

# **Report on the activities of the Bank Pekao S.A. Group**

**Warsaw, 12<sup>th</sup> September 2005**

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## **1 Introduction**

In the report for the first half of 2005 the Group and the Bank present their results in accordance with the International Financial Reporting Standards (IFRS).

The Group's consolidated financial statements fulfil the requirements of IFRS including IFRS 1 "First Time Adoption of International Financial Reporting Standards". Enclosed shortened report of the Bank fulfils the requirements of IAS 34 "Interim Financial Reporting" and IFRS 1.

In the preparation of the financial statements according to IFRS, the Group applied the admissible exemptions.

The pro forma data for the first half of 2004 was prepared to ensure comparability of the results.

The Group's net profit generated in the first half of 2005 amounted to PLN 725.4 million and was 18.3% higher than in the previous year.

The increase in the net profit of PLN 112.0 million in the first half of 2005 compared with the first half of the previous year was possible thanks to the increased business activity which translated into higher income particularly interest income, stable operating costs and lower cost of risk.

- The Group's income amounted to PLN 2,144.3 million in the first half of 2005 and was 7.5% higher than in the previous year, with interest income being higher by 6.2% and other income higher by 8.9%.
- In the first half of 2005, the Group noted a continued positive trend in the results of its business activity, with successful sales of key products: mutual funds, new consumer loans, PLN mortgage loans and credit cards. The value of mutual funds increased by 26.3% and the number of credit cards increased by 43.9% compared with the end of 2004. The sales of the new consumer loan product "Express Loan" nearly 4 times higher than in first half of 2004.
- In the first half of 2005, total overhead costs including depreciation amounted to PLN 1,153.5 million and were only by 0.4% higher than in the comparable period of the previous year, thanks to lower by 3.2% non-personnel costs almost offsetting an increase in personnel costs and depreciation by 2.7% and 1.4% respectively.
- In the first half of 2005, impairment losses on loans and advances amounted to PLN 128.6 million and were 28.0% lower than in the previous year. This resulted primarily from the improved quality of the portfolio and effective credit risk management. The ratio of non-performing loans to total loans decreased from 19.9% at the end of 2004 to 18.3% at the end of June 2005 due to an increase in the volume of performing loans and the drop in the volume of non-performing loans.
- Savings of the Group's clients increased by PLN 4,048.3 million (7.2%) in the first half of 2005 resulting from both an increase in the savings of individual clients (of PLN 2,873.9 million, i.e. 7.0%) and in corporate deposits (of PLN 1,174.4 million, i.e. 7.7%). Demand for mutual funds continued to be high allowing the Group to increase mutual funds assets by PLN 3,413.1 million in the first half of 2005, which in turn contributed to a further 1.9 p.p. increase in the market share to 36.4%.
- In the first half of 2005, the loan portfolio increased by PLN 1,991.0 million (6.7%) primarily due to the successful sale of the new consumer loan product "Express Loan", continued sale of PLN mortgage loans and acceleration in corporate lending.

## 2 Consolidated pro forma report

The consolidated report of the Bank Pekao S.A. Group was prepared in compliance with the International Financial Reporting Standards (IFRS), published by the International Accounting Standards Board including the International Financial Reporting Standard IFRS 1, which describes the requirements concerning first-time adoption of International Financial Reporting Standards and of the Decree of the Council of Ministers dated 21 March 2005 on current and periodic information submitted by the issuers of securities.

The report for the first half of 2005 was prepared using the same accounting principles as described in detail in the consolidated financial statements that are integral part of this report.

Taking into consideration the usefulness of the financial report, the Group has prepared pro-forma statements, which include balance sheet as at 30 June 2004 and profit and loss statement for the first half of 2004. Pro-forma statements approximate the effect of adjustments related to the above mentioned IAS 39 issues, i.e. impairment and valuation at amortised cost using effective interest rate.

CONSOLIDATED INCOME STATEMENT (in '000 PLN)	1 H 2005	1 H 2004 PRO FORMA
I. Interest income	1,954,316	1,787,353
II. Interest expense	(822,238)	(710,712)
III. Net interest income	1,132,078	1,076,641
IV. Fee and commission income	830,083	824,522
V. Fee and commission expense	(82,468)	(82,360)
VI. Net fee and commission income	747,615	742,162
VII. Dividend income	48	6
VIII. Result on financial instruments at fair value	53,186	5,133
IX. Result on investment securities	33,859	4,119
X. Foreign exchange result	146,478	143,203
XI. Other operating income	135,470	142,724
XII. Other operating expenses	(104,460)	(118,403)
XIII. Net other operating income	31,010	24,321
XIV. Impairment losses on loans and advances	(128,670)	(178,644)
XV. Overhead costs	(1,153,489)	(1,148,926)
XVI. Operating profit	862,115	668,015
XVII. Share of profit of associates	22,149	20,683
XVIII. Profit before income tax	884,264	688,698
XIX. Income tax expense	(158,871)	(75,304)
XX. Net profit	725,393	613,394
1. Attributable to equity holders of the Company	727,296	615,194
2. Attributable to minority interest	(1,903)	(1,800)

CONSOLIDATED BALANCE SHEET (in '000 PLN)	A at 30.06.2005	As at 31.12.2004 PRO FORMA
<b>Assets</b>		
I. Cash and balances with Central Bank	3,200,041	3,939,275
II. Debt securities eligible for rediscounting at the Central Bank	8,851	8,768
III. Loans and advances to banks	7,286,094	5,961,477
IV. Financial assets held for trading	2,508,823	3,195,771
V. Derivative financial instruments	631,694	503,482
VI. Other financial instruments at fair value through profit or loss	1,736,328	1,336,721
VII. Loans and advances to customers	26,739,530	25,749,048
VIII. Net investment in the finance lease	638,502	547,324
IX. Investment securities	14,477,687	15,036,457
1. Available for sale	11,694,383	10,106,484
2. Held to maturity	2,783,304	4,929,973
X. Investments in associated undertakings	149,312	124,662
XI. Intangible assets	629,512	631,925
XII. Tangible fixed assets	1,489,705	1,541,645
XIII. Investment property	99,384	102,869
XIV. Deferred income tax assets	170,943	127,339
XV. Other assets	750,210	729,487
<b>Total assets</b>	<b>60,516,616</b>	<b>59,536,433</b>

<b>Liabilities</b>		
I. Amounts due to the Central Bank	2,054,190	2,151,743
II. Amounts due to other banks	2,081,117	1,332,557
III. Financial liabilities held for trading	90,424	590,119
IV. Derivative financial instruments	736,257	623,683
V. Other financial liability at fair value through profit or loss	-	-
VI. Amounts due to customers	45,993,771	45,821,645
VII. Debt securities in issue	2	23,205
VIII. Other liabilities	1,609,508	1,060,369
IX. Current income tax liabilities	117,570	256
X. Provisions for deferred income tax	2,866	1,222
XI. Provisions	106,176	100,613
<b>Total liabilities</b>	<b>52,791,881</b>	<b>51,705,412</b>
<b>Equity</b>		
Capital and reserves attributable to the Company's equity holders	7,708,279	7,812,245
XII. Share capital	166,482	166,482
XIII. Retained earnings	(26,288)	(6,620)
XIV. Other capital and reserves	7,568,085	7,652,384
Minority interest	16,456	18,776
<b>Total equity</b>	<b>7,724,735</b>	<b>7,831,021</b>
<b>Total equity and liabilities</b>	<b>60,516,616</b>	<b>59,536,433</b>

### 3 Factors and events of significance to the Group's performance

#### 3.1 Macroeconomic situation

The first half of 2005 was characterized by moderate economic growth compared to the first half of the prior year, when the growth was particularly fast due to joining the European Union.

Sales of industrial production in the first half of the year were only 1.5% higher than in the corresponding period of the prior year. The increase in the production volume and growth rate compared with the prior year, in sectors considered to be technological progress carriers, undoubtedly was a positive phenomenon. The revival in the construction industry, observed since mid 2004, has been maintained.

The State Budget's income was higher by 1.1 p.p. and expenses were higher by 2.7 p.p. compared with the corresponding period of the prior year. The deficit amounted to 52.9% of the amount stipulated in the 2005 State Budget Act.

Due to the integration with the European Union and low dynamics of internal demand, the high export dynamics was maintained and the foreign trade balance improved.

The growth rate of consumer prices and manufacturer prices has dropped. The twelve-month inflation ratio as at the end of June amounted to 1.4%. Lower inflation resulted in a higher real income of households in the second quarter of this year.

As a result of the economic processes assessment, the Monetary Policy Council commenced interest rate reductions in March. The total reduction in the first half of the year amounted to 1.5 p.p.

#### 3.2 Situation in the banking sector

The development of the macroeconomic situation affected the dynamics and structure of loans and deposits in the banking sector. Net foreign assets were the main money creating factor in the first half of 2005. Compared with the end of the prior year, they increased by 21.0%, and compared with June 2004 – by 11.7%. Receivables were another factor increasing the supply of money in the first half of the year. They increased by 5.9% compared with the end of the prior year. Amounts due from households maintained high dynamics, i.e. 9.2%, however, their growth was considerably slower than in the prior comparable periods. The downward trend of corporate receivables has been reversed, and their increase amounted to 3.6% in the first half of the year. The growth rate of deposits has decreased to 3.0%, partly due to low dynamics of deposits in foreign currencies caused by the appreciation of the Polish zloty. The growth of corporate deposits has been maintained, although its rate has considerably decreased. Following a decrease in the prior year, in the first half of this year household deposits began to grow again and at the end of the period were higher by 1.7% than in the prior year.

