

7th Capital Markets Day –

4 October 2010, Dubrovnik, Croatia

Taking stock after 20 years of transformation –

Czech Republic: Safe haven in stormy times

Gernot Mittendorfer, CEO, Česká spořitelna

– Long-term economic development patterns

- Economic and political timeline
- Economic scorecard: real economy, fiscal performance & monetary policy
- Social indicator scorecard: backing up economic progress
- Focus topic: charting the development of residential real estate

– Evolution of the banking market

- The emergence of retail banking
 - Moving away from the cash economy
 - The loan growth story
 - Wealth creation: from deposits to fund management
- The transformation of corporate banking
 - From recklessness in the early years to responsible financing

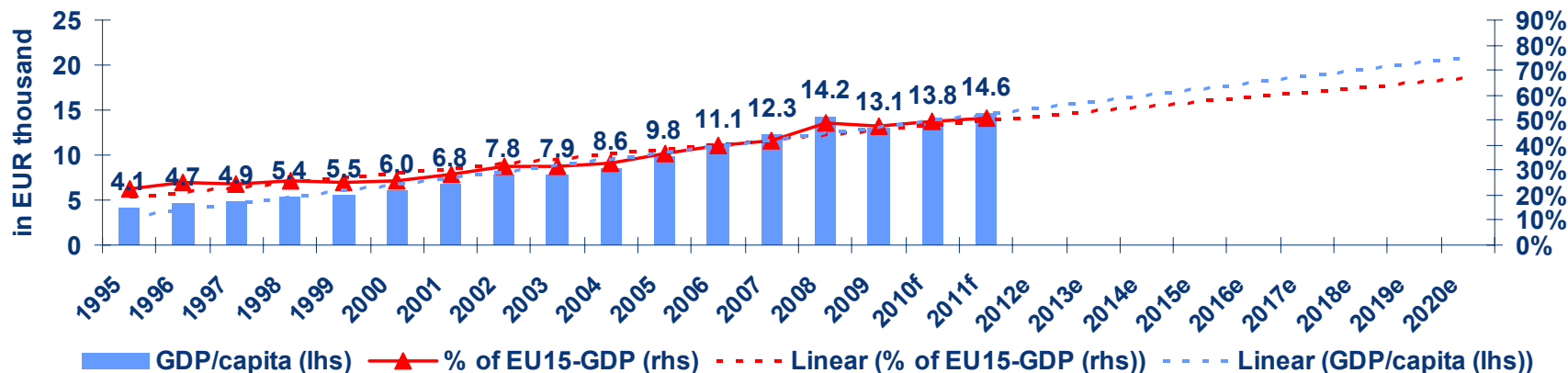
– Post-acquisition track record of Česká spořitelna

- Long-term financial performance
- Analysing credit risk
- Conclusion

Economic and political timeline –

The definition of successful economic convergence

Czech Republic - GDP/capita vs % of EU15 GDP/capita



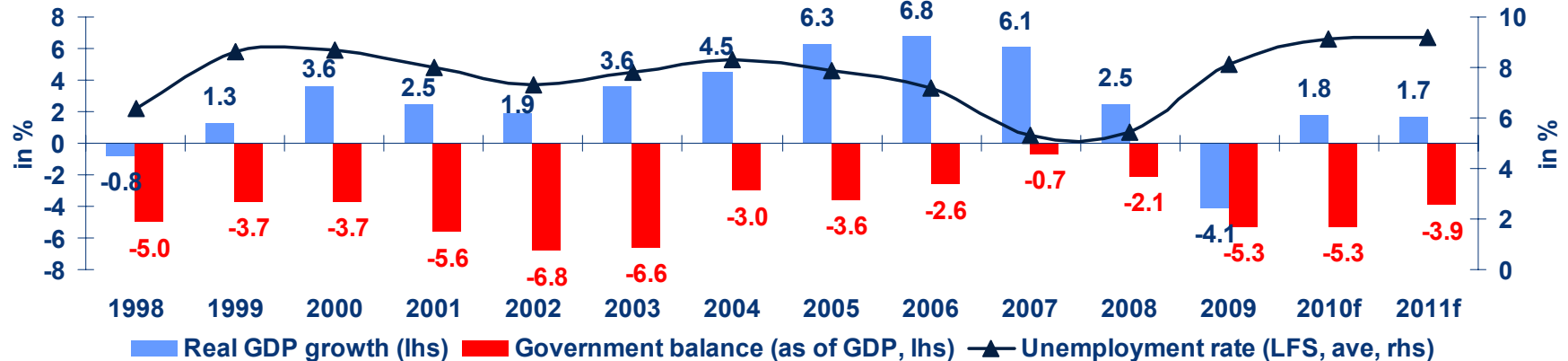
1992-1998 V. Klaus (right)	1998-2002 M. Zeman (left)	2002-2006: Leftist governments	2006-2009: M. Topolánek (right)	since 2010: P. Nečas (right, Gov. of fiscal consolidation)
<ul style="list-style-type: none"> » Break-up of Czechoslovakia; privatization process » 1995: financial account liberalization; retaining fixed exchange rate » Currency crisis in 1997-1998 led to floating of CZK and to inflation targeting of CNB » Debt/GDP: end-1998 at 15% of GDP 	<ul style="list-style-type: none"> » Minority government of Leftist CSSD tolerated by Rightist ODS » Economy reeling from recession caused by currency crisis and possibly aggravated by policy response » Thereafter, gradual stabilization, increase of FDI » 1999: NATO entry » Debt/GDP: end-2002 at 28.2% 	<ul style="list-style-type: none"> » May 2004: Entry to European Union » Slender majority hindering the government (101/200 seats) » Economy expanding strongly (average GDP growth of 5.3% p.a. 2003-2006 due to FDI continuing to grow) » Exports support growth » Debt/GDP: end-2006 at 29.4% 	<ul style="list-style-type: none"> » ODS-led government again crippled by having only 100 seats in Parliament. Government finally stepped down in March 2009 » Czech Republic still without comprehensive pension, healthcare reforms » Global economic crisis begins, economy falls 4% in 2009 » Debt/GDP: end-2009 at 35.4% 	<ul style="list-style-type: none"> » Recovery begins, economy profiting from tight links to Germany » May elections brought right-wing government to power, decisive majority finally (118/200) » Government intends to get fiscal deficit to below 3% of GDP by 2012 » Consolidation to be mostly expenditure-based » Pension reform planned

