**Tbilisi, 26 April, 2010**

*Bank of Georgia Annual Financial Report*

In compliance with DTR 6.3.5, the following information constitutes the Annual Financial Report for the year ended 31 December 2009. The audited consolidated financial results of JSC Bank of Georgia and its Subsidiaries, prepared in accordance with International Financial Reporting Standards, are published as part 2 of the Annual Financial Report.

**Responsibility Statement**

The Management Board confirms to the best of their knowledge that:

- the consolidated financial statements have been prepared in accordance with International Financial Reporting Standards;
- the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank and the undertakings included in the consolidation taken as a whole; and
- the Annual Report and Accounts include a fair review of the development and performance of the business and the position of the Bank and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

JSC Bank of Georgia (LSE: BGEO; GSE: GEB) is the leading Georgian bank with operations in Georgia, Ukraine and Belarus. It is the largest bank by assets, loans, deposits and equity in Georgia with 33.0% market share1 by assets as of 31 December 2009. The Bank offers a broad range of retail banking and corporate banking services to its clients. It is also leading provider of brokerage, insurance and wealth management services in Georgia.

**Discussion of financial statements**

**Statement of Income**

Bank of Georgia reported 2009 Net loss of GEL 98.9 million and total Net operating income (Revenue)[2] of GEL 297.6 million, compared with Net income of GEL 174 thousand and total Net operating income of GEL 335.7 million in 2008. The Net loss for the year was primarily a result of a high Impairment charge on Loans to Customers of GEL 118.9 million and Goodwill impairment charge of GEL 73.1 million, predominantly associated with the goodwill write-off of BG Bank, the Bank's subsidiary in Ukraine. All of the goodwill associated with BG Bank has been written off.



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**Revenue**

Revenue of GEL 297.6 million was down GEL 38.1 million, or 11.4%, compared to the prior year. The decline resulted from the challenging business environment in the first half of 2009.

**Revenue distribution by item**

| *GEL thousands* | **2008** | **2009** | **Change** |
|---|---|---|---|
| Interest income | | | |
| *Loans to customers* | *363,013* | *361,176* | *-0.5%* |
| *Finance lease receivables* | *7,010* | *5,844* | *-16.6%* |
| *Investment securities – held-to-maturity* | *16,457* | *5,725* | *-65.2%* |
| *Amounts due from credit institutions* | *10,732* | *5,037* | *-53.1%* |
| *Investment securities – available-for-sale* | *6,727* | *1,276* | *-81.0%* |
| Total Interest income | 403,939 | 379,058 | -6.2% |
| Interest expense | | | |
| *Amounts due to customers* | *(85,358)* | *(96,749)* | *13.3%* |
| *Amounts due to credit institutions* | *(97,035)* | *(91,582)* | *-5.6%* |
| *Debt securities issued* | *(706)* | *(186)* | *-73.7%* |
| Total Interest expense | (183,099) | (188,517) | 3.0% |
| Net interest income | 220,840 | 190,541 | -13.7% |
| Net fee & commission income | 49,969 | 55,025 | 10.1% |
| Net gains (losses) from for trading securities | (5,447) | 2,763 | NMF |
| Net gains from investment securities available-for-sale | 513 | 174 | -66.1% |
| Net losses from derivative financial instruments | - | (6,266) | NMF |
| Net losses from revaluation of investment properties | (389) | (4,087) | NMF |
| Net gains from foreign currencies: | 47,134 | 28,766 | -39.0% |
| Net insurance revenue | 9,016 | 15,375 | 70.5% |
| Share of loss of associates | (713) | (2,649) | NMF |
| Other operating income | 14,747 | 17,908 | 21.4% |
| **Total Revenue** | **335,670** | **297,550** | **-11.4%** |

Net interest income decreased by 13.7% from 2008 to GEL 190.5 million, in 2009, primarily due to significantly decreased yield on liquid assets and increased funding costs, a result of the growth of deposits (Amounts owed to customers) and the increase in effective average interest rates on deposits in 2009 compared to 2008.

