NLB Group Strategy 2010-2015

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NLB Group

Contents

1. Introduction

The banking sector was significantly influenced by the global financial and economic crisis. The expectations of the owners, regulators, investors and clients have changed. The standards that were in force until just recently have also changed. Banks are much more prudent in their operations. The banks will need more capital for their operations than they did before, and limited dependence on international markets will also be permissible.

The Bank has changed its strategy significantly. The Management Board of the Bank redefined the strategic, geographic and product markets. The NLB will strengthen its presence on certain markets of SE Europe as prime provider of banking services. The Bank will gradually withdraw from other, non-strategic markets. A clear strategic focus is namely crucial for successful operations of the Bank in the environment in which strategic resources such as capital and primary sources of financing, as well as labour force are important restricting factors.

The strategic rationale is based on the belief that long-term above-average economic growth and development of banking can be expected on defined strategic markets and that the NLB has, for now still unspecific, strategic advantages on these markets compared to other players, both local and international.

In agreement with the Supervisory Board, the Management Board has **defined certain key long-term financial goals.** With the normalisation of the environment and the operations, these and other goals will have to be supplemented, particularly the long-term ones. This means that the strategic document is at this stage focused on the measures and orientations in the first years, when the focus is on the consolidation of the NLB.

Key long-term performance indicators of the NLB Group operations:

	2009	2010	2011	2012	2013	2014	2015
ROE	-	-	3%	5%	10%	10%	10%
CIR	65%	63%	58%	59%	55%	54%	53%
Loan growth	-2%	-3%	-5%	-6%	4%	3%	3%
Deposit growth	14%	-7%	1%	0%	3%	5%	5%
LTD[1]	115%	121%	114%	107%	108%	105%	102%
Capital adequacy	10,68%	10,57%	12,30%	11,13%	11,37%	11,15%	12,01%
Tier 1 ratio	6,92%	6,46%	8,96%	9,95%	9,67%	10,25%	10,78% [1]

Generation of shareholder value also leads the Bank in the direction of **NLB share listing on the stock exchange.** Better liquidity of shares and transparency of the NLB's operations generates value for shareholders.

The Bank's internal operation will also be adjusted to new operating conditions, mainly in the area of corporate governance, risk management and investment appraisal. The direction of the development will be towards increased centralisation of supervisory functions.

The Management Board and the Supervisory Board will **focus on consistent implementation of the strategy**, thus ensuring efficient operations of the NLB.

[1] LTD ratios in this documet calculated based on loans net of impairments

2. External environment

In the mid-term period, the Bank's and the Group's operations will be strongly affected by the situation in the external environment. In the next mid-term period, we can expect a decrease in the profitability of the banking sector, accompanied by slowed-down business and banking activity.

We can expect the trend of great uncertainty and instability both in the area of economic growth as well as development of the financial branch in the SE Europe. However, there is no doubt about the political stabilisation of the region and the trend of accession to the EU, even after the financial and economic crisis.

The key changes present in the banking sector, which will affect the operation and governance of banks in the long run, are:

1. **Increased role of the state and the regulators**. The outburst of crisis stimulated a wave of state interventions all over the world, which will have long-term implications on the functioning of the financial system. Simultaneously with the active intervention of the state, we are also witnessing increased supervision over the operations of the financial institutions. The previously existing trend of increasing the burden imposed on the banks and financial institutions through regulatory requirements will be further strengthened. In the time of crisis, special attention is paid to the banks that are important for the system in a certain environment. Regarding the latter, we can expect even more rigorous control and additional requirements concerning solvency. Consequently, all these changes – stricter rules of operations, greater need for collecting and forwarding data to the supervisory institutions – will also be reflected in the form of pressures on costs as well as in the form of reduced responsiveness of the banks.
2. **The process of reallocating household savings.** The financial crisis also affected the changed attitude of the households to investment risk. In the time of crisis, client preferences have been mostly directed towards simple products and solutions and their risk tolerance has sunk. Nevertheless, the trend of gradual reallocation of savings from bank deposits to other savings and investment forms (particularly supplementary pension saving, mutual funds and life insurance products) will continue towards the saving patterns of the population of the European Union. At the same time, we can expect declining interest in direct investments in equity securities and real estate and growing interest in direct placements in debt securities. In the medium and long run, the providers that will offer the clients integral and transparent saving and investment solutions, tailored to their needs while providing quality and objective financial advice, delivered in a kind and understandable manner, will be the most successful on the market of savings and investment products.
3. **Increasing significance of own sources of financing**. Availability of financing will be limited to long-term sources and thus more expensive. Deposits by non-banks are therefore again coming to the fore as a primary source of financing. In addition, the anticipated changes in capital regulation will have an effect on the range of financial instruments used for providing capital adequacy making the most basic forms of equity capital the most important source of capital adequacy. Further growth in the volume of operations will thus be subject to the ability to provide the sources (of finance and capital) and the process of deleveraging and increased stability of financial institutions will affect the profitability of the entire banking industry.
4. **Strengthening of the mechanisms of risk management and governance** in financial institutions with the aim of increasing the safety and transparency of operations, which will be of crucial importance for regaining the lost confidence of clients and the fulfilment of regulator requirements.
5. **Changes in market strength of banks** In the past months, we saw a number of restructurings and reorganisations of banks, often based on regulator interventions and with substantial state aids. Thus, we can expect more changes in the regional banking structure: new players will emerge on the bank market, some will be removed from it and many will have to redefine their strategies.

3. SWOT analysis

The below analysis of external factors summarises the principal opportunities and threats generated by the environment, and the main strategic strengths and weaknesses of the institution.

