables are in thousands of Azerbaijani manats)

18. Commitments and contingencies (continued)

Legal

In the ordinary course of business, the Group is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations of the Group.

Taxation

Azerbaijani tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Bank may be challenged by the relevant authorities. Recent events within the Azerbaijan suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and, as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review.

Management believes that its interpretation of the relevant legislation as at 30 June 2017 is appropriate and that the Group's tax, currency and customs positions will be sustained.

Insurance

The Bank has not currently obtained insurance coverage related to liabilities arising from errors or omissions. Liability insurance is generally not available in Azerbaijan at present.

Compliance with CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 30 June 2017, the Bank was in compliance with these ratios except for the followings:

- a) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 7 percent of the Bank's total capital when the market value of the collateral of credit exposures is less than 100 percent of such credit exposures, or the market value of real estate collateral of loans is below 150% of the loan value. As at 30 June 2017 the Bank's ratio was 12.72% (2016: 18.94%);
- b) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers that should not exceed 20 percent of the Bank's total capital when the market value of the collateral of credit exposures is more than 100 percent of such credit exposures, or the market value of real estate collateral of loans is above 150% of the loan value. As at 30 June 2017 the Bank's ratio was 23.32% (2016: 24.25%);
- c) Ratio of maximum credit exposure to one related party of the Bank or their representatives should not exceed 10% of total capital. As at 30 June 2017 the Bank's ratio was 11.6%;
- d) Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 30 June 2017 the Bank's ratio was 48.23% (2016: 39.55%);
- e) Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 30 June 2017 the Bank's ratio was 70.78% (2016: 58.05%).

Throughout the year the Bank submitted information regarding these breaches to the Financial Markets Supervision Chamber (the "FMSC") on a monthly basis and no sanctions were imposed on the Bank. Management believes that the Bank will not face any sanctions against the Bank in the future.

Financial commitments and contingencies

The Group provides guarantees and letters of credit to customers with primary purpose of ensuring that funds are available to a customer as required. Guarantees and standby letters of credit represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties. Documentary and commercial letters of credit, which are written undertakings by the Group on behalf of a customer authorizing a third party to draw drafts on the Group up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods, to which they relate, or cash deposits and, therefore, carry less risk than a direct borrowing.

*(Figures in tables are in thousands of Azerbaijani manats)***18. Commitments and contingencies (continued)****Financial commitments and contingencies (continued)**

Financial commitments and contingencies comprise:

| | 30 June 2017 <i>(unaudited)</i> | 31 December 2016 |
|--|---|-------------------------|
| Credit-related commitments | | |
| Guarantees issued | 300,207 | 239,314 |
| Unused credit lines | 82,950 | 86,545 |
| Letters of credit | 8,616 | 12,940 |
| | <u>391,773</u> | <u>338,799</u> |
| Operating lease commitments | | |
| Not later than 1 year | 4,257 | 4,197 |
| Later than 1 year but not later than 5 years | 16,225 | 16,699 |
| Later than 5 years | 2,801 | 4,780 |
| | <u>23,283</u> | <u>25,676</u> |
| Less – provisions (Note 19) | (1,949) | (6,959) |
| Commitments and contingencies (before deducting collateral) | <u>413,107</u> | <u>357,516</u> |
| Less – cash held as security against guarantees issued (Note 12) | (9,403) | (8,123) |
| Commitments and contingencies | <u>403,704</u> | <u>349,393</u> |

19. Impairment losses on interest bearing assets and provision for guarantees and letters of credit

The movements in allowance for impairment losses on interest bearing assets and provisions for guarantees and letters of credit were as follows:

| | 6 month ended 30 June 2017 <i>(unaudited)</i> | | | | | | |
|-----------------------------------|---|-------------------------------|-------------------------------------|---|--|---|---|
| | <i>Corporate lending</i> | <i>Individual lending</i> | <i>Total loans to customers</i> | <i>Amounts due from credit institutions</i> | <i>Investment securities – loans and receivables</i> | <i>Total</i> | <i>Guarantees and letters of credit</i> |
| At 1 January | (58,089) | (4,244) | (62,333) | (907) | (134) | (63,374) | (6,959) |
| (Charge)/reversal for the year | (5,330) | (1,328) | (6,658) | 35 | 47 | (6,576) | 5,010 |
| Amounts written off | – | – | – | – | – | – | – |
| Recovery | (244) | (2) | (246) | – | – | (246) | – |
| Exchange difference | (58) | – | (58) | – | (6) | (64) | – |
| At 31 December | <u>(63,721)</u> | <u>(5,574)</u> | <u>(69,295)</u> | <u>(872)</u> | <u>(93)</u> | <u>(70,260)</u> | <u>(1,949)</u> |
| | 6 month ended 30 June 2016 <i>(unaudited)</i> | | | | | | |
| | <i>Corporate lending</i> | <i>Individual lending</i> | <i>Total loans to customers</i> | <i>Amounts due from credit institutions</i> | <i>Total</i> | <i>Guarantees and letters of credit</i> | |
| At 1 January | (42,127) | (5,571) | (47,698) | (780) | (48,478) | (379) | |
| Charge for the period | (13,156) | (342) | (13,498) | (9) | (13,507) | (53) | |
| Amounts written off | – | 8 | 8 | – | 8 | – | |
| Recovery | (2,314) | (2) | (2,316) | – | (2,316) | – | |
| Exchange difference | (13) | – | (13) | – | (13) | – | |
| At 30 June (unaudited) | <u>(57,610)</u> | <u>(5,907)</u> | <u>(63,517)</u> | <u>(789)</u> | <u>(64,306)</u> | <u>(432)</u> | |

