Hrvatska banka za
obnovu i razvitak

2012 SEMI-ANNUAL REPORT

August 2012

HBOR

Hrvatska banka za obnovu i razvitak

STATEMENT OF PERSONS RESPONSIBLE FOR THE PREPARATION OF SEMI-ANNUAL REPORTS

To the best of our knowledge the 2012 semi-annual management report contains a truthful development of events and business results as well as the position of the Croatian Bank for Reconstruction and Development and the Group and the description of the most significant risks and contingencies the Croatian Bank for Reconstruction and Development and the Group are exposed to.

President of the Managing Board

Anton Kovačev

Member of the Managing Board

Emilija Nagj

Zagreb, 23rd August 2012

2012 SEMI-ANNUAL MANAGEMENT REPORT

The 2012 semi-annual management report comprises the concise description of business activities, description of risks and contingencies, a summary of financial information and unaudited financial reports for the period from 1st January to 30th June 2012.

Description of business activities during the first half of 2012

During the first half of 2012, HBOR has approved 675 loans in the total amount of HRK 3.5 billion.

The most of the funds were approved for export finance (HRK 1.5 billion) out of which over HRK 1 billion for pre- and post-shipment export finance. During the reporting period a significant increase is recorded in the approvals within the framework of loan programmes for small and medium-sized enterprises. For such companies, 395 loans were approved amounting to HRK 950 million which is more than double in comparison to the same period of the previous year (in the first half of 2011, 291 loans were approved in the total amount of HRK 454 million). Within the framework of all HBOR loan programmes, in the first half of the year, 567 loans were approved for small and medium-sized enterprises in the total amount of HRK 1.6 billion.

In the reporting period, 11% investment loans more than in the same period of the previous year were approved.

The trend of increased interest in HBOR's programme for issuing bank guarantees on exporters' orders has been visible, during the first half of 2012. Consequently, 20 guarantees amounting to HRK 122 million were issued during the first half of 2012, while 3 guarantees amounting to HRK 500 thousand were issued in the same period of the last year. The increase is the result of HBOR's efforts to meet the needs of exporters that have used up their limits with commercial banks, due to increased needs for financing of their activities, maintenance of liquidity and operations, by means of issuing bank guarantees for the purpose of participating in international bidding procedures.

From the beginning of 2012, HBOR has taken a series of measures (lowering interest rates, loans without a currency clause, risk sharing) with the aim of encouraging new investment and economic recovery and development of the Croatian economy. Measures taken during the first half of 2012 have resulted in increased interest from Croatian entrepreneurs for HBOR loans, which was particularly prominent in July when HRK 1.44 billion of loan funds were approved, which represents more than 40% of the total funds approved in the first half of 2012. Most of the loans approved in July are related to investments so that, if comparing the approvals during the first seven months of the previous year with approvals during the first seven months of this year, the amount of investment loans increased by 45%.

MEASURES TAKEN TO ENCOURAGE NEW INVESTMENT

Lowering interest rates

In November 2011, repayment periods were extended and interest rates were lowered within loan programmes for environmental protection, infrastructure and innovations. After that, in February 2012, interest rates were reduced again by one percentage point within the framework of 11 loan programmes. Lower interest rates are approved for new investments in agriculture and fishery, tourism, industry and energy efficiency projects, environmental protection and renewable energy resources. The interim measure referring to loans approved in 2012 was introduced in order to encourage a new investment cycle which would induce economic growth and achieve positive trends in strategically important sectors of the Croatian economy.

Lending without a foreign currency index

In April 2012, a possibility for lending in HRK without a currency clause was introduced for all loans approved until the year-end, with the exception of loans granted at an interest rate linked to EURIBOR.

Risk sharing

In May, HBOR introduced in co-operation with commercial banks a new form of lending involving risk sharing within the framework of its existing loan programmes. The aim of HBOR is to encourage commercial banks to increase lending to the real economy. Funding is intended for entrepreneurs utilising new investments to contribute to employment increase, growth of exports and added value and strengthening competitiveness in domestic and international markets, in the following industries - agriculture, manufacturing industry, tourism and industries related to projects for renewable energy resources and energy efficiency. In case of large investment projects (over HRK 9 million), HBOR assumes 50 percent of the risk, and the bank the other 50 percent of the total loan amount and ensures it by means of common banking security instruments. For small and medium-sized enterprises, HBOR assumes up to 40 percent of risk for the total loan amount against a guarantee of HAMAG Invest, and a commercial bank assumes up to 60 percent of risk for the total loan amount, which it secures in accordance with its internal regulations.

New Loan Programmes

During the first half of 2012, HBOR introduced four new loan programmes:

- Loan Programme for IPA SME Grant Candidate Projects,
- Financing of Manufacturing,
- Loan Program for the Development of the Economy,
- Loan Programme for IPA Candidate Projects.

