# REPORT ON OPERATIONS OF
# THE CAPITAL GROUP OF
# BANK HANDLOWY W WARSZAWIE SA
# IN THE YEAR 2001

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# I. The Polish economy in 2001

## *1. Key macroeconomic trends*

In 2001, the development of the Polish economy was affected by the clear weakening. The real GDP growth came to 1.1%, the lowest increase since the recession of the early 1990s. The principal factor behind slow GDP growth was a fall in investment, with gross capital formation dropping 13.8%, including a 12.9% decline in fixed investment. This fall was primarily responsible for the 2% decrease in domestic demand recorded in 2001. Consumption growth was also slower, at just 1.8%, with personal consumption up 2.1%, whereas a year earlier the corresponding figures had stood at 2.4% and 2.6%, respectively.

Industry slid into recession. Industrial output contracted in absolute terms from the second quarter onwards, and over the whole of 2001 slipped 0.2% on the previous year, with manufacturing output down 0.6%. Last year also saw the slump in construction become more pronounced, with output here sinking almost 10%.

One consequence of sluggish economic growth, and also of demographic changes and the continuation of restructuring within the economy, was a surge in the rate of registered unemployment, which leapt to 17.4% in December 2001, as against 15% twelve months before. The jobless total increased to over 3.1 million.

Weakening of the economic expansion was followed by improvement in internal and external imbalance. On a cash basis, exports rose 7.2% year-on-year, while imports went up just 1.3%, which is traceable to weak domestic demand, low oil prices and PLN appreciation. However, a gradual slowdown in export growth had already become visible by the latter half of the year, the result of poorer economic activity worldwide, and particularly in the EU countries. With growth in exports outpacing that of imports, the trade gap narrowed, leading to a decrease in the current account deficit, which dropped to USD 7.08 billion, or 4% of GDP, compared to 6.3% a year before. The pattern of financing for this deficit also improved, with a dominant role being played by foreign direct investment (accounting for over 90% of the deficit), despite FDI coming down in nominal terms compared to 2000 due to the weaker Polish economy and the smaller scale of privatisation.

The official reserve assets declined USD 901 million in 2001, to stand at USD 26.6 billion, mainly as a result of the early repayment of Polish government debt to Brazil, which was partly funded from the foreign exchange reserves of the central bank.
The year 2001 brought a distinct fall in inflation. The annual increase in the Consumer Price Index (CPI) declined to 3.6% in December, as against 8.5% a year earlier, thereby well undershooting the 6%-8% inflation target set by the National Bank of Poland (NBP). Producer price growth (as measured by the PPI) was 0.2% lower December-on-December, and annualised average growth came to 1.6%. The most important factors constraining inflation were positive price shocks (fuel prices down 17.6% over the year, and moderate food price growth), weak consumer demand, and the appreciation of the PLN.

Growth in monetary aggregates did not represent any threat to the process of containing inflationary pressure. Money supply growth stood at PLN 40.1 billion, equivalent to an annual 13.7%. Total deposits rose 14% (as against 15.5% in 2000, albeit in a situation of much higher inflation), which attests to a maintenance of the propensity to save despite the reduction in deposit rates in the wake of successive cuts in official interest rates. The second half of the year saw growth in foreign currency deposits pick up substantially, while the final two months witnessed waning growth in PLN deposits (particularly personal balances); the latter was undoubtedly linked to the introduction of a tax on interest income. The downward trend in lending growth, a positive factor in holding down inflation, was sustained both for personal outstandings (up just under 14.7% compared to 31.7% in 2000) and loans to corporates (up 5.4%, as against 13.5%), which constituted yet another confirmation of sagging domestic demand.

The government deficit came to PLN 32.6 billion, equivalent to 98.8% of the target as twice revised. In relation to GDP the deficit increased to 4.5% from 2.2% in previous year. The deficit of public sector increased to 5.3% of GDP from 3.2% in 2000, and economic deficit (deficit of public sector less payments to pension funds and increased by compensation for diminished indexation of pension payments and remuneration of budget sector) – to 4.9% of GDP from 2.1% in 2000.

**Basic economic indicators**

| | **2001** | **2000** | **1999** | **Change 2001/2000** |
|---|---|---|---|---|
| | % change on previous year | | | |
| Gross Domestic Product (real growth) | 1.1 | 4.0 | 4.1 | -2.9 |
| Personal consumption | 2.1 | 2.6 | 5.2 | -0.5 |
| Gross fixed investment | -10.2 | 2.7 | 6.8 | -12.9 |
| Industrial output (real growth) | -0.2 | 7.1 | 4.4 | -7.3 |
| Inflation | December/December | | | |
| CPI | 105.5 | 108.5 | 109.8 | -3.0 |
| PPI | 101.6 | 105.7 | 108.1 | -4.1 |
| Unemployment, December (%) | 17.4 | 15.0 | 13.0 | 2.4 |
| | % GDP | | | |
| Government deficit | 4.5 | 2.2 | 2.0 | 2.3 |
| Current deficit | 4.0 | 6.3 | 7.5 | -2.3 |
| | **In USD million** | | | |
| Exports, goods | 30 275 | 28 257 | 26 347 | 7.1 |
| Imports, goods | 41 956 | 41 424 | 40 727 | 1.3 |
| Balance of trade | -11 681 | -13 167 | -14 380 | -11.3 |
| Current balance | - 7 080 | -9 952 | -11 569 | -28.9 |

## 2. *The money market and FX market*

With inflationary pressure ebbing markedly and economic stagnation deepening, the National Bank of Poland gradually loosened its monetary policy in 2001, carrying out six cuts in official interest rates, totalling seven and a half points altogether. As a result, at year end 2001 the lombard rate stood at 15.5% and the rediscount rate at 14.0%, while the reference rate (the minimum rate on 28-day reverse repos) stood at 11.5%. Nevertheless, the exceptionally steep fall in inflation (down from an annual 8.5% in December 2000 to 3.6% in December 2001) meant that real interest rates stayed in double figures for the greater part of the year, remaining the highest among those emerging markets of comparable investment risk, which had specific consequences for developments on the market for debt securities.

Cuts in base rates led to a steady decline in interbank rates, which were also impacted by the open market operations conducted by the central bank (primarily reverse repos involving NBP money market bills). The National Bank also continued outright sales, begun in September 2000, of Treasury bonds issued as a result of the conversion of Treasury liabilities to the NBP into negotiable securities; these sales are intended to achieve an “operational liquidity shortage” within the banking system, thereby heightening the effectiveness of interest rate policies.

The policy of bringing down base rates little by little was one of the main factors conditioning the situation on the Treasury bill market. Combined with the high level of real interest rates, this produced record demand for T-bills (139 billion PLN), which – despite the very large supply of bills on the primary market, amounting to almost 50 billion PLN – pushed prices up and yields down; this downtrend in yields was also maintained on the secondary T-bill market and on the T-bond market.

The dominant trend on the Polish FX market in 2001 was for the PLN to appreciate strongly in both nominal and real terms. The twelve-month average value of the dollar slipped to 4.0976 PLN in 2001 from 4.3455 PLN a year previously, representing nominal PLN appreciation against that currency of 5.7%. The euro traded at an average of 3.5867 PLN during the year, down from 4.0114 PLN in 2000, with the PLN thus gaining a hefty 10.6% against the single currency in nominal terms, which was largely the result of last year's euro depreciation against the dollar. In relation to the reference currency basket (the "virtual basket", as it existed before the PLN was floated), the PLN gained a nominal 8.4%, while in real terms it went up some 6.5% (as adjusted by annualised average PPI inflation of 1.6%). Over the whole year, the PLN dipped sharply only once, in July, due to the financial difficulties being suffered by Argentina and Turkey, and also because of the statement by Leszek Miller that a financial crisis in Poland was probable.

PLN appreciation in 2001 was chiefly fed by an influx of foreign portfolio investment targeting Polish debt securities, the result of the high yields obtainable on these and the slow narrowing of interest rate differentials. Another factor attracting foreign investors to Poland was the decrease in investment risk issuing from the gradual restoration of macroeconomic equilibrium, particularly external equilibrium. Last year's PLN appreciation was also fuelled by the inflow of capital associated with the privatisation of further Polish companies, although the smaller scale of privatisation meant that this factor was of much less importance to the PLN than it had been in previous years.

### 3. *The capital market*

The year 2001 was exceptionally unfortunate for stock market investors. From January to September, the Warsaw Stock Exchange was in the grip of an acute slump that represented a continuation of the downward trend begun back in the first half of 2000. This downswing was linked to the deteriorating economic environment both in Poland and abroad. An improvement in investor sentiment was not forthcoming until the fourth quarter, when the market began pricing in an expected economic upturn and healthier company profits, these being projected to follow on from the monetary easing carried out by the central bank.

All in all, the main Warsaw share index, the WIG, lost 22.0% over the year, as against a decline of 1.3% the year before. The WIG-20 index, which tracks the largest companies by market capitalisation and turnover, tumbled even further, sliding 33.5%, compared to a 1.5% increase in 2000. In this context, the share prices commanded by the banks listed on the Warsaw Exchange fared relatively well. The WIG-BANKI index gained 8.9%, whereas in 2000 it had gone down 4.1%. Stock exchange turnover in 2001 came to PLN 84.5 billion (down 53% on 2000), while total market capitalisation at year end stood at PLN 103.4 billion (down 21%). The number of companies listed on the Warsaw Exchange rose from 225 to 230.

### *4. The banking sector*

The slowdown in the economy in 2001 and deterioration in the financial situation of both corporates and individuals led to weaker growth in income from banking activity and in total assets at the banks, especially in the size of loan books. Figures from the NBP put the net earnings of the banking sector in 2001 at 4.5 billion PLN, an increase of 7% on the year before. However, this increase was made possible almost exclusively by stronger earnings at the two largest retail banks, while the remaining banks together recorded a fall in profits of 24%.

Growth in the sector's net earnings from banking activity declined to 5%. A major factor behind this was the narrowing of interest margins as asset yields dropped (the reasons for this included falling interest rates at home and abroad, and also the rise in the relative proportion of foreign currency assets, earning lower rates of interest), together with a decrease in the relative share of performing assets as loss assets increased dramatically. However, the adverse effect of movements in interest margins was offset by growth in non-interest income. Particularly rapid growth was seen in net FX gains (up 64%), the result of the banks' active involvement on the currency market, including forwards and options.
In response to flagging growth in income, some institutions undertook restructuring measures, which allowed growth in expense within the banking industry to be reduced to 3%, the lowest level for several years. An especially large part in cutting costs was played by staff downsizing, which was additionally encouraged by consolidations and by the expanding application of modern banking technologies.

The banks experienced a further worsening in loan portfolio quality, expressed in a rising proportion of irregular assets within those portfolios. This is attributable to the decline in the credit capacity of their customers, particularly corporate ones, due to the mounting crisis within the Polish economy. The upshot of this was that net provisioning expense climbed 14%, to 5.1 billion PLN. Overall provisioning expense was further increased by the steep downturn on the capital market, which forced banks to establish additional valuation allowances against financial fixed assets.

The year 2001 brought a continuation of consolidations within the banking industry. Of the 20 largest banks at the beginning of 2001 by total footing, 6 were incorporated into other institutions in the course of the year as a result of mergers. At year end, the concentration ratio within the industry, as measured by the proportion of total banking sector assets held by the 10 largest banks, stood at 76%, compared to 67% at the end of 2000.

## II. Major events exerting a significant influence on the business and earnings of the Group in 2001

- On 12 January 2001, the Polish Treasury transferred to PKO Bank Polski S.A. 1,558,067 shares in the Bank, which then represented 2.23% of the Bank's authorised capital and confer the right to 1,558,067 votes at the General Meeting of Shareholders, this constituting 2.23% of all voting rights. Following the transaction, the Treasury held 3,250,000 shares in the Bank, representing 4.65% of the Bank's authorised capital and conferring the right to 3,250,000 votes at a General Meeting of Shareholders, which constituted 4.65% of all voting rights.

