Komerční banka growing its business while changing itself

- **The number of KB Mobilní banka users swiftly broke through the 500,000 mark and continues to rise. As of 30 June 2018, KB's mobile banking application was being used by 514,000 of Komerční banka's clients, up by 150,000 year on year. The total number of the Bank's clients rose by 12,000 to 1,666,000. KB Group was attending to a total of 2,393,000 clients (up by 0.6% year on year).**

- **The total volume of KB Group's lending expanded by 4.2% year on year. Housing loans were up by 5.9%, with a strong contribution coming from Modrá pyramida. Consumer loans grew by 5.8%. Lending to businesses rose by 3.4% overall while loans to small business clients grew at an even faster 6.4% rate.**

- **KB reported a 3.7% increase in net interest income, boosted by volume growth in both deposits and loans. Net profit from financial operations declined in line with expectation by 29.4%, as last year's first half had brought a spike in clients' hedging activity linked to release of the currency floor. Fee income was down by a slight -1.5%.**

- **Recurring operating costs increased by less than the rate of inflation, despite faster growth in personnel expenses. KB created a restructuring provision of CZK 0.3 billion in the second quarter for costs related to branch network optimisation and other targets of the KB Change strategic programme.**

- **The quality of the loan portfolio remained excellent, reflecting the favourable phase of the business cycle. Clients' good repayment discipline in combination with KB's successful recovery performance created an exceptional situation in which the Bank was able to effect a net release of loan loss provisions.**

- **Recurring net profit was almost stable year on year, at CZK 6.8 billion. Reported net income, including various one-off items, such as creation of the restructuring reserve or sale of a head office building in 2017, was down 12.3%.**

- **In the second quarter, KB started delivering on the first items from its KB Change programme. It has shortened the loan approval process for SME clients, introduced branches dedicated to small businesses, trimmed the management structure in retail distribution, and established the first units organised around customer journeys while introducing agile work methods.**

Prague, 2 August 2018 – Komerční banka reported today its unaudited consolidated results for the first half of 2018.

Total revenues declined by 1.5% to CZK 15.4 billion. Net interest income, which constitutes the main contribution to revenues, was higher by 3.7% from the year earlier due to growth in the volumes of deposits and loans, as well as higher market interest rates that positively influenced returns from reinvestment of deposits. Despite growing customer numbers and activity, net fees and commissions were lower by 1.5%. Net gains from financial operations were off by 29.4% due to an elevated base from the previous year that was linked to strong hedging activity among clients associated with the discontinuation of Czech National Bank (CNB) interventions.

Recurring operating expenditures were up by 1.7%,[1] at CZK 7.5 billion, driven by personnel expenses and depreciation, while administrative costs were lower year on year. Reported operating costs, including various one-off items both this year and last, were down by a slight 0.3% to CZK 7.6 billion.

The quality of the loan portfolio remained excellent, reflecting the favourable phase of the business cycle. Clients' good repayment discipline combined with KB's successful recovery performance to create an exceptional situation enabling net release of loan loss provisions in the amount of CZK 0.4 billion.

Recurring attributable net profit (i.e. excluding one-off items) reached CZK 6.8 billion, which was almost the same level (-0.7%) as in the first half of 2017.

KB recognised several one-off items in the first halves of both 2017 and 2018.[2] Including these, the reported net profit attributable to shareholders was lower by 12.3%, at CZK 6.8 billion.

Lending to clients increased by 4.2% to CZK 624.8 billion.[3] Within this total, financing of housing from KB and Modrá pyramida expanded by 5.9% and consumer lending by KB and ESSOX grew by 5.8%. Business lending climbed by 3.4%. Deposits from clients grew by 4.6% year on year to CZK 806.6 billion.[4] The volume of KB Group clients' assets in mutual funds, pension savings and life insurance rose by 5.5% to CZK 165.9 billion.

The capital adequacy ratio reached a strong 18.1%, and Core Tier 1 capital stood at 17.5%.

"The first half result was underpinned by better interest income and an excellent result in terms of cost of risk. We were able to grow lending to business clients, even though the market dynamics in this segment were rather disappointing. The pace of housing loans was steady ahead of the central bank's announcement of new regulations," remarked Jan Juchelka, KB's Chairman of the Board of Directors and Chief Executive Officer.

"We fully embarked during the second quarter on the new strategic direction formulated in the KB Change plan. We started with the first organisational changes to enhance our efficiency and our ability to more quickly implement technological innovations that will benefit our customers. We have just celebrated opening of the new head office building in Stodůlky, and this provides space for effective work by teams fully dedicated to finding solutions to our clients' evolving needs. Through the rest of the year, we will populate the new agile teams, open dozens of "Profi" branches for entrepreneurs, and bring several relevant new services to our clients."

The Bank had 48,205 shareholders as of 30 June 2018 (up by 1,981 year on year), of which 42,879 were private individuals from the Czech Republic (greater by 1,843 from a year earlier). Strategic shareholder Société Générale maintained its 60.4% stake while minority shareholders owned 39.0% and KB held 0.6% of registered capital in treasury.

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[1] Excluding the before tax impacts in the first half of 2017 from revaluation of a headquarters building of CZK 242 million (negative, i.e. higher costs) and in the first half of 2018 from creation of the restructuring reserve for branch optimisation of CZK 295 million (negative, i.e. higher costs) and from release of over-accrued amounts for corporate services of CZK 193 million (positive, i.e. lower costs). If these one-off item are included, reported operating expenditures decreased by 0.3% to CZK 7.6 billion.

