

Komerční banka reports improved revenues, tight cost control and excellent risk performance from first half of 2019

KB's mobile banking being used by 700,000 clients

- **The number of clients with KB's Mobile banking increased by more than 184,000 year on year to 700,000, confirming KB's No. 1 position on the Czech market in mobile banking.**
- **In June, more than 260,000 customers were using the KB Key authentication app, launched just over seven months ago, and clients had tokenised 112,000 payment cards into their mobile wallet applications, mainly with the Apple Pay service.**
- **The total volume of KB Group's lending expanded by 3.2% year on year to CZK 644.8 billion. Within KB Group, the portfolio of housing loans from Modrá pyramida enlarged fastest, by 13.7%. Mortgages from KB grew by 1.5%. Lending to businesses rose by 3.1%.**
- **The overall volume of standard client deposits within KB Group expanded by 4.0% to CZK 838.6 billion. Client assets in pension funds managed by KB Penzijní společnost were higher by 8.2% from a year earlier and the volume in mutual funds expanded by 9.4%.**
- **Revenues improved by 5.0%, while recurring operating costs were up by just 2.9%. The quality of the loan portfolio remained excellent and KB was once again able to release some provisions for credit losses. Recurring net profit grew by 6.0% year on year to CZK 7.2 billion.**

Prague, 1 August 2019 – Komerční banka reported today its unaudited consolidated results for the first half of 2019.

Total revenues increased by 5.0% to CZK 16.2 billion. Within this total, net interest income was higher by 8.0% from the year earlier, reflecting growth in the volume of assets by 6.6%. Net fees and commissions were down by a slight 0.7%, as lower fees for transactions and loans were almost offset by improving income from services to corporations, assets under management, and clients' upgrading to higher account packages. Net gains from financial operations decreased by 4.9%, influenced by relatively stable CZK exchange and interest rates at the beginning of the year that limited clients' demand for hedging.

Operating expenditures excluding one-off items from last year (creation of a reserve for restructuring and release of amounts accrued for corporate services) were up by 2.9%, at CZK 7.7 billion. Recurring personnel costs rose by 1.8%, as faster growth in average remuneration was partly offset by a 4.0% decrease in the average number of employees to 8,144. Recurring non-personnel expenses were higher by 4.0%, driven mainly by development of information technologies.

The Bank was again able to book a net release of provisions for credit losses of CZK 0.4 billion, thanks to continued low client default rates and good performance from recovery activities.

Recurring net profit attributable to the Group's equity holders totalled CZK 7.2 billion, which was an improvement by 6.0% year on year.

Lending to clients increased by 3.2% to CZK 644.8 billion.¹ KB and Modrá pyramida's financing of housing expanded by 3.6%. KB Group lending to businesses was up by 3.1%.

Deposits from clients climbed by 4.0% year on year to CZK 838.6 billion.² The volume of KB Group clients' assets in mutual funds, pension savings, and life insurance rose by 6.6% to CZK 176.8 billion.

The capital adequacy ratio reached a strong 19.0%, and Core Tier 1 capital stood at 18.4%.

“In the first half, and specifically in the second quarter, we introduced several useful new services, mainly in the digital space. Moreover, our clients' switch to using banking services through digital channels has been unrelenting. We have been investing significant resources into making our digital channels not only even more attractive to clients but also safer. At the same time, we remain committed to improving the client value proposition offered through the branch network,” remarked Jan Juchelka, Komerční banka's Chairman of the Board of Directors and Chief Executive Officer.

“In the first half, we have managed to maintain a stable net interest margin in spite of continuing competitive pressure on lending spreads and decreasing long-term interest rates. Income from fees and from financial operations improved a bit in the second quarter, getting back on track with our revenues expectation for the full year. Operating expenditures clearly reflected our ongoing strategic transformation, including organisational optimisation and investments into digitalisation. The very good result seen in the cost of risk continues to show the support from the favourable environment,” he added.

The Bank had 48,834 shareholders as of 30 June 2019 (up 629 year on year), of which 43,451 were private individuals from the Czech Republic (that number being higher by 572 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 its registered capital in treasury.

¹ Excluding volatile reverse repo operations with clients but including debt securities issued by KB's clients and held by the Bank. If reverse repo operations are included, gross lending increased by 2.6% to CZK 651.7 billion.

