# REPORT ON ACTIVITIES OF

# BANK HANDLOWY W WARSZAWIE SA

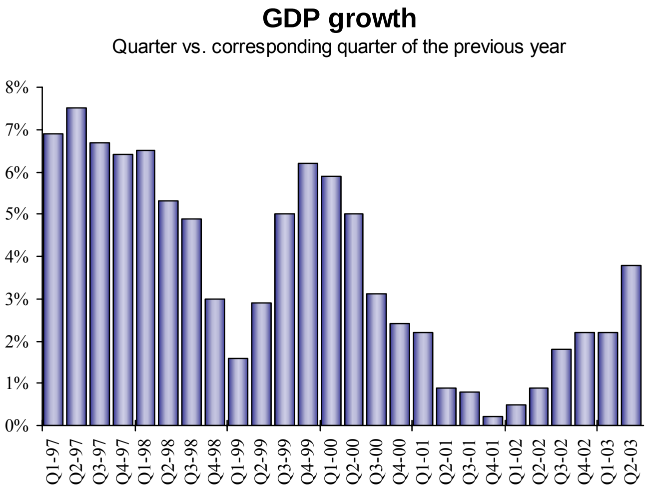
# FOR THE SIX MONTHS ENDED JUNE 30, 2003

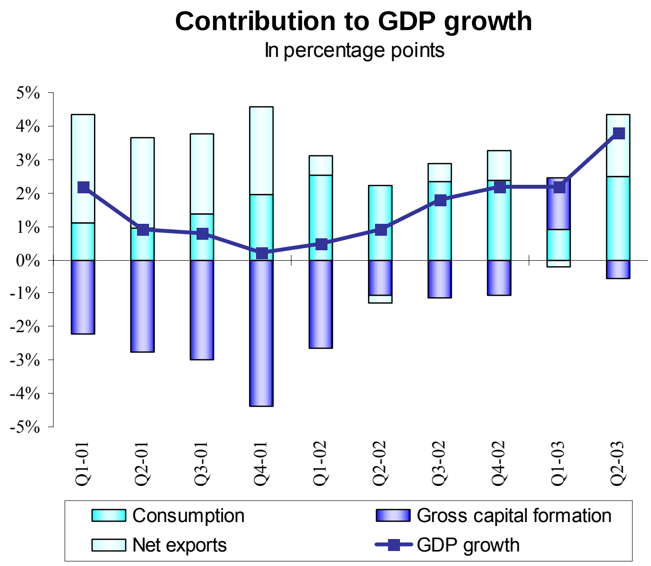
# CONTENTS

# I. The Polish economy in the first half of 2003

## 1. Main macroeconomic trends

In the first half of 2003 the Polish economy was overcoming the stagnation. 1Q was still a period of slow growth; according to information from the Central Statistical Office (GUS) GDP grew in real terms by o 2.2% y-o-y, i.e. by the same growth rate as in 4Q of 2002. In 2Q the economic growth accelerated to 3.8%. As a result, the GDP grew by 3.0% y-o-y in 1H 2003. Key factor behind of the GDP growth in 1H 2003 was domestic consumption (up 2.0% y-o-y), fuelled by personal consumption (up 2.6% y-o-y). On the other hand, gross fixed investment shrank by 2.6%. This was, however, neutralised by sagging inventories, which brought the overall gross capital formation growth rate to the level of 3.1% y-o-y. Total domestic demand increased by 2.1% y-o-y in 1H 2003, i.e. lower than the GDP, thus pointing at a relatively strong contribution from the external balance of goods and services (i.e. net exports) to the GDP growth creation.



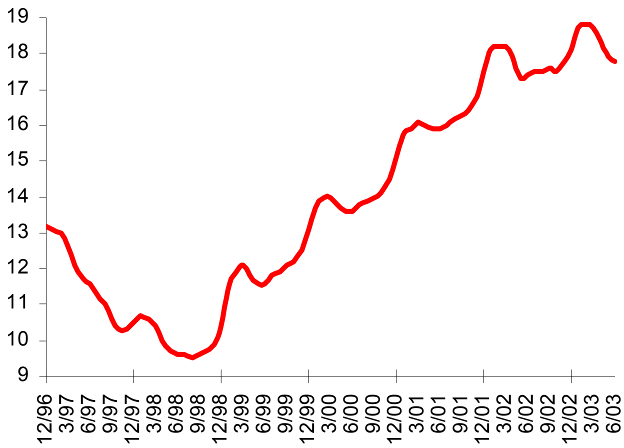




Industry, first and foremost processing industry, was the main stimulator of economic growth on the supply side. In the first six months the dynamics of sold industrial output was 6.7% y-o-y and was higher than in the corresponding period of the previous year. The output of processing industry grew even faster by 8.1% y-o-y. The highest growth was recorded by those industry branches that do some of their production abroad: furniture industry (output growth in the first six months of 2003 by 31.2% y-o-y), machines and electric devices (24.3%) as well as cars and automobile parts (18.8% y-o-y).

Despite gradual acceleration, the pace of economic activity did not allow of a substantial improvement of the labour market situation. The registered unemployment rate was still high – 17.8% in June 2003, and although it fell down in comparison to December 2002 (18.1%), it was still higher than one year ago (17.4% in June 2002). The registered jobless figure was 3,134,600 at the end of June and was higher by 43,700 than one year ago.

In spite of adverse external factors, primarily the continuing stagnation in the EU, the growth of foreign trade volume was very high in the first six months of 2003. That especially concerns exports, which in terms of payment grew by 29.4% y-o-y as expressed in USD, while imports grew by 21.2% y-o-y. These high growth rates resulted mainly from sharp euro appreciation vis-à-vis the dollar; in EUR terms exports increased by 5.1%, while imports shrank by 1.5%. The exports to those EU countries with a relatively superior market condition, e.g. France and the Netherlands, compensated slower dynamics of exports to Germany, which is Poland's major trade partner.

Registered unemployment rate, %




The export growth outpacing that of imports helped to reduce the negative trade balance, which in the first six months of 2003 was USD 4.7 billion in comparison to USD 4.9 billion for the same period of the previous year. Lower trade deficit in conjunction with much higher transfer surpluses and unregistered trade (most from cross-border trade) helped to reduce the current account deficit. The deficit was USD 2.7 billion and was by USD 1.3 billion lower than one year ago, showing a clear improvement of external imbalance. As measured by a percentage of GDP, the current account deficit narrowed from 3.6% in 1H 2002 to 2.7% in 1H 2003. Official foreign currency reserve reached the level of USD 32.1 billion, maintaining a very safe level in relation to foreign debt and imports, as last year.

In the first six months of 2003 the inflationary pressure abated significantly. The annual growth of consumer prices was 0.8% in June (1.6% a year ago). From the start of year the growth of CPI was 0.8% while in the first six months of 2002 it was 1.1%. Disinflation was primarily an effect of lower clothes and footwear and electricity prices, as well as a moderate growth of other goods and services, including food and fuels. The prices of sold industrial production grew slightly; the annual PPI growth was 2.1% in June 2003, in comparison to 1.2% in June 2002, mostly due to a faster price growth in the processing industry. A helpful factor in the limiting the PPI growth rate was poor domestic demand, especially in 1Q, and additionally the appreciation of the zloty to the dollar in 2Q.

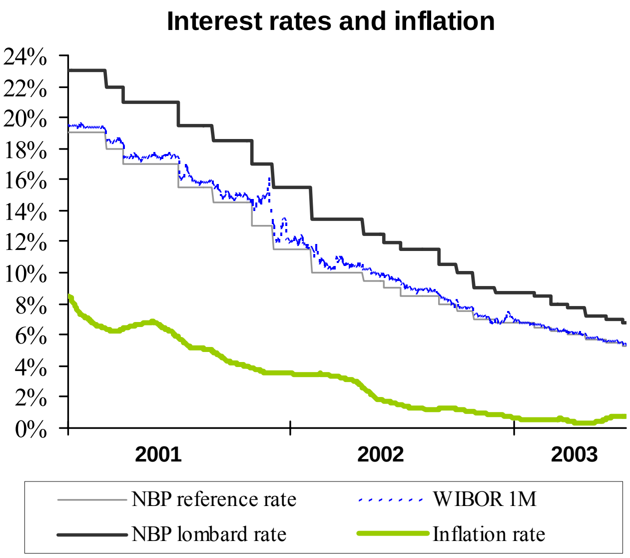
The dynamics of monetary aggregates in the first six months of 2003 reflected the absence of inflationary drivers. The money supply, as measured by M3 aggregate, increased by 1.5% from the beginning of year. As a result of further interest rate cuts, reduced interest rate on deposits, and low inflation, the high growth rate of cash on hand was sustained and stood at 12.3% in the first six months of 2003.

The budget deficit at the end of June was PLN 23.8 billion, i.e. 61.5% of the figure planned for 2003 (PLN 38.7 billion). The result is slightly better than last year – in June 2002 the deficit was 62.5% of the annual plan; this, however, is solely an effect of one-off transfer of profit from the NBP of PLN 4.7 billion made in June (in 2002 NBP transferred the profit in July). If income was adjusted for that payment, the deficit would be much higher, i.e. 73.6% of the plan.

## 2. The money and FX market

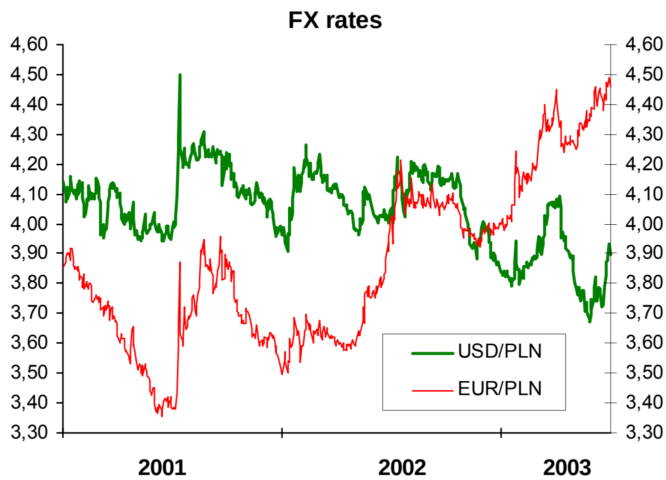
In the first six months of 2003 the National Bank of Poland ('NBP') continued the cycle of easing the monetary policy. In the conditions of a systematic drop of inflation rate and moderate economic recovery, the Monetary Policy Council ('MPC') cut its base rates six times, including the main reference rate (for open market operations) by 1.5 pp in total, to the level of 5.25%. The continuation of small steps policy by the MPC in cutting interest rates sustained the downward trend of money market rates in the first six months of 2003, which was a result of discounting subsequent expected downward adjustments of base rates by the market; consequently the yield curve remained inverted.

The level of interbank market interest rates was strongly influenced by the NBP's open market operations aimed at controlling liquidity of the banking sector. NBP used primarily the issue of money bills to absorb excessive operational liquidity of the sector. The maturity of money bills was shortened from 28 to 14 days from January 2003. That change was supposed to increase the effectiveness of monetary policy transmission mechanism and ensure a more targeted influence of the central bank on the liquidity of




financial sector; it was also an adjustment to the European Central Bank standards. Moreover, the NBP continued to sell the converted Treasury bonds (issued in 1999 to convert the State debt to the NBP into market securities); these were structural outright transactions, permanently absorbing liquidity of the banking sector. In effect market interest rates were reduced in the first six months of 2003 from 1.66 pp (WIBOR 1M) to 1.14 pp (WIBOR 12M). At the end of June 2003 WIBOR 1M was 5.32%.

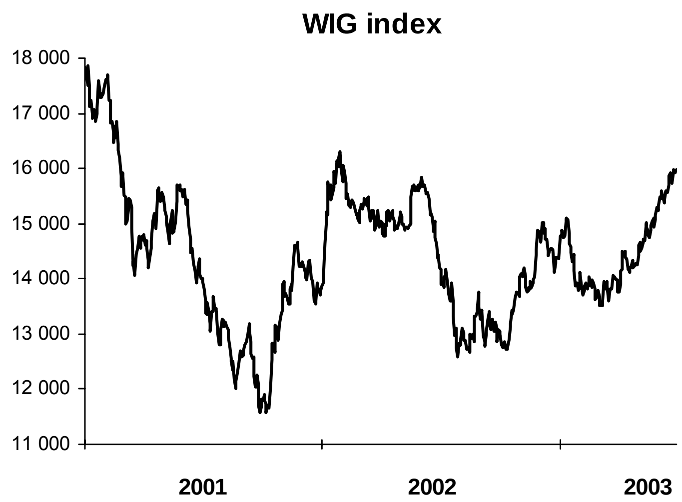
The effect of expectations on the reduction of basic interest rates was reflected in the downward yield trend in the Treasury bill market. The yield was much feebler than last year, although in January and in June the yield on T-bills grew due to geopolitical tensions related to the Iraq war, and higher premium for risk after interest rate fluctuations in Hungary (in January: an increase by 3 pp, in June: a reduction by the same value). The demand for T-bills, 2.5 times higher than the supply (in the first half year the offer of the Ministry of Finance included bills of PLN 26.4 billion) was sufficient for their price to grow and the yield to go down. In the first six months of 2003 the yield of T-bills 52-week decreased in the primary market by 0.86 pp to 4.98% at the end of June.




In the first half of 2003 the Polish zloty oscillated between two opposite trends: nominal and real depreciation in Q1 and appreciation in Q2. The reason for the drop of zloty were mostly external factors: an aggressive interest rate cut in Hungary in order to weaken the forint, and increased aversion to risk in view of the Iraq war. Those factors, and political destabilisation in the country after a collapse of the ruling coalition, brought about violent changes in the direction of foreign portfolio investment and increased speculation in the FX markets. Subsequently, lower political risk in the world after the end of the Iraq war and defusing political tensions in Poland reversed the downward trend of the zloty and led to its moderate appreciation in Q2, halted in June due to developments in the Hungarian market (destabilising the exchange rate of the forint after a sharp interest rate cut) as well as another spell of tension on the Polish political scene after the resignation of the Minister of Finance G. Kołodko and before the parliamentary voting on the vote of confidence for the government. The rate of zloty to the euro and the dollar was shaped by a strong upswing of the euro in foreign currency markets. As a result, the average USD exchange rate in the first half year was PLN 3.8687 and was 5.3% lower than in the first half year of 2002, while the average EUR exchange rate in the same period was PLN 4.2705 and was 16.5% higher than in the corresponding period of the previous year. At the end of June 2003 USD and EUR reached PLN 3.8966 and PLN 4.0202 respectively, comparing to PLN 3.8388 and PLN 4.0202 at the end of 2002.

## *3. The stock market*

The first half of 2003 brought about a definite improvement of the market in the Warsaw Stock Exchange (WSE). Although in Q1 most indices were bearish, the dynamic growth of Q2 allowed to more than offset




the losses suffered in the first months. The market started to discount economic recovery in Poland, which gradually became evident, e.g. through increasing industrial production sales and an improvement of corporate financial results. The main stock exchange index, WIG, grew from 14.367 to 15.988 points, i.e. by 11.3% in the first half year of 2003, with the main upward force coming from better performance of IT and telecom companies, demonstrated by a growth of sector sub-indexes, WIG-BUDOW and WIG-TELEKOM by 18.9% and 10.5% respectively. Construction companies and banks had a much poorer performance for the period, which was noticeable in a decrease of WIG-BUDOW and WIG-BANKI indexes by 3.0% and 2.6% respectively. The bear market of the sector was due to relatively poor sector results for 2002 published in Q1 2003, and concern of the market about further deterioration of the sector in the first six months of 2003.

Despite a climb of the main exchange index in the first six months of 2003, the turnover in the equity market decreased in comparison to the same period in 2002, and was also lower than in the second half of 2002. The total equity turnover for the period was PLN 25.3 billion against PLN 38.3 billion and PLN 29.2 billion in the first and second half year of 2002 respectively. The declining turnover made the number of active brokerage houses shrink from 24 in December 2002 to 22 in June 2003.

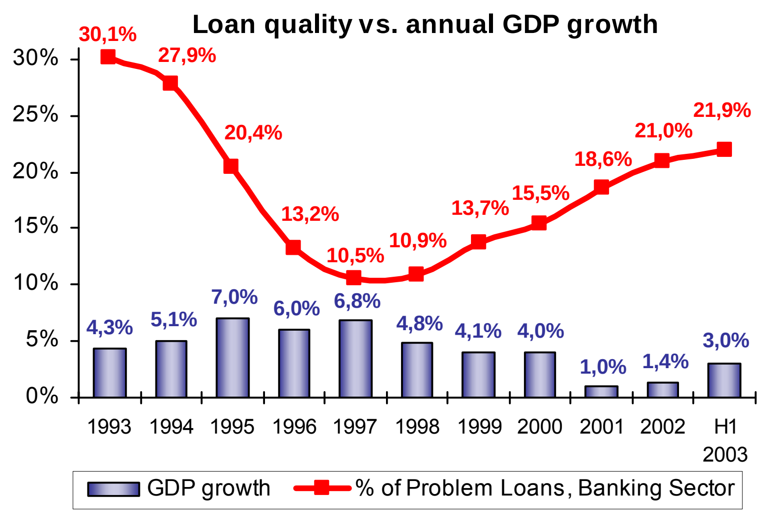
The total capitalisation in the equity market grew from PLN 110.6 billion to 112.9 billion, i.e. by 2.7% in the first half of 2003, although the number of companies quoted on the stock exchange in that period decreased from 216 to 205.

## 4. Banking sector

The net profit earned by the banking sector for the first half-year of 2003 was 2,074 PLN million and was by 11% smaller than in the corresponding period of previous year. One of the top ten largest banks reported a net loss for the first half of 2003 of more than PLN 200 million.

Smaller profitability of the banking sector was caused by poorer result on banking operations. The result decreased e.g. in the case of all ten largest banks. The main reasons of declining revenues of the banks were:

- lower interest rates, which affected interest income from interest-earning assets financed with equity,
- narrowing interest margins on customer assets and liabilities, in particular deposits in current accounts.

