





ProCredit Bank

Serbia

Annual Report 2004

Serbia



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Key Figures

EUR '000	2004	2003	Change
Balance Sheet Data			
Total Assets	171,216	103,991	65%
Gross Loan Portfolio	123,116	74,323	66%
Business Loan Portfolio	111,046	65,370	70%
< EUR 10,000	46,057	24,876	85%
> EUR 10,000 < EUR 50,000	39,211	28,661	37%
> EUR 50,000 < EUR 150,000	11,210	8,489	32%
> EUR 150,000	14,568	3,344	336%
Housing Loan Portfolio	-	-	-
Other Loan Portfolio	10,967	8,161	34%
Loan Loss Reserves	2,420	1,932	25%
Accrued Interest	1,103	792	39%
Net Loan Portfolio	120,696	72,391	67%
Customer Funds	90,396	55,172	64%
Borrowings from Financial Institutions	59,539	37,074	61%
Shareholders' Equity	16,926	10,779	57%
Income Statement			
Operating Income	17,165	12,291	40%
Operating Expenses	14,574	10,991	33%
Operating Profit Before Tax	1,579	1,300	21%
Net Profit	1,728	1,444	20%
Key Ratios			
Cost/Income Ratio	80%	84%	
ROE	16%	11%	
Capital to Equity Ratio	15%	12%	
Operational Statistics			
Number of Loans Outstanding	37,465	25,437	47%
Number of Business Loans Outstanding	24,044	11,722	105%
Number of Deposit Accounts	151,534	89,773	69%
Number of Staff	744	536	39%
Number of Branches and Outlets	27	21	29%

Mission Statement

ProCreditBank Serbia is a development-oriented full-service bank. We offer excellent customer service and a wide range of banking products. In our credit operations, we focus on lending to micro, small and medium-sized enterprises, as we are convinced that these businesses create the largest number of jobs and make a vital contribution to the economies in which they operate. Our bank explicitly avoids all speculative lines of business and issues large loans only in exceptional cases, thus minimising the risk associated with such activities.

Our shareholders expect a sustainable return on investment, but are not primarily interested in short-term profit maximisation. We invest extensively in the training of our staff in order to create an enjoyable and efficient working atmosphere, and to provide the friendliest and most competent service possible for our customers.



Letter from the Board of Directors



It is my pleasure to present our bank's annual report for 2004, which documents another successful year in fulfilling our mission to help establish a strong private sector in Serbia.

The current economic environment is promising. Four years after the end of the Milosevic era, the recovery of the Serbian economy appears to be well underway. An agreement was reached with the London Club, and Serbia cooperated satisfactorily with the IMF. On the macroeconomic level, GDP and industrial output grew substantially, the unemployment rate decreased slightly, and regional trade picked up. The initial rating of B+ by Standard and Poor's shows that the country is making progress. This rating will further open doors to the international capital markets. Still, some dangers might dampen this positive outlook, such

as the widening current account deficit, the slow privatization process, and inflationary pressures.

In this environment, ProCredit Bank is concentrating on its specific strengths. With its unequivocal dedication to the small businesses which comprise the core of the Serbian economy, the bank continued to contribute to the country's transition in 2004. ProCredit Bank is by far the leading provider of loans to very small enterprises in Serbia. 10% of all loans to the Serbian private sector were issued by our bank. In 2004, we provided more than 24,000 loans to small businesses, of which more than 22,000 were for amounts of less than EUR 10,000. At this lower end of the market, ProCredit Bank is a unique and vital source of financing, as very small enterprises typically find it nearly impossible to access other sources of finance inside or outside the banking sector. ProCredit Bank is strongly committed to supplying loans to micro and small enterprises. We are convinced that no other banking product has a greater direct impact on the economy and on the social welfare of our target group. Our credits financed the expansion of these ventures, helped to boost production in the manufacturing and agricultural sectors, created and safeguarded employment, and ultimately contributed to overall economic growth.

ProCredit Bank is among the top 10 banks in Serbia in terms of total assets. As a result of successful consolidation and institutional development, we reached break-even in 2003, and 2004 was a year of steadily continuing growth. This growth manifested itself in particular in the considerable expansion of the branch

network. In 2004 alone, ProCredit Bank opened 13 new branches, raising the total number of branches and outlets to 27. Regional presence is and will remain a high priority for the bank, as close proximity to the customer is a key factor for success in both micro and small business lending and also in non-credit operations.

To support this rapid development, the shareholders increased the bank's capital by EUR 6 million, which will be followed by another EUR 4 million in early 2005. We thank Commerzbank, EBRD, IMI, and KfW for their contributions. Thank you to all shareholders for their belief and dedication to our bank's mission.

In the long run ProCredit Bank's success will also depend on its ability to reduce its dependency on external sources of finance. Thus, the bank is also making a concerted effort to attract new deposit customers, and considerable resources have been invested in measures aimed at fostering the bank's retail activities in 2004. The 64% increase in the deposit base during the year is an indication of how successful these efforts have been.

Our strategy of determined business development and branch network expansion could not have been implemented without dynamic and competent personnel who identify with the bank's mission. On behalf of the Board of Directors, I would like to take this opportunity to express my thanks to our staff for their effort and dedication in supporting the development of ProCredit Bank. I am confident that we can look forward to a prosperous 2005 in which ProCredit Bank will continue to be the bank of choice for Serbian micro, small and medium enterprises, while strengthening its position in the market as one of the leading retail banks in Serbia.



Dr. Klaus Glaubitt
Chairman

**Members of the
Board of Directors as at
December 31, 2004:**

*Dr. Klaus Glaubitt
Dr. Helmut Töllner
Dr. Claus-Peter Zeitingner
Karlo de Waal
Elizabeth Wallace
Martin Godemann*

Letter from the Management

Developments in the year 2004 confirmed once again that despite structural economic problems and political instability, Serbia is a country with enormous economic potential. This potential is most certainly reflected in the growth that ProCredit Bank achieved during the year. For the bank it was a year in which the product range was strengthened, internal control systems were built up, customer care was improved and a major expansion of the branch network was undertaken. As a result, by the end of 2004 the bank's client base comprised a total of 85,000 customers, consisting of both entrepreneurs and private individuals. ProCredit Bank remains firmly committed to its primary mission, i.e. providing financing for the development of small enterprises and serving the banking needs of customers in all income ranges, with a particular focus on those in the lower and middle income groups.

The bank increased its loan portfolio by 60%, raising the outstanding loan volume to EUR 120 million. More than 24,000 business loans were disbursed during the year. As of the end of December, 24,044 enterprises had a loan outstanding from ProCredit Bank, and there was an increased focus on micro loans: 87% of all business loans outstanding were for amounts of less than EUR 10,000. The agricultural lending programme also developed favourably, with 7,400 agricultural loans totalling EUR 19.6 million outstanding as of the end of the year. The overall portfolio quality was consistently excellent: loan quality did not have to be sacrificed in order to achieve the substantial quantitative increase in lending operations which took place during the year under review.

The bank also became one of the fastest growing institutions in Serbia in terms of the volume of savings entrusted to it by private individuals, achieving a 64% increase in its deposit volume. This growth was the result of an increased focus on retail operations. One of ProCredit Bank's major challenges as a full-service bank has been, and will continue to be, to rebuild people's confidence in the banking system. An estimated 60% of the population still does not have a bank account or use financial institutions for payment transactions. However, we see this as an opportunity for further growth in our non-credit operations and not as an obstacle to the development of this part of our business. The bank's well-trained, experienced staff provide fast and reliable customer service based on uncomplicated procedures, and they are able to dispel clients' doubts and convey to them that the bank is a trustworthy institution which effectively safeguards depositors' funds. In turn, this enables the bank to attract new deposit customers.

In line with its goal of being able to offer affordable and easy-to-use banking services throughout the country, ProCredit Bank opened 13 new branches during the year under review, and its branch network now covers a sizeable portion of Serbia. Although the investments entailed in this expansion had an impact on the bank's financial results, it reported a profit under IFRS of EUR 1.7 million for 2004, resulting in a return on equity of 16%.

The shareholders were pleased with the development of the bank's business in 2004, as was indicated by their implementation of a capital increase which raised the institution's

share capital to EUR 16 million as of the end of the year. We would like to thank the shareholders' representatives and the members of the Board of Directors, as well as all of the other organizations and individuals that have contributed to the success of our institution, for their continued support. We are especially grateful to the Spanish Government (Spanish Microfinance Program), which approved a EUR 15 million credit line to fund lending to micro enterprises, providing a very helpful additional source of financing for our credit operations.

In line with the bank's increased staffing needs due to the expansion of the branch network and the strengthening of structures and capabilities at head-office level, 200 young Serbian professionals and university graduates were recruited during the year under review. We are very grateful for the dedication shown by our staff, which now totals 750 individuals. Their strong commitment to the bank is manifested in an equally strong commitment to providing the best possible service to our customers. The executive managers, branch managers and department managers have done a tremendous job in terms of ensuring that the bank's mission, values and overall corporate culture are not only understood and actively supported by all of the employees in our branches, but are also reflected in the way in which they deal with customers.

Last but not least, the good results for the year 2004 were rounded out by the credit rating awarded by the Fitch rating agency. ProCredit Bank Serbia was the first Serbian bank to obtain an individual rating, and it was given a "B+", the best score possible given that in-



dividual ratings cannot be higher than the country rating, which is also "B+" in Serbia's case.

For 2005, our priorities are to efficiently utilise the financial and human resources available to us, strengthen our existing network and substantially increase the volume of banking operations, while retaining the flexibility that has always characterized the bank's approach to its business. Thus, we expect a further improvement in ProCredit Bank's financial position, a development that is likely to be supported by a reduced tax burden and a stable exchange rate in the coming year. We are firmly convinced that, with its strong management, highly qualified staff and well-structured organisation, ProCredit Bank is well equipped to achieve the goals that it has set for itself for the

Dörte Weidig
General Manager

Gian Marco Felice
Deputy General Manager

The Bank and its Shareholders

ProCredit Bank Serbia was established in April 2001 by international investors who aimed at adding a valuable complement to the existing financial sector in Serbia. By providing financial services to micro, small and medium-sized businesses, the shareholders intend to make a vital contribution to the economic

development of the private sector in Serbia. However, in the four years since its founding ProCredit Bank has developed into a full-scale commercial bank. It remains focused on its target group but in parallel manages to provide a broad range of banking services to the general public throughout Serbia.

Shareholder	Sector	Headquarters	Share	Paid-in Capital in EUR million
KfW	Banking	Germany	16.7%	1.7
IFC	Banking	USA	16.7%	1.7
EBRD	Banking	UK	16.7%	1.7
FMO	Banking	Netherlands	16.7%	1.7
ProCredit Holding	Investment	Germany	16.7%	1.7
Commerzbank	Banking	Germany	16.7%	1.7
Total Capital			100%	10.0



KfW Entwicklungsbank (KfW Development Bank): On behalf of the German federal government KfW Entwicklungsbank finances investments and accompanying advisory services in developing countries. It typically works together with governmental institutions as well as the private sector in the respective countries. Its aim is to build up and expand the social and economic infrastructure of the countries in which it is active, and to create efficient financial institutions while protecting resources and ensuring a healthy environment. KfW Entwicklungsbank is a leader in the field of micro-finance and is involved in target group-oriented financial institutions around the world. It is part of KfW Bankengruppe (KfW Banking Group), which has a balance sheet total of EUR 335 billion, is one of the ten biggest banks in Germany and is 'AAA' rated.

The **International Finance Corporation (IFC)**, a multilateral institution, promotes



the development of the private sector in its developing member countries. A member of the World Bank Group, but legally and financially independent, IFC provides long-term loan and equity finance on market terms in support of private sector activities, helps mobilise additional financing from other sources and provides advisory services to both government and business. It participates in projects without a government guarantee of repayment. During FY 2004, IFC approved USD 5.6 billion in new loan and equity investments supporting projects with a total cost of over USD 23.4 billion. Since its founding in 1956, IFC has invested almost USD 44 billion of its own funds in more than 3,100 companies in 140 developing countries.



The **European Bank for Reconstruction and Development (EBRD)** was

established in 1991. It aims to foster the transition towards open, market-oriented economies and to promote private and entrepreneurial initiative in the countries of Central and Eastern Europe and the Commonwealth of Independent States (CIS) committed to democracy, pluralism and market economics. The EBRD seeks to help its 27 countries of operations to implement structural and sectoral economic reforms, promoting competition, privatisation and entrepreneurship. In fulfilling its role as a catalyst of change, the Bank encourages cofinancing and foreign direct investment from the private and public sectors, helps to mobilise domestic capital, and provides technical cooperation in relevant areas.



The **Netherlands Development Finance Company (FMO)** supports financial institutions and private enterprises in

developing countries. Its aim is to promote sustainable economic growth. By providing tailor-made finance, FMO acts as a catalyst for private sector activity. Although it finances at market terms, FMO complements rather than competes with commercial financiers. FMO was formed in 1970 through a partnership between the Netherlands government and Dutch financial institutions, industrial companies and trade unions. With an investment portfolio of EUR 1.9 billion and more than 200 employees, FMO is one of the largest bilateral development banks in the world that focuses on the private sector. FMO has a 'Triple A' rating from Standard & Poor's.

ProCredit Holding AG was founded as **Internationale Micro Investitio-**



nen AG (IMI) in 1998 as an investment company specialised in equity participations in micro-finance banks located in transition and developing countries. These microfinance banks, now collectively known as the ProCredit group, focus on providing banking services to people who other banks either do not serve at all (usually on the grounds of cost or risk) or only serve inadequately. ProCredit Holding is now, or soon will be, the majority owner of nearly all of the institutions in the ProCredit group, as it is currently implementing a strategy of purchasing from the publicly-owned institutions the shares they hold in the individual ProCredit banks. ProCredit Holding, working closely with Internationale Projekt Consult GmbH (IPC), actively guides the development of the institutions, taking responsibility at the corporate governance level. The company has so far taken equity stakes totalling EUR 53 million in 19 banks and financial institutions. Its shareholders are a 50:50 mix of private and public investors.

