# ANNUAL REPORT ON OPERATION OF KOMERCIJALNA BANKA AD FOR 2017

March 2018

# C O N T E N T

## 1. KEY PERFOMANCE INDICATORS OF THE BANK

| PROFIT AND LOSS(in 000 RSD) | 2017. | 2016. | Index 17/16 | 2015. | 2014. | 2013. |
|---|---|---|---|---|---|---|
| ***Positions*** | | | | | | |
| *Profit / loss before taxation* | *7.187.250* | *-8.377.636* | *-* | *-6.175.885* | *4.757.589* | *4.588.375* |
| *Net interest income* | *12.446.197* | *13.462.734* | *92,4* | *13.768.082* | *13.298.586* | *12.929.237* |
| *Net income from fees* | *5.082.226* | *4.817.314* | *105,5* | *4.899.947* | *4.717.757* | *4.565.148* |
| *Operating costs** | *10.833.081* | *11.086.858* | *97,7* | *10.799.510* | *10.745.910* | *10.161.794* |
| *Net expenses from indirect write-offs of loans and provisions* | *17.883* | *-14.907.539* | *-* | *-13.008.526* | *-2.725.389* | *-3.220.075* |

** Note: Operating expenses include costs of wages, material and non-material operating costs*

| BALANCE SHEET (in RSD 000) | 2017. | 2016. | Index 17/16 | 2015. | 2014. | 2013. |
|---|---|---|---|---|---|---|
| **BS ASSETS** | *369.183.538* | *400.017.469* | *92,3* | *393.439.874* | *406.261.524* | *362.786.319* |
| **RETAIL** | | | | | | |
| *Loans *** | *81.712.222* | *75.522.465* | *108,2* | *70.784.957* | *69.039.387* | *61.848.487* |
| *Deposits* | *230.033.982* | *231.312.395* | *99,4* | *218.836.847* | *207.430.548* | *186.766.804* |
| **CORPORATE** | | | | | | |
| *Loans* | *71.725.704* | *74.083.897* | *96,8* | *89.204.275* | *112.768.251* | *112.261.312* |
| *Deposits* | *52.548.029* | *78.300.568* | *67,1* | *55.503.896* | *57.437.462* | *42.131.535* |
| *Securities**** | *117.288.767* | *136.366.773* | *86,0* | *129.607.464* | *95.654.325* | *57.001.465* |

***Note: The position of loans does not include other loans and receivables, position deposits do not include other liabilities and funds received through credit lines. At the request of the auditor in 2017, the balance sheet for 2015 was adjusted.*
****Note: The position Securities includes financial assets at fair value through P&L intended for trading, financial assets initially recognized at fair value through P&L, Available-for-sale financial assets and financial assets held to maturity.*

| RATIOS | 2017. | 2016. | Index 17/16 | 2015. | 2014. | 2013. |
|---|---|---|---|---|---|---|
| **LOANS/DEPOSITS RATIO** | | | | | | |
| *Gross loans/deposits* | *61,3%* | *58,7%* | | *67,4%* | *72,4%* | *77,8%* |
| *Net loans/deposits* | *56,1%* | *50,7%* | | *57,2%* | *66,3%* | *72,0%* |
| **CAPITAL (in RSD 000)** | 63.260.055 | 55.424.302 | *114,1* | 62.838.046 | 69.546.804 | 64.962.218 |
| *Capital adequacy* | *27,89%* | *26,97%* | | *22,70%* | *17,67%* | *19,02%* |
| *Number of employees* | *2.806* | *2.858* | *98,2* | *2.877* | *2.906* | *2.966* |
| **PROFITABILITY PARAMETERS** | | | | | | |
| *ROA* | *1,89%* | *-2,05%* | | *-1,56%* | *1,25%* | *1,33%* |
| *ROE - on total capital* | *11,91%* | *-13,86%* | | *-8,99%* | *7,05%* | *7,33%* |
| *Net interest margn on total loans* | *3,3%* | *3,3%* | | *3,5%* | *3,5%* | *3,7%* |
| *Cost/income ratio* | *61,8%* | *60,7%* | | *57,9%* | *59,6%* | *58,0%* |
| *Assets per employee (in 000 EUR)* | *1.111* | *1.134* | *98,0* | *1.124* | *1.067* | *951* |

The business in 2017 was in a relatively stable macroeconomic environment, with positive trends in key sizes. The year behind us was marked by the growth of gross domestic product (GDP), high level of foreign direct investment, surplus of the republic budget, and decline in public debt in GDP, dinar appreciation and unemployment drop.

In the previous year, the National Bank of Serbia (NBS), in the framework of the activities aimed at further strengthening the overall stability of the banking sector, paid special attention to the issue of nonperforming loans. As part of the resolution of this issue, the NBS adopted the Decision on the accounting write-off of the balance sheet assets of the bank, according to which banks are obliged to carry out the transfer of balance sheet assets of low level of collectability (when the amount of impairment of the loan was recorded by the bank as 100% impaired by its gross book value) into off-balance sheet records. As a result of the implementation of the Decision, a significant reduction in the NPL share in total loans was recorded (from 17.0% at the end of 2016 to 11.1% at the end of November).

The capital adequacy ratio of the sector is further increased after the beginning of the implementation of Basel 3 standards. Interest rates on newly approved loans are additionally reduced to historically low values. Low inflationary pressures during the previous year caused the NBS to further relax the monetary policy during the previous year (the reference interest rate was reduced from 4.0% to 3.5%).

As the sublimation of all of these, at the end of 2017, the country's risk premium dropped to 100 basis points (a further reduction in the beginning of 2018 to a level of 85 basis points), and the country's credit rating was increased.

During 2017, the Bank implemented all planned activities, in accordance with the adopted Strategy and Business Plan.

The Bank managed to retain the position of systemically important Bank in the banking sector of Serbia, expressed in the amount of balance assets (other position in the sector with a share of 11%) and the volume of share capital (the other position in the sector with a share of 10%). In a longer period of time, the Bank also stands out in the sector in terms of the volume of retail foreign currency savings. At the end of 2017, retail foreign currency savings amounted to EUR 1,624 million.

Safe and stable business, as a priority objective of the Bank in 2017, was achieved and the Bank recorded one of the best business years, which is unmistakably confirmed by the high liquidity, capitalization, growth of business activity and realized profit.

The Bank fulfils all statutory performance indicators, while the indicator of the capital adequacy of the Bank, as the most important indicator of business safety, at the end of 2017, amounts to 27.89% (minimum 8% + prescribed capital buffer). Total equity of the Bank at the end of 2017 amounted to RSD 63,260.1 million or EUR 533.9 million and compared to the end of the previous year it increased by RSD 7,835.8 million.

In 2017, certain organizational changes were made. Since mid-April 2017, the full implementation of the new organization of a business network comprised of 6 Business Centres (intended for working with retail clients), the Kosovska Mitrovica Branch and 5 Business and Corporate Centres (intended for working with business clients) has begun. When creating a new business network, the key goals were to: increase efficiency in working with clients, speed up the process of making credit decisions with further rationalization of operating costs. As part of these efforts, further centralization of operations was carried out, transfer of business from the branch network to the Bank's seat, creating additional space for the employees in the network to dedicate themselves to the clients of the Bank as much as possible.

In the previous period, banks have unequivocally established that the whole society is increasingly based on the Internet, electronic and digital business, and have sought ways to apply modern technologies to their business.

In the previous period, and especially during 2017, Komercijalna Banka also listed the digitization of the business as one of the significant goals. The focus is on providing customers with, based on state-of-the-art technology, services that will satisfy their everyday needs. In addition to focusing on clients, digitization is a process that we use for internal modernization, improvement of the process, that is, increasing the efficiency and quality within the Bank. In this way, we try to leave more time to devote to our customers.

If we should extract the most important from the digitalization segment in 2017, then we proudly emphasize that the "electronic" branch ("KOMeCENTAR") "has been opened", which enables the application for a specific products and services via the Internet, without leaving the comfort of one's home, such as current accounts, overdrafts per current account and debit cards with deferred payment.

In the area of retail banking, the Bank has implemented a range of new products such as cash sending services ("KOMeCASH”) on the market, only with the use of a mobile phone, and via the mBank application. Another service, the digital Visa card ("KOMePAY"), is based on "HCE" technology, also used in the mBank application, which enables all contactless payments with the help of a mobile phone - no wallet required. Since August 2017, the Kombank Trader application, the application for electronic trading of securities, which now allows trading on the 35 most famous world stock exchanges, was released in full use.
As a result of all this, the Bank increased the number of clients in 2017, so now the Bank has more than 1.0 million customers.

The most pronounced risk to the Bank's operations (as well as the entire sector) remains the credit risk. In order to further improve the risk management system, and in accordance with the NBS regulations and the preparation for the implementation of the IFRS 9 standard, the Bank has taken all necessary measures for the sound management of credit and other risks.
As a result of the established risk management system and the implementation of the National Bank of Serbia's Decision on write-off of balance sheet assets in 2017, the Bank significantly reduced the indicator of non-performing loans (NPL). At the end of 2017, the NPL is 13.8% (planned value is 16.8%); while at the end of 2016 it was 19.4%.
Komercijalna Banka is also one of the regional banking leaders, because its business success is contributed by the subsidiaries, Komercijalna Banka Budva, Komercijalna Banka Banja Luka and KomBank Invest Beograd.
In contrast to 2015 and 2016, when the Bank recorded a negative result, in 2017, the Bank ended with a positive result of RSD 7,187.3 million. In addition to the positive result and high capital adequacy, additional business security has also been provided by reserves from profit. Formed reserves from profit are exceeding the required reserves calculated in accordance with the regulations of the National Bank of Serbia (Decision on classification of balance sheet assets and off-balance sheet items of banks).
As a result of all of the above, the Bank fulfils all the parameters prescribed by the Banking Law.

After the audit of the financial statements for 2017, the external auditor of the Bank issued a clean opinion, i.e. stated that the financial statements fairly and accurately present the Bank's financial position in accordance with the International Financial Reporting Standards, the Law on Accounting and Regulations of the National Bank of Serbia.

In the following period, according to the Strategy and Business Plan, the focus of the Bank will remain on:

- Preservation and improvement of the client base;
- Growth of lending;
- Maintaining the stability of the Bank's business and reputation;
- Raising the value of the Bank;
- Sustainable business growth and profitability - stable revenue with cost control.

| Financial targets of KB (in%) | 2017 achieved | 2018 plan | 2019 plan | 2020 plan |
|---|---|---|---|---|
| Growth of assets | -7,7 | 3,8 | 5,1 | 5,9 |
| Profit/loss before tax (RSD mn) | 7.187 | 7.145 | 7.516 | 8.065 |
| ROA | 1,9 | 1,9 | 1,9 | 1,9 |
| ROE - total capital | 11,9 | 11,2 | 11,2 | 11,3 |
| Interest margin (net interest income / total assets) | 3,3 | 3,3 | 3,3 | 3,2 |
| Breakeven margin | 1,4 | 1,5 | 1,4 | 1,3 |
| Cost/income ratio | 61,8 | 57,8 | 56,2 | 54,7 |
| NPL | 13,8 | 12,8 | 11,2 | 9,7 |

## *2. MACROECONOMIC CONDITIONS OF OPERATIONS*

In the international financial market, the past 2017 marked the diversity of monetary policies of leading central banks, the Federal Reserve (FED, USA) and the European Central Bank (ECB). Federal Reserve raised the reference rate at the end of 2017 (1.25% -1.50%), the European Central Bank kept the reference rate (0.00%), the Bank of England increased the interest rate at the end of last year (0.50% ), while the Swiss National Bank did not change the reference rate in 2017 (from -1.25% to -0.25%). The aforementioned divergence of the monetary policies of the leading central banks makes global capital flows to the developing countries uncertain, Serbia included. In mid-December 2017, the ECB decided to continue with the asset purchase program, but with a reduced monthly volume of EUR 30 billion (instead of the previous EUR 60 billion), or until inflation reaches the targeted level. On the commodity market, the crude oil price oscillation continued. The oil price fluctuations was affected by the weather in the Gulf of Mexico and in Florida in September, the closing of the North Sea oil pipeline in December. The news that members of "OPEC" and other manufacturers are working on gradual exit plans from the agreement on reduction of production[1] has positively reflected on the price of oil. At the end of December 2017, the Brent type crude oil price was around US $ 64.0 per barrel.
The International Monetary Fund (IMF) has revised the global economic growth estimate for 2017 from 3.5% to 3.6% and for 2018 from 3.6% to 3.7%[2] (0.1 pp. more than April assessment). China remains the main driver of global economic development. China's GDP growth in 2016 was 6.7%, while growth estimates in 2017 and 2018 is 6.8% and 6.5% respectively[3]. Also, in 2017 geopolitical tensions continued in the Middle East (Syria, Iraq).

In the Republic of Serbia, according to the first estimates, GDP growth in 2017 is expected to be 1.9%[4] (2.0%, MFIN[5]). Economic activity in 2017 continued with positive developments, which were somewhat slowed down by unfavourable meteorological conditions, and consequently, the decline in agricultural output as well as unfavourable developments in the electricity sector at the beginning of the year. Low inflationary pressures over the previous year and low inflation in the region have influenced domestic inflation (3.0% y.o.y[6]) to remain within the targeted rate. According to the results from the Labour Force Survey (third quarter of 2017), there was a decrease in unemployment or an increase in employment compared to the same period in 2016. In the first ten months of 2017, the total value of the exported goods was EUR 12.6 billion, while the value of the imported goods was EUR 15.9 billion, i.e. the foreign trade deficit amounted to EUR 3.6 billion (an increase of 15.4%[7]). The net inflow of foreign direct investment (FDI) at the end of November 2017 amounted to about EUR 2.3 billion[8], an increase of 37.5% y.o.y and exceeded the forecast for the entire 2017. FDIs were mainly directed towards export-oriented sectors. In addition to the EU, FDIs have come from the Asia-Pacific region and the Middle East. The improvement of the domestic business environment was also confirmed by further progress on the Doing Business list of the World Bank from 47th to 43rd place. Central government debt at the end of November 2017 amounted to EUR 23.4 billion, representing 62.6% of GDP as opposed to the end of 2016, when it amounted to 71.9% of GDP. Country risk premium, measured by EMBI index (bonds index of developing countries), continued to decline in 2017, indicating higher investment security. From mid-December, EMBI for Serbia is below 100 b.p. which is the lowest level[9]. The corresponding contribution to all referred to above was also given by the IMF's positive assessment of the successful completion of the eighth revision of the "stand by" precautionary arrangement.

At the end of the year under review, the Serbian Parliament adopted a set of financial laws aimed at implementing financial consolidation, a further fight against the "grey economy" and economic development. The Law on Amendments to the VAT Law was adopted; Law on Amendments to the Law on Corporate Income Tax; Law on Amendments to the Law on Personal Income Tax; Law on Prevention of Money Laundering and Financing of Terrorism; Law on Amendments to the Law on Public Debt of the Republic of Serbia on the basis of unpaid foreign currency savings of citizens deposited with banks whose seats are on the territory of the Republic of Srpska and their

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1 NBS, Overview of events on the global financial market, December 2017

2 Source: IMF, World Economic Outlook, october 2017

3 Source: IMF, World Economic Outlook, october 2017

4 SORS, Economic Trends in RS, December 2017

5 MFIN, Basic Macroeconomic Indicators, December 2017

6 SORS, Press Release, December 2017

7 MFIN, Current Macroeconomic Movements, December 2017

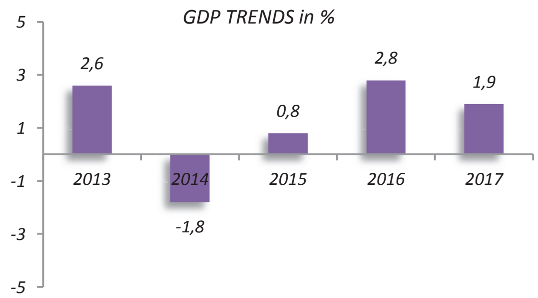
8 NBS, Macroeconomic Trends, January 2018

9 NBS, Macroeconomic Trends, January 2018

branches in the territory of the former Republics of the SFRY; Law on Amendments to the Law on Bankruptcy; Law on Amendments to the Labour Law.

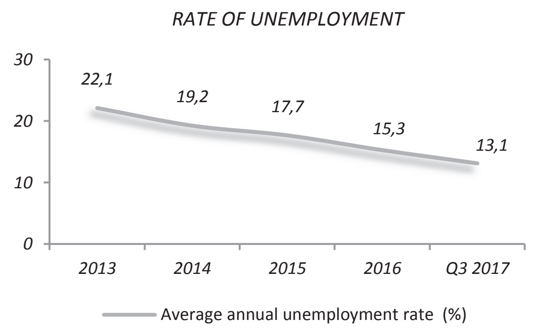
**GDP trends**

After 2016 and the economic growth of 2.8%[10], the economic activity continued positive developments during 2017. As a result of the measures taken, economic growth followed the growth of total economic activity in the third quarter of 2017, measured by gross domestic product of 2.1% in relation to the same quarter of the previous year. According to the first estimates, the overall economic activity in 2017, measured by GDP, grew by 1.9%[11] compared to the previous year. The largest contribution to the growth of GDP on the supply side has been the growth of industrial production, primarily the processing industry and service sector. Within the processing industry, chemical, rubber and mechanical industry stand out, as well as the production of metal products and the production of electrical equipment, which are among the most important. The tobacco industry and the production of core metals[12] are also making steady growth, with an increasingly important role. Construction also made a positive contribution, while agriculture had the biggest negative impact. Extreme drought followed by high temperatures in early 2017 significantly reduced yields of all planted crops. On the consumption side, GDP growth was driven by investment activity and personal consumption, and government consumption also gave a slight positive contribution. The electricity sector, after agriculture, had the most significant negative impact on GDP growth.




**Employment/unemployment**

In 2017, the 2016 trend continued, the labour market continues to recover. The growth of economic activity has also positively reflected on the labour market by increasing the number of employees since the beginning of the year. According to data obtained from the Labour Force Survey at the end of the third quarter of 2017, there was a significant reduction in unemployment compared to the same period in 2016. The unemployment rate at the end of the third quarter of 2017 was 12.9% and it was lower compared to the same period of 2016 when it was 13.8%. The number of employed persons aged 15 and older is higher by 67,900, and the number of unemployed persons is lower by 21,900[13]. In the structure of employed persons, the number of formally hired employees increased by 117,000, mostly in the manufacturing industry and in professional, scientific and technical activities. The number of informally hired employed persons is lower by 49,000 in relation to the same period of the previous year.



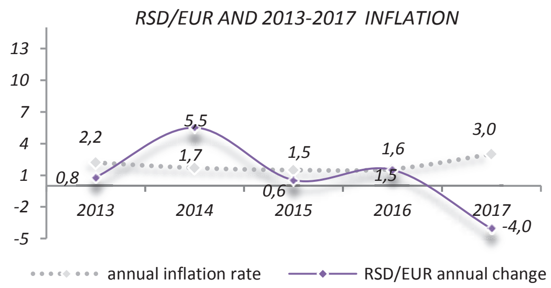

Source: Statistical Office of the Republic of Serbia (average for the period)

**Inflation**

During 2017, y.o.y inflation was constantly within the boundaries of the target NBS corridor of 3.0% ± 1.5pp. At the end of 2017, year-on-year inflation was 3.0%[14]. Level of inflation in 2017 was impacted by the prices of primary agricultural products, prices of crude oil and petroleum products and inflation in the international environment. According to the NBS projection, year-on-year inflation will continue to move within the target of 3.0% ± 1.5 pp. in the coming period, with a decrease in the beginning of 2018.

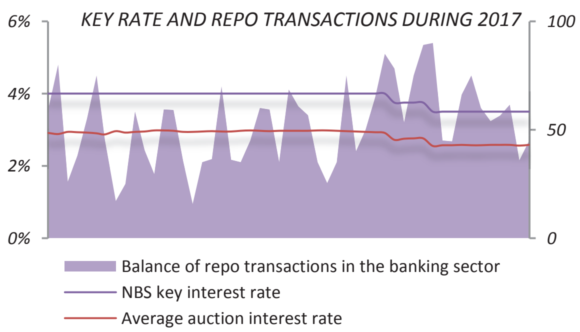
10 MFIN RS, Current macroeconomic developments, December 2017
11 SORS, Press Release, Economic Trends in RS, December 2017
12 MFIN, Fiscal Strategy 2018-2020

13 SORS, Labor Force Survey, Third Quarter 2017
14 SORS, Press Release, Consumer Price Index, December 2017



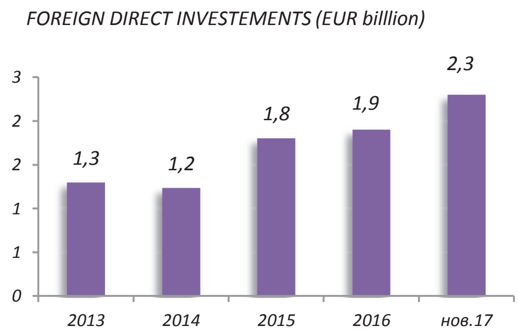

## Key interest rate

Total macroeconomic developments enabled the National Bank of Serbia to maintain a relaxed monetary policy in 2017 and to continue the decline in the reference interest rate (RKS) from 4.00% at the beginning of the year to 3.50% at the end of the year. When reducing key rate, the NBS took into account the mid-term inflation projection, in conditions of reduced country risk premium, unchanged inflation expectations and lower "import" inflation. With the additional reduction of key rate in conditions of low inflationary pressures, the NBS provided additional support to the growth of lending activities of commercial banks. By returning the reverse repo instrument, the NBS again allowed banks to place excess liquid assets in treasury bills, using an auction method and multiple interest rates. This resulted in the separation and formation of the auction (lower) and the reference (higher) interest rate. The average weighted REPO rate at the end of 2017 amounted to 2.57%, while at the end of 2016 it was 2.89%. The volume of REPO transactions ranged from a minimum of RSD 15.8 billion to a maximum volume of RSD 90.0 billion in October, ending the end of the year with RSD 45.1 billion.




