ANNUAL REPORT

NOVABANKA

ON BUSINESS PERFORMANCE OF THE BANK FOR 2017

March, 2018

Contents:

1. GENERAL INFORMATION

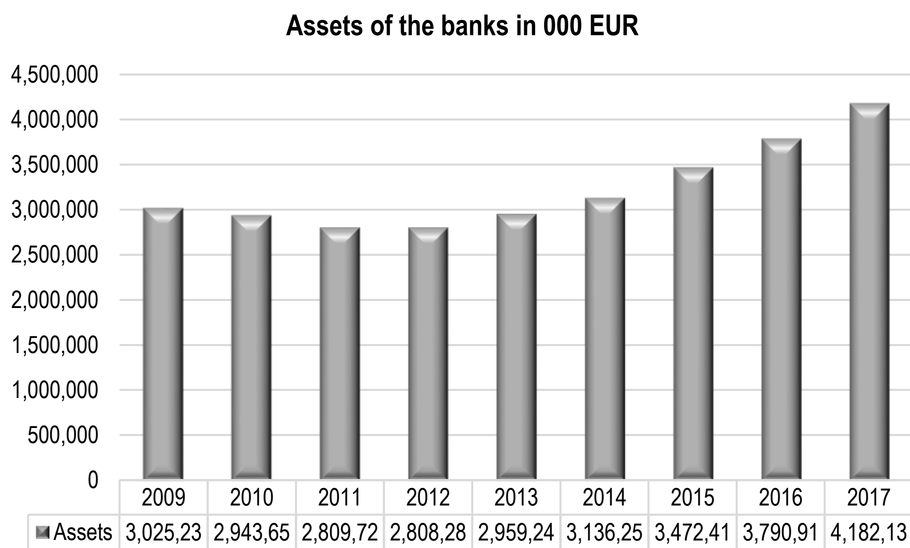
Nova Banka A.D. was formed by Azmont Investment DOO, the company that operates in Montenegro since 2012.

The Bank is headquartered in Podgorica, Marka Miljanova Street, No. 46.

Table 1 – Market share of the bank on December 31, 2017

	31.12.2017			
Bank	**Assets**	**Loans**	**Deposits**	**Equity**
Banking sector (in 000 Eur)	4.182.131	2.257.868	3.279.083	514.231
Nova banka AD (in 000 Eur)	22.607	10.789	13.127	9.188
% of share	0,54%	0,48%	0,40%	1,79%

Graph 1 – Asset of the banking sector for the period 2009-2017



In order to better positioning in the banking market, the Bank has maintained the quality of human resources, range of products and services and the selection and development of information systems.

Nova Banka AD Podgorica, the bank with the level of capital that provides the basis for a stable and safe operations, with the absorption capacity of potential risks from operations. The level of own funds at 31 December 2017 was EUR 8.689 thousands (31 December 2016: EUR 10.304 thousands)

As at 31 December 2017, the Bank is consisted of headquarter in Podgorica and one branch office on the same location.

1.1. Registraztion and activity of the Bank

Nova banka A.D., Podogrica (hereinafter: the “Bank”) has been founded in 2016 by issuing the license form the Central bank of Montenegro. In accordance to article 44, paragraph 2, point 7 on Law on Central Bank (Official Gazette of Montenegro 40/10, 46/10 and 6/13) and article 23, paragraph 2 Law on Banks (Official Gazette of Montenegro 17/08, 44/10 and 40/11) Council of the Central Bank of Montenegro, on the meeting held on 26th of February 2016, issued a decision to issue the banking license to the Bank.

Activity of the Bank includes loan, deposit and guarantee activities, as well as foreign-exchange transactions, depot operations, treasury services, issuance, processing and recording of payment instruments.

Bank is registred in Central Registry of Business Entities in Podgorica, under registration number 4-0009471 on 13th of April 2016 as Azmont Banka AD Podgorica. Under the registration number 4-0009471/003 on 9th of September 2016, Bank is registred to the Commercial Court in Podgorica as Nova Banka AD, Podgorica.

1.2. Organization and employees

a) Board of directors

Table 2 - Board of directors of the bank

Position	Name	Date of birth	Residence
1. President	Ahmet Erentok	21.9.1962	Turkey
2. member	Rashad Aliyev	25.1.1982	Azerbaijan
3. member	Rashad Rasullu	11.4.1980	Azerbaijan
4. member	Gorhmaz Aghayev	1.5.1980	Azerbaijan
5. member	Ana Ivanović	12.8.1981	Montenegro

b) Executive management of the Bank

Table 3 - Executive directors of the Bank

Name	Position	On the position starting from
Kamran Mammadov	Chief Executive Officer	01.03.2017.
Đorđe Lukić	Executive Director for Commercial Business and Banking Operations	19.10.2017.

c) Members of Asset and Liability Committee (ALCO)

Table 4 - Members of ALCO

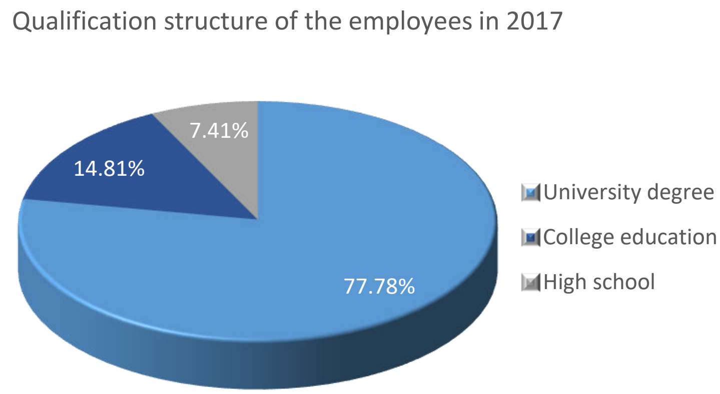
Name	Position
Kamran Mammadov	President
Đorđe Lukić	Member
Ana Rašović	Member
Enesa Bekteši	Member
Maja Barada	Member
Nikola Marinović	Member

1.3. Personnel qualification structure

On 31 December 2017 the Bank had 27 employees, with the following structure:

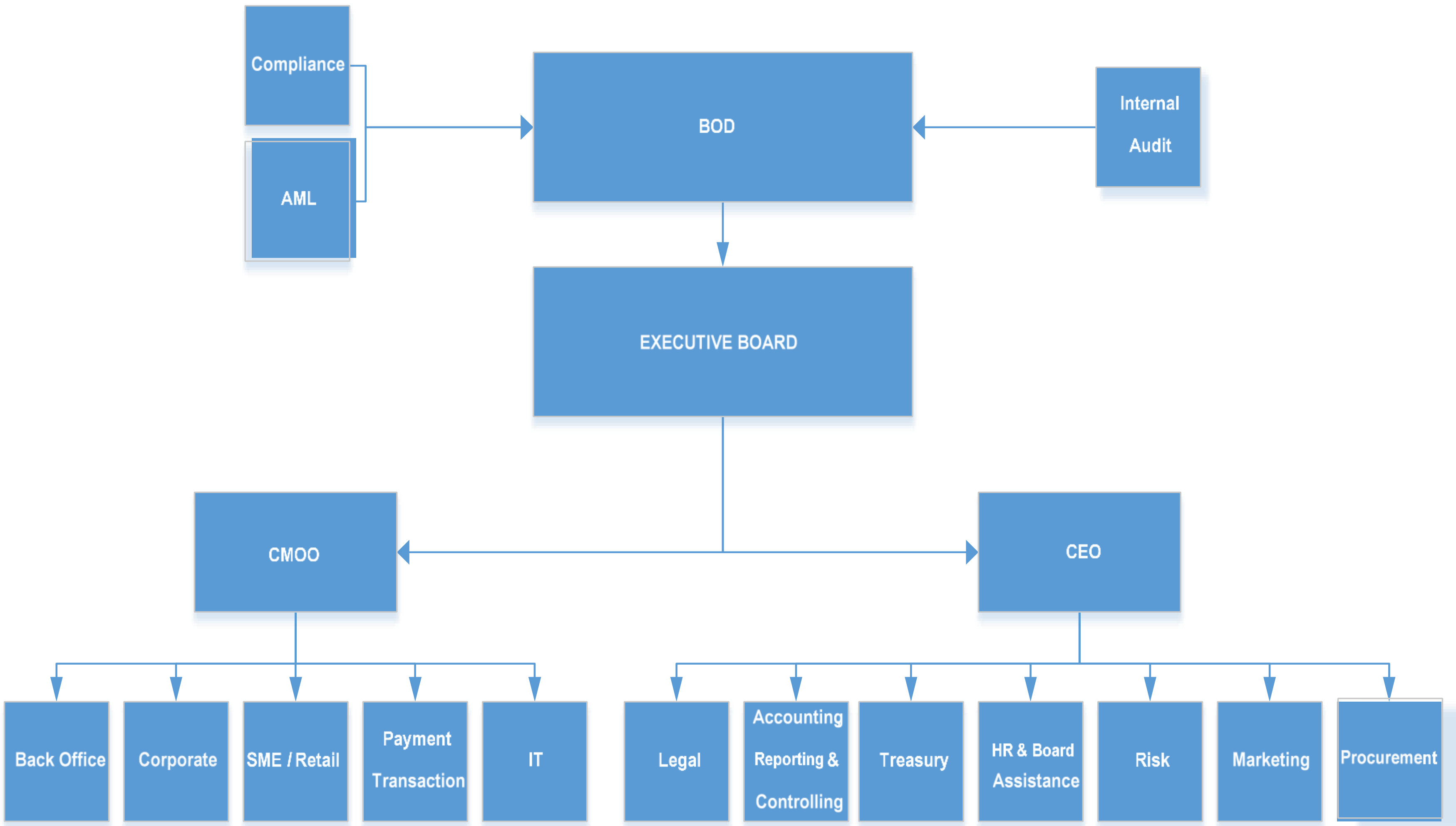
- University degree 21 employees or 78%,
- College education 4 employees or 15%,
- High school 2 employees or 7%.

Graph 2. – Personnel structure



1.4. **Organizational structure of the Bank**

Graph 3 – Organizational chart



2. PERFORMANCE OF THE BANK IN 2017

Table 5. - Performance indicators in 2017 (in 000 EUR)

DESCRIPTION	2017	2016 (13.04.2016-31.12.2016)
BALANCE SHEET ASSETS	**22.607**	**11.686**
GROSS LOANS	10.819	2.254
Retail loans	2.701	1.289
Corporate loans	8.117	965
DEPOSITS	**13.127**	**668**
Retail deposits	1.543	428
Corporate deposits	11.584	240
Total equity	**9.188**	**10.753**
LOSS FROM OPERATIONS	-1.565	-1.227
PROFITABILITY RATIOS IN %		
ROA - financial result / balance sheet assets %	**-11,87**	**-18,00**
ROE – financial result / total equity %	**-29,20**	**-19,56**
NET INTEREST INCOME	408	27
NET FEE AND COMMISSION INCOME	-33	-100
NUMBER OF EMPLOYEES	27	25
Assets per employee in 000 EUR	837	467
OPERATING EXPENSES	-1.901	1.137
INDICATORS		
CAPITAL ADEQUACY %	**81,92**	**325,94**
LIQUIDITY RATIOS %	**4,53**	**17,7**
CASH IN 000 EUR	**8.817**	**5.950**
Interest income / Interest bearing assets %	5,46	3,42
Interest income / Total assets %	3,08	0,47
Interest expenses / Interest bearing liabilities%	1,01	1,04
Operating expenses / Total expenses %	92,14	91,53
Liquid assets / Deposits %	63,76	890,15
Liquid assets / Total assets %	36,97	50,91
Liquid assets / Short-term liabilities %	142,29	1.582,89

3. REGULATORY REQUIREMENTS IN 2017

Table 6. - Regulatory requirements on 31 December 2017

R.Br.	OPIS	LIMIT	31.12.2017
1	Capital Adequacy Ratio	min. 10 %	81,92%
3	Exposure to the related parties to the Bank	Max. 25%	16,07%
4	Sum of big exposures	Max. 800%	39,38%
5	Total equity in 000 EUR	min 5 mil	9.188
6	Own funds in 000 EUR	min 5 mil	8.689
7	Total risk assets and other risks in 000 EUR		
7.1.	Risk weighted assets		9.310
7.2.	Capital need for market risk		44
7.3.	Capital need for operating risk		40
7.4.	Capital need for country risk		114
7.5.	Capital need for other risks		345
7.6.	Open FX position		0

Audit company Ernst&Young d.o.o Montenegro, audited financial statements and regulatory requirements for 2017 and stated that there was no breaching of the same.

