



ANNUAL OPERATING REPORT FOR 2019

Belgrade, February 2020

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I DEVELOPMENT, ORGANISATIONAL STRUCTURE AND BUSINESS ACTIVITIES

1. ESTABLISHMENT

HALKBANK a.d. Beograd has been operating in the Republic of Serbia since 2015 when Turkiye Halk Bankasi A.S. became the major owner of Cacanska banka (operating since 1956).

The Bank was registered with the Serbian Business Registers Agency under Decision no. BD 54244 dated 13th September 2005.

The Bank has been operating under the name of Halkbank a.d. Beograd since 22nd October 2015 when the change of its legal name was registered in the Serbian Business Registers Agency under Decision no. BD 89155/2015.

2. ORGANISATION OF OPERATIONS

HALKBANK a.d. Beograd is a universal bank, which offers all types of banking products and services to corporate clients, entrepreneurs and retail clients. The Bank encourages and finances growth and development of the domestic economy, but is also a safe place for savings deposits of all clients. The Bank's primary goal is to create products that will completely satisfy all customers' expectations.

The Bank is registered in the Republic of Serbia for performance of payment operations and credit and deposit operations in the country and abroad and it operates in compliance with the Law on Banks.

HALKBANK a.d. Beograd has successfully expanded its business network and client base. Today the Bank offers services and products through a network of 25 branches, 9 sub-branches and 4 cash desks. As at 31st December 2019 the Bank was comprised of 8 branches in Belgrade, 2 branches in Čačak and branches located in the towns of Smederevo, Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Arandjelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar and Subotica and 9 sub-branches in Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac, Tutin and Čačak.

3. BASIC PERFORMANCE RATIOS

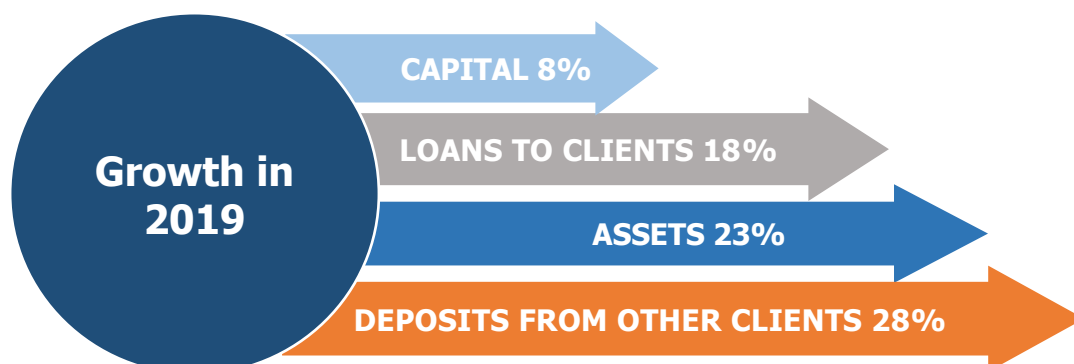
(in RSD thousand)

Income Statement	31.12.2018	31.12.2019	Plan 2019	Plan realization
Net interest income	1,752,511	2,104,276	2,192,053	96%
Net fee and commission income	698,552	771,359	895,677	86%
Net income/(losses) on impairment of financial assets	-75,127	-214,832	-223,919	96%
Operating expenses	2,044,457	2,220,922	2,362,939	94%
Net profit before tax	361,725	472,836	530,335	89%
Balance Sheet	31.12.2018	31.12.2019	Plan 2019	Planned growth realization
Loans to clients*	38,786,695	45,786,729	45,720,081	101%
Deposits from other clients*	32,239,586	41,370,483	37,982,474	159%
Capital	11,151,685	12,098,719	11,624,048	200%
Total assets	56,905,090	69,993,543	64,676,040	168%
Key Performance Indicators (KPI)	31.12.2018	31.12.2019	Plan 2019	
Costs to Income Ratio (CIR)**		82.58%	75.67%	76.09%
Non-interest income to Operating costs Ratio		35.09%	36.51%	38.65%
Capital Adequacy Ratio (CAR)		27.82%	24.22%	24.30%
ROA		0.74%	0.75%	0.87%
ROE		3.93%	4.10%	4.66%
NIM		4.56%	4.33%	4.58%

All financial projections for 2019 are prepared in EUR and realization of goals is followed in EUR. Planned amounts in this report are presented in EUR by using middle exchange rate RSD/EUR valid on 31.12.2019 for balance sheet positions and middle exchange rate RSD/EUR for 2019 for income statement positions.

*The difference of positions „Loans to clients“ and „Deposits from other clients“ from the positions in the official Balance sheet form are explained in the items 3.1 and 3.2

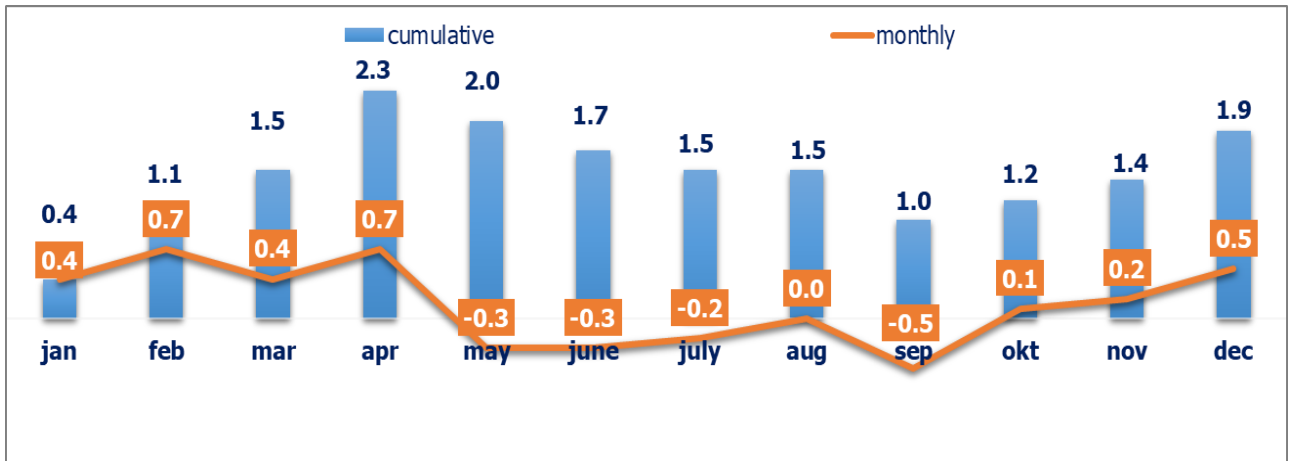
**In order to calculate the cost-to-income ratio, cost of provisions for liabilities have been excluded from the 'Other expenses' position in the statutory statement. Income from the 'Other income' position, with the exception of Reversal of provisions for liabilities, have been included within revenues along with net interest and fee income.



II FINANCIAL POSITION AND OPERATING RESULTS

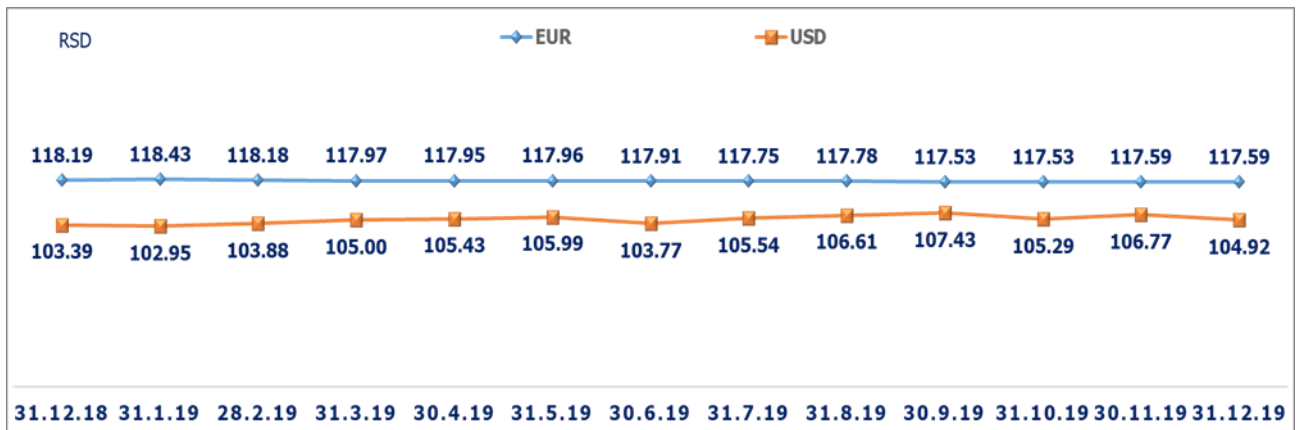
1. MACROECONOMIC ENVIRONMENT

Consumer prices trends in Serbia during 2019



In 2019, cumulative growth of consumer prices was 1.9%. The highest monthly increase was in February and April and it was 0.7%.