In 2009 all Interest income items contributed to the decline of total Interest income. Despite of the contraction of the gross loan book by 14.8% during the year, interest income on Loans to customers remained largely unchanged, declining by 0.5% to GEL 361.2 million. In 2008 loan balances increased until mid-year and declined at the end of the year. Loan balances continued their decline during the first half of 2009, increasing only slightly towards the end of the year. (*see the **Average Interest Earning Assets and Average Interest Bearing Liabilities** table below*).

Interest income on Bank of Georgia's securities portfolio (interest income from Investment securities held-to-maturity and available-for-sale taken together) decreased by GEL 16.2 million to GEL 7.0 million in 2009. The decline, despite growth in the Bank's securities portfolio from GEL 56.6 million as of 31 December 2008 to GEL 268.8 million as of 31 December 2009, was a result of higher daily average securities portfolio maintained by the Bank in 2008 (*see the **Average Interest Earning Assets and Average Interest Bearing Liabilities** table)* and significantly higher average interest rates on these instruments during 2008. The Bank's debt securities portfolio in 2009 was comprised of Certificates of Deposit of central banks and Ministry of Finance treasury bills of Georgia, both Held-to-maturity, and

Available-for-sale securities such as Corporate bonds and Ministry of Finance treasury bills of Ukraine. *(see more on Investment securities under Assets discussion)*

Interest earned on Amounts due from credit institutions decreased by 53.1% to GEL 5.0 million in 2009, mostly due to the decline of interest earned from the interbank deposits (Time deposits with effective maturity of more than 90 days) placed at several international banking institutions. In 2009 Amounts due from credit institutions comprised of interbank deposits, short-term interbank loans and Obligatory reserves with the central banks. Obligatory reserves with the central banks increased from GEL 57.9 million in 2008 to GEL 62.3 million in 2009, a result of deposit growth.

Interest expense, consisting of interest expense on the Amounts due to credit institutions, interest expense on deposits (Amounts due to customers) and interest expense on Debt securities issued, increased by 3.0% to GEL 188.5 million in 2009. The growth resulted primarily from the 13.3% increase in Interest expense on deposits (Amounts due to customers) to GEL 96.7 million, as deposits increased by 6.7% to the record high level of GEL 1,272.5 million at 31 December 2009. Effective average interest rate paid on customer account balances was 8.3% in 2009 and 6.7% in 2008. Interest expense on the Amounts due to credit institutions declined by 5.6% to GEL 91.6 million as a result of the reduction of the Amounts due to credit institutions by GEL 288.1 million in 2009. As a result, cost of funds[3] increased from 8.1% in 2008 to 8.4% in 2009.

**Average Interest Earning Assets and Average Interest Bearing Liabilities**[4]

| *GEL thousands* | **2008** | **2009** | **Change** |
|---|---|---|---|
| Average amounts due from credit institutions | 224,158 | 324,819 | 44.9% |
| Average loans to customers and finance lease receivables, net | 1,965,982 | 1,754,691 | -10.7% |
| *- Average loans to customers, gross* | *2,037,977* | *1,912,278* | *-6.2%* |
| Average investment securities[5] | 124,776 | 95,592 | -23.4% |
| **Average interest earning assets** | **2,314,917** | **2,175,102** | **-6.0%** |
| Average amounts due to customers | 1,256,082 | 1,138,276 | -9.4% |
| Average amounts due to credit institutions | 1,010,814 | 1,055,986 | 4.5% |
| Average other liabilities - debt securities issued | 7,504 | 159 | -97.9% |
| **Average interest bearing liabilities** | **2,274,400** | **2,194,421** | **-3.5%** |

Despite the loan book contraction and high liquidity in the second half of the year, Bank of Georgia’s Net Interest Margin (NIM)[6] stood at healthy 9.2% in 2009 (compared to 9.3% in 2008).

Net fee and commission income rose by 10.1% to GEL 55.0 million. Net fee and commission income comprised fee and commission income from settlement operations, guarantees, letters of credit, cash collections, currency conversion operations, fees from brokerage, fees from advisory services and other fees. This growth was driven by the increases in sales of fee generating products and services listed above.

