

Českomoravská záruční a rozvojová banka, a.s., Jeruzalémská 964/4, Praha 1

ANNUAL REPORT

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In the Czech Republic, we represent a promotional bank aimed at contributing to the efficient development of national infrastructure and economic sectors that have been approved for public support according to the economic policy of the Czech Republic government and its regions.

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## INTRODUCTION BY THE CHAIRMAN



Dear customers, business partners and shareholders,

very good results achieved in business activities as well as an overall prosperous economic performance have been a regular phenomenon of the Bank's performance during past years. From this point of view, 2004 was another successful year; nevertheless, we can't say it was a restful period running routinely within the previous years grooves only. Several moments of the last year may be even regarded as breaking points being the accession of the Czech Republic to the European Union the most significant of them. This event had an important impact on the Bank's activities, which, besides current functions, had to include also accelerating the final phase of the adjustment process for smooth continuation of the operation within the new conditions of the single market.

In 2004, CMZR Bank started providing preferential loans under three programmes scheduled within the Operational Programme Industry and Enterprise integrated in the framework of the EU structural funds. The Bank also introduced providing subordinated loans, which was quite an innovation within the range of loan products offered till that time. At the same time, bank guarantees traditionally remained one of the most required products. This way, the Bank put in practice its long-term strategy oriented on using the most efficient tools of public support developed to help extending the room for larger utilization of bank loans in financing development projects. Bank guarantees and subordinated loans proved to be the most supportive instruments.

Despite the fact that in 2004 the volume of funds allocated from the state budget for the SME support was lower than in 2003, CMZR Bank managed to achieve best results ever in providing preferential loans and bank guarantees scheduled under the programmes administered through the Bank. Such accomplishment was enabled thanks to the increase of resources reached by an effective combination of funds gained from financial markets with the means repaid from loans issued in past years; the well-considered management of funds thus helped to actively answer the increasing needs of small and medium-sized entrepreneurs.

Successful performance was registered also in the implementation of the programme for financing water sector projects development realized in close co-operation with the Ministry of Agriculture of the Czech Republic; long-term loans were provided with the support of means from the European Investment Bank. Fruitful cooperation went on also with the State Fund for Transport Infrastructure with the aim to support motorways and main roads development. Another dynamic increase was registered in the realization of the programme earmarked on financing repairs of panel-block houses launched by the State Fund for Housing Development. Furthermore, the Bank fostered its relations with regional authorities in order to better understand their needs and prospective; the effort was completed by developing a specific type of guarantees which the CMZR Bank could then provide to small and medium-sized entrepreneurs in one of the regions.

I believe that the last year's experience has contributed to further fostering the Bank's capability to act as a specialized development institution, which is able and willing to efficiently meet the needs of its clients. The Bank is ready to respond any new challenge with an active and highly professional approach.

A handwritten signature in black ink, appearing to read 'Ladislav Macka'. The signature is fluid and cursive, written over a light grey background.

Ladislav Macka  
Chairman of the Board of Directors and Chief Executive Officer

## GENERAL INFORMATION ON THE BANK

- Established:** January 28, 1992
- Bank licence:** Full banking licence, foreign exchange licence (keeping FX accounts for individuals and legal entities, FX deposits with banks licensed to operate in the Czech Republic, FX trading on the Bank's account or client's account, with the exception of trading in derivatives under the § 8a of the Act No. 591/1992 Coll., on Securities). Security Trader licence under the § 45, section 1 of the Act No. 591/1992 Coll., on Securities.
- Shareholders:** Czech Republic represented by:  
 Ministry of Industry and Trade (24.25 %)  
 Ministry for Regional Development (24.25 %)  
 Ministry of Finance (23.83 %)  
 Česká spořitelna, a. s. (13.0 %)  
 Komerční banka, a. s. (13.0 %)  
 Československá obchodní banka, a. s. (1.67 %)

## Key indicators:

TABLE No. 1

	Unit	2000	2001	2002	2003	2004
Total assets	CZK mil.	42 593.5	56 682.4	86 604.5	47 618.7	48 512.8
Liabilities	CZK mil.	39 094.4	52 663.6	83 736.5	43 578.1	44 155.8
Equity	CZK mil.	3 499.1	4 018.8	2 868.0	4 040.6	4 357.0
Share capital	CZK mil.	1 400.0	1 780.0	1 975.8	2 131.5	2 131.5
Profit after tax	CZK mil.	556.0	772.3	473.3	679.7	938.5
Guarantee portfolio	CZK mil.	5 573.6	6 381.3	7 372.0	8 201.0	9 326.0
Capital adequacy	%	13.1	17.2	21.7	22.2	23.8
Employees	average number	235	246	252	258	260
Branches	number	5	5	5	5	5



## GOVERNING BODIES

## Board of Directors

Ladislav Macka, Chairman

Pavel Weiss, Vice-Chairman

Jiří Jirásek, member

Lubomír Rajdl, member

Jan Ulip, member

## Supervisory Board

Václav Polák, Chairman

Pavel Jiráček, Vice-Chairman

Ladislav Dvořák, member

Jaroslav Gacka, member

Eduard Janota, member

Václav Kupka, member

Jana Šindelářová, member

Josef Vaník, member

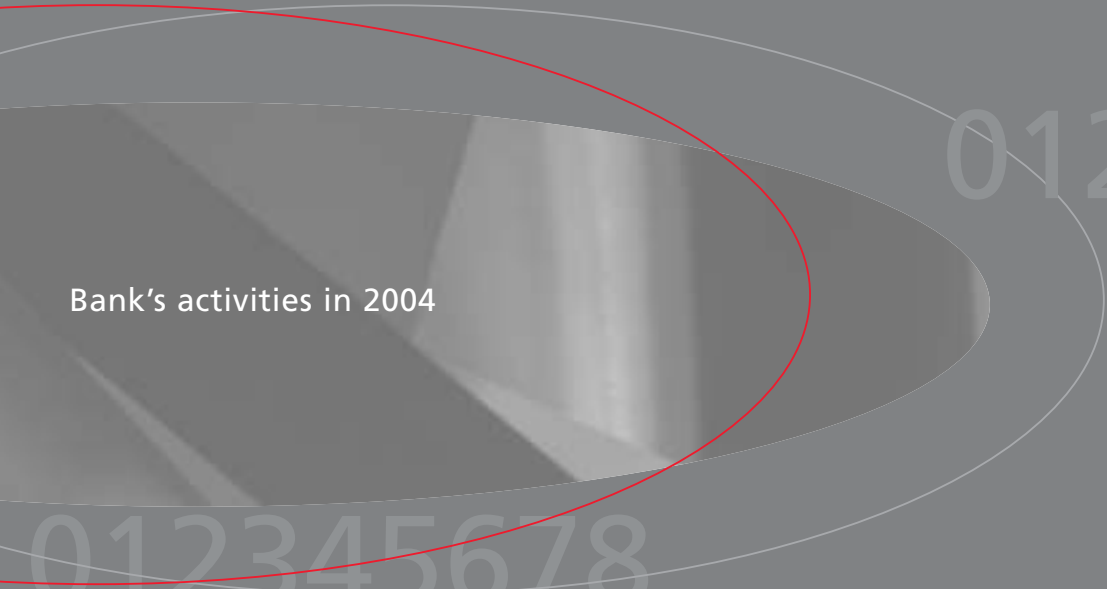
Zdeněk Vorlíček, member

During 2004, the following representatives terminated their membership in the Supervisory Board:

Heinz Knotzer,

František Komrská





Bank's activities in 2004

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## ECONOMIC ENVIRONMENT AND ITS IMPACT ON THE BANK'S PERFORMANCE

The accession of the Czech Republic to the European Union was undoubtedly a crucial issue that has influenced the Bank's activities during 2004; due to its versatility, this event shall be a source of further changes that the Bank will have to pass through within the coming years. The impact of the EU accession was obviously reflected in the development of all business operations. The most perceptible changes touched the area of support provided to small and medium-sized enterprises where the possibility to use the EU structural funds required significant modifications in the procedures related to providing some of the Bank's products. The progress of trading on domestic financial market was influenced by the recent incorporation of the Czech Republic into the EU structures as well.

Following the global economic development and the inflation rate, the Czech National Bank went on increasing the repo rates gradually up to the level of 2.50 % p. a. in the course of the first semester of 2004. Short-term interest rates due up to 12 months were floating between 2.00 % - 2.60 % p.a. during the year. In the same period, interest rates with longer due date slumped even to their historical low, nevertheless, in the second half of 2004, they went up again finally achieving values slightly higher than those recorded at the beginning of the year. The 10-years interest rate swaps opened at 4.45 % p.a., dropped to 3.65 % p.a. in the midterm and then returned to rise reaching 4.60 % p.a. at the end of 2004. Compared to the year beginning, the yield curve has closed in a much more risen position. The development of trading on financial markets had a positive impact on the Bank's performance in this field in 2004 creating a challenging basis for further period. The Czech crown strengthening towards the Euro and US dollar influenced negatively the export capabilities of the clients selling abroad, however, the exchange rates development had no significant impact on the Bank's loan portfolio or its monetary positions in foreign currencies.

The disproportion between high demands for support and the available financial means persisted in 2004 so that some programmes of SME assistance financed from the state budget allocation had to be ended earlier because of the respective sources total disbursement. The initiation of the Operational Programme Industry and Enterprise, co-financed from the means of the European Regional Development Fund, brought new sources and possibilities in providing support to small and medium-sized enterprises. Besides the aid disbursed through the CMZR Bank, the new funds were mainly used for the support provided in form of subventions (grants), most of them in the area of infrastructure and enterprise development.

Furthermore, grants were exclusively used as a specific support tool within the Joint Regional Operational Programme implemented by some regions to help small and medium-sized enterprises operating in economically weak districts. Though conditions of these schemes did not allow their combination with other tools of support provided by the CMZR Bank, the launching of grant schemes together with some other measures showed the increasing interest and capacity of regions to assist their SMEs. Nevertheless, the actual effectiveness of this type of aid may be questionable because of the limited amount of available means, too large range of activities eligible for support, and, the extensive administrative requirements related to the funds management.

The increasing interest of banks in financing the SME sector was another positive feature of the last year. It was reflected in the increasing amount of loans issued by individual banks as well as in growing demand for the guarantees provided by the CMZR Bank. The bank loan market focused on SME finance was characteristic with the effort to simplify and accelerate processes related to providing loans to this segment of clients; some banks also began to show higher willingness to assume the credit risk.

In 2004, the Business Environment Development Council was created within the competence of the Ministry for Industry and Trade of the Czech Republic. Its activities contributed to the fruitful co-operation on the determination of the orientation of support programmes implemented by the CMZR Bank where the space for

providing specific subordinated loans has been extended. The positive impact of this initiative should materialize in the enhanced financing available in 2005, primarily for the medium-sized businesses.

Though there were no substantial improvements within the last year's general environment related to granting CMZR Bank's guarantees for loans provided to repair prefab panel-block housing estates, the interest of banks in financing this type of projects went on growing. Certain hesitation among the related group of clients and lending banks was registered at the end of the year when new interpretation of the EU guidelines came up surprisingly putting in doubts the compliance of some types of support with the EU regulations; subventions to housing reconstruction belonged to the issues discussed. During the past year, the government adopted some new measures in support of individual and co-operative construction of new housing premises but their impact on the market would come up only later.

The last year's development also proved that the EU means together with the national sources could cover only a part of financing needs arisen from the obligation to meet the commitments assumed in the area of waste water treatment. In this connection, the attention was drawn also to difficulties related to financing projects of small municipalities where their ability to repay the bank loans received for projects realization was closely related to the compensation in form of promised grants income.

In 2004, the Bank's activities were considerably influenced also by the necessity to comply with some new regulatory requirements related to its operations in capacity of a bank, entrepreneurial entity and state aid provider. The changes particularly touched the fields of interest rate risk and operational risk management, security trader's activities, loans disbursement, and, monitoring and checking supported projects and clients. Incorporating the necessary amendments in the Bank's internal set of guidelines involved high demands on experts and software engagement.

The experience gained during 2004 clearly confirmed the tendency towards general electronic data collection and transmission and the indispensability of electronic systems operation for improving the efficiency of the evaluation of applications for state aid. Following the trend, the CMZR Bank has quickly introduced new procedures enabling now the clients to submit by electronic means their applications for support provided within the programmes co-financed from the EU structural funds.



## BUSINESS ACTIVITIES IN 2004

## 1/ Business development assistance

## a) SME support programmes

In the course of 2004, the Bank went on providing different types of support within the following programmes launched by the decision of the Ministry of Industry and Trade: ZÁRUKA (Guarantee), KREDIT (Credit), START, TRH (Market), VESNICE (Community), REGENERACE (Regeneration).

The funds available for the SME support programmes in 2004 totalled CZK 2,340 million, of which CZK 912 million were allocated from the state budget, CZK 23 million from the PHARE Revolving Fund, CZK 688 million were gained by the Bank on financial markets and the remaining part of CZK 717 million were the resources generated during the year mainly by repayments of preferential loans issued, means committed but not paid out due to the clients' breach of conditions under contracts signed between 1992 – 2003, and, interests earned on the funds committed to entrepreneurs.

In total, the entrepreneurs submitted 4,742 applications for assistance. Of them, 3,531 applications were processed and approved, 322 rejected for not meeting the programme criteria or for unacceptable project economy. 190 clients withdrew their applications during the process of evaluation. Processing of remaining 699 applications could not be concluded in a satisfactory way mainly because of the lack of funds allocated for the support.

## Processing of applications for support

TABLE No. 2

Indicator		2000	2001	2002	2003	2004
Total applications submitted	number	2 937	3 092	3 881	4 467	4 742
From that: approved	number	2 198	2 093	2 937	3 732	3 531
rejected or revoked	number	573	344	291	442	482
shifted to the next year	number	166	655	653	293	729

The support granted in the form of guarantees, preferential loans and subsidies to interest payment were designated for the realisation of 1,998 projects with total costs of approximately CZK 13 billion. The support was wholly given to the beneficiaries from private sector where physical persons undertaking pursuant to their individual trading licenses prevailed (58%), legal entities represented 42 %.

## Supported projects and applicants' structure

TABLE No. 3

Indicator		2000	2001	2002	2003	2004
Projects supported by guarantees, loans or interest subsidies	number	1 394	1 368	1 629	2 407	1 998
Total project costs	CZK bil.	14	13	16	18	13
Applicants - physical persons	%	35	37	43	55	58
Applicants - legal entities	%	65	63	57	45	42

In 2004, the supported projects were mostly implemented by small entrepreneurs. Referring to the total number of all types of support provided, businesses with up to 49 employees received 64 % of subsidised guarantees, 100 % of preferential loans (according to the respective programmes criteria) and 100 % of contributions to

interest payments. Including in that figures, micro-enterprises with up to 9 employees were granted 20 % of guarantees issued, 80 % of preferential loans and 85 % of subsidised interest.

Other types of special-purpose subsidies were provided to support the realization of 1,533 projects, being 87 % of them implemented by legal entities and 13 % by individuals.

Applicants for guarantees and preferential loans documented employment of 34,158 persons at the date of their requests submission, and, within 1 year, they expected to increase the number by additional 1,475 employees.

### Bank guarantees

In 2004, the Bank issued 511 subsidised guarantees for bank loans and leasing amounting to CZK 3,076 million and 247 guarantees for bids in public tenders totalling CZK 180 million; all these guarantees were provided under the ZÁRUKA (Guarantee) Programme.

The total sum of all types of guarantees issued amounted to CZK 3,257 million, which is by 15 % more than in 2003. The guarantees secured loans in total amount of more than CZK 5.4 billion. Under the ZÁRUKA (Guarantee) Programme, the largest portion of guarantees was provided on loans for financing investment projects (53.1 %), 41.3 % secured operational loans, and, 5.5 % bids in public tenders; the share of guarantees for leasing was only about 0.1 %.

### Loan guarantees

TABLE No. 4

Indicator		2000	2001	2002	2003	2004
Guarantees issued	number	463	484	520	499	511
Amount of guarantees issued	CZK mil.	1 972	2 260	2 406	2 677	3 076
Amount of loans guaranteed	CZK mil.	3 867	4 034	4 243	4 528	5 368
Average guarantee rate	%	51	56	57	59	57



The highest financial support provided in form of guarantees related to projects implemented in the regions Moravskoslezský (Moravia-Silesia), Zlínský, and Jihomoravský (South Moravia); the lowest use of guarantees was registered in the Karlovarský region. Regional share shown in the following table refers to the per cent of the contract value of new guarantees issued.

Regional profile of guarantees issued

TABLE No. 5

Region		2000	2001	2002	2003	2004
Capital City of Prague	%	2.3	3.0	7.6	4.3	5.4
Středočeský	%	4.8	9.8	12.2	8.1	10.4
Jihočeský	%	4.7	4.4	5.7	4.7	2.9
Plzeňský	%	7.7	9.5	6.8	6.8	6.8
Karlovarský	%	3.6	0.8	4.1	1.4	1.5
Ústecký	%	2.7	3.5	3.2	3.6	3.3
Liberecký	%	0.2	2.0	4.0	2.1	3.5
Královéhradecký	%	14.3	7.5	7.6	13.2	5.5
Pardubický	%	6.3	10.7	7.9	7.4	9.1
Vysočina	%	4.0	7.5	2.1	1.3	4.7
Jihomoravský	%	9.0	8.7	8.8	11.9	11.4
Olomoucký	%	10.1	10.9	4.9	10.9	9.9
Zlínský	%	12.9	11.3	10.9	12.1	11.8
Moravskoslezský	%	17.4	10.4	14.1	12.2	13.9
Total	%	100.0	100.0	100.0	100.0	100.0

In 2004, guarantees were mainly issued to support projects in manufacturing and retail trading confirming again the long-term dominant position of these sectors. The table below gives a picture on the sectoral share expressed in per cent of the total contract value of new guarantees granted.

