

1999

REPORT ON KOMERČNÍ BANKA'S FINANCIAL RESULTS AS AT 30 JUNE 1999



THE CZECH ECONOMY IN THE FIRST HALF OF 1999

The recession in the Czech economy continued in the first months of 1999, as it was still affected on the one hand by the depressed level of aggregate demand from the previous period and on the other hand by the absence of any upturn in the economies of the countries which constitute the main business partners of the Czech Republic. If measured by the net inflation index the Czech economy faced deflation in the first half of the year. At the same time there were signs of an incipient recovery in demand. As had been expected, governmental consumption rose considerably. Consumption by households showed an improvement. Whereas it had been in decline, at the turn of the year it was stagnant and in the first half of 1999 it actually grew. Thus the decrease in the Gross Domestic Product, which in the first quarter of 1999 was at its maximum (4.5 %); was significantly smaller in the second quarter (between 1.5 and 2 %). There may be a moderate upturn in the second half of the year.

Low domestic demand was felt most acutely in industry and construction. Apart from the domestic recession, however, the industrial growth in the first months of 1999 was also strongly affected by the stagnation in foreign demand due to the strong exchange rate of the Czech koruna and the low level of economic performance in the countries of the European Union. Whilst the subsequent revival of those economies together with a weakening of the rate of the Czech koruna led to an increase of exports, the stimulus is still weak and not sufficient to compensate for the general stagnation in domestic demand, in particular the continuing decrease in investments into the fixed capital which above all affects construction. Building investments decreased by nearly one third in the first quarter. Neither house-building nor the so-called small constructions are able to fill this gap.

The financial situation of KB corporate clients has deteriorated due to the macroeconomic development. Czech banks continued to pursue their policy of cautious lending, of cleansing their loan portfolios and of applying stricter criteria to entrepreneurial projects. A "credit crunch" situation persisted. In spite of growth in M2 by some 8 % and a significant decrease in interest rates loans practically stagnated. No material change is expected in this situation in the second half of the year.

BUSINESS POLICY OF THE BANK

An important event for Komerční banka in the second quarter of 1999 was its Annual General Meeting held on 31 May 1999. It produced a number of changes, the most important being undoubtedly the approval of the change in the level of share capital. This is to be increased by up to CZK 9.5 billion, the pre-emption rights of existing shareholders being fully guaranteed. At the Annual General Meeting shareholders also approved the financial statements of Komerční banka for the year 1998, the method of settlement of the accounting loss of 1998 from capital funds and from other funds created from profit and the possibility of acquiring own shares up to 10 % of the share capital of the Bank. The proposed amendments to the statutes were also approved.

An event of no less importance at the Annual General Meeting was the change in the composition of the Supervisory Board. Miroslav Bartoň and Evžen Kočenda were recalled and replaced by Martin Fassman and Jan Juchelka. The membership of Jan Stiess was also duly confirmed; with effect from 8 April 1999 he became a deputy member of the Supervisory Board following the resignation of Petr Čermák.

As at 30 June 1999 the Bank completed the final phase of preparation and testing for the transfer of information technologies into the year 2000. The Bank followed the methodology of the world-renowned company Gartner Group. Komerční banka met all the requirements of the Czech National Bank within the required time limits so that the whole financial group is prepared for the millennium.

The Bank had a major success with its issue of five-year mortgage bonds of CZK 4 billion, with demand being more than double the offer. The nominal value of these bonds is CZK 10 thousand and the interest rate 8.125 % p. a. The Bank will use the proceeds of the issue to finance mortgage loans.

The confidence of foreign investors in Komerční banka was evidenced by the increase in the proportion of Global Depository Receipts (GDRs) in the share capital of the Bank. In May it reached a record level of 17.3 %.

At the end of the first half of the year the Bank embarked upon preparations for several changes in its business policy. Underlying these changes is an emphasis upon modern methods of communication and non-cash payments, with particular reference to reducing the cost of electronic banking services such as KB Express Line, BEST KB or BBS and KB Voice Information System. Charges for accounting for payments realized through the KB Telephone Centre were also decreased. A summer campaign was also prepared to support cash-free payments enabling every client of Komerční banka who meets standard terms for the issue of the UNIKARTA payment card to receive this card for use with his account free for the duration of its validity, i. e. two years. This offer is open from 1 July to 30 September 1999. This type of card is now accepted by more than 16,700 points of sale and 1,350 ATMs in the Czech Republic.

