JSC Terabank

Consolidated

Management Report

2020

Contents

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Report in accordance with the requirements of Article 7, paragraph 10 of the Georgian Law on Accounting, Reporting and Auditing

To the Shareholders and Board of Directors of JSC Terabank

We expressed an unmodified audit opinion on the audited financial statements in our report dated 11 May 2021. The audited financial statements do not reflect the effects of events that occurred subsequent to the date our report on the audited financial statements. The effect of events described in the Annual report that occurred after the date of our auditor's report on the audited financial statements were not audited by us.

In our opinion, based on the work undertaken in the course of the audit:

- The information given in the Management report for the financial year for which the financial statements are prepared is consistent with the Consolidated financial statements; and
- The Management report includes the information required by the Article 7 of the Georgian Law on Accounting, Reporting and Auditing and complies with respective regulatory normative acts.

Ruslan Khoroshvili,

On behalf of EY LLC

Tbilisi, Georgia

14 September 2021

1. Business Entity

Terabank (the "Bank") was established in Georgia as a joint stock company on 30 December 2007 under the legal name of JSC Kor Bank. On 23 May 2016 the Bank changed its legal name to JSC Terabank.

Terabank plays an important role in the Georgian banking sector for almost 20 years now. It appeared on the market on December 10th, 1999 under the name of "Georgian Agro Business Bank". After June 13th, 2005 it changed its name and became "Standard Bank". On December 30th, 2007, UAE based DHABI Group has made its first investments in Georgia and obtained a license of "Kor Bank Georgia". On June 26th, 2008 Standard Bank and Kor Bank Georgia merged and thus Kor Standard Bank was established, later positioned as KSB Bank. In 2015-2016 KSB Bank worked on the rebranding project and as of May 23, 2016 it operates with new business strategy, branch environment, communication style and new name – Terabank.

As per 31 December, 2020, the Bank operated through 26 branches, service centers and service desks and 67 ATMs. These are located in all major cities of Georgia.

The Bank's principal activities are deposit taking, customer account maintenance, credit operations, issuing guarantees, cash and settlement operations, and securities and foreign exchange transactions. The Bank's activities are regulated by the National Bank of Georgia ("NBG"). The Bank has a general banking license issued by NBG on 25 January 2008. The Bank's registered legal address is 3, K. Tsamebuli Avenue, Tbilisi 0103, Georgia.

The Bank has one subsidiary (together referred to as the "Group"), Standard Insurance LLC, which does not have operations in 2020 and 2019.

Average number of the Group employees was 492 (325 female, 167 male) in 2020, compared to 498 (325 female, 173 male) in 2019.

2. Terabank Strategy

Strategic market segments for Terabank, where it continues an ambitious acquisition strategy in the coming years are Micro, Small and Medium businesses as well as Retail Banking.

Terabank has the following Strategic Business Objectives to achieve:
- Maintain specific profitability targets annually;
- Increase market share in MSME (Micro and SME) and Retail lending;
- Become a benchmark for excellence in MSME banking and active player in Retail Banking

The Group's vision is "to become the benchmark for excellence in MSME Banking and active player in Retail banking in Georgia and aspires to be a bank of choice and a trusted partner for entrepreneurs and individuals; a valuable investment for our shareholders; a preferred employer for our staff, and a good corporate citizen for society. "

According to mission statement of the Group, "mission is to improve the lives of entrepreneurs and individuals by fulfilling their business and personal financial needs. We achieve this by providing solutions, exceptional service and personal attention. By supporting entrepreneurs in a responsible, flexible and efficient way, we contribute to the growth and development of business sector and overall economy of Georgia. "

MSME segment is one of the top priority segments for Terabank, and it aspires to build a strong franchise and increase the market share. MSME loan portfolio has grown from GEL 415,607 thousand in 2019 to GEL 533,970 thousand in 2020 (+28%), reaching 57% share of the total loan portfolio of the Group. The keys to success were understanding the customer, designing the right value proposition and developing effective acquisition, delivery and communication channels.