The dynamics of deposits and loans in 2004, during the last 12 months and in the first half of 2005 is shown in the table below:

	Change (%)		
	in 2004	June 2005 / June 2004	June 2005 / December 2004
<b>Deposits</b>	<b>8.4</b>	<b>9.1</b>	<b>3.0</b>
Corporate	24.2	17.9	5.2
of which: companies	24.8	13.8	0.6
Households	0.5	4.3	1.7
<b>Loans</b>	<b>3.2</b>	<b>7.5</b>	<b>5.9</b>

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Corporate	(4.5)	1.8	3.4
of which: companies	(4.0)	0.8	3.6
Households	13.8	15.5	9.2

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### **3.3 Important factors influencing Group's activities and results**

The main factors that had an impact on the Group's activities and results in the first half of 2005 are the following:

- Development of business activity.
- Positive influence of interest margin.
- Change in the structure of households' savings.
- Effective management of overhead costs.
- Reduction in costs of risk.
- Strong results of the Group companies.

#### **Development of business activity**

In the first half of 2005, the Group noted a continued positive trend in the further development of its business activity, with successful sales of key products: mutual funds, new consumer loans, PLN mortgage loans and credit cards. The value of mutual funds increased by 26.3% and the number of credit cards increased by 43.9% compared with the end of 2004. The sales of the new consumer loan product "Express Loan" was nearly 4 times higher compared with the first half of 2004.

Development of business activity translated into an increase in income, especially interest income.

#### **Positive influence of interest margin**

Interest margin increased by 0.4 p.p. in the first half of 2005 compared with the first half of 2004 to the level of 4.2%. It was mainly a result of better asset mix, higher average market interest rates and the foreign currency structure in the SWAP transactions that was favourable to the margin.

#### **Change in the structure of households' savings**

Change in the structure of savings continued in the first half of 2005, mainly being a transfer from individuals' deposits to mutual funds, the share of which in total savings increased from 23.0% to 27.1% during this period. Participation units of Pioneer Pekao TFI S.A. mutual funds were distributed through the network of Bank Pekao S.A., CDM Pekao S.A. and Xelion. Doradcy Finansowi Sp. z o.o. branches. Total assets of these funds increased in the first half of 2005 by PLN 3,413.1 million, while the assets of other TFIs increased by PLN 3,987.9 million, which in turn contributed to a further 1.9 p.p. increase in the market share to 36.4%.

#### **Effective management of overhead costs**

In the first half of 2005, total overhead costs including depreciation amounted to PLN 1,153.5 million and were only by 0.4% higher than in the comparable period of the previous year, thanks to lower by 3.2% non-personnel costs almost offsetting an increase in personnel costs and depreciation by 2.7% and 1.4% respectively. 7.5% increase in total income was a reason for a decrease in cost / income ratio to 53.8% in the first half of 2005 that was 3.8 p.p. lower than a year before.

#### **Reduction in costs of risk**

Improved quality of the portfolio and effective credit risk management resulted in 28.0% lower than in the previous year impairment losses on loans and advances. The ratio of non-performing loans to total loans decreased from 19.9% at the end of 2004 to 18.3% at the end of



June 2005 due to an increase in the volume of performing loans and the drop in the volume of non-performing loans (according to the NBP's classification).

### **Strong results of Group's companies**

Strong results of both Bank Pekao S.A. as well as the Group's companies contributed to the good results of the whole Group.

## **3.4 Major sources of risk and threats**

### **Economic factors**

The predominant part of the assets of Bank Pekao S.A. and its subsidiaries is located on the territory of Poland. Therefore, the results of the Bank will be influenced by the economic events occurring in this country and the worldwide events that influence the domestic economy.

Group results can be influenced by decisions of Monetary Policy Council, which shape zloty market interest rates and by decisions of FED, which impact USD market interest rates. Additionally, further development of economic situation in Poland, including the level of investments, will impact the corporate customers loan demand, while changes in the level of employment and salaries together with improvement of customers creditworthiness will impact the level of retail savings and demand for loans.

#### **3.4.1 Liquidity risk and market risk**

Asset and liability management policy of Bank Pekao S.A. Group is aimed at the optimisation of the balance sheet and off-balance sheet structure of the Bank regarding the assumed risk/income ratio and comprehensive view of influence of different types of risk (mainly credit risk, interest rate risk, liquidity risk, currency risk and operational risk), which the Bank undertakes in its business activities. The risks are monitored and controlled with reference to profitability and with reference to the capital indispensable to take on such risks as well as regularly reported.

Financial risk management that constitutes an important part of assets and liabilities management system in the Bank has a comprehensive and consolidated character. It covers all Bank's units and subsidiaries to evaluate their potential influence on the financial situation of the whole Group. Comprehensive character of risk management means, on the one hand, consideration of all material for the Bank types of financial risk and, on the other hand, financial risk management in close relation to other types of risk.

The Management Board of the Bank is responsible for achieving the strategic goals of risk management policy.

The Asset and Liability Committee controls the capital adequacy of the Group, as well as the level of liquidity risk and market risk (interest rate and currency risks) borne by the Group within the external banking supervision limits and within the internal limits of the Group.

### **Liquidity risk**

The objective of managing the liquidity risk is:

- to ensure and maintain Bank's solvency with respect to current and future planned payables, taking into account liquidity acquisition costs and profitability of Bank's equity,
- to prevent any crisis situation,
- to outline solutions that would allow the Bank to endure in case the situation occurred.

The Bank's investments both in PLN and foreign currencies are carried out in accordance with the requirements of the Banking Law and the recommendations of the National Bank of Poland (NBP). The Bank invests primarily in treasury securities of Polish government, securities issued



by countries and financial institutions with the highest ratings and those with high levels of liquidity and desired profitability. Thanks to their saleability, the financial instruments constitute the Bank's liquidity stock enabling to get through potential crisis situations.

According to the Banking Supervisory Authorities recommendations, the Bank applies and monitors internal liquidity indices that reflect the ratios of total adjusted maturing assets to total adjusted maturing liabilities

The Bank has set procedures in place to protect against the liquidity risk increase and in the event of a substantial deterioration of the Bank's financial liquidity.

The emergency plan in case of deterioration of financial liquidity of the Bank takes into consideration four levels of liquidity risk, depending on the amount and duration of cash outflow from the non-banking clients' accounts. The plan also determines the sources from which the expected cash outflows will be covered and states to what extent the Bank's Management is responsible for making necessary decisions in order to restore the required financial liquidity level. Both the emergency plan and the possibility of obtaining cash from sources specified in this plan are subject to periodical verification.

### **Market risk**

In its trading, retail, corporate and investment activities, the Bank is exposed to market risk, i.e. interest rate risk, currency risk and price risk of securities owned by the Bank and to other types of risk the source of which are changes in market conditions.

In managing the interest rate risk of the banking book, the Bank follows the objectives of maximising the economic value of capital and realizing the budgeted net interest income within the adopted limits. The financial position of the Bank in the light of the changing interest rates is monitored through the interest rate gap (revaluation gap), duration analysis, simulation analyses and stress testing.

The sensitivity of net interest income and the sensitivity of the economic value of the Bank's capital to changes in interest rates was maintained within the binding internal limits.

The objective of the currency risk management is to create currency profile of the balance and off-balance sheet positions so that it remains within external and internal limits. In the first half of 2005 the currency risk was low. Bank's exposure to the currency risk is measured on a daily basis, for the internal needs, by means of Value at Risk (VaR) model, as well as by the extreme conditions analysis testing that is supplementary to VaR method.

VaR method is an integral component of the market risk management of all investment portfolios in the Bank. Therefore, the Bank has determined the VaR limits the actual usage of which is monitored on a daily basis. However, these limits do not protect the Bank against rare and very significant changes on the market. Therefore, the market risk management system is supplemented by the analysis of shock scenarios (stress test) in order to estimate the effects of the changes of market parameters on the result of the Bank should such events occur on the market.

Instruments in the trading portfolio and in the available for sale portfolio, as well as derivative instruments are valued regularly using current market prices or, if the quotations are not available, using models of valuation that from the Bank's point of view reflect fair value of these instruments in the best way.

### **3.4.2 Credit risk**

The principles of the lending policy of the Group comply with those of the Bank. Bank Pekao S.A. follows a conservative policy with respect to the assumption of credit risk, by applying established safety rules to lending activity in the individual market segments as well as necessary instruments limiting asset exposure to the credit risk.

Procedures of credit risk assessment applied in the Group's companies require reconciliation with the Bank's Head Office.

In accordance with the Bank's lending policy, the main directions of mitigating credit risk are followed:

- diversification of the objective and subjective structure of the portfolio along with the current analysis of the portfolio structure to ensure early identification of threats arising from excessive commitments and introduction of appropriate limitations,
- limitation of lending in certain areas of activities,
- acting with special care in lending to higher risk areas,
- transfer of competencies to decide on loan transactions with higher risk to the Bank's Head Office,
- preferences to grant loans to areas characterised by the relatively low risk.

