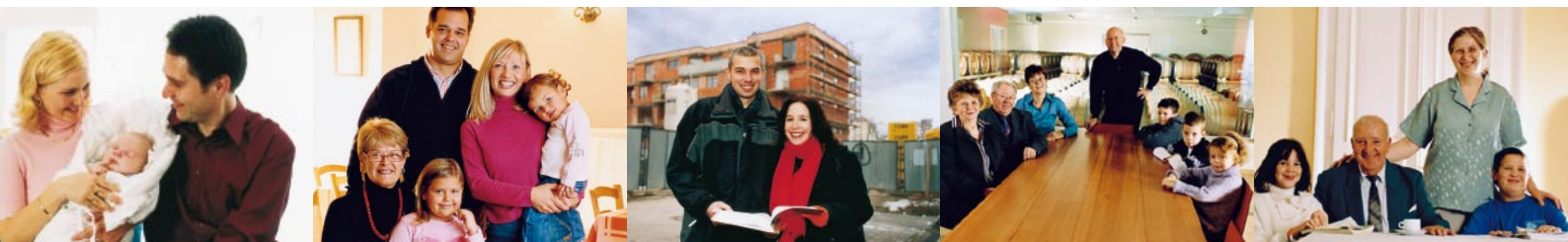


# ERSTE BANK

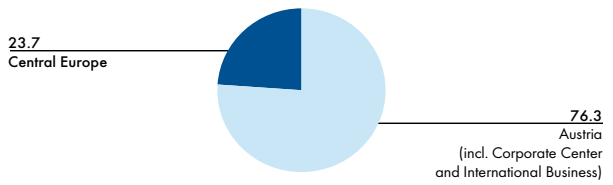
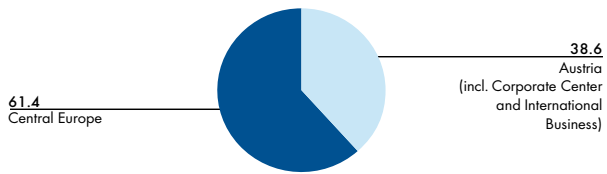
The Bank for Central and Eastern Europe



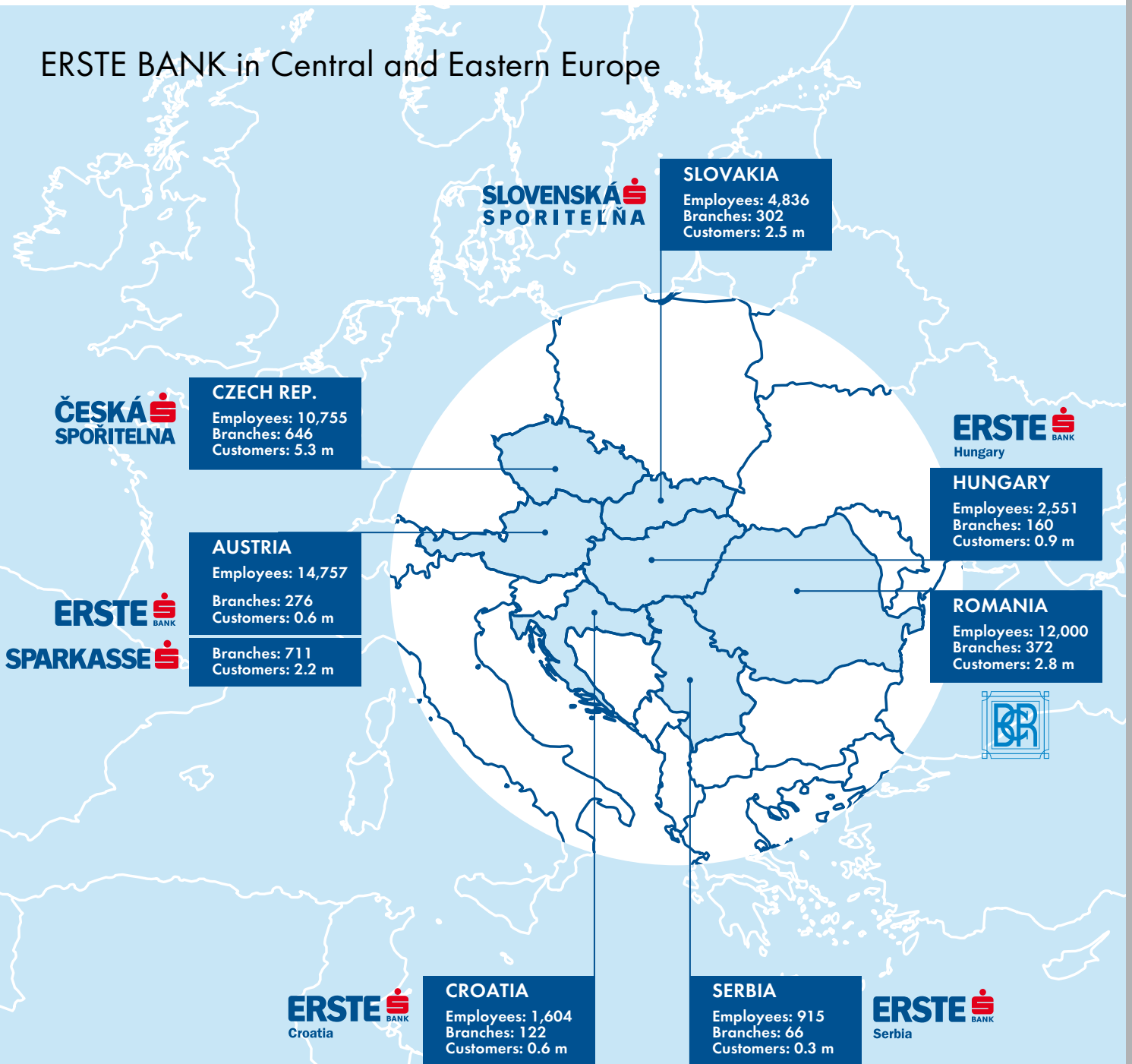
Annual Report 2005

## Net profit contribution by region (in %)

## Risk-weighted assets by region (in %)



## ERSTE BANK in Central and Eastern Europe



# Key financial and operating data

EUR million (unless otherwise stated)	2001	2002 <sup>1)</sup>	2003	2004 <sup>2)</sup>	2005
<b>BALANCE SHEET</b>					
<b>Total assets</b>	<b>86,033</b>	<b>121,222</b>	<b>128,575</b>	<b>139,812</b>	<b>152,660</b>
Loans and advances to credit institutions	18,913	15,492	13,140	15,684	16,858
Loans and advances to customers	39,210	64,435	67,766	72,843	80,419
Risk provisions for loans and advances	-1,875	-2,983	-2,772	-2,804	-2,817
Securities and other financial investments	21,093	32,795	39,093	42,521	47,681
Other assets	8,692	11,483	11,348	11,568	10,519
<b>Total liabilities and shareholders' equity</b>	<b>86,033</b>	<b>121,222</b>	<b>128,575</b>	<b>139,812</b>	<b>152,660</b>
Amounts owed to credit institutions	28,642	26,425	25,704	28,551	33,911
Amounts owed to customers	37,175	61,308	64,839	68,213	72,793
Debts evidenced by certificates, including subordinated capital	12,707	17,577	20,482	23,416	25,581
Other liabilities, provisions	4,346	10,708	11,880	13,679	13,914
Shareholder's equity	1,904	2,481	2,791	3,424	4,129
Minority interests	1,259	2,723	2,879	2,529	2,332
<b>Changes in total qualifying capital</b>					
Risk-weighted assets pursuant to Sec. 22 Banking Act	37,803	60,257	62,188	65,384	75,078
Qualifying consolidated capital pursuant to Sec. 23 & 34 Banking Act	4,308	6,983	7,009	7,286	8,611
of which core capital (Tier 1)	2,337	3,800	3,912	4,377	5,112
of which hybrid Tier 1 capital	455	469	605	711	900
Solvency ratio pursuant to Sec. 22 Banking Act	10.7%	11.0%	10.7%	10.7%	11.0%
of which core capital ratio	6.2%	6.3%	6.3%	6.7%	6.8%
<b>Income statement</b>					
Net interest income	1,438.9	2,463.0	2,586.8	2,660.3	2,794.2
Risk provisions for loans and advances	-203.6	-406.4	-406.4	-406.2	-421.6
Net commission income	574.6	944.3	996.6	1,135.4	1,256.8
Net trading result	152.6	167.4	214.6	216.5	241.7
General administrative expenses	-1,454.3	-2,432.0	-2,460.8	-2,594.9	-2,676.9
Operating result	711.7	1,151.2	1,370.1	1,454.1	1,652.5
Pre-tax profit	405.7	664.6	761.6	996.6	1,214.8
Net profit after minority interests	223.3	255.2	353.3	520.8	711.7
<b>Operating data</b>					
Number of employees	28,222	36,923	37,830	35,862	36,150
Number of branches <sup>3)</sup>	1,540	2,285	2,370	2,242	2,283
Number of customers (million)	9.1	10.6	11.9	11.9	12.4
<b>Share price and key ratios<sup>4)8)</sup></b>					
High (EUR)	15.50	21.46	24.55	39.80	47.50
Low (EUR)	11.75	13.25	14.61	24.78	36.36
Closing price (EUR)	14.93	16.04	24.49	39.30	47.05
Price/earnings ratio	13.4	13.6	16.5	18.0	15.9
Dividend per share <sup>5)</sup> (EUR)	0.31	0.31	0.38	0.50	0.55
Payout ratio	27.7 %	29.1%	25.4%	23.2%	18.8%
Dividend yield	2.1 %	1.9%	1.5%	1.3%	1.2%
Book value per share (EUR)	9.5	10.4	11.6	14.3	17.1
Price/book ratio	1.6	1.5	2.1	2.7	2.7
Total shareholder return (TSR)	27.0%	9.5%	54.6%	62.0%	21.0%
Average TSR (since 1997 IPO)	9.2%	9.2%	15.7%	21.5%	21.4%
<b>Number of shares</b>					
Number of shares outstanding <sup>6)</sup>	201,451,820	239,300,456	239,775,232	241,442,892	243,183,600
Average number of shares outstanding <sup>7)</sup>	199,863,776	215,769,476	237,845,836	238,576,585	240,145,648
Market capitalisation (EUR billion)	3.0	3.8	5.9	9.5	11.4
Trading volume (EUR billion) <sup>8)</sup>	1.3	2.9	2.0	6.9	8.9

1) First-time consolidation of the members of the Haftungsverbund.

2) The revised IASB standards, IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement), became compulsory as of 1 January 2005.

Under the transitional provisions, prior-year figures must be restated. The rates of change indicated are based on the restated prior-year figures. The details of these changes were outlined in press releases published on 3 May 2005 and 6 December 2005, which can be found on the Erste Bank home page at ([www.erstebank.com](http://www.erstebank.com)).

3) As of 2004 source for Austria: Austrian National Bank, prior to that: Savings Banks Association.

4) Values adjusted for 4:1 stock split of 8 July 2004.

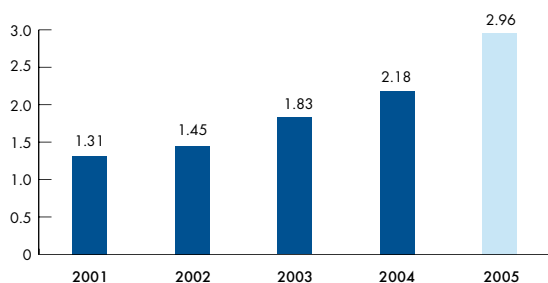
5) Proposal to Annual General Meeting.

6) Erste Bank shares held by savings banks that are members of the Haftungsverbund were not deducted from shares outstanding.

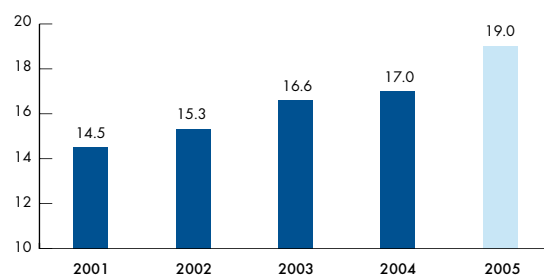
7) Including those shares representing minority interests.

8) Source: Vienna Stock Exchange, based on single counting.

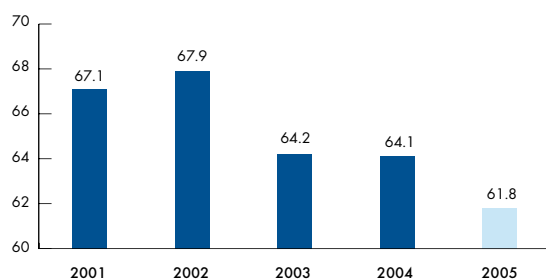
### Earnings per share<sup>1)</sup> in EUR



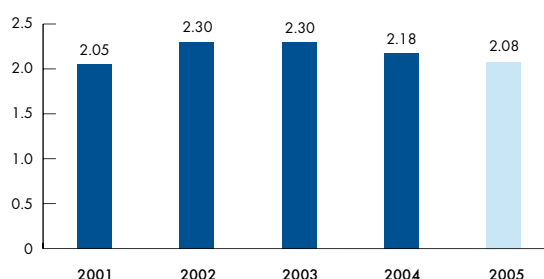
### Return on equity<sup>1)</sup> in %



### Cost/income ratio in %



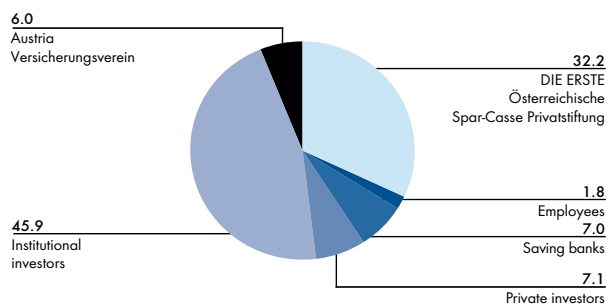
### Net interest margin<sup>2)</sup> in %



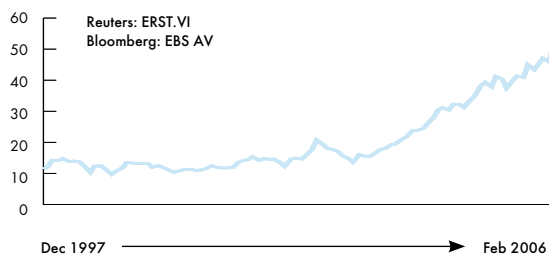
1) Until 2003 adjusted for straight-line goodwill amortisation.

2) Based on average interest-bearing assets.

### Shareholder structure at 31 December 2005 in %



### ERSTE BANK share price development in EUR



## INVESTOR RELATIONS

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Email: [gabriele.werzer@erstebank.at](mailto:gabriele.werzer@erstebank.at)

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#### Josef Kerekes

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## Ratings

### Fitch

Long-term

Short-term

Individual

### Moody's Investors Service

Long-term

Short-term

Bank Financial Strength Rating

### Standard & Poor's

Short-term

A  
F1  
B/C

A1  
P-1  
B-

A-2

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# Highlights 2005

## Record profit

- \_8th consecutive record earnings
- \_New, ambitious growth targets

## Central Europe

- \_Strong loan growth across the board
- \_Market share gains, particularly in retail

## Retail Austria

- \_Challenging targets outperformed
- \_Return on equity surpasses 10%

## New Group Architecture

- \_Tangible savings in procurement
- \_Structured investment products launched in all markets

## Acquisition in Romania

- \_Purchase of 62%-stake in Banca Comerciala Romana
- \_Instant market leadership in Romania

## Acquisition in Serbia

- \_Transformation programme in full swing
- \_Network and market share expansion started

# Letter from the CEO

Dear shareholders,

**2005 was an exceptional year for Erste Bank. We have delivered record earnings for the eighth consecutive year since 1997, growing net profit by nearly 40% to EUR 712 million; we have strategically extended our footprint into two new emerging growth markets – Romania and Serbia; we have maintained or expanded market shares in our existing central European markets; our Austrian retail operations have met their highly ambitious targets; and, on group level, we have pressed on with our pursuit of operational excellence through our New Group Architecture initiative.**

## **Moving to the next level in Central and Eastern Europe**

Our key achievement in 2005 was the reinforcement of our unique market position in Central and Eastern Europe: by adding Romania and Serbia to our business portfolio we have almost doubled our potential market to nearly 70 million people; we increased our client base by about 3 million to 15.2 million and we now maintain a network of some 2,700 branches. No other bank can offer its clients the same depth of coverage in a coherent region of fast growing countries, as we do.

This exciting development was facilitated by strong privatisation activity in Central and Eastern Europe. Encouraged by strong economies, rising asset prices and renewed interest in the region, the governments of Romania and Serbia, as well as private sellers in the Ukraine proceeded with asset sales. While we selectively evaluated acquisition opportunities in all of these target markets, Banca Comerciala Romana (BCR) was an ideal match in terms of fitting our existing network and its long term growth prospects.

Consequently, we signed a share purchase agreement to acquire a 62% majority stake in BCR for a cash consideration of EUR 3.75 billion in December 2005. BCR is the market leader in Romania, a country set to join the European Union by 2008 and, behind Poland, the most populous country in Central and Eastern Europe. BCR is already in good shape: it serves some 2.8 million corporate and retail customers and owns roughly a quarter of the market.



Andreas Treichl, Chief Executive Officer

In Serbia we acquired 96% of Vojvodina-based savings bank Novosadska banka for EUR 84 million in cash. The bank, which was subsequently rebranded into Erste Bank Serbia, is a small regional retail bank with an asset market share of about 2% and a strategic location in Serbia's northern most province – bordering Hungary, Croatia and Romania. Going forward, we will use Erste Bank Serbia as a bridge head for further careful expansion steps into the Serbian market.

## **Credit expansion drives growth**

In our existing markets there was one dominant economic theme, which fuelled strong business growth in 2005: healthy GDP growth combined with record low interest rates led to buoyant private sector credit demand. While at the start of the year the jury was out on whether our deposit rich central European operations in the Czech Republic and Slovakia could cope with such an environment, the verdict became clear at the end of the year: on balance the positive effect of increased private sector credit demand, particularly in the retail segment, outweighed lower interest rates.

Hence, we are particularly delighted with the performance of Česká spořitelna. Our Czech operation yet again delivered double digit top line and bottom line growth. This achievement is all the more remarkable as they had to combat such additional adverse factors as a historically unfavourable – albeit strongly improving – loan/deposit ratio, an antitrust investigation related to banking fees, and a 2004 result that was aided by substantial one-off gains. The signs for 2006 are also promising: interest rates seem to have seen their trough and demand for retail credit products, in which we are market leaders in the Czech Republic, remains strong.

Slovenská sporiteľňa also delivered solid bottom line growth and enjoyed the strongest retail loan growth within the group. Further progress was held back by the gradual expiry of Slovenská sporiteľňa's high-yield bond portfolio and the lowest, but also fastest growing loan/deposit ratio within our group. While these factors will continue to play a role in 2006, we foresee a bright future thereafter, stimulated by a vibrant Slovak economy.

Erste Bank Hungary was the top performer within the group, strongly outperforming its business plan targets formulated at the time of acquisition of Postabank two years ago. Net income more than doubled, overall business remained brisk and the fall in interest rates was more than compensated by loan growth and an exploding fund management market. For 2006 we expect another solid performance.

At Erste Bank Croatia the story line was similar to the one at our other central European operations: loan growth was the defining element in the growth mix. In addition, Erste Bank Croatia won a major government fund management mandate; as a result our Croatian fund management market share rocketed to 25%.

Progress at our Austrian operations also continued apace in 2005. The Retail and Mortgage segment surpassed its 10% return on equity target, helped along by strong commission

income growth, which in turn was fuelled by a strong domestic stock market and the continued trend towards private old age provision. Furthermore, we implemented a new pay scheme that offers an improved link to performance and will yield long term benefits. The cooperation with the savings banks, though not having a substantial bottom line impact, was also successfully continued for the benefit of our Austrian customers.

The New Group Architecture (NGA) remained very much at the core of our efforts to more efficiently exploit synergies across the group. It is primarily designed to streamline back office functions, while allowing local banks to focus on their core competencies of developing and selling products. An equally important outcome of the NGA is that our local banks maintain their distinctive local character and the competitive advantage that comes with it.

### **We look forward with great confidence**

We have never been in better shape when entering a new year than at the start of 2006: our market capitalisation has for the first time touched EUR 15 billion; we successfully carried out the largest secondary offering in Austrian capital markets history with a volume of nearly EUR 3 billion; and, we are in the process of executing the largest cross border transaction in Austrian corporate history.

Most importantly, we have raised our profit targets to reflect our new growth profile: we now expect to grow net income by more than 20% on average per annum for the period of 2005 to 2009; we aim to push our cost/income ratio down to below 55% by 2009 and we plan to reach a return on equity of at least 18% – 20% by 2009.

Our assessment of the business environment in our home market remains positive: we believe that interest rates have bottomed out during 2005 and will only rise gradually over the course of 2006, thereby not hitting loan demand. GDP growth is set for another strong performance. Credit quality was not an issue in 2005 and we expect a similarly benign scenario for 2006.



Our bank is on a more balanced, longer term growth track than ever before. We feel that we have struck the ideal balance between risk and growth. This achievement would not have been possible without our dedicated employees, the continued support from our shareholders and the trust of our clients.

I would therefore like to thank all our employees for their commitment and entrepreneurial spirit, our investors for their unwavering support and our clients for using our services in ever growing numbers. I would also like to extend our warmest welcome to our new Romanian and Serbian colleagues, who I am certain will swiftly follow in the footsteps of their central European peers and quickly become an integral part of our group.



Andreas Treichl

# Management Board



**ANDREAS TREICHL**

Chairman of the Management Board since July 1997

Group Communication, Group Human Resources, Corporate Strategic Development, Company Secretary, Internal Audit, Legal Services, Group Marketing, Investor Relations, Česká spořitelna



**ELISABETH BLEYLEBEN-KOREN**

Deputy Chairwoman of the Management Board since May 1999

Savings banks, Private Banking & Asset Management, Product Management, Retail Customers Austria, SME Customers, Corporate Customers, Multi-Channel Management



**REINHARD ORTNER**

Member of the Management Board since July 1984

Group Accounting, Planning & Controlling, International Business, Management of Subsidiaries & Investments, Slovenská sporiteľňa, Erste Bank Hungary, Erste Bank Croatia, Erste Bank Serbia, Erste Bank Malta

**CHRISTIAN CORETH**

Member of the Management Board since July 2004

Group Risk Management

**FRANZ HOCHSTRASSER**

Member of the Management Board since January 1999

Group Large Corporates, Group Treasury, Research

**ERWIN ERASIM**

Member of the Management Board since January 2001

Payments & Settlement, Group Information Technology, Securities & Treasury Operations, Group Procurement

# Supervisory Board Report

## Dear shareholders,

In the year under review, we discharged our duties under the law and Erste Bank's Articles of Association. We advised the Management Board regularly on the governance of Erste Bank and monitored its management. The Management Board provided us with regular, timely and comprehensive oral and written reports. At Supervisory Board meetings, Management Board members reported on the trends in their respective business divisions. For specific topics covered on the agenda, experts were invited to provide detailed information. Furthermore current topics and decisions were raised in discussions between the Chairman of the Management Board and the Supervisory Board. In addition, we were continuously informed on the status of acquisition efforts in Serbia and Romania.

## Supervisory Board meetings

The Supervisory Board met nine times during the financial year. No member attended fewer than half of the meetings.

The following major issues were discussed:

At the first meeting of the year on 31 March 2005, we approved the audit reports, the 2004 Company Management Report, the 2004 Consolidated Financial Statements and the 2004 Group Management Report and upon the recommendation of the Accounting Committee approved the 2004 Financial Statements. We also approved the proposed dividend for 2004 and discussed the future dividend policy.

The Supervisory Board also discussed the Corporate Governance Report and approved the agenda for the 2005 Annual General Meeting.

At several meetings beginning with the extraordinary Supervisory Board meeting of 25 July 2005, we were presented with comprehensive analyses of the economic situation and of the developments and potential of the Romanian Banca Comerciala Romana (BCR) in its political and economic environment. The impact of a potential acquisition on Erste Bank Group was discussed, in particular with regard to capital adequacy and balance sheet ratios. After extensive consultations, we ap-



Heinz Kessler, President of the Supervisory Board

proved the participation in the privatisation process of Banca Comerciala Romana as well as the offer price proposed by the Management Board.

At the meeting of 14 September 2005, we were informed as to changes related to the Company Law Amendment Act (GesRÄG).

The final regular meeting of the year took place on 14 December 2005. The Management Board provided detailed information on the status of the privatisation process of Banca Comerciala Romana (BCR). At this meeting, the budget planning for the period 2006 to 2008 was discussed and overall investment plans were approved.

## Corporate Governance

Since February 2003, the Supervisory Board of Erste Bank has been expressly committed to compliance with the Austrian Code of Corporate Governance and thereby to the company's responsible management and control based on the creation of long-term value.

A comprehensive presentation of the Erste Bank's corporate governance is published in this annual report and is available on the Erste Bank web site.

### **Supervisory Board Committees**

The Supervisory Board has created four committees. Their composition is available on the Erste Bank web site.

The Management Board Committee handles relations between the company and members of the Management Board. In 2005 the Management Board Committee met once.

The Audit Committee, formerly Financial Audit Committee, was entrusted with new areas of responsibility as from 1 January 2006. It reviews and prepares the approval of the financial statements, the proposed appropriation of net profit, the Company Management Report, the consolidated financial statements and the Group Management Report. The committee also makes a recommendation regarding the selection of an independent auditor. In 2005 the Audit Committee met once.

The Risk Management Committee examines the risk situation and risk management of Erste Bank Group, in particular with regard to market, credit and operating risk. The committee is responsible approving investments and major investments within the scope of authorisation delegated by the Supervisory Board. In 2005 the Risk Management Committee met 23 times.

The Strategy Committee is involved in the company's strategic planning and is responsible for reviewing the budget, taking note of business performance reports, setting the investment policy and determining the company's strategic interests. The committee also monitors the company's participating interests. In 2005 the Strategy Committee met four times.

### **Financial statements**

The company financial statements and Management Report as well as the Consolidated Financial Statements and Group Management Report for 2005 were audited by the Sparkassen Prüfungsverband as the legally mandated auditor and by Deloitte Wirtschaftsprüfungs GmbH as the supplementary auditor appointed by the Annual General Meeting, and received an unqualified opinion.

Representatives from both auditors participated in the Supervisory Board's balance sheet meeting and provided supporting information. We are in agreement with the results of these audits and the proposed appropriation of net profit.

We approved the company financial statements prepared by the Managing Board, which are now duly established in accordance with § 125 para. 2 of the Austrian Stock Corporation Act. We also approved the consolidated financial statements and Group Management Report.

### **Members**

Klaus Braunegg, a member of the Supervisory Board since 1993, resigned from the Board as from 11 May 2005, the date of the 12th ordinary Annual General Meeting. The 12th ordinary Annual General Meeting appointed Wilhelm Rasinger as a representative for individual shareholders and new member of the Supervisory Board. The appointments of Elisabeth Gürtler (the second representative for individual shareholders), Theresa Jordis, Hubert Singer and Georg Winckler to the Supervisory Board were reconfirmed.

The Supervisory Board would like to thank the Management Board as well as the employees of Erste Bank for their major personal contributions last year.