- On 16 January 2001, a subsidiary undertaking of the Bank, Handlowy Inwestycje Sp. z o.o., Warsaw, sold 6,134 shares in Danuta S.A., Malbork, to D International Sp. z o.o., these representing an interest of 28.77% in the equity of Danuta S.A. and conferring the right to 28.77% of votes at a General Meeting of that company's Shareholders.
- On 29 January 2001, Citibank Overseas Investment Corporation, New Castle, USA ("COIC"), in an off-market transaction acquired 437,500 of the Bank's Series I Convertible Bonds, admitted for public trading, from ZCI Netherlands B.V., a subsidiary of Zurich Financial Services. After the transaction COIC held 17,648,500 of the Bank's Convertible Bonds, which are exchangeable for 17,648,500 shares at dates set by the Management Board.
- On 13 February 2001, the Bank acquired from the National Bank of Poland 34,549 shares in Bank Handlowy International S.A., Luxembourg ("BHI"), representing an interest of 28.79% in the share capital of BHI and conferring the right to the same percentage of votes at that bank's General Meeting of Shareholders. The acquisition of these shares in BHI stemmed from a conditional agreement, concluded on December 27, 2000, by which the Bank was to purchase all shares in BHI held by the NBP. In line with the provisions of that agreement, the Bank had obtained the requisite approvals for the transaction from the Supervisory Board of BHI and the Luxembourg Monetary Institute. As a result of the transaction, the Bank holds 87,741 shares in BHI, constituting 73.12% of its share capital.
- **On 28 February 2001, the Registry Court entered in the business register maintained at the National Court Registry the merger of the Bank and Citibank (Poland) S.A. ("CPSA") performed pursuant to resolutions of extraordinary general meetings of shareholders of both the banks adopted on 3 November 2000 ("the Merger"), and registered the increase in the authorised capital of Bank Handlowy ensuing from the Merger. The Merger was carried out by transferring the entire assets of CPSA to the Bank in consideration for shares to be provided by the Bank to the shareholders of CPSA. On the registration of the increase in the Bank's authorised capital stemming from the Merger, this capital stands at 430,308,400 PLN, divided into 107,577,100 bearer shares, each with a par value of 4 PLN. Following the recording of the Bank's Series C shares on the securities accounts held by the previous CPSA shareholders, which took place on March 21, 2001, COIC, a subsidiary of Citibank N.A., together with its direct subsidiaries Centaur Investment Corporation and Foremost Investment Corporations, held 99,069,074 shares in the Bank, representing 92.09% of the Bank's authorised capital and conferring the right to 90,069,074 votes at a General Meeting of Shareholders, which constitutes 92.09% of total voting rights.**
- On 14 March 2001, a Preliminary Act of Sale was signed concerning shares in Cuprum Bank S.A., Lubin. The shares being sold by Bank Handlowy w Warszawie SA represent an interest of 55.2% in the authorised capital of Cuprum Bank SA, carrying 50.2% of voting rights at a General Meeting of that bank's shareholders. The Preliminary Act of Sale is a conditional agreement, containing covenants that defer performance of the transaction, such as the requirement that the purchasing party obtain the approval of the Commission for Banking Supervision to acquire the shares in Cuprum Bank S.A. on the terms and conditions specified in the Act of Sale, and also obtain a final ruling from the President of the Agency for Competition and Consumer Protection permitting acquisition of the shares.
- On 1 April 2001, in performance of an agreement concluded on 23 March 2001, between Bank Handlowy and Citibrokerage S.A. ("Citibrokerage") the transfer of a business as understood under Art. 551, of the Civil Code, this constituting an organisationally separate establishment of Bank Handlowy, previously trading as Bank Handlowy w Warszawie SA, Warsaw Branch V, Capital Markets Centre ("COK BH") to Citibrokerage was effected. The

COK BH brokerage business was transferred to Citibrokerage as a non-cash consideration for equity against an increase in the authorised capital of Citibrokerage, pursuant to a resolution of the General Meeting of Shareholders of that company adopted on 7 March 2001. On the transfer of COK BH to Citibrokerage, the name of the latter company was changed to “Dom Maklerski Banku Handlowego SA” (“DM BH”).

- After the assimilation of 37,659,600 Series C ordinary bearer shares with the 69,917,500 Series A ordinary bearer shares already listed, which took place on 12 April 2001, there were 107,577,100 of the Bank’s ordinary bearer shares listed for trading on the Warsaw Stock Exchange.

- On 26 April 2001, the rating agency Moody’s Investors Service Limited upgraded the Bank’s financial strength rating from D+ to C-. This change stemmed from the agency expanding its ratings scale from nine to thirteen grades. The current scale is as follows: A, A-, B+, B, B-, C+, C, C-, D+, D, D-, E+, E.

- On 7 May 2001, the Bank concluded a syndicated loan agreement with Polish State Railways S.A., with the total amount of the facility provided being the euro equivalent of 700m PLN. Other participants in the syndication are Dresdner Kleinwort Wasserstein, Westdeutsche Landesbank Girozentrale London Branch, and Westdeutsche Landesbank Polska S.A. The Bank’s participation was agreed at the euro equivalent of PLN 233.3 million. The loan was granted for one year, to finance the objectives set for the borrower under the Act on the Commercial Incorporation, Restructuring and Privatisation of the “Polish State Railways” State Enterprise, of 8 September 2000.

- On 18 May 2001, 4,000,000 shares in the company of Pia Piasecki S.A., Kielce, were recorded on the Bank’s securities account. As a result of the exchange of 400 convertible bonds held by the Bank, each with a par value of PLN 100,000, for shares in Pia Piasecki S.A., the Bank acquired 4,000,000 shares in the company, each with a par value of PLN 2, at a price of PLN 10 per share, which shareholding constitutes an interest of 36.52% in the company’s authorised capital and confers the same percentage of votes at a General Meeting of Shareholders. Together with its subsidiary undertakings, the Bank held 4,615,093 shares in the company, representing 42.13% of its authorised capital and carrying the same percentage of voting rights at a General Meeting of Shareholders. Prior to this transaction, the Bank did not hold any shares in that company.

- On 1 June 2001, a subsidiary undertaking of the Bank, Handlowy Investments S.A., Luxembourg, disposed of 2,500,000 shares in Frantschach Świecie S.A., which represented a 5% interest in this company’s capital and conferred the same proportion of voting rights. As a result of this transaction, neither the Bank nor Handlowy Investments S.A. hold any shares in Frantschach Świecie S.A.

- On 25 June 2001, an Ordinary General Meeting of Shareholders of the Bank adopted a resolution on the distribution of net earnings for the year 2000, which also specified the date of record and the date for payment of a dividend.

  The Ordinary General Meeting resolved:

  1. that net earnings for the year 2000, amounting to PLN 204,711,297.06 be distributed as follows:
     a) payment of a dividend of PLN 130,659,600.00 to shareholders and bondholders holding Series I convertible bonds, meaning that the dividend attributable per share and per bond shall be PLN 1,

   b) appropriation to capital of PLN 71,051,697.06, this comprising:
      – an appropriation to the capital surplus of PLN 21,051,697.06,
      – an appropriation to the general risk reserve of PLN 50,000,000.00,
   c) appropriation of PLN 3,000,000.00 to a special-purpose fund, namely, the Employee Social Benefit Fund,
2. that the Bank's Management Board be authorised to make use of the appropriation of PLN 3,000,000.00 to the Employee Social Benefit Fund in order to increase funds available for the purpose of addressing the housing needs of the Bank's staff,
3. that the date of record be 26 July 2001,
4. that the date for payment of the dividend be 3 September 2001.

- On 27 June 2001, the Bank sold part of the shares it held in MHB Mitteleuropaische Handelsbank Aktiengesellschaft Deutsch-Polnische Bank ("MHB AG"). In performance of an Act of Sale signed on 21 December 2000, the Bank (as the selling party), transferred 2,131 ordinary shares in MHB AG, each with a par value of DM 10,000, to NORD/LB Nordeutsche Landesbank Girozentrale, Hannover (the purchasing party), for a consideration of DM 24,184,795. The shareholding thus sold represented an interest of 22.80% in the share capital of MHB AG and conferred the right to exercise 22.80% of votes at a General Meeting of Shareholders.

- On 10 July 2001, the Warsaw Regional Court ruled that an increase be registered in the authorised capital of the Bank's subsidiary, Dom Maklerski Banku Handlowego S.A., and amendments be registered to that company's articles of association. The company's authorised capital was increased against a non-cash consideration to the company made by Bank Handlowy in the form of its brokerage business, previously trading as Bank Handlowy w Warszawie SA, Warsaw Branch V, Capital Markets Centre. As a result of the increase in the company's authorised capital, the Bank took up 37,300 Series B registered ordinary shares, each with a par value of PLN 1,500, i.e., all the shares newly issued by the company. Following the registration of the increase, the company's authorised capital now amounts to PLN 70,950,000, divided into 47,300 registered ordinary shares with a par value of PLN 1,500 each, these comprising 10,000 Series A shares and 37,300 Series B shares, which confer the right to 47,300 votes at a General Meeting of the company. All of these shares are held by Bank Handlowy.

- On 18 September 2001, the Bank sold its entire shareholding of 295,336 shares in Centro Internationale Handelsbank AG (Centrobank) to Raiffeisen Zentralbank Oesterreich AG (RZB, Austria), for a consideration of ATS 300,000,000, with this holding constituting 45.09% of the share capital of Centrobank and conferring the right to the same percentage of votes at a General Meeting of Shareholders.

- On 12 November 2001, the Bank concluded a subscription agreement with the European Investment Bank, whereby Bank Handlowy committed itself to take up, on the primary market, bonds to a par value of PLN 200,000,000 at an issue price equivalent to 45.7893 percent, with these bonds subsequently being issued on 23 November 2001.

- On 16 November 2001, the Bank concluded another subscription agreement with the European Investment Bank, whereby Bank Handlowy committed itself to take up, on the primary market, bonds to a par value of PLN 300,000,000 at an issue price equivalent to 45.8696 percent, with these bonds subsequently being issued on 29 November 2001.

- On 3 December 2001, the Bank concluded an agreement with an associated undertaking, Mostostal Zabrze-Holding S.A., to terminate the Investment Agreement concluded between Mostostal Zabrze-Holding S.A. and the Bank on 27 April 2000, which had provided for the possibility of taking up that company's issue of series VI shares.

- On 19 December 2001, the rating agency Moody's Investors Service Limited downgraded the Bank's financial strength rating from C- to D+. Moody's said that these rating actions reflected the impact of a difficult operating environment on the Bank's financial fundamentals, the deterioration of asset quality and the high restructuring expense flowing from the Bank's merger with Citibank (Poland) SA. However, the agency noted that the Bank was strengthening its franchise, developing its product range, working to improve asset quality and reducing costs. Nonetheless, in view of the current difficult economic environment, the agency believed that the effects of these measures will only become visible in the longer term.

- By 31 December 2001, the Bank had sold its entire claim on OAO Gazprom, then valued at USD 33,800,000, to a connected undertaking, namely, OOO Commercial Bank "Citibank T/O", Moscow. This claim had arisen on the Bank's sub-participation in a syndicated loan arranged by Dresdner Bank. The bank received from Citibank T/O 100% of the value of the claim thus sold, as carried at the transaction date.

