Regulatory information

Komerční banka reports improving revenues in 2018, much progress on transformation

- **The number of clients with KB Mobile Banking leapt by 175,000 year on year to 611,000. The total number of the Bank's clients was up by 3,000 to 1,668,000. KB Group as a whole was attending to 2.4 million clients. Three months after launch, the new KB Klíč application for accessing banking services was being used by almost 100,000 clients.**

- **Komerční banka has thoroughly altered its organisation and way of working in order to better serve its clients while maintaining its relevance and success in the fundamentally changed banking industry of the future.**

- **Net profit reached CZK 14.8 billion. This denoted an improvement by 5.8% on a recurring basis. If several one-off items are included, such as creation of the restructuring reserve in 2018 and sale of a head office building in 2017, the reported attributable net profit was down by 0.6%.**

- **The Management Board proposes a dividend of CZK 9.7 billion (i.e. CZK 51 per share) from the 2018 profit. Looking ahead, the Board intends to propose distributing as dividends 65% of attributable consolidated net profit earned in 2019.**

- **In a market characterised by intense competition, the total volume of KB Group's lending expanded by 4.7% year on year. Housing loans were higher by 4.6%, with faster growth occurring mainly at Modrá pyramida. Consumer loans grew also by 4.6%. Lending to businesses rose by 5.5%.**

- **The overall volume of standard client deposits within KB Group expanded by 5.2%. Bank deposits from individuals were higher by fully 10%.**

- **KB reported a 3.7% increase in revenues, driven mainly by net interest income, while income from fees and financial operations was slightly down.**

- **Recurring operating costs excluding exceptional items grew by 1.9%, thus a tick less than the rate of inflation.**

- **KB recorded a CZK 0.6 billion net release of provisions. This was enabled by a successful recovery performance and clients' good repayment discipline as the economy headed into a late-recovery phase of the business cycle.**

Prague, 7 February 2019 – Komerční banka reported today its unaudited consolidated results for the year 2018.

Total revenues increased by 3.7% to CZK 32.2 billion. Within this total, net interest income was higher by 7.3% from the year earlier due to growth in the volumes of deposits and loans, as well as higher market interest rates that positively influenced yields from financial assets. Net fees and commissions were lower by 1.0%, as an expanding share of customers used account packages with a range of services and transactions included for a flat fee. Net gains from financial operations were strong, at CZK 3.2 billion, but this amount was still off by 10.2% because the prior year's result had been boosted by clients' exceptionally strong currency hedging activity linked to discontinuation of currency interventions by the Czech National Bank (CNB).

Recurring operating expenditures were up by 1.9%,[1] at CZK 14.5 billion, driven by personnel expenses and depreciation. Administrative costs, meanwhile, were lower year on year. Reported operating costs, including various one-off items both this year and last, were up by a slight 0.9% to CZK 14.6 billion.

The quality of the loan portfolio remained excellent, positively influenced by the late-expansion phase of the business cycle. KB recorded a successful recovery performance and low client loan default rates, permitting a net release of loan loss provisions in the amount of CZK 0.6 billion (compared to CZK 0.4 billion a year earlier).

Recurring attributable net profit (i.e. excluding one-off items) reached CZK 14.8 billion, which was 5.8% more than in 2017.

KB recognised several one-off items in the comparison periods of both 2017 and 2018.[2] When these are included, the reported net profit attributable to shareholders was almost stable (−0.6%), at CZK 14.8 billion.

Lending to clients increased by 4.7% to CZK 634.6 billion.[3] Within this total, financing of housing from KB and Modrá pyramida expanded by 4.6% and consumer lending by KB and ESSOX grew also by 4.6%. Business lending was up by 5.5%.

Deposits from clients climbed by 5.2% year on year to CZK 795.6 billion.[4] The volume of KB Group clients' assets in mutual funds, pension savings, and life insurance rose by 2.2% to CZK 167.5 billion.

The capital adequacy ratio reached a strong 18.5%, and Core Tier 1 capital stood at 17.9%.

"Komerční banka is committed to sharing the value generated from its operations with all key stakeholders, including clients, employees, shareholders and our society. We are proud to see improvements in client satisfaction levels across all customer segments and that we are leading the market in satisfaction indicators of corporate clients. We are developing a non-discriminatory corporate culture and creating hundreds of purposeful new jobs each year. For a number of years, KB has been listed among the largest taxpayers in the country. We are dutiful in respecting the principles of responsible business practices and lending, and the Bank and its employees engage in numerous charitable activities. Furthermore, KB is developing a robust and diversified business model able to support our clients while sustainably generating good returns for the Bank's shareholders for years to come," remarked Jan Juchelka, KB's Chairman of the Board of Directors and Chief Executive Officer.

