

Czech University of Life Sciences Prague

Faculty of Economics and Management

Department of Economics



Bachelor Thesis

Financial Analysis of Erste Group Savings Bank and its influence on the Central and East European market

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CZECH UNIVERSITY OF LIFE SCIENCES PRAGUE

Faculty of Economics and Management

BACHELOR THESIS ASSIGNMENT

Ledion Mihilli

Economics and Management

Thesis title

Financial Analysis of Erste Group Savings Bank and its influence and standing on the Central and East European market

Objectives of thesis

Objective of this thesis is to financially evaluate Erste Group Savings Bank and its influence and standing on the Central and East European market.

Main objective of the theoretical part of this thesis is to write quality literature and to determine the main strengths and difficulties that the private savings bank “Erste Group” has and faces to.

Main objective of the practical part of this thesis is by gaining data to evaluate and assess the differences between Erste Group and the other operating competitors in the Central and East European region. This information will help to evaluate where the oldest private savings Austrian bank with its international branches including Czech Republic stand on the market, the pattern of banking deposits and behavior of depositors and whether countries that are more integrated with liberalized financial systems have seen a greater rise in co-dependence in their banking systems and using the Erste Group data as a parameter for conducting an evaluation of it.

Methodology

Theoretical part will be described from specialized financial annually reports and books related to the concerning study and internet sources. The literature review will be done by using the methods of: abstraction, induction, deduction and synthesis.

Practical part of this diploma thesis will be based upon economic data evaluation and gathering. That evaluation will compare data of the Erste Group with other banks operating in the Central and East European region such as: growth evaluation, marketplace, financial gains and losses, pattern of banking deposits and rates of return analysis.

The proposed extent of the thesis

35+

Keywords

Erste group, banking, deposits, Central Europe, consumer behavior

Recommended information sources

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Declaration

I declare that I have worked on my bachelor thesis titled " Financial Analysis of Erste Group Savings Bank and its influence on the Central and East European market" by myself and I have used only the sources mentioned at the end of the thesis. As the author of the bachelor thesis, I declare that the thesis does not break copyrights of any third person.

In Prague on 3 March 2016

Ledion Mihilli

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I owe my deepest gratitude to my thesis supervisor Ing. Petr Procházka, MSc, Ph.D. for his patience and his immense support, careful guidance and encouragement. I am also deeply indebted to my parents for their unconditional support in my academic efforts.

Finanční analýza Erste Group spořitelny a její vliv na trhu střední a východní Evropy

Financial Analysis of Erste Group Savings Bank and its influence on the Central and East European market

Souhrn

Erste Group je jeden z největších poskytovatelů finančních služeb ve střední a východní Evropě. Hlavním cílem mého studie byl vyhodnotit pozici této bankovní společnosti a její postoj na trhu CEE.

Analýza byla rozdělena do dvou částí: strategická analýza, která sjednocuje interní a externí analýzy a finanční analýza, která byla provedena s použitím indikátorů jako výkonnost na trhu, ziskovost a výhled růstu.

Shromážděná sekundární data v období 2005 až 2015 byla analyzována a použita k prověření Rentabilita aktiv (ROA), Návratnost vlastního kapitálu (ROE), Návratnost kapitálu (ROC) z hlediska dlouhodobé perspektivy.

Geografická segmentace této společnosti byla zkoumaná tak, aby společnost měla vliv na trzích Střední a Východní Evropy a dosahovala správných výsledků během svého působení.

Z výsledků těchto analýz vyplývá, že Erste Banka si udržuje konstantní pozitivní přítomnost ve finančním sektoru s pozitivními parametry. Také se jim podařilo získat prémii na kapitálových nákladech, která je udržovatelná v dlouhodobém horizontu.

Udržitelný růst a schopnost rozšířit kapitál pod jejich vedením je důkazem toho to, že Erste Group má silné předpoklady k pozitivnímu výhledu a k rozšíření a expanzi dalších poboček v jiných rozvojových zemích.

Klíčová slova: Erste group, bankovníctví, vklady, střední Evropa, chování spotřebitelů

Abstract

Erste Group is one of the largest financial services providers in Central and East Europe. The main objective of the study was to evaluate the position of the banking group and its stance on the CEE market. The analysis was structured on two divisions; the strategic analysis which was evaluated through internal and external analysis and financial analysis which was done by using indicators as performance on the market, profitability and growth outlook. The collected secondary data of time period 2005 to 2015 was analyzed and used to examine Return on Assets (ROA), Return on Equity (ROE), Return on Capital (ROC) on the long term perspective. The Group's Geographical segmentation was examined to gain proper results on its influence on the CEE markets. The results of the analysis revealed that Erste Bank has maintained a constant positive presence on the finance sector with positive parameters and has been able to earn premium on capital costs that is sustainable over the long term. The sustainable growth and its capability to extend the capital under its management reinforce that Erste Group has strong premises for a further positive outlook and enlargement and extending its branches in other developing countries.

Keywords: Erste group, banking, deposits, Central Europe, consumer behavior

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List of Abbreviations

EG	Erste Group
ECB	European Central Bank
BCR	Banca Comerciala Romana S.A.
EBRD	European Bank for Reconstruction and Development
CEE	Central and Eastern Europe
CZ	Czech Republic
EU	European Union
AT	Austria
SK	Slovakia
HU	Hungary
HR	Croatia
SWOT	Strength; Weakness; Opportunity and Threats
PESTEL	Political, Economic, Social, Technological, Environmental, Legal
FIFO	first-in, first-out
LIFO	last-in, first-out
SFAS	Statement of Financial Accounting Standards
UHNWIs	Ultra High Net Worth Individuals
EBA	European Banking Authority
ICAAP	Internal Capital Adequacy Assessment Process
GDP	Gross Domestic Product
ERM	Enterprise-wide Risk Management
ROE	Return on Equity
ROC	Return on Capital
ROA	Return on Assets

Chapter One

Introduction

1.1 Statement

Erste Group Bank AG (Erste Group) headquartered in Vienna, Austria is consistently one of the largest financial services providers in Central and Eastern Europe (CEE).

It actually serves to more than 16.2 million clients in 2,700 branches in 7 countries. Its branches include countries like: Czech Republic, Hungary, Slovakia, Romania, Croatia, Serbia and Ukraine. In the core markets, the group is well positioned to benefit from the medium- to long-term growth opportunities in the eastern part of the European Union and Austria. The strive of the group is to offer the customers – private individuals, professionals, SMEs and large corporate customers, suitable and transparent modern financial products and bank services. Especially in Austria, the Czech Republic and Slovakia, a lending growth was seen, driven by increased demand already in 2014. In Hungary, recent developments make it possible to leave the past behind. As the government and the European Bank for Reconstruction and Development (EBRD) signed an agreement in February 2015 designed to strengthen the financial sector and providing, among other things, for a gradual reduction of Hungarian banking taxes from 2016, Erste Group invited the Hungarian government and the EBRD to acquire shares in Erste Bank Hungary. It is seen with confidence that the Erste Group will be able to earn a premium on capital costs that is sustainable over the long term even though the steady rise in capital requirements is not exactly helpful. (Erste Group, Final Report 2014)

1.2 Background and Rise to Prominence

Its history goes as far as 1819 when the Viennese priest Johann Baptist- Weber and a consortium of philanthropic-citizens found what was the first Austrian Savings Bank at the time with the aim of helping poor people save money and gain financial independence.

This is where it all started. Open only for a few hours on two days of the week, the St. Leopold church in the 2nd Viennese district is where the less affluent come to deposit or withdraw their hard-earned cash.

From the very beginning the bee, an old symbol for saving and frugality, is used to promote the Savings Bank slogan "work, collect and increase". It can still be found on our main building in the first district in Vienna.

Over time, the savings bank idea spreads from Austria to other parts of Austro-Hungarian empire and beyond. After the war, the economy slowly gains momentum again and in the 1960s Erste modernizes its entire organisation. The computer comes to stay. The 1970s see a change in consumer habits. Austria becomes one of the richest countries in the world and people want to not only save their money, but also to spend it. A change in the savings banks law allows "Die Erste" to become a general bank. Expansion begins, even beyond the Austrian border. In 1997 Erste Bank starts its expansion into an area where its predecessors, then independent savings banks, had already gone in the past. First Hungary, then the Czech Republic, later Croatia, Slovakia, Serbia and even Romania and Ukraine become markets for the group. In each country Erste acts as an international brand with strong local ties. Erste Bank acquired a majority stake of 52.07% in Česká spořitelna, the biggest retail bank in the Czech Republic. The acquisition was another important step in Erste Bank's strategy to become the leading retail bank in Central Europe. Erste Bank became the majority shareholder (87.18%) of Slovenská sporiteľňa in the Slovak Republic. The acquisition of the largest Slovak bank was a logical further step in the strategy of the enlarged internal market in Central Europe. Erste Bank bought 61.88% of Banca Comercială Română S.A. (BCR), the biggest bank in Romania. With a little over 2.8 million customers and 12,000 employees, the Bank is an ideal addition to the existing Erste Bank network in Central and Eastern Europe. In the last years Erste Bank also built up and increased the presence in Hungary, Croatia and Serbia. In 2008, separation of the Holding and Erste Bank Österreich took legal effect. The registered company name of the Holding is "Erste Group Bank AG". Ever since, the registered company name of split-off Erste Bank Österreich is "Erste Bank der österreichischen Sparkassen AG". Like everything in life also businesses and companies are part of the undergoing evolutionary process. Social, economical and cultural environments change constantly and the group is determined to adapt to these changes. The constant updates and developments represent who the group is,

how they do business and how they want their customers to experience banking with them.
(Erste Group History Timeline)

1.3 Objectives

Main objective is to financially evaluate Erste Group Savings Bank and its influence and standing on the Central and East European market.

Main objective of the theoretical part of this thesis is to write quality literature and to determine the main strengths and difficulties that the private savings bank “Erste Group” has and faces to.

Main objective of the practical part of this thesis is by gaining data to evaluate and assess the differences between Erste Group and the other operating competitors in the Central and East European region. This information will help to evaluate where the oldest private savings Austrian bank with its international branches including Czech Republic stand on the market, the pattern of banking deposits and behavior of depositors and whether countries that are more integrated with liberalized financial systems have seen a greater rise in co-dependence in their banking systems and using the Erste Group data as a parameter for conducting an evaluation of it.