4. BALANCE SHEET FOR 2017

4.1. Assets of the bank on 31 December 2017

Table 7. – Assets of the Bank on 31 December 2017 in 000 EUR

ASETS	31 December 2017.	31 December 2016.	Index (2017/2016)
ASSETS			
Cash and cash on the accounts with Central bank	7.024	5.488	1,28
Loans and receivables form banks	1.793	462	3,88
Loans and receivables form clients	10.789	2.254	4,79
Investments securities held to maturity	2.011	2.411	0,83
Property, plant and equipment	458	560	0,82
Intangible assets	436	449	0,97
Other financial receivables	42	8	5,21
Other operational receivables	54	54	1,01
TOTAL ASSETS	22.607	11.686	1,93

Total assets of the Bank in 2017 amounted EUR 22.607 thousands.

Loans to the clients amounted EUR 10.789 thousands and loan portfolio represents 48% of total Bank's assets. The realized growth in 2017 is 379% (31 December 2016: EUR 2.254 thousands)

As at 31 December 2017 the portfolio of the securities held to maturity amounts EUR 2.011 thousands (9% of total Bank assets). This consists of the following:

- Government bonds of EUR 2.000 thousand purchased on 15 November 2016, with yearly interest rate of 4%, and maturity on 15 November 2020,
- Accrued interest on government bonds in amount of EUR 11 thousand.

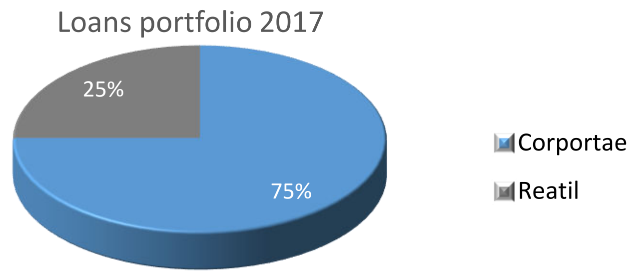
Except loans to the clients, significant part of the assets of the Bank is cash, representing 39%.

4.2. Loans to the clients on 31 December 2017

Table 8. - Net loans to the clients on 31 December 2017 in 000 EUR

NO	DESCRIPTION	31.12.2017	31.12.2016
I	**Loans to the clients**	**10.798**	**2.254**
1	Corporate	8.103	965
2	Retail	2.695	1.289
II	Loan impairment	-9	0
I+II	**Net loans to the clients**	**10.789**	**2.254**

Graph 4. - Loans to the clients - 2017



Total loans to the clients, on 31 December 2017, amounted EUR 10.789 thousands (31 December 2016: EUR 2.254 thousands).
Reatail loans amounted EUR 2.695 thousands, and corporate loans were EUR 8.103 thousands.

Table 9. - Portfolio overview on 31 December 2017 in 000 EUR

Type of loan	2017	% share 2017	2016	% share 2016
Balance sheet item				
Loans and receivables form banks	1.793	12%	462	9%
Short term loans to clients	2.252	15%	110	2%
Long term loans to clients	8.436	58%	1.567	31%
Overdue loans	131	1%	580	11%
Interest receivables and prepayments	-21	0%	-3	0%
HTM securities	2.011	14%	2.411	47%
Total balance sheet exposure to credit risk	*14.602*	100%	5.127	100%
Off-balance sheet items				
Performance guarantees	159	14%	1	20%
Undrawn loans	990	86%	4	80%
Total off-balance sheet exposure to credit risk	*1.149*	*100%*	5	100%
Total exposure to credit risk	15.751		5.132	

In the Bank placement structure, the most dominant is the participation of long-term loans (58%), primarily corporate long-term loans.

Table 10 - Overview of total portfolio by holders 31 December 2017 in 000 EUR

Type of loan	2017	% share	2016	% share
Banks, non–resident	1.789	12%	462	9%
Banks, residents	4	0%	0	0%
State - owned companies	1.391	10%	0	0%
Privately owned companies	6.531	45%	728	14%
Entrepreneurs	145	1%	165	3%
NGOs and other non-profit organizations, residents	36	0%	70	1%
Individuals, residents	2.667	18%	1.291	25%
Individual, non-residents	28	0%	0	0%
Government Bonds	2.011	14%	2.411	47%
Total credit risk exposures	14.602	100%	5.127	100%

In 2017 the highest amount of approved loans relates to corporate loans.

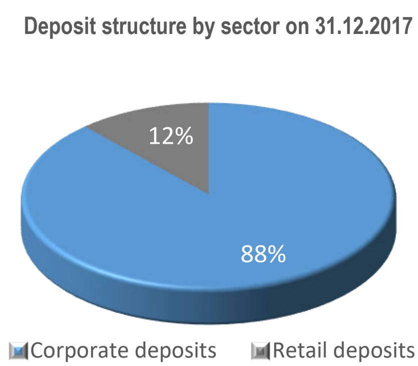
4.3. Equity and liabilities of the bank on 31 December 2017

Table 11. - Equity and liabilities on 31 December 2017 in 000 EUR

EQUITY AND LIABILITIES PASIVA	31 December 2017.	31 December 2016.	Index (2017/2016)
LIABILITIES			
Deposits of the banks	0	0	0
Deposits of the clients	13.127	668	19,65
Borrowings from other clients	81	0	0,00
Other liabilities	211	265	0,80
TOTAL LIABILITIES	13.419	933	14,38
EQUITY			
Share capital	11.980	11.980	1,00
Profit / Loss of the current year	-2.792	-1.227	2,28
TOTAL EQUITY	9.188	10.753	0,85
TOTAL EQUITY AND LIABILITIES	**22.607**	**11.686**	1,93
OFF-BALANCE SHEET RECORDS	**15.557**	**2.204**	**7,06**

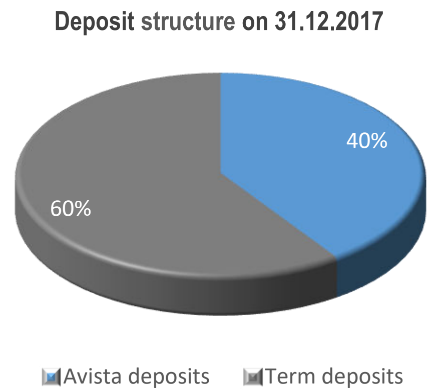
In the equity and liabilities structure total deposits of the clients, with accrued interest on 31 December 2017, represents 58% and amounts EUR 13.127 thousands.