## III. Structure of the Group

The Capital Group of Bank Handlowy w Warszawie SA („Group") includes:

- **Parent entity** – Bank Handlowy w Warszawie SA („Bank", „Parent entity")

and the following consolidated or non-consolidated subsidiary and associated undertakings:

- **Entities constituting the Group and fully consolidated**

  Subsidiary undertakings:

  Dom Maklerski Banku Handlowego SA

- **Entities constituting the Group and consolidated on an equity basis**

  Subsidiary undertakings:

  Handlowy Inwestycje Sp. z o.o., Warsaw

  Handlowy Inwestycje II Sp. z o.o., Warsaw

  Handlowy Investments S.A., Luxembourg

  Handlowy Investments II S.a.r.l., Luxembourg

  Associated undertakings:

  PKO/Handlowy Powszechne Towarzystwo Emerytalne S.A., Warsaw

- **Entities constituting the Group and excluded from consolidation**

Subsidiary undertakings:

Bank Handlowy International S.A., Luxembourg

Bank Rozwoju Cukrownictwa S.A., Poznań

Budowa Centrum Plac Teatralny Sp. z o.o., Warsaw

Citileasing Sp. z o.o., Warsaw

Cuprum Bank S.A., Lubin

Handlowy Leasing S.A., Warsaw

Handlowy Zarządzanie Aktywami S.A., Warsaw

Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A., Warsaw

PPU Spomasz Sp. z o.o., Warsaw

Towarzystwo Funduszy Inwestycyjnych BH S.A., Warsaw

Tower Service Sp. z o.o., Warsaw

Associated undertakings:

Creditreform PL. Sp. z o.o., Warsaw

Elektromontaż Poznań S.A., Poznań

Hortex Holding S.A., Płońsk

Handlowy Heller S.A., Warsaw

IPC JV Sp. z o.o., Warsaw

KP Konsorcjum Sp. z o.o., Warsaw

Mostostal Zabrze Holding S.A., Zabrze

NIF FUND Holdings PCC Ltd, Guernsey

Obsługa Funduszy Inwestycyjnych Sp. z o.o., Warsaw

Pia Piasecki S.A., Kielce

Polimex - Cekop S.A., Warsaw

Polska Giełda Finansowa S.A., Warsaw

Zakłady Odzieżowe Bytom S.A., Bytom

## IV. Shareholders holding at least 5% of the parent entity authorised capital and of total votes at a General Meeting of Shareholders

At 31 December 2001, the shareholders in the Bank holding no less than 5% of the Bank's authorised capital and of total voting rights at a General Meeting of Shareholders, either directly or indirectly (via subsidiary undertakings), were as follows:

- Citibank Overseas Investment Corporation, New Castle, Delaware, USA ("COIC"), a subsidiary of Citibank N.A., which was entitled to exercise 91.39% of voting rights at a General Meeting of Shareholders (i.e., 98,315,774 votes), and held a 91.39% interest in the Bank's authorised capital (i.e., 98,315,774 shares).
- All other shareholders, including the Polish Treasury, held less than 5% of the Bank's authorised capital and of voting rights at a General Meeting of Shareholders.

## V. Basic data on balance sheet and financial performance of the Group

### 1. Consolidated balance sheet

The consolidated financial data included in the present Report of the Management Board on the operations of the Group in 2001 refer to the financial data for the Group subsequent to the merger with Citibank (Poland) S.A. ("CPSA") and the transfer of COK BH to Dom Maklerski Banku Handlowego SA ("DM BH") as a non-cash consideration for equity.

Balance sheet of the Bank as parent entity in the Group determines both total assets and the structure of assets and liabilities of the Group.
At 31 December 2001, the Group's total assets amounted to PLN 33,081 million, representing an increase of 57.9 % on year end 2000. The Group's increase of operations accelerated mainly due to merger of the Bank with CPSA.

At 31 December 2001, the largest single item in the consolidated assets, amounting to PLN 14,100 million, were amounts due from customers and Budget. Compared to year end 2000, growth in this asset item came to PLN 4,160 million, i.e. 41.8%, with a slight decrease in its share in total assets, down from 47.5% to 42.6%.

The Group's total portfolio of debt securities climbed 69.3% compared to the end of 2000, to stand at PLN 2,462 million at the end of December 2001. Their share in total assets increased only from 6.9% to 7.4% at the end of current reporting period.
Treasury securities represented 65.4% of this portfolio (with 21.1% of these securities being Treasury bonds and 78.9% being Treasury bills). The second largest component were debt securities issued by the National Bank of Poland, which accounted for 25.1% of the total portfolio. The remainder of the portfolio, accounting for 9.5%, mainly comprised corporate bonds and commercial paper.

Amounts due from financial institutions came to PLN 6,283 million, representing an increase by 27.9%. However, this item shrank as a proportion of total assets, coming down from 23.5% to 19%.

The Group's holdings of equities and other securities came down by 13.6%, primarily due to a reduction in the interests held in subsidiary and associated undertakings consolidated on an equity basis.

Large growth was recorded at year end in fixed assets and intangibles. The value of fixed assets amounted PLN 903 million, an increase of 36% compared to the end of 2000. This increase was mainly associated with the Bank's merger with CPSA.
Intangible fixed assets amounted to PLN 1.483 million, representing an increase of PLN 1,416 million compared to the end of 2000. This increase was mainly associated with acquired goodwill arising on the Bank's merger with CPSA. At the end of December 2001, the latter amounted to PLN 1,389 million.

Customer deposits principally supported the growth in the Group's business activity in 2001. At year end, amounts due to customers and Budget represented the biggest part of the Group's liabilities. Amounts due to customers and Budget increased by 72%. This resulted in the growth of their share in total liabilities from 47.5% to 51.7%.

Due to the substantial deposit growth recorded, the use of interbank funding was scaled down. At the end of December 2001, the volume of funds sourced from financial institutions declined by 5.6% when comparing to the end of 2000, and their share declined from 24% of total liabilities and capital at the end of 2000 to 14.3% at the end of the reporting period.

Major change in consolidated liabilities of the Group in 2001 was an increase in own equity of the Bank resulting from issue of new C series shares. As at 31 December 2001 own funds (excluding net profit) amounted to PLN 5,673 million, representing 17.1% of liabilities and their share increased during 2001 by 2.95%. When comparing to the end of 2000 it increased by PLN 2,699 million, i.e. 90.7%.

## CONSOLIDATED BALANCE SHEET of the Group

| PLN thousand | As of the end of the period 2001 | 2000 | Change % 2001/2000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and due from central bank | 2 322 443 | 699 315 | 232.1% |
| Due from financial institutions | 6 283 223 | 4 914 049 | 27.9% |
| Due from non-financial sector and the State Budget | 14 100 256 | 9 940 585 | 41.8% |
| Due from non-consolidated subsidiary and associated undertakings | 822 933 | 493 586 | 66.7% |
| Due from subsidiary and associated undertakings consolidated on an equity basis | - | 409 654 | - |
| Debt securities | 2 462 497 | 1 454 331 | 69.3% |
| Equity investments | 542 636 | 628 317 | -13.6% |
| Tangible and intangible fixed assets | 2 386 986 | 731 227 | 226.4% |
| Other assets | 4 160 143 | 1 675 159 | 148.3% |
| **TOTAL ASSETS** | **33 081 117** | **20 946 223** | 57.9% |
| **LIABILITIES** | | | |
| Due to central bank | 212 486 | 315 483 | *-32.6%* |
| Due to financial sector | 4 741 318 | 5 020 547 | *-5.6%* |
| Due to non-financial sector and the State Budget | 17 100 595 | 9 939 416 | *72.0%* |
| Due to non-consolidated subsidiary and associated undertakings | 149 286 | 172 785 | *-13.6%* |
| Due to subsidiary and associated undertakings included in the consolidation on an equity basis | 79 272 | 389 658 | *-79.7%* |
| Securities issued | - | 4 | - |
| Other liabilities | 4 528 678 | 1 649 719 | *174.5%* |
| Provisions | 432 972 | 299 411 | *44.6%* |
| Equity reserve from consolidation | - | 2 513 | - |
| Own equity | 5 673 224 | 2 974 351 | *90.7%* |
| Net profit | 163 286 | 182 336 | *-10.4%* |
| **TOTAL LIABILITIES** | **33 081 117** | **20 946 223** | 57.9% |

Value of off-balance sheet commitments of the Group amounted to PLN 9.765 million as at 31 December 2001.

## 2. Consolidated profit and loss statement

The consolidated profit and loss statement includes earnings of the Group generated by the Bank as parent entity and consolidated subsidiary and associated undertakings.

### CONSOLIDATED PROFIT AND LOSS STATEMENT OF THE GROUP

| | **01.01 - 31.12** | | **Change %** |
|---|---|---|---|
| PLN 000's | **2001** | **2000** | **2001/2000** |
| Net interest income | 727 931 | 658 344 | 10.6% |
| Net fee and commission income | 498 650 | 331 669 | 50.3% |
| Income from shares and other securities | 11 180 | 5 358 | 108.7% |
| Net profit on financial operations | 17 311 | -1 452 | -1292.2% |
| Net profit on foreign exchange | 783 468 | 482 658 | 62.3% |
| **Profit on banking activity** | **2 038 540** | **1 476 577** | **38.1%** |
| Other net operating income | -9 502 | 21 264 | -144.7% |
| General expenses | -1 064 945 | -816 835 | 30.4% |
| Depreciation | -161 588 | -119 434 | 35.3% |
| Net charges to/releases of provisions and revaluation | -430 292 | -365 853 | 17.6% |
| **Operating profit** | **372 213** | **195 719** | **90.2%** |
| Extraordinary gains/losses | 14 239 | 19 | - |
| Charge to capital reserve from consolidation | 0 | 1 006 | -100.0% |
| **Profit before tax** | **386 452** | **196 744** | **96.4%** |
| Corporate income tax | -187 646 | -80 754 | 132.4% |
| Share in profits/loss of entities included in consolidation on an equity basis | -35 520 | 66 346 | -153.5% |
| **Net profit** | **163 286** | **182 336** | **-10.4%** |

Due to low impact of consolidation on the Group's results in 2001 its level was determined by factors affecting non-consolidated results of the Bank. Among these factors the merger of the Bank and CPSA as at 28 February 2001 was of greatest importance.

In 2001 the Group generated net profit of PLN 163 million down 10.4% on the previous year. The drop in net profit in spite of a 96.4% increase in gross profits was brought about by a major increase in the corporate income tax.

The most important constituent of the Group's gross profit is profit on banking activity which in 2001 rose by 38.1% over the preceding year. Its growth was faster than that of general expenses and amortisation on a combined basis. The primary contributors to this fast revenue growth were fees and commissions (which increased by 50.3%) and FX gains (increase by 62.3%). the share of which in profit on banking activity rose from 22.5% to 24.5% and 32.7% to 38.4% respectively. On the other hand net interest income dropped by 10.6%, which is a result of falling interest rates and the subsequent narrowing of spreads and the net interest margin.

The merger of Bank Handlowy with Citibank (Poland) not only increased the Group's revenues but also general expenses (by 30.4%) and amortisation (by 35.3%). The restructuring of the Bank which commenced in 2001 involving inter alia major headcount reductions were not yet fully reflected in the financial results for that year. At the same time new expense items appeared which the Bank did not have in prior years. In 2001 the Bank for the first time established a provision against retirement pay and anniversary bonuses amounting to PLN 25 million. The reporting period also saw an amortisation charge of PLN 60.4 million against the goodwill arising on the Bank's merger with CPSA. This was reported as "other operating expenses".

The Group's earnings in 2001 were impacted by higher charges to specific provisions against irregular receivables and off-balance sheet exposures and against capital investments and also charges to general provisions which together on a net basis amounted to PLN 430 million an increase of PLN 64 million (17.6%) on the previous year. The additional specific provisioning carried out against irregular receivables and off-balance sheet exposures stemmed from the deterioration observed in corporate finances resulting in a lowering of loan portfolio quality. This involved customers in the car steel and metal industries and one customer in the transportation industry.

The increase in corporate income taxes mentioned earlier was brought about by a change in the rate applied in calculating the deferred tax asset relating to specific loan provisions. It was now assumed that the vast majority of these provisions would not be charged off prior to the end of 2003. and the calculation of deferred tax was therefore performed at the 22% rate that is to be in force after that date rather than the 28% rate currently applicable.