Source: Eurostat, Erste Group Research

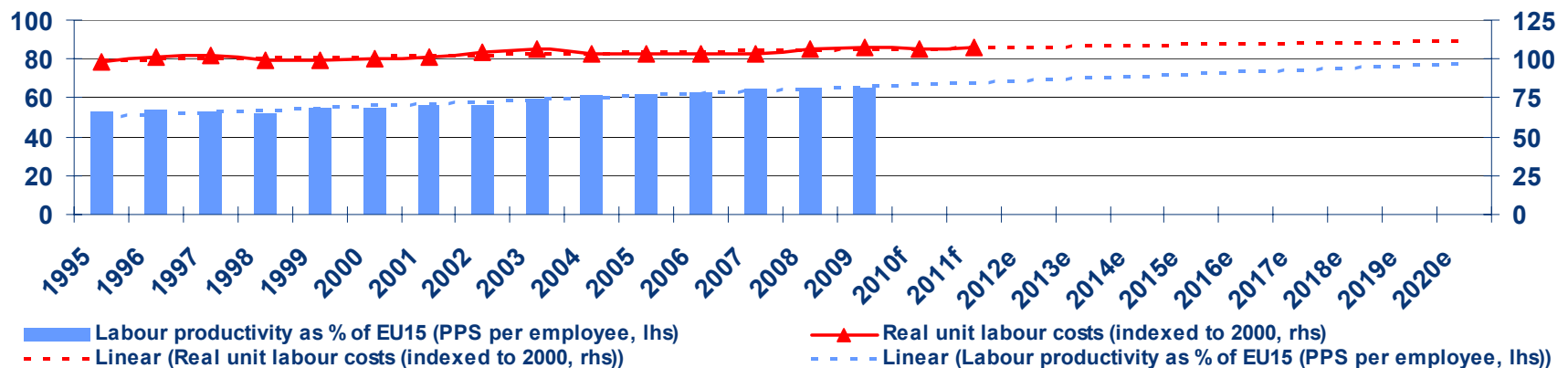
Economic scorecard: the real economy –

Competitive real economy paired with fiscal stability

Czech Republic - Real GDP growth vs fiscal balance vs unemployment rate



Czech Republic - Labour productivity vs real unit labour costs

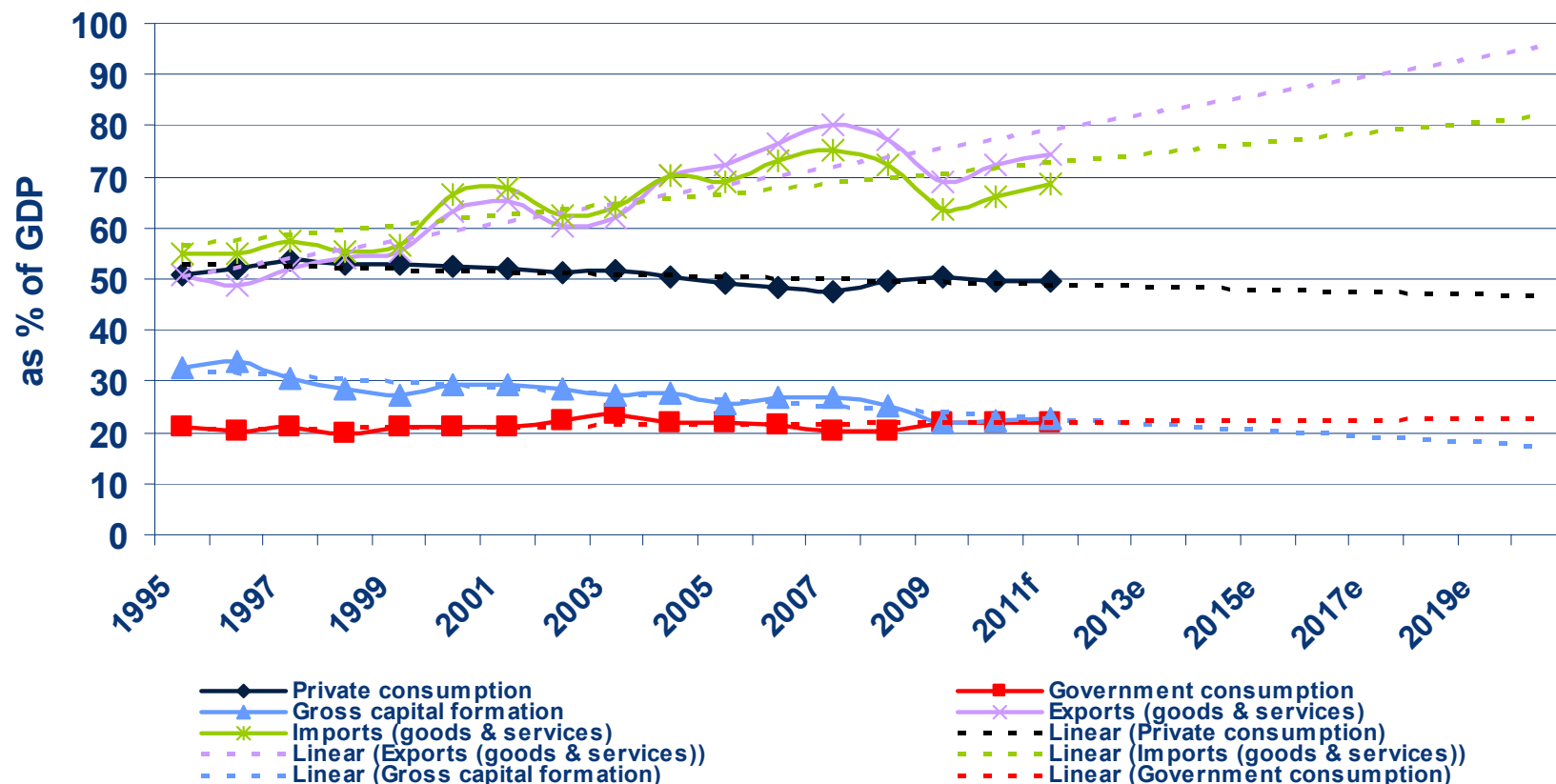


Source: Eurostat, Erste Group Research

Economic scorecard: GDP composition –

Rising trade surplus fuels GDP growth

Czech Republic: Composition of GDP - expenditure approach



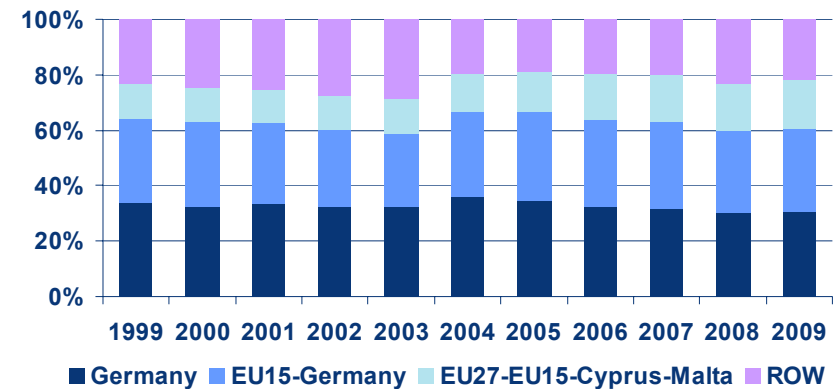
