



ANNUAL OPERATING REPORT FOR 2018

Belgrade, March 2019

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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 24 branches, 9 sub-branches and 4 cash desks. As at 31st December 2018 the Bank was comprised of 8 branches in Belgrade, 2 branches in Čačak and branches located in the towns of 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

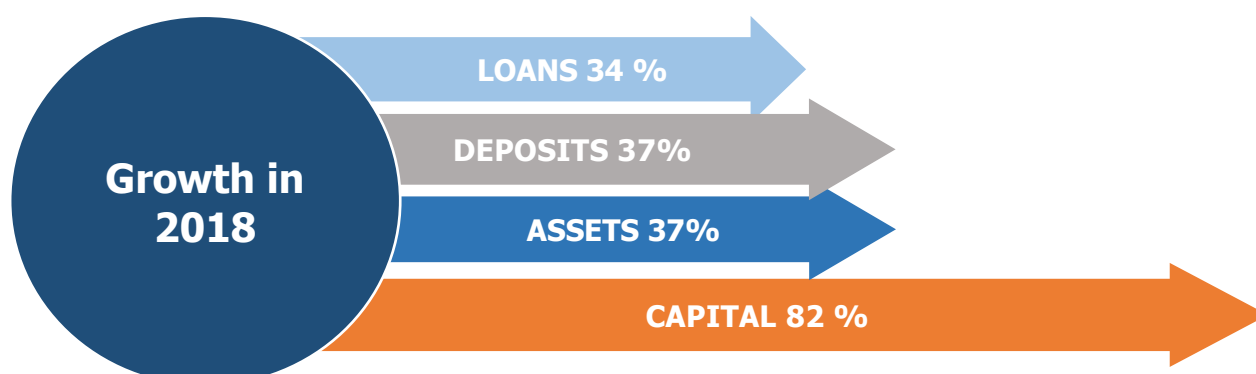
(in RSD thousand)

Income Statement	31.12.2017	31.12.2018	Plan 2018	Plan realization
Net interest income	1,489,305	1,752,511	1,833,210	96%
Net fee and commission income	604,345	698,552	709,630	98%
Net income/(losses) on impairment of financial assets	-269,765	-75,127	-224,716	33%
Operating expenses	1,685,888	2,044,457	2,057,926	99%
Net profit before tax	194,631	361,725	295,679	122%
Balance Sheet	31.12.2017	31.12.2018	Plan 2018	Planned growth realization
Loans to clients	28,907,976	38,786,695	35,458,380	151%
Deposits from other clients	23,449,090	32,239,586	29,666,845	141%
Capital	6,119,707	11,151,685	10,951,321	104%
Total assets	41,449,177	56,905,090	50,823,678	165%
Key Performance Indicators (KPI)	31.12.2017.	31.12.2018.	Plan 2018	
Costs to Income Ratio (CIR)		79.38%	82.58%	80.18%
Non-interest income to Operating costs Ratio		37.26%	35.09%	35.63%
Capital Adequacy Ratio (CAR)		17.11%	27.82%	26.51%
ROA		0.52%	0.74%	0.64%
ROE		3.20%	3.93%	3.46%
NIM		5.12%	4.56%	-

All financial projections for 2018 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 31.12.2018 for balance sheet positions and middle exchange rate RSD/EUR for 2018 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

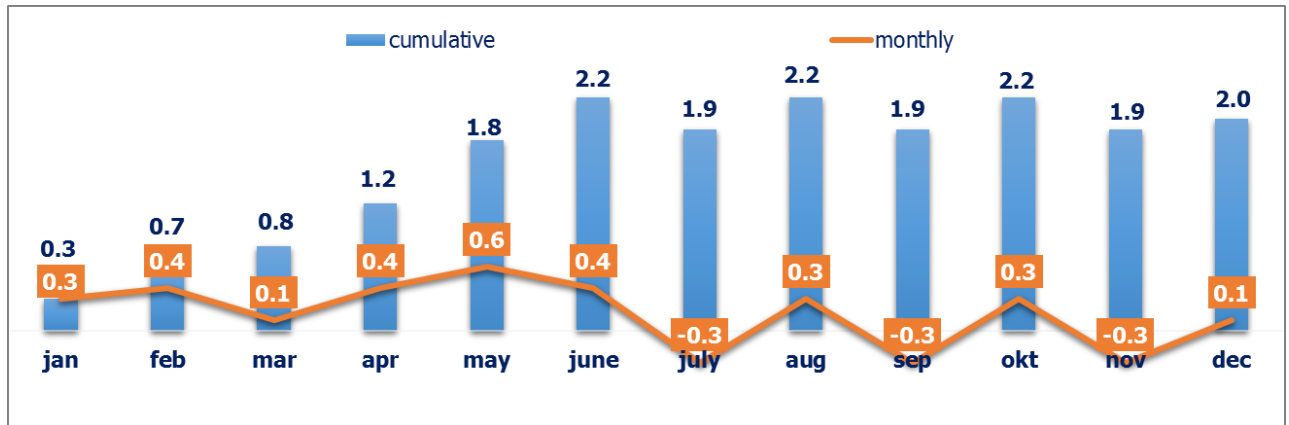
*In order to calculate the cost-to-income ratio, cost of provisions for liabilities have been excluded from the 'Other expenses' position in the statutory statement. Income from the 'Other income' position, with the exception of Reversal of provisions for liabilities, have been included within revenues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



II FINANCIAL POSITION AND OPERATING RESULTS

1. MACROECONOMIC ENVIRONMENT

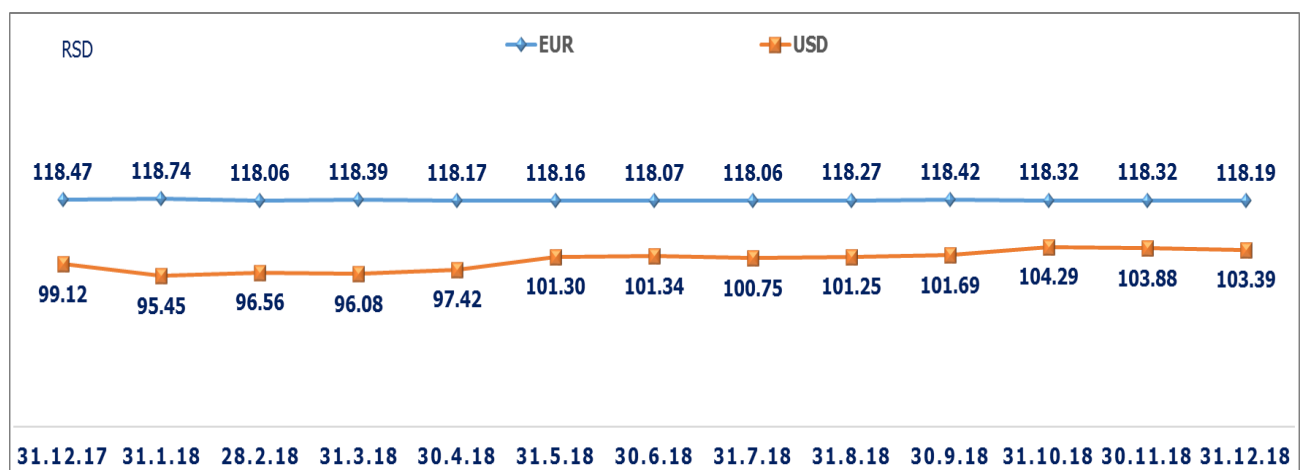
Consumer prices trends in Serbia during 2018



In 2018, cumulative growth of consumer prices was 2%. The highest monthly increase was in May and it was 0.6%.