## 3. Consolidated cash flow statement

As at the end of December 2001 cash and its equivalents in the Group amounted to PLN 2.726 million and doubled when comparing to the end of 2000. The change consisted of the following cash flows:

- From operational activity - PLN 3 319.9 million
- From investment activity - PLN 20.2 million
- From financing activity - PLN (1 478) million

The material increase in cash and cash equivalents in the Group in 2001 resulted from the merger of the Bank and CPSA and full consolidation of DM BH.
The increase of cash and cash equivalents in the Group in 2001 was generated mainly by cash inflows from operational and investing activity. In core activity of the Group the additional funds came from increase in amounts due to customers and Budget. Elimination of non-cash flows impact of the Bank's merger with CPSA and transfer of COK BH to DM BH resulted in decrease of amounts due from customers and budget and finally increasing the volume of operating cash flows. Positive cash flow from investing activity resulted from sale of shares and other investment securities (i.e. Mitteleuropäische Handelsbank AG) and repayment of subordinated loans. Funds received in this way was utilised to cover the Group's liabilities resulting from financing activity. In this group of operations long term loans received by the Bank in previous period were repaid and also dividend was paid.

## 4. Consolidated own equity

The Group's total capital funds at year end 2001 stood at PLN 5.673 million (excluding net earnings) reflecting an increase on year end 2000 of PLN 2.699 million or 91%. The basic factor behind this significant capital growth was the merger of the parent entity and CPSA.

**Own equity of the Group**

| | As of the end of the period | | Change % |
|---|---|---|---|
| **In PLN thousand** | **2001** | **2000** | **2001/2000** |
| Authorised capital | 430 308 | 279 670 | 53.9% |
| Capital surplus | 3 059 638 | 538 000 | 468.7% |
| Revaluation reserve | 76 958 | 77 860 | -1.2% |
| Other reserves | 2 106 320 | 2 078 821 | 1.3% |
| Total own equity | **5 673 224** | **2 974 350** | 90.7% |

As a result of the merger of the Bank and CPSA, the Group's capital funds increased by PLN 2.636 million. The Bank's authorised capital, previously amounting to PLN 279.670 thousand, was raised by PLN 150.638 thousand, to stand at PLN 430.308 thousand. This was carried out by the issue of 37.659.600 Series C ordinary bearer shares with a par value of PLN 4 each, which were provided to the shareholders of CPSA in exchange for the transfer of the entire assets of CPSA to the Bank. This authorised capital of PLN 430.308 thousand has been divided into 107.577.100 bearer shares, each with a par value of PLN 4. At the same time, the surplus of the fair value of the shares issued over their par value was taken to the Bank's capital surplus, which as a result rose PLN 2.486 million.

Another source of capital growth was the retention of net earnings for 2000, with 26.7% of these earnings being taken to capital.

The contribution of capital funds to financing the Bank's activity came to 17.15%, compared to 14.20% at the end of 2000.

At year-end 2001, the Bank was the most strongly capitalised in Poland, accounting for 14.2% of total capital within the Polish banking sector.

## 5. Performance ratios

In 2001, the performance ratios of the Group were as follows:

| | As at 31 December | |
|---|---|---|
| | 2001 | 2000 |
| Return on assets (net profit/net assets)* | 0.6% | 0.9% |
| Return on equity (ROE) (net profit/equity)** | 3.8% | 6.3% |
| Earnings per ordinary share (EPS) (in PLN)*** | 1.52 | 2.61 |
| Diluted profit/loss per ordinary share (in PLN)**** | 1.25 | 1.96 |

* *Return on assets is calculated as net profit for twelve months divided by average total assets*

** *Return on equity is calculated as net profit for twelve months divided by average equity.*

*** *Calculated based on weighted average number of ordinary shares held by the Bank's Shareholders in the period and the net profit for last 12 months;*

**** *Calculated based on total number of shares. convertible bonds and the net profit for last 12 months;*

# VI. Operations of the Group

## 1. Parent entity

### *1. Credit products*

Traditionally, loans and other credit risk products are the core product of the Bank. The portfolio of the loans granted by the Bank by particular groups of customers as of the end of 2001 can be presented as follows:

**Lending to non-bank customers (gross)**

| | **2001** | **2000** | **Change** |
|---|---|---|---|
| PLN thousand | **Period end** | | **2001/2000** |
| PLN loans | 10 803 111 | 6 419 085 | 68.3% |
| Foreign currency loans | 5 022 047 | 4 704 688 | 6.7% |
| **Total loans outstanding** | **15 825 158** | **11 123 773** | **42.3%** |
| Non-financial customers | 14 904 640 | 10 485 547 | 42.1% |
| Financial institutions | 891 297 | 598 586 | 48.9% |
| Budget | 29 221 | 39 640 | -26.3% |
| **Total loans outstanding** | **15 825 158** | **11 123 773** | **42.3%** |
| Corporates | 14 410 200 | 10 914 650 | 32.0% |
| Individuals | 1 385 737 | 169 483 | 717.6% |
| Budget | 29 221 | 39 640 | -26.3% |
| **Total loans outstanding** | **15 825 158** | **11 123 773** | **42.3%** |

*excluding interest receivable*

At 31 December 2001, outstanding loans receivables (gross) to non-bank customers totalled PLN 15.825 million. This reflected growth of 42.3% compared to the previous reporting period. The prime reason for this growth was the merger of the Bank and CPSA.
This strong growth in loan receivables increased the Bank's share in the total credit market, which climbed from 5.3% at year end 2000 to 7.1% at the end of 2001.

The largest segment of the Bank's loan portfolio was constituted by loans to corporates. These went up 32.0% compared to the year before, to stand at PLN 14.410 million. The Bank's share of total bank lending to corporates rose 2.0 points, coming to 9.0% at year end 2001. Dynamic growth was seen in outstanding individual loans (up 718%). These accounted for 8% of the Bank's loan exposures. By contrast, loans to budget institutions trended downwards, falling 26.3% compared to the previous period.

At 31 December 2001, the volume of PLN loans granted by the Bank was 68.3% higher than at the end of 2000. The proportion of PLN loans in the overall portfolio increased from 57.7% at year end 2000 to 68.3% at the end of 2001.

In the course of 2001, the Bank played an active part in arranging and funding syndicated loans for large investment projects. The most important of these included the following:

- a loan for the restructuring and commercial incorporation of Polish State Railways S.A., with the total facility representing the euro equivalent of PLN 700 million. Other participants in the syndication are Dresdner Kleinwort Wasserstein, Westdeutsche Landesbank Girozentrale London Branch, and Westdeutsche Landesbank Polska S.A. The Bank's participation, as arranger and agent bank, amounts to EUR 18.151.000;
- a USD 392 million facility for the construction of a power station by the firm of Elektrownia Pątnów II Sp. z o.o. Other participants in the syndication are Citibank N.A. London, Westdeutsche Landesbank Girozentrale, the European Bank for Reconstruction and Development, and Kredyt Bank S.A. The Bank's share of this syndication is USD 27.500 thousand;
- a loan for the modernisation and expansion of the hotel stock of Orbis S.A., with the Bank providing EUR 7.5 million of the finance involved;
- a loan for the purchase of passenger aircraft by LOT Polish Airlines S.A., totalling PLN 28.6 million. The Bank's share of this facility, as the co-arranger alongside Citibank N.A. London, and a participant in funding the syndication, amounts to USD 10. 000 thousand
- a loan to the firm of Polska Telefonia Cyfrowa Sp. z o.o., with the Bank's participation standing at EUR 25.000 million;
- a EUR 4.700 thousand loan to the company of Lafarge Cement Polska S.A. to finance ongoing operations.

At 30 December 2001 the Bank's off-balance sheet commitments totalled PLN 9.884 million. This represents an increase of 59.4% compared to the end of 2000. The increase involved here is primarily traceable to steep growth in undrawn credit lines. This growth mainly stemmed from the Bank's merger with CPSA. At year-end, the undrawn credit lines made available by the Bank amounted to PLN 6.779 million, an increase of 115.2% on the end of 2000. As a proportion of all contingent commitments extended, these facilities rose 17.8 points, to stand at 68.6%.

The volume of guarantees extended by the Bank also trended upwards. The Bank's commitments on these stood at PLN 2.738 million, up 8.3% compared to 31 December 2000.

In the period under review, a decline was seen in the value of the Bank's off balance sheet commitments under both import L/Cs issued and export L/Cs confirmed. L/Cs issued fell 39%, to PLN 185 million, while L/Cs confirmed dropped 45%, to PLN 63 million. Altogether, the Bank's exposure on L/Cs utilised as a payment instrument in foreign trade came to 2.5% of the off balance sheet commitments it had extended.

**OFF BALANCE SHEET COMMITMENTS granted**

| PLN thousand | 2001 Period end | 2000 Period end | Change 2001/2000 |
|---|---|---|---|
| **Total off-balance commitments** | **9 884 155** | **6 198 946** | **59.4%** |
| Guarantees | 2 737 591 | 2 527 225 | 8.3% |
| L/Cs issued | 184 874 | 302 674 | -38.9% |
| L/Cs confirmed | 63 155 | 115 360 | -45.3% |
| Undrawn credit lines | 6 779 275 | 3 149 687 | 115.2% |
| Underwriting commitments | 119 260 | 104 000 | 14.7% |
| **Provisions against contingent liabilities** | **125 913** | **25 330** | **397.1%** |
| **Provisions/ contingent liabilities** | **1.3%** | **0.4%** | **0.9** |

Compared to the end of 2000, the Bank stepped up its specific provisioning against contingent liabilities, mainly against guarantees. At 31 December 2001 the ratio of specific provisions established to contingent liabilities undertaken had risen to 1.3%, as against 0.4% at year-end 2000.

## 2. *Quality of loan portfolio*

The year 2001 brought deterioration in loan portfolio quality, which was mirrored in a 4.5 point increase relative to December 2000 in the percentage of special mention and irregular loans within the total portfolio. This also contributed to a 40% growth in specific provisions. There were a number of factors at work here, namely:

- the worsening economic situation in Poland;
- the deterioration in the financial performance of certain industries or borrowers, which necessitated the downgrading of the exposures concerned, now classified in higher risk categories;
- the application of a stricter provisioning policy.

**Quality of loan portfolio**

| PLN thousand | | 2001 Period end | 2000 Period end | Change 2001/2000 |
|---|---|---|---|---|
| **Loans to customers. gross** | | **15 825 158** | **11 123 773** | **42.3%** |
| Normal | | 10 641 956 | 7 978 713 | 33.4% |
| Watch | | 1 116 543 | 1 103 524 | 1.2% |
| **Irregular** | | **4 066 659** | **2 041 536** | **99.2%** |
| of which: | *substandard* | *1 149 105* | *248 684* | *362.1%* |
| | *doubtful* | *1 622 261* | *748 810* | *116.6%* |
| | *loss* | *1 295 293* | *1 044 042* | *24.1%* |

| | | | |
|---|---|---|---|
| **Share in total portfolio:** | | | |
| Watch & irregular loans | 32.8% | 28.3% | 4.5 |
| Watch | 7.1% | 9.9% | - 2.9 |
| Irregular loans | 25.7% | 18.4% | 7.3 |

*Excluding interest receivable*

Receivables classified substandard increased very sharply, going up 362% compared to the end of the previous year, and rising from 2.2% to 7.3% of the portfolio. The proportion of doubtful loans also increased, up from 6.7% to 10.3% of total receivables. On the other hand, the proportion of loss loans in the total loan book declined, coming down from 9.4% of the portfolio to 8.2% at 31 December 2001.

**Provisions against outstanding loans to non-bank customers**

| PLN thousand | 2001 | 2000 | Change |
|---|---|---|---|
| | **period end** | | **2001/2000** |
| **Specific provisions** | **1 177 080** | **840 905** | **40.0%** |
| Against loans classified as normal and watch | 1 245 | - | - |
| Against loans classified irregular | 1 175 835 | 840 905 | 39.8% |
| Specific provisions/ total loans | 7.4% | 7.6% | - 0.2 |
| Specific provisions/ normal and watch loans | 0.0% | - | - |
| Specific provisions/ irregular loans | 28.9% | 41.2% | - 12.3 |

The volume of specific provisions established against irregular classifications, standing at PLN 1.177 million, fully complies with the requirements laid down in the regulations of the National Bank of Poland.
The Bank also charged PLN 50 million to general provisions, making full use of the statutory incentive to do so. These funds, which the Bank can dispose of freely, constitute a guarantee of full financial safety.

