Unaudited Annual Financial Statements 2016

NLB Group

	NLB d.d., Ljubljana
Number of branches	113
Number of active clients	700,917
Total assets (in EUR million)	8,778
Market share by total assets (in %)	23.7
Result after tax (in EUR million)	63.8

	NLB Skladi, Ljubljana
Assets under management (in EUR million)	1,035
Market share[1] (in %)	27.2 (mutual funds)
Result after tax (in EUR million)	2.9

[1] Market share of assets under management in mutual Funds.

	NLB Banka, Belgrade
Number of branches	31
Number of active clients	133,095
Total assets (in EUR million)	275.8
Market share by total assets (in %)	1.0
Result after tax (in EUR million)	2.2

	NLB Vita, Ljubljana
Assets of covered funds without own resources (in EUR million)	401
Market share[2] (in %)	11.1
Result after tax (in EUR million)	7.4

[2] Market share in traditional life insurances.

	NLB Banka, Banja Luka	NLB Banka, Sarajevo
Number of branches	60	37
Number of active clients	209,254	139,524
Total assets (in EUR million)	634.5	497.9
Market share by total assets (in %)	19.6[3]	5.3[4]
Result after tax (in EUR million)	14.1	5.4

[3] Market share in the Republic of Srpska.
[4] Market share in the Federation of Bosnia and Herzegovina.

	NLB Banka, Podgorica
Number of branches	18
Number of active clients	57,853
Total assets (in EUR million)	473
Market share by total assets (in %)	13.3
Result after tax (in EUR million)	5.3

	NLB Banka, Skopje
Number of branches	51
Number of active clients	370,842
Total assets (in EUR million)	1,153
Market share by total assets (in %)	15.9
Result after tax (in EUR million)	25.0

	NLB Banka, Pristina
Number of branches	45
Number of active clients	185,315
Total assets (in EUR million)	516
Market share by total assets (in %)	14.9
Result after tax (in EUR million)	11.3

Note: The result after tax data in the above figure show NLB Group members' standalone result and not their contribution to the consolidated result after tax.

KEY FINANCIAL and operating data

Table 1: Key financial captions for NLB Group and NLB d.d. (Slovenia)

Key Income statement data (in EUR million)	NLB Group 2016	NLB Group 2015	NLB Group Change YoY	NLB d.d. 2016	NLB d.d. 2015	NLB d.d. Change YoY
Net operating income[1]	475.7	483.4	-2%	312.6	327.0	-4%
Costs	-289.5	-297.8	-3%	-181.0	-187.2	-3%
Result before impairments and provisions[1]	186.2	185.6	0%	131.7	139.8	-6%
Impairments and provisions	-60.6	-83.1	-27%	-64.0	-88.0	-27%
Result after tax	110.0	91.9	20%	63.8	43.9	45%
Key financial indicators						
Return on equity after tax (ROE a.t.)	7.4%	6.6%	0.8 p.p.	4.3%	3.2%	1.1 p.p.
Return on assets after tax (ROA a.t.)	0.9%	0.8%	0.1 p.p.	0.5%	0.4%	0.2 p.p.
RORAC a.t.[2]	9.7%	8.1%	1.6 p.p.	8.8%	6.0%	2.8 p.p.
Costs to income ratio (CIR)	60.9%	61.6%	-0.8 p.p.	57.9%	57.2%	0.6 p.p.
Interest margin (on interest bearing assets)[3]	2.59%	2.70%	-0.1 p.p.	2.03%	2.33%	-0.3 p.p.
Interest margin (on total assets - BoS ratio)	2.66%	2.88%	-0.2 p.p.	1.99%	2.38%	-0.4 p.p.

Key financial position statement data (in EUR million)	NLB Group 31.12.2016	NLB Group 31.12.2015	NLB Group Change YTD	NLB d.d. 31.12.2016	NLB d.d. 31.12.2015	NLB d.d. Change YTD
Total assets	12,039	11,822	2%	8,778	8,707	1%
Loans to customers (net)	6,997	7,088	-1%	4,929	5,221	-6%
Deposits from customers	9,439	9,026	5%	6,617	6,298	5%
Total equity	1,495	1,423	5%	1,265	1,242	2%
Loans to customers/deposits from customers (L/D)[4]	74.1%	75.1%	-1.0 p.p.	71.8%	78.0%	-6.1 p.p.
Common Equity Tier 1 Ratio[5]	17.0%	16.2%	0.8 p.p.	23.4%	22.6%	0.8 p.p.
Total capital ratio	17.0%	16.2%	0.8 p.p.	23.4%	22.6%	0.8 p.p.
Asset quality indicators						
NPL- Gross (in EUR million)	1,299	1,896	-31%	753	1,101	-32%
NPL coverage ratio[6]	64.6%	62.8%	1.8 p.p.	60.8%	59.1%	1.7 p.p.
NPL coverage ratio[7]	76.1%	72.2%	3.9 p.p.	71.7%	67.9%	3.8 p.p.
NPL ratio - Gross	13.8%	19.3%	-5.5 p.p.	11.9%	16.5%	-4.6 p.p.
NPL ratio - Net[8]	5.4%	8.3%	-2.9 p.p.	5.1%	7.6%	-2.5 p.p.
NPE ratio[9]	10.0%	14.3%	-4.3 p.p.	8.5%	12.1%	-3.6 p.p.
Employees						
Number of employees	6,175	6,372	-3%	2,885	3,028	-5%

[1] NLB d.d. includes dividends from subsidiaries, associates and joint ventures.

[2] RORAC a.t. = profit a.t. / average capital requirement normalized at 14.75% RWA

[3] Further analyses of interest margins are based on interest bearing assets

[4] Net loans to customers (without BAMC bond)/Deposits from customers

[5] Result for 2016 included, reduced for the expected dividend pay out

performing loans

[7] NPL Coverage ratio = Coverage of gross non-performing loans with impairments for all loans

[8] NPL ratio - Net = Net non performing loans / Net loan portfolio

[9] EBA definition

International credit ratings NLB d.d.	31.12.2016	31.12.2015	Outlook
Standard & Poor's	BB-	BB-	Positive
Fitch	BB-	B+	Stable

- **NLB Group (the Group) increased its profit after tax for the third consecutive year to EUR 110 million, up 20% from 2015 (EUR 91.9 million) in a challenging interest rate environment.**
- **NPL levels were strongly reduced by 31%, thus, the NPL ratio came down to 13.8% (from 19.3% in 2015); the NPE ratio is already at 10%.**
- **The Bank remains a stronghold of profitability with the core foreign banks catching up fast and collectively coming almost even in terms of their contribution to the Group profits.**
- **Liquidity and capital ratios are very strong and a solid basis for further growth – fully anticipating a 100% (EUR 63.8 million) of NLB d.d. (NLB or the Bank) profit dividend payout to shareholders. ROE stands at 7.4% whereas the after tax RORAC (on a normalised capital requirement of 14.75% of RWA) stands at 9.7%.**
- **International rating agencies have acknowledged strong progress by upgrading the Bank to BB- (S&P outlook Positive).**
- **NLB Group has defined a new medium-term strategy to reinforce its regional specialist leadership position and ambitious plans for further profitable growth based on better services to its clients by leveraging on digital channels, improved efficiency, an enhanced client experience, Group synergies and the dedication to be a regional solutions' innovation champion – aiming to achieve above 10% ROE, CIR of 50% while maintaining a strong dividend flow of approximately 70% of the Group profits.**

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BUSINESS REPORT

MACROECONOMIC environment

Central bank policies remained at the forefront of financial markets throughout the year. They played a key role in soothing markets in times of the unfavourable conditions resulting from the numerous economic, political and banking system disturbances. As markets transitioned into the final quarter of the year, speculation surrounding the potential extension and tapering of the European Central Bank's (ECB) asset purchase programme and the expected interest rate increase in the United States continued to have a significant influence on markets and the interest rate environment.

Economic data in the euro area remained resilient upon Britain's decision to leave the European Union (EU). Positive trends in the region's labour market remained supportive of domestic demand, which continues to grow in importance for the sustainability of economic growth, while the global economy continued to show signs of slowing down, as reflected by the numerous global growth forecast downgrades in the year. A continuation of the region's positive economic trends remains the base scenario; however, uncertainties regarding Britain's exit from the EU, elections in Europe and a further deterioration of the global economy are notable factors which could negatively impact the aforementioned positive expectations.

Slovenia

Outlook

Slovenia's positive economic trends maintained momentum throughout 2016. In addition to growth rate forecast upgrades by numerous institutions, in the third quarter Fitch raised the country's credit rating by one notch to 'A-' with a stable outlook, while Moody's increased the country's macroeconomic rating and upgraded the credit rating outlook to 'positive'. The government is expected to continue the notable progress it has made in reducing its deficit. The nation's public debt is expected to have decreased in the year, for the first time since 2008. In addition to the strong trade performance, domestic demand is projected to make notable gains in the near term. Considerable labour market progress, with a notable 0.5 percentage point drop in average unemployment levels to 10.8% in 2016, combined with growing wages and the nascent recovery of the real estate market should have a continued positive impact on private consumption. Although the significant progress made in recent years is expected to continue, Slovenia's economic recovery remains dual natured. Export-oriented sectors of the economy have experienced significant advances, while domestically oriented sectors remain mostly stagnant in comparison. The successful revival of the construction sector remains a key milestone of the nascent economic recovery.

Banking System

The local banking system continues to make significant headway. The system's capital adequacy is among the highest in the EU, while a notable improvement in credit quality has been achieved. Non-performing loans (NPLs) decreased to 6.5% as of November, a drop of 3.4 percentage points. As the quality of the credit portfolio improves, the release of impairments and provisions continues to benefit the system's profitability, and during the year the system generated a profit of EUR 344.3 million, for a return on equity (ROE) of 8.3%, an almost 200% increase compared with 2015 despite the falling interest margins. Supported by the recovery of the real estate market and low interest rates, loans to households continue to be the sole credit category experiencing growth, while systemic overcapacities and a high deposit base continue to depress private sector loans. Household deposits increased by 6.7% during the year. Competitive pressures within the Slovenian banking system resulted in a continued downward trend of interest rates through the year, with interest rates on loans to the corporate sector experiencing a particularly notable fall. The high level of competition will continue to put pressure on earnings in the mid-term, a factor pointing to the need for further consolidation within the system.

SEE Markets

After returning to economic growth in 2015, following the flood-induced economic contraction of 2014, **Serbia's** economic growth accelerated in 2016. The government solidified its position in the April elections, ensuring the necessary stability for continued reform implementation. Investments made a significant contribution to growth during the year, as did strong external demand. Improved economic growth dynamics combined with labour market reforms resulted in employment growth. Continued labour market improvements and positive economic developments are expected to support the nascent recovery of private consumption. The economic recovery resulted in a revival of the corporate credit portfolio, which expanded by 1.8% while loans to households grew by 10.4%.

Kosovo's economy continued the strong economic expansion from the previous year, while in the medium term further growth will be supported by private consumption and private investment. Due to the importance of remittances in Kosovo's economy, it has generally remained stable and resilient to regional downturns. In spite of a strong economic performance, unemployment levels remained elevated due to structural issues; however, notable progress was achieved in 2016. The banking system achieving a return on equity of 18.5%, slightly lower than in the previous year, primarily due to the drop in interest income. Credit growth accelerated from the previous year, with corporate loans increasing by 8.3%, while household loans expanded by 14.7%. NPL levels remain the lowest within the region at 4.9%.

Economic growth in **Montenegro** will be driven by the considerable public investment stemming from the Bar Boljare highway project, which will result in further fiscal strain and rising public debt in the medium term. Tourism has shown notable growth, while further growth is expected as hotel capacity and investments increase. Tempered growth in the first two quarters resulted in a slight deterioration of the labour market, which reversed in the second half as the economy picked up. In the banking system, loans to households grew by 10.5% during the year, while the corporate loan portfolio grew by 1.9%.

Continuing political uncertainty proved restrictive for **Macedonia's** economy, impacting private investment and resulting in a tapering of economic growth. Despite the noted uncertainty, household consumption remained robust and was the primary driver of growth, supported by increasing employment and household lending. Consumer loans experienced strong growth of 7.0% during the year, while political tension negatively impacted corporate loans, which decreased by 3.7%. The country has a strong economic base and potential, yet the strong growth projections are predicated on the resolution of lingering political issues, which the December elections failed to achieve.

The economy of **Bosnia and Herzegovina** expanded during the year, with net exports and resurgent private consumption being the main drivers of growth, with a notable contribution from manufacturing. Economic growth is expected to accelerate to 4.0% in the mid-term, supported by consumption, which will in turn be supported by continued remittance inflows. Modest export gains are also expected, while investment in energy, construction and tourism will support investment growth. The banking system was profitable during the year. Modest credit growth was recorded, with both household and corporate loans finishing the year higher.

BUSINESS operations

Retail banking in Slovenia

Retail operations have continuously represented a solid anchor for the Bank and in 2016 the Group continued to improve the offer of client solutions and customer experience maintaining the leading position in the Slovenian market. Special attention was paid to further enhancing the mobile service platform (functionalities of the mobile app Klikin etc.) as well as the continued reshaping and modernisation of the branch network which is still by far the most important sales channel.