[2] In 1H 2017: revaluation and sale of head office buildings with a positive net impact of CZK 896 million. In 1H 2018: finalisation of the sale price for KB's former stake in Cataps with a positive net impact of CZK 82 million, creation of a restructuring reserve with a negative net impact of CZK 238 million, and release of over-accrued amounts for corporate services with a positive net impact of CZK 156 million.

[3] Excluding volatile reverse repo operations with clients but including debt securities issued by KB's clients and held by the Bank. Including repo operations, lending rose by 3.3% year over year to CZK 635.2 billion.

[4] Excluding repo operations with clients. The total volume of 'Amounts due to customers' moved up by 6.4% to CZK 832.0 billion.

Comments on business and financial results

The published financial data are from unaudited consolidated results under IFRS (International Financial Reporting Standards).

BUSINESS PERFORMANCE OF KB GROUP

Market environment[5]

The overall growth of the Czech economy remained solid through the first half of the year, although its pace was noticeably slowing. High consumer confidence fuelled the growth in household consumption, companies were investing to increase their productivity and thereby to mitigate the effects of scarcity in the workforce and rising wage costs, and the public sector was pushing to tap into more EU funds. Export dynamics declined, however, and this reflected in part exporters' limited ability to expand their capacities due to labour shortages.

Unemployment has fallen to its lowest level in the country's history. At just 2.3% (according to the Eurostat methodology after seasonal adjustment),[6] this figure is the lowest anywhere within the entire EU. The labour market situation is tight all across the country, and the shortage of workers is now the bottleneck of economic growth. Growth in average wages, which reached 8.6% in nominal terms in the first quarter and 6.6% in real terms year on year[7], clearly outpaced the growth in labour productivity, and this may endanger the future international competitiveness of Czech production.

Rising wages were reflected also in accelerating inflation. In June, it reached 2.6% and was thus in the upper half of the CNB's tolerance band. At the same time, the Czech crown ceased to strengthen and even weakened moderately during the second quarter. The CNB Board thus evaluated the risks of its forecast as being pro-inflationary, and on June 27 it advanced to the fourth increase in monetary policy rates since the start of the tightening cycle in August of last year. The CNB's main two-week repo rate was raised by 25 basis points to 1.0%. Market rates also moved higher. Three-month PRIBOR rose by 26 basis points to 1.16% in the second quarter, and the long-term ten-year interest rate swap added 20 basis points to hit 2.03%.

In June, the Czech National Bank also announced another tightening of prudential policy in the financial sector. With effect from 1 July 2019, it boosted the countercyclical capital requirement for banks by 25 basis points to 1.5%. In presenting its Financial Stability Report, the CNB has recommended that from October of this year banks should severely restrict the provision of housing loans if the ratio of a debtor's total liabilities exceeds by nine times its disposable income per year or if the proportion of repayment costs exceed 45% of disposable income.

Total bank lending (excluding repo operations) grew by 5% year on year,[8] with lending growth concentrated mainly in retail banking. Corporate lending, meanwhile, grew just slightly and public sector credit declined significantly. In the households segment, housing loans grew by more than 8% and it is possible that the sales of mortgages will accelerate somewhat before the new CNB measures will come into effect. Reflecting strong confidence in the economy among households, consumer lending accelerated slightly to 5%.

The volume of deposits in Czech banks expanded by 6% year over year. Growth was faster in retail

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[5] Data sources for this section: Czech Statistical Office, Czech National Bank, KB Economic Research, unless stated otherwise. Comparisons are year on year.

[6] Source: http://ec.europa.eu/eurostat/statistics-explained/index.php?title=Unemployment_statistics. Data up to May 2018.

[7] Source: https://www.czso.cz/csu/czso/labour_and_earnings_ekon

[8] Source of data on banking market developments: ARAD statistics of the CNB, www.cnb.cz.

banking, while corporate deposits increased only slightly.

Update on KB Change deliveries in the second quarter 2018

In order to address key challenges existing in the Czech banking market, Komerční banka has decided to update its strategic direction. The transformational programme KB Change was announced in May 2018. Its ultimate vision is to be a lifetime partner with a human touch for active individual, small business, and corporate customers, to provide employees a sense of purpose and room for growth, and to deliver long-term sustainable profitability to shareholders while acting responsibly towards society.

During the second quarter, KB implemented first steps towards achieving the goals of the KB Change programme. With KB Express Financing (KB Financování expres), the Bank has shortened to 7 days the time required to decide on uncomplicated loans of up to CZK 25 million for SME clients. With its KB Key (KB Klíč) token, the Bank also prepared an important improvement in the digital experience for clients. Customers will be given a choice to replace their security certificates by a smartphone application, thus allowing them access to their bank accounts from any device. The KB Key will progressively simplify clients' access to additional services, such as to make ATM withdrawals without a card or in authorising e-shop purchases. Transactions will of course continue to be executed in a highly secure manner.

In the distribution network, KB has opened the first of several dozen planned "Profi" branches fully dedicated to serving entrepreneurs as well as small and medium-sized businesses. By the end of June, KB was offering cash handling via ATM and deposit boxes in place of a teller at twenty of its branches.