Commerzbank AG was established **COMMERZBANK**



in 1870 and today is one of the leading private commercial banks in Europe. With a strong international network comprising offices and shareholdings in more than 40 countries, Commerzbank is a universal bank providing retail and corporate banking services. It also offers financial services via a number of subsidiaries, such as leasing, asset management and real estate investment.

ProCredit – An International Group



ProCredit Bank Serbia is a member of an international group consisting of 19 financial institutions operating in as many countries. All of these institutions have a similar ownership structure and share a common corporate mission and focus: to provide micro, small and medium-sized enterprises with reliable access to credit and other banking services.

In the countries where the ProCredit group has a presence, the conventional commercial banks often focus their lending operations on corporate finance and consumer lending, but tend to neglect small businesses as a potential clientele. Their main reasons for not lending to micro, small and medium-sized enterprises are the perceived inadequacy of MSMEs' accounting methods, the ostensible inability of MSMEs to provide sufficient collateral and the high administrative costs incurred in small business lending. Yet MSMEs are seen by many economists and development experts as the main engine of growth and job creation in developing and transition economies. Moreover, in political terms, the middle class which emerges when MSMEs grow and flourish usually plays a stabilising role in society. It was these insights which prompted the initiators of the ProCredit group to establish target group-oriented financial institutions in Eastern Europe, Latin America and Africa, a process which began six years ago. In the meantime, these institutions have grown substantially: taken together, the 19 banks and finance companies operate through a total of some 300 branches and have roughly 7,000 employees.

The main shareholders of the group's institutions are the ProCredit Holding, KfW Group, IFC, FMO, and the Doen Foundation. ProCredit Holding, which is owned largely by the same entities that hold shares in the individual ProCredit institutions, is or soon will be the majority shareholder in the ProCredit institutions. ProCredit Holding produces consolidated financial statements for the group, and has a BBB- (investment grade) international rating from Fitch Ratings.

The activities of the group's member institutions are guided and supervised by ProCredit Holding and by IPC, the consulting firm which provides management services to the banks. Both ProCredit Holding and IPC are located in Frankfurt am Main, Germany. This centralised management and supervision makes it possible to achieve synergies which have a positive impact in many areas – for example, in training, corporate culture and identity, risk management, auditing, business policies, and funding for lending activities, as well as ethical and other professional standards.

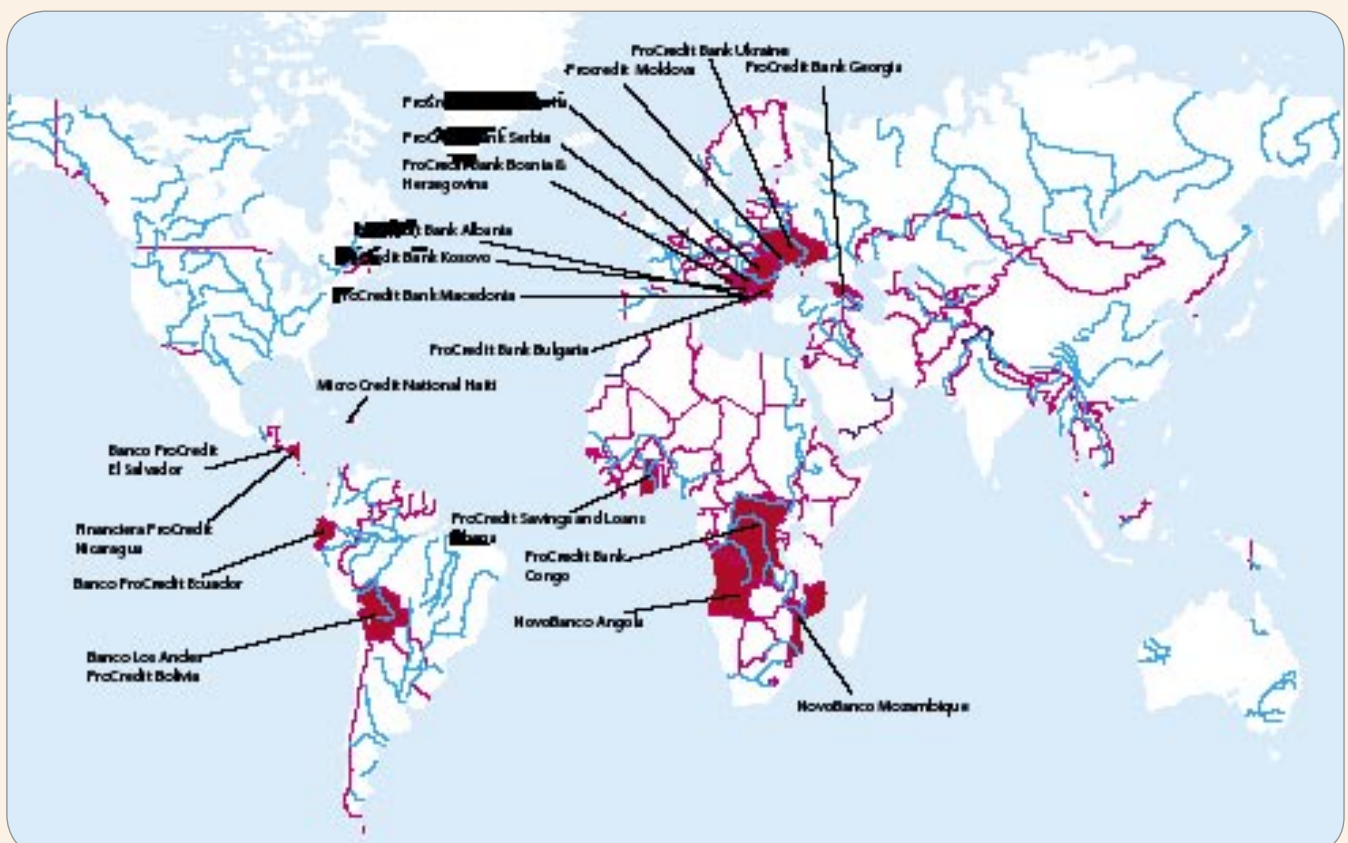
Over the years, the ProCredit group and IPC, which developed the lending methodology used by the ProCredit group, have gained a profound understanding of both the problems faced by small businesses and the opportunities available to them, and have tailored the credit technology to reflect the realities of their operating environment. Thanks to this credit technology, which combines careful analysis of all credit risks with a high degree of standardisation and efficiency, the ProCredit institutions are able to reach a large number of small borrowers: currently they disburse more

than 40,000 loans totalling more than EUR 100 million to small enterprises every month. By the end of 2004, the number of loans outstanding had grown to more than 420,000 (representing EUR 949 million), a 60% increase compared to 2003. And while the average loan amount outstanding is just EUR 2,250, the loan portfolio quality remains excellent with a ratio of loans in arrears (>30 days) to total loan portfolio of only 1.0%. This demonstrates that small borrowers are indeed creditworthy.

No small business financing operation can survive over the long term if it is forced to rely on external sources of funds. Accordingly, the ProCredit institutions are actively seek-

ing to make locally mobilised deposits their main means of financing their loan portfolios. In line with their development orientation, the network institutions strive to ensure that their deposit facilities are appropriate to a broad range of customers; in particular, they make their services accessible to low income groups by offering simple savings products with no minimum deposit. By placing a higher priority on deposit mobilisation in 2004, the ProCredit institutions have succeeded in enlarging their combined deposit volume to EUR 824 million, compared to EUR 552 million at the end of 2003. In addition to deposit facilities, business clients are offered a full range of standard non-credit banking services, including domestic and international

The international network of ProCredit institutions; see also www.procredit-holding.com





transfers, debit and credit cards, documentary services and foreign exchange operations.

At the same time, ProCredit institutions strive to set new standards in their respective banking sectors in terms of transparency and business ethics, as well as risk management and auditing. In this way, the group also aims to help to build public confidence in banks.

The ProCredit institutions can only be successful in their developmental mission if their sustainability is assured. Accordingly, they have been established as commercial, i.e. for-profit, entities. However, the shareholders of the group aim to strike a balance between, on the one hand, the developmental goals which motivated their investment in the ProCredit group, and on the other, the commercial success which forms the basis of long-term sustainability, and is reflected in an adequate return on investment. In 2004, the return on equity for the group as a whole, expressed in hard currency, after deduction of profit taxes, is expected to reach 14%.

This level of profitability is sufficient to ensure the further development of the group. By the end of 2009, the group expects to have institutions in 22 countries, with the total number of branches growing to almost 600, the number of employees rising to over 13,000, and the loan portfolio increasing to EUR 3 billion. To achieve the envisaged level of growth, it will be necessary to mobilise substantial financial resources. But in itself, access to additional funding will not be enough: human resource development will also continue to be a key priority for the group. This will entail not only intensive training in technical and management skills at the level of the individual institutions, but also a continuous exchange of personnel between the member institutions, so as to take full advantage of the opportunities for staff development which are created by their membership of a truly international group.

Partner Banks in the Region

Since the early 1990s, small businesses have become the driving force in Eastern Europe with respect to economic growth and job creation, thus playing a major role in the transition process. With many large, state-owned enterprises simply disappearing, many people found that starting their own business was the only available means of earning a living and creating a future for their family. One might assume that in the meantime the financial services markets in these countries would be sufficiently well developed to address the demand for loans exhibited by small businesses, but the reality is somewhat different: Many banks claim that they are perfectly willing

to serve small businesses, but in practice they continue to focus almost exclusively on more conventional, and more familiar, lines of business, such as corporate finance and consumer loans. Thus, the growth potential of small businesses is still constrained by their limited access to finance.

The ProCredit group aims to remedy this situation. Since 1998 the group has expanded its operations to cover 10 countries in the Balkans and the CIS. Nine out of the 10 institutions are fully licensed banks offering a wide range of financial services to business clients and private individuals. With its 185 branches,



the sheer size of the Pro Credit network makes the group a major player in the region, and in fact in some countries the local ProCredit institution is one of the leaders in the banking industry, setting new standards in terms of small business finance and customer service. Six of the 10 institutions have received an international rating, and in each case it was one of the highest awarded to any bank in the country in question.

Using a credit technology that is tailor-made to fit the specific requirements of small businesses, the ProCredit institutions have been able to quickly expand their lending operations. Currently, the group serves approximately 187,000 loan clients across the region. Particular attention is now being paid to rural areas, and an increasing number of ProCredit loans are being disbursed to businesses in the agricultural sector.

However, in accordance with their mission “to provide a broad range of reliable financial services”, the ProCredit banks are not merely lending institutions, but also offer a considerable number of simple and straightforward non-credit products aimed at the general public, including deposit facilities, private current accounts and debit/credit cards. Particularly the institutions in Eastern Europe have invested considerable financial and human resources in developing these operations over the last 12 months. The regional network offers special advantages when it comes to providing various kinds of non-credit products which are increasingly in demand. As cross-border travel and business activities gain in importance, the ProCredit banks have simplified the procedures for international money transfers between group institutions, and made their prices even more competitive. And ProCredit clients now have access to more and more ATMs across the region, at no extra cost.

Even more importantly, the strong ProCredit network permits a continuous exchange of know-how between the institutions to take place. Management staff exchanges, cross-border training programmes and regional workshops and seminars ensure that improvements and experience are quickly shared across the region, thus accelerating the institutional development of the network banks and enhancing the quality and reliability of their services. As part of the regional network, ProCredit Bank Bulgaria is benefiting from this steadily increasing cooperation.



Name	Highlights	Contact
ProCredit Bank Albania	Founded in March 1999 15 branches 18,951 borrowers / EUR 79 million in loans 50,311 depositors / EUR 116 million 387 employees	Rruga Sami Frasheri, Tirana Tel./Fax: +(355) 4-271 272 / 276 info@procreditbank.com.al www.procreditbank.com.al
ProCredit Bank Bosnia and Herzegovina	Founded in October 1997 13 branches 19,866 borrowers / EUR 61.4 million in loans 24,609 depositors / EUR 21 million 291 employees	Sime Milutinovica Sarajlije 4 71000 Sarajevo Tel./Fax: +(387) 33-250 950 / 250 971 info@procreditbank.ba www.procreditbank.ba
ProCredit Bank Bulgaria	Founded in October 2001 35 branches 26,852 borrowers / EUR 139.3 million in loans 53,384 depositors / EUR 75.6 million 623 employees	131, Hristo Botev Blvd. Sofia Tel./Fax: +(359) 2 921 71 00 / 71 10 contact@procreditbank.bg www.procreditbank.bg
ProCredit Bank Georgia	Founded in May 1999 19 branches 16,295 borrowers / EUR 50.4 million in loans 36,532 depositors / EUR 24.9 million 605 employees	D. Agmashenebeli Ave 154 Tbilisi Tel./Fax: +(995) 32-20 2222 / 0580 info@procreditbank.ge www.procreditbank.ge
ProCredit Bank Kosovo	Founded in January 2000 16 branches 28,600 borrowers / EUR 109.9 million in loans 157,500 depositors / EUR 310 million 430 employees	Rr Skenderbeu 38000 Prishtina/ Kosovo UNMIK Tel./Fax: +(381) 38-249624 /-248777 info@procreditbank-kos.com www.procreditbank-kos.com
ProCredit Bank Macedonia	Founded in July 2003 7 branches 8,008 borrowers / EUR 23.7 million in loans 14,018 depositors / EUR 11.6 million 171 employees	Marks I Engels 3 1000 Skopje Tel./Fax: +(389) 2 321 99 00 / 01 info@procreditbank.com.mk www.procreditbank.com.mk
ProCredit Moldova	Founded in December 1999 16 branches 5,483 borrowers / EUR 9.2 million in loans 140 employees	Izmail, 31 Chisinau Tel./Fax: +(373) 22 27-07 07/-34 88 office@procredit.md www.procredit.md
ProCredit Bank Romania	Founded in June 2002 10 branches 10, 870 borrowers / EUR 50.7 million in loans 18, 600 depositors / EUR 25 million 269 employees	Calea Buzesti, nr. 62-64, Sector 1 011017 Bucharest Tel./Fax: +(40) 21-201.6000/305.5663 headoffice@procreditbank.ro www.procreditbank.ro
ProCredit Bank Ukraine	Founded in January 2001 28 branches 17,400 borrowers / EUR 74.4 million in loans 25,891 depositors / EUR 26 million 853 employees	86 Bozhenka Str. 03150 Kiyv Tel./Fax: +(380) 44-490 60 52 / 80 info@procreditbank.com.ua www.procreditbank.com.ua

Business Review

2004 was another exciting year for business in Serbia, and in particular for ProCredit Bank. While Serbia's political leadership struggled to maintain a balance between nationalistic ideas and democratic policies, the economy showed clear signs of stabilisation and revitalisation. Despite procedural impediments, 135 socially owned enterprises were tendered and sold to private investors. Production increased in agriculture, manufacturing industry, trade and construction, giving cause for optimism regarding the GDP growth rate, which is estimated to have reached 6%. The restructuring of Serbia's debt to the London and Paris Club creditors and the launch of a new IMF programme are further encouraging signs for the business community. Serbia received its first credit rating – a B+/Stable from Standard & Poor's – engendering hope of increased foreign investments in the near future. Finally, although progress is slow, the legislative reform process is definitely underway. In particular, VAT is introduced in early 2005, and cash registers were made compulsory for shops. Measures like these will help to reduce the influence of the shadow economy, which still accounts for an estimated 50% of the country's overall economic activity.

