

# ANNUAL REPORT FOR THE YEAR 2014



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# 1. KEY PERFORMANCE INDICATORS

ITEM	2014	2013	Index 14/13	2012	2011	2010
<b>INCOME STATEMENT</b> <span style="float: right;">in 000 RSD</span>						
Profit before tax	4,757,589	4,588,375	103.7	4,572,662	3,952,066	2,791,964
Net interest income	13,298,586	12,929,237	102.9	10,910,317	9,853,368	7,437,483
Net fee income	4,717,757	4,565,148	103.3	4,554,466	4,423,399	3,892,459

ITEM	2014	2013	Index 14/13	2012	2011	2010
<b>PROFITABILITY INDICATORS</b> <span style="float: right;">in %</span>						
ROA	1.2%	1.3%		1.5%	1.5%	1.2%
ROE – on share capital	11.9%	11.5%		15.1%	13.9%	12.3%
ROE – on total capital	7.1%	7.3%		9.4%	9.2%	7.0%
Net interest margin on total assets <sup>1</sup>	3.5%	3.7%		3.6%	3.8%	3.1%
Cost / income ratio <sup>1</sup>	59.6%	58.0%		63.5%	63.0%	74.7%
Operating expenses (000 RSD) <sup>2</sup>	10,745,910	10,161,794	105.7	9,812,888	8,995,578	8,462,471
Net expenses from indirect loan write-off and provisions (000 RSD)	2,725,389	3,220,075	84.6	1,444,299	1,335,461	1,416,354

ITEM	2014	2013	Index 14/13	2012	2011	2010
<b>BALANCE SHEET</b> <span style="float: right;">in 000 RSD</span>						
Balance sheet assets	406,261,524	362,786,319	112.0	323,384,909	275,488,718	255,868,309
Off-balance sheet operations	373,803,974	224,949,027	166.2	204,642,280	183,524,897	145,180,526

ITEM	2014	2013	Index 14/13	2012	2011	2010
<b>RETAIL<sup>3</sup></b> <span style="float: right;">in 000 RSD</span>						
Loans	69,039,387	61,848,487	111.6	55,917,000	48,555,491	45,372,699
Deposits	207,430,548	186,766,804	111.1	164,532,866	143,061,647	130,964,790

ITEM	2014	2013	Index 14/13	2012	2011	2010
<b>CORPORATE</b> <span style="float: right;">in 000 RSD</span>						
Loans	112,768,251	112,261,312	100.5	118,860,421	98,486,288	90,244,925
Deposits	57,437,462	42,131,535	136.3	40,526,379	31,728,178	36,543,673

ITEM	2014	2013	2012	2011	2010
<b>LOANS TO DEPOSITS RATIO</b> <span style="float: right;">in %</span>					
Gross loans/deposits	72.4%	77.8%	80.2%	80.7%	80.9%
Net loans/deposits	66.3%	72.0%	75.2%	75.5%	75.6%

ITEM	2014	2013	2012	2011	2010
<b>CAPITAL (RSD 000)</b>					
Capital adequacy ratio	17.7%	19.0%	21.9%	17.3%	17.1%
Number of employees	2,906	2,966	2,989	3,022	3,101
Assets per employee (EUR 000)	1,156	1,067	951	871	782

<sup>1</sup> Due to application of new „unwinding“ concept at the end of 2014, interest income decreased by RSD 442.6 million

<sup>2</sup> Within operating costs are shown wages, material and non-material operational costs

<sup>3</sup> Item „retail“ in part of loans includes retail clients, farms, entrepreneurs and micro clients

## 2. MACROECONOMIC OPERATING CONDITIONS

2014 is the year of geopolitical tensions and uneven and slower than expected growth of global economy, despite numerous pro-cyclical measures and the significant „easing“ in the financial markets which, however, did not spread to consumption and investments, except in the United States, whose recovery is evident but the sustainability is still uncertain. The year was marked by political crisis in Ukraine, the introduction of sanctions against Russia, riots in the Middle East, a number of natural disasters a significant drop in oil prices as well as gold. Global repositioning is strong - China's GDP is for the first time higher than in the United States, the conclusion of the gas agreement between Russia and China, economic association of BRICS countries... IMF lowered its growth forecast for the global economy this and next year, with the necessity for implementation of numerous and diverse structural reforms and a more powerful launch of infrastructure projects.

Slow and uneven growth, strong deflationary pressures and still high unemployment rate, with uncertain magnitude of the negative effect of the Ukrainian crisis characterize the European Union. There is a growing concern regarding the growth of the German economy, especially after the introduction of sanctions against Russia, while France and Italy are already on the verge of recession. Further effects are expected of relaxation of monetary policy of the ECB.

In Serbia 2014 was marked by formal start of EU accession negotiations, early parliamentary elections and the announcement of a number of structural reforms, in major part deferred due to catastrophic floods in May, which further slowed the growth and contributed to further deterioration of the economic environment. In November 2014 the negotiations with the IMF were finalized on a three-year stand-by precautionary arrangement (EUR 1.0 billion), which is expected to be concluded in February 2015.

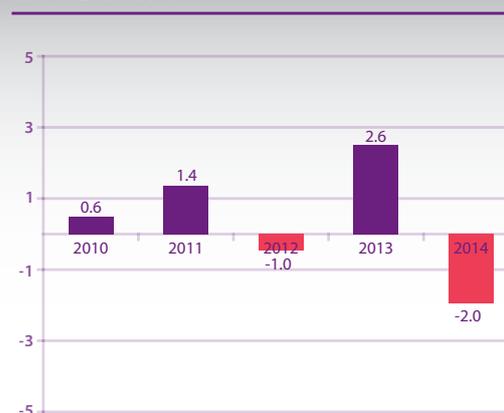
The risk premium for Serbia, measured by the EMBI index has increased and equals 309 b.p.

### GDP Trends

According to first estimates, GDP dropped by 2% in 2014, compared to 2013 according to preliminary estimates of the Statistical Office of the Republic of Serbia. Broken down by sector, growth in GDP is recorded in agriculture, forestry and fishing, in sector of information and communication and in transport and storage. The fall in GDP was recorded in electricity supply sector, mining, construction, sector of financial activity and insurance. Industrial production in 2014 recorded a decline in the physical volume of production of 6.8 % mainly due to the decline in sector of electricity production (as a result of flooding).

One of the key issues and indicators of economic activity, unemployment, has recorded a surprisingly

GDP TRENDS IN %



large decline according to the October Labour Force Survey (from 20.3% in April 2014 to 17.6% in October 2014) and it is primarily the result of seasonal factors but also of the growth in the number of employees in the informal ("grey") economy. According to the Statistical Office the total number of formally employed in 2014 was 1,697,686 which represents a decrease of 1.0% compared to 2013. The largest decline in employment in case of legal entities was recorded in the financial activities and insurance (5.8%) and in construction (5.5%).

UNEMPLOYMENT RATE IN %



Source: Ministry of Finance of the Republic of Serbia

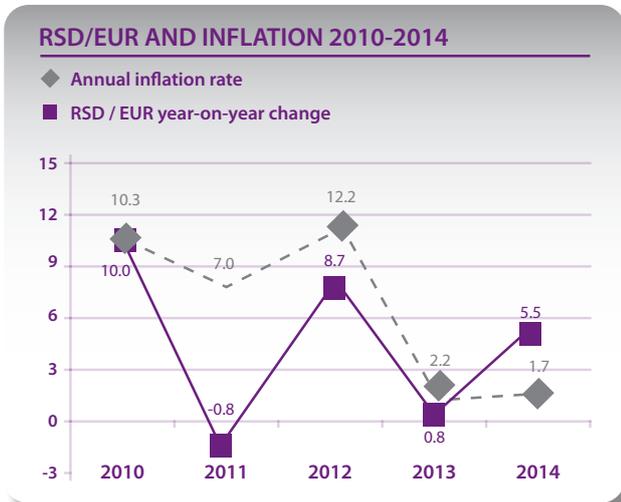
An important feature of 2014 is still present insolvency of a large part of the economy. The number of corporate clients, especially large ones, which from the liquidity problems fall into insolvency, is constantly growing with the growing trend of solving the problems through PPRP (pre-packaged reorganization plans). As of December 31st, 2014 the number of registered companies, according to data from the Serbian Business Registers Agency, was 115.692, this being an increase of 4.3% compared to 2013. 7740 companies were registered as being in the process of liquidation and in the process of bankruptcy 2062 companies. In order to revive the economy, by the end of June 2014, a new Program of subsidized lending was launched from which, by the end of 2014, RSD 136 billion were disbursed (2014: EUR 1,124.9 million, in 2013 around EUR 320 million, 2012 around EUR 950 million).

<sup>4</sup> Statistical Office of the Republic of Serbia

<sup>5</sup> Business Registers Agency

## Inflation

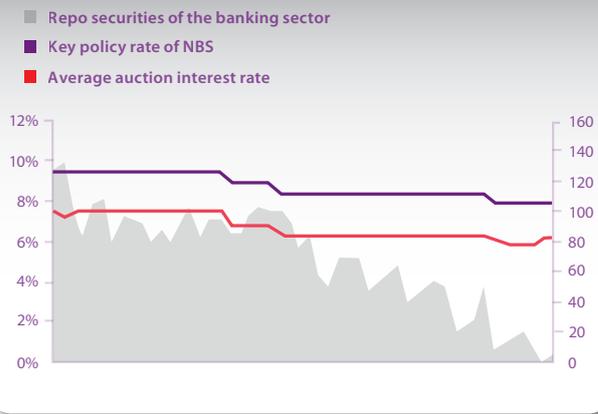
After extremely high rates in previous years, the year-on-year inflation in the first two months of 2014 entered the limits of tolerance of  $4 \pm 1.5\%$ , and at the end of the year it ended below the lower limit of the target (1.7%).



It is a result of significant decline in aggregate demand, low prices of primary agricultural products, sudden and drastic decline in oil prices that occurred at the end of the financial year and the lack of the planned growth in regulated prices. The y-o-y core inflation (excluding energy, food, alcohol and cigarettes) at the end of December 2014 stood at 2.3%.

During 2014 the National Bank of Serbia, despite the significant weakening of inflationary pressures, maintained a high degree of monetary policy restrictiveness. The key policy rate at the beginning of the year stood at level of 9.5% only to lower to 9.0% in the month of May. Another reduction of the key policy rate was in mid-June (8.5%) and by the end of the year it decreased to the level of 8.0%. Additionally, the rates and currency structure of allocation of required reserves were changed (total rate of allocation is reduced by 1pp while allocation in RSD has been increased by 2pp). Further easing of the monetary policy of the National Bank of Serbia in the coming period will depend on monetary policies of the leading world economies in the following year (quantitative benefits and overcoming the problem of the borrowing limit by FED), announced new measures of the ECB, and internal factors, primarily the implementation of measures of fiscal consolidation.

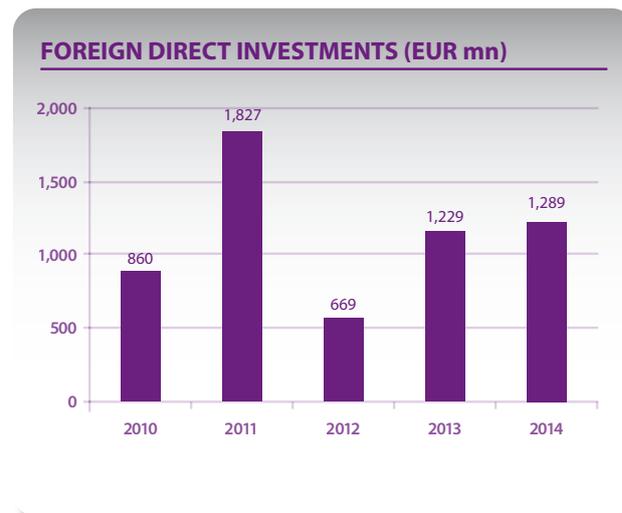
## REPO TRANSACTIONS IN 2014



After abolishment of reverse and introduction of direct repo transactions in mid-2012, the banks were again enabled to invest liquid funds in T-bills, but by application of auction and multiple interest rates, which resulted in dividing the auction (lower) and key policy (higher) interest rate. Unlike the trend from 2013, in the course of 2014 the volume of repo transactions decreased during the year from the initial RSD 130 billion to a level of RSD 7.5 billion at the year end.

## Foreign Direct Investments

Foreign direct investments reached at the end of 2014 the amount of EUR 1.3 billion<sup>6</sup> which is by EUR 112.9 million higher relative to the same period in 2013, or 40.7% greater than the amount in 2010 (note: since 2014 the reinvestment of profit is also included).



During 2014 a set of laws has been amended (Labour Law, Law on Privatization, Law on Bankruptcy...) in order to enhance the investment climate and to attract investors.

Investment portfolio net inflow amounted to EUR 424.7 million<sup>7</sup>.

<sup>6</sup> Ministry of Finance of the Republic of Serbia

<sup>7</sup> Same

## Foreign Trade

The total foreign trade of the Republic of Serbia, by the end of November 2014, reached the amount of EUR 24.3 billion, thus representing an increase of 22.6% compared to 2010 level. However, speaking year-on-year, exports in the third quarter of 2014 recorded a decline of 10.6% for the first time since the beginning of 2012.



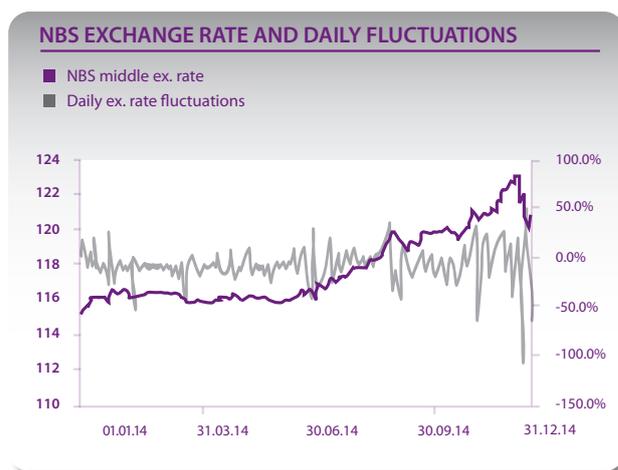
The company Fiat Automobiles Serbia d.o.o Kragujevac (FAS), continues to be a leading exporter with exports volume of EUR 1,364 million (by the end of December 2014); it is followed by NIS ad Novi Sad, Tigar Tyres d.o.o. Pirot and Železara Smederevo d.o.o. Smederevo. Observed year-on-year, FAS however, in the fourth quarter alone recorded a decline in exports of EUR 98.8 million. Broken down by regions and countries, the EU countries accounted for 64.9% of total export, while the import from these countries accounts for 63.3% of total import. The main foreign trade partners from the EU are Italy and Germany which account for 29.7% of total export, while the import from the same countries accounts for 23.2% of total import.

## EUR/RSD Exchange Rate

Global geopolitical crisis, reduced capital inflow, floods that in May afflicted Serbia and the region, unfavourable news about the sustainability of local public finances, increased energy import and weaker export, have influenced the EUR/RSD nominal exchange rate to fluctuate more in 2014 than in 2013. Greater exchange rate fluctuations have started since the end of July. In first nine months the exchange rate depreciated by 3.6%, or 5.4% for the whole year. In order to prevent drastic daily exchange rate fluctuations in 2014 the

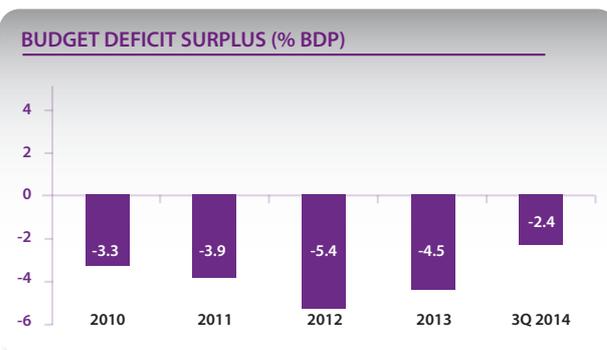
National Bank of Serbia intervened in FX market in both directions, by selling EUR 1,910 million and by purchasing EUR 260 million. Still important factor in establishing EUR/RSD exchange rate are foreign direct investments and portfolio investors.

