

CORPORATE BONDS GUIDE:

How to Invest and Issue Corporate Bonds in Uzbekistan?

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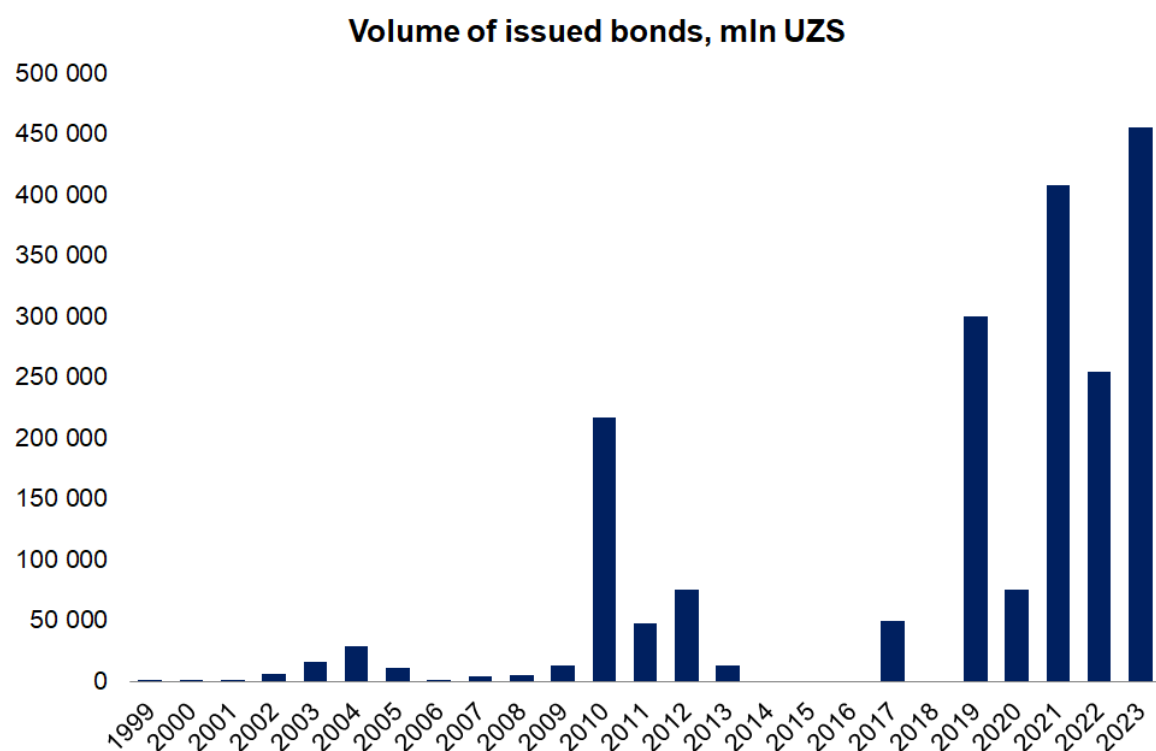
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I. INFORMATION FOR INVESTORS

1.1. Market Overview

i. History of the Corporate Bond Market

The corporate bond market in Uzbekistan started to take shape in August 2001. During the period from 1999 to 2001, individual companies and banks began issuing corporate bonds (CBs) as an alternative means of borrowing financial resources. The total volume of these initial issuances was approximately 600 million UZS (equivalent to about \$900 thousand), and they were primarily short-term in nature and did not have a significant market presence. TS Technology, a computer assembly company, was the first to implement a CB issuance, with a debut issue of 70 million UZS on June 29, 1999.



