ANNUAL REPORT

HIPOTEKARNA BANKA

2011

ANNUAL REPORT 2011

Report of the Chairman of the Board of Directors
and Chief Executive Officer Report

Report of the Chairman of the Board of Directors

Dear clients, partners and shareholders,

On behalf of the Board of Directors, I have the honour to present the Annual Report of Hipotekarna banka AD Podgorica for the year 2011.

Last year, following years of crisis, was marked by a challenging market and economic environment. The first two quarters of 2011 were shaped by a temporary relief and improvement in the general economic situation, continuing the optimistic trend which started in 2010 when general conditions improved materially. However, in the second half of the year, a significant slowdown in economic growth, accompanied by the intensifying sovereign debt crisis in Europe dominated the economic agenda. Profound changes to the regulatory standards concerning capital requirements which have to be implemented within a short timeframe will likely be amongst the most debated topics of concern for the majority of European banks.

Alongside the Management, the Board safely navigated through the current and previous difficult economic environment, ensuring to appropriately position Hipotekarna banka AD Podgorica to remain and continue to be profitable and successful. Given the difficulties in which the Bank operates, we are pleased that we were able to increase the income, underlying profit, and market share in many of our businesses. We enter 2012 in a stronger competitive position. We obtained a net profit growth of 17.80% and a return on equity of 6.59%, with a 10.38% increase compared to the previous year.

Despite the difficulties and in order to have a significant presence all over the country, we continued our territorial expansion by opening a new branch in Ulcinj. We expect this branch to be fully operative and profitable by the end of 2012.
By focusing on keeping a strong capital base, we succeeded to grow through dramatic changes and volatility. At the end of 2011, the Bank's solvency ratio stood at 16.98%, demonstrating that disciplined risk management supports long-term and sustainable success. We highlighted the development and implementation of risk

principles, taking the time to ensure that risk is properly understood and embedded throughout every aspect of our business and making sure that every employee at every level of our organisation is aware and accountable for risk management. Hipotekarna Banka remains a market oriented bank, in the sense that client satisfaction is our main purpose, alongside the profitability of his/her and our businesses. We work hard in order to establish strong, deep and long-term relationships with customers.

Education and continuous training were in 2011, like every year, among the top priorities of the bank. Our employees, of whom we are proud, are motivated to improve their skills in order to give our clients the best professional service.

I would like to thank all our customers, employees and shareholders and to express my deep appreciation for their loyalty and trust.

Sigilfredo Montinari
Chairman of the Board of Directors

Report of the Chief Executive Officer

Dear clients, partners and shareholders,

It is my honour to present you the Annual report of the Hipotekarna banka AD Podgorica for the year 2011.

The global economic crisis, although having a strong negative impact on global markets, is not significantly influencing the function and liquidity of the Montenegrin banking sector in general, as was the case in the rest of Europe. Spill over effects of the global crisis were felt to a lesser extent than the banks with headquarters situated in countries that bore the heaviest burden of the global recession.

The problems which the banking sector has faced in recent years have not had a negative impact on the operations of Hipotekarna banka AD Podgorica, primarily due to the consistent implementation of internal procedures, risk diversification and a conservative approach to loan approval process. Starting in 2006, when the shift in ownership and management structure occurred, the Bank recorded constant growth in all relevant business parameters, with no significant deposit outflows or possible occurrence of insolvency.

The biggest challenges to the banking sector in 2011 were reflected in the high level of nonperforming loans, the lack of a quality deposit base, and the consequent insufficiency of the top class credit products, absence of quality projects which needed funding and an inefficient judicial system. However, the Montenegrin banking sector remained stable and in an enviable position in the last year given the overall economic environment in the country. The overall situation is considerably better compared to the past few years. Competition in the sector is growing stronger, and resulting in a gradual increase in the participation of small and medium-sized banks with regard to relatively large banks. Problems that banks have faced in the late 2008, 2009 and in part of 2010, among which the sudden outflow of deposits and insolvency of individual banks which resulted in the most severe consequences, were mostly overcome in 2011.

Today, the coefficients of liquidity for all the banks in the system are above the legal limit and the consolidation of the banking sector is achieved through the increase in capital of certain banks. By introducing the international standards in business, obtaining steady progress in Euro-Atlantic integration, and improving the business environment in Montenegro at the same time, Montenegro HAS sent positive signals giving cause for optimism.

Hipotekarna banka AD Podgorica ended the previous year with a growth in net income. It has become one of the few banks in Montenegro that has achieved a series of seven-digit profits in six consecutive years, which were mostly a growing figure year on year. We made progress in every business segment even compared to the successful year of 2010. Total assets of the Bank increased by 20.81%, along with an achieved increase in deposits of 14.94% and with an increase in the loan portfolio of 11.30% over the previous year. New products and services have been successfully placed on the market, with an active marketing campaign in all the medias, and promotion of its high ranking position from the previous year in the capital market. All financial, regulatory and internal solvency indicators of the Bank in all business segments during the year have been above the prescribed standards, with the trends which continue to move in a favourable direction.

Hipotekarna banka AD Podgorica will continue upgrading its technological processes in order to achieve better results in all key business segments, preserving and increasing the capital base as security for our stakeholders, continuously improving the business model to incorporate the best banking practices and anticipated changes in business environment as well as investing in human capital, because our business is based on ideas, work and knowledge.

Finally, I will take the opportunity on behalf of the management of Hipotekarna banka AD Podgorica, and on my own behalf, to thank our clients, shareholders, associates and employees for their loyalty, diligence and support in another successful year.

Esad Žaimović
Chief Executive Officer

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1. Summary of the Montenegrin economy in 2011.

Macroeconomy

Last year featured a lower level of foreign direct investment, weaker credit activity of banks and problems in the industrial sector.

The beneficial effects of the recovery of the world economy in the first half of 2011 had generated an additional positive effect in the growth in most economic indicators of Montenegro. The summer of 2011 indicated a possible new crisis. The deepening of the negative trends in Europe is not only a consequence of the continued crisis in the peripheral countries of the euro zone, but it is rather an outturn into the central countries of the region.

The new wave of the crisis in the second half of 2011, in Montenegro, according to statistical indicators, did not generate a negative impact on some segments of the real sector. The growth in tourism exceeded all expectations (10.2% in first 9 months of 2011), induced by the prolonged summer season due to favourable weather conditions, and had generated positive effects on related industries in the areas of services and food production and beverages.

The real growth of 2.5%, generated by the growth in the tourism and electricity generation sectors, was most likely to continue in 2011. In spite of the crisis in the Eurozone, the Montenegrin economy has continued with the growth in the service sector, while the low prices of aluminium in the international markets affected the growth in its production and exports. The projected economic growth of 2.5% in 2011 is most likely to be achieved. However, the economic illiquidity problem is still a top priority, being pronounced on the basis of scarce funds in the next year and a restrictive fiscal policy.

Montenegro's GDP (EUR million)

Year	GDP	Real growth rate
2000	1,065.70	
2001	1,295.10	1.10%
2002	1,360.40	1.90%
2003	1,510.10	2.50%
2004	1,669.80	4.40%
2005	1,815.00	4.20%
2006	2,149.00	8.60%
2007	2,680.50	10.70%
2008	3,085.60	6.90%
2009	2,981.00	-5.70%
2010	3,104.00	2.50%
2011*	3,273.00	2.50%
2012*	3,405.00	2.00%

Source: MONSTAT
Source: Estimates Ministry of finance

GDP

After several years characterised by high GDP growth, a budget surplus, a record inflow of foreign direct investments, an increase in the number of employed as well as the very dynamic development of the banking system, a period of crisis and recession was experienced. In 2009 the GDP growth rate was -5.5%, which is a significant decrease after several years of increase with rates of 10.7% in 2007 and 6.9% in 2008. In 2011 the economy recovered with GDP growing by 2.5%.

The participation of individual sectors in the formation of GDP from the production side

	Real growth rates in 2011	Contribution to 2011	The structure of GDP-2011
GDP		2.5	100
Net taxes	3	0.5	16.7
Gross added value		2	83.3
Agriculture, hunting, forestry and fisheries	0.9	0.1	7.5
Mining and quarrying	6.3	0.1	1.3
Manufacturing	6.8	0.3	4.7
Production and supply of electric. energy	-32.7	-1.8	3.6
Construction	19.4	1	5.9
Trade	10.5	1.3	13.2
Hotels and restaurants	10.2	0.5	5.6
Transport, storage and communication	-3.9	-0.4	9
Financial intermediation	3	0.1	4
Activities related to real estate and other services	7	0.6	9
Public administration and defence, compulsory social security	1.8	0.1	8.2
Education	3	0.1	4.5
Health and social work	-2.6	-0.1	3.8
Other community, social and personal services	1	0	3

Source: Estimates Ministry of finance

Foreign Exchange

Positive changes are occurring in foreign trade. The volume of foreign trade of Montenegro for the period January-December 2011 increased by 14.6% compared to same period last year. Exports of goods increased by 37.5% over the same period last year, while imports more than 10% compared to same period last year. The export structure is diversified between non-ferrous metals, iron and steel. The import structure is diversified between food and livestock.

The international exchange of services increased in the first nine months of 2011. The surplus amounted to 521.8 million EUR as a result of the simultaneous increase of revenues and reduction in expenses.

The total volume of services in the first three quarters of 2011 was 7.3% over the same period last year.

Revenues from services amounted to 751.8 million or 13.7% over the same period last year. Most of the revenues are in travel, transport, other business services and construction services.

Inflation

Annual inflation was 2.8%, and was 2.1 percentage points higher than the annual inflation in 2010. The average rate in 2011 amounted to 3.1%.

Producer prices of manufacturing products recorded an annual increase of 1%, mainly due to the price increase in the manufacturing industry and mining and quarrying of 2.2% and 2.1%, respectively. Producer prices of electricity, gas and water showed annual declines of 2.6%.

Employment

Employment increased by 0.8% during 2011, while unemployment decreased (ZZZCG) 3.1%. The unemployment rate in 2011 fell in the fourth quarter, when it increased to 13.2%.

Tourism

According to Monstat, some 1,373.5 thousand tourists visited Montenegro in 2011, which is 8.7% more than in 2010. Tourist overnight stays amounted to 8,775.2 thousand, which is a 10.2% increase over 2010. Foreign tourists accounted for 89.1% of total tourist overnight stays.

Industrial Production

During 2011, compared to 2010, total industrial output decreased by 10.3%. The electricity, gas and water supply sector recorded a decline of 32.7%, while the highest growth was recorded in the sub-sector production of wood and wood products (34.6%) and mining and quarrying and the manufacturing industry sector recorded respective growth of 6.3% and 6.8%.

Foreign Direct Investments (FDI)

Due to unfavourable trends in the Euro area countries, uncertainties in the global financial markets, and lower interest of foreign investors, Montenegro recorded a decline in the FDI inflow. According to preliminary data, net FDI inflow amounted to EUR 389 million in 2011, being 29.5% lower compared to 2010. The share of net FDI inflow in the estimated GDP for 2011 was 11.9%, being some 6 percentage points lower compared to 2010.