Source: Eurostat

Economic scorecard: trade drilldown –

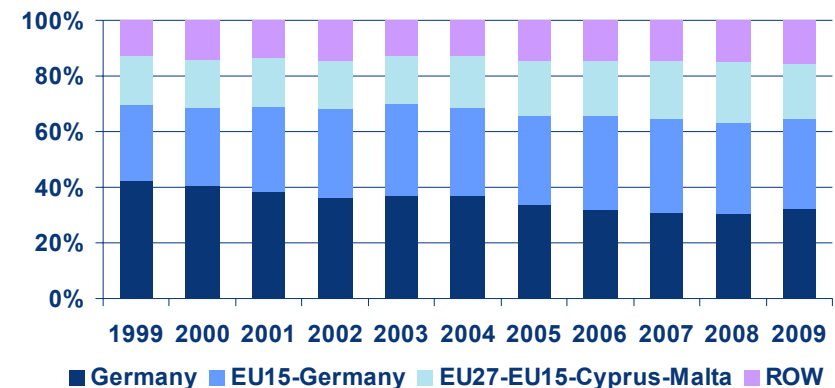
EU15, CEE are biggest export markets

- **Czech Republic has a very open economy**
 - Export of goods account for 58% of GDP
- **Tightly linked to global economy via Western Europe**
 - 33% of exports to Germany alone
 - 65% of total exports generated by EU15 countries
- **Largest non-EU export partners are Russia and USA**
 - Russia: 2%; USA: 1.5% of total exports
- **Main trade items are machinery and transport goods**
 - Skoda has become a popular car brand in Western Europe