On the other hand, there are still a number of issues which threaten to undermine Serbia's economic recovery. First of all, continuing political uncertainty over the future status of Kosovo is one of the main obstacles to Serbia's further integration into the European Union. The incidents that shook the province in March demonstrated the volatility of the situation on both sides of the ethnic divide, and also fostered a stronger than expected showing from the nationalistic Radical Party in both presi-

dential and regional elections in Serbia. On the economic front, a deepening trade deficit and a steady depreciation of the dinar against the euro, coupled with inflation rising to around 10% during the year are all issues that will need to be addressed in order to further stabilise the economy.

With total assets of EUR 6.5 billion and bank lending to the private sector amounting to only 3.5% of GDP, the Serbian banking sector still lacks financial depth. However, the banks reported a healthy 25% growth in deposit-taking and even a 36% rise in lending activities in 2004. The financial sector's business lending grew by 28% during the year, compared to a mere 4% in 2003. However, there was an even more marked rise in the level of consumer lending: the volume of loans to private households increased by no less than 82%, five percentage points more than in 2003.

It should be noted, however, that these overall figures mask the significant differences that exist between the various types of bank. With strong backing from their home base, particularly in terms of equity, foreign banks adopted an aggressive approach in their efforts to gain market share during 2004, offering loan and account packages on very favourable terms and conditions, and thus putting considerable pressure on domestic banks. In contrast, the assets of domestic private banks increased only slightly, while most of the state-owned banks actually lost market share. As a result, the 15 financial institutions operating with foreign capital hold approximately 47% of the sector's total assets.

While there are 46 fully operational banks in Serbia, in practice the market is clearly divided between a few strong players and a large number of minor “spectators”. The sector includes 31 small banks each holding less than 2% of the combined total assets, and thus having almost no influence on market development. In contrast, the top four banks (in terms of total assets) command 42% of the market for deposits and as much as 51% of the credit market. This market structure is not expected to change significantly in the near future. Although the National Bank of Serbia (NBS) has adopted a restrictive policy on issuing new licences, strong measures such as a substantial rise in the minimum capital requirements are not envisaged. However, changes in the market structure might arise from the privatisation of the remaining state-owned banks. The state still controls 37% of the sector’s total assets. Only one state-owned bank had been sold by the end of the year, while two others were under tender. Many foreign banks are waiting for their chance to enter the Serbian market, so this will undoubtedly lead to a significant influx of foreign capital.

Lending to and medium enterprises is becoming more and more “fashionable” in Serbia and financial institutions have discovered small businesses as potential credit clients. Nevertheless, ProCredit Bank has retained its leadership of the market for loans to the MSME sector. Despite its narrowly defined mission, ProCredit Bank has firmly established itself in the market, and now ranks 10th in total assets. Given the bank’s focus on micro lending operations, its development has been remarkable: still ranked 21st in June 2003, ProCredit

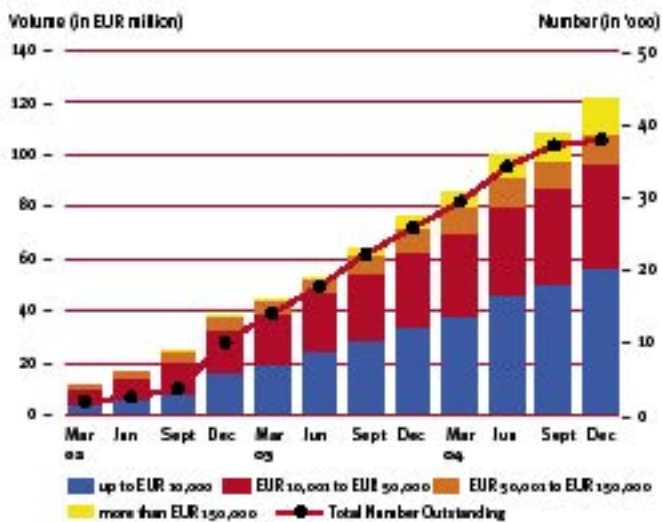


Bank caught up with its main competitors in 2004, rising to 12th place in terms of total assets by mid-2004 and overtaking another two banks towards the end of the year. This proves that a lending operation focused on micro, small and medium enterprises can generate substantial volume. In turn, it is an indication of the impact the bank has already had on the development of the small business sector.

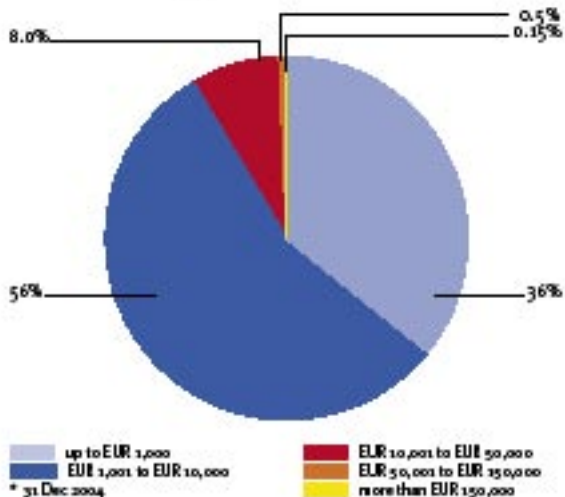
Thanks to the strong increase in long-term savings and deposits, as of December 2004 the bank held a 3% market share in total deposits, thus maintaining its strong position among the top 10 banks in personal savings. These encouraging results are due not only to the wide range of products offered by the bank but also to the excellent reputation it was able to build during 2004. ProCredit Bank is widely known as a bank which stands for fast, professional and affordable banking services.

LOAN PORTFOLIO DEVELOPMENT

Loan Portfolio Development



Number of Outstanding Loans by Loan Size*



ProCredit Bank's lending activity developed strongly throughout the year. At present, the bank has 37,500 outstanding loans to businesses, private individuals and farmers. As of

December 31 2004, 159 loan officers were handling a loan portfolio totalling EUR 121 million. During the year the bank's overall outstanding loan portfolio increased by 60%, almost double the rate of overall market growth.

In the business loan portfolio there were 12,300 more outstanding loans at end-2004 than at the end of the previous year. The bank's continued dedication to its mission and its primary target group is reflected in the fact that 87% of all outstanding business loans (representing 41% of the portfolio in volume terms) were micro loans (i.e., smaller than EUR 10,000). The bank disbursed almost 22,400 micro loans during the year, 12,100 more than in 2003. They vary in maturity from 12 to 24 months, and are disbursed within 3 days from the date on which the application was submitted. In all, more than 2,000 Serbian small businesses received loans from ProCredit Bank every month, and the average loan size disbursed was EUR 5,300. EUR 34 million was issued in the form of small loans to enterprises (i.e., between EUR 10,000 and EUR 50,000).

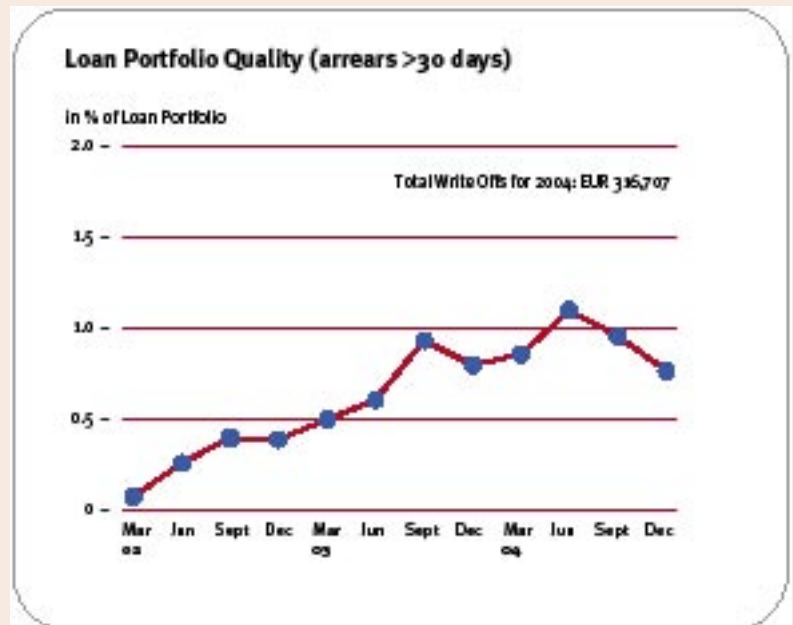
Medium-sized loans – amounts exceeding EUR 50,000 – accounted for another 17% of the total loan portfolio. In the course of the year this component of the portfolio doubled to EUR 22 million. It is also important to note that an increasing number of our corporate clients are taking advantage of the other services the bank provides, such as payment and documentary services. A total of 298 letters of credit and guarantees worth EUR 10 million were issued during the year, an increase of roughly 60% in terms of both volume and number.

The bank also increased its lending to the agricultural sector, mostly targeting small-scale primary producers. In total, 7,100 agricultural loans were disbursed in 2004, averaging EUR 3,100. ProCredit Bank is the only financial institution in Serbia which is making a serious attempt to provide the financial services that small primary agricultural producers require. The success we have achieved so far in this line of business is something that the bank is particularly proud of.

In consumer lending, some foreign financial institutions in particular have issued personal loans on a massive scale in an attempt to gain market share, but ProCredit Bank has not followed this trend: consumer loans account for only 10% of its loan portfolio. Taking account of the low level of salaries in Serbia, the bank ensures that its customers do not become over-indebted by limiting monthly instalments to no more than 25% of the borrower's salary.

As a result of its intensive efforts to attract new lending business, ProCredit Bank now accounts for 10% of all loans disbursed in Serbia. Since its foundation, a total of 37,500 loans, amounting to EUR 225 million, have been issued to small and very small enterprises. Thus, ProCredit Bank is the clear market leader in this segment. And despite this rapid growth, the quality of the portfolio remained excellent throughout the year.

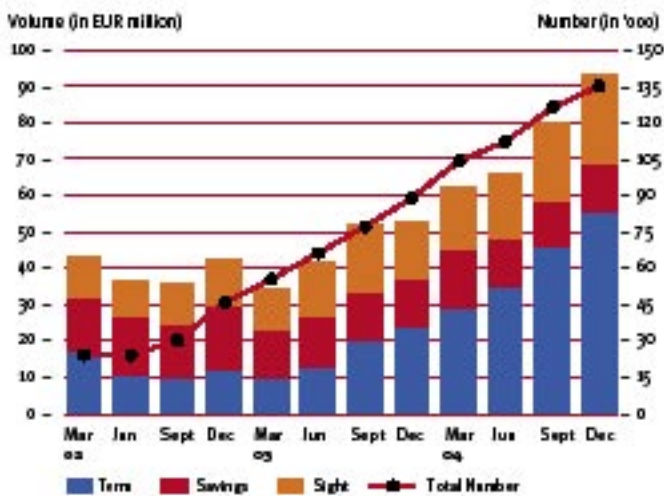
The balance of loans with payments more than 30 days overdue never exceeded 1% of the total outstanding loan portfolio, ending the year at around 0.78%, while the rate of accumulated loan losses remained under 0.2%.



The year 2004 saw a major campaign to promote the bank's deposit facilities and payments services. Following the introduction of the new Serbian debit card, the DINA card, payment operations increased gradually over the year.

OTHER BANKING SERVICES

Client Deposits



By the end of the year 37 banks had joined the DINA system. More than 300 ATMs have been installed across the country, though mostly concentrated in the largest cities, and 8,000 retailers throughout Serbia accept DINA as a means of payment. The fact that payments totalling USD 202 million were carried out through VISA indicates that credit cards are slowly but surely supplanting cheques, a development which is strongly favoured by the NBS and will significantly benefit the banking system as a whole.