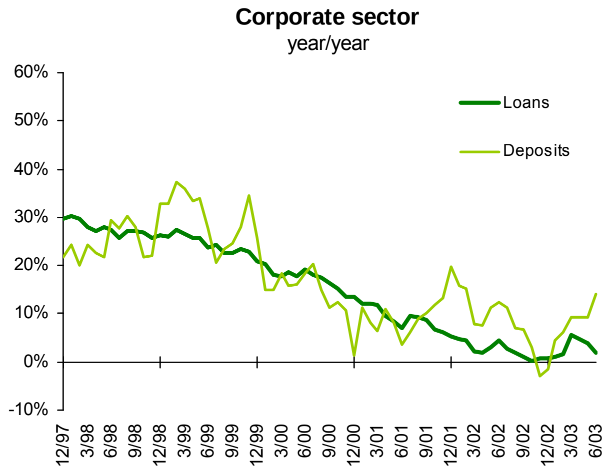


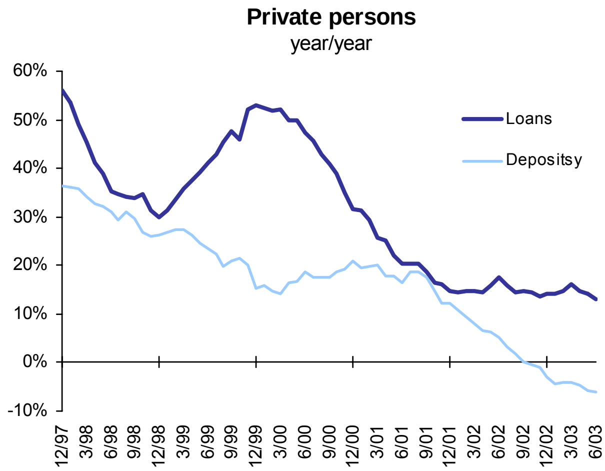

Continuing the trend of recent years, the loan portfolio of the sector deteriorated. The share of problem loans in the gross loan portfolio grew from 21.0% in

December 2002 to 21.9% in June 2003. Despite that, the total value of write-offs for specific provisions and revaluation of financial assets was lower than year ago, which was related e.g. to extraordinarily high cost of provisioning that some banks had to make in Q2 2002 for their exposure to Stocznia Szczecińska S.A.

In the first half year 2003 the dynamics of individual loans was stable at 15% y-o-y. The downward trend of deposits for private customers continued. It was mostly due to diminishing attractiveness of bank deposits because of interest rate cuts and the introduction of a tax on interest income from bank deposits at the end of 2001, and also the customers' efforts to maintain their existing level of spending among high unemployment and low wages growth rate. The first factor also sparked the growth of the share of demand deposits and a flow of part of the funds towards alternative saving or investment instruments (e.g. investment funds). The banks tried to compensate the run on deposits by issuing bonds. At the end of June 2003 the banks' debt for bonds was PLN 3,764 million, i.e. by PLN 1,986 (111.7%) more than the beginning of year.

Lending to corporate sector accelerated only slightly. Loans to this group of customers grew in the fisrt half-year 2003 by 3.6% in comparison to 2.5% in the previous year. Corporate deposits improved considerably growing by 0.9%, while they fell by 12.7% in the first half of 2002.



# II. Financial results of Bank Handlowy w Warszawie SA

## 1. Summarised financial data for the last years

| PLN '000 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 1st half of 2003 |
|---|---|---|---|---|---|---|---|
| Assets | 17,020.1 | 17,744.4 | 19,159.9 | 21,002.5 | 33,150.4 | 32,181.6 | 32,589.6 |
| Equity* | 2,040.8 | 2,557.8 | 2,758.4 | 3,034.8 | 5,742.1 | 5,726.4 | 5,729.3 |
| Loans** | 8,546.9 | 9,292.7 | 10,208.8 | 10,054.1 | 14,200.0 | 13,540.4 | 14,344.2 |
| Deposits** | 5,460.9 | 7,084.0 | 8,733.9 | 10,166.3 | 17,370.1 | 16,699.3 | 16,839.1 |
| Profit on banking activity | 1,353.3 | 1,191.8 | 1,330.9 | 1,555.3 | 2,074.5 | 2,099.4 | 903.9 |
| Net profit | 577.5 | 301.5 | 472.5 | 204.7 | 163.6 | 242.7 | 89.3 |
| Earnings per share or convertible bond (in PLN) | 6.21 | 3.24 | 5.08 | 1.57 | 1.25 | 1.86 | 1.43 *** |
| Dividend per share or convertible bond (in PLN) | 1.40 | 1.00 | 2.00 | 1.00 | 1.25 | 1.85 | --- |
| Dividend payout ratio | 22.51% | 30.84% | 39.37% | 63.83% | 99.81% | 99.60% | --- |
| Capital adequacy ratio | 12.7% | 13.7% | 14.5% | 15.6% | 21.2% | 18.5% | 14.4% |

** Excluding net profit for the current period.*

*** Non-financial and public sector.*

**** Last 4 quarters.*

## 2. The Bank's financial results in the 1st half of 2003

### 2.1 Income statement

Net profit of the Bank in the first half of 2003 was PLN 89.3 million i.e. by PLN 55.7 million or 38.4% lower than for the same period last year. The drop of the Bank's net financial result was a combined effect of the following factors:

- a drop in the profit on banking activity by PLN 124.3 million (12.1%),
- growth of general expenses by PLN 11.5 million (2.2%).

A decrease of net charges to specific provisions and revaluation of financial assets, which amounted to PLN 131.9 million, or by 21.2% lower than in the first half of 2002, had a positive effect on the financial result. The participation in profits/ (losses) of subordinated entities accounted for under the equity method was also higher than in the first six months of 2002 (PLN 11.4 against PLN 4.8 million).

## INCOME STATEMENT

| PLN '000 | Six months ended June 30 2003 | 2002 | Change PLN '000 | % |
|---|---|---|---|---|
| Interest income | 711,785 | 945,170 | (233,385) | (24.7%) |
| Interest expense | (343,330) | (626,555) | 283,225 | (45.2%) |
| Net interest income | 368,455 | 318,615 | 49,840 | 15.6% |
| Net fee and commission income | 247,257 | 250,945 | (3,688) | (1.5%) |
| Income on shares, other securities and other financial instruments with variable income securities | 523 | 7,933 | (7,410) | (93.4%) |
| Gains on financial operations | 93,353 | 54,483 | 38,870 | 71.3% |
| Foreign exchange profit | 194,269 | 396,148 | (201,879) | (51.0%) |
| **Profit on banking activity** | **903,857** | **1,028,124** | **(124,267)** | **(12.1%)** |
| Other operating income | 31,866 | 31,500 | 366 | 1.2% |
| Other operating expenses | (18,179) | (22,103) | 3,924 | (17.8%) |
| General expenses | (540,924) | (529,406) | (11,518) | 2.2% |
| Depreciation and amortisation | (76,409) | (82,393) | 5,984 | (7.3%) |
| Goodwill depreciation | (36,223) | (36,223) | - | - |
| Net charges to provisions | (131,897) | (167,460) | 35,563 | (21.2%) |
| **Operating profit** | **132,091** | **222,039** | **(89,948)** | **(40.5%)** |
| Extraordinary items | - | - | - | --- |
| **Profit before taxation** | **132,091** | **222,039** | **(89,948)** | **(40.5%)** |
| Corporate income tax | (54,126) | (81,823) | 27,697 | (33.8%) |
| Participation in net profit/(loss) of subordinated entities accounted for under the equity method | 11,362 | 4,829 | 6,533 | 135.3% |
| **Net profit** | **89,327** | **145,045** | **(55,718)** | **(38.4%)** |

### *2.1.1 Profit on banking activity*

In the first half-year of 2003 the Bank recorded a drop of profit on banking activity by PLN 124.3 million, i.e. 12.1%. Lower revenues of the Bank affected most significantly the foreign exchange profit, which in that period decreased by PLN 201.9 million, which is more than a half. It included, e.g. a PLN 32.9 million loss on CIRS transactions involving the exchange of principal.

The downward dynamics of the Bank's revenues was slowed down by an increase of net interest income by PLN 49.8 million (15.6%), which was a combined effect of interest income increase on:

- debt securities by PLN 11.5 million,
- subordinated loans by PLN 5.4 million (in the first half of 2002 there was no income from this item)

and an increase of net interest income made on customer and bank loans and deposits by PLN 32.9 million.

An improvement of the last component of the net interest income was partially connected with a change of currency structure of interest assets and liabilities, as a result of which the surplus of currency assets over currency liabilities decreased, and therefore the Bank's balance sheet currency position. This was mostly due to a change in the behaviour of borrowers, who possibly encouraged by a downward trend of interest rates in Poland, and at the same time worried by depreciation of the Polish zloty, were more frequently inclined to borrow in Polish zloty, although nominal interest rate of Polish zloty loans continued above the interest rates of currency loans. In other words, the pool of currency assets financed with Polish zloty loans with relatively higher interest rates decreased. As the Bank reports its net interest income exclusive of its result on currency swaps and cross currency interest rate swaps, which counterbalance the effect of balance sheet currency structure on the net interest income, the described change of the structure improved the net interest income.

Another stimulant of the net interest income during the period in question was a growth of credit exposure to SME, where the Bank generated higher interest margin than on large corporates, which was due to different loans risk profile for SME customers.

Another factor to slow down the slump of gains on financial operations by PLN 38.9 million (71.3%) to the amount of PLN 93.4 million, comprising:

- profit on sale and revaluation of debt securities of PLN 69.6 million
- result on financial instrument transactions of PLN 23.3 million, including the profit on FRA transactions, IRS, CIRS, IRO, Equity Option, Commodity Option and other derivatives.
- profit on the sale of minority investments of PLN 0.5 million

### *2.1.2 Expenses*

**EXPENSES**

| | Six months ended June 30 | | Change | |
|---|---|---|---|---|
| **PLN '000** | **2003** | **2002** | **PLN '000** | **%** |
| Salaries | 218,686 | 203,772 | 14,914 | 7.3% |
| Social security and other benefits | 45,350 | 46,871 | (1,521) | (3.2%) |
| **Total personnel expenses** | **264,036** | **250,643** | **13,393** | **5.3%** |
| Administrative expenses | 267,335 | 271,311 | (3,976) | (1.5%) |
| Taxes and fees | 4,006 | 3,450 | 556 | 16.1% |
| Contributions and payments to the Bank Guarantee Fund | 5,547 | 4,002 | 1,545 | 38.6% |
| **Total general expenses** | **540,924** | **529,406** | **11,518** | **2.2%** |
| Depreciation | 76,409 | 82,393 | (5,984) | (7.3%) |
| **Total expenses** | **617,333** | **611,799** | **5,534** | **0.9%** |

In the first half year of 2003 the Bank continued restructuring activities aimed at improvement of profitability through a reduction of operating expenses. The most important projects in that period was a reorganisation of the Bank's branch network and completion of the last stage of employment restructuring.

Following a profitability analysis of individual outlets of the Bank, a decision was made to discontinue the operation as of 28 February 2003 in 12 Retail Banking Sector branches and to transfer another 6 branches to the developing CitiFinancial network. Moreover, as of 1 March 2003 the Banking Customer Service Point in Kostrzyń on the Oder, belonging to the Corporate and Investment Sector, discontinued operations. As a result, by the end of June 2003 the network of the Bank's units for the service of retail customers comprised 11 CitiGold branches, 75 standard branches and 11 CitiFinancial branches (including 6 transferred from the Retail Banking), while the Corporate and Investment Sector network comprised 59 locations – including 27 branches, 31 sub-branches and 1 banking customer service point. Further restructuring exercises for the Bank's branch network are planned to take place in the 2nd half of 2003.

At the beginning of 2003 the Bank started the last stage of staff reduction, contingent on the full implementation of Flexcube system for the Corporate and Investment Sector, which was eventually completed in December 2002. In the first half of 2003 470 persons in total were subject to employment restructuring, including 343 persons in Operations and Technology. The employees who were made redundant were offered severance packages and vocational training, in pursuance of an agreement made on 19 December 2002 between the Bank and labour unions operating within the Bank. Severance pay for redundant employees of Operations and Technology was accounted for in the reserve for restructuring, while similar payments to other dismissed employees were posted directly as expenses, which resulted in increased expenses for salaries in comparison with the first half of 2002. Among other factors of salary growth was a pay rise in the Bank in April, by 4% on average, and recruiting by contract of employment persons who had worked for the Bank in an outsourcing scheme. That in particular concerned persons working in the CitiPhone call centre of the Retail Banking Sector (190 persons) and a number of direct sales agents in the SME Division (13 persons). In effect, despite the last stage of redundancies, the overall employment in the Bank fell only slightly, i.e. from 4,902 positions in December 2002 to 4,879 at the end of June 2003 (as measured by full-time equivalent).

An increase of personnel expenses was to some extent neutralised by a drop of administrative expenses by PLN 4.0 million (1.5%) and depreciation by PLN 6.0 million (7.3%). Those savings managed to be generated on optimising the use of fixed assets, in particular real estate, which was evident in a drop of administrative expenses for the maintenance of buildings and structures by PLN 7.6 million (11.4%). Also travelling and transport expenses decreased considerably, i.e. PLN 5.0 million (38.2%).

### *2.1.3 Provisioning charges*

**NET CHARGES TO PROVISIONS**

| | Six months ended June 30 | | Change | |
|---|---|---|---|---|
| **PLN '000** | **2003** | **2002** | **PLN '000** | **%** |
| Specific provisions | 121,149 | 137,439 | (16,290) | (11.9%) |
| - financial institutions | (23,562) | (1,901) | (21,661) | 1139.5% |
| - non-financial sector | 72,527 | 139,429 | (66,902) | (48.0%) |
| - subordinated loans | 79,450 | - | 79,450 | --- |
| - off-balance sheet contingent liabilities | (7,266) | (89) | (7,177) | 8064.0% |
| Provisions for general risk | - | - | - | --- |
| Valuation allowances for permanent diminution in value of financial assets | 10,748 | 30,021 | (19,273) | (64.2%) |
| **Total net charges to provisions** | **131,897** | **167,460** | **(35,563)** | **(21.2%)** |

The first half of 2003 brought a considerable reduction of pressure on specific provision expenses. It was an effect of relative stabilisation of the Bank's loan portfolio, as well as high level of provision coverage of receivables already in the past. The net charges to specific provisions for loans to non-financial sector were PLN 66.9 million (48.0%) lower than in the first half of 2002; additionally, PLN 23.6 million worth of provisions for receivables from the financial sector was released, i.e. PLN 21.7 million more than in the same period in 2002.

At the same time the Bank created specific provisions of PLN 79.4 million for subordinated loans financing the activity of special purpose investment vehicles Handlowy Investments S.A. and Handlowy Investments S.a.r.l.

The figure of PLN 10,748 thousand of net charges to provisions from revaluation of financial assets included write-offs for investments in the companies: Wschodni Bank Cukrownictwa S.A. (PLN 10,396 thousand), Biuro Informacji Kredytowej S.A. (PLN 844,000) and PPU Spomasz Sp. z o.o. (PLN 4,059,000) and releasing the provision for exposure in Budowa Centrum Plac Teatralny Sp. z o.o. (PLN

4,551,000). Creating a provision for exposure in WBC S.A. was a result of the Bank's participation in the Rehabilitation Programme of WBC S.A., whereby the Bank took a 7.39% holding in the equity if WBC S.A. The acquisition of WBC S.A. shares for PLN 14,781,000 was financed on preferential terms by the Bank Guarantee Fund. Meanwhile, the release of provision for investment in BCPT Sp. z o.o. was a result of the company's liquidation and its assets were taken over as fixed assets of the Bank.

### *2.1.4 Accounting for subordinated entities*

In the first half of 2003 the net profit of the Bank increased by PLN 11,362,000 by virtue of valuation of long-term major shares in subsidiaries, using the equity method. This amount was reflected in the income statement under „Participation in net profit/(loss) of subsidiaries accounted for under the equity method" item and comprised of valuations of the following entities: Dom Maklerski Banku Handlowego SA, Handlowy Leasing S.A., Citileasing Sp. z o.o., Handlowy Zarządzanie Aktywami S.A., Towarzystwo Funduszy Inwestycyjnych BH S.A., Handlowy Inwestycje Sp. z o.o., Handlowy Inwestycje II Sp. z o.o., Handlowy Investments S.A., Handlowy Investments II S.a.r.l., Bank Rozwoju Cukrownictwa S.A., Polskie Pracownicze Towarzystwo Emerytalne DIAMENT S.A., PKO/ Handlowy PTE S.A., Handlowy-Heller S.A., KP Konsorcjum Sp. z o.o. The largest was that of Dom Maklerski Banku Handlowego SA, totalling PLN 15,432,000.

### *2.1.5 Ratio analysis*

Generally ROE and ROA followed the net profit. An additional impediment for the Bank in generating a higher ROE is its capital surplus, which demonstrates a relatively high level of the capital adequacy ratio. Cost/income deteriorated mostly due to a drop of profit on banking activity.

**PROFITABILITY AND COST EFFICIENCY RATIOS**

| | **Six months ended June 30** | |
|---|---|---|
| **PLN '000** | **2003** | **2002** |
| Return on owners' equity (ROE)* | 3,0% | 4,9% |
| Return on assets (ROA)* | 0,6% | 0,9% |
| Net interest margin (NIM)** | 2,3% | 2,0% |
| Earnings per share or convertible bond (EPS), in PLN | 0,68 | 1,11 |
| Cost/Income Ratio**** | 67,3% | 59,0% |

** Net profit divided by average equity (including the net profit of the current period) calculated on a monthly basis.*

*** Net profit divided by average assets calculated on a monthly basis.*

**** Net interest income divided by average assets calculated on a monthly basis.*

***** Relation of the sum of total operating expenses and depreciation to the sum of the profit on banking activity and net other operating income (excluding goodwill amortisation).*

## 2.2 Balance sheet

As of 30 June 2003 the Bank's balance sheet total was PLN 32,590 million and was 0.6% than a year ago.