With a view to improving the quality and soundness of the loan portfolio, credit risk management methods were updated in 2001. The Bank is now applying a new system of credit risk assessment and new lending procedures, and has altered the organisation of its lending division. The change in credit risk assessment methodology was accompanied by a stricter separation of responsibilities between risk assessment and lending decisions, and also credit administration and monitoring functions. Further, changes were made in the structure of authority concerning the Bank's financial exposures, and the process of management decision-making was made more efficient.

The Bank monitors its exposure to particular sectors of the economy on an ongoing basis, pinpointing those areas where the Bank's exposure should be increased, and also those sectors where the outlook is unfavourable and its exposure should be reduced. In the case of large corporate customers and financial institutions, the divisions of the Bank responsible for its policy concerning exposures to particular sectors are those of Corporate Banking, Investment Banking and Financial Institutions, while the Commercial Banking Division exercises a similar function with respect to small and medium enterprises.

### 3. *Deposit products*

At 31 December 2001, the Bank's external funding totalled PLN 22.191 million, an increase of 41.6% compared to year end 2000.

Deposits represented the core source of funding for the Bank's assets in 2001. The balance of funds taken from non-bank customers rose 74.5% on the previous reporting period, to stand at PLN 18.529 million. Thanks to this growth, the Bank's share of the total deposits taken by the banking sector (excluding interbank deposits) climbed from 3.7% to 5.7% at year end. Meanwhile, the funding from financial institutions decreased 8.4%.

The strong deposit growth achieved was the result of the Bank expanding its product range and applying a more flexible pricing policy.

**EXTERNAL FUNDING**

| | **2001** | **2000** | **Change 2001/2000** |
|---|---|---|---|
| PLN thousand | **period end** | | **%** |
| **Due to NBP and financial institutions** | **5 060 710** | **5 600 472** | **-9.6%** |
| Demand | 1 446 189 | 882 624 | 63.9% |
| Term | 3 614 521 | 4 717 848 | -23.4% |
| Interbank deposits | 841 193 | 2 162 552 | -61.1% |
| Borrowings | 1 662 954 | 2 062 238 | -19.4% |
| Due to other financial institutions | 1 110 374 | 493 058 | 125.2% |
| **Due to customers and Budget** | **17 130 228** | **10 070 252** | **70.1%** |
| Demand | 3 767 864 | 1 873 078 | 101.2% |
| Term | 13 362 364 | 8 197 174 | 63.0% |
| **Total external funding** | 22 190 938 | 15 670 724 | 41.6% |

Excluding interest payable

The Bank's deposit products were not only addressed to large companies and institutions, but also to personal customers. In winning personal deposits, the Bank was able not only to take advantage of the launch and expansion of its own Retail Banking Division, but also to draw extensively on the enlarged branch network afforded by the merger of the retail operations of Handlobank and Citibank. The Retail Banking Sector of Bank Handlowy w Warszawie SA now operates under the Citibank logo.

The Bank continued its relationship with various budget sector institutions, such as Health Trusts and local government institutions, and also with universities and colleges (both public and private); as a result, it was able to maintain it's funding from government deposits, which totalled PLN 878 million.

**Due to non-bank customers**

| PLN thousand | 2001 | 2000 | Change 2001/2000 |
|---|---|---|---|
| | Period ended | | % |
| Due to: | | | |
| Individuals | 6 037 483 | 3 813 048 | 58.3% |
| of which: Retail Banking Sector | 4 244 432 | 862 958 | 391.8% |
| Corporates and institutions | 10 205 405 | 5 349 958 | 90.8% |
| Budget | 877 679 | 880 648 | -0.3% |
| Non-bank financial institutions | 1 398 788 | 550 334 | 154.2% |
| Other | 9 660 | 26 597 | -63.7% |
| **Total due to non-bank customers** | **18 529 015** | **10 620 585** | 74.5% |

*excluding interest payable*

Particularly fast growth was attained in individuals' PLN balances. These went up from PLN 2.305 million in the previous year to PLN 3.906 million at the end of 2001, an increase of 69.4%. This allowed the Bank to increase its share of total individuals deposits at the banks from 1.9% at year end 2000 to 2.8% at 31 December 2001 (with the Bank's share of individual PLN deposits rising from 1.5% to 2.2%).
The deposits taken by the Retail Banking Sector rose 392%, going up from PLN 863 million to PLN 4.244 million at 31 December 2001. This represented 70% of personal deposits at the bank and 23% of all liabilities to non-bank customers.

**Due to non-bank customers**

| PLN thousand | 2001 | 2000 | Change 2001/2000 |
|---|---|---|---|
| | period end | | % |
| **PLN deposits** | **12 975 470** | **7 198 694** | **80.2%** |
| Demand | 2 551 227 | 1 108 125 | 130.2% |
| Term | 10 424 243 | 6 090 569 | 71.2% |
| **Foreign currency deposits** | **5 543 885** | **3 395 295** | **63.3%** |
| Demand | 1 495 389 | 795 636 | 87.9% |
| Term | 4 048 496 | 2 599 659 | 55.7% |
| **Other** | **9 660** | **26 597** | **-63.7%** |
| **Total due to non-bank customers** | **18 529 015** | **10 620 585** | **74.5%** |

*excluding interest payable*

The determining factor behind the overall growth in deposits in 2001 was the stronger growth recorded in PLN balances. Compared to the previous year. PLN deposits from non-bank customers grew 80.2%, to stand at PLN 12.975 million. This was equivalent to 70% of all deposits taken. Foreign currency deposits totalled PLN 5.544 million, an increase on the year of 63.3%.

### *4. Retail banking*

In the past the Bank funded its operations mainly from corporate deposits. One of the strategic objectives of the Bank is a significant increase of individuals' deposits in funding base of the Bank.

The fusion of the safety and soundness that is guaranteed by the tradition and track record of Bank Handlowy w Warszawie SA on the Polish market with the international experience of Citigroup on global markets has brought this objective closer. Even in 2001 the Bank significantly increased in retail banking sector the amount of amounts due to individuals from PLN 862 million to PLN 4.244 million, i.e. 391.8%.

The retail network consists of 112 full-service offices. The number of retail customers climbed from 211 thousand at the end of 2000 to 608 thousand at year end 2001.

In 2001, the Bank's retail product range was enhanced by the inclusion of a whole series of investment products. The development was also begun of the Citibank Online Internet platform. In 2002, expanding and upgrading this platform will be a priority task for the Bank in its quest to become a leading player on the Internet banking market. The launch of new retail banking products is supported by intensive, state-of-the-art marketing efforts designed to increase recognition of the Citibank brand name and particular Citibank products.

In the years ahead, the Bank's activity in this area will focus on promoting personal accounts, investment products and insurance. In 2002, the Bank plans to offer its customers life assurance.

In April 2001,the customer accounts maintained within the Handlobank retail-banking sector were converted from the Profile system to the Systematics system in use at Citibank. Initial problems stemming from this conversion were subsequently eliminated, and the Bank's system is currently fully operative and stable. No changes to the system are envisaged in the near future.

### 5. Treasury operations

In 2001 there were events that had a material influence on financial markets. This includes terrorist actions in the USA and crisis in Argentina. In Poland the major impact was from Monetary Policy Council and problems with budget deficit.

Following the merger of Bank Handlowy and Citibank Polska SA the Bank's share in interbank FX market increased to 15%. The Bank was also a leader in derivatives market with 30% market share in swaps and FRA. The Bank's share in deposit market in 2001 is estimated at 10% and 8%-10% in debt securities market.

The Bank enters on interbank market and with non-banking customers the following transactions:

- FX Spot. Forward and Swap,
- Placements and deposits,
- Repo and Reverse Repo,
- FRA,
- IRS and CIRS,
- Options.

## 6. Custody and agency services

In 2001, Bank Handlowy continued its provision of custody services involving securities. The Bank is one of Poland's leading depositories. It offers its services both to foreign investors active on the Polish capital market and to domestic financial institutions, including investment and pension funds. In doing so, the Bank operates as an integral part of the global custody network of Citibank N.A. known as Global Securities Services.

The custody services provided by the Bank include operating securities and cash accounts, settling securities transactions, handling dividend and interest payments, portfolio valuation and execution of customer proxies, and it also arranges customer representation at general meetings of shareholders.

The Bank acts as depository for five open-ended pension funds, namely, AIG OFE, SAMPO OFE, OFE Pocztylion, Pekao OFE and Zurich OFE, and also for the Staff Pension Fund of Telekomunikacja Polska SA.

The Bank acts as depository for 27 investment funds set up by the following investment fund companies: Skarbiec TFI SA. WBK AIB TFI SA. SEB TFI SA. Invesco TFI SA, and Pioneer Pekao TFI SA.

The Bank's activity as Payment Agent to the Government, carried out under an agreement concluded with the Minister of Finance, involves the provision of services related to the foreign assets and liabilities of the Polish Treasury.
In 2001, the Bank handled over 400 agreements concerning loans, refinancing, debt reduction, compensatory settlements, debt-for-nature swaps and Treasury Eurobond issues, and also operated 12 clearing, countertrade and special accounts.
The settlements performed by the Bank for the account of the Ministry of Finance in connection with the repayment of liabilities and collection of debts totalled PLN 31 billion.

Pursuant to an agreement with the Ministry of Finance, in 2001 the Bank continued to administer Treasury liabilities arising on the unsettled debts of health service establishments; totalling PLN 8.4 billion, these debts are held by thousands of creditors.

## *7. Cooperation with international financial institutions*

The scope of the Bank's cooperation with international financial institutions altered in 2001 as a result of the merger with Citibank (Poland) S.A. Being able to draw on the extensive Citibank international network, there was no need to maintain such a large number of correspondent accounts as in previous years, and settlements were concentrated within the Citibank network as far as was rationally possible. Moreover, due to the substantial growth seen in settlements performed in euros, correspondent accounts in euro legacy currencies were closed during the year. At year end, the Bank had 31 nostro accounts in 23 countries, these being used for both interbank settlements and customer payments.

In August 2001, the Bank concluded a strategic agreement with Kreditanstalt fur Wiederaufbau concerning the opening of a EUR 25 million line of credit to finance the capital projects of small and medium enterprises in the areas of infrastructure, environmental protection, energy efficiency, and also investment in industry and services. This is the third initiative of this kind taken by the Bank, alongside facilities provided in previous years by the European Investment Bank. Thanks to lines such as these, small and medium enterprises are able to use the offices of Bank Handlowy to access long-term financing from the assistance funds of the European Union.

The Bank also arranged a PLN 3 billion long-term bond issuance facility for the European Investment Bank, the aim of which is to provide finance for infrastructure projects in Poland. The bonds have a maturity of from 1 to 30 years, have been admitted for public trading, and are being issued in several tranches. The end of 2001 had performed two issues, to a value of PLN 200 million and PLN 300 million, both maturing in 2011. The Bank is the sole arranger and underwriter for this facility.

At year end 2001, the Bank operated 222 vostro accounts in PLN and 34 in foreign currencies for foreign banks from a total of 34 countries, thereby continuing its longstanding traditions in settling foreign trade. The PLN accounts are also used to a significant extent by the largest international financial institutions investing in Polish securities. The Bank holds an individual foreign exchange licence from the National Bank of Poland allowing it to settle the PLN claims and liabilities of non-residents in a manner that fulfils their expectations.