The Bank’s Other non-interest income declined by 10.5% to GEL 82.1 million in 2009. Net gains from trading securities amounted to GEL 2.8 million in 2009, compared to the Net loss of GEL 5.4 million in 2008. Due to the drop in real estate prices in Georgia by approximately 20%, the revaluation of investment properties mostly owned by the Bank through its subsidiaries resulted in the Net losses of GEL 4.1 million, compared to the Net losses of GEL 0.4 million in 2008.

Gains from foreign currencies decreased 39.0% to GEL 28.8 million in 2009. Net insurance revenue comprised of Net premiums earned less Net claims incurred increased by 70.5% to GEL 15.4 million, mostly a result of the increase in Net insurance premiums earned driven by the rise of the premiums earned on health insurance.

The Bank's Share of loss of associates, where the Bank owned less than or equal to 50% equity interest, resulted in the total Share of loss of GEL 2.6 million in 2009 compared to the Share of loss of GEL 0.7 million in 2008.

**Expenses[7] and Impairment charge on loans to customers**

| *GEL thousands* | **2008** | **2009** | **Change** |
|---|---|---|---|
| Depreciation, amortization and impairment | 20,532 | 101,700 | 395.3% |
| Salaries and other employee benefits | 108,767 | 100,505 | -7.6% |
| General and administrative expenses | 68,649 | 57,339 | -16.5% |
| Impairment charge on other assets and provisions | 4,551 | 6,431 | 41.3% |
| Other operating expenses | 9,828 | 11,740 | 19.5% |
| **Total Expenses** | **212,327** | **277,715** | **30.8%** |
| Impairment charge on loans to customers | 122,812 | 118,882 | -3.2% |
| Impairment charge on finance lease receivables | 1,335 | 6,859 | 413.8% |
| **Total Impairment charge** | **124,147** | **125,741** | **1.3%** |

In 2009 Salaries and other employee benefits decreased by 7.6% from 2008 to GEL 110.5 million, a result of headcount reduction and cost optimization measures undertaken by the Bank in December 2008 and in 2009. The number of personnel of the Bank reached 4,781 employees at the year-end 2009 compared to 4,979 employees as of 31 December 2008 and 6,196 as of November 2008 immediately prior to the headcount reduction conducted by the Bank in December 2008. Salaries and other employee benefits accounted for 36.2% of the Expenses (compared to 51.2% in 2008).

General and administrative expenses declined by 16.5% to GEL 57.3 million and comprised of expenses for occupancy and rent, marketing and advertisement, legal and other professional services, communications, repairs and maintenance, operating taxes, security, office supplies, travel expenses, corporate hospitality and entertainment, banking services, penalties, insurance, personnel training and recruitment and other General and administrative expenses.

Depreciation, amortization and impairment expense amounted GEL 101.7 million in 2009, an increase of GEL 81.2 million in 2009, which more than offset the decline in Salaries and other employee benefits expense and General and administrative expenses and resulted in a 30.8% increase of the Bank's Expenses to GEL 277.7 million in 2009 (compared to 65.9% growth in 2008). The significant increase of the Depreciation, amortization and impairment cost in 2009 was largely driven by the Goodwill impairment charge of GEL 73.1 million associated predominantly with the goodwill write-off of BG Bank, while the devaluation of BG Bank property amounted to GEL 3.2 million. The Bank's charge for depreciation of property increased by GEL 3.6 million, or 19%, to GEL 22.5 million due to additions of furniture and fixtures. The charge for amortization of intangibles increased by GEL 1.3 million, or 80% to GEL 2.9 million, mostly due to American Express license acquired by the Bank in December 2008 and other software additions during 2009.

Impairment charge on other assets and provisions increased to GEL 6.4 million in 2009, compared to Impairment charge on other assets and provisions in 2008 of GEL 4.6 million. Despite the reversal of Provision for guarantees and commitments in the amount of GEL 2.1 million, the increase of Impairment charge was driven by the Impairment charge for investments in associates of GEL 2.2 million and Impairment charge for other assets totaling GEL 5.5 million, which is predominantly attributable to the provisioning of the Bank's Receivable from documentary operations.