"The excellent financial results achieved in 2018 were due to solidly developing revenues in combination with disciplined costs management. The quality of the loan portfolio was strong and the cost of risk even extraordinarily low, as both benefitted from the economy's being at its cyclical peak. The changes we have made and which will continue in 2019 will allow KB to maintain a leadership

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[1] Excluding the impacts (before tax) in 2017 from revaluation of a headquarters building of CZK 242 million (a negative item, i.e. increasing costs) and in 2018 from creation of the restructuring reserve for branch optimisation of CZK 295 million (a negative item, i.e. increasing costs) and from release of over-accrued amounts for corporate services of CZK 193 million (a positive item, i.e. decreasing costs).

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

[3] Excluding volatile reverse repo operations with clients but including debt securities issued by KB's clients and held by the Bank. Inclusive of repo operations, lending rose by 4.8% year over year to CZK 636.6 billion.

[4] Excluding repo operations with clients. The total volume of 'Amounts due to customers' moved up by 6.6% to CZK 812.5 billion.

position in terms of client service quality, innovativeness, efficiency and safety," he added.

The Bank had 48,265 shareholders as of 31 December 2018 (up by 1,155 year on year), of which 42,907 were private individuals from the Czech Republic (greater by 1,038 from the year earlier). Strategic shareholder Société Générale maintained its 60.4% stake while minority shareholders owned 39.0% and KB held 0.6% of registered capital in treasury.

In accordance with its intention announced in February 2018 regarding the share of 2018's net profit to be paid out in dividends, and in view of KB's 2018 result, capital position and outlook for growth in risk-weighted assets and capital requirements, Komerční banka's Board of Directors has decided to propose to the Supervisory Board a dividend payment of CZK 9,693 million. That would come to CZK 51 per share and put the payout ratio at 65% of KB Group's attributable consolidated net profit. The corresponding gross dividend yield based on 2018's closing share price is 6.02%. The distribution of the year's earnings, including the decision on dividend payment, is subject to a vote of the Annual General Meeting.

KB management strives to maintain the Bank's capital structure so that it is safe, efficient and adequate with respect to applicable and anticipated regulations. Considering the current state of affairs, KB management intends for 2019 to propose distributing as dividends 65% of attributable consolidated net profit earned in the year, subject to no significant changes in regulatory requirements.

Comments on business and financial results

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

BUSINESS PERFORMANCE OF KB GROUP

Market environment[5]

It is expected that growth of the Czech economy in 2018's fourth quarter was again driven by household demand and private sector investments. Compared to 2017, the economy has slowed noticeably, constrained as it is by the tight labour market. Unemployment remains at the lowest level seen anywhere within the entire EU (2.1% in December, according to the Eurostat methodology after seasonal adjustment),[6] and wage inflation stood at 8.5% in the third quarter. Moreover, high capacity utilisation is encouraging private sector investments, which are rising at a robust pace as businesses strive to improve their productivity. In the second half of 2018, investments began to accelerate also in the previously sluggish public sector.

Higher wage costs and more expensive raw materials pushed the dynamics of industrial producer prices at an average level of 2.1% in 2018. Consumer price inflation eased in December to 2.0%, mainly due to declining food prices and deceleration of core inflation. Meanwhile, the Czech crown's exchange rate depreciated in the first half of the fourth quarter, moving above CZK 26 per euro. It later recovered, and as of 31 December 2018 the exchange rate was CZK 25.725 to the euro. That put the Czech currency at an unchanged level quarter on quarter but down by 0.7% year on year.

As both consumer price inflation and core inflation were above the Czech National Bank's monetary policy targets throughout most of the year, and with the Czech crown relatively depreciated as compared to CNB's forecast, the central bank displayed its confidence by hiking its main two-week repo rate as of 1 November for the fifth time, to 1.75%. Interbank market interest rates also moved higher. Three-month PRIBOR rose by 31 basis points to 2.01% in the fourth quarter, but after the drop in global markets at the end of the year, the ten-year interest rate swap narrowed by 77 basis points to 1.66%. Yields on Czech government bonds declined as well, but to a significantly lesser extent.

Prices of residential real estate picked up somewhat early in the third quarter of 2018. That was prior to the Czech National Bank's implementing its new prudential policy measures from 1 October 2018 that tightened conditions for granting residential mortgages. Prices paid in the third quarter for previously owned flats were up 9% year on year, but prices obtained for new flats (in Prague only) were higher by 16.8% from the year earlier.[7]

Total bank lending for the overall market (excluding repo operations) grew by 7.2% year on year.[8] Lending growth was faster in retail banking, with mortgage growth continuing apace and consumer loans gradually accelerating with support from high levels of consumer confidence and growing incomes. Lending to corporations picked up somewhat in recent months. Public sector borrowing generally was on a declining trend despite a year-on-year rise in public investment activity during 2018's second half.

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

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

[7] Source: https://www.czso.cz/csu/czso/ceny-nemovitosti. Publication code 014007-18, released 14 December 2018.

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

The volume of deposits in Czech banks expanded by 6.6% year over year.[9] Here, too, growth was faster in retail banking and corporate deposits increased somewhat more slowly.