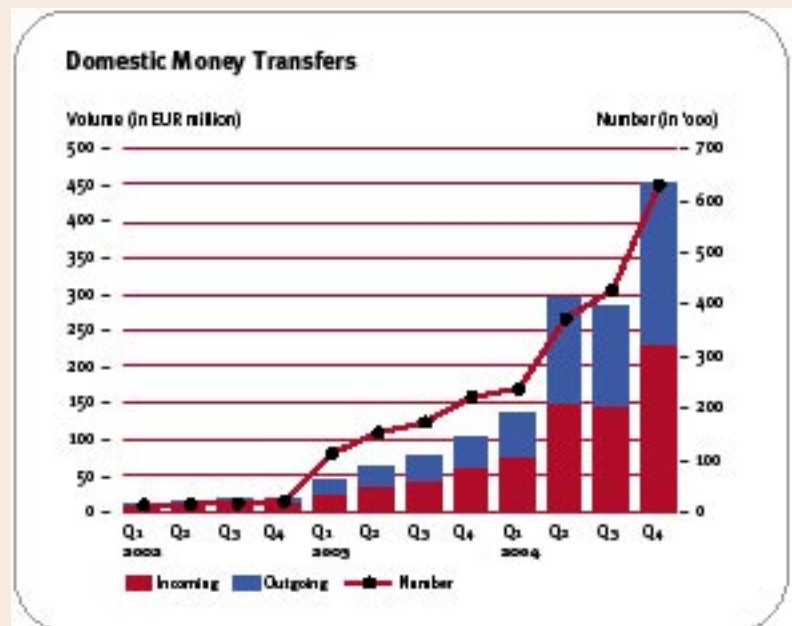
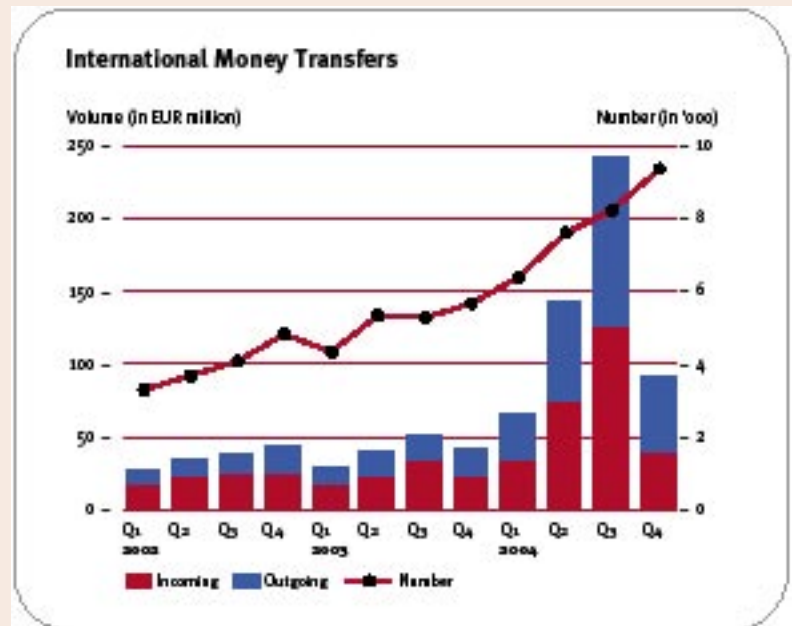
ProCredit Bank invested considerable effort in keeping abreast with demand during the year under review, and this has clearly paid off: by the end of the year 85,000 retail clients were using ProCredit Bank's services. We enhanced our range of non-credit products for both private individuals and business customers by introducing new services and making improvements to our existing ones.

The bank started to provide overdraft facilities on current accounts for legal entities in 2004. Term deposit accounts were restructured, introducing different interest levels for different sizes of deposit, and flexible interest rates for savings. As of December 31, the bank's customers held 137,000 current accounts, 5,900 term deposits and 8,801 savings accounts. Almost half of the total volume of deposits held with ProCredit Bank is accounted for by savings with maturities exceeding three months. During 2004, ProCredit Bank's deposit base grew by 64% to EUR 92 million, putting the institution among the top three Serbian banks in terms of deposit growth.



Now that it has become a genuine full-service financial intermediary, ProCredit Bank has also gained a significant share of the market for transfer and payment operations. ATMs, DINA cards and POS terminals have accelerated both domestic and international money transfers, and the total number of these operations almost doubled in 2004, albeit from a low base. During the year under review, the bank doubled the size of its ATM network from 10 to 20 machines, representing 8% of the total number of ATMs in Serbia. It also set up 928 POS terminals, a market share of 13%. On average, 189 operations per month are recorded on each ATM. A total of EUR 139 million was transferred during the year through the bank's ATMs. Since the launch of the DINA card system in October 2003, the bank has issued a total of 15,700 debit cards to its customers.

A significant number of payment orders were also placed through ProCredit's e-banking service. In 2004, the system allowing business customers to monitor their accounts and to execute payments through the internet was extended to private individuals. The client interface was improved, and foreign exchange clients were given access to exchange rate reports, a prerequisite for the addition of international payment facilities to the e-banking package. At present more than 1,050 customers use this facility for money transfers and payment orders. The trend towards e-banking is clearly reflected in the number of payment orders. In December 2004 alone, over 23,000 payment orders were placed through the internet. In 2005 inexpensive e-banking services will be offered



as part of our account and deposit packages for both business and personal customers.

FINANCIAL PERFORMANCE

As in the previous year, ProCredit Bank's operational success was also reflected in its financial performance. The bank posted a net profit of EUR 1.7 million according to IAS, resulting in a return on equity of 16%. Interest income for the year grew by 60%, and a 27% increase in fee income helped to ease the pressure arising from costs incurred in connection with the aggressive branch network expansion strategy. In addition the bank started to fully apply IFRS 39, which meant that the bank started to account for origination fees as deferred income throughout the lifetime of the loan, the effect of which was to postpone the booking of revenues totalling more than EUR 1 million during the course of year. However, thanks to strict management and a cautious spending policy, these and other difficulties were successfully overcome.

ProCredit Bank's enlarged deposit base and increased income led to a significant shift in its funding base, moving the bank closer to

self-sustainability. More than 47% of its loans are now financed with customers' deposits. Another 17% are funded with deposits from other banks, while the remaining 32% are covered by long-term loans from IFIs. Overall, the total deposit base amounts to the equivalent of 74% of the loan portfolio, which dominates the asset side of the balance sheet. The bank's treasury operations ensure that at any given time the risks associated with open currency positions are minimised, and as a matter of policy the bank does not participate in any operation of a speculative nature. "Sticking to the basics" in this way has proved to be a wise policy for a number of reasons, not least of all because our core business has been sufficiently profitable.

Much of Serbia consists of fertile pastures and farmland: 70% of its total surface area is given over to agriculture. The farming tradition is especially strong in the northern part of the country, the Vojvodina region, where the quality of the soil is considered to be higher than anywhere else in Europe.



AGRICULTURAL LENDING PROGRAMME



Agriculture's role in the Serbian economy is both extensive and diverse. Primary production from agriculture, hunting and forestry accounted for 15.2% of GDP in 2004, second only to manufacturing (24%). Indeed, if food and beverage processing is added to primary production, agriculture becomes the largest sector in the economy, representing a quarter of the country's GDP. Approximately 44% of the population live in rural areas, one third of them relying wholly or partly on agriculture for their livelihoods. More than 1.3 million people, 17.3% of the population, are employed in agriculture. Exports of primary agricultural products, processed food, beverages and tobacco products accounted for 26% of total exports in 2003 and 2004.

The development of the agricultural sector has been severely impeded during the last 20 years by socialist policies, the break-up of former Yugoslavia, and the economic distur-

tions and political strife of the Milosevic era. As a result, agricultural output has fallen far short of its potential levels. These factors have also depleted the capital base of farmers and agricultural processors, and led to the adoption or retention of inefficient production methods and the establishment of public-sector entities that are not suited to a market economy. Yet unlike the rest of the economy, agricultural output has already recovered to pre-1990 levels, an indication of the strength of the sector's underlying resource base and its considerable potential for further growth.

However, underdeveloped infrastructure, ancient agricultural machinery and equipment, and rudimentary irrigation systems present tough challenges to the new generation of agricultural producers. In general, the productivity of the agricultural sector in Serbia is low. On average, farms in Serbia are small – 75% have less than 5 ha of land – and this inhibits the utilisation of economies of scale, which are

most evident on farms of between 50 and 200 ha. The market for arable land is weak in Serbia due to insecure property rights. Farmers and agricultural processors have been reluctant to invest in the necessary modernisation of their machinery and equipment because for a long time they were left without access to credit from financial institutions or support from the government. Hardly any of the existing banks considered developing agricultural loan programmes for small farmers, presumably because they felt that the natural uncertainties to which farmers are exposed – rainfall, disease or harvest yields – in combination with their limited size made it too risky to lend to them.

ProCredit Bank was thus the first bank to develop mechanisms for analysing the credit risks associated with small-scale farmers. Methods have been devised for assessing the farmers' assets and estimating their monthly/yearly output, and procedures have been established which guide the loan officers in their dealings with farmers and cattle breeders through all phases of the agricultural production cycle.

To date, ProCredit Bank Serbia has played a leading role in lending to the country's farmers. Since the introduction of the agricultural lending programme in March 2002, the bank has disbursed over 11,000 loans, totalling EUR 36 million, and the volume of agricultural lending has grown steadily: During 2004 alone, more than 7,000 agricultural loans were issued, bringing the total volume of loans outstanding to this clientele up to EUR 19 million, or 18% of the bank's overall business loan portfolio. At present, the bank holds 7,400 outstanding agricultural loans with an average amount outstanding of EUR 2,600.

When dealing with small agricultural producers, ProCredit Bank Serbia applies a sophisticated credit technology. The bank's dedicated agricultural lending staff have specially crafted tools at their disposal for the analysis of loan applications, and apply a prudent approach which takes full account of the specific risks associated with lending to the agricultural sector. As a consequence, the quality of the agricultural loan portfolio has consistently remained very high. Current arrears in agricultural lending are no higher than in other segments.

When it was launched, the programme initially focused on the Vojvodina region surrounding Novi Sad. The favourable results achieved here gave rise to similar projects in Central and Southern Serbia later in 2002, and in the wider Belgrade region in 2003. Today every ProCredit Bank branch in Serbia offers agricultural loans.

Despite the increase in government funding during 2004, demand for ProCredit Bank's agricultural loan products remains high. Most of the other banks are still reluctant to finance development in the agricultural sector, which leaves numerous opportunities for ProCredit Bank to expand its business with this market segment in the coming years.

Bearing in mind the encouraging signs on the economic front, the coming year promises further financial success for ProCredit Bank. A lowering of corporate income tax to 10% and the introduction of an 18% VAT charge should boost domestic investment, and this in turn should enable the bank to continue expanding its loan portfolio. It will continue to streamline the procedures involved in each of its four types of

OUTLOOK

loan packages (including housing improvement loans and leasing deals), and in order to reach out to clients living in remote regions of Serbia, the bank will systematically extend its branch network, selectively strengthening existing outlets and opening new branches. At the same time, it will modify its network structure, building strong regional branch centres that will coordinate and supervise the activities of the smaller branches and outlets, thus ensuring that its lending and other banking operations remain flexible and fast. As a full service bank that puts customer care first, ProCredit Bank will concentrate on offering its clients conve-

nient and financially attractive savings opportunities and other new products, such as VISA cards and MasterCard accounts, while at the same time keeping the focus on the core competencies we have applied so successfully to date.



Risk Management

All daily operations expose a bank to various kinds of risk. The aim of risk management is not only to manage the most obvious form of risk, namely the credit risk arising from banks' lending activities. Financial institutions also have to deal with other risks to which the bank and its customers may be exposed, including foreign exchange risk arising from currency mismatches, market risk, and operational risk, and they must be all the more watchful in a volatile environment such as Serbia. Risks can never be eliminated entirely, but it is a bank's obligation to manage risk professionally.

In 2003, ProCredit Bank Serbia introduced a centralised Risk Management Com-

mittee as a first step towards institutionalising the assessment and analysis of its risk exposure. The committee consisted of a member of the executive management, the respective heads of the Credit, Retail, Treasury and Controlling Departments, a member of the Internal Audit Department and two branch managers, the latter on a rotating basis. The centralised Risk Management Committee proved an effective forum for exchanging information on the bank's risk exposure and increasing the awareness of middle management of the various kinds of risks the bank has to deal with.

In the course of 2004, however, as a response to the growth of the business, the centralised Risk Management Committee was replaced by several smaller more specialized committees in order to increase efficiency, focus on certain sources of risk and provide the management with suitable recommendations.

The Credit Risk Committee (CRC) monitors loan portfolio quality. Credit risk is the inherent risk involved whenever the bank lends money to a customer or issues a credit instrument such as a guarantee or a letter of credit on a customer's behalf.

Credit risk is managed broadly in accordance with ProCredit group guidelines. The CRC takes decisions on loan classifications, monitors limits for portfolio diversification and determines loan loss policy, taking into account the country's overall macroeconomic situation.

During 2004 the portfolio at risk over 30 days was below 1% on average, and only 0.14% of the total loan portfolio had to be writ-



ten off. The bank performed especially well in regard to arrears in the micro loan segment up to EUR 1,000. Here the portfolio at risk over 30 days averaged only 0.3% over the year. At the same time, the bank has set aside loan loss provisions amounting to 2.6% of the gross loan portfolio.

Liquidity and funding risk is monitored by the Asset Liability Risk Committee. It focuses on interest rate risk, foreign currency risk, liquidity risk and counterparty risk. Thanks to an increased volume of deposits and the strong support of its shareholders, ProCredit Bank was able to consistently maintain a strong liquidity position. In spite of a steady decline in the total monetary base of the Serbian economy, the bank was able to maintain an average liquidity ratio of 2.76 throughout the year, thereby exceeding the minimum ratio set by the NBS.

Since ProCredit Bank mainly grants loans with fixed interest rates and receives credit lines with floating interest rates, the bank is exposed to some interest rate risk. However, the interest rate risk is still limited: Firstly, a major portion of the bank's liabilities consists of term deposits with fixed interest rates. Secondly, all loan contracts include a clause giving the bank the right to change the interest rate in the event of serious macroeconomic shocks (e.g. major changes in inflation or the exchange rate). Finally, all loans with a maturity exceeding 36 months have a floating interest rate.

Compliance with the regulations of the National Bank of Serbia and internal limits on the open currency position (OCP) is particularly important in a relatively volatile monetary



environment such as the one prevailing in Serbia. While the NBS sets a limit of 30% of equity for open currency exposures, the bank adheres to an internal limit of 15% of equity. The OCP is monitored daily, aiming for a closed position in each individual currency. The ALRC monitors and reports on the bank's OCP on a weekly basis, ensuring compliance with all standards set.

The Performance Risk Committee monitors the bank's profitability and market position. Specifically, it monitors performance risk, capital adequacy, market risk and reputation risk. The committee evaluates profit and loss accounts, the balance sheet structure and cost structure ratios, the market position and public

standing of ProCredit Bank, and the business activities and strategies of competitors.