At the end of December 2014 FX reserves of the National Bank of Serbia amounted to EUR 9.9 billion, which is sufficient for coverage of six month import of goods and services.



## Budget Deficit

The consolidated budget deficit in 2014 amounted to RSD 187.5 billion, or 6.6% of GDP under the new methodology.



Source: National Bank of Serbia

Fiscal consolidation measures adopted in late 2013 proved to be inadequate - the budget deficit in 2014 is primarily the result of lower than planned income and high interest costs (3% of GDP). Budget revision adopted in October 2014 envisages reduction of wages in public sector and pensions, while other measures (some of the announced are the restructuring of public enterprises and abolishment of subsidies, reducing the number of employees in public sector, the completion of privatization and enterprise restructuring) are defined by budget for 2015 and are agreed with the IMF in November 2014.

## Public Debt

At the end of 2014, the public debt reached the level of 70.9%, despite the statutory limitation of 45% of GDP (Law on budget system)<sup>9</sup>, primarily due to growing needs for financing of budget deficit. In 2014 the Government of the Republic of Serbia organized several auctions of securities of which the significant are the issues of five-year bonds in the month of January (EUR 50.0 million, yield 5.10%) and in the month of August (EUR 75.0 million, yield 5.00%), seven-year bonds in the month of March (RSD 10.0 billion, yield 13.00%), in the month of June (RSD 15.0 billion, yield 11.80%), and in the month of September (RSD 15.0 billion, yield 11.79%), and ten-year bonds (RSD 10.0 billion, yield 12.99 %). In addition, the government received the loan from UAE in the amount of USD 1.0 billion. After all, the public debt amounts to EUR 22.8 billion (+EUR 2.6 billion), and/or approximately 70.9% of GDP.

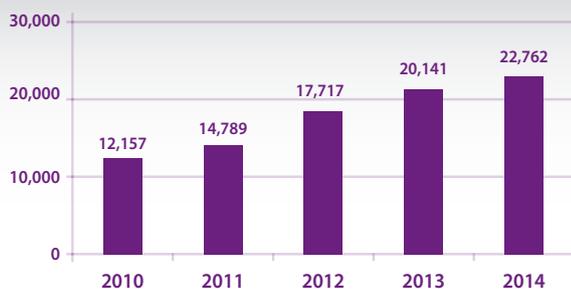
## External Debt

Due to reduced demand for loans the banks continued deleveraging abroad (EUR 814.5 million, December 2014) while the companies increased the indebtedness (EUR 77.2 million, December 2014), and thus the external debt increased by EUR 284.1 million compared to the end of 2013. Total external debt at the end of December 2014 amounted to EUR 26.0 billion<sup>10</sup>. The external debt of private sector decreased by EUR 736.2 million and amounted to EUR 11.8 billion, and the external debt of public sector increased by EUR 1.0 billion and amounted to EUR 14.2 billion.

PUBLIC DEBT RS (% of GDP)



PUBLIC DEBT RS (EUR mn)

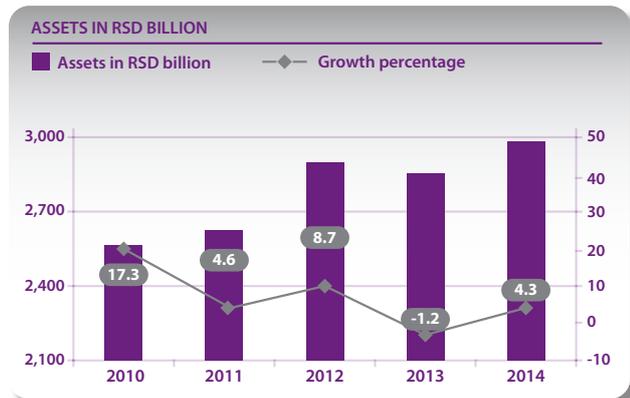


<sup>9</sup> Ministry of Finance of the Republic of Serbia

<sup>10</sup> National Bank of Serbia

### 3. BANKING SECTOR OF THE REPUBLIC OF SERBIA

At the end of 2014 the banking sector of Serbia comprised 29 banks with the assets of EUR 24.6 billion, total capital of EUR 5.1 billion and 24,749 employees. During the year, among significant events those standing out are revocation of operating licence to Univerzal banka a.d. Beograd (January 2014), beginning of work of Telenor bank and issuance of operating licence to Mirabank from the United Arab Emirates.

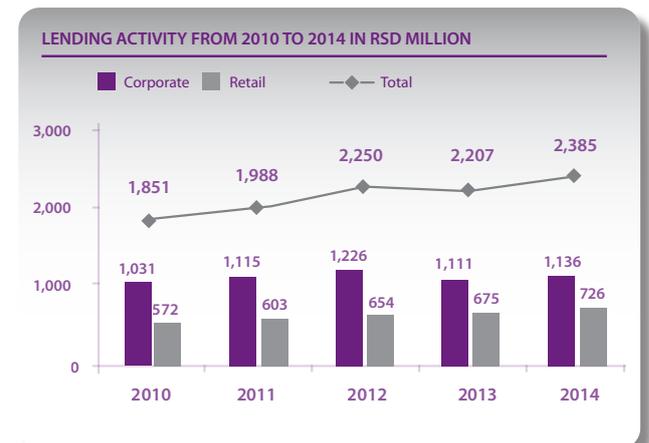
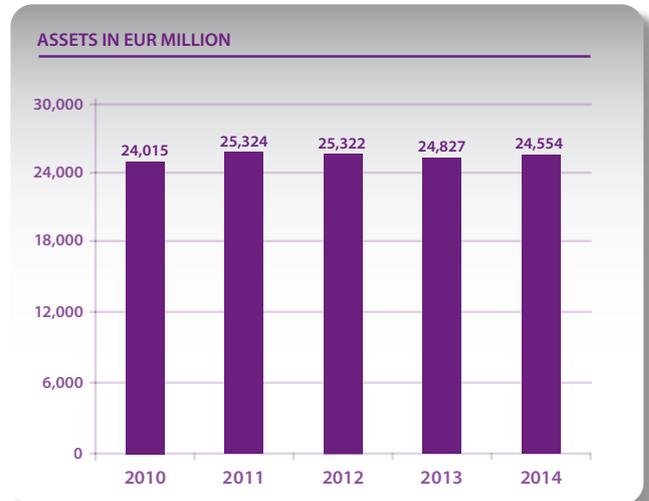


Decline in lending activity in the first half of the year, has been halted by the Program of subsidized lending through which RSD 136.1 billion were disbursed. At the end of December 2014, according to the data of the National Bank of Serbia, gross loans have increased throughout 2014 by RSD 75.4 billion (and/or nominally 8.0% with exchange rate depreciation of 5.5%), retail loans recorded a growth RSD 50.9 billion, or 7.6%, while corporate loans recorded a growth of RSD 24.5 billion, or 2.2%. As of December 31th, 2014, a significant part of funds have been invested in securities (RSD 457.4 billion), which is an increase of 35.8% relative to the end of 2013 (RSD 336.8 billion).

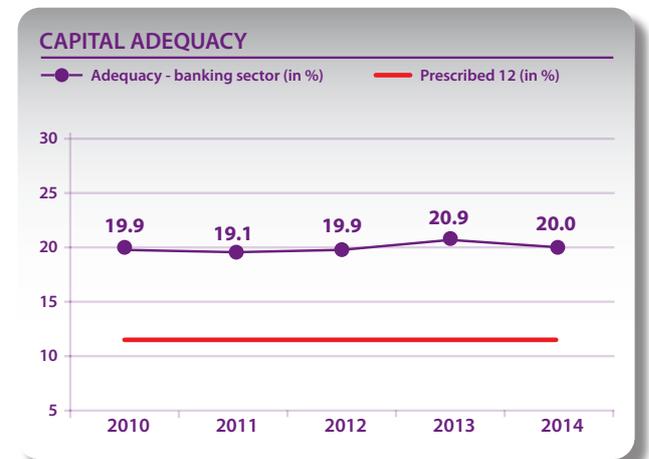
Share of NPLs (loans defaulting over 90 days), at the end of December 2014 reached the level of 21.5% (at the end of December 2013 it equalled 21.4%). Despite adopting the law that limited the deadlines for payments between commercial entities for up to 60 days, and payments by the state up to 45 days, increase in NPLs is a result of unfavourable overall business climate. In case of large corporate clients that have long resisted the influence of many years of economic crisis, in 2014 a problem showed up of regulating loan commitments (NPL of corporate clients 27.2%, and of retail clients 10.3%<sup>11</sup>). Impairment provision of total loans covers 56.7% of gross NPLs while coverage by statutory provisions equals 115.9% at the end of November<sup>12</sup>. Number of corporate clients, particularly large ones, which from the liquidity problems fall into insolvency, continually grows with the growing trend of solving the problems through PPRP (pre-packaged reorganization plans).

In order to solve accumulated NPLs the banks in first three quarters of 2014, through assignment of matured receivables to persons outside financial sector, released the amount RSD 7.2 billion<sup>13</sup>.

Retail foreign currency savings, in 2014 continues to grow and by the end of the year it reaches the amount of EUR 8.5 billion<sup>14</sup> with still high level of insured deposits (EUR 50,000).



Capital adequacy, as of December 31th, 2014 equals 19.95, which is still significantly above the prescribed minimum of 12%. As of December 2014 the total capital of the banking sector amounts to EUR 5.1 billion<sup>15</sup>.



<sup>11</sup> Internet site of the National Bank of Serbia

<sup>12</sup> Same

<sup>13</sup> Same

<sup>14</sup> Same

<sup>15</sup> Same

In 2014 as well, the outflow continues, or deleveraging of banks to foreign countries, which is a trend in operations of subsidiaries of the European banks in the region since mid-2011. By the end of December 2014 the outflow has been recorded in the amount of EUR 814.5 million.

*Profitability of banks* in 2014 has been growing but partially as a result of lack of large individual losses of the banks that have been recorded in the previous three years, and which have been closed in the meantime. Compared to the same period of 2013, the banking sector posted profit of EUR 37 million. At the end of 2014, twelve banks operating at a loss, seventeen with the profit, of which only six banks have a ROE above 5%.

#### INTEREST MARGIN IN %

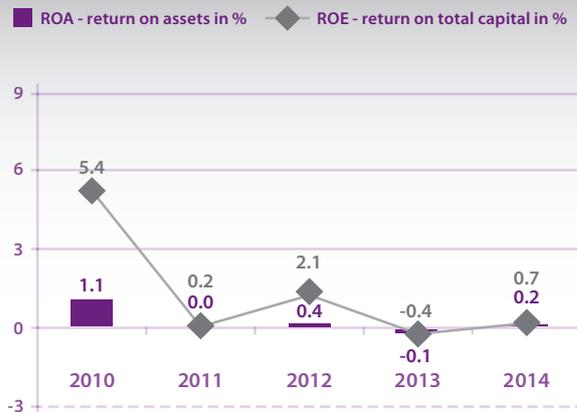


#### PROFIT BEFORE TAX IN RSD MILLION



*Note: result before tax in 2011 includes the loss of Agrobanka of EUR 284 million, result at the end of 2012 includes the loss of Razvojna banka Vojvodina of EUR 128 million, and the result at the end of 2013 includes the loss of Univerzal banka of EUR 13 million.*

#### RETURN ON ASSETS



Factor that have a prevailing impact on profitability of banks in Serbia are high costs of credit risk, level of required reserve, focus on local funding sources, lack of demand of retail clients, limited number of quality corporate clients.

#### COST TO INCOME RATIO IN %



Cost-to-income ratio continues downward trend, after an increase in 2012, reaching the value of 70.6%.

The new Law on Accounting defined a new chart of accounts which is in effect as from December 31st, 2014, as well as the full implementation of IFRS, where significant changes are presented through application of unwinding concept, and/or recognition of interest income on impaired financial assets which are measured at amortized cost.

## 4. BUSINESS OPERATIONS AND ORGANIZATIONAL STRUCTURE

Within its registered activities the Bank performs the following operations:

1. Deposit operations (accepting and placing deposits);
2. Lending operations (lending and borrowing);
3. Foreign exchange, foreign exchange-currency and exchange operations;
4. Payment system operations;
5. Issuance of payment cards;
6. Securities operations (issue of securities, custody bank operations and other);
7. Broker-dealer operations;
8. Issuance of guarantees, sureties and other forms of guarantees (guarantee operations);
9. Purchase, sale and collection of receivables (factoring, forfeiting and other);
10. Insurance agency activities, upon prior consent of the National Bank of Serbia;
11. Operations for which it is authorized by the law;
12. Other operations which are essentially similar or related to the operations referred to in Items 1) to 11) of this paragraph, in line with the Agreement and the Bank's Articles of Association.

The Bank has been authorized for performing international payment transactions since 2003.

The Bank has been authorized for conducting the operations of a broker-dealer company since 2005.

The Bank has been authorized to perform the activities of the custody bank since 2006.

### 4.1. Bank's Board of Directors

The Bank's Board of Directors has been established in accordance with the Law on Banks and the Agreement between the shareholders - Republic of Serbia and the group of international financial institutions (EBRD, IFC, DEG, SwedFund) and is composed of nine members, inclusive of the Chairman, of whom three members are persons independent of the Bank. The members of the Bank's Board of Directors are appointed by the General Meeting of Bank's Shareholders for a period of four years.

The competences of the Bank's Board of Directors are defined by the Article 73 of the Law on Banks and Article 27 of the Bank's Articles of Association. The members of the Bank's Board of Directors as of December 31st, 2014 are as follows:

NAME AND SURNAME	SHAREHOLDER / MEMBER INDEPENDENT OF THE BANK	FUNCTION
Professor Milovan Stanišić, PhD	Republic of Serbia	Chairman
Radomir Kostadinović	Republic of Serbia	Member
Miroљjub Ćosić	Republic of Serbia	Member
Andreas Kligen	EBRD	Member
Philippe Delpal	EBRD	Member
Khosrow Zamani	IFC	Member
Ismail Musabegović, PhD	Member independent of the bank	Member
Milan Šojić, PhD	Member independent of the bank	Member
Mats Kjaer	Member independent of the bank	Member

### 4.2. Bank's Executive Board

The Executive Board is composed of the President of the Executive Board, Deputy President of the Executive Board and of at least three members. The President of the Executive Board manages the work of the Executive Board and is responsible for implementing decisions within the competence of the Executive Board.

The term of office of the members of the Bank's Executive Board, including the President and the Deputy President is four years from the day of appointment.

The competences of the Executive Board are defined by the Article 76 of the Law on Banks and Article 31 of the Bank's Articles of Association.