Strengths

- **NLB d.d. is the controlling bank of the NLB Group and Slovenia's biggest bank.** NLB d.d. is the bank with the longest tradition and one of the best banks in SE Europe.
- **In Slovenia, the NLB Group provides a wide range of products and services,** which enables it **to achieve business synergies and customer loyalty ("one-stop shop").**
- **NLB Group banking network, covers the entire Slovenia and a large part of the Balkans.**
- **Cultural and historical connection with the countries in the Balkans.**
- **Many Slovenian companies do business in countries of the former** Yugoslavia, which is a big opportunity, as the Bank can meet their needs by offering a wide range of products and services.

Weaknesses

- **Lower profitability and cost efficiency** compared to foreign competitors.
- **Existing relationships among owners** do not enable the Bank to quickly adapt in the case of need for additional capital. Time schedules for resolving this problem are unknown, which makes the planning of the Bank's activities more difficult.
- **Low capital adequacy and unfavourable capital structure;** In comparison with other banks, the NLB's capital adequacy is low and the substantial share of its capital are capital instruments that fall due in the next years and will have to be replaced.
- **Limited resources:** in addition to capital, deposits by non-banks as the most important source of financing and human resources.
- **Organisation of the Group** – it is non-transparent, the group corporate governance mechanisms have not yet been optimised (corporate governance, risk management, legal governance, etc.).
- **The Bank's corporate culture** is not entrepreneurial and in favour of changes; low company loyalty.
- **Low level of internationalisation.**
- **Diminished reputation of the NLB in the public.**

Opportunities

- **Above-average growth in the volume of savings and relatively low indebtedness of the Slovene population.**
- **Large potential for cross-selling banking and non-banking products** (in the mid-term, particularly in Slovenia, and in the long run also on the territory of SE Europe).
- **Great potential of growth on the markets of SE Europe.** The level of development of these markets lags considerably behind the markets of W Europe, which present great opportunities to increase market shares and consequently income, also through the transfer of know-how from the parent bank to the members of the Group.
- **Enhanced productivity and cost efficiency** via process streamlining and synergy utilisation within the NLB Group.

Threats

- **Entry of foreign banks on the Group's strategic markets.** More and more foreign banking groups are entering the market of SE Europe, stronger and larger than the NLB Group and thus able to quickly gain a good market position, **and their bank strategies are very similar**. All banks focus on retail and core banking products which is reflected in price wars.
- **Announced changes in the regulation**, which will put more emphasis on equity capital, use of capital instruments will be very limited. Capital strength of the Bank is low compared to foreign banks and the capital structure unfavourable given the market situation and the anticipated changes (a high level of short-term debt instruments).
- If the Bank fails to provide adequate **amount and structure of capital**, its market position will deteriorate.
- **Falling margins in banking.** If the Bank failed to upgrade the offer with higher value-added products, performance might deteriorate sharply in the long run.
- **Loss of key personnel;** in the case of inappropirate motivation and remuneration policies.
- **Competition by non-banking financial agents is growing stronger and the number of substitutes is rising.**
- **Political and macroeconomic instability of the SEE countries.**

4. Strategy

The strategic orientations are prepared on the assumption that the NLB Group is an independent banking and financial group building its own business model.

4.1. Values, vision and mission

The vision and mission of the NLB Group are based on its **core values**: **security, reliability, focus on the clients, quality, expertise, proactive attitude and performance orientation.**

The mid-term **vision** of the Bank is to become one of the leading and, with regard to the assumed risks, highly profitable and reliable banking & financial groups in SE Europe.

Mission of the Bank is to be a reliable long-term partner the clients can rely on. The Bank provides top-quality and integral financial services and solutions to its clients, needed for achieving their goals.

4.2. Strategic goals

➔ The NLB Group is a group operating in South-eastern Europe

The criteria for assessing the strategic (non)importance of a market are:

- **Market share** – the Group can achieve market share of a leading institution on the market (> 10%).
- The ability to collect **deposits from non-banks**.
- The market has **above-average growth potential and profitability of operations**.
- **Slovenian business** is present on the market.

The key strategic market of the NLB Group is Slovenia, the domestic market of the NLB, where the Group generates the bulk of its income. The strategic goal on this market is to keep the existing market share in traditional banking and increase the market share in complementary business (notably life insurance and mutual funds or asset management).

The Bank's another strategic market is SE Europe, where it is already present, mostly with its retail operations, namely in the following countries: **Bosnia and Herzegovina, Montenegro, Kosovo and Macedonia.**

➔ The NLB is a provider of universal banking & financial services.

The NLB is a universal banking group which offers its clients, **in addition to the basic banking services also other financial services**, which allows it to provide complete servicing of the clients' financial needs. Offering a comprehensive range of products and services may entail co-operation with reliable partners, with no equity links, with regard to the situation on the market in question.

The criteria for assessing the strategic (non)importance of a product/service are:

- **Market position of the Group** in individual segments.
- **Complementary nature of products** with regard to the basic banking products.
- Comparative advantage in the form of **know-how**.
- **Creating value-added with acceptable risks and in consideration of the investment appraisal principles.**
- **Development potential.**

The key strategic pillars of the Group's offer are:

Retail banking
- commercial banking
- asset management,
- life and pension insurance
- private banking
- leasing of movable property[2] in Slovenia

Corporate and investment banking
- commercial banking
- corporate finance
- leasing of movable property in Slovenia
- brokerage on capital markets for the clients
- trade finance

As banking is the Group's core activity, banks are the principal entities on all markets of the Bank. Leasing of movable property (vehicles and equipment) is organised within banks where the local law permits it. If not, the activity will be organised in a separate legal entity working in co-ordination with the local bank.