In 2004 ProCredit Bank experienced some challenges in this area. Starting in 2004 and in accordance with IFRS 39, disbursement fees are now deferred and are amortised over the lifetime of the loans (rather than being booked when collected). This had a negative one-off effect on the bank's income. In addition, the opening of new branches during 2004 caused significant additional expenses. However, the bank still achieved a satisfactory financial performance, as an increased volume of business led to a substantial increase in income which was sufficient to compensate for the factors mentioned above. As a result, the bank reported a positive net result for the year.

Markets change constantly; new products appear, as do new technology and new competitors. ProCredit Bank is aware of these changes and adapts to the risks arising from them. The bank has invested a great deal of effort in rounding out its product range and becoming a full-service financial intermediary. Accordingly, the bank has a strong market position, being among the 10 largest banks in Serbia by assets and one of the fastest-growing financial institutions, especially in terms of deposits from private individuals.

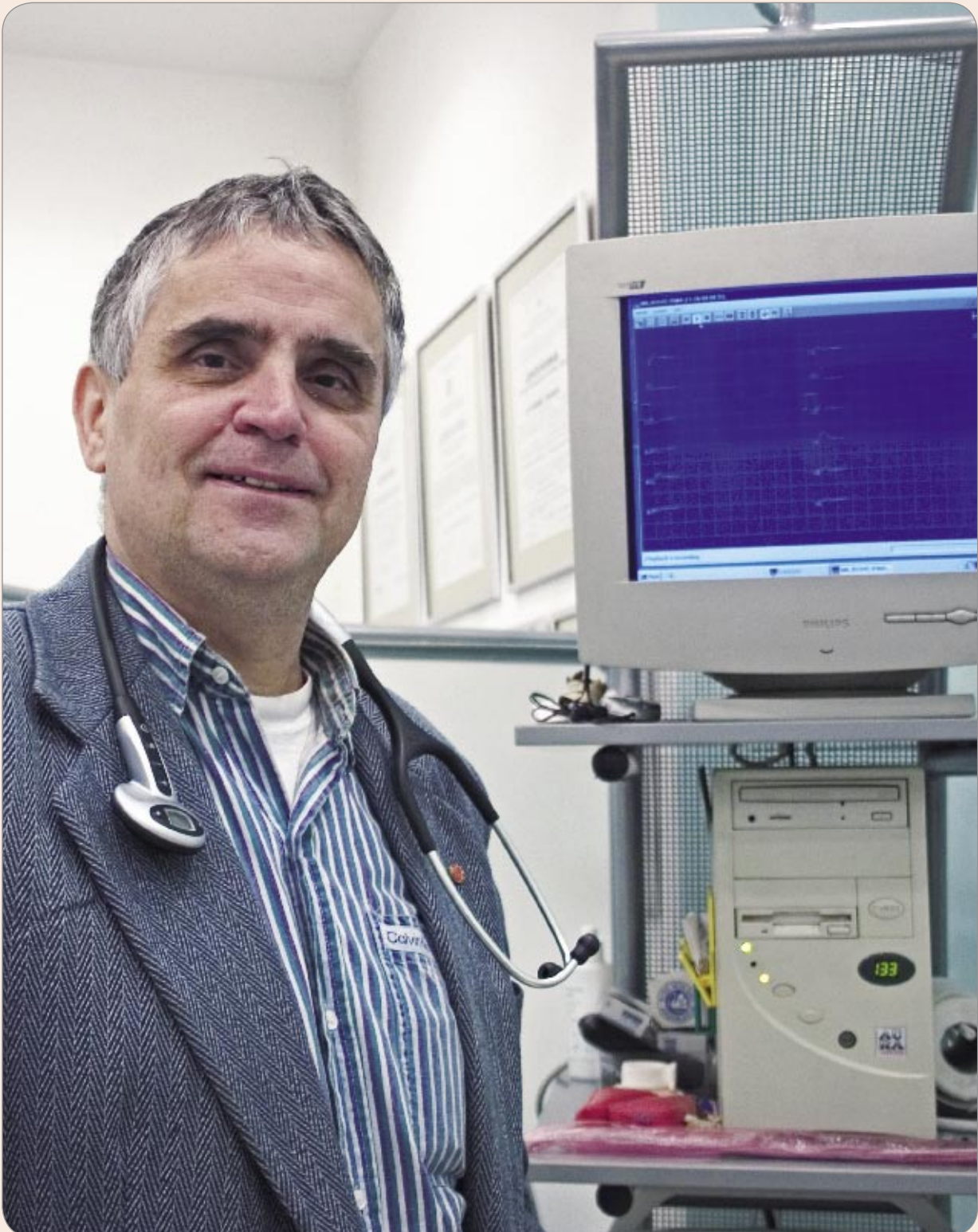
The Operational Risk Committee examines and manages risks arising from internal processes or systems, from human error, or from external events, in particular transaction risk, compliance risk, and legal and regulatory risk.

Operational risk is inherent in virtually all of a bank's transactions and activities. However, with the establishment of information systems and internal control measures and a strong management oversight, ProCredit Bank has established reliable structures for the management of its operational risks. Every bank operation is based on set procedures, and manuals have been established which guide employees through all business activities. The bank applies the four-eyes principle in all areas.

Regarding information security, the bank has worked consistently towards its goal of safeguarding its operations against fraud and misdemeanour, whether internal or external.

Thanks to centralised group risk controls, operational risk has been well managed to date. Here, ProCredit Holding has taken a guiding role, among other things setting strict standards for the internal audit function. The centralised internal audit department of ProCredit Holding maintains close contact with ProCredit Bank's internal audit team, monitoring the efficiency of procedures, processes and systems.

We are aware that, if we are to maintain a successful business, we must monitor financial and market risks on an ongoing basis. Thus, procedures and measures are scrutinised regularly and adjusted to the pace of the bank's development, so that any risks which arise, whether external or internal, can be managed effectively.

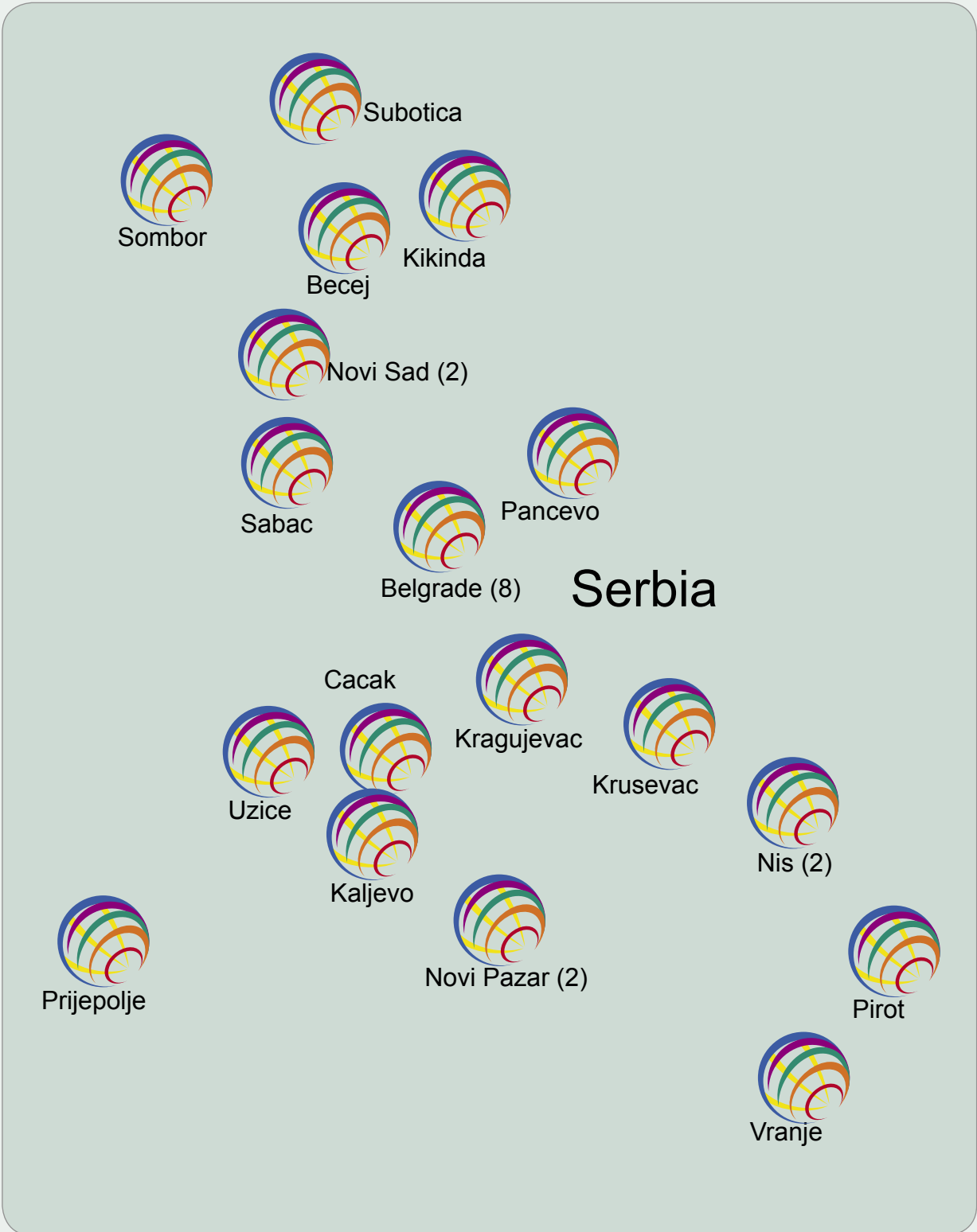


Branch Network

In line with the growth of its lending operations and the diversification of its product range, ProCredit Bank was once again very actively engaged in extending and enhancing its branch network in 2004. As well as upgrading credit outlets to fully-fledged branches in Becej, Pancevo, Kagujevac, Kraljevo and Kruševac the bank entered several new markets and strengthened its presence in existing ones. New branches were opened in Niš, Vranje, Kikinda and Novi Pazar, and another five offices were set up in Belgrade, where 30% of the country's population lives. By the end of the year, ProCredit Bank had a total of 25 branches and three credit outlets offering banking services throughout Serbia, even in politically fragile areas where no other foreign bank operates.

The bank also invested in the refurbishment of its premises. Our aim is to establish a strong, easily recognisable corporate image that will increase awareness of ProCredit Bank among potential clients, and achieving this objective will continue to be an important part of our network strategy in 2005. With yet another expansion offensive, ProCredit Bank will strive to attract new clients in every part of the country, focusing on regions with strong potential for MSME development.





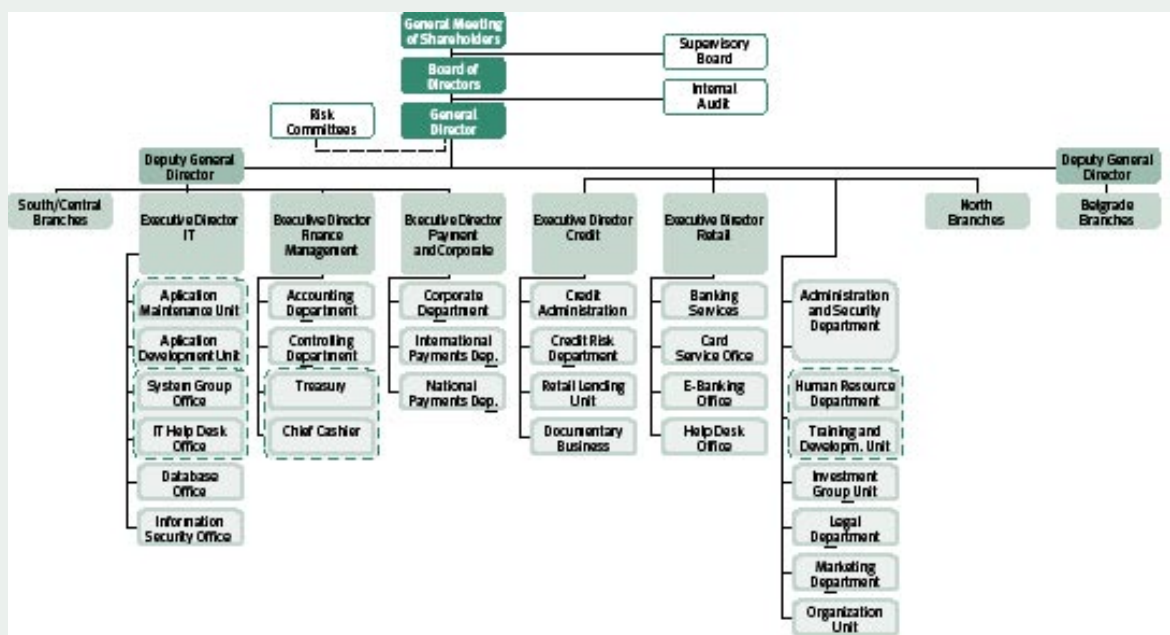
Organisation, Staff and Staff Development

Having lived through rampant inflation, seen their bank savings disappear, and experienced periods of extreme political and economic instability, Serbians understandably lost all confidence in their banking system and their local currency. Regaining people's trust is a challenge facing domestic and foreign banks alike. Simply offering banking products, be they deposits or loans, is not enough in itself to persuade people to place their faith in financial intermediaries again. The services provided by a bank must be of a high quality; they must be delivered with a high degree of efficiency and professionalism; and they must be "sold" by

well trained, highly qualified and experienced employees. That is why ProCredit Bank places so much emphasis on training and motivating its staff, who remain its most valuable asset.

In accordance with its mission to support the financial development of enterprises and private individuals, ProCredit Bank seeks to build long lasting relationships with its customers. To this end, we make sure that each client receives professionally competent attention from staff members who are sensitive to his or her specific requirements. This philosophy is reflected in the fact that 60% of our employees

Organisational Structure





are deployed in the front office: client advisers, loan officers, account managers and cashiers see themselves as mediators between customers and the back office team. It is this “people-oriented” approach which sets ProCredit apart from other institutions in the Serbian banking market.

