Komerční banka completed its 30th year in good shape and fit for the future

KB reports growth in business and revenue volumes in 2019

- **The number of clients with KB Mobile Banking leapt by 175,000 year on year to 786,000, representing 47% of all KB's 1,664,000 customers. The new KB Klíč (KB Key) authentication application for accessing banking services was being used by 477,000 clients.**
- **The long list of client services improvements introduced in 2019 was completed in the fourth quarter by new functionalities of the Mobilní banka application (including authentication via facial recognition also for Android users), a convenient finance assistant for CFOs available in MojeBanka Business internet banking, and an upgraded Global Cash application for companies operating in multiple country markets. Clients of ESSOX can newly sign their loan contracts by text message, and they can pay with their mobile devices using the Google Pay application.**
- **The total volume of KB Group's lending to customers expanded by 3.1% year on year. The overall volume of standard client deposits within KB Group was up by 2.6%. The volume of KB Group clients' assets in mutual funds, pension savings, and life insurance rose by 9.7%.**
- **KB reported a 1.1% rise in revenues, 2.7% increase in recurring operating expenditures, and a release of credit risk provisions. Net profit attributable to shareholders reached CZK 14.9 billion.**
- **The Board of Directors proposes a dividend of CZK 11.0 billion (i.e. CZK 58 per share) from the 2019 profit. Looking ahead, the Board intends to propose distributing as dividends 65% of attributable consolidated net profit earned in 2020.**

Prague, 6 February 2020 – Komerční banka reported today its unaudited consolidated results for the year 2019.

Total revenues increased by 1.1% to CZK 32.6 billion. This growth was driven by net interest income, up 3.9% to CZK 23.6 billion on the back of growing volumes of loans and deposits. Net fee and commission income diminished by a slight 0.7% to CZK 6.0 billion due to lower income from transactions, while other fee categories were stable or even improved year over year. Net profit on financial operations decreased by 12.7% to CZK 2.8 billion, as the base from the previous year had been boosted by some extraordinarily large hedging transactions developed for clients.

When excluding the effects of various one-off items in 2018 and 2019, operating expenses were up by 2.7% to CZK 14.9 billion. Adjusted personnel expenses rose by 2.3% to CZK 7.8 billion even as the average number of employees declined by 2.9% to 8,167.

The Bank is reporting overall very low client default rates and very good results from recovery activities, thus resulting in a net release of provisions for the year 2019 of CZK 0.6 billion. Nevertheless, the provisioning trend in the corporate segments began normalising in the second half of the year.

Recurring attributable net profit (i.e. excluding one-off items) reached CZK 14.8 billion, almost the same amount as for 2018. The reported attributable net profit including one-off items was up 0.4%, at CZK 14.9 billion.

Lending to clients increased by 3.1% to CZK 654.0 billion.[1] Within this total, financing of housing from KB and Modrá pyramida expanded by 4.0% and consumer lending by KB and ESSOX grew by 1.3%. Lending to businesses and other clients was up by 2.4%.

Deposits from clients climbed by 2.6% year on year to CZK 816.3 billion.[2] The volume of KB Group clients' assets in mutual funds, pension savings, and life insurance rose by 9.7% to CZK 183.8 billion.

The capital adequacy ratio reached a strong 19.7%, and Core Tier 1 capital stood at 19.1%.

"Komerční banka celebrated in January its 30-year anniversary. During those three decades, KB was often the first bank introducing to the Czech market banking innovations that are now considered indispensable. With implementation of the KB Change transformation programme, we have even improved our responsiveness to the changes in client demands, technologies, and the market environment. We are now working hard on a programme for the upcoming years to ensure that KB remains an acknowledged leader in providing quality financial services through safe, simple, and convenient digital channels and via courteous and professional personal contact. This is our way to secure the Bank's long-term successful development," remarked Jan Juchelka, KB's Chairman of the Board of Directors and Chief Executive Officer.

"The year 2019 was one of significant changes in the organisation and culture of KB Group. Even though these changes required significant efforts and attention from the management and all staff, we were able to record growth in revenues and strengthen our relationships with clients. In 2020, the agile working and upgraded distribution platforms will underpin our efforts to reinforce KB's market position, even in the context created by a somewhat less favourable economic environment," Mr Juchelka added.

The Bank had 50,462 shareholders as of 31 December 2019 (up by 2,197 year on year), of which 45,360 were private individuals from the Czech Republic (greater by 2,453 from the 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.

In view of KB's 2019 result, strong capital position at the upper end of the target range, and outlook for growth in risk-weighted assets and capital requirements, Komerční banka's Board of Directors has decided to propose to the Supervisory Board a dividend payment of CZK 11.0 billion. That would come to CZK 58 per share and put the payout ratio at the exceptional level of 74% of KB Group's attributable consolidated net profit. The corresponding gross dividend yield based on 2019's closing share price is 7.0%. The distribution of the year's earnings, including the decision on dividend payment, is subject to a vote of the Annual General Meeting.

