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BOARD OF DIRECTORS REPORT



It has been already more than one year since the appointment of the Board of Directors by the Annual General Assembly Meeting of X.A.C. Ltd. on October 20, 1999.

We hereby present to our shareholders, employees, partners, and customers our Annual Report 2000, consisting of this Report from the Board of Directors (BoD), Report from the executive management team and our audited annual accounts.

The first responsibility of the BoD is to supervise the Executive Director's performance and monitor the implementation process of the Business Plan based on monthly reports, presented to the BoD by X.A.C. management. In the last year we have made significant improvements to further strengthen a healthy working relationship between BoD members and Executive Management and to establish appropriate governance within the institution.

The Business Plan, approved by the Annual General Assembly, has become a basic guiding document of X.A.C. for the next 4 years. It is our great pleasure to mention that Ms.Enkhtuya, Chairman of the BoD, worked intensively to promote X.A.C. to potential investors, thus enabling the Company to achieve desired funding levels.

In the year 2000 the BoD met in plenary session on 12 occasions. Regular items on the agenda were discussions on the financial and operational results of X.A.C in the preceding periods and reviews of existing policies. At several meetings the Board also discussed the Company's budget, the report of the external auditor, the new share issue and the involvement of foreign investors. Once we also invited chairpersons our NGO shareholders to the BoD meeting and discussed the strategic goals of the Company.

Ms.Gerelsuren, one of seven members of BoD, was elected as a Member of Mongolia's Parliament and Ms. Odonchimeg was appointed to fill the vacancy on the Board.



In accordance with the authority provided by the Shareholders, the Board has approved the Business Plan, which included the major objective of X.A.C. to become a fully fledged commercial bank dedicated to servicing microentrepreneurs.

In conformity with the Memorandum of Understanding between UNDP Mongolia and X.A.C., the Board has decided not to distribute dividends this year.

We propose to the Shareholders to approve the Financial Statements of X.A.C. as of December 31, 2000 audited by Itgelt Audit, Ltd.



EXECUTIVE MANAGEMENT REPORT

EXECUTIVE SUMMARY FOR THE YEAR 2000

For X.A.C., the first non-bank financial institution in Mongolia, the year 2000 was a crucial year in building and strengthening of some solid foundation laid in its early years, and determining the path of its future development. The company is not only conducting the broadest micro-lending activities in the financial sector of Mongolia, but also has shown the government of Mongolia, investors, and the community, that financial sector development is on the right path. During the last year the company opened 5 branch offices and disbursed MNT 2.6 billion¹ in loans through its 12 branches. The total loan portfolio outstanding as of the end of 2000 reached MNT 935.8 million, which is 3.6 times higher than the previous year's result. We also disbursed 9,832 loans or 4.2 times more loans in the year 2000 than in 1999. Loan repayment rate was 99.7 per cent as of the end of year 2000.



The market that we are operating in is experiencing substantial and rapid changes. Even though the number of clients interested in our services is increasing, on the other hand commercial banks are starting to disburse micro-loans, and donor organizations are implementing new projects in this field. All these result in increased competition. Thanks to these new challenges we have been driven to greater achievements such as flexible marketing policies, offering new products, and improving existing ones to bring an increased quality of service to our clients.

The fact that other non-bank financial institutions (NBFIs) and some commercial banks are making changes into their credit methodology based on X.A.C. micro-lending practices also shows our position as leaders in this field.

To assure organization's stable development X.A.C. continued to invest appropriate amount of resources to building sustainable network of local and international partners, demand-driven information systems, and capable human resources. We conclude that the first steps taken towards achieving our mission statement were successful.

While the company achieved 380 per cent increase of its total assets in the year 1999, we showed an increase of 290 per cent in the year 2000. According to the 5-Year Business Plan we opened 5 new branches, and are now operating through 12 branches.

Rapid growth of our activities and the positive trend toward self-sufficiency are still the main features of X.A.C. operations.