In early 2012, HBOR has introduced a new loan programme (<u>Loan Programme for IPA SME Grant Candidate Projects</u>) for small and medium-sized enterprises with candidate projects for IPA pre-accession grant fund, component III C "Support for Increase of SME

Competitiveness in the Republic of Croatia". Loans are granted for a 5-year period at an interest rate of 2% per annum.

In February, a new loan programme for Financing of Manufacturing was introduced for domestic exporters and manufacturers, intended for financing of working capital in manufacturing. Loan funds can be used for settlement of obligations to suppliers, staff costs, overheads and other expenses. Loans under this programme are granted in HRK not indexed to a foreign currency at an interest rate of 4% per annum for a period of up to one year with a possible renewal. The programme is implemented via commercial banks. During the first half of 2012, under the programme, 23 loans were approved in the total amount of HRK 202.4 million.

In May, HBOR introduced in co-operation with the Government of the Republic of Croatia, the Croatian National Bank and commercial banks a new Loan Programme for the Financing of the Development of the Economy for the purpose of strengthening entrepreneurial capacity, maintaining and improving liquidity. The programme is primarily intended to fund working capital for commercial companies with growth potential. Funds can be used for strengthening the company's competitiveness, achieving, maintaining and enhancing the liquidity as well as maintenance and expansion of existing operations. The loans are intended for servicing company's obligations to creditors. Loans are granted in co-operation with commercial banks according to the principle that 50% of the loan amount is approved out of HBOR's funds (the quota) and the rest is approved out of commercial bank's funds. For the award of HBOR credit quota, commercial banks participate in auctions and their bids are ranked according to the offered interest margin. HBOR's loan funds are granted in Croatian kuna at an interest of 1.8 % p.a. and commercial banks grant their loans in Croatian kuna or indexed to a foreign currency. The commercial banks' interest rate is equal to the sum of the fixed margin offered at auction increased by a benchmark interest rate (yield on treasury notes with a 364-day maturity on HRK loans or a 12-month EURIBOR on foreign currency indexed loans). Loans will be granted with a three-year repayment term including up to one-year grace period. The disbursement will be possible up to six months after signing of the loan agreement with the possibility of bridge loans. Until 30th June 2012, one auction was held. Commercial banks were offered a quota in the amount of HRK 500 million, which was fully allocated. Until 1st August 2012, three auctions were held and the allocated quota totalled HRK 1.9 billion.

Beside the programmes for the financing of candidate projects for IPARD Measures 101, 103, 301 and 302 and IPA MSP grant, in May 2012, HBOR introduced a new Loan Programme for IPA Candidate Projects which includes all projects that were not covered by existing HBOR's loan programmes. Loans will be approved in HRK with an up to 3 year grace period and an up to 15 year repayment period, with interest rate that stands at 4 percent p.a. (or 3 percent in accordance with the temporary reduction measure). The Programme is intended for the financing of eligible expenditures pursuant to the requirements contained in the Invitation to Submit Project Proposals and for the financing of those expenditures that are part of a certain project but cannot be nominated for the financing under the IPA programme pursuant to the conditions of the Invitation. The borrowers under this programme can be units of local and regional government, companies majority-owned by units of local and regional government or the state, and other borrowers that meet the requirements of the IPA programme.

Beside the new programmes, in the first half of 2012, entrepreneurs that invest in the improvement of energy efficiency were enabled to use the Grant funds under the European Commission Programme developed and implemented in co-operation with the European Investment Bank (EIB). The Grant funds may be used together with the loan funds provided by the EIB directly through HBOR or through commercial banks that have entered into co-operation agreements with HBOR. The loans are intended for the financing of fixed assets within the framework of investments which contribute to the saving of energy and/or the reduction of CO_2 emissions, i.e. investments which increase energy efficiency of facilities in the building and the industry sector. The Grant intended for final borrowers equals 15 percent of the amount of the loan invested in the raising of energy efficiency (depending on the type of project the maximum amounts of principal reduction are determined). The approved Grant funds will be used solely for the reduction of the committed loan principal. Eligible to be nominated for the Grant are those investments that will, after their completion, contribute to the improvement of energy efficiency of existing facilities in the building sector – projects that generate energy savings of at least 30 percent, and in the industry sector – projects that generate energy savings of at least 20 percent and/or reduce CO_2 emissions. Within the framework of the Grant, borrowers are offered free consultancy services for the assessment and verification of the achieved level of energy savings and/or reduction of CO_2 emissions, i.e. for the confirmation of success in investing in renewable energy resources.

Taking into account the undertaken activities and the expressed interest in the beginning of the second half of 2012, we expect further interest of business entities for HBOR's loan programmes.