1.4 Structure and Methodology

This section deals with explaining the methods of data collection, financial analysis and performance factors that were used to determine the Erste Group financial performance. Micro analysis of Financial Statement, Profit and Loss account and Balance Sheet Account of the Erste Group Savings bank was undertaken to gather the required information.

Secondary data was used for the purpose of detailed analysis and was collected from the annual reports of Erste Group throughout the years. To evaluate its standing on CEE market data from other eligible competitors were collected and used to determine the market positioning of the EG and its international branches. The Annual reports published by EG in from 2005 until 2015 were used for the data collection of this process. The methods of comparison, data research and other adequate evaluation techniques were used.

1.5 Erste Group at Glance

46,000 employees serve 16.2 million customers with approx. 2,700 branches in 7 countries in the eastern part of the EU

- One of the leading financial providers in the eastern part of the EU
- Among the Top 3 banks in its core markets in CZ, AT, SK, RO, HU and HR
- Innovation leader in retail banking in the home (Erste Group General Presentation)

1.5.1 Austria Head Offices

The group operates under Erste Bank der oesterreichischen Sparkassen AG name in the Austrian Market. With 955 branches inside Austria, EG serves to 3.5 million customers. The retail deposits in the market are at the 18.4 percent of the total market and share and the retail loans are at 19.2 percent of market.

1.5.2 International Branches

EG branches are spread in Central and Eastern Europe. It's branches are as following:

1. Mezőbank in Hungary from 1997
2. Česká spořitelna in Czech Republic from 2000
3. Slovenská sporiteľňa in Slovakia from 2000
4. Bjelovarska banka, Trgovačka banka, Čakovečka banka and Riječka banka operate in Croatia from 1997
5. Novosadska banka in Serbia from 2005
6. Banca Comercială Română in Romania from 2005
7. Bank Prestige in Ukraine from 2007

Figure 1: Erste Group, its positioning in 7 countries



Source: Annual Report 2014, Erste Group

Chapter 2

Strategic Analysis

2.1 External Analysis

To be able to determine the most appropriate strategies it is essential to identify from the outset the boundaries of the territory in which the EG has decided to act. It is probably also necessary to draw a map identifying the different areas within these boundaries so as to understand their various features, keeping in mind the space-time coordinates. To not be underdetermined is, that the original environment will be subject to modifications over time.

The external factors that the company must deal with are as follows:

1. details of the environment in which the group is operating
2. the Banking sector
3. the competitors
4. the purchasing behaviour of potential customers.

Analysis of these external factors it enables , on the one hand to increase the required knowledge of the target market and on the other hand to compare the resources of the EG with those available in the proper banking sector.

The external environment has two aspects: the macro-environment that affects all companies and a micro-environment that affects only the firms in a particular industry like the finance and banking industry.

2.1.1 Porter's Five Forces

Michael Porter developed the Five Forces Model in 1989 and it is one of the most widely used strategic models for determining rivalry and competition within the financial industry. The model analyses consumers, suppliers, new entrants on the market and substituted products and how these forces are affecting rivalry.

The model identifies three factors in the chosen industry and determines the possible profitability (Strategic management concepts, David, 2011)

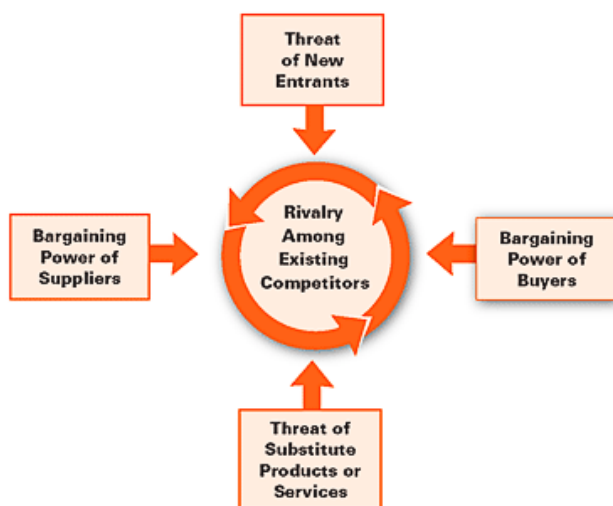
1. Identify key aspects or elements of each competitive force that impact the firm.

2. Evaluate how strong and important each element is for the firm.
3. Decide whether the collective strength of the elements is worth the firm entering or staying in the industry.

The model is widely used to evaluate and gain understanding of the financial industry in which the EG is operating (Porter M. E., 1999). This model was chosen because the outcomes provide the researcher with the drivers of the competition and profitability influencing the competition in long and medium run (Porter, 2008), which the researcher needs to find out and consider for formulation of the conclusions and recommendations. As well as, because the Five Forces Model is widely used by management consultants, businesses journalists and finance strategists. To mention some criticism, according to Steve Denning, leadership and management writer, the model should be re-examined and the whole focus of the company's strategy should not be only based on the competitor's position (Denning, 2012).

Figure 2: The Five Forces Model

The Five Forces That Shape Industry Competition



Source: Harvard Business Review

2.1.2 Pestel Analysis

To undertake a Pestel Analysis is needed the assessment of the following factors:

1. Analysis of banking industry environment
2. Analysis of market size

3. Analysis of competition
4. Analysis of financial products and services
5. Location assessment
6. Evaluation of possible distribution channels

A deeper understanding of the total market is achieved through this analysis. (8th Portorož Business Conference, Strategies of small specialized bank entering the Ukrainian Market, 2006)

An analysis of Austria as an operating country, can determine the conditions in which the Erste Group operates inside the country.

Table 1. Pest Analysis for Austria

Social , cultural and demographic	Technological	Environmental	Economic and market issues	Political /legal institutional
A strong movement to protect the environment has been formed in the 1970s. The green party was born in that period. The large majority is for strong environmental regulation.	Austria has excellent research in some areas, such as mathematics or physics.	Austria's priority after the World War II was the reconstruction of the country. As early as the 1970s, it has been recognised that human intervention has lasting negative effects on the environment.	Austria could not avert the effects of the financial crisis. Nevertheless, it did recover slightly better than other countries – its annual GDP growth is about 2 %. The crisis is still ongoing and there is no indication that any structural, systemic changes to prevent similar crises are under way.	Austria has been politically stable for decades and will remain so for the foreseeable future.

Source: National Innovation System Study, PESTLE & SWOT Analysis – Austria, p.7, 2012)

2.2 Internal Analysis

The two best indicators of how well a company's strategy is working are (1) whether the company is achieving its stated financial and strategic objectives and (2) whether the company is an above-average industry performer. Persistent shortfalls in meeting company performance targets and weak performance relative to rivals are reliable warning signs that

the company suffers from poor strategy making, less-than-competent strategy execution, or both. Other indicators of how well a company's strategy is working include the following:

1. Trends in the company's sales and earnings growth.
2. Trends in the company's stock price.
3. The company's overall financial strength.
4. The company's customer retention rate.
5. The rate at which new customers are acquired.
6. Changes in the company's image and reputation with customers.
7. Evidence of improvement in internal processes such as defect rate, order fulfillment, delivery times, days of inventory, and employee productivity.

The stronger a company's current overall performance, the less likely the need for radical changes in the long term strategy. The weaker a company's financial performance and market standing, the more its current strategy must be questioned and put under review. (Internal Situation Analysis, p.73)

Table 2. Performance of the Erste Group share versus indices*

		Erste		Stoxx
Since IPO (Dec 1997		73.6%	65.6%	
Since SPO (Jul		10.4%	77.1%	-46.5%
Since SPO (Jan		-57.3%	-44.6%	-64.5%
Since SPO (Nov		-33.7%	-17.1%	-40.9%
2014		-24.1%	-15.2%	-4.9%

* IPO ... initial public offering, SPO ... secondary public offering.

Source: Erste Group. Annual Report 2014

2.2.1 Vision Statement

It is planned to consolidate Erste Group banks' card business operations to the single EGCP entity, in which it will be provided reliable, secure and cost-effective card processing services to all banks.

Primary goal remains to be a trusted partner to card business in all EGB and MBNet banks, supporting their payment strategy and constantly improving it.

2.2.2 Mission Statement

Accessibility- Providing access to financial services without discriminating has been the heritage since the group's foundation in 1819. The goal of Erste Group is to provide access to all those seeking advice on how to make better decisions in their money-lives and better up their financial administration.

Simplicity- The ability to sell products customers understand. This does not mean that our products or services are in any way primitive. To understand exactly what the intentions and problems of the customers are. Understanding the need for simplicity leads to integrity: which acting in the interests of the customers remains a priority of the Erste Group.

Independence- The creation of wealth is the purpose of EG banking model. Individuals should have the chance to be able to stand on their own feet and financially stable. They should have opportunities to make free and independent decisions on each situation that appears. EG will further improve the independence of the customers by fostering financial literacy. **Growth-** Growth remains a principle of the wealth creation model – especially in times like these. There are limits to growth. But beyond every limit there are new opportunities which the group focuses to use. Resources are limited, human creativity is not. Ideas are boundless and the combinations of ideas are unlimited and the use of creative ideas is a base of the corporate identity. Growth does not necessarily mean “more”. Growth also can mean “better”.

2.2.3 Assets

Erste Group assets stand at the value of EUR 202.6bn and the total equity of the company stands at EUR 14.0bn.

It's main shareholders are:

20.1% ERSTE Stiftung direct & indirect

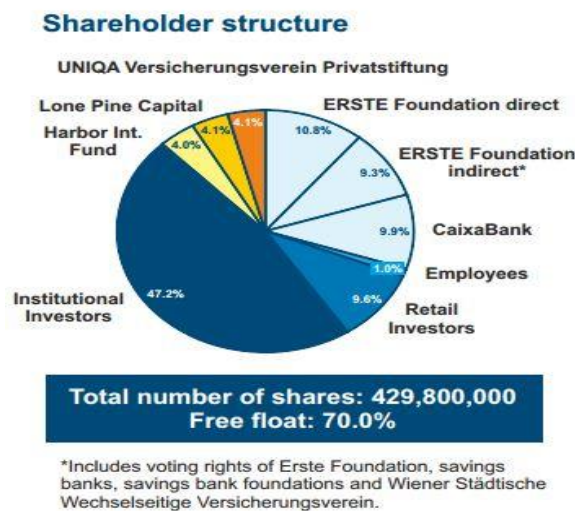
9.9% Criteria Caixa Corp, S.A.