## Foreign direct investments

Foreign direct investment (FDI), as of November 2017, reached an amount of about EUR 2.3 billion[15] while in the same period of the previous year they amounted to about EUR 1.7 billion. FDIs were mainly directed towards export-oriented sectors. Within the manufacturing industry, where most of the FDIs were placed, the largest inflow of investments was made in the production of motor vehicles, basic metals, rubber and plastics, pharmaceutical and chemical products.

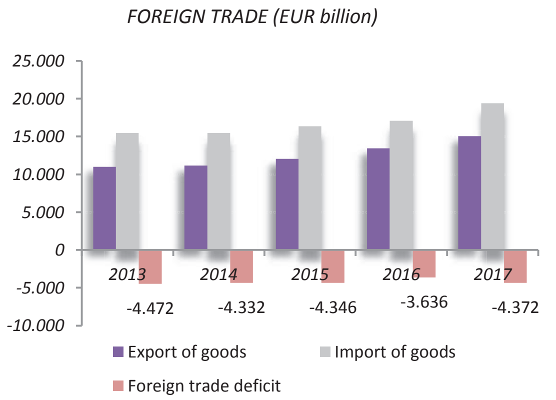



The mentioned investments led to the growth of employment, the growth of production and export of the processing industry. The volume of foreign direct investments of around EUR 2.3 billion would be sufficient to cover the current account deficit, which is estimated at EUR 1.7 billion or 4.6% of GDP for the entire 2017[16].

## Foreign-trade exchange

The total foreign trade of the Republic of Serbia in the previous year amounted to EUR 34.5 billion[17]. This volume represents an increase of about EUR 4.0 billion compared to the same period of the previous year. Export of goods, for the twelve months of 2017, reached a value of EUR 15.0 billion. Import of goods in the same period amounted to EUR 19.4 billion, i.e. deficit of the realized trade exchange amounted to EUR 4.4 billion (an increase of 20.2% compared to the same period of the previous year).

15 NBS, Macroeconomic Trends, January 2018
16 MFIN, Fiscal Strategy 2018-2020
17 MFIN, Macroeconomics Trends, February 2018




The most important export products are electric machines, appliances and devices with a share of 9.1[18]%. Observed by companies exporting, company Fiat automobili Srbija d.o.o. Kragujevac (FAS) is a leading exporter (by the end of November 2017). By the end of November 2017, the volume of FAS exports amounted to EUR 870.2 million, followed by HBIS Group Serbia d.o.o. Smederevo (former Zelezara Smederevo), Tigar tires d.o.o. Pirot and NIS a.d. Novi Sad[19].

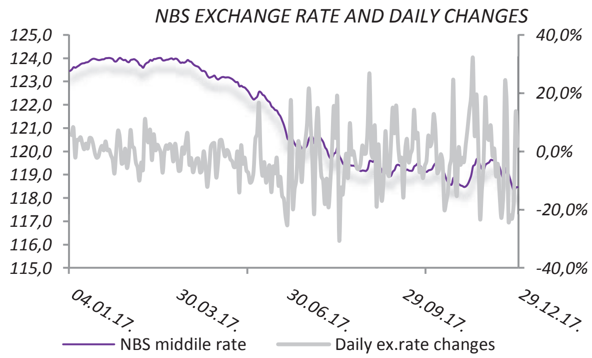
Looking at the structure of foreign trade by regions and countries, about 2/3 of the foreign trade is still being carried out with EU countries. Imports from EU countries account for 62.4% of total imports, while exports to EU countries account for 66.1% of total exports[20] in the period January-December 2017. The main foreign trade partners from the EU are Italy and Germany and in 2017 with 25.8% of total exports, and 22.7% of total imports from the same countries [21].

**EUR / RSD Exchange Rate**

The EUR/RSD exchange rate (118.47) at the end of 2017 is 4.0% lower than the end of 2016. During 2017 the EUR/RSD rate ranged from 118.29 to 124.02 RSD for EUR. The movements in the dinar exchange rate were under the influence of favourable macroeconomic indicators, positive IMF estimates regarding the implementation of the signed stand by arrangement with the Government of RS, improved country credit rating (Moody's, S & P, Fitch[22]), increased confidence of foreign investors and growth of investments in securities of the Republic of Serbia.

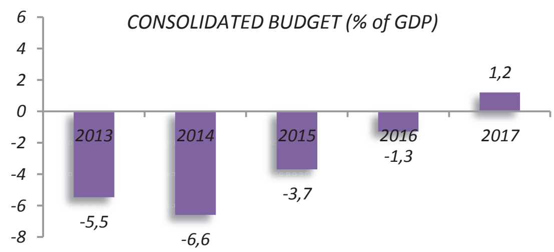
During 2017, the dinar appreciated against the euro by 4.2% and in relation to the dollar by 18.2%. In the course of 2017, the National Bank of Serbia (NBS) intervened on the interbank foreign exchange market (MDT) in both directions, through the purchase and sale of foreign exchange, thus preventing greater daily oscillations in the value of the domestic currency. During 2017, the volume of NBS purchases at MDT amounted to EUR 1,355 million, while sales volume was EUR 630 million.

The NBS foreign exchange reserves at the end of December 2017 reached the amount of EUR 10.0 billion (according to preliminary data) and decreased by 2.4% compared to the end of 2016.




**Budget deficit / surplus**

At the end of 2017, at the general government level, total fiscal surplus in the amount of RSD 52.3 billion [23]. According to the previous agreement with the IMF, a total fiscal deficit was foreseen, for a full year, from RSD 75.2 billion, which means that budgeting is better than planned due to better collection of all types of income.




Source: MFIN (consolidated fiscal result)

At the end of December 2017, a surplus of the budget of the Republic in the amount of RSD 33.9 billion was achieved[24]. In the mentioned period revenues were collected in the amount of RSD 1,119.1 billion, and expenditures in the amount of RSD 1,085.2 billion. In the period January-December, budget revenues increased by 7.1% y.o.y. while expenditure on the expenditure side of the budget grew by only 1.3% y.o.y[25] Compared

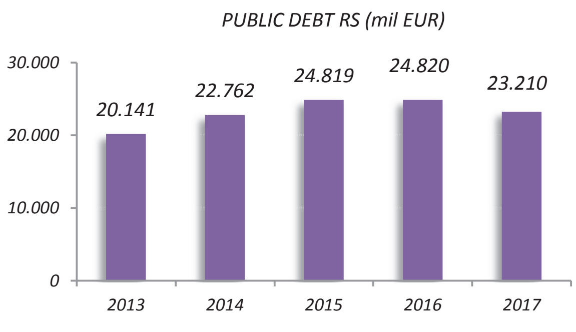
18 MFIN, Current Economic Flows, February 2018
19 MFIN, Current Economic Developments, December 2017
20 MFIN, Current Economic Flows, February 2018
21 MFIN, Current Economic Flows, February 2018
22 NBS, Macroeconomic Trends in Serbia, January 2018

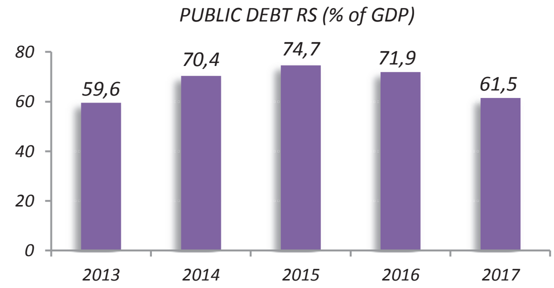
23 MFIN, announcement for December 2017
24 MFIN, announcement for December 2017
25 MFIN, Current Economic Flows, February 2018

to 2016, the highest individual growth on the revenue side of the budget was recorded in corporate income tax, while on the expenditure side of the budget, growth was recorded in other current expenditures. With the budget expenditures, for the first time since the pre-crisis period, there was a fall in interest payments. In the structure of budget revenues, in the period January-December 2017, excise revenues increased by RSD 14.3 billion. This increase is the result of an increase in the excise tax on sales of tobacco products in 2017 compared to 2016 in the amount of RSD 7.3 billion[26].
With the fiscal consolidation program, the state mainly affected the adjustments on the expenditure side of the budget in 2015. More favourable fiscal results from 2016 are due, above all, to higher budget revenues due to economic growth and more efficient collection of all tax items.

**Sovereign debt**

The public debt of the Republic of Serbia (central government level) at the end of December 2017 amounted to EUR 23.2 billion [27] which represents 61.5% of GDP. According to the available data of the Ministry of Finance, compared to the same period in 2016, the public debt was reduced by EUR 1.6 billion. The biggest obstacle to reducing the share of public debt in GDP lies in the international environment, and primarily in the exchange rate of the dollar against the dinar (around 30% of the debt is in the US) and interest rate changes (about 20% of the debt is RS at variable interest rates)[28].




**Foreign debt**

According to the NBS data at the end of September 2017, the total external debt, public and private sector, amounted to EUR 26,0[29] billion and compared to September 2016, it increased by EUR 431.4 million. External debt of the private sector increased by EUR 710.9 million in the observed period, while the public sector debt was reduced by EUR 279.5 million. The external solvency indicator, presented as a ratio between the amount of external debt and the value of exports of goods and services, slightly improved at the end of September 2017, amounting to 137.6%, and (beginning of the year 152.4%)[30].

[26] MFIN, Current Macroeconomic Movements, February 2018
[27] MFIN, macroeconomic and fiscal data, February 6, 2018
[28] MFIN, balance of debt and debt structure, December 2017

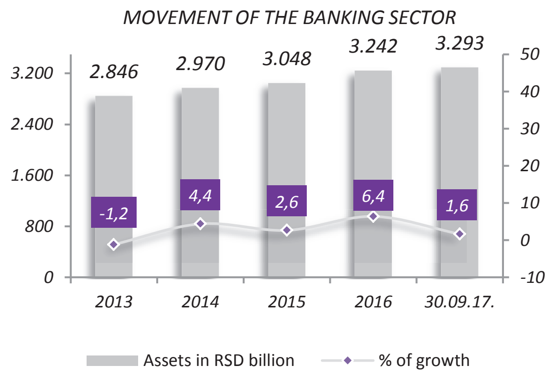
29 NBS, external debt of RS to debtors dated December 29, 2017
30 NBS, Indicators of the external position of Serbia from February 5, 2018

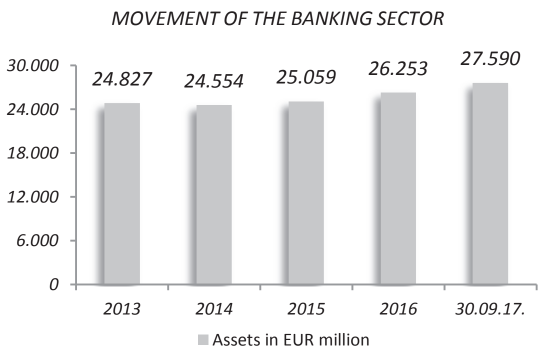
## 3. BANKING SECTOR OF THE REPUBLIC OF SERBIA AND THE FINANCIAL POSITION OF THE BANK

### 3.1. Banking Sector

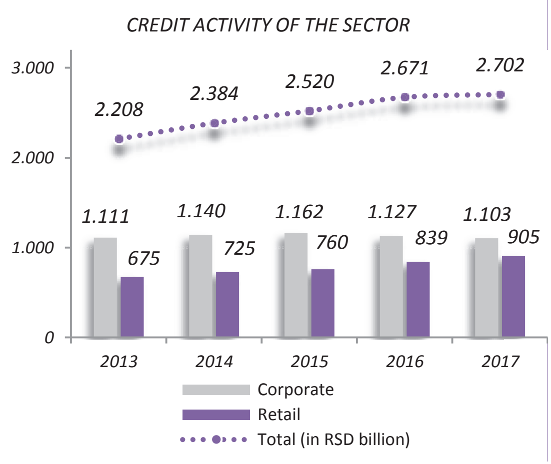
At the end of September 2017, the banking sector of the Republic of Serbia comprises a total of 30 banks with 23,342 employees[31], with total assets of RSD 3,293.3 billion and total capital of RSD 662.7 billion. The ten largest banks with balance sheet assets account for 77.4% of total sector assets.

During the first nine months of 2017, the balance sheet assets of the banking sector increased by 1.6% compared to the end of the previous year, total capital increased by 4.8%, while the number of employees decreased by 2.1%.




During the first three quarters of 2017, the trend of decreasing interest rates on dinar corporate and retail loans continued, which contributed to the growth of total loans (5% in September in 2017), and was mainly driven by the growth of retail loans (11.4%[32]). In the meantime, the banking sector had significant surpluses of liquid assets, bearing in mind the reference indicators of liquidity. The surplus of liquid assets of the banking sector is mainly marketed in government securities and reverse REPO operations of the NBS. At the end of September 2017, the balance of banks' investments in REPO transactions amounted to RSD 75.0[33] billion, while in September 2016 it amounted to RSD 65.0 billion. The total value of government securities portfolio at the end of September amounted to RSD 613.3 billion. The share of securities available for sale amounted to 16.6% of the assets of the banking sector, while cash and balances with the Central Bank amounted to 13.4% (as of September 30, 2017).



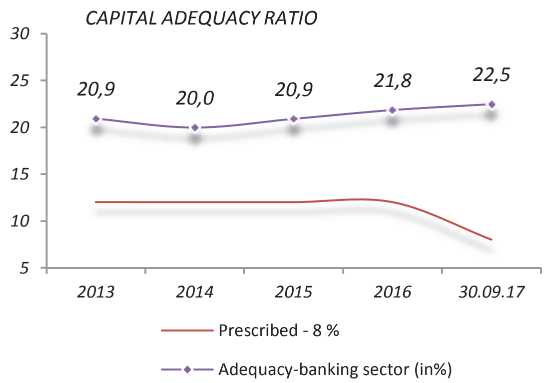

The share of gross NPL loans in total gross loans at the end of September 2017 amounted to 12.2%, while at the end of December 2016 it was 17.0%, and at the end of 2015 as much as 21.6%.[34] Observed by sector structure, most of the gross NPL loans continue to apply to companies. At the end of September 2017, the gross NPL loan coverage calculated by the reserve for estimated losses on balance sheet positions amounted to 127.2%. Impairment losses of NPL loans cover 62.2% of gross NPL loans[35]. Gross NPL loans to individuals at the end of the third quarter of 2017 amounted to RSD 63.0 billion and were reduced by 19.5% compared to the second quarter of the same year. Gross NPL loans to companies amounted to RSD 124.3 billion and were by 13.0% lower than in the previous quarter.[36]

31 NBS, Third Quarter Report 2017
32 NBS, Macroeconomic Trends in Serbia, November 2017.

33 NBS, Third Quarter Report 2017
34 NBS, Third Quarter Report 2017
35 NBS, Third Quarter Report 2017
36 Idem

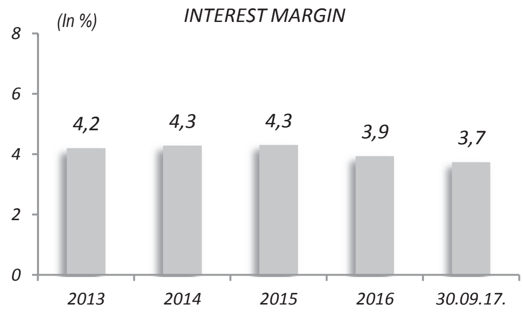
Retail *FX savings* tended to grow steadily and in 2017 and at the end of September 2017 reached EUR 8.9 billion, an increase of 3.3% compared to December 2016.

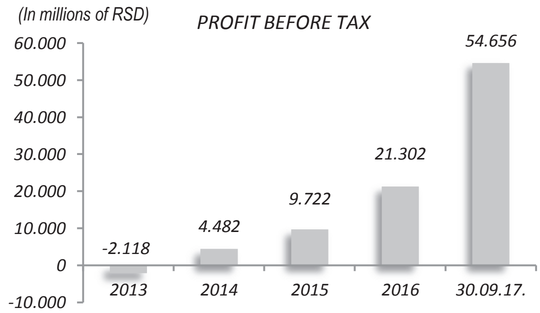
In order to align with EU legal acts (in the field of banking) the NBS has adopted new regulations in line with the Basel 3 standards, which apply from June 30, 2017. Average value of *capital adequacy* ratio, as of September 30, 2017 amounted to 22.5%[37]. The stated value, in relation to the new prescribed minimum ratio of 8.0%, means that the banking sector is adequately capitalized. At the end of September 2017, the share capital of the banking sector amounted to RSD 400.9 billion.



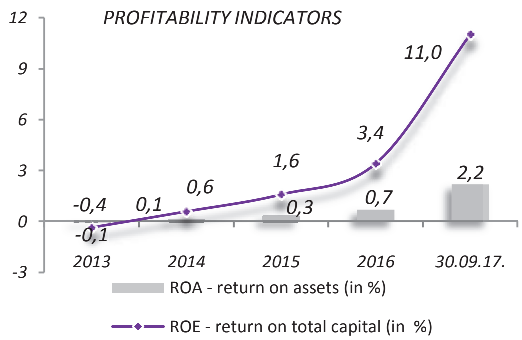

At the end of the third quarter of 2017, the total indebtedness of banks by credit operations abroad was RSD 150.6 billion, a decrease of 2.3% compared to the end of 2016 [38].

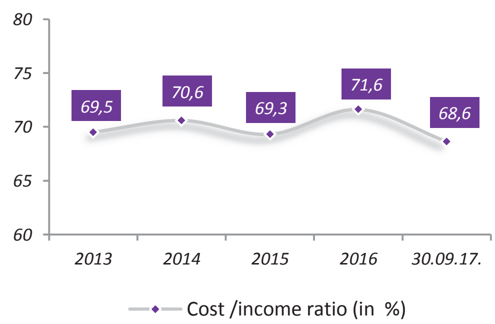
In the first three quarters of 2017, banks recorded profit growth. At the end of the third quarter of 2017, a positive net financial result, before taxation, was realized in the amount of RSD 53.5 billion. In the observed period, 25 banks operated positively with a total profit of RSD 54.7 billion, while 5 banks operated with a total loss of RSD 1.2 billion. The most important factor for the growth of the net profit of the banking sector is the decrease in net credit losses in relation to the same period in 2016. Costs of value adjustments recorded a decrease compared to the same period last year (September 2017 - RSD 2.2 billion, September 2016 - RSD 15.6 billion).




*Note: the end-2013 result includes the loss of Universal Bank of EUR 13 million.*



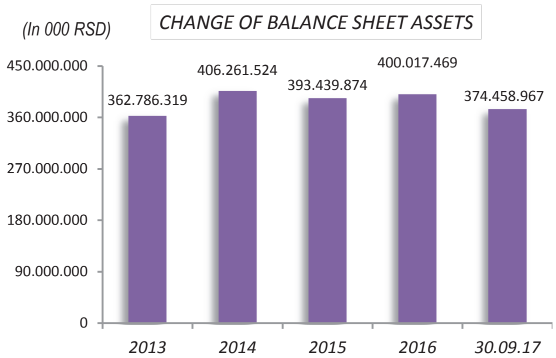

Cost / Income ratio continues the downward trend after the increase in 2016, and amounts to 68.6% (as of September 30, 2017).