FX trend during 2019

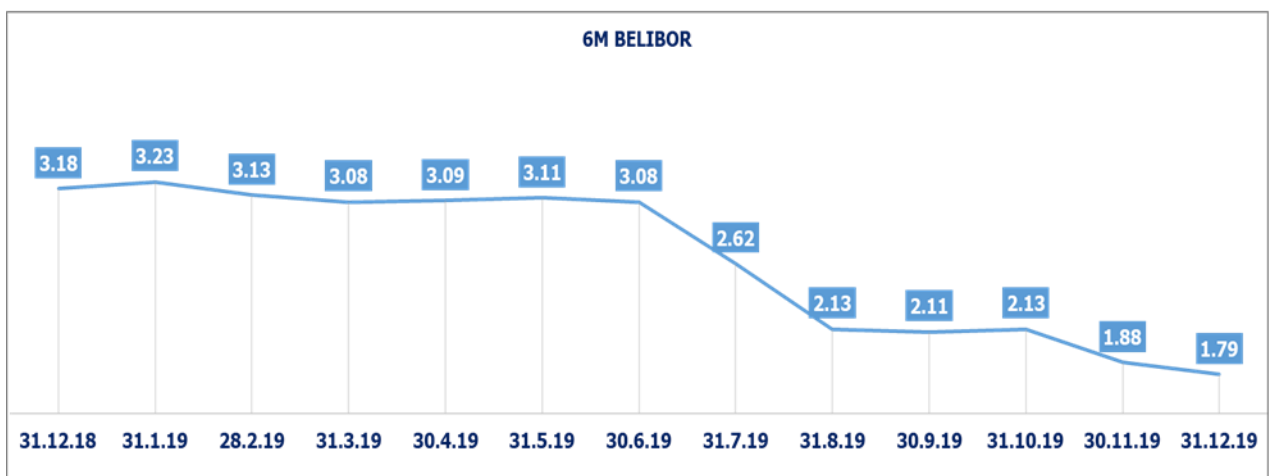
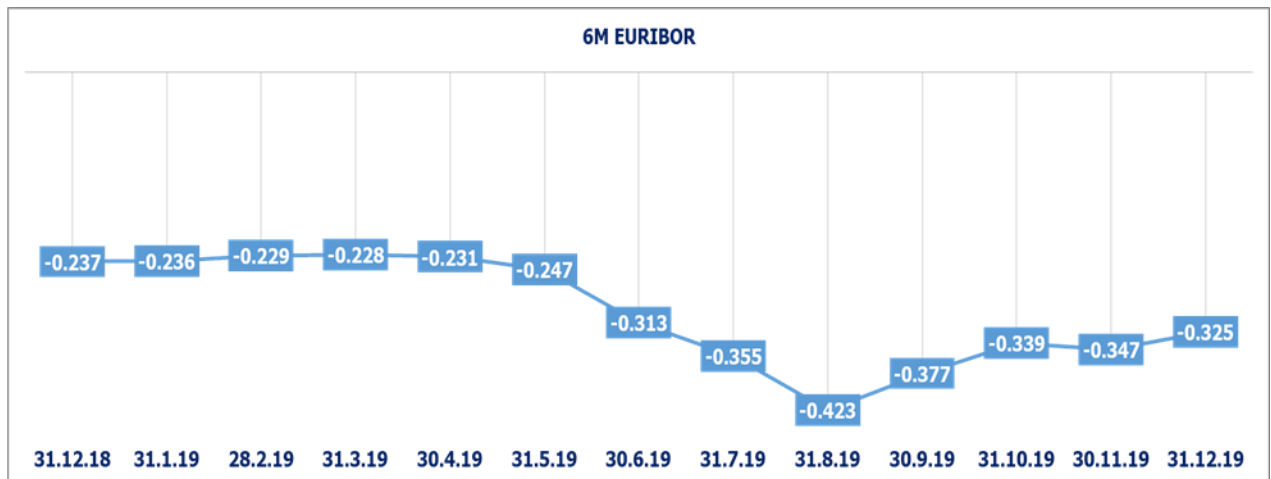


In 2019, Serbian dinar (RSD) has strengthened against the Euro (EUR) by 0.51% and in relation to the United States Dollar (USD), Serbian dinar (RSD) depreciated by 1.48%.

Fluctuation of the National Bank Key Policy Rate

In 2019, the National Bank of Serbia reduced the key policy rate on three occasions, in July, August and November 2019, by 75 basis points in total, from 3.0% to 2.25%.

Fluctuation of the interest rates on the financial markets



2. ACHIEVEMENT OF BASIC OPERATING TARGETS

The targets set out in the Operating Policy for 2019 are implemented through the following activities:

1. The Bank has planned expansion of branch network by opening 4 new branches, in the region of Belgrade and regions where it has not been present so far, and to relocate 4 existing ones. In 2019, the Bank relocated a branch in Novi Sad to the better and more appropriate location and opened new branch in Smederevo. Additionally, at the end of the year the Bank has started process of opening new sub-branch in Zrenjanin.
2. Realized value of Average Liquidity Ratio and its target is shown in following table:

Indicators	2019	Plan 2019 (minimum)
The average liquidity ratio	1.77	1.2
The average narrow liquidity ratio	1.50	0.9
The average ratio of liquid assets	27.51%	20%

2. During 2019, the Bank achieved positive financial result in the amount of RSD 472,836 thousand.

Realized values regarding this goal are shown in the following table:

Indicators	31.12.2019	Plan 2019	Realization of the plan
Net interest and fees income	2,875,635	3,087,730	93.13%
Operating costs	2,220,922	2,362,939	93.99%
Profit	472,836	530,335	89.16%

(in RSD thousand)

4. The Bank has initiated implementation of new core banking system. The Bank expecting to start technical implementation during 2020. During 2019, workshops were held with vendors who submitted requests for information (RFI) and the Bank sent requests for proposals (RFP) to a narrow circle of vendors.

5. In the field of implementation of in-house solution for processing and printing of payment cards, the focus was on compliance with PCI DSS standards. In addition, plans and preparations for the final phase of the project are implemented, which involves the final harmonization of individual products, the formation of instructions and documentation. The extensive staff training was performed, in order to better prepare them for the migration to the new system. The plan is to implement this project in the first quarter of 2020.

3. BALANCE SHEET

3.1. Assets

As of December 31st 2019 the Bank's total assets amounts to RSD 69,993,543 thousand and account for 23% increase compared to the end of 2018.

The main driver of this growth was a positive development in lending to corporate and retail clients, where the growth in the observed period amounted to RSD 7 billion (18.05%). This has been achieved through continuous improvement of loan products so that the Bank can properly respond to the needs of its clients, offer them complete solutions for their financial requirements and further strengthen their trust. Another significant factor of increase relates to the position Cash, cash equivalents and assets held with the central bank and position Financial assets (government bonds of the Republic of Serbia), as a consequence of activities of the Bank in the area of deposit collection, which provides a good basis for the continuation of quality and profitable investment in credit operations in the upcoming period.