According to the National Bank of Serbia’s projection inflation will remain stable in the upcoming period and continue to move within the target tolerance band, $3 \pm 1.5\%$. The same can be concluded from the results of the inflation expectations survey conducted monthly by the National Bank of Serbia, because both the financial and corporate sector expect that predictability and price stability will be preserved in the following 12 months, as well as in medium term, which is one of the main conditions necessary for sustainable growth.

FX trend during 2018

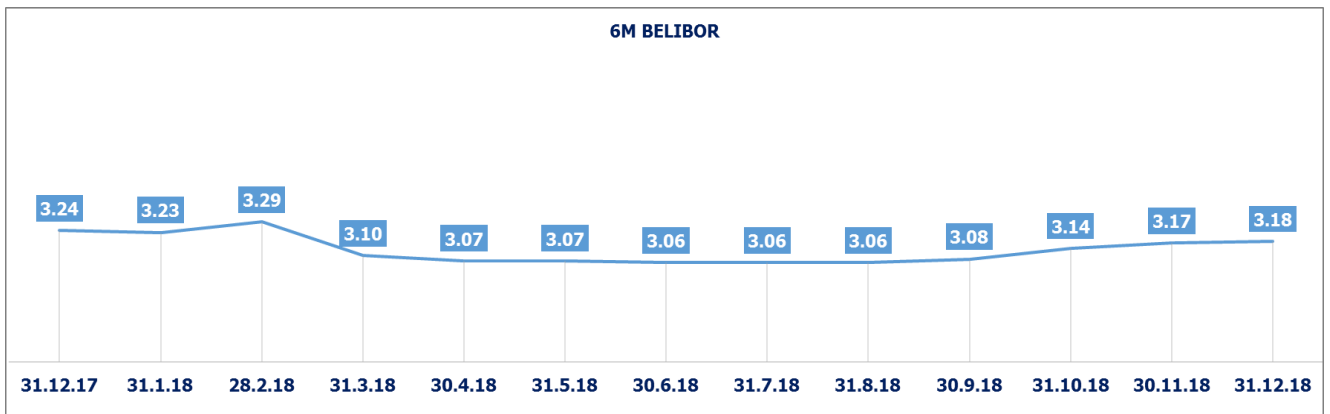
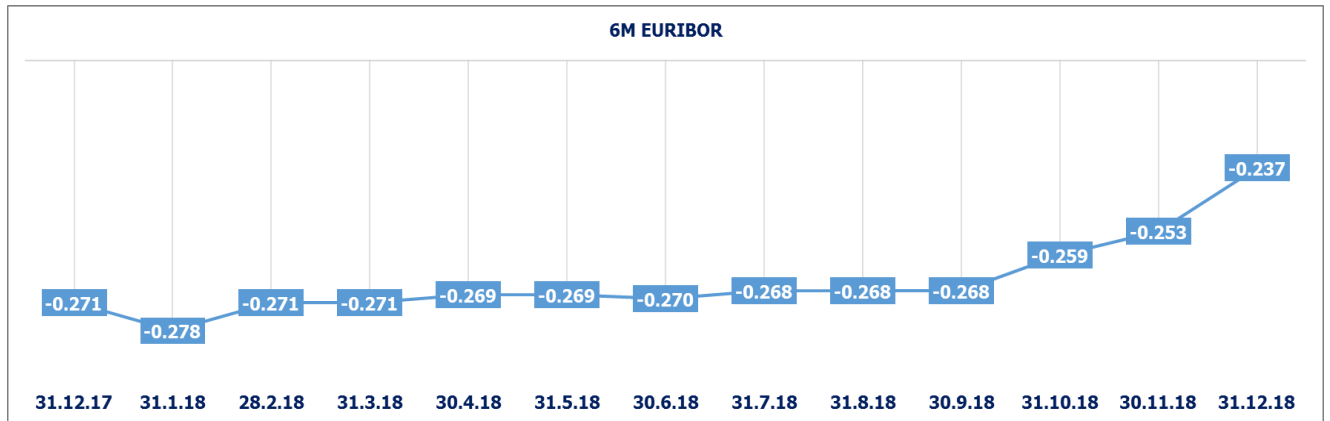


In 2018, Serbian dinar (RSD) has strengthened against the Euro (EUR) by 0.23% and in relation to the United States Dollar (USD), Serbian dinar (RSD) depreciated by 4.31%.

Fluctuation of the National Bank Key Policy Rate

In 2018, the National Bank of Serbia reduced the key policy rate on two occasions, in March 14th and April 12th, by 50 basis points in total, from 3.5% to 3.0%.

Fluctuation of the interest rates on the financial markets



2. ACHIEVEMENT OF BASIC OPERATING TARGETS

The targets set out in the Operating Policy for 2018 are implemented through the following activities:

1. The Bank has planned expansion of branch network by opening 3 new branches, in the region of Belgrade and regions where it has not been present so far. At the end of September, the Bank opened branch in Belgrade in Bulevar kralja Aleksandra street, which is a modern equipped branch that aims to enable to the new and existing clients to operate efficiently in all areas of modern banking. Additionally, in the 2018 the Bank relocated a branches in Kragujevac, Užice, Niš and a sub-branch in Požega to the better and more appropriate locations. Additionally, process of relocation the branch in Novi Sad started in the middle of December and the branch has started operating at a new location in February 2019.
2. Realized value of Average Liquidity Ratio and its target is shown in following table:

Indicators	2018	Plan 2018 (minimum)
The average liquidity ratio	1.53	1.2
The average narrow liquidity ratio	1.27	0.9
The ratio of liquid assets	28.51%	20%

3. During 2018 the Bank achieved positive financial result in the amount of RSD 361,725 thousand. Realized values regarding this goal are shown in the following table:

Indicators	(in RSD thousand)		
	31.12.2018	Plan 2018	Realization of the plan
Net interest and fees income	2,451,063	2,542,839	96.39%
Operating costs	2,044,457	2,057,926	99.35%
Profit	361,725	295,679	122.34%

4. The Bank has initiated implementation of new core banking system. In the second quarter of 2018 the Bank selected consultant company Ernst&Young, that will offer project management services and assistance in vendor selection. All activities are in line with the plan. The Bank expecting to start technical implementation in the first half of 2019.