Source: Avesta Investment Group

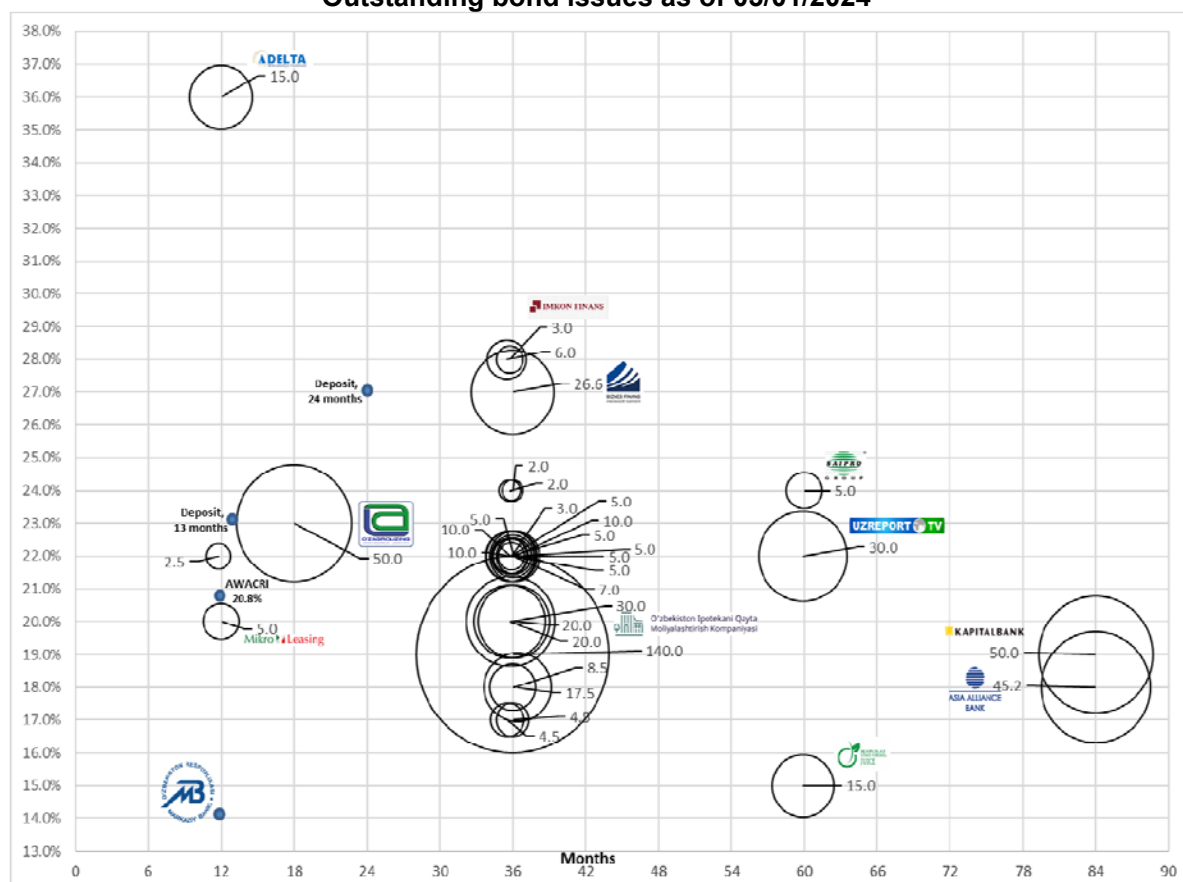
In 2006-2007, the corporate bond market in Uzbekistan faced challenges due to several defaults on private bond issues, with some instances linked to alleged fraud. Consequently, the market regulator implemented stricter rules for issuing bonds, leading to a temporary closure of the market. From 2009-2010 onwards, the government made efforts to revive the market by instructing banks to issue bonds. These bonds were primarily circulated among banks themselves or large bank clients through the conversion of deposits into bonds, often accompanied by verbal assurances of liquidity.

Since 2017, efforts have been undertaken to reform the legislation governing the corporate bond market in Uzbekistan. A significant milestone was reached in 2020 when the first non-bank bond issue without collateral was successfully executed. One of the most notable changes introduced was the authorization for limited liability companies (LLCs) to issue corporate bonds, a privilege previously restricted to joint-

stock companies until November 2020. These regulatory adjustments were implemented through Order No. 2000-8 issued by the Director of the Agency for the Development of the Capital Market of the Republic of Uzbekistan on November 6, 2020.