Reflecting the improved but still weak operating environment in Georgia in 2009, the Loan impairment charge declined only slightly to GEL 118.9 million, compared to GEL 122.8 million in 2008. Approximately GEL 84.8 million Loan impairment charge was attributed to the Bank's loan book in Georgia and approximately GEL 40.8 million was related to the loan book of BG Bank in Ukraine. In 2008, the Loan impairment charge of GEL 110.6 million and GEL 18.0 million were attributed to the Bank's loan book in Georgia and BG Bank, respectively.

Income tax benefit for 2009 amounted to GEL 7.0 million, due to the Loss before income tax benefit for the year. Income tax benefit in 2008 amounted to GEL 1.0 million.

**Balance Sheet highlights**

**Assets**

As of 31 December 2009 Bank of Georgia had Total assets of GEL 2,913.4 million, as compared to Total Assets of GEL 3,258.9 million in 2008, a decrease of 10.6%. Cash and cash equivalents, which accounted for 11.6% of Total assets, decreased by 15.1% to GEL 337.4 million in 2009, mostly a result of the decrease in the Time deposits with credit institutions up to 90 days. The average liquidity ratio, based on the NBG standards, was 36.5% in 2009, compared to 31.4% in 2008, higher than the NBG's 20% requirement. The Bank's securities portfolio grew by GEL 212.2 million to GEL 268.8 million in 2009, predominantly a result of GEL 144.1 million held-to-maturity Georgia's Ministry of Finance treasury bills purchased by the Bank in 2009. Available-for-sale securities decreased from GEL 33.7 million in 2008 to GEL 19.6 million in 2009, mostly attributable to the disposal of the Corporate bonds in the aggregate value of GEL 3.8 million. In 2009, the Bank disposed of Corporate shares in the aggregate amount of GEL 8.3 million.

In 2009, gross loan book predominantly comprised of the loans issued in Georgia, decreased by 14.8% to GEL 1,827.8 million. While residential mortgage loans held steady at -1.1%, the difficult business environment negatively affected all other loan categories except gold-pawn loans, which profited from the increased demand for this product during the economic downturn. The majority of lending was accounted for by commercial loans in 2009.

**Gross Loans**

| *GEL thousands* | **2008** | **2009** | **Change** |
|---|---|---|---|
| Commercial loans | 1,044,959 | 939,814 | -10.1% |
| Residential mortgage loans | 391,606 | 387,415 | -1.1% |
| Consumer loans | 496,197 | 332,537 | -33.0% |
| Micro loans | 151,313 | 99,981 | -33.9% |
| Gold – pawn loans | 46,374 | 62,829 | 35.5% |
| Others | 15,174 | 5,241 | -65.5% |
| **Loans to customers, gross** | **2,145,623** | **1,827,817** | **-14.8%** |
| Less – Allowance for loan impairment | (106,601) | (166,486) | 5.0% |
| **Loans to customers, net** | **2,039,022** | **1,661,331** | **-9.1%** |

Loans to Private companies accounted for 51.1% of total gross loan book (includes portion of Micro Loans), decreased 9.2% to GEL 934.5 million in 2009, accounted for 51.1% of total grow loan book at year end. Loans to individuals of GEL 862.4 million, declined by 20.1% compared to 2008, and represented 47.2% of total gross loans. Loans extended to State-owned entities in the amount of GEL 31.0 million, or a 15.6% decrease from 2008, continued to hold the smallest share with 1.7% of the total gross loan book.

Bank of Georgia maintained the diversified loan book across various sectors of the economy. By the end of 2009, ten largest borrowers accounted for 11% of the total gross loan book, at the same level as in 2008.

Allowance for the loan impairment increased from the prior year due to an increase in estimated losses predominantly for consumer loans, due to the weakening of economic environment. As a result, the Allowance for the loan impairment amounted to GEL 166.5 million, compared to GEL 106.6 million in 2008. Allowance for the loan impairment to gross loans ratio in 2009 increased to 9.1% from 5.0% in 2008.