- The Bank maintained a strong and leading market position with a market share in retail lending of 23.5%, and 30.4% in deposit taking:
  - the retail loan book has, despite the sale of part of the non-performing portfolio, been growing steadily in line with the market to EUR 1,992 million (from EUR 1,959 million in 2015),
  - loan production has been picking up, especially in the second half of 2016 – with demand strongly growing for housing lending, and
  - the Bank clearly remains the market leader in deposit taking, providing a key strategic funding source and information capital base.
- The Bank continues to be a market leader in terms of client accessibility and market coverage with a comprehensive network of 113 branch offices, 558 ATMs, online banking services and the Bank's Contact Centre operating 24/7.
  - Branch offices continue to be the key area for maintaining existing and creating new contacts. In 2016, six were modernised according to the »open space« concept, enabling simpler and more convenient interaction with clients.
  - A team of mobile bankers was established to enable a higher degree of flexibility to provide services at the time and place of clients' choosing in a professional, efficient and discreet manner. Clients can now open an NLB Personal account online in a process entailing a few steps, as well as with the support of mobile advisors.
  - With its Contact Centre, the NLB is the only bank in Slovenia to provide clients with 24/7 access to banking services. The Contact Centre responds to clients' questions, performs clients' orders and will, with the pending introduction of video chat functionality, become a very strong point of differentiation in the local market.
- The Bank started to concentrate on simplifying its service offering and streamlining its procedures, thus substantially improving the client experience, which will be the main focus.
  - As one of the first banks in Slovenia to do so, the NLB introduced the ePero (E-pen) solution throughout the branch network, enabling digital signing via tablets and access to signed documents in NLB Klik, thus significantly reducing paper consumption and the operational risks of documentation handling and archiving.
- The Bank is continuously improving its client experience through innovative ways to engage with various segments tuned to their respective expectations.
  - The Bank opened a mini bank branch office in the creative playing centre for children, Minicity in BTC in Ljubljana. Through play, children can learn about bank operations, the daily work of a banker, as well as gain basic financial literacy.
  - The Bank continued to share knowledge with its clients in the areas of personal finances and banking. All over Slovenia, 505 local professional and educational events were organised for retail clients. Information and advice are also shared by the e-newsletters Osebno and Privatno, the contents of which are adjusted to individual segments of clients.

Corporate and Investment banking in Slovenia

The Bank continues to maintain its leading position as the key bank and advisor for Slovenian corporates of all sizes. The Bank offers a full spectrum of financial services to its clients, including lending, cash management, payment services and guarantees as well as advisory on capital market transactions.

- The Bank maintains its stronghold in all client segments, where it is especially active and successful with key clients/large corporates given the depths and scale of services on offer and the tailored service model for mid and small corporates based on a simplified and more standardised offer.

  - The Bank maintains relationships with more than 48,000 customers, resulting in a 22.6% market share in corporate loans. Special focus has been given to fee income with good successes achieved specifically in trade finance where the Bank's market share grew to 26.9%.

- The Bank has invested specifically in the higher availability and ease of access to its services for small and medium-sized companies.

  - With the automation of the approval process including a creditworthiness check, »Quick financing« up to EUR 100,000 is provided for small enterprises within 24 hours.
  - The mobile application “NLB Klikpro” was introduced to allow companies, entrepreneurs and private individuals with small businesses simple “Check – pay – order” services at their fingertips.
  - The Bank introduced – as the first in the Slovenian market to do so – the “All in one POS” that allows companies to easily comply with changes in tax legislation with a direct connection to the fiscal register as well as offering connectivity to all card providers and the printing of invoices.

- The Bank has continuously been investing substantial efforts in improving its standing and perception not just among large corporates – a traditional stronghold – but also among SMEs and small businesses.

  - As a unique innovation of engaging with clients and prospective clients from the entrepreneurial segment, the so-called Innovative Entrepreneurship Centre (IEC) was established already in 2015. The IEC is a physical space and will also become a virtual community space in the centre of Ljubljana with flexible facilities for meeting and organising events – both for the Bank as well as the entrepreneurial eco system. Besides offering a physical space in which companies can be set up in one stop, organised know-how sharing and trainings, more importantly, through this hub the Bank will be connecting entrepreneurs with investors, off-takers and suppliers to deliver practical value and build a real value chain community. In 2016, the concept was very positively accepted, as proven by the numerous events – reaching a total of over 9,000 visitors.
  - The Bank has made available several unused premises for free use by the best initiatives with a multiplication impact by way of fostering the enhancement of an entrepreneurial environment in the country.

- In Investment Banking, in close cooperation with other business segments, the Bank continued its successful coverage of corporate and institutional clients with advisory and capital markets, as well as its standard range of treasury solutions.

  - The Bank successfully reinforced its leading role in organising domestic and international loan syndicates with a total volume of EUR 800 million, including a benchmark transaction for Telekom Slovenia.
  - The Bank concluded as financial advisor for a consortium of owners one of the largest and most complex merger and acquisition (M&A) transactions on the Slovenian market – successfully selling a production business to international investors.
  - The Bank helped raise EUR 192 million in domestic capital market instruments listed on the Ljubljana Stock Exchange.
  - Brokerage and custody volumes were up substantially compared to 2015, with custody assets standing at approximately EUR 12 billion thanks to a generally much more active market

environment. The Bank continued to invest in the highest client service and execution – successfully managing the transition to the new Target2-Securities (T2S) standard.

Core foreign markets

The Group **operates with six banking entities in five markets (Serbia, Montenegro, Macedonia, Kosovo, Bosnia and Herzegovina)** – all of which have been growing strongly in terms of market activities (especially retail lending with its attractive margins) and profitability. All core subsidiaries operating on core foreign markets collectively contributed approximately EUR 67.6 million to the Group profits (compared to EUR 44.7 million in 2015), representing an increase of almost 51%.

This is a result of strong loan production, especially in Serbia, Macedonia and Kosovo as well as the exceptionally low risk results in all entities. All entities have been showing positive dynamics in business evolution – operating in markets that also show higher GDP and loan growth compared to Slovenia as well as still substantially higher margins.

All members have started efforts to enhance the efficiency of their operations and moreover invest significantly in new channels and digital service offerings. The Bank as a group has launched a number of initiatives aimed at the continuous streamlining and harmonising of its offering and appearance towards clients as much as by standardising operations across countries. The **Rebranding of all subsidiary banks** under the "**NLB Bank" brand** was concluded in 2016, finally facilitating the full exploitation of the brand and activity synergies on the Group level.

- **NLB Banka Skopje**. As the 3rd largest bank in Macedonia with a market share of 15.9%, NLB Banka Skopje continued its exceptional success in profit and volume growth. 2016 ended with a record performance of net profit of EUR 25 million (2015: EUR 13.1 million) on the back of the strong net income growth (11% YoY) and normalised cost of risk of 73 bps (2015: 218 bps). The entity continued to enhance its retail offer by providing insurance products in life/non-life, pension products and a range of innovations in payments and channel services. Very solid growth of highly diversified retail lending at stable attractive margins has been the basis for further strong positioning in the market. The bank received the award National Champion in Macedonia granted by the European Business Network for the second time in a row.

- **NLB Banka Sarajevo** recorded its highest profit ever of EUR 5.4 million in 2016 (2015: EUR 4.2 million). The bank continued to enlarge its client base by adding over 4,500 new clients in 2016. A new branch office was opened in the centre of Sarajevo, allowing the Group to further strengthen its appearance in the Federation of Bosnia and Herzegovina after having moved its headquarters from Tuzla to Sarajevo. Further branch offices in Sarajevo, Tuzla, Cazin, Široki Brijeg and Ljubuški were redesigned during 2016 in order to reinforce a client-centric model and raise the quality of services. Retail operations have consequently shown especially encouraging trends.

- **NLB Banka Banja Luka** is the 3rd largest bank in the market with the largest banking distribution network in the Republic of Srpska and a 19.6% market share in total assets. Despite difficult market conditions, the bank managed to achieve a net profit of EUR 14.1 million in 2016 (2015: EUR 9.9 million). The bank paid special attention to optimising its branch network, reducing the number of branches by five. The bank invested in digitalisation as well and launched Mobile banking, while additional improvements were made in e-banking services, providing new functionalities and improving the customer experience. The bank offers a wide range of banking products and services designed for individuals, small to medium enterprises (SMEs) and large corporations to over 209,000 active clients with a growth focus on retail lending and card operations.

- **NLB Banka Prishtina** is the 3rd largest bank in Kosovo with a market share of 14.9% in total assets and enjoys exceptional credit quality with the lowest NPL ratio in the Group. 2016 was another very successful year for the bank, ending it with a record profit of EUR 11.3 million (2015: EUR 8.2 million), the highest since it was established in 2008. The bank developed and successfully implemented the POS merchant acquiring service and mobile banking and will continue with upgrades of e-banking and other banking services focusing on integral solutions to properly address clients' needs. The bank will continue to strengthen the skills and competencies of its staff through training in order to continuously provide more complex financial solutions to its clients.

- **NLB Banka Beograd** recorded a net profit of EUR 2.2 million in 2016 (2015: EUR 1.2 million) and continued the positive performance trend for the second consecutive year. After finishing its turnaround and comprehensive restructuring efforts in 2015, the bank is increasing its presence in the market, also reflected in the opening of new branch offices in Western Serbia in the cities of Čačak, Šabac and Užice. With a low market share, the bank is strictly focussing on select target segments for the time being, especially in agrobusiness and consumer finance. In 2016, the bank significantly increased its loan production and also expects to continue its accelerated growth in 2017.

- **NLB Banka Podgorica** is the 2nd largest bank in Montenegro with a market share of 13.3% in total assets. The bank recorded a net profit of EUR 5.3 million (2015: EUR 6.2 million). In a very competitive market, even seeing new entries in 2016, the bank confirmed its ability for the qualitative development of its business model. In 2016, several new products were launched, such as a new loan facility for SMEs operating in the tourism sector, and the bank successfully finished its participation by approving household loans in the governmental project 1000+ and loans for enrolling students in the Work and Travel in USA programme. In a very competitive environment, the bank has been focusing on operational efficiencies and will be exploring growth opportunities mainly in the retail segment.

Wind down of non-core operations

The Group is following its strategy and objectives of the Restructuring Plan which define non-core markets and activities and foresee the controlled and gradual wind down of the non-core segment. Most leasing subsidiaries and factoring entities were put into liquidation in 2016 to comply with the EC commitments. Non-core segment assets were reduced in 2016 by 33% YoY to the level of EUR 503 million (2015: EUR 755 million). The non-core cost base was reduced by 20% YoY to the level of EUR 24.2 million (2015: EUR 29.8 million). The non-core pre-tax segment result was EUR -18.9 million – much improved from 2015 (EUR -70.1 million).

Efficient and proactive risk management of operations

- 2016 was an exceptional year by decreasing the volume of NPLs by more than 30% to just below EUR 1.3 billion (2015: EUR 1.9 billion) – this reducing the NPL ratio to 13.8% (2015: 19.3%), while the internationally more comparable NPE ratio (based on EBA guidelines) already dropped to 10% (2015: 14.3%).

- This strong performance in reducing NPLs was enabled by the strong results in collection and the continued divestment of exposures at the asset and portfolio level.

- The Group Real Estate Management function (GREAM) continues to be an important facilitator/back-stop investor/asset manager for real estate at foreclosures, respectively, transacting on exposures backed up with real estate collateral and holds approximately EUR 128 million in foreclosed assets under professional, dedicated real estate management.

- Coverage ratios were further improved to 64.6% (impairments for NPL portfolio / NPL portfolio stock, 2015: 62.8%) and 76.1% (total impairments / NPL portfolio stock, 2015: 72.2%).

- 2016 saw the conclusion of a benchmark sale of part of the non-performing portfolio (non-performing portfolio sale) of EUR 500 million in gross exposures – reducing NPL balances by EUR 233 million (the difference having previously already been taken off the balance sheet). The transaction resulted in realising a one-off negative effect on the profit and loss account in the amount of EUR 29.9 million, of which minus EUR 4.1 million was shown in interest income. This effect can largely be attributed to the difference in external investors' yield expectations compared to those of the Bank.

- New production since 2014 has been underwritten according to the much improved credit standards, as evidenced by the NPL formation from these vintages being cumulatively very low.

Strong liquidity and capital position

- The Group ended 2016 with a very **strong capital ratio (CET1) of 17.0%** – this figure already assumes the envisaged dividend payout of EUR 63.8 million (100% of the 2016 result of the Bank and 58% of the Group result) to the shareholders and is still well above the regulatory thresholds. **The Group ROE stands at 7.4% while the normalised after-tax Group RORAC (calculated on 14.75% of RWAs) stands at 9.7%.**

- **Liquidity remains extremely strong, with sizable amounts (EUR 4.9 billion) of unencumbered liquidity reserves in cash and securities.** Consequently, attention is placed on the structure and concentration as well as the yield generated from liquidity reserves. The Group's exposure to interest rate risk is within the targeted, low-risk appetite profile.