The members of the Bank's Executive Board as of December 31st, 2014 are as follows:

NAME AND SURNAME	FUNCTION
Ivica Smolić	President
Dragan Santovac	Deputy President
Slavica Đorđević	Member
Andrijana Milanović	Member
Lidija Sklopić	Member

### 4.3. Audit Committee

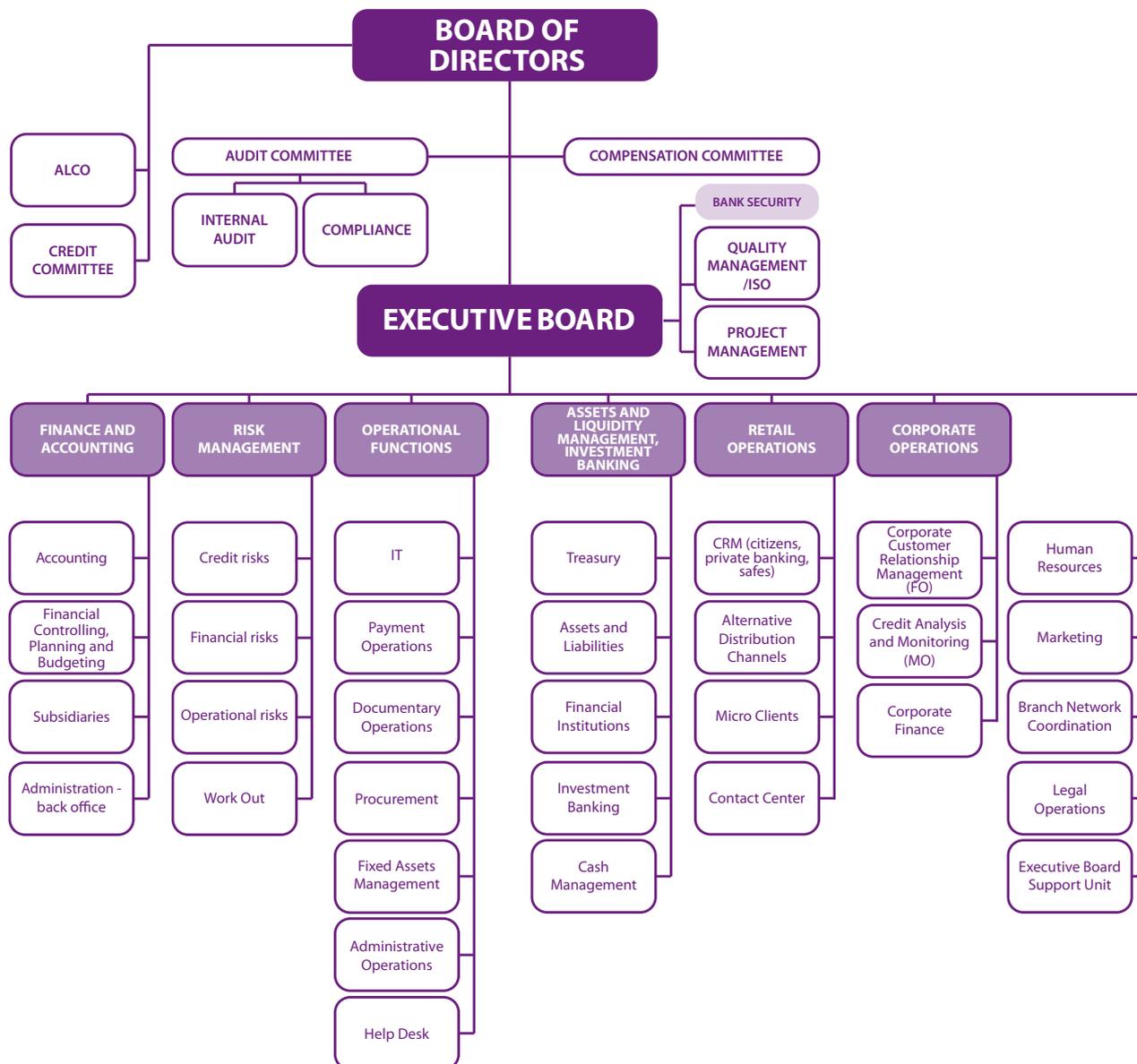
The Bank's Audit Committee is composed of three members, of whom two are the members of the Bank's Board of Directors with relevant experience in finance. One member of the Audit Committee is a person independent of the Bank. Members of the Audit Committee are appointed for a period of four years.

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

The following are the members of the Audit Committee as of December 31st, 2014:

NAME AND SURNAME	FUNCTION
Mats Kjaer	Chairman
Andreas Kligen	Member
Radomir Kostadinović	Member

#### 4.4. Organizational Structure

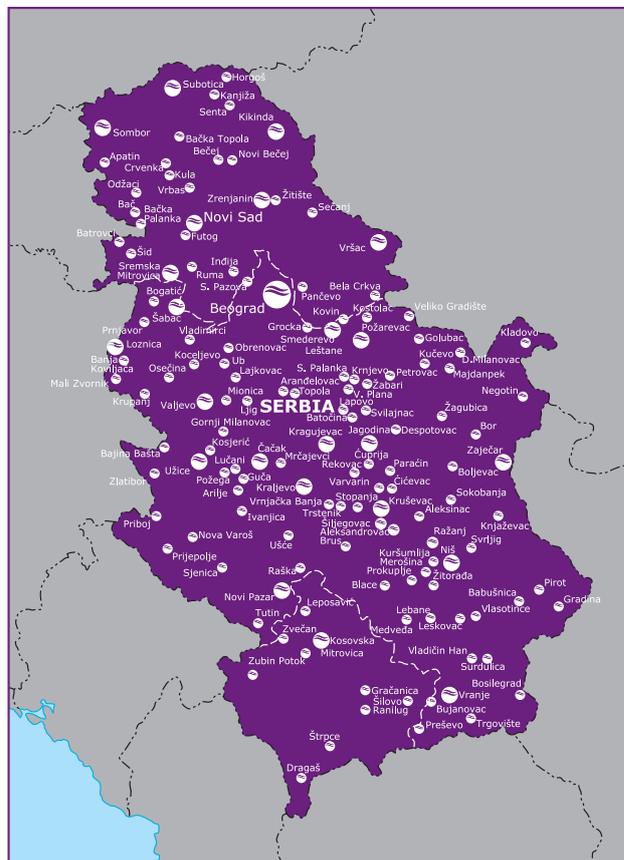


#### 4.5. Locations of Bank's Head Office

ADDRESS	Svetog Save 14	Svetogorska 42-44	Makedonska 29
TELEPHONE	+381-11- 30-80-100	+381-11-32-40-911	+381-11-33-39-001
TELEX	12133 COMBANK YU	12133 COMBANK YU	12133 COMBANK YU
FAX	3442-347	32-36-160	33-39-196
S.W.I.F.T. code	KOBBRSBG	KOBBRSBG	KOBBRSBG
REUTERS code	KOMB	KOMB	KOMB
INTERNET	www.kombank.com	www.kombank.com	www.kombank.com
E-mail	posta@kombank.com	posta@kombank.com	posta@kombank.com

#### 4.6. Regional Distribution of Bank's Branches in the Republic of Serbia

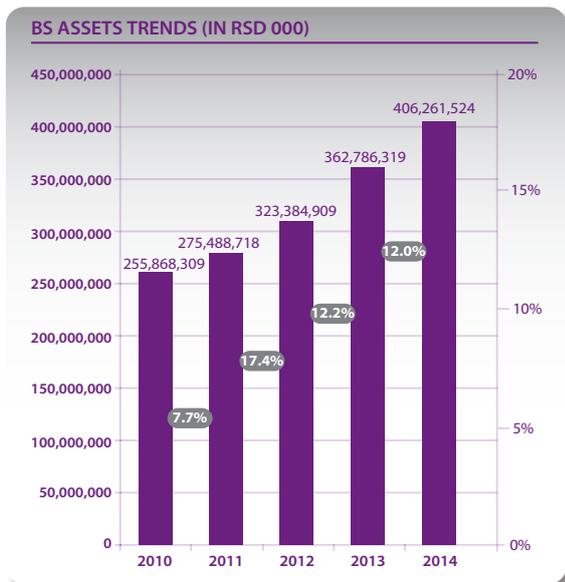
	BRANCHES	ADDRESS
1.	Niš	Episkopska 32
2.	Kruševac	Trg Fontana 1
3.	Kraljevo	Trg S. Ratnika bb
4.	Novi Pazar	Njegoševa 1
5.	Novi Sad	Novosadskog sajma 2
6.	Užice	Petra Čelovića 4
7.	Zrenjanin	Trg Slobode 5
8.	Čačak	Gradsko šetalište 10-14
9.	Vranje	K. Stefana Prvovenčanog 58
10.	Valjevo	Gradski Trg bb
11.	Subotica	Korzo 10
12.	Šabac	Gospodar Jevremova 2
13.	Kragujevac	Save Kovačevića 1
14.	Smederevo	Karađorđeva 37
15.	Požarevac	Moše Pijade 2
16.	Jagodina	Knjeginje Milice 10
17.	Loznica	Gimnazijska 1
18.	S. Mitrovica	Kralja Petra I 5-7
19.	Zaječar	Nikole Pašića 25
20.	Kikinda	Braće Tatić 7
21.	Sombor	Staparski put 14
22.	Vršac	Trg Sv. Teodora vršačkog 2
23.	Beograd	Svetogorska 42-44
24.	K. Mitrovica	Kneza Miloša 27



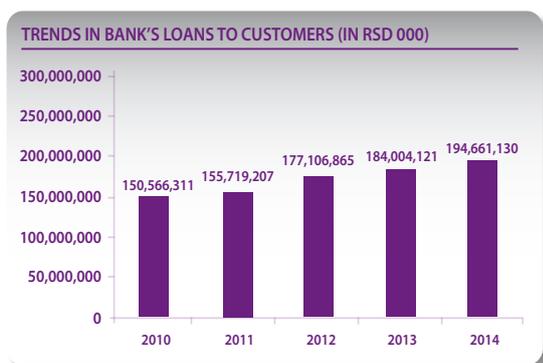
## 5. DEVELOPMENT OF THE BANK, FINANCIAL POSITION AND BUSINESS RESULTS

### INTRODUCTION

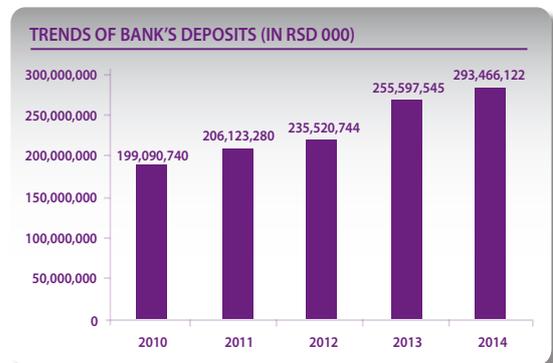
In the previous five-year period the Bank accomplished a steady growth in relation to the banking sector and its main competitors. Looking at the results of the banking sector (balance as of September 30th, 2014) the Bank, with the balance sheet assets in the amount of RSD 380,099 million held 12.9% of the market, while at the end of 2010 it held 10.1%.



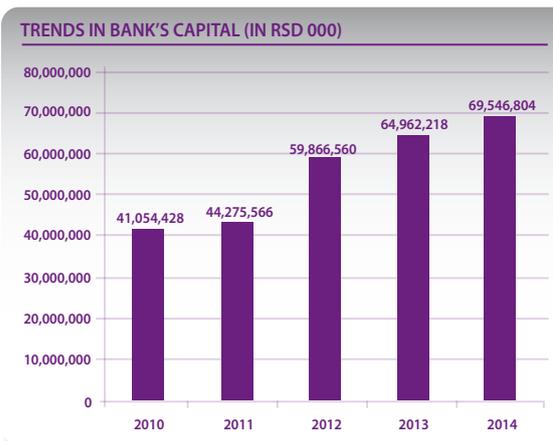
Item loans and deposits to customers<sup>16</sup>, records a stable growth over the period 2010 - 2014, with an increase in Bank's market share from 9.2% to 11.5% (September 30th, 2014).



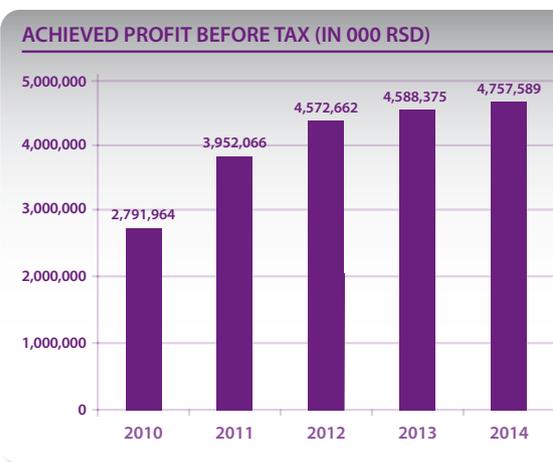
The collected deposits<sup>17</sup> also recorded a stable five-year growth from RSD 199,091 million and 13.2% of market share to over RSD 267,874 million and 14.8% of share (September 30th, 2014).



Broken down by share in sectors, the Bank has further strengthened the capital base from RSD 41,054 million to over RSD 68,341 million, respectively from 8.2% to 11.1% of the market (September 30th, 2014).



Profit before tax over the period 2010 - 2014 also records a slight growth from 11.0% to 13.4% of market share (September 30th, 2014), or from RSD 2.8 billion to over RSD 4.8 billion at the end of 2014.



<sup>16</sup> Item loans and deposits to customers does not include other placements

<sup>17</sup> Item deposits does not include other liabilities and assets received through credit lines

## 5.1. Business Operations of Komercijalna banka in 2014

All activities and operations of KB continue in 2014 to be focused to short-term sustainability and stability.

### Balance Sheet Total

Growth of balance sheet total from RSD 43.5 billion or 12.0% to over RSD 406.2 billion (EUR 3.4 billion), is primarily a result of growth in collected deposits of customers (RSD 35,934.6 million or 13.5%). Focus is still on sustainable business operations, through a balance between profitability and portfolio quality, further optimization of the structure of assets, finding new sources of income and faster employment of funds.

### Sources

In 2014 the growth of FX savings continued (EUR 55 million), but also the growth of deposits and other obligations towards the clients and the banks and other financial organizations (OFO) in the amount of RSD 38,619.1 million (under the new balance sheet format).

During 2014, credit lines were drawn in the amount of EUR 40 million: EBRD credit line for energy efficiency and the use of renewable energy source, in the amount of EUR 10 million, EFSE credit line for retail lending for improvement of housing conditions, renovations and extensions, (re)construction of real estate for people who live in them, in the amount of EUR 15 million and IFC credit line for financing the program pertaining to housing loans, also of EUR 15 million.

Subordinated liabilities at the end of the reporting year amount to RSD 6,036.7 million.

### Loans

Despite the complex business conditions in the preceding business year, the Bank achieved the growth in corporate and retail loans and recorded a slight decline in loans to banks and OFO. The launching of the program of subsidized loans (since May 2014) resulted in growth of loans to customers, despite the present problem of quality demand for loans. Significant part of liquid funds was invested in RSD and FX securities. At the end of the year, RSD 95,481.2 million were invested in securities available for sale, which makes for an increase of RSD 38,596.0 million compared to the same period in 2013 (increase of 67.8%).

### Loan Portfolio Quality

The operations of Komercijalna banka, as well as the rest of the sector, in 2014 were mainly marked by the problem of illiquidity, or insolvency of large corporate clients. The above problem placed even stronger focus on maintaining the portfolio quality. The growth of NPLs in the market is for the most part a consequence of excessive length of the crisis, failure to solve the problem of illiquid companies, but also the stagnation of sector's lending activity. The trend of corporate NPLs was mainly affected by the companies from the processing industry, trade, construction and by the companies in bankruptcy. The level of retail NPLs continued in 2014 to be significantly lower in comparison to companies (10.3%, November 2014 at the sector level<sup>18</sup>).

### Profitability

Interest margin on total assets for 2014 equals 3.5%, which is a significant result in view of the pressures to reduce lending and debit interest rates. Strong pressures of loans on the interest margin have continued; the lack of quality demand and huge competitive pressure on limited number of quality clients affect the cost-to-risk ratio, which along with high level of required reserve make for main factors that exert adverse impact on the interest margin. Optimization of interest margin in 2014 is a result of further optimization and diversification of sources of funds, whereas the key factor for overall profitability is still the quality of assets, but also the additional unplanned deposit insurance premium, which increased the operating costs by RSD 440 million.

### Capital Adequacy

Capital adequacy at the end of the reporting period equalled 17.7% which represents a satisfactory level in view of the environment, regulatory requirements and the requirements of the Bank to cover all business risks, primarily the credit risk. The capital base is stable and at the required level.

<sup>18</sup> National Bank of Serbia

## 5.2. Corporate Banking Operations

### Market - key tendencies

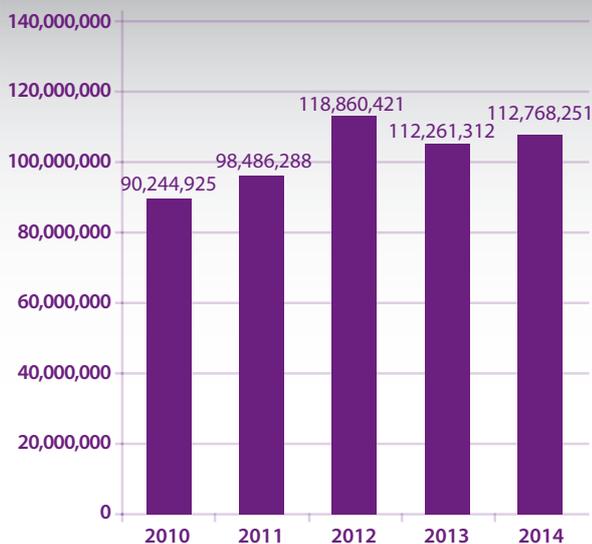
An absence of investment activities as well as the reluctance of clients to borrow more marked 2014 as well. Until the Program of subsidized lending to corporate entities was launched (end of May) there had been constant decline in the banking sector exposure to the economy. According to NBS data (Statistical Bulletin for the month of November) decrease in bank's engagement with corporate entities in 2014 amounts to RSD 10.8 billion.

