



Annual Report 2006

The Administration Division prepared and issued this report and will handle any comments or requests for further information related to the annual report.
Cover design, graphic images and pictures by the Marketing Division.

XacBank HQ
Prime Minister Amar's street
PO Box – 46/721
Ulaanbaatar-210604, Mongolia
Tel: 976-11-318185
Fax: 976-11-328701
E-mail: info@xacbank.mn
Web site: www.xacbank.mn



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

Our Mission

First, to contribute to the socio-economic development of the country by providing access to comprehensive financial services to all citizens and legal entities, including those who are normally excluded, e.g. low-income and remote rural households.

Second, but equally important, to maximize the value of shareholders' investment, while creating a profitable and sustainable financial institution.

International Ratings



Moody's Investors Service

XacBank became the first commercial bank in Mongolia rated by Moody's Investor Service, a global leader in credit and institutional rating services.

The Bank received the following Moody's rating on 5 December 2006, with the adoption of joint-default analysis methodology resulting in "Ba1" upgrades on 14 May 2007 in the long term global local currency deposit and long term domestic currency issuer ratings:

Long and short term foreign currency deposit rating	B2
Long and short term local currency deposit rating	Ba1
Long and short term foreign currency issuer rating	Ba2
Long and short term local currency issuer rating	Ba1
Bank financial strength rating (BFSR)	D

All the categories have "Stable" outlook.



Planet Rating, an agency specializing in rating of microfinance institutions, conducted its second rating of the Bank and in April 2006 assigned XacBank the "A" or 'Excellent' rating with a "Stable" trend. This was an upgrade from the "A-" assigned in 2004.

Below is the Bank's rating grades from Planet Rating:

	2006	2004
Governance	A	A
Information	B	B
Risk management	A	B
Activities	A	A
Financing and Liquidity	A	A
Efficiency and Profitability	A	B
Rating	A	A-

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OUR CREDO

We believe our first responsibility is to our clients – rural and urban residents of Mongolia micro and small business people, herders and employed people without conventional access to financial services. In meeting their needs everything we do must be of high quality. We must constantly strive to reduce our costs in order to maintain reasonable prices. Client's orders must be serviced promptly and accurately in a friendly fashion. Our business partners must have an opportunity to make a fair return.

We are responsible to our employees, men and women, who work with us throughout Mongolia. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs. Compensation must be fair and adequate to performance, and working conditions clean, orderly and safe.

We must be mindful of ways to help our employees fulfill their family and social responsibilities. Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement adequate to qualification and performance. We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities, in which we live and work. We must be good citizens – abide by the laws, support good work and charities, and bear our fair share of taxes. We must encourage civic improvements and better health and education. We must maintain in good order the property we are privileged to use, protecting the environment and natural resources as our own.

Our final responsibility is to our shareholders. Business must make a sound profit. We must experiment with new ideas. Research must be carried out, innovative programs developed and mistakes paid for. Reserves must be created to provide for adverse times.

When we operate according to these principles, our clients will benefit from our services, our employees will have high morale, and shareholders should realize a fair return, which all in the end should lead to development of Mongolia.

XACBANK

GRI Content Index

	Pages		
1. Vision and Strategy			
1.1 Statement of sustainable development	2	EN6. Renewable energy products and services	28,30
1.2 Statement of key elements	2	EN7. Initiatives to reduce indirect energy use	28,30
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2.2 Principal activities	59	EN11. Land with high biodiversity	23
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2.6 Legal form	59	EN15. IUCN Red List species affected	N/A
2.7 Markets served	59	EN16. Green house gas emissions	N/A
2.8 Key figures	16	EN17. Indirect greenhouse gas emissions	N/A
2.9 Shareholders and size	4-5	EN18. Initiatives to reduce greenhouse gases	N/A
2.10 Contact person for report	5,11	EN19. Emission of ozone-depleting substances	N/A
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3.3 Reporting cycle	53	EN24. Transported hazardous waste	N/A
3.4 Contact point	5,11	EN25. Water ecology affected by water discharge	N/A
3.5 Process of defining scope	8-11	EN26. Initiatives to mitigate environmental impacts	30
3.6 Boundary of report	8-11	EN27. Packaging material reclaimed	N/A
3.7 Statement of reporting limitations	8-11	EN28. Environmental fines	N/A
3.8 Outsourced operations	26	EN29. Environmental impact of transportation	N/A
3.9 Data measurement methodology	N/A	EN30. Environmental protection expenditure	N/A
3.10 Re-statements	N/A	Social Performance	
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EN3. Direct energy consumption	N/A	PR7. Non-compliance with marketing regulations	N/A
EN4. Indirect energy consumption	N/A	PR8. Customer confidentiality	2,11
EN5. Total water withdrawal	N/A	PR9. Breaches in product and services regulations	N/A
		<i>Note: N/A = Not Available</i>	

Board of Directors Report

DEAR SHAREHOLDERS, CLIENTS, PARTNERS AND STAFF,

The Board of Directors of XacBank is pleased to present to you this annual report of the results achieved by the Bank as accompanied by the Management Report and Audited Financial Statements for the year ended on 31 December 2006.

2006 has been yet another successful year for the Bank as it has consolidated previous achievements and positioned itself firmly in the Mongolian banking and financial sector. The Bank earned a net income after tax of MNT¹ 1.8 billion during the reporting period, generating a 2.4 percent return on assets. Total assets of the Bank reached MNT 89.1 billion with the gross loan portfolio of MNT 59.8 billion, while maintaining an excellent portfolio quality.

The Bank was evaluated by the Planet Rating agency in the second quarter of 2006, earning "A" or "Excellent" - a point higher from the previous rating. In December 2006, the Moody's Investors Service assigned a first-time "Ba1" rating to XacBank in the long term global local currency deposit and long term domestic currency issuer ratings, which reflects the Bank's well-managed micro-finance franchise service, its strong profitability, solid capital position and superior asset quality. In both of these international ratings, XacBank scored higher than two other largest Mongolian banks that obtained ratings, which stands as proof of demonstrated capacity for further sustainable growth of the organization, anchored by its Vision and Mission.

The annual shareholders' regular meeting was held in June 2006, in Ulaanbaatar, to discuss operational and financial performance reports by the Board and Management for the fiscal year 2005. MicroVest's share conversion was approved and election of directors was carried out.

The Board met in five plenary sessions during the year to decide upon matters as stipulated in the Charter of the Board, with no issues to call an extraordinary meeting. The four standing committees provided necessary technical input between the Board meetings, monitored the Bank's performance, reviewed key agenda items for further discussion and decision making by the full Board of Directors. Conclusion of investment agreements with the European Bank of Reconstruction and Development (EBRD) for USD 5 million, BlueOrchard Finance together with Morgan Stanley for USD 6.5 million, Deutsche Bank's Global Commercial Microfinance Consortium for USD 4.5 million (in MNT equivalent) and Triple Jump for USD 2.5 million (in MNT equivalent) were major decisions made by the Board upon presentation by the management.

As part of its policy setting role, the Board approved several key policy documents developed by the management, including Credit Policy, Risk Management Policy, Financial Risk Management Policy and Funds Management Policy. In December, the Board approved the Bank's Action Plan and Budget for 2007 with a commitment to the Global Reporting Initiative (GRI).

The Board approved a proposal by the management team to replace the Bank's current Management Information System (MIS) as a forward planning strategic move. Given its significance and magnitude of change ahead, status updates on MIS migration became a permanent item on the agenda of the Board. Renovation of the HQ building and acquisition of the adjacent building for infrastructure expansion have been approved by the Board in addition to permitting injection of further investments for new acquisitions and renovations in 2006.

During its March meeting, the Board approved management's request to distribute shares from the Employee Stock Ownership Program (ESOP) fund allowing the Bank's employees, who met eligibility criteria, to own shares in the Employee Investment Trust (EIT) LLC. MNT 247.2 million worth of stocks were approved for ownership to qualified employees at a 50 percent discount rate. This action was a part of the human resources management strategy to

¹ MNT – Mongolian national currency, Tugrog

provide a positive incentive to employees, in light of relatively high turnover rates experienced by the Bank.

There were several significant changes in the shareholding structure during the past year. Two of the founding shareholders of XAC-GE LLC, the holding company of XacBank, the Liberal Women's Intellectual Pool (LEOS) and Local Governance Development Fund (LGDF) decided to divest their shareholding in the Group. ShoreCap International, Triodos-Doen and Triodos Fair Share Fund, and EIT LLC exercised their preemptive rights to purchase these shares. Sale of 200,000 shares by LEOS left them a minor stake of 14,581 shares in the holding company.

Correspondingly, several major changes occurred in the membership of the Board during the past year. Mr. Munhbat Ganhuuyag, Vice President of LGDF and Ms. Enhtuya Tsend, Chairperson of LEOS, resigned from the Board. Mr. Tanto Hiroshi was invited to join the Board after Newcom Group acquired LGDF shares in December 2005. Mr. Mark Coffey, President of ShoreBank Pacific, joined the Board replacing Ms. Anne Arvia, who moved on to accept a position with another bank. Mr. Steve Zimmerman was replaced by Mr. Jim Anderson, Senior Technical Advisor from Mercy Corps. The Board of Directors endorsed and the shareholders approved EIT LLC application for representation in the Board in December. The Board welcomes back Mr. Stephen D. Vance, its first Chairman until 2003 and founding Chairman of Goviin Ehlel (Gobi Start) LLC, one of the two merger partners, which created XacBank in 2001.

The Board wishes its departing colleagues well in their future endeavors and warmly welcomes new directors. It firmly believes in the added value they are bringing as experienced professionals and as outstanding individuals to the Bank in the course of fulfilling its Vision and Mission.

The Board conducted a self-appraisal in 2006 to enhance its corporate governance system, the results of which were presented for discussion at its June meeting. The Board plans to enrich further the appraisal system, aiming to align the long-term strategic objectives of the Bank with the skills and qualifications required for the Board to provide necessary leadership and guidance. Meanwhile, changes in the rank of Board of Directors provided an opportunity to strengthen the composition of the Board's standing committees to better address the changing needs based on professional experience and insights of the directors. The President of the Bank, Mr. Bold Magvan, became a non-voting member of the Executive Committee of the Board - another important development that addresses the succession planning for the Bank's senior management.

The Board continued building its technical capacity through participations in international training on general bank management and best practices in microfinance. Mr. Zorigt Namsrajjav, Mr. Bekhbat Sodnom and Ms. Erdenechimeg Jambaldorj took part in international conferences and training events in Hungary and in the United States of America in 2006.

Finally, the Board is pleased to recommend a dividend of MNT 66.22 per share based on the results of 2006. This dividend constituted 30 percent of the Bank's MNT 1.8 billion net income that represents a yield per share of 6.62 percent. In keeping with XacBank's previous practice, 70 percent of retained earnings are proposed to be transferred to the general reserve fund.



Ch. Ganbold, Chairman of the Board of Directors

Board of Directors

CHAIRMAN:

Mr. Ganbold Chuluun
Mercy Corps, CEO of EDN Co LTD
Serving from 2003 to present

DIRECTORS:

Ms. Anne Arvia	ShoreCap International, President, COO of ShoreBank Served from 2005 to 2006
Mr. Bekhbat Sodnom	Rotary Club of Ulaanbaatar, Member of the Board Serving from 2005 to present
Ms. Erdenechimeg Jambaldorj	Mongolian Women's Federation, President Serving from 2001 to present
Ms. Enhtuya Tsend	Liberal Women's Intellectual Pool, Chairperson Served from 2003 to 2006
Ms. Erdenejargal Perenley	Open Society Forum, Executive Director Serving from 2005 to present
Ms. Femke Bos	Triodos Fair Share Fund and Triodos-Doen, Fund Manager of Triodos Doen Serving from 2005 to present
Mr. Ganhuyag Ch. Hutagt	XacBank, CEO Serving from 2001 to present
Mr. Gil Crawford	Micro Vest One, LP, Managing Director Serving from 2005 to present
Mr. Jim Anderson	Mercy Corps, Senior Technical Advisor Serving from 2003 to present
Mr. Mark Coffey	ShoreCap International, President of ShoreBank Pacific Serving from 2006 to present
Mr. Munhbat Ganhuyag	Local Governance Development Fund, Vice President Served from 2003 to 2006
Mr. Stephen D. Vance	EIT LLC, Asia Region Director, Chemonics International Elected in 2006
Mr. Stephen Mitchell	Mercy Corps, CFO Serving from 2002 to present
Mr. Tanto Hiroshi	Newcom LLC, CEO Served from January 2006 to January 2007
Mr. Zorigt Namsrayjav	Tuushin LLC, General Director Serving from 2004 to present

Standing Committees of the Board of Directors

EXECUTIVE COMMITTEE

Chairman: Mr. Ganbold Chuluun
Members: Mr. Bold Magvan
Ms. Erdenejargal Perenley
Mr. Ganhuyag Ch. Hutagt
Mr. Jim Anderson
Mr. Tanto Hiroshi

AUDIT COMMITTEE

Chairman: Mr. Stephen Mitchell
Members: Ms. Erdenechimeg Jambaldorj
Mr. Jim Anderson
Mr. Zorigt Namsrayjav

RISK MANAGEMENT COMMITTEE

Chairman: Mr. Mark Coffey
Members: Mr. Bekhbat Sodnom
Mr. Ganhuyag Ch. Hutagt
Mr. Gil Crawford
Ms. Femke Bos

CREDIT COMMITTEE

Chairman: Mr. Jim Anderson
Members: Mr. Ganhuyag Ch. Hutagt
Mr. Gil Crawford
Ms. Femke Bos

Management Report

“The reward for work well done is the opportunity to do more.”

Dr. Jonas Edward Salk

EXECUTIVE SUMMARY

The management of XacBank presents the operational and financial performance report for the fiscal 2006 – the Year of the 800th anniversary of the Great Mongol State as well as the 8th anniversary of the Bank. Management would like to highlight the fact that this is its first annual report built around the Global Reporting Initiative (GRI) framework, which is believed to be the first-ever such effort in Mongolia.

Overall, positive trends in the economic and fiscal situation of the country sustained from previous years resulted in a generally positive operating environment in which the Bank grew by 50 percent amidst intensifying competition, and crisis in the savings and credit cooperatives sector.

Net income after tax, despite being short of the projections, grew to MNT 1.8 billion, which is reflected in the ROAE of 17.8 percent.

Total loan portfolio grew by 57.1 percent to MNT 59.8 billion², of which 27.7 percent came from loan disbursements to micro entrepreneurs and nomadic herders, 42.1 percent from mortgage and SME loans and 30.3 percent from other loans. Portfolio at risk (PAR) with delinquent payments over 1 day was maintained at satisfactory 1.5 percent of the outstanding portfolio.

Total deposits reached MNT 42.6 billion up from MNT 30.9 billion despite intense competition for public deposits from other commercial banks. The management implemented policies throughout the year on lowering the cost of funding through lower rates paid on public deposits coupled with the decision to focus on attracting international commercial funding rather than competing on deposit interest rates. Lending rates continued their downward slide and the yield on the Bank's portfolio reached a new low of 29.2 percent further reducing margins.

In 2006, the Bank launched many new initiatives and continued further development of existing products, which included: financial leasing for renewable energy technologies; expansion of franchisee financing and adjustments to the Mobile Banking service; introduction of IT-based banking services; the new student tuition and housing finance products. These are products of innovation combined with time-tested concepts of financial market instruments, and from which the Bank expects to start yielding positive results in the very near future. Also, through the review of related internal policies and procedures, the GRI requirements began to be implemented, including loan product manuals and forms. XacBank spent time and effort on developing appropriate policies and infrastructure for SME financing, enabling the Bank to tap this market opportunity - financing new technologies and know how, and providing greater support to employment generation - the new priorities established by the government for private sector initiatives in 2007.

The Bank pursued a policy of gradual shift from direct lending in soums³ to offering financial services through a network of rural franchisee cooperatives. The Pro-Poor Innovation Challenge Grant of USD 50,000 from the Consultative Group to Assist the Poor (CGAP) financed improvements in the franchising model of the Bank. Over 80 savings and credit cooperatives have signed up to provide XacBank's services and 19 of these are using a management information system (MIS) developed in-house by the Bank's own IT team. This new strategy should help reduce risks and costs associated with the delivery of lending services to the most remote areas of the country.

The mortgage loan product of the Bank stayed competitive and the portfolio stood at MNT 9.1 billion at year-end. The Bank took a leadership position in the housing finance initiative and is chairing the Board of Directors of the newly established Mongolian Mortgage Corporation (MIK) established to promote secondary trading of mortgage backed securities and enable access to longer term funding by commercial banks.

² Before adjustments by auditors

³ Soum – a rural administrative unit, county

Management continued its efforts to better position the Bank in the international worker remittances market. The Eurogiro system configuration, delayed due to internal technical adjustments by the vendor, is expected to become fully operational in the first half of 2007.

The Bank continued to expand its correspondent banking network and Sberbank (Savings Bank) in the Russian Federation, Kookmin Bank in the Republic of Korea, Sumitomo Mitsui Banking Corporation in Japan and the National Bank of Canada opened nostro accounts for XacBank. Management is working further to establish partnerships with a number of banking institutions in the countries of strategic interest to Mongolia in 2007.

In the fast developing world of technology-based banking services, the Bank commissioned an assessment of its IT needs and following the expert recommendations made a decision to migrate to a new MIS capable of carrying its future expansion and innovation needs. The new MIS system will allow a full reporting under the GRI framework. The Bank also continued to connect its branches and extensions to an online network, completing work at all branches in Ulaanbaatar and 5 aymags in 2006, in other words 46 out of a total 65 branches and extension units. This online connectivity allows the Bank not only to offer more robust customer service, but also improve efficiency of internal communications, bringing cost savings and improving client information security. Investments made in the Contact Center resulted in opening a call center by the end of August 2006 – the first fully functional IVR⁴ powered system in Mongolia.



Official opening of the Bank's Contact Center took place on 29th of August 2006. HE Ms. Katalin Szilli, Speaker of the Hungarian Parliament, and Mongolian government officials participated in the ribbon-cutting ceremony. The Contact Center, a first of its kind in Mongolia, will provide information on all XacBank products and services and can be reached at the Bank's dedicated telephone hotline number – 1888.

In 2006, the Bank's card business expanded rapidly, attracting over 21 thousand card account holders, advancing its market position to the fourth among the card issuing banks.

The stable financial performance of XacBank and overall positive situation in the Mongolian economy enabled the Bank to increase further the local currency share in the commercial funding mix. A total of USD 20 million was brought in from local and international funding organizations. Furthermore, 38.2 percent of assets were funded by commercial loans from investors such as EBRD, Deutsche Bank, Morgan Stanley, Triodos Bank and Calvert Foundation. At the same time, the Bank continued accessing other funds through cooperation with international initiatives in Mongolia such as IFAD supported Rural Poverty Reduction Program, ADB funded

⁴IVR (Interactive Voice Response) is a telephony technology in which someone uses a touch-tone telephone to interact with a database to acquire information from or enter data into the database.

Employment Generation Project and Agricultural Sector Development Project, Microfinance Development Fund Project implemented by World Bank and Small and Medium Enterprise (SME) Support Project initiated by Ministry of Trade and Industry.

Important changes were made during the year to further streamline the Bank's executive management structure and add necessary breadth and depth to its functions. To this effect, in January 2006 Ms. Gerelmaa Yunden assumed the responsibilities of the Chief Credit Officer (CCO) of the Bank in place of Ms. Delgerjargal Bayanjargal, who took a maternity leave. Later in the year, upon her return, Ms. Delgerjargal was appointed as the Chief Financial Officer (CFO), in place of the first CFO of the Bank, Mr. Bat-Ochir Dugersuren, who took a sabbatical leave to attend a master's degree program in the United States. Mr. Tur-Od Lhagvajav joined the Bank as Director of the Administration Division in October.

In an unprecedented event, the Mongolian national currency - the togrog - appreciated 4.5 percent against the US dollar year-on-year. Important changes were introduced in the tax regime of the country to become effective in January 2007. Corporate, personal income and value added taxes were all lowered to a flat 10 percent, which places Mongolia in the ranks of countries with most enabling taxation environments in the world. These changes coupled with the Bank's own initiatives to enhance its operational performance present a positive and stable institutional outlook for the near future.

The Bank will focus on further reducing operating cost ratios, tightening control over portfolio quality, increasing non-interest income, and delivering high quality customer care in order to improve and sustain its competitive edge.

OUR BRIEF HISTORY

XacBank was created as the result of a merger of the two largest non-bank financial institutions (NBFI) in Mongolia, Goviin Ehlel (Gobi Start) LLC and X.A.C (Golden Fund for Development) LLC, on 1st of October 2001. Goviin Ehlel LCC was established by Mercy Corps in December 1999 with funding from USAID as a NBFI serving rural businesses. X.A.C. LLC began in 1998 as part of the MicroStart Mongolia project under UNDP, shortly afterwards transformed into Mongolia's first NBFI by uniting the micro-financial service activities of six national NGOs.