² Excluding repo operations with clients. The total volume of 'Amounts due to customers' moved up by 7.3% to CZK 893.0 billion.

CORPORATE SOCIAL RESPONSIBILITY

In the second quarter of 2019, KB was again developing numerous activities that reflected on its responsibility as a leading Czech bank. Furthermore, scores of employees took part in various beneficial activities, many using their one day for volunteer activities that KB has newly made available to each employee. The largest number of employees joined in the campaign Uklidme Česko (Let's tidy up Czechia), where KB was the main partner. Many others helped with repairs in charity and shelter houses, children centres or hospices, or dedicated their time to other good purposes.

Sponsoring by Komerční banka comprised area of culture as well. Fans at the Rock for People festival in Hradec Králové appreciated the performance by the PKF – Prague Philharmonia of a previously unfinished part of Antonín Dvořák's symphony called From the Future World that had been created using an artificial intelligence program known as AIVA. The sponsoring of the National Gallery Prague and Zoo Prague also continued successfully.

KB Jistota Foundation supported six projects relating to prevention of relationship and behavioural problems among vulnerable and disadvantaged children. The Foundation also contributed to three long-term projects on quality of life for patients with incurable illnesses, including help to caring personnel and to the bereaved.

Komerční banka also increased to 207 the number of its branches where hearing-impaired clients can deal with the Bank using the eScribe on-line service that provides rapid transcription of negotiations prepared by blind speed-writers from the Transkript online charity.

In July 2019, KB was affirmed as a constituent company in the FTSE4Good Index Series. The FTSE4Good Index Series is designed to identify companies that demonstrate strong environmental, social and governance practices measured against globally recognised standards.

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 environment³

Growth of the Czech economy in the second quarter of 2019 was again most probably driven by household demand, followed by the contribution of fixed investments. Economic growth has thus far held to around the 2.7% mark in 2019. The domestic economy continues still to be constrained mainly by tight labour market conditions. Unemployment remains the lowest seen anywhere across the entire EU (2.2% in May, according to the Eurostat methodology after seasonal adjustment)⁴ and wage inflation picked up again somewhat in the first quarter to 7.4%. The full utilisation of capacities and favourable financing situation are supporting private sector investments directed to improving productivity. Although investments had begun to accelerate in the second half of 2018 due to public sector activity, as well, that activity slowed again at the beginning of 2019.

Consumer price inflation reached 2.7% in June, staying in the upper part of the Czech National Bank's 2% inflation target tolerance band. The rising price level is supported mainly by food prices and administered prices. Core inflation continued at its previous level. Meanwhile, the volatility of Czech

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

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

crown increased in the second quarter and its exchange rate appreciated toward the end of the half. It closed the second quarter at CZK 25.4 per euro, 1.2% stronger than at the beginning of the year.

Interest rates in the interbank market reflected the latest hike in CNB's two-week repo rate by 25 basis points in early May, but otherwise the yield curve deepened its inversion. Three-month PRIBOR hovered around 2.23% in the quarter, but the ten-year interest rate swap declined further to 1.55% at the end of the period. Similarly, yields on Czech government bonds sunk to 1.47% at the end of June compared to 1.92% at the beginning of the quarter.

Prices for residential real estate slowed their growth in the first quarter of 2019, as demand was curbed by CNB's tightened macroprudential measures for granting residential mortgages that had come into force on 1 October 2018 and affordability of housing was impacted by fast growing prices. Prices paid in the first quarter for previously owned flats were up 10.8% year on year, while prices obtained for new flats (in Prague only) were 14.4% higher from the year earlier.⁵

Total bank lending for the overall market (excluding repo operations) grew by 5.4% year on year.⁶ Lending growth was faster in retail banking, with growth in the outstanding volume of mortgages slowing while new mortgage production dropped significantly in year-on-year terms. Consumer loans growth kept its pace, supported by still high levels of consumer confidence as well as strong wage dynamics. Lending to non-financial corporations expanded by 2.4% year on year.

The volume of deposits in Czech banks expanded by 11.4% year over year in June.⁶ Here, the growth in retail deposits and deposits from non-financial corporations was around 6%, but the market reported an inflow of deposits from public sector institutions (including foreign).