In 2000 the Company joined the Mongolian Chamber of Commerce and Industry (MCCI) and the Banker's Association of Mongolia, and participated actively in these organizations as a full-time member.

We are also proud to announce that Mr. Ganhuyag, our Executive Director, was awarded the title of the Best Manager in Finance at the Entrepreneur 2000, an event organized by MCCI.

¹ Official exchange rate as of December 31, 2000 to one US dollar was MNT 1,097.

	(MNT*,000)	
	1999	2000
Some indicators of the balance sheet		
Total Assets	498,921	1,444,346
Total loans	253,675	944,316
Loan loss reserve	5,099	11,156
Some indicators of the income statement		
Total income	122,383	356,992
Net income after taxes ²	-7,370	33,379
Basic ratios indicators		
Return on Assets (ROA) ³	-5.2%	3.4%
Return on Equity (ROE) ⁴	-6.3%	18.5%
Operational self-sufficiency	88.9%	115%
Financial self-sufficiency ⁵	74.4%	103%



² Portion of the previous year's retained earnings to be added on retained earning of year 2000 is not included for the calculations of the ratios.

³ Simple Average Asset is used for ROA calculation.

⁴ ROE calculated only for total share equity.

⁵ Adjustments are made for inflation and subsidy.

MARKET AND CUSTOMERS

Within the framework of our mission to provide financial services to those who are not able to access financial services from financial institutions, we have set a goal to reach more customers with our services, and the number of clients reached grew 2.4 times compared to that of the previous year, and reached a total of 3,602 clients.

In 2000 we have provided loans not only to small business entrepreneurs, but have also developed a new consumer loan product for salaried.

In order to ensure outreach into less densely populated and small communities we successfully piloted mobile units providing lending services to nearby Sums (counties) and other settlements.

During the 28 months of work since the start of our activities we have disbursed 15,270 loans to 5,780 small business entrepreneurs (2,367 clients in Ulaanbaatar city, approximately 246-662 clients per rural branch). Assuming that 1 client is 1 family (4.4 persons⁶ in one family) we could say that 24,000 people received services from us. If we compare this number to the local population⁷, 1.5% of the total population of Ulaanbaatar, 3.8% of total population of Darhan, 6-15.3% of the population of other regions, 54.2% of total population of Airag Sum (the smallest branch) benefited from financial services offered by X.A.C. Ltd.

Demand for financial services in our country is very high and we understand that we met only small percentage of that demand during 2 years of work. Recently the number of non-bank financial institutions willing to work in this field has increased and it also started to attract commercial banks. Government's Agricultural Bank, private Zoos Bank and Golomt Bank, GobiStart Ltd. (NBFI, funded by USAID), Credit Mongol Ltd. (NBFI, funded by TACIS) entered into micro and small lending business. X.A.C. will build on its reputation for fast, effective service to preserve.

PORTFOLIO QUALITY AND REPAYMENT

This year like all others, we set the objective to maintain the quality of loan portfolio and repayment rate, and by 31st December 2000, portfolio at risk (PAR)⁸ decreased from 1.3% to 0.3%, and the rate of repayment improved from 98.7% to 99.7%⁹. The percentage of delinquent clients is 0.8% of total active clients.

In spite of the fact that 30-40% of all loans in the mainstream commercial banking sector of Mongolia is under the "bad" or "late" loan categories, we again have proven our motto that "MONGOLIANS DO REPAY THEIR LOANS".



⁶ Statistical Bulletin of Mongolia, 1999.

⁷ Based on the population of Ulaanbaatar, Darhan, and other Aimag (province) centers where X.A.C. operates.

⁸ PAR=(Outstanding balance of Loans Past Due for more than 1 day+Outstanding balance of Restructured Loans)/Total Outstanding Portfolio.

⁹ Repayment rate=1-Payments in arrears/Total Outstanding Portfolio.