Since 2020, the Central Bank of Uzbekistan has granted permission for microfinance organizations to broaden their resource base through the issuance of corporate bonds. Furthermore, tax incentives have been implemented on coupon income derived from all bond issuances.

Outstanding bond issues as of 03/01/2024



Source: Avesta Investment Group

ii. History of the State Debt Securities Market

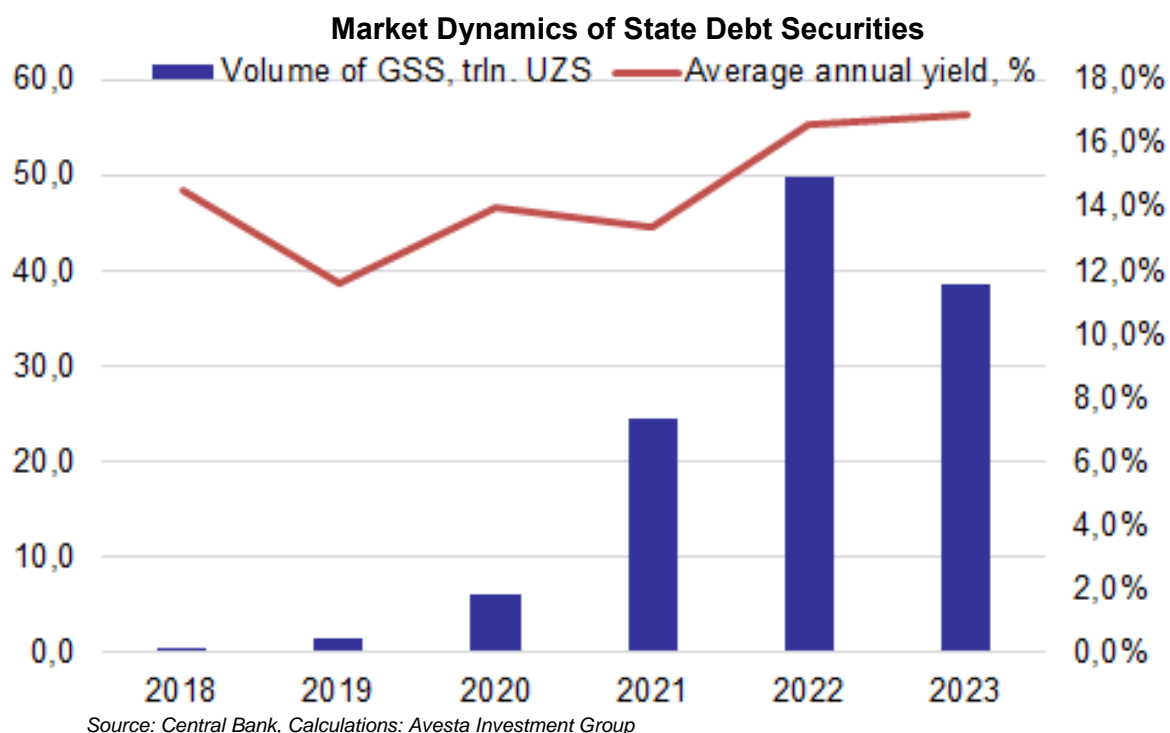
From 1996 to 2011, government securities totaling 803.1 billion UZS were issued in Uzbekistan. However, in 2012, the issuance of government securities was halted. It is worth noting that a significant portion of these issuances was placed on non-market terms.

In 2018, the Central Bank issued Resolution N30/15 on September 22, 2018, which declared the previous resolution regarding the regulation of the issue and circulation of bonds of the Central Bank of the Republic of Uzbekistan for legal entities invalid. This resolution marked a significant development in the government securities market in Uzbekistan. Government bonds are now issued not only by the Central Bank of Uzbekistan but also by the Ministry of Economy and Finance (MEF).