9.6% Retail Investors

4.1% UNIQA Versicherungsverein

- 4.1% Lone Pine Capital
- 4.0% Harbor Int. Fund
- 1.0% Employees
- 47.2% Institutional Investors

Figure 3: Structures of shares in %



Source: Erste Group Factsheet

To be taken under consideration are the expenses. These noncash expenses reduce net income but do not affect cash, so they are added back to net income in order to arrive at cash from operations. Depreciation and amortisation declined to EUR 466.1 million (EUR 517.7 million) (currency-adjusted: -1.5%). The line item other administrative expenses included deposit insurance contributions in the amount of EUR 87.6 million (EUR 77.2 million). The line item depreciation and amortisation included the straight-line amortisation of intangible assets (i.e. customer relationships) in the amount of EUR 37.0 million (EUR 65.2 million).

The headcount increased slightly by 0.9%, partly due to the expanded consolidation scope, to 46,067; average headcount went down to 45,996 (46,843)

Table 3: EG total assets through the years

EUR million (unless otherwise stated)	2006	2007	2008	2009	2010
Balance sheet					
Total assets	181,703	200,519	201,441	201,710	205,938
Loans and advances to credit institutions	16,616	14,937	14,344	13,140	12,496
Loans and advances to customers	97,107	113,956	126,185	129,134	132,729
Risk provisions for loans and advances	-3,133	-3,296	-3,783	-4,954	-6,119
Securities, other financial assets	41,009	42,404	39,238	40,298	39,957
Other assets	30,104	32,518	25,457	24,092	26,875

Source: EG Annual Report, 2010

Erste Group has its own subsidiary on Asset Management named Erste Assets Management. The EAM subsidiary company ERSTE-SPARINVEST KAG was founded in 1965. With a fund volume of 33.1 billion Euros (per 31 March 2015), ERSTE-SPARINVEST is both the largest investment company in Austria and the largest subsidiary company of Erste Asset Management.

RINGTURM KAG was established in May 1988 and manages a fund volume of approximately 5.1 bn euro in both special and mutual funds (31 March 2015). In 2009 RINGTURM KAG became a subsidiary of EAM (95 per cent) and VIENNA INSURANCE GROUP AG Wiener Versicherung Gruppe (5 per cent). The company pursues a conservative, risk-minimising investment style with all its products.

2.2.4 Corporate Values

Erste Group determines its corporate values through its attitude, culture, principles and actions. Establishing a modern financial culture to support the creation of wealth is essential. The model for creation of wealth is based on four principles: Accessibility, Simplicity, Independence, Innovation.

Combination of profitability and legality is the key to Erste Group principles of a successful and solid corporate.

2.3 SWOT Analysis

Important decisions are to be made every day by each one of us. There are times when we have to make a quick judgment, and we will base those decisions on the information we have available at each moment. Yet, there are other times when we have to look at lots of other different factors available, and this is one of the times when we need to use a SWOT

analysis. Many people wrongly assume a SWOT analysis is only relevant for businesses and organizations alike, but it can be invaluable for individuals and even for team building. There is another benefit from completing a SWOT analysis, and this is when you complete the analysis on behalf of your competitors. (The SWOT Analysis Using your Strength to overcome Weaknesses, Using Opportunities to overcome Threats, Lawrence G Fine, 2009) SWOT is an acronym which stands for Strength; Weakness; Opportunity and Threats. SWOT is used to assess a business or a proposition. This shouldn't be restricted to a business you own, but also to use it for your competitor's business.

Figure 4: SWOT Analysis



Source: A SWOT Analysis of Ford Motor Company Stock, Daniel Miller, 2015

From a strategic point of view, Erste Group is highly dependent on the economic development in the CESEE region. In meantime, the worst part of the economic crisis is over now in the CESEE. (Erste Group SWOT Analysis Publication) For businesses who are involved in research, a SWOT analysis again is crucial as the results are recorded and “White Papers” are written. Economic forecasts are also important factors to be taken into consideration. In Romania and Hungary, the economy is growing again. The Czech Republic returned to growth in 2014. The recession in Slovenia and Croatia is projected to end in 2015. In the medium term, the frame conditions will remain tense and under pressure.

Despite enormous macroeconomic and market difficulties, Erste Group could improve its

capital ratio and could absorb write-offs in foreign markets. In the next quarters, Erste Group is expected to face slightly stagnating results. Due to several reasons, the banking group's profitability will remain under pressure.

- First, the low interest rate and the small interest margins cause a decrease in the net interest income. Due to the extremely loose monetary policy, a trend reversal is not in sight yet and this creates concerns.

- Second, the lending growth will be very modest. Private households and companies remain cautious and continue to deleverage.

Only in the Czech Republic and in Austria, Erste Group registered a small lending growth.

- Third, although the peak has been left behind, loan loss provisions for bad debt remain high. Apart from Hungary, risk provisions are going down. The decrease in loan loss provisions will be more than offset by lower operating income. In the next years, Erste Group has it as must to improve its asset quality in order to retain confidence of the financial markets. Erste Group will take years to bring the NPL ratio down to the pre-crisis level. For Erste Group, the medium-term outlook is more promising than the short-term outlook. As the lending activity is pegged to the deposits, Erste Group is not expected to record the same dynamic growth rates as in the years before 2008.

2.4 Corporate Energy

The Retail & SME segment is the Erste Group's core activity, encompassing business with private individuals and small to medium-sized enterprises in Central and Eastern Europe. The focus remains to be among the best financial services providers. In Austria the local retail operations are further subdivided into two divisions: the Erste Bank Oesterreich, with its subsidiaries, and the Austrian savings banks. The international operations of Erste Group, including the Corporate & Investment Banking and the Capital Markets business are coordinated by Erste Group Bank AG, shortly also named Erste Holding (EH). More than 60.000 clients are part of Erste Group, which make it a leading banking corporate inside CEE. Based on the relationship approach with dedicated teams in each local bank the aim is to offer to the corporate clients as well as institutional and public-sector clients the full product and service range of Erste Group such as Financing, Cash

Management Solutions, Payments and Accounts Management, Investment Banking, Real Estate Services and Infrastructure Finance. Additionally the group has under management investment banks in Turkey, Poland and Hungary. The Erste Group has a diverse range of supporting units as well as subsidiaries. One of the most essential is Organisation/IT, which is responsible for the implementation and maintenance of all IT systems as well as the strategic systems development in coordination with all business lines. Other supporting units include human resources management, marketing, performance measurements and finance, operations management, property management, procurement, and restaurant services. (Erste Corporate Release)

Chapter 3

Financial Analysis

3.1 Performance Analysis

In order for the financial analysis to be fully done, all the data from these resources should be taken under consideration (ESSENTIALS of Financial Analysis ,George T. Friedlob, Lydia L.F. Schleifer, p.5, 2003):

- Consolidated Statements of Income
- Consolidated Balance Sheets
- Consolidated Statements of Cash Flows
- Consolidated Statements of Share-Owners' Equity

3.1.1 Income Statement

- Net operating revenues. Revenues earned performing fundamental business operations.
- Cost of goods and services sold.
- Gross profit. The difference between sales (or operating) revenues and cost of goods sold
- Selling, administrative, and general expenses. Operating expenses in addition to cost of goods sold.
- Other operating charges. A category that may include nonrecurring expenses and costs like write downs of asset values and settlements of lawsuits
- Operating income. Typically is the income from basic business operations and is also known as earnings before interest and taxes.
- Interest income and interest expense. Interest earned on investments and interest incurred for borrowing.
- Equity income or loss. This is Erste Group's share of the income earned by companies that EG has bought enough stock in to be able to influence their management practices.
- Other income. Can include atypical events like when a subsidiary merges with another company and decreases the parent's ownership interest in the combined activity.

- Gains on issuances of stock by equity investees. An equity investee is a company that EG owns stock in. The investee issued more stock to a third party, EG's investment value decreased, so EG had a loss.
- Income taxes. The income tax effect of every item preceding this line
- Income before cumulative effect of accounting change. Also known as income from continuing operations; operations that are discontinued or are being discontinued are shown separately
- Cumulative effect of accounting change, net of income taxes. When a company changes how it accounts for something, it may be necessary to report the impact on net income in prior years as if the company had always used the new method.

Table 4: Income Statement

Income statement			
EUR thousand	Notes	1-12 13 <i>(restated)</i>	1-12 14
Net interest income	1	4,685,041	4,465,201
Net fee and commission income	2	1,806,463	1,869,848
Dividend income	3	89,676	74,217
Net trading and fair value result	4	218,816	242,259
Net result from equity method investments		21,313	15,810
Rental income from investment properties & other operating leases	5	173,326	180,593
Personnel expenses	6	-2,232,410	-2,184,224
Other administrative expenses	6	-1,145,997	-1,136,930
Depreciation and amortisation	6	-517,658	-466,113
Gains/losses from financial assets and liabilities not measured at fair value through profit or loss, net	7	62,365	18,283
Net impairment loss on financial assets not measured at fair value through profit or loss	8	-1,774,371	-2,159,242
Other operating result	9	-1,008,622	-1,752,936
Levies on banking activities	9	-311,035	-256,271
Pre-tax result from continuing operations		378,418	-803,232
Taxes on income	10	-178,539	-509,404
Net result for the period		199,880	-1,312,636
Net result attributable to non-controlling interests		139,605	129,357
Net result attributable to owners of the parent		60,275	-1,441,993