Sectoral structure of guarantees issued

TABLE No. 6

Sector		2000	2001	2002	2003	2004
Manufacturing	%	68.4	58.4	59.0	58.0	57.8
From that: food processing	%	7.3	7.8	11.7	11.0	11.2
Building industry	%	5.6	11.1	13.1	10.9	10.4
Transport services	%	3.9	3.9	1.1	1.7	1.7
Retail trading	%	15.0	19.5	16.5	18.1	19.6
Accommodation services	%	1.4	3.3	4.5	2.7	1.1
Services for the public	%	0.4	1.7	2.0	4.8	3.7
Health care	%	1.5	1.1	1.4	1.2	1.0
Others	%	3.8	1.0	2.3	2.6	4.8
Total	%	100.0	100.0	100.0	100.0	100.0

In 2004, guarantee deals were mainly made with CMZRB's shareholding banks (77 % of the total amount of guarantees newly issued). Just like in previous years, Komerční banka, a.s., was the most significant business partner benefiting from some 40 % of guarantees issued. As relates to the non-shareholding banks, the eBanka, a. s., was the most active collaborator using almost 9 % of the total amount of the product. The following table

shows the utilization of CMZR Bank's guarantees by lending banks; the figures represent per cent shares of the total number, or total amounts, of guarantees newly issued in the respective years.

Share of lending banks on guarantees issued

TABLE No. 7

Bank		2000		2001		2002		2003		2004	
		number	amount	number	amount	number	amount	number	amount	number	amount
Komerční banka, a.s.	%	44.3	41.4	53.5	61.7	49.5	48.1	51.3	48.9	45.8	39.5
ČSOB, a.s.	%	5.3	4.0	13.8	8.3	13.3	11.0	9.5	9.4	7.0	5.9
ČSOB - IPB division, a.s.	%	25.4	21.3								
Česká spořitelna, a.s.	%	13.2	13.6	16.7	15.5	25.7	23.8	27.3	26.8	26.4	31.6
Other banks	%	11.8	19.7	16.0	14.5	11.5	17.1	11.9	14.9	20.7	23.0
Total	%	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

### Preferential loans

In 2004, the Bank continued providing preferential loans directed for financing capital projects expenditures. Under the KREDIT (Credit) Programme, standard loans amounting up to CZK 7 million with maturity up to 6 years, or, small loans up to CZK 1 million with maturity up to 4 years, were available. Within the START Programme, start-up businesses could apply for loans up to CZK 1 million with maturity up to 6 years.

In connection with the implementation of the Operational Programme Industry and Enterprise (OPIE) some changes had to be made in the implementation of the KREDIT (Credit) and START programmes. As of June 30, 2004, the Bank stopped accepting applications for support under the KREDIT and START programmes provided from national resources pursuant to conditions launched for the period 2001 – 2004 (with the exception of applications for loans related to projects located in the Capital City of Prague). As from July 1, 2004, programmes of SME assistance with the same names of KREDIT (Credit) and START were launched again but their conditions have been partially amended according to the EU structural funds requirements.

Despite that the nationally funded support in form of preferential loans was provided only during the first six months of 2004, its amount reached nearly 95 % of the total sum of loans issued to entrepreneurs in 2003. Under the KREDIT Programme, 82 standard loans amounting to CZK 252 million, and, 926 small loans totalling CZK 760 million were provided. Start-up entrepreneurs obtained 403 loans amounting to CZK 178 million within the START Programme. The yearly development of providing loans is shown in the following table.

Preferential and interest-free loans provided

TABLE No. 8

Indicator		2000	2001	2002	2003	2004
Loans provided	number	360	357	571	1 340	1 411
Amount of loans	CZK mil.	984.3	655.8	618.2	1 257.4	1 190.7
Average loan amount	CZK mil.	2.7	1.8	1.1	0.9	0.8

Most loans were provided for financing projects implemented in the Moravskoslezský region (336 loans amounting CZK 270 million), the lowest support went for the Liberecký region (32 loans totalling CZK 28 million). The table below gives a picture on shares of regional use of loans stated in per cent of the total value of new loans issued in the respective years.

Regional profile of loans provided

TABLE No. 9

Region		2000	2001	2002	2003	2004
Capital City of Prague	%	5.1	4.2	3.6	7.0	4.0
Středočeský	%	11.5	12.3	10.9	10.6	8.2
Jihočeský	%	4.2	5.6	2.9	6.9	5.9
Plzeňský	%	9.1	9.5	8.5	12.4	8.7
Karlovarský	%	4.7	1.1	4.4	2.3	3.7
Ústecký	%	4.4	5.1	7.1	5.0	5.8
Liberecký	%	3.4	1.1	1.5	2.7	2.4
Královéhradecký	%	8.3	4.8	7.1	4.8	6.6
Pardubický	%	6.3	2.6	2.1	3.2	4.2
Vysočina	%	4.6	3.9	1.1	3.8	3.2
Jihomoravský	%	8.9	6.6	12.5	9.4	9.5
Olomoucký	%	7.0	6.2	4.6	4.6	7.2
Zlínský	%	7.5	12.2	7.6	8.0	7.9
Moravskoslezský	%	15.1	24.8	26.1	19.3	22.7
Celkem	%	100.0	100.0	100.0	100.0	100.0

Preferential loans were mainly used to support implementation of projects in the sectors of manufacturing and retail trading. Figures registered in the following table show the share of projects credited in the respective sectors stated in per cent of the total value of new loans issued in the respective years.

Sectoral structure of loans provided

TABLE No. 10

Sector		2000	2001	2002	2003	2004
Manufacturing	%	49.5	42.2	38.3	40.8	37.4
From that: food processing	%	5.4	5.9	6.4	6.6	6.1
Building industry	%	4.9	8.7	10.2	10.1	11.8
Transport services	%	1.7	0.5	1.7	1.5	1.1
Retail trading	%	24.1	25.6	24.5	19.7	23.6
Accommodation services	%	9.5	14.2	12.0	13.2	14.3
Services to the publics	%	1.6	2.2	4.0	5.3	4.0
Health care	%	3.1	3.4	2.2	2.6	2.8
Other	%	5.6	3.2	7.1	6.7	5.0
Total	%	100.0	100.0	100.0	100.0	100.0

### Financial subsidies

In 2004, the support provided in form of contributions to the payment of loan interests (interest subsidies) was available within the VESNICE (Community) and REGENERACE (Regeneration) programmes only. In the course of 2004, these programmes were limited considerably, nevertheless, 76 interest subsidies were granted in the total amount of CZK 35 million.

#### Interest subsidies

TABLE No. 11

Indicator		2000	2001	2002	2003	2004
Subsidies granted	number	571	529	538	529	76
Amount of subsidies	CZK mil.	578	463	478	410	35
Amount of supported loans	CZK mil.	4 229	3 837	4 558	4 086	373

Other special-purpose financial subsidies, not related to any bank loan granting, were provided in the following structure: 1,238 subsidies amounting to CZK 132 million were provided under the TRH (Market) Programme contributing to cover costs expended to get quality system certifications, brand compliance with the Czech standard ČSN TEST, or, environmental certificates; 26 subsidies totalling CZK 47 million helped to increase the employment of people from specific groups of population under the SPECIAL Programme; within the KOOPERACE (Cooperation) Programme, 22 subsidies amounting to CZK 31 million supported specific activities of business associations (clusters).

#### Financial subsidies

TABLE No. 12

Indicator		2000	2001	2002	2003	2004
Special-purpose subsidies granted	number	881	656	1 097	1 151	1 286
Amount of subsidies	CZK mil.	171	188	258	270	210

As relates to the employment issue, the projects supported in 2004 were expected to create 245 new job opportunities in municipalities with up to 2 999 inhabitants where the aid in form of subsidized interest was provided to local entrepreneurs. Generating 351 jobs for people from less flexible groups of the population was planned under the SPECIAL programme support.

### b) Operational Program Industry and Enterprise

Pursuant to the decision of the Ministry of Industry and Trade, the Bank started the implementation of the relevant part of the Operational Programme Industry and Enterprise as of July 1, 2004. Since then, preferential loans for financing investment-oriented projects have been provided under the respective programmes being their basic characteristics as follows:

- KREDIT (Credit) Programme: standard loans (amounts between CZK 2 – 5 million, maturity up to 6 years), small loans (CZK 0.2 – 2 million, for up to 5 years), and, subordinated loans (CZK 2 – 7 million, maturity up to 8 years with the possibility of a grace period up to 5 years, fixed interest rate at 4 % p.a., or, 3 % p.a., respectively);
- START Programme: interest-free loans for start-up businesses (up to CZK 1 million, for up to 6 years);
- INOVACE (Innovation) Programme: loans for financing projects aimed at products, technologies or services innovation (CZK 1 – 50 million, for up to 9 years with the possibility of a grace period up to 4 years).

In 2004, the entrepreneurs submitted a total number of 403 applications for preferential loans; 213 of them were approved and the support was provided under the respective programmes (KREDIT: 60 loans amounting to CZK 115 million, START: 153 loans totalling CZK 65 million). 43 applications were rejected for not meeting the programme criteria or for unacceptable project economy, 15 clients withdrew their applications during the process of evaluation. Processing of remaining 132 applications could not be finished until the end of 2004 due to its later submission at the year-end, or, because of not providing enough information on project readiness for funding.

The loans provided under the above-mentioned programmes were used for the realization of 213 projects whose total cost approached CZK 342 million. The support was wholly granted to the beneficiaries from private sector, where physical persons undertaking pursuant to their individual trading licenses prevailed (75%); legal entities represented 25 % of the aid beneficiaries' total number.

Pursuant to the programme conditions, all the preferential loans issued were used by small-sized business entities employing up to 49 people. More specifically, the micro-enterprises (with up to 9 employees) represented 92 % of this group of aid recipients.

Entrepreneurs benefiting from preferential loans documented employment of 444 persons at the date of their applications submission, and, within 1 year, they expected to increase the number by additional 206 employees.

#### c) Loan programme in support of South Bohemia Region

In 2004, 5 preferential loans amounting to CZK 1.4 million were provided on the basis of existing agreement concluded between the Bank and the Jihočeský region (South Bohemia) authorities on the implementation of a specific programme designed to support the development of micro-enterprises in this region.

## 2/ Assistance to the repair of prefab housing estates

The Bank continued providing assistance in the field of housing improvement pursuant to the PANEL Programme launched by the State Fund for Housing Development in support of financing the repair of residential prefab panel-block houses. In 2004, the total sum of CZK 576 million was disbursed for vital repairs and refurbishment of houses specified under this programme; the cumulative sum expended from 2001 amounted to CZK 1,445 million. Since the programme beginning till the end of 2004, repairs of some 30 thousand flats were supported.

CMZR Bank provided the support in form of subsidised guarantees and grants to interests paid on loans issued to enable the owners of prefab panel-block houses to finance their repairs; the eligible aid beneficiaries (i.e., buildings owners) were municipalities, housing co-operatives and other individuals and legal entities as well as the owners associations established pursuant to the novel of the Act on Flat Ownership.

The following table gives a picture on the progress in the number of housing repair projects supported by CMZR Bank's guarantees or interest grants and on the structure of the aid beneficiaries.

**Assistance to panel-block houses repair**

TABLE No. 13

Indicator		2000	2001	2002	2003	2004
Projects supported	number	0	3	110	188	281
Aid beneficiaries:						
- housing co-operatives	%	0	67.0	75.0	90.0	81.0
- municipalities	%	0	33.0	15.0	6.0	5.5
- flat owners associations	%	0	0.0	6.0	3.0	11.7
- physical persons (individuals)	%	0	0.0	0.0	0.5	1.8
- legal entities	%	0	0.0	4.0	0.0	0.0

**a) Subsidised guarantees**

In 2004, the Bank issued 118 guarantees amounting to CZK 602 million; this assistance helped the flat owners to obtain loans for financing the panel-block houses repair in the total amount of CZK 891 million. The guarantees were granted to 88 housing co-operatives, 26 associations of flat owners and 4 individuals.

**Subsidised guarantees**

TABLE No. 14

Indicator		2000	2001	2002	2003	2004
Guarantees issued	number	0	3	41	96	118
Amount of guarantees issued	CZK mil.	0	22	340	484	602
Amount of loans guaranteed	CZK mil.	0	32	584	746	891
Average guarantee rate	%	0	69	58	65	68

**b) Grants to interest payment**

According to approval decisions issued by the State Fund for Housing Development, the CMZR Bank provided 163 grants amounting to CZK 395 million to subsidise interests paid on loans given for the prefab panel-block houses repair. From that, 132 grants were provided to housing co-operatives, 19 were granted to the owners associations, 9 to municipalities and 3 to physical persons.

**Grants to interest payment**

TABLE No. 15

Indicator		2000	2001	2002	2003	2004
Grants provided	number	0	0	69	92	163
Amount of grants	CZK mil.	0	0	358	261	395
Amount of supported loans	CZK mil.	0	0	1 121	793	1 310

### 3/ Preferential loans to support water sector investments

CMZR Bank went on with its involvement in the implementation of the programme aimed at the enhancement of the quality of drinking water and wastewater treatment required to meet the standards set in the EU directives. Within this programme, the Bank utilised funds made available by the European Investment Bank as a source for long-term preferential loans provided to water sector project investors. These loans were completed by the investors' own resources and by allocations from the state budget designated for financing projects eligible under this programme.

In 2004, the Bank provided 37 preferential loans totalling CZK 587 million to towns or associations of towns and communities, as well as to water administration utilities, in which municipalities held majority shares. 23 loans were provided to finance water supply lines and drinking water treatment plants construction, 11 loans were used for sewage systems projects, 3 loans helped to finance wastewater treatment plants. Almost one third of the supported projects were implemented in Moravian regions, the rest of aid was split within the remaining national territory.

The cumulative records for the period 2001 – 2004 show that 105 projects were supported and their total costs related to construction and technology expenditures amounted to CZK 1,340 million. The programme implementation entered the final stage.

### 4/ Infrastructure projects finance

In 2004, the Bank continued acting as financial manager of infrastructure programmes and it arranged a total of CZK 20.6 billion for their financing (incl. the water sector investments mentioned in the preceding section 3). This amount was funded by resources obtained from the European Investment Bank, the state budget (allocated through the State Fund for Transport Infrastructure) and the respective investors' own means. Compared to 2003, the amount of funds provided by the Bank to finance infrastructure projects increased by 23 %.

CMZR Bank used the respective funds to finance 10 programmes and projects aimed mainly at the transport and water sectors infrastructure improvement. The significant portion of the support was disbursed for financing the construction of highway communications, where CZK 10.4 billion were expended. More specifically, the main projects related were as follows: the city of Plzeň by-pass and the connecting feeder roads, the A-highway approach to the city of Hradec Králové, the D8-highway section between the municipality of Trmice and the state border between the Czech Republic and Germany, the south-west section of the motorway circle around Prague. Nearly CZK 5 billion were further used within the implementation of two existing programmes aimed at the improvement of technical quality of the Czech territory sections of international motorways as well as the technical enhancement of other highways and priority roads. In 2004, about 60 transport infrastructure projects were financed.

Referring to the water sector, the realization of the specific Programme for Removal of Flood Damages caused in 2002 continued also in 2004. The support was provided mainly for the restoration of destroyed railroads, motorways and some local roads. Furthermore, the funds of the Flood Prevention Programme, implemented within the Czech Republic's land protection strategy, were used to finance selected projects as well.

#### 5/ Support to enterprises in specific areas of intensive state aid

CMZR Bank continued acting as the payment agency for the disbursement of grants approved by the Ministry for Regional Development within the Regional Programme to assist the development of industrial businesses within the NUTS 2 areas and other districts of intensive state aid. In total, CZK 130 million were disbursed, of which CZK 41 million helped 8 companies located in the Ostravsko area, CZK 65 million went to 13 companies located in the Severozápad (North-West), CZK 25 million supported 5 businesses in the Jihovýchod (South-East) area.

#### 6/ Trading on financial markets

CMZR Bank's main reason and goal for trading in money and capital markets have been the liquidity management, financial and capital market instruments portfolio administration, and, gaining additional funds for realisation of loan support programmes for SMEs. Market risks have been regularly hedged by currency and interest rate derivatives.

The Bank's investment strategy allows investing into fixed yield instruments, such as government, corporate and municipal bonds, mortgage bonds, treasury bills and promissory notes. In its investment policy, the Bank pays maximum attention to credit risk management and therefore it invests only in instruments issued by foreign and local companies which have got a very good credit rating.



## EXTERNAL COMMUNICATION

CMZR Bank's contacts in 2004 were featured by intensified communication with external partners, both foreign and national, related to the EU enlargement and the consequent changes in some activities and procedures; the co-operation with some domestic partners was further improved and deepened.

The Bank continued fostering the good cooperation with its key partners from the state administration institutions, which is an essential condition for the Bank's efficient operation and further development in capacity of provider of assistance in terms of the SME support programmes and infrastructure projects finance. High quality of these relations significantly helped the solution of common issues related to the preparation stage and the initiation of practical implementation of the EU structural funds in support of the SME development. CMZR Bank also participated in activities of one of working groups of the Business Environment Development Council created by the Ministry of Industry and Trade.

