

Addiko Bank

Annual Report 2019

Addiko Bank a.d. Beograd

Key data

Addiko Bank a.d. Beograd operating results

based on the financial statements prepared in accordance with the IFRS

The accompanying financial statements are presented in the format prescribed by the Decision on Forms and Contents of Items in Financial Statement Forms to Be Completed by Banks (Republic of Serbia Official Gazette nos. 101/2017, 38/2018 and 103/2018).

	2019	2018
Income statement (in RSD '000)	01-Jan to 31-Dec	01-Jan to 31-Dec
Net operating income	4,953,980	4,438,148
Net interest income	3,584,298	3,169,165
Net fee and commission income	1,369,682	1,268,983
Other operating income	668,586	767,435
Operating expenses	-4,248,008	-4,149,380
Operating result before credit risk provisions	1,374,558	1,056,203
Credit risk provisioning costs	-226,370	284,523
Income tax	-40,493	-40,768
Result for the period after tax	1,107,695	1,299,958
Balance sheet (in RSD '000)	31/12/2019	31/12/2018
Loans and receivables due from clients	67,586,939	73,001,855
Deposits and financial liabilities due to clients	60,988,985	65,789,053
Equity	22,386,667	21,397,933
Total assets	94,756,170	100,118,520
Key performance ratios	2019	2018
Net interest income/total assets	3.78%	3.17%
Cost to income ratio (CIR)	67.18%	71.40%
Tier 1 capital ratio	26.30%	16.56%
Total capital adequacy ratio	27.05%	18.44%
Headcount as of the reporting date	558	585
Number of branches	37	38

The Annual Business Report is prepared in accordance with Article 29 of the Law on Accounting (Official Gazette of RS nos. 62/13, 30/2018 and 73/2019 - the other law), containing the following:

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Pismo Izvršnog odbora

Poštovani,

Još jedna izazovna, ali pre svega uspešna godina je za nama. Nastavili smo našu priču specijalizovane banke za finansiranje građana i SME segmenta. Istovremeno, ono na šta smo posebno ponosni je što smo i tokom 2019. godine opravdali ulogu lidera digitalne transformacije na bankarskom tržištu Srbije. Takođe, trudimo se da Addiko banka iz dana u dan bude što bolje mesto za rad i napredovanje.

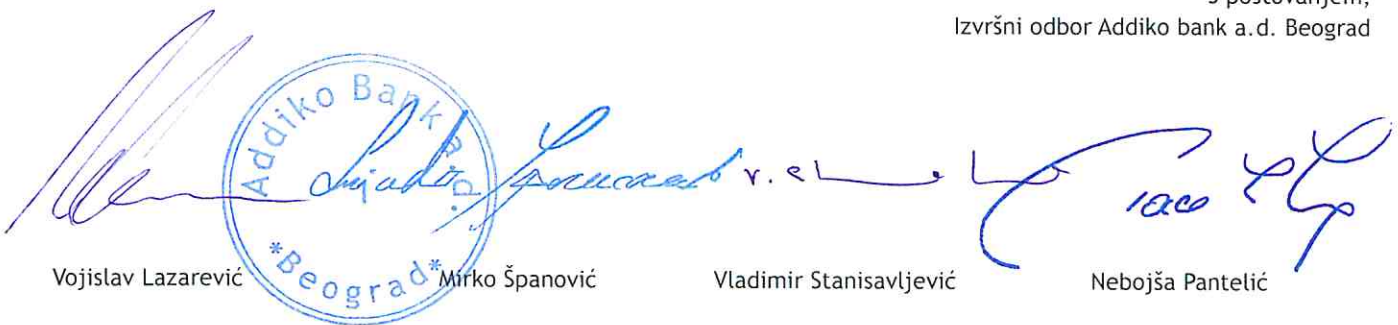
Korisničko iskustvo i digitalne inovacije izdvojile su nas u odnosu na druge banke. Ono što smo poslednjih godina radili, a što se ne vidi kroz proizvode, bilo je digitalizacija i pojednostavljivanje procesa. Kao logični nastavak svega, došao je i mKredit i dozvoljeno prekoračenje kroz m-banking aplikaciju - kompletno digitalni proizvod za koje klijenti Addiko banke mogu da apliciraju 365 dana godišnje, 24 sata dnevno. U trenutku puštanja, mKredit je bio jedinstven proizvod na bankarskom tržištu Srbije. Da je takav digitalni proizvod potreban rekli su klijenti. Već početkom četvrtog kvartala imali smo hiljadu prodatih m-proizvoda. Paralelno, jednostavnost i kvalitet m-banking aplikacije klijenti su ocenili na Google Play-u i App Store. Na kraju 2019. godine prosečna ocena na ove dve platforme bila je 4,6 što je najviša ocena u kategoriji bankarskih aplikacija na tržištu Srbije.

Tokom 2019. godine odličan rezultat banka je ostvarila i u domenu finansiranja građana i u radu sa privredom. U keš kreditima, što je jedan od naših fokusa, smo ostvarili neto rast za 26 miliona evra odnosno za 17 odsto. Plasirali smo skoro 200 miliona evra kredita u Corporate sektoru od čega polovinu čine SME krediti. Fokusirali smo se na produkciju putem inovativne digitalne platforme za upravljanje poslovnim procesima, uveli nove proizvode, unapredili korisničko iskustvo i kao rezultat toga realizovali 16 miliona evra plasmana od početka godine u SME segmentu.