The Central Bank of Uzbekistan issues discount bonds to manage liquidity levels. These instruments have terms ranging from 30 to 365 days. Currently, the yield at placement in Uzbekistani Som (UZS) varies between 16% and 17% per annum.

The Ministry of Economy and Finance of Uzbekistan commonly issues coupon bonds denominated in Uzbekistani Som (UZS) with maturities spanning from six months to five years. These bonds offer yields ranging from 16% to 18% per annum. The primary placements of MEF government securities occur through auctions on the Uzbekistan Republican Currency Exchange (UzRVB) among primary dealers.

To foster market development and establish a comprehensive yield curve, Uzbekistan introduced its inaugural inflation-linked bonds on July 19, 2022, followed by the issuance of ten-year bonds on January 25, 2022.



Initially, only banks and legal entities were permitted to acquire government securities. However, in February 2022, a resolution by the Cabinet of Ministers was enacted, enabling all categories of investors to partake in primary auctions.

It is important to highlight that banks are the primary participants in trading government securities. Their main motivation for engaging in this market is the favorable regulatory treatment by the Central Bank of the Republic of Uzbekistan (CBU), which assigns a 100% liquidity ratio and a 0% risk ratio to these instruments. Additionally, the CBU regularly offers REPO operations on these securities without applying discounts to their nominal value, essentially enabling banks to invest all available funds in government securities.

In 2021, the UZONIA rate was established through a collaborative effort with the EBRD to bolster interbank trading and market benchmarks. This rate represents a weighted average overnight deposit rate within the interbank market. While its current

utilization in the market remains limited, the IMF actively advocates for its adoption and utilization.

A pivotal catalyst for market expansion could stem from regulatory endorsement of the "regulatory sandbox" framework, facilitating access to the market for foreign banks and brokers. Notably, in late February 2024, Bank of Georgia emerged as the inaugural participant in this initiative. Serving as a custodian bank for prominent international investment banks and the Clearstream clearing system, this development enables direct acquisition of government securities on the local market by international investors.

1.2. How to buy corporate bonds in Uzbekistan?

There are no restrictions on the purchase of corporate bonds in Uzbekistan. Both individuals and legal entities, residents and non-residents alike, can invest in these securities.

i. How to open an Account?

To buy bonds, you will need to have or open an account with a licensed investment intermediary (broker). The following documents are required to open an account:

| Personal account, resident | Company, resident | Personal account, non-resident | Company, non-resident |
|---|--|---|--|
| <ul style="list-style-type: none"> • Application; • Questionnaire; • Contract; • Passport or ID; • Banking details, tax number, address, etc.; | <ul style="list-style-type: none"> • Application; • Questionnaire; • Account card; • Contract; • Passport or ID; • Banking details, tax number, address, etc.; • Charter documents; | <ul style="list-style-type: none"> • Application; • Questionnaire; • Contract; • Passport or ID; • Banking details, tax number, address, etc.; | <ul style="list-style-type: none"> • Application; • Questionnaire (apostilled); • Account card (apostilled); • Contract; • Passport or ID for all specimen; • Banking details, tax number, address, etc.; • Charter documents confirming name of the company, date and jurisdiction of registration, UBOs, equity size, authority of specimens, list of directors (apostilled); |

Account opening typically takes up to 2 working days after the submission of all necessary documents. If you already have an account, it is advisable to verify its active status and the authorities of specimen with the broker.

When opening or checking the status of an account, it is recommended to request a password and login for online access to the trading platform from your broker.

ii. How to fund the Account?