Quarterly update on KB Change strategic transformation programme

Komerční banka had announced its strategic transformational programme KB Change in May 2018. Its ultimate vision is to be a lifetime partner with a human touch for active individual, small business, and corporate customers, to provide employees a sense of purpose and room for growth, and to deliver long-term sustainable profitability to shareholders while acting responsibly towards society.

During the fourth quarter, KB Group pursued customer-experience improvements and leadership in digital banking. The Bank established 48 new Business Centres, where the service level and expertise of banking advisors are customised to meet the needs and preferences of small and medium-sized businesses. It also expanded its network of deposit-taking ATMs (already the largest in the country) to a total of 320 machines. Another new feature is that clients' payments moving between accounts within KB now are processed instantly 24/7. KB has also significantly accelerated payments sent to other banks. Respecting some clients' wish to have the rate of interest on their mortgage fixed for longer time periods, the Bank extended the maximum reset period on mortgages to 15 years.

KB has the highest number of clients with mobile banking on the Czech market. Their number increased during 2018 by 175,000 to reach 611,000. The volume of transactions submitted from mobile banking rose by 89% to CZK 46 billion. Komerční banka was the first bank on the Czech market enabling clients also to check balances on their accounts with other banks[10] using KB's internet as well as mobile banking applications. KB successfully rolled out KB Key, a new and secure method of authentication for access to banking services via a smartphone app, downloaded by almost 100,000 clients in first three months. From November, KB clients have been able to pay by smartwatches of additional two brands, Garmin and Fitbit. Also, Komerční pojišťovna in cooperation with a partner start-up platform expanded its portfolio of insurance policies available online with a fully digital Cubiq insurance for personal belongings.

The Bank has also moved forward with its organisational optimisation. It has rolled out the agile@KB organisational concept while launching 16 cross-functional teams fully dedicated to specific customer journeys or business needs. The teams are supported by 5 specialised centres of expertise. The share of headquarter employees deployed in the agile concept reached 40%. KB has reorganised its management structure, leading to a significantly lower number of management positions. Within this distribution network, the changes included reducing the number of regional management districts from ten to five and decreasing the overall number of branches by 22. KB also established a new platform for development of start-up projects, KB SmartSolutions. The risk control environment of the Bank remains unaffected.

Developments in the client portfolio and distribution networks

At the end of December 2018, KB Group was serving 2,391,000 clients on a consolidated basis. Standalone KB recorded 1,668,000 clients (+0.2% year on year), 1,410,000 of which were individuals. The remaining 258,000 customers were comprised of entrepreneurs, businesses and corporations (including municipalities and associations). Modrá pyramida was attending to 490,000 customers, and the number of pension insurance participants at KB Penzijní společnost reached 532,000. Services of ESSOX Group (including the PSA Finance franchise) were being used by 212,000 active clients.

The number of clients using at least one direct banking channel (such as internet or telephone banking) reached 1,455,000 by the end of December 2018 and corresponds to 87% of all clients. Mobile banking was itself being used by 611,000 of KB's clients. Customers held 1,565,000 active

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

[10] Currently accessible for two other Czech banks.

payment cards, of which 178,000 were credit cards. The number of active credit cards issued by ESSOX came to 104,000.

Komerční banka's clients had at their disposal 365 banking branches (including one branch for corporate clients in Slovakia) and 776 ATMs (of which 320 are deposit-taking). Modrá pyramida's customers had at their disposal 204 points of sale and 720 advisors. SG Equipment Finance (SGEF) was providing its leasing services via nine branches (two of which are in Slovakia), as well as through KB's network. Financing from ESSOX was available at almost 1,700 merchants.

Loans to customers

Total **gross volume of lending to clients** rose by 4.7% year on year to CZK 634.6 billion.[11]

In lending to individuals, the overall volume of housing loans[I] grew by 4.6% from the year earlier. Within this total, the portfolio of mortgages to individuals expanded by 2.3% to CZK 223.9 billion. The loan portfolio of Modrá pyramida grew by a strong 16.2% to CZK 50.7 billion. The volume of KB Group's consumer lending (provided by the Bank and ESSOX Group in the Czech Republic and Slovakia) was up by 4.6%, at CZK 39.2 billion.

The total volume of **loans to businesses** provided by KB Group climbed by 5.5% year on year to CZK 321.2 billion. Lending to small businesses grew by 4.0% to CZK 35.5 billion. The overall CZK volume of credit granted by KB to medium-sized and large corporate clients in the Czech Republic and Slovakia[12] increased by 5.4% year on year to CZK 257.6 billion. At CZK 28.1 billion, the total credit and leasing amounts outstanding at SGEF were up by 7.7% year over year.

Amounts due to customers and assets under management

The **volume of standard client deposits** within KB Group rose by 5.2% year on year to CZK 795.6 billion.[13]

Deposits at Komerční banka from individual clients grew by 10.0% from the year earlier to CZK 276.6 billion. The deposit book at Modrá pyramida contracted by 1.4% year on year to CZK 61.8 billion. Total deposits from businesses and other corporations climbed by 3.2% to CZK 446.3 billion.

