Kereskedelmi és Hitelbank Zrt.

CONSOLIDATED SEMI-ANNUAL REPORT

30 June 2013

Budapest, 29 August 2013

CONTENT

Statement of the Issuer

K&H Bank Zrt., as the Issuer (represented by Hendrik Scheerlinck, CEO and Attila Gombás, CFO hereby declare that K&H Bank Zrt.'s consolidated 2013 Semi-annual Report has been prepared in compliance with the applicable accounting laws and regulations, to the best of the Issuer's knowledge, and that the financial details contained therein reflect a true and reliable status of the assets, liabilities, financial position and profit of K&H Bank Zrt. and of the companies involved in the consolidation, and that the consolidated management report shows a true and fair picture of the position, development and performance of K&H Bank Zrt. and the companies involved in the consolidation, also including the major risks and uncertainties pertaining to the remaining six months of the financial year.

Furthermore, the Issuer hereby declares that the Semi-annual Report has not been verified by an independent auditor, thus the financial details contained therein are not audited figures.

Budapest, 29 August 2013

Hendrik Scheerlinck	**Attila Gombás**
Chief Executive Officer	Chief Financial Officer

Consolidated Statement of Financial Position

in million HUF CONSOLIDATED STATEMENT OF FINANCIAL POSITION	Not audited 30 June 2013	Audited 31 December 2012
ASSETS		
Cash and cash balances with central banks	47 194	78 784
Financial assets	2 410 003	2 279 367
Held for trading	156 503	159 634
Designated at fair value through profit or loss	2 798	3 022
Available for sale	420 658	293 014
Loans and receivables	1 286 099	1 315 946
Held to maturity	540 303	507 751
Hedging derivatives	3 642	0
Tax assets	2 896	3 290
Current tax assets	1 027	3 223
Deferred tax assets	1 869	67
Investments in associated companies	1 984	2 201
Investment property	608	472
Property and equipment	43 270	45 634
Intangible assets	11 743	11 826
Other assets	41 295	40 620
Total assets	**2 558 993**	**2 462 194**

in million HUF CONSOLIDATED STATEMENT OF FINANCIAL POSITION	Not audited 30 June 2013	Audited 31 December 2012
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Financial liabilities	2 252 617	2 165 429
Held for trading	38 354	46 042
Designated at fair value through profit or loss	244 713	241 826
Measured at amortised cost	1 911 292	1 810 096
Hedging derivatives	58 258	67 465
Tax liabilities	23	368
Current tax liabilities	23	0
Deferred tax liabilities	0	368
Provisions for risks and charges	35 093	35 507
Other liabilities	53 185	45 020
Total liabilities	**2 340 918**	**2 246 324**

in million HUF **CONSOLIDATED STATEMENT OF FINANCIAL POSITION**	**Not audited** **30 June 2013**	**Audited** **31 December 2012**
Share capital	140 978	140 978
Share premium	48 775	48 775
Statutory risk reserve	18 517	18 517
Available for sale reserve	-1 325	-2 519
Cash flow hedge reserve	-3 117	-3444
Retained earnings	14 247	13563
Total equity	**218 075**	**215 870**
Total liabilities and equity	**2 558 993**	**2 462 194**

Budapest, 29 August 2013

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Statement of Changes in Equity