The problem of illiquidity of the real sector is still caused by a drop in bank loans in 2011,which on an annual basis amounted to 11% and a drop in FDI of 29%, compared to the 2010. Retail deposits are continuously growing. Current account balance is reduced to 19% of GDP, due to the growth in goods and services exports.

In the fourth quarter of 2011 most economic aggregates decreased.

2.] Overview of the Bank's operations

Organisation And Staff

As at 31.12.2011, the Bank had 163 employees who have the necessary skills and information-technological base to perform banking operations. Working with customers (“front office”), engages 56% of employees. The number of employees increased by 8 (eight), compared to 31.12.2010. The average age of employees in the Bank is 35.6 and average tenure of employees is 9.3 years.

An appropriate organisational structure had to be adapted to business development. Therefore the Bank has introduced some organisational changes in order to achieve greater efficiency and optimum utilisation of technical and human resources (Quality control of the loan portfolio Department was established in the Risk Management Division). During 2011 the Bank opened a branch in Ulcinj, which employs 4 (four) people.

Continuity in educating and training employees is a primary objective of the Bank. During 2011, a large number of employees participated at numerous internal and external training courses in various areas relevant to the Bank. At the same time, the Bank employs young, professional people who will bring their commitment to improve the quality of the Bank’s development.

The educational structure of employees is: 6 (six) employees have Masters of Science (MSc), 78 (seventy-eight) employees with higher education (university degree), 12 (twelve) employees have a bachelor degree, 17 (seventeen) with a college degree and 50 (fifty) with secondary education.

Governing Bodies

Governing bodies of the Bank are: Assembly of Shareholders and the Board of Directors. The General Assembly consists of all shareholders. Members of the Board of Directors, the Bank’s management authorities, are elected and appointed by the Assembly of Shareholders.

The structure of the largest shareholders as at 31.12.2011 is:

HB - Custody Account 4	16.8695%
Cerere S.r.l. Italy	13.9275%
Gorgoni Antonia, Italy	10.0016%
Gorgoni Lorenzo, Italy	8.2766%
Todorović Miljan, Italy	7.3982%
Podravska banka D.D. Koprivnica, Croatia	6.5389%
Nereo finance S.A., Luxembourg	4.8682%
Jugopetrol A.D. Kotor, Montenegro	4.7021%
Montinari Dario, Italy	4.6159%
Montinari Sigilfredo, Italy	4.6159%
Montinari Andrea, Italy	4.6127%
Montinari Piero, Italy	4.6127%

The Board of Directors of the Bank has 5 (five) members and the majority is not employed at the Bank. Standing Bodies of the Board of Directors of the Bank are: the Audit Committee and Credit Risk Management Committee.

List of the Boards, its members and executive directors of the Bank

1. The Board of Directors of Hipotekarna Banka AD

- Sigilfredo Montinari, President
- Božana Kovačević, Deputy President
- Snježana Pobi, Member

- Renata Vinković, Member
- Esad Zaimović, Member

2. Audit Committee of Hipotekarna Banka AD

- Marko Žigmund, Chairman
- Božana Kovačević, Member
- Jovan Papić, Member

3. Credit Risk Management Committee of Hipotekarna Banka AD

- Renata Vinković, Chairman
- Esad Zaimović, Member
- Snježana Pobi, Member

4. Executive Directors of Hipotekarna Banka AD

- Esad Zaimović, Chief Executive Officer
- Jelena Vuletić, Risk Management Executive Director
- Ana Golubović, Executive Director of Commercial Affairs
- Aleksandar Mitrović, Executive Director of Finance and Informatics

Shareholders' Assembly

The Assembly of Shareholders held one session in 2011 which, considering materials that were subject to assessments and decisions were regularly (annually) held.

At the 13th regular meeting (held on 27.06.2011), the Shareholders' Assembly reviewed the annual report of Hipotekarna Bank AD Podgorica for 2010 with the report of external auditors and adopted the Decision on profit distribution for 2010 which is used to cover losses from previous accounting periods.

Board of Directors and Governing bodies

In 2011 the Board of Directors of the Bank, in accordance with the Law on Banks ("Official Gazette of Montenegro no. 17/08, 44/10, 40/11), held a total of 12 regular sessions (legal obligation is to hold a session at least once a month).

The work of the Bank's Board of Directors was primarily focused on activities that represented the realisation of the tasks and objectives set with the strategic and annual planning documents.

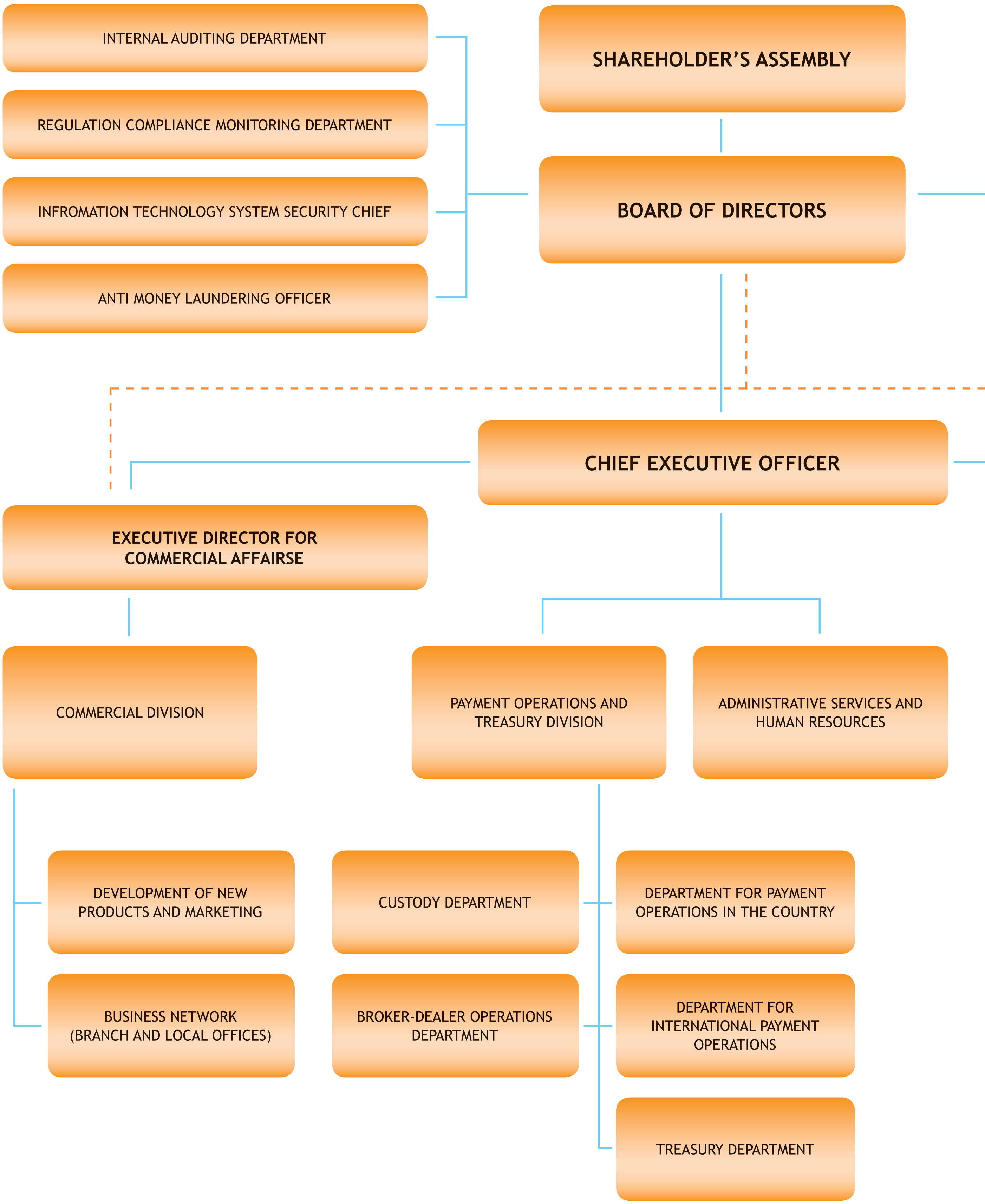
The Bank's Board of Directors regularly discussed issues relevant to the Bank (monthly business and financial statements, reports on liquidity, reports on the risks and specifically analyzed the reports related to lending activities and the activity of billing claims, and any other reports which covered the entire business activity of the Bank.

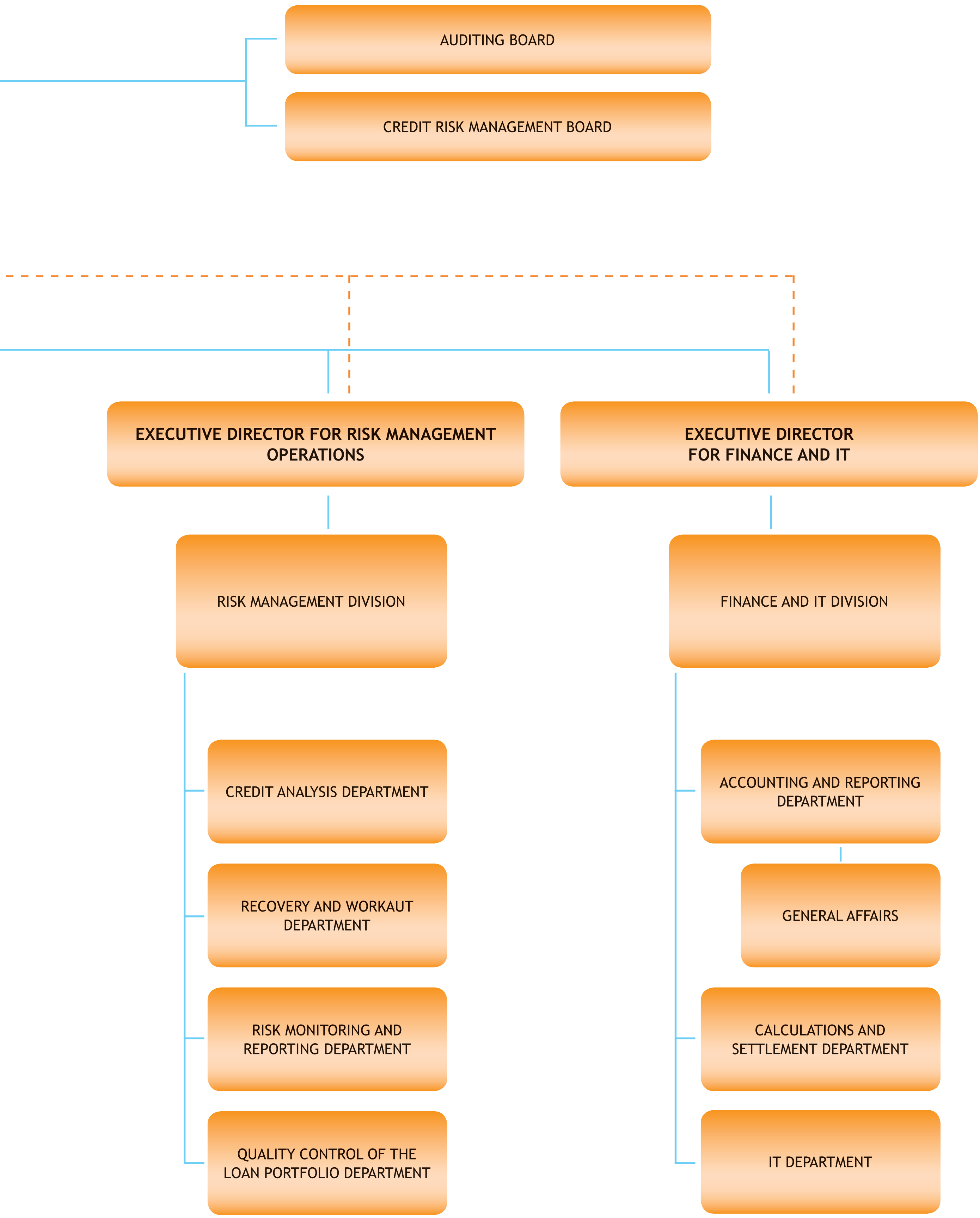
Also, if necessary, it carried out the alignment of interest, rentals and other fees with market conditions in the area of loan activities and other banking services, and discussed other issues of the current operations of the Bank and carried the appropriate decisions and conclusions about them.