Organisational changes were focused on improving efficiency and introducing Agile@KB working concept. The Bank is simplifying its decision making and delayering the management structure. It has decided to reduce the number of regional divisions in retail distribution to five from ten. KB has set up new organisational units covering complete customer journeys or enabling activities. An upcoming move into the new head office building in Prague – Stodůlky will facilitate collocation of related activities, thus supporting agile team work. The Bank has even engaged in robotic process automation, and two back office processes in business lending and credit card administration are newly and fully automated.

Developments in the client portfolio and distribution networks

At the end of June 2018, KB Group was serving 2,393,000 clients on a consolidated basis (+0.6% year on year). Standalone KB recorded 1,666,000 clients (+0.7% year on year), of which 1,408,000 were individuals. The remaining 258,000 customers were comprised of entrepreneurs, businesses and corporations (including municipalities and associations). Modrá pyramida was attending to 487,000 customers, and the number of pension insurance participants at KB Penzijní společnost reached 532,000. Services of ESSOX Group (including the PSA Finance franchise) were being used by 214,000 active clients.

Komerční banka's clients had at their disposal 378 banking branches (including one branch for corporate clients in Slovakia), 761 ATMs (of which 274 were deposit-taking ATMs), plus full-featured direct banking channels supported by two call centres. The number of clients using at least one direct banking channel (such as internet or telephone banking) reached 1,437,000 by the end of June 2018 and corresponds to 86.3% of all clients. Mobile banking was itself being used by 514,000 of KB's clients. Customers held 1,564,000 active payment cards, of which 179,000 were credit cards. The number of active credit cards issued by ESSOX came to 106,000. Modrá pyramida's customers had at their disposal 213 points of sale and approximately 800 advisors. SG Equipment Finance (SGEF) was providing its leasing services via nine branches (two of which are in Slovakia), as well as through KB's network.

Loans to customers

Total **gross volume of lending to clients** rose by 4.2% year on year to CZK 624.8 billion.[9]

In lending to individuals, the overall volume of housing loans[I] grew by 5.9% from the year earlier. Within this total, the portfolio of mortgages to individuals expanded by 3.9% to CZK 221.7 billion. Modrá pyramida accelerated growth of its portfolio to reach 16.0% year on year (CZK 47.1 billion). The volume of KB Group's consumer lending (provided by the Bank and ESSOX Group in the Czech Republic and Slovakia) was up by 5.8%, at CZK 39.0 billion.

The total volume of **loans to businesses** provided by KB Group rose by 3.4% year on year to CZK 318.3 billion. This growth rate was influenced by greater issuance of bonds by corporations and intense competition in the market characterised by abundant liquidity. Lending to small businesses grew by 6.4% to CZK 35.3 billion. The overall CZK volume of credit granted by KB to medium-sized and large corporate clients in the Czech Republic and Slovakia (inclusive of factor finance outstanding at Factoring KB and car dealers' financing from PSA Finance) increased by 2.9% year on year to CZK 256.2 billion. At CZK 26.7 billion, the total credit and leasing amounts outstanding at SGEF were up by 4.6% year over year.

Amounts due to customers and assets under management

The **volume of standard client deposits** within KB Group rose by 4.6% year on year to CZK 806.6 billion.[10]

Deposits at Komerční banka from individual clients grew by a swift 9.7% from the year earlier to CZK 265.5 billion. The deposit book at Modrá pyramida contracted by 2.1% to CZK 61.3 billion due to maturing of older contracts. Total deposits from businesses and other corporations climbed by 2.9% to CZK 465.8 billion.

Client assets managed by KB Penzijní společnost were higher by 8.3%, at CZK 55.5 billion. Technical reserves in life insurance at Komerční pojišťovna, totalling CZK 47.3 billion, were at the same level as a year earlier. The volumes in mutual funds held by KB Group clients grew by 7.4% to CZK 63.1 billion.

The Group's liquidity as measured by the ratio of net loans[11] to deposits (excluding repo operations with clients but including debt securities held by KB and issued by the Bank's clients) was at 75.5%.

FINANCIAL PERFORMANCE OF KB GROUP

Income statement

As part of updating its reporting methodology, and mainly in the context of implementing the new IFRS 9 reporting standard, Komerční banka reclassified with effect from 1 January 2018 certain items of the Income Statement and the Statement of Financial Position. For improved information value, the comparative comments below are based on a pro-forma retrospective restatement of the respective accounting lines of the Income Statement from 2017.

Komerční banka's **revenues** (**net operating income**) for the first six months of 2018 decreased by 1.5% year on year to CZK 15,396 million. Within this total, net interest income improved and net fees

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[9] Excluding volatile reverse repo operations with clients but including debt securities issued by KB's corporate clients. If reverse repo operations are included, gross lending increased by 3.3% to CZK 635.2 billion.

[10] Excluding volatile repo operations with clients. The total volume of 'Amounts due to customers' climbed by 6.4% to CZK 832.0 billion.

[11] Gross volume of loans reduced by the volume of provisions.

and commissions declined slightly. Net profit from financial operations dropped visibly and as expected, due to a high base in the first half of 2017, when the CNB's discontinuation of its currency commitment had boosted clients' activity in hedging financial risks.

