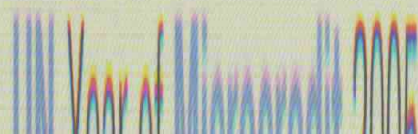
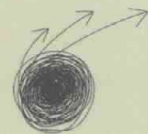


## 2004 ANNUAL REPORT



### OUR VISION

XacBank will be the dynamic leader in serving the marginalized citizens of Mongolia with the most innovative and transparent banking services supplied in a professional and sustainable manner. The Bank will use technology together with personalized customer service to grow its market share and support the development of micro and small business in Mongolia.



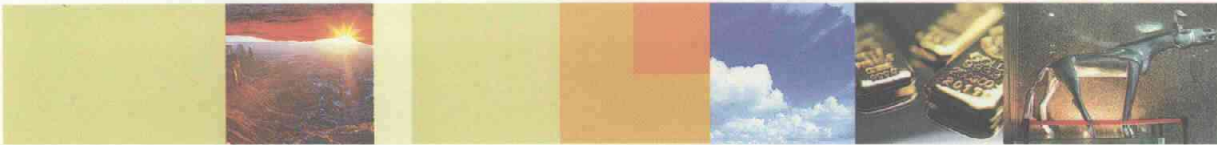






*The Vision of XacBank is as follows:*

*XacBank will be the dynamic leader in serving the marginalized citizens of Mongolia with the most innovative and transparent banking services supplied in a professional and sustainable manner. The Bank will use technology together with personalized customer service to grow its market share and support the development of micro-business in Mongolia.*



# Right Bank. XacBank

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## Board of Directors

### CHAIRMAN

Mr. Chuluun Ganbold  
President  
Email Daily News

### DIRECTORS

Mr. Stephen Mitchell  
Chief Financial Officer  
Mercy Corps

Ms. Jambaldorj Erdenechimeg  
President  
Mongolian Woman's Federation

Ms. Tsend Enhtuya  
President  
Liberal Women's Intellectual Pool

Mr. Chuluun Ganhuyag  
Executive Director  
XacBank

Mr. Jim Anderson  
Senior Technical Advisor  
XacBank

Mr. Tuvdendorj Galbaatar  
Chairman of the Board  
Open Society Forum

Mr. Steve Zimmerman  
Chief of Party  
Mercy Corps Mongolia

Mr. Ganhuyag Munhbat  
Local Governance Development Fund

Mr. Namsrajav Zorigt  
General Director  
Tuushin LLC

Mr. Ser-Od Jargalsaihan  
President  
Rotary Club of Ulaanbaatar

Ms. Nyamaa Tumenbayar  
Legal Advisor  
National Association of Mongolian Agricultural  
Cooperatives



## BOARD OF DIRECTORS REPORT

### Dear Shareholders,

The Board of Directors is proud to present to you the results of another successful year for XacBank in 2004. The Bank turned in another year of strong growth, record earnings and its capital base is stronger than ever. In the beginning of the year, we were challenged with a deadline to meet a minimum capital requirement hurdle of MNT 4 billion established by the Central Bank of Mongolia. After negotiating with a series of potential investors, the Bank reached agreement early in the year with two privately held companies and a savings and credit cooperative to support the Bank's mission of a double bottom-line. The Bank's largest shareholder Mercy Corps also contributed towards meeting the minimum capital requirement by injecting MNT 237 million to ensure the Bank reached the target. As a result, the Bank fulfilled the Central Bank's requirement and ended 2004 with MNT 4.2 billion in Paid in Capital. However, we are challenged again, as subsequently, the Central Bank announced the next increase doubling the current capital requirement by April 2006 to be met by all commercial banks.

In 2004 XacBank earned a record MNT 787 million in after tax profits. At its final meeting of the year, the Board approved payment of a cash dividend to shareholders to be disbursed in early 2005. This will be the first ever cash dividend for XacBank's shareholders, although the Bank and its predecessor NBF distributed a number of stock dividends. The decision by the Board to pay 20 percent of the net earnings, or MNT 127 million is a yardstick in the short history of our evolution and is a prime example of a sustainable microfinance institution meeting the profit motive of its two pronged mission. The Board considered that this payment will show goodwill of the Bank to pay fair and material returns to its shareholders and raise the confidence of potential investors contemplating investing in the microfinance sector of Mongolia. It also signals to investors that microfinance can be a profitable way to contribute to development and that the sector led by XacBank is mature enough to compete for scarce investor interest. We believe that this is a result of much hard work of the management team and staff throughout the year.

With ongoing support and guidance of the Board, XacBank continued to expand its services throughout the year, opening 5 new branches, bringing the total to 36 branches staffed with 506 professionals. The Bank also reaches out to 141 soums in 21 aimags with mobile banking services in the rural areas. To further and sustain its rural outreach, the Bank is pursuing a strategy of "franchising" rural savings and credit cooperatives, and at year-end it had enrolled ten of these cooperatives as new franchisees.

Continued innovation, aggressive marketing, extensive branch network, mobile banking coupled with franchising and building of strategic alliances resulted in strong loan growth for the Bank. With a year-end 2004 loan portfolio of MNT 20.3 billion and over 31,000 active borrowers, the Bank again exceeded its planned performance. The Bank also extended a record 53 thousand loans during the year of which 82.8 percent had active balances below MNT 1 million.

Since 2003 the Bank has taken steps to improve its governance process by expanding the capacities of the Members of the Board and the transparency of its governance process. In late 2003 and throughout 2004, the Board displayed new assertiveness by assessing and taking critical decisions regarding new investors, while under pressure to meet a mandated capital increase for the Bank. The Board started looking critically at its future role and is taking proactive steps to ensure its effectiveness and continuity well beyond the time when this Bank will become a publicly traded company.

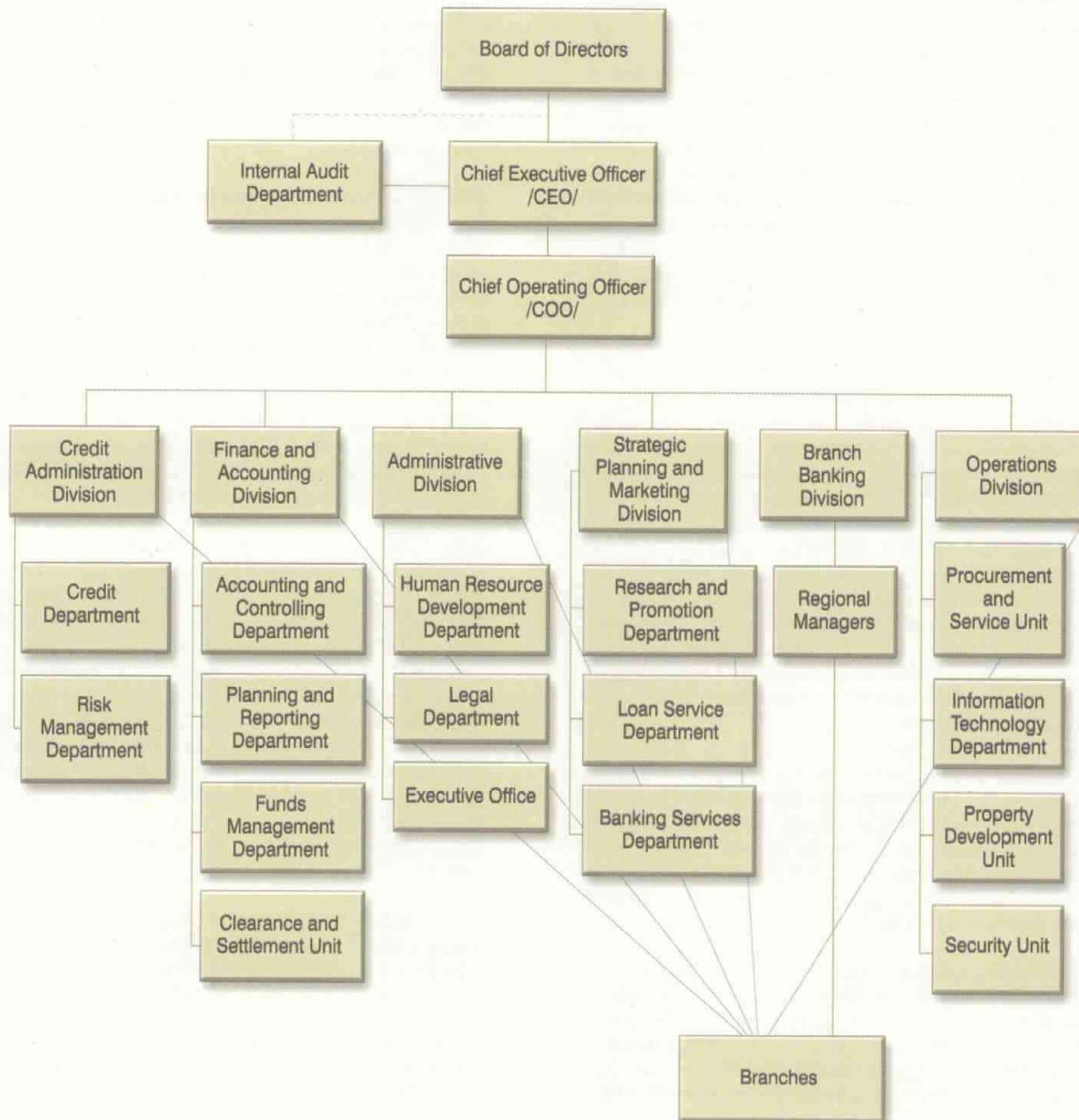
A number of procedures and guidelines were developed during the year to reflect the growing complexity of the operations of the Bank. In doing so XacBank has become a model of corporate governance in Mongolia. This was recognized with the MIXMarket's "5 Diamond Profile of the Month" award for transparency during the year. It was reinforced in early 2005 by CGAP's Special Mention category award for Financial Transparency. Governance training and Board development remain critical if the Board is to continue to serve as a model of good corporate governance and transparency for Mongolia and the microfinance industry for the future. Accomplishments of the Bank in this regard have been recognized in the Central Bank's annual on-site inspection report for 2004, released in February 2005. XacBank received 1.6 points on the CAMELS scoring scale, which is one of the highest grades given among Mongolia's commercial banks for 2004 by the Central Bank and represents 0.2 points improvement over the 2003 grade.

Another milestone event, also occurring at the last Board meeting of the year, was the handover of the Chairmanship to a local national. Mr. Stephen Mitchell stepped down as Chairman of XacBank and also XAC-GE LLC and was replaced by Mr. Chuluun Ganbold. Mr. Mitchell held the Chair since April 2003 and will hold the position of Vice Chairman of the Board. Mr. Ganbold, who has extensive experience in both the private and public sectors, possesses solid business acumen and a strong sense of the history of the Bank and its predecessor organizations, while also maintaining a deep commitment to the Bank's mission. The Board was expanded in 2004 reflecting the addition of one of our new shareholders, Tuushin Group, a prominent member of the business community. We welcome Mr. Namsrajav Zorigt, General Director of Tuushin LLC, to the Board. The Board has accepted resignations from two of its members, Ms. Nyamaa Tumenbayar, Legal advisor of NAMAC and Mr. Ser-Od Jargalsaihan, President of Rotary Club of Ulaanbaatar and wishes them good luck and all the best in their future endeavors.

The Board of Directors has approved the Business Plan of the Bank for the coming three years and feels confident that it is up to the task and ready to face the challenges ahead and deliver superior performance in both social and commercial terms to the shareholders of XAC-GE and XacBank.

The Board is eager to continue to steer the Bank towards success and ensure that XacBank remains a top-notch performer as a commercial bank as well as a true ground-breaker in the microfinance industry.

## ORGANIZATIONAL CHART







# MANAGEMENT REPORT

## EXECUTIVE SUMMARY

In the past six years XacBank has developed from a donor project to a major player in the commercial banking sector in Mongolia and become widely recognized as the country's leading microfinance institution. Headquartered in Ulaanbaatar, the Bank is the result of a merger of a UNDP Microstart Program implemented by X.A.C. (Golden Fund for Development) NBF[1] owned by six local NGO's and a USAID/USDA funded SME lending program operated by Mercy Corps' Goviin Ekhlel (Gobi Start) NBF. XacBank received its banking license in December 2001 and began taking deposits in February 2002. The Bank had a start-up loss in 2002, achieved profitability in 2003 and has remained profitable in every quarter since then.

The year just passed has been the most successful one for the Bank since its inception in a number of ways. The Bank's assets grew by MNT 14 billion to MNT 31.6 billion accompanied by soaring profits of MNT 787 and generating ROE of 19 percent. The loan portfolio increased by 84.5 percent from the previous year reaching MNT 20.3 billion with PAR (Portfolio At Risk) over one day of 1.03 percent. In terms of outreach the Bank disbursed a record 53 thousand loans, opened 5 new branches in both urban and rural locations bringing the total to 36, and closed the year with 506 staff. The Bank's market share rose from 2.5 to 3.3 percent in terms of loans outstanding in the total banking sector of the country.

A rigorous expansion to rural areas has resulted in the provision of financial services for the residents of 141 soums[2] through mobile banking services serving 3,574 borrowers at the soum level, which comprise 11.2 percent of the total borrowers. The loan portfolio of soum borrowers reached MNT 1.8 billion or 8.8 percent of the total loan portfolio. It is worth noting that 66.6 percent of the Bank's borrowers are from rural areas at the year-end. During the reporting period the Bank has written-off 28 loans amounting to MNT 167.1 million, of which one loan of MNT 154.6 million comprised 92.5 percent of the total write-offs. Continuous efforts are being made to recover these loans in collaboration with the relevant authorities.

The Bank started to market its new initiative titled "Development Guide" a franchising service aimed at providing sustainable financial services for the residents of rural areas through assisting the local residents initiative to set up savings and credit cooperatives. The Bank plays a crucial role in building local capacity to establish such entities on a sustainable and inclusive manner by offering specialized training as well as providing a franchising package consisting of guidelines and policy manuals adapted specifically for start-up savings and credit cooperatives. Presently franchising services are provided to 10 cooperatives in 8 soums on a pilot basis.

XacBank is successfully cooperating with programs and projects funded by the Mongolian Government and external donors aimed at providing sustainable financial services to urban poor and rural communities. Employment Generation Support Fund, Rural Poverty Reduction Project, Agricultural Sector Development Project, Microfinance Development Fund, Gobi Initiative, CHF International and ADRA Mongolia are some of the main partners of the Bank in development. In total, XacBank extended its services with the above mentioned partners to over 11,000 clients with a total loan portfolio of MNT 9.3 billion spread out in rural and urban areas.

The Bank actively positioned itself in the market as a reliable deposit taker with several deposit products ranging from current accounts to term savings, and also offers money remittance and payment services, domestically and internationally, through its nationwide branch network. Total deposits rose by 56.8 percent in 2004 to MNT 15.7 billion, while the number of active depositors rose 50.8 percent to 78,378. The Bank's total deposit market share increased from 1.75 percent to 2.23 percent in 2004.

*We are what we repeatedly do.  
Excellence then is not an act, but a habit.*

*Aristotle*

Human resources development was in the center of the Bank's attention for the past year. Without dynamic, innovative and skilled people, the Bank would not be able to progress. In order to boost staff productivity and increase the Bank's overall performance several staff members took part in local and international training courses on various topics. Also, a performance based incentive system was introduced with the goal of establishing a fair system that takes into account an individual's performance and fulfillment.

To address the growing complexity of the Bank's operations, streamline its functions and clarify the standing of the different products, a working group was formed with support from an international expert to undertake Activity Based Costing. The Bank expects to use the data from this exercise to reinforce its competitive position in the market.

The Bank broadened its funding with additional international funds from ASN-NOVIB, MicroVest 1, Calvert Foundation and Dexia Blue Orchard.

PlaNerRating's "A-" with positive outlook rating was issued in August 2004 making XacBank the first and only commercial bank in Mongolia rated by an international rating institution. It became another milestone in the development course of the Bank and demonstrates the effectiveness of the Bank's team as well as an indicator of the competitive strengths of the Bank. This outcome was reinforced by the issuance of a score of 1.6 under the CAMELS[3] rating system by the Central Bank for 2004, making XacBank one of the best performing commercial banks in Mongolia.

As an endorsement of the above mentioned ratings, XacBank received several awards during the year. One of them was the "5 Diamond Profile of the Month" award, given by the MIXMarket for transparency and quality of reporting standards. We are also very proud of the fact that CGAP, a consortium of 28 public and private development agencies working together to expand access to financial services for the poor, awarded XacBank an "Honorable Mention" for its high level of transparency and disclosure standards in its financial reporting for 2004.

XacBank has also served as a model for regional cooperation, hosting representatives from the Russian organization "Women's Microfinance Network" and China's "Sustainable Microfinance to Alleviation of Poverty" at seminars on bank management, governance and product development. This opened new horizons for the Bank to share its experience and learn from others not only locally, but also as an internationally recognized microfinance institution.

The Bank played a central role in promoting the United Nation's International Year of MicroCredit in Mongolia and its efforts have paid-off when the Government announced 2005 as the National Year of Microfinance and Support to Small and Medium Entrepreneurship. XacBank plays a key role in the National Coordinating Committee responsible for observance of both of these events in Mongolia. The Bank initiated and supported the establishment of a permanent exhibition of products by its clients at "Made by Entrepreneur - Grassroots" to assist the Bank's clients to improve their marketing opportunities.