(in RSD thousand)				
ASSETS	31.12.2018	31.12.2019	Plan 2019	% of change
Cash, cash equivalents and assets held with the central bank	7,643,117	10,013,564	6,643,993	31.01%
Financial assets*	6,720,145	10,607,350	6,820,382	57.84%
Loans to banks and other financial organizations**	2,276,152	1,453,132	2,351,856	-36.16%
Loans to clients*	38,786,695	45,786,729	45,720,081	18.05%
Intangible assets, property, plant and equipment and investment property	1,248,062	1,726,263	2,909,246	38.32%
Other assets***	230,919	406,505	230,482	76.04%
Total assets	56,905,090	69,993,543	64,676,040	23.00%

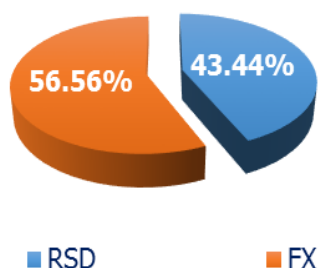
* The position "Financial assets" consists of pledged financial assets, receivables from derivatives and securities from official Balance sheet.

** The positions of „Loans to clients" and „Loans to banks and other financial organizations" differ from the positions „Loans and receivables from clients" and „Loans and receivables from banks and other financial organizations" presented in the official Balance sheet form for the amount of claims for accrued interest, fee and accrued interest receivable and accrued income for EIR compensation, shown in the „Other assets" position. Position „Other assets" includes position „Deferred tax assets" from official Balance sheet form.

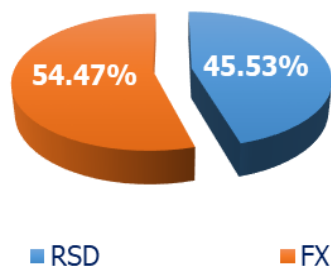
*** The position „Other assets" includes position „Deferred tax assets" from official Balance sheet form.

The following graphs present the currency structure of assets as at 31.12.2018 and 31.12.2019:

**Structure of Assets
31.12.2018**



**Structure of Assets
31.12.2019**



3.1.1 Loans to clients

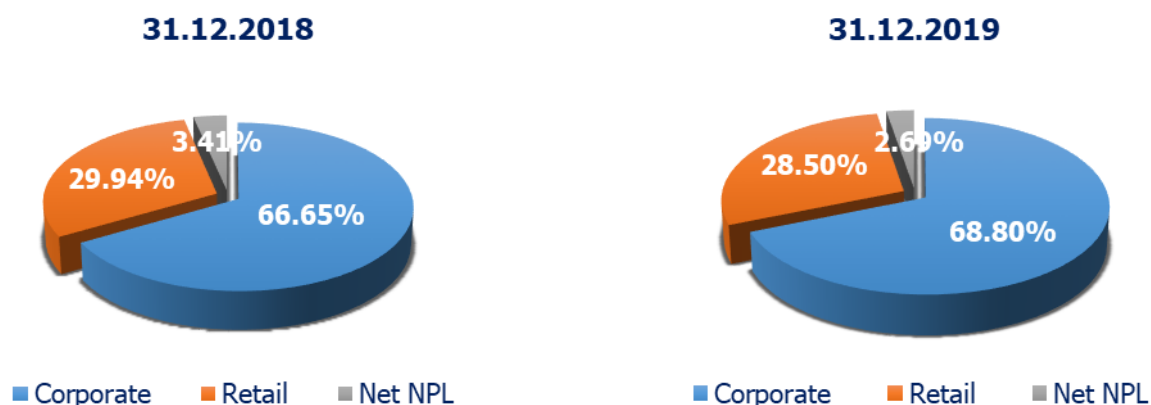
Since arriving to the Serbian market, focus of Halkbank a.d. Beograd is on the maximum satisfaction of clients, the development of innovative products and services, the improvement and digitization of the processes in order to strengthen the efficiency of operations.

The structure of position loans to clients as of December 31st 2018 and December 31st 2019 is given in the following table:

	(in RSD thousand)			
	31.12.2018	31.12.2019	Plan 2019	% of change
Loans to clients - net	38,786,695	45,786,729	45,720,081	18.05%
Corporate clients without NPL	25,850,569	31,502,109	29,633,386	21.86%
Retail clients without NPL	11,614,258	13,051,055	15,051,878	12.37%
NPL (net)	1,321,868	1,233,565	1,034,817	-6.68%

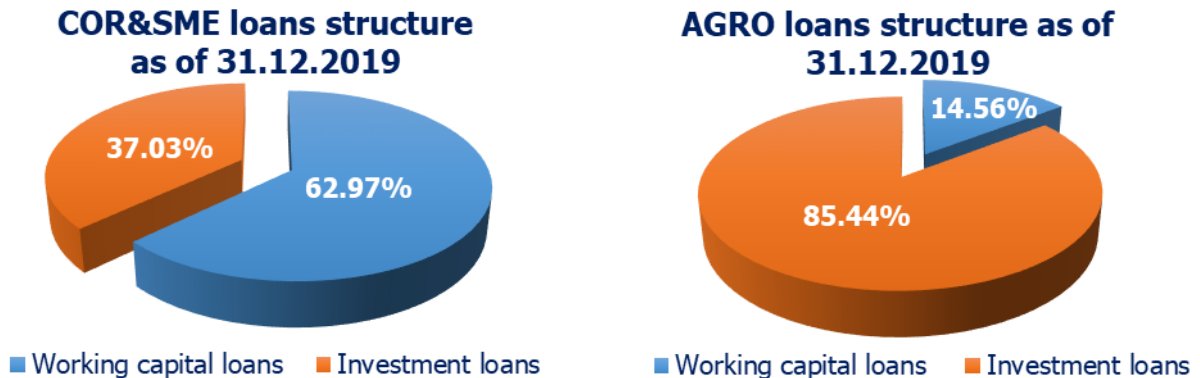
**NPL position refers to net receivables from problematic customers, without receivables for interest and fee*

The Bank's net loan portfolio increased during the 2019 by 18.05%, or by RSD 7 billion.



Gross loans - Corporate

Gross corporate loans, including gross NPL, as of December 31st 2019 amounted to RSD 33,576,769 thousand with growth of 18% comparing to the end of 2018. In the following graphs, structure of these loans is presented:



The most important activities of Corporate and SME Marketing Division in 2019 were as follows:

- Bank realized RSD 23,342 million (4,474 loans) in Corporate and SME segment through regular business activities, as well as certain programs and actions described below.
- Once again, the Bank took an active role in the program of the Government of the Republic of Serbia – “Program for supporting small enterprises in the purchase of equipment in 2019”. Six banks and two leasing companies took part in this Program. The Bank has disbursed RSD 1,364 million through 215 investment loans. Halkbank ranks 1st in the number of granted loans and 2nd in total loan amount, according to the report created by Ministry of Economics.
- In November of 2017, the Bank signed Intermediary finance agreement for realization of APEX loan for SME and other priorities by European Investment Bank. Part of funds is dedicated to financing SME project for employing young people, under age of 30. Realization of loans from this credit line in 2019 was RSD 2,105 million.
- In the third quarter of 2019, the focus was also on the Micro Loans Campaign for working capital loans in the amount of EUR 10, 20 and 30 thousand. By the end of the quarter, a total of RSD 1,117 million was disbursed through 514 working capital loans.
- Bank started Agro business in the second quarter of 2018. The Bank realized RSD 776 million through 569 loans in Agro segment in 2019.