Export credit insurance

Through export credit insurance transactions implemented by HBOR for and on behalf of the Republic of Croatia in the first half of the year, new export transactions were insured in the total amount of HRK 1.49 billion. As at 30th June 2012, HBOR's total exposure towards debtors amounted to HRK 1.93 billion. The most represented markets were the Russian Federation (30%), Bosnia and Herzegovina (15%), Albania (14%), Norway (5%) and Italy (4%). In the same period, 3 indemnities were paid in the amount of HRK 764,000 and recoveries realised in the amount of HRK 1.17 million for the indemnity paid by HBOR in 2011 due to the occurrence of political risk in Libya.

Within the framework of export credit insurance business, exposure under the medium-term/long-term insurance transactions was increased significantly, from HRK 688 million to

HRK 1.2 billion, primarily due to the commitment of receivables insurance arisen on the basis of export of telecommunication equipment to the Russian Federation.

In the period under review, three insurance policies were concluded under the newly introduced Programme for the Insurance of Bank Guarantees issued for the purpose of conclusion or execution of an export contract with the total insured sum of HRK 116.5 million, thus enabling the exporters to obtain bank guarantees and conclude export contracts in the total amount exceeding HRK 654 million.

Other activities

In February 2012, HBOR signed a Finance Contract in the amount of EUR 150 million for the financing of small and medium-sized enterprises and mid-cap companies in the Republic of Croatia, which represents the first tranche of the Contract in the total amount of EUR 250 million. The conclusion of the second tranche of the Loan is expected in the second half of the year. The co-operation between EIB and HBOR has been existing since 2001 and since then, loans in the total amount of EUR 644 million have been realised.

At the end of July, a EUR 50 million Loan Agreement has been signed with the Council of Europe Development Bank intended for the financing of projects implemented by SMEs, units of local and regional government and other public sector entities in the Republic of Croatia. The co-operation between CEB and HBOR started in 2001 and since then, three contracts have been signed in the total amount of EUR 108 million.

In March 2012, HBOR signed the Co-operation Agreement with Investiciono-razvojni fond of Montenegro. This Agreement was signed for the purpose of establishing a framework for future co-operation between HBOR and IRF of Montenegro in terms of participation and provision of services in common projects in the third countries' markets.

In May, the General Assembly of the European Association of Public Banks took place in Dubrovnik and was chaired by Mr Anton Kovačev, President of the Managing Board of HBOR. Topics at the general Assembly covered the operations in the past year, the business plans and activities of EAPB members for the coming period, particularly those relating to the adoption of a new financial perspective that includes the representation of certain standpoints of EAPB towards the bodies of the European Commission with a special emphasis on regulations pertaining to public procurement, supervision of banks, capital market, small and medium-sized companies and programmes targeting SMEs. It was also emphasised that in order to sustain a faster economic recovery, it is important to allow the implementation of long-term investments through specific models of public banks with a possibility of using the benefits of various funds for the same projects.

B.

In February, HBOR published its third social responsibility report, i.e. the report on the manner and progress of application of the UN Global Compact principles in the field of human rights, labour rights, environment and corruption combat.

The Hrvatsko kreditno osiguranje Group

In the first six months of 2012, the Hrvatsko kreditno osiguranje Group insured transactions in the total amount of HRK 1.12 billion, of which 77.7 percent related to insured export receivables, and 22.3 percent to insured domestic receivables. As at 30th June 2012, Hrvatsko kreditno osiguranje had 34 concluded insurance contracts in its portfolio, within the framework of which 955 limits towards buyers in 49 countries. The largest portion in the number of approved limits related to the following countries: Italy 14.2%, Germany 11.9%, Bosnia and Herzegovina 11.1%, Slovenia 10.7% and Serbia 9.0%. The total exposure per approved limits as at 30th June 2012 amounted to HRK 765.6 million, whereas the largest portion in the total exposure related to the following markets: Italy 22.3%, Germany 13.4%, Bosnia and Herzegovina 8.7%, Serbia 8.5% and Slovenia 7.8.

The total charged premium in the first six months of 2012 amounted to HRK 3.5 million, i.e. it was by 8% higher compared to the same period previous year. In the first half of 2012, two indemnities were paid in the total amount of HRK 117.6 thousand.

As at 30th June 2012 there were 275 employees in HBOR.

As at 30th June 2012 there were 289 employees in the HBOR Group.

Description of risks and contingencies

The most significant financial risks to which HBOR is exposed in its operations are credit risk, liquidity risk, interest rate and currency risk, operational risk and externalisation risk. HBOR continuously monitors the mentioned risks by applying appropriate measurement and assessment methods and systems of limits and early warning signals, which are also the precondition for adequate monitoring and timely and efficient management of the mentioned risks.

Scenario and sensitivity analyses are regularly prepared and stress tests implemented, and in accordance with their results, guidelines for a proactive management of risks to which HBOR may be exposed in its operations, are determined.

The risk management system is continuously revised and enhanced. Legislation and secondary legislation of the Croatian National Bank, the principles of the Basle Committee applicable to HBOR as a special financial institution as well as good banking practices are observed.