For the Supervisory Board



Heinz Kessler  
President of the Supervisory Board

Vienna, March 2006

# Supervisory Board

## **HEINZ KESSLER**

**President of the Supervisory Board**  
**Retired CEO**

Additional supervisory board memberships:  
Deputy Chairman Austria Versicherungsverein auf Gegenseitigkeit Privatstiftung  
Member DIE ERSTE österreichische Spar-Casse Privatstiftung  
Deputy Chairman Duropack Aktiengesellschaft  
Chairman Nettingsdorfer Papierfabrik Management AG  
Member Rath Aktiengesellschaft  
Chairman Reform-Werke Bauer & Co Gesellschaft m.b.H.  
Chairman Reform-Werke Bauer & Co Holding Aktiengesellschaft  
Deputy Chairman UNIQA Versicherungen AG  
Functions in companies of the savings banks sector

## **KLAUS BRAUNEGG**

**First Vice President until 11 May 2005**  
**Attorney at law**

## **GEORG WINCKLER**

**First Vice President since 11 May 2005**  
**Rector of the University of Vienna**  
**Professor of Economics at the University of Vienna**

Additional supervisory board memberships:  
Member Austria Versicherungsverein auf Gegenseitigkeit Privatstiftung  
Deputy Chairman INITS Universitäres Gründerservice Wien GmbH  
Member Innovationszentrum Universität Wien GmbH  
Member UNIQA Versicherungen AG  
Functions in companies of the savings banks sector

## **THERESA JORDIS**

**Second Vice President**  
**Attorney at law**

Additional supervisory board memberships:  
Member Generali Holding Vienna AG  
Chairwoman Miba Aktiengesellschaft  
Chairwoman Mitterbauer Beteiligungs-Aktiengesellschaft  
Chairwoman Wolford Aktiengesellschaft

## **BETTINA BREITENEDER**

**Businesswoman**

Additional supervisory board memberships:  
Deputy Chairwoman Drina Neretva Kraftwerke Aktiengesellschaft  
Member ZS Einkaufszentren Errichtungs- und Vermietungs-Aktiengesellschaft

## **ELISABETH GÜRTLER**

**Businesswoman**

**Member of the Management Board of the Austrian Hotel Association**

## **JAN HOMAN**

**Chief Executive Officer of Teich AG**

Additional supervisory board memberships:  
Member Allianz Elementar Versicherungs-Aktiengesellschaft

## **WERNER HUTSCHINSKI**

**Retired General Manager**

Additional supervisory board memberships:  
Deputy Chairman VAV Versicherungs-Aktiengesellschaft  
Functions in companies of the savings banks sector

## **JOSEF KASSLER**

**Retired CEO**

Additional supervisory board memberships:  
Member Donau Allgemeine Versicherungs-Aktiengesellschaft  
Member „Messe Center Graz“ Betriebsgesellschaft m.b.H.  
Member ÖWGES Gemeinnützige Wohnbaugesellschaft m.b.H.  
Functions in companies of the savings banks sector

## **LARS-OLOF ÖDLUND**

### **Senior Advisor**

Additional supervisory board memberships:  
Chairman EntreprenadMaskinSpecialisten i Sthlm AB  
Chairman Litorina Capital Management AB  
Chairman Baltic Rim Fund  
Chairman Eurotema AB

## **WILHELM RASINGER FROM 11 MAY 2005**

### **Businessman**

Additional supervisory board memberships:  
Member BÖHLER-UDDEHOLM Aktiengesellschaft  
Member Steirerobst Aktiengesellschaft

## **FRIEDRICH RÖDLER**

### **Public Accountant and Tax Consultant**

## **HUBERT SINGER**

### **Chief Executive Officer of Dornbirner Sparkassen AG**

Additional supervisory board memberships:  
Deputy Chairman Dornbirner Seilbahn Gesellschaft m.b.H.  
Functions in companies of the savings banks sector

## Representatives of the Staff Council:

### **GÜNTER BENISCHEK**

#### **Chairman of the Central Staff Council**

Additional supervisory board memberships:  
Member Die ERSTE österreichische Spar-Casse Privatstiftung

### **ERIKA HEGMALA**

#### **Vice Chairwoman of the Central Staff Council**

Additional supervisory board memberships:  
Member BVP-Pensionskasse

### **ILSE FETIK**

#### **Member of the Central Staff Council**

### **JOACHIM HÄRTEL**

#### **Member of the Central Staff Council**

### **CHRISTIAN HAVELKA**

#### **Member of the Central Staff Council**

### **ANTON JANKU**

#### **Member of the Central Staff Council**

# The Share

The Erste Bank share rose to new highs last year, building on the positive trend of previous years. These gains were driven mainly by the Erste Bank's double-digit earnings growth and a new milestone in its expansion strategy, the acquisition of a majority interest in Romania-based Banca Comerciala Romana. Thus the Group further strengthened its excellent positioning in the central and eastern European growth markets.

## PERFORMANCE OF EQUITY INDICES

### Stock markets driven by oil prices and interest rates

With the exception of the US Dow Jones Industrial Index, all the major international stock markets posted gains for the third consecutive year. The European stock exchanges and Tokyo Stock Exchange posted record gains. The Nikkei 225 Index in Tokyo and some of the European benchmark indices reached new highs since 2000, while US stock exchanges turned in disappointing performances.

At 31 December 2005, the US Dow Jones Industrial Average was down 0.6% relative to the previous year. The other two US benchmark indices, the Nasdaq and the Standard & Poors 500, gained a very modest 1.4% and 3.0%, respectively. In comparison, the FTSE Eurotop 300 Index advanced 22.4% in 2005.

In 2005, equity market trends were driven by rising oil prices and their impact on economic growth, inflation and interest rates. The contrast between the negative impact of higher oil prices, which peaked in the third quarter, and economic and corporate earnings growth produced sharp volatility. Inflationary jitters related to the higher oil prices and their impact on US economic growth and corporate earnings were accompanied by US monetary tightening, as the Federal Reserve raised its benchmark rate eight times from 2.25% to 4.25%. Against this backdrop, US equity markets trended downwards in the third quarter of 2005 even as European equity markets posted double-digit gains. In the fourth quarter, the markets rebounded on corporate earnings largely exceeding expectations, favourable economic data, declining crude oil prices and signals from the Federal Reserve that an end to the interest rate

hikes might be possible. In early December, the first interest rate increase by the European Central Bank in five years – a 25 basis point hike in the benchmark rate to 2.25% – had no impact on European equity market trends.

### Banking sector profits from earnings growth and mergers

After a 10.9% increase in 2004, the DJ Euro Stoxx Bank Index rose at an even faster rate last year, gaining 26.5% to 364.79 points. The negative short-term impact of US monetary policy tightening was more than offset by other factors. In the European banking sector, stock prices rose on the strength of reported earnings that exceeded expectations in the first three quarters of 2005 and, more importantly, robust merger activity and take-over offers in the second half of the year. None was bigger than UniCredit's acquisition of HVB and its related offer to the shareholders of Bank Austria and BPH.

### ATX climbs to record highs.

With a 50.8% gain to 3,667.03 points, the Austrian Traded Index (ATX) not only reached an all-time high in 2005 but also turned in one of the strongest performances of any stock market index world-wide. Among the key factors driving the above-average gains on the Vienna Stock Exchange were the higher earnings of listed companies with successful positions in the central and east European growth markets. Also contributing were the robust share price increases of electricity distributors and commodities firms, which benefited from higher oil and other commodity prices.

## ERSTE BANK SHARE PERFORMANCE

### New all-time high before capital increase

The Erste Bank share continued to post gains, rising by 19.7% to EUR 47.05. The bulk of these gains were achieved in the second half. A major factor was Erste Bank's continued earnings growth, which reflected the company's strong positioning in the central European growth markets and the successful restructuring of its domestic business.

The announcement of the acquisition of a 62% equity interest in Banca Comerciala Romana one week before the end of the year led to a further increase in the share price. Analysts and investors viewed the acquisition of Romania's largest bank and the related capital increase favourably. As a result, the Erste Bank share reached a new all-time high of EUR 47.50 on the penultimate trading day of 2005. The subsequent capital increase in January 2006 was the largest ever on the Vienna Stock Exchange: 64.8 million shares valued at EUR 2.9 billion were successfully placed with institutional and individual investors. The offering price was set at EUR 45.00 per share.

### Trading volume and market capitalisation

In 2005, the average daily trading volume of Erste Bank shares was approximately 428,800, a more than 26% increase from the previous year. The daily trading volume on the Prague Stock Exchange (PSE), where the Erste Bank shares have been listed since October 2002, increased by 25% to reach approximately 152,600 shares. In early January 2006, Erste Bank's market capitalisation increased on the strength of the rising share price to a new record of EUR 11.67 billion, up from EUR 9.49 billion at 31 December 2004.

### Overview of share price trends<sup>1)</sup>

in %	Since IPO Dec. 1997 <sup>2)</sup>	Since SPO Sept. 2000 <sup>3)</sup>	Since SPO July 2002 <sup>3)</sup>	2005
Erste Bank Share	324.5	300.4	170.0	19.7
ATX	181.0	213.8	200.7	50.8
DJ Euro Stoxx				
Bank Index	- <sup>4)</sup>	3.8	45.2	26.5

<sup>1)</sup> Based on closing prices year-end 2005

<sup>2)</sup> Initial Public Offering

<sup>3)</sup> Secondary Public Offering/Capital increase

<sup>4)</sup> Comparison since IPO would not be meaningful as Erste Bank has been included in this index only since 16 January 1998.

### DIVIDEND POLICY

Erste Bank is a rapidly growing company and has successfully completed several acquisitions in Central and Eastern Europe. In order to ensure an adequate basis for further expansion in this region, Erste Bank's Management Board has chosen not

to set a fixed pay-out ratio, but instead to increase the dividend by at least 10% annually, provided that the company meets its targets. In this fashion, the company can ensure that its Tier 1 capital ratio remains between 6.5% and 7%. Should the Tier 1 capital ratio exceed 7%, the dividend may be adjusted such that the pay-out increase significantly exceeds 10% compared to the previous year.

### Proposed net profit distribution

A dividend of EUR 0.55 per share will be proposed to the Annual General Meeting on 19 May 2006. The recent 10% dividend increase relative to the previous year reflects the Erste Bank's successful performance, as net profit rose by 36.6%. The pay-out ratio is 18.8%.

### INVESTOR RELATIONS

Erste Bank's management participated in numerous investor meetings last year. They attended more than 10 bank conferences, at the invitation of leading international investment firms (UBS, Goldman Sachs, Morgan Stanley, ING, Deutsche Bank, Merrill Lynch, Société Générale, HSBC etc.). In addition, Erste Bank Group presented its strategy and equity story to international investors through road shows in London, Warsaw, Milan and New York and met with investors individually. These road shows were organised jointly by the Vienna Stock Exchange, Erste Bank and other European banks.

On 16 September 2005, Erste Bank held its third international capital markets day in Prague. At this event, the management of Erste Bank and its central European subsidiaries gave the more than 40 institutional investors and analysts in attendance a comprehensive overview of business developments and opportunities in the group's central and east European markets. Management also provided updates on the progress and continued implementation of the New Group Architecture programme to enhance productivity. The webcast of this event also generated significant interest.

For the sixth consecutive year, Erste Bank hosted an internet chat with CEO Andreas Treichl on 18 April 2005. This opportunity to communicate directly with the Erste Bank Group's



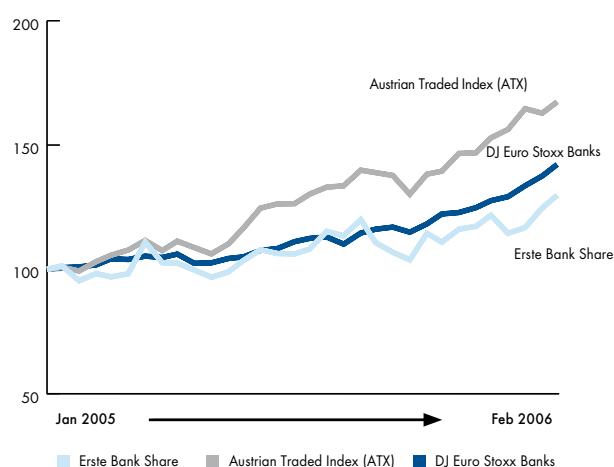
management board was welcomed by retail investors and interested parties, who participated in record numbers. In the chat session lasting more than two hours, 200 questions were submitted regarding the Erste Bank Group's current developments. The forum drew participants from all the Group's home market countries and Romania.

The growing interest in the Erste Bank share was reflected last year by the new coverage initiated by leading brokerage firms, including Bear Stearns, Goldman Sachs, Redburn Partners and Cazenove. In all, 21 firms published research reports on Erste Bank in 2005.

### Research reports on the Erste Bank share

- \_Bear Stearns
- \_Bank Austria Creditanstalt
- \_Cazenove
- \_Citigroup
- \_CSFB
- \_Deutsche Bank
- \_Dresdner Kleinwort Wasserstein
- \_Fox-Pitt, Kelton
- \_Goldman Sachs
- \_ING
- \_JP Morgan
- \_KBC Securities
- \_KBW Keefe, Bruyette & Woods
- \_Merrill Lynch
- \_Morgan Stanley
- \_Raiffeisen Centrobank
- \_Redburn
- \_Sal. Oppenheim
- \_Société Générale
- \_UBS
- \_WestLB

### Performance of the Erste Bank Share in EUR



# "It was worth it"

Sanja and Christian Nikolac live with their two children, Kelli and Paola, in Lovranska Draga, Croatia. This is one of the most scenic parts of the Dalmatian coast, very near to the cities of Opatija and Rijeka. The region has historically attracted tourists. In the days of the Habsburg empire, the town was a sophisticated tourist destination thanks to its proximity to Austria and Italy. The Nikolac family wanted to revive those good old days by restoring the Hotel Draga di Lovrana to its original splendour after the building had been run-down for years. In the late 19th century, this fine hotel welcomed the Austrian Emperor Franz Josef, who would enjoy the spectacular view. Today, with Croatia's growing ties to the European Union and the region's easy access from Italy, a new tourist boom is expected. Many historic hotels and villas have been restored in recent years, and are in prime condition to welcome visitors.

**Erste Bank: "Mr Nikolac, how did you come up with the idea of restoring the Hotel Draga di Lovrana?"**

Christian Nikolac: "Well, this spot is so unique and this view so spectacular, that I could not imagine a better place for an exclusive hotel with first-class dining. Clearly some people might think we're crazy, but tell us, don't you think it's worth it?"

**Erste Bank: "This must have been an adventure for you! After all, you were not already in the hotel business."**

Christian Nikolac: "That is true, I am in the fishing business. First, I wanted to have a base on land. Second, it has long been my dream to rebuild this historic building. We believe in the future of first-class tourism in our region. Even now, we yet have many Italian guests who appreciate high quality and are prepared to pay accordingly. Many of them are boat owners!"

Sanja Nikolac: "And we are also expecting more visitors from Austria and Germany! Thanks to my hotel management training in the United States, we are not coming into this project without any experience. For an investment on this scale, you must have the necessary expertise!"

**Erste Bank: "In rebuilding the hotel, you paid close attention to remaining true to the original design. How did you achieve that?"**

Sanja Nikolac: "Precisely. Every window, every door and all the other woodwork was custom built according to the original blueprints. Fortunately, they were still available! All the decorative glasswork and lamps were hand-made in Italy. These measures were necessary to preserve the character of this beautiful building!"

Christian Nikolac: "We certainly could have invested one-third less and still had a nice hotel, but it would not have been true to its origins! We have a good concept based on a premium product! In the first stage, we built the hotel and restaurant. In the second stage, we would like to build an extension in order to increase the overnight capacity."

Sanja Nikolac: "We would like for our guests to feel at home here! They should be able to enjoy this beautiful countryside and eat our fresh fish in a peaceful setting. We are working to that end as a team!"

**Erste Bank: "Mr and Mrs Nikolac, we wish you all the best in the future!"**



Nikolac family, clients of Erste Bank Croatia, Croatia



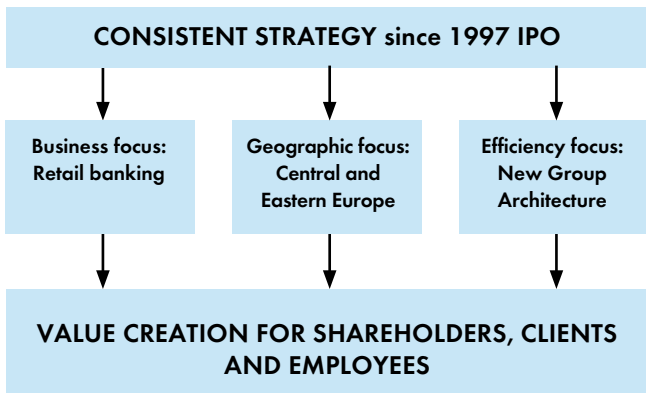
# Strategy

## Focused growth in Central and Eastern Europe

We have followed a consistent growth strategy since our initial public offering in 1997. This strategic commitment has led to substantial value creation for shareholders, clients and employees alike. At the time Erste Bank formulated four core strategies:

1. Focus on core business potentials in retail banking
2. Build a strong brand with the Austrian savings banks
3. Target a home market of 40 million people in Central Europe
4. Transfer the multi-channel distribution model throughout Central Europe

Following successful implementation and building on the key strengths, we have fine-tuned our core strategies to reflect the evolution of Erste Bank and its goals as well as changes in the operating environment. The result is a set of three main strategic pillars that define Erste Bank's historic and future business success, as outlined below:



The **business focus** pillar unites our former retail and multi-channel strategies, in line with today's reality that electronic distribution channels form an integral part of any successful retail banking strategy. Otherwise our focus on **retail banking** remains unchanged. The same is true for our **geographic focus**: it now reflects our broader regional coverage and integrates our Austrian strategy to work more closely with the savings banks sector. Our third strategic pillar, while seemingly new, has also strong roots in our former retail banking strategy, which was very much centred on better exploitation of our core business

potentials. The New Group Architecture programme carries on this **efficiency focus** on a group-wide basis. The following paragraphs describe our three main strategic pillars in more detail.

## Business focus: retail banking

A clearly defined business focus lies at the core of Erste Bank's operations: we directly serve 15.2 million retail clients in seven countries and operate some 2,700 branches, as well as state-of-the-art alternative distribution channels, such as internet and phone banking. Hence, while we do have substantial operations outside retail banking, retail banking is our core competence.

In a way, retail banking is also woven into Erste Bank's genetic fabric. In 1819 wealthy Viennese citizens donated funds in order to establish Erste Bank's predecessor, a savings bank. They aimed to bring affordable banking services to wide sections of the population. This goal is just as valid today as it was some 190 years ago, especially against the backdrop of operating in Central and Eastern Europe.

In today's context, retail banking is attractive for us because it offers a compelling business case, comprehensive scope in terms of product offering and the opportunity to operate in well diversified markets.

The business case is characterised by a number of favourable parameters, one of which is the lower level of volatility than experienced in corporate or investment banking. Consequently, our earnings growth is strong and stable, our provisioning levels are almost unchanged over a number of years and our capital requirements are lower. Another positive factor is the longevity of our growth path, which is a result of operating in a portfolio of markets that are at different stages of economic development.

Austria is a mature and stable banking market, the Czech Republic, Hungary, Slovakia and Croatia are developing transformation economies, while Romania and Serbia are emerging banking markets. This means that we can draw on our broad product knowledge in mature markets and selectively apply those retail banking products in lesser developed markets that are most suited to our clients' needs.

### Geographic focus: Central and Eastern Europe

In the late 1990-ies we came to the conclusion that our long-term future as an independent bank was very much contingent on finding new markets outside Austria: at that time growth opportunities were limited, leaving only repeated cost cutting exercises as a way to improve the bottom line. As a result we decided to make a long term commitment to the markets at our doorstep, essentially our neighbouring countries in Central Europe – the Czech Republic, Slovakia, Hungary, Croatia and Slovenia. We defined an extended home market of 40 million people with the clear intention to enter these markets by making selected acquisitions. In Austria we pursued a policy of seeking closer integration with the savings banks sector in order to increase scale, offer our clients better value and work more efficiently.

Since then we have far surpassed our initial goals. Our home market now covers a contiguous region of nearly 70 million inhabitants, we have successfully integrated more than ten acquisitions in Central and Eastern Europe, and in Austria we have made a quantum leap forward in our efforts to work more closely with the savings banks through the establishment of the cross guarantee system. This agreement forms the basis for a wide-ranging cooperation between Erste Bank and the savings banks covering such aspects as common back office structures, common marketing and common product development.

Our expansion into Central and Eastern Europe has yielded great benefits: shareholders have enjoyed sustainable earnings growth, customers can access our comprehensive range of services in more countries than ever before, and our employees have more development opportunities than at any time in the company's history. Consequently, we will continue on our proven growth path, extending our footprint in Central and Eastern Europe, when suitable opportunities arise.

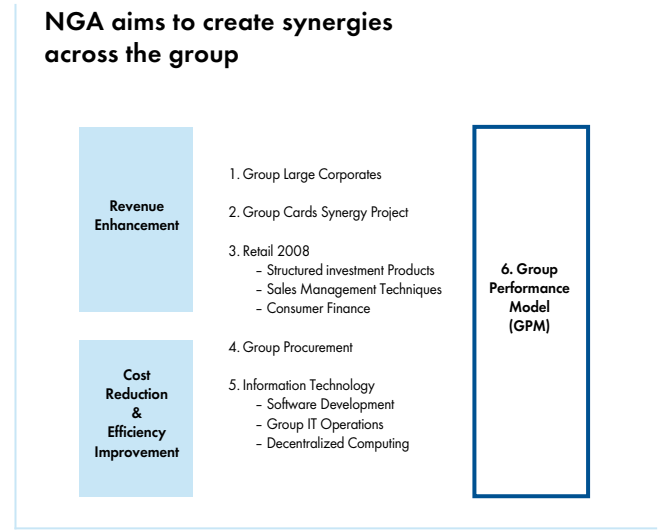
### Efficiency focus: New Group Architecture

The New Group Architecture (NGA) programme lies at the heart of our ambition to work more efficiently across the group and is a direct result of our expansion as well as the realisation that a number of tasks are more efficiently carried out on a group-wide, standardised basis, while sales and marketing efforts are best handled locally. Or put differently, the New

Group Architecture aims to create a more successful banking group of what is already a successful group of banks.

Launched in mid-2004, the NGA programme will translate into revenue enhancements, cost reductions and efficiency improvements. Accordingly, we grouped the six major programme streams along these lines, as shown below: the Group Large Corporates project, the Group Cards Synergy Project and the Retail 2008 project are designed to deliver revenue enhancements, while the Group Procurement project and the Information Technology project will be sources of cost reductions and higher work efficiency. The Group Performance Model will deliver the transparency needed to effectively steer the group.

The Group Performance Model (GPM) acts as the strategic backbone of the NGA programme. It standardises definitions and processes, aiming to make all our operating units comparable. More specifically the GPM creates uniform standards for the recognition and allocation of costs and revenues and organises major performance indicators and controlling tools for benchmarking purposes, in order to facilitate identification of additional savings potentials and revenue synergies.



Source: Erste Bank.

A unified, group-wide approach towards our large corporate customers is behind the establishment of the Group Large Corporates business unit. Through better integration of treasury, capital markets and other investment banking activities we aim to be the partner of choice for all the financing needs of our large corporate customers. The target group consists of some 650 companies with annual revenues of more than EUR 175 million each, which operate in one or more of our markets. In 2005 we had a business relationship with approximately 200 of these entities.

The Group Cards Synergy Project concerns the payment card business. The card business is broadly defined to include debit cards, credit cards, and the installation of additional POS systems and ATMs. Erste Bank's goal in the card business is to be the leading provider of debit and credit cards as measured by both number of cards and usage. As part of the Group Cards Synergy Project, a new group-wide card responsibility is being set up. This responsibility is designed to achieve a coordinated market approach through a common card business plan, a card loyalty programme, intensified merchant acquisition, uniform card credit risk management as well as harmonisation of group-wide card processing.

"Retail 2008" represents a package of knowledge sharing initiatives under a single umbrella. "Retail 2008" aims to spread best practices in retail banking across our group. The programme involves developing business and product initiatives – for example, in the area of structured investment products and an enterprise-wide consumer finance strategy complementary to the traditional retail business. These projects are intended partly to address existing clients and partly to target new customer groups and additional medium term revenue potentials.

The main objectives of the Group Procurement project comprise group-wide pooling of information on non-staff administrative expenses and investment, bundling of procurement volumes, identifying potential savings achievable through improved demand management and standardised specifications, and creating a single procurement organisation with uniform procurement processes.

The Information Technology project is expected to yield substantial cost reductions, but also efficiency improvements. It will focus, amongst other elements, on streamlined demand management, a uniform IT master plan, the bundling of software development functions as well as operating units and will unify desktop and decentralised equipment management.

We have already achieved a number of quick wins: we have established a group-wide software development unit and have formed a separate procurement organisation that is well on track in realising substantial savings. The new business unit Group Large Corporates is fully operational since mid 2005 and has already shown favourable operating result development. Structured investment products, which were rolled-out in all countries of our extended home market in 2005, are also performing well. Accordingly, we are confident to achieve the concrete financial target – a positive pre-tax contribution of EUR 210 million annually as of 2008 – set out at the Capital Markets Day 2005.

## **GROWTH DRIVERS**

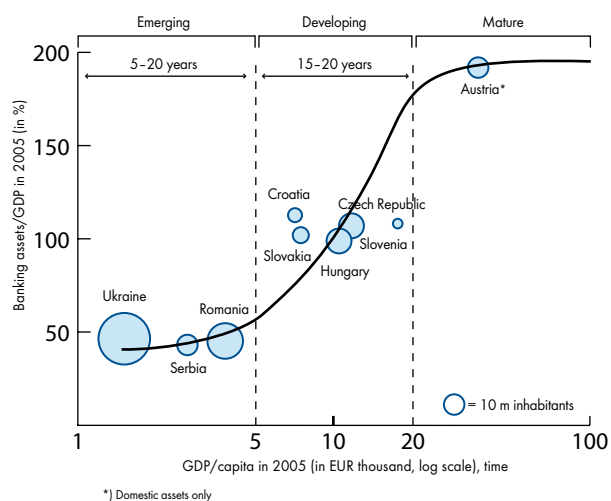
Our investors routinely ask us where future growth will come from. Since growth is not only an essential part of our equity story, but also of strategic importance to our business model we will briefly present long-term development patterns in our markets, as well as the three most important determinants of future growth: loan growth, wealth management and regional expansion.

## **GROWTH PATTERNS**

Our business model benefits from a unique growth profile that extends over the next 20 - 30 years and is tied to the economic catch-up process of Central and Eastern Europe. It derives its strength from the fact that our markets are at different stages of development. For this purpose we have classified our markets into three clusters: emerging, developing and mature markets, as shown in the chart overleaf.

Emerging markets are characterised by a GDP/capita level of below EUR 5,000 and a banking asset penetration of some 50% or less. Depending on the economic position at the start of transformation, we estimate this period to take between

## Banking development in transformation economies



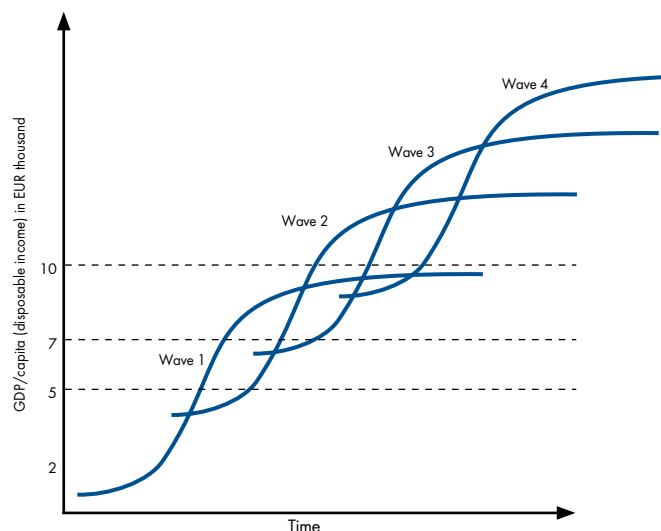
Source: Local central banks, Eurostat, Erste Bank.

5 – 20 years. Within our business portfolio Erste Bank Serbia and Banca Comerciala Romana, our Serbian and Romanian subsidiaries respectively, operate in such markets. At this stage of development growth is mostly derived from plain-vanilla banking products, such as savings, payments transfers as well as current accounts and debit cards, which are represented by waves 1 and 2 in the right-hand exhibit. While household loans usually play an insignificant role at these levels of income, an increase in the banked population is typically a major source of growth.

Developing markets feature GDP/capita between EUR 5,000 and EUR 20,000 and a banking asset penetration ratio of anywhere between 60% and 140%. We estimate that this stage lasts at least 15 – 20 years. In this period retail lending comes off age and transformation countries reach a level of wealth that facilitates the introduction of more sophisticated banking products, such as mortgages, credit cards, consumer loans as well as wealth management products, represented by growth waves 3 and 4 in the right-hand chart. Our central European businesses in the Czech Republic, Slovakia, Hungary and Croatia fall into this bracket.

## Banking growth paths in transformation economies

- Wave 1: Savings, payment transfers
- Wave 2: Current accounts, debit cards, mortgages
- Wave 3: Credit cards, consumer finance
- Wave 4: Wealth management – asset management, pensions, life insurance



Source: Erste Bank illustration.

Mature markets are defined by GDP/capita in excess of EUR 20,000 and banking asset penetration north of 150%. These tend to offer only selected growth opportunities and typically only grow in line with GDP. We find it useful to operate in such markets to the extent that we can draw on experiences and transfer knowledge to less developed markets. Depending on the factors that influence market structure, the most significant of which is shareholder orientation or the lack thereof, these markets can either be very profitable such as in the UK or Spain, or less so, such as in Austria or Germany.

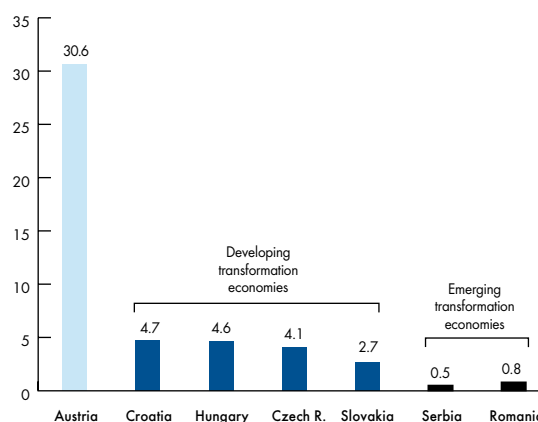
## LOAN GROWTH

In many countries we operate in retail lending was non-existent just a couple of years ago, firstly because nominal and real interest rates were high, secondly because disposable incomes did not support household credit growth and thirdly because of a lack of a healthy competitive environment due to high levels of state ownership. All this has changed over the last years: in developing transformation economies interest rates are in the process of convergence or have already converged, disposable incomes have risen strongly on the back of overall GDP growth, and most state banks have been sold to foreign strategic investors fostering product innovation and competition. This powerful combination underlies current growth trends and will fuel future growth.

To assess the maturity and hence the credit growth potential of banking markets such loan penetration measures, as customer loans/GDP, household loans/GDP and/or mortgages/GDP are commonly used. For countries with highly diverging levels of GDP/capita, though, this masks the true growth opportunity, as it discounts the impact of GDP growth itself. For instance, the assumption that developing transformation economies with customer loan penetrations of between 40% to 60% are already fairly developed and hence offer limited incremental growth opportunities compared to mature economies such as Austria, where domestic loan penetration is somewhat above 100%, are not factoring in that it is the GDP growth differential that is the major driving force behind the loan growth opportunity. As a result, we believe that absolute per capita figures offer a fairer reflection of the growth opportunity than relative measures.