Graph 5. - Deposit structure by sector 31 December 2017



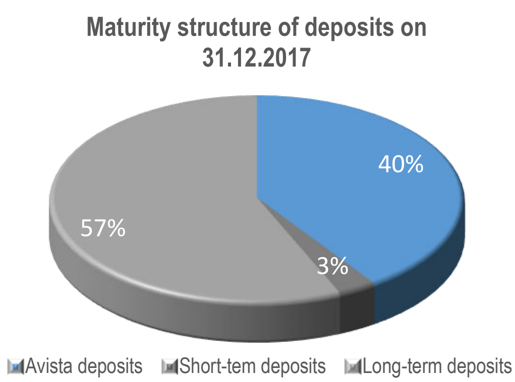
Deposit structure by sector at the end of 2017, shows that retail deposits represents 12% of total deposits, or EUR 1.543 thousands.
Corporate deposits are 88% of total deposits of the Bank, or EUR 11.584 thousands. The higher participation of the corporate deposits is the result due to change of the bank's strategy in the last quarter of 2017. Intensification of deposit collection activities are to provide diversification of funding sources and self-financing model. The attraction of corporate deposits, in this operational phase of the Bank, is much more realistic than retail.

Graph 6. - Deposit structure on 31 December 2017 by type



Avista deposits at the end of 2017 amounts EUR 5.310 thousands or 40% of total deposits, while term deposits are EUR 7.817 thousands or 60% total Bank's deposits. As in the first year of operations, the interest rates offered by the Bank on term deposits have been at the level of major international banks on the Montenegrin market, a change in strategy will require a small increase in interest rates on term deposits.

Graph 7. - Maturity structure of deposits on 31 December 2017



Maturity structure of deposits at the end of 2017, shows that long-term deposits represents 57% of total deposits and they amounts EUR 7.420 thousands.
Short-term and a vista deposits are 43% of total deposit portfolio of the Bank and amounts EUR 5.707 thousands.

4.4. Changes on equity fup to 31st of December 2017

As of 31 December 2017, the Bank's share capital was comprised of 299.511.761 ordinary shares, with nominal value per share of EUR 0, 04.

Table 12 - The ownership structure of the Bank as at 31 December 2017

	31 December 2017		
Name of the person/company	**No of shares**	**In EUR**	**% ownership**
Azmont Investments d.o.o. Herceg Novi	299.511.761	11.980.470,44	100,00%
	299.511.761	**11.980.470,44**	**100,00%**

In accordance with the regulations of the Central Bank of Montenegro, the Bank is required to maintain a minimum capital adequacy ratio of 10%. The Bank is required to comply its operations within the prescribed parameters, to comply the volume and structure of risky assets with the Law on Banks ("Official Gazette of Montenegro" no. 17/08, 44/10, 40/11, 73/17) and the regulations of the Central Bank of Montenegro.

The Bank's solvency ratio as at 31 December 2017 amounted to 81,92%.

As of 31 December 2017, the own funds of the Bank are above prescribed minimum of EUR 5.000 thousand and amount EUR 8.689 thousand.

The Law on Banks ("List of CGs" Nos. 17/2008, 44/2010, 40/2011 and 73/2017) defines the minimum amount of bank capital in the amount of EUR 5 million.

On 31 December 2017 the Bank's capital is above the regulatory minimum.

Table 13. - Changes on equity

Position	Share Capital	Retained earnings	TOTAL
Balance on 13. April 2017	0	0	0
Issue of share capital	11.980	0	11.980
Profit/Loss 2016	0	-1.227	-1.227
Balance on 31 December 2016	**11.980**	**-1.227**	**10.753**
Loss of current period		-1.565	-1.565
Balance on 31 December 2017	**11.980**	**-2.792**	**9.188**

4.5. Bank's off-balance sheet records

Commitments of the Bank as at 31 December 2017 consists of the contingent liabilities of the Bank and the rest off-balance sheet relating to the records of received collateral for loan receivables and contingent liabilities of the bank.

Table 14. - Off-balance records of the Bank

In thousands EUR	31 Dec **2017.**	31 Dec **2016.**
Contingent liabilities of the Bank	**1.149**	**5**
Irrevocable commitments to grant loans	990	4
Guarantees	159	1
- *issued performance guarantees*	*126*	*1*
- *other guarantees*	*33*	*0*
Other off-balance items	**14.408**	**2.199**
Collaterals on receivables	14.408	2.199
Total	**15.557**	**2.204**

Off-balance sheet exposure of the Bank on December 31, 2017 amounts to EUR 1.149 thousands, of which 990 EUR thousands (86%) of the unused approved loans and approved guarantees of EUR 159 thousands (14%).

In accordance with the Decision of Central Bank of Montenegro on Minimum Standards for Credit Risk Management in Banks ("Official Gazette of Montenegro", no. 22/12, 55/12 and 57/2013) the receivables from bank balance sheets are transferred to the internal records if the bank estimates in the process of collecting the receivables that the value of receivables measured at amortized cost will not be compensated and that the conditions are met for derecognition of financial assets, which includes the following cases:

1) For unsecured receivables:
- When the debtor subject to bankruptcy proceedings lasting longer than one year, or
- If the debtor is late with payments for more than two years
2) For secured receivables, when the debtor is late with payments for more than four years, or if the bank during this period did not receive any payment from the realization of collateral.

In accordance with current regulations, as at 31 December 2017, no receivables were written off from the Bank's balance sheet records.

5. INCOME STATEMENT FOR 2017

Table 15.- Income statement

In thousands EUR:	2017.	2016.	Index (2017/2016)
Interest income	458	28	16,17
Interest expenses	-50	-2	30,43
NET INTEREST INCOME	408	27	15,29
Impairment losses	-32	0	0,00
Bank loan-loss provisions cost	-6		0,00
Fee and commission income	73	4	18,32
Fee and commission expenses	-106	-104	1,03
NET FEE AND COMMISSION INCOME	-33	-100	0,33
Net FX result	0	0	-4,07
Personal expenses	-919	-571	1,61
Other administrative expenses	-756	-464	1,63
Depreciation	-221	-102	2,17
Other costs	-5	0	13,38
Other income	0	0	0,00
OPERATING PROFIT	-1.564	-1.210	1,29
Income tax	-1	-17	0,05
NET PROFIT	-1.565	-1.227	1,28

5.1. Interest income and expenses

Table 16.- Interest income and expenses in 000 EUR

Interest income and expenses	2017	2016
Interest income		
Loans:		
-state owned companies	42	3
-privately owned companies	173	0
-entrepreneurs	9	1
-NGOs and other non-profit organizations, residents	3	0
-individuals	141	12
	368	16
Interest on HTM securities	90	12
Total interest income	**458**	**28**
Interest expenses		
International banks	6	0
Central bank of Montenegro	8	0
	14	0
Deposits:		
-Government of Montenegro	12	0
-state owned companies	10	0
-privately owned companies	1	0
-individuals	13	1
	36	1
Total interest expenses	50	1
Net interest income	**408**	**27**

From the interest income details we can see that the highest share in income by holder is related to interest income from privately owned companies and individuals, which is understandable having in mind bank's portfolio structure.