RESULTS UNDER INTERNATIONAL ACCOUNTING STANDARDS

PROFIT AND LOSS ACCOUNT

In the first half of 1999 the Bank achieved an operating profit, i. e. profit before provisions for loan losses, of CZK 4.6 billion, which represents a fall of 33.1 % against the same period of 1998. One of the main reasons for the fall was the unfavourable development of the income side. The major factor in the drop of 19 % in total net income was net interest income, this being attributable to the ongoing fall in interest rates and the lower volume of loans granted to clients. A positive development was to be seen on the other hand in income from financial market trading as well as in non-interest income, particularly in the share of fees and commissions in total income. The Bank was successful in controlling administrative expenses, these being down by 2.5 % on the first half of 1998. The final results also reflected the ongoing effort of the Bank to stabilize its loan portfolio; in the first half of 1999 provisions for loan losses were created in the amount of CZK 9.1 billion. After accounting for provisions for loan losses and income tax the Bank reported an accounting loss of CZK 4.5 billion as at 30 June 1999. This is more than 50 % lower than the loss in the first half of 1998.

Net interest income as at 30 June 1999 stood at CZK 5.6 billion. This is down by more than CZK 3 billion in comparison with the first half of 1998, representing a fall of 35.1 %. This trend, already discernible in the first quarter of this year, was caused by the general economic situation of the Czech Republic. The main reason for the decrease of net interest income was the gradual decline of market interest rates, which was reflected in the drop of the Komerční banka reference rate by 1.6 percentage points during the first half-year of 1999. Another reason was the fall in the volume of loans granted to clients - by over CZK 8 billion from the beginning of 1999 - leading logically to a lower volume of interest paid by clients. The fall in interest received from clients (33.8 %) being greater than the fall of the interest paid to clients (31.9 %) resulted in the decrease of net interest income from clients by 36.8 %. There was on the other hand a positive development in net interest income from securities which was 18.3 % up on the same period of the previous year.

The decrease of net interest income had an impact on the **net interest margin**; this was down by 0.8 of a percentage point in comparison with the end of 1998 and stood at 3.14 % as at 30 June 1999.

Net fees and commissions rose by 1.3 % on the first half-year of 1998. The biggest contribution to this figure was through fees and commissions received from clients, constituting 96.7 % of total fees and showing an increase of 3.9 % against the same period of 1998. The result of this favourable development in the fees was offset by the decrease in fees and commissions from securities due to higher fees and commissions paid in relation to the issue of mortgage bonds. The share of fees and commissions in total net income was 22.1 %, a rise of 4.5 percentage points against last June.

The Bank reported very good results in trading on the financial markets. **Dealing profit** rose inter-yearly by 122.9 % and reached CZK 1.4 billion as at 30 June 1999. The increase was mainly due to trading in

foreign currencies where the Bank achieved a profit of CZK 1.4 billion, over one third better than for the first half-year of 1998. One contributory factor to this improvement was that the result of trading in securities was up by CZK 574 million against the first half of 1998 and a profit-winning item for this year.

Other income totalling CZK 0.8 billion showed a decrease of 17.2 % on the first half of 1998. Almost 90 % of this item is made up of foreign exchange transactions (at foreign exchange offices) showing a year-on-year drop in income of 11.7 %.

The Bank continued its efforts to strengthen the **share of non-interest income** in its total income. The share rose year-on-year by 13.8 percentage points and reached 44.1 % as at 30 June 1999.

A very favourable development was seen in **administrative expenses** which were down by 2.5 % against the first half of 1998 and stood at the final CZK 4.7 billion. The decrease was achieved in both personnel expenses, which fell by 3.1 % year-on-year, and other administrative expenses showing an inter-year fall of 3.8 %. The decrease in personnel expenses was linked to the ongoing reduction in the number of employees, involving 481 persons in the first half of 1999 and bringing the number of employees to a total of 13,543.