As a permanent body of the Board of Directors, the Audit Committee and Credit Risk Management Committee on risk management regularly reported to the Board of Directors within its jurisdiction.

In addition to the permanent body, the Committee on Asset and Liability Management (ALCO) and the Committee on Development and management of information system of the Bank met at least once a month to set and discuss issues within the scope of its work and report to the Board of Directors of the Bank.

ORGANIZATIONAL CHART OF HIPOTEKARNA BANKA AD PODGORICA




AUDITING BOARD
CREDIT RISK MANAGEMENT BOARD
EXECUTIVE DIRECTOR FOR RISK MANAGEMENT OPERATIONS
EXECUTIVE DIRECTOR FOR FINANCE AND IT
RISK MANAGEMENT DIVISION
FINANCE AND IT DIVISION
CREDIT ANALYSIS DEPARTMENT
RECOVERY AND WORKAUT DEPARTMENT
RISK MONITORING AND REPORTING DEPARTMENT
QUALITY CONTROL OF THE LOAN PORTFOLIO DEPARTMENT
ACCOUNTING AND REPORTING DEPARTMENT
GENERAL AFFAIRS
CALCULATIONS AND SETTLEMENT DEPARTMENT
IT DEPARTMENT

Business operations

Deposits

In 2011, Hipotekarna Bank placed particular emphasis on increasing savings and improving the structure of deposits, i.e. increasing the share of time deposits in total deposits amount.

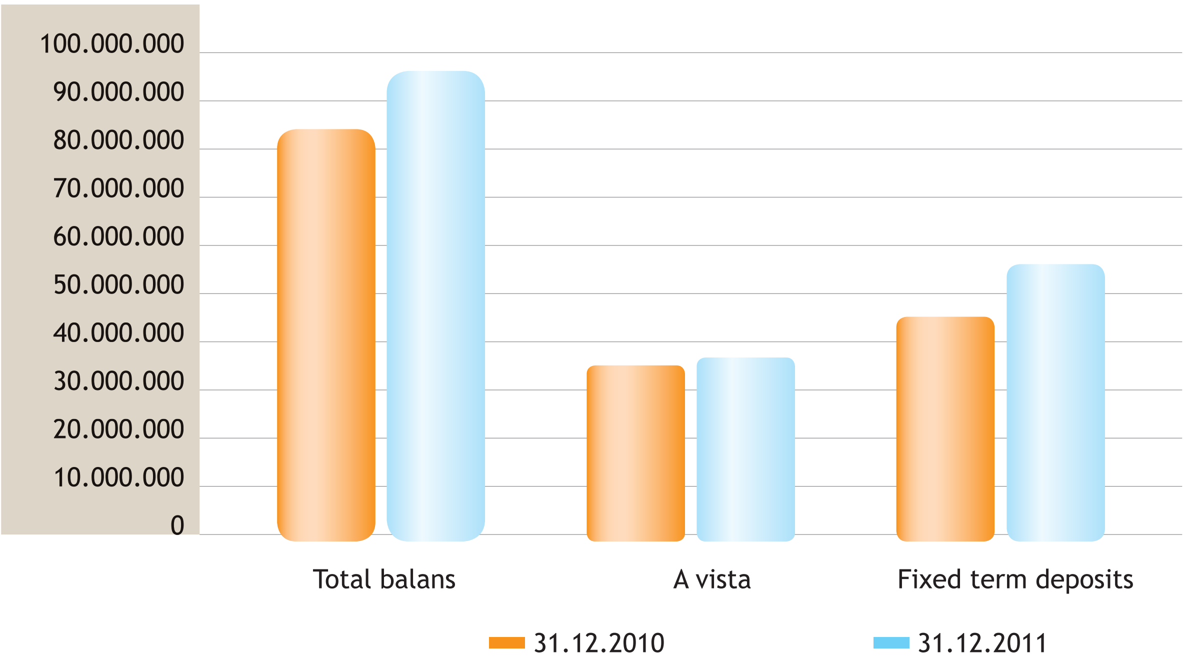
In order to achieve a defined goal, the Bank launched new products that in addition to the existing offer, provided more benefits for clients, both in terms of interest rates and managing funds from time deposits.

In 2011 the Bank organised a campaign for collecting deposits using stimulating interest rates, and campaign caused a great response from citizens and legal entities.

As a result of these activities we recorded significant growth of total deposits and improvement of its structure.

Balance of total deposits:

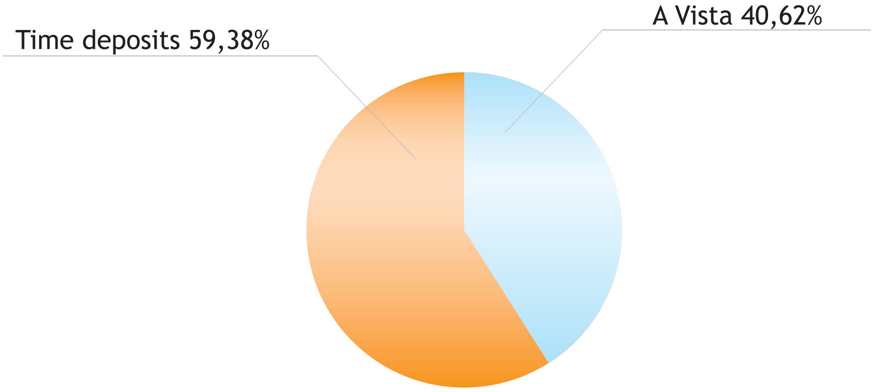
Date	Total balance	A vista	Fixed term deposits
31.12.2010.	85,133,265	38,004,211	47,129,054
31.12.2011.	97,852,745	39,749,882	58,102,862



Comparing the results from 2010, total deposits increased by 14.94%, with a 23.28% growth in time deposits, while the growth in a vista deposits was 4.59%.

The share of term deposits in total deposits is 59.38% and a vista deposits participate in total amount for 40.62%.

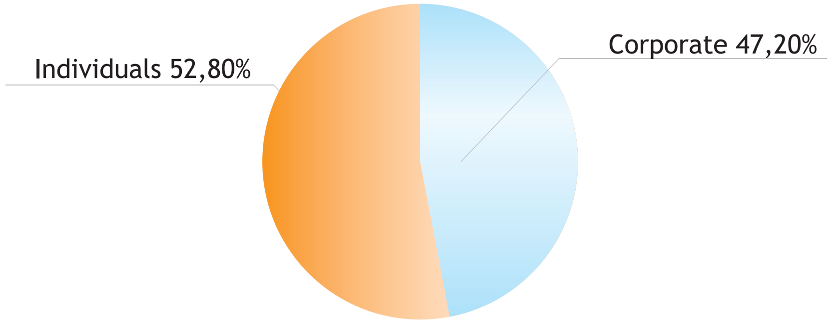
Deposit structure by type



This increase, both total deposits and time deposits in total deposits, indicates that the Bank, thanks to a high quality offer and a very active approach to sales itself, managed to confirm the great trust of its clients and to earn the trust of new ones.

In total deposits, the share of retail deposits amounted 52.80% and the corporate deposits were 47.20%.

Deposit structure - clients

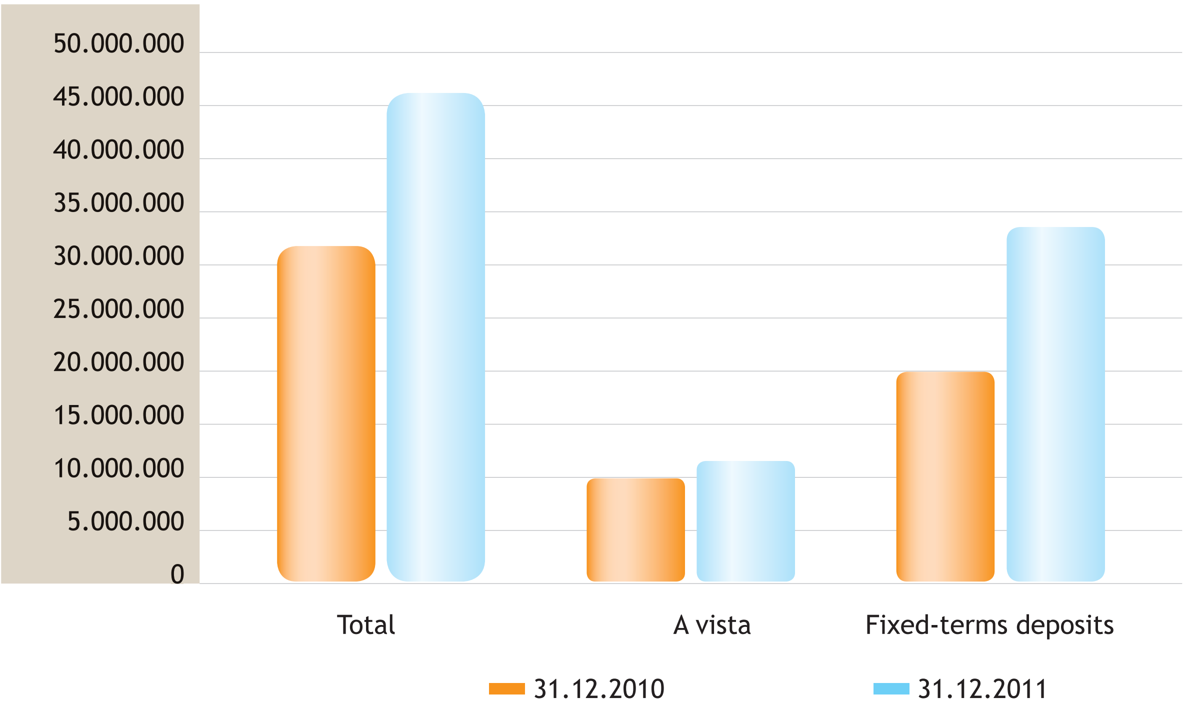


Retail deposits

Total retail deposits at the end of 2011 recorded a growth of 43.93%, compared to the results of 2010. The growth was achieved in a vista deposits, as well as in time deposits.

Date	Total deposits	A vista	Fixed term deposits
31.12.2010.	33,074,868	11,110,675	21,964,193
31.12.2011.	47,603,495	12,546,475	35,057,021

Retail deposits



Retail savings grew by 59.61%; short-term deposits increased by 36.66% and growth of long-term deposits was 244.85%.