**BALANCE SHEET**

| | As at: | | | Change from: | |
|---|---|---|---|---|---|
| **PLN '000** | **30/06/2003** | **31/12/2002** | **30/06/2002** | **31/12/2002** | **30/06/2002** |
| Cash, operations with the Central Bank | 1,132,036 | 979,308 | 1,139,203 | 15.6% | (0.6%) |
| Due from the financial sector* | 5,194,503 | 5,408,047 | 7,365,730 | (3.9%) | (29.5%) |
| Due from the non-financial sector | 14,337,425 | 13,535,347 | 13,871,401 | 5.9% | 3.4% |
| Due from the public sector | 6,733 | 5,096 | 9,620 | 32.1% | (30.0%) |
| Debt securities* | 4,521,689 | 4,296,398 | 3,020,675 | 5.2% | 49.7% |
| Equity investments* | 503,588 | 598,164 | 756,278 | (15.8%) | (33.4%) |
| Other securities and financial assets* | 4,030,248 | 4,523,450 | 3,417,708 | (10.9%) | 17.9% |
| Intangible assets | 1,331,087 | 1,377,477 | 1,414,203 | (3.4%) | (5.9%) |
| - including: goodwill | 1,279,868 | 1,316,091 | 1,352,313 | (2.8%) | (5.4%) |
| Tangible fixed assets | 782,023 | 816,655 | 838,193 | (4.2%) | (6.7%) |
| Other assets | 750,302 | 641,665 | 561,021 | 16.9% | 33.7% |
| **TOTAL ASSETS** | **32,589,634** | **32,181,607** | **32,394,032** | **1.3%** | **0.6%** |
| Due to the Central Bank | 83,633 | 121,940 | 172,245 | (31.4%) | (51.4%) |
| Due to the financial sector | 3,506,989 | 3,448,194 | 4,181,473 | 1.7% | (16.1%) |
| Due to the non-financial sector | 16,335,038 | 16,062,959 | 15,941,736 | 1.7% | 2.5% |
| Due to the public sector | 504,051 | 636,294 | 1,004,349 | (20.8%) | (49.8%) |
| Other liabilities arising from financial instruments | 3,904,377 | 4,182,578 | 3,349,807 | (6.7%) | 16.6% |
| Other liabilities | 1,997,355 | 1,315,138 | 1,445,883 | 51.9% | 38.1% |
| Provisions | 439,584 | 445,395 | 427,279 | (1.3%) | 2.9% |
| Equity and retained earnings | 5,729,280 | 5,726,420 | 5,726,215 | 0.0% | 0.1% |
| Net profit | 89,327 | 242,689 | 145,045 | (63.2%) | (38.4%) |
| **TOTAL LIABILITIES** | **32,589,634** | **32,181,607** | **32,394,032** | **1.3%** | **0.6%** |

** Subordinated loans funding investment vehicles, convertible bonds issued by Handlowy Investments and investment fund units have been reclassified and are presented as equity investments.*

### 2.2.1 Assets

Traditionally, the main component of the Bank's assets were receivables from the non-financial sector. In 2003 this item grew by PLN 802.1 million, i.e. 5.9%, which was a combined effect of the following factors:

- an increase of gross loans to non-financial customers by PLN 774.9 million (5.4%), stimulated mostly by a growth of loans to corporates;
- an increase of suspense account receivables by PLN 7.7 million (33.6%);
- an increase of accrued interest by PLN 66.2 million (12.4%);
- an increase in specific provisions, decreasing the balance sheet value of receivables by 46.7 million (3.4%).

The growth of credit business in the first months of 2003 corresponded to the gradual economic recovery in Poland.

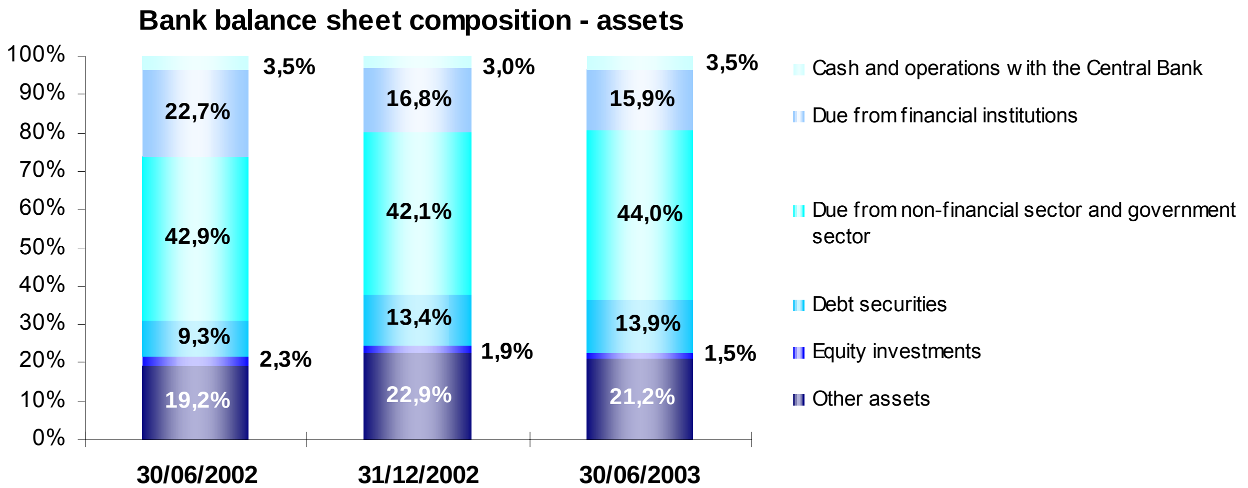
In the first six months of 2003 the growth trend of debt securities portfolio continued, increasing by PLN 225.3 million over the period (5.2%), mostly due to a greater Treasury bond portfolio and securities issued by non-financial corporates. Further growth of the T-bond portfolio followed from an attempt to exploit a bullish trend in the market of those instruments, connected with expectations of continued interest rate cuts by the Central Bank. The growth of the corporate debt securities followed from the Bank's active involvement in the commercial paper origination market, where it occupied a dominant position.

### DEBT SECURITIES PORTFOLIO

| | As at: | | | Change from: | |
|---|---|---|---|---|---|
| **PLN '000** | **30/06/2003** | **31/12/2002** | **30/06/2002** | **31/12/2002** | **30/06/2002** |
| Treasury bonds | 3 366 393 | 3 101 129 | 1 679 347 | 8,6% | 100,5% |
| NBP bonds | 376 201 | 644 489 | 632 010 | (41,6%) | (40,5%) |
| Treasury bills | 191 538 | 94 534 | 479 072 | 102,6% | (60,0%) |
| Certificates of deposit and bonds issued by banks | 34 512 | 79 229 | - | (56,4%) | --- |
| Issued by other financial institutions | 11 652 | 2 691 | 26 054 | 333,0% | (55,3%) |
| Issued by non-financial sector | 541 393 | 374 326 | 204 192 | 44,6% | 165,1% |
| **T O T A L** | **4 521 689** | **4 296 398** | **3 020 675** | **5,2%** | **49,7%** |

In view of the growing credit volume and debt security portfolio while the balance sheet stabilised as a whole, unutilised funds were invested in the interbank market to a much lesser extent. This trend is depicted by a decrease of receivables from the financial sector by PLN 213.5 million (3.9%), and receivables from banks dropped from PLN 4,287 million do PLN 4,059.6 million, i.e. by PLN 227.4 million (5.3%).

The strategy of gradual reduction of the Bank's equity investments and additional provisions for subordinated loans financing the Bank's investment companies contributed to a drop in the balance sheet value of equity investments in the first half of 2003 by PLN 94.6 million (15.8%).



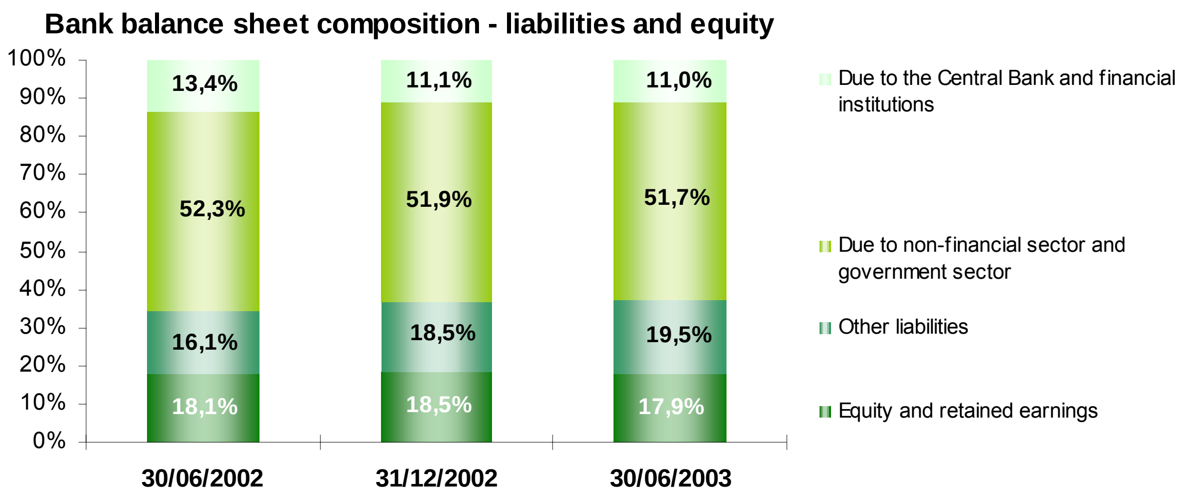

### 2.2.2 *Liabilities and equity*

The first half of 2003 brought no significant changes in the Bank's liabilities structure, which is largely attributable to its stable deposit base.

The main item financing the Bank's assets were liabilities to non-financial customers. In comparison to the end of 2002 this item grew slightly, i.e. by PLN 272 million (1.7%), offsetting lower liabilities to the public sector (PLN 132.2 million) and the Central Bank (PLN 38.3 million).

The stability of customer deposits, accompanied by a limited growth of the entire balance sheet had an effect on the Bank's borrowing needs. This trend was reflected in a relatively small growth of liabilities to the financial sector in the first half of 2003 (by PLN 58.8 million, i.e. 1.7%). Liabilities to banks, which account for a major share of the liabilities to the financial sector, increased from PLN 1,920.3 to PLN 1,968.2 million, i.e. by PLN 48 million (2.5%) in the period in question. In the first half of 2003 the liabilities continued at a lower level than receivables from the banks, which indicated a liquidity surplus in the Bank.

A decrease in share of equity and retained earnings in the balance sheet total in comparison with 2002 was the result of distributing almost the entire 2002 profit as dividend to shareholders. After the approval of a resolution on the distribution of net profit for 2002 by the General Meeting of Shareholders on 25 June 2003 the amount of dividend was accounted for under 'Other liabilities to sundry creditors', where it will remain until actual payment, i.e. 1 September 2003. Despite distributing 99.6% of its 2002 profit as dividend, the share of equity in the Bank's balance sheet total remained at the highest level among 20 largest Polish banks.




An important occurrence on both sides of the Bank's balance sheet is the share of unrealised profit / loss on derivatives transactions, which reflects the scale of off-balance sheet purchase/sale transactions carried out by the Bank. Balance sheet valuation is specified under 'Other securities and other financial assets for the assets side, and under 'Other liabilities from financial instruments' on the liabilities side of the balance sheet.

## 2.3 Capital and capital adequacy

In the first half of 2003, the total capital increased by PLN 2,860 thousand, as a result of the following:

- An increase of the revaluation reserve by PLN 1,891 thousand due to revaluation of debt securities available-for-sale,
- an increase of reserve capital by PLN 969 thousand as a result of distribution of the net profit for 2002. The other part of net profit, amounting to PLN 241,720 thousand, was earmarked for dividend to shareholders.

During the described period, changes took place in capital structure, including:

- increasing the authorised capital equity by PLN 21,736 thousand through a share conversion of 5,434,000 Special Participating Convertible Bonds owned by Powszechny Zakład Ubezpieczeń S.A. The increase of the authorised capital was registered on June 16, 2002 by the District Court for the Capital City of Warsaw, 19th Commercial Register Department

- transfer of the amount of PLN 673 thousand from the revaluation reserve to reserve capital in relation to the sale of fixed assets, due to which the revaluation reserve was realised.

## EQUITY

| | | As at: | | Change from: | |
|---|---|---|---|---|---|
| **PLN '000** | **30/06/2003** | **31/12/2002** | **30/06/2002** | **31/12/2002** | **30/06/2002** |
| Authorised capital | 522,638 | 500,902 | 500,902 | 4.3% | 4.3% |
| Capital surplus | 3,044,585 | 3,044,585 | 3,044,585 | - | - |
| Reserve capital | 1,724,871 | 1,754,547 | 1,754,251 | (1.7%) | (1.7%) |
| Revaluation reserve | 47,186 | 45,968 | 46,059 | 2.6% | 2.4% |
| General risk fund | 390,000 | 390,000 | 390,000 | - | - |
| Other supplementary capital* | - | 21,736 | 21,736 | (100.0%) | (100.0%) |
| Profit (loss) from previous years | - | (31,318) | (31,318) | (100.0%) | (100.0%) |
| **Total capital** | **5,729,280** | **5,726,420** | **5,726,215** | **0.0%** | **0.1%** |
| Core capital | 5,682,094 | 5,658,716 | 5,658,420 | 0.4% | 0.4% |
| Supplementary capital | 47,186 | 67,704 | 67,795 | (30.3%) | (30.4%) |

** Special Participating Convertible Bonds.*

Moreover, on June 25, 2003 the Ordinary General Meeting of Shareholders of Bank Handlowy w Warszawie SA adopted a resolution on utilising the reserve capital, according to which the loss in the amount of PLN 31,318 resulting from the application – for the first time as of January 1, 2002 – the valuation of investments in subordinated entities using the equity method, has been covered from the Bank's reserve capital. The financial statement of the Bank as of December 31, 2002 reports this loss under profit/(loss) from previous years.

As at the end of June 2003, in terms of size of own capital, the Bank ranked second in the banking sector. The level of capital was sufficient to guarantee financial security to the institution and the deposits it accepts.

At June 30, 2003, the only shareholder holding a minimum 5% of the Bank's authorised capital and of total voting rights at the General Meeting of Shareholders was Citibank Overseas Investment Corporation, New Castle, USA ("COIC"), a subsidiary of Citibank N.A., which then held 116,717,574 shares of the Bank, i.e. 89.33% interest in the Bank's authorised capital entitling it to exercise 89.33% votes at the General Meeting of Shareholders. In the first half of 2003 the holding of COIC decreased as a result of the dilution of the authorised capital due to the conversion of 5,434,000 Special Participating Convertible Bonds held by Powszechny Zakład Ubezpieczeń S.A., into ordinary series B bearer shares. The increase of the authorised capital of the Bank as a result of the above operation was registered on June 16, 2003 by the District Court for the Capital City of Warsaw, 19th Commercial Register Department.

As of June 30, 2003 the capital adequacy ratio amounted to 14.41% and was by 4.12 pp lower than at the end of 2002. The decrease was due to:

- additional capital requirement resulting from exceeding by the Bank the credit concentration limit towards a related entity from the banking sector, pursuant to the provisions of Art. 71 of the Banking Law Act, the Resolution no 5/2001 of the Commission for Banking Supervision of December 12, 2001 on the scope and detailed principles of establishing capital requirements due to specific types of risk (…) and the Resolution no 7/2001 of the Commission for Banking Supervision of December 12, 2001 on detailed principles and conditions of taking into account debts and granted off-balance sheet liabilities while assessing the observance of debt concentration limits (…).

- increase in the deduction rate applicable to intangible assets (including goodwill) from 30% in 2002 to 60% in 2003 used for calculating the capital eligible for calculation of the capital adequacy ratio. In 2004 the said rate will increase to 100%, according to appropriate provisions of law.

**CAPITAL ADEQUACY RATIO** **As of:**

| PLN '000 | 30/06/2003 | 31/12/2002 | 30/06/2002 |
|---|---|---|---|
| **Total capital funds** | **5,729,280** | **5,726,420** | **5,726,215** |
| Deductions, of which: | 1,181,849 | 780,686 | 817,973 |
| - goodwill | 767,921 | 394,827 | 405,694 |
| - other intangible fixed assets | 30,731 | 18,416 | 18,567 |
| - investments in subordinated financial institutions | 365,933 | 352,070 | 393,712 |
| - financial assets revaluation reserve fund | 17,264 | 15,373 | - |
| **Capital eligible for calculation of the capital adequacy ratio** | **4,547,431** | **4,945,734** | **4,908,242** |
| **Risk-weighted assets and contingent liabilities (bank portfolio)** | **19,496,879** | **21,525,850** | **22,102,662** |
| **Total capital requirement, of which:** | **2,525,182** | **2,134,678** | **2,133,494** |
| - capital requirement for credit risk | 1,559,750 | 1,722,068 | 1,768,213 |
| - capital requirement due to the excess of credit concentration limit | 515,625 | - | - |
| - total capital requirement for market risks | 449,807 | 412,610 | 365,281 |
| **Capital Adequacy Ratio** | **14.41%** | **18.53%** | **18.40%** |

In spite of the reduction during the first half of 2003, the capital adequacy ratio of the Bank has remained at relatively high level in comparison with other banks.

# III. The Bank's activities

## *1. Lending and other risk exposures*

### *1.1 Lending*

The first half of 2003 saw a moderate recovery in the Bank's credit portfolio. A the end of June 2003, gross lending to non-bank customers stood at PLN 16,281 million, being higher both against the end of 2002 (by PLN 775.5 million or 5.0%) and against the end of June 2002 (by PLN 456.2 million or 2.9%). The rate of growth of the Bank's credit portfolio in the first half of 2003 was close to the average rate of growth of lending in the entire banking system, and consequently the Bank's share in the credit market remained at 6.7%. As at the end of the first half of 2003, the Bank's share in the portfolio of loans granted to enterprises, private companies and co-operatives was 10.0% as compared with 9.7% at the end of 2002.

As in the previous years, lending to non-financial corporate customers formed the core of the gross loan portfolio – 84.4% as at 30 June 2003. In the first half of 2003, loans to those customers rose by PLN 867.8 million or 6.7%, greatly contributing to the increase of the whole credit portfolio.