Gross loans - Retail

Gross retail loans as of December 31st of 2019 amounted to RSD 13,281,754 thousand with the following structure:

	(in RSD thousand)		
Loan type	31.12.2018	31.12.2019	% change
Cash loans	6,632,890	7,258,433	9.43%
Housing loans	4,275,124	4,910,910	14.87%
Consumer loans	595,635	801,417	34.55%
Allowed overdraft	138,541	126,217	-8.90%
Other	109,392	184,777	68.91%
Total	11,751,582	13,281,754	13.02%

Retail Marketing and ADC Division realized numerous activities during 2019 with an aim to improve products and services available to retail clients, with a focus on optimization and improvements of process in the respect of approving and realization of loan requests in accordance with regulations:

- At the beginning of the year implementation of procedures and technical solutions for adjusting loan approving process to the retail clients with regulatory requests has been done. The changes in regulation primarily refer to cash loans maximum maturity (95 months), as the most used type of loans on Serbian market, as well as to the maximum indebtedness of the client (60% of salary).
- Realization of cash and refinancing loans campaign "Halk predah" which was supported by TV commercial. At the end of August a new cash and refinancing campaign was launched and until the year end RSD 2,187 million cash loans and RSD 917 million other placements were disbursed. Bank's retail portfolio increased by RSD 1,399 million during this period.
- The DigitalEdge project has been launched as one of the Bank's priorities, which is an enhanced Bank's services to retail customers. The improvement is reflected in a more modern and functional payment method through e-banking and m-banking applications. The additional benefit of DigitalEdge is a web and mobile solution, for both Android and iOS users, to open an account at Halkbank via PC, mobile phone or tablet without going to the Bank. In addition to opening an account, the DigitalEdge platform also enables customers to be informed about other bank's services, while the next step is to improve the service related to digital application for loans or deposits. The plan is to implement this project during April 2020.
- As described in Basic Operating Targets, significant activities were carried out in the implementation of the project of in-house solution for processing and printing of payment cards, as well as activities on preparation of final testing environment and migration of old cards to the new system.

3.2. Liabilities

Total liabilities as of December 31st 2019 amounted to RSD 69,993,543 thousand with the following structure:

	(in RSD thousand)			
Passive	31.12.2018	31.12.2019	Plan 2019	% of change
Deposits from banks and other financial organizations*	3,724,393	6,109,502	5,291,676	64.04%
Deposits from other clients*	32,239,586	41,370,483	37,982,474	28.32%
Funds borrowed**	8,833,825	8,821,223	8,701,867	-0.14%
Other liabilities***	955,601	1,593,616	1,075,974	66.77%
Total liabilities	45,753,405	57,894,824	53,051,992	26.54%
Share capital	8,972,603	8,972,603	8,926,940	0.00%
Current period profit	361,725	472,836	529,168	30.72%
Undistributed profit from previous years	52,373	0	0	-
Reserves	1,764,984	2,653,280	2,167,941	50.33%
Total capital	11,151,685	12,098,719	11,624,048	8.49%
Total passive	56,905,090	69,993,543	64,676,040	23.00%

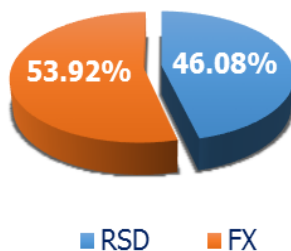
*The positions "Deposits from other clients" and "Deposits from banks and other financial organizations" differ from positions "Deposits and other liabilities from other clients" and "Deposits and other liabilities from banks, other financial institutions and central bank" presented in the official Balance sheet form for the amount of liabilities based on interest, fees, accrued liabilities for accrued interest and other financial obligations towards clients, shown in the „Other liabilities" position. Position "Other liabilities" includes position "Provisions" from the official Balance sheet form.

** The position "Funds borrowed" is presented without accrued interest liabilities that are presented in "Other liabilities" in this table.

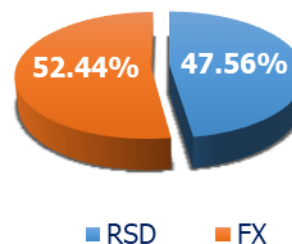
*** The position "Other liabilities" includes position "Provisions" from the official Balance sheet form.

The following graphs present the currency structure of liabilities as at 31.12.2018 and 31.12.2019:

**Structure of liabilities
31.12.2018**



**Structure of liabilities
31.12.2019**



3.2.1 Deposits from banks, other financial organizations and central bank

The structure of deposits from banks, other financial organizations and central bank and comparative analysis as of December 31st 2018 and December 31st 2019 is presented in the following table:

(in RSD thousand)			
Deposits from banks and other financial organizations	31.12.2018	31.12.2019	% of change
Transaction deposits	15,633	224,075	1333.35%
Other deposits	3,708,760	5,885,427	58.69%
Total	3,724,393	6,109,502	64.04%

Within the position, other deposits are deposits of insurance companies and "money market" deposits of domestic and foreign banks.

3.2.2 Deposits from other clients

The structure of deposits from other clients and comparative analysis by segments as of December 31st 2018 and December 31st 2019 is presented in the following tables and graphs:

(in RSD thousand)				
Deposits from other clients	31.12.2018	31.12.2019	Plan 2019	% of change
Transaction deposits	14,215,085	15,471,872	15,287,064	8.84%
Other deposits	18,024,501	25,898,611	22,695,410	43.69%
Total	32,239,586	41,370,483	37,982,474	28.32%

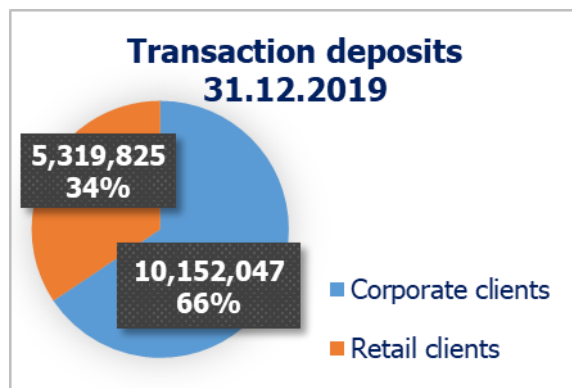
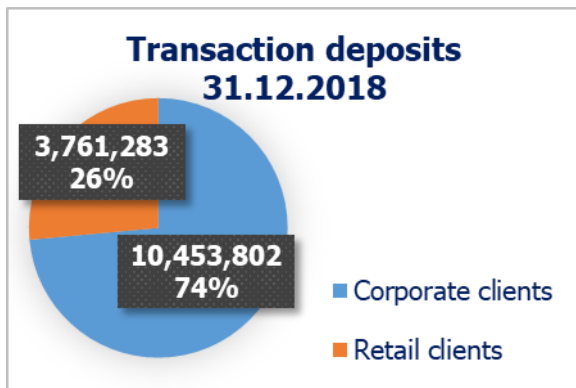
Total increase of deposits from other clients in 2019 amounted to 28.32%.

(in RSD thousand)				
Deposits from other clients	31.12.2018	31.12.2019	Plan 2019	% of change
Corporate clients	16,792,417	21,781,545	18,579,662	29.71%
Retail clients	15,447,169	19,588,938	19,402,812	26.81%
Total	32,239,586	41,370,483	37,982,474	28.32%

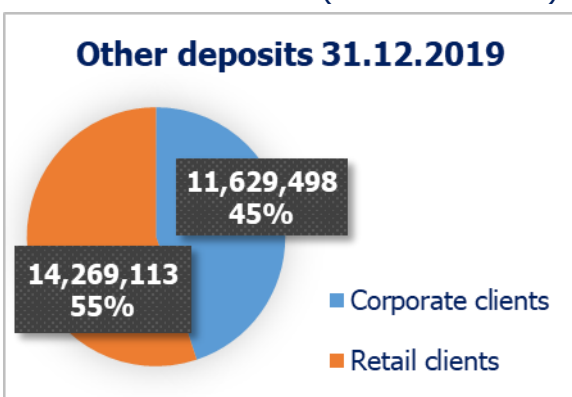
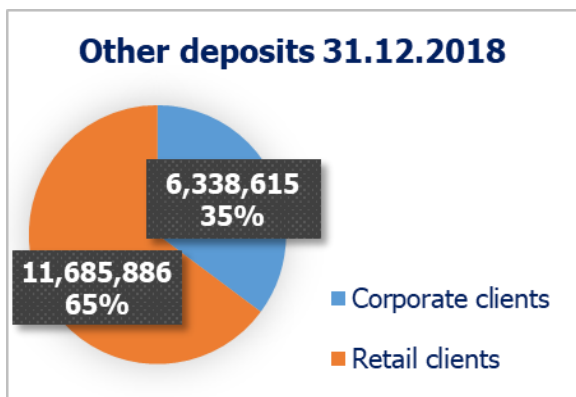
By constant monitoring of market trends, individual and proactive approach to clients, the Bank increased the level of deposits from corporate clients by 29.71%, and the level of deposits from retail clients by 26.81%.