Period	Total	Short-term de-posits	Long-term deposits
31.12.2010.	21,964,193	19,542,903	2,421,290
31.12.2011.	35,057,021	26,707,312	8,349,708

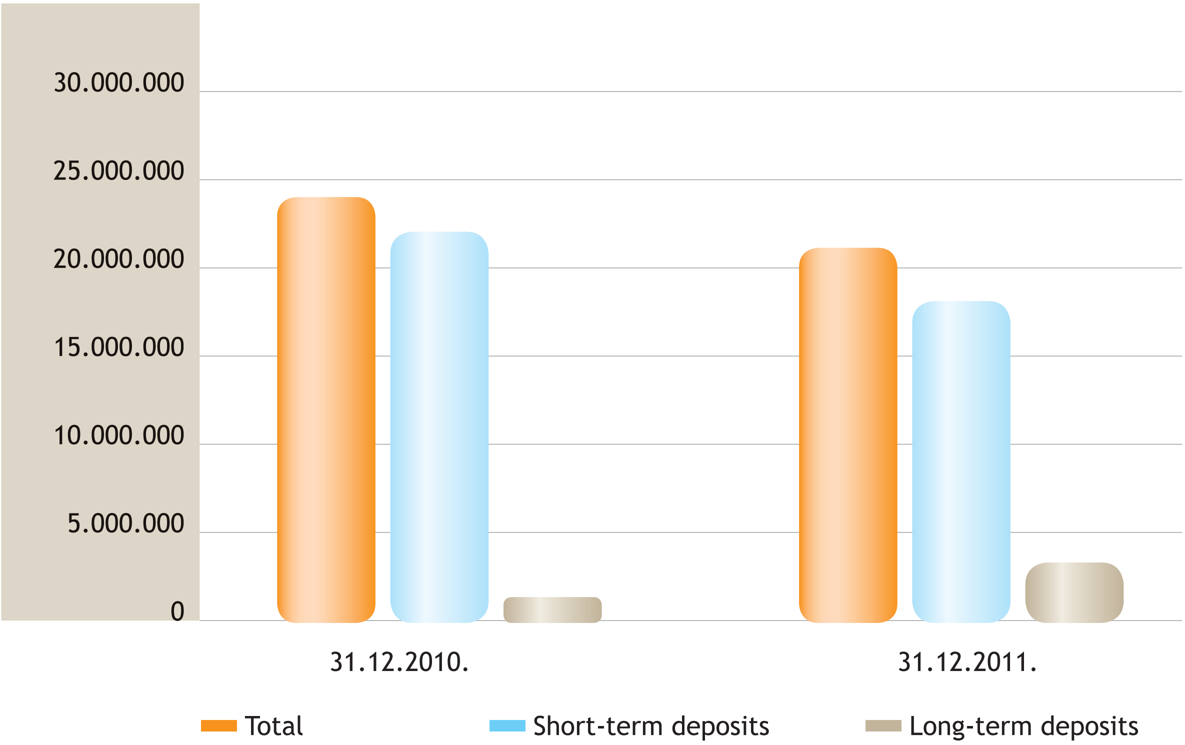
Retail a vista savings increased by 12.92%.

Corporate deposits

Total corporate time deposits reduced by 8.42%, but the structure of deposits was significantly improved. Specifically, when it comes to long-term time deposits of business entities the Bank managed to achieve a growth of 200.22%.

Period	Total	Short-term deposits	Long-term deposits
31.12.2010.	25,164,861	24,240,160	924,700
31.12.2011.	23,045,842	20,269,734	2,776,107

Corporate terms deposits



Compared with 2010, corporate a vista deposits increased by 1.15% in 2011.

Deponents base

Since one of the Bank's goals was to increase deponents base, the number of newly opened accounts in 2011 grew, regarding citizens as well as business subjects.

Period	Individuals	Legal entities	Total
01.01.-31.12.10.	7,381	1,390	8,771
01.01.-31.12.11.	11,022	1,455	12,477

The total number of open accounts recorded a growth of 42.25%. Retail accounts increased for 49.33% and the growth of corporate accounts was 4.68%.

This increase of deponent base is a sufficient indicator of confidence that citizens and businesses subjects have in Hipotekarna bank.

Loans

During 2011 Hipotekarna Bank, along with credit support for its existing clients, and through existing and new products approved a number of loans for new credit worthy clients.

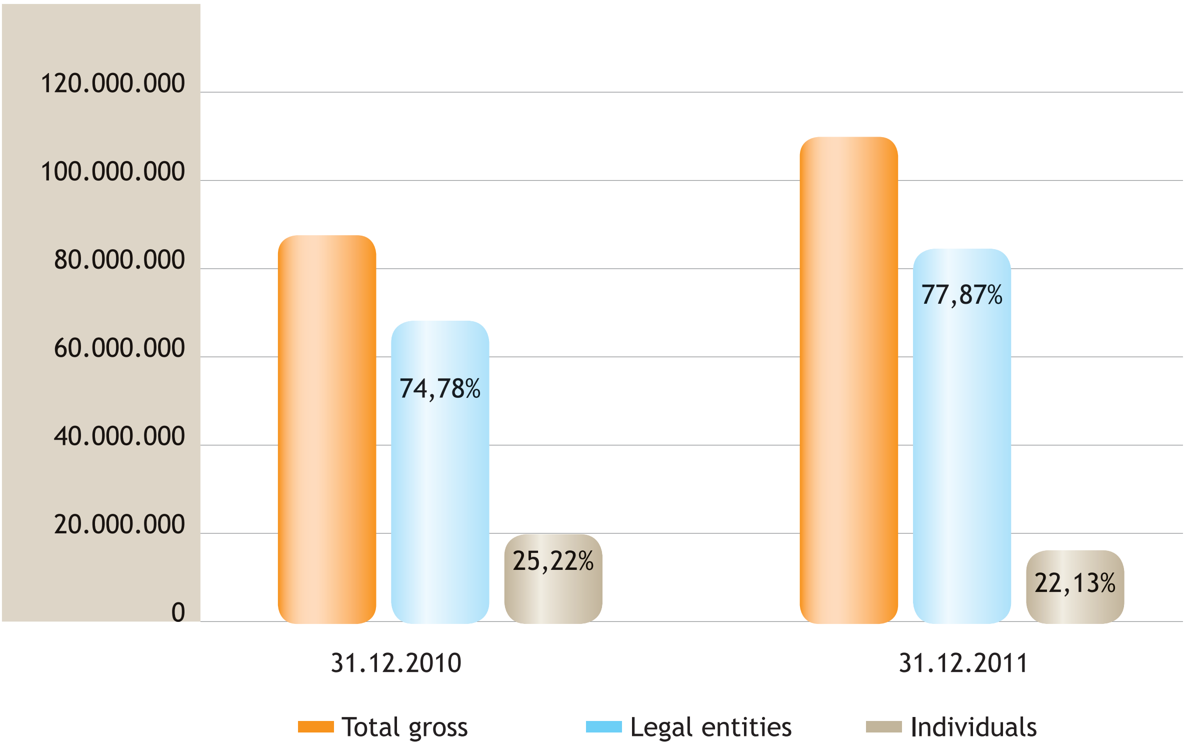
One of the distinguishing features of the Bank is providing consulting services, along with financial support for its clients, all in order to improve business operations and achieve better business results for both the Bank and its clients.

Despite the conservative policy that the Bank has traditionally maintained, when it comes to granting loans, the total gross of loan portfolio in the previous year increased by 12.32%

Loans	31.12.2010.	31.12.2011.	Growth
Gross loans	101,035,398	113,480,818	12.32%
Reserves	2,656,843	4,008,099	50.86%
Net loans	98,378,555	109,472,718	11.28%

In the structure of total loans, retail loans constitute 22.13%, while the share of corporate loans is 77.87%.pravnim licima čini 77,87%.

Credit portfolio



And in 2011 in cooperation with the European Investment Bank (EIB), Hipotekarna Bank AD Podgorica continued to provide loans and enable small and medium sized enterprises to achieve loans at very favourable conditions concerning the interest rate and repayment period.

With EIB loan funds, the Bank is financing projects for small and medium enterprises in the area of:

- Industry,
- Services,
- Tourism,
- Environmental protection and energy saving,
- Infrastructure, etc.

Also, the Bank has continued the excellent cooperation with the European Fund for Southeastern Europe and the Investment Development Fund in the field of placing loans under better terms.

In 2011, the Bank recorded an expansion of guarantees issued. Compared to the result of 2010, a number of guarantees issued increased by 27.37%, while the amount of guarantees issued increased by 24%

Period	Number	Total amount
31.12.2010.	950	28,199,245
31.12.2011.	1,210	34,965,936

In order to satisfy its clients and respond to their needs, in 2011 the Bank began with the approval of overdraft loans and factoring transactions.

Aiming to increase the loan portfolio and maintain competitiveness in the market, in 2011 the Bank implemented an action to reduce interest rates on retail loans. Since the results of these actions were positive, the Board of Directors made a decision for its continuation the next year.

Business network and distribution channels

The Business network, which now consists of 8 subsidiaries and 7 branches, provides a good basis for achieving results in the following year.

Except the widespread branch network, the Bank is available to its clients through other distribution channels - ATMs, EFTPOS terminals, internet banking through Hbklik service.

The Call Center of Hipotekarna bank Ad Podgorica started working in 2011. By calling 19 905 all the information on all the products offered by the Bank to existing and prospective clients is provided.

Special attention is devoted to managing our business network, continuous education of employees, as well as decorating and equipping branches in order to provide more quality services to clients.

Hipotekarna Bank AD Podgorica will continue to care and be more accessible to its clients either through the branches, ATMs, Internet or telephone.

New products and services

Focused on the client needs, the Bank has continually worked on improvement of existing and development of new products and services, trying to achieve and maintain quality and competitiveness.

The unique design in our market that the Bank has implemented in cooperation with Cnogorski Telekom AD is PREMIUM project of payment cards that are intended to individuals, users of Crnogorski Telekom services.

Cardholders have many benefits. As a result of these actions the Bank achieved significant increase of new clients as well as other positive effects. By launching this project in cooperation with Crnogorski Telekom AD, Hipotekarna bank AD has improved its reputation, given that in competition with other banks in Montenegro we are selected as a partner of Crnogorski Telekom, a bank throughout this project is realised.

Our standard offer of savings products was expanded with a few appropriate actions in order to stimulate term savings to both retail and corporate clients.

Placing new savings product HB DUET SAVINGS, unique in our market, will enable clients to deposit certain amounts at higher interest rates and shorter terms than standard ones.