Account funding can be done in four currencies - UZS, USD, EUR, RUB - through bank transfers, depositing funds at the bank's cash desk, or online transfers via the mobile application.

| | UZS | USD | EUR | RUB |
|----------------------|-----|-----|-----|-----|
| Bank payment (SWIFT) | + | + | + | + |
| Cash desk | + | + | + | + |
| App | + | - | - | - |

The funds will be securely held in the broker's segregated account with the National Bank of Uzbekistan (B1 Stable/ BB- Stable / BB- Negative; M/F/S&P). Although the account is nominally under the broker's name, the funds are kept in off-balance accounts, inaccessible to the broker for its own operations. These funds are strictly separated by currencies and clients.

Non-resident investors are not obligated to convert their foreign currency deposits. Currency conversion is only necessary when conducting transactions and can be done partially if needed.

iii. How to Buy?

For purchases on the primary market, investors can submit a written order to the broker specifying the desired number of securities and maximum price (as per the broker's form). The broker will then execute the order based on prevailing market conditions.

In the secondary market, bonds can be acquired through a written order to the broker or by utilizing online access to the trading platform.

iv. What are the Fees?

Brokerage fees are determined through an agreement between the investor and their broker and are independent of the issuer or bond yield. These fees apply to transactions on both the organized market (RSE Tashkent) and the over-the-counter market (private placements via direct agreements).

In addition to brokerage fees, investors are required to pay infrastructure fees to the Stock Exchange and the Central Securities Depository of Uzbekistan (CSD). Details regarding tariffs can be found [here](#) and [here](#).

Fees are applicable for both primary and secondary market transactions.

v. How to Conduct Regular Reporting?

All securities are held within the CSD, and ownership rights are recorded on the investor's account with the broker.

To verify ownership of securities and ensure accurate reflection on financial statements, the broker will furnish clients with a transaction report and other relevant documents within two business days post-transaction. Additionally, clients can monitor their account status, including the quantity and value of purchased securities, online or by requesting an account statement in writing, often provided at no cost.

vi. How to Receive Coupon Interest Payments?

Interest income is accrued according to the terms outlined in the decision and prospectus of the issue on a specified date. To receive income, investors must be listed in the bondholders' register on the closing day. Subsequently, the issuer is obligated to transfer the income to the bank details provided in the register within a specific timeframe.

Should an investor wish to receive income in different account details, they have the option to update their account information with the broker and notify the issuer of the desired changes.

Non-resident investors can opt to receive payments in foreign currencies (USD, EUR, RUB), which will be directly facilitated by the issuer. The conversion of funds for such transactions is legally mandated and guaranteed without constraints.

vii. How to Monitor the Issuer's Financial Position?

To assess the issuer's status and growth trends, investors can access necessary information on the issuer's website, the stock exchange's website, and the Unified Corporate Information Disclosure Portal (openinfo.uz), where the issuer is mandated to publish quarterly reports and other critical details.

Investors also retain the right to request additional information from the issuer, which will be disclosed in compliance with relevant laws.

Issuers typically plan to regularly issue statements, provide commentary on publications, and engage in consistent communication with investors through direct interactions and broker-mediated calls and conferences.

viii. How to Sell?

Upon commencement of circulation (full placement), investors have the liberty to sell their bonds on either the secondary organized or unorganized market. Bonds can be involved in any legal transaction permissible by law (pledge, REPO, contribution to the statutory fund, etc.).

For selling on the exchange market, investors can utilize online trading access or submit a written order to their broker. Investors are empowered to set their selling price independently.

Redemption of bonds at the circulation period's conclusion will be conducted through over-the-counter redemption, with funds directly transferred to bondholders listed in the closing register. Additionally, issuers may allow partial early redemption upon investors' request within specified limits (if outlined in the prospectus).

ix. How to Handle Tax Obligations?

As of April 1, 2022, interest income from bonds is exempt from taxation for all investor groups.

In case of capital gains from trading bonds on the secondary market, investors are subject to a fee of 0.01% of the sale amount with simultaneous exemption from income

tax for transactions on the Tashkent Stock Exchange, and 0.3% for over-the-counter transactions.