Ne želimo da samo nominalno kažemo da vodimo računa o zaposlenima. Posebno smo ponosni što smo interno promovisali 68 zaposlenih od kojih je polovina iz Retail-a. Zato smo uveli fleksibilno radno vreme, slobodan dan za rođendan i slobodan dan za polazak prvaka u školu.

I pored velikih izazova sa regulatorne strane i brojnih ograničenja koja su došla Addiko tim je napravio odličan rezultat i nastavio je pozitivan trend koji postoji od kad se brend našao na tržištu. Takođe, ovi odlični rezultati, ne samo u Srbiji, već i u svim zemljama, potvrda su strategije koja je usvojena i koja uspešno usmerava poslovanje banke. Upravo zato možemo da kažemo da ćemo i tokom 2020. godine nastaviti sa našim fokusima (finansiranje građana i SME segmenta), kao i da ćemo i dalje biti izazivači na tržištu u domenu digitala i nosioci promena kroz nadogradnju naše m-banking aplikacije.

S poštovanjem,
Izvršni odbor Addiko bank a.d. Beograd



Vojislav Lazarević Mirko Španović Vladimir Stanisavljević Nebojša Pantelić

Predsednik Izvršnog odbora Zamenik predsednika
Izvršnog odbora Član Izvršnog odbora Član Izvršnog odbora

Annual Business Report of Addiko Bank a.d. Beograd

1. About Addiko Bank

Addiko Bank a.d. Beograd (Addiko Bank) is a member of an international financial group headquartered in Vienna, Austria. Addiko Group operates in five markets: Serbia, Croatia, Bosnia and Hercegovina, Slovenia and Montenegro. The strategy of Addiko Group is to concentrate on SEE markets, with clients and their needs in focus. Operations of Addiko Bank are focused on consumer and SME lending and payment services - in all countries of operation. There is also a service of placing online deposits in Austria and Germany. Addiko Group serves approximately 860 thousand clients. The strategy of Addiko Bank is to offer a unique experience to clients through the straightforward banking strategy introduced into the market by Addiko as a brand - focus on essentials, deliver on efficiency and communicate simplicity. Products and services at the Group level are standardised, especially regarding focus areas of consumer and SME lending, in order to increase efficiency and mitigate risks, with clients receiving the best possible service.

Since 12 July 2019, Addiko Bank AG is listed at the Vienna Stock Exchange. In this way, the share of Al Lake (Luxembourg) S.à r.l., a company in indirect ownership of funds managed by Advent International and the EBRD was decreased to 44.99%, while the remainder of shares is in free circulation. Up-to-date information on the ownership structure is available at <https://www.addiko.com/shareholder-structure/>. There were no changes regarding ownerships of Addiko Bank a.d. Beograd, i.e., the local bank is entirely (100%) owned by the parent bank Addiko Bank AG.

2. Macroeconomic environment

Despite the continued intense economic growth, unlike the previous year result, the achieved growth rate stood at below 4%. In the following two years, further mild deceleration is expected as a result of external demand lowering and partial limitation of local capacities. The monetary policy continues to be relaxed based on low inflationary tendencies and highly expansive policy of the ECB. Factors on the offer side, especially low prices of energy products, indicate that recent inflationary pressures are not to be expected. The expansive phase of the credit cycle is continued through an intense growth of financing of the non-financial private sector, with the retail credit demand being much higher than the corporate demand, implying further consumption increase.

In the Republic of Serbia, the deceleration was not so intense as it initially seemed: the real GDP increased up to estimated 3.4% in 2019, partially due to the construction of a part of the gas pipeline TurkStream crossing Serbia. For

2020 and 2021, the forecasted growth rate was revised upward to 3.4% and 3.2%, respectively. It is expected that FDI inflow will continue to provide support to investments, whereas the wage growth and generous social policy will support further growth of private consumption. In 2018, there was an intense credit growth due to increased trust of citizens and despite the fact that the current growth rate of app. 9% p.a. may not be maintained, outlook for the following two years is positive.

3. 2019 at a glance

3.1. Stock exchange listing of Addiko Group

On 12 July 2019, Addiko Bank AG offered its shares at the Vienna Stock Exchange totalling 19,500,000 at EUR 16 per share. This was the third largest process at the Vienna Stock Exchange in 2019 and the largest one within the European financial sector. The successful completion of the process is the key achievement for the Group, ensuring further implementation of the defined strategy and stable business growth.

3.2. Retail

Addiko Bank offers to its clients - private individuals a modern user experience based on the straightforward banking strategy - focus on essentials, aiming at becoming a primary bank for the key products: cash loans, authorised overdrafts, credit cards and current accounts.

Retail banking products are standardised and improved. The primary focus in 2019, in addition to the lending business, was the improvement of card business. Clients accepted the new debit MasterCard card extremely well, along with the successful implementation of the new MasterCard credit card offering repayment in three different ways (as per client's choice). The offer of bankassurance products was enlarged by products available to the majority of our clients.

The digital potential of the Bank was continually developed with the mission to improve the user experience primarily on the mobile platform. In addition to transaction banking, Addiko Bank's clients can now apply for cash loans and authorised overdrafts through m-banking, with their current accounts being credited within few minutes, without having to go to the bank.