The following chart shows the enormous gap that even today exists between mature and developing economies on the one hand and between developing and emerging economies on the other. Countries, such as Hungary and the Czech Republic, but also Croatia and Slovakia are many years away from reaching Austrian, let alone west European levels of loans per capita. This picture is even starker with the countries we entered in 2005: Romania's and Serbia's levels of private sector indebtedness are barely registering on the radar screen in the context of developed economies. Hence, we believe that credit expansion will be a secular growth trend, rather than a process that has already surpassed its peak.

## Customer loans/capita in CEE (2005) in EUR thousand



Source: Local central banks, Eurostat.

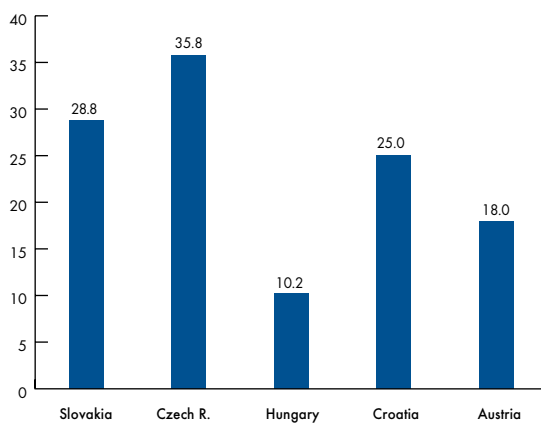
Within the overall loan growth trend, we will particularly benefit from our exposure to the retail customer. Retail lending, particularly in the form of residential mortgages, has only just started in almost all our markets. A point in case is mortgage penetration: it equals about 10% of GDP in our most developed markets, while it is yet substantially lower in Romania or Serbia. Even in Austria this measure only stands at 22%, leaving room for growth, while in the European Union it has reached an estimated 46% in 2005.

## WEALTH MANAGEMENT

While private sector and especially retail credit expansion will be the growth engine of the immediate future, wealth management, which covers our private banking, fund management and life insurance business lines, will drive growth as our markets become wealthier. Irrespective of when this actually happens, we are already uniquely positioned to benefit from any such development: we dominate the fund management markets in our existing central and east European universe with a market share of 24.3% and we can draw on our experience in Austria, where we are leaders in retail funds and hold the No. 2 spot



**Erste Bank fund management market shares (2005)  
 in %**



Source: Erste Sparinvest.

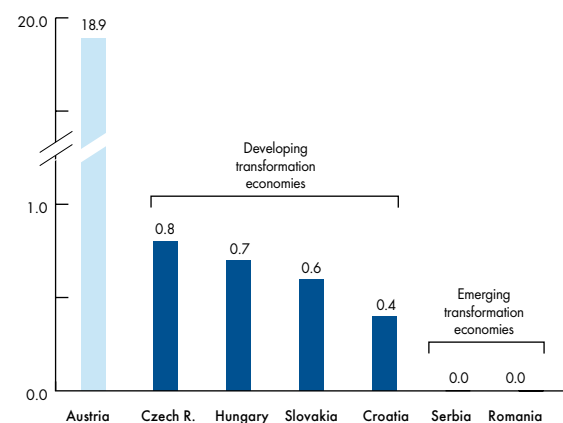
overall with a market share of 18%, as detailed above. In life insurance, we lead the market in Austria, while we have established strong footholds in all other markets.

As pointed out, the growth dynamics in fund management differ fundamentally from those experienced in standard banking products, in so far as meaningful growth typically kicks in at a later stage of economic development. Based on historic trends in countries such as Spain or Austria, we estimate that growth in fund management reaches critical mass when nominal GDP/capita hits the trigger point of about EUR 10,000. Many of our central and east European markets are quickly approaching this threshold. It is at this level that we believe basic consumption needs are satisfied and attention starts to shift to providing for the future.

Accordingly, the divide in fund management between mature and developing markets on the one hand, and between developing and emerging transformation economies on the other is even starker than that experienced in the area of loans. As shown in the right-hand exhibit, funds under management per capita in Austria equalled EUR 18,900 at the end of 2005,

while the same figure stood at about EUR 700 and EUR 800 in Hungary and the Czech Republic, respectively. In Romania fund management was in the process of regaining credibility after a number of fraud cases at the turn of the century. While funds under management per capita were higher a couple of years ago than the EUR 4 registered at the end of 2005, either figure pales into insignificance compared to more developed markets. At the end of 2005 Serbia still lacked the legal infrastructure for fund management and accordingly all the growth is still ahead.

**Funds under management/capita in CEE (2005)  
 in EUR thousand**



Source: Local fund management associations, Eurostat.

While growth in fund management follows a more cyclical pattern, life insurance growth is steadier and tied to state regulations on pensions and savings as well as tax breaks. Demographic trends, such as the ageing of society, and the increasing requirement for private old age provision also play a significant role in determining demand for wealth management products in general and life insurance policies in particular.

## REGIONAL EXPANSION

Regional expansion was a major growth driver in the past and will continue to be a significant source of growth in the future. In this context, acquisitions play a major role in our business model. So far acquisitions were the preferred way by which we executed our central and east European expansion strategy. Since 1997 we have bought ten banks and invested about EUR 6.5 billion into Central and Eastern Europe, thereby actively contributing to the regeneration and redevelopment of the region.

When we buy a bank we adhere to a defined set of guiding principles. Firstly, we always aim to buy a bank with a leading market position or when this is not feasible an operation that we feel has a chance of reaching a market share of 15 – 20 % in terms of clients and/or retail products, either through bolt-on acquisitions or organic growth. Secondly, any new bank has to fit the existing network and be beneficial to our clients. Thirdly, we stick to the following financial acquisition criteria:

**\_A return on equity of at least 20% by the third year following the year of closing of the acquisition. Historically we have always achieved this target.**

**\_A return on investment of 10% by the third year following the year of closing of the acquisition. This measure is important to us because it includes the impact of goodwill. Historically we have achieved ROI figures in the range of 12% - 15%.**

**\_Achievement of earnings accretion by the third year following the year of closing of the acquisition.**

What really sets our acquisition policy apart is our post deal integration expertise. The restructuring and integration process typically starts after the day of signing. A service agreement gives Erste Bank experts immediate access, so that they can familiarise themselves with day-to-day operations of the bank right away. Following closing of the transaction, a tried and tested transformation programme is put in place and executed by a multinational transformation team, led by a senior Erste Bank executive. It typically lasts no longer than 18 months and covers all material aspects of the business. In sensitive areas, such as risk management, existing staff are immediately assisted by Erste Bank staff in order to upgrade the function to group standards as quickly as feasible.

As a result of our highly developed regional expertise and our positive acquisition track record, we will continue to grow our regional franchise both through carefully selected acquisitions that fit the existing network, and organically.

# Corporate Governance

In the interest of accountable management, Erste Bank is committed to implementing the Austrian Code of Corporate Governance. To ensure the greatest possible transparency for all stakeholder groups, Erste Bank adheres to all statutory rules and recommendations of this Code. Good corporate governance is regarded as a key element of Erste Bank's corporate culture.

## **The Austrian Code of Corporate Governance**

In October 2002 the Austrian Working Group for Corporate Governance presented the Austrian Code of Corporate Governance. The Code constitutes a voluntary, self-regulatory initiative and goes beyond a corporation's statutory responsibilities. The Code seeks to promote accountable corporate management and supervision to create value in a sustainable way, and to balance and define the rights and responsibilities of every stakeholder – management, supervisory board, employees, shareholders, customers and the general public – and the relationships between these groups. The Code is designed to ensure a high degree of transparency for all stakeholders. The complete wording of the Code is available at [www.corporate-governance.at](http://www.corporate-governance.at).

## **Erste Bank is committed to good corporate governance**

Erste Bank complies with all statutory rules and recommendations of the Austrian Code of Corporate Governance. Detailed explanations of the compliance with specific provisions of the Code are provided on the web site of Erste Bank at [www.erste-bank.com/ir](http://www.erste-bank.com/ir).

At the public offerings in 1997 and 2000, Erste Bank's employees had the opportunity to acquire shares in Erste Bank on preferential terms and thus benefit from the Group's upside potential in the stock market. In 2002, in addition to a management share option plan, a new employee share ownership programme (ESOP) under the name "Creating Value" was launched for all Group staff. The strong demand from staff has reinforced management's intention to continue the ESOP, with the medium-term goal of raising employees' ownership in Erste Bank from the current level of slightly less than 2% to approximately 5%.

The inclusion of employees forms an important part of Erste Bank's corporate culture. This is manifested in the regularly implemented, large-scale staff surveys whose results are analysed by external consultants and taken into account by management during decision-making process. The latest such poll

was conducted in the first half of 2003. Similar surveys are carried out at subsidiaries in Central Europe. A new employee survey is planned for the first half of 2007 that will cover the entire Erste Bank Group for the first time.

The high esteem in which Erste Bank holds its employees is expressed in the Staff Charter signed at the beginning of 2004. The Staff Charter documents the employee-friendly value system as well as the aims of management and staff. In addition, in order to keep pace with the changing market environment, the Charter aims to create a focus on joint productivity at Erste Bank.

Safeguarding the rights of all shareholders is the cardinal rule of corporate management. Erste Bank thus created a clear capital structure consisting only of ordinary shares. The management embraces a retail strategy not only in the banking business, but also by encouraging retail investors to become shareholders. With this in mind, Erste Bank shares were made more accessible and marketable last year through a 4-to-1 stock split.

Shareholders' desire to speak directly with top management is accommodated by internet chats that have been held regularly since 2000. These events allow investors to find out first-hand about current developments at Erste Bank.

The rights and responsibilities of employees and appropriate conduct towards customers (Code of Conduct) are specified in a detailed and comprehensive set of instructions. The current version of these standards, which are binding for all employees, is posted on Erste Bank's intranet.

In 2005, Erste Bank voluntarily subjected its compliance with the regulations of the Austrian Code of Corporate Governance to an independent review. The findings of this review are available on the web site.

The Austrian Working Group for Corporate Governance amended the Code of Corporate Governance in 2005, adopting the core of the EU recommendations with regard to the Supervisory Board's duties and management compensation and making the necessary adjustments to reflect the 2005 Company Law Amendment Act. This amended version of the Austrian Code of Corporate Governance applies to financial years beginning 1 January 2006.

# "I think of the children's future"

Klara Novak and her two children, Klara Eva and Imre, live in a nice, large historic building in Budapest. Not long ago, Klara Novak took advantage of the opportunity to work abroad for several years before entering her parents' restaurant business. Today, she is one reason Hungary is among the most prosperous and fastest growing economies of the former Eastern Bloc. With a per capita GDP of EUR 8,700 and a 7.0% unemployment rate, Hungary is among the most successful of the new European Union members. In Budapest, which has been restored to its former splendour in many areas following several years of costly renovations, Novak works as a software consultant.

**Erste Bank:** "Ms Novak, you worked for a few years outside of Hungary?"

Klara Novak: "Yes, it was a strenuous and often difficult time. But I learned a lot. The nearly two years that I spent in Leipzig not only prepared me to work in my parents' restaurant, but also provided me with a lot of experience."

**Erste Bank:** "First you worked in the family restaurant, now you are in a totally different field. How did that happen?"

Klara Novak: "Simple. My father retired, and we sold the business. I am very happy in my current job as a software consultant. Currently, I instruct and train civil servants, who are learning to work with new, specialised software. In Hungary, there is tremendous demand for software consulting. That is how I entered this field. And it pays well!"

**Erste Bank:** "You are also the mother of two children. How do you manage these dual roles?"

Klara Novak: "Well, I am not the only woman in this position. In my current work, I am constantly meeting women who have to deal with

this situation. But naturally it can be demanding. The children themselves are a great help to me."

Klara Eva: "We are at school in the afternoons, too. We do our homework there, and our mother can be sure that we are not getting into trouble. For me at least ..."

Imre: "For me, too! And our grandfather Lajos is often home with us."

Klara Novak: "As a working woman, naturally I have little free time. But I spend every free minute with the children. In the summer, we often spend weekends at our cottage in the country."

**Erste Bank:** "Have you been able to put aside any of the money you have earned?"

Klara Novak: "I save a portion of my salary and invest it in a structured savings plan at Erste Bank Hungary. The sale of the parent's business also provided some income. We will be able to afford something with that later, since it is mainly for the children's education."

**Erste Bank:** "Thank you very much for speaking with us and for your hospitality. We are pleased to have kind clients such as yourself, and we wish you well in the future."



Novak family, clients of Erste Bank Hungary, Hungary



# Management Report

## MANAGEMENT REPORT AND FINANCIAL REVIEW OF ERSTE BANK GROUP FOR 2005

### General economic environment

In 2005, the global economic environment, and financial market trends in particular, were marked by the impact of rising oil prices on economic growth, inflation and interest rates. The contrast between the negative impact of higher oil prices and related inflationary fears on the one hand and economic and corporate earnings growth on the other lead to increased volatility.

Austria's GDP grew by 1.7% last year, a rate that was above the Eurozone average. In Erste Bank's main central European markets (Czech Republic, Slovakia, Hungary and Croatia), however, growth rates were substantially higher, ranging from 3.6% to 5.1%. The Czech and Slovakian currencies posted significant gains against the Euro. In 2005, monetary policy was marked by eight successive increases in the US benchmark interest rate from 2.25% to 4.25%, while Austria's benchmark rate stabilised at a very low level. Central European rates posted further declines, which clearly put pressure on net interest margins in the retail business.

### Erste Bank Group's performance

The recently acquired Serbian bank Erste Bank Serbia (Erste Bank a.d., Novi Sad, formerly Novosadska Banka) is consolidated in the financial statements as from 9 August 2005, the transaction closing date. The impact of this first-time consolidation is minimal, however. As of 31 December 2005, the subsidiary's total assets were EUR 142 million; during the period from 9 August through 31 December 2005, it had operating income of EUR 6.7 million, operating expenses of EUR 10.7 million (which includes restructuring costs of EUR 5.9 million) and a pre-tax loss of EUR 7.8 million.

The revised IASB standards, IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement), became compulsory as of 1 January 2005. They mainly affect the presentation of securities trading, the valuation of loans and the presentation of hybrid capital. Under the transitional provisions, prior-year figures must be restated. The rates of change indicated are based on the restated prior-year figures. Additional informa-

tion is presented in the Notes to the Consolidated Financial Statements. The details of these changes were outlined in press releases published on 3 May 2005 and 6 December 2005, which can be found on the Erste Bank home page at ([www.erstebank.com](http://www.erstebank.com)).

In 2005, Erste Bank recorded outstanding results yet again, following up on the success of recent years. **Operating income** (consisting of net interest income, net commission income, net trading result and income from insurance business) rose by 6.9% to EUR 4,329.4 million. Despite the low interest rate levels – in Central Europe as well as in Austria – net interest income increased by 5.0% overall to EUR 2,794.2 million. Meanwhile, net commission income rose by 10.7% to EUR 1,256.8 million, a very favourable result.

Given the modest 3.2% increase in **general administrative expenses** to EUR 2,676.9 million, **operating profit** (operating income less general administrative expenses) increased by 13.6% to EUR 1,652.5 million.

The **cost/income ratio** (general administrative expenses as a percentage of operating income) improved from 64.1% in 2004 to 61.8% last year.

After factoring in a slight 3.8% increase in **risk provision allocations for loans and advances** to EUR 421.6 million and a reduction in the **other operating result** from negative EUR 51.3 million to only EUR 16.1 million, **pre-tax profit** increased by 21.9% to EUR 1,214.8 million.

Based on the Erste Bank Group's average number of employees (36,643 in 2005, up from 36,533 the previous year – see Notes for details), employee productivity rose substantially in 2005. The pre-tax profit per employee totalled EUR 33 thousand last year, up from EUR 27 thousand in 2004.

**Group net profit** after taxes and minority interests advanced 36.6% to EUR 711.7 million, while the **return on equity (ROE)** – i.e. group net profit after taxes and minority interests as a percentage of average consolidated shareholders' equity – improved from 17.0% in 2004 to 19.0%.

At 31 December 2005, the Erste Bank Group had a total of 987 branches in Austria (including Haftungsverbund savings banks) and 1,296 branches in Central Europe.

At 31 December 2005, Erste Bank Group's **total assets** were EUR 152.7 billion, up 9.2% from the previous year's total of EUR 139.8 billion. **Loans and advances to customers** increased by 10.4% from EUR 72.8 billion to EUR 80.4 billion, while **amounts owed to customers** rose by 6.7% from EUR 68.2 billion to EUR 72.8 billion.

Despite an above-average increase in risk-weighted assets, the Erste Bank Group's **Tier 1 capital ratio** (Tier 1 capital under the Austrian Banking Act (BWG) as a percentage of risk-weighted assets under §22 para. 2 of the BWG) was 6.8% as of 31 December 2005, up from 6.7% the previous year. The **solvency ratio** (own funds less trading book requirements and unsettled currency positions as a percentage of risk-weighted assets under §22 para. 2 of the BWG) was 11.0%, up from 10.7% the previous year.

## ANALYSIS OF BUSINESS PERFORMANCE

### Operating income

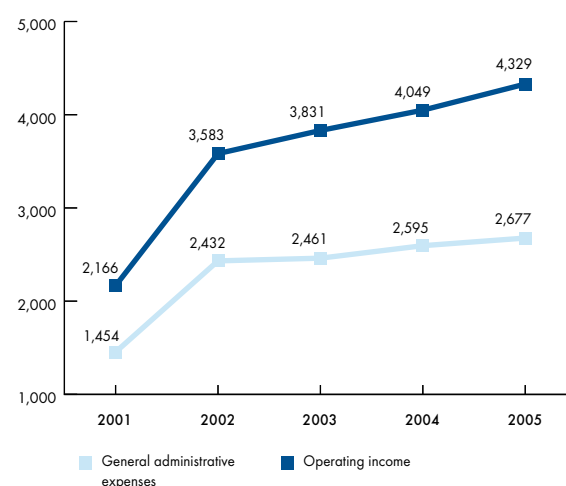
As mentioned above, total operating income increased by 6.9% to EUR 4,329.4 million. Nearly every income category recorded substantial gains, led by net commission income and the net trading result.

### Net interest income

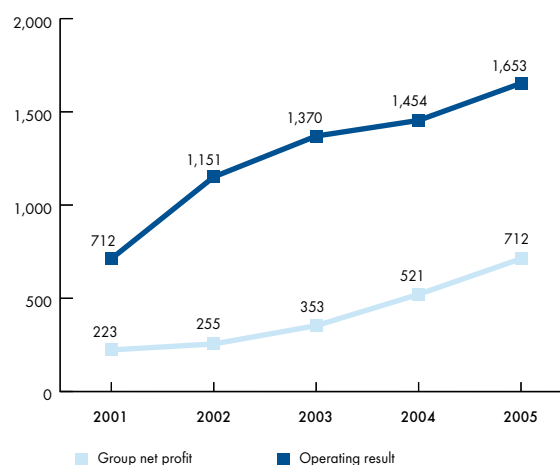
Despite a particularly difficult market environment for the retail banking business, marked by persistent low interest rates in Austria and Central Europe, **net interest income** rose by 5.0% from EUR 2,660.3 million to EUR 2,794.2 million in 2005. This result includes EUR 22.0 million in income from associates and other investments (EUR 22.7 million the previous year), as well as EUR 24.8 million in income from companies valued at equity (EUR 13.7 million the previous year).

Income from investment properties totalled EUR 70.6 million in 2005, up from EUR 68.8 million the previous year.

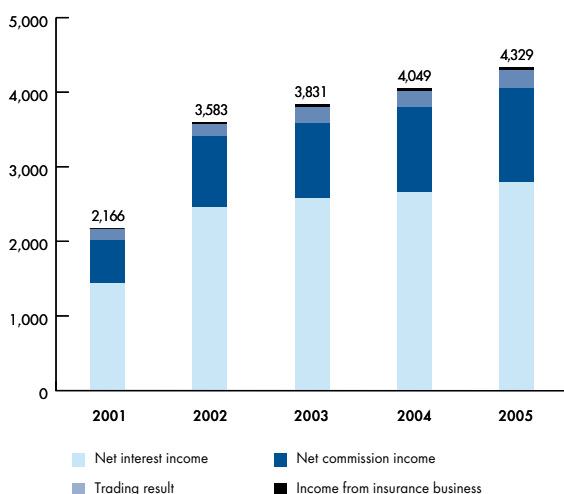
### Operating income and general administrative expenses (EUR million)



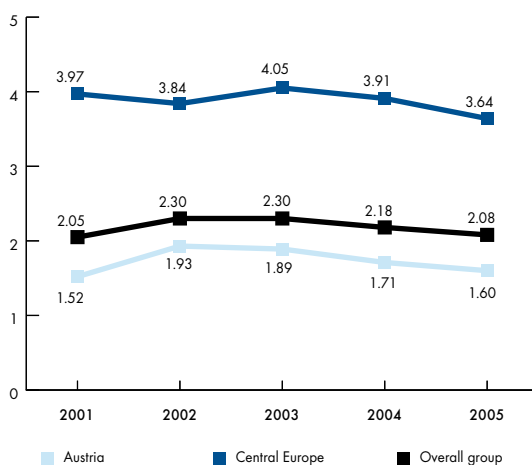
### Operating result and group net profit (EUR million)



## Operating income structure and trend (EUR million)



## Net interest margin (in %)



The overall net interest margin (net interest income as a percentage of average interest-bearing assets – calculated as total assets less cash, trading assets, tangible and intangible fixed assets and other assets) contracted slightly by 2.18% to 2.08%. This contraction resulted from the continuing margin pressure and low interest rate environment as well as the additional refinancing costs for the January 2005 acquisition of the remaining 19.99% equity interest in Slovenská sporiteľňa. In Austria, the net interest margin decreased from around 1.7% to around 1.6%, mainly as a result of the flat yield curve. In the central European subsidiaries, this margin ranged between 3.2% and 5.0%, slightly below the previous year's level but well above the level in Austria.

## Net commission income

**Net commission income** posted substantial gains once again in 2005, rising by 10.7% from EUR 1,135.4 million to EUR 1,256.8 million and making a significant contribution to overall earnings growth. These gains were generated mainly in the securities business, which rose by 29.3% to EUR 391.9 million thanks to a favourable securities market environment, and sales of insurance products, which increased by 12.3% to EUR 69.2 million. The payments business also performed well, gaining 9.5% to EUR 485.7 million. Net commission income posted above-average growth in all countries, including Austria.

## Net trading result

After recording above-average growth to EUR 216.5 million in 2004, the **net trading result** gained a robust 11.6% in 2005 to reach EUR 241.7 million. The trading units at Erste Bank Vienna and the Central European subsidiaries all made positive earnings contributions. Of the central European subsidiaries, Ceska sporitelna, Erste Bank Hungary and in particular Erste Bank Croatia delivered robust earnings.

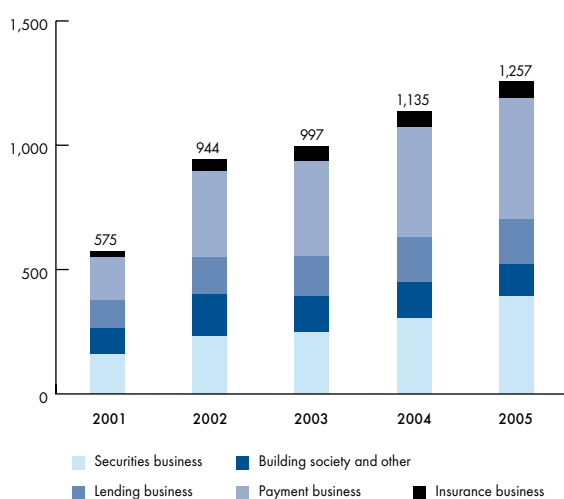
Securities and derivatives trading increased by 7.5% to EUR 96.6 million, while foreign exchange trading grew by 14.6% to EUR 145.1 million.

## Income from insurance business

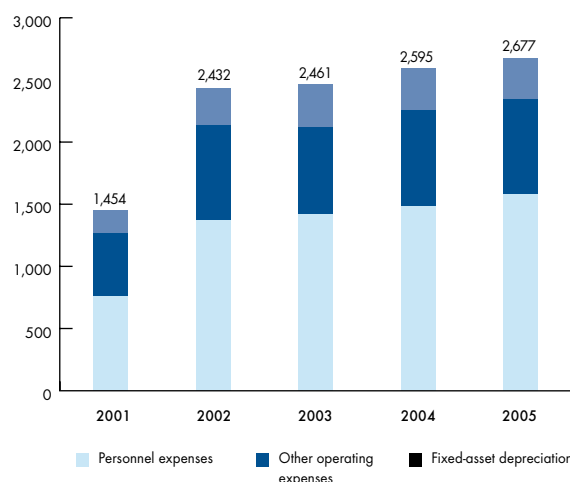
**Income from insurance business** was very favourable in 2005, maintaining the previous year's result of nearly EUR 37 million despite the non-recurring expense related to the conversion to new actuarial tables and a corresponding one-off charge of EUR 23 million for 2005.



**Net commission income structure and trend (EUR million)**



**General administrative expenses structure and trend (EUR million)**



s Versicherung, the Austrian life insurance market leader, and the local Central European companies performed very well. The favourable results in 2005 were supported by market-driven gains on financial investments held by group insurance businesses.

### General administrative expenses

In 2005, **general administrative expenses** increased by a modest 3.2% to EUR 2,676.9 million. The increase can be attributed mainly to the Central European subsidiaries, whose expenses rose by 10.0%. In part they involved higher value-added tax rates (as from May 2004) in the Czech Republic and Slovakia. The impact of local currency gains against the Euro also played a role. Although the first-time consolidation of Erste Bank Serbia, is largely immaterial, the impact on expenses is nevertheless greater, since restructuring costs related to the company were already booked in 2005. Overall, the Erste Bank Group consolidated financial statements include EUR 10.7 million in general administrative expenses from Erste Bank Serbia. Adjusted for Erste Bank Serbia, general administrative expenses in Central Europe increased by 8.8%.

Meanwhile, in Austria (incl. Corporate Center and the International Business) these expenses contracted by 0.5% despite increased expenditures to establish group-wide functions and preparations for strategic projects.

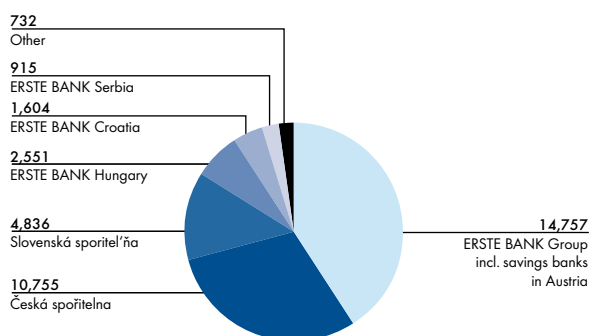
**Total personnel expense** increased by 6.8% from EUR 1,482.4 million to EUR 1,583.4 million.

This increase was disproportionately high in Central Europe, where it increased by 9.6%, or by 8.2% after adjusting for Erste Bank Serbia. Along with the generally higher wage and salary adjustments, the increase reflects investments in continuing employee training. The Erste Bank Group substantially increased the relative share of performance-related compensation.

At 31 December 2005, the **headcount** had risen by 0.8% to 36,150 from the previous year. This figure includes 915 employees (2005 year-end total) from the first-time consolidation of Erste Bank Serbia. Adjusted for these employees, the group's headcount in fact fell by 1.7%. Further staff reductions were made in the Czech Republic in particular. The expansion of the branch networks in Hungary and Croatia resulted in higher

headcounts in those countries. The increase at other subsidiaries can be attributed to the increased presence in Central Europe of the Immorent Group and s Versicherung.

### Headcount at 31 December 2005



At 31 December 2005, 63 employees (66 the previous year) worked in non-banking subsidiaries (mainly hotel and leisure branches).

The ongoing cost management efforts were reflected most notably in the very modest increase in **other administrative expenses**. Despite the continued expansion of group-wide functions and preparations for strategic group-wide projects, which led to an increase in expenses, but are expected to reduce the overall cost base in the future, these expenses decreased by 1.7% from EUR 772.2 million in 2004 to EUR 759.0 million last year.

In Austria (incl. Corporate Center and International Business), other administrative expenses contracted by 11.3% to EUR 387.1 million while in Central Europe they rose by 10.8% to EUR 371.9 million as a result of restructuring costs related to Erste Bank Serbia and currency appreciation. Adjusted for Erste Bank Serbia, they increased by 9.4%. In particular the

Group was able to reduce its IT expenses by 13.0% to EUR 169.5 million.

**Depreciation on tangible fixed assets** also fell by 1.7% from EUR 340.3 million to EUR 334.5 million. Overall depreciation expense included an increase on intangible assets (mainly software) from EUR 136.9 million to EUR 139.0 million, a decrease on real estate property from EUR 53.9 million to EUR 46.9 million and a decrease on other items (mainly office fixtures, including minor assets) from EUR 149.5 million to EUR 148.6 million.

### Risk provisions

**Risk provisions for loans and advances** included net allocations (allocations less releases) of EUR 383.5 million, up from EUR 360.3 million the previous year. This item includes EUR 74.7 million in write-offs for loans, up from EUR 61.2 million the previous year, as well as EUR 36.6 million in amounts recovered on non-performing loans and advances, up from EUR 15.3 million the previous year.