5. In the field of implementation of in-house solution for processing and printing of payment cards the following activities were realized:

- The processes of establishing a mutual connection between the Bank's system and the card organization system (VISA, MasterCard and Dina) have been completed;
- In the process of certification of systems and hardware components, the project has entered its final phase;
- In the field of application development, parameter setting is in pre-production phase and the final testing;
- In the field of harmonization with PCI DSS standards, the final framework for GAP analysis is defined.

The pre-production environment and testing of the final characteristics and components of the system is expected at the beginning of 2019, after which the system will be operational.

6. The main assumption for preparation of Business Policy for 2018 was capital addition in the amount of EUR 40 million. On February 20th 2018 the Bank increased share capital, by issuing new shares, from RSD 4,248,483 thousand to RSD 6,612,603 thousand (approximately EUR 20 million). New share issue of RSD 2,360,000 thousand (approximately EUR 20 million) is realized on August 1st 2018, when Bank's capital increased from RSD 6,612,603 thousand to RSD 8,972,603 thousand.

3. BALANCE SHEET

3.1. Assets

As of December 31st 2018 the Bank's total assets amounts to RSD 56,905,090 thousand and account for 37.29% increase compared to the end of 2017.

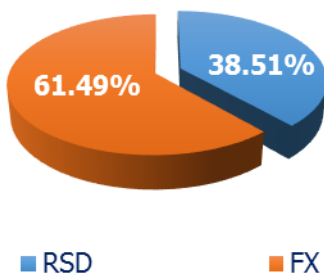
The main driver of this growth was a positive development in lending to corporate and retail clients, where the growth in the observed period amounted to RSD 9,878,719 thousand (34.17%). This has been achieved through continuous improvement of loan products so that the Bank can properly respond to the needs of its clients and offer them complete solutions for their financial requirements and further strengthen their trust.

ASSETS	31.12.2017	31.12.2018	(in RSD thousand)	
			Plan 2018	% of change
Cash, cash equivalents and assets held with the central bank	4,839,851	7,643,117	5,318,757	57.92%
Financial assets	4,857,500	6,720,145	5,791,535	38.35%
Loans to banks and other financial organizations*	1,522,008	2,276,152	2,381,621	49.55%
Loans to clients*	28,907,976	38,786,695	35,458,380	34.17%
Intangible assets, property, plant and equipment and investment property	1,044,516	1,248,062	1,639,005	19.49%
Other assets	277,326	230,919	234,380	-16.73%
Total assets	41,449,177	56,905,090	50,823,678	37.29%

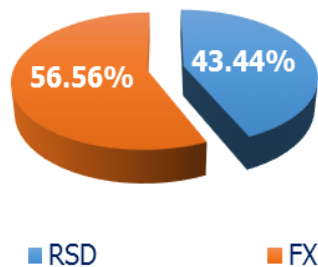
*The positions of „Loans to clients“ and „Loans to banks and other financial organizations“ differ from the positions „Loans and receivables from clients“ and „Loans and receivables from banks and other financial organizations“ presented in the official Balance sheet form for the amount of claims for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

The following graphs present the currency structure of assets as at 31.12.2017 and 31.12.2018 where it is possible to notice a slight increase in the share of dinar assets in total assets, from 38.51% to 43.44%:

**Structure of Assets
31.12.2017**



**Structure of Assets
31.12.2018**



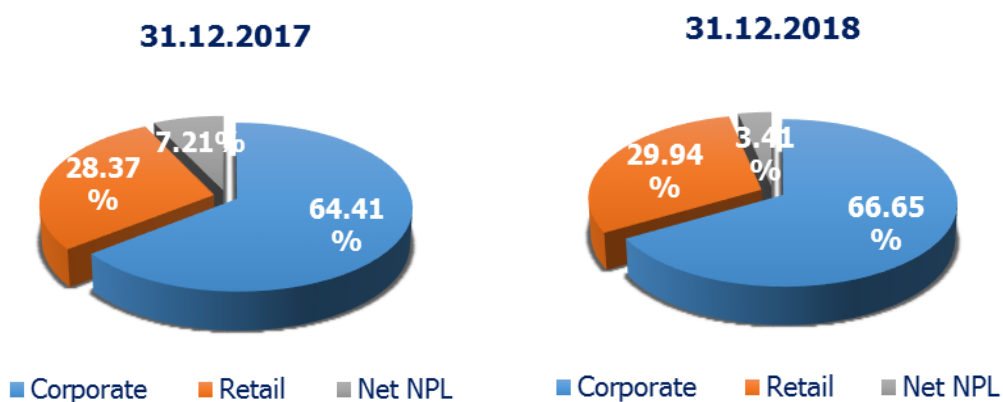
3.1.1 Loans to clients

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. This approach and strategic orientation enabled the Bank to realize plans for 2018, both in the sector of lending to the corporate and retail sector, continuing a positive growth trend from 2017.

The structure of position loans to clients as of December 31st 2017 and December 31st 2018 is given in the following table:

	(in RSD thousand)			
	31.12.2017	31.12.2018	Plan 2018	% of change
Loans to clients - net	28,907,976	38,786,695	35,458,380	34.17%
Corporate clients without NPL	18,620,433	25,850,569	21,866,001	38.83%
Retail clients without NPL	8,202,223	11,614,258	11,464,876	41.60%
NPL (net)	2,085,320	1,321,868	2,127,503	-36.61%

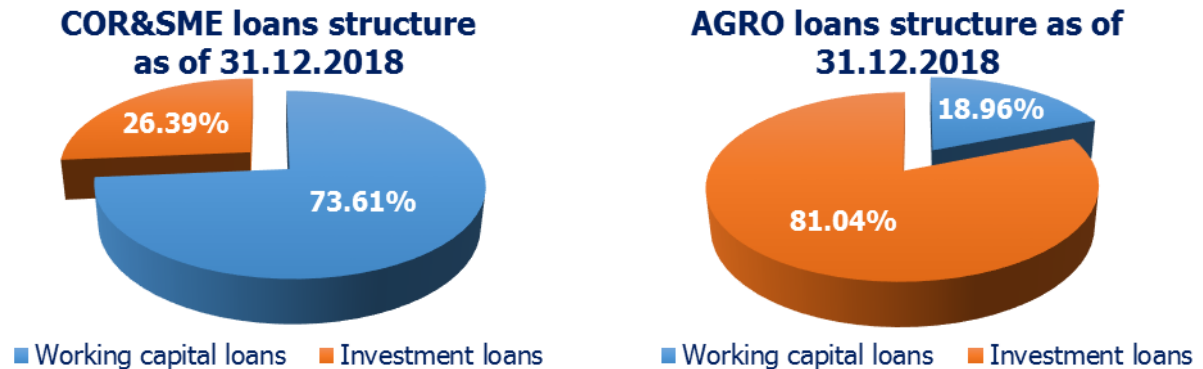
The Bank's net loan portfolio increased during 2018 by 34.17%. Corporate loans increased by RSD 7,230,136 thousand, retail loans increased by RSD 3,412,035 thousand, while the net NPL decreased by RSD 763,452 thousand.