Our results confirm the benefits of a consistent strategy and strong business model. During 2004 this has resulted in strengthened market position in loans, deposits and money transfers, improved operational performance and increased profits. We enter 2005 with a strong focus on remote rural areas and urban ger districts. These factors, supported by our investments in operational efficiency, underpin our expectation of continued outreach to the clients and growth in profits.

[1] Non-bank financial institution  
[2] Administrative unit, county

[3] Capital adequacy, Asset quality, Management capacity, Earnings, Liquidity, interest rate Sensitivity. Rating from 5 (bad) to 1 (excellent).

## MANAGEMENT TEAM

**Mr. Chuluun  
Ganhuyag**

Chief Executive  
Officer

**Ms. Gira  
Delgermaa**

Chief Operating  
Officer

**Mr. Dugersuren  
Bat-Ochir**

Chief Financial  
Officer  
Director of Finance  
and Accounting  
Division

**Ms. Bayanjargal  
Delgerjargal**

Chief Credit Officer  
Director of Credit  
Administration  
Division

**Mr. Lhagvasuren  
Soronzonbold**

Director of Strategic  
Planning and  
Marketing Division

**Mr. Galbadrah  
Tsogbadrah**

Director of Branch  
Banking Division

**Mr. Chuluun  
Gantulga**

Director of  
Operations Division

**Mr. Zundui  
Bat-Itgel**

Director of  
Administrative  
Division

**Ms. Gansuh  
Bolormaa**

Director of Funds  
Management  
Department

**Ms. Zayat  
Bulgan**

Director of Credit  
Department

**Ms. Galzagd  
Tuul**

Director of Banking  
Services  
Department

**Mr. Urtnasan  
Naranbaatar**

Director of  
Information  
Technology  
Department

**Ms. Ganzorig  
Zul**

Director of Human  
Resource  
Development  
Department

**Ms. Baljir Tuul**

Director of Planning  
and Reporting  
Department

**Mr. Serikjan  
Daurenbek**

Director of Risk  
Management  
Department

**Ms. Byambajav  
OyungereI**

Director of Loan  
Service Department

**Ms. Dagvadorj  
Undral**

Director of Legal  
Department

**Ms. Batbeh  
Solongo**

Director of Research  
and Promotion  
Department

**Mr. Jargalsayhan  
Munhsayhan**

Director of Card  
Center



## EXTERNAL ENVIRONMENT

### Macro Economic Situation

In 2004, the Mongolian economy grew at a robust 10.6 percent due to the growth in the mining sector and other commodities related industries. According to the Government's action plan, Mongolia is projecting average annual GDP growth of over 6 percent during the next three years. This growth is expected to come from the agricultural sector (4.2 percent), mining sector (10.3 percent), manufacturing (9 percent) and service sector including hotels, restaurants and tourism (7 percent).

In early 2004, the inflation rate was maintained in the single digits range, however, the rise in oil prices during the year increased the inflation rate to 11 percent by year-end. In 2005, one of the main goals of monetary policy for the Central Bank of Mongolia will be to bring the inflation rate back down to single digits as in the previous 5 years.

In 2004, the government's net currency reserves reached USD 163.6 million and the foreign currency reserve of the banking sector reached USD 227.6 million. As of December 2004, money supply (M2) increased by MNT 148 billion or 20.7 percent to MNT 847.0 billion.

The average interbank exchange rate for USD against the MNT was 1,212 at the end of 2004, representing depreciation of 3.5 percent for the year.

### Poverty

"Income poverty" is a new phenomenon in Mongolia. It was virtually non-existent before 1990. According to the survey "Household Income and Expenditure/ Living Standards Measurement" by the World Bank, UNDP and the National Statistical Office in 2004, 36.1 percent of the population live below the poverty line. Other poverty indicators confirm that the depth of poverty and inequality among the poor is also substantial. There is strong evidence showing that the inequality gap is higher in urban areas than rural areas of the country.

The negative consequence of Dzud (summer drought followed by very cold winter) and the dry summer in 2002 reduced livestock numbers to unprecedented levels. These climate extremes also caused a dramatic increase in poverty in rural areas of the country, and influenced the remarkable increase of migration flows to the urban areas.

The Government fully accepted and is making efforts to fulfill the Millennium Development Goals to reduce the proportion of people in extreme poverty by at least 25 percent by 2005 and by 50 percent by 2015. It will also strive to reduce by at least half the proportion of people below the Government's official poverty line by 2005, and by a further 25 percent by 2015.

### Banking and Financial Sector

By the end of 2004, 17 banks, 110 NBFIs and more than 270 out of a total 580 savings and credit cooperatives were active in the financial services market. The banking sector's total assets increased 27.5 percent compared to 2003 to MNT 1,053 billion as the population's trust in the banking system continued to increase. Total loans outstanding for the sector amounted to MNT 606.8 billion at the end of 2004, higher by MNT 164.7 billion from the prior year. Non-performing loans remain a serious problem in the banking sector, rising by 65 percent during 2004 to MNT 61 billion.

At the end of December 2004, banks' weighted average lending rate was 24.8 percent, which is the lowest in the last several years. While rates fell in the first half of 2004, they rose again in the summer months, and fell again by year-end. On the other hand, banks' interest rates for deposits remained largely unchanged throughout 2004.



## FINANCIAL REVIEW

In 2004, XacBank made excellent progress in improving its profitability, while strengthening its internal risk management and accounting systems. After meeting the minimum paid-in capital requirement of the Central Bank of Mongolia in early 2004, the Bank continued to seek new investors locally and internationally within a reasonable timeframe to meet the next capital increase in 2006.

During the year, the Bank concluded a series of investment transactions and in addition underwent several reviews, examinations and on- and off-site appraisals. Among these the following appraisals took place:

- XacBank became the first bank in Mongolia to be rated by an international rating agency. PlaNer Rating, a leading microfinance rating agency, assigned the Bank a rating of "A-" after a thorough on-site review;
- Calvert Foundation (USA) disbursed a USD 200,000 loan in February 2004 and expressed interest in continued cooperation;
- ASN-NOVIB (Netherlands) disbursed a USD 1.0 million loan after conducting due diligence in October 2004;
- MicroVest (USA) disbursed USD 1.5 million of convertible debt after conducting due diligence in October 2004;

■ After two field visits by the Global Microfinance Facility, the Bank remains in the course of negotiations for a term loan;

■ In April, International Cooperation Development Fund (ICDF) of Taiwan conducted on-site due diligence in consideration of a term loan to the Bank. In November 2004 a USD 3.0 million loan was approved and disbursement is anticipated in 2005;

■ The Microfinance Information Exchange, the MIXMarket, awarded the Bank its "5 Diamond Profile of the Month" in July 2004, recognizing the Bank's achievements in transparency;

■ The Bank was awarded an Honorable Mention by CGAP for achieving a high level of disclosure standards in their first-ever competition recognizing institutions that attain a high degree of transparency in their annual financial reporting;

■ In its annual audit, the Central Bank of Mongolia gave the Bank a positive grade for liquidity, profitability, asset structure and portfolio quality. The rating of 1.6 was stronger by 0.2 points from last year's result.

Selective financial indicators for the last 3 years are presented in the table below:

	2002	2003	2004	Change (04-02)/02	Percent Change (04-03)/03
<b>PROFITABILITY</b>					
Return on Average Assets	-2.04%	1.90%	3.42%	268%	80%
Return on Average Equity	-5.47%	9.15%	18.60%	440%	103%
Net Profit Margin	-8.68%	6.76%	12.18%	240%	80%
Net Income After Taxes	(170,465.59)	276,878.67	787,493.96	562%	184%
<b>BALANCE SHEET</b>					
Earning Assets to Total Assets	75.67%	79.21%	80.35%	6%	1%
Deposit to Loan Ratio	119.72%	90.92%	77.27%	-35%	-15%
Commercial and Project Funds to Total Liabilities	24.65%	25.43%	38.66%	57%	52%
Operating Expenses to Total Expenses	73.94%	59.93%	52.88%	-28%	-12%
<b>PRUDENTIAL RATIOS</b>					
Risk Weighted Assets to Capital	38.14%	24.71%	18.73%	-51%	-24%
Liquidity Ratio	48.93%	33.50%	28.45%	-42%	-15%
20 Largest Borrowers to Shareholders Equity	10.76%	12.48%	6.98%	-35%	-44%
Related Party Loans to Shareholders Equity	5.13%	7.94%	12.13%	136%	53%

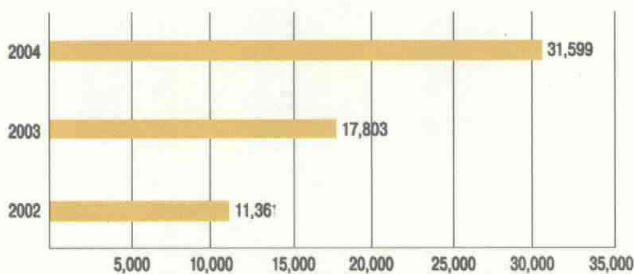
## Balance Sheet Structure

The Bank ended 2004 with total assets of MNT 31.6 billion, an increase of 80 percent from 2003 and largely in line with the Business Plan.

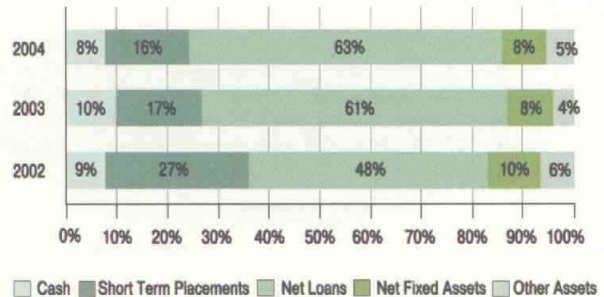
The balance sheet was strengthened as liquid and earning assets as a percentage of total assets ended 2004 at 80.4 percent compared to 79.2 percent in 2003, where loans as a percentage of assets increased from 61 percent in 2003 to 63 percent in 2004. Major highlights relating to the Bank's balance sheet are given below:

- The Bank maintained high levels of liquid and earning assets without decreasing asset quality;
- Treasury became more pro-active in implementing a liquidity management policy and investing excess liquidity into short-term interest earning instruments. As a result, investment income rose by 45 percent in 2004;
- The Bank expanded its activity in the interbank market for purposes of meeting short-term liquidity needs and raising medium-term funds in local currency;
- Policies and procedures related to day-to-day accounting were improved or upgraded during the year.

TOTAL ASSETS /million MNT/

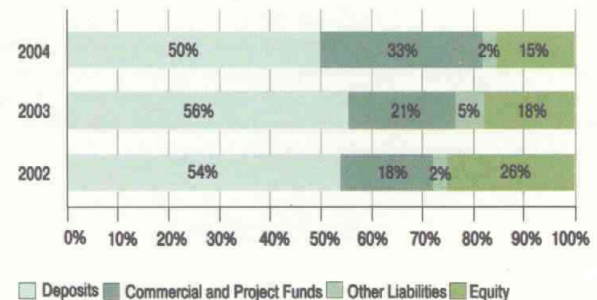


ASSET COMPOSITION



The Bank has supplemented its deposit base with loans from international financial institutions, particularly those which support microfinance, together with project funds. This has allowed the Bank to diversify its funding mix and lengthen its liability duration. Extensive utilization of these funds have grown as a percentage of overall funding sources from 18 percent in 2002 to 33 percent in 2004. Because this funding typically has a lower cost than retail deposits, the result has been a positive impact on the Bank's profitability.

LIABILITY COMPOSITION

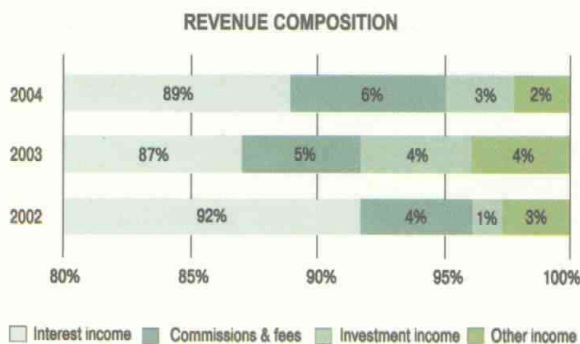


## Profitability

With after tax earnings of MNT 787.5 million, the Bank exceeded its Business Plan by 32.4 percent and exceeded the prior year's profit by approximately 3 times. This result was achieved through efficient lending operations, utilization of lower cost funds and tight cost control. Although total assets expanded by approximately 77.5 percent from 2003, return on assets rose to 3.42 percent from 1.9 percent, and return on equity was a strong 18.6 percent vs. 9.15 percent in 2003.



The Bank exceeded its total revenue target in 2004 by 4.7 percent to MNT 6.5 billion while maintaining strong portfolio quality and minimal past due loans. Fee income met the projection and is likely to rise as a percentage of total revenue in coming years. The Bank intends to offer high quality, premium priced services which is expected to result in higher fee income. Despite a 60 percent increase in total interest income in 2004, interest income as a percentage of total income rose only slightly to 89 percent from 87 percent. However, this is in line with management's strategy to increase other income, including investment and fee income as a percentage of the overall revenue stream.



Due to the utilization of lower cost commercial and project funds, interest expense on deposits was below budget. In 2004, the average cost of deposits was 12.9 percent while the cost of commercial and project funds was an average of 9.09 percent. Total operating expenses were inside the budgeted amounts for the full year 2004.

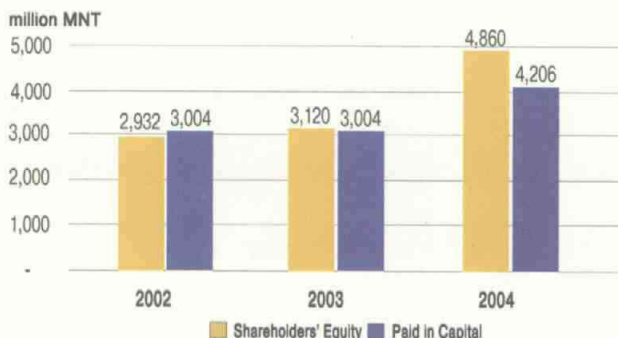
Given the string of profitable years for the Bank in 2003 and 2004, the Board agreed to distribute a cash dividend in January 2005 of approximately 20 percent of after tax income. This gave the shareholders of XAC-GE Group their first cash return on their investment since 2001, allowing these NGO shareholders to fund some of their ongoing activities. In addition, the Bank eliminated the prior year's loss (2002) from its books and also redistributed MNT 503.9 million to paid-in capital, which will go toward meeting the 2006 capital requirement.

## Equity Building

The Central Bank of Mongolia declared that all banks in Mongolia were required to have minimum Paid-In Capital from their shareholders of MNT 4 billion by 1 April, 2004.

Although the Bank had a successful track record together with a clear vision and development strategy and solid institutional base, negotiations with international investors were postponed in late 2003 without concluding a transaction. As a result, the Bank tapped local investors, with a longer investment horizon, local vision and a willingness to share the mission. These investors recognized the Bank's institutional capacity, growing financial performance, potential for a solid future return, and an opportunity to participate in the Bank's mission. Consequently, the Bank raised over MNT 1.2 billion of new capital to meet the requirement prior to the 1 April, 2004. The increase in paid-in capital was achieved mainly with investment at the holding company level from its first local private investor, Tuushin LLC as well as an additional investment from Mercy Corps. CIDAN, a local savings and loan cooperative, also invested MNT 50 million in the Bank, for a 1.2 percent stake.

Retained earnings remain one of the most important sources of increasing the Bank's share capital to meet the next paid-in capital increase bringing the minimum to MNT 8 billion by April 2006. In 2003, MNT 261.5 million was capitalised from net income into paid-in capital and in 2004 MNT 506 million of net income after the dividend was also reinvested into the Bank. The Bank is confident that it will achieve this new requirement from a combination of internal sources and external investments.



Going forward, the strategy of the Bank is to transfer existing shareholders at the Bank level to the XAC-GE holding company level, thus allowing the Bank to be a 100 percent subsidiary of the holding company in the future. The first steps were taken towards the realization of this strategy when employees and holding company shareholders agreed to swap employee owned XacBank shares with XAC-GE shares. The implementation of this agreement is pending Central Bank approval. From the ESOP distribution for 2003 67,729 shares declared were used to directly purchase shares in the holding company. For 2004, the Board approved the distribution of 158,500 shares from the ESOP to the Bank staff.

The shareholders of the Bank were as follows in 2004:

Shareholders of XacBank	12/31/2004	
	Number of shares	Ownership
XAC-GE LLC	3,948,254	93.88%
Employees	204,821	4.87%
Other Minority Shareholders	52,455	1.25%
<b>TOTAL</b>	<b>4,205,530</b>	<b>100.00%</b>



## OUTLOOK FOR THE NEXT THREE YEARS

The Bank has been operating under a 2002-2006 Business Plan, however the fact that the Bank met its 2006 strategic goals by the end of 2004 necessitated management to develop a new, three-year Business Plan – considering the previous one was successfully implemented two years ahead of time.

