OJSC PASHA Bank

Interim condensed consolidated financial statements

30 June 2020

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Report on Review of Interim Condensed Consolidated Financial Statements

To the Shareholders and Supervisory Board of OJSC PASHA Bank

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of OJSC PASHA Bank and its subsidiaries (the Group), which comprise the interim consolidated statement of financial position as at 30 June 2020 and the related interim 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 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.

28 August 2020

Baku, Azerbaijan

Interim consolidated statement of financial position

As at 30 June 2020

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

	Notes	*30 June 2020 (unaudited)*	*31 December 2019*
Assets			
Cash and cash equivalents	3	1,116,824	1,185,839
Amounts due from credit institutions	4	446,971	624,394
Investment securities	5	1,282,188	1,146,353
Derivative financial assets	13	2,293	457
Loans to customers	6	2,402,302	2,296,988
Investment property	7	37,649	43,202
Property and equipment		41,273	46,036
Intangible assets		44,641	50,421
Right-of-use assets		14,761	9,142
Current income tax assets	14	298	3,198
Deferred income tax assets		3,873	4,466
Other assets	8	60,503	29,943
Total assets		**5,453,576**	**5,440,439**
Liabilities			
Amounts due to banks and government funds	9	867,102	862,143
Amounts due to customers	10	3,795,362	3,788,941
Lease liabilities		15,618	9,537
Debt securities issued	11	154,275	136,031
Derivative financial liabilities	13	4,568	137
Current income tax liabilities	14	4,827	560
Deferred income tax liabilities		8,120	13,037
Provision for guarantees and other commitments	16	12,704	10,550
Subordinated debts	12	27,107	27,111
Other liabilities	8	35,151	32,336
Total liabilities		**4,924,834**	**4,880,383**
Equity			
Share capital	15	333,000	333,000
Shares issued but not registered	15	21,500	–
Additional paid-in capital	15	343	343
Retained earnings		104,419	143,432
Other reserves	15	16,431	1,983
Net unrealised gain on investment securities	15	803	4,668
Foreign currency translation reserve	15	(19,387)	(4,331)
Total equity attributable to shareholders of the Bank		**457,109**	**479,095**
Non-controlling interests		71,633	80,961
Total equity		**528,742**	**560,056**
Total liabilities and equity		**5,453,576**	**5,440,439**

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

Jalal Orujov Chief Operations Officer

Bahruz Naghiyev Chief Financial Officer

28 August 2020

The accompanying notes on pages 7 to 29 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of profit or loss

For the six months ended 30 June 2020

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

		For the six months ended 30 June (unaudited)	
	Notes	***2020***	***2019***
Interest income			
Loans to customers		92,527	77,344
Investment securities		26,681	30,686
Cash and cash equivalents		5,401	13,979
Amounts due from credit institutions		4,927	9,511
Interest revenue calculated using effective interest rate		**129,536**	**131,520**
Interest expense			
Amounts due to customers		(18,169)	(16,703)
Amounts due to banks and government funds		(9,875)	(6,423)
Debt securities issued		(2,801)	(3,415)
Subordinated debts		(707)	(279)
Lease liabilities		(451)	(516)
Other borrowed funds		(128)	(5)
		(32,131)	**(27,341)**
Net interest income		**97,405**	**104,179**
Credit loss expense on financial assets	17	(23,592)	(17,652)
Net interest income after credit loss expense		**73,813**	**86,527**
Net fee and commission income	18	14,005	12,126
Net gains from trading securities		–	39
Net losses from investment securities		–	(219)
Net gains/(losses) from foreign currencies:			
- dealing		18,769	8,425
- translation differences		(2,627)	118
Other income		559	849
Non-interest income		**30,706**	**21,338**
Personnel expenses	19	(30,078)	(27,008)
General and administrative expenses	19	(26,423)	(16,930)
Depreciation and amortisation		(10,264)	(8,813)
Net losses on modification of financial assets measured at amortised cost	6	(1,149)	(99)
Impairment of digital products		(1,482)	–
Impairment of miles under loyalty programme		(977)	–
Other operating expenses		–	(403)
Provision for credit related commitments and other assets	17	(2,477)	(8,746)
Non-interest expenses		**(72,850)**	**(61,999)**
Profit before income tax expense		**31,669**	**45,866**
Income tax expense	14	(9,379)	(10,170)
Net profit for the period		**22,290**	**35,696**
Attributable to:			
- shareholders of the Bank		20,857	33,645
- non-controlling interests		1,433	2,051
		22,290	**35,696**

The accompanying notes on pages 6 to 26 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of comprehensive income

For the six months ended 30 June 2020

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

	Notes	*For the six months ended 30 June (unaudited)* 2020	2019
Net profit for the period		**22,290**	**35,696**
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Reclassification of cumulative gain on disposal of investment securities at fair value through other comprehensive income to profit or loss		–	219
Net change in fair value of investment securities at fair value through other comprehensive income		(5,256)	1,144
Changes in allowance for expected credit losses of investment securities at fair value through other comprehensive income		427	(44)
Net unrealised (losses)/gains on investment securities at fair value through other comprehensive income		**(4,829)**	**1,319**
Income tax relating to components of other comprehensive income	14	964	(264)
Foreign currency translation differences	15	(25,817)	(19,566)
Net other comprehensive loss to be reclassified to profit or loss in subsequent periods		**(29,682)**	**(18,511)**
Total comprehensive (loss)/income for the period		**(7,392)**	**17,185**
Attributable to:			
- shareholders of the Bank		1,936	23,242
- non-controlling interests		(9,328)	(6,057)
		(7,392)	**17,185**

The accompanying notes on pages 6 to 26 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of changes in equity

For the six months ended 30 June 2020

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

	Attributable to shareholders of the Bank									
	Share capital	*Shares issued but not registered*	*Additional paid-in capital*	*Retained earnings*	*Net unrealised gain/ (losses) on investment securities*	*Other reserves*	*Foreign currency translation reserve*	*Total*	*Non-controlling interests*	*Total equity*
As at 1 January 2019	**333,000**	**–**	**–**	**114,930**	**338**	**1,983**	**9,774**	**460,025**	**87,984**	**548,009**
Net profit for the period	–			33,645	–	–	–	**33,645**	2,051	**35,696**
Other comprehensive loss for the period	–	–	–	–	1,055	–	(11,458)	**(10,403)**	(8,108)	**(18,511)**
Total comprehensive income/(loss) for the period	**–**	**–**	**–**	**33,645**	**1,055**	**–**	**(11,458)**	**23,242**	**(6,057)**	**17,185**
Dividends to shareholders of the Bank (Note 15)	–	**–**	**–**	(45,232)	–	–	–	**(45,232)**	–	**(45,232)**
As at 30 June 2019 (unaudited)	**333,000**	**–**	**–**	**103,343**	**1,393**	**1,983**	**(1,684)**	**438,035**	**81,927**	**519,962**
As at 1 January 2020	**333,000**	–	**343**	**143,432**	**4,668**	**1,983**	**(4,331)**	**479,095**	**80,961**	**560,056**
Net profit for the period	–	–	–	20,857	–	–	–	**20,857**	1,433	**22,290**
Other comprehensive loss for the period	–	–	–	–	(3,865)	–	(15,056)	**(18,921)**	(10,761)	**(29,682)**
Total comprehensive income/(loss) for the period	**–**	–	–	**20,857**	**(3,865)**	**–**	**(15,056)**	**1,936**	**(9,328)**	**(7,392)**
Increase in charter capital	**–**	**21,500**	**–**	**–**	**–**	**–**	**–**	**21,500**	–	**21,500**
Transfer to reserves	–	–	–	(14,448)	–	14,448	–	**–**	–	**–**
Dividends to shareholders of the Bank (Note 15)	–	–	–	(45,422)	–	–	–	**(45,422)**	–	**(45,422)**
As at 30 June 2020	**333,000**	**21,500**	**343**	**104,419**	**803**	**16,431**	**(19,387)**	**457,109**	**71,633**	**528,742**

The accompanying notes on pages 6 to 26 are an integral part of these interim condensed consolidated financial statements.