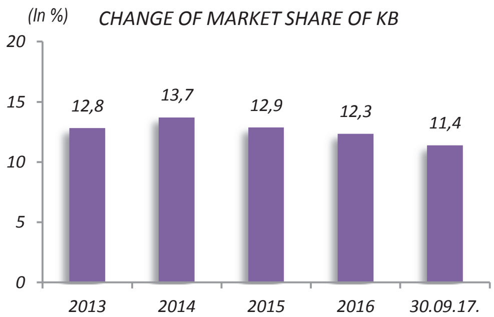
37 NBS, Banking Sector in Serbia, Third Quarter Report 2017

38 NBS, Banking Sector in Serbia, Third Quarter Report 2017

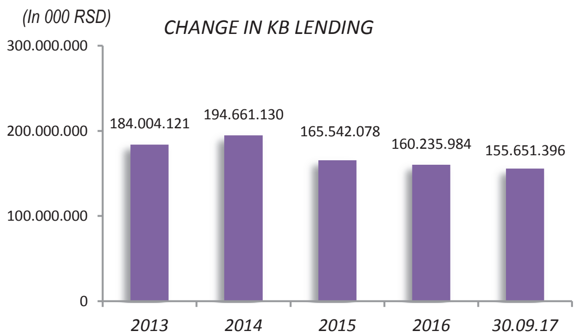
3.2. Financial position of KB compared to banking sector

With the amount of balance sheet assets of RSD 374,459.0 million, as of September 30, 2017, KB took 11.4% of the Serbian banking market and retained the second position according to this parameter. The Bank had an identical position at the end of 2016.



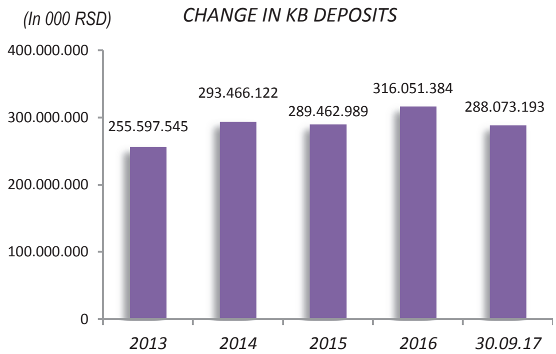




Loans and receivables of the Bank on 30.09.2017, in the amount of RSD 179,787.7 million, accounting for 8.6% of the market share. The result is slightly weaker than the end-2016 achievement, when the Bank had 9.8% share in the banking sector (RSD 191,012.8 million).



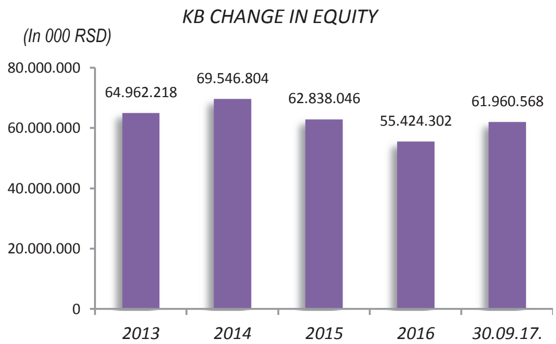

*Note: Due to comparability with previous years, the graph shows the Bank's loans without other loans, advances and receivables*

The position of collected deposits and other liabilities also slightly changed during the first three quarters of 2017. The share of deposits and other liabilities of the Bank in total deposits of the banking sector amounted to 11.8% as of September 30, 2017 (RSD 298,294.8 million), while at the end of 2016 it amounted to 13.1% of total deposits of the banking sector (RSD 330,456.3 million).




*Note: Due to comparability with previous years, the chart shows deposits of the Bank without other liabilities and credit lines*

Observing the position of total capital, the Bank increased its share in the banking sector from 8.8% (RSD 55,424.3 million at the end of 2016) to 9.3% of the banking market on 30.09.2017(RSD 61,960.6 million).



# 4. *ORGANISATIONAL STRUCTURE AND BODIES OF KB*

## 4.1. KB Board of Directors

The Bank's Board of Directors was established in accordance with the Law on Banks Law and the Agreement between the shareholders - the Republic of Serbia and a group of international financial institutions (EBRD, IFC, DEG, and SwedFund) and consists of nine members, including the president, three of which are independent directors. The members of the Board of Directors of the Bank are appointed by the Shareholders Assembly of the Bank to a period of four years.

The responsibilities of the Bank's Board of Directors are defined in Article 73 of the Law on Banks and Article 27 of the Bank's Statute. The members of the Board of Directors of the Bank on December 31, 2017 were as follows:

| FIRST AND LAST NAME | SHAREHOLDER / MEMBER INDEPENDENT OF THE BANK | FUNCTION |
|---|---|---|
| Dr Vladimir Krulj | Republic of Serbia | President |
| Mirijana Ćojbašć | Republic of Serbia | Member |
| Lilja Jovanović | Republic of Serbia | Member |
| Andreas Klingen | EBRD | Member |
| Philippe Delpal | EBRS | Member |
| Khosrow Zamani | IFS | Member |
| Olivera Matić Brbora | Member independent of the Bank | Member |
| Mila Korugić Milošević | Member independent of the Bank | Member |
| Mats Kjaer | Member independent of the Bank | Member |

## 4.2. Executive Board of KB

The Executive Boards consists of the President of the Executive Committee, the Deputy President of the Executive Board and at least three members. The term of office of the members of the Executive Board of the Bank, including the President and the Deputy President, is four years from the date of appointment.
The responsibilities of the Executive Board are defined in Article 76 of the Law on Banks and Article 31 of the Bank's Statute.
The members of the Executive Board of the Bank as of December 31, 2017 were:

| FIRST AND LAST NAME | FUNCTION |
|---|---|
| - | President |
| Slađana Jelić | Deputy President |
| Dragiša Stanojević | Member |
| Dr Dejan Tešić | Member |
| Miroslav Perić | Member |

## 4.3. Committee for Monitoring Operations of the bank (Audit Committee)

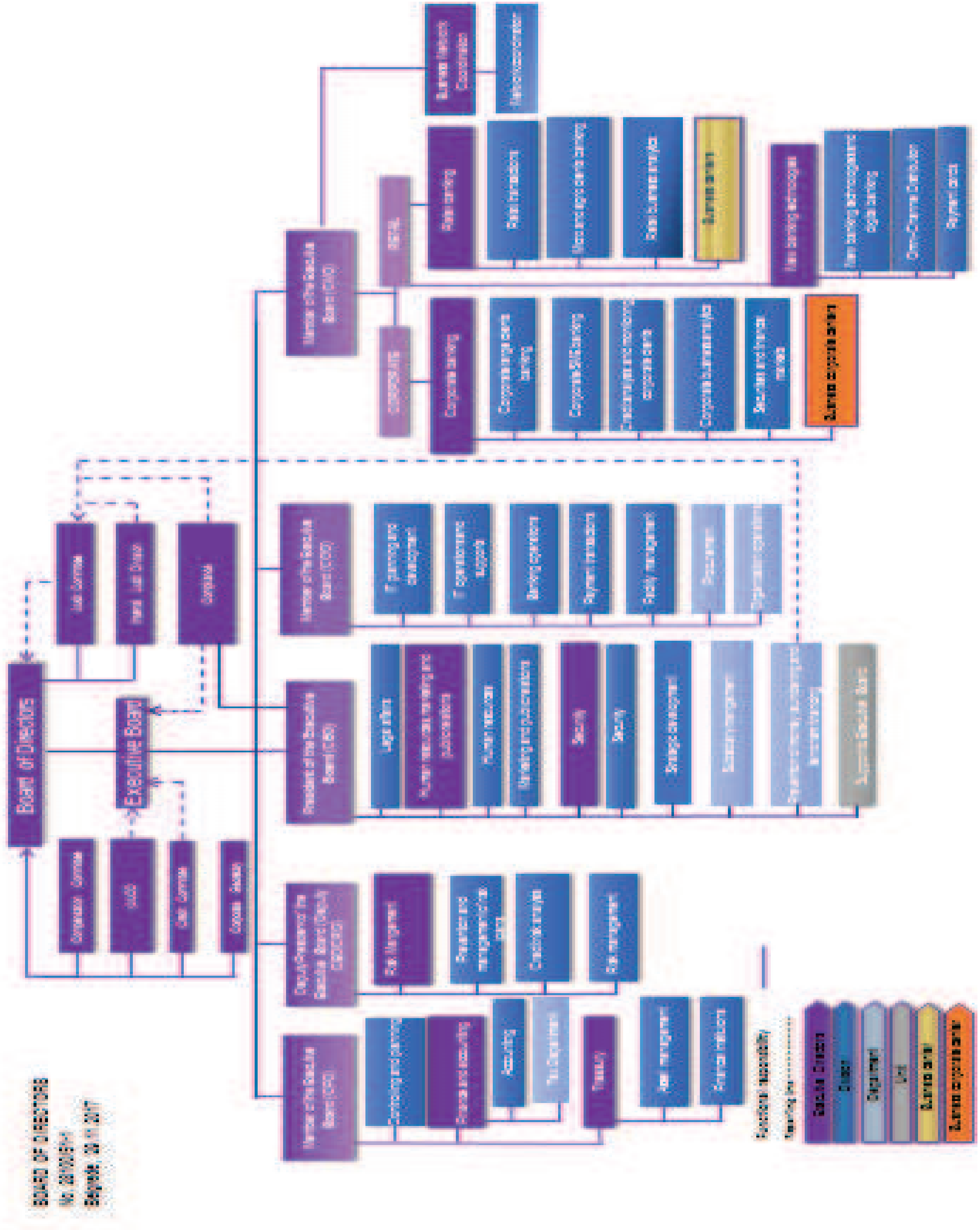
The Committee for Monitoring the Bank's Operations consists of three members, two of which are members of the Board of Directors of the Bank, who have appropriate experience in the field of finances. One member of the Committee for Monitoring is the is the person independent of the Bank. The members of the Committee are elected for a period of four years.

Duties of the Audit Committee are defined by the article 80 of the Law on Banks and Article 34 of the Bank's Statute.

As of December 31st 2017, the members of the Audit Committee were:

| FIRST AND LAST NAME | FUNCTION |
|---|---|
| Mats Kjaer | Chairman |
| Andreas Klingen | Member |
| Milena Kovačević | Member |

## 4.4. KB’S Organisational Structure




*Note: Organisational structure of KB on 31.12.2017.*

## 4.5. Regional distribution of the Bank's business network

### BUSINESS NETWORK OF THE BANK

| | BUSINESS CENTERS | SEAT |
|---|---|---|
| 1. | BC Belgrade 1 | Svetogorska 42-44, Belgrade |
| 2. | BC Belgrade 2 | Svetogorska 42-44, Belgrade |
| 3. | BC Kragujevac | Moše Pijade 2, Požarevac |
| 4. | BC Niš | Episkopska 32, Niš |
| 5. | BC Novi Sad | Novosadskog sajma 2, Novi Sad |
| 6. | BC Užice | Petra Ćelovića 4, Užice |
| | **BRANCH** | **SEAT** |
| 1. | Kosovska Mitrovica | Kneza Miloša 27 |

| | CORPORATE BUSINESS CENTERS | SEAT |
|---|---|---|
| 1. | CBC Belgrade | Svetogorska 42-44, Belgrade |
| 2. | CBC Užice | Gradski trg bb, Valjevo |
| 3. | CBC Kragujevac | Save Kovačevića 1, Kragujevac |
| 4. | CBC Niš | Episkopska 32, Niš |
| 5. | CBC Novi Sad | Korzo 10, Subotica |

The development of the banking sector, the strengthening of competition among banks, the emergence of new banks, services and products imposed the need to reorganize the existing business network of the Bank in order to create an efficient network that will give adequate contribution to the Bank's sustainable and profitable operations in the coming period.

In accordance with the previous Strategies and Business Plans, in the end of 2016, the Bank started restructuring its business network by establishing the first two Business Centres (Belgrade 1 and Belgrade 2).
During the reorganization process, the Bank's business network, one of the largest business networks in the banking sector, has been restructured in the way that the previous 24 branches formed Business Centres and Corporate Business Centres. The Bank retained a network of branches, which are classified in several types, depending on the type of services and products they offer to clients (at the end of 2017, the Bank had 204 branches, which is less by one at the end of 2016).

The process of reorganization of the business network was realized very successfully, in the short term and without any influence on the current operations of the Bank.
After the reorganization, from mid-April 2017, the Bank's business network was divided into Corporate Business Centres (for dealing with corporate clients) and Business Centres (for dealing with retail clients) as shown in the previous table.

During the establishment of Corporate Business Centres, the Bank applied the territorial and principle of approximately balanced market potentials.

The territorial principle applied during the establishment of Corporate Business Corporative was also applied in the establishment of Business Centres, with business activities in the retail segment in Belgrade being divided into "Belgrade 1" and "Belgrade 2". This is done due to the size of this market, which includes the capital area with suburban municipalities (Obrenovac, Stara Pazova, Lazarevac, Mladenovac, Sopot, Surčin) and the area of Pančevo, Kovin and Smederevo.

The changes in the organization of the network created preconditions for improving / accelerating the loan approval process in transactions with legal and natural persons. The analysis and processing of loan applications, as well as the decision on granting loans to legal entities, from mid-April 2017, is done centrally.

In the retail segment, special attention was devoted to ways to reduce the time needed to decide on credit applications, without affecting the quality of the decisions made. The goal of the Bank is to approve the majority of retail loans as soon as possible through the application of standardized credit analysis. In this way, only part of the loan applications from the retail segment (non-standard retail loan applications, loan applications of micro clients and agricultural producers) would require a slightly longer period of time for the decision to approve the loan.

The sales activities of the business network were additionally supported through a successful centralization of support operations. In the process of centralization of support operations, the extensive scope of indebtedness was transferred from the level of Business Centres and Branches to the bank's Head Office. Firstly, the centralization was implemented in national and international payment transactions, accounting operations, administrative and technical operations.

The new organization of Business Centres has also allowed changes in the organization of cash transactions. After the full implementation of the Corporate Business Centres and Business Centres, KB organized and received cash only in 5 regional treasuries, which led to faster and more efficient work, with lower operating costs.

The new organization of the network, the changes in the loan approval process, the centralization of work, as well as the changes in the organization of other business processes and activities resulted in:

- Focusing of employees in Business Centres and Corporate Business Centres only on sales activities with a high degree of productivity;
- Creating preconditions for more effective decision-making about loan applications (shortened time for reviewing loan applications);

- Further improvement of the risk management process and
- Reduction of operating costs.

## 5. *KB BRANCHES*

In accordance with the new business network organization, which was fully implemented since mid-April 2017, the Bank conducts its business activities through a network of Business Centres, Corporate Business Centres, one branch office (Kosovska Mitrovica) and network of outlets, whose number is changing and adjusting to the market needs. Since mid-April 2017, business operations have been performed at the Bank's Seat in Belgrade, 5 Corporate Business Centres (intended for dealing with corporate clients), 6 Business Centres (intended for dealing with retail clients), 204 outlets and branch of Kosovska Mitrovica (organized for doing business in the territory of Kosovo and Metohija).

The Bank also has three subsidiaries that together make up the Komercijalna Banka ad, Belgrade, as follows:

1. Komercijalna Banka ad, Budva in the Republic of Montenegro (100% ownership),
2. Komercijalna Banka ad, Banja Luka in Bosnia and Herzegovina (99.998% of ownership) and
3. KomBank INVEST ad, Belgrade, investment fund management company (IFMC) (100% ownership).

**Komercijalna Banka ad Banja Luka**
-157 employees,
-16 organisational units
(9 branches and 7 agencies).

**Komercijalna Banka ad Budva**
-138 employees
-13 organisational units
(3 branches and 10 outlets).

**KomBank Invest ad Beograd**
-5 employees.



### 5.1. Important transactions with related persons

The total exposure to persons related to the Bank as at 31 December 2017 amounted to RSD 558.5 million, which compared to the regulatory capital of RSD 51,130.7 million accounted for 1.1% (the maximum value of total placements to all persons related with the Bank according to the Banking Law, is 25% of the Bank's capital).

The largest part of the exposure to persons related to the Bank (in accordance with the methodology of the National Bank of Serbia regarding presentation of exposure to persons related to the Bank) as of December 31, 2017 is the amount of RSD 417.6 million or 0.8% of regulatory capital of the Bank . The data stated relate to investments in KomBank Invest ad Beograd.

Pursuant to Article 37 of the Law on Banks, persons related to the Bank have not had any loans approved under conditions that are more favourable than conditions approved to other persons, unrelated to the Bank, in other words, persons not being employed by the Bank.

Further review of the persons related to the Bank can be found in Notes to the financial statements.

# 6. FINANCIAL POSITION AND PERFORMANCE RESULTS OF KB IN 2017

## 6.1. Introduction

The Bank's operations in 2017 suffered a major impact on the continuation of the privatization process and, in that respect, on the activities of the Bank's management. The biggest change is the reorganization of the Bank's business network that has been in use since April 2017. In the past year, a great deal of attention was paid to managing credit risk (and other risks in business) in order to achieve the highest quality loan portfolio. The negative result reported in 2016 did not affect the Bank's safety, stability and liquidity. The management policy of the Bank allocating a significant part of the earned profit to reserves in the previous period gave the possibility to cover the entire loss from 2015 and 2016 without reducing the share capital. The realized net interest income and fees in 2017 was slightly lower than in the end of 2016.

The results of the Bank's operations were also significantly influenced by the NBS, following the Decision on accounting write-off of balance sheet assets that has been applied since September 2017. The decision stipulates that part of the balance sheet assets of low level of collectability be transferred to the off-balance sheet of the Bank. Transfers to off-balance sheet items refers to the non-performing loans, when the calculated amount of loan impairment, which the bank recorded in favour of impairment provision, comes to 100% of its gross book value.

### *Balance Sheet Sum*

At the end of 2017, the balance sheet total of the Bank (net assets) amounted to RSD 369,183.5 million (EUR 3.1 billion), representing a decrease of 7.7% in relation to the previous year. The focus of the Bank's operations continues on sustainable business, growth of profitability, maintenance and further improvement of the loan portfolio quality, finding new sources of income and more efficient use of available funds.

### *Funding sources*

In 2017, the growth of retail foreign currency savings of about EUR 33.1 million continued, which is the main funding source of the Bank. Deposits from legal entities decreased by RSD 25,752.5 million compared to the end of 2016.

Deposits from banks and other financial organizations decreased by RSD 338.1 million.

During 2017, the Bank paid back to foreign creditors the sum of around EUR 42.9 million, while the amount of newly taken credit lines was negligible. The balance of liabilities of the Bank at the end of 2017, based on the received credit lines, amounted to RSD 7,392.3 million and compared to the end of 2016 it was reduced by RSD 5,591.9 million.

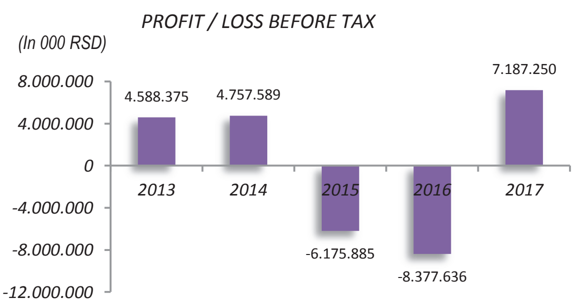
On December 31, 2017, the Bank has no subordinated liabilities in the balance sheet. In December of the same year, a subordinated loan of EUR 50.0 million, taken at the end of 2011 in order to increase the capital, was repaid.

### *Loans and advances*

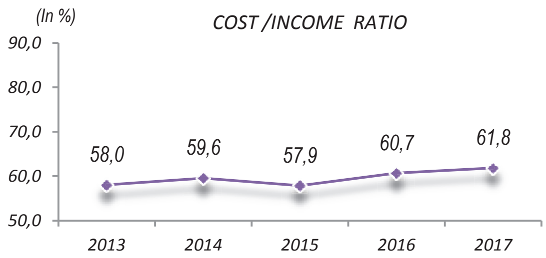
During the previous year, the Bank recorded a decrease in corporate lending in the amount of RSD 2,358.2 million or 3.2%. In the segment of retail business, lending increase was achieved to the amount of RSD 6,189.8 million. Cash loans and housing loans dominate in the structure of loans. KB continued to invest a significant part of the liquid assets in securities, despite the decrease in this position. At the end of the previous year, the amount of RSD 117,288.8 million was invested in securities, which is a decrease of RSD 19,078.0 million compared to the same period in 2016.

### *Profitability*

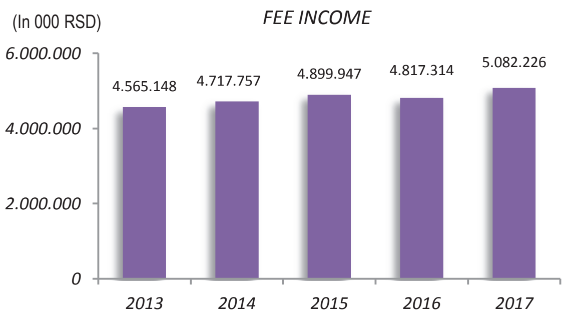
After the year 2015 and 2016, when the Bank recorded a negative result (due to the above-average expenses for loan impairment and credit risk bearing off-balance sheet items totalling RSD 27,916.1 million), at the end of 2017, the Bank achieved a positive result.