### Loans<sup>19</sup> - KB Operations

CORPORATE	31.12.2014		31.12.2013		Growth in %, 14/13
	Amount in RSD 000	Share (%)	Amount in RSD 000	Share (%)	
LOANS	112,768,251	100.0%	112,261,312	100.0%	0.5%
RSD LOANS	100,635,521	89.2%	100,105,254	89.2%	0.5%
Short-term	17,322,551	15.4%	16,768,501	14.9%	3.3%
Long-term	83,312,970	73.9%	83,336,753	74.2%	0.0%
FX LOANS	12,132,730	10.8%	12,156,058	10.8%	-0.2%
Short-term	784,774	0.7%	962,905	0.9%	-18.5%
Long-term	11,347,956	10.1%	11,193,153	10.0%	1.4%

In order to alleviate the effects of the poor market environment and to stimulate the demand, before the Program of subsidized lending the Bank launched KOM PROGRESSIVE program (the mix of credit and non-credit products) intended to SMEs. The Bank has taken significant participation in the Program of subsidized lending (RSD 12.1 billion disbursed), through which 70% of total number of clients in segment of small, medium and macro enterprises borrowed. In segment of small enterprises the Bank ranked first in the market in terms of amount of disbursed loans (RSD 7.6 billion disbursed).

### CORPORATE LOANS (IN RSD 000)



The fact that the subsidized loans were available exclusively in RSD led to significant share growth of RSD loans in loan portfolio (December 31st, 2014); share of RSD loans 22.8%, growth by 5.4 p.p. in comparison to the end of 2013).

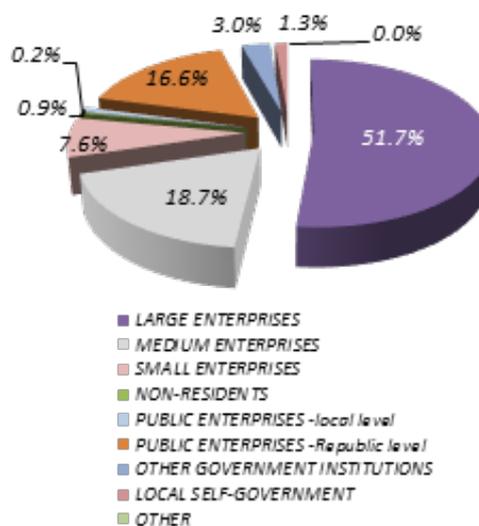
In 2014 there was a slight growth of share of short-term loans.

### CORPORATE CLIENTS (IN %)



The huge competitive pressure to reduce interest rates, the portfolio decline due to early repayment of loans in the first half of the year as well as the effect of unwinding (in the amount of RSD 315.8 million) resulted in significant reduction in interest income in 2014. As regards the competition Sberbank Srbija a.d. Beograd, Erste bank a.d. Novi Sad and ProCredit Bank a.d. Beograd have noticeably stepped up their activities while Banca Intesa a.d. Beograd, Raiffeisen banka a.d. Beograd and UniCredit bank Srbija a.d. Beograd keep their activities at its usual high level.

### Structure of clients as of 31.12.2014

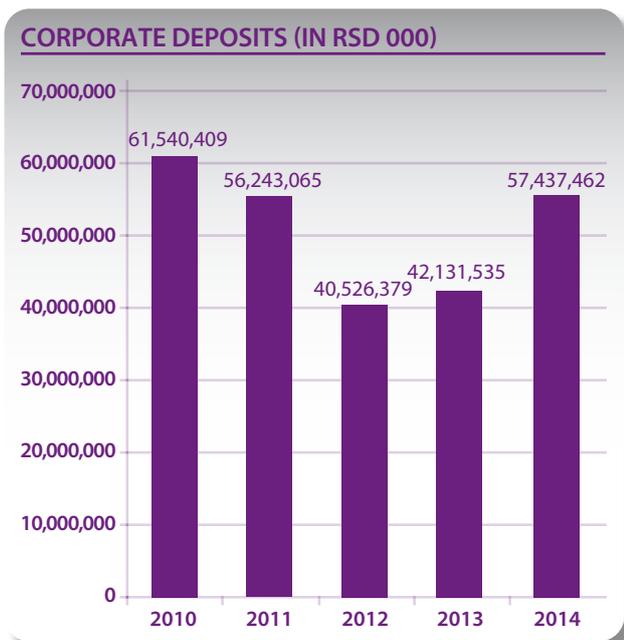


<sup>19</sup> Item loans and deposits to customers does not include other loans and advances

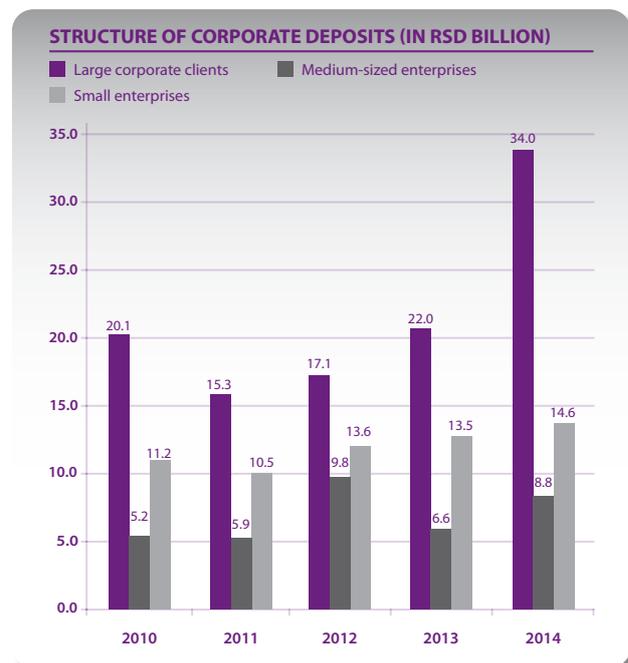
## Deposits<sup>20</sup>

CORPORATE	31.12.2014		31.12.2013		Growth in %, 14/13
	Amount in RSD 000	Share (%)	Amount in RSD 000	Share (%)	
DEPOSITS	57,437,462	100.0%	42,131,535	100.0%	36.3%
RSD DEPOSITS	37,761,817	65.7%	29,007,305	68.8%	30.2%
Transaction	24,005,453	41.8%	20,539,213	48.8%	16.9%
Other	13,756,364	24.0%	8,468,092	20.1%	62.4%
FX DEPOSITS	19,675,645	34.3%	13,124,230	31.2%	49.9%
Transaction	10,352,299	18.0%	6,277,674	14.9%	64.9%
Other	9,323,346	16.2%	6,846,556	16.3%	36.2%

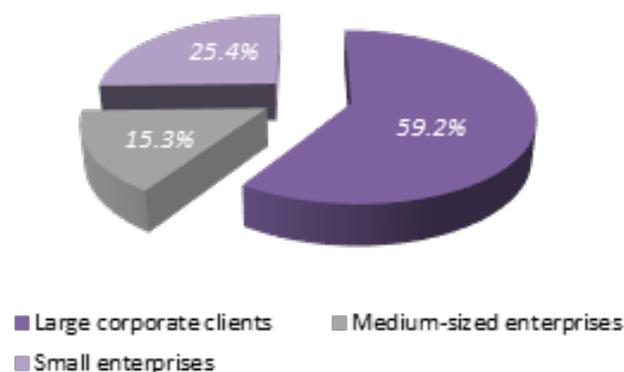
Despite the reduction in debit interest rates and significantly deteriorated market conditions, and/or reduced liquidity of the economy, the growth has been recorded of corporate deposits of 36.3% as a result of the fall of the price sensitivity of customers, along with increase in sensitivity to reputation, or image of the banks, taking into account the circumstances and developments in the banking sector in 2014.



Following a decline in corporate deposits in 2012 and 2013, in 2014 the Bank achieved the growth of deposits.



Structure of depositors as at 31.12.2014



<sup>20</sup> Item deposits does not include other liabilities and funds received through credit lines

### 5.3. Retail Banking Operations

#### Market - key tendencies

General facts that have an impact on lending activity and characterize 2014 are as follows:

- High average unemployment rate of over 20% during 2014 (17.6% in the last quarter);
- The average debt is still relatively low compared to the other countries in the region and amounts to EUR 861 or 2.3 average salaries, of which EUR 780 in loans, EUR 32 in current account overdraft, EUR 43 in credit cards and EUR 6 in lease instalments<sup>21</sup>;
- Since January 1<sup>st</sup>, 2014, the salaries of the employees in the public sector are reduced by the introduction of "solidarity tax" (20% personal income tax on salaries over RSD 60,000 or 25% personal income tax on salaries over RSD 100,000) which subsequently leads to decrease in demand by the highest quality segment of clients, in terms of taking loans;
- Instead of solidarity tax, in order to reduce the budget deficit, in October 2014, the Serbian Government adopted the Decision on reduction of wages in public sector (linear 10%) and on reduction of pensions in excess of RSD 25,000 as of November 2014;
- The difficulties in the operations of companies in private sector, which is reflected in the shift of a number of employees to a minimum guaranteed salary, as well as delays in payment of salaries, further affect the servicing of existing obligations towards the banks and the possibility of new borrowings.

Generally speaking, in spite of all the above and due to even more prominent limiting factors in corporate segment, the banks have still focused its operations on retail clients. Thus, according to the Association of Serbian Banks (ASB), the number of loan beneficiaries - retail clients in relation to the year 2013 increased by 42,687 which is actually the number of clients at the level in 2012.

On the other hand, activities in debt collection are slower and there is a stagnation of the defaulting loan users. Namely, the number of loan users - retail clients who are in default for over 90 days continuously, is practically the same as in 2013 (approximately 118,000). According to the data of the National Bank of Serbia, at the level of the banking sector there is an increase in share of NPLs in the total loans (as of 30 June 2014), and the same according to the latest data equals 10.3% (November 2014, while as at 31st December, 2013 it stood at 9.6%).

90% of the above mentioned increase in the number of clients using loans, according to ASB, refers to cash loans which proves that presently these loans are in highest demand in the market and particularly so in local currency. The competitors have taken quite an aggressive approach supported through constant different marketing campaigns aimed to lower interest rates, longer repayment periods and lower fees.

In the housing loan segment, since 2011, there has been a tendency of reduced demand, intensified in 2014, especially bearing in mind the abolishment of subsidies by the Republic of Serbia for the first time since 2006.

According to the National Mortgage Insurance Corporation (NMIC), in 2014 the total amount of disbursed housing loans was by 18.3% lower compared to 2013, while subsidized loans had a decrease of 61.5% and unsubsidized loans a slight growth of 4.9%. For subsidized loans, "belated" disbursement of loans under the program of the Government of the Republic of Serbia from the previous year existed until May, after which the subsidized loans intended for the army are only disbursed by AIK Banka a.d. Niš and Societe Generale Bank Serbia a.d. Belgrade.

HOUSING LOANS INSURED BY THE NMIC WITHOUT SUBSIDIES (IN EUR 000)					
Year	Banking sector		KB		Share of KB in the amount of
	Number	Amount	Number	Amount	
2014	4,630	152,306	1,035	32,025	21.03%
SUBSIDIZED HOUSING LOANS (IN EUR 000)					
Year	Banking sector		KB		Share of KB in the amount of
	Number	Amount	Number	Amount	
2014	790	29,970	96	3,377	11.27%
TOTAL DISBURSED HOUSING LOANS (IN EUR 000)					
Year	Banking sector		KB		Share of KB in the amount of
	Number	Amount	Number	Amount	
2014	5,420	182,276	1,131	35,402	19.42%

In order to stimulate demand in segment of corporate clients and entrepreneurs, at the end of the second quarter the Government introduced a program of subsidized liquidity loans, which led to growth of loans in the micro client segment.

After a one year break in 2013, the Government continued with subsidized loans for agriculture in 2014.

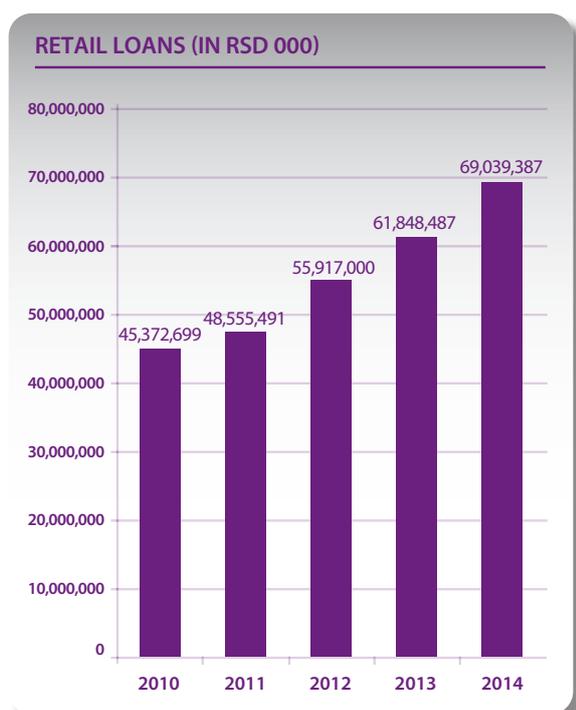
<sup>21</sup> Association of Serbian Banks

## Loans<sup>22</sup> - KB Operations

In 2014 loans were disbursed in the amount of RSD 24.2 billion, which is an increase by 14.4% in comparison to 2013. Disbursement has been increased in all segments except in segment of housing loans where due to lack of subsidies and reduced demand there is a decline of 19.1%. On the other hand, the biggest increase when compared to 2013 pertains to loans to micro clients (35.1%) and cash loans (27.1%). The Bank also managed to achieve a significant increase in agricultural loans, primarily by coordinating the subsidized and the loans from Bank's own lending potential, and also the loans from KFW credit line and by cooperating with dealers of agricultural machinery.

Cash loans accounted for the highest share of total loans approved in 2014 (42.6%), followed by loans to micro clients (25.7%) and housing loans (19%). This growth of retail loans has been achieved due to redesigning of the existing offer in terms of adjusting to market demands and maintaining the competitiveness by introducing new products in Bank's regular offer (in particular loans for pensioners with life insurance), launching discounted products and by increased engagement of Bank's business network. Additionally, the government subsidies make for significant contribution as do competitive credit lines for micro client and agriculture segment.

Of the total number of loans disbursed, 64% were denominated in dinars, while dinar-denominated loans account for 35.2% in total balance of retail loans.



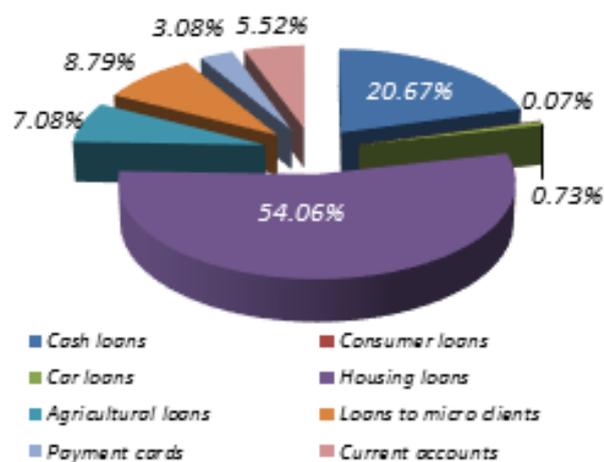
PRODUCTS	31.12.2014		31.12.2013	
	000 RSD	%	000 RSD	%
Types of loans				
Cash loans	14,269,953	20.67%	12,021,153	19.44%
Consumer loans	45,133	0.07%	218,060	0.35%
Car loans	502,485	0.73%	891,478	1.44%
Housing loans	37,325,144	54.06%	33,340,228	53.91%
Agricultural loans	4,885,651	7.08%	3,848,933	6.22%
Loans to micro clients	6,070,222	8.79%	5,390,211	8.72%
Payment cards	2,128,345	3.08%	2,098,319	3.39%
Current accounts	3,812,453	5.52%	4,040,105	6.53%
<b>TOTAL</b>	<b>69,039,387</b>	<b>100.00%</b>	<b>61,848,487</b>	<b>100.00%</b>

In line with reduced demand and absence of government subsidies, car and consumer loans have been gradually decreasing.