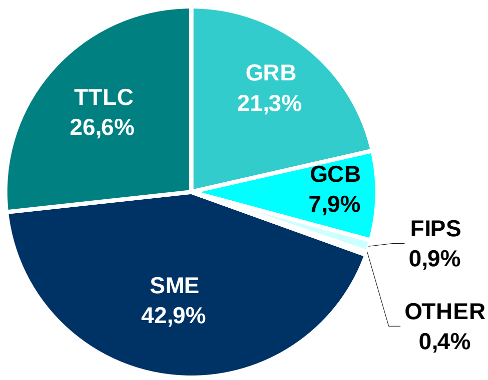
## Lending to non-bank customers (gross)

| | As at: | | | Change from: | |
|---|---|---|---|---|---|
| **PLN '000** | **30/06/2003** | **31/12/2002** | **30/06/2002** | **31/12/2002** | **30/06/2002** |
| Loans in PLN | 11,136,519 | 10,604,932 | 10,323,532 | 5.0% | 7.9% |
| Loans in foreign currencies | 5,144,193 | 4,900,307 | 5,500,957 | 5.0% | (6.5%) |
| **Total** | **16,280,712** | **15,505,239** | **15,824,489** | **5.0%** | **2.9%** |
| Loans to non-financial customers | 15,119,798 | 14,344,867 | 14,641,799 | 5.4% | 3.3% |
| Loans to financial institutions | 1,154,400 | 1,155,708 | 1,174,521 | (0.1%) | (1.7%) |
| Loans to public sector | 6,514 | 4,664 | 8,169 | 39.7% | (20.3%) |
| **Total** | **16,280,712** | **15,505,239** | **15,824,489** | **5.0%** | **2.9%** |
| Non-financial corporate customers | 13,742,464 | 12,874,634 | 13,205,329 | 6.7% | 4.1% |
| Non-bank financial institutions | 1,154,400 | 1,155,708 | 1,174,521 | (0.1%) | (1.7%) |
| Individual customers | 1,359,984 | 1,365,152 | 1,280,493 | (0.4%) | 6.2% |
| Other non-financial entities | 17,350 | 105,081 | 155,977 | (83.5%) | (88.9%) |
| Public sector | 6,514 | 4,664 | 8,169 | 39.7% | (20.3%) |
| **Total** | **16,280,712** | **15,505,239** | **15,824,489** | **5.0%** | **2.9%** |

*Gross loans, excluding interest receivable.*

Increase in credit exposure to non-financial corporate customers was mainly attributable to loans to customers in the SME (Small and Medium Enterprises) and GRB (Global Relationship Banking) segments, which reflected the Bank's intention to strengthen its position in those segments of the credit market in view of the forthcoming economic recovery. In the first half of 2003 credit exposure to SME and GRB customers increased by PLN 438.6 million (6.7%) and PLN 400.5 million (13.1%) respectively. Against this background, lending to individuals, represented mainly by debt on credit cards used by customers, displayed a stable pattern. At the end of June 2003, the gross value of receivables in respect of credit cards was PLN 753.3 million against PLN 752.6 million at the end of 2002.

**Gross loan portfolio composition by customer segments**
30/06/2003




SME - Small and Medium Enterprises
TTLC - Top Tier Local Companies
GRB - Global Relationship Banking
GCB - Global Consumer Banking
FIPS - Financial Institutions and Public Sector
OTHER - Other, non-segmented customers

The majority of the Bank's credit exposure to non-bank financial institutions was attributable to the funding of the Bank's subsidiaries, which provide leasing services (Handlowy-Leasing S.A. and Citileasing Sp. z o.o.). As at 30 June 2003, the total value of credit exposure to those entities amounted to PLN 785.8 million, compared with PLN 832.7 million at the end of 2002. Lending to the Bank's Capital Group entities is based on the same terms as to third-party customers.

In the first half of the year, the Bank remained an active player in the syndicated loan market, taking the market leader position in terms of the total amount of accepted credit exposure. Overall, during the reported period, the Bank arranged 3 credit consortia and accepted credit exposure totalling PLN 327.2 million. Those were the following syndicated transactions:

- the 31-month syndicated facility for Polskie Górnictwo Naftowe i Gazownictwo S.A. (Polish Gas and Oil Co.) for the total amount of USD 150.0 million (equivalent to PLN 570.4 million); the Bank acted as mandated arranger and agent for the facility with own participation of PLN 75,742 thousand;

- the opening, together with a consortium of banks, of a 5-year liquidity line for Telekomunikacja Polska S.A. (Poland's largest telecom operator) for the total amount of EUR 400 million (equivalent to PLN 1,770.3 million); the Bank acted as mandated arranger and agent for the facility with own participation of PLN 39,333.3 thousand (equivalent to PLN 174,078 thousand)

- the EUR 190 million facility for Polskie Koleje Państwowe S.A. (Polish Railroads Co.); the Bank acted as co-arranger of the facility with own participation of EUR 18,100 thousand.

Other major credit transactions made in the first half of 2003 included:

- the 6-year working capital facility for Telekomunikacja Polska S.A. for the amount of PLN 150.0 m;

- three loans granted to Stocznia Szczecińska Nowa sp. z o.o. (the Szczecin shipyard) for the total amount of PLN 180,566 thousand to finance the building of ships intended for export; two container ships for a Vietnamese customer and one for a German customer; the facilities are secured in part by guarantee agreements made with the State Treasury represented by the Minister of Finance.

During the first half of 2003 the currency composition of the credit portfolio remained stable, with a 31.6% share of foreign currency loans. By comparison, at the end of June 2003 it was 34.8%. Foreign currency loans are granted only to customers who can provide a natural hedge against FX risk in the form of foreign currency cash flows from exports or those who, in the Bank's opinion, are able to absorb the risk of depreciation of the Polish currency without a significant deterioration of their financial position.

The Bank monitors the concentration of its exposure portfolio on a regular basis, seeking to avoid a situation where the portfolio is dependent on a limited group of customers. As at 30 June 2003, the non-bank portfolio did not include any exposure exceeding the exposure limits laid down by law. The greatest exposure was related to the financing of a leasing company owned by the Bank (Customer 1).

**Credit concentration – non-bank customers**

| PLN '000 | Total exposure | Balance sheet exposure* | Off-balance sheet exposure |
|---|---|---|---|
| Customer 1 | 831,517 | 681,576 | 149,941 |
| Customer 2 | 302,440 | 150,906 | 151,534 |
| Customer 3 | 273,898 | 188,104 | 85,794 |
| Customer 4 | 227,002 | 76,269 | 150,733 |
| Customer 5 | 104,792 | 104,326 | 466 |
| Customer 6 | 220,960 | 166,014 | 54,946 |
| Customer 7 | 220,321 | 220,321 | 0 |
| Customer 8 | 196,171 | 107,868 | 88,303 |
| Customer 9 | 118,792 | 118,792 | 0 |
| Customer 10 | 192,776 | 723 | 192,053 |
| **Total 10** | **2,688,669** | **1,814,899** | **873,770** |

** Exclusive of exposures in respect of equitiy investments and other securities held. The data are given net of exposures to entities related to the customer concerned.*

## *1.2 Quality of loan portfolio*

In the first half of 2003 the Bank experienced a deterioration of the quality of its loan portfolio. The share of classified loans in total loans (gross) rose during the period from 29.4% to 33.0%. However, a comparison with the corresponding ratio as measured a year earlier (31.6%) shows that the portfolio quality has reached a moderately stable level at around 30% over the last 12 months.

## QUALITY OF LOAN PORTFOLIO

| | As at: | | | | | |
|---|---|---|---|---|---|---|
| | 30/06/2003 | | 31/12/2002 | | 30/06/2002 | |
| **Gross loans to non-bank customers*** | | | | | | |
| by classification: | PLN '000 | % share | PLN '000 | % share | PLN '000 | % share |
| Normal | 9,340,154 | 57.4% | 9,245,925 | 59.6% | 9,370,759 | 59.2% |
| Watch | 1,570,152 | 9.6% | 1,694,536 | 10.9% | 1,451,069 | 9.2% |
| Problem | 5,370,406 | 33.0% | 4,564,778 | 29.4% | 5,002,662 | 31.6% |
| - substandard | 1,314,233 | 8.1% | 1,096,069 | 7.1% | 1,468,126 | 9.3% |
| - doubtful | 2,225,823 | 13.7% | 1,889,792 | 12.2% | 1,952,991 | 12.3% |
| - loss | 1,830,350 | 11.2% | 1,578,917 | 10.2% | 1,581,545 | 10.0% |
| **Total** | **16,280,712** | **100.0%** | **15,505,239** | **100.0%** | **15,824,489** | **100.0%** |

*Excluding interest receivable.*

The lack of improvement of the quality of loan portfolio in the first half of 2003 was due to the fact that the impact of economic recovery on corporate balance sheets was a rather slow process. A significant proportion of problem loans was classified by the Bank owing to an uncertain financial position of borrowers, irrespective of whether they services their debt on a timely basis or whether the loans were secured by guarantees from high-rated companies. This relationship is confirmed by the share of overdue loans in the gross loan portfolio. As at 30 June 2003, the total value of loans to the non-bank sector, which are past maturity (i.e. more than 30 days of delinquency), amounted to PLN 1,719.4 million, which translated into a 10.6% share in the gross portfolio, much below the share of problem loans (33.0%).

Another useful measure of quality of the Bank's credit portfolio is the amount of loans under restructuring or in collection. As at the end of June 2003 it was PLN 2,118 million, compared with PLN 2,132 million at the end of December 2002. Overall, the headcount in the units responsible for managing such loans, i.e. the Corporate Bank Restructuring Department as well as a similar unit responsible for managing problem loans in SME portfolio, totalled 31 people.

As at 30 June 2003, the amount of specific provisions for problem loans was PLN 1,493 million and it met the requirements of the National Bank of Poland. The Bank also maintained general risk provision in the amount of PLN 300 million, created in previous years, which provided an additional security against risk not covered by specific provisions.

## SPECIFIC PROVISIONS FOR LOANS TO NON-BANK CUSTOMERS

| | As at: | | | Change from: | |
|---|---|---|---|---|---|
| PLN '000 | 30/06/2003 | 31/12/2002 | 30/06/2002 | 31/12/2002 | 30/06/2002 |
| Specific provisions for: | 1,493,664 | 1,470,434 | 1,299,862 | 1.6% | 14.9% |
| - watch loans | 541 | - | 454 | --- | 19.0% |
| - problem loans | 1,493,123 | 1,470,434 | 1,299,408 | 1.5% | 14.9% |
| General risk provision | 300,000 | 300,000 | 300,000 | - | - |
| **Total provisions** | **1,793,664** | **1,770,434** | **1,599,862** | **1.3%** | **12.1%** |
| Provision coverage of the total loan portfolio | 11.0% | 11.4% | 10.1% | | |
| Provision coverage of problem loans | 33.4% | 38.8% | 32.0% | | |

The decline in the provision coverage of problem loans from 38.8% to 33.4%, experienced over the first half of 2003, was largely attributable to the increase in collaterals reducing the specific provision base. For example, in the case of non-bank customers the value of collateral increased over the reported period from PLN 2,567 million to PLN 3,339 million (by PLN 771.5 million or 30.1%).

During the first half of 2003, the Bank wrote-off loss loans against previously created provisions amounting to PLN 25,017 thousand.

### *1.3 Off-balance sheet exposures*

The amount of contingent liabilities extended by the Bank remained stable during the first half of 2003. This was the due to the amount of PLN 436.5 million shown under the other financing item, representing contingent liabilities granted in connection with Smart Accounts product, allowing the Bank's customers comprising a group of entities to better manage their liquidity thanks to an application of the same interest rate on the mutually off-setting credit and debit balances in their accounts held with the Bank.

**CONTINGENT LIABILITIES EXTENDED**

| | | As at: | | Change from: | |
|---|---|---|---|---|---|
| **PLN '000** | **30/06/2003** | **31/12/2002** | **30/06/2002** | **31/12/2002** | **30/06/2002** |
| Guarantees | 2,662,641 | 2,738,719 | 3,028,068 | (2.8%) | (12.1%) |
| Letters of credit issued | 117,036 | 187,117 | 206,998 | (37.5%) | (43.5%) |
| Confirmed letters of credit | 20,577 | 12,013 | 24,907 | 71.3% | (17.4%) |
| Undrawn credit lines | 6,403,718 | 6,662,409 | 6,092,069 | (3.9%) | 5.1% |
| Forward placements | 40,106 | - | - | --- | --- |
| Other financing | 436,468 | - | - | --- | --- |
| **Total contingent liabilities extended** | **9,680,546** | **9,600,258** | **9,352,042** | **0.8%** | **3.5%** |
| Provisions for contingent liabilities | 138,041 | 145,307 | 127,279 | (5.0%) | 8.5% |
| Provision coverage | 1.43% | 1.51% | 1.36% | | |

The PLN 258.7 million or 3.9% drop in undrawn credit lines was mainly a reflection of the increase in overdrafts. In other words, the increased use of the overdraft facility resulted in the reduction of the amount of credit available to holders of current accounts, which is shown off-balance sheet as part of the item "Undrawn credit lines". This development is illustrated by data on non-financial customer overdraft debt – as at the end of June 2003 it amounted to PLN 4,438 million compared with PLN 3,849 million at the end of 2002 (up by PLN 589.0 million or 15.3%).

The decrease in the value of letters of credit issued, witnessed during the past 12 months, reflects the declining demand for this instrument, which corresponds to an increasing use of simpler methods of payment of trade accounts, such as direct debit.

### *1.4 Leasing*

Leasing services are provided by two subsidiary companies of the Bank: Handlowy-Leasing S.A. and Citileasing S.A. The offering of Handlowy-Leasing S.A. and Citileasing Sp. z o.o. was primarily aimed at corporate customers serviced by Bank Handlowy w Warszawie SA. The range of products includes the leasing of truck-tractors, complete trucks, trailers and semi-trailers, delivery vans, machinery and equipment, as well as other fixed assets. At the end of 2003, the two Companies employed 61 staff overall.

The merger of the two Companies is planned to take place in the nearest future and the combined institution is to operate under the name of Handlowy-Leasing S.A. To this end, during the first half of

2003 both subsidiaries worked on unification of the internal procedures as well as on improvement of the rules of co-operation with branches of Bank Handlowy w Warszawie SA.

In the first half of 2003, the Bank's leasing subsidiary companies, led by Handlowy–Leasing S.A., signed 731 new leasing contracts for PLN 240,099.7 thousand, a 46.1% increase against the first half of 2002 with 574 new leasing contracts for PLN 164,381.6 thousand. With the 5.8% combined share the two companies held companies in the reported period, they ranked sixth in the market.

As at 30 June 2003, the balance of assets leased by the companies was PLN 1,023,072.4 thousand, and their portfolio comprised 3,848 contracts with 1,758 customers. In 2002, the figures for the corresponding period were as follows: 2,974 contracts signed and outstanding receivables of PLN 878,333.6 thousand. Hence the percentage growth of net assets leased in the first half of 2003 compared with the first half of 2002 was 16.5%. Between 30 June 2002 and 30 June 2003, the Companies recorded an increase in the number of customers by 296 new lessees.

On 25 November 2002, a lease finance agreement was finalised between Handlowy-Leasing S.A. and the European Investment Bank. Under this agreement as well as an agreement between Citileasing Sp. z o.o. and the European Investment Bank of 20 May 2000, the Companies were granted a line of credit up to EUR 15 million, carrying interest at LIBOR for EUR plus 15 basis points. By 30 June 2003, the Companies had disbursed the amount of EUR 5,723.3 thousand to finance 48 existing leasing contracts. The disbursement deadline for the outstanding amount of the facility is 31 December 2003, while its maturity date is 15 December 2010.

On 3 June 2003, Handlowy-Leasing S.A. entered into a long-term loan agreement with Citibank N.A., Bahrain Branch, with a view to financing leasing transactions. Under the loan agreement, Citibank N.A., Bahrain Branch, made available to the Company a facility equivalent to USD 100 million, carrying interest at 1M LIBOR for EUR plus 5 basis points p.a. As at 30 June 2003, the first tranche of the loan was disbursed to the Company in the amount of EUR 30 million. The disbursement deadline for the outstanding amount of the facility is 31 December 2004 and its maturity date is 31 December 2006.

In addition to the above-mentioned foreign sources of funding, the Companies continued to be funded by means of credit lines drawn from Bank Handlowy w Warszawie SA. As at the end of June 2003, the total amount of the Bank's loan exposure to both Companies was PLN 785.8 million.

### 1.5 Factoring

The Capital Group of Bank Handlowy S.A. provides factoring services through the Bank and through the company Handlowy-Heller S.A., in which the Bank has a 50% interest (25% indirectly through Handlowy Inwestycje Sp. z o.o.). The remaining shares are held by the Dutch NMB Heller Holding N.V. (50% interest).

The unit of Bank Handlowy w Warszawie S.A. responsible for factoring services is the Trade Finance Department. In May 2003, the Bank's factoring product range was expanded by Non-financial Factoring, under which the Bank settles payments in respect of receivables transferred by an assignor without discounting them at the same time. The customer who does not need funds in respect of discount, and only requires the management and monitoring of payments, is provided by the Bank with detailed reports on the payment of receivables and sends dunning letters to debtors. Overall, in the first half of the year the Bank's factoring turnover measured by the value of invoices acquired, amounted to PLN 744 million.

Handlowy-Heller S.A. carries on factoring business for its own account, i.e. with no involvement on the part of the Bank. In the first half of 2003, the Company reported a significant increase in the value of receivables acquired, which resulted from an increase of demand for factoring services generated by higher corporate sales. In total, during the first half of 2003 the value of receivable acquired reached PLN 572.9 million, compared with PLN 375.6 million in the corresponding period of 2002, which translated into a growth of 52.5%. The number of the Company's customers increased during the period from 104 to

144, and the number of new contracts from 25 to 42. The increase in the Company's turnover translated into an increase in sales by 8.8%. The estimated market share remained at 15%.

In response to the upturn in the factoring services market, Handlowy-Heller devoted the first months of 2003 to improving its distribution structures. The measures included the opening of new regional representative offices in Katowice and Wrocław, and the creation of the Key Account position. In addition, the Company started co-operation with the collection firm Credit Control, which resulted in a significant improvement of the quality and effectiveness of collection services, and commenced the implementation of a complex credit risk management (CRM) programme.

## 2. External Funding

As at 30 June 2003 the Bank's external funding totalled PLN 20,348 million and was higher than at the end of 2002 by PLN 177 million (0.9%). Liabilities due to the non-financial sector increased by PLN 277 million (1.7%) and had the largest share in the increase of external funding of the Bank's operations. The second half of 2003 was marked by a further fall in term deposits, reflecting a general drop in propensity to save caused by a reduction in the rates of interest paid to depositors. Moreover, some of the customers started seeking alternative ways to optimise earnings on their funds, more and more often resolving to buy Treasury bonds or investment fund units. On the other hand, assets held in current accounts increased, which may be due to the drop in the cost of lost opportunities owing to a reduction of interest on term deposits, as well as the general improvement of liquidity experienced by businesses as a result of an increase in the industrial production sales.

The increase in deposits from non-financial corporate customers in the first half of 2003 translated into an improvement in the Bank's position in the corporate deposit market from 15.5% to 15.6% (this refers to liabilities to enterprises, private companies and co-operatives). The Bank is a leader in the corporate deposit market, and its strong position is to a large extent a result of the competitive product offering in cash management and trade finance.