STRATEGY of NLB Group

The Group has successfully applied restructuring measures over the last 4 years, thereby stabilising its franchise and returning to profit in all of its core markets. However, the Group is fully conscious of the future challenges to its profitability and growth such as increased competition in a low interest rate environment, more demanding and knowledgeable clients with a greater preference for digital channels, technological trends leading to the tearing down of industry barriers, further regulatory challenges as well as geopolitical risks and volatility in financial markets.

In order to best respond to its future challenges, the Group launched a review of its strategy in the second quarter of 2016. Adopted by the Supervisory Board of the Bank in August 2016, the renewed Group Strategy 2016–2020 is directed at improving the customer experience, optimising its offer of solutions, simplifying the Bank's systems and operations and enhancing distribution channels and capabilities. As the largest banking group with its headquarters and exclusive strategic interest in Southeastern Europe (SEE), the Group will further strengthen its position as a regional specialist.

Part of the strategy aims to deliver modernised information technology (IT) capabilities by establishing or updating key elements of the Bank's IT application architecture. In addition to supporting target business improvements, the Bank aspires for a leaner, more agile and cost-effective IT architecture, thereby becoming fit to respond to the main digital challenges of the industry. On the basis of the new strategy, the Group aims to achieve both short-term improvements to its results as well as build a basis for a better mid- to long-term competitive position. The Group has a clear ambition to increase ROE to above 10% and reduce cost to income (CIR) to approximately 50% with measures defined for both the cost reductions and revenue increases.

OVERVIEW OF NLB GROUP'S financial performance

Key developments

- **Net profit after tax** of EUR 110.0 million in 2016, an increase of EUR 18.1 million or 20% compared to 2015.

- The return on equity **(ROE after tax)** increased to 7.4% (up from 6.6% in 2015). The **common equity tier 1 capital ratio** (CET 1) grew to 17.0% and comfortably exceeds the regulatory requirements. This ratio already assumes a 100% dividend payout of the Bank's 2016 results in the amount of EUR 63.8 million. The RORAC after tax (calculated on an assumed economic need of CET1 of 14.75% of RWA) stands at 9.7%.

- **Profit before impairments and provisions** increased slightly to EUR 186.2 million (2015: EUR 185.6 million). Positive non-recurring effects (successful divestments) somewhat offset the lower recurring revenues, mostly due to the lower interest income from Financial markets activities in Slovenia given the very low interest environment in the euro area. Non-recurring effects influenced the 2016 results:

  - positive effects in the amount of EUR 13.2 million, which include the effects of the sale of a non-core equity investment (EUR 5.5 million) and the Visa EU share transaction (EUR 7.8 million), and
  - non-recurring restructuring costs of EUR 3.8 million.

- **The net interest margin** decreased slightly from 2.70% to 2.59% YoY, with strategic foreign markets showing robust growth in margins of 3.96% (2015: 3.64%), and margins in the Bank dropping to 2.03% (2015: 2.33%) chiefly as a result of the rapidly falling yields in international bond markets and the substantial amounts invested in predominantly investment grade securities (approximately EUR 2.15 billion at the level of the Bank as of the end of 2016).

- **Costs** decreased by 3% YoY due to a further sizable reduction in non-labour costs. CIR consequently improved by 0.8 of a percentage point to 60.9%.

- Impairments and provisions amounted to EUR 60.6 million (2015: EUR 83.1 million), whereas credit-related impairments and provisions amounted to a mere EUR 26 million (2015: EUR 51 million) or 38 bps (on net loans outstanding; 2015: 75 bps), fully accommodating for a one-off provision of EUR 25.8 million on the non-performing portfolio sale in the amount of EUR 500 million of nominal exposure. Other impairments and provisions were established in the net amount of EUR 22.0 million (EUR 27.6 million in 2015), of which majority relates to HR provisions in the amount of EUR 10.6 million (anticipating a further reduction of the headcount) and impairments of real estate assets.

- Active management of the non-performing portfolio resulted in a substantial reduction of NPE according to the European Banking Authority (EBA) methodology from 14.3% in 2015 to 10.0% in 2016. In addition to the organic reduction of NPE, the Group was able to sell off part of the NPL portfolio to investors, which after closing resulted in an NPE reduction of EUR 233.3 million. The Group has adopted a comprehensive and ambitious strategy and action plan on a further significant mid-term reduction of NPE, which is decisively being implemented.

- Total assets amounted to EUR 12.0 billion, having risen by EUR 217.4 million in 2016 due to excess liquidity in the market and consequently the increase of retail and corporate deposits, in spite of the prepayments of the Targeted Long Term Refinancing Operations (TLTRO) 1 and other selected wholesale borrowings, as well as the introduction of an asset management fee for deposits and balances exceeding certain thresholds.

- **Gross loans stood at EUR 7.9 billion** (2015: EUR 8.35 billion) of which gross loans in Key business activities (Corporate/Retail Slovenia, Strategic foreign markets) increased by EUR 483.5 million or 7.7% to EUR 6.7 billion, whereas gross loans of the non-core segment were reduced by EUR 362.3 million in 2016 to the level of EUR 675.9 million.

Income statement

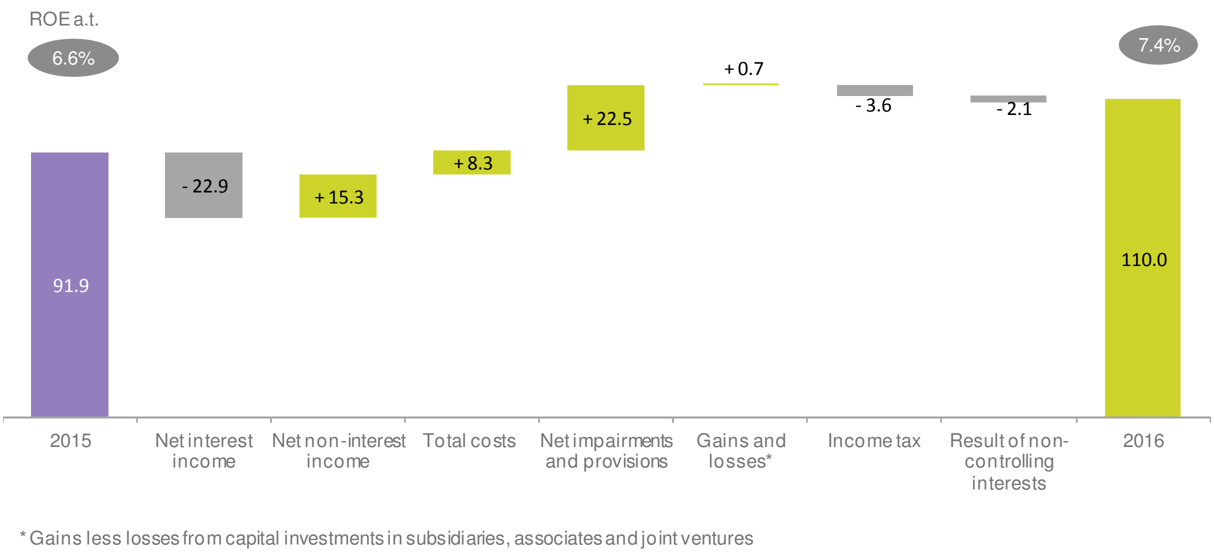
Table 2: Income statement of NLB Group and NLB

	NLB Group			NLB d.d.		
in EUR million	2016	2015	Change	2016	2015	Change
Net interest income	317.3	340.2	-7%	174.9	208.0	-16%
Net fee and commission income	145.7	147.1	-1%	95.3	98.1	-3%
Dividend income	1.2	1.3	-8%	1.1	1.3	-9%
Net income from financial transactions	19.9	3.8	417%	13.3	8.9	50%
Net other income	-8.3	-9.1	-8%	-0.9	-2.9	-70%
Net non-interest income	158.4	143.2	11%	108.8	105.3	3%
Total net operating income	**475.7**	**483.4**	**-2%**	**283.7**	**313.3**	**-9%**
Employee costs	-165.4	-163.2	1%	-103.2	-101.8	1%
Other general and administrative expenses	-95.8	-102.8	-7%	-58.9	-64.0	-8%
Depreciation and amortisation	-28.3	-31.9	-11%	-18.9	-21.4	-12%
Total costs	**-289.5**	**-297.8**	**-3%**	**-181.0**	**-187.2**	**-3%**
Result before impairments and provisions	**186.2**	**185.6**	**0%**	**102.7**	**126.1**	**-18%**
Impairments of AFS and HTM financial assets	-0.3	-4.7	-94%	-0.3	-2.6	-89%
Credit impairments and provisions	-26.1	-50.9	-49%	-15.2	-28.1	-46%
Investments in ass.&JV - using the equity method	-12.3	-	-	-37.6	-50.3	-25%
Other impairments and provisions	-22.0	-27.6	-20%	-10.8	-7.0	55%
Impairments and provisions	-60.6	-83.1	-27%	-64.0	-88.0	-27%
Gains less losses from capital investments in subsidiaries, associates and joint ventures[1]	5.0	4.3	16%	28.9	13.7	110%
Profit before income tax	**130.6**	**106.8**	**22%**	**67.7**	**51.8**	**31%**
Income tax	-15.0	-11.4	32%	-3.9	-8.0	-51%
Result of non-controlling interests	5.6	3.5	62%	0.0	0.0	-
Profit for the period	**110.0**	**91.9**	**20%**	**63.8**	**43.9**	**45%**

[1] NLB d.d. includes dividends from subsidiaries, associates and joint ventures

Profit

Figure 1: Profit after tax of NLB Group – evolution YoY (in EUR million)

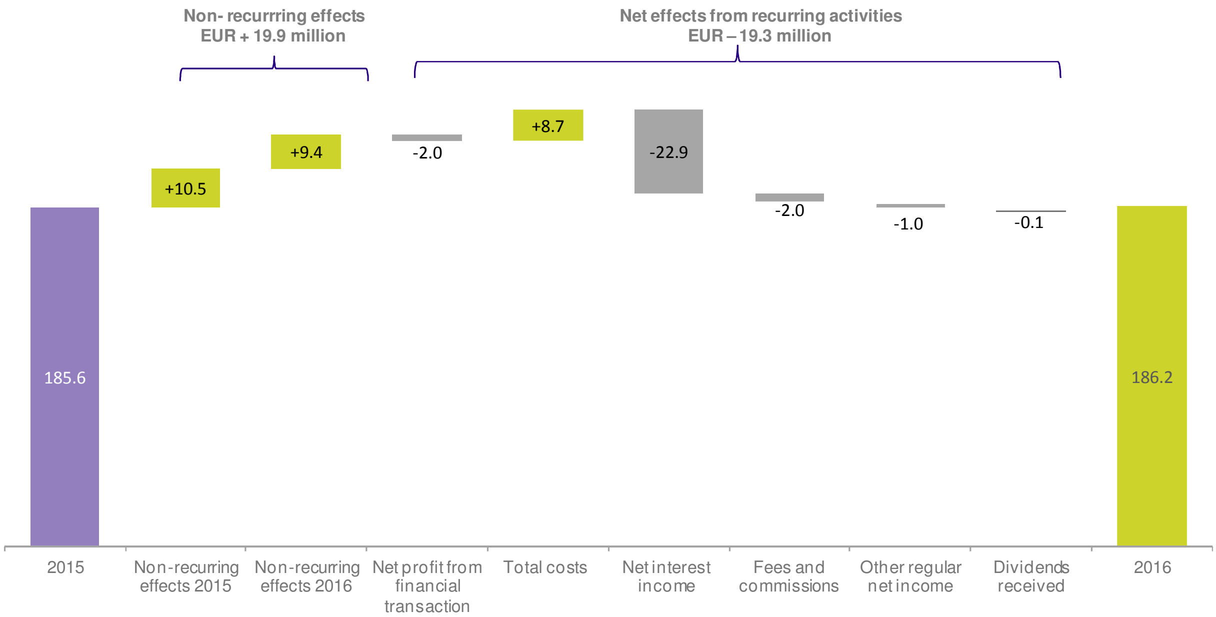


The net profit for 2016 was EUR 110.0 million, which is 20% higher compared to 2015. This result is based on the following key drivers:

- solid performance in key business areas with very positive profit evolution especially in Foreign strategic subsidiaries and solid recovery in loan demand in all key business areas resulting in 8% asset growth YoY over all key business segments (Retail/Corporate Slovenia, Foreign strategic markets)

- a successful cost-reduction process with substantial savings achieved specifically in general and administrative expenses (-7% YoY)
- a very solid performance in the cost of risk, being substantially lower than last year although fully accommodating the effects of the non-performing portfolio sale,
- resilient fee and commission income and positive results from asset disposals (Visa shares, Trimo).

Figure 2: Profit before impairments and provisions of NLB Group – Non-recurring and recurring effects



Non-recurring results turned out to be EUR 19.9 million higher YoY, of which EUR 9.4 million is attributable to non-recurring effects in 2016. The Bank divested a non-core equity stake (Trimo) at a profit of EUR 5.5 million (comprising of realized gain on equity investment and fee received as a financial consultant for the bank syndicate), Visa shares at a profit of EUR 7.8 million, and booked a restructuring charge of EUR 3.8 million.