KB management strives to maintain the Bank's capital structure so that it is safe, efficient, and adequate with respect to applicable and anticipated regulations. Considering the current state of affairs, KB management intends for 2020 to propose distributing as dividends 65% of attributable consolidated net profit earned in the year, subject to there being no significant changes in regulatory requirements.

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[1] Excluding volatile reverse repo operations with clients but including debt securities issued by KB's clients and held by the Bank. Inclusive of repo operations, lending rose by 3.1% year over year to CZK 656.6 billion.

[2] Excluding repo operations with clients. The total volume of 'Amounts due to customers' moved up by 1.1% to CZK 821.5 billion.

Market environment (in the fourth quarter 2019)[3]

It is presumed that growth of the Czech economy in 2019's fourth quarter was again driven mainly by household and public consumption. Constrained especially by the tight labour market, the economy has further slowed in comparison to 2018. The unemployment rate remains at the lowest level seen anywhere within the EU (standing at 2.0% in December, according to the Eurostat methodology after seasonal adjustment),[4] and wage inflation was measured at 6.9% in the third quarter. Declining but still above average capacity utilisation is keeping productivity at healthy levels and supporting private sector investments. In the second half of 2019, investments slowed mainly in the public component.

Among other factors, higher wage costs pushed the dynamics of industrial producer prices to an average level of 3.1% in 2019. The pressure from the primary price categories flowed through to consumer price inflation, which accelerated throughout the course of 2019. In the final two months it even surpassed the upper bound of the Czech National Bank's inflation target tolerance band, reaching 3.2% in December. That reflected mainly increasing food prices and housing costs, inclusive of energy prices. The tight labour market continues to lift core inflation. Meanwhile, the Czech crown's exchange rate appreciated in the fourth quarter to CZK 25.41 per euro, reaching the strongest level in 2019. That put the Czech currency at a 1.6% higher level quarter on quarter and up by 1.2% year on year.

As both consumer price inflation and core inflation were above the Czech National Bank's monetary policy targets throughout the year, the central bank only increased its monetary policy rates once, in May. This policy stance was due to the CNB Bank Board's concerns about risks in the external economic environment, which include a slowing in Germany's automotive sector, pending Brexit, and US–China trade disputes. The steady monetary policy stance (with the exception of a single rate hike in May 2019) left short-term interbank market interest rates languishing. Three-month PRIBOR hovered around 2.17% in the fourth quarter, and the ten-year interest rate swap moved to 1.72% (6 bps higher than at the beginning of the year). The inversion of the CZK yield curve deepened over the course of 2019 even as yields on 10-year Czech government bonds declined by 18 bps over the year.

Growth in prices of residential real estate was slowing in year-over-year terms during the third quarter. Real estate prices have reached levels not acceptable to many potential buyers, and especially in view of the demand-limiting prudential policy measures implemented by the CNB from 1 October 2018. Prices paid in the third quarter for previously owned flats were up 9% year on year, but prices obtained for new flats (in Prague only) were higher by 6.7% from the year earlier.[5]

Total bank lending for the overall market (excluding repo operations) grew by 4.1% year on year.[6] Lending growth was faster in retail banking, with mortgage growth continuing apace and acceleration in consumer lending supported by still-high levels of consumer confidence and rising incomes. Lending to businesses and corporations slowed to 1.9%. Public sector borrowing even declined, in connection with slowing public investments.

The volume of client deposits in Czech banks expanded by 6.4% year over year.[7] Deposits growth was fastest from non-bank financial institutions. Deposits from individuals were growing by 6.1%, while

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

[4] Source: http://ec.europa.eu/eurostat/statistics-explained/index.php?title=Unemployment_statistics. Data up to December 2019.

[5] Source: https://www.czso.cz/csu/czso/ceny-nemovitosti. Publication code 014007-19, released 16 December 2019.

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

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

deposits from private non-financial corporations were a bit slower (4.3%).

Selected business achievements of the fourth quarter

The renowned business and management magazine Euromoney named Komerční banka as Market Leader Cash Management 2019 in the Czech Republic based on voting by executives of medium and large corporations. Cash management comprises services related to cash flow offered primarily to larger business customers. These include accounts administration, cash handling, advanced web services, and tools for cash flow management.

During the fourth quarter, KB maintained a stream of innovative solutions that help clients to address their financial needs in simple, convenient, and secure ways.

The Mobilní banka application was upgraded. In its version for the Android operating system, KB was the first bank in the Czech Republic to allow authentication via facial recognition. The version for iOS got a new design that is simpler, clearer, and more intuitive. KB Mobilní banka was named the best mobile banking application on the Czech market in Finparada.cz awards for 2019.

Lending by ESSOX has become easier for consumers, for participating merchants and e-shops, as well as for the lender. Upon approval of an on-line credit application, a client may sign the contract by SMS text message, significantly reducing the time and paperwork required. Furthermore, ESSOX clients can also newly pay with their mobile devices using the Google Pay application.

CFOs at KB’s clients have the overview of performance indicators of their businesses ready directly from MojeBanka Business internet banking. The solution has been provided to customers in co-operation with the fintech company BudgetBakers.

Companies operating in multiple international markets appreciated the upgraded multi-bank application Global Cash, allowing secure and comprehensive accounts administration across the global network of Société Générale Group.