These NBFIs originally operated in different geographic regions and were serving different markets, Small and Medium enterprises loans vs. Micro business. However, both organizations had the same strategic goal of becoming nationwide banking institution, offering a full range of financial services. All these factors became the foundation of the merger of these two independent institutions to form XacBank - the first commercial bank in Mongolia with a social mission.

By the end of its first year of operation in 2002, the Bank established its presence in each of 21 aymags⁵ in the country. Since that time the Bank has continued to expand with new branch and extension openings, fulfilling its mission and strategy of providing the most accessible and transparent banking services aimed at the marginalized citizens in remote rural areas, including the nomadic herders. The Bank is continuously growing and becoming a dynamic leader in offering a full range of innovative loan and deposit products as well as personalized customer service targeted at various segments of the market and supporting the business development in Mongolia.

⁵ Aymag - largest rural administrative unit, province.

Additional key factors for enhancing XacBank's competitive position in the banking sector are:

- Improve the Bank's client service delivery through cost-effective, technology-based solutions. Continue building its capacity to enable further expansion of small and medium enterprise banking and trade financing services, especially in rural areas;
- Enhance the Bank's leading position in the micro and small credit market by building a nationwide retail banking network to capture greater market share and by opening up new market niches in rural areas, both through its own branches and in cooperation with other like-minded institutions with a nationwide outreach;
- Relentlessly pursue the Bank's staff skills and knowledge building and sharing opportunities. Continue developing regional and global networks and partnerships.

Management acknowledges several challenges and issues faced during the past year. Specifically: outreach numbers were short of plans; the Bank struggled to maintain its portfolio quality; building renovation and construction projects were not completed according to approved schedules; employee turnover rate did not drop as anticipated, effectively staying at 2005 levels; the Bank did not meet its profit goal for the year. Management will draw lessons from these shortcomings and will focus on further strengthening its internal management system, structure and processes as it moves into ever more competitive and fast evolving market in 2007.

The abovementioned challenges point to a certain degree on the continuing saturation of the microfinance market and costs associated with efforts to expand the Bank's outreach to remote regions in a restricted market such as Mongolia. However, the Bank stays firmly committed to its Vision and Mission, and continues to seek opportunities to serve existing and potential clients through innovation and improvement in customer service quality, competitive pricing owing to its streamlined operations, as well as continuing the further growth of its infrastructure.

XacBank believes that sustainable development can only come from educated and skilled people and businesses concerned equally about Planet, People and Profit. This new, triple bottom line approach will enrich the Bank's current Vision and Mission. The Bank is committed to economic, environmental and social reporting under the GRI framework, which the management firmly believes to be of strategic importance both to the Bank and to the Mongolian society. Thus, XacBank will position itself to become a champion of corporate social responsibility in 2007.

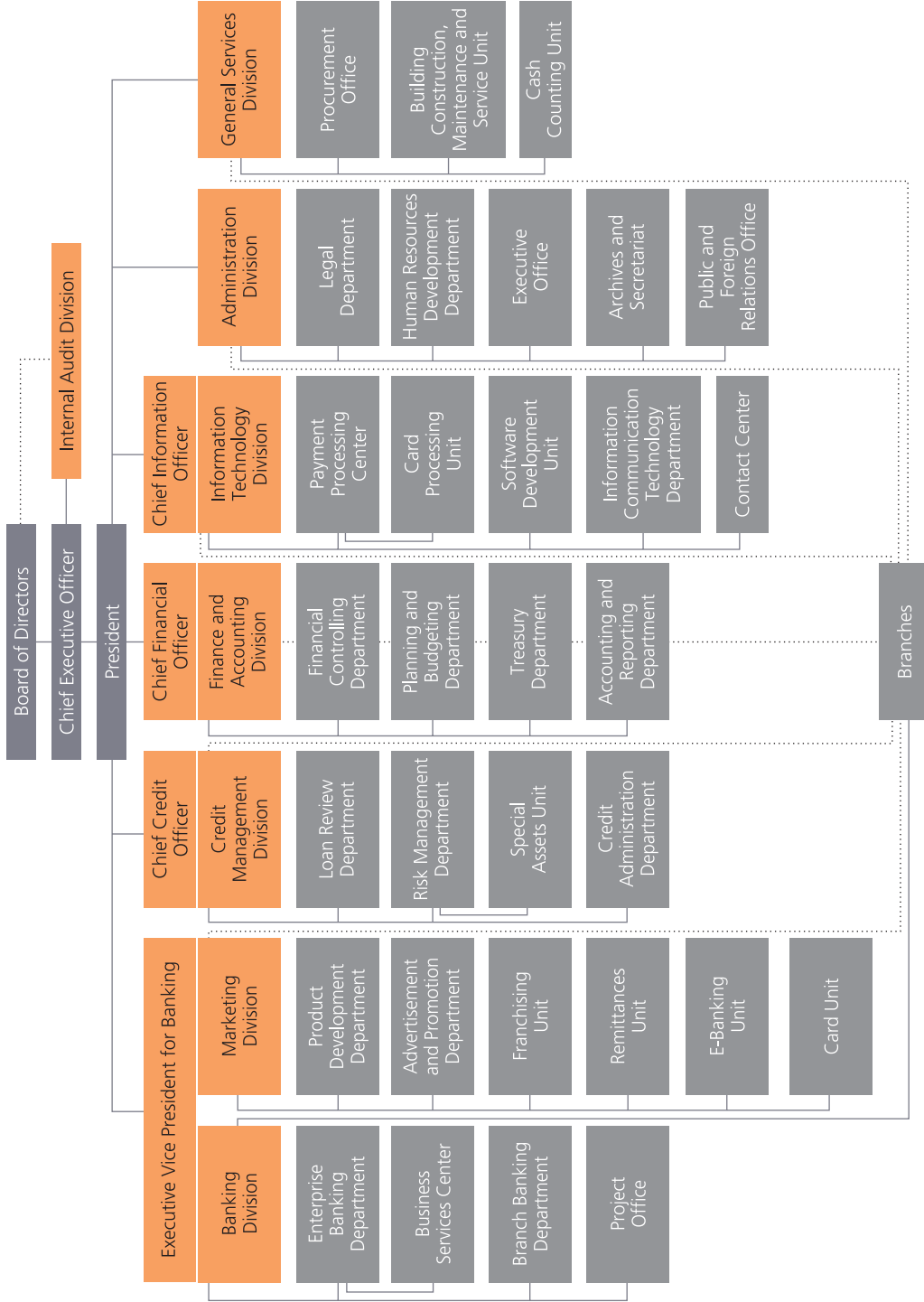


Ganhuyag Ch. Hutagt, Chief Executive Officer

Executive Management Team

Mr. Batbold Aryasuren	Chief Operating Officer (until October 2006) Director, Administration Division
Mr. Bat-Ochir Dugersuren	Chief Financial Officer (until August 2006) Director, Finance and Accounting Division
Mr. Bold Magvan	President
Ms. Delgerjargal Bayanjargal	Chief Financial Officer (from October 2006) Director, Finance and Accounting Division
Ms. Erdenechimeg Dorjgotov	Chief Auditor Director, Internal Audit Division
Mr. Ganbat Baramsay	Director, General Services Division
Mr. Ganhuyag Ch. Hutagt	Chief Executive Officer
Ms. Gerelmaa Yunden	Chief Credit Officer Director, Credit Management Division
Mr. Naranbaatar Urtnasan	Chief Information Officer Director, Information Technology Division
Mr. Soronzonbold Lhagvasuren	Executive Vice President Director, Banking Division
Mr. Tur-Od Lhagvajav	Director, Administration Division (from October 2006)

Organizational Chart of the Bank



Highlights of the Year

- XacBank's net after tax income was MNT 1,773.2 million. Its total assets reached MNT 89.1 billion with the gross loan portfolio of MNT 59.8 billion.
- Moody's Investors Service rating made XacBank as the first commercial bank in Mongolia to receive a rating of "Ba1" from the mainstream international rating agency. The ratings assigned were higher than the country ratings for all debt issuances, while the financial strength rating was a notch higher than of the Trade and Development Bank.
- Planet Rating's second time assessment of XacBank upgraded its earlier rating to "A" or "Excellent" for being a model in the microfinance sector, which is one point higher than that of Khan Bank's first time rating in the same year.
- XacBank concluded agreement with the BlueOrchard Finance, a Geneva-based microfinance asset management company, and Morgan Stanley, an American investment bank, to participate in a USD 100 million structured finance transaction.
- XacBank arranged a USD 2 million five-year term credit facility from Symbiotics SA, a Geneva-based microfinance investment brokerage company, as its first transaction in Mongolia. Symbiotics acted as a co-arranger with Development World Markets, a public-private partnership with extensive structured finance experience.
- Deutsche Bank's Global Commercial Microfinance Consortium, an international group of institutional, corporate and development investors, has provided local currency financing equivalent to USD 4 million for four years to XacBank.
- XacBank established correspondent banking relationships with Sberbank in Russia, Kookmin Bank in the Republic of Korea, Sumitomo Mitsui Banking Corporation in Japan and the National Bank of Canada.
- Mongolian National Chamber of Commerce and Industry (MNCCI) awarded XacBank with the inaugural "Best Good Corporate Governance" Award at its annual "Mercury 2006" ceremony. This award was followed by joint with Government of Mongolia newly instituted award – "Top Corporate Social Responsibility" Award for 2006.
- The Bank's XacMasterCard marketing campaign was given the "Best Television Advertisement" Award followed by the "Best FIFA Program of the Year" at the MasterCard Worldwide meeting for member organizations held in Beijing, China.
- CGAP's Financial Transparency Annual Award was presented to XacBank by HRH Prince Willem Alexander of the Netherlands (Prince of Orange) and HRH Princess Maxima during their visit to Mongolia.
- XacBank became a runner-up in the European Microfinance Awards for 2006 in recognition of the Bank's work to reduce poverty through innovative solutions that increased rural outreach and contributing to the creation of an inclusive financial sector.
- XacBank organized the first National Conference of Franchisee Savings and Credit Cooperatives, which elected the Consultative Committee of Franchisee Cooperatives. Rural representatives of more than 120 soums participated and shared their experiences.
- XacBank signed a Memorandum of Understanding with the Financial Regulatory Commission (FRC), a newly created government agency charged with monitoring and regulating all non-bank financial institutions. This document outlines collaborative ways to support and strengthen franchisee savings and credit cooperatives in rural areas.



In September 2006, Mr. Jean Lemmier, President of the European Bank of Reconstruction and Development (EBRD), signed the first investment agreement in Mongolia, providing XacBank with a loan of USD 5 million.

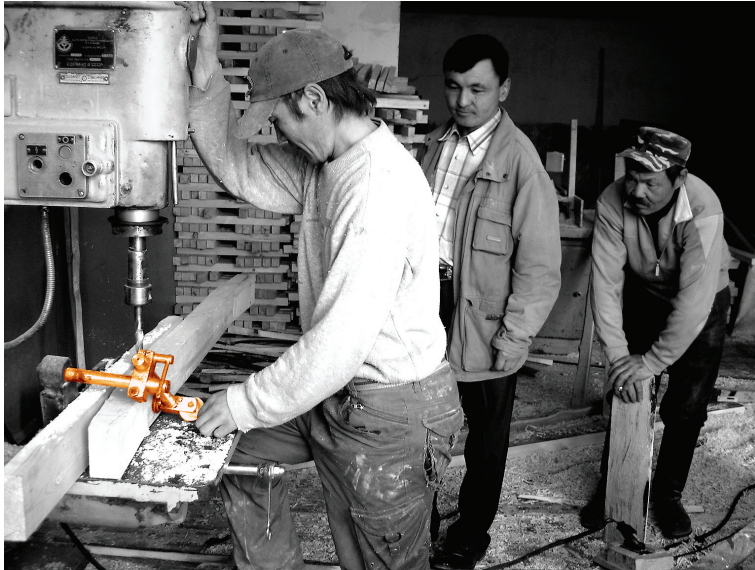
- XacBank celebrated the Bank's 50,000th "Future Millionaire" child savings account holder.
- XacBank Received the Visa International Associate Membership license and is in the process of developing Visa cards for launch in the second quarter of 2007.
- XacBank signed a Letter of Cooperation with the Mayor of Ulaanbaatar city to work towards improving living conditions of the ger⁶-district residents and reducing air pollution in the capital city.
- XacBank agreed to issue soft loans of MNT 300 million to micro-entrepreneurs, on behalf of the Enterprise Mongolia project implemented by the Ministry of Industry and Trade and UNDP.
- XacBank was named one of the five finalists, from an applicant pool of over 250 microfinance institutions worldwide, in this year's Pro-Poor Innovation Challenge Round VIII, organized by the Consultative Group to Assist the Poor (CGAP), a consortium led by the World Bank. The Bank received a USD 50,000 grant to scale up its franchisee cooperatives activities.
- XacBank opened the Contact Center during the official ceremony attended by HE Ms. Katalin Szilli, Speaker of the Hungarian Parliament. A first of its kind in Mongolia, it will provide information on all XacBank products and services via a dedicated telephone hotline – 1888.
- XacBank became the first Mongolian member of the Eurogiro network, in order to provide international remittances service for Mongolians working and living abroad.
- XacBank provided consultancy service and training for the Kazakhstan Loan Fund (KLF), a major microfinance institution from Almaty. The Bank also assisted Barakot, a Mercy Corps project in Uzbekistan.
- XacBank received the "Capital City's Best Business Entity for 2006" Award from the Mayor of Ulaanbaatar city.
- Foreign Investment and Foreign Trade Agency (FIFTA) awarded XacBank in recognition of its contribution made to promote Mongolia as an investment host country in 2006.

⁶ Traditional nomadic dwelling of Mongol people made from felt and wooden structures

FINANCIAL AND OPERATIONAL SUMMARY (IN MILLIONS OF MNT, UNLESS OTHERWISE INDICATED)

INDICATORS	2006	2005	Change (2006 vs. 2005)	
ASSETS AND PORTFOLIO			(06-05)	%
Total assets	89,115.7	59,252.3	29,863.4	50.4
Earning assets	67,752.0	44,120.4	23,631.6	53.6
Gross portfolio outstanding	59,813.0	38,077.9	21,735.1	57.1
Number of active loans	56,744	50,101	6,643	13.3
Average loan balance (In thousands of MNT)	1,054.1	760.0	294.1	38.7
Yield on portfolio (%)	29.24	32.75	(3.51)	(10.7)
PAR >1 day (%)	1.32	0.97	0.35	36.2
Number of loans per credit officer	261	86	(25)	(8.7)
PUBLIC DEPOSITS				
Demand and time deposits	37,197.9	27,226.6	9,971.3	36.6
Number of depositors	82,868	65,056	17,812	27.4
Balance of current accounts	5,372.8	3,671.5	1,701.3	46.3
Number of current accounts	66,785	53,773	13,012	24.2
Deposit to loan ratio (%)	62.2	71.5	(9.3)	(13.0)
BORROWED FUNDS				
Project funds	3,872.9	3,320.1	552.8	16.6
Interbank borrowings	4,080.0	4,100.0	(20.0)	(0.5)
Foreign funds	26,119.8	10,068.1	16,051.7	159.4
PROFITABILITY AND EFFICIENCY				
Net income after tax	1,773.2	1,488.9	284.2	19.1
ROA (%)	2.4	3.3	(0.9)	(27.4)
ROE (%)	17.8	23.6	(5.9)	(24.8)
PRUDENTIAL RATIOS				
Capital adequacy (%)	15.81	21.12	(5.3)	(25.2)
Currency mismatch (%)	8.7	2.3	6.4	275.5
Liquidity ratio (%)	24.0	26.6	(2.5)	(9.5)
Largest related party lending (%)	3.5	1.4	2.1	149.1
Largest loan exposure (%)	3.7	1.7	2.0	116.2
MEMORANDUM ITEMS				
Number of employees (including XacSecurity)	836	700	136	19.4
Number of branches & extension units	65	55	10	18.2
Number of card holders	21,252	9,030	12,222	135.4
Number of soums covered	182	165	17	10.3
Number of LAC members	379	495	(116)	(23.4)
Number of SCCs	80	51	29	56.9
Number of SCCs' members	4,830	2,400	2,430	101.3
Number of SCCs' borrowers	2,471	1,229	1,242	101.1
MAIN ECONOMIC INDICATORS				
Inflation rate (%)	6.0	9.5	(3.5)	(36.8)
Exchange rate (MNT/USD)	1,165	1,221	(56)	(4.6)
GDP growth rate (%)	8.4	6.2	2.2	35.5
GDP per capita (MNT thousands)	1121.2	888.4	232.8	26.2

Sources: XacBank and Government of Mongolia, 2007



A CLIENT SUCCESS STORY

XacBank client Mr. Hureltogoo Dashdorj graduated from the Darhan Polytechnic vocational school in 1989 and began his career at the construction unit of Arhangay aymag's Heating Plant. In 2002, when the construction unit was privatized, he left to start up his private business. Mr. Hureltogoo started a private carpentry shop in 1992 making furniture during his spare time. He financed the purchase of materials from his savings of MNT 20,000 (approximately \$18) and sold his products to residents of the aymag center. ▶▶

External Environment

MACRO ECONOMIC ENVIRONMENT

Favorable macro economic and weather conditions in 2006 coupled with auspicious mineral prices in the world market provided Mongolia with the robust economic growth - greater capital inflows particularly into the mining and construction sectors and a recovery of livestock herds after consecutive droughts and hard winters. Real GDP is estimated to have risen by over 8 percent⁷ in 2006, up from 6 percent in 2005, and GDP per capita rose near to USD 1000. After the 9 percent upward spike in 2005, inflation has been brought back down to 6 percent; and the budget and current account balances recorded growing surpluses in 2005-06, for the first time during the last several decades.

The estimated foreign trade turnover is at its historical high of USD 3.0 billion, with exports and imports reaching about USD 1.5 billion each, producing a foreign trade surplus of USD 39.6 million. Compared to 2005, the total foreign trade turnover increased by 34.2 percent, within which exports rose by 43.6 percent and imports by 25.7 percent. This positive outcome was influenced by an exceptionally favorable improvement in the terms of trade, driven by high prices of copper and gold in the world market accompanied with the increase in the volume of exports of raw cashmere and textiles.

The increased foreign investment inflow and remittances, as well as mineral production resulted in remarkable growth of currency reserves, which amounted to USD 687.3 million, to reach 24 weeks of imports of goods and services at end-2006. The net present value of external public debt is estimated to fall to 32 percent of GDP, half the level at end-2003.

The improvements in the terms of trade and capital inflows reflected in exchange rate developments. The real effective exchange rate of the togrog has appreciated by about 18 percent since end-2004. In terms of USD, the togrog depreciated by 0.5 percent in 2005, while appreciating by 4.5 percent during the 2006.

The fiscal position continued its dazzling improvement in the last few years, brought about by an increase in mining revenues, as well as the introduction of a new windfall tax on copper and gold. The overall budget surplus widened from 3 percent of GDP in 2005 to an estimated 4 percent of GDP in 2006. The budget revenues and aid reached MNT 1,353.2 billion, expenditures MNT 1,228.7 billion.

Mongolia received favorable ratings in international business environment surveys. In 2006, Mongolia was formally surveyed and ranked in the World Economic Forum's (WEF) Growth Competitiveness Index. The following indices reflect Mongolia's international rankings: economic growth competitiveness index at 96th; macroeconomic environment index at 105th; macroeconomic stability at 94th; access to credit at 35th; and technology index at 81st. Overall, Mongolia ranked 97th out of a total 117 countries covered. Although the ranking went down from a previous 90th position, Mongolia still positioned higher than the average developing country, performing better in most business environment related indicators. In Transparency International's Corruption Perceptions Index for 2006 Mongolia stands better than all the CIS countries, although the country ranking has dropped down.

In January 2007 Moody's Investors Service has assigned to Mongolia a "Ba1" local currency bond ceiling and a "Ba2" local currency deposit ceiling with a "Stable" outlook. In March 2006 Moody's first annual report on Mongolia gave the country "B1/B2" ratings amid improving government's fiscal position and a reduction in government debt burden.

POVERTY SITUATION

New survey data for 2006 show that poverty in Mongolia has continued to fall in recent years. The national

⁷ Government of Mongolia 2007



HRH Prince Willem Alexander of the Netherlands (Prince of Orange) and HRH Princess Maxima visited XacBank during their June 2006 royal visit to Mongolia and presented CGAP's Financial Transparency Award for 2005.

poverty headcount fell from 36 percent in 2002 (i.e. the date of the previous comparable household income and expenditure survey) to 32.6 percent in the first 9 months of 2006. Urban poverty incidence fell from 30.3 percent to 27.7 percent while rural poverty incidence dropped from 43.4 percent to 38 percent during this period. Poverty incidence declined most markedly in the Western region and in Ulaanbaatar, falling from 51 percent to 40 percent, while it remained unchanged in Hangay, Central and Eastern regions. The poverty decline in recent years continues a longer term trend – the national poverty headcount is estimated to have fallen by 10 percentage points⁸ between 1998 and 2002.