in million HUF **CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**	Share capital	Share premium	Statutory risk reserve	Available for sale reserve	Cash flow hedge reserve	Retained earnings	Total equity
31. December 2012. Audited							
Balance at the beginning of the period	**140 978**	**48 775**	**15 873**	**-10 286**	**- 409**	**- 255**	**194 676**
Net profit for the year	-	-	-	-	-	20 457	20 457
Other comprehensive income for the period	-	-	-	7 767	- 3 035	-	4 732
Total comprehensive income	-	-	-	7 767	- 3 035	20 457	25 189
Dividend	-	-	-	-	-	- 3 995	- 3 995
Transfer from retained earnings to statutory risk reserve	-	-	2 644	-	-	- 2 644	-
Total change	-	-	2 644	7 767	- 3 035	13 818	21 194
Balance at the end of the period	**140 978**	**48 775**	**18 517**	**- 2 519**	**- 3 444**	**13 563**	**215 870**
of which							
revaluation reserve for shares	-	-	-	748	-	-	748
revaluation reserve for bonds	-	-	-	- 3 267	-	-	- 3 267
30. June 2013. Not audited							
Balance at the beginning of the period	**140 978**	**48 775**	**18 517**	**- 2 519**	**- 3 444**	**13 563**	**215 870**
Net profit for the year	-	-	-	-	-	684	684
Other comprehensive income for the period	-	-	-	1 194	327	-	1 521
Total comprehensive income	-	-	-	1 194	327	684	2 205
Total change	-	-	-	1 194	327	684	2 205
Balance as at 30 June 2013	**140 978**	**48 775**	**18 517**	**- 1 325**	**- 3 117**	**14 247**	**218 075**
of which							
revaluation reserve for bonds	-	-	-	- 1 325	-	-	- 1 325

The dividend paid on ordinary shares was HUF 3 995 million, 0.028338 HUF/share in 2012.

Budapest, 29 August 2013

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Income Statement

in million HUF **CONSOLIDATED INCOME STATEMENT**	**Not audited** **1st half of year 2013**	**After reclassification and restatement** **Not audited** **1st half of year 2012**
Interest income	73 464	83 418
Interest expense	-35 692	-45 303
Net interest income	**37 772**	**38 115**
Fee and commission income	27 288	21 097
Fee and commission expense (after reclassification)	-7 620	-7 342
Net fee and commission income (after reclassification)	**19 668**	**13 755**
Net gains / losses from financial instruments at fair value through profit or loss and foreign exchange	8 848	10 188
Net realised gains / losses from available-for-sale assets	1 689	0
Dividend income	3	4
Other net income	4 246	99
Total income (after reclassification)	**72 226**	**62 161**
Operating expenses (after restatement and reclassification)	-63 996	-50 153
Staff expenses	-14 922	-15 294
General administrative expenses (after reclassification)	-29 482	-15 395
Depreciation and amortisation of tangible and intangible assets	-3 751	-3 623
Bank tax (after restatement)	-15 841	-15 841
Impairment	-6 264	-9 130
Loans and receivables	-5 993	-9 111
Other	-271	-19
Share in results of associated companies	137	207
Profit before tax (after restatement)	**2 103**	**3 085**
Income tax expense (after restatement)	-1 419	-1 617
Profit after tax (after restatement)	**684**	**1 468**

Budapest, 29 August 2013

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Statement of Comprehensive Income

in million HUF **CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**	**Not audited** **1st half of year 2012**	**After restatement** **Not audited** **1st half of year 2011**
Profit after tax (after restatement)	**684**	**1 468**
Other comprehensive income		
Net change in revaluation reserve for available-for-sale equity instruments	-751	568
Net gain / loss from fair value changes	209	716
Deferred tax impact on fair value changes	-44	-148
Transfer from available for sale reserve to net profit	-916	0
Losses/ gains on disposal	-1 153	0
Deferred income tax	237	0
Net change in revaluation reserve for available-for-sale debt instruments	1 945	5 028
Net gain / loss from fair value changes	-175	6 341
Deferred tax impact on fair value changes	37	-1 307
Transfer from available for sale reserve to net profit	2 083	-6
Losses/ gains on disposal	-537	0
Amortisation of reclassified assets	3 161	-8
Deferred income tax	-541	2
Net change in cash flow hedge reserve	327	-2 675
Net gain / loss from fair value changes	5 079	-5 023
Deferred tax impact on fair value changes	-1 047	1 036
Transfer from cash flow hedge reserve to net profit	-3 705	1 312
Gross amount	-4 667	1 653
Deferred income tax	962	-341
Total other comprehensive income	**1 521**	**2 921**
Total comprehensive income (after restatement)	**2 205**	**4 389**