The structure deposits from other clients is presented in the following graphs:

(in RSD thousand)



(in RSD thousand)



2.3 Funds borrowed

(in RSD thousand)

Borrowed loans in foreign currency	31.12.2018	31.12.2019	% of change
- EIB	5,725,497	5,950,863	3.94%
- Revolving loan FRK- EAR	865,516	841,385	-2.79%
- European Fund for Southeast Europe	1,181,946	839,949	-28.94%
- Demir-Halk Bank (Nederland) N.V.	295,487	587,964	98.98%
- GGF	590,973	553,378	-6.36%
- Government of Republic of Italy	66,956	47,684	-28.78%
- KfW	107,450	0	-100.00%
Total	8,833,825	8,821,223	-0.14%

In 2019, the Bank paid the principle of long-term loans to IFIs on a regular basis in the amount of EUR 17,969 thousand. In the same period, the Bank withdrew EUR 18,244 thousand of IFI's funds.

3.2.3 Capital

The capital of the Bank as of December 31st 2019 amounted to RSD 12,098,719 thousand and comprised of the following:

Capital	(in RSD thousand)		
	31.12.2018	31.12.2019	% of change
Share capital – ordinary shares	5,658,940	5,658,940	0.00%
Share capital – preference cumulative shares	1,340	1,340	0.00%
Share capital - preference non-cumulative shares	600,000	600,000	0.00%
Share premium	2,712,323	2,712,323	0.00%
Revaluation reserves	452,553	926,753	104.78%
Reserves from profit	1,312,431	1,726,527	31.55%
Undistributed profit from previous years	52,373	0	-
Profit of the current year	361,725	472,836	30.72%
Total	11,151,685	12,098,719	8.49%

By the decision of the Bank's Shareholders Assembly dated 30.04.2019, the Bank's profit from 2018, as well as remaining undistributed profit from 2017, was allocated to position reserves from profit.

The information about the number of shareholders and the basic information of shares is presented in the following table:

Information on shares	31.12.2018	31.12.2019
Number of shareholders	1	1
Number of shares	626,028	626,028
Nominal value per share in RSD	10,000	10,000
Net book value per share in RSD	17,813.40	19,326.16

4. OFF-BALANCE SHEET ITEMS

During 2019, the Bank issued performance and payment guarantees and letters of credit for its customers. The structure of off-balance sheet items as of December 31st 2018 and December 31st 2019 is presented in the following table:

Off-balance sheet items	(in RSD thousand)		
	31.12.2018	31.12.2019	% of change
Contingent liabilities (guarantees, avals, acceptances and irrevocable liabilities)	9,692,565	13,492,419	39.20%
Operations for and on behalf of third parties	271,833	265,345	-2.39%
Derivatives (SWAP)	1,579,341	943,938	-40.23%
Other off-balance sheet items	47,548,920	65,334,154	37.40%
Total	59,092,659	80,035,856	35.44%

The following table compares the structure of the item guarantees, avals, acceptances and irrevocable liabilities as of December 31st 2018 and December 31st 2019:

Contingent liabilities (guarantees, avals, acceptances and irrevocable liabilities)	(in RSD thousand)		
	31.12.2018	31.12.2019	% of change
Performance guarantees	5,337,428	8,411,994	57.60%
Payment guarantees	2,116,315	2,854,307	34.87%
Unused limits which cannot be revoked	1,813,172	1,574,212	-13.18%
Issued foreign currency letters of credit with Banks' confirmation	384,132	617,362	60.72%
Issued uncovered letters of credit	41,518	34,544	-16.80%
Total	9,692,565	13,492,419	39.20%

5. STATEMENT OF PROFIT AND LOSS FOR THE PERIOD

The Income Statement for the period from January 1st to December 31st 2019 is presented in compliance with the Law on Accounting, IFRS and NBS regulations.

The Bank finished its operation in 2019 with a profit of RSD 472,836 thousand.

(in RSD thousand)

Income Statement	31.12.2018	31.12.2019	Plan 2019	% of change
Interest income	2,068,379	2,528,261	2,663,462	22.23%
Interest expense	315,868	423,985	471,409	34.23%
Net interest income	1,752,511	2,104,276	2,192,053	20.07%
Fee and commission income	843,582	929,972	1,084,241	10.24%
Fee and commission expense	145,030	158,613	188,564	9.37%
Net fee and commission income	698,552	771,359	895,677	10.42%
Net trading income	13,866	972	11,785	-92.99%
Other operating income	16,380	31,983	17,678	95.26%
Net income/(losses) on impairment of financial assets	-75,127	-214,832	-223,919	185.96%
Total net operating income	2,406,182	2,693,758	2,893,274	11.95%
Salaries, salary compensation and other personal expenses	802,875	906,313	907,463	12.88%
Depreciation costs	150,143	362,928	418,376	141.72%
Other expenses	1,091,439	951,681	1,037,100	-12.80%
Total operating expenses	2,044,457	2,220,922	2,362,939	8.63%
NET PROFIT BEFORE TAX	361,725	472,836	530,335	30.72%

*The position "Other operating income" includes position "Other operating income" and "Other income" from official Statement of profit and loss.

In 2019, the Bank increased its net interest income by 20.07%, or by RSD 351,765 thousand, comparing to the same period last year, while net income from fees and commission is higher by 10.42% in the observed period, or by RSD 72,807 thousand. Total operating expenses are higher by 8.63%, or by RSD 176,465 thousand comparing to same period in 2018. The increase in depreciation costs is primarily conditioned by the new way of recording lease contracts, in accordance with the new lease standard IFRS 16, which caused an increase in amount of RSD 175,667 thousand.

The structure of interest income is presented in the following table:

	(in RSD thousand)		
Interest income	31.12.2018	31.12.2019	% of change
Corporate clients	992,011	1,221,065	23.09%
Retail clients	771,937	906,912	17.49%
Securities	268,481	338,215	25.97%
Other	35,949	62,069	72.66%
Total	2,068,379	2,528,261	22.23%

The structure of fee and commission income is presented in the following table:

	(in RSD thousand)		
Fee and commission income	31.12.2018	31.12.2019	% of change
Fees from payment operations	483,145	532,061	10.12%
Fees from guarantees	111,321	146,193	31.33%
Fees from FX changes	103,389	110,150	6.54%
Fees from checks and payment cards	63,446	59,944	-5.52%
Fees from loan processing	45,041	48,415	7.49%
Fees from SWAP	25,611	23,848	-6.88%
Other fees	11,629	9,361	-19.50%
Total	843,582	929,972	10.24%

The structure of interest expense is presented in the following table:

	(in RSD thousand)		
Interest expense	31.12.2018	31.12.2019	% of change
Deposits – corporate	91,757	161,119	75.59%
Deposits – retail	85,349	112,612	31.94%
Borrowings FI's	102,116	87,005	-14.80%
Banks deposits	36,646	52,711	43.84%
IFRS 16	-	10,538	-
Total	315,868	423,985	34.23%

The structure of fee and commission expense is presented in the following table:

	(in RSD thousand)		
Fee and commission expenses	31.12.2018	31.12.2019	% of change
Payment operations	86,295	97,328	12.79%
VisaCard and MasterCard	43,740	46,350	5.97%
Credit biro	13,862	14,935	7.74%
Credit lines	1,133	0	-100.00%
Total	145,030	158,613	9.37%

6. CASH FLOWS

Cash flows from operating activities during 2018 and 2019 are presented in the table below:

(in RSD thousand)

Cash inflows from operating activities	I - XII 2018	I - XII 2019	Change
Interest	2,018,094	2,406,095	388,001
Fees	858,916	943,344	84,428
Other operating income	3,849	12,055	8,206
Dividend and share in profit	886	2,152	1,266
Total cash inflows	2,881,745	3,363,646	481,901
Cash outflows from operating activities			
Interest	291,577	394,245	102,668
Fees	141,536	155,653	14,117
Salaries	751,379	892,133	140,754
Tax and contribution	185,280	184,911	-369
Other operating expenses	926,684	774,999	-151,685
Total cash outflows	2,296,456	2,401,941	105,485
Net cash inflows from operating activities before increase/decrease in financial assets or financial liabilities	585,289	961,705	376,416

Cash inflows from operating activities before increase/decrease in financial assets or financial liabilities in 2019 increased for RSD 481,901 thousand comparing to the same period in 2018.