Net interest and similar income[12] was up by 3.7% to CZK 10,793 million. The result was underpinned by higher market interest rates that support yields from reinvestment of deposits and capital. On the other hand, intense competition on the banking market pushed down spreads on loans. The net interest margin, computed as the ratio of net interest income to interest-earning assets reported on the balance sheet, reached 2.2% in the first half 2018.[13]

Net fee and commission income[14] moved lower by 1.5% to CZK 3,077 million. The overall number of transactions executed by clients rose, most notably in card payments. Transaction fees were diminished, however, due to inclusion of more transactions in account packages in 2017. This was partly offset by higher income from account maintenance, as more clients opted for superior accounts with wider range of included services. Fees from cross-selling were up slightly, supported mainly by volume growth in mutual funds. Income from loan services declined, influenced by shrinking fees from housing loans in KB and Modrá pyramida and lower fees from certain loans to business clients. Fees from specialised financial services were down, mainly because the comparison base had been elevated in the first half of 2017 by several large deals.

Net profit on financial operations decreased by 29.4% to CZK 1,407 million. A lower level had been expected, because the 2017 result had been boosted by clients' exceptionally strong currency hedging activity before and shortly after the CNB eliminated its floor under the CZK exchange rate on 6 April 2017. In the first half of 2018, clients' demand for hedging of currency risks was solid, especially when movement in the Czech crown's exchange rate took a rather unexpected direction. On the other hand, some clients did not perceive the market interest rates as particularly attractive for entering into new positions for hedging interest rate risks. Fees and commissions from FX transactions were higher year on year, on a slight increase in the volume of these transactions.

Dividend and other income rose by 15.5% to CZK 119 million. This line primarily comprises revenues from property rental and ancillary services.

Recurring **operating expenses** were up by a modest 1.7% to CZK 7,493 million. Recurring personnel expenses were higher by 4.0% to CZK 3,775, reflecting mainly an increase in average remuneration as the number of employees was almost stable (+0.3%) at 8,481.[15] General administrative expenses (excluding the regulatory funds) were lower by 3.8%, at CZK 2,002 million. The cost of Resolution and similar funds declined by 2.5% to CZK 833 million. This amount comprises the full-year cost of contributions to the Deposit Insurance Fund and Resolution Fund. Recurring depreciation and amortisation grew by 9.4% to CZK 883 million, driven mainly by new and upgraded software and IT equipment.

In accordance with International Financial Reporting Standards (mainly IAS 13), KB created **a restructuring reserve** in June 2018 covering the expected expenditures arising directly from

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[12] As from 1 January 2018, Komerční banka reclassified fees for early repayment of loans, which compensate the Bank for a loss from necessary adjustments of the hedging position, from 'Net fee and commission income' to 'Net interest income'. Year on year commentaries are in comparison with the restated base.

[13] Net interest margin stood at 2.3% in the half of 2017, but the ratios are not fully comparable, because of impacts from application of the new IFRS 9 standard on certain balance sheet values.

[14] As from 1 January 2018, Komerční banka reclassified fees for early repayment of loans, which compensate the Bank for a loss from necessary adjustments in the hedging position, from 'Net fee and commission income' to 'Net interest income'. Year on year commentaries are in comparison with the restated base

[15] Recalculated to a full-time equivalent number.

restructuring **within the KB Change** programme. The total restructuring reserve amounts to CZK 295 million, of which CZK 223 million in expected costs of severance payments linked to optimising the retail network and headquarters were recognised in personnel expenses. The Bank also booked a charge of CZK 71 million in general administrative expenses related mainly to the expected cost of reducing branch facilities.

Also in 2018's second quarter, KB released CZK 193 million over-accrued in the previous years in general administrative expenses for various services from entities of Société Générale Group. Including this one-off positive impact (i.e. reduction) on operating expenditures and also including the prior year's one-off impairment of a head office building of CZK 242 million, **reported operating expenses** were lower by a slight -0.3%, at CZK 7,594 million.

Profit before allowances for loan losses, provisions for other risk, profit on subsidiaries, and income tax (**gross operating income**) for the first half of 2018 was down by 2.7% to CZK 7,802 million. **Recurring gross operating income**, excluding one-off impairment of a building booked in first quarter 2017, as well as one-off creation of the restructuring reserve and one-off release of the over-accrued amounts for corporate services in second quarter 2018, was down by 4.3% to CZK 7,904 million.

Cost of risk, calculated in accordance with the methodology established by the new accounting standard IFRS 9, reached a negative CZK 401 million, inasmuch as the Group was able to release loan loss provisions on certain exposures due to a positive performance from recovery activities. The economic environment in the Czech Republic and Europe was supportive throughout the first half of 2018 and the default rates remained low. Cost of risk in relative terms[II] as measured over the average volume of the lending portfolio in the first half of 2018 reached -13 basis points.

Income from shares in associated undertakings (i.e. Komerční pojišťovna) increased by 4.6% to CZK 113 million. **Profit attributable to exclusion of companies from consolidation** reached CZK 82 million (CZK 0 in the first half of 2017). That was related to finalising the sale price for KB's stake in Cataps in connection with the sale of an additional 19% in Cataps in February 2018.

Net profit from other assets reached CZK 17 million for the first half, generated from sales of buildings in the held-for-sale portfolio. This had been CZK 1,109 million in the same period of last year, when it had included also a gain from the sale of a headquarters building.