Enhancing client value proposition

KB has focused on enhancing its client value proposition and making sure it remains at the leading edge of the digital transformation of banking.

Attesting to the Bank's leading position in open banking, Komerční banka's internet and mobile banking currently enables its clients to access their accounts also in 8 other banks, including 1 foreign (Slovak) bank. In the second quarter, KB introduced three new web portals: (1) cincink.cz – providing on-line assistance with residential property sales, purchases and rentals, including intermediation, legal services, valuation and financing; (2) KB M&A Point – offering advisory services, including an on-line tool for companies valuation, and (3) KB API portal, providing a stable environment for third-party developers using KB's application programming interfaces. Authentication service provisioning for third parties will be the first commercially launched API.

KB has also been active in a sector initiative of the Czech Banking Association to enable secure communication by individuals with government and private institutions using banking clients' digital identities. Full launch of the service is expected in 2021.

Meeting great acceptance among clients, KB issued, under license from Warner Bros, a limited edition of payment cards featuring designs from the popular The Big Bang Theory television series.

⁵ Source: <https://www.czso.cz/csu/czso/ceny-nemovitosti>. Publication code 014007-19, released 14 June 2019.

⁶ Source of data on banking market developments: ARAD statistics of the CNB, www.cnb.cz. Latest data for June 2019.

Developments in the client portfolio and distribution networks

	1H 2018	1H 2019	YoY
Number of clients			
KB Group's clients	2,393,000	2,376,000	-17,000
Komerční banka	1,666,000	1,662,000	-4,000 *
– individual clients	1,408,000	1,406,000	-2,000 *
– using at least one direct banking channel	1,437,000	1,468,000	31,000
– internet banking clients	1,370,000	1,405,000	35,000
– mobile banking clients	514,000	699,000	185,000
Modrá pyramida	487,000	489,000	2,000
KB Penzijní společnost	532,000	532,000	0
ESSOX (Group)	214,000	208,000	-6,000
Distribution network			
KB Retail branches	378	344	-34
KB Business centres	10	10	0
KB Corporate divisions	5	5	0
Modrá pyramida points of sale	213	200	-13
SGEF branches	9	9	0
ESSOX Group points of sale	1,340	1,045	-295 **
ATMs	761	786	25
of which deposit-taking	274	359	85

* 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

KB was among the first Czech banks to introduce the Apple Pay service to the Czech market, and the service uptake has been successful. By the end of June, clients had tokenised some 73,000 payment cards in Apple's Wallet application. In total, Komerční banka's customers had virtualised 112,000 cards into payment applications from Apple, Google, Garmin and Fitbit. The Bank also recorded a rapid roll-out of its new KB Key authentication application introduced in December 2018. As of the end of June, the number of clients with KB Key already exceeded 260,000.

Loans to customers

Total **gross volume of lending to clients** rose by 3.2% year on year to CZK 644.8 billion.⁷

In lending to individuals, the overall volume of housing loans¹ grew by 3.6% from the year earlier. Within this total, the portfolio of mortgages to individuals expanded by 1.5% to CZK 225.1 billion. Modrá pyramida's loan portfolio grew by a strong 13.7% to CZK 53.5 billion. The volume of KB Group's consumer lending (provided by the Bank and ESSOX Group in the Czech Republic and Slovakia) was up 0.8%, to CZK 38.7 billion.

The total volume of **loans to businesses** and other lending provided by KB Group climbed by 3.1% year on year to CZK 327.5 billion. Lending to small businesses grew by 2.2% to CZK 36.1 billion. The overall CZK volume of credit granted by KB to medium-sized, large corporate, and other clients in the Czech Republic and Slovakia⁸ increased by 2.9% year on year to CZK 263.0 billion. At CZK 28.4 billion, the total credit and leasing amounts outstanding at SGEF were 6.4% higher year over year.

⁷ 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 2.6% to CZK 651.7 billion.

⁸ Inclusive of factor finance outstanding at Factoring KB and merchant and car dealers' financing from ESSOX Group.