Resident investors are responsible for calculating and paying their taxes independently. The issuer acts as a tax agent for non-resident investors, calculating and remitting taxes on their behalf.

2. INFORMATION FOR ISSUERS

2.1. Issue

i. Who can issue bonds?

Legal entities, whether residents or non-residents of the country, have the ability to issue bonds. However, non-residents are required to undergo a distinct approval process for bond issuance.

Resident issuers have the option to establish themselves as either a Joint Stock Company (JSC) or a Limited Liability Company (LLC). It is important to note that an LLC must adhere to the regulations outlined in the Law on Joint-Stock Companies and the Securities Market. This includes compliance with the prescribed procedures for issuing and trading bonds, as well as fulfilling reporting obligations related to the bond issuance process.

ii. What types of bonds are there?

Bonds can be issued in various forms, including:

- Interest-bearing bonds: These are purchased at par value and repaid at par value, with interest payments made to the investor.
- Discount bonds: These are sold below par value, redeemed at par value, and the difference serves as the investor's income. Companies with long-term projects often opt for these bonds to manage cash flow without interest payments burdening them. The profitability on discount bonds should exceed interest rates.
- Winning/Lottery bonds: These may be percentage or discount bonds that include additional winnings in a draw.
- Serial bonds (based on a bond program): These involve a series of issues within a predetermined limit.
- Targeted (interest-free) bonds: These are used for specific project financing.

Additionally, there are infrastructure bonds for large-scale projects and convertible bonds that can be exchanged for company shares.

Currently, interest-bearing bonds are the most common type issued in Uzbekistan. There are plans to introduce Islamic bonds, known as sukuk, in the near future.

iii. In what currency can bonds be issued?

All securities issued in the Republic of Uzbekistan are denominated in the national currency, the Uzbek Soum, with the par value of each bond expressed in this currency. There are no restrictions on the size of the par value of bonds.

There have been instances of bonds being issued with interest and principal payments tied to the USD/UZS exchange rate set by the Central Bank of Uzbekistan. Furthermore, there are no limitations on linking these payments to other financial or non-financial indicators.

Efforts are currently underway to enable local companies to issue bonds denominated in foreign currencies.

iv. How are bonds different from loans?

While both involve the repayment of borrowed funds with interest, they are distinct financial products with unique characteristics and applications.

Bonds can be issued without requiring collateral, whereas obtaining unsecured corporate loans from banks is often challenging.

Bond repayments are typically made at the end of the maturity period, providing companies with flexibility in managing their cash flow compared to loans, where principal payments are made regularly.

Bonds allow for early or periodic repayments to be included, offering convenience to investors.

Bonds are considered liquid instruments, enabling investors to easily sell some or all of their holdings on the secondary market without requiring approval from the issuer. In contrast, selling a portion or the entirety of a loan involves significant negotiations, legal processes, collateral re-registration, and other complexities.

**Comparison of cash flow from a bond and a similar loan
(100bln UZS, 24% coupon, quarterly payments)**



v. What are the requirements for registration?

To issue bonds, a company must meet several requirements:

- The equity size of the company must be confirmed by an auditor on the date of the decision to issue bonds. If the equity size exceeds a certain threshold, security for the excess must be provided in the form of a real estate pledge, bank

guarantee, or insurance. In the case of a public offering, a third party provides this security.

- The company must have positive indicators of profitability, liquidity, solvency, and stability for the last completed financial year, as confirmed by an auditor on the decision date. There are no specific formulas for calculating these indicators in legislation.
- A positive audit opinion on the financial statements for the last completed year (according to NAS or IFRS) is required.
- When placing bonds on the open market to an unlimited list of persons, a rating assessment is also necessary.

Upon issuance, agreements must be signed with a bank for interest payments and redemption of bonds, an investment intermediary (broker) for opening securities accounts for the issuer and investors, and an underwriting agreement for assistance in attracting investors.

It is important to note that the requirement for an auditor's report on equity and financial ratios may conflict with auditing standards and logic due to the time-consuming nature of auditing equity.