Income tax was higher by 4.8%, at CZK 1,515 million. If the tax effect of the one-off items were to be excluded, income taxes would be up by 0.6%.

KB Group's consolidated **net profit** for the first half of 2018, at CZK 6,902 million, was lower by 12.4% in comparison with the prior year's first six months. Of this amount, CZK 149 million was profit attributable to the Non-controlling owners of minority stakes in KB's subsidiaries (−19.0% versus the year earlier).

Reported **net profit attributable to the Group's equity holders** totalled CZK 6,754 million, which is 12.3% less than in the first half of 2017. **Recurring attributable net profit** (i.e. excluding one-off effects from revaluation and sale of headquarters buildings in 2017 and from finalisation of the sale price for Cataps, creation of the restructuring reserve, and release of over-accrual for corporate services in 2018) was almost stable, dipping by 0.7% year on year to CZK 6,754 million (as one-off items from the first half 2018 generally offset one another).

Other comprehensive income, which derives mainly from revaluations and remeasurements of some hedging, foreign exchange, and securities positions, reached CZK -458 million. **The Group's comprehensive income** for the first half of 2018 amounted to CZK 6,444 million, of which CZK 150 million was attributable to owners of non-controlling stakes.

Statement of financial position

Unless indicated otherwise, the following text provides a comparison of the balance sheet values as of 30 June 2018 with the values from the statement of financial position as of 1 January 2018 after first-time application of IFRS 9. Since 2018, the IFRS 9 reporting standard has introduced a new approach to the classification and measurement of financial assets, a new credit risk impairment methodology, and new hedge accounting rules. Financial assets must be classified based on the entity's business model for managing the financial assets and on the financial assets' contractual cash flow characteristics. According to the determined business model, financial assets are measured at amortised cost, at fair value through profit or loss, or at fair value through other comprehensive income. Due to this change in accounting methodology, comparison with the audited statement of financial position as of 31 December 2017 would be less meaningful.

Assets
As of 30 June 2018, KB Group's total assets had risen by 11.1% year to date to CZK 1,112.7 billion.

Cash and current balances with central banks were down by 34.7%, at CZK 21.3 billion. A large component of this item is comprised of liquidity reserves at central banks.

Financial assets at fair value through profit or loss (trading securities and derivatives and financial assets whose cash flows do not comprise solely payments of principal and interest) increased by 46.1% to CZK 31.5 billion.

The fair value of hedging financial derivatives declined by 22.0% to CZK 10.5 billion.

Year to date, there was a 5.4% rise in financial assets at fair value through other comprehensive income amounting to CZK 25.3 billion. This consisted mainly of public debt securities.

Financial assets at amortised cost increased by 13.0% to reach CZK 1,001.7 billion. The biggest portion of this, (net) loans and advances to customers, went up by 4.9% to CZK 622.8 billion. A 97.3% share in the gross amount of client loans was classified in Stage 1 or Stage 2, while 2.7% of the loans were classified in Stage 3 (non-performing loans). Loans and advances to banks rose by 36.7% and reached CZK 304.5 billion. The majority of this item consists in reverse repos with the central bank. Debt securities went up slightly as well, growing by 5.8% to reach CZK 74.4 billion at the end of the first half.

Revaluation differences on portfolio hedge items were CZK −0.4 billion. Current and deferred tax assets stood at CZK 0.2 billion. Other assets and accrued accounts, which include receivables from security trading and settlement balances, declined overall by 9.7% to reach CZK 5.3 billion. Assets held for sale diminished by 66.4% to CZK 0.1 billion.

Investments in subsidiaries and associates decreased by 12.9%, reaching CZK 1.0 billion.

The net book value of tangible assets rose by 2.1% to CZK 7.6 billion, and intangible assets grew by 3.8% to reach CZK 4.9 billion. Goodwill, which primarily derives from the acquisitions of Modrá pyramida, SGEF, and ESSOX, remained unchanged at CZK 3.8 billion.

Liabilities
Total liabilities were 12.6% higher in comparison to the beginning of 2018 and stood at CZK 1,017.6 billion.

Financial liabilities at amortised costs went up by 12.8% to CZK 959.6 billion. The largest proportion of this total, amounts due to customers, was larger by 9.2% and reached CZK 832.0 billion. This total included CZK 25.3 billion of liabilities from repo operations with clients and CZK 7.9 billion of other payables to customers. Amounts due to banks increased in 2018's first half by 43.2% to CZK 120.3 billion.

The volume outstanding of securities issued grew by 51.9% to CZK 7.3 billion.

Revaluation differences on portfolios hedge items expanded to CZK −4.7 billion. Current and deferred tax liabilities decreased by 15.3% to CZK 0.9 billion. Other liabilities and accruals, which include payables from securities trading and settlement balances, climbed by 14.0% to CZK 21.5 billion.

Provisions increased by 6.7% to CZK 2.1 billion. The provisions for other credit commitments are held to cover credit risks associated with credit commitments issued. The provisions for contracted commitments principally comprise those for ongoing contracted contingent commitments, legal disputes, self-insurance, and the retirement benefits plan.

Subordinated debt, at CZK 2.6 billion, was up by 1.9% year to date. As that debt is issued in euro, the change reflects the weakening of the Czech crown over the same period.