Amounts due to customers and assets under management

The **volume of standard client deposits** within KB Group rose by 4.0% year on year to CZK 838.6 billion.⁹

Deposits at Komerční banka from individual clients grew by 6.0% from the year earlier to CZK 281.5 billion. The deposit book at Modrá pyramida expanded by a slight 0.5% to CZK 61.6 billion. Total deposits from businesses and other corporations climbed by 4.4% to CZK 486.0 billion.

Client assets managed by KB Penzijní společnost were 8.2% higher, at CZK 60.0 billion. Technical reserves in life insurance at Komerční pojišťovna were up by 0.8% year on year, at CZK 47.7 billion. The volumes in mutual funds held by KB Group clients grew by 9.4% to CZK 69.1 billion.

The Group's liquidity as measured by the ratio of net loans¹⁰ to deposits (excluding repo operations with clients but including debt securities held by KB and issued by the Bank's clients) stood at 75.7%.

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 first half of 2019 improved by 5.0% year on year to reach CZK 16,172 million. This growth was driven by net interest income, while fee income was almost stable and net gains from financial operations diminished.

Net interest and similar income¹¹ was up by 8.0%, at CZK 11,759 million. The result reflected growth in the volume of assets and higher CZK interest rates, which supported returns from reinvesting deposits and capital. Meanwhile, intense competition has compressed the spreads on loans. The net interest margin for the first six months of 2019, computed as the ratio of net interest income to interest-earning assets reported on the balance sheet, reached 2.2%, similar to that of a year earlier.

Net fee and commission income¹² declined by a slight 0.7% to CZK 2,961 million. KB recorded higher income from specialised financial services, such as loan syndications, issuance of trade finance instruments, guarantees and advisory. The maintenance fee income improved, as well, due

⁹ Excluding volatile repo operations with clients. The total volume of 'Amounts due to customers' increased by 7.3% to CZK 893.0 billion.

¹⁰ Gross volume of loans reduced by the volume of provisions for loan losses.

¹¹ 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 the quarterly net interest income.

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.

to clients' increasing preference for better account packages that include a wider range of 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 price of account packages, and despite the rapidly increasing number of transactions, mainly due to greater use of payment cards. Income from loan services declined, especially in connection with smaller loans production in retail.

Net profit on financial operations decreased by 4.9% to CZK 1,338 million. Clients' demand for hedging of financial risks was constrained in the first months of the year by an absence of clear trends for CZK exchange and interest rates. This demand recovered in the second quarter, however, with greater volatility of the Czech crown and changed perception for the interest rate outlook. 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 4.2% to CZK 114 million. This line primarily comprises revenues from property rental and ancillary services.

Operating expenses were up by 1.6%, at CZK 7,712 million. Excluding the effect from creating a restructuring reserve and release of over-accrued charges for corporate services, growth of operating expenses reached 2.9%.¹³ Adjusted personnel expenses rose by 1.8% to CZK 3,844 million, reflecting mainly higher remuneration even as the average number of employees declined by 4.0% to 8,144.¹⁴ Reported personnel expenses, including last year's restructuring reserve, were lower by 3.9%. General administrative expenses (excluding contributions to the regulatory funds) were lower by 2.4%, at 1,835 million. However, this line was also influenced last year by creation of the restructuring reserve¹⁴ and in 2019 by implementation of the new IFRS 16 standard that has replaced rent expense with the depreciation expense of rights-of-use. Adjusted for these extraordinary factors, general administrative expenses increased by 2.7%, 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 847 million. Depreciation and amortisation grew by 34.3% to CZK 1,186 million, including the effect of IFRS 16 implementation. Adjusted depreciation and amortisation charges were higher by 9.2%, driven mainly by new and upgraded software and IT equipment.

Profit before allowances for loan losses, provisions for other risk, profit on subsidiaries, and income tax (**gross operating income**) was up by 8.4%, at CZK 8,460 million. Excluding the contribution of one-off items from last year,¹⁴ gross operating income improved by 7.0%.

Cost of risk reached a negative CZK 354 million (net release of provisions), which amount is 11.7% smaller than the net release in the first half of 2018. This was made possible by the still supportive economic environment, continued low client default rates, and good performance from recovery activities. The cost of risk in relative terms¹¹ and as measured against the average volume of the lending portfolio during the first three months came to -11 basis points.