Treasury

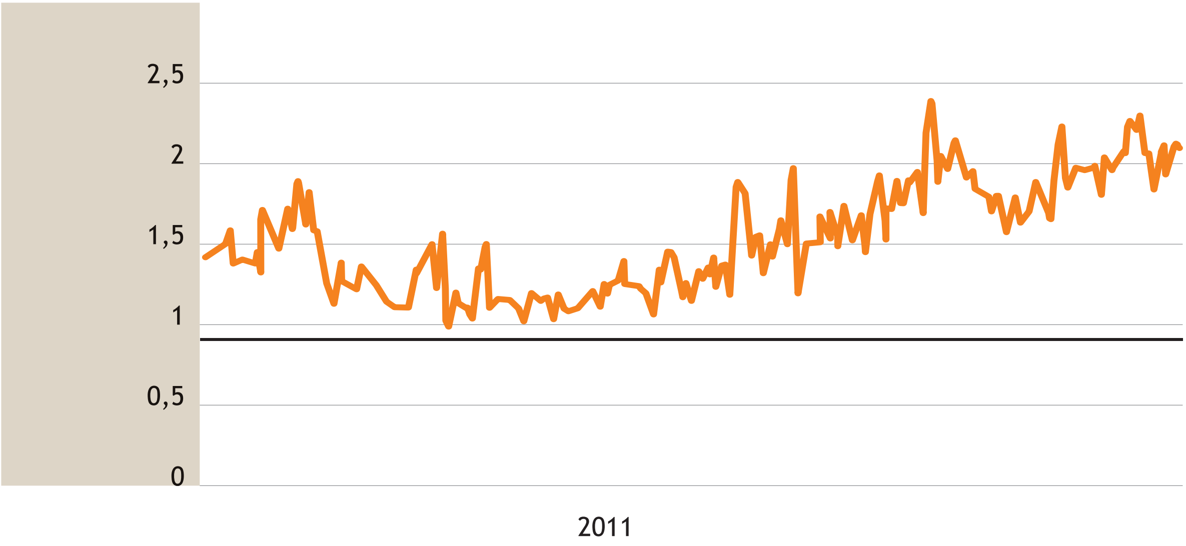
Providing optimal liquidity is a basic requirement for safe and efficient operations of any bank. Banks have to achieve necessary liquidity by rational management of assets and liabilities in order to maintain an appropriate ratio between liquid assets and total liabilities.

Hipotekarna banka AD Podgorica in 2011 also placed emphasis on stabilizing domestic sources of funding, expanding its client base, reducing short-term in favour of long-term sources of funding and obtaining new credit lines from foreign banks and international financial institutions.

In 2011, the Payment operation and Treasury Division, and especially the Treasury Department succeeded in maintaining liquid assets and the overall liquid position of the Bank at a satisfactory level. In addition, the Treasury Department performed reconciliation of sources of funds with placements by daily, weekly, decadal and monthly scheduling of available liquid assets. Adequate fund allocation was performed through effective cooperation with other divisions and departments in the bank, especially with the Commercial Division and Risk management Division. All of the above enabled the Bank to regularly fulfil its obligations toward creditors, as well as fulfil every customer requirement in the shortest time.

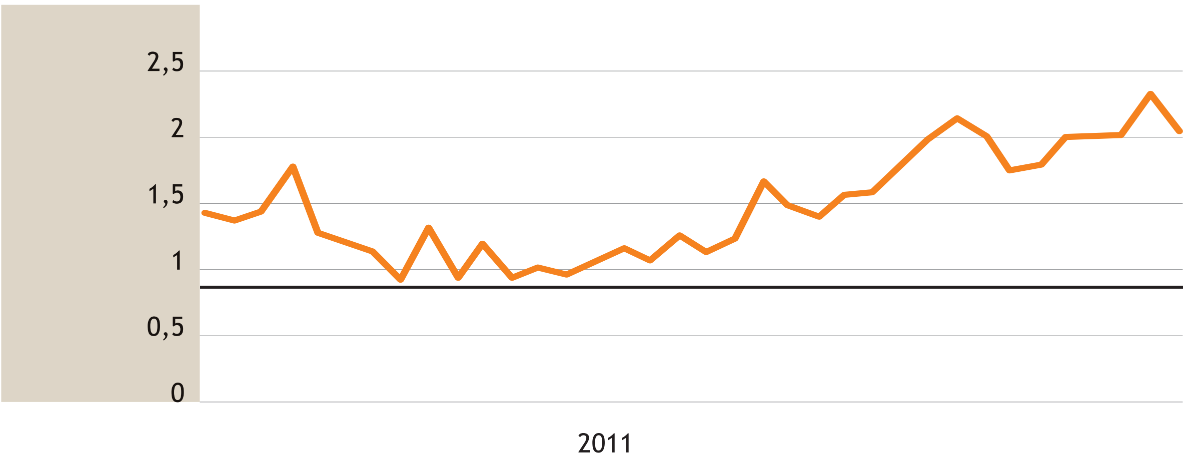
The daily liquidity ratio, which is calculated with the methodology regulated by the Central Bank of Montenegro, varied throughout 2011, above the legally required minimum of 0.90.

Daily liquidity



Also, the ten-day liquidity ratio was above the legally required minimum of 1.00.

Ten-Day liquidity

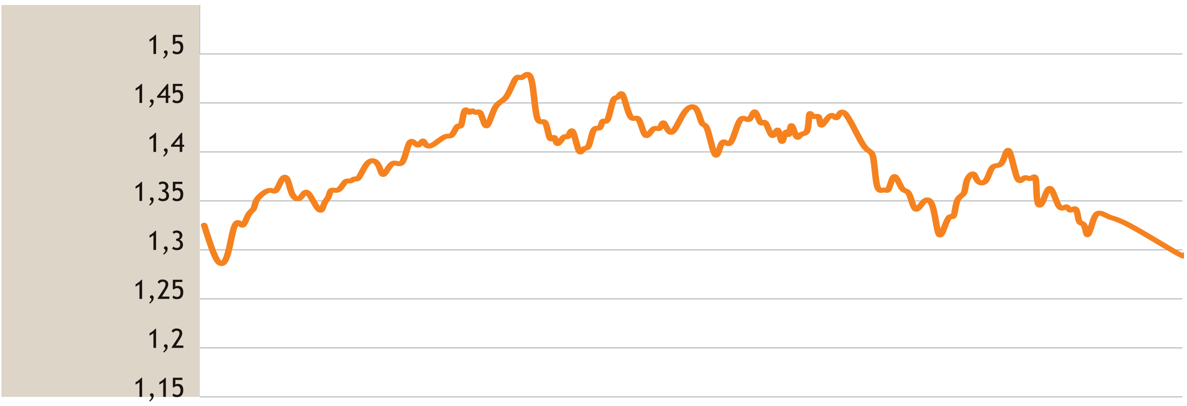


In order to manage tenor liquidity and maintain the same at satisfactory levels, the Bank regularly monitored indicators of structural liquidity through tenor adjustment of financial assets and liabilities, review of maturities of larger deposits as well as by establishing a stable part of a vista deposits through an internally developed model.

Considering the effects of the global economic crisis were significantly felt throughout 2011 and taking into account the customers' cautiousness when it comes to the disposal of their own funds, it can be concluded that in these circumstances Hipotekarna banka AD Podgorica was recognised as one of the most reliable and the most liquid banks in the banking system of Montenegro. To support this claim, data shows that at the end of 2010, total deposits of the Bank amounted to 85.1 million EUR and at the end of 2011, total deposits of the Bank amounted to 97.8 million EUR, which represents an annual growth of 14.94%. Liquidity surpluses, except through credit activity, were also placed in marketable securities.

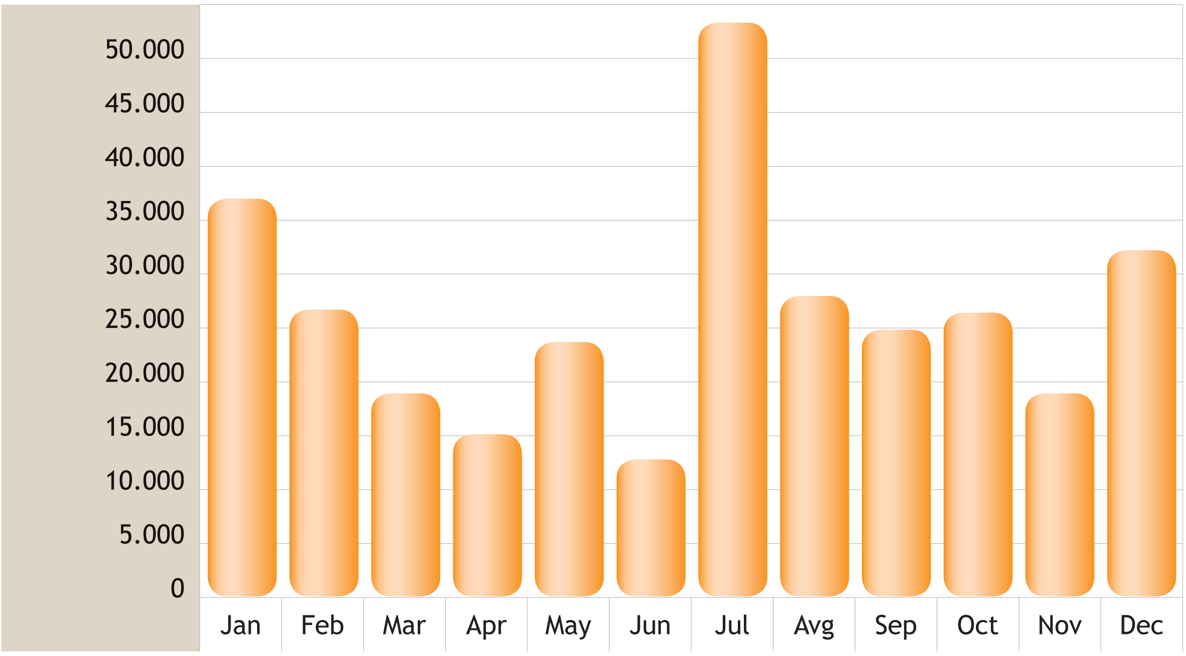
In 2011, the Bank participated in government security auctions, and in accordance with the decision of the Central bank of Montenegro, up to 25% of obligatory reserve was placed. Through activities of the Custody Department and Brokerage-Dealer Department, the Bank invested assets in other securities that are traded on the stock exchange in Montenegro as well as on stock exchanges in the region.

There were large fluctuations in exchange rates in 2011, in particular in the EUR/USD currency pair, which had the greatest impact on the Bank's exposure to the exchange rate risk.