Cost income ratio grew by 9.6 percentage points against the first half of 1998, reaching 54.1 %. The increase of the ratio is caused by the inter-year decrease of net income which is more significant than the above-mentioned decrease of administrative expenses.

Provisions for loan losses amounting to CZK 9.1 billion reflect bankruptcy proceedings concerning some large clients of the Bank and necessitating the additional creation of provisions for debts under bankruptcy proceedings in the amount of CZK 3.2 billion. Almost the same amount is deducted from the total balance on account of the measure of the Czech National Bank concerning real estate collateral in the amount of almost CZK 3.0 billion.

During the first half of 1999 the Bank wrote off to the off-balance sheet CZK 7.7 billion of loss loans fully covered by specific provisions, which means that the Bank's costs were in no way encumbered. The overall volume of loans written off to the off-balance sheet with the possibility of subsequent recovery thus rose to CZK 36.1 billion. More than half of this amount was comprised of loans to subjects in bankruptcy proceedings. Through the recovery and sale of loans already written off the Bank managed in the first six months to acquire extraordinary income of CZK 444 million, representing more than 80 % of the total amount recovered in 1998. The income of CZK 109 million since the beginning of 1999 generated by the realisation of collateral remains unsatisfactory for the Bank. The result is a reflection of the unchanged state of legislation and the unfavourable situation on the property market. However, a positive result was recorded in the sale of loans, which produced income of CZK 2.3 billion, with a yield on sale of 66.2 %.

BALANCE SHEET

Total assets amounted to CZK 401.7 billion, a fall of 4.8 % on the end of 1998. This was primarily due to the continuing unfavourable economic and legislative environment.

ASSETS

The volume of **cash in hand, balances with the central bank** decreased by 27.4 % to CZK 23.1 billion during the first two quarters of 1999. One of the reasons for this is the lower rate of obligatory minimum reserves (*a decrease from 7.5 % to 5 % as announced by CNB with effect from January this year*) and the still growing preference for cash-free payments as supported by the Bank.

The total volume of **amounts due from financial institutions** of CZK 117.4 billion increased in the first half of the year by 2 %. REPO operations reached CZK 53.9 billion.

The total volume of **Treasury bills and other bills** decreased by CZK 1.4 billion to CZK 0.5 billion, as a result of their repayment. No further purchases were made because of lower interest rates on these securities.

In response to developments on the capital market the Bank is further reducing its activities in **securities**. The securities trading portfolio amounting to CZK 14.0 billion fell by 14.3 % and the securities investment portfolio decreased by 12.2 % against the end of 1998 to CZK 14.1 billion. Bonds make up almost 90 % of both portfolios.

Loans to clients fell by 3.9 % to CZK 205.7 billion as against the end of 1998. This is due on the one hand to the continuing recession and the lack of quality business plans and on the other to the stricter criteria stipulated by the new loan procedure in assessing such plans, which has resulted in a generally far more cautious loan policy on the part of the Bank.

The proportion of mortgage and consumer loans continues to grow in the loan structure. During the first half of 1999 mortgage loans rose by 14.1 % to CZK 7.2 billion while consumer loans rose by 47.1 % to CZK 2.4 billion.

The quality of the loan portfolio was also influenced by continuing corporate insolvency and the still unresolved situation regarding creditors' rights. Although the volume of loss loans in the first half-year fell by 2.7 %, the steeper decline in the overall loan volume caused the proportion of loss loans in the Bank's portfolio to rise to 21.8 %. A small increase (of 0.6 %) in the volume of loans under special review (i. e. loans in the categories sub-standard, doubtful and loss) resulted in their figure as a proportion of total loans rising to 29.82 %. Non-performing loans (loans more than 90 days beyond their maturity date) showed a positive development in a decrease of CZK 1.4 billion to CZK 44.7 billion. Of the 39 billion of loans granted this year more than 95 % come under the problem-free categories of standard and watch.

LIABILITIES

The total volume of **amounts owed to financial institutions** fell by 16.7 % during the first half of 1999 to CZK 59.8 billion. This was due to the maturing of several loans in foreign currency.