Client assets managed by KB Penzijní společnost were higher by 8.1%, at CZK 57.6 billion. Technical reserves in life insurance at Komerční pojišťovna were down by 2.4% year on year to CZK 46.6 billion. The volumes in mutual funds held by KB Group clients grew by 0.7% to CZK 63.3 billion.

The Group's liquidity as measured by the ratio of net loans[14] to deposits (excluding repo operations with clients but including debt securities held by KB and issued by the Bank's clients) was at 77.9%.

FINANCIAL PERFORMANCE OF KB GROUP

Income statement

As part of updating its reporting methodology, and mainly in the context of implementing the new IFRS 9 reporting standard, Komerční banka reclassified with effect from 1 January 2018 certain items of the income statement and statement of financial position. In the interest of improved

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[11] 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 4.8% to CZK 636.6 billion.

[12] Inclusive of factor finance outstanding at Factoring KB and car dealers' financing from PSA Finance.

[13] Excluding volatile repo operations with clients. The total volume of 'Amounts due to customers' climbed by 6.6% to CZK 812.5 billion.

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

information value, the comparative comments below are based on a pro-forma retrospective restatement of the respective accounting lines of the income statement from 2017.

Komerční banka's **revenues** (**net operating income**) for the 12 months of 2018 improved by 3.7% year on year to CZK 32,203 million. Within this total, net interest income increased and net fees and commissions declined slightly. Net profit from financial operations was excellent but still lower than in the previous year, when the clients' activity in hedging financial risks had been elevated in connection with release of the CNB's currency commitment.

Net interest and similar income[15] was up by 7.3% to CZK 22,509 million. The result was underpinned by growing volumes of loans and deposits. Higher market interest rates also supported yields from reinvestment of deposits and capital. On the other hand, intense competition on the banking market pushed down spreads on loans. The net interest margin, computed as the ratio of net interest income to interest-earning assets reported on the balance sheet, reached 2.3% in the full year 2018.[16]

Net fee and commission income[17] moved lower by 1.0% to CZK 6,220 million. The maintenance fee income improved due to a higher number of the Bank's clients and their increasing preference for better account packages that include a wider range of services. Fees from cross-selling were also up, supported mainly by volume growth in mutual funds. On the other hand, transaction fees dropped, even though there was a rise in the overall number of transactions. That is because more of clients' transactions are included in the prices of their account packages. Income from loan services declined due to smaller fees related to housing loans from KB and Modrá pyramida. Fees from specialised financial services were also down, due to lower issuance of bank guarantees and a relatively high 2017 base of fees from credit structuring deals, but income from trade finance and custody services improved.

Net profit on financial operations decreased by 10.2% to CZK 3,210 million. That was still an excellent result, and it was boosted by some extraordinarily large hedging deals developed for clients. A level lower than that in 2017 had been expected, because the comparison base from that year had been boosted by clients' exceptionally strong currency hedging activity linked to the end of currency interventions by the CNB. The decline in long-term interest rates at the end of 2018 influenced the valuation of certain positions, but also demand of clients for interest rate hedging. Net gains on FX payment transactions were higher year on year, reflecting a slight increase in the volume of these transactions and wider spreads.

Dividend and other income rose by 22.8% to CZK 264 million. This line primarily comprises revenues from property rental and ancillary services.

Recurring operating expenses were up by 1.9% to CZK 14,534 million. Recurring personnel expenses rose by 3.9% to CZK 7,604 million, reflecting mainly an increase in remuneration as the average number of employees was down by 0.9% to 8,411.[18] Recurring general and administrative expenses (excluding contributions to the regulatory funds) were lower by 3.8%, at CZK 4,234 million. Savings were achieved in expenditures for marketing and telecommunications services, while real

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

[16] Net interest margin stood at 2.3% in the full year 2017. These ratios are not fully comparable, however, due to impacts from application of the new IFRS 9 standard on certain balance sheet values.

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

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

estate costs rose in connection with changing office and branch locations. The cost of Resolution and similar funds declined by 2.6% to CZK 840 million. Recurring depreciation and amortisation grew by 10.2% to CZK 1,856 million, driven mainly by new and upgraded software and IT equipment, as well as technical improvements to buildings.

For both comparison periods, KB Group has reported several non-recurring items in operating expenses. In 2017, this concerned the impairment of a head office building by CZK 242 million. In 2018, it was 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. Also in 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. Including these non-recurring items, **reported operating expenses** were up by a slight 0.9%, at CZK 14,634 million.

Recurring profit before allowances for loan losses, provisions for other risk, profit on subsidiaries, and income tax (**gross operating income**), excluding one-off impairment of a building booked in 2017, as well as one-off creation of the restructuring reserve and one-off release of the over-accrued amounts for corporate services in 2018, was up by 5.2% to CZK 17,670 million. Reported gross operating income for the full year 2018 increased by 6.2% to CZK 17,569 million.