5.2. Fee and commissions income and expenses

Table 17.- Fee and commissions income and expenses in 000 EUR

Fee and commissions income and expenses	2017	2016
Fee and commission income		
Guarantee fees	4	0
Loan approval fees	26	1
Payment transaction and e-banking fees	43	3
Total fee and commission income	**73**	**4**
Fee and commissions expenses		
Central bank fees	18	16
International payment fees	42	35
Deposit protection Fund fees	12	50
E-banking fees	16	3
Cards processing fees	10	0
MasterCard fees	8	0
Total fee and commission expenses	**106**	**104**
Net fee and commission income	**-33**	**-100**

The realized income from fees in 2017 increased significantly compared to 2016 (7 months of operational work), but the net result of fees is still negative.

Fees expenses are still on high level due to fees for payment transactions which are fixed monthly charges not based on number or amount of transactions.

5.3. Operating expenses

Table 18.- Operating expenses in 000 EUR

Operating expenses	2017	2016
Personnel expenses		
Net salaries	519	311
Taxes, contributions and surtax on salaries	364	220
Other payments to employees	0	1
Temporary contracts	9	9
Provision for unused annual leave	4	24
Provisions for severance payments	14	0
Travel expenses and per diem	8	4
Training expenses	1	2
Total personnel expenses	**919**	**571**
Other administrative expenses		
Rent	108	68
Audit expenses (CBM and external audit)	109	98
Security	34	22
Advertising and marketing	37	47
Legal cost	43	29
Licenses and SW maintenance	239	106
Maintenance of facilities, equipment, IT equipment, ATMs	3	0
Vehicle maintenance and registration	1	0
Consulting fees	63	22
Electricity and fuel	15	8
Office material	7	10
Communication network	17	10
Subscriptions	12	4
Phone charges	12	6
Membership fees for Bank Association	16	8
Insurance	13	5
Representation	5	4
Cleaning	16	8
Other Costs	11	9
Total administrative expenses	**761**	**464**
Depreciation	**221**	**102**
TOTAL OPETAING EXPENSES	**1.901**	**1.137**

Operating and other expenses in 2017 amounted EUR 1.901 thousands out of which EUR 919 thousands or 48% are related to staff costs.

6. MEASURES FOR ENVIRONMENTAL PROTECTION

Nova Banka AD keeps its policy environmentally conscious and committed, in accordance with the Law on Environment (Official Gazette of Montenegro, No. 052/16 of 09.08.2016) and the Law on Environmental Impact Assessment ("Official Gazette of the Republic of Montenegro Gore ", No. 080/05 of 28.12.2005, Official Gazette of Montenegro", No. 040/10 of 22.07.2010, 073/10 of 10.12.2010, 040/11 of 08.08.2011, 027/13 of 11.06 .2013, 052/16 of 09.08.2016).
In accordance with Article 9 of the Law on Environment, the Bank performs the following activities in order to ensure the protection of the environment:

• Sustainable use of natural resources, goods and energy;
• Introduction of energy-efficient technologies and the use of renewable natural resources;
• Use of products, processes, technologies that less jeopardize the environment;
• Take measures to prevent and eliminate the consequences of endangering and harm to the environment;
• Other measures in accordance with the law.

In accordance with the criteria defined by the Law, the Bank is not recognized as a pollutant and, on this basis, does not pay any penalties. In the foreseeable future, it does not plan any project that could have a negative impact on the environment.

In accordance with the Law on Environmental, if a particular project or business activity planned by the Bank can or will have an impact on the environment, the competent authority approval will be provided on the the impact assessment report or the decision that impact assessment on the environment is not required.

7. PLANNED FUTURE DEVELOPMENT

In accordance to adopted budget of the Bank end of November 2017, the following projection of the financial results is made for the period 2017-2020:

Table 19.- Planed profit and loss (2017-2020)

POSITION (in TEUR)	dec.17	dec.18	dec.19	dec.20
Interest Income	460,30	1.108,60	2.553,72	3.458,45
Interest Expense	-36,14	-348,58	-994,09	-1.314,87
Net interest income	**424,16**	**760,02**	**1.559,63**	**2.143,58**
Fees and commissions income	57,60	197,71	328,57	471,96
Fees and commissions expenses	-105,04	-188,76	-321,87	-393,21
Net fee income	**-47,44**	**8,95**	**6,70**	**78,75**
Net income from financial operations	-0,36	0,00	0,00	0,00
Other operating expenses	-4,55	0,00	0,00	0,00
OVERHEAD EXPENSES	**-1.850,62**	**-2.320,57**	**-2.577,78**	**-2.673,87**
Staff expenses	-905,48	-1.132,70	-1.258,32	-1.323,21
Other administrative costs	-727,03	-901,20	-991,77	-1.015,50
Depreciation	-218,11	-286,66	-327,68	-335,15
NET COST OF RISK	**-60,53**	**-400,09**	**-659,01**	**-411,57**
PROFIT BEFORE TAX	-1.539,34	-1.951,68	-1.670,46	-863,11
Corporate tax	0,00	0,00	0,00	0,00
NET PROFIT	**-1.539,34**	**-1.951,68**	**-1.670,46**	**-863,11**

Period considered by this business plan, will be very demanding for the Bank and its management team. This is the period in which the Bank needs to position itself at the market and continue a successful cooperation with the clients, who were acquired by the Bank during 2016 and 2017. Also, the work on the expansion of the clients base will be continuous. Plan is to realize close business relations with our clients, to understand their business activities and financial needs, in order to be able to support them in their business requests within the shortest possible period – for

for liquidity loans, loans for fixed assets, guarantees, letters of credit, etc. The Bank wants to create the operation conditions, which would be more favourable than the conditons in the other banks, not just regarding lower fees, but much more in terms of active understanding and moniring of the clients' business.