The newly developed strategy is well illustrated by the Vision Statement developed at the end of 2003 – XacBank will be the dynamic leader in serving the marginalized citizens of Mongolia with the most innovative and transparent banking services supplied in a professional and sustainable manner. The Bank will use technology together with personalized customer service to grow its market share and support the development of micro and small business in Mongolia.

The growth of XacBank could be separated into two parts: first, marketing of new products and services to meet the demand for our services, such as herder loans, building a savings and credit cooperatives franchising network at the soum level, ger district penetration in towns and cities, entering the housing finance market, maintaining the leading position in the leasing market, introduction of a call center and e-banking, extending our services to Mongolian expatriates in the West.

**Rating:** PlaNet Rating, the rating arm of PlaNet Finance, awarded XacBank an "A-" rating in August 2004. Ms. Alice Negre, Director of PlaNet Rating said, "We congratulate XacBank for the performance and risk rating that it has just received. It is one of the very few regulated banks specializing in microfinance and its achievements surpass most MFIs. As a bank that specializes in microfinance, XacBank faces additional challenges that other MFIs would not ordinarily face, and therefore, must reach a much higher level of performance than its peers to succeed. This highly professional bank has a skilled Board of Directors, strong competitive advantages, diversified sources of funds and a very high quality portfolio. We have been impressed by its development from a project to a Bank." See [www.planetfinance.org](http://www.planetfinance.org) for a copy of the rating report.

**MIXMarket:** The Bank was awarded the "5 Diamond Profile of the Month" by the MIXMarket in July 2004 for its transparency and reporting standards. The MIXMarket is the global information exchange for the microfinance industry. It strives to facilitate exchange and investments flows, promote transparency and improve reporting standards in the microfinance industry. See [www.mixmarket.org](http://www.mixmarket.org) for further details.

**CGAP Transparency Award:** XacBank was awarded Honorable Mention for its high level of transparency and disclosure standards in its financial reporting, in a recent competition sponsored by the Consultative Group to Assist the Poor (CGAP). Nearly 150 microfinance institutions from 48 countries applied for the award, while 40 institutions, including XacBank, received Honorable Mention. CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor. Please see more on [www.cgap.org](http://www.cgap.org).

**Ministry of Foreign Affairs:** The Bank was asked by the Ministry of Foreign Affairs to lead the work in Mongolia on preparing for the United Nations 2005 International Year of MicroCredit and to coordinate the work of the National Coordinating Committee of Mongolia. See more on [www.yearofmicrocredit.mn](http://www.yearofmicrocredit.mn).

Second, in order to meet the Central Bank's minimum capital requirement of MNT 8 billion in 2006 and become a formidable force in the banking sector the Bank will need to grow its market share in traditional banking - SME and corporate lending, domestic and international payments and transfers, international trade finance, card business, public deposit mobilization – at the expense of other competitors.

The main driver behind the growth strategy of the Bank is in innovation. The notion of innovation is impossible to embrace without creative people, flexible technology, and a dynamic culture within the Bank.

During this planning period the Bank will diversify its funding mix with both international and local investors. Strategic investors from abroad will be welcomed to our shareholder ranks and management will prepare the Bank to eventually go public. XacBank will not shy away from opportunities when they present themselves, be it a takeover/merger, investment, cross-border expansion or a strategic partnership.

In these next three years XacBank is poised to grow and develop – and attain its true shape and form, which will determine its path into the future.

**Government Cooperation.** A letter from the Ministry of Finance and Economy (Mr. O. Erdembileg, Director of Financial Sector Department), concluded with the following statement: *As a privately-owned banking institution engaged in microfinance services and providing financial support to micro, small and medium enterprise activities, XacBank is fulfilling a vital need of the citizens of Mongolia and is seen as an example of the private sector contributing to the national effort in accelerating economic growth and reducing poverty.*

**The World Bank:** Mr. Jamal-ud-din Kassum, World Bank Vice President, visited the Bank on October 21, 2004 and commented, "This Bank started out helping people with very small loans and very small transactions. The Bank is growing with their clients. Clients grow... and continue to come back and get new loans and repay them very reliably. A terrific report for this kind of a Bank. A transformation into this kind of commercial bank while maintaining its connection with the very small world is very, very impressive. This is exactly the kind of private sector development this country needs to grow and sustain itself."

**Calvert Foundation:** Lori Chatman, Director of Lending for Calvert, said "Calvert Foundation and its investors are pleased to support the emerging microfinance market of Mongolia through a USD 200,000 loan to XacBank. We look forward to our investment helping to spur further expansion of credit to Mongolia's micro entrepreneurs."

**Dexia BlueOrchard:** Upon issuing USD 1 million in debt for XacBank, Cedric Lombard, director, said, "We are glad to work with XacBank, an innovative, professional and dynamic microfinance bank."

**Mongolian National Chamber of Commerce and Industry:** XacBank became one of the top 100 corporations in Mongolia based on its financial performance and impact on society. XacBank was awarded "Best Business Entity in Financial Sector" for 2004 during the MNCCI organized annual Entrepreneur ceremony.



Women borrowers comprise 54.5 percent of total borrowers of XacBank





## PORTFOLIO REVIEW

In 2004 total loans of the banking system increased by 37.2 percent or MNT 606.8 billion. XacBank ranked second among all banks in the sector in terms of percentage increase in total loans outstanding.

The Bank has developed a growing range of loan products that finance the working capital and fixed asset needs of private businesses, formal and informal, engaged in retail trade, services, light industry, transportation, manufacturing, herding and agricultural product processing. The Bank offers 14 different loan products after adding three more products – apartment pledged loan, individual herder loan and crop loan – during the year.

The Bank also extends loans to individuals for financing consumer goods, educational and other needs. Loan sizes range from MNT 30,000 (approx. USD 25) in micro lending to MNT 200 million (approx. USD 165,000) for SME lending, with terms of 3 to 36 months.

The loan portfolio increased by 84.5 percent in 2004 reaching MNT 20.3 billion. The number of active loans increased by 71.7 percent to 31,962 and the Bank's market share for loans went up from 2.5 to 3.3 percent.



The total loan portfolio of the banking sector concentrated in rural areas was 13.5 percent in 2004, whereas the loan portfolio of XacBank in the rural areas was 57.2 percent. As a result, the Bank's market share in rural areas was 14.2 percent and only 1.7 percent in urban areas of Ulaanbaatar, Darhan and Erdenet. It is notable that 66.6 percent of the Bank's borrowers are from rural areas.

	2004	2003	Change	Percent Change
Loans Disbursed	53,105	32,677	20,428	62.5%
Amount Disbursed (million MNT)	42,862.9	24,286.8	18,576.1	76.5%
Average Loan Size (MNT)	807,135	743,237	63,898	8.6%
Total Number of Loans Disbursed since 1998	138,502	85,397	53,105	62.2%
Total Amount of Loans Disbursed since 1998 (million MNT)	89,376.0	46,513.1	42,862.9	92.2%
Number of Active Loans	31,962	18,610	13,352	71.7%
Total Loan Portfolio (million MNT)	20,313.6	11,012.2	9,301.3	84.5%
Average Loan Balance (MNT)	635,553	591,736	43,817	7.4%
Number of Loans Per Loan Officer	240	158	82.0	51.9%
Loan Portfolio Per Loan Officer (million MNT)	152.7	93.3	59.4	63.7%
Market Share (percent)	3.35%	2.49%	0.86%	34.5%

Loan disbursement continued to increase with an average monthly disbursement of 4,425 loans of MNT 3.6 billion which translated into 76.5 percent growth in the amount disbursed and 62.5 percent increase in number of loans disbursed for the year. Average loan size disbursed was MNT 807,135 showing an increase of MNT 63,898 compared with the previous year. On average 60 percent of loan applications received each month by the Bank were approved.

Ms. Bataa Byambasuren

Ms. Byambasuren was born in Huvsgul province, a rural forested region of northern Mongolia nearby to the famous Lake Huvsgol. She studied wood processing technology in college and was working for various local organizations after her graduation in 1990. When her husband left his job as an administrator in a Soum the couple and their child moved to the capital city Ulaanbaatar. Their reason for moving was similar to most urban migrants, to get closer to the urban center and the economic opportunities it offered.



To make a living in the city, Byambasuren began working from home sewing clothes. As her small business succeeded, she bought a second sewing machine and employed some of her relatives to help her keep up with the growing volume. She eventually needed money to finance her expansion, but a loan from a bank was virtually impossible, so she thought, because she didn't own her apartment and thus lacked the traditional form of collateral to receive a small loan.

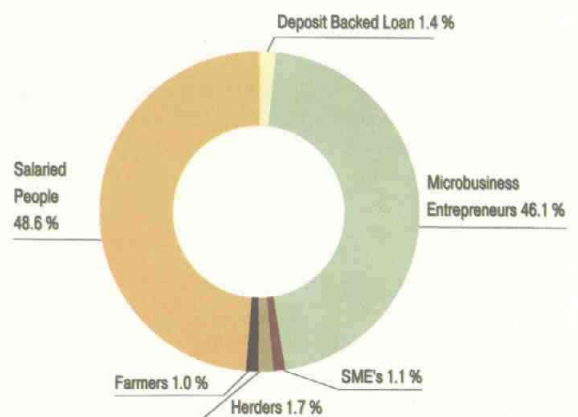
At the recommendation of a friend, she visited XacBank and learned that she could obtain a loan for her small business with just the assets of her business as collateral. She was approved for a Start-Up loan for MNT600,000 which she used to buy two more sewing machines. She then hired four tailors, giving her time to organize other sides of the business, such as sales and sourcing supplies. She also found the time to complete an accounting course at the Institute of Finance and Economy.

With a financial partner in XacBank and her new accounting skills, she is looking forward to further expanding her sewing business, opening a general merchandise shop and also buying a building.

## Borrowers at a Glance

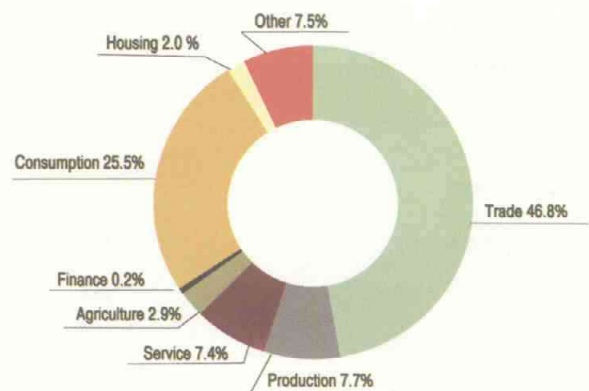
The percentage of borrowers engaged in small or informal business, SMEs as well as herders and salaried people, remain almost the same compared to the previous year, constituting approximately 54 percent of the loan portfolio. Loans provided to entrepreneurs from medium scale business comprise 17.8 percent, while salaried people comprise 23.5 percent of the loan portfolio. Women borrowers comprise 54.5 percent of total borrowers compared to 56 percent in 2003, while loans taken by women comprise 49 percent of the total portfolio. Women with loans ranging between MNT 100,000 and MNT 5 million comprise over 50 percent of the total loan portfolio.

CLIENTELE (NUMBER OF BORROWERS)



In terms of the loan portfolio composition there were minor changes compared to the previous reporting period, with little increase in the proportion of service, agriculture and consumption borrowers.

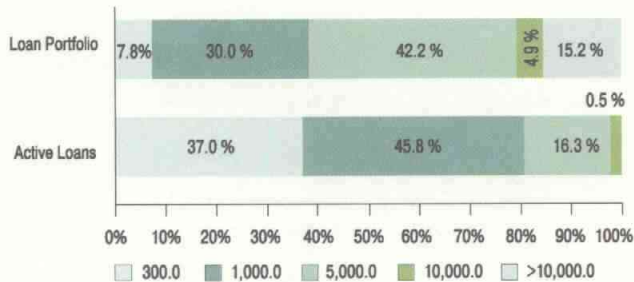
LOAN PORTFOLIO COMPOSITION



## Loan Structure

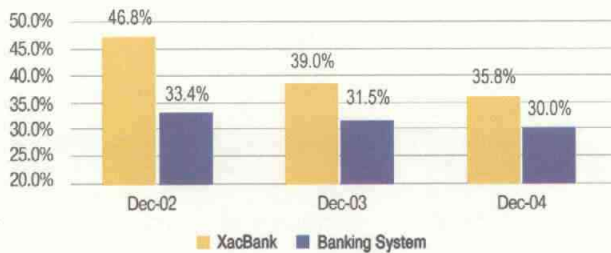
Loans up to MNT 1 million made up 83 percent of active loans the end of 2004 and 37.8 percent of the total loan portfolio in terms of the amount. 20.1 percent of the total loan portfolio and only 1.0 percent of active loans was above MNT 5 million, illustrating the Bank's dedication to microcredit.

LOAN PORTFOLIO BY LOAN SIZE



In response to economic growth and competitiveness in the banking and finance sector, the Bank reduced its rates on all loan and leasing products from 3 to 12 percentage points in the second quarter of 2004. As a result, the Bank's weighted average interest rate on loans fell by 3.2 percentage points to 35.8 percent.

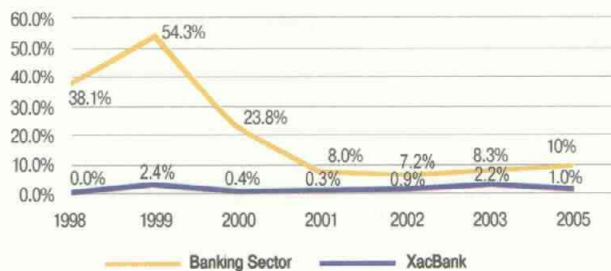
WEIGHTED AVERAGE LOAN INTEREST RATE



## Loan Portfolio Quality and Risk Management

As of 31 December, 2004 the Bank's loan repayment rate was 99.6 percent, and its Portfolio at Risk more than 1 day, including restructured loans, was 1.03 percent, compared to 2.24 percent in 2003.

PERCENTAGE OF NON-PERFORMING LOANS /PAR/



### Ms. Baljin Tsendmaa

Ms. Tsendmaa's family owns Dolgoon Jogol Carpentry Company, established in 2003 after eight years of operating as an individual proprietorship. Dolgoon Jogol employs 17 carpenters and makes approximately MNT 4 million profit per month making wooden structures, furniture and felt for gers. In 2004, a ger with wood carvings made by Tsendmaa's company won the Best Product award at the International Trade Fair in Ulan Ude.

Tsendmaa's husband, Mr. Turmunh used to teach home economics to secondary school students in Umnugobi province. In 1996 the family of six moved to Erdenet where Tsendmaa and her husband started making home furniture. The start-up capital of their business was MNT 50,000 of family savings. While Turmunh ran the daily carpentry work, Tsendmaa organized the other issues of the business, including taking orders, delivering products and overseeing the finances.

In 2001, Tsendmaa got her first loan for MNT 600,000 from the Golden Fund for Development (X.A.C. LLC), one of preceding lending institutions of XacBank. In 2003, just before they received their license and became a registered business, the company moved into a new two story building which was completed with financing from XacBank. During last four years Tsendmaa received five loans from XacBank ranging from MNT 600,000 to MNT 5 million.

Currently, her two oldest children are studying mining technology and accounting at universities in Ulaanbaatar. Tsendmaa wants her daughter to carry on the family business upon her graduation from the School of Economics of the National University of Mongolia.

As their business grew, the family wanted to give back to the community and decided to donate a ger to a local orphanage in Erdenet every year. This year Tsendmaa's family donated its third ger to the orphanage.



Mr. Buural Davaasuren

XacBank staff in Bayanzurh district of Ulaanbaatar regularly visit neighboring organizations to inform the community about the types of loans available at the Bank. It was during one of those usual visits, at the local police station, when Mr. Davaasuren, a young policeman, was about to make an important decision. He was about to leave his job and start his own business. Davaa, as his friends and family call him, had taken consumer loans from XacBank while he was working for the police department and was aware that he could also obtain a small business loan once he had established his business.

In 2003, Davaa quit the police, rented space in the "Norjin" market and with his wife began a business fitting and selling eyeglasses. He started with MNT 200,000 borrowed from relatives and an eyeglass fitting machine borrowed from a friend.

A few months later, Davaa got his first business loan for MNT 150,000 from XacBank. He invested it in working capital and bought more equipment to provide one-point service to his customers. A repeat client, Davaa recently took his third loan, for MNT 800,000, and now his business is thriving. When this loan is repaid he plans to purchase a computer which will check his patients' eyesight, and will finance it with another XacBank loan.

As their business has grown, the family has also become savings clients of XacBank. Davaa and his wife have recently opened Future Millionaire children's savings accounts for each of their two children which will fund their education. According to Davaa, his son Osobbayar wants to be a policeman like his father used to be and his daughter Munhzaya, hasn't decided, but she's only four.



For 2004 the Bank's loan loss ratio was at 1.08 percent, as 28 loans for MNT 167.1 million were written off. 92.5 percent of total write offs was due to one loan for MNT 154.6 million. The total recovery of the written-off loans from previous years was MNT 1.3 million. In its six years XacBank has written off 105 loans for MNT 208 million.