### EXTERNAL FUNDING

| | As at: | | | Change from: | |
|---|---|---|---|---|---|
| PLN '000 | 30/06/2003 | 31/12/2002 | 30/06/2002 | 31/12/2002 | 30/06/2002 |
| **Due to the central bank** | **82,895** | **121,344** | **170,343** | **(31.7%)** | **(51.3%)** |
| **Due to financial institutions** | **3,501,433** | **3,430,715** | **4,140,618** | **2.1%** | **(15.4%)** |
| Current | 2,339,609 | 1,886,237 | 2,134,793 | 24.0% | 9.6% |
| Term deposits | 1,161,824 | 1,544,478 | 2,005,825 | (24.8%) | (42.1%) |
| - Interbank deposits | 416,944 | 472,923 | 660,979 | (11.8%) | (36.9%) |
| - Interbank loans | 559,535 | 522,103 | 783,540 | 7.2% | (28.6%) |
| - Term deposits of non-bank financial institutions | 185,345 | 549,452 | 561,305 | (66.3%) | (67.0%) |
| **Due to non-financial sector** | **16,261,233** | **15,984,177** | **15,854,958** | **1.7%** | **2.6%** |
| Current | 8,373,192 | 7,548,770 | 6,722,311 | 10.9% | 24.6% |
| Term deposits | 7,888,041 | 8,435,407 | 9,132,647 | (6.5%) | (13.6%) |
| **Due to the public sector** | **502,789** | **634,793** | **1,002,205** | **(20.8%)** | **(49.8%)** |
| Current | 301,589 | 410,686 | 353,330 | (26.6%) | (14.6%) |
| Term deposits | 201,200 | 224,107 | 648,875 | (10.2%) | (69.0%) |
| **Total external funding** | **20,348,350** | **20,171,029** | **21,168,124** | **0.9%** | **(3.9%)** |

*Excluding accrued interest.*

The declining trend in deposits from individuals was continued in the first half of 2003. As the drop in such deposited is witnessed throughout the banking sector, the Bank's share in this market remained during the reported period at 2.9%. The phenomenon is largely due to a general shift in the model of saving and investing by individuals, which became dramatically evident in 4Q 2001. In view of the declining yields on bank deposits owing to a series of interest rate reductions over the period 2001-2003 and the introduction of the withholding tax on interest income, at the end of 2001, some of the deposit holders opted for alternative savings/investment vehicles, such as investment funds, asset management products, or life insurance. Within the Bank's Capital Group, the decline in bank deposits from individuals is largely offset by growth of business reported by the companies Handlowy Zarządzanie Aktywami S.A. and Towarzystwo Funduszy Inwestycyjnych Banku Handlowego S.A.

**DEPOSITS OF NON-BANK CUSTOMERS**

| | As at: | | | Change from: | |
|---|---|---|---|---|---|
| PLN '000 | **30/06/2003** | **31/12/2002** | **30/06/2002** | **31/12/2002** | **30/06/2002** |
| Due to: | | | | | |
| Individual customers | 5,871,492 | 6,013,546 | 6,167,731 | (2.4%) | (4.8%) |
| Non-financial corporate customers | 9,449,356 | 9,066,496 | 8,673,360 | 4.2% | 8.9% |
| Non-profit organisations | 869,158 | 890,373 | 983,424 | (2.4%) | (11.6%) |
| Non-bank financial institutions | 1,327,122 | 1,363,253 | 1,487,889 | (2.7%) | (10.8%) |
| Public sector | 502,789 | 634,793 | 1,002,205 | (20.8%) | (49.8%) |
| Suspense account liabilities | 71,222 | 13,762 | 30,443 | 417.5% | 134.0% |
| **Total** | **18,091,139** | **17,982,223** | **18,345,052** | **0.6%** | **(1.4%)** |
| Current | 9,816,560 | 8,773,258 | 8,002,225 | 11.9% | 22.7% |
| Term deposits | 8,274,579 | 9,208,965 | 10,342,826 | (10.1%) | (20.0%) |
| **Total** | **18,091,139** | **17,982,223** | **18,345,052** | **0.6%** | **(1.4%)** |
| PLN | 13,005,704 | 12,985,687 | 12,346,587 | 0.2% | 5.3% |
| Foreign currency | 5,085,435 | 4,996,536 | 5,998,465 | 1.8% | (15.2%) |
| **Total** | **18,091,139** | **17,982,223** | **18,345,052** | **0.6%** | **(1.4%)** |

*Excluding accrued interest.*

Of all sectors, the growth trends were most suppressed in the area of deposits from the public sector, which resulted to a large extent to increasing competition from banks controlled by the State. Among other things, public entities were relieved of the obligation to report an invitation to tender for banking services if they chose to contract such services to Bank Gospodarstwa Krajowego S.A. The Bank's share in the public sector deposit market decreased during the reported period from 3.2% to 2.3%.

In the second half of 2003 the Bank continued to a show surplus funding, which was illustrated by the widening gap between amounts due to and from financial institutions. The strong deposit and liquidity base allows the Bank to react to new opportunities on credit market in a flexible way and provides a funding potential that may be utilised when the economic recovery fully materialises.

### 3. Cash management

In terms of cash management and trade finance the Bank is able to offer a broad range of modern and comprehensive products. In parallel with offering traditional banking services – such as current accounts, domestic and foreign money transfers, term deposits, overdrafts etc. – the Bank continued its efforts to add new products to the more refined cash management product range, especially electronic and Internet banking products, and intensified its efforts to acquire customers seeking such services. The fast changes taking place in this area are facilitated by the Bank's access to the state-of-the-art technology used by Citigroup.

In the first half of 2003, the Bank's offering in transaction and cash management was expanded by the following services:

- *Electronic Statements* – through this service customers receive bank statements in the form of a PDF file in the same format as that used so far in paper statements. Electronic Statements were made available to customers on 1 March 2003, and as at the end of June 2003 the service was already used by 737 customers with 2,550 bank accounts.

- *Cash Collection* – in partnership with Patron Service, a new service was introduced for cash transportation the Bank's branches providing cash service. The Bank also expanded its co-operation with Securitas C.I.T. in the field of cash counting and sorting. Consequently, the firm took over 13 cash counting offices, while 3 more remained with the Bank. The corresponding figures in 20002 were 5 and 16 respectively.

- *CitiPłynnościowy SFIO* – the Bank offering units of this fund to corporate customers as an alternative to overnight (O/N) deposits.

- *Escrow Accounts* – intended to secure one party to a transaction against loss of funds in the event of a counterparty's breach of contract, and at the same tome to guarantee payment to the counterparty in the case the counteparty performs the contract.

- *Tendering Support Accounts* – intended mainly to facilitate the management of tendering procedures by firms in the public sector, including the control of bid security payments, return of bid security to unsuccessful bidders, calculation of accrued interest, etc.

In addition, the Bank started receiving term deposits from customers who have no current account with the Bank.

*CitiDirect* is a key component of the Internet cash management services for corporate customers. The first half of 2003 saw a further dynamic increase in the use of *CitiDirect*, which is testified by the increase in the number of active installations of the system from 3,170 to 5,000. Excellent quality and technological features of the Bank's Internet banking offer for corporate customers was appreciated by experts of prestigious "Global Finance" magazine, who again nominated the Bank as "Best Corporate/Institutional Internet Bank in Poland 2003".

The first half of 2002 was also a successful period for the Card Products Management Department, offering *Citibank Business* cards for covering business expenses by employees of corporate customers as well as *Pre-Paid Cards* which serve as loyalty cards, cards for making money transfers and for promotions. The number of customers using *Citibank Business* cards increase during the reported period from 3,818 to 4,660, which translated into the increase in the number of cards serviced from 15,463 to 15,856. On the other hand, the number of firms using *Prepaid Cards* introduced in 2002 increased from 2 to 9, which brought the number of cards in circulation from 830 to 1,787. One of the examples is the co–branded card issue in co-operation with Nestlé Polska S.A. In January 2003, the Polish edition of the "Business Week" magazine granted the Portfolio of the Year award for the most innovative product of 2002 – *Prepaid Cards*.

In the first half of 2003 the use of *SpeedCollect* for mass-payment handling continued to increase. *SpeedCollect* enables the Bank's corporate customers to automatically allocate payments made by their clients to appropriate accounts and reconcile account balance. The system is offered to such customers as fixed and mobile telecom operators, cable TV providers, distributors of gas and power supply, or insurance companies. At the end of the first half of 2003 the system was used by 764 customers, including 8 using the *SpeedCollect Plus* version, which was introduced by the Bank in 2002. The average number of transactions processed monthly by the Bank as part of *SpeedCollect* services in the first half of 2003 reached 10.2 million.

In the first half of 2003 the Bank played an active role in the direct debit market. Overall, 1,209 such transactions were processed during the reported period.

The *Unikasa* service, launched in 2002 also enjoyed growing popularity. The service enables customers to make utility bill payments at trade establishments on a cyclic basis. The increase in the turnover of Sieć Obsługi Płatności (*Payment Service Network*) Unikasa resulted from the implementation of the product in the Geant hypermarket network (15 stores) and the Leader Price supermarket network (100 stores) as well as the inclusion in the service of 40 largest bill issuers. The increase in consumer interest in this method of payment was stimulated by promotion campaigns carried on by Geant stores and by one of the issuers serviced, Telekomunikacja Polska S.A. Consequently, the monthly number of transactions made through S.O.P. Unikasa increased to 23 thousand. A further growth of the product will be boosted by its planned implementation in the Carrefour hypermarket network and the PKN Orlen petrol station network.

In the first half of 2003 the *CitiConnect* Internet payment authorisation functionality handled 7,116 transactions for the total amount of PLN 1.38 million. *CitiConnect* is a settlement system, which accepts both payment and virtual cards. At the end of June 2003 *CitiConnect* served 103 Internet shops.

### 4. Trade finance

Bank Handlowy w Warszawie SA maintains a dominant position in the trade finance market. It is based on an extensive customer base and long-standing experience in financial services provided to Polish exporters and importers. The Bank's strong competitive advantage is the extensive range of products offered, which includes a number of types of letters of credit, documentary collections, guarantees, sureties, avals, bankers' acceptances, bill discounting and discounting of invoiced receivables. Co-operation with Korporacja Ubezpieczeń Kredytów Eksportowych S.A. ("KUKE"; Poland's export credit insurance corporation), in particular with regard to insurance of trade receivables for transactions with Eastern European countries, has proved beneficial.

The value of foreign trade transactions handled in the first half of 2003 by Bank Handlowy w Warszawie SA reached USD 10,922 million, of which export transaction accounted for USD 4,718 million and import transactions for USD 6,204 million. Those results translated into the overall market share of 25.3%, and 24.5% and 26.0% in export and import respectively.

### 5. FX and money market activity

Bank Handlowy is the leading participant in the Polish FX and money market, acting as a market-maker in the segment of standard FX and interest rate dealings. The Bank is a member of the group of 12 banks selected by the Ministry of Finance to act in 2003 as the Treasury Securities Dealer, which facilitates access to the primary market for such instruments, and the group of 12 banks selected by the National Bank of Poland to act in 2003 as the Money Market Dealer, which ensures access to open market operations conducted by the central bank.

The strong position of the Bank in the FX and money market is a result of:

- the large number of the Bank's major customers for FX transactions (5,000 companies) and derivative products (500 companies),
- the large number and volume of operations on the Bank's own account as a result of excess liquidity,
- the wide, flexible and innovative product offering,
- the Bank's leading position in the area of trade finance,
- its dynamic and experienced team responsible for these transactions,
- Bank Handlowy's excellent reputation on the Polish FX market and the esteem shown both by domestic and foreign counterparties,
- the support and assistance of the Bank's strategic investor, Citigroup, in accessing international financial markets, implementing new products and managing market risk.

In the first half of 2003 Treasury continued activities aimed to expand the customer base for derivatives through enhanced educational activities promoting foreign exchange and interest rate hedging, etc.

### 6. Commercial paper origination

For several years Bank Handlowy has been among the largest participants of the primary market for debt securities issued by corporations and financial institutions. In the first half of 2003 the Investment Banking, Securities and Capital Markets Department took part in launching new issue programmes for the following entities:

- a 3-year bond issue programme (in physical format) for Geant Sp. z o.o. to an amount of PLN 300 million. The Bank acted as arranger, principal payments agent and depository for the issue.
- a 5-year bond and CD issue programme (in electronic format) for Rabobank Polska S.A. to an amount of PLN 600 million. The Bank acted as arranger, issue agent, dealer, payment agent and depository for the programme.
- a 3-year bond issue programme (in electronic format) for the companies Electrolux Poland Sp. z o.o. and Electrolux Production Poland Sp. z o.o. to a total amount of USD 10 million. The Bank was the arranger, issue agent, dealer, payment agent and depository for the programme.
- a 2-year bond issue programme (in electronic format) for a company in the construction sector to a total amount of PLN 300 million. The Bank was the arranger, issue agent, dealer, payment agent and depository for the programme.
- a 2-year bond issue programme (in electronic format) for a company in the construction sector to a total amount of PLN 15 million. The Bank was the arranger, issue agent, dealer, payment agent and depository for the programme.

The launching of such a large number of issue programmes in the first half of 2003 enabled the Bank to increase its already dominant position in the market. Its market share in terms of the total value of securities placed in the market was 27.6% in the reported period, compared with 19.2% in the first half of 2002. As at 30 June 2003, the Bank operated 34 Issue Programmes for 46 Issuers, and the total debt in respect of the securities placed through the Bank reached PLN 2,438.7 million, which translated into a market share of 20.8% (at the end of June 2002 it was 2,473.1 million and 20.0% respectively).

### 7. Small enterprise banking

In the first half of 2003 the Bank continued to pursue the strategy of strengthening its position in the market for services provided to small companies, defined as those having annual sales below PLN 8 million. As from 2002, services to customers in this group are provided under the *Inter Biznes* product offer, which consists of two service packages: *Inter Konto* and the *Tele Konto* package offered in 2Q 2003.

Within the internal structure of Bank Handlowy corporate customers are segmented as small enterprises, whose annual income is lower than the equivalent of USD 2 million (PLN 8 million) – those customers are offered the *Inter Konto* package, and the smallest ones the *Tele Konto* package – and as medium enterprises, whose annual income ranges between USD 2 ÷ 35 million.

| Package | Target market | Range of services within package | Access channels |
|---|---|---|---|
| Tele Konto | Business entities with annual income up to PLN 4 million (Tier 0) | • opening and maintenance of a current account<br>• opening and maintenance of 3 additional accounts<br>• telephone banking – Inter Centrum | • telephone<br>• branch network |
| Inter Konto | Corporate customers with annual income between PLN 4 and PLN 8 million | • opening and maintenance of a current account<br>• opening and maintenance of 3 additional accounts<br>• issue of up to 2 bank cards – Citibusiness Visa Electron charge cards<br>• telephone banking – Inter Centrum<br>• Internet banking – CitiDirect | • Internet<br>• telephone<br>• branch network |

In addition, the Inter Konto package is offered to customers who achieve annual sales of not less than PLN 2 million if they are credit customers.

The improving position of the Bank in credit services to small enterprises is confirmed by an increase in the Bank's market share in lending to sole proprietorships, which increased in the first half of 2003 from 6.2% to 6.7%. At the end of June 2003 exposures to the SME segment accounted for 42.9% of the Bank's credit portfolio.

The growth of the customer base in the SME segment in the first half of 2003 is shown in the table below:

| Portfolio | Number of customers as at: | | |
|---|---|---|---|
| | 30/06/2003 | 31/12/2002 | 31/12/2001 |
| Head Office | 509 | 495 | 437 |
| Tier0 | 11,045 | 9,521 | 7,270 |
| SME Classic | 8,443 | 8,610 | 8,825 |
| **Total** | **19,997** | **18,626** | **16,532** |

In May 2002, the Management Board of the Bank took a decision to make certain organisational changes related to the transfer of services provided to small enterprises (Tier 0) from the Corporate and Investment Banking Sector to the Retail Banking Sector. Pursuant to that decision, on 1 June 2003 the Small Enterprise Division (SED) and the Commercial Credit Division (CCD) were established within the Retail Banking Sector. The *Tele Konto* service package became the basic product of the SED. During the first half of 2003 work was in progress on the implementation and adaptation of IT systems intended to ultimately provide a basis for serving customers of the Small Enterprise Division, i.e. Systematics – as a financial/accounting system, Citibank OnLine – Internet banking, NAS – credit risk, and PeopleSoft – a CRM system.

Addressing the real demand from SME customers, in May and June 2003 the Bank, working in partnership with Telekomunikacja Polska S.A., arranged a series of seminars entitled "Europe – a Union of Entrepreneurs. Seminars for Small and Medium Enterprises". The sessions were intended to convey to the existing and prospective customers of the Bank practical knowledge of changes in the operating conditions of business entities after Poland's accession the European Union. The Delegation of the European Commission in Poland was the patron of the project, and outstanding specialists in law, taxation and European integration presented their lectures.

## 8. Equity investments

### Equity investments

| PLN '000 | As at 30/06/2003 | 31/12/2002 | 30/06/2002 | Change from 31/12/2002 | 30/06/2002 |
|---|---|---|---|---|---|
| Investments in subsidiaries | 364,843 | 371,271 | 372,434 | (1.7%) | (2.0%) |
| Investments in joint-ventures | 21,210 | 20,072 | 20,661 | 5.7% | 2.7% |
| Investments in associated companies | 20,474 | 19,942 | 94,064 | 2.7% | (78.2%) |
| Other direct equity investments | 30,769 | 23,512 | 62,355 | 30.9% | (50.7%) |
| Investment fund units | - | 4,000 | 3,874 | (100.0%) | (100.0%) |
| Subordinated loans | - | 99,572 | 143,260 | (100.0%) | (100.0%) |
| Convertible bonds of Handlowy Investments SA | 66,292 | 59,795 | 59,630 | 10.9% | 11.2% |
| **Total equity investments** | **503,588** | **598,164** | **756,278** | **(15.8%)** | **(33.4%)** |

In the first half of 2003 the Bank continued its previously adopted equity investment policy, based on seeking to achieve the intended design of the Bank's Capital Group, while optimising the performance of equity transactions and minimising risks attached to such transactions. The major products of that policy in the first half of 2003 were the following transactions:

- disposal of shares held in Zakłady Odzieżowe Bytom S.A. by the Group's dominant company and the investment company Handlowy Inwestycje II Sp. z o.o. The equities sold represented 27.64% of the authorised capital of the company.