Cost of risk reached a negative CZK 642 million (net release of provisions). This exceptional result was driven by continued low client default rates and good performance from recovery activities. The economic environment in the Czech Republic was supportive throughout 2018, as the economy moved into a late-recovery phase of the economic cycle. Cost of risk in relative terms[II] and as measured against the average volume of the lending portfolio during this period came to −10 basis points.

Income from shares in associated undertakings (i.e. Komerční pojišťovna) was higher by 10.2%, at CZK 238 million. **Profit attributable to exclusion of companies from consolidation** reached CZK 82 million (compared to a loss of CZK 7 million in 2017). That was related to finalising the selling price for KB's stake in Cataps in connection with the sale of an additional 19% of that company in February 2018.

Net loss from other assets totalled CZK 14 million and was linked to sales of buildings in the held-for-sale portfolio. This had been CZK 1,140 million in 2017, when it had included also a gain from the sale of a headquarters building.

Income tax was higher by 11.2%, at CZK 3,349 million. If the tax effect of the one-off items were to be excluded, income taxes would be up by 9.0%.

KB Group's consolidated **net profit** for the full year 2018, at CZK 15,171 million, was lower by 0.7% in comparison with the prior year. Of this amount, CZK 325 million was profit attributable to the non-controlling owners of minority stakes in KB's subsidiaries (-5.5% year on year).

Reported **net profit attributable to the Group's equity holders** totalled CZK 14,846 million, which is 0.6% less than in 2017. Recurring attributable net profit (i.e. excluding one-off effects from revaluation and sale of headquarters buildings in 2017 and from final determination of the sale price for Cataps, creation of the restructuring reserve, and release of over-accrual for corporate services in 2018) was up 5.8% year on year to CZK 14,845 million (as one-off items from 2018 generally offset one another).

Other comprehensive income, which derives mainly from revaluations and remeasurements of some hedging, foreign exchange, and securities positions, reached CZK -550 million. **The**

consolidated comprehensive income for 2018 amounted to CZK 14,621 million, of which CZK 325 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 31 December 2018 with the values from the statement of financial position as of 1 January 2018 and reflect newly introduced IFRS 9. Since the start of 2018, the IFRS 9 reporting standard has brought a new approach to the classification and measurement of financial assets, a new credit risk impairment methodology, and new hedge accounting rules. Financial assets must be classified based on the entity's business model for managing the financial assets and on the financial assets' contractual cash flow characteristics. Depending upon the business model that is determined, financial assets are measured at amortised cost, at fair value through profit or loss, or at fair value through other comprehensive income. Due to this change in accounting methodology, comparison with the audited statement of financial position as of 31 December 2017 would be less meaningful.

Assets
As of 31 December 2018, KB Group's total assets had risen by 5.8% year to date to CZK 1,059.9 billion.

Cash and current balances with central banks were down by 23.9%, at CZK 24.9 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 20.0% to CZK 22.6 billion. The fair value of hedging financial derivatives declined by 6.3% to CZK 12.6 billion.

Year to date, there was a 5.5% decline in financial assets at fair value through other comprehensive income amounting to CZK 25.3 billion. This consisted mainly of public debt securities.

Financial assets at amortised cost grew by 7.3% to CZK 951.1 billion. The largest portion of this consisted of (net) loans and advances to customers, which went up by 5.3% to CZK 625.0 billion. A 97.3% share in the gross amount of client loans was classified in Stage 1 or Stage 2, while 2.7% of the loans were classified in Stage 3 (non-performing loans). The volume of loss allowances created for amounts due from customers came to CZK 12.2 billion. Loans and advances to banks rose by 15.0% to CZK 256.3 billion. The majority of this item consists in reverse repos with the central bank. The value held in debt securities was down by a slight 0.7% and reached CZK 69.9 billion at the end of the fourth quarter.

Revaluation differences on portfolio hedge items were CZK -0.4 billion. Current and deferred tax assets stood at CZK 0.2 billion. Other assets and accrued accounts, which include receivables from securities trading and settlement balances, declined overall by 1.2% to CZK 5.8 billion. Assets held for sale diminished by 38.6% to CZK 0.2 billion.

Investments in subsidiaries and associates decreased by 4.0% to CZK 1.1 billion.

The net book value of tangible assets rose by 3.7% to CZK 7.7 billion, and intangible assets grew by 12.0% to reach CZK 5.2 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 5.9% higher in comparison to the beginning of 2018 and stood at CZK 956.6 billion.

Financial liabilities at amortised costs went up by 6.6% to CZK 907.3 billion. Amounts due to customers comprise the largest proportion of this total, and these grew by 6.6% to CZK 812.5 billion. This total included CZK 16.9 billion of liabilities from repo operations with clients and CZK 6.3 billion of other payables to customers. Amounts due to banks increased in 2018 by 9.8% to CZK 92.3 billion.

The volume of outstanding securities issued was down by 47.4% to CZK 2.5 billion.