Developments in the client portfolio and distribution networks

	FY 2018	FY 2019	YoY
KB Group's clients	2,391,000	2,365,000	-26,000
Komerční banka	1,668,000	1,664,000	-4,000*
– individual clients	1,410,000	1,407,000	-3,000*
– using at least one direct banking channel	1,455,000	1,484,000	29,000
– internet banking clients	1,389,000	1,423,000	34,000
– mobile banking clients	611,000	786,000	175,000
Modrá pyramida	490,000	490,000	0
KB Penzijní společnost	532,000	530,000	-2,000
ESSOX (Group)	212,000	202,000	-10,000
KB Retail branches	364	342	-22
KB Business centres	10	10	0
KB Corporate divisions	5	5	0
Modrá pyramida points of sale	204	205	1
SGEF branches	9	9	0
ESSOX Group points of sale	1,031	920	-111**
ATMs	776	796	20
of which deposit-taking	320	389	69
of which contacless	0	241	241
Number of active debit cards	1,388,000	1,402,000	14,000
Number of active credit cards	178,000	180,000	2,000
Number of cards virtualized into payment apps	23,000	178,000	155,000
KB key authentication users	51,000	477,000	426,000

* *Affected by write-off of non-active defaulted clients in recovery in 1Q 2019*
** *Influenced by the new qualification requirements for intermediaries of consumer financing*

Comments on business and financial results

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

Loans to customers

Total **gross volume of lending to clients** rose by 3.1% year on year to CZK 654.0 billion.[8]

In lending to individuals, the overall volume of housing loans[I] grew by 4.0% from the year earlier. Within this total, the portfolio of mortgages to individuals expanded by 2.5% to CZK 229.4 billion. Modrá pyramida's loan portfolio grew by a strong 10.8% to CZK 56.2 billion. The volume of KB Group's consumer lending (provided by the Bank and ESSOX Group in the Czech Republic and Slovakia) was up 1.3%, at CZK 39.2 billion.

The total volume of **loans to businesses** and other lending provided by KB Group climbed by 2.4%

[8] 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 3.1% to CZK 656.6 billion.

year on year to CZK 329.1 billion. Lending to small businesses grew by 3.4% to CZK 36.7 billion. The overall CZK volume of credit granted by KB to medium-sized, large corporate, and other clients in the Czech Republic and Slovakia[9] increased by 2.2% year on year to CZK 263.4 billion. At CZK 29.0 billion, the total credit and leasing amounts outstanding at SGEF were 3.0% greater year over year.

Amounts due to customers and assets under management

The **volume of standard client deposits** within KB Group rose by 2.6% year on year to CZK 816.3 billion.[10]

Deposits at Komerční banka from individual clients grew by 3.3% from the year earlier to CZK 285.8 billion. The deposit book at Modrá pyramida expanded by a slight 0.1% to CZK 61.8 billion. Total deposits from businesses and other corporations climbed by 3.6% to CZK 462.4 billion.

Client assets managed by KB Penzijní společnost were 8.4% greater, at CZK 62.4 billion. Technical reserves in life insurance at Komerční pojišťovna were up by 2.9% year on year, at CZK 48.0 billion. The volumes in mutual funds held by KB Group clients grew by a strong 16.0% to CZK 73.4 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) stood at 79.0%.

FINANCIAL PERFORMANCE OF KB GROUP

With effect from 1 January 2019, Komerční banka is applying the new accounting standard IFRS 16 Leases, which replaces the previous standard IAS 17. Particularly as a lessee under operating lease of office buildings and branches, the Bank must recognise those leases on its balance sheet. That increases both the assets (right-of-use assets) and the liabilities (lease liabilities). In addition, the nature of expenses related to those leases has changed, because IFRS 16 replaces the straight-line operating lease expenses with a depreciation charge for right-of-use assets and interest expense on lease liabilities. KB followed the modified retrospective approach in adopting the new standard, which means there was no restatement of comparative information.

Income statement

Komerční banka's **revenues** (**net operating income**) for the full year 2019 improved by 1.1% year on year to reach CZK 32,573 million. This growth was driven by net interest income, even as fee income diminished slightly and net gains from financial operations were down relative to the high base of the previous year.

Net interest and similar income[12] were up by 3.9%, at CZK 23,591 million. Although loan and deposit volumes were growing year over year, the low market interest rates caused returns from reinvesting deposits and the Bank's own funds to be lower during most of the year. The product spreads on lending also were compressed due to stiff market competition. The net interest margin

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[9] Inclusive of factor finance outstanding at Factoring KB and merchant and car dealers' financing from ESSOX Group.

[10] Excluding volatile repo operations with clients. The total volume of 'Amounts due to customers' increased by 1.1% to CZK 821.5 billion.

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

[12] As from 1 January 2019, Komerční banka reclassified charges for reservation of funds (commitment fees) from 'Net fee and commission income' to 'Net interest income'. The data for the comparative period have been restated and year-on-year commentaries are made in comparison with the restated base. The contribution of interest expense on lease liabilities newly charged according to IFRS 16 represented 0.2% of net interest income for 2019.

for 2019, computed as the ratio of net interest income to interest-earning assets reported on the balance sheet, reached 2.35%. That figure is very close to that of a year earlier.