The Bank further sustained its long-term relations with the German bank Kreditanstalt für Wiederaufbau (KfW); the fruitful co-operation enabled to get additional financial means, incl. EU grants, that helped to promote the range of the CMZR Bank's lending activities designed for the SME support. At the end of 2004, the Bank concluded an amendment to the agreement signed with the European Investment Fund (EIF) in 2003; the amendment extended the availability period for providing the EIF counter-guarantee and enabled the Bank to take advantage of the involvement in the EU Multiannual Programme for Enterprise and Entrepreneurship (MAP) launched for the period 2001 - 2005. The Bank's active attendance to workshops organized by the specific Directorates General of the European Commission helped to better understand the EU systems, tools and policies implemented in the field of state aid, with special view to the support of SMEs. In addition, the Bank's membership in the European Association of Guarantee Institutions (AECM) and the Club of Institutions Specialising in Long-Term Credits (ISLTC) also contributed to better monitoring of useful information and professional knowledge extension.

The Bank went on enhancing its close cooperation with the Economic Chamber of the Czech Republic. In 2004, the Framework Agreement on joint cooperation was signed with the aim to determine the main principles and procedures of the long-term strategy assumed in support of the SME development. Bank's specialists spoke at various seminars organized by the Chamber for the representatives of its Business Information Spots at the year beginning, and, during the year, participated also in further consultations to help the dissemination of information provided for the entrepreneurs through the net of the Chamber's advisors.

The Bank extended its existing co-operation also with the CzechInvest agency in order to coordinate terms, conditions and procedures related to the implementation of the Operational Programme Industry and Enterprise. In terms of regional co-operation, the most active contacts were held with the Jihočeský region (South Bohemia), where the Bank participated in a specifically modified loan programme implementation, and with the Zlínský region, where a tailored guarantee scheme was developed.

An important step to the improvement of the Bank's external communication was the conclusion of the project of a new internet site launched at the end of 2004. The recent web site image was created with the aim to provide better access to information as well as an easier orientation for its final users; this way, better conditions have been prepared for more efficient dissemination of information to the Bank's clients, partners and interested publics.

## EQUITY HOLDINGS

The Bank holds a 49 % share in the Municipal Finance Company, a.s. (hereinafter the "Company"). In 2004, the registered capital of the Company remained at the same level of CZK 1 million. Since 1994, the Company has been implementing the Programme for Financing Municipal Infrastructure Development in the Czech Republic under the Programme Agreement signed between the governments of the Czech Republic and the United States of America.

In 2004, the Company's activities continued focused on the management of the portfolio of existing loans granted under the Programme and on negotiations related to the reimbursement of receivables due from banks that went bankrupt.



## STRATEGIES FOR FURTHER DEVELOPMENT

CMZR Bank's efforts for 2005 and the following years will still focus on providing specific loan and guarantee products developed with the aim to help the clients to get easier access to finance available in form of bank loans, leasing or venture capital. The Bank's products and services shall be granted in the highest possible quality, flexibly satisfying the needs of its clients who prevail to be small and medium-sized entrepreneurs, water sector utilities, municipalities, and prefab panel-block houses owners (incl. cooperatives, individuals or associations). Furthermore, the Bank shall continuously pay attention to the efficient management and use of funds administered within the support programmes. The Bank shall go on diligently performing in line with its shareholders interests, which primarily means maintaining its profitability and credibility as the basis for sustainable long-term development.

One of the Bank's main priorities shall be the utilisation of the EU structural funds in the support scheme of the small and medium-sized entrepreneurship. The effort shall concentrate on the efficient use of the available funds through providing preferential loans, incl. subordinated loans, which are expected to contribute to a larger volume of financing in a new way.

The coming period of preparation for the next EU planning period, supposed to start in 2007, will be an important opportunity to further determine the Bank's position and the nature of adequate tools used in the area of SME assistance. The Bank is ready to support efficient solutions and tools leading to using mainly returnable types of financial aid or those showing a high leverage effect.

The Bank is going to take advantage of a larger engagement of advanced information technologies, which contribute to an easier external communication with clients and partners as well as to the internal control, and use it for further enhancement of the quality of products and services provided. Further stage of the project designed for more intensive utilisation of information technologies in processing applications and business operation management is about to be concluded.

Main areas of the Bank's future activities concern:

- providing assistance to small and medium-sized enterprises, using primarily those support tool that foster the SMEs capability to efficiently get financing from banks or other external sources (guarantees),
- granting support in the area of prefab panel-block housing estates refurbishment,
- financing the water sector investment projects realization,
- acting in capacity of a qualified financial manager of funds allocated for infrastructure projects development.

Within the coming period, the Bank shall also keep seeking further perspective areas for wider use of its guarantee and loan products.

CMZR Bank's ongoing activities shall be based on the employees' higher engagement and enhanced motivation to actively participate in bringing new ideas and the necessary changes implementation.



## **Českomoravská záruční a rozvojová banka, a. s.** **Supervisory Board's Report**

During 2003, the Supervisory Board carried out the duties as defined by law and the Company Articles of Association. In capacity of the Bank's controlling body, the Supervisory Board watched the sphere of action of the Board of Directors, the Bank's business activities implementation, the way of economic performance and its strategic conception realization. The Supervisory Board was regularly given information about the Bank's operations, its financial position and all other essential matters.

Having checked the regular financial statement for the period from 1 January to 31 December 2004, and, on the basis of the external auditor's report, the Supervisory Board states that the accounting records and books were kept in a documented manner, in compliance with the generally binding regulations for book-keeping of banks and in line with the Company Articles of Association. Accounting records and books reflect the Bank's financial situation in all important respects.

The Deloitte, s.r.o., performed the audit of the Bank's financial statements and reported that, in all important aspects, the final accounts and records provided a true and fair picture of assets, liabilities, equity and financial position of Českomoravská záruční a rozvojová banka, a.s., as of 31 December 2004, as well as of the Bank's economy results for 2004, in accordance with the Accounting Act and other relevant regulations of the Czech Republic. The Supervisory Board acknowledged and accepted the auditor's opinion.

On view of the above-mentioned facts and pursuant to the Company Articles of Association, the Supervisory Board recommends that the General Meeting of shareholders approves the final accounts of Českomoravská záruční a rozvojová banka, a. s., for the year ended 31 December 2004 and the proposed profit distribution as submitted by the Board of Directors. It recommends that the General Meeting also approves the Bank's long-term development strategy and proposed changes to the Company Articles of Association.

The Supervisory Board further reviewed the Report of the Board of Directors on Relations between Controlling and Controlled Entities with the conclusion that the Report did not contain inaccuracies.

Prague, 15 March, 2005



Václav Polák  
Supervisory Board Chairman

## **Independent Auditor's Report to the Shareholders of Českomoravská záruční a rozvojová banka, a.s.**

We have audited the accompanying consolidated balance sheets of Českomoravská záruční a rozvojová banka, a.s. and subsidiaries (the "Group") as of 31 December 2004 and 2003, and the related statements of income, cash flows and changes in equity for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the group as of 31 December 2004 and 2003, and the results of its operations, cash flows and changes in equity for the years then ended in accordance with International Financial Reporting Standards.

In Prague on 31 March 2005

Audit firm:  
Deloitte s.r.o.  
Represented by:



Michal Petrman, statutory executive



Consolidated Financial Statements  
Prepared in Accordance with International Financial Reporting Standards  
for the Years Ended 31 December 2004 and 2003

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CONSOLIDATED PROFIT AND LOSS ACCOUNTS  
FOR THE YEARS ENDED 31 DECEMBER 2004 AND 2003

		Year ended 31 December 2004	Year ended 31 December 2003
		CZK '000	CZK '000
Interest income		2 294 131	2 477 181
Interest expense		-1 687 923	-1 877 479
<b>Net interest income</b>	<b>4.1</b>	<b>606 208</b>	<b>599 702</b>
Fee and commission income		862 108	822 239
Fee and commission expense		-33 207	-25 518
<b>Net fees and commissions</b>	<b>4.2</b>	<b>828 901</b>	<b>796 721</b>
Net profit/(loss) on financial operations	4.3	54 568	-387 689
Other income	4.4	123 331	166 866
<b>Total operating income</b>		<b>177 899</b>	<b>-220 823</b>
Administrative expenses	4.5	-305 711	-248 580
Depreciation and other provisions	4.6	-61 458	409 744
Other expenses		-116 835	-61 800
<b>Total operating costs</b>		<b>-483 824</b>	<b>99 364</b>
Income from share of associated undertakings		34 111	43 084
<b>Profit before provision for loan and investment losses and income taxes</b>		<b>1 163 295</b>	<b>1 318 048</b>
Provisions for loan and investment losses	4.7	102 618	-200 612
<b>Profit/(loss) before income taxes</b>		<b>1 265 913</b>	<b>1 117 436</b>
Income taxes	4.8	-327 435	-437 735
<b>Net profit/(loss)</b>		<b>938 478</b>	<b>679 701</b>

## CONSOLIDATED BALANCE SHEETS AS OF 31 DECEMBER 2004 AND 2003

	Notes	31 December 2004	31 December 2003
		CZK '000	CZK '000
<b>Assets</b>			
Cash and current balances with banks	5	142 934	144 616
Amounts due from banks	6	7 588 289	8 027 479
Trading securities	7	0	1 066 657
Positive fair value of financial derivative transactions		347 477	338 803
Loans to customers, net	8	29 722 400	28 518 030
Securities available for sale	9	8 278 841	8 317 151
Investments held to maturity	10	1 706 143	675 076
Prepayments, accrued income and other assets	11	313 701	127 232
Deferred tax asset	4.8	28 164	24 995
Investments in associates	12	97 137	63 025
Intangible fixed assets	13	33 938	44 294
Property and equipment	13	253 738	271 342
<b>Total assets</b>		<b>48 512 762</b>	<b>47 618 700</b>
<b>Liabilities</b>			
Amounts due to banks	14	28 971 161	28 937 360
Amounts due to customers	15	9 325 165	9 569 724
Negative fair value of financial derivative transactions		1 761 044	1 271 237
Accruals, provisions and other liabilities	16	1 723 856	1 443 092
Income taxes payable		113 927	5 379
Provisions for off balance exposures	4.7	2 260 645	2 351 312
<b>Total liabilities</b>		<b>44 155 798</b>	<b>43 578 104</b>
<b>Shareholders' equity</b>			
Share capital	17	2 131 550	2 131 550
Share premium and reserves		2 225 415	1 909 046
<b>Total shareholders' equity</b>		<b>4 356 965</b>	<b>4 040 596</b>
<b>Total liabilities and shareholders' equity</b>		<b>48 512 762</b>	<b>47 618 700</b>


CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
FOR THE YEARS ENDED 31 DECEMBER 2004 AND 2003

	Share capital	Capital contributions	Retained earnings	Total
	CZK '000	CZK '000	CZK '000	CZK '000
<b>Balance at 31 December 2003</b>	<b>2 131 550</b>	<b>826 745</b>	<b>1 082 301</b>	<b>4 040 596</b>
Hedging derivatives – fair value (see Note 3s)	0	0	0	0
Hedging derivatives – deferred tax (see Note 3s)	0	0	0	0
Bonus issue	0	0	0	0
Approved dividends	0	0	-622 110	-622 110
Other contributions to capital reserves	0	13 624	-13 624	0
Net profit	0	0	938 478	938 478
<b>Balance at 31 December 2004</b>	<b>2 131 550</b>	<b>840 369</b>	<b>1 385 046</b>	<b>4 356 965</b>

**CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED 31 DECEMBER 2004 AND 2003**

	Note	2004	2003
		CZK '000	CZK '000
Profit before taxes		1 265 913	1 117 438
<b>Adjustments for non-cash transactions</b>			
Creation/(release) of provisions and adjustments for losses on loans		-183 647	-418 618
Loans written off		90 331	120 931
Depreciation and amortisation of assets		61 458	60 795
Gains on sale of fixed assets		-782	-544
Net profit on remeasurement of equity investments		-34 111	-43 084
Change in fair values of financial instruments		-116 744	157 140
Adjustment for interest flows		-606 208	-599 702
<i>Operating cash flow before changes in operating assets and liabilities</i>		476 210	394 356
<b>Cash flows from operating activities</b>			
<i>(Increase)/decrease in operating assets</i>			
Loans and advances to financial institutions		435 074	37 058 094
Loans and advances to clients		-2 368 933	-2 564 064
Other assets		-186 469	-44 617
<i>Increase/(decrease) in operating liabilities</i>			
Amounts owed to financial institutions		1 768 911	2 794 983
Amounts owed to customers		-243 213	-40 631 964
Other liabilities		280 764	152 048
<b>Net cash flow from operating activities before income tax</b>		<b>162 344</b>	<b>-2 841 165</b>
Interest received		2 315 527	2 562 522
Interest paid		-1 702 816	-1 917 825
Income taxes paid		-222 056	-218 650
<b>Net cash flow from operating activities</b>		<b>552 999</b>	<b>-2 415 118</b>
<b>Cash flows from investing activities</b>			
Purchases of securities AFS and held to maturity		-20 108 117	-54 484 783
Sales of securities available for sale and held to maturity		19 702 458	53 718 443
Purchase of tangible and intangible fixed assets		-92 139	-107 193
Proceeds from the sale of tangible and intangible fixed assets		59 422	57 934
<b>Net cash flow from investing activities</b>		<b>-438 376</b>	<b>-815 600</b>
<b>Cash flows from financing activities</b>			
Dividends paid		-622 110	-320 934
<b>Net cash flow from financing activities</b>		<b>-622 110</b>	<b>-320 934</b>
<b>Net decrease in cash and cash equivalents</b>		<b>-507 487</b>	<b>-3 551 652</b>
Cash and cash equivalents at beginning of year		1 150 055	4 701 707
Cash and cash equivalents at end of year	18	642 568	1 150 055





Notes to the Consolidated Financial Statements  
for the Year Ended 31 December 2004

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## 1/ GENERAL INFORMATION

Českomoravská záruční a rozvojová banka, akciová společnost (henceforth the "Bank" or "ČMZRB") was formed as a joint stock company pursuant to the Commercial Code and was incorporated following its registration in the Register of Companies held at the District Court for Prague 1 on 28 January 1992 (Volume Rg. B, File 1329). The Bank's registered office is located at Jeruzalémská 964/4, Prague 1. The Bank has five branches in the Czech Republic (in Brno, Ostrava, Hradec Králové, Plzeň and Praha) and one regional workplace in České Budějovice.

The Bank has been licensed by the Czech National Bank (CNB) and the Securities Commission. The CNB granted the Bank a full banking licence and a foreign exchange licence (maintenance of foreign currency accounts for individuals and legal entities, placement of foreign currencies on accounts with banks in the Czech Republic and proprietary trading and trading on clients' accounts with foreign currency assets, with the exception of trading with derivatives under Section 8a of the Securities Act).

The Bank's activities are focused on supporting small and medium sized businesses in the Czech Republic through providing guarantee and credit products and issuing infrastructure loans from the funding made available by international financial institutions.

The Bank's activities principally involve:

- Issuance of Czech Crown and foreign currency loans and guarantees;
- Acceptance and provision of Czech Crown and foreign currency deposits;
- Maintenance of current and term Czech Crown and foreign currency accounts;
- Provision of ordinary banking services via a network of branches; and
- Securities trading.

## 2/ PRINCIPAL ACCOUNTING POLICIES

### a) Basis of Accounting

The consolidated financial statements are prepared in accordance with and comply with International Financial Reporting Standards ('IFRS') effective for the year ended 31 December 2004. The consolidated financial statements are prepared on the accrual basis of accounting whereby the effects of transactions and other events are recognised when they occur and are reported in the financial statements of the periods to which they relate, and on the going concern assumption. The financial statements include a balance sheet, a profit and loss statement, a statement of changes in shareholders' equity, a cash flow statement and notes to the financial statements.

The consolidated financial statements are prepared under the historical cost convention, as modified by the fair value revaluation of available-for-sale securities, financial assets and financial liabilities held for trading and all derivative contracts. Assets that are not remeasured to fair value and suffered an impairment are stated at net recoverable amount.

ČMZRB and its associated („the Group“) entities maintain their books of account and prepare statements for regulatory purposes in accordance with Czech accounting principles and those of other jurisdictions in which the Group operates. The accompanying financial statements are based on the accounting records, together with appropriate adjustments and reclassifications necessary for fair presentation in accordance with IFRS.

The presentation of consolidated financial statements in conformity with IFRS requires management of the Group to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

contingent assets and liabilities as of the date of the financial statements and their reported amounts of revenues and expenses during the reporting period. These estimates are based on the information available as of the date of the financial statements and actual results could differ from those estimates.

The reporting currency used in the consolidated financial statements is the Czech Crown ('CZK') with accuracy to CZK thousand.

#### **b) Basis of Consolidation**

Investments in associated undertakings are accounted for using the equity method of accounting. These are undertakings in which the Group has between 20 percent and 50 percent of the voting rights, and over which the Group exercises significant influence, but which it does not control. Equity accounting involves recognising in the profit and loss statement the Group's share of the associates' profit or loss for the period. The Group interest in the associate is carried in the balance sheet at an amount that reflects its share of net assets of the associate and includes goodwill on acquisition.