Allowance for impairment of assets is deducted from the carrying amount of the related assets. Provision for guarantees and letters of credit is recorded in liabilities.

*(Figures in tables are in thousands of Azerbaijani manats)***20. Net fee and commission income**

Net fee and commission income comprise:

| | 2017 (6 months) (unaudited) | 2016 (6 months) (unaudited) |
|--------------------------------------|--|--|
| Settlements operations | 3,739 | 2,080 |
| Servicing plastic card operations | 3,660 | 1,814 |
| Guarantees and letters of credit | 2,930 | 3,001 |
| Cash operations | 650 | 1,301 |
| Securities operations | 116 | 922 |
| Other | 146 | 470 |
| Fee and commission income | 11,241 | 9,588 |
| Servicing plastic card operations | (3,568) | (1,824) |
| Settlements operations | (1,396) | (654) |
| Cash operations | (562) | (149) |
| Guarantees and letters of credit | (485) | (472) |
| Securities operations | (7) | (4) |
| Other | (186) | (219) |
| Fee and commission expense | (6,204) | (3,322) |
| Net fee and commission income | 5,037 | 6,266 |

21. Personnel, general and administrative expenses

Personnel expenses comprise:

| | 2017 (6 months) (unaudited) | 2016 (6 months) (unaudited) |
|---------------------------------|--|--|
| Salaries and bonuses | (18,036) | (13,139) |
| Social security costs | (5,879) | (2,452) |
| Other employee related expenses | (1,206) | (1,684) |
| Total personnel expenses | (25,121) | (17,275) |

General and administrative expenses comprise:

| | 2017 (6 months) (unaudited) | 2016 (6 months) (unaudited) |
|--|--|--|
| Operating leases | (3,511) | (3,396) |
| Professional services | (1,832) | (1,985) |
| Charity and sponsorship | (1,825) | (8,627) |
| Software cost | (1,229) | (1,099) |
| Advertising costs | (779) | (621) |
| Insurance | (642) | (343) |
| Repair and maintenance | (438) | (495) |
| Impairment of investment property | (338) | - |
| Utilities | (320) | (317) |
| Transportation and business trip expenses | (294) | (210) |
| Communications | (288) | (242) |
| Membership fees | (276) | (119) |
| Security expenses | (270) | (212) |
| Taxes, other than income tax | (154) | (295) |
| Stationery | (144) | (96) |
| Printing expenses | (11) | (34) |
| Losses on disposal of property and equipment | - | (3) |
| Other expenses | (1,487) | (526) |
| Total general and administrative expenses | (13,838) | (18,620) |

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair values of financial instruments

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- ▶ Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- ▶ Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly; and
- ▶ Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