Net fee and commission income[13] diminished by a slight 0.7% to CZK 5,984 million. KB recorded higher income from specialised financial services due to improved demand for bank guarantees, more client activity in loan syndications, issuance of trade finance instruments, and advisory. The maintenance fee income also improved as clients continued switching to better account packages that include wider ranging services. Fees from cross-selling were up slightly thanks to income from life insurance products and mutual funds. This positive development was offset by decline in fees for transactions, mainly caused by inclusion of more transactions into the prices of account packages and despite the rapidly increasing number of transactions (especially those carried out using payment cards). Income from loan services was stable year over year.

Net profit on financial operations decreased by 12.7% to CZK 2,803 million. This drop was influenced by some extraordinarily large hedging transactions developed for clients in the previous year. During 2019, clients' demand for hedging of financial risks was weaker in those periods when CZK exchange and interest rates lacked trends and volatility. On the other hand, the Bank was successful in promoting hedging and trading services also among smaller corporate clients. Net gains on FX payment transactions were higher year on year, reflecting an increase in the volume of these transactions and wider spreads.

Dividend and other income declined by 26.1% to CZK 195 million. This line primarily comprises revenues from property rental and ancillary services. Less business intelligence advisory was provided to external parties in 2019.

Operating expenses were up by 2.0%, at CZK 14,932 million. Excluding the effects from creating a restructuring reserve and release of over-accrued charges for corporate services, growth in operating expenses reached 2.7%.[14] Adjusted personnel expenses rose by 2.3% to CZK 7,780 million, reflecting mainly higher remuneration even as the average number of employees declined by 2.9% to 8,167.[15] Reported personnel expenses, inclusive of the restructuring reserve in the comparative base, were lower by 0.6%. General administrative expenses (not including contributions to the regulatory funds) were down by 6.6%, at 3,839 million. This line was also influenced in 2018, however, by creation of the restructuring reserve[14] and in 2019 by implementation of the new IFRS 16 standard that has replaced rent expense with the depreciation expense for rights-of-use. Adjusted for these extraordinary factors, general administrative expenses increased by 0.5%, mainly as a result of higher cost for IT support. The full-year cost of contributions to the regulatory funds (Deposit Insurance Fund, Resolution Fund) reached CZK 854 million, up 1.7% year on year. Depreciation and amortisation grew by 32.4% to CZK 2,458 million, including the effect of IFRS 16 implementation. Adjusted depreciation and amortisation charges were higher by 10.0%, driven mainly by new and upgraded software and IT equipment but influenced also by writing of the new headquarters building into use in the last quarter of 2018.

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[13] As from 1 January 2019, Komerční banka reclassified charges for reservation of funds (commitment fees) from 'Net fee and commission income' to 'Net interest income'. The data for the comparative period have been restated and year-on-year commentaries are made in comparison with the restated base.

[14] In the second quarter of 2018, KB created a restructuring reserve for anticipated costs arising from the KB Change programme. These comprised CZK 223 million in expected costs of severance payments recognised in personnel expenses and CZK 71 million in estimated costs of reducing branch facilities recognised in general and administrative expenses. In the same period of 2018, KB released CZK 193 million over-accrued in previous years within general and administrative expenses for various services from entities of Société Générale Group.

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

The sum of profit before allowances for loan losses, provisions for other risk, profit on subsidiaries, and income tax (**gross operating income**) was up by 0.4%, at CZK 17,641 million. Excluding the contribution of one-off items from the previous year[14], gross operating income was stable (-0.2%).

Cost of risk reached a negative CZK 571 million (net release of provisions), which amount is 11.1% smaller than the net release in the full year 2018. This extraordinarily good result reflects overall very low client default rates and very good results from recovery activities. Moreover, in the final quarter, the Bank completed a process resolving an historic large defaulted corporate exposure, leading to a one-off release of the respective credit provisions. The provisioning trend began to normalise in the second half of the year, and particularly in the corporate segments, as some business clients' financial conditions deteriorated in the face of rising wage costs and slowing demand for their production. The cost of risk in relative terms[ll] and as measured against the average volume of the lending portfolio during the full year 2019 came to −9 basis points.

Income from shares in associated undertakings (i.e. Komerční pojišťovna) was up 28.6% year on year, at CZK 306 million. The Group booked CZK 55 million in **profit attributable to exclusion of companies from consolidation** that was from settling the sale price of KB's stake in Komerční pojišťovna agreed in 2006. In 2018, this line had comprised CZK 82 million related to finalising the selling price for KB's stake in Cataps. **Net profits on other assets** reached CZK 17 million, which amount was linked mainly to sales of buildings in the held-for-sale portfolio. In the previous year, this result had been negative CZK 14 million.

Income tax was higher by 2.1%, at CZK 3,419 million.

KB Group's consolidated **net profit** for the full year 2019, at CZK 15,172 million, remained essentially at the same level as a year earlier. Of this amount, CZK 271 million was profit attributable to the non-controlling owners of minority stakes in KB's subsidiaries (-16.6% year on year).