Despite these significant achievements, poverty still remains a nationwide problem, and much needs to be done in Mongolia to achieve the Millennium Development Goals (MDGs) by 2015.

BANKING AND FINANCIAL SECTOR

Monetary and credit aggregates continued to rise sharply during the year. Broad money increased on average by about 35 percent over the period, reaching MNT 1.5 trillion. The significant force behind the monetary expansion was strong growth in togrog and foreign deposits, which constituted 80 and 17 percent of the total deposit growth, respectively. Total deposits grew by over 38 percent to MNT 1.2 trillion⁹. The economy remains heavily dollarized, reflected in the composition of quasi money that constitutes 78.4 percent of broad money, of which domestic currency deposits make up 45.1 percent, foreign currency deposits 19.7 percent, and foreign currency current accounts 13.6 percent.

Improved competition in the banking sector and the influx of foreign investors continued to aid the deepening of financial intermediation. In the course of 2006, the banking sector disbursed MNT 2.0 trillion in loans, of which 58.1 percent were issued in domestic currency and the remaining 41.9 percent in foreign currencies. The share of non-performing loans in total outstanding loans was 4.9 percent, an increase by 0.8 percentage points from the previous year.

Most banking indicators in Mongolia are strong. Although interest rates are continuously declining, it still remains high.

⁸ East Asia & Pacific Update - Ten Years After Asia's Financial Crisis. World Bank, April 2007
⁹ Bank of Mongolia (Central bank), 2007

COMPARISON OF MONGOLIAN BANKING SECTOR TO WORLD AVERAGES

	Mongolia	CIS average	EBRD average
Number of banks (2005)	17	147.6	74.7
Number of state owned banks (2005-06)	0	14.2	15.8
NPL ratio (% , 2005)	6	11.8	8.9
Domestic credits to GDP (%)	39.9	20.5	36.2
Lending rate (2005)	23.6	17.6	13.6
Deposit rate (2005)	13	8.6	5.8

Source: EBRD, 2006

The MNT lending rate declined from 28.3 percent in 2005 to 24.5 percent in 2006, and the USD lending rate grew to 15.5 percent in 2006 up from 14.8 percent in 2005. The reduction in loan interest rate was mainly attributable to fierce competition in the micro and small business financing sector. To attract profitable rural clients, some banks have started mobile banking services in rural areas and opened branches in soum centers.

In overall, high interest rates reflect poor financial infrastructure and inefficiencies still evident in the banking and financial sector.

Despite abovementioned circumstances, international evidence shows that Mongolia is one of the countries with highest market penetration in microfinance. In terms of borrowers per population, Mongolia is ranking second to Bangladesh, with 8.1¹⁰ percent. This high level of penetration is a likely consequence of Mongolia's enabling policy environment that supports microfinance and the high level of competition in the sector and small population.

COUNTRIES WITH HIGH MICROFINANCE PENETRATION

Country	MFI Banks & NBFIs ¹¹	MFI NGOs, Credit Unions, Other	Total Portfolio (US\$ Millions)	Borrowers (Thousands)	Average Loan Balance (US\$)	Borrowers/ Population	Total Population (Millions)
Bangladesh	1	43	995	13,600	73	9.2%	147
Mongolia	2	0	135	228	592	8.1%	3
Bolivia	5	4	437	391	1,117	4.4%	9
Bosnia	7	4	372	183	2,034	4.1%	4
Cambodia	9	0	145	479	302	3.5%	14

Source: Microfinance Information eXchange (MIX), 2004

¹⁰ MIX data 2004

¹¹ NBFi—Non Bank Financial Institution



► In 2001, Mr. Hureltogoo took his first-ever credit from the X.A.C. (Golden Fund for Development) LLC borrowing MNT 200,000 (approximately USD 180) to supplement his operating capital of MNT 500,000. Since then he has been able to access credit necessary to grow his small business enterprise, becoming a long-term client and a trusted partner of XacBank. ►►

Products and Services

BORROWERS AND PORTFOLIO STRUCTURE

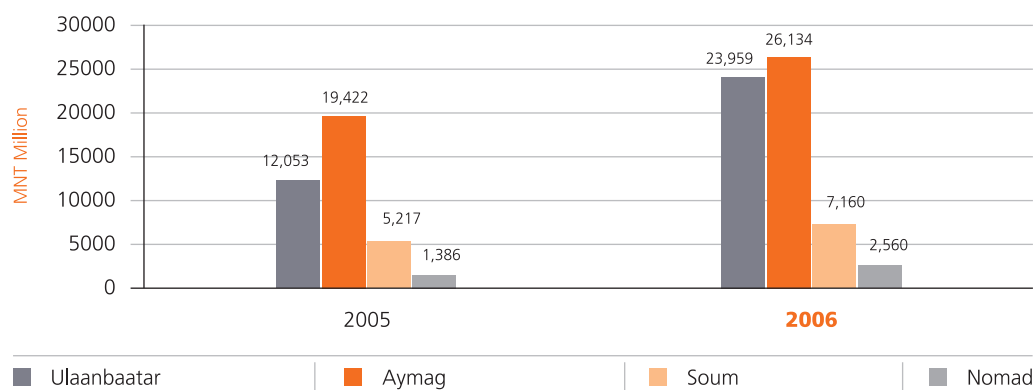
In 2006, XacBank disbursed a total of 101,246 loans for MNT 103.1 billion.

By the end of 2006, the Bank's loan portfolio reached MNT 59.8 billion, a 57.1 percent increase over the previous year. The Bank ended the year with 56,744 loans outstanding, a 13.3 percent increase from 2005.

Main Indicators	2006	2005	Growth (%)
Number of loans disbursed	101,246	85,132	18.9
Loan disbursement (million MNT)	103,104.4	76,582.0	34.6
Number of outstanding loans at the year-end	56,744	50,101	13.3
Loan portfolio outstanding (million MNT)	59,813.0	38,077.9	57.1
Average size of outstanding loans (MNT)	1,054,084.8	760,022.5	38.7
Market share (%)	4.89	4.43	10.4

Amidst intensifying market competition, the Bank maintained its commitment to its clients by developing new financial products, improving existing services and products and utilizing innovative solutions to enhance operational efficiency.

LOAN PORTFOLIO



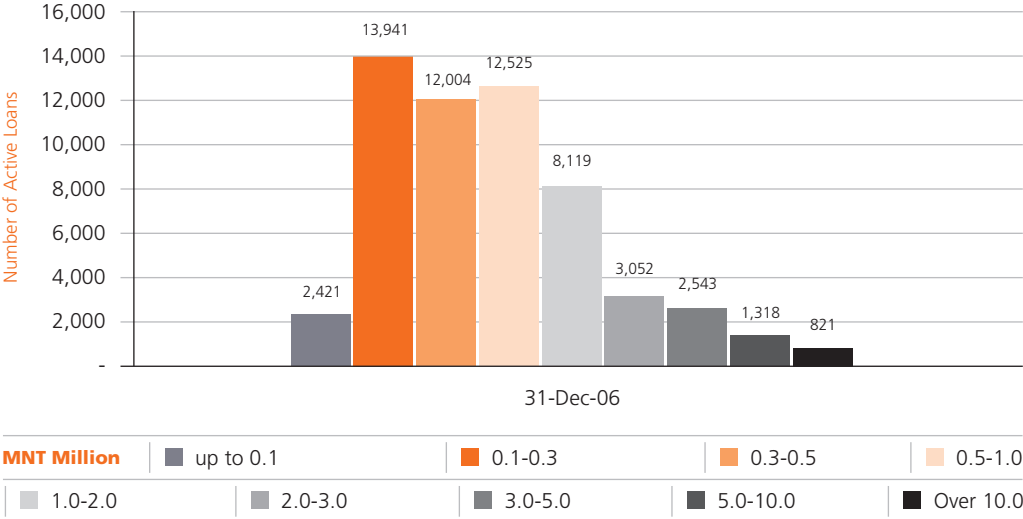
As a result, Ulaanbaatar city portfolio almost doubled and comprised 40.1 percent of total loans at the end of 2006 as opposed to 31.7 percent in 2005. At the same time, rural branches have been able to grow their loan portfolio by 37.8 percent to MNT 35.9 billion, which includes MNT 9.6 billion in mobile banking portfolio. The Bank's active rural borrowers comprised 74.9 percent of its total number of borrowers.

The Bank's market share in total banking system loans reached 4.9 percent in 2006, an increase of 0.5 percentage points from 2005. This was largely due to expansion into housing mortgages, reflecting an acute shortage of affordable housing in urban areas caused by ever increasing rural-to-urban migration that has become one of Mongolia's pressing issues.

Launched in June 2005, mortgage loans have nearly doubled in the number of borrowers, most of whom are purchasing two-room apartments with the financing obtained from the Bank. Ulaanbaatar comprises 38 percent of the total mortgage loan portfolio. Average disbursement size of mortgage loans is MNT 9.7 million, which reflects the fact that most borrowers are lower-middle class clients.

While pursuing market opportunities such as those in the livestock sector, which brought a 109.1 percent growth for herder loans in 2006, the Bank made decision to set limitations on and tight review of loan applications in those aymags where the grazing capacity and soil erosion have become an environmental problem.

ACTIVE LOANS BY SIZE



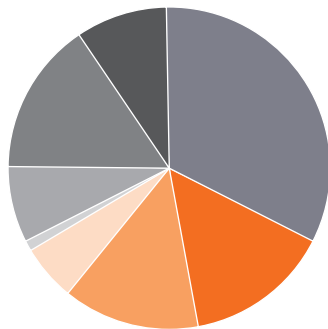
Loans disbursed under MNT 300 thousand comprised 28.8 percent, while 72.1 percent were below MNT 1 million and 96.2 percent under MNT 5 million. The average outstanding loan was MNT 1.1 million, which is slightly below Mongolia’s per capita GDP of MNT 1.2 million in 2006.

XacBank believes that in order to reduce poverty it is important to focus on both income and employment generation: the Bank supports not only micro entrepreneurs but also larger enterprises, which create sustainable jobs. This is done through offering working capital and long-term equipment financing for SMEs. Reflecting the Bank’s efforts to support small and growing businesses, SME loans had doubled during the reporting period.

Adhering to its social mission of contributing to poverty reduction, the Bank offers microcredit and small business credit aimed at supporting business growth: “Start up” and “Business Growth” loan products are most popular with micro entrepreneurs. Repeat loans have made it possible to grow businesses from a single person micro businesses to small business, providing employment to other people in their local communities. Around 50 percent of total borrowers are repeat borrowers, who continue to grow their business with the financial support from the Bank. Based on its market survey the Bank has introduced two new products especially suited for urban areas. In May 2006, the Bank piloted its new ger-district mortgage product, which addresses high demand for

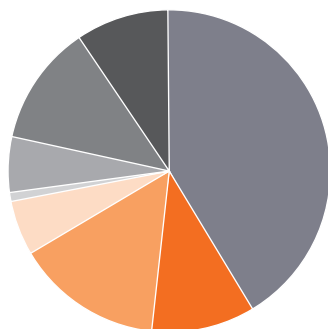
housing finance among new residents of Ulaanbaatar city and other urban centers. The Bank also launched a new student tuition loan product, investing in education for young people and preparing prospective employees for the country.

LOAN PORTFOLIO BY PRODUCTS-2006



Micro	33%
SME	14%
Consumer	14%
Financial leasing	6%
Whole	1%
Herder	8%
Mortgage	15%
Other	9%

LOAN PORTFOLIO BY PRODUCTS-2005



Micro	41%
SME	10%
Consumer	15%
Financial leasing	6%
Whole	1%
Herder	6%
Mortgage	12%
Other	9%

The Bank's borrower-couple Mr. Hureltogoo Dashdorj and Mrs. Uranbileg Adiya's success story in Arhangay aymag is representative of the typical XacBank client (Please see box: A Client Success Story).

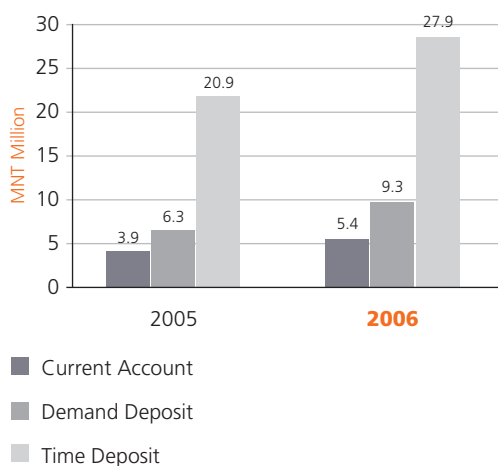
XacBank not only practices gender equality in lending but also seeks to educate the youth and local community about banking services and make its products more accessible. One example is providing learning opportunities for students through short internships in the Bank. Over 52 percent of the Bank's borrowers are female, and around 38 percent are between 18-35 years of age.

DEPOSIT MOBILIZATION

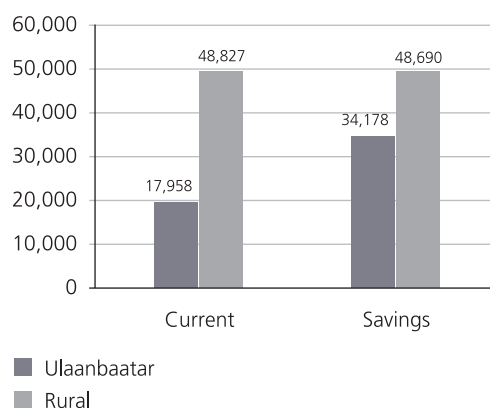
In 2006, the total number of current account and savings account holders in the Bank increased by 25.9 percent to 149,653, while total amount of deposits grew by 37.8 percent to MNT 42.6 billion, reflecting growing public confidence in the banking system and in XacBank in particular.

Total number of time-deposit accounts in the Bank increased by 24.2 percent in 2006, whereas the outstanding balance in deposit accounts grew by 33.4 percent from the past year.

DEPOSIT COMPOSITION



NUMBER OF CURRENT AND SAVINGS ACCOUNTS



The Bank maintained 2,283 foreign currency accounts with a total balance of MNT 5.5 billion equivalent at the year-end. These accounts are largely US Dollar denominated, but also include Euro, Russian Ruble, Chinese Yuan and Japanese Yen.

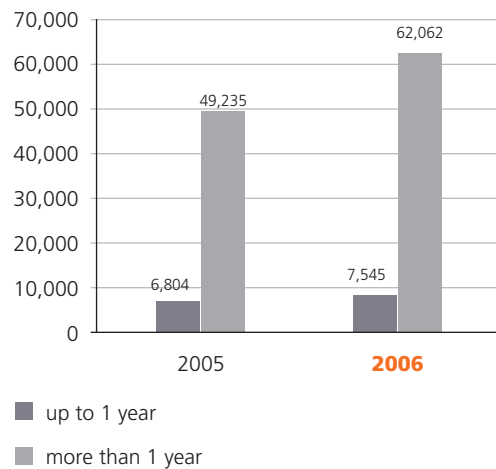
A total of 97,473 rural individual persons and business entities owned savings and demand deposit accounts with the Bank, showing a 22 percent increase in 2006.

Although accounts of private individuals still made up a significant part of the total number of current accounts, the corporate accounts compose a bulk of balances, MNT 3.7 billion. The five-fold increase in the amount of corporate accounts illustrates a high level of trust that business entities have in XacBank.

During the year, the demand deposit balances in the Bank increased by 47.4 percent to MNT 9.3 billion, of which 70.7 percent were held by private individuals.

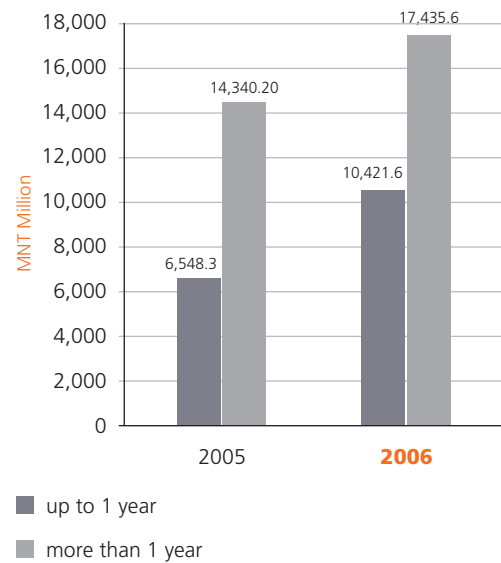
Long-term time deposit balances grew by 59.1 percent in 2006. Overall, 37.4 percent of time deposit balances have maturities of greater than one year. Much of the growth in long term time deposits was in the Bank's "Ireeduin Sayatan" (Future Millionaire), "Nasny Nunjig" (Retiring Rich), and "XacUrguu" (XacPalace) specialized accounts for respectively child, pension and housing long-term savings.

TIME DEPOSITS BY MATURITY



Long-term savings accounts represent 89.2 percent of total time deposit accounts.

AMOUNT OF TIME DEPOSITS BY MATURITY



REMITTANCES

In 2005, 71 percent of remittance transactions flow went to Ulaanbaatar city from rural areas, through "XacBuuha" (XacExpress), the Bank's domestic remittances service. Whereas in 2006, this volume decreased to 64 percent as online services offered by other banks took substantial market share from the Bank. Remittances volume from the rural areas to Ulaanbaatar city increased by 28.6 percent during the year, with rural remittances share in the total remittances increasing from 31 to 37 percent. Thus, total remittances volume grew by 33 percent during 2006 to MNT 13.2 billion.

Foreign payments and settlements remained strong during the year. The Bank achieved nearly a seven-fold increase in transactions and almost a nine-fold increase in volume of foreign settlements and remittances to USD 76.4 million. This was largely the result of increasing the number of current accounts and their balances, as well as expansion of the scope of foreign account services and an effective cross selling with small and medium size business loans. To further expand its market share and meet customer demand, the Bank established correspondent-banking relationships with four major foreign banks during 2006. New correspondent relationships were established with Sberbank in the Russian Federation, Kookmin Bank in the Republic of Korea, Sumitomo Mitsui Banking Corporation in Japan and the National Bank of Canada.

Demand is strong for a legal, efficient and accessible foreign remittances service from over 120,000 Mongolians living and working abroad. To meet this demand, the Bank is negotiating with several respected international money remittances networks. Eurogiro, an international organization with more than 60 members in over 40 countries, was selected by XacBank as one of the vehicles for delivering foreign remittances service. The Bank also offered transactions through the MoneyGram network, and its volume doubled compared to 2005. Over 80 percent of all transactions were incoming remittances, which increased by 8 percent from the past year.

The SWIFT international payment system, of which XacBank has been a member since September 2004, was also upgraded during the year, enabling the Bank to send and receive transfers without disruption and significantly improving efficiency and customer satisfaction. To enhance security the SWIFT service room has been isolated and its control system has been improved in 2006.

CARD SERVICE



In 2006, XacBank issued over 12,200 MasterCards, almost doubling the number of card holders from the prior year and raising its market share to 5 percent in the Mongolian banking sector.

In collaboration with the local television station - TV5, the Bank hosted a nationwide live broadcast of the FIFA World Cup 2006 games. This one-month period of football air time was used to enhance the Bank's public image and promote its "FIFA" MasterCard.

To commemorate the 800th Anniversary of the Great Mongol State, the Bank printed new versions of MasterCard such as "Soyombo-Independence", "Chinggis - Grand Khan" and "Great Mongol Empire" using historical and cultural themes. The Bank also issued a "Family" XacMasterCard, created to exemplify harmonious family relationship, which was implemented in partnership with the Wedding Palace. Card accounts generated a balance of MNT 982.8 million, while non-cash payment transactions reached MNT 39.6 billion, generating a significant additional fee income.

In addition to providing a non-cash payment service to its clients, the Bank is testing a cash withdrawal service through its more than 70 participating merchants. As part of its card insurance service, the Bank was the first commercial bank to offer free replacement of cards in either case of loss, theft or damage.

In November, the Bank received an Associate Member license from VISA, and expects to issue and launch its first VISA cards in 2007.



In commemoration of the 800th Anniversary of the Great Mongol State, the Bank printed "Independence", "Grand Khan" and "Great Empire" versions of XacMasterCard, using historical and cultural themes and images. Another new "Family" XacMasterCard product was created to exemplify harmonious family relationship, in cooperation with the Wedding Palace.

BRANCH AND MOBILE BANKING

For XacBank, 2006 was also a year of further growth and expansion of its extensive branch network, the second largest in Mongolia. In March a new branch was opened in Tosontsengel soum, Zavhan aymag, while during the year two other branches were merged into one, and new extension units were opened in Yarmag, Zuun-ail, Chingeltei and Suhbaatar districts of Ulaanbaatar city. Regionally, the Bank opened additional extension units in the centers of Huvsgul, Bayanhongor, Dornod, Darhan-Uul and Uvurhangay aymags, thereby expanding its nationwide network to a total of 65 branches and extension units.