Interim consolidated statement of cash flows

For the six months ended 30 June 2020

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

	Notes	*For the six months ended 30 June (unaudited)* 2020	2019
Cash flows from operating activities			
Interest received		123,844	129,087
Interest paid		(30,900)	(26,665)
Fees and commissions received		26,412	21,852
Fees and commissions paid		(12,229)	(9,688)
Net realized losses on sale of investment securities		–	(219)
Net realized gain from trading securities		–	38
Realised gains less losses from dealing in foreign currencies and from operations with foreign currency derivatives		17,125	9,626
Personnel expenses paid		(36,914)	(34,468)
General and administrative expenses paid		(26,387)	(15,740)
Other operating income received		212	672
Cash flows from operating activities before changes in operating assets and liabilities		**61,163**	**74,495**
Net (increase)/decrease in operating assets			
Investment securities purchased under agreement to resell		–	(18,995)
Trading securities		–	845
Amounts due from credit institutions		176,129	(211,414)
Loans to customers		(143,139)	(152,818)
Other assets		(1,696)	(3,760)
Net increase/(decrease) in operating liabilities			
Amounts due to banks and government funds		15,154	91,354
Amounts due to customers		6,379	(262,454)
Other liabilities		2,483	837
Net cash flows from / (used in) operating activities before income tax		**116,473**	**(481,910)**
Income tax paid		(5,868)	(16,818)
Net cash flows from / (used in) from operating activities		**110,605**	**(498,728)**
Cash flows from investing activities			
Proceeds from sale and redemption of investment securities		1,612,920	3,875,868
Purchase of investment securities		(1,755,694)	(3,746,611)
Proceeds from sale of property and equipment		–	129
Purchase and prepayments for property and equipment		(6,487)	(4,743)
Acquisition of intangible assets		(1,097)	(4,297)
Purchase of investment property		–	(96)
Net cash flows (used in) / from investing activities		**(150,358)**	**120,250**
Cash flows from financing activities			
Proceeds from bonds issued		39,505	61,698
Redemption of bonds issued		(19,643)	(30,579)
Proceeds from subordinated debts		–	(1)
Finance lease paid		(3,236)	(2,005)
Dividends paid	15	(45,422)	(45,232)
Net cash used in financing activities		**(28,796)**	**(16,119)**
Effect of exchange rates changes on cash and cash equivalents		(412)	(3,059)
Effect of expected credit losses on cash and cash equivalents	3	(54)	(2)
Net decrease in cash and cash equivalents		**(69,015)**	**(397,658)**
Cash and cash equivalents, beginning of the year		1,185,839	1,503,046
Cash and cash equivalents, ending of the period		**1,116,824**	**1,105,388**

The accompanying notes on pages 6 to 26 are an integral part of these interim condensed consolidated financial statements.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

1. Principal activities

OJSC PASHA Bank ("the Bank") was established 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 No. 250 issued by the Central Bank of the Republic of Azerbaijan (the "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.

As at 30 June 2020 and 31 December 2019, the Bank has six service points, three branches in Azerbaijan 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 2020 and 31 December 2019, the following shareholders owned the outstanding shares of the Bank:

Shareholders	***30 June 2020, (%)***	***31 December 2019, (%)***
PASHA Holding Ltd.	60	60
Ador Ltd.	30	30
Mr. Arif Pashayev	10	10
Total	**100**	**100**

As at 30 June 2020 and 31 December 2019, the ultimate beneficial owners of the Group are Mrs. Leyla Aliyeva, Mrs. Arzu Aliyeva and Mr. Arif Pashayev who exercise joint control over the Group.

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 at 31 December 2013. In March 2014 share capital of subsidiary was increased and amounted to GEL 103,000 thousand as at 30 June 2020 and 31 December 2019. 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 the Republic of 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. and it 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 increasing ownership in subsidiary to 99.92%. On 6 June 2018, share capital of subsidiary was increased by TRY 245,000 thousand to TRY 500,000 thousand. The increase was made based on decision of Supervisory Board of the Bank, according to which newly issued shares were acquired by PASHA Holding Ltd. As a result, the Bank's shares in the subsidiary decreased from 99.92% to 50.96% and PASHA Holding Ltd became a new non-controlling shareholder with ownership of 49% as at 30 June 2020. Head office of PASHA Yatirim Bankasi A.Ş. is 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 (together – "the Group") were consolidated in these financial statements.

2. Basis of preparation

General

These interim condensed consolidated financial statements for the six months ended 30 June 2020 have been prepared in accordance with International Accounting Standard (IAS) 34 *Interim Financial Reporting*.

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 consolidated financial statements as at 31 December 2019.

Effect of COVID-19 pandemic

Due to rapid spread of COVID-19 pandemic in the early of 2020 many governments, including the Government of the Republic of Azerbaijan, the Government of the Republic of Georgia and the Government of the Republic of Turkey, have introduced various measures to combat the outbreak, including travel restrictions, quarantines, closure of business and other venues and lockdown of certain area. These measures have affected the global supply chain, demand for goods and services, as well as scale of business activity.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

2. Basis of preparation (continued)

Effect of COVID-19 pandemic (continued)

It is expected that pandemic itself as well as measures for its consequences' minimization may influence the business of the entities in wide range of industries. Since March 2020 significant volatility in stock, currency and commodity markets exists, including decrease in crude oil prices and decrease of GEL and TRY against USD and EUR.

In order to prevent the widespread of COVID-19 pandemic, the Government of the Republic of Azerbaijan keeps taking comprehensive measures in all directions. As a response, in March 2020 the President of the Republic of Azerbaijan signed a decree for action plans to minimize the impact of the pandemic. In accordance with this decree, anti-crisis stimulus package of AZN 2,500,000 thousand is being developed to support individuals and various businesses in the country. Also, the CBAR continues its monetary policy to ensure stability of AZN exchange rates

In 2020, support measures were introduced by the Government of the Republic of Georgia and NBG to counter the economic downturn caused by the COVID-19 pandemic. These measures include, among others, subsidized lending to affected industries and individuals, payment holidays and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and to help customers avoid liquidity shortages as a result of the COVID-19 containment measures.

In 2020, the Government of the Republic of Turkey, the CBRT and The Banking Regulation and Supervision Agency (hereafter, "BRSA") have announced measures and incentives, due to the spread of the virus in Europe, and in Turkey. The CBRT cut its policy rate and announced liquidity measures. The government has also announced the economic stability package. In this context, the Credit Guarantee Fund limit was increased twice. Within the fiscal package, deferral options for tax and debt payments were also announced.

The Group continues to assess pandemic effect and changing micro- and macroeconomic conditions on its activities, financial position and financial results.

Estimation uncertainty

To the extent that information is available as at 30 June 2020, the Group has reflected revised estimates of expected future cash flows in its expected credit loss (hereafter, "ECL") assessment (Note 6) and estimation of fair values of financial instruments.

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 2019. Several other amendments effective since 1 January 2020 were applied but do not have an impact on the interim condensed consolidated financial statements of the Group.

3. Cash and cash equivalents

Cash and cash equivalents comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Cash on hand	148,511	95,661
Current accounts with the CBAR, the NBG and the CBRT	385,080	499,615
Current accounts with other credit institutions	69,041	85,319
Time deposits with credit institutions up to 3 months	512,525	463,239
Reverse repurchase agreements with credit institutions up to 3 months	1,737	42,025
Less: allowance for impairment	(70)	(20)
Cash and cash equivalents	**1,116,824**	**1,185,839**

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 5,739 thousand (31 December 2019: AZN 302 thousand) and AZN 63,302 thousand (31 December 2019: AZN 85,017 thousand), respectively.