Income from shares in associated undertakings (i.e. Komerční pojišťovna) was up 25.7% year on year, at CZK 142 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 the first half of 2018, this line comprised CZK 82 million related to

¹³ In second quarter 2018, KB created the restructuring reserve for anticipated costs arising from the KB Change programme, comprising 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.

¹⁴ Recalculated to a full-time equivalent number.

finalising the selling price for KB's stake in Cataps. **Net profits on other assets** were at CZK 14 million, compared to CZK 17 million in 2018, which amounts were linked to sales of buildings in the held-for-sale portfolio).

Income tax was higher by 8.8%, at CZK 1,648 million.

KB Group's consolidated **net profit** for the first half of 2019, at CZK 7,378 million, was higher by 6.9% in comparison with the first half a year ago. Of this amount, CZK 166 million was profit attributable to the non-controlling owners of minority stakes in KB's subsidiaries (+11.4% year on year).

Reported **net profit attributable to the Group's equity holders** totalled CZK 7,213 million, which is 6.8% 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 up 6.0% year on year (at CZK 7,158 million).

Other comprehensive income, which derives mainly from revaluations and remeasurements of some hedging, foreign exchange, and securities positions, reached CZK 274 million. **Consolidated comprehensive income** for the first six months of 2019 amounted to CZK 7,653 million, of which CZK 164 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 2019 with the values from the statement of financial position as of 31 December 2018 and reflects the newly introduced accounting methodology according to IFRS 16.

Assets

As of 30 June 2019, KB Group's total assets had risen by 11.9% year to date to CZK 1,186.0 billion.

Cash and current balances with central banks were down by 9.8%, at CZK 22.4 billion. 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 25.0% to CZK 28.3 billion. The fair value of hedging financial derivatives declined by 2.0% to CZK 12.3 billion.

Year to date, there was a 27.7% increase in financial assets at fair value through other comprehensive income amounting to CZK 32.3 billion. This consisted mainly of public debt securities.

Financial assets at amortised cost grew by 11.9% to CZK 1,063.9 billion. The largest portion of this consisted of (net) loans and advances to customers, which went up by 2.6%, at CZK 641.5 billion. A 97.7% share in the gross amount of client loans was classified in Stage 1 or Stage 2, while 2.3% 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 10.8 billion. Loans and advances to banks rose by 36.3% to CZK 349.2 billion. The majority of this item consists in reverse repos with the central bank. The value held in debt securities was up by 4.7% and reached CZK 73.1 billion at the end of June 2019.

Revaluation differences on portfolio hedge items were CZK -0.2 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, grew overall by 3.2% to CZK 5.9 billion. Assets held for sale declined by 40.0% to CZK 0.1 billion.

Investments in subsidiaries and associates decreased by 4.8% to CZK 1.1 billion.

The net book value of tangible assets rose by 37.0% 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 6.2% to reach CZK 5.6 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 13.4% higher in comparison to the end of 2018 and stood at CZK 1,085.2 billion.

Financial liabilities at amortised costs went up by 13.1% to CZK 1,026.0 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 9.9% to CZK 893.0 billion. This total included CZK 54.4 billion of liabilities from repo operations with clients and CZK 5.6 billion of other payables to customers. Amounts due to banks increased in 2019 by 35.3% to CZK 124.8 billion.

The volume of outstanding securities issued was higher by 104.0% at CZK 5.2 billion.

Revaluation differences on portfolios hedge items turned from CZK -0.7 billion at the end of 2018 to CZK 0.1 billion at the end of 2019's first half. Current and deferred tax liabilities increased by 10.4% to CZK 1.0 billion. Other liabilities and accruals, which include payables from securities trading and settlement balances, expanded by 44.9% to CZK 19.5 billion.

Provisions declined by 7.7% to CZK 1.7 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 down by 1.1% year to date. Because that debt is issued in euro, the change reflects the strengthening of the Czech crown over the same period.

Equity

Total equity declined year to date by 2.5% to CZK 100.8 billion, as generation of net profit for six months was offset by payment of annual dividend. The value of non-controlling interests reached CZK 3.0 billion. As of 30 June, 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 85.7 billion as of 30 June 2019, up 2.8% year to date. **Capital adequacy** stood at 19.0%. The Core Tier 1 capital amounted to CZK 83.1 billion (+2.9% year on year), and the Core Tier 1 ratio stood at 18.4%. Tier 2 capital totalled CZK 2.6 billion, which was 0.6% of risk-weighted assets.