Competence, integrity and friendliness are key components of our customer service, requiring our staff to develop and exhibit a range of social skills and a high degree of flexibility in their thinking. Yet, the bank’s code of conduct calls for employees not only to show a commitment to the clients, but also to adopt a professional attitude towards their colleagues. Transparency and reliability create a productive and inspiring working atmosphere and ensure high quality results. ProCredit Bank greatly appreciates the loyalty and team spirit shown by its employees, who realise that in serving our clients well, they are also doing a vital service to the bank.

The rapid growth of ProCredit Bank’s branch network has posed a challenge to the Human Resources department. In 2004 our recruitment process and training policy were modified to reflect the pace of expansion. Group assessment was introduced into the recruitment procedure, and preparatory training sessions for newly hired personnel were inaugurated. These sessions are held in our newly established internal training centre, which is also used to provide regular seminars and courses designed not only to enhance our employees’ proficiency in performing their duties at the bank, but also to enable them to develop skills that go beyond the realm of work. In order to ensure that the

quality of training is consistently high, the centre is also dedicated to advancing the teaching skills of its trainers.

In line with the introduction of new retail products and the broadening of the bank’s client base, a significant number of additional client advisers were hired and trained in 2004. A new unit that was set up to deal with comparatively large corporate clients necessitated the appointment of account managers and credit analysts, who were carefully trained to serve this clientele. During the year under review the number of employees increased by 206 to a total of 744. Our staff consists of young professionals and university graduates whose average age is 30. The various departments are led by a middle management layer made up of young, dynamic and accessible individuals. Five executive managers mediate between the general management, the departmental units and the individual employees; each executive manager is responsible for an entire division of the bank. A decentralised organisational structure like the one in place at ProCredit Bank confers a high degree of trust and responsibility on the branch managers, who run their branches as profit centres with a considerable measure of autonomy. This encourages them to cultivate an entrepreneurial approach and act with the flexibility needed to deal effectively with the bank’s target groups. At the same time, meetings of the branch network coordinating committee and the branch managers are convened on a regular basis as an instrument of control and coordination throughout the network. Additionally, ProCredit’s Head Office provides strong support and supervision by making regular visits to the branches.

Ethical and Environmental Standards



Our high standards of business ethics are reflected in the bank's Code of Conduct. It was introduced with the aim of creating and maintaining an open and transparent working environment, in which the interests of the bank, its employees and its clients are all equally well protected. All of our staff members are expected to adhere to the highest standards of conduct and to act with honesty, integrity, impartiality and respect in all their dealings with fellow employees, clients and the general public.

It is a strict rule that the bank must not conduct or support transactions involving funds which may be suspected to have originated from criminal activities. Accordingly, compliance with the legal requirements for the prevention of money laundering is given special emphasis. The operational modules of ProCredit Bank's IT system are designed to detect and track suspicious transactions, and the anti-money laundering compliance officer reports to the local authorities on a regular basis.

As a member of the ProCredit group, Pro Credit Bank Serbia defines its role as a development-oriented institution not only in commercial and economic terms. It also regards promoting environmentally sound and ethical business practices as an integral part of its mission to support long-term development.

Both in the way it conducts its own operations and in the criteria it applies when selecting its clients, ProCredit Bank Serbia adheres to strict environmental standards. In order to facilitate compliance with these standards, the bank has formulated an Environmental Policy Statement, which is part of an overall Environmental Management System that has been adopted by all of the institutions belonging to the ProCredit group. In addition to applicable legal requirements, the Environmental Policy Statement includes an Exclusion List which defines a number of environmentally hazardous activities that may not be financed with a ProCredit loan. ProCredit Bank Serbia also refuses to finance, or be associated in any other way, with economic activities that involve coercive or unsafe forms of labour, in particular harmful child labour.



Our Clients

MILAN DJOKOVIC – BARREL PRODUCER



Exporting a traditional Serbian craft Product to Western Europe

Milan Djokovic produces wooden barrels, which are mainly used to store “rakija” (locally produced spirits) and vinegar. He started out by selling his hand-made casks at village fairs around Uzice, a remote Serbian town in the Slatibor Mountains. Milan, his father and his grandfather are all exponents of this rare craft, and at that time they were able to produce about 90 barrels a month.

When Mr. Djokovic signed a contract to export all of his barrels to a customer in Italy, he decided to enlarge his business and applied to ProCredit Bank for a first loan of EUR 1,500. After a successful year he received two more loans from the bank, one for EUR 4,000, the other for EUR 10,000, which he invested in new machinery. Today, thanks to the new equipment, he can produce a total of 150 barrels per month. Not wishing to be dependent on just one customer, Mr. Djokovic has systematically broadened his client base. Nonetheless, he still ships 400 barrels to Italy every three months and is currently seeking to hire two employees to help with production.

WEDDING DRESS BOUTIQUE – “YES”



Satisfied Clients are at the heart of our business

Ilona Takac has been a private entrepreneur for 10 years. Before going into business for herself, she worked for 15 years for a socially-owned enterprise, where she acquired the dressmaking skills she applies so successfully today. In 1999 she opened her own wedding dress shop, “Yes”, in Subotica. The dressmaking workshop she had set up in her own home soon became too small, so in order to keep pace with demand she moved to a new workshop outside the city.

Ms. Takac became a client of ProCredit Bank in 2002. Over the next two years the bank supported her business by providing her with two loans of EUR 5,000 each. This enabled her to open two showrooms in the centre of Subotica and created an opportunity for her to start manufacturing small decorative objects and accessories. Thanks to her innovative business ideas, which included renting out wedding dresses and selling accessories, she has established a firm position for herself in the market, leaving all her competitors behind.

RESTAURANT BYBLOS



Meeting EU quality standards

“Byblos” is the only restaurant in Belgrade where clients can savour not only a good meal but also a taste of Middle Eastern culture. The only Lebanese restaurant in the city is managed by Jelena and Katarina Kovacevic. After running a restaurant on Cyprus for five years, the sisters decided to establish their own enterprise, relying on the management skills they had developed abroad. In 2003 they hired a Lebanese cook and opened Byblos in an area of Belgrade where most of the embassies are situated. Belgrade’s gourmets soon discovered the exotic venue, with its authentic environment and excellent cuisine. Starting out with six employees, the business grew so fast that the Kovacevic sisters soon had to employ additional staff. At present 12 people work there on a regular basis, with three more on standby to cover shortages as the need arises.

The restaurant is known for its warm and welcoming service. In September 2004, the sisters received a EUR 5,000 loan from ProCredit Bank, which was used to remodel the restaurant’s kitchen, ensuring that clients will continue to enjoy the delicious Lebanese food for which it has become famous.

SASA AND IGOR STOJANOVIC – GROCERY RETAILERS



Business success born out of necessity

Sasa and Igor Stojanovic are two brothers living in Nis. Each manages his own retail store selling processed food. They opened their first consumer goods store in 1990, when international sanctions were holding back the economy. In fact, the idea arose out of necessity, as the government had frozen all savings placed in domestic banks and the only way to access them was to start up some kind of entrepreneurial activity. “*It was very hard at the beginning,*” remembers Igor, “*but we knew all along that we would succeed.*” Today, after 14 successful years, each of the two brothers owns two stores, together employing 33 people.

The two brothers utilise the full range of banking products: their families’ salaries are paid straight into their bank accounts, they hold DINA cards and keep their personal deposits with the bank. As business clients they also use overdraft facilities and international payment services, and their employees are able to receive personal loans from ProCredit Bank. The two brothers “*couldn’t be more satisfied*” with the service provided by ProCredit Bank.

AZZARO – SHIRT MANUFACTURER



A growing company striving for perfection

Azzaro, a shirt manufacturing company, is one of the most dynamic enterprises in Serbia. The family business, run by Rade Simikic, produced its first shirt in 1987 in Bosnia-Herzegovina, and soon became a market leader throughout the former Republic of Yugoslavia. Over the years, Azzaro invested in its retail network and today operates 28 retail stores selling over 100,000 shirts a year.

The company's relationship with ProCredit Bank began in 2002, and in the meantime it has become one of ProCredit Bank's largest clients. It uses many of the bank's services, and has been granted a EUR 1 million credit line to finance its working capital requirements. The business loans provided by ProCredit Bank will help the enterprise to continue expanding. As well as boosting its retail sales in Serbia, the company expects to see strong growth in its export operations and aims to broaden its outreach in neighbouring countries. In 2004 Azzaro opened its own design studio where the company's fashion team strives to create "the perfect shirt".

SLOBODAN ZIVANOVIC – LIVESTOCK



Helping a farmer to explore new business opportunities

Slobodan Zivanovic lives in Dublje, a small village 30 km from Sabac. He owns 16.5 ha of farmland, which he uses for livestock breeding, and currently has a herd of 50 head of cattle as well as approximately 400 pigs.

Some time ago Mr. Zivanovic wanted to expand the scope of his activities, and applied to ProCredit Bank for a loan. He received an investment loan of EUR 20,200 to purchase machinery for land cultivation, which he now uses to provide services to other farmers, in addition to his livestock business. Mr. Zivanovic says he is very satisfied with the service he receives from the bank, and plans to continue doing business with ProCredit Bank in the future.

SNEZANA GORDANIC – PUBLIC SECTOR EMPLOYEE



Education loans – investing in our children's future

Snezana Gordanic works for the Ministry of Health. Opening a current account at the start of 2004, she was one of the first clients of the newly established Belgrade V Branch. For the 54-year-old mother of two children, education is one of the most valuable things in a person's life. Receiving only a small salary she did not know how she would be able to afford to send her children to university – until ProCredit Bank showed her how it could be done: in June 2004, she applied for a bank loan for the first time in her life. She used the EUR 1,100 consumer loan to pay the university entrance fee for her son Nemanja, who is now studying Arabic at Belgrade University's faculty of philology. Ms. Gordanic greatly appreciates the support she has received from ProCredit Bank, knowing that the loan has been a fruitful investment in her son's future.

Ms. Gordanic also uses other ProCredit Bank services. She holds a current account, receives her salary through the bank, is entitled to an overdraft, and pays for goods and services with a DINA card.

EP 2005 – ORGANISER OF THE EUROPEAN BASKETBALL CHAMPIONSHIPS



Champions choose ProCredit Bank

Predrag Bogosavljev, a well known Serbian basketball player, is the director general of EP 2005, the company founded specifically to organise the European Basketball Championships taking place in September 2005 in Serbia and Montenegro. ProCredit Bank is also sponsoring the matches, and is therefore proud to provide its full range of banking services to EP 2005.

The company uses domestic payment facilities and e-banking services, and has been granted a EUR 25,000 overdraft. Two earlier loans totalling EUR 80,000 have already been repaid. To support Serbia's bid to host the world basketball championships in 2010, the bank has issued a guarantee worth USD 125,000 in favour of the country's national basketball association, backed by EP 2005.

MD MARKET – GROCERY STORE



Growing and diversifying with support from ProCredit Bank

Dragan Krstic opened his mini supermarket in a Belgrade suburb in 2000. He started out selling food, beverages and other everyday items, supported by three sales staff. During 2002 he expanded his business, moved to larger premises and hired additional staff. It was then that he became a client of ProCredit Bank, receiving a EUR 11,000 loan to refurbish and equip the store.

The business continued to develop well, and in 2003 Mr. Krstic decided to build another extension to his shop, so that he could broaden his product range and open a bakery right next to the supermarket. ProCredit Bank financed this project with a EUR 20,000 loan, most of which was spent on machinery and fittings for the bakery. In order to improve his delivery service, he purchased several used vehicles with another loan from ProCredit Bank. Mr. Krstic's business is thriving: he now employs five people and has many more ideas for enlarging the scope of his operations even further.

ZAR – BISTRO



Snack bar prides itself on quick service – so does ProCredit Bank


Lazar Radovanovic was born in Smederevska Palanka. Although he loves his home town, he felt that the high unemployment rate and the level of poverty there left him no scope for his personal and professional development. Eventually, he decided to move to Belgrade, in search of happiness and success. Settling in Belgrade a few years ago, he opened a small bistro called Zar. It was his first experience of operating a business of his own. Together with his mother and five employees, he prepares and serves tasty quick meals: hot or cold sandwiches, hamburgers, steaks, salads and drinks.

Chicken or beef, sirloin steak or spare ribs – Mr. Radovanovic believes in offering his clients a wide choice. After doing well in the suburbs, he moved his restaurant to a location nearer the city centre in March 2004. However, the premises needed refurbishing, and the equipment had to be modernised. Unable to finance these investments with his savings, he asked ProCredit Bank for a loan. Only days after his application, a loan of EUR 3,500 was disbursed.



Financial Statements

For the year ended 31 December 2004. Prepared under International Financial Reporting Standards.



**KPMG d.o.o. Beograd**

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TO THE SHAREHOLDERS OF
PROCREDIT BANK A.D. BEOGRAD

NUR LAYOUT / SCREENSHOT

Independent Auditor's Report

We have audited the accompanying balance sheet of ProCredit Bank a.d. Beograd as at 31 December 2004 and the related statement of income, cash flows and changes in shareholders equity for the year then ended. The financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audit. The financial statements of the Bank as of and for the year ended 31 December 2003, were audited by another auditor who in his report dated 6 February 2004, expressed an unqualified opinion.

We conducted our audit in accordance with International Standards on Auditing (ISA). Those Standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements, referred to above, give a true and fair view of the financial position of ProCredit bank a.d. Beograd as at 31 December 2004, and the results of its operations, cash flows and changes in equity for the year then ended, in accordance with International Financial Reporting Standards.