Over and above its integration and close collaboration with the Citibank international network, the Bank has retained its own well-established position in handling and settling foreign trade transactions, cooperating with over 700 banks and their respective offices worldwide. In 2001, the geographical pattern of this cooperation corresponded to the structure of Poland's foreign trade (primarily involving European countries), and in this respect the Bank utilised its long contacts with the largest banks in particular countries, concentrating on partners with strong and sound financial condition.

The Bank also maintained ongoing contacts with selected foreign financial institutions on the international money and capital markets, upholding its reputation in this area as one of the largest, most active and most innovative partners in Poland.

## *8. Changes in range of banking products and level of computerisation*

### *New products and distribution channels*

The Bank has been systematically modernising the product delivery technologies it employs, and is also constantly expanding the product range offered to customers, introducing new instruments to support efficient funds management and modifying those instruments already available. Customers can access the Bank's services via:

- Inter Centrum – a call centre that provides access to ongoing account and transaction information, allows the performance of payment instructions and opening of time deposits, and functions as an information bureau regarding the Bank's products and services;
- CitiDirect – an Internet banking system that offers direct 24-hr access to customer accounts (information on balances and account history. bill payment. other transfers);
- Telephone Sales – an integrated customer sales service.

In 2001, the Bank made available a number of new products for corporate customers, including:

- Banker's Acceptances – a financing facility whereby the Bank accepts bills drawn by customers and then offers the resulting acceptances to third-party investors in search of short-term instruments secured by a first-class bank;
- Channel Financing – a revolving finance facility for retail distribution outlets;

- Franchise Financing – a financing facility for franchisees under leasing arrangements or direct advances;
- Securitisation – a financing facility whereby a pool of earmarked assets generating regular cash flows are used to access immediate funds from investors in return for debt securities backed by those assets.

With respect to structured products, the Bank began offering customers exotic options and customised swaps.

To meet the constantly growing needs and expectations of smaller businesses (firms with annual sales of up to PLN 4 million), the Bank has developed a special Inter Biznes programme, which ensures quick and easy access to the Bank and to new products via the Inter Centrum call centre. 24-hr Internet banking, and a network of 62 offices staffed by qualified financial advisors; the extension of the Bank's opening hours thanks to telephone and Internet services; the provision of top-quality services; the use of simple, easily understandable banking procedures; and a safety and reliability that is guaranteed by the tradition and track record of the Bank on the Polish market and by the international experience of Citigroup on global markets.

The Inter Biznes programme for small businesses includes the Inter Konto package, comprising a current account and debit card together with call centre and CitiDirect.

The Inter Biznes programme was extended in 2001 to incorporate insurance products and overdraft facilities. In addition, the Bank introduced unsecured lines of credit for new customers, and business development loans for the development of small and medium enterprises, refinanced by Kreditanstalt fur Wiederaufbau and the European Union.

October 2001 saw the launch of the first "Universal Banking Kiosk", a self-service machine that accepts simple payments, such as for telephone or gas bills. In the near future, kiosks of this type, which currently only take cash, will also accept payment by bankcard.

During the year, the Bank also introduced the FakturyOnline.pl system to handle customers' commercial finance transactions. The standard functions of this system allow customers to issue and present invoices, and make payments. The system was expanded to include a module that handles invoice discounting under factoring facilities and the submission of applications for loan disbursements under finance facilities for the distribution trades.

Acting in conjunction with Polska Telefonia Cyfrowa. the operator of the Era mobile phone network. Bank Handlowy was the first institution in Poland to offer customers with these phones the opportunity to use them to carry out secure payments for purchases made over the Internet. To access this service, customers with a mobile phone that receives SMS messages and a credit card issued under the Visa or MasterCard systems simply have to log in at http://zakupy.eranet.pl.

## *IT systems*

The merger of the Bank and CPSA necessitated the establishment of a telecommunications platform ensuring access for all of the Bank's staff to the IT systems of the new institution. One of the tasks posed in this field was to integrate the telecommunications networks of the two banks. In order to separate the public address resources of the former Bank Handlowy within the structures of the Citicorp network. a firewall was installed at the interface of the two networks.

The central area of work in 2001 was the IT integration of the two systems. A month after the official merger, an interoffice settlement function was implemented within the IT systems in operation. Due to the withdrawal from operation of the Profile system in the Retail Banking Division, the remaining systems (Ibis and Promak) were adapted to run in conjunction with Sytematics.

Another important undertaking during the reporting period was the major overhaul of the WAN/LAN telecommunications infrastructure at the Settlement Centre in Olsztyn. This was made necessary by the continuing work on constructing an operational processing centre for interbank settlements. supporting all of the Bank's offices and units.

The Bank's systems were adapted to correspond to the requirements of centralising the processing of domestic and international transfers by means of scanning customer transfer orders at branch offices and their subsequent processing at the Settlement Centre in Olsztyn.

During the year, the Bank finalised the conversion to the euro of accounts held in the national component currencies (the "IN" currencies). In the framework of the "Euro project", accounts in the single currency were opened automatically for those customers holding accounts in the IN currencies, yet not holding euro accounts. Software was developed to allow the successive and automatic conversion to the euro of these customer accounts (deposits).

A key task for the Bank was the implementation of the new Flexcube IT system, which replaced the IBBS system, operated at the former CPSA. In parallel with the work being conducted on implementation and on data conversion from IBBS to Flexcube, intensive efforts were made to carry out the conversion to Flexcube from the Bank's other accounting system. Ibis. Special software was written for this purpose, and appropriate procedures were developed for the conversion itself and for validation of the conversion process. The work involved here also included developing an interface to integrate the Goniec electronic banking system with Flexcube and to allow reports generated within Flexcube to be delivered under the COOL system, used to store report archives. As of December 1, the Flexcube system was brought on stream in the Bank's Wrocław region, which had previously been running Ibis, the basic IT platform for the corporate banking area within Bank Handlowy prior to the merger, Completion of Flexcube implementation at all the Bank's branches and at Head Office, signifying the transition to a single IT platform throughout the entire Bank. is projected to take place in October 2002.

## *9. Changes in management framework*

As of the beginning of February 2001, the Bank has been operating within a new organisational structure that has been adjusted to reflect the existing division of the Bank's activity into commercial and retail business, and which also provides for support functions related to the Bank in its entirety.
The new organisational structure of Bank Handlowy is based on three sectors:

- **Commercial and Investment Banking**
  comprising the divisions and departments involved in servicing business organisations and other institutional customers (customer service management, products, loans, operations and technology);

- **Retail Banking**
  comprising the divisions and departments involved in servicing personal customers (distribution, marketing, loans, operations and technology, financial control, direct sales and Citiphone);
- **Management and Support**
  responsible for providing both front office sectors with the uniform level of support necessary for them to function properly. This sector comprises personnel management, legal support, financial control, and other support departments (including internal audit. property management and compliance monitoring).

The changes made to the Bank's organisational structure are designed to promote the Bank's future development and ensure the performance of the business strategy adopted. In addition, these changes are intended to assist the Bank's operations on new segments of the market, increase the efficiency of customer service, and enable the Bank to offer its customers a modern and comprehensive range of products.

## 2. Entities constituting the Group and included in the consolidation

### 1. Entities fully consolidated

**Dom Maklerski Banku Handlowego S.A.**

Following the agreement dated 23 March 2001 between the Bank and Citibrokerage – its subsidiary undertaking – located in Warsaw („Citibrokerage") commencing from 1 April 2001 the transfer of a business constituting an organisationally separate establishment of Bank Handlowy, previously trading as Bank Handlowy w Warszawie SA. Warsaw Branch V, Capital Markets Centre ("COK BH") to Citibrokerage was effected.

The COK BH brokerage business was transferred to Citibrokerage as a non-cash consideration for equity against an increase in the authorised capital of Citibrokerage, pursuant to a resolution of the General Meeting of Shareholders of that company adopted on 7 March 2001. The resolution implied increase of share capital by issue of 37.300 inscribed shares B series with face value of PLN 1.500 each, totalling PLN 55.950.000. The Bank against a non-cash consideration acquired the shares.

As at 1 April 2001, the book value of all the assets of the COK BH brokerage house, constituting a non-cash consideration for equity in Citibrokerage, as entered in the Bank's books of account, amounted to PLN 231.099 thousand. The net assets value of the COK BH brokerage house, constituting the non-cash consideration for equity, as computed at 31 January 2001, and subsequently revised at 1 April 2001, amounted to PLN 55.950.000.

Following the provisions of the resolution dated 7 March 2001 as of the day of transfer of COK BH to Citibrokerage, the existing name of the Citibrokerage SA undertaking was changed into "Dom Maklerski Banku Handlowego SA" ("Dom BH").

As a result of the transaction the market share of Dom Maklerski increased. The homogenous product range and brokerage services available to customers via merged network were developed. It is critical due to increasing competition in this market in Poland. The quality of service both in respect of individuals and corporate customers increased.

The Bank currently conducts its capital market brokerage activity through the offices of DM BH. in which it holds 100% of the equity. Share capital of DM BH S.A. equals PLN 70.950 million. As at 31 December 2001 total assets amounted to PLN 185.259 million. The entity recognised profit of PLN 7.845 million in the year ended 31 December 2001.

| Name of undertaking (legal form) | Location | BH share in share capital | Total assets | Own equity excluding net profit*) | Net profit*) |
|---|---|---|---|---|---|
| | | % | PLN thousand | | |
| Dom Maklerski Banku Handlowego SA | Warszawa | 100.00 | 185 259 | 73 049 | 7 845 |

*) before consolidation adjustments

Primary activity of Dom Maklerski Banku Handlowego S.A. in the analysed reporting period was concluding purchase-sale transactions at Giełda Papierów Wartościowych w Warszawie S.A. both on behalf of customers (brokerage activity) and on its own account. Additionally, the entity provided services to securities issuers including maintenance of issue sponsor register and acting as market arranger or market maker at WSE or CeTO.

In 2001, DM BH came second in the annual ranking of all brokerage houses in terms of their primary market activity, compiled by the *Rzeczpospolita* daily newspaper.

The value of the securities issues arranged by DM BH in 2001 stood at PLN 2.507.2 million. giving it a 22.92% share of the Polish market. DM BH organised 5 of the 32 public offerings arranged in Poland, thereby capturing a 15.63% share of all public offerings. It also played a pioneering role in establishing the first Internet portal site for the Warsaw Stock Exchange. This involved the first pending public offering in Poland where share subscriptions were carried out utilising the IT system in place at the Exchange. In addition, in 2001 DM BH acted as underwriter for public issues totalling PLN 22.133.4 thousand.

The business transacted by DM BH in 2001 also put it in second place among all brokerage houses in terms of both share trading on the Warsaw Stock Exchange (trades totalling PLN 7.003.79 million. representing a market share of 11.57%) and bond trading (trades totalling PLN 490.16 million. representing a market share of 9.62%). In addition, DM BH was the seventh largest broker in futures contracts, accounting for 5.33% of turnover by volume (398.963 contracts).

DM BH was also a leading player on the Polish capital market in its role as sponsor for issues by 40 listed companies and 8 unlisted ones.

DM BH was rewarded for its highest activity as a market arranger in 2001. DM BH played this function for 51 security issues (22.2% of shares quoted on WSE). It is a market arranger's responsibility to give its bids and offers for certain constant size or value. Market arranger is a guarantor for investors that their orders will be realised.

In 2001, the number of securities accounts maintained by DM BH fell by 6 when compared to the 13.389 accounts operated altogether by COK BH and Citibrokerage SA at the beginning of the year. Nevertheless. it is worth noting that DM BH gained 153 new clients that do not hold their securities at DM BH, but at a depository banks, among which is Bank Handlowy.

During the period under review, DM BH launched a package of analytical services for institutional and private clients that encompasses daily and weekly bulletins, fundamental analyses. Teleconferencing, and direct meetings between investors and analysts. Several dozen presentations were also held concerning the various products on offer to clients. These presentations mainly focussed on asset management services and share offerings on the primary market.

Wide cooperation with Schroders Salomon Smith Barney enabled DM BH to take third place in the Institutional Investors ranking conducted among top international and domestic investment funds.