| | Date of valuation | Fair value measurement using (unaudited) | | | Total |
|--|-------------------|---|---|---|-----------|
| | | Quoted prices in active markets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | |
| Assets measured at fair value | | | | | |
| Trading securities | 30 June 2017 | – | 25,650 | – | 25,650 |
| Investment securities – available for sale | 30 June 2017 | 15,689 | 103,303 | 3,563 | 122,555 |
| Derivative financial assets | 30 June 2017 | – | 2,897 | – | 2,897 |
| Assets for which fair values are disclosed | | | | | |
| Cash and cash equivalents | 30 June 2017 | 1,454,255 | – | – | 1,454,255 |
| Amounts due from credit institutions | 30 June 2017 | – | – | 668,620 | 668,620 |
| Investment securities – loans and receivables | 30 June 2017 | – | 2,145 | 43,378 | 45,523 |
| Loans to customers | 30 June 2017 | – | – | 1,181,107 | 1,181,107 |
| Investment property | 30 June 2017 | – | – | 4,757 | 4,757 |
| Liabilities measured at fair value | | | | | |
| Derivative financial liabilities | 30 June 2017 | – | 1,219 | – | 1,219 |
| Liabilities for which fair values are disclosed | | | | | |
| Amounts due to banks and government funds | 30 June 2017 | – | – | 312,896 | 312,896 |
| Amounts due to customers | 30 June 2017 | – | – | 2,706,477 | 2,706,477 |
| Other borrowed funds | 30 June 2017 | – | – | 45,354 | 45,354 |
| Debt securities | 30 June 2017 | – | – | 28,829 | 28,829 |
| | Date of valuation | Fair value measurement using | | | Total |
| | | Quoted prices in active markets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | |
| Assets measured at fair value | | | | | |
| Trading securities | 31 December 2016 | – | 22,669 | – | 22,669 |
| Investment securities – available for sale | 31 December 2016 | 35,790 | 134,187 | 3,352 | 173,329 |
| Derivative financial assets | 31 December 2016 | – | 984 | – | 984 |
| Assets for which fair values are disclosed | | | | | |
| Cash and cash equivalents | 31 December 2016 | 1,105,769 | – | – | 1,105,769 |
| Amounts due from credit institutions | 31 December 2016 | – | – | 728,121 | 728,121 |
| Investment securities – loans and receivables | 31 December 2016 | – | 2,074 | 61,027 | 63,101 |
| Loans to customers | 31 December 2016 | – | – | 1,088,091 | 1,088,091 |
| Investment property | 31 December 2016 | – | – | 1,654 | 1,654 |

(Figures in tables are in thousands of Azerbaijani manats)

22. Fair values of financial instruments (continued)

| | Date of valuation | Fair value measurement using | | | Total |
|--|-------------------|---|---|---|-----------|
| | | Quoted prices in active markets (Level 1) | Significant observable inputs (Level 2) | Significant unobservable inputs (Level 3) | |
| Liabilities measured at fair value | | | | | |
| Derivative financial liabilities | 31 December 2016 | – | 2,468 | – | 2,468 |
| Liabilities for which fair values are disclosed | | | | | |
| Amounts due to banks and government funds | 31 December 2016 | – | – | 330,294 | 330,294 |
| Amounts due to customers | 31 December 2016 | – | – | 2,354,701 | 2,354,701 |
| Other borrowed funds | 31 December 2016 | – | – | 51,473 | 51,473 |
| Debt securities issued | 31 December 2016 | – | – | 18,690 | 18,690 |

Fair value of financial assets and liabilities not carried at fair value

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are not carried at fair value in the statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

| | Carrying value 30 June 2017 (unaudited) | Fair value 30 June 2017 (unaudited) | Unrecognized gain/(loss) 30 June 2017 (unaudited) | Carrying value 31 December 2016 | Fair value 31 December 2016 | Unrecognized gain/(loss) 31 December 2016 |
|---|---|---|---|---------------------------------------|-----------------------------------|---|
| Financial assets | | | | | | |
| Cash and cash equivalents | 1,454,255 | 1,454,255 | – | 1,105,769 | 1,105,769 | – |
| Amounts due from credit institutions | 668,620 | 668,620 | – | 728,121 | 728,121 | – |
| Investment securities – loans and receivables | 43,679 | 45,523 | 1,844 | 61,220 | 63,101 | 1,881 |
| Loans to customers | 1,190,650 | 1,181,107 | (9,543) | 1,107,274 | 1,088,091 | (19,183) |
| Financial liabilities | | | | | | |
| Amounts due to banks and government funds | 312,896 | 312,896 | – | 330,294 | 330,294 | – |
| Amounts due to customers | 2,702,754 | 2,706,477 | (3,723) | 2,350,687 | 2,354,701 | (4,014) |
| Other borrowed funds | 45,354 | 45,354 | – | 51,473 | 51,473 | – |
| Debt securities issued | 28,901 | 28,829 | 72 | 18,705 | 18,690 | 15 |
| Total unrecognized change in unrealised fair value | | | (11,350) | | | (21,301) |

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that are liquid or having a short term maturity (less than three months) it is assumed that the carrying amounts approximate to their fair value. This assumption is also applied to demand deposits, without a specific maturity and variable rate financial instruments.