Under the cooperation with UniCredito Italiano, the Bank carries out intensive work on on-going rationalisation of the lending process aimed at improving its efficiency and security. In particular, the Bank works on the improvement of procedures and tools for credit risk measurement and monitoring. In the first half of 2005, in order to reduce the risk level, works in the area of strengthening the loan monitoring in the particular client segments were intensified.

### **3.4.3 Operating risk**

The Operating Risk Management Strategy approved by the Supervisory Board constitutes the core document on which the operating risk management is based. The document is consistent with the "M Recommendation" published by the General Inspectorate of Banking Supervision and with the "Unification of Capital Measurement and Capital Standards on the International Scale" published by the Basel Committee. The Strategy defines operating risk, provides the rules for its management and defines the control system at the Bank.

Bank Pekao S.A. defines operating risk as the risk of loss arising from errors, violation of regulations, operation breaks or damage caused by the internal processes, people, systems or external events.

The operating risk management control system covers both Bank Pekao S.A. and its subsidiaries. The Bank's Management Board receives risk reports containing, among other things, an analysis of operating events by categories and regions, an analysis of risk ratios and an analysis of capital necessary to cover the operating risk.

For the purpose of mitigating the operating risk, the Bank has security procedures in place, including, for example, anti-money laundering procedures and rules for safeguarding the Bank's units, management of the continuity of operations, compliance with the banking secrecy, personal data protection, as well as rules regulating the relationships between the Bank and third parties. The operating risk mitigation instruments also include emergency plans, internal audit controls, insurance contracts and ongoing improvement of the process quality. Moreover, in the event of identifying any irregularities, guidance is immediately provided concerning the scope, method and frequency of functional inspections in the specific areas of the Bank's operations.

## 4 Organisation of the Group

Bank Pekao S.A. Capital Group consists of Bank Pekao S.A as the parent entity and 15 subsidiaries.

The following entities are included in the consolidated financial report at 30.06.2005:

No	Name of company	Core activity	% of shareholder's share capital	Status	Consolidation method
1.	Bank Pekao S.A.	banking	-	parent	-
2.	Bank Pekao (Ukraina) Ltd.	banking	100,00	subsidiary	full
3.	Centralny Dom Maklerski Pekao S.A.	brokerage	100,00	subsidiary	full
4.	Pekao Fundusz Kapitałowy Sp. z o.o.	financial	100,00	subsidiary	full
5.	Pekao Leasing Sp. z o.o.	leasing	100,00	subsidiary	full
6.	Pekao Faktoring Sp. z o.o.	financial	100,00	subsidiary	full
7.	Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A.	financial	65,00	subsidiary	full
8.	Drukbank Sp. z o.o.	no activities performed	100,00	subsidiary	full
9.	Centrum Kart S.A.	financial	100,00	subsidiary	full
10.	Pekao Financial Services Sp. z o.o.	financial	100,00	subsidiary	full
11.	Pekao Development Sp. z o.o.	real estate management	100,00	subsidiary	full
12.	Pekao Access Sp. z o.o.	consulting	55,26	subsidiary	full
13.	BDK Consulting Sp. z o.o.	consulting, hotels, transportation	99,99	subsidiary	full

The companies listed below were not consolidated, due to the insignificant size of their operations in comparison to the size of the operations of the whole Group. Companies that were not consolidated, in the consolidated financial statements are recognized at the cost of purchase established on 01.01.2004

14.	Fabryka Maszyn w Janowie Lubelskim Sp. z o.o.	manufacturing of spare parts to building machinery	86,68	subsidiary	non-consolidated
15.	Pekao Immobilier s.a.r.l.	real estate management	100,00	subsidiary	non-consolidated

Other listed below exposures of the Group constitute investments in the associated and co-subsidiary entities and are recognized in the consolidated report of the Group using the equity method. Companies that were not revalued, were recognized in the consolidated financial report at cost established on 01.01.2004. Companies were not revalued due to the immateriality of the financial results of these companies.

1.	Anica System S.A.	IT	33,84 / 13,49	co-subsidiary	equity
2.	Central Poland Fund LLC	financial intermediary	53,19	associated	equity
3.	Xelion. Doradcy Finansowi Sp. z o.o.	auxiliary, financial and insurance	50,00	associated	equity
4.	Pioneer Pekao Investment Management S.A.	financial intermediary	49,00	associated	equity
5.	Krajowa Izba Rozliczeniowa S.A.	chamber of settlement	22,96	associated	equity
6.	Grupa Inwestycyjna NYWIG S.A.	financial advisory	24,60	associated	equity
7.	Hotel Jan III Sobieski Sp. z o.o.	hotel	37,50	associated	equity
8.	Fabryka Sprzętu Okrętowego "Meblomor" S.A.	manufacturing of ship equipment	23,81	associated	equity
9.	CPF Management	mutual funds management- does not operate	40,00	associated	not valued under equity method
10.	Pracownicze Towarzystwo Emerytalne „Nowy Świat” S.A.	management of employee pension fund	39,57	associated	not valued under equity method

## **5 Core products, services and activities of the Group**

### **5.1 Core products, services and activities of the Bank**

In order to tailor its offer to various customer groups, the Bank divided customers into four basic segments: family banking, private banking, VIP/SME as well as corporate clients.

#### **5.1.1 Family banking customers' service**

The Bank's offer for the largest group of retail customers using standard products is among the most comprehensive available on the Polish banking market.

For retail customers, the Bank offers a large variety of current accounts – "Eurokonto", term-deposits in PLN and in foreign currencies and also Bank's key lending products: "Express Loan" and mortgage loans.

Packages Eurokonto were enriched by a unique insurance assistance programme, which was prepared in cooperation with Towarzystwo Ubezpieczeniowe Allianz Zycie Polska S.A. and Elvia - insurance companies that was named Pakiet Pomocny.

In response to changing preferences of households with respect to savings and considerable interest in alternative forms of savings, the Bank extended its product offer to include the capital market products (through the sale of participation units of Pioneer mutual funds), investment programmes and investment-insurance programmes.

#### **5.1.2 Private banking customers' service**

The most affluent clients of the Bank are offered private banking services which give them the guarantee of comprehensive and individualized service rendered with the highest quality by personal advisors dedicated to each client.

In addition to services rendered to all individual clients, the Bank offers products and services tailored to meet sophisticated needs and expectations of private banking clients.

#### **5.1.3 VIP/SME customers' service**

Affluent customers who simultaneously run a micro- or small - sized companies are offered an individualized service rendered by a professional advisor. Customers receive a comprehensive banking service both of the company's and private accounts. Affluent clients, who do not own enterprises or are not interested in joint banking services, benefit from personal advisory services, whereas small enterprises being the Bank's clients are serviced individually by Relationship Managers.

The products offered in these packages provide complex banking services for small enterprises and micro-firms, convenient financing of ongoing operations, beneficial deposit opportunities as well as safe and convenient debit cards.

Small- and micro-sized enterprises are offered leasing services for means of transport using a simplified lease procedure – AutoLeasing Package.

#### **5.1.4 Corporate clients customers' service**

The Bank offers one of the widest range of products on the corporate client market, dedicated to medium and large companies. The Bank offers its products also to public administration bodies, local authorities, social and non-profit organizations. Banking products are constantly adjusted to the specific customer needs resulting from the character, range and size of its business activities.

In order to ensure professional, comprehensive banking services and advisory, medium corporate clients are attended in 27 Centres for Corporate Clients. Centres for Corporate

Clients coordinate sales of bank products to medium size enterprises, while retaining the significant role of both the Bank's branch (account transactions, cash deposits and withdrawals, term deposits) and the Bank's Head Office (operations with dealing room). Experts in foreign trade financing, derivatives, liquidity management and investment projects support client Relationship Managers in the Centres for Corporate Clients.

Services to large corporate clients are rendered on individualised basis by specialized Relationship Managers in the Bank's Head Office. In implementing the agreed individualised service policies, customer Relationship Managers are responsible for service quality and efficiency, proper choice of banking products and cooperation with Bank's branches that carry out operational service for the client.

Apart from traditional credit and deposit products, the Bank also offers other financial services such as factoring and leasing services, guarantees and sureties in domestic and foreign trade, bill of exchange operations. The Bank also organises issuance of company and municipal bonds, convertible bonds, as well as the issuance of short-term debt securities.

### 5.1.5 Basic data on market activities

The results of the market activities in the first half of 2005 include:

	30.06.2005	31.12. 2004	Change
Number of customers (in thousand)	3,376.2	3,372.3	3.9
Total number of PLN current accounts (in thousand) *	3,019.7	3,038.2	(18.5)
of which packages**	2,161.3	2,149.6	11.7
Number of mutual fund registers (in thousand)	562.6	434.9	127.7
Payment cards (in thousand)***	2,630.0	2,582.5	47.5
Credit	103.0	71.6	31.4
Charge	284.9	294.0	(9.1)
Debit (including Maestro)	2,242.1	2,216.9	25.2
Total number of outlets (in items)	783	782	1
Total number of ATMs (in items)	1,217	1,211	6

\* Number of accounts including accounts of pre-paid cards

\*\* Packages – current accounts with additional services

\*\*\* Number of cards is calculated according to the definition used by international payment organizations Visa and MasterCard

### 5.1.6 Results of Bank Pekao S.A.

In the first half of 2005 the Bank's net profit amounted to PLN 730.9 million and was 23.5% higher than in the previous year.