In 2018 the Bank disbursed loans to corporate, SME and retail clients in the amount of RSD 30,325 million.

Gross loans - Corporate

Gross corporate loans, including gross NPL, as of December 31st 2018 amounted to RSD 28,455,074 thousand with growth of 22.40% comparing to the end of 2017. In the following graphs structure of these loans is presented:



The most important activities of Corporate and SME Marketing Division in 2018 were as follows:

- Bank realized RSD 23,394 million in Corporate and SME through 4,115 loans.
- In 2018 COSME program (EU program for competitiveness of SME clients) was the main focus and core product which covers working capital and investment loans secured with COSME guarantee. Bank disbursed 1,119 COSME loans in the amount of RSD 5,456 million in 2018.
- 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 2018”. Five banks took part in this Program. The Bank has granted RSD 503 million through 83 investment loans.
- 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 started in 2018 and as of December 31st 2018 the Bank granted 30 loans in the amount of RSD 1,607 million, out of which realized amount equals RSD 1,206 million.
- Bank started Agro business in the second quarter of 2018. All products and procedures are prepared and the Bank also signed contract with Ministry of agriculture for subsidized loans for working capital and agro equipment. The Bank realized RSD 281 million in Agro segment in 2018.

Gross loans - Retail

Gross retail loans as of December 31st of 2018 amounted to RSD 11,751,582 thousand with the following structure:

	(in RSD thousand)		
Loan type	31.12.2017	31.12.2018	% change
Cash loans	4,529,143	6,632,890	46.45%
Housing loans	2,989,251	4,275,124	43.02%
Consumer loans	588,305	595,635	1.25%
Allowed overdraft	125,995	138,541	9.96%
Other	89,044	109,392	22.85%
Total	8,321,738	11,751,582	41.22%

Retail Marketing and ADC Division realized numerous activities in 2018 with an aim to improve products and services available to retail clients:

- New placements in the amount of RSD 6,588 million resulted in increase of market share, from 1.03% at the end of 2017 to 1.30% at the end of 2018. The growth of the loan portfolio was 41%, while the number of credit clients increased by 15%.
- The most significant result was achieved by realization of two cash and refinancing loans campaign of which one was supported by TV commercial. In 2018 the Bank realized RSD 4,754 million through cash loans to employed persons and pensioners that represents 1.70% of total amount of disbursed cash loans in the market during respected period.
- The active approach on the market and improvement in loan process has resulted in significant increase in the number and level of placement of housing loans. Thus, in 2018 the Bank placed RSD 1,585 million through 255 loans, which represents 2.02% of total amount of disbursed housing loans in banking market during respected period. Result is significantly better than results in placement for whole 2017, when RSD 733 million was realized through 132 loans.
- 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. Preconditions have been created that in the first half of 2019 the project will be completed by beginning of the issuance of new types of cards and the development of the receiving network.

3.2. Liabilities

Total liabilities as of December 31st 2018 amounted to RSD 56,905,090 thousand with the following structure:

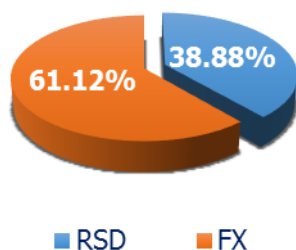
	(in RSD thousand)			
Passive	31.12.2017	31.12.2018	Plan 2018	% of change
Deposits from banks and other financial organizations	3,190,355	3,724,393	2,245,697	16.74%
Deposits from other clients	23,449,090	32,239,586	29,666,845	37.49%
Funds borrowed	7,585,899	8,833,825	7,800,844	16.45%
Other liabilities	1,104,126	955,601	158,972	-13.45%
Total liabilities	35,329,470	45,753,405	39,872,357	29.50%
Share capital	4,248,483	8,972,603	8,966,242	111.20%
Current period profit	194,631	361,725	295,487	85.85%
Undistributed profit from previous years	0	52,373	0	
Reserves	1,676,593	1,764,984	1,689,592	5.27%
Total capital	6,119,707	11,151,685	10,951,321	82.23%
Total passive	41,449,177	56,905,090	50,823,678	37.29%

*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. Additionally, position „Fund borrowed" is excluded from aforementioned positions as well. Position "Other liabilities" includes position "Provisions" from the official Balance sheet form.

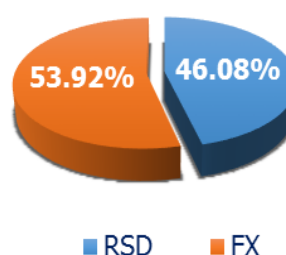
The most significant changes on the Bank's liabilities side during 2018 were related to the increase in the Bank's share capital by the parent bank in the amount of RSD 4,724,120 thousand, as well as the increase in client deposits in the amount of RSD 8,790,496 thousand.

The following graphs present the currency structure of liabilities as at 31.12.2017 and 31.12.2018:

**Structure of liabilities
31.12.2017**



**Structure of liabilities
31.12.2018**



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 2017 and December 31st 2018 is presented in the following table:

(in RSD thousand)			
Deposits from banks and other financial organizations	31.12.2017	31.12.2018	% of change
Transaction deposits	14,956	15,633	4.53%
Other deposits	3,175,399	3,708,760	16.80%
Total	3,190,355	3,724,393	16.74%

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 2017 and December 31st 2018 is presented in the following tables and graphs:

(in RSD thousand)				
Deposits from other clients	31.12.2017	31.12.2018	Plan 2018	% of change
Transaction deposits	10,134,074	14,215,085	13,355,990	40.27%
Other deposits	13,315,016	18,024,501	16,310,855	35.37%
Total	23,449,090	32,239,586	29,666,845	37.49%

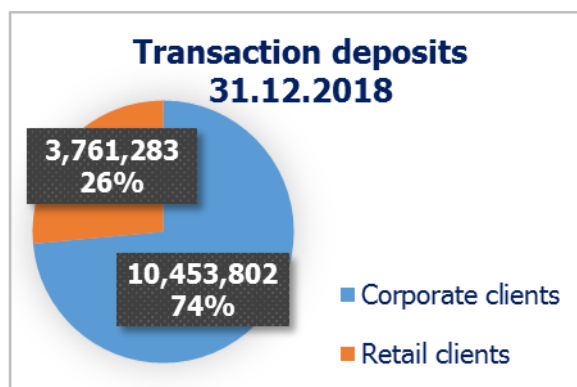
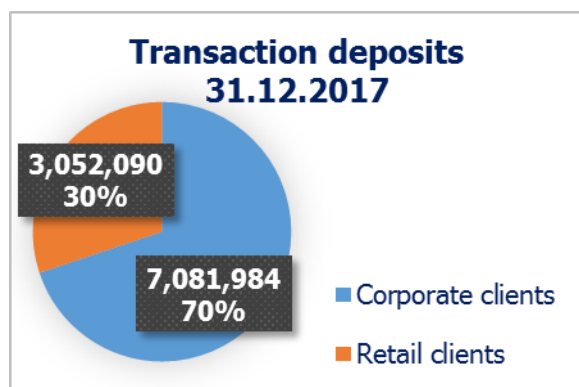
Total increase of deposits from other clients in 2018 amounted to 37.49%.