	2004	2003	Percent Change
Loan Repayment	<b>99.61%</b>	99.15%	0.46%
PAR > 1 day (thousand MNT)	<b>209,772.9</b>	246,994.3	-37,221.4
PAR > 1 day (Percent)	<b>1.03%</b>	2.24%	-1.21%
Loan Loss (thousand MNT)	<b>167,134.4</b>	13,108.8	154,025.6
Loan Loss Ratio	<b>1.08%</b>	0.16%	0.92%
Loans Recovered (thousand MNT)	<b>1,351.3</b>	3,803.6	- 2,452.3
Recovery Rate	<b>0.8%</b>	29.0%	-28.2%
Loan Loss Reserve (Percent)	<b>1.32%</b>	1.56%	-0.24%

To better manage risk, the Bank reorganized its credit area during the year to create a Credit Management Division.

The Bank also reorganized the loan approval process structuring loan approval authorizations at three levels of Credit Committees. The approval authorities of the committees were based on the skills and experience of their members.

#### LOAN PORTFOLIO CONCENTRATION

	Percentage of Loan Portfolio	Percentage of Shareholders' Equity
20 Largest Borrowers	<b>7.44%</b>	31.09%
Single Largest Borrower	<b>1.67%</b>	6.98%
Total Loans to Related Parties	<b>2.90%</b>	12.13%
Single Loan to Related Party	<b>0.30%</b>	1.24%

## Lending in Rural Areas

XacBank has intensified its services to citizens in rural soum areas by providing mobile lending and franchise services to further fulfill its mission to provide financial services to remote households.

As a result of such initiatives, the Bank reached 141 soums serving 3,574 borrowers, or 11.2 percent of its total borrowers. The loan portfolio of soum borrowers reached MNT 1.8 billion by year end, or 8.8 percent of its total loan portfolio.

The Bank started to market its new franchise service aimed at providing sustainable financial services for the residents of rural areas through assisting the local residents' initiative to set up savings and credit cooperatives. The Bank plays a crucial role in building the local capacity to establish such entities in a sustainable and inclusive manner. Offering specialized training as well as providing a "Development Guide" of guidelines and policy manuals adapted specifically for the start up SCCs, the Bank plays a key role in their establishment. At year end, franchise services were piloted to savings and credit cooperatives in eight soums.

Also, special attention was paid toward assisting herders, which comprise about 70 percent of the rural residents of Mongolia. For this purpose, the Bank developed a new product to serve individual herders and meet their basic needs for loans and other financial services. This has resulted in an increase in herder borrowers to 508 comprising 1.7 percent of total borrowers and 1.8 percent of the total loan portfolio.

A promising increase was marked in 2004 in terms of the number of entrepreneurs engaged in the agricultural business, especially crop production. During 2004, the Bank disbursed 432 loans for crop production for MNT 276.4 million.

### Partnerships

XacBank is cooperating with several international and government projects delivering financial services to rural communities throughout Mongolia.

### Employment Generation Support Fund

In 2002 XacBank won a tender from the Ministry of Labor and Social Security and has been selected to disburse microloans from the Employment Generation Support Fund. This program started in rural areas from June 2002 and in Ulaanbaatar from December. The Employment Generation Support Fund has extended its funding term for an additional year in the spring of 2004. The total amount of MNT 500 million has been placed at XacBank and a total of 2,011 loans were disbursed for MNT 1,623.8 million serving the unemployed of six Ulaanbaatar districts and 21 aimags across Mongolia.

### Rural Poverty Reduction Program

The Bank has been independently managing the rural financial services component of the Rural Poverty Reduction Program of IFAD and the Government of Mongolia since February 2003. The Bank's rural working group has worked with local people providing financial services and training for herders, savings and credit cooperatives, low income and other underserved people. As a result, XacBank served 39 remote soums in four aimags. At the end of 2004, the Bank had 4,600 outstanding loans for MNT 2.7 billion. In total 2,500 loans were disbursed to soum residents amounting to MNT 1.4 billion. Of those borrowers 3.5 percent are herders, and 56.8 percent are women. Additionally, four savings and credit cooperatives in the soum areas were trained under the project as well with the aim of strengthening their operations. Also, the Bank has organized a number of training sessions in Ulaanbaatar, including a Training of Trainers, training for coordinators from 32 soums and representatives from 4 aimags on establishing herder groups.

### Agricultural Sector Development Project Program

XacBank joined this project funded by the Asian Development Bank and the Government of Mongolia which aims to support small and medium enterprises in the agricultural sector in 2003. In 2003 the Bank disbursed 420 loans amounting to MNT 326.2 million through its 7 branches. In 2004, the Bank disbursed 1,036 loans totaling MNT 958.3 million to individuals and enterprises engaged in the agricultural sector production, services and trade. MNT 871.3 million was refinanced from the project.

### Microfinance Development Fund

The Microfinance Development Fund (MDF) was established in 2002 under the microfinance outreach component of the Sustainable Livelihoods Project of the World Bank. In March 2004 XacBank received authorization to disburse loans in Uvurhangai, Umnugobi and Dundgobi aimags with the total funding of USD 200,000 from the Fund. In December the Bank received another MNT 460.0 million and started disbursing in Bayanhongor, Dornod, Uvs, Bayan-Ulgii, Tuv and Dundgobi aimags. The number of borrowers, including repeat borrowers, reached 763 with loans totaling MNT 667 million.

### Rural AgriBusiness Support Program

The Bank is cooperating with the "Gobi Initiative" project of Mercy Corps within the "Rural AgriBusiness Support Program". This project is implemented in Uvurhangai, Gobisumber, Dornogobi, Bayanhongor, Gobi-Altai, Umnugobi, and Dundgobi aimags covering 46 herder groups. To date a total of MNT 124.6 million in loans for up to 24 months have been disbursed to herder groups. Mercy Corps, has placed MNT 104.5 million with the Bank to support these loans. The project is to be expanded in 2005 by disbursing the loans not only to herder groups and lending cooperatives but also to other businesses active in those 10 aimags.

### Perpetual Education Fund

In order to support students from poor families with further education opportunities, the Perpetual Education Fund is financing student loans since late 2004. In total, MNT 4.9 million was disbursed to 16 students with terms of up to 48 months.

### CHF International (Ger Initiative)

To strengthen the capacity of entrepreneurs from ger areas to start a business or expand their existing business, CHF International is implementing the "GER Initiative" funded by USAID and USDA. XacBank is cooperating with the project in Ulaanbaatar, Darhan, Erdenet and Choibalsan cities and by end of the year, the Bank had 186 active loans of MNT 84.1 million outstanding.

### ADRA Mongolia

ADRA organizes business training to residents of ger areas of Bayanzurh and Songino-Hairhan districts in Ulaanbaatar. These are mostly migrants from rural areas who have come to the city without any formal registration. XacBank signed a cooperation agreement with ADRA to provide micro loans to the participants of their business training programs. At the end of 2004 there were 93 active borrowers with MNT 19.8 million outstanding.



## DEPOSIT MOBILIZATION

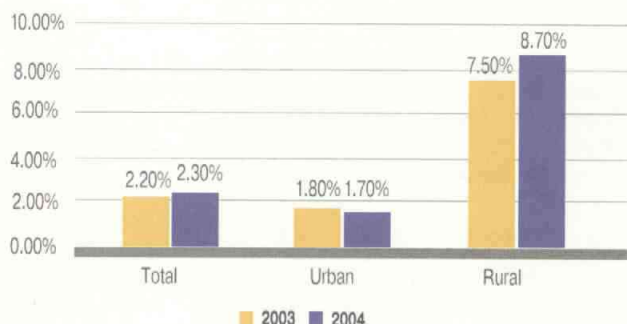
The Bank is an active deposit taker with several deposit products ranging from current accounts to term savings, also offering money remittance and payment services, both domestically and internationally, through its nationwide branch network.

At the end of 2004 total deposits of the Bank rose by 56.8 percent to MNT 15.7 billion, while the number of depositors rose by 50.8 percent to 78,378. The Bank's total deposit market share increased from 1.75 percent to 2.23 percent nationally in 2004.

During the year, total deposits in the Mongolian banking sector increased by 23 percent to MNT 703.5 billion as depositors continued developing trust in the banking sector.

The Mongolian banking sector is highly concentrated, with 91.4 percent of all deposits in the urban areas (Ulaanbaatar, Darhan and Erdenet). However, 58.3 percent of XacBank's total account holders and 29.9 percent of the Bank's deposits are sourced from rural markets. As a result, the Bank's market share in the rural areas is 8.7 percent while its urban market share is only 1.7 percent.

MARKET SHARE (Public Deposits)



In 2004, total deposits increased by MNT 5.7 billion, of which 21.05 percent or MNT 1.2 billion was denominated in US dollars.

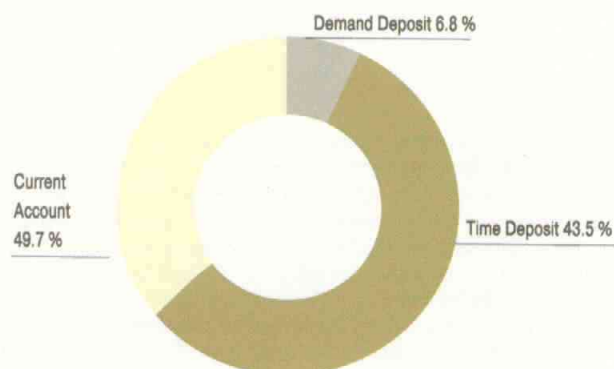
## DEPOSITS

	2004	2003	Change	Percent Change
Depositors	39,166	25,574	13,592	53.1%
Deposit Balance (million MNT)				
Demand and Savings	14,331.9	9,132.1	5,199.8	56.9%
Current Accounts	1,364.5	880.0	484.5	55.1%
Average Deposit Balance (MNT)	365,928	357,087	8,841	2.5%
Current Account Holders	39,212	26,402	12,810	48.5%
Average Account Balance	34,798	33,332	1,466	4.4%
Market Share in Public Deposits	2.3%	2.2%	0.1%	4.3%

## Depositors

Among active deposit account holders, 49.7 percent have current accounts of which most are also borrowers. Additionally, 43.5 percent have time deposits (deposits made for fixed time period with limited withdrawal options) and 6.8 percent have demand deposits (deposits immediately available).

STRUCTURE OF TOTAL DEPOSIT ACCOUNT HOLDERS



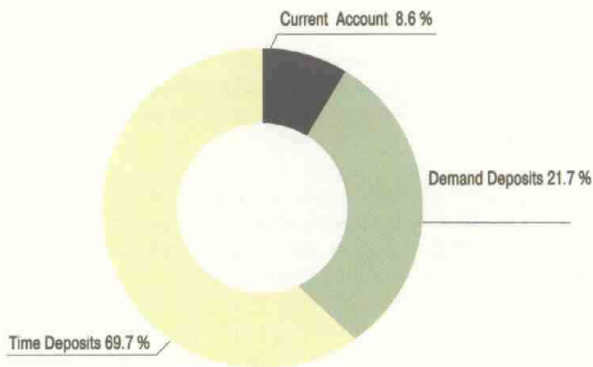
During 2004, on average the Bank opened 1,768 time deposit accounts each month, of which 968 were Future Millionaire children's savings accounts and 582 were demand deposit accounts.

The Bank offers monthly compounding of interest rates on all deposits.

## Deposit Structure

In 2004, current account balances rose by 55.1 percent to MNT 1,364.5 million, demand deposits rose by 87.1 percent to MNT 3,398.3 million and time deposits increased by 49.5 percent to MNT 10,933.7 million. The Bank plans to increase its current account balances, a low cost source of funds, by introducing international payment services and credit cards in 2005, both of which, we believe, can contribute to higher balances in current account.

STRUCTURE OF TOTAL DEPOSITS



The time deposit product with the highest average balance is "Arvijih" with an average balance of MNT 3.9 million. The average for the most popular time deposit, "Future Millionaire", is MNT 107,700. At the end of 2004, the 20 largest time depositors together comprised 24.7 percent of the total deposits for the Bank.

Time Deposit Types	"Arvijih"	"Hurimtlah"	"Future Millionaire"	"Graceful Aging"
Average Balance (thousand MNT)	3,908.4	585.2	107.7	243.6

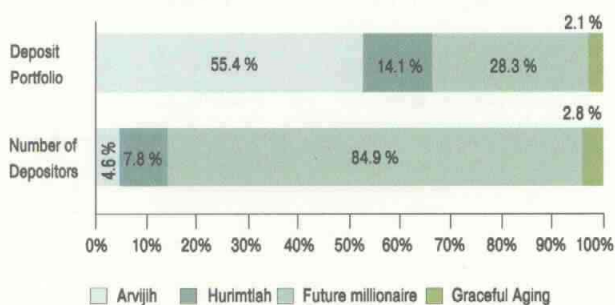
*Arvijih* – fixed term deposit, penalty for each withdrawal

*Hurimtlah* – deposit allowing additional pay-ins, but no withdrawals during the fixed term

*Future Millionaire* – deposit for children below 16 years old with encouragement of add-ins, but penalties for early withdrawal

*Graceful Aging* – deposit for adults (similar to pension scheme) with no withdrawal right for five years, but with encouragement for regular additions.

STRUCTURE OF TIME DEPOSITS /By Products/



To attract new depositors, the Bank conducted a "Savings + Luck = Millionaire" (the abbreviation in Mongolian language make "XAC") savings lottery. Depositors who opened new deposit accounts and made deposits of more than a specified amount to their account were entered in the lottery for prizes. In addition, to mark the occasion of Children's Day, special events were conducted among existing Future Millionaire account holders, as well as a "Fisherman" contest among the staff to target depositors through cross-selling. The Bank revised its deposit interest rates twice during the year in response to market forces and its own funding needs.

The Bank has kept its funding costs low compared to its competitors, with the maximum interest rate paid on its longest term deposit product equal to the average interest rate paid by all commercial banks. XacBank raised substantial deposits from soum areas through mobile banking services as well.

## Other Banking Services

To increase its domestic money remittance service volume, the Bank improved its inter-branch payments systems and marketed a bonus card among users. As a result, the number of money remittances increased 65.2 percent from 2003 to 66,794 while the value of those remittances grew by MNT 700 million to MNT 8.6 billion.

Domestic Funds Transfer	2004	2003	Percent Change
Number of Money Remittances	66,794	40,426	65.2%
Value of Remittances (billion MNT)	8.6	7.9	8.9%
Average Value (MNT)	129,274	196,534	- 34.2%

In 2004, the Bank also started offering MoneyGram International money transfer service in cooperation with the Trade and Development Bank of Mongolia. The Bank also became a member of SWIFT and is able to independently serve customers with international payment services.

## Customer Service

In order to maintain excellent quality customer service, the following initiatives were also implemented during the year:

- A third "Client Satisfaction Survey" was conducted by the market research company "MMCG" LLC and follow-up actions were implemented in line with the survey results;
- XacBank's Customer Service Standard was developed and the Bank's operations now comply with it;
- A customer opinion survey was conducted by telephone by the middle managers of the Bank;
- A new schedule for extended branch opening hours was implemented including Saturday opening for select branches and extended evening hours for some Ulaanbaatar branches.



## OPERATIONS

### Human Resources Management

#### Our Team

The Bank is proud of its team of highly dedicated and qualified staff. In 2004 the Bank experienced a net increase in headcount of 17 percent and ended the year with 506 staff.

The importance that the Bank attaches to the management style and structure resulted in a further organizational restructuring that took place in March and October of 2004. This reorganization was implemented based on better segregation of functions among divisions based on the role that each plays in the implementation of the Bank's strategy along with the resources and risks that it manages. It also reflected a total commitment to the customer service.

The management team was strengthened in the 4<sup>th</sup> quarter with the addition of Ms. Gira Delgermaa, new Chief Operating Officer. Delgermaa brings a wealth of banking experience as well as solid academic credentials to the Bank.

#### HUMAN CAPITAL IN NUMBERS

Total Employees	506
Branch Staff	80 %
Rural Branch Staff	60 %
Average Age	28
Male/Female Ratio	47/53
Support Staff	23 %
Loan Approval Committee Members	148



#### Employee Compensation

A new performance-based remuneration system for branch staff was designed and piloted in August 2004 to attempt to establish a fair compensation system that takes into account an individual's achievement of results and merit, giving the individual the opportunity for recognition and a potential performance bonus each month. The results of this system will boost staff productivity and increase the Bank's overall performance.

#### Selection

The Bank's policy on new hires is guided by the objective to ensure equal opportunity for all those who aspire to join us, resulting in diversifying staff with employees having different backgrounds other than finance and banking. Almost 173 people joined the Bank during the year.

To prepare future human resources the Bank actively works with the best local universities offering internships and scholarships, then recruiting new graduates. For the first time, in 2004, XacBank organized a competition where students presented their research on microfinance development in Mongolia and internationally.

#### Training

As part of its effort to raise the knowledge, skill and competencies of all employees, XacBank organized over 2,000 hours of in-house, external and international training to staff at all levels during 2004.

In-house training continues to have considerable impact on the staff to enable them to apply new knowledge and acquire necessary skills to perform their work in more effective and efficient ways. To facilitate integration of our staff into the organization, an orientation program, which includes classroom training and on-the-job training, is consistently delivered to all new team members.

Further knowledge sharing was conducted in 2004 when the Bank sent five middle management staff to Bank Rakyat Indonesia for exposure training.