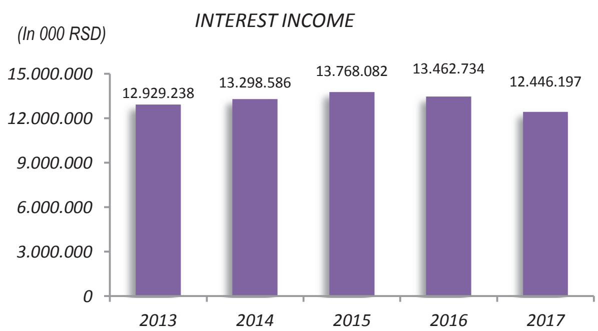
With a slight growth in the Cost / Income ratio (61.8% at the end of 2017 compared to 60.7% at the end of 2016), net income for impairment of loans and credit risk bearing off-balance sheet items was recorded in 2017 (RSD 17.9 million) as opposed to the previous years when the net expense was recorded.

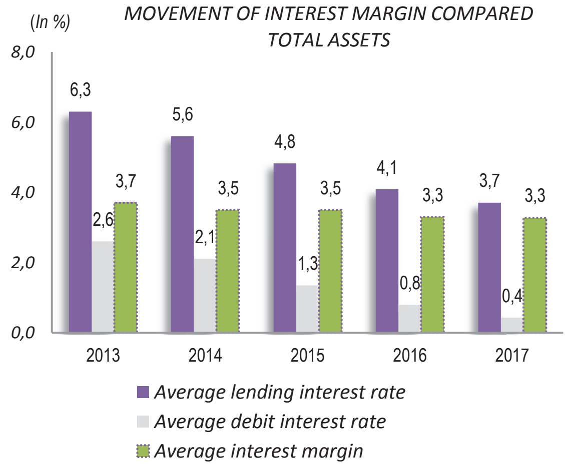



Cost / Income ratio registered slight growth at the end of 2017 compared to 2016.

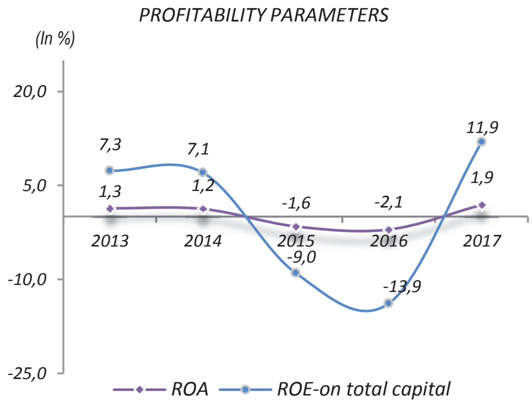



In 2017, the interest income declined by 7.6% compared to the same period in 2016. At the same time, fees and commission income increased by 5.5%.




During 2017, the trend of decreasing in both lending and debit interest rates continued, as well as during 2016. The optimization of the price and structure of the sources of funds, as well as the more efficient loan approval policy, resulted in an interest margin that was achieved in accordance with the adopted business plan for 2017 (3.3%).

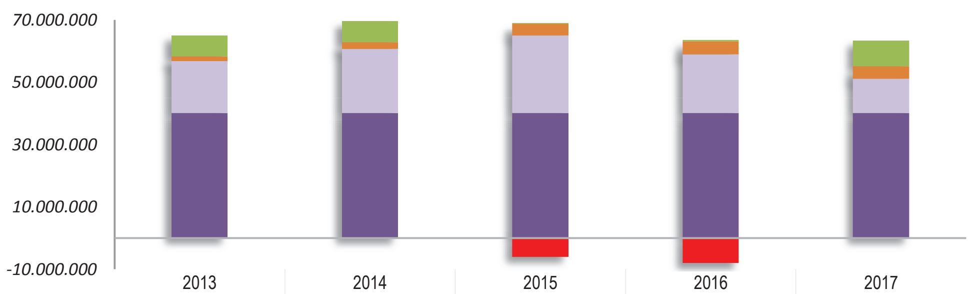


***Capital of KB***

*Changes in equity in the period from 2013 to 2017:*

| DESCRIPTION | 2013. | 2014. | 2015. | 2016. | 2017. |
|---|---|---|---|---|---|
| **KB CAPITAL** (In 000 RSD) | | | | | |
| Share capital | 40.034.550 | 40.034.550 | 40.034.550 | 40.034.550 | 40.034.550 |
| Reserves from profit | 16.635.440 | 20.635.440 | 24.935.440 | 18.791.828 | 11.061.535 |
| Revaluation reserves | 1.604.257 | 2.120.959 | 3.749.864 | 4.311.409 | 4.026.721 |
| Non allocated profit | 6.687.971 | 6.755.855 | 179.550 | 349.698 | 8.137.249 |
| Loss | - | - | 6.061.358 | 8.063.183 | - |
| TOTAL CAPITAL | 64.962.218 | 69.546.804 | 62.838.046 | 55.424.302 | 63.260.055 |

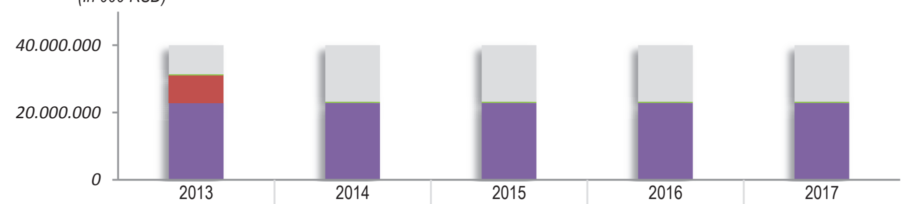
*TOTAL CAPITAL OF KB IN THE PERIOD 2013-2017*




| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| LOSSS | | | -6.061.358 | -8.063.183 | |
| NON-ALLOCATED PROFIT | 6.687.971 | 6.755.855 | 179.550 | 349.698 | 8.137.249 |
| REVALUATION RESERVES | 1.604.257 | 2.120.959 | 3.749.864 | 4.311.409 | 4.026.721 |
| RESERVES FROM PROFIT | 16.635.440 | 20.635.440 | 24.935.440 | 18.791.828 | 11.061.535 |
| SHARE CAPITAL | 40.034.550 | 40.034.550 | 40.034.550 | 40.034.550 | 40.034.550 |
| CAPITAL MOVEMENTS IN % | 9% | 7% | -10% | -12% | 14% |
| TOTAL CAPITAL | 64.962.218 | 69.546.804 | 62.838.046 | 55.424.302 | 63.260.055 |

At the end of 2017, the total capital of the Bank is RSD 63,260.1 million and it is increased by 14.1% compared to the end of 2016. In the period from 2011 to 2017, the Bank's total capital increased by 42.9%. In the same period, share capital increased by 40.7% or RSD 11,572.0 million. So far, the Bank has increased share capital based on two issues of preferential convertible shares (in 2010, RSD 11,400 million and 2012, RSD 11,572 million). For an extensive time period, the Bank allocated most of its generated profit to reserves for estimated losses in order to maintain business safety and capital adequacy, i.e. to protect share capital from potential losses, but also to increase core capital. Over the past five years, the Bank has been able to firstly increase its total reserves, from generated profit and on the account of revaluation, in order to use them to cover the losses declared in 2016 and 2015. Profit reserves at the end of 2017 were reduced compared to 2016 for RSD 7,730.3 million, as the bank used part of its reserves to cover the recorded loss from 2016.

SHARE CAPITAL OF THE BANK 2013-2017



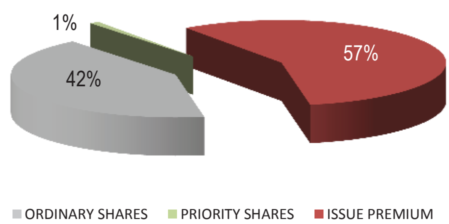

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| ORDINARY SHARES | 8.709.310 | 16.817.956 | 16.817.956 | 16.817.956 | 16.817.956 |
| PRIORITY SHARES | 373.510 | 373.510 | 373.510 | 373.510 | 373.510 |
| PREVERRED CONVERTIVLE SHARES | 8.108.646 | | | | |
| ISSUE PREMIUM | 22.843.084 | 22.843.084 | 22.843.084 | 22.843.084 | 22.843.084 |
| GROWTH RATES IN % | 0% | 0% | 0% | 0% | 0% |
| TOTAL SHARE CAPITAL | 40.034.550 | 40.034.550 | 40.034.550 | 40.034.550 | 40.034.550 |

The ordinary (regular) shares of the Bank are traded on the Belgrade Stock Exchange Standard listing since 2010. During 2014, the conversion of preferential convertible shares into ordinary shares was made and since then there have been no changes in the share capital structure. As at 31 December 2017, the Bank has 16,817,956 ordinary shares (regular) and 373,510 preferred (preferential) shares of RSD 1,000 value per share. At the end of 2017, 1,194 KB shareholders hold ordinary shares, and 635 shareholders hold priority shares.

*KB'S shareholders as of December 31, 2017:*

| SHAREHOLDERS | ORDINARY SHARES | % OF STAKE | PRIORITY SHARES | % OF STAKE | TOTAL SHARES | % OF STAKE IN SHARE CAPITAL |
|---|---|---|---|---|---|---|
| Republic of Serbia | 7.020.346 | 41,7 | - | 0,00 | 7.020.346 | 40,8 |
| EBRD | 4.109.440 | 24,4 | - | 0,00 | 4.109.440 | 23,9 |
| IFC | 1.706.810 | 10,2 | - | 0,00 | 1.706.810 | 9,9 |
| DEG | 772.850 | 4,6 | - | 0,00 | 772.850 | 4,5 |
| SWEDFUND | 386.420 | 2,3 | - | 0,00 | 386.420 | 2,3 |
| OTHER | 2.822.090 | 16,8 | 373.510 | 100,00 | 3.195.600 | 18,6 |
| TOTAL | 16.817.956 | 100,0 | 373.510 | 100,0 | 17.191.466 | 100,0 |

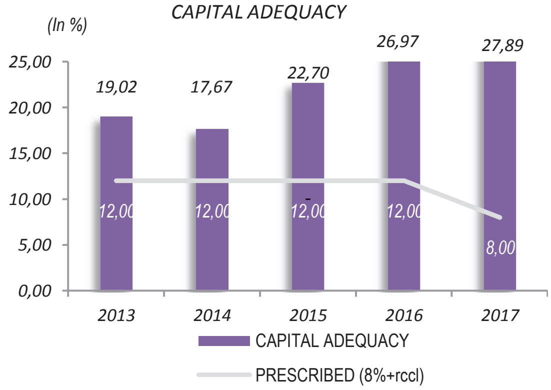
*SHARE CAPITAL STRUCTURE AS OF 31.12.2017.*




***Capital adequacy***

The Bank's capital adequacy ratio at the end of 2017, despite still considerable reserves, comes to 27.89%, which are the best indicators of the Bank that managed to keep adequate capitalization. During 2017, the Bank also fulfilled all the operating parameters prescibed by the Law on banks and met all obligations, this being a reliable indicator of stable and safe operation.

*CAPITAL ADEQUACY*



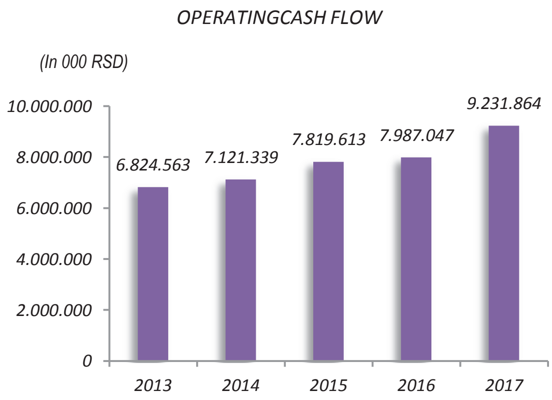
***Performance indicators prescribed by law***

| No. | ITEM | PRESCRIBED | 2017. | 2016. | 2015. | 2014. | 2013. |
|---|---|---|---|---|---|---|---|
| 1. | CAPITAL ADEQUACY INDICATOR(CAPITAL / RISK ASSETS); * REQUIREMENTS FOR COMBINED CAPITAL (BUFFER) LAYER | Min 8% +rccl* | 27,89% | 26,97% | 22,70% | 17,67% | 19,02% |
| 2. | INDICATOR OF INVESTING IN ENTITIES THAT ARE NOT PART OF THE FINANCIAL SECTOR AND FIXED ASSETS | Max 60% | 14,96% | 17,47% | 23,13% | 27,60% | 24,67% |
| 3. | KB'S LARGE EXPOSURE INDICATOR | Max 400% | 34,96% | 38,48% | 79,76% | 160,59% | 97,78% |
| 4. | FX RISK INDICATOR | Max 20% | 4,40% | 2,96% | 10,60% | 2,90% | 2,12% |
| 5. | LIQUIDITY INDICATOR (monthly, last day of the month) | Min 0,8 | 4,30 | 2,86 | 2,73 | 2,84 | 3,45 |

*Note: In accordance with the NBS regulations, the Bank calculates a protective (buffer) layer for the preservation of capital, a protective layer of capital for systemically significant banks, and a protective layer of capital for structural systemic risk.*

***Operating Cash Flow***

At the end of 2017, the operating cash flow in relation to the same period in 2016 was higher by RSD 1,244.8 million (an increase of 15.6% was achieved). In the observed period, the growth of inflows from fees by RSD 436.3 million or 7.0% was recorded, while inflows from interest decreased in the same period by RSD 2,133.6 million or 12.1%. Reason for the above can be found in further reduction of lending interest rates. On the side of cash outflow from operating activities, interest withdrawals were at a lower level by RSD 2,221.5 million, i.e. decreased by 51.7%. The reason for the decrease in interest outflow lies in the reduction in the average interest rate on term deposits.




***Description of changes in business policies of the company***

During 2017, the Bank did not make any changes in the Business Policy. Business policy of the Bank was adopted at the Shareholders Assembly of the Bank on 26.01.2012.

The business policy determines the basic principles of business and defines the operations performed by the Bank in order to fulfil the business results and priorities defined in the Bank's current Strategy and Business Plan, which is based on:

- KB's position on financial market and won customers' confidence in the bank;
- Projections of key parameters of macro-economic policy and
- Development objectives of the bank.

The Bank's business policy is also harmonized with the Risk Management Strategy and the Capital Management Strategy, as well as the policies for managing individual risks.

The Bank operates independently, according to market principles, applying the principles of liquidity, profitability and security, while respecting laws, other regulations and general principles of banking operations in achieving its objectives in a socially responsible manner, in accordance with the basic values and business ethics.

***Corporate governance rules***

The Bank's corporate governance rules are based on appropriate legal regulations (primarily the Law on Banks and Law on Companies).

The competencies and powers of all the Bank's bodies (Shareholders Assembly, Board of Directors, Executive Board, Audit Committee, Assets and Liabilities Management Committee, Credit Committee) are based on the relevant legal regulations and are defined by internal acts (Memorandum on Association, Statute of the Bank, operating rules of the Bank's bodies and other internal acts).

*In accordance with the Decision made by the KB's Executive Board in April 2003, the Bank applies in its operation The Code of Corporate Governance of the Serbian Chamber of Commerce ("Official Gazette of the Republic of Serbia", No. 99/2012), adopted by the Assembly of the Serbian Chamber of Commerce.*

Corporate governance rules have been implemented through internal acts of the Bank and there are no deviations in their application.

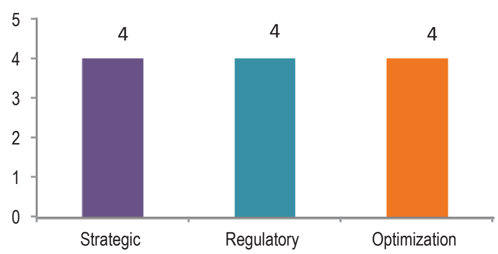
The Code of Corporate Governance has established the principles of corporate practice which is abided by the holders of KB's corporate governance, both in business and in their personal behaviour. The goal of the Code is to introduce good business practices in the field of corporate governance, the equal impact of all stakeholders, existing and potential shareholders, employees, clients, banks, state etc. The ultimate goal is to ensure the long-term and sustainable development of the Bank.

The text of the Corporate Governance Code is publicly available on the web site of the Serbian Chamber of Commerce (www.pks.rs/PoslovnoOkruzenje.aspx?id=1412&p=3) as well as on the Bank's website (www.kombank.com/korporativno-upravljanje).

### *Project Management and Project Portfolio Management*

In 2017, a total of 12 projects and 77% of the planned budget for the project portfolio were realized, while on December 31, 2017, 8 projects from the project portfolio of the Bank continue their realization in 2018.

*PROJECTS REALIZED IN 2017*




All key projects planned by the Strategy and Business Plan of the Bank for 2017 were realized, both in terms of their scope and in terms of planned short-term realization:

- **Reorganization of business network –** The project successfully and in very short time, without affecting the Bank's operation, reorganized the complete operating process of 24 branches (with a network of over 200 outlets) with the formation of 6 Business and 5 Corporate Business Centres aimed at managing, controlling and improving sales and service activities towards clients. Workplace classification and optimized management structure was standardized by more than 50%, centralized network management in the business sectors of the Bank was implemented. Standardization of the branches was carried out with a clear division of tasks and targets for the employees working in sales departments. In order to optimize the process, a large number of operational processes that had been carried out in KB's branches were centralized, "outsourced" and improved. Centralization covers all retail, corporate operations, national and international payment transactions, accounting, legal affairs as well as all administrative and technical-operational activities, which has improved a large number of operational processes. Centralization of jobs led to a reduction in risk, increasing employee productivity, reducing operating costs, improving business processes and establishing a more adequate control system. In addition, the project reorganized the Treasury operations of the Bank with a decrease in the number of treasuries from 24 treasury locations to only 5 regional treasuries, thereby optimized operating costs in cash operations.

  The realization of this project laid out strong foundations for further modernization of Komercijalna Banka's operations.
- **Middle Office centralization** – The project redefined the work of the credit committees of the Bank and improved the efficiency of the credit process in the decision-making part (the approval period for standard cash loans is shortened) with a significant reduction in the number of participants in the decision-making process. A unique decision-making process for retail products has been introduced, which accelerated the loan approval process in this business segment. Over 95% of decisions for this client group were made by lower decision making levels of the Bank. Credit analysis has been standardized and stronger sales activities have been facilitated.
- **Centralization of back office activities** – In order to support the process of reorganization of the business network, a successful centralization of national and

international payment transactions was carried out, optimizing centralized processes, increasing the productivity of employees at the Bank's head office by more than 50%, with the reduction of operational risks. All processes are involved, including the opening of accounts of legal entities and entrepreneurs, processing security instruments, complaints, etc. After centralization, there was also an increase in the share of clients' orders delivered through eBank, which additionally optimized the engagement of employees in the Bank's network, and provided the customers with more efficient services.

- **Digitalization program** – In the continuation of the project implementation from 2016, a digital office ("KOMeCENTAR") was introduced, which enabled the use of a set of the existing services to clients, so that they could avoid coming to the premises of the Bank. "KOMePAY" digital payment card has been introduced on a mobile device, providing customers with NFC technology to pay for goods and services at POS terminals equipped for non-contact payment; thus, the clients do not have to physical have payment card for payment. Additional improvements of eBank and mBank applications were implemented, and two-currency ATMs were introduced, which significantly expanded the offer of the Bank's services through the digital sales channel.

In accordance with the regulations that came into force in 2017, the following regulatory projects were successfully implemented:

- **Implementation of IFRS 9 standard** – According to the implementation of the new standard since January 2018, during 2017 major part of the project was realised, including: amended methodology of valuation impairment and preparing the new methodology on assessment at fair value, analysed the KB's portfolio, implemented analysis of current KB's portfolio, adopted regulations explaining contracted clauses that apply in operation. Prepared and changed accounting policies and regulations, and all systemic changes, thus ensuring successful implementation of the provisions of standard at the beginning of 2018.
- **Basel standards implementation** –According to the new Decision on Capital Adequacy of the National Bank of Serbia, through which the provisions of Basel 3 standard were implemented in the part of credit, market, operational and liquidity risks and capital, changes in the bank's regulations were implemented, involving the application solution based on modern Oracle application solution OFSAA for calculating capital requirements for credit and market risk on the level of the Bank and Group.

Other important realized projects:

- **Implementation of MDS solution 4.11.** – The project has enhanced the system for identification and automated monitoring of suspicious transactions in subsidiaries, thus establishing unique legal and international standards in the field of prevention of money laundering and terrorist financing at the level of the Bank and the Group.
- **Improvement of "storage" and SAN infrastructure** – A new "storage" infrastructure was installed, whereby the Bank, along with the optimization of maintenance costs, also passed on technologically advanced devices that contributed to better performance but also the higher capacities of the Bank's information system.
- **Implementation of ISO 20000-1 standard** – In accordance with the strategic orientation of the Bank to continue with its direction towards service-oriented organization with clearly defined IT processes, the realization of the project Implementation of ISO20000-1 standards was started in 2017, with the goal to ensure the establishment of the IT Management System and the Bank's Certification according to the ISO20000-1 standard. The certification body carried out GAP analysis of the Bank's compliance with the stated standard, which showed an extremely high level of maturity of the IT process. In the course of 2018 there will be final compliance with the requirements of the standards, as well as the Bank's certification.