The presence of a positive financial conclusion does not necessarily mean a positive financial result (profit).

vi. How long does it take to release?

The process for making decisions regarding bond issuance varies depending on the issuer. If, according to the company's Charter, the authority to make such decisions lies with the general meeting of shareholders (EGM), the process typically takes 25-30 days to convene, announce, and conduct the meeting.

Alternatively, if the decision-making power rests with the Supervisory Board or a meeting of LLC participants, the timeline is usually expedited.

Following the preparation of the necessary documents, they are submitted for registration to the Market Regulator, who then has 30 days to either register the documents or provide a reasoned refusal. In the event of a refusal due to technical issues, the issuer is permitted to resubmit corrected documents.

It is highly recommended to delegate the decision-making authority for bond issuance to the Supervisory Board. This is crucial because if technical inaccuracies are identified in the Resolution and Prospectus and only the EGM has the right to make changes, a re-convening of the meeting will be necessary.

The issuer must submit the documents to the Regulator within thirty days of their approval. Once the issuance is registered by the Regulator, a copy is forwarded to the Central Depository of the Republic of Uzbekistan (CD) to establish an electronic record of the securities in the system.

Furthermore, it is mandatory for the issuer to disclose the registration of securities on the Unified Portal of Corporate Information (UPCI, openinfo.uz).

2.2. Placement

i. Who can be an investor and what are the coupon rates?

As specified, there are no restrictions on the type of investors in Uzbekistan – they can be individuals or legal entities, residents or non-residents.

However, each issuer must clearly identify the investor groups they are targeting to determine issue parameters accurately. The primary investor types in Uzbekistan include:

- International Financial Institutions (IFIs) and foreign investors who prioritize stringent material preparation, auditing standards, and financial project performance. They often seek products with currency risk protection.
- Local banks may prefer collateralized instruments and liquidity management tools (early repayment). They typically focus on investments outside the financial sector to avoid funding potential competitors in leasing and microfinance.
- Local insurance companies place high importance on instrument liquidity due to reserve regulation and the need for funds to cover insurance claims.
- Retail investors are concerned with competition against bank deposits, which offer almost instant liquidity (sometimes with partial interest loss upon early withdrawal) and are fully guaranteed by the Fund for Guaranteeing Citizens' Deposits in Banks.

ii. Where and how can you place bonds?

To place securities, they need to be transferred from the Central Depository (CD) to the issuer's DEPO account with a broker. The account can be opened before the transfer, and the issuer can maintain multiple accounts with different brokers.

From the DEPO account, the issuer can place bonds on the primary market through closed or open subscription.

In a closed subscription, the issue documentation must specify the exact list of investors and securities purchased during registration (a predetermined group of individuals). Placement involves direct contracts and registration through a broker.

In an open subscription, the issuer does not know the precise list of investors and may place bonds at open exchange auctions or over-the-counter markets.

For placement via open subscription on the over-the-counter market, agreements similar to private subscription placements are made, allowing the issuer full control over the investor list.

Placing on the exchange market requires a listing procedure, which can be initiated beforehand and completed after bond prospectus registration. Bonds on stock exchanges are available to an unlimited number of individuals during application collection or auctions.

Upon completion of securities placement, the issuer notifies both the Regulator and UPCI.

2.3. Circulation and redemption

i. Is it possible to control who will own the bonds?

As highlighted earlier, when placing securities through private subscription or open subscription on the over-the-counter market, the issuer retains control over the list of security owners. However, it is important to note that the secondary market cannot be controlled, as owners of securities have the freedom to engage in various transactions such as buying and selling, pledging, donating, contributing to capital, and other legally permissible activities. Currently, there have been no instances in the market where restrictions were introduced into issue documents.

ii. How to pay a coupon?