EUR/USD in 2011

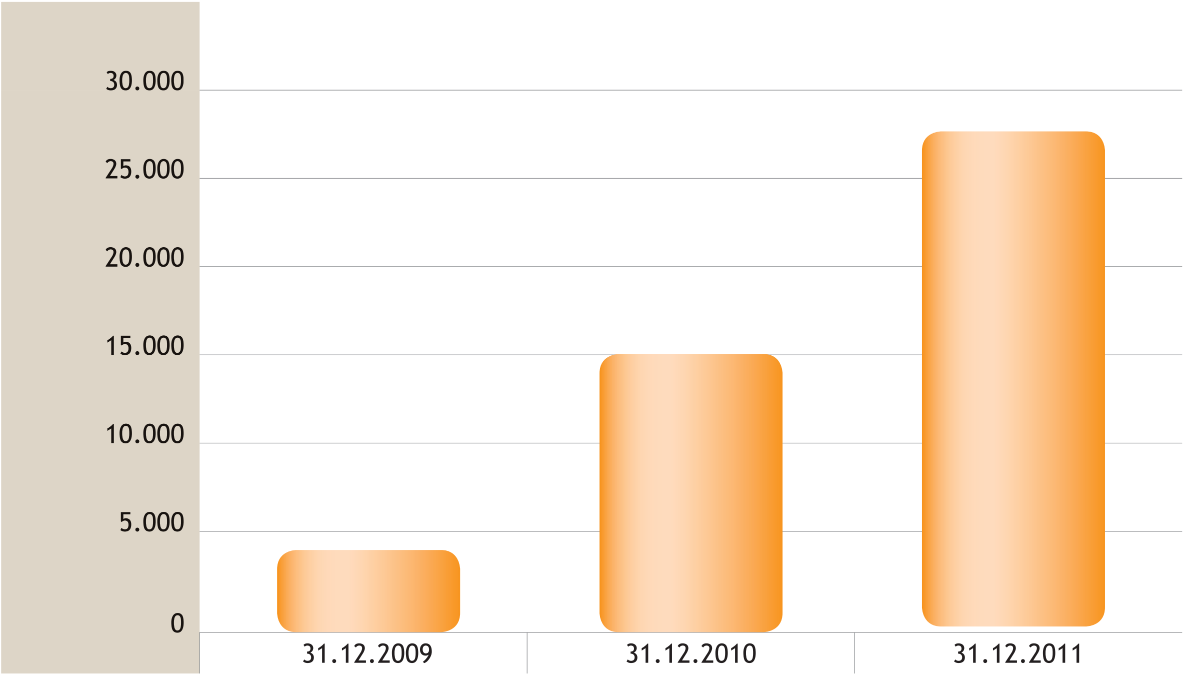
In these circumstances the Treasury Department managed to achieve remarkable results regarding income from realised exchange rate differences as a result of adequate exchange rate risk management. The total net result at the end of 2011, from foreign exchange differences amounted to 286 thousand EUR which had a significant impact on final financial result of the Bank.



Income from realized exchange rate differences in 2011

At the beginning of 2011, necessary corrections and amendments to existing internal regulations were made as well as the adoption of new documents that define the jurisdiction and responsibilities of the Treasury Department, all in accordance with the valid legislation in Montenegro and modern banking practices.

Payment operations and the Treasury Division expanded cooperation with foreign banks as well as with international financial institutions. In the course of 2011, the Bank concluded two arrangements with the European Investment Bank for the project of financing small and medium enterprises, based on the arrangement between the Government of Montenegro and European Investment Bank. Considering these arrangements, the Bank provided credits to the economy with lower interest rates and with longer terms, which is recognised by our customers as the Bank's willingness to adapt to changing business conditions in a period of global economic crisis.



Loans and Borrowings

Payment operations

The Bank's overall payment operations in 2011 were characterised by the growth of all parameters which define the Bank's business operations in this segment. All business plans which had been previously set up were mostly exceeded which clearly shows the Bank's efficiency and progress over the previous year.

Domestic payments

The main characteristic of domestic payment operations in 2011 was the rise in internal payment operations, and related to this, the growth in the number of opened accounts for both legal entities and private individuals as well as the rise in the electronic payment transactions over the total number of the payment transactions.

The total number of client accounts opened rose by 47% in comparison to 2010. The highest increase was accounts opened by private individuals. The number of accounts opened by private individuals rose by 52% and for legal entities this increase was 6% in comparison to the previous year. The growing trend in number of accounts opened by private individuals for their regular earnings continued during 2011. However, the highest increase in the accounts opened was achieved in the number of a-vista accounts which were opened as the necessity for usage of the new electronic card of Hipotekarna banka AD Podgorica – Premium card. The number of opened a-vista accounts rose by almost five times in comparison to 2010, or precisely 397%.

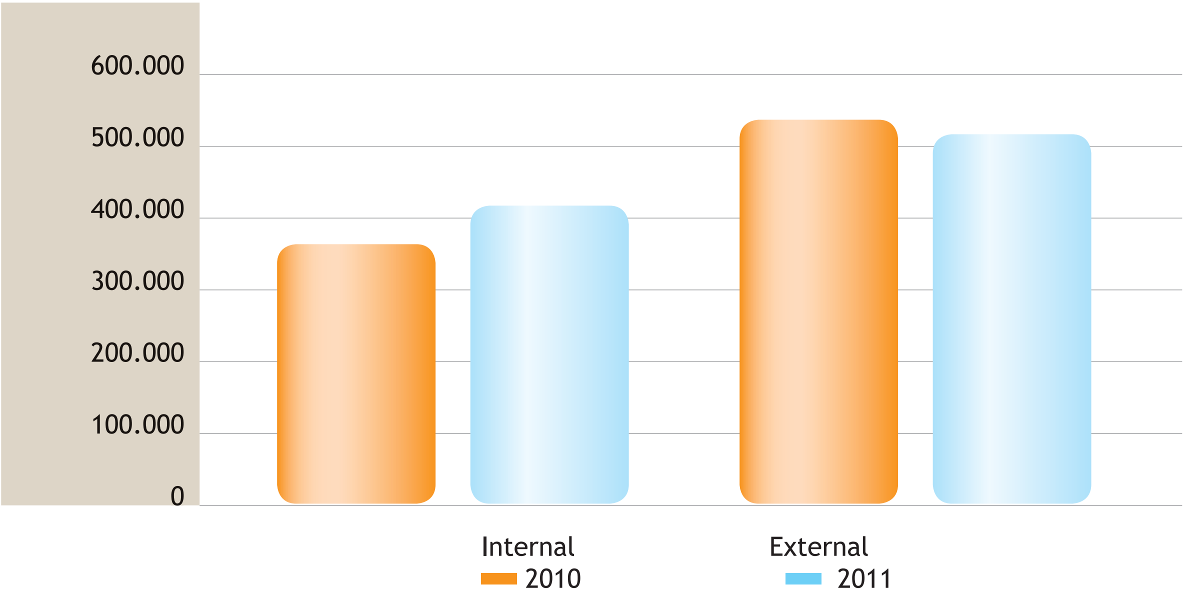
The total number of payment transactions rose by 3% in comparison to 2010. The highest increase was achieved in the number of internal payment transactions between the Bank's clients. This increase was 10% in comparison to the previous year which clearly shows the rise in the number of the Bank's clients which execute their payments within the Bank's payment system, i.e. internally.

The number of external outgoing payment transactions in favour of other domestic bank's clients maintained last year's level. Concerning the structure of the external outgoing payments the participation of 'low value' payments (< EUR 1,000) rose by 11%.

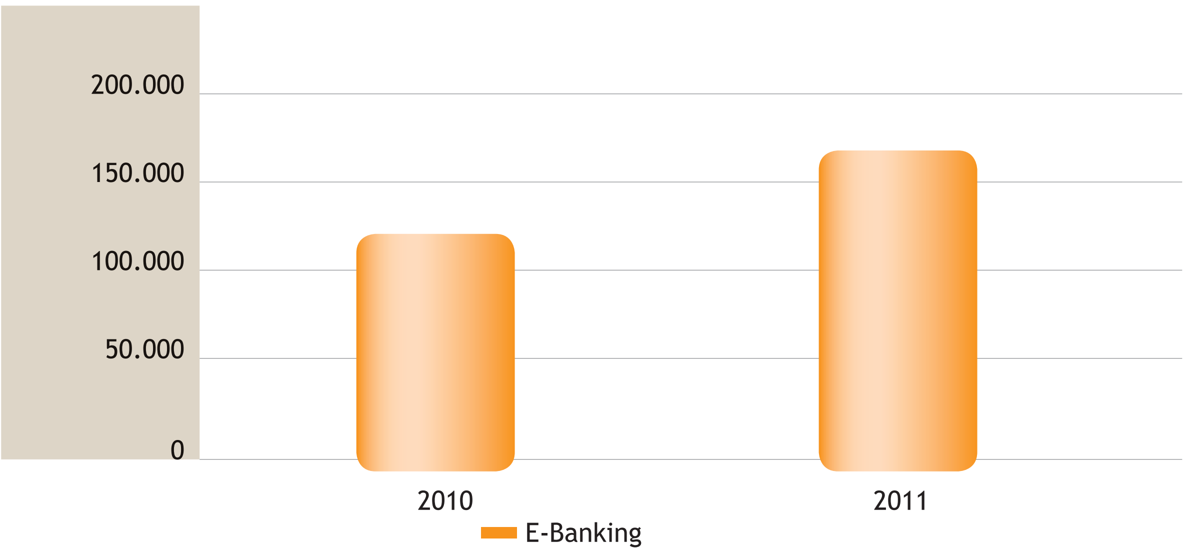
Incoming payments from the clients of other domestic banks also rose by 7% in comparison to the previous year.

The significant increase was achieved in the number of electronic outgoing payment transactions (e-banking) which means that clients more often used electronic payments orders. This rise was 25% in comparison to the previous year.

Domestic payment transactions



Domestic outgoing e-payment transactions



International payments

International payments in 2011 featured growth in all types of payment transactions, incoming and outgoing, documentary operations - guarantees and other international services as well as other transactions.

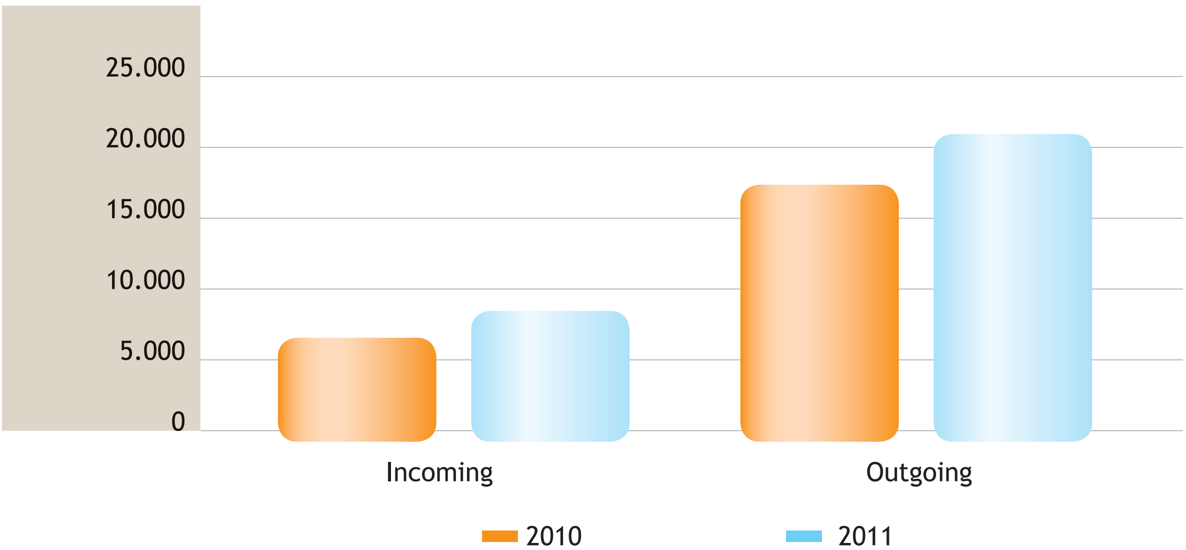
The total number of accounts opened rose by 27%. The number of accounts opened by private individuals rose by 39% while this number for legal entities rose by 5% in comparison to 2010.