### 6.2. Corporate Operations

*Market-key tendencies*

The downward trend in lending interest rates since 2014 has continued in 2017, largely as a result of competition between banks and, to a lower extent, due to decrease in the lending pricing. Historically, the lowest lending interest rates were recorded in 2017 (loans with a currency clause below 1.4%; dinar loans below 3.0%).

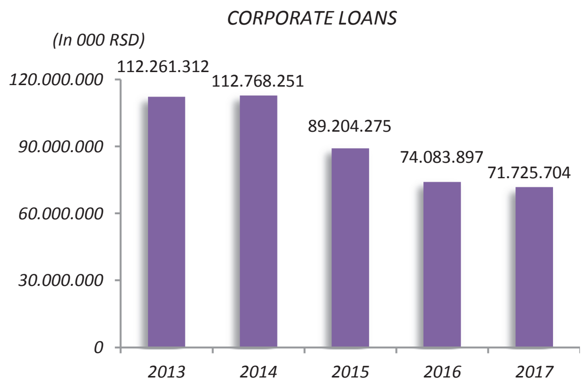
Banks' standards for newly approved loans in the corporate sector were mitigated in 2017, primarily in terms of small and medium enterprises, and to a lesser extend for large enterprises. Observed by maturity structure and currency, mitigation of the standard was also observed in short-term and long-term RSD lending to corporate entities, and short term lending to corporate entities in FX sign.

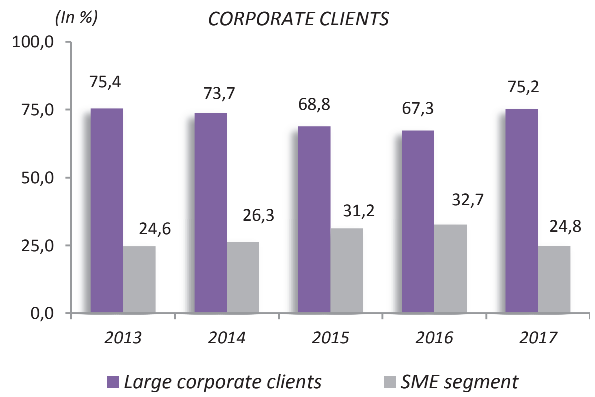
Banks also show greater willingness to take risks when lending to the corporate entities.

A tendency of mild increase of corporate sector's loan demand in 2017, primarily by large companies. Growth of demand was influenced by the higher need to finance working funds and refinance the existing liabilities. There were no economic subsidies in both 2017 and 2016.

*Loans[39] - KB Operation*

Newly approved loans in 2017 were higher by RSD 4.1 billion compared to 2016. The newly approved loans were by RSD 4.1 billion higher in 2017 compared to 2016. There was a growth of share of the large corporate clients in the bank's portfolio by 67.3% to 75.2% due to the increase of loan approval in this segment by 63.8%.

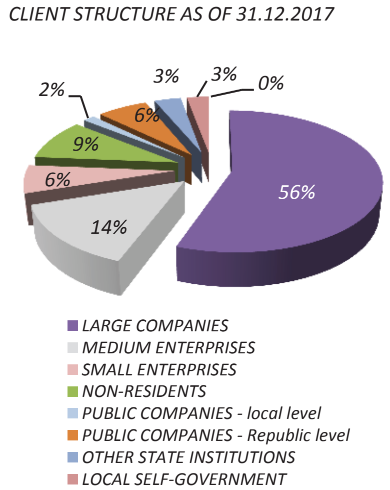



The interest rate on loans indexed in EUR is still significantly lower in relation to loans in dinars, which, in conditions of stable exchange rate, was determining market factor for higher demand in the segment of loans with a currency sign compared to net dinar loans. Accordingly, the share of dinar loans in the portfolio at the end of 2017 remained at a low level of only 10.9%.

Early repayment of loans and continued interest rate reduction as a result of pressure from the competition caused a decrease in interest income in 2017.

In terms of competition throughout 2017, the most active were Banca Intesa a.d. Belgrade, UniCredit Banka Serbia a.d. Belgrade, Societe Generale Banka a.d. Belgrade, with occasional shares of the following banks circulating on the market: ProCredit a.d. Belgrade and Erste Bank a.d. Novi Sad. We observed more flexible approach (in terms of interest rates, maturities, required collateral instruments) of all market competitors when granting loans, compared to previous years.




*Deposits* [40]

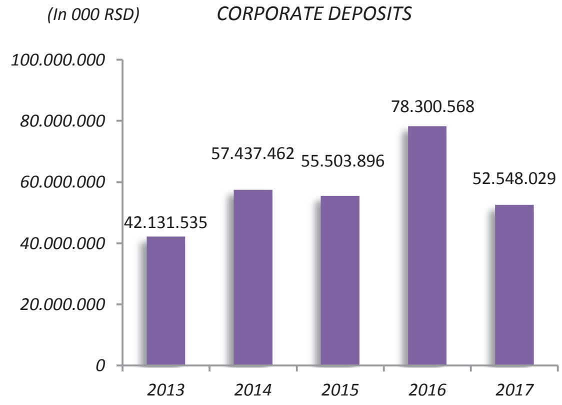
Bearing in mind the strong deposit base and the constantly high liquidity of the Bank, as well as the fact that the demand for loans, despite the slight growth, was at a low level in 2017, the focus was on managing the amount and the structure of deposits, in order to optimize the price of funds and decrease of interest expenses.

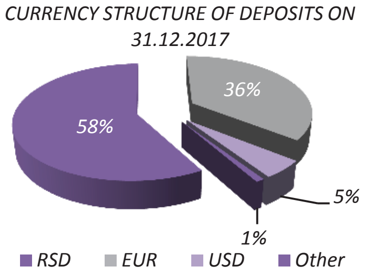
In addition, the significant limiting factor when referring to the possibility of growth of the

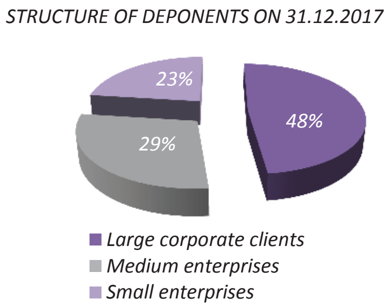
39 Position of loans and advances to customers excludes other lending

40 Position deposits excludes other liabilities and funds acquired through credit lines

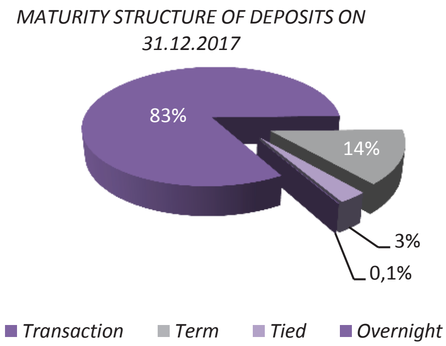
corporate sector's deposit base 2017, was the fact that due to the negative result at the end of 2016, the Bank was limited in terms of taking part in tenders and public invitations.

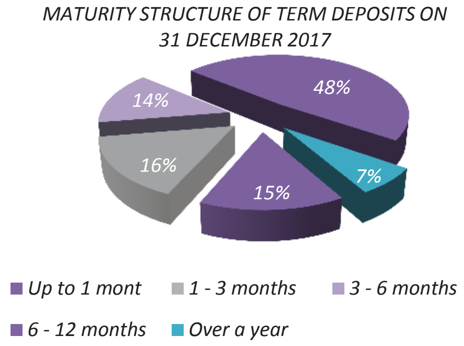



*Note: The depot structure is presented based on internal client segmentation.*




## 6.3. Retail operations

In the conditions of a very dynamic and competitive market, retail business achieved significant results in 2017. The focus was on the growth of lending and generation of net income.

By directing all our attention to the client, we have introduced a number of innovative products, new technological solutions, improved procedures and increased their efficiency.

*Loans – Operation of the Bank*

The growth of retail loans has been achieved thanks to the constant innovation of product offerings in order to adapt to market demands and improve competitiveness. In 2017 RSD 39.2 billion was realized, which is 24% more than in 2016.

The achievement grew in all business segments. The major increase was generated in **cash loans** (32%), primarily owing to the adjusted regular offer of the Bank as well as the special offer for specific client groups. The offer in this segment is constantly changing and adapting during the years, as this is the most attractive segment of the market in the retail segment. The bank completed its offer with dinar cash loans with insurance - CPI. The offer for pensioners, as one of the most important categories of clients, was also innovated in terms of extending the terms and increasing the maximum amount. A new segmentation of clients has been carried out, so that each client gets optimal conditions, and a special offer has been created for the most important clients of the Bank.

In the **housing loans** segment, we generated the increase by 6%, firstly due to new approval conditions, which were considerably more favourable than the last year (regular offer with more favourable conditions started at the end of

February 2017). Additionally, and taking into account the current trend of falling interest rates on the market, the Bank has enabled the existing credit-worthy clients to reduce the interest rate on loans in repayment in order to preserve the quality and the amount of the portfolio.

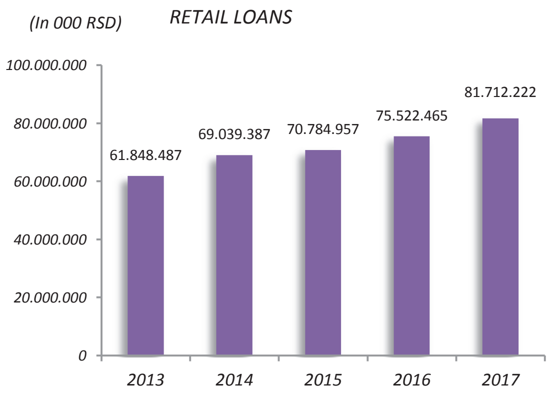
For a second year in a row, the Bank approved subsidized loans to professional military personnel, which gradually increased lending to this segment of clients.

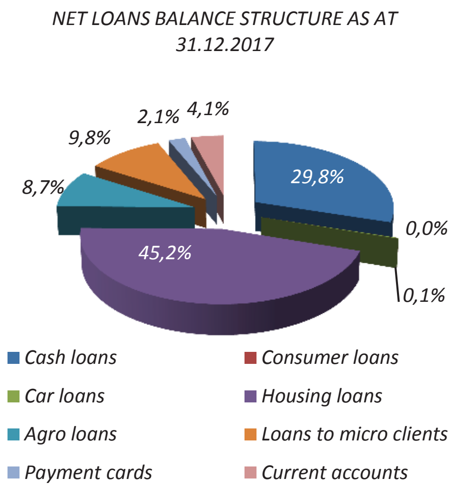
In agricultural business, we achieved growth of **agro loans** by 26%, using the effect of regular offer, special and fair-related loans, subsidized loans in cooperation with the Ministry of Agriculture, Forestry and Water Management, loans in cooperation with the local self-governments and sellers of machinery special contribution to this success was provided by an action short-term dinar loan designed to provide adequate loan support until start-up of granting the subsidized loans (in this way, clients have favourable dinar loans available throughout the year). With this, the Bank achieved a market share of 18% in the structure of all agricultural borrowers.

Increase of realization of loans in **micro business** amounted to 15%, primarily thanks to special products and products from the Bank's credit line, while the share of funds from credit lines was at minimum, unlike previous years.

In 2017, cash loans were amongst the highest in terms of realization (53%), followed by microbusiness loans (23%), farmers (14%) and housing loans (10%). Out of the total loans realized in 2017, 66% was granted without a currency clause, mostly cash loans.

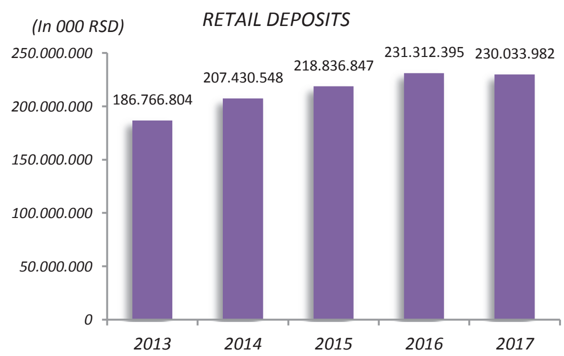
All this led to an increase in the net balance of retail loans of RSD 6.2 billion or 8.2%.



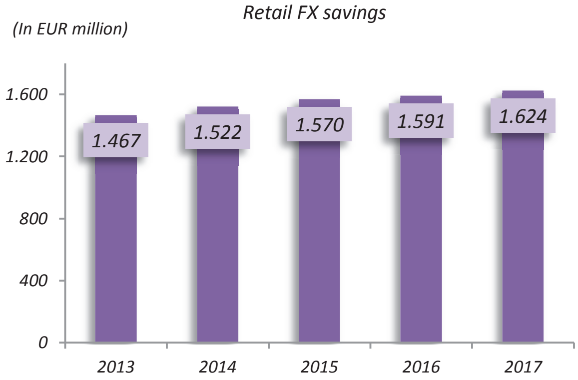

*Deposits[41] - KB Operation*

At the level of the banking sector, in 2017, the growth of total foreign currency deposits amounted to EUR 395 million, while the Bank, with the growth of EUR 44 million in 2017, despite the reduction of interest rates, retained the leading position on the market with slightly reduced market share which amounts to 18.76% (19.11% as of December 31, 2016)).

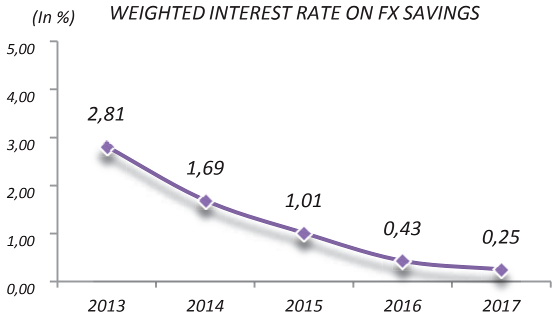



In these market conditions, the proper relationship between the price, the Bank's brand and the desired and stable deposit growth has been established.

[41] Position of deposits excluded othe liabilities and funds acquired through credit lines



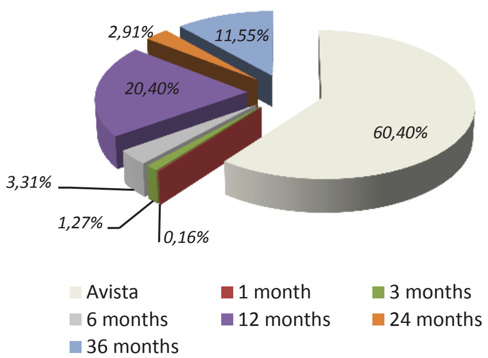

*  The shown foreign currency savings do not includea dedicated foreign exchange accounts (pensioners) and entrepreneurs




*Presentd WIR on saving accounts excludes dedicated FX accounts (pensioners) and entrepreneurs

Retail deposit prices continue to fall in line with market conditions. The bank is still perceived by the clients as the most trusted institution, therefore deposits are constantly increasing although the deposit interest rate falls.

STRUCTURE OF FX SAVINGS AS AT 31.12.2017.




Share of over 12-month terms savings decreased in total FX savings and accounts for 34.9% (increased share of a vista savings, amounts to 60.4%). Deposits of up to EUR 50,000 are predominant (by number over 99%, and by amount of 76%).

*Other products*

Distinctive of 2017 were the activities to improve the offer of other products and services of the Bank. New products in the field of digital banking have been introduced, while the set of accounts that were introduced in December 2016 experienced a true expansion, with a total of 160,000 active set of accounts. We emphasize the good reception of account sets for the youngest clients, which creates the basis for safe business in the future. Significant activities have been dedicated to the further development of bank insurance activities in order to offer more complete financial services to our clients at one place, and to generate additional fee income. At the end of the year, microbusiness account sets were introduced.

*Business Network*

In the first half of 2017, the reorganization of the Bank was completed, with the main goal of creating conditions for higher customer satisfaction by converting branches into modern sales and advisory centres.
After the reorganization of the business network, at the end of 2017, the Bank's network in the retail segment consists of 6 Business Centres and one branch (instead of the former 24 branches) and 204 outlets, whereby the Bank remained the leader of market coverage and accessibility to clients. Having in mind the needs of clients, the Bank continued to improve its customer experience by improving the appearance of branches, through moving to new premises, adapting the working hours, etc. The reorganization of the business network increased the number of sellers and sales outlets.

*Profitability*

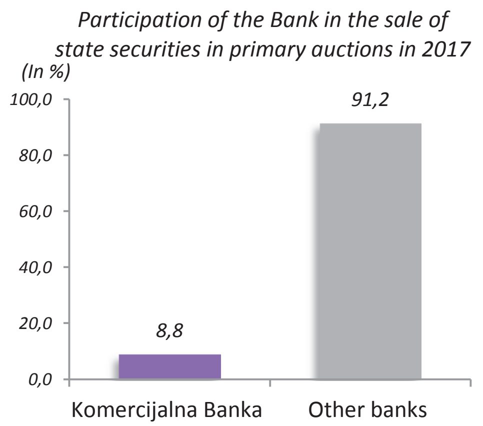
All of the business activities resulted in retail business generating total net interest and fee income of RSD 8,685.8 million, which represents a growth of 8.8% in relation to the previous year.

## 6.4. Asset Management

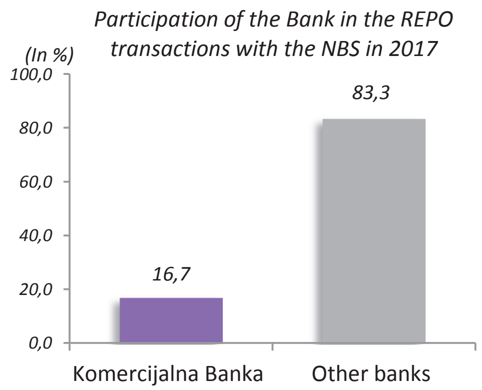
Starting from the strategic orientation of the Bank, the activity of the Treasury's business function is focused on active asset and liquidity management while ensuring the smooth functioning of the Bank and meeting the business needs of its clients.
The environment in which the Treasury's business function operated was marked by a reduction in the reference interest rate (RIR) in 2017 from 4.0%

to 3.5% successively, stabilization of interest rates at a relatively low level, decline in yields on domestic government securities and negative interest rates on EUR and CHF in foreign markets, which, given the available funds, represented a very significant challenge in liquidity management.

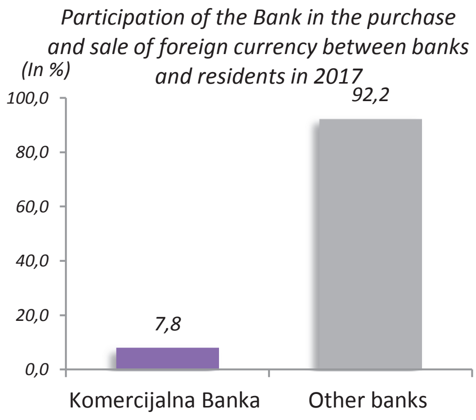
In 2017, the Bank's liquidity position was stable, and liquid assets were mainly invested in govt. securities of the Republic of Serbia, followed by seven-day reverse REPO transactions and overnight deposits with the National Bank of Serbia, as well as through short-term borrowings on the interbank market.




High participation of the Bank in primary auctions of state securities of the Republic of Serbia was followed by a very active participation in the secondary market, while taking into account the maturity structure of the source, most of the short-term dinar liquidity was invested through reverse REPO transactions with the National Bank of Serbia.




The activities of Treasury function on the foreign exchange market were also intense. In dealing with residents with a total purchase of foreign currency in the amount of EUR 976 million (an increase of 13.9% compared to the previous year) and with the total sale of foreign currency in the amount of EUR 913 million (an increase of 7.4% compared to the previous year), KB is one of the most active participants in the foreign exchange market.




At the end of 2017, the Bank fully repaid subordinated debt in the amount of EUR 50.0 million "withdrawn" by the International Finance Corporation ("IFC") in 2011. Repayment was made in conditions of high capital adequacy, well above the regulatory requirements. In the coming period, positive effects are expected to lower the total cost of funding sources.

The Strategy of the Treasury's function in the forthcoming period will focus on the careful employment of liquid assets into risk-free and low-risk financial instruments and further lowering the price of the funding sources.

***Key Results of New Banking Technologies Business Function, With its Special Parts***

*Market – Key Tendencies*

In 2017, it is noteworthy that there are changes in the market that bring about a higher degree of automation of the process, as well as the emergence of new digital products. New technologies in banking take the lead when considering the most efficient channels for customer acquisition.

Also, following the technology development, legal regulations are adapted to use new digital products and services in a safe, transparent and easy way.