The volume of **amounts owed to clients** decreased by 2.3 % to CZK 267.3 billion in the first half of 1999. This was brought about by savers seeking other forms of investment in reaction to the continuing decrease in interest rates on deposits. Investiční kapitálová společnost KB may well have proved a beneficiary of such a development, recently reporting a significant increase in deposits.

Bonds amounted to CZK 29.5 billion as at 30 June 1999. The reduction of 6.6 % against the end of 1998 was due to the maturing of one of the Bank's bond issues.

The change in the dollar-koruna rate was reflected in the increase in the book value of the **subordinated debt** to CZK 7.1 billion.

Total shareholders' equity amounted to CZK 16.0 billion as at the end of the first half-year. Its decrease by 21.9 % from the beginning of 1999 was caused by the inclusion of the accounting loss. The proportion of own funds on the balance sheet total thus amounted to 4 % as at 30 June 1999.

The **capital adequacy** of the Bank according to BIS methodology reached 8.91 % as at 30 June 1999. This figure, as well as that of 9.38 % reached according to CNB methodology, was comfortably above the 8 % level stipulated by the CNB.

SHAREHOLDER STRUCTURE

Major shareholders of Komerční banka with over 1 % of the share capital (as at 6 July 1999):

Shareholder	Proportion in %
Fond národního majetku České republiky	48.74
The Bank of New York ADR Department ¹⁾	17.92
Restituční investiční fond České republiky	3.38
Česká pojišťovna, a. s.	2.90
Rentiérský investiční fond, a. s.	1.57
Bank Austria AG	1.56
State Street Bank and Trust Company	1.32
P.I.F., a. s. - 1. Privatizační investiční fond, a. s.	1.08

¹⁾ With the permission of the Czech National Bank, the Bank of New York ADR Department is the holder of those shares for which Global Depository Receipts were issued and which are in the possession of a significant number of foreign investors.

The share capital remained unchanged at CZK 9.5 billion and was divided into 19,004,926 shares which as at 6 July 1999 were in the possession of 75,927 shareholders. From the beginning of 1999 the number of shareholders decreased by 2,867, while a concentration of ownership was evident both among corporate entities and private individuals.

Altogether 348 corporate entities held 90.8 % of shares, the remaining portion being held by 75,579 private individuals.

At the close of the first half of 1999 foreign shareholders owned 28.3 % of the share capital of the Bank, 27.9 % being in the possession of foreign corporate entities and 0.4 % being held by foreign private individuals.

**KOMERČNÍ BANKA'S PROFIT AND LOSS ACCOUNT
ACCORDING TO INTERNATIONAL ACCOUNTING STANDARDS**

(in CZK million)

	Item	30 June 1999 (Unaudited)	30 June 1998 (Unaudited, Restated)
1.	Interest income	17,652	25,552
2.	Interest expense	(12,079)	(16,968)
3.	Net interest income	5,573	8,584
4.	Net fees and commissions	2,199	2,171
5.	Dealing profits / (losses)	1,438	645
6.	Other income	760	917
7.	Operating profit	9,970	12,317
8.	Administrative expenses	(4,657)	(4,778)
9.	Depreciation and other provisions	(735)	(697)
10.	Profit / (loss) before provision for loan losses and income taxes	4,578	6,842
11.	Provision for loan losses	(9,050)	(16,318)
12.	Profit / (loss) before income taxes	(4,472)	(9,476)
13.	Income taxes	(3)	(21)
14.	Net profit / (loss) for the period	(4,475)	(9,497)

**KOMERČNÍ BANKA'S BALANCE SHEET
ACCORDING TO INTERNATIONAL ACCOUNTING STANDARDS**

(in CZK million)