Equity

Equity decreased year to date by 3.1% to CZK 95.1 billion inasmuch as the CZK 8.9 billion in the yearly dividend paid out during the second quarter exceeded the profit accrued during the first six months of the current year. Of this total dividend payout, the value going to non-controlling interests reached CZK 3.2 billion. As of 30 June 2018, KB held in treasury 1,193,360 of its own shares constituting 0.63% of the registered capital.

Regulatory capital and capital requirements

Total **regulatory capital** for the capital adequacy calculation came to CZK 80.9 billion as of 30 June 2018, up 9.0% year on year. **Capital adequacy** stood at 18.1%. The Core Tier 1 capital amounted to CZK 78.3 billion (+5.5% year on year), and the Core Tier 1 ratio was at 17.5%. The Tier 2 capital amounted to CZK 2.6 billion, or 0.6% of risk-weighted assets.

KB's overall capital requirement as of 30 June 2018 was 15.5% relative to the consolidated volume of risk-weighted assets. As from 1 July 2018, KB's overall capital requirements climbed to approximately 16.0%, the required minimum Core Tier 1 capital level to 12.125%, and the minimum Tier 1 capital ratio to 14.0%. This follows the increase by 50 basis points to 1.00% in the countercyclical capital buffer for Czech exposures with effect from 1 July 2018.

The CNB announced a further rise in this buffer with effect from 1 January 2019 by 25 basis points (to 1.25%) and by an additional 25 basis points (to 1.5%) from 1 July 2019.

As measured by the Liquidity Coverage Ratio, KB's liquidity throughout the first half of 2018 safely met requirements established by the applicable regulations.

Changes in corporate governance

With effect from 30 June 2018, Mr Jan Pokorný has decided due to personal reasons to resign his membership on the Board of Directors of Komerční banka and the position of Senior Executive Director for Large Corporate Clients, Structured Financing, Investment Banking, and KB's Branch in Slovakia.

Effective from 31 July 2018, Mr Peter Palečka has terminated his membership on the Board of Directors of Komerční banka and the position of Senior Executive Director, Corporate Secretary. Mr

Palečka will remain at KB until the end of 2018 as an advisor to the CEO.

On the proposal of the Nominations Committee and with the consent of the Czech National Bank, Komerční banka's Supervisory Board elected Mr David Formánek and Mr Miroslav Hiršl as members of the Board of Directors with effect from 1 August 2018.

Expected development and main risks to that development in the second half of 2018

In its baseline macroeconomic scenario, Komerční banka expects the Czech economy will grow its output by approximately 3.0%, mainly driven by rising household consumption and fixed investments but with somewhat diminishing contribution of net exports (as imports should expand faster than exports).

In the second half, the situation on the labour market will still be favourable from a workers' perspective, but employers will experience increasing difficulties to find sufficient staff to pursue expansion plans and the mounting wage bill will eat into profit margins.

In combination with year-on-year higher prices of some important inputs, such as crude oil, the higher labour costs will feed inflation. Although the reported year-on-year growth rate should decelerate slightly compared to the high June figure (due to a higher base from 2017), the CNB will probably continue in gradually raising its monetary policy rates.

Competition on the banking market will remain vigorous, marked by excessive Czech crown liquidity in the market, attempts by some players to acquire or regain market shares in certain important product categories, and rapid adoption of technological innovations by clients as well as financial institutions.

Regulation will pose further impediments for the banking business, as the countercyclical capital buffer will be increased by an additional 50 basis points from July (plus a further 25 basis points from January 2019 and again from July 2019) and there will be new limits on the debt-to-income and debt service-to-income ratios of mortgage borrowers. The latter measure may cause some front-loading of mortgage sales before it becomes effective in October.

In such context, KB management expects the annual growth rate of the loan portfolio in 2018 will remain in the mid- to low- single digits, although it will be somewhat faster than the 2% pace achieved in 2017. This growth will be driven mainly by retail lending. Competition on the mortgage market may intensify especially before the CNB's new regulations begin from October to reduce access to housing credit for a part of the population. Given the favourable labour market situation and high levels of household confidence, unsecured lending to consumers could see an accelerating trend in 2018's remaining months. Business lending may not grow much, given the increasing bond issuance and intense competition, as well as still-abundant liquidity at many companies. Total deposits will probably grow faster than loans, and particularly in the retail and SME segments. In the situation of rising interest rates, clients may increasingly prefer to place their cash reserves into saving and term accounts instead of current accounts. The volume of assets under management in mutual funds, life insurance, and pension funds should continue to expand.

KB Group's total net operating income for 2018 should end at a similar level as in 2017. Growth in net interest income will be driven by increasing volumes of loans and deposits, as well as rising interest rates. The upside will be limited, however, by competitive pressure on lending spreads. Income from fees and commissions will diminish marginally, despite overall growth in the numbers and activity of clients, mainly due to residual effects from previous repricing of certain services. Net profit from financial operations will decrease significantly on a year-on-year basis, because the previous year's gains generated by significant customers' hedging activity around the time of the currency floor's release had been extraordinary.

Recurring operating expenditures are targeted to grow at below the rate of inflation. Personnel expenses will be the main contributor to that growth but depreciation and amortisation charges also will rise, reflecting investments into new software applications, equipment, and facilities. Administrative expenses will thus need to be managed very vigorously.