Business plan for the following period are projected growth rates which will provide realization of the objectives, profitability increase and market share. The plan is to realize growth of total assets during the budgeted period 2018-2020 of 104% in 2018, 45% in 2019 and 38% in 2020.

Table 20 – Planned balance sheet for the period 2017 to 2020

Balance Sheet - (in TEUR)	**dec.17**	**dec.18**	**dec.19**	**dec.20**
Assets:				
Cash	5.342	5.752	3.366	6.396
Obligatory reserve	610	1.960	3.310	4.840
Gross Loan receivables	8.697	25.681	43.620	61.563
Minus- LLP	-31	-541	-1.200	-1.612
Net loans	8.666	25.140	42.420	59.951
Securities	2.007	2.007	2.007	0
Premises and other fixed assets	565	704	681	601
Intangible assets	347	353	401	366
Other assets	93	133	172	219
Total Assets	17.631	36.048	52.357	72.373
Liabilities:				
Deposits	8.138	26.138	44.138	64.538
Sight deposits	4.470	6.870	9.270	15.270
Term deposits	3.668	19.268	34.868	49.268
Borrowings	79	2.558	2.537	16
Other liabilities	200	200	200	200
Other liabilities	8.417	28.896	46.875	64.754
Share capital	**11.980**	**11.980**	**11.980**	**14.980**
Subordinated debt	-1.539	-1.952	-1.670	-863
Retained earnings current year	-1.227	-2.767	-4.718	-6.389
Retained earnings previous years		-110	-110	-110
Total equity	9.214	7.152	5.482	7.618
Equity and liabilities	17.631	36.048	52.357	72.373

Table 21 – Other important indicators for the period 2017 to 2020

Balance Sheet - Assets, Liabilities and Capital	**dec.17**	**dec.18**	**dec.19**	**dec.20**
Interest bearing assets	11.009	28.668	47.282	63.983
Interest bearing liabilities	8.217	28.696	46.675	64.554
Share of interest bearing in total assets	62%	79%	90%	88%
Share of interest bearing in total liabilities	47%	80%	89%	89%
Interest income	460	1.109	2.554	3.458
Interest expense	(36)	(349)	(994)	(1.315)
Weighted average IR-active	4,46	5,38	6,72	6,22
Weighted average IR-passive	0,66	1,88	2,64	2,36
Margin	3,79	3,50	4,09	3,85

8. RISK MANAGEMENT

The Bank is exposed to various risks in its operations, of which the most significant are the following:

- credit risk;
- market risk;
- liquidity risk;
- operational risk

The risk management procedures are designed to identify and analyze risks, to define limits and controls required for risk management and to monitor the Bank's exposure to each individual risk. The risk management procedures are subject to regular review in order to allow adequate response to the changes in the market, products and services.

The Risk Management Department is responsible for monitoring the Bank's exposures to certain risks. In addition, monitoring of the Bank's exposures to certain risks is the responsibility of Asset and Liability Management Committee.

Credit risk

Credit risk is of possible negative effects on financial result and capital of the Bank due to unsettled liabilities of the Bank's debtors. The primary exposure to credit risk arises trough loans and investments. Bank approves loans in accordance to its business policies, aligning the maturities of loans approved and interest rate policy with the purpose of the loan and credit ability of the debtor.

Bank is providing for credit losses based on impairment test, and those losses are losses incurred on the date of statement of financial position. Significant changes in the economy, or in certain industries which are involved in Bank's loan portfolio, could result in losses that are different from losses provided for in the statement of financial position. Management therefore carefully manages exposure to credit risk.

Exposure to credit risk is risk of financial loss resulting from the inability of the debtor to fulfill its obligations towards the Bank. Bank is managing credit risk by setting up the limits for big exposures, individual exposures and related parties. Those risks are monitored continuously and are reviewed regularly.

In accordance to the limits prescribed by the Central Bank of Montenegro, sector concentration is constantly monitored.

Credit risk exposure is managed by means of regular analyses of the ability of borrowers and potential borrowers to repay the liabilities in terms of principal and interest.

Commitments and Contingent Liabilities

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, and therefore carry the same credit risk as loans. Documentary and commercial letters of credit, which represent written undertakings of the Bank on behalf of a customer authorizing a third party to draw bills of exchange on the Bank up to the amount agreed under specific terms are secured by the underlying deliveries of goods that they relate to and therefore carry less risk than loans.
Loan portfolio at the end of 2017 amounts EUR 10.798 thousands while off-balance sheet exposure was EUR 1.149 thousands, and all exposures were classified in the table below:

Table 22. – Exposures and impairments on 31 December 2017

No.	DESCRIPTION	31.12.2017		31.12.2016	
	Category	**Exposure**	**Impairments**	**Exposure**	**Impairments**
I	**Balance**	**10.798**	**9**	**2.254**	**0**
1	A	8.945	0	2.254	0
2	B	1.868	6	0	0
3	C	5	3	0	0
4	D	0	0	0	0
5	E	0	0	0	0
II	**Off - Balance**	**1.149**	**0**	**5**	**0**

As at 31 December 2017, impairments have been calculated in accordance with IAS 39, but the bank is required to apply IFRS 9, issued in July 2015, starting from 1 January 2018. IFRS focuses on three main accounting parts of financial instruments: classification and measurement, impairment and hedge accounting.

During 2017, the Bank has been engaged in developing major business concepts, policies, procedures, processes and systems in order to be prepared for implementation of IFRS 9 on January 1, 2018. As a result, the Bank has measured potential financial effects with aim to move from the development phase to the implementation phase.

Based on the above, the Bank does not expect this standard to have a significant impact on the balance sheet and measurement methodology of financial instruments. In the area of classification and measurement, the Bank has not identified a significant risks that would have as a result that part of its loan portfolio would have to be measured at fair value through P&L, considering the contractual cash flow characteristics (SPPI test). An impact analysis on impairment has been made and a negative effect of EUR 27 thousand has been determined. Also, the Bank expects that the structure of the financial statements (main components and notes) will have to be adjusted, especially in the light of new reporting and disclosure requirements in accordance with IFRS 7, which is affected by the implementation of IFRS 9. Adjustments will be made in accordance with the requirements of the Central Bank of Montenegro in the forthcoming period.

Market risk

The Bank is exposed to market risks. Market risks arise from open positions due to changes in interest rates and foreign currency exchange rates.
On December 31, Nova Banka is exposed to the market risk that can be realized on a portfolio of debt securities that make EUR 2,000 thousand of government bonds with maturity date November 15, 2020.
The allocated capital required for the general risk of debt instruments is EUR 44 thousand.