Budapest, 29 August 2013

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Statement of Cash Flows

in million HUF **CONSOLIDATED STATEMENT OF CASH FLOWS**	**Not audited**	**Not audited**
OPERATING ACTIVITIES	**1st half of year 2013**	**1st half of year 2012**
Profit before tax	2 103	3 085
Adjustments for:		
Net transfer from available for sale reserve	1 471	-8
Net transfer from cash flow hedge reserve	-4 667	1 653
Depreciation and impairment of property, plant and equipment, intangible assets, available-for-sale financial assets and other assets	4 029	3 646
(Profit)/Loss on the disposal of property and equipment	19	61
(Profit)/Loss on the disposal of investment property	4	0
Change in impairment on loans and advances*	5 993	9 111
Change in other provisions	-545	-48
Unrealised valuation differences	-24 045	23 522
Income from associated companies	-137	-207
Cash flows from operating profit before tax and before changes in operating assets and liabilities	**-15 774**	**40 815**
Changes in financial assets held for trading	16 781	76 244
Changes in financial assets designated at fair value through profit or loss	366	301
Changes in financial assets held to maturity	5 257	4 492
Changes in financial assets available for sale	-127 613	68 371
Changes in loans and receivables	19 864	191 087
Changes in other assets	3 918	9 965
Changes in operating assets	**-81 427**	**350 459**
Changes in financial liabilities held for trading	-3 271	-111 110
Changes in financial liabilities designated at fair value through profit or loss	2 392	37 878
Changes in financial liabilities measured at amortised cost	52 712	-281 232
Changes in other liabilities	4 599	-2 093
Changes in operating liabilities	**56 431**	**-356 558**
Income taxes paid	-2 170	2 292
Net cash from/(used in) operating activities	**-42 940**	**37 008**

* Including impairments on loans and receivables and loan commitments.

in million HUF **CONSOLIDATED STATEMENT OF CASH FLOWS**	**Not audited**	**Not audited**
INVESTING ACTIVITIES	**1st half of year 2013**	**1st half of year 2012**
Purchase of held-to-maturity securities	-78 448	-57 138
Proceeds from the repayment of held-to-maturity securities at maturity	40 638	17 588
Dividends received from associated companies	353	346
Purchase of intangible fixed assets	-1 405	-1 596
Purchase of property, plant and equipment	-1 076	-1 888
Proceeds from the sale of property, plant and equipment	442	84
Net cash from/(used in) investing activities	**-39 496**	**-42 605**
FINANCING ACTIVITIES		
Dividends paid*	0	-3 995
Net cash from/(used in) financing activities	**0**	**-3 995**
CHANGE IN CASH AND CASH EQUIVALENTS		
Net increase/(decrease) in cash and cash equivalents	-82 436	-9 592
Net foreign exchange difference	-1 433	25 401
Cash and cash equivalents at beginning of the period	-13 388	-70 739
Cash and cash equivalents at end of the period	**-97 257**	**-54 930**

in million HUF	**Not audited**	**Not audited**
OPERATING CASH FLOWS FROM INTEREST AND DIVIDENDS	**1st half of year 2013**	**1st half of year 2012**
Interest received	82 069	90 485
Interest paid	-38 305	-41 882
Dividend received**	356	350

in million HUF	**Not audited**	**Not audited**
COMPONENTS OF CASH AND CASH EQUIVALENTS	**1st half of year 2013**	**1st half of year 2012**
Cash and cash balances with central banks	47 194	47 192
Loans and advances to banks repayable on demand and term loans to banks < 3 months	51 538	40 534
Deposits from banks repayable on demand and redeemable at notice	-195 989	-142 656
Total cash and cash equivalents	-97 257	-54 930

*For dividends paid see Consolidated statement of changes in equity.
**Dividends received also includes dividends received from associated companies

Most of the interest cash flows are results from the Group's banking activity and are part of the operating cash flow.

Loans and advances to banks repayable on demand and term loans to banks < 3 months are recorded as Loans and receivables in the consolidated statement of financial position. Deposits from banks repayable on demand and redeemable at notice are presented as financial liabilities measured at amortised cost.