In the near future, the entity intends to extend its brokerage activity by offering intermediation in conducting transaction on offshore regulated markets.

## 2. Entities consolidated on an equity basis

### *2.1. Banking institutions*

In 2001 the Bank was implementing the strategy of decreasing its equity investments in other banks.

The Bank sold part of the shares held by the Bank in Mitteleuropäische Handelsbank AG, valued at PLN 37.361 thousand. Following the sale, the Bank holds 19.99% of this company’s capital, classing this as a minority holding.

In 2001 the Bank sold its entire shareholding in associated undertaking of Centro Internationale Handelsbank AG, previously consolidated on an equity basis. The transaction was concluded with Raiffeisen Zentralbank Oesterreich AG (RZB. Austria) and the shareholding constituted 45.09% of the share capital of Centrobank and conferred the right to the same percentage of votes at a General Meeting of Shareholders.

As of 31 December 2001 Bank Handlowy International S.A. was not consolidated due to liquidation process and redemption of equity stake in the entity.

### *2.2. Investment companies*

The Bank conducted equity investment activities through special purpose investment vehicles (SPVs). As a result of Management’s intention to limit this activity it is expected that these companies will be gradually restructured or liquidated. Currently the Bank owns four such SPVs. the main financial information for which is presented below:

Investment companies

| Name of undertaking (legal form) | Location | BH share in share capital | Total assets | Own equity excluding net profit*) | Net profit*) |
|---|---|---|---|---|---|
| | | % | PLN thousand | | |
| Handlowy Inwestycje Sp. z o.o. | Warsaw | 100.00 | 59 199 | 15 409 | 4 540 |
| Handlowy Inwestycje II Sp. z o.o. | Warsaw | 100.00 | 16 666 | 17 749 | -1 232 |
| Handlowy Investments S.A. | Luxembourg | 100.00 | 154 632 | 15 481 | -28 244 |
| Handlowy Investments II S.a.r.l. | Luxembourg | 100.00 | 40 514 | 10 831 | -2 153 |

*) before consolidation adjustments

**Handlowy Inwestycje Sp. z o.o.**

As at 31 December 2001 Handlowy - Inwestycje Sp. z o.o. managed a portfolio that included shares in Handlowy Heller S.A.. Handlowy Leasing S.A. and Lubelska Fabryka Maszyn Rolniczych S.A. totalling PLN 3.742 thousand. The highest single equity investment in the reported period remained commercial papers issued by Hortex Holding S.A. and bonds issued by ZO Bytom S.A.

As a result of agreement on 26 July 2001 signed between Handlowy Inwestycje Sp. z o.o., Hortex Holding S.A., Bank of America (Polska) S.A., Bank of America International Investment Corporation. EBRD and BGŻ S.A. on restructuring of Hortex Holding S.A. indebtness resulting from commercial papers the repayment of receivables due on 26 July 2001 was postponed.

In most cases investments made by Handlowy Inwestycje Sp. z o.o. were financed by the Bank in a form of repayable contributions to capital, subordinated loans or from capital surplus of the entity.

In 2001 investment portfolio of Handlowy Inwestycje Sp. z o.o. was reduced. As a result of concluded transactions value of investment portfolio decreased from PLN 92.4 million to PLN 55.4 million. The biggest transactions included sale of shareholding in Danuta S.A. and partial sale to the Bank of bonds issued by ZO Bytom S.A. Shareholding in Danuta S.A own by Handlowy Inwestycje Sp. z o.o. was sold on 11 January 2001 to “D.International” Sp. z o.o. located in Malbork.

Handlowy Inwestycje Sp. z o.o. recognised a net profit of PLN 4.540 thousand in 2001.

**Handlowy Inwestycje II Sp. z o.o.**

At the end of 2001 Handlowy Inwestycje II Sp. z o.o. managed the portfolio comprising of shareholding in TIM S.A.. Browary Strzelec S.A.. Inter Groclin Auto S.A.. ZO Bytom S.A.. Rafamet S.A.. Karen S.A.. EMA S.A. and Fasing S.A. As at 31 December 2001 the total value of the portfolio amounted to PLN 7.128 thousand.

In 2001 the entity purchased from Centrum Operacji Kapitałowych Banku Handlowego w Warszawie S.A. 2.072.388 shares of TIM S.A. On 18 December 2001 the entity repurchased from DM BH shareholdings in Rafamet S.A., Karen S.A., EMA S.A. and Fasing S.A. Simultaneously, at the end of December 2001part of the shareholdings was sold in stock exchange transactions. Additionally, in 2001 whole shareholding in NFI 04 Progress S.A. and part of the shareholding in Browary Strzelec S.A. was sold.

As a result of the transactions during 2001 value of investment portfolio held by Handlowy Inwestycje II Sp. z o.o. decreased from PLN 21.1 million to PLN 16.0 million.

Likewise in Handlowy - Inwestycje Sp. z o.o., in most cases investments made by Handlowy Inwestycje II Sp. z o.o. were financed by the Bank in a form of repayable contributions to capital, subordinated loans.

As at 31 December2001 Handlowy Inwestycje II Sp. z o.o. recognised a net loss amounting to PLN 1.232 thousand. The loss mainly resulted from deterioration of investment portfolio and expense related to repayment of subordinated debt.

### Handlowy Investments S.A.

The total value of the portfolio of Handlowy Investments S.A. in the end of 2001 amounted to LUF 1.515 million, or PLN 132 million (compared to PLN 198 million at the end of 2000). The portfolio was comprised mainly of the following companies: Eastbridge N.V., NIF Fund Holdings PCC Ltd., Polimex-Cekop S.A., Handlowy Investment II S.a.r.l. and Pol-Mot Holding S.A. and Hortex Holding S.A.

The most significant transactions concluded by Handlowy Investments S.A in 2001 include:

- sale, for PLN 51.250 thousand. 2.500.000 ordinary bearer shares (whole shareholding) of Frantschach Świecie S.A.: the shares represented 5% share in capital and voting rights on General Meeting of Shareholders of the entity.
- acquisition of 4.866.924 ordinary registered shares D series of Polimex Cekop S.A. issued in a form of capital increase amounting to PLN 25.308 thousand.

The net loss at the end of December 2001 amounting to PLN 28.244 thousand resulted from creation of provision for diminution in value of shares held in investment portfolios.

### Handlowy Investments II Sarl

At the end of 2001 total value of Handlowy Investments II Sarl investment portfolio amounted to LUF 221.769 thousand. i.e. PLN 19.362 thousand. The portfolio comprised of shareholding in Techmex S.A and 1 share in Handlowy Investments S.A.

The most important transactions concluded by Handlowy Investments II Sarl in 2001 include sale of 134.523 Pekao SA shares. Despite realisation of profit on the sale of the shares amounting to PLN 3.016 thousand, the entity recognised a loss of PLN 2.153 thousand, mainly due to material expense on subordinated loan paid to the Bank.

### *2.3. PKO/Handlowy Powszechne Towarzystwo Emerytalne S.A.*

PKO/Handlowy Powszechne Towarzystwo Emerytalne S.A. – "The Fund" (Pension Fund Company). is a joint-stock company founded on 1 August 1998 by Powszechna Kasa Oszczędności - Bank Państwowy (currently Powszechna Kasa Oszczędności Bank Polski S.A.) and Bank Handlowy w Warszawie SA. The entity offers pension insurance within II Pillar on pension systems.

The Bank's share in the Fund's equity is 50%. The share capital of this company, at PLN 260 million, is one of the largest among all pension fund companies. The value of funds invested almost doubled in 2001, going up from PLN 300 million at the end of 2000 to PLN 582 million at year end 2001. Towarzystwo recognised a loss of PLN 88.725 thousand for financial year ended 31 December 2001

The adverse financial results of the Towarzystwo in 2001 resulted from unsuccessful investments made in previous years in high-tech entities. During 2001, as a result of deterioration of investments made in previous years, despite significant change in investment strategy that resulted in visible improvement of management results Towarzystwo, as the Fund's manager, was required to contribute an additional sum of over PLN 38 million to the Fund's assets. The necessity of contributions made to the Fund managed was the result of twice failing to achieve the minimum rate of return for the preceding 24 months, as calculated by the Agency for the Supervision of Pension Funds on a quarterly basis.

Given the failure to achieve the minimum rate of return, the investment strategy of Bankowy OFE underwent a change in the course of 2001. At the beginning of the year, 41% of its funds were invested in equities and 46% in bonds, whereas by year end only 19% remained in equities and 61% had been placed in bonds. Due to the lack of stability on the stock exchange, the Fund has scaled back the above-average holding of equities it had in its investment portfolio in favour of debt securities, these being viewed as safer instruments, with less downside risk. The share of equities in its investment portfolio will be increased again when it is considered that there is a real chance of the market downtrend being reversed.

## 3. Choosen entities constituting the group and excluded from consolidation

### *1. Leasing*

The Bank owns 2 lease finance entities: Handlowy-Leasing S.A. and Citileasing Sp. z o.o. Leasing activity in 2001 was focused both on low, medium and large value leasing transactions and supporting sale programmes arranged by producers and distributors.

The primary method for getting new transactions was the network of the Bank's advisors and proper targeting of selected customers via leasing advisors of Handlowy-Leasing S.A., dealers' network and financial intermediaries.
Product range of the entities includes operating lease, capital lease and term lease. The fixed assets financed by the company, under lease agreements, comprise mainly the following groups:

- industrial machinery and equipment, complete process technology and industrial plant installations;
- telecommunication equipment systems;
- transportation equipment;
- printing equipment;
- construction machinery.

Financing is provided both in PLN and in foreign currencies.

The net value of the assets leased by the company in 2001 stood at PLN 409.8 million, while the number of lease agreements concluded rose to 1.092 including 907 operating lease agreements and 185 capital lease agreements. Lease portfolio of the entities at the end of 2001 increased up to PLN 733 million and. having in mind difficulties of the leasing sector in Poland, it should be treated as a real achievement.

At present, the leasing entities are one of the largest lease finance companies in Poland in terms of the volume of assets leased equalling 4.4%. As per ranks published related to volume of assets leased in 2001 the entities together rank in top 5 in Poland.

These two companies are to merge in 2002 and will subsequently continue trading as Handlowy-Leasing S.A.

In 2002 Handlowy-Leasing SA plans to conclude some new lease transactions amounting to PLN 680 thousand, which should significantly increase its market share and strengthen its stake in the segment of motor vehicles, machinery and industrial equipment. In the structure of fixed assets subject to leasing agreements concluded by the entity motor vehicles, machinery and industrial equipment will play dominant role. Expected dynamic growth and further expansion of transportation means leasing will be enhanced by improved product range within transportation leasing programme.

### 2. *Factoring*

Factoring services are provided by the specialised company of Handlowy-Heller S.A. The company was established by the Bank (50%) together with a Dutch partner, NMB Heller Holding N.V. (50%), in 1994.

The financial services offered by Handlowy-Heller S.A. include the factoring of domestic receivables on a recourse or non-recourse basis, the non-recourse factoring of export receivables, the ongoing handling of receivables collection, and debt recovery in relation to delinquent receivables.

Handlowy-Heller S.A holds a leading position in terms of turnover on the market for factoring services. Its share of the total market, measured by the value of receivables purchased, stands at around 12%.

In 2001, the company’s turnover amounted to PLN 973.4 million, a decrease of 26.2% compared to the year before. This decline involves customers with whom factoring agreements had been signed in previous years. However, turnover on services provided to new customers gained during the year came to almost PLN 198 million, an increase of 31% compared to the new business obtained in 2000. In the course of 2001, the company entered into 38 new factoring agreements.

In 2001, the company joined the Polish Confederation of Private Employers and began liaison with other factoring companies in Poland with a view to initiating changes to statutory regulations concerning the taxation of factoring services.