As to Loans to Retail segment, the Group's approach was to develop excellence in customer service. Personal attention to each customer and flexibility remained as competitive edge, thus helping it stand out in the market and in spite of stricter regulation of lending in this segment, the Bank's Retail segment increased from GEL 185,054 thousand in 2019 to GEL 215,347 thousand in 2020 (+16%).

3. Key financial information

The Group's Gross Loans to customers in 2020 was GEL 936,494 thousand (GEL 774,827 thousand in 2019), 21% more than the previous year.

Amounts due to Customers also increased by 22.5% up to GEL 861,486 thousand in 2020 (from GEL703,148 in 2019).

The Group had the Operating Income (net interest income and non-interest income) of GEL32,069 thousand for the year 2020 (GEL52,630 thousand in 2019). The decrease of GEL 20,561 thousand in 2020 in operating income is mainly due to increased Loss from Loan Impairment. In more details it is the net effect of:

a) reduction of net interest income: Interest Income from loans to Customers increased by GEL 5,374 thousand up to GEL 81,438 thousand in 2020, as a result of increased Loan Portfolio. Interest income from Investment Securities increased by GEL 2,108 thousand up to GEL 6,440 thousand and Interest income from Cash and cash Equivalents decreased by GEL 587 thousand down to GEL 916 thousand; On the other hand, Interest Expense on Amounts due to Customers increased by GEL 4,355 thousand up to GEL 31,578 thousand as a result of increased Deposits Portfolio. Interest Expenses on Amount due to Credit Institutions increased by GEL 4,299 thousand up to GEL11,965 thousand and Interest Expense on Subordinated debts increased by GEL 788 thousand up to GEL3,917 thousand as a result of new senior and subordinated funds were received.

b) increase in Loss for Loan Impairment by GEL 17,976 thousand up to GEL 20,393 thousand, as a result of increased Stage 2 loans due to COVID-19 pandemic.

c) increase in net gains from FX operations (trading, forward contracts and FX translation) – gains increased by GEL 2,595 thousand up to GEL 7,998 thousand, mainly due to increased gains from FX translations,

d) decrease in Net fee and commission – it decreased by GEL 1,317 thousand down to GEL 2,887 thousand mainly due to decrease in Fee and Commission Income, which was followed by the minor decrease of Fee and Commission Expense;

e) decrease in Other Operating Income by GEL 1,316 thousand down to GEL 243 thousand.

Non-interest expenses decreased by GEL 2,449 thousand down to GEL 28,221 thousand in 2020: Personnel expenses decreased by GEL 2,156 thousand down to GEL13,823 thousand as a result of decrease in average number of employees during the year and not issued bonuses; Other provisions decreased by GEL 576 thousand in 2020 and the rest of non-interest expenses have not changed significantly.

The profit and total comprehensive income for the year decreased by GEL 16,111 thousand compared to previous year, amounting to GEL 3,919 thousand in 2020 (in 2019 profit was GEL20,030 thousand). The decrease in profit was mainly caused by generally deteriorated market situation which was translated in increased level of loan loss provisions to reflect expected credit losses related to financial crisis caused by the virus outbreak and decreased fee income due to lower level of clients activates connected to Covid-19 situation. The management expects improvements in all directions in 2021.