Reported **net profit attributable to the Group's equity holders** totalled CZK 14,901 million, which is 0.4% better year on year. Recurring attributable net profit (i.e. excluding one-off effects in 2018 from the restructuring reserve, release of accrual for corporate services, and sale price for Cataps, and in 2019 from settlement of the sale price for Komerční pojišťovna) was stable year on year (at CZK 14,846 million).

Other comprehensive income, which derives mainly from revaluations and remeasurements of some hedging, foreign exchange, and securities positions, reached CZK 280 million. **Consolidated comprehensive income** for 2019 totalled CZK 15,452 million, of which CZK 269 million was attributable to owners of non-controlling stakes.

Statement of financial position

Unless indicated otherwise, the following text reflects the newly introduced accounting methodology according to IFRS 16.

Assets

As of 31 December 2019, KB Group's total assets had risen by 1.6% year to date to CZK 1,077.3 billion.

Cash and current balances with central banks were down by 28.6%, at CZK 17.7 billion. Financial assets at fair value through profit or loss (trading securities and derivatives) increased by 3.5% to CZK 23.4 billion. The fair value of hedging financial derivatives declined by 20.4% to CZK 10.0 billion.

Year to date, there was a 43.3% rise in financial assets at fair value through other comprehensive income totalling CZK 36.2 billion. This consisted mainly of public debt securities.

Financial assets at amortised cost grew by 1.3% to CZK 963.4 billion. The largest portion of this consisted of (net) loans and advances to customers, which went up by 3.6% to CZK 647.3 billion. A 97.9% share in the gross amount of client loans was classified in Stage 1 or Stage 2, while 2.1% of the loans were classified in Stage 3 (non-performing loans). The volume of loss allowances created for amounts due from customers came to CZK 10.1 billion. Loans and advances to banks decreased by 4.6% to CZK 244.6 billion. The majority of this item consists in reverse repos with the central bank. The value held in debt securities was up by 2.4% and reached CZK 71.6 billion at the end of the year.

Revaluation differences on portfolio hedge items totalled CZK -0.4 billion. Current and deferred tax assets stood at CZK 0.1 billion. Other assets and accrued accounts, which include receivables from securities trading and settlement balances, declined overall by 10.0% to CZK 5.2 billion. Assets held for sale diminished by 30.5% to CZK 0.1 billion.

Investments in subsidiaries and associates increased by 10.6% to CZK 1.3 billion.

The net book value of tangible assets rose by 37.2% to CZK 10.5 billion, as rights-of-use, recognised under IFRS 16, added CZK 3.0 billion to this total. Intangible assets grew by 14.7% to reach CZK 6.0 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 1.3% higher in comparison to the end of 2018 and stood at CZK 968.7 billion.

Financial liabilities at amortised costs went up by 1.6% to CZK 921.7 billion. Within that total, lease liabilities, an item under IFRS 16, amounted to CZK 3.0 billion. Amounts due to customers comprise the largest proportion of this total, and these grew by 1.1% to CZK 821.5 billion. This total included CZK 5.2 billion of liabilities from repo operations with clients and CZK 7.8 billion of other payables to customers. Amounts due to banks increased in 2019 by 1.4% to CZK 93.6 billion.

The volume of outstanding securities issued was down up 42.6%, at CZK 3.6 billion.

Revaluation differences on portfolios hedge items expanded to CZK -4.1 billion. Current and deferred tax liabilities increased by 30.1% to CZK 1.2 billion. Other liabilities and accruals, which include payables from securities trading and settlement balances, declined by 10.8% to CZK 12.0 billion.

The provisions balance was 27.4% smaller, at CZK 1.3 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 2.5 billion, was down by 1.2% year over year. Because that debt is issued in euro, the change reflects the strengthening of the Czech crown over the same period.

Equity

Total equity grew year to date by 5.1% to CZK 108.6 billion. The value of non-controlling interests reached CZK 3.1 billion. As of 31 December 2019, KB held in treasury 1,193,360 of its own shares constituting 0.63% of the registered capital.

Regulatory capital and requirements

Total **regulatory capital** for the capital adequacy calculation came to CZK 86.6 billion as of 31 December 2019, up 3.9% year on year. **Capital adequacy** stood at 19.7%. The Core Tier 1 capital amounted to CZK 84.1 billion (4.1% higher year on year), and the Core Tier 1 ratio stood at 19.1%. Tier 2 capital totalled CZK 2.5 billion, which was 0.6% of risk-weighted assets.

As the Bank announced on 18 December, it received information from the Czech National Bank regarding the minimum level of capital ratio set for Komerční banka by joint decision of the so-called "college" of supervisors within the Société Générale Group. According to that decision, Komerční banka is required to maintain its capital ratio on a consolidated basis at the minimum level of 10.2% with effect from 1 January 2020. This total SREP (Supervisory Review and Evaluation Process) capital ratio, or TSCR, consists of the following:

1. Minimum capital requirement according to Article 92 (1) of the EU regulation on prudential requirements for credit institutions and investment firms (i.e. maintaining a Tier 1 core capital ratio of 4.5%, a Tier 1 capital ratio of 6%, and a capital ratio of 8%), and

2. Additional requirement of 2.2% established in Pillar 2 above the aforementioned requirements. This additional requirement must be covered fully by Tier 1 capital, and at least 75% of this requirement must be covered by Core Tier 1 capital. This requirement has been increased by 0.6 percentage point in comparison with the previous level.