Factoring, forfeiting and leasing of real estate are not strategic activities and the Group therefore plans to withdraw from them.

4.2.1 Retail banking

As regards the market positioning, NLB is the leading provider of comprehensive solutions for the households' personal finances and for financial servicing of SMEs in terms of product and service quality, efficiency and profitability, and integral market share. The goals of achieving (partial) market shares will be subjected to the goals of generating added value for the Bank and the clients.

The foundation for achieving the competitive advantage and adequate profitability of retail banking which, in the long run increases the value of the Bank's equity capital are:
- quality and kindness of the service, which puts individual clients first;
- technological competitiveness of the Bank and efficient development pace which will take into account the changed needs of the clients on the market;
- quality, educated and sufficiently motivated personnel;
- efficient segmentation of clients and adaptation of the offer to individual segments;
- appropriate performance measurement criteria of individuals, products, services and organisational units in the branch network, and continued streamlining of operations on the right points;
- transparent and simple products and services;
- internal culture which stimulates the support units (IT, back offices, legal office, etc.) to provide quality internal service to those who provide final services to the clients.

The core of the retail and private banking strategy is the model **"banking – asset management – life and pension insurance".** Because of the trend of long-term changes in saving habits of the retail clients efficient implementation of this model is a precondition for the NLB Group to keep the important role in the Slovene financial sphere over a longer period. With the implementation of the integral financial advice with higher added value and higher level of cross-selling, the NLB will be able to successfully fight off the competitive and price pressures, increased the stability of clients and revenues and improve the profitability of its operations.

The areas of **retail loans** (mortgages in particular), **card operations and SMEs servicing will be particularly important for the growth** in the Bank's operations in the future. Services to retail clients in these areas will be more tightly connected with the areas of saving and investment products (more emphasis will be put on the management of personal finance of the clients instead of partial marketing of separate products and services). Services provided to SMEs will be connected to other expert areas in the Bank and, if reasonable, with reliable external partners (more focus on the consulting function).

By expanding the offer of products, the Bank's responsibility to the clients will also increase. Accordingly, the Bank has to introduce stricter internal controls over the selling practices. Adequate standardised models for consultancy and sales are important preconditions for the efficient control. The mechanisms of remunerating the commercial sector must be stimulative and must prevent the occurrence of the moral hazard. Client complaints will be resolved efficiently and the NLB Group will be famous as a provider of highly transparent products. The experts in the NLB Group will be integrated to a greater extent and their services provided to the branch network and its clients as support. The Bank will invest considerable efforts in the following years in training of and providing information for the sales personnel and clients.

[2] Leasing products are marketed to SMEs and large corporates.

The Bank's business risks in retail banking are very high at the moment and development is strongly influenced by negative factors (considerably eroded reputation of the NLB brand, risk of rationalisation of the operations in the wrong areas, the problem of financing the Bank, the risk of losing a considerable portion of market share and further lagging of retail banking development). The Bank as a whole will only be successful in the long run based on successful retail banking and in the future important private banking. The strength and innovativeness of the NLB on the domestic market are the preconditions for a successful transfer of the Bank's good practices to the markets of SE Europe.

4.2.2 Corporate and investment banking

In the years to come, corporate banking will be focused on the **marketing of financial services and long-term partnership with companies**, for which we need excellent knowledge of the needs and purposes of use of financial products in the company. Proactive conduct of corporate client managers is important if we are to achieve this; through constant contact with the clients, they are able to timely identify their needs and quickly react by providing an optimal set and structure of financial products (commercial and investment banking, project finance, treasury and hedging products, looking for synergies between different product areas in the Bank and at the level of the NLB Group), **in which the basic goal remains optimisation of profitability in view of exposure risk.**

In addition to proactive marketing, the emphasis in the future will have to be put on **active approach in the restructuring of financial debt of the companies**, which means assuming the leadership in the process of solving major and/or complex cases of restructuring debt liabilities of over-indebted, insolvent or otherwise problematic companies and looking for compromises that will lead to resolutions which will be good both for the NLB and the client in trouble (opportunity for new businesses of the NLB in the future).

The basis for achieving the set goals are **tools adapted to active sales, processes and method of organisation**, namely:

- Flow of information about the client within the NLB Group with the aim of responding and realising synergies (except when the "Chinese Wall" principle within the Bank or NLB Group must be observed).
- The matrix and traceability of overall relationships with both existing and prospective clients.
- CRM and the client's risk-adjusted return for the Bank and the NLB Group.
- The price policy geared towards synergies and cross-selling.
- Continuous optimisation of product portfolio allocation by client, increasing value added (what is termed side-business which does not require additional capital but is related to the credit/guarantee portfolio, which is the main support for the business relation with the client).
- Client Segmentation.
- A strong and motivated team of key-account sales personnel with clear marketing and synergy objectives, and a proactive connection between the sales and back offices.
- Quality maintained through the entire processing of deals, transverse exchange of good practice and products within the NLB Group.

4.3. Target performance indicators

The global financial and economic crisis has made a deep impact on the banks' business models and their performance. It is therefore difficult to define the value of indicators representing a normal international profitability benchmark. Undoubtedly, the banking industry will not produce within the next few years returns on equity seen before the crisis and the risks in the banking business will receive even more attention than before. Consequently, the key indicators of the Group for the next medium-term period are divided into two categories – financial indicators and risk management indicators.