#### INTELLECTUAL CAPITAL DEVELOPMENT

Total Investment in Training	MNT 44,705,797
Hours of In-House Training	313 person hours
Local Outsourced Training	262 hours
International Training	1,304 hours
International Consultants	488 hours



### Hosting international MFIs

The Bank shared its knowledge by organizing and hosting various training events for microfinance organizations from China and Russia during the year, as well as hosting Mercy Corps International's Microfinance Practitioners Workshop to share our experiences in microfinance and development endeavors. We also shared our capacity building experiences with Japanese and Chinese counterparts via video conferences from Ulaanbaatar.

### Open Library

In 2004 the Bank opened its library to the public for sharing books and publications on microfinance, banking, management and other topics for all interested parties. The library will be fully operational in 2005.

### Long and Short Term Technical Assistance

During 2004 the Bank received Technical Assistance (TA) from two primary sources, the International Finance Corporation (IFC) and USAID in the form of an Implementation Grant Program (IGP) grant. The IFC grant was fully utilized during 2004 while the USAID IGP grant will expire in 2005. The IGP grant is aimed at assisting the Bank to expand its branch network, train staff, develop new products and services as well as the internal systems needed to manage its growth.

**During the past year the Bank received specific TA in the following areas:**

#### Internal Audit

Targeted to the Internal Audit staff with a focus on improving their analytical skills, the training was designed to help them improve their skills in recognizing potential risk, including fraud, and developing systems to mitigate that risk. The result was the development of a risk assessment system for the auditors, including a quantitative methodology for grading branch audit results, as well as improved policies and procedures for the Internal Audit team.

#### SME Credit Training

This was conducted by a credit training specialist from the Bankakademie, Germany, and targeted to lending staff. It focused on cash flow lending and business cycle assessment.

#### Portfolio Grading and Organizational Structure Advisory

This consultancy addressed various issues within the Bank, including training for Branch Managers and Regional Managers in roles and responsibilities, additional training for credit officers, the establishment of a portfolio grading system that sorts existing loans in the portfolio by risk assessment as well as cost of maintenance. The consultant also assisted the Bank with the framework for reorganizing its corporate structure.

#### Activity Based Costing (ABC)

This training included implementation of a program to assign and assess the costs of each of the Bank's products and provided tools for staff to continue to apply this process. ABC allows the Bank to calculate the actual cost of each of its products by measuring both fixed and variable overhead, and determine if they are being priced appropriately.

### Strategic Marketing

An international marketing consultant worked with the Bank over 3 months to assess its marketing strengths and weaknesses for each product and create a detailed Marketing Strategy and budget. This included a schedule for advertising form, media and frequency for each product as well as brand development for the Bank for 2005.

### Technical Assistance program for 2005:

#### Asset Liability Management (ALM)

A consultant will review and assess the Bank's ALM procedures, provide training to treasury staff and provide tools for sophisticated treasury management. As the Bank's balance sheet has become more complex, it has become critical to be able to measure and manage liquidity, maturity and foreign exchange risk.

#### Internal Audit Training

Follow up training will be sourced to give the Internal Audit staff additional tools to assess the Bank's systemic risks, evaluate its existing policies and procedures and upgrade the skills of the audit team.

#### Trade Finance Training and Product Development

The Bank is a member of SWIFT, has one international correspondent bank account and has applied for another. This will provide an opportunity for trade finance services for clients doing international business. Training in this area will be sourced to develop products and services for international payments and other trade finance services.

#### Residential Housing Finance

This is intended to complement the Bank's new residential housing loan product. Because the Bank may decide to securitize these loans; standardization and performance measurement is critical. The consultancy will assist the Bank in product development as well as staff training in assessing and monitoring housing loans.

#### Credit Scoring System

The Bank has evaluated a credit scoring system to standardize the credit approval process. This will continue to grow in importance as the branch network continues to expand and the Bank forms strategic alliances with other MFIs, i.e. savings cooperatives. A scoring system will ensure that the credit approval procedures are uniform and also flexible to allow tightening or loosening of lending standards to meet market conditions.

#### Follow-up on Risk Grading

A portfolio risk grading system was introduced during 2004 and is to be implemented during 2005. This will allow the Bank to systematically evaluate the quality of its portfolio and maintain better risk management systems. As Credit Officers currently monitor over 200 loans each, tools to manage the portfolio and methods for determining which loans require greater monitoring attention will be critical to maintaining efficiency in the lending operation.

## Branch Network

During 2004 the Bank opened 4 new branches, including three new branches in Ulaanbaatar city and one in a soum, expanding the network to 36 full branches.

XacBank has gone through a rapid growth phase since its transformation, opening new branches in soum areas, near markets, ger districts and elsewhere where its client base lives and works. As a result, XacBank is

- represented in each provincial center in Mongolia;
- does business in over 120 rural soums;
- has over MNT 1.3 billion in loans in soum areas alone.

To better meet our customers' needs, the Bank has extended working hours in some branches. These branches are open from 8 am to midnight, in some cases, seven days a week, to meet customer needs for convenience.



## Branch Renovations

"Simply because people are poor doesn't mean that they should suffer poor surroundings" said Mr. Chuulun Ganhuyag, Executive Director of XacBank, upon opening newly renovated XacBank branch office in Hutul soum in May 2004. This is one of many branch offices renovated and upgraded during the year.

In 2004 the Bank converted 13 branch offices into attractive, engaging business outlets, where clients are comfortable conducting business. The Bank invested over MNT 100 million in branch renovation in 2004.

To attract depositors and instill confidence in the Bank, as well as attract and retain highly qualified and motivated staff, clean, attractive premises are essential. This may mean simply fresh paint or sealed windows to keep out the extreme cold of Mongolia, but it also includes installation of secure teller windows and cash counters, upgrading of electrical wiring to accommodate a computer network to execute funds transfers and maintain secure record keeping.

Negotiations for the acquisition of the headquarters building started in 2004 and were successfully concluded in early 2005. As a result, the Bank now owns its flagship headquarters building and is not susceptible to the unstable and legally vague market for rental property in Mongolia.

In 2004, much investment focused on expansion of the branch network. Seven premises were purchased for branches at a cost of MNT 515 million bringing the branch premises owned by the Bank to 15. Construction of two branch offices, in Hovd and Darhan started in 2004 will be completed in 2005.

In 2004, the Bank invested over MNT 1.7 billion in property, premises and outfitting of its branch network.

## Management Information Systems

XacBank introduced the first teller system in Mongolia and continues to set new standards for excellence in customer service. Ms. Chimeddorj Galya, XacBank branch manager said "We can promise that our customers will spend the least amount of time completing their transactions in our Bank compared to any other bank in Mongolia. XacBank has eliminated many forms that require stamps and signatures, decreasing the time clients spend in the Bank. Since there are no forms to complete, there are also no extra fees to pay, like other banks charge. Most of our customers do small transactions, so they really appreciate that we don't charge for withdrawal slips and transaction forms."

Bankers Realm, the Bank's management information system, has been installed in all branches and has been operational for over 2 years. It is particularly appropriate for XacBank and its high volume of relatively small transactions across a large number of branches. Its client-centric features and a suite of reports allow daily consolidated reporting from all the branches, allowing the Bank to have the prior day's closing balances at the start of the next business day. It also enables the Bank to generate all required reports from the Central Bank directly from the system. In addition, security is enhanced by storing client photos and signatures. During 2004 interbranch settlement was enhanced further and now allows our customers to receive their remittances much faster. As part of its business continuity plan, the Bank installed servers at all of its branches that provide back up in the event of interruptions or disasters. The Bank's investment in PCs and servers during 2004 was MNT 181 million.

## Internal Audit

To accommodate the expansion of the Bank's branches and subsequently operations, and to provide adequate support and field control, the Internal Audit Department recruited additional staff during the year bringing the total number of audit staff to 8. In 2004, the Department conducted audits at least twice at each of the Bank's branches and its divisions, a policy that will be continued in the coming year.

Planned Branch Audits	65
Randomly Selected Audits	19
Total	84

The Internal Audit Department has also revised its audit policy which consists of the audit program and product evaluations. In addition, the branch network is now assessed using a scoring system assigning a numerical rating to each branch upon completion of a periodic audit.

During 2004, the Bank continued to raise the professional qualifications of its staff and provided international training to its staff and will continue to target resources for additional training in 2005.



Mr. Enebish Sundui

Software Manager  
Information Technology  
Department of XacBank

*I joined X.A.C. LLC's information technology team in 2001 as a UN volunteer to work on their Management Information System. Defining the needs and requirements for a new MIS were the main tasks for our team in the period before the transformation of X.A.C. from a lending institution into a commercial bank. Later in the year, I became an employee of X.A.C., as a software engineer.*

*In 2002, I joined the working group assigned to implement all the necessary components customization and configuration of Bankers Realm, the new MIS the Bank chose. Once the system was ready for implementation, we installed it in all branches in just five months, a relatively short period considering the Bank had over thirty branches all across Mongolia at that time.*

*Meanwhile, with the support of the IT team, I initiated and developed several subprograms which increased staff efficiency, reduced operational costs and was able to automate the process of consolidating reports, providing more accurate information to senior management.*

*As a result of improving the system, the Bank was able to generate consolidated reporting from the entire branch network into the Head Office in a shorter period, giving detailed information for marketing and management decision making.*

*As mentioned in our Vision "The Bank will use technology together with personalized customer service to grow its market share and support the development of micro and small business in Mongolia." Our IT team is keen to achieve more every day by implementing modern technology into our operations.*



*I*n 2002 XacBank won a tender from the Ministry of Labor and Social Security and has been selected to disburse microloans from the Employment Generation Support Fund.

The total amount of MNT 500 million has been placed at XacBank and a total of 2,011 loans were disbursed for MNT 1,623.8 million serving the unemployed of six Ulaanbaatar districts and 21 aimags.



## OWNERSHIP AND GOVERNANCE

In 2004, the Board expanded to 12 members with the addition of the first member of the private sector to join the shareholder group and in turn to join the Board. Mr. Namsrajav Zorigt, General Director of Tuushin LLC, the 2<sup>nd</sup> largest shareholder in XAC-GE LLC, was elected to the Board by the shareholders in April 2004. Mr. Zorigt has brought a strong business perspective to the Board and has enthusiastically supported the Bank's mission. Also, throughout the year the Board members gave generously of their time to meet with prospective investors and new stakeholders, and to participate in various Bank sponsored events.

At the close of 2004, the Board of Directors has again taken on issues that show their dedication to the Bank and its mission of pursuing a "double bottom-line". The Board took on the task of assessing a new shareholder and granting them equity conversion rights under the Bank's first convertible debt offering. If this investor elects to exercise their conversion option, they will likely become the 2<sup>nd</sup> largest shareholder. This potential shareholder appears to be a like-minded investor for the Bank, pursuing socially responsible investment together with a commercial profit motive. If the convertible debt is exercised during 2005, the equity generated together with projected 2005 profit, will bring the Bank close to meeting its next mandated capital requirement well before the 2006 deadline.

The Board will be asked to continue to support the Bank both publicly and through its decision making and strategy setting capacity, to fulfill its mission. The individuals on this Board already support the Bank's Vision of providing the most innovative and transparent financial services to the micro-entrepreneur and small business person. The Board and shareholders have seen that this business can be done profitably, fulfilling the double bottom line mission and carving a niche for the Bank in the highly competitive Mongolian banking market.

The shareholders, largely NGO's with social missions of their own, fully support the Bank's activities and its approach to business, its plans for further expansion into the rural areas of Mongolia through franchising, mobile banking, and other initiatives.

While hopeful of equity through exercise of the conversion option and reinvestment of earnings, these are not guaranteed. Thus, the Bank will continue to seek new equity partners to ensure compliance with the 2006 capital requirement of MNT 8 billion. Such new investment is essential if the Bank is to continue to pay a dividend prior to meeting the requirement, as it will divert funds which would otherwise be reinvested in the Bank. Several parties have expressed interest in becoming shareholders, including socially responsible investors seeking to invest in microfinance. By partnering with these institutions, including existing investors, the Bank will find support in pursuing its mission and encounter less pressure to "drift" away from its microfinance, urban and rural, mandate.

In time, the Bank may choose to float its shares publicly, making XacBank a publicly traded institution. This will require stronger governance policies including the need for independent Board members, strong accounting, auditing and compliance standards and a limitation on shareholder representatives at the Board level. However, the decision to take the Bank or the holding company public will require deep commitment from the Board members and existing shareholders as it could put the mission of the Bank at risk.

The Board's activities are regulated by the "Internal Rules of Procedure", a document that outlines the main principles and procedures of the work of the Board and its members. There are three standing committees of the Board – Executive, Audit and Risk Management, each with their own governing charters. The Committees meet periodically, not less than quarterly, and the full Board meets at least quarterly. The Board's primary responsibilities are to supervise the work of the Chief Executive Officer and provide guidance to the Bank's management on strategic direction. Board membership is diverse in terms of skills, experience and individual expertise. The Board maintains its own Secretariat at the Bank to ensure proper record keeping and communication. This adds further to one of the major distinguishing characteristics of the Bank in the Mongolian business environment – its commitment to transparency at all levels to all stakeholders.



## MARKETING AND PUBLIC RELATIONS

Our challenge to position the Bank as a leading financial institution, one which makes things happen instead of watching things happen, has succeeded in a number of ways. XacBank's financial lease product, introduced in 2003, won "The Nation's Most Appreciated Financial Product" award in 2004 based on a public opinion poll conducted among 7,500 randomly selected respondents by independent surveyors. The Bank was also awarded "Best Company of the Year – Financial Sector" for 2004 by the Mongolian National Chamber of Commerce and Industry.

Further diversifying promotion channels, strengthening the public relations function and initiating marketing research and post promotion impact analysis within the department, the Bank has improved both its internal and external communication flow which resulted in a more effective promotional activities.

### Public Relations

During the year, the Bank organized several events on the national and international level that were widely supported with PR activities to raise public awareness of the XacBank brand. The Bank's public exposure soared during the last quarter, however, largely due to the UN's Year of Microcredit (YoM) announcement, as evidenced by the following:

- Prime Minister Mr. Tsahia Elbegdorj visited the Bank and its Made by Entrepreneurs- Grassroots retail shop in December;
- Mr. Jemal-ud-din Kassum, World Bank Vice-President for East Asia and Pacific, and newly appointed Country Director Mr. David Dollar visited XacBank in October during their official visit to Mongolia;
- A Cooperation Agreement was signed with the Mongolian Chamber of Commerce and Industry for YoM in the presence of the Minister of Industry and Trade, Mr. Batbold Suhbaatar and UNDP Resident Representative, Ms. Pratibha Mehta;
- The Bank took active part in planning and organizing the National Microfinance Summit dedicated to the YoM and successfully lobbied the government through UNDP and the National Coordinating Committee to announce 2005 as the National Year of Microfinance and Entrepreneurship in Mongolia;
- In November XacBank's CEO attended the global launch of the YoM at UN headquarters in New York;
- The Bank helped launch "Made by Entrepreneurs – Grassroots" a permanent exhibition dedicated to support of the Bank's clients and provide them with a venue for better market exposure; it is also to become an information center for microfinance and other related subjects as well as a training center for XacBank and its partner organizations;
- X.A.C. celebrated its 5th anniversary as the first licensed NBFi in September and XacBank celebrated its 3rd anniversary as a Bank in December 2004;

The Bank has also participated in several social events organized among banks commemorating the 80th anniversary of the Banking Sector in Mongolia. Notably, XacBank took 1st place from the football Championship, 3rd place in the chess Championship and received the "Best Participant" award from the "Bank Expo-2004" exhibition.



### Advertising

Brand and product advertisements have been mostly broadcasted through local and national media, including television, supported with print magazines. A twenty minute television program was produced to familiarize customers with XacBank financial leasing. The TV program allowed customers to quickly learn about leasing and resulted in a strong response from the public. Trade fairs organized throughout the country in cooperation with equipment suppliers also contributed to this increase in XacBank leasing activity.

During the local broadcast of the Athens Olympic Games, a XacBank brand commercial was aired presenting XacBank together with featured Mongolian athletes.

The Bank's Graceful Aging and Future Millionaire long-term savings products are featured to offer solutions for social issues such as low pensions for older citizens and lack of financing for higher education. Advertisements produced for these deposits were designed to promote the benefits of personal financial planning to customers to make their lives better.

The Bank's marketing strategy was created with the assistance of an international consultant funded by a USAID grant.

The Bank has incorporated this marketing strategy into its 2005-2007 Three Year Business Plan.



## COMMUNITY RELATIONS

In addition to its financial operations, the Bank is also active in the social arena. During the year, the Bank took a leading role in a number of events which had a direct and lasting impact on the local community.

In October, XacBank organized the Second Annual "Three Rivers Clean-Up Day" event with participation from Mercy Corps, Nike and local corporate sponsors. The event was organized within the framework of the UN YoM, and mobilized over 4,100 local participants to clean banks along three rivers running through Ulaanbaatar city. Over 720 cubic meters of trash was collected, filling over 120 six ton trucks. This was one of the largest clean-up events in Ulaanbaatar city, attracting attendance by government officials, diplomats and the NGO community.