In the micro segment, Addiko Bank focused on client transaction business and further sale of the unique offer of account packages in 2019. Clients recognised the simplicity and speed of the account package opening process (with the only prerequisite being the ID card) and the customer database of users of these products is constantly increasing.

In order to further increase client satisfaction, Addiko Bank launched a new and unique Addiko Business e-bank solution for micro clients which offers simple creation of electronic payment orders, overview of dinar and foreign currency accounts, deposits and loans the clients are using.

3.3. Corporate

Addiko Bank is one of the leaders in the digital transformation segment, both in Serbia and other markets where operating.

Client needs represent our foremost interest and the main reason for introducing changes and improving existing processes. The SME segment is one of the three focus areas of Addiko Bank and accordingly, the corporate digital team, in cooperation with the company Appian, launched an internal platform for business process management.

The platform provided significant expedition and simplification of the loan approval process, resulting in increased satisfaction of Addiko Bank clients. The Appian BPM platform provides the following functionalities:

- high-level automation,
- shorter time of approval procedure,
- approval process transparency through its real-time monitoring,
- improved data quality,

resulting in a faster and more efficient loan approval decision-making.

Based on the simple Addiko loan approval procedure, the Bank is able to disburse loan funds to clients within three business banking days. In view of this, the process of loan approval and disbursement is now by over 50% faster.

Consequently, SME clients of Addiko Bank can now submit an application for a loan or a trade finance product (performance guarantees, binding letters of intent) up to EUR 300,000 in three simple steps.

In parallel, a new Addiko Business e-bank solution was developed, offering an overview of all loans approved and disbursed by the Bank. The plan for 2020, being currently actively implemented by the Addiko Bank team, is to create a new version which will offer even better and faster service.

Undoubtedly, speed, transparency and simplicity are the three things appreciated by clients when doing business with a bank. Digital transformation of processes and products implemented by Addiko Bank ensures these three factors.

3.4. Digital transformation

Addiko Bank continued working on the digital transformation of its products and services, being an integral part of its business strategy from the launching of the brand. In time, Addiko Bank became recognised in the market as a leader in digitalisation, not only in Serbia but in other countries of operation as well. Retaining the focus areas (private individuals and SMEs) in the course of 2019, Addiko Bank introduced novelties for clients - a unique m-loan product, as well as an application for authorised overdraft, and continued the trend of streamlining and expediting corporate processes.

At the beginning of 2019, the Bank launched a new product - an m-loan and application for authorised overdraft through the m-banking application. Addiko Bank clients may apply for loans through the m-banking application 24/7, all year round, without having to go to a branch. We take exceptional pride in the fact that the process is end-to-end digital. With this product, we reconfirmed our leader position in digital product innovations. Our efforts were also recognised by the Veracomp Top 100 CIOs Forum, which rewarded us with the 'Best Project' award.

Digital transformation and creation of new digital products and services will remain the strategic course of Addiko Bank. Addiko Bank will continue to invest in and deliver products tailor-made for clients, simple and easy to use. This especially pertains to the m-banking application as a unique ecosystem upgraded and shaped according to client needs.

3.5. Focus on customer experience improvement

Resulting from everyday focus on customer satisfaction increase, in 2019, Addiko Bank released an application for assessing satisfaction with its services.

The application offers the possibility of surveying clients who visit Addiko Bank branches about their satisfaction with services used. The survey can be used for measuring client satisfaction and identifying critical issues in processes.

Mystery shopping activities and the Contact Centre surveying of clients are continually carried out in order to improve the quality of services provided at branches and increase customer satisfaction.

3.6. Ongoing cost management and efficiency increase

Constantly focusing on optimisation of processes and establishment of an efficient, agile and integrated organisation, the existing IT applications were further upgraded in 2019.

Based on the current initiatives for cost optimisation, operating costs were decreased in spite of additional investments and the Bank's digital capacities were improved. Addiko Bank has a good position for further significant improvement of the overall efficiency, positively reflecting to the cost-income ratio (CIR).

3.7. Business strategy overview

After successful implementation of its original business strategy (created after ownership change in July 2015) and extensive repositioning as a specialised bank in the SEE region, Addiko Bank further advanced its strategy towards differentiation from the universal banking model predominant in the SEE region, focusing on daily banking activities where accessibility and efficiency may generate higher margins. Such services mainly imply transactions not requiring special advisory support, with being convenient for standardisation and delivery through digital channels.

The Bank focuses on loans generating higher yields after risk costs as a specialist for financing consumers and SMEs in the 'real economy' involved in manufacturing, trade and agricultural activities with proven earning ability. SEE region markets not adequately covered by such banking services offer attractive potential for growth which will be achieved through converging European standards, especially when the digital banking potential spreads in the region.

Addiko Bank offers a fresh user experience based on its strategy of straightforward banking - focus on essentials, deliver on efficiency and communicate simplicity. Banking products and services are continually standardised and improved, especially in the segment of consumer and SME business, aiming at increasing efficiency, promoting simplicity and improving client convenience, with decreasing risks and maintaining portfolio quality at the same time.

Based on this approach, Addiko Bank achieved its goal of business transformation toward key strategic segments of growth of the consumer and SME lending, as well as payment services ('focus areas'). Addiko Bank is primarily focused on placing unsecured cash loans to private individuals and credit lines for working capital to SMEs, funded mostly from retail deposits. The portfolios of mortgage loans, public and large corporate lending ('non-focus areas') are steadily decreased over time since client repayments exceed new placements in these segments, thereby redirecting funds to the consumer and SME lending growth. Furthermore, the Bank continues establishing a recognisable business model with digital potential.