As at 30 June 2020, the Group placed AZN 512,525 thousand in time deposits with CBAR and fifteen non-resident banks maturing through September 2020 with interest rates ranging between 0.05% and 9.70% p.a. (31 December 2019: AZN 463,239 thousand with CBAR and fourteen non-resident banks maturing through March 2020 with interest rates ranging between 0.37% and 13.70% p.a.). All balances of cash equivalents are allocated to Stage 1.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

4. Amounts due from credit institutions

Amounts due from credit institutions comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Time deposits with credit institutions for more than 3 months	266,446	372,284
Loans to banks	32,529	62,819
Obligatory reserve with the CBAR, the NBG and the CBRT	67,501	97,229
Restricted deposits	80,906	92,623
	447,382	**624,955**
Less: allowance for impairment	(411)	(561)
Amounts due from credit institutions	**446,971**	**624,394**

As at 30 June 2020, time deposits with credit institutions mature between July 2020 and April 2023 (31 December 2019: between January 2020 and November 2021) with interest rates ranging between 0.67% and 3.20% p.a. (31 December 2019: between 1.92% and 2.65% p.a.).

As at 30 June 2020, the Group had outstanding amount of AZN 30,611 thousand (31 December 2019: AZN 43,728 thousand) of secured loans issued to four resident commercial banks (31 December 2019: two resident commercial banks) and AZN 1,918 thousand (31 December 2019: AZN 19,091 thousand) of unsecured loans issued to one non-resident commercial bank (31 December 2019: five resident commercial bank) with contractual maturity through March 2022 (31 December 2019: December 2020) and with interest rates ranging between 1.7% and 11.0% p.a. (31 December 2019: 1.7% and 10.0% p.a.).

Credit institutions in the Republic of Azerbaijan are required to maintain reserve rates (with restriction on withdrawal) with the CBAR at the level of 0.5% (31 December 2019: 0.5%) and 1.0% (31 December 2019: 1.0%) of the previous month average of funds attracted from customers by a credit institution in AZN and foreign currencies, respectively.

Credit institutions in the Republic of Georgia are required to maintain a mandatory interest earning cash deposit with the NBG at the level of 5.0% (31 December 2019: 5.0%) and 25.0% (31 December 2019: 25.0%) of the average of funds attracted from customers and non-resident financial institutions by a credit institution for the appropriate two-week period in GEL and foreign currencies, respectively.

Credit institutions in the Republic of Turkey are required to maintain reserve rates for deposits with the CBRT in the range of 1.0% and 2.0% (31 December 2019: 1.0% and 7.0%) and 0% and 16.0% (31 December 2019: 5.0% and 21.0%) of average of funds attracted from customers by a credit institution in TL and foreign currencies, respectively.

An analysis of changes in the ECLs allowances during the six months ended is as follows:

	30 June (unaudited)	
	2020	*2019*
	Stage 1	*Stage 1*
ECL allowance as at 1 January	**(561)**	**(369)**
New assets originated or purchased	(141)	(718)
Assets repaid	287	330
Foreign exchange adjustments	4	4
At 30 June	**(411)**	**(753)**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

5. Investment securities

Investment securities comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Debt securities at FVOCI		
Bonds of the Ministry of Finance of the Republic of Azerbaijan	458,119	504,441
Certificate of deposits	317,772	316,508
Notes issued by the CBAR	265,833	117,933
Corporate bonds	116,470	51,648
Bonds of financial institutions	24,281	17,232
Other foreign government bonds	41,644	41,304
US treasury bonds	4,477	4,336
AMF bonds	–	52,376
Debt securities at FVOCI	**1,228,596**	**1,105,778**

	30 June 2020 (unaudited)	*31 December 2019*
Equity securities at FVOCI		
Corporate Shares	1,900	2,189
Equity securities at FVOCI	**1,900**	**2,189**

	30 June 2020 (unaudited)	*31 December 2019*
Financial assets at FVTPL		
Mutual funds participation certificate	1,134	–
Financial assets at FVTPL	**1,134**	**–**

	30 June 2020 (unaudited)	*31 December 2019*
Debt securities at amortized cost		
Bonds of financial institutions	27,685	18,258
Corporate bonds	11,298	12,003
Turkey Government Bonds	10,305	8,551
Treasury bonds of the Ministry of Finance of Georgia	1,949	–
	51,237	**38,812**
Less: allowance for impairment	(679)	(426)
Debt securities at amortized cost	**50,558**	**38,386**

An analysis of changes in the ECLs allowances during the six months ended is as follows:

	30 June (unaudited)	
	2020	*2019*
Debt securities at FVOCI	*Stage 1*	*Stage 1*
ECL as at 1 January	**(833)**	**(756)**
New assets originated or purchased	(846)	(385)
Assets repaid	419	430
Changes to models and inputs used for ECL calculations	–	(1)
Foreign exchange adjustments	4	(27)
At 30 June	**(1,256)**	**(739)**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

5. Investment securities (continued)

	30 June (unaudited)	
	2020	2019
Debt securities at amortized cost	***Stage 1***	***Stage 1***
ECL as at 1 January	**(426)**	**(308)**
New assets originated or purchased	(1,072)	(177)
Assets repaid	761	12
Changes to models and inputs used for ECL calculations	–	(21)
Foreign exchange adjustments	58	35
At 30 June	**(679)**	**(459)**

6. Loans to customers

Loans to customers comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Legal entities	2,243,287	2,115,655
Individuals	248,730	248,254
Loans to customers (gross)	**2,492,017**	**2,363,909**
Less: allowance for impairment	(89,715)	(66,921)
Loans to customers at amortised cost	**2,402,302**	**2,296,988**

Loans are made in the following industry sectors:

	30 June 2020 (unaudited)	*31 December 2019*
Trade and services	1,035,935	889,367
Manufacturing	329,128	322,285
Individuals	248,730	248,254
Construction	225,312	223,634
Agriculture and food processing	165,374	167,688
Non-banking credit organizations	156,637	143,347
Transport and telecommunication	118,287	159,608
Energy	65,430	47,125
Mining	54,115	69,702
Real estate management	33,818	34,058
Leasing	29,307	24,781
Other	29,944	34,060
Total loans (gross)	**2,492,017**	**2,363,909**

As at 30 June 2020, loans granted to top 8 customers (31 December 2019: 9 customers) which individually exceeded 5% of the Group's equity, amounted to AZN 648,551 thousand (31 December 2019: AZN 660,118 thousand).

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

6. Loans to customers (continued)

An analysis of changes in the ECL allowances during the six months ended 30 June 2020 is, as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(12,102)**	**(21,090)**	**(33,729)**	**(66,921)**
New assets originated or purchased	(19,963)	–	–	**(19,963)**
Assets repaid	5,915	4,508	6,739	**17,162**
Transfers to Stage 1	(787)	787	–	**–**
Transfers to Stage 2	10,771	(10,795)	24	**–**
Transfers to Stage 3	5,034	379	(5,413)	**–**
Impact on period end ECL of exposures transferred between stages during the period	477	(6,659)	(4,023)	**(10,205)**
Unwinding of discount (recognised in interest revenue)	–	–	(1,652)	**(1,652)**
Changes due to modifications not resulting in derecognition	312	(9)	1	**304**
Changes to models and inputs used for ECL calculations	(4,449)	(553)	(5,242)	**(10,244)**
Amounts written off	–	–	1,315	**1,315**
Recoveries	–	–	(1,642)	**(1,642)**
Foreign exchange adjustments	543	702	886	**2,131**
At 30 June 2020	**(14,249)**	**(32,730)**	**(42,736)**	**(89,715)**