Czech Republic - Goods import distribution



Czech Republic - Goods export distribution

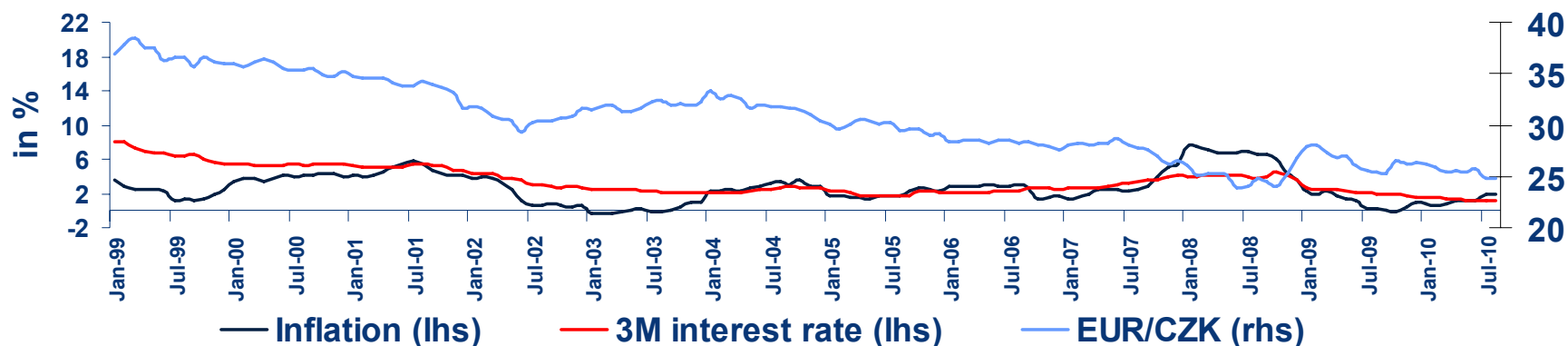


Source: Eurostat

Economic scorecard: monetary policy –

Strong currency, low inflation underpin stable economy

Czech Republic: Inflation, interest rate, exchange rate



1992-1998 V. Klaus (right)	1998-2002 M. Zeman (left)	2002-2006 Leftist governments	2006-2009: M. Topolánek (right)	since 2010: P. Nečas (right, Gov. of fiscal consolidation)
<ul style="list-style-type: none"> » Monetary policy played a stabilizing role during shock phase of adjustment » Interest rates were high (peaking at 39% for repo in June 1997) » Fixed currency rate & capital account liberalization = increased money supply and pressure on trade balance » Currency crisis in summer 1997 and recession 1998 	<ul style="list-style-type: none"> » CZK stabilized, high interest rates worsening the recession » Interest rates then began to fall to normal levels (single-digit) as did inflation » Monetary policy targeted core inflation, heavy undershooting of target occurred at the end of 1998. » Interest rates fell further through '02 as CZK began appreciating on more balanced fundamentals, improved CA 	<ul style="list-style-type: none"> » Period of calm, strong growth of economy, "golden time of CZ economy", inflation subdued. » Interest rates were declining for most of the time (until '05) » CZK initially gave up gains not backed by economic fundamentals (until Spring 2004), thereafter embarked on 4 year long strengthening path 	<ul style="list-style-type: none"> » January 2006: New inflation target set at 3% \pm 1% » Rates consistently hiked to slow overheating economy, peaking in summer 2008 at 3.75% » Crisis hitting Czech Republic with full force in 2H/2009, rates falling rapidly to all-time lows 	<ul style="list-style-type: none"> » New inflation target: 2% \pm 1% » CNB's final rate cut in May, to 0.75% » Key for Czech Republic: the speed of Eurozone recovery, particularly dependence on Germany, and world trade » Demand inflation to pick up with recovery » Three central bankers hinting at rate hikes this year

Source: Eurostat, Bloomberg

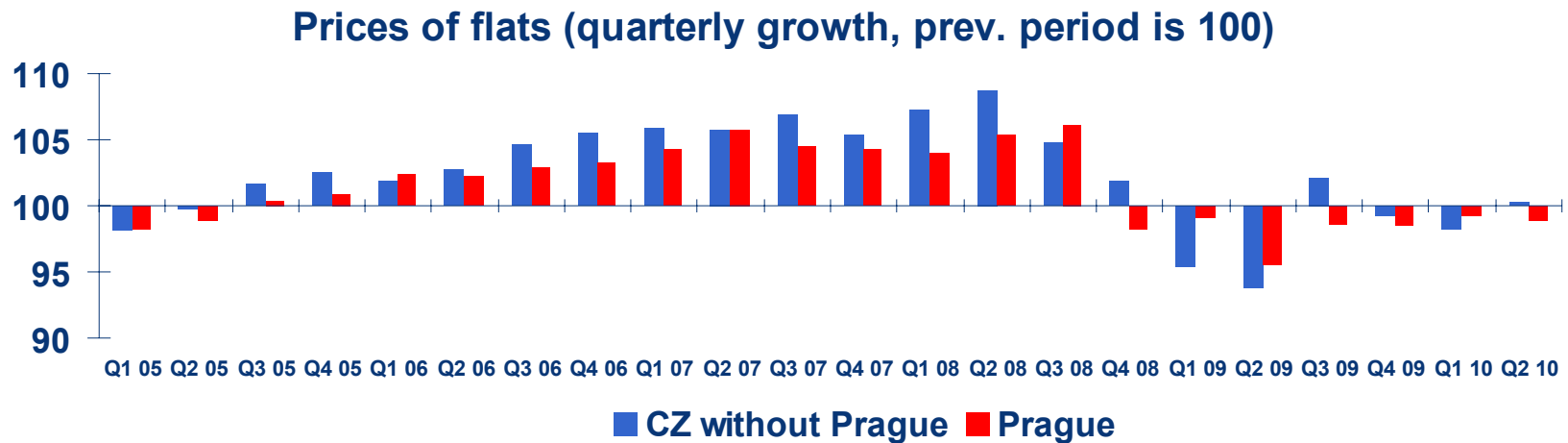
Social indicator scorecard –

Backing up economic progress

- **Life expectancy rose by 6 years (from 71.4 to 77.3) between 1990-2008**
 - Catch-up towards the European Union countries
 - Faster rise than in the majority of other European Union countries
- **Tertiary enrolment and number of graduates increased significantly**
 - 1998: 18 graduates per 1,000 people between age of 20-29
 - Represented one of the lowest figures in Europe
 - 2008: 59 graduates per 1,000 people
 - Similar to the Netherlands, Sweden, and Norway
- **Human Development Index rose from 0.847 (1990) to 0.903 (2007)**
 - Larger increase than in the USA, Finland, France, and the Netherlands, and identical with Austria