Currency Risk

Currency risk management is defined with Risk Management Strategy and Interest rate management Policy from banking book and market risks. Those documents define the way in which the bank identifies, measures, controls, mitigates and monitors the currency risk. Measuring the currency risk is performed applying GAP analysis for currency risk, while the control system established by limiting long, short and net positions individually by currencies and aggregately. On a daily basis Treasury Department reports to the risk management the amount and character of currency update. Risk Management Department reports on a monthly basis to Asset and Liability Committee on all important aspects of the management of foreign exchange risk.

The Bank's financial position and cash flows are exposed to the effects of the changes in foreign currency exchange rates. Currency risk exposure is continuously monitored and reconciled with the limits prescribed by the Central Bank of Montenegro.

Exposure of the Bank to the currency risk on 31 December 2017 was low, with net long position amounted EUR 17 thousands. Long position balance in foreign currency was low on 31 December 2017, amounted to EUR 87 thousands and EUR 70 thousands of short positions in the euro counter value.

Interest Rate Risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank assumes exposure to the effects of fluctuations in the prevailing levels of market interest rates on cash flows. Interest margins may increase as a result of such changes; however, these may reduce profit or give rise to losses in instances of unexpected fluctuations. Interest rates are based on market rates and the Bank performs regular repricing.

The following table presents the level of interest bearing and non-interest bearing assets and liabilities of the Bank on 31 December 2017:

Table 23 - Interest bearing and non-interest bearing assets and liabilities of the Bank

Thousands EUR	Interest bearing	Non-interest bearing	Total
ASSETS			
Cash balances and deposits with central banks	7.276	1.541	8.817
Loans and receivables from clients	10.819	-30	10.789
Investment securities	2.000	11	2.011
Total assets	**20.095**	**1.522**	**21.617**
LIABILITIES			
Deposits from clients	10.956	2.171	13.127
Borrowings from others	81	0	81
Total liabilities	**11.037**	**2.171**	**13.208**
Exposure to interest rate risk:	**9.058**	**-649**	**8.409**

Exposure to interest rate risk on 31 December 2017 is shown in the table below:

Table 24 – The risk of interest rate changes

Interest sensitive assets in 000 EUR	**Up to one month**	**From 1 to 3 months**	**From 3 to 6 months**	**From 6 to 12 months**	**Over 1 year**	**Total**
Interest-bearing deposits, other institutions	7.276	-	-	-	-	7.276
Interest bearing securities	-	-	-	-	2.000	2.000
Loans and receivables from clients	132	1.080	1.049	2.253	6.305	**10.819**
Total	**7.408**	**1.080**	**1.049**	**2.253**	**8.305**	**20.095**
% total interest bearing assets	**36,86%**	**5,37%**	**5,22%**	**11,21%**	**41,33%**	**100,00%**
Interest sensitive liabilities						
Interest-bearing deposit	3.156	175	186	5.568	1.871	10.956
Interest-bearing borrowings	3	5	5	10	58	81
Total	**3.158**	**180**	**191**	**5.578**	**1.929**	**11.037**
% interest bearing liabilities	**28,62%**	**1,63%**	**1,73%**	**50,54%**	**17,48%**	**100,00%**
Interest rate GAP:						
-31 December 2017	4.249	900	858	-3.325	6.376	**9.058**
-31 December 2016	196	222	169	-65	3.464	**3.986**
Cumulative GAP:						
-31 December 2017	**4.249**	**5.149**	**6.007**	**2.682**	**9.058**	
-31 December 2016	**196**	**418**	**587**	**522**	**3.986**	

Liquidity risk

Liquidity risk includes the risk of the Bank being unable to provide cash to settle liabilities upon maturity, or the risk that the Bank will have to obtain funds at reasonable prices and in a timely manner to be able to settle its matured liabilities.

The matching and controlled mismatching between the maturities and interest rates of assets and of liabilities are fundamental to the management of the Bank. It is uncommon for banks to have completed matching since business transactions are often made for indefinite term and are of different types. A mismatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability of the Bank to obtain sources of funding upon maturity of liabilities at an acceptable cost are an important factor in assessing the liquidity of the Bank and its exposure to changes in interest rates and foreign exchange rates.

Liquidity requirements to support calls on guarantees and contingent liabilities in 2017 amount EUR 1.149 thousands.

As of 31 December 2017, the Bank has managed the liquidity risk in accordance with the adopted Strategy for risk management. To measure liquidity risk, the Bank uses the GAP analysis. Beside liquidity risk monitoring on a daily basis it is monitored for a 10-days and monthly period through a set of reports prepared for supervisor as well for Asset and Liability Committee.

According to the Central Bank of Montenegro methodology liquidity ratio is calculated comparing receivables, liquid assets (cash, bank accounts domestic and foreign banks and mandatory reserve) with due liabilities (loans received, liabilities for fees and interest, liabilities for term deposits and 30% of a vista deposits, 10% of approved unused loans – credit lines, and other due liabilities.

Calculation of daily liquidity ratio on 31 December 2017 is shown in the following table:

Table 25 – Liquidity ratio on 31 December 2017

No.	DESCRIPTION	AMOUNT
I	**Liquid assets/receivables(claims)**	**8.357**
1.	Cash	617
2.	Assets on the account in Central Bank of Montenegro	5.488
3.	Other cash claims	0
4.	Assets on the accounts in domestic banks (Avista deposits)	4
5.	Assets in the agents of payment system	0
6.	Assets on the accounts in international banks (A vista deposits)	1.789
7.	Required reserve in the Central Bank of Montenegro (according to the current decision)	459
II	**Matured liabilities for loans and borrowings**	**1.845**
1.	Due liabilities based on loans received (borrowings)	2
2.	Due liabilities based on interest rates and fees	0
3.	Due liabilities based on term deposits	0
4.	30% Avista deposits	1.592
5.	10% Approved but unused, irrevocable credit obligations (credit lines)	99
6.	Other due liabilities	152
	SUFICIT / DEFICIT (I - II)	**6.512**
	Liquidity ratio (I / II)	**4,53**

The Bank is exposed to daily calls on its available cash resources which influence the available cash held on the current accounts or as deposits. The Bank does not maintain cash to meet all of these needs since historical experience demonstrates that a minimum level of reinvestment of maturing funds can be predicted with a high degree of certainty.

