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From: Management Board

To: Ordinary General Meeting of Shareholders of Banca Comerciala Carpatica

Subject: Activity Programme and 2016 Budget

## **ACTIVITY PROGRAMME AND 2016 BUDGET**

Banca Comerciala Carpatica SA („Carpatica Bank” or the „Bank”) is one of the Romanian banks which enjoys a loyal and stable clientele that has shown resilience and maturity in the context of the problems that the Bank has faced in the last 3 years.

At the end of January 2016 Carpatica Bank was recapitalised through a capital infusion of 98.7 mio RON by Patria Bank (former Nextebank), a small size bank which was acquired in 2014, April by Emerging Europe Accession Fund („EEAF”) investment fund, whose primary investors are EBRD (European Bank for Reconstruction and Development), EIF – European Investment Fund, DEG – Deutsche Investitions und entwicklungs Gesellschaft MBH and Black Sea Trade & Development Bank. Patria Bank currently owns 64.16% of Banca Carpatica and reinforces the Bank, both accounting and prudential.

Banca Carpatica proposes to its shareholders a revised 2016 budget and activity plan , as compared with the precedent version presented in the OGSM dated April 27 and rejected by OGSM; the revised version is considering the current situation of the Bank, the 4m 2016 realized revenues, the realistic options of relaunching the lending activity and growth of operational Another reason for reviewing the precedent budget version consists in the fact that the previous version of the budget considered a one-off sales to a potential investor of the written-off loan book, at prices similar with the recent market prices’ transactions. . Such a transaction could generate a one-off income stream in 2016, however lower as compared with the potential value that might be obtained through a direct sales of the bank of the loan collaterals in a longer period of time, a one-off selling transaction. A one-off sales would lead to a lower future shareholders’ value of the Bank against a positive one-off result in 2016. Thus, the 30 mio RON income from the sale of the portfolio of written-off loans has been replaced with an ambitious goal of direct sell off for part of the collaterals related to this portfolio, worthing 18.6 mio RON, in the next 6 months until the end of 2016.

## Strategic objectives of Banca Carpatica in 2016

In 2016 Banca Carpatica, with new capital raised in early 2016, , aims to **restart the commercial activity**, including the loan origination process, being focused in 2016 on segments where the bank has expertise and qualified personnel, meaning:

- **SMEs segment:** *50% of the new loan originations*, on this segment the Bank already having a sales force based on banking officers specialised in relationship with this type of clients and having expertise in loans underwriting;
- **Retail segment:** *between 6% and 20% of the 2016 new origination volumes* will target this segment. As well, in the context of the uncertainties of the retail loans market (especially for mortgages loans) generated by the not enough assessed impact for the new law “Darea in plata”, the Bank estimates that the significant extension of the exposures on the retail segment is not possible until the end of this year.
- **Micro financing segment:** Banca Carpatica aims to realise *between 5% and 20% of the 2016 new origination volumes to micro segment*, the Bank having the assistance and relevant expertise of Patria Bank in lending to micros, and also using its branches network and their staff in promoting and selling loans to microenterprises.
- **Corporate Segment (large companies):** in order to restore the interest and commissions income base, heavily eroded by the *de-leveraging* effort in H2 2015 (decrease to risk exposures in order to touch the regulated solvency level) realised in the second half of 2015, the Bank will continue to lend to Corporate clients, up to a maximum of 30% of its new 2016 loan production.

Another objective in 2016 is to implement decisions aimed to **significantly cut of operational and administrative costs**, with the scope of **reducing with at least 15% of the annualized expenditures till the end of 2016**. However, given that this projected budget is subject to GMS approval in June 2016, and also considering the time needed to prepare these measures and negotiate their impact with the stakeholders, such measures (e.g. re-negotiations of the vendors’ agreements, restructuring and reorganiziation plans, including the reduction of the management positions, will only be visible starting with the last months of 2016 and their impact in 2016 financial year will have a limited effect, sett-off by the intrinsic costs of the reorganization plans (e.g. compensations for restructured personnel). etc).