**Allowance for loan impairment**

| *GEL thousands* | **2008** | **2009** | **Change** |
|---|---|---|---|
| Commercial loans | 45,755 | 82,042 | 79.3% |
| Consumer loans | 42,153 | 54,989 | 30.5% |
| Residential mortgage loans | 7,969 | 23,490 | 194.8% |
| Micro loans | 4,921 | 3,788 | -23.0% |
| Others | 5,803 | 2,177 | -62.5% |
| **Total** | **106,601** | **166,486** | **56.2%** |

As of 31 December 2009 the non-performing loans (NPLs) accounted for 7.7% of total gross loans (NPLs are more than 90 days overdue loans including principal and interest payment).

The Bank's loan book remains highly collateralized, with 87.9% of the total volume of gross loans to clients secured by mostly property, inventory and trade receivables for commercial lending and by mortgages over residential properties for individual lending.

**Liabilities**

As of 31 December 2009, Total liabilities decreased 8.9% to GEL 2,315.0 million, primarily due to the 23.7% decrease in the Amounts due to credit institutions to GEL 928.6 million following the repayment of the aggregate of GEL 225 million wholesale debt funding by the Bank during the year.

Amounts due to customers, or deposits, increased by 6.7%, or GEL 79.3 million, to GEL 1,272.5 million in 2009 driven by 28.7% increase in deposits from Individuals, which increased by GEL 142.0 million to GEL 637.8 million as of 31 December 2009. Deposits from Private enterprises declined by GEL 48.2 million, or 7.7% to GEL 578.9 million, while deposits of State and budget organizations decreased by GEL 14.5 million, or 20.6%, to GEL 55.8 million.

As of 31 December 2009, Time deposits of GEL 712.5 million accounted for 56.0% of total deposits, up from 48.7% in 2008, translating into the growth of 22.7%, or GEL 131.9 million. Current accounts declined by 8.6%, or GEL 52.5 million, to GEL 560.0 million.

As of 31 December 2009, ten largest customers accounted for 17% (or GEL 217.3 million), of deposits, down from 27% in 2008.

**Equity**

As of 31 December 2008, authorized share capital comprised of 43,308,125 ordinary shares, of which 31,306,071 were Ordinary shares issued and fully paid compared to 31,253,283 Ordinary shares issued and fully paid as of 31 December 2008.

**Regulatory capital and Capital adequacy (BIS)**

Bank of Georgia maintained a well-capitalised position, based on Tier I and Total Capital Ratios (BIS) as of 31 December 2009 and 31 December 2008.

| *GEL thousands, unless otherwise noted* | **2008** | **2009** |
|---|---|---|
| Ordinary shares | 31,253 | 31,306 |
| Share premium | 468,732 | 478,779 |
| Retained earnings | 137,768 | 38,625 |
| **Tier I capital** | **637,753** | **548,710** |
| Undisclosed Reserves | 56,913 | - |
| General loan loss provisions | 32,662 | 27,302 |
| Revaluation reserves | 26,201 | 24,387 |
| Subordinated term debt | 157,535 | 317,791 |
| **Tier II capital** | **273,311** | **369,480** |
| Deductions from capital | (134,238) | (67,454) |
| **Total Capital** | **776,826** | **850,736** |
| Risk weighted assets | 2,950,653 | 2,454,763 |
| **Tier I capital adequacy ratio** | **21.6%** | **22.4%** |
| **Total capital adequacy ratio** | **26.3%** | **34.7%** |

Total capital was GEL 850.7 million at 31 December 2009, compared with GEL 776.8 million in 2008, an increase of GEL 73.9 million. The increase in Total capital was largely attributable to the 35.2% increase of Tier II capital to GEL 369.5 million driven by the increase in subordinated term debt to GEL 317.8 million. The Bank's Tier I capital declined by 14.0% to GEL 548.7 million a result of the decline in Retained earnings of GEL 38.6 million in 2009.

Risk-weighted assets decreased by 16.8% to GEL 2,454.8 million in 2009 from GEL 2,950.7 in 2008, in line with the contraction of the loan book during the year.