The recurring results were mainly influenced by a solid improvement in costs (-3% YoY) and strong dynamics in the composition of interest income:

- the stable performance in interest income in Key business activities at EUR 243.0 million (2015: EUR 244.4 million) – strong growth in Strategic foreign markets (+9.4% YoY to EUR 136.9 million) offset by lower interest income due to higher margin pressure in Slovenia especially in the Corporate segment (-14.0% YoY) with more stable results in Retail (-6.5% YoY normalised by the impact of the non-performing portfolio sale), where high growth of new loans in last quarter of 2016 was recorded, and
- the rapid decline in interest income from Financial markets (mostly invested in medium-term investment grade securities) and the expiry of higher yielding bonds received by the BAMC in 2013.

Profit before tax - segment results

Figure 3: Profit before tax of NLB Group by segments (in EUR million)

Core markets and activities[1]: a significant improvement in operations in strategic foreign markets

In 2016, the main commercial activities of the Group, comprising Corporate Banking – Slovenia[2], Retail Banking – Slovenia and Strategic Foreign Markets, collectively showed, normalised by the non-recurring effects of divesting a larger Slovenian non-performing portfolio sale, a positive evolution with profit before tax increasing from EUR 134.8 million to EUR 151.6 million.

Both Retail and Corporate segments in Slovenia show a solid performance, with the Retail segment in particular – normalised for the non-performing portfolio sale – revealing healthy growth with a positive outlook for the future. The highest growth in profitability resulted from the strong development of Strategic foreign markets with record results in Macedonia and the strong performance of the entities in Bosnia and Herzegovina and Kosovo. Solid growth of retail lending with still attractive margins was recorded in all markets, providing support for implementation of the strategy.

The Financial markets segment reflects the rapid decline in yields on investments in securities which get reinvested and thus repriced over a 3–4 year cycle. In addition, the higher yielding bonds received in 2013 as compensation for the transfers to the Bank Asset Management Company (BAMC; the Slovenian 'bad bank') matured (EUR 300 million as at end of 2015, the rest with the end of 2016). With the Bank maintaining a conservative investment profile in mostly Sovereigns and Financial Institutions, yields on reinvestments have considerably declined over the last years, including 2016. However, a slight reversal of this trend was seen towards the end of 2016.

Non-core markets and activities: a controlled wind down

The process of an intensive reduction in non-core members and business activities continued successfully throughout the year. In most of the remaining non-core members, liquidation processes were initiated in 2016 in compliance with the EC stipulations. Nonetheless, collection activities from all these entities continue with full dedication. The loss of this segment was substantially lower compared

[1] Corporate banking in Slovenia, Retail banking in Slovenia, Financial Markets in Slovenia, Foreign Strategic markets

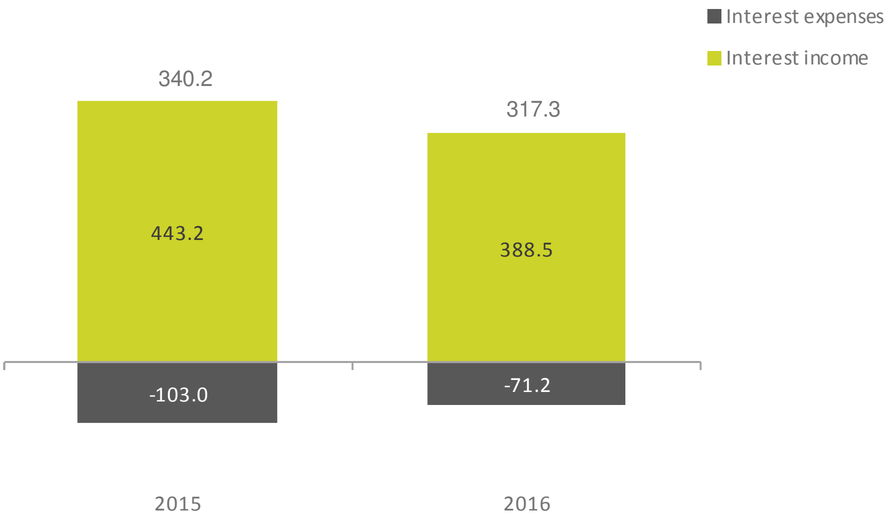
[2] Corporate banking in Slovenia includes Key, Mid and Small Corporate and Restructuring and Workout

to 2015 thanks to the much strengthened collection ability and already quite high coverage ratios. However, the segment still accounts for a sizable cost base of some EUR 24 million (of which approximately EUR 20 million is in non-core subsidiaries). In addition, the result of the segment was burdened by the non-performing portfolio sale in the amount of EUR 7 million.

Other activities
Other activities include categories in the Bank whose operating results cannot be allocated to individual segments, restructuring costs, and expenses from the vacant business premises. In 2016, the segment was burdened by the HR provisions in the Bank for strategy implementation in the amount of EUR 9.4 million and other restructuring charges in amount of approximately EUR 7 million on top of the regular contributions to the European Single Resolution Fund (SRF) and Slovenian Deposit Guarantee Scheme (DGS) payments in a total amount of EUR 8.5 million. The non-recurring effect of the Visa EU share transaction amounting to EUR 7.8 million increased the result of the segment.

Net interest income

Figure 4: Net interest income of NLB Group (in EUR million)

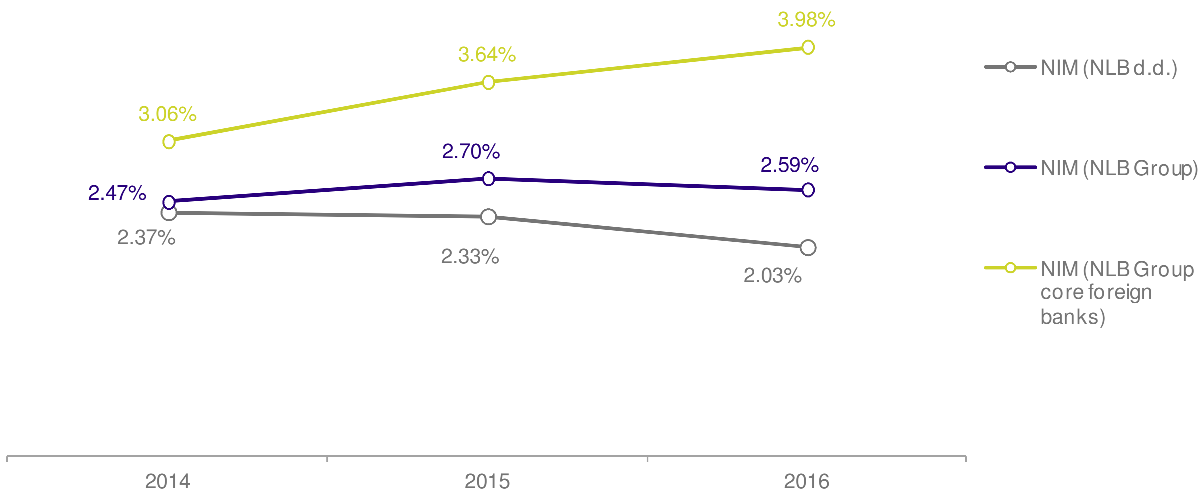


Net interest income of the Group accounted for 66.8% of the Group's total net revenues, decreasing by 6.7% YoY to EUR 317.3 million, mostly due to falling interest income in Slovenia – especially in the Financial markets segments given the historically low yield environment. The Group continued with the very active management of its interest expenses, repaying or repricing some funding lines and continuously adjusting deposit pricing to the prevailing low interest rate environment, thereby substantially reducing interest expenses (-30.9% YoY). As a reaction to the negative deposit rates quoted by the ECB, the NLB partially introduced asset management fees for larger deposits placed by Corporates in Slovenia.

Net interest margin

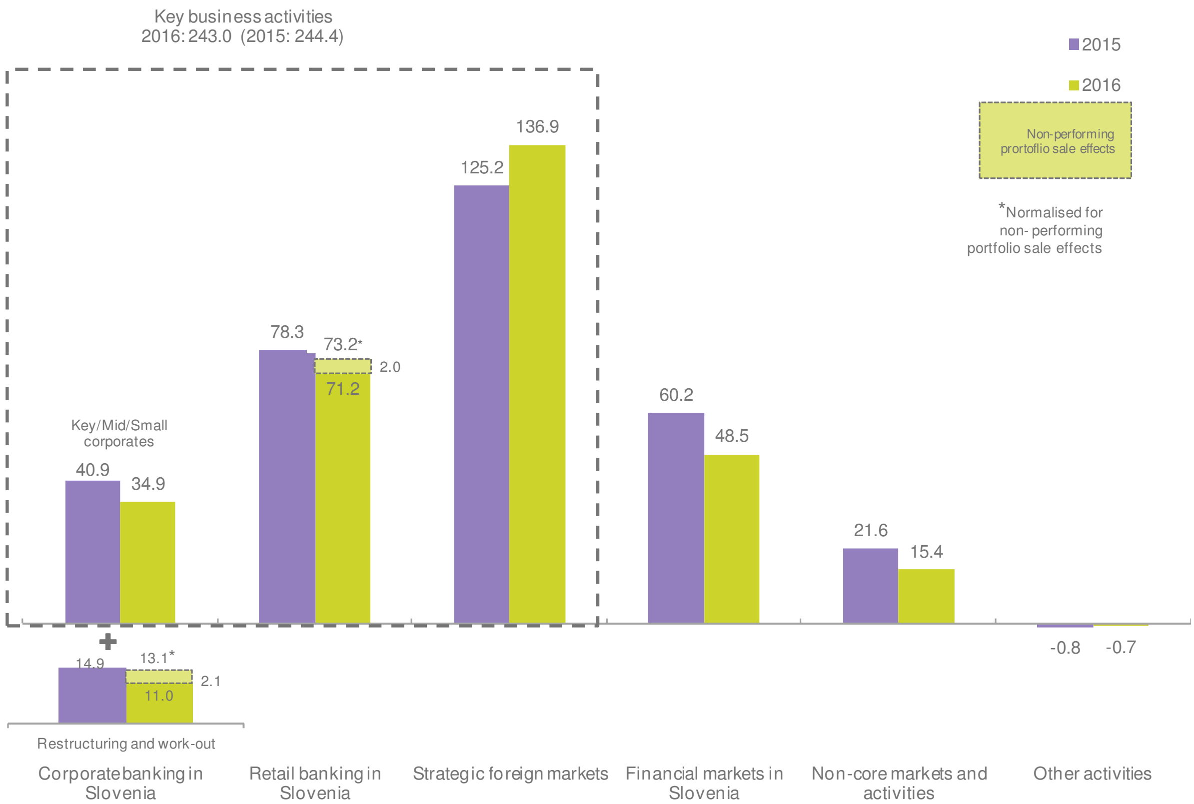
The decline in the interest margin in Slovenia and the euro area **was partly compensated by the improved margins in SEE markets.** The net interest margin (NIM) on the Group level decreased from 2.70% to 2.59% YoY, mostly as a result of the rapidly falling market interest rates in international bond markets and ongoing repricing of the securities investment book, respectively, the very competitive environment of the Slovenian banking market which in the Corporate segment is still in a deleveraging process. However, a slight reversal of this trend occurred towards the end of 2016. Especially retail lending growth has picked up in Slovenia due to the improved macro environment helping to stabilise margins in this segment. Foreign strategic subsidiaries still showed growth in margins thanks to the increased efforts to manage the cost of funding and the strong performance of higher yielding activities in consumer lending throughout the region.

Figure 5: Net interest margin (in %)



Net interest income – segment results

Figure 6: Net interest income of NLB Group by segments (in EUR million)



Net interest income in **Key business activities** remained very stable overall, with the higher pressure from business in Slovenia being offset by the higher growth in Strategic Foreign Markets.

Net interest income in Financial markets decreased predominantly due to the continuous reinvestment of the securities portfolio at lower yields and the expiry of higher yielding securities received from the BAMC (EUR 300 million expiring already in 2015, EUR 300 million expiring at the end of 2016).

In line with the strategy of the Group, non-core markets and activities decreased and consequently net interest income was lower.