The most important changes arise from Payment Services Directive 2 (PSD2) that came into force within the European Union and has a big impact on our market when it comes to new banking technologies, even though Serbia is not yet a member of the European Union. By introducing the PSD2 regulations, the financial institutions in the European Union are obliged to present their services and data to third parties in a safe manner and in accordance with the rules that the PSD2 prescribes. Although the first impression is that the PSD2 activity of financial institutions makes it available to third parties (especially "fintek" companies and "fintek" "start-ups"), it is a fact that by joining financial institutions and fintek companies, we get innovative services and products that bring new modern services to the clients and allow access to new clients and additional fee income to the financial institutions. Some of the banks in Serbia (mainly banks with majority foreign ownership) have recognized the possibilities that PSD2 brings about and have already begun to implement services that are in line with this regulation. Other important legal regulations that are expected to come into effect and which will have a major impact on digital services and products is the new Personal Data Protection Law (complementary to GDPR regulations in the European Union) and the new Law on the Prevention of Money Laundering and Financing of Terrorism, while the Law on Electronic Signature and Electronic Identification is pending the adoption of bylaws in order to become fully effective.

The market opens generally for all kinds of new digital services and products, banks with majority foreign ownership bring knowledge and technology from their parent banks, which will be an additional challenge and a motive to continue with innovations and implementation of new banking technologies in Komercijalna Banka as well.

## 6.5. New Banking Technologies and Digital Banking Division

During 2017, the work on achieving goals set by the previous year's strategy and the digitization program continued, ensuring continuity and consistency, and thus confirming the strategy set up when forming a business function. As it was planned, the scope of work with products and services intended for the retail segment and products and services intended for micro-entities was extended, which was successfully implemented.

- February 2017 (mBank) and May 2017 (eBank). New versions of applications for e-banking were released (eBank and mBank) for retail clients, bringing contemporary, new design and new functionalities with numerous technical and logical improvements compared to previous versions, but with new services first of that kind on the domestic market. Mobile application was enhanced by the first-on-the-market digital payment card, as an integral part of mBank application. This “Visa” card, called “KOMePay” offers to the client the possibility to make payments by phone, instead of using physical card. Komercijalna Banka was the first bank to introduce this type of digital card on the market (HCE), with this functionality integrated in the very mBank application. More than 1,300 clients have chosen this type of card until now. As opposed to the competition, the customers can now apply for this card through mBank application, not having to go to the outlet. An as opposed to the competition, we provide „tap&pay“option – payment with no need to log into the application. The development of this card and launching of the same in the primary competitions lasted about a year and a half, while in our Bank, from idea to launching, the entire process ended in eight months, with better ultimate result. Application and mBank offer, in addition to the service such as “KOMeCASH”, also offers the profile and card administration. It was put in production with the options of biometric identification of the client by fingerprint, for the users of mBank application, and for the clients that want this option and have technical possibilities thereof.
- May 2017. Opening of the first digital “*online”* outlet of Komercijalna Banka, called “KOMeCENTER“, which opens the possibility for the clients that want to end all transitions via internet, the same as in the physical outlet but without waiting in line and coming to the bank:
  - Opening sets of accounts;
  - Submitting the applications for payment cards;
  - Overdraft application at client’s selection:
    - Digital signing,
    - Delivery of agreements to home address, or
    - Going to the outlet.

This is not all in development of “KOMeCENTRE”, on the contrary, the work on developing new possibilities for the clients is largely underway, and will soon be finished, such as:

- Savings.
- Permanent orders.
- Payments abroad.
- On-line loans.

Since the beginning of operation of “KOMeCENTRE” until the end of 2017, the clients placed 2.363 applications, with 78% of these approved. The major interest was for the set of accounts, 44% and overdrafts 42%, of all offered products to clients via “KOMeCENTRE”. Interesting thing is that, in terms of signing documentation, most clients still opt for coming to the outlet, no less than 82%, while the delivery of documents to home address for signing was used by 12% of clients, and only 6% chose to electronically sign documents.

- In 2017, as part of promoting of benefits for the clients who would choose to open Premium current account, which goes with Gold “Master” debit card, debit contactless card, the Division contributed by directly helping the colleagues from sales by directly negotiating with several first-class traders, who offered special benefits for our clients paying by this type of card (Gold). All these activities led to very significant result, it being that a number of Gold cards increased by more than 56%, with directly contribute to the strategic direction of attracting clients that have higher purchasing power.
- November 2017. Account packages launched for micro-legal entities, "Kombank Standard current account" and "Kombank Expert current account". These accounts were formed on the basis of a comprehensive analysis of the needs and demand of this type of clients, by combining several different products. These accounts were well accepted by clients and introduced the innovation and refreshment to the market because they offered banking products of highest importance and use to this segment of clients. This project was fully implemented according to the plan, with limited resources, and exceeded the expectations, which was shown through demand and realization. In just over two months since the launch, 1,712 sets of accounts have been opened.
- In the course of 2017, the concept was developed resulting in publishing "Ecosystem for Payments", which is now underway, in the testing phase and should soon be put into practice. This system brings a brand new payment model and promotes ease of payment to customers. This product offers customers the ability to make payments via the Internet not only by payment cards, as before, but by direct transactions from their current account, which belongs to the domain of the so-called instant payments. This system will be named "KOM4PAY", alluding to comfortable payment, which is the essence of this product. In addition to the conventional "on-line" channel, this system will also be available through a mobile application that will be independent of the mBank application. Expected implementation time is the first quarter of 2018.
- During the second half of 2017, the development of the offer of “KOMeCENTRE” continued through new opportunities for clients that will soon be completed, such as the options already mentioned: savings, standing orders, payments abroad and online loans.

*6.6. Omnichannel Distribution Division*

The omnichannel distribution division actively participated and made outstanding contributions in digital banking projects, in the field of improving the overall supply of the Bank, improving the Bank's competitiveness on the market, improving security, optimizing business operations, and in addition to these results, the following:

- WEB and mobile banking for microbusiness and small and medium enterprises "KOmBANK BIZ" has been implemented. As one of the first banks in the market with the offer of this type in two months, we managed without any marketing campaign to activate about 1,000 users.
- An ANTIFRAUD solution for detecting suspicious and preventing malicious eBank transactions has been implemented. With this solution, the Bank provided additional security for its clients in performing electronic banking and provided additional comfort in the work.
- A module for the exchange of electronic invoices between legal entities was implemented and in this way clients who exchange a large number of invoices made savings in the segment of printing, sending, archiving of paper invoices.
- The total number of e-banking users-legal entities increased by 1,235, or 6% more than in 2016, and the number of active e-Bank users-legal entities increased by 966, or 8% compared to the previous year.
- The total number of e-transactions executed increased by 6%, which is about half a million transactions more than in the previous year.
- The share of eBank in the total payment operations of the Bank increased by 1.28% and amounted to 85.77%.
- Cost of eBank for legal entities decreased by 23%, i.e. 29 million dinars compared to 2016.
- The number of e-banking users-physical persons increased by 27,000, or 28% compared to the previous year.
- The total retail turnover of eBank in the segment of retail clients increased by 29% compared to 2016.

- The number of mBank users-physical persons/retail clients has increased by 128% and now amounts to 62,309.
- Despite the increase in the number of mBank retail users of 128%, the costs have been reduced by 6%, i.e. by one million dinars.
  The total turnover of mobile bank transactions for retail clients has been duplicated.
- Digital office "KOMeCENTRE" has been introduced.
- An online "opening" account for new clients has been introduced.
- Clients were given the possibility of "on-line" application for the set of current accounts, allowed overdrafts and payment cards with deferred payment.
- In the past 8 months, the Digital Branch had 4,573 "on-line" applications.
- The number of missed calls at the Contact Centre of the Bank decreased by 55% and in 2017 there were 1,014 missed calls.
- The average call time in the Contact Centre of the Bank has been reduced to 12 seconds.

## 6.7. Payment Cards Division

In 2017, the Payment Card Division implemented a number of new products / services for the clients of the Bank, with particular emphasis on the following:

- "KOMePAY" digital card - Card implemented under the mBank of Komercijalna Banka's application, which enables the contactless payment using a mobile phone.
- mPOS terminals - by implementing this type of terminal Komercijalna Banka has singled out as the only bank on the market with this type of terminal.
- Enabling e-commerce payments on the eGov portal - Komercijalna Banka is the first bank in the market that enabled payment by "DINA" cards on the Internet.
- Withdrawal of the EUR (Euro) currency at the ATMs of the Bank - In this way, the Bank has enabled its clients an efficient channel for raising funds in the EUR currency. In addition to the dinar, the Bank's clients can also withdraw the EUR currency through ATMs.

In addition the above-listed results, the following were also achieved, compared to 2016:

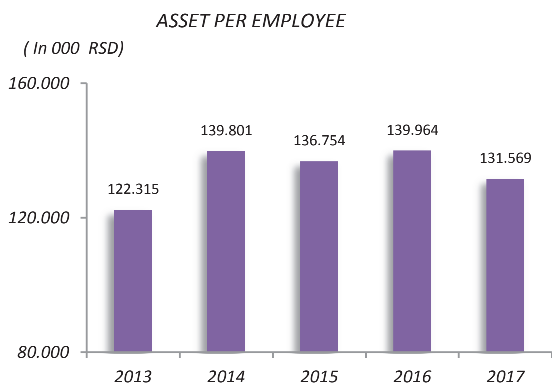
- increase in the number of POS terminals by 25%;
- growth in turnover at POS terminals by 23%;
- growth in turnover on ATMs by 10.94%;
- increase in the number of issued cards by 13%;
- card turnover growth by 11%;
- growth of interest-free instalment sales of 14.6% (realized on a total of 1.863 locations in relation to 2016, when the number of locations was 1.626), while the increase in turnover of interest-free instalment sale was 26.8%.

*Conclusion*

KB continued the successful work focused on digitization projects, projects of development and improvement of existing services, monitoring of the latest positive world trends in banking, adjustment to the conditions on the domestic market and creation of innovative and modern solutions for the needs of the target groups of clients, with the aim of achieving a better market position of the Bank. All of the above contributes to stable business of the Bank, with planned growth, and providing the sales segment with have high quality products and arguments that will retain the old clients, but will primarily acquire the new ones.

## 6.8. KB's Human Resources

The Human Resources Management Mission at Komercijalna Banka is to develop and maintain a high level of professionalism and motivation of employees in order to realize the Bank's business plans. With the continuous optimization of the number and structure of employees in recent years, the Bank's efficiency, measured by assets per employee, has also increased significantly. The Bank continuously invests in employee training and development.



During 2017, a development program aimed at developing talents was implemented, called the Kombank Academy, designed to identify and develop the leadership potential of its employees. The first generation of the Academy met its objective, which was in the area of development and improvement of the professional knowledge of the students. The programs were structured multidisciplinary with an approach that provided students with an insight into the whole banking processes and support activities and a deeper understanding of banking operations.

The program was divided into several segments: professional training through 6 modules, testing of knowledge, creation and realization of individual development plans, training Time and stress management, business case management. Participants who took part during the entire period of the Academy program attended professional training Project Management.
The program included the preparation and analysis of professional profiles of participants, as well as the development and implementation of individual development plans. Given that this program is of high importance for the overall operations of the Bank, the Human Resources Sector has started planning the program for the second generation of Kombank Academy participants.

Such an integrative approach to the management and development of skills and skills of employees influences the improvement of motivation, loyalty, interpersonal relationships and team spirit among employees working in different organizational units.

Development activities in 2017 indicate the continuation of a qualitative and proactive approach to the realization of training, based primarily on identifying training needs and adapting training contents, defining and providing internal training, organizing internal and external training, measuring and improving the quality of training and training process.

<table>
<tr><td>Number of employees</td><td colspan="5">2.806</td></tr>
<tr><td>Network</td><td colspan="5">1.707</td></tr>
<tr><td>Divisions</td><td colspan="5">1.099</td></tr>
<tr><td rowspan="2">Gender</td><td colspan="2">Male</td><td colspan="3">Female</td></tr>
<tr><td colspan="2">751</td><td colspan="3">2.055</td></tr>
<tr><td rowspan="2">Work relation status</td><td>Full time</td><td colspan="2">Part-time</td><td colspan="2">Standstill</td></tr>
<tr><td>2.710</td><td colspan="2">92</td><td colspan="2">4</td></tr>
<tr><td rowspan="2">Educational structure</td><td>Faculty</td><td>College</td><td>High school</td><td colspan="2">UN/SQ/HS worker*</td></tr>
<tr><td>1.245</td><td>643</td><td>891</td><td colspan="2">27</td></tr>
<tr><td rowspan="2">Age structure</td><td>20-30</td><td>31-40</td><td>41-50</td><td>51-60</td><td>61+</td></tr>
<tr><td>87</td><td>1.029</td><td>786</td><td>826</td><td>78</td></tr>
</table>

* Unqualified / semi-qualified/ highly-skilled workers

The Bank attaches special attention to the organization of internal and external professional training, external and internal "skills" trainings, which aim to develop the skills of employees that are necessary for their successful performance. Observed by the subject of training, the most frequent are professional trainings aimed at acquiring new and improving existing knowledge. According to the criterion of the importance of the topic and the scope of training in terms of the number of participants, the most important trainings during 2017 were:
a) internal professional: Prevention and Money Laundering and Terrorist Financing, Operational Risks and Self-Assessment Preparation, Annual Evaluation of Employees, Emergency Situation Prevention, Client Complaints and Code of Conduct;
b) External professional: Products and applications of "Generali" insurance, training for the insurance agent, Cash flow management.

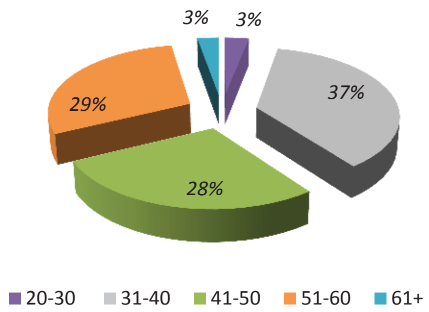
In 2017, the HR department launched an initiative to maintain internal skills trainings - Efficient Leadership, Assertive Communication, Stress Management, Time Management - that were attended by a total of 228 employees, while 294 employees attended external "skills" trainings, and most often on the topic of Leadership Skills, How to Become a Partner with a Client, Sales Skills and Sales Coaching. This year, six internal "on-line" trainings were organized and 5,999 employees were tested, namely: OFAC sanctions, Deposit insurance, establishing business cooperation with individuals, Micro client sets, Financing retail clients, testing for employees in the network from outlets authorized to work with securities.

Observed by the subject of training, the most frequent are professional trainings aimed at acquiring new and improving existing knowledge.

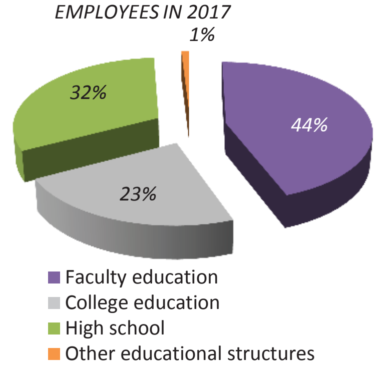
Since 2008, the Bank has been carrying out an annual evaluation of performance of employees based on the set of annual goals, monitoring the achievement of these goals, as well as proved capabilities of the employees in achieving the goals. The annual evaluation of employees' work is also the basis for rewarding, career planning of employees and budget planning and the Employee Training Program.

The principles of remuneration of employees are clearly defined by the Remuneration Policy adopted by the Bank's Board of Directors at the proposal of the Compensation Committee, a body of the Board of Directors. The aim of this policy is not only to adequately reward employees, but also motivate them to achieve better results.

*AGE STRUCTURE OF EMPLOYEES 2017*




*(EDUCATIONAL) QUALIFICATION STRUCTURE OF EMPLOYEES IN 2017*



## 6.9. Balance sheet of the Bank as at 31 December 2017

| No. | BS ITEM | 31.12.2017. | 31.12.2016. | INDICES | % OF SHARE AS OF 31.12.2017. |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| | **ASSETS** (in 000 RSD) | | | | |
| 1. | Cash and funds held with Central Bank | 49.840.887 | 55.153.209 | 90,37 | 13,50 |
| 2. | Pledged financial assets | - | - | - | - |
| 3. | Financial assets at fair value through P&L intended for trading | 5.269.709 | 242.920 | 2.169,32 | 1,43 |
| 4. | Financial assets initially recognized at fair value through profit and loss | - | - | - | - |
| 5. | Financial assets available for sale | 112.019.058 | 136.123.853 | 82,29 | 30,34 |
| 6. | Financial assets held until maturity | - | - | - | - |
| 7. | Loans and receivables from banks and other financial institutions | 29.543.789 | 40.601.413 | 72,77 | 8,00 |
| 8. | Loans and receivables from customers | 153.897.367 | 150.411.409 | 102,32 | 41,69 |
| 9. | Changes in fair value of items subject to risk protection | - | - | - | - |
| 10. | Receivables from financial derivatives intended for risk protection | - | - | - | - |
| 11. | Investments in subsidiaries and joint ventures | - | - | - | - |
| 12. | Investments in subsidiaries | 2.611.859 | 2.611.859 | 100,00 | 0,71 |
| 13. | Non-tangible investments | 460.263 | 362.507 | 126,97 | 0,12 |
| 14. | Property, plant and equipment | 5.655.248 | 5.856.458 | 96,56 | 1,53 |
| 15. | Investment property | 1.988.608 | 2.217.816 | 89,67 | 0,54 |
| 16. | Current tax assets | - | - | - | - |
| 17. | Deferred tax assets | 857.096 | - | - | 0,23 |
| 18. | Fixed assets intended for sale and assets from discontinued operations | 241.148 | 183.170 | 131,65 | 0,07 |
| 19. | Other assets | 6.798.506 | 6.252.855 | 108,73 | 1,84 |
| | **TOTAL ASSETS (from 1 to 19)** | **369.183.538** | **400.017.469** | 92,29 | 100,00 |

| No. | BS ITEM | 31.12.2017. | 31.12.2016. | INDICES | % OF SHARE AS OF 31.12.2017. |
|---|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 | 6 |
| | **LIABILITIES** (in 000 RSD) | | | | |
| 1. | Financial liabilities at fair value through profit & loss intended for trading | 7.845 | - | - | 0,00 |
| 2. | Financial liabilities initially recognized at fair value through profit and loss | - | - | - | - |
| 3. | Liabilities based on financial derivatives for risk protection | - | - | - | - |
| 4. | Deposits and other liabilities to banks, other financial organizations and the central bank | 4.532.505 | 7.834.962 | 57,85 | 1,23 |
| 5. | Deposits and other liabilities to other customers | 292.471.640 | 322.621.360 | 90,65 | 79,22 |
| 6. | Changes in fair value of items subject to risk protection | - | - | | |
| 7. | Issued treasury shares and other borrowed funds | - | - | | |
| 8. | Subordinated liabilities | - | 6.178.390 | - | - |
| 9. | Provisions | 1.368.051 | 1.787.294 | 76,54 | 0,37 |
| 10. | Liabilities intended for sale and operating funds from discontuned operations | - | - | | |
| 11. | Current tax liabilities | - | - | | |
| 12. | Deferred tax laibilites | - | 23.592 | - | - |
| 13. | Other liabilities | 7.543.442 | 6.147.569 | 122,71 | 2,04 |
| **14.** | **TOTAL LIABILITIES ( from 1 to 13)** | **305.923.483** | **344.593.167** | 88,78 | 82,87 |
| | **CAPITAL** | | | | |
| 15. | Share capital | 40.034.550 | 40.034.550 | 100,00 | 10,84 |
| 16. | Treasury shares | - | - | | |
| 17. | Profit | 8.137.249 | 349.698 | 2.326,94 | 2,20 |
| 18. | Loss | - | 8.063.183 | - | - |
| 19. | Reserves | 15.088.256 | 23.103.237 | 65,31 | 4,09 |
| 20. | Ungenerated losses | - | - | | |
| 21. | Non-controlling share | - | - | | |
| **22.** | **TOTAL CAPITAL (from 15 to 21)** | **63.260.055** | **55.424.302** | 114,14 | 17,14 |
| **23.** | **TOTAL LIABILITIES (14+22)** | **369.183.538** | **400.017.469** | 92,29 | 100,00 |

## 6.10. Statement of Proft & Loss of KB for 2017

| No. | BALANCE SHEET ITEM | 31.12.2017. | 31.12.2016. | INDICES |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| | **INCOME AND EXPENSES FROM ORDINARY OPERATION** (000 RSD) | | | |
| 1.1. | Interest income | 14.052.436 | 16.689.075 | 84,20 |
| 1.2. | Interest expenses | -1.606.239 | -3.226.341 | 49,79 |
| 1. | **Net interest income** | **12.446.197** | **13.462.734** | 92,45 |
| 2.1. | Fees and commission income | 6.700.216 | 6.252.370 | 107,16 |
| 2.2. | Fees and commission expenses | -1.617.990 | -1.435.056 | 112,75 |
| 2. | **Net fees and commission income** | **5.082.226** | **4.817.314** | 105,50 |
| 3. | Net gain on trading assets | 103.798 | 70.478 | 147,28 |
| 4. | Net gain / loss (-) based on risk protection | - | - | - |
| 5. | Net gain / loss (-) from financial assets initially recognized at fair value through profit and loss | - | - | - |
| 6. | Net profit / loss (-) from available-for-sale financial assets | 44.323 | 69.062 | 64,18 |
| 7. | Net expenses from exchange rate differences and effects of contractual currency clause | -56.358 | -9.282 | 607,18 |
| 8. | Net gain / loss (-) based on investments in subsidiaries and joint ventures | 306 | 5.143 | 5,95 |
| 9. | Other operating income | 937.777 | 573.235 | 163,59 |
| 10. | Net income / expense (-) based on impairment of financial assets and credit risk-bearing off-balance sheet items | 17.883 | -14.907.539 | - |
| 11. | **TOTAL NET OPERATING INCOME** | **18.576.152** | **4.081.145** | 455,17 |
| 12. | Costs of salaries, compensation of salaries and other personal expenses | -4.520.197 | -4.498.212 | 100,49 |
| 13. | Depreciation costs | -563.582 | -666.025 | 84,62 |
| 14. | Other expenses | -6.305.123 | -7.294.544 | 86,44 |
| 15. | **PROFIT / LOSS (-) BEFORE TAX (from 1 to 14)** | **7.187.250** | **-8.377.636** | - |
| 16. | Income tax | | - | - |
| 17. | Profit from deferred taxes | 1.335.828 | 314.453 | 424,81 |
| 18. | Loss from deferred tax | -405.710 | | - |
| 19. | **PROFIT / LOSS (-) AFTER TAX (from 15 to 18)** | **8.117.368** | **-8.063.183** | - |
| 20. | Net profit from discontinued operations | | - | - |
| 21. | Net loss from discontinued operations | | - | - |
| **22.** | **RESULT OF PERIOD PROFIT / LOSS (-) (19 to 21)** | **8.117.368** | **-8.063.183** | - |

## *7. INVESTMENT IN ENVIRONMENT PROTECTION*

The Bank observes the highest international standards and values when creating financial products and services and develops and implements activities to protect the environment and to protect human and labour rights. In its Policy and Procedure of Environmental and Social Risk Management, the Bank set out standards for identifying, monitoring and managing environmental and social risks in the loan approval and monitoring process. The aim of the environmental risk management system is to incorporate this system in the lending activity and loan monitoring process, thus increasing the opportunities for environmentally acceptable and sustainable economic development and minimising any adverse environmental and social impact.