Moreover, credit institutions in the Czech Republic are simultaneously subject to the combined capital requirements, which are additive to the TSCR requirement set in the aforementioned joint decision. As of 1 January 2020, KB will be required to maintain a combined capital buffer comprising, in the case of Komerční banka, the capital conservation buffer at 2.5%, the countercyclical buffer set for exposures in particular countries (in the Czech Republic at 1.75% from 1 January 2020 and at 2.00% from 1 July 2020), and the capital systemic buffer at 3.0%.

Thus, Komerční banka's overall capital requirements as of 1 January 2020 reach approximately 17.4% in relation to the consolidated volume of risk-weighted assets. The minimum Core Tier 1 capital level is approximately 13.4% and the minimum Tier 1 capital ratio stands at approximately 15.4%.

As measured by the Liquidity Coverage Ratio, KB's liquidity safely met requirements established by the applicable regulations throughout 2019.

Changes in corporate governance (in fourth quarter 2019)

Mr. Laurent Goutard ceased to serve as a member of the Supervisory Board on 4 December 2019. The Supervisory Board appointed Ms. Maylis Coupet a substitute member of the Supervisory Board with effect from 4 December 2019 until the next general meeting. Ms. Coupet previously worked as Head of the Financial Market Division of the French Treasury (2011–2014) and as Managing Director at the Inspection of Société Générale (2014–2017). Since 2017, she has been a Senior Banker at the Retail Banking Department of Société Générale.

Expected development and main risks to that development in 2020

In its baseline macroeconomic scenario, Komerční banka expects that the Czech economy will moderate its growth rate during 2020 towards 2%. Rising household consumption should continue to be the main driver of that growth, while government consumption, fixed investments, and net exports should contribute positively albeit marginally. The main reason for the deceleration is weakening industrial output. The lower growth is set to gradually feed through to other sectors, but the impact should be fairly limited. But the outlook is still quite uncertain due to the global environment and to stringent regulation in the automotive sector.

The labour market should react only gradually to the economic slowdown, which has so far been

evident mainly in the manufacturing sector. The gradual economic deceleration is expected to become visible in the service sector, and therefore the labour market will be affected, albeit with some delay. Wage growth has been decelerating slowly. For 2020, average nominal wage growth should reach 5.6%. Private sector wage growth will likely slow, while public wage growth should speed up, especially in education. A slight increase in unemployment and slower wage growth will probably lead to slower household consumption, rising by around 2% in 2020.

The pick-up in inflation increases the likelihood of further interest rate hikes However, given the prevailing uncertainties and the assumption of weak economic growth abroad, KB expects in its baseline scenario that the key CNB interest rate remains unchanged over the year. The yield curve will likely remain flat in 2020. High demand for Czech government bonds should persist. Yields will likely be pulled up by higher inflation and a hawkish CNB. The yield curve is expected to return to growth shape in the second half of the year.

The banking market will remain intensely competitive, particularly due to excessive Czech crown liquidity in the market, clients’ expectations to have swiftly available all technological advances in banking products and access channels, and attempts by large and smaller players to strengthen their market shares in certain important product categories.

The development in 2020 will be affected by several regulatory changes. The lending for housing will already have absorbed the effects of regulatory limits on the debt-to-income and debt service-to-income ratios of mortgage borrowers in effect since October 2018. The CNB will continue in raising the countercyclical capital buffer requirement, doing so twice in 2020, with effect from January and from July, by 0.25 percentage point each time. KB will comply, too, with the increase in the additional (Pillar II) capital requirement by 0.6 percentage point effective from January. Komerční banka also expects during 2020 to be required to issue additional volumes of debt to cover the Minimum Required Level of Eligible Liabilities (MREL) with a phase-in period until 2023.[16] This issuance must ultimately total tens of billions of crowns and will effectively reduce potential growth in net interest income during the next four years. Moreover, 2020 will bring the full impact on fee income from the cap on fees charged for cross-border payments within the Single European Payments Area, effective from 15 December 2019.[17]

The loan market should grow similarly as in 2019, which means at a mid-single-digit pace, in all main categories. Mortgages may grow a tick more slowly due to the regulations implemented in 2018. Unsecured consumer lending could accelerate slightly, given the relatively dynamic expansion in households’ aggregate disposable incomes. Business lending will probably grow less than the nominal rate of GDP expansion, reflecting lower investments of private businesses in the context of slowing demand and the tight labour market. The growth of the overall deposit market will be again influenced by the volatile placements from financial institutions and the public sector, and the underlying trend of deposits from individuals, entrepreneurs, and non-financial corporations may slow somewhat as it follows the broader economy.