Furthering its successful initial strategy, Addiko Bank will continue endeavouring to become, based on its top performance, a bank of choice for selected products, satisfying

key banking needs in an efficient and most convenient manner for clients, with clear and transparent communication.

3.8. Branches

At 2019 end, Addiko Bank had the total of 37 branches in Serbia. The branch network is divided in three regions, with 17 branches being located in the Region Beograd, 10 branches located in the Region Central and South Serbia and 10 branches located in the Region Novi Sad.

3.9. Financial performance in brief

In the course of 2019, Addiko Bank a.d. Beograd confirmed, pursuing its values - focus on essentials, deliver on efficiency and communicate simplicity, the strategy of repositioning from a universal to a specialised bank and achieved substantial growth in products and segments yielding higher margins - cash loans and SME loans. The total net result at year-end 2019 stood at RSD 1.11 billion.

The Bank generated the total interest income of RSD 4.54 billion. The Retail Division generated RSD 2.1 billion (excluding mortgage loan portfolio), while the SME segment generated RSD 0.7 billion. Based on the achieved growth rates of the portfolio of consumer and micro loans of 14% (RSD 2.7 billion) and SME loans of 6% (RSD 1.1 billion), Addiko Bank a.d. Beograd successfully overcame challenges imposed by dynamic environment and remained a reliable business partner to its clients.

The orientation to cash and SME loans made an impact on the growth of interest income of these focus areas by 32% and 21% respectively, yoy.

The total loan portfolio of Addiko Bank at 2019 end stood at RSD 67.6 billion. The implementation of the Bank's business strategy resulted in the growth of the share of these two profitable segments to 62% in total gross loans (year-end 2018: 52%).

Net commission income amounted to RSD 1.4 billion. Client appreciation of high-quality services and focus on clients and their actual needs, as well as business transparency, are best supported by the fact that net commission income grew by RSD 100.1 million yoy.

Being engaged in continual creation of new products and services and adjustment to client needs based on market conditions, Addiko Bank gained trust of a significant number of clients.

Following global developments in its pursuit for improving customer satisfaction, in the course of 2019, Addiko Bank a.d. Beograd launched a significant number of innovations

based on the development of digital services and sale channels, one of them being the m-loan as one of the most efficient and effective manners for loan approval.

The total credit card portfolio was increased in 2019. The offer of payment cards of Addiko Bank a.d. Beograd was also enlarged in 2019 by the unified MasterCard Credit 3in1 payment card, replacing three cards offered by the Bank until that moment, which offered the opportunity of client choosing whether to use it for instalment repayment, as a credit revolving card or as a charge card, indicating the Bank's focus on client satisfaction.

One of the most important goals for 2019 was to support positive sale results, with careful pricing and obtaining of funds required for assets growth. In view of that, Addiko Bank a.d. Beograd, in cooperation with the European Bank for Reconstruction and Development (EBRD), provided additional financing sources for investments and working capital of SMEs. In parallel, the Bank was focused on decreasing heavy concentration of individual client deposits, with successful realisation. The Bank also signed a contract with the USAID which will be effected in 2020.

The portfolios of mortgage, large corporate and public loans are not the focus of the Bank, in line with its business strategy, and the steady decrease of these segments in the course of 2019 provided additional liquid funds which were redirected to financing Bank focus areas. Mortgage loans do not make the Bank's offer for a rather long period of time and their steady decrease is a result of regular repayments of existing clients. In May 2019, the Law on the Conversion of Housing Loans Indexed to Swiss Francs came into force, prescribing the obligation of writing off 38% of EUR-converted debt, which added to the decrease of this portfolio. Large corporate and public segments were recognised as less profitable and rather volatile, resulting in steady lowering of the exposure. Nevertheless, Addiko Bank a.d. Beograd improved the existing successful cooperation with individual/profitable clients from these segments. The total assets of the Bank at 2019 end stood at RSD 94.8 billion.

Asset quality was substantially improved based on resolving old NPLs implying successful resolving of individual large corporate clients, intensified enforced collection and accounting write-offs. Furthermore, the level of new NPLs is low, confirming the Bank's focus on long-term sustainable loan portfolio growth through responsible credit policy.

Based on efficient asset and liability management and currency structure monitoring, the Bank ensured compliance of other operating income with the growth of focus business areas.

Operating expenses, excluding depreciation, stood at RSD 3.8 billion in 2019, making the decrease of RSD 142 million yoy due to the applied operating model and strict cost control. The cost optimisation process was continued by revising organisation and processes in order to increase efficiency, save time and ensure higher-quality services, with phasing out of activities without added value.

Depreciation costs increased predominantly due to the implementation of the IFRS 16.

3.10. Corporate social responsibility

In 2019, Addiko Bank continued implementing the unified strategy for social responsibility at all markets where operating. The primary focus implied the youth and education. Accordingly, Addiko Bank, partnering with the publishing company Laguna within the Addiko Cares program, continued organising visits of children's authors to institutions for children with special needs or children without parental care. The final event was organised in Belgrade and each of the events was attended by a number of employees. In addition, the campaign of donating fixed assets to institutions in need was continued. The priority was given to educational institutions.

Furthermore, the strategic orientation of Addiko Bank, as a digital transformation implementing bank, is environmental protection, entailing discouraging of the use of printers and paper.