Revaluation differences on portfolios hedge items expanded to CZK -0.7 billion. Current and deferred tax liabilities decreased by 8.5% to CZK 0.9 billion. Other liabilities and accruals, which include payables from securities trading and settlement balances, declined by 28.9% to CZK 13.4 billion.

Provisions declined by 5.4% to CZK 1.9 billion. The provisions for other credit commitments are held to cover credit risks associated with credit commitments issued. The provisions for contracted commitments principally comprise those for ongoing contracted contingent commitments, legal disputes, self-insurance, and the retirement benefits plan.

Subordinated debt, at CZK 2.6 billion, was up by 0.7% year to date. Because that debt is issued in euro, the change reflects the weakening of the Czech crown over the same period.

Equity
Total equity grew year to date by 5.3% to CZK 103.3 billion. The value of non-controlling interests reached CZK 3.4 billion. As of 31 December 2018, KB held in treasury 1,193,360 of its own shares constituting 0.63% of the registered capital.

Regulatory capital and capital requirements

Total **regulatory capital** for the capital adequacy calculation came to CZK 83.4 billion as of 31 December 2018, up 5.4% year on year. **Capital adequacy** stood at 18.5%. The Core Tier 1 capital amounted to CZK 80.8 billion (+5.6% year on year), and the Core Tier 1 ratio was at 17.9%. Tier 2 capital totalled CZK 2.6 billion, which was 0.6% of risk-weighted assets.

KB's overall capital requirement as of 31 December 2018 was approximately 16.0% relative to the consolidated volume of risk-weighted assets, the required minimum Core Tier 1 capital level was at 12.125%, and the minimum Tier 1 capital ratio at 14.0%. This followed the increase by 50 basis points to 1.00% in the countercyclical capital buffer for Czech exposures with effect from 1 July 2018.

The CNB has announced further rises in this buffer with effect from 1 January 2019 by 25 basis points (to 1.25%), by an additional 25 basis points (to 1.5%) from 1 July 2019, and by another 25 basis points (to 1.75%) from 1 January 2020.

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

Changes in corporate governance

On 3 October 2018, Mrs Sylvie Remond terminated her membership on the Supervisory Board.

With effect from 5 October 2018, Mr Libor Löfler has terminated his membership on the Board of Directors of Komerční banka and the position of Chief Administrative Officer.

The members of the Supervisory Board Mr Pavel Jelínek, Mr Bořivoj Kačena and Mrs Miroslava Šmídová terminated their functions on 13 January 2019. With effect from 14 January 2019, Ms Sylva Kynychová, Mr Ondřej Kudrna and Mr Vojtěch Šmajer were elected members of the Supervisory Board. The newly elected members of the Supervisory Board are employees of Komerční banka.

With effect from 14 January 2019, Mr Margus Simson was elected by the Supervisory Board as a new member of the Board of Directors. Mr Simson will hold the post Chief Digital Officer with managing responsibility for Information Technology, Organization and Change Management, Information Management and Tribes: Platform Services, Enterprise Services, Business Services and Data Management.

The Supervisory Board appointed Ms Cécile Camilli a substitute member of the Supervisory Board with effect from 15 January 2019 until the next general meeting. Komerční banka, a.s., has received a favourable opinion from the Czech National Bank regarding her appointment. Ms Camilli is Managing Director and head of CEEMEA Debt Capital Markets at Société Générale.

With effect from 14 January 2019, Mr Pavel Jirák became the Chairman and CEO of Modrá pyramida stavební spořitelna.

With effect from 1 February 2019, Mr Jan Kotík became the Chairman and CEO of Factoring KB.

Changes in the Group structure

On 7 January 2019, KB SmartSolutions, s.r.o. (a fully owned subsidiary of KB) was established with the aim of facilitating preparations of some new KB Group services. Subsequently, My Smart Living, s.r.o. (a fully owned subsidiary of KB SmartSolutions, s.r.o.) was established. This new company will address clients' needs in relation to housing.

Expected development and main risks to that development in 2019

In its baseline macroeconomic scenario, Komerční banka expects the Czech economy will grow its output in 2019 at a similar, or just a slightly slower, pace compared to 2018. Rising household consumption should still be the main driver of that growth, while fixed investments should contribute positively, too.

The labour market is expected to remain tight. On the one hand, that will boost disposable incomes and households' consumption. On the other, employers will continue to experience difficulties in finding sufficient staff to pursue expansion plans and the mounting wage bill will eat into profit margins.

Price pressures from abroad have recently receded, following a decline in crude oil prices, but core inflation will be affected by domestic factors, mainly rising wages. Average consumer price inflation is thus expected to accelerate slightly to 2.3%, and the CNB will probably continue in gradually raising its monetary policy rates, albeit more slowly than in 2018.

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

The regulatory limits on the debt-to-income and debt service-to-income ratios of mortgage borrowers in effect from October 2018 will hinder access to credit by some potential borrowers. The CNB will also continue in raising banks' capital requirements. Most notably, the countercyclical capital buffer requirement is going to increase every half year. A new cross-border payments regulation that will put a cap on charges for payments within the Single European Payments Area is expected to enter into force only towards the end of 2019.

