Arctic Securities Investor Conference

B2 HOLDING®
Making each other better

Zagreb, 19 January 2017

Agenda

1. Introduction to B2Kapital SEE

- A. Region overview
- B. Operations in general
- C. Business drivers

2. Croatia at a glance by KF Finance

- A. Economic Situation in Croatia
- B. Political Situation in Croatia
- C. Banking Sector in Croatia
- D. NPLs in Croatia

A. Region overview

Croatia

Country overview

- Population = 4,2 milion
- GDP per capita = 10.400 €
- Credit rating (S&P) = BB

B2 in Croatia

- Established in July 2013
- Number of employees = 141

Slovenia

Country overview

- Population = 2 milion
- GDP per capita = 18.700 €
- Credit rating (S&P) = A

B2 in Slovenia

- Established in August 2014
- Number of employees = 9

Serbia

Country overview

- Population = 7,2 milion
- GDP per capita = 4.700 €
- Credit rating (S&P) = BB-

B2 in Serbia

- Established in August 2014
- Number of employees = 10

Montengero

Country overview

- Population = 0,6 milion
- GDP per capita = 6.300 €
- Credit rating (S&P) = B+

B2 in Montenegro

- Established in September 2014
- Number of employees = 0*

Bosnia and Herzegovina

Country overview

- Population =3,8 milion
- GDP per capita = 4.300 €
- Credit rating (S&P) = B

B2 in Montenegro

- Established in December 2016
- Number of employees = 0*

*Collection activities outsourced

Country overview data source: EUROSTAT, World Bank

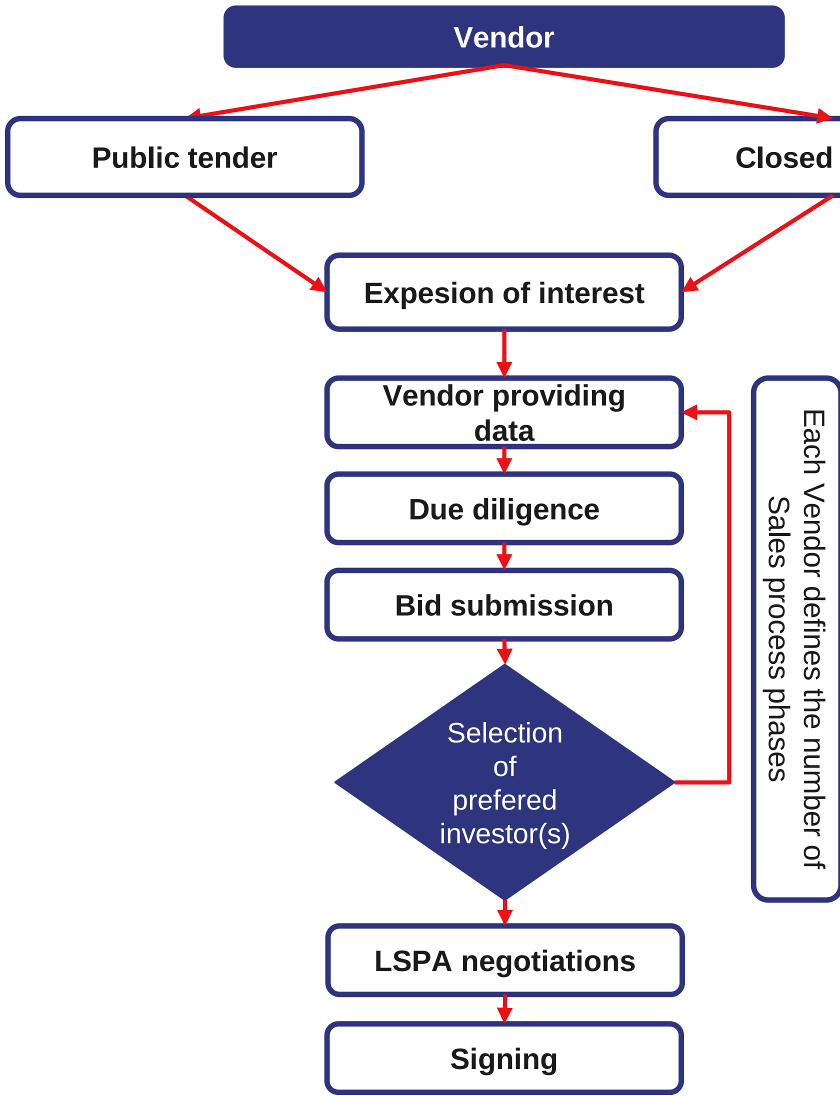
B. Operations in general

1. Acquisition process

2. Portfolio onboarding

3. Collection overview

1. Acquisition process



2. Portfolio onboarding

Data onboarding

Agreeing on import file with the Vendor

↓

Comparing data after purchase with data disclosed during Sales process

↓

Importing portfolio into the system
**highly sophisticated software used*

Documentation onboarding

Taking over the documentation

↓

Reconciliation of received documentation and balance amount

3. Collection overview

Retail portfolios

- **Mass collection**
- **Key role = IT system**
- **Amicable approach**

Non-retail portfolios

- **Case by case collection**
- **Key role = experienced employees**
- **Legal approach**

C. Business drivers

- **Growth potential**
  - Relatively new market
  - Growing number of transactions and Vendors
  - Legal legislation changes alowing NPL transactions (e.g. in Retail sector)
  - New product types / Vendors
    - Insurance
    - Other crediting institutions
    - Telecom and utilities
- **Challenges**
  - Market not fully developed
    - Limited number of experienced employees
    - In some Counties certain licences needed for purchase of NPL portfolios

C. Business drivers

- **Licences/approvals for NPL portfolio purchase from the Bank**
  - Croatia
    - Approval of Central Bank (in certain cases)
  - Serbia
    - Non-Retail portfolios – opinion of Central Bank
    - Retail portfolios – banking licence
  - Montenegro
    - Opinion of Central Bank (in certain in cases)

- **Licences/approvals for NPL portfolio purchase from other Vendors**
  - Slovenia
    - Licence from Ministry of Economic Development and Technology

C. Business drivers

- **Areas to improve**
  - Cost to collect

- **Compliance**
  - Employees educated to use high ethical standards, soft communication skills and to communicate with clients in accordance with Personal Data Protection Law
  - Operating in compliance with Anti Money Laundering and Terrorist Financing Law
  - Following changes in legislation (Compliance officer in charge in Croatia)

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2. **Croatia at a glance by KF Finance**
   - **A. Economic Situation in Croatia**
   - B. Political Situation in Croatia
   - C. Banking Sector in Croatia
   - D. NPLs in Croatia
   - E. Appendix

CROATIA AT GLANCE

OVERVIEW

19TH JANUARY 2017

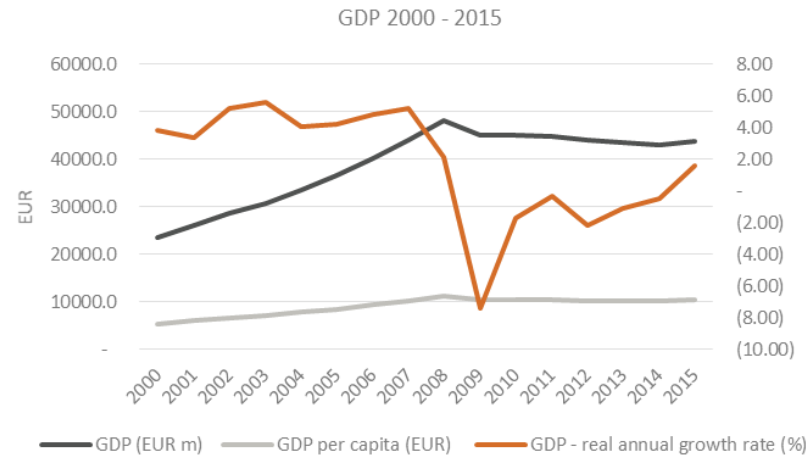
KF Finance
valuations & financial advisory
Ljubljana • Zagreb • Belgrade