4. Financial statements

4.1. Income statement analysis

In RSD '000

	2019	2018	Change
Interest income	4,540,370	4,152,679	9.34%
Interest expenses	-956,072	-983,514	-2.79%
Net interest income	3,584,298	3,169,165	13.10%
Commission income	1,519,427	1,401,414	8.42%
Commission expenses	-149,745	-132,431	13.07%
Net commission income	1,369,682	1,268,983	7.94%
Net gains on changes in the fair value of financial instruments	121,122	241,398	-49.82%
Net gains on reclassification of financial instruments	32,598	-	
Net gains on derecognition of financial instruments measured at fair value	49,587	170,624	-70.94%
Net exchange losses and negative currency clause effects	-5,483	-8,845	-38.01%
Net losses on impairment of financial assets not measured at fair value through profit or loss	-226,370	284,523	-179.56%
Net gains on derecognition of financial instruments measured at amortized cost	110,691	-	
Other operating income	255,113	244,699	4.26%
TOTAL NET OPERATING INCOME	5,291,238	5,370,547	-1.48%
Salary expenses, salary compensations and other personal expenses	-1,420,345	-1,450,282	-2.06%
Amortisation/depreciation charge	-432,291	-187,935	130.02%
Other income	99,475	110,714	-10.15%
Other expenses	-2,389,889	-2,502,318	-4.49%
PROFIT / (LOSS) BEFORE TAX	1,148,188	1,340,726	-14.36%
Income tax	-750	-1,025	-26.83%
Deferred tax losses	-39,743	-39,743	-
PROFIT / (LOSS) AFTER TAX	1,107,695	1,299,958	-14.79%

Despite the ongoing trend of interest rate cutting in the market and intense competition, Addiko Bank a.d Beograd recorded the growth of **net interest income** of RSD 415 million. The growth was predominantly driven by the increase in the cash and SME loan portfolios, reflecting the business policy of the Bank focused on loans with higher margins generating higher income. However, the growth was partially neutralised by a decrease in t-bill yields by RSD 59 million. Careful pricing of financing sources resulted in the drop of interest expenses by RSD 27 million.

Net fee and commission income also recorded growth in 2019, standing at RSD 101 million. The positive result was primarily driven by the continual development of cooperation with the existing clients and observance of their needs. Launching of new products and services and further development of digital platforms show the readiness of Addiko Bank a.d Beograd to fulfil all client needs and facilitate their operations. The growth of the fee and commission income stems from an increase of fees for off-balance sheet business, bankassurance and account administration income. Increase in expenses per card operation was the major generator of the fee and commission expenses growth.

Other operating income continued its upward trend and recorded an increase of RSD 10 million in 2019, with the largest share of intragroup services income.

Operating result before changes of credit loss costs stood at RSD 1.375 million, recording the yoy increase of RSD 318 million primarily due to the increase of interest income, as well as the process and organisational structure optimisation ensuring performance of client-related activities in a very short period of time. Moreover, the Bank was intensely focused on control of operating expenses, resulting in their decrease by RSD 142 million in 2019.

4.2. Balance sheet analysis

The total assets of Addiko Bank a.d Beograd dropped by RSD 5.362 million compared to 2018, primarily due to the Law on the Conversion of Housing Loans Indexed to Swiss Francs imposing the obligation of writing off 38% of EUR-converted debt on banks. Further, natural depreciation of housing loans and large corporate and public loans that are not fo-

However, depreciation charge increased in 2019, mostly due to the implementation of IFRS 16, whereby operating leases are accounted for in the same manner as finance leases.

Losses on impairment of financial assets recorded a growth in 2019, however, a positive effect of the NPL management was manifest in a decrease of the NPL portfolio, recovery of individual large corporate clients and intensified enforced collection.

Profit after tax was lower by RSD 192 million.

cus areas of the Bank, was an additional driver of the decrease in loans and receivables due from clients. Regardless of the decrease in this balance sheet item, Addiko Bank a.d Beograd achieved a significant growth of focus segments, i.e., consumer and micro cash loans of 14% (RSD 2.7 billion) and SME loans of 6% (RSD 1.1 billion).

In RS'000

	31-Dec-2019	31-Dec-2018	Change
Cash and balances held with the Central Bank	7,884,737	11,174,771	-29%
Pledged financial assets	-	-	
Receivables from derivatives	1,680	25,656	-93%
Securities	13,667,997	11,108,524	23%
Loans and receivables due from banks and other financial institutions	2,776,939	2,442,156	14%
Loans and receivables due from customers	67,586,939	73,001,855	-7%
Intangible assets	1,045,046	946,053	10%
Property, plant and equipment	1,016,499	629,876	61%
Deferred tax assets	70,003	158,974	-56%
Non-current assets held for sale and discontinued operations	15,446	72,446	-79%
Other assets	691,634	558,209	24%
TOTAL ASSETS	94,756,920	100,118,520	-5%

Cash and balances with the Central Bank decreased by RSD 3.290 million to RSD 7.885 million on account of a decrease of the required foreign exchange reserve.

Total net receivables (gross receivables after credit risk provisioning) decreased by RSD 5.080 million (clients: RSD 5.415 million, banks: RSD 335 million). Decrease in the volume of housing and working capital loans was partly compensated by an increase of cash loans and credit cards. At

year-end 2019, credit risk provisions were lower yoy, reflecting the continual improvement of results in collection and addressing NPLs.