In July, XacBank donated MNT 1 million to the Museum of Danzan Ravjaa, the Great Hutagt of the Gobi, for protection and preservation of valuable cultural artifacts in the museum. This contribution was made to contribute to the research into and preservation of Great Hutagt's heritage for future generations.

Myths and fairytales play great role in educating youth about Mongolian traditional customs and nomadic culture. During the year, XacBank supported the Chugu recording studio's initiative to produce a CD of children's fairytales and also sponsored the first album of Mongolian fairytale stories.

The Bank continued its support of local handicrafts and artisans, especially products made by low income women. For the second year, and in cooperation with EH-SAN (Mother Fund), women and youth development center, the Bank supported this group to bring their products to market and give them added exposure.

From its six year experience of organizing trade fairs of clients, XacBank staff realized the benefits of such events to micro-entrepreneurs. In December 2004, X.A.C., an NGO founded by XacBank staff, opened "Made by Entrepreneurs - Grassroots", a retail shop in the center of Ulaanbaatar city. The shop displays and sells local handicrafts and other items made by XacBank clients. In addition, with support from the UNDP and other supporters, the shop has an information corner on microfinance and entrepreneurship in Mongolia and internationally.

XacBank continues to support annual scholarship programs dedicated to the support of students in the fields of finance, accounting, management, and business. In addition to scholarships, the Bank has sponsored several events to support creative initiatives of students such as Robocon Mongolia, an annual competition among students in electronic hardware design. During 2004, XacBank sponsored a team of students from the University of Science and Technology. As a user of high technology the Bank strongly supports the need to contribute to the development of well educated and enthusiastic professionals in this field.

Through its participation in events organized by the Mongolian Arts Council, XacBank has supported national artists and contributed to the development of arts and culture of Mongolia. Purchased at the Mongolian Arts Council Grand Auction 2004, a unique sculpture of a racing horse now stands in the headquarters building symbolizing the Bank's dynamic team attitude.

For the entire country, there is only one professional kindergarten for disabled children, and 1 of every 300 newborn children suffers from infantile paralysis. The Number Ten Kindergarten in Ulaanbaatar city provides care and medical services and a kindergarten environment to 100 disabled children. For the 40<sup>th</sup> anniversary of the kindergarten, XacBank sponsored the cost of a major fundraising event amounting to MNT 1 million.

XacBank has helped to establish an information center with personal computers at two secondary schools in the low-income ger districts of Ulaanbaatar. Some schools in these areas of the capital are still without computers for their classes. Thus, since 2002 XacBank has initiated this annual initiative of establishing information centers in secondary schools and providing computers for them. In total, the Bank has donated 22 computers for low-income schools around Ulaanbaatar.

With sponsorship of XacBank, a community radio station in Darhan received USD 1,000 worth of radio equipment, which is vital for its sustainable operation to provide information to the community independent from politics and commercialization. The station produced a series of radio programs on starting micro-businesses, which was brought to the community with the support of XacBank.

Grants of MNT 3.5 million were made to two schools in low income districts and a kindergarten for handicapped children.

Finally, in 2005, in response to the need for help to assist the victims of the Asian "Tsunami", the Bank staff together with Bank resources, raised a total MNT 15 million which was donated to three leading international relief agencies. This was the largest private donation raised in Mongolia for this purpose.



*Imagine all the people  
Sharing all the world  
You may say I am a dreamer  
But I am not the only one  
I hope some day you'll join us  
And the world will be as one*  
John Lennon



*I*n 2004 the Bank opened its library to the public for sharing books and publications on microfinance, banking, management and other topics for all interested parties. The library will be fully operational in 2005.



# XacBank LLC

Financial Statements for the year ended  
31 December 2004

<b>Banking Licence No. 24</b>	dated 27 December 2001, issued by the Bank of Mongolia	
<b>Board of Directors</b>	Chuluun Ganbold Stephen Mitchell Chuluun Ganhuyag Jambaldorj Erdenechimeg Tsend Enhtuya Ser-Od Jargalsaihan Nyamaa Tumenbayar Ganhuyag Munhbat Tuvdendorj Galbaatar Steve Zimmerman Namsrajav Zorigt James Anderson	Chairman Vice Chairman Director Director Director Director Director Director Director Director Director Non-voting Director
<b>Executive Committee</b>	Chuluun Ganbold Chuluun Ganhuyag Nyamaa Tumenbayar Steve Zimmerman James Anderson	Chairman Member Member Member Non-voting Member
<b>Audit Committee</b>	Stephen Mitchell James Anderson Ser-Od Jargalsaihan Jambaldorj Erdenechimeg	Chairman Non-voting Vice-chairman Member Member
<b>Risk Management and Lending Committee</b>	James Anderson Chuluun Ganhuyag Tsend Enhtuya Tuvdendorj Galbaatar Ganhuyag Munhbat	Non-voting Chairman Member Member Member Member
<b>Executive Officers</b>	Chuluun Ganhuyag Gira Delgermaa Dugersuren Bat-Ochir Bayanjargal Delgerjargal Lhagvasuren Soronzonbold	Chief Executive Officer Chief Operations Officer Chief Financial Officer Chief Credit Officer Strategic Planning & Marketing Division, Director
	Zundui Bat-Itgel Galbadrah Tsogbadrah Chuluun Gantulga	Administration Division, Director Branch Banking Division, Director Operations Division, Director
<b>Registered office</b>	XacBank Building Prime Minister Amar's Street Sukhbaatar District, Ulaanbaatar Mongolia	
<b>Auditors</b>	KPMG	

**Board of Directors' responsibility statement**

The Bank's Board of Directors is responsible for the preparation of the financial statements.

The financial statements of XacBank LLC have been prepared to comply with International Financial Reporting Standards. The Board of Directors is responsible for ensuring that these financial statements present fairly the state of affairs of the Bank as at 31 December 2004 and the results and cash flows for the year then ended on that date.

The Board of Directors have responsibility for ensuring that the Bank keeps proper accounting records which disclose with reasonable accuracy the financial position of the Bank and which enable them to ensure that the financial statements comply with the requirements set out in note 2(a) thereto.

The Board of Directors also have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

The Board of Directors consider that, in preparing the financial statements on pages 4 to 38, they have used appropriate policies, consistently applied and supported by reasonable and prudent judgement and estimates, and that all applicable accounting standards have been followed.

Signed in accordance with a resolution of the Board of Directors:



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Chuluun Ganhuyag  
Executive Director

Ulaanbaatar, Mongolia

31 March 2005



**KPMG (Firm No.AF 0758)**  
Chartered Accountants  
Wisma KPMG  
Jalan Dungun, Damansara Heights  
50490 Kuala Lumpur, Malaysia

Telephone +60 (3) 20953388  
Fax +60 (3) 20950971  
Internet www.kpmg.com.my

**Report of the auditors to the members of XacBank LLC**

We have audited the financial statements of XacBank LLC on pages 5 to 34. The preparation of the financial statements is the responsibility of the Bank's Board of Directors.

It is our responsibility to form an independent opinion, based on our audit, on the financial statements and to report our opinion to you, as a body, and for no other purpose. We do not assume responsibility towards any other person for the content of this report.

We conducted our audit in accordance with International Standards on Auditing. These standards require that we plan and perform the audit to obtain all the information and explanations which we consider necessary to provide us with evidence to give reasonable assurance that the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. An audit also includes an assessment of the accounting principles used and significant estimates made by the Directors as well as evaluating the overall adequacy of the presentation of information in the financial statements. We believe our audit provides a reasonable basis for our opinion.

In our opinion, except for the non-compliance with International Accounting Standard ("IAS") 39 and IAS 30 with respect to general provision as disclosed in Note 2(a), the financial statements on pages 5 to 34 present fairly, in all material respects, the state of affairs of XacBank as at 31 December 2004 and the results and cash flows for the year then ended on that date in accordance with International Financial Reporting Standards.

A handwritten signature in dark ink, appearing to read 'KPMG', is written over a horizontal line.

KPMG

Ulaanbaatar, Mongolia

31 March 2005

KPMG, a partnership established under the Malaysian law, is the Malaysian member firm of KPMG International, a Swiss cooperative.

# XacBank LLC

Balance sheet at 31 December 2004

	Note	2004 MNT'000	2003 MNT'000
<b>ASSETS</b>			
Cash on hand	3	1,052,516	637,419
Balances with other banks	3	4,204,447	1,143,765
Balances with the Bank of Mongolia	3	1,392,439	1,121,497
Investment securities - Available for sale	4	965,169	1,946,792
Loans and advances - Net	5	20,044,996	10,840,446
Property, plant and equipment	6	2,437,507	1,386,299
Other assets	7	1,501,697	727,184
<b>TOTAL ASSETS</b>		<b>31,598,771</b>	<b>17,803,402</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
Deposits from customers	8	15,696,429	10,012,172
Loans from local financial institutions	9	3,581,350	1,680,000
Loans from foreign financial institutions	10	5,108,025	1,197,200
Loans from government agencies	11	1,648,899	856,245
Taxation		30,903	45,709
Deferred grants	12	41,235	88,365
Other liabilities	13	632,078	803,862
<b>Total liabilities</b>		<b>26,738,919</b>	<b>14,683,553</b>
<b>Shareholders' equity</b>			
Share capital	14	4,205,530	3,004,000
Other reserves		22,415	9,436
Retained earnings		631,907	106,413
<b>Total shareholders' equity</b>		<b>4,859,852</b>	<b>3,119,849</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>		<b>31,598,771</b>	<b>17,803,402</b>

Chuluun Ganhuuyag  
Executive Director



Dugersuren Bat-Ochir  
Finance and Accounting Division Director



The notes set out on pages 10 to 34 form an integral part of these financial statements

# XacBank LLC

Statement of income for the year ended 31 December 2004

	Note	2004 MNT'000	2003 MNT'000
Interest income	15	5,936,418	3,715,511
Interest expense	16	(1,974,577)	(1,168,688)
<b>Net interest income</b>		<b>3,961,841</b>	<b>2,546,823</b>
Net fees and commissions income	17	384,895	212,495
Net foreign exchange gains/(losses)		15,216	(451)
Other operating income	18	108,658	151,930
<b>Net non-interest income</b>		<b>508,769</b>	<b>363,974</b>
<b>Operating income</b>	19	<b>4,470,610</b>	<b>2,910,797</b>
General and administrative expenses	20	(2,985,140)	(2,284,411)
Impairment losses		(274,891)	(123,164)
Grant income		132,269	241,187
Other expenses		(132,269)	(241,187)
<b>Profit from operations</b>		<b>1,210,579</b>	<b>503,222</b>
Corporate income tax	22	(423,085)	(226,343)
<b>Net profit after tax</b>		<b>787,494</b>	<b>276,879</b>

Chuluun Ganhuyag  
Executive Director



Dugersuren Bat-Ochir  
Finance and Accounting Division Director



The notes set out on pages 10 to 34 form an integral part of these financial statements

# XacBank LLC

Statement of cash flows for the year ended 31 December 2004

			← Non-distributable	→ Distributable		
		Share capital	Share premium	Share reserves	Retained earnings/ (accumulated losses)	Total
	Note	MNT'000	MNT'000	MNT'000	MNT'000	MNT'000
Balance at 1 January 2003		3,004,000	-	9,436	(170,466)	2,842,970
Net profit for the year		-	-	-	276,879	276,879
Balance at 1 January 2004		3,004,000	-	9,436	106,413	3,119,849
Issue of share capital	14	940,000	8,551	-	-	948,551
Capitalisation of retained profits	21	261,530	-	-	(261,530)	-
Dividend paid	21	-	-	-	(470)	(470)
Increase during the year		-	-	4,428	-	4,428
Net profit for the year		-	-	-	787,494	787,494
Balance at 31 December 2004		4,205,530	8,551	13,864	631,907	4,859,852

Note 14

The notes set out on pages 10 to 34 form an integral part of these financial statements

	Note	2004 MNT'000	2003 MNT'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
<b>Profit before tax</b>		<b>1,210,579</b>	<b>503,222</b>
<i>Adjustments for</i>			
Depreciation		220,958	168,555
Gain on disposal of property, plant and equipment		(4,364)	(5,324)
<b>Operating profit before changes in operating assets and liabilities</b>		<b>1,427,173</b>	<b>666,453</b>
Increase in loans and advances		(9,204,550)	(5,439,278)
Decrease in amount due from the holding company		-	101,868
Increase in other assets		(772,999)	(204,012)
Increase in deposits from customers		5,684,257	3,832,159
(Decrease) / increase in other liabilities		(171,784)	637,072
Corporate income tax paid		(3,037,903)	(405,738)
		(437,891)	(136,577)
<b>Net cash flows used in operating activities</b>		<b>(3,475,794)</b>	<b>(542,315)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Net acquisition / (disposal) of investment securities			
- available for sale		981,623	(1,048,732)
Purchase of property and equipment		(1,311,278)	(457,317)
Proceeds from disposals of property, plant and equipment		41,962	21,247
<b>Net cash flows used in investing activities</b>		<b>(287,693)</b>	<b>(1,484,802)</b>

The notes set out on pages 10 to 34 form an integral part of these financial statements



	Note	2004 MNT'000	2003 MNT'000
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from the issue of shares		948,551	-
Increase in general reserves		4,428	-
Increase in loans from local financial institutions		1,901,350	1,000,000
Increase in loans from foreign financial institutions		3,910,825	44,075
Increase in loans from government agencies		792,654	611,245
Decrease in deferred grants		(47,130)	(4,824)
Dividends paid	i)	(470)	-
<b>Net cash flows generated from financing activities</b>		<b>7,510,208</b>	<b>1,650,496</b>
<b>Net cash flows generated from / (used in) the year</b>		<b>3,746,721</b>	<b>(376,621)</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>2,902,681</b>	<b>3,279,302</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>3</b>	<b>6,649,402</b>	<b>2,902,681</b>

**Note:**

i) During the year, the bank declared an interim dividend of MNT262,000,000 of which MNT261,530,000 was capitalised as share capital and the remaining MNT470,000 was paid in cash.

These notes form an integral part of and should be read in conjunction with the accompanying financial statements.

### 1. Corporate information and principal activities

X.A.C. Co., Ltd. commenced operations in 1999 as a non-bank financial institution. The company first started its operation by rendering five types of loan services. In October 2001, this company entered into a merger agreement with Goviin Ekhlel Co., Ltd., another non-bank financial institution, to form XAC-GE, a holding company, which owns a majority stake in XacBank LLC. The shareholders of the holding company are:

- 
- Mercy Corps
- Open Society Forum
- Mongolian Women's Federation
- Liberal Women's Intellectual Pool
- National Association of Mongolian Agricultural Cooperatives
- Rotary Club of Ulaanbaatar
- Local Governance Development Foundation
- Tuushin LLC
- Monnis

The principal activities of XacBank LLC ("the Bank"), which is incorporated as a commercial bank under the Mongolian Banking Law, are to provide a wide range of banking products and services, including deposit taking, lending, international and domestic payment services, foreign exchange dealing, securities trading, financial and investment consulting, under Banking Licence No. 24 issued by the Bank of Mongolia on 27 December 2001 (referred to as "the Banking Licence").

The Bank has been and continues to be predominantly involved in providing micro financing to the general public to develop retail and small and medium enterprises.

As at 31 December 2004 the Company had 506 employees (2003: 413 employees).

The financial statements were authorised for issue by the Board of Directors on 31 March 2005.

### 2. Summary of significant accounting policies

The following significant accounting policies have been adopted by the Bank in the preparation of these financial statements.

#### (a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued and adopted by the International Accounting Standards Board ("IASB"), and interpretations issued by the Standing Interpretations Committee of the IASB except as follows:

As required by the Bank of Mongolia's 'Regulations On Asset Classification And Provisioning' ("BoM's regulations"), the Bank had maintained a 1% general provision for all its performing loans, movement of which are charged to the Income Statement, amounting to approximately MNT201 million (2003: MNT108 million) as at 31 December 2004. This however represents a non-compliance with the following International Financial Reporting Standards:

- a) International Accounting Standard 39 - Financial Instruments: Recognition and Measurement ("IAS 39") which does not allow for the recognition of an impairment loss through an establishment of an allowance for future losses charged to the Income Statement; and
- b) International Accounting Standard 30 - Disclosures in the Financial Statements of Banks and Similar Financial Institutions ("IAS 30") which requires any general provision to be treated as an appropriation of retained earnings.

Had the Bank complied with the above and not maintained the general provision, its profit from operations would increase by MNT93 million (2003: MNT53 million) to MNT1,303 million (2003: MNT556 million).

**(b) Basis of financial statement preparation**

The financial statements are presented in Mongolian Tugrug ("MNT"), rounded to the nearest thousand. MNT is the Bank's measurement currency. The financial statements are prepared on the historical cost basis, except for the following financial assets and liabilities which are stated at fair value: investments held for trading and investments available-for-sale. The accounting policies have been consistently applied by the Bank and are consistent with those used in the previous year.

**(c) Foreign currency transactions**

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated at the foreign exchange rate ruling at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at fair value, are translated into MNT at foreign exchange rates ruling at the dates that the values were determined.

**(d) Financial instruments****(i) Classification**

Trading instruments are those that the Bank principally holds for the purposes of short-term trading and liquidity management.