Likewise, in segment of gross retail loans, according to the latest available data as at November 30th, 2014, the year-on-year Bank's growth equals 12.6%, and the growth of the banking sector 7.6%.

Interest income amounts to RSD 7.05 billion and records a growth compared to 2013 of 4.6%, whereas the fee income amounts to RSD 3.52 billion, which is an increase of 5.7%. Total net income amounts to RSD 5.57 billion, which is a significant increase of 27.1% in comparison to the preceding year.

**STRUCTURE OF NET LOANS AND ADVANCES AS AT 31.12.2014**



<sup>22</sup> Item loans and deposits to customers does not include other loans and advances

### Payment Cards Operations

In the segment of payment cards operations the Bank focuses on the quality of its offer by introducing new products and services, improving the security of payments and maintaining a high quality of service. Below are some of the activities undertaken during the year 2014:

- Incentives for using PayPass cards at Bank's terminals and technological improvements;
- The promotional campaign "Use the card and win the gift" in cooperation with MasterCard and major acceptants;
- New service: MasterCard Secure Code and Verified by Visa protection for online credit card payment.

Compared to 2013, the following has been achieved:

- POS transactions increased by 12.4%, ATM transactions increased by 17.9%;
- The number of issued cards increased by 16.5%;
- Interest-free sale in instalments: around 400 merchants and more than 1,200 locations.

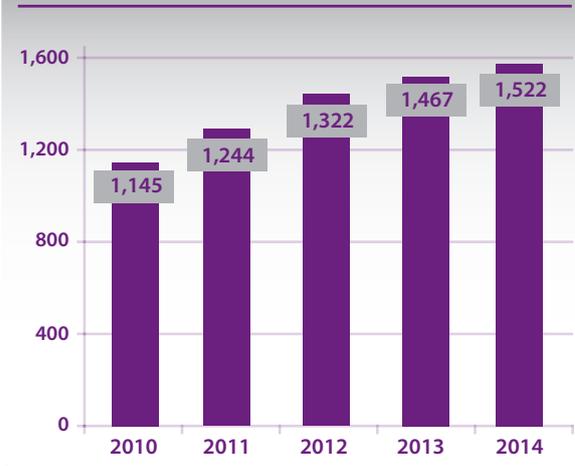
All this, according to NBS data, contributed to Bank having a significantly faster growth in value of transactions (17.1%) compared to Serbian average (9.5%), which in turn increased its market share to 14.14%.

### Deposits<sup>23</sup> - KB Operations

At the level of the banking sector in 2014 (as of November 30<sup>th</sup>, 2014), a growth of FX deposits was EUR 66 million, while the Bank with its growth of EUR 59 million in 2014, despite the reduction in interest rates on several occasions, maintained its leading position in the market and increased its share to 19%.

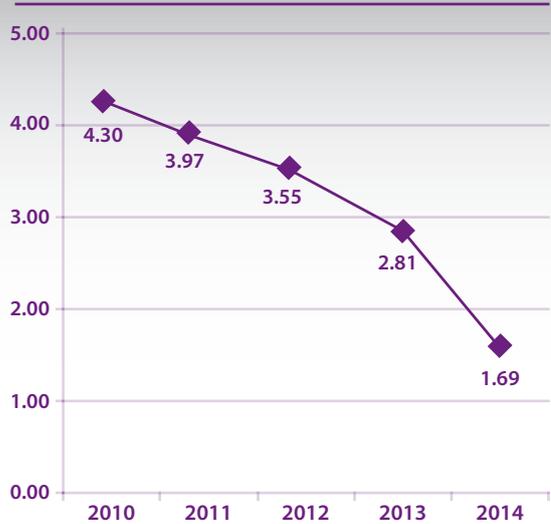
Under the existing market conditions, a proper balance has been struck between the cost, the Bank's image and brand and the desired stable growth of deposits.

#### FX SAVINGS (IN EUR MILLION)



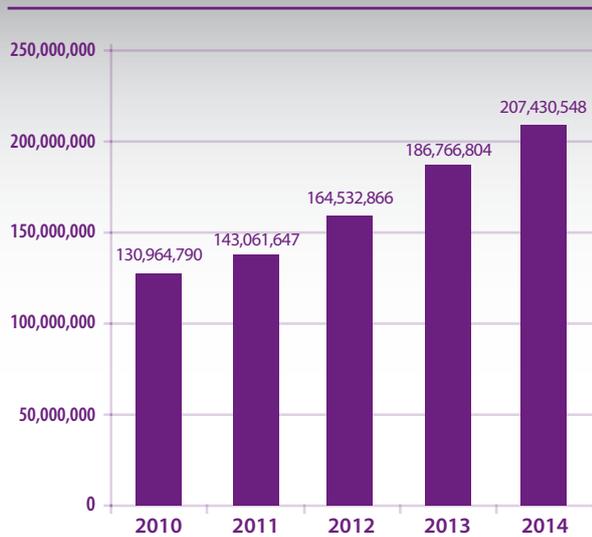
\*Presented FX savings do not include earmarked FX accounts (pensioners) and entrepreneurs.

#### THE MOVEMENT OF WEIGHTED INTEREST RATE ON FX SAVINGS DEPOSITS

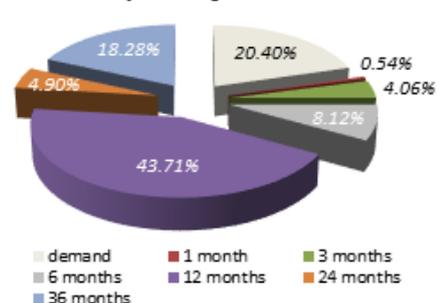


It is evident that the weighted interest rate has a downward tendency.

#### RETAIL DEPOSITS (IN RSD 000)



Structure of FX savings as at 31.12.2014.



<sup>23</sup> Item deposits does not include other liabilities and assets received through credit lines

In FX savings there is a stable share of deposits placed for a fixed term of up to and over 12 months, which stands at 60.7%, and there is also a prevailing share of deposits of up to EUR 50,000 (in terms of number over 99%, in terms of amount 80.5%).

The Bank will continue the active policy with respect to interest rates in order to maintain the balance between the cost and the desired growth of deposits with full utilization of Bank's brand.

#### 5.4. Treasury Operations

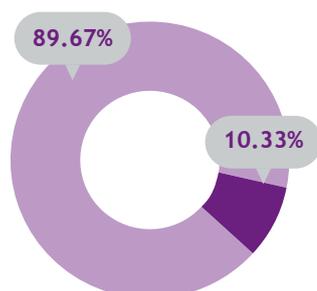
Pursuant to the Bank's strategic orientation, the key objectives and business activities of the Treasury business function in 2014 focused on adequate liquidity management coupled with investment of free assets in the money and capital markets; support to operations with clients (retail and corporate) and ensuring the appropriate funding sources while reducing concentration and improving the maturity and currency match, thus successfully overcoming the limitations arising from the fact that there is no foreign parent bank, and/or global Treasury, and therefore inability to use favourable financial instruments and to exercise more flexibility in liquidity management.

In the last quarter of 2014 the National Bank of Serbia on two occasions reduced the foreign currency required reserve rate with concurrent changes in structure of allocation of FX required reserve (increase in allocation in dinars). In this way, the foreign currency liquidity was released to commercial banks in Serbia while sterilizing dinar liquidity which, in addition to the expected stabilizing effect on the foreign exchange market and the dinar exchange rate also had a significant impact on yields on government securities. Likewise, in 2014 there was a substantial spill over of short-term local currency placements (REPO with the National Bank of Serbia) in long-term investments in government securities and subsidized loans.

Through its policy of cautious investment in first-class financial instruments, in 2014 Komercijalna banka reaffirmed itself as one of the most active participants in the local financial market.

Bank's share in investment in securities of the Republic of Serbia as of 31.12.2014

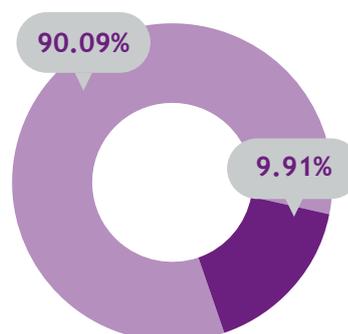
■ Komercijalna banka ■ Other participants



Extremely active participation of Komercijalna banka in the securities market was accompanied by the participation in the operations of the National Bank of Serbia on the open market - reverse REPO operations. In the course of 2014 the share of Komercijalna banka in total volume of reverse REPO operations in average stood at 9.91%. Compared to the preceding year this is a decrease by 40%.

Bank's share in repo operations with NBS during 2014

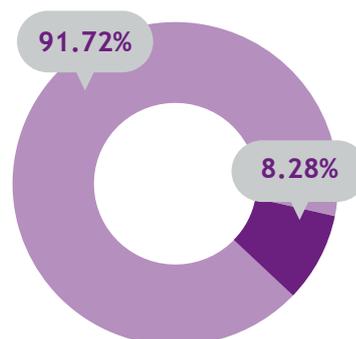
■ Komercijalna banka ■ Other participants



With total sales amounting to EUR 763 million and with total purchases amounting to EUR 810 million, Komercijalna banka is one of the most active participants in the foreign exchange market.

Bank's share in FX sale and purchase between banks and residents in 2014

■ Komercijalna banka ■ Other banks



By drawing down new credit lines in 2014, Komercijalna banka continued to rearrange its sources working towards achieving the mid-term objective of their full optimization. The effects achieved include both lower average cost of funds and greater flexibility in managing deposits.

Due to participation of the International Financial Institutions (IFIs) in its ownership structure and the earned international reputation of the first-class, safe bank, Komercijalna banka has facilitated access to international favourable funding sources. In 2014 Komercijalna banka used that fact to its advantage by attracting new credit lines from the international organisations, and agreeing credit lines which are expected to be disbursed in the course of 2015.

In 2014 the Bank drew a total of EUR 40 million in credit lines from IFIs to finance the needs of a wide range of clients, with different repayment terms depending on loan purpose. This enabled the Bank both to retain the existing clients and to attract the new ones with its offer of competitive products. In addition, the Bank provided for a better maturity match of funding sources/loans and advances, given the maturities of disbursed credit lines.

#### Overview of credit lines for 2014

<p><b>EFSE</b> EUROPEAN FUND FOR SOUTHEAST EUROPE</p>	<p><b>EUR 15,000,000, September 2014</b> (financing of end users (retail clients) for improvement of housing conditions, renovations, extensions, (re)construction and purchase of houses or housing units)</p>
<p><b>IFC</b> International Finance Corporation World Bank Group</p>	<p><b>EUR 15,000,000, October 2014</b> (financing and extension of program of housing loans, to finance the purchase, renovation or reconstruction of real estate for people who live in them)</p>
<p><b>European Bank</b> for Reconstruction and Development</p>	<p><b>EUR 10,000,000, December 2014</b> (financing of projects of energy efficiency and the use of renewable energy sources for private sector (small and medium-sized enterprises) and local self-government)</p>

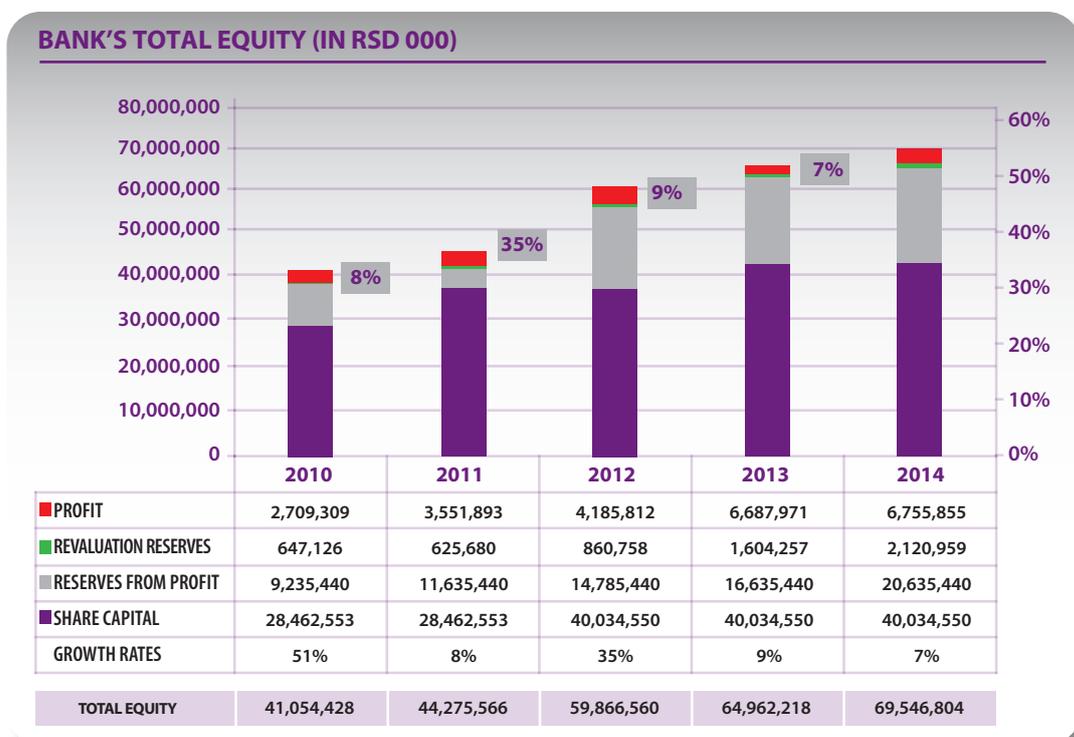
## 5.5. Bank's Equity

Changes in equity from 2010 to 2014:

ITEM	2014	2013	2012	2011	2010
<b>BANK'S EQUITY (IN RSD 000)</b>					
Share capital	40,034,550	40,034,550	40,034,550	28,462,553	28,462,553
Reserves from profit	20,635,440	16,635,440	14,785,440	11,635,440	9,235,440
Revaluation reserves	2,120,959	1,604,257	860,758	625,680	647,126
Retained earnings	6,755,855	6,687,971	4,185,812	3,551,893	2,709,309
<b>TOTAL EQUITY</b>	<b>69,546,804</b>	<b>64,962,218</b>	<b>59,866,560</b>	<b>44,275,566</b>	<b>41,054,428</b>

The following are the Bank's shareholders as at December 31<sup>st</sup>, 2014, following the conversion of convertible preferred shares into ordinary shares:

SHAREHOLDERS	Ordinary shares	% of STAKE	Preferred shares	% of STAKE	TOTAL SHARES	% of STAKE
Republic of Serbia	7,020,346	41.74	0	0.00	7,020,346	40.84
EBRD	4,109,440	24.43	0	0.00	4,109,440	23.90
IFC	1,706,810	10.15	0	0.00	1,706,810	9.93
DEG	772,850	4.60	0	0.00	772,850	4.50
SWEDFUND	386,420	2.30	0	0.00	386,420	2.25
OTHERS	2,822,090	16.78	373,510	100.00	3,195,600	18.59
<b>TOTAL</b>	<b>16,817,956</b>	<b>100.00</b>	<b>373,510</b>	<b>100.00</b>	<b>17,191,466</b>	<b>100.00</b>

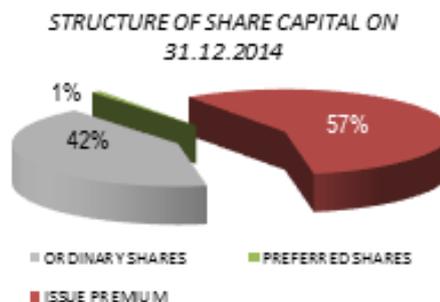


Bank's total capital at the end of 2014 amounted to RSD 69,546.8 million and increased by over 69% since 2010. Share capital, in the same period has increased on the basis of two issues of convertible preference shares (in 2010 to the amount of RSD 11,400.0 million and RSD 11,572.0 million in 2012).