BRANCHES

In 2000 we opened 2 new branch offices in Ulaanbaatar city and 3 branches in Uvurhangai, Selenge and Govi-Sumber Aimags. This brought us to 12 branch offices in 2000, of which 5 are in Ulaanbaatar and 7 in the countryside. Also a Development Loan Unit was established at the Central Office in October 2000.

	2000	1999
Number of branches	12	7
Number of branch employees	43	20
Number of branch credit officers	31	13

The number of outstanding loans at the branches is 185-426 and the average number of loans per branch is approximately 300. The average loan portfolio per branch increased 2.1 times and reached MNT 76.1 million in 2000, compared to MNT 36.9 million in 1999.

Our branches disbursed from 465 to 1,251 loans each in 2000 for MNT 90.6-356.1 million. The average number of loans disbursed by each branch each month is approximately 100 with an average amount of MNT 37.0 million.

By the end of 2000 the average total assets per branch was MNT 86.1 million 3.5 times higher than in 1999.



RISK MANAGEMENT AND INTERNAL SYSTEMS

Based on the appraisal recommendations made by CGAP/World Bank, IFC and Triodos Bank, X.A.C. incorporated necessary amendments and changes to its Five-Year Business Plan.

In financial year 2000 the company initiated first steps to build up a risk management system. Within this system Risk Management Committee and Head Office Credit Committee were established and became operational.



OPERATIONS RISK MANAGEMENT

During the last year the management of the company mostly focused on operations risk management through the following actions:

- An international consultant was contracted to improve the internal control system and the quality of external financial audit. The policies and procedures of our Internal Auditor and our Internal Audit Committee have been improved.
- The main policies and procedures regulating the accounting and lending activities were amended and relevant changes were made. Auditing of financial statements for the year 2000 has been completed in two stages: an interim audit and an end-of-year financial statements audit.
- A highly skilled team of Mongolian specialists was contracted to develop and introduce a fully automated management information system, based on the newest achievements of information technology. By the end of year accounting module was ready for testing.

INVESTMENTS

In financial year 2000 the company has worked intensively into mobilization and re-distribution of financial resources, to finance organizational growth and create an appropriate ownership structure:

- The Government of Finland donated USD 600,000 to UNDP to fund MicroStart-Mongolia project.¹⁰
- Technical assistance was provided by CGAP/World Bank and IFC to assist us in institutional capacity building.
- The company made necessary changes within its ownership structure, which will allow participation of international investors. For example, X.A.C. obtained a convertible loan of USD 400,000 from Triodos Bank, a Dutch commercial bank with social mission.



¹⁰ X.A.C. is founded under this project and continues to be the sole implementer. The Project is expected to finalize by July 2001.

HUMAN RESOURCES DEVELOPMENT

From the very beginning the company has regarded its human resources as its most valuable and important asset. In order to manage its human resources properly X.A.C. has developed and maintained HR policies and procedures and developed a small, but comprehensive HR database.

Four staff members attended high quality international trainings in the following areas: Risk Management (Bankakademie, Germany), Viability projections of Microfinance institutions (New Hampshire, USA), Banking Management (IDI, Ireland), Bank Governance (Central Bank of Egypt, Cairo). Also 9 staff completed a two-week course on “Loan Product Design in Banking” at the Banking Training Center in Ulaanbaatar.

A five-year technical assistance plan has been developed and it is tied closely to our human resources development plan.

A small library of about 200 high quality books in banking, microfinance, finance, accounting and management has been set up.



Staff performance appraisals are conducted annually. Our branch incentive system, allowing the branch staff to receive a quarterly bonus, is designed to reward team performance, rather than individual achievements.

As of the end of 1999 our total staff number was 34 and by the end of the year 2000 this number reached 63, an increase of almost 100 per cent.

STAFF BENEFITS

In order to guarantee the security of staff, full-time employees of the company are covered with accident insurance.