An analysis of changes in the ECL allowances during the six months ended 30 June 2019 is, as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(12,079)**	**(9,523)**	**(27,615)**	**(49,217)**
New assets originated or purchased	(12,769)	–	–	**(12,769)**
Assets repaid	2,559	1,348	3,303	**7,210**
Transfers to Stage 1	(1,162)	1,162	–	**–**
Transfers to Stage 2	6,984	(6,993)	9	**–**
Transfers to Stage 3	5,432	3,670	(9,102)	**–**
Impact on period end ECL of exposures transferred between stages during the period	964	(791)	(6,865)	**(6,692)**
Unwinding of discount (recognised in interest revenue)	–	–	(1,547)	**(1,547)**
Changes to models and inputs used for ECL calculations	31	(3,852)	(1,052)	**(4,873)**
Amounts written off	44	–	1,459	**1,503**
Foreign exchange adjustments	672	313	(283)	**702**
At 30 June 2019	**(9,324)**	**(14,666)**	**(41,693)**	**(65,683)**

As at 30 June 2020, the Group introduced certain changes in its process of estimation of expected credit losses in the context of the ongoing COVID-19 pandemic. The approach focused on three dimensions: borrower's business segment, industry and size of the loan. In particular, it has revised indicators of significant increase in credit risk and does not automatically consider the credit risk to have significantly increased in the case of a loan modification being part of "Loan Holiday during COVID-19" measures. The Group applied additional notch downgrades for the borrowers' ratings that are related to strongly affected by pandemic industries to reflect appropriately the uncertainty associated with the spread of COVID-19 pandemic. Both collective and individual LGD rates were re-considered and adjusted to account for the market fluctuations of the particular properties. The Group also updated forward looking information, including forecasts of macroeconomic indicators and scenarios' weights. The credit loss expense increased by AZN 7,679 thousand for the six months ended 30 June 2020 due to the changes described above.

Modified and restructured loans

The Group derecognises a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognised as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognised loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be purchased or originated credit impaired asset.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original effective interest rate, the Group records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

6. Loans to customers (continued)

Modified and restructured loans (continued)

The table below includes Stage 1, Stage 2 and Stage 3 assets that were modified during the period, with the related modification loss suffered by the Group.

	30 June 2020 (unaudited)	*30 June 2019 (unaudited)*
Loans modified during the period		
Amortised cost before modification	171,638	–
Net modification loss	(1,149)	–

7. Investment property

The movements in investment property were as follows:

	30 June 2020 (unaudited)	*31 December 2019*
Opening balance at 1 January	**43,202**	**71,719**
Additions (subsequent expenditure)	–	174
Amortisation for the period	(68)	(337)
Transfer of the cost to buildings and lands	–	(25,900)
Transfer of the accumulated depreciation to building	–	41
Transfer of impairment loss to building and land	–	4,239
Foreign translation difference	(5,485)	(6,734)
Closing balance	**37,649**	**43,202**

In 2011, the Group acquired land for the amount of AZN 2,000 thousand as investment property which is held for long term appreciation in value. As at 30 June 2020, the fair value of this investment property amounted to AZN 1,590 thousand (2019: AZN 1,590 thousand) which is not lower than cost value of this investment property amounted to AZN 1,590 thousand (2019: AZN 1,590 thousand).

In June 2018, after the increase of share capital, PASHA Yatirim Bankasi A.S. purchased a real estate classified as investment property amounting to AZN 97,061 thousand. As of 31 December 2018, the Group recognised impairment amounting to AZN 13,546 thousand and then reclassified part of investment property of AZN 21,620 thousand to buildings and land within property and equipment, caused by using part of the building for own purposes as the Bank’s new headquarter. As at 30 June 2020, the fair value of this investment property equals to its cost value amounted to AZN 36,059 thousand (2019: AZN 41,612 thousand).

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

8. Other assets and liabilities

Other assets comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Other financial assets		
Settlements on money transfers	4,958	6,498
Receivable from shareholder (Note 15)	21,500	-
Clearance cheque accounts	4,902	2,685
Accrued commission receivable on guarantees and letters of credit	1,431	1,066
Other	25	28
	32,816	**10,277**
Less: allowance for impairment of other financial assets	(307)	(315)
Total other financial assets	**32,509**	**9,962**
Other non-financial assets		
Repossessed collateral	14,939	12,264
Deferred expenses	2,828	2,017
Prepayments for acquisition of property, equipment and intangible assets	4,904	1,722
Purchased miles under loyalty programme	3,020	1,490
Other prepayments	2,184	2,476
Taxes, other than income tax	119	12
	27,994	**19,981**
Other assets	**60,503**	**29,943**

Other liabilities comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Other financial liabilities		
Settlements on money transfer	7,737	267
Clearance cheque accounts	4,902	2,685
Accrued expenses	5,570	3,870
Money market placement	1,209	–
Other	443	2,070
	19,861	**8,892**
Other non-financial liabilities		
Payable to employees	13,345	20,448
Deferred income	1,719	2,476
Taxes, other than income tax	35	453
Other	191	67
	15,290	**23,444**
Other liabilities	**35,151**	**32,336**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

9. Amounts due to banks and government funds

Amounts due to banks and government funds comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Entrepreneurship Development Fund of the Republic of Azerbaijan	361,678	301,885
Long-term deposits from banks	339,824	330,447
Short-term deposits from banks	76,484	87,309
Azerbaijan Mortgage and Credit Guarantee Fund	34,955	31,858
Correspondent accounts with other banks	18,017	35,073
Short-term loans from banks	12,504	–
Loan from the National Bank of Georgia	8,338	–
Deposit from the Ministry of Finance of Georgia	5,792	4,163
Agro Credit and Development Agency	4,986	3,691
Amount due to IT Development Fund	3,465	4,250
State Agency on Mandatory Health Insurance	1,059	1,041
Repurchase agreements	–	35,595
Long-term loans from banks	–	8,629
Other amount	–	18,202
Amounts due to banks and government funds	**867,102**	**862,143**

As at 30 June 2020, Entrepreneurship Development Fund of the Republic of Azerbaijan had current account amounting to AZN 75,476 thousand (31 December 2019: AZN 56,353 thousand) and time deposits amounting to AZN 30,083 thousand (31 December 2019: nil). The Group had loans received from the Entrepreneurship Development Fund of the Republic of Azerbaijan amounting to AZN 256,119 thousand (31 December 2019: AZN 245,532 thousand), maturing through December 2029 (31 December 2019: through December 2029), and bearing interest rate of 1.0% p.a (31 December 2019: 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 not higher than 6.0% p.a. (31 December 2019: not higher than 6.0% p.a.).

As at 30 June 2020, the Group attracted long-term deposits from both resident and non-resident commercial banks comprising AZN 339,824 thousand (31 December 2019: AZN 330,447 thousand) maturing through March 2023 with interest rate ranging between 0.3% and 4.3% p.a. (31 December 2019: December 2022 with interest rate ranging between 1.5% and 4.3% p.a.).

As at 30 June 2020, the Group attracted short-term deposits from resident commercial banks (31 December 2019: both resident and non-resident) comprising AZN 76,484 thousand (31 December 2019: AZN 87,309 thousand) maturing through February 2021 (31 December 2019: December 2020) and with interest rates ranging between 0.01% and 8.3% p.a. (31 December 2019: ranging between 0.01% and 11.3% p.a.).

As at 30 June 2020, the Group had loans refinanced from the Azerbaijan Mortgage and Credit Guarantee Fund amounting to AZN 29,948 thousand (31 December 2019: AZN 31,858 thousand), maturing through July 2050 (31 December 2019: through September 2049) and bearing interest rate of 1.0% and 4.0% p.a. (31 December 2019: 1.0% and 4.0% p.a.). The loans have been granted to borrowers at interest rate not higher than 8.0% p.a. (31 December 2019: not higher than 8.0%). Also, the Group had short-term deposit from the Azerbaijan Mortgage and Credit Guarantee Fund amounting AZN 5,007 thousand (31 December 2019: nil), maturing through June 2021 with interest rate of 6.5% p.a.

As at 30 June 2020, the Group received short-term loan from one (31 December 2019: nil) non-resident commercial financial institution comprising AZN 12,504 thousand maturing through September 2020 and with interest rate 8.8% p.a.