This rapid expansion of the branch network required a greater management and staff effort, leading to a reorganization of the Branch Banking Department with four regional units. This reorganization improved outreach to the branches and allowed expansion of mobile banking and franchisee services to clients in soum centers and nomadic settlements. In addition, branches were allowed a greater autonomy over setting interest rates on some products and disbursements to repeat borrowers. This was supported by an increased training for branch staff and managers, which included on-the-job training time in the Bank Headquarters for some branch employees, while others were assigned to the other large branches.

To deliver its financial services to the rural population, the Bank extended its services to 17 additional soums during the year, bringing the soums served at the year-end to a total of 182 soums. As a result of this expansion, the outstanding soum loans increased by 30.1 percent to MNT 9.6 billion. Rural lending is an important activity for the Bank, both to fulfill its social Mission and as a profitable line of business. The soum lending comprised 16 percent of the Bank's loan portfolio at the end of 2006.

Finally, the Bank introduced specialized credit officers with expertise in microfinance, SME and consumer credit products, allowing the concerned staff more time to work on specific sectors, resulting in sustained growth in market share. The Bank is providing credits for acquiring solar and wind energy equipment for its rural borrowers, as part of its environmentally responsible lending activities, including support to building and constructing straw-bale houses in a number of places.

"DEVELOPMENT GUIDE" FRANCHISING SERVICE



XacBank has been an innovator in collaborating with the rural savings and credit cooperatives (SCCs) through its franchising service – "Development Guide". During the year, 29 more SCCs joined, bringing the total to 80 franchisees with over 4,800 members and 2,471 outstanding loans with a total amount of MNT 768.4 million.

Member SCCs franchises have received on a regular basis comprehensive training and technical assistance from the Bank, which guides them towards greater sustainability in an increasingly volatile market.

During the year, the Bank offered its franchisees an accounting software program developed in-house by the IT Division. Named "RightBanker", this software was installed initially in 19 SCCs and had a substantial positive impact on their daily accounting operations.

In the fall of 2006, XacBank signed a Memorandum of Understanding with the Financial Regulatory Commission (FRC), a newly created Mongolian government agency charged with monitoring and regulating cooperatives and other NBF activities. The Memorandum focuses on the Bank's collaboration with the FRC to improve and strengthen rural credit cooperatives, as well as organizing training and business promotion activities.

In February 2006, the Bank has received a grant of USD 50,000 from CGAP as a part of its Pro- Poor Innovation

Challenge award for further expansion of its franchising activities in remote areas. The Bank was one of only five grantees to receive such an award from over 250 applicants world-wide in 2006.

In November 2006, the Bank also received a Certificate of Achievement from the European Microfinance Platform in recognition of its work in reducing poverty through innovative activities to increase rural outreach and contributing to the creation of an inclusive financial sector, specifically through its "Development Guide" franchising model.

Looking ahead, the Bank will continue to closely work with its franchisee SCCs to strengthen their financial structures and further enhance their operations by improving its "Development Guide".

DEVELOPMENT PARTNERSHIPS

During 2006, as part of its socially responsible and environmentally friendly activities, XacBank has provided support and actively participated in many project and program initiatives funded by the international community in collaboration with the Government of Mongolia as meaningful partnerships for development.

ENTERPRISE MONGOLIA



The Enterprise Mongolia project, implemented by the United Nations Development Programme (UNDP) and Ministry of Trade and Industry, attempts to improve the livelihoods of the poor people in rural areas and support their entrepreneurial initiatives that leads to the creation and expansion of micro and small businesses. XacBank's cooperation with the Enterprise Mongolia project commenced in May 2006 and was carried out in Hovd, Zavhan, Huvsgul, Hentiy, Selenge, Uvurhangay, Bayan-Ulgiy aymags as well as Han-uul and Suhbaatar districts in Ulaanbaatar city. Since November 2006, the Bank has collaborated in the project's "One Village, One Product" (OVOP) Initiative, a key activity of the Enterprise Mongolia aimed at stimulating local economic development by creating nationally and globally-branded products.

RURAL POVERTY ALLEVIATION PROGRAM



The Rural Poverty Alleviation Program of the International Fund for Agriculture Development (IFAD) and Government of Mongolia aims to ensure that the poor rural people have better access to, and the skills and organizational knowledge that they need to benefit and manage natural resources. In Mongolia the program aims to build up herd sizes that would minimize the beneficiaries' risk of losing their whole herd as a result of epidemic diseases or harsh winters. Since May 2005 XacBank has been cooperating with the implementation process of the rural poverty alleviation program in Arhangay, Huvsgul, Bulgan, and Hentiy aymags. As a priority, this program aims to reach low-income herder households or those with a herd size less than 500 and the poor households in soums. In 2006, within the sphere of the IFAD program a total of 6,496 households received loans of MNT 3.6 billion.

GER INITIATIVE



Growing Entrepreneurship Rapidly (GER) Initiative, managed by CHF International and funded by USAID seeks to improve the quality of life for low- and medium-income families in the peri-urban areas through supporting business development services and increasing employment opportunities. Since 2004, XacBank has collaborated with GER Initiative on a loan facilitation product offered in Ulaanbaatar city, Darhan Uul, Orhon, Dornod, Selenge, Bayan-Ulgiy and Tuv aymags. In 2006, the Bank extended loans of MNT 367 million to GER Initiative project businesses.



MICROFINANCE DEVELOPMENT FUND

The Microfinance Development Fund (MDF) was established within the framework of the Sustainable Livelihoods Project, which is implemented jointly by the Government of Mongolia and International Development Association (IDA) of the World Bank (WB), in order to expand the outreach of microfinance services in rural Mongolia. The Fund provides wholesale loans to qualified financial institutions that provide microfinance service to the poor and vulnerable groups of the Mongolian population in rural areas. XacBank has been working with MDF since June 2004, and during 2006 has disbursed total loans of MNT 1.8 billion to 2,525 households in the country.



AGRICULTURAL SECTOR DEVELOPMENT PROJECT

The Agricultural Sector Development Project of Asian Development Bank (ADB) seeks to develop the agricultural sector of Mongolia through increased efficiency and improved financial capacity. Since April 2003, XacBank disbursed loans to borrowers in Zavhan, Gobi-Altay, Uvs, Hovd, Darhan-Uul, Bayanhongor and Selenge aymags. In 2006, the Bank disbursed total loans of MNT 2,155 million to 1,545 households and rural entrepreneurs under this project.



RURAL AGRIBUSINESS SUPPORT PROGRAM

The Rural Agribusiness Support Program (RASP) is a rural business development project, designed and managed by Mercy Corps with financing from the United States Department of Agriculture (USDA), which is helping expand agribusinesses in central and southern regions of Mongolia by providing loan guarantees for small producers to diversify and "scale-up" their agribusinesses. In addition to assisting rural agribusinesses, the loan guarantee mechanism is designed to strengthen the linkages between businesses and financial institutions and promote greater competition between financial institutions in rural areas. XacBank has been cooperating with this program since March 2004 and is implementing the program's activities in three Gobi aymags as well as in Bayanhongor, Arhangai, Zavhan, Suhbaatar and Hovd aymags. In 2006, a total of 112 households received loans of MNT 292 million.



CONSULTATIVE GROUP TO ASSIST THE POOR

Consultative Group to Assist the Poor (CGAP) is a consortium of 33 public and private development agencies working together to expand access to financial services for the poor in developing countries. CGAP was created by these aid agencies and industry leaders to help create permanent financial services for the poor on a large scale (often referred to as "microfinance"). XacBank cooperates with CGAP in support of its services in rural Mongolia, through the franchisee service. XacBank was named one of the five finalists, from an applicant pool of over 250 microfinance institutions worldwide, in the 2006 Pro-Poor Innovation Challenge Round VIII, organized by CGAP. The Bank received a USD 50,000 grant to scale up its franchisee cooperatives activities.



IMPROVED HOUSEHOLD STOVES

The Improved Household Stoves project, implemented by the Ministry of Environment and Nature in cooperation with the WB, aims to reduce air pollution in urban areas, in particular to diminish carbon dioxide emissions. In 2006, XacBank signed a Memorandum of Understanding with the Mayor of Ulaanbaatar city aimed at assisting the capital city's ger-district residents to replace old inefficient heating/cooking furnaces with more energy efficient and environmentally friendly smoke-less stoves. As part of this initiative, the Bank is supporting through its loan service production of heat efficient fuel.



► Mr. Hureltogoo's wife Ms. Uranbileg Adiya, a nurse by profession, is their manager of the micro enterprise. The couple's enterprise is a well-planned and managed business that has grown to yield fruit of their hard and diligent work put into the enterprise during the past 14 years. In 2004, the couple was able to purchase the space they rented for their small business production.

Today the couple produces complete sets of traditional gers and furniture for both settled and nomadic use, which they sell at markets in their home aymag as well as in neighboring Umnugobi, Bulgan and Dundgobi aymags. Their marketing strategy is based on quality and affordability of their products rather than price. Even at times of 110-140 percent price increases they stayed true to offering affordable prices to their customers. Mr. Hureltogoo travels to market his products in other aymags several times a year. He has earned the top prize in 2005 for the largest volume of sales at the Umnugobi aymag fair. ►►

Risk Management

LOAN PORTFOLIO QUALITY

Despite strong competition among commercial banks, a crisis in the savings and credit cooperatives sector and the deficient credit information system, XacBank's PAR of more than one day and loan repayment ratio during the reporting year remained strong at 1.3 percent and 99.3 percent respectively. The Bank wrote off a total of 54 loans during the year, mainly microcredit, with business start up and growth loans, in the amount of MNT 28.5 million.

In 2006, XacBank's loan portfolio concentration indicators were in full compliance with the Bank of Mongolia (Central bank) requirements.

LOAN PORTFOLIO

	Share in loan portfolio	Share in equity
Loan portfolio of 20 largest borrowers (%)	7.3	40.0
Largest single borrower's exposure (%)	0.7	3.7
Loan portfolio to related parties (%)	2.8	15.2
Largest related party exposure (%)	0.6	3.5

Management of the Bank began to gradually decentralize the loan approval authority in the second half of 2006 and extend higher credit approval limits to branches with good portfolio quality and experienced credit staff. At the same time it reduced existing credit approval authorities of branches with high levels of portfolio at risk.

Changes were also made in lending procedures, credit cards, overdrafts, mortgage loans, herder loans and mobile lending. These changes are expected to have a positive impact on the overall portfolio quality.

In 2006, the Credit Scoring Module, designed to help determine appropriate size and specific risk level of each loan, was developed and tested at all the Bank's Ulaanbaatar city branches. Management believes that this module will yield a greater attainment of portfolio targets by significantly increasing productivity of credit officers.

CREDIT MANAGEMENT

To streamline its credit approval processes, XacBank developed the General Procedure for Credit Operations, for handling non-performing loans and guidelines for on-site revision of branch loan operations, which are now implemented in daily operations.

In order to actively promote SME lending and mitigate risks associated with larger loans, the Bank now requires a submission of separate and independent risk summaries by credit and risk managers for loans exceeding certain amounts to appropriate level Credit Committees. In addition, collateral valuation for the same loan application is carried out by an independent collateral risk manager.

The Bank organized specialized trainings, seminars and workshop sessions for its credit managers, senior branch officers and junior credit officers. To increase the benefit and efficiency of training, on the job training was arranged for credit officers in addition to classroom sessions to improve the Bank's loan service quality.

A new position of Credit Manager was created to foster the decentralization of credit portfolio management and

to improve on-site monitoring of the loan portfolio at the branch level. Specialization of branch credit officers is also expected to bring higher productivity and efficiency together with lower operating costs.

In addition, a Credit Administration Department was created within the Credit Management Division to improve the quality and objectivity of credit reporting.

ADJUSTMENTS IN PRODUCT TERMS AND CONDITIONS

During the year, the Bank carried out a gradual adjustment of its terms and conditions for its loan products to ensure that they meet customer demand and remain competitive. These included changes in the maximum amounts and grace periods for micro and consumer loans, as well as introduction of greater flexibility in lending terms. The housing mortgage product, available only in USD, was revised and provided in USD or MNT beginning in December 2006.

In order to stay competitive, interest rates were lowered twice during 2006. Interest rate cuts resulted in a decline in yield on portfolio, which was 29.3 percent at the end of the year compared to 32.8 percent in 2005.

The Bank also decreased interest rates paid on its deposits, resulting in reductions in funding costs and eased the stress on margins caused by lower yields on the portfolio. Interest rates on time deposits were revised during the year to lower levels than that of the banking sector average. Notwithstanding this reduction in interest rates, time deposits grew by MNT 7 billion for the year.

RISK MANAGEMENT SYSTEM

The risk management system of the Bank consists of specialized committees at the Board of Directors, Headquarters and every Branch levels, as well as Internal Audit Division and Risk Management Department. This institutional structure assures effective management of the different risks at different levels, which the Bank may be exposed to.

XacBank applied to the Bank of Mongolia (Central bank) for a license permitting it to use the Value-at-Risk (VaR) method as its foreign exchange risk management tool, and started applying the concept in the day-to-day risk assessments. The maximum value that may be lost from an open foreign currency position in one day with a 99 percent confidence interval was MNT 3.1 million under the VaR calculation at the end of 2006.

As part of the Bank's interest rate risk management practice, assets and liabilities sensitive to changes in interest

BASIC RATIOS

Ratios	2006	2005
Basic liquidity ratio (%)	15.1	10.1
Total deposits / Loan ratio (%)	80.4	83.4
Total deposits / Assets ratio (%)	51.7	52.9
Borrowings / Assets ratio (%)	26.4	24.6
Loans from Fls < 1 year maturity / Assets ratio (%)	12.1	19.6
3 months liquidity ratio (%)	63.9	55.9
Quick ratio (%)	42.8	30.9
USD deposits / Total deposits (%)	12.3	9.9

rate were closely monitored and their impact on the net interest income was calculated on a monthly basis.

The Bank also maintained liquidity limits both at unit and at consolidated levels. The limits were monitored on a daily basis, while assets and liability duration reports were generated on a monthly basis.



In 2006, the Bank organized table tennis, volleyball, chess, basketball and hiking competitions among its employees to promote a healthy lifestyle and provide an opportunity to relieve work related stress. The 43 brave participants of the first hiking competition attracted great deal of attention and support from all staff members.



► The couple's enterprise has created four permanent job positions and strives to provide job opportunity to vulnerable groups in their local community. Mr. Hureltogoo believes that deaf and mentally disabled persons can be more creative in designing and painting traditional patterns on Mongol gers.

Mr. Hureltogoo's future plans are based on the principle of producing and marketing good quality, affordable products with identifiable brand design, which would allow him to further expand his market and customer base. ►►

Financial Performance

ASSETS

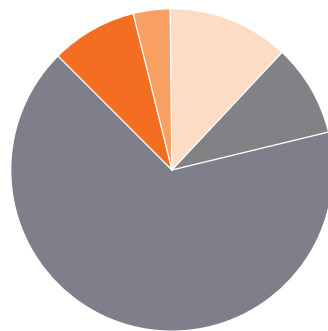
In 2006, total assets of the Mongolian banking sector grew by MNT 528.1 billion or 38.5 percent from 2005. XacBank's assets grew by MNT 29.9 billion or 50.4 percent, exceeding the banking system growth by 11.9 percentage points. At the year-end, the Bank comprised 4.7 percent of total banking sector assets, improving its position by 0.4 percentage points from 2005.

COMPOSITION OF ASSETS AND LIABILITIES BY CURRENCY

	2006	2005
Assets in local currency (%)	70.3	76.6
Assets in foreign currency (%)	29.7	23.4
Liabilities in local currency (%)	76.8	76.8
Liabilities in foreign currency (%)	23.2	23.2

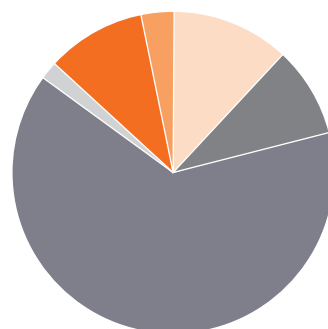
The Bank increased its USD loan disbursements in 2006 as a part of its foreign currency risk management activities. This brought the weight of foreign currency denominated assets up to 29.7 percent from 23.4 percent in 2005. Foreign and local currency cash balances kept with other commercial banks reached the equivalent of MNT 7.9 billion at year-end to support a growing customer demand in international settlements, manage a foreign currency exposure, and enhance returns from a short-term excess liquidity.

COMPOSITION OF ASSETS-2006



Cash	12%
Placement	9%
Loans /net/	67%
Securities	0%
Fixed assets	9%
Other assets	3%

COMPOSITION OF ASSETS-2005



Cash	12%
Placement	9%
Loans /net/	64%
Securities	2%
Fixed assets	10%
Other assets	3%

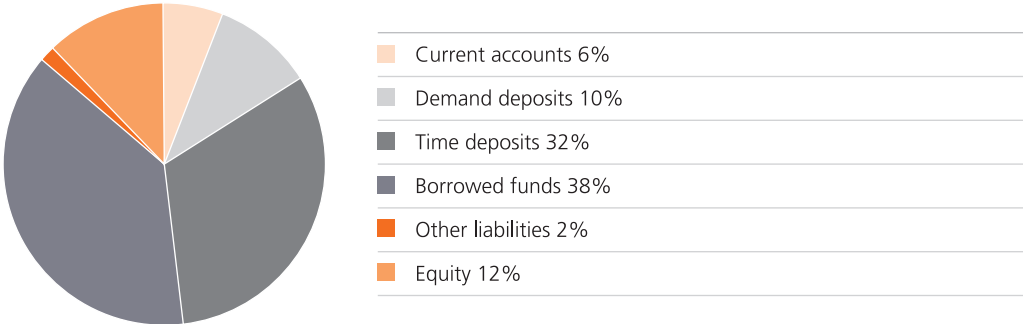
Although the year-end balance in the securities portfolio declined from 2005, total trading activity of the Bank during 2006 increased significantly. Trading volume increased by more than three fold from 2005 levels, reaching a turnover of MNT 33.9 billion.

LIABILITIES AND EQUITY

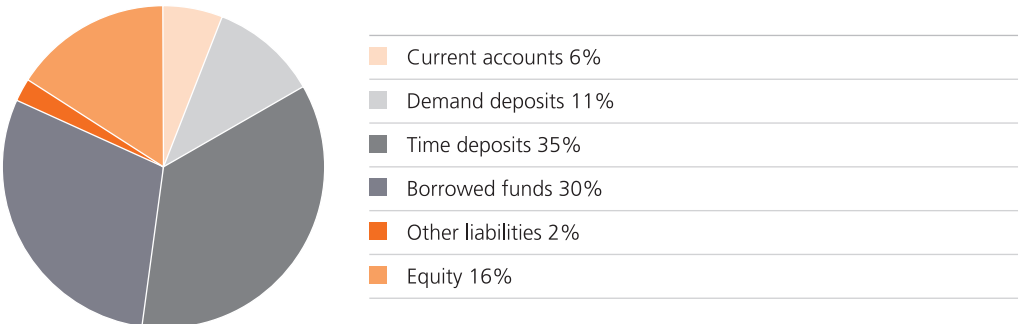
Equity of XacBank stood at MNT 10.9 billion after payment of a dividend, leaving the Bank well capitalized with an asset to equity ratio of 8.2 at the year-end compared to 6.2 in 2005.

Borrowed funds made up 38.2 percent of total funding sources and reflect the Bank’s efforts to attract more medium and long-term funding from international financial institutions. As the share of borrowed funds increased, the time deposits and equity weight decreased each by 4 percent and accounted for 31.3 and 12.2 percent of total funding sources respectively at the end of the 2006.

COMPOSITION OF LIABILITES AND EQUITY-2006



COMPOSITION OF LIABILITES AND EQUITY-2005



BORROWED FUNDS

XacBank continued its policy of maintaining a prudent mix of borrowed and public funds. The priority in 2006 was given to foreign borrowings, in light of high deposit rates in domestic market.

To establish adequate funds management practices, the Bank developed a Funds Management Strategy based on the economic environment and XacBank’s position.