Cash outflows from operating activities before increase/decrease in financial assets or financial liabilities increased for RSD 105,485 thousand comparing to 2018.

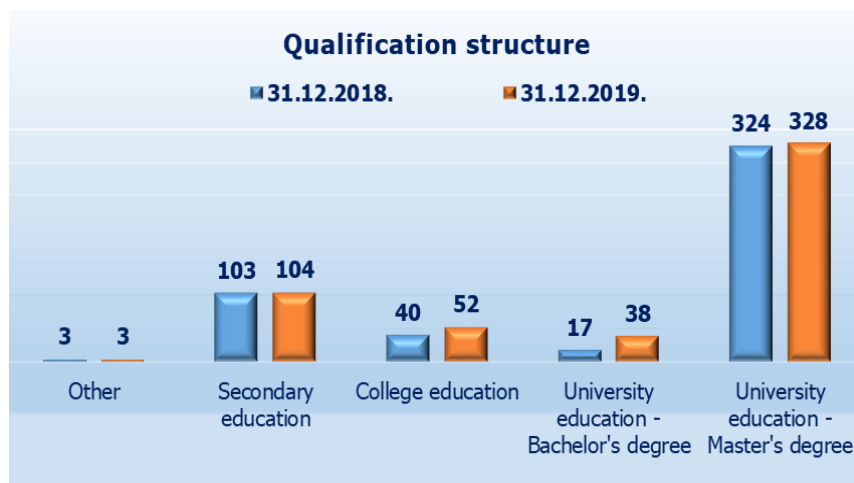
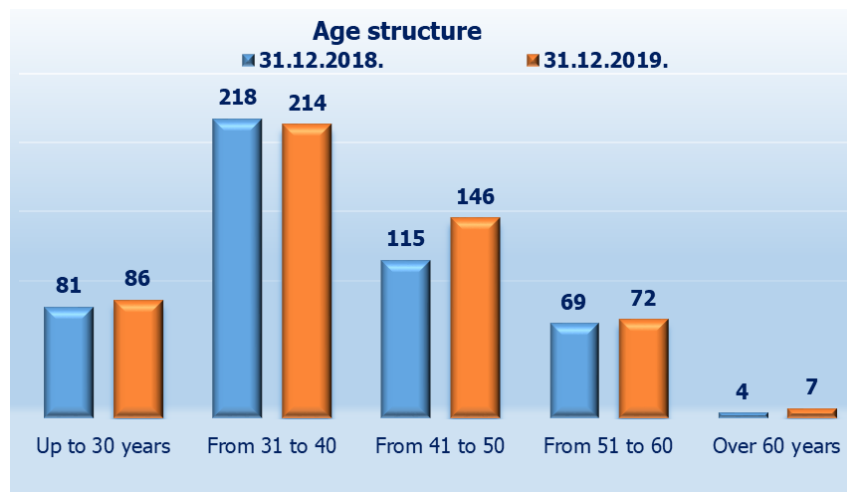
Net cash inflows from operating activities before increase/decrease in financial assets or financial liabilities in 2019 amounted to RSD 961,705 thousand which is increase of RSD 376,416 thousand comparing to same period in 2018.

7. HUMAN RESOURCES

Employees present one of the most important resources on which the Bank's overall activities are based. At the end of 2019, the Bank had 525 employees and the following structure:

Number of employees	31.12.2018	31.12.2019	Plan 2019
Headquarter	203	219	223
Branches	284	306	330
Total	487	525	553

The following graphs show the qualification and age structure of employees as of December 31st 2018 and December 31st 2019:



In the qualification structure of employees at the end of 2019, the share of employees with higher education was 70%, while the participation of younger than 40 years was 57%. The Bank intensively invests in improving the skills and knowledge of employees through external and internal trainings and participation in educational panels. Particular attention is paid to the Bank's internal communication to all employees in order to be familiar with the strategic goals and results, and the most important challenges and activities.

Expenses for salaries, salary compensation and other personal expenses in 2019 amounted to RSD 906,313 thousand and accounts for 99.87% of planned budget for 2019.

8. INVESTMENT PLAN

During 2019 total investments in fixed assets, investment property and intangible investments amounted to RSD 859,783 thousand.

Changes at these balance sheet items are presented in the following table:

(in RSD thousand)

Investments	Buildings	Equipment	Investment property	Intangible investments	Rents in IFRS 16 scope	Total	Plan for 2019
Balance 31.12.2018	448,325	402,716	123,883	273,138	-	1,248,062	1,248,062
Total increase:	2,052	94,965	17,971	48,160	696,638	859,783	1,321,688
IT	-	39,230	-	48,160	-	87,390	568,624
Adaption of business premises	1,529	33,572	-	-	-	35,099	695,561
Other	-	22,163	-	-	-	22,163	57,503
IFRS 16 – rents (building and cars)	-	-	-	-	696,638	696,638	763,295
Revaluation	523	-	-	-	-	523	-
Reclassification*	-	-	17,970	-	-	17,970	-
Total decrease:	35,747	115,590	4,009	50,572	175,667	381,582	418,358
Depreciation	17,775	114,908	4,009	50,572	-	187,261	235,687
Depreciation – IFRS 16	-	-	-	-	175,667	175,667	182,671
Sell	-	574	-	-	-	576	-
Disposal and retirement	-	108	-	-	-	108	-
Reclassification*	17,972	-	-	-	-	17,970	-
FX effects	-	-	-	-	-	-	-757,854
Balance 31.12.2019	414,630	382,091	137,845	270,726	520,971	1,726,263	2,909,246

*Presented in net amount

The investments of the Bank in 2019 were in accordance with the planned activities, such as relocation of the branch Novi Sad to the better and more appropriate location, opening new branch in Smederevo, renewal of security and IT user equipment, as well as additional investment in equipment and licenses for finishing TESLA project.

Of the total increase in 2019 amount of RSD 696,638 thousand is caused by IFRS 16 application, whereby RSD 646,693 thousand is related to the first-time application effects.

9. COMPLIANCE OF OPERATIONS WITH THE NBS REGULATIONS AND IFI AGREEMENTS

As of December 31st of 2019 all the operating ratios of the Bank were within the limits prescribed by the Law on Banks and NBS regulations.

Ratio	The values prescribed by the NBS regulations	Values as at December 31th 2019
Regulatory Capital	Min 10,000,000 €	95,363,415 €
Capital adequacy ratio	min 8%	24.22%
Foreign exchange risk ratio	max 20%	3.35%
Liquidity ratio	Min 1	2.12
Narrow liquidity ratio	Min 0.7	1.87
Exposure to one person or group of related persons	max 25%	13.28%
Sum of large exposures	max 400%	14.99%
Investment in non-financial sector	max 10%	0%
Investments in fixed assets and investment property	max 60%	12.98%

Business policy for 2019 as one of the main goals in the risk management process defines maintenance capital adequacy ratio above 22%. As of December 31st of 2019, the capital adequacy ratio was above the stated target (24.22%).

By the Decision on the Minimum Requirement for Capital and Eligible Liabilities of a Bank, National Bank of Serbia defines ratio of Capital and Eligible Liabilities to total liabilities for the Bank equal to 6.20%. The ratio of the Capital and Eligible Liabilities to total liabilities of the Bank as of June 30th 2019 was 26.51%, which is significantly above the defined limit.