The Group uses the indirect method for presentation of cash flows resulting from operating activities.

Budapest, 29 August 2013

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer

Consolidated Management Report

On 30 June 2013, the Group's consolidated balance sheet total stood at 2 559 billion HUF. As a financial institution that offers banking and insurance products alike and has a nation-wide branch network of 220 branches, K&H provides the full range of financial services to its clients.

1. Economic environment

Mixed figures were published about global economic growth in 1H13, mainly the big emerging markets' (like China, Brazil, India etc.) and European peripheral countries' (like Italy, Spain etc.) economic outlook deteriorated further, while USA, Japan and Germany's economic performance suggests slow acceleration for 2H13. After the decrease in 2012 Hungary's GDP is expected to have a moderate increase in 2013. The improving growth outlook of the main trading partners of Hungary may strengthen slightly the Hungarian export, but domestic demand is likely to remain subdued. Hungarian economy may increase by 0.4% YoY in 2013.
The deleveraging process continued in 1H13, decreasing further Hungary's external deficit. Current and capital account surplus improved further.

	2012	2013 forecast
GDP growth	-1.7%	0.4%
CPI (avg)	5.7%	2.3%
Investments	-5.2%	-2.5%
Unemployment rate	10.7%	10.5%
Budget deficit (ESA)	-1.9%	-2.7%
Balance of payments (in % of GDP)	+1.7%	+1.9%

Source: MNB, KSH, K&H

The quantitative easing (QE) policy continued in developed markets in 1H13, additionally Bank of Japan started an aggressive QE cycle, which improved market sentiment, but in May FED started to talk about slowing down its QE policy in 4Q13, which pushed developed markets bond yields up. In the positive international sentiment the National Bank of Hungary continued its rate cut cycle and lowered base rate every month by 25-25bps, cutting the base rate to 4.25% by the end of June.

2. The Strategic Objectives of the bank

K&H Bank Group is a universal bancassurer, providing banking, leasing, asset management and insurance services for individuals and corporate (focusing on SME and Mid-cap) customers.
In order to fulfill our mandate by our shareholder and our clients:

- we combine the best international practice with sound local knowledge;
- we provide our clients with a distinctively modern banking and insurance service which begins with their needs and concludes with the delivery of excellent solutions at competitive prices.

Customer strategy:
Retail: customers are served based on the different segments' special needs.
Corporate clients: focus on cross-sales, intensify new client acquisition in selected areas.

Product strategy:

Retail:

- Innovative saving products and add-on services to keep up our market leader status.
- Growth in lending, based on a good understanding of credit risk.

- Strong focus on transactional banking.
- Fast and simple credit process.

SME:

- Reliable transactional banking services.
- More standard products fitting client needs with easy and quicker processes.
- Fast and simple credit process.

Corporate:

- Full service provider, emphasis is advisory to provide tailored solutions to clients.

Strategy on distribution channels:
Branch-centric multi-channel distribution approach: although the diversity of channels and the role of tied agent, 3rd party and remote channels are significant, the most important channel will remain our extensive branch network.
Key differentiators of the Bank Group:

- Being close to our clients: easy access both physically (see our large branch network) and virtually (see remote channels).
- Speaking our clients' language (investment to 'client-conform' communication).
- Clients' individual needs and profiles are permanently in focus (offered services always fit their real needs)
- K&H Group acts as 'one-stop-shop' for our clients (universal financial institution)

3. Characteristics of the Group's consolidated activities

The Bank Group's balance sheet total increased by 4% compared to 31 December 2012:

Billion HUF	31 Dec 2012	30 Jun 2013	variance
Balance sheet total	2,462.2	2,559.0	+3.9%
Loans and receivables	1,315.9	1,286.1	-2.2%
Deposits from customers	1,689.7	1,764.6	+4.4%
Equity	215.9	218.1	+1.0%

The most important elements of the evolution of the consolidated balance sheet are as follows:

- In the course of the year the amount of *loans and receivables* decreased by 2%. Similarly to the entire banking sector the demand for credits of both retail and corporate clients remained moderate.
- The increase in *Deposits from customers* is mainly driven by deposits of K&H mutual funds and by corporate business (related to some large deposits). The bank has further strengthened its market position both in corporate and retail savings.