(in RSD thousand)				
Deposits from other clients	31.12.2017	31.12.2018	Plan 2018	% of change
Corporate clients	11,217,654	16,792,417	14,537,936	49.70%
Retail clients	12,231,436	15,447,169	15,128,909	26.29%
Total	23,449,090	32,239,586	29,666,845	37.49%

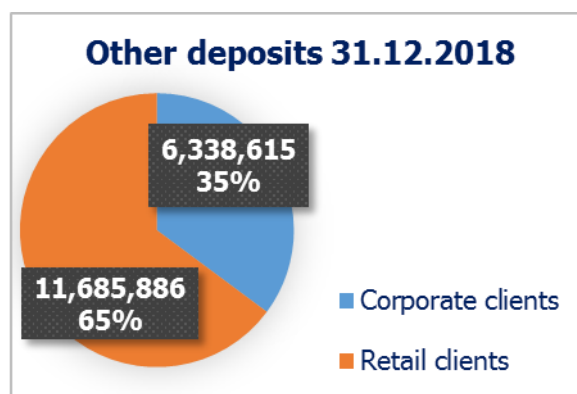
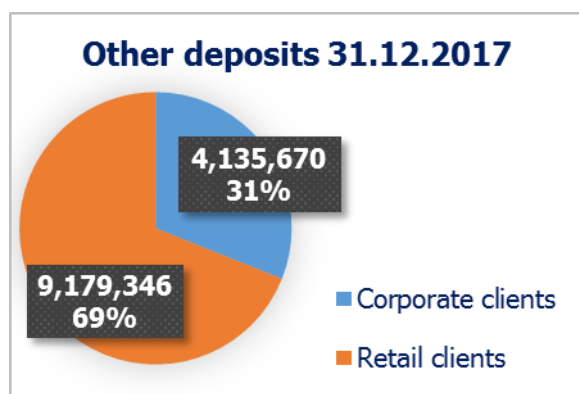
By constant monitoring of market trends, individual and proactive approach to clients, the Bank increased the level of deposits from corporate clients by 49.70%, and the level of deposits from retail clients by 26.29%.

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	31.12.2017	31.12.2018	% of change
- EIB	3,719,147	5,725,497	53.95%
- European Fund for Southeast Europe	1,184,727	1,181,946	-0.23%
- EAR long-term revolving line	1,085,062	865,516	-20.23%
- GGF	699,580	590,973	-15.52%
- Demir-Halk Bank (Nederland) N.V.	592,364	295,487	-50.12%
- KfW	215,405	107,450	-50.12%
- Italian Republic Government	89,614	66,956	-25.28%
Total	7,585,899	8,833,825	16.45%

In 2018, the Bank paid the principle of long-term loans to IFIs on a regular basis in the amount of EUR 15,969 thousand. In the same period, the Bank withdrew EUR 26,678 thousand of IFI's funds, from which refers to EIB credit line in the amount of EUR 23,983 thousand and EAR long-term revolving line in the amount of EUR 2,695 thousand.

3.2.3 Capital

The capital of the Bank as of December 31st 2018 amounted to RSD 11,151,685 thousand and comprised of the following:

	(in RSD thousand)		
Capital	31.12.2017	31.12.2018	% of change
Share capital – ordinary shares	1,819,820	5,658,940	210.96%
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	1,827,323	2,712,323	48.43%
Revaluation reserves	364,162	452,553	24.27%
Reserves from profit	1,312,431	1,312,431	0.00%
Undistributed profit from previous years before the first application of IFRS 9	0	194,631	-
Decrease in Undistributed profit from previous years from the first application of IFRS 9 as of 1.1.2018.	0	-142,258	-
Profit of the current year	194,631	361,725	85.85%
Total	6,119,707	11,151,685	82.23%

On February 20th 2018 the Bank increased share capital by issuing a new issue of shares (XXXI) in the amount of 236,412 number of ordinary shares with nominal value of RSD 10,000.00 per share. Share capital increased from RSD 4,248,483 thousand to RSD 6,612,603 thousand (approximately EUR 20 million). The new issue of shares (XXXII) of RSD 2,360,000 thousand (147,500 ordinary shares with nominal value of RSD 10,00.00 per share and share premium in the amount of RSD 885,000) is realized on August 1st 2018, that influenced increase of share capital from RSD 6,612,603 thousand to RSD 8,972,603 thousand.

The Bank implemented IFRS 9 standard starting from January 1st 2018 which is followed by adoption of new Accounting policies in the first quarter of 2018. Bank's business model of valuation of placements, loans and receivables and documentary operations, except debt securities is amortized cost ("hold to collect contractual cash flows" and "solely payments of principal and interest" the so-called HTC and SPPI model). All contract clauses passed SPPI test and all placements are measured at amortized cost. The negative effects of the first implementation of the IFRS 9 was booked in the 2018 in the amount of RSD 142,258 thousand (EUR 1,204 thousand) against undistributed profit from 2017 in accordance with Decision of the Bank's Assembly.

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

Information on shares	31.12.2017.	31.12.2018.
Number of shareholders	6	1
Number of shares	242,116	626,028
Nominal value per share in RSD	10,000	10,000
Net book value per share in RSD	25,275.93	17,813.40

On November 27th of 2018 the process of buying shares from minority shareholders has ended. In this way, Turkiye Halk Bankasi A.S. became the only shareholder of the Bank.

The Bank on June 22nd 2018 adopted the Decision on exclusion of shares from the Belgrade Stock Exchange and after conducting this procedure it ceased to be open joint stock company pursuant to the Law on Capital Market.

4. OFF-BALANCE SHEET ITEMS

During 2018, 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 2017 and December 31st 2018 is presented in the following table:

Off-balance sheet items	(in RSD thousand)		
	31.12.2017	31.12.2018	% of change
Contingent liabilities (guarantees, avals, acceptances and irrevocable liabilities)	6,400,560	9,692,565	51.43%
Operations for and on behalf of third parties	278,305	271,834	-2.33%
Derivatives (SWAP)	36,024	1,579,341	4284.26%
Other off-balance sheet items	45,919,922	47,548,920	3.55%
Total	52,634,811	59,092,660	12.27%

The following table compares the structure of the item guarantees, avals, acceptances and irrevocable liabilities as of December 31st 2017 and December 31st 2018:

Contingent liabilities (guarantees, avals, acceptances and irrevocable liabilities)	(in RSD thousand)		
	31.12.2017	31.12.2018	% of change
Performance guarantees	3,313,643	5,337,428	61.07%
Payment guarantees	1,384,362	2,116,315	52.87%
Unused limits which cannot be revoked	1,259,108	1,813,172	44.00%
Issued foreign currency letters of credit with Banks' confirmation	385,037	384,132	-0.24%
Issued uncovered letters of credit	58,410	41,518	-28.92%
Total	6,400,560	9,692,565	51.43%

In the following table, position "Other off-balance sheet items" is presented.