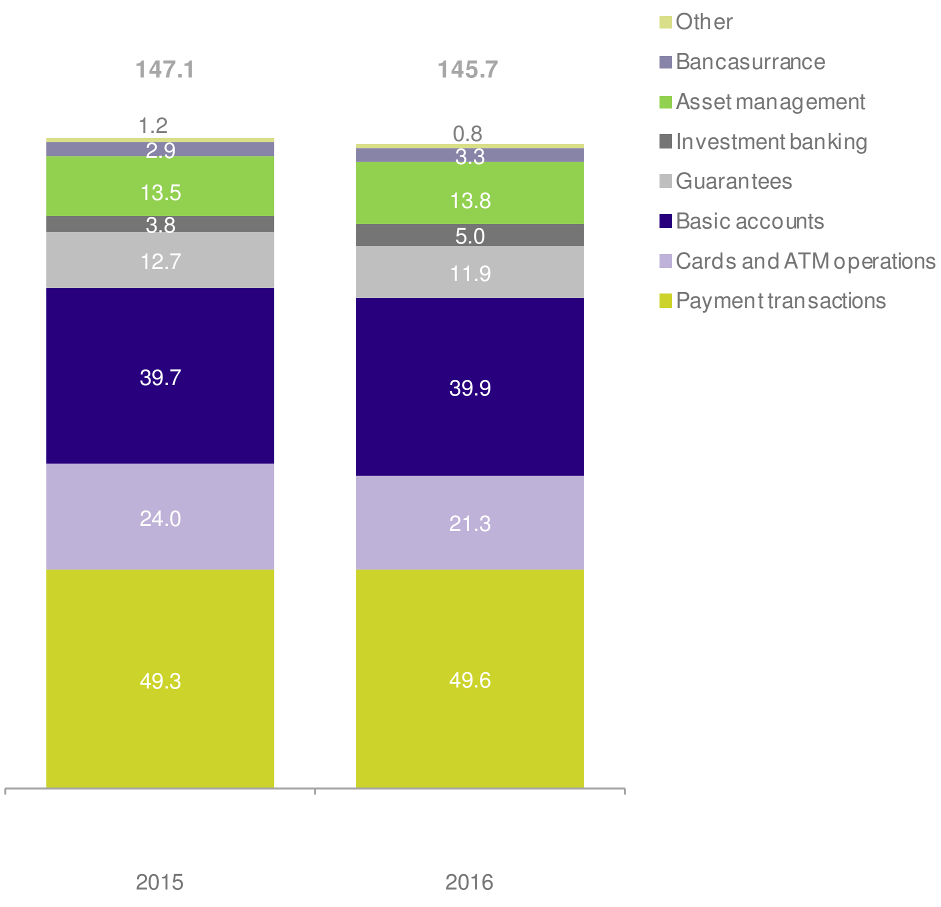
Net non-interest income

Net non-interest income of the Group was EUR 15.3 million higher compared to 2015 at the level of EUR 158.4 million (2015: EUR 143.2 million), primarily due to the positive non-recurring effects from asset disposals in 2016 (Visa, Trimo) while the negative non-recurring effects incurred in 2015.

Net fees and commissions

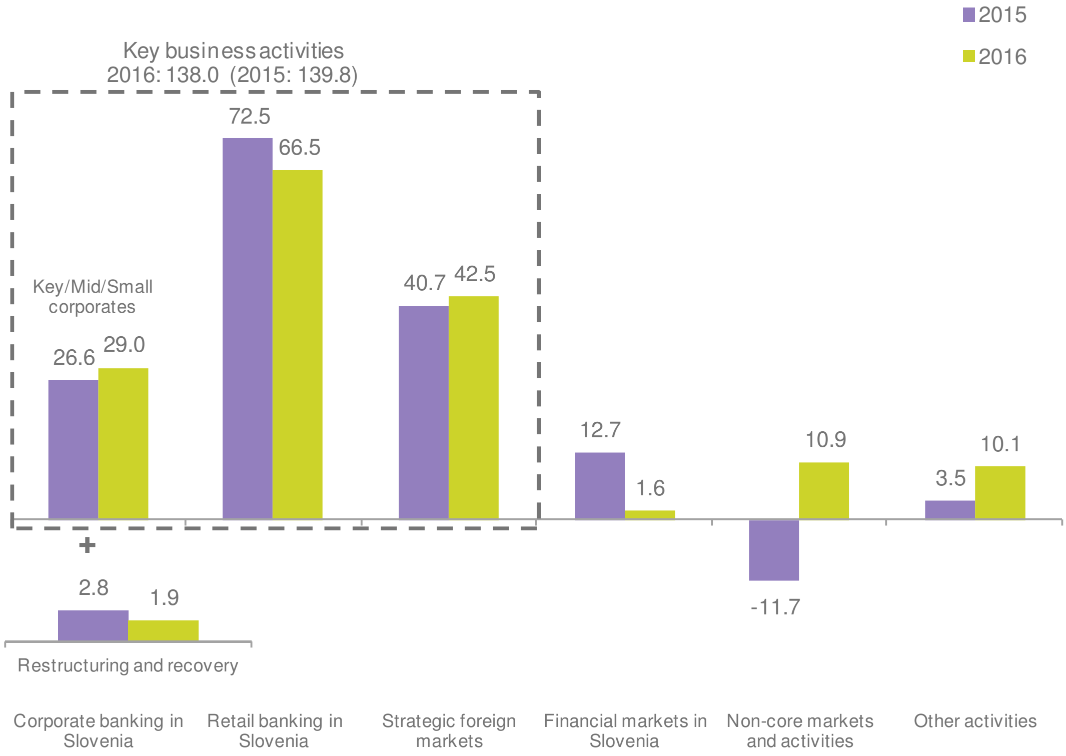
The most important source of net non-interest income is **net fees and commissions,** which remained very resilient at the level of EUR 145.7 million (2015: EUR 147.1 million) with the Group making increased efforts to grow its ancillary revenue base with fee-based products such as insurance and asset management. Some decline in cards and ATM operations was notably due to the negative effects of the EU Directive in the area of card operations (MiFiD).

Figure 7: Structure of net fees and commissions of NLB Group (in EUR million)



Net non-interest income – segment results

Figure 8: Net non-interest income by segments of NLB Group (in EUR million)



The net non-interest income of Key business activities continues to be resilient in both Slovenia and in Strategic foreign markets. Some decline was noted in Retail banking in Slovenia, largely explained by the new regulation on card pricing.

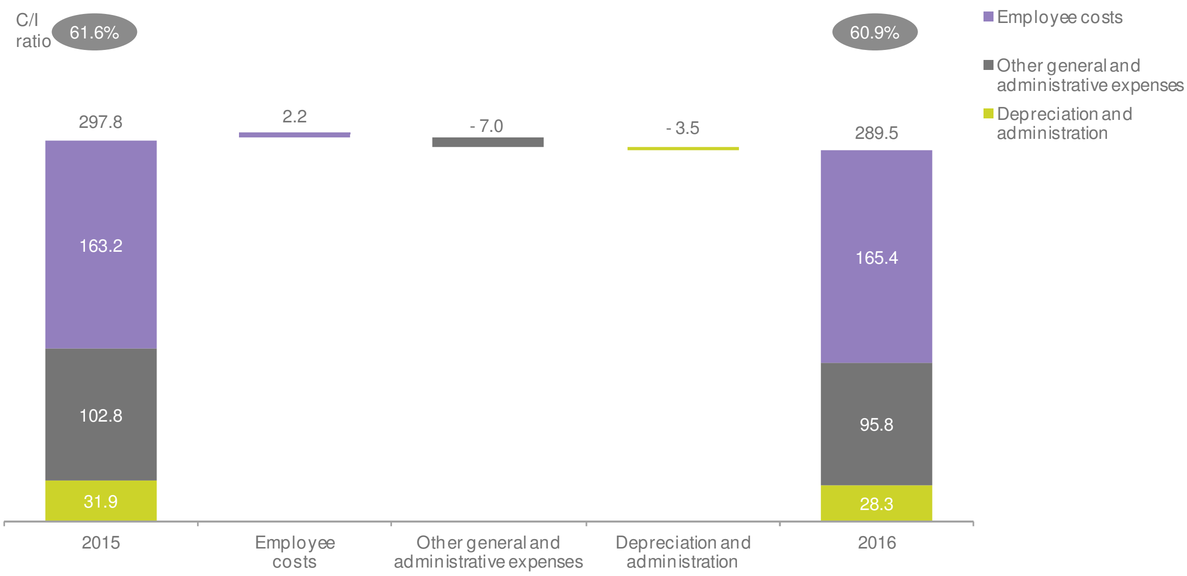
Net non-interest income in Financial markets in Slovenia was EUR 11.1 million lower as the 2015 result included profits from the non-recurring event of selling RoS bonds (EUR 5.2 million), while the 2016 result includes negative effects in the amount of EUR 3.0 million from the prepayment of wholesale funding.

Non-core markets and activities in 2016 include the positive non-recurring income from the sale of non-strategic equity investments, while in 2015 the result was burdened by the non-recurring FX charge.

The other activities segment includes income from non-bank services for external customers (EUR 8.8 million) and in 2016 also non-recurring income from the VISA EU share transaction (EUR 7.8 million) and payments to the SRF as well as the DGS in the amount of EUR 8.5 million, as well as restructuring charges booked in the Bank (2016: EUR 3.8 million).

Total costs

Figure 9: Total costs of NLB Group – evolution YoY (in EUR million)



Costs continue to be a focus of management attention. Costs declined overall by 3% YoY in 2016. Special attention was given in 2016 to General and administrative expenses with substantial savings achieved (-7% or EUR 7.0 million YoY). The cost-reduction trend is present in most members of the Group, especially the non-strategic ones.

Employee costs were higher mainly due to the reintroduced payment of supplementary pension insurance for employees, the higher holiday allowance paid in the Bank and one-off costs incurred with HR redundancies in NLB Banka Beograd in a total amount of EUR 0.9 million. The Group also created provisions totalling EUR 10.6 million in anticipation of future HR redundancies envisaged in Slovenia (shown in Other Provisions in the Financial Statement).

As a result, the cost to income ratio (CIR) amounted to 60.9%, namely a slight improvement (0.8%) compared to 2015.

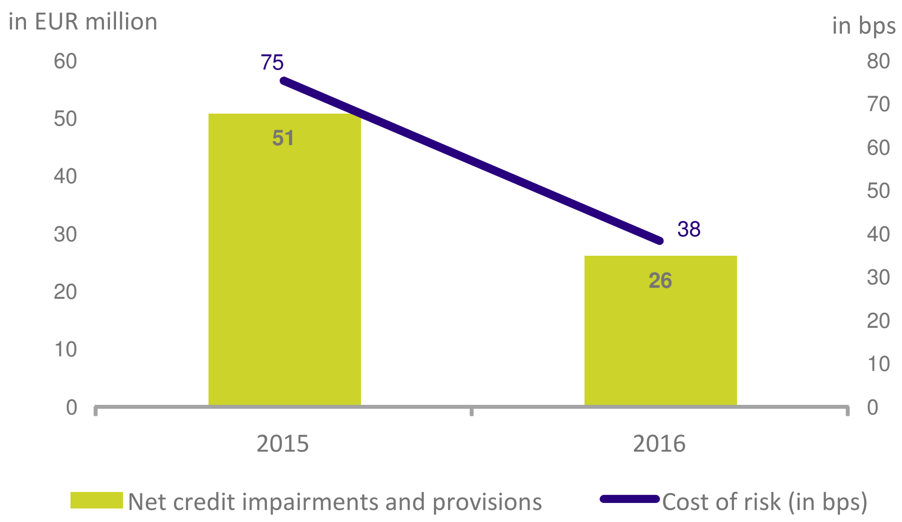
Going forward, NLB Group will aim to significantly improve operational efficiency by focusing on the transition to STP processing via online channels with the consequent further rationalisation of the traditional network, employee and other general and administrative costs, while ensuring a reduction of the remaining non-core cost base in an accelerated manner.

Net impairments and provisions

Net impairments and provisions amounted to EUR 60.6 million, which is 27% less than in 2015 due to the improvement in the quality of the credit portfolio's structure, positive effects from the successful restructuring, and the resolution of non-performing receivables. Accordingly, the net cost of risk decreased from 75 basis points to 38 basis points despite the additional impairments related to the non-performing portfolio sale in the amount of EUR 25.8 million.

Other impairments and provisions were established in a net amount of EUR 22.0 million of which most material were HR provisions (EUR 10.6 million) and impairments of real-estate assets (EUR 3.3 million).