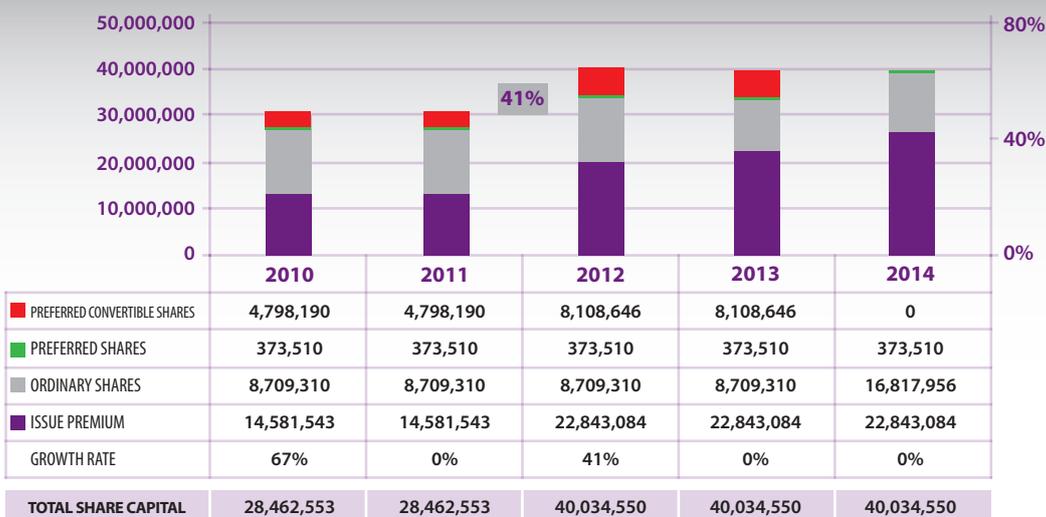
In the last five years, the Bank has formed additional reserves to the amount of RSD 12,874 million from the achieved profit and revaluation reserves, whereof RSD 4,516.7 million in 2014. The significant increase in reserves from the realized profit for each year was a rational decision of the shareholders and management in order to protect the operations of the Bank from risks, on the one hand, and to ensure safe operations of the Bank in the adverse macroeconomic conditions, on the other.

The Bank decided to strengthen its capital base by increasing reserves from profit, bearing in mind that no new increase in capital through the issue of shares is planned for the next three years and that the subordinated debt (supplementary capital) is decreasing by 20% each year.

The formation of additional reserves was the guarantee of preserving stability of operations in the conditions of reduced loan demand and rising credit risk.



#### SHARE CAPITAL OF THE BANK



The Bank's ordinary shares have been traded on the Standard Market of the Belgrade Stock Exchange since 2010.

The conversion of preferred convertible shares into ordinary shares was carried out in 2014. The bank issued an additional 8,108,646 ordinary shares with a nominal value of RSD 1,000 per share. After the conversion, the Bank has 16,817,956 ordinary shares as of December the 31st 2014.

At the end of 2014, 1,099 shareholders hold ordinary shares of the Bank and 630 shareholders hold preferred shares.

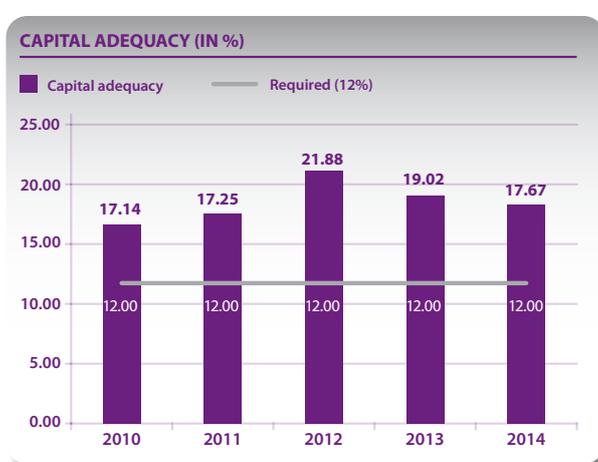
The Dividend Policy of Komercijalna Banka a.d. Beograd was adopted at the session of the General Meeting of Shareholders held on 19 November 2014.

Dividend policy aims to provide a regular and satisfactory flow of dividends (the desired ratio of dividend pay-out on ordinary shares is 30-50% of the unconsolidated audited net profit from that financial year) and at the same time enable the Bank to maintain its financial stability and the potential for future growth and development.

## 5.6. Performance Indicators

No.	DESCRIPTION	REQUIRED	31. 12. 2014	31. 12. 2013	31. 12. 2012	31. 12. 2011	31. 12. 2010
1.	CAPITAL ADEQUACY RATIO (NET CAPITAL/CREDIT RISK+OPERATIONAL RISKS+OPEN FX POSITION)	MIN. 12%	17.67%	19.02%	21.88%	17.25%	17.14%
2.	INDICATOR OF INVESTMENTS IN NON-FINANCIAL SECTOR ENTITIES AND FIXED ASSETS	MAX 60%	27.60%	24.67%	18.38%	27.98%	21.70%
3.	BANK'S LARGE EXPOSURE RATIO	MAX 400%	160.59%	97.78%	107.37%	109.51%	82.51%
4.	FX RISK RATIO	MAX 20%	2.90%	2.12%	0.82%	1.68%	7.19%
5.	LIQUIDITY RATIO	MIN. 0,8	2.84	3.45	2.18	2.91	2.45

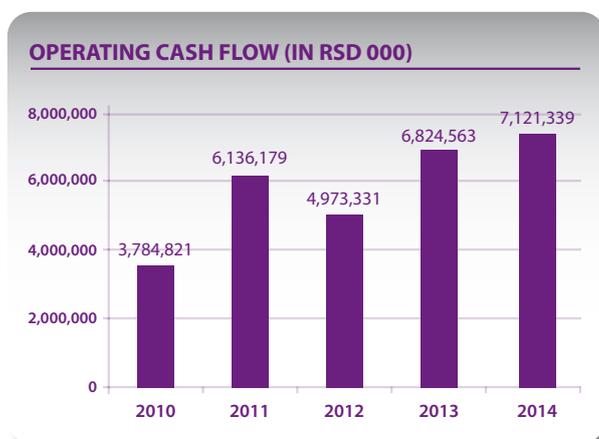
In the observed period, the Bank has met all the required performance parameters, which is a reliable indicator of stable and secure business.



In accordance with regulatory requirements, the Bank has implemented a process of internal capital adequacy assessment process, whereby identifying all the risks to which it has been exposed or may become exposed in its operations and calculated internal capital requirements for materially significant risks, as well as the available internal

capital. The process of internal capital adequacy assessment is a continuous process, which is involved in the daily decision-making and is an integral part of the risk management system.

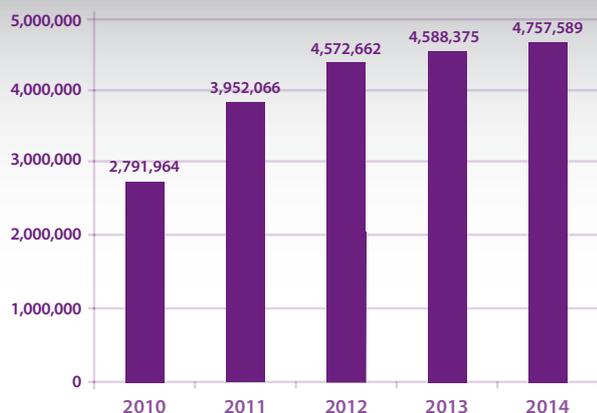
Percentage of interest and fees collection in 2014 came to 94.7%.



Operating cash flow at the end of 2014 was slightly higher than at the end of 2013. There was a growth in the fees inflow (3.1%), while the interest inflow was on the lower level (1.3%). The decrease in interest income of the corporate business line was partly compensated by higher interest inflow from the investments in government securities and the securities issued by National Bank of Serbia. On the other hand, interest outflows were on the lower level (9.8%) primarily due to the fall of the average interest rate on term deposits.

## 5.7. Bank's Profitability

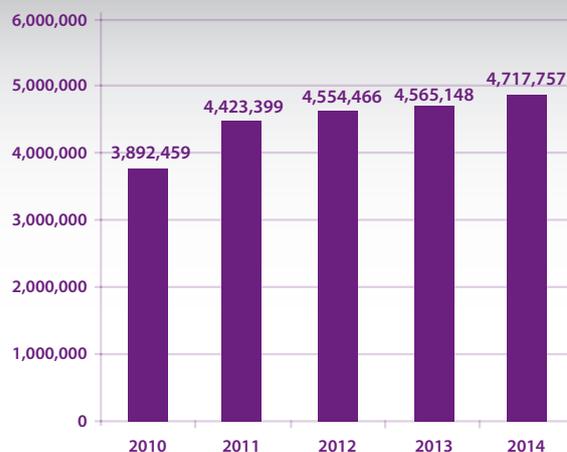
### ACHIEVED PROFIT BEFORE TAX (IN 000 RSD)



In the last three years the Bank achieved profit in excess of RSD 4.5 billion.

In 2014, interest income recorded 2.9% growth. In 2014, fee income recorded 3.3% growth.

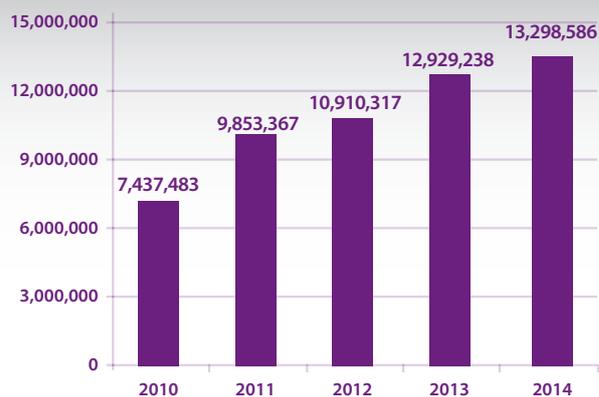
### FEE INCOME (IN 000 RSD)



### PROFITABILITY PARAMETERS (IN %)

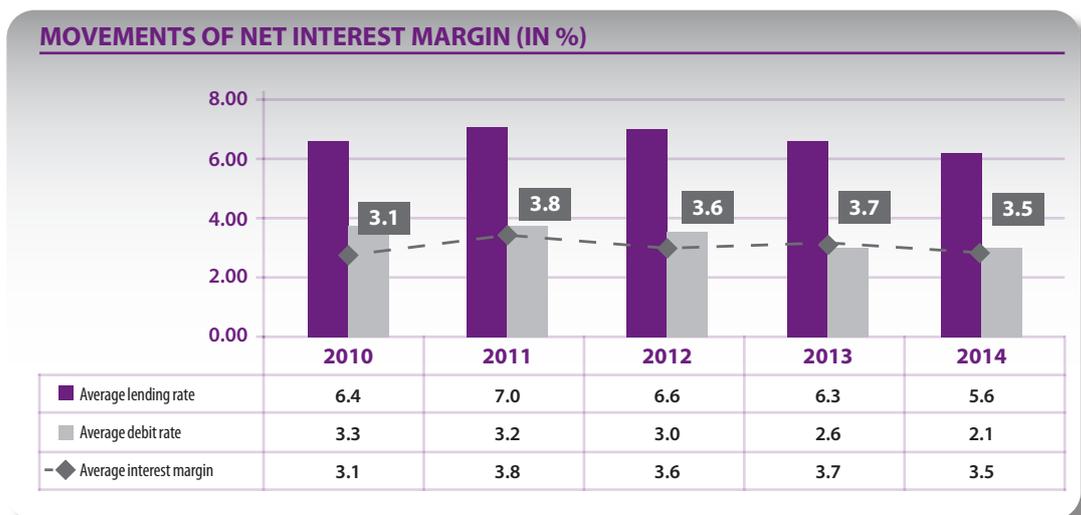


### INTEREST INCOME (IN 000 RSD)



### COST INCOME RATIO (IN %)

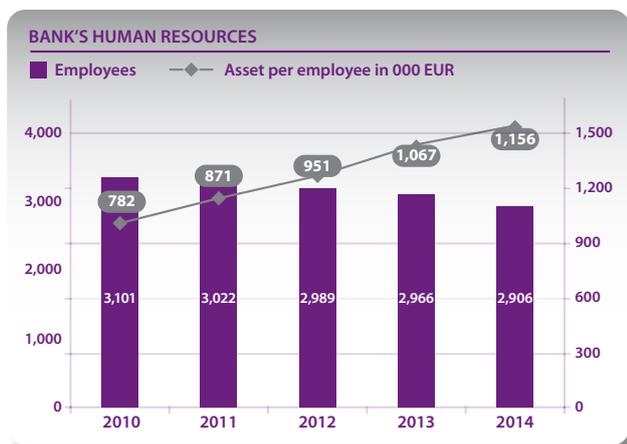




The interest margin was under strong pressure due to a significant reduction in the price of funding sources, as a result of the limited possibilities of investing with a reasonable return to risk ratio, the focus of all active banks and IFIs on a small number of high quality customers and local funding, with constantly present, and necessary maintaining of a higher liquidity level compared to the competition (subsidiaries of European banks). The Bank continues to work towards further optimization of funding sources in terms of prices, currency structure, maturity, and the balanced investing.

### 5.8. Bank's Human Resources

A significant increase in the volume of business with the continuous optimization of the number and structure of employees resulted in an increase in the efficiency of the Bank, as measured by asset per employee in RSD and in EUR.



The Bank continually invests in training and development of employees. Development activities in 2014 indicate a continuation of qualitative and proactive approach to the implementation of training, based primarily on the identification of training needs, adapting the training content, design, and delivering internal training, organization of internal and external trainings, measuring and improving the quality of trainings and the training process.

	2010	2011	2012	2013	2014
Asset per employee in 000 RSD	82,512	91,161	108,192	122,315	139,801

Classification of educational degrees	Total	Up to 30	31-40	41-50	51-60	Over 60
I	19		5	5	9	
II	3			1	2	
III	29		8	9	11	1
IV	1,050	41	270	306	417	16
V	3		1	2		
VI	645	56	283	141	150	15
VII1	1,128	86	550	248	225	19
VII2	27	1	14	9	3	
VIII	2			2		
<b>TOTAL</b>	<b>2,906</b>	<b>184</b>	<b>1,131</b>	<b>723</b>	<b>817</b>	<b>51</b>

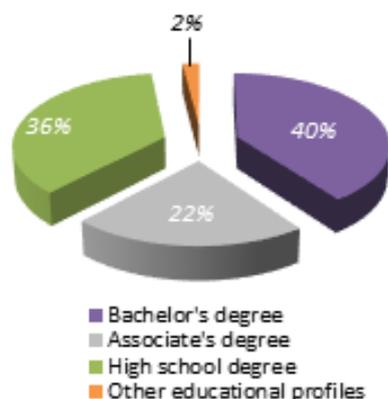
Observed by the subject of training, the most common were occupational trainings, aimed at the acquisition of new and improvement of the existing knowledge. The most important areas of training in 2014 according to the criteria of the topic importance and the number of participants are: product knowledge; retail business; compliance; e-banking; payment operations; credit analysis etc. In addition, the Bank also invests in trainings aimed at developing the capacity of staff in order to efficiently perform work (sales skills, presentation, leadership, communication), as well as technical skills.

Since 2008, the Bank has conducted appraisals based on set annual targets, monitoring the achievement of these targets, but also the abilities employees demonstrated in achieving them.

The annual performance appraisal is the basis for rewarding (reward system was developed in cooperation with German consultant ADG), staff career planning and planning of the budget and training programs.

The principles of rewarding the employees are clearly defined by the Remuneration Policy adopted by the Board of Directors at the proposal of Compensation Committee, which is one of the bodies established by Board of Directors. The objective of this Policy is not only to adequately reward the staff, but also to motivate them to achieve better work results. The amount of remuneration depends on the tasks that the employee performs and annual performance appraisal of the respective employee.

*Classification of employees' educational degrees in 2014*



### 5.9. Marketing and CSR Activities

Marketing activities of the Bank contributed to the further improvement of the strong market position and corporate branding, developing distribution channels and sales promotions of products and services of the Bank. Marketing communication was directed towards existing and potential target groups of customers, as well as the general public. In this continuous process, an adequate support to the work of other business sectors of the Bank has been provided.