#### **c) Recognition Date**

The date of the recognition of individual transactions is principally the date of payment or receipt of cash, the day of purchase or sale of foreign currencies, the date on which a payment is made or an amount is collected from the client's account, the day of settlement of the Bank's orders with the CNB Clearing Centre, the day on which funds are credited according to a report from the Bank's correspondent (the report is taken to mean a statement of an account maintained by the correspondent), the settlement date relating to transactions with securities and derivatives, the date of issuance or acceptance of a guarantee or loan commitment, and the date of accepting assets into custody.

Purchases and sales of financial assets on terms that require delivery within a typical timeframe and fixed forward and option transactions are retained off balance sheet in the period between the trade date and the settlement date.

The Bank derecognises a financial asset or a portion of the financial asset from its balance sheet when it loses control of the contractual rights that comprise the financial asset or a portion of the financial asset. The Bank loses such control if it realises the rights to benefits specified in the contract, the rights expire, or the Bank surrenders those rights.

#### **d) Bank Guarantees**

Issued bank guarantees are retained off balance sheet from the date on which a bank guarantee agreement is entered into. The Bank's off balance sheet commitment arising from the bank guarantee is decreased on the basis of information on the cumulative repaid principal balance of the guaranteed loan.

Proceeds from guarantees are recognised on an accruals basis (refer to Note 4.2). When a call for pay-out under a guarantee is received from a creditor, the Bank records the pay-out call in its off balance sheet accounts. Subject to the fulfilment of the conditions set out in the guarantee certificate, the pay-out under the bank guarantee is passed on to the creditor. The off balance sheet commitment in respect of the pay-out call is reversed and the Bank accounts for an on balance sheet balance due from the client as a result of a guarantee pay-out being made.

### e) Foreign Currencies

Assets and liabilities denominated in foreign currencies are translated into Czech Crowns and reported in the financial statements at the exchange rate declared by the Czech National Bank ('CNB') prevailing as of the balance sheet date. Income and expenses denominated in foreign currencies are recorded in Czech Crowns in the underlying accounting system of the Bank and are therefore reported in the financial statements as re-translated at the official exchange rate prevailing as of the date of the transaction. All gains and losses arising from movements in exchange rates are recognised in *'Net profit or loss on financial operations.'*

### f) Amounts due from Banks and Customers

Loans originated by the Bank by providing money directly to a borrower are categorised as loans originated by the Bank and are carried at amortised cost. All loans and advances are recognised when cash is advanced to borrowers.

Loans and advances to customers and financial institutions are stated net of provisions for loan losses. Further details about provisioning are set out in Note 4.7 to these financial statements. Loans hedged by financial derivatives are measured at fair value.

Reserves and provisions are charged against expenses and are reported in the profit and loss account line *'Provision for loan losses.'*

Write-offs of bad receivables are reported in the profit and loss account line *'Provision for loan losses.'* The receivable is written off against the related provision or reserve. Recoveries of receivables, if previously written off, are included in *'Provision for loan losses.'*

### g) Securities

Securities held by the Bank are categorised into portfolios in accordance with the Bank's intent on the acquisition of the securities and pursuant to the Bank's security investment strategy. The Bank has classified securities that are not equity investments in subsidiaries or associates as *'Trading securities'*, *'Available for sale'* and *'Held to maturity.'*

All securities held by the Bank are initially recognised at cost which, for coupon bonds, includes purchase price, accrued coupon and an element of direct transaction costs associated with the acquisition of securities. All purchases and sales of securities that do not meet the *'regular way'* settlement criterion are treated as financial derivatives and are recognised on the face of the balance sheet upon settlement in fair value. The cost of debt securities is increased to reflect the accrued interest income using the effective interest rate method. Interest income includes the accrued difference between the nominal value of the security and its cost, and the accrued coupon.

#### Fair Value of Securities

Fair value of securities is determined as equal to the market value quoted on recognised stock exchanges or any other public securities market as appropriate. Fair value of unlisted securities is established as equal to:

- Net present value of cash flows taking into account the risks attached to bonds and bills of exchange; and
- Third party quotes.

### Trading Securities

Trading securities are financial assets (debt securities, treasury bills and bills of exchange) acquired by the Bank for the purpose of generating a profit from short-term fluctuations in prices. Subsequent to the initial recognition, these securities are accounted for and stated at fair value.

Unrealised gains and losses arising from the fair value remeasurement of securities as well as realised gains and losses are recognised in the profit and loss account line '*Net profit or loss on financial operations.*'

### Investments Held to Maturity

Investments held to maturity are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity. The Bank carries debt securities in the held-to-maturity portfolio. Held-to-maturity investments are carried at amortised cost using the effective yield method.

The Bank assesses on a regular basis whether there is any objective evidence that an investment held to maturity may be impaired. A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount which is equal to the present value of the expected future cash flows discounted at the financial instrument's original effective interest rate. The amount of the impairment loss for assets carried at amortised cost is calculated as the difference between the asset's carrying amount and its recoverable amount. When an impairment of assets is identified, the Bank recognises provisions through the profit and loss account line '*Provision for losses on securities.*'

### Securities Available for Sale

Available for sale securities are those financial assets that are not classified as financial assets held for trading or held-to-maturity investments and are used in managing the Bank's interest rate exposure. Securities available for sale are measured on the same basis as securities held for trading.

#### **h) Sale and Repurchase Agreements**

Securities received as collateral under reverse repo transactions are not recognised on the Bank's balance sheet and are stated at fair value in off balance sheet accounts. The off balance sheet accounts do not reflect collateral that is subject to a short sale. The reverse repo is defined as a standard reverse repurchase transaction and also as a borrowing of securities secured by the transfer of financial assets and a purchase of securities with a concurrently negotiated resale. Securities provided as collateral under repurchase transactions are retained within the portfolio in which they were carried prior to their being provided in the repurchase transaction.

In regard to the sale of a security acquired as collateral under a reverse repurchase transaction, the Bank recognises in the balance sheet an amount payable from a security which is remeasured to fair value.

#### **i) Derivative Financial Instruments and Hedging**

In the normal course of business, the Bank enters into contracts for derivative financial instruments which represent a financial instrument that requires a very low initial investment. The derivative financial instruments used include interest rate and currency forwards, swaps, options and securities based derivatives. These financial instruments are held by the Bank for speculative purposes and in order to hedge interest rate risk and currency exposures associated with its transactions.

Derivative financial instruments are initially recognised in off balance sheet accounts at the value of the underlying instruments and are subsequently remeasured to their fair value. Fair values are obtained from quoted market prices and discounted cash flow models. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Certain derivatives are embedded in other financial instruments and are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value with unrealised gains and losses reported in the profit and loss account.

Changes in the fair value of derivatives held for trading are included in the profit and loss account line '*Net profit or loss on financial operations.*'

On the date a derivative contract is entered into, the Bank designates certain derivatives as either a hedge of the fair value of a recognised asset or liability (fair value hedge) or a hedge of a future cashflow attributable to a recognised asset or liability, a forecasted transaction or a firm commitment (cash flow hedge). Hedge accounting is used for derivatives designated in this way provided that certain criteria are met.

The Bank's criteria for a derivative instrument to be accounted for as a hedge include:

- They meet the Bank's risk management strategy;
- At the inception of the hedge, the hedging relationship is formally documented, the documentation identifies the hedged item and the hedging instrument, defines the risk that is being hedged and the approach to establishing and documenting whether the hedge is effective;
- The hedge is effective, that is, if, at inception and throughout the period, changes in the fair value or cash flows of the hedged item are almost fully offset by changes in the fair value or cash flows of the hedging instrument and the results are within a range of 80 percent to 125 percent.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that prove to be highly effective in relation to the hedged risk, are recorded in the profit and loss account along with the corresponding change in fair value of the hedged asset or liability that is attributable to the specific hedged risk. The ineffective element of the hedge is charged directly to the profit and loss account line '*Net profit or loss on financial operations.*'

#### **j) Interest Income and Expense**

Interest income and expense are recognised for all interest bearing instruments on an accruals basis. Interest income includes amortised coupons and accreted discount for all fixed income instruments.

Interest income on loans provided as part of the support of small and medium sized businesses includes additional interest income, which is also recognised on an accruals basis and paid by the State under concluded contracts.

Interest on non-performing loans is also recognised on an accruals basis and included in the balance of the relevant loan. These amounts are fully provided for.

#### **k) Penalty Interest**

Penalty interest is accounted for on an accruals basis to income solely in respect of standard and watch loans issued subsequent to 1 January 2001. Penalty interest on other loans is no longer accrued and is removed from income until collected.

#### l) Provisions for guarantees and other off balance sheet credit related commitments

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

In the normal course of business, the Bank enters into credit related commitments which are recorded in off balance sheet accounts and primarily include guarantees and undrawn loan commitments. Specific provisions are made for estimated losses on these commitments on the same basis as set out in Note 4.7.

#### n) Tangible and Intangible Fixed Assets

Tangible and intangible fixed assets are stated at historical cost less accumulated depreciation together with accumulated impairment losses. Fixed assets are depreciated through the accumulated depreciation charge. Depreciation is calculated on a straight line basis to write off the cost of each asset to their residual values over their estimated useful economic life. Land and assets in the course of construction are not depreciated.

The estimated useful economic lives in years are set out below:

Machinery and equipment, computers, vehicles, software	4 years
Fixtures, fittings and equipment	10 years
Buildings and structures	30 years

The Group periodically tests its assets for impairment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to its recoverable amount. Where assets are identified as being surplus to the Group's requirements, management of the Group determines a provision for an asset impairment. In respect of the assets owned by the Group, the provision is assessed by reference to a net selling price based on third party valuation reports adjusted downwards for an estimate of associated sale costs. Leasehold assets are provisioned by reference to the net present value of future costs and the residual value of any technical improvements.

Repairs and renewals are charged directly to the profit and loss statement when the expenditure is incurred.

#### o) Income Tax

Taxation is calculated in accordance with the provisions of the relevant legislation of the Czech Republic and other jurisdictions in which the Group operates, based on the profit recognised in the profit and loss statement prepared pursuant to Czech accounting standards and accounting standards of other jurisdictions.

Deferred income tax is provided, using the balance sheet liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred income tax is determined using tax rates effective in the periods in which the temporary tax difference is expected to be realised. The principal temporary differences arise from depreciation on property, plant and equipment, specific provisions for loans, and tax losses carried forward. Deferred tax assets in respect of tax losses carried forward and other temporary differences are recognised to the extent that it is probable that future taxable profit will be available against which the tax assets can be utilised.

#### p) Subsequent Events

The effects of events which occurred between the balance sheet date and the date when the financial statements are authorised for issue are reflected in the financial statements in the event that these events provide further

evidence of conditions which existed at the balance sheet date.

Where significant events occur subsequent to the balance sheet date prior to authorising the financial statements for issue which are indicative of conditions which arose subsequent to the balance sheet date, the effects of these events are disclosed but are not themselves reflected in the financial statements.

#### q) Regulatory Requirements

The Bank is subject to the regulatory requirements of the Czech National Bank. These regulations include limits and other restrictions pertaining to minimum capital adequacy requirements, classification of loans and off balance sheet commitments and provisioning to cover credit risk associated with the Bank's clients, liquidity, interest rate and foreign currency position.

#### r) Cash and Cash Equivalents

The Group considers cash and deposits with the CNB, treasury bills with a residual maturity of three months or less, nostro accounts with financial institutions and loro accounts with financial institutions to be cash equivalents (see Note 18).

#### s) Significant Events

The Czech Republic's accession to the European Union led to a change of the structure of the funding of the programmes designed to support small and medium sized businesses. The programmes will be funded not only from the budget of the Czech Republic but also from the budget of the European Union via structural funds. The revised conditions for funding triggered a change in the Bank's share of risks arising from lending.

With effect from 1 January 2005, the Bank has revised its treatment of accounting for the remeasurement of securities available for sale into equity. In 2004, the remeasurement was taken to the profit and loss account.

With effect from 1 January 2005, the approach to categorising securities as 'Securities acquired under initial offerings not designated for trading' has been revised. In connection with this change, the Bank reclassified a portion of this portfolio as of 1 January 2005.

### 4/ SOURCE OF PROFITS AND LOSSES

All income included in operating income was substantially generated from the provision of financial services in the Czech Republic. The Group considers that its products and services arise from one segment of business, that is, the provision of financial services.

## 4.1 INTEREST INCOME

	2004 CZK '000	2003 CZK '000
Interest on interbank transactions	349 631	619 315
Interest on loans granted to customers	194 062	170 775
Interest on loans granted to the State	1 361 403	1 342 197
Income from hedging interest rate derivatives	0	0
Interest and discount on bonds	389 035	344 894
<b>Total interest income</b>	<b>2 294 131</b>	<b>2 477 181</b>
Interest on interbank transactions	1 235 962	1 264 958
Interest on deposits and loans from customers	77 612	95 880
Interest on deposits from the State	231 408	415 622
Costs of hedging interest rate derivatives	142 114	100 806
Interest on issued bills of exchange	827	213
<b>Total interest expenses</b>	<b>1 687 923</b>	<b>1 877 479</b>
<b>Net interest income</b>	<b>606 208</b>	<b>599 702</b>

Penalty interest is included in income on a cash basis. Recorded unpaid penalty interest of CZK 500,752 thousand (2003: CZK 541,785 thousand) was not accrued to income.

## 4.2 FEE AND COMMISSION INCOME

	2004 CZK '000	2003 CZK '000
Fees and commissions from lending activities	81 023	76 063
Fees and commissions from payment transactions	188 687	166 850
Fees and commissions from transactions with securities	40	57
Fees and commissions from foreign currency transactions	34	38 243
Fees and commissions from transactions with securities and derivatives for clients	90	13
Fees and commissions from guarantees	578 792	528 020
of which: 'pricing advantage' in the form of government grant	551 914	500 213
Fees and commissions from other financial operations	13 442	12 993
<b>Total fee and commission income</b>	<b>862 108</b>	<b>822 239</b>
Fee and commission expense	33 207	25 518
<b>Total net fees and commissions</b>	<b>828 901</b>	<b>796 721</b>

## 4.3 NET PROFIT OR LOSS ON FINANCIAL OPERATIONS

	2004 CZK '000	2003 CZK '000
Profit or (loss) on the sale of securities	0	1 264
Profit or (loss) from revaluation	29 799	38 440
Profit or (loss) from foreign currency transactions	19 265	-49 135
Net change in fair value of hedging derivatives	-24 932	-374 969
Profit or (loss) on other derivatives	30 436	-3 289
<b>Total net profit or loss on financial operations</b>	<b>54 568</b>	<b>-387 689</b>

The net change in the fair value of hedging derivatives in 2003 included the net book value of the negative fair value that originated at the conclusion of derivatives totalling CZK 383,918 thousand.

#### 4.4 OPERATING INCOME AND EXPENSES

In 2003, there was a methodological change in the treatment of accounting for hedging derivatives. The negative fair value recognised through expenses in 2003 was assessed as being a tax deductible charge for 2001 and 2002 and was taken out of tax deductible expenses for 2003. This led to an increase in the tax payable of CZK 119,118 thousand for the year ended 31 December 2003. In parallel, additional tax returns for 2001 and 2002 were filed to recover the amount of CZK 119,118 thousand stated above. The anticipated recovery of this amount was accounted for through the recognition of an amount due from the taxation authorities as part of other operating income for the year ended 31 December 2004.

#### 4.5 ADMINISTRATIVE EXPENSES

	Year ended 31 December 2004 CZK '000	Year ended 31 December 2003 CZK '000
Wages, salaries and bonuses	144 672	136 970
Social security costs	47 458	44 900
<b>Employees' expenses</b>	<b>192 130</b>	<b>181 870</b>
Other administrative expenses	113 401	66 710
<b>Total administrative expenses</b>	<b>305 531</b>	<b>248 580</b>

Other administrative expenses comprise:

	Year ended 31 December 2004 CZK '000	Year ended 31 December 2003 CZK '000
Audit, legal and tax advisory services	6 601	9 476
Rental charges 13 807	13 791	
Other administrative expenses	92 993	43 443
<b>Total other administrative expenses</b>	<b>113 401</b>	<b>66 710</b>

#### Staff Analysis

	Year ended 31 December 2004	Year ended 31 December 2003
Number of members of the Supervisory Board	9	9
Number of members of the Board of Directors	5	5
Average number of managers	27	26
<b>Total number of other employees</b>	<b>228</b>	<b>232</b>

#### 4.6 DEPRECIATION AND OTHER PROVISIONS

Depreciation and other provisions comprise:

	Year ended 31 December 2004 CZK '000	Year ended 31 December 2003 CZK '000
Depreciation of tangible and intangible fixed assets	61 458	60 526
Other provisions, net	0	-470 000
<b>Total depreciation and other provisions</b>	<b>61 458</b>	<b>-409 744</b>

#### 4.7 PROVISIONS FOR LOAN LOSSES

The movement in the provisions was as follows:

	Year ended 31 December 2004 CZK'000	Year ended 31 December 2003 CZK'000
Balance at 1 January	3 661 599	3 613 688
Net creation/(release) of provisions for loan losses	-94 576	200 612
Impact of loans written off and transferred	-92 723	152 701
<b>Balance at period end</b>	<b>3 474 300</b>	<b>3 661 599</b>

The balance of provisions as of 31 December 2004 and 2003 comprises:

	Year ended 31 December 2004 CZK '000	Year ended 31 December 2003 CZK '000
Specific provisions for loans to customers (Note 8)	1 235 243	1 340 167
Provisions for guarantees and other credit related commitments (Note 16)	2 239 058	2 321 432
<b>Total</b>	<b>3 474 300</b>	<b>3 661 599</b>

#### 4.8 INCOME TAXES

	Year ended 31 December 2004 CZK '000	Year ended 31 December 2003 CZK '000
Pre-tax profit	1 265 913	1 081 521
Non-taxable income	-1 250 493	-1 140 243
Non-tax deductible expenses	1 165 978	720 705
Items decreasing/increasing tax base	-671	10 839
<b>Tax base</b>	<b>1 180 727</b>	<b>672 822</b>
Due corporate income tax rate of 28 percent (31 percent in 2003)	330 604	208 576
Deduction of half of tax withheld on dividends	0	- 24 070
Income tax – due	330 604	184 506
Income tax - deferred	-3 169	253 229
<b>Total income tax</b>	<b>327 435</b>	<b>437 735</b>

#### Profit and loss reconciliation

	31 December 2004 CZK '000	31 December 2003 CZK '000
Statutory profit and loss unconsolidated gross	1 006 346	1 081 523
Income tax charge	-327 435	-437 735
Statutory profit and loss unconsolidated net	678 911	643 788
Share on MUFIS profit	34 111	43 084
Contribution to social fund in accordance with statutory provisions	-7 326	-7 171
Decrease of provisions in IFRS	232 782	0
Revaluation of available for sale securities	0	0
<b>Profit and loss calculated in accordance with IFRS</b>	<b>943 593</b>	<b>679 701</b>

A portion of the provisions held for the portfolio of standard loans and guarantees of CZK 233 million was released as the Bank believes the amount of anticipated loss which can be quantified reduced by this amount.