- disposal of the entire shareholding in the subsidiary company Bytom Collection Sp. z o.o. based in Radzionków, representing a 100.00% share in the authorised capital and attached voting rights;

In addition, the Bank sold all shares in its subsidiary Handlowy-Leasing S.A. based in Warsaw, within the Bank's Capital Group, to the subsidiary company Handlowy Inwestycje Sp. z o.o and took over the liquidation assets of its subsidiary Budowa Centrum Plac Teatralny Sp. z o.o.

On 30 June 2003 the District Court in Kielce declared bankrupt the associated company PIA PIASECKI S.A. (construction sector), in which the Bank holds a 36.52% interest. Following the prudent valuation principle, in 2002 the Bank made a value adjustment in respect of the balance-sheet value of the shareholding, as a result of which the value was reduced to nil.

## 9. Brokerage and capital market activity

The Bank operates in the capital market through its wholly-owned brokerage subsidiary Dom Maklerski Banku Handlowego S.A. ("DMBH"). DMBH was established on April 1, 2001 as a result of the transfer of all assets of Centrum Operacji Kapitałowych Banku Handlowego (Capital Markets Centre, previously a unit within Bank Handlowy) to Citibrokerage S.A., which as of that day changed its name to that used currently.

As of 1 March 2003 the position of President of the Management Board of DMBH was taken by Mr. Paweł Szymański, who previously served as director in charge of analyses of the Polish market with Schroder Salomon Smith Barney. The outgoing President, Mr. Witold Stępień, took the position of Vice-President of the Management Board of DMBH.

As at 30 June 2003 DMBH operated 13,459 investment accounts, compared with 13,746 at the beginning of the year.

In April 2003 DMBH announced its corporate restructuring and development strategy. An important component of the strategy will be the adoption of new standards of individual customer service, including an offer of investing opportunities in foreign stock markets. In addition to the existing CitiPhone call centre, the Internet will become the leading service channel for this group of customers, and brokerage products will be sold through the retail branch network of Bank Handlowy w Warszawie SA. The launching of the electronic platform is scheduled for late 2003/early 2004, and the first branches of the Retail Banking Sector will be prepared for the provision of services to DMBH by the end of 2003. Owing to the proposed transfer of distribution to the electronic platform and to the Bank's branch network, DMBH has closed down 5 of its own 6 Customer Service Outlets and reduced staffing from 89 at the end of 2002 to 54 at the end of June 2003.

Irrespective of the planned development of relations with individual customers, the corporate customer service will remain a priority, as they generate more than 90% of the Company's turnover. Owing to the access to the global Citigroup network, DMBH offers the opportunity of making transactions worldwide. DMBH's additional advantage is its extensive analytical base, which draws upon the pool of world-class experts of Smith Barney European Equity Research, a unit owned by Citigroup Global Markets Inc. The results of the Warsaw-Scan 2003 survey conducted among representatives of 34 financial institutions – stock-exchange analysts and asset managers – by NBS Public Relations, show that DMBH's analytical service offer ranks third among the market's best.

In the first half of 2003 Dom Maklerski Banku Handlowego S.A. consolidated its market leader position. This was reflected by an increase in the company's share in trading on the Warsaw Stock Exchange (WSE) to 17.1% from 10.8% in the first half of 2002. This was possible owing to a dynamic increase of the share in the equity market to 18.2% from 10.7% respectively. March 2003 was a record month, when DMBH's share in the equity market on the WSE reached 24.7%. The overall value of equity transactions completed by DMBH in the first half of 2003 amounted to PLN 3,964 million, 41.5% higher than in the corresponding period of the previous year. Over the same period other brokerage houses reported an overall drop in turnover by 23.7%. The value of bond transactions completed by DMBH in the first half of 2003 reached PLN 158.2 million, i.e. 4.6% less than in the corresponding period of 2002. Owing to this amount, the company ranked third with a share of 6.7%.

The increase of the market position of DMBH in the first months of 2003 was attributable, among other things, to the increase in the corporate customer base as a result of closer relationships with Citigroup Global Markets, the playing of the role of market maker for about 1/5 of the stock listed on the WSE, and the employment of a group of sales staff from the liquidated brokerage house ABN Amro Securities Polska.

As already mentioned, active fulfilment of the role of market maker for trading was an important factor that helped DMBH maintain a high share in stock exchange trading. DMBH started operation on the stock exchange for its own account in 1994, initially as Stock Exchange Member – Specialist, and then Market Maker. From the moment the futures market was established on the WSE, DMBH acted as Market Maker for futures contracts on the WIG 20 index. In addition, for six years the company has acted as arranger of trading on the over-the-counter CeTO market, which corresponds to the Market Maker function on the WSE.

For two years, DMBH has maintained its leader position as Market Maker among 14 houses serving this function. As at the end of the first half of 2003 DMBH acted as Market Maker for 44 stocks listed on the WSE, which represented 21.4% of all stock listed on the WSE, one convertible bond, and futures contracts on the WIG 20 index. On the CeTO exchange, DMBH, acting as Arranger, performed operations for one stock, BZWBK bonds and investment certificate of CitiObligacji Dolarowych Fundusz Inwestycyjny Mieszany. Also the turnover realised in the first half of 2003 by DMBH as Market Maker makes the company a leader with a share of 37.21% in total turnover in equities generated on the WSE by all brokerage houses that act as Arrangers.

In the first half of 2003 DMBH arranged trading in unlisted stocks of the following issuers:

| Issuer name | No. of sessions | Turnover value in PLN | Turnover volume |
|---|---|---|---|
| Elektrociepłownie Warszawskie SA | 1 | 9,414,181.52 | 55,844 |
| Elektrotim S.A. | 1 | 801,410.40 | 286,218 |
| Polskie Linie Lotnicze LOT S.A. | 6 | 162,510.00 | 2,226 |
| Sempertrans Bełchatów S.A. | 2 | 142,587.00 | 5,281 |
| **Total** | | **10,520,688.92** | |

In the period reported, DMBH also acted as dealer of 190,000 Series H bonds issued by the clothing company LPP S.A. The issue price was set at PLN 265, and hence the value of the issue amounted to PLN 50,350 thousand. DMBH also held 7 public offerings (which involved stock options – Energomontaż Północ S.A., Cersanit S.A., Simple S.A., Getin S.A., and conversion of debt to shares in the case of Stalexport S.A.), of which one issue was not completed – Simple S.A. The value of all actually made offerings reached PLN 425,759 thousand, which enabled DMBH to achieve a 11.83% of the value of completed new issues.

## 10. Custody services

The Bank's Custody Department in providing custody services to its customers complies with Polish as well as international standards set in respect to these services. This enables it to meet requirements of the largest and most demanding corporate clients. The Custody Department forms an integral part of the global custody network of Citigroup known as Global Securities Services, which offers trade finance services, including training in securities.

The Bank is one of the leading banks offering custody services in Poland. It offers its services both to foreign institutional investors and to domestic financial institutions, especially investment and pension funds.

As part of its statutory activities, the Custody Department operates securities and cash accounts, settles securities transactions, handles dividend and interest payments, portfolio valuation, individual reports, execution of customer proxies, and arranges customer representation at general meetings of shareholders of listed companies. It also maintains registers of foreign securities, which also involves intermediation in the settlement of transactions for domestic customers and safekeeping of securities abroad.

The Bank is also active in its efforts to assist in the further improvement of the broadly understood Polish securities law, taking part, through its representatives, in the workings of the Depository Council organised under the *aegis* of the Association of Polish Banks (Związek Banków Polskich). The strong position of the Bank in this market allows it to present its own drafts of amendments to the different regulations in question as well as to help establish practices bringing the Polish market even closer to international standards. Using their resources, experience and competencies employees of the Bank work closely with the Polish SEC (Komisja Papierów Wartościowych i Giełd), the National Depository for Securities (Krajowy Depozyt Papierów Wartościowych S.A.), the WSE and the Insurance and Pension Funds Supervision Commission (Komisja Nadzoru Ubezpieczeń i Funduszy Emerytalnych) in introducing new systemic solutions.

During the first half of the year the Bank continued the implementation of a new method of servicing foreign financial brokers, by simplifying its existing structure of securities and investment accounts used for booking transactions handled by foreign brokers on behalf of international investors. The new transaction settlement process will be compliant with the standards of advanced capital markets.

In the latest ranking held by an international specialised periodical – Global Custodian Magazine – the Bank was ranked as first for its custody services provided in Poland, achieving the highest score (Top Rated). The aim of the annual ranking for the Global Custodian Agent Bank category is to evaluate the quality of custody services offered to foreign customers by depositories operating in developing markets. The ranking is based on the results of meetings and questionnaires completed by global custodian banks, brokers, insurance companies and other financial institutions.

As at 30 June 2003 the Bank maintained 4,664 securities accounts, i.e. 508 more than at the beginning of the year.

In the first half of 2003 the Bank acted as depository for 5 open-ended pension funds: AIG OFE, SAMPO OFE, OFE Pocztylion, Pekao OFE and Zurich OFE as well as for Pracowniczy Fundusz Emerytalny Telekomunikacji Polskiej S.A. – the employee pension fund of Poland's largest telecom operator.

In addition, during the reported period the Bank acted as depository for 19 investment funds managed by the following investment fund societies: SKARBIEC TFI S.A., BZ WBK AIB TFI S.A., SEB TFI S.A., PIONEER PEKAO TFI S.A. and DWS Poland TFI S.A

## 11. Co-operation with international financial institutions

The Bank's activity in the field of co-operation with international financial institutions involved mainly current settlements of payments, conclusion of money market transactions, and acting as an intermediary in the purchase and sale of securities.

Owing to the increased investing activity and foreign trade, two new correspondent accounts were opened with Citigroup units in two new countries. At the same time the number of EUR accounts was rationalised, reducing their number from six to four. Consequently, the number of nostro accounts did not change in the first half of 2003 relative to that reported at the end of 2002 and it was 19 (in 14 countries).

The Bank is leader in the Polish zloty settlement market for commercial and treasury payments ordered by foreign banks. This is confirmed by the fact that 210 vostro accounts are kept for foreign bank from 36 countries.

The Bank also had a leading role in arranging credit consortia to provide funding to Polish enterprises. In the first half of 2003 they involved the participation of 2 foreign banks. Lending operations in the context of co-operation with foreign financial institutions also involved continued distribution of funds from the European Investment Bank. The funds are intended to refinance loans and leasing contracts made primarily with customers in the SME sector.

A key event of the first half of 2003 was the singing on 7 March 2003 of the "Co-operation Agreement" ("Agreement") between Bank Handlowy w Warszawie SA and FöreningsSparbanken AB („Swedbank"). The Agreement is aimed to create a mutual service model with a view to providing corporate customers, mainly SMEs, with easier access to financial services offered by the two banks in Poland and the Nordic countries. The main areas of co-operation covered by the Agreement include the opening and operating bank accounts, handling foreign trade settlements, and offering cash management as well as money market and FX market management products. The implementation of the Agreement and the setting of new directions of prospective co-operation will be safeguarded by the Supervisory Committee consisting of representatives of the parties.

The intention of both banks is to expand the Agreement to the Baltic States and to sign an identical document with Swedbank's subsidiary AS Hansapank in Estonia and its daughter companies in Lithuania and Latvia ("Hansabank Group"). Such agreement would benefit mainly Polish entrepreneurs carrying on business in Lithuania, Latvia and Estonia, branches of multinational corporations based in the Baltic States, being global customers of Citigroup. The Bank also plans joint participation with the Hansabank

Group in the "Polexport" 2003 Fair to be held in Kaunas to promote banking services and financial solutions for Polish and Lithuanian enterprises.

## 12. Retail banking

### 12.1 Retail Banking Sector

The mast important event of the first half of 2003 in the Retail Banking Sector was the launching of a new retail banking service on 11 June – CitiGold Zarządzanie Majątkiem (CitiGold Wealth Management) – based on an integrated package of savings, investment and insurance products, supported by the computer applications Plan Majątkowy (Asset Plan) and Analityk Portfela (Portfolio Analyst). The new offering operates under a sub-brand and it is targeted at customers who have investment funds available in the amount of not less than PLN 100,000 and need customised financial advice. CitiGold Zarządzanie Majątkiem provides a comprehensive analysis of the customer's investment profile and makes it possible to create a financial needs fulfilment model based on a broad range of products and adjusted to the individual needs of the customer. CitiGold Zarządzanie Majątkiem is available in 11 CitiGold branches and 18 corporate branches of the Bank. Poland was the first country in Europe where a CitiGold Wealth Management program was implemented.

In May 2003, two years after the service was launched, the number of registered customers of the Citibank Online (CBOL) Internet platform exceeded 100,000. A month earlier, CBOL made available to its user the free-of-charge service *Online Statements*, which enables electronic statements of account to be obtained for current accounts and credit card accounts in the form of a PDF file. Overall, from the beginning of the year, the number of customers using the Internet banking service increased from 86.3 thousand to 108.9 thousand, i.e. by 26%, and CBOL consolidated its position of a leading service channel in the Retail Banking Sector. In June 2003 the share of transactions initiated through CBOL was 52% compared with 40% in December 2002. The increased use of the Internet channel provides measurable benefits to the Bank through savings in other service channels.

In March a new version of CBOL was launched, with a modified graphical layout and web navigation tools, which made it even user-friendlier. The functionality of the transaction service was expanded by providing the possibility of using less common browsers, such as Mozilla or Opera. This means that the channel was opened up to a large target group. In April CBOL made another new functionality available to its customers: the Tax Office transfer option. The high standard of the CBOL service package was recognised by independent experts from the prestigious monthly "Global Finance", who recognised the service as the "Best Consumer Internet Bank in Poland 2003".

The first half of 2003 was a period rapid growth in the use of the CitiGSM service, through which the customer is provided daily reports on the balance on his or her current account or credit card account via an SMS channel. At the end of June 2003 the number of customers using the service reached 33.9 thousand, i.e. 13.5 thousand (66.2%) more than at the beginning of the year. In total, 1,480 thousand of such reports were sent in the first half of 2003.

The first half of 2003 saw intensive restructuring of the Retail Banking Sector branch network. Having analysed the profitability of each branch, it was decided to:

- transfer 6 sites to the Citifinancial network – Częstochowa, Leszno, Piła, Łódź, Bydgoszcz, Białystok
- scale down the operations of 5 sites to a Customer Service Outlet attached to a corporate branch of Bank Handlowy – Leszno, Piła, Świdnica, Słupsk, Kutno

- transfer customer service in 9 cities to another retail branch in the same city – Warsaw, Łódź, Białystok, Bydgoszcz, Tarnów, Rzeszów, Częstochowa, Siemianowice Śląskie, Będzin

- close down retail customer operations altogether in 4 cities – Ostrołęka, Siedlce, Tczew, Starogard Gdański

As a result of the above decisions, as of 28 February 2003 the operation of 12 branches of the Citibank Retail Banking Sector was terminated, and another 6 branches were moved to the developing CitiFinancial network. At the end of June 2003 the network of the Retail Banking Sector consisted of 11 CitiGold branches and 75 standard branches with 180 ATMs. In addition, customers were able to use the Euronet ATM network free-of-charge.

The first half of 2003 saw the beginning of branch reconstruction process including the provision of cash services at the existing credit centres and the expansion of the existing transaction branches. By the end of June 2003 the project involved 10 credit branches and 14 transaction branches.

At the end of June 2003 the Retail Banking Sector maintained 295.3 thousand current accounts, compared with 305.6 thousand at the beginning of the year, and the Bank's share in the individual deposit market was 2.9%. As in 2002, during the first half of the year the Bank maintained a subscription for investment deposits. For example, on 23 June 2003 the subscription for the 3-year Citibank investment deposit in PLN was opened, linked to Dow Jones Euro Stoxx 50.

The number of active Citibank credit cards increased over the reported period from 425.7 thousand to 440.3 thousand, i.e. by 3.4%. As at the end of June 2003 the Bank's share in the credit card market was 50.2% in terms of the number of cards serviced and 45.0% in terms of customer debt. On 3 February 2003 a new functionality was added to the Citibank Credit Card, with which the customers can now pay all utility bills with a credit card. The transaction is initiated through the CitiPhone call centre or through the Automatic Banker.

**Number of active credit cards (in thousands)**

| Name | System | As at 30/06/2003 | As at 31/12/2002 |
|---|---|---|---|
| Citibank Silver | Visa | 289.3 | 284,9 |
| Citibank Gold | Visa | 43.8 | 42,8 |
| Citibank-Elle | Visa | 36.9 | 35,1 |
| Citibank Silver | Mastercard | 38.7 | 34,1 |
| Citibank-Era Silver | Visa | 27.0 | 24,9 |
| Citibank Gold | Mastercard | 2.8 | 2,1 |
| Citibank-Era Gold | Visa | 1.8 | 1,7 |
| **Total** | | **440.3** | **425.7** |

The first half of 2003 saw a growing customer interest in credit products other than the credit card, offered by the Retail Banking Sector, which was largely the effect of the TV promotion campaign for Citibank Credit. Overall, during the first half of 2003, 7,347 personal instalment loans were granted, the dynamics of the process increasing month-on-month. While in January 617 loans were granted, in June the figure reached 1,926. In order to make the credit offering even more attractive to private individuals, the Bank introduced a unique, innovative feature of the Citibank Credit Line – "0% for 7 days". It makes it possible to use a revolving credit limit interest-free up to 7 days in each calendar month.

An important product innovation was the addition in May to the Bank's product range of the ING TFI S.A. investment funds. Intense work was also carried on with a view to making the investment fund offering available throughout the Bank's distribution network. In the first half of the year, the number of the Bank's branches selling investment fund units increased from 70 to 98, where 18 investment funds were available characterised by diverse investment strategies, rated among the best in the market. In the second half of 2003 the Bank plans to expand the range by selling Union Investment TFI S.A. investment fund units.

### 12.2 CitiFinancial

The first half of 2003 was a period of intense development of CitiFinancial, the Bank's business line focused on cash lending services to low-income customers and instalment loans. The CitiFinancial network increased from 4 to 11 branches situated in 8 cities, which was facilitated by the taking over of 6 branches of the Retail Banking Sector. Further expansion of the network is planned to 60 units in 2005.

Overall, during the first six months of 2003, CitiFinancial granted 6,232 new credit facilities and loans, and hence the credit portfolio increased from PLN 13,128 thousand to PLN 25,130 million, i.e. by 91.4%. Despite the increased risk inherent in lending to customers with incomes below average, the quality of the CitiFinancial credit portfolio remained during the reported period at a satisfactory level.