Source: Erste Group, Annual Report 2014

Table 5: Comprehensive Income

Statement of comprehensive income			
in EUR thousand	Notes	1-12 13 restated	1-12 14
Net result for the period		199,880	-1,312,636
Other comprehensive income			
Items that may not be reclassified to profit or loss			
Remeasurement of net liability of defined pension plans	34	-6,713	-188,198
Deferred taxes relating to items that may not be reclassified		2,260	47,993
Total		-4,453	-141,102
Items that may be reclassified to profit or loss			
Available for sale reserve (including currency translation)		-113,178	581,154
Gain/loss during the period	7,8	-121,843	574,144
Reclassification adjustments		8,665	7,311
Cash flow hedge reserve (including currency translation)		-71,642	172,783
Gain/loss during the period	45	-72,380	224,285
Reclassification adjustments		438	-51,502
Currency translation		-241,390	-63,962
Gain/loss during the period		-321,192	-63,962
Reclassification adjustments	9	79,802	0
Deferred taxes relating to items that may be reclassified	28	44,931	-190,587
Gain/loss during the period		40,982	-193,363
Reclassification adjustments		3,969	2,765
Total		-381,579	500,288
Total other comprehensive income		-386,032	359,186
Total comprehensive income		-186,152	-953,450
Total comprehensive income attributable to non-controlling interests		17,353	270,310
Total comprehensive income attributable to owners of the parent		-203,505	-1,223,760

Source: Erste Group Annual Report 2014

3.1.2 Balance Sheet

- Assets. Resources that a company has legal control of
- Current assets. Cash and other assets likely to be converted to cash or consumed within a year; usually includes the following five components
 1. Cash and cash equivalents. The latter are marketable and highly liquid securities with short-term maturities (say, no more than three months).
 2. Marketable securities. May include any investment in the stocks or bonds of another entity (probably small enough to not involve influence or control)
 3. Trade accounts receivable. Receivables that result from credit sales to customers, reduced by an amount that is likely to be uncollectible
 4. Inventories. Contains merchandise inventory for a retail company; raw materials, supplies, work-in-process, and finished goods inventories for a manufacturing company. Companies disclose in the notes what inventory method(s) are used (e.g., first-in, first-out [FIFO] or last-in, first-out [LIFO] or average)
 5. Prepaid expenses and other assets. Includes resources paid for but not consumed yet, like prepaid rent, prepaid insurance, prepaid advertising, and supplies
- Equity method investments. The equity method involves recognizing a share of the net earnings of investee companies (subsidiaries) in the income of the investor (Erste Group)

- Cost method investments. These are also investments in other companies but of a lesser percentage so as not to have influence (less than 20 percent). These investments are carried at cost or fair market value.
- Other assets.
- Property, plant and equipment. Typically, tangible, long-term plant assets (useful for more than a year); some plant assets (not land) are depreciated.
- Trademarks and other intangible assets. May also include patents, copyrights, goodwill, and other resources that have no physical existence.
- Liabilities and share-owners' equity. Represent the sources of all those assets on the other side of the balance sheet (e.g., the sources being either creditors [liabilities] or owners [owners' equity])
- Current liabilities. Obligations that will be settled within a year, usually, by payment from current assets
- Accounts payable and accrued expenses. Obligations to parties that have provided goods or services to the company. May include liabilities for purchases, wages and salaries, taxes, and advertising
- Loans and notes payable. If current, probably includes commercial paper from banks in the United States and outstanding amounts from a line of credit
- Current maturities of long-term debt. The portion of a company's long-term debt (typically, notes and bonds) that is due in the coming year
- Accrued income taxes. Taxes associated with profits already earned but on which the payment is avoided in the current year
- Long-term debt. Includes interest-bearing debt that is due beyond a year (typically, notes and bonds)

Table 6: Balance Sheet 2014

iq EUR thousand	Notes	01.01.2013 (restated)	31.12.2013 (restated)	Dec 14
Assets				
Cash and cash balances	12	9,740,468	9,300,683	7,835,417
Financial assets - held for trading		15,954,801	12,283,046	10,530,878
Derivatives	13	10,776,816	6,342,237	7,173,388
Other trading assets	14:18	5,177,984	5,940,808	3,357,490
Financial assets - at fair value through profit or loss	15:18	715,800	528,984	349,583
Financial assets - available for sale	16:18	22,537,158	20,677,648	22,373,356
Financial assets - held to maturity	17:18	18,971,705	17,779,013	16,877,214
Loans and receivables to credit institutions	19	9,007,832	8,376,688	7,442,288
Loans and receivables to customers	20	124,353,061	119,644,501	120,833,876
Derivatives - hedge accounting	22	2,658,845	1,843,645	2,871,807
Property and equipment	26	2,439,100	2,319,501	2,264,041
Investment properties	26	1,022,911	950,572	950,188
Intangible assets	27	2,893,886	2,440,833	1,440,946
Investments in associates and joint ventures	23	174,099	207,594	194,984
Current tax assets	28	127,634	100,398	107,310
Deferred tax assets	28	657,508	719,015	301,466
Assets held for sale	29	708,119	74,774	291,394
Other assets	30	2,108,221	2,470,898	1,622,702
Total assets		214,071,137	200,117,792	196,287,334
Liabilities and equity				
Financial liabilities - held for trading		10,640,382	6,474,745	7,746,381
Derivatives	13	10,159,387	6,086,938	7,188,388
Other trading liabilities	31	480,995	387,807	557,994
Financial liabilities - at fair value through profit or loss		2,552,290	2,339,171	2,072,728
Deposits from banks		0	0	0
Deposits from customers		632,477	459,964	319,960
Debt securities issued	32	1,919,813	1,879,207	1,752,768
Other financial liabilities		0	0	0
Financial liabilities measured at amortised cost		177,321,578	170,785,614	166,921,248
Deposits from banks	33	21,822,081	17,299,491	14,802,602
Deposits from customers	33	122,366,767	121,656,141	122,262,812
Debt securities issued	33	32,510,004	31,244,697	29,388,741
Other financial liabilities		322,724	286,285	469,294
Derivatives - hedge accounting	22	719,499	644,319	725,928
Changes in fair value of portfolio hedged items		1,646,691	733,747	1,225,473
Provisions	34	1,487,745	1,447,605	1,652,688
Current tax liabilities	28	53,022	84,519	91,050
Deferred tax liabilities	28	323,507	169,392	98,778
Liabilities associated with assets held for sale		338,870	0	0
Other liabilities	35	2,650,819	2,653,713	2,309,805
Total equity		16,336,937	14,784,966	13,443,457
Equity attributable to non-controlling interests		3,491,397	3,465,959	3,605,371
Equity attributable to owners of the parent		12,845,540	11,319,006	9,838,086
Total liabilities and equity		214,071,137	200,117,792	196,287,334

Source: Erste Group Annual Report 2014

3.1.3 Cash Flow Statement

- Operating activities. Activities related to the fundamental business operation of the company (i.e., buying and selling goods and/or services)
- Net income. When the operating section of the cash flow statement begins with net income, then it has been prepared by reconciling net income to cash provided by operating activities.
- Depreciation and amortization. These noncash expenses reduce net income but do not affect cash, so they are added back to net income in order to arrive at cash from operations.
- Net change in operating assets and liabilities. In general, the adjustments explained in the note are related to increases and decreases in current assets and current liabilities (here

called operating assets and liabilities).To explain just one of those changes, let's think about credit sales. Credit sales increase sales revenues (and therefore increase net income) but do not affect cash (the company receives an account receivable instead of getting cash), so the increase in accounts receivable should be deducted from net income to arrive at cash from operations.

- Investing activities. Activities generally related to the purchase and sale of long-term assets.
- Financing activities. Activities generally related to obtaining financial resources from the credit market and stock market (or paying off debt or paying dividends)
- Effect of exchange rate changes on cash and cash equivalents. Because the group operates in a global environment, it is exposed to the risk of changes in foreign currency exchange rates.To reduce this risk, the company engages in foreign currency hedging.These hedging activities are described in the notes.

Table 7: Cash Flow Statement

in EUR million	1-12 13 restated	1-12 14
Net result for the period	200	-1,313
Non-cash adjustments for items in net profit/loss for the year		
Depreciation, amortisation, impairment and reversal of impairment, revaluation of assets	972	1,812
Allocation to and release of provisions (including risk provisions)	1,808	2,194
Gains/(losses) from the sale of assets	7	-153
Other adjustments	-272	-23
Changes in assets and liabilities from operating activities after adjustment for non-cash components		
Financial assets - held for trading	3,871	1,902
Financial assets - at fair value through profit or loss	179	107
Financial assets - available for sale	1,924	-1,382
Loans and receivables to credit institutions	842	-1,188
Loans and receivables to customers	4,230	-890
Derivatives - hedge accounting	560	-755
Other assets from operating activities	-1,521	988
Financial liabilities - held for trading	-3,574	1,272
Financial liabilities - at fair value through profit or loss	173	-268
Financial liabilities measured at amortised cost		
Deposits from banks	-4,898	-2,497
Deposits from customers	-767	307
Debt securities issued	-1,432	-1,875
Other financial liabilities	0	183
Derivatives - hedge accounting	68	82
Other liabilities from operating activities	-1,914	4
Cash flow from operating activities	277	-1,691
Proceeds of disposal		
Financial assets - held to maturity and associated companies	5,660	3,078
Property and equipment, intangible assets and investment properties	347	231
Acquisition of		
Financial assets - held to maturity and associated companies	-4,500	-2,160
Property and equipment, intangible assets and investment properties	-726	-834
Acquisition of subsidiaries (net of cash and cash equivalents acquired)	0	0
Disposal of subsidiaries	62	0
Cash flow from investing activities	844	514
Capital increases	842	0
Capital decrease	-1,764	0
Acquisition of non-controlling interest	0	0
Dividends paid to equity holders of the parent	-299	-171
Dividends paid to non-controlling interests	-44	-122
Other financing activities	0	0
Cash flow from financing activities	-1,465	-292
Cash and cash equivalents at beginning of period¹	9,740	9,301
Cash flow from operating activities	277	-1,691
Cash flow from investing activities	844	514
Cash flow from financing activities	-1,465	-292
Effect of currency translation	-95	4
Cash and cash equivalents at end of period¹	9,301	7,835

Source: Erste Group Annual Report 2014

3.1.4 Share-owners' Equity Statement

- Comprehensive income. Changes in share-owners' equity that are not part of net income or due to transactions with owners
- Net income. The amount of income as shown on the income statement. Notice that it is added to reinvested earnings (see also dividends, the last component in this list).
- Translation adjustments. Contains the dollar effect of changes in foreign currency exchange rates
- Cumulative effect of SFAS No. 133. Shows the effect of adapting Statement of Financial Accounting Standards (SFAS) No. 133 on January 1, 2001. This SFAS requires companies

to show the fair value of derivative instruments as either assets or liabilities on the balance sheet. Derivative instruments are generally used to reduce exposure to risk.