	Item	30 June 1999 (Unaudited)	31 December 1998 (Audited)
ASSETS			
1.	Cash and balances with the central bank	23,098	31,827
2.	Due from financial institutions	117,377	115,077
3.	Treasury bills and other bills eligible for refinancing	481	1,833
4.	Loans and advances to customers (net)	205,685	214,018
5.	Dealing securities	14,013	16,349
6.	Prepayments, accrued income and other assets	7,797	7,686
7.	Investment securities	14,103	16,056
8.	Investments in subsidiaries and associates	3,958	3,960
9.	Tangible and intangible fixed assets (net)	15,210	15,278
	Total assets	401,722	422,084
LIABILITIES			
1.	Amounts owed to financial institutions	59,808	71,769
2.	Amounts owed to customers	267,275	273,698
3.	Certificated debts	29,542	31,646
4.	Accruals, provisions and other liabilities	22,034	18,542
5.	Subordinated debt	7,080	5,971
	Total liabilities	385,739	401,626
Shareholders' equity			
6.	Share capital	9,502	9,502
7.	Share premium and reserves	6,481	10,956
	Total shareholders' equity	15,983	20,458
	Total liabilities and shareholders' equity	401,722	422,084

**KOMERČNÍ BANKA'S PROFIT AND LOSS ACCOUNT
ACCORDING TO THE ACCOUNTING METHODOLOGY OF THE CZECH BANKS**

(in CZK million)

	Item	30 June 1999	30 June 1998
1.	Interest income and similar income	20,416.3	29,731.6
	of which: interest income from fixed income securities	1,211.2	1,638.8
2.	Interest expense and similar expenses	(14,769.7)	(20,936.7)
	of which: interest expense on fixed income securities	(1,678.8)	(2,722.4)
3.	Income from variable yield securities	20.5	60.1
	a) income from shares and other variable yield securities	5.5	1.4
	b) income from investments in associated undertaking	15.0	58.7
	c) income from investments in subsidiary undertaking	0.0	0.0
	d) income from investments	0.0	0.0
4.	Fee and commission income	2,389.3	2,312.6
5.	Fee and commission expense	(190.0)	(141.2)
6.	Profit (loss) from financial operations	1,423.7	2,085.6
7.	Other income	2,792.4	1,408.2
8.	General operating costs	(4,984.1)	(5,152.0)
	a) staff costs	(2,295.3)	(2,354.1)
	aa) salaries and wages	(1,689.3)	(1,732.8)
	ab) social insurance	(487.4)	(500.9)
	ac) health insurance	(118.6)	(120.4)
	b) other operating costs	(2,688.8)	(2,797.9)
9.	Creation of reserves and provisions for tangible and intangible assets	0.0	0.0
	a) creation of reserves for tangible assets	0.0	0.0
	b) creation of provisions for tangible assets	0.0	0.0
	c) creation of provisions for intangible assets	0.0	0.0
10.	Use of reserves and provisions for tangible and intangible assets	0.0	0.0
	a) use of reserves for tangible assets	0.0	0.0
	b) use of provisions for tangible assets	0.0	0.0
	c) use of provisions for intangible assets	0.0	0.0
11.	Other costs	(12,428.6)	(14,005.9)
12.	Creation of reserves and provisions for loans and guarantees	(13,011.0)	(20,606.6)
13.	Use of reserves and provisions for loans and guarantees	11,033.8	16,434.7
14.	Creation of reserves and provisions for fixed asset investments and other financial investments	(153.5)	0.0
15.	Use of reserves and provisions for fixed asset investments and other financial investments	0.0	0.0
16.	Creation of other provisions and reserves	(697.2)	(1,043.8)
17.	Use of other provisions and reserves	3,531.7	226.4
18.	Income tax from current activities	(2.5)	(20.8)
19.	Extraordinary income	141.8	67.8
20.	Extraordinary costs	(215.5)	(66.1)
21.	Income tax from extraordinary activities	0.0	0.0
22.	Profit or loss from extraordinary activities after tax	(73.7)	1.7
23.	Profit or loss for accounting period	(4,702.6)	(9,646.1)

**KOMERČNÍ BANKA'S BALANCE SHEET
ACCORDING TO THE ACCOUNTING METHODOLOGY OF THE CZECH BANKS**

(in CZK million)