Figure 10: NLB Group credit impairments and provisions, costs of risk (in bps)



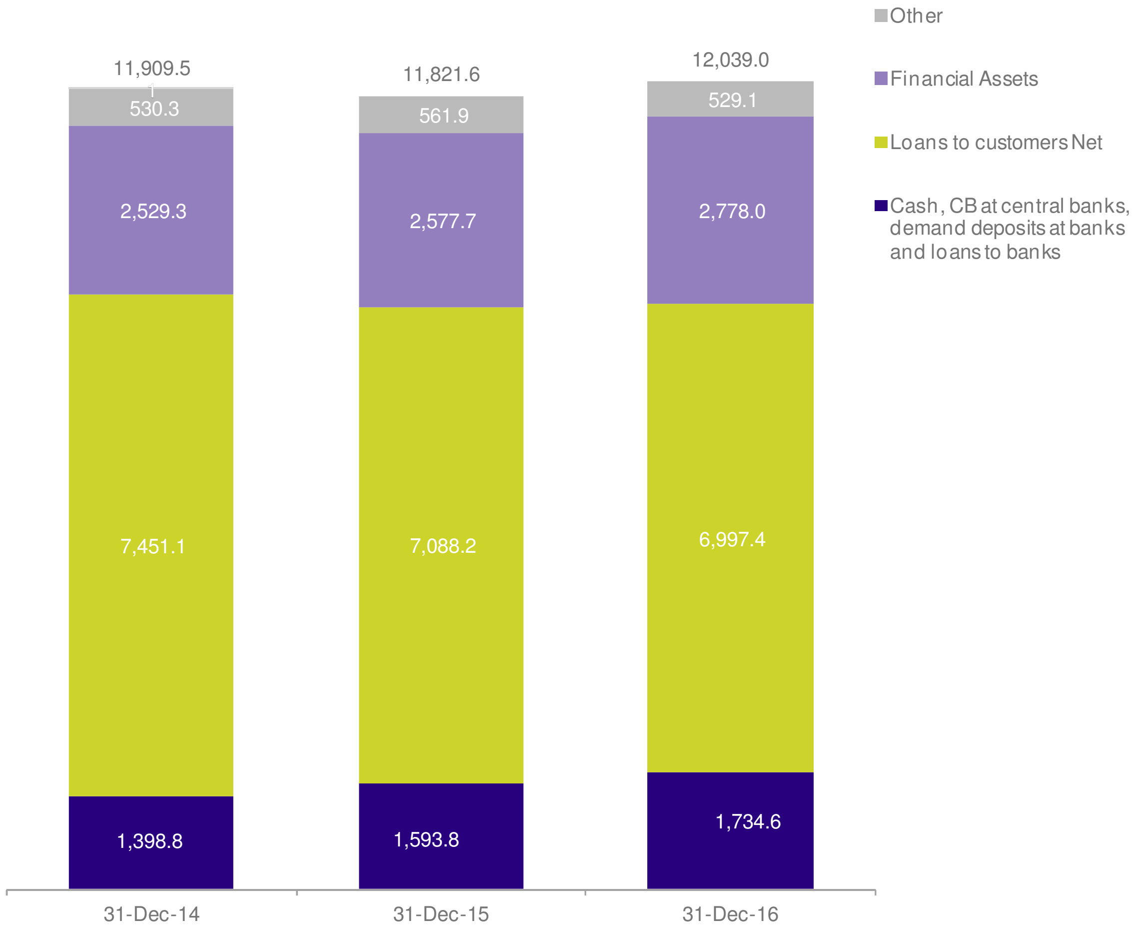
Statement of financial position

Table 3: Statement of financial position of NLB Group and the NLB

in EUR million	NLB Group 31.12.2016	NLB Group 31.12.2015	Change	NLB d.d. 31.12.2016	NLB d.d. 31.12.2015	Change
Cash, cash balances at central banks and other demand deposits at banks	1,299.0	1,162.0	12%	617.0	496.8	24%
Loans to banks	435.5	431.8	1%	408.1	345.2	18%
Loans to customers	6,997.4	7,088.2	-1%	4,928.9	5,220.7	-6%
Gross loans	7,900.8	8,351.0	-5%	5,433.7	5,915.4	-8%
- corporate	3,917.4	4,282.3	-9%	2,769.1	3,063.0	-10%
- individuals	3,190.7	3,050.8	5%	1,990.2	1,957.9	2%
- state	792.7	708.3	12%	674.4	585.0	15%
- BAMC bonds	-	309.6	-100%	-	309.6	-100%
Impairments	-903.4	-1,262.8	-28%	-504.7	-694.7	-27%
Financial assets	2,778.0	2,577.7	8%	2,295.2	2,086.7	10%
- Held for trading	87.7	267.4	-67%	87.7	267.9	-67%
- Available-for-sale, held to maturity and designated at fair value through income statement	2,690.3	2,310.3	16%	2,207.6	1,818.8	21%
Investments in subsidiaries, associates and joint ventures	43.2	39.7	9%	346.7	353.1	-2%
Property and equipment, investment property	280.5	301.2	-7%	98.6	103.2	-4%
Intangible assets	34.0	39.3	-14%	23.3	29.6	-21%
Other assets	171.4	181.7	-6%	60.0	71.5	-16%
TOTAL ASSETS	**12,039.0**	**11,821.6**	**2%**	**8,778.0**	**8,706.8**	**1%**
Deposits from customers	9,439.2	9,025.6	5%	6,617.4	6,298.3	5%
- corporate	2,182.6	2,168.5	1%	1,442.3	1,416.0	2%
- individuals	6,905.1	6,493.5	6%	4,943.5	4,630.1	7%
- state	351.5	363.6	-3%	231.7	252.1	-8%
Deposits from banks and central banks	42.3	58.0	-27%	75.0	96.7	-22%
Debt securities in issue	277.7	305.0	-9%	277.7	305.0	-9%
Borrowings	455.4	671.3	-32%	342.7	536.1	-36%
Other liabilities	271.6	284.1	-4%	200.3	228.6	-12%
Subordinated liabilities	27.1	27.3	-1%	-	-	-
Equity	1,495.3	1,422.8	5%	1,264.8	1,242.2	2%
Non-controlling interests	30.3	27.6	10%	-	-	-
TOTAL LIABILITIES AND EQUITY	**12,039.0**	**11,821.6**	**2%**	**8,778.0**	**8,706.8**	**1%**

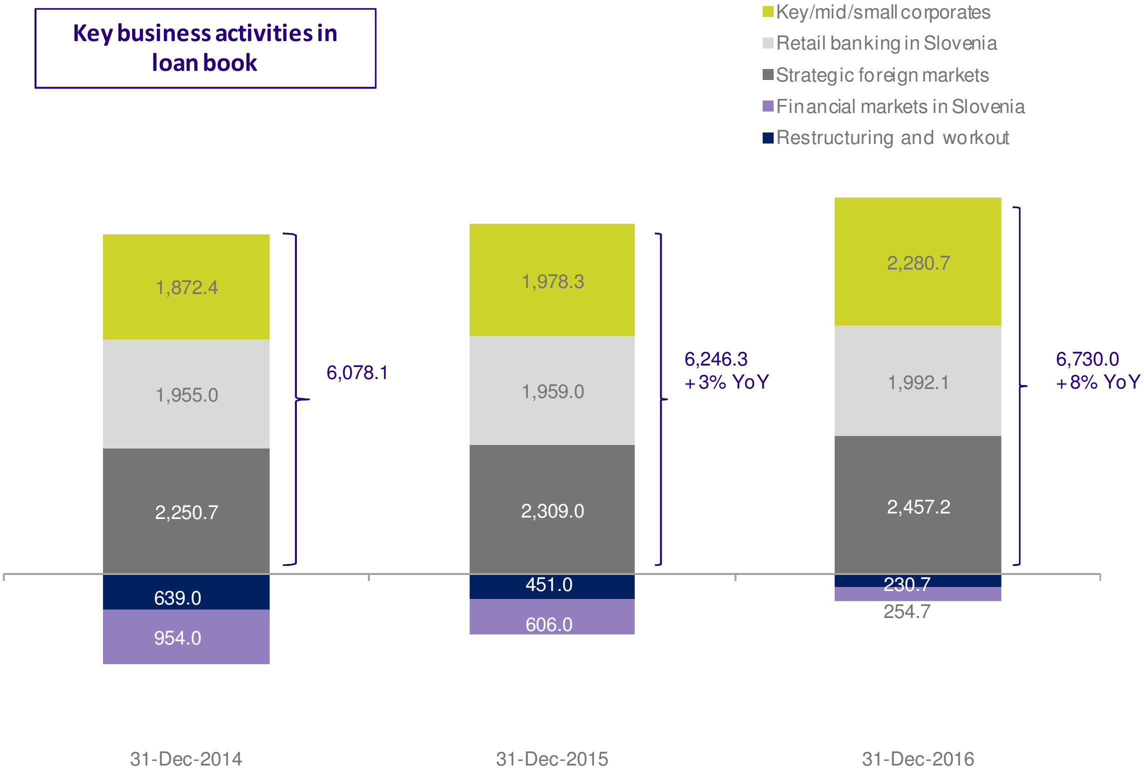
Assets

Figure 11: Total assets of NLB Group – structure (in EUR million)



Total assets increased by EUR 217.4 million in 2016 due to excess liquidity in all core markets and the continued inflow of deposits. In Slovenia the Bank benefits from a particularly strong deposit franchise with a market share in excess of our market share on total assets.

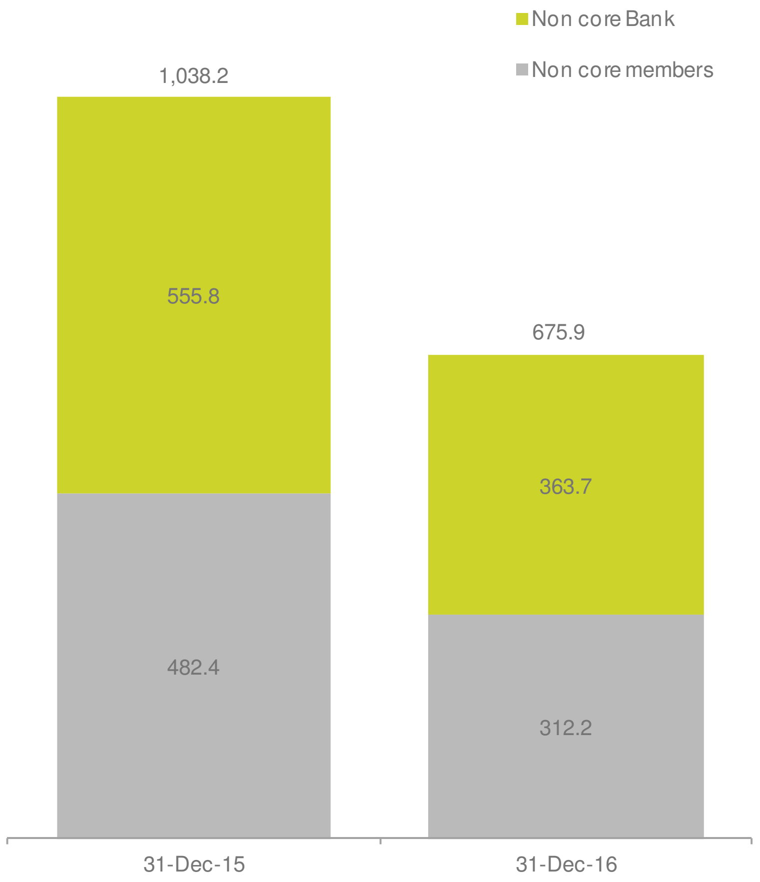
Figure 12: NLB Group gross loans to customers by core segment (in EUR million)



Gross loans in **Key business activities** increased by EUR 483.5 million or 7.7% compared to the end of 2015. Very strong volume growth was shown in the Corporate segment in Slovenia with an increase of EUR 302.3 million (+15.3% YoY), followed by growth in Strategic foreign markets (+EUR 148.2 million or 6.4%). This represents a very solid basis for the future evolution of the core performing client portfolios.

Loans to Retail clients in Slovenia rose by EUR 33.1 million, normalised by the effects of non-performing portfolio sale the increase would have been EUR 87.4 million (+4.2% YoY) in line with the market evolution a noticeable pickup in activities in the housing loans segment.

Figure 13: NLB Group gross loans to customers by non-core segment (in EUR million)



Thanks to the continuous efforts to wind down non-core exposures with a dedicated taskforce, gross loan volumes continued to decline to the level of EUR 675.9 million (-34.9% YoY), now representing 8.5% of total gross loans outstanding.

The non-core segment assets continued to decline substantially to a level of EUR 503 million (2015: EUR 755 million, -33% YoY).

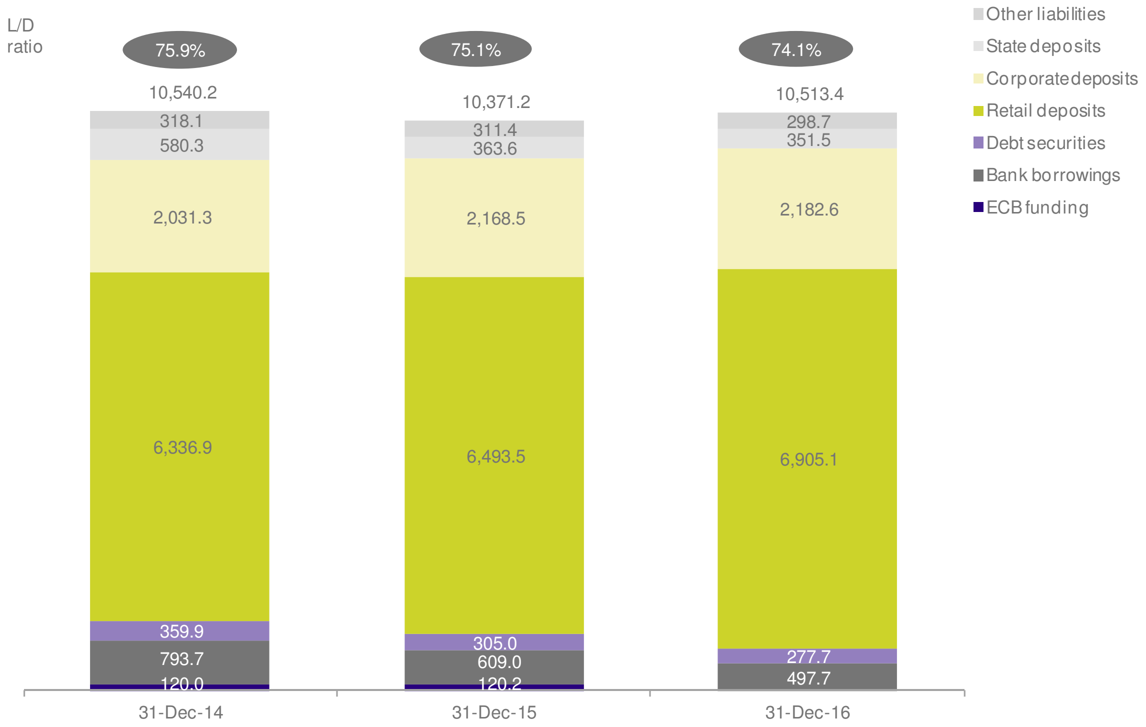
Liabilities

Total liabilities increased to EUR 10,513.4 million, chiefly due to an increase in customer deposits.