Focus: residential real estate development –

Gradual price growth interrupted by economic downturn



– Stable price development in the real estate market

- Gradual increase of prices until the last quarter of 2008
- Declining prices in 2009 due to impact of financial crises - but still above 2006 levels
- Relatively stable prices in 2010
- More stable residential real estate prices in Prague than outside the capital city

– Long term housing loan demand drivers

- Still low household indebtedness: housing loans to GDP at 22%
- Floorspace low versus Western Europe (26sqm/capita vs. 36sqm/capita)
- Low local interest rates, relatively favourable unemployment rate (8.6% in July 2010)

Source: Czech Statistical Office

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– Evolution of the banking market

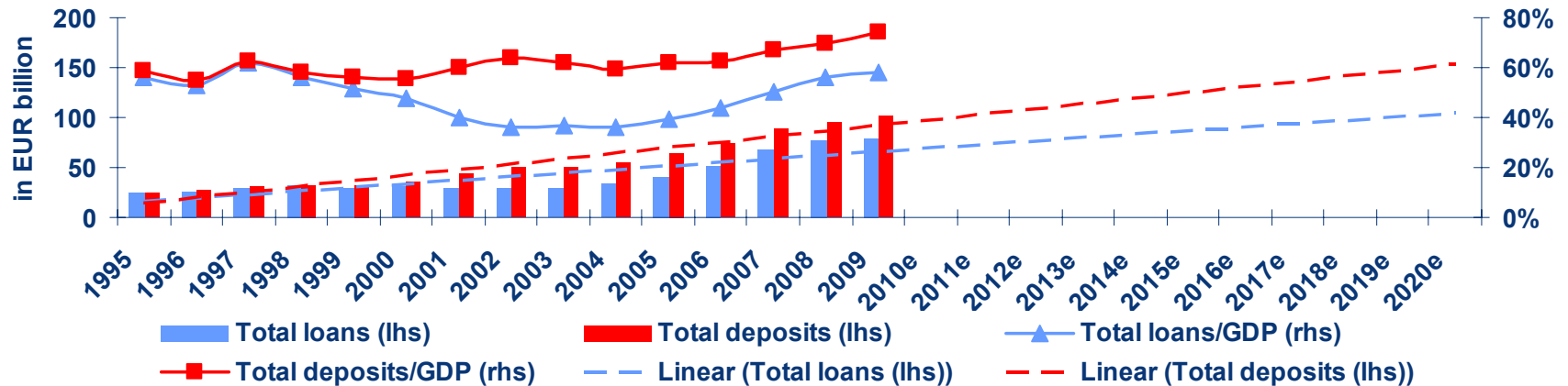
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Evolution of the banking market – A real success story

Czech Republic - Development of banking sector



1993-1997 Forming of the banking sector

- » Czech National Bank established
- » Entry of new banks – 53 in 4 years
- » Implementing of international standards (Basel)
- » Banks undercapitalised
- » Burden of bad loans
- » Inexperienced staff
- » Political pressure (enormous financial needs)

1998-2002 Consolidation of the banking sector

- » Consolidation of banking sector (number of banks reduced)
- » Massive state support to save big players: Consolidation („Bad“) Bank
- » Privatisation to foreign banks after the bail-out
- » Foreign owners leading to stronger capitalisation and know-how transfer
- » Banking sector became profitable again

since 2003 Banking sector stabilization

- » Both deposits and loans business boom
- » Conservative business model
- » Low NPL ratio
- » Strong liquidity position (surplus)
- » High profitability (stable net profit = capital cushion)
- » No state support needed during crises

Source: Czech National Bank

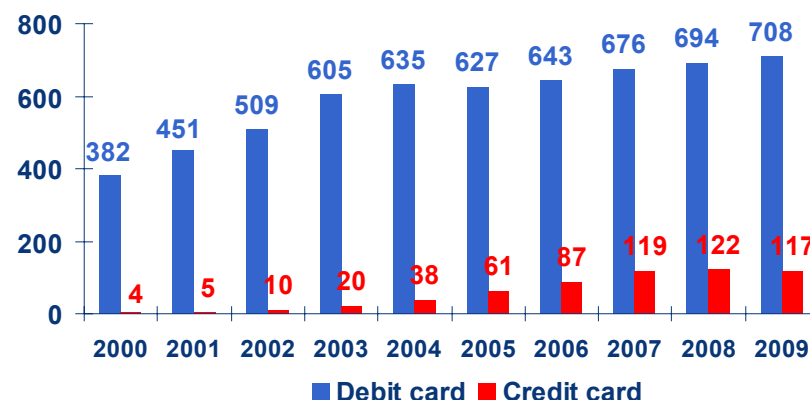
The emergence of retail banking – Moving away from the cash economy