As at 30 June 2020, the Group had loans from National Bank of Georgia amounting AZN 8,338 thousand (31 December 2019: nil) maturing through July 2020 and with interest rates 8.5% p.a.

As at 30 June 2020, the Group had deposit from Ministry of Finance of Georgia amounting AZN 5,792 thousand (31 December 2019: AZN 4,163 thousand) maturing through August 2020 (31 December 2019: February 2020) and with interest rates 10.6% p.a. (31 December 2019: 8.1% and 8.3% p.a.).

As at 30 June 2020, the Group had loans received from the Agro Credit and Development Agency amounting to AZN 4,986 thousand (31 December 2019: AZN 3,691 thousand), maturing through June 2024 (31 December 2019: November 2024) and bearing interest rate between 2.0% and 3.3% p.a. (31 December 2019: 2.0% and 3.3% p.a.). The loans have been granted to local entrepreneurs at interest rate of 7.0% p.a.

As at 30 June 2020, the Group had loans refinanced from the IT Development Fund amounting to AZN 3,465 thousand (31 December 2019: AZN 4,250 thousand), maturing through June 2024 (31 December 2019: through June 2024) and bearing interest rate of 1.0% p.a. (31 December 2019: 1.0% p.a.). The loans have been granted to local entrepreneurs at interest rate of 5.0% p.a.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

10. Amounts due to customers

The amounts due to customers include the following:

	30 June 2020 (unaudited)	*31 December 2019*
Demand deposits	2,110,737	2,149,775
Time deposits	1,684,625	1,639,166
Amounts due to customers	**3,795,362**	**3,788,941**
Held as security against guarantees issued (Note 16)	31,539	42,014

An analysis of customer accounts by economic sector follows:

	30 June 2020 (unaudited)	*31 December 2019*
Individuals	1,174,270	1,089,773
Trade and services	822,484	930,602
Investment holding companies	497,125	468,001
Transport and communication	463,824	385,421
Manufacturing	232,191	251,532
Construction	159,868	198,697
Insurance	159,713	166,626
Mining	81,041	56,633
Agriculture	71,884	31,502
Public organizations	50,621	38,845
Non-banking credit organizations	26,218	39,762
Energy	12,630	16,584
Hotel business	11,064	62,938
Other	32,429	52,025
Amounts due to customers	**3,795,362**	**3,788,941**

As at 30 June 2020, customer deposits included balances with eight (31 December 2019: nine) largest customers comprised AZN 1,778,462 thousand or 47% of the total customer deposits portfolio (31 December 2019: AZN 1,751,160 thousand or 46% of the total customer deposits portfolio).

11. Debt securities issued

As at 30 June 2020, PASHA Yatirim Bankasi A.S. had issued interest-bearing bonds with carrying amount of AZN 154,275 thousand (31 December 2019: AZN 136,031 thousand) maturing in February 2023 (31 December 2019: matured in February 2023) and bearing annual interest rates ranging from 1.8% to 9.4% p.a. (31 December 2019: from 1.7% to 11.4% p.a.).

12. Subordinated debts

As of 30 June 2020, the amount of subordinated debts represents USD denominated subordinated loans of AZN 27,107 thousand (31 December 2019: AZN 27,111) borrowed by the Group from its parent and entities under common control maturing through August 2024 and December 2025 (31 December 2019: through August 2024 and December 2025) and with interest rates ranging from 3.0% and 5.9% p.a. (31 December 2019: interest rates ranging from 3.0% and 5.9% p.a.), respectively.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

13. 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. The notional amount, recorded gross, is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the period end and are not indicative of the credit risk.

	30 June 2020 (unaudited)			*31 December 2019*		
	Notional amount	*Fair values Asset*	*Fair values Liability*	*Notional amount*	*Fair value Asset*	*Fair value Liability*
Interest rate contracts						
Forwards and swaps – foreign	141,981	199	(3,363)	59,771	250	(137)
Foreign exchange contracts						
Forwards and swaps − foreign	190,943	2,015	(1,205)	6,743	38	−
Forwards and swaps − domestic	29,500	79	−	−	−	−
Options − domestic		−	−	37,680	79	−
Futures – domestic		−	−	26,706	90	−
Total derivative assets/ (liabilities)		**2,293**	**(4,568)**		**457**	**(137)**

Foreign and domestic in the table above stand for counterparties where foreign means non-Azerbaijani entities and domestic means Azerbaijani entities. As at 30 June 2020 and 31 December 2019, the Group has positions in the following types of derivatives:

Forwards

Forwards and futures contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customised contracts transacted in the over-the-counter market.

Swaps

Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

Options

Options are contractual agreements that convey the right, but not the obligation, for the purchaser either to buy or sell a specific amount of a financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

14. Taxation

The corporate income tax expense comprises:

	For six months ended (unaudited)	
	30 June 2020	*30 June 2019*
Current tax charge	(12,897)	(14,489)
Deferred tax credit − origination and reversal of temporary differences	4,482	4,055
Less: deferred tax recognised in other comprehensive income	(964)	264
Income tax expense	**(9,379)**	**(10,170)**

As at 30 June 2020, current income tax assets and deferred income tax assets of the Group were AZN 298 thousand and AZN 3,873 thousand, respectively (31 December 2019: AZN 3,198 thousand and AZN 4,466 thousand, respectively).

As at 30 June 2020, current income tax liabilities and deferred income tax liabilities of the Group were AZN 4,827 thousand and AZN 8,120 thousand, respectively (31 December 2019: AZN 560 thousand and AZN 13,037 thousand).

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

15. Equity

As at 30 June 2020 and 31 December 2019, 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 29 April 2019 Shareholders of the Bank declared dividends totalling AZN 45,232 thousand on ordinary shares (AZN 4,523 per share) which was paid as at 31 December 2019.

On 24 April 2020 Shareholders of the Bank declared dividends totalling AZN 45,422 thousand on ordinary shares (AZN 4,542 per share) which was paid as at 30 June 2020.

Additional paid-in capital

As at 31 December 2019, additional capital of AZN 343 thousand represents gain from fair value measurement of subordinated debts of AZN 8,531 thousand, borrowed from entities under common control.

Shares issued but not registered

On 24 June 2020 Shareholders of the Group decided to increase share capital in the amount of AZN 21,500 thousand comprising of 646 ordinary shares. As of 30 June 2020, shares were not registered in Ministry of Tax and no cash injection was made (Note 8). The capital injection is recognised as shares issued but not registered.

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.

Other reserves

Other reserves consist of first and second legal reserves in accordance with the Turkish Commercial Code. The first legal reserve is appropriated out of the statutory profits at the rate of 5%, until the total reserve reaches a maximum of 20% of the entity's share capital. The second legal reserve is appropriated at the rate of 10% of all distributions in excess of 5% of the entity's share capital. The first and second legal reserves are not available for distribution unless they exceed 50% of the share capital but may be used to absorb losses in the event that the general reserve is exhausted.

The total reserve is AZN 16,431 thousand as of 30 June 2020 AZN (31 December 2019: AZN 1,983 thousand).

Unrealised gains on investment securities

This reserve records fair value changes on investment securities at FVOCI which amounted to AZN 803 thousand (31 December 2019: AZN 4,668 thousand).

16. Commitments and contingencies

Operating environment

In the first half of 2020 the global economy was negatively impacted by coronavirus pandemic (COVID-19) spread.

By June-July 2020 many countries have started to demonstrate signs of reduced spread of the pandemic. And the authorities started to gradually lift or ease restrictions. This tendency has supported a recovery in global financial and commodity markets. However, the peak of the pandemic in the countries was reached during the months of June-July 2020, and as a result the lock-down measures became even more stringent. These measures resulted in gradual reduction of novel coronavirus cases, and by August 2020 many governments, including the Government of the Republic of Azerbaijan, the Government of the Republic of Georgia and the Government of the Republic of Turkey started easing restrictions.