In this context, KB management expects that the annual percentage growth rate of the loan portfolio in 2020 will fluctuate within mid-single digits. In comparison with 2019, KB aims to accelerate mainly

[16] https://www.cnb.cz/en/resolution/general-approach-of-the-czech-national-bank-to-setting-a-minimum-requirement-for-own-funds-and-eligible-liabilities-mrel/

[17] REGULATION (EU) 2019/518 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019 amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges

its unsecured consumer lending. The Group's housing loans should expand at a pace similar to that of the market's growth. The negative impulse from an uncertain economic outlook for business lending should be mitigated by improved efficiency in KB's lending processes. The result will be influenced also by the volume of bond issuance, which KB is promoting as a financing alternative to its corporate clients. Growth in total deposit balances will probably slow in accordance with the overall market trend. The volume of assets under management in mutual funds has potential to expand at a high single-digit pace, while technical reserves in life insurance and client assets in the pension funds are expected to expand only moderately.

KB Group's total net operating income for 2020 should rise slightly in comparison with that from 2019. This growth should be driven mainly by net interest income, underpinned by increasing volumes of loans and deposits, while the net interest margin will be negatively influenced by continuing competitive pressure on lending spreads and moderately increasing costs of deposits. Income from fees and commissions is expected to benefit from clients' increasing utilisation of various financial services and growing volume of their assets under KB Group's management. This positive trend will be more than offset, however, by the impact from implementing the cap on fees for euro-denominated payments within the Single European Payment Area. The level of net profit from financial operations will reflect mainly the volume of financing deals, the volatility and trend of interest and exchange rates, as well as the gradually developing demand for hedging of financial risks from smaller businesses.

Operating expenditures are targeted to increase at a rate similar to that of inflation. The Bank has agreed with the trade unions to 3.6% growth in average remuneration for 2020. At the same time, KB is continuing its optimisation and simplification and is investing substantial amounts into such areas as digitalisation and new products development. During 2020, the Bank will introduce a strategic programme that will build upon the successful transformation achieved within the KB Change plan introduced in 2018.

Cost of risk is expected to begin gradually normalising from the exceptionally favourable results of the previous two years. The effects of the slowing economy should be first felt in the corporate segments, while the risk profile of the retail lending portfolio will be still benefitting from the strong labour market and rising welfare transfers. The expected continuing, albeit slower, growth trend within the Czech economy is consistent with a cost of risk for 2020 that is still below a normalised rate of 30 to 40 basis points.

Among the key risks to the expectations described above is a potential scenario wherein the European and, within that, the Czech economy decelerates more sharply than is currently expected, including a situation of a drop in car sales within Europe. An escalation of conflicts in global trade that affects the European Union is also a possible but not central assumption. The Czech banking sector would suffer if, potentially due to global factors, interest yields on Czech crown-denominated financial assets would decrease markedly.

The management expects that KB's operations will generate sufficient profit in 2020 to cover the Group's capital needs ensuing from its growing volume of assets, as well as to pay out dividends constituting 65% of consolidated net profit attributable to shareholders.

ANNEX: Consolidated results as of 31 December 2019 under International Financial Reporting Standards (IFRS)

Profit and Loss Statement (CZK million, unaudited)	Reported			Recurring		
	FY 2018	**FY 2019**	**Change YoY**	**FY 2018**	**FY 2019**	**Change YoY**
Net interest income and similar income	22,704	23,591	3.9%	22,704	23,591	3.9%
Net fee & commission income	6,025	5,984	-0.7%	6,025	5,984	-0.7%
Net profit of financial operations	3,210	2,803	-12.7%	3,210	2,803	-12.7%
Dividend and other income	264	195	-26.1%	264	195	-26.1%
Net banking income	**32,203**	**32,573**	**1.1%**	**32,203**	**32,573**	**1.1%**
Personnel expenses	-7,827	-7,780	-0.6%	-7,604	-7,780	2.3%
General admin. expenses (excl. regulatory funds)	-4,112	-3,839	-6.6%	-4,234	-3,839	-9.3%
Resolution and similar funds	-840	-854	1.7%	-840	-854	1.7%
Depreciation, amortisation and impairment of operating assets	-1,856	-2,458	32.4%	-1,856	-2,458	32.4%
Total operating expenses	**-14,634**	**-14,932**	**2.0%**	**-14,534**	**-14,931**	**2.7%**
Gross operating income	**17,569**	**17,641**	**0.4%**	**17,670**	**17,642**	**-0.2%**
Cost of risk	642	571	-11.1%	642	571	-11.1%
Net operating income	**18,211**	**18,212**	**0.0%**	**18,312**	**18,213**	**-0.5%**
Income from share of associated companies	238	306	28.6%	238	306	28.6%
Profit/(loss) attributable to exclusion of companies from consolidation	82	55	-32.9%	0	0	n.a.
Impairment losses on goodwill	2	0	n.a.	2	0	n.a.
Net profits on other assets	-14	17	+/-	-14	17	+/-
Profit before income taxes	**18,520**	**18,591**	**0.4%**	**18,538**	**18,536**	**0.0%**
Income taxes	-3,349	-3,419	2.1%	-3,368	-3,419	1.5%
Net profit	**15,171**	**15,172**	**0.0%**	**15,170**	**15,117**	**-0.3%**
Profit attributable to the Non-controlling owners	325	271	-16.6%	325	271	-16.6%
Profit attributable to the Group's equity holders	**14,846**	**14,901**	**0.4%**	**14,845**	**14,846**	**0.0%**