- Net gain (loss) on derivatives. Contains gains and losses on hedges. Derivative instruments are supposed to be classified as a fair-value hedge, a cash-flow hedge, or a hedge of net investment in a foreign operation (depending on the exposure being hedged).
- Net change in unrealized gain (loss) on securities. This contains the effect of a changing fair market value for securities classified as available for sale
- Minimum pension liability. This represents, a decrease in comprehensive income due to having to increase a liability related to pension plans.
- Stock issued to employees exercising stock options. Represents the cash raised by selling stock to employees at a specified option price
- Restricted stock. Restricted stock plans are for certain officers and key employees of the company. These are adjustments to equity accounts that may or may not have affected the income statement, but did not directly result in a cash flow.

Table 8: Group Statement of Changes in Total Equity

in EUR million	Subscribed capital	Capital reserves ^a	Retained earnings ^b	Cash flow hedge reserve	Available for sale reserve	Currency translation	Remeasurement of net liability of defined pension plans	Deferred tax	Equity attributable to owners of the parent	Equity attributable to non-controlling interests	Total equity
As of 31 December 2013	860	7,037	4,256	-33	259	-785	-277	2	11,319	3,466	14,785
Changes in treasury shares	0	0	-77	0	0	0	0	0	-77	0	-77
Dividends paid	0	0	-171	0	0	0	0	0	-171	-122	-292
Capital increases	0	0	0	0	0	0	0	0	0	0	0
Participation capital	0	0	0	0	0	0	0	0	0	0	0
Change in interest in subsidiaries	0	0	-10	0	0	0	0	0	-10	-9	-19
Other changes	0	-5,659	5,659	0	0	0	0	0	0	0	0
Acquisition of non-controlling interest	0	0	0	0	0	0	0	0	0	0	0
Total comprehensive income	0	0	-1,442	173	321	-65	-117	-94	-1,224	270	-953
Net result for the period	0	0	-1,442	0	0	0	0	0	-1,442	129	-1,313
Other comprehensive income	0	0	0	173	321	-65	-117	-94	218	141	359
As of 31 December 2014	860	1,478	8,116	140	580	-849	-394	-92	9,838	3,605	13,444
As of 1 January 2013	2,547	6,472	4,395	41	227	-555	-268	-4	12,855	3,483	16,338
Restatement	0	0	1	0	-11	0	0	0	-10	8	-2
Restated as of 1 January 2013	2,547	6,472	4,396	41	216	-555	-268	-4	12,845	3,491	16,336
Changes in treasury shares	0	0	100	0	0	0	0	0	100	0	100
Dividends paid	0	0	-289	0	0	0	0	0	-289	-44	-333
Capital increases	70	571	0	0	0	0	0	0	642	0	642
Participation capital	-1,757	-7	0	0	0	0	0	0	-1,764	0	-1,764
Change in interest in subsidiaries	0	0	-2	0	0	0	0	0	-2	1	0
Other changes	-1	0	1	0	0	0	0	0	0	0	0
Acquisition of non-controlling interest	0	0	0	0	0	0	0	0	0	0	0
Total comprehensive income	0	0	60	-73	44	-231	-9	5	-203	17	-186
Net result for the period	0	0	60	0	0	0	0	0	60	140	200
Other comprehensive income	0	0	0	-73	44	-231	-9	5	-263	-123	-386
As of 31 December 2013	860	7,037	4,256	-33	259	-785	-277	2	11,319	3,466	14,785

Source: Erste Group Annual Report 2014

3.1.5 Profitability

The profit and loss statement of the segment report is based on the measures reported to the Erste Group management board for the purpose of allocating resources to the segments and assessing their performance. (Erste Annual Report 2014)

Management reporting as well as the segment report for Erste Group, is based on IFRS. Accounting standards and methods as well as measurements used in segment reporting are the same as for the consolidated financial statement of accounting.

Capital consumption per segment is regularly reviewed by the management of Erste Group to assess the performance of the segments. The average allocated equity is determined by the credit risk, market risk and operational risk.

For measuring and assessing the profitability of segments, Erste Group also uses the return on allocated equity defined as net result for the period before minorities in relation to the average allocated equity of the respective segment. In addition the cost/income ratio is calculated for each segment as operating expenses (general administrative expenses) in relation to operating income (total of net interest income, net fee and commission income, dividend income, net trading and fair value result, net result from equity method investments, rental income from investment properties and other operating lease).

Return on assets:

Return on assets (net profit for the year divided by average total assets) was -0.33% at 31 December 2014 (0.10% in 31 December 2013 restated).

Finance leases receivables are included under the balance sheet item 'Loans and advances to customers'.

Erste Group leases both movable property and real estate to other parties under finance lease arrangements.

The maturity analysis of gross investment in leases and present values of minimum lease payments under non-cancellable leases is undertaken.

In the reporting period, the total amount of accumulated allowance for uncollectable minimum lease payments, presented as risk provisions for loans and advances, was EUR 191 million (2013: EUR 291 million).

The total amount of contingent rents from finance leases recognised as income in the period was EUR 28 million (2013: EUR 33 million).

Under operating leases, Erste Group leases both real estate and movable property to other parties. Operating leases from the view of Erste Group as lessor.

The total amount of contingent rents from operating leases recognised as income in the period was EUR 9 million (2013: EUR 4 million).

Operating leases from the view of Erste Group as lessee:

Lease payments from operating leases recognised as expense in the period amounted to EUR 88.1 million (2013: EUR 108.4 million).

3.1.6 Growth and Sustainable Development

The accounting principles of financial sustainability can be categorised as following:

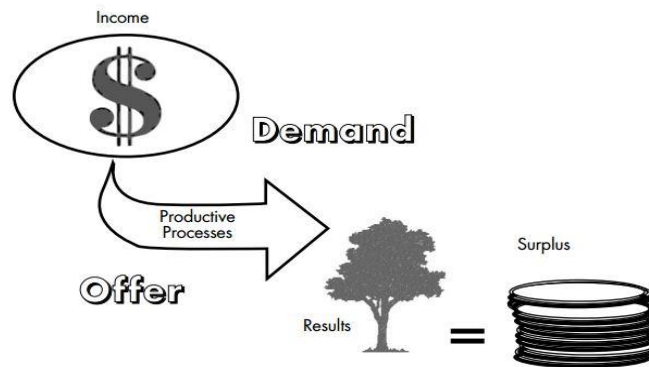
Gross earnings-Grants and/or loans. In business terms, it is referred to as equity capital and includes periodic expenditures as well as the purchase of equipment and infrastructure which most donors allow organizations to retain ownership of beyond the life of the project. (Four Pillars Of Financial Sustainability, Patricia León,p.12, 2001)

Direct Costs- All expenses directly and exclusively related to the project. To identify these costs, ask yourself: if the project ends, would my organization necessarily spend money on this?

Overhead Costs- The operational expenses of the organization which has been assigned the project. To identify these costs, simply figure out the expenses incurred by the organization in order to carry out core, administrative functions.

Balance - This is the term that non-profit organizations use to describe the monetary results (positive or negative) for a specific time period. If the result is positive, it is called a surplus, if it is negative, a deficit. The equivalent terms in the corporate realm are defined as profits and losses.

Figure 5: The road to surplus



Source: Four Pillars of Financial Sustainability, Patricia León

Another crucial factor for further development and growth is the importance of developing markets.

Emerging markets countries are the key drivers for wealth and their influence can be seen in EG financial data.

The number of super-rich people with assets of more than 30 million USD (UHNWIs – Ultra High Net Worth Individuals) increased in 2014 by 3 percent (5,200 people) on a global scale. There are currently 172,850 ultra-rich people. In 15 countries, the number of super-rich people increased by more than 5%. Twelve out of these countries were emerging markets, which underlines the fact that these countries will be the future key drivers for the creation of wealth. The strongest future growth is to be expected for example in Myanmar, the Ivory Coast, Kazakhstan or Tanzania. (EG, Press Release)

3.1.7 Central Bank Supervision

Central Bank Supervision remains crucial in Erste Group's operations in the financial sector.

ECB Asset Quality Review and Stress Test

From 2013 to 2014 Erste Group participated in the Comprehensive Assessment of the European Central Bank (ECB). The Comprehensive Assessment was a financial health

check of 130 banks in the euro zone area, covering approximately 82% of total bank assets. Erste Group passed the asset quality review and the stress test carried out within the scope of the Comprehensive Assessment. (Erste Group Annual Report, 2014)

Asset quality review

A phase-in CET1 ratio of 11.2% as at 31 December 2013 (Basel 3) was used as the reference point for the asset quality review. Aggregated adjustments due to the outcome of the AQR were mainly related to Romanian and Hungarian assets and amounted to 117 basis points, resulting in an AQR-adjusted phase-in CET1 ratio as at 31 December 2013 of 10.0%.

Stress test (adverse scenario) results

An AQR-adjusted phase-in CET1 ratio of 10% as at 31 December 2013 was used as the reference point for the stress test. In spite of severe macroeconomic stress test conditions the AQR and adverse scenario stress-test-adjusted CET1 ratio, according to the transitional provisions of Basel 3, amounted to 7.6% (minimum ratio of 5.5%). Even without the application of transitional Basel 3 rules, the adverse scenario stress-test-adjusted CET1 ratio (fully loaded CET1) was 6.8% which shows that stable results were obtained.

3.1.8 Corporate Governance

In 2003, Erste Group Bank AG declared its commitment to comply with the rules of the Austrian Code of Corporate Governance (Austrian CCG) with the objective of ensuring responsible and transparent corporate governance. (Erste Group Corporate Governance Report, 2014)

The management board is responsible for managing the company as required for the benefit of the company taking into account the interests of the shareholders and the employees as well as the overall public interest. The management board develops the strategic orientation of the company and aligns it with the supervisory board and its guidance.

The supervisory board advises the management board on its strategic planning and actions. It takes part in making decisions as provided for by law, the articles of association and its internal rules of procedure.