The Bank has also defined a procedure for handling and replying to complaints arising from direct or indirect environmental and social impact of the Bank's operations.
Under the credit lines it had agreed to finance investment in increased energy efficiency and renewable energy development, the Bank has been approving loans which contribute to lower energy consumption and lower $CO_2$ emissions. The Bank did not draw any new credit lines for energy efficiency projects from international financial institutions in 2017.

The Bank demands of its customers to run their business in compliance with the applicable environment protection, health care and safety regulations where applicable, EU standards and other standards of good international practice, which are in line with the requirements of the EBRD and IFC standards. To ensure consistent application of standards, the Bank uses a list of industries, projects and activities excluded from financing by the Bank and activities which may be finance by the Bank only after obtaining prior approval in writing from the EBRD. With the approval of International Financial Institutions, the Bank operates in compliance with the defined lending limits in relation to the following activities: alcohol production and trade, tobacco and manufactured tobacco production and trade and gambling. Production of and trade in weapons and ammunition are excluded from financing by the Bank.

The approaches to environmental risk and social risk management involves two levels of management: the level of individual loans and the level of the entire portfolio. In respect of every business activity of its customers, the Bank assigns a risk level or category based on its environmental and social impact.
In the loan approval process, in compliance with the requirements of international financial institutions and the legislation relevant for environment protection, the Bank categorises its customers' applications based on environmental and social impact using the Environmental and Social Risk Categorisation List.
The Bank monitors the structure of its portfolio and the share of risk categories in terms of environmental and social impact. Monthly reports are submitted to the Credit Committee, the Audit Committee and ALCO, while the Board of Directors receives quarterly reports on exposure to environmental and social impact risk. The Bank also continually monitors any extraordinary events at its customers that may have adverse environmental, health or safety impact or adverse impact on the community in general and regularly reports its findings to the Bank's managing bodies and shareholders.

## *8. SIGNIFICANT EVENTS AFTER THE FINANCIAL YEAR*

Between 31 December 2017 and the end of February 2018, the General Meeting of Shareholders held one session.
A regular General Meeting of Shareholders was held on 29 January 2018. It passed the following decisions:
- Decision on release from duty and appointment of a member of the Board of Directors of Komercijalna banka AD;
- Decision on release from duty and appointment of the Chairperson of the Board of Directors of Komercijalna banka AD;
- Decision on adoption of the Bank's Strategy and Business Plan for 2018-2020.

A description of the events after the financial year is provided in item "Events after the Balance Sheet Date" in the Notes to the 2017 Financial Statements.

## 9. PLAN FOR BANK'S FUTURE DEVELOPMENT

The main pillars of the Bank's development strategy for the next three years are as follows:

- Growth of lending to customers (as a key aspect of future profitability),
- Control of business risks in the future to maintain a low net impairment charge (because of the significant credit loss posted in 2015 and 2016),
- Improvement/change of the customer structure in terms of demographics and standard (taking into account the development of innovative products), so that, in addition to large corporates, the Bank intends to further develop its business with local self-governments, SMEs and customers from neighbouring countries,
- Increasing the share of fee and commission income relative to interest income (the Bank will increasingly focus on fee and commission income because of the downward trend of interest rates and because of digitalisation and other development initiatives it is implementing),
- Capping operating expenses and further increase in operating efficiency to ensure a sustained decline in the cost-to-income ratio (CIR) throughout the period covered by the plan,
- Maintaining an adequate capital position, with the distribution of accumulated dividends from earlier years and dividend from planned profit in the next three-year period.

**Retail**

In the coming period, the Bank intends to:

- Increase the number of credit customers, primarily through better utilisation of the existing customer base by implementing and improving software tools for retail banking,
- Further expand its customer base with regular salary or pension inflow,
- Shift the customer structure towards a greater focus on wealthier customers with better creditworthiness and attract the younger population as the basis for future lending growth,
- Focus on cross selling of bundled products or services to increase revenue per customer,
- Implement new proactive sales campaigns, including lending based on preliminary approval,
- Increase cash and mortgage lending, as these credit products are in highest demand, and increase current account overdraft loans as its most profitable product,
- Modify its products for micro enterprises and sole traders to keep abreast of market developments in order to maintain the required level of competitiveness,
- Maintain its leading position in the farmer loan market. Lending activity will focus on loans for equipment purchase and agricultural land purchase, as well as on keeping up with IPARD lending activities,
- Expand its product range by introducing products to finance non-current assets of farms, designed primarily to support the development of secondary agricultural production and improve the standard of living on farms,
- Introduce scoring for farms and begin preparations for introducing the same in the micro segment,
- Maintain its current position in the retail savings segment,
- Continue the ongoing efforts to digitalise its operations and implement new banking technologies.

One of the Bank's main strategic objectives for the coming period is to improve customer structure by attracting customers with higher purchasing power, which we intend to achieve by offering new innovative products and services such as Premium current account sets.
Another important objective in the Retail segment is to rejuvenate the customer portfolio, which is why we have developed Start current account sets.

In recent years, the Bank saw a significant increase in retail FX deposits, making it a leader in forex savings. The planned growth of retail deposits in the following period is somewhat lower than in recent years, due among other things to the offering of new government securities intended for domestic natural persons (savings bonds of the Republic of Serbia).
The Bank plans to increase its interest income from retail operations in 2018. The anticipated decline in lending interest will be offset by

increased lending, in particular through cash loans.

Fee and commission income is expected to increase in 2018 due to the stable growth of card operations and retail current account maintenance fees.

The expected GDP growth of approximately 3% will create a more favourable business climate for micro enterprises and sole traders. The Bank will make efforts to have a suitable offering of credit products for these clients at all times. An ongoing task is to make the process of making credit decisions faster, which will be achieved through new software applications, implementation of a new scoring model and the use of automatic and preliminary approval.

**Corporate**

In the coming period, the Bank intends to:

- Improve its utilisation of the existing corporate customer base,
- Increase efficiency of the corporate lending procedure,
- Preserve the quality of its loan portfolio,
- Expand its product range by launching new products,
- Increase its off-balance sheet portfolio (letters of credit and guarantees),
- Maintain its profitability at the projected level.

The Bank expects the business environment in 2018 to remain unchanged from 2017. The anticipated GDP growth will be due mainly to the operations of customers in export-oriented industries and due to the inflow of foreign direct investment.

The banking sector is expected to remain highly liquid during the planned period, as a result of the lack of demand by creditworthy customers on the one hand and continuing wariness of borrowing on the other. Instead of borrowing from banks, creditworthy companies will try to cover some of their asset shortfall from alternative financial arrangements (direct financing by International Financial Institutions (IFI), EU pre-accession programmes, various state programmes, the Development Fund of the Republic of Serbia etc.).

The period behinds us was characterised by a significant decline in lending interest rates. The Bank expects lending interest rates to stabilise and sees room for further interest rate cuts only in lending to first-class customers.

Public enterprises and local self-governments will remain crucial customers in the coming period. Lending to these groups of customers is characterised by price competition among banks and constant striving towards a faster lending process (through simplified credit analysis procedures and methodologies).

The Bank anticipates significant lending growth in the SME segment. This will be funded both from the Bank's own funds and from credit lines and funds provided by international financial institutions (EIB - APEX III/B programme, EIF COSME programme etc.).

The focus in the forthcoming period will be on the regions of Belgrade and Vojvodina, due to the high concentration of corporate customers in these regions.

Lending growth in the coming period is expected in food industry, agriculture with ancillary activities, the services sector (trade, transport), energy and construction, driven by the execution of large infrastructure projects.

The Bank also plans to be more involved in syndicated loans (joint lending with other banks) for large private- and public-sector projects, as well as project loans in the real estate segment.

The Bank will remain open to providing loans pursuant to large loan applications by public- and private-sector customers through cross-border finance in the coming period. As before, the Bank will engage in these activities in coordination with its subsidiaries in Montenegro and Bosnia and Herzegovina.

The plan for off-balance sheet portfolio growth (guarantees, letters of credit etc.) will depend on the execution of major infrastructure and construction projects and the choice of contractors for their execution. The Bank will aim to introduce additional services in the coming period based on trade finance instruments (factoring of loro letters of credit, pledge on claims arising from loro letters of credit etc.).

**Securities trading**

In an effort to complete its product offering, the Bank has been improving its securities trading segment for some time. In this context, the Bank intends to:

- Implement improvements to the Kombank Trader web application for online securities trading in foreign stock

exchanges and to enable customers to trade using Android-based applications on their mobile phones and portable computers,
- Promote issuing of orders by phone – an option that went into production in December 2017,
- Enable the taking of collateral made up of investment units of the KomBank Money Fund for trading in domestic and foreign stock exchanges using the Kombank Trader application,
- Implement automation of back-office cash balancing of transactions with foreign stock exchanges,
- Improve its dealer operations involving government debt securities by more frequent trading through the trading ledger and expansion of its customer base for dealer operations to include customers in the banking, insurance and investment fund segments,
- Further expand the range of financial products it offers (derivatives, currency pairs).

**Profitability**
- Stable interest income,
- Fee and commission income growth,
- Opex control and
- Low expense for indirect loan write-off.

In the past period, Serbia's banking sector saw a significant decline in both lending and borrowing interest rate. As a result, interest rate margin was significantly squeezed interest margin. Neither lending nor borrowing interest rates are expected to drop significantly in the future.
Net interest income at the end of 2018 is expected be slightly below the 2017 level. To maintain and increase profitability in the coming period, the Bank will make efforts to increase fee and commission income, primarily from payment system transactions, foreign exchange purchase and sale and issuing of L/Cs and guarantees.
Similarly as in earlier years, focus in the period covered by the plan will be on the amount of operating expenses, which will result in a further reduction of the cost-to-income ratio.
After the significant impairment costs in 2015 and 2016, the Bank does not expect any major impairment costs in the next three years.

In view of the foregoing, the Bank plans profitable operations and adequate return on assets and equity in the next three-year period.

**Asset management *("Treasury")***
The Bank's strategy with regard to asset management in the coming period includes:
- Active management of the total securities portfolio,
- Optimising credit line funds and
- Contributing to profitable operations of the Bank.

As a result of lack of quality demand in the past period, a significant share of the bank's assets is invested in highly liquid and risk-free securities (treasury bonds and bills of the Republic of Serbia). The Bank does not plan any further significant increase in its investment in securities; instead, it intends to reinvest the funds freed from securities in instruments with longer maturity periods. This will mitigate the adverse effect of declining interest rates, especially on securities with shorter maturity periods.

Due to the amount of retail and corporate deposits and the lack of quality demand for loans, the Bank had lower demand for foreign credit lines. To optimise its liabilities and cut interest expenses, the Bank prepaid some of the credit lines. Optimisation of credit lines will continue in the coming period: the Bank will repay credit lines with high interest upon maturity and will borrow new credit lines only if there is interest among creditworthy customers for loans under those credit lines.

Based on the foregoing, the Bank's objectives with regard to asset management include having access to adequate liquidity reserves at all times in the form of highly-liquid assets that are readily convertible to cash. Any surplus liquid assets will be invested in low-risk securities or lent to other first-class financial institutions to generate appropriate income. Innovative product development and foreign exchange purchase and sale in the money and capital markets will also generate an appropriate level of net fee income.

**Deposit potential**
The main sources of the Bank's deposit potential will remain:
- Retail forex savings, as the dominant source of finance in the forthcoming period,
- Deposits by corporate customers and financial institutions and
- Funds obtained in the form of credit lines from international financial institutions.

For many years, the Bank has stood out in the banking sector for the amount of its retail forex savings. The Bank's strategic commitment is to maintain its leading position in this segment and to remain among the leading banks in terms of retail forex savings, coupled with efforts to optimise the cost and structure of this source of finance. The Bank intends to continue with its retail forex savings policy based on a large number of deposits with small individual deposits.

Corporate deposits have remained stable over a longer period and it is expected that new loan customers would transfer their deposits to the Bank, which would result in an increase in corporate deposits.

Due to its recognised and stable market position, the Bank is able to apply for finance with international financial institutions in the form of designated credit lines.

The Bank will use this source of finance to the extent of its ability to generate loan products acceptable to the market from them.

## *10. RESEARCH AND DEVELOPMENT*

The financial market was characterised by intensive development of digitalisation during the past year. Keeping abreast of these events and market changes, the Bank prioritised digital banking, both in terms of developing new products and services and in terms of improving and modifying the existing ones, to maintain its leading market position, which is reaffirmed by surveys. Komercijalna banka has made significant improvements in the e-banking and m-banking segments.

The market positioning of the Bank as a brand and of its products and services were again checked in 2017 through the Banking Omnibus, carried out by the opinion polling agency IPSOS, which specialises in surveys of this type. According to the surveys, the Bank has held a leading position in public perception for quite some time, as measured by the criteria of brand recognition, product and service quality and customer satisfaction. All survey results are posted on the Bank's internal Portal and are also presented to focus groups, in order to further strengthen the Komercijalna banka brand.
According to the most recent Banking Omnibus (November 2017), the respondents rated Komercinalna banka Beograd second among the 15 leading banks in Serbia in terms of brand recognition.

Top banks in Serbia:

## *11. REDEMPTION OF OWN SHARES AND EQUITY HOLDINGS*

The Bank has no redeemed own shares as at 31 December 2017 and had not held any redeemed own shares in 2017.

In addition, the Bank does not intend to redeem own shares in the coming period.

## *12. FINANCIAL INSTRUMENTS RELEVANT FOR ASSESSING FINANCIAL STANDING*

The following balance sheet positions are key for a proper assessment of the Bank's financial standing at the end of the financial year 2017:

- On the asset side:
  - Loans to and receivables from customers,
  - Loans to and receivables from banks and other financial organisations,
  - Available-for-sale financial assets
  - Cash and assets with the Central Bank.
- On the liability side:
  - Deposits and other liabilities to other customers,
  - Deposits and other liabilities to banks, other financial organisations and the Central Bank,
  - Equity.

Loans to and receivables from customers, banks and other financial organisations at 2017 year-end amounted to RSD 183,441.2 million and accounted for 49.7% of total balance sheet assets. At 2016 year-end, loans and receivables amounted to RSD 191,012.8 million and accounted for 47.8% of total assets. In the past year, the Bank focused in particular on its risk management policy, since loans and advances accounted for nearly 50% of total assets, with emphasis on credit risk. During the past year, credit and receivables were reduced by RSD 7,571.7 million, or by 4.0%. In 2017, the Bank again managed a large credit portfolio, which was secured by an appropriate amount of impairment allowance and reserve.

Available-for-sale financial assets amounted to RSD 112,019.1 million at 2017 year-end, accounting for 30.3% of total assets. Relative to 2016 (RSD 136,123.9 million, 34.0% of total assets), they were RSD 24,104.8 million down. Available-for-sale financial assets comprise mainly treasury securities of the Republic of Serbia – RSD and EUR-denominated bonds.

At 2017 year-end, cash and assets with the central bank amounted to RSD 49,840.9 million and were RSD 5,312.3 million or 9.6% down compared with the beginning of the year. This position comprises mainly transfer account funds (30.2%) and funds held with the National Bank of Serbia as statutory reserve (55.9%). This position declined as a result of higher investment of the Bank's free assets in securities.

Taking into account the asset structure, it appears that assets sensitive to credit risk was maintained at an optimum level, with a sensible risk-taking policy. Through a much more restrictive credit risk assessment in the past two years, the Bank's management safeguarded its loan portfolio and ensured that financial statements realistically reflect the actual situation. The Bank's operations in 2017 were free from any significant burden arising from impairment expense for financial assets ad credit risk-weighted off-balance sheet assets.

Deposits and other liabilities to banks and other customers (included credit line funds) at 2017 year-end amounted to RSD 297,004,1 million, accounting for 80.4% of total balance sheet liabilities. Relative to the beginning of the year, deposits and other liabilities to other customers were RSD 33,452.2 million lower. The Bank's deposit potential comprises mainly forex deposits by natural persons. As at 31 December 2017, retail forex savings amounted to EUR 1,623.6 million and included a large number of small deposits. Notwithstanding the decline in borrowing 9interest relative to previous years, at 2017 year-end, retail forex deposits were EUR 33.1 million higher compared with 2016 year-end.

Deposits and other liabilities to banks, other financial organisations and the central bank at 2017 year-end amounted to RSD 4,532.5 million, accounting for 1.2% of the Bank's total liabilities, and were reduced by RSD 3,302.5 million.

As at 31 December 2017, the Bank had no subordinated liabilities, as it had repaid the IFC (International Financial Corporation) loan which it had obtained at the end of 2011 to strengthen its capital.

The Bank's total equity at 2017 year-end was RSD 63,260.1 million, which was 17.1% of its total liabilities. During the reporting financial year, total equity was increased by RSD 7,835.8 million, or 14.1%. This equity increase was the result of the profit generated in 2017. The Bank's reserves were reduced by RSD 8,015.0 million in 2017 due to the coverage of the 2016 loss.

The Bank had a capital adequacy ratio of 27.89% at 2017 year-end, which was above the statutory minimum (8%+required combined capital buffer).

In conclusion, in 2017 the Bank once again ensured the necessary diversification of its sources of finance from the viewpoint of stable and profitable operations.

## *13. RISK MANAGEMENT*

### 13.1. Goals and policies of financial risks management

Risk management is a key element of business management, since exposure to risks stems from all business activities, as an inseparable part of banking operations, managed through identification, measurement, evaluation, monitoring, control and mitigation, and risk reporting, or the establishment of risk limits, as well as reporting in accordance with strategies and policies.

The Bank has established a comprehensive and reliable risk management system that includes: strategies, policies and risk management procedures, individual risk management methodologies, appropriate organizational structure, effective and efficient process of managing all risks that the Bank is exposed to or exposed to in its operations, adequate internal control system, an appropriate information system and an adequate process of internal capital adequacy assessment. Also, in the risk management system, the Bank Recovery Plan is integrated as a mechanism for early identification of the situation of a severe financial disturbance in which the Bank can take measures or apply the defined recovery options in order to prevent entry into the early intervention phase in which the active participation has a regulator or improvement already worsened financial situation. Risk Management Strategy and Capital Management Strategy, the Bank set the following goals within the framework of the risk management system: minimizing negative effects on the financial result and capital, respecting the defined framework of acceptable level of risk, maintaining the required level of capital adequacy, developing the Bank's activities in accordance with business opportunities and market development in order to achieve competitive advantages, risk diversification to which the Bank is exposed, maintenance of NPL participation in total loans until accepted NPL level for the Bank, maintain a ratio of liquid assets to cover above the statutory regulations and internal limits. The Bank permanently monitors all announcements and changes in the regulatory framework, analyzes the impact on the level of risk and takes measures to timely align its business with new regulations, such as the implementation of the International Financial Reporting Standard 9 (IFRS 9). Through a clearly defined process of introducing new and significantly altered products, services and processes related to processes and systems, the Bank analyzes their impact on future risk exposure in order to optimize their revenues and costs for the estimated risk, and minimize any potentially adverse effects on the financial result Banks. A more detailed overview of the Bank's risk management objectives and policies is presented in point 4. Note to the financial statements.