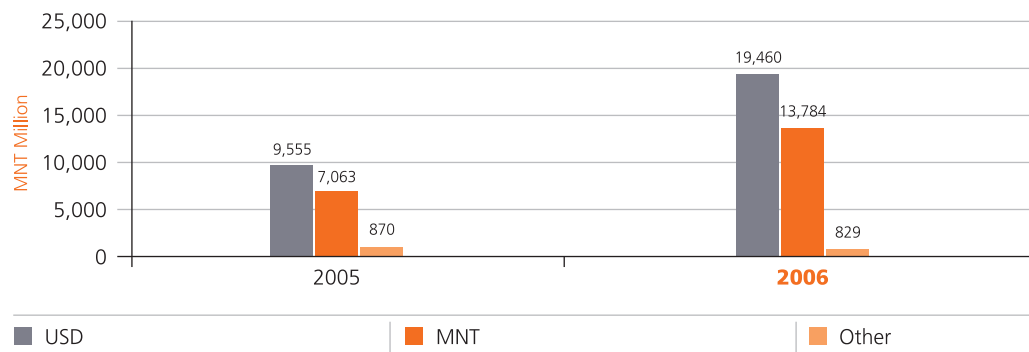
In 2006 XacBank soccer team won first place and received the "XAC Cup" in the annual interbank football tournament competition, which has become a tradition among commercial banks.

By expanding its cooperation with existing lenders the Bank borrowed USD 200 thousand from Calvert Foundation, MNT 1 billion and USD 500 thousand from Triodos-Doen and Triodos Fair Share Foundation and USD 1 million and MNT 584 million from Triple Jump. Altogether, a funding equivalent to MNT 21 billion was raised in 2006.

The Bank increased its project funds from the government agencies and various international organizations to MNT 3.9 billion.

Borrowed and project funds comprised 38.2 percent of the year-end balance of total funding sources. In spite of steep increases in LIBOR during 2005 and 2006, the weighted average nominal interest rate on borrowed funds declined to 7.6 percent in 2006 from 8.8 percent in 2005 and 10 percent in 2004. The average maturity of borrowed funds increased to 35.6 months in 2006 from 21 months in 2005 and 16.4 months in 2004.

FUNDING BY CURRENCIES



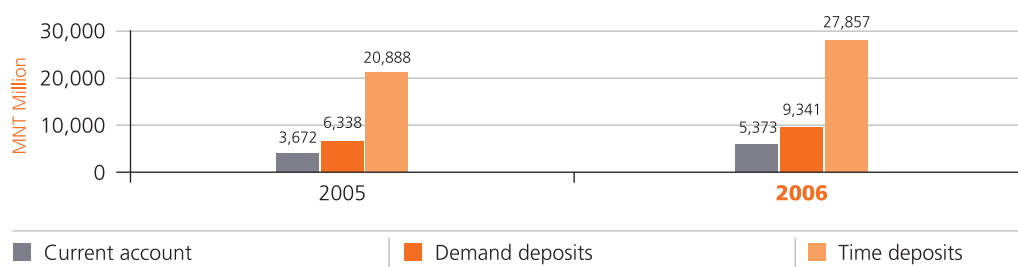
The Bank continued its use of swap arrangements with local banks, placing USD borrowed from international sources with a local banks and borrowing local currency against that deposit, resulting in a local currency funding. The Bank raised MNT 7.3 billion in local currency funds under this scheme in 2006, comprising 29.4 percent (10 percent in 2005) of total funds received from the international financial institutions.

PUBLIC DEPOSITS

Turbulence in the local financial market caused by the bankruptcies of several savings and credit cooperatives and intense competition of other commercial banks primarily through aggressive bidding for public deposits pushed the average deposit interest rate up by 0.2-1.56 percentage points. In response, XacBank attempted to retain depositors by offering high quality customer service rather than increasing its interest rates. As a result, public deposits with the Bank grew by MNT 11.7 billion or 37.8 percent, whereas the average cost of deposits decreased from 11.8 percent in 2005 to 10.71 percent in 2006.

Outstanding current accounts increased by 46.3 percent, demand and time deposits grew by 36.6 percent bringing the balance of public deposits to MNT 42.6 billion. The growth in current accounts was 20.6 percent above the banking sector, reflecting ever-growing confidence of the public and private sectors in XacBank. The Bank ended the year with 82,868 depositors, 66,785 current account holders and an average deposit balance of MNT 448.9 thousand, 7.3 percent up above its 2005 average.

PUBLIC DEPOSITS



Total deposit balances consists of 12.6 percent of current accounts, 21.9 percent of demand deposits, and 65.4 percent of time deposits.

EQUITY BASE

At year-end 2006, total equity stood at MNT 10.9 billion which was up by 13.9 percent or MNT 1.3 billion from 2005. The source of this growth was retained income after taxes and dividends of MNT 1.8 billion. The Bank paid 30.2 percent of 2005 after-tax profits as a dividend, and it anticipates paying a similar percentage of 2006 earnings as well.

Although the Bank remains in compliance with the Bank of Mongolia (Central bank)'s minimum capital requirement, capital adequacy ratios have declined partly due to rapid growth of its assets.

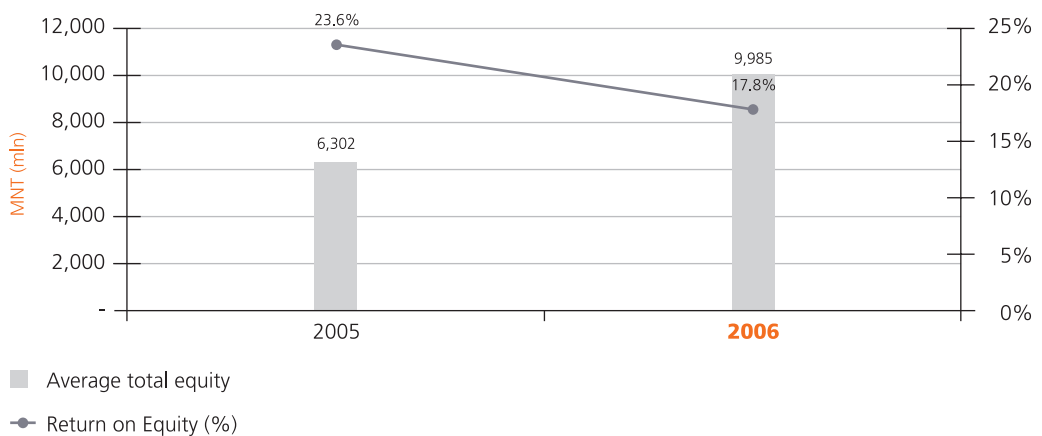
The management is aware of the need to maintain an adequate equity base to achieve its planned growth and will continue to focus attention on ensuring proper levels of capital for the Bank.

Prudential Ratios	2006	2005
Capital to risk weighted assets ratio (%)	15.8	21.1
First tier capital to risk weighted assets ratio (%)	15.8	21.1
First tier capital to total assets ratio (%)	12.9	18.0

PROFITABILITY

XacBank closed the year with net profit after tax of MNT 1,773.2 million, up MNT 284.2 million from 2005. In response to growing competition, interest rates on all loan products were lowered while investing continuously into expansion in a service coverage. Between January and August 2006, interest rates were reduced on most loan products by 0.1-0.5 percentage points. This caused a return on average portfolio to drop to 29.2 percent, or down by 3.5 percent from the previous year levels. Together these measures resulted in a 4.3 percentage points increase in total expenses over total income, in turn the ROA declined from 3.3 percent to 2.4 percent and ROE from 23.6 to 17.8 percent.

CHANGE IN AVERAGE TOTAL EQUITY AND ROE



REVENUE

XacBank generated MNT 16.0 billion in total revenue in 2006, up by MNT 5.1 billion or 46.5 percent from 2005.

The Bank received 86.8 percent of its income from loan interest. Interest income grew 47.3 percent or MNT 4.5 billion from 2005. This was due to an increase in lending, changes in lending policies to make products more attractive and introduction of more diverse loan products.

The micro loan portfolio grew by 23 percent to MNT 19.2 billion in 2006. Housing and SME loans growth rate was higher than the growth of micro loans. Consequently, this growth reduced the share of the micro loan portfolio in relation to the total portfolio.

Mortgage loan interest income increased about 4 fold due to strong demand for housing, while herder loan income increased 3 fold, producing the highest interest income increase.

INVESTMENT INCOME

Short-term investment activities, including trading of the Bank of Mongolia (Central bank) bills and notes, have generated MNT 728.1 million in 2006 grew by a MNT 307.3 million more from 2005.

The Bank placed MNT 3.5 billion and USD 19.6 million in deposits and certificates of deposit through 23 interbank

contracts in 2006. This compares with MNT 1.2 billion and USD 12.2 million placements through 28 interbank contracts in 2005. Interest income from placements with other banks almost doubled yielding about 10 percent return on deposits with other banks, up by 3 percent from previous year level.

The total volume of securities trading in the primary and secondary markets among all banks in Mongolia grew by MNT 21.7 billion to MNT 34 billion, whereby XacBank earned 8.9 percent yield on its total turnover.

COMMISSIONS AND FEE INCOME

Income from commissions and fees increased by MNT 403.6 million, or 55.2 percent, to MNT 1.1 billion, of which loan commissions rose 31.3 percent, customer service commissions increased 80.4 percent and card service commissions and fees increased 3.6 fold.

Income from money remittances and transfers doubled, cash collection fees increased 18 fold, escrow account fee increased 7 fold, fees from foreign currency withdrawals grew 9 fold and income from information and inquiry services grew 3 fold from the prior year. Altogether, this income accounted for 82.8 percent of total growth in commission and fee income.

EXPENSES

Total expenses of the Bank were higher by MNT 4.8 billion, or 50.8 percent, compared with 2005 and stood at MNT 14.2 billion. The Bank used 41.2 percent of the total expenses to pay for costs of borrowed funds and the remaining 47.5 percent to cover operational expenses.

INTEREST EXPENSE

The Bank's strategy during the year was to retain and increase its loyal client base, while relying less on high cost, price sensitive time deposits. After a reduction in interest rates on some deposit products, the Bank had one of lowest average interest rates compared with the other banks and average cost for current and deposit accounts declined to 10.7 percent.

The average cost of borrowed funds declined from 10.4 percent in 2005 to 8.8 percent in 2006, in spite of rising LIBOR, due to a decrease in the price of funds in the interbank market and the appreciation of the local currency. The cost of local currency funds fell by 3.9 percentage points from 2005 levels to 9.1 percent.

PROVISIONING EXPENSE

The Bank has reversed the provisioning expense equaling to 1 percent of the performing loans to comply with International Accounting Standards (IAS) 39 in 2005. But the decision was reviewed in 2006 as per recommendation of a rating agency and the management's decision to increase the Bank's protection against loan default. This resulted in MNT 358.6 million increase of the loan loss reserve account along with loan write off of MNT 28.6 million. Due to a change in reserve policy and a need to comply with IAS, the Bank spent MNT 387.1 million in total as loan loss provisions.



- In the early days of their small business, that started with a micro credit from XacBank, the couple lived in the ger-district. Today Mr. Hureltogoo and Ms. Uranbileg' family live in a three-room apartment in one of the new and comfortable modern residential buildings in Arhangay aymag center. ■

Organizational Development

HUMAN RESOURCES

By the end of 2006, XacBank employed 741 staff, of which 168 were employed at the Head Office, while the remaining 573 staff members were employed at its branches nationwide. In addition, XacBank finances and manages security personnel of 95 staff from XacSecurity LLC. As of 31 December 2006, 283 new employees were recruited while 170 staff left the Bank. During 2006 the Bank added 124 new jobs, a 20 percent increase in workforce, of which 51 new jobs were created outside the capital city. Staff average age increased from 28 to 29.5 years, while the average employment duration was 2.3 years across the Bank.

STAFF RATIOS

	Dec 06	Dec 05
Support staff to total staff (%)	18.1	25.8
Credit officers to total staff (%)	29.3	28.4
Female credit officers to total credit officers (%)	52.5	55.4
Tellers to total staff (%)	22.3	13.4
Customer service officers to total staff (%)	n.a. ¹²	9.9
Front office staff (%)	22.3	23.3
Management staff to total staff ¹³ (%)	7.7	10.2

The Bank maintains a non-discrimination policy based on ethnic origins, gender, social status, political party or religious affiliation. Moreover, in 2006, the Bank reaffirmed itself as an equal opportunity employer by encouraging disabled persons to join the organization on suitable job places. Terminations and resignations were higher among male staff, representing 60 percent of all cases, while 58 female employees were promoted to managerial positions across the Bank, representing 38.4 percent of all internal promotions. In general, the issue of ethnic or race discrimination is considered to be rare in Mongolia due to the homogenous nature of the population. Overall, 94 percent of staff members, both at the Headquarters and branches, received regular work performance reviews and feedback.

Staff turnover across the Bank decreased slightly from 20 percent in 2005 to 19.01 percent by the end of the reporting period. The persistently high turnover rate among professional staff has become a priority issue for the management as well as the Board of Directors. Management undertook series of actions to address high turnover, including monthly review of staff turnover reports, adjustments in performance based remuneration system for branch staff, revision of job descriptions, gradual increase of base salaries, specialization among lending officers, introduction of additional allowances as part of remuneration package, and linking branch turnover targets to branch director's performance appraisal.

Adjustments were made to distribution of workload, such as decreasing the number of borrowers per lending officer from 286¹⁴ to 261, which is expected to have a positive impact on performance of branch staff, especially credit officers.

¹² Customer service officer was merged with the teller position in 2006.

¹³ Staff numbers include branch managers, department directors and above.

¹⁴ International microfinance industry benchmark for institutions with individual lending methodology is 250 borrowers per credit officer.



In partnership with TV5, XacBank sponsored a nationwide live broadcasting of the FIFA World Cup 2006 games, providing all football fans and the public with a rare opportunity to witness the games. One-month long football air time was used to advertise the Bank and its "FIFA" XacMasterCards.

All branches were delegated a decision-making authority in recruiting their new staff, provided that recruitment was in line with merit based selection and the Bank's policy. The new and enhanced social responsibility and sustainability focus has led to recruitment policy of hiring non-career job seekers and disabled citizens for applicable job positions.

Human Resources Advisory Council (HRAC), consisting of representatives from the Bank Headquarters and branch managers as well as branch staff was established in order to ensure consistent human resources development policy implementation across the Bank. As part of new MIS, Human Resources Management Information System (HRMIS) was developed to monitor staffing and ensure establishment control.

The new employee induction program was updated and formalized, placing more emphasis on building team spirit, reinforcing the company culture, and enhancing motivation of incoming employees.

While planning further actions aimed at improving staff retention and increased productivity for implementation in the new fiscal year, the Bank management hopes that the comprehensive initiatives implemented in 2006 will start producing results in 2007.

STAFF TRAINING

In 2006, XacBank set up a Training Center in the new annex building with three full time instructors and essential equipment, increasing the capacity to train up to 30 people at a time. Training focused on building technical knowledge on banking business, communications, management and leadership skills as well as English language proficiency for staff members.

Credit officers training continued to have a considerable uptake in the internal training program. The internal certification of credit officers was formalized and conducted twice a year. The results were used to assign to job positions and credit approval authority, as well as determine needs and design training programs.

The management and leadership training provided to all middle and senior level management is especially noteworthy as it was conducted by a consultant from a leading business school received through technical assistance facility of XacBank's investor ShoreCap International. The Bank is looking at further development

and building of strong core middle and senior management team as a strategy for maintaining and enhancing its competitive advantage. In 2006, over 80 percent of all training was delivered internally while over 20 staff attended various international training programs in microfinance and banking. The Bank received TA and training from Triodos TSF project and developed the G3 XacBank Indicators in order to introduce GRI reporting on its banking activities and support operations.

HUMAN CAPITAL IN NUMBERS

To manage gender mix as a competitive advantage, ensure equal opportunity and respect for human rights

Number of Employees	741
Rural	401
Ulaanbaatar	340
Branches	573
Head Office	168
Middle Management (Branch Managers, Department Heads)	48
Senior Management (Executives, Division Heads)	9
Total Male/Female Ratio	40/60
Management Male/Female Ratio	12/7

To promote professional development and life-long learning, by reconciling the Bank's and individual's interests

New Jobs Created	124
Expenditure on student scholarships (MNT thousands)	2,305.5
Total Investment in training (MNT million)	170
Hours of training given	> 19,000
Hours of international training	1,000
Hours of international technical assistance	240
Number of employees participated in training (cumulative)	1,100
Middle managers (percentage of total)	100
Staff (percentage of total)	65
Evaluation of employee satisfaction with training (1-5, with 5 highest)	4.5
Percentage of employees receiving regular performance and career development review	94
Ratio of average remuneration of men and women broken down by employee category	50/50

INFRASTRUCTURE

In 2006, XacBank initiated a renovation of the Headquarters building to improve facilities and working conditions for its 168 employees. The Bank also purchased an adjacent building and completed its renovation. This annex building has added 800 m² of office space and now houses a new Training Center and a cafeteria for employee convenience. Major construction work was also carried out to provide adequate office premises for the branch staff in the five aymag centers.

In total, investments of MNT 1.4 billion were made for the purchase, construction and capital repair of office

buildings, increasing the Bank's fixed assets accordingly. Management is confident that these infrastructure investments will create an environment conducive to staff productivity and greater customer satisfaction, resulting in more sustainable business for the Bank.

In 2006, the Bank's procurement process was further improved by revising procedures, establishing requirements for open and competitive tender process and screening of local and foreign contractors/suppliers, including goods and services in accordance with the IFC Exclusion List¹⁵.

Bank is aiming to implement a triple-bottom line approach under GRI framework, and has plans to reduce operating costs as well as consumption of materials, and seeks opportunities to introduce more efficient and environmentally friendly technologies. These measures include:

- A work plan will be implemented in 2007, introducing initial measures to reduce existing consumption of electricity, water and materials;
- A requirement to screen construction and procurement activities for safety, health and environmental impact of products and technologies;
- A system of incentives aimed at improving more responsible handling of office equipment, materials and other assets by staff members.

COMMUNITY SUPPORT

Since its establishment, XacBank has been supportive of community activities, which included protection of the natural environment, support to the most vulnerable groups of society and small entrepreneurs and extended various forms of assistance to make real contributions to the future of children - the future generation of the country.

In 2006 to commemorate the 800th Anniversary of Great Mongol State, the Bank organized the "Nike in the Homeland of Chinggis Khaan" street basketball tournament, bringing together over more than 15 thousand



The first mini football international competition in Mongolia was sponsored by XacBank in 2006. "Zvezda" (The Star) a top league team from the Russian Federation participated in these games.

¹⁵ The IFC Exclusion List defines the types of projects that International Finance Corporation does not finance.

children for street basketball competitions, jointly with Mobicom Corporation and XAC Association NGO through the support of Nike Corporation and Mercy Corps International. A total of more than MNT 250 million was dedicated to these street ball tournaments aimed at promoting basketball and sports as sensible way of spending spare time were further organized in rural areas, covering 80 soums, among sports teams of all secondary schools.

On June 1st - International Children's Day - the Bank organized its annual "Children's Village" open fair activities in the Prime Minister Amar's Street. The 2006 Open Fair was organized together with Mobicom and Petrovis



Under patronage of the President of Mongolia, XacBank in collaboration with TV5 sponsored a mini football "Sensation-2020" competition among universities and secondary schools in Ulaanbaatar. A total of 2,140 youth from 10 universities and 62 secondary schools participated in this competition.

partner companies. This event included different activities designed to attract children, youth and parents to spend the weekend with the Bank.

Under patronage of the President of Mongolia, the Bank in partnership with TV5 and XAC Association NGO, sponsored the "Duulian (Sensation)-2020" a five-month long event start-up with an aim to develop soccer sports among youth with participation of 181 secondary school and university teams.

Last but not least, the XAC (Golden Fund for Development) Association – a non-governmental organization - which was set by the Bank's employees at their own initiative with a noble social mission to provide children, especially from disadvantages families, with opportunities to grow up in dignity and harmony and promote a healthy living environment, and quality education conducive to nurturing our children's talents and creativity. As of the past year, XAC Association NGO boasted more than 750 employees as its active members, who are voluntarily contributing 1 percent of their salary each month to support its public activities. Major actions include awareness arising on environmental and social responsibilities. In 2006 XAC Association NGO alone provided a total of MNT 14.3 million for various public campaign activities that involved more than 24 thousand children in all corners of Mongolia, including more than MNT 4 million that were donated compassionately to children from poor families and to disabled children.

PUBLIC RELATIONS

2006 was a significant year for XacBank and for Mongolia. It was the 800th anniversary of the Great Mongol State as well as the 8th anniversary of X.A.C. (Golden Fund for Development) LLC – the first Mongolian licensed microfinance institution and one of the two predecessor institutions of the XacBank. As a result, the Bank organized many public relations activities around these major events.

For example, the “XacKid Token” savings promotion campaign was conducted to support the leadership of the “Future Millionaire” child savings product. The campaign included a three-month jigsaw puzzle contest designed to tell the history of the Mongols to the younger generation in collaboration with the “Chinggis Khan Comics” book series for children.

The Bank concluded a cooperation agreement in 2006 with the Mongolian National Public Television (MNTV) aiming to contribute to the cause of social development. Through this arrangement, the Bank has gained opportunity to advertise its public relations activities, promote prudent and healthy lifestyle for general public and call upon the business community for socially and environmentally responsible activities. The Bank sponsored with TV5 studio a direct transmission of the FIFA World Cup from Germany allowing fellow countrymen to watch live all the football matches and promoting sports and solidarity among the general public.