## Deferred Tax

The recognised deferred tax asset can be analysed as follows:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Provisions and reserves for loans and guarantees	21 503	17 198
Other reserves and provisions	5 857	7 245
Difference between accounting and tax accumulated depreciation	804	552
Differences arising from the remeasurement of hedging derivatives	0	0
<b>Total deferred tax asset</b>	<b>28 164</b>	<b>24 995</b>
<b>Deferred tax balance at 1 January</b>	<b>24 995</b>	<b>643 864</b>
Movement through the profit and loss account	3 169	-253 229
Movement through equity	0	-365 640
<b>Deferred tax balance at 31 December</b>	<b>28 164</b>	<b>24 995</b>

The deferred tax asset is calculated taking into account the statutory income tax rate of 24 percent valid in 2006 when the Bank anticipates realising the differences.

The deferred tax liability is calculated using the statutory income tax rate valid for the period when the Bank anticipates realising the differences.

## 5/ CASH IN HAND AND CURRENT BALANCES WITH BANKS

	31 December 2004 CZK '000	31 December 2003 CZK '000
Cash in hand	8 049	8 324
Obligatory minimum reserves	134 885	136 292
<b>Total cash in hand and balance with central bank</b>	<b>142 934</b>	<b>144 616</b>

Obligatory minimum reserves represent mandatory deposits with the Czech National Bank. The deposits have borne interest at the CZK repo rate (31 December 2004: 2,50 percent p.a.).

## 6/ AMOUNTS DUE FROM BANKS

	31 December 2004 CZK '000	31 December 2003 CZK '000
Current accounts	819	2 161
Term deposits with banks and central bank	1 559 444	1 185 203
Amounts due under repo transactions	5 465 944	6 832 642
Securities acquired under initial offerings	551 835	0
Accrued interest	10 247	7 473
<b>Total amounts due from banks</b>	<b>7 588 289</b>	<b>8 027 479</b>

All amounts due from banks are presented net of provisions. No provisions were recorded in 2004 and 2003.

## 7/ TRADING SECURITIES

Trading securities comprise:

	31 December 2004		31 December 2003	
	Fair value CZK '000	Cost CZK '000	Fair value CZK '000	Cost CZK '000
Fixed income debt securities	0	0	85 459	85 459
Treasury bills	0	0	981 198	968 428
<b>Total debt securities</b>	<b>0</b>	<b>0</b>	<b>1 066 657</b>	<b>1 053 887</b>

As of 31 December 2004, bank did not have any trading securities.

As of 31 December 2003, the portfolio of trading securities included securities at a fair value of CZK 85,459 thousand that were publicly traded on stock exchanges and securities at a fair value of CZK 981,198 thousand that were not publicly traded on stock exchanges (they were traded on the interbank market).

Trading securities are denominated in CZK (refer to Note 21).

Treasury bills are eligible for rediscounting with the central bank.

Debt trading securities at fair value, allocated by issuer, comprise:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Debt trading securities issued by:		
- State institutions in the Czech Republic	0	1 066 657
- Other entities in the Czech Republic	0	0
- Other foreign entities	0	0
<b>Total trading debt securities</b>	<b>0</b>	<b>1 066 657</b>

## 8/ LOANS TO CUSTOMERS

	31 December 2004 CZK '000	31 December 2003 CZK '000
Loans to private legal entities and individuals	5 001 086	4 433 187
Loans to the Ministry of Finance	23 841 722	24 549 201
Loans to municipalities	928 397	569 673
Other receivables from customers	3	15
Securities acquired under initial offerings	892 743	0
Accrued interest	293 692	305 239
<b>Gross amounts due from customers</b>	<b>30 957 643</b>	<b>29 857 315</b>
Loan specific and general provisions (Note 4.7)	-1 235 243	-1 339 285
<b>Net amounts due from customers</b>	<b>29 722 400</b>	<b>28 518 030</b>

Loans to the Ministry of Finance principally represent loans in connection with infrastructure programs which were transferred to ČMZRB from Konsolidační banka Praha, s.p.ú., as of 31 December 2000. These programs are principally targeted at funding the construction of the highway network, repairs of international roads, removal of flooding damage and water management investments. The funding of these programs was provided by the European Investment Bank and partially also by major banks that are the Bank's shareholders.

Set out below is the currency structure of the outstanding infrastructure loan principal amounts on the side of assets and liabilities:

	31 December 2004		31 December 2003	
	Assets CZK '000	Liabilities CZK '000	Assets CZK '000	Liabilities CZK '000
CZK	19 254 307	10 049 965	18 331 251	8 043 767
EUR	6 939 255	15 575 855	7 398 504	17 625 981
USD	44 283	44 283	59 260	59 260
Fair value remeasurement	-2 396 123	-2 885 421	- 1 240 458	- 1 723 164
<b>Total</b>	<b>23 841 722</b>	<b>22 784 682</b>	<b>24 548 557</b>	<b>24 005 844</b>

The Bank entered into cross currency swap transactions to close out the open positions and to cover the associated foreign currency and interest rate exposures (refer to Note 21 (c)).

The loan portfolio of the Group as of 31 December 2003 comprises the following breakdown by classification:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Standard	26 352 174	26 795 059
Watch	2 204 739	1 525 836
Substandard	299 918	235 164
Doubtful	117 093	109 483
Loss	797 284	886 534
Securities acquired under initial offerings	892 743	0
Accrued interest	293 692	305 239
<b>Total</b>	<b>30 957 643</b>	<b>29 857 315</b>
Loan specific and general provisions (Note 4.7)	-1 235 243	-1 339 285
<b>Net amounts due from customers</b>	<b>29 722 400</b>	<b>28 518 030</b>

The loan portfolio of the Group as of 31 December 2004 comprises the following breakdown by type of collateral:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Bank guarantees and collateral by reliable guarantors	1 533 432	0
Cash collateral	10 400	13 301
Real estate collateral	2 619 062	2 401 972
Other loan collateral	908 625	2 761 002
Uncollateralised	25 886 124	24 681 040
<b>Total</b>	<b>30 957 643</b>	<b>29 857 315</b>
Loan specific and general provisions (Note 4.7)	-1 235 243	-1 339 285
<b>Net amounts due from customers</b>	<b>29 722 400</b>	<b>28 518 030</b>

Set out below is the breakdown of loans by sector:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Mining of minerals	12 806	10 620
Processing	1 586 457	1 546 333
Production and distribution of electricity, gas and water	1 350 640	1 026 774
Construction	365 689	266 972
Trade, repair of motor vehicles and products for personal consumption	897 318	764 677
Accommodation and public catering	394 952	297 167
Transportation, warehouses and communication	64 522	70 959
Financial brokerage	401 679	560 901
Insurance	1 003	1 003
Public administration and defence	24 727 918	24 762 397
Other activities	860 967	244 273
Accruals	293 692	305 239
<b>Total</b>	<b>30 957 643</b>	<b>29 857 315</b>
Loan specific and general provisions (Note 4.7)	-1 235 243	-1 339 285
<b>Net amounts due from customers</b>	<b>29 722 400</b>	<b>28 518 030</b>

## 9/ SECURITIES AVAILABLE FOR SALE

Securities available for sale comprise:

	31 December 2004 Fair value CZK '000	31 December 2003 Fair value CZK '000
Fixed income debt securities	3 637 606	5 279 636
Variable yield debt securities	2 333 019	1 940 249
Treasury bills	2 308 216	1 097 266
<b>Total securities available for sale</b>	<b>8 278 841</b>	<b>8 317 151</b>

As of 31 December 2004, the available-for-sale portfolio includes securities at a fair value of CZK 7,059,155 thousand (2003: CZK 6,759,107 thousand) that are publicly traded on stock exchanges and securities at a fair value of CZK 1,219,686 thousand (2003: CZK 1,558,044 thousand) that are not publicly traded securities.

The available securities are denominated in various currencies (see Note 21).

Treasury bills are eligible for rediscounting with the central bank.

Debt securities available for sale at fair value, allocated by issuer, comprise:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Debt securities available for sale issued by:		
- State institutions in the Czech Republic	4 041 121	2 454 806
- Financial institutions in the Czech Republic	913 636	1 683 561
- Foreign financial institutions	2 185 244	1 934 383
- Other entities in the Czech Republic	573 325	1 332 820
- Other foreign entities	565 515	911 581
<b>Total debt securities available for sale</b>	<b>8 278 841</b>	<b>8 317 151</b>

## 10/ INVESTMENTS HELD TO MATURITY

Investments held to maturity comprise:

	31 December 2004 Carrying value CZK '000	31 December 2003 Carrying value CZK '000
Fixed income debt securities	1 706 143	675 076
<b>Total investments held to maturity</b>	<b>1 706 143</b>	<b>675 076</b>

As of 31 December 2003, the Group's held-to-maturity portfolio includes CZK 356,406 thousand (2003: CZK 348,667 thousand) state bonds that are publicly traded on stock exchanges. Remaining balance are bonds not traded on securities exchange.

State bond in amount of CZK 939,784 thousand (2003: CZK 352,867 thousand) are eligible for rediscounting with the central bank.

Investments held to maturity, allocated by issuer, comprise:

Debt securities held to maturity issued by:	31 December 2004 CZK '000	31 December 2003 CZK '000
State institutions in the Czech Republic	1 152 106	352 867
Foreign financial institutions	356 406	322 209
Other entities in the Czech Republic	197 631	0
<b>Total debt securities held to maturity</b>	<b>1 706 143</b>	<b>675 076</b>

## 11/ PREPAYMENTS, ACCRUED INCOME AND OTHER ASSETS

Prepayments, accrued income and other assets comprise:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Receivables from unsettled transactions with securities	700	705
Accrued expenses and deferred income	111 815	76 621
Other receivables and other assets	201 435	50 853
<b>Other assets, gross</b>	<b>313 950</b>	<b>128 179</b>
Impairment provisions (Note 4.7 )	-249	-947
<b>Other assets, net</b>	<b>313 701</b>	<b>127 232</b>

## 12/ INVESTMENTS IN ASSOCIATES

The Bank's consolidated financial statements include an investment in the associate, MUFIS, a.s., having its registered office address at Jeruzalémská 964/4, Prague 1 ('MUFIS'), whose key details are set out below.

The Bank formed MUFIS as a wholly owned subsidiary with share capital of CZK 1 million in 1994. In 1995, the Bank disposed of 51 percent of the issued share capital and holds a 49 percent investment in MUFIS as of 31 December 2004.

Shareholder structure	2004	2003
Českomoravská záruční a rozvojová banka, a. s.	49 %	49 %
Ministry of Finance	49 %	49 %
Association of Czech Municipalities	2 %	2 %

MUFIS acts as the official broker and administrator of long-term funding obtained on the basis of an agreement with USAID from private US investors. This funding is designed to finance the infrastructure projects of municipalities. The ultimate beneficiaries are provided with the funding following an assessment of their business plans, through a selected number of commercial banks which act as MUFIS's debtors.

Following preparatory negotiations with US investors and Czech institutions, MUFIS began to implement the program in early 1995 by taking on the first loan of USD 20 million. In August 1996, an amendment to the intergovernmental agreement was signed whereby both governments provided guarantees in respect of the issuance of another loan of USD 14 million. In the latter half of 1997, the parties discussed and signed a second amendment to the Program Agreement which enabled MUFIS to enter into a USD 10 million loan agreement. In accordance with this agreement, in February 1998 MUFIS took on a third loan to further finance lending under the Housing Guaranty Program in the Czech Republic. At present, MUFIS is working with program funding from the three loans amounting to USD 44 million.

### Significant Events

In accordance with applicable accounting procedures and principles, foreign currency denominated receivables and payables were retranslated into CZK. The retranslation gave rise to an unrealised gain of CZK 152,558 thousand as a result of a notable decrease in the US dollar rate.

### Summary Audited Financial Information

	Equity CZK '000	The Bank's share of equity CZK '000	Total assets CZK '000	Income CZK '000	Profit/(loss) before tax CZK '000
At 31 December 2004 and for the year then ended	198 239	97 137	1 444 792	636 890	69 615
At 31 December 2003 and for the year then ended	128 623	63 025	1 460 342	1 703 540	87 928

## 13/ TANGIBLE AND INTANGIBLE FIXED ASSETS

### Intangible Fixed Assets

	31 December 2003 CZK '000	Additions CZK '000	Disposals CZK '000	31 December 2004 CZK '000
<b>Cost</b>				
Software	120 464	28 072	0	148 536
Other	79 558	0	0	79 558
Fixed assets under construction and prepayments	10 146	18 918	28 940	124
<b>Total</b>	<b>210 168</b>	<b>46 990</b>	<b>28 940</b>	<b>228 218</b>
<b>Accumulated amortisation</b>				
Software	101 421	18 336	0	119 757
Goodwill	0	0	0	0
Other	64 453	10 070	0	74 523
<b>Total</b>	<b>165 874</b>	<b>28 406</b>	<b>0</b>	<b>194 280</b>
<b>Net book value</b>	<b>44 294</b>			<b>33 938</b>

## Tangible Fixed Assets

	31 December 2003 CZK '000	Additions CZK '000	Disposals CZK '000	31 December 2004 CZK '000
<b>Cost</b>				
Land	10 544	0	0	10 544
Buildings	298 161	834	0	298 995
Equipment and fittings	135 765	19 204	3 838	151 131
Fixed assets under construction and prepayments made	4 541	25 111	29 647	5
<b>Total</b>	<b>449 011</b>	<b>45 149</b>	<b>33 485</b>	<b>460 675</b>
<b>Accumulated depreciation</b>				
Buildings	57 676	16 196	0	73 872
Equipment and fittings	119 993	16 857	3 785	133 065
<b>Total</b>	<b>177 669</b>	<b>33 053</b>	<b>3 785</b>	<b>206 937</b>
<b>Net book value</b>	<b>271 342</b>			<b>253 738</b>

## 14/ AMOUNTS DUE TO BANKS

	31 December 2004 CZK '000 Accounting value	31 December 2003 CZK '000 Accounting value
Loans received from banks	26 385 818	26 215 083
Change in fair values of loans received from EIB	-2 885 421	-1 723 164
Change in fair values of other loans	19 255	0
Received term deposits	3 550 000	2 829 000
Loans received under repo transactions	1 658 771	1 357 382
Accrued interest	242 738	259 059
<b>Total amounts owed to banks</b>	<b>28 971 161</b>	<b>28 937 360</b>

Of the aggregate balance of amounts loans received from banks, the payable to the European Investment Bank (EIB) amounts to CZK 25,670,103 thousand (2003: CZK 25,729,008 thousand).

## 15/ AMOUNTS DUE TO CUSTOMERS

Amounts due to customers, by type of deposit, comprise:

	31 December 2004 CZK '000 Accounting value	31 December 2003 CZK '000 Accounting value
Current accounts	5 304 397	4 905 299
Term deposits	1 236 066	1 756 774
Repo operations with clients	0	116 660
Other credits received from clients	10 000	5 000
Security deposits	23 642	28 199
Other payables to clients	2 751 060	2 757 792
<b>Total amounts owed to customers</b>	<b>9 325 165</b>	<b>9 569 724</b>

Amounts due to customers, by type of customer, comprise:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Amounts owed to state institutions	7 112 866	6 448 769
Amounts owed to local government institutions	25 629	117 254
Amounts owed to social security funds	300 967	561 048
Payables to other customers	1 884 770	2 439 674
Accrued interest	933	2 979
<b>Total amounts owed to customers</b>	<b>9 325 165</b>	<b>9 569 724</b>

The 'Amounts owed to state institutions' line includes, *inter alia*, payables comprising funds to cover risks attached to the Regional Guarantee, Prefab and Reconstruction Programs. The structure of these payables is as follows:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Support programs funding	2 272 787	2 179 973
Fund to cover risks attached to the Regional Guarantee, Prefab and Reconstruction Programs	912 205	847 702

## 16/ ACCRUALS, PROVISIONS AND OTHER LIABILITIES

Accruals, provisions and other liabilities comprise:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Other liabilities to employees	7 326	0
Deferred expenses and accrued income	1 619 823	1 383 175
Other	96 707	59 917
<b>Total accruals, provisions and other liabilities</b>	<b>1 723 856</b>	<b>1 443 092</b>

Movements in reserve balances can be analysed as follows:

	Provisions for issued guarantees CZK '000	General reserves for financial investments and risks CZK '000	Provisions for loan commitments CZK '000	Other provisions CZK '000	Total CZK '000
At 1 January 2003	2 232 456	470 000	0	27 262	2 729 718
Creation	506 607	0	0	29 880	536 487
Use	-417 631	-470 000	0	-27 262	-914 893
At 31 December 2003	2 321 432	0	0	29 880	2 351 312
Creation	476 151	0	55 825	363 006	894 982
Use	-606 925	0	-7 425	-371 299	-985 649
At 31 December 2004	2 190 658	0	48 400	21 587	2 260 645

Other reserves represents reserve for unused vacation calculated based on days of unused vacation per individual employee and their average wage and reserve for bonuses of management pending on the decision of annual general meeting.