The shareholder's rights are compiled as follows:

Each share of Erste Group Bank AG entitles its holder to one vote at the annual general meeting. In general, shareholders may pass resolutions at an annual general meeting by a simple majority of the votes cast or, in the event that the majority of the share capital present is required to approve a measure, by a simple majority of the share capital present, unless Austrian law or the articles of association require a qualified majority vote. The articles of association differ from the statutory majority requirements in three cases: First, the appointment of supervisory board members can be revoked before the end of their respective term by a resolution of the annual general meeting that requires a majority of 75% of the votes cast and a majority of 75% of the share capital present at such meeting. Second, the articles of association may be amended by a resolution of the annual general meeting. Provided that such amendment does not concern the business purpose, this requires a simple majority of the votes cast and a simple majority of the share capital present at such meeting. Third, any provision regulating increased majority requirements can only be amended with the same increased majority.

Dividend rights are as follows:

Each shareholder is entitled to receive dividends, if and to the extent the distribution of dividends is resolved by the annual general meeting.

Liquidation proceeds:

In case of dissolution of Erste Group Bank AG, the assets remaining after the discharge of liabilities and repayment of supplementary capital will be distributed pro rata to the shareholders. The dissolution of Erste Group Bank AG requires a majority of at least 75% of the share capital present at an annual general meeting.

3.1.9 Risk Management

It is a core function of every bank to take risks in a conscious and selective manner and to manage such risks professionally. Erste Group's proactive risk policy and strategy aims at achieving balanced risk and return in order to generate a sustainable and adequate return on equity. (Erste Interim Report Q1, 2015)

Erste Group uses a risk management and control system that is proactive and tailored to its business and risk profile. It is based on a clear risk strategy that is consistent with the Group's business strategy and focused on early identification and management of risks

and trends. In addition to meeting the internal goal of effective and efficient risk management, Erste Group's risk management and control system has been developed to fulfil external and, in particular, regulatory requirements.

Given Erste Group's business strategy, the key risks for Erste Group are credit risk, market risk, liquidity risk, and operational risk. Erste Group also focuses on managing macroeconomic risks as well as concentrations within and across risk types. In addition, Erste Group's control and risk management framework takes into account a range of other significant risks faced by the banking Group.

The year 2014 was marked by the clear strategy of the management for the implementation of adequate measures to extensively clean up the bank's portfolio. These included higher risk provisions in Romania accompanied by an accelerated reduction of non-performing loans as well as higher expenses disclosed under other operating result in Hungary as a result of the new consumer loan law. Furthermore, the key focus was also on the Asset Quality Review and associated stress test carried out by the European Central Bank (ECB) and the European Banking Authority (EBA), which Erste Group has comfortably passed. Risk governance strengthening and ensuring compliance with new regulatory requirements remains strategically important.

3.2 Capital Analysis

3.2.1 Capital Management

Erste Group's risk management framework has been continuously strengthened. In particular, Enterprise-wide Risk Management (ERM) has continued to strengthen its comprehensive framework. This includes as its fundamental pillar the Internal Capital Adequacy Assessment Process (ICAAP), as required under Pillar 2 of the Basel framework.

The ERM framework is designed to support the bank's management in managing the risk portfolios as well as the coverage potential to assure at all times adequate capital reflecting the nature and magnitude of the bank's risk profile. ERM is tailored to the Group's business and risk profile, and it reflects the strategic goal of protecting shareholders and senior debt holders while ensuring the sustainability of the organisation.

ERM is a modular and comprehensive management and steering system within Erste

Group that serves as an essential part of the overall steering and management instruments. The ERM components necessary to ensure all aspects, in particular also to fulfil regulatory requirements, and moreover to provide an internal value added, can be clustered as follows:

1. Risk appetite statement
2. Portfolio & risk analytics including
3. Risk materiality assessment
4. Concentration risk management
5. Stress testing
6. Risk-bearing capacity calculation
7. Risk planning & forecasting including
8. Risk-weighted asset management
9. Capital allocation
10. Recovery and resolution plans

The ERM components serve to support the bank's management in pursuing its strategy.

3.2.2 Capital Ratios

Leverage ratio

The leverage ratio represents the core capital (tier 1) in relation to the leverage exposure according to Article 429 CRR. Essentially, the leverage exposure represents the unweighted on and off-balance-sheet positions considering valuation adjustments and risk adjustments as defined within the CRR.

In January 2014, the Basel Committee on Banking Supervision (BCBS) published the Basel 3 leverage ratio framework and disclosure requirements, which is a revised version of the global guideline on calculation and disclosure requirements for the leverage ratio. Based on this framework, the European Commission prepared a delegated regulation ((EU) 2015/62 of 10 October 2014), which was published in the Official Journal of the European Union on 17 January 2015.

The implementation of the revised requirements for calculation and disclosure of the leverage ratio within the European Union will take place by the end of 2015. Erste Group has agreed to apply these regulations accordingly.

Chapter 4

CEE market positioning

4.1 Geographical segmentation

Central and Eastern European (CEE) countries have gone through significant economic and political transformations during the last decade. As they moved away from state control to a relatively free-market system, these countries launched wide-ranging economic and financial reform programs to stabilize their economies and to establish market forces as performance drivers. Throughout the transition, strengthening and restructuring of the financial sectors, as well as improving the supervision and regulation of banking and financial services, received a strong emphasis to cope with market forces and sustain economic stability and growth. (Competition and contestability in Central Eastern European banking markets, H. Semih Yildirim, George C. Philippatos, 20003) Privatization of state-owned banks and elimination of the restrictions on domestic and foreign market entries increased the number of commercial banks operating in their highly concentrated and inefficient national markets, and changed the competitive conditions in banking profoundly.

Table 9: Peer Competition and the shares value in the market

BANCO SANTANDER SA	6.192	-1.81%
BARCLAYS PLC	274.4405	-1.40%
BNP PARIBAS EUR2	58.29	-2.26%
COMMERZBANK AG	11.29	-2.04%
DEUTSCHE BANK AG	29.59	-2.15%
DEUTSCHE POSTBANK AG	36.80	+0.00%
ERSTE GROUP BANK AG	27.795	-2.63%
INTESA SANPAOLO S.P.A. EUR0.52	3.374	-2.65%
KBC GROEP	61.71	-3.23%
RAIFFEISEN BANK INTERNATIONAL AG	12.16	-2.80%
ROYAL BK OF SCOTLD GRP PLC,THE	341.70	-0.87%
SOCIETE GENERALE EUR1.25	46.83	-2.25%
UNICREDIT SPA	6.21	-1.74%

Source: Unicredit Bank official website

4.1.1 Austrian Market

The Austrian banking market, with total assets equivalent to 273% of GDP (total domestic assets of GDP: 186%) in 2014, is a highly competitive and developed banking market. It is

characterised by significantly lower margins than in Central and Eastern Europe. Growth rates remained low throughout the year, with customer loans expanding by less than 1% while deposits rose by 3.2%. The banking system's loan-to-deposit ratio stood at 102% at year-end. Capitalisation of the banking system improved further in 2014.

Erste Bank Oesterreich and the savings banks held on to their very strong market position in the Austrian market. Their combined market share as measured by total assets stood at 19% at year-end 2014. Based on their balanced business models, Erste Bank Oesterreich and the savings banks maintained their market shares between 18% and 20% in both the retail and corporate segments.

4.1.2 Česká spořitelna a.s. branch, CZ

The Czech Republic is one of the most developed and stable countries in Central and Eastern Europe. Although the country is among the most open economies in the region, growth in 2014 was clearly driven by household consumption and investments. Consumption was positively impacted by higher consumer confidence, lower unemployment and accelerating growth of real wages. In addition, the European funds absorption rate improved further in 2014 and supported investments. Exports, on the other hand, performed only moderately with the automotive industry remaining one of the bright spots. Overall, real GDP expanded by 2.0% in 2014, while GDP per capita stood at EUR 14,800. Reflecting the strong economic performance, the unemployment rate declined further in 2014 to 5.9%.

The Czech Republic experienced political stability in 2014. After the political turmoil of 2013, the outcome of the lengthy negotiations was the formation of a three-party coalition that consists of the Czech Social Democratic Party, the newly founded party ANO and the Christian Democrats. This agreement among parties was reached in January 2014 and played an important role in the prudent fiscal policy. Stronger real GDP growth supported tax revenues in 2014, while a higher value-added tax rate of 21% had already been introduced the previous year. As a result, the government deficit of 1.2% in 2014 remained significantly below the 3% Maastricht criterion and the country exited the Excessive Deficit Procedure during the year. Public debt as a percentage of GDP remained one of the lowest in Central and Eastern Europe and declined even further to 43.6% in 2014. Rating agencies acknowledged the performance of the Czech economy with S&P,

Moody's and Fitch affirming the country's long-term credit rating at AA-, A1, and A+ respectively in 2014.

The Czech banking system remained very profitable in 2014, with favourable asset quality indicators playing a significant role. Foreign exchange-based lending remained insignificant compared to some other Central Eastern European countries.

Česká spořitelna maintained its market leadership positions across all major product categories in 2014. Its retail market shares ranged from 23% to 26%, while its share in the corporate segment remained lower at around 20%. Overall, its market share as measured by total assets stood at 18.3%. Česká spořitelna also retained its number one position in consumer lending including the credit card market with a market share of 34%. In addition, Česká spořitelna continued to control more than one quarter of the asset management market.

4.1.3 Slovenská sporiteľňa branch, SK

The positive macroeconomic environment continued to favourably impact Slovakia's banking market. Customer loans grew by 6.4% in the year, with the retail segment leading the way on the back of improved consumer confidence. Corporate loan volumes increased only marginally. Foreign-currency lending remained insignificant. Customer deposits grew less than loans at 3.8%. With its loan-to-deposit ratio of 91%, Slovakia maintained one of the most liquid and balanced banking sectors in the region. In order to maintain a sound and prudent banking market, the National Bank of Slovakia.

Slovenská sporiteľňa successfully retained its leading market positions. The bank continued to control one-fifth of the country's banking market as measured by total assets, while it also led the market in customer loans and deposits. In the housing loan business, Slovenská sporiteľňa's market share increased further in 2014 to 27.6%. On the deposit side, its market share was significantly lower in corporate business, at 10.6%, than in retail, at 26.4%.