Other off-balance sheet items	(in RSD thousand)		
	31.12.2017	31.12.2018	% of change
Received fixed assets (buildings, cars, land etc.) as collateral in favor of the Bank	32,438,723	30,019,818	-7.46%
Receivables for evidencing interest	4,542,059	4,713,469	3.77%
The unused amount of combined (revolving loans plus off-balance) framework	2,245,606	3,569,773	58.97%
Write-off of receivables – directly write-off of receivables in accordance with IAS 39	2,149,401	3,208,517	49.27%
The unused amount of revolving loans	1,564,945	2,432,907	55.46%
Received guarantees and other collaterals as collateral in favor of the Bank	1,402,964	1,966,033	40.13%
Other off-balance sheet items	1,493,514	1,443,424	-3.55%
The unused amount of off-balance framework	82,710	194,979	135.74%
Total	45,919,922	47,548,920	3.55%

5. STATEMENT OF PROFIT AND LOSS FOR THE PERIOD

The Income Statement for the period from January 1st to December 31st 2018 is presented in compliance with the Law on Accounting, IFRS and NBS regulations.

The Bank finished its operation in 2018 with a profit of RSD 361,725 thousand.

(in RSD thousand)

Income Statement	31.12.2017	31.12.2018	Plan 2018	% of change
Interest income	1,754,993	2,068,379	2,105,234	17.86%
Interest expense	265,688	315,868	272,025	18.89%
Net interest income	1,489,305	1,752,511	1,833,210	17.67%
Fee and commission income	710,404	843,582	851,556	18.75%
Fee and commission expense	106,059	145,030	141,926	36.74%
Net fee and commission income	604,345	698,552	709,630	15.59%
Net trading income	35,518	13,866	11,827	-60.96%
Other operating income	21,116	16,380	23,654	--22.43%
Net income/(losses) on impairment of financial assets	-269,765	-75,127	-224,716	-72.15%
Total net operating income	1,880,519	2,406,182	2,353,605	27.95%
Salaries, salary compensation and other personal expenses	648,765	802,875	780,593	23.75%
Depreciation costs	151,567	150,143	189,235	-0.94%
Other expenses	885,556	1,091,439	1,088,099	23.25%
Total operating expenses	1,685,888	2,044,457	2,057,926	21.27%
NET PROFIT BEFORE TAX	194,631	361,725	295,679	85.85%

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

In 2018, the Bank increased its net interest income by 17.67%, or by RSD 263,206 thousand, comparing to 2017, while net income from fees and commission is higher by 15.59% in the observed period, or by RSD 94,207 thousand. Total operating expenses are higher by 21.27%, or by RSD 358,569 thousand comparing to 2017.

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

	(in RSD thousand)		
Interest income	31.12.2017	31.12.2018	% of change
Corporate clients	909,642	989,956	8.83%
Retail clients	602,376	773,992	28.49%
Securities	212,996	268,481	26.05%
Other	29,979	35,949	19.91%
Total	1,754,993	2,068,379	17.86%

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

	(in RSD thousand)		
Fee and commission income	31.12.2017	31.12.2018	% of change
Fees from payment operations	438,884	483,145	10.08%
Fees from guarantees	83,397	111,321	33.48%
Fees from FX changes	91,831	103,389	12.59%
Fees from checks and payment cards	37,971	63,446	67.09%
Fees from loan processing	34,723	45,041	29.72%
Fees from SWAP	9,211	25,611	178.05%
Other fees	14,387	11,629	-19.17%
Total	710,404	843,582	18.75%

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

	(in RSD thousand)		
Interest expense	31.12.2017	31.12.2018	% of change
Deposits – retail	84,468	86,131	1.97%
Deposits – corporate	72,406	85,098	17.53%
Banks deposits	20,659	42,525	105.84%
Borrowings FI's	88,155	102,114	15.83%
Total	265,688	315,868	18.89%

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

	(in RSD thousand)		
Fee and commission expenses	31.12.2017	31.12.2018	% of change
Payment operations	70,784	86,295	21.91%
VisaCard and MasterCard	22,486	43,740	94.52%
Credit biro	12,101	13,862	14.55%
Credit lines	688	1,133	64.68%
Total	106,059	145,030	36.74%

6. CASH FLOWS

Cash flows from operating activities during 2017 and 2018 are presented in the table below:

(in RSD thousand)

Cash inflows from operating activities	I - XII 2017	I - XII 2018	Change
Interest	1,615,643	2,018,094	402,451
Fees	712,474	858,916	146,442
Other operating income	5,538	3,849	-1,689
Dividend and share in profit	759	886	127
Total cash inflows	2,334,414	2,881,745	547,331
Cash outflows from operating activities			
Interest	245,085	291,577	46,492
Fees	121,289	141,536	20,247
Salaries	651,930	751,379	99,449
Tax and contribution	142,180	185,280	43,100
Other operating expenses	747,029	926,684	179,655
Total cash outflows	1,907,513	2,296,456	388,943
Net cash inflows from operating activities	426,901	585,289	158,388

Cash inflows from operating activities in 2018 increased for RSD 547,331 thousand comparing to the same period in 2017.

Cash outflows from operating activities increased for RSD 388,943 thousand comparing to 2017.