The following assumptions have been considered in the setup of target indicators:

- **The risk profile** will be adapted to a reduced appetite for risk. The Bank will assume moderate risks in its business and the limits for individual categories of exposure, including large exposure to individual groups of clients, will be decreased accordingly.
- **Reducing dependence on wholesale financing** and focus on stable deposits from non-banks.
- Retained earnings will be the main generator of capital for organic growth and the **dividend policy** will follow this goal. The Bank will distribute the surplus dividend that is not needed for growth.
- **The increase in profitability will be based on** increased cost efficiency and a shift towards products and services with higher value-added.

- **The process of disinvesting non-strategic activities** will first of all bring certain negative effects; after the completion of the process it will reduce the need for capital and the risk profile of the NLB Group.
- **The anticipated regulation changes** restricting the use of debt capital instruments to ensure capital adequacy and giving greater emphasis to equity capital.

In addition to the assumptions listed above in the of process defining key financial indicators, which the NLB Group will achieve in the mid-term, the performance indicators of comparable foreign banks (with similar business models and presence on strategic markets of the Group) were also taken into account.

	2009	Goal 2013	Goal 2015	Benchmark*
Profitability				
ROE a.t.	-6.3%	10%	10%	8-12%
CIR	65.2%	55%	53%	50-52%
Capital adequacy				
CAR	10.7%	11%	12%	13-15%
Tier 1 capital	6.9%	9%	10%	~10%
NBS loans/deposits	115%	<120%	<120%	110-120%
Maximum exposure				
Client – in % of capital for OR				
SLO	25%	10%	10%	
Abroad	25%	5%	5%	

* - average for comparable banks for the period 2009 – 2011 Source: Citi Group

5. Necessary resources for achieving strategic goals

It is essential to provide sufficient resources in order to achieve the set strategic goals, i.e. capital and sources of financing by non-banking sector.

5.1. Capital

Capital is one of the key limiting factors in the achievement of the set strategic goals. Compared to the previous versions, the proposed strategy reduces the need for capital. Capital requirement shall not change in the period until 2015 in spite of the expected growth in strategic segments – retail and SEE markets.

The principal element of reduced need for capital is the **planned divestment of non-strategic activities** where the present capital requirement is EUR 155 million or 16% of total capital requirement in the Group. The requirement will be gradually reduced with the implementation of the foreseen measures. Additionally, the reduction of capital requirement will be positively affected by further reduction in risk-weighted assets of strategic activities. (EUR 500 million by the end of 2012).

The need for capital is increased by **anticipated payments of subordinated instruments** which will be only partially replaced by new ones. Besides that, the Bank's capital strength will also have to be strengthened in a relatively short time and the target indicators (capital adequacy, Tier 1) brought closer to the levels of benchmark banks.

Sources of capital:

- **Retained profits** represent one of the most important sources of capital. In the period until 2015 the NLB Group will destine most of the profits for the strengthening of the Bank's capital and in a limited extent to the payment of dividends.

  The NLB's dividend policy will be determined with the Tier 1 indicator:
  - **< 8.5% - no dividends are paid[3].**
  - **8.5%-10% - payment of dividends in the amount still allowing for the increase in the Tier 1 indicator.**
  - **>10% - payment of dividends in the amount of profit exceeding 10% Tier 1, but not more than 40% of profit.**

  Based on the projections, the first payment of dividends is foreseen for the business year 2013. In the interim period, the Bank will pay minimum dividend according to the Companies Act.[4]

- **Sales of Banka Celje and Adria bank**; According to the existing capital regulation, the capital investment in the said banks is a deduction capital item [5], which currently amounts around EUR 95 million (of which the majority represent Banka Celje). In the event of sales, the capital of the NLB Group (and NLB d.d.) is increased by the relevant amount because of reduced deduction item.

- **Maintaining part of capital instruments**. The projection of capital foresees the repayment of subordinate instruments upon their maturity or the exercising of the call option[6]. Also in the future, the plan is to preserve part of capital instruments, which is why it is anticipated that upon maturity or call options, they would be partially replaced by new ones in accordance with the requirements of the new capital regulations.

- **Increase in the Bank's capital in 2011 in the amount of EUR 250 million**, which will enable the fulfilment of regulatory requirements according to Basel III and faster achievement of strategic goals in the field of capital, and accordingly:
  - **Payment of higher dividends in this period** - The payment of dividends would also improve the attractiveness of investments in the Bank (an important factor in the case of IPO).

[3] Pursuant to Basel III requirements

[4] Payment of dividends in this period is also related to the provisions of the guarantee contract signed with the state in the issue of state-guaranteed bonds in 2009, falling due for payment in 2012

[5] After the introduction of Basel III in 2013, only the capital requirement will be calculated for these two investments.

[6] To exercise an option, a permission must first be obtained from the Bank of Slovenia, which may reject it, should it find that the repayment would deteriorate the Bank's capital position. In such a case, the recall is not possible.

- **More optimised implementation of divestment** – in the conditions of insufficient capital, the key goal of disinvestment is immediate release of capital, which could negatively affect the financial impacts of these transactions (the “stress sale” effect).
- **Easier and cheaper access the wholesale finance markets** and faster achievement of the international investors’ and the rating agencies’ expectations.

Taking into account these assumptions and the assessed effects of the implementation of Basel III in 2013, **the Group’s capital adequacy is improved to 12% by 2015 and Tier 1 to 10.8%.**

Nevertheless, we need to point out a rather high level of uncertainty and the related risks that could impact the deteriorated capital position of the Bank. The following are noteworthy:

- **Slower and inefficient economic recovery** which can result in reduced profit.
- **Divestment of non-strategic activities** could be slower than anticipated and the effect poorer. Divestment dynamics strongly depends on the issue of assuring capital, which could lead to the occurrence of the so-called "stress sale" in which the effects are worse than in the situation in which the time schedule is not so decisive.