The main items of the Bank's Profit and Loss Statement for the first half of 2005 compared with pro forma data for the first half of 2004 are shown below:

	PLN million		
	First half of 2005	First half of 2004 pro forma	Change
Net interest income*	1,074.0	1,019.1	5.4%
Non interest income	993.3	863.2	15.1%
<b>Total income</b>	<b>2,067.3</b>	<b>1,882.3</b>	<b>9.8%</b>
<b>Total overhead costs (including depreciation)</b>	<b>(1,068.3)</b>	<b>(1,066.5)</b>	<b>0.2%</b>
<b>Operating income</b>	<b>999.0</b>	<b>815.8</b>	<b>22.5%</b>
Impairment losses on loans and advances	(126.6)	(158.6)	(20.2%)
Pre-tax profit	872.4	657.2	32.7%

<b>Net profit</b>	<b>730.9</b>	<b>591.8</b>	<b>23.5%</b>
Cost / Income ratio	51.6%	56.7%	(5.1 p.p.)

\*Including income on SWAP transactions.

The main items of the Bank's Balance Sheet as at the end of the first half of 2005 compared with the end of 2004 are presented below:

	30.06.2005	31.12.2004	Change
Gross loans (principal) in PLN million*	31,195.5	29,284.4	1,911.1
Non-performing loans / Total loans ratio (in %)*	17.2	18.7	(1.5 p.p.)
Deposits including the Bank's bonds (principal) in PLN million*	44,237.8	43,688.0	619.6
Balance sheet total (in PLN million)	60,150.5	59,532.4	618.1
Participation units sold in the Bank's network (in PLN million)	13,157.4	10,208.7	2,948.7
Capital adequacy ratio (in %)	18.5	18.7	(0.2 p.p.)

\* in nominal value

## 5.2 Major areas of the Group's companies activities

### 5.2.1 Brokerage services

#### Centralny Dom Maklerski Pekao S.A. (CDM)

CDM provides the full scope of services (permitted to brokerage houses), excluding asset management. At the end of June 2005, CDM maintained 154.3 thousand investment accounts and its market share was 18.0%. CDM also offered on-line access to investment accounts, allowing its customers to buy and sell all instruments listed on the Warsaw Stock Exchange and on the OTC market (CeTO) through the Internet. As at 30 June 2005, CDM maintained 16.8 thousand on-line accounts.

#### Services of CDM on the primary market

Thanks to the favourable situation on the secondary market of shares, also the primary market maintained increased activity. In the first half of 2005, CDM (Central Brokerage House) carried out 6 public offers, including an initial public offer (IPO). Additionally, CDM was a member of a consortium in 3 public offers. The total value of share issues carried out by CDM on the primary market was PLN 750 million.

#### Activities on the secondary market

In the first half of 2005, the favourable situation on the stock exchange was maintained. The high level of trading was accompanied by an increase in the WIG stock exchange index, which has increased by 7% since the beginning of the year. Trading on the cash market increased by 47.0% and the trading volume on forward contracts increased by almost 300 thousand contracts. The share trading volume exceeded PLN 73 billion, and the total trade volume on the forward contracts market reached 4.4 million contracts.

In the first half of 2005, the Company achieved:

- a 29.2% share in the bond trading volume at the Warsaw Stock Exchange;
- a 12.8% share in the stock trading volume at the Warsaw Stock Exchange;
- a 9.4% share in the futures trading volume at the Warsaw Stock Exchange.

In the first half of 2005, CDM generated the net profit of **PLN 43.7 million** compared with the net profit of PLN 32.3 million achieved in the comparable period of the previous year.



### 5.2.2 Banking activity

#### **Bank Pekao (Ukraine) Ltd. in Luck (Bank Pekao (Ukraine))**

Bank Pekao (Ukraine) is a universal commercial bank specialising in settlements of foreign trade transactions and supporting the Polish-Ukrainian and Italian-Ukrainian trade. It offers a broad range of banking services and guarantees high quality of customer services and customisation of its offer to the needs of customers.

To eliminate the currency risk and costs of purchase of Ukrainian currency, Bank Pekao (Ukraine) also settles foreign-trade transactions between Poland and Ukraine in Polish currency. The company co-operates with the most reliable Ukrainian banks. Through its cooperation with over 165 banks worldwide, Bank Pekao (Ukraine) is able to settle inter-bank transactions effectively.

Bank Pekao (Ukraine) provides services through two branches located in Kiev and in Luck.

In the first half of 2005, the Company generated the net profit of **PLN 0.1 million** compared with the loss of PLN -1.5 million achieved in the comparable period of the previous year.

### 5.2.3 Asset management

#### **Pekao Pioneer Powszechne Towarzystwo Emerytalne S.A. (Pekao Pioneer PTE)**

The activity of Pekao Pioneer PTE - Pension Fund (OFE) management company - involves gathering and investing funds that will be paid out to the customers after reaching retirement age.

As at 30 June 2005, the number of open-end pension fund accounts was 250.7 thousand and was 47.5 thousand lower compared with 31 December 2004. The number of persons with at least one contribution recorded on the account was 216.6 thousand.

At the end of the first half of 2005, the value of assets managed by the company was PLN 1,164.6 million, which is an increase of PLN 150.8 million compared with the end of 2004. As at the end of June 2005, PTE had 1.6% share in the market of open-end pension funds, and remained unchanged as compared with the comparable period of 2004.

Change in the value of net assets and the number of Pekao OFE members is presented in the table below:

	30.06.2005 r.	31.12.2004 r.	Change
Net assets (PLN million)	1,164.6	1,013.8	150.8
Total number of accounts (in thousands)	250.7	298.3	(47.5)
Non-zero accounts * (in thousands)	216.6	212.3	4.4
% of non-zero accounts	86.4%	71.1%	15.3 p.p.
Active accounts ** (in thousands)	182.2	171.6	10.6
% of active accounts	72.6%	57.5%	15.1 p.p.

\* accounts with at least one contribution recorded

\*\* accounts with at least PLN 50 received in 12 months

In the first half of 2005, OFE Pekao achieved 5.24% rate of return on investment.

In the first half of 2005, the Company generated the net profit of **PLN 2.7 million** compared with the net profit of PLN 1.9 million achieved in the comparable period of the previous year.

#### **Pioneer Pekao Investment Management S.A. (PPIM)**

PPIM manages, under a contract of management, the assets of mutual funds belonging to Pioneer Pekao TFI. The company offers also investment portfolio management services to retail customers.



As at 30 June 2005, the Company had 700.0 thousand investment accounts (569.9 thousand as at 31 December 2004), i.e. an increase by 130.1 thousand in the first half of 2005.

At at 30 June 2005, the value of net assets of Pioneer Pekao TFI S.A., the company managed by Pioneer Pekao Investment Management S.A. (the Bank holds 49.0% of shares) totalled to PLN 16,415.2 million and was higher by PLN 3,413.1 million as compared with the end of 2004.

The value of net assets of the mutual funds of Pioneer Pekao TFI S.A. is shown in the table below:

	(PLN million)		
	30.06.2005	31.12.2004	Change
<b>Net assets value of Pioneer Pekao TFI</b>	<b>16,415.4</b>	<b>13,002.3</b>	<b>26.3%</b>
Pioneer Balanced Investment Fund	2,729.3	2,629.7	3.8%
Pioneer Dollar Bond Plus Investment Fund	2,591.9	2,234.3	16.0%
Pioneer Treasury Bond Investment Fund	2,370.2	697.7	239.7%
Pioneer Stable Growth Investment Fund	2,083.1	1,989.4	4.7%
Pioneer Bond Investment Fund	1,394.6	1,293.4	7.8%
Pioneer Dollar Bond Investment Fund	1,101.6	905.4	21.7%
Pioneer Capital Protection Investment Fund	874.8	581.5	50.4%
Pioneer Money Market Investment Fund	856.8	603.5	42.0%
Pioneer Polish Equity Investment Fund	706.3	-	x
Pioneer European Bond Plus Investment Fund	677.8	490.0	38.3%
Pioneer Bond Plus Investment Fund	266.5	173.0	54.0%
Pioneer American Equity Investment Fund	200.0	153.8	30.1%
Pioneer European Equity Investment Fund	125.3	63.4	97.7%
Pioneer Dynamic Capital Protection Investment Fund	42.6	-	x
Pioneer Aggressive Investment Fund	-	788.0	(100%)
Pioneer Arbitrage Investment Fund	-	69.7	(100%)
Other (III Pillar)	394.6	329.7	19.7%
<b>Net assets value of TFI (market)</b>	<b>45,127.4</b>	<b>37,726.4</b>	<b>19.6%</b>
<i>Market share of Pioneer Pekao TFI</i>	<i>36.4%</i>	<i>34.5%</i>	<i>1.9 p.p.</i>

As at 30 June 2005 the net value of Pioneer Pekao TFI S.A. assets acquired through Bank Pekao S.A., CDM Pekao S.A. and Xelion. Doradcy Finansowi Sp. z o.o. amounted to PLN 15,272.2 million (93.0% of total assets), compared with PLN 11,857.2 million at the end of 2004 (91.2%). In the first half of 2005, the Company included in its offer a new specialist open investment fund – Pioneer Dynamic Capital Protection Investment Fund.

In the first half of 2005, the consolidated net profit of the Company amounted to PLN 52.3 million and was 30.7% higher compared with the net profit achieved in the first half of 2004. The share of the Bank is **PLN 25.4 million**.