KB's overall capital requirement as of 30 June 2019 was approximately 16.35% relative to the consolidated volume of risk-weighted assets. The required minimum Core Tier 1 capital level was at 12.450%, and the minimum Tier 1 capital ratio at 14.35%. This followed the rise by 25 basis points to 1.25% in the countercyclical capital buffer for Czech exposures with effect from 1 January 2019 and increase by 10 basis points to 1.6% in the additional requirement set in Pillar II of the EU regulation on prudential requirements for credit institutions and investment firms.

As of 1 July 2019, the countercyclical capital buffer for Czech exposures was raised by an additional 25 basis points to 1.5%. The CNB has announced further increases in this buffer with effect from 1 January 2020 by 25 basis points (to 1.75%) and by another 25 basis points (to 2.00%) from 1 July 2020.

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

Expected development and main risks to that development in the second half of 2019

In its baseline macroeconomic scenario, Komerční banka expects the Czech economy will grow its output by approximately 2.7% this year. Domestic consumption and investments as well as net exports should contribute positively to that growth.

The tight labour market will remain the main factor limiting faster growth in the economy and also the driver of domestic inflation. Despite the strong domestic economic fundamentals, the fragile global context will probably prevent the Czech National Bank from continuing on the path of monetary policy normalisation. The CZK yield curve will likely stay inverted into the next year.

Competition has quickly pushed down banks' profit margins to those levels seen in Western Europe. The relative prices dropped most visibly in retail lending and for such basic banking services as payments. The rollover effect from maturing loans will squeeze average spreads into the future, even if new sales margins stabilise. Banks have been facing mounting competition also from technology companies offering so-called "fintech", often focused upon providing streamlined services in such specific areas as payments, currency conversions or even consumer lending.

The CNB continued to tighten its macroprudential policy. The central bank raised the countercyclical capital requirement by an additional 25 basis points to 1.50% from July 2019, and further 25 basis point increases are planned for January 2020 and July 2020.

In such context, KB management expects the annual growth rate of the loan portfolio in 2019 will remain in mid- to low-single digits. This growth will be rather slower in retail segments, as production of mortgages will be affected by the regulations imposed by the CNB in October 2018 and overall diminished affordability of housing. In a year-on-year comparison, the outstanding volume of mortgages is still expected to expand marginally in 2019, with sales recovering somewhat from the slump at the beginning of the year. Lending by Modrá pyramida is still expected to record strong growth close to the rate achieved in the year's first half. Unsecured lending to consumers should grow faster than mortgage lending, boosted by the favourable situation on the labour market.

Business lending will reflect the more cautious expectations of corporations about future demand but also by their need to invest in boosting productivity and, mainly in the construction sector, to have pre-funded investment orders from the public sector. Overall growth in business lending is thus expected in mid-single digits, but the result may be further influenced by bond issuance used by some large corporations to refinance loans, as well as by intense competition. Total deposits will probably grow faster than loans, and the trend of clients transferring part of their cash reserves from current accounts into saving and term accounts will likely continue. The deposit book at Modrá pyramida is not expected to grow, as it still is influenced by maturing of old deposit contracts with relatively high rates. The volume of assets under management in pension funds, mutual funds and life insurance should continue to expand.

KB Group's total net operating income for 2019 should improve slightly in comparison with 2018. Net interest income in the second half will be affected by the negatively sloped yield curve, while the effect of increasing loan and deposit volumes will be offset by the continuing competitive pressure on lending spreads and moderately rising cost of deposits. Income from fees and commissions should be stable year on year, benefitting from growth in clients' activity but limited by pressure on prices. By 15 December, the Bank must implement a cap on fees for cross-border transactions within the Single European Payment Area,¹⁵ and that will hit fee income in 2020. Net profit from financial operations will decrease on a year-on-year basis, because the previous year's result had been boosted by some extraordinarily large hedging deals developed for clients.