Compliance with the covenants from the agreements concluded with the international financial institutions (IFIs)

Pursuant to the defined limits in the agreements concluded with the international financial institutions (IFIs) - German Development Bank (KfW), Green for Growth Fund (GGF), and European Fund for Southeast Europe (EFSE) the Bank is required to comply with certain financial covenants until the final repayment of the loans. As of December 31st of 2019, the Bank is aligned with all indicators. Loan from the international financial institution German Development Bank (KfW) is repaid at the end of the year 2019. During 2019, the bank was aligned with all indicators required by agreement concluded with KfW.

III INVESTMENT FOR THE PURPOSE OF ENVIRONMENTAL PROTECTION

The Bank is particularly cautious to invest only in the projects that do not cause any environmental and social harm. Environmental and social (E&S) protection includes, besides ecological aspects, the issues of a local community and employee protection.

The aim of managing E&S risk is identification, assessment and control of the risks that may cause E&S harm and it is carried out in accordance with the E&S Risk Management Policy and the E&S Risk Management Procedure.

The following bodies are responsible for managing the E&S risk in the Bank:

- Board of Directors that establishes and at least once a year reviews E&S Risk Management Policy and identifies the need for any amendments,
- Executive Board that establishes and implements the E&S Risk Management Procedure,
- Credit Committees that make decisions on loan disbursement on the basis of the E&S information available and the opinion of the Corporate and SME Marketing Division,
- Credit Division that assesses the impact of the activity and the project during the process of appraising customers' creditworthiness,
- The Risk Management Department that monitors loans at the portfolio level by categories of E&S risks through the preparing and analysis of reports.

When processing individual clients' applications, E&S risk is classified for the basic activity of the client and the activity which is subject to financing.

There are the following E&S risk categories:

- High – Exclusion List;
- High – Category A;
- High;
- Medium and
- Low

Environmental risk

Overview of the Bank's exposures by environmental and social risk categories

(in RSD thousand)

Risk category	Number of clients		Amount of placements (balance and off-balance)		Increase/ decrease
	31.12.2018	31.12.2019	31.12.2018	31.12.2019	
High – Exclusion List	2	0	238,534	0	-238,534
High – Category A	8	10	72,576	465,438	392,862
High	292	342	7,895,397	11,807,138	3,911,741
Medium	1,359	1,948	16,655,673	21,023,659	4,367,986
Low	2,287	2,296	19,560,691	22,443,645	2,882,954
Total	3,948	4,596	44,422,871	55,739,880	11,317,009

*For the purpose of analysis of environmental risk, the Bank includes only relevant part of portfolio.

In the structure of balance and off-balance exposure to clients, legal entities and entrepreneurs, as of December 31st, 2019, the largest share have clients with activities with low environmental and social impact, 40.26%, then placements to clients with activities with medium impact participate with 37.72%, high impact 21.18% and activities with high risk category A participate with 0.84%.

IV SIGNIFICANT EVENTS AFTER THE END OF BUSINESS YEAR

After the reporting period, there have been no events which had materially impact on financial statements of the Bank for the year ended 31st December 2019.

V ANTICIPATED FUTURE DEVELOPMENT

The business policy and strategy for the period from 2018 to 2022 defined the basic business goals and main guidelines for the development of Halkbank a.d. Belgrade on the Serbian market.

By increasing share capital in 2018 in the amount of EUR 40 million, the Bank achieved an excellent base for rapid growth in order to achieve the assets size of EUR 1 billion by the end of 2022.

As one of the main goals it is planned the expansion of the branch network to more than 50 branches, opening 4 to 5 new branches annually, with a high potential for raising market share in Belgrade and other regions where the Bank does not currently have branches. The Bank will be oriented towards SME clients, with a strong focus on the retail segment. Loans will grow above 20% on the annual basis, while client deposits will grow 30% on the annual basis.

All listed activities will lead to increase in market share in the banking sector to 3%, based on the size of total assets, with sustainable growth, good liquidity and capital adequacy position.

VI RESEARCH AND DEVELOPMENT ACTIVITIES

The Bank carries out a regular financial market research, analyses customers' financial needs and investigates a degree of satisfaction of the users of financial services.

The Marketing Division constantly develops new products and services, and based on the information and conclusions that it obtains through market research activities and customers' needs, strives to develop and offer modified existing products, as well as completely new products and services.

VII INFORMATION ON PURCHASE OF OWN SHARES

The Bank did not acquire its own shares during 2019.

VIII EXISTENCE OF AFFILIATES

HALKBANK a.d. Beograd has successfully expanded its business network and client base. Today the Bank offers services and products through a network of 25 branches, 9 sub-branches and 4 cash desks. As at 31st December 2019 the Bank was comprised of 8 branches in Belgrade, 2 branches in Čačak and branches located in the towns of Smederevo, Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Arandjelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar and Subotica and 9 sub-branches in Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac, Tutin and Čačak.

IX RISK MANAGEMENT ADEQUACY

The Bank's targets in risk management are identification, measuring, mitigating and monitoring all types of risks and thus minimizing the Bank's exposure to such risks.

Credit Risk

The Bank measures and monitors the credit risk level through assessing the clients' solvency and controlling the loan portfolio through the calculation of loan loss reserves pursuant to the NBS regulations and impairment provisions pursuant to the IFRS rules.

Structure of gross risk-weighted assets in terms of classification categories

(in RSD thousand)

Classification category	Classified amount as at 31.12.18	% of the share in gross risk-weighted assets		Classified amount as at 31.12.19	% of the share in gross risk-weighted assets	
A	29,638,883	50.67%	85.00%	28,378,670	40.03%	70.67%
B	20,083,191	34.33%		21,716,803	30.64%	
V	5,574,816	9.53%	9.53%	13,790,931	19.46%	19.46%
G	483,354	0.83%	5.47%	2,946,405	4.16%	9.87%
D	2,715,735	4.64%		4,049,661	5.71%	
Total	58,495,979	100.00%		70,882,353	100.00%	

The total assets that are classified are increased as of December 31st 2019 compared to the end of 2018 by 21.17%.

Compared to the end of 2018, there was a certain deterioration in structure of the Bank's portfolio, which was caused by increase of share of receivables classified in G and D category by 4.40 percentage points, in category V by 9.93 percentage points and decrease of share of receivables classified in categories A and B by 14.33 percentage points.

Portfolio quality as of December 31st 2019 is in medium risk level, taking into account that less than 75% of asset is classified in categories A and B. Decrease in the share of exposures classified in the A and B categories and their transfer to category V is motivated by the amendments to the internal Procedure for classification of balance sheet assets and off-balance sheet items, for the part of classification of private individuals. The Bank introduced buckets of debt-to-income ratio and set the minimum risk category in line with those buckets by taking into consideration also currency structure of monthly income of clients and their monthly financial liabilities.

Collection and coverage of NPLs

NPL based on the methodology of reporting to the National Bank of Serbia is shown in the following table:

	(in RSD thousand)		
	31.12.2018	31.12.2019	Change
NPL portfolio	2,569,350	2,144,650	-424,700

NPL as of December 31st 2019 was reduced by RSD 424,700 thousand compared to December 31st 2018, as a result of NPL collection and accounting write-off conducted for 100% impaired non-performing receivables. In the year of 2019, the Bank has collected RSD 271,051 thousand of NPL including write-off receivables, while accounting write-off of 100% impaired non-performing receivables in the same period amounted to RSD 505,767 thousand. Despite of performing accounting write-off of receivables and transfer to off-balance sheet items the Bank does not waive its rights for the collection of non-performing exposures and legal rights arising from such loans. On the other hand, new exposures that became the NPL comparing the end of year 2019 to the end of the year 2018 amounted RSD 242,359 thousand.

Share of gross NPLs in total gross Bank's loans

Ratio	31.12.2018	31.12.2019	Change
Share of NPLs in total loans	6.42%	4.59%	-1.83 p.p.

The credit risk management policy adopted in the December 27th of 2019 defined the limit for the level of non-performing loans (NPL ratios) as a ratio of gross NPLs and gross loans in the level of 7.5%. As of December 31st of 2019, the Bank is below defined limit.