Originated loans and receivables are loans and receivables created by the Bank providing money to a debtor other than those created with the intention of short-term trading. Originated loans and receivables comprise loans and advances to banks and customers.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the intent and ability to hold to maturity.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity.

**(ii) Initial recognition**

Financial instruments are measured initially at cost, including transaction costs, when purchased or originated by the Bank.

**(iii) Subsequent measurement**

Subsequent to initial recognition, all trading instruments and all available-for-sale assets are measured at fair market value, except that any instrument that does not have a quoted market price in an active market and whose fair market value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities, originated loans and receivables and held-to-maturity assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

**(e) Cash and cash equivalents**

Cash and cash equivalents for cash flow purpose comprises cash on hand, balances with other banks and balances with the Bank of Mongolia.

**(f) Loans and advances**

Loans and advances originated by the Bank are classified as originated loans and receivables. Loans and advances are reported net of allowances to reflect the estimated recoverable amounts (refer to accounting policy (i)).

**(g) Property, plant and equipment****(i) Cost**

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. The initial cost of an item of property, plant and equipment comprises its purchase price, including import duties, non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after property, plant and equipment have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the year in which the costs are incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditure is capitalised as an additional cost of property, plant and equipment.

**(ii) Depreciation**

Depreciation is charged to the statement of income on a straight-line basis over the estimated useful lives of property, plant and equipment. The estimated useful lives are as follows:

- buildings 40 years
- motor vehicles 10 years
- office equipment 10 years
- computers 5 years

**(h) Construction in progress**

Construction in progress represents the cost of construction of new buildings and premises, which have not been fully completed or installed. No depreciation is provided for construction in progress during the period of construction.

**(i) Impairment**

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If such an indication exists, the asset's recoverable amount is estimated.

**(i) Originated loans and advances**

Loans and advances are presented net of specific and general allowances for uncollectability. Specific allowances are made against the carrying amount of loans and advances that are identified as being potentially impaired, based on regular reviews of outstanding balances, to reduce these loans and advances to their recoverable amount. General allowances are maintained to reduce the carrying amount of portfolios of similar loans and advances to their estimated recoverable amounts at the balance sheet date. Increases in the allowance account are recognised in the statement of income. When a loan is known to be uncollectible, all the necessary legal procedures have been completed and the final loss has been determined, the loan is written off directly.

If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write down, the write-down or allowance is reversed through the statement of income.

**(ii) Assets other than loans and advances**

The recoverable amount is the greater of the asset's net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the statement of income.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. All reversals of impairment are recognised in the statement of income.

**(j) Non-trading financial liabilities**

Non-trading financial liabilities include deposits from customers and from other financial institutions, interest-bearing borrowings and other amounts payable. Non-trading financial liabilities are initially stated at cost. Subsequent to the initial recognition, they are stated at amortised cost with any difference between cost and redemption value being recognised in the statement of income over the period of the instrument on an effective interest basis.

**(k) Grants**

Grants are recognised initially in the balance sheet as deferred grants when there is reasonable assurance that they will be receivable and that the Bank will comply with the conditions attaching to them. Grants that compensate the Bank for expenses incurred are recognised as revenue in the statement of income on a systematic basis in the same period in which the expenses are incurred. Grants that compensate the Bank for the cost of an asset are recognised in the statement of income on a systematic basis over the useful life of the asset.

**(l) Provisions**

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risk specific to the liability.

**(m) Revenue****(i) Interest income**

Interest income and expense is recognised in the statement of income as it accrues, taking into account the effective yield of the asset. Interest income and expense include the amortisation of any discount or premium or other differences between the carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis. The recognition of interest income is suspended when the recoverability of principal or interest becomes doubtful. In accordance with the requirement of the Bank of Mongolia, interest is suspended when payment are in arrears for three months (non performing loans). On the commencement of the suspension, related interest receivable is written off. Subsequent to the suspension, interest income is recognised on a cash basis. Interest income recognition will resume on an accrual basis when the uncertainties surrounding the recoverability are removed.

**(ii) Fee income and commission**

Fee and commission income is charged to customers for the financial services provided. Fee and commission income is recognised when the corresponding service is provided.

**(iii) Rental income**

Rental income from leased property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

**(n) Operating lease payments**

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

**(o) Income tax**

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the statement of income except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using the tax rates approved at balance sheet date and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not provided for temporary differences arising on the initial recognition of assets or liabilities that affect neither accounting nor taxable profit. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using the tax rates approved at balance sheet date. Deferred tax assets are recognised in the financial statements only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

**(p) Employee benefits**

***(i) Defined contribution plan***

Employee benefits include statutory social insurance payments to the State Social Insurance Scheme. Contributions to this defined contribution plan are recognised as an expense in the statement of income as incurred.

***(ii) Equity compensation benefits***

The Employee Stock Ownership Plan allows the Bank's staff to acquire shares of the Bank from XAC-GE. No compensation cost or obligation is recognised when options are granted. When shares are purchased, the holding company records the proceeds and share discount in respect of the options exercised and shares will be transferred from the holding company to the employees. No change is made to the Bank's total share capital and no compensation cost is recognised by the Bank.

**3. Cash and cash equivalents**

	2004 MNT'000	2003 MNT'000
Cash on hand	1,052,516	637,419
Balances with other banks	4,204,447	1,143,765
Balances with the Bank of Mongolia	1,392,439	1,121,497
<b>Total cash and cash equivalents</b>	<b>6,649,402</b>	<b>2,902,681</b>

Balances are maintained with the Bank of Mongolia in accordance with the Bank of Mongolia's requirements and bear no interest. Balances are determined based on average deposits and liabilities balances.

**4. Investment securities – available for sale**

	2004 MNT'000	2003 MNT'000
Bank of Mongolia bills	366,714	1,946,792
Other debt securities	604,500	-
	971,214	1,946,792
<b>Impairment losses</b>	<b>(6,045)</b>	<b>-</b>
	965,169	1,946,792

**5. Loans and advances**

	2004 MNT'000	2003 MNT'000
Loans and advances to customers	19,819,550	10,753,582
Loans to staff	463,307	203,732
Loans to executive officers	30,700	54,901
	20,313,557	11,012,215
Allowance for loan impairment	(268,561)	(171,769)
<b>Net loans and advances</b>	<b>20,044,996</b>	<b>10,840,446</b>

Included in the gross balance of loans and advances is an amount of non-performing loans of MNT210 million (2003: MNT247 million).

### 5. Loans and advances (continued)

Movements in the allowance for loan losses during the year are as follows:

	Specific allowances MNT'000	General allowances MNT'000	Total MNT'000
<b>Allowance for loan losses</b>			
At 1 January 2003	15,199	54,600	69,799
Charge for the year	62,026	53,053	115,079
Written off	(13,109)		(13,109)
 At 31 December 2003	 64,116	 107,653	 171,769
 Charge for the year	 172,729	 93,385	 266,114
Written back	(2,188)	-	(2,188)
Written off	(167,134)	-	(167,134)
 At 31 December 2004	 67,523	 201,038	 268,561

Loans and advances can be analysed by industry as follows:

	2004 MNT'000	2003 MNT'000
Textile and production	1,722,440	771,066
Trading	9,726,531	5,188,031
Food processing	531,917	314,608
Services	1,554,131	717,099
Consumption	5,239,542	2,298,856
Others	1,044,989	1,463,922
Loans to staff	463,307	203,732
Loans to executive officers	30,700	54,901
	<b>20,313,557</b>	<b>11,012,215</b>

Others include borrowers in construction, mining and education.



## 6. Property, plant and equipment

	Buildings MNT'000	Motor vehicles MNT'000	Office equipment MNT'000	Computers MNT'000	Construction in progress MNT'000	Total MNT'000
<b>Cost</b>						
At 1 January 2004	451,459	348,355	260,151	644,785	36,000	1,740,750
Additions	514,852	252,206	130,519	179,881	233,820	1,311,278
Disposals	(22,704)	(21,257)	(2,961)	(1,049)	-	(47,971)
Transfer	-	-	(2,196)	-	-	(2,196)
At 31 December 2004	943,607	579,304	385,513	823,617	269,820	3,001,861
<b>Accumulated depreciation</b>						
At 1 January 2004						
Charge for the year	23,317	55,407	73,057	202,670	-	354,451
Disposals	15,695	41,782	3,859	159,622	-	220,958
Transfer	(2,223)	(7,393)	(490)	(267)	-	(10,373)
	-	-	(682)	-	-	(682)
At 31 December 2004	36,789	89,796	75,744	362,025	-	564,354
<b>Net book value</b>						
At 31 December 2004	906,818	489,508	309,769	461,592	269,820	2,437,507
At 31 December 2003	428,142	292,948	187,094	442,115	36,000	1,386,299
Depreciation charge for year ended 31 December 2003	11,472	27,280	43,960	85,843	-	168,555

During the year, certain office equipment were transferred to other assets.

**7. Other assets**

	2004 MNT'000	2003 MNT'000
Foreclosed properties	-	32,698
Prepaid expenses	637,131	284,717
Supplies and low value assets	253,444	156,171
Accrued interest receivable	391,544	206,722
Other receivables	219,578	46,876
	1,501,697	727,184

Foreclosed properties and other receivables are presented net of impairment loss amounting to MNT1,500,000 and MNT4,738,000 respectively (2003: MNT330,000 and MNT1,227,000)

During the year, foreclosed properties and other receivables amounting to MNT98,000 and MNT141,000 respectively are written off against the impairment losses.

**8. Deposits from customers**

	2004 MNT'000	2003 MNT'000
Current accounts	1,364,484	880,022
Demand deposits	3,398,260	1,816,232
Time deposits	10,933,685	7,315,918
	15,696,429	10,012,172

Current accounts bear interest at a rate of 3.6% (2003: 3.6%) per annum applicable to individual balances more than MNT5 million. Demand deposits bear interest at a rate of approximately 6% (2003: 8.60%) per annum. Time deposits bear interest at rates ranging from 4.2% to 18% (2003: 3.60% to 18.00%) per annum.

**9. Loans from local financial institutions**

	2004 MNT'000	2003 MNT'000
Loan from Anod Bank	-	280,000
Loan from MongolPost Bank	1,600,000	400,000
Loan from Golomt Bank	1,800,000	1,000,000
Loan from UB City Bank	181,350	-
	3,581,350	1,680,000

The loans bear interest at rates ranging from 7% to 16% per annum and are repayable in 2005.

**10. Loans from foreign financial institutions**

	2004	2003
	MNT'000	MNT'000
Loan from Deutsche Bank Micro Credit Development Fund ("DBMCDF")	151,125	146,000
Loan from International Finance Corporation ("IFC")	483,600	467,200
Loan from Dexia Micro Credit Fund ("DMCF")	604,500	584,000
Loan from Credit Suisse Microfinance Fund ("CSMF")	604,500	-
Loan from Calvert Social Investment Foundation ("CSIF")	241,800	-
Loan from Microvest 1, LP	1,813,500	-
Loan from ASN-Novib Fonds	1,209,000	-
	5,108,025	1,197,200

The loan from the DBMCDF is in the form of subordinated debt issued by the Bank for a principal amount of USD125,000. The loan bears interest at a rate of 2% (2003: 2%) per annum and is repayable in August 2007.

The loan from IFC, amounting to USD400,000, bears interest at rate of LIBOR+3.5% (2003: LIBOR+3.5%). The loan is repayable in twelve semi-annual instalments commencing 15 January 2005.

The loan from DMCF is in the form of a promissory note issued by the Bank for a principal amount of USD500,000. The note bears interest at a rate of LIBOR+6% (2003: LIBOR+6%) per annum. The loan is repayable in four equal two-monthly instalments of USD125,000 each, commencing in February 2006.

The loan from CSMF is in the form of a promissory note issued by the Bank for a principal amount of USD500,000. The note bears interest at a rate of LIBOR+6% per annum. The loan is repayable in four equal two-monthly instalments of USD125,000 each, commencing in June 2005.

The loan from CSIF is in the form of a promissory note issued by the Bank for a principal amount of USD200,000. The note bears interest at a rate of 6% per annum and is repayable in January 2007.

The loan from Microvest, amounting to USD1,500,000, bears interest at a rate of LIBOR+5.21%. The loan is repayable in three equal instalments commencing March 2006.

The loan from ASN-Novib Fonds, amounting to USD1,000,000, bears interest at a rate of 9% per annum. The loan is repayable in three instalments commencing in May 2006.

These loans are to support further expansion of the Bank's micro-finance and small-medium enterprise lending activities and to strengthen the Bank's technical capability.

**11. Loans from government agencies**

	2004 MNT'000	2003 MNT'000
Loan from Employment Generation Support Fund	500,000	445,000
Loan from Asian Development Bank (ADB)	493,169	260,956
Loan from United Nations Development Funds (UNDP)	150,289	150,289
Loan from Micro Finance Development Fund	237,711	-
Loan from International Foundation for Agricultural Development	267,730	-
	<b>1,648,899</b>	<b>856,245</b>

The objective of the loan from Employment Generation Support Fund is to channel funds to small business entities and individuals. The loan, which is in Mongolian Tugrug, bear interest at a rate of 6% (2003: 6%) per annum and is repayable on 23 May 2005.

The ADB loan was channelled through the Bank of Mongolia. The objective of the loan is to develop Mongolia's agricultural sector. The loan, which is in Mongolian Tugrug, bears interest of 5.5% (2003: 5.5%) per annum and is repayable from 19 May 2004.

The UNDP loan was channelled through the Bank of Mongolia. The objective of the loan is to develop Mongolia's credit and saving cooperatives. The loan, which is in Mongolian Tugrug, bears interest of 6% (2003: 6%) per annum and is repayable from 15 January 2006.

The objective of the loan from Micro Finance Development Fund is to support and improve the living standard in the rural areas. The loan, which is in Mongolian Tugrug, bears interest at a rate of 5% per annum and is repayable from September 2005 to June 2006.

The objective of the loan from International Foundation for Agricultural Development is to support and reduce the poverty in the rural areas. The loan, which amounted to USD1,823,380, is disbursed from March 2004 to June 2009. It bears interest at a rate of LIBOR + 3.5% per annum and is repayable in 10 equal semi-annual instalments commencing from January 2013.

**12. Deferred grants**

	2004 MNT'000	2003 MNT'000
Grant from Consultative Group to Assist the Poorest ("CGAP")	30,732	46,557
Grant from International Finance Corporation ("IFC")	7,584	38,872
Others	2,919	2,936
	<b>41,235</b>	<b>88,365</b>

The CGAP grant was approved in 2001 with the objective of assisting the X.A.C. Co., Ltd in making a successful transition to a micro-finance bank. The grant allows the Bank to carry out the following activities:

- Develop internal systems that meet the requirements and needs of a micro-finance bank;
- Secure higher standard of external audit services; and
- Strengthen senior management and governance, in particular, financial management and banking skills.

The IFC grant was received during 2002 with the objective of providing funds for technical assistance in the following initiatives: technical advice, training for senior managers with an established micro-finance institution and participation by an international participant in the meetings of the Bank's Board of Directors and training for the Bank's Board members.

**13. Other liabilities**

	2004	2003
	MNT'000	MNT'000
Interest payable	353,232	299,941
Remittances payable	16,006	248,492
Other payables	262,840	255,429
	632,078	803,862

**14. Share capital**

<i>In number of shares</i>	2004	2003
In issue at 1 January	3,004,000	300,400
Issued for cash	940,000	-
Capitalisation of retained profits	261,530	-
	4,205,530	300,400

During the year, the Bank's shares were split at a ratio of 1 common share of MNT10,000 each to 10 common shares of MNT1,000 each. The authorised share capital of the Bank had also increased from MNT4,000 million to MNT6,000 million, which consists of 6,000,000 common shares of MNT1,000 per share.

The Bank increased its share capital during the year as follows:

- (a) The issue of 940,000 common shares of MNT1,000 each for a total consideration of MNT948,551,000.
- (b) The issue of 261,530 common shares of MNT 1,000 each by the capitalisation of retained profits of MNT261,530,000.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

As at 31 December 2004, 94% (2003: 96%) of the issued shares are owned by XAC-GE, the holding company, and 6% (2003: 4%) are owned by other shareholders.

**15. Interest income**

	2004 MNT'000	2003 MNT'000
Loans and advances	5,746,713	3,573,322
Balances with other banks	93,212	98,258
Investment securities	96,493	43,931
	<b>5,936,418</b>	<b>3,715,511</b>

**16. Interest expense**

	2004 MNT'000	2003 MNT'000
Deposits from customers	1,456,743	973,179
Loans	517,834	195,509
	<b>1,974,577</b>	<b>1,168,688</b>

**17. Net fees and commissions income**

	2004 MNT'000	2003 MNT'000
Fees and commissions income	400,065	218,398
Fees and commissions expenses	(15,170)	(5,903)
	<b>384,895</b>	<b>212,495</b>

Net fees and commissions income includes loan application fees, payment service fees, loan commissions and money transfer service fees

**18. Other operating income**

	2004 MNT'000	2003 MNT'000
Rental income	74,527	117,670
Other income	34,131	34,260
	<b>108,658</b>	<b>151,930</b>

Included in other income are gains from disposal of property and equipment, penalty income, etc.