PROFESSIONAL MEMBERSHIPS

XacBank continued to play an active role in several professional associations at both national and international level. The Bank has been a founding member of the Mongolian Bankers Association (MBA) and leading a number of initiatives in 2006, including establishment of the Mongolian Mortgage Corporation (MIK) and enhancing the Credit Information Bureau (CIB) with support from USAID funded Economic Policy Reform and Competitiveness (EPRC) project. MIK’s main goal is to create a secondary mortgage market in Mongolia, that will allow to promote affordable housing finance and to lower the cost of mortgage loan to homeowners. The Bank’s leading role is recognized through the election of its CEO as first Chairman of the MIK Board of Directors, composed of ten shareholders from all 16 commercial banks and the Bank of Mongolia (Central bank). On the CIB front, XacBank’s President has been elected as Chair of the five-member Working Group to develop a private sector-led credit information system in Mongolia to mitigate risks associated with lending service. XacBank CEO continued to play a pro-active role in public policy development in his capacity as a member of the Business Advisory Council to the President of Mongolia since 2005.

XacBank is active member of the Microfinance Center (MFC) for Central and Eastern Europe and the New Independent States, which is international grass-root network of over 90 microfinance institutions engaged in contributing to poverty reduction and human potential development by providing adequate financial and non-financial services to poor families and micro-entrepreneurs. In 2006 the Bank continued to provide technical assistance and training to MFC members in this region. Workshop training was hosted for representatives from Kazakhstan Loan Fund (KLF), a major microfinance institution from Almaty, sharing the Bank’s experience and its best practices of the transformation process from a microfinance institution to a socially-oriented and sustainable commercial bank. The Bank also assisted Barakot, a Mercy Corps project in Uzbekistan, by sending its Executive Vice President, as acting director for four months until a permanent manager was hired. Thus, XacBank is recognized internationally as one of the few successful transformation models for microfinance institutions worldwide.

XacBank of Mongolia

Audited Financial Statements
31 December 2006

XACBANK LLC

THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

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XACBANK LLC

CORPORATE INFORMATION

Registered office XacBank Building Prime Minister Amar's Street
Suhbaatar District, Ulaanbaatar Mongolia

Board of directors

Mr. Ganbold Chuluun
Mr. Stephen Mitchell
Mr. Ganhuyag Ch. Hutagt
Ms. Erdenechimeg Jambaldorj
Mr. Bekhbat Sodnom
Mr. Zorigt Namsrayjav
Ms. Erdenejargal Perenley
Mr. Mark Coffey
Mr. Stephen D. Vance
Ms. Femke Bos
Mr. Gilbert Crawford
Mr. Tanto Hiroshi
Mr. Jim Anderson

Board secretary Ms. Botagoz Gulislam

Auditors Ernst & Young Mongolia Audit LLC
Certified Public Accountants

STATEMENT BY DIRECTOR AND MANAGEMENT

I, Ganhuyag Ch. Hutagt, being one of the directors of XACBANK LLC ("the Bank"), and Delgerjargal Bayanjargal, being the officer primarily responsible for the financial management of the Bank, do hereby state that, in our opinion, the accompanying financial statements set out on pages 4 to 51 give a true and fair view of the financial position of the Bank as at 31 December 2006 and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



Ganhuyag Ch. Hutagt
(Chief Executive Officer)



Delgerjargal Bayanjargal
(Chief Financial Officer)

Ulaanbaatar, Mongolia

REPORT OF THE INDEPENDENT AUDITORS TO THE SHAREHOLDERS OF XACBANK LLC

We have audited the accompanying financial statements of XacBank LLC as at 31 December 2006 set out on pages 4 to 51.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

AUDITORS' RESPONSIBILITY

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 in accordance with Article 91 of Company Law of Mongolia and for no other purpose. We do not assume responsibility to any other person for the content of this report.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

REPORT OF THE INDEPENDENT AUDITORS (CONTD.)
TO THE SHAREHOLDERS OF XACBANK LLC

OPINION

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



Ulaanbaatar, Mongolia

30 MAR 2007

Ernst & Young Mongolia Audit LLC

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 MNT'000	2005 MNT'000
Interest and similar income	3	14,595,145	9,834,002
Interest and similar expenses	4	(6,205,888)	(4,258,189)
Net interest income		8,389,257	5,575,813
Non-interest income	5	1,302,524	875,585
Operating income		9,691,781	6,451,398
Operating expenses	6	(6,724,769)	(4,444,193)
Profit before impairment losses		2,967,012	2,007,205
(Impairment losses)/Write back of impairment losses	7	(397,439)	135,461
Grant income	22	83,803	227,558
Grant expenses	22	(83,803)	(227,558)
Profit before taxation		2,569,573	2,142,666
Taxation	8	(796,421)	(653,738)
Profit for the year attributable to equity holders of the Bank		1,773,152	1,488,928

The accompanying notes form an integral part of the financial statements.

XACBANK LLC

BALANCE SHEET AS AT 31 DECEMBER 2006

	Note	2006 MNT'000	2005 MNT'000
ASSETS			
Cash and short term funds	10	5,301,179	2,100,229
Deposits and placements with other banks and financial institutions	11	13,492,176	10,141,200
Financial investments	12	500	1,105,366
Loans and advances	13	60,350,085	38,597,470
Other assets	14	1,422,422	1,230,830
Property, plant and equipment	15	7,978,334	5,919,929
Intangible assets	16	376,876	112,756
TOTAL ASSETS		88,921,572	59,207,780
LIABILITIES			
Deposits from customers	17	43,007,055	31,396,813
Deposits from local financial institutions	18	4,080,959	2,800,917
Loans from local financial institutions	19	-	1,305,167
Loans from foreign financial institutions	20	26,264,286	10,178,109
Loans from the Bank of Mongolia and government agencies	21	3,889,314	3,336,197
Deferred grants	22	160,629	126,864
Other liabilities	23	409,858	312,466
Tax payable		240,718	205,646
TOTAL LIABILITIES		78,052,819	49,662,179
EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK			
Ordinary shares	24	8,034,200	8,034,200
Share premium		8,551	8,551
Other reserves	25	1,052,792	13,864
Retained profits		1,773,210	1,488,986
TOTAL EQUITY		10,868,753	9,545,601
TOTAL EQUITY AND LIABILITIES		88,921,572	59,207,780

The accompanying notes form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	Ordinary shares MNT '000	distributable Share premium MNT '000	Distributable Other reserves MNT '000	Retained profits MNT '000	Total MNT '000
At 1 January 2005		4,205,530	8,551	13,864	631,907	4,859,852
Profit for the year		-	-	-	1,488,928	1,488,928
Issuance of ordinary shares		3,324,750	-	-	-	3,324,750
Dividends capitalised to ordinary shares	9	503,920	-	-	(503,920)	-
Dividends	9	-	-	-	(127,929)	(127,929)
At 31 December 2005		8,034,200	8,551	13,864	1,488,986	9,545,601
Profit for the year		-	-	-	1,773,152	1,773,152
Transfer to other reserves	25	-	-	1,038,928	(1,038,928)	-
Dividends	9	-	-	-	(450,000)	(450,000)
At 31 December 2006		8,034,200	8,551	1,052,792	1,773,210	10,868,753

The accompanying notes form an integral part of the financial statements.

XACBANK LLC

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

	2006 MNT '000	2005 MNT '000
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit before taxation	2,569,573	2,142,666
<i>Adjustments for:-</i>		
Depreciation of property, plant and equipment	544,697	409,941
Amortisation of intangible assets	66,181	2,427
Net impairment losses/(written back) for loans and advances	387,118	(130,469)
Impairment of other assets	10,321	1,053
Impairment written back of financial investments	-	(6,045)
Loss on disposal of property, plant and equipment	9,613	6,255
Amortisation of deferred grants	(83,803)	(227,558)
Operating profit before working capital changes	3,503,700	2,198,270
<i>Changes in operating assets:-</i>		
Loans and advances	(22,139,733)	(17,774,817)
Other assets	(201,913)	(422,098)
<i>Changes in operating liabilities:-</i>		
Deposits from customers	11,610,242	15,201,730
Deposits from local financial institutions	1,280,042	1,818,650
Other liabilities	97,333	445,294
Cash (used in)/generated from operations	(5,850,329)	1,467,029
Income tax paid	(761,349)	(478,995)
Net cash flow (used in)/generated from operating activities	(6,611,678)	988,034
CASH FLOWS FROM INVESTING ACTIVITIES		
Net decrease/(increase) in financial investments	1,104,866	(133,947)
Proceeds on disposal of property, plant and equipment	75,793	120,429
Purchase of property, plant and equipment	(2,688,508)	(4,019,047)
Purchase of intangible assets	(330,301)	(115,183)
Net cash flow used in investing activities	(1,838,150)	(4,147,748)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of ordinary shares	-	3,324,750
Net drawdown of loans from local and foreign financial institutions	14,781,010	3,660,082
Net drawdown of loans from the Bank of Mongolia and government agencies	553,117	1,671,236
Deferred grants received	117,568	222,512
Dividends paid	(449,941)	(126,839)
Net cash flow generated from financing activities	15,001,754	8,751,741
Net increase in cash and cash equivalents	6,551,926	5,592,027
Cash and cash equivalents brought forward (Note 26)	12,241,429	6,649,402
Cash and cash equivalents carried forward (Note 26)	18,793,355	12,241,429

The accompanying notes form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006

1. CORPORATE INFORMATION

The Bank is principally engaged in the business of provision of banking and financial services pursuant to License No. 24 issued by the Bank of Mongolia. There have been no significant changes in the nature of these activities during the year.

The Bank is a limited liability company, incorporated and domiciled in Mongolia. The registered address and the principal place of business of the Bank is XacBank Building, Prime Minister Amar's Street, Suhbaatar District, Ulaanbaatar, Mongolia.

The holding company of the Bank is XAC-GE LLC, which is incorporated in Mongolia. The shareholders of the holding company are:

- Mercy Corps
- MicroVest 1, LP
- Tuushin LLC
- Shorecap International LTD
- EIT LLC
- Triodos Fair Share Fund
- Stichting Triodos Doen
- Open Society Forum
- Newcom LLC
- Mongolian Women's Federation
- Rotary Club of Ulaanbaatar
- CYDAN SCC
- Employees of XAC-GE LLC and XacBank LLC
- Liberal Women's Intellectual Pool

These financial statements of the Bank for the year ended 31 December 2006 were authorised for issue by the Board of Directors in accordance with a resolution of the directors on 29 March 2007

2. ACCOUNTING POLICIES

2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with International Financial Reporting Standards.

The financial statements have been prepared under the historical cost basis, except for revaluation of certain financial instruments. The financial statements are presented in the Mongolian Tugrug, which is denoted by the symbol MNT, rounded to the nearest thousand, except when otherwise indicated.

2.2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Interest income and expense

Interest income and expense for all interest-bearing financial instruments except those classified as held for trading or designated at fair value are recognised in "Interest and similar income" and "Interest and similar expenses" in the income statement using the effective interest rates of the financial assets or financial liabilities to which they relate. Interest income is recognised in the income statement as it accrued, except in the case of impaired loans and advances. Interest on impaired financial assets is recognised at the original effective interest rate of the financial assets applied to the impaired carrying amount.

XACBANK LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

(b) Fees and commission income

Fees and commission income derived by the Bank relate mainly to card service, application, transaction, money transfer service, and other fees. Fees and commission are generally recognised on an accrual basis when service has been provided.

(c) Foreign currencies translation

The financial statements are presented in Mongolian Tugrug, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded at the rates ruling at the date of the transaction. Foreign currency monetary assets and liabilities are translated at the exchange rates ruling at the balance sheet date. All exchange differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(d) Income tax

The Bank provides for current income tax based on its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purpose, in accordance with the regulations of the Mongolian Government and is measured using the tax rates that have been enacted at the balance sheet date.

Deferred tax is provided for, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the financial statements. In principle, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised for all deductible temporary differences, unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be utilised. Deferred tax is not recognised if the temporary difference arises from goodwill or negative goodwill or from the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction, affects neither accounting profit nor taxable profit. Deferred tax is measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date. Deferred tax is recognised in the income statement, except when it arises from a transaction which is recognised directly in equity, in which case the deferred tax is also recognised directly in equity, or when it arises from a business combination that is an acquisition, in which case the deferred tax is included in the resulting goodwill or negative goodwill.

(e) Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents consist of cash and short term funds, deposits and placements with other banks and financial institutions.

(f) Investments and other financial assets

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets, as appropriate. Financial assets are initially measured at fair value plus, in the case of financial assets not classified at fair value through profit or loss, directly attributable transaction costs. The Bank determines the classification of its financial assets at initial recognition.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Bank commits to purchase or sell the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

(i) Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category financial assets at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

In addition, a financial instrument, other than one held for trading, is classified in this category if it meets certain criteria and is so designated by management. This designation, once made, is irrevocable in respect of the financial instruments to which it is made. Financial assets so designated, and financial assets classified as held for trading, are recognised initially at fair value, with transaction costs taken directly to the income statement, and are subsequently remeasured at fair value. Gains or losses arising from changes in fair value are recognised in the profit or loss.

(ii) Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Bank has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. After initial recognition, held-to-maturity financial investments are subsequently measured at amortised costs using the effective interest rate method, less allowance for impairment. The amortisation is included in "Interest and similar income" in the income statement. The losses arising from impairment of such investments are recognised in the income statement under "Impairment losses".

(iii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provide money directly to a debtor with no intention of trading the receivable. After initial recognition, such assets are carried at amortised cost using the effective interest method, less allowance for impairment. The amortisation is included in "Interest and similar income" in the income statement. The losses arising from impairment of such investments are recognised in the income statement under "Impairment losses".

(iv) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition, available-for-sale financial assets are measured at fair value, with fair value changes recognised as a separate component of equity until the asset is derecognised or until the asset is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in the profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. Impairment losses on equity instruments previously recognised in the income statement that are no longer required are reversed through reserves, not through the income statement.

(g) Determination of fair value

The fair value of financial assets that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For assets where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis and option pricing models.

(h) Impairment of financial assets

The Bank assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more loss events that has occurred after the initial recognition of the assets (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in economic conditions that correlate with defaults.

XACBANK LLC

NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

(i) Loans and advances

For loans and advances carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued based on the original effective interest rate of the asset. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is reduced accordingly. The reduction of an impairment loss under these circumstances is recognised in the income statement in the period in which it occurs.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of type of the Bank's loan products that considers credit risk characteristics such as purpose of the loan, type of borrowers and collateral type and industry. The Bank adopted the basic approach where the impairment losses are computed on an average of historical loss experience of each risk grouping over the outstanding balance. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

(ii) Held-to-maturity financial investments

For held-to-maturity investments the Bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the income statement.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the "Impairment losses on financial investments".

(iii) Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each balance sheet date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement - is removed from equity and recognised in the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in their fair value after impairment are recognised directly in equity.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of "Interest and similar income". If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

(i) Property, plant and equipment

All items of property, plant and equipment are initially recorded at cost. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Subsequent to recognition, property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses.

Assets under construction are not depreciated. Depreciation of other property, plant and equipment is provided for on a straight-line basis to write off the cost of each asset to its residual value over the estimated useful life at the following annual rates:

Buildings	40 years
Furniture, fixtures and vehicles	10 years
Computers	5 years

The residual values, useful life and depreciation method are reviewed at each financial year-end to ensure that the amount, method and period of depreciation are consistent with previous estimates and the expected pattern of consumption of the future economic benefits embodied in the items of property, plant and equipment.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. The difference between the net disposal proceeds, if any and the net carrying amount is recognised in profit or loss.

(j) Intangible assets

Intangible assets include the value of computer software and licences, and patents and rights. Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives as follows:

Software and licences	3-5 years
Patents and rights	3 years

(k) Deposits from customers

Deposits from customers are stated at cost which is the fair value of the consideration to be paid in the future for deposits received.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

(l) Impairment of other assets

The Bank assesses at each balance sheet date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Bank makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair values less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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.

An assessment is made at each balance sheet date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

(m) Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are retained in the financial statements as available-for-sale or held-for-maturity securities and the counterparty liability is included in amounts due to other financial institutions or as appropriate. Securities purchased under agreement to resell ('reverse repos') are recorded as amount due from other financial institutions or as appropriate. The difference between the sale and repurchase price is treated as interest and accrued over the life of the repo agreements using the effective yield method.

(n) Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letter of credit and guarantees to their customers. These guarantees, with the exception of related premiums, are kept off-balance sheet unless a provision is needed to cover probable losses. Premiums received are initially recognised in the financial statements at fair value, in "Other liabilities". Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amortised premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the income statement in "Impairment losses". The premium received is recognised in the income statement in "Non-interest income" on a straight-line basis over the life of the guarantee.

(o) 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 attached to them. Grants that compensate the Bank for expenses incurred are amortised as revenue in income statement 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 income statement on a systematic basis over the useful life of the asset.

(p) Employee benefits**(i) Short term benefits**

Wages, salaries and other salary related expenses are recognised as an expense in the year in which the associated services are rendered by employees of the Bank. Short term accumulating compensated absences such as paid annual leave are recognised when services rendered by employees that increase

their entitlement to future compensated absences, and short term non-accumulating compensated absences such as sick leave are recognised when absences occur.

(ii) Defined contribution plans

As required by the law, companies in Mongolia make contributions to the government pension scheme, Social and Health Fund. Such contributions are recognised as an expense in profit or loss as incurred.

(iii) Equity compensation benefits

The Employee Stock Ownership Plan allows the Bank's staff to hold XAC-GE LLC's shares through an employee investment trust company, EIT LLC. The purchase price is at 50% (2005: 30%) of the par value of EIT LLC shares. No charge is made to the Bank's total share capital and no compensation cost is recognised by the Bank.

(q) Operating leases

Lease payments for operating leases, where substantially all risk and benefits remain with the lessor, are charged as an expense in the income statement on a straight-line basis over the term of the relevant lease.

(r) Financial instruments

Financial instruments are recognised in the balance sheet when the Bank has become a party to the contractual provisions of the instrument. The accounting policies on recognition and measurement of these items are disclosed in their respective accounting policies.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends and gains and losses relating to a financial instrument classified as a liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are recognised directly in equity. Financial instruments are offset when the Bank has a legally enforceable right to offset and intends to settle either on a net basis or to realise the asset and settle the liability simultaneously.

(s) Equity instruments

Ordinary shares are classified as equity and dividends are recognised in equity in the year in which they are declared.

(t) Financial liabilities

The Bank classifies its financial liabilities in the following categories:

- (i) financial liabilities at fair value through profit or loss; and
- (ii) non-trading liabilities.

Financial liabilities classified at fair value through profit or loss are carried at fair value, with gains and losses from change in fair value recognised through the income statement. Non-trading liabilities are carried at amortised cost using the effective interest method. A financial liability is removed or derecognised from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

2.3 CHANGE IN ACCOUNTING POLICIES

The Bank has adopted the following new and amended IFRS and IFRIC interpretations during the year. Adoption of these new and amended standards and interpretations does not have any effect on equity and changes in comparative figures as at 1 January 2006.

- IAS 19 Amendment - Actuarial Gains and Losses, Group Plans and Disclosures;
- IAS 39 Amendment - Cash Flow Hedge Accounting of Forecast Intragroup Transactions;

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

- IAS 39 Amendment - The Fair Value Option;
- IAS 39 and IFRS 4 Amendment - Financial Guarantee Contracts;
- IFRS 6 - Exploration for and Evaluation of Mineral Resources;
- IFRIC 4 - Determining whether an Arrangement contains a Lease.

At the date of authorisation of these financial statements, the following Standards, Amendments and Interpretations were in issue but not yet effective:

- IFRS 7 - Financial Instruments: Disclosures;
- IAS 1 - Amendment - Presentation of Financial Statements;
- IFRIC 8 - Scope of IFRS 2;
- IFRIC 9 - Reassessment of Embedded Derivatives;
- IFRIC 10 - Interim Financial Reporting and Impairment;
- IFRIC 11 - IFRS 2 Group and Treasury Share Transactions;
- IFRIC 12 - Service Concessions Arrangement.

The directors anticipate that the adoption of these Standards, Amendments and Interpretations in the financial year ended 31 December 2007 will have no material impact on the financial statements of the Bank. They will however give rise to additional disclosures.

2.4 SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

In the process of applying the Bank's accounting policies, management has used its judgments and made estimates in determining the amounts recognised in the financial statements. The most significant use of judgments and estimates are as follows:

Impairment losses on loans and advances

The Bank reviews its problem loans and advances at each reporting date to assess whether an allowance for impairment should be recorded in the income statement. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of allowance required. Such estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

In addition to specific allowance against individually significant loans and advances, the Bank also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This takes into consideration factors such as any deterioration in industry risk and technological obsolescence, as well as identified structural weaknesses or deterioration in cash flows.