Deposits from customers rose, accounting for 90% of the total funding of the Group. Retail segment deposits were 6% higher, corporate ones remained stable, while government deposits decreased. Given the negative ECB deposit rate, the Bank introduced a fee on larger corporate deposits, with the threshold being adjusted gradually.

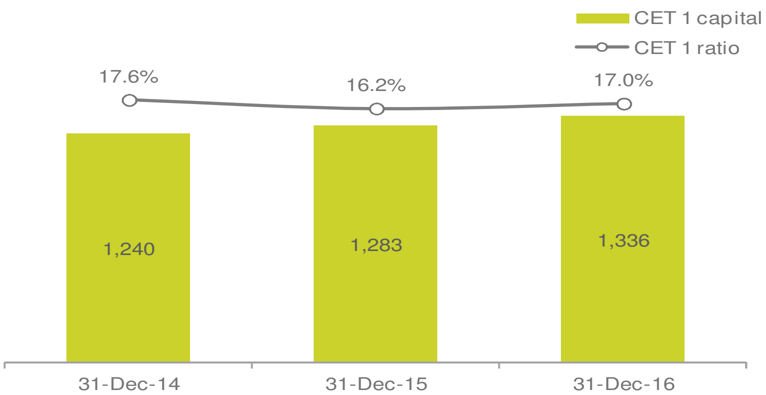
At the end of December 2016, the **LTD (net)** was **74%** on the Group level, having decreased by 1.0 percentage point compared to the end of December 2015. The Group thus shows a robust self-funding capacity, also supporting the planned growth predominantly in retail lending.

Figure 14: Total liabilities of NLB Group – structure (in EUR million)



Capital adequacy

Figure 15: NLB Group CET 1 capital (in EUR million) and CET 1 ratio (in %)



The Bank maintains a capital ratio that is comfortably above the current regulatory thresholds on a fully-loaded basis.

The CET 1 ratio of the Group equalled 17.0%[3], increasing by 0.8 of a percentage point from 2015. The Group capital is currently exclusively comprised of CET 1, i.e. capital of the highest quality, therefore all three capital ratios (CET 1 ratio, Tier1 ratio and Total capital ratio) are the same.

According to the SREP decision at the end of 2016, the Bank was obliged to maintain the CET 1 ratio on a consolidated basis at the level of 12.75% (covering the Pillar 1 and Pillar 2 requirement and also the capital conservation buffer in the amount of 0.625%). From 1 January 2017, the new SREP decision applies, prescribing that the Bank maintains the total capital ratio on a consolidated basis at the level of 12.75% (covering the Pillar 1 and Pillar 2 requirement and also the capital conservation buffer in the amount of 1.25%).

[3] Result of 2016 already included, reduced by the expected dividend payout in the amount of EUR 63.8 million.

RISK management

The key goal of Risk Management is to assess, monitor and manage risks within the Group. In 2016, upgrades were made to the Risk Appetite Statement and Risk Strategy, representing the Group's fundamental risk management documents. Moreover, the Group further enhanced its risk management system in order to support the business decision-making process by upgrading the Internal Capital Adequacy Assessment Process (ICAAP), introducing the Internal Liquidity Adequacy Assessment Process (ILAAP), enhancing internal stress-testing capabilities and further upgrading the comprehensive steering processes.

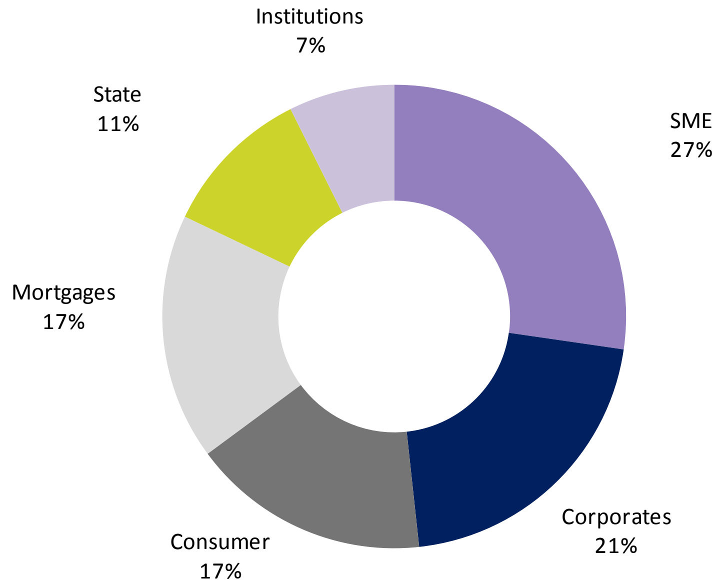
One of the key aims of Risk Management is to preserve a prudent level of the Group's capital adequacy. The Group monitors its capital adequacy at the Group and individual subsidiary bank level within the established ICAAP process under both normal conditions (regulatory capital adequacy) and stressed conditions. As at 31 December 2016, the Group had a strong level of capital adequacy (CET 1) of 17%, which is well within the stated risk appetite limit and above the EU average as published by the European Banking Authority (EBA). In line with the Supervisory Review and Evaluation Process (SREP), CET 1 and the total capital requirement for the Group in 2017 are currently fulfilled in the current and fully loaded requirement.

The second key aim is to maintain a solid level and structure of liquidity. The Group holds a strong liquidity position at the Group and individual subsidiary bank level, which is well above the risk appetite with the liquidity coverage ratio (LCR) (according to the delegated act) of 332% and unencumbered eligible reserves in the amount of EUR 4,856 million. Even in the event the stress scenario were to be realised, the Group has sufficiently high liquidity reserves in place in the form of placements at the ECB, prime debt securities and money market placements. The main funding base of the Group at the Group and individual subsidiary bank level predominately entails customer deposits with a comfortable level of LTD in the amount of 74%, giving the Group the potential for further customer loan placements.

The improving quality of the credit portfolio represents the third and the still most important key aim, with a focus on the quality of new placements leading to a diversified portfolio of customers. The Group is actively present on the market, financing existing and new creditworthy clients. The lower indebtedness of companies in Slovenia and their successful restructuring has had a positive influence on the approval of new loans. In the retail segment, positive trends were shown throughout the region in clients' greater trust in economic developments and the related consumption and selective recovery of the real estate market. The Group puts considerable emphasis on new corporate and retail financing, the sustainability of the credit risk volatility and the sustainable size of the subsidiary banking members.

Their primary goal is to provide comprehensive services to clients by taking prudent risk management principles into account. The efforts resulted in the moderate formation of new NPLs and a sustainable cost of risk in 2016, also partly related to the positive macroeconomic environment conditions. The current structure of gross exposures (on- and off-balance sheet) consists of 33.8% of retail clients, 21.0% of large corporate clients, 27.3% of SMEs and micro companies, while the remainder of the portfolio entails other liquid assets.

Figure 16: NLB Group structure of the credit portfolio by segment as at 31 December 2016



Gross exposures also include reserves at Central Banks and demand deposits at banks

Figure 17: Structure of the NLB Group credit portfolio by client credit ratings (in EUR million) as at year end

The restructuring and work-out capacities and approaches built in the past are largely still occupied by the legacy of NPE, although increasingly focused on actively resolving new cases with a faster and more active approach to restructuring and work-out. The structured approach from the past and successful application of various restructuring tools resulted in numerous clients being cured in 2016 and their transfer to the front office. The Bank has made substantial progress in retail restructuring by focussing on a systematic approach and proactively using standardised tools for the timely restructuring of exposures to private individuals.

The strong commitment to reduce the NPE legacy on the Group level continued in 2016. Precisely set targets and constant monitoring of the realisation enabled a further substantial reduction in the volume of the non-performing portfolio to be achieved. The existing non-performing credit portfolio stock in the Group was reduced from EUR 1,896 million to EUR 1,299 million, which does not include the restructured exposures in the last year, which hold good potential to be cured in 2017. The realised sale of the non-performing portfolio to investors in two tranches (corporate and retail) resulted in an NPE reduction of EUR 233.3 million. The combined result of all effects was that the share of NPLs decreased from 19.3% to 13.8%, while the share of NPE by the EBA methodology was reduced from 14.3% to 10.0%.

An important Group strength is the coverage ratio, which remains high at 76.1% (an increase of 3.9 percentage points). Further, the Group's NPL coverage ratio grew to 64.6%, which is well above the EU average as published by the EBA (44.3%). As such, it enables a further reduction in NPLs without significant influencing the cost of risk in the next years.

Figure 18: NLB Group NPE ratio (year-end NPE% by the EBA)

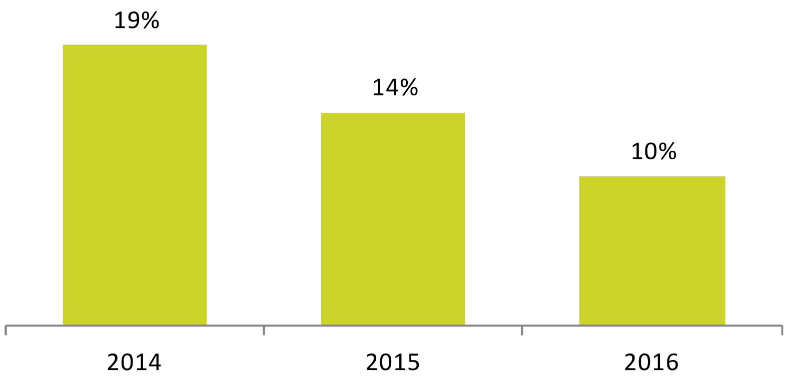


Figure 19: NLB Group Coverage ratio (year-end %)[1]

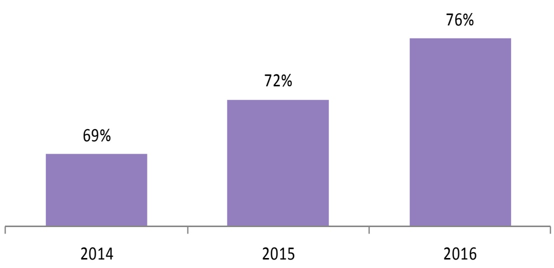
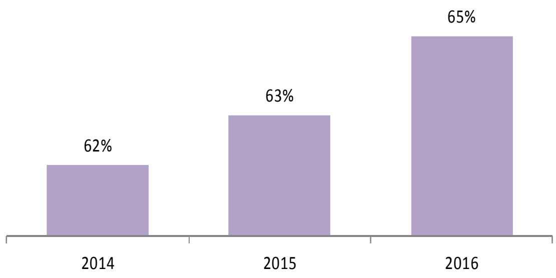


Figure 20: NLB Group NPL Coverage ratio (year-end %)[2]



[1] The coverage of the gross non-performing loan portfolio with impairments on all of the loan portfolio
[2] The coverage of the gross non-performing loan portfolio with impairments on the non-performing loan portfolio

When considering market risks, the Group pursues the orientation that such risks should not significantly affect a single Group subsidiary or the whole operations of the Group. The Group operates its main business activities in euros, while in the case of the banking subsidiaries, beside their domestic currencies, they also partly operate in euros. Nevertheless, the Group's net open FX position is very low and amounts to less than 5.7% of capital.

Consequently, the Group's exposure to interest rate risk is relatively low, but has recently increased moderately. The Bank's net interest income sensitivity in the case of a Euribor increase by 50 bps would amount to EUR 14.9 million, while in the case of a decrease the exposure would be lower due to zero floor clauses. Moreover, the basis point value (BPV) sensitivity of 200 bps equals 14.8% of capital.

In the area of operational risks, additional efforts were made with regard to proactive prevention and the minimisation of potential damage in the future. Special attention was paid to developing the stress-testing system, based on modelling data on loss events and scenario analysis referring to potential high severity, low frequency events. Further, key risk indicators as an early warning system for the broader field of operational risks were established with the aim of improving the existing internal controls and reacting on time when necessary.