The situation of a net release of provisions for credit losses is exceptional. The pace of future normalisation of risk costs will depend mainly on how macroeconomic conditions develop in the Czech Republic, and to some extent in Slovakia, or, possibly, on individual circumstances of clients with larger exposures. The expected continuation of a supportive economic trend is consistent with cost of risk for 2018 that is significantly below a normalised rate of 30 to 40 basis points.

Among the key risks to the expectations described above (albeit with a low probability of their occurring during 2018) are the following: an abrupt worsening of the macroeconomic environment, caused, for example, by imposition of major obstacles to international trade or a sudden spike in interest rates; a solitary impairment of a large credit exposure; or a significant worsening of the competitive situation on the Czech banking market leading to material erosion of profit spreads on key products.

The management expects that KB’s operations will generate sufficient profit in 2018 to cover the Group’s capital needs ensuing from its growing volume of assets as well as to pay 65% of consolidated net profit attributable to shareholders in dividends.

Regulatory information

ANNEX: Consolidated results as of 30 June 2018 under International Financial Reporting Standards (IFRS)

Profit and Loss Statement (CZK million, unaudited)	Reported			Recurring		
	1H 2017	**1H 2018**	**Change YoY**	**1H 2017**	**1H 2018**	**Change YoY**
Net interest income and similar income	10,410	10,793	3.7%	10,410	10,793	3.7%
Net fee & commission income	3,125	3,077	-1.5%	3,125	3,077	-1.5%
Net profit of financial operations	1,992	1,407	-29.4%	1,992	1,407	-29.4%
Dividend and other income	103	119	15.5%	103	119	15.5%
Net banking income	**15,630**	**15,396**	**-1.5%**	**15,630**	**15,396**	**-1.5%**
Personnel expenses	-3,630	-3,998	10.1%	-3,630	-3,775	4.0%
General admin. expenses (excl. regulatory funds)	-2,080	-1,880	-9.6%	-2,080	-2,002	-3.8%
Resolution and similar funds	-854	-833	-2.5%	-854	-833	-2.5%
Depreciation, amortisation and impairment of operating assets	-1,049	-883	-15.8%	-807	-883	9.4%
Total operating expenses	**-7,614**	**-7,594**	**-0.3%**	**-7,371**	**-7,493**	**1.7%**
Gross operating income	**8,016**	**7,802**	**-2.7%**	**8,259**	**7,904**	**-4.3%**
Cost of risk	94	401	>100%	94	401	>100%
Net operating income	**8,110**	**8,204**	**1.2%**	**8,353**	**8,305**	**-0.6%**
Income from share of associated companies	108	113	4.6%	108	113	4.6%
Profit/(loss) attributable to exclusion of companies from consolidation	0	82	n.a.	0	0	n.a.
Impairment losses on goodwill	0	2	n.a.	0	2	n.a.
Net profits on other assets	1,109	17	-98.5%	50	17	-66.0%
Profit before income taxes	**9,327**	**8,417**	**-9.8%**	**8,511**	**8,437**	**-0.9%**
Income taxes	-1,446	-1,515	4.8%	-1,525	-1,534	0.6%
Net profit	**7,881**	**6,902**	**-12.4%**	**6,986**	**6,903**	**-1.2%**
Profit attributable to the Non-controlling owners	184	149	-19.0%	184	149	-19.0%
Profit attributable to the Group's equity holders	**7,697**	**6,754**	**-12.3%**	**6,802**	**6,754**	**-0.7%**

1H 2017: Adjusted for net positive contribution from the sale and revaluation of KB's headquarters buildings (CZK -242 mil. in Depreciation, amortisation and impairment of operating assets; CZK 1,059 mil. in Net profit on other assets; CZK 79 mil. in Income taxes).

1H 2018: Finalisation of sale price for KB's former stake in Cataps in connection with the sale of additional 19% in Cataps (CZK 82 mil. in Profit attributable to exclusions of companies from consolidation), restructuring reserve (CZK -223 mil. in Pers. expenses, CZK -71 mil. in GAE and CZK 56 mil. in Income taxes) and release of corporate service fees for SG assistance (CZK 193 mil. In GAE and CZK -37 mil. in Income taxes)

Regulatory information

Statement of financial position (CZK million, unaudited)	30 Jun 2017 According to IAS 39	31 Dec 2017 According to IAS 39	1 Jan 2018 According to IFRS 9	30 Jun 2018 According to IFRS 9	Ytd
Assets	**1,039,362**	**1,004,039**	**1,001,652**	**1,112,710**	**11.1%**
Cash and current balances with central bank	214,365	32,663	32,663	21,318	-34.7%
Loans and advances to banks	61,452	228,373	222,821	304,488	36.7%
Loans and advances to customers (net)	601,634	598,102	593,639	622,804	4.9%
Securities and trading derivatives	123,974	108,468	115,913	131,217	13.2%
Other assets	37,936	36,432	36,616	32,885	-10.2%
Liabilities and shareholders' equity	**1,039,362**	**1,004,039**	**1,001,652**	**1,112,710**	**11.1%**
Amounts due to banks	88,165	84,050	84,050	120,335	43.2%
Amounts due to customers	781,919	762,043	762,043	831,974	9.2%
Securities issued	15,106	4,832	4,832	7,337	51.8%
Subordinated debt	0	2,560	2,560	2,608	1.9%
Other liabilities	54,716	50,208	50,005	55,352	10.7%
Total equity	99,456	100,346	98,162	95,104	-3.1%