3. INTEREST AND SIMILAR INCOME

	2006 MNT '000	2005 MNT '000
Loans and advances	13,867,013	9,413,196
Deposits and placements with other banks and financial institutions	595,875	308,813
Financial investments - available-for-sale	132,257	111,993
	14,595,145	9,834,002

4. INTEREST AND SIMILAR EXPENSES

	2006 MNT '000	2005 MNT '000
Current account	101,206	15,774
Time and demand deposits	3,956,379	2,782,966
Deposits and placements of financial institutions	212,244	279,382
Loans from local and foreign financial institutions and government agencies	1,936,059	1,180,067
	6,205,888	4,258,189

5. NON-INTEREST INCOME

	2006 MNT '000	2005 MNT '000
Fees and commission income:		
Card service fees	114,616	31,933
Deposit account maintenance and service fees	105,640	81,279
Loan application fees	501,256	386,630
Money transfer fees	153,425	97,376
Other fees income	259,267	133,414
	1,134,204	730,632
Less: Fees and commission expenses	(76,097)	(49,593)
	1,058,107	681,039
Other income:		
Realised foreign currencies gain	111,914	80,602
Unrealised foreign currencies gain	22,345	26,974
Rental income	70,872	64,493
Income from penalties	692	763
Recovery of bad loans	2,626	1,568
Other operating income	35,968	20,146
	244,417	194,546
Total non-interest income	1,302,524	875,585

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

6. OPERATING EXPENSES

	2006 MNT '000	2005 MNT '000
Advertising	218,499	137,057
Amortisation of intangible assets (Note 16)	66,181	2,427
Armoured guard and security	252,907	51,341
Business trips	399,215	357,093
Cash collection service	809	108
Communication	371,237	211,502
Computer expenses	20,484	6,289
Depreciation of property, plant and equipment (Note 15)	544,697	409,941
Entertainment	161,032	107,583
Insurance expense	29,798	23,860
Loans collection expenses	5,547	5,259
Maintenance of property, plant and equipment	71,396	26,852
Membership and audit expenses	87,880	71,041
Other operating expenses	483,059	318,996
Staff costs *	2,975,312	1,987,091
Rental expenses	355,683	211,728
Stationery	245,613	200,703
Transportation and fuel supplies	304,305	220,237
Utilities	131,115	95,085
	6,724,769	4,444,193
* Staff costs		
Salaries, incentives and allowances	2,492,526	1,663,095
Contribution to social and health fund	476,907	318,512
Training	5,879	5,484
	2,975,312	1,987,091

7. IMPAIRMENT LOSSES/(WRITE BACK OF IMPAIRMENT LOSSES)

	2006 MNT '000	2005 MNT '000
Loans and advances	387,118	(130,469)
Foreclosure properties	10,321	98
Other receivables	-	955
Financial investments	-	(6,045)
	397,439	(135,461)
Current income tax: Based on results for the year	796,421	653,738

The Bank provides for income taxes on the basis of its income for financial reporting purposes, adjusted for items which are not assessable or deductible for income tax purposes. The income tax rate for profits of the Bank is 15% (2005 : 15%) for the first MNT 100 million of taxable income, and 30% (2005 : 30%) on the excess of taxable income over MNT 100 million. Interest income on government bonds is not subject to income tax. Impairment losses for loans and advances is deductible for income tax purposes.

A reconciliation of income tax expense applicable to profit before taxation at the statutory income tax rate to income tax expense at the effective income tax rate of the Bank for the year ended 31 December is as follows:

	2006 MNT '000	2005 MNT '000
Profit before taxation	2,569,573	2,142,666
Tax at statutory tax rate of 30% (2005: 30%)	770,872	642,800
Effect of income subject to lower tax rate	(15,000)	(15,000)
Effect of income not subject to tax	(96,416)	(46,321)
Effect of expenses not allowable for tax purposes	136,965	78,370
Other items	-	(6,111)
Tax expense for the year	796,421	653,738

Deferred tax is not provided for in the current and previous financial years as there are no temporary differences.

Management believes that the Bank is in substantial compliance with the tax laws affecting its operations.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

9. DIVIDENDS

	2006 MNT '000	2005 MNT '000
Declared during the year in respect of:		
Year 2005	450,000	-
Dividends declared: MNT 56.01 per ordinary shares		
Year 2004		
Dividends declared: MNT 30.42 per ordinary shares	-	127,929
Dividends capitalised: MNT 119.82 per ordinary shares	-	503,920
	450,000	631,849

10. CASH AND SHORT TERM FUNDS

	2006 MNT '000	2005 MNT '000
Cash and short term funds represented by:		
Local currency	2,572,761	3,255,842
Foreign currencies	2,728,418	6,885,358
	5,301,179	10,141,200

Current accounts with the Bank of Mongolia are maintained in accordance with the Bank of Mongolia's requirements. The balances maintained with the Bank of Mongolia are determined at set percentages based on 15 days average cash balances.

Placements with other banks and financial institutions represent local and foreign currencies current accounts maintained with foreign and local financial institutions and short term deposits with local financial institutions.

Other information on financial risks of deposits and placements with other banks and financial institutions are disclosed in Note 27.

12. FINANCIAL INVESTMENTS

	2006 MNT '000	2005 MNT '000
Available-for-sale:		
Bank of Mongolia treasury bills, at fair value	-	1,104,866
Equity, unquoted	500	500
	500	1,105,366

Unquoted equity represents an investment made in NTB Art Exhibition LLC, a small handcraft production company. The investment is recorded at cost since its fair value cannot be reliably estimated. There is no market value for this investment.

Other information on financial risks of financial investments are disclosed in Note 27.

13. LOANS AND ADVANCES

	2006 MNT '000	2005 MNT '000
Term loans	58,545,723	37,183,513
Staff loans	1,051,498	768,000
Loans to key management personnel	215,769	126,376
Accrued interest receivables	1,023,269	647,188
Gross loans and advances	60,836,259	38,725,077
Allowance for impairment losses		
- specific	(357,851)	(127,607)
- collective	(128,323)	-
Net loans and advances	60,350,085	38,597,470

Loans and advances analysed by their economic purposes are as follows:

	2006 MNT '000	2005 MNT '000
Textile and production	2,513,272	1,726,861
Trading	18,905,075	15,677,211
Food processing	1,407,442	787,028
Services	6,883,889	2,911,046
Consumption	13,056,348	7,577,500
Agricultural	3,264,052	2,470,119
Mortgage	9,045,439	4,664,828
Deposit backed	2,237,728	1,251,998
Construction, mining and education	1,232,478	116,922
Loans to staff	1,051,498	768,000
Loans to key management personnel	215,769	126,376
	59,812,990	38,077,889
Accrued interest receivables	1,023,269	647,188
Allowance for impairment losses	(486,174)	(127,607)
Net loans and advances	60,350,085	38,597,470

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

In accordance with guidelines and regulations issued by the Bank of Mongolia, a loan is classified as non-performing when payment of interest and principal is overdue by more than 90 days. The details of non-performing loans ("NPLs") are as follows:

	2006 MNT '000	2005 MNT '000
Gross balance at end of year	517,080	178,242
Less: Allowance for impairment losses	(344,115)	(118,009)
Net balance at year end	172,965	60,233
Gross NPLs as a percentage of gross total loans	0.8%	0.5%
Net NPLs as a percentage of net total loans	0.3%	0.2%

Movements in the impairment losses are as follows:

	2006 MNT '000	2005 MNT '000
Specific Impairment		
Balance at beginning of year	127,607	67,523
Impairment made during the year	258,795	70,569
Impairment written off	(28,551)	(10,485)
Balance at end of year	357,851	127,607

	2006 MNT '000	2005 MNT '000
Collective Impairment		
Balance at beginning of year	-	201,038
Impairment made during the year	134,286	-
Impairment written back	(5,963)	(201,038)
Balance at end of year	128,323	-

Other information on financial risks of loans and advances are disclosed in Note 27.

The allowance for impairment losses is considered adequate by the management based upon their formal reviews and analysis of existing credits using their knowledge of prevailing and anticipated economic conditions.

14. OTHER ASSETS

	2006 MNT '000	2005 MNT '000
Other receivables	354,696	106,915
Less: Allowance for impairment losses	(2,393)	(5,711)
	352,303	101,204
Foreclosure properties	11,821	1,500
Less: Allowance for impairment losses	(11,821)	(1,500)
	-	-
Prepaid expenses	564,423	656,744
Consumables and other inventories	505,696	467,658
Accrued interest receivables	-	5,224
	1,422,422	1,230,830

31 December 2006	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Capital work-in- progress MNT '000	Total MNT '000
At Cost					
At 1 January 2006	3,622,083	1,415,086	1,319,931	431,361	6,788,461
Additions	341,341	501,177	374,452	1,471,538	2,688,508
Disposals	(4,967)	(109,673)	(52,698)	-	(167,338)
Write-offs	-	-	(11,801)	-	(11,801)
Transfer	397,605	-	-	(397,605)	-
At 31 December 2006	4,356,062	1,806,590	1,629,884	1,505,294	9,297,830
Accumulated Depreciation					
At 1 January 2006	118,074	229,605	520,853	-	868,532
Charge for the year (Note 6)	96,367	165,754	282,576	-	544,697
Disposals	(704)	(33,299)	(47,929)	-	(81,932)
Write-offs	-	-	(11,801)	-	(11,801)
At 31 December 2006	213,737	362,060	743,699	-	1,319,496
Net Book Value	4,142,325	1,444,530	886,185	1,505,294	7,978,334

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

15. PROPERTY, PLANT AND EQUIPMENT

31 December 2005	Buildings MNT '000	Furniture, fixtures and vehicles MNT '000	Computers MNT '000	Capital work-in- progress MNT '000	Total MNT '000
At Cost					
At 1 January 2005	943,607	964,817	823,617	269,820	3,001,861
Additions	2,573,076	584,324	594,706	266,941	4,019,047
Disposals	-	(134,055)	(74,842)	-	(208,897)
Write-offs	-	-	(23,550)	-	(23,550)
Transfer	105,400	-	-	(105,400)	-
At 31 December 2005	3,622,083	1,415,086	1,319,931	431,361	6,788,461
Accumulated Depreciation					
At 1 January 2005	36,789	165,540	362,025	-	564,354
Charge for the year (Note 6)	81,285	109,642	219,014	-	409,941
Disposals	-	(45,577)	(36,636)	-	(82,213)
Write-offs	-	-	(23,550)	-	(23,550)
At 31 December 2005	118,074	229,605	520,853	-	868,532
Net Book Value	3,504,009	1,185,481	799,078	431,361	5,919,929

16. INTANGIBLE ASSETS

31 December 2006	Software and Licenses MNT '000	Patents and Rights MNT '000	Total MNT '000
At Cost			
At 1 January 2006	114,133	1,050	115,183
Addition	330,208	93	330,301
At 31 December 2006	444,341	1,143	445,484
Accumulated Amortisation			
At 1 January 2006	2,427	-	2,427
Charge for the year (Note 6)	65,868	313	66,181
At 31 December 2006	68,295	313	68,608
Net Book Value	376,046	830	376,876

	Software and Licenses MNT '000	Patents and Rights MNT '000	Total MNT '000
31 December 2005			
At Cost			
At 1 January 2005	-	-	-
Addition	114,133	1,050	115,183
At 31 December 2005	114,133	1,050	115,183
Accumulated Amortisation			
At 1 January 2005	-	-	-
Charge for the year (Note 6)	2,427	-	2,427
At 31 December 2005	2,427	-	2,427
Net Book Value	111,706	1,050	112,756

17. DEPOSITS FROM CUSTOMERS

	2006 MNT '000	2005 MNT '000
Current account	5,372,795	3,671,545
Demand deposits	9,349,055	6,345,471
Time deposits	28,271,453	21,379,797
Other deposits	13,752	-
	43,007,055	31,396,813

18. DEPOSITS FROM LOCAL FINANCIAL INSTITUTIONS

	2006 MNT '000	2005 MNT '000
Time Deposit from Chinggjs Khaan Bank	1,750,959	-
Time Deposit from Ulaanbaatar City Bank	2,330,000	-
Time Deposit from Mongol Post Bank	-	800,000
Time Deposit from Zoos Bank	-	2,000,917
	4,080,959	2,800,917

Other information on financial risks of deposits from financial institutions are disclosed in Note 27.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

19. LOANS FROM LOCAL FINANCIAL INSTITUTIONS

	2006 MNT '000	2005 MNT '000
Unsecured:	-	800,000
Mongol Post Bank	-	505,167
Chinggis Khaan Bank	-	1,305,167

Other information on financial risks of loans from local financial institutions are disclosed in Note 27.

20. LOANS FROM FOREIGN FINANCIAL INSTITUTIONS

	2006 MNT '000	2005 MNT '000
Unsecured:		
Deutsche Bank Microcredit Development Fund, Inc	101,613	154,549
International Finance Corporation	364,358	445,102
Dexia Micro Credit Fund	587,012	1,854,593
Calvert Social Investment Foundation, Inc	836,010	618,198
Microvest 1, LP	-	1,854,594
ASN-Novib Fonds	1,764,657	1,236,395
Oikocredit Ecumenical Development Cooperative Society U.A	1,745,762	2,221,140
Shorecap International Ltd	583,228	611,178
Triodos Doen	1,557,667	578,057
Triodos Fair Share Fund	1,160,990	604,303
BlueOrchard Finance S.A.	7,583,539	-
DB-Global Commercial Microfinance Consortium, Ltd	4,798,047	-
DWM Securitizations S.A.	2,321,777	-
European Bank for Reconstruction and Development	2,859,626	-
	26,264,286	10,178,109

Loans from Foreign Financial Institutions are non-secured and the Bank has not had any defaults of principal, interest or other breaches with respect to their liabilities during the year.

Loan from Deutsche Bank Microcredit Development Fund, Inc ("DB")

The loan was obtained in 2002 in the form of subordinated debt for a principal amount of USD 125,000 to finance the Bank's micro-finance and small and medium enterprise ("SME") lending activities. The loan bears interest at a rate of 2% (2005: 2%) per annum and is repayable in August 2007.

Loan from the International Finance Corporation ("IFC")

The loan from IFC, amounting to USD 400,000, bears interest at a rate of 9.11% (2005: 7.32%) per annum. The loan was obtained in 2002 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in twelve semi-annual instalments which commenced on 15 January 2005 and will be fully repaid in July 2010.

Loans from Dexia Micro Credit Fund ("DMCF")

The loans obtained from DMCF comprise the following:

- (i) A promissory note issued by the Bank for a principal amount of USD 500,000. The note bears interest at a rate of 11.53% (2005: 10.67%) per annum. The loan was fully settled during the year.
- (ii) A promissory note issued by the Bank for a principal amount of USD 1,000,000. The note was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The note bears interest at a rate of 9.75% (2005: 9.75%) per annum. The loan is repayable in two equal semi-annual instalments of USD 500,000 each, commencing in December 2006 and to be fully repaid in June 2007.

Loan from Calvert Social Investment Foundation, Inc ("CSIF")

The loan obtained from CSIF is in the form of promissory notes issued by the foundation for a principal amount of USD 700,000. The note was obtained in 2004, 2005 and 2006 respectively to finance the bank's micro-finance and SME lending activities. The notes bear interest at a rate of 6% (2005: 6%) per annum and will be fully repaid in July 2008.

Loan from Microvest 1, LP

The loan obtained from Microvest 1, LP, amounting to USD 1,500,000, bears interest at a rate of 10.48% (2005: 9.77%) per annum. The loan was obtained in 2004 to support further expansion of the Bank's micro-finance and SME lending activities. The loan has been fully repaid during the year.

Loans from ASN-Novib Fonds

The loans obtained from ASN-Novib Fonds comprise the following:

- (i) USD 1,000,000, which bears interest at a rate of 9% (2005: 9%) per annum. The loan was obtained in 2004 to support further expansion of the Bank's micro-finance and SME lending activities. The loan has been fully repaid during the year.
- (ii) MNT 584,000,000, which bears interest at a rate of 12.5% per annum. The loan was obtained in 2006 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in September 2008.
- (iii) USD 1,000,000, which bears interest at a rate of 8.5% per annum. The loan was obtained in 2006 to support further expansion of the Bank's micro-finance and SME lending activities. The loan will be fully repaid in September 2008.

Loans from Oikocredit Ecumenical Development Cooperative Society U.A ("Oikocredit")

The loans obtained from Oikocredit comprise the following:

- (i) MNT 444,690,000, which bears interest at a rate of 13% (2005: 13%) per annum. The loan was obtained to finance the Bank's micro-finance and SME lending activities. The loan has been fully repaid during the year.
- (ii) USD 724,920, which was converted to MNT 853,955,760 during the year, bears interest at a rate of 12% per annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal semi-annual instalments of MNT 213,488,940 each commencing April 2007 and will be fully settled in October 2008.
- (iii) EUR 600,000, which bears interest at a rate of 9.09% (2005: 8.02%) per annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal semi-annual instalments commencing April 2007 and will be fully repaid in October 2008.

Loan from Shorecap International Ltd ("SCI")

The loan obtained from SCI, amounting to USD 500,000, bears interest at a rate of 9% (2005: 9%) per

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annum. The loan was obtained in 2005 to finance the Bank's micro-finance and SME lending activities. The loan is repayable in four equal quarterly instalments commencing December 2007 and will be fully repaid in September 2008.

Loans from Triodos Doen

The loans obtained from Triodos Doen comprise of the following:

- (i) MNT 560,185,000, which bears interest at a rate of 13% (2005: 13%) per annum. The loan was obtained in 2005 to finance the expansion of Bank's lending activities. The loan will be fully repaid in October 2008.
- (ii) MNT 1,000,000,000, which bears interest at a rate of 13% per annum. The loan was obtained in 2006 to finance the expansion of Bank's lending activities. The loan will be fully repaid in July 2010.

Loans from Triodos Fair Share Fund

The loans obtained from Triodos Fair Share Fund comprise of the following:

- (i) USD 500,000, which bears interest at a rate of 9% (2005: 9%) per annum. The loan was obtained in 2005 to finance the expansion of Bank's lending activities. The loan will be fully repaid in October 2008.
- (ii) USD 500,000, which bears interest at a rate of 8.5% per annum. The loan was obtained in 2006 to finance the expansion of Bank's lending activities. The loan will be fully repaid in July 2011.

Loan from BlueOrchard Finance S.A.

The loan obtained from BlueOrchard, amounting to USD 6,500,000, bears interest at a rate of 8.25% per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro-finance lending activities. The loan is repayable in four equal quarterly instalments commencing June 2010 and will be fully repaid in March 2011.

Loan from DB-Global Commercial Microfinance Consortium, Ltd. ("DBGC")

The loan obtained from DBGC, amounting to MNT 4,672,000,000, bears interest at a rate of 9.25% per annum. The loan was obtained in 2006 to finance the Bank's micro-finance and small-medium enterprise lending activities. The loan is repayable in eight equal semi-annual instalments commencing March 2007 and will be fully repaid in September 2010.

Loan from DWM Securitizations S.A. ("DWMS")

The loan obtained from DWMS, amounting to USD 2,000,000, bears interest at a rate of 8.25% per annum. The loan was obtained in 2006 to finance the expansion of the Bank's micro-finance and small-medium enterprise lending activities. The loan will be fully repaid in June 2011.

Loan from the European Bank for Reconstruction and Development ("EBRD")

The loan was obtained from EBRD, amounting to USD 2,500,000, bears interest at a rate of 9.12% per annum. The loan was obtained in 2006 to assist the development of the micro and small business sector in Mongolia. The loan is repayable in five equal semi-annual instalments commencing September 2008 and will be fully repaid in September 2010.

Other information on financial risks of loans from foreign financial institutions are disclosed in Note 27.

21. LOANS FROM THE BANK OF MONGOLIA AND GOVERNMENT AGENCIES

	2006 MNT '000	2005 MNT '000
Unsecured:		
Loans from the Bank of Mongolia		
Agricultural Sector Development Project Loan	290,966	497,136
Employment Generation Project	70,300	42,200
	361,266	539,336
Loan from the Ministry of Social Welfare and Labour		
Employment Generation Support Fund	500,000	500,000
Loan from the World Bank		
Micro Finance Development Fund	837,579	924,858
Loan from the International Fund for Agricultural Development		
Rural Poverty Reduction Program	1,849,458	1,372,003
Loan from the Ministry of Trade and Industry	341,011	-
	3,889,314	3,336,197

Loans from the Bank of Mongolia

(i) Agricultural Sector Development Project Loan

The Bank obtained this loan in Mongolian Tugrug from the Bank of Mongolia. The objective of the loan is to provide financial aid to small and medium enterprises in the agricultural sector. The loan bears interest at 5.5% (2005: 5.5%) per annum, payable on a quarterly basis which commenced on 5 January 2006 and will be fully repaid in October 2007.