The issuer disburses coupon income to bondholders at regular intervals as outlined in the issue documents. To ascertain the list of owners entitled to payment, the issuer requests a register of owners from the Central Depository (CD) for a specific date. Upon receipt, the issuer can transfer funds directly to the account details specified in the register or based on individual instructions received from investors for updating their details.

For non-residents, coupon income payments can be made directly abroad in the requested currency. In such cases, the issuer assumes the role of a tax agent for investors, responsible for withholding and remitting any applicable taxes on dividends at the source of payment.

Coupon income payments can be scheduled monthly, quarterly, semi-annually, or at any other agreed-upon frequency without restrictions. With each payment, the issuer issues a notice regarding the income accrual deadline to the UPCI.

iii. How to repay?

Bond repayment is conducted through direct payments in accordance with the register of owners provided by the CD. Upon redemption, the issuer transfers funds to bondholders, who then authorize the write-off of securities from the issuer's issue account. Once all redeemed securities are collected in the issuer's account, they are transferred back to the CD for final redemption.

Following the repayment process, a notification is published on the UPCI, and a report is submitted to the regulator.

For effective financial management, it is advisable for companies to consider issuing new bonds before existing ones mature to refinance the principal debt. This strategic approach allows for seamless debt repayment through regular refinancing, potentially eliminating the need for direct principal repayments. By maintaining consistent income payments, timely bond redemptions, and fostering business growth, companies can secure larger, longer-term, and more cost-effective borrowing options.

2.4. Bond issue cost?

The cost associated with issuing bonds encompasses various payments, including:

- Obtaining audit confirmation for the capital amount and covenants.
- Obtaining a rating assessment (applicable only for public placements).
- Expenses related to lawyers and consultants for the preparation of issue documentation (if necessary).
- Fee for the review and registration process with the regulator.
- Costs associated with the registration of pledges and security (if applicable).
- Broker's commission for registering the transaction to transfer securities to investors' accounts.
- Underwriter's commission for searching and attracting investors.
- Marketing expenses (if required).
- Commission for storing securities (if the issuer assumes these expenses on behalf of investors).

It is important to highlight that the issuance of bonds, their sale to investors, payment of coupon income, and redemption do not incur any tax obligations for the issuer (except for the payment as an agent of tax for non-residents). Additionally, there is no requirement for the issuance of invoices and acts of acceptance of the transfer of securities in these processes.

Approximate calculation of the cost of issuing corporate bonds

| | | Private placement | Public placement |
|--|-------------------|-------------------|------------------|
| Number of bonds | | 100,000 | 100,000 |
| Nominal value, UZS | | 1,000,000 | 1,000,000 |
| Issue size, UZS | | 100,000,000,000 | 100,000,000,000 |
| Repayment term, months | | 24 | 24 |
| Profitability | | 24% | 24% |
| Coupon payments | | Quarterly | Quarterly |
| Pledge | | No | No |
| Registration fee | 0.01% | 10,000,000 | 10,000,000 |
| Fixed fee for review | 5 MPU | 1,650,000 | 1,650,000 |
| Confirmation of capital and liquidity audit | 5-400mUZS | 10,000,000 | 10,000,000 |
| Rating for public placement | 20-3000 mUZS | 0 | 25,000,000 |
| Storage fee | 1 MPU/quarter | 2,640,000 | 2,640,000 |
| Registration of an over-the-counter contract, including: | | 400,000,000 | 400,000,000 |
| Infrastructure Commission | 0.15% | 150,000,000 | 150,000,000 |
| Taxes | 13% | 52,000,000 | 52,000,000 |
| Guarantee Fund | 5% | 20,000,000 | 20,000,000 |
| Net brokerage commission | | 178,000,000 | 178,000,000 |
| Underwriting commission | 1-3% | 0 | 1,000,000,000 |
| Legal services | от 20 до 200 mUZS | 50,000,000 | 50,000,000 |
| Total fees | | 474,290,000 | 1,499,290,000 |
| Annual commissions, % | | 0.24% | 0.75% |
| Total cost, % | | 24.24% | 24.75% |