### *3. Asset management and investment funds*

In 2001 third party asset management was one of the most rapidly growing product lines offered by the Bank's capital group. Assets entrusted to Handlowy Zarządzanie Aktywami SA for management increased from PLN 437 million at the end of 2000 to PLN 767 million at 31 December 2001, which represents a 76% growth. Of this PLN 404 million was managed for the different funds of Kapitał Handlowy. PLN 204 million were on Discretionary Managed Accounts of insurance firms and the remaining PLN 159 million on Discretionary Managed Accounts of other corporate and individual customers. If advisory services offered by Handlowy Zarządzanie Aktywami SA are included, total assets under management and for which advisory services are offered rose by 102% from PLN 596 million to PLN 1.202 million.

2001 was also a very good year for the Bank's investment fund society Towarzystwo Funduszy Inwestycyjnych Banku Handlowego SA (TFI BH). Assets entrusted to TFI BH by customers rose rapidly – primarily as a result of the inflow of funds from individual customers, which rose by 1.820%. Assets of the five Kapitał Handlowy funds managed by TFI BH rose by PLN 89 million at the end of 2000 to PLN 404 million at the end of 2001. The 354% growth over the 12 months of the year placed TFI BH among the most rapidly growing societies and gave it the seventh position with a market share of 3.4%. This was primarily the result of the commencement of distribution of Kapitał Handlowy investment funds through retail branches in the second half of the year.

In 2001 most of the customers was interested in Debt Securities Fund Kapitał Handlowy III OFI, which assets amount to PLN 300 million at the moment. (PLN 175 million increase). The fund is one of the biggest debt securities fund in the market in terms of assets size.

Winning of the tender for setting up and management of the Employee Ownership Fund of Polish State Railroads (Fundusz Własności Pracowniczej Polskich Kolei Państwowych) was another great success of TFI BH. Over 400 thousand employees are to participate in the Fund and total assets that are to be placed in the fund over the next few years are estimated by the management of Polish State Railroads to reach PLN 1.3 billion. Employee Ownership Fund of Polish State Railroads is an unique undertaking of employees' participation in privatisation programme. The Fund should receive 15% of funds from sale of PKP S.A. property (inter alia real estate and shareholding in subsidiaries). Signing on 20 February 2002 of an agreement between PKP S.A. and TFI BH, on establishment and management of the fund was the last stage of a tender process. Registration of the Fund and first payments are expected in 2002.

After 2001 TFI BH is still the clear leader on the Employee Pension Programme market. By the end of the year over 22 Employee Pension Programmes in the form of an agreement with Kapitał Handlowy Senior Special Open Investment Fund (Kapitał Handlowy Senior SOFI) have been registered with the Office of the Superintendent of Pension Funds (UNFE). As a result of the effective management and regular inflow of fees, assets of this Fund rose in 2001 by over 400% and at the end of December 2001 amounted to PLN 29.6 million.

At the West-Pomeranian Exhibition “My Money” TFI BH received the best fund award for the Employee Pension Programme based on the Kapitał Handlowy Senior SOFI.

Plans for 2002 include a further dynamic growth of assets managed by Handlowy Zarządzanie Aktywami SA and TFI BH through direct asset management and advisory services offered by the company. This is expected to the result of both a growth in the whole asset management business in Poland, as well as a strengthening of the competitive position. The planned 100% growth in assets under management will be made possible primarily through the introduction of new asset management products offered both to institutional and individual customers. Among the new products for release in 2002 is a liquidity fund designed to allow companies to invest surplus funds with attractive returns. Another important element of our strategy is the change of name of our investment funds from Fundusze Kapitał Handlowy to CitiFundusze (CitiZrównoważony FIO. CitiAkcji FIO. CitiObligacji FIO i CitiSenior SFIO) made on 26 March 2002. This should help increase our brand awareness among potential customers.

## VII. Information on members of the Management and the Supervisory Board in parent entity

### Changes in the composition of the Management and the Supervisory Board in 2001

At 31 December 2001. the Supervisory Board of Bank Handlowy w Warszawie SA comprised:

| | |
|---|---|
| Mr Stanisław Sołtysiński | Chairman |
| Mr Jean Paul Votron | Deputy Chairman |
| Mr Göran Collert | Member |
| Mr Heinrich Focke | Member |
| Mr Krzysztof Grabowski | Member |
| Mr Mirosław Gryszka | Member |
| Mr Allan Hirst | Member |
| Mr Krzysztof Opawski | Member |
| Mr Ryszard Pessel | Member |
| Mr Carlos Urrutia | Member |
| Mr Edward Walsh | Member |
| Mr Ryszard Wierzba | Member |

Pursuant to resolutions adopted by the Ordinary General Meeting of Shareholders on 25 June 2001, the following changes had previously been made to the composition of the Bank’s Supervisory Board:

- the following members were recalled: Mr Dinyar Devitre,<br>Mr Jacek Michalski,<br>Mr Dipak Rastogi,<br>Mr Aamir Zahidi,
- the following members were appointed: Mr Allan Hirst,<br>Mr Carlos Urrutia,<br>Mr Jean Paul Votron,<br>Mr Edward Walsh.

At 31 December 2001 the Management Board of Bank Handlowy w Warszawie SA comprised:

| | |
|---|---|
| Mr Cezary Stypułkowski | President |
| Mr Shirish Apte | Vice President |
| Mr Wiesław Kalinowski | Vice President |
| Mr Philip King | Vice President |
| Mr Witold Walkowiak | Vice President |
| Mr Edward Brendan Ward | Vice President |

Pursuant to resolutions adopted by the Supervisory Board, the following changes had previously been made to the composition of the Bank's Management Board:

- on 29 March 2001:
  - Mr Shirish Apte was appointed Vice President of the Bank as of 29 March 2001,
  - Mr Antoni Sala was recalled as Vice President of the Bank as of 25 June 2001,
  - Mr Marek Oleś was recalled as Vice President of the Bank as of 30 June 2001,

- on 25 June 2001:
  - Mr Richard Jackson was recalled as Vice President of the Bank as of 25 June 2001,

- on 25 September 2001:
  - Mr Witold Walkowiak was appointed Vice President and Chief Financial Officer of the Bank as of 25 September 2001,
  - Mr Artur Nieradko was recalled as Vice President of the Bank as of 25 September 2001,

- on 4 December 2001:
  - Mr Raymond Lim was recalled as Vice President of the Bank as of 4 December 2001,
  - Mr Philip King was appointed Vice President of the Bank as of 4 December 2001.

Mr Sarwar Iqbal holds the post of Executive Director at the Bank responsible for the IT and Operations Division. while Mr Artur Nieradko holds the post of Executive Director responsible for the equity investment portfolio.

## VIII. Significant risk factors related to the group's environment and operations

### *Competition within the banking sector*

Mounting competition is observable on the Polish banking market between banks active in particular segments of that market. Many international financial institutions have been investing in the Polish banking industry. In addition, corporates are making use of financing alternatives to bank loans, such as commercial paper, bonds, equity issues or lease finance. There is a strong likelihood that the increase in foreign investment in the banking sector, coupled with the consolidations taking place in that sector, will result in fiercer competition on the banking market.

The progressive integration of Poland with the European Union will strongly expose the Polish banking industry to competition from foreign institutions. particularly in such segments of the market as asset management and Corporate Finance. The growing level of competition within the banking sector could have an adverse effect on the Group's operations.

***Equity investment risk***

Decisions concerning the Bank' equity investments are taken by the Management Board and the Capital Investments Committee. Due to various macroeconomic developments, the situation on the capital market and other factors impacting the operations of the companies in which the Bank has an equity interest, the realisable value of the holdings in question may prove lower than expected, or even lower than their carrying value in the Bank's accounts. which could have an unfavourable effect on the pricing of the Bank's own shares. The level of equity investment risk is moderate.

***Legal risk***

The Bank is a subsidiary undertaking of Citibank N.A., which belongs to the Citigroup group of companies. In order for the Bank's majority shareholder to be able to control the risk inherent in its operations properly, on a global scale, and also to maintain compliance with the American regulations which it is governed by. the Bank must ensure the compliance of its own regulations and activity with the standards set by Citibank and with the relevant regulations applicable to Citibank and Citigroup. Certain operational questions that arise in the context of relations with strategic investors and the outsourcing of data processing are not always addressed with sufficient clarity in Polish law. This gives rise to legal risk. which the Bank mitigates by conducting detailed legal analyses.

## IX. Prospects for the Group's development

Equity investments of Bank Handlowy w Warszawie SA are divided into 2 categories:

- strategic investment portfolio
- active investment portfolio

In 2002 the Bank will continue its policy of restructuring equity investment portfolio that includes long-term financial and business objectives and the new circumstances ensuing from the Bank's merger with CPSA.

The guiding principle of this policy is to seek to achieve the target profile of equity investments while optimising the earnings stream from capital transactions and minimising the risk, including reputation risk. carried by those transactions.

**Strategic Investment Portfolio**

The Bank seeks to expand its product range and presence. and also to competitive position on financial services market. The strategy is implemented through specialised strategic subsidiary undertakings. Examples of these investments include the Dom Maklerski Banku Handlowego S.A. the Towarzystwo Funduszy Inwestycyjnych Banku Handlowego S.A. Handlowy

Zarzadzanie Aktywami S.A.. Handlowy Leasing S.A., Citileasing sp. z o.o., Handlowy Heller S.A.

*Brokerage activity*

Brokerage activity within the Group is performed by Dom Maklerski Banku Handlowego SA (DM BH). Major client of Dom Maklerski in terms of revenue generation are corporate customers. Following a decrease in the number of foreign institutional investors interested in Polish stock exchange DMBH will focus on increasing its share in servicing of domestic retail customers. Cost efficiency in this case will be achieved by close cooperation of DMBH with Consumer Banking sector and marketing "Pakiet Inwestora" (products enabling a funds transfer in real time between brokerage account and current account in Citibank) and also providing internet access to the account.

*Assets management*

Asset management services (AM) is conducted by two entities from the Group fully owned by the Bank: Handlowy Zarządzanie Aktywami (Hanza) and Towarzystwo Funduszy Inwestycyjnych Banku Handlowego (TFI). Increase of Hanza share capital is considered in order to acquire shareholding in TFI Kapitał Handlowy. AM products are intended for marketing via Citibank branch network and external sale network of Consumer Banking Sector. There are plans to undertake actions to widen a cooperation with insurance companies offering insurance with investment fund.

*Leasing activity*

Leasing activity of the Group is currently performed via two entities fully owned by the Bank: Handlowy Leasing SA. Citileasing Sp. z o.o. It is planned to merge the entities in 2002 in order to increase market share.

*Factoring activity*

Factoring services in the Group are provided both directly by the Bank Handlowy w Warszawie SA and by the specialised company of Handlowy-Heller S.A. In the near future the Bank intends to maintain the strategy and rank in the top of factoring companies in Poland.

## Active investment portfolio

The active investment portfolio comprises equity holdings offering a potentially high return on investment. Investments within active investment portfolio are undertaken directly by Bank Handlowy or indirectly by its specialised investment subsidiaries (where the Bank holds 100% stake), i.e. Handlowy Inwestycje Sp. z o.o. Handlowy Inwestycje II Sp. z o.o., Handlowy Investments S.A., Handlowy Investments S.a.r.l.

It is forecasted that the specialised investment subsidiaries may reduce their operations in the near future and some of them may be reorganised or liquidated. However, the Bank is not excluding their further utilisation for equity investment management. servicing other type of operations and developing new forms of the Bank’s activity.

The Bank does not plan any new investments to active investment portfolio in 2002.

Signatures of all members of the Management Board

| Date | name | Position | signature |
|---|---|---|---|
| 22.05.2002 | Cezary Stypułkowski | President | |
| 22.05.2002 | Shirish Apte | Vice President | |
| 22.05.2002 | Wiesław Kalinowski | Vice President | |
| 22.05.2002 | Philip King | Vice President | |
| 22.05.2002 | Witold Walkowiak | Vice President | |
| 22.05.2002 | Edward Brendan Ward | Vice President | |