¹⁵ 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

Operating expenditures will increase at a rate similar to that of inflation. The Bank has agreed with the trade unions upon 6.5% growth in average remuneration for 2019, but the impact on costs will be mitigated by an ongoing decrease in employee numbers that is facilitated by improving productivity of operations. Non-personnel costs will be managed very vigorously, even as KB Group will continue to invest substantial amounts into such areas as new products development, digitalisation, and staff training.

KB expects that the clients will maintain their overall excellent repayment discipline throughout the second half and that the Group's recovery performance will remain strong. If this is the case, the cost of risk for the full year may reach even negative level (i.e. net release of provisions). The situation of a net release of provisions for credit losses is exceptional. The pace of future normalisation of risk costs will depend mainly upon how macroeconomic conditions develop in the Czech Republic, and to some extent in Slovakia. Another possible factor could be individual circumstances of clients with larger exposures. The normalised rate of provisioning across the whole business cycle is estimated to float around 30 to 40 basis points.

Among the key risks to the expectations described above are the following: (1) a severe worsening of the macroeconomic environment, due to, for example, distortions in international supply chains caused by disorderly withdrawal of the United Kingdom from the European Union or by escalation of trade frictions among the global economic regions; (2) a significant worsening of the competitive situation on the Czech banking market leading to material erosion of profit spreads on key products, or (3) a solitary impairment of a large credit exposure.

The management expects that KB's operations will generate sufficient profit in 2019 to cover the Group's capital needs ensuing from its growing volume of assets as well as to pay out in dividends 65% of consolidated net profit attributable to shareholders.

Changes in corporate governance (in the second quarter 2019)

Based on an assessment by the Nominations Committee and a proposal by the Board of Directors, the Annual General Meeting held on 24 April 2019 elected with effect from 25 April 2019 Ms. Cécile Camilli and Ms. Petra Wendelová members of the Supervisory Board. Ms. Wendelová was also elected a member of the Audit Committee.

ANNEX: Consolidated results as of 30 June 2019 under International Financial Reporting Standards (IFRS)

Profit and Loss Statement (CZK million, unaudited)	Reported			Recurring		
	1H 2018	1H 2019	Change YoY	1H 2018	1H 2019	Change YoY
Net interest income and similar income	10,887	11,759	8.0%	10,887	11,759	8.0%
Net fee & commission income	2,983	2,961	-0.7%	2,983	2,961	-0.7%
Net profit of financial operations	1,407	1,338	-4.9%	1,407	1,338	-4.9%
Dividend and other income	119	114	-4.2%	119	114	-4.2%
Net banking income	15,396	16,172	5.0%	15,396	16,172	5.0%
Personnel expenses	-3,998	-3,844	-3.9%	-3,775	-3,844	1.8%
General admin. expenses (excl. regulatory funds)	-1,880	-1,835	-2.4%	-2,002	-1,835	-8.3%
Resolution and similar funds	-833	-847	1.7%	-833	-847	1.7%
Depreciation, amortisation and impairment of operating assets	-883	-1,186	34.3%	-883	-1,186	34.3%
Total operating expenses	-7,594	-7,712	1.6%	-7,493	-7,712	2.9%
Gross operating income	7,802	8,460	8.4%	7,904	8,460	7.0%
Cost of risk	401	354	-11.7%	401	354	-11.7%
Net operating income	8,204	8,815	7.4%	8,305	8,815	6.1%
Income from share of associated companies	113	142	25.7%	113	142	25.7%
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	17	14	-17.6%	17	14	-17.6%
Profit before income taxes	8,417	9,026	7.2%	8,437	8,971	6.3%
Income taxes	-1,515	-1,648	8.8%	-1,534	-1,648	7.4%
Net profit	6,902	7,378	6.9%	6,903	7,323	6.1%
Profit attributable to the Non-controlling owners	149	166	11.4%	149	166	11.4%
Profit attributable to the Group's equity holders	6,754	7,213	6.8%	6,754	7,158	6.0%

Notes to "Recurring" results:

1H 2019: Adjustment of the selling price of Komerční pojišťovna (CZK 55 mil. in Profit attributable to exclusion of companies from consolidation)

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)