The loan market should grow similarly as in 2018, with the exception that housing loans are expected to decelerate due to the recently implemented regulations, as well as issues of affordability. On the deposit market, meanwhile, the faster growth in retail segments will probably continue.

In this context, KB management expects that the annual percentage growth rate of the loan portfolio in 2019 will remain in mid- to low-single digits. The expansion could be faster in unsecured consumer lending. KB will aim to maintain the pace of growth in housing loans, despite the anticipated deceleration of the market. Business lending should benefit from the investment activity and increasing need for working capital financing, but the result also will be influenced by the volume of bond issuance, which KB is promoting as a financing alternative to its corporate clients. Total deposit balances will probably climb relatively faster in the retail segments and on saving and term accounts more so than current accounts. The volume of assets under management in mutual funds, life insurance, and pension funds should continue to expand.

KB Group’s total net operating income for 2019 should rise slightly in comparison with 2018. This growth should be driven mainly by net interest income, underpinned by increasing volumes of loans and deposits and by higher average interest rates year on year. The upside will be limited, however, by competitive pressure on lending spreads. Income from fees and commissions is expected to recover marginally (mainly due to more transactions), if the boost from growth in numbers and activity of clients prevails over negative effects in relation to pricing. The level of net profit from financial operations achieved in 2018 was excellent, reflecting in part the contributions from several extraordinarily large deals, and that is rather unlikely to repeat in 2019.

Recurring operating expenditures are targeted to increase at a rate similar to that of inflation. The Bank has agreed with the trade unions to 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.

The net release in 2018 of provisions for credit losses was an exceptional situation. The pace for future normalisation of risk costs will depend mainly on how macroeconomic conditions develop in the Czech Republic, and to some extent in Slovakia, or, possibly, on individual circumstances of clients with larger exposures. The IFRS 9 accounting standard newly implemented in 2018 requires that part of credit loss provisions be created on an expected-loss basis. In comparison with the previous regulation, this means an earlier building up of provisions once the economic outlook worsens. The expected continuing growth trend within the Czech economy is consistent with a cost of risk for 2019 that is still below a normalised rate of 30 to 40 basis points.

Among the key risks to the expectations described above is that deceleration in growth of the Czech and European economies would be sharper than expected. Such slowing could potentially be triggered by a range of uncertain factors, such as obstacles to international trade stemming from the United Kingdom’s planned departure from the European Union or erecting of new trade barriers. Sudden changes in the main parameters of the financial markets, such as interest rates, a solitary impairment of a large credit exposure, or a significant worsening of the competitive situation on the Czech banking market that leads to material erosion of profit spreads on key products are examples of ever-present risks to the banking business.

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 dividends constituting 65% of consolidated net profit attributable to shareholders.

ANNEX: Consolidated results as of 31 December 2018 under International Financial Reporting Standards (IFRS)

Profit and Loss Statement (CZK million, unaudited)	Reported			Recurring		
	FY 2017	**FY 2018**	**Change YoY**	**FY 2017**	**FY 2018**	**Change YoY**
Net interest income and similar income	20,985	22,509	7.3%	20,985	22,509	7.3%
Net fee & commission income	6,284	6,220	-1.0%	6,284	6,220	-1.0%
Net profit of financial operations	3,576	3,210	-10.2%	3,576	3,210	-10.2%
Dividend and other income	215	264	22.8%	215	264	22.8%
Net banking income	**31,060**	**32,203**	**3.7%**	**31,060**	**32,203**	**3.7%**
Personnel expenses	-7,320	-7,827	6.9%	-7,320	-7,604	3.9%
General admin. expenses (excl. regulatory funds)	-4,402	-4,112	-6.6%	-4,402	-4,234	-3.8%
Resolution and similar funds	-862	-840	-2.6%	-862	-840	-2.6%
Depreciation, amortisation and impairment of operating assets	-1,926	-1,856	-3.6%	-1,684	-1,856	10.2%
Total operating expenses	**-14,510**	**-14,634**	**0.9%**	**-14,268**	**-14,534**	**1.9%**
Gross operating income	**16,550**	**17,569**	**6.2%**	**16,792**	**17,670**	**5.2%**
Cost of risk	386	642	66.3%	386	642	66.3%
Net operating income	**16,937**	**18,211**	**7.5%**	**17,178**	**18,312**	**6.6%**
Income from share of associated companies	216	238	10.2%	216	238	10.2%
Profit/(loss) attributable to exclusion of companies from consolidation	-7	82	+/-	-7	0	n.a.
Impairment losses on goodwill	0	2	n.a.	0	2	n.a.
Net profits on other assets	1,140	-14	+/-	81	-14	+/-
Profit before income taxes	**18,286**	**18,520**	**1.3%**	**17,468**	**18,538**	**6.1%**
Income taxes	-3,012	-3,349	11.2%	-3,091	-3,368	9.0%
Net profit	**15,274**	**15,171**	**-0.7%**	**14,377**	**15,170**	**5.5%**
Profit attributable to the Non-controlling owners	344	325	-5.5%	344	325	-5.5%
Profit attributable to the Group's equity holders	**14,930**	**14,846**	**-0.6%**	**14,033**	**14,845**	**5.8%**