As regards the issue of providing capital, we need to point out the problem of **ownership structure** of the Bank, which is currently as follows:

- Republic of Slovenia – 33.10%,
- KBC Bank – 30.57%,
- Poteza Naložbe – 5.8%,
- Slovene Compensation Fund – 5.05%,
- Capital Fund – 5.01%,
- Other shareholders – 20.47%.

A rigid ownership structure coupled with a clear wish of the second biggest shareholders for exit from shareholding will prevent the Bank from responding fast if capital needs to be increased. A key condition for successful strategy implementation is therefore setting up an ownership structure in which the shareholders will be able to support the Bank's development by an increase in capital.

The Bank has the following strategic goals regarding the ownership structure:

- **Following the completed restructuring of the Group, public listing of shares is foreseen** which will improve the Bank’s liquidity and the attractiveness of investment for minor shareholders, while at the same time facilitate the Bank’s accessibility to capital.
- **Target shareholder structure**: a combination of the government, private share funds, portfolio investors, and minor shareholders.

5.2. Debt financing

One of the target policies for the next five-year period is to **decrease dependence on wholesale financing** and thus improve the **loan to deposit ratio** of the non-banking sector **to 120%**, which is an international benchmark for universal banks.

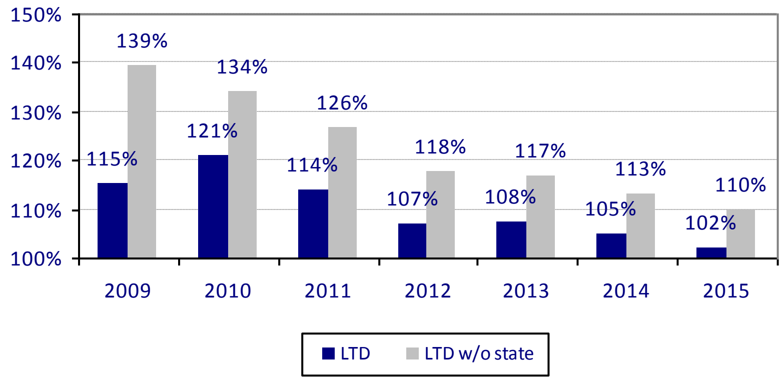
In the past, growth in credit activity was much faster than growth in deposits of the non-banking sector, therefore, NLB d.d. additionally financed its fast credit growth through borrowing on international financial markets. Consequently, the Bank’s dependence on the conditions on financial markets increased, which is also evident from the movements in the loan to deposit ratio – in the past five years it rose from 94% to 143% (as at the end of 2008). This method of operations financing was not sustainable in the long run and was also contrary to the NLB’s character of a universal bank with strong retail business.

During the implementation of the strategy the following measures will have to be adopted to achieve the target loan to deposit ratio:

- **Emphasis on attracting of deposits from the non-banking sector**, considering also the profitability of the savings/investment products, the clients’ needs and the quality of the client servicing.
- **Active reduction of the volume of weighted assets in strategic activities;** a reduction of EUR 500 million in RWA is planned by the end of 2012.
- **Consistent implementation of the territorial management principle**, which means that the LTD indicator is calculated for individual geographical market not for individual company.

The planned disinvestment of non-banking companies will also lower the indicator. By consistent implementation of these measures the loan to deposit ratio in the period until 2015 shall be reduced below the 120% target.

Movement of the NLB Group's loan/deposit[7] ratio



Despite the above the Bank will continue to acquire part of the financial sources from international markets, where its future activities will be geared towards **diversification of the debt financing**, which will make the structure of financing of NLB d.d. comparable to other banks.

5.3. Human resources

Employees are the key factor of high performance of a company, including NLB d.d.

With the aim of providing adequate human resources in the NLB Group, **we are establishing HR management at a strategic level**, which will enable adequate selection of human resources with adequate competencies, capable of managing changes and adjusting to them.

The strategic level of HR management means concrete work with those human resources that are crucial for the NLB Group and have a significant impact on the Group's operations Human resources are needed for achieving the strategic and business goals, and if they are well managed, qualified and motivated, they are a guarantee for good performance of the Bank.

Specific measures that will be taken in this area:

- **Provision of uniform HR policy and work with key personnel in the NLB Group**, including the internationalisation of employment.
- **Systematic overview of HR in key positions** – what are their knowledge, skills and competences.
- Ensuring that **the Group identifies or builds human resources who can immediately assume key functions** in the NLB Group.
- **Definition of knowledge and competences** that will be needed in the future in the NLB Group and their provision.
- **Supporting development of each individual**, primarily in line with the Bank's needs.
- **Provision of a high level of motivation, loyalty and commitment of the employees to work in the NLB Group.**

In order to achieve strategic goals, the NLB Group must become the most desired employer that provides safe working environment, takes care of health and safety at work, competitive remuneration and offers a wide range of bonuses and benefits, and also has a good reputation in the environment where it operates. This means **establishment of the culture of trust and respect** which is based on the values in which we believe. We need to establish a flexible business model, which depends on external and internal clients (employees) which **create the culture of excellence**. This will make the NLB Group even more attractive and thus enable it to preserve its talented staff as well as attract new, which it will achieve if its salaries are competitive, if it offers interesting jobs and career opportunities and establishes good corporate climate.

The activities will be aimed at:

- **A change in the corporate culture**
  - Create team spirit and the feeling of belonging to the NLB Group.