## 17/ EQUITY AND PROFIT ALLOCATION

### Share capital

	31 December 2004 CZK '000	31 December 2003 CZK '000
<b>8,900 shares with a nominal value of CZK 239,500</b>	<b>2 131 550</b>	<b>2 131 550</b>

*The shares are registered and issued in the book-entry form.*

During the year ended 31 December 2003, the Bank raised additional share capital of CZK 155,755 thousand from retained earnings by increasing the nominal value of each share by CZK 17,500.

The amount of share capital as of 31 December 2004 recorded in the Register of Companies was CZK 2,131,550 thousand. The capital increase referred to above was registered on 19 November 2003.

The Bank's shareholders and their ownership interests as of 31 December 2004 and 2003 are set out below:

Name	2004 %	2003 %
Ministry of Industry and Trade	24,25	24,25
Ministry for Regional Development	24,25	24,25
Ministry of Finance	23,83	23,83
Komerční banka, a. s.	13,00	13,00
Česká spořitelna, a. s.	13,00	13,00
Československá obchodní banka, a. s.	1,67	1,67
<b>Total</b>	<b>100,00</b>	<b>100,00</b>

### Profit Allocation

The net profit for the year ended 31 December 2004 is proposed to be allocated as follows:

- CZK 407,620 thousand will be distributed as dividends,
- the rest will be transferred to retained earnings.

## 18/ COMPOSITION OF CASH AND CASH EQUIVALENTS AS REPORTED IN THE CASH FLOW STATEMENT

	31 December 2004 CZK '000	31 December 2003 CZK '000	Change in the year CZK '000
Cash and balances with central bank	142 934	144 616	1 682
Current accounts with other banks	819	2 161	1 342
Treasury bills	498 815	1 003 277	504 462
<b>Total</b>	<b>642 568</b>	<b>1 150 054</b>	<b>507 486</b>

## 19/ CONTINGENT LIABILITIES

Commitments to extend loans, guarantees for loans to third parties and letters of credit expose the Bank to credit risk and losses in the event that the client fails to comply with contractual conditions. In the normal course of its business, the Bank incurs various commitments and potential liabilities which carry an element of credit risk, interest rate risk and liquidity risk.

Contingent liabilities can be analysed as follows:

	31 December 2004 CZK '000	31 December 2003 CZK '000
Total issued client guarantees	9 325 727	8 201 122
Commitments issued to clients	1 378 751	4 218 708
<b>Total balance of off balance sheet commitments</b>	<b>10 704 478</b>	<b>12 419 830</b>

Management of the Bank believes that as of 31 December 2004 the Bank has no commitments arising from its activities as a trustee.

In conducting repo and reverse repo transactions, the Bank exclusively uses bonds and other income-earning securities. Receivables from reverse repo transactions are included in amounts due from banks (Note 6).

Payables from repo transactions are included in amounts owed to banks and clients (Notes 14 and 15).

### Contingencies

On 21 February 2002 a Czech company, AO Invest, spol. s r. o., filed a legal action against the Bank asking for CZK 237,883 thousand in damages. The plaintiff has indicated that the damage was incurred in connection with the brokered purchase of 1,050 bonds of ZPS, a.s. originally held by the Bank. The lawsuit has not yet been completed, it has been postponed due to the declaration of bankruptcy of AO Invest, spol. s r. o. The court ruled that the current plaintiff may be replaced by a new plaintiff, Panaglobal INVEST, a. s. The Bank has appealed against this ruling. It is not probable that the case will lead to an unfavourable result for the Bank.

## 20/ RELATED PARTY TRANSACTIONS

Major payables and receivables to related parties of the Bank are:

	31 December 2004 CZK '000	31 December 2003 CZK '000
<b>Amounts due from banks</b>		
Komerční banka, a. s. – current account	311	249
Komerční banka, a. s. – term deposit	150 000	0
Komerční banka, a. s. – initial offerings	445 123	0
Česká spořitelna, a. s. – term deposit – repo	743 944	0
<b>Amounts due from customers</b>		
Ministry of Finance	23 841 722	24 549 201
<b>Amounts due to banks</b>		
Česká spořitelna, a. s. – loan	100 000	100 000
Česká spořitelna, a. s. – deposit – repo	1 658 771	49 740
<b>Amounts due to customers</b>		
MUFIS, a. s. - current account	7 831	12 478
MUFIS, a. s. - term deposit	258 800	294 280
Ministry of Industry and Trade	3	3
Ministry for Regional Development	92	27
Ministry of Finance	2 249 411	1 853 565

## Major items of profit and loss earned or paid to related parties are:

	31 December 2004 CZK '000	31 December 2003 CZK '000
<b>Interest income</b>		
Komerční banka, a. s.	2 432	4 390
Česká spořitelna, a. s.	2 290	37 191
Ministry of Finance	1 105 285	1 341 121
<b>Interest expense</b>		
Komerční banka, a. s.	5	26
Česká spořitelna, a. s.	14 657	42 024
Ministry of Finance	12 548	10 610
<b>Commission income</b>		
Ministry for Regional Development	45 941	46 806
Ministry of Industry and Trade	551 914	500 213
Ministry of Finance	104 773	89 326
<b>Commission expense</b>		
Ministry for Regional Development	14 405	15 380

## 21/ RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

## a) Credit Risk

## Credit Rating of Borrowers

The credit rating of borrowers that are small and medium sized businesses, municipalities, water management enterprises, housing associations and associations of owners of housing units and not-for-profit organisations is undertaken in accordance with the Bank's internal regulations and involves assessing the borrower's solvency on the basis of an analysis of economic and other aspects. The assessment of other than economic aspects involves analysing external and internal factors that impact on the client's activities and operations. The economic assessment focuses on undertaking a financial analysis of economic indicators and additional information. Solvency is evaluated in relation to each transaction that carries an element of credit risk and credit risk exposure is periodically assessed over the whole life of the loan transaction. Credit risk is expressed by assigning the borrower into the relevant risk category. Credit risk exposure involved in a specific transaction is controlled by establishing contractual conditions and obtaining collateral in support of the transaction.

## Measuring Credit Risk of the Portfolio

The Bank uses the following techniques in measuring risks inherent in the loan and guarantee portfolio:

*The method of a quantified loss* on the portfolio of on and off balance sheet exposures compares total quantified losses on doubtful and loss receivables with the repaid balance of the exposures. The quantification of anticipated losses also reflects the current balances of substandard exposures adjusted by an empirical and well-established coefficient which represents an estimate of the default rate of exposures in this category.

*The weighted risk exposure method* compares the weighted risk exposure with the original contractual amount of the loans (the balance of the actual loan draw-down) and guarantees. The weighted risk exposure consists of the sum of recorded provisions, the sum of receivables written-off, the sum of outstanding principal, the sum of outstanding interest and the sum of outstanding contractual penalties on client accounts, segmented by individual years of the portfolio's duration.

*The risk category method* compares quantified losses including off balance sheet values (sanctions) with the original contractual value of the loans or guarantees.

In measuring credit risk attached to guarantee and loan receivables the Bank largely uses software systems for assessing both economic and other than economic aspects of the credit risk, depending on the type of the client, transaction volume and degree of credit risk carried by the Bank. Principles to be followed in identifying, measuring and monitoring credit risk are outlined in the Bank's internal regulations, that is, due consideration is given to the fact whether the transactions are effected by the business division or the financial services division. A set of limits is approved for credit risk management purposes.

### **Risk Categories**

The Bank has risk categories 5 to 10, which are linked to Czech National Bank risk categories. Standard loans 5 and 6, watch 7, substandard 8, doubtful 9 and loss 10.

In respect of transactions entered into on financial markets and issuers of securities, solvency of the borrower is assessed on the basis of ratings published by internationally recognised rating agencies and evaluation of economic and other aspects. The solvency of counter-parties and issuers is periodically assessed over the whole life of the loan transaction.

### **Provisioning and Loan Collateral**

The Bank records provisions against amounts due from individual borrowers by reference to the uncovered exposure which represents the balance receivable after deducting the net recoverable value of collateral multiplied by a risk coefficient in accordance with the relevant ČNB regulation.

Movable and immovable asset collateral is recorded in memorandum accounts and is valued on the basis of an appraisal prepared by a licensed appraiser (nominal value of collateral). The Bank centrally re-values real estate collateral to market values once in two years on the basis of pricing maps prepared by an external agency. Guarantees provided by individuals and legal entities and bills of exchange are recorded in memorandum accounts and are valued at values established pursuant to the Bank's internal regulation.

The recoverable value of collateral takes into account both the cost of recovering collateral and the time value of money.

If the borrower's on balance sheet receivable is past due by more than 360 days, the Bank does not attribute any value to the collateral. In assessing the solvency of individual receivables, the Bank does not draw upon the services of external agencies.

The Bank records reserves for off balance sheet receivables from individual borrowers in respect of uncovered risk which represents the balance of the off balance sheet exposure net of net recoverable value of collateral multiplied by a risk coefficient in accordance with the relevant ČNB regulation. The collateral may be held by ČMZRB or the lending bank. ČMZRB records the collateral held by the lending bank in circumstances where the use of the guaranteed loan is conditional upon the signing of pledge agreements. In connection with the provision of 'zone guarantees' ČMZRB does not account for the collateral held by the lending bank.

Immovable and movable asset collateral is recorded on a similar basis as is the case with loans.

### **Recovery of Amounts due from Borrowers**

The Bank recovers due receivables arising from bank guarantees and loans through its internal debt work-out system by using all statutory recovery instruments available according to generally applicable legal regulations. With a view to expediting the recovery process, the Bank has employed an arbitration clause in respect of loan contracts (beginning 2000) and enforceable notarial and distrainer deeds.

### **The Bank Approach to Recovering Amounts due from Housing Products**

Recovery of all receivables is exclusively within the remit of the relevant taxation authority. The Bank supplies information regarding a borrower's default on loan conditions and past due receivables and if the borrower does not provide evidence as to the compliance with the loan conditions and does not pay the outstanding balance, the Bank sends to the relevant taxation authority a motion to commence proceedings regarding the unauthorised use of the funds of the State budget. On the basis of a report of the taxation authority regarding the result of the investigation and issuance of a payment assessment, the receivables are settled from the funds of the State budget intended for financing the program.

### **The Bank's Approach to Imposing Penalties for the Failure to Comply with the Conditions set out in the START Program**

The Bank informs the taxation authority to impose a penalty for the failure to comply with the conditions set out in the program when the conditions are breached. Without undue delay, the Bank provides the relevant taxation authority that operates in the area, in which the borrower has its registered office, with information and evidence documenting that the conditions of the program have been breached and that penalties may be imposed. If conditions underlying a program under which an advantageous loan was issued were breached, the Bank halts the further use of the loan and calls for its instant repayment, files a motion with the taxation authority regarding the imposing of a penalty and settles the receivable from the funds of the State budget intended for financing the program.

### **Advantageous Loans within the Operating Programme Industry and Enterprise ('Operační program Průmysl a podnikání – the OPPP Programme')**

With effect from 1 July 2004, the Bank has been providing advantageous loans under the OPPP Programme. The loans are granted to clients with a zero interest rate (loans under the Start Programme) or with an advantageous interest rate relative to market interest rates (loans in the Kredit and Inovace Programmes). The products are financed from the state budget, structural funds and funding obtained by the Bank in the financial market. The ratio between the state budget and structural funds and the Bank's funds is 60:40. Any breach of the conditions of the programme triggers an instant repayment of the loan. If the loan is not repaid, the Bank calls for the taxation authorities to claim a payment from the state budget and, in parallel, according to the rules agreed-upon with the Ministry of Industry and Trade, settles the loan receivable with a charge against the state budget and EU structural funds which participated in the funding of the loans.

### **Advantageous Loans in the Kredit Programme**

#### **Standard Advantageous Loan**

The amount of the advantageous loan ranges from CZK 2 million to CZK 5 million with maturity up to six years and an interest rate of 4 percent p. a. The loan is available to small businesses with a minimum of two and maximum of five closed successive taxation periods. The loan is collateralised only by a bill of exchange issued by the beneficiary of the support endorsed by no less than one individual or legal entity.

### **Subordinated Loan**

This is a loan ranging from CZK 2 million to CZK 7 million, with maturity up to eight years, grace period up to five years, and a fixed interest rate of 3 percent p. a. The loan is available to small businesses with a minimum of two closed successive taxation periods. The subordination of the loan stems from the business conditions underlying the loan contract between the client and the Bank. By entering into the subordinated loan contract, the Bank agrees that a client's obligations to repay the loan principal amount under the subordinated loan contract will be, until the first loan repayment, subordinated to all other both collateralised and uncollateralised cash obligations that originated before, in parallel or subsequent to the conclusion of the subordinated loan contract. The loan is collateralised only by a bill of exchange issued by the beneficiary of the support endorsed by no less than one individual or legal entity.

### **Small Loan**

This is a loan ranging from CZK 0.2 million to CZK 2 million, with maturity up to five years and interest at 4 percent p. a. The loan is available to small businesses with a minimum of five closed successive taxation periods. The loan is collateralised only by a bill of exchange issued by the beneficiary of the support endorsed by no less than one individual or legal entity

### **The Start Programme**

As part of this programme, the Bank provides interest-free loans of up to CZK 1 million with maturity up to six years to persons that start a business. New businessmen represent persons that were registered as income tax payers with the taxation authorities in the year in which the application for support was filed or in the previous year. The loan is collateralised only by a bill of exchange issued by the beneficiary of the support.

### **The INOVACE Programme**

Small and medium sized businesses with a minimum of three closed successive taxation periods are entitled to receive a loan of CZK 50 million with maturity up to nine years, grace period up to four years, and a fixed interest rate of 3 percent p. a., to implement innovation projects. In order to mitigate credit risk, the Bank uses collateral to the extent set out in its internal regulations.

### **Risk Concentration**

The Bank principally monitors risk concentrations in the area of guarantees for loans to small and medium sized businesses, loans issued to small and medium sized businesses and receivables arising primarily from water management loans. The bulk of these loans and guarantees are provided in cooperation with the State administration and given that the State participates in covering a portion of risks inherent in certain transactions, the risk is spread among a number of entities. With a view to eliminating the risks, the Bank does not enter into any hedging derivatives or reallocate its positions. The Bank manages the level of credit risk undertaken by establishing limits for risks acceptable in respect of one borrower, Group of economically linked borrowers and territorial segments. These risks are periodically monitored and reassessed on an annual basis or even more frequently. Credit risk limits are approved by the Board of Directors.

### **Financial Market Instruments**

In accordance with its internal regulations, the Bank defines financial instruments in which investments can be made. These principally involve deposits, bonds (mortgage bonds, CZK bonds, eurobonds and foreign currency bonds), bills of exchange, and derivatives (FRA, CCS, IRS). Counter-parties in transactions entered into on financial markets and issuers of securities can include only entities from the zone A states. Credit assessment of counter-parties and issuers involves analysing the borrower's solvency on the basis of credit ratings published by internationally recognised rating agencies and evaluating economic and other aspects. The solvency of counter-parties and issuers is periodically assessed over the whole life of the commercial loan transaction.

### Development Loans Taken over from Konsolidační banka, s. p. ú.

Loans of CZK 26,237,845 thousand predominantly comprise loans issued to the Ministry of Finance which were taken over from Konsolidační banka, s. p. ú., as of 31 December 2000. These loans are principally designed to fund the development of infrastructure in the Czech Republic.

### Analysis by territorial segment

#### 31 December 2004

Assets	Czech Republic CZK '000	European Union CZK '000	Other CZK '000	Provisions and accumulated depreciation CZK '000	Total CZK '000
Cash and current balances with banks	142 934	0	0	0	142 934
Amounts due from banks	6 688 289	900 000	0	0	7 588 289
Positive fair value of derivative financial transactions	347 477	0	0	0	347 477
Trading securities	0	0	0	0	0
Loans to customers, net	30 957 643	0	0	-1 235 243	29 722 400
Available for sale securities	5 528 082	2 349 721	401 038	0	8 278 841
Investments held to maturity	1 349 737	356 406	0	0	1 706 143
Prepayments, accrued income and other assets	188 948	124 753	0	0	313 701
Deferred tax asset	28 164	0	0	0	28 164
Investments in associates	97 137	0	0	0	97 137
Tangible and intangible fixed assets	688 893	0	0	-401 217	287 676
<b>Total</b>	<b>46 017 304</b>	<b>3 730 880</b>	<b>401 038</b>	<b>-1 636 460</b>	<b>48 512 762</b>

#### 31 December 2003

Assets	Czech Republic CZK '000	European Union CZK '000	Other CZK '000	Provisions and accumulated depreciation CZK '000	Total CZK '000
Cash and current balances with banks	144 616	0	0	0	144 616
Amounts due from banks	8 027 479	0	0	0	8 027 479
Trading securities	1 066 657	0	0	0	1 066 657
Positive fair values of financial derivative transactions	338 803	0	0	0	338 803
Loans to customers, net	29 857 250	0	0	-1 339 220	28 518 030
Available for sale securities	5 471 187	2 464 636	381 328	0	8 317 151
Investments held to maturity	352 867	322 209	0	0	675 076
Prepayments, accrued income and other assets	82 746	44 486	0	0	127 232
Deferred tax asset	24 995	0	0	0	24 995
Investments in associates	63 025	0	0	0	63 025
Tangible and intangible fixed assets	660 125	0	0	-344 489	315 636
<b>Total</b>	<b>46 089 750</b>	<b>2 831 331</b>	<b>381 328</b>	<b>-1 683 709</b>	<b>47 618 700</b>

### Summary of Restructured Receivables

Year	Balance in CZK '000*	Number
2004	181 066	75
2003	138 838	50

\* Balances presented together with default interest recorded off balance sheet.