The company is paying careful attention to the health of its staff and we contracted a medical institution for conducting annual medical examinations of all employees.

In order to improve the efficiency of the credit officers of Ulaanbaatar branches, the company provided these branches with a car, which is to be used for client visits distant from branches.



EXTERNAL RELATIONS

X.A.C. worked hard to develop and widen its external network of partners and we are pleased to note that our achievements in developing sustainable microfinance operations are increasingly being recognized internationally.

The following table provides a brief summary of the work that was done towards this end:

February 2000	The Finnish Government approved a donation of USD 600,000 to support MicroStart's activities and a funding contract has been signed between the Ambassador of Finland Mr. Taisto Tolvannen and the Resident Representative of UNDP in Mongolia Mr. Douglas Garder.
April 2000	In search of international partners Mr. Ganhuyag Chuluun and Mr. Robert Cater visited Holland's Triodos Bank and promoted the activities of X.A.C.
June 2000	As part of a TA assistance package from CGAP Mr. Khantiko Kong worked on improving internal control systems and fine-tuning the audit capacity of a local audit company.
July 2000	Mr. Xavier Reille of CGAP conducted an external appraisal of X.A.C., which followed a CGAP model for appraisal of microfinance institutions.
July 2000	Investment Officer of Triodos Bank, Ms. Jacqueline Barendse, conducted an investment due diligence of X.A.C.
August 2000	Germany's KfW indicated an interest in supporting microfinance activities in Mongolia and initial discussions commenced with the Government.
October 2000	Mr. Sander Tideman and Ms. Hedwig Siewertsen worked for one month on improving X.A.C.'s governance practices and strategic planning capacity as part of IFC sponsored technical assistance.
December 2000	Triodos convertible loan disbursed and IFC (Worldbank Group)'s management approved a straight loan to X.A.C.
December 2000	A team comprised of Mr. Robert Cater, Mr. Jargalsayhan and Ms. Zul made an investment promotion tour to USA and began negotiations for a possible equity investment from Shore Bank, Chicago.



ORGANIZATIONAL STRUCTURE

The Company's structure evolved organically along with our rapid growth of activities and increase of staff by almost twofold during last year. X.A.C. has rationalized and strengthened its management in response.

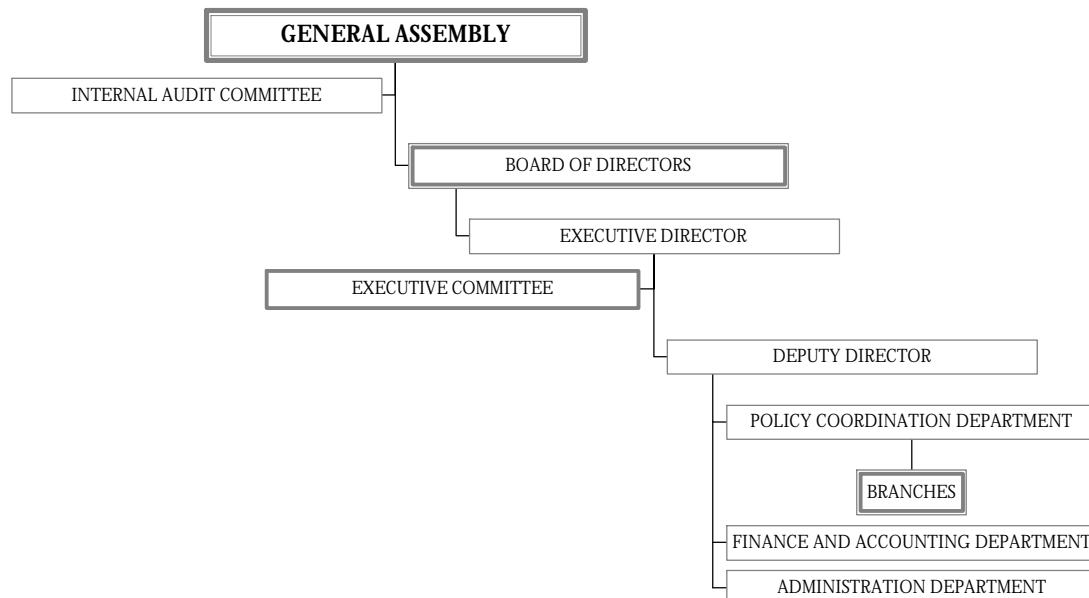
By December Ms. Ts.Oyunjargal was appointed to the position of Deputy Executive Director. The Operations and Finance Departments have changed to Policy Coordination, and Finance and Accounting Departments respectively. These are not only name changes, but they reflect the widened breadth of duties and responsibilities assigned to each of those key operational departments following the growth of the Company.