[7] LTD based on gross loans w/o deposits of the state 2013= 125%

    - Identify the employees with business goals.
    - Encourage individuals and teams to become responsible for achieving good results.
    - Raise awareness in the field of social responsibility.
    - Establish more efficient horizontal and vertical communication channels.
    - Promote non-authoritative management that will ensure the vision and respect of the employees.
    - Developing the culture of costs, efficiency.
- **Staff development and motivation**
    - Define skills needed for successful performance of the NLB Group today and tomorrow.
    - Connect career plans of key personnel with the strategy of the NLB Group.
    - Increase executives' responsibility for employee and own development.
    - Introduce development and motivation systems for different generations of employees.
    - Create a working environment that will take care of the employees' health, offer modern technological equipment and be family-friendly.
    - Take care of the measurement and increase in the level of internal and external clients' satisfaction.
- **Development of remuneration systems**
    - Set concrete goals to employees and define performance criteria so as to stimulate expert work and correct client attitude.
    - Increase the amount of performance bonus and thus boost employee differentiation.
    - Treat underperforming employees appropriately.
    - Link profitability of organisational parts and efficient performance of managers with remuneration.
    - Introduce employee-tailored remuneration systems that are harmonised with the career plan).
- **Increase internal and international mobility within the NLB Group**, both from NLB d.d. to subsidiaries and from subsidiaries to NLB d.d.;
    - Emphasised care of staff mobility and flexibility of jobs.
    - Connecting the system of promotion of management staff and key employees with the system of mobility in the NLB Group.

In its operations, the NLB Group will strive for the implementation of the **»Fair Balance Strategy«**[8], which comprises the following basic documents:

- Focus on **long-term success and reputation** of the NLB Group, taking into account high ethical standards.
- **Innovative approach to resolving business problems.**
- **Raising the level of the quality of attitude towards the employees** (investment in personnel, equal relationship, relations between the managers and the employees, introduction of the culture of respect).

5.4. Technology

An important factor in the achievement of goals of the NLB Group is information technology which has become an integral part of the operations and also one of the drivers of development. Size of the Group does not allow for **in-house development** of the main systems by business segment. In-house development will be kept for counter operations, payment systems, system linking and integration, the development of business intelligence systems and regular maintenance. Card operations will remain in the Bankart processing centre and the e-business systems will be developed with partners.

Application systems and infrastructure will be developed in a way enabling offering of solutions to other Group members and financial institutions outside the NLB Group which will provide for better utilisation of investments due to the economies of scale.

The key activities and goals in IT:

- **Preserving high level of availability** and proper functioning of the systems.
- **Centralisation of the IT systems** in the NLB Group and setting up of mechanisms connecting the subsidiaries' systems with that of the NLB.
- **Upgrading of distribution channels with state-of-the-art security mechanisms** to maintain or improve clients' confidence. The development of the systems will also enable selling of IT services to financial institutions outside the NLB Group.

[8] A document compiled by the NLB Union

- **Support to the business process redesign** to improve cost efficiency and ensure that clients use modern services through all distribution channels.

Detailed plans by major areas of NLB d.d. are presented in the continuation.

Retail: The key systems supporting retail banking are Bancs and the *New Banking Counter* where emphasis will be given in the next few years to **supplementing functionalities** for marketing new products, **introduction of a uniform following of contacts** with clients and to the tools **and models** for financial consulting to the **clients.**

Corporate: The key system supporting corporate banking is the T24 system where emphasis will be given in the next few years to enhanced migration **of products from the old applications and supplementing of functionalities** for marketing new products.

The main emphasis in **e-business** will be given to **following the trends in development** of purpose-built self-service banking equipment and **redesign of the existing e-banking and mobile banking** with the aim of modernisation, improved security, inclusion of new products and simpler maintenance.

The data management systems will continue to be linked to the integration of data and information in a harmonised **data warehouse system.** To increase cost efficiency, we will continue with the consolidation of technology by promoting migrations into the target products and production of efficient solutions for the back office on strategic platforms.