All types of transactions increased in comparison to the previous year. The Bank has already been recognised as an efficient and reliable partner by other foreign banks.

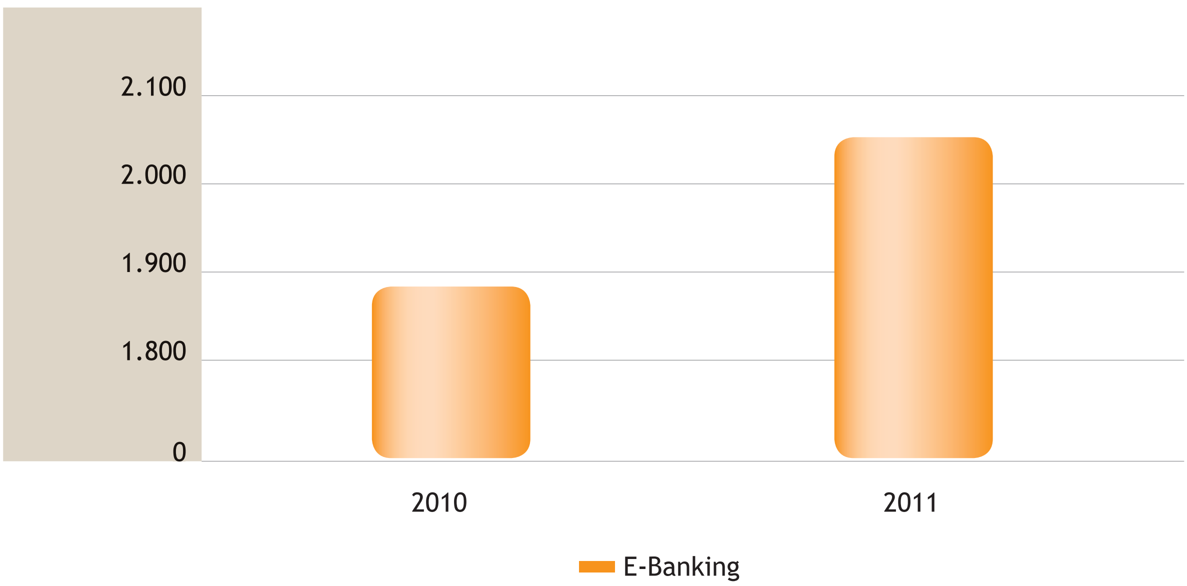
The number of outgoing payment transactions rose by 12%. The highest growth was achieved in the number of electronic outgoing payment transactions by using e-banking application in comparison to 2010, which rose by 9%.

The number of incoming payment transactions rose by 25% in comparison to the previous year.

International payment transactions



International outgoing e-payment transactions



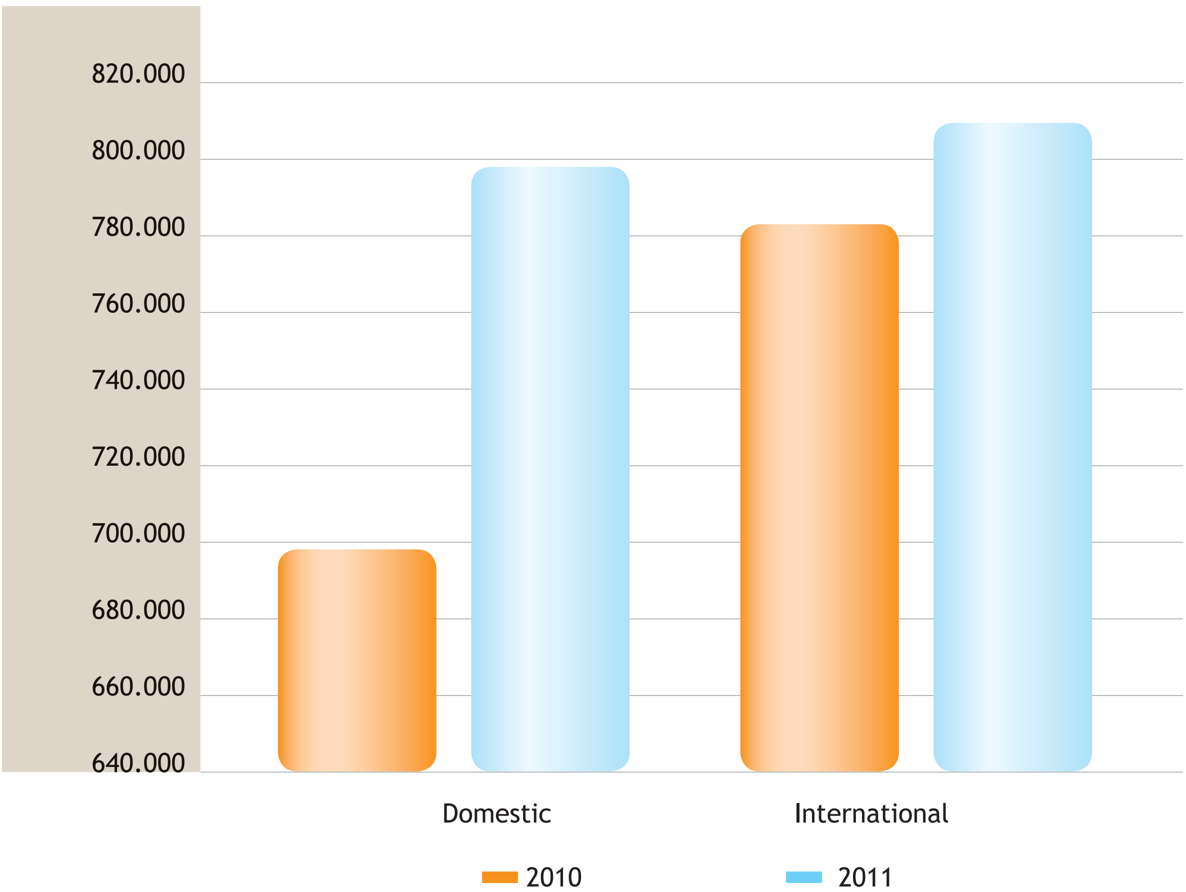
Considering the fact that Montenegro is an import-oriented country and that Montenegrin import companies had established the business relations with their foreign partners over the years, the decrease in the number of the opened Letters of Credit in the comparison to the previous year is not a surprise, while the number of issued guarantees rose by 4% in comparison to the 2010.

The overall payment operations increased compared to the previous year. The efforts made by all employees to raise their working efficiency with the use of efficient technical and software solutions and supports created the growth of all payment operations parameters.

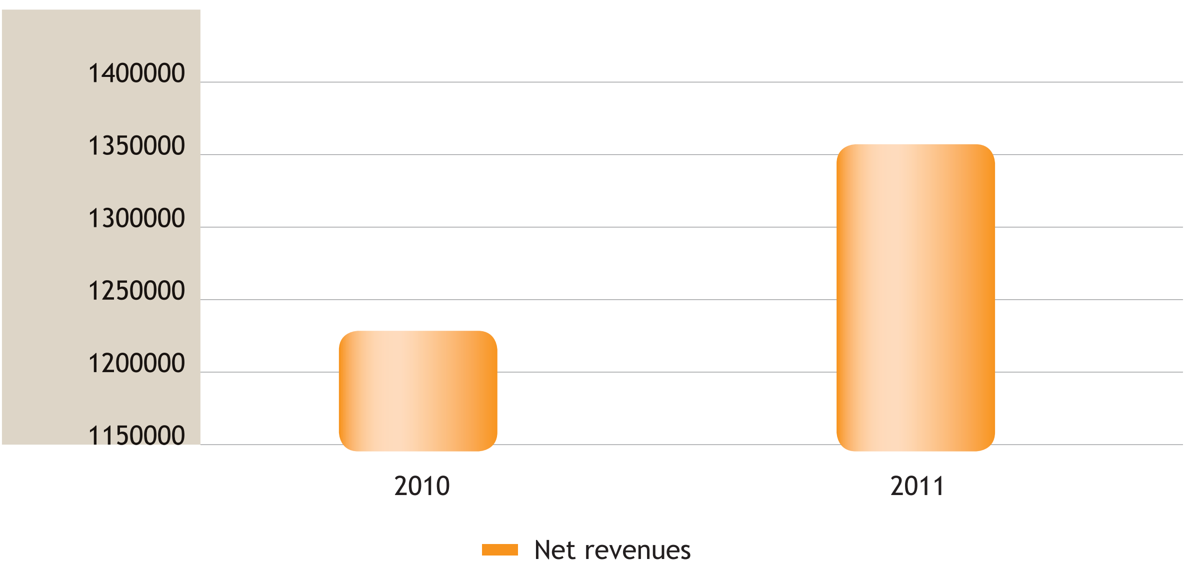
The total revenues of the commissions for payment operation services rose by 8% in comparison to the 2010. The increase of the revenues of the domestic payment operation commissions rose by 14% and for the international payment service commissions rose by 3% in comparison to the previous year.

Net revenues from the total payment operation services rose by 10% in comparison to the previous year.

Domestic and international payment operations total revenues



Payment operations net revenues



Information technology

Hipotekarna banka AD Podgorica has continued improving its information system in terms of reliability, security and efficiency. The audit reports have acknowledged continuous advancements of existing and quality of new services. The audit company Ernst & Young noted a high quality of the information system in their 2011 Report.

The Board of Directors of Hipotekarna banka AD Podgorica adopted amendments for the Procedure For Backup Management, amendments for the Procedure For System Event Tracking and amendments for the Internet Usage Policy.

Hipotekarna banka AD Podgorica has successfully deployed a Disaster Recovery location in Niksic. During the testing period, the Disaster Recovery location was used exclusively for business processes of Hipotekarna banka AD Podgorica. The Primary location recovery deployment has also been tested.

To provide better service to its customers, Hipotekarna banka AD Podgorica has implemented a Call Center service. The Call Center, with an interactive menu, provides information about Hipotekarna banka AD Podgorica services and presents offers to customers. The Call Center also provides direct communication to operators which will provide information, solve problems and sell Hipotekarna banka AD Podgorica services.

Hipotekarna banka AD Podgorica has implemented a server virtualization system which uses hardware resources better, reduces infrastructure and maintenance costs, provides full system redundancy, faster deployment of new services and simplified maintenance. Along with the production system, a test system has also been implemented which is used for trial run of new services.

Hipotekarna banka AD Podgorica has reorganised the passive server room infrastructure at the Primary and Disaster Recovery locations in compliance with telecommunication standards. This reorganisation has provided better space usage, easier software maintenance, easier system upgrade, systematisation of all system components and a better usage of cooling and fire fighting systems.