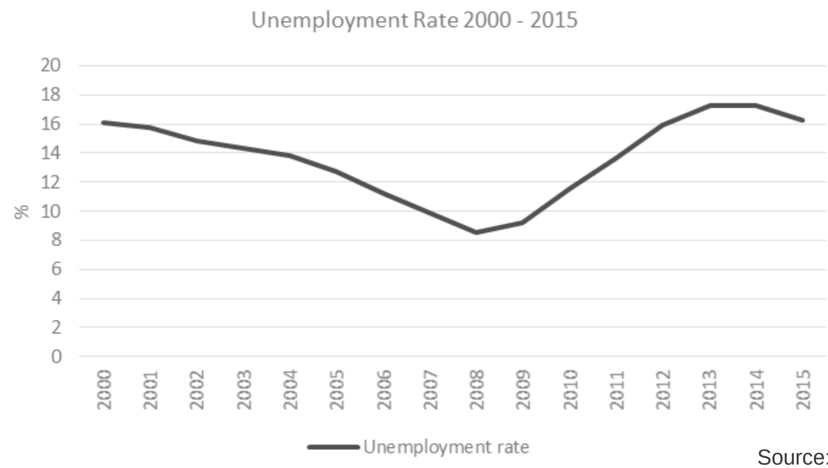
Recent Economic Developments

2016 in review

- In the Q3 2016, growth strengthened for the eight consecutive quarter to 2.8%, after six years of recession. This was the result of the growth in exports, increased private consumption, and a rebound of investment. Growth was broad-based, with an encouraging performance from industrial production and retail trade and robust tourist and construction activity1.
- As the economy recovered, the labor market continued to improve, with the survey-based unemployment rate dropping to 15.4% in the Q1 2016 (from 16.1% in the fourth quarter of 2015) and kept dropping trough the year. There are already shortages of low-skilled workers in construction, tourism, and other seasonal services2.
- Fiscal consolidation continued in 2016, with the general government deficit declining to 2.1% of GDP through March, due to rising tax revenues and social contributions and lower expenditures caused by the temporary financing in effect in the first quarter after the November 2015 general elections. At the end of May, public debt further declined to 83% of GDP1.
- The European Commission (EC) decided not to step up the Macroeconomic Imbalance procedure for Croatia because of a positive assessment of the country's National Reform Plan (NRP) and Convergence Program. However, the EC strongly recommended five measures:
  - (1) reducing the general government debt ratio, with a fiscal adjustment of at least 0.6% of GDP in 2017, and introducing a property tax and a debt management strategy;
  - (2) penalizing early retirement, accelerating the transition to full retirement age, and consolidating social benefits;
  - (3) reducing fragmentation and harmonizing wage-setting systems across the public administration system, reinforcing the monitoring of SOEs, and speeding up the process of divesting state assets;
  - (4) reducing para-fiscal charges and administrative burdens on businesses and removing regulatory restrictions on professions; and
  - (5) improving the quality and efficiency of the judicial system and the tax treatment of nonperforming loans.

Graphs





Source: CNB

1 Central National Bank (CNB)
2 National Statistics Bureau (DZS)

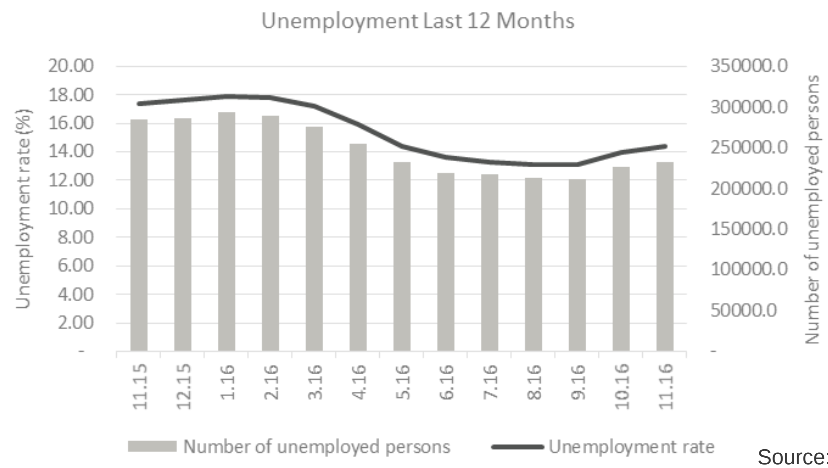
Unemployment

Steady Decrease of Unemployment

- In Q3 2016 unemployment rate continued to decrease, but with less intensity compared to H1 2016. Number of unemployed persons decreased by 4,2% in Q3 2016 while in H1 2016 average Q/Q decrease amounted to 5,7%. Main driver of the decrease is new employment while deletion from registry due to inactivity and migration accounted for the remaining part of decrease2.
- Furthermore, the unemployment decreased in the beginning of Q4 2016, and in October the unemployment decreased by further 3% when compared to Q3 average2. As stated the decrease can partially be connected with migration of people in developed EU countries as is shown by data of Croatian Central Bureau of Statistics (DZS), as well as by other EU countries bureaus of statistics.
- According to Croatian National Bank (CNB) projections, the unemployment rate in 2017. is expected to be below 14% with the same gross salary growth as in 2016. (1,8%), while the net salary should growth should be stronger due to income tax legislation changes effective from January 1st 20171.

	2012	2013	2014	2015	2016	2017
Number of employed	(1,2)	(1,5)	(2,0)	0,7	1,8	1,5
Unemployment rate	15,9	17,3	17,3	16,3	14,3	13,9
Average nominal gross salary	1,0	0,8	0,2	1,3	1,8	1,9

Graphs



Source: DZS

1 Central National Bank (CNB)
2 National Statistics Bureau (DZS)

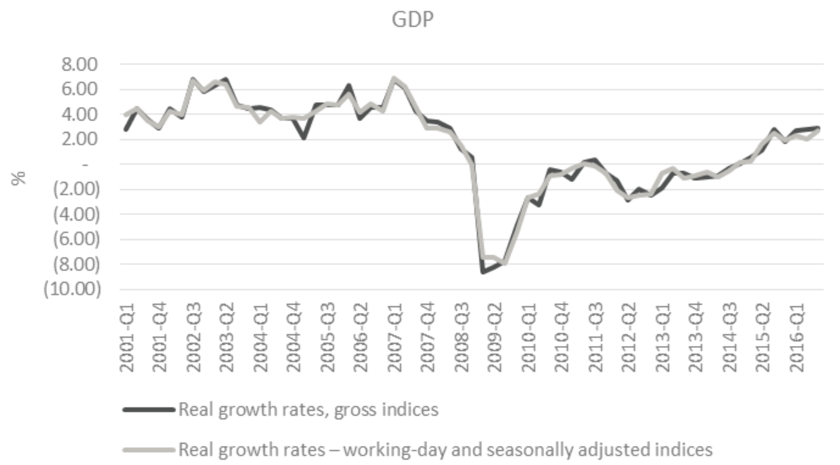
GDP

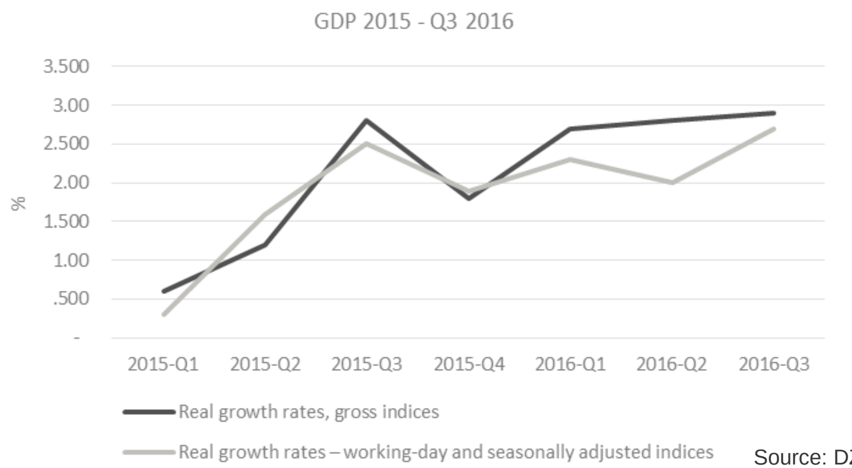
8 Consecutive Quarters of Growth

- Q3 2016 GDP real growth rate (gross) amounted to 2,9%, due to noticeable increase of services export which influenced net foreign demand to be positive. At the same time production side calculation of GDP shows that the annual growth in gross value added (GVA) of 2.7%, while the increase was recorded in all industries1.
- According to Central National Bank (CNB), GDP growth is expected to be 2,8% at the end of 2016., due to high growth rates in exports of goods and services, boosting investment activity and a significant increase in personal consumption. In 2017 a slight acceleration of GDP growth (to 3.0%) is expected, influenced by the effect of tax reform on personal consumption and investment. The exports of goods and services continue to individually make the greatest contribution to the overall growth of GDP, but notable increase of domestic demand is expected.
- When looking at different sources GDP growth is expected to be between 1,9% and 2,8% in 2016., while in 2017. GDP growth is expected to be between 2,0% and 3,2% with an average value of 2,4%.