The Republic of Azerbaijan

PASHA Bank Azerbaijan conducts all of its operations in the Republic of Azerbaijan. The economy of the Republic of Azerbaijan is particularly sensitive to oil and gas prices. During the recent years the Government of the Republic of Azerbaijan initiated major economic and social reforms to accelerate transition to a more balanced economy and reduce dependence on oil and gas sector.

During 2019 the CBAR continued easing monetary conditions while maintaining stability of the Azerbaijani manat. As a result, CBAR refinancing rate was reduced from 9.8% to 7.5% p.a. In addition, significant foreign currency sales were made to maintain stability of the Azerbaijani manat, which was kept flat at 1.7000 for 1 USD throughout the period.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

16. Commitments and contingencies (continued)

Operating environment (continued)

On 28 February 2019, according to the Decree of the President of the Republic of Azerbaijan on problematic loans, the government provided funds for compensation to citizens, whose loans burden increased due to the devaluation of Azerbaijani manat in 2015. This measure significantly reduced amounts of non-performing loans as well as supported capital and liquidity in the banking system.

During period of March-June 2020 the increasingly restrictive lock-down measures to combat COVID-19 in the country were significantly reducing economic activity and aggregate spending levels. Social distancing and quarantine measures were resulting in the closure of retail, transport, travel, catering, hotel, entertainment and many other businesses. The activity of international trade was also significantly reduced. Finally, oil prices have tumbled to historical lows and moderately recovered by the end of the period. Support package was introduced by the Government of the Republic of Azerbaijan and the CBAR to counter the economic downturn caused by the COVID-19 pandemic.These measures include, but are not limited to, subsidized lending to affected industries, payments to unemployed individuals and easing of certain regulatory restrictions to help the financial sector maintain its capabilities to provide resources and help customers avoid liquidity shortages as a result of the COVID-19 containment measures. On 23 April 2020, the CBAR decided to reduce the minimum required capital adequacy ratio from 12.0% to 11.0% for banks of systematic importance, which include the Bank, and from 10.0% to 9.0% for all other banks. These new minimum required ratios will be in effect until September 2020.

The Republic of Georgia

PASHA Bank Georgia conducts all of its operations in the Republic of Georgia. The economic policies of the Government of the Republic of Georgia in the last decade have been mostly consistent and effective in terms of investment and increasing short-term economic growth rates. According to country's socio-economic development strategy, the economic policy of the Republic of Georgia is based on the principles of fast and efficient economic growth driven by development of the real sector of economy, implementation of economic policies that would facilitate inclusive economic growth and rational use of natural resources, ensuring environmental safety and sustainability.

During period of March-June 2020 the increasingly restrictive lock-down measures to combat COVID-19 in the country has also significantly reduced economic activity and aggregate spending levels. While the governments' actions to fight the spread of the recent COVID-19 virus have been very efficient and are viewed as successful example worldwide, the negative effect of the pandemic on the economy of the Republic of Georgia has been severe. GDP shrank by 5.8% in the six months of 2020, the level of unemployment reached 12.0% and GEL devaluated against USD 6.6%.

On March 27, 2020, the Government of the Republic of Georgia announced a set of monetary easing measures including a decrease of the policy rate by 25 bps to 3.3%, a decrease of the Marginal Lending Facility rate by 100 bps to 5.0%, a suspension of absorption operations, an increase of liquidity provision from FCFA 240 to 500 billion, and a widening of the range of private instruments accepted as collateral in monetary operation. Thus, the Government of the Republic of Georgia has announced the anti-crisis economic recovery plan, which includes financial support to vulnerable groups of population and entrepreneurs, deferral of property and income tax payments for companies operating in the tourism sector, providing opportunity to borrowers to restructure their loans with commercial banks and other. The country's international partners have allocated significant funds as aid for the recovery of the country's economy.

The Republic of Turkey

Turkey's economic and social development performance since 2000 has been impressive, leading to increased employment and incomes and making the Republic of Turkey an upper-middle-income country. During, in the past few years, growing economic and a more improved external environment have boosted those achievements.

The outbreak of COVID-19 is resulting in a health crisis and subsequent containment and mitigation measures have had direct economic impacts. The government adopted multiple containment measures to address the pandemic including: social distancing, curfews, travel bans along with quarantines for returning nationals, and the closures of schools/universities, stores, and entertainment venues. Sectors closed by administrative decisions were narrow in international comparison, and not more than 40.0% of the population was formally locked down, except during national curfews over weekends, and public holidays. The pandemic spread fast, but targeted lockdowns and complementary measures were effective. After 4.5% GDP growth in the first quarter of the year, country's output is projected to contract by nearly 4.3% in 2020 due to the COVID-19 outbreak and subsequent containment measures.

A package of financial measures was introduced at the onset of the COVID-19 pandemic. Specifically, liquidity facilities were augmented, including with longer-term instruments and at discounted rates. The reserve requirements on foreign currency deposits were reduced by 500 bps for banks meeting lending growth targets. On 18 March 2020, the Government of Republic of Turkey have announced a new extensive economic relief package 5.6% of GDP called the Economic Stability Shield. The fiscal package so far has supported business cash-flow, household income, and employment.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

16. Commitments and contingencies (continued)

Operating environment (continued)

Support to businesses has been provided via tax, loan deferrals, and additional credits, principally by the public, but also private banks, incentivized by expanded government loan guarantees, newly introduced lending and prudential regulations. On May 4, following reported improvements in COVID -19 statistics, the government announced a phased approach to lifting lockdown measures from May to July.

Management expectation

While the governments of all three countries have introduced a range of stabilization measures aimed at providing liquidity and support for local banks and companies, there continues to be some level of uncertainty regarding the future operating conditions for the Group and its counterparties, which could affect the Group's financial position, results of operations and business prospects. Adverse changes in economic conditions may result in deterioration in the value of collateral held against loans of the Group, in addition to impact on performance of the borrowers. To the extent that information is available, the Group has reflected revised estimates of collateral values, fair value assessment of financial instruments and ECL assessment.

The future economic and regulatory environment and its impact on the Group's operations may differ from managements current expectations. Due to the high level of uncertainly and limited actual and consistent information on the financial position of the Group's counterparties and borrowers, it is practically impossible to present a reliable assessment of the impact of the changes in the economic environment on the Group's 2020 results in these interim condensed consolidated financial statements.

The Group’s management is monitoring economic 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. The Group considers its current liquidity position to be sufficient for the sustainable functioning. The Group monitors its liquidity position on daily basis.

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 Group 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 preceding the year of review.

Management believes that its interpretation of the relevant legislation as at 30 June 2020 is appropriate and that the Group’s tax, currency and customs positions will be sustained.

Insurance

The Group has not currently obtained insurance coverage related to liabilities arising from errors or omissions.

Compliance with the CBAR ratios

CBAR requires banks to maintain certain prudential ratios computed based on statutory financial statements. As at 30 June 2020 and 31 December 2019, the Bank was in compliance with these ratios except for the followings:

a) Ratio of the share in one legal entity which should not exceed 10% of total capital. As at 30 June 2020 the Bank’s ratio was 34.86% (31 December 2019: 33.28%);

b) Ratio of the total share in other legal entities which should not exceed 40% of total capital. As at 30 June 2020 the Bank’s ratio was 51.28% (31 December 2019: 48.95%);

c) Ratio of maximum credit exposure of a bank per a single borrower or a group of related borrowers on unsecured loan that should not exceed 10%. As at 30 June 2020 the Bank’s ratio was 13.94% (31 December 2019: nil).

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

16. Commitments and contingencies (continued)

Throughout the period the Bank submitted information regarding these breaches to the CBAR 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.