## Some considerations on the current status of the Bank as of the date of the proposed budget

The 2015 loan deleverage process , implemented as a result of capital constraints has a significant impact on the current results of 2016: the 4m 2016 annualized operating income is registering a -15% (19 mio RON) reduction as compared with 2015, as stated bellow:

<i>RON k</i>	<i>Budget</i>					<i>Apr. 2016</i>	<i>Apr. 2016</i>	<i>Budget 2016</i>		
<b>Banca Carpatica</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>Total 2016</b>		<b>annualized</b>	<b>annualized vs. 2015</b>	<b>vs. Apr. 2016 annualized</b>		
Liquid assets	2,410,726	1,759,268	1,928,087	1,568,886	-19%	1,801,256	(126,832)	-7%	(232,370)	-13%
Loans to customers, net	1,226,135	1,069,610	793,973	870,729	10%	752,328	(41,645)	-5%	118,401	16%
<b>Total Asset</b>	<b>4,063,066</b>	<b>3,216,897</b>	<b>3,055,993</b>	<b>2,780,427</b>	<b>-9%</b>	<b>2,915,956</b>	<b>(140,036)</b>	<b>-5%</b>	<b>(135,529)</b>	<b>-5%</b>
Customers deposits	2,820,300	2,884,460	2,853,542	2,554,394	-10%	2,619,228	(234,314)	-8%		0%
Total liabilities	3,666,742	3,026,837	2,942,768	2,600,480	-12%	2,716,051	(226,716)	-8%		0%
hereof, subordinated loan	-	-	-	22,500						
<b>Total equity</b>	<b>396,324</b>	<b>190,061</b>	<b>113,225</b>	<b>179,947</b>	<b>59%</b>	<b>199,905</b>	<b>86,680</b>	<b>77%</b>		<b>0%</b>
Total operating revenues	217,159	214,319	123,580	101,057	-18%	104,494	(19,086)	-15%	(3,437)	-3%
Net interest income	71,418	66,589	47,899	47,840	0%	44,193	(3,707)	-8%	3,647	8%
Net commission income	28,155	24,576	21,555	21,728	1%	19,054	(2,500)	-12%	2,673	14%
Treasury sales and other revenues	117,587	123,153	54,126	31,489	-42%	41,247	(12,879)	-24%	(9,758)	-24%
Total operating expenses (OPEX)	(151,134)	(144,328)	(134,605)	(115,063)	-15%	(137,088)	(2,483)	2%	22,025	-16%
Non-operating expenses	(14,616)	(53,205)	(11,250)	(4,182)	-63%					
<b>Operational profit / (loss) before provisions</b>	<b>51,409</b>	<b>16,786</b>	<b>(22,275)</b>	<b>(18,188)</b>	<b>-18%</b>	<b>(35,680)</b>	<b>(13,405)</b>	<b>60%</b>	<b>17,493</b>	<b>-49%</b>
Loan loss provisions	(24,900)	(233,376)	(45,594)	(14,968)						
hereof Net IFRS charge	(33,899)	(237,397)	(51,794)	(33,588)	-35%	(7,976)	43,818	-85%	(25,612)	321%
hereof Recoveries from write off	8,999	4,020	6,200	18,620	200%	6,732	532	9%	11,888	177%
Taxation	11,896	13,529	(7,579)	-						
<b>Net profit /(net loss) of the period</b>	<b>38,405</b>	<b>(203,062)</b>	<b>(75,448)</b>	<b>(33,156)</b>	<b>-56%</b>	<b>(36,924)</b>	<b>38,524</b>	<b>-51%</b>	<b>3,768</b>	<b>-10%</b>
<i>Cost/income (%)</i>	<i>70%</i>	<i>67%</i>	<i>109%</i>	<i>114%</i>		<i>131%</i>				

In the above analysis, comparing the 4m 2016 annualized level of realized revenue, with the 2015 similar level and with the levels contained in the 2016 draft of the budget, we can conclude the following with regard to the current status of the Bank:

- a. **The level of productive assets** (interest bearing) of the Bank, the loan portfolio and the government bonds is declining in April 2016 versus December 2015 by 7% (securities) and by 5% (loans). This reduction is partly offset by a 8% reduction of resources, thus generating a reduction in the net interest income of -8% in April (annualized results) from the previous year. The Bank intends to stop declining trend of the net interest revenues by increasing the loan portfolio with +16% until the end of the year, which would restore the level of the net interest income to 2015 level (47.8 mio RON), mainly due to the lower cost of funds.
- b. **Net commission income** recorded in the 4m 2016 an annualized a decrease of -12% comparing to the previous year, for this year the Bank aiming to restore the annual level of this revenues by new loan production, which is consider to also trigger non-lending revenues from clients.
- c. **Total revenues (interest and capital gains) generated by the government securities portfolio are estimated to decrease with 20.9 mio. RON (-44% compared to 2015) due to the** following causes:
- i. The market interest rate decrease; the Bank's Tbonds portfolio estimated average yield has been projected at levels which are 0.86% lower in 2016 than the previous year. Thus, the interest income on the government securities in 2016 will record a decrease of 9.7 mio. RON (-33%) than the previous year, the decrease being offset by the reduced costs of funds raised from the market and from clientele;
  - ii. The revenues from the sale of government securities are expected to drop by 11 million RON in 2016 compared to 2015, following a decline of 78.5 million RON in 2015 compared to 2014, due to the decline of 83% of the reserve of the fair value (marked to market reserves) of the government securities available for sale from 2016. The Bank aims to achieve the same level of trading revenues based of the average portfolio of government securities as in the previous year (as shown in the comparison below), but *without increasing the leverage securities portfolio,* as realised until 2014, in line with the low market risk appetite of the bank for 2016 and proposing to maintain the leverage indicator in the regulated limits:

('000 RON)	<b>Budget</b>		
	<b>2014</b>	<b>2015</b>	<b>2016</b>
T bills reserve – BOP	15,558	11,375	1,901

T bills reserve – EOP	11,375	1,901	1,845
reserve decline during the year	(4,183)	(9,474)	(56)
Net revenues from AFS	95,999	17,534	6,389
Average balance T bills portfolio		1,228,731	1,113,458
% Revenues (w/o reserve decline)/T bills portfolio		0.66%	0.57%
Net revenues from AFS compared to previous year		(78,466)	(11,144)

- d. Out of the **-18% projected 2016 reduction of the total operating (-22.5 mio. RON) as compared with 2015**, at annualized level, -15% have already been lost until the publication date of this budget and the Bank has limited possibilities to restore the income volume at the level of 2015 year because the lending activity revival and the revenues generation through this activity can not be achieved immediately and it can only be done in a timely manner.
- e. **The effort to reduce the operating expenses** will start just after the budget approval, with an ambitious objective to reduce de operational expenses by 15% by the end of the year (19.5 mio. RON). These operating expenses reduction measures are absolutely necessary in order to cancel the negative effect of reducing the level of the operating revenues mentioned above and is represented by the implementation of some measures that should have been taken since 2015, when the operational income streams dramatically dropped for the first time (-42%) compared to the previous year (2014), but the operational costs reduction was only of 7%.
- f. **The operating result** (before the effect of the adjustments for the impairment loans) **remains in a negative territory of 18 mio. RON operational loss, 18% lower than the previous year** (2015: 22.3 mio. RON operational loss), but puts the Bank in a better position for the operational result in 2017 when the operational expenses cuts will take effect for the entire year. Thus, the December 2016 annualized effect of savings will show a 30% reduction of the operating expenses compared to 2015 (a reduction of -19% in the staff expenses and a decrease of -41% in non-staff expenses). This is an ambitious target and the management will apply measures of reducing expenses only to the extent that the Bank could control and reduce the operational risks, compliance, reputational and other risks that may appear during or as a result of the reduction expenses programme. The management wishes to stress the possibility of such exceeding expenditures in the budget execution in 2016, exceeding that can be caused by delaying the implementation or the incomplete implementation of the reducing measures in order to prudent manage the risks.

- g. The Bank records at the proposal date of this budget plan (May 2016) **net losses from the impairment adjustments of over 25 mio. RON, out of the 33.6 mio. RON proposed in the 2016 budget by year-end.** The Bank applies a periodic write-off policy for fully provisioned loans and on May 31, 2016 took off the balance sheet (direct decrease of the fully covered loans value with impairment adjustments) of a gross exposure of 74 mio. RON, following a review of the loan portfolio with delays higher than 180 days, for which the probability of the net exposure recovery, including the guarantees revaluation is very low. In order to reduce the losses already registered at the date of the present Budget, the Bank assumed a **written- offs loan recovery level (incomes) of 18.6 mio. RON** to be realised in the next 6 months until the end of 2016, 3 times bigger than the amounts realized in 2015, and representing the sum of 2013-2015 achievements from written—off loans. (in the period 2013-2015 there were achieved total revenues of 19.2 mio. RON).

### **Conclusion:**

*Because of the capitalization problems from previous years that were solved at the beginning of 2016 through the capital increase, Banca Carpatica is experiencing one of the lowest levels of operating revenues in recent years, a level which requires the implementation of fast and efficient measures in order to reduce the operational losses but will take effect starting with 2017.*

*Compared to this problem faced by the Bank, with the risks generated by the high rates of the nonperforming loans and the limited historic of nonperforming loans recovery and written-offs guarantees revaluations or taken into the receivables account, Banca Carpatica aims for 2016 a wide restructuring process and an intensive programme to reduce the operational costs aimed mainly to the headquarters and the operational centers of the Bank, simultaneously with an ambitious programme of lending activity revival and increasing the operating revenues with the clients in which the branches network will play a key role.*

### **The key assumptions for drafting the proposed budget were:**

When drafting the budget for 2016, the following hypothesis and facts have been considered:

- a) Bank's audited financial statements as at 12/31/2015
- b) The preservation of Bank's liquidity in terms of continuing efforts to reduce the costs of resources of non-bank customers
- c) Carpatica's ability to originate new loan production, considering the current capital level, as result of Patria Bank's subscription in the bank's capital;
- d) Enhance the recovery activity of non-performing loans (on and off balance sheet), and of sales of the repossessed assets, with significant aging in the Bank's balance sheet;
- e) High priority program to cut operational costs

Main assumptions used in the construction of this budget are:

All amounts are expressed in million RON (The 2016 EUR/RON exchange rate: 4.50) -

	Δ Budget 2016/2015
Loans and advances to customers, net	10%
Securities portfolio variation	-11%
Customers deposits variations	-10%
Loans Interest Income	-22%
Interest income from financial assets AFS/HTM	-33%
Interest expenses (customers deposits and other)	-46%
Net Commission Income	1%
Net Trading Revenues	-16%
Net revenues from Financial assets available for sale	-64%
<b>Total operating expenses (OPEX)</b>	<b>-15%</b>

Therefore, we forecast the following evolution of Bank's Balance Sheet and Profit and Loss Account:

Million RON	ACTUAL	ACTUAL	BUDGET	Δ (%)
	2014	2015	2016	2016/2015
<b>Total ASSETS, of which</b>	<b>3,216.9</b>	<b>3,056.0</b>	<b>2,780.4</b>	<b>-9%</b>
Loans and advances to customers, net	1,069.6	794.0	870.7	10%
Financial assets available for sale / held to maturity / held for trading	1,328.3	1,348.7	1,203.2	-11%
Cash and accounts with the Central Bank	424.4	560.7	338.7	-40%
Treasury placements	6.6	18.7	26.9	44%
Other assets	388.0	333.9	340.8	2%
<b>Total LIABILITIES, of which</b>	<b>3,216.9</b>	<b>3,056.0</b>	<b>2,780.4</b>	<b>-9%</b>
Customers deposits	2,884.5	2,853.5	2,554.4	-10%
Borrowings and other liabilities	142.4	89.2	23.6	-74%

Million RON	ACTUAL	ACTUAL	BUDGET	Δ (%)
	2014	2015	2016	2016/2015
Subordinated loans	0.0	0.0	22.5	
Equity	190.1	113.2	179.9	59%
Net Interest Income, of which:	66.6	47.9	47.8	0%
<i>Loans Interest Income</i>	104.3	75.9	59.2	-22%
<i>Financial assets available for sale/ Financial assets held to maturity Interest Income</i>	53.9	29.8	20.1	-33%
<i>Other interest income</i>	1.9	0.9	0.4	-56%
<i>Interest Expense (customers deposits and other)</i>	(93.6)	(58.7)	(31.8)	-46%
Net Commission Income	24.6	21.6	21.7	1%
Net Trading Revenues, of which:	13.6	14.3	12.0	-16%
<i>Treasury Sales</i>	12.0	12.3	8.7	-29%
<i>Other net trading revenues</i>	1.5	2.1	3.3	61%
Net revenues from Financial assets available for sale	96.0	17.5	6.4	-64%
Other operating revenues	13.6	22.2	13.1	-41%
<b>Total operating revenues</b>	<b>214.3</b>	<b>123.6</b>	<b>101.1</b>	<b>-18%</b>
Net expense related to impairment of loans /equity participations, of which:	(233.4)	(45.6)	(15.0)	-67%
<i>Expense related to impairment of loans / equity participations</i>	(237.4)	(51.8)	(33.6)	-35%
<i>Recoveries from written off loans</i>	4.0	6.2	18.6	200%
<b>Net operating revenues/(expenses)</b>	<b>(19.1)</b>	<b>78.0</b>	<b>86.1</b>	<b>10%</b>
<b>Total operating expenses (OPEX)</b>	<b>(144.3)</b>	<b>(134.6)</b>	<b>(115.1)</b>	<b>-15%</b>
Non-operating expenses	(53.2)	(11.2)	(4.2)	-63%
<b>Gross Profit/( Gross Loss)</b>	<b>(216.6)</b>	<b>(67.9)</b>	<b>(33.2)</b>	<b>-51%</b>
Taxation	13.5	(7.6)	0.0	-100%
<b>Net Profit/(Net loss) for the period</b>	<b>(203.1)</b>	<b>(75.4)</b>	<b>(33.2)</b>	<b>-56%</b>



	2014	2015	2016
Total solvency ratio	10.8%	4.9%	13.1%
RWA (M. RON)	1,771	1,182	1,190

**The investments budget for 2016** has been drawn up as follows:

- Tangible assets: RON 3.7 M
  - IT software and other intangible assets: RON 3.1 M
- TOTAL: RON 6.9 M

Member of the Management Board

Daniela Iliescu