Overall, risk provision allocations for loans and advances rose slightly from EUR 406.2 million to EUR 421.6 million in 2005. Central Europe accounted for approximately 19.0% of that total.

This figure does not include interest receivable, which is instead reflected in net interest income. Additions to and releases of other risk provisions unrelated to the lending business are reported under other operating result.

The increase in risk provision allocations resulted in large part from the Haftungsverbund savings banks. Other factors included the strong growth in lending in the Central European countries, as well as the non-recurrence of the previous year's releases in the Slovakian and Croatian bank subsidiaries.

In 2005, risk provision allocations totalled 0.55% of the average volume of loans and advances to customers during the year, compared with 0.58% the previous year.

Detailed information on the Erste Bank's financial risks and its risk management goals and methods are provided in the Risk Report in the Notes.

### Other operating result

Other operating result comprises price gains from securities not held for trading, valuation gains and income from the disposal of equity interests, income from disposal of financial assets, risk provisions not related to lending, expenses for deposit insurance at the central European subsidiaries, and other expenses and income.

The other operating result was significantly reduced from negative EUR 51.3 million in 2004 to only EUR 16.1 million last year. In 2004, this position included several one-off items that for the most part offset one another (in particular a gain on the sale of the Czech property insurance unit and a valuation gain related to the pending sale of the equity interest in Investkredit AG on the one hand and goodwill depreciation on impairments on the other). Income from securities in the non-trading portfolio increased from EUR 51.3 million to EUR 77.8 million in 2005. Also, the proceeds from the sale or exceptional valuation of property assets increased significantly from EUR 11.3 million in 2004 to EUR 36.4 million, largely as a result of the sale of a Vienna office building for approximately EUR 21.6 million. Regulatory changes in the Czech Republic led to a reduction in the contribution to the deposit insurance. Overall, these payments fell from EUR 54.0 million in 2004 to EUR 42.6 million last year. This item is broken down in detail in the Notes.

These developments all resulted in a 21.9% increase in **pre-tax profit** EUR 996.6 million in 2004 to EUR 1,214.8 million last year.

### Tax situation

Under the regulations governing consolidated tax groups that entered into force in 2005, Erste Bank AG and the largest Austrian subsidiaries (in particular Bausparkasse der österreichischen Sparkassen, Immorent, Erste-Sparinvest KAG, s Versicherung and Salzburger Sparkasse) form a consolidated tax group as defined by §9 of the Austrian Corporation Tax Law and are subject to group tax.

In 2005, this profit pool incurred no current expense for Austrian corporation tax as a result of tax loss carry-forwards, substantial tax-exempt earnings and available tax credits, especially abroad, on capital gains taxes. Therefore, the amounts reported under **taxes on income** include mainly foreign income-based taxes, the deferred tax assets and liabilities required to be recognised under IFRS and taxes payable by smaller Austrian subsidiaries and various Haftungsverbund savings banks.

The reported tax expense for 2005 of EUR 300.0 million (2004: EUR 277.9 million) includes a deferred tax charge of EUR 22.1 million (2004: EUR 45.5 million).

At 31 December 2005, EUR 244 million in deferred tax assets were capitalised, while EUR 119 million in deferred tax liabilities were recognised.

In 2005, the Erste Bank Group's reported **tax rate** (taxes on income as a percentage of pre-tax profit) was 24.7%, down from 27.9% the previous year. The decrease resulted mainly from the non-recurring exceptional depreciation of deferred tax assets in 2004 prior to the reduction in the Austrian corporate tax rate (approximately EUR 20 million), the application as from 1 January 2005 of this tax rate reduction from 34% to 25% and the lowering of the corporate tax rate in the Czech Republic from 28% in 2004 to 26% last year.

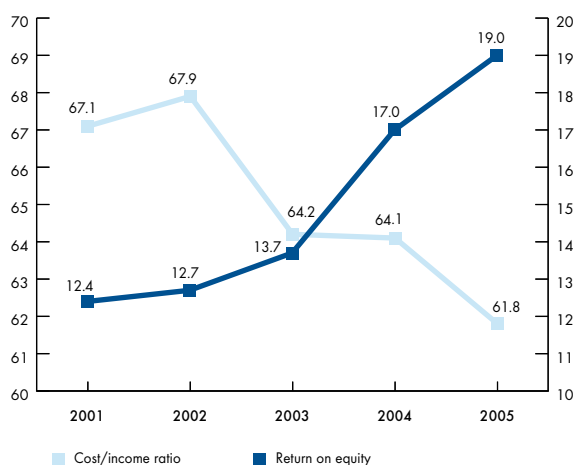
### Net profit after taxes and minority interests

**After deducting taxes on income and minority interests** (i.e. interests held by third parties on the earnings of consolidated companies, and in particular of Haftungsverbund savings banks), the **Group net profit** totalled EUR 711.7 million, up 36.6% from the previous year's result of EUR 520.8 million.

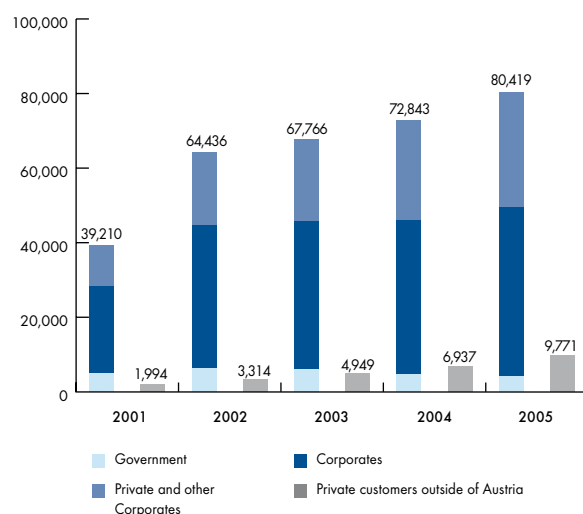
In 2005 the return on equity based on Group net profit after taxes and minority interests stood at 19.0%, up from 17.0% in 2004. **Earnings per share** increased from EUR 2.18 in 2004 to EUR 2.96 last year.

For the 2005 financial year, the Management Board proposes a **dividend** of EUR 0.55 per share, a 10.0% increase from the previous year's dividend of EUR 0.50.

### Key profitability ratios (in %)



### Loans and advances to customers, structure and trend (EUR million)



### Balance sheet developments

At 31 December 2005, the Erste Bank Group's **total assets** were EUR 152.7 billion, up 9.2% from EUR 139.8 billion the previous year.

Overall, **loans and advances to customers** increased by 10.4% to EUR 80.4 billion. In Austria, these loans rose by 5.9% to EUR 49.8 billion, while abroad they increased by 18.6% to EUR 30.6 billion. The retail lending business segment outside of Austria (which in this segment is virtually synonymous with Central Europe) recorded very satisfactory growth rates, rising by 40.9% to EUR 9.8 billion.

**Risk-weighted assets** as defined under § 22 para. 2 of the Austrian Banking Act (BWG) increased by 14.8% to EUR 75.0 billion in 2005.

At 31 December 2005, **risk provisions** totalled EUR 2.8 billion, virtually unchanged from the previous year as additions in 2005 were offset by releases and uses.

Central Europe accounted for 21% of these provisions, while Austria and other regions accounted for approximately 79%. Detailed information on existing risks and the presentation of the risk management goals and methods is presented in the Notes.

**Trading assets** increased substantially, rising by 17.2% from EUR 4.6 billion to EUR 5.4 billion. At 31 December 2005, 53.9% of the trading assets consisted of listed, fixed-income securities.

**Other current assets** also rose at an above-average rate of 16.8% from EUR 16.0 billion in 2004 to EUR 18.6 billion. This item includes securities in the available-for-sale portfolio, which under the revised version of IAS 39 must report changes in fair value in the equity statement (at 31 December 2005, aggregate changes in fair value totalled EUR 406 million, up from EUR 429 million the previous year).

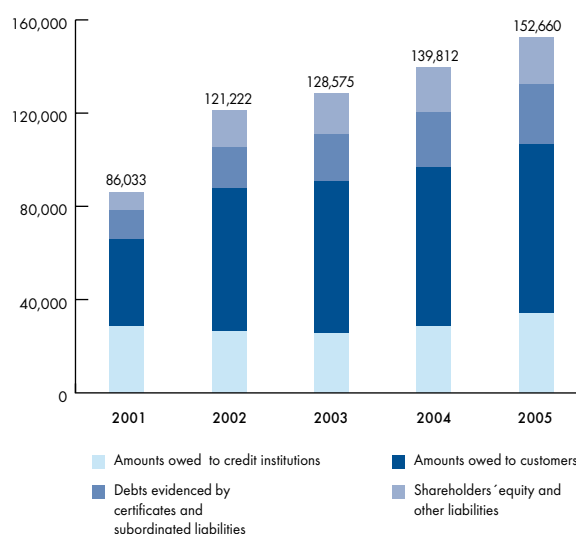
This position also includes the new fair value portfolio category, for which changes in fair value and realised capital gains and losses must be entered on the income statement.

At 31 December 2005, assets in the fair value portfolio totalled EUR 4.4 billion, while those in the available-for-sale portfolio stood at EUR 14.2 billion. The increase was concentrated exclusively in the available-for-sale portfolio. Approximately 64.5% of all the securities included under other current assets consisted of listed, fixed-income securities.

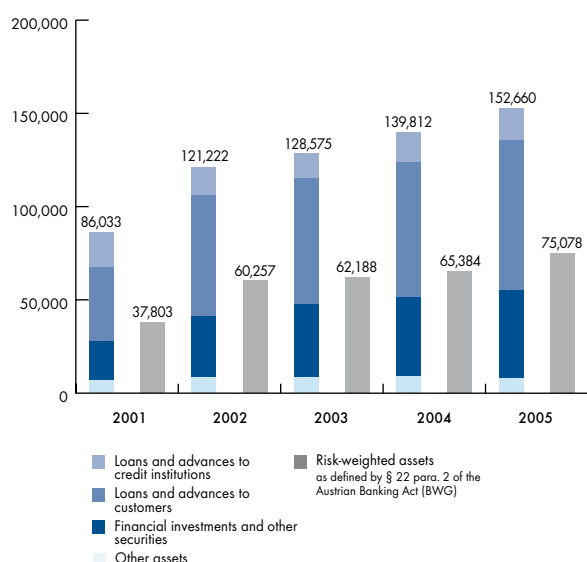
Since **financial investments** also increased by 7.7% to EUR 23.6 billion (of this total, investments of insurance companies grew by 15.4% to EUR 7.1 billion while the held-to-maturity portfolio — representing the bank's own investments and consisting mainly of listed fixed-income securities — increased by 6.7% to EUR 15.1 billion), the **total investment assets** in the form of trading assets, financial assets and other current assets increased by 12.1% from EUR 42.5 billion to EUR 47.7 billion last year.

Of the total at 31 December 2005, 11.4% consisted of trading assets, 39.1% of other current assets and 49.5% financial investments.

### Balance sheet structure/liabilities and shareholders' equity trends (EUR million)



### Balance sheet structure/assets (EUR million)



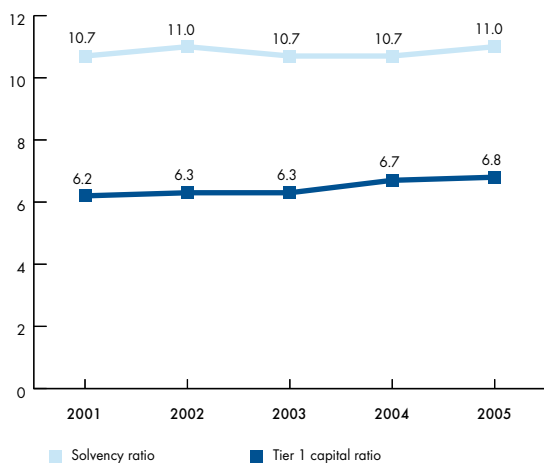
**Intangible assets** rose by 4.8% to EUR 1.9 billion. At 31 December 2005, they included approximately EUR 1.5 billion in goodwill.

Interbank transactions increased substantially on both sides of the balance sheet. **Loans to credit institutions** rose by 7.5% to EUR 16.9 billion, as the bulk of the loans were to foreign credit institutions. These loans increased by 10.6% to EUR 14.6 billion.

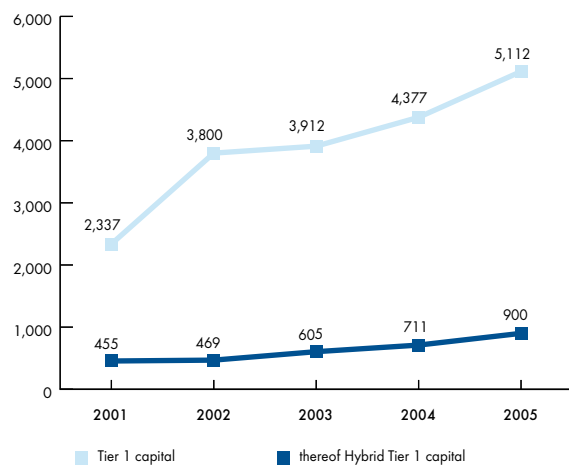
In terms of liabilities, amounts owed to credit institutions rose by 18.8% to EUR 33.9 billion, as liabilities to domestic credit institutions increased by 47.3% to EUR 9.8 billion and those to foreign credit institutions increased by 10.1% to EUR 24.1 billion.

Amounts owed to customers increased by 6.7% to EUR 72.8 billion. Of that total, savings deposits increased by 2.3% to EUR 38.8 billion. Of the other customer deposits, those from private customers increased by 7.9% to EUR 16.3 billion. At 31 December 2005, Central Europe accounted for approximately 36% of the total.

### Solvency and Tier 1 capital ratio (in %)



### Tier 1 capital under BWG and hybrid Tier 1 capital (EUR million)



Refinancing through **own securities issues** increased by 9.2% to EUR 25.6 billion. **Debts evidenced by certificates** rose by 8.0% to EUR 21.3 billion, while **subordinated liabilities** increased by 15.8% to EUR 4.3 billion. Finally, this last item at 31 December 2005 included hybrid capital (which qualifies as Tier 1 capital under the Austrian Banking Act (BWG)) in the amount of EUR 900 million (previous year: EUR 711 million), with EUR 200 million in gross new issues in 2005.

**Total equity**, which in accordance with revised IFRS now includes shareholders' equity and minority interests, increased by 8.5% to 6.5 billion in 2005. This increase was mainly due to the net profit for the period. It broke down into a 20.6% increase in Erste Bank AG **shareholders' equity**, and a 7.8% decline in **minority interests**. These changes reflect for the most part the buy-out of all minority interests in Slovenská sporiteľňa and the deconsolidation of Erste Immobilien AG. Minority interests also include the equity interests of the Haftungsverbund savings banks in which Erste Bank either does not have an interest or only a minority interest.

At 31 December 2005, **total own funds** of the Erste Bank Group as defined by the Austrian Banking Act (BWG) stood at approximately EUR 8.6 billion, up from EUR 7.3 billion the previous year. Since the statutory minimum requirement at this date was about EUR 6.4 billion, the Group's coverage ratio is 135%, up from 130% the previous year.

At 31 December 2005, **Tier 1 capital** as defined by the Austrian Banking Act (BWG) totalled approximately EUR 5.1 billion, up from EUR 4.4 billion the previous year.

The **risk-weighted assets** as defined by § 22 para. 2 of the Austrian Banking Act (BWG) increased by an above-average rate of 14.8% to EUR 75.0 billion, such that at 31 December 2005 the Tier 1 capital ratio as defined by the Austrian Banking Act was 6.8%, up from 6.7% the previous year. The **solvency ratio** as defined by the Austrian Banking Act (BWG) stood at 11.0% at 31 December 2005, up from 10.7% the previous year and well above the statutory minimum requirement of 8%.

### Outlook for 2006 and recent developments

In January 2006, Erste Bank AG successfully carried out a **capital increase**. Including the greenshoe offering, a total of

64,848,960 new shares were issued at a price of EUR 45.00 per share. The share capital was thus increased by EUR 129.7 million to EUR 616.1 million. The new shares will be eligible for dividends for the full financial year 2006. The capital increase is intended to finance the acquisition of a 61.9% share of **Banca Comerciala Romana** (BCR), Romania's largest bank. The share purchase agreement was signed on 21 December 2005, and the transaction is expected to close in the second quarter of 2006. The acquisition price (excluding ancillary costs) is EUR 3.75 billion.

The Erste Bank Group expects **further earnings growth** in 2006 despite the adverse effect that restructuring costs and first-time consolidation expenses will have on the earnings of the new subsidiary BCR. However, the acquisition of a majority stake in BCR will provide a substantial basis for dynamic growth in subsequent years. As in previous years, the other central European subsidiaries will continue to contribute a substantially to the Group's profit growth, and the Austrian business is also expected to record further earnings gains.

The **group-wide synergy projects** within in the NGA programme currently being implemented should generate further earnings growth potential through revenue enhancements, cost reductions and efficiency improvements. These projects include a common purchasing, centralisation of IT developments, fine-tuning of the groups performance models and ongoing customer service improvements.

Based on the above-mentioned efforts, the Erste Bank Group's **targets** for the period **2005 through 2009** include more than 20% average annual growth in net profit after taxes and minority interests. In 2009, the cost/income ratio is forecast to be below 55%. Given the nearly 70% increase in shareholders' equity, the return on equity in the years ahead is expected to contract, but should return to the 18% to 20% range by 2009.

## CORPORATE SOCIAL RESPONSIBILITY

The present sustainability report, which is being published for the first time, focuses on the activities of the parent company Erste Bank AG. A wide range of initiatives are also in the works for the central and eastern European subsidiaries, and they will be examined in greater detail in next year's report.

### **Social responsibility is a central theme for Erste Bank.**

Ever since "Die Erste oesterreichische Spar-Casse" was founded in 1819, the mission of this institution has been aligned with serving the public interest. Erste Bank has always served the community, been a responsible business partner for constituent groups and has shared its entrepreneurial success. Erste Bank's motto is therefore no coincidence: "Every relationship is about people". The bank's business philosophy is based on transparency, ethical conduct and respect for all those affected by its activities. The bank also has a long tradition of supporting social and cultural endeavours.

### **Toward CSR**

The concept of corporate social responsibility (CSR), or sustainable development, has become increasingly important in the German-speaking part of Europe as well as in Central and Eastern Europe. The financial services industry has recently taken up this practice. CSR promotes standards-based accountability for companies – especially listed companies – in terms of how they do business and treat people and the environment.

It goes without saying that a venerable institution with nearly 200 years of history conducts business in a sustainable manner. Although the term CSR may have been coined only recently, Erste Bank has always practised social responsibility in diverse ways that reflect the times.

### **CSR Programme**

Erste Bank strongly supports CSR both in principle and in deed. In 2005, Erste Bank acted on this commitment by taking the first step of appointing a CSR Manager.

To gather the necessary information and data in systematic fashion and lay the groundwork for CSR reporting, Erste Bank began the process of reconfiguring its reporting systems and

developing a specific reporting procedure. Erste Bank's CSR performance will become increasingly transparent each year and meet internationally recognised standards. One enormous advantage in this respect is that Erste Bank does not first have to create most of the CSR measures and elements, since the bank's identity has always been based on socially responsible business practices.

### Expansion of the CSR commitment

The concrete steps being taken by Erste Bank toward expanding its CSR commitment have been established in an action plan:

- \_Expansion of CSR reporting in 2006 annual report
- \_Bringing CSR performance indicators into line with internationally recognised standards such as the Global Reporting Initiative
- \_Systematic stakeholder management
- \_Broadening of risk management to include social, ethical and environmental issues
- \_Supplier selection based on fair treatment principle
- \_Environmental audit with certification
- \_Increased co-operation with schools on skills training
- \_Group-wide employee satisfaction survey
- \_Customer satisfaction survey
- \_Bringing central and east European subsidiaries up to Erste Bank standards
- \_Stepped up sustainability information
- \_Inclusion in the Dow Jones Sustainability Index and FTSE4Good

## OUR INITIATIVES ON BEHALF OF STAKEHOLDERS

### SHAREHOLDERS

Erste Bank is particularly committed to being responsible and accountable to shareholders. In 2005, the bank further enhanced its investor relations programme through greater transparency and responsiveness. The bank was recognised for these efforts on several occasions and is now working on maintaining and further enhancing its high communication standards.

### Top 10 among European banks

In the "2005 European Investor Relations Perception Study", an annual ranking of investor relations departments of listed European companies compiled by the Institutional Investor Research Group, Erste Bank was rated first out of 19 Austrian companies. In the European banking sector, Erste Bank vaulted into the top 10 out of 90 banks rated.

### Recognised for sustainability and social responsibility

One measure of the Erste Bank's widely acknowledged socially responsible business practices is its inclusion in VöniX, the first sustainability index of listed Austrian companies. The companies in the index are all leaders in terms of their social and environmental activities, which are assessed on the basis of more than 100 criteria. Ever since the index was launched in June 2005, Erste Bank has been a major component of this index, which includes 23 listed companies.

## EMPLOYEES

### Outstanding employees

Currently, the data for the key employee figures exist only for Erste Bank AG. As the CSR reporting is expanded, employee figures will be established on a group-wide basis and presented in the annual report. Noteworthy achievements include the low absenteeism and employee turnover.

### Employee turnover

in %	2005	2004
Departures through voluntary retirement	4.50	4.60

The LIFETIME programme supports a successful three-generation company. Erste Bank offers its staff, which is characterised by a well-balanced age structure, targeted measures to promote health and fitness. These measures include training initiatives, the development of the company health care clinic into a work health centre and the creation of a work life centre.



### Employee charter as the Code of Conduct

At Erste Bank, the Code of Conduct (in CSR terminology) goes under the name of the “Richard Wollein Employee Charter”. This charter sets forth the principles for plotting the company’s future course and maintaining relations with stakeholders. This basic covenant is intended to ensure that Erste Bank’s corporate culture is consistent with the company’s goals. In that sense, it is based on values that put people and employees first. Changes and challenges are addressed and overcome through measures based on these common values and principles.

### Equal opportunities, training for women and employee advisory service

Erste Bank stands for equal opportunity for men and women and provides targeted career development support for women. It also provides a free employee advisory service to help employees solve their needs both at work and at home. This service is available at all times.

### The first European staff council

At the beginning of 2005, the “European Staff Council of the Erste Bank Group” was established. This expanded staff council was the first such council to be founded in Austria since the accession of the central and east European countries to the European Union.

### 2005 apprenticeship initiative

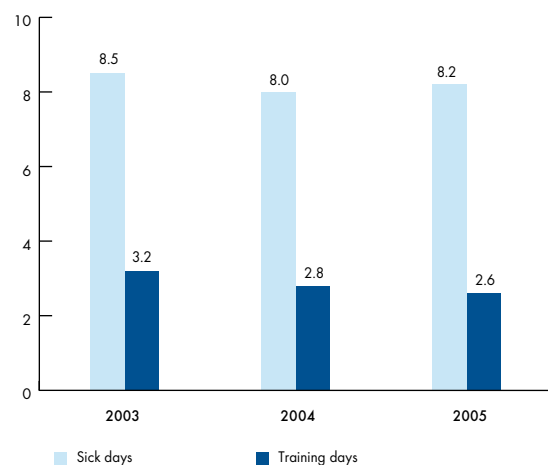
Erste Bank has had its own apprenticeship training programme since 1997, and has a special responsibility to participate in the creation of apprenticeship positions, which have been sorely lacking. As part of its 2005 apprenticeship initiative, the bank worked closely with Wiener Städtische Versicherung to create an incentive package for commercial customers, thereby providing these companies with additional incentives to create new apprenticeship positions.

### CUSTOMERS

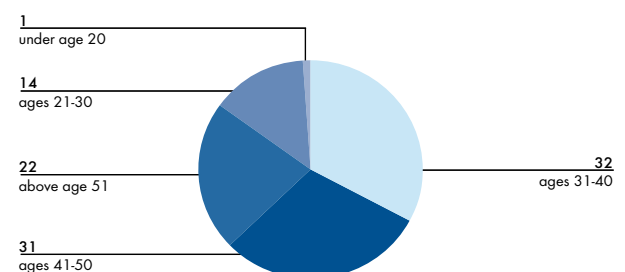
Customer satisfaction is a decisive success factor for financial services providers, just as it is for any other company.

As a quality leader, Erste Bank places great value on this criterion. The customer’s needs, goals and expectations are therefore at the heart of all the bank’s activities.

### Attendance and absenteeism Average per person in days



### Age structure (in %)



### **Quality control and complaint management**

In Austria as well as Central and Eastern Europe, Erste Bank has a highly developed quality control system that includes complaint management in order to ensure lasting customer satisfaction. The quality standards are developed jointly with clients. Managers and employees always take care to ensure strict compliance with these standards.

### **Retirement expertise on behalf of customers**

Numerous demographic studies currently confirm ever-higher life expectancies. In that context, the elderly need supplementary retirement insurance in addition to social security in order to maintain their living standards.

## **CIVIL SOCIETY**

### **“Kontakt”: the Central European sponsoring platform**

Erste Bank’s programme for arts and civil society in Central and Eastern Europe was launched under the name “Kontakt” in 2004. This programme serves as the platform for the bank’s sponsoring activities.

Erste Bank partners with institutions and artists and takes part in initiatives in the Central European region by supporting contemporary artistic, cultural, educational and social projects.

The countries in which the Group is based – Austria, Hungary, the Czech Republic, Slovakia, Croatia and, since 2005, Serbia – are part of a region marked by strong economic growth. In some parts, however, the infrastructure for civil society remains underdeveloped. Erste Bank therefore would like to have a major positive impact in this respect.

### **Social sponsoring**

Together with Caritas, Erste Bank supports the annual “ÖsterReich helps ÖsterArm” campaign in Austria as well as the annual eastern European campaign on behalf of ethnic minorities and street children in Romania and Ukraine. Erste Bank thereby contributes to the social welfare of these countries and the development of stable yet diverse civil societies in the new Europe.

### **Economics research**

In conjunction with the University of Economics Vienna, Erste Bank sponsors economic research in Central Europe. These initiatives include the “Joszef” management training program, the “Masterclass Eastern Europe” to develop theoretical and practice-based understanding for the region and the “Erste Bank Award for Research in Central Europe”. This award, backed by a EUR 20,000 prize, was handed out for the second time in 2005 to young scientists examining issues involving economic integration and internationalisation.

Each year, 60 selected students from Austria, the Czech Republic, Slovakia, Hungary and Croatia participate in the “Erste Bank Summer University Danubia”, established in conjunction with University of Economics Vienna. This programme is offered in English and is held on a rotating basis in the participating countries. It combines practical know-how from the central European business environment with academic knowledge, and promotes the exchange of opinions and experience.

## **ENVIRONMENT**

Erste Bank has a strong commitment to environmental protection in its everyday operations. Energy consumption and the use of non-renewable resources are continuously reduced through numerous programmes.

### **Energy saving and waste management**

In 2005, Erste Bank’s waste management policy and comprehensive measures for controlled energy consumption at the various branches resulted in 10% savings relative to the previous year. In addition, paper consumption was kept constant at 570 tonnes. As recently as 2001, paper consumption was 700 tonnes.

### **Procurement**

Erste Bank’s procurement policy is to purchase products that can be recycled and use limited natural resources. In the future, suppliers will be chosen based on the fair treatment principle. Preference will be given to suppliers who comply with specific social, ethical and environmental principles.

# Segment Report

## INTRODUCTORY REMARKS

We have redesigned this year's segment report. While we kept the usual reporting structure – as detailed below – that investors are used to from previous annual and quarterly reports we have expanded the content to include a structured round-up of our operating environment.

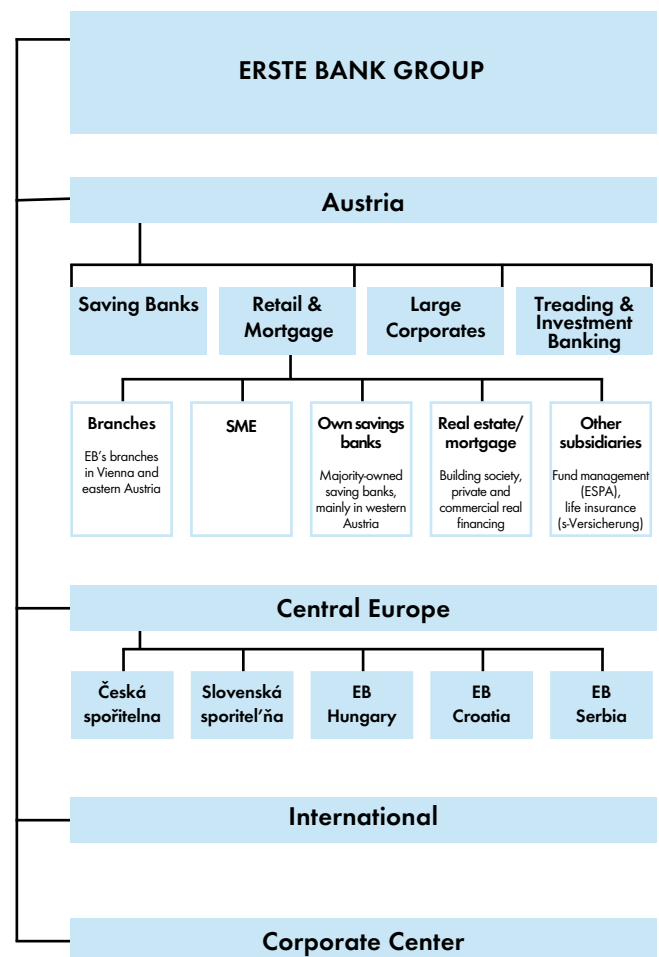
The expanded segment report now includes an economic review for each country Erste Bank is operating in. The review draws on independent findings of the European Bank for Reconstruction and Development, the European Commission and the Vienna Institute for International Economic Studies. This is complemented by a review of the banking market and a discussion of Erste Bank's market position, based mainly on local central bank data.