- **Czech Republic is among the most developed banking markets in Central and Eastern Europe**
- **First payment card was issued in 1988**
 - Number of issued debit cards at 9mn in 2009
 - Pace of growth has been impacted by crisis
- **Credit card business started in 1998**
 - Share of credit cards within total card business has been continually increasing
 - 1.2 million credit cards in 2009
- **Cards originally were only used for ATM transactions**
 - Since 2000 strong increase of POS transactions
 - Internet payments have been increasing

ATMs and POS per 1m inhabitants



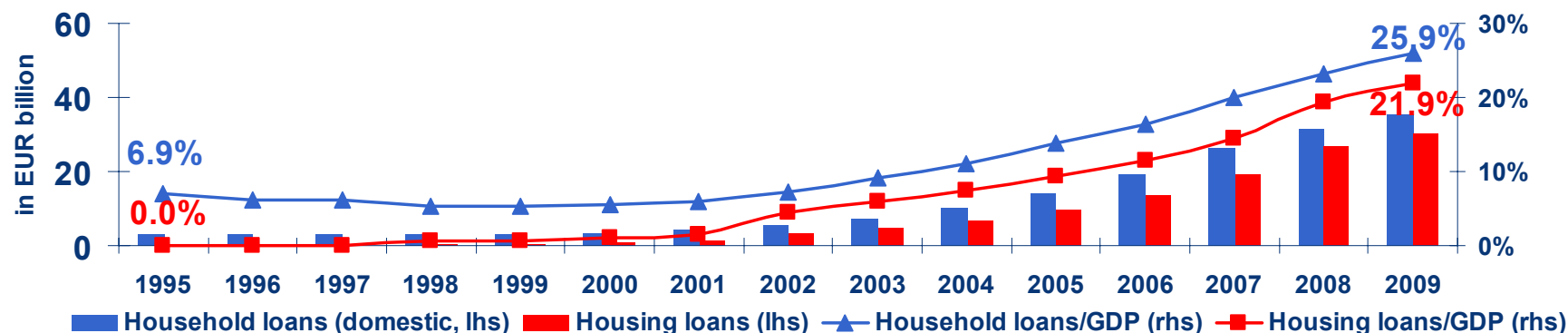
Payment cards per 1,000 inhabitants



Source: Czech Bank Card Association

The emergence of retail banking – The loan growth story

Czech Republic: Development of retail banking



- **Retail loans have been the main driver of loan growth**
 - Driven mainly by mortgage loans
 - Despite growing volumes, consumer loans still represent a limited share within retail loans
- **Mortgage business started in 2001, the market potential remains high**
 - Pace of growth has been impacted by global economic downturn
 - Housing loans to GDP at 22%
- **Insignificant FX lending**
- **NPL ratio remains at low levels, even after 2008 turbulences**
- **Favourable balance between loans and deposits**

Source: Czech National Bank

The emergence of retail banking –

Wealth creation: from deposits to fund management

– Highly developed savings market compared to other CEE markets

- Positively impacted by society's attitude towards savings
- Household deposits at 43% to GDP

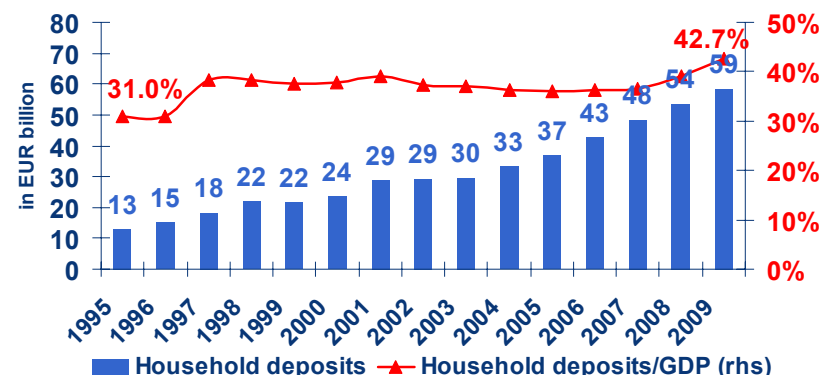
– Retail deposit market has grown constantly and accounts for 60% of total deposits

- Prior to 1993 the passbook was the prevailing deposit product
- Since then current accounts and other deposit products have become popular
 - Term deposits, saving accounts
- Building society savings with state subsidy support deposits growth

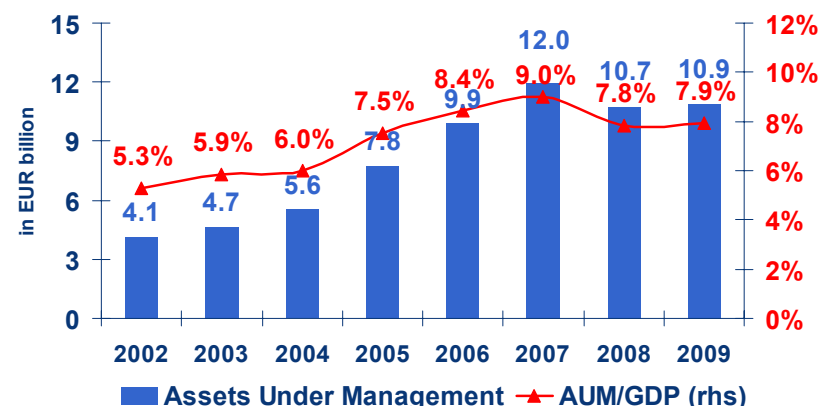
– Asset management has developed rapidly but is still behind Western European standards