Securities, encompassing items of financial assets available for sale, recorded a growth yoy. Securities were also affected by the Law on the Conversion of Housing Loans Indexed to Swiss Francs due to the envisaged obligation of the Republic of Serbia to refund 15% of converted debt to banks

in the form of securities. On 1 October 2019, the government issued securities totalling RSD 1.6 billion with 4% interest rate to Addiko Bank a.d Beograd.

Fixed assets had an upward trend and went up by RSD 387 million in 2019, primarily due to implementation of IFRS 16.

Intangible assets increased by RSD 99 million, from RSD 946 million, as a result of further development of new e-banking applications and investments in digital capacities, indicating that the Bank follows market trends endeavouring to provide best conditions for efficient and safe client operations and consequently, proving to be a reliable business partner to its clients.

Other assets increased by RSD 133 million in line with an increase of other receivables from card business.

In RSD '000

	31/12/2019	31/12/2018	Change
Liabilities under derivatives	9,608	24,942	-61%
Deposits and other financial liabilities due to banks, other financial institutions and the Central Bank	5,641,891	7,589,826	-26%
Deposits and other financial liabilities due to customers	60,988,985	65,789,053	-7%
Subordinate liabilities	3,934,511	3,911,759	1%
Provisions	385,714	369,533	4%
Current tax liabilities	750	1,025	-27%
Deferred tax liabilities	-	33,785	-100%
Other liabilities	1,408,794	1,000,664	41%
Share capital	20,545,294	20,545,294	0%
Profit	1,107,695	1,299,958	-15%
Loss	-1,126,066	-1,126,066	
Reserves	1,859,744	678,747	174%
TOTAL LIABILITIES	94,756,920	100,118,520	-5%

Total liabilities dropped in 2019 predominantly due to a decrease of customer deposits. Accordingly, good cooperation with the European Bank for Reconstruction and Development (EBRD) was continued and a contract with the USAID was signed in order to provide additional financing sources predominantly for SMEs. The item with the second largest drop was financial liabilities at amortised cost, being lower by RSD 1.948 million, mainly due to a decrease of short-term interbank RSD loans. One of the key priorities of

Addiko Bank a.d Beograd in 2019 was development of a stable deposit base to support further assets growth.

Provisions rose by RSD 16 million yoy due to higher provisions for litigations and decreased provisions for guarantees.

In 2019, Addiko Bank a.d Beograd paid dividends to its shareholders.

5. Human resource management

The human resource strategy is a driver of the cultural transformation of Addiko Bank. HR processes of Addiko Bank possess quality and imply performance management, selection and recruiting, talent development, education and development of leadership skills aiming at ensuring agility of employee opinions and capabilities. Performance appraisal and talent management were the key processes for the identification, development, valuation and recognition of high-quality employees and talents. In this way, Addiko Bank aims at establishing a good work environment in order to become one of the most desirable employers, attract talents and offer possibilities for further career development of its employees.

In 2019, Addiko Bank a.d. Beograd was granted the Employer Partner Certificate based on an assessment of HR processes in five segments: strategy, recruitment and selection, performance management, education and development and employer-employee relationship, thus becoming the first Serbian bank with the Employer Partner status.

In the course 2019, one of the focus segments of the Human Resources were new trainings aimed at developing leadership and sale skills. Standardisation of HR processes was continued in the segments of employment, onboarding and personal cost reporting. In order to achieve the adequate balance of professional and private life, Addiko Bank a.d. Beograd introduced benefits for its employees, such as flexible working hours, a day off for birthday, a day off for child's first day of primary school and solidarity allowance for child birth. Addiko Bank a.d. Beograd endeavoured to help employees when faced with negative events in their lives by various activities in the form of solidarity allowances.

Continual internal communication and promotion of desirable behaviours at workplace (Addiko Values and Behaviours) were the key to further business culture development. In 2019, these elements were integrated in initiatives and programs of performance management, talent development and leadership skill development. In 2019, the Bank also adopted the Diversity and Inclusion Strategy for the period 2019 - 2021. At 2019 year-end, Addiko Bank had 530 FTEs. In the forthcoming period, HR measurements will be undertaken aiming at ensuring that right employees take key positions.

6. Internal control system for accounting procedures

Addiko Bank possesses the internal control system for accounting procedures defining and implementing processes within the entire organisation. Management bodies at each organisational part are responsible for the implementation of rules and procedures of the Bank. Observance of Bank policies is monitored within audits performed by internal and external auditors.

The internal control system, being an integral part of the Bank risk management system, is assigned the following general objectives:

- Protection and implementation of business strategies, risk strategies, and policies of the Bank;
- Effective and efficient use of all resources aiming at achieving targeted commercial success;
- Ensuring of a reliable financial reporting;
- Support to and harmonisation with all relevant laws, rules and regulations.

Special objectives related to Bank's accounting procedures imply ensuring of recording of all business transactions by the internal control system in a timely, correct and unified manner, for accounting purposes.

Additionally, the internal control system should ensure avoidance of errors or frauds which would affect adequate presentation of the financial position and performance of the Bank.

This is the case whenever data presented in financial statements and notes to the financial statements are essentially conflicting to correct data, meaning, whenever, individually or collectively, they may affect decisions of financial statement users, with such decisions having the potential of causing substantial damage such as financial losses, sanctions imposed by the banking supervisor or reputational damage.