Belgrade, 4 February 2005



KPMG d.o.o. Beograd

Nina Bulatović
Managing Partner

INCOME STATEMENT

	Note	2004	2003
<i>In thousands of CSD</i>			
Interest and similar income	2(c), 3	1,218,012	756,588
Interest and similar expenses	2(c), 3	(336,993)	(160,750)
Net interest income		881,019	595,838
Fees and commission income	2(d), 4	249,793	196,261
Fees and commission expenses	2(d), 4	(24,579)	(25,580)
Net fee and commission income		225,214	170,681
Foreign exchange gains/(losses), net	2(b)	99,240	82,615
Other operating income		41,386	9,083
Operating income		1,246,859	858,217
Impairment losses, net of recoveries	2(f), 6	(73,507)	(56,104)
Other operating expenses	5	(1,058,621)	(717,251)
Result from operating activities before tax		114,731	84,862
Income tax	2(i),7	10,777	9,385
Result for the year		125,508	94,247

The notes on pages 50 to 61 form an integral part of these financial statements. Independent Auditor's Report – page 1.

ProCredit Bank a.d. Beograd
Financial Statements

BALANCE SHEET AS AT 31 DECEMBER 2004

In thousands of CSD	Note	2004	2003
ASSETS			
Cash and balances with the Central Bank	8	3,193,283	1,855,584
Loans and advances to banks	2(e), 9	375,350	32,115
Loans and advances to customers	2(e), 10	9,427,418	4,890,601
Financial assets held for trading	2(g), 11	2,489	-
Tangible and intangible assets	2(h), 12	305,517	176,269
Other assets	13	159,129	117,013
Deferred tax	7	43,155	32,378
Total assets		13,506,341	7,103,960
LIABILITIES			
Deposits and loans from banks	14	4,696,746	2,516,004
Deposits from customers	15	7,130,877	3,747,350
Other liabilities	16	343,528	104,234
Total liabilities		12,171,151	6,367,588
SHAREHOLDERS' EQUITY			
Share capital	17	1,247,995	774,685
Retained earnings/(loss)	17	87,195	(38,313)
Total shareholders' equity		1,335,190	736,372
Total liabilities and shareholders' equity		13,506,341	7,103,960

NUR LAYOUT / SCREENSHOT

Belgrade, 4 February 2005

For and on behalf of the management



Mrs Dore Weidig
General Manager

The notes on pages 6 to 22 form an integral part of these financial statements.
Independent Auditor's Report – page 1.

STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY

<i>In thousands of CSD</i>	Share Capital	Share Premium	Retained earnings	Total
Balance as at 1 January 2003	720,000	54,685	(132,560)	642,125
Net profit for the year	–	–	94,247	94,247
Balance as at 31 December 2003	720,000	54,685	(38,313)	736,372
Balance as at 1 January 2004	720,000	54,685	(38,313)	736,372
Issuance of new shares	360,000	113,310	–	473,310
Net profit for the year	–	–	125,508	125,508
Balance as at 31 December 2004	1,080,000	167,995	87,195	1,335,190

The notes on pages 50 to 61 form an integral part of these financial statements. Independent Auditor's Report – page 1.

CASH FLOW STATEMENT

For the year ended 31 December 2004

	2004	2003
<i>In thousands of CSD</i>		
Operating activities		
Result for the year	125,508	94,247
Adjustments for non cash items:		
Depreciation	45,488	18,729
Net foreign exchange differences	(99,240)	–
Net increase in impairment losses	73,507	56,104
Deferred income tax	(10,777)	(9,385)
Loss on disposal of tangible assets	143	118
	134,629	159,813
Changes in operating assets and liabilities		
Loans and advances to customers	(5,060,039)	(2,707,450)
Other assets	(224,089)	(37,363)
Deposits from customers	3,379,066	1,551,519
Other liabilities	549,245	37,299
Cash used in operating activities	(1,221,188)	(996,182)
Investing activities		
Fixed assets increase	(129,248)	(112,751)
Cash used in investing activities	(129,248)	(112,751)
Financing activities		
Net increase in long term loans and subordinated liabilities	2,180,742	1,202,966
Net increase in share capital	473,310	–
Cash from financing activities	2,654,052	1,202,966
Net increase in cash and balances with the Central Bank	1,303,616	94,033
Cash and balances with the Central Bank as at 1 January	1,889,667	1,795,634
Cash and balances with the Central Bank as at 31 December	3,193,283	1,889,667

The notes on pages 50 to 61 form an integral part of these financial statements. Independent Auditor's Report – page 1.

NOTES TO THE FINANCIAL STATEMENTS

1. Activity

ProCredit Bank a.d. Beograd (hereinafter: "the Bank") was established in 2001 as a bank limited by shares. The National Bank of Yugoslavia (the Central Bank) issued the Bank with a banking license on 5 April 2001. In 2003, the Bank changed its name from Micro Finance Bank a.d. Beograd to ProCredit Bank a.d., Beograd.

The Bank is licensed to perform payments, deposit and credit activities domestically and abroad.

At the end of December 2004, the Bank has head office located in Belgrade and twenty-four branches of which seven in Belgrade, two in Novi Sad, two in Nis, two in Novi Pazar and one in Subotica, Becej, Sabac, Cacak, Pancevo, Kikinda, Kraljevo, Krusevac, Uzice, Vranje, Kragujevac, and three credit outlets – in Pirot, Sombor and Prijepolje.

As at 31 December 2004, the Bank has 744 employees (2003: 536).

2. Summary of significant accounting policies

a. Basis of preparation of financial statements

The financial statements are presented in Dinars (CSD), rounded to the nearest thousand.

The accompanying financial statements are based upon the statutory accounting records, which are maintained under the historical cost convention and are prepared under local Serbian GAAP that is broadly in accordance with the International Financial Reporting Standards (IFRS).

The statutory accounting records and associated financial statements have been restated to present these financial statements in accordance with International Financial Reporting Standards.

Comparative information for 2003 was based on the figures given in the financial statements audited by Deloitte & Touche.

Where necessary, the corresponding figures have been reclassified to conform to changes in the presentation of the current year.

b. Foreign currency

Transactions in foreign currencies are translated into CSD at the foreign exchange rate ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies which are stated at cost, are translated at the rate ruling at the balance sheet date. Foreign exchange differences arising on translation are recognized in the income statement. Non-monetary assets denominated in foreign currency are translated at the foreign exchange rate ruling at the date of transaction.

Official exchange rates for major currencies used in the translation of the balance sheet items denominated in foreign currencies were as follows:

<i>In CSD</i>	2004	2003
USD	57.9355	54.6372
CHF	51.0913	43.7847
EUR	78.8850	68.3129

c. Interest and similar income/expense

Interest and similar income and expense are recognized in the income statement on an accrual basis.

d. Fees and commission income/expense

Fees and commission income/expenses arising upon financial services provided by/to the Bank include transfer payments in foreign currency, domestic payments transactions, loan administration, guarantee, letter of credit business and other banking services.

Fees and commissions are deferred and recognized as an adjustment to the effective interest yield.

In 2003 loan origination fees are charged to income when loans are disbursed.

This change in the accounting policy has not been accounted for retrospectively and the comparative statements 2003 have not been restated as it was not material.

e. Loans and advances to customers/banks

All loans and advances are initially recognized at cost, being the fair value of the consideration received net of issue costs associated with the borrowings.

After initial recognition, these are subsequently measured at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into

account any issue costs and any discount or premium on settlement.

Loans that are disbursed in CSD and index-linked to the CSD-EUR exchange rate are revalued in accordance with the individual loan agreements. The effects of such revaluation are included under net foreign exchange gains/losses.

f. Impairment

The Bank recognizes an allowance for impairment for the amounts of outstanding receivables which are more than 30 days overdue.

Financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any indication exists, the recoverable amount of assets is estimated.

Loans and advances are presented net of specific allowances. Specific allowances relate to loans that have been individually reviewed and identified as bad or doubtful due to their uncollectability, illiquidity of debtors or other reasons.

Specific allowance for impairment is made against the carrying amount of loans and advances that are identified as being impaired in order to reduce their value to a recoverable amount. In determining the level of specific allowance for impairment required, management consider numerous factors, including domestic economic conditions and the composition of the loans portfolio.

A general loan loss impairment is accounted for the group of retail clients, and individuals, where it is not possible to arrange individual valuations. General loan loss impairment is accounted at 1.5% of the portfolio based on historical information.

g. Financial assets

The Bank classified its financial assets into the following categories: available-for-sale and originated loans and receivables.

Available-for-sale financial assets are not held for trading purposes, originated by the Bank or held-to-maturity. Financial assets available-for-sale are measured at fair value. These include bonds issued by the Republic of Serbia.

Originated loans and receivables are loans and receivables created by the Bank providing money to a debtor other than those created with the intention of short-term profit taking. Originated loans and receivables comprise loans and advances to banks and customers.

Originated loans and receivables are measured at cost less impairment losses. At the balance sheet date originated loans and receivables are reviewed for any indication of impairment. If there is any indication of impairment, the amount of impairment loss arising is determined as the difference between the carrying amount and the recoverable amount of any such instrument.

h. Tangible and intangible assets

Tangible and intangible assets are stated in the balance sheet at cost decreased for accumulated depreciation. Depreciation is provided on a straight-line basis at the following prescribed rates designed to write-off costs over their estimated useful lives.

Description	%
Buildings	1.3
Furniture and other equipment	11 – 12.5
Computers	20
Motor vehicles	15.5
Other equipment	7 – 16.5
Intangible assets	20

Intangible assets include computer software licenses. Maintenance and repairs are charged to the profit and loss account when incurred.

i. Income tax

Tax on profit represents an amount calculated and payable under the Serbian Corporate Income Tax Law. The income tax rate is 10% and is payable on taxable profit reported. For 2004 only, the income tax rate is 12.33%. The taxable profit reported includes the profit shown in the statutory income statement, as adjusted for permanent differences, as defined by the Serbian Corporate Income Tax Law. Such adjustments comprise mainly of adding back certain disallowed expenses and deducting certain capital expenditure and investments incurred during the year.

Tax effects of all significant temporary differences between the tax basis of assets and liabilities and their reported amounts in the accompanying financial statements, are recognized as deferred taxed assets or deferred tax liabilities.

Serbian tax law does not allow tax losses of the current period to be used to recover tax paid in prior periods within specific carry back period. However current year losses may be used to decrease taxable profits for future period, but not longer than for ten years.

According to a decree of the Serbian tax authorities, the Bank is corporate income tax exempted during the first five years of operations. The tax holiday expires in the year 2005.

3. Net interest income

Net interest income includes:

<i>In thousands of CSD</i>	2004	2003
Interest and similar income		
Interest and similar income arises from:		
Cash and balances with the Central Bank	38,292	22,589
Loans and advances to banks	7,857	5,601
Loans and advances to customers	1,171,863	728,398
	1,218,012	756,588
Interest and similar expenses		
Interest and similar expenses arises from:		
Deposits from banks	(13,949)	(16,642)
Deposits from customers	(165,452)	(69,815)
Deposits from other banks and financial institutions	(157,592)	(74,293)
	(336,993)	(160,750)
Net interest income	881,019	595,838

4. Net fee and commission income

Net fee and commission income includes:

<i>In thousands of CSD</i>	2004	2003
Fees and commission income		
Fees and commission income arises from:		
Payments transfer business	97,679	73,619
Loan administration and guarantee business	71,950	110,904
Other banking services	80,163	11,738
	249,792	196,261
Fees and commission expenses		
Fees and commission expenses arises from:		
Payments transfer business	(24,381)	(9,185)
Loan administration and guarantee business	–	(16,371)
Other banking services	(198)	(24)
Net fee and commission income	225,214	170,681

j. Fair values

The directors are of the opinion that as a result of Bank's nature of operations and general policies there is no material difference between the book value and fair value of the Bank's financial assets and liabilities.

k. Employment benefits

The Bank does not have defined benefits plans or share-based remuneration options as of 31 December 2004.

5. Other operating expenses

Other operating expenses include:

<i>In thousands of CSD</i>	2004	2003
Wages and salaries	525,107	254,649
Building and office space expenses	141,111	81,233
Advertising, public relation and representation expenses	70,505	45,157
Office supplies and other office utilities	62,877	40,842
Depreciation and amortization	45,488	18,729
Legal and advisory expenses	39,905	21,212
Communication expenses	36,689	23,626
Sales taxes and other taxes	23,199	173,290
Security	22,583	12,245
Other expenses	91,157	46,268
Total general and administrative expenses	1,058,621	717,251

6. Impairment losses

Movements in the balance of allowance for impairment:

<i>In thousands of CSD</i>	2004	2003
Opening balance		
Loans and advances to customers	131,954	77,099
Additions net of recoveries	73,507	56,104
Collected previously written off receivables net of additions	(8,985)	(2,542)
Foreign exchange differences	1,170	1,293
Balance as at 31 December	197,646	131,954

7. Income tax

7.1 Income tax includes:

<i>In thousands of CSD</i>	2004	2003
Current income tax		
Deferred tax asset	10,777	9,385
Balance as at 31 December	10,777	9,385

7.2 Deferred tax assets are attributable to the following items:

<i>In thousands of CSD</i>	2004	2003
Tax loss carry forwards (expiring in the period from 1 – 5 years)	15,495	21,693
Tax credit carry forwards expiring in the period from 1 – 5 years	2,296	2,301
Tax credit carry forwards expiring in the period over 5 years	6,774	8,384
Fixed assets	18,590	–
Balance as at 31 December	43,155	32,378

8. Cash and balances with Central bank

8.1 Cash and balances with the Central bank include:

<i>In thousands of CSD</i>	2004	2003
Cash on hand	503,979	169,526
Balances with the National bank of Serbia	2,689,304	1,686,058
Balance as at 31 December	3,193,283	1,855,584

8.1 Balances with the National Bank of Serbia (NBS) include compulsory obligatory reserves in foreign currency amounting to CSD 179,475 thousand, foreign currency reserve for public savings amounting to CSD 2,346,721 thousand and other balances amounting to CSD 163,108 thousand.

The obligatory reserve is calculated monthly by applying the rate of 21% (the rate has been changed from 18% in August 2004) on the average daily amount of particular categories of the Bank's funding (including average balance of deposits and certain other liabilities) in the preceding month. The obligatory reserve for citizens' savings in foreign currency relates to the liability of the Bank to deposit 47% (the rate has been changed from 50% in June 2004) of citizens' savings in foreign currency on an account with the NBS.