Notes to "Recurring" results:

FY 2019: Adjustment of the selling price of Komerční pojišťovna (CZK 55 million in profit attributable to exclusion of companies from consolidation)

FY 2018: Finalisation of sale price for KB's former stake in Cataps in connection with the sale of an additional 19% in Cataps (CZK 82 million in profit attributable to exclusions of companies from consolidation), restructuring reserve (CZK −223 million in personnel expenses, CZK −71 million in general and administrative expenses, and CZK 56 million in income taxes), and release of corporate service fees for assistance from Société Générale (CZK 193 million in general and administrative expenses and CZK −37 million in income taxes)

Statement of financial position (CZK million, unaudited)	**31 Dec 2018**	**31 Dec 2019**	**Ytd**
Assets	**1,059,932**	**1,077,334**	**1.6%**
Cash and current balances with central bank	24,851	17,744	-28.6%
Loans and advances to banks	256,268	244,561	-4.6%
Loans and advances to customers (net)	624,954	647,258	3.6%
Securities and trading derivatives	117,761	131,184	11.4%
Other assets	36,099	36,587	1.4%
Liabilities and shareholders' equity	**1,059,932**	**1,077,334**	**1.6%**
Amounts due to banks	92,271	93,581	1.4%
Amounts due to customers	812,451	821,506	1.1%
Securities issued	2,540	3,621	42.6%
Subordinated debt	2,578	2,546	-1.2%
Other liabilities	46,764	47,445	1.5%
Total equity	103,329	108,635	5.1%

Regulatory information

Key ratios and indicators	31 December 2018	31 December 2019	Change year on year
Capital adequacy (CNB)	18.5%	19.7%	▲
Tier 1 ratio (CNB)	17.9%	19.1%	▲
Total risk-weighted assets (CZK billion)	451.1	439.2	-2.6%
Risk-weighted assets for credit risk (CZK billion)	375.4	367.6	-2.1%
Net interest margin (NII / average interest-bearing assets)[III]	2.3%	2.4%	▲
Loans (net) / deposits ratio[IV]	78.3%	79.0%	▲
Cost / income ratio[V]	45.4%	45.8%	▲
Return on average equity (ROAE)[VI]	15.3%	14.5%	▼
Return on average Tier 1 capital[VII]	18.9%	18.1%	▼
Return on average assets (ROAA)[VIII]	1.4%	1.4%	
Earnings per share (CZK)[IX]	79	79	0.4%
Average number of employees during the period	8,411	8,167	-2,9%

Business performance in retail segment – overview	31 December 2019	Change year on year
Mortgages to individuals – volume of loans outstanding	CZK 229.4 bil.	2.5%
Building savings loans (MPSS) – volume of loans outstanding	CZK 56.2 bil.	10.8%
Consumer loans (KB + ESSOX + PSA Finance) – volume of loans outstanding	CZK 39.2 bil.	1.3%
Small business loans – volume of loans outstanding	CZK 36.7 bil.	3.4%
Insurance premiums written (KP)	CZK 8.3 bil	61.5%

Financial calendar:

6 May 2020 – 1Q 2020 results
3 August 2020 – 1H and 2Q results
5 November 2020 – 9M and 3Q 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], and 'Debt securities');

IV **Net loans to deposits:** ('Net loans and advances to customers' inclusive of debt securities held by KB and issued by the Bank's clients less 'reverse repo operations with clients') divided by the quantity ('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 Tier 1 capital:** annualised 'Net profit attributable to equity holders' divided by average group 'Tier 1 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)		**FY 2018**	**FY 2019**
Net interest income and similar income, year to date		**22,704**	**23,591**
Of which:			
Loans and advances at amortised cost		20,085	24,270
Debt securities at amortised cost		1,922	1,746
Debt securities other		445	587
Financial liabilities at amortised cost		-2,361	-4,193
Hedging financial derivatives - income		11,191	17,402
Hedging financial derivatives - expense		-8,578	-16,222

(source: Balance Sheet)	**1 Jan 2018**	**31 Dec 2018**	**31 Dec 2019**
Cash and current balances with central banks/ Current balances with central banks	22,593	16,347	7,737
Loans and advances to banks	222,821	256,268	244,561
Loans and advances to customers	593,639	624,954	647,258
Financial assets at fair value through profit of loss/ Debt securities	1,633	3,248	4,112
Financial assets at fair value through profit of loss - non SPPI/ Debt securities	2,694	0	0
Financial asset at fir value through other comprehensive income (FV OCI)/ Debt securities	23,798	24,909	35,682
Debt securities	70,340	69,881	71,581
Interest bearing assets (end of period)	**937,518**	**995,608**	**1,010,931**
Average interest bearing assets, year to date		**966,563**	**1,003,270**

NIM year to date		**2.35%**	**2.35%**