As in previous years, we use a number of financial measures to assess the performance of our business segments. All measures are calculated in accordance with IFRS and show the group contribution of the single business lines in relation to the overall group performance. In any case, this leads to differences between locally reported figures and measures, and segment numbers.

We use return on equity on a segmented basis for performance evaluation and resource allocation decisions. While return on equity for the group as a whole provides a measure of return on common equity, return on equity on a segmented basis provides a similar metric related to the capital allocated to the segments. We allocate capital to calculate segment return on equity based on the distribution of risk-weighted assets. Accordingly, locally reported return on equity and segmented return on equity differ substantially from each other.

We also allocate funding costs in segment reporting to account for the cost of acquisitions. These are booked against net interest income in the respective segments. Accordingly, the net interest income line in segment reporting can show material differences compared to local reporting. It also impacts such profitability and efficiency measures as return on equity and the cost/income ratio.

The detailed business results are summarised by segment and geographic market in Note 27 to the Consolidated Financial Statements.



# "Quality always pays"

The Robert Goldenits vineyard in Tadtten, Burgenland is doing its part to contribute to Austria's remarkable rise as a major red wine producer in Europe. Some 20 years ago, several winemaking families decided to focus their production on high quality. Today, this strategy has clearly paid off. Robert Goldenits still runs the family business, located near the Hungarian border in the so-called Heideboden region, south-east of Lake Neusiedl. The region is in the heart of a highly prized red wine growing area and is a major reason why Austria is now known for more than just its Green Veltliner variety. The success of Austrian vineyards is also reflected in the growth of their exports. In the past, most of Austria's domestic wines were consumed within the country, but today the premium wines from Austria are prized world-wide.

**Erste Bank:** "Mr Goldenits, congratulations on your success!"

Robert Goldenits: "What do you mean?"

**Erste Bank:** "Well, your Mephisto premium vintage was chosen one of the five best wines of 2003. That is a major success!"

Robert Goldenits: "Indeed, that is a major recognition for our consistent work over the previous years. The 2003 Mephisto comes very close to what I consider to be a good and balanced wine from our region."

**Erste Bank:** "What is the secret to your success?"

Robert Goldenits: "First, we insist on uncompromising quality for all our wines. Second, we try to extract the typicity of our sites in order to give the wines a distinctive character. This is very labour-intensive, especially in the vineyards, where we are cutting back sharply on volume and harvesting only the finest quality grapes. Moreover, in recent years we have invested heavily in our wine production

technology, including a new building and modern presentation room, and have agreements with contract growers covering eight hectares of vineyards."

**Erste Bank:** "You just mentioned your significant investments. How does a family-owned operation finance them?"

Robert Goldenits: "To be sure, we and especially our colleagues have invested huge sums. Despite the reduction in volume, however, we were able to generate more income by significantly raising the quality of our wines. As they say, quality always pays! A family-owned winery must be prepared to make those investments, which naturally requires a generational agreement and a strong passion. The combined efforts of all the partners are required to produce a fine, harmonious, varietal wine."

**Erste Bank:** "Mr Goldenits, thank you for talking with us and we wish you the best of luck in the future."



Goldenits family, clients of Erste Bank, Austria



## AUSTRIA

The Austria segment includes most banking activities in Austria and additional activities conducted on a group-wide basis. It is divided into four sub-segments: Savings Banks, Retail and Mortgage, Large Corporates, and Trading and Investment Banking.

### ECONOMIC REVIEW

Our Austrian businesses operated against a stable economic background in 2005. The Austrian economy outperformed Eurozone growth for the fourth year running, and continued on its path of stable growth. Real GDP rose by 1.7% in 2005, while GDP/capita hit a level of EUR 29,800, among the highest in the European Union. Exports and domestic demand contributed in equal measure to overall growth. In 2005 exports accounted for some 52% of GDP. The unemployment rate deteriorated somewhat to 5.0%, but remained well below the Eurozone average of 8.5%.

The inflationary environment remained benign with consumer price inflation edging up only slightly to 2.2%. As this was the

trend throughout the Eurozone, short term interest rates were flat at 2.1%. In December 2005 the European Central Bank has for the first time in more than five years raised interest rates and indicated that further rises may be on the horizon, following an improved growth outlook for Eurozone countries.

Austria's external position as represented by the current account balance continued to stay in positive territory, helped along by a strong trade balance: it amounted to 0.8% of GDP as opposed to 0.3% in 2004. The general government balance deteriorated significantly in 2005 to -1.9%, triggered by higher public spending, but remained well inside the limits set out by the Stability and Growth Pact.

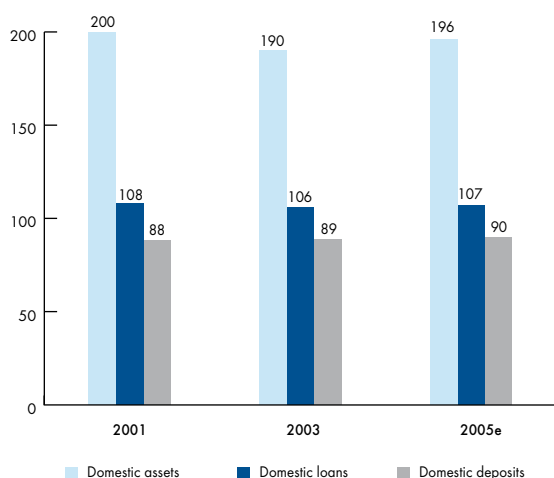
### MARKET REVIEW

Austria's domestic banking market shows all the features of a mature western market: a high degree of competitive tension, high operating costs and low profit margins; and a market structure that is not conducive to operating at above average levels of profitability due to the high number of non-shareholder oriented institutions. Despite this scenario the Austrian market offers selected growth opportunities in such areas as mortgages and wealth management.

Key economic indicators - Austria	2002	2003	2004	2005e
Population (ave, million)	8.1	8.1	8.2	8.2
GDP (nominal, EUR billion)	220.7	227.0	237.0	245.0
GDP/capita (in EUR thousand)	27.3	28.0	29.0	29.8
GDP growth (real, in %)	1.0	1.4	2.4	1.7
o/w: domestic demand contribution (in %)	-0.7	2.5	0.7	0.9
Exports (% of GDP)	48.7	48.4	51.0	51.9
Imports (% of GDP)	43.9	44.8	46.1	46.7
Unemployment (% of labour force)	4.2	4.3	4.8	5.0
Consumer price inflation (ave, in %)	1.7	1.3	2.0	2.2
Interest rate (1m interbank offer rate, in %)	3.3	2.3	2.1	2.1
EUR FX rate (ave)	1.0	1.0	1.0	1.0
EUR FX rate (eop)	1.0	1.0	1.0	1.0
Current account balance (% of GDP)	0.3	-0.5	0.3	0.8
General government balance (% of GDP)	-0.4	-1.2	-1.0	-1.9

Source: Eurostat.

**Financial intermediation – Austria (in % of GDP)**

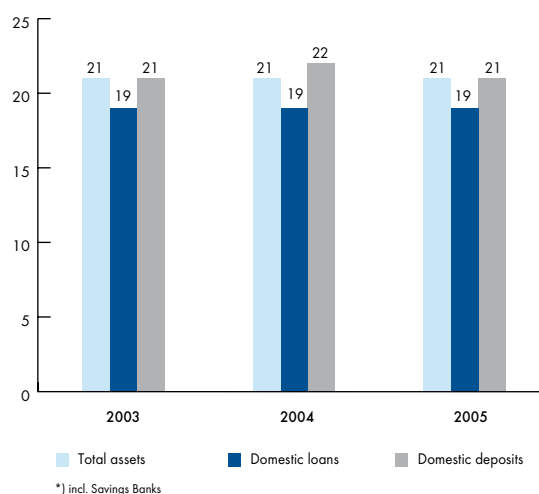


Source: Oesterreichische Nationalbank, Eurostat.

Overall market aggregates, i.e. those including foreign assets, also paint a very positive picture, reflecting the Austrian banks' push into Central and Eastern Europe. In 2005 total banking assets/GDP were just shy of 300%, an impressive level even by international standards and up from 272% in 2001. Growth in the Austrian market is lopsided, though. While the total market grows strongly on the back of the ever increasing central and east European exposure, the domestic asset/GDP ratio has been hovering around the 190% mark for the past decade, or so. A similar dichotomy can be observed for such other aggregates as deposits and loans. Domestic aggregates grow in line with GDP, while foreign aggregates tend to grow in excess of both Austrian and local GDP.

In unison with the stable development of the domestic market, Erste Bank maintained its position as one of the leading Austrian banks. In 2005 it intermittently edged its nearest competitor to the No. 1 spot with a 21% total asset market share. In addition, Erste Bank held similar market shares in domestic deposits and loans. It served some 2.8 million customers through a network of some 987 own and savings bank branches as well as electronic channels.

**Erste Bank market shares – Austria<sup>\*)</sup> (in %)**



Source: Erste Bank, Oesterreichische Nationalbank.

## SAVINGS BANKS/HAFTUNGSVERBUND

**Business profile.** In 2005 the Savings Banks segment encompassed 45 Austrian savings banks that were consolidated as a result of their membership in the Haftungsverbund and in which Erste Bank AG held little or no equity interest. Savings banks that are majority-owned by Erste Bank AG (Salzburger Sparkasse, Tiroler Sparkasse and Sparkasse Hainburg-Bruck-Neusiedl) are included in the Retail and Mortgage segment.

The relationship between Erste Bank AG and the savings banks is to the mutual benefit of both parties. Erste Bank AG provides a wide range of services and products to the savings banks and its customers. These services and products include syndication, asset management and securities-related services, risk management and legal advice, as well as retail mortgage, life insurance and investment fund products, which enable independent savings banks to reduce costs while providing full service to their clients. In return Erste Bank AG has access to a large additional distribution network of some 711 branches for its products without the operational costs associated with operating of additional branches.

In addition Erste Bank AG and the savings banks cooperate on such key operational issues, as common product development; the projection of a unified identity through a one-brand strategy; the standardisation of business and marketing strategies for retail and corporate banking; the development of common management information and control systems and integration of central functions; and the introduction of a common performance-related remuneration scheme for management.

## BUSINESS REVIEW

**Strategy.** The Savings Bank segment continues to focus on strengthening its existing strong ties to Erste Bank AG. This co-operation is intended to bolster the distribution and market development capabilities while promoting an efficient division of labour within the organisation, up-to-date human resources policies and appropriate decision-making structures. Other key goals include optimising customer service while improving profitability.

**Successful market presence.** In 2005, Erste Bank AG and the savings banks were once again able to expand their client share in Austria. The overall client share increased to 27.7%, while main client share increased to 22.6%. As in previous years, Erste Bank and the savings banks once again received top honours in advertising recognition across all banking sectors.

**Greater efficiency through modern IT.** In 2005, several technological improvements were implemented that resulted directly in greater efficiency. A more targeted customer relationship management software coupled with the necessary employee training led to better sales results. "s Abwicklungsmanagement" will provide the Lending and Securities divisions with electronic document management software. The "Business Intelligence" project will create a common database for compliance with Basle II requirements and the soon to be established risk-oriented reporting system. Finally, the Internet portal of the savings banks has been totally updated. These projects are all illustrative of the major projects in 2005.

**Common risk management policy.** As part of the development of a common risk management policy, the savings banks successfully implemented or started joint projects on Basle II, credit business minimum standards and risk-oriented reporting.

## Outlook

In 2006, the savings banks intend to step up their combined efforts in sales and cross-selling. Moreover, they will focus on themes such as retirement savings, real estate, bank cards and structured products. They will also focus on implementing best practices management techniques and increase the use of benchmarking.

This year, the savings banks also plan to generate further cost-saving synergies in the area of development and processing costs and improve their market success through the upgraded customer relationship management programmes.

## Financial review

in EUR million	2005	2004
Pre-tax profit	185.2	182.1
Net profit after taxes and minority interests	3.2	7.1
Cost/income ratio in %	68.1	67.5
Return on equity in %	1.3	2.9

Net profit after taxes and minority interests contracted by EUR 3.9 million from EUR 7.1 million to EUR 3.2 million. Return on equity fell from 2.9% to 1.3%, while the cost/income ratio increased slightly from 67.5% to 68.1%.

As expected, net interest income declined by 1.8%, or EUR 15.5 million, from EUR 849.6 million to EUR 834.0 million. This decrease resulted from persistent low interest rates and a highly competitive market environment. Risk provisions were up sharply from the previous year, increasing by EUR 31.2 million from EUR 184.5 million to EUR 215.8 million. The increase followed two one-off negative events at two of the savings banks. Given the relatively insignificant equity interest in these banks, net profit after taxes and minority interests was only marginally affected.

Net commission income trended very favourably, rising by 12.3%, or EUR 39.4 million. This gain was generated primarily in the funds business as well as through securities sales commissions. It reflects the successful co-operation between Erste Bank and the savings banks.



General administrative expenses increased by 3.0%, or EUR 23.9 million, from EUR 801.7 million to EUR 825.6 million. At a rate of 3.0% this growth outpaced inflation only slightly. The other operating result improved by EUR 32.6 million, from a loss of EUR 18.8 million in 2004 to a gain of EUR 13.8 million last year, despite non-recurring gains in 2004 from the sale of a Haftungsverbund savings bank's branches and thanks to financial asset valuation gains.

## RETAIL AND MORTGAGE

**Business profile.** The Retail and Mortgage segment comprises all activities in Austria relating to retail, mortgage and small and medium-sized corporate customers. More specifically, it includes Erste Bank's 142 strong own branch network in eastern Austria, including Vienna, which predominantly serves professionals, retail clients and SMEs. As noted above, it also includes three majority-owned savings banks (Salzburger Sparkasse, Tiroler Sparkasse, Sparkasse Hainburg-Bruck-Neusiedl).

A portion of the results of the investment fund business (Erste-Sparinvest), consisting of private banking and portfolio management for retail customers, and of the life insurance business (s Versicherung), are also included in this sub-segment. Erste-Sparinvest is the market leader in retail funds in Austria and No. 2 overall, while s Versicherung, which is the exclusive partner to Erste Bank, the savings banks and s Bausparkasse, leads the Austrian life insurance market.

Furthermore Erste Bank's Austrian retail real estate and mortgage activities form part of this segment, covering retail mortgages, non-profit, subsidised and commercial housing finance, and property management and brokerage. The main operating units are building society s Bausparkasse – market leader in Austria – which finances private and non-profit housing development and is also responsible for Erste Bank's mortgage bond transactions as of 2005; property agency s REAL, with 84 offices across Austria; and s Wohnbaubank, a specialist property finance provider.

## BUSINESS REVIEW

**Strategy.** While the Retail and Mortgage segment comprises a diverse range of financial services businesses the common denominator is the strategic focus on the retail customer. Collectively, Erste Bank aims to offer its retail customers a one stop solution for all their financing and investment needs, irrespective of the distribution channel they use. The same holds true for retail mortgages and related services as well as for commercial and publicly subsidised property financing. Within this framework Erste Bank aims to adapt to the quickly changing regulatory environment for subsidised residential property development and building society saving plans.

### Highlights 2005

**Own branches outperform targets.** The performance of Erste Bank's own branch network was excellent in 2005. On the back of a strong domestic stock market and increasing public awareness for private old age provision, securities commissions rose by 24%, while securities based savings plans leapt ahead by 62%. The strong demand for retail mortgages equally contributed to the strong showing of Erste Bank's own branch network, as did high sales volumes for government-subsidised and private pension products.

**SME business achieves turnaround in 2005.** Following years of unsatisfactory business performance, our SME business has successfully completed its restructuring efforts in 2005 and made a positive contribution to group profit. The business unit expanded operating profit by 45% to EUR 26.5 million, while keeping volumes stable. This progress was mainly due to higher commission income and tight cost management. An improved portfolio composition led to a decrease in risk provisions. Overall, these developments translated into a net profit of EUR 4.5 million and substantial uplift in the cost/income ratio and return on equity. This performance was achieved despite ongoing, difficult market conditions and thanks successful cross-selling into the existing client base.

**Solid gains in the mortgage business.** In 2005 we expanded our housing finance volumes both through Erste Bank AG and s Bausparkasse. Total loan volume increased from EUR 10.3 billion to EUR 11.2 billion. 2005 also brought a regulatory change for subsidised building society savings: which can now also be used

to finance education and care home expenses. In response Erste Bank developed and successfully marketed a number of new tailor-made products.

**Rapid growth in fund management.** Erste-Sparinvest continued to grow faster than the market in 2005. The firm's performance was also recognised by such fund rating agencies as Standard & Poor's, Morningstar, Lipper and Feri Rating & Research. According to Morningstar, Erste-Sparinvest ranked No. 1 among 36 European bond funds. Operationally, Erste-Sparinvest extended its market share to 18.0%. Funds under management grew to EUR 28.1 billion by year-end 2005, up from EUR 21.5 billion a year earlier, helping comfortably maintain its position as the second largest fund manager in Austria. In retail funds Erste Bank's fund management unit maintained its market leadership.

**Life insurance growth continues apace.** s Versicherung further expanded its market leadership position in Austrian life insurance in 2005, reaching a market share of about 15.3%, up on last year's 14.3%. In total the portfolio of policies, covering life and accident policies, exceeded the one million mark in 2005 for the first time ever. Correspondingly, gross premium written leapt from EUR 900 million in 2004 to EUR 1.1 billion in 2005. s Versicherung also successfully expanded its position in the market for government-incentivised retirement savings products.

## Outlook 2006

Through the businesses that are consolidated into the Retail and Mortgage segment we will continue to exploit the growth opportunities that do exist in the Austrian market: these are essentially centred on wealth management and wealth creation. Private old age provision, be in the form of recurring savings plans, investment funds, private or government subsidised pension plans, and multi-purpose building society savings will remain top sales priorities for us. Residential mortgages will also be a key growth driver. In the area of commercial and non-profit housing finance the focus will be student and care homes. In financial terms the segment targets a return on equity of 11% in 2006, after having more than doubled this metric in 2005 to 10%.

## Financial review

in EUR million	2005	2004
Pre-tax profit	151.6	76.3
Net profit after taxes and minority interests	93.2	41.1
Cost/income ratio in %	72.2	76.0
Return on equity in %	10.1	5.0

In 2005, the Retail and Mortgage segment, including the savings banks in which Erste Bank AG holds a majority interest, performed very satisfactorily. Net profit after taxes and minority interests more than doubled, rising by EUR 52.2 million from EUR 41.1 million to EUR 93.2 million, while the return on equity in this segment exceeded the 10% target level for the first time and the cost/income ratio contracted sharply from 76.0% to 72.2%.

As expected, net interest income contracted by 1.0%, or EUR 5.0 million. This decrease occurred mainly in the branch network as a result of persistent low interest rates. Meanwhile, s Bausparkasse, which is also assigned to this segment, recorded strong gains thanks to the expiration of high-rate deposits. Loan loss provision expense trended favourably, falling by 11.6%, or EUR 13.8 million from EUR 118.9 million to EUR 105.1 million. This decrease resulted mainly from the improved risk situation in the SME business as well as at Tiroler Sparkasse.

Net commission income, which increased by 11.6%, or EUR 34.1 million, from EUR 280.4 million to EUR 314.5 million, made a substantial earnings contribution to this segment. This increase was driven by noticeable gains in the securities business — in the branch network and at the Tirol and Salzburg savings banks — as well as through Erste-Sparinvest's improved earnings in the retail funds business. The SME business also contributed through an increase in the number of real estate lease agreements and guarantees.

General administrative expenses were reduced by 1.7%, or EUR 10.7 million, through a strict cost control policy in the branch network and SME business. The other operating result improved from a loss of EUR 5.5 million to a gain of EUR 16.2 million, mainly through proceeds on disposals and project-related income.

## LARGE CORPORATES

**Business profile.** The Large Corporates segment caters to domestic and international corporate customers with sales of EUR 70 million and above and sovereign borrowers. Following the establishment of the business unit Group Large Corporates within this segment and as part of the New Group Architecture efficiency programme in January 2005, the Large Corporate segment now acts as a one stop shop for corporate customers across Central and Eastern Europe: it offers project finance for commercial real estate in Austria and abroad, other forms of structured finance, trade finance, debt and equity corporate finance services, export financing as well as documentary credits and guarantees, in addition to general commercial lending.

A small component of the investment fund business, institutional clients, is also included in the Large Corporates segment. Furthermore, Immorent, Erste Bank's leasing specialist for real estate and equipment, also forms part of the Large Corporates segment. Immorent is a full-service provider of complete solutions in leasing, real estate-related services and real estate investment products. In line with Erste Bank's regional strategy, Immorent has also expanded its activities into Central and Eastern Europe and currently has subsidiaries in the Czech Republic, Slovakia, Hungary, Slovenia, Croatia, Serbia, Bulgaria and Romania.

### BUSINESS REVIEW

**Strategy.** The Large Corporates segment seeks to cover the entire value chain proactively, comprehensively and across borders through tailored customer care. To further deepen our client relationships and to reflect the growing importance of the central and east European markets we have established the Group Large Corporates business unit as of 2005. As a result a group-wide client relationship manager has been assigned to each large corporate client with annual sales in excess of EUR 175 million. The relationship manager serves all the client's needs by tapping the resources of country and product teams, thereby providing a single source of advice. A primary strategic goal of this measure is cross-border market share growth in investment banking, especially in corporate finance. To this effect, we are particularly focused on arranging more debt and equity transactions in Central and Eastern Europe.

### Highlights 2005

**Improved market position in corporate finance.** Our corporate finance business performed well in 2005, driven mainly by the continued expansion of our clients' activities in Central and Eastern Europe. Last year, corporate bond financing was especially popular, given the favourable interest rates and declining risk premiums across all risk classes. Erste Bank also recorded outstanding performances in equity financing. We had lead roles in the equity offerings by Wiener Städtische Versicherung (deal size: EUR 1,050 million) and by s Immo AG (deal size: EUR 267 million).

**Strong growth in financing of real estate funds.** Although the development of new real estate development projects in Central and Eastern Europe remained flat at a high level, the investment activities of Austrian and foreign real estate funds continued apace. These investments led to several transactions, in particular the financing of the Airport Logistic Park in Prague, the financing of a portfolio of shopping centers in Hungary and of a real estate portfolio in Poland.

**Tourism financing on solid ground.** Last year, tourism properties were increasingly prized by international investors and financial institutions as investments and finance projects. In a competitive environment, Erste Bank successfully increased its financing volume. Its acquisition financing on behalf of Walton Street Capital for the Prague Marriott Hotel, including the Millennium Plaza office and commercial centre, achieved international recognition.

### Outlook 2006

The successful establishment of the "Group Large Corporates" department will also have a favourable impact in 2006 and is expected to lead to a further strengthening of the risk-return ratio, despite an unfavourable lending business environment marked by unsatisfactory margins. The growing focus on fee and project financing businesses to complement the traditional lending business is also expected to yield positive results. Finally, we expect capital market transactions to increase significantly in both number and volume, given the above-average growth in Central and Eastern Europe. This growth applies to both equity and debt financing.

## Financial review

in EUR million	2005	2004
Pre-tax profit	77.8	83.8
Net profit after taxes and minority interests	55.5	55.8
Cost/income ratio in %	39.4	39.1
Return on equity in %	11.0	12.6

Last year, the operating result of the Large Corporates segment increased by 6.1% from EUR 129.3 million to EUR 137.2 million. Business volume increased slightly by 3.1%, or EUR 530 million, with the growth concentrated mainly in the area of lease financing. Net interest income increased by 2.2%, or EUR 3.0 million, from EUR 139.9 million to EUR 142.9 million.

Net commission income advanced significantly by 15.4%, or EUR 11.0 million, from EUR 71.2 million to EUR 82.2 million. Commissions on capital market and leasing transactions contributed to this positive development.

The other operating result contracted by EUR 21.3 million from a loss of EUR 7.7 million to a loss of EUR 29.0 million. Last year, the volume of project-related provisions, reflected in the other operating result, was essentially unchanged from 2004. Risk provision allocations declined by 19.6% from EUR 37.9 million to EUR 30.5 million, as the decline in provision allocations for the financing business was only partially offset by a modest increase in provision allocations in the leasing business.

General administrative expenses increased by 7.7% from EUR 83.0 million to EUR 89.4 million, mainly as a result of the leasing business' growth in the extended home market (legal and advisory) and through the establishment of new processes.

In the Large Corporates segment, net profit after taxes and minority interests remained essentially unchanged. Given the generally higher equity allocation, the return on equity dipped slightly to 11.0% and the cost/income ratio was 39.4%. The very favourable earnings trend in net interest income and net commission income was offset by the higher costs and expenses in the other operating result.

## TRADING AND INVESTMENT BANKING

**Business profile.** The Trading and Investment Banking segment comprises third-party and proprietary trading activities in Vienna, London, New York and Hong Kong, as well as asset-liability management. Amongst others the segment carries out the following tasks on behalf of the group:

- \_Management of asset-liability risk (interest rate and liquidity risks) for Erste Bank Group
- \_Foreign currency, fixed-income and securities trading products for all client groups
- \_Development of structured products, especially for all central and east European growth markets

The aforementioned establishment of the Group Large Corporates business unit in 2005 led to a reallocation of the investment banking functions, such that large corporate clients are now served by a single entity. Capital market transactions are therefore processed by the Group Large Corporates unit, while the traditional equities business (trading, sales) has been integrated into the Group Treasury business unit. This change created synergies in the trading business and a pooling of resources for the structuring of investment and financing products.

### BUSINESS REVIEW

**Strategy.** The Trading and Investment Banking segment's strategic goal is to be the best product provider in Central and Eastern Europe. We want to provide optimum service for our retail and institutional clients in their investment activities. Product innovation is also essential. By continuously developing and extending our product range, we enable our clients to participate directly in the future success of the central and east European growth markets. For trading, we leverage our market position as one of the region's largest liquidity providers as well as our market knowledge and proximity.

### Highlights 2005

**Expansion of our equities market position and launch of the New Europe Blue Chip Index (NTX).** Last year, Erste Bank again further expanded its market position in central and east European securities trading. Relative to total trading volume

on the local stock exchanges, our market share in 2005 was as follows:

2005	Average Market share	Average Market position
Erste Bank (Vienna)	19.57%	2
Erste Bank Investment Hungary	19.10%	1
Česká spořitelna	9.01%	3
Slovenská sporiteľňa	2.26%	10
Erste Securities Polska	3.75%	9
Erste Securities Zagreb	7.71%	4

Source: Local stock exchanges.

The creation of the New Europe Blue Chip Index (NTX) as a new benchmark for the central and east European growth markets is noteworthy. The NTX includes the 30 largest and most liquid stocks in the region, and was launched jointly with the Vienna Stock Exchange in autumn 2005. In the fourth quarter of 2005 alone, we placed EUR 165 million in index-based products such as investment funds, certificates and warrants.

After having steadily built-up our equity derivatives product range, we added two further distribution channels in this area last year. We created our own Internet portal, which can be accessed at [www.erstebank-derivate.at](http://www.erstebank-derivate.at). In addition, Erste Bank is now present as an issuer on EUWAX, Europe's largest derivatives exchange.

**First CDO placement in Central and Eastern Europe.** Erste Bank extended its credit market leadership in Central and Eastern Europe through the development of a new product. Last year, working with an international partner, we capitalised on our expertise and ongoing technology investments by successfully placing a collateralised debt obligation in our core markets.

**Treasury products for large corporates and SMEs.** In 2005, we satisfied the ever-growing demand from our corporate clients for hedging foreign currency, interest rate and liquidity risk. On the interest rate and currency side, Erste Bank developed more than 50 new structured products that enable our large corporate clients and SMEs to implement innovative zero-cost strategies. Last year, income from this product group more than doubled. We expect similar growth in the years ahead.

## Outlook 2006

In 2006, the focus of the Trading and Investment Banking segment will again be on innovative structured products. We would like to expand our product range by adding new asset classes such as commodities. The goal is not only to increase volume, but also the level of in-house production. By expanding our product range and working closely with the savings banks, our medium-sized enterprise clients will benefit from currency and interest rate hedging and optimisation. For our institutional clients, meanwhile, we remain a key partner for their equities trading in Central and Eastern Europe. Furthermore, our competency in the central and east European markets will also play a growing role in the credit area and lead to innovative products. Along with credit trading, we want to offer our clients assets and liabilities management advisory services in 2006.

## Financial review

in EUR million	2005	2004
Pre-tax profit	122.2	140.8
Net profit after taxes and minority interests	90.3	105.6
Cost/income ratio in %	43.3	38.8
Return on equity in %	31.9	43.2

Net profit after taxes and minority interests contracted by 14.4%, or EUR 15.2 million from EUR 105.6 million to EUR 90.3 million, as the very favourable trend in net commission income did not fully offset the market-led decline in net interest income. The return on equity fell from 43.2% to 31.9%, while the cost/income ratio increased from 38.8% to 43.3%.

The segment result breaks down differently from the previous year. The asset-liability management result fell by around EUR 40 million, mainly as a result of interest rate trends and currency hedging effects, while earnings in the Treasury segment increased by 33%, or EUR 25 million.