National Bank of Georgia requires capital adequacy calculation based on the NBG methodology, which is done on a standalone basis. Based on the NBG calculation method, Bank of Georgia's Tier I and Total Capital Ratios as of 31 December 2009 were at 19.7%, and 16.8%, respectively, and above the statutory minimum of 8% for Tier I and 12% for Total Capital. In 2008, Tier I and Total Capital, based on the NBG methodology, amounted to 16.6% and 13.5%, respectively.

## Shareholders

| **31 December, 2009** | **Share** |
|---|---|
| Bank of New York (Nominees), Limited | 88.86% |
| East Capital Financial Institutions | 4.36% |
| Others (less than 4% individually) | 6.78% |
| **Total** | **100.00%** |

As of 31 December 2009 the members of the Supervisory Board and Management Board owned 612,962 shares of Bank of Georgia. In addition, the members of the Supervisory Board and Management Board and employees were awarded 463,912 and 198,139 GDRs in 2009 and 2008, respectively. The following table depicts the interest of the members of the Supervisory Board and Management Board as of 31 December 2009.

| Shareholder | 31 December, 2009<br>Shares and GDRs held |
|---|---|
| Irakli Gilauri, Chief Executive Officer (CEO) | 214,230 |
| Sulkhan Gvalia, Deputy CEO, Chief Risk Officer | 136,049 |
| Nicholas Enukidze, Chairman of the Supervisory Board | 122,259 |
| Allan Hirst, Vice Chairman of the Supervisory Board | 46,772 |
| Avto Namicheishvili, Deputy CEO, Legal Affairs | 29,999 |
| Irakli Burdiladze, Deputy CEO, Chief Operating Officer | 23,035 |
| Kakha Kiknavelidze, Member of the Supervisory Board | 15,027 |
| Mikheil Gomarteli, Deputy CEO, Retail Banking | 9,916 |
| David Morrison, Member of the Supervisory Board | 7,342 |
| Giorgi Chiladze, Deputy CEO, Finance | 6,333 |
| **Total** | **612,962** |

**Risks and Uncertainties**

The Bank is subject to the following Risks and Uncertainties.

Emerging Market Risks

Risks Relating to the Bank's Business

- Current Economic and Market Conditions
- Dependence on Banking and Other Licenses
- Geographical Diversification
- Liquidity Risks
- Exposure to Credit Risk of Corporations and Individuals
- Allowance for Impairment Loss Risk
- Enforcement of Security
- Foreign Exchange and Currency Risk
- Interest Rate Risk
- Risks Associated with Cost-Control Measures
- Risks Associated with Planned Disposals
- Competition
- Technological Risks
- Restrictive Covenants
- Dependence on Key Management and Qualified Personnel

Risks Related to Georgia and the Other Principal Markets

- Political Risk
- Regional Tensions
- Economic Instability
- Dependence on Donor Pledges
- Currency Regulation
- Developing Legal Systems
- Risks Related to Money Laundering and/or Terrorist Financing
- Uncertainties of Tax Systems
- Statistical Information
- Possible non-enforceability of foreign judgments and arbitral awards
- Volatility of the Trading Market

*The Audited Financial Statements are published as part 2 of the Annual Financial Report and will be available on the Bank's website at [www.bog.ge/ir](http://www.bog.ge/ir).*

The material presented above *is not a substitute for reading the full Annual Report and Accounts .The Annual Report and Accounts for the year ended 31 December 2009 will be available on the Bank's website on 30 April 2010.*

[1] Market date according to the information published by the National Bank of Georgia (NBG)

[2] Revenue equals sum of Net interest income, Net fee and commission income and Other non-interest income less Net insurance claims incurred

[3] Cost of funds calculation is based on monthly average balance in 2009 and 2008

[4] Average interest earning assets and Average interest bearing liabilities are based on monthly balances

[5] Includes held-to-maturity investment securities as well as Ministry of Finance treasury bills

[6] NIM calculations is based on monthly average balance in 2009 and 2008

[7] Expenses (Costs) comprise of Other non-interest expense less Insurance claims incurred