Financial commitments and contingencies comprise:

	30 June 2020 (unaudited)	*31 December 2019*
Credit-related commitments		
Guarantees issued	584,075	629,296
Unused credit lines	270,210	216,417
Letters of credit	22,240	25,989
	876,525	**871,702**
Operating lease commitments		
Not later than 1 year	50	409
Later than 1 year but not later than 5 years	–	1,195
	50	**1,604**
Less: provision for ECL for credit related commitments	(12,704)	(10,550)
Commitments and contingencies (before deducting collateral)	**863,871**	**862,756**
Less: cash held as security against guarantees issued (Note 10)	(31,539)	(42,014)
Commitments and contingencies	**832,332**	**820,742**

An analysis of changes in the ECLs during the period ended 30 June 2020 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2020	**(5,228)**	**(5,049)**	**(273)**	**(10,550)**
New exposures	(3,292)	–	–	**(3,292)**
Exposures derecognised or matured (excluding write-offs)	1,657	969	19	**2,645**
Transfers to Stage 1	(122)	122	–	**–**
Transfers to Stage 2	3,306	(3,306)	–	**–**
Transfers to Stage 3	33	–	(33)	**–**
Impact on period end ECL of exposures transferred between stages during the period	75	(1,983)	(557)	**(2,465)**
Changes to inputs used for ECL calculations	106	587	(66)	**627**
Foreign exchange adjustments	87	244	–	**331**
At 30 June 2020	**(3,378)**	**(8,416)**	**(910)**	**(12,704)**

An analysis of changes in the ECLs during the period ended 30 June 2019 is as follows:

	Stage 1	*Stage 2*	*Stage 3*	*Total*
ECL as at 1 January 2019	**(3,735)**	**(1,859)**	**(876)**	**(6,470)**
New exposures	(2,830)	(45)	–	**(2,875)**
Exposures derecognised or matured (excluding write-offs)	653	522	931	**2,106**
Transfers to Stage 1	(236)	236	–	**–**
Transfers to Stage 2	2,706	(2,706)	–	**–**
Transfers to Stage 3	–	–	–	**–**
Impact on period end ECL of exposures transferred between stages during the period	222	(5,812)	–	**(5,590)**
Changes to inputs used for ECL calculations	(554)	(1,805)	–	**(2,359)**
Foreign exchange adjustments	99	348	(221)	**226**
At 30 June 2019	**(3,675)**	**(11,121)**	**(166)**	**(14,962)**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

17. Credit loss expense and other impairment and provision

The table below shows the ECL charges on financial instruments recorded in the consolidated statement of profit or loss for the six months period ended 30 June 2020:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents	3	(54)	–	–	**(54)**
Due from credit institutions	4	146	–	–	**146**
Debt securities at FVOCI	5	(427)	–	–	**(427)**
Debt securities at amortised cost	5	(311)	–	–	**(311)**
Loans to customers at amortised cost	6	(2,690)	(12,342)	(7,914)	**(22,946)**
Credit loss on financial assets		**(3,336)**	**(12,342)**	**(7,914)**	**(23,592)**
Other financial assets	8	–	–	8	**8**
Commitments and contingencies		1,763	(3,611)	(637)	**(2,485)**
Total credit loss expense		**(1,573)**	**(15,953)**	**(8,543)**	**(26,069)**

The table below shows the ECL charges on financial instruments recorded in the consolidated statement of profit or loss for the six months period ended 30 June 2019:

	Note	*Stage 1*	*Stage 2*	*Stage 3*	*Total*
Cash and cash equivalents	3	2	–	–	**2**
Due from Credit Institutions	4	(388)	–	–	**(388)**
Debt securities at FVOCI	5	44	–	–	**44**
Debt securities at amortised cost	5	(186)	–	–	**(186)**
Loans to customers at amortised cost	6	2,039	(5,456)	(13,707)	**(17,124)**
Credit loss on financial assets		**1,511**	**(5,456)**	**(13,707)**	**(17,652)**
Other financial assets	8	–	–	(28)	**(28)**
Commitments and contingencies		(39)	(9,610)	931	**(8,718)**
Total credit loss expense		**1,472**	**(15,066)**	**(12,804)**	**(26,398)**

Allowance for impairment of other assets is deducted from the carrying amounts of the related assets. Provision for ECL for credit related commitments are recorded in liabilities.

18. Net fee and commission income

Net fee and commission income comprises:

	For six months ended (unaudited)	
	30 June 2020	*30 June 2019*
Servicing plastic card operations	10,795	7,754
Guarantees and letters of credit	7,116	6,136
Settlements operations	6,873	6,349
Cash operations	1,588	1,192
Other	306	480
Fee and commission income	**26,678**	**21,911**
Servicing plastic card operations	(9,044)	(6,319)
Settlements operations	(1,559)	(1,420)
Guarantees and letters of credit	(1,101)	(785)
Cash operations	(314)	(854)
Securities operations	(80)	(13)
Other	(575)	(394)
Fee and commission expense	**(12,673)**	**(9,785)**
Net fee and commission income	**14,005**	**12,126**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

19. Personnel, general and administrative expenses

Personnel expenses comprise:

	For six months ended (unaudited)	
	30 June 2020	***30 June 2019***
Salaries and bonuses	(25,255)	(22,925)
Social security costs	(3,189)	(2,160)
Other employee related expenses	(1,634)	(1,923)
Total personnel expenses	**(30,078)**	**(27,008)**

General and administrative expenses comprise:

	For six months ended (unaudited)	
	30 June 2020	***30 June 2019***
Charity and sponsorship	(11,213)	(315)
Professional services	(3,989)	(5,117)
Insurance	(2,693)	(1,212)
Software cost	(1,826)	(1,732)
Advertising costs	(950)	(1,393)
Taxes, other than income tax	(786)	(818)
Utilities	(740)	(731)
Communications	(661)	(332)
Membership fees	(660)	(711)
Impairment of repossessed collateral	(655)	(2,109)
Stationery	(483)	(150)
Security expenses	(474)	(474)
Repair and maintenance	(453)	(397)
Operating leases	(333)	(729)
Entertainment	(171)	(170)
Transportation and business trip expenses	(153)	(306)
Printing expenses	(13)	(28)
Other expenses	(178)	(206)
Total general and administrative expenses	**(26,431)**	**(16,930)**

20. Fair values measurement

Fair value hierarchy

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: other 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.

For the purpose of fair value disclosures, the Group's has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy.

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

	Recurring fair value measurement			
At 30 June 2020 (unaudited)	***(Level 1)***	***(Level 2)***	***(Level 3)***	***Total***
Financial assets				
Investment securities − at FVOCI	500,781	729,715	−	**1,230,496**
Derivative financial assets	−	2,293	−	**2,293**
Investment securities at FVTPL	−	1,134	−	**1,134**
Financial liabilities				
Derivative financial liabilities	−	4,568	−	**4,568**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

20. Fair values measurement (continued)

Fair value hierarchy (continued)

At 31 December 2019	*Recurring fair value measurement (Level 1)*	*(Level 2)*	*(Level 3)*	*Total*
Financial assets				
Investment securities − at FVOCI	168,561	939,406	−	**1,107,967**
Derivative financial assets	−	457	−	**457**
Financial liabilities				
Derivative financial liabilities	−	137	−	**137**

Recurring fair value measurements

The following is a description of the determination of fair value for recurring fair value measurements which are recorded using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

Derivatives

Derivatives valued using a valuation technique with market observable inputs are mainly interest rate swaps, currency swaps and forward foreign exchange contracts. The most frequently applied valuation techniques include forward pricing and swap models, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates and interest rate curves.

Iinvestment securities

Investment securities valued using a valuation technique or pricing models primarily consist of unquoted equity and debt securities. These securities are valued using models which incorporate data observable in the market.

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 consolidated statement of financial position. The table does not include the fair values of non-financial assets and non-financial liabilities.

	30 June 2020 (unaudited)			*31 December 2019*		
	Carrying value	*Fair value*	*Unrecognized gain/(loss)*	*Carrying value*	*Fair value*	*Unrecognized gain/(loss)*
Financial assets						
Cash and cash equivalents	1,116,824	1,116,824	−	1,185,839	1,185,839	−
Amounts due from credit institutions	446,971	446,971	−	624,394	624,394	−
Investment securities measured at amortised cost	50,558	51,570	1,012	38,386	39,973	1,587
Loans to customers	2,402,302	2,385,653	(16,649)	2,296,988	2,271,826	(25,162)
Other financial assets	32,509	32,509	−	9,962	9,962	−
Financial liabilities						
Amounts due to banks and government funds	867,102	869,061	(1,959)	862,143	862,071	72
Amounts due to customers	3,795,362	3,808,420	(13,058)	3,788,941	3,789,139	(198)
Subordinated debts	27,107	27,107	−	27,111	27,111	−
Debt securities issued	154,275	155,503	(1,228)	136,031	137,580	(1,549)
Other financial liabilities	19,861	19,861	−	8,892	8,892	−
Total unrecognised change in unrealised fair value			**(31,882)**			**(25,250)**

Valuation techniques and assumptions

The following is a description of the determination of fair value for financial instruments which are recorded at fair value using valuation techniques. These incorporate the Group's estimate of assumptions that a market participant would make when valuing the instruments.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

20. Fair values measurement (continued)

Fixed and variable rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and maturity. For quoted debt issued the fair values are calculated based on quoted market prices. For those notes issued where quoted market prices are not available, a discounted cash flow model is used based on a current interest rate yield curve appropriate for the remaining term to maturity.

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.

21. 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 2020 (unaudited)					*31 December 2019*				
	Share-holders/ ultimate owners	*Entities under common control*	*Key manage-ment personnel*	*Other*	*Total*	*Share-holders/ ultimate owners*	*Entities under common control*	*Key manage-ment personnel*	*Other*	*Total*
Cash and cash equivalents	–	612	–	–	**612**	–	297	–	–	297
Amounts due from credit institutions	–	3	–	–	**3**	–	–	–	–	–
Investment securities	–	–	–	51,000	**51,000**	–	–	–	–	–
Loans, gross	–	545,497	6,864	66,039	**618,400**	–	453,485	5,018	35,338	493,841
Less: allowance for impairment	–	(6,099)	(177)	(1,064)	**(7,340)**	–	(5,598)	(143)	(543)	(6,284)
Loans, net	**–**	**539,398**	**6,687**	**64,975**	**611,060**	**–**	**447,887**	**4,875**	**34,795**	**487,557**
Amounts due to banks and government funds	–	34,467	–	–	**34,467**	–	49,928	–	–	**49,928**
Time deposits	85,325	413,673	9,591	22,817	**531,406**	–	539,043	6,204	97,733	**642,980**
Demand deposits	289,535	343,815	9,205	365,615	**1,008,170**	173,750	348,748	3,892	375,406	**901,796**
Right-of-use assets	–	6,313	–	–	**6,313**	–	4,029	–	–	**4,029**
Shares issued but not registered	21,500	–	–	–	**21,500**	–	–	–	–	**–**
Additional paid-in capital	–	343	–	–	**343**	–	343	–	–	**343**
Other assets	21,500	1,523	–	55	**23,078**	25	498	–	26	**549**
Subordinated debts	18,920	8,187	–	–	**27,107**	18,923	8,188	–	–	**27,111**
Lease liabilities	–	6,485	–	–	**6,485**	–	4,152	–	–	**4,152**
Other liabilities	–	3,570	–	64	**3,634**	–	3,549	–	219	**3,768**
Debt securities	98,860	37,543	–	–	**136,403**	85,199	37,882	–	–	**123,081**
Guarantees issued	–	20,989	–	18,395	**39,384**	–	18,799	–	11,725	**30,524**
Letters of credit	–	405	–	1,751	**2,156**	–	492	–	1,872	**2,364**
Unused credit lines	–	10,513	897	41,720	**53,130**	180	10,103	1,662	17,681	**29,626**

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

21. Related party disclosures (continued)

	For the six months ended (unaudited)									
	30 June 2020					*30 June 2019*				
	Share-holders/ ultimate owners	*Entities under common control*	*Key manage-ment personnel*	*Other*	*Total*	*Share-holders/ ultimate owners*	*Entities under common control*	*Key manage-ment personnel*	*Other*	*Total*
Interest income on loans	–	9,741	211	2,208	**12,160**	–	2,930	190	1,445	**4,565**
Interest expense on deposits	(2,143)	(3,919)	(100)	(847)	**(7,009)**	(284)	(7,653)	(73)	(2,685)	**(10,695)**
Interest expense on subordinated debts	(277)	(215)	–	–	**(492)**	(279)	–	–	–	**(279)**
Net gains from foreign currencies: dealing	211	1,398	58	1,140	**2,807**	13	1,522	16	773	**2,324**
Net losses from foreign currencies: translation differences	(721)	(3,421)	–	–	**(4,142)**	–	(197)	–	–	**(197)**
Net gains from foreign currencies: operations with foreign currency derivatives	–	3,698	–	–	**3,698**	–	–	–	–	**–**
General and administrative expenses	–	(1,376)	–	–	**(1,376)**	–	(1,173)	–	(211)	**(1,384)**
Fee and commission income	62	3,295	25	872	**4,254**	108	2,587	27	836	**3,558**
Fee and commission expense	–	(2,691)	–	(5)	**(2,696)**	(200)	(151)	–	(35)	**(386)**

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

	For six months ended (unaudited)	
	30 June 2020	***30 June 2019***
Salaries and other benefits	(9,399)	(9,593)
Social security costs	(1,212)	(1,828)
Total key management compensation	**(10,611)**	**(11,421)**

22. Capital adequacy

The Bank maintains 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.

During the past period, the Bank had complied in full with all 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.

(Figures in tables are in thousands of Azerbaijani manats, unless otherwise indicated)

22. Capital adequacy (continued)

CBAR capital adequacy ratio

The CBAR requires banks to maintain a minimum capital adequacy ratio of 11.0% (31 December 2019: 11.0%) of risk-weighted assets for regulatory capital. As at 30 June 2020 and 31 December 2019 the Bank's capital adequacy ratio on this basis was as follows:

	30 June 2020 (unaudited)	*31 December 2019*
Tier 1 capital	365,652	342,836
Tier 2 capital	74,808	87,684
Less: deductions from capital	(149,301)	(149,301)
Total regulatory capital	**291,159**	**281,219**
Risk-weighted assets	**2,321,905**	**2,363,195**
Capital adequacy ratio (Tier 1)	15.8%	14.5%
Capital adequacy ratio (Total Capital)	12.6%	11.9%

NBG capital adequacy ratio

The NBG requires the Bank to maintain a minimum total capital adequacy ratio of 14.3% (31 December 2019: 24.8%), Tier 1 Capital ratio of 7.70% (31 December 2019: 9.4%) and Core Tier 1 Capital ratio of 5.8% of risk-weighted assets, computed based on Basel III requirements. As at 30 June 2020 the Bank's capital adequacy ratio and Tier 1 Capital ratio calculated on this basis were 22.6% (31 December 2019: 26.1%) and 15.4% (31 December 2019: 19.1%) respectively.

BRSA capital adequacy ratio

BRSA requires banks to maintain a minimum total capital adequacy ratio of 8% (31 December 2019: 8%) of risk-weighted assets for regulatory capital. Capital Adequacy Standard Ratio of PASHA Yatirim is calculated in accordance with BRSA. As at 30 June 2020 the bank's capital adequacy ratio was 26.50% (31 December 2019: 32%).

23. Events after reporting date

During subsequent period, shares issued but no registered in the amount of AZN 21,500 thousand were fully paid by the shareholders and registered with the CBAR and the Ministry of Justice.

Further to the capitalization, the Group's new shareholder structure became as follows:

Shareholders	***28 August 2020, (%)***
PASHA Holding Ltd.	57
Ador Ltd.	28
Mr. Arif Pashayev	15
Total	**100**