Other liquidity ratios of the Bank on the quarterly bases are presented below:

Table 26 – Liquidity ratios

Description	*31.12.2017*	*30.9.2017*	*30.6.2017*	*31.03.2017*
Liquid assets	8.357	5.240	3.178	4.484
Total assets	22.607	15.204	12.537	12.705
Short-term liabilities	5.873	4.029	2.093	1.922
Liquid assets / Total assets	*36,97%*	*34,46%*	*25,35%*	*35,29%*
Liquid assets / Short-term liabilities	*142,30%*	*130,06%*	*151,84%*	*233,30%*
Daily liquidity ratio	*4,53*	*4,66*	*4,00*	*5,94*
Loan to Deposit ratio	*81,69%*	*125,44%*	*186,88%*	*158,89%*

The remaining contractual maturity matching of financial assets and liabilities as of 31 December 2017 is as follows:

Table 27 – Maturity gap

In thousands EUR	**Up to a month**	**From 1 to 3 months**	**From 3 to 6 months**	**From 6 to 12 months**	**From 1 to 5 years**	**Over 5 years**	**Total**
Financial assets							
Cash balances and deposits with central banks	7.024	-	-	-	-	-	7.024
Loans and receivables to banks	1.793	-	-	-	-	-	1.793
Loans and receivables to customers	132	1.080	1.049	2.253	4.862	1.443	10.819
Investment securities - HTM	-	-	-	11	2.000	-	2.011
Total	**8.949**	**1.080**	**1.049**	**2.264**	**6.862**	**1.443**	**21.647**
Financial liabilities							
Deposits due to clients	5.307	179	188	5.577	1.866	10	13.127
Borrowings from IRF	2	5	5	10	58		80
Other financial liabilities	151	-	-	-	18	-	169
Total	**5.460**	**184**	**193**	**5.587**	**1.942**	**10**	**13.376**
Maturity GAP							
- 31 December 2017	**3.489**	**896**	**856**	**-3.323**	**4.920**	**1.433**	**8.271**
- 31 December 2016	**6.001**	**144**	**169**	**-54**	**2.562**	**885**	**9.707**
Cumulative GAP:							
-31 December 2017	**3.489**	**4.385**	**5.241**	**1.918**	**6.838**	**8.271**	
-31 December 2016	**6.001**	**6.145**	**6.314**	**6.260**	**8.822**	**9.707**	
% of total funds:							
- 31 December 2017	**26,08%**	**32,78%**	**39,18%**	**14,34%**	**51,12%**	**61,83%**	
- 31 December 2016	**661,70%**	**677,60%**	**696,30%**	**690,30%**	**972,80%**	**1070,30%**	

Operating risk

Operational risk management at the Bank is not internally regulated. The Bank is currently working on the preparation of the procedure for the operational risk management, which precisely defines method of identification, assessment and monitoring, management, and giving proposals of measures for the elimination of exposure and consequences arising from operational risk exposure
The Bank will in 2018 work on establishing a system for the management of operational risk. The measurement or assessment of operational risk will be done through quantitative and / or qualitative assessment of identified operational risk. In addition, the Bank will carry out the identification of operational risks, classifying them according to priority by measuring the potential financial impact and frequency of events that can result in losses.

In order to efficiently manage operational risk, the Bank will created an internal model, through which organizational units are obliged to submit reports on adverse events occurred and identify operational risks for the reporting period.

In the process of identifying sources of operational risk, the Bank shall take care to identify risks arising from:

- inadequate information and other systems in the Bank;
- business interruption and fault in the system (for example, faults related to the information technology, telecommunications, interruptions in the work etc.);
- inability of adequate integration or sustainability of information and other systems, in case of status changes of the Bank;
- unproper treatment of employees in the Bank, as well as attempts of fraud, money laundering, unauthorized access to client accounts, misuse of confidential information, giving false or misleading information about the status of the Bank, delays in carrying out tasks, errors in data entry, failure to comply with good business practices, etc. .;
- involvement of people outside the Bank to perform the jobs for the Bank;
- acts or omissions which may cause court and other proceedings against the Bank (legal risk);
- Foreign illegal acts such as theft, unauthorized transfer of funds, unauthorized entry into a database, illegally obtaining documents of the Bank, etc. .;
- events that can not be predicted, such as natural and other disasters, terrorism etc.

Operational risk events records includes the systematic collection and analysis of operational risk in the Bank's operations that led to the losses.

According to the plan of improving operational risk management system, the Bank will in future:

- work on improving the model for identifying operational risks and collecting data on adverse events that occurred as a result of operational risk;
- to train employees in order to increase operational risk management at the Bank

9. CAPITAL ADEQUACY

Own Funds

The Bank is required to publicly disclose information and data relating to the amount of own funds, including:
1) a summary comprising the main characteristics of all items which are included in the calculation of its own funds and its elements;
2) the amount of capital, with special public disclosure of all items included in the share capital and deductibles;
3) the total amount of additional capital;
4) deductions from Tier I and Tier II capital, and
5) the total own funds, reduced by the deductions

Table 28 – Own Funds for 2017

		in 000 EUR
		31.12.2017
I	***Own Funds***	**11.980**
	Issued share capital	*11.980*
II	***Deduction in calculation of Tier I capital***	**3.291**
	Losses from the previous years	*1.227*
	Loss for the current year	*1.565*
	Intangible assets	*436*
	Positive difference between the amount of regulatory provisions for potential losses and impairments for balance and off-balance sheet items	*63*
III(I-II)	***Tier I capital***	**8.689**

On 31 December 2017, deductible items reducing the Bank's own funds are related to:

- Actual loss in 2016 of EUR 1.227 thousands,
- Actual loss from the current year of EUR 1.565 thousands,
- The book value of intangible assets of the Bank at December 31, 2017 n the amount of EUR 436 thousands.
- Positive difference between the amount of regulatory provisions for potential losses and impairments for balance and off-balance sheet items in the amount of EUR 63 thousands.

Risk weighted assets calculated in accordance to the Decision on Capital Adequacy for the banks, on December 31, 2017 amounted EUR 9.310 thousands.

In accordance to Decision on Capital Adequacy for the banks, which is applicable on 31 December 2017, Bank is obliged to keep Capital Adequacy Ratio on a level of at least 10%.

Capital Adequacy Ratio of the Bank on 31 December 2017 was **81,92%** and it is above prescribed limit of 10%.