#### **Pekao Fundusz Kapitalowy Sp. z o.o. (PFK)**

In accordance with the business strategy, PFK actively searched for investors interested in the purchase of the shares of 4 companies held in its portfolio. The sale-purchase offer was made, among others, to investors in various industry segments and to financial investors who carried out consolidation projects for individual segments of Polish economy.

PFK did not make any investments in shares.

In the first half of 2005, the Company generated the net profit of PLN 1.0 million compared with the net profit of PLN 1.8 million achieved in the first half of 2004.

### **Central Poland Fund LLC (CPF)**

The Company manages asset portfolios to gain satisfactory level of growth of companies' value and to gain optimum return on assets held for sale. In the first half of 2005, none of the company's included in the portfolio was sold.

In the first half of 2005, the Company made a loss of PLN -1.3 (the Bank's share **PLN -0.7 million**) compared with the loss of PLN -0.1 million in the previous year.

### **5.2.4 Leasing activity**

#### **Pekao Leasing Sp. z o.o. (Pekao Leasing)<sup>1</sup>**

Pekao Leasing provides financial services supporting selling and buying fixed assets i.e. motor vehicles, machines and equipment and also office real estate – mostly by operational and financial leasing.

In the first half of 2005, the Company concluded 1,815 new contracts. The value of leased assets was PLN 275.0 million. The majority of leased assets accounted for motor vehicles - 56.0% (compared with 70.7% in 2004) and machines and equipment - 34.5% (16.1% accordingly).

Thanks to the implemented cooperation programme between the Company and the Bank, the value of assets leased via the Bank's branches was PLN 94.2 million. This constitutes a 124% increase in sales via this distribution channel compared with the corresponding period of 2004 (sales on the level of PLN 42.0 million).

In the first half of 2005, Pekao Leasing generated the net profit of **PLN 1.9 million** compared with the net profit of PLN 3.7 million (both Pekao Leasing and Leasing Fabryczny) achieved in the comparable period of the previous year.

### **5.2.5 Other financial services**

#### **Pekao Faktoring Sp. z o.o. (Pekao Faktoring)**

Apart from factoring services (recourse and non-recourse factoring) the company offers services related to factoring, i.e. collecting information regarding debtors' standing and monitoring of payments on ongoing basis. Additionally, the company offers financial advisory and consulting services regarding the choice of business financing methods, as well as extends loans relating to factoring agreements. The company cooperates with Bank Pekao S.A. in the area of development of new and activating existing sales distribution channels.

In the first half of 2005, the Company managed to maintain its leading position among the factoring firms in Poland in terms of the market share, measured with the value of invoices purchased.

In the first half of 2005, Pekao Faktoring generated the net profit of **PLN 4.0 million**, i.e. PLN 1.4 million higher compared the comparable period of the previous year.

#### **Pekao Financial Services Sp. z o.o. (PFS)**

The Company acts as a transfer agent for all members of the assets management market i.e. mutual funds, pension funds, employees' pension programs and insurers.

In 2005, PFS continued its strategy of strengthening its market leader position on the Polish market of transfer agents. The number of serviced accounts of mutual and pension funds amounted to 2.1 million.

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<sup>1</sup> For comparability purposes, 2004 financial data represents aggregate data of both merged companies.

The share in the market of open-end pension funds using external Transfer Agents, calculated as the number of serviced accounts, was 41% and increased 1% compared with the end of 2004.

In the first half of 2005, the Company generated the net profit of **PLN 6.6 million** compared with the net profit of PLN 5.0 million achieved in the comparable period of the previous year.

#### **Xelion. Doradcy Finansowi Sp. z o.o. (Xelion)**

The company was created in response to increasing demand for customized services and financial products offer and thus represents a distribution channel supplementary to the Bank's own distribution channels. It is focused on servicing affluent customers that demand highly individualised approach at convenient locations.

A broad package of modern products and financial services is tailored to the individual needs and financial abilities of customers. An innovative model of service is offered to such customers, which guarantees an access not only to the Bank's products but also to investment and insurance products. In the first half of 2005, two new investment funds and eight investment portfolios were added to the Company's product offer; additionally, the offer was enriched by the possibility of obtaining a prestigious credit card.

In the first half of 2005, the Company made a loss of PLN -11.7 million (the Bank's share **PLN -5.9 million**) compared with the loss of PLN -9.2 million achieved in the comparable period of the previous year.

#### **Centrum Kart S.A. (CK S.A.)**

The company provides a comprehensive servicing of card system management, transaction authorization and card embossment.

In the first half of 2005 the activities of the company related mainly to rendering services to Bank Pekao S.A. After obtaining access to a modern technical platform for servicing payments made with the use of electronic instruments, the services provided by CK S.A. are intended to be offered also to other entities on the market, including banks (also for the banks of the UniCredito Italiano Group) and institutions issuing payment cards or servicing ATMs, or accepting payment cards for the settlement of transactions made at customer service-trade points.

In the first half of 2005, CK S.A. generated the net profit of **PLN 1.1 million**, i.e. 38% less than in the comparable period of the previous year.

#### **Grupa Inwestycyjna Nywig S.A. (Nywig)**

Nywig is a specialised arranger of big-ticket lease transactions of a non-standard, individualised nature and of a significant individual value, primarily relating to real estate, plant and equipment.

The other area of Nywig's business activity is economic and financial advisory.

The Company finished the first half of 2005 with the net profit of **PLN 0.0 million**, similarly as in the first half of 2004.

#### **5.2.6 Other entities included in the consolidated financial statements**

Other subordinated and associated entities included in the consolidated financial statement for the first half of 2005 include:

#### **Pekao Development Sp. z o.o. (Pekao Development)**

In the first half of 2005, business activities of Pekao Development mainly included the following:

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- realisation of housing projects – Olszyny II housing estate in Warsaw, Jarzebiny housing estate in Warsaw, and Wilanow Park housing complex in Warsaw,
- commencement of work on 2 large housing projects in Warsaw,

Additionally, the company provided services to Bank Pekao S.A. in the capacity of substitute investor for the project of development and modernization of the network of outlets on the whole territory of Poland.

In the first half of 2005, the Company generated the net profit of **PLN 10.5 million**, i.e. five times higher than in the comparable period of the previous year.

#### **Pekao Access Sp. z o.o. (Access)**

The company's main business activities include:

- advisory on acquisitions accompanied by advisory on obtaining transactions' finance,
- advisory projects on new markets,
- advisory on restructuring accompanied by obtaining finance.

In the first half of 2005 the company continued its close cooperation with the Bank within the scope of comprehensive financial advisory and obtaining new clients.

In the first half of 2005, the Company generated the net profit of **PLN 0.3 million** compared with the net profit of PLN 1.1 million achieved in the comparable period of the previous year.

#### **Krajowa Izba Rozliczeniowa S.A. (KIR)**

The main business activities of KIR include management of inter-bank settlement system, which covers exchange of payment orders, registration of such orders, determining parties' liabilities and reporting the results of inter-bank settlements made on the territory of Poland to the National Bank of Poland.

In the first half of 2005, KIR generated the net profit of PLN 14.0 million (the Bank's share **PLN 3.0 million**) and was PLN 4.6 million lower than in the comparable period of the previous year.

#### **Hotel Jan III Sobieski Sp. z o.o.**

The company's business activities include the management of Hotel Jan III Sobieski in Warsaw. According to the adopted accounting principle, the Group ceases to recognize the losses of its associated entity.

#### **Drukbank Sp. z o.o.**

Drukbank Sp. z o.o. did not conduct any business activities in the first half of 2005. The company's profit includes valuation of shares in the associated company – Bank Pekao (Ukraine) Ltd.

In the first half of 2005, the Company's net profit amounted to **PLN 1.0 million** compared with the loss of PLN -0.3 million in the previous year.

## **6 Financial results of the Group**

### **6.1 Consolidated profit and loss account**

In the financial statements for the first half of 2005, the presentation of income statement items for the first half of 2004 has been restated to ensure comparability.

The Group's net profit generated in the first half of 2005 amounted to PLN 725.4 million and was 18.3% higher than in the previous year.

The increase in the net profit of PLN 112.0 million in the first half of 2005 compared with the first half of the previous year was possible thanks to an increase in commercial activity which translated into a growth in income, particularly interest income, a lower cost of risk and stable operating costs.

Apart from the good results of Bank Pekao S.A., the results of the Group's companies, which were much better than in the previous year, contributed to the improvement in the overall Group result.

The consolidated profit and loss account for the first half of 2005 in comparison with the first half of 2004 is presented below:

	(PLN million)		
	1H 2005	1H 2004 pro forma	Change
Net interest income *	1,126.6	1,060.8	6.2%
Fee and commission income	747.6	742.2	0.7%
Dividend income	0.0	0.0	x
Result on financial instruments at fair value	58.7	20.9	180.9%
Result on investment securities	33.8	4.2	704.8%
FX income	146.5	143.2	2.3%
Other operating income / cost net	31.1	24.3	28.0%
<b>Total income</b>	<b>2,144.3</b>	<b>1,995.6</b>	<b>7.5%</b>
<b>Overhead costs (including depreciation)</b>	<b>(1,153.5)</b>	<b>(1,148.9)</b>	<b>0.4%</b>
Personnel	(595.2)	(579.7)	2.7%
Non-personnel	(397.0)	(410.1)	(3.2%)
Depreciation	(161.3)	(159.1)	1.4%
<b>Operating income</b>	<b>990.8</b>	<b>846.7</b>	<b>17.0%</b>
Impairment losses on loans and advances	(128.6)	(178.7)	(28.0%)
Share in net profit (loss) of the associates	22.1	20.7	6.8%
<b>Pre-tax profit</b>	<b>884.3</b>	<b>688.7</b>	<b>28.4%</b>
Tax charge	(158.9)	(75.3)	111.0%
<b>Net profit</b>	<b>725.4</b>	<b>613.4</b>	<b>18.3%</b>
<b>Attributable to equity holders of the Company</b>	<b>727.3</b>	<b>615.2</b>	<b>18.2%</b>
Attributable to minority interest	(1.9)	(1.8)	5.6%

\*Including income on SWAP transactions.