### b) Market Risks

#### Characteristics of Market Risks

The principal market risk management strategy is defined in the Bank's internal regulations and documents approved by the Board of Directors of the Bank and primarily provides guidance on the following areas:

- Acceptable degree of market risks;
- Market risk management techniques;
- Set of limits used; and
- Basic requirements regarding the Bank's organisational structure in terms of market risk management, including segregation of duties and information flows.

#### Description of Transactions Carrying Market Risks

The Bank is exposed to market risks associated with losses arising from fluctuations in prices, exchange rates and financial market rates.

The Bank is exposed to market risks in acquiring, holding and selling investment instruments defined in the Investment Strategy of ČMZRB, a. s. This risk arises from open positions in interest rates and currencies.

#### Market Risk Measurement

The Bank measures interest rate risk using basic techniques (interest rate GAP analysis, duration, elasticity of interest rates) and techniques to calculate capital adequacy as set out in the CNB Regulation 333/2002 Coll. In addition, the Bank has developed a series of internal limits to restrict its market risk exposure. The interest rate GAP analysis measures interest rate risk inherent in the trading and banking book on a collective basis. Interest rate risk is restricted through limits to net interest rate exposure in each time bucket. Interest rate risk inherent in all bond portfolios is restricted by having a limit in place in respect of the elasticity of the bond portfolio. The Bank undertakes stress testing only to a limited extent.

#### Market Risk Management

The Bank's instrument for managing market risks involves the external capital adequacy limit and internal limits for interest rate risk and elasticity of the interest rate in respect of the bond portfolio. In addition, the market risk is mitigated through the implementation of an internal capital adequacy limit. Foreign currency risk is controlled through the use of the limits set out in the CNB Regulation 333/2002 Coll.

Interest rate risk limits restrict the size of interest rate GAP in each time bucket of an interest rate GAP analysis in relation to the Bank's capital and are expressed in percentage terms.

The limit for elasticity of the interest rate in respect of the bond portfolio restricts the market risk associated with all bond portfolios together with derivatives hedging risk arising from the change of exchange rates when the Bank holds foreign currency bonds.

The Bank's internal capital adequacy limit sets out requirements that are more stringent than the external capital adequacy limit established by the banking regulator.

### c) Financial Derivatives

Trading derivatives are derivatives for which the Bank does not monitor hedge effectiveness even though they are used for risk management purposes.

#### Trading Derivatives

	31 December 2004		31 December 2003	
	Notional value	Notional value	Notional value	Notional value
	Asset CZK '000	Liability CZK '000	Asset CZK '000	Liability CZK '000
<b>Interest rate derivatives</b>				
FRAs	0	0	1 000 000	1 000 000
Swaps	100 000	100 000	200 000	200 000
<b>Currency derivatives</b>				
Forwards	693 340	690 620	842 618	839 486
Swaps	1 006 994	961 388	1 081 748	1 040 636
<b>Total</b>	<b>1 800 334</b>	<b>1 752 008</b>	<b>3 124 366</b>	<b>3 080 122</b>

	31 December 2004		31 December 2003	
	Positive fair value	Negative fair value	Positive fair value	Negative fair value
	CZK '000	CZK '000	CZK '000	CZK '000
<b>Interest rate derivatives</b>				
FRAs	0	0	12	0
Swaps	0	6 950	0	13 792
<b>Currency derivatives</b>				
Forwards	168 958	166 239	147 392	144 261
Swaps	147 638	117 959	112 193	95 379
<b>Total</b>	<b>316 596</b>	<b>291 148</b>	<b>259 597</b>	<b>253 432</b>

Set out below is the maturity analysis of trading derivatives as of 31 December 2004:

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Total CZK '000
Interest rate swaps	0	0	0	100 000	100 000
Forwards	693 340	0	0	0	693 340
Swaps	50 381	45 698	847 515	63 400	1 006 994
<b>Total</b>	<b>743 721</b>	<b>45 698</b>	<b>847 515</b>	<b>163 400</b>	<b>1 800 334</b>

Set out below is the maturity analysis of trading derivatives as of 31 December 2003:

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Total CZK '000
FRAs	0	1 000 000	0	0	1 000 000
Interest rate swaps	200 000	0	0	0	200 000
Forwards	55 406	55 314	731 898	0	842 618
Currency swaps	54 506	48 107	947 255	31 880	1 081 748
<b>Total</b>	<b>309 912</b>	<b>1 103 421</b>	<b>1 679 153</b>	<b>31 380</b>	<b>3 124 366</b>

#### Hedging Derivatives

	31 December 2004		31 December 2003	
	Notional value Asset CZK '000	Notional value Liability CZK '000	Notional value Asset CZK '000	Notional value Liability CZK '000
Interest swaps	557 556	557 556	0	0
Cross currency swaps	9 606 100	10 209 658	10 446 832	10 540 337
<b>Total</b>	<b>10 163 656</b>	<b>10 767 214</b>	<b>10 446 832</b>	<b>10 540 337</b>

	31 December 2004		31 December 2003	
	Positive fair value CZK '000	Negative fair value CZK '000	Positive fair value CZK '000	Negative fair value CZK '000
Interest swaps	6 283	296	0	0
Cross currency swaps	24 597	1 469 600	79 206	1 017 805
<b>Total</b>	<b>30 880</b>	<b>1 469 896</b>	<b>79 206</b>	<b>1 017 805</b>

Set out below is the maturity analysis of hedging derivatives as of 31 December 2004:

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Total CZK '000
Interest swaps	441 854	876 348	5 163 375	3 124 523	9 606 100
Cross currency swaps	0	100 000	350 289	107 267	557 556
<b>Total</b>	<b>441 854</b>	<b>976 348</b>	<b>5 513 664</b>	<b>3 231 790</b>	<b>10 163 656</b>

Set out below is the maturity analysis of hedging derivatives as of 31 December 2003:

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Total CZK '000
Cross currency swaps	398 397	861 858	4 686 294	4 500 282	10 446 832

#### d) Foreign Currency Risk

The Bank's financial position and cash flows are exposed to the risks of changes in exchange rates of common foreign currencies. The Bank monitors its foreign currency positions on a daily basis. In the event that the Bank breaches limits, it undertakes measures as outlined in its internal regulations relating to foreign currency exposure limits.

The table below provides summary information about the Bank's exposure to foreign currency risk. The tables sets out foreign currency assets and liabilities at carrying values, analysed by currency.

#### 31 December 2004

	CZK CZK '000	EUR CZK '000	USD CZK '000	SKK CZK '000	GBP CZK '000	Others CZK '000	Total CZK '000
Cash and current balances with banks	142 924	8	0	2	0	0	142 934
Amounts due from banks	7 578 421	9 508	360	0	0	0	7 588 289
Trading securities	0	0	0	0	0	0	0
Positive fair value of derivatives	347 477	0	0	0	0	0	347 477
Loans to customers, net	22 731 582	6 946 352	44 466	0	0	0	29 722 400
Securities available for sale	7 541 200	191 115	246 567	0	0	299 959	8 278 841
Investments held to maturity	1 706 143	0	0	0	0	0	1 706 143
Prepayments, accrued income and other assets	307 736	5 965	0	0	0	0	313 701
Deferred tax asset	28 164	0	0	0	0	0	28 164
Investments in associates	97 137	0	0	0	0	0	97 137
Tangible and intangible fixed assets	287 676	0	0	0	0	0	287 676
<b>Total</b>	<b>40 768 460</b>	<b>7 152 948</b>	<b>291 393</b>	<b>2</b>	<b>0</b>	<b>299 959</b>	<b>48 512 762</b>
Amounts due to banks	12 427 050	16 499 645	44 466	0	0	0	28 971 161
Amounts due to customers	9 305 551	19 261	353	0	0	0	9 325 165
Negative fair value of financial derivative transactions	1 761 044	0	0	0	0	0	1 761 044
Accruals, provisions and other liabilities	1 723 697	0	153	0	6	0	1 723 856
Income taxes payable	113 927	0	0	0	0	0	113 927
Provisions for loan losses	2 260 645	0	0	0	0	0	2 260 645
Equity	4 356 965	0	0	0	0	0	4 356 965
<b>Total</b>	<b>31 948 879</b>	<b>16 518 906</b>	<b>44 972</b>	<b>0</b>	<b>6</b>	<b>0</b>	<b>48 512 762</b>
On balance sheet position, net	8 819 581	-9 365 958	246 421	2	-6	299 959	0
Off balance sheet position, net	-12 473 032	9 257 956	-223 650	0	0	-272 668	-3 711 394
<b>Net position</b>	<b>-3 653 451</b>	<b>-108 002</b>	<b>22 771</b>	<b>2</b>	<b>-6</b>	<b>27 291</b>	<b>-3 711 394</b>

## 31 December 2003

	CZK CZK '000	EUR CZK '000	USD CZK '000	SKK CZK '000	GBP CZK '000	Total CZK '000
Cash and current balances with banks	144 583	21	5	3	4	144 616
Amounts due from banks	8 009 463	16 345	1 671	0	0	8 027 479
Trading securities	1 066 657	0	0	0	0	1 066 657
Positive fair value of financial derivative transactions	338 803	0	0	0	0	338 803
Loans to customers, net	21 052 191	7 406 332	59 507	0	0	28 518 030
Securities available for sale	8 046 157	34 905	236 089	0	0	8 317 151
Investments held to maturity	675 076	0	0	0	0	675 076
Prepayments, accrued income and other assets	116 860	10 372	0	0	0	127 232
Deferred tax asset	24 995	0	0	0	0	24 995
Investments in associates	63 025	0	0	0	0	63 025
Tangible and intangible fixed assets, net	315 636	0	0	0	0	315 636
<b>Total</b>	<b>39 853 446</b>	<b>7 467 975</b>	<b>297 272</b>	<b>3</b>	<b>4</b>	<b>47 618 700</b>
Amounts due to banks	10 532 715	18 345 138	59 507	0	0	28 937 360
Amounts due to customers	9 550 593	17 477	1 654	0	0	9 569 724
Negative fair value of financial derivative transactions	0	1 271 237	0	0	0	1 271 237
Accruals, provisions and other liabilities	1 442 883	0	190	0	19	1 443 092
Income taxes payable	5 379	0	0	0	0	5 379
Provisions for loan losses	2 351 312	0	0	0	0	2 351 312
Equity	4 040 596	0	0	0	0	4 040 596
<b>Total</b>	<b>27 923 878</b>	<b>19 633 852</b>	<b>61 351</b>	<b>0</b>	<b>19</b>	<b>47 618 700</b>
On balance sheet position, net	11 929 968	-12 165 877	235 921	3	-15	0
Off balance sheet position, net	-16 467 152	10 906 401	-205 232	0	0	-5 765 983
<b>Net position</b>	<b>-4 537 184</b>	<b>-1 259 476</b>	<b>30 689</b>	<b>3</b>	<b>-15</b>	<b>-5 765 983</b>

### e) Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk.

The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next re-pricing date. Those assets and liabilities that do not have contractual maturity or a re-pricing date were grouped in the 'maturity undefined' category.

#### 31 December 2004

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Maturity undefined CZK '000	Total CZK '000
Cash and current balances with banks	134 885	0	0	0	8 049	142 934
Amounts due from banks	6 676 207	250 000	651 836	0	10 246	7 588 289
Positive fair value of financial derivative transactions	0	0	0	0	347 477	347 477
Loans to customers, net	1 158 664	1 866 845	9 085 746	17 650 661	-39 516	29 722 400
Available for sale securities	1 659 858	3 416 149	3 027 766	175 068	0	8 278 841
Investments held to maturity	36 670	33 479	1 108 516	527 478	0	1 706 143
Prepayments, accrued income and other assets	0	0	0	0	313 701	313 701
Deferred tax asset	0	0	0	0	28 164	28 164
Investments in associates	0	0	0	0	97 137	97 137
Tangible and intangible fixed assets	0	0	0	0	287 676	287 676
<b>Total</b>	<b>9 666 284</b>	<b>5 566 473</b>	<b>13 873 864</b>	<b>18 353 207</b>	<b>1 052 934</b>	<b>48 512 762</b>
Amounts due to banks	4 660 200	1 828 660	8 730 061	16 375 669	-2 623 429	28 971 161
Amounts due to customers	4 359 619	111 903	31 930	1 944 295	2 877 418	9 325 165
Negative fair value of financial derivative transactions	0	0	0	0	1 761 044	1 761 044
Accruals, provisions and other liabilities	0	0	0	0	1 723 856	1 723 856
Income taxes payable	0	0	0	0	113 927	113 927
Provisions for loan losses	0	0	0	0	2 260 645	2 260 645
Equity	0	0	0	0	4 356 965	4 356 965
<b>Total</b>	<b>9 019 819</b>	<b>1 940 563</b>	<b>8 761 991</b>	<b>18 319 964</b>	<b>10 475 924</b>	<b>48 512 762</b>
<b>Net position</b>	<b>646 465</b>	<b>3 625 910</b>	<b>5 111 873</b>	<b>33 243</b>	<b>-9 417 492</b>	<b>0</b>

## 31 December 2003

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Maturity undefined CZK '000	Total CZK '000
Cash and current balances with banks	0	0	0	0	144 616	144 616
Amounts due from banks	7 773 063	252 255	0	0	2 161	8 027 479
Trading securities	499 072	567 585	0	0	0	1 066 657
Positive fair value of derivatives	0	0	0	0	338 803	338 803
Loans to customers, net	553 614	379 737	1 346 587	25 380 103	857 989	28 518 030
Available for sale securities	2 383 818	2 427 615	3 440 929	64 789	0	8 317 151
Investments held to maturity	42 222	0	397 977	234 877	0	675 076
Prepayments, accrued income and other assets	0	0	0	0	127 232	127 232
Deferred tax asset	0	0	0	0	24 995	24 995
Investments in associates	0	0	0	0	63 025	63 025
Tangible and intangible fixed assets	0	0	0	0	315 636	315 636
<b>Total</b>	<b>11 251 789</b>	<b>3 627 192</b>	<b>5 185 493</b>	<b>25 679 769</b>	<b>1 874 457</b>	<b>47 618 700</b>
Amounts due to banks	14 875 423	1 544 381	593 065	13 647 656	-1 723 165	28 937 360
Amounts due to customers	1 389 745	157 729	229 933	101 028	7 691 289	9 569 724
Negative fair value of financial derivative transactions	0	0	0	0	1 271 237	1 271 237
Accruals, provisions and other liabilities	0	0	0	0	1 443 092	1 443 092
Income taxes payable					5 379	5 379
Provisions for loan losses	0	0	0	0	2 351 312	2 351 312
Equity	0	0	0	0	4 040 596	4 040 596
<b>Total</b>	<b>16 265 168</b>	<b>1 702 110</b>	<b>822 998</b>	<b>13 748 684</b>	<b>15 079 740</b>	<b>47 618 700</b>
<b>Net position</b>	<b>-5 013 379</b>	<b>1 925 082</b>	<b>4 362 495</b>	<b>11 931 085</b>	<b>-13 205 283</b>	<b>0</b>

## f) Liquidity Risk

Liquidity risk is the risk that the Bank will lose its ability to meet its financial obligations as they fall due or that it will not be able to fund its assets. Liquidity risk may result from a temporary payment insolvency and low liquidity of the market with financial instruments which makes it impossible to quickly close out positions thereby limiting access to funding. The basic liquidity management tool involves the record-keeping and planning of the Bank's cash flows. In support of liquidity management, the Bank uses two mechanisms - payment notices and price setting. The liquidity management strategy is established and implemented through the preparation of a 'Liquidity Scenario' and 'Emergency Plan for Events Jeopardising the Bank's Liquidity'. The Bank's liquidity position is monitored through the liquidity reserve limit in relation to the value of adjusted weighted risk exposure.

The Bank is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan draw-downs, guarantees, margins and settlement of derivatives. The Bank does not maintain cash resources to meet all of these needs as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

The table below analyses assets and liabilities of the Bank into relevant maturity groupings based upon the remaining maturity period as of the balance sheet date.