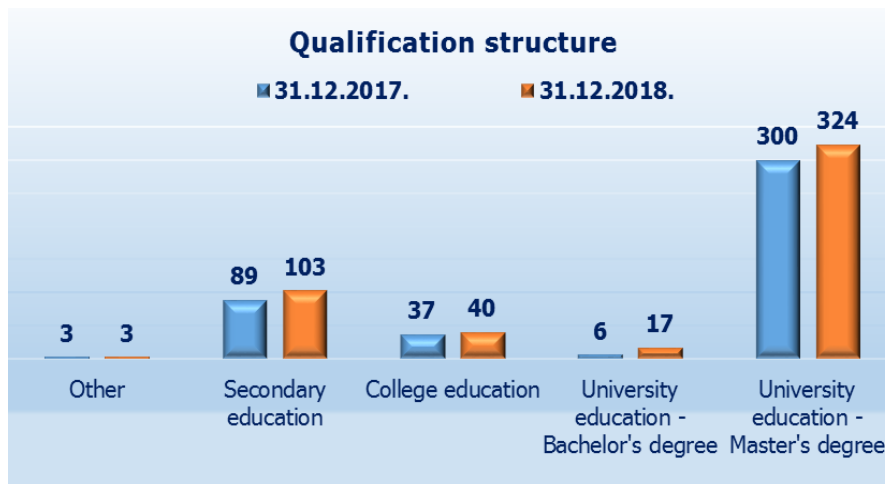
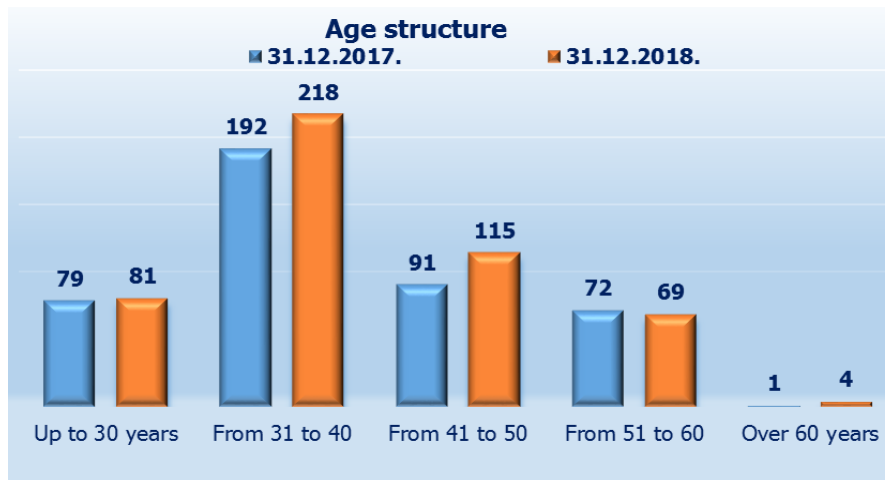
Net cash inflows from operating activities in 2018 amounted to RSD 585,289 thousand which is increase of RSD 158,388 thousand comparing to same period in 2017.

7. HUMAN RESOURCES

Employees present one of the most important resources on which the Bank's overall activities are based. At the end of 2018 the Bank had 487 employees and the following structure:

Number of employees	31.12.2017.	31.12.2018.	Plan 2018
Headquarter	187	203	206
Branches	248	284	268
Total	435	487	474

The following graphs show the qualification and age structure of employees as of December 31st 2017 and December 31st 2018:



In the qualification structure of employees at the end of 2018, the share of employees with higher education was 70.02%, while the participation of younger than 40 years was 61.40%. 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 2018 amounted to RSD 802,875 thousand and accounts for 102.85% of planned budget for 2018.

8. INVESTMENT PLAN

During 2018 total investments in fixed assets, investment property and intangible investments amounted to RSD 362,828 thousand.

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

(in RSD thousand)

Investments	Buildings	Equipment	Investment property	Intangible investments	Total	Plan for 2018
Balance 01.01.2018	475,163	342,679	127,727	98,947	1,044,516	1,044,516
Total increase:	23	159,070		203,735	362,828	785,994
IT		55,626		203,735	259,361	663,899
Adaption of business premises	23	67,031			67,054	79,900
Other		36,413			36,413	42,195
Total decrease:	29,428	99,033	3,844	29,544	161,849	191,506
Depreciation	17,722	99,033	3,844	29,544	150,143	189,235
Sell	11,706				11,706	0
FX effects					0	2,271
Revaluation - net	2,567				2,567	
Balance 31.12.2018	448,325	402,716	123,883	273,138	1,248,062	1,639,005

The investments of the Bank are in accordance with the adopted budget, except in the part of IT investments, where replacement of Bank's "Core" system is planned in the amount of EUR 3 million, but was not realized in 2018. The activities on this project have been started with selection of the external consultant and will be continued in 2019.

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

As of December 31st of 2018 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 31st 2018
Regulatory Capital	Min 10,000,000 €	87,827,287 €
Capital adequacy ratio	min 8%	27.82%
Foreign exchange risk ratio	max 20%	0.63%
Liquidity ratio	Min 1	1.69
Narrow liquidity ratio	Min 0.7	1.42
Exposure to one person or group of related persons	max 25%	12.34%
Sum of large exposures	max 400%	12.34%
Investment in non-financial sector	max 10%	0%
Investments in fixed assets and investment property	max 60%	9.39%

Business policy for 2018 as one of the main goals in the risk management process defines maintenance capital adequacy ratio above 17%. As of December 31st of 2018 the capital adequacy ratio was above the stated target (27.82%).

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 2018 was 25.95%, which is significantly higher than 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 2018 the Bank is aligned with all indicators.

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,
- The Corporate and SME Marketing 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
	31.12.2017.	31.12.2018.	31.12.2017.	31.12.2018.	
High – Exclusion List	-	2	-	238,534	238,534
High – Category A	8	8	70,640	72,576	1,936
High	244	292	7,682,454	7,895,397	212,943
Medium	1,048	1,359	11,748,016	16,655,673	4,907,657
Low	1,975	2,287	13,960,351	19,560,691	5,600,340
Total	3,275	3,948	33,461,461	44,422,871	10,961,410

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

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 as of and for the year ended 31st December 2018.

On 1st January 2019 the Bank has implemented the new accounting standard IFRS 16 - Leases.

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 will have an excellent base for rapid growth in the future 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 2018.

VIII EXISTENCE OF AFFILIATES

As of December 31st 2017 the Bank operates in business network of 24 branches, 9 sub-branches and 4 cash desks. As at 31st December 2018 the Bank was comprised of 8 branches in Belgrade, 2 branches in Čačak and branches located in the towns of Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar and Subotica and 9 sub-branches in Čačak, Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac and Tutin.

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 31.12.17	% of the share in gross risk-weighted assets		Classified amount as at 31.12.18	% of the share in gross risk-weighted assets	
A	23,601,471	54.12%	82.7%	29,638,883	50.67%	85.00%
B	12,454,845	28.56%		20,083,191	34.33%	
V	2,070,139	4.75%	4.7%	5,574,816	9.53%	9.53%
G	1,273,389	2.92%	12.6%	483,354	0.83%	5.47%
D	4,207,751	9.65%		2,715,735	4.64%	
Total	43,607,595	100.00%		58,495,979	100.00%	

Total classified asset increased in 2018 compared to the end of 2017 by 34.46%.

Compared to December 31st 2017, the structure of the Bank's portfolio has improved by increase of share of receivables classified in A and B in total classified asset by 2.30 p.p. and decrease of receivables classified in categories G and D are reduced by 7.13 percentage points.

Portfolio quality as of December 31st 2018 is in low risk level, taking into account that less than 10% of portfolio is classified in categories G and D and it is improved compared to December 31st 2017, when the quality of the Bank's portfolio was in medium risk, due to the collection of non-performing exposures and write-off of receivables that were 100% impaired.