(ii) Employment Generation Project

The Bank obtained this loan in Mongolian Tugrug from the Bank of Mongolia amounting to MNT 118,500,000 bears interest at a rate of 10% (2005: 10%) per annum. The loan was obtained through 4 disbursements from October 2005 to June 2006 to support micro and medium business entities in Mongolia. The loan is repayable in 7 instalments, commencing on April 2006 and to be fully repaid in June 2007.

Loan from the Ministry of Social Welfare and Labour

The Bank obtained this loan in Mongolian Tugrug from the Ministry of Social Welfare and Labour. The objective of the loan is to provide financial aid to small and medium enterprises. The loan amounting to MNT 500 million obtained in 2005, which bears interest at rate of 6% per annum was fully repaid in 2006. The Bank obtained another loan which amounts to MNT 500 million during the year. The loan bears interest at a rate of 0.8% per annum and will be fully repaid in July 2007.

Loan from the World Bank

The objective of the loan is to support and improve the living standard of inhabitant in the rural areas. The loan bears interest rate at 8% (2005: 5%-8%) per annum, payable on a monthly basis with principal repayment commencing on September 2005 and final repayment due in March 2009 in accordance with the repayment schedule.

Loan from the International Fund for Agricultural Development

The objective of the loan is to support and reduce the poverty in the rural areas. The loan, which amounts to

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USD 1,823,380, is to be received from March 2004 to December 2009. It bears interest at a rate of 6% (2005: 6%) per annum. The loan is repayable in 10 equal semi-annual instalments commencing from June 2013 and will be fully repaid in December 2017.

Loan from the Ministry of Trade and Industry

The objective of the loan is to support micro and medium businesses. The loan, which is in Mongolian Tugrug amounting to MNT 340 million was obtained in 2006, bears interest at a rate of 1.2% per annum and will be due and fully repaid on 8 November 2008.

The loans are unsecured and the Bank has not had any defaults of principal, interest or other breaches with respect to their liabilities during the year.

Other information on financial risks of loans from the Bank of Mongolia and government agencies are disclosed in Note 27.

22. DEFERRED GRANTS

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 corporate governance, in particular, financial management and banking skills.

During the year, XacBank won the CGAP's Pro Poor Innovation Challenge for its "Development Guide" service supporting rural savings and credit cooperatives. The grant was disbursed to XacBank to improve the Bank's service to the public, which include provide training to cooperative managers and members, finance awards for the best cooperatives and provides MIS program to cooperatives.

The IFC grant was received in 2002 with the objective of providing funds for technical assistance in the following initiatives:

- Hiring of technical advisor;
- Provide 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.

The Microenterprise Implementation Grant Program ("MIGP") grant was received in 2003 from United States Agency for International Development ("USAID") with the objective of assisting the Bank in expanding its branch network, staff training and developing new products and services, as well as internal systems needed to control growth.

Expenditure financed by grants

Donor and Purpose

	2006 MNT '000	2005 MNT '000
• Expenditure financed by grants from "CGAP" covering consulting fee	-	
• Expenditure financed by grants from "CGAP" covering meeting and training fee	4,689	
• Expenditure financed by grants from United Nations Development Program covering scholarships to students	710	497,136 42,200
• Expenditure financed by grants from USAID's Income Generation Project covering facility improvements	-	539,336
• Expenditure financed by grants from USAID's Income Generation Project covering internal systems development & IT audit consultancy, training and exposure trip	14,243	500,000 924,858
• Expenditure financed by grants from MIGP covering purchasing of accounting program	14,825	1,372,003
• Expenditure financed by grants from MIGP covering renovation of building	49,336	- 3,336,197
	83,803	

23. OTHER LIABILITIES

	2006 MNT '000	2005 MNT '000
Delay on clearing settlement	95,406	150,550
Other payables	313,303	160,826
Dividends payable	1,149	1,090
	409,858	312,466

24. ORDINARY SHARES

	Number of Ordinary Shares of MNT1,000 each		2006 MNT '000	Amount 2005 MNT '000
	2006	2006		
At 1 January	95,406	95,406	95,406	150,550
Issued during the year	313,303	313,303	313,303	160,826
Dividend capitalised to ordinary shares	1,149	1,149	1,149	1,090
At 31 December	409,858	409,858	409,858	312,466

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

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 meetings of the Bank. All shares rank equally with regard to the Bank's residual assets.

25. OTHER RESERVES

During the year the Board of Directors approved the transfer of MNT 1,038,928,000 from retained profits to other reserves. At the date of this report, no policy is formalised by the Board as to the purpose of this reserves.

26. CASH AND CASH EQUIVALENTS

	2006 MNT '000	2005 MNT '000
Cash and short term funds	5,301,179	2,100,229
Deposits and placements with other banks and financial institutions	13,492,176	10,141,200
	18,793,355	12,241,429

27. FINANCIAL RISK MANAGEMENT POLICIES

Management of risk is fundamental to the banking business and is an essential element of the Bank's operations. The main risks inherent to the Bank's operations are those related to credit exposures, liquidity and market movements in interest rates and foreign exchange rates. A description of the Bank's risk management policies in relation to those risks are as follows:

Credit risk

The Bank is exposed to credit risk which is the risk that Bank's customers, clients or counterparties will be unable or unwilling to pay interest, repay capital, or otherwise fulfil their contractual obligations under loan agreements, other credit facilities, or in respect of other financial instruments. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Credit limit to any single borrower and portfolio limits by loan products are approved and reviewed periodically by the Board Credit Committee.

Exposure to credit risk is managed through regular analysis of the ability of borrowers and potential borrowers to meet interest and capital repayment obligations and by changing these lending limits where appropriate. Exposure to credit risk is also managed in part by obtaining collaterals and corporate and personal guarantees.

Apart from deposits and placements with other banks and financial institutions amounting to MNT 904 million (2005 : MNT 1,082 million), all banking assets and liabilities were geographically concentrated in Mongolia.

Currency risk

The Bank is exposed to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Bank's management sets limits on the level of exposure by currencies (primarily USD) and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December.

Concentrations of assets, liabilities and off balance sheet items	Local Currency (MNT million)	Foreign Currencies		Total (MNT million)
		USD (MNT million)	Others (MNT million)	
As at 31 December 2006				
Assets				
Cash and short term funds	2,573	1,528	1,200	5,301
Deposits and placements with other banks and financial institutions	5,668	7,390	434	13,492
Financial investments	1	-	-	1
Loans and advances	45,205	15,403	228	60,836
Other assets	1,125	294	3	1,422
	54,572	24,615	1,865	81,052
Liabilities				
Deposits from customers	37,514	5,405	88	43,007
Deposits from local financial institutions	4,081	-	-	4,081
Loans from foreign financial institutions	7,827	17,575	862	26,264
Loans from the Bank of Mongolia and government agencies	2,039	1,850	-	3,889
Other liabilities	377	33	-	410
Tax payable	241	-	-	241
	52,079	24,863	950	77,892
Net position	2,493	(248)	915	3,160
Off balance sheet items	70,236	160	-	70,396

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

Currency risk (contd.)

Concentrations of assets, liabilities and off balance sheet items	Local Currency (MNT million)	Foreign Currencies USD Others (MNT million)	Total (MNT million)
As at 31 December 2005			
Assets			
Cash and short term funds	1,343	528 229	2,100
Deposits and placements with other banks and financial institutions	4,441	5,039 661	10,141
Financial investments	1,105	- -	1,105
Loans and advances	31,330	7,250 145	38,725
Other assets	831	400 -	1,231
	39,050	13,217 1,035	53,302
Liabilities			
Deposits from customers	28,096	3,296 5	31,397
Deposits from local financial institutions	2,801	- -	2,801
Loans from local financial institutions	1,305	- -	1,305
Loans from foreign financial institutions	999	8,296 883	10,178
Loans from the Bank of Mongolia and government agencies	1,967	1,369 -	3,336
Other liabilities	159	153 -	312
Tax payable	206	- -	206
	35,533	13,114 888	49,535
Net position	3,517	103 147	3,767
Off balance sheet items	41,732	- -	41,732

Liquidity risk

The Bank is exposed to liquidity risks that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. The Bank sets limits on the minimum proportion of maturing funds available to cover such cash outflows and on the minimum level of interbank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand. The following table analyses assets and liabilities of the Bank into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

The contractual maturities of banking assets and liabilities for the year ended 31 December 2006 are as follows (MNT million):

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and short term funds	5,301	-	-	-	-	5,301
Deposits and placements with other banks and financial institutions	9,631	3,830	-	31	-	13,492
Financial investments	-	-	-	-	1	1
Loans and advances	14,543	13,904	15,169	10,902	6,318	60,836
Other assets	688	106	13	110	-	917
	30,163	17,840	15,182	11,043	6,319	80,547
Liabilities						
Deposits from customers	23,481	4,469	4,969	3,762	6,326	43,007
Deposits from local financial institutions	1,751	2,330	-	-	-	4,081
Loans from foreign financial institutions	21	1,329	722	24,192	-	26,264
Loans from the Bank of Mongolia and government agencies	262	187	714	887	1,839	3,889
Deferred grants	-	-	-	-	161	161
Other liabilities	202	53	151	4	-	410
Tax payable	241	-	-	-	-	241
	25,958	8,368	6,556	28,845	8,326	78,053
Net liquidity gap	4,205	9,472	8,626	(17,802)	(2,007)	2,494
Accumulated gap	4,205	13,677	22,303	4,501	2,494	

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

The contractual maturities of banking assets and liabilities for the year ended 31 December 2005 are as follows (MNT million):

	Less than 3 months	3 to 6 months	6 months to 1 year	1 to 5 years	Over 5 years	Total
Assets						
Cash and short term funds	2,100	-	-	-	-	2,100
Deposits and placements with other banks and financial institutions	8,432	1,098	611	-	-	10,141
Financial investments	1,105	-	-	-	-	1,105
Loans and advances	12,501	10,057	9,460	3,389	3,318	38,725
Other assets	615	128	1	19	-	763
	24,753	11,283	10,072	3,408	3,318	52,834
Liabilities						
Deposits from customers	16,127	5,118	3,897	2,595	3,660	31,397
Deposits from local financial institutions	2,801	-	-	-	-	2,801
Loans from local financial institutions	-	505	800	-	-	1,305
Loans from foreign financial institutions	948	1,217	2,761	5,252	-	10,178
Loans from the Bank of Mongolia and government agencies	193	751	230	800	1,362	3,336
Deferred grants	-	-	-	-	127	127
Other liabilities	65	244	3	-	-	312
Tax payable	206	-	-	-	-	206
	20,340	7,835	7,691	8,647	5,149	49,662
Net liquidity gap	4,413	3,448	2,381	(5,239)	(1,831)	3,172
Accumulated gap	4,413	7,861	10,242	5,003	3,172	

Interest rate risk

The Bank is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk is measured by the extent to which changes in market interest rates impact margins and net income. To the extent the term structure of interest bearing assets differs from that of liabilities, net of interest income will increase or decrease as a result of movements in interest rates. The Bank's expected repricing and maturity dates do not differ significantly from the contract dates, which are disclosed in the liquidity risk table above.

Interest rate risk is managed by increasing or decreasing positions within limits specified by the Bank's management. These limits restrict the potential effect of movements in interest rates on interest margin and on the value of interest sensitive assets and liabilities.

The Bank's interest rate policy is reviewed and approved by the Board's Risk Management Committee. The following table summarises repricing 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 reprice to market rate or mature, and are summed to show the interest rate sensitivity gap.

Interest rate risk

As at 31 December 2006	Effective interest rate %	Non-interest sensitive MNT million	Less than 3 months MNT million	3 to 6 months MNT million	6 months to 1 year MNT million	1 to 5 years MNT million	Over 5 years MNT million	Total MNT million
Assets								
Cash and short term funds	-	5,301	-	-	-	-	-	5,301
Deposits and placements with other banks and financial institutions	3.00%	5,468	4,163	3,830	-	31	-	13,492
Financial investments	-	1	-	-	-	-	-	1
Loans and advances	27.67%	-	25,589	13,665	12,498	9,084	-	60,836
Other assets	-	917	-	-	-	-	-	917
		11,687	29,752	17,495	12,498	9,115	-	80,547
Liabilities								
Deposits from customers	11.38%	-	43,007	-	-	-	-	43,007
Deposits from local financial institutions	0.86%	-	1,751	2,330	-	-	-	4,081
Loans from foreign financial institutions	7.92%	-	21	1,329	722	24,192	-	26,264
Loans from the Bank of Mongolia and government agencies	5.37%	-	262	187	714	887	1,839	3,889
Other liabilities	-	410	-	-	-	-	-	410
Tax payable	-	241	-	-	-	-	-	241
		651	45,041	3,846	1,436	25,079	1,839	77,892
Net financial assets/(liabilities)		11,036	(15,289)	13,649	11,062	(15,964)	(1,839)	2,655

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

Interest rate risk (Contd.)

As at 31 December 2005	Effective interest rate %	Non-interest sensitive MNT million	Less than 3 months MNT million	3 to 6 months MNT million	6 months to 1 year MNT million	1 to 5 years MNT million	Over 5 years MNT million	Total MNT million
Assets								
Cash and short term funds	-	2,100	-	-	-	-	-	2,100
Deposits and placements with other banks and financial institutions	7.19%	3,256	5,176	1,098	611	-	-	10,141
Financial investments	6.79%	-	1,105	-	-	-	-	1,105
Loans and advances	30.59%	-	12,501	10,057	9,460	3,389	3,318	38,725
Other assets	-	763	-	-	-	-	-	763
		6,119	18,782	11,155	10,071	3,389	3,318	52,834
Liabilities								
Deposits from customers	10.48%	-	16,127	5,118	3,897	2,595	3,660	31,397
Deposits from local financial institutions	9.80%	-	2,801	-	-	-	-	2,801
Loans from local financial institutions	12.00%	-	-	505	800	-	-	1,305
Loans from foreign financial institutions	9.38%	-	948	1,217	2,761	5,252	-	10,178
Loans from the Bank of Mongolia and government agencies	6.42%	-	193	751	230	800	1,362	3,336
Other liabilities	-	312	-	-	-	-	-	312
Tax payable	-	206	-	-	-	-	-	206
		518	20,069	7,591	7,688	8,647	5,022	49,535
Net financial assets/(liabilities)		5,601	(1,287)	3,564	2,383	(5,258)	(1,704)	3,299

28. 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 and the employee must complete more than 1,000 hours of service.

- Performing rating in the most recent evaluation period; and
- "Employee shall read, understand and agree to abide by the policy prior to purchasing any Stock under this policy."

The number of shares offered for sale and its price will be determined at the discretion of the Bank's Board of Directors. The shares were offered at a price of 50% (2005: 30%) of the par value of EIT LLC shares. Prior to 2005, the Plan enables employees to purchase shares which were held by XAC-GE LLC in XacBank LLC. In 2005, all XacBank's shares (except 12,311 shares) previously held by the employees in XacBank LLC are transferred to XAC-GE LLC. In return the employee's interest were transferred to EIT LLC, an investment trust company set up to hold the shares in XAC-GE LLC. The share capital of XacBank LLC is not affected by these transactions. The Bank does not bear or incur any cost in connection with these transactions.

29. RELATED PARTY DISCLOSURES

The Bank is controlled by XAC-GE LLC (incorporated in Mongolia). XAC-GE LLC is owned by the shareholders as disclosed in Note 1.

A number of banking transactions are entered into with related parties in the normal course of business. These include loans, deposits and foreign currency transactions. These transactions were carried out on commercial terms and at market rates. The volumes of related party transactions, outstanding balances as at the year end, and relating expense for the year are listed below.

	2006 MNT '000	2005 MNT '000
(a) Compensations to key management personnel		
• Salaries, incentives and allowances	199,336	98,414
• Contribution to social and health fund	37,874	18,699
	237,210	117,113
(b) Loans to key management personnel	220,561	119,405
Repayable	24,227	11,617
• within one year	55,631	83,003
• one year to five years	140,703	24,785
• over five years	220,561	119,405

The loans to Bank's employees bear interest rates ranging from 5% to 30% (2005 : 5% to 18.0%) per annum.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

	2006 MNT '000	2005 MNT '000
(c) Loans from shareholders of XAC-GE LLC		
Microvest 1, LP	-	1,854,594
Shorecap International Ltd	583,228	611,178
Triodos Doen	1,557,667	578,057
Triodos Fair Share Fund	1,160,990	604,303
	3,301,885	3,648,132

	2006 MNT '000	2005 MNT '000
(d) Loan interest paid to shareholders of XAC-GE LLC	355,053	221,615

	2006 MNT '000	2005 MNT '000
(e) Deposits from corporate shareholders	4,011,256	3,634,495

30. CAPITAL ADEQUACY

Bank of Mongolia requires commercial banks to maintain a core capital adequacy ratio of 5% and risk weighted capital ratio of 10%, compiled on the basis of total equity and total assets as adjusted for their risk. The capital adequacy ratios of the Bank as at 31 December are as follows:

	2006	2005
Core capital ratio	15.81%	21.12%
Risk weighted capital ratio	15.81%	21.12%

	2006 MNT '000	2005 MNT '000
Tier I capital		
Statutory fund	8,034,200	8,034,200
Share premium	8,551	8,551
Other reserves	1,052,792	13,864
Retained profits	1,773,210	1,488,986
Total Tier I capital	10,868,753	9,545,601

Breakdown of risk weighted assets in the various categories of risk weights are as follows:

	2006 MNT '000		2005 MNT '000	
	Assets	Risk Weighted	Assets	Risk Weighted
%				
0	9,287,565	-	6,450,438	-
10	-	-	-	-
20	9,580,297	1,916,059	6,852,474	1,370,495
50	9,278,324	4,639,162	4,673,022	2,336,511
100	62,207,945	62,207,945	41,494,295	41,494,295
Total	90,354,131	68,763,166	59,470,229	45,201,301

31. CAPITAL COMMITMENTS

	2006 MNT '000	2005 MNT '000
Approved and contracted for:		
Property, plant and equipment	407,315	-

Letters of credit commit the Bank to make payment on behalf of customers in the event of a specific act, generally related to the import or export of goods.

Assets pledged to the Bank are strictly for the purpose of providing collateral for loans and advances. To the extent that the Bank is permitted to sell the assets, they are classified on the balance sheet as foreclosure properties. The pledged assets will be returned when the underlying transaction is terminated.

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NOTES TO THE FINANCIAL STATEMENTS - 31 DECEMBER 2006 (CONTINUED)

33. COMPARATIVES

The comparative figures have been audited by a firm of certified public accountants other than Ernst & Young Mongolia Audit LLC. The presentation and classification of items in the current year financial statements have been consistent with the previous financial year except that certain comparative amounts as at 31 December 2005 have been reclassified to conform with current year presentation as disclosed belows:

	As Restated MNT'000	Adjustment MNT'000	As Previously Stated MNT'000
Income statements			
Interest and similar expenses	(4,258,189)	(23,488)	(4,234,701)
Non-interest income	875,585	29,742	845,843
Operating expenses	(4,444,193)	(6,254)	(4,437,939)
Balance sheet			
Deposits and placements with other banks and financial institutions	10,141,200	32,884	10,108,316
Financial investments	1,105,366	205	1,105,161
Loans and advances	38,597,470	647,188	37,950,282
Other assets	1,230,830	(724,796)	1,955,626
Deposits from customers	31,396,813	498,654	30,898,159
Deposits from local financial institutions	2,800,917	917	2,800,000
Loans from local financial institutions	1,305,167	5,167	1,300,000
Loans from foreign financial institutions	10,178,109	110,002	10,068,107
Loans from the Bank of Mongolia and government agencies	3,336,197	16,062	3,320,135
Other liabilities	312,466	(675,321)	987,787

34. FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments comprise financial assets and financial liabilities. The fair value of a financial instrument is the amount at which the instrument could be exchanged or settled between knowledgeable and willing parties in an arm's length transaction, other than in a forced or liquidation sale. Where quoted market prices are not available, the fair values are measured at discounted rates commensurate with the quality and duration of the asset or liability. 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.

A considerable portion of the financial instruments as at 31 December 2006 and 2005 are short term in nature with maturities of less than one year. Based on fair value assessments as indicated above, the estimated fair values of those financial assets and financial liabilities, both short and long term as at the balance sheet date, approximate their carrying amounts as shown in the balance sheet except for the followings:

	Carrying Values		Fair Value	
	2006 MNT'000	2005 MNT'000	2006 MNT'000	2005 MNT'000
Loan from Deutsche Bank Microcredit Development Fund	101,613	154,549	142,414	144,072
Loan from the Ministry of Social Welfare and Labour	500,000	500,000	481,048	470,281
Loan from the Ministry of Trade and Industry	341,011	-	301,306	-
	942,624	654,549	924,768	614,353

35. MONGOLIAN TRANSLATION

These financial statements are also prepared in the Mongolian language. In the event of discrepancies or contradictions between the English version and the Mongolian version, the English version will prevail.

TO BE CONTINUED...