The internal control system is not a static system in itself, constantly adjusting to new environments. The implementation of the internal control system is essentially based on the integrity and ethical behaviour of employees. The Executive Board and the management team actively and consciously accept its role with leading by example.

7. Financial risk management

The risk management system of the Bank is aimed at ensuring, by observing and applying risk management principles, policies and procedures, that the risks the Bank is exposed to in its operation are minimised to the largest possible extent, that all aspects of the Bank's business operations are stable and sensitive to negative internal and

external factors to the smallest possible extent and that the Bank's risk profile satisfies requirements of prudent banking operation at all times.

The Bank's risk strategy stems from its business strategy and depicts planned business structure, strategic development and growth with considering processes, methodologies and organisational structure relevant for managing risk factors. It defines a framework for monitoring, control and limiting of risks to which the Bank is exposed in its operations, while ensuring adequacy of internal capital, liquidity position, solvency position and total profitability. Policies and procedures for managing individual risks are grounded on requirements of laws and bylaws of the National Bank of Serbia and guidelines, principles and relevant documents of the Addiko Group.

The Bank established a comprehensive risk management system which is integrated in all business activities and ensures the compliance of the Bank's risk profile with the established risk appetite framework - RAF at all times. The risk management framework defines the level of risks acceptable by the Bank. Measures of the RAF definition are calibrated with considering the business plan, risk strategy and recovery plan representing a framework for adequate internal risk management and control.

Furthermore, within its strategic risk management, the Bank implements another key process - Internal Capital Adequacy Assessment Process - ICAAP in order to establish the level of capital sufficient to cover all material risks the Bank is exposed to. The ICAAP serves as a tool for assessment of internal capital adequacy in relation to the Bank's risk profile and implementation of the Bank's strategy applied to preserve adequate internal capital level.

In the course of 2019, the Bank's risk management (risk identification, measurement/assessment, mitigation and monitoring) was performed by the following:

- Bank bodies and other committees envisaged by the Law on Banks - Board of Directors, Executive Board, Audit Committee, Asset & Liability Management Committee (ALCO) and Credit Committee;
- Working bodies of the Executive Board of the Bank - Risk Control Advisory Body, Corporate Client Monitoring Advisory Body and Operational Risk Management Body;
- Organisational units of the Bank - Risk Control Department, Corporate Risk Management Division, Retail Risk Management and Collection Division, Balance Sheet Management and Treasury Department, Compliance Department and other organisational parts of the Bank when needed.

The key risks the Bank is exposed to are inherent in the Bank's business and market conditions and they are manifested as the credit risk, liquidity risk, interest rate risk, market risks, operational risk and other risks, such as the risk of investments in legal entities and fixed assets and country risk.

7.1. Credit risk

The process of credit risk assessment and monitoring at the level of individual clients and groups of related parties is performed in line with adopted policies and procedures establishing rules and criteria for approving new placements and defining activities to be undertaken and obligations and responsibilities of persons involved in the credit risk monitoring process.

The credit risk identification, assessment, measurement and management is implemented on an ongoing basis and covers the total Bank portfolio prone to credit risk.

The Bank's impairment methodology under the IFRS 9 was additionally improved in 2019 by applying new macroeconomic forecasts, calibrating to longer time series, improving the behavioural model and changing certain model parameters resulting from the current validation of applied credit risk models.

In the course of 2019, the Bank was fully compliant with the Basel III standards of capital adequacy. As at 31 December 2019, the total capital requirement for credit risk stood at RSD 5.3 billion, the capital adequacy ratio (CAR) stood at 27.05%, while the Common Equity Tier 1 capital ratio (equalling the Tier 1 capital ratio) stood at 26.30%.

7.2. Liquidity risk and interest rate risk

The Bank's liquidity risk management system is based on measures and criteria prescribed by the National Bank of Serbia and it is focused on short-term and structural liquidity, with implementing an adequate limit system and early warning policies and procedures compliant with the ICAAP and ILAAP (Internal Liquidity Adequacy Assessment Process) and liquidity risk management principles of the Addiko Group.

The liquidity risk management activities in the course of 2019 were aimed at measurement, monitoring and reporting on forecasts of liquidity inflows and outflows, liquidity reserves in various scenarios of normal business and potential liquidity crises and at monitoring and regular reporting to Bank bodies and ALCO on movements of regulatory liquidity ratios (liquidity ratio, quick liquidity ratio, liquidity coverage ratio - LCR and other liquidity ratios according to the internal methodology of the Bank or the

Basel III standard (Liquidity Value-at-Risk, Net Stable Funding Ratio - NSFR).

In the course of 2019, all liquidity ratios, both regulatory and internally-defined, in relation to liquidity risk management were aligned and above the prescribed limits. The liquidity ratios prescribed by regulations of the National Bank of Serbia as at 31 December 2019 were as follows: liquidity ratio: 1.87%, quick liquidity ratio: 1.54% and LCR: 167%.

The interest rate risk management system of the Bank is based on principles prescribed by the National Bank of Serbia and the Addiko Group, focusing on the analysis, measurement, monitoring and reporting on banking book interest rate risk. In the course of 2019, all interest rate risk ratios of the Bank were aligned and within limits defined by Bank's policies and procedures on interest rate risk management.