Source	Date	2016	2017
Croatian National Bank (CNB)	Dec-16	2,8	3,0
Croatian Ministry of Finance	Dec-16	2,7	3,2
European Commision	Nov-16	2,6	2,5
Eastern Europe Consensus	Nov-16	2,4	2,3
EBRD	Nov-16	2,3	2,0
Addiko Bank Economic Research	Oct-16	2,7	2,2
Raiffeisen Research	Oct-16	2,3	2,5
IMF	Oct-16	1,9	2,1
World Bank	Jun-16	1,9	2,0
Min		1,9	2,0
Max		2,8	3,2
Average		2,4	2,4
Median		2,4	2,3

Graphs





Source: DZS

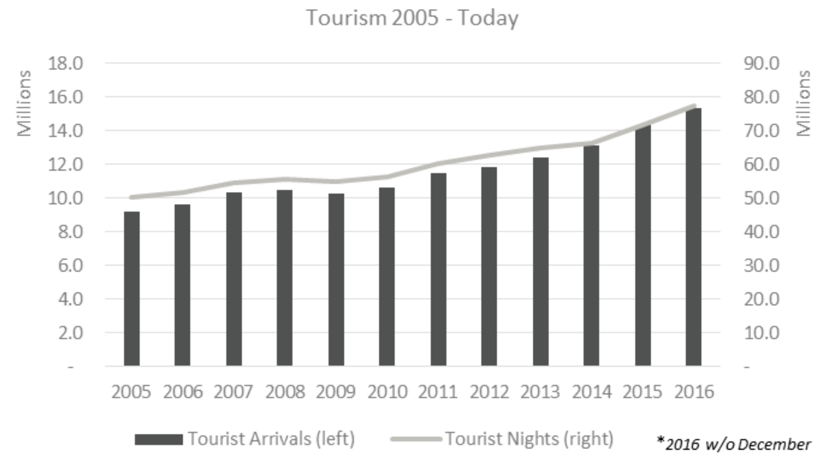
1 Central National Bank (CNB)

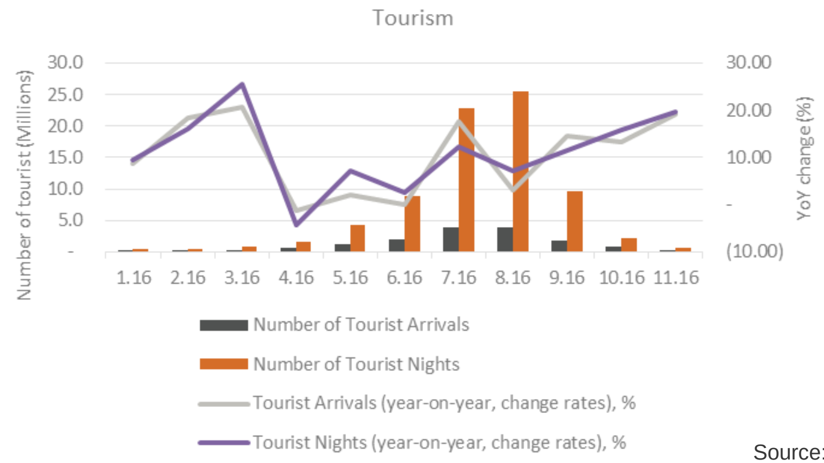
Economy

Record Tourism Saves the Day

- Having grown steadily in the H1 2016, Croatia's economic activity accelerated further in the summer months of the year. The positive trends were primarily supported by strong tourism performance and the acceleration of recovery in personal consumption.
- Positive labor market trends notwithstanding, concerns have been raised over a gradual decline in the labor force, partly caused by the outflow of working age population, which has a diminishing effect on long-term growth potentials. The annual consumer price decline decelerated substantially in September and October from August, to a large extent due to energy price trends1.
- Favorable fiscal development6s continued, with the result that the general government deficit contracted significantly compared with the first ten months in 2015 and public debt remained almost unaltered from the end of 2015.1
- Over 81 million overnight stays are expected to be recorded in 2016, about 10 million more than in 2015, while in 2017 their number could exceed 93 million on the back of positive demand trends and planned investments. Revenues from foreign tourists in 2016 are expected to exceed 8b EUR for the first time, and a new record is expected in 20172.
- Following a pickup in economic activity in 2016, further strengthening of the Croatian economy and new tourism records in 2017, as well as a return of inflation, continued wage growth, an exit from the EU's excessive deficit procedure, and a possible upgrade of Croatia's credit rating is expected. Both of the GDP components will feel positive effects of the tax reform, which entered into force at the beginning of 2017. The aim has been to create a stable, simple and sustainable tax system, while at the same time unburdening businesses and households.

Graphs





Source: DZS

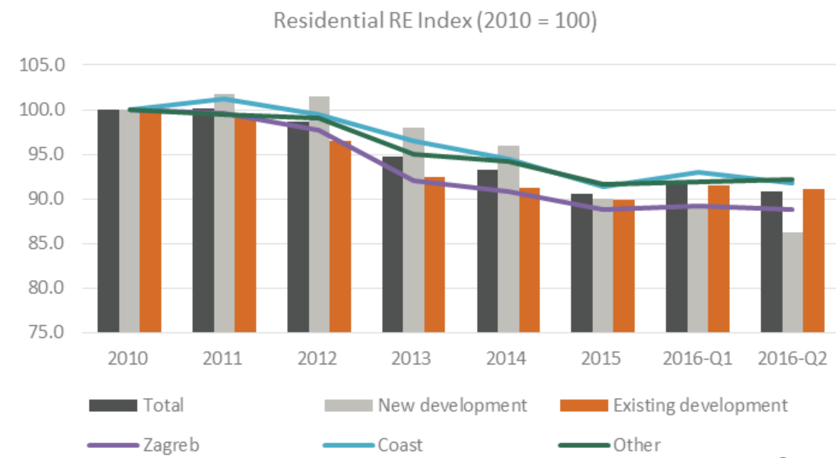
1 Central National Bank (CNB)
2 National Statistics Bureau (DZS)

Real Estate Market - Residential

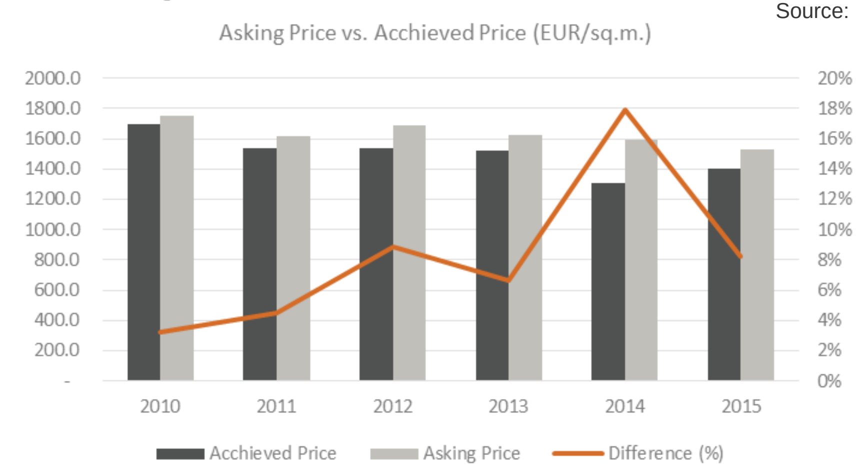
Steady Decline in RE Prices for 8 Years

- Currently there are approximately 165,000 properties offered for sale in Croatia, including 17,000 properties which entered the market in December. In 2016, the fall in prices of old apartments was stopped and the market began a slow recovery, although the prices of new apartments are still quite low. Tax reform which entered into force on 1st January brought a slight stimulus to the market through the reduction of property transaction tax rate from 5% to 4%.
- Families which are searching for their first home lost with the tax reform, since the exemption from payment of tax on property transactions for such buyers has been abolished. However, if they buy the property in the second half of the 2017. on loan, the government is expected to subsidize half of their loan instalments for at least four years.
- Also, 2017 is probably the last year in which property owners will pay utility fee, which should become a real estate tax in 2018. During 2017., the Tax Authority and local government bodies will prepare a new model of taxation which will take into account the size, quality and age of the property, and by March 2018 everybody should receive at their home addresses a notice about new amount of their tax liability. The real estate tax should be the same or lower for older properties, and slightly higher for newer apartments and houses then current utility fee.
- **It remains to be seen how will the latest legislative changes affect the real estate market, but the expectations are following:**
  - Stagnation of the market, with possible slight increase in transaction volume
  - Price stabilization but not increase
  - Polarization of the value. The real estates in Zagreb, and coast are likely to stabilize the price wile price drop is expected in remaining parts of Croatia, especially rural parts.
  -