Key financial ratios of the Group were as following:

	2020	*2019*	*Explanation*
Net interest margin on average earning assets	3.9%	4.8%	Change in NIM ratio was mainly due to increase in Average Interest Earning Assets (16.8%), while Net interest income is decreased (-5.8%) mainly due to increase of Interest Expenses (that had higher growth rate (24.8%) than Interest Income (8.4%).
Spread	3.6%	4.5%	Yield of interest earning Assets decreased from 9.0% down to 8.4%. On the other hand, Cost of Interest Bearing liabilities increased (from 4.5% up to 4.8%), resulting the Spread ratio to decrease.
Cost to income ratio	50.7%	52.1%	Personnel and other non-interest expenses (excluding Other impairment and provisions expense and Loss from Sale and Revaluation of Repossessed Assets) decreased by 8% mainly due to reduction in Personnel expenses, while decrease in Operating Revenue was 5%, resulting in the Cost to Income ratio to decrease.
ROE	2.4%	13.0%	Profit decreased by GEL 16,111 thousand in 2020 compare with 2019, therefore resulting the ROE to decrease.
Cost of risk	2.4%	0.3%	Cost of risk increased due to increase in Loss for Loan Impairment by GEL 17,976 thousand as a result of increased Stage 2 loans due to COVID-19 pandemic.
L/D ratio	108.7%	110.2%	As mentioned above, both Loan and Deposit portfolios increased. The growth of Amounts due to Customers (+22.5%) exceeded the growth of Loans to Customers (+21%) and causing the L/D ratio to decrease.

4. Risk management

4.1 Types of risks

Management of risk is fundamental to the business of banking and forms an essential element of the Group's operations. The risk management policies aim to identify, analyze and manage the risks faced by the Group, to set appropriate risk limits and controls, and to continuously monitor risk levels and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered and emerging best practice. The Group has developed a system of reporting on significant risks and capital.

The Group identifies and manages following risks related to its business:

- **Credit risk-** arises from the possibility that counterparty to a financial instrument may fail to meet its contractual obligation and this failure may cause a loss to Bank. Credit risk arises as a result of the Bank's lending operations and other similar transactions.
- **Market risk-** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises of currency risk, interest rate risk and other price risks. Market risk mainly arises from open positions in interest rate financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.
- **Liquidity risk-** arises from the mismatch of the maturities of liabilities and assets. This mismatch may affect on the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due.
- **Operational risk-** is the risk of loss arising from systems failure, human error, fraud or external events (such as cyber attack risks, etc). Such events and/or failure may cause damage to bank's reputation, have regulatory or legal implications, may result in financial losses.
- Compliance risk- is a risk that Bank may not act in compliance with existing regulations, laws and agreements and may incur financial loss as part of such non-compliance.
- **Macroeconomic risk-** arises from the possibility that any adverse developments at country, regional or global level (such as fluctuation in commodity prices, increase in unemployment, decrease of GDP of a major trade partner, etc.) may have a negative impact on Bank's performance.

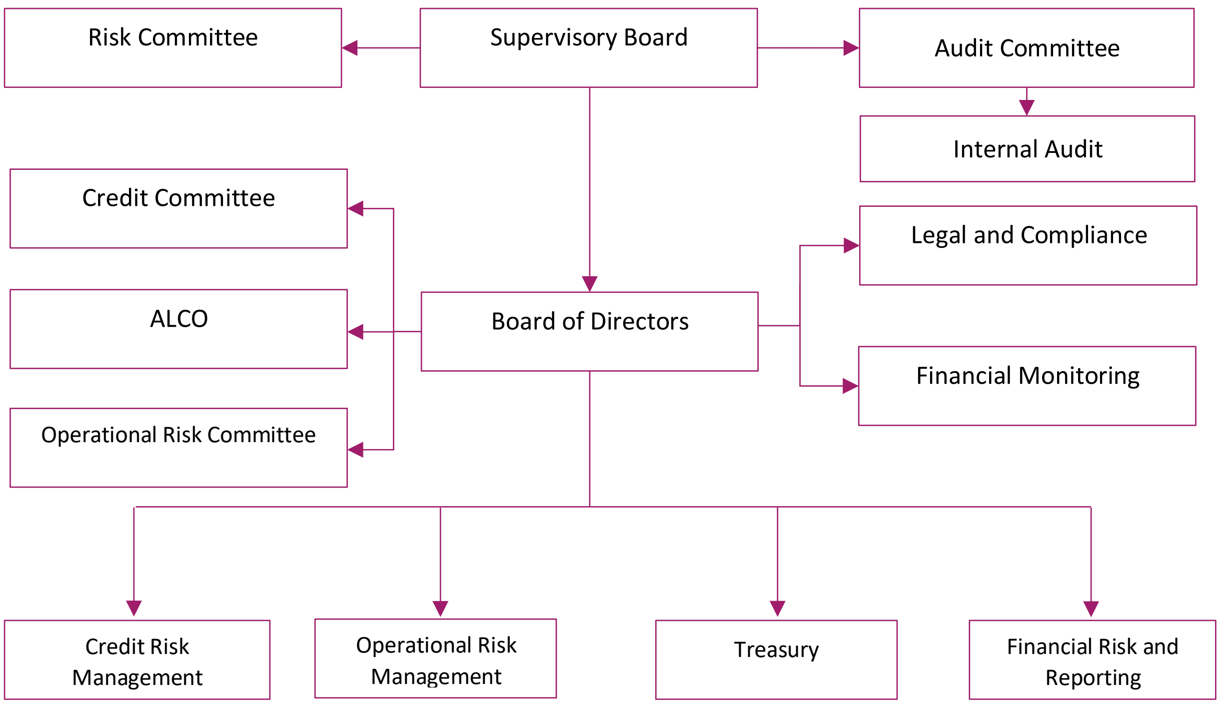
The Group has approved risk management policies, procedures and governance structures in to manage these risks. Supervisory Board has overall responsibility for the oversight of the risk management framework, overseeing the management of key risks and reviewing its risk management policies and procedures. Supervisory Board uses internal audit process to monitor execution of risk management framework and compliance with respective policies and procedures. Supervisory Board ensures that risk mitigation procedures are in line with the Group's strategy to focus on Micro, SME and Retail segments. Supervisory Board monitors risk management process and implementation of risk policies and procedures via regular meetings and reporting, where different risk measurement data are presented.

Board of Directors is responsible for implementing overall risk culture within the organization, monitoring and implementing risk mitigation measures, and ensuring that the Group operates within established risk parameters. Board of Directors presents to the supervisory board or approves independently, within its delegated authorities, risk related policies and procedures. Board of Directors is responsible for aligning risk strategy with the Group's overall strategy. Board of Directors controls risk related issues via various reports and committee meetings where risk related topics and performances are related.

Risk Director is responsible for the overall risk management and compliance functions, ensuring the implementation of common principles and methods for identifying, measuring, managing and reporting both financial and non-financial risks. He reports directly to the Chief Executive Officer and indirectly to the Board of Directors.

In addition to risk directorate, several departments within the bank are engaged in managing risks in their specific areas.

Chart below shows overall risk management structure at enterprise level:



4.2 Risk mitigation strategy

The Group has established structural units that monitor compliance with risk procedures and policies and implement them. These units are: Credit Risk and Portfolio Analysis Department, Operational Risk Department, Controlling Department, Collection and Recovery Department, Treasury Department, Financial Risks and Reporting Department, Legal and Compliance Department, Financial Monitoring Department. Legal and Compliance Department and Financial Monitoring Department report directly to CEO, Credit Risk and Portfolio Analysis Department, Operational Risk Department, Controlling Department and Collection and Recovery Department report to Risk Director (CRO), Treasury Department and Financial Risks and Reporting Department report to Finance Director (CFO). Each of these units focuses on their particular area of risk mitigation.

- **Legal and Compliance Department** is engaged in mitigating legal and compliance risks of the Group, either in the form of participation in litigation processes or by setting internal procedures and policies to ensure that the Group remains compliant with legal and regulatory requirements.
- **Financial Monitoring Department** is engaged in mitigating risks associated with customer and transaction identification, their compliance with regulatory requirements and international rules.
- **Treasury Department** manages open currency position of the Group, liquidity-related, market and interest rate risks and uses respective financial instruments and limits to mitigate them.
- **Financial Risks and Reporting Department** manages risks related with various financial elements and provides reporting and monitoring tools to manage various types of financial risks.
- **Credit Risk and Portfolio Analysis Department** monitors and mitigates credit-related risks to various non-financial counterparties, supports Board of Directors with credit-related reporting and analysis of portfolio. This department covers also social and environmental risk management. The department monitors and further implements Environmental and Social Management System(ESMS) through the bank according to the procedures and policies approved by the management.
- **Operational Risk Department** is engaged in daily activities to monitor operational risk issues, implementation of rules and procedures set by operational risk committee and relevant policies.
- **Controlling Department** monitors compliance with credit risk policies and procedures, provides independent on-site opinion on implementation of risk mitigants set by Board of Directors, Credit Committee and Credit Risk and Portfolio Analysis Department.
- **Collection and Recovery Department** manages the Group’s higher risk assets and mitigates credit-related risks via active asset management, ensures compliance with the Group’s credit, legal and compliance policies for this customer segment.

4.3 Risk Committee

The Risk Committee is established under Supervisory Board and has responsibility for controlling the Group's compliance with risk limits and capital adequacy ratios pursuant to the Group's internal documentation. The Committee has three members which are independent members of the supervisory board. Competence of the Risk committee contains:

- Discusses all risk strategies and make recommendations to the supervisory board thereon, and on the bank's overall current and future risk appetite;
- Reports on the state of risk culture in the bank and reviews the bank's risk policies
- Oversees that management has in place processes to promote the bank's adherence to the approved risk policies;
- Cooperates and monitors the activities of CRO;
- Provides recommendations to the Supervisory board regarding the risk strategies and effectiveness of the policies, including distribution and keeping adequate level of capital for identified risks;
- Monitors the strategies for capital and liquidity management; additionally, all other types of risks in order to ensure adequacy with risk appetite.

4.4 Risk committees

To execute policies and procedures established by the Group and execute its risk strategy, Board of Directors has established several committees:

Credit Committee is engaged in supervising, managing and approving credit exposures to the Group's retail, MSME, corporate and private banking clients. Credit Committee comprises of different members from risk and respective business functions. Loan proposals are initiated at branch / front office level and are then forwarded to respective committees for approval. The Group established different levels of credit committees that are responsible for approving credit limits for borrowers.

All business loans are approved by respective credit committees, based on the amount of loan, after loan proposals are analyzed. Loan limits are set at levels ranging from individual risk manager to credit committee chaired by CEO and attended by management.

For retail loans, only retail loans with the maximum amount of GEL 10 thousand and sanctioned retail loans (payroll/credit card/overdraft) with the maximum amount of GEL 20 thousand are issued on branch level. Other loan applications originated by the relevant client relationship managers are passed on to the relevant credit committee for approval of credit limit.

In some cases loans may be approved by Supervisory Board- if the borrower is related party or if the loan terms deviate from limits delegated by Supervisory Board to Board of Directors.

Loan approval limits are reviewed annually and are changed if necessary.

Assets and Liabilities Committee (ALCO) is engaged in managing and supervising market risk, liquidity risk, currency risk, interest rate risk. ALCO sets and monitors compliance with external or internal liquidity requirements, plans future cash flows, sets limits to manage interest rate risk, currency risk, liquidity and solvency risks. ALCO comprises of treasury, financial risk and reporting department employees, heads of businesses and the Group's top management. ALCO meetings are held regularly.

Operational Risk Committee is engaged in supervising and managing operational risks. It sets framework for operational risk management, sets controls for effective segregation of duties, access, authorization and reconciliation procedures, staff education and assessment processes, including the use of internal audit. Operational Risk Committee consists of operational risk department employees and members of Board of Directors.

In addition to these committees, Board of Directors conducts meetings on various risk-related subjects where issues are discussed at overall (enterprise), product or business level.

4.5 Credit risks

To mitigate Credit Risk, the Group has established number of procedures of policies that address particular areas of credit risk:

- The Group has in place limits that manage exposures on an individual and group level (maximum limits per borrower and group), on a sectoral level (limits are set for maximum exposures in particular sectors, these limits are linked to The Group's portfolio size and capital), on a product level (several products have their own limits expressed in GEL). These limits are set by Supervisory Board and Board of Directors and are monitored by Credit Risk and Portfolio Department. These limits are additional to the regulatory limits that are mandatory to comply with. Limits are reviewed periodically, but at least once per year.
- The Group accepts collateral as a tool to mitigate its credit risk. Policies and procedures are established for evaluation, pledge and monitoring of the collateral. The Group accepts following types of collateral: residential real estate, commercial real estate, land plots, machinery and equipment, vehicles, corporate and personal guarantees, guarantees from other financial institutions, deposits/CDs, precious metals. For each type of collateral specific discount rate, evaluation specifics, monitoring procedures is set. Normally, evaluation is performed by The Group's professional internal evaluators, but well-established external companies may be used.
- Collaterals are periodically re-evaluated based on their type and loans status, for higher-risk exposures re-evaluations are performed more frequently. Collateral evaluation is performed by designated unit within Credit Risk and Portfolio Analysis Department.
- The Group currently does not employ internal credit models. Credit ratings by Credit Info Georgia are used in loan approval process, primarily for retail exposures. Credit agency ratings of Fitch, Moody's or Standard and Poor's are used to assess credit risk of claims or contingent claims on the Groups.
- As part of risk mitigation process and regulatory requirement, The Group conducts stress tests on its assets (credit exposures, open currency exposure, depreciation of assets, etc.) according to scenarios provided by NBG. Based on the stress-test models the Group determines the possible additional loss in terms of worsening of various macroeconomic factors. Scenarios includes the following parameters: national currency devaluation with respect to US dollar, decrease of interest rates, increase of operational costs, worsening of credit portfolio quality, decrease of prices on real estate market. Depending on the listed parameters, possible change of liquidity position and profit or loss effects are determined, which eventually is reflected in the calculation of capital adequacy. Results of the stress test are discussed by Board of Directors.
- Starting from 01-01-2018 The Group has adopted new loan provisioning policy which meets requirements of IFRS 9 standards. New model was developed with the help of external consultants (KPMG). The new model is more sophisticated compared to previous model. The Group calculated Expected Credit Loss by incorporating following components into calculations: Probability of Default, Exposure at Default, Loss Given Default. The new model also allows to incorporate macroeconomic scenarios into Expected Credit Loss calculations.
- Risk reporting is performed by designated team within Credit Risk and Portfolio Analysis Department. Reporting includes periodical reporting to Supervisory Board and Board Directors where different risk measurements are presented and discussed, as well as ad hoc reporting on any risk-related topic. Risk reporting is performed in collaboration with other similar units of The Group.

4.6 Liquidity risk and funding management

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. It refers to the availability of sufficient funds to meet deposit withdrawals and other financial commitments associated with financial instruments as they actually fall due. Liquidity risk exists when the maturities of assets and liabilities do not match. The matching and/or controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of financial institutions.

In order to manage liquidity risk, the Group performs daily monitoring of future expected cash flows on clients' and banking operations, which is part of the assets/liabilities management process. The Management Board set limits on the minimum proportion of maturing funds available to meet deposit withdrawals and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals under both normal and stressed conditions. They also set parameters for the risk diversification of the liability base.

The Bank's liquidity management is comprised of the following:

- projecting cash flows and maintaining the level of liquid assets necessary to ensure liquidity in various time-bands;
- maintaining a funding plan commensurate with the Bank's strategic goals;
- maintaining a diverse range of funding sources thereby increasing the Bank's borrowing capacity, domestically as well as from foreign sources;
- maintaining highly liquid and high-quality assets;
- adjusting its product base by time bands against available funding sources;
- daily monitoring of liquidity ratios against regulatory requirements; and
- constant monitoring of asset and liability structures by time-bands.

Treasury function within the Group is charged with the following responsibilities:

- compliance with the liquidity requirements of the NBG as well as with the liquidity requirement covenants contained in the agreements with foreign lending sources;
- daily reports to management, including reporting to management on the levels of liquid assets in the main currencies (GEL, USD, EUR), cash positions;
- weekly reports to management on the forecasted levels of cash flows in the main currencies (GEL, USD, EUR);
- constantly controlling/monitoring the level of liquid assets;
- monitoring of deposit and other liability concentrations; and
- maintaining a plan for the instant increase of cash to provide liquidity under stressed conditions.

The liquidity position is assessed and managed by the Bank on a standalone basis, based on certain liquidity ratios established by the NBG. ALCO is responsible for ensuring that Treasury properly manages the Bank's liquidity position. Decisions on liquidity positions and management are made by ALCO.

4.7 Effect of COVID 19 on the Bank

Due to the rapid spread of COVID-19 pandemic in 2020 many governments, including the government of Georgia imposed various restrictions over activities within the country to contain the spread of the virus and manage its consequences. The restrictions imposed at various times include ban on all cross-border travel, restriction over all travel within the country during specific hours, closing of all public transport, stopping all commercial activity except those which can be done distantly from home as well as except specific business (groceries, pharmacies, commercial banks, gas stations, post offices etc.). The restrictions imposed by the Government of Georgia do not apply to any of the Bank's operations. The Bank continues working under the business continuity plan with personnel mostly working remotely from home, as much as possible. From internal control perspective to have the most secure environment under this remote working period the bank improved information security via implementing the best practices.

From Financial perspective, in general due to decrease in demand side of the economy, the bank's clients' activities were also decreased which has been reflected in decreased from revenue side, but most significant changes were regarding the estimations and assumption in ECL calculations. The Bank has identified number of loans as loans with increased credit risk and shifting them in Stage 2. Gross carrying value of the loans transferred to Stage 2 due to COVID-19 pandemic amounted to GEL156,278 thousand as at 31 December 2020 which created additional Expected Credit loss of GEL 17,964 thousand.

The group was in compliance with all financial covenants as of 31 December, 2020. By the end 2020 all covenants breach statuses were analyzed and if there was risk of its breach as of 31 December, 2021, the Group received all necessary waivers as of the end of 2020 financial year.

From business model perspective it is not planned any significant changes in strategy, just further enhance already declared strategic directions such as SME/Micro lending and digital channels improvements.

4.8 Audit Committee

The audit committee is established under the Supervisory Board. The majority of the Audit Committee members are represented by independent members of the Supervisory Board. Competence of the audit committee contains:

- Development of the internal audit functions, organization and monitoring of the Internal Audit department activities;
- Development of staff schedule of the Internal Audit department and submit it for approval of the Supervisory Board;
- Consideration of the issue of appointment and dismissal of the Head of the internal audit department and submission to the Supervisory Board for approval;
- Ensuring presence of the adequate resources for the Internal Audit department and proper remuneration and motivation systems for the members thereof;

- Evaluation of quality and efficiency of the Group's reporting and accounting records, inner control, management of risks and management systems and processes through the Internal Audit department;
- Consideration and approval of the activities plan of the Internal Audit Department for each fiscal year according to quarters; Contribution to the external audit activities;

Audit committee meets on quarterly basis. During 2020 the committee meetings had discussed internal audit plan, approving recommendations prepared by internal audit, supervising performance of internal audit etc.

Thea Lortkipanidze
General Director

Sophie Jugeli
Chief Financial Officer

14 September 2021