## 13. Asset management and investment funds

In the first half of 2003 the Capital Group of Bank Handlowy w Warszawie SA experienced further dynamic growth of its asset management business. Assets entrusted to Handlowy Zarządzanie Aktywami SA ("HanZA") increased by 20.5% from PLN 1,438.4 million at the end of December 2002 to PLN 1,733.4 million as 30 June 2003. Of the above amount, PLN 1028.3 million came from CitiFundusze, PLN 179.3 million from individual customers, PLN 494.0 million from insurance companies and other financial institutions, and PLN 31.7 million from other corporate customers. A particularly high increase of customer interest in HanZA asset management services was reported in the corporate customer segment (increase in assets by 91.0%).

The first half of 2003 was successful in terms of HanZA management results. All basic investment strategies underlying the management of customer portfolios exceeded their respective benchmarks. The best performers in the first half of this year were portfolios invested in equities. Selective portfolios produced a rate of return of 16.04%, and correlated portfolios – 14.61%.

The reported period was particularly good for the Bank's investment fund society Towarzystwo Funduszy Inwestycyjnych Banku Handlowego SA ("TFI BH"). Assets under management by TFI BH exceeded PLN 1 billion. As at 30 June 2003 the value of assets of 8 CitiFundusze was PLN 1,028,290 thousand and it increased from the beginning of the year by PLN 245,551 thousand, i.e. 31.4%. The assets of Fundusz Inwestycyjny Otwarty CitiObligacji represented more than 68% of CitiFundusze. In terms of the value of assets under management as at 30 June 2003, TFI BH ranks tenth, with a market share of 3.26%.

The effects of the growth of assets in the first half of 2003 included the improvement of accessibility of CitiFundusze. Currently the branch network of Bank Handlowy w Warszawie SA (89 branches prepared for the distribution of fund units) is the main and most effective distribution channel for CitiFundusze. The Company expects that assets under management entrusted to it will be growing at least as fast as the market. Under an optimistic scenario they will double by the end of the year.

In the first half of 2003 the bond fund CitiObligacji FIO was the most popular one among individual customers. Net assets of the fund increased over the fist six months of 2003 by more than PLN 90 million to reach PLN 684.7 million at the end of June. Over the reported period customers showed fast-growing interest in equity funds. In view of the falling interest rates, customers started seeking investments capable of generating gains exceeding interest on deposits. The assets of the balanced fund CitiZrównoważony FIO increased during the last 6 months by 72% and amounted to PLN 29.9 million at the end of June 2003. The assets of CitiAkcji FIO increased during the six months by 65% to PLN 13.2 million at the end of June.

Equity funds offered by TFI BH generated satisfactory profit. The value of the CitiAkcji FIO participation unit increased during the 6 months by 8.98% (15.08% over 12 months). The value of the CitiZrównoważony FIO participation unit increased during 6 months by 6.75% (12.90% over 12 months). With the results reported by the balanced fund CitiZrównoważony FIO it ranks third in terms of 12-month profitability and first in terms of 36-month profitability in the balanced fund group.

However, the highest rate of growth in assets among CitiFundusze was reported by CitiPłynnościowy Specjalistyczny Fundusz Inwestycyjny Otwarty. This fund is targeted exclusively at corporate entities and it is characterised by high liquidity, attractive profitability and low investment risk. CitiPłynnościowy SFIO is modelled on liquidity funds offered in many countries by Citigroup Asset Management. The fund generated great interest among customers seeking an alternative to overnight deposits. Net assets of CitiPłynnościowy SFIO increased during the last 6 months by over 422% to reach PLN 73.67 million at the end of June. The highest increase in assets was reported by the fund in May at 289.4%. The fund was then supplied with more than PLN 44 million.

TFI BH also continues to be the clear leader in the Employee Pension Programme market. As at the end of June 2003, 17 Employee Pension Programmes were registered with the Insurance and Pension Funds Supervision Commission (KNUiFE) in the form of an agreement with the CitiSenior SFIO. As a result of effective management and regular inflow of contributions, the assets of this fund rose in the first half of 2003 by over 39% and amounted to PLN 98.2 million as at the end of June 2003. The unit value increased during the past period by 4.64%.

Before the end of 2003 TFI BH is planning to expand the CitiFundusze distribution network through the co-operation with other external distributors. A significant increase in the number of new customers is expected, both retail and corporate. The company expects a high increase in customer interest in balanced and equity shares.

### *14. Pension Funds*

As at 30 June 2003 the Bank had a 50% interest in the pension fund company PKO/Handlowy Powszechne Towarzystwo Emerytalne S.A., which manages the Bankowy open-ended pension fund ("OFE Bankowy").

During the first half of 2003 OFE Bankowy experienced a net inflow of 6,886 members, owing to which the overall number of members increase to 390,629 (eighth in the market with a share of 3.5%). At the end of June 2003 the value of the assets under management was PLN 1,150,667 thousand (seventh in the market with a share of 3.0%) and it was higher by PLN 182,763 thousand or 18.9% than at the end of 2002. Bonds and T-bills prevailed (68.0%) in the fund's investment portfolio, followed by shares in companies listed on the regulated stock market (26.7%). The corresponding proportions at the end of 2002 were 63.8% and 29.6% respectively.

In the first half of 2003 the Bank negotiated the sale of its shareholding in PKO/Handlowy PTE.[1]

### *15. Insurance*

Since August 2002 the Bank has co-operated the company CitiInsurance Towarzystwo Ubezpieczeń na Życie S.A. owned by CitiInsurance International Holdings Inc.

The CitiInsurance bancassurance offering is aimed at the customers of the Retail Banking Sector and CitiFinancial and it comprises 7 products: group endowment insurance, group life insurance for credit

[1] Finally, on 11 September 2003 the Bank made an agreement for the disposal of all shared held in PKO/Handlowy PTE to the other shareholder of the Company, Bank PKO BP S.A.

card holders, group life insurance for instalment and cash loans, group life insurance for cash loans, group term life insurance for credit card and bank account holders. Two of those products were launched in the first half of 2003: "Every Day Safe" Cover for Citibank Personal Account holders and Accident Cover for Citibank Credit Card holders.

In the first half of 2003 earned premiums of CitiInsurance reached PLN 18,232 thousand. The Bank charges commission fees to CitiInsurance for acting as intermediary in the sale of the Company' products.

Also since 2002, the Bank's product range includes the Investment-Linked Life Insurance product offered together with Nationwide Towarzystwo Ubezpieczeń na Życie. The programme covers an extensive range of prime investment funds. In addition, in co-operation with CitiInsurance, the Bank offers its customers the Savings Programme with Life Insurance.

# IV. Other information

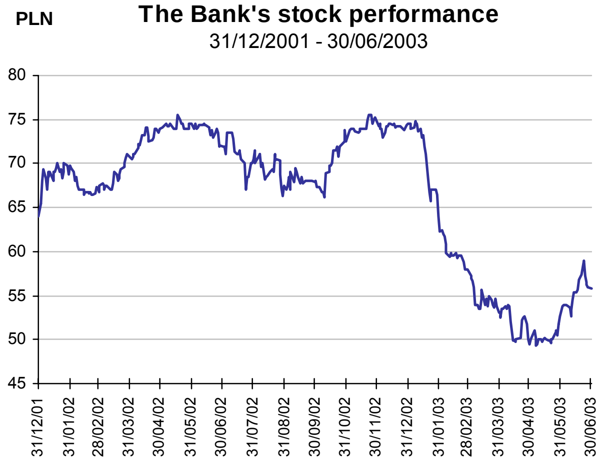
## 1. *Rating*

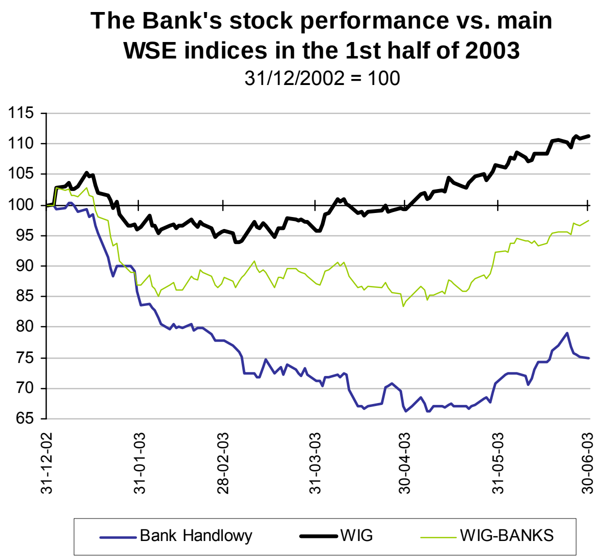
The Bank has a full rating from the international rating Agency Moody's Investors Service.

On November 12th, 2002 the Moody's upgraded the ratings of Poland (so called "sovereign rating") from Baa1 to A2 for long-term bonds and bank deposits, and from Prime-2 to Prime-1 for short-term debt securities and bank deposits. The decision was made due to the advanced process of Poland's integration with the EU. On the same day Moody's placed the Bank on the watch list with the option of upgrading the Bank's rating in relation to the increased sovereign rating.

Finally, on January 14th, 2003 the Moody's Investors Service upgraded the ratings of the Bank to A2 for long-term deposits (grade 6 from the top in the 21 degree scale for investment grades) and Prime-1 for short-term deposits (grade 1 from the top in the 4 degree scale). So the rating of the Bank appeared on the highest level from the ones available for entities domiciled in Poland.

## 2. *The Bank's stock performance on the Warsaw Stock Exchange*



In the first half of 2003 the share price on the Warsaw Stock Exchange (WSE) fell from 74,5 PLN (December 31st, 2002) to 55,8 PLN (June 30th, 2003), i.e. by 25,1%. As a comparison, in that period the main bank index of the WSE WIG-BANKI lost 2,6%, and the main index of the WSE, WIG, rose by 11,3%.

### 3. Awards and honours

In the ranking “Best Emerging Market Banks 2003” published in Global Finance Bank Handlowy w Warszawie SA was honoured as the Best Bank in Poland.

Bank Handlowy w Warszawie SA won the ranking “Złota Setka Pomorza i Kujaw” („Golden Hundred of Pomerania and Kuyavia”) in the category of Banks. In the seventh edition of that ranking this year, for the first time organized jointly by the regional newspapers “Gazeta Pomorska”, “Głos Szczeciński” and “Głos Pomorza”, the Bydgoszcz branch of Bank Handlowy was chosen as the best one by entrepreneurs from the Kuyavia-Pomerania Voivodeship.

## V. Changes in IT technology

Continuing the process of application platform integration is one of the basic work trends of the Operations and Technology Department belonging to the Commercial and Investment Banking Sector in 2003. In January 2003 the analysis of all applications functioning in the institution was carried out in order to verify the indispensability of their use in the production environment. During the process 37 applications were isolated. They were provisionally qualified as applications that were to go out of use, conducting a detailed analysis in their case was also necessary.

The following were identified within the detailed analysis:

- 22 applications to be withdrawn (with 6 withdrawn in the first half of the year);
- 12 applications to be left in the production environment;
- 3 conditionally qualified to be withdrawn depending on the possibility of substituting them by regional solutions.

The next important achievement was completion in 2003 of the implementation of the version of the Flexcube 3.9.1 system and successive modification of the Flexcube system with the view of identified needs. Among others, the following projects were realized during those works:

- implementation of the interface between the TTS factoring system and the Bills and Collections module of the Flexcube system;
- transferring the servicing of Direct Debit from the CPC system to the Flexcube system;
- implementation of the daily refinancing for the needs of management information system (MIS Refinancing)
- implementation of automatic calculation of the withholding tax on interest income earned on deposits by non-residents (WHT)
- implementation of the Anti-Money Laundering module enabling automatic control of money.

An agreement upon and closed list of expansions and modifications for the new version of the Flexcube 4.3 system was also prepared and its implementation is planned for the beginning of 2004.

Intensive works have also been conducted to shorten the process of final calculation of accounting data after end of accounting day and month in order to ensure on time delivery of indispensable files and generating needed reports. With this end in view, the new disc matrix XP1024 was implemented; this permitted significant shortening of the processing time and so for the process of:

- end of day (EOD) the time of the processing process was shortened from 8 ½ h to 6 h (by 29%);
- end of month (EOM) the time of the processing process was shortened from 10 ¼ h to 8 h (by 22%).

Overall, in the first half of 2003 the total expenditures in the field of IT in the Corporate and Investment Banking Sector amounted to 12,7 million PLN.

# VI. Major risk factors relating to the Bank's environment and operations

## 1. Environmental risk

### 1.1 The economy

The Bank's forecasts on Polish economy assume a gradual improvement of the macroeconomic situation in 2003 and return to the 4% GDP growth rate in the next years. The GDP growth shall be stimulated by the growth of domestic demand and exports. Simultaneously, inflation shall remain at the fixed low level – depicted in the average annual rate it shall not exceed 2%. That shall be accompanied by gradual, small reductions of the NBP interest rates that shall additionally stimulate economic activity and credit demand. The perspective of joining the European Union and then the Economic and Monetary Union shall attract investors, first of all encouraged by the supply of qualified workforce and low labour costs with a similar level of economic activity risk and level of technological development. Apart from the inflow of foreign investments, mainly in the form of direct investments, the growth of foreign trade turnover is also expected thanks to the opening of the European Union borders and the growth of Polish companies' productivity resulting from the flow of know-how and modern technologies. On the other hand, Polish companies shall face increased competition from union companies and that also concerns the banking sector.

The situation of the banking industry in Poland, and thus the financial condition of the Bank is integrally linked to the overall state of the national economy, and also to the conditions prevailing on local and regional markets within the country. First of all, the prolonging period of low GDP growth in Poland may result in more customers of the bank being unable to pay their liabilities to the Bank on time, which will have an adverse effect on the Bank's financial results.

Similarly, the Bank's results can be influenced by such factors as inflation, wage levels, unemployment, interest rates, performance in foreign trade and the current account balance, the size of the government deficit, exchange rate fluctuations and demographic trends. Any unfavourable changes in these macroeconomic factors, particularly a protraction of economic slowdown (implying uncertain growth associated with investment spending) or any significantly negative movements in interest or exchange rates, or a substantial fall in foreign direct investment, could have an adverse effect on the earnings and overall financial condition of the Bank's Capital Group. It should also be noted in this regard that lower interest rates, both in nominal and real terms, will promote customer interest in savings vehicles and increase of credit demand that are alternative to bank deposits.

Macroeconomic policies and the measures taken by government institutions exert a major impact on the national economy, and – directly or indirectly – on the Bank's financial performance. In this connection, it cannot be excluded that future political decisions could have an adverse effect on the Bank's financial situation.

## 1.2 Regulatory risk

Any changes in economic policies or in the legal system could have a considerable effect on the Bank's financial condition. In terms of banking sector regulation, a particularly important role is played by statute law, and by the secondary provisions issued by the Minister of Finance, resolutions of the Commission for Banking Supervision ("KNB"), resolutions of the Management Board of NBP, and regulations issued by the President of the NBP.

In terms of the regulations mentioned above, those of key significance include:

- permissible concentration of credit exposure limits (Banking Act),
- the ceiling on equity investments, measured in relation to the capital base (the Banking Act),
- liquidity and credit risk standards (resolutions of the Commission for Banking Supervision),
- calculation and maintenance of mandatory reserves (the Act on the NBP, Banking Act, resolutions of the Commission for Banking Supervision and the NBP Management Board),
- obligation to create specific provisions against irregular assets (the Accounting Act and the Banking Act), and
- taxation and similar charges.

The reforms associated with Poland's accession to the European Union that will most probably be carried out in the coming years are expected to bring about serious changes in the domestic economy that could affect the Bank's operations, financial condition, earnings and growth prospects. Poland is currently bringing its legal regulations into line with those in force in the European Union. As of October 2002, Polish citizens gained full access to financial services provided by EU financial institutions. This could cause a certain decrease in the interest shown in services offered by domestic banks, including Bank Handlowy w Warszawie SA.

Polish legislation contains provisions that govern capital flows and transfers to and from Poland. While these provisions do not at present restrict the possibility of transferring dividends and other income, such restrictions could be introduced in the event of major economic problems.

## 1.3 Taxation

Poland's tax system is subject to frequent changes, many regulations have not been drawn up with sufficient precision, and there are no clear interpretative rulings on those regulations. The interpretation of tax regulations alters frequently, and there is no uniformity in the practice of the tax authorities or in the rulings of the courts on matters of taxation. Compared to a more stable tax regime, this divergence of interpretation with respect to tax regulations generates greater risk that the operations of a Polish bank and the manner in which these are reported in tax declarations and returns could be judged to be in breach of those regulations.

One aspect of the inadequate precision that marks Polish tax regulations is that there is no provision for formal procedures constituting final verification of the accuracy with which tax liabilities have been calculated for a given period. Tax declarations and the amount of tax actually paid may be reviewed by the tax authorities for a period of five years subsequent to the taxable event. Were the tax authorities to adopt an interpretation of tax regulations differing from that assumed by the Bank, this could have a material adverse effect on the operations of the Bank, its financial condition, earnings and growth prospects.

### 1.4 Competition within the banking sector

The competition between the banks in different segments of the Polish banking market seems to be getting even fiercer, following organisational and technological development of the banks. In the Bank's opinion, competition on the market of banking services provided to large corporate customers and municipalities will be growing. Additionally, corporate entities are going to use financial alternatives to bank loans, such as issuance of short-term debt securities, bonds and equity or lease finance. Moreover, numerous banks declared their expansion plans for 2003 to the sector of small businesses and in the area of retail services, which will have a direct impact on increased competition in these areas of banking services. It is possible that due to a growth in foreign investment in the banking sector, and to the sector's consolidation process, as well as the progressive integration of Poland with the European Union the Polish banking industry shall be strongly exposed to competition from foreign institutions, particularly in such segments of the market as foreign exchange operations, foreign trade settlement and investment banking. The growing level of competition within the banking sector could have an adverse effect on the Bank's operations.

## 2. Operational risk

### 2.1 Liquidity risk

Maturity mismatches between loans and the deposits that fund them are a typical aspect of banking activity, and these occur at the Bank as well. They could give rise to potential problems for current liquidity, were there to be a build-up of large payments to customers. The management of the Bank's assets and liabilities, including the regulation and control of liquidity risk, is the responsibility of the Assets and Liabilities Committee, which maps out a strategy then implemented by the Treasury Department. There is no certainty, however, that the persistence of maturity mismatches will not have an adverse effect on the Bank's financial condition in the future.