- Voucher privatization and capital market establishment enabled rapid development of investment funds
- Funds per capita at EUR 1,100 (Austria: EUR 16,300)

Czech R. - Development of household deposits



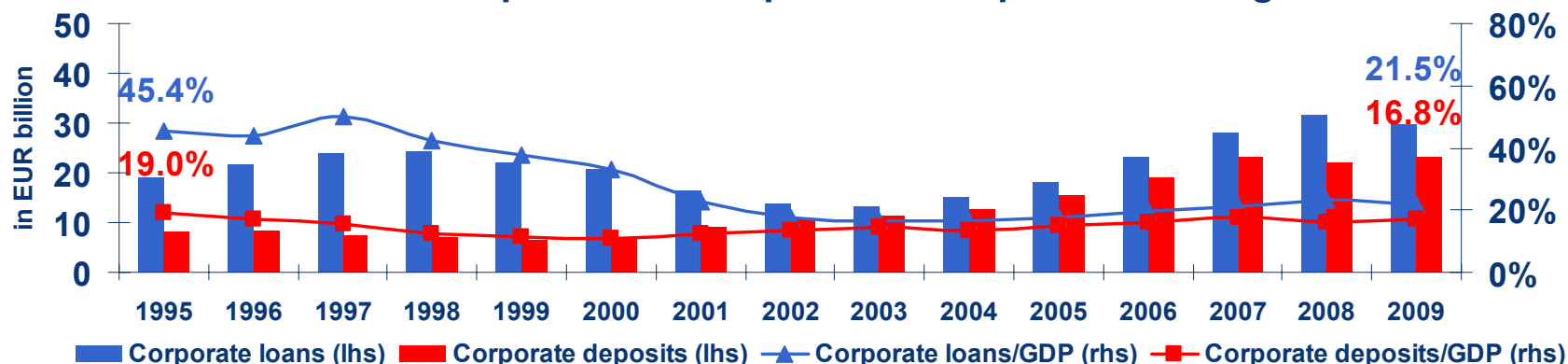
Czech R. - Development of asset management



Source: Czech National Bank

The transformation of corporate banking – From recklessness to responsible financing

Czech Republic: Development of corporate banking



– Corporate loan growth restarted at the beginning of the new millennium

- Boom in 90's accompanied by weak risk policies was followed by decline of loan volumes
- After consolidation of the sector solid growth with adequate risk policy returned
 - NPL ratio constantly decreased and reached 3% in 2007
 - Notable increase to 8% since then is due to the difficult macro environment
- Low ratio of FX loans
 - Slightly below 20% is reasonable for an export-oriented economy

– Corporate deposits developed more constantly

- Deposit volume has tripled since 2000

Source: Czech National Bank

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Post-acquisition track record of CS – Long term financial performance*

– Česká spořitelna was Erste Group's first major acquisition in CEE

- CS became member of Erste Group in 2000
- Today CS is the leading financial provider of the country with 5.3 million clients

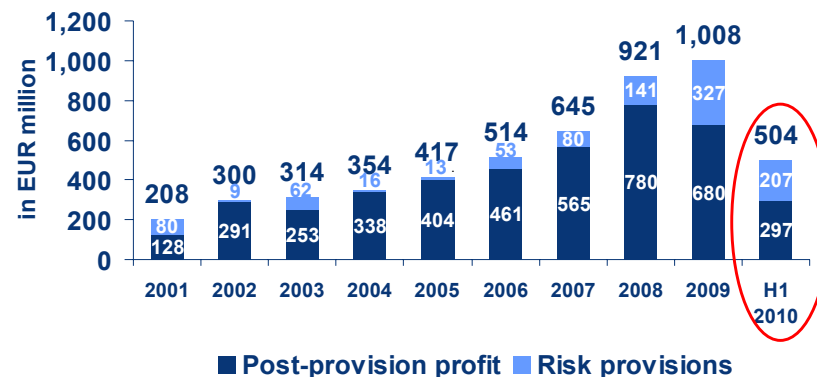
– Continuous improvement of operating performance

- Driven by growing revenues supported by an improved product range and service quality
- Reduced costs as a result of ongoing efficiency improvement initiatives
 - Significant improvement of C/I ratio from almost 70% to current 42%
 - Number of staff has been reduced by more than 5,000 employees since 2000

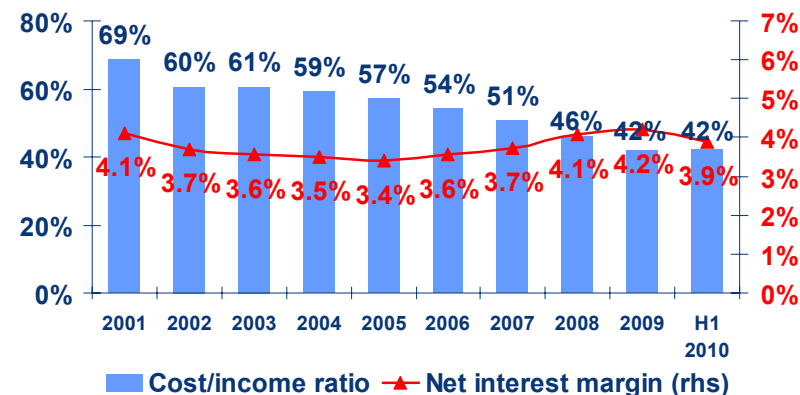
– NIM has been very stable over the years