9. Loans and advances to banks

Loans and advances to banks include:

<i>In thousands of CSD</i>	2004	2003
Nostro covered letters of credit and guarantees with foreign banks	48,129	10,995
Receivables – items in transit	726	–
Money market placements	326,495	21,120
Net loans and advances to banks as at 31 December	375,350	32,115

Money market placements in the amount of CSD 326,495 include overnight deposits.

10. Loans and advances to customers

Loans and advances to customers include:

<i>In thousands of CSD</i>	2004	2003
Corporate customers		
short term	784,904	254,015
long term	2,841,156	1,324,411
Retail customers – small and medium size enterprises		
short term	1,013,401	741,050
long term	4,008,087	2,177,718
Retail customers – private individuals		
short term	6,658	6,055
long term	955,036	512,648
Other customers	15,822	6,658
Less: allowance for impairment	(197,646)	(131,954)
Net loans and advances to customers as at		
31 December	9,427,418	4,890,601

11. Financial assets held for trading

Financial assets available for sale include bonds issued by the Republic of Serbia in the amount of CSD 2,489 thousand.

12. Tangible and intangible assets

12.1 Tangible and intangible assets include:

<i>In thousands of CSD</i>	2004	2003
Advance payments for tangible assets	13,812	37,263
Equipment	219,418	95,696
Tangible assets	233,230	132,959
Advance payments for intangible assets	578	7,144
Purchased licenses	18,807	15,192
Other	52,902	20,974
Intangible assets	72,287	43,310
Balance as at 31 December	305,517	176,269

12.2 The movements in tangibles and intangible assets for the year were as follows:

<i>In thousands of CSD</i>	Equipment	Other fixed assets	Advance payments for tangible assets	Intangible assets	Total
Cost or valuation					
Balance as at 1 January 2004	109,593	7,287	37,263	50,859	205,002
Additions	–	–	133,441	42,249	175,690
Transfers	142,860	14,032	(156,892)	–	–
Disposals	(1,159)	–	–	–	(1,159)
Balance as at 31 December 2004	251,294	21,319	13,812	93,108	379,533
Accumulated Depreciation					
Balance as at 1 January 2004	20,331	853	–	7,549	28,733
Depreciation	30,174	1,872	–	13,272	45,318
Disposals	(35)	–	–	–	(35)
Balance as at 31 December 2004	50,470	2,725	13,812	20,821	74,016
Net book value as at 31 December 2004	200,824	18,594	13,812	72,287	305,517
Net book value as at 31 December 2003	89,262	6,434	–	43,310	176,269

13. Other assets

<i>In thousands of CSD</i>	2004	2003
Deferred interest income	91,333	56,390
Advances paid	2,773	4,775
Other assets and receivables	20,795	6,348
Other prepayments and deferred expenditure	44,30	51,427
Provisions	(77)	(1,927)
Balance as at 31 December	159,129	117,013

14. Deposits and loans from banks

14.1 Deposits from banks include:

<i>In thousands of CSD</i>	2004	2003
Payable on demand	9,443	–
Term deposits	1,623,066	455,295
Long term loans	3,064,237	2,060,709
Balance as at 31 December	4,696,746	2,516,004

14.2 Long term loans include:

Loans are granted under following terms:

	Initial loan	Carrying		Amount in	Amount in
<i>Initial loan in EUR</i>	in EUR	value in	Maturity	CSD 000	CSD 000
		EUR 2004		2004	2003
European bank for reconstruction and development (EBRD)	12,299,012	12,229,012	2005 – 2008	964,686	630,461
Kreditanstalt fur Wiederaufbau (KfW), (Frankfurt am Main)	12,533,876	9,113,550	2002 – 2008	718,923	506,904
Commerzbank AG, Frankfurt am Main	2,500,000	2,500,000	2007	197,213	170,782
International Finance Corporation, Washington	11,016,397	10,001,787	2005 – 2008	788,991	752,562
Instituto de credito oficial	5,000,000	5,000,000	2010 – 2014	394,424	–
Balance as at 31 December				3,064,237	2,060,709

15. Deposits from customers

15.1 Deposits from customers include:

<i>In thousands of CSD</i>	2004	2003
Public sector	27,577	12,112
Corporate customers and SME	1,163,704	405,739
Retail customers – private individuals	5,627,694	3,087,050
Foreign entities	259,585	191,778
Unsettled payments	43,841	35,296
Other	8,476	15,375
Balance as at 31 December	7,130,877	3,747,350

15.2 Maturity structure of deposits from customers is as follows:

<i>In thousands of CSD</i>	2004	2003
Deposits payable on demand	2,844,090	2,150,625
Deposits with agreed repayment period up to 3 months	918,760	460,507
Deposits with agreed repayment period from 3 months to 1 year	2,969,862	1,069,715
Deposits with agreed repayment period from 1 to 2 years	304,430	66,503
Deposits with agreed repayment period over 2 years	93,735	–
Balance as at 31 December	7,130,877	3,747,350

16. Other liabilities

Other liabilities include the following:

<i>In thousands of CSD</i>	2004	2003
Taxes, contributions and other charges	23,431	13,716
Liabilities from currency swap agreement	3,527	–
Liabilities to suppliers	21,689	13,446
Accrued interest and fees	180,613	38,625
Received coverage based on unsettled international payments	104,008	34,938
Provision for liabilities and charges	3,121	1,320
Other	7,139	2,189
Balance as at 31 December	343,528	104,234

The Bank has entered into currency swap agreement with Commerzbank AG for swapping USD 2,700,000 and CHF 500,000 with EUR, which is to be repaid at an agreed exchange rate resulting in a liability of EUR 2,351,518. The difference between the initial exchange rate and agreed exchange rate at the day of repurchase has resulted in liability of CSD 3,527 thousand as at 31 December 2004. The Bank has not valued swaps at estimated forward rates since these instruments are for a period not longer than one month and it would have no material effect on financial statements.

Presentation of swap transaction in its net amount resulted in aggregate open currency position in the amount of CSD 260,173 thousand (Note 21 - Currency risk). If presented in gross amount it would reduce aggregate open currency position to CSD 103,974 thousand.

17. Equity

Equity comprises of the following:

<i>In thousands of CSD</i>	2004	2003
Share capital	1,080,000	720,000
Share premium	167,995	54,685
Retained earnings	87,195	(38,313)
Balance as at 31 December	1,335,190	736,372

Based on the Shareholders Decision, the Bank has carried out distribution of the third issue of ordinary shares for the purpose of capital increase in the total amount of EUR 6,000,000. The equity increase is registered with the Commercial Court in Belgrade under register number XVI-FI-14261/04 as at 18 January 2005.

The ownership structure of the Bank as at 31 December 2004 is as follows:

	Number of shares	% of shareholders
European Bank for Reconstruction and Development	600,000	16.67
Commerzbank AG Frankfurt am Main	600,000	16.67
Kreditanstalt für Wiederaufbau (KfW), Frankfurt am Main	600,000	16.67
Internationale Micro Investitionen AG (IMI)	1,000,000	27.78
Nederlandse Financierings Maatschappij voor Ontwikkelingslanden N.V. (FMO), The Hague	400,000	11.11
International Finance Corporation (IFC), Washington	400,000	11.11
Total	3,600,000	100

Nominal value of shares is CSD 300 per share.

18. Capital adequacy and regulatory requirements

The National Bank of Serbia requires the Bank to maintain a minimal capital adequacy ratio of 8%. This requirement was changed in August 2004 to 10% and the new regulation requires the banks to comply with it until 31 March 2005. The Bank's capital adequacy ratio was 14% as at 31 December 2004.

19. Contingent liabilities and commitments

19.1 The Bank provides guarantees and letters of credit to guarantee the performance of customers to third parties. These agreements have fixed limits and generally extend for a period up to one year. The contractual amounts of contingent liabilities are set out in the following table by category. The amounts reflected in the table for guarantees, acceptances and endorsements and letters of credit represent the maximum accounting loss that would be recognized at the balance sheet date if counterparties failed completely to perform as contracted.

19.2 Contingent liabilities comprise of the following:

<i>In thousands of CSD</i>	2004	2003
Payment guarantees	26,708	23,206
Performance guarantees	224,052	124,101
Acceptances and endorsements	5,616	3,616
Letters of credit (documentary business)	36,205	5,050
Other contingent liabilities	84,919	27,450
Balance as at 31 December	377,500	183,423

20. Related party transactions

20.1 In the normal course of business, the Bank enters into transactions with its shareholders and other micro finance institutions in Central and Eastern Europe.

20.2 Outstanding balances with related parties at the year end are as follows:

<i>In thousands of CSD</i>	31 Dec 2004
Balance Sheet	
Demand deposits	
Commerzbank AG	144,271
Procredit Bank a.d., Bulgaria	3,091
Loans and other	
Commerzbank AG (covered guarantees)	34,170
Commerzbank AG (money market placement)	110,439
Deposits and loans from banks	
Procredit Bank a.d., Bulgaria	157,770
Procredit Bank S.H.A., Albania	157,770

21. Risk management disclosures

a. Credit risk

Credit risk is the risk of financial loss occurring as a result of counterpart default regarding its contractual obligations to the Bank.

To manage the level of credit risk, the Bank:

- reviews the creditworthiness of customers applying for loans, guarantees and other credit products,
- establishes credit limits on the basis of the risk assessment,
- deals with counterparties of good credit standing and takes appropriate collateral.

Customers are monitored continually and risk limits are adjusted if necessary. The risk limits also take into account various collateral types.

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the balance sheet.

The Bank had managed its off balance sheet credit risk by demanding foreign exchange deposits or mortgages.

b. Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its liquidity position. It includes both the risk of being unable to fund assets at appropriate maturities and rates and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

The Bank has access to a diverse funding base. Funds are raised using:

- deposits with wide ranges of maturity
- loans

- subordinated liabilities and
- share capital.

The Bank continually assesses liquidity risk by identifying and monitoring changes in funding required meeting business goals and targets set in terms of the overall Bank's strategy.

The following table provides an analysis of the financial assets and liabilities of the Bank into relevant maturity groupings:

<i>In thousands of CSD</i>	to 3 months	3 months to 1 year	1 – 5 years	Over 5 years	Total
Assets					
Cash and balances with Central bank	3,193,28	–	–	–	3,193,283
Loans and advances to banks	375,350	–	–	–	375,350
Loans and advances to customers	1,910,086	4,625,976	2,721,331	170,025	9,427,418
Financial assets held for trading	2,489	–	–	–	2,489
Deferred tax	–	–	–	43,155	43,155
Tangible and intangible assets	–	–	–	305,517	305,517
Other assets	159,129	–	–	–	159,129
Total assets	5,640,337	4,625,976	2,721,331	518,697	13,506,341
Liabilities					
Deposits and loans from banks	1,316,969	315,540	2,669,813	394,424	4,696,746
Deposits from customers	3,762,850	2,969,862	398,165	–	7,130,877
Other liabilities	48,647	284,621	10,260	–	343,528
Equity	–	–	–	1,335,190	1,335,190
Total liabilities	5,128,466	3,570,023	3,078,238	1,729,614	13,506,341
Net liquidity gap	511,871	1,055,953	(356,907)	(1,210,917)	–

c. Interest rate risk

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature at different times or in differing amounts. Risk management activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Bank's business strategies.

In managing maturity structure, senior management considers among others:

- macro and micro economic forecasts,
- forecasts in liquidity conditions and
- the anticipated trends in interest rates.

The table below summarizes the Bank's exposure to interest rate movements by reprising periods:

<i>In thousands of CSD</i>	to 3 months	3 months to 1 year	1 – 5 years	Non interest bearing	Total
Assets					
Cash and balances with Central bank	2,689,304	–	–	503,979	3,193,283
Loans and advances to banks	375,350	–	–	–	375,350
Loans and advances to customers	1,910,086	4,625,976	2,891,356	–	9,427,418
Financial assets held for trading	2,489	–	–	–	2,489
Deferred tax	–	–	–	43,155	43,155
Tangible and intangible assets	–	–	–	305,517	305,517
Other assets	–	–	–	159,129	159,129
Total assets	4,977,229	4,625,976	2,891,356	1,011,780	13,506,341
Liabilities					
Deposits and loans from banks	9,443	1,623,066	3,064,237	–	4,696,746
Deposits from customers	1,800,743	2,969,862	398,165	1,962,107	7,130,877
Other liabilities	284,021	–	–	59,507	343,528
Equity	–	–	–	1,335,190	1,335,190
Total liabilities	2,094,207	4,592,928	3,462,402	3,356,804	13,506,341
Interest sensitivity gap	2,883,022	33,048	(571,046)	(2,345,024)	–

d. Currency risk

The Bank is exposed to currency risk through transactions in foreign currencies.

Foreign currency risk arises in cases of mismatch in assets and liabilities denominated in foreign currencies.

The Bank ensures that its foreign currency position as far as practical is minimized.

The Bank maintains the foreign currency position by granting loans with foreign currency clauses.

	USD	EUR	Other	CSD	Total
<i>In thousands of CSD</i>					
Assets					
Cash and balances with Central bank	377,288	2,491,196	42,307	282,492	3,193,283
Loans and advances to banks	80,362	148,104	0	146,884	375,350
Loans and advances to customers*	11	9,337,764	2	89,641	9,427,418
Financial assets held for trading	–	2,489	–	–	2,489
Deferred tax	–	–	–	43,155	43,155
Tangible and intangible assets	–	–	–	305,517	305,517
Other assets	552	132,159	–	26,418	159,129
Total assets	458,213	12,111,71	42,309	894,107	13,506,341
Liabilities					
Deposits and loans from banks	92,696	4,599,066	–	4,984	4,696,746
Deposits from customers	480,612	5,762,960	46,052	841,253	7,130,877
Other liabilities	9,577	285,364	1,671	46,916	343,528
Equity	–	1,335,190	–	–	1,335,190
Total liabilities	582,885	11,982,580	47,724	893,153	13,506,341
Net currency gap**	(124,672)	129,132	(5,415)	(954)	–

* Loans and advances to customers in CSD mostly represent loans granted in CSD with attached foreign currency clause.

** Please refer to Note 16

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