Market share	**30 June 2012**	**31 Dec 2012**	**30 June 2013**
Corporate loans	7.9%	7.9%	8.1%
Retail loans	8.5%	8.7%	8.5%
Corporate deposits	10.8%	11.1%	12.0%
Retail deposits + mutual funds	10.4%	10.2%	10.4%

- *Shareholders' equity* increased by 2.2 bln by the end of H1 2013, primarily as a net balance of the following factors: current year profit (+0.7 bln); increase in cash flow hedge reserves (+0.3 bln) and AFS revaluation reserves (+1.2 bln).

The Bank Group's profit was HUF 684 mln in the first half of 2013 which contains the full year amount of both the bank tax and the one-off extra charge related to Financial Transaction Levy (208% of the Financial Transaction Levy paid in the Jan-Apr period). H1 2012 result after restatement, including the full year bank tax of 2012, amounted to HUF 1,468 mln.
The evolution of the main P&L items:

- The 1% decrease in *net interest and interest-type income* (2013: 37.8 bln, 2012: 38.1 bln) is primarily due to the lower amount of loans and receivables.
- The *net fee and commission income* was HUF 19.7 bln in the first half of 2013. Taking into consideration the Financial Transaction Levy paid (accounted for among operating expenses), commission income net of Financial Transaction Levy remained at the same level as in the first half of 2012.
- The decrease in *net gains from financial instruments at fair value* (2013: 8.8 bln, 2012: 10.2 bln) is primarily due to mark-to-market valuation of ALM hedging derivatives.

In the first half of 2013, the Bank Group's *operating expenses* came to 64.0 bln, of which

- 15.8 bln represents the full year bank tax and
- the Financial Transactional Levy (FTL) paid in H1 and the full amount of the one-off extra charge based on 208 % of the FTL paid in the period of Jan-Apr totaling to 13.8 bln.

Disregarding the above listed items, operating expenses would have remained practically unchanged compared to the corresponding period of the previous year.

Impairments amounted to 6.3 bln HUF in H1 2013 (H1 2012: 9.1 bln HUF). The portfolio quality and the related credit cost ratio in corporate and SME segments are still favourable, while the positive impact of the government's and the bank's own payment easement programs on the evolution of portfolio quality in Retail business was still perceptible in H1 of 2013.

The bank helps its retail clients to retain their solvency by credit restructuring. Due to the government and own debtor relief programs portfolio quality indicators for the first time since the beginning of the financial crisis have shown improvement from mid 2012. These improvements have slowed down in 2013, as applications for restructuring have slowed down.

Non-performing loans	30 June 2012	31 December 2012	30 June 2013
Retail	19.4%	16.9%	18.6%
Corporate	8.4%	8.0%	7.0%
Leasing	13.3%	11.6%	12.7%
Total	13.3%	12.0%	11.9%

The economic conditions, especially the expected evolution of unemployment and FX rates can have a considerable influence on the future quality of the credit portfolio along with uncertainties regarding the impact of possible future government measures.

The business performance of the Bank Group is illustrated by the following figures:

million HUF	2012 H1	2013 H1	variance
Cost / income	80.7%	88.6%	7.9%
Cost / income*	55.2%	66.7%	11.5%
Non-interest type income/ total income	38.7%	47.7%	9.0%
Commission income / total income	22.1%	27.2%	5.1%
	-		
Operating income / average headcount	35.4	42.2	19.2%
Operating expenses* / average headcount	19.6	28.2	44.0%
Operating profit* / average headcount	15.9	14.1	-11.3%
Credit cost ratio	0.9%	0.8%	-0.1%
Non-performing loans	13.3%	11.9%	-1.4%
Loan / deposit	73.0%	64.1%	-8.9%
Capital**/total liabilities	9.1%	9.4%	0.3%
Solvency ratio (Basel II)***	12.8%	13.5%	0.7%
ROE (based on average balance of equity)****	8.0%	6.8%	-1.2%
ROA (based on average balance sheet total)****	0.6%	0.6%	0.0%