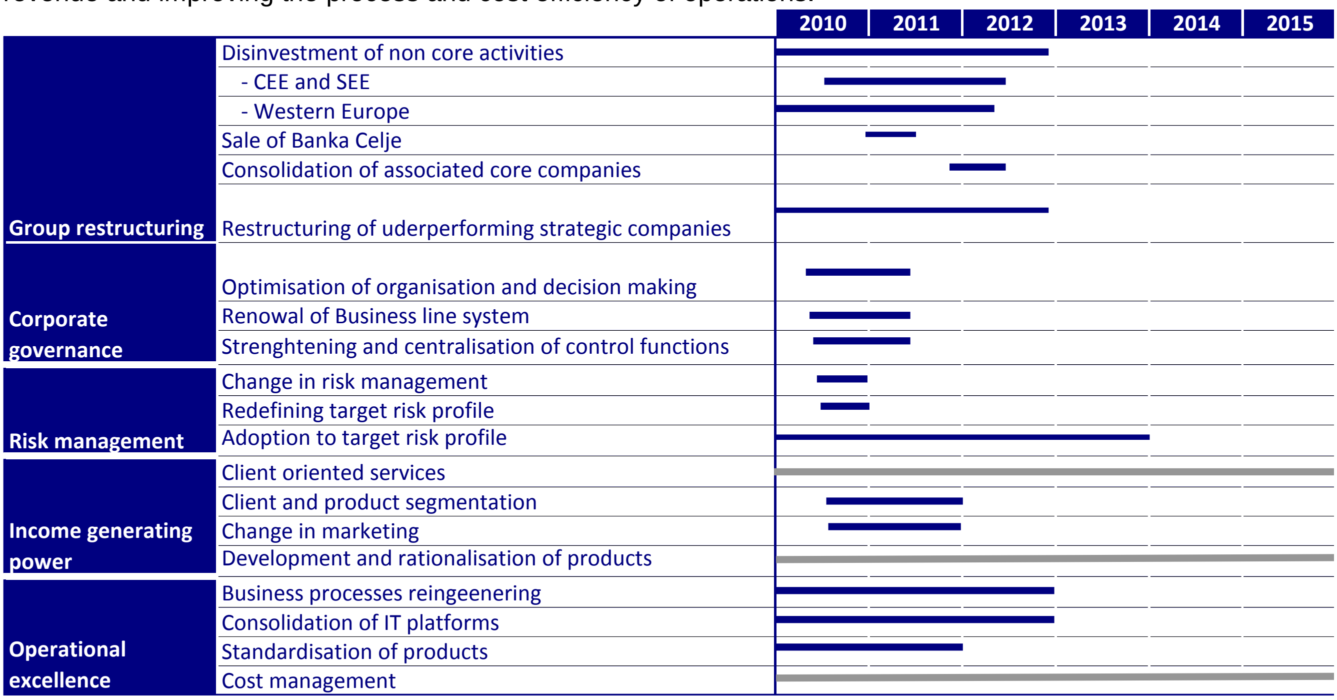
Infrastructure: The key goal will continue to be **keeping the existing high level of system operation stability.** Consolidation of data centres of the members of the NLB Group will be introduced gradually, with centralisation of infrastructure for some services (e-mail, IP technologies, call centres, business analyses, cross-linking or even centralisation of backup centres, etc.).

6. Measures to achieve strategic goals

The activities needed to achieve strategic goals in the next period can be divided into two categories:

Short-term activities that will eliminate the key deficiencies in the current mode of operation of the Group – restructuring and consolidation of the Group and changes in the manner of Group and risk management.

In the **medium term (until 2015)**, achieving the set goals will require enhancing the ability to generate revenue and improving the process and cost efficiency of operations.



6.1. Restructuring of the NLB Group

The following will be in focus in the next period:

- **A speedy withdrawal from non-strategic markets and activities.** The basic guideline for this will be long-term and sustainable maximisation of value for the shareholders, to which the method and dynamics of withdrawal will be adjusted.
- **Restructuring of activities and markets deemed strategic** but with suboptimal operation at the moment.
- **Gradual reduction of credit exposure** on the markets where the NLB is not directly present with its companies.

The necessary activities are evident from the **strategic product & geographic matrix of the NLB Group presented** below**.**

		banking		insurance		asset man.	leasing		factoring
		Retail	corp.	pens.	life		movables	real est.	
strategic markets	Slovenia	●	●	●	●	●	●	●	●
	BiH	●	●				●	●	●
	Montenegro	●	●	●			●	●	
	Kosovo	●	●						
	Macedonia	●	●	●			●	●	●
non strategic markets	Serbia	●	●	●			●	●	●
	Croatia						●	●	●
	Italy (border area)		●						
	Austria		●						
	Bulgaria		●				●	●	
	Czeck rep.								●
	Germany		●						
	Slovakia								●
	Switzerland								●

Legenda

● - presence of a NLB subsidiary
strategic - growth and development
non strategic - disinvestment

6.2. Corporate governance of the NLB

Fast development of the NLB Group resulted in organisation and management which are too complex, fragmented and inefficient. Measures to improve efficiency:

- **Reducing the number of companies in the Group (sale, mergers, winding up etc.)**

It is planned that disinvestment activities begin immediately for the companies included in the category of **non-strategic companies**. The first choice will be sale and liquidation only if sale is not possible or feasible for a reason.

Acquiring of a majority stake (in agreement with the other owners) is planned for **NLB Vita and Skupna pokojninska** which are currently not in majority ownership of the NLB Group but are counted as strategic companies. **Banka Celje** is planned to be sold in 2011.

- **Changed mechanism of corporate governance**

More efficient corporate governance require

- Optimisation and simplification of organisational structure of NLB d.d. and decision-making systems.
- Redefinition of the competencies of business lines and their role in group corporate governance.
  - Reduction and consolidation of business lines.
  - Define the level of decentralisation and autonomy granted to individual business lines, given their nature (back and front office) while setting clear boundaries and centralised control.
- Strengthen and centralise the control mechanisms of Group management (risk and finance) and those business functions where synergy effects are potentially the greatest (IT, purchasing, human resources etc.).