Graphs



Source: CNB



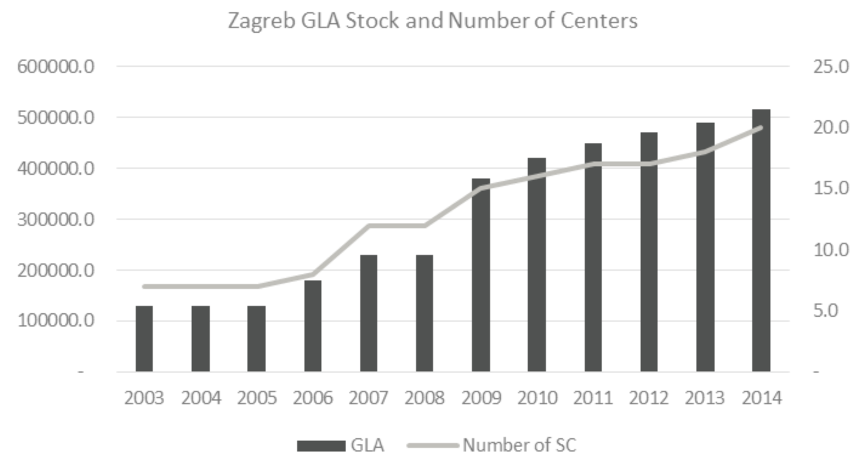
Source: Burza nekretnina

Real Estate Market - Retail

Saturation in Zagreb, Opportunities in Secondary Cities

- Retail market is dominant in Croatia. Retail stock includes over 80 retail centers and hundreds of retail warehouse units mainly occupied by FMCG retailers, furniture and homeware stores, and DIY stores.
- Several centers suffered from impact of crisis and tenants are attempting to renegotiate their leases to reduce costs. Landlords therefore made certain business decisions which consequently led to decrease in effective rent levels. Despite a number of projects that have been negatively affected by the crisis, so far there has been no significant distress in the shopping center sector which may have led to forced sales. Some chains (mainly FMCG) already present in Croatia are still expanding, yet at a slower pace than before, while development of large retail projects slowed down significantly in the last few years.
- The period between the start of 2005 until 2015 could be referred to as a golden decade of shopping center development. Most of the shopping center stock in Croatia, namely 57 projects generating 1.05 million square meters of gross leasable area were built during that period. 29 of them cover more than 10,000 sq.m. GLA each.
- There are currently 80 operating shopping centers (including retail parks and outlet centers) in Croatia. Their total leasable area exceeds 1.45 million sq.m., out of which 35% is located in Zagreb and its metropolitan area. An average shopping center in Croatia covers approx. 18,000 sq.m. GLA. The ratio of shopping center space per capita in Croatia stands at approximately 339 sq.m. GLA/1,000 inhabitants, which is approx. 60% higher than the European average.
- Development opportunities can still be found, especially in secondary and tertiary cities where retail parks could be the most appropriate solution considering the smaller catchment area, but Zagreb shopping center market is saturated and several subprime malls are in need of repositioning on the market.
- Despite the saturation of Zagreb's shopping center market several transactions occurred in 2016. Most noticeable one was acquisition of City Center One East & West by Morgan Stanley. .

Graphs



Asset	Type	Location	Seller	Buyer	Price (m €)	GLA	€/GLA
Super Konzum	Supermarket	Zagreb	Agrokor	Tower Property Fund	13,15	3.223	4.080,63
Sub City Centre	Shopping centre	Dubrovnik	Agrokor	Tower Property Fund	28,75	12.259	2.344,92
Super Konzum	Supermarket	Velika Gorica	Agrokor	Tower Property Fund	8,81	5.510	1.598,90
Meridijan 16	Shopping centre	Zagreb	Agrokor	Tower Property Fund	15,68	9.362	1.674,64
City Center One East / City Center One West	Shopping centres	Zagreb	Manta / Gradski centar	Morgan Stanley	220,00	90.000	2.444,44

Source: KF Finance

Real Estate Market – Office & Industrial

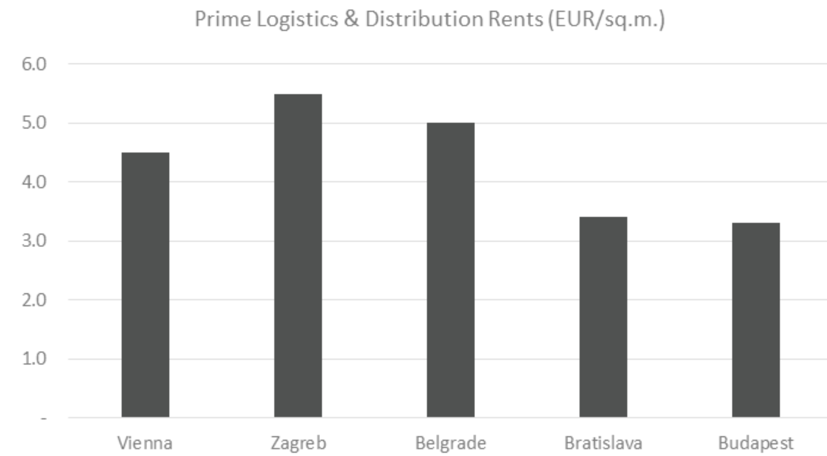
Industrial Below European Average

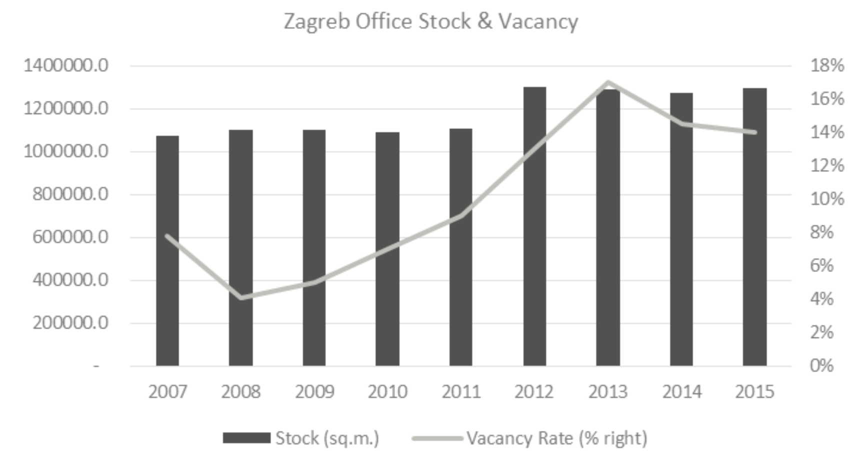
- The industrial and logistics sector remains the least developed real estate sector in Croatia, and is characterized by lack of modern Class A warehouse supply. Zagreb area has a total industrial and logistics stock of approx. 900.000 m², a small fraction of which of can be classified as “modern’” by European standards. Zagreb area and its satellite cities serve as the main focal point for business and location where majority of the logistic stock is situated. Much of the city’s industrial space is situated in the old industrial zones located in the city outskirts, particularly to the east and west of the city around Žitnjak, Jankomir and Jastrebarsko.
- There are no indicators of change in prime rents within Zagreb area, which range from 4 to 5,50 EUR/sq.m.. Rents for older and refurbished industrial premises are also stable and range from 3 to 4,5 EUR/sq.m. Rents in other secondary and terciary cities varies arounf 4 EUR/sq.m. while in the rural parts rent varies between 1 to 2 EUR/sq.m.

Increase in A Class Office Rent

- The majority of office supply is located in Zagreb where almost all foreign and domestic companies present on the Croatian market have their headquarters. Second-tier cities with significant office supply in Croatia are Split and Rijeka. At the end of 2015, total office supply in City of Zagreb stood at approx. 1,28 million sq.m. including A and B class competitive, owner-occupied and mixed-occupied buildings. The supply is still limited for requirements above 1.500 – 2.000 sq.m.. in quality buildings. Zagreb’s office vacancy rate currently stands at 14%. A class buildings have significantly lower vacancy levels in comparison to B class buildings. New office completions in 2015 totaled 18.500 m² of space (VMD Kvart Strojarska building B).
- Average rent for A class buildings bottomed up following a gradual decrease in the past few years and currently stands at 12 EUR/sq.m. An increase in A class rent is expected as a result of domestic economy’s growth and small pipeline. The secondary rent across the city ranges from 8 to 10 EUR/sq.m. In older buildings and buildings in suburban areas downward pressure on the rent levels is expected.

Graphs





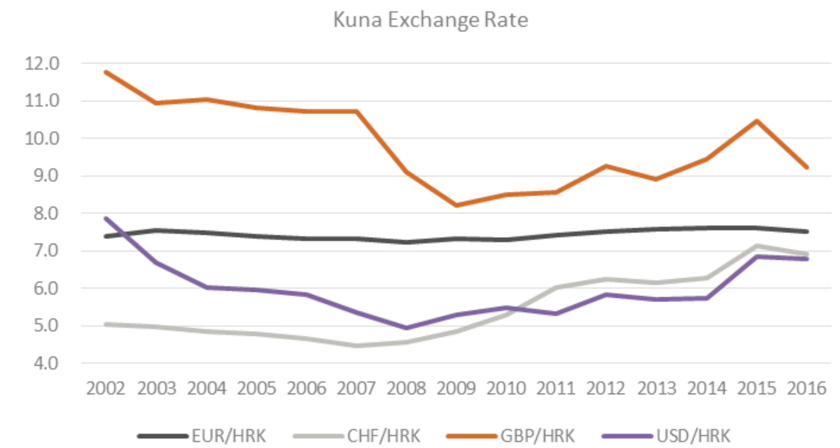
Source: Colliers

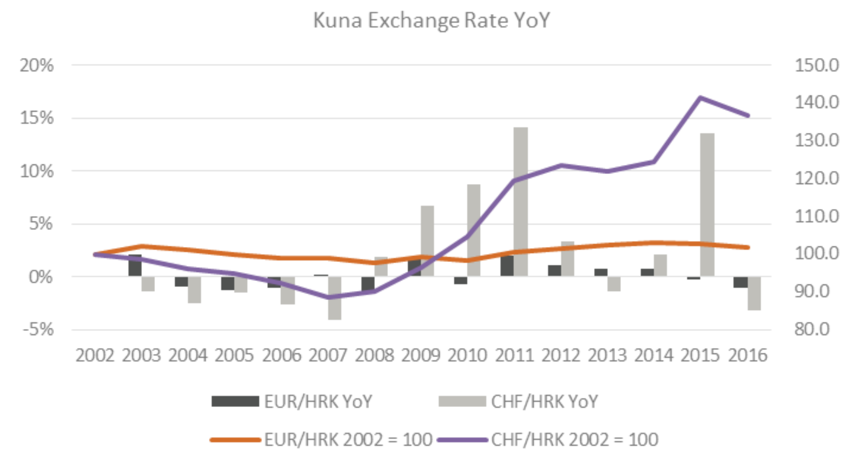
Currency Risk

National Bank is Defending Kuna/Euro Exchange Rate

- Currency risk exposure resulting from foreign currency-denominated debt is a source of vulnerability.
- Due to a low sovereign credit rating, Croatian companies encounter 2 - 3% higher costs for long-term loans than their euro area peers. Larger private corporations continue to borrow directly from abroad, and their borrowings from domestic credit institutions are also often denominated in foreign currency. By end 2014, 73.3 % of total corporate loans were denominated in foreign currency, exposing the corporate sector to currency risk. The share of non-kuna denominated loans is unevenly distributed across sectors: above average in construction and real estate, but lower in trade retail and manufacturing. The limited share of export (non-kuna) revenues from abroad amplifies the currency risk in the construction sector, whereas the risk is mitigated in the hotel and restaurant industry, which generate foreign currency revenues1.
- Household indebtedness is coupled with currency risk exposure due to the banks' practice of extending EUR and CHF long term loans. By end 2014, 71,4% of total household loans were denominated in foreign currency, of which over 53% in EUR and over 17%. in CHF (predominantly mortgage loans). The appreciation of the Swiss Franc in January 2015 had a substantial impact on households that had contracted mortgages in that currency and prompted government intervention. Moreover, the share of loans with variable interest rate (variable within a one year period) is still very high. The risk of rises in the repayment burden imposes a drag on household credit demand1.
- In period from 2002. to 2016. year over year (YoY) changes of Kuna to Euro exchange rate varied between -1,5% and 2,1% with an average change of 0,1% compared to previous year. Monetary politics of the Central National Bank (CNB) is to defend Euro exchange rate and in 3 interventions in 2016. CNB acquired 430,5m EUR from the banks and additional 124,4m EUR from Ministry of Finance in order to keep the exchange rate stabile. CNB gross reserves amounted to 14b EUR and the expansive monetary politics with a goal of keeping the stabile exchange rate to Euro is one of a key area of focus for CNB1.

Graphs





Source: CNB

1 Central National Bank (CNB)

Agenda

Government

KF Finance
valuations & financial advisory
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6 Month Experiment is Over

- Since the beginning of 2016 Croatian politics has faced serious turmoil and unprecedented events which brought into question the established norms of government stability in Croatia. After less than five months in office, the government of technocratic Prime Minister Tihomir Orešković was brought-down in the Parliament by vote of no-confidence. This was the first time in modern Croatian history that a government lost the confidence of its own parliamentary majority and ended its term after only 146 days due to severe intra-coalition paralysis and decision-making deadlocks. Even during negotiations between HDZ and Most on the government formation after the 2015 parliamentary elections, it was evident that the new coalition would face serious threats and internal challenges. The main reason behind inefficiency of the first HDZ-Most coalition government lies in mutual mistrust between the two parties, which was further propelled by personal animosities of the two leading figures in the government – Deputy Prime Ministers Tomislav Karamarko and Božo Petrov.

- The early 2016 elections once again set the stage for the interplay between HDZ and Most. However, this time cards were dealt somewhat differently, making it much easier for HDZ and Most to negotiate a new coalition. Prior to the elections HDZ made leadership change with which unpopular party president Karamarko, overburdened with corruption allegations, was replaced by Andrej Plenković, who was one of the rare critics of the previous party leadership. Plenković very soon proved to be much more moderate, liberal and opened than his predecessor.

- This time coalition talks were very predictable and went much smoother. Immediately after the elections it was obvious that only HDZ was in a position to form a government. However, early elections also produced new constellation of political strength between smaller parties which gave the HDZ a backup plan in case that everything would go wrong with Most.

Croatia Credit Rating		
S&P	Fitch	Moody's
BB	BB	Ba2

Political Risk

- Standard & Poor's rating agency as well as Fitch and Moody's, still keep Croatia's credit rating two grades below the investment level, but S&P believes that positive trends will continue in 2017 and that Croatia will exit the EU's excessive deficit procedure. Both S&P and economic analysts noted that the second half of 2016 was marked by the recovery of political stability after the inauguration of the Andrej Plenković government.

- Standard & Poor's announced in December 2016. that it will keep the current long-term credit rating of Croatia at "BB" and short-term credit rating at "B", but it upgraded the outlook from negative to stable, which is the first positive move for the Croatian rating in nine years. The change in outlook is explained with better than expected economic growth and fiscal outcome in 2016, since adverse effects of political upheavals and early elections were not as pronounced as the agency expected. Moreover, S&P analysts expect continuation of favourable trends in 2017, because the political uncertainty has been decreased after a stable result of early elections which took place in September 2016.

- The government will continue with activities aimed at facilitating business operations, reducing parafiscal levies, and implementing other economic policy measures from its programme, and those activities will reflect on employment and the standard of living in the country.

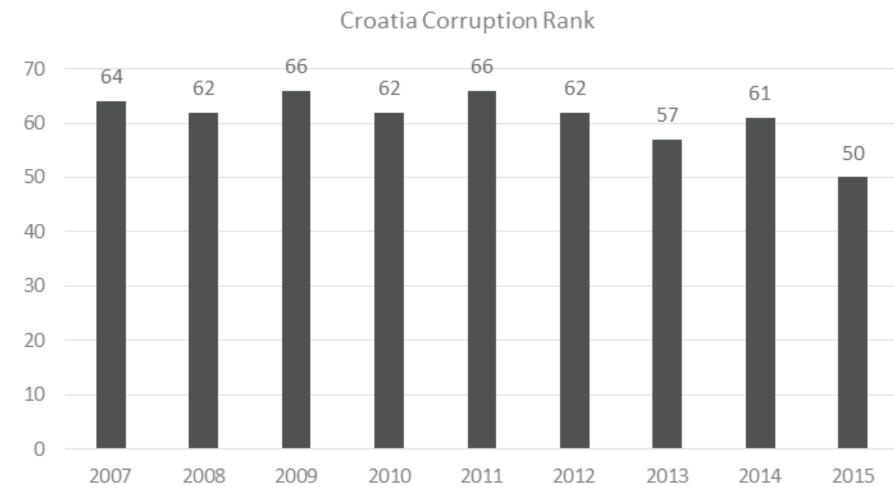
- Despite relatively short governance, all trends are in favor of new government and it is expected the government will continue to head in direction alligned with EU with a goal of economic prosperity. Althought Zivi Zid ("Human Shield"), a populist left alliance, which surged from one to eight spots in parlament in early 2016 elections with promises to be tough on banks and demands for prosecutions of unnamed corrupt officials, controversial policies by the government like ones in Poland (Populist, ultra-conservative, Eurosceptic and nationalist, the Law and Justice party used the first parliamentary majority after winning the elections in October to push through a range of political, economic and social reforms which shocked foreign investors) or Hungary are highly unlikely to happen.

Corruption & Money Laundering

Progress

- Fighting corruption was one of the key criteria Croatia had to meet to join the European Union. Corruption in Croatia is perceived to be pervasive in major public companies, the health sector, universities, public procurement systems, the construction sector, land registry offices and the Agency for Management of State Owned Property (formerly the Privatization fund). Foreign investors, including U.S. companies, have expressed general complaints that the level of corruption is a barrier to investment.
- The government of Croatia recognizes this as a problem and, at the highest political levels, has shown a willingness to combat corruption. The government continued to give special attention in 2010 to the legal and institutional framework used to combat corruption. Following revisions to the Criminal Procedure Act in July 2009, which granted additional authorities to corruption and organized crime prosecutors, Croatian prosecutors launched investigations which targeted high level government officials, including a former Croatian Prime Minister, former Deputy Prime Minister, other ministers, high ranking officials and senior managers from several state owned companies.
- Most money laundering in Croatia is considered to be of domestic origin. The main criminal offenses which are the primary sources of money laundering are: economic crimes such as abuse of power and authority in economic operations; abuse of power and authority; tax evasion; and abuse of drugs. Although Croatia is part of a major transit route for drugs entering Europe, there is little evidence that these networks have utilized Croatia's financial system in order to launder the proceeds of sales.
- The Anti-Money Laundering Office (AMLO) is an independent organizational unit within the structure of the Ministry of Finance, performing tasks aimed at money laundering and terrorist financing prevention, as well as other tasks as provided for in the Act. In the money laundering and terrorist financing prevention and detection, AMLO cooperates with the State Attorney's Office of the Republic of Croatia, the Ministry of the Interior - the General Police Directorate, the supervisory services of the Ministry of Finance, the Croatian Financial Services Supervision Agency, CNB, the Security-Intelligence Agency, the Ministry of Justice and with other state bodies.

Graphs



- For the purpose of achieving the strategic and operational objectives, mentioned bodies (including AMLO) signed a protocol on cooperation and on the establishment of an inter-institutional money laundering and terrorist financing working group. AMLO has a timely access, to financial, administrative and security data, information and documentation relative to the implementation of the Law and regulations passed on the basis of the Act for the purpose of the AMLO's tasks performance, including the suspicious transactions analyses.

Agenda

1. Introduction to B2Kapital SEE
   - A. Region overview
   - B. Operations in general
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2. **Croatia at a glance by KF Finance**
   - A. Economic Situation in Croatia
   - B. Political Situation in Croatia
   - C. Banking Sector in Croatia
   - D. NPLs in Croatia
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Overview of the Banking Sector

Bank Lending Again Decreased in 2015

- Reduced credit demand in the private sector (especially that in lower-risk segment) accompanied by diminished risk appetite of local commercial banks, gave raise to a simultaneous continuation of decline in lending to the private sector and an increase of lending to the government

Structure of the local banking sector

- **Fully operational credit institutions**: 27 commercial banks (down from 29 in 2013), 1 savings bank, 5 housing savings banks, representative offices of 4 commercial banks from the other EU member states, and Croatian Bank for Reconstruction and Development (HBOR)
- **Not operational credit institutions**: Credit institutions : 1 commercial bank and 2 savings banks undergoing winding-up proceedings, while 10 commercial banks undergoing bankruptcy proceedings

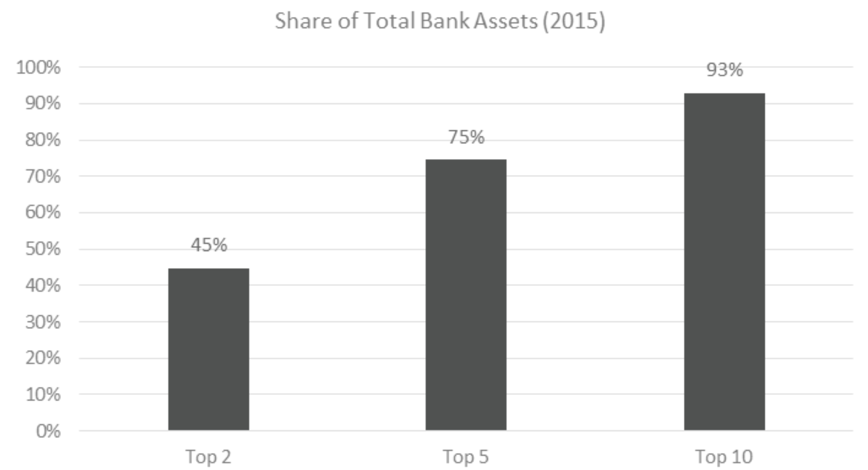
Dominant Trends

- **Concentration**: System concentration high and increasing; assets of the first 5 banks accounting for almost ¾ of the total assets the sector and with the banks in foreign ownership dominating (accounting for over 90% of the total bank assets). Process of market consolidation continues.
- **Sources of funding**: Prolonged period of low nominal deposit rates caused an increase in the share of transaction deposits, thus reducing the overall maturity of bank liabilities
- **Loans**: Bank lending decreased in 2015. Loans to corporates went down the most as regards almost all activities within the sector. A noticeable increase was registered only in lending to tourism and agriculture. Household loans decreased for the seventh consecutive year, and there was a noticeable currency restructuring. Kuna loans to households went up noticeably, especially general-purpose cash loans and home loans, reflecting a change in household preferences.
- **Riskiness of assets**: The average risk weight continued to fall (thus positively affecting the average Capital adequacy of the sector)
- **Credit growth**: The economic recovery has thus far failed to spur credit growth and its expected continuation does not necessarily have to spill over to credit growth.

Graphs

Result

- Slight recovery in the quality of non-housing loans to households and the stagnation of the quality of corporate loans, as well as the continued sale of bank NPLs pushed the share of non-performing loans down to 15.0% in Q2 2016 (still among the highest in the EU)
- Indication of recovery of the annual growth rate in bank assets, after 3 consecutive years of decline



Source: CNB

Announced merging in December 2016. creating 4th largest bank

Overview of the Banking Sector – Cont'd

Swiss Franc Issue

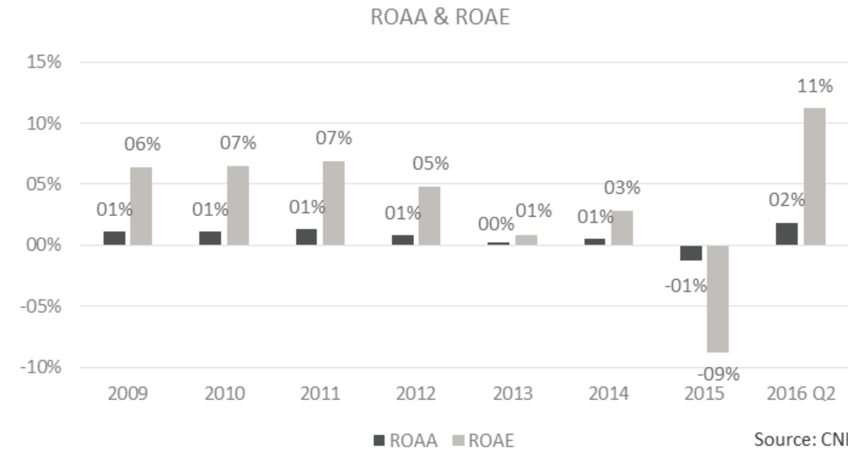
Key vulnerabilities

- The cost of conversion of loans indexed to the Swiss franc into euros considerably burdened the banking sector and caused a fall in the profitability and capitalization of the sector due to the losses sustained (ROAA fell to –1.3% and ROAE reached –8.8%)
- The stabilization of the share of non-performing loans and the parallel continuation of the growth in their LLP coverage have positively contributed to the stability of the local banking sector
- Banks liabilities towards their owners continued to decline due to the ongoing deleveraging of the domestic private sector
- Reduced maturity of bank domestic liabilities further exposes banks to refinancing risk and risk of liquidity outflows
- Banks capital is under pressure due to sustained losses and increased dividend payments
- Banks exposed to losses arising from a possible decline in the value of their portfolio of government debt securities resulting from (possible) growth in the country risk premium

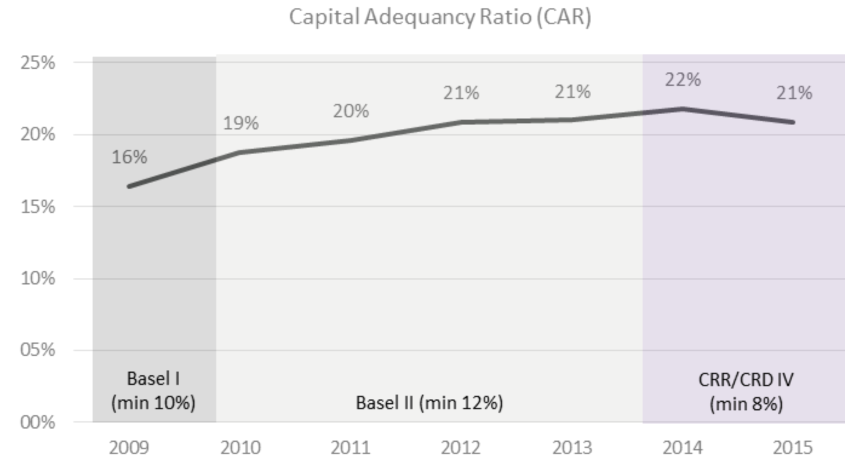
Expectations

- The majority of changes in bank balance sheets in the upcoming period will be related further optimization of costs
- Sustained losses, relatively high average price of liabilities despite the low cost of capital are likely together to bring about a further reduction of exposures by foreign owners in the Croatian market
- In 2016 there will be no further impact of the conversion cost related to the loans in the Swiss franc (ROAA is expected to increase to 1,8% and ROAE to 11,2%)
- Although banks operating in Croatia are still adequately capitalized (with equity-to-assets ratio at 12%, CAR at 20,9%) and liquid, the continuation of resolution of the NPL issue will help reducing the perception of the overall risk and activating assets currently locked in such placements

Graphs



Source: CNB



Source: CNB

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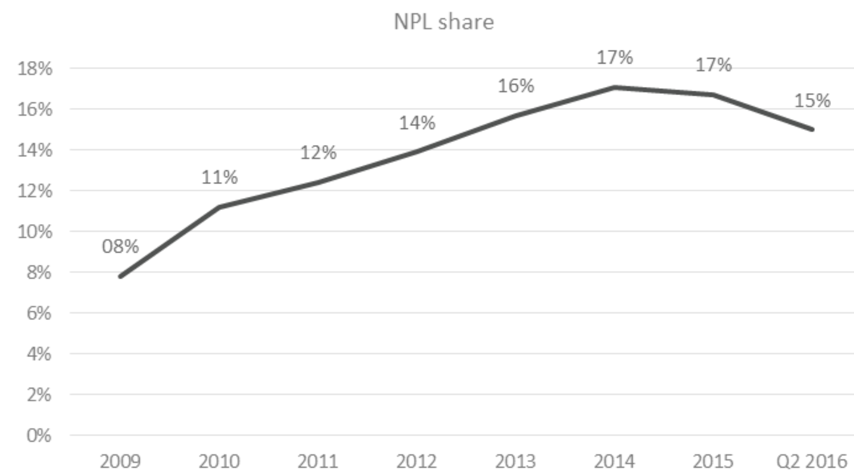
NPL Volume

Sale of Claims Halted NPL share

- A years-long upward trend in the share of NPLs was halted in 2015, under the key influence of the sale of claims. The share of NPLs had been increasing since 2008 and the onset of the global crisis, totaling 17.1% at the end of 2014. By the end of 2015, it went down to 16.7%, as a result of the 4.0% decrease in NPLs primarily to the corporate sector (where the sale of loans was most intensive).
- After having stagnated for several months, the share of loans classified into NPLs in total corporate loans stabilized at a very high level of 30.1%. On the other hand, in the household sector, which reacted to the crisis with a time lag, the share NPLs is still growing. At the end of 2015, this share amounted to 12.2%.
- NPLs of the corporate sector went down by 5.7%, predominantly under the influence of the sale of claims. If the effects of the sale were excluded, they would be stagnating, as a result of multiple factors, such as concluded pre-bankruptcy settlements and completed bankruptcy proceedings. During these processes banks partially wrote off, that is, forgave debts and took over real estate or other client assets.
- In addition, debt write-off not related to pre-bankruptcy or bankruptcy proceedings and sale of claims gained strength at the end of the year. A portion of the decrease was also a result of the improvement in the creditworthiness of borrowers, as indicated by the reclassification of individual clients into a better risk category.
- High investor appetite and bank disposals activity during the past 18 months, fueled by available stock and regulatory support for deleveraging, with further intense activity expected in 2017, as some vendors continue disposal programs.
- Special licensing not required for NPL portfolios acquisition; however, National Bank non-prohibition confirmation of LSPAs is required for signing.
- Further streamlining of the Croatian law with EU standards is seen as an additional driver of confidence in the Croatian jurisdiction and increased interest in its distressed debt market.
- Local subsidiaries of UniCredit, Erste and Intesa held approx. 2/3 of the system's NPL stock as at end of 2015., with state owned HPB registering highest NPL ratio.

Graphs



Source: CNB

Selected Large Transactions 2015 - 2016

Project Name	Seller	Type	GBV (m EUR)	Year	Status	Buyer
Taurus Croatia	UniCredit	NPL - mixed	790	2016	Ongoing	n/a
Goran 2.0	Erste	NPL/REO	110	2016	Ongoing	n/a
Sunrise	HPB	NPL - mixed	320	2016	Closed	APS/B2
Sapphire	HETA	NPL - Corp.	135	2016	Closed	n/a
NKBM	NKBM	NPL - Corp.	95	2016	Postponed	n/a
Pathfinder	HETA	NPL - Corp.	400	2016	Closed	DB/EOS
Goran	Erste	NPL - Corp.	60	2015	Postponed	n/a
Ivica	Erste	NPL - Corp.	200	2015	Closed	B2
Janica	Erste	NPL - Corp.	217	2015	Closed	B2

Source: KF Finance

NPL Market in 2017

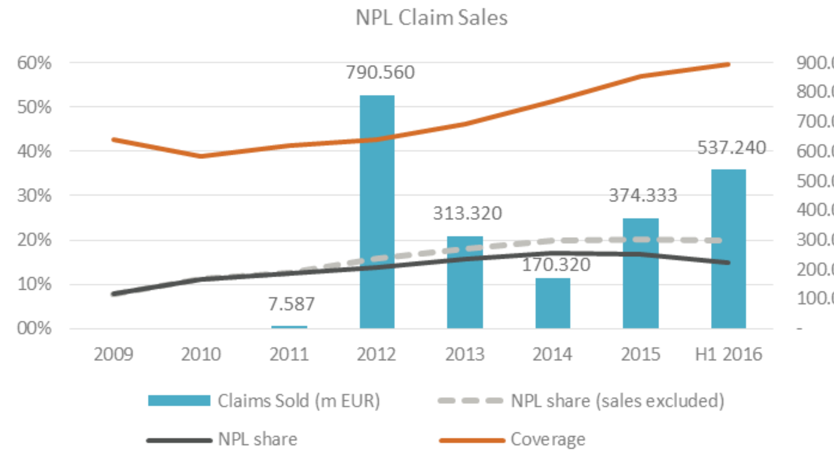
NPL share below 15% in Q2 2016

- First time since 2012. the NPL ratio fell below 15% to 14,99% in June 2016 (further to 14,65% in September 2016). The reduction in NPL share is primarily tied to sale of claims. The 14,99% amounts to approx. 5,2b EUR. If transactions that were closed in second half of 2016., and transactions to be closed in first half of 2017. are deducted it is estimated that Croatian NPL market amounts to over 3,5b EUR. The estimation only includes banks that are reporting to CNB. If foreign banks are taken into account it can be assumed that NPL volume is still over 5b EUR.
- Most likely to sell are banks with large amount of NPLs including ZABA, Erste, and PBZ. HPB sold almost entire NPL portfolio within project Sunrise and it is not likely another portfolio from HPB will come to the market.
- Reiffeisen Bank has not had a large portfolio disposal and it is possible that it will bring one large portfolio to the market in 2017.
- HETA (former Hypo Bank NPLs were transferred to company HETA before Hypo Bank was sold and rebranded as Addiko Bank), a wind down company is expected to bring couple of portfolios in 2017. and 2018. as it is estimated that the company still has over 1b EUR of NPLs in Croatia.

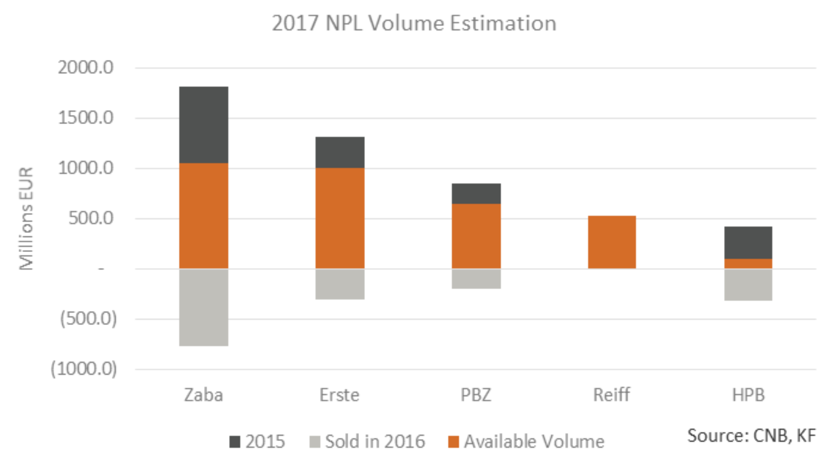
Regulatory Changes

- The new out-of-court NPL restructuring (OOCR) framework will contribute to a comprehensive resolution set-up in Croatia and provide an additional tool to deal with the NPL problem.
- Well designed and conducted OOCR offer sound alternative to regular debt collection through courts and other institutions, but following criteria needs to be met to allow NPL resolution trough OOCR:
  - OOCR effective only if complementary to functional courts
  - Tax laws and uniform practices thereof must be supportive of OOCR
  - OOCR statutory framework reasonably flexible not to discourage specific arrangements
  - Advanced training for certain judicial and non judicial posts beneficial
- It is unlikely the criteria will be met in 2017, and therefore the new framework does not present threat to debt collection agencies in near future.

Graphs



Source: CNB



Source: CNB, KF

Agenda

Serbia NPL Market

Emerging 3,5b EUR Market

- Non-performing loans (NPL) are one of the principal problems of Serbian banking sector.
- Since 2009, number of domestic and international institutions have conducted various studies regarding NPL growth and have concluded that such growth is indicative of relevant macroeconomic factors. The main macroeconomic reasons for NPL growth in Serbia since 2008 have been increasing unemployment, currency depreciation and higher inflation rate.
- Pursuant to the Decision on Risk Management, a bank may assign its corporate NPL to another bank or to another legal entity, with the obligation to inform National Bank of Serbia (NBS) of such assignment no later than 30 days prior to executing the agreement giving effect to it. The NBS introduced novelty pursuant to recently (July 2016) amended Decision on Risk Management allowing the banks to assign also not matured receivable, to another legal entity, that is considered as problematic pursuant to NBS Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (also amended in July 2016 and applicable as of 1st October 2016).
- With respect to the retail NPL, pursuant to applicable Law on Protection of Financial Services Users, retail NPL may be assigned only to another bank. Notably, there are additional legal impediments to the NPL market development in Serbia. Applicable Litigation Law does not provide for a possibility for NPL acquirer to takeover the place in an ongoing dispute, without prior explicit consent of the counterparty.
- In case of an NPL transfer, re-registration of mortgagees in the name of a new creditor (acquirer of NPL) is extremely slow due to inefficiencies of real estate cadasters, which adversely affects NPL transfers. In addition, a debtor may obstruct the re-registration of such mortgage by submitting an appeal which could last for several years due to slow proceedings.
- There have been noteworthy positive changes. New Consensual Financial Restructuring Law was passed in 2015 allowing for a creditor and a debtor to execute Consensual Financial Restructuring Agreement providing for the Serbian Chamber of Commerce to act in capacity of the institutional mediator. However, due to ineffectiveness of the 2011 Law, outcomes of the new legislation can not be predicted with certainty.
- In addition, by amendments of the tax regulations, the more lenient conditions for recognizing write-offs of NPL in banks' tax balance have been introduced.
- For the issues to be favourably resolved, in near future it will be paramount that substantive regulatory and non-regulatory changes take place. Some changes regarding tax treatment of NPL and financial restructuring have already been made. In addition the NBS relevant decisions have been amended and supplemented in order for sustainable restructuring practice to be encouraged. Rendering the Strategy was an important step in order to set out the most essential NPL issues. The Strategy implementation is now a matter of practical commitment and cooperation of relevant institutions and stakeholders.
- NBS announced in December 2016 that the Serbian NPL ratio declined to 18.7% at the end of September 2016, down by 3 percentage points from December 2015, its lowest level since June 2013. Three funds: B2, APS Holding and EOS Matrix bought from Serbian banks the total amount of 94 billion dinars (762.7m EUR) until the end of H1 2016.

Slovenia NPL Market

Sharp Decline in NPL Share

- In order to stabilise the financial market in Slovenia, one of the most important measures adopted by the State was to help banks scale down the volume of NPLs, which was done through implementation of measures provided by the Act Defining the Measures of the Republic of Slovenia to Strengthen Bank Stability (Bank Stability Act) and establishment of the BAMC in 2012 to which NPLs were transferred. Following significant losses over the past three years, the banking sector has regained its momentum and returned to profitability in 2014.

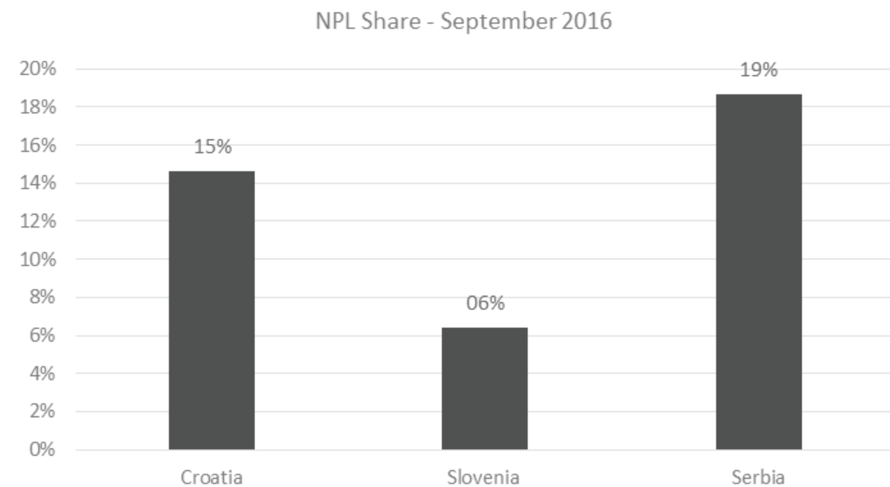
- BAMC is an entity owned wholly by the Republic of Slovenia. Its statutory goals are, inter alia, to ensure efficient use of public funds and to increase lending to the non-financial sector by enabling the transfer of NPLs from banks to BAMC. Measures adopted by Slovenia are similar to measures already implemented in Germany (Soffin), Spain (SAREB) and Ireland (NAMA).

- Under the current provisions of the Bank Stability Act, BAMC will be dissolved no later than 31st of December 2017, or alternatively and potentially as soon as it sells 75% of all of its assets. An amendment of the Bank Stability Act is currently being considered which would extend the functioning of the BAMC to 2022. As mentioned above, according to current legislation, BAMC must sell at least 10% of its portfolio each year.

- The value of loans that have not been serviced for more than 90 days declined 4.5% month-on-month to 2,1b EUR at end of September 2016. At end of 2015 Slovenian banks' NPLs stood at 3.46b EUR, down from 4,45b EUR a year earlier. The NPL ratio declined to 9.9% from 11.9% over the period.

- The share NPLs in the Slovenian banking sector fell to 6.4% at the end of September 2016 from 6.7% a month earlier, according to Slovenian central Bank.

Graphs



**Numbers reported by National banks for September 2016.*

Source: KF

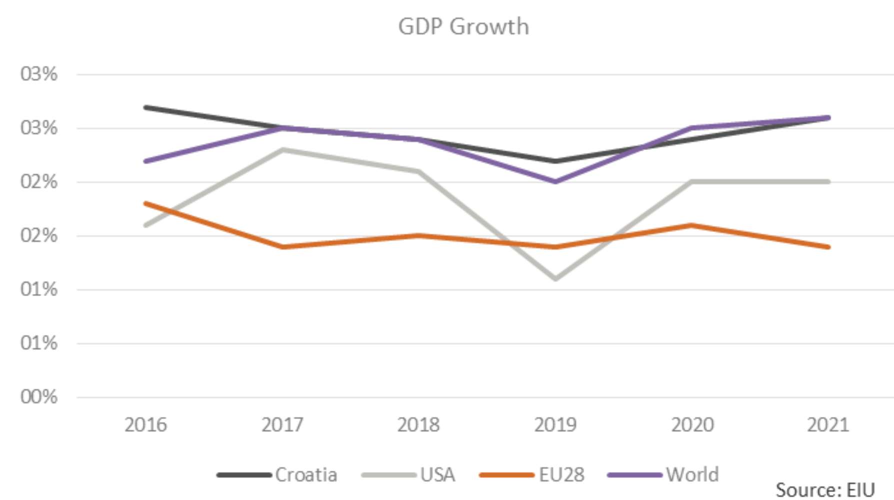
Croatia Key Indicators Forecast

What to Expect in 2017

- The new government faces several challenges, including hefty public and external debt, an ageing and shrinking population, and an uncertain external environment. Monetary policy has been surrendered to preserve the stability of the nominal kuna exchange rate against the euro, and control over fiscal policy has in effect been given to the EU following Croatia's entry to the excessive-deficit procedure (EDP). However, Croatia's recent success in reducing the fiscal deficit should enable it to exit the EDP by the end of 2017.
- Mr Plenković has said that his new government will boost economic growth by reforming the public administration, the public finances and the education system. He has also said that the government will channel investment in the important agriculture, tourism and industrial sectors. This appears to coincide with Most's reform agenda, which includes public-sector, judicial, municipal, fiscal and monetary reform. On 2nd December parliament adopted a reform package of 15 tax laws, to come into effect on 1st January 2017. However, there is a significant risk that the government will struggle to pass far-reaching reform in other areas in the face of opposition from powerful interest groups.
- Banks' lending activity remains subdued, which reflects caution on the part of lenders and borrowers as well as the impact of the Swiss franc conversion programme, and this despite the positive effect of an expansive monetary policy stance including weekly reverse repurchase (repo) auctions on domestic financial conditions. A significant improvement in credit growth next year remains unlikely.
- In 2017 the hit to private consumption from lower real income growth will be offset by a slew of tax cuts and minimum wage rises. Growth will be held back by the rising level of emigration, labor shortages in industries such as the construction sector, and a slowdown in Europe brought on by uncertainty surrounding the UK's exit from the EU.

Graphs

Key indicators	2016	2017	2018	2019	2020	2021
Real GDP Growth	2,7%	2,5%	2,4%	2,2%	2,4%	2,6%
Consumer Price Inflation	-1,2%	0,7%	1,5%	1,5%	1,8%	2,0%
Budget Balance (% GDP)	-2,4%	-2,1%	-1,9%	-2,0%	-1,9%	-1,8%
Current Account Blance (% GDP)	3,4%	2,4%	2,2%	2,0%	2,2%	1,5%
HRK/USD	6,79	7,12	7,06	6,81	6,71	6,59
HRK/EUR	7,53	7,51	7,52	7,54	7,56	7,58



Source: EIU

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