4.1.4 Erste Bank Hungary ZRT.

The Hungarian economy grew surprisingly well in 2014 at 3.6%, the strongest growth since 2006. This development was mainly supported by household consumption and investments; however, exports also contributed positively to the country's overall

economic performance. The surge in both public and private investments was partly supported by one-off factors such as an accelerated absorption of European Union funds and measures of the National Bank, such as the Funding for Growth scheme. The highest growth rates in investments were registered in manufacturing, logistics, defence and agriculture. Exports were supported by car manufacturers, such as Mercedes, Audi and General Motors, which again performed well in 2014. High distortionary taxes, most notably very high additional burdens on the financial sector, however, remained a drag on the economic performance in 2014.

Despite its significantly shrinking balance sheet and lower market shares, Erste Bank Hungary continued to be a major market player in the country. The bank remained loss-making in 2014 mainly due to very limited customer demand, elevated risk provisions, and a number of extraordinary items that the government imposed on banks. As part of its strategy, Erste Bank Hungary continued to focus on local currency lending from locally sourced liquidity and a reduction of parent company funding. The bank's market shares were impacted by the relatively high portion of foreign currency based loans, which declined significantly in 2014. Overall, Erste Bank Hungary's total asset market shares decreased to 5.6% in 2014.

4.2 East Europe market

4.2.1 Banca Comerciala Romana

Romania's economy continued to perform well in 2014. Growth was mainly driven by private consumption and exports, while investments failed to pick up during 2014. Private consumption was supported by higher real disposable income and improved consumer confidence levels. Exports also performed well in 2014, with industrial production being an important driver. With 70%, the European Union continued to represent the main export destination from Romania. Dacia, a Romanian car maker, had another excellent year. In addition, information technology, paper manufacturing and agriculture also had positive impacts on the economic performance. The latter with its relatively high share in the overall economy, however, contributed to economic growth to a much lower extent than in the exceptionally favourable conditions of the previous year. In addition, European funds absorption clearly improved further in 2014 and reached 52%, still low compared to other countries in the region. Altogether, real GDP grew by 2.9% in 2014 and GDP per capita

rose to EUR 7,600. The unemployment rate improved to 6.7%. Despite losing some market shares on both the lending and deposit sides, Banca Comercială Română held on to its leadership position in almost all major product categories. By the end of 2014, the bank was ranked number one based on total assets, customer loans, customer deposits, and asset management. Banca Comercială Română's customer loan market share, however, was impacted by the significant reduction of non-performing loans, most visibly in the corporate sector in which the market share decreased to 17.1%. Customer deposit market shares remained stable in 2014. Overall, Banca Comercială Română had a market share as measured by total assets of 16.2% at the end of 2014.

4.2.1 Erste Bank Croatia

The Croatian economy struggled to fully recover, and the country concluded 2014 as the sixth consecutive year of recession. Domestic demand remained weak throughout the year and was impacted by low consumer confidence. Investments continued to be sluggish in 2014 mainly due to the low activity of the private sector. The bright spot of the economy was the performance of exports with transport equipment, textiles and machinery being the most important sectors. Croatia's well-developed tourism industry with more than 10 million visitors annually also performed well in 2014. Altogether, real GDP showed a decline of 0.4% in 2014, while GDP per capita stood at EUR 10,000 at the end of the year. The unemployment rate reflected the economic performance and remained high at 17.2% by the end of 2014. Erste Bank Croatia remained among the top three players in the market, with a total asset market share of 14.9%. Erste Bank Croatia's performance reflected the development of the overall banking market, with customer loans declining and deposits increasing. The bank's loan-to-deposit ratio decreased to 123% by year-end 2014.

4.3 Further Investment

4.3.1 Erste Group Immorent AG

The EG has gone under further development by extending its profile in real estate under EGI.

Erste Group Immorent is the specialist for real estate financing, infrastructure financing and project development in Central, Eastern and South-Eastern Europe. In the years since

its founding, this Austrian company has grown to become a service provider with comprehensive expertise along the entire real estate value chain. The services offered by Erste Group Immorent range from the construction to the sale of properties, and also include a wide variety of financing solutions for real estate projects.

The many service which the group operates under categories:

Real estate lending: senior lending, junior lending

Real estate leasing: operating leases, finance leases, sale and lease back transactions

Infrastructure financing: long-term financing for transport, social infrastructure and energy projects (renewable and conventional energy), PPP finance and advising

Real estate investment: investment funds, business participations, direct investments, subordinated debt

Real estate development and construction services: site scouting, project management, general planner/contractor services, supervision, appraisal and technical due diligence

Client proximity is a key objective for Erste Group Immorent, whether in Austria, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Ukraine, Slovenia, Croatia or Serbia. Personal client executives are supported by an internal network of specialists that includes architects, project managers, legal professionals and tax experts. Clients in every country are provided with comprehensive, individually designed services that include advising, financing and support.

Chapter 5

Deposits Flow

5.1 Depositors Behaviour

The deposits of the public like demand deposits, savings deposits and fixed deposits constitute an important item on the liabilities side of the balance sheet. The success of any banking business depends to a large extent upon the degree of confidence it can instill in the minds of the depositors. The bank can never afford to forget the claims of the depositors. Hence, the bank should always have enough cash to honour the obligations of the depositors. (Commercial Banking, New Age International, 2009)

The basis of credit money is the bank deposits. The bank deposits are of two kinds:

(1) Primary deposits, and (2) Derivative deposits.

1. Primary Deposits: Primary deposits arise or formed when cash or cheque is deposited by customers. When a person deposits money or cheque, the bank will credit his account. The customer is free to withdraw the amount whenever he wants by cheques. These deposits are called “primary deposits” or “cash deposits.” It is out of these primary deposits that the bank makes loans and advances to its customers.

The initiative is taken by the customers themselves. In this case, the role of the bank is passive. So these deposits are also called “passive deposits.” These deposits merely convert currency money into deposit money. They do not create money. They do not make any net addition to the stock of money. In other words, there is no increase in the supply of money.

2. Derivative Deposits: Bank deposits also arise when a loan is granted or when a bank discounts a bill or purchase government securities. Deposits which arise on account of granting loan or purchase of assets by a bank are called “derivative deposits.” Since the bank play an active role in the creation of such deposits, they are also known as “active deposits.” When the banker sanctions a loan to a customer, a deposit account is opened in the name of the customer and the sum is credited to his account. The bank does not pay him cash. The customer is free to withdraw the amount whenever he wants by cheques. Thus the banker lends money in the form of deposit credit. The creation of a derivative

deposit does result in a net increase in the total supply of money in the economy, Hartly Withers says “every loan creates a deposit.” It may also be said “loans make deposits” or “loans create deposits.” It is rightly said that “deposits are the children of loans, and credit is the creation of bank clerk’s pen.”

Bank runs are situations where depositors withdraw their deposits from banks for the fear of the safety of their deposits. The length and depth of bank-depositor relationships (as measured by account age and loan linkages) are important factors in mitigating the propensity to run. Also social networks are important. The more people in the depositors’ network that run, the more likely is the depositor to run. (Understanding Bank Runs: The Importance of Depositor-Bank Relationships and Networks, Rajkamal Iyer and Manju Puri, 2012) However, even within the network, the length and depth of relationships acts as a dampening factor on the depositor propensity to run. Theoretical models such as Goldstein and Pauzner (2005), and Morris and Shin (2003) put the emphasis on the fact that depositors with longer and deeper relationships get more positive signals about the bank fundamentals, and therefore are less likely to run despite the negative information received about other people in their network running. From the bank’s point of view it can be highlighted the importance of relationships with a bank in influencing depositors’ incentive to run. Suggestions made by experts reflect the point that one rationale to encourage cross-selling of deposits and loans to depositors, is not simply to enhance revenues as is often thought, but because it can protect the bank’s downside by acting as complementary insurance mechanism.

5.2 Rates of Return Analysis

Forward Rate of Return is a concept that Don Yacktman uses in his investment approach. Yacktman explained the forward rate of return concept in detail in his interview with GuruFocus. Yacktman defines forward rate of return as the normalized free cash flow yield plus real growth plus inflation. He said in the interview (March 2012, when the S&P 500 was at about 1400)

If the business is stable, this calculation is fairly straightforward. For instance, on the S&P 500, the technique would be to normalize earnings. Then would be calculated what percentage of those earnings are not reinvested in the underlying businesses and are

therefore free. Historically, for the S&P 500, this has been just under 50% of earnings. Currently, it is expected the S&P to earn about 70 on a normalized basis, a number which is far below reported earnings due to the adjusting for record high profit margins. $\$70 \times \frac{1}{2} / 1400$ gives you a normalized free cash flow yield of approximately 2.5%.

The historical real growth rate of the S&P 500 (companies) is about 1.5%. Assuming an inflation rate of 2.5%, the forward rate of return on an investment in the S&P 500 is about 6.5% today (2.5% free cash flow yield plus 1.5% real growth plus 2.5% inflation).

Erste Group Bank AG's Forward Rate of Return of Jun. 2015 is:

Table 10: Erste Group Historical Data on Rate of Return

Erste Group Bank AG Annual Data										
	Dec05	Dec06	Dec07	Dec08	Dec09	Dec10	Dec11	Dec12	Dec13	Dec14
RateOfReturn	0.00	0.00	0.00	0.00	0.00	0.00	0.00	5.94	-0.58	0.00

Erste Group Bank AG Quarterly Data										
	Mar13	Jun13	Sep13	Dec13	Mar14	Jun14	Sep14	Dec14	Mar15	Jun15
RateOfReturn	6.57	-4.62	-3.07	-0.58	-0.59	-0.62	-0.81	0.00	0.00	0.00

Source: gurufocus.com

Forward Rate of Return = Normalized Free Cash Flow / Price + Growth rate

The Forward Rate of Return uses the normalized Free Cash Flow of the past seven years, and considers growth. The forward rate of return can be thought of as the return that investors buying the stock today can expect from it in the future.

For the growth part of the Forward Rate of Return calculation, it is used the lower of total revenue growth or per share revenue growth, and the growth rate is always capped at 20%. For the Free Cash Flow is used per share data averaged over seven years. The reason it is used seven years is because research shows that seven years is the length of the typical business cycle.