NPL coverage

Ratio	31.12.2018	31.12.2019
Ratio of NPL coverage with Impairment provisions for loans	54.54%	49.32%
Ratio of NPL coverage with NPL Impairment provisions	47.97%	42.53%

In Credit Risk Management Policy adopted in the December 27th of 2019, the Bank defined the highest acceptable level of non-performing exposures (NPE) in relation to total balance sheet and off-balance sheet assets that are classified at a level that is less than 7.5%, as well as the NPL coverage ratio which is calculated as a ratio of NPL impairments and non-performing loans (NPL) at the level above than 35%. The share of non-performing exposures (NPE) as of December 31st 2019 in total classified assets amounts to 3.24% and is significantly below the defined limit. The share of NPE decreased compared to December 31st 2018 for 1.45 p.p. due to the reduction of non-performing loans and in the same time increase of loan portfolio. The NPL coverage ratio as of December 31st 2019 amounted to 42.53% and it is above the defined limit.

Liquidity Risk

Liquidity Ratio and Narrow Liquidity Ratio prescribed by NBS in the period from January 1st to December 31st of 2019

	Liquidity Ratio	Narrow Liquidity Ratio
Value as of December 31 st	2.12	1.87
Average	1.77	1.50
Maximum	2.12	1.87
Minimum	1.56	1.24
Daily NBS limit	Min 0.8	Min 0.5
NBS limit on monthly level	Min 1	Min 0.7

Liquidity ratios of the Bank during the period from January 1st to December 31st 2019 were in accordance with the prescribed limits by the Decision on risk management by banks. In order to manage liquidity risk adequately, the Bank monitors internally established indicators of structural liquidity, besides the limits prescribed by the NBS.

Additional liquidity ratios in the period from 01.01-31.12.2019 – internally established

	Min.	Max.	Average	Limit
Liquid assets ratio	24.43%	30.29%	27.51%	Min 20.00%
Net loans to total deposits ratio	96.43%	110.85%	103.77%	Max 200.00%
Customers' deposits to total deposits ratio	85.67%	93.48%	88.66%	Min 75.00%
Deposit concentration ratio	24.04%	28.07%	26.10%	Max 30.00%

The Bank was within internally prescribed liquidity limits during the period from 01.01-31.12.2019.

Foreign exchange risk

FX Risk ratio in the period from 01.01 - 31.12.2019

Value as of December 31 st	3.35%
Average	1.99%
Maximum	6.98%
Minimum	0.13%
Limit NBS	Max 20%

Foreign currency risk measured by FX Risk ratio was located in the low risk category during the 2019.

Interest rate risk

The impact of changes in interest rates on the economic value of the Bank is monitored through total net weighted position of the banking book.

Total net weighted position of the Bank as of December 31st of 2019

	(in RSD thousand)
Total net weighted position	-128,826
Equity	11,214,051
Total net weighted position and equity ratio	1.15%
Internally prescribed maximum	20%

Operational risk

In the period from January 1st to December 31st 2019 in terms of Operational risk, 176 events were reported in the Application of Operational risks. Seventy-one of all events of operational risk that were reported referred to cash shortage or surpluses and have been successfully resolved (51 events of cash shortage and 20 events of cash surpluses).

Number of events	176
Cash shortage	51
Cash surplus	20
Other	105
Net loss in EUR	10,372

The Bank performs also risk assessment of Outsourcing processes, based on the contract concluded with third parties, which have clearly defined rights and obligations of the parties. When introducing new products, processes and systems or new business activities the Bank also performs assessment and identification of operational risk.

Exposure risk

The Bank's exposure to persons related to the Bank and its large exposures as of December 31st of 2019

	(in RSD 000)	% of equity	Limit NBS
Persons related to the Bank	1,642,301	14.64%	-
Large exposures	1,681,224	14.99%	Max 400%

Concentration risk

The Bank monitors the concentration risk through a concentration ratio that was defined as the ratio of the 20 largest gross exposures at the level of the client or the group of related parties and total regulatory capital.

The policy of credit risk management has determined that the concentration ratio should be maintained at a level below 300%.

	31.12.2018	31.12.2019	Prescribed value
Concentration ratio of 20 largest clients/groups of related parties	89.69%	119.87%	Max 300% of regulatory capital

As of December 31st 2019, the concentration ratio is within an internally defined limit.

Additionally, in order to manage the concentration risk, by the Procedure for the Credit Risk Management at the portfolio level, exposure limits (balance sheet assets and off-balance sheet items) have been established to specific geographical areas and to a specific sector / business activity, which provide diversification of the portfolio. As of December 31st in the mining and alimentary industry, the largest exposure of the bank is 24.55% and in retail 20.17%, which is significantly below the internally defined limit of 60% and 25% respectively. The exposure of the Bank in relation to geographical areas is monitored through the participation of exposures to clients from individual geographical areas in the total classified gross balance sheet assets and off-balance items. The Bank's largest exposure is to clients belonging to the region of Central and Western Serbia and amounts to 38.03% and in the region of Belgrade 33.41%, which is significantly below the internally defined limit of 70% and 50% respectively.

Exposures of the Bank to retail loans with a contractual maturity of more than 2920 days may not exceed 30% of the Bank's capital determined in accordance with the decision regulating the bank's capital adequacy increased by the amount of all bank liabilities in dinars with a remaining maturity of more than 1825 days. The calculation of the capital amount referred to in the preceding paragraph shall not be subject to the regulatory adjustments and deductions from capital prescribed by the NBS decision regulating the bank's capital adequacy, except for deductions for the loss of the current year and earlier years and for unrealized losses. As of December 31st 2019, concentration risk ratio in retail segment calculated as previously described is 16.10%, which is significantly below the defined limit.

Investment Risk

The Bank did not have investments in non-financial sector as of December 31st 2019. Total investments in entities that are not in financial sector and in fixed assets and investment property were in the category of low risk (below 45% of capital).

Bank's investments into non-financial sector and fixed assets as of December 31st 2019

	Investments into non-financial sectors	Investments into fixed assets	Total
Amount (000 RSD)	0	1,455,446	1,455,446
Share in equity	0%	12.98%	12.98%
Limit NBS	Max 10%	-	Max 60%

Country risk - The risk relating to the country of origin of the person to whom the Bank is exposed

Bank establishes a system of country classification regarding the level of country risk and is committed to a system of risk classification by applying categories assigned by international rating agencies (Moody's, Standard&Poors and Fitch).

In the period from 01.01. to 31.12.2019, the Bank had exposures to clients, which operate in countries that are classified as low-risk and medium-risk countries, according to the Classification of official international credit rating agencies and the Bank Procedure.

Bank exposure towards countries, which are in the category of low risk, is without limits. The country from this category as of December 31st 2019 were Germany, Austria and USA. Countries in the category of medium risk were Turkey, Romania, Bosnia, Macedonia, Croatia and Albania. Exposure to countries in the category of medium risk was significantly below adopted internal limits during observed period.

Review of countries of clients whose exposure is involved in country risk as of December 31st 2019

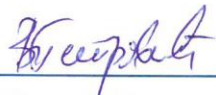
Country	Risk category	Limit	Share in Bank capital
Germany	low	without limit	2.58%
Austria	low	without limit	1.81%
USA	low	without limit	0.76%
Turkey	medium	100% regulatory capital	20.79%
Romania	medium	20% regulatory capital	13.28%
Bosnia	medium	40% regulatory capital	3.15%
Macedonia	medium	100% regulatory capital	2.38%
Croatia	medium	10% regulatory capital	0.03%
Albania	medium	25% regulatory capital	0.00%

X CORPORATE GOVERNANCE RULES

Corporate governance rules of Halkbank a.d. Beograd are regulated in the following by-laws:

- Statute;
- Foundation Agreement;
- Corporate Governance Code;
- Business Code of Supervisory Board Members;
- Code of Conduct and Ethical Principles;
- Anti-corruption Policy and
- General Operating Conditions.

HALKBANK AD BEOGRAD



Head of Financial Management and Planning Division
Vesna Petrović



Member of Executive Board
Dušica Erić



President of Executive Board
Kenan Bozkurt