* excluding bank tax but including FTL related charges
** in addition to equity it also includes subordinated debt capital
*** according to the rules prescribed by the Hungarian supervisory authority
**** bank tax included on a pro rata basis

Like in the entire banking sector, the introduced new taxes had an unfavourable effect on the main profitability ratios of the bank. Considering risk, liquidity and capital adequacy ratios K&H Bank preserved its position as one of the banks with the most favourable financial position in the banking sector.

4. Introduction of important subsidiaries

Leasing operation

At the end of June 2013, the Leasing operation was made up of 6 separate legal entities and 3 entities which merged with K&H Bank.

Name	Main profile	Comment
K&H Autófinanszírozó Zrt.	Financial leasing	on the 30th of September 2012 it has merged with K&H Bank Zrt
K&H Autópark Kft.	Operative leasing, fleet management	
K&H Eszközfinanszírozó Zrt.	Financial leasing	on the 30th of September 2012 it has merged with K&H Bank Zrt
K&H Eszközlízing Kft.	Operative leasing	
K&H Ingatlanlízing Zrt.	Financial leasing	
K&H Alkusz Kft.	Brokerage of insurance products	
K&H Lízing Zrt.	Not active, under liquidation	
K&H Lízingház Zrt.	Not active, under liquidation	
K&H Pannonlízing Zrt	Lending	on the 30th of November 2011 it has merged with K&H Bank Zrt

At the end of June 2013, K&H's leasing portfolio (including the portfolio of merged entities) stood at 61 billion HUF, which represents a 12% decrease compared to the end of the previous year The discontinuation of retail car financing activities from the end of 2008 resulted in a gradual drop in the retail car and dealer financing portfolio (by 7.5 billion in the first half of 2013, 19% decrease vs the end of 2012).
Since 2012, the sales strategy is focused to provide leasing products to the corporate and SME clients of the K&H Group via the distribution network of the K&H Bank.
The 1H 2013 production figures show that the leasing operation obtained a 4% share on the lease market in overall terms, 3.8% of the fleet financing market and 4.1% of the Truck, Agricultural and Other Machinery markets, with a total new production figure of HUF 4.4 bln.

K&H Fund Management Zrt.

K&H Fund Management is a fully owned subsidiary of K&H Bank. In the first half of 2013 the assets managed in investment funds increased by 12.8 %, the growth of the total AuM was 10%. Decreasing yield environment turned the attention of clients from term-deposit to alternative saving products (e.g. mutual funds), which had positive effect on the investment fund market generating considerable inflow to K&H funds as well.

10 funds were launched in the first half to this year: 8 retail closed-end CPF (Capital Protected Funds), 1 open-end liquidity fund and 1 CPPI fund.

Concerning institutional portfolio management, there was not significant change in the level of asset under management.

At the end of June 2013 the assets managed by K&H Fund Management was 845 bln, of which assets managed in investment funds was 722 bln, resulting in the second biggest market share of 18.2% for us in the Hungarian investment funds market. We could keep our market leader position in CPF segment (with 50% market share).

The Company achieved a profit after tax of HUF 0.8 billion in the first half of 2013.

K&H Csoportszolgáltató Kft. (K&H Shared Service Center Kft.)