### Group's income

In the first half of 2005, the Group's income amounted to PLN 2,144.3 million and was PLN 148.7 million (7.5%) higher than in the comparable period of the previous year.

The main reason for the increase in income was the development of business activity supported by the pro-selling campaigns focused on key products both in the Bank and in its related entities.

Net interest income increased by 6.2% as a result of increasing volumes and better spreads resulting, among others, from an increase in the loan portfolio which positively influenced the asset structure.

	(PLN million)		
<b>Net interest income</b>	1H 2005	1H 2004 pro forma	Change
Interest income	2,452.7	2,035.3	20.5%
Interest expense	(1,326.1)	(974.5)	36.1%

<b>Net interest income</b>	<b>1,126.6</b>	<b>1,060.8</b>	<b>6.2%</b>
Net interest margin %	4.2	3.8	0.4 p.p.

Fee and commission income increased mainly thanks to an increase in lending, card and mutual fund business activity. Other non-interest income also increased (mainly the gains on financial operations).

(PLN million)			
<b>Non-interest income</b>	1H 2005	1H 2004 pro forma	Change
Commission income	830.1	824.5	0.7%
Commission expense	(82.5)	(82.4)	0.1%
<b>Net commission income</b>	<b>747.6</b>	<b>742.2</b>	<b>0.7%</b>
Dividend income	0.0	0.0	x
Result on financial instruments at fair value	58.7	20.9	180.9%
Result on investment securities	33.8	4.2	704.8%
FX income	146.5	143.2	2.3%
Other operating income / cost net	31.1	24.3	28.0%
<b>Total non-interest income</b>	<b>1,017.7</b>	<b>934.8</b>	<b>8.9%</b>

#### **The Group's overhead costs (including depreciation)**

In the first half of 2005, total overhead costs including depreciation amounted to PLN 1,153.5 million and were only by 0.4% higher than in the comparable period of the previous year, thanks to lower by 3.2% non-personnel costs almost offsetting an increase in personnel costs and depreciation by 2.7% and 1.4% respectively.

In the first half of 2005, the Group's cost / income ratio amounted to 53.8% and was 3.8 p.p. lower than in the previous year.

As at 30 June 2005, the Bank had 15,047 employees (a drop of 244 compared with the end of 2004). In the first half of 2005, the number of Group employees dropped by 247 and amounted to 16,161 as at the end of June 2005.

(PLN million)			
<b>Overhead costs (including depreciation)</b>	1H 2005	1H 2004 pro forma	Change
Personnel costs	(595.2)	(579.7)	2.7%
Non-personnel costs	(397.0)	(410.1)	(3.2%)
Depreciation	(161.3)	(159.1)	1.4%
<b>Total</b>	<b>(1,153.5)</b>	<b>(1,148.9)</b>	<b>0.4%</b>

#### **Impairment losses on loans and advances**

In the first half of 2005, impairment losses on loans and advances amounted to PLN 128.6 million and were 28.0% lower than in the comparable period of the previous year. This resulted primarily from the improved quality of the portfolio and effective credit risk management. The ratio of non-performing loans to total loans decreased from 19.9% at the end of 2004 to 18.3% at the end of June 2005 (according to the NBP classification) as a result of an increase in the volume of performing loans and a simultaneous decrease in the volume of non-performing loans.

(PLN million)			
	1 H 2005	1 H 2004 pro forma	Change
<b>Costs</b>	<b>(657.0)</b>	<b>(660.9)</b>	<b>(0.6%)</b>

loan receivables	(627.7)	(630.5)	(0.4%)
off-balance sheet liabilities	(29.3)	(30.4)	(3.6%)
<b>Income</b>	<b>528.3</b>	<b>482.2</b>	9.6%
loan receivables	505.2	454.6	11.1%
off-balance sheet liabilities	23.1	27.6	(16.3%)
<b>Total</b>	<b>(128.6)</b>	<b>(178.7)</b>	<b>(28.0%)</b>

## 6.2 Structure of net profit

The structure of the consolidated profit and loss account of the related entities for the first half of 2005 and first half of 2004 is presented below:

	PLN million	
	1H 2005	1H 2004 pro forma
<b>Net profit of Bank Pekao S.A.</b>	<b>730.9</b>	<b>591.8</b>
<b>Net profit (loss) of entities consolidated under full method</b>	<b>72.3</b>	<b>49.7</b>
Centralny Dom Maklerski Pekao S.A.	43.7	32.3
Pekao Development Sp. z o.o.	10.5	1.8
Pekao Financial Services Sp. z o.o.	6.6	5.0
Pekao Faktoring Sp. z o.o.	4.0	2.6
Pekao Pioneer PTE S.A.	2.7	1.9
Pekao Leasing Sp. z o.o./Leasing Fabryczny Sp. z o.o.	1.9	3.7
Centrum Kart S.A.	1.1	1.8
Drukbank Sp. z o.o.	1.0	(0.3)
Pekao Fundusz Kapitałowy Sp. z o.o.*	0.4	0.5
Pekao Access Sp. z o.o.	0.3	1.1
Bank Pekao (Ukraine) Ltd. in Luck	0.1	(1.5)
Pekao Usługi Korporacyjne S.A.	-	0.8
<b>Net profit (loss) of entities valued under equity method</b>	<b>22.1</b>	<b>20.7</b>
Pioneer Pekao Investment Management S.A.	25.4	19.5
Krajowa Izba Rozliczeniowa S.A.	3.0	4.3
Associates of Pekao Fundusz Kapitałowy Sp. z o.o.	0.3	0.5
Jan III Sobieski Sp. z o.o.	0.0	0.0
Grupa Inwestycyjna Nywig S.A.	0.0	0.0
Central Poland Fund LLC	(0.7)	(0.1)
Xelion. Doradcy Finansowi Sp. z o.o.	(5.9)	(4.6)
Trinity Management Sp. z o.o.	-	5.0
NFI Jupiter S.A.	-	(3.9)
<b>Exclusions and consolidation adjustments**</b>	<b>(99.9)</b>	<b>(48.8)</b>
<b>Net profit (loss) of the Group</b>	<b>725.4</b>	<b>613.4</b>

\* The result of the company does not include the valuation of associates based on equity method, which was included in the item "net profit (loss) of the entities valued under the equity method".

\*\* Include transactions within the Group, including dividends from subsidiaries and associates.



### 6.3 Structure of the balance sheet

In the financial statements for the first half of 2005, the presentation of balance sheet figures as at 31 December 2004 has been restated to ensure comparability.

The balance sheet of Bank Pekao S.A. as the parent company dominates the balance sheet of the Group. Not only does it determine the amount of total assets in balance sheet, but also the structure of the assets and liabilities. As at the end of June 2005, the share of the total assets of Bank Pekao S.A. in the total assets of the whole Group was 99.4%.

The total assets of the Group at the end of June 2005 amounted to PLN 60,516.6 million and was 1.6% higher compared to the end of 2004.

The table below presents the balance sheet of the Group:

Assets	30.06.05	31.12.04	pro forma	Change
	PLN million			
Cash and balances with the Central Bank	3,200.1		3,939.3	(18.8%)
Loans and advances to banks	7,286.1		5,961.5	22.2%
Loans and advances to customers*	27,386.9		26,305.1	4.1%
Securities**	18,722.8		19,568.9	(4.3%)
Investments in associated undertakings	149.3		124.7	19.7%
Tangible and intangible assets	2,119.2		2,173.6	(2.5%)
Other assets	1,652.2		1,463.3	12.9%
<b>Total assets</b>	<b>60,516.6</b>		<b>59,536.4</b>	<b>1.6%</b>

Liabilities and equity	30.06.05	31.12.04	pro forma	Change
	PLN million			
Amounts due to the Central Bank	2,054.2		2,151.7	(4.5%)
Amounts due to banks	2,081.1		1,332.6	56.2%
Amounts due to customers***	45,993.8		45,844.9	0.3%
Other liabilities	2,662.8		2,376.2	12.1%
Shareholders' equity	7,724.7		7,831.0	(1.4%)
including minority interest	16.5		18.8	(12.4%)
<b>Total liabilities and equity</b>	<b>60,516.6</b>		<b>59,536.4</b>	<b>1.6%</b>

\* including debt securities eligible for rediscounting at the Central Bank and net investment in the finance lease

\*\* including financial assets held for trading and other financial instruments at fair value through profit or loss

\*\*\* including own securities in issue

#### 6.3.1 Assets

##### Changes in the structure of assets

Loans and advances to customer and securities are the dominant item in the structure of assets.