7.3. FX risk and other market risks

In accordance with the Decision of the National Bank of Serbia on Capital Adequacy of Banks, the Bank must maintain the foreign exchange risk ratio, being the ratio between the total net open fx position and the capital of the Bank, so that the total net open fx position of the Bank, including the absolute value of the net open position in gold, at the end of each business day, does not exceed 20% of the Bank's capital. In the course of 2019, the fx risk ratio of the Bank was aligned with requirements of the National Bank of Serbia and as at 31 December 2019, it stood at 1.92%.

Market risk management of the Bank is regulated by adequate policies defining the manner of implementing criteria and measures prescribed by the National Bank of Serbia and principles of the Addiko Group for market risk control and management adopted, at a proposal of the Executive Board, by the Board of Directors of the Bank. In the course of 2019, the Bank managed and continually aligned the level of exposure to the price risk stemming from Bank investments in debt securities, and the exposure was predominantly generated from Bank investments in government securities of the Republic of Serbia.

7.4. Exposure risk

The risk of exposure to one person or a group of related persons is controlled and monitored through unified databases of information on related persons, active monitoring and the regulatory reporting process. In the course of 2019, the Bank did not record any exceeding of regulatory limits of exposure to one person/group of related persons,

which was regularly reported to the Risk Control Advisory Body and bodies of the Bank.

7.5. Operational risk

Aiming at comprehensive monitoring of Bank's exposure to the operational risk, the operational risk management system is based on standard principles of identification through obtaining and classifying data on operational risk events and related losses, implementing and monitoring measures for the elimination and mitigation and regular reporting to Bank bodies and the Operational Risk Advisory Body, focusing on timely analysis of causes and proposals of measures for minimisation of Bank's exposure to the operational risk.

In the course of 2019, the Bank continued assessing potential operational risks from new products and outsourcing, as well as the Risk and Control Self-Assessment.

The calculation of the capital requirement for operational risk is based on the standardised approach according to which the capital requirement for operational risk of the Bank as at 31 December 2019 stood at RSD 826 million.

7.6. Adequacy of the risk management system

In the course of 2019, the Bank's risk management system was adequate, in view of the following facts for the period:

- As a result of an adequate approach to approving new placements and improvements in NPL management and resolving, the Bank substantially decreased the share of NPLs in total exposure, being well below the planned level and in line with the market average;
- The Bank successfully implemented the procedure of debt conversion related to housing loans indexed to CHF to EUR-indexed debt and timely complied with the Law on the Conversion of Housing Loans Indexed to Swiss Francs coming into force in May 2019;
- Within the continued implementation of the IFRS 9 standards for the calculation of impairment of financial assets, the Bank applied new macroeconomic forecasts and updated risk parameters - PD (Probability of Default) and LGD (Loss Given Default) models for calculation of value adjustment of on-balance sheet assets and off-balance sheet items;
- The Bank aligned the concentration from exposure to certain product types by lowering the share of the portfolio with initial maturity above 8 years below the prescribed ratio;

- The Bank improved the methodology for the analysis of the risk of introduction of a new product and the analysis of risks which may stem from outsourcing and the determination of the impact to the risk profile and capital adequacy of the Bank by harmonising the introduction of new products and outsourcing with the risk management strategy, defined risk appetite and related Bank risk limits;
- The Bank maintained regulatory and internal ratios of exposure to significant risks within prescribed limits and regularly monitored and reported to the management bodies and working bodies of the Bank, including the ratios envisaged by the effective recovery plan;
- The Bank regularly monitored exposures to various types of risk in relation to regulatory and internal limits and timely defined measures for limit breaching prevention;
- The Bank implemented the ICAAP regularly and maintained all calculated capital values aligned with internal and regulatory limits;
- The Bank received recommendations from the National Bank of Serbia within the Supervisory Review and Evaluation Process (SREP) and incorporated them in the improvement of its system of integrated risk management.

8. Expectations

It is expected that the favourable macroeconomic environment, both in Serbia and other Addiko countries, will remain in the years to come. Despite the expectation of global deceleration of growth and constant deflationary impulses, the growth of the SEE region economies remains stable. Still, it is unlikely that the county growth rates reach 2018 levels. The forecasted growth in Serbia stands at 3.4%, which is above the average of developed European economies.

At the same time, it is expected that previous years' trends in the European banking sector will continue. On one side, the sector is faced with challenges in the form of low interest rates, general price pressures due to surplus liquidity in markets and constant stricting of regulatory requirements negatively affecting bank profitability. Additionally, these regulatory activities, such as consumer protection mechanisms limiting loan growth in the consumer segment, will also negatively affect private consumption, making an additional impact to profitability. On the other side, the pressure on market players to introduce innovations is increasing, consequently inducing the need of full-scale investments.

In view of these challenges, being opportunities as well, Addiko Bank retained its role of a leader in digital transformation and accordingly made further significant steps toward fulfilling its medium-term goals. Addiko is positioned as an innovative brand and specialist for unsecured consumer and SME loans.

The main risk factors affecting the banking industry are still interest rate outlook deterioration, political or regulatory measures directed to banks and geopolitical and global economic instability. Potential consequences of the recent appearance of the COVID-19 virus in Europe to the macroeconomic environment may not be clearly perceived currently and they will largely depend on further events.

Addiko will continue implementing its strategy focused on private individuals and SMEs and its digital transformation. Strict management of the profile of yield from taken risks and the self-financing principle will remain key strategy elements.

9. Organisational chart

The organisational chart of the Bank as at 31 December 2019 is presented below:



