

CROATIAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

The Condensed Separate and Consolidated Interim Financial Statements for the Period 1 January – 30 June 2018

Zagreb, August 2018

This version of the Condensed Separate and Consolidated Interim Financial is a translation from the original, which was prepared in Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the annual report and financial statements takes precedence over translation.

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Responsibilities of the Management and Supervisory Boards for the preparation and approval of the condensed separate and consolidated interim financial statements for the period 1 January – 30 June 2018

We confirm that, to the best of our knowledge, the condensed separate interim financial statements of the Croatian Bank for Reconstruction and Development ("the Bank" or "HBOR") and condensed consolidated interim financial statements of the Croatian Bank for Reconstruction and Development Group ("the Group") set out on pages 10 to 124 have been prepared in accordance with International Accounting Standard 34: "Interim Financial Reporting" applicable for the preparation of interim financial statements, and give a true and fair view of assets, liabilities, financial position, financial performance and cash flows for the reporting period.

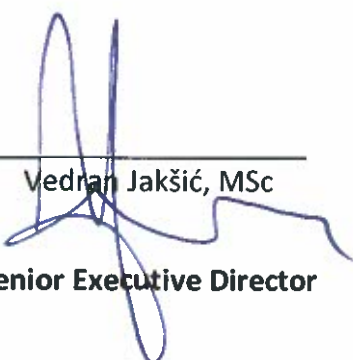
The Management Board has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and the Group and to prevent and detect fraud and other irregularities.

The Management Board is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; making judgements and estimates that are reasonable and prudent; and preparing the financial statements on a going concern basis unless it is inappropriate to presume that the Bank and the Group will continue in business.

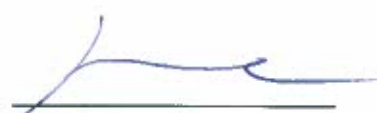
The Management Board is responsible for the submission to the Supervisory Board of its Condensed interim financial statements which includes the condensed separate and consolidated interim financial statements. If the Supervisory Board approves the Condensed interim financial statements it is deemed confirmed by the Management Board and Supervisory Board.

The Condensed separate and consolidated interim financial statements on pages 10 to 124 have been approved by the Management Board on 24 August 2018 as confirmed by the signatures below.

For and on behalf of HBOR



Vedran Jakšić, MSc
Senior Executive Director



Tamara Perko, MSc
President of the Management Board



Marin Pranjic
Accounting Division Executive Director



Hrvoje Čuvalo, MSc
Member of the Management Board

Zagreb, 24 August 2018



Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development

Report on the Audit of the Condensed Separate and Consolidated Interim Financial Statements

Opinion

We have audited the condensed separate financial statements of Croatian Bank for Reconstruction and Development ("the Bank") and consolidated financial statements of the Bank and its subsidiaries ("the Group"), which comprise respective condensed separate and consolidated statements of financial position as at 30 June 2018, and their respective separate and consolidated statements of profit or loss, comprehensive income, cash flows and changes in equity for the six-month period then ended, and notes, comprising significant accounting policies and other explanatory information (further referred to as "the condensed financial statements").

In our opinion, the accompanying condensed financial statements give a true and fair view of the unconsolidated and consolidated financial position of the Bank and the Group, respectively, as at 30 June 2018 and of their respective unconsolidated and consolidated financial performance and cash flows for the six-month period then ended in accordance with IAS 34 Interim Financial Reporting.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the Condensed Financial Statements* section of our report. We are independent of the Bank and the Group in accordance with the ethical requirements that are relevant to our audit of the condensed financial statements in Croatia and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Matter

The separate and consolidated financial statements of the Bank and the Group as at and for the year ended 31 December 2017 and the condensed separate and consolidated interim financial statements as at and for the six-month period ended 30 June 2017 were audited by another auditor who expressed unmodified opinions on those statements on 19 March 2018 and 28 August 2017, respectively.



Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (*continued*)

Report on the Audit of the Condensed Separate and Consolidated Interim Financial Statements (*continued*)

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the condensed financial statements of the current period. These matters were addressed in the context of our audit of the condensed financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment of loans to other customers

As at 30 June 2018, in the condensed financial statements of the Group and the Bank, gross loans to other customers: HRK 15,734 million, related impairment allowance: HRK 3,464 million and income from impairment loss release in the income statement for the six-month period then ended: HRK 129 million (30 June 2017: gross loans to other customers: HRK 14,330 million, impairment allowance: HRK 2,683 million, impairment loss recognized in the income statement for the six-month periods then ended: HRK 118 million).

Refer to pages 23 to 31 (note 4.1.1 Changes in accounting policies due to the application of IFRS 9 Financial instruments), pages 32 to 34 (note 5 Transition to IFRS 9), page 40 (note 9 Impairment loss and provisions) pages 45 to 46 (note 13 Loans to other customers), and pages 65 to 89 (credit risk section of the note 26 Risk management).

Key audit matter

Impairment allowances represent the Management Board's best estimate of the expected credit losses within the loans to other customers at the reporting date. We focused on this area as the determination of impairment allowances requires a significant amount of judgment from the Management Board over both the timing of recognition and the amounts of any such impairment.

Additionally, as at 1 January 2018, the Bank and the Group applied the new financial instruments standard, IFRS 9 *Financial Instruments*, whose impairment requirements are based on the expected credit loss (ECL) model rather than the incurred loss model, as previously used.

How our audit addressed the matter

Our audit procedures in this area included, among others:

- Inspecting the Bank's and the Group's IFRS 9-based impairment provisioning methodology and assessing its compliance with the relevant requirements of IFRS 9. As part of the above, we challenged the Management Board on whether the level of the methodology's sophistication is appropriate based on an assessment of the entity-level and portfolio-level factors;
- Inquiring of the risk management and IT personnel as well as reading conclusions of Bank's external expert documentation to obtain an understanding of the provisioning process, IT applications used therein, key data sources and assumptions for data used in the ECL model. Also, assessing and testing of IT control environment for data security and access, assisted by our own IT specialists;
- Assessing and testing the design, implementation and operating effectiveness of selected key controls over the approval, recording and monitoring of loans, including, but not limited to, the controls relating to the identification of loss events and default, appropriateness of the classification of exposures into performing and non-performing and their segmentation into homogenous groups, calculation of days past due, collateral valuations and calculation of the impairment allowances;

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Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (*continued*)

Report on the Audit of the Condensed Separate and Consolidated Interim Financial Statements (*continued*)

Key audit matter

How our audit addressed the matter

Following the initial application of IFRS 9, impairment allowances for performing exposures (Stage 1 and Stage 2 in the IFRS 9 hierarchy) and non-performing exposures (Stage 3) below HRK 1.5 million individually (together "collective impairment allowance") are determined by modelling techniques. Historical experience, identification of exposures with a significant deterioration in credit quality, forward-looking information and management judgment are incorporated into the model assumptions. For non-performing exposures exceeding HRK 1.5 million individually, the impairment assessment is based on the knowledge of each individual borrower and often on estimation of the fair value of the related collateral. Related impairment allowances are determined on an individual basis by means of a discounted cash flows analysis.

- With respect of the IFRS 9 transition effects:
 - Understanding the overall transition process activities and controls, including the process and controls over determining the impact as well as the underlying process activities that generated the related disclosures;
 - Testing completeness and accuracy of input data used for establishing risk parameters (probability of default (PD), loss given default (LGD), exposure at default (EAD)) and obtaining explanations for exceptions where necessary;
 - Obtaining the relevant forward looking information and macroeconomic forecasts used in the Bank's and the Group's ECL assessment. Independently assessing the information by means of corroborating inquiries of the Management Board and inspecting publicly available information;
 - Assessing whether the definition of default and the new standard's staging criteria were consistently applied. Also analyzing whether the definition of default applied for each segment/portfolio is appropriate based on the requirements of IFRS 9;
 - Performing an analysis of IFRS 9-based impairment allowances as at the standard's initial application date, to those calculated in accordance with IAS 39, and assessing their reasonableness based on inquiries of the credit risk management personnel.

For impairment allowances calculated individually:

- Selecting a sample of individual exposures, with focus on those with the greatest potential impact on the condensed financial statements due to their magnitude and risk characteristics, as well as lower value items, which we independently assessed as high-risk, such as watchlisted, restructured or rescheduled exposures, loans to clients operating in higher risk industries, non-performing exposures with low provision coverage and loans with significant change in the provision coverage;
- For the sample selected, critically assessing, by reference to the underlying documentation (loan files) and through discussion with the loan officers and credit risk management personnel, the existence of any triggers for classification to Stage 2 or Stage 3 as at 30 June 2018;
- For those loans where triggers for classification in Stage 3 were identified, challenging key assumptions applied in the Management Board's estimates of future cash flows used in the impairment calculation, such as discount rates, collateral values and realization period, and performing respective independent recalculations, where relevant, with the assistance of our own valuation specialists.

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Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (*continued*)

Report on the Audit of the Condensed Separate and Consolidated Interim Financial Statements (*continued*)

Key audit matter	How our audit addressed the matter
<p>For the above reasons, impairment of loans to other customers was considered by us to be a significant risk in our audit, which required our increased attention. Accordingly, we considered the area to be our key audit matter.</p>	<ul style="list-style-type: none">● In addition to testing of model, as described above, for collective impairment allowance, independently estimating the key ECL model parameters, as follows:<ul style="list-style-type: none">– EAD - by agreeing data on exposures (both balance and off balance sheet) back to source system and contractual data on a sample basis;– PD - by independent back-testing of PDs derived by the Bank and the Group, by using more recent data;– LGD – by independent back-testing of LGDs produced by the Bank's and the Group's model by reference to date on defaults that occurred in the prior periods; <p>For exposures assessed on an individual and collective basis:</p> <ul style="list-style-type: none">● Independently recalculating projected ECL, reconciling it with actual ECL recognized and inspecting any significant differences;● Assessing the accuracy and completeness of the impairment-related financial statement disclosures, included, but not limited to, those associated with the initial application of IFRS 9.

Responsibilities of Management and Those Charged with Governance for the Condensed Financial Statements

Management is responsible for the preparation of the condensed financial statements that give a true and fair view in accordance with IAS 34 Interim Financial Reporting, and for such internal control as management determines is necessary to enable the preparation of the condensed financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the condensed financial statements, management is responsible for assessing the Bank's and the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank and/or the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's and the Group's financial reporting process.



Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (*continued*)

Report on the Audit of the Condensed Separate and Consolidated Interim Financial Statements (*continued*)

Auditors' Responsibilities for the Audit of the Condensed Financial Statements

Our objectives are to obtain reasonable assurance about whether the condensed financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these condensed financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the condensed financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's and/or the Group's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's and/or the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the condensed financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank and the Group to cease to continue as a going concern.



Independent Auditors' Report to the owner of Croatian Bank for Reconstruction and Development (*continued*)

Report on the Audit of the Condensed Separate and Consolidated Interim Financial Statements (*continued*)

Auditors' Responsibilities for the Audit of the Condensed Financial Statements (continued)

- Evaluate the overall presentation, structure and content of the condensed financial statements, including the disclosures, and whether the condensed financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the condensed financial statements of the Group. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the condensed financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

We were appointed by those charged with governance on 14 March 2018 to audit the condensed financial statements of the Bank and the Group for the six-month period ended 30 June 2018. Our engagement so far covers the period ending 30 June 2018.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated 23 August 2018;
- for the period to which our statutory audit relates, we have not provided any non-audit services (NASs), hence we have not provided any prohibited non-audit services referred to in Article 44 of the Audit Act. We also remained independent of the audited entity in conducting the audit.

KPMG Croatia d.o.o. za reviziju
Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb
Croatia

K P M G Croatia
d.o.o. za reviziju
Eurotower, 17. kat
Ivana Lučića 2a. 10000 Zagreb

24 August 2018

Katarina Kecko

Director, Croatian Certified Auditor

This version of our audit report is a translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation

Condensed Consolidated Interim Financial Statements of the Group
Statement of Profit or Loss
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	Notes	2018		2017	
		Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000
Interest income	6	190,152	381,034	212,930	451,841
Interest expense	7	(84,890)	(169,293)	(107,046)	(215,153)
Net interest income		105,262	211,741	105,884	236,688
Fee income		12,267	24,986	8,851	16,344
Fee expense		(1,681)	(2,145)	(793)	(1,677)
Net fee income		10,586	22,841	8,058	14,667
Net gains/(losses) on financial operations		5,289	18,389	(4,529)	(7,813)
Other income		4,978	7,841	4,405	8,362
		126,115	260,812	113,818	251,904
Operating expenses	8	(41,973)	(75,490)	(40,881)	(78,029)
Impairment loss and provisions	9	36,907	10,721	16,414	(43,125)
Profit before income tax		121,049	196,043	89,351	130,750
Income tax		-	-	-	-
Profit for the period		121,049	196,043	89,351	130,750
Attributable to:					
Owner of the Bank		121,049	196,043	89,351	130,750

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Consolidated Interim Financial Statements of the Group
Statement of Profit or Loss and Other Comprehensive Income
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	2018		2017	
	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
	HRK '000	HRK '000	HRK '000	HRK '000
Profit for the period	121,049	196,043	89,351	130,750
Other comprehensive income				
Items that are not transferred subsequently to profit or loss:				
Deferred tax – adjustment for previous period	-	(16)	-	-
Total items that are not transferred subsequently to profit or loss	-	(16)	-	-
Items that may be reclassified subsequently to profit or loss:				
Increase in fair value of financial assets at fair value through other comprehensive income	3,730	14,615	n/a	n/a
Decrease in fair value of financial assets at fair value through other comprehensive income	(8,867)	(16,518)	n/a	n/a
Increase in fair value of assets available for sale	n/a	n/a	5,211	21,763
Decrease in fair value of assets available for sale	n/a	n/a	(5,347)	(20,156)
Net foreign exchange on available for sale equity instruments	(180)	(457)	(109)	(517)
Transfer of realized gains on assets available for sale to statement of profit or loss	n/a	n/a	(8,115)	(8,116)
Transfer of realized losses on assets available for sale to statement of profit or loss	n/a	n/a	6,499	6,505
Impairment of financial assets at fair value through other comprehensive income	404	1,155	n/a	n/a
Deferred tax – other comprehensive income	42	(13)	(24)	(25)
Total items that may be reclassified subsequently to profit or loss	(4,871)	(1,218)	(1,885)	(546)
Other comprehensive income after income tax	(4,871)	(1,234)	(1,885)	(546)
Total comprehensive income after income tax	116,178	194,809	87,466	130,204
Attributable to:				
Owner of the Bank	116,178	194,809	87,466	130,204

*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Consolidated Interim Financial Statements of the Group
Statement of Financial Position
as of

(All amounts are expressed in HRK thousand)

	Notes	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Assets			
Cash on hand and current accounts with banks	10	818,191	1,403,680
Deposits with other banks	11	14,569	29,138
Loans to financial institutions	12	10,033,644	10,836,141
Loans to other customers	13	12,269,881	12,383,623
Financial assets at fair value through profit or loss	14	661,894	291
Financial assets at fair value through other comprehensive income	15	3,102,164	n/a
Debt instruments at amortised cost	16	1,364	n/a
Assets available for sale	17	n/a	3,321,564
Assets held to maturity	18	n/a	1,399
Investments in associates		-	-
Property, plant and equipment and intangible assets		51,974	53,557
Non-current assets held for sale	19	25,015	16,697
Other assets	20	12,640	29,471
Total assets		26,991,336	28,075,561
Liabilities			
Deposits from customers		177,704	644,741
Borrowings	21	15,067,557	15,387,881
Debt securities issued	22	1,109,293	1,161,699
Other liabilities	23	632,423	605,453
Total liabilities		16,986,977	17,799,774
Equity			
Founder's capital		7,009,632	7,009,632
Retained earnings and reserves		2,717,118	2,996,968
Other reserves		69,483	94,683
Profit for the period		196,043	162,201
		9,992,276	10,263,484
Guarantee fund		12,083	12,303
Total equity		10,004,359	10,275,787
Total liabilities and total equity		26,991,336	28,075,561

*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Consolidated Interim Financial Statements of the Group
Statement of Cash Flows
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	Notes	2018 HRK '000	2017 HRK '000
Operating activities			
Profit before income tax		196,043	130,750
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>			
Depreciation		3,320	3,956
Income tax		-	25
Impairment loss and provisions		(10,721)	43,125
Accrued interest		(42,474)	(64,118)
Deferred fees		(19,646)	(7,715)
Other changes in assets at fair value		7,693	(3,035)
<i>Operating profit before working capital changes</i>		<i>134,215</i>	<i>102,988</i>
<i>Changes in operating assets and liabilities:</i>			
Net decrease in deposits with other banks, before impairment		14,888	22,570
Net decrease in loans to financial institutions, before impairment		930,129	613,697
Net increase in loans to other customers, before impairment		(353,287)	(246,516)
Net loss/(gain) on financial assets at fair value through profit or loss		3	(3)
Decrease of discount in debt securities issued		1,901	2,498
Net (increase)/decrease in non-current assets held for sale		(8,268)	212
Net increase in other assets, before impairment		(1,584)	(395)
Net increase/(decrease) in deposits from banks and companies		(467,037)	338,134
Net decrease in other liabilities, before provisions		(52,553)	(55,174)
Net cashflow from operating activities		198,407	778,011
Investment activities			
Net purchase of assets available for sale		n/a	(941,243)
Sale of assets available for sale		n/a	1,215,201
Purchase of financial assets at fair value through profit or loss		(1,500)	n/a
Sale of financial assets at fair value through profit or loss		150,450	n/a
Purchase of financial assets at fair value through other comprehensive income		(1,439,166)	n/a
Sale of financial assets at fair value through other comprehensive income		835,000	n/a
Net purchase of property, plant and equipment and intangible assets		(1,705)	(1,814)
Net cash (used in)/provided from investment activities		(456,921)	272,144
Financing activities			
Increase in borrowings – withdrawn funds		1,435,724	3,154,491
Decrease in borrowings – repayments of principal		(1,501,702)	(823,167)
Decrease in debt securities issued – repayment		-	(1,852,051)
Net cash (used in)/provided from financing activities		(65,978)	479,273
Effect of foreign currency to cash and cash equivalents			
Net foreign exchange		(261,823)	(340,595)
Net effect		(261,823)	(340,595)
Net (decrease)/increase in cash and cash equivalents		(586,315)	1,188,833
Balance as of 1 January, before impairment		1,404,538	494,325
Net (decrease)/increase in cash and cash equivalents		(586,315)	1,188,833
Balance as of 30 June, before impairment	10	818,223	1,683,158
Additional note - Operational cash flows			
Interest paid		201,043	294,418
Interest received		310,324	386,192

*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Consolidated Interim Financial Statements of the Group
Statement of Changes in Equity
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Profit for the year HRK '000	Total HRK '000
Balance as of 1 January 2017	6,959,632	2,682,127	73,733	314,841	10,030,333
Profit for the period	-	-	-	130,750	130,750
Other comprehensive income	-	-	(546)	-	(546)
Total comprehensive income	-	-	(546)	130,750	130,204
Transfer of profit 2016 to retained earnings	-	314,841	-	(314,841)	-
Balance as of 30 June 2017	6,959,632	2,996,968	73,187	130,750	10,160,537
Balance as at 31 December 2017	7,009,632	2,996,968	94,683	162,201	10,263,484
The effect of first time adoption of IFRS 9 as at 1 January 2018	-	(469,974)	-	-	(469,974)
Provisions recognised in Other comprehensive income	-	-	4,288	-	4,288
The effect of reclassification financial assets under IFRS 9 ¹	-	28,254	(28,254)	-	-
Other adjustments	-	(331)	-	-	(331)
Balance as of 1 January 2018	7,009,632	2,554,917	70,717	162,201	9,797,467
Profit for the period	-	-	-	196,043	196,043
Other comprehensive income	-	-	(1,234)	-	(1,234)
Total comprehensive income	-	-	(1,234)	196,043	194,809
Transfer of profit 2017 to retained earnings	-	162,201	-	(162,201)	-
Balance as of 30 June 2018	7,009,632	2,717,118	69,483	196,043	9,992,276

The accompanying accounting policies and notes are an integral part of these financial statements.

¹ The effect of reclassification of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through profit or loss, due to which the effect was transferred from Other reserves (fair value reserve) to Retained Earnings.

Condensed Separate Interim Financial Statements of the Bank
Statement of Profit or Loss
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	Notes	2018		2017	
		Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
		HRK '000	HRK '000	HRK '000	HRK '000
Interest income	6	189,809	380,302	212,509	451,012
Interest expense	7	(84,890)	(169,293)	(107,046)	(215,153)
Net interest income		104,919	211,009	105,463	235,859
Fee income		11,652	23,865	8,215	15,060
Fee expense		(1,681)	(2,145)	(793)	(1,677)
Net fee income		9,971	21,720	7,422	13,383
Net gains/(losses) on financial operations		5,476	18,692	(4,483)	(7,574)
Other income		3,339	4,574	2,926	4,970
		123,705	255,995	111,328	246,638
Operating expenses	8	(40,013)	(71,786)	(38,642)	(74,132)
Impairment loss and provisions	9	36,851	10,724	16,419	(43,150)
Profit before income tax		120,543	194,933	89,105	129,356
Income tax		-	-	-	-
Profit for the period		120,543	194,933	89,105	129,356
Attributable to:					
Owner of the Bank		120,543	194,933	89,105	129,356

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Separate Interim Financial Statements of the Bank
Statement of Profit or Loss and Other Comprehensive Income
for the period 1 January – 30 June

(All amounts are expressed in HRK thousand)

	2018		2017	
	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
	HRK '000	HRK '000	HRK '000	HRK '000
Profit for the period	120,543	194,933	89,105	129,356
Other comprehensive income				
Items that may be reclassified subsequently to profit or loss:				
Increase in fair value of financial assets at fair value through other comprehensive income	3,619	14,072	n/a	n/a
Decrease in fair value of financial assets at fair value through other comprehensive income	(8,525)	(16,045)	n/a	n/a
Increase in fair value of assets available for sale	n/a	n/a	4,706	20,527
Decrease in fair value of assets available for sale	n/a	n/a	(4,986)	(19,056)
Net foreign exchange on available for sale equity instruments	(180)	(457)	(109)	(517)
Transfer of realized gains on assets available for sale to statement of profit or loss	n/a	n/a	(8,115)	(8,115)
Transfer of realized losses on assets available for sale to statement of profit or loss	n/a	n/a	6,499	6,499
Impairment of financial assets at fair value through other comprehensive income	404	1,155	n/a	n/a
Total items that may be reclassified subsequently to profit or loss	(4,682)	(1,275)	(2,005)	(662)
Other comprehensive income after tax	(4,682)	(1,275)	(2,005)	(662)
Total comprehensive income after tax	115,861	193,658	87,100	128,694
Attributable to:				
Owner of the Bank	115,861	193,658	87,100	128,694

*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Separate Interim Financial Statements of the Bank
Statement of Financial Position as of
(All amounts are expressed in HRK thousand)

		Jun 30, 2018	Dec 31, 2017
	Notes	HRK '000	HRK '000
Assets			
Cash on hand and current accounts with banks	10	810,309	1,401,146
Deposits with other banks	11	14,569	29,138
Loans to financial institutions	12	10,033,644	10,836,141
Loans to other customers	13	12,269,881	12,383,623
Financial assets at fair value through profit or loss	14	655,451	n/a
Financial assets at fair value through other comprehensive income	15	3,062,673	n/a
Assets available for sale	17	n/a	3,277,194
Investments in subsidiaries		36,124	36,124
Investments in associates		-	-
Property, plant and equipment and intangible assets		51,883	53,514
Non-current assets held for sale	19	25,015	16,697
Other assets	20	10,364	22,226
Total assets		26,969,913	28,055,803
Liabilities			
Deposits from customers		177,704	644,741
Borrowings	21	15,067,557	15,387,881
Debt securities issued	22	1,109,293	1,161,699
Other liabilities	23	618,751	592,651
Total liabilities		16,973,305	17,786,972
Equity			
Founder's capital		7,009,632	7,009,632
Retained earnings and reserves		2,715,028	2,995,656
Other reserves		64,932	90,457
Profit for the period		194,933	160,783
		9,984,525	10,256,528
Guarantee fund		12,083	12,303
Total equity		9,996,608	10,268,831
Total liabilities and total equity		26,969,913	28,055,803

*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Separate Interim Financial Statements of the Bank
Statement of Cash Flows
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	Notes	2018 HRK '000	2017 HRK '000
Operating activities			
Profit before income tax		194,933	129,356
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>			
Depreciation		3,298	3,926
Impairment loss and provisions		(10,724)	43,150
Accrued interest		(42,478)	(64,096)
Deferred fees		(19,646)	(7,715)
Other changes in assets at fair value		7,634	(3,255)
<i>Operating profit before working capital changes</i>		<i>133,017</i>	<i>101,366</i>
<i>Changes in operating assets and liabilities:</i>			
Net decrease in deposits with other banks, before impairment		14,888	22,570
Net decrease in loans to financial institutions, before impairment		930,129	613,697
Net increase in loans to other customers, before impairment		(353,287)	(246,516)
Decrease of discount in debt securities issued		1,901	2,498
Net (increase)/decrease in non-current assets held for sale		(8,268)	212
Net increase in other assets, before impairment		(6,651)	(2,187)
Net (decrease)/increase in deposits from banks and companies		(467,037)	338,134
Net decrease in other liabilities, before provisions		(53,008)	(55,263)
Net cash from operating activities		191,684	774,511
Investment activities			
Net purchase of assets available for sale		n/a	(934,826)
Sale of assets available for sale		n/a	1,211,829
Sale of financial assets at fair value through profit or loss		150,450	n/a
Purchase of financial assets fair value through other comprehensive income		(1,439,166)	n/a
Sale of financial assets fair value through other comprehensive income		835,000	n/a
Net purchase of property, plant and equipment and intangible assets		(1,635)	(1,804)
Net cash (used in)/provided from investment activities		(455,351)	275,199
Financing activities			
Increase in borrowings – withdrawn funds		1,435,724	3,154,491
Decrease in borrowings – repayments of principle		(1,501,702)	(823,167)
Decrease in debt securities issued – repayment		-	(1,852,051)
Net cash (used in)/provided from financing activities		(65,978)	479,273
Effect of foreign currency to cash and cash equivalents			
Net foreign exchange		(262,018)	(340,857)
Net effect		(262,018)	(340,857)
Net (decrease)/increase in cash and cash equivalents		(591,663)	1,188,126
Balance as of 1 January, before impairment		1,402,004	493,774
Net (decrease)/increase in cash and cash equivalents		(591,663)	1,188,126
Balance as at 30 June, before impairment	10	810,341	1,681,900
Additional note – operating activities			
Interest paid		201,043	294,418
Interest received		309,462	385,174

*n/a = not applicable due to the implementation of IFRS 9

The accompanying accounting policies and notes are an integral part of these financial statements.

Condensed Separate Interim Financial Statements of the Bank
Statement of Changes in Equity
for the period 1 January – 30 June
(All amounts are expressed in HRK thousand)

	Founder's capital HRK '000	Retained earnings and reserves HRK '000	Other reserves HRK '000	Profit for the period HRK '000	Total HRK '000
Balance as at 1 January 2017	6,959,632	2,682,131	70,317	313,525	10,025,605
Profit for the period	-	-	-	129.356	129.356
Other comprehensive income	-	-	(662)	-	(662)
Total comprehensive income	-	-	(662)	129.356	128.694
Transfer of profit 2016 to retained earnings	-	313,525	-	(313,525)	-
Balance as at 30 June 2017	6.959.632	2.995.656	69.655	129.356	10.154.299
Balance as at 31 December 2017	7,009,632	2,995,656	90,457	160,783	10,256,528
The effect of first time adoption of IFRS 9 as at 1 January 2018	-	(469,658)	-	-	(469,6658)
Provisions recognised in Other comprehensive income	-	-	3,997	-	3.997
The effect of reclassification financial assets under IFRS 9 ²	-	28,247	(28,247)	-	-
Balance as at 1 January 2018	7,009,632	2,554,245	66,207	160,783	9,790,867
Profit for the period	-	-	-	194,933	194,933
Other comprehensive income	-	-	(1,275)	-	(1,275)
Total comprehensive income	-	-	(1,275)	194,933	193,658
Transfer of profit 2017 to retained earnings	-	160,783	-	(160,783)	-
Balance as at 30 June 2018	7,009,632	2,715,028	64,932	194,933	9,984,525

The accompanying accounting policies and notes are an integral part of these financial statements.

² The effect of reclassification of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through profit or loss, due to which the effect was transferred from Other reserves (fair value reserve) to Retained Earnings.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018

(All amounts are expressed in HRK thousand)

1. General information

1.1. Group:

The Croatian Bank for Reconstruction and Development („HBOR“ or „the Bank“) is the parent company of the Croatian Bank for Reconstruction and Development Group („Group“) that operates in the Republic of Croatia. The Group primarily performs banking activities and, to the lesser extent, insurance activities and credit risk assessment activities. These Financial Statements include condensed separate and consolidated financial statements of the Bank and the Group (“Condensed Interim Financial Statements”).

The headquarters of the Bank is located at Strossmayerov trg 9, Zagreb, Croatia.

The Group was formed in 2010, the Bank’s subsidiary companies are Hrvatsko kreditno osiguranje d.d. and Poslovni info servis d.o.o. that constitute the Hrvatsko kreditno osiguranje Group (“HKO Group”).

The Croatian Bank for Reconstruction and Development is the 100% owner of HKO, which is 100% owner of Poslovni info servis d.o.o.

The legal address of the HKO Group is Zagreb, Bednjanska 12.

As of 30 June 2018, the Group had 391 employees (as of 30 June 2017: 377 employees), of which 7 are new employees and 7 employees are in substitution for maternity leave, long-term sick leave and return from unpaid leave.

1.2. Bank:

The Croatian Bank for Reconstruction and Development (“HBOR” or “the Bank”) was established on 12 June 1992 under the Act on the Croatian Credit Bank for Reconstruction (“HKBO”). In December 1995, the Bank changed its name to Croatian Bank for Reconstruction and Development. The founder and 100% owner of HBOR is the Republic of Croatia.

The Republic of Croatia guarantees HBOR’s liabilities unconditionally, irrevocably and on first call, without issuing any particular guarantee.

The responsibility of the Republic of Croatia as guarantor for HBOR’s liabilities is joint and unlimited.

With the Act on the Croatian Bank for Reconstruction and Development passed in December 2006, HBOR’s founding capital was HRK 7 billion, the payment schedule of which is determined by the State budget.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

1. General information (continued)

1.2. Bank (continued):

Supervisory Board

On the date of preparing these statements, members of the Supervisory Board were as follows:

- Zdravko Marić, DSc, Minister of Finance - ex officio President of the Supervisory Board,
- Darko Horvat, Minister of the Economy, Entrepreneurship and Trade – ex officio Vice President of the Supervisory Board,
- Predrag Štromar, Deputy Prime Minister of the Republic of Croatia and Minister of Construction and Physical Planning,
- Tomislav Tolušić, Deputy Prime Minister and Minister of Agriculture,
- Gabrijela Žalac, Minister of Regional Development and EU Funds,
- Gari Cappelli, Minister of Tourism,
- Luka Burilović, President of the Croatian Chamber of Economy – ex officio Member of the Supervisory Board,
- Boris Lalovac, MSc, Member of the Croatian Parliament,
- Božica Makar, Member of the Croatian Parliament,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament.

Management Board

On the date of preparing these statements, members of the Management Board of HBOR were as follows:

- Tamara Perko, MSc, President of the Management Board and
- Hrvoje Čuvalo, MSc, Member of the Management Board.

As of 30 June 2018, HBOR had 372 employees (as of 30 June 2017: 361 employees), of which 4 are new employees and 7 employees are in substitution for maternity leave, long-term sick leave and return from unpaid leave.

Audit Committee

On the date of preparing these statements, members of the Audit Committee were as follows:

- Prof. DSc. Lajoš Žager, Dean of the Faculty of Economics and Business of the University of Zagreb, acting as the Chairman of the Audit Committee,
- Grozdana Perić, Chairman of the Finance and Central Budget Committee of the Croatian Parliament, acting as the Vice Chairman of the Audit Committee,
- Aurora Volarević, Director of Internal Controls, Audit and Risk in Hrvatski telekom d.d., acting as a Member of the Audit Committee.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

1. General information (continued)

1.2. Bank (continued):

1.2.1. Activities of the Bank:

The principal activities of the Bank comprise the following:

- financing of reconstruction and development of the Croatian economy,
- financing of infrastructure,
- promoting exports,
- providing support to the development of SMEs,
- promoting environmental protection, and
- providing domestic goods and services export insurance against non-market risks for and on behalf of the Republic of Croatia.

HBOR may perform other financial activities according to the decisions of the Government of the Republic of Croatia if, in their opinion, it is in the best interest of the Republic of Croatia.

2. Basis of Preparation of the Condensed Interim Financial Statements

The Condensed Interim Financial Statements of the Bank and HBOR Group for the period 1 January to 30 June 2018 have been prepared in accordance with the International Accounting Standard 34 Interim Financial Reporting.

The Condensed Interim Financial Statements for the period from 1 January to 30 June 2018 do not include all information and disclosures that are required in the annual financial statements and should be read in combination with the annual financial statements of the HBOR Group for the year ended 31 December 2017, except for changes in the accounting of financial instruments arising from the application of IFRS 9 Financial instruments. The application of IFRS 9 resulted in changes in the accounting policies relating to the classification and measurement and impairment of financial assets as well as derecognition.

Changes in significant accounting policies are described in Note 4.1.

The Condensed Interim Financial Statements of the Group and the Bank are prepared on a going concern basis.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

3. Significant accounting judgments and estimates

For the preparation of financial statements in accordance with IFRS's, the Management Board is required to give estimations and make assumptions that influence the reported balances of assets and liabilities and to disclose contingent amounts of assets and liabilities at the date of financial statements, and present income and expense for the reporting period. Estimations and related assumptions are based on historical experience and various other factors that are considered to be reasonable in the given circumstances and with available information as of the date of preparation of the financial statements, which together form the basis for estimating the carrying amount of assets and liabilities that cannot be easily identified from other sources. Actual results may differ from these estimations. Estimations and related assumptions are continuously reviewed. Changes in accounting estimates are recognised in the period in which the estimate is changed if the change affects only that period, or in the period of change or future periods if the change affects the current and future periods.

Significant accounting judgements and estimates were the same as those described in the last annual financial statements, except for new significant judgements and key sources of estimation uncertainty related to the application of IFRS 9, which are described in Note 4.1.

4. Summary of significant accounting policies

4.1. Accounting policies

Since 1 January 2018, the Group has applied the International Standard of Financial Reporting (IFRS) 9 Financial Instruments and has not restated comparative data for 2017, as allowed by the standard. Pursuant to the mentioned, the current period from 1 January to 30 June 2018 is based on IFRS 9, whereas the results for 2017 and for the period from 1 January to 30 June 2017 are based on the International Accounting Standard (IAS) 39, Financial instruments: recognition and measurement and comparative data for 2017 are not comparable with the information presented in 2018.

The effects of the application of IFRS 9 recognised directly in retained earnings and reserves as at 1 January 2018 for the Group amount to HRK 469.97 million and for the Bank amount to HRK 469.66 million.

Detailed description of changes has been disclosed in notes 4.1.1. Changes in accounting policies due to the application of IFRS 9 Financial instruments and 5. Transition to IFRS 9 of these condensed interim financial statements.

Since 1 January 2018, the Group has also applied the International Financial Reporting Standard 7R (revised due to the application of IFRS 9) in the extent required for the preparation of interim financial standards in accordance with IAS 34.

Other basic accounting policies applied in the preparation of condensed interim financial statements are the same as for the preparation of the Annual Financial Statements as at 31 December 2017 that are publicly available at the address: <http://www.hbor.hr>.

Although subsidiary companies, the HKO Group, due to immateriality, uses the temporary exemption from 1 January 2018 until 1 January 2021, pursuant to the amendment of IFRS 4 – application of IFRS 9 Financial instruments with IFRS 4 Insurance Contracts, and the financial statements of the Group are prepared with the full application of IFRS 9.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments

I. Financial assets

Financial assets are initially recognised at their fair value, which is, in case of financial assets that are not subsequently measured at fair value through profit or loss, increased by transaction costs that may be directly attributed to the acquisition or issuing of financial assets. If the fair value of the financial assets is different from the transaction cost, the difference established in such manner is recognised in the statement on profit and loss.

Financial assets of the Group consist of:

- Cash in hand and funds on the transaction accounts,
- Deposits with banks,
- Loans,
- Debt securities,
- Equity securities,
- Shares in investment funds,
- Derivative financial assets and
- Other receivables.

a) Business models

All financial assets, except for investments in equity securities classified in the category of investments in associates and subsidiary with more than 20% of voting power or control, are grouped in business models which reflects how the Group manages the group of financial assets to realise certain business objective and to generate cash flows.

Business models of the Group are:

- Business model, whose objective is to hold assets for the collection of contractual cash flows – it includes all financial assets held for the purpose of collection of contractual cash flows over the lifetime of the financial instrument.

For the purpose of classification in this business model, financial assets goes through the SPPI (Solely payment of principal and interest) test, and the following financial assets are allocated to this model:

- o Cash on hand and funds on transaction accounts,
- o Deposits with banks,
- o Loans and reversed repo placements,
- o Other receivables,

Credit risk is a basic risk managed under this business model.

- Business model aimed to collect the contractual cash flows and sale of financial assets – it includes financial assets held for the purpose of collecting the agreed cash flows and sale of financial assets.

The following financial assets are allocated to the business model for the purpose of collection and sale:

- o Debt securities (pass SPPI test),
- o Equity securities (fail SPPI test),
- o Shares in investment funds (fail SPPI test),

Liquidity risk is a basic risk managed under this business model.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

a) Business models (continued)

- Business model under which financial assets are measured at fair value through profit and loss account (fail SPPI test) – combines all financial assets that are not held under the previously mentioned two business models.
Financial assets under this business model are managed for the purpose of generating cash flows from the sale of assets and generating short-term profit.

b) SPPI test

Test of features of contractual cash flows from the point of view of solely payment of principal and interest (hereinafter: SPPI test) is one of the criteria for the classification of financial assets in an individual category of measurement. SPPI test is implemented for the purpose of establishing whether the interest rate on unsettled principle reflects the fee for time value of money, credit risk and other basic risks of borrowing, lending costs and profit margin.

SPPI test is performed:

- For each financial asset, allocated to a business model whose purpose is to hold financial assets for the payment of contractual cash flows and a business model for the purpose of collecting contractual cash flows and selling financial asset on the date of its initial recognition,
- For each financial asset in cases where the original asset has been significantly modified and therefore re-recognised as new assets,
- When introducing new models and/or loan programs to determine in advance the eligibility of the considered loan term and conditions in relation to the need to subsequently monitor the value of any financial assets that would arise from them.

c) Classification of financial assets

All financial assets are classified based on the allocation of financial assets in business models and SPPI test as assets measured subsequently at:

1) amortised cost, if both conditions are fulfilled:

- financial assets are allocated to the business model with the objective of holding the assets for the purpose of collection of contractual cash flows and
- financial asset pass SPPI test – for financial assets, cash flows are established that are solely payment of principal and interest on unsettled principal amount.

2) fair value through other comprehensive income, if both conditions are fulfilled:

- financial assets are allocated to the business model with the objective of collecting the contractual cash flows and selling financial assets and

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

c) Classification of financial assets (continued)

- financial asset pass SPPI test – for financial assets, cash flows are established that are solely payment of principal and interest on unsettled principal amount.

3) fair value through profit and loss

Financial value is measured at fair value through profit and loss, if not measured at amortised cost or at fair value through other comprehensive income. Exceptionally, for investments in equity instruments that would otherwise be measured at fair value through profit and loss, at the initial recognition there is a possibility of irrevocable option of classification of the asset at fair value through other comprehensive income. In such case, the loss allowance recognised under other comprehensive income will never be transferred to statement on profit and loss, even in the case of derecognition of a financial instrument (financial assets valued at fair value through other comprehensive income without „recycling“). The Bank has used this possibility for a portion of equity instruments.

d) Reclassification of financial assets

In case of change in the business model of financial assets management, all financial assets affected by the reclassification will be reclassified. Reclassification will be made prospectively, from the date of the reclassification, or from the first day of the next accounting period, respectively, without restating the previously recognised profit, loss or interest.

e) Impairment

Impairment of financial assets is recognised under the model of expected credit losses for assets that are subsequently measured at amortised cost and assets that are subsequently measured at fair value through other comprehensive income.

Impairment is performed during the accounting periods and at the year end at the balance sheet date, and the effects of impairment are stated for each asset individually in the statement on financial position, other comprehensive income and statement on profit and loss.

Impairment is performed by applying the general and simplified approach.

According to the **general approach** of impairment, financial assets are allocated at initial recognition to:

- Stage 1 – financial assets with no significant credit risk or
- POCI assets as financial assets that are purchased or originally credit impaired that are allocated to stage 3.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

e) Impairment (continued)

Following initial recognition, all financial assets that have not been recognised as POCI assets are allocated in risk categories depending on the assessment whether significant increase in credit risk occurred and in accordance with other credit impairment criteria to three stages:

Stage 1 – financial instruments with low credit risk are allocated to this stage, such as:

- Financial instruments of issuers with investment rating given by external credit rating agencies
- Exposures to the Republic of Croatia and units of local and regional government, the Croatian National Bank, the European Investment Bank or other development banks.

Financial instruments which are not deemed instruments of low credit risk only due to the value of collaterals, because without such collaterals they are not deemed low credit risk instruments.

For financial instruments allocated to this stage, impairments are calculated on a collective basis for twelve-month expected credit losses.

Stage 2 – financial instruments of clients where significant increase in credit risk is identified since initial recognition to this stage. Also individually significant clients included in the watch list, are also in this category.

For detailed explanation of the triggers for classification in Stage 2 please see note 26. Risk management.

For the financial instruments of clients classified into Stage 2, loss allowances are calculated on a collective basis for lifetime expected credit losses.

Stage 3 – financial instruments of clients in default – where objective evidence of the impairment has been identified as well as purchased or originated credit-impaired (POCI) financial assets.

Financial assets recognised as POCI assets remain allocated to Stage 3 until derecognition.

Expected credit losses are measured on a collective basis for clients allocated to Stage 1 and Stage 2 as well as for clients allocated to Stage 3, which are in the portfolio of small loans (gross exposure amount equal or lower than HRK 1,500 thousand), whereas individual assessment is carried out for the financial instruments of clients who are in a default status and for POCI assets.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

e) Impairment (continued)

When measuring the expected credit losses on a collective basis, HBOR has, on the basis of common credit risk characteristics, defined the following homogeneous groups:

- financial institutions,
- central government and local and regional government,
- direct large,
- direct SME,
- direct MICRO,
- direct citizens, and
- other receivables.

The calculation of the expected credit losses, i.e. probability of default (PD), for the category of central government and local and regional government was based on the ratings of external rating agencies for the Republic of Croatia: Standard & Poor's and on the publicly available reports of rating agencies on historical default rates.

The assessment of credit losses for financial institutions is based on the mapping of HBOR's ratings with the PDs of S&P rating agency, where the rating of Zagrebačka banka and the PD of Zagrebačka banka is used as the benchmark because this bank has an established rating.

The approach based on migration matrices was used for the modelling of PDs in the categories of direct loans (large, small and medium, micro, citizens) and others – development of exposure among the following risk categories:

- from 0 to 30 days overdue – Stage 1,
- from 31 to 90 days overdue – Stage 2,
- more than 90 days overdue and restructuring – default.

Credit loss is the difference between all contractual cash-flows and all cash-flows expected from debtors, discounted to the present value by using the original effective interest rate, or, in the case of POCI assets, by using the credit risk adjusted effective interest rate.

For the financial assets subsequently measured at amortised cost, the impairment is recognised in Profit or Loss, and the loss allowances reduce the carrying value of financial assets in the Statement of Financial Position. In the case of a reduction of the expected credit losses or due to the collection of receivables, loss allowances are reduced or cancelled in the Statement of Financial Position and are simultaneously recognised as income from the reversed loss allowance or income upon the collection in the Statement of Profit or Loss.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

e) Impairment (continued)

Impairment of financial assets classified at fair value through other comprehensive income is calculated by applying the model of expected credit losses in the manner that the loss allowances are recognised in other comprehensive income and do not reduce the carrying value of these financial assets in the Statement of Financial Position, with all gains or losses resulting from the impairment recognised in the Statement of Profit or Loss.

Gains or losses resulting from the change in the fair value of these financial assets are recognised as other comprehensive income, whereas foreign exchange gains or losses are recognised in the Statement of Profit or Loss.

The accumulated gains/losses recognised as other comprehensive income are reclassified from equity to the Profit or Loss after derecognition of assets and represent the reclassification adjustment, except for equity securities classified as financial assets at fair value through other comprehensive income, where reserves recognized within other comprehensive income will never be transferred to profit and loss.

Financial assets classified as assets at fair value through the Profit or Loss are initially and subsequently measured at the established fair value and are not subject to impairment; the fair value of assets is, however, established in accordance with the internal documents that regulate the methods of determining the value of financial instruments until derecognition of financial instruments.

Decrease or increase in the fair value of these financial assets is recorded through the increase or decrease in their carrying amount in the Statement of Financial Position, whereas gains or losses resulting from the change in the fair value are recognised in the Statement on Profit or Loss.

Simplified approach of impairment can be applied only from receivables from customers or receivables for leases as well as on other non-interest fees, and this impairment always equals the amount of the expected credit losses during the lifetime of the instrument.

At the initial recognition, the financial assets are allocated to Stage 2 (all financial assets that have not been credit impaired at initial recognition) or Stage 3 (all purchased or originated credit-impaired assets – POCI assets).

At the future reporting dates, all financial assets that have not been recognised as POCI assets are allocated exclusively in accordance with the credit impairment criteria to Stage 2 and Stage 3.

Financial assets that have been recognised as POCI assets remain allocated to Stage 3 until derecognition. Details regarding the methodology are stated in Note 26 Risk Management.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

f) Modification of financial assets

Modification of financial assets means any change in contractual terms that results in the change in contractual cash-flows. In the case of a modification that is not substantial, the change in contractual terms does not result in the derecognition of the respective financial assets and the new gross carrying amount is established as present value of modified contractual cash-flows discounted by applying the original effective interest rate (EIR).

The difference between the original gross carrying amount before modification and the gross carrying amount established on the basis of modified cash-flows after modification is recognised in Profit or Loss.

In the case of a substantial modification of financial assets, the financial assets are derecognised before modification and the modified financial assets are newly recognised as “new” financial assets and the new effective interest rate is established. The date of modification of contractual provisions is considered to be the date of initial recognition.

Impairment of newly recognised financial assets is recognised in the amount of the expected credit losses in a twelve-month period (Stage 1) until the conditions for the reclassification to Stage 2 have been met. If it is established that the modified financial assets at initial recognition have been credit impaired, the financial assets are recognised as purchased or originated credit-impaired financial assets (POCI assets) and the credit risk adjusted effective interest rate is determined.

g) Purchased or originated credit-impaired financial assets (POCI assets)

POCI assets are financial assets for which, at initial recognition, there is objective evidence of credit impairment as the credit risk of originated or issued assets is very high or, in the case of purchase, the assets have been purchased at a high discount.

At initial recognition, the expected credit losses are included in the fair value of POCI assets and the loss allowance equal zero.

On the reporting date, only cumulative changes in the lifetime expected credit losses that occur after the initial recognition of POCI assets are recognised as loss allowance for the impairment of POCI assets.

For the purposes of impairment calculation, the lifetime expected credit losses are always recognised for these assets.

POCI assets remain allocated to Stage 3 until derecognition.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

4. Summary of significant accounting policies (continued)

4.1. Accounting policies (continued)

4.1.1. Changes in the accounting policies due to the application of IFRS 9 Financial instruments (continued)

I. Financial assets (continued)

h) Interest income

Interest income for assets measured subsequently at amortised cost is calculated by using the effective interest rate (EIR) method, it is allocated and recorded in the Statement of Profit or Loss during a given period of time and relates to the entire interest income from financial instrument, including income from regular interest, subsidised interest and all fees of financial instrument that are a constituent element of the effective interest rate calculation.

Interest income is recognised depending on the credit risk stage of financial instrument, and the effective interest rate is applied on the gross carrying value of the financial assets when calculating interest income for the financial assets categorised as Stage 1 and Stage 2, whereas the effective interest rate is applied on the amortised cost of the financial assets when calculating interest income for the financial assets categorised as Stage 3. In the case of a reduction in credit risk and transfer of the financial assets from Stage 3 to Stage 2, the effective interest rate is again applied on the gross carrying value of the financial assets when calculating interest income in the future reporting periods.

For the purchased or originated credit-impaired financial assets (POCI assets), the credit risk adjusted effective interest rate is applied on the amortised cost of the POCI assets when calculating interest income.

4.2. Standards, supplements and interpretations of existing standards that are not yet in force and that have not been applied in the preparation of these financial statements

Numerous new standards and supplements to standards are in force for annual periods beginning on or after 1 January 2018 and earlier application is allowed; however, the Group has not adopted them earlier for the preparation of these financial statements. The Group considers that new standards and additions to the standards will not have a significant impact on consolidated and separate financial statements.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

5. Transition to IFRS 9

Below, the impact of adoption of IFRS 9 on the Statement of Financial Position and the Retained Earnings and Reserves of the Group and the Bank is presented, including the effect of replacement of accounting losses under IAS 39 with expected credit losses under IFRS 9:

Group	IAS 39		Remeasurement				IFRS 9		
	Category	Amount HRK '000	Reclassification HRK '000	ECL HRK '000	Impairment recognized in OCI HRK '000	Other ³ HRK '000	The effect of adjusting to fair value HRK '000	Amount HRK '000	Category
Financial assets									
Cash on hand and current accounts with banks	L & R ⁴	1,403,664	-	817	-	-	-	1,404,481	AC ⁵
Deposits with other banks	L & R	29,138	-	202	-	-	-	29,340	AC
Loans to financial institutions	L & R	10,836,141	-	106,906	-	943	-	10,943,990	AC
Loans to other customers	L & R	12,383,623	(3,840)	(717,902)	-	135,001	(176)	11,796,706	AC
<i>To: Financial assets at FVPL⁶</i>	A	-	(3,840)	-	-	-	(176)	-	
Other assets	L & R	19,297	-	(6,664)	-	-	-	12,633	AC
Assets held to maturity	L & R	1,399	(1,399)	-	-	-	-	-	
<i>To: Debt instruments at AC</i>	B	-	(1,399)	-	-	-	-	-	
Debt instruments at AC		-	1,399	(2)	-	-	-	1,397	AC
	L & R	24,673,262	(3,840)	(616,643)	-	135,944	(176)	24,188,547	AC
Assets available for sale	AFS	3,321,564	(3,321,564)	-	-	-	-	-	n/a
<i>To: Financial assets at FVOCI⁷</i>	C	-	(2,508,833)	-	-	-	-	-	
<i>To: Financial assets at FVPL</i>	D	-	(812,731)	-	-	-	-	-	
	AFS	3,321,564	(3,321,564)	-	-	-	-	-	n/a
Financial assets at FVOCI	n/a	-	-	-	-	-	-	2,508,833	FVOCI
<i>From: AFS⁸</i>	E	-	2,508,833	-	-	-	-	-	
	n/a	-	2,508,833	-	-	-	-	2,508,833	FVOCI
Financial assets at FVPL	FVPL/n/a	291	-	-	-	-	-	291	FVPL
<i>From: AFS</i>	F	-	812,731	-	-	-	-	812,731	
<i>From: Loans to other customers</i>	G	-	3,840	-	-	-	176	4,016	
	FVPL/n/a	291	816,571	-	-	-	176	817,038	FVPL
Total assets		27,995,117	-	(616,643)	-	135,944	-	27,514,418	
Provision for guarantees and commitments	H	(64,360)	-	15,013	-	-	-	(49,347)	
Other reserves		(94,683)	28,254	-	(4,288) ⁹	-	-	(70,717)	
<i>To: Retained earnings and Reserves</i>	I	-	28,254 ¹⁰	-	-	-	-	-	
<i>Recognition of expected credit losses in retained earnings</i>	J	-	-	(4,288)	-	-	-	-	
The effect of IFRS 9 on Retained Earnings and Reserves	K	-	-	(605,918)	(4,288)	135,944	-	-	

³ Others relates to interest nad fees transferred from the off-balance shet records net of the transfer of loan principal to financial assets at fair value through profit or loss.

⁴ L & R: Loans and receivables

⁵AC: Amortised cost

⁶ FVPL: Financial assets at fair value through profit or loss

⁷ FVOCI: Financial assets at fair value through other comprehensive income

⁸ AFS: Assets available for sale

⁹ The allowance for financial assets classified at fair value through other comprehensive income does not impact the carrying amount of financial assets in the Statement on Financial Position, but is recognised in the accounts of other comprehensive income.

¹⁰ The effect of adjusting to fair value of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through the Statement on Profit or Loss, due to which the effect from Other reserves is stated on Retained Earnings and Reserves.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

5. Transition to IFRS 9 (continued)

Bank	IAS 39		Remeasurement					IFRS 9	
	Category	Amount HRK '000	Reclassification HRK '000	ECL HRK '000	Impairment recognized in OCI HRK '000	Other ¹¹ HRK '000	The effect of adjusting to fair value HRK '000	Amount HRK '000	Category
Financial assets									
Cash on hand and current accounts with banks	L & R ¹²	1,401,130	-	817	-	-	-	1,401,947	AC ¹³
Deposits with other banks	L & R	29,138	-	202	-	-	-	29,340	AC
Loans to financial institutions	L & R	10,836,141	-	106,906	-	943	-	10,943,990	AC
Loans to other customers	L & R	12,383,623	(3,840)	(717,902)	-	135,001	(176)	11,796,706	AC
<i>To: Financial assets at FVPL¹⁴</i>	A		(3,840)	-	-	-	(176)	-	
Other assets	L & R	12,282	-	(6,641)	-	-	-	5,641	AC
	L & R	24,662,314	(3,840)	(616,618)	-	135,944	(176)	24,177,624	AC
Assets available for sale	AFS	3,277,194	(3,277,194)	-	-	-	-	-	n/a
<i>To: Financial assets at FVOCI¹⁵</i>	C		(2,469,160)	-	-	-	-	-	
<i>To: Financial assets at FVPL</i>	D		(808,034)	-	-	-	-	-	
	AFS	3,277,194	(3,277,194)	-	-	-	-	-	n/a
Financial assets at FVOCI	n/a	-	-	-	-	-	-	2,469,160	FVOCI
<i>From: AFS¹⁶</i>	E		2,469,160	-	-	-	-	-	
	n/a	-	2,469,160	-	-	-	-	2,469,160	FVOCI
Financial assets at FVPL	n/a	-	-	-	-	-	-	812,050	FVPL
<i>From: AFS</i>	F		808,034	-	-	-	-	808,034	
<i>From: Loans to other customers</i>	G		3,840	-	-	-	176	4,016	
	n/a	-	811,874	-	-	-	176	812,050	FVPL
Total assets		27,939,508	-	(616,618)	-	135,944	-	27,458,834	
Provision for guarantees and commitments	H	(64,360)	-	15,013	-	-	-	(49,347)	
Other reserves		(90,457)	28,247	-	(3,997) ¹⁷	-	-	66,207	
<i>To Retained earnings and reserves</i>	I		28,247 ¹⁸	-	-	-	-	-	
<i>Recognition of expected credit losses in retained earnings</i>	J		-	(3,997)	-	-	-	-	
The effect of IFRS 9 on Retained Earnings and Reserves	K		-	(605,602)	(3,997)	135,944	-	-	

¹¹ Others relates to interest and fees transferred from the off-balance sheet records net of the transfer of loan principal to financial assets at fair value through profit or loss

¹² L & R: Loans and receivables

¹³ AC: Amortised cost

¹⁴ FVPL: Financial assets at fair value through profit or loss

¹⁵ FVOCI: Financial assets at fair value through other comprehensive income

¹⁶ AFS: Assets available for sale

¹⁷ The allowance for financial assets classified at fair value through other comprehensive income does not impact the carrying amount of financial assets in the Statement on Financial Position, but is recognised in the accounts of other comprehensive income.

¹⁸ The effect of adjusting to fair value of financial assets that were measured under IAS 39 through other comprehensive income and reclassified under IFRS 9 as financial assets at fair value through the Statement on Profit or Loss, due to which the effect from Other reserves is stated on Retained Earnings and reserves.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

5. Transition to the IFRS 9 (continued)

- A** Since 1 January 2018, the Group has mezzanine loans, that are complex structured products and do not meet the criteria of the SPPI test. Therefore, these loans, which previously were measured at amortised cost in accordance with IAS 39, have been reclassified to financial assets measured at fair value through profit or loss. As at 31 December 2017, net value of these loans for the Group and the Bank amounted to HRK 3,840 thousand, whereas, as at 1 January 2018, estimated fair value equaled HRK 4,016 thousand and the estimation effect of HRK 176 thousand was recorded in the retained earnings and reserves.
- B** As of 1 January 2018, the Group has concluded that the assets previously classified as held to maturity are managed within the business model for collecting contractual cash flows and are measured at amortised cost as well as in accordance with IAS 39. Consequently, the Group has classified these instruments as Debt Securities at Amortised Cost and, as at 1 January 2018, the value of these instruments for the Group amounts to HRK 1,397 thousand and for the Bank HRK 0 thousand.
- C** Since 1 January 2018, the Group has concluded that, except for a small part, as described under D, the financial instruments, which were previously classified as liquidity reserve to the portfolio of assets available for sale, have been managed under the business model of collecting contractual cash flows and selling financial assets. Therefore, the Group has classified these instruments as debt securities, i.e. as financial assets at fair value through other comprehensive income. As at 1 January 2018, the value of these instruments for the Group amounted to HRK 2,508,833 thousand and for the Bank amounted to HRK 2,469,161 thousand. This category includes equity securities (shares of companies) that the Group has no intention to sell and which are subject to irrevocable option of subsequent measurement at fair value through other comprehensive income without recycling. As at 1 January 2018, the value of these instruments for the Group and the Bank amounted to HRK 25,462 thousand.
- D** Since 1 January 2018, the Group has classified part of its equity instruments in the amount of HRK 19,112 thousand as financial assets measured at fair value through profit or loss because they are measured neither at amortised cost nor at fair value through other comprehensive income. In addition, investments in investment funds (obligatorily under IFRS 9) for the Group in the amount of HRK 793,619 thousand and for the Bank HRK 788,921 thousand have been classified to these assets. These financial assets were previously classified to assets available for sale and gains/losses from measurement at fair value of investments in investment funds were previously recognised in other comprehensive income. At the reclassification of these assets, the cumulative gains/losses of HRK 28,254 thousand for the Group and HRK 28,247 thousand for the Bank, that were previously recognised in other comprehensive income have been reclassified from other reserves to retained earnings and reserves.
- E** As described under C
- F** As described under D
- G** As described under A
- H** Since 1 January 2018, the effect of calculating provisions pursuant to IFRS 9 for loan commitments amounts to HRK 15,013 thousand.
- I** As described under D
- J** Impairment of debt securities classified to Financial assets at fair value through other comprehensive income is calculated by recognising impairment losses in other comprehensive income without reducing the carrying amount of these financial assets in the Statement of Financial Position. As at 1 January 2018, for the Group they amounted to HRK 4,288 thousand and for the Bank HRK 3,997 thousand.
- K** The total effect of expected credit losses under IFRS 9 as a result of remeasurement amounts to HRK 469,974 thousand for the Group and HRK 469,658 thousand for the Bank, whereas the effect of reclassification of financial instruments, due to which cumulative gains/losses previously recognized in other comprehensive income were reclassified from equity to retained earnings and reserves, amounts to HRK 28,254 thousand for the Group and HRK 28,247 thousand for the Bank.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

6. Interest income

Interest income by borrowers:

	Group				Bank			
	2018		2017		2018		2017	
	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Public sector	31,811	56,155	27,443	55,378	31,469	55,424	27,022	54,549
State-owned companies	3,744	16,285	13,470	25,985	3,744	16,285	13,470	25,985
Foreign companies	4,820	9,430	3,223	6,509	4,820	9,430	3,223	6,509
Domestic companies	83,663	169,283	94,817	186,462	83,663	169,283	94,817	186,462
Domestic financial institutions	55,750	110,254	61,107	125,822	55,749	110,253	61,107	125,822
Foreign financial institutions	94	407	38	173	94	407	38	173
Penalty interest	3,712	5,680	1,922	4,157	3,712	5,680	1,922	4,157
Other	6,558	13,540	10,910	47,355	6,558	13,540	10,910	47,355
	190,152	381,034	212,930	451,841	189,809	380,302	212,509	451,012

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

6. Interest income (continued)

Interest income by type of facility:

	2018		2017		2018		2017	
	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000
Interest on loans								
- financial institutions	55,974	110,486	61,826	128,389	55,974	110,486	61,826	128,389
- other customers	125,580	252,889	140,932	302,003	125,580	252,889	140,932	302,003
	181,554	363,375	202,758	430,392	181,554	363,375	202,758	430,392
Investments in securities	8,498	17,245	10,132	21,270	8,155	16,513	9,711	20,441
-Bonds of the Ministry of Finance of the Republic of Croatia	7,554	15,075	7,838	15,780	7,223	14,366	7,462	15,022
-Corporate bonds	29	57	62	105	17	34	17	34
-Treasury bills of the Ministry of Finance of the Republic of Croatia	915	2,113	2,232	5,385	915	2,113	2,232	5,385
Deposits	100	414	40	179	100	414	40	179
	190,152	381,034	212,930	451,841	189,809	380,302	212,509	451,012

The difference between interest income and interest received or collected (see Statement of Cash Flows) mostly relates to the income in respect to interest subsidies inflows that are recorded upon payment. The discounted amount of the interest subsidies provided for the final user is presented as deferred interest income and is recognised in the statement of profit or loss and other comprehensive income on a time basis during the repayment of the loan. Interest income earned on this basis for the period 1 January to 30 June 2018 amounts to HRK 37,565 thousand (1 January to 30 June 2017: HRK 53,015 thousand).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

7. Interest expense

Interest expense by type of payee:

	Group				Bank			
	2018		2017		2018		2017	
	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000
Domestic financial institutions	1,017	1,260	754	1,469	1,017	1,260	754	1,469
Foreign financial institutions	83,873	168,033	106,292	213,684	83,873	168,033	106,292	213,684
	84,890	169,293	107,046	215,153	84,890	169,293	107,046	215,153

Interest expense by type of facility:

	Group				Bank			
	2018		2017		2018		2017	
	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000	Current period April 1 – June 30 HRK '000	Cumulatively January 1 – June 30 HRK '000
Borrowings	67,378	134,388	69,923	137,293	67,378	134,388	69,923	137,293
Debt securities	17,508	34,892	36,922	77,599	17,508	34,892	36,922	77,599
Deposits from customers	4	13	201	261	4	13	201	261
	84,890	169,293	107,046	215,153	84,890	169,293	107,046	215,153

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

8. Operating expenses

Operating expenses can be shown as follows:

	Group				Bank			
	2018		2017		2018		2017	
	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
General and administrative expenses:								
Employee expenses	23,187	45,398	22,396	45,622	22,366	43,802	21,460	43,933
Depreciation	1,583	3,320	1,864	3,956	1,570	3,298	1,848	3,926
Administration expenses	7,658	9,653	3,716	6,648	7,582	9,518	3,646	6,472
Material and services	7,462	12,887	9,150	15,205	7,125	12,158	8,684	14,251
	39,890	71,258	37,126	71,431	38,643	68,776	35,638	68,582
Other expenses:								
Recalculation expenses	1,074	2,279	2,646	4,395	1,074	2,279	2,646	4,395
Other expenses	1,009	1,953	1,109	2,203	296	731	358	1,155
	2,083	4,232	3,755	6,598	1,370	3,010	3,004	5,550
	41,973	75,490	40,881	78,029	40,013	71,786	38,642	74,132

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

8. Operating expenses (continued)

Other expenses of the Group presented contain changes in technical reserves:

	Group				Bank			
	2018		2017		2018		2017	
	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Changes in claims provisions	741	595	827	799	-	-	-	-
Changes in claims provisions, reinsurer's share	(327)	(254)	(314)	(265)	-	-	-	-
Expenses of insurance operations	414	341	513	534	-	-	-	-

The most significant part of provisions for losses relates to IBNR provision, the method of calculation of which was changed as compared to the same reporting date of the previous year, due to the Agrokor's systemic risk inclusion. The Bornhuetter-Ferguson method was used for the gross amount of provisions. The reinsurance share is determined in accordance with the valid terms and conditions of the reinsurance contract. Further to this, this provision decreased both in the gross amount and in the reinsurance share in comparison with the same reporting period previous year.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations
for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

9. Impairment loss and provisions

The provision for impairment gains/losses on placements may be summarised as follows:

	Notes	Group				Bank			
		2018		2017		2018		2017	
		Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30	Current period April 1 – June 30	Cumulatively January 1 – June 30
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	
Impairment losses on cash on hand and due from banks	10	5	(9)	(14,970)	(1,212)	5	(9)	(14,970)	(1,212)
Impairment losses on deposits with other banks	11	(1)	(140)	(190)	(229)	(1)	(140)	(190)	(229)
Impairment losses on loans to financial institutions	12	(8,761)	(14,500)	(20,896)	(57,354)	(8,761)	(14,500)	(20,896)	(57,354)
Impairment losses on loans to other customers	13	(99,699)	(129,144)	31,617	117,761	(99,699)	(129,144)	31,617	117,761
Modification (gain)/loss – financial	12	(302)	2,224	n/a	n/a	(302)	2,224	n/a	n/a
Modification gain – other customers	13	(520)	(1,044)	n/a	n/a	(520)	(1,044)	n/a	n/a
POCI assets – impairment at initial recognition	13	8,282	24,797	n/a	n/a	8,282	24,797	n/a	n/a
Impairment losses on non-current assets held for sale	19	(44)	(50)	(2)	(12)	(44)	(50)	(2)	(12)
Impairment of financial assets at fair value through other comprehensive income	15	415	1,182	n/a	n/a	415	1,182	n/a	n/a
Impairment losses on other assets	20	7,200	11,854	339	532	7,245	11,840	321	483
Total increase/(decrease) for impairment losses on assets		(93,425)	(104,830)	(4,102)	59,486	(93,380)	(104,844)	(4,120)	59,437
Provision for guarantees and commitments	23	73,875	111,287	(6,197)	(8,410)	73,875	111,287	(6,197)	(8,410)
Other provisions	23	(17,357)	(17,178)	(6,115)	(7,951)	(17,346)	(17,167)	(6,102)	(7,877)
Total increase/(decrease) in provision for guarantees and commitments and other provisions		56,518	94,109	(12,312)	(16,361)	56,529	94,120	(12,299)	(16,287)
		(36,907)	(10,721)	(16,414)	43,125	(36,851)	(10,724)	(16,419)	43,150

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

10. Cash on hand and current accounts with banks

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Account with the Croatian National Bank	748,170	1,316,520	748,170	1,316,520
Cash on hand	1	16	1	16
Foreign currency account -domestic banks	1,509	1,544	1,509	1,544
Foreign currency account - foreign banks	65,223	83,924	60,661	83,924
Domestic currency account- domestic banks	3,320	2,534	-	-
	818,223	1,404,538	810,341	1,402,004
Loss allowances	(32)	(858)	(32)	(858)
	818,191	1,403,680	810,309	1,401,146

The movements in the loss allowances on amounts due from banks may be summarized as follows:

	Group HRK '000	Bank HRK '000
Balance as of 1 January 2017	3,079	3,079
Increase of loss allowances on amounts due from banks	-	-
Release of loss allowances on amounts due from banks	(2,221)	(2,221)
Balance as of 31 December 2017	858	858
The effect of IFRS 9 (Note 5)	(817)	(817)
Balance as of 1 January 2018	41	41
Increase of loss allowances on amounts due from banks	96	96
Release of loss allowances on amounts due from banks	(105)	(105)
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>(9)</i>	<i>(9)</i>
Balance as of 30 June 2018	32	32

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

11. Deposits with other banks

	Jun 30, 2018	Group Dec 31, 2017	Jun 30, 2018	Bank Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Deposits with foreign banks	14,574	-	14,574	-
Deposits with domestic banks	-	29,468	-	29,468
Accrued interest	1	24	1	24
	14,575	29,492	14,575	29,492
Loss allowances	(6)	(354)	(6)	(354)
	14,569	29,138	14,569	29,138

The movements in the loss allowances on deposits with other banks may be summarized as follows:

	Group HRK '000	Bank HRK '000
Balance as of 1 January 2017	248	248
Increase of loss allowances on deposits with other banks	106	106
Balance as of 31 December 2017	354	354
The effect of IFRS 9 (Note 5)	(202)	(202)
Balance as of 1 January 2018	152	152
Increase of loss allowances on deposits with other banks	37	37
Release of loss allowances s on deposits with other banks	(177)	(177)
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>(140)</i>	<i>(140)</i>
Net foreign exchange losses on loss allowances	(6)	(6)
Balance as of 30 June 2018	6	6

Net foreign exchange losses on loss allowances are shown within net gains/ (losses) from financial activities in the Statement on Profit and Loss.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

12. Loans to financial institutions

	Group		Bank	
	Jun 30, 2018	Dec 31, 2017	Jun 30, 2018	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Long-term loans under loan programs	10,129,224	10,868,288	10,129,224	10,868,288
Short-term loans and reverse repo transactions	44,030	236,400	44,030	236,400
Accrued interest	25,398	27,672	25,398	27,672
Deferred recognition of loan origination fees	(47,409)	(58,293)	(47,409)	(58,293)
Recognition of modification loss	(2,224)	-	(2,224)	-
	10,149,019	11,074,067	10,149,019	11,074,067
Loss allowances	(115,375)	(237,926)	(115,375)	(237,926)
	10,033,644	10,836,141	10,033,644	10,836,141

The movements in the loss allowances on loans to financial institutions may be summarized as follows:

	Group	Bank
	HRK '000	HRK '000
Balance as of 1 January 2017	363,317	363,317
Increase of loss allowances on loans to financial institutions	7,949	7,949
Release of loss allowances on loans to financial institutions	(131,795)	(131,795)
Net foreign exchange losses on loss allowances	(1,438)	(1,438)
Acquisition of immovable property	(1,105)	(1,105)
Loss allowances transferred from loans to other customers	998	998
Balance as of 31 December 2017	237,926	237,926
The effect of IFRS 9 (Note 5)	(106,906)	(106,906)
Balance as of 1 January 2018	131,020	131,020
Increase of loss allowances on loans to financial institutions	19,204	19,204
Release of loss allowances on loans to financial institutions	(33,704)	(33,704)
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>(14,500)</i>	<i>(14,500)</i>
Net foreign exchange losses on loss allowances	(1,285)	(1,285)
Loss allowances transferred to loans to other customers	(18)	(18)
Unwinding – changes due to the lapse of time	160	160
Other	(2)	(2)
Balance as of 30 June 2018	115,375	115,375

Net foreign exchange losses on loss allowances are shown within net gains/ (losses) from financial activities in the Statement on Profit and Loss.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

12. Loans to financial institutions (continued)

Loans to financial institutions, impaired for loss allowances, by purpose of the loan programs:

	Group		Bank	
	Jun 30, 2018	Dec 31, 2017	Jun 30, 2018	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Loan programme for reconstruction and development of the economy	1,943,160	2,218,744	1,943,160	2,218,744
Export financing	2,663,224	2,935,166	2,663,224	2,935,166
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	1,325,485	1,584,242	1,325,485	1,584,242
Loan programme for small and medium-sized enterprises	4,189,421	4,121,412	4,189,421	4,121,412
Loan programme for war-torn and demolished housing and business facilities	7,934	8,724	7,934	8,724
Other	44,030	236,400	44,030	236,400
Accrued interest	25,398	27,672	25,398	27,672
Deferred recognition of loan fees	(47,409)	(58,293)	(47,409)	(58,293)
Recognition of modification loss	(2,224)	-	(2,224)	-
	10,149,019	11,074,067	10,149,019	11,074,067
Loss allowances	(115,375)	(237,926)	(115,375)	(237,926)
	10,033,644	10,836,141	10,033,644	10,836,141

Average interest rates for total loans to financial institutions, at year level, are stated at 0.80.% (1 January to 30 June 2017: 0.93%) and for loans under HBOR loan programmes excluding the liquidity reserve at 0.80% (1 January to 30 June 2017: 0.93%).

Average interest rates reflect the ratio of interest income generated from the mentioned placements and average assets.

Item „Other“ refers to reverse REPO agreements in the total amount of HRK 44,030 thousand (31 December 2017: HRK 236,400 thousand). The above placements are collateralised by securities in the amount of HRK 46,332 thousand (31 December 2017: HRK 249,727 thousand).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

13. Loans to other customers

	Group		Bank	
	Jun 30, 2018	Dec 31, 2017	Jun 30, 2018	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Domestic companies	11,060,901	11,294,141	11,060,901	11,294,141
State-owned companies	962,216	1,260,227	962,216	1,260,227
Public sector	2,432,990	1,744,426	2,432,990	1,744,426
Foreign companies	475,615	316,005	475,615	316,005
Non-profit institutions	5,497	3,407	5,497	3,407
Other	622,785	653,179	622,785	653,179
Accrued interest	275,399	101,042	275,399	101,042
Deferred recognition of loan origination fees	(102,322)	(113,501)	(102,322)	(113,501)
Recognition of modification gain	1,044	-	1,044	-
	15,734,125	15,258,926	15,734,125	15,258,926
Loss allowances	(3,464,244)	(2,875,303)	(3,464,244)	(2,875,303)
	12,269,881	12,383,623	12,269,881	12,383,623

The movements in the loss allowances on loans to other customers may be summarized as follows:

	Group	Bank
	HRK '000	HRK '000
Balance as of 1 January 2017	2,579,501	2,579,501
Increase of loss allowances on loans to other customers and interest	553,952	553,952
Release of loss allowances on loans to other customers and interest	(213,979)	(213,979)
Net foreign exchange losses on loss allowances	(3,643)	(3,643)
Collection of off-balance sheet receivables	(2,085)	(2,085)
Loss allowances transferred from off-balance sheet	2,085	2,085
Acquisition of immovable property	(284)	(284)
Write-offs	(7,610)	(7,610)
Sale of receivables	(31,636)	(31,636)
Loss allowances transferred to loans to financial institutions	(998)	(998)
Balance as of 31 December 2017	2,875,303	2,875,303
The effect of IFRS 9 (Note 5)	717,902	717,902
Balance as of 1 January 2018	3,593,205	3,593,205
Increase of loss allowances on loans to other customers and interest	405,073	405,073
Release of loss allowances on loans to other customers and interest	(534,177)	(534,177)
Collection of off-balance sheet receivables	(40)	(40)
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>(129,144)</i>	<i>(129,144)</i>
Net foreign exchange losses on loss allowances	(23,769)	(23,769)
loss allowances transferred from off-balance sheet	40	40
Write-offs	(1,383)	(1,383)
Loss allowances transferred from loans to financial institutions	18	18
Unwinding – changes due to the lapse of time	25,688	25,688
Acquisition of immovable property	(826)	(826)
Interest transferred from the off-balance sheet records	415	415
Balance as of 30 June 2018	3,464,244	3,464,244

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

13. Loans to other customers (continued)

Net foreign exchange losses on loss allowances are shown within net gains/ (losses) from financial activities in the Statement on Profit and Loss.

The total effect of loss allowances for POCI assets amounts to HRK 25,629 thousand, and relates to loss allowances at initial recognition of HRK 24,797 thousand (Note 9. Impairment loss and provisions) and foreign exchange gains/losses on this basis in the amount of HRK 832 thousand.

Loans to other customers, net of loss allowances, may be summarized by loan programme as follows:

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Loan programme for reconstruction and development of the economy	4,182,841	4,546,833	4,182,841	4,546,833
Export financing	5,205,255	5,274,935	5,205,255	5,274,935
Loan programme for reconstruction and development of infrastructure in the Republic of Croatia	3,484,187	3,392,439	3,484,187	3,392,439
Loan programme for small and medium-sized enterprises	1,943,210	2,010,315	1,943,210	2,010,315
Other	744,511	46,863	744,511	46,863
Accrued interest	275,399	101,042	275,399	101,042
Deferred recognition of loan origination fees	(102,322)	(113,501)	(102,322)	(113,501)
Recognition of modification gain	1,044	-	1,044	-
	15,734,125	15,258,926	15,734,125	15,258,926
Loss allowances	(3,464,244)	(2,875,303)	(3,464,244)	(2,875,303)
	12,269,881	12,383,623	12,269,881	12,383,623

Average interest rates for total loans to other customers, at year level, are stated at 1.84% (1 January to 30 June 2017: 2.19%).

Average interest rates reflect the ratio of interest income generated from the mentioned placements and average assets.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

14. Financial assets at fair value through profit or loss

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Loans:				
Mezzanine loans	4,016	n/a	4,016	n/a
	4,016	n/a	4,016	n/a
Investments in investment funds:				
Investments in investment funds	644,930	291	638,487	-
	644,930	291	638,487	-
Listed equity instruments:				
Investments in corporate shares	12,787	n/a	12,787	n/a
	12,787	n/a	12,787	n/a
Unlisted equity instruments:				
Investments in financial institutions' shares	161	n/a	161	n/a
	161	n/a	161	n/a
	661,894	291	655,451	n/a

Corporate equity investments comprise shares in capital of the company for the production of agricultural products, Vinka d.d., and of the shipyard company Brodogradilište Viktor Lenac d.d., Rijeka. The shares were acquired within restructuring measures for those companies in exchange for a portion of receivables.

The percentage of HBOR's share in the equity of the company Vinka d.d., Vinkovci representing a 0.9365%. The shares of the company Vinka d.d., Vinkovci (LPVC-R-B) are not listed and the fair value is estimated to be HRK 0 thousand (31 December 2017: HRK 0 thousand; shares classified as assets available for sale).

The percentage of HBOR's share in the equity of the shipyard Brodogradilište Viktor Lenac d.d., Rijeka is 8.1321%. The shares of the company (VLEN-R-B) were officially admitted to the Zagreb Stock Exchange in 2008 and were listed in May 2009. The listed price per share as at 30 June 2018 amounted to HRK 9.35 (31 December 2017: HRK 13.86 per share) and the fair value amounted to HRK 12,787 thousand (31 December 2017: HRK 18,951 thousand; classified as Assets Available for Sale).

The shares of financial institutions that are not listed relate to the Money Market shares and are stated in the amount of HRK 161 thousand (31 December 2017: HRK 161 thousand; classified as Assets Available for Sale).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

15. Financial assets at fair value through other comprehensive income

	Jun 30, 2018 HRK '000	Group Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Bank Dec 31, 2017 HRK '000
Listed debt instruments:				
Bonds of the Republic of Croatia	995,346	n/a	957,188	n/a
Corporate bonds	770	n/a	-	n/a
Treasury bills of the Ministry of Finance	2,062,575	n/a	2,062,575	n/a
Accrued interest	17,179	n/a	16,616	n/a
	3,075,870	n/a	3,036,379	n/a
Unlisted debt instruments:				
Corporate bonds	523	n/a	523	n/a
Accrued interest	198	n/a	198	n/a
	721	n/a	721	n/a
Unlisted equity instruments:				
Investments in shares of foreign legal entities	34	n/a	34	n/a
Shares of foreign financial institutions – EIF	25,539	n/a	25,539	n/a
	25,573	n/a	25,573	n/a
	3,102,164	n/a	3,062,673	n/a

Changes in the loss allowances of financial assets at fair value through other comprehensive income, do not impair the carrying value of financial assets, may be summarized as follows:

	Jun 30, 2018 HRK '000	Group Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Bank Dec 31, 2017 HRK '000
Balance as of 1 January 2018 – The effect of IFRS 9 (Note 5)	4,288	n/a	3,997	n/a
Increase of loss allowances	2,784	n/a	2,784	n/a
Release of loss allowances	(1,602)	n/a	(1,602)	n/a
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>1,182</i>	<i>n/a</i>	<i>1,182</i>	<i>n/a</i>
Net foreign exchange losses on loss allowances	(27)	n/a	(27)	n/a
Balance as of 30 June 2018	5,443	n/a	5,152	n/a

Net foreign exchange losses on loss allowances are shown within net gains/ (losses) from financial activities in the Statement on Profit and Loss.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

15. Financial assets at fair value through other comprehensive income (continued)

The following text contains investment breakdown:

	Date of issue	Date of maturity	Interest rate (%)	Jun 30, 2018 HRK '000	Group Dec 31, 2017 HRK '000	June 30, 2018 HRK '000	Bank Dec 31, 2017 HRK '000
Listed debt instruments:							
<i>Bonds of the Republic of Croatia indexed to foreign currency:</i>							
RHMF-O-19BA	29.11.2004.	29.11.2019.	5.375	45,584	n/a	44,636	n/a
RHMF-O-227E	22.7.2011.	22.7.2022.	6.5	170,575	n/a	170,575	n/a
RHMF-O-247E	10.7.2013.	10.7.2024.	5.75	18,063	n/a	12,740	n/a
RHMF-O-203E	5.3.2010.	5.3.2020.	6.5	814	n/a	-	n/a
<i>Bonds of the Republic of Croatia in foreign currency:</i>							
XS0645940288	8.7.2011.	9.7.2018.	5.875	51,686	n/a	51,686	n/a
XS1117298916	11.3.2015.	11.3.2025.	3.0	55,126	n/a	55,126	n/a
<i>Bonds of the Republic of Croatia in HRK:</i>							
RHMF-O-187A	10.7.2013.	10.7.2018.	5.25	185,613	n/a	180,594	n/a
RHMF-O-203A	5.3.2010.	5.3.2020.	6.75	36,077	n/a	33,162	n/a
RHMF-O-257A	9.7.2015.	9.7.2025.	4.5	9,811	n/a	-	n/a
RHMF-O-26CA	14.12.2015.	14.12.2026.	4.25	44,321	n/a	35,107	n/a
RHMF-O-217A	8.7.2016.	8.7.2021.	2.75	209,265	n/a	207,131	n/a
RHMF-O-222A	7.2.2017.	7.2.2022.	2.25	73,233	n/a	73,233	n/a
RHMF-O-282A	7.2.2017.	7.2.2028.	2.875	12,499	n/a	10,519	n/a
RHMF-O-023BA	27.11.2017.	27.11.2023.	1.75	82,680	n/a	82,680	n/a
<i>Corporate bonds in HRK:</i>							
JDGL-O-20CA	21.12.2015.	21.12.2020.	5.81	770	n/a	-	n/a
Treasury bills in HRK up to 364 days			0.086 – 0.292	1,767,539	n/a	1,767,539	n/a
Treasury bills in foreign currency up to 455 days			0.082	295,035	n/a	295,035	n/a
Accrued interest				17,179	n/a	16,616	n/a
				3,075,870	n/a	3,036,379	n/a
Unlisted debt instruments:							
<i>Corporate bonds indexed to foreign currency:</i>							
LNGU-O-31AE	24.7.2015.	15.10.2031.	4.5	523	n/a	523	n/a
Accrued interest				198	n/a	198	n/a
				721	n/a	721	n/a
Equity instruments:							
<i>Unlisted equity instruments:</i>							
Investments in shares of foreign legal entities in foreign currency - SWIFT				34	n/a	34	n/a
Investments in shares of foreign financial institutions in foreign currency - EIF				25,539	n/a	25,539	n/a
				25,573	n/a	25,573	n/a
				3,102,164	n/a	3,062,673	n/a

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

16. Debt instruments at amortised cost

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Debt instruments:				
Listed debt instruments:				
Bonds of the Republic of Croatia	1,353	n/a	-	n/a
Accrued interest	13	n/a	-	n/a
	<u>1,366</u>	<u>n/a</u>	<u>-</u>	<u>n/a</u>
Loss allowances	(2)	n/a	-	n/a
	<u>1,364</u>	<u>n/a</u>	<u>-</u>	<u>n/a</u>

The movements in the loss allowances on debt instruments at amortised cost may be summarized as follows:

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Balance as of 1 January 2018 – The effect of IFRS 9 (note 5)	2	n/a	-	n/a
Increase of loss allowances	-	n/a	-	n/a
Release of loss allowances	-	n/a	-	n/a
<i>Total recognised through Statement on Profit and Loss (note 9)</i>	<u>-</u>	<u>n/a</u>	<u>-</u>	<u>n/a</u>
Net foreign exchange	-	n/a	-	n/a
Balance as of 30 June 2018	<u>2</u>	<u>n/a</u>	<u>-</u>	<u>n/a</u>

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-203E) issued with foreign currency clause on 5 March 2010 are repayable over 10 years with an interest rate of 6.5%. As of 30 June 2018, the value of these outstanding bonds amounted to HRK 455 thousand (31 December 2017: HRK 467 thousand; classified as Assets held to maturity).

Bonds of the Ministry of Finance of the Republic of Croatia (RHMF-O-19BA) issued with foreign currency clause on 29 November 2004 are repayable over 15 years with an interest rate of 5.375%. As of 30 June 2018, the value of these outstanding bonds amounted to HRK 898 thousand (31 December 2017: HRK 918 thousand; classified as Assets held to maturity).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

17. Assets available for sale

Below we give an overview of investments in financial instruments as at 31 December 2017, pursuant to IAS 39 that have been reclassified to Financial assets at fair value through other comprehensive income and Financial assets at fair value through profit and loss according to IFRS 9:

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Debt instruments:				
Listed debt instruments:				
Bonds of the Republic of Croatia	n/a	884,763	n/a	846,428
Financial institution bonds	n/a	-	n/a	-
Corporate bonds	n/a	770	n/a	-
Treasury bills of the Ministry of Finance	n/a	1,583,313	n/a	1,583,313
Accrued interest	n/a	13,836	n/a	13,269
	n/a	2,482,682	n/a	2,443,010
Unlisted debt instruments:				
Corporate bonds	n/a	522	n/a	522
Accrued interest	n/a	167	n/a	167
	n/a	689	n/a	689
Equity instruments:				
Listed equity instruments:				
Investments in companies' shares	n/a	18,951	n/a	18,951
	n/a	18,951	n/a	18,951
Unlisted equity instruments:				
Investments in shares of foreign legal entities	n/a	35	n/a	35
Investments in financial institutions shares	n/a	161	n/a	161
Shares of foreign financial institutions – EIF	n/a	25,427	n/a	25,427
Investments in companies' shares	n/a	16,725	n/a	16,725
Impairment losses	n/a	(16,725)	n/a	(16,725)
	n/a	25,623	n/a	25,623
Investments in investment funds:				
Shares classified as assets available for sale	n/a	793,619	n/a	788,921
	n/a	793,619	n/a	788,921
Balance as at 31 December 2017	n/a	3,321,564	n/a	3,277,194

18. Assets held to maturity

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Debt instruments:				
Listed debt instruments:				
Bonds of the Ministry of finance of the Republic of Croatia	n/a	1,385	n/a	-
Accrued interest	n/a	14	n/a	-
Balance as at 30 June 2018	n/a	1,399	n/a	-

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

19. Non-current assets held for sale

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Non-current assets held for sale	57,672	48,225	57,672	48,225
Impairment losses	(32,657)	(31,528)	(32,657)	(31,528)
	25,015	16,697	25,015	16,697

In the reporting period 2018, repossession of property took place with current value in the amount of HRK 8,268 thousand, acquisition value of HRK 9,447 thousand and provisions of HRK 1,179 thousand, and relates to land plot in the amount of HRK 2,285 thousand, apartments in the amount of HRK 31 thousand and buildings in the amount of HRK 5,952 thousand (in 2017, repossession of property took place with current value of HRK 154 thousand, acquisition value of HRK 1,827 thousand and provisions of HRK 1,673 thousand, and relates to land plot).

In the period 1 January – 30 June 2018, there was no sale of the above assets (in 2017, a sale of non-current assets held for sale took place with current value in the amount of HRK 317 thousand, acquisition cost of HRK 1.333 thousand and provisions of HRK 1.016 thousand, and relates to land plot in the amount of HRK 27 thousand, buildings in the amount of HRK 26 thousand and dwellings in the amount of HRK 264 thousand).

In 2017, this property was transferred to long-term lease and reclassified to apartments on the item Investments in property in the amount of HRK 1,807 thousand, which is presented under Other assets due to immaterial significance. In the reporting period, this property was depreciated in the amount of HRK 32 thousand (in 2017 in the amount of HRK 64 thousand).

The fair value of non-current assets held for sale at the beginning of the reporting period amounted to HRK 27,773 thousand and the end of the reporting period at HRK 24,641 thousand.

The movements in impairment losses on non-current assets held for sale may be summarized as follows:

	Group		Bank	
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Balance as of 1 January	31,528	30,409	31,528	30,409
Increase of impairment losses on non-current assets held for sale	-	711	-	711
Decrease of impairment losses on non-current assets held for sale	(50)	(185)	(50)	(185)
<i>Total recognized through Statement on Profit and Loss (Note 9)</i>	<i>(50)</i>	<i>526</i>	<i>(50)</i>	<i>526</i>
Derecognition of impairment resulting from the sale of fixed assets intended for sale	-	(1,014)	-	(1,014)
Impairment losses at takeover	-	1,607	-	1,607
Acquisition of immovable property	1,179	-	1,179	-
Balance as of 30 June 2018	32,657	31,528	32,657	31,528

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

20. Other assets

	Jun 30, 2018 HRK '000	Group Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Bank Dec 31, 2017 HRK '000
Fees receivable	18,972	9,363	18,972	9,363
Other receivables	8,566	9,511	8,461	9,365
Prepaid expenses	3,118	2,146	3,118	2,146
Accrued income	3,123	6,113	3,123	6,113
Premium receivables	1,016	6,318	-	-
Receivables for reinsurance commissions	708	583	-	-
Receivables for risk assessment fees	271	259	-	-
Deferred tax assets	325	231	-	-
Other assets	1,607	1,684	1,607	1,685
	37,706	36,208	35,281	28,672
Loss allowances	(25,066)	(6,737)	(24,917)	(6,446)
Balance as of 31 December, net of loss allowances	12,640	29,471	10,364	22,226

The following text contains the breakdown of positions stated as credit risk:

	Jun 30, 2018 HRK '000	Group Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Bank Dec 31, 2017 HRK '000
Fees receivable	18,972	9,363	18,972	9,363
Other receivables	8,566	9,511	8,461	9,365
Premium receivables	1,016	6,318	-	-
Receivables for reinsurance commissions	708	583	-	-
Receivables for risk assessment fees	271	259	-	-
Loss allowances	(25,066)	(6,737)	(24,917)	(6,446)
Subtotal – credit risk	4,467	19,297	2,516	12,282

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

20. Other assets (continued)

The movements in the loss allowances on other assets may be summarized as follows:

	Group HRK 000	Bank HRK 000
Balance as at 1 January 2017	4,541	4,537
Increase of loss allowances on other assets	2,756	2,399
Release of loss allowances on other assets	(559)	(489)
Collection of off-balance sheet receivable items	(2)	(2)
Loss allowances transferred from off-balance sheet	2	2
Write-offs	(1)	(1)
Balance as of 31 December 2017	6,737	6,446
The effect of IFRS 9 (Note 5)	6,664	6,641
Other adjustments	(178)	-
Balance as of 1 January 2018	13,223	13,087
Increase of loss allowances on other assets	14,985	14,892
Release of loss allowances on other assets	(3,126)	(3,052)
Collection of off-balance sheet receivable items	(5)	-
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>11,854</i>	<i>11,840</i>
Write-offs	(11)	(10)
Balance as of 30 June 2018	25,066	24,917

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

21. Borrowings

	Group		Bank	
	Jun 30, 2018	Dec 31, 2017	Jun 30, 2018	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as of 1 January	15,399,788	13,378,057	15,399,788	13,378,057
New borrowings	1,435,724	3,849,787	1,435,724	3,849,787
Repayments	(1,501,702)	(1,729,575)	(1,501,702)	(1,729,575)
Net foreign exchange losses	(253,239)	(98,481)	(253,239)	(98,481)
	<u>15,080,571</u>	<u>15,399,788</u>	<u>15,080,571</u>	<u>15,399,788</u>
Accrued interest	59,395	63,737	59,395	63,737
Deferred fees	(72,409)	(75,644)	(72,409)	(75,644)
	<u>15,067,557</u>	<u>15,387,881</u>	<u>15,067,557</u>	<u>15,387,881</u>

The bank is subject to various financial clauses from the Contract, as of 30 June 2018 the Bank was in compliance with all required financial clauses from the Contract.

22. Debt securities issued

The carrying value of bonds includes interest.

Group and Bank	Effective interest rate	Fair value	Net book value	Fair value	Net book value
		Jun 30, 2018	Jun 30, 2018	Dec 31, 2017	Dec 31, 2017
		HRK '000	HRK '000	HRK '000	HRK '000
Bonds EUR 150 million	6.37	1,211,664	1,099,913	1,255,316	1,118,122
Accrued interest		-	9,644	-	43,909
Deferred fees		-	(264)	-	(332)
		<u>1,211,664</u>	<u>1,109,293</u>	<u>1,255,316</u>	<u>1,161,699</u>

The fair value of bonds issued by HBOR is presented by using level 2 inputs corroborated by the market and observable at Bloomberg service on the basis of the mid-rate of Bloomberg Generic prices (BGN).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

23. Other liabilities

	Jun 30, 2018	Group Dec 31, 2017	Jun 30, 2018	Bank Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Deferred recognition of interest income	266,155	314,271	266,155	314,271
Liabilities in respect of subsidized interest	115,316	107,262	115,316	107,262
Provisions for guarantees and commitments	161,064	64,360	161,064	64,360
Provisions for other liabilities	59,802	76,980	59,556	76,723
Accrued salaries	7,238	6,997	7,081	6,660
Liabilities to suppliers	412	1,393	380	1,261
Liabilities for prepaid receivables	3,192	2,759	3,192	2,759
Deferrable premium	3,115	2,925	-	-
Provisions for claims	5,653	5,235	-	-
Provisions for return premiums	634	642	-	-
Liabilities to re-insurers	1,845	1,165	-	-
Deferred tax liabilities	995	889	-	-
Other liabilities	7,002	20,575	6,007	19,355
	632,423	605,453	618,751	592,651

Liabilities in respect of subsidized interest represent advances taken in respect of interest subsidies on loans, which are provided for final customers at a lower interest rate in accordance with the following programmes implemented by HBOR for and on behalf of the Republic of Croatia. These liabilities include:

- HRK 114,857 thousand in respect of the Programme of Preferential Financing through HBOR's Loan Programmes (31 December 2017: HRK 107,262 thousand),
- HRK 148 thousand (31 December 2017: HRK 0 thousand) in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet – the Ministry of the Sea, Transport and Infrastructure – interest subsidy,
- HRK 148 thousand (31 December 2017: HRK 0 thousand) in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet – the Ministry of Agriculture – interest subsidy,
- HRK 148 thousand (31 December 2017: HRK 0 thousand) in respect of the Financing Model for the Reconstruction and Modernisation of the Fishing Fleet – the Ministry of the Economy, Entrepreneurship and Crafts – interest subsidy,
- HRK 15 thousand (31 December 2017: HRK 0 thousand) in respect of the Loan Programme for the Financing of Youth Entrepreneurship – interest subsidy.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

23. Other liabilities (continued)

Movements in the provision for guarantees, commitments and other liabilities may be summarized as follows:

	Group HRK '000	Bank HRK '000
Balance as at 1 January 2017	75,103	75,103
Increase in provision for guarantees and commitments	11,523	11,523
Release in provision for guarantees and commitments	(21,878)	(21,878)
Net foreign exchange losses on provision for impairment losses	(388)	(388)
Balance as of 31 December 2017 - Provision for guarantees and commitments	64,360	64,360
The effect of IFRS 9 (Note 5)	(15,013)	(15,013)
Balance as at 1 January 2018	49,347	49,347
Increase in provision for guarantees and commitments	184,512	184,512
Release in provision for guarantees and commitments	(73,225)	(73,225)
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>111,287</i>	<i>111,287</i>
Net foreign exchange gains on provision for impairment losses	430	430
Balance as at 30 June 2018 – Provision for guarantees and commitments	161,064	161,064
Balance as at 1 January 2018 – Provision for other liabilities	76,980	76,723
Increase in provision for other liabilities	6,405	6,405
Release in provision for other liabilities	(23,583)	(23,572)
<i>Total recognised through Statement on Profit and Loss (Note 9)</i>	<i>(17,178)</i>	<i>(17,167)</i>
Balance as at 30 June 2018 – Provision for other liabilities	59,802	59,556

Net foreign exchange gains on loss allowances are shown within net gains/ (losses) from financial activities in the Statement on Profit and Loss.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

24. Guarantees and commitments

In its regular activities, the Group HBOR contracts various commitments and contingent liabilities. The purpose of these instruments is to ensure that the funds are available to a customer when required.

Group and Bank

	Jun 30, 2018	Dec 31, 2017
	HRK '000	HRK '000
Guarantees issued in HRK	19,988	34,338
Guarantees issued in foreign currency	2,152,812	2,475,971
Open letters of credit in foreign currency	11,472	-
Undrawn loans	3,518,257	3,021,163
EIF – subscribed, not called up capital	47,229	48,087
Other irrevocable contingent liabilities	339	339
	<u>5,750,097</u>	<u>5,579,898</u>
Provisions for guarantees and commitments	<u>(161,064)</u>	<u>(64,360)</u>
	<u>5,589,033</u>	<u>5,515,538</u>

Guarantees and open letters of credit

Issued guarantees and open letters of credit represent the liability to the Bank to make payments on behalf of customers if the customer is unable to honor its commitments towards third parties or in the event of a specific act, generally related to the export or import of goods and other purposes specified in the contracts with the customers. Guarantees and letters of credit bear the same credit risk as loans. However, since all the stated guarantees issued are non-financial guarantees, i.e. they are performance related guarantees, they are not measured in accordance with IFRS 9 but in accordance with the IAS 37 provisions, Contingent Liabilities and Contingent Assets.

Bank guarantees are, to the extent of 82%, collateralised by the guarantees, deposits and bank guarantees or the liability was taken over by the Republic of Croatia. Open letters of credit are fully covered by deposits.

Commitments upon undrawn loans

The Bank has an obligation to disburse funds for loans and revolving loans upon committed undrawn loans. The expiry date of disbursement or other termination clause is determined by the contract. Disbursements are exercised in several withdrawals, depending on the purpose of the loan, phase of the project or documentation needed for disbursement. Since commitments may expire without being drawn upon, the total contractual amounts do not necessarily represent future cash outflows.

Committed undrawn loans include less potential credit risk than loans, since most commitments depend upon meeting specific terms and conditions by the customers in order to use the funds. The Bank monitors the terms to maturity of loan commitments.

Other irrevocable contingent liabilities

Other irrevocable contingent liabilities relate to HBOR's obligation based on the Agreement concluded on 24 January 2014 with HBOR – Export Credit Insurance performing transactions for and on behalf of the Republic of Croatia. Pursuant to this Agreement, HBOR shall, in case of disposal of the real estate taken over and the recovery from debtors in a pre-bankruptcy settlement, provided that certain conditions have been fulfilled, pay the recovered funds to the Guarantee fund of the Export Credit Insurance.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

25. Related-party transactions

Related parties are companies that directly or indirectly, through one or more intermediaries, control, or are controlled by, the reporting company.

The majority of related-party transactions relate to the transactions with the Republic of Croatia, the 100% owner of the Bank and state-owned companies over which the Republic of Croatia has the controlling influence.

All transactions stated were carried out under usual/regular conditions of the Bank.

Assets and liabilities as of 30 June 2018 and 31 December 2017, and income and expense for the period 1 January to 30 June 2018 and for the period 1 January to 30 June 2017 arising from transactions with related parties, including the Bank's key management personnel, include the following:

a) Related-party transactions

Group	Assets	Liabilities	Assets	Liabilities
	Jun 30, 2018	Jun 30, 2018	Dec 31, 2017	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	4,318,232	210,336	3,059,698	185,536
Government funds, executive authorities and agencies	1,146,236	39,704	1,076,606	30,358
State-owned companies	1,128,287	-	1,354,828	1
Associates	49	-	1	-
Key management personnel	4,716	725	5,073	587
Total	6,597,520	250,765	5,496,206	216,482

Group	Income	Expense	Income	Expense
	January 1 – June 30 2018	January 1 – June 30 2018	January 1 – June 30 2017	January 1 – June 30 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	28,434	6,200	39,347	136
Government funds, executive authorities and agencies	133,641	529	11,717	160
State-owned companies	32,488	59,824	30,535	2,322
Associates	9	3	3,668	-
Key management personnel	76	4,386	66	4,509
Total	194,648	70,942	85,333	7,127

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

25. Related-party transactions (continued)

a) Related-party transactions (continued)

Bank	Assets		Liabilities	
	Jun 30, 2018	Jun 30, 2018	Dec 31, 2017	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	4,318,232	210,336	3,059,698	185,536
Government funds, executive authorities and agencies	1,105,880	39,419	1,032,525	30,199
State-owned companies	1,128,286	-	1,354,442	-
Subsidiary companies	36,124	-	36,124	-
Associates	49	-	1	-
Key management personnel	4,525	649	4,844	552
Total	6,593,096	250,404	5,487,634	216,287

Bank	Income		Expense	
	January 1 – June 30 2018	January 1 – June 30 2018	January 1 – June 30 2017	January 1 – June 30 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Owner	28,434	6,200	39,347	136
Government funds, executive authorities and agencies	132,756	268	11,561	25
State-owned companies	32,488	59,784	30,524	2,281
Subsidiary companies	-	-	-	-
Associates	9	3	3,668	-
Key management personnel	71	3,898	62	4,090
Total	193,758	70,153	85,162	6,532

Assets include loans to other customers, debt instruments at amortised cost, financial assets at fair value through other comprehensive income, other assets and off-balance sheet exposure relating to commitments.

Liabilities include liabilities for deposits, key management salaries and other liabilities.

Income includes interest income, fee income and reversal of impairment losses and provisions.

Expenses include expenses for key management salaries, impairment loss and provisions.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

25. Related-party transactions (continued)

b) Collateral received

	Jun 30, 2018	Group Dec 31, 2017	Jun 30, 2018	Bank Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
The Republic of Croatia	4,088,174	4,235,919	4,005,654	4,138,695
State agencies	526,045	573,727	526,045	573,727
Total	4,614,219	4,809,646	4,531,699	4,712,422

Collateral received relates to first-class collateral instruments received as security for HBOR's placements comprising the Republic of Croatia guarantees, HAMAG-BICRO guarantees, insurance policies of export transactions against political and/or commercial risks and statutory guarantees in cases when the Republic of Croatia or other state executive body guarantees the liabilities of certain borrowers pursuant to provisions of certain laws.

HBOR issues reinsurance policies for and on behalf of the Republic of Croatia, i.e. covers a proportional part (quota reinsurance) of political and commercial risks of export loans and receivables arising from export of goods and services. The reinsurer covers all non-marketable (non-market) risks underwritten by the Insurer or Hrvatsko kreditno osiguranje d.d. in the percentage ranging from 30% to 90% of an insured amount.

c) Salaries of key management personnel

Salaries include compensation paid for regular work, annual vacation, national holidays, paid leave, sick leave, jubilee awards and payments pursuant to contracts. Salaries for the Group in the reporting period amounted to HRK 4,296 thousand (1 January to 30 June 2017: HRK 4,300 thousand), and for the Bank amounted to HRK 3,838 thousand (1 January to 30 June 2017: HRK 4,010 thousand).

Remuneration for the work of the members of the Supervisory Board for the Group amounted to HRK 90 thousand (1 January to 30 June 2017: HRK 209 thousand) and for the Bank amounted to HRK 60 thousand (1 January to 30 June 2017: HRK 80 thousand).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management

Based on the Act on the Croatian Bank for Reconstruction and Development, the Group is obliged to mitigate business risks directed by the principles of banking operations.

In the process of risk management, the Group identifies, estimates, measures, monitors, contains and controls the risks to which it is or might be exposed in the course of business and reports about them to the relevant authorities. By the mentioned procedures, appropriate internal documents and adequate organisational structure, a comprehensive and complete risk management system is provided.

The most significant risks the Group is exposed are credit risk, liquidity risk, interest rate risk in the Bank's book, foreign exchange risk, operational risk and outsourcing risk. These risks are managed daily in accordance with the policies, ordinances, procedures, methodologies and limit systems as well as decisions/conclusions of the Supervisory Board, the Management Board and the risk management committees.

The Group implements the sensitivity analyses and scenario analyses, provided that one or several risk factors are changed in regular or stressful circumstances, and the systems of pro-active risk management are continuously developed for the purpose of reducing possible future risks.

26.1. Overview of the most important risks

Credit risk

The Group controls credit risk through credit policies, ordinances and prescribed procedures that determine the internal control systems with an objective to act preventively.

The credit risk management system is the most important part of the HBOR business policy and is an important factor of its operation strategy.

Liquidity risk, currency risk and interest rate risk in the Banks's book

The Group ensures quality management of liquidity, currency and interest rate risks in the banking book through the Asset and Liability Management Committee. The management of these risks implies a reduction of interest rate risk, currency risk and liquidity risk to the lowest possible level. The majority of the Group's organisational units are included, directly and indirectly, in the operations of the Asset and Liability Management Committee in order to ensure a high-quality, integrated and comprehensive system for the management of these risks.

Liquidity risk

The basic principles for managing HBOR's liquidity risk are determined in the internal documents as well as in the decisions and conclusions made by the Supervisory Board, the Management Board and the Asset and Liability Management Committee.

In order to manage liquidity risk, the Group has established a system of limits, it monitors and controls limit utilisation, maintains the adequate level of liquidity reserve, continuously monitors current and planned liquidity, ensures HRK and foreign currency funds necessary for timely settlement of liabilities and for disbursements of approved loans and planned loan approvals. In terms of liquidity risk management, the Group monitors and strives to achieve compatibility of contracted and planned placements with the respective sources according to maturity. The Group does not hold deposits of citizens and is therefore not exposed to wide daily fluctuations in liquidity.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.1. Overview of the most important risks (continued)

Liquidity risk (continued)

The Group monitors liquidity risk by implementing the sensitivity analyses and scenario analyses in regular or stressful business conditions. Early warning signals and procedures for liquidity crisis indication or occurrence are determined by the Ordinance on Liquidity Risk Management.

Interest rate risk in the Bank's book

The basic principles for managing the Group's interest rate risk are determined in the internal documents as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. For the purpose of measurement and monitoring of interest rate risk, the Group carries out interest rate gap analysis. Interest rate gap is calculated for certain periods according to the possibilities of interest rate changes and presents the sensitivity of the Group to the changes in interest rates. Interest rates are structured per currency, type and value and projections of average weighted interest rates for Group's funds and placements are made. Furthermore, in addition to harmonising interest rates on sources and placements, current market conditions and movements in forecasted market indicators are also monitored.

Currency risk

The basic principles for managing HBOR's currency risk are determined in the internal acts as well as in the decisions and conclusions made by the Management Board and the Asset and Liability Management Committee. Methods for the measurement, i.e. assessment, monitoring and management of currency risk have been established, limits and proceedings both for cases of crisis indication and occurrence have been determined, and reports necessary for comprehensive perception of this risk have been defined.

The Group measures exposure to currency risk by monitoring open foreign currency position. In addition to the daily monitoring of the open foreign currency position and the projections of its developments, the Group uses, for the measurement/assessment of currency risk, the VaR model as an auxiliary model and regularly reports to the bodies in charge on maximum possible losses on significant currencies. Scenario analyses and sensitivity analyses in regular or stressful business conditions are also performed.

Operational risk

The Group has established a framework for operational risk management that is, to a considerable extent, aligned with regulations prescribed by the Croatian National Bank applicable to the Bank's business and good banking practices in the area of risk management that was introduced in 2012.

The basic principles of operational risk management were identified in the umbrella act, Operational Risk Management Policies, the structure of management and accountability in the system was set up, the approach for the calculation of capital requirements for operational risk was determined, the recording and reporting system was established.

The Committee for IT management was established in order to monitor IT system performance with the purpose of IT resources management by setting the appropriate level of efficiency and security of IT for providing, among other things, appropriate management of risks arising from IT technology utilisation. The IT system security control function is in charge of monitoring the security of the IT system. Within this function, a system for the management of business continuity was established.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.1. Overview of the most important risks (continued)

Outsourcing risk

The Group manages the outsourcing risk on the basis of internal documents that are in compliance with the regulations prescribed by the Croatian National Bank applicable to the Group as a special financial institution. The internal documents that determine the management of this risk determine also the procedures for the outsourcing of activities, the rules for the management of relations with the service providers and the obligation to reduce the risk to the lowest level.

The central records of outsourced activities have been established and reports on materially significant outsourced activities are submitted to the Management Board and the Supervisory Board of the Bank on annual basis.

26.2. Strategy and risk management systems

The Supervisory Board is responsible for monitoring the appropriateness and effectiveness of the risk management process in the Group. The Supervisory Board adopts HBOR's Risk Management Strategy that lays out the main principles and standards of risk management and defines the tendency towards risk-taking.

The Management Board of the Bank is responsible for implementing the risk management strategy and establishing an effective and reliable risk management system. In order to accomplish its task, the Management Board delegated their risk management authority to four committees.

Risk management committees

- **Assets and Liabilities Management Committee (ALCO)** – manages liquidity risk, interest rate risk in the Bank's book and currency risk within the framework of the Liquidity Risk Management Ordinance, the Currency Risk Management Procedures and the Interest Rate Risk Management Procedures, the Assets and Liabilities Management Policies as well as other documents of the Bank that regulate this area,
- **Credit Risk Evaluation and Measurement Committee** – manages credit risk within the framework set through accepted Loan Policies, Credit Risk Management Ordinance, methodologies, ordinances and other internal acts that cover issues related to credit risk,
- **HBOR Information System Management Committee** – manages the resources of the information system and adequately manages the risks that result from the use of information technology,
- **Business Change Management Committee** – manages business changes (co-ordination of procedures for the suggestion, approval, monitoring and implementation of business changes) in order to reduce risks associated with the implementation of business changes.

Organizational unit for Risk Management

The Risk Management unit is organised as a functionally and organizationally separate and independent organizational unit for the control of business risks, which is directly responsible to the Management Board. This organisational unit is responsible for defining, evaluating or measuring, monitoring and controlling the risks to which the Group is exposed in the course of its business.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.2. Strategy and risk management systems (continued)

Organizational unit for Risk Management (continued)

The Risk Management unit carries out its role by performing risk analyses and evaluations or measurements, developing risk management ordinances, procedures and methodologies, supervising and monitoring their application, recommending and controlling the accepted exposure limits, giving suggestions and recommendations for adequate risk management as well as reporting to the relevant authorities.

The risk management strategy is directed towards achieving and maintaining the system that would provide quality and efficiency in risk management complied with domestic and international banking practices and Croatian National Bank, European regulations and Basel Committee recommendations applicable to the Bank as a special financial institution.

Risk measurement and reporting systems

When assessing or measuring risk, the Group takes into account historical data, business plans, current and expected market conditions and the specific characteristics of the Group as a special financial institution. The results of risk assessments or measurements, analyses carried out and stress test are presented at the meetings of the Risk Management Committee, the Management Board and the Supervisory Board. For the purpose of risk monitoring and control, systems of limits are introduced for the management of credit risk, liquidity risk, interest rate risk in the Bank's book and currency risk.

Bodies in charge are systematically reported on the quality of the loan portfolio, high exposure and the highest permissible exposure, regulatory capital adequacy, collection of receivables and risk placements, changes in internal ratings of commercial banks and measures taken in case of rating deterioration, a number of liquidity status indicators and projections of open foreign currency positions, possible losses by significant currencies, interest rate gap, projections of average weighted rates for sources and placements of financial institutions, etc. The reporting dynamics and the risk measurement and assessment methodologies are prescribed by the Group's internal acts.

26.3. Credit risk

The Group controls credit risk by way of credit policies and ordinances for the management of this risk that determine internal control systems aiming to act preventively.

The credit risk management system is a crucial part of the Group's business policy and it is an important strategic factor of business conduct, and therefore this area is regulated by a separate act - Credit risk management ordinance, that are applied on all phases of the credit process (from the development of new bank products or from the credit application, monitoring of the client's business operations until the final loan repayment).

Credit risk management ordinance is a comprehensive document that includes the methodologies intended for the assessment of operations of different client target groups.

Notes to the Consolidated Interim Condensed Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

In the case of direct financing, the Group uses the Credit risk evaluation methodology (for loans over HRK 1,500 thousand) or the Credit scoring methodology (for loans below HRK 1,500 thousand) to determine creditworthiness. The Credit scoring methodology is used to determine creditworthiness of clients that belong to the “small portfolio” and contains five scoring models: placements up to HRK 300 thousand to companies, crafts businesses and farmers, placements to start-ups up to HRK 300 thousand, placements from HRK 300 thousand to HRK 1,500 thousand to companies, placements to start-ups from HRK 300 thousand to HRK 1,500 thousand and placements from HRK 300 thousand to HRK 1,500 thousand for all other entrepreneurs.

The Credit Rating Assessment Methodology is used for the assessment of the risk of the clients that have been classified to the portfolio of individually significant clients, i.e. the loans exceeding HRK 1,500 thousand. The risk assessment can be contained in the assessment of client creditworthiness, assessment of investment project success and assessment of client creditworthiness containing analysis of future operations.

Pursuant to the HBOR Act, the Group on-lends part of its placements via commercial banks or leasing companies. The assessment of commercial banks is based on the Methodology for the Evaluation and Selection of Banks and the Methodology for the Evaluation and Selection of Foreign Banks, whereas the assessment of leasing companies is based on the Methodologies for the Evaluation and Selection of Leasing Companies. With an objective of facilitating the availability of HBOR’s funds, the Group channels part of its placements through the risk sharing model, under which commercial banks and HBOR participate in the financing of clients in accordance with in advance agreed proportions.

The Group, as a developmental financial institution, supports growth and development of the Croatian economy through investment. For this reason, the clients mainly approach the Group with applications for credit financing of investment projects. In order to minimize risk and objectively estimate economic sustainability of the project as well as a return on investment, the Group is constantly improving existing organizational and technical solutions, reports and internal acts and proposes new organization regulations and implementation instructions.

By continuous monitoring and evaluation of the clients’ businesses, the Group makes an effort to identify difficulties in their operation on a timely basis. For clients with difficulties, the Group tries to find appropriate ways to collect receivables by considering the possibilities of alternative repayment terms with a view to continue the production process and employment increase. Special emphasis is placed on identifying and monitoring reasons for bad debts, and procedures for prevention are built in operational procedures with a view to decreasing the share of high risk placements of the Group.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

For the purpose of risk monitoring and control, the systems of limits have been established for the management of credit risk. High exposure limits and amounts of maximum permitted credit exposure to individual borrowers and persons related to borrowers have been established.

26.3.1. Risk related to loan commitments

Bank clients can be issued guarantees and letters of credit with deferred payment terms (also from loan proceeds) in accordance with the same procedure as prescribed for loan commitments to direct clients.

All guarantees are monitored on the basis of validity periods, whereas letters of credit with deferred payment terms are monitored on the basis of maturities. In the case of calling for payment, the Group shall make a payment on behalf of client. For the Group, such obligations generate exposures to risks that are similar to credit risks and they are mitigated by the same procedures that are applied to loans.

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018)

Impairment is formed in accordance with the International Financial Reporting Standard 9, documents made by CNB applicable to HBOR and ordinances and methodologies regulating the Group's operations.

On the basis of the assessed level of credit risk and the manner of calculating expected credit losses, clients are allocated to the following categories:

- Stage 1 – includes all clients with low credit risk and clients with respect to which no significant increase in credit risk has been established,
- Stage 2 – includes all clients with respect to which a significant increase in credit risk since initial recognition has been established,
- Stage 3 – includes clients in default, i.e. clients with respect to which there is objective evidence of value impairment as well as purchased or originated credit-impaired (POCI) financial assets.

During the contractual relationship with a client, the level of expected credit losses of client is estimated. The estimation is carried out on the basis of the following three criteria:

- Debtor's creditworthiness
- Due fulfilment of obligations, and
- Quality of collateral.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

For the entire duration of contractual relationship, debtor's creditworthiness is assessed in order to identify possible changes in the client's (debtor's) financial position, i.e. the probability of deterioration in its creditworthiness. When establishing client's creditworthiness, the group of related entities is also taken into account due to the effect of contamination, i.e. the possibility of the transfer of risk among related entities, and the creditworthiness of client is monitored through:

- Changes in financial rating of client and entities related to client,
- Criteria whose objective is to identify financial difficulties of client,
- Criteria contained in the client watch list, and
- Criteria for identification of increased credit risk.

A client is considered to duly meet its obligations if it settles all of its obligations fully (principal, interest, commissions, fees and other charges) in the amounts and within the deadlines determined in the respective contracts, where all placements and of-balance sheet liabilities are considered as one.

Collateral assessment is based on the quality of collateral and the assessed amount as well as expected period of collection through collateral.

26.3.2.1. Definition of default status and exit from default status

Default status of an individual client occurs when one or both of the following conditions are met:

- it is considered probable that client will not settle its obligations towards HBOR entirely without taking into account the possibility of collection through collateral activation,
- clients is more than 90 days overdue in settling its due obligation under any significant loan liability. The significance threshold equals HRK 1,750 and is calculated on the client level by adding due obligations under all client placements.

When assessing the probability of a debtor not settling its obligations entirely, the following elements are considered:

- recognised impairment for credit losses due to identified significant deterioration in credit quality of debtor,
- selling of credit exposure at a considerable economic loss,
- rescheduling or restructuring of credit exposure owing to financial difficulties of debtor,
- bankruptcy or similar proceedings (pre-bankruptcy settlement, liquidation) against debtor,
- appointment of extraordinary administration, revoke of operating license, application of early intervention measures,
- cancellation of contract.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

26.3.2.1. Definition of default status and exit from default status (continued)

When determining a default status, in addition to the aforementioned, the relations within a group of related entities are also considered if the default status has been established with regard to one of the debtors within the respective group of related entities that results in the spreading of the default status on other entities within the same group.

All financial instruments of client in default status are classified to Stage 3.

Placements to clients in default status due to a material delay in the payment of obligations for more than 90 days can be classified to the rehabilitated category if 150 days have lapsed from the moment of non-existence of the default status trigger. During the 150-day trial period, client must not be more than 30 days overdue in the payment of obligations in a materially significant amount.

After the lapse of 150 days, only those clients are considered to have been cured who are found not to be in financial difficulties. If there are signs of default status recurrence, the status is not changed until a genuine and permanent improvement in the credit quality of client.

Restructured exposures caused by financial difficulties and repayment problems can be classified as cured after the lapse of two years from the last occurrence of the following events:

- restructuring day,
- default status establishment date,
- grace period expiry if approved under the restructuring process.

During the two-year trial period, the exposures that meet all of the following conditions can be classified to non-default status exposures:

- debtor has duly settled, upon maturity, at least the amount of restructured obligations in the amount of those due at the moment of the restructuring implementation,
- debtor has been regularly settling due obligations in accordance with the repayment schedule (or up to 30 days overdue),
- default status is not probable to occur,
- there are no overdue obligations after restructuring,
- there is no doubt that the debtor will continue to settle its obligations upon maturity.

All of the above conditions have to be satisfied also for the new placements to the same client. Only the placements to client that is not in financial difficulties can be reclassified to the cured category.

After all trial-period conditions have been satisfied, the financial instruments of cured clients can be reclassified to Stage 1.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

26.3.2.2. Bank's procedure of internal rating and probability of default (PD) assessment

The approach used for the modelling of PD is based on TTC (Through-the-Cycle) migration matrices for exposures in homogenous groups of direct borrowers and others. Risk categories (bucket) have been identified, and the movements of exposures among the aforementioned categories is analysed.

Risk categories for the aforementioned exposures are defined on the basis of the days overdue and the restructured exposure status. Before the modelling of PD, the data for the preceding 5-year period are collected.

On the occasion of the modelling of PD, the movement of exposures among the following categories is analysed:

- from 0 to 30 days overdue – category 1,
- from 31 to 90 days overdue – category 2,
- more than 90 days overdue and restructuring – default status event.

On the basis of the matrices of exposure movements from category to category, a PD 12-month value is calculated. PD marginal values are calculated by further multiplication of matrices and they are used for vector creation. PD borderline value vector is the basis for the calculation of a lifelong PD. The value of a lifelong PD depends on the tenor, i.e. the remaining period until maturity of individual exposure.

Approach based on external rating published by external credit rating agencies has been used for the calculation of PD for exposures from homogenous categories of financial institutions and central government and local and regional government.

For exposures to domestic financial institutions, owing to the fact that there is no external rating for all financial institutions in the Group portfolio, the existing internal ratings for domestic financial institutions have been mapped against the external rating, where a financial institution that has an external rating has been used as the mapping starting point, due to which the Group's internal rating has been made equal to the rating of S&P: "BB". In this way, the upper limit has been established for domestic financial institutions at the level of the government rating. Distribution of PD value for the other internal ratings is determined on the basis of the method of linear interpolation.

Ratings of external credit rating agencies are used for exposures to foreign financial institutions and, therefore, the appropriate PD value from their matrices is used, and if non-existing, the internal rating is used, i.e. the rules are applied that are identical to those applied to domestic financial institutions.

The value of 12-month PD is assessed by multiplying TTC matrix with itself. The value of lifelong PD is the cumulative value of marginal PD values or the sum of borderline PD values depending on the exposure tenor.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

26.3.2.3. Exposure at default

For the purpose of modelling exposures at the moment of the occurrence of default status (Exposure at Default, hereinafter: EAD), or for the purpose of calculating credit conversion parameter (Credit Conversion Factor, hereinafter: CCF) and prepayment ratio, the data for the preceding five-year period are taken into account.

Pursuant to the mentioned historical data, the established ratio of premature collection almost equals zero and the loan conversion factor equals 1.

EAD is calculated for each contract. There are two approaches to the calculation of EAD:

- if there is a repayment schedule for exposure – based on the cash flow from the repayment schedule,
- if there is no repayment schedule for exposure – based on exposure amount on the reporting date.

For exposures classified in risk stage 1 and for exposures due, EAD is equal to the current exposure.

For exposures not yet due, lifelong EAD is calculated based on the repayment schedule, taking into account the amounts and the maturity period, but not later than until the final date of exposure maturity (tenor).

26.3.2.4. Loss given default

For groups of direct borrowers and others, loss at the moment of occurrence of the status of non-fulfilment of obligations (Loss Given Default, hereinafter: LGD) is estimated based on transactions after the date of occurrence of loss given default. Each transaction is discounted on the date of occurrence of loss given default by an appropriate discount rate, and the discount factor depends on the time elapsed. All increases after the date of occurrence of loss given default are cumulated with an individual exposure. The result of the mentioned calculation is the collection rate for each exposure in a homogenous group, and the total collection rate for a single homogenous group is comprised of the weighted average of collection rates of all individual exposures.

The probability of exit from the loss given default status is also taken into consideration in the calculation of LGD.

A report of external credit rating agencies is used as foundation for determining LGDs for the group's central government and local and regional government, and financial institutions. In the annual reports on the occurrence of loss given default and collection status, credit rating agencies publish both historical and market rates of collection. The market rate of collection is the market price of a bond as compared to its value immediately before or at the moment of bond default. Based on market rates of collection for senior unsecured debt, issuer-weighted recovery rate is determined.).

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

26.3.2.5. Significant increase in credit risk

For the purpose of identifying an increased credit risk, changes for all clients of the Group are monitored continuously, but at least once a year. All placements to the client, where an increased credit risk has been identified or in case of individually significant clients, whose exposure exceeds HRK 1,500 thousand and are on the client watch list, on the next reporting date, all financial instruments of the client with increased credit risk are classified to stage 2 based on the observed criteria such as:

- client's delay in the settlement of any significant obligation due towards HBOR more than 30 days (and less than 90 days),
- the client is in financial difficulties, but is not in LGD status,
- deterioration of rating, low credit rating of the client,
- non-compliance with contractual provisions
- loss of key buyers or suppliers
- etc.

Exit from the increased credit risk status is conditional on non-existence of all the criteria based on which the client has been grouped into the respective status upon the occurrence of the risk, and verification of all indicators is made at least once a year within the framework of the annual monitoring of the client. Deactivation of a portion of indicators can be carried out after six months. Indicators of an increased credit risk are active for a year, after which they have to be checked, and based on the monitoring results, either reactivated or deactivated. The result of any change is either the reclassification of financial instruments of the client to stage 1 or its stay in stage 2.

Financial instruments of the client with an investment rating of external credit rating agencies are deemed financial instruments of low credit risk. All exposures to the Republic of Croatia and units of local and regional government (ULRG), the Croatian National Bank, the European Investment Bank (EIB) and other development banks are also deemed financial instruments of clients with low credit risk. Financial instruments of clients with low credit risk are always grouped into stage 1.

26.3.2.6. Grouping financial assets measured on a collective basis

Credit risk is evaluated on a collective basis for all clients classified into risk stages 1 and 2 as well as for clients in the risk stage 3 belonging to the small loan portfolio. The clients belonging to the small loan portfolio are clients to which HBOR is exposed in the gross amount that is equal or less than HRK 1,500 thousand.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.2. Impairment assessment (Methodology for the impairment of financial instruments in effect since 1 January 2018) (continued)

26.3.2.6. Grouping financial assets measured on a collective basis (continued)

For the purpose of identifying a significant increase in credit risk and recognition of loss allowances for impairment on a collective basis, financial instruments are grouped into the following groups, based on the common features of credit risk, for the purpose of easier evaluation of a significant increase in credit risk:

- financial institutions,
- central government and local and regional government,
- direct borrowers – large,
- direct borrowers – small and medium-sized,
- direct borrowers – micro,
- direct borrowers – citizens,
- others.

By grouping financial instruments into homogeneous groups, it is ensured that in case of a significant increase in credit risk, the goal of recognising expected credit losses during the entire lifetime of a financial instrument is attained, even if the evidence on such significant increase in credit risk is still not available on the level of an individual instrument.

26.3.3. Analysis of input for ECL model within the framework of impact of macroeconomic conditions on PD

When including any information about the future, available sources (Croatian National Bank, Croatian Bureau of Statistics) on macroeconomic conditions are used with a view to projecting their impact on the current value of risk parameters.

Based on a historical analysis of impact of macroeconomic conditions and the available macroeconomic forecasts, a potential impact of future movement of macroeconomic conditions on the value of risk parameters is established by using the scenarios with related probabilities of occurrence of an individual scenario.

When estimating expected credit losses through the application of a previous experience on credit losses, the data on earlier credit losses rates are applied to the formed homogenous groups, and through the application of a certain method, connecting of a single group of financial instruments with the data on earlier experience on credit losses in the groups of financial instruments with similar characteristics of credit risk is made possible, as well as with important relevant data reflecting the current status.

The expected credit losses reflect the Group's expectations in respect of credit losses. However, when the Group, during the estimation of such expected credit losses, considers all reasonable and reliable data that are available with no necessary costs and efforts, the Group also considers appropriate market data on the credit risk of a certain financial instrument or similar financial instruments.

For the calculation of expected credit losses, the Group uses a large number of macroeconomic conditions, of which for two of them, correlations on PDs have been established per individual homogenous groups: GDP and exchange rate.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.3. Analysis of input for ECL model within the framework of impact of macroeconomic conditions on PD (continued)

In order to determine the impact of future macroeconomic conditions on expected credit losses, by analysis based on historical data, the connection between macroeconomic conditions and PD is identified. After that, the impact of macroeconomic forecasts on PD values is estimated and the ratio is calculated, by means of which the estimated value of PD in two scenarios, an optimistic and a pessimistic one, is corrected.

26.3.4. Quantitative analysis of the reliability of the information used to calculate the ECL allowance

For the application of macroeconomic factors, the Bank uses a methodology with the level of reliability of 90%.

26.3.5. Overview of modified and restructured loans

Any amendment to the contractual provisions resulting in the conversion of contractual cash flows from financial assets is deemed to be modification.

A change of placement terms and conditions includes changes to certain contractual terms defined, mostly for the purpose of adaptation to changes during the implementation of an investment, and possibly also during repayments, and not caused by financial difficulties of the client. The amended terms would most frequently be accepted when approved if known or are the result of circumstances not controlled by the client.

Any changes in contractual obligations, by which a concession is made to the client that is considered to be in financial difficulties, are deemed to be rescheduling or restructuring. Concession may relate to any of the following measures:

- change of earlier contractual terms and conditions that are considered impossible to be met by the client and lead to the loss of its ability to settle liabilities and which would not be approved if the borrower had no financial difficulties (e.g. interest rate reduction, reduction or cancellation of interest income, change in principal amount, change or prolongation of repayment terms etc.)
- complete or partial refinancing of placements that would not be approved if the debtor had no financial difficulties.

Evidence on concession includes the following:

- the difference in favor of the client between the changed terms and conditions of the contract and former terms and conditions of the contract,
- inclusion of more favorable terms and conditions in the changed contract as compared to the terms and conditions that other debtors with a similar risk profile in the Bank portfolio could have obtained.

Rescheduling is considered any change of the originally agreed loan terms and conditions due to temporary financial difficulties of the client. Restructuring is considered any change of the originally agreed loan terms and conditions due to significant financial difficulties of the client that needs financial, business and operational restructuring, i.e. the client that is already in default.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.6. Analysis of risk concentration

Through its development loan programmes, the Group encompasses the area of the entire Republic of Croatia with emphasis on supported areas. Credit risk is spread across geographic areas, industries, sectors and loan programmes. The Group seeks to avoid excessive concentration of credit risk and support the development of less developed areas of the Republic of Croatia through more favorable terms and conditions and new loan programmes (products) in accordance with the national strategy of development of certain activities.

Through financing of different sectors by stimulating production and development with the purpose of developing the Croatian economy, the Group is creating a better base for repayment of loans and minimization of risk.

As of 30 June 2018, the highest credit exposure of the Group and the Bank to one debtor equaled HRK 2,258,640 thousand (31 December 2017: HRK 2,536,756 thousand) without considering the effect of mitigation through collateral received.

As a special financial institution, the Bank performs its development role by granting loans to final borrowers via commercial banks with which it has entered into co-operation agreements. Since the exposure towards some of the banks has reached the maximum permitted level, the Bank, in order to be able to continue performing its development role and make the loans accessible to as many final borrowers as possible, has an approval from the Supervisory Board for an increase in the exposure towards the banks and their associated entities that have, in accordance with HBOR's internal methodology, been assigned a high rating. The exposure level is maintained by using all instruments and techniques available for mitigating HBOR's exposure towards the banks.

This exposure increase approved by the Supervisory Board was used by the Bank for further operating activities carried out with two banks.

26.3.7. Collaterals and other credit quality (creditworthiness) improvement

Collateral for the Bank's placements are:

1. obligatory (bills of exchange and promissory notes),
2. ordinary (property, ships, airplanes, bank guarantees, guarantees from the Republic of Croatia, guarantees from the local (regional) authorities, guarantees from HAMAG-BICRO (Croatian Agency for SMSs, Innovation and Investment), insurance policy against political and/or commercial risks), and
3. other collateral (movable property, bills of exchange or guarantees from other companies with solid creditworthiness, fiduciary or pledge of companies' equity instruments, repossession of cash receivables or assignment for collectible receivables, deposit repossession, restriction of transferability on insurance policy of assets and/or person, pledge on a trademark, etc.).

All Group placements have to be secured with obligatory collateral. Low-exposure placements must be secured with one obligatory instrument of collateral at least. The selection of eligible collaterals does not depend on the insurance ratio achieved only, but also on the risks identified, with marketable and more valuable collaterals being preferred.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.7. Collateral and other credit enhancements (creditworthiness) (continued)

Acceptable ordinary and other collateral are classified according to quality in five groups. The evaluation of collateral is based on quality, estimated based on marketability, documentation and possibility of supervision by the Bank as well as the possibility of enforced collection. Only the acceptable collateral is evaluated while the sixth group of collateral is unacceptable.

When deciding on loan approval, weak creditworthiness cannot be replaced by quality collateral, except when the security instruments are first class instruments: guarantees from the Republic of Croatia, guarantees of local/regional authorities (JLPS), guarantees from HAMAG-BICRO, loan insurance policy and when the Republic of Croatia, JLPS or other government authorities guarantee for clients implicitly.

For the purpose of mitigation of credit risk and reduction of business costs, and in compliance with the Act on the Croatian Bank for Reconstruction and Development, the Group approves part of its placements through financial institutions. As collateral for placements approved to final customers through financial institutions, the Group uses mandatory collateral from commercial banks/leasing companies. The financial institution is obliged to deliver them based on the Mutual business cooperation agreement, but not for each individual placement to the final customer based on that Agreement. In the individual contracts for placements to the final customers, the use of obligatory collateral delivered with the Agreement on mutual business cooperation is contracted. As the financial institutions takes on the risk of default by the final customer, they are given the option to contract sufficient collateral with the final customer/leasing company.

Where the loan is approved through a commercial bank, depending on the financial institution's internal rating, the Bank contracts a sub-mortgage. In this case, either the commercial bank transfers the ownership over the collateral, while the Bank takes a mortgage over the same collateral, or the commercial bank forms a mortgage on the collateral, while the Bank takes a sub-mortgage on the same collateral.

By signing the Agreement on mutual business cooperation, a transfer of any claims the commercial bank may have towards the final customer is made to HBOR. Pursuant to the Agreement, the commercial bank authorises HBOR to unilaterally inform the bank in written form that, in the case of the commercial bank's insolvency or threat of liquidation, untimely repayments or default on the commitments agreed in the individual contract on interbank loan or actual (insolvent or regular) liquidation, the Bank assumes the receivable towards the final customer from the commercial bank, with the effect of assignment of receivables instead of contract fulfilment.

Additionally, based on the Agreement on mutual business cooperation and based on the said unilateral statement, the commercial bank authorises HBOR that HBOR may, without having to obtain any further consent or approval from the commercial bank, enter itself into all public registers, books or records as the creditor instead of the commercial bank under any security arrangements for assigned receivables as well as under any other proceedings.

From the moment of the assignment, the final customer is obliged to make all payments related to the assigned receivable directly to HBOR. Should the commercial bank receive any payments in the name of collection of receivables per particular placement, the bank is obliged to immediately transfer the funds to HBOR.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

26.3.7. Collateral and other credit enhancements (creditworthiness) (continued)

All direct placements are mainly secured with a transfer of ownership or with a mortgage over real estate and, if is possible, the Group obtains as security against credit risk a guarantee from HAMAG-BICRO, a guarantee from the local (regional) authority, a guarantee from the Republic of Croatia, etc.

The Group has the right to verify the appraisal of the collateral value and such a confirmed appraisal is considered as the final collateral value.

Depending on the type of collateral, the credit programme, the general terms of security or the decision of an authorised body, the Group has determined the necessary ratio of placements and collateral.

In case of the real estate, the necessary ratio of placement and estimated market value of the real estate should be 1:1.3, except in case of investments on the islands, supported areas where such ratio is 1:1.2. In case of moveable property, the necessary ratio of placement and estimated market value of moveable property should be 1:2. If a lower ratio of the collateral value than those prescribed is proposed, reasons and justifications of deviations from the prescribed ratio are explained.

The Bank continually monitors the value of collaterals by re-estimation or confirmation/verification of the value. Monitoring of the value of mortgaged real estate is performed once a year for business real estate, and every three years for residential buildings. The Bank has formed a special organizational unit for:

- evaluation and verification of already appraised and offered collateral (real estate and movables),
- technical and technological analysis of investment projects, and
- financial supervision over the withdrawal of loan funds for the purpose of the construction of the investment project.

In the event that it is not possible for the Bank to collect from regular operations, the Bank starts collection from the collateral at its disposal. This encompasses initiating collection from the obligatory collateral, then from first-class, unconditional collateral payable on first demand and then from the mortgage or fiduciary ownership of the real estate or movable property, including their repossession with a view to decreasing or fully settling the Bank's receivables. The Bank does not use repossessed assets for business purposes.

In the case of risk-sharing models, collateral is created by commercial banks depending on the type of the model:

- in accordance with their own internal documents and good banking practices, and, consequently, HBOR's documents and collateral ratios prescribed in them do not apply,
- or collateral is created by commercial banks and HBOR for their respective shares in the loan in accordance with their own documents, decisions and/or procedures.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure

The table below shows the highest gross credit risk exposures existing in the Statement of Financial Position and in guarantees and commitments as of the reporting date, before the effect of mitigation through collateral received:

	Group		Bank	
	Highest exposure	Highest exposure	Highest exposure	Highest exposure
	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Assets				
Cash on hand and current accounts with banks	818,190	1,403,664	810,308	1,401,130
Deposits with other banks	14,569	29,138	14,569	29,138
Loans to financial institutions	10,033,644	10,836,141	10,033,644	10,836,141
Loans to other customers	12,269,881	12,383,623	12,269,881	12,383,623
Financial assets at fair value through profit or loss*	4,016	-	4,016	-
Financial assets at fair value through other comprehensive income*	3,076,591	n/a	3,037,100	n/a
Debt instruments at amortised cost	1,364	n/a	-	n/a
Assets available for sale	n/a	2,483,371	n/a	2,443,699
Assets held to maturity	n/a	1,399	n/a	-
Other assets	4,467	19,297	2,516	12,282
Total	26,222,722	27,156,633	26,172,034	27,106,013
Guarantees and commitments				
Guarantees issued in HRK	19,787	33,993	19,787	33,993
Issued guarantees in foreign currency	2,077,597	2,446,324	2,077,597	2,446,324
Open letters of credit in foreign currency	11,472	-	11,472	-
Undrawn loans	3,432,609	2,986,798	3,432,609	2,986,798
Other irrevocable contingent liabilities	339	335	339	335
Total	5,541,804	5,467,450	5,541,804	5,467,450
Total credit risk exposure	31,764,526	32,624,083	31,713,838	32,573,463

*The disclosed financial statements as at and for the year ended on 31 December 2017 under these positions included also investments in investment funds. This change relates to all parts of note 26.3. Credit risk.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received, is as follows:

Group	Republic of Croatia	EU countries	Other countries	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	757,553	60,063	574	818,190
Deposits with other banks	-	14,569	-	14,569
Loans to financial institutions	10,033,644	-	-	10,033,644
Loans to other customers	11,798,726	-	471,155	12,269,881
Financial assets at fair value through profit or loss	4,016	-	-	4,016
Financial assets at fair value through other comprehensive income	3,076,591	-	-	3,076,591
Debt instruments at amortised cost	1,364	-	-	1,364
Other assets	3,781	686	-	4,467
Total	25,675,675	75,318	471,729	26,222,722
Guarantees and commitments				
Guarantees issued in HRK	19,185	602	-	19,787
Issued guarantees in foreign currency	2,077,597	-	-	2,077,597
Open letters of credit in foreign currency	11,472	-	-	11,472
Undrawn loans	3,404,803	-	27,806	3,432,609
Other irrevocable contingent liabilities	339	-	-	339
Total	5,513,396	602	27,806	5,541,804
Total credit risk exposure	31,189,071	75,920	499,535	31,764,526

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received, is as follows (continued):

Group	Republic of Croatia	EU countries	Other countries	Total
Dec 31, 2017	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	1,320,579	82,884	201	1,403,664
Deposits with other banks	29,116	22	-	29,138
Loans to financial institutions	10,836,141	-	-	10,836,141
Loans to other customers	12,075,474	-	308,149	12,383,623
Assets available for sale	2,483,371	-	-	2,483,371
Assets held to maturity	1,399	-	-	1,399
Other assets	13,105	6,045	147	19,297
Total	26,759,185	88,951	308,497	27,156,633
Guarantees and commitments				
Guarantees issued in HRK	33,391	602	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	2,446,324
Undrawn loans	2,844,366	-	142,432	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
Total	5,324,416	602	142,432	5,467,450
Total credit risk exposure	32,083,601	89,553	450,929	32,624,083

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received, is as follows:

Bank Jun 30, 2018	Republic of Croatia HRK '000	EU countries HRK '000	Other countries HRK '000	Total HRK '000
Assets				
Cash on hand and current accounts with banks	749,671	60,063	574	810,308
Deposits with other banks	-	14,569	-	14,569
Loans to financial institutions	10,033,644	-	-	10,033,644
Loans to other customers	11,798,726	-	471,155	12,269,881
Financial assets at fair value through profit or loss	4,016	-	-	4,016
Financial assets at fair value through other comprehensive income	3,037,100	-	-	3,037,100
Other assets	2,507	9	-	2,516
Total	25,625,664	74,641	471,729	26,172,034
Guarantees and commitments				
Guarantees issued in HRK	19,185	602	-	19,787
Issued guarantees in foreign currency	2,077,597	-	-	2,077,597
Open letters of credit in foreign currency	11,472	-	-	11,472
Undrawn loans	3,404,803	-	27,806	3,432,609
Other irrevocable contingent liabilities	339	-	-	339
Total	5,513,396	602	27,806	5,541,804
Total credit risk exposure	31,139,060	75,243	499,535	31,713,838

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to geographical segments, before the effect of mitigation through collateral received, is as follows (continued):

Bank	Republic of Croatia	EU countries	Other countries	Total
Dec 31, 2017	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Cash on hand and current accounts with banks	1,318,045	82,884	201	1,401,130
Deposits with other banks	29,116	22	-	29,138
Loans to financial institutions	10,836,141	-	-	10,836,141
Loans to other customers	12,075,474	-	308,149	12,383,623
Assets available for sale	2,443,699	-	-	2,443,699
Other assets	11,911	224	147	12,282
Total	26,714,386	83,130	308,497	27,106,013
Guarantees and commitments				
Guarantees issued in HRK	33,391	602	-	33,993
Issued guarantees in foreign currency	2,446,324	-	-	2,446,324
Undrawn loans	2,844,366	-	142,432	2,986,798
Other irrevocable contingent liabilities	335	-	-	335
Total	5,324,416	602	142,432	5,467,450
Total credit risk exposure	32,038,802	83,732	450,929	32,573,463

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, before and after the effect of mitigation through collateral received, is as follows:

Group	Highest exposure	Highest exposure after the effect of mitigation through collateral received	Highest exposure	Highest exposure after the effect of mitigation through collateral received
	Jun 30, 2018	Jun 30, 2018	Dec 31, 2017	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Financial intermediation and insurance	12,708,552	-	13,991,248	-
Water and electric supply and other infrastructure	1,327,648	969,208	1,260,064	931,740
Tourism	3,350,627	120,029	3,550,174	268,536
Transport, warehousing and connections	2,368,146	914,520	1,979,350	857,758
Shipbuilding	2,560,828	310,276	2,994,248	416,604
Agriculture and fishery	529,394	124,761	455,716	68,992
Food industry	876,573	126,261	952,014	143,121
Construction industry	1,181,131	34,759	1,225,516	52,841
Other industry	478,705	114,904	493,034	149,251
Public administration	3,759,633	3,759,633	2,473,206	2,473,206
Education	45,803	41,305	47,201	42,085
Manufacture of basic metals and fabricated metal products, except machinery and equipment	303,776	18,372	321,123	55,470
Manufacture of chemicals and chemical products	55,155	35,509	403,043	89,662
Manufacture of other non-metallic mineral products	243,067	55,715	261,053	55,823
Pharmaceutical industry	403,626	1,084	544,777	891
Other	1,571,862	377,913	1,672,316	476,548
Total credit risk exposure	31,764,526	7,004,249	32,624,083	6,082,528

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

Concentration of assets and guarantees and commitments, according to industry, before and after the effect of mitigation through collateral received, is as follows:

Bank	Highest exposure	Highest exposure after the effect of mitigation through collateral received	Highest exposure	Highest exposure after the effect of mitigation through collateral received
	Jun 30, 2018 HRK '000	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000	Dec 31, 2017 HRK '000
Financial intermediation and insurance	12,700,018	-	13,982,804	0
Water and electric supply and other infrastructure	1,327,648	969,208	1,260,064	931,740
Tourism	3,350,623	120,025	3,550,170	268,533
Transport, warehousing and connections	2,368,127	914,501	1,979,333	857,741
Shipbuilding	2,560,828	310,276	2,994,248	416,604
Agriculture and fishery	529,353	124,720	455,679	68,956
Food industry	876,468	126,155	951,920	143,027
Construction industry	1,181,129	34,756	1,225,514	52,839
Other industry	478,396	114,595	492,757	148,974
Public administration	3,719,544	3,719,544	2,432,805	2,432,805
Education	45,803	41,305	47,201	42,085
Manufacture of basic metals and fabricated metal products, except machinery and equipment	303,656	18,253	321,017	55,363
Manufacture of chemicals and chemical products	55,134	35,488	403,025	89,644
Manufacture of other non-metallic mineral products	243,049	55,698	261,037	55,807
Pharmaceutical industry	402,543	-	543,887	0
Other	1,571,519	377,564	1,672,002	476,249
Total credit risk exposure	31,713,838	6,962,088	32,573,463	6,040,367

Concentration of assets and guarantees and commitments according to industry for both years has been compiled in accordance with the National Classification of Activities 2007 ("NKD 2007").

In the preparation of the Note, a combined approach is applied, which takes into consideration business activities of a debtor, retains the names of activities different from those in the National Classification of Activities and unites similar business activities.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Concentration of risk and maximum credit risk exposure (continued)

The fair value of collateral for the Group as of 30 June 2018 amounted to HRK 24,760,277 thousand (31 December 2017: HRK 27,335,451 thousand), and for the Bank HRK 24,751,750 thousand (31 December 2017: HRK 27,322,017 thousand).

In the total net highest exposure of the Bank as of 30 June 2018, the credit risk of HRK 5,134,464 thousand (31 December 2017: HRK 3,966,003 thousand) is not covered with ordinary collateral, but it relates to receivables and received funds from the Republic of Croatia of HRK 1,284,867 thousand (31 December 2017: HRK 619,922 thousand), from local (regional) authorities of HRK 443,825 thousand (31 December 2017: HRK 510,573 thousand), state-owned companies for whose commitments the Republic of Croatia guarantees jointly and unconditionally of HRK 240,791 thousand (31 December 2017: HRK 240,099 thousand), government funds of HRK 44 thousand (31 December 2017: HRK 43 thousand), government bonds and Treasury bills of the Ministry of Finance of HRK 3,036,379 thousand (31 December 2017: HRK 2,443,010 thousand). In addition, an amount of HRK 128,558 thousand (31 December 2017: HRK 152,356 thousand) relates to receivables from a majority state-owned company (controlling influence).

Part of the placements with net exposure relates to placements provisionally and partially covered with collateral and the further increase in exposure has been stopped pending the submission of the full collateral necessary for compliance with the requested collateral coverage ratio.

Financial intermediation includes mainly commercial banks.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Credit risk quality according to type of financial assets

Credit risk analysis, before the effect of mitigation through collateral received and after loss allowances, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows:

Group	Net exposure of portfolio - risk Stage 1 HRK '000	Net exposure of portfolio - risk Stage 2 HRK '000	Net exposure of portfolio - risk Stage 3 HRK '000	Net exposure of portfolio of risk POCI HRK '000	Not subject to IFRS 9 risk stages HRK '000	Net exposure of total portfolio HRK '000
Jun 30, 2018						
Assets						
Cash on hand and current accounts with banks	818,190	-	-	-	-	818,190
Deposits with other banks	14,569	-	-	-	-	14,569
Loans to financial institutions	9,810,384	187,777	35,483	-	-	10,033,644
Loans to other customers	8,815,772	971,629	2,354,492	127,988	-	12,269,881
Financial assets at fair value through profit or loss	-	-	-	-	4,016	4,016
Financial assets at fair value through other comprehensive income	3,075,099	1,492	-	-	-	3,076,591
Debt instruments at amortised cost	1,364	-	-	-	-	1,364
Other assets	3,359	6	1,102	-	-	4,467
Total	22,538,737	1,160,904	2,391,077	127,988	4,016	26,222,722
Guarantees and commitments						
Guarantees issued in HRK	2,809	-	16,978	-	-	19,787
Issued guarantees in foreign currency	172,570	15,554	1,889,473	-	-	2,077,597
Open letters of credit in foreign currency	-	-	-	-	11,472	11,472
Undrawn loans	3,324,248	108,098	263	-	-	3,432,609
Other irrevocable contingent liabilities	339	-	-	-	-	339
Total	3,499,966	123,652	1,906,714	-	11,472	5,541,804
Total credit risk exposure	26,038,703	1,284,556	4,297,791	127,988	15,488	31,764,526

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Credit risk quality according to type of financial assets (continued)

Credit risk analysis, before and after the effect of mitigation through collateral received and after loss allowances, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows (continued):

Group	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio	Net exposure of portfolio of risk group A after the effect of mitigation through collateral received	Net exposure of portfolio of risk group B after the effect of mitigation through collateral received	Net exposure of portfolio of risk group C after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Dec 31, 2017								
Assets								
Cash on hand and current accounts with banks	1,403,664	-	-	1,403,664	-	-	-	-
Deposits with other banks	29,138	-	-	29,138	-	-	-	-
Loans to financial institutions	10,624,635	211,506	-	10,836,141	-	-	-	-
Loans to other customers	10,990,700	1,392,923	-	12,383,623	2,761,223	50,706	-	2,811,929
Assets available for sale	2,483,371	-	-	2,483,371	2,483,371	-	-	2,483,371
Assets held to maturity	1,399	-	-	1,399	1,399	-	-	1,399
Other assets	18,871	426	-	19,297	10,608	426	-	11,034
Total	25,551,778	1,604,855	-	27,156,633	5,256,601	51,132	-	5,307,733
Guarantees and commitments								
Guarantees issued in HRK	33,993	-	-	33,993	1,254	-	-	1,254
Issued guarantees in foreign currency	2,425,975	20,349	-	2,446,324	330,170	-	-	330,170
Undrawn loans	2,984,971	1,827	-	2,986,798	443,036	-	-	443,036
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
Total	5,445,274	22,176	-	5,467,450	774,795	-	-	774,795
Total credit risk exposure	30,997,052	1,627,031	-	32,624,083	6,031,396	51,132	-	6,082,528

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Credit risk quality according to type of financial assets (continued)

Credit risk analysis, before the effect of mitigation through collateral received and after loss allowances, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows (continued):

Bank	Net exposure of portfolio - risk Stage 1 HRK '000	Net exposure of portfolio - risk Stage 2 HRK '000	Net exposure of portfolio - risk Stage 3 HRK '000	Net exposure of portfolio of risk POCI HRK '000	Not subject to IFRS 9 risk stages HRK '000	Net exposure of total portfolio HRK '000
Jun 30, 2018						
Assets						
Cash on hand and current accounts with banks	810,308	-	-	-	-	810,308
Deposits with other banks	14,569	-	-	-	-	14,569
Loans to financial institutions	9,810,384	187,777	35,483	-	-	10,033,644
Loans to other customers	8,815,772	971,629	2,354,492	127,988	-	12,269,881
Financial assets at fair value through profit or loss	-	-	-	-	4,016	4,016
Financial assets at fair value through other comprehensive income	3,036,379	721	-	-	-	3,037,100
Other assets	1,408	6	1,102	-	-	2,516
Total	22,488,820	1,160,133	2,391,077	127,988	4,016	26,172,034
Guarantees and commitments						
Guarantees issued in HRK	2,809	-	16,978	-	-	19,787
Issued guarantees in foreign currency	172,570	15,554	1,889,473	-	-	2,077,597
Open letters of credit in foreign currency	-	-	-	-	11,472	11,472
Undrawn loans	3,324,248	108,098	263	-	-	3,432,609
Other irrevocable contingent liabilities	339	-	-	-	-	339
Total	3,499,966	123,652	1,906,714	-	11,472	5,541,804
Total credit risk exposure	25,988,786	1,283,785	4,297,791	127,988	15,488	31,713,838

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.3. Credit risk (continued)

Credit risk quality according to type of financial assets (continued)

Credit risk analysis, before and after the effect of mitigation through collateral received and after loss allowances, according to the type of financial assets on positions of assets and guarantees and commitments by risk category, is as follows (continued):

Bank					Net exposure of portfolio of risk group A after the effect of mitigation through collateral received	Net exposure of portfolio of risk group B after the effect of mitigation through collateral received	Net exposure of portfolio of risk group C after the effect of mitigation through collateral received	Net exposure of total portfolio after the effect of mitigation through collateral received
Dec 31, 2017	Net exposure of portfolio of risk group A	Net exposure of portfolio of risk group B	Net exposure of portfolio of risk group C	Net exposure of total portfolio				
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets								
Cash on hand and current accounts with banks	1,401,130	-	-	1,401,130	-	-	-	-
Deposits with other banks	29,138	-	-	29,138	-	-	-	-
Loans to financial institutions	10,624,635	211,506	-	10,836,141	-	-	-	-
Loans to other customers	10,990,700	1,392,923	-	12,383,623	2,761,223	50,706	-	2,811,929
Assets available for sale	2,443,699	-	-	2,443,699	2,443,699	-	-	2,443,699
Other assets	11,856	426	-	12,282	9,518	426	-	9,944
Total	25,501,158	1,604,855	-	27,106,013	5,214,440	51,132	-	5,265,572
Guarantees and commitments								
Guarantees issued in HRK	33,993	-	-	33,993	1,254	-	-	1,254
Issued guarantees in foreign currency	2,425,975	20,349	-	2,446,324	330,170	-	-	330,170
Undrawn loans	2,984,971	1,827	-	2,986,798	443,036	-	-	443,036
Other irrevocable contingent liabilities	335	-	-	335	335	-	-	335
Total	5,445,274	22,176	-	5,467,450	774,795	-	-	774,795
Total credit risk exposure	30,946,432	1,627,031	-	32,573,463	5,989,235	51,132	-	6,040,367

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.4. Liquidity risk

The table below provides an analysis of total assets and total liabilities and equity as of 30 June 2018 and 31 December 2017 placed into relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date, as follows:

Group Jun 30, 2018	Up to 1 month HRK '000	1 to 3 months HRK '000	3 months to 1 year HRK '000	1 to 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and current accounts with banks	818,191	-	-	-	-	818,191
Deposits with other banks	14,569	-	-	-	-	14,569
Loans to financial institutions*	332,685	402,822	1,227,425	2,758,193	5,312,519	10,033,644
Loans to other customers	2,670,993	497,362	942,106	1,845,686	6,313,734	12,269,881
Financial assets at fair value through profit or loss	657,878	-	-	-	4,016	661,894
Financial assets at fair value through other comprehensive income	3,085,236	16,910	18	-	-	3,102,164
Debt instruments at amortised cost	-	10	4	-	1,350	1,364
Investments in associates	-	-	-	-	-	-
Property, plant and equipment and intangible assets	-	-	-	-	51,974	51,974
Non-current assets held for sale	-	-	1,491	10,857	12,667	25,015
Other assets	4,239	1,603	4,582	1,021	1,195	12,640
Total assets	7,583,791	918,707	2,175,626	4,615,757	11,697,455	26,991,336
Liabilities						
Deposits from customers	113,798	-	14,249	36,781	12,876	177,704
Borrowings	238,304	370,147**	1,338,603	3,899,954	9,220,549	15,067,557
Debt securities issued	-	9,644	-	1,099,649	-	1,109,293
Other liabilities	211,637	23,929	79,781	155,793	161,283	632,423
Total liabilities	563,739	403,720	1,432,633	5,192,177	9,394,708	16,986,977
Liquidity gap	7,020,052	514,987	742,993	(576,420)	2,302,747	10,004,359

The items with undefined maturity are included in terms over 3 years.

* Receivables of HRK 44,030 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 7,749 thousand was placed in the 1 to 3 months category.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.4. Liquidity risk (continued)

Group Dec 31, 2017	Up to 1 month	1 - 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	1,403,680	-	-	-	-	1,403,680
Deposits with other banks	29,138	-	-	-	-	29,138
Loans to financial institutions*	499,790	411,937	1,369,798	2,888,174	5,666,442	10,836,141
Loans to other customers	2,048,659	396,509	885,769	2,116,638	6,936,048	12,383,623
Financial assets at fair value through profit or loss	291	-	-	-	-	291
Assets available for sale	3,308,009	13,532	23	-	-	3,321,564
Assets held to maturity	-	9	5	-	1,385	1,399
Property, plant and equipment and intangible assets	-	-	-	-	53,557	53,557
Non-current assets held for sale	-	-	1,932	2,827	11,938	16,697
Other assets	18,904	7,543	1,397	497	1,130	29,471
Total assets	7,308,471	829,530	2,258,924	5,008,136	12,670,500	28,075,561
Liabilities						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	168,310	307,151**	1,155,999	3,853,447	9,902,974	15,387,881
Debt securities issued	-	43,909	-	1,117,790	-	1,161,699
Other liabilities	186,306	22,257	81,485	152,731	162,674	605,453
Total liabilities	606,438	373,504	1,408,775	5,335,102	10,075,955	17,799,774
Liquidity gap	6,702,033	456,026	850,149	(326,966)	2,594,545	10,275,787

The items with undefined maturity are included in terms over 3 years.

* Receivables of HRK 236,400 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 150,000 thousand was placed in the 3 months up to 1 year maturity category.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.4. Liquidity risk (continued)

The table below provides an analysis of total assets and total liabilities and equity as of 30 June 2018 and 31 December 2017 placed into relevant maturity groupings based on the remaining period as at the Statement of Financial Position date related to the contractual maturity date, as follows:

Bank Jun 30, 2018	Up to 1 month HRK '000	1 to 3 months HRK '000	3 months to 1 year HRK '000	1 to 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and current accounts with banks	810,309	-	-	-	-	810,309
Deposits with other banks	14,569	-	-	-	-	14,569
Loans to financial institutions*	332,685	402,822	1,227,425	2,758,193	5,312,519	10,033,644
Loans to other customers	2,670,993	497,362	942,106	1,845,686	6,313,734	12,269,881
Financial assets at fair value through profit or loss	651,435	-	-	-	4,016	655,451
Financial assets at fair value through other comprehensive income	3,045,859	16,814	-	-	-	3,062,673
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	51,883	51,883
Non-current assets held for sale	-	-	1,491	10,857	12,667	25,015
Other assets	3,046	894	4,526	1,021	877	10,364
Total assets	7,528,896	917,892	2,175,548	4,615,757	11,731,820	26,969,913
Liabilities						
Deposits from customers	113,798	-	14,249	36,781	12,876	177,704
Borrowings	238,304	370,147**	1,338,603	3,899,954	9,220,549	15,067,557
Debt securities issued	-	9,644	-	1,099,649	-	1,109,293
Other liabilities	211,103	22,079	75,115	146,655	163,799	618,751
Total liabilities	563,205	401,870	1,427,967	5,183,039	9,397,224	16,973,305
Liquidity gap	6,965,691	516,022	747,581	(567,282)	2,334,596	9,996,608

The items with undefined maturity are included in terms over 3 years.

* Receivables of HRK 44,030 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 7,749 thousand was placed in the 1 to 3 months category.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.4. Liquidity risk (continued)

Bank Dec 31, 2017	Up to 1 month HRK '000	1 - 3 months HRK '000	3 months to 1 year HRK '000	1 - 3 years HRK '000	Over 3 years HRK '000	Total HRK '000
Assets						
Cash on hand and current accounts with banks	1,401,146	-	-	-	-	1,401,146
Deposits with other banks	29,138	-	-	-	-	29,138
Loans to financial institutions*	499,790	411,937	1,369,798	2,888,174	5,666,442	10,836,141
Loans to other customers	2,048,659	396,509	885,769	2,116,638	6,936,048	12,383,623
Assets available for sale	3,263,758	13,436	-	-	-	3,277,194
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	53,514	53,514
Non-current assets held for sale	-	-	1,932	2,827	11,938	16,697
Other assets	17,831	1,648	1,350	497	900	22,226
Total assets	7,260,322	823,530	2,258,849	5,008,136	12,704,966	28,055,803
Liabilities						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	168,310	307,151**	1,155,999	3,853,447	9,902,974	15,387,881
Debt securities issued	-	43,909	-	1,117,790	-	1,161,699
Other liabilities	185,299	21,082	76,872	144,072	165,326	592,651
Total liabilities	605,431	372,329	1,404,162	5,326,443	10,078,607	17,786,972
Liquidity gap	6,654,891	451,201	854,687	(318,307)	2,626,359	10,268,831

The items with undefined maturity are included in terms over 3 years.

* Receivables of HRK 236,400 thousand relate to reverse REPO agreements. The maturity of part of receivables was prolonged after the Statement of Financial Position date, and an amount of HRK 150,000 thousand was placed in the 3 months up to 1 year maturity category.

** Accrued interest on loans not yet due is allocated to the category from 1 to 3 months.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.4. Liquidity risk (continued)

The table below indicates the remaining contractual maturity of financial liabilities of the Group in undiscounted amounts:

Group Jun 30, 2018	Up to 1 month	1 - 3 months	3 months to 1 year	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	113,798	-	14,249	36,781	12,876	177,704
Borrowings	265,350	342,979	1,521,276	4,347,402	10,029,865	16,506,872
Debt securities issued	-	-	66,416	1,166,065	-	1,232,481
Other liabilities	211,637	23,929	79,781	155,793	161,283	632,423
Total	590,785	366,908	1,681,722	5,706,041	10,204,024	18,549,480

Group Dec 31, 2017	Up to 1 month	1 - 3 months	3 months to 1 year	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	197,142	283,160	1,358,672	4,292,634	10,758,724	16,890,332
Debt securities issued	-	-	67,623	1,253,036	-	1,320,659
Other liabilities	186,306	22,257	81,485	152,731	162,674	605,453
Total	635,270	305,604	1,679,071	5,909,535	10,931,705	19,461,185

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.4. Liquidity risk (continued)

The table below indicates the remaining contractual maturity of financial liabilities of the Bank in undiscounted amounts:

Bank Jun 30, 2018	Up to 1 month	1 - 3 months	3 months to 1 year	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	113,798	-	14,249	36,781	12,876	177,704
Borrowings	265,350	342,979	1,521,276	4,347,402	10,029,865	16,506,872
Debt securities issued	-	-	66,416	1,166,065	-	1,232,481
Other liabilities	211,103	22,079	75,115	146,655	163,799	618,751
Total	590,251	365,058	1,677,056	5,696,903	10,206,540	18,535,808

Bank Dec 31, 2017	Up to 1 month	1 - 3 months	3 months to 1 year	1 - 3 years	Over 3 years	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Financial liabilities						
Deposits from customers	251,822	187	171,291	211,134	10,307	644,741
Borrowings	197,142	283,160	1,358,672	4,292,634	10,758,724	16,890,332
Debt securities issued	-	-	67,623	1,253,036	-	1,320,659
Other liabilities	185,299	21,082	76,872	144,072	165,326	592,651
Total	634,263	304,429	1,674,458	5,900,876	10,934,357	19,448,383

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk

Management of market risks at the Bank implies the reduction of interest rate risk and the currency risk to a minimal level.

26.5.1. Interest rate risk in the Bank's book

The following tables demonstrate the sensitivity of the Group to interest rates risk as of 30 June 2018 and 31 December 2017 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter. Assets and liabilities on which interest is not charged are placed into the non-interest bearing category. The tables below demonstrate the estimation of Group's interest rate risk exposure as of 30 June 2018 and 31 December 2017 which may not be indicative for the positions in other periods.

Group	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets							
Cash on hand and current accounts with banks	70,020	-	-	-	-	748,171	818,191
Deposits with other banks	14,568	-	-	-	-	1	14,569
Loans to financial institutions	309,191	695,695	1,195,160	2,647,339	5,161,424	24,835	10,033,644
Loans to other customers	2,677,506	903,263	879,800	1,681,335	6,008,116	119,861	12,269,881
Financial assets at fair value through profit or loss	-	-	-	-	4,016	657,878	661,894
Financial assets at fair value through other comprehensive income	3,059,214	-	-	-	-	42,950	3,102,164
Debt instruments at amortised cost	-	-	-	-	1,351	13	1,364
Property, plant and equipment and intangible assets	-	-	-	-	-	51,974	51,974
Non-current assets held for sale	-	-	-	-	-	25,015	25,015
Other assets	-	-	-	-	-	12,640	12,640
Total assets	6,130,499	1,598,958	2,074,960	4,328,674	11,174,907	1,683,338	26,991,336

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

Group	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non- interest bearing	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Liabilities							
Deposits from customers	-	-	-	-	-	177,704	177,704
Borrowings	238,304	469,008	1,325,771	3,865,736	9,109,343	59,395	15,067,557
Debt securities issued	-	-	-	1,099,649	-	9,644	1,109,293
Other liabilities	-	-	-	-	-	632,423	632,423
Total liabilities	238,304	469,008	1,325,771	4,965,385	9,109,343	879,166	16,986,977
Interest rate gap	5,892,195	1,129,950	749,189	(636,711)	2,065,564	804,172	10,004,359

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

Group	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total
Dec 31, 2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets							
Cash on hand and current accounts with banks	2,534	-	-	-	-	1,401,146	1,403,680
Deposits with other banks	29,114	-	-	-	-	24	29,138
Loans to financial institutions	474,348	733,865	1,345,038	2,759,113	5,496,436	27,341	10,836,141
Loans to other customers	2,104,487	745,415	927,758	1,848,681	6,689,547	67,735	12,383,623
Financial assets at fair value through profit or loss	-	-	-	-	-	291	291
Assets available for sale	2,473,578	-	-	-	-	847,986	3,321,564
Assets held to maturity	-	-	-	-	1,385	14	1,399
Property, plant and equipment and intangible assets	-	-	-	-	-	53,557	53,557
Non-current assets held for sale	-	-	-	-	-	16,697	16,697
Other assets	-	-	-	-	-	29,471	29,471
Total assets	5,084,061	1,479,280	2,272,796	4,607,794	12,187,368	2,444,262	28,075,561
Liabilities							
Deposits from customers	150,273	-	169,057	169,057	-	156,354	644,741
Borrowings	168,310	243,414	1,155,999	3,853,447	9,902,974	63,737	15,387,881
Debt securities issued	-	-	-	1,117,790	-	43,909	1,161,699
Other liabilities	-	-	-	-	-	605,453	605,453
Total liabilities	318,583	243,414	1,325,056	5,140,294	9,902,974	869,453	17,799,774
Interest rate gap	4,765,478	1,235,866	947,740	(532,500)	2,284,394	1,574,809	10,275,787

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

The following tables demonstrate the sensitivity of HBOR to interest rates risk as of 30 June 2018 and 31 December 2017 on the basis of known dates of changes in prices of assets and liabilities to which floating and fixed interest rates are applied. Periods of interest rates changes are determined on the basis of residual maturity and contracted period when interest rates change, depending on which is shorter. Assets and liabilities on which interest is not charged are placed into the non-interest bearing category. The tables below demonstrate the estimation of HBOR's interest rate risk exposure as of 30 June 2018 and 31 December 2017 which may not be indicative for the positions in other periods.

Bank	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets							
Cash on hand and current accounts with banks	62,138	-	-	-	-	748,171	810,309
Deposits with other banks	14,568	-	-	-	-	1	14,569
Loans to financial institutions	309,191	695,695	1,195,160	2,647,339	5,161,424	24,835	10,033,644
Loans to other customers	2,677,506	903,263	879,800	1,681,335	6,008,116	119,861	12,269,881
Financial assets at fair value through profit or loss	-	-	-	-	4,016	651,435	655,451
Financial assets at fair value through other comprehensive income	3,020,286	-	-	-	-	42,387	3,062,673
Investments in subsidiaries	-	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	-	51,883	51,883
Non-current assets held for sale	-	-	-	-	-	25,015	25,015
Other assets	-	-	-	-	-	10,364	10,364
Total assets	6,083,689	1,598,958	2,074,960	4,328,674	11,173,556	1,710,076	26,969,913

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

Bank	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non- interest bearing	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Liabilities							
Deposits from customers	-	-	-	-	-	177,704	177,704
Borrowings	238,304	469,008	1,325,771	3,865,736	9,109,343	59,395	15,067,557
Debt securities issued	-	-	-	1,099,649	-	9,644	1,109,293
Other liabilities	-	-	-	-	-	618,751	618,751
Total liabilities	238,304	469,008	1,325,771	4,965,385	9,109,343	865,494	16,973,305
Interest rate gap	5,845,385	1,129,950	749,189	(636,711)	2,064,213	844,582	9,996,608

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

Bank	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Non-interest bearing	Total
Dec 31, 2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets							
Cash on hand and current accounts with banks	-	-	-	-	-	1,401,146	1,401,146
Deposits with other banks	29,114	-	-	-	-	24	29,138
Loans to financial institutions	474,348	733,865	1,345,038	2,759,113	5,496,436	27,341	10,836,141
Loans to other customers	2,104,487	745,415	927,758	1,848,681	6,689,547	67,735	12,383,623
Assets available for sale	2,430,262	-	-	-	-	846,932	3,277,194
Investments in subsidiaries	-	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	-	53,514	53,514
Non-current assets held for sale	-	-	-	-	-	16,697	16,697
Other assets	-	-	-	-	-	22,226	22,226
Total assets	5,038,211	1,479,280	2,272,796	4,607,794	12,185,983	2,471,739	28,055,803
Liabilities							
Deposits from customers	150,273	-	169,057	169,057	-	156,354	644,741
Borrowings	168,310	243,414	1,155,999	3,853,447	9,902,974	63,737	15,387,881
Debt securities issued	-	-	-	1,117,790	-	43,909	1,161,699
Other liabilities	-	-	-	-	-	592,651	592,651
Total liabilities	318,583	243,414	1,325,056	5,140,294	9,902,974	856,651	17,786,972
Interest rate gap	4,719,628	1,235,866	947,740	(532,500)	2,283,009	1,615,088	10,268,831

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

Total assets, total liabilities and equity on the basis of a possibility of changes in interest rates (fixed or variable):

	Group		Bank	
	Jun 30, 2018	Dec 31, 2017	Jun 30, 2018	Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Assets				
Fixed interest rate assets	24,054,930	24,358,274	24,006,768	24,311,039
Variable interest rate assets	1,253,068	1,273,025	1,253,069	1,273,025
Non-interest bearing	1,683,338	2,444,262	1,710,076	2,471,739
Total assets	26,991,336	28,075,561	26,969,913	28,055,803
Liabilities				
Fixed interest rate liabilities	15,945,278	16,440,995	15,945,278	16,440,995
Variable interest rate liabilities	162,533	489,326	162,533	489,326
Non-interest bearing	879,166	869,453	865,494	856,651
Total liabilities	16,986,977	17,799,774	16,973,305	17,786,972

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.1. Interest rate risk in the Bank's book (continued)

Sensitivity analysis

Assumptions used in preparing the interest risk sensitivity analysis relate to possible changes in reference interest rates in order to assess the hypothetical effect on HBOR's profit.

Volatility of reference interest rates in the previous 12 months has been determined using the standard deviation method on the daily changes of the reference interest rates linked to EUR and USD. On the basis of the above volatility, possible changes in reference interest rates linked to EUR and USD have been established and used in the sensitivity analysis.

The analysis presents the sensitivity of interest rates to reasonably expected changes in basis points. All other variables remain constant.

The sensitivity of profit is influenced by hypothetical changes in interest rates during a period of one year based on interest bearing assets and liabilities with a variable interest rate.

Currency	Increase in b.p. Jun 30, 2018	Effect on profit Jun 30, 2018 HRK '000	Increase in b.p. Dec 31, 2017	Effect on profit Dec 31, 2017 HRK '000
EUR	+1	87	+1	93
USD	+13	340	+10	349

Currency	Decrease in b.p. Jun 30, 2018	Effect on profit Jun 30, 2018 HRK '000	Decrease in b.p. Dec 31, 2017	Effect on profit Dec 31, 2017 HRK '000
EUR	-1	(87)	-1	(93)
USD	-13	(340)	-10	(349)

Notes to the Condensed Consolidated Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.2. Currency risk

Total assets and total liabilities and equity as of 30 June 2018 and 31 December 2017 in HRK and foreign currencies can be shown as follows:

Group	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	622	60,060	1,456	62,138	756,053	818,191
Deposits with other banks	14,569	-	-	14,569	-	14,569
Loans to financial institutions	-	5,567,907	-	5,567,907	4,465,737	10,033,644
Loans to other customers	523,183	8,247,867	-	8,771,050	3,498,831	12,269,881
Financial assets at fair value through profit or loss	-	48,836	-	48,836	613,058	661,894
Financial assets at fair value through other comprehensive income	-	674,910	-	674,910	2,427,254	3,102,164
Debt instruments at amortised cost	-	1,364	-	1,364	-	1,364
Property, plant and equipment and intangible assets	-	-	-	-	51,974	51,974
Non-current assets held for sale	-	-	-	-	25,015	25,015
Other assets	-	679	-	679	11,961	12,640
Total assets	538,374	14,601,623	1,456	15,141,453	11,849,883	26,991,336
Liabilities						
Deposits from customers	20,450	37,157	82	57,689	120,015	177,704
Borrowings	553,145	14,514,412	-	15,067,557	-	15,067,557
Debt securities issued	-	1,109,293	-	1,109,293	-	1,109,293
Other liabilities	31,395	56,396	1,160	88,951	543,472	632,423
Total liabilities	604,990	15,717,258	1,242	16,323,490	663,487	16,986,977
Currency gap	(66,616)	(1,115,635)	214	(1,182,037)	11,186,396	10,004,359

*Amounts linked to a one-way currency clause represent HRK 147,744 thousand.

Notes to the Condensed Consolidated Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.2. Currency risk (continued)

Group	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
Dec 31, 2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	239	82,947	1,424	84,610	1,319,070	1,403,680
Deposits with other banks	29,115	23	-	29,138	-	29,138
Loans to financial institutions	-	6,075,420	-	6,075,420	4,760,721	10,836,141
Loans to other customers	429,298	9,092,613	-	9,521,911	2,861,712	12,383,623
Financial assets at fair value through profit or loss	-	291	-	291	-	291
Assets available for sale	-	735,821	-	735,821	2,585,743	3,321,564
Assets held to maturity	-	1,399	-	1,399	-	1,399
Property, plant and equipment and intangible assets	-	-	-	-	53,557	53,557
Non-current assets held for sale	-	-	-	-	16,697	16,697
Other assets	-	6,308	-	6,308	23,163	29,471
Total assets	458,652	15,994,822	1,424	16,454,898	11,620,663*	28,075,561
Liabilities						
Deposits from customers	20,112	527,668	77	547,857	96,884	644,741
Borrowings	410,011	14,977,870	-	15,387,881	-	15,387,881
Debt securities issued	-	1,161,699	-	1,161,699	-	1,161,699
Other liabilities	3,291	18,222	2,665	24,178	581,275	605,453
Total liabilities	433,414	16,685,459	2,742	17,121,615	678,159	17,799,774
Currency gap	25,238	(690,637)	(1,318)**	(666,717)	10,942,504	10,275,787

*Amounts linked to a one-way currency clause represent HRK 157,325 thousand.

**Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Condensed Consolidated Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.2. Currency risk (continued)

Total assets and total liabilities and equity as of 30 June 2018 and 31 December 2017 in HRK and foreign currencies can be shown as follows:

Bank	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
Jun 30, 2018	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	622	60,060	1,456	62,138	748,171	810,309
Deposits with other banks	14,569	-	-	14,569	-	14,569
Loans to financial institutions	-	5,567,907	-	5,567,907	4,465,737	10,033,644
Loans to other customers	523,183	8,247,867	-	8,771,050	3,498,831	12,269,881
Financial assets at fair value through profit or loss	-	46,527	-	46,527	608,924	655,451
Financial assets at fair value through other comprehensive income	-	664,047	-	664,047	2,398,626	3,062,673
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	51,883	51,883
Non-current assets held for sale	-	-	-	-	25,015	25,015
Other assets	-	-	-	-	10,364	10,364
Total assets	538,374	14,586,408	1,456	15,126,238	11,843,675*	26,969,913
Liabilities						
Deposits from customers	20,450	37,157	82	57,689	120,015	177,704
Borrowings	553,145	14,514,412	-	15,067,557	-	15,067,557
Debt securities issued	-	1,109,293	-	1,109,293	-	1,109,293
Other liabilities	31,193	48,957	1,118	81,268	537,483	618,751
Total liabilities	604,788	15,709,819	1,200	16,315,807	657,498	16,973,305
Currency gap	(66,414)	(1,123,411)	256	(1,189,569)	11,186,177	9,996,608

* Amounts linked to a one-way currency clause represent HRK 147,744 thousand.

Notes to the Condensed Consolidated Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.2. Currency risk (continued)

Bank	USD	EUR	Other foreign currencies	Total foreign currencies	HRK	Total
Dec 31, 2017	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Assets						
Cash on hand and current accounts with banks	239	82,947	1,424	84,610	1,316,536	1,401,146
Deposits with other banks	29,115	23	-	29,138	-	29,138
Loans to financial institutions	-	6,075,420	-	6,075,420	4,760,721	10,836,141
Loans to other customers	429,298	9,092,613	-	9,521,911	2,861,712	12,383,623
Assets available for sale	-	724,243	-	724,243	2,552,951	3,277,194
Investments in subsidiaries	-	-	-	-	36,124	36,124
Property, plant and equipment and intangible assets	-	-	-	-	53,514	53,514
Non-current assets held for sale	-	-	-	-	16,697	16,697
Other assets	-	488	-	488	21,738	22,226
Total assets	458,652	15,975,734	1,424	16,435,810	11,619,993*	28,055,803
Liabilities						
Deposits from customers	20,112	527,668	77	547,857	96,884	644,741
Borrowings	410,011	14,977,870	-	15,387,881	-	15,387,881
Debt securities issued	-	1,161,699	-	1,161,699	-	1,161,699
Other liabilities	3,054	10,696	2,611	16,361	576,290	592,651
Total liabilities	433,177	16,677,933	2,688	17,113,798	673,174	17,786,972
Currency gap	25,475	(702,199)	(1,264)**	(677,988)	10,946,819	10,268,831

*Amounts linked to a one-way currency clause represent HRK 157,325 thousand.

**Reported gap is a result of provisions made for issued foreign currency guarantees in other foreign currencies stated under "Other liabilities".

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

26. Risk management (continued)

26.5. Market risk (continued)

26.5.2. Currency risk (continued)

Sensitivity analysis

Sensitivity analysis of the Bank's total assets and total liabilities to fluctuations in foreign exchange rates is carried out for those foreign currencies that represent Bank's significant currencies as at the reporting date.

An assumption of reasonably possible fluctuations in EUR exchange rates against HRK was used in the foreign currency risk sensitivity analysis, with the other variables remaining stable, in order to assess the hypothetical effect on HBOR's profit as of 30 June 2018.

Volatility of the exchange rate EUR/HRK, determined using the standard deviation method on the changes of the foreign exchange rate EUR/HRK, equaled 2.06% in the previous 12 months.

The effect of the assumed changes in the foreign exchange rate EUR/HRK by total asset, total liabilities and equity items denominated or indexed to EUR on HBOR's profits is stated below.

	Change in currency rate Jun 30, 2018 %	Effect on profit Jun 30, 2018 HRK' 000	Change in currency rate Dec 31, 2017 %	Effect on profit Jan 1 to Dec 31, 2017 HRK' 000
EUR	+2.06	(16,056)	+1.56	(190)
EUR	-2.06	17,226	-1.56	1,697

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities

Fair value represents the price that would be received to sell an asset or paid to transfer a liability of the Group in an orderly transaction at the measurement date in the principal or the most advantageous market under current market conditions.

Basic price is an exit price, regardless of whether that price is directly observable or estimated using another valuation technique.

At initial recognition, when an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price).

The fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price).

If another IFRS or legal provision requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the Group shall recognise the resulting gain or loss in profit or loss unless otherwise specified.

For measuring fair value, the Group is maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The Group selects inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability.

If an asset or a liability measured at fair value has a bid price and an ask price (e.g. an input from a dealer market), the Group uses the price within the bid-ask spread as the most representative of fair value.

Pursuant to aforesaid, the carrying amounts of cash and balances with the Croatian National Bank approximately present their fair values.

The estimated fair value of deposits with other banks approximates their carrying amounts since all deposits mature up to 90 days.

Loans and advances to financial institutions and other customers are presented net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. The interests subsidies that are recognised as deferred income in discounted amounts and presented within other liabilities are taken into account in estimating fair value. The fair value of HRK loans with one-way currency clause is assessed as described under the "Foreign currency transactions and foreign currency clause" paragraph.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27 Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value

The Group's long-term borrowings have no quoted market price, and their fair value is estimated as the present value of future cash flows, discounted at interest rates in effect at the Statement of Financial Position date for new borrowings of a similar nature and with a similar remaining maturity.

The fair value of bonds issued by HBOR is presented by using level 2 inputs that are observable at Bloomberg service on the basis of mid-rate of Bloomberg Generic (BGN) prices and as of June 30, 2018, is disclosed in Note 22.

BGN or Bloomberg Generic price is the simple average price that includes indicative prices and executable prices. The mid-rate is the average between the quoted "ask" price and the "bid" price.

The Group takes care of the fair value hierarchy presentation that comprises three levels of inputs to valuation techniques used to measure fair value as follows:

	Level 1	Level 2	Level 3
Inputs:	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.	Unobservable inputs for the asset or liability or adjusted market inputs.

The Group discloses transfers between levels of the fair value hierarchy at the end of the reporting period during which the transfer occurred.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)
(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value (continued)

Below is a breakdown of the financial assets at fair value based on IFRS 9 classification.

Group	Jun 30, 2018		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
Financial assets at fair value through profit or loss:			
<i>Loans at FVPL:</i>			
Mezzanine loans	-	-	4,016
<i>Investments in investment funds:</i>			
Investments in investment funds at fair value through profit or loss	644,930	-	-
Equity instruments:			
<i>Listed equity instruments:</i>			
Investments in corporate shares	12,787	-	-
<i>Unlisted equity instruments:</i>			
Investment in financial institutions shares	-	161	-
Total financial assets at fair value through profit or loss	657,717	161	4,016
Financial assets at fair value through other comprehensive income:			
Debt instruments:			
<i>Listed debt instruments:</i>			
Bonds of the Republic of Croatia	995,346	-	-
Corporate bonds	770	-	-
Treasury bills of the Ministry of Finance	2,062,575	-	-
Accrued interest	17,179	-	-
<i>Unlisted debt instruments:</i>			
Corporate bonds	-	-	523
Accrued interest	-	-	198
Total debt instruments	3,075,870	-	721
Unlisted equity instruments:			
Investment in shares of legal entities	-	34	-
Shares of foreign financial institutions – EIF	-	25,539	-
Total equity instruments	-	25,573	-
Total financial assets at fair value through other comprehensive income	3,075,870	25,573	721

Treasury Bills of the Ministry of Finance of the Republic of Croatia were classified within Level 1 of the fair value hierarchy because credit institutions in the country started to list prices at Bloomberg, and quoted market price is used as the valuation technique.

Debt Instruments: Corporate Bonds were classified within Level 3 of the fair value hierarchy. The valuation technique used was the method of the discounted cash flows based on market interest rates, spread linked to internal credit-rating and internally determined spread linked to financial instrument liquidity.

There were no transfers between the levels in the reporting period.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value (continued)

Below we give an overview of investments in financial instruments as at 31 December 2017, pursuant to IAS 39 that have been reallocated to Financial assets at fair value through other comprehensive income and Financial assets at fair value through profit and loss according to IFRS 9:

Group	Dec 31, 2017		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
Financial assets at fair value through profit or loss:			
Shares in investment funds	291	-	-
Total financial assets at fair value through profit or loss	291	-	-
Assets available for sale:			
Debt instruments:			
Listed debt instruments:			
Bonds of the Republic of Croatia	884,763	-	-
Financial institution bonds	-	-	-
Corporate bonds	770	-	-
Treasury bills of the Ministry of Finance	1,583,313	-	-
Accrued interest	13,836	-	-
Unlisted debt instruments:			
Corporate bonds	-	-	522
Accrued interest	-	-	167
Total debt instruments	2,482,682	-	689
Equity instruments:			
Listed equity instruments:			
Corporate shares	18,951	-	-
Unlisted equity instruments:			
Investment in shares of foreign companies	-	35	-
Investment in financial institutions shares	-	161	-
Shares of foreign financial institutions – EIF	-	25,427	-
Corporate shares	-	-	-
Total equity instruments	18,951	25,623	-
Investments in investment funds:			
Shares classified as assets available for sale	793,619	-	-
Total investments in investment funds	793,619	-	-
Total assets available for sale	3,295,252	25,623	689

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value (continued)

Bank	Jun 30, 2018		
	Level 1	Level 2	Level 1
	HRK '000	HRK '000	HRK '000
Financial assets at fair value through profit or loss:			
<i>Loans at FVPL:</i>			
Mezzanine loans	-	-	4,016
<i>Investments in investment funds:</i>			
Investments in investment funds at fair value through profit or loss	638,487	-	-
<i>Equity instruments:</i>			
<i>Listed equity instruments:</i>			
Investments in companies' shares	12,787	-	-
<i>Unlisted equity instruments:</i>			
Investment in financial institutions shares	-	161	-
Total financial assets at fair value through profit or loss	651,274	161	4,016
Financial assets at fair value through other comprehensive income:			
Debt instruments:			
<i>Listed debt instruments:</i>			
Bonds of the Republic of Croatia	957,188	-	-
Treasury bills of the Ministry of Finance	2,062,575	-	-
Accrued interest	16,616	-	-
<i>Unlisted debt instruments:</i>			
Corporate bonds	-	-	523
Accrued interest	-	-	198
Total debt instruments	3,036,379	-	721
Unlisted equity instruments:			
Investment in shares of legal entities	-	34	-
Shares of foreign financial institutions – EIF	-	25,539	-
Total equity instruments	-	25,573	-
Total financial assets at fair value through other comprehensive income	3,036,379	25,573	721

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations
for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value (continued)

Below we give an overview of investments in financial instruments as at 31 December 2017, pursuant to IAS 39 that have been reallocated to Financial assets at fair value through other comprehensive income and Financial assets at fair value through profit and loss according to IFRS 9:

Bank	Dec 31, 2017		
	Level 1 HRK '000	Level 2 HRK '000	Level 3 HRK '000
Assets available for sale:			
Debt instruments:			
Listed debt instruments:			
Bonds of the Republic of Croatia	846,428	-	-
Treasury bills of the Ministry of finance	1,583,313	-	-
Accrued interest	13,269	-	-
Unlisted debt instruments:			
Corporate bonds	-	-	522
Accrued interest	-	-	167
Total debt instruments	2,443,010	-	689
Equity instruments:			
Listed equity instruments:			
Corporate shares	18,951	-	-
Unlisted equity instruments:			
Investment in shares of foreign companies	-	35	-
Investment in financial institutions shares	-	161	-
Shares of foreign financial institutions – EIF	-	25,427	-
Corporate shares	-	-	-
Total equity instruments	18,951	25,623	-
Investments in investment funds:			
Shares classified as assets available for sale	788,921	-	-
Total investments in investment funds	788,921	-	-
Total assets available for sale	3,250,882	25,623	689

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value (continued)

27.1.1. Stage 3 - fair value

a) Technique of valuation of corporate bonds that are allocated to stage 3

For the assessment of fair value of illiquid corporate bonds in the HBOR portfolio, the method of discounted cash flow of bonds is used. The fair value of bonds is the current value of all future cash flows of bond by calculated by applying the discount rate defined as yield on risk-free investments increased by the premium of specific credit risk for the respective bond and the premium for bond liquidity risk.

The amount of discount rate on risk-free investments is calculated as linearly interpolated/extrapolated yield of Croatian bonds of the same duration and of the same foreign currency as the bonds valued. The source of information on the yields on bonds of the Republic of Croatia is the Bloomberg information system, and the information published on the day of valuation is used in the period from 14:00 to 16:00 if the valuation is made on a working day, and if the valuation is performed on a non-working day, the used information are information published on the last working day before the valuation date.

The specific risk premium amount for the respective bond depends on HBOR's internal credit rating of the bond issuer, i.e. if the issuer is a member of business group, the risk premium depends on internal rating of the parent company.

b) Sensitivity analysis of corporate bond with the stated potential effect on profit/loss as at 29 June 2018, under the assumption of a change in discount rate of 2% and 10%

Under the assumption that the market interest rates changes by 2% compared with those in effect as at 29 June 2018, the impacts would be as follows:

- a) In the case of a decrease in market yield on no-risk investment (linearly interpolated/extrapolated yield on bonds of the Republic of Croatia of the same duration and the same currency as the respective bond) by 2%, the discount rate would equal 12.54%, the bond price would be 36.06%, which would result in an increase in HBOR's generated profits of HRK 18 thousand.
- b) In the case of an increase in market yield on no-risk investment (linearly interpolated/extrapolated yield on bonds of the Republic of Croatia of the same duration and the same currency as the corporate bond) by 2%, the discount rate would equal 16.54%, the bond price would be 33.78%, which would result in a decrease in HBOR's generated profits of HRK 17 thousand.

The change in interest rates defined in the "Decision on the Management of Interest Rate Risk in the Bank Book", which is applied when calculating standard interest rate shock, is used as the basis for the change in the market interest rate of 2% compared with the market terms and conditions in effect as at 29 June 2018. (Standard interest rate shock is a parallel positive or negative change in interest rates on a reference yield curve of 200 basis points by applying the lower limit rate of 0%, except for the cases in which negative interest rate can be achieved.)

In the case of a decrease in expected cash flows on corporate bonds of 10%, the generated profit of HBOR would decrease by HRK 52 thousand.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

27. Fair value of financial assets and financial liabilities (continued)

27.1. Fair value of financial assets and financial liabilities initially recognised and measured at fair value (continued)

27.1.1. Stage 3 - fair value (continued)

c) Adjustment of fair value of Stage 3:

The fair value of Stage 3 financial assets measured at fair value upon initial recognition – unlisted debt securities*:

	Jun 30, 2018	Group Jun 30, 2017	Jun 30, 2018	Bank Jun 30, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Balance as at 1 January	689	601	689	601
Increase in fair value through other comprehensive income	28	25	28	25
Net foreign exchange	(27)	(31)	(27)	(31)
Accrued interest	31	32	31	32
Balance as of 30 June	721	627	721	627

* Debt securities – bonds of companies, until 1 January 2018, classified as Assets available for sale in accordance with IAS 39; and since 1 January 2018, classified as Financial assets at fair value through other comprehensive income in accordance with IFRS 9.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

28. Reporting by segments

General information on segments is given in relation to business segments of the Group.

Since the Group does not allocate administrative costs and equity by segments, the profitability of segments is not presented.

Assets and liabilities by segments are presented in net terms, i.e. gross after impairment and provisioning, and before the effect of mitigation through collateral received.

Business operations of segments are divided in terms of organisation and management. Each segment as a whole provides various products and services and operates in various markets.

Business segments:

The Group has following business segments:

Segment:	Business activities of the segment include:
Banking activities	Financing reconstruction and development of the Croatian economy, financing of infrastructure, export promotion, support for the development of small and medium-sized companies, environmental protection, and export credit insurance of Croatian goods and services against non-market risks for and on behalf of the Republic of Croatia.
Insurance activities	Insurance of foreign and domestic short-term receivables of business entities relating to deliveries of goods and services
Other	Preparation of analyses, credit risk assessment and providing information on creditworthiness

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

28. Reporting by segments (continued)

Jun 30, 2018	Banking activities	Insurance activities	Other activities	Unallocated	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Net interest income	211,009	732	-	-	211,741
Net fee income	21,720	459	662	-	22,841
Net income/(expenses) from financial operations	18,692	(301)	(2)	-	18,389
Net premiums earned	-	3,222	-	-	3,222
Other income	4,574	42	147	(144)	4,619
Income from operating activities	255,995	4,154	807	(144)	260,812
Operating costs	(71,786)	(2,533)	(605)	144	(74,780)
Impairment loss and provisions	10,724	(9)	6	-	10,721
Expenses for insured cases	-	(159)	-	-	(159)
Net change in provisions	-	(341)	-	-	(341)
Other expenses	-	(210)	-	-	(210)
Operating expenses	(61,062)	(3,252)	(599)	144	(64,769)
Profit/(loss) before income tax	194,933	902	208	-	196,043
Income tax	-	-	-	-	-
Profit/(loss) for the year	194,933	902	208	-	196,043
Assets of segment	26,969,913	56,714	1,358	(36,649)	26,991,336
Total assets	26,969,913	56,714	1,358	(36,649)	26,991,336
Liabilities of segment	16,973,305	13,585	110	(23)	16,986,977
Total equity	9,996,608	5,629	948	1,174	10,004,359
Total liabilities and total equity	26,969,913	19,214	1,058	1,151	26,991,336

Intra-group transactions are presented under "Unallocated".

For the purposes of this Note, Net income/(expense) from financial activities is reported as an income item, regardless the actual realisation, to enable comparison of the amounts stated in the Statement of profit or loss and other comprehensive income.

The Group decided to apply a simple approach of stating operating segments by taking into consideration the main business model of each member of the Group as previously described in this Note.

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

28. Reporting by segments (continued)

Jun 30, 2017	Banking activities	Insurance activities	Other activities	Unallocated	Total
	HRK '000	HRK '000	HRK '000	HRK '000	HRK '000
Net interest income	235,859	829	-	-	236,688
Net fee income	13,383	661	623	-	14,667
Net income/(expenses) from financial operations	(7,574)	(237)	(2)	-	(7,813)
Net premiums earned	-	3,356	-	-	3,356
Other income	4,970	42	140	(146)	5,006
Income from operating activities	246,638	4,651	761	(146)	251,904
Operating costs	(74,132)	(2,752)	(553)	146	(77,291)
Impairment loss and provisions	(43,150)	41	(16)	-	(43,125)
Expenses for insured cases	-	(69)	-	-	(69)
Net change in provisions	-	(534)	-	-	(534)
Other expenses	-	(135)	-	-	(135)
Operating expenses	(117,282)	(3,449)	(569)	146	(121,154)
Profit/(loss) before income tax	129,356	1,202	192	-	130,750
Income tax	-	-	-	-	-
Profit/(loss) for the year	129,356	1,202	192	-	130,750
Dec 31, 2017					
Assets of segment	28,055,803	55,213	1,201	(36,656)	28,075,561
Total assets	28,055,803	55,213	1,201	(36,656)	28,075,561
Liabilities of segment	17,786,972	12,680	152	(30)	17,799,774
Total equity	10,268,831	5,033	749	1,174	10,275,787
Total liabilities and total equity	28,055,803	17,713	901	1,144	28,075,561

Intra-group transactions are presented under "Unallocated".

Notes to the Condensed Interim Financial Statements which include significant accounting policies and other explanations for the period 1 January – 30 June 2018 (continued)

(All amounts are expressed in HRK thousand)

29. Capital management

The primary objectives of the Group's capital management are to ensure the presumptions of going concern and to respect regulatory and contracted demands imposed by creditors regarding a certain capital adequacy level.

The Group has identified own funds as a manageable capital category.

Regulatory capital has to be, at every moment, at least at the level of share capital or at the level that ensures that the capital adequacy ratio is at least 8% and that it is sufficient for covering capital requirements regarding business risks.

Regulatory capital is comprised of core capital minus debit items.

The Group has determined measures for the implementation and monitoring of the capital management policy as follows:

- At every reporting date, own funds have to be at least at the level of founder's capital for the reporting period.
- The capital adequacy ratio at the reporting date has to be at the level prescribed for the banks in the Republic of Croatia as well as at the level stated within regular financial covenants determined in loan contracts and contracts with special financial institutions that HBOR has concluded as a borrower.

Since 1 January 2018, the Group has calculated regulatory capital and capital requirements in accordance with Basel II requirements, whereas, until 31 December 2017, this was calculated in accordance with Basel I requirements. By the calculation in accordance with Basel II regulations, the capital adequacy ratio has been reduced, and below is a breakdown of capital adequacy ratio as at 30 June 2018 and 31 December 2017.

	Unaudited	Unaudited	Unaudited	Unaudited
	Jun 30, 2018	Group Dec 31, 2017	Jun 30, 2018	Bank Dec 31, 2017
	HRK '000	HRK '000	HRK '000	HRK '000
Total regulatory capital	9,739,638	10,487,346	9,738,551	10,485,928
Credit risk weighted exposure amount	18,266,241	n/a	18,256,729	n/a
Initial credit requirements for operating risk	903,952	n/a	884,450	n/a
Initial capital requirements for currency risk	703,824	n/a	692,250	n/a
Risk weighted assets	n/a	16,159,625	n/a	16,183,382
Capital requirements for currency risk	n/a	129,933	n/a	113,018
Total capital requirements	19,874,017	16,289,558	19,833,429	16,296,400
Capital adequacy ratio	49.01	64.38	49.10	64.35
	HRK '000	HRK '000	HRK '000	HRK '000
Own funds needed for ensuring capital adequacy according to regulatory requirements	1,589,921	1,303,165	1,586,674	1,303,712

Minimum capital adequacy ratio as of the reporting date, i.e. 30 June 2018 was 8% (31 December 2017.: 8%).

Appendix - financial performance of the HKO Group
Statement of Profit or Loss and Other Comprehensive Income
for the period 1 January – 30 June (unaudited)

(All amounts are expressed in HRK thousand)

	Jun 30, 2018 HRK '000	Jun 30, 2017 HRK '000
Premium earned		
Gross premium written	4,962	5,153
Premium impairment allowance originated and reserved on collection	(14)	(42)
Gross outward reinsurance premium	(1,891)	(2,080)
Net premium written	3,057	3,031
Changes in the gross unearned premium reserve	59	669
Changes in the gross unearned premium reserve, reinsurer's share	92	(386)
Net premium earned	3,208	3,314
Fee and commission income	1,121	1,284
Net investment income	539	577
Other operating income	45	36
Net income	4,913	5,211
Gross expense for returned premiums	(400)	(215)
Reinsurer's share in premium return	190	80
Gross reserve for returned premiums	33	(204)
Reinsurer's share in reserves	(22)	81
Net expense and reserve for returned premiums	(199)	(258)
Claims incurred	(130)	(111)
Claims incurred, reinsurer's share	(29)	42
Change in the claims provision	(628)	(595)
Change in the claims provision, share of reinsurance	276	184
Net claims incurred	(511)	(480)
Marketing and provision expenses	(464)	(225)
Administrative expenses	(2,502)	(2,862)
Other operating expenses	(34)	(5)
Net exchange differences other than those on financial instruments	(105)	13
Profit before income tax	1,098	1,394
Income tax	-	-
Profit/(loss) for the period	1,098	1,394
Other comprehensive income		
Items that are not transferred subsequently to profit or loss:		
Deferred tax – adjustment for previous period	(17)	-
Total items that are not transferred subsequently to profit or loss	(17)	-
Items that may be reclassified subsequently to profit or loss:		
Gains on revaluation of financial assets available for sale	587	1,236
Decrease in the fair value of financial assets available for sale	(525)	(1,100)
Transfer of realised gains on asset available for sale to statement of profit or loss	-	(1)
Transfer of realised losses on asset available for sale to statement of profit or loss	-	6
Deferred tax	(11)	(25)
Total items that may be reclassified subsequently to profit or loss	51	116
Other comprehensive income after income tax	34	116
Total comprehensive income after income tax	1,132	1,510
Attributable to:		
Equity holders of the parent	1,132	1,510

Appendix - financial performance of the HKO Group (continued)
Statement of Financial Position as of (unaudited)

(All amounts are expressed in HRK thousand)

	Jun 30, 2018 HRK '000	Dec 31, 2017 HRK '000
Assets		
Non-current assets		
Property and equipment	69	41
Intangible assets	23	2
Held to maturity investments	1,366	1,399
Deferred tax	325	231
Total non-current assets	1,783	1,673
Current assets		
Investments available for sale	45,645	44,370
Investments at fair value through profit or loss	289	291
Receivables from insurance operations	1,619	6,631
Other receivables	341	385
Cash and cash equivalents	7,881	2,534
Total current assets	55,775	54,211
Total assets	57,558	55,884
Equity and liabilities		
Equity		
Share capital	37,500	37,500
Accumulated losses	2,237	1,167
Other reserves	3,050	2,999
Profit for the year	1,098	1,417
Total equity	43,885	43,083
Technical provisions		
Gross technical provisions	22,518	16,726
Technical provisions, reinsurer's share	(13,035)	(7,873)
	9,483	8,853
Current liabilities		
Liabilities from insurance operations	1,866	1,183
Other liabilities	2,324	2,765
Total liabilities	4,190	3,948
Total equity and liabilities	57,558	55,884

Appendix - financial performance of the HKO Group (continued)
Statement of Cash Flows
for the period 1 January – 30 June (unaudited)
(All amounts are expressed in HRK thousand)

	Jun 30, 2018 HRK '000	Jun 30, 2017 HRK '000
Operating activities		
Profit before income tax	1,098	1,394
<i>Adjustments to reconcile to net cash from and used in operating activities:</i>		
Depreciation	22	31
Impairment gain/(loss) and provisions	20	(26)
Income tax	-	-
Accrued interest	5	(22)
<i>Operating profit before working capital changes</i>	<i>1,145</i>	<i>1,377</i>
Changes in operating assets and liabilities:		
Net realised (gain) on assets available for sale	-	(1)
Decrease of discount in assets available for sale and assets held to maturity	125	220
Net (losses) on financial assets at fair value through profit or loss	(3)	(3)
Premium receivables	5,145	(242)
Net (increase)/decrease in other assets	(78)	1,624
Net decrease/(increase) of assets and liabilities from insurance operations	683	294
Net increase in technical provisions	189	251
Net (decrease) in other liabilities	(484)	(19)
Net cash provided/(used in) by operating activities	6,722	3,501
Investment activities		
Net (purchase) of assets available for sale	(1,500)	(6,417)
Net sale of assets available for sale	-	3,372
Net (purchase) of property, plant and equipment and intangible assets	(70)	(10)
Net cash (used in) investment activities	(1,570)	(3,055)
Effect of foreign currency to cash and cash equivalents		
Net foreign exchange	195	261
Net effect	195	261
Net increase in cash and cash equivalents	5,347	707
Balance as of 1 January	2,534	551
Net increase in cash and cash equivalents	5,347	707
Balance as of 30 June	7,881	1,258

Appendix - financial performance of the HKO Group (continued)
Statement of Changes in Equity
for the period 1 January – 30 June (unaudited)
(All amounts are expressed in HRK thousand)

	Share capital HRK '000	Accumulated losses HRK '000	Other reserves HRK '000	Profit/(loss) for the year HRK '000	Total equity attributable to the equity holders of the Company HRK '000	Total equity HRK '000
Balance as of 1 January 2017	37,500	(148)	2,188	1,315	40,855	40,855
Profit for the period	-	-	-	1,394	1,394	1,394
Other comprehensive income	-	-	116	-	116	116
Total comprehensive income	-	-	116	1,394	1,150	1,150
Transfer of profit 2016 to retained earnings	-	1,315	-	(1,315)	-	-
Balance as of 30 June 2017	37,500	1,167	2,304	1,394	42,365	42,365
Balance as of 1 January 2018	37,500	1,167	2,999	1,417	43,083	43,083
Profit for the period	-	-	-	1,098	1,098	1,098
Other comprehensive income	-	-	51	-	51	51
Total comprehensive income	-	-	51	1,098	1,149	1,149
Balance adjustment of 1 January 2018	-	-	-	(347)	(347)	(347)
Transfer of profit 2017 to retained earnings	-	1,070	-	(1,070)	-	-
Balance as of 30 June 2018	37,500	2,237	3,050	1,098	43,885	43,885