The expected decline in net interest income by 39.3%, or EUR 40.3 million, from EUR 102.4 million to EUR 62.2 million was due to low interest rate levels, a flat yield curve and the impact of currency hedging on the results of our central European subsidiaries.

# “For now we have bought the apartment”

Barbora Jarosova and her husband, Jiri Jaros, live and work in Prague, the capital of the Czech Republic. Barbora is an events manager for a large events agency, while Jiri is responsible for data processing at a bank. They are both contributing to their country's tremendous economic resurgence. Since the fall of the Iron Curtain, the Czech Republic has become one of the most successful economies of all the former Eastern Bloc countries. With 5% GDP growth and per capita GDP of EUR 9,600, the Czech Republic leads the way not only among the new EU members but throughout all of Central and Eastern Europe. Thus it comes as no surprise that in the centre of all this activity, Prague is brimming with optimism as well as business and construction activity. Many residents are taking advantage of this situation. The Jarosovas are among them, and have purchased a modern apartment under construction in a Prague suburb.

**Erste Bank: “Ms Jarosova and Mr Jaros, when will your apartment be finished?”**

Jiri Jaros: “Very soon! In May or June, we can move into the new building. Of course, we have a nice home now, since it all depends on what you make of it, right? But naturally we are looking forward to the new building.”

Barbora Jarosova: “It will be different. The new apartment is more than 60 square metres larger than our current one, and everything is new: the building and fixtures. It's an exciting time.”

Jiri Jaros: “One should not forget that we are paying a lot of money for it. Nowadays, the cost of living in Prague is as high as in many west European capitals. Therefore we are happy to move into the nice suburb of Zahradni cvrt, since the prices there are lower than in the city.”

**Erste Bank: “Would it not have been cheaper to rent?”**

Barbora Jarosova: “That is not the custom here. Typically, one purchases a property and pays down the mortgage to the bank, in this case, your bank. It's an investment in the future.”

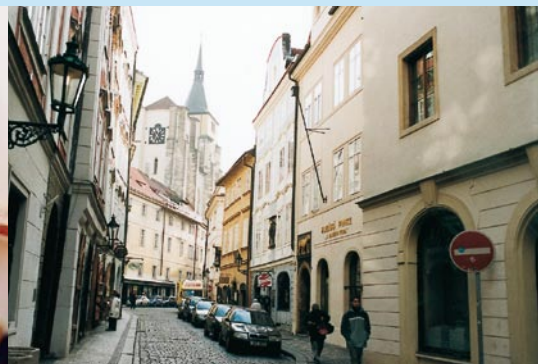
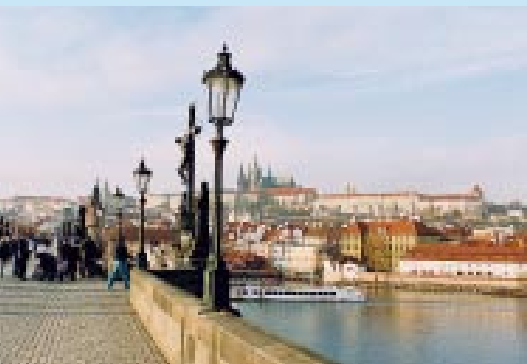
Jiri Jaros: “You can see for yourself just how well the country has developed in recent years. Therefore we want to stay here, since we believe that this will continue. I think that this apartment is a good investment.”

**Erste Bank: “What are your goals for the future?”**

Jiri Jaros: “First, we will completely furnish our new house. We have enough room! That will take a while, until we have found everything: furniture, lamps, all the little things that make an apartment comfortable.”

Barbora Jarosova: “And at some point we would naturally like to have children. We are planning to try in the next five years. Until then, we will enjoy our new apartment just the two of us. Moreover, in September I just started a new job as an events manager, which I greatly enjoy. I have a lot of responsibility and will be needed there.”

**Erste Bank: “We wish you a lot of joy in your new apartment and are happy to be able to help you.”**



Jarosova family, clients of Česká spořitelna, Czech Republic



Net commission income trended very favourably, rising by 37%, or EUR 19.1 million, from EUR 51.7 million to EUR 70.9 million, mainly as a result of higher securities commission income (given the sharp increase in trading volume on the Vienna Stock Exchange) and sales of structured products. The net trading result of EUR 84.5 million was consistent with the previous year level.

General administrative expenses increased by a very slight 0.7%, or EUR 0.6 million, from EUR 93.5 million to EUR 94.1 million thanks to effective cost management. The other operating result improved by EUR 5.8 million from a loss of EUR 7 million to a loss of EUR 1.1 million, mainly as a result of the portfolio's fair value measurement.

## CENTRAL EUROPE

Erste Bank's Central Europe segment comprises Erste Bank's operations in the transformation economies of Central and Eastern Europe, covering Česká spořitelna, Slovenská sporiteľňa, Erste Bank Hungary, Erste Bank Croatia and Erste Bank Serbia. While the share purchase agreement for Banca Commerciale Romana was signed on 21 December 2005, BCR will only be consolidated following closing of the transaction.

## ČESKÁ SPOŘITELNA

**Business profile.** Česká spořitelna is the leading retail bank in the Czech Republic and the largest among Erste Bank's operations in Central Europe. Since its privatisation in 2000 the former state savings bank has transformed into a universal bank serving some 5.3 million retail, small and medium enterprise and large corporate clients; it operates a network of 646 branches and over 1,070 ATMs. In addition Česká spořitelna occupies leading positions in fund management, securities trading and foreign exchange dealing.

## ECONOMIC REVIEW

In 2005 Česká spořitelna benefited from a strong Czech economy. GDP grew at an estimated 5.0%, the fastest rate in a decade, supported by strong exports, while domestic demand remained subdued, yet positive. GDP/capita reached some EUR 9,600 in 2005, among the highest levels in Central and Eastern Europe. A positive development was also registered in the unemployment rate which stood at 8.3% in 2004 and improved somewhat to about 7.9%.

Inflation remained tame and the Czech Crown continued to appreciate against the Euro both in nominal and real terms. Correspondingly, the Czech National Bank stemmed further upward pressure against its currency by lowering its short term

Key economic indicators - Czech Republic	2002	2003	2004	2005e
Population (ave, million)	10.2	10.2	10.2	10.2
GDP (nominal, EUR billion)	78.4	80.3	86.8	98.2
GDP/capita (in EUR thousand)	7.7	7.9	8.5	9.6
GDP growth (real, in %)	1.5	3.2	4.4	5.0
o/w: domestic demand contribution (in %)	3.4	4.5	2.6	2.3
Exports (% of GDP)	61.5	62.2	71.2	71.9
Imports (% of GDP)	63.6	64.4	71.7	69.7
Unemployment (% of labour force)	7.3	7.8	8.3	7.9
Consumer price inflation (ave, in %)	1.4	-0.1	2.6	1.7
Interest rate (1m interbank offer rate, in %)	3.6	2.3	2.3	2.0
EUR FX rate (ave)	30.8	31.8	31.9	29.8
EUR FX rate (eop)	31.6	32.4	30.5	29.0
Current account balance (% of GDP)	-5.7	-6.3	-5.2	-2.9
General government balance (% of GDP)	-6.8	-12.5	-3.0	-3.2

Source: Eurostat, Czech National Bank.



interest rate to an all-time low of 1.75%. Even though the short term reference rate was raised again towards the end of 2005 to 2%, in line with the European Central Bank's rate actions, Czech rates remained below Euro levels.

The overall positive picture was rounded off by a strongly improving current account balance – once again the trade balance was the chief contributor. The general government balance, while still in negative territory, came in at an estimated 3.2% of GDP, only marginally worse than in 2004, but substantially better than in either 2002 or 2003.

#### MARKET REVIEW

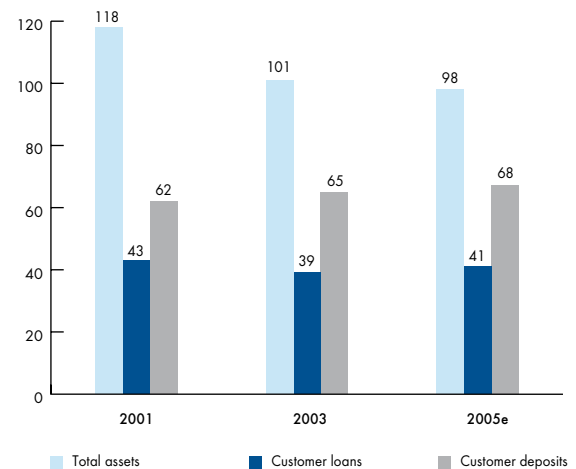
The very favourable economic environment characterised by strong growth, muted inflationary pressures and record low interest rates provided a fertile ground for growth of the Czech banking sector. As a result 2005 was the first year following a severe restructuring process in the late 90-ies and the early years of this decade that saw all benchmark penetration ratios move up.

Total assets/GDP reached 98% in 2005 after years of decline and compared to 95% in 2004. Similarly, customer loan penetration rose to a four year high of 41%, as did deposit penetration which surpassed the 68% mark in 2005. In addition, the general aggregates mask the very positive development in sub segments such as in retail and particularly mortgage lending. Household mortgage lending, for instance, rose from just 1.6% of GDP in 2001 to about 9.3% in 2005. FX lending, which played a dominant role in markets with higher nominal interest rates such as Hungary or Croatia, remained insignificant in the Czech Republic in 2005.

On the back of the positive overall market environment Česká spořitelna once again maintained its No. 1 position in retail banking and continued to rank among the three leading banks in terms of total assets. Its market share of total assets stood at 22% in 2005, unchanged on 2004 and slightly up on 2003.

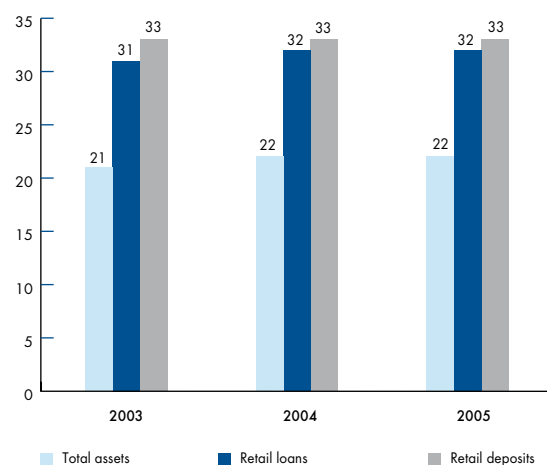
In terms of retail products Česká spořitelna maintained its dominant position owning almost one third of the retail loan and deposit market. In high growth segments of the market, such as residential mortgages, it fared even better, carving out a market share of almost 40%. Česká spořitelna was similarly successful in credit and debit cards, as well as current accounts.

#### Financial intermediation – Czech Republic (in % of GDP)



Source: Czech National Bank, Eurostat.

#### Market shares – Czech Republic (in %)



Source: Česká spořitelna, Czech National Bank.

## BUSINESS REVIEW

**Strategy.** Česká spořitelna's strategy remained unchanged in 2005. While maintaining customer satisfaction was an important goal, the continued expansion of its retail lending activities was the main business priority. Through building up a quality loan book, Česká spořitelna aimed to better leverage its large deposit base, leading to a more balanced loan/deposit ratio, which stood at 59% at year-end 2005. The continued shift of excess liquidity into higher margin retail lending products also aimed to support margins and made Česká spořitelna less sensitive to low interest rates.

**Strong loan growth.** Strong and sustained double-digit loan growth was the major growth driver in 2005. The effects of lower interest rates, compounded by a low, albeit strongly rising loan/deposit ratio were more than compensated by a favourable shift in the asset mix: while the overall loan book posted a healthy gain of 21% year on year, the retail loan book recorded growth in excess of 36%. For the first time in Česká spořitelna's history, total customer loan volume almost reached the EUR 10 billion mark in 2005.

In addition to a very favourable economic environment, loan growth was fuelled by such other factors as improved client advice, product innovation and a generally higher propensity to consume. The latter factor is especially reflected in strong demand for mortgage products and home improvement loans, as well as consumer loans. The dynamic development of loans to small and medium companies and municipalities also contributed to loan growth.

**Customer growth in alternative distribution channels.** In line with overall business growth Česká spořitelna expanded the number of customers using electronic channels, such as the internet, phone or mobile banking by 13% to above 1 million in 2005. An equally positive trend is the ever larger proportion of clients using credit and payment cards: by the end of 2005 Česká spořitelna had issued some 2.9 million payment cards, while the number of issued credit cards surpassed the 300 thousand mark, translating into exceptional annual growth of 70%.

**International and local recognition.** As in previous years Česká spořitelna has been awarded a number of local and international awards, first and foremost, for the third year running "The

Bank of the Year" award sponsored by "The Banker" magazine. In the local MasterCard Bank of the Year survey, Česká spořitelna regained the title of "Most Trustworthy Bank in the Czech Republic"; it also won four Zlata koruna (Golden Crown) awards for a range of retail banking products, recognising Česká spořitelna's ability to create competitive and high quality retail banking products.

## Outlook 2006

In line with its strategic focus Česká spořitelna will continue to grow its retail business, especially on the asset side. Consumer loans, credit cards, mortgages and the financing of small and medium enterprises will dominate the bank's business development efforts in 2006. Česká spořitelna will also continue on the path of headcount reduction, as part of the efficiency programme embarked on in 2005. This is expected to push employee numbers to substantially below 11,000. Financial targets for 2006 are equally ambitious as those for 2005: net profit growth of at least 10%, return on equity in excess of 20% and a cost/income ratio of below 54%. All targets relate to locally reported figures.

## Financial review

in EUR million	2005	2004
Pre-tax profit	364.1	289.3
Net profit after taxes and minority interests	265.4	193.7
Cost/income ratio in %	58.6	61.3
Return on equity in %	38.5	39.4

Last year, group net profit increased by 37.1%, or EUR 71.8 million, from EUR 193.7 million to EUR 265.4 million. Aided by the robust earnings growth, the cost/income ratio fell from 61.3% to 58.6%. The return on equity contracted slightly from 39.4% to 38.5%, mainly as a result of the increased equity allocation.

Despite two interest rate cuts by the Czech central bank totalling 50 basis points, net interest income increased by 18.0%, or EUR 90.8 million, from EUR 504.2 million to EUR 595.0 million. This increase was driven mainly by the robust gains in the lending business. The loan loss provision expense increased by EUR 17.9 million from EUR 15.8 million to EUR 33.7 million, mainly as a result of the growth in the lending business.

Starting from its existing high level in 2004, net commission income rose by 9.1% (2.0% adjusted for the currency impact), or EUR 24.1 million, from EUR 262.9 million to EUR 287.0 million. This increase was largely due to the expansion of the payments and asset management businesses as well as the aforementioned gains in the lending business.

Driven by substantial gains in the interest rate derivatives and securities activities, the net trading result also improved considerably, rising by 20.5% (12.6% adjusted for the currency impact), or EUR 8.4 million, to EUR 49.4 million.

The 9.9% (2.7% adjusted for the currency impact), or EUR 49.6 million, increase in general administrative expenses from EUR 500.5 million to EUR 550.1 million was mainly due to the establishment of additional severance reserves for the redundancy programme under way and an increase in the sales tax following a tax law change in 2004.

The other operating result increased by EUR 19.5 million from a loss of EUR 10.8 million to a gain of EUR 8.7 million thanks to regulatory changes involving compulsory payments to the deposit insurance fund on the one hand and gains on the disposal of other current assets on the other.

## SLOVENSKÁ SPORITEL'ŇA

**Business profile.** Slovenská sporiteľňa is the clear market leader in the Slovakian banking market. The former state savings bank serves some 2.5 million clients, equaling roughly 50% of the Slovak population, through a network of 302 branches. It is the market leader in retail as well as total deposits, and for the first time eclipsed the competition in terms of retail as well as total loans in 2005. In the tailwind of Slovenská sporiteľňa's dominant market position, its asset management subsidiary maintained its No. 1 position, while life insurance provider Poist'ovňa SLSP kept gaining market share very fast.

### ECONOMIC REVIEW

Slovakia enjoyed another year of stellar economic performance in 2005, thereby supporting Slovenská sporiteľňa in its business development efforts. Real GDP growth amounted to an estimated 5.7%, surpassing last year's 5.5%, and translating into GDP/capita of about EUR 6,900. Growth was supported by FDI-driven gross fixed capital formation and robust private consumption. Within domestic demand, households played an important role reflecting both strong real wage and employment growth – the unemployment rate fell from 18.1% in 2004 to estimated 16.4% in 2005. Strong growth was also reflected in the trade balance, which remained in negative territory on the back of strong import growth.

In 2005 Slovakia made substantial progress in combating inflation: the average rate more than halved to 2.7% from 7.5% in 2004 on the back of a stronger currency and lower regulatory price increases. The upward pressure against the Slovak Crown was also due to an up-tick in foreign direct investment. As a result the Slovak National Bank lowered its short-term reference refinancing rate by another 100 bps to an all time low of 3%. In line with its all encompassing economic progress, Slovakia entered the Exchange Rate Mechanism II in November 2005, boding well for Euro adoption as early as in January 2009. The resulting reference rate that serves as the mid-point for the 30% fluctuation band was fixed at SKK 38.455.

In 2005 the general government deficit is expected to improve slightly on last year's of 3.1% of GDP, outperforming initial forecasts. At the same time, the current account deficit increased

Key economic indicators – Slovakia	2002	2003	2004	2005e
Population (ave, million)	5.4	5.4	5.4	5.4
GDP (nominal, EUR billion)	25.7	29.0	33.1	37.0
GDP/capita (in EUR thousand)	4.8	5.4	6.2	6.9
GDP growth (real, in %)	4.6	4.5	5.5	5.7
o/w: domestic demand contribution (in %)	4.0	-0.2	2.8	5.3
Exports (% of GDP)	71.7	77.7	76.8	76.8
Imports (% of GDP)	78.9	79.2	79.5	80.8
Unemployment (% of labour force)	18.7	17.5	18.1	16.4
Consumer price inflation (ave, in %)	3.5	8.4	7.5	2.7
Interest rate (1m interbank offer rate, in %)	7.8	6.3	4.8	3.0
EUR FX rate (ave)	42.7	41.5	40.0	38.7
EUR FX rate (eop)	41.5	41.2	38.7	37.8
Current account balance (% of GDP)	-7.3	-0.5	-3.4	-5.4
General government balance (% of GDP)	-7.8	-3.8	-3.1	-3.1

Source: Eurostat, National Bank of Slovakia.

to an estimated 5.4%, on the back of strong domestic demand in 2005, but was covered to a healthy degree by foreign direct investment.

#### MARKET REVIEW

The strong performance of the Slovak economy created a solid base for the growth of the overall banking market. Low interest rates, combined with growing real wages and higher employment resulted in increased demand for retail loans, particularly mortgages, and also led to shifts on the liability side – clients moved assets from low-yielding deposits into more sophisticated products such as funds and life insurance policies. Hence, after a series of restructuring steps undertaken before 2001, 2005 was the second consecutive year in which all market penetration indicators moved up. This development very much resembles the Czech experience, where 2005 was in fact the first year in which all major market benchmarks improved markedly after a similar clean-up process.

Asset penetration reached a 7-year high of 98%, while loans/GDP moved up to 5-year high of 39%. Deposit penetration remained essentially unchanged on both 2003 and 2004, but down compared to a couple of years ago, on the back of strong household

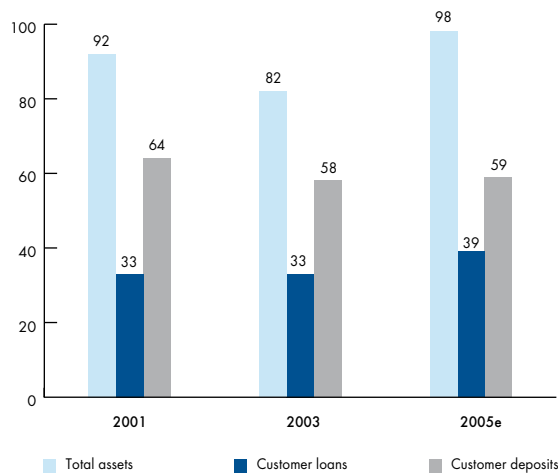
consumption, falling interest rates and an increased uptake of alternative investment products.

Slovenská sporiteľňa once again successfully defended its leading market position in 2005, with a total asset market share of 18.2%. It did especially well in extending its market positions on the asset side. For the first time ever, Slovenská sporiteľňa became the market leader in overall as well as retail lending, reaching market shares of 17% and 25% respectively. It also made significant further inroads into the residential mortgage market by successfully launching asset-backed loans (UverPlus) with real estate as collateral.

#### BUSINESS REVIEW

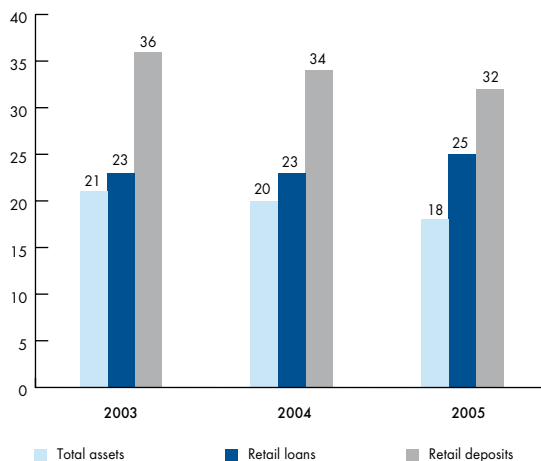
**Strategy.** The strategic alignment of Slovenská sporiteľňa is very similar to that of Česká spořitelna. While excellent customer service and relevant products remain the key to success for any mass market retail bank, the real issue is an increase in the loan/deposit ratio, which, at 55% has risen strongly on last year's level of 36%, but is the lowest within the entire group. The further improvement of the loan/deposit ratio will support net interest income development in the light of maturing high yielding restructuring bonds in 2006.

### Financial intermediation – Slovakia (in % of GDP)



Source: National Bank of Slovakia, Eurostat.

### Market shares – Slovakia (in %)



Source: Slovenská sporiteľňa.

### Highlights 2005

**Above-average loan growth.** Vigorous private sector, and in particular household credit expansion was the key business theme of 2005. Growth was supported by a number of innovative product launches, such as so called American mortgages, i.e. home equity loans that allow consumers to extract equity from their property, so called “10 minute” loans that aim to reduce administrative requirements in the loan extension process, and any purpose customer loans. As a result Slovenská sporiteľňa recorded the highest growth rates of any group member, with the overall loan book growing by some 55%, nearly reaching the EUR 2.5 billion mark. Once again, the retail loan book posted the same strong growth of some 54% and accounted for 45% of total customer loans.

**Customer growth in alternative channels.** Another area in which Slovenská sporiteľňa was doing outstandingly well, is payment transactions. In 2005 more than 90% of customers performed non-cash transactions, used the largest ATM network and made payments with bank cards. We issued almost 38 thousand new bank cards last year, bringing the total number in circulation to nearly 1.1 million. The number of customers using electronic banking has also grown substantially and stood at more than 300 thousand, up by more than 30% as compared with 2004.

**Efficiency improvements.** After careful analysis, more than 30 inefficient branches were closed down during the course of the year, reducing the number of branches to 302. As a result staff numbers are also fell by some 5% to below 4,800.

**Brand awareness and international recognition.** Slovenská sporiteľňa was named as the “Best Bank” in Slovakia by The Banker and Euromoney magazines. At the same time, Slovenská sporiteľňa was the best known brand in the Slovak banking market for another year. These results are testament to our strong client orientation continuing improvements in service quality.

**100% ownership by Erste Bank.** In January, Erste Bank completed the purchase of the remaining 19.99% of the share capital of Slovenská sporiteľňa by exercising the call option

received from the European Bank for Reconstruction and Development and effectively became the 100% owner of the Slovenská sporiteľňa.

### Outlook 2006

While Slovenská sporiteľňa expects another strong year in terms of underlying business growth, overall success in terms of profitability will be hampered by the expiry of high-yielding government bonds – volume: EUR 250 million, coupon: 8% – that were received at the time of privatisation in lieu of bad loans and the continued low interest rate environment. All efforts will therefore be directed at increasing customer loans especially in the retail segment, thereby further driving up the loan/deposit ratio. In 2006 Slovenská sporiteľňa aims to keep net profit at last year's level, while further improving its cost/income ratio to below 55% and maintaining its return on equity at 20% (the targets relate to local accounts).

### Financial review

in EUR million	2005	2004
Pre-tax profit	100.6	82.6
Net profit after taxes and minority interests	87.3	57.2
Cost/income ratio in %	57.2	59.0
Return on equity in %	47.7	46.1

In 2005, net profit after taxes and minority interests increased by EUR 30.1 million from EUR 57.2 million to EUR 87.3 million. In January, the Erste Bank raised its equity interest in Slovenská sporiteľňa to 100%, with the result that minority interest expenses were no longer incurred and that higher refinancing costs were borne. The return on equity increased from 46.1% to 47.7%, while the cost/income ratio was reduced from 59.0% to 57.2%.

As had been forecast the previous year, the retail business recorded strong gains in 2005. Higher earnings contributions from at equity participations and the favourable currency effect more than offset the aforementioned increase in refinancing costs. Despite the additional burden on the securities portfolio represented by the impact of lower interest rates in Slovakia (redemption of high-yield bonds and adjustment of variable-

interest securities to reflect the lower interest rates), net interest income increased by 4.9% (0.9% adjusted for the currency impact), or EUR 9.1 million, from EUR 185.8 million to EUR 194.9 million. Risk provisions rose to EUR 11.1 million, commensurate with the increase in lending volume.

Net provision income rose by 24.2% (19.5% adjusted for the currency impact), or EUR 16.1 million, from EUR 66.4 million to EUR 82.5 million, mainly in the payment transaction, financing and asset management businesses.

General administrative expenses increased by EUR 8.8 million from EUR 158.5 million to EUR 167.3 million. Adjusted for the currency effect, this 1.5% increase was well below the inflation rate.

The EUR 15.2 million improvement in other operating result from a loss of EUR 28.4 million to a loss of EUR 13.2 million can be attributed to proceeds on the sale of fixed-income securities last year as well as non-recurring reserve allocations in 2004.

### ERSTE BANK HUNGARY

**Business profile.** Following the merger with Postabank, Erste Bank Hungary is one of the leading players in Hungarian retail banking. It serves approximately 900 thousand customers through its nationwide network of 160 branches, more than 365 ATMs and about 630 POS terminals. In addition Erste Bank Hungary holds strong and fast growing positions in the area of fund management and leasing.

### ECONOMIC REVIEW

In 2005 Erste Bank Hungary benefited from the continued, solid growth of the Hungarian economy. GDP rose by an estimated 4.2%, while GDP/capita reached a level of EUR 8,700. Growth was supported by strong domestic demand, mainly in the form of private consumption and very strong investments. An up-tick in exports also contributed to overall growth. The situation on the labour market was characterised by declining growth in real wages and a concurrent rise in the unemployment rate to 7%, up from 6% in 2004.

Key economic indicators – Hungary	2002	2003	2004	2005e
Population (ave, million)	10.2	10.1	10.1	10.1
GDP (nominal, EUR billion)	69.6	73.5	81.1	88.2
GDP/capita (in EUR thousand)	6.9	7.3	8.0	8.7
GDP growth (real, in %)	3.8	3.4	4.6	4.2
o/w: domestic demand contribution (in %)	8.8	6.1	3.4	3.6
Exports (% of GDP)	64.1	62.7	65.7	66.7
Imports (% of GDP)	66.5	67.2	68.8	69.4
Unemployment (% of labour force)	5.6	5.8	6.0	7.0
Consumer price inflation (ave, in %)	5.2	4.7	6.8	3.6
Interest rate (1m interbank offer rate, in %)	9.2	8.4	11.5	7.2
EUR FX rate (ave)	243.0	253.6	251.7	248.0
EUR FX rate (eop)	236.3	262.5	246.0	252.7
Current account balance (% of GDP)	-7.1	-8.7	-8.8	-8.4
General government balance (% of GDP)	-8.5	-6.5	-5.4	-6.1

Source: Eurostat, Hungarian National Bank.

Annual inflation declined to an estimated 3.6% in 2005. This positive development facilitated a series of interest rate cuts. The Hungarian National Bank lowered its short term reference rate from 9.5% in January 2005 to 6% by the end of the year. Further declines are contingent on the improvement in a number of macro variables, most notably on a reduction of the current account and general government deficits. Persistent weakness in the latter already led to the postponement of the target Euro entry date, allowing more time to meet the criteria of the Stability and Growth Pact. Due to the relatively high level of both nominal and real interest rates, the Hungarian currency remained stable around the HUF 250 mark in 2005.

The Achilles heel of the Hungarian economy is the exuberant attitude towards public spending. This has manifested itself in large general government deficits, which typically become even more pronounced in election years. As 2006 is an election year not much improvement can be expected in this respect, all the more as the VAT rate was slashed to 20% from 25% at the start of 2006. At the same time gross government indebtedness still remains at a much more manageable 58% of GDP, than is the

case in many other EU countries. Nonetheless strong government spending has contributed to the external imbalance: the current account deficit again surpassed a level of above 8% to GDP in 2005, but was financed to a healthy degree by foreign direct investments.

#### MARKET REVIEW

Hungary has benefited from a sound banking sector, sustained market-oriented reforms and large-scale foreign direct investments since the beginning of transition. Accordingly, maturity benchmarks took a much more linear development than either in the Czech Republic or Slovakia. Asset/GDP reached a level of 93% in 2005, up strongly on 68% in 2001. Loan penetration followed a similar trend, rising from 42% in 2001 to 53% in 2005. Over the same period residential mortgage penetration has increased nearly fivefold from 2.2% to 10.4%, and accordingly was the major growth driver underlying credit expansion. Deposit penetration remained essentially unchanged at 45%, reflecting the increased uptake of more sophisticated investment products, such as funds and life insurance policies.