A total of 7 ATL campaigns were realized, with the primary objective to promote the products and services of the Bank (New Year's Eve / gift cards, cash loans, housing loans, teen cards, Kombank agriculture, electronic banking, savings) and an extremely extensive CSR / ATL campaign - Together for Babies.

In addition to standard communication channels, we continued with a planned, intensive, targeted and comprehensive communication on social networks (Facebook, Twitter, YouTube, Google+, 4square, LinkedIn), which boosted the effects of promotional campaigns.

Almost all marketing activities were also promoted on the Bank's own web site, and after extensive preparations and testing, we have created and set up a new, updated, functionally improved and redesigned web site of Komerčijalna Banka, with the same web address [www.kombank.com](http://www.kombank.com). The new site was created in line with "responsive" design, which means that the site adjusts itself to the device used to open it. Regardless of whether the site is being opened by

desktop or laptop computers, tablet or mobile phone, responsive site retains its structure, design and visual solution. Technological improvements make the content easier to share on social networks. The effectiveness of promotional campaigns has been continuously enhanced by the sophisticated and appropriate PR support.

In order to rejuvenate the customer base, marketing activities aimed at a younger target population have been intensified, especially in the card segment.

CSR activities gave a special contribution to maintaining and increasing the value of corporate image; the Bank took an active part in these activities that were carefully chosen and supported.

Mostly in the first half of the year, the Bank donated significant funds to help the community in the elimination of the consequences of floods.

However, the greatest media attention was given to the action "Together for Babies". The Bank started with realization of this campaign together with B92 Fund in 2014, and continued in 2015. The medical equipment for four maternity wards was provided in this action in 2014.

We got notable media space and public acceptance through 17 highly appreciated exhibitions in our gallery KOMBANK ART HOL.

We continued with the high-quality exploitation of the title sponsorship of Kombank Arena, as the most prestigious sports and concert facility in the country. We held 17 concerts and 12 sporting events (basketball Euro league), which also had significant media coverage through announcements and reports on all of these events in all the media.

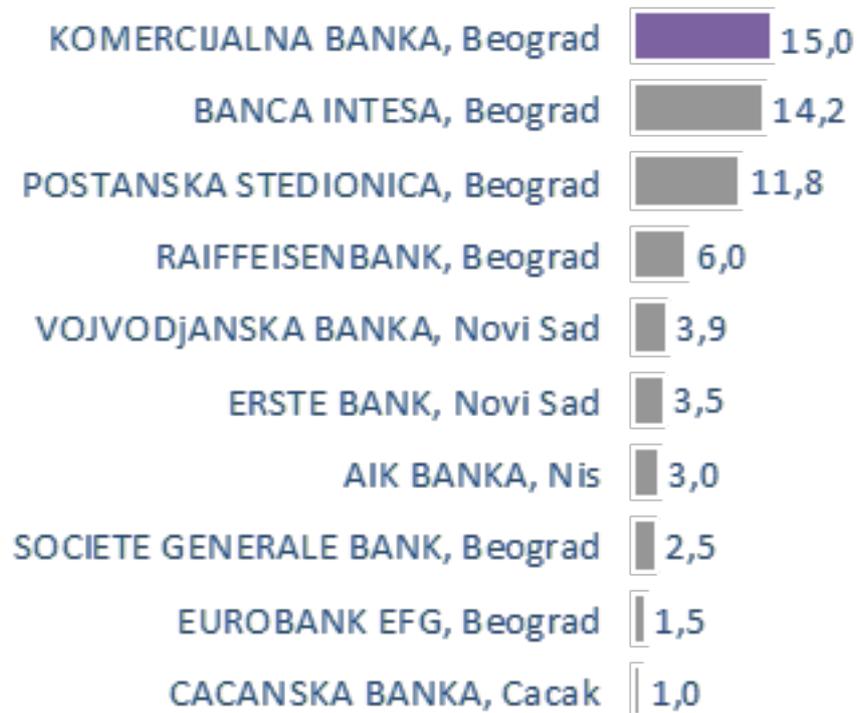
The Bank has helped the growing number of humanitarian, cultural, artistic and sports projects and actions.

In addition to maximized feedback effects of investment in donations, sponsorships and CSR activities, we got an additional pleasure from the support to our athletes who won medals at European and international level - the basketball team, Taekwondo Club Galeb - Milica Mandić, Athletic Association of Serbia - Ivana Španović and Mihailo Dudaš...

All marketing activities are coordinated with the Bank's subsidiaries in Montenegro and the Republic of Srpska.

For consideration of the Bank's market position as a brand, its products and services, a good part of the marketing efforts were directed to the constant monitoring and analysis of quantitative and qualitative researches, aimed at improving the marketing activities. Studies show that the Bank has maintained a leading position in the public eye, as measured by the criteria of familiarity and quality. The practice of uploading the results of available researches to the Bank's internal portal continued, which provided additional information to the employees and management, as work and decision-making assistance.

### Best Bank in Serbia - 10 best banks



Source: IPSOS Strategic Marketing, Banking omnibus, November 2014.



KOMBANK  
ARTHOL



ZAJEDNO ZA BEBE

## 5.10. Project and Project Portfolio Management

Altogether 11 projects with a total budget of EUR 523 thousand were implemented in 2014, while 22 projects remained in the Bank's project portfolio as of 31 December 2014.

Project finished in 2014

CATEGORY	Number of projects
Regulatory	1
Optimization and improvement	4
IT projects	5
Other	1
<b>Total</b>	<b>11</b>

The most important finished projects in 2014 were:

- Classification of KB Beograd Information - The implementation of solutions which organize the process of classification and labelling of documents, records and security conditions for the protection of classified information (cryptography, storage, control, distribution).
- Optimization of printing on laser printers in KB's network - Optimization of printing process that contributes to a significant reduction in operating costs by replacing and updating obsolete printing equipment as well as "outsourcing" of the printing services to external company.
- Management of business processes - Improvement of the Bank's business processes by applying „Lean/Six Sigma“ methodology. Successful implementation of the "pilot" project, wherewith the Bank received an adequate know-how which will in future be used in other business processes.
- Consolidated reporting - Compliance of the banking group with the legal requirements of the parent bank and with the regulatory requirements of the National Bank of Serbia.

Active projects as of 31 December 2014

CATEGORY	Number of projects
Strategic	2
Regulatory	1
Optimization and improvement	9
IT projects	2
Other	1
<b>Total</b>	<b>15</b>

The most important active project as of 31 December 2014:

- Program of Basel II implementation internal approach - The program includes five projects. The aim of the implementation of the Bank's internal approach is to improve risk management through the development of customized internal models to correspond to the provided risk profile of the Bank. The increase in the Bank's ability to accurately measure and assess the risks to which it is exposed would lead to a reduction in adverse effects on the financial result and capital, and thus to increase the capital adequacy ratio.
- The centralization of Middle Office - Coordination of the overall risk management process with the requirements of the National Bank of Serbia, so that there is a clearly defined division of tasks and responsibilities of employees, which prevents a conflict of interest in risk analysis operations.
- Improvement of the system of project and project portfolio management - More efficient selection and allocation of resources of the Bank to projects and programs that will contribute to achieving the strategic goals of the Bank; Improving cost management system; Improving reporting systems; Improving the PMO document management system; Increased efficiency in PMO operations and better use of human resources.
- The introduction of ISO27001 certificates - project is of great importance to information security, risk reduction and improving information security management system (ISMS). The project objective and success criterion is to ensure all the necessary controls for the application of the principle of confidentiality, uniformity and availability of information, protection of information and data as well as acquiring ISO27001: 2013 certificate.
- Migrating SQL Server - Successful migration was performed with minimal downtime of the Core banking applications that depend on the Core system, with the same or better application performance and the same or better functionality brought by the new version of the SQL Server 2008 R2.

### 5.11. Bank's Balance Sheet as of 31 December 2014<sup>24</sup>

IN 000 RSD

No.	POSITION	31.12.2014	31.12.2013	INDICES	% OF SHARE AS OF 31.12.2014
1	2	3	4	5=(3:4)*100	6
	<b>ASSETS</b>				
1.	Cash and funds held with the Central Bank	68,547,389	70,934,839	96.6	16.9
2.	Pledged funds	-	-	-	
3.	Financial assets by fair value through balance sheet intended for sale	121,634	115,319	105.5	0.0
4.	Financial assets initially recognized at fair value through profit or loss	-	-	-	
5.	Financial assets available for sale	95,481,249	56,885,285	167.8	23.5
6.	Financial assets held to maturity	51,442	149,900	34.3	0.0
7.	Loans and receivables due from banks and other financial institutions	34,737,605	35,247,935	98.6	8.6
8.	Loans and receivables due from customers	185,377,035	177,560,058	104.4	45.6
9.	Changes in fair value of items that are the subject of hedging	-	-	-	
10.	Receivables from financial derivatives held for hedging	-	-	-	
11.	Investments in associated companies and joint ventures	-	-	-	
12.	Investments in subsidiaries	5,480,888	5,480,888	100.0	1.3
13.	Intangible investments	405,774	537,445	75.5	0.1
14.	Real-estate, buildings and equipment	6,329,077	6,577,670	96.2	1.6
15.	Investment property	2,581,144	1,808,554	142.7	0.6
16.	Current tax assets	73,835	712,700	10.4	0.0
17.	Deferred tax assets	-	-	-	
18.	Fixed assets intended for sale and funds from discontinued operations	84,227	71,630	117.6	0.0
19.	Other assets	6,990,225	6,704,096	104.3	1.7
	<b>TOTAL ASSETS (1 to 19)</b>	<b>406,261,524</b>	<b>362,786,319</b>	112.0	100.0

<sup>24</sup> The new Chart of Accounts for banks is in effect as of 31 December 2014, which is why the form of financial statements for 2014 was changed. For reasons of comparability of the financial data, the "translation" of balance sheet formats for 2013 was done on the new chart of accounts.

No.	POSITION	31.12.2014	31.12.2013	INDICES	% OF SHARE AS OF 31.12.2014
1	2	3	4	5=(3:4)*100	6
	<b>LIABILITIES</b>				
1.	Financial liabilities at fair value through profit or loss held for trading	-	-	-	
2.	Financial liabilities initially recognized at fair value through profit or loss	-	-	-	
3.	Liabilities arising from financial derivatives held for hedging	-	-	-	
4.	Deposits and other liabilities to banks, other financial institutions and the central bank	23,743,018	21,058,542	112.7	5.8
5.	Deposits and other liabilities to other customers	301,954,911	266,020,289	113.5	74.3
6.	Changes in fair value of items that are the subject of hedging	-	-	-	
7.	Issued own securities and other borrowed funds	-	-	-	
8.	Subordinated liabilities	6,036,680	5,711,409	105.7	1.5
9.	Provisions	1,640,595	765,132	214.4	0.4
10.	Liabilities arising from funds intended for sale and funds from discontinued operations	-	-	-	
11.	Current tax liabilities	-	-	-	
12.	Deferred tax liabilities	150,407	10,156	1.481.0	0.0
13.	Other liabilities	3,189,109	4,258,573	74.9	0.8
<b>14.</b>	<b>TOTAL LIABILITIES (1 to 13)</b>	<b>336,714,720</b>	<b>297,824,101</b>	<b>113.1</b>	<b>82.9</b>
	<b>CAPITAL</b>				
15.	Share capital	40,034,550	40,034,550	100.0	9.9
16.	Own shares				
17.	Profit	6,755,855	6,687,971	101.0	1.7
18.	Loss				
19.	Reserves	22,756,399	18,239,697	124.8	5.6
20.	Unrealized gains	-	-	-	
21.	Non-controlling interest	-	-	-	
<b>22.</b>	<b>TOTAL CAPITAL (15 to 21)</b>	<b>69,546,804</b>	<b>64,962,218</b>	<b>107.1</b>	<b>17.1</b>
<b>23.</b>	<b>TOTAL LIABILITIES (14+22)</b>	<b>406,261,524</b>	<b>362,786,319</b>	<b>112.0</b>	<b>100.0</b>

## 5.12. Bank's 2014 Profit&Loss Statement

IN 000 RSD

No.	POSITION	31.12.2014	31.12.2013	INDICES (3:4)*100
1	2	3	4	5
	<b>INCOME AND EXPENSES</b>			
1.1.	Interest income <sup>25</sup>	21,224,379	22,023,774	96.4
1.2.	Net interest income	7,925,793	9,094,536	87.1
<b>1.</b>	<b>Net interest income</b>	<b>13,298,586</b>	<b>12,929,238</b>	<b>102.9</b>
2.1.	Fee and commission income	5,677,040	5,493,211	103.3
2.2.	Fee and commission expenses	959,283	928,063	103.4
<b>2.</b>	<b>Net fee and commission income</b>	<b>4,717,757</b>	<b>4,565,148</b>	<b>103.3</b>
3.	Net gain / loss on financial assets held for trading	6,076	22,342	27.2
4.	Net gain / loss on risk hedging	-	-	
5.	Net gain / loss on financial assets initially recognized at fair value through profit or loss	-	-	
6.	Net gain / loss on financial assets available for sale	51,282	1,738	2.950.6
7.	Net gains / losses on foreign exchange transactions and effects of foreign currency clause	-205,943	-48,733	422.6
8.	Net gain / loss on investments in associated companies and joint ventures	-	-	
9.	Other operating income	569,191	1,123,546	50.7
10.	Net gains / losses on impairment of financial assets and off-balance sheet credit risk items	-2,725,389	-3,220,075	84.6
<b>11.</b>	<b>TOTAL NET OPERATING INCOME/EXPENSES</b>	<b>15,711,560</b>	<b>15,373,204</b>	<b>102.2</b>
12.	Wages, salaries and other personal expenses	4,211,489	4,262,123	98.8
13.	Depreciation costs	844,632	792,648	106.6
14.	Other expenses	5,897,850	5,730,058	102.9
<b>15.</b>	<b>PROFIT BEFORE TAX (1 TO 14)</b>	<b>4,757,589</b>	<b>4,588,375</b>	<b>103.7</b>
16.	Profit tax	-	-	
17.	Profit from deferred tax	47,547	87,950	54.1
18.	Loss from deferred tax	19,559	-	
<b>19.</b>	<b>PROFIT AFTER TAX (15 TO 18)</b>	<b>4,785,577</b>	<b>4,676,325</b>	<b>102.3</b>
20.	Net profit from discontinued operations	-	-	
21.	Net loss from discontinued operations	-	-	
<b>22.</b>	<b>RESULT FOR THE PERIOD – PROFIT (19 TO 21)</b>	<b>4,785,577</b>	<b>4,676,325</b>	<b>102.3</b>

<sup>25</sup> Due to the application of the new "unwinding" concept at the end of 2014, interest income decreased by RSD 442.6 million.

## 6. INVESTMENTS IN ENVIRONMENTAL PROTECTION

The Bank abides by the highest international standards and values in the creation of financial products and services, developing activities in the field of environmental protection and the protection of human and labour rights. By adopting the policies and procedures on natural and social environment, the Bank has defined standards for identifying and managing the risks for natural and social environment in the process of approving and monitoring loans. The Bank has defined the procedure for addressing and responding to complaints against direct or indirect impact of the Bank's business activities to environment and society.

By negotiating credit lines to finance investments aimed at increasing energy efficiency and development of renewable energy, the Bank approved loans that contribute to reduction of energy consumption and carbon dioxide emissions.

Also, the Bank continuously monitors the emergency events occurring in business of its customers, which may have adverse effect on the environment, health, safety or the entire community, and regularly informs management bodies and the shareholders of the Bank thereof.

In order to protect the environment and minimize the possibilities for the occurrence of events that may have a material adverse impact on the environment, health or safety or the community as a whole, the Bank does not finance or provides minimal funding to the customers whose main activity is associated with the production of or trade in arms and ammunition, alcoholic beverages, radioactive materials and other technologies that can have a negative impact on the environment.

## 7. SIGNIFICANT EVENTS AFTER THE END OF THE FINANCIAL YEAR

One General Meeting of Bank's Shareholders was held from 31 December 2012 until 28 February 2015.

- Regular General Meeting of Bank's Shareholders was held on 26 January 2015.