FINANCIAL STATEMENTS

Unaudited Annual Financial Statements of NLB Group and NLB

Condensed income statement

in EUR thousand

	NLB Group		NLB	
	2016	2015	2016	2015
Interest and similar income	388,494	443,203	215,550	269,000
Interest and similar expense	(71,189)	(103,001)	(40,672)	(60,993)
Net interest income	**317,305**	**340,202**	**174,878**	**208,007**
Dividend income	1,238	1,346	1,144	1,264
Fee and commission income	194,371	195,710	123,014	128,896
Fee and commission expense	(48,706)	(48,640)	(27,728)	(30,828)
Net fee and commission income	**145,665**	**147,070**	**95,286**	**98,068**
Gains less losses from financial assets and liabilities not classified as at fair value through profit or loss	14,788	10,659	14,639	10,685
Gains less losses from financial assets and liabilities held for trading	6,921	(18,877)	336	(25,304)
Gains less losses from financial assets and liabilities designated at fair value through profit or loss	235	(3)	-	-
Fair value adjustments in hedge accounting	(3,239)	231	(2,437)	231
Foreign exchange translation gains less losses	1,158	11,831	738	23,251
Gains less losses on derecognition of assets	867	(624)	252	(450)
Other operating income	24,442	27,329	12,267	13,234
Other operating expenses	(33,204)	(35,083)	(13,176)	(15,133)
Administrative expenses	(261,160)	(265,984)	(162,083)	(165,813)
Depreciation and amortisation	(28,345)	(31,856)	(18,880)	(21,410)
Provisions for other liabilities and charges	(4,357)	696	482	5,153
Impairment charge	(56,288)	(83,801)	(64,433)	(93,114)
Gains less losses from capital investments in subsidiaries, associates and joint ventures	5,006	4,312	28,915	13,747
Net gains or losses from non-current assets held for sale	(432)	(690)	(220)	(567)
PROFIT BEFORE INCOME TAX	**130,600**	**106,758**	**67,708**	**51,849**
Income tax	(14,975)	(11,380)	(3,925)	(7,968)
PROFIT FOR THE YEAR	**115,625**	**95,378**	**63,783**	**43,881**
Attributable to owners of the parent	110,017	91,914	63,783	43,881
Attributable to non-controlling interests	5,608	3,464	-	-
Earnings per share/diluted earnings per share (in EUR per share)	5.5	4.6	3.2	2.2

Condensed statement of financial position

in EUR thousand

	NLB Group		NLB	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Cash, cash balances at central banks and other demand deposits at banks	1,299,014	1,161,983	617,039	496,806
Trading assets	87,699	267,413	87,693	267,880
Financial assets designated at fair value through profit or loss	6,694	7,595	2,011	4,913
Available-for-sale financial assets	2,072,153	1,737,191	1,594,094	1,248,359
Derivatives - hedge accounting	217	1,083	217	1,083
Loans and advances				
- debt securities	85,315	394,579	85,315	394,579
- loans and advances to banks	435,537	431,775	408,056	345,207
- loans and advances to customers	6,912,067	6,693,621	4,843,594	4,826,139
- other financial assets	61,014	69,521	36,151	48,944
Held-to-maturity financial assets	611,449	565,535	611,449	565,535
Fair value changes of the hedged items in portfolio hedge of interest rate risk	678	741	678	741
Non-current assets classified as held for sale	4,263	4,629	1,788	1,776
Property and equipment	196,849	207,730	90,496	94,570
Investment property	83,663	93,513	8,151	8,613
Intangible assets	33,970	39,327	23,345	29,627
Investments in subsidiaries	-	-	339,693	346,001
Investments in associates and joint ventures	43,248	39,696	7,031	7,094
Current income tax assets	2,888	929	2,124	-
Deferred income tax assets	7,735	9,400	10,622	9,139
Other assets	94,558	95,354	8,419	9,779
TOTAL ASSETS	**12,039,011**	**11,821,615**	**8,777,966**	**8,706,785**
	=========	==========	=========	==========
Trading liabilities	18,791	29,920	18,787	29,909
Financial liabilities designated at fair value through profit or loss	2,011	4,912	2,011	4,912
Derivatives - hedge accounting	29,024	33,842	29,024	33,842
Financial liabilities measured at amortised cost				
- deposits from banks and central banks	42,334	57,982	74,977	96,736
- borrowings from banks and central banks	371,769	571,029	338,467	519,926
- due to customers	9,437,147	9,020,666	6,615,390	6,293,339
- borrowings from other customers	83,619	100,267	4,274	16,168
- debt securities in issue	277,726	304,962	277,726	304,962
- subordinated liabilities	27,145	27,340	-	-
- other financial liabilities	110,295	75,307	68,784	47,346
Provisions	100,914	122,639	79,546	105,137
Current income tax liabilities	3,146	7,514	-	6,681
Deferred income tax liabilities	727	313	-	-
Other liabilities	8,703	14,539	4,186	5,676
TOTAL LIABILITIES	**10,513,351**	**10,371,232**	**7,513,172**	**7,464,634**
	==========	==========	==========	==========
EQUITY AND RESERVES ATTRIBUTABLE TO OWNERS OF THE PARENT				
Share capital	200,000	200,000	200,000	200,000
Share premium	871,378	871,378	871,378	871,378
Accumulated other comprehensive income	29,969	23,603	34,581	31,841
Profit reserves	13,522	13,522	13,522	13,522
Retained earnings	380,444	314,307	145,313	125,410
	1,495,313	**1,422,810**	**1,264,794**	**1,242,151**
Non-controlling interests	30,347	27,573	-	-
TOTAL EQUITY	**1,525,660**	**1,450,383**	**1,264,794**	**1,242,151**
TOTAL LIABILITIES AND EQUITY	**12,039,011**	**11,821,615**	**8,777,966**	**8,706,785**
	==========	==========	==========	==========

Condensed statements of changes in equity

in EUR thousand

NLB Group	Share capital	Share premium	Accumulated other comprehensive income	Profit reserves	Retained earnings	Equity attributable to owners of the parent	Equity attributable to non-controlling interests	Total equity
Balance at 1 January 2015	200,000	871,378	36,485	13,522	221,676	1,343,061	26,234	1,369,295
- Net profit for the year	-	-	-	-	91,914	91,914	3,464	95,378
- Other comprehensive income	-	-	(12,882)	-	-	(12,882)	23	(12,859)
Total comprehensive income after tax	-	-	(12,882)	-	91,914	79,032	3,487	82,519
Dividends paid	-	-	-	-	-	-	(1,048)	(1,048)
Transactions with non-controlling interests	-	-	-	-	717	717	(1,100)	(383)
Balance at 31 December 2015	**200,000**	**871,378**	**23,603**	**13,522**	**314,307**	**1,422,810**	**27,573**	**1,450,383**
- Net profit for the year	-	-	-	-	110,017	110,017	5,608	115,625
- Other comprehensive income	-	-	6,366	-	-	6,366	(35)	6,331
Total comprehensive income after tax	-	-	6,366	-	110,017	116,383	5,573	121,956
Dividends paid	-	-	-	-	(43,880)	(43,880)	(2,799)	(46,679)
Balance at 31 December 2016	**200,000**	**871,378**	**29,969**	**13,522**	**380,444**	**1,495,313**	**30,347**	**1,525,660**

in EUR thousand

NLB	Share capital	Share premium	Accumulated other comprehensive income	Profit reserves	Retained earnings	Total equity
Balance at 1 January 2015	200,000	871,378	38,491	13,522	81,529	1,204,920
- Net profit for the year	-	-	-	-	43,881	43,881
- Other comprehensive income	-	-	(6,650)	-	-	(6,650)
Total comprehensive income after tax	-	-	(6,650)	-	43,881	37,231
Balance at 31 December 2015	**200,000**	**871,378**	**31,841**	**13,522**	**125,410**	**1,242,151**
- Net profit for the year	-	-	-	-	63,783	63,783
- Other comprehensive income	-	-	2,740	-	-	2,740
Total comprehensive income after tax	-	-	2,740	-	63,783	66,523
Dividends paid	-	-	-	-	(43,880)	(43,880)
Balance at 31 December 2016	**200,000**	**871,378**	**34,581**	**13,522**	**145,313**	**1,264,794**

Condensed statement of comprehensive income

in EUR thousand

	NLB Group		NLB	
	2016	2015	2016	2015
Net profit for the year after tax	**115,625**	**95,378**	**63,783**	**43,881**
Other comprehensive income after tax	**6,331**	**(12,859)**	**2,740**	**(6,650)**
Items that will not be reclassified to income statement				
Actuarial gains/(losses) on defined benefit pensions plans	**1,515**	**(1,975)**	**1,466**	**(706)**
Share of other comprehensive income/(losses) of entities accounted for using the equity method	**(6)**	**69**	**-**	**-**
Income tax relating to components of other comprehensive income	**(191)**	**738**	**(191)**	**740**
Items that may be reclassified subsequently to income statement				
Foreign currency translation	**(1,910)**	**(2,685)**	**-**	**-**
Translation gains/(losses) taken to equity	(1,910)	(2,685)	-	-
Cash flow hedges (effective portion)	**2,703**	**509**	**2,703**	**509**
Net valuation gains/(losses) taken to equity	(343)	(78)	(343)	(78)
Transferred to profit or loss	3,046	587	3,046	587
Available-for-sale financial assets	**3,899**	**(8,496)**	**171**	**(8,562)**
Valuation gains/(losses) taken to equity	18,529	(2,316)	14,652	(314)
Transferred to profit or loss	(14,630)	(6,180)	(14,481)	(8,248)
Share of other comprehensive income/(losses) of entities accounted for using the equity method	**2,731**	**(2,804)**	**-**	**-**
Income tax relating to components of other comprehensive income	**(2,410)**	**1,785**	**(1,409)**	**1,369**
Total comprehensive income for the year after tax	**121,956**	**82,519**	**66,523**	**37,231**
Attributable to owners of the parent	116,383	79,032	66,523	37,231
Attributable to non-controlling interests	5,573	3,487	-	-

Condensed statement of cash flows

in EUR thousand

	NLB Group		NLB	
	2016	2015	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES				
Interest received	413,337	467,091	240,789	294,113
Interest paid	(78,401)	(121,143)	(44,510)	(72,613)
Dividends received	1,233	1,346	1,139	1,264
Fee and commission receipts	192,295	194,133	119,296	126,371
Fee and commission payments	(51,996)	(48,713)	(27,056)	(30,993)
Realised gains from financial assets and financial liabilities not at fair value through profit or loss	13,296	10,964	13,147	10,886
Realised losses from financial assets and financial liabilities not at fair value through profit or loss	(40)	(234)	(40)	(234)
Net gains/(losses) from financial assets and liabilities held for trading	3,246	(23,110)	(2,785)	(28,335)
Payments to employees and suppliers	(262,202)	(271,456)	(165,579)	(174,051)
Other income	26,352	31,129	13,256	14,136
Other expenses	(26,132)	(28,935)	(14,857)	(16,487)
Income tax paid	(19,991)	(4,980)	(14,489)	(678)
Cash flows from operating activities before changes in operating assets and liabilities	**210,997**	**206,092**	**118,311**	**123,379**
(Increases)/decreases in operating assets	**(139,839)**	**(143,429)**	**30,540**	**(34,116)**
Net (increase)/decrease in trading assets	163,609	(135,235)	164,609	(135,235)
Net (increase)/decrease in financial assets designated at fair value through profit or loss	1,026	(880)	2,795	-
Net (increase)/decrease in available-for-sale financial assets	(344,588)	(45,544)	(353,677)	(88,304)
Net (increase)/decrease in loans and advances	37,715	33,155	214,615	189,680
Net (increase)/decrease in other assets	2,399	5,075	2,198	(257)
Increases/(decreases) in operating liabilities	**197,351**	**(200,359)**	**101,342**	**(208,931)**
Net increase/(decrease) in financial liabilities designated at fair value through profit or loss	(2,801)	-	(2,801)	-
Net increase/(decrease) in deposits and borrowings measured at amortised cost	227,842	(146,993)	130,815	(155,700)
Net increase/(decrease) in securities measured at amortised cost	(26,913)	(53,469)	(26,913)	(53,469)
Net increase/(decrease) in other liabilities	(777)	103	241	238
Net cash used in operating activities	**268,509**	**(137,696)**	**250,193**	**(119,668)**
CASH FLOWS FROM INVESTING ACTIVITIES				
Receipts from investing activities	**77,903**	**178,923**	**98,095**	**188,913**
Proceeds from sale of property and equipment and investment property	5,536	3,718	400	68
Proceeds from dividends from subsidiaries and associates	3,587	35	28,915	13,747
Proceeds from non-current assets held for sale	128	170	128	98
Proceeds from disposals of held-to-maturity financial assets	68,652	175,000	68,652	175,000
Payments from investing activities	**(153,178)**	**(51,377)**	**(161,064)**	**(70,863)**
Purchase of property and equipment and investment property	(17,896)	(11,404)	(10,990)	(5,672)
Purchase of intangible assets	(6,981)	(7,685)	(4,466)	(5,577)
Purchase of subsidiaries and increase in subsidiaries' equity	-	(404)	(17,307)	(27,730)
Increase in associates and joint ventures' equity	(12,250)	-	(12,250)	-
Purchase of held-to-maturity financial assets	(116,051)	(31,884)	(116,051)	(31,884)
Net cash flows used in investing activities	**(75,275)**	**127,546**	**(62,969)**	**118,050**
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from financing activities	**-**	**9,900**	**-**	**-**
Issue of subordinated debt	-	9,900	-	-
Payments from financing activities	**(46,655)**	**(977)**	**(43,880)**	**-**
Dividends paid	(46,655)	(977)	(43,880)	-
Net cash from financing activities	**(46,655)**	**8,923**	**(43,880)**	**-**
Effects of exchange rate changes on cash and cash equivalents	693	10,246	1,507	8,226
Net increase/(decrease) in cash and cash equivalents	**146,579**	**(1,227)**	**143,344**	**(1,618)**
Cash and cash equivalents at beginning of year	**1,302,003**	**1,292,984**	**525,831**	**519,223**
Cash and cash equivalents at end of year	**1,449,275**	**1,302,003**	**670,682**	**525,831**