The structure of the Hungarian market differs substantially from that prevailing in our other markets. While the vast majority of banks in terms of assets are privatised and have either strategic or financial owners, the market is dominated by one major player that owns about a quarter of the market in terms assets and up to one third in certain other product categories. A handful of other banks, including Erste Bank Hungary, hold asset market shares in the high single digits, and aim to win market share while maintaining industry profitability.

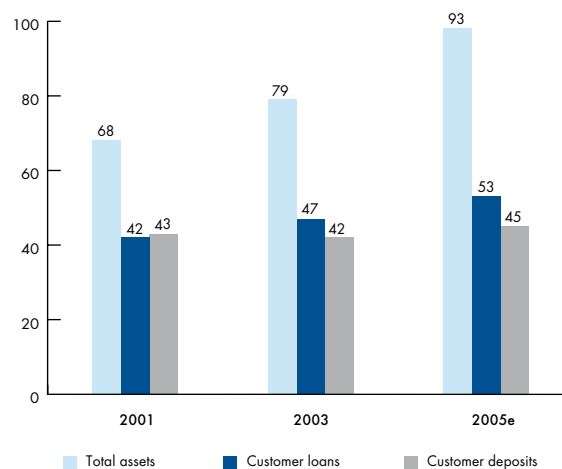
Another peculiarity of the Hungarian banking market that it shares with other markets with high nominal interest rates is the dominance of foreign exchange loans. The vast majority of retail loans in general and mortgages in particular were disbursed in Euros and Swiss Franks in 2005. While this creates a certain level of risk, especially given the potential vulnerability of the Hungarian currency, the downside risk is limited due to prudent loan-to-value ratios, especially in the case of mortgages. Additionally, the Hungarian National Bank has historically managed the currency well, even in the face of high foreign ownership of Hungarian government bonds, as well as external and internal imbalances.

As for Erste Bank Hungary, 2005 was the first year in which it has surpassed the 7% mark in terms of total asset market share. It ranked second by branch numbers and clients. The decline in retail deposit market share has to be viewed in the context of a fourfold increase in fund management market share, which stood at 10.2% at the end of 2005. The strong expansion in retail lending market share to 9.1% is directly related to Erste Bank Hungary's successful focus on the retail market.

#### BUSINESS REVIEW

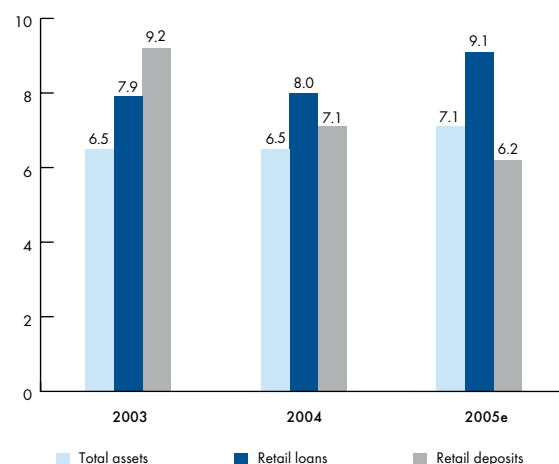
**Strategy.** The main strategic goal of Erste Bank Hungary – in line with overall group strategy of achieving at least 15 – 20% market share in all markets it operates in – is the expansion of its market position in the Hungarian market. One means by which the bank plans to achieve this is by further deepening its relationship with the Hungarian Post Office: in return for using their outlets as a secondary distribution network, Erste Bank Hungary supplies them with modern banking products ranging from current accounts to bank cards and investment funds. In terms of corporate customers, Erste Bank Hungary focuses on small and

### Financial intermediation – Hungary (in % of GDP)



Source: Hungarian National Bank, Eurostat.

### Market shares – Hungary (in %)



Source: Erste Bank Hungary, Hungarian National Bank.



medium enterprises which they serve through 25 commercial centres, in addition to mass market retail business.

### Highlights 2005

**Solid loan growth.** As in most other central and east European transformation economies loan growth was the major growth driver within the banking sector. The fastest growing segment within the loan book was retail housing finance. Due to the relatively high level of nominal interest rates in Hungary FX mortgages – mostly denominated in Euro or Swiss Franks – were the product of choice for most customers. Overall, the loan book grew by 27% to a level of nearly EUR 4 billion, while the retail loan book expanded by 41% year on year.

**Hungarian Post Office cooperation.** The collaboration with the Hungarian Post Office progressed very well in 2005: the number of online postal points reached 248; the partners have developed a completely new technical environment for online working, installed a postal version of the front end used by Erste Bank Hungary; and introduced a web-based user interface for postal employees as well as help desk. All these measures will bear fruit through increased business in future years.

**Strength in car leasing.** Despite a declining new car market and increased competition, Erste Bank Hungary preserved its No. 4 spot in the Hungarian car leasing market. The key to success were a broader product range, a successfully operating agent network and fully integrated back-office processes.

### Outlook 2006

In 2006 Erste Bank Hungary once again targets solid profit growth, an improvement in our cost/income ratio and a return on equity north of 25% (all measures relate to local accounts). The bank will continue to pursue business opportunities in the lower tier SME segment and further develop our relationship with the Hungarian Post Office by establishing an additional 72 online postal points in the first half of 2006 as well as improving mid and back office integration. Erste Bank Hungary will also expand its own branch network to some 200 by the end of 2006. Mortgage and consumer loans will be a continued source of growth.

### Financial review

in EUR million	2005	2004
Pre-tax profit	84.3	31.3
Net profit after taxes and minority interests	67.1	31.5
Cost/income ratio in %	61.2	68.1
Return on equity in %	34.1	23.6

All of Erste Bank Hungary's businesses performed well last year. Net profit after taxes and minority interests more than doubled, rising by EUR 35.7 million from EUR 31.5 million to EUR 67.1 million. The cost/income ratio fell from 68.1% to 61.2%, while the return on equity improved from 23.6% to 34.1%.

As expected, the significant expansion of the retail business led to a EUR 30.4 million increase in net interest income from EUR 174.0 million to EUR 204.4 million. Risk provisions totalled EUR 17.1 million, well below the previous year's level, although this figure includes approximately EUR 9 million in releases as a result of the first-time consolidation of Posta Bank.

Net commission income increased by a satisfactory EUR 12.2 million from EUR 52.6 million to EUR 64.8 million, mainly as a result of the gains in the securities and payment transactions businesses.

General administrative expenses rose by a modest 5.8%, or EUR 10.1 million, from EUR 175.7 million to EUR 185.8 million. This increase was largely due to the expansion of the branch network and performance-related compensation.

The sharp rise in the tax expense was due to changes in Hungary's tax law, which calls for a special 8% tax on financial institutions and leasing companies.

## ERSTE BANK CROATIA

**Business profile.** Erste Bank Croatia is one of the largest and fastest growing universal banks in Croatia, serving about 600 thousand clients through a nationwide network of 122 branches. While its core strength is retail banking, it is also the market leader in treasury products, such as in fixed income, foreign exchange and derivatives trading, as well as in fund management. In addition, Erste Bank Croatia successfully distributes a wide range of para-banking products in the areas of asset management, life insurance, securities brokerage, leasing and pension funds.

### ECONOMIC REVIEW

In 2005 Erste Bank Croatia benefited from continued stable growth of the Croatian economy. GDP grew by an estimated 3.6% in 2005, while GDP/capita reached a level of some EUR 6,700. Strong domestic demand in the form of private consumption and public investments was the major growth driver. Exports did not contribute significantly to overall growth, but still played an important role through the generation of substantial tourism revenues. The unemployment rate improved slightly to an estimated 13.3% in 2005, down from 13.8% in the previous year.

Annual inflation remained relatively low at 3% in 2005. Nevertheless, this meant a full percentage point increase on the level of 2004, mainly due to higher energy and food prices as well as higher excise taxes. The Croatian National Bank remained committed to exchange rate stability in 2005, mainly through the maintenance of relatively high nominal and real interest rates – the discount rate stood at a level of 4.5% for the third consecutive year. As a result the Croatian currency, the Kuna, remained unchanged against the Euro.

On the fiscal side, the general government deficit improved to an estimated 4.5% of GDP in 2005, a slight improvement on the previous year, but substantially up on 2003. A continuation of this trend is dependent on additional reforms of the pension and health care systems. The current account deficit expanded from 5.3% to 6.2%, on the back of stronger public spending, even though the trade balance improved year-on year.

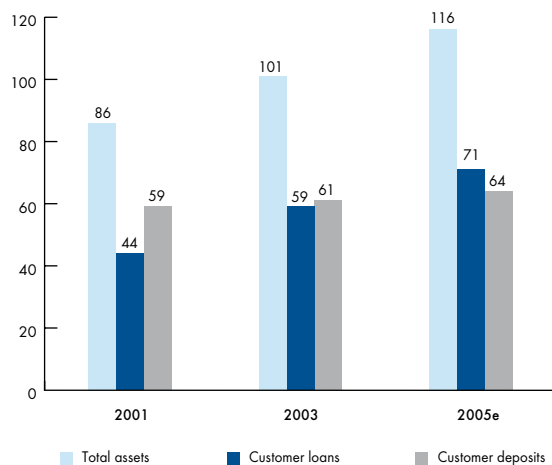
### MARKET REVIEW

The Croatian banking system ranks among the most developed in terms of banking intermediation levels. Its continued growth was supported by a stable economic environment. The asset/GDP ratio stood at 116% in 2005, up strongly from 86% recor-

Key economic indicators – Croatia	2002	2003	2004	2005e
Population (ave, million)	4.4	4.4	4.4	4.4
GDP (nominal, EUR billion)	24.2	25.5	27.6	29.7
GDP/capita (in EUR thousand)	5.4	5.7	6.2	6.7
GDP growth (real, in %)	5.2	4.3	3.8	3.6
o/w: domestic demand contribution (in %)	6.8	6.5	3.5	3.4
Exports (% of GDP)	45.4	47.1	47.5	48.9
Imports (% of GDP)	54.7	56.8	55.7	56.4
Unemployment (% of labour force)	14.7	14.1	13.8	13.3
Consumer price inflation (ave, in %)	1.7	1.8	2.1	3.0
Interest rate (1m interbank offer rate, in %)	3.6	5.3	7.0	6.0
EUR FX rate (ave)	7.4	7.6	7.5	7.4
EUR FX rate (eop)	7.5	7.6	7.7	7.4
Current account balance (% of GDP)	-8.6	-7.4	-5.3	-6.2
General government balance (% of GDP)	-5.0	-6.3	-4.9	-4.5

Source: Eurostat, European Commission.

### Financial intermediation – Croatia (in % of GDP)

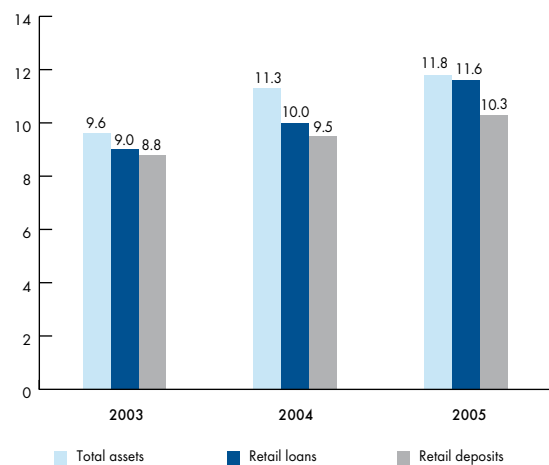


Source: Croatian National Bank, Eurostat.

ded in 2001. Growth of the sector was mainly driven by the asset side, in particular by household loans which rocketed over the same period from 18.2% of GDP to 35.8%. As was the case in our other central and east European markets, growth within household loans was fuelled by strong demand for residential mortgages: the mortgage/GDP ratio leapt from 5.3% in 2001 to 12.5% in 2005. On the liability side, deposit growth was more moderate, but still measurable. The deposit-to-GDP ratio grew from 59% in 2001 to 64% in 2005; while other growth in competing investment products, such as funds was even stronger.

As in Hungary and in contrast to the Czech Republic and Slovakia loan growth was driven by increased foreign exchange lending. The Croatian National Bank, whose main aim is to maintain exchange rate stability, reacted by increasing the marginal reserve requirement on foreign liabilities of commercial banks twice in 2005. This was followed by an additional step in 2006. While such measures do cover banks, they do not cover leasing companies, which continue to record even stronger growth rates than banks.

### Market shares – Croatia (in %)



Source: Erste Bank Croatia, Croatian National Bank.

The positive market environment provided a solid base for Erste Bank Croatia's growth. In fact, the bank outperformed market growth in all segments. This impressive development translated into the following market shares in 2005: 11.8% of total assets, strongly up from 9.6% just two years ago, 11.6% in retail loans, substantially up on both 2003 and 2004; and, 10.3% in retail deposits, equally a healthy improvement on the levels registered in the two previous years.

### BUSINESS REVIEW

**Strategy.** Erste Bank Croatia's strategic objective is to further expand its market position as a premier provider of universal financial services in Croatia, catering in particular to a broad base of retail and mid-market corporate clients. To achieve this, the bank is constantly developing its product portfolio and distribution capabilities, in order to bring innovative financial solutions closer to its customers. A continuous emphasis on quality improvement in the services and products offered as well as a proactive and personalised approach to customers, is at the core of the bank's strive for delivering superior value to its clients.

## Highlights 2005

**Strong retail business.** Erste Bank Croatia posted exceptional growth rates in its retail lending activities (retail loans grew by about 40% in 2005), rounding off the very positive picture seen throughout Central and Eastern Europe. In so doing it attracted close to 50,000 new customers. Lending growth was driven by substantial increases of the customer base, as well as continued product innovation. By launching several new and highly successful mortgage and consumer lending products, Erste Bank Croatia strengthened its position as one of the most dynamic banks in the retail market. On the liability side the bank introduced new saving products, such as structured deposits with a capital guarantee.

**Continued market share gains in corporate business.** In the area of corporate lending, Erste Bank Croatia maintained its solid growth and increased its market share by a full percentage point to some 13%. This growth was driven by ongoing strong performance in the SME segment, as well as significant gains in the segment of large corporates and project finance.

**Expansion of distribution capabilities.** In line with its expansion strategy, Erste Bank Croatia opened 11 new branches in 2005, more than any of its competitors. This strengthened the bank's geographic coverage considerably, particularly in eastern and southern Croatia, where growth opportunities are the most attractive. In the area of alternative distribution channels, the bank significantly upgraded its capabilities by launching an operator-independent mobile phone banking platform combining the advantages of JAVA and GPRS technologies. Erste Bank Croatia is among the first five banks world-wide to introduce such level of functionality for mobile phone banking.

**Leadership in fund management.** On the back of excellent cross-selling results the Croatian asset management subsidiary posted one of the highest growth rates in the industry in 2005, continuing its very strong performance from 2004. Furthermore, the group's asset management subsidiary won the management

mandate for a large, government-sponsored fund project, thus reaching the position of the largest asset manager in Croatia with a share of over 25% of total assets under management.

**National recognition.** Erste Bank Croatia was for the first time ever named the „Best Bank of the Country“ in 2005 in an annual competition sponsored by the Croatian Chamber of Commerce recognising its achievements in innovation and customer service.

## Outlook 2006

In 2006 Erste Bank Croatia will very much build on the successes of 2005. In line with its customer-centric approach, the bank aims to continuously expand its offering in order to position itself as an integrated solution-provider for the growing investment and financing needs of its customer base. More specifically, it will move forward with further branch expansion, opening additional 10 – 15 branches over the next two to three years in order to take advantage of the strong momentum in its retail business. While pursuing an accelerated growth path, Erste Bank Croatia is committed to delivering strong financial results to its shareholders and aims to maintain target return on equity levels at or above 20% over the medium term, with a cost/income ratio in the low 50-ies. All targets relate to locally reported figures.

## Financial review

in EUR million	2005	2004
Pre-tax profit	52.7	43.2
Net profit after taxes and minority interests	25.6	22.1
Cost/income ratio in %	52.3	56.6
Return on equity in %	14.8	17.7

In 2005, Erste Bank Croatia's net profit after taxes and minority interests rose by 15.7%, or EUR 3.5 million, from EUR 22.1 million to EUR 25.6 million. This modest increase relative to that of pre-tax profit was due to the increase in minority interests following Erste Bank AG's sale of a 15% equity interest to Steiermärkische Bank und Sparkassen AG (thereby reducing its majority stake from 59.8% to 51.4%). Pre-tax profit increased by 22.0%, or EUR 9.5 million, from EUR 43.2 million to EUR 52.7 million. The return on equity contracted from 17.7%

to 14.8% as a result of the overall higher equity allocation and the aforementioned increase in minority interests. The cost/income ratio, meanwhile, fell from 56.6% to 52.3%.

Net interest income rose by 18.7%, or EUR 15.8 million, mainly as a result of the more than 30% increase in loans and advances to customers. After adjusting for the legally mandated reclassification of the derivatives result of EUR 9 million from net interest income to the net trading result, net interest income rose by 27%, which largely reflected the expansion of the lending business.

Given the existence of non-recurring items in 2004, such as the reduction in general risk provisions required by the Croatian central bank and loan recoveries, last year's EUR 9.4 million increase in loan loss provision expense is not directly comparable. In 2005, changes in risk provision totals reflected the growth of the credit portfolio.

Net commission income increased by 39.4%, or EUR 6.6 million, from EUR 16.7 million to EUR 23.3 million through gains in the payment transactions, credit and debit card businesses. The net trading result increased by an even greater margin, advancing by 62.4%, or EUR 7.8 million, from EUR 12.6 million to EUR 20.4 million. This gain resulted primarily from the aforementioned reclassification of the derivatives result from net interest income as well as higher foreign exchange trading income.

In 2005, Erste Bank Croatia's expansion strategy led to a 17.0%, or EUR 10.9 million, increase in general administrative expenses from EUR 64.3 million to EUR 75.3 million. The increase resulted from the opening of new branches and the partly related increase in the average number of employees as well as product launch expenses.

## ERSTE BANK SERBIA

**Business profile.** Erste Bank Serbia is one of Serbia's smaller banks, with a market share of approximately 2%. Its operations are concentrated in the Vojvodina region, one of Serbia's more prosperous regions, where it is the second largest bank by asset market share. The bank has some 900 employees, 66 branches, and serves around 260 thousand customers.

## ECONOMIC REVIEW

Erste Bank Serbia operated in a mixed economic environment in 2005. While GDP growth was healthy at an estimated 4% in 2005 it did not reach the previous year's exceptional level of more than 8%. At the same time, GDP/capita equalled EUR 2,500, a level that is much lower than in the other markets we operate in. While the Serbian economy grows strongly it is not yet as balanced as those in more developed central and east European countries. A point in case is the huge trade deficit, a result of strong domestic demand combined with the late start of privatisation and restructuring efforts. Serbia's ongoing transformation process is also reflected in a relatively high unemployment rate, which stood at an average 20% in 2005.

The Serbian interest rate environment is characterised by high nominal and real interest rates, and a higher level of volatility than in more developed countries. This is due to inflation fluctuations, which also impact the exchange rate versus the Euro: it is broadly stable in real terms, but depreciates in nominal terms, in line with inflation.

While the trade balance is heavily in the red as a result of strong domestic demand and responsible for a persistent, double digit current account deficit, the fiscal situation is very much under control and actually in positive territory: the general government surplus reached an estimated 1.4% in 2005, up from a flattish -0.3% in the previous year. Foreign direct investments picked up in 2005, following good privatisation progress, especially in the banking sector.

## MARKET REVIEW

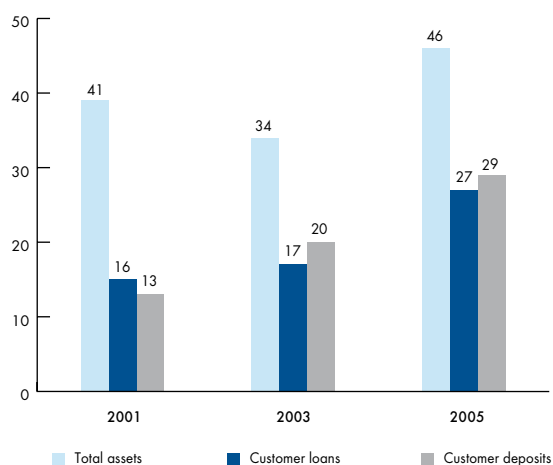
The Serbian banking sector experienced very strong growth over the last two years, albeit from a very low base. This was mainly driven by a boom in imports and financed largely by the expansion of private sector credit. The regulatory environment also improved with the adoption of a new deposit insurance law. The development of the banking sector was also aided by strong privatisation activity.

Following a period of falling penetration ratios, during which the central bank revoked the licenses of some of the largest banking groups in the country, Serbia is now firmly on track of catching up with its central and east European peers. Assets/GDP reached a level of 46% at the end of 2005, strongly up

Key economic indicators – Serbia	2002	2003	2004	2005e
Population (ave, million)	7.5	7.5	7.6	7.6
GDP (nominal, EUR billion)	15.1	16.8	18.2	19,0
GDP/capita (in EUR thousand)	2.0	2.2	2.4	2.5
GDP growth (real, in %)	4.5	2.4	8.6	4.0
o/w: domestic demand contribution (in %)	na	na	na	na
Exports (% of GDP)	20.4	20.3	23.8	26.3
Imports (% of GDP)	43.4	43.2	53.2	48.5
Unemployment (% of labour force)	13.3	14.6	18.5	20.0
Consumer price inflation (ave, in %)	16.6	9.9	11.4	15.0
Interest rate (1m interbank offer rate, in %)	na	na	na	20.2
EUR FX rate (ave)	60.7	65.2	72.6	82.7
EUR FX rate (eop)	61.5	68.5	78.9	85.5
Current account balance (% of GDP)	-10.0	-9.2	-13.0	-11.0
General government balance (% of GDP)	-4.6	-3.4	-0.3	1.4

Source: Vienna Institute for International Economic Studies.

### Financial intermediation – Serbia (in % of GDP)



Source: National Bank of Serbia.

from 34% two years ago. In a similar fashion loan penetration rose by more than 50% over the same period. Deposits/GDP increased as well, but to a lesser degree.

#### BUSINESS REVIEW

**Strategy.** Erste Bank Serbia's strategic aim is to strengthen its market position in the Vojvodina region and in Serbia as a whole, aiming to increase its total asset market share from some 2% to 10% by 2010. To this effect Erste Bank Serbia intends to make substantial investments into the expansion and refurbishment of the branch network. The bank plans to open about 15 branches in 2006 and an additional 20 outlets each in 2007 and 2008.

#### Highlights 2005

**Start of transformation programme.** The key achievement of 2005 at Erste Bank Serbia was the launch of the transformation programme in September 2005. It concentrates on organisational restructuring, the appointment of key management personnel as well as on the upgrading of risk management, accounting and controlling policies to group standards. In addition Erste Bank's name and logo replaced the former Novosadska banka brand at the end of December when the first new branch in Belgrade was opened in the new design.

## Outlook 2006

The focal point of 2006 will be the continued execution of the transformation programme. The emphasis will be on product redesign, improvements in process efficiency, increased training for the employees and upgrading of the IT infrastructure. As a result service quality for our customers should improve noticeably.

In addition, the planned expansion and refurbishment of the branch network as well as the launch of special business development initiatives in the retail mortgage lending area and special long term financing schemes for SME clients are expected to result in considerable growth of business volume.

## Financial review

in EUR million	2005	2004 <sup>*)</sup>
Pre-tax loss	8.8	
Net loss after taxes and minority interests	8.3	
Cost/income ratio in %	-	
Return on equity in %	-	

<sup>\*)</sup> Segment contribution: no comparable figures for 2004.

In 2005, the net loss after taxes and minority interests totalled EUR 8.3 million, largely as a result of the EUR 5.8 million in restructuring costs booked in 2005. Loans and advances to customers increased by 26.6% to EUR 127 million. Following Erste Bank Serbia's consolidation within the Erste Bank Group, the bank's performance improved dramatically. From September through December 2005, retail loan volume grew by 41.4%, well above the market average of 29.2%. Erste Bank Serbia's performance in the corporates and SME segment was even better, with a 47.0% increase compared to only 15.7% for the market.

This spectacular volume growth was also reflected in net interest income, which rose by 132.9% from EUR 3.8 million to EUR 8.8 million. After factoring in restructuring costs, operating profit was up 94.1%. Excluding these costs, the increase would have exceeded 500%. Despite the booking of restructuring costs, the cost/income ratio remained unchanged from 2004.

## INTERNATIONAL BUSINESS

**Business profile.** The International Business segment covers commercial lending to foreign banks, leasing companies and sovereign debtors, excluding treasury-related interbank business, of Erste Bank's branches in London, New York and Hong Kong as well as of Erste Bank Vienna and Erste Bank Malta.

Erste Bank's London Branch, with some 40 employees, is a wholesale banking operation with a service portfolio ranging from leveraged finance, asset backed securities, structured trade and commercial property to aircraft finance. The New York Branch is a US federally licensed wholesale banking operation. With about 30 employees and a USD 10 billion balance sheet, the branch operates via its lending and treasury profit centres. The Hong Kong Branch is Erste Bank's sole Asia Pacific point of representation. It employs some 20 staff and engages in regional wholesale lending and treasury trading.

## BUSINESS REVIEW

**Strategy.** To achieve the greatest possible group-wide diversification of the credit portfolio and accompanying credit risk diversification, the activities of the international business are intended to balance out the loan books of the extended home market. The strategic focus remains the participation in primary market credit syndications as well as secondary market underwriting, but no direct client business.

## Highlights 2005

**New York exceeds budget targets.** In comparison to 2004 the volume of commitments rose by 25% to EUR 1.8 billion; in contrast the size of the overall loan portfolio remained stable as a result of a moderate increase in corporate lending and a minor reduction in trade finance volumes. Operationally, the New York Branch also registered a very satisfactory development, as it exceeded budget by approximately 16%, achieved a fully-allocated return on capital in excess of 25% and cut general expenses by 5% while maintaining a stable headcount. Additionally, loan portfolio quality was further improved while enhancing portfolio liquidity and diversity, to the extent that no specific credit provisions were required during the year.

**London Branch with low credit costs.** Despite the upheaval and the big challenges in the airline industry and in aircraft finance, the branch has managed the existing portfolio well and incurred low credit expenses in 2005. In executing selected new leasing transactions, it benefited from the experience gained in the last business cycle. As for Western European acquisition finance, the market was somewhat sluggish in 2005. Overall, commitments rose from EUR 2.5 billion in 2004 to EUR 2.8 billion in 2005, or 11%. For 2006 the signs are for stronger growth, which should lead to an improved deal flow.

**Hongkong outperforms targets.** Notwithstanding continued pressure on lending margins and with the benefit of lower than planned credit costs, all 2005 financial targets were surpassed. 2005 loan volume, as measured by commitments, exceeded last year's level by 25% and reached EUR 2.3 billion, primarily as a result of increased lending to financial institutions. The focus continued to be on the maintenance of a high-grade portfolio of regional credit exposures principally to governments and their related entities, financial institutions, industry leading corporate entities engaged in staple industries and asset backed securities. The investment grade portion of the loan portfolio was maintained at 87%.

**Vienna Profit Center.** In spite of sizeable redemptions, the Vienna Profit Center has grown its commitments by EUR 1.9 billion or 25%, to a total exposure of EUR 9.5 billion. At the same time credit quality remained stable, with a share of assets rated investment grade of 86%. Some 96% was concentrated financial institutions and sovereign borrowers. The proportion of credit default swaps continued to grow and represented approximately one third of the portfolio at the end of 2005.

### Outlook 2006

In 2006, we will continue to implement our conservative credit policy. We will pay close attention to the selection of transactions in light of the weak demand on the one hand and high liquidity on the other. As has been the case for many years, the capital efficiency of individual transactions will be among the top criteria in our credit decisions, given the implementation of Basle II. In order to overcome the expected pressure on margins, we plan to examine alternative investment opportunities to a greater extent.

### Financial review

in EUR million	2005	2004
Pre-tax loss	158.5	120.4
Net loss after taxes and minority interests	113.2	93.6
Cost/income ratio in %	19.7	19.1
Return on equity in %	22.9	22.8

In 2005, net profit after taxes and minority interests advanced by a substantial 20.8%, or EUR 19.6 million, from EUR 93.6 million to EUR 113.2 million. This favourable earnings growth was primarily due to the increased lending volume in Vienna, while the foreign subsidiaries also contributed as a result of the decrease in risk provisions, which benefited from unexpectedly high loan recoveries as well as necessary releases of existing provisions. The cost/income ratio rose slightly from 19.1% to 19.7%, while the return on equity remained essentially unchanged at 22.9%.

Despite the expected narrowing of credit margins and restrained volume growth on account of unfavourable market conditions, net interest income increased by a slight 1.3%, or EUR 2.0 million, from EUR 150.8 million to EUR 152.7 million. In particular, the New York Branch's results were slightly below expectations on account of depressed secondary market activity, weak demand from Latin American banks and lower margins.

Net commission income posted a very satisfactory increase of 30.5%, or EUR 6.9 million, from EUR 22.5 million to EUR 29.4 million. This rise resulted from one-off gains in the area of securities transactions and increased volume, mainly in Hong Kong and Vienna. The net trading result contracted slightly by EUR 1.7 million.