The Bank's deposit base is stable, diversified and trending upwards. In addition, the Bank has good access to interbank funding and adequate capital. The level of liquidity risk is thus low.

### 2.2 Foreign exchange risk

The Bank performs foreign exchange operations both on behalf of its customers and for its own account, and holds open FX positions within established limits. As a result, the Bank is exposed to exchange rate risk, and there is no certainty that future movements in exchange rates will not have an adverse effect on the Bank's financial condition. The control of foreign exchange risk is the responsibility of the Market Risk Department, which co-operates in this area with the Treasury Department. The whole process of market risk management in the Bank is supported by the Citigroup Global Market Risk system from London, making, among other things, Value-at-Risk calculations for the benefit of the Bank. Additional help, from the point of view of market risk management in the Bank is provided by the principle of closing positions characterized by the non-linear risk from Citibank London. The level of foreign exchange risk is moderate, mainly due to the large scale of operations transacted, particularly in derivatives. Open FX positions do not generally exceed 10% of the capital base

### 2.3 Interest rate risk

As is the case with other Polish banks, the Bank is exposed to mismatch risk regarding the repricing of its assets and the liabilities that support them. Interest rate risk can arise where it proves impossible to offset the fall in income caused by lower rates of interest on loans through a corresponding reduction in the rates of interest paid to depositors. This risk also applies to situations where a rise in deposit rates cannot be offset by a corresponding rise in lending rates. The management of interest rate risk is one of the functions of the Bank's Assets and Liabilities Committee, which – among other things – determines principles for provisioning against various financial risks being incurred and develops the Bank's pricing policies in terms of interest rate risk. There is no certainty that future interest rate movements will not have an adverse effect on the Bank's financial condition. The present level of interest rate risk is low.

### 2.4 Credit risk

The conduct of business involving the extension of loans and guarantees is inextricably connected with the risk of payment delinquency (in terms of both loan principal and interest), and also with the risk that the asset represented by an outstanding loan or funded guarantee will prove impossible to recover. The Bank monitors its risk assets on an ongoing basis, classifies them in accordance with the relevant regulations laid down by the National Bank of Poland, and establishes all the requisite specific provisions against loans classified irregular. The Bank's Management Board is of the opinion that the current level of provisions is adequate. Additionally, in respect of a portion of loans, their risk-related classification is based on assessment of the possibility of acquiring a strategic investor for a given debtor. Therefore, maintaining high level of foreign investment may be crucial to evaluation of certain loans. Nevertheless, given the possibility of changes in the external environment, such as a deterioration in the overall economy or the emergence of other factors that could have a negative impact on the financial situation of the Bank's customers, there is no certainty that in the future the need to provision adequately against the existing asset portfolio will not have an adverse effect on the Bank's financial condition, or that the provisions and collateral in place will prove sufficient to absorb the losses possibly arising on lending activity. The present level of credit risk is moderate.

### 2.5 Equity investment risk

Decisions concerning investment activities of the Bank are made by the Management Board and the Equity Investment Committee. Equity investments can be divided into three categories: active, strategic and restructuring. Active investment aims at ensuring high rate of return. Strategic investment portfolio includes the Bank's shares in financial institutions, being of a strategic significance to the Bank due to its operations. Restructuring exposure results from operations consisting of receivables conversion into equity shares. Investments are executed directly by the Bank or indirectly via the Bank's special purpose investment vehicles. The net value of equity investments together with subordinate loans and convertible bonds financing the Bank's special purpose investment vehicles amounted at the end of June 2003 to PLN 503.6 million in comparison with PLN 589.2 million at the end of 2002. For some equity investments, the assessment is based on the assumption of finding a strategic investor for the company, in which the Bank holds shares. Therefore, maintaining a high level of foreign investment may be crucial to evaluation of such investment. Moreover, due to a number of macroeconomic effects, the situation on equity market and other factors having an impact on activities of the companies, in which the Bank is a shareholder, the selling price of owned shares may turn out lower than expected, or even lower than their value in the Bank's books, which may have a negative impact on market valuation of the Bank's shares. In 2002 and in the first half of 2003 the Bank already created considerable provisions related to its equity investment; hence the risk level connected with further drop in the value of the Bank's investment portfolio is low.

### 2.6 Risk related to the reduction of the strategic investor involvement

After the merger of Bank Handlowy w Warszawie S.A. and Citibank (Poland) S.A. on February 28th, 2001, Citigroup controls 89,33% of the Bank's authorised capital. The Bank's majority shareholder declared to scale down the size of the owned package of the Bank's shares to 75% in a term of 24 months from the date of the specified merger, with the reservation that the transaction had to be profitable. The generally known information about the planned reduction of the Citigroup share in Bank Handlowy carries the risk of share rate drop.

### 2.7 Operating risk

The Bank completed projects connected with integration of the IT systems resulting from the merger with Citibank (Poland) S.A. As a result, the Bank operations are based on two systems – corporate and retail operations. The Bank is not planning to carry out further changes in these systems, except for current modifications aiming at increased system functionality or introducing new products.

Data processing for Retail Banking Sector is performed in the data centre located in Singapore. This allows the Bank to achieve cost efficiencies, gives it easy access to technical support and allows it to adopt the most modern solutions developed by that centre. However, this increases the risk associated with the transmission of data over large distances, the potential exposure of the Bank to natural disasters that may happen in the region of South-East Asia. The Bank has security procedures (COB – Continuity of Business) in case of the occurrence of such threats – e.g. it has reserve capacities at its disposal in the Clearing Centre in Olsztyn and in other locations, which guarantee maintenance of the institution's functioning.

The overall level of operating risk is low.

### 2.8 Legal risk

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

### 2.9 Contribution to the Bank Guarantee Fund

Pursuant to the Act on the Bank Guarantee Fund, the Bank is included in a mandatory deposit protection scheme for personal deposits. Banks included in this scheme are required to make specified payments to the Fund.

Due to the generally worsening situation within the banking sector, or the failure or financial distress of one of the participating institutions, it might prove necessary for the Bank and other participants in the Bank Guarantee Fund to make large payments to the Fund, in proportion to the sums held within the individual deposit protection funds established at given institutions. This could have negative repercussions for the Bank's earnings.

# VII. Prospects for the business development of Bank Handlowy w Warszawie SA

## 1. General objectives of the Bank's development

The Bank's objective is to increase systematically shareholder value by ensuring an appropriate return on equity and maximising the value of the institution and its business relationships. The integration between Bank Handlowy w Warszawie SA and Citibank (Poland) S.A. was completed in March 2003. *Inter alia*, the product offering and customer service standards have been uniformed, technological and operational processes has been changed and uniform brand Citibank Handlowy has been introduced. In the same time, the Bank's involvement in Citigroup, the largest financial institution worldwide, will allow it to compete effectively in all market segments and to gain new groups of customers. In 2002 the bank increased its customer base, among other things, due to the expansion of services rendered to small businesses and private individuals with low income (CitiFinancial). In the years to come, the Bank's intention will be to continue active acquisition of new customers from all market segments, with a particular emphasis on the area of retail banking.

In the medium term, the Bank will be striving for a double-digit market share, as measure by its share in the net income from banking activity generated by the banking sector. In the first half of 2003 this share stood at 7.1%. This increase in market share is to be attained by maintaining the Bank's leading position in servicing corporate clients, treasury operations, private individuals with the highest income (Private Banking), and also by enhancing the Bank's position in servicing small and medium-size enterprises, financial institutions and retail banking for medium-income customers. The Bank is planning to develop dynamically the newest business areas, i.e. services for small businesses (the *Inter Biznes* offer), cash loans for private individuals of low income (CitiFinancial) and life insurance (co-operaiton with CitiInsurance).

Simultaneously, the Bank will place special emphasis on efficient cost management policy. The Bank's share in general expenses of the banking sector in the 1st half of 2003 amounted to 6.9%. In the years to come, the Bank is planning to maintain high discipline of costs management, so that cost/income ratio remains constantly at the level below 50%.

An additional goal consists in increasing the lending activity. The Bank enjoys high level of own funds that may be used for that purpose, which will lead, *inter alia*, to a decrease of the Bank's capital adequacy ratio. In the longer term the Bank plans to achieve a typical Citigroup level of Return on Owners' Equity (ROE) ratio which is approx. 20%. In 2002 this ratio amounted to 4.1%

## 2. Banking services to corporate and institutional customers

Bank Handlowy w Warszawie SA is a leader on the corporate banking market in Poland. Its share in the corporate lending market (loans for private and state-owned companies as well as co-operatives), as at the end of June 2003, reached 10.0% as compared to 9.7% at the end of 2002 (third place in the sector), whereas the share in the corporate deposits market amounted to 15.6% as compared to 15.5% respectively (first place). The Bank's share in corporate debt origination market amounted to 21.0% at the end of June 2003 as compared to 22% at the end of 2002 (first place).

During the first half of 2003 the Bank continued works on introducing a new, more effective model for servicing corporate customers. This model will be gradually implemented in all the Citigroup regions. As a consequence of introducing the new Customer Coverage Model, the product offering for big and medium-size domestic enterprises with high growth potential will be broadened. The service provided to the group of the biggest Bank's customers will be fully customised.

The Bank's potential customer base in the area of corporate banking includes all companies operating in Poland, except for those belonging to sectors lying outside the Bank's target market due to the policy of Citigroup or included on restriction lists as a result of sanctions imposed either by international organisations or the US government, however, active soliciting will be undertaken only in the case of customers with annual sales revenues exceeding USD 100,000.

The Bank's position is particularly strong in handling international corporations and the largest Polish companies. Moreover, it is the foremost institution in handling money market and foreign exchange transactions. The Bank's goal is to retain its present market share in these areas. In developing relationships with the largest customers, the Bank has the powerful advantage of being part of Citigroup. The Bank will be able to accommodate the financial needs of these customers by offering unique services that blend its own knowledge of the domestic business environment with the international experience and global reach of Citigroup. Simultaneously, the Bank will expand its financial consulting services offered to the Bank's customers.

The Bank also holds a strong position in handling other segments of corporate and institutional clients, as well as financial institutions. The Bank's goal is to achieve a double-digit market share in these customer groups within a time frame of three years.

Loans will remain the key product group sustaining the Bank's relationships with customers, although a majority of revenues will be generated from cash management, trade finance and treasury products. The specific solutions and innovations in these product groups will be the key factors behind the Bank's competitive advantage, especially in relation to the most demanding international customers, leading local corporations and financial institutions. The Bank will also aim at utilising to a greater extent the potential for sale of these products in the SME segment.

The Bank will also continue to market its services actively to the small business sector that includes companies with revenues from sales below USD 1 million. The Bank intends to be one of the top five institutions servicing this market segment in the next three years. These customers will be serviced through all the consumer and corporate Bank branches and via remote distribution channels.

Investment banking services are to be made available through close co-operation between Bank Handlowy w Warszawie SA and Citigroup Global Markets (former Salomon Smith Barney). This will allow to offer servicing of large-scale international transactions as well as services to smaller domestic companies.

### 3. Retail banking

Retail banking services are considered to possess high growth potential in medium term.

Bank Handlowy w Warszawie SA is a medium-sized player in consumer banking. The Bank's share in lending to private persons totalled 2.1% at the end of the first half of 2003 as compared to 2.2% at the end of 2002, whereas in deposits the market share in the first half of 2003 remained at the level of 2.9%, which places the Bank at the bottom of the first ten in the sector.

Parallel to the wide product range for private individuals, the Bank specialises in credit cards. The Bank's market share in this segment remained stable, maintaining at the level of approximately 50%. Another area of the Bank's specialisation, in which it has a strong position, is rendering services to high-income private individuals through the network of CitiGold outlets. Private Banking services offered to well-to-do private individuals are available worldwide, which distinguishes the Bank among its competitors.

Over the next three years, the Bank plans to double its market share in retail banking segment, measured by the amount of revenues. The Bank's target is to capture a double-digit share of the market. The Retail Banking Sector will concentrate its efforts on the acquisition of customers with above-average and high incomes (over PLN 1,500 gross monthly), living in cities over 100,000 inhabitants. The Bank's product offering has been tailored to suit the expectations/requirements of this customer profile.

In 2002 the Bank began to grant cash loans to low-income customers, but this activity has been separated from other business areas, and is conducted under the CitiFinancial brand, the part of Citigroup specialising in lending activity to this group of the Bank's customers. The Bank anticipates dynamic growth of this activity.

One of the Bank's key goals is to further strengthen its position among the highest income customers. In the first half of 2003 the customers, who possess investment funds in the amount of at least PLN 100,000 were offered new services under the *CitiGold Wealth Management* brand. The most important highlight of the wealth management service is the savings and investment plan including investment, insurance and banking products. The products available under *CitiGold Wealth Management* package include current accounts, term deposits, investment deposits and two-currency deposits, investment funds, treasury bills and bonds. The customer funds management shall be based on personalised investment portfolio creation according to individual customer's needs and preferences. Poland is the first European country where Citigroup introduced its *CitiGold Wealth Management* service.

Moreover, the offer addressed to medium-income customers holding *CitiOne* or *CitiKonto* accounts is expanded. Except for developing traditional deposit services and increasing transactional functionality of the accounts, the emphasis will be placed on extending investment and insurance offering. The Bank will expand systematically its investment fund offering (*CitiFundusze*) together with the increasing customers' demand for new ways of depositing their savings. Sales of life insurance in co-operation with CitiInsurance will be actively pursued, based on co-operation with CitiInsurance Towarszystwo Ubezpieczeń na Życie, a company that belongs to Citigroup.

From the product perspective, a key goal for the Bank will be maintaining its strong position on the credit cards market, whose worldwide leader is Citigroup. New types of card will be made available and loyalty programmes introduced. The target group, to which the Bank will offer its cards, will be expanded.

## 4. Distribution network

At the end of 2002 a new trademark of the Bank have been introduced: Citibank Handlowy. It is valid for the whole Bank that had been known in the corporate banking sector under the Bank Handlowy w Warszawie S.A. brand, and in the retail banking sector under the Citibank brand. The change of the branding will gradually take place until the end of 2003. As a result a uniform visual identity of the Bank will be achieved, which will increase the recognition of the whole institution among the customers (who frequently perceived the two divisions as separate entities) and generate savings by reduced marketing expenses.

The Bank's present distribution network consists of outlets, banking consultants for corporate banking, direct sales agents for retail banking and remotely operated distribution channels, such as Internet banking, direct banking, call centre, IVR (interactive automatic telephone service) and multi-functional ATMs.

Evolution of the Bank's distribution network takes into account plans of increasing the scope of activities in retail banking and the synergies achieved with the corporate bank. The priority is to increase functionality and accessibility of remotely-operated distribution channels and further enhance the capabilities of banking consultants, in particular these handling large entities that report their demand for more sophisticated financial products. In case of retail banking great emphasis will be placed on further growth of the Internet usage (Citibank Online platform). Currently more then half of the transactions is carried out using this transaction channel. As a target, the Internet is to become basic source of conducting transactions for private individuals.

In the coming years the Bank will slightly change the functional scope of the corporate outlets and gradually expand the CitiFinancial network. As of the end of June 2003 the corporate bank had 27 branches and 31 affiliated branches. Retail customers had 86 branches (including 11 branches offering also CitiGold services) and 11 CitiFinancial branches at their disposal. Private individuals are also serviced in selected corporate branches (18 outlets). Small businesses will be serviced at all retail and corporate banking branches. In the case of corporate and *CitiGold* customers, the mainstay of the distribution network will be relationship managers.

High functionality and high quality of access to call centre are maintained. For private individuals and small businesses, these services will be integrated at one call centre, with a single access number. This centre will handle individual *CitiKonto* customers, small businesses, *CitiConnect*, and the brokerage services of DMBH, and will provide a general helpline for the Bank. CitiGold customers use a separate call centre CitiPhone Gold. Telephone services to large and medium-sized companies and institutional customers will remain partly decentralised, at the level of 8 regional branches.

## 5. Synergies

Wide-ranging experience and diverse operations provide Bank Handlowy with strong competitive leverage and allow it to offer customers comprehensive solutions by taking advantage of the opportunities afforded by synergies between corporate and retail banking, between banking services, asset management and brokerage services, and also between banking products and insurance.

Packages of deposit and loan products are offered to the staff of the largest corporate customers (Bank@Work project). A typical package of this type will include personal current accounts (e.g. CitiKonto) together with payroll support facilities, credit cards, mortgage loans and cash advances. In addition to pricing incentives, in justified cases the Bank will be prepared to install an ATM on site at the company or open a branch office there.

The Bank will also continue to sell corporate products to its retail customers from the CitiGold sector. Specialised Treasury products, brokerage services and asset management facilities will be particularly offered. All groups of retail customers will further be offered investment products, in particular participation units in *CitiFundusze*. The product range of *CitiFundusze* will be systematically expanded, adequately to new demands of the customers. Expertise in this scope will be provided by Handlowy Asset Management company, supported by the Treasury units in Poland and internationally.

Synergy will be also enhanced by introduction of the unified logo for the whole institution. Promotional campaigns run for one part of the Bank will automatically have a strengthening effect on the image of its other parts. The new logo – Citibank Handlowy – will be coherent, both in terms of its visual effect and sound, with the names of other companies and business lines belonging to the Citigroup holding operating in Poland, as well as with CitiInsurance and CitiFinancial.

Moreover, the transfer of settlements of Citigroup companies operating in the EU countries and in Central and Eastern Europe to the Clearing Centre of the Bank in Olsztyn is considered to be performed over the next year.

## 6. Model corporation

The Bank aspires to be a model corporation in Poland, with a strong sense of social responsibility. The Bank will actively support various cultural, educational and philanthropic activities – both at the national level and in local communities, especially through the Kronenberg Foundation. Moreover, the Bank will actively participate in the dialogue between the state authorities and business milieu about regulations that influence the climate and conditions of conducting business activity in Poland.

Signatures of all members of the Management Board

| Date | Name | Position | Signature |
|---|---|---|---|
| 24.09.2003 | Sławomir Sikora | President | |
| 24.09.2003 | Wiesław Kalinowski | Vice President | |
| 24.09.2003 | Philip Vincent King | Vice President | |
| 24.09.2003 | David J. Smith | Vice President | |
| 24.09.2003 | Sunil Sreenivasan | Vice President | |