### 31 December 2004

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Maturity undefined CZK '000	Total CZK '000
Cash and current balances with banks	142 934	0	0	0	0	142 934
Amounts due from banks	6 686 453	250 000	651 836	0	0	7 588 289
Positive fair value of financial derivative transactions	0	0	0	0	347 477	347 477
Loans to customers, net	3 491 607	1 644 641	8 689 091	15 902 285	5 224	29 722 400
Securities available for sale	1 659 858	3 416 149	3 027 766	175 068	0	8 278 841
Investments held to maturity	36 670	33 479	1 108 516	527 478	0	1 706 143
Prepayments, accrued income and other assets	189 011	22 723	101 755	212	0	313 701
Deferred tax asset	0	0	0	0	28 164	28 164
Investment in associated undertaking	0	0	0	0	97 137	97 137
Tangible and intangible assets	0	0	0	0	287 676	287 676
<b>Total</b>	<b>12 206 533</b>	<b>5 366 992</b>	<b>13 578 964</b>	<b>16 605 043</b>	<b>755 230</b>	<b>48 512 762</b>
Amounts due to banks	4 829 547	1 902 050	8 730 061	13 490 248	19 255	28 971 161
Amounts due to customers	1 185 901	112 162	31 930	2 690 775	5 304 397	9 325 165
Negative fair value of derivative financial transactions			1 761 044			1 761 044
Accruals, provisions and other liabilities	393 472	564 552	62 721	502 430	200 681	1 723 856
Income taxes payable		113 927				113 927
Provisions for loan losses					2 260 645	2 260 645
Equity				4 356 965	4 356 965	
<b>Total</b>	<b>6 408 920</b>	<b>2 692 691</b>	<b>10 585 756</b>	<b>16 683 453</b>	<b>12 147 441</b>	<b>48 512 762</b>
<b>Net liquidity exposure</b>	<b>5 797 613</b>	<b>2 674 301</b>	<b>2 993 208</b>	<b>-78 410</b>	<b>-11 386 713</b>	<b>0</b>

## 31 December 2003

	Up to 3 months CZK '000	3 months to 1 year CZK '000	1 year to 5 years CZK '000	Over 5 years CZK '000	Maturity undefined CZK '000	Total CZK '000
Cash and current balances with banks	144 616	0	0	0	0	144 616
Amounts due from banks	7 777 479	250 000	0	0	0	8 027 479
Trading securities	499 072	567 585	0	0	0	1 066 657
Positive fair value of financial derivative transactions	0	0		0	338 803	338 803
Loans to customers, net	2 390 588	1 872 975	8 074 190	16 180 277	0	28 518 030
Securities available for sale	2 383 817	2 427 615	3 440 929	64 789	0	8 317 151
Investments held to maturity	42 222	0	397 977	234 877	0	675 076
Prepayments, accrued income and other assets	114 716	7 525	0	0	4 991	127 232
Deferred tax asset	0	0	0	0	24 995	24 995
Investments in associates	0	0	0	0	63 025	63 025
Tangible and intangible fixed assets	0	0	0	0	315 636	315 636
<b>Total</b>	<b>13 352 510</b>	<b>5 125 700</b>	<b>11 913 097</b>	<b>16 479 943</b>	<b>747 450</b>	<b>47 618 700</b>
Amounts due to banks	3 284 857	2 483 815	7 410 239	15 510 859	247 590	28 937 360
Amounts due to customers	1 937 289	192 226	189 337	2 981 163	4 269 709	9 569 724
Negative fair value of derivative financial transactions	0	0	0	0	1 271 237	1 271 237
Accruals, provisions and other liabilities	242 712	377 513	718 698	104 169	0	1 443 092
Income taxes payable	0	0	0	0	5 379	5 379
Provisions for loan losses	0	0	0	0	2 351 312	2 351 312
Equity	0	0	0	0	4 040 596	4 040 596
<b>Total</b>	<b>5 464 858</b>	<b>3 053 554</b>	<b>8 318 274</b>	<b>18 596 461</b>	<b>12 185 823</b>	<b>47 618 970</b>
<b>Net liquidity exposure</b>	<b>7 887 651</b>	<b>2 072 146</b>	<b>3 594 823</b>	<b>-2 116 518</b>	<b>-11 438 373</b>	<b>0</b>

## g) Operational Risk

The Bank defines operational risk as the risk of loss arising from human errors, the inappropriateness or failure of internal processes, failures of systems or the risk of loss resulting from external events.

The system of the Bank's operational risk management is built around the following four cornerstones:

- Strategy (clear vision, management attitude, culture);
- Organisation (Board of Directors, Assets and Liabilities Management Committee, internal audit, operational risk management coordinator, and the Bank's departments);
- Processes (identification, evaluation, countermeasures, monitoring and reporting); and
- Infrastructure (system, source of information, data collection and communication).

## Identification of Operational Risk

The Bank identifies individual operational risks in all of its departments and categorises them according to the underlying cause (human error, internal process, information system, external factor). Responsibility for identifying operational risks primarily rests with the head of the department where the risk originates (self-evaluation form).

Collection of information from individual departments and its processing is within the remit of the coordinator. The Bank identifies and records each risk to which it is exposed, even a risk that is no longer treated as a risk due to the countermeasures that are currently being implemented.

### Evaluation of Operational Risk

Operational risk is evaluated in terms of the likelihood of its occurrence (grading one to five) and the significance of impact if it materialises (grading one to five). The Bank has opted for a qualitative approach to evaluating the risk which better meets its needs and better reflects the situation within the Bank. The evaluation is based on a reasonable estimate and uses scores to assess the likelihood of the occurrence and significant of impact. Following the evaluation, individual risks are rated according to their overall significance (risk profile) into the following three levels:

- Low (ideal risk profile where the Bank only check the effectiveness of the existing measures);
- Medium (the risk is acceptable only if the implementation of an appropriate countermeasure to mitigate the risk was too costly); and
- High (the risk is not acceptable, additional countermeasures need to be put in place and the risk mitigated).

### Countermeasures

Responsibility for the implementation of an appropriate countermeasure against operational risks rests with the department where the risk originates (mitigation of the likelihood of the occurrence of operational risk or its impact on the Bank).

### Monitoring and Reporting

The basic tool for monitoring is the database of incidents and a report on operational risk management within the Bank. These activities result in a risk profile of the Bank. Operational risk events include all events that have a direct impact on the Bank's profit or loss according to the Bank's activity in which the event occurred.

## 22/ ESTIMATED FAIR VALUE OF ASSETS AND LIABILITIES OF THE GROUP

Fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Where available, fair value estimates are made based on quoted market prices. However, no readily available market prices exist for a significant portion of the Group's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other generally acceptable pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affect the estimates. Therefore, the calculated fair market estimates cannot be realised in a current sale of the financial instrument.

In estimating the fair value of the Group's financial instruments, the following methods and assumptions were used.

### a) Cash and balances with the central bank

The carrying values of cash and balances with the central bank are generally deemed to approximate their fair value.

### b) Investments held to maturity

Fair values of securities carried in the 'Held to maturity' portfolio are calculated by discounting future cash flows using prevailing market rates.

### c) Due from banks

The fair value of due from banks is estimated based upon discounted cash flow analyses using interest rates currently offered for investments with similar terms (market rates adjusted to reflect credit risk). The fair value of non-performing amounts due from banks is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral. Provisions are not taken into consideration when calculating fair values.

### d) Loans to customers

The fair value of variable yield loans that regularly re-price, with no significant change in credit risk, generally approximates their carrying value. The fair value of loans at fixed interest rates is estimated using discounted cash flow analyses, based upon interest rates currently offered for loans with similar terms to borrowers of similar credit quality. The fair value of non-performing loans to customers is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral, where available. Loans at fixed interest rates represent only a fraction of Trading derivatives are derivatives for which the Bank does not monitor hedge effectiveness even though they are used for risk management purposes. The total carrying value and hence the fair value of total loans to customers approximates the carrying values as of the balance sheet date. Provisions are not taken into consideration when calculating fair values.

### e) Amounts due to banks and customers

The fair value of term deposits repayable on demand approximates the carrying value of amounts repayable on demand as of the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as of the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using market interest rates.

The following table summarises the carrying values and fair values of those financial assets and liabilities not presented on the balance sheet at their fair value:

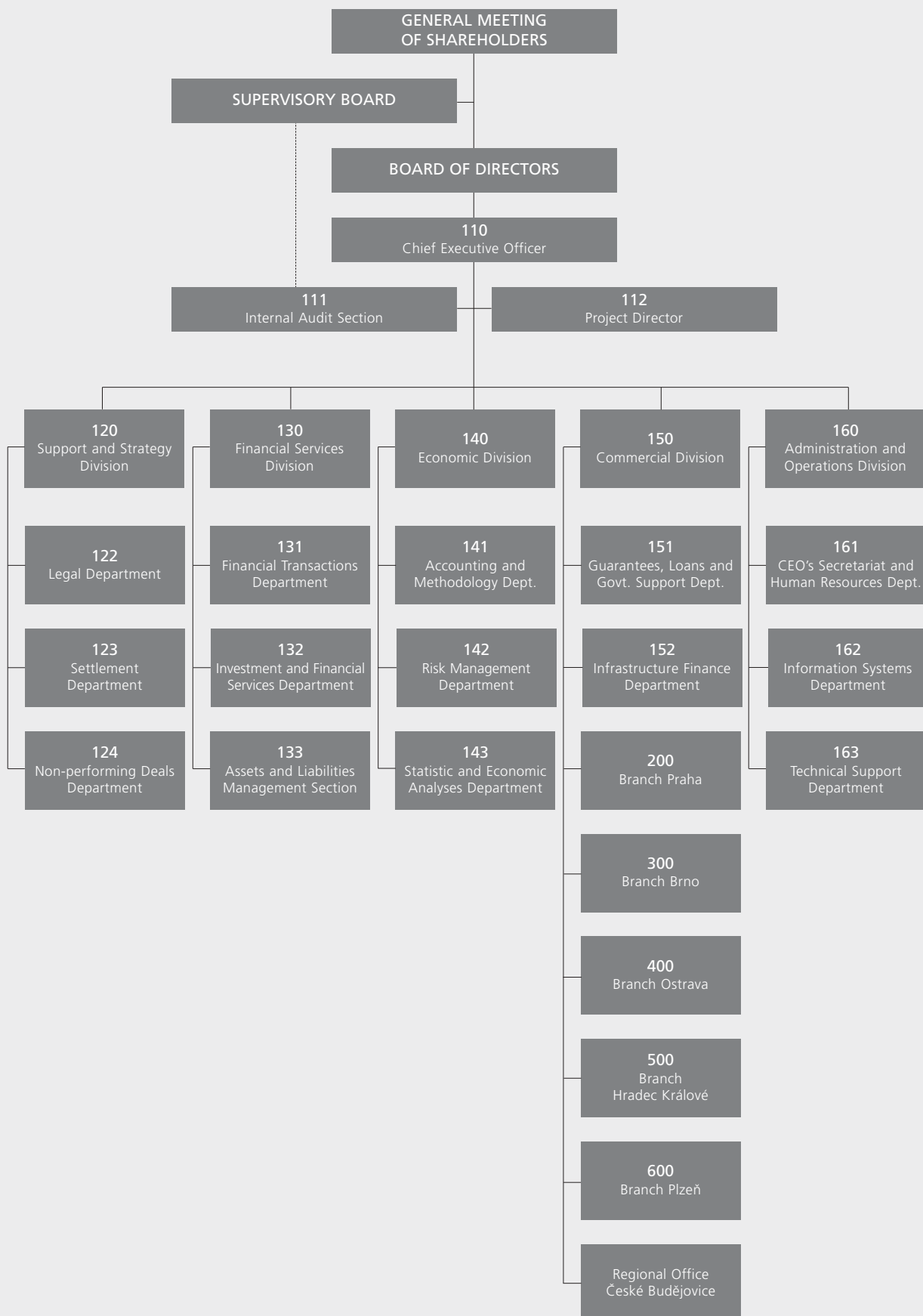
	31 December 2004		31 December 2003	
	Carrying value CZK '000	Fair value CZK '000	Carrying value CZK '000	Fair value CZK '000
<b>Financial assets</b>				
Cash and balances with the central bank	142 934	142 934	144 616	144 616
Amounts due from banks	7 588 289	7 578 300	8 027 479	8 008 582
Loans to customers	29 722 400	29 136 484	28 518 030	29 405 122
Investments held to maturity	1 706 143	1 687 572	675 076	665 496
<b>Financial liabilities</b>				
Amounts due to banks	28 971 161	28 911 220	28 937 361	28 896 672
Amounts due to customers	9 325 165	8 615 539	9 569 724	9 273 720

### 23/ SUBSEQUENT EVENTS

No significant events having a significant impact on the financial statements of the Bank for the year ended 31 December 2004 occurred subsequent to the balance sheet date.

The Board of Directors has authorized these financial statements for submission to the General Meeting of Shareholders.

## BANK'S ORGANIZATION CHART



## ADDRESSES

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## PRODUCTS AND SERVICES REVIEW (scheduled for 2005)

**1/ SME assistance programmes**

The Bank provides various types of assistance scheduled within the national programmes and the Operational Program Industry and Enterprise to help small and medium-sized enterprises (SMEs) complying with the Commission Regulation (EC) No. 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to the state aid to SMEs, and, with the Act No. 47/2002, Coll., on support to SMEs.

Currently, the following products are available:

**a) Bank guarantees**

Various types of subsidised guarantees are granted within the ZÁRUKA (Guarantee) programme to secure:

- bank loans (both investment and operational) - may cover up to 80 % of the outstanding loan principal; a specific regional guarantee, in case of loans issued for the realization of projects in the Zlínský region, may go up to 90 % of the outstanding loan principal;
- leasing finance - up to 70 % of the purchase price of the leased object,
- bids in public tenders – guarantee security between CZK 0.1 – 5 million,
- venture capital – up to 70 % of the capital investment (maximum limit CZK 20 million).

**b) Preferential loans**

A range of loans has been tailored to help different categories of entrepreneurs as follows:

- Interest-free loans provided within the START and TRH (Market) programmes are available for start-up businesses; loans amounting between CZK 0.1 million – 1 million may cover up to 90 % of the total expected project costs; loan maturity can go up to 6 years.
- Preferential loans within the KREDIT (Credit) programme for small businesses that have concluded not more than 5 consecutive tax periods; loans amounting between CZK 0.2 million – 2 million are available to cover up to 90 % of the total expected project costs; the interest rate is fixed at 4 % p. a., maturity up to 5 years.
- Preferential loans within the KREDIT programme for small businesses with 2 – 5 consecutive tax periods concluded; loans amounting between CZK 2 million – 5 million are available to cover up to 80 % of the total expected project costs; the interest rate is fixed at 4 % p. a., maturity up to 6 years.
- Subordinated loans within the KREDIT programme for small businesses with a minimum of 2 consecutive tax periods concluded; loans amounting between CZK 0.5 – 7 million are available to cover up to 50 % of the total expected project costs; the interest rate is fixed at 3 % p. a., maturity up to 8 years, grace period of up to 5 years may be agreed.
- Preferential loans within the INOVACE (Innovation) programme for small and medium-sized enterprises implementing innovative projects; loans amounting between CZK 1 million – 50 million are available to cover up to 60 % of the total expected project costs; the interest rate is fixed at 3 % p. a., maturity up to 9 years, grace period of up to 4 years may be agreed.
- Subordinated loans within the PROGRES (Progress) programme for small and medium-sized businesses with a minimum of 3 consecutive tax periods concluded; loans amounting between CZK 2 million – 25 million are available to cover up to 50 % of the total expected project costs; the interest rate is fixed at 3 % p. a., maturity up to 8 years, grace period of up to 5 years may be agreed. To encourage entrepreneurship development in small municipalities, the interest rate can be reduced to 1 % p. a. and the maturity extended up to 10 years (with up to 8-years grace period) if the project is implemented in a municipality with less than 5000 residents.

### c) Financial subsidies

Special-purpose financial contributions may be obtained within the TRH (Market) programme to partially cover specified costs directly linked to the project implementation as specified at the relevant period (ISO and EMAS certifications, e.g.). The extent of this type of assistance fully depends on the amount of funds allocated from the state budget for the respective year.

## 2/ Regional assistance

Pursuant to a specific agreement signed between the CMZR Bank and regional authorities, small enterprises operating in the Jihočeský (South Bohemia) region, which have concluded a minimum of 2 consecutive tax periods, can be granted preferential loans amounting to CZK 0.75 million at a fixed interest rate of 5 % p. a. and a 4-years maturity (5-years maturity applies to specified localities of the region).

## 3/ Water sector development programme

Within this programme, municipalities (incl. its associations), water administration utilities that operate the respective water and sewage nets, or, other project investors who meet the programme criteria set by the Ministry of Agriculture of the Czech republic, can take advantage of interest-free loans for up to 15 years to cover 40 – 60 % of costs of the building and technological part of specific water sector projects.

## 4/ Housing improvement programme

Within the specific PANEL programme, the owners or co-owners of residential prefab panel-block houses may be granted the following support to repair the relevant buildings:

- subsidised guarantee covering up to 70 % of the bank loan required to finance the repair,
- grant to partially cover the interests paid on the bank loan used for the housing repair, equivalent to 4 % p. a.

## 5/ Transport infrastructure finance

In capacity of financial manager of loans provided by the European Investment Bank, the CMZR Bank administers the respective means determined for transport infrastructure financing such as the development of highways network, and, repairs and improvement of technical quality of motorways and priority roads.

## 6/ Investment banking services

The Bank's clients can take advantage of financing arranged through the issue of debt securities such as bonds and bills of exchange; the service is provided under standard commercial terms and conditions.

## 7/ Term deposits

Term deposit accounts are opened and kept both for individuals and legal entities; the annual interest rate is fixed, an automatic deposit renewal may be agreed.