Key ratios and indicators	30 Jun 2017	30 Jun 2018	Change year on year
Capital adequacy (CNB)	16.5%	18.1%	▲
Tier 1 ratio (CNB)	16.5%	17.5%	▲
Total risk-weighted assets (CZK billion)	451.3	446.8	-1.0%
Risk-weighted assets for credit risk (CZK billion)	381.5	369.0	-3.3%
Net interest margin (NII/average interest-bearing assets)[III]	n.a.*	2.2%	
Loans (net) / deposits ratio[IV]	n.a.*	75.5%	
Cost / income ratio[V]	48.7%	49.3%	▲
Return on average equity (ROAE)[VI]	n.a.*	14.5%	
Return on average regulatory capital[VII]	22.1%	16.9%	▼
Return on average assets (ROAA)[VIII]	n.a.*	1.3%	
Earnings per share (CZK)[IX]	81.5	71.5	-12.3%
Average number of employees during the period	8,455	8,481	0.3%
Number of branches (KB standalone in the Czech Republic)	390	378	-12
Number of ATMs	769	761	-8
Number of clients (KB standalone)	1,657,000	1,666,000	0.7%

* n.a. – Data according to the IFRS 9 is not available. According to the IAS 39 standard, the following financials as of 30/6/2017 were amouting to:

- NIM (annualised): 2.3%;
- Loan (net)/deposit ratio (excl. Repo with clients): 76.0%,
- ROAE (annualized): 15.6%,
- ROAA (annualized): 1.6%

KB

Regulatory information

Business performance in retail segment – overview	30 Jun 2018	Change year on year
Mortgages to individuals – volume of loans outstanding	221.7 billion	3.9%
Building savings loans (MPSS) – volume of loans outstanding	47.1 billion	16.0%
Consumer loans (KB + ESSOX + PSA Finance) – volume of loans outstanding	39.0 billion	5.8%
Small business loans – volume of loans outstanding	35.3 billion	6.4%
Total active credit cards – number	179,000	-5.2%
– of which to individuals	141,000	-5.7%
Total active debit cards – number	1,385,000	0.0%
Insurance premiums written (KP)	2.9 billion	-17.8%

Financial calendar:

8 November 2018: Publication of 9M 2018 and 3Q 2018 results
7 February 2019: Publication of FY 2018 and 4Q 2018 results

Definitions of the performance indicators mentioned herein:

[I] **Housing loans:** mortgages to individuals provided by KB + loans to clients provided by Modrá pyramida;

[II] **Cost of risk in relative terms:** annualised 'Allowances for loan losses' divided by the average of 'Gross amount of client loans and advances', year to date;

[III] **Net interest margin (NIM):** 'Net interest income' divided by average interest-earning assets (IEA) year to date (IEA comprise 'Cash and current balances with central banks' [Current balances with central banks only], 'Loans and advances to banks', 'Loans and advances to customers', 'Financial assets at fair value through profit or loss' [debt securities only], , 'Financial assets at fair value through profit or loss – non SPPI' [debt securities only], , 'Financial assets at fair value through other comprehensive income' [debt securities only], 'Debt securities')

[IV] **Net loans to deposits:** ('Net loans and advances to customers' including debt securities held by KB issued by the Bank's clients less 'reverse repo operations with clients') divided by the quantity (total 'Amounts due to customers' less 'repo operations with clients');

[V] **Cost to income ratio:** 'Operating costs' divided by 'Net operating income';

[VI] **Return on average equity (ROAE):** annualised 'Net profit attributable to equity holders' divided by the quantity average group 'Shareholders' equity' less 'Minority equity', year to date;

[VII] **Return on average regulatory capital:** annualised 'Net profit attributable to equity holders' divided by average group 'Regulatory capital', year to date;

[VIII] **Return on average assets (ROAA):** annualised 'Net profit attributable to equity holders' divided by average 'Total assets', year to date;

[IX] **Earnings per share:** annualised 'Net profit attributable to equity holders' divided by the quantity average number of shares issued minus average number of own shares in treasury.

Reconciliation of 'Net interest margin' calculation, (CZK million, consolidated, unaudited):

CONSOLIDATED (CZK million)

(source: Profit and Loss Statement)	**1H 2018**	
Net interest income and similar income, year-to-date	**10,793**	
Of which:		
Loans and advances at amortised cost	9,112	
Debt securities at amortised cost	966	
Debt securities other	208	
Financial liabilities at amortised cost	-971	
Hedging financial derivatives - income	4,798	
Hedging financial derivatives - expense	-3,321	
(source: Balance Sheet)	**30 Jun 2018**	**1 Jan 2018**
Cash and current balances with central banks/ Current balances with central banks	13,324	22,593
Loans and advances to banks	304,488	222,821
Loans and advances to customers	622,804	593,639
Financial assets at fair value through profit of loss/ Debt securities	5,897	1,633
Financial assets at fair value through profit of loss - non SPPI/ Debt securities	2,652	2,694
Financial asset at fir value through other comprehensive income (FV OCI)/ Debt securities	25,030	23,798
Debt securities	74,433	70,340
Interest bearing assets (end of period)	**1,048,627**	**937,518**
Average interest bearing assets, year-to-date	**993,072**	
NIM year-to-date, annualized	**2.17%**	