5.2.1 Return on Equity (ROE)

Return on equity (ROE) measures the rate of return on the money invested by common stock owners and retained by the company thanks to previous profitable years. It demonstrates a company's ability to generate profits from shareholders' equity (also known as net assets or assets minus liabilities).

ROE shows how well a company uses investment funds to generate growth. Return on equity is useful for comparing the profitability of companies within a sector or industry.

Investors generally are interested in company's that have high, increasing returns on equity.

Table 11: Erste Group Bank Historical Return on Equity (TTM) Data

Data for this Date Range			
June 30, 2015	-1.13%	Sept. 30, 2012	6.87%
March 31, 2015	-14.02%	June 30, 2012	-6.97%
Dec. 31, 2014	-13.93%	March 31, 2012	-5.80%
Sept. 30, 2014	-16.94%	Dec. 31, 2011	-5.86%
June 30, 2014	-10.28%	Sept. 30, 2011	-4.53%
March 31, 2014	-0.18%	June 30, 2011	8.16%
Dec. 31, 2013	0.39%	March 31, 2011	8.29%
Sept. 30, 2013	2.53%	Dec. 31, 2010	8.01%
June 30, 2013	2.59%	Sept. 30, 2010	6.24%
March 31, 2013	2.43%	June 30, 2010	7.07%
Dec. 31, 2012	3.80%		

Source: ycharts.com

5.2.2 Return on Capital (ROC)

Return on Capital measures how well a company generates cash flow relative to the capital it has invested in its business. It is also called Return on Invested Capital. The reason book values of debt and equity are used is because the book values are the capital the company received when issuing the debt or receiving the equity investments.

There are four key components to this definition. The first is the use of operating income rather than net income in the numerator. The second is the tax adjustment to this operating income, computed as a hypothetical tax based on an effective or marginal tax rate. The third is the use of book values for invested capital, rather than market values. The final is

the timing difference; the capital invested is from the end of the prior year whereas the operating income is the current year's number.

A firm that generates higher returns on investment than it costs the company to raise the capital needed for that investment is earning excess returns. A firm that expects to continue generating positive excess returns on new investments in the future will see its value increase as growth increases, whereas a firm that earns returns that do not match up to its cost of capital will destroy value as it grows.

Erste Group Bank AG's annualized return on capital (ROC) for the quarter that ended in Jun. 2015 was 15.61%. As of today, Erste Group Bank AG's weighted average cost Of capital is 15.99%. Erste Group Bank AG's return on capital is 1.78%.

Table 12: Erste Group Bank Historical data on Return on Capital

Erste Group Bank AG Annual Data

	Dec05	Dec06	Dec07	Dec08	Dec09	Dec10	Dec11	Dec12	Dec13	Dec14
ROC	114.84	25.76	19.71	9.24	4.25	4.00	-3.17	4.86	1.66	-10.62

Erste Group Bank AG Quarterly Data

	Mar13	Jun13	Sep13	Dec13	Mar14	Jun14	Sep14	Dec14	Mar15	Jun15
ROC	8.10	5.02	5.36	-7.62	2.07	-9.52	-7.58	4.51	11.06	15.61

Source: gurufocus.com

5.2.3 Return on Assets (ROA)

Return on assets (ROA) measures the rate of return on the total assets (shareholder equity plus liabilities). It measures a firm's efficiency at generating profits from shareholders' equity plus its liabilities. ROA shows how well a company uses what it has to generate earnings. ROAs can vary drastically across industries. Therefore, return on assets should not be used to compare companies in different industries. For retailers, a ROA of higher than 5% is expected. For example, Wal-Mart (WMT) has a ROA of about 8% as of 2012. For banks, ROA is close to their interest spread. A bank's ROA is typically well under 2%. Return on assets is calculated as net income divided by its average total assets.

Erste Group Bank AG's annualized net income for the quarter that ended in Jun. 2015 was \$1,174 Mil. Erste Group Bank AG's average total assets for the quarter that ended in Jun. 2015 was \$220,464 Mil. Therefore, Erste Group Bank AG's annualized return on assests (ROA) for the quarter that ended in Jun. 2015 was 0.53%.

During the past 13 years, Erste Group Bank AG's highest Return on Assets (ROA) was 0.81%. The lowest was -0.73%. And the median was 0.44%.

Table 13: Erste Group bank Historical Data on ROA

Erste Group Bank AG Annual Data

	Dec05	Dec06	Dec07	Dec08	Dec09	Dec10	Dec11	Dec12	Dec13	Dec14
ROA	0.46	0.58	0.85	0.50	0.50	0.55	-0.34	0.23	0.03	-0.69

Erste Group Bank AG Quarterly Data

	Mar13	Jun13	Sep13	Dec13	Mar14	Jun14	Sep14	Dec14	Mar15	Jun15
ROA	0.33	0.24	0.25	-0.74	0.21	-2.04	-1.09	0.08	0.42	0.53

Source: gurufocus.com

5.3 Loans and Risk Minimisation

Syndicated loans and Corporate Schuldscheindarlehen are a flexible and efficient source of lending. The effective effective communication is ensured with several investors by coordinating a group of banks which work together to provide funds to a client under the umbrella of a single loan/ SSD agreement. The group raises substantial financing facilities on pre-agreed terms which would exceed the capacity of any single bank.

Procedures concerning position limit approval/review:

- » Dual limit structure (VaR - and sensitivity limits)
- » Combination of top down and bottom up approach
- » Global market risk limit allocated by the Risk Committee congruent with economic capital utilization
- » Market Risk Committee assigns global market risk VAR limits to risk taking units. Sensitivity limits are allocated for trading units consistent with VAR limits.
- » Market risk limit structure: Value-at-Risk limits, Sensitivity limits, Stop loss limits, Nominal limits
- » Position flow processes:

- » centralized real-time position keeping
- » common trading systems
- » real-time interfaces

Table 14: EG credit risk profile- segmental structure

in EUR million	Total Outstanding				Total
	Low risk	Management attention	Substandard	Doubtful	
Savings Banks	21.916	4.355	1.764	1.643	29.678
Retail and Real Estate	18.884	3.056	998	1.116	24.054
Large Corporates	6.815	2.678	933	670	11.096
Trading and Investment Banking	18.257	158	0	1	18.415
Austria total	65.872	10.247	3.695	3.429	83.243
Ceska Sporitelna	14.713	182	124	410	15.429
Slovenska Sporitelna	3.867	290	16	116	4.290
Erste Bank Hungary	1.048	395	31	19	1.493
Erste & Steiermärkische Bank + Rijecka Banka	1.607	70	143	60	1.881
Central Europe total	21.235	938	314	606	23.092
International Business	13.045	852	151	192	14.240
Corporate Center	192	0	0	0	192
Total	100.345	12.036	4.160	4.226	120.767

Source: Risk Management at Erste Bank Group, AndrÈ Horovitz, CRO

Chapter 6

Conclusions

6.1 Overview

It is found that the prime objective of Erste Group is to satisfy and meet the expectations of the shareholders of the group, to have a positive cash flow at all times and a balanced long term growth. The key to success is to find profitable customers and retaining them for long term. A major risk associated with the banking industry are bank runs. They are situations where depositors withdraw their deposits from banks for the fear of the safety of their deposits. Erste Group has maintained the focus on the fact that depositors with longer and deeper relationships get more positive signals about the bank fundamentals, and therefore are less likely to run despite the negative information received about other people in their network running.

It is found that Erste Group's savings bank strategy is based on its role as the central institution of the Austrian savings bank sector. By co-operating with legally independent savings banks, this strategy offers a means of generating synergies with respect to both costs and earnings on the basis of a profit-oriented division of labour. The potential for rationalisation will be fully utilised by combining resources within the scope of Erste Bank, and the advantages of the decentralised structure of the savings bank sector at the distribution level.

Also, maintaining positive indicators has been crucial for the group's long term growth and stability on the market.

Erste Group's minimum lease payments, presented as risk provisions for loans and advances, was EUR 191 million (2013: EUR 291 million).

The total amount of contingent rents from finance leases recognised as income in the period was EUR 28 million (2013: EUR 33 million). The total amount of contingent rents from operating leases recognised as income in the period was EUR 9 million (2013: EUR 4 million). Lease payments from operating leases recognised as expense in the period amounted to EUR 88.1 million (2013: EUR 108.4 million). Erste Group Bank AG's annualized return on capital (ROC) for the quarter that ended in Jun. 2015 was 15.61%. Erste Group Bank AG's return on capital is 1.78%. During the past 13 years, Erste Group

Bank AG's highest Return on Assets (ROA) was 0.81%. Erste Group Bank AG's annualized net income for the quarter that ended in Jun. 2015 was \$1,174 million. Erste Group Bank AG's average total assets for the quarter that ended in June 2015 was \$220,464 Mil. Therefore, Erste Group Bank AG's annualized return on assets (ROA) for the quarter that ended in Jun. 2015 was 0.53%. The constant positive reports from the accumulated data show that the group's efforts have proven to be efficient.

Also the group's branches have been performing very well in their markets, with Česká spořitelna being the most profitable. Česká spořitelna maintained its market leadership positions across all major product categories. Its retail market shares ranged from 23% to 26%, while its share in the corporate segment remained lower at around 20%. Overall, its market share as measured by total assets stood at 18.3%. Česká spořitelna also retained its number one position in consumer lending including the credit card market with a market share of 34%. In addition, Česká spořitelna continued to control more than one quarter of the asset management market. Also the group's smaller branches like the one in Croatia have performed well and have shown a growing trend in their respective markets. Overall, Erste Group continues to maintain its leading presence and influence on the Central and East European banking system.

6.2 Perspective

This thesis was only focused on the structural evaluation and profitability of Erste Group but further in-depth research could be done to understand the core functioning of the overall CEE financial market and Erste Group's country by country detailed performance and perspective of credit risk and clients relations management to other forms of risk management. In recent times, not only savings banks but also other forms of financial institutions plays a significant role in financial market. Hence why, it is essential for more research that can be focused on other market leaders of financial sphere in Central and Eastern Europe and how they impact the market. Meanwhile, a deeper breakdown of competitors can help on more enriched results. Extending this topic to European banking industry, would be more interesting to reinforce how savings banks are such a valued part in the finance world.

Chapter 7

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