The following decisions were passed: On adoption of the Strategy and Business Plan of the Bank 2015 - 2017.

After the end of the financial year there were no events that have had a materially significant impact on the Bank's financial statements for the period ending on December 31, 2014.

## 8. PLAN FOR FUTURE DEVELOPMENT OF THE BANK

The Bank's strategy in the coming period is defined in the planning process starting with a workshop with members of the Board of Directors in September 2014 and finally through the adoption by the General Assembly of Shareholders of the Bank at its meeting held on 26 January 2015, thus continuing the practice of the three-year planning of the Bank's development, while retaining "roll-over" principle, or the detailed planning, following indicative projections for the next two years and keeping the main focus and orientation, all in line with uncertain and changing environment. When setting up basic strategic goals for the next period, the in focus has been set to a stable and sustainable business primarily through the following:

- Defence of interest margin.
- Increasing efficiency and,
- Maintaining the portfolio quality rather than focusing on the growth.

The Bank is also facing the beginning of privatization process.

The mission and long-term commitment of the Bank in the coming period remain - KB is and will continue to be:

- Leading Serbian bank with regional presence.
- Universal bank with an equal focus on corporate and retail sector.

Additionally, in these times, there is a significant KB's role in mitigating the crisis effects on its customers, and support, within the limits of its potential and not at the expense of its shareholders, to all measures aiming at the recovery of Serbian economy.

We can define the strategic goals as:

- Stable and sustainable business development.
- Management of all risks inherent to the Bank's operations.
- Sustainable profitability that enables creation of the conditions for its growth in the post-crisis period.

The principles which govern the Bank when setting its goals are as follows:

- Stability and long-term business sustainability and shareholder value.
- Prudence.
- Conservative approach.

The strategic goals of the Bank and the expected macro situation and environment, define business targets and priorities of KB for the upcoming period:

1. To maintain the quality of the existing portfolio through intensive monitoring and collection.
2. Further diversification and extension of the funding term structure, as well as stabilization of funding prices at the level lower than present.
3. The diversified growth of investments, primarily by use of withdrawn credit lines (agriculture, micro customers, small businesses, housing loans) with an emphasis on quality.
4. Active securities portfolio management in order to optimize the liquidity level.
5. Expanding the customer base and increase the efficiency of the network in order to create possibilities for rapid exploitation in the post-crisis period.
6. Active management of the asset portfolio (sale / leases).
7. Optimization of all available resources.

Plan	2015	2016	2017
Real growth of ban. sector	0.0%	3.0%	5.0%
Targeted market share	≥12%	≥12%	≥12%
KB growth (ex.rate effect incl.)	3.6%	5.2%	5.5%
ROE on KB share capital	11.9%	13.7%	15.4%
ROE on KB total capital	6.8%	7.5%	8.1%
ROA KB	1.2%	1.3%	1.4%

## 9. RESEARCH AND DEVELOPMENT

Komerčijalna Banka has been monitoring the results of the banking and financial market researches for years, seeking to examine the needs of customers, as well as the satisfaction of those who use its services.

For the purpose of conducting market and customer satisfaction research, the Bank engages specialized agencies for public opinion research. Thus it seeks to provide adequate information that will be helpful both as compared to the competition, and in the process of making business decisions, particularly important in respect to the development of new and improvement and modification of existing products and services.

According to the results of independent research, the Bank has occupied the leading position by brand recognition and quality of services offered for a considerable period of time. The Bank occupies a strongly perceived position owing to the palette and quality of its products and services, and their constant improvement.

In the process of continuous monitoring of market signals and needs of users and potential customers, business sectors of the Bank have, in the previous period, offered to the customers new and / or improved certain types of retail and micro customer loans, and developed a whole range of services in the field of electronic banking, debit and credit cards.

The results of research and development have been implemented in the Strategy and Business Plan Bank.

## 10. ACQUISITION OF OWN SHARES AND STAKES

The Bank did not hold own shares as of December 31, 2014, or during 2014.

The Bank also does not intend to acquire its own shares in the coming period.

## 11. BRANCHES OF THE BANK

The Bank has organized its business through a network of branches and outlets. Business is taking place in the head office in Belgrade, 24 branches and 218 outlets, as shown in item 1.6.

The Bank has three subsidiaries, which together form Komerčijalna Banka ad Beograd banking group:

1. Komerčijalna Banka a.d. Budva in the Republic of Montenegro (100% ownership)
2. Komerčijalna Banka a.d. Banja Luka in Bosnia and Herzegovina (99.99% ownership) and
3. KomBank INVEST a.d. Beograd, Investment Fund Management Company (IFMC) (100% ownership).

	KOMERCIJALNA BANKA AD BUDVA	KOMERCIJALNA BANKA AD BANJA LUKA	DZUIF KomBank INVEST AD BEOGRAD
ADDRESS	Potkošljun bb	Veselina Masleše 6	Kralja Petra 19
PHONE	00382-86-426-300	00387-51-244-700	011-330-8310



### KB BUDVA

Komercijalna banka AD Budva has:

- 124 employees,
- 17 organisational units (6 branches and 11 outlets).

### KB BANJA LUKA

Komercijalna banka AD Banja Luka has:

- 144 employees,
- 26 organisational units (8 branches and 18 agencies).



## 12. FINANCIAL INSTRUMENTS OF IMPORTANCE FOR ASSESSMENT OF FINANCIAL POSITION

At the end of the fiscal 2014, the following financial instruments were of crucial importance for the assessment of the financial position of the Bank:

- On the right hand side of the balance sheet:
  - Loans and receivables due from customers;
  - Loans and receivables due from banks and financial organisations;
  - Financial assets available for sale and
  - Cash and funds held with the central bank.
- On the left hand side of the balance sheet:
  - Deposits and other liabilities to customers;
  - Deposits and other liabilities to banks, financial institutions and the central bank;
  - Subordinated obligations and
  - Capital.

Loans and advances to customers, banks and other financial institutions at the end of the year amounted to RSD 220,114.6 million and make up 54.2% of total assets, while at the end of 2013, loans amounted to RSD 212,808.0 million and were accounted for 58.7% in total assets.

During 2014, loans and advances increased by RSD 7306.6 million or 3.43%. Bearing in mind that loans and advances have made up more than 50% of the total assets for a considerable period of time, Bank has developed a risk management system in the previous period, with particular emphasis on credit risk. As a result of these efforts, the Bank now has a quality loan portfolio, which is provided with the appropriate amount of the allowance and profit-formed reserves.

Financial assets available for sale at the end of 2014 amounted to RSD 95,481.2 million RSD (23.5% of total assets), and compared to the situation as of the end of 2013 (RSD 56,885.3 million, 15.7% of total assets) increased by RSD 38,596.0 million or 67.8%. These assets are mainly related to investments in short-term and long-term securities of the Republic of Serbia.

Cash and funds held with the central bank, credit risk-free assets as of 31 December 2014 amounted to RSD 68,547.4 million RSD, and comparing to the beginning of the year decreased by 3.4% or RSD 2,387.5 million. The amount of the funds held in the drawing account and funds allocated to be held with the National Bank of Serbia as the required reserve are dominant in the structure of this position. Bearing in mind the structure of assets, it can be concluded that the assets sensitive to credit risk are maintained at an optimum level, abiding by the reasonable risk taking policy.

Deposits and other liabilities due to customers (including the assets taken in the form of credit lines) as of 31 December 2014 amounted to RSD 301,954.9 million and account for 74.3% in total liabilities. If compared to the beginning of the year, deposits and other liabilities due to customers increased by RSD 35,934.6 million or 13.5%.

Deposit potential of the Bank predominantly consists of retail foreign currency deposits, whereby there is a great diversification of deposits and a large number of small deposits.

Deposits and other liabilities due to banks financial institutions and the Central Bank amounted to RSD 23,743.0 million as of December 31, 2014, accounting for 5.8% of total liabilities.

In order to create a basis for better lending conditions for the customers, as well as for strengthening the capital base, the Bank has provided a portion of funds in the form of subordinated debt by the IFC. At December 31, 2014, subordinated liabilities amounted to RSD 6036.7 million and constitute 1.49% of liabilities.

As of December 31, 2014, the total capital of the Bank amounted to RSD 69,546.8 million RSD and makes 17.1% of total liabilities. Total capital increased by RSD 4584.6 million or 7.1% in the fiscal year.

Based on the above, we can conclude that the Bank has provided a variety of funding sources and that there is no high concentration of deposits.

## 13. OBJECTIVES AND POLICIES OF FINANCIAL RISK MANAGEMENT

The Bank has recognized the risk management process as a key element of business management, given that the exposure to risks arising from all the operations, as an inseparable part of the banking business, is managed through the identification, measurement, mitigation, monitoring, control and reporting, i.e. specifying the risk limits, and reporting in accordance with the strategies and policies.

The Bank has established a comprehensive and reliable risk management system which includes strategies, risk management policies and procedures, the appropriate organizational structure, effective and efficient management system for all the risks, adequate system of internal controls, appropriate information system and an adequate process of internal capital adequacy assessment process.

In the Risk Management Strategy and Capital Management Strategy, the Bank has set the following objectives within the system of risk management: minimizing adverse effects on the financial result and equity with respect to the defined framework of acceptable risk levels, maintaining the required level of capital adequacy, the development activities of the Bank in accordance with business opportunities and market development in order to achieve competitive edge.

There is a more detailed overview of the objectives and risk management policies of the Bank presented in Section 4 Notes to the Financial Statements.

### *Policy of Protection from Exposure to Credit Risk*

In order to protect against exposure to credit risk, when approving loans, the Bank especially takes into account two sources of debt collection: cash flow, as a primary source of repayment and security instruments (collaterals) as the secondary source of loan repayment. Types of collateral depend on the assessment of the debtor's credit risk and are determined in each case individually. Collaterals are provided after signing the contract and before the loan disbursement.

The Bank regulated the evaluation of credit risk protection instruments, as well as management of these instruments, by internal regulations.

When assessing the value of collateral, the Bank engages licensed appraisers, whose task is to reduce the potential risk of unrealistic assessments to a minimum, and the subject of pledge must be insured with an insurance company acceptable to the Bank with an insurance policy set up in favour of the Bank.

In order to protect against changes in the market value of the collateral, estimated value is adjusted for a defined percentage depending on the type of collateral and the location, which are reviewed and revised at least annually.

The Bank pays special attention to the monitoring of collateral and undertakes activities on securing new evaluations, as well as an additional collateral, primarily with respect to the customers who face some problems in business, but also with respect to the customers whose collateral coverage reduced due to declining collateral values.

## 14. RISK EXPOSURE (PRICE, CREDIT, LIQUIDITY AND CASH FLOW) WITH THE STRATEGY FOR RISK MANAGEMENT AND ASSESSMENT OF THEIR EFFECTIVENESS

The Bank is particularly exposed to the following risks in its operation:

1. Credit and related risks;
2. Liquidity risks;
3. Market risks;
4. Operational risks;
5. Investment risks;
6. Exposure risks and
7. Country risk and all other risks that may occur in the ordinary course of business of the Bank.

Credit risk is the possibility of adverse effects on the financial result and equity of the Bank due to defaulting debtors. Credit risk is conditioned by the creditworthiness of the debtor, regularity of servicing his liabilities to the Bank, as well as the quality of collateral. Acceptable level of credit risk exposure of the Bank is in accordance with defined risk management strategy and depends on the structure of the Bank's portfolio, which serves as the basis for ensuring the limitation of the negative effects on the financial result and minimizing capital requirements for credit risk, settlement risk and

delivery and counterparty risk, in order to maintain a capital adequacy ratio at an acceptable level. The Bank grants loans to customers (legal and natural persons) that are estimated as creditworthy. On the other hand, the Bank does not invest in high-risk investments such as investments in potentially profitable projects involving high risk or investment funds with the high-risk portfolios, etc.

Liquidity risk represents the possibility of occurrence of adverse events that may adversely affect the financial results and equity. Liquidity risk arises from the difficulty of the Bank to settle due liabilities in the event of a liquidity reserves shortfall and the inability to cover unexpected outflows and other liabilities. In its operation, the Bank abides by the basic liquidity principles, providing sufficient level of funds to cover liabilities incurred in the short term, or in other words it respects the principle of solvency by forming the optimal structure of its own and borrowed funds and the establishment of a sufficient level of liquidity reserves that do not compromise the achievement of the planned return on equity. Liquidity risk arises from the Bank's inability to meet its payment obligations. Liquidity risk may appear in the form of funding risk and market liquidity risk. The problem of liquidity in terms of funding sources relates to the structure of liabilities, or obligations, and is expressed through a potentially significant share of unstable sources, short term sources or their concentrations. On the other hand, liquidity risk also arises from the deficit of the liquidity reserves and difficulty or impossibility of obtaining liquid assets at reasonable market prices.

Market risk represents the possibility of negative effects on the financial result and equity due to changes in market variables and comprises interest rate risk in the banking book, foreign exchange risk for all business activities performed and the price risk of the trading book positions.

Interest rate risk is the risk of negative effects on the financial result and equity arising from banking book positions due to adverse changes in interest rates. Exposure to this type of risk depends on the ratio of interest-sensitive assets and liabilities. Interest rate risk management aims to maintain an acceptable level of exposure to interest rate risk in terms of the impact on the financial result and economic value of equity, by conducting an adequate policy of maturity match between the period of interest rates repricing and compliance with lending sources by type of interest rate and maturity.

The Bank is exposed to FX risk, which is manifested through the possibility of adverse effects on the financial result and equity due to changes in inter-currency ratios, changes in the value of the domestic currency against foreign currencies and changes in the value of gold and other precious metals. In order to minimize exposure to foreign exchange risk, the Bank diversifies the currency structure of the portfolio and currency structure of liabilities, harmonizes the open positions by individual currencies, while respecting the principles of maturity transformation of funds.

Operational risk is the possibility of adverse effects on the financial result and equity due to failures in the work of employees, inappropriate internal procedures and processes, inadequate management information and other systems in the bank, as well as due to the occurrence of unforeseen external events.

Investment risk of the Bank is the risk of investments in other legal entities and fixed assets.

Large exposures to a single person or a group of related persons, including persons related to the Bank, is the exposure that exceeds 10% of its capital.

Country risk is the risk that relates to the country of origin of the entity to which the Bank is exposed, or the risk of negative effects on the financial result and equity due to the inability of the Bank to collect receivables from debtors for reasons that are the result of political, economic or social conditions in the debtor's country of origin.

The detailed review and explanation of risks to which the Bank is exposed in its operations is presented in Section 4 Notes to the Financial Statements.

## 15. RULES OF CORPORATE GOVERNANCE

The rules of corporate governance implemented in the Bank are based on the relevant legislation (primarily the Law on Banks and the Law on Companies).

Competences and powers of the Bank's bodies (General Meeting of Shareholders, Board of Directors, Executive Board, Audit Committee, the Asset and Liabilities Management Committee (ALCO Committee), Compensation Committee, credit committees and other committees), are based on the relevant legislation and defined in internal regulations (Memorandum on Association, the Bank's Statute, Rules of Procedure of the Bank's bodies and other internal regulations).

In its operation the Bank implements the Code of Corporate Governance of the Serbian Chamber of Commerce, which was adopted by the Assembly of the Serbian Chamber of Commerce.

The rules of corporate governance are implemented through internal regulations of the Bank and there are no discrepancies in their implementation.

Code of corporate governance has established the principles of corporate practice abided by the holders of the Bank's corporate governance who behave in accordance with these principles. The objective of the Code is the introduction of good business practices in corporate governance, equal influence of all stakeholders, existing and potential shareholders, employees, customers, the Bank's bodies, State and others. The final objective is to provide long-term and sustainable development of the Bank.

The text of the Code of Corporate Governance was published on the website of the Serbian Chamber of Commerce ([www.pks.rs-ventricular services](http://www.pks.rs-ventricular-services), corporate governance) as well as the Bank's web site ([www.kombank.com/korporativno-upravljanje](http://www.kombank.com/korporativno-upravljanje)).

In 2014, IFC (International Finance Corporation) consultant carried out a detailed analysis of corporate governance; he estimated that the corporate governance practices of the Bank were among the best observed in the region and provided guidance for further "fine tuning", which will be implemented in the coming period.