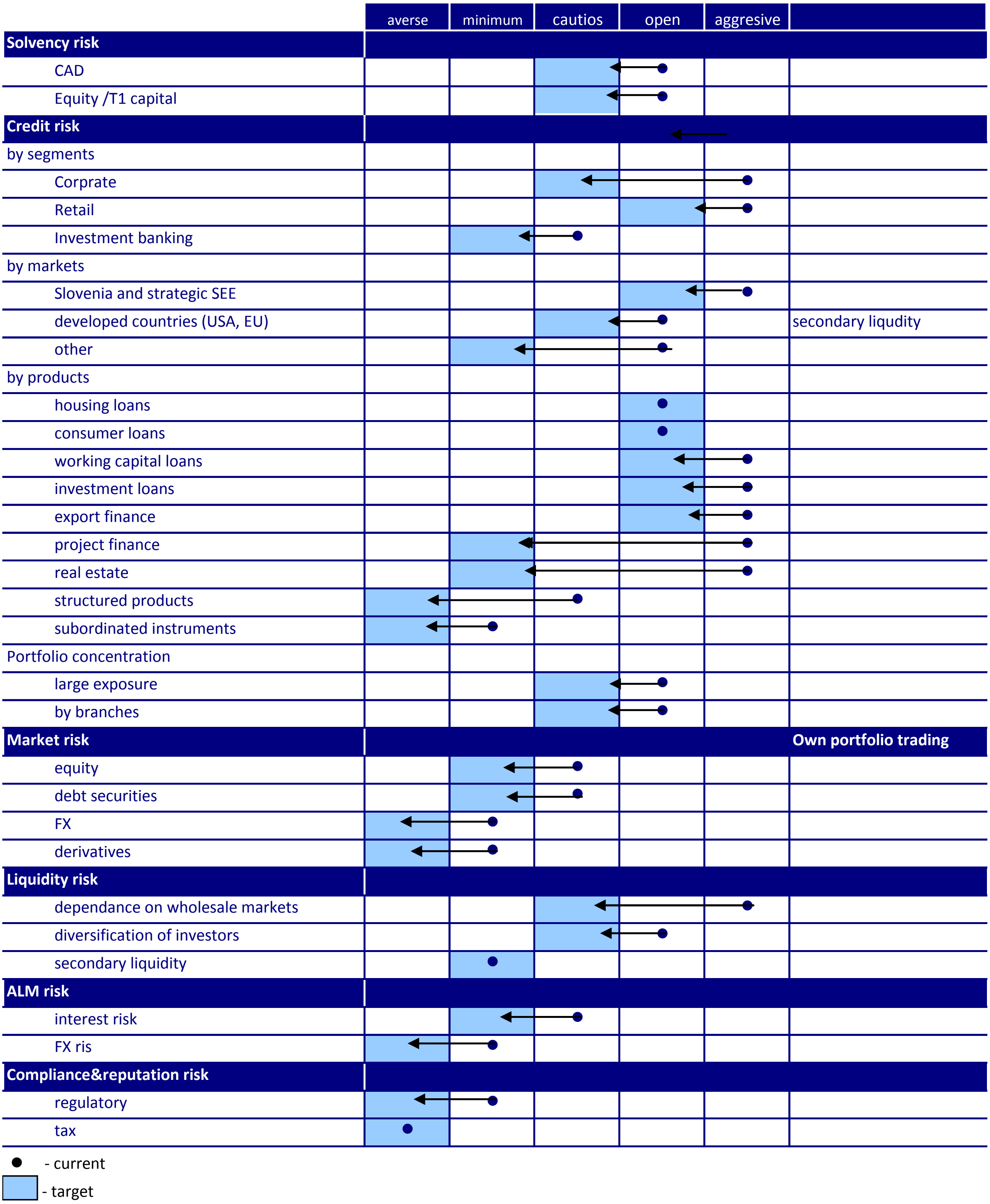
6.3. Risk management

Two elements of the system reconstruction are the key to more efficient risk management:

- **Changed method of risk management in the Group:**
  - introducing risk management architecture on consolidated basis,
  - the centralisation of risk management in the NLB Group,
  - updating of the process of establishing provisions,
  - redefine the process of loan granting.
- **Redefine the target risk profile of the NLB Group in terms of increasing the conservative approach, namely:**
  - decrease the risk of large exposure,
  - improve the structure of capital and reduce the risk profile (collaterals, etc.) and consequently reduce the use of capital,
  - decrease the dependence on the wholesale market (reduce the loan-to-deposit ratio).

Given the Group's business model, the most important risk is credit risk which also makes up for the biggest share of capital requirements. The second risk with regard to capital requirements is operational risk followed by market risks.

The table on the next page presents the attitude of the NLB Group towards individual risk categories.



Accounting for the importance and risk apetite, the bulk of measures and activities is aimed at managing credit risk within the NLB Group.

6.4. Improving the ability to generate revenue

The client should be put to the fore and must be offered integral solutions on the basis of competitive products and quality services. Measures that will be taken:

- Focus on the overall client treatment.
  - Improve understanding of the clients' needs and adjust the products to their needs.
  - Transition from transaction and marketing treatment of the client to consulting.
  - Harmonise the client's access to the Bank through various distribution channels.
- Product and client segmentation.
  - Establish more efficient segmentation of clients and accordingly adapt products and services accordingly.
  - Positioning in upper middle price class based on the above-average quality of service and competitive products.
- Changed marketing method.
  - Improve cross-selling and more emphasis on products and services with increased value-added.
  - More emphasis on systematic marketing of non-banking savings and investment products through the sales network in retail.
  - Integration of marketing of non-banking products (leasing, factoring) through banking distribution channels also in the area of corporate banking.
- Development and streamlining of the product range.
  - Profitability/value-added to become the basic assessment criterion.
  - Standardisation of products and simplification of processes with the aim of improving cost efficiency.

6.5. Improving efficiency of operations

The Group's cost efficiency is currently below the level at comparable banks and it should therefore be improved by strict business streamlining to come close to that of comparable banks. The following will be needed:

- A shift towards in-house culture of profitability – adjustment of the system for measuring performance (profitability or value-added) at the level of organisational units, products and clients, which will enable rational business decisions, responsibility and sufficient autonomy of adopting decisions with adequate governance.
- Thorough and in-depth overview of business processes with the aim of streamlining.
- Harmonisation of technological platforms within the Group.
- Eliminate the unnecessary deviations from the standard characteristics of products.
- Maintain constant orientation in cost management, streamlining of the staff number and improve the structure of staff to benefit the front office.
- Strict exploitation of synergies within the Group through the transfer of best practices.