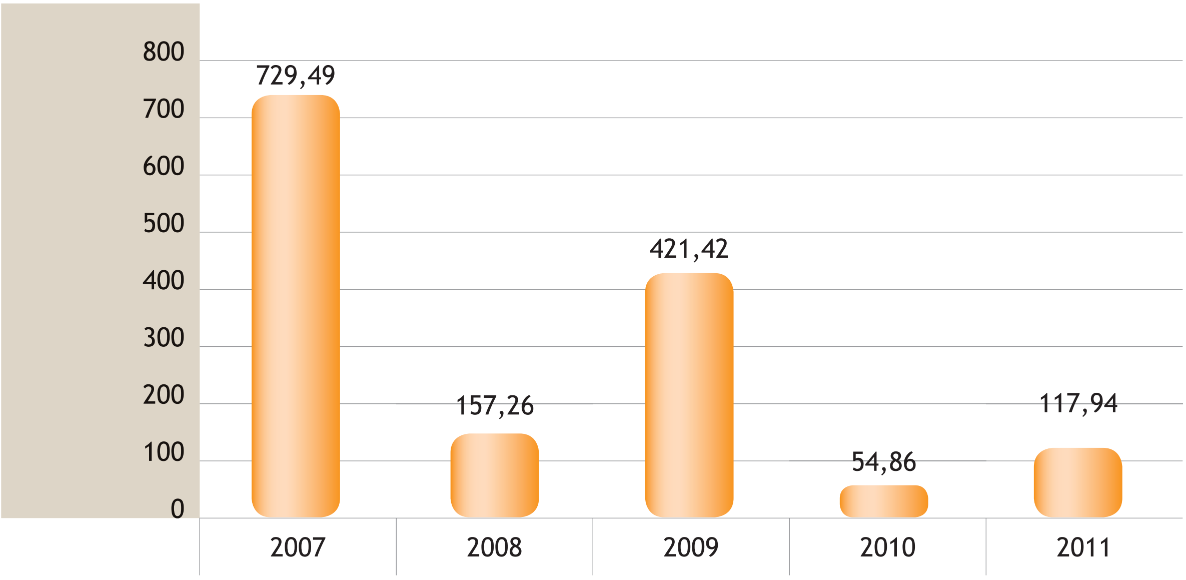
Hipotekarna banka AD Podgorica has implemented POS concentrator as part of the T-Card project. POS concentrator provides a direct connection with POS terminals of Hipotekarna banka AD Podgorica and in addition forwards transactions to the payment card processor.

Hipotekarna banka AD Podgorica in cooperation with the audit company Deloitte has completed internal and external penetration tests. External penetration tests were performed on all systems of Hipotekarna banka AD Podgorica which are accessible from outside networks, either directly or indirectly. Internal penetration tests were performed on all systems which are accessible from the Hipotekarna banka AD Podgorica network. A configuration review of the electronic payment system was also performed. According to the audit's findings and recommendations, further actions were taken to secure the system.

Investment banking

Montenegroberza recorded a turnover of 117.95 million EUR in 2011, an increase of 115% compared to 2010 when the lowest turnover in the past five years was recorded. This trading volume is still low when compared with 2008, when the turnover amounted to EUR 157.26 million, several times lower than in 2009 when the takeover of EPCG occurred with a total turnover of 421.42 million, and way below 2007, when turnover amounted to EUR 729,49 million.

Total turnover on stock exchange in millions of EUR

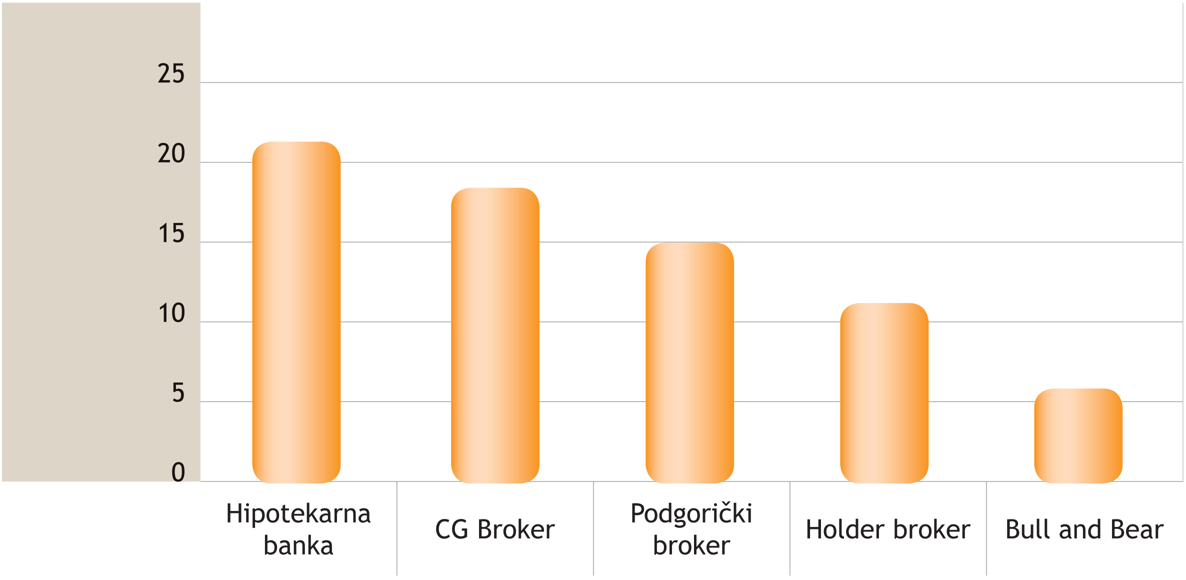


In 2011 stock indexes recorded also a significant decline. Monex 20 began in the year with 14,646.11 points and ended with 9,324.9 points, declining by 36.34%. For the identical percentage of 36.34%, the value of Monex PIF decreased from 6,595.82 at the beginning of the year to 4,265.29 points at the end of the year. Despite the prolonged effects of the crisis that hit the Montenegrin capital market, 2011 was a successful year for the Custody department and Brokerage - dealer department of Hipotekarna banka AD Podgorica.

Hipotekarna banka AD Podgorica achieved a turnover of 23,090,487 EUR in 2011, which is more than double the amount compared to 2010 when the turnover amounted to 11.2 million. The market share also doubled with an increase from

10.2% in 2010, to 20.27% in 2011. With this market share Hipotekarna banka AD Podgorica became the market leader on the Montenegroberza. The turnover of EUR 23.09 million was achieved through 943 transactions on the exchange this year, thus resulting in Brokerage - dealer department doubling the number of transactions compared to 2010. The largest share in total turnover made by the Bank was the transactions with shares of HTP Primorje AD and Hipotekarna banka AD Podgorica.

Percentage share in total market turnover in 2011



The Brokerage – dealer department started its dealer operations in the fourth quarter of 2010. At the end of 2011, Hipotekarna banka AD Podgorica had invested 157,974 EUR in the Montenegrin capital market, of which EUR 121,508 or 78.81% in the shares of Crnogorski Telekom AD. On 31.12.2011, the Bank had 61 336 EUR invested in the foreign, Serbian, market in shares of NIS and Imlek.

Risk management

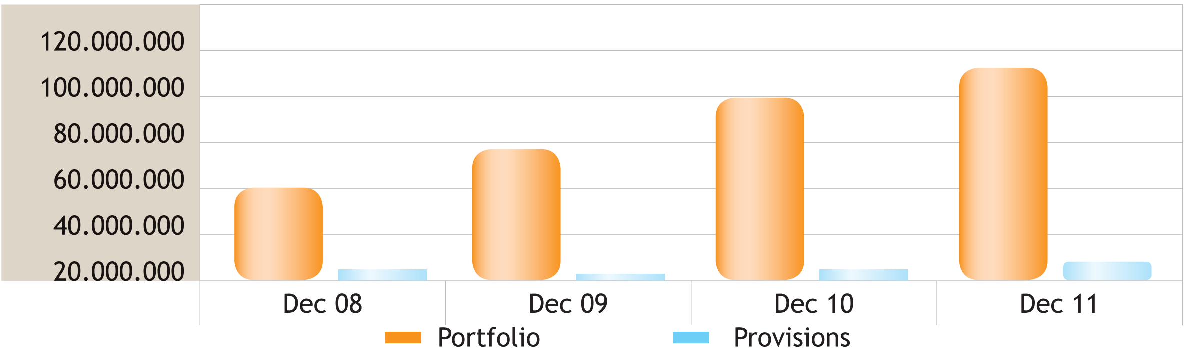
Hipotekarna Bank AD Podgorica recognises professional risk management as a key competence required for the sustainable development of the company and as a generator of the positive image of modern financial institution which is ready to respond to all challenges in environment and permanently create value for the shareholders. With an active approach to those issues, the risk department implemented the techniques and procedures in order to create a modern system for managing risks in accordance with legislation of the Central Bank of Montenegro. The aim of this project generates adequate information for making quality business decisions, which implies considering the risk of return ratio for every action taken and product. According to this, the Risk Department systematically and continuously monitors the following types of risk: credit risk, market risk, liquidity risk, country risk and operational risk.

Credit risk

The Bank is managing the credit risk on two complementary levels: at individual level and portfolio level. In this way the Bank has established an effective system for identifying, measuring, monitoring and controlling credit risk, which provides a timely assessment of the impact of the credit activity on available capital and projected financial result of the bank.

The Portfolio of the Hipotekarna Bank AD Podgorica on 31December 2011, amounted to EUR 113,480,818. This is an increase of 12.35% when compared to 31 December 2010. Provisions for loan losses at 31 December 2011 were EUR 4,008,149 or 3.53% of the loan portfolio. Compared to the end of 2010, Provisions increased by EUR 1,351,306 or 50.86%.

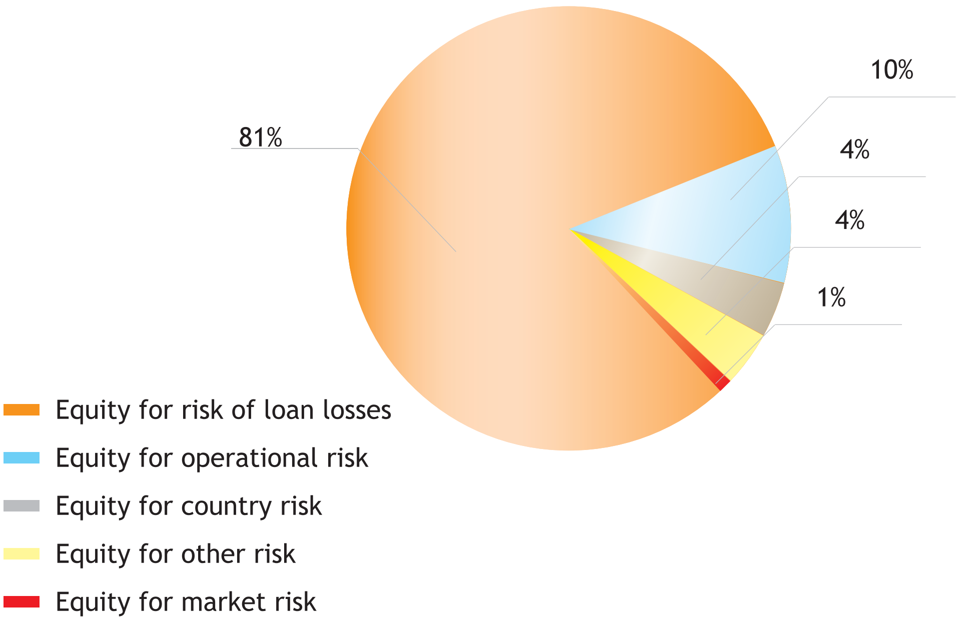
Portfolio/provisions 2008-2011