- Regardless of the development of interest rates and their current historically low level
 - NIM has remained between 3.4% and 4.2%

Ceska sporitelna: operating profit history
(pre-provision profit)



Ceska sporitelna: CIR and NIM



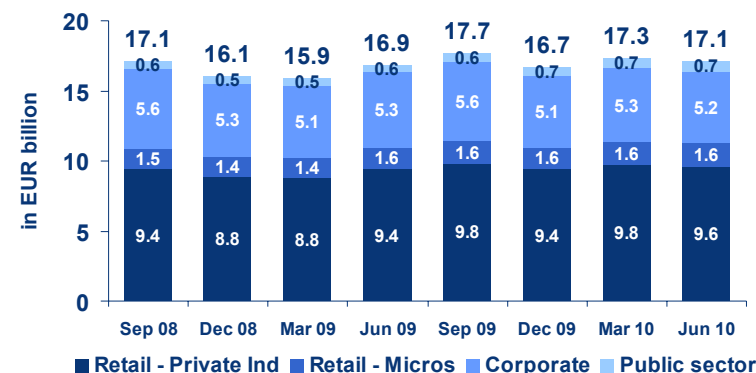
*) Based on local consolidated IFRS data

Post-acquisition track record of CS –

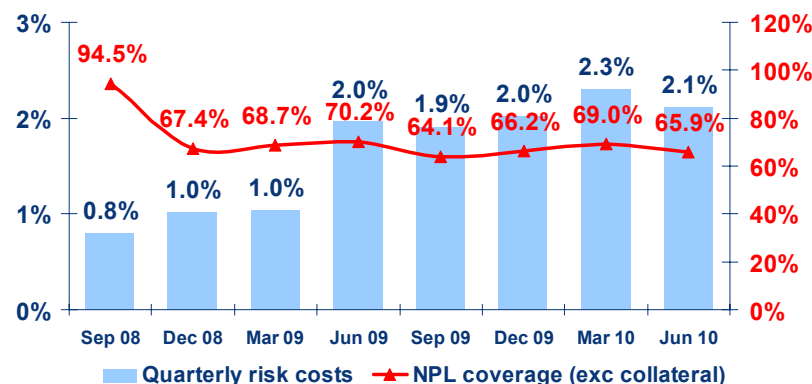
Analysing credit risk*

- **Customer loans driven mainly by retail lending**
 - Changing business mix to higher margin consumer loans
 - Retail loans to grow at a faster pace than SMEs
- **Loan portfolio quality has deteriorated but NPL ratio at manageable level**
 - Rise in NPLs is mainly driven by corporate business while rise in retail is due to increasing share of consumer loans
 - NPL ratio at 5.9% while coverage ratio at 65.9%
 - Asset quality set to improve going forward
- **Credit risk costs have increased to around 200bps**
 - Yoy increase driven by higher NPLs as a lag effect of the economic slowdown

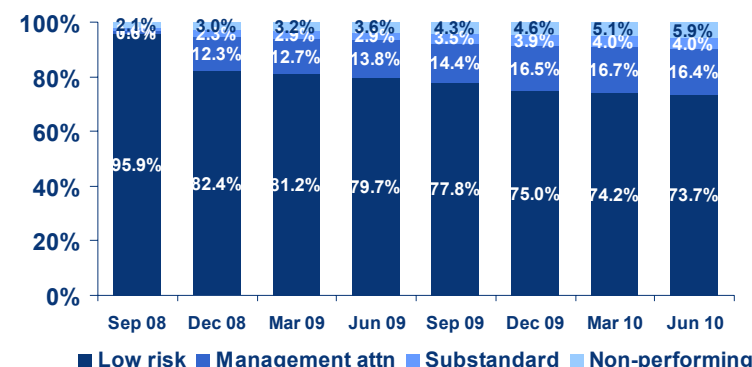
Segment Czech Republic -
Customer loans by Basel II customer segment



Segment Czech Republic -
Risk costs vs NPL coverage



Segment Czech Republic - Migration analysis



*) Based on Segment figures

– Keeping excellent profitability track record

– Supporting loan demand

- Corporate lending currently on hold; retail loans will be the driver of loan growth
- CS has started to offer attractive interest rate discounts for private mortgages based on the level of client activity within personal accounts and the selected terms of the mortgage
- For consumer loans a marketing campaign has been prepared for launch before the last quarter of the year which is usually the strongest

– Employing excess liquidity

- Loan to deposit ratio declined to 66% in H1 2010 as a result of continuing inflow of customer deposits and limited loan growth
- Excess liquidity placed mostly at the interbank market (repos with CNB)

– Managing credit risk

- Asset quality set to improve going forward supported by expected positive macroeconomic developments

– Expanding services to affluent clients

- After the acquisition of three HSBC Premier branches CS established its own sub-brand “CS Premier” and will launch a tailor-made proposition for affluent customers under this brand in the last quarter of 2010

– Building on trust and improving client satisfaction