As at 30 June 2005, loans and advances to customers amounted to PLN 27,386.9 million and constituted 45.3% of the Group assets (at the end of 2004, this ratio was equal to 44.2%). The increase in this item in the first half of 2005 resulted mainly from increased lending activities in

Bank Pekao S.A. due to an increase in the corporate clients' debt, an increase in consumer loans and PLN mortgages.

In the first half of 2005, the value of securities decreased by PLN 846.1 million (i.e. by 4.3%), and their share in total assets fell by 1.9 p.p. reaching the level of 30.9%.

### Cash and balances with the Central Bank

Assets	30.06.05	31.12.04 pro forma	Change
	PLN million		
Cash and balances with the Central Bank, including:	3,200.1	3,939.3	(18.8%)
cash	884.7	1,081.3	(18.2%)
current account	971.7	1,474.7	(34.2%)
reserve bond	1,313.1	1,377.6	(4.7%)
other	30.6	5.7	(436.8%)

The decrease in this item of 18.8% in the first half of 2005 resulted mainly from a decrease in the balance of cash on the current account in NBP and cash in hand.

### Loans and advances

#### Customer structure of loans and advances\*

	30.06.05	31.12.04 pro forma	Change
	PLN million		
Loans and advances in nominal value	31,735.1	30,608.6	3.7%
loans	31,644.9	29,653.9	6.7%
retail**	7,313.2	6,776.9	7.9%
corporate	24,331.7	22,877.0	6.4%
non quoted securities	69.8	565.8	(87.7%)
buy-sell-back	20.4	388.9	(94.7%)
Nominal value adjustment	(4,348.2)	(4,303.5)	1.0%
Net loans and advances	27,386.9	26,305.1	4.1%

\* Including debt securities eligible for rediscounting at the Central Bank and net investment in finance lease.

\*\* The item includes retail loans in Bank Pekao S.A.

Loans and advances in nominal value increased by PLN 1,129.6 million in the first half of 2005. This resulted from PLN 1,991.0 million increase in loans, PLN 492.9 million decrease in non quoted securities and PLN 368.5 million decrease in buy-sell-back transactions.

Increase in the gross loan portfolio in the first half of 2005 results primarily from growing loan portfolio in Bank Pekao S.A. mainly thanks to an increase in loans granted to corporate customers (by PLN 1,454.7 million), increase in the volume of "Express Loan" (by PLN 575.0 million) and PLN mortgages (by PLN 406.5 million).

### Loan portfolio quality

Loans* (gross principal) in category:	30.06.05		31.12.04	
	PLN million	%	PLN million	%
Normal	23,934.9	75.6	21,833.0	73.7
Watch category	1,923.2	6.1	1,905.7	6.4
Non-performing	5,786.8	18.3	5,915.2	19.9
Sub standard	462.7	1.5	768.4	2.6
Doubtful	630.3	2.0	481.4	1.6

Lost	4,693.8	14.8	4,665.7	15.7
<b>Total loans</b>	<b>31,644.9</b>	<b>100.0</b>	<b>29,653.9</b>	<b>100.0</b>

\* according to the NBP's classification

In the first half of 2005, the loan volume increased by PLN 1,991.0 assisted by simultaneous decrease in non-performing loans by PLN 128.4 million. This resulted from effective credit risk management and improved macroeconomic conditions. As a result, the ratio of non-performing loans to total was 18.3% as at 30 June 2005 and was 1.6 p.p. lower compared to the end of 2004.

## Securities

Securities	30.06.05	31.12.04 pro forma	Change
	PLN million		
Financial assets as held for trading	2,508.8	3,195.7	(21.5%)
debt securities	2,506.0	3,192.0	(21.5%)
other securities and financial assets	2.8	3.7	(24.3%)
Other financial instruments at fair value through profit or loss	1,736.3	1,336.7	29.9%
Investment securities	14,477.7	15,036.5	(3.7%)
available for sale	11,701.3	10,114.2	15.7%
held to maturity	2,785.1	4,931.8	(43.5%)
impairment	(8.7)	(9.5)	(8.4%)
<b>Total securities</b>	<b>18,722.8</b>	<b>19,568.9</b>	<b>(4.3%)</b>

The largest component of the securities structure are investment securities, which at the end of June 2005 accounted for 77.3% of the total securities. The largest value among investment securities constitute securities available for sale.

## 6.3.2 Liabilities

### Changes in the structure of liabilities

Funds deposited by customers represent the most significant part of the total liabilities of the Group. As at the end of June 2005 amounts due to customers and liabilities arising from securities issued amounted to PLN 45,993.8 million and increased by PLN 148.9 million during the first half of 2005. The share of those items in the liabilities stood at 76.0% as at the end of June 2005.

In the first half of 2005, amounts due to Central Bank fell by PLN 97.5 million as a result of partial repayment of the refinancing loan for the central state investment. The share of this item in the liabilities was 3.4%.

The Group's equity (including net profit) increased in the first half of 2005 by PLN 106.3 million. Change in the equity was mainly due to: repayment PLN 1,065.5 million in form of dividend of the net profit for 2004 and the profit of the current year (PLN +725.4 million). The share of the equity in the total balance sheet amount stood at 12.8%.

### Sources of financing

Customers' deposits as well as deposits placed by banks are the main sources of financing of lending and investment activities of the Group. At the end of June 2005 they amounted to PLN 48,074.9 million, i.e. 79.4% of the total liabilities.

As at the end of June 2005 customers' deposits represented 91.8% of the total external sources of financing, and their share decreased by 1.1 p.p. in comparison to the end of 2004.

The Group also takes advantage of the refinancing loan from NBP in order to finance the central state investment. The amount due to NBP (resulting from the valuation using the effective interest rate method) decreased during 6 months of 2005 by PLN 97.5 million to the level of PLN 2,054.2 million.

Financing on the financial institutions market constitutes 4.2% of external sources of the financing of the Group's activities.

### External sources of the Group's financing

	30.06.05	31.12.04 pro forma	Change
	PLN million		
Amounts due to the Central Bank	2,054.2	2,151.7	(4.5%)
Amounts due to banks	2,081.1	1,332.6	56.2%
Amounts due to customers	45,993.8	45,821.6	0.4%
Banku Pekao S.A. bonds	0.0	23.2	x
<b>Total external sources of financing</b>	<b>50,129.1</b>	<b>49,329.1</b>	<b>1.6%</b>

Deposits acquired by entities consolidated under full method accounted for less than 1% of the Group's deposits. Bank Pekao S.A. acquires deposits mainly in Poland.

### Deposits

	30.06.05	31.12.04 pro forma	Change
	PLN million		
Customer deposits	44,122.7	43,465.0	1.5%
retail	27,620.4	28,137.1	(1.8%)
corporate	16,502.3	15,327.9	7.7%
sell-buy-back	1,726.4	2,142.4	(19.4%)
other	144.7	214.2	(32.4)
<b>Liabilities to customers</b>	<b>45,993.8</b>	<b>45,821.6</b>	<b>0.4%</b>
<b>Bank Pekao S.A. bonds (principal)</b>	<b>0.0</b>	<b>22.5</b>	<b>x</b>
<b>Mutual funds</b>	<b>16,415.4</b>	<b>13,002.3</b>	<b>26.3%</b>
including sold in the Group's network	15,272.2	11,857.2	28.8%
<b>Total savings</b>	<b>60,538.1</b>	<b>56,489.8</b>	<b>7.2%</b>
including retail	44,035.8	41,161.9	7.0%

Savings of the Group's clients increased by PLN 4,048.3 million (7.2%) in the first half of 2005 resulting from both an increase in the savings of individual clients (of PLN 2,873.9 million, i.e. 7.0%) and in corporate deposits (of PLN 1,174.4 million, i.e. 7.7%). Demand for mutual funds continued to be high allowing to increase mutual funds assets by PLN 3,413.1 million in the first half of 2005 (compared with a growth of PLN 7,401.0 million in the mutual fund market), which in turn contributed to a further 1.9 p.p. increase in the market share to 36.4%.

## 7 Management and Supervisory Boards of the Bank as at 30 June 2005

### 7.1 Management Board of Bank Pekao S.A.

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1. Jan Krzysztof Bielecki - President, CEO
  2. Luigi Lovaglio - Deputy President, COO
  3. Sabina Olton - Deputy President, Chief Accountant
  4. Przemysław Figarski - Member of the Management Board
  5. Irene Grzybowski - Member of the Management Board
  6. Paolo Iannone - Member of the Management Board
  7. Christopher Kosmider - Member of the Management Board
  8. Marian Wazynski - Member of the Management Board
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## **7.2 Supervisory Board of Bank Pekao S.A.**

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1. Jerzy Woznicki - Chairman
  2. Paolo Fiorentino - Deputy Chairman, Secretary
  3. Andrea Moneta - Deputy Chairman
  4. Paweł Dangel - Member of the Supervisory Board
  5. Fausto Galmarini - Member of the Supervisory Board
  6. Oliver Greene - Member of the Supervisory Board
  7. Enrico Pavoni - Member of the Supervisory Board
  8. Leszek Pawłowicz - Member of the Supervisory Board
  9. Jerzy Starak - Member of the Supervisory Board
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## **7.3 The Bank's shareholding structure**

Table below shows the Bank's shareholders who have (directly or indirectly through subsidiaries) at least 5% of total votes at the Bank's General Shareholders Meeting:

Shareholder	Number of shares and votes at GSM	Share in the share capital and in total votes at GSM
	30 June 2005	
UniCredito Italiano S.p.A.	88,121,725	52,93%
Other shareholders	78,359,962	47,07%
<b>Total</b>	<b>166,481,687</b>	<b>100,00%</b>

## **7.4 Shares owned by the Members of the Bank's Management and Supervisory Boards**

As at the date of submitting this report, Mrs Sabina Olton owned 10,000 shares of Bank Pekao S.A. The number of shares owned by Members of the Management and Supervisory Boards of the Bank did not change as compared to the end of 2004.