In 2005, K&H Group decided to set up a group services centre under the management of K&H Bank, which is the 100% owner of K&H Csoportszolgáltató Kft. (KHCSK). The purpose of this unit was the centralisation and efficient organisation of supplementary service activities closely linked to the core activities of individual group members. Comprehensive service activities performed for the group include the management of the real estate portfolio, logistical and bank security tasks, operative business responsibilities (the booking of trade receivables and payables, fixed assets etc.; tax accounting and payroll management).
The company takes out service level agreements and contracts with individual group members for each individual service. Since 2007, services offered by KHCSK have also been used by K&H Insurance's and K&H Leasing Group's member companies as well. At present, KHCSK acts as a group services centre for 10 companies, including K&H Bank. Since May 1, 2008, KHCSK has also been performing the financial and accounting responsibilities and operative services of the Hungarian branch of KBC Global Services N.V. (KBC GSC). On 1 January 2008 the Tendering Directorate was set up, which is responsible for advisory and support services related to EU tenders. In 2009, the scope of the company's activities was extended with financial and accounting services provided K&H Factoring, a company 100% owned by K&H Bank.
A directorate was established on 1 January 2012 for SZÉP Card operation. The SZÉP card is a cafeteria item and product at K&H group. KHCSK is responsible for the entire operation of the SZÉP card system and the related transactions.

K&H Factoring Zrt.

The K&H Factoring Zrt's main activity is factoring (purchase of receivables, financing, discounting). The company's business activities have started in 2010, (factoring) turnover has been steadily increasing since then (2010: 5.9 billion, 2011: 22.3 billion, 2012: 54.5 billion, H1.2013: 35.9 billion). The amount of trade receivables towards debtors was 6.8 billion at 30 June 2013.

5. Risk Management

Banks are exposed to several types of risks due to their operations. K&H Bank has a system in place for the accurate measurement and appropriate management and limitation of these risks. The system has been adjusted to the risk management system of the shareholder KBC Group both in terms of methodology and work organisation.

5.1 Risk management governance model

The risk management governance model seeks to define the responsibilities and tasks of various bodies and persons within the organisations with a view to ensuring the sound management of value creation and all the associated risks to which the banking and insurance businesses are exposed. The Group's risk governance model is organised in three tiers:

- Overarching company and risk committees are the Board of Directors (BoD), the Audit, Risk and Compliance Committee (ARCC), the Supervisory Board (SB), the Executive Committee (ExCo), the Country Team (CT) and the Capital and Risk Oversight Committee (CROC). These committees concentrate on overarching risk management and on monitoring value creation.
- Specialised risk councils (Credit Risk Council (CRC), Trading Risk Councils (TRC), Operational Risk Councils (ORC)) concentrate on implementing a group-wide framework for one particular type of risk and monitoring the associated risk management process. The risk councils are composed of representatives from line management and Value and Risk Management Division.
- Line management and activity-specific committees have primary responsibility for value and risk management on the operational level. Whereas Value and Risk Management Division measures risks, economic capital and value creation for all relevant business entities and reports its findings directly to line management and the relevant activity-specific committees.
- Within Risk Management Division the Integrated Value and Risk Department is dedicated to overarch the three existing risk centers of competence (Credit Risk, Market and Liquidity Risk and Non-financial Risks), enhance coordination and transfer synthesized message to senior management regarding value creation, risk and capital.

The Board of Directors and the Audit, Risk and Compliance Committee have an important role to play in value creation and risk governance. Regular reporting to the Audit, Risk and Compliance Committee ensures that there is an ample flow of information to the members of the Board over the course of the year. Moreover, through the involvement of the Board in the annual round of approvals of risk-tolerance limits, the Board is able to take informed decisions on the degree of risk it finds acceptable for the Group and on the adequacy of the risk management structure.

5.2 Risk types

- **Credit risk** means the potential loss suffered by the bank if a customer becomes insolvent or cannot perform their payment obligations in due time. Credit risks are managed by risk mitigating techniques approved by the management of the bank. Regulations cover the whole lending process. The bank continuously monitors the credit portfolio and prepares reports on the findings to the senior management of the bank.

In the framework of the Basel II program, late 2010 the bank was granted the permission of HFSA to use the internal rating model (IRB Foundation) which has been applied for regulatory capital calculation for credit risk since 1 January 2011. During the program, the bank reviewed all debtor rating models and upgraded them in line with the uniform KBC group-level methodology.