Statement of financial position (CZK million, unaudited)	31 Dec 2018	30 Jun 2019	Ytd
Assets	1,059,932	1,185,993	11.9%
Cash and current balances with central bank	24,851	22,425	-9.8%
Loans and advances to banks	256,268	349,218	36.3%
Loans and advances to customers (net)	624,954	641,514	2.6%
Securities and trading derivatives	117,761	133,658	13.5%
Other assets	36,099	39,178	8.5%
Liabilities and shareholders' equity	1,059,932	1,185,993	11.9%
Amounts due to banks	92,271	124,838	35.3%
Amounts due to customers	812,451	892,997	9.9%
Securities issued	2,540	5,183	104.1%
Subordinated debt	2,578	2,550	-1.1%
Other liabilities	46,764	59,644	27.5%
Total equity	103,329	100,781	-2.5%

Key ratios and indicators	30 June 2018	30 June 2019	Change year on year
Capital adequacy (CNB)	18.1%	19.0%	▲
Tier 1 ratio (CNB)	17.5%	18.4%	▲
Total risk-weighted assets (CZK billion)	446.8	451.8	1.1%
Risk-weighted assets for credit risk (CZK billion)	369.0	373.5	1.2%
Net interest margin (NII / average interest-bearing assets) ^{III}	2.2%	2.2%	=
Loans (net) / deposits ratio ^{IV}	75.9%	75.7%	▼
Cost / income ratio ^V	49.3%	47.7%	▼
Return on average equity (ROAE) ^{VI}	14.5%	14.6%	▲
Return on average Tier 1 capital ^{VII}	17.4%	17.6%	▲
Return on average assets (ROAA) ^{VIII}	1.3%	1.3%	=
Earnings per share (CZK) ^{IX}	72	76	6.8%
Average number of employees during the period	8,481	8,144	-4.0%
Number of branches (KB standalone in the Czech Republic)	378	344	-34
Number of ATMs	761	786	25
Number of clients (KB standalone)	1,666,000	1,662,000	-0.2%

Business performance in retail segment – overview	30 June 2019	Change year on year
Mortgages to individuals – volume of loans outstanding	CZK 225.1 bil.	1.5%
Building savings loans (MPSS) – volume of loans outstanding	CZK 53.5 bil.	13.7%
Consumer loans (KB + ESSOX + PSA Finance) – volume of loans outstanding	CZK 38.7 bil.	0.8%
Small business loans – volume of loans outstanding	CZK 36.1 bil.	2.2%
Total active credit cards – number	179,000	-0.4%
– of which to individuals	142,000	+0.8%
Total active debit cards – number	1,391,000	+0.5%
Insurance premiums written (KP)	CZK 4.9 bil	+68.9%

Financial calendar:

- 6 November 2019 – 3Q 2019 results
- 6 February 2020 – FY and 4Q 2018 results
- 6 May 2020 – 1Q 2019 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)

<i>(source: Profit and Loss Statement)</i>	1H 2018		1H 2019	
Net interest income and similar income, year-to-date	10,887		11,759	
Of which:				
Loans and advances at amortised cost	9,205		11,839	
Debt securities at amortised cost	966		903	
Debt securities other	208		266	
Financial liabilities at amortised cost	-971		-1,931	
Hedging financial derivatives - income	4,798		8,172	
Hedging financial derivatives - expense	-3,321		-7,490	

<i>(source: Balance Sheet)</i>	1 Jan 2018	30 Jun 2018	31 Dec 2018	30 Jun 2019
Cash and current balances with central banks/ Current balances with central banks	22,593	13,324	16,347	14,058
Loans and advances to banks	222,821	304,488	256,268	349,218
Loans and advances to customers	593,639	622,804	624,954	641,514
Financial assets at fair value through profit of loss/ Debt securities	1,633	5,897	3,248	6,426
Financial assets at fair value through profit of loss - non SPPI/ Debt securities	2,694	2,652	0	0
Financial asset at fir value through other comprehensive income (FV OCI)/ Debt securities	23,798	25,030	24,909	31,799
Debt securities	70,340	74,433	69,881	73,137
Interest bearing assets (end of period)	937,518	1,048,627	995,608	1,116,152
Average interest bearing assets, year-to-date		993,072		1,055,880
NIM year-to-date, annualized		2.19%		2.23%