An incentive programme in the form of management options is in force in the Bank Pekao S.A. Group. The programme covers the Management Board, other management, key employees implementing the Bank's strategy and selected employees of the subsidiaries.

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As at the date of submitting this report, 41 people participate in the incentive programme for the year 2003. The total number of shares offered under this programme was 653,126, of which 253,271 shares will be offered to the management.

The incentive programme for the year 2004 has 46 participants and the total number of shares offered is 717,662, of which 391,348 shares will be offered to the management.

In the first half of 2005 the Bank issued registered Series A, B, C and D bonds. The registered bonds were allocated to Pekao Factoring Sp. z o.o. acting as the Trustee.

The period for the acquisition of Series A bonds from the Trustee by the people participating in the incentive programme started on 6 May 2005 and will last until 30 December 2005. The execution of the right to take up Bank's shares can be exercised from 1 January 2006 and no later than 31 December 2010.

## 7.5 Remuneration for the Members of the Bank's Management and Supervisory Boards

### Management Board and Supervisory Board remuneration

	30.06.2005 '000 PLN	30.06.2004 '000 PLN
<b>Management Board of the Bank</b>		
Short-term employee benefits	9,432	5,501
Share-based payments*	1,328	743
<b>Total</b>	<b>10,760</b>	<b>6,244</b>
<b>Supervisory Board of the Bank</b>		
Short-term employee benefits	233	218
<b>Total</b>	<b>233</b>	<b>218</b>
<b>Grand total</b>	<b>10,993</b>	<b>6,462</b>

\* The value of Share-based payments was established as part of Payroll/Employee Expenses recognized by the Group, according to IFRS 2 during the reporting period, representing the amortization of initial fair value of options (pre-emptive rights to take up the Bank's shares) pertaining to options granted to members of the Management Board of the Bank.

### Remuneration of members of the Management Boards and Supervisory Boards of the subsidiary companies

	30.06.2005 '000 PLN	30.06.2004 '000 PLN
Short-term employee benefits	6,138	6,888
Share-based payments *	207	120
<b>Total</b>	<b>6,345</b>	<b>7,008</b>

\* The value of Share-based payments was established as part of Payroll/Employee Expenses recognized by the Group, according to IFRS 2 during the reporting period, representing the amortization of initial fair value of options (pre-emptive rights to take up the Bank's shares) pertaining to options granted to members of the Management Boards of the subsidiary companies.

## 8 Assessment of the financial credibility of Bank Pekao S.A.

As at 30 June of 2005, Bank Pekao S.A. had the following financial credibility ratings:

### Fitch Ratings

Long-term rating	A
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Short-term rating	F1
Individual rating	C
Support rating	1
Prospective rating	Positive

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**Standard and Poor's**

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Long-term rating	BBB
Short-term rating	A-2
Prospective rating	Positive

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**Moody's Investors Service Ltd.**

The Bank has not ordered Moody's rating.

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Long-term deposit rating	A2
Short-term deposit rating	Prime-1
Financial strength	C
Prospective rating	Stable

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On 15 June, Fitch Ratings placed the ratings of Bank Pekao S.A. on the watch list:

- long-term, on the watch evolving list,
- short-term, on the watch negative list.

Placing the ratings on the above-mentioned lists was due to the fact that the ratings of UniCredito Italiano S.p.A. (UCI), the majority shareholder of Bank Pekao S.A., were placed on the watch negative list in connection with announcing the offer of acquiring Bayerische Hypo- und Vereinsbank (HVB).

On 17 June 2005, Standard & Poor's Ratings Services maintained the ratings of Bank Pekao S.A. on an unchanged level, in spite of placing the rating of UCI, the majority shareholder of Bank Pekao S.A., on the watch negative list.

The Agency also announced that the ratings of Bank Pekao S.A. shall remain unchanged in the event of its potential merger with Bank BPH S.A. as a result of the merger between UCI and HVB.

Standard & Poor's took into consideration the continued improvement of the lending situation in Bank Pekao S.A. and the fact that in the event of the merger with Bank BPH S.A., the potential of the merged banks would make it possible to create the largest bank in Poland with over 20% share in the assets of the Polish banking system.

On 30 June 2005, Standard & Poor's Ratings Services announced that it has placed the rating of the Bank's long-term liabilities on the BBB level, on the watch positive list.

Standard & Poor's informed that placing the long-term rating of Bank Pekao S.A. on the above-mentioned list indicates the possibility of increasing the rating of the Bank's financial reliability due to its strategic position in the UniCredito Italiano S.p.A. Group and the expected improvement of the results. If the Agency decides to increase the Bank's ratings, the scale of the increase shall not exceed one or two degrees.

## **9 Debt securities issue agreements**

On 30 June 2005 F series bearer bonds were redeemed under the second bond issue programme.

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Issuance of registered bonds with pre-emptive rights to take up the Bank's F and G shares

The Bank issued 415 thousand registered A series bonds and 415 thousand registered B series bonds with pre-emptive rights to take up the Bank's F series shares, and 415 thousand registered C series bonds and 415 thousand registered D series bonds with pre-emptive rights to take up the Bank's G series shares.

1,660 of the Bank's registered bonds were allocated to Pekao Faktoring (the Bank's subsidiary) acting as the trustee, and registered in the Bonds Register of Centralny Dom Maklerski Banku Pekao S.A.

The Bonds were issued on the basis of Resolution No. 6 of the Bank's Extraordinary General Meeting dated 25 July 2003 on the issue of registered bonds under an incentive programme.

Each Bond entitles to take up 1 ordinary bearer share of the Bank:

- 1 A series bond entitles taking up 1 F series share;
- 1 B series bond entitles taking up 1 F series share;
- 1 C series bond entitles taking up 1 G series share;
- 1 D series bond entitles taking up 1 G series share.

The nominal value of one bond is PLN 0.01. The total value of the issued A, B, C and D series bonds amounts to PLN 16,600. The issue price of one bond is equal to its nominal value.

The bonds do not bear interest. The bonds are not secured.

The issue price of F series shares amounts to PLN 108.37, and of G series shares PLN 123.06.

Bonds of each series will be available for purchase from the trustee by the eligible persons in the following periods:

- A series bonds in the period from 6 May to 30 December 2005.
- B series bonds in the period from the 31st day after the date of the General Shareholders' Meeting, approving financial statements for the financial year 2005 until 30 December 2006.
- C series bonds in the period from the 31st day after the date of the General Shareholders' Meeting, approving financial statements for the financial year 2006 until 30 December 2007.
- D series bonds in the period from the 31st day after the date of the General Shareholders' Meeting, approving financial statements for the financial year 2007 until 30 December 2008.

All Bonds which are not sold off by the trustee by 30 December 2005, 2006, 2007 and 2008 respectively shall be acquired by the Bank on 31 December 2005, 2006, 2007 and 2008 respectively to be redeemed at their nominal value.

The execution of the pre-emptive rights to take up F and G series shares can be exercised in the following periods:

- in respect of A series bonds - from 1 January 2006 to 31 December 2010;
- in respect of B series bonds - from 1 January 2007 to 31 December 2010;
- in respect of C series bonds - from 1 January 2008 to 31 December 2012;
- in respect of D series bonds - from 1 January 2009 to 31 December 2012.

## 10 Selected financial ratios

	in %	
	1 H 2005	1 H 2004
<b>Profitability ratios</b>		
Return on equity (ROE)	18.7%	17.5%
Net interest margin	4.2%	3.8%
Non-interest income / total income	47.5%	46.8%
Operating costs (including depreciation) / total income	53.8%	57.6%
Effective tax rate	18.0%	10.9%
	<b>30.06.2005</b>	<b>30.12.2004</b>
<b>Balance sheet structure ratios</b>		
Net loans / Balance sheet total	45.2%	44.2%
Securities / Balance sheet total	30.9%	32.8%
Deposits / Balance sheet total	76.0%	77.0%
Equity / Balance sheet total	12.8%	13.2%
<b>Asset quality ratios (according to NBP's methodology)</b>		
Non-performing loans / gross total loans	18.3%	19.9%
Non-performing loans / equity	74.9%	75.4%
<b>Capital adequacy ratios</b>		
Capital adequacy ratio	20.1%	19.7%

## **11 Representations of the Bank's Management Board**

The Management Board of Bank Pekao S.A. declares to its best knowledge that:

- the semi-annual financial statements and comparative figures have been prepared in accordance with the binding accounting policies and that they reflect in a true, fair and clear manner the Bank Pekao S.A. Group financial position and its results,
- the semi-annual Report on the activities for the first half of 2005 provides the true picture of the Bank Pekao S.A. Group development, achievements and situation, including the main risks and threats.

The Management Board of Bank Pekao S.A. declares that the registered audit company performing the review of the semi-annual financial statements of the Bank Pekao S.A. Group has been selected in line with the binding legal regulations. The company and the registered auditors performing the review meet the requirements indispensable for issuing an objective and independent review report, in line with the relevant provisions of the Polish law.