Within the Policy Coordination Department new positions have been added and new functions added to the existing ones. Regional managers now perform the duties of former Field Coordinators and a Marketing Manager position has been added.

Structural changes have taken place in branches as well. Lead Credit Officers with outstanding performance, leadership and management capabilities have been appointed to newly created Branch Managers' positions to further decentralize the management decision making processes of the Company, and increase personal accountability.

Finance and Accounting Department's primary functions are financial planning and accounting of the organization. This Department is currently comprised of 4 people.



ENVIRONMENTAL AND SOCIAL INFORMATION MEMORANDUM

X.A.C. has been negotiating an investment term sheet with the International Finance Corporation, which is the private sector investor of the World Bank Group, and came to an initial agreement. One of the conditions set for X.A.C. in order to meet eligibility criteria for the investment is that the company should sign an agreement with IFC which obligates X.A.C. to strictly comply with environmental, social security and human rights laws of Mongolia.

Within the framework of this agreement we proposed to the BoD certain changes and amendments to the loan policy and it was approved in November 2000. The amendments covered the issue of loan purpose and the provisions, which prohibit financing the following activities, were amended. These include:

- Activities harmful for the nature and environment.
- Production or trade of alcoholic beverages, tobacco and cigarettes.
- Production, trade, storage, or transportation of significant volumes of hazardous chemicals, petroleum, fuel and oil.
- Production and trade of military equipment.
- Other illegal actions.



Branches of X.A.C. began implementation of these amendments since 15th November 2000. Our Internal auditor will make quarterly on-site inspections of the implementation of above provisions of the policy.

OFFICE RENOVATION

Related to the significant growth of the activities of the company, expansion of internal and external relations and increase in the number of employees, we faced the need to expand central office and thus to move its location. The central office has been moved to Zoos Goyol company building, which is located in the Commerce street of Ulaanbaatar city, in the central avenue along with other banks and finance companies. Time has shown that this was the most appropriate and adequate action. We have purchased apartments to be used for office space in four of our branch offices and 2 of them have gone through complete renovation.

SECURITY

The management of the company has been paying due attention to the security of its employees and safety of company's property and developed a comprehensive plan to resolve this issue.

In order to ensure the security of branch offices the company is collaborating with "Tsagaan Bar" Security Company. The latest security equipment and accessories were installed in eight of twelve branches. City branch offices are connected to 24-hour security system.



COMMUNICATION

Our focus has been placed in 2000 to improve internal information flow and quality of communication means between central and branch offices.

The internal newspaper X.A.C.-BUUHIA is being published since June 2000 with an initiative of the Executive Director and with the aim of disseminating internal information of the company to all staff in a more informal way. 6 editions of this newspaper were published in 2000 and were welcomed by all staff and stakeholders.

The management of the company gave a high importance to an improvement of communication between central and branch offices.

An installation of internal telephone network at the central office also positively affected time utilization and work efficiency of the employees.

On December 29, 2000 X.A.C. officially announced an opening of the company's WEB page, a strong marketing tool in today's world.