*Credit risk exposure protecion policy*

In order to protect against exposure to credit risk, the Bank applies credit risk mitigation techniques by providing and providing collateral security instruments (collateral) as secondary sources of collateral. The Bank strives to deal with clients with good creditworthiness, assessing it at the moment of submitting the request and regular monitoring of debtors, placements and collaterals, in order to timely undertake appropriate activities in the collection process. Types of collateralisation depend on the credit risk assessment of the debtor, and are determined in each specific case individually, and their acquisition is done after the contract is concluded and before the realization of the placement.

By internal regulations, the Bank regulated the valuation of credit protection instruments and the management of these instruments.

When assessing the value of collateral, the Bank engages the authorized appraisers in order to minimize the potential risk of unrealistic valuation, and the immovable property, goods, equipment and other movable items that are the subject of inventory must be insured with an insurance company acceptable to the Bank, with insurance policies vinculated for the benefit of the Bank.

In order to protect against the change in the market value of collateral, the estimated value is adjusted for the defined percentage of impairment, depending on the type of collateral and the location of the real estate, which are regularly reviewed and revised.

The Bank devotes special attention to the monitoring of collaterals and undertakes activities to provide new valuation, but also to the provision of additional collaterals, primarily to clients with identified problems in the business, as well as clients whose coverage of exposure to collateral is reduced due to the collapse of the value of collateral.

For the purpose of adequate risk management, the Bank conducts credit risk analysis activities for the approval of placements and the establishment of a system for monitoring, preventing and managing risky placements, including the adequate identification of potentially risky clients (Watch List), alleviating credit risk in clients of the said status, as well as through taking measures and actions in order to protect the Bank's interests and prevent negative effects on the financial result and capital of the Bank.

During 2017, the Bank continued to improve the risk management system. The Bank revised the Risk Management and Risk Management Policy, supplemented the policies and procedures with the aim of aligning with the changes in domestic and international regulations. In line with the amended regulatory requirements, credit risk management has been improved. Also, the Bank made significant changes in the organizational structure (grouping the branches of the Bank into Business centers, organizational changes within the corporate and retail functions, changes in decision making methods - abolishment of credit committees by branches and the Credit Committee for Individuals, Microbusiness and Agriculture, Billing, Liquidity Committee and Investment Committee). At the level of the Bank one is identified, the Central Credit Committee, and within the Function of Risk Management, a Person with a decision-making authority has been appointed.

In 2017, the Bank focused on improving the quality of the loan portfolio by reducing the emergence of new bad loans and tackling the problems of clients that have already been identified as problematic and also implementing activities to reduce non-performing loans (improved collection, sale / transfer, and write-off by transferring entirely impaired receivables into off-balance sheet records). In accordance with the Decision of the National Bank of Serbia on the accounting write-off of the balance sheet assets of the bank (application dated September 30, 2017), the Bank transferred 100% of impaired loans from the balance sheet to off-balance sheet records and collected in a significant amount the risk loans, resulting in a decrease indicators of NPL.

Real growth in value adjustments (profit and loss) in 2017 was well below the planned value for 2017, as the collection of risky placements was twice as high as planned. Also, the small increase in value adjustments also affected the conservative placement policy in 2017. A significant reduction in value adjustments in the balance sheet is a consequence of the transfer of 100% of impaired placements from balance sheet to off-balance sheet records.

As of 01.01,2018, the Bank applies IFRS 9 standard and, in accordance with the above standard, has implemented a new Methodology for assessing the impairment of balance sheet assets and probable loss on off-balance sheet items. From the concept of "incurred losses" switches to the concept of "expected losses", the portfolio is differentiated into three levels (level 1-PL clients without identified credit risk, level 2-PL clients with identified credit risk deterioration, level 3-NPL clients). Exposure to the state of Serbia (the largest share of securities is also) has also been impaired. The Bank has aligned all relevant internal regulations in accordance with the application of IFRS 9 standards.

13.2. Exposure to Risks (Price, Credit, Liquidity and Cash Flow) with a Risk Management Strategy and Assessment of its Effectiveness

In its operations, the Group is exposed in particular to the following types of risk:

1. Credit risk and related risks;
2. Liquidity risk;
3. Market risk;
4. Interest rate risk on the bank ledger;
5. Operational risk;
6. Investment risk;
7. Exposure risk, and
8. Country risk, as well as any other risks that may arise in the Group’s operations.

***Credit risk*** is the risk of negative effects on the financial result and capital of the Bank caused by a debtor's failure to settle its liabilities towards the Bank. Credit risk is determined by the debtor’s creditworthiness, timeliness of his debt repayment to the Bank and the quality of collateral. The acceptable level of exposure to credit risk for the Bank is defined by the Risk Management Strategy and depends on the structure of the Bank’s portfolio; it limits the negative effects on profit and minimises capital requirements for credit risk, default risk, delivery risk and counterparty risk in order to maintain capital adequacy at an acceptable level. The Bank manages credit risk at customer level, at related group level and at the level of the entire portfolio. The Bank grants loans to those (corporate and retail) clients whom they consider to be creditworthy based on credit risk analysis and its quantitative and/or qualitative measurement and assessment. The process of credit risk measurement is based on measuring the risk level assigned to individual loans according to the internal rating system and in accordance with the applicable regulations of the National Bank of Serbia, which require the classification of each loan according to the statutory criteria and calculation of the required level of loan loss reserve. Through monitoring and control of its portfolio as a whole and by specific segments, the Bank makes comparisons with earlier periods, identifies trends and determines the underlying causes for changes in credit risk levels. The Bank also monitors asset quality indicators (NPL trends, loan loss provision coverage ratio etc.), as well as exposure according to the regulatory and internal limits. The process of loan quality monitoring allows the Bank's members to assess potential loss as a result of the risks to which they are exposed and to undertake remedial action. On the other hand, the Bank avoids high-risk investments, such as high-profit and high-risk projects, investment funds with a high-risk portfolio etc.

***Liquidity risk*** is the risk of negative effects on the Bank's financial performance and capital due to failure of its members to settle its liabilities as they fall due and to obtain liquid assets at short notice without major difficulties. Liquidity risk manifests itself as difficulty in settling the Bank's liabilities as they fall due meeting when liquidity reserves and the inability to cover unexpected outflows and other liabilities. In its operations, the Bank adheres to the core principles of liquidity by generating a sufficient level of liquid assets to cover their liabilities in the short term, i.e. it adheres to the principle of solvency by forming an optimum structure of own and borrowed sources of finance and forming sufficient liquidity reserves without jeopardising the planned return on equity. Liquidity risk also manifests itself as inability of the Bank to convert certain parts of its assets into liquid assets on short notice. The Bank conducts analyses of funding liquidity and market liquidity. The funding aspect of liquidity risk refers to the structure of liabilities and manifests itself as a potentially material increase in the share of unstable sources or short-term sources or their concentration. The funding liquidity risk is in fact the risk that the Bank would not be able to settle its obligations when due as a result of withdrawal of unstable funding and inability to obtain new funding. On the other hand, liquidity risk also manifests itself as a deficit of liquidity reserves and difficult or impossible access to liquid assets at acceptable market prices. In accordance with the Decision on Liquidity Risk Management by Banks, in effect since 30 June 2017, the Bank has brought its operations in compliance with the regulatory provisions pertaining to the liquidity coverage ratio (LCR). In 2017, the Bank complied with the regulatory and internal limits. The Bank actively undertakes preventive activities to minimise their exposure to liquidity risk.

***Market risk*** risk is the risk of negative effects on the financial performance and capital of the Bank caused by changes in market variables and includes foreign exchange risk relating to all of its operations and the price risk relating to trading ledger positions.

The Bank is exposed to ***foreign exchange risk***, which manifests itself as the risk of negative effects on its financial performance and capital due to foreign exchange volatility, changes in the value of national currency relative to foreign currencies or changes in the value of gold or other precious metals. To minimise its exposure to foreign exchange risk, the Bank diversifies the currency structure of its portfolio and the currency structure of labilities and matches open positions by specific currencies, in accordance with the principle of maturity transformation of assets. In 2017, the Bank complied with the regulatory foreign exchange risk indicator, which is set at 20% of regulatory capital.

***Interest rate risk*** is the risk of negative effects on the financial performance and capital of the Bank caused by adverse changes in interest rates, to which the Bank is exposed on the basis of items recorded in the bank ledger. The Bank comprehensively and timely identifies the causes of any current exposure to interest rate risk and assesses the factors of potential future exposure to this risk. Exposure to this type of risk depends on the ratio of interest-sensitive assets and liabilities. The aim of interest rate risk management is to maintain an acceptable level of exposure to interest rate risk from the aspect of its impact on financial performance and economic value of equity by applying an appropriate policy of maturity matching in the repricing period and by matching sources of finance with loans by types of interest rates and maturity.

***Operational risk*** is the risk of potential negative effects on the Bank's financial performance and capital due to omissions of its employees, inadequate internal procedures and processes, inadequate management of information systems and other systems at the Bank or due to unforeseeable external events. Operational risk also includes legal risk, which is the risk of potential negative effects on the Bank's financial performance and capital due to lawsuits or out-of-court proceedings. The Bank undertakes activities to mitigate operational risks and proactively respond to potential operational risk events through continual monitoring of all activities by implementing an appropriate and reliable information system designed to improve business practices and optimise the Bank's operating processes. To minimise legal risk and its effects on financial performance, the Bank continues improving its business practice as it pertains to timely provisioning against lawsuits against the Bank, based on an assessment of anticipated future loss on this basis.

The Bank's ***investment risk*** is the risk of investment in other legal entities and in fixed assets and investment properties. The level of non-current investment is monitored in accordance with the regulations and the Bank's Bodies and Committees are notified accordingly. This ensures that investments by the Bank in any entity outside of the financial sector do not 10% of the Bank's capital and that investments by the Bank in any entity outside of the financial sector and in fixed assets and investment properties of the Bank do not exceed 60% of the Bank's capital.

***Large exposure*** of the Bank to a single person or a Bank of related parties, including the Bank's related parties, is defined as any exposure the value of which is at least 10% of the Bank's equity. In 2017, the Bank complied with the regulatory and internal exposure limits.

***Country risk*** is the risk associated with the country of origin of a person to whom the Bank is exposed, i.e. The risk of potential negative effects on the Bank's financial performance and capital due to the Bank's inability to collect its receivables from debtors for reasons associated with political, economic or social circumstances in the debtor's country of origin. The Bank's exposure to country risk is at an acceptable level.

A detailed breakdown and explanation of the risks to which the Bank is exposed in its operations is provided in section 4 of the Notes to Financial Statements.

## *14. SOCIALLY RESPONSABLE OPERATIONS*

Corporate social responsibility (CSR) activities, carefully selected and supported by the Bank through active engagement with its partners, contributed greatly to maintaining and increasing the value of its corporate image. In 2017, the Bank continued its cooperation with the B92 Fund on its project "Together for Babies", which provides equipment to maternity clinics in Serbia. Thanks to this charity project, in 2017 funds were collected to equip the maternity clinics in Jagodina and Priboj, while the Medical Centre in Vrnjačka Banja received an ultrasound device, purchased in cooperation with Women's Association "Milica". Apart from its use in the medical examination of women, the device can also be used for hip examination in children.

We are the proud sponsors of the Athletics Federation of Serbia, as well as of Ivana Španović, the "Galeb" Taekwondo Team, Milica Mandić and Tijana Bogdanović. We were also present at the International Knights Festival "Despot Stefan Lazarević – Manasija 2017" and the Comedy Festival in Jagodina.

KOMBANK ART HALL, our gallery in Belgrade city centre, remained in the focus of the media and the public in 2017 through 14 conceptually different exhibitions, which were organised in collaboration with the Faculty of Applied Arts.

PR support is indispensable to modern market operations. The Bank had sound, clear and targeted communication with its stakeholders to ensure mutual understanding and build a favourable opinion of the company, thus maintaining the image and reputation it has earned.

### *Bank's marketing activities*

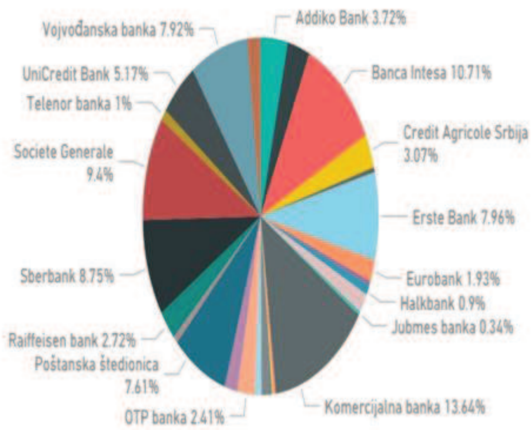
Under the 2017 Marketing Plan, we continued promoting our existing and new products and services, with constant brand reminders and rejuvenation. In 2017, we implemented a number of campaigns relating to the Bank's existing products and services, including cash and refinancing loans, loans to pensioners, agriculture loans, current accounts, credit cards etc. We also promoted a special offering of small business and entrepreneurship loans. We promoted the agriculture loans at the Agricultural Fair in Novi Sad and at a number of relevant events across Serbia.

Appropriate promotional activities also accompanied the launching of new products and services or improvement of existing ones, including m-banking and e-banking, KOMePAY virtual card, Kombank Trader application, Mikrokom loan and the KOMeCENTAR digital outlet.

The campaigns we implemented were integrated, i.e. they coordinated numerous communication channels through which we sent a clear and attractive message about the Bank and its product. In addition to the traditional communication channels, we also continued our comprehensive communication on the social networks, including Facebook, Twiter, Youtube, Google+, Instagram and Linkedin. This ensured maximum effectiveness of the promotions, since we utilised the advantages of both traditional and modern media.

All marketing activities are covered on our website, www.kombank.com, as well as on the Bank's social network accounts.

*Shares of media reporting on commercial banks (November 2017)*



## 15. *EXECUTION OF BANK'S 2017 BUSINESS PLAN*

### 15.1. Execution of the 2017 Balance Sheet

| No. | ASSET ITEM | ACHIEVED IN 2017 | PLAN FOR 2017 | INDICES |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| | **ASSETS** (in RSD million) | | | |
| 1. | Cash, cash equivalent and deposits with CB | 49,841 | 60,956 | 81,8 |
| 2. | Securities * | 117,289 | 106,108 | 110,5 |
| **3.** | **Loans and receivables from banks and other financial organisations** | **29,544** | **25,193** | 117,3 |
| 3.1. | Loans | 8,539 | 1,883 | 453,6 |
| 3.2. | Other loans and receivables | 21,005 | 23,310 | 90,1 |
| **4.** | **Loans and receivables from customers** | **153,897** | **167,842** | 91,7 |
| 4.1. | Corporate (loans) | 71,726 | 82,964 | 86,5 |
| 4.2. | Retail (loans) | 81,712 | 84,112 | 97,1 |
| 4.3. | Other loans and receivables (corporate+retail) | 459 | 766 | 60,0 |
| 5. | Investments in subsidiaries and affiliates | 2,612 | 2,612 | 100,0 |
| 6. | Fixed assets and investment property | 7,644 | 8,026 | 95,2 |
| 7. | Other assets | 8,357 | 6,093 | 137,2 |
| **8.** | **TOTAL ASSETS** | **369,184** | **376,830** | 98,0 |

**Note: The Item "Securities" includes Financial assets at fair value through P&L intended for trading, Financial assets initially recognized at fair value through P&L, Available-for-sale financial assets and Financial assets held to maturity.*

- The balance of cash and deposits with the Central Bank was lower than planned due to increased investment of free assets, primarily in securities.
- Securities were RSD 11,180.9 million higher than planned, as a result of increased investment in government securities of the Republic of Serbia.
- Loans to and receivables from banks and other financial organisations were higher than planned primarily due to the higher level of investment in repo transactions and the higher amount of lending to banks compared with the planned figures.
- Corporate loans underperformed compared with the planned level (-13.5%) due to lower-than-planned lending to SMEs and the prepayment of some loans.
- Retail loans were slightly lower than planned (-2.9%).
- The lack of loan portfolio growth was offset by higher-than-planned investment in securities (10.5%).
- Fixed assets and investment properties reached the planned figures.
- Other assets exceeded the planned figures (37.2 %), primarily as a result of posting of deferred tax assets (by utilising a tax benefit available under the Law on Corporate Income Tax), which had not been planned.

| No. | LIABILITIES ITEM | ACHIEVED IN 2017 | PLAN FOR 2017 | INDICES |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| | **LIABILITIES** (in RSD million) | | | |
| **1.** | **Deposits and liabilities to banks, financial org. and CB** | **13,493** | **16,795** | 80,3 |
| 1.1. | Deposits | 6,100 | 7,133 | 85,5 |
| 1.2. | Credit lines | 7,392 | 9,632 | 76,7 |
| 1.3. | Other liabilities | 1 | 30 | 2,1 |
| **2.** | **Deposits and other liabilities to customers** | **283,511** | **295,265** | 96,0 |
| 2.1. | Corporate | 52,611 | 59,418 | 88,5 |
| 2.1.1. | Deposits | 52,548 | 59,268 | 88,7 |
| 2.1.2. | Other liabilities | 63 | 150 | 41,7 |
| 2.2. | Retail | 230,900 | 235,847 | 97,9 |
| 2.2.1. | Deposits | 230,034 | 234,460 | 98,1 |
| 2.2.2. | Other liabilities | 866 | 1,387 | 62,5 |
| 3. | Subordinated liabilities | 0 | 0 | - |
| 4. | Provisions | 1,368 | 1,477 | 92,6 |
| 5. | Other liabilities | 7,551 | 4,168 | 181,2 |
| **6.** | **TOTAL LIABILITIES** | **305,923** | **317,705** | 96,3 |
| 7. | Share capital and issue premium | 40,035 | 40,035 | 100,0 |
| 8. | Reserves from profit and non-allocated profit | 23,226 | 19,090 | 121,7 |
| 9. | **TOTAL CAPITAL** | **63,260** | **59,125** | 107,0 |
| **10.** | **TOTAL LIABILITIES** | **369,184** | **376,830** | 98,0 |

- Deposits with and liabilities to banks and financial organisations were lower than planned due to lower deposits by financial organisations and lower credit lines as a result of prepayments in the previous year.
- Corporate deposits were lower than planned.
- Retail deposits were slightly higher than planned, which was in part due to the appreciation of the dinar against the euro in the past year.
- Total capital was higher than planned as a result of the higher-than-planned profit and the higher amount of reserves.

## 15.2. Execution of the 2017 Income Statement

| NO. | ITEM | ACHIVED IN 2017 | PLAN FOR 2017 | INDICES |
|---|---|---|---|---|
| 1 | 2 | 3 | 4 | 5 |
| | (in RSD million) | | | |
| 1.1. | Interest income | 14,052 | 14,911 | 94,2 |
| 1.2. | Interest expenses | -1,606 | -2,202 | 72,9 |
| **1.** | **Net interest income (1.1.-1.2)** | **12,446** | **12,709** | 97,9 |
| 2.1. | Fees and commission income | 6,700 | 6,974 | 96,1 |
| 2.2. | Fees and commission expenses | -1,618 | -1,305 | 124,0 |
| **2.** | **Net fees and commission income (2.1. -2.2.)** | **5,082** | **5,669** | 89,6 |
| **3.** | Net rate of ex.differencies and change in value (currency clause) | -56 | 0 | - |
| **4.** | Net expenses of indirect write-offs of loans and provisions | 18 | -3,300 | - |
| **5.** | Other operating income | 1,094 | 737 | 148,5 |
| **6.** | Operating and other expenses | -11,397 | -11,285 | 101,0 |
| **7.** | **PROFIT FROM REGULAR OPERATION BEFORE TAX** | **7,187** | **4,530** | 158,6 |

- Net interest income achieved in 2017 was 2.1% lower than planned. Interest income from corporate and retail business was lower than planned due to lower lending and declining lending interest rates. Interest income generated by the Treasury function was also lower than planned. As a result, total interest income was RSD 858.6 million lower than planned. Total interest expenses were RSD 596.1 million lower than planned, which can in part be attributed to lower borrowing interest rates.
- Net fee and commission income achieved in the past year was 10.4% lower than planned. Fee income from retail banking was higher than planned. At the same time, retail expenses were also higher than planned, which was in part due to the appreciation of the dinar against the euro in 2017.
- At 2017 year-end, net income from indirect write-offs of loans and provisions was RSD 17.9 million, whereas the plan had envisaged a net expense of RSD 3,299.7 million.
- Operating and other business expenses were on target.
- In the period January-December 2017, the Bank generated earnings before tax of RSD 7,187.3 million, which was 58.6% higher than planned. The profit generated by the Bank in 2017 was in part due to the lower-than-planned loan impairment allowance and provisions.
- The Bank is stable and well-capitalised.

Signed on behalf of Komercijalna Banka a.d. Beograd

| Miroslav Perić | Slađana Jelić |
|---|---|
| Member of the Executive Board | Deputy President of the Executive Board |

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