Notes to "Recurring" results:

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

FY 2018: Excluding final determination of the sale price for KB's former stake in Cataps in connection with the sale of an additional 19% in Cataps (CZK 82 million in 'Profit attributable to exclusions of companies from consolidation'), restructuring reserve (CZK −223 million in 'Personnel expenses', CZK −71 million in 'General and administrative expenses', and CZK 56 million in 'Income taxes'), and release of corporate service fees for SG assistance (CZK 193 million in 'General and administrative expenses' and CZK −37 million in 'Income taxes').

Regulatory information

Statement of financial position (CZK million, unaudited)	31 Dec 2017 According to IAS 39	1 Jan 2018 According to IFRS 9	31 Dec 2018 According to IFRS 9	Ytd
Assets	**1,004,039**	**1,001,652**	**1,059,932**	**5.8%**
Cash and current balances with central bank	32,663	32,663	24,851	-23.9%
Loans and advances to banks	228,373	222,821	256,268	15.0%
Loans and advances to customers (net)	598,102	593,639	624,954	5.3%
Securities and trading derivatives	108,468	115,913	117,761	1.6%
Other assets	36,432	36,616	36,099	-1.4%
Liabilities and shareholders' equity	**1,004,039**	**1,001,652**	**1,059,932**	**5.8%**
Amounts due to banks	84,050	84,050	92,271	9.8%
Amounts due to customers	762,043	762,043	812,451	6.6%
Securities issued	4,832	4,832	2,540	-47.4%
Subordinated debt	2,560	2,560	2,578	0.7%
Other liabilities	50,208	50,005	46,764	-6.5%
Total equity	100,346	98,162	103,329	5.3%

Regulatory information

Key ratios and indicators	31 Dec 2017	31 Dec 2018	Change year on year
Capital adequacy (CNB)	18.6%	18.5%	▼
Tier 1 ratio (CNB)	18.0%	17.9%	▼
Total risk-weighted assets (CZK billion)	424.6	451.1	6.2%
Risk-weighted assets for credit risk (CZK billion)	352.9	375.4	6.4%
Net interest margin (NII / average interest-bearing assets)[III]	n.a.*	2.3%	
Loans (net) / deposits ratio[IV]	n.a.*	77.9%	
Cost / income ratio[V]	46.7%	45.4%	▼
Return on average equity (ROAE)[VI]	n.a.*	15.3%	
Return on average regulatory capital[VII]	19.8%	18.3%	▼
Return on average assets (ROAA)[VIII]	n.a.*	1.4%	
Earnings per share (CZK)[IX]	79	79	-0.6%
Average number of employees during the period	8,492	8,411	-0.9%
Number of branches (KB standalone in the Czech Republic)	386	364	-22
Number of ATMs	764	776	12
Number of clients (KB standalone)	1,664,000	1,668,000	0.2%

* n.a. – Data in accordance with IFRS 9 is not available. According to the IAS 39 standard, the following financial indicators as of 31 December 2017 were as follow:

- NIM (annualised): 2.3%;
- Loan (net)/deposit ratio (excl. repo operations with clients): 78.9%
- ROAE (annualised): 15.1%,
- ROAA (annualised): 1.5%

Business performance in retail segment – overview	31 Dec 2018	Change year on year
Mortgages to individuals – volume of loans outstanding	CZK 223.9 billion	2.3%
Building savings loans (MPSS) – volume of loans outstanding	CZK 50.7 billion	16.2%
Consumer loans (KB + ESSOX + PSA Finance) – volume of loans outstanding	CZK 39.2 billion	4.6%
Small business loans – volume of loans outstanding	CZK 35.5 billion	4.0%
Total active credit cards – number	178,000	-3.5%
– of which to individuals	140,000	-3.2%
Total active debit cards – number	1,388,000	-0.8%
Insurance premiums written (KP)	CZK 5.1 billion	-16.3%

Regulatory information

Financial calendar:

3 May 2019:	Publication of 1Q 2019 results
1 August 2019:	Publication of 2Q 2019 results
6 November 2019:	Publication of 3Q 2019 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 regulatory capital:** annualised 'Net profit attributable to equity holders' divided by average group 'Regulatory capital', year to date;

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

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

Regulatory information

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

CONSOLIDATED (CZK million)

(source: Profit and Loss Statement)	**FY 2018**
Net interest income and similar income, year-to-date	**22,509**
Of which:	
Loans and advances at amortised cost	19,890
Debt securities at amortised cost	1,922
Debt securities other	445
Financial liabilities at amortised cost	-2,361
Hedging financial derivatives - income	11,191
Hedging financial derivatives - expense	-8,578

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

NIM year-to-date, annualized	**2.33%**