Loan loss reserves and required reserves pursuant to the NBS Decision on Classification of Balance Sheet and Off-Balance Items of Banks

(in RSD thousand)

	31.12.2017	31.12.2018	Change
Loan loss reserve for potential losses	4,872,042	3,544,296	-1,327,746
Required reserves for estimated losses without coefficient	2,300,006	2,201,860	-98,146
Required reserve for estimated losses with coefficient	713,002	0	-713,002

Required reserve for estimated losses starting from June 30th 2018 by using coefficient is not calculated as a deductible item of capital, due to the fact that NPL ratio started from June 30th 2018 is below 10%.

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)		
	31.12.2017	31.12.2018	Change
NPL portfolio	4,504,911	2,569,350	-1,935,561

NPL as of December 31st of 2018 was reduced by RSD 1,935,561 thousand compared to December 31st of 2017 as result of NPL collection and accounting write-off conducted for 100% impaired non-performing receivables. In 2018, the Bank has collected EUR 7.9 million of NPL, while accounting write-off of 100% impaired non-performing receivables in the first three quarters of 2018 amounted to EUR 12.9 million. By accounting write-off of receivables and transfer to off-balance sheet items the Bank does not waive from the collection of exposure to non-performing clients and legal rights arising from such loans.

Share of gross NPLs in total gross Bank's loans

Ratio	31.12.2017	31.12.2018	Change
Share of NPLs in total loans	14.40%	6.42%	-7.98 p.p.

The credit risk management policy 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 10%. As of December 31st of 2018 the Bank is below defined limit.

NPL coverage

Ratio	31.12.2017	31.12.2018
Ratio of NPL coverage with Impairment provisions for loans	55.48%	54.54%
Ratio of NPL coverage with NPL Impairment provisions	53.69%	47.97%
Cost of risk	0.86%	0.19%

Credit Risk Management Policy defines the limit of Cost of Risk coefficient as ratio of cost of impairment (as per income statement) and loans in amount of 2%. As of December 31st of 2018 the Bank is in line with this indicator.

The Strategy for NPL Management and Collection defines basic ratios and their values for ensuring satisfactory coverage of NPLs, as well as the level of loan loss reserves that enables minimizing negative effects of any deterioration of asset quality on the Bank's capital adequacy. In accordance with this Strategy, the bank's target is to maintain NPL coverage ratio by impairment provisions of total loans above 55%. As of December 31st of 2018 the Bank is slightly below this indicator as direct consequence of write-offs of 100% impaired receivables.

In Credit Risk Management Policy, 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 10%. The share of bad non-performing exposures (NPE) as of December 31st 2018 in total classified assets amounts to 4.70% and is significantly below the defined limit. Participation decreased compared to December 31st 2017 for 6.79 p.p. due to the reduction of non-performing loans and in the same time increasing of the loan portfolio.

Liquidity Risk

Liquidity Ratio and Narrow Liquidity Ratio prescribed by NBS in the period from January 1st to December 31st of 2018

	Liquidity Ratio	Narrow Liquidity Ratio
Value as of December 31 st	1.69	1.42
Average	1.53	1.27
Maximum	2.02	1.70
Minimum	1.28	1.02
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 of 2018 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 01.01-31.12.2018 – internally established

	Min.	Max.	Average	Limit
Liquid assets ratio	23.04%	29.26%	26.42%	Min 20.00%
Net loans to total deposits ratio	105.63%	112.68%	110.50%	Max 200.00%
Customers' deposits to total deposits ratio	83.89%	89.64%	85.91%	Min 75.00%
Deposit concentration ratio	20.53%	25.16%	23.25%	Max 30.00%

The Bank was within internally prescribed liquidity limits during the period from 01.01-31.12.2018.

Foreign exchange risk

FX Risk ratio in the period from 01.01 - 31.12.2018

Value as of December 31 st	0.63%
Average	1.37%
Maximum	5.68%
Minimum	0.18%
Limit NBS	Max 20%

Foreign currency risk measured by FX Risk ratio was located in the low risk category during 2018.

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 2018

	(in RSD thousand)
Total net weighted position	105,379
Equity	10,380,711
Total net weighted position and equity ratio	1.01%
Internally prescribed maximum	20%

Operational risk

In the period from January 1st to December 31st of 2018 in terms of Operational risk, 129 events were reported in the Application of Operational risks.

Ninety two of all events of operational risk that were reported referred to cash shortage or surpluses and have been successfully resolved (58 events of cash shortage and 34 events of cash surpluses).

Number of events	129
Cash shortage	58
Cash surplus	34
Other	37
Gross loss in RSD thousand	40,196
Net loss in RSD thousand	6,506

The Bank performs also risk assessment of Outsourcing, on the basis of 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 2018**

	(in RSD 000)	% of equity	Limit NBS
Persons related to the Bank	1,281,466	12.34%	-
Large exposures	1,281,466	12.34%	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 300.00%.

	31.12.2017	31.12.2018	Prescribed value
Concentration ratio of 20 largest clients/groups of related parties	145.95%	89.69%	Max 300% of regulatory capital

Additionally, in order to manage the concentration risk, by the Credit Risk Management Policy and Procedure for the Credit Risk Management at the portfolio level, exposure limits have been established to specific geographical areas and to a specific sector / business activity, which provide diversification of the portfolio. The Credit Risk Management Policy has defined a maximum exposure limit of 30% share in classified asset for a specific geographical area and sector / business activity.

Investment Risk

The Bank did not have investments in non-financial sector as of December 31st of 2018. 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 2018

	Investments into non-financial sectors	Investments into fixed assets	Total
Amount (000 RSD)	0	974,925	974,925
Share in equity	0%	9.39%	9.39%
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).

During 2018, the Bank had exposures to clients, which operate in countries that are classified as low-risk and medium-risk countries, according to 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 31.12.2018 were Germany, Belgium, Austria and USA. Countries in the category of medium risk were Turkey, Macedonia, Croatia and Albania. Exposure to countries in the category of medium risk was significantly below adopted internal limits during the period of December 2018.

Review of countries of clients whose exposure is involved in country risk as of December 31st 2018

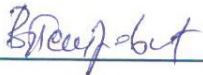
Country	Risk category	Limit	Share in Bank capital
Germany	low	without limit	3.75%
Belgium	low	without limit	0.12%
Austria	low	without limit	2.38%
USA	low	without limit	0.79%
Turkey	medium	100% regulatory capital	23.75%
Macedonia	medium	100% regulatory capital	3.23%
Croatia	medium	10% regulatory capital	0.04%
Albania	medium	25% regulatory capital	1.14%

X CORPORATE GOVERNANCE RULES

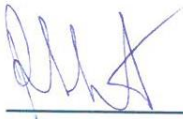
Corporate governance rules of Halkbank a.d. Beograd are regulated in the following by-laws:

- 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
Radojica Popović



President of Executive Board
Kenan Bozkurt