ASSETS

	Item	30 June 1999	31 December 1998
1.	Cash in hand, deposits with central banks, post checking accounts	21,066.5	30,494.2
2.	Treasury bills and other bills	54,307.3	60,471.8
	a) treasury bills and similar bonds issued by the state	480.7	1,831.9
	b) other bills	53,826.6	58,639.9
3.	Amounts due from banks	119,408.5	116,410.0
	a) payable on demand	1,483.3	1,332.2
	b) other receivables	117,925.2	115,077.8
	of which: subordinated assets	0.0	0.0
4.	Amounts due from clients	207,686.7	218,025.1
	a) payable on demand	520.4	313.7
	b) other receivables	207,166.3	217,711.4
	of which: subordinated assets	0.0	0.0
5.	Bonds and other fixed income securities for trading	13,352.1	15,849.7
	a) issued by banks	3,846.0	4,291.3
	of which: own bonds	700.9	1,142.5
	b) issued by other subjects	9,506.1	11,558.4
6.	Shares and other variable yield securities for trading	606.8	470.7
7.	Fixed asset investments in associated undertakings	2,762.8	2,763.9
	a) in banks	280.0	280.0
	b) in other entities	2,482.8	2,483.9
8.	Fixed asset investments in subsidiary undertakings	1,195.2	1,195.8
	a) in banks	444.7	445.3
	b) in other entities	750.5	750.5
9.	Other financial investments	14,466.5	16,141.4
10.	Intangible assets	632.7	590.5
	a) expenses of foundation	0.0	0.0
	b) goodwill	0.0	0.0
11.	Tangible assets	13,425.7	13,879.7
	a) land and buildings for banking activities	9,674.5	9,813.9
	b) other	3,751.2	4,065.8
12.	Own shares	0.0	3.5
13.	Other assets	3,216.6	3,439.8
14.	Subscribed capital called-up and not paid	0.0	0.0
15.	Prepayments and accrued income	7,616.4	7,582.6
	TOTAL ASSETS	459,743.8	487,318.7

LIABILITIES

		30 June 1999	31 December 1998
1.	Amounts due to banks	113,733.6	130,411.7
	a) payable on demand	3,158.7	6,885.7
	b) other	110,574.9	123,526.0
2.	Amounts due to clients	267,274.7	273,697.7
	a) savings deposits	35,178.0	38,390.2
	of which: payable on demand	1,674.3	1,771.4
	b) other amounts due to clients	232,096.7	235,307.5
	of which: payable on demand	99,073.3	113,818.6
3.	Certificates of deposit and similar debentures	32,500.7	35,000.8
	a) certificates of deposit	0.7	0.8
	b) other	32,500.0	35,000.0
4.	Accruals and deferred income	5,487.1	8,062.4
5.	Reserves	2,873.2	5,651.0
	a) reserves for standard loans and guarantees	2,158.3	4,108.8
	b) reserves for foreign exchange rate losses	420.8	835.8
	c) reserves for other banking risks	93.3	505.9
	d) other reserves	200.8	200.5
6.	Subordinated liabilities	7,079.8	5,971.0
7.	Other liabilities	15,507.4	8,508.6
8.	Share capital	9,502.5	9,502.5
	of which: share capital paid-up	9,502.5	9,502.5
9.	Share premium fund	6,008.0	6,008.0
10.	Reserve funds	2,408.2	2,408.2
	a) obligatory reserve funds	1,903.0	1,903.0
	b) reserve funds for own shares	5.0	5.0
	c) other reserve funds	500.2	500.2
11.	Capital funds and other funds from profit	1,602.3	11,377.4
	a) capital funds	0.0	54.7
	b) other funds from profit	1,602.3	11,322.7
12.	Retained earnings and not compensated loss of previous periods	468.9	523.9
13.	Profit or loss for the accounting period	(4,702.6)	(9,804.5)
	TOTAL LIABILITIES	459,743.8	487,318.7

OFF-BALANCE SHEET

	Item	30 June 1999	31 December 1998
1.	Total future potential liabilities	38,524.5	35,197.7
	of which:		
	a) received bills of exchange (acceptances) and endorsements of bills of exchange	148.7	0.0
	b) commitments from guarantees	38,375.8	35,197.7
	c) commitments from collateral	0.0	0.0
2.	Other irrevocable commitments	19,881.0	21,627.6
3.	Receivables from spot, forward and option operations	240,579.6	237,963.2
4.	Liabilities from spot, forward and option operations	236,082.0	234,207.7