In the following years the bank paid special attention to the enhancement of the applied risk management methodology, with special regard to the analyses of the various stress scenarios affecting the credit portfolio (macro-economic indicators, foreign exchange rate changes and the changes in real estate values). An additional instrumental component of the further development of the risk management methodology was the revision of the management reports to better highlight the various quantitative risk indicators in order to allow the continuous monitoring of the credit portfolio.

Based on the preparedness of the bank, Hungarian Financial Supervisory Authority recently proposed to the National Bank of Belgium for the joint decision to provide the license for the application of Advanced IRB method to the calculation of the credit risk capital requirement on the non-retail portfolio as of 1 July 2013.

- **Market risk** means the potential loss suffered by the bank upon a change in the value of foreign currency and interest positions. Both the asset-liability management and market risk management are based on the methodology applied by the shareholder KBC Group. Accordingly, the Capital and Risk Oversight Committee constantly monitors banking and trading book risks and controls them by setting limits (in compliance with the limit policy of KBC). Interest risks are measured and controlled by the joint application of various methods and limits (gap analysis, interest sensitivity, duration, BPV, NII).

  The limit system has been extended by incorporating spread risk measurement in the limit monitoring. For monitoring market risks in the banking book a group-wide platform was implemented.

  The risk taking has been moderate and constantly within the risk playing field in the trading book, while banking book is characterized by increasing interest rate risk, although it also remains within the comfort zone.

- **Liquidity risk** means the risk of the inability of an institution to comply with net financing requirements. Liquidity risk may be caused by disturbances on the market, credit downgrading, which may result in the constant cessation of certain financing sources. To eliminate this risk, the management seeks to diversify the financing sources and manages assets with due regard to liquidity requirements, maintaining a healthy balance between cash, liquid funds and promptly marketable securities. Short term liquidity risk is measured by the operational liquidity limit which establishes whether there is sufficient coverage for the 30-day cumulative liquidity gap. From 2011 structural liquidity is determined by the application of the coverage ratio, the calculation of the new regulatory and Basel III liquidity rates (LCR, NSFR) as well as by liquidity stress tests conducted in compliance with KBC directives. The Risk Management Directorate prepares regular reports to the K&H Bank Capital and Risk Oversight Committee on the various liquidity indicators and limits.

- K&H Bank group manages **operational risks** (the potential loss that may arise as a result of inappropriately operating systems, processes or human errors; or external events) based on uniform principles and methodology. The methodology includes various techniques of risk identification, risk analysis such as self-assessments (top-down and bottom-up), analysis of losses incurred and the assessment and implementation of key control principles defined by KBC group. The risk mitigation measures (or risk acceptance) are decided according to the uniform accountability rules (decision-making authority). The identified exposures and handling of the risk is monitored and followed up by the Capital and Risk Oversight Committee and analyzed by the Operational Risk Councils that are established throughout the organization. K&H Bank group applies the standardized method to calculate the Pillar I. capital requirement for operational risk, according to the permission of the Hungarian Financial Supervisory Authority that was granted in December 2007 (from 1 January 2008).

6. Operating Conditions of the bank

Capital investments in branches:

In H1 2013 the set-up, full or partial reconstruction of 18 branches was started or completed as follows:

- 2 new branches were completed and opened
- 3 branches are being moved to new locations; or construction is still in progress
- 13 branches were fully or partially reconstructed; or construction is still in progress
- 8 branches were closed during the first half of 2013

In connection with the construction of the branches, 2 ATMs were installed at new locations (in the branches) and 12 ATMs were mounted at other external locations (especially at shopping malls).

The accessibility improvement of the branch network is being done concurrently with the constructions and reconstructions. Currently 171 of the 220 branches can be accessed without obstruction (78%).

The most important IT development projects of 2013 H1 were the following:

- a new, centralized customer data management application has been launched
- pilot of new retail and SME e-bank application started, developments are ready
- the implementation of new SME loan origination tool and enhanced retail loan origination tool continued, new products and processes have been introduced.

Budapest, 29 August 2013

Hendrik Scheerlinck
Chief Executive Officer

Attila Gombás
Chief Financial Officer