Fixed and variable rate financial instruments

For quoted debt instruments the fair values are determined based on quoted market prices. The fair values of unquoted debt instruments are estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

(Figures in tables are in thousands of Azerbaijani manats)

23. Related party disclosures

In accordance with IAS 24 *Related Party Disclosures*, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The volumes of related party transactions, outstanding balances at the year end, and related expense and income for the year are as follows:

| | 30 June 2017 (unaudited) | | | | | 31 December 2016 | | | | |
|---|-----------------------------|-------------------------------|--------------------------|------------|----------------|------------------|-------------------------------|--------------------------|------------|----------------|
| | Parent | Entities under common control | Key management personnel | Other | Total | Parent | Entities under common control | Key management personnel | Other | Total |
| Loans, gross | - | 125,162 | 4,492 | 142 | 129,796 | - | 124,512 | 3,293 | 214 | 128,019 |
| Less: allowance for impairment | - | (237) | (48) | - | (285) | - | (1,097) | (9) | - | (1,106) |
| Loans, net | - | 124,925 | 4,444 | 142 | 129,511 | - | 123,415 | 3,284 | 214 | 126,913 |
| Amounts due to banks and government funds | - | 47,386 | - | - | 47,386 | - | 48,317 | - | - | 48,317 |
| Deposits | - | 402,930 | 5,247 | 92,452 | 500,629 | - | 454,434 | 5,800 | 58,806 | 519,040 |
| Current accounts | 36,857 | 304,453 | 139,968 | 35,569 | 516,847 | 29,564 | 240,425 | 1,712 | 248,151 | 519,852 |
| Unused credit lines | 182 | 2,023 | 1,128 | 242 | 3,575 | 182 | 1,787 | 801 | 231 | 3,001 |

The income and expense arising from related party transactions are as follows:

| | 30 June 2017 (unaudited) | | | | | 30 June 2016 | | | | |
|-------------------------------------|-----------------------------|-------------------------------|--------------------------|-----------------------|---------|--------------|-------------------------------|--------------------------|-----------------------|---------|
| | Parent | Entities under common control | Key management personnel | Other related parties | Total | Parent | Entities under common control | Key management personnel | Other related parties | Total |
| Interest income on loans | - | 4,418 | 161 | 9 | 4,588 | - | 2,573 | 85 | 2 | 2,660 |
| Interest expense on deposits | (51) | (8,467) | (147) | (114) | (8,779) | (291) | (6,090) | (28) | (1,359) | (7,768) |
| Fee and commission income | 36 | 2,064 | 18 | 1 | 2,119 | 33 | 1,668 | 1 | 1 | 1,703 |
| General and administrative expenses | - | (1,364) | - | - | (1,364) | - | (2,381) | - | - | (2,381) |

The Bank has guarantee from its parent received as a collateral in respect of deposits placed in one local bank (31 December 2016: one local bank) and 7 borrowers (31 December 2016: 6 borrowers) in the amount of AZN 6,654 thousand and AZN 110,610 thousand respectively as at 30 June 2017 (31 December 2016 – AZN 6,872 thousand and AZN 85,348 thousand).

Compensation to members of key management personnel was comprised of the following:

| | 2017 (6 months) (unaudited) | 2016 (6 months) (unaudited) |
|--|-----------------------------------|-----------------------------------|
| Salaries and other benefits | (5,170) | (3,539) |
| Social security costs | (875) | (778) |
| Total key management compensation | (6,045) | (4,317) |

(Figures in tables are in thousands of Azerbaijani manats)

24. Capital adequacy

The Bank and its banking subsidiaries maintain an actively managed capital base to cover risks inherent in the business. The adequacy of the Bank's capital is monitored using, among other measures, the ratios established by the CBAR in Azerbaijan and banking regulators in the countries where respective subsidiaries are located.

During the 6 months of 2017, the Bank have complied in full with its externally imposed capital requirements.

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes from the previous years.

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 10% (2016: 10%) of risk-weighted assets for regulatory capital. As at 30 June 2017 and 31 December 2016 the bank's capital adequacy ratio on this basis was as follows:

| | 30 June 2017 (unaudited) | 31 December 2016 |
|---------------------------------|---|-------------------------|
| Tier 1 capital | 329,710 | 330,438 |
| Tier 2 capital | 29,758 | 75,195 |
| Less: deductions from capital | (148,987) | (148,987) |
| Total regulatory capital | 210,481 | 256,646 |
| Risk-weighted assets | 1,195,131 | 1,136,889 |
| Capital adequacy ratio | 15% | 20% |

The NBS requires banks to maintain a minimum total capital adequacy ratio of 9.6% (2016 – 10.8%) of risk-weighted assets for regulatory capital. As at 30 June 2017, capital adequacy ratio of PASHA Bank Georgia was 42% (31 December 2016 – 42%).

The BRSA requires banks to maintain a minimum total capital adequacy ratio of 8% (2016 – 8%) of risk-weighted assets for regulatory capital. Capital Adequacy Standard Ratio of PASHA Yatirim Bankasi A.S. is calculated in accordance with BRSA. As at 30 June 2017 the bank's capital adequacy ratio was 41.07% (31 December 2016: 54%).