General administrative expenses rose by 7.2%, or EUR 2.4 million, from EUR 33.4 million to EUR 35.8 million, driven by higher personnel costs and currency effects. The other operating result advanced sharply by EUR 7.7 million from a loss of EUR 5.7 million to a gain of EUR 2.0 million as a result of the decline in impairment charges on other financial assets.



## CORPORATE CENTER

**Business profile.** The Corporate Centre segment encompasses those banking activities that do not qualify for direct allocation to business lines, including non-banking subsidiaries, e-business and subsidiaries that provide marketing, organisation, information technology and other support services. The Corporate Centre segment also includes intragroup profit and loss eliminations, which make line-item and period-to-period comparisons of the results of this segment not meaningful. By reporting the one-time effects of business disposals and expenses for group-wide projects in the Corporate Centre segment, we seek to improve the period-to-period comparability of the results of our core business segments.

### BUSINESS REVIEW

#### Highlights 2005

**Effective marketing.** Last year, our marketing activities in Austria focused on wealth creation and estate transfer. Through our initiatives to sell securities based savings plans, we contributed to the increase in securities volume. The estate transfer theme continues to play a growing role in the light of demographic changes. Last year, we made further progress towards our goal of positioning ourselves as a long-term and forward looking partner for financial planning in the estate transfer area.

In Central and Eastern Europe, Erste Bank Hungary successfully borrowed from a current advertising concept in Slovakia. This represented a first use of major synergies and enabled us to repeat the success of the concept in Hungary. In Serbia, the decision was reached in October 2005 to re-brand Novosadska Banka under the Erste Bank Serbia name. In the Czech Republic, we finished integrating the marketing departments of the local bank subsidiaries into the marketing department of Česká spořitelna. This move generated significant synergies and further strengthened the Česká Spořitelna brand as the major distribution channel for products of the subsidiaries such as leasing, insurance and mortgage savings plans.

**Increased use of electronic channels.** In 2005, we also stepped up our efforts to shift standardised services towards complementary online distribution channels. In the retail banking segment, we saw an increase in the number of clients who registered for – and regularly used – netbanking, the online service of Erste

Bank and the savings banks. Last year, the number of registered users at Erste Bank and the savings banks increased by 11% from 570 thousand to 633 thousand, while the use of netbanking by retail clients increased by a disproportionate 18.8% from 240 thousand to 285 thousand.

In 2006, the multichannel management activities will continue to focus on adapting the product range and service processes to online distribution channels and making them directly accessible in order to further improve and expand rapid and transparent processing. For retail banking clients, we will redouble our efforts to increase the use of direct access and online services. For our corporates and SME clients, we will continue to exploit all possibilities for shifting transaction services from paper-based to electronic payments.

#### Financial review

in EUR million	2005	2004
Pre-tax loss	73.4	53.0
Net loss after taxes and minority interests	81.1	86.9
Cost/income ratio in %	-	-
Return on equity in %	-	-

The trends for net commission income and general administrative expenses were largely determined by profit consolidation of bank support operations, as general administrative expenses rose in large part through capital expenditure for group-wide projects launched in 2004, reduced inter-company eliminations of group services for central European units and due diligence expenses. The deterioration in the other operating result was mainly due to the aforementioned non-recurring items assigned to the Corporate Center, in particular the proceeds from the sale of Investkredit in the fourth quarter of 2004 and gains on real estate disposals in the fourth quarter of 2005.

The major change in tax expense resulted from the non-recurring tax charge related to the write-down of deferred tax assets in the first quarter of 2004 as a result of the decrease in the Austrian corporation tax (KÖST) from 34% to 25% as of 1 January 2005.

# "Life is upside down"

Last year was an eventful one for the Miklosova family. For Andrea and her husband Erik, an engineer, the birth of their son Filipko, as he is affectionately called by his parents, was clearly the most exciting development. Since then, the now five-month-old baby has become the centre of the family. Far less eventful but not insignificant was the purchase of a new car. Every day, Erik Miklos commutes for a solid hour to reach his job as an air traffic controller at the Bratislava airport. Flexibility is crucial, given the difficult environment in the Slovakian job market. Even though the economy grew by 5.7% last year and the unemployment rate fell from 18.1%, unemployment remains high at 16.4%. Therefore one thing is clear for the Miklosova family: they want to stay in their home town of Sala.

**Erste Bank:** "Ms. Miklosova, you have a family now. Your son Filip is several weeks old."

Andrea Miklosova: "And everything revolves around him! (laughs) Isn't he wonderful? We are so lucky!"

**Erste Bank:** "Will you now all move to Bratislava, Herr Miklos, so that you can spend more time with your family?"

Erik Miklos: "It is true that during the week I don't get much time to be with my family. But in any event, we plan to remain in Sala."

Andrea Miklosova: "We feel very good here. Moreover, we have our family and friends nearby. And that is also important for later, when I start working again."

**Erste Bank:** "How long is your commute each day?"

Erik Miklos: "About two-and-a-half hours. Sure, it's long. Therefore I bought a new car. That makes the daily commute somewhat easier. And every evening I am happy to be home. I am already curious to

see when Filipko will really be able to greet me for the first time. For now he sleeps most of the time."

Andrea Miklosova: "Except at night!" (laughs)

**Erste Bank:** "With a child come many changes..."

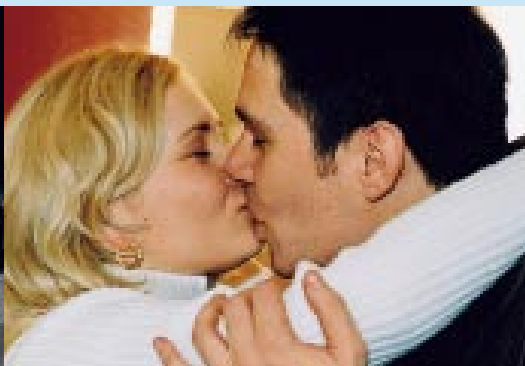
Andrea Miklosova: "For sure! With our little Filipko, for example, we will soon need more room. Therefore we will build a new house here in Sala. It should be ready by the end of 2008 at the latest."

Erik Miklos: "Also, Andrea is on maternity leave."

Andrea Miklosova: "But as soon as little Filip is ready, I would definitely like to go back to work. After all, I have a degree in business management, and I would like to put it to use. In addition, I took out a loan in order to pay for the studies. I would like to pay that off as quickly as possible."

**Erste Bank:** "We wish you the best of luck in that endeavour. We would like to remain your trusted partner in the future."

Erik Miklos: "We will certainly take you up on that for our new house!"



Miklosova family, clients of Slovenská sporiteľňa, Slovakia



# Credit Risk Report

## INTRODUCTION

The credit exposure corresponds to the total of the balance sheet items loans and advances to credit institutions and loans and advances to customers, all fixed-income securities (held in the trading book, other current assets or financial investments), off-balance sheet credit risks in the form of guarantees and letters of credit, and finally the investment portfolio of insurance company's Versicherung.

The Erste Bank Group's total credit exposure as of 31 December 2005 increased by 11.3%, or EUR 14.9 billion, relative to the previous year to reach EUR 146.9 billion. This increase broke down as follows: EUR 5.3 billion at Erste Bank AG (mainly interbank transactions and securities investments); EUR 5.8 billion at the subsidiaries in the central European core markets (growth in lending volume, in particular to private households); EUR 1.9 billion at the Haftungsverbund and independent savings banks (mainly growth in the retail lending business); EUR 1.1 billion at s Versicherung.

## RISK CLASSES

The allocation of credit exposure into the following risk classes is based on internal client rating systems, which comprise five rating levels for private individuals and 14 rating levels for corporate clients. Credit exposure is divided into the following risk classes.

**Low risk:** the borrower demonstrates a strong repayment capacity; new business generally involves clients in this risk class.

**Management attention:** the borrower's financial situation is in effect good, but his repayment ability may be negatively affected by unfavourable economic conditions. New business with clients in this risk class requires adequate structuring of the credit risks, e.g. by way of collateral.

**Substandard:** the borrower is vulnerable to negative financial and economic impacts; such loans are managed in specialised risk management departments.

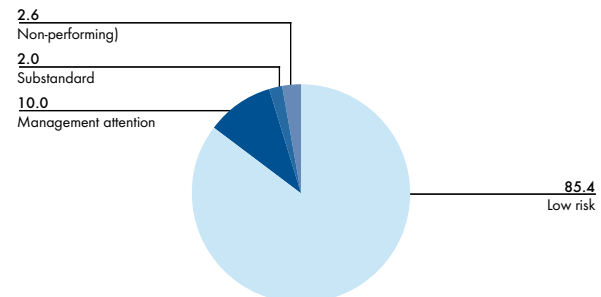
**Non-performing:** at least one of the default criteria under Basle II, e.g. total repayment unlikely, interest or principal payment more than 90 days past due, restructuring resulting in a loss to lender, realisation of a loan loss, or opening of bankruptcy proceedings.

## CREDIT RISK REVIEW

### Overall trend

The increase in overall credit exposure was limited to the two best risk classes (low risk and management attention). Credit exposure with high default risk posted significant declines, while the non-performing class contracted slightly.

**Credit exposure by risk class in 2005 (in %)**



Of Erste Bank Group's total credit exposure, 85.4% was concentrated on the best risk class and 10% on the second-best, while the relative shares of the two highest-risk classes contracted significantly.

## Credit exposure by risk class – 2005 vs 2004

in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Total exposure at 31 Dec 2005	125,296	14,751	2,973	3,833	146,853
% of total	85.3	10.0	2.0	2.6	100.0
Risk provisions at 31 Dec 2005	106	152	514	2,115	2,886
% of exposure	0.1	1.0	17.3	55.2	2.0
Total exposure at 31 Dec 2004	112,235	12,406	3,473	3,879	131,993
% of total	85.0	9.4	2.6	2.9	100.0
Risk provisions at 31 Dec 2004	93	107	484	2,185	2,869
% of exposure	0.1	0.9	14.0	56.3	2.2
Change in total exposure in 2005	13,061	2,345	-500	-46	14,861
% change	11.6	18.9	-14.4	-1.2	11.3
Change in risk provisions in 2005	13	45	30	-71	17
% change	14.0	42.1	6.1	-3.2	0.6

## Credit exposure by risk class/Austria

in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Total exposure at 31 Dec 2005	51,651	10,672	2,305	2,932	67,559
% of total	76.5	15.8	3.4	4.3	100.0
Risk provisions at 31 Dec 2005	21	38	372	1,560	1,992
% of exposure	0.0	0.4	16.2	53.2	2.9
Total exposure at 31 Dec 2004	49,591	9,242	2,894	3,033	64,760
% of total	76.6	14.3	4.5	4.7	100.0
Risk provisions at 31 Dec 2004	12	20	391	1,577	2,001
% of exposure	0.0	0.2	13.5	52.0	3.1
Change in total exposure in 2005	2,060	1,430	-590	-102	2,799
% change	4.2	15.5	-20.4	-3.3	4.3
Change in risk provisions in 2005	9	18	-19	-17	-9
% change	74.2	87.1	-4.8	-1.1	-0.5

In Austria, total credit exposure rose by EUR 2.8 billion, or 4.3%, primarily as a result of increases in retail lending by the Haftungsverbund savings banks and investments by s Versicherung equalling EUR 1.1 billion. The bulk of the growth was recorded in the two best risk classes, as shown in the associated table.

## Credit exposure by risk class/Outside Austria

in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Total exposure at 31 Dec 2005	73,645	4,080	668	901	79,295
% of total	92.9	5.1	0.8	1.1	100.0
Risk provisions at 31 Dec 2005	84	114	142	555	894
% of exposure	0.1	2.8	21.2	61.5	1.1
Total exposure at 31 Dec 2004	62,644	3,164	578	846	67,233
% of total	93.2	4.7	0.9	1.3	100.0
Risk provisions at 31 Dec 2004	80	86	93	608	868
% of exposure	0.1	2.7	16.1	71.9	1.3
Change in total exposure in 2005	11,001	915	90	55	12,062
% change	17.6	28.9	15.6	6.6	17.9
Change in risk provisions in 2005	4	27	48	-54	26
% change	4.9	31.5	51.9	-8.8	3.0

Credit exposure outside Austria increased by nearly EUR 12.1 billion, or 17.9%. This increase was driven mainly by the interbank transactions and securities business of Erste Bank AG and the growth in lending volume in Central Europe. Here as well, as shown in the table above, the increase was almost entirely concentrated on the two best risk classes.

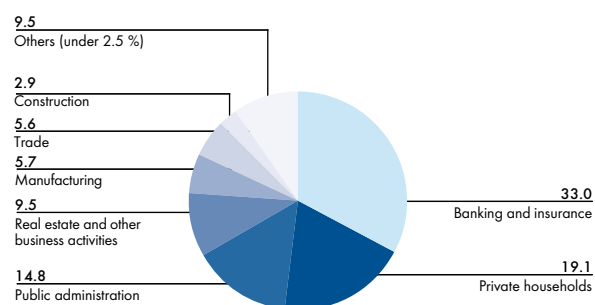
## CREDIT RISK BY SECTOR

As in previous years, sector exposure was concentrated mainly in banking and insurance, private households and public administration. Combined, these sectors accounted for approximately two-thirds of total exposure. These sectors were followed by real estate and other business services, manufacturing and trade. With the exception of construction, all the other sectors accounted for less than 2.5% of the total. Thus once again the sector mix was balanced, with an appropriate degree of risk diversification.

The sector distribution at Group level is representative of most individual companies in Erste Bank Group. The Group is very

much a retail bank, with a largely uniform risk structure. Any deviations from this pattern are found mainly at companies with specialised products, such as s Bausparkasse, s Wohnbau-bank (real estate) and Immorent (leasing).

## Credit risk by sector in 2005 (in %)



## Credit risk by sector/Total

in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Agriculture and forestry	639	453	66	76	1,234
Mining	347	551	43	22	963
Manufacturing	5,859	1,547	517	457	8,379
Energy and water supply	1,134	259	30	11	1,435
Construction	2,846	913	213	301	4,274
Trade	5,186	1,942	564	483	8,175
Tourism	1,422	1,255	335	405	3,417
Transport and communication	1,942	612	196	184	2,933
Banking and insurance	47,514	799	66	40	48,419
Real estate and other business activities	9,414	3,707	374	524	14,019
Public administration	21,411	217	13	23	21,664
Healthcare and social services	678	412	31	44	1,166
Other services	1,137	581	105	140	1,964
Private households	25,063	1,442	418	1,111	28,033
Other	703	62	2	10	778
<b>Total</b>	<b>125,296</b>	<b>14,751</b>	<b>2,973</b>	<b>3,833</b>	<b>146,853</b>



## Credit risk by sector/Austria

in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Agriculture and forestry	305	391	50	55	802
Mining	80	293	35	16	424
Manufacturing	2,784	1,016	313	335	4,448
Energy and water supply	423	139	14	9	587
Construction	2,045	782	202	273	3,302
Trade	2,830	1,340	485	398	5,052
Tourism	878	1,027	308	336	2,549
Transport and communication	1,008	411	84	86	1,588
Banking and insurance	12,345	215	37	14	12,610
Real estate and other business activities	5,619	2,956	328	453	9,355
Public administration	5,846	57	7	3	5,912
Healthcare and social services	564	368	27	38	997
Other services	624	487	70	91	1,272
Private households	16,225	1,176	344	822	18,566
Other	76	14	1	4	95
<b>Total</b>	<b>51,651</b>	<b>10,672</b>	<b>2,305</b>	<b>2,932</b>	<b>67,559</b>

The EUR 2.8 billion increase in overall credit exposure in Austria resulted from a EUR 3.2 billion increase in the private household, banking and insurance and real estate and other business services sectors, which was partially offset by declining exposure in other sectors.

## Credit risk by sector/Outside Austria

in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Agriculture and forestry	334	62	16	21	433
Mining	267	257	8	7	539
Manufacturing	3,074	530	204	123	3,931
Energy and water supply	711	119	16	2	848
Construction	802	131	11	29	973
Trade	2,356	602	79	85	3,123
Tourism	545	228	26	69	868
Transport and communication	934	202	112	98	1,345
Banking and insurance	35,170	584	29	26	35,809
Real estate and other business activities	3,795	751	46	71	4,664
Public administration	15,566	161	6	20	15,752
Healthcare and social services	114	44	4	7	168
Other services	514	94	35	50	692
Private households	8,838	266	74	289	9,467
Other	628	48	2	6	683
<b>Total</b>	<b>73,645</b>	<b>4,080</b>	<b>668</b>	<b>901</b>	<b>79,295</b>

Outside Austria, the banking and insurance and public sectors accounted for EUR 6.3 billion of the overall EUR 12.1 billion increase in risk exposure. The private household sector's exposure also rose by a significant 47.0%, or EUR 3.0 billion. The growth in retail lending in Central Europe accounted for the bulk or EUR 2.5 billion of this increase.

In 2005, the non-Austrian share of risk exposure increased from 51% of the total to 54%. However, no significant change in Erste Bank Group's overall risk exposure resulted from this.

## CREDIT RISK BY REGION

In the following table, credit exposure is broken down by the home country of the borrower; the distribution among the Erste Bank Group subsidiaries can be seen in the breakdown by segments.

The overall increase of EUR 14.9 billion broke down as follows: EUR 2.8 billion, or 19% in Austria, EUR 8.4 billion or 56% in the central European home markets EUR 2.8 billion or 19% in other EU and industrialised countries and EUR 0.9 billion or 6% in emerging markets.

## Credit risk by region

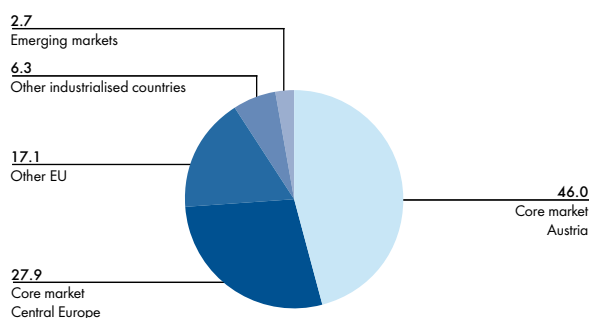
in EUR million	Low risk	Management attention	Substandard	Non-performing	Total exposure
Core market	89,322	12,890	2,826	3,537	108,575
Austria	51,651	10,672	2,305	2,932	67,559
Croatia	4,090	516	143	136	4,885
Romania	253	17	1	0	271
Serbia	275	12	45	21	354
Slovakia	6,010	418	161	83	6,671
Slovenia	1,120	188	18	35	1,362
Czech Republic	18,014	432	87	197	18,730
Hungary	7,909	635	66	134	8,743
Other EU	24,059	852	73	198	25,182
Other industrialised countries	8,815	274	39	69	9,197
Emerging markets	3,101	736	34	28	3,899
Southeastern Europe / CIS	623	240	2	0	865
Asia	1,133	93	0	3	1,229
Latin America	757	65	31	2	855
Middle East / Africa	588	338	1	23	949
<b>Total</b>	<b>125,296</b>	<b>14,751</b>	<b>2,973</b>	<b>3,833</b>	<b>146,853</b>

The volume increase in Central Europe resulted from both organic growth at the subsidiary banks and increased cross-border lending, especially at Erste Bank AG. In the other EU and industrialised countries, interbank transaction volume increased.

Erste Bank Group's core markets and the European Union accounted for 91% of the Group's overall risk exposure.

Volume in the emerging markets increased by a total of EUR 0.9 billion but at 2.7% remained relatively insignificant.

### Credit risk by region in 2005 (in %)



## CREDIT RISK BY SEGMENT

This section describes the composition of credit exposure based on reporting segments. Exposure is allocated based on the domicile of Group entities that carry the credit risk on their books.

### Credit risk by segment

	Low risk	Management attention	Substandard	Non-performing	Total exposure	Non-performing loans	Total risk provisions	NPL Coverage
in EUR million								in%
Austria	75,544	12,267	2,431	3,275	93,517	3,275	2,168	66.2%
Central Europe	32,915	1,699	470	500	35,584	500	602	120.4%
International Business	16,439	784	72	58	17,353	58	116	199.8%
Corporate Center	397	1	0	0	398	0	0	
<b>Total</b>	<b>125,296</b>	<b>14,751</b>	<b>2,973</b>	<b>3,833</b>	<b>146,853</b>	<b>3,833</b>	<b>2,886</b>	<b>75.3%</b>

The differences in provisioning levels for the segments resulted from the risk situation in the respective markets, regulatory requirements and the local legal environment.

## NON-PERFORMING LOANS (NPLs) AND RISK PROVISIONS

Credit assets are classified and reported as non-performing if one or more of the default criteria set out by Basle II are met. The NPL amounts presented here constitute gross volumes, meaning that collateral has not been deducted.

On average in the Group, risk provisions covered 75.3% of reported NPLs. As NPLs include secured outstandings, this level can be considered sufficient, especially when taking into account the actual loss experience given default. By adopting the Basle II definition of default in 2002, Erste Bank chose a conservative approach.

In 2005, NPL fell slightly by EUR 46 million, or 1.2%, to EUR 3,833 million. A slight increase in Central Europe related to the consolidation of Erste Bank Serbia was offset by declines in Austria and the international business. Meanwhile, risk provisions for NPLs rose to EUR 2,886 million (up EUR 17 million, or 0.6%), with in particular an increase in risk provisions in Central Europe as a result of the first-time inclusion of Erste Bank Serbia. This resulted in a 1.3 percentage point increase in NPL coverage through risk provisions versus last year.

## CREDIT RISK SEGMENT REPORT

### AUSTRIA

In 2005, Austria's stable but modest economic growth and higher energy prices caused many companies to implement capacity-adjustment, cost-reduction and productivity-enhancing programmes. Larger companies cleaned up their balance sheets, and demand for credit softened as margin pressures increased.

In 2005, Austria had 7,056 bankruptcies, up 11.7% from the previous year. The corresponding bankruptcy liabilities contracted by 4% to EUR 2.4 billion, however. Household bankruptcies rose by nearly 16% last year to reach 6,460. This development was instigated by improved debtor education and the economic environment. Further increases are expected for 2006.

## Corporate bankruptcies in Austria in 2005

	2005	2004	Change
Total bankruptcies	7,056	6,318	+ 11.7%
Estimated bankruptcy liabilities in EUR	2.4 billion	2.5 billion	- 4.0%

## Household bankruptcies in Austria in 2005

	2005	2004	Change
Total bankruptcies	6,460	5,573	+ 15.9%
Estimated bankruptcy liabilities in EUR	763 million	697 million	+ 9.5%

Sources: WIFO, KSV.

### **Savings Banks**

In 2005, the risk exposure of the Haftungsverbund savings banks increased by EUR 1.6 billion, or 5.2%, to EUR 33.1 billion. Their share relative to the overall total contracted to 22.5% as a result of below-average growth. Non-performing loans contracted by 2.3%, and their share relative to the total loan volume for Haftungsverbund savings banks contracted slightly from 5.2% to 4.9% even as the cover ratio through provisions increased to 77.4%.

Foreign risk exposure increased from 11.3% to 13.3%, mainly in the core market. No major changes occurred in the sector distribution, with the exception of household exposure, which as a share of the overall total increased by 1.8 percentage points to 28.7%. Once again, private households and real estate represented the largest sectors.

Since the savings banks are regional institutions, credit growth varied according to local economic conditions. Retail lending tended to increase at a stronger rate than did corporate credit.

### **Retail and Mortgage**

In 2005, the retail and mortgage credit exposure of Erste Bank and its subsidiaries assigned to this segment – notably Salzburger Sparkasse, Tiroler Sparkasse, s Bausparkasse, s Wohnbaubank and s Versicherung – increased by EUR 28.3 billion. Non-performing loan exposure decreased by 8.8% to EUR 1.0 billion.

**Retail.** Rating systems for retail clients are implemented comprehensively and effectively support risk mitigation.

The rating system implemented in late 2004 for small business and professional clients, which enables a rapid assessment of their risk situation and thereby the possibility to adopt early measures to avoid or minimise risk, is already providing initial results. Moreover, since the second half of 2005, clients in sectors with a higher default risk are subject to a special review procedure.

The risk management system will be further enhanced in 2006 through the scheduled launch of risk assessment software for new credit applications (credit analysis).

**Mortgage.** The satisfactory quality of the loan portfolio at all of Erste Bank's specialised mortgage financing units was managed successfully once again through the continued application of a conservative credit risk policy. Lending volumes increased by around 3%, with the low risk class continuing to account for a relatively high percentage of the overall total (75%). Management attention class exposure increased by around 18%, while the substandard and non-performing class exposures contracted by 14.5% and 5.1%, respectively.

The residential construction loan portfolio of s Bausparkasse der österreichischen Sparkassen AG, well secured through mortgages and broadly diversified throughout Austria, remained characterised by its traditional low default risk. s Wohnbaubank AG's lending situation is also noteworthy, with a well-structured portfolio that so far has remained free of default.

**SME business.** The successful completion of the restructuring started in 2003 yielded good results in the SME business unit in 2005. In that context, the volume of low risk credit exposure increased by 17.2%, while volumes in the management attention, substandard and non-performing classes decreased by 3.3%, 23.3% and 14.4%, respectively. With the addition of new clients and expansion of loans with lower default risk, overall credit volume increased by 2.1% relative to the previous year.

In 2005, the unsecured portion of loans was further reduced through successful maintenance of the business focus. This was achieved mainly through strict collateral requirements, risk-adjusted pricing and the selective addition of new clients.

In terms of sector distribution, lending was concentrated mainly on manufacturing, trade and other business services.

### Large Corporates

In 2005, the risk exposure of the credit portfolio was further reduced. Volume in the substandard risk class contracted significantly by 66.3%, while the management attention and non-performing classes increased by only 5.5% and 2.0%, respectively.

In the area of property and project financing, lending volume increased by a slight 1.2% in 2005, while the portfolio's risk exposure and collateral coverage improved. Volume in the low risk class increased by around 47%, while volumes in the management attention, substandard and non-performing classes contracted by 10.7%, 86.7% and 12.7%, respectively.

No defaults were observed in this subsegment last year. The quality of the portfolio was further improved, and ample provisions have been established to cover the few remaining risks. In terms of the portfolio's sector composition, real estate and other business services accounted for some 71%, while tourism made up around 22%.

### Trading and Investment Banking

In the treasury business (money market, derivatives business, securities business), Erste Bank assumes mainly partner risks with banks and sovereign borrowers, for which a limit is established and adjusted where necessary. To a limited extent, the treasury business assumes some corporates-related risks.

### CENTRAL EUROPE

#### Česká spořitelna

The quality of overall loans to customers (EUR 9.8 billion) improved in relative terms. Despite the substantial lending volume growth in 2005, the relative share of non-performing loans – loans more than 90 days overdue – decreased from 1.8% to 1.6%. The overall volume of non-performing loans changed only slightly, rising from EUR 136 million to EUR 144 million.

Regarding the quality of individual client segments, the corporate and retail portfolios were marked by contrasting trends. The quality of corporate loans improved significantly due to a positive economic environment, which resulted in an extremely low level of defaults. The corporate portfolio still contains EUR 33 million in historical non-performing loans in the work-out stage.

While the retail segment lending portfolio continued to grow significantly in 2005, its share of non-performing loans remained stable at 2.3%. In absolute terms, they increased by EUR 26 million. This increase was driven almost solely by a new consumer lending product.

In 2005, the volume of loan loss reserves decreased from EUR 192 million to EUR 174 million mainly due to increased usage of existing reserves. Coverage of non-performing loans by total loan loss reserves decreased to 121% (compared with 141.4% at end-2004).

#### Slovenská sporiteľňa

Loan loss provisioning and asset protection remained on a very comfortable level, the share of non-performing loans declined from 7% at end-December 2004 to 3.6% last year, with an adequate provision level of approximately 60%. Including collateral, NPL coverage remained at more than 90% on average. Due to the switch from the previous National Bank category to a new internal rating risk assessment and provisioning system (in accordance with IAS 39 requirements) the detailed provisioning figures for 2004 and 2005 are not directly comparable, but the total coverage remains comfortable.

### **Erste Bank Hungary**

The general quality of the credit portfolio improved last year. In retail lending this was due to regular monitoring of non-performing loans, while in corporate lending this was due to the restructuring of the corporate work-out department and the establishment of an intensive care unit, which led to a recovery rate of nearly 90%.

In 2005, the non-performing loan volume decreased from 2.4% to 2.3% of total lending volume. Coverage of non-performing loans by specific provisions increased from 48.5% to 50.0%.

### **Erste Bank Croatia**

Erste Bank Croatia posted positive trends in all parts of the portfolio in 2005.

With the exception banks and the public sector, the total exposure coverage through the overall risk provisions was permanently lowered thanks to a strong increase in the portfolio and good work-out collection. Their combined impact was a reduction in risk provisions.

In the area of corporate lending corporate work-out collection in the first quarter, resulted in a strong decrease in specific provisions. The risk distribution was positive throughout the year in both absolute and relative terms. The relative share of the low risk class increased from 77.5% to 80.6%, and portions of all other rating classes, especially non-performing loans, were permanently lowered.

### **Erste Bank Serbia**

Erste Bank Serbia was consolidated into Erste Bank Group for the first time in 2005. The loan portfolio of EUR 149 million is small from a group perspective and it is 36.2% covered by risk provisions. In the usual integration project the risk management function will be upgraded to Erste Bank standards.

### **INTERNATIONAL BUSINESS**

Credit risk developed favourably in the International Business segment. Thanks to the low level of new defaults, the volume of non-performing loans decreased. In contrast risk provisions decreased only slightly, resulting in a NPL coverage ratio of nearly 200%.



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