**19. General and administrative expenses**

	2004	2003
	MNT'000	MNT'000
Salaries, provision for staff welfare and bonus	1,210,368	922,244
Depreciation on property, plant and equipment	220,958	168,555
Travel	164,431	83,571
Rental	350,040	329,255
Representation	67,187	39,040
Fuel and maintenance of vehicles	121,740	77,367
Communication	134,274	111,341
Advertising	96,364	68,389
Maintenance of property, plant and equipment	11,748	12,797
Office supplies	114,297	96,744
Social insurance	231,390	177,003
Other	262,343	198,105
	2,985,140	2,284,411

**20. Impairment losses**

	2004	2003
	MNT'000	MNT'000
Loans and advances (allowance for loan losses)	263,926	115,079
Other assets	4,920	8,085
Investment securities	6,045	-
	274,891	123,164

**21. Dividend**

	2004	2003
	MNT'000	MNT'000
Ordinary:		
Interim paid	262,000	228,403

During the year, an interim dividend amounting to MNT262,000,000 was declared of which MNT261,530,000 was capitalised as share capital and the remaining MNT470,000 was paid in cash.

A final dividend of MNT127,000,000 has been proposed subsequent to the year end and has not been accounted for in the financial statements.

**22. Corporate income tax**

Recognised in the statement of income:	2004	2003
	MNT'000	MNT'000
<b>Current tax expense</b>		
Current year	423,085	228,403
Over provided in prior years	-	(2,060)
Income tax expense in the statement of income	423,085	226,343
<b>Reconciliation of effective tax rate</b>		
	2004	2003
	MNT'000	MNT'000
Profit before tax	1,210,579	503,222
Tax at income tax rate of 15%	181,587	75,483
Tax effect of non-deductible expenses	48,278	16,835
Tax effect of tax exempt revenues	-	(576)
Under/(over) provided in prior years	-	(2,060)
Tax effect of progressive tax rate of 30% (2003: 40%) on the portion of taxable income exceeding MNT100 million	193,220	136,661
Income tax expense	423,085	226,343

The calculation of income tax is subject to the review and approval of the tax authorities.

According to Mongolian Tax Laws, the Company has an obligation to pay the Government Income Tax at the rate of 15% (2003: 15%) of the portion of taxable profits up to MNT100 million and 30% (2003: 40%) of the portion of taxable profits above MNT100 million.



## 23. Employee benefits

### Equity compensation benefits

Under the Bank's Employee Stock Ownership Plan, shares are allocated to employees on the following conditions:

- Employment duration with the Bank and its predecessor companies must be at least one year;
- Performance rating in the most recent evaluation period; and
- No disciplinary action is pending or due.

The number of shares offered for sale and its price will be determined at the discretion of the Bank's Board. For 2004, the shares were offered at a price of 30% of the par value. The Plan enables employees to purchase shares in XacBank LLC already held by XAC-GE. The share capital of XacBank LLC is not affected by these transactions.

The shares are purchased within the financial year in which they are offered.

	Movement of shares offered under the Plan (expressed in number of shares)	
	2004	2003
Share offer vested during the year	166,100	10,160
Shares offered outstanding at 1 January	-	-
Shares offered during the year	166,100	10,160
Shares offered and purchased during the year	(67,729)	(8,030)
Shares offered and expired during the year	(98,371)	(2,130)
Shares offered outstanding at 31 December	-	-

The Bank does not bear or incur any cost in connection with these transactions.

## 24. Significant transactions with related parties

The Bank has a controlling related party relationship with XAC-GE, the holding company. The Bank also has a related party relationship with the shareholders of XAC-GE (see note 1), and with its directors and executive officers.

As at 31 December 2004, executive officers held 10,298 (2003: 3,200) voting shares of the Bank.

During the year the Bank had the following transactions with related parties:

	2004	2003
	MNT'000	MNT'000
Loans to executive officers	30,700	54,901

Total remuneration of directors and executive officers included in general and administrative expenses:

	2004	2003
	MNT'000	MNT'000
Directors	52,832	3,050
Executive officers	76,542	80,264
	129,374	83,314

## 25. Capital adequacy

The Bank of Mongolia requires banks to maintain a minimum capital adequacy ratio of 10%, compiled on the basis of total equity and total assets as adjusted for their risk. As at 31 December 2004, the Bank's core capital ratio and risk weighted capital ratio are 19% (2003: 24%) and 19% (2003: 24%) respectively.

Components of Tier I and Tier II capital:

	2004 MNT'000	2003 MNT'000
<b>Tier I capital</b>		
Share capital	4,205,530	3,004,000
Share premium	8,551	-
General reserve	13,864	9,436
Retained earnings	631,907	106,413
<b>Total capital</b>	<b>4,859,852</b>	<b>3,119,849</b>
<b>Tier II capital</b>	<b>-</b>	<b>-</b>
<b>Total Tier I and Tier II capital</b>	<b>4,859,852</b>	<b>3,119,849</b>

Breakdown of risk weighted assets as follows:

	2004 MNT'000	2003 MNT'000
<b>Risk weighted factor (%)</b>		
0	2,813,955	3,705,708
10	-	-
20	4,204,447	1,143,765
50	-	-
100	25,116,231	12,953,929
<b>Total</b>	<b>31,604,816</b>	<b>17,803,402</b>

## 26. Risk management disclosure

This section provides details of the Bank's exposure to risk and describes the methods used by management to control risk. Because of the Bank's activities, which are predominantly non-trading, assets structure consists mainly of loans and advances, and their financing, which is mainly from deposits from customers. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk, interest rate risk and, to a less extent, foreign currency risk.

Below is a discussion of these risks and the approach taken to manage them:

### *(i) Credit risk*

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit risk exposure in this regard is represented by the carrying amounts of the assets on the balance sheet.

The Bank structures the level of credit risk it undertakes by placing limits on the amount of risk acceptable to one individual borrower or a group of borrowers and to an industry sector. Exposure to credit risk is managed through regular analysis of the ability of the borrowers and potential borrowers to meet interest and capital repayment obligations. Credit limit is changed when needed. Exposure to credit risk is also managed by obtaining collateral and corporate and personal guarantees.

The major concentration of credit risk arises by industry sector in relation to the Bank's loans and advances to customers. See note 5 for analysis of total loans and advances to customers by industry sector. The Bank has no significant exposure to any individual borrower.

### *(ii) Liquidity risk*

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. It includes both risk of being unable to fund assets at appropriate maturities and rates and risk of being unable to liquidate an asset at a reasonable price in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised using a broad range of instruments including deposits, interest-bearing borrowings from local and overseas financial institutions and share capital. This enhances funding flexibility and limits dependence on any source of funds or any fund provider. The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required to meet business goals and targets set in terms of the overall strategy.

In addition, the Bank holds a portfolio of liquid assets as part of its liquidity risk management policy.

## 26. Risk management disclosure (continued)

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings based on the remaining periods to repayment:

As at 31 December 2004

	Less than three months MNT'000	Three to six months MNT'000	Six months to one year MNT'000	One to five years MNT'000	Over five years MNT'000	Total MNT'000
<b>Financial assets</b>						
Cash on hand	1,052,516	-	-	-	-	1,052,516
Balances with other banks	2,995,447	-	1,209,000	-	-	4,204,447
Balances with the Bank of Mongolia	1,392,439	-	-	-	-	1,392,439
Investment securities	366,714	-	598,455	-	-	965,169
Loans and advances	8,423,303	6,284,705	4,332,179	1,004,809	-	20,044,996
Other assets	1,050,109	432,979	16,628	1,981	-	1,501,697
	15,280,528	6,717,684	6,156,262	1,006,790	-	29,161,264
<b>Financial liabilities</b>						
Deposits from customers	7,993,024	1,613,958	2,851,687	1,051,469	2,186,291	15,696,429
Loans from local financial institutions	981,350	800,000	1,800,000	-	-	3,581,350
Loans from foreign financial institutions	779,805	1,233,180	1,662,375	1,432,665	-	5,108,025
Loans from government agencies	153,825	627,493	406,170	193,681	267,730	1,648,899
Other liabilities	332,301	66,303	233,474	-	-	632,078
	10,240,305	4,340,934	6,953,706	2,677,815	2,454,021	26,666,781
Net financial assets/(liabilities)	5,040,223	2,376,750	(797,444)	(1,671,025)	(2,454,021)	2,494,483
Cumulative total	5,040,223	7,416,973	6,619,529	4,948,504	2,494,483	

## 26. Risk management disclosure (continued)

As at 31 December 2003

	Less than three months MNT'000	Three to six months MNT'000	Six months to one year MNT'000	One to five years MNT'000	Over five years MNT'000	Total MNT'000
<b>Financial assets</b>						
Cash on hand	637,419	-	-	-	-	637,419
Balances with other banks	63,365	350,400	-	730,000	-	1,143,765
Balances with the Bank of Mongolia	1,121,497	-	-	-	-	1,121,497
Investment securities	1,946,792	-	-	-	-	1,946,792
Loans and advances	1,314,462	2,726,718	5,911,499	887,767	-	10,840,446
Other assets	470,782	-	83,900	172,502	-	727,184
	5,554,317	3,077,118	5,995,399	1,790,269	-	16,417,103
<b>Financial liabilities</b>						
Deposits from customers	2,713,309	1,661,750	4,156,326	421,240	1,059,547	10,012,172
Loans from local financial institutions	-	400,000	280,000	1,000,000	-	1,680,000
Loans from foreign financial institutions	-	-	-	1,010,320	186,880	1,197,200
Loan from government agencies	-	452,500	215,320	188,425	-	856,245
Other liabilities	642,955	-	61,859	99,048	-	803,862
	3,356,264	2,514,250	4,713,505	2,719,033	1,246,427	14,549,479
Net financial assets/(liabilities)	2,198,053	562,868	1,281,894	(928,764)	(1,246,427)	1,867,624
Cumulative total	2,198,053	2,760,921	4,042,815	3,114,051	1,867,624	

## 26. Risk management disclosure (continued)

### *(iii) Interest rate risk*

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or re-price at different times or in different amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in re-pricing characteristics of the various floating rate indices, such as six months LIBOR and different types of interest. Risk management activities are aimed at optimising net interest income, given market interest rate levels consistent with the Bank's business strategies.

Assets-liabilities risk management activities are conducted in the context of the Bank's sensitivity to interest rate changes. Interest rate risk is managed by increasing or decreasing positions within limits set by the Bank's management. These limits restrict the potential effect of movement in interest rates on interest margin and on the value of interest sensitive assets and liabilities.

The table below summarises re-pricing mismatches on the Bank's financial assets and liabilities at the balance sheet date. The carrying amounts of interest rate sensitive assets and liabilities are presented in the periods in which they next re-price to market rate or mature, and are summed to show the interest rate sensitivity gap.

## 26. Risk management disclosure (continued)

As at 31 December 2004

	Effective interest rate %	Total MNT'000	Non-interest sensitive MNT'000	Less than three months MNT'000	Three to six months MNT'000	Six months to one year MNT'000	One to five years MNT'000	Over five years MNT'000
<b>Financial assets</b>								
Cash on hand	-	1,052,516	1,052,516	-	-	-	-	-
Balances with other banks	6.63%	4,204,447	93,847	2,901,600	-	1,209,000	-	-
Balances with the Bank of Mongolia	-	1,392,439	1,392,439	-	-	-	-	-
Investment securities	12.66%	965,169	-	366,714	-	598,455	-	-
Loans and advances	35.79%	20,044,996	-	8,423,303	6,284,705	4,332,179	1,004,809	-
Other assets	-	1,501,697	1,501,697	-	-	-	-	-
		29,161,264	4,040,499	11,691,617	6,284,705	6,139,634	1,004,809	-
<b>Financial liabilities</b>								
Deposits from customers	12.00%	15,696,429	-	7,993,024	4,851,718	2,851,687	-	-
Loans from local financial institutions	14.82%	3,581,350	-	981,350	800,000	1,800,000	-	-
Loans from foreign financial institutions	8.06%	5,108,025	-	3,506,100	-	-	1,601,925	-
Loans from government agencies	6.30%	1,648,899	-	153,825	627,493	406,170	193,681	267,730
Other liabilities	-	632,078	632,078	-	-	-	-	-
		26,666,781	632,078	12,634,299	6,279,211	5,057,857	1,795,606	(267,730)
Net financial assets/(liabilities)		2,494,483	3,408,421	(942,682)	5,494	1,081,777	(790,797)	(267,730)

## 26. Risk management disclosure (continued)

As at 31 December 2003

	Effective interest rate %	Total MNT'000	Non-interest sensitive MNT'000	Less than three months MNT'000	Three to six months MNT'000	Six months to one year MNT'000	One to five years MNT'000	Over five years MNT'000
<b>Financial assets</b>								
Cash on hand	-	637,419	637,419	-	-	-	-	-
Balances with other banks	5.36%	1,143,765	63,365	-	350,400	-	730,000	-
Balances with the Bank of Mongolia	-	1,121,497	1,121,497	-	-	-	-	-
Investment securities	8.46%	1,946,792	-	1,946,792	-	-	-	-
Loans and advances	39.02%	10,840,446	-	1,314,462	2,726,718	5,911,499	887,767	-
Other assets	-	727,184	727,184	-	-	-	-	-
		16,417,103	2,549,465	3,261,254	3,077,118	5,911,499	1,617,767	-
<b>Financial liabilities</b>								
Deposits from customers	10.8%	10,012,172	-	2,713,309	1,661,750	5,637,113	-	-
Loans from local financial institutions	14.02%	1,680,000	-	-	400,000	280,000	1,000,000	-
Loans from foreign financial institutions	5.41%	1,197,200	-	1,051,200	-	-	146,000	-
Loans from government agencies	5.85%	856,245	-	-	452,500	215,320	188,425	-
Other liabilities	-	803,862	803,862	-	-	-	-	-
		14,549,479	803,862	3,764,509	2,514,250	6,132,433	1,334,425	-
Net financial assets/(liabilities)		1,867,624	1,745,603	(503,255)	562,868	(220,934)	283,342	-



### (iv) Foreign currency risk

The Bank is exposed to foreign currency risk through transactions in foreign currencies, primarily in USD. The Bank's management sets limits on the level of exposure by currencies. These limits have been set below the minimum requirements of the Bank of Mongolia.

The Bank's transactional exposures comprise the monetary assets and monetary liabilities that are not denominated in the measurement currency. These exposures are as follows:

	31 December 2004			31 December 2003		
	MNT denominated MNT'000	Foreign currencies MNT'000	Total MNT'000	MNT denominated MNT'000	Foreign currencies MNT'000	Total MNT'000
<b>Financial assets</b>						
Cash on hand	824,686	227,830	1,052,516	517,222	120,197	637,419
Balances with other banks	38,125	4,166,322	4,204,447	36,052	1,107,713	1,143,765
Balances with the Bank of Mongolia	1,250,932	141,507	1,392,439	700,923	420,574	1,121,497
Investment securities	366,714	598,455	965,169	1,946,792	-	1,946,792
Loans and advances	18,480,739	1,564,257	20,044,996	10,321,670	518,776	10,840,446
Other assets	1,077,184	424,513	1,501,697	445,305	281,879	727,184
	22,038,380	7,122,884	29,161,264	13,967,964	2,449,139	16,417,103
<b>Financial liabilities</b>						
Deposits from customers	13,515,959	2,180,470	15,696,429	9,382,519	629,653	10,012,172
Loans from local financial institutions	3,581,350	-	3,581,350	1,680,000	-	1,680,000
Loans from foreign financial institutions	-	5,108,025	5,108,025	-	1,197,200	1,197,200
Loan from government agencies	1,381,169	267,730	1,648,899	856,245	-	856,245
Other liabilities	399,007	233,071	632,078	353,791	450,071	803,862
	18,877,485	7,789,296	26,666,781	12,272,555	2,276,924	14,549,479
Net financial assets/(liabilities)	3,160,895	(666,412)	2,494,483	1,695,409	172,215	1,867,624

## 27. Fair value information

As there is no active market for a large part of the Bank's financial instruments, judgement is necessary in estimating fair value, based on current economic conditions and specific risk attributable to the instrument. Based on these estimates, fair value of financial assets and liabilities are considered to not differ significantly from their carrying amount. The following methods and assumptions are used in estimating the fair value of financial instruments:

### (i) Loans and advances

The fair value of the loan portfolio is based on the credit and interest rate characteristics of each individual loan. The estimation of the provision for loan losses includes consideration of risk premium applicable to various types of loans based on factors such as the current situation of the borrower and collateral obtained. Accordingly, the provision for loan losses is considered a reasonable estimate of the discount required to reflect the impact of the credit risk. The carrying amount of loans is a reasonable estimate of their fair value.

### (ii) Deposits from customers

For demand deposits and deposits with no defined maturity, fair value is taken to be the amount payable on demand at the balance sheet date. The estimated fair value of fixed-maturity deposits is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. As most of the deposits have original maturity of less than one year and the rates offered by the Bank are similar to the market rate, the carrying amount of deposits is considered to be a reasonable estimate of fair value.

### (iii) Other financial assets and financial liabilities

The majority of other financial assets and financial liabilities of the Bank matures or re-prices in less than one year. Accordingly, their fair values do not significantly differ from their respective carrying amounts.

## 28. Commitments

	2004	2003
	MNT'000	MNT'000
Property, plant and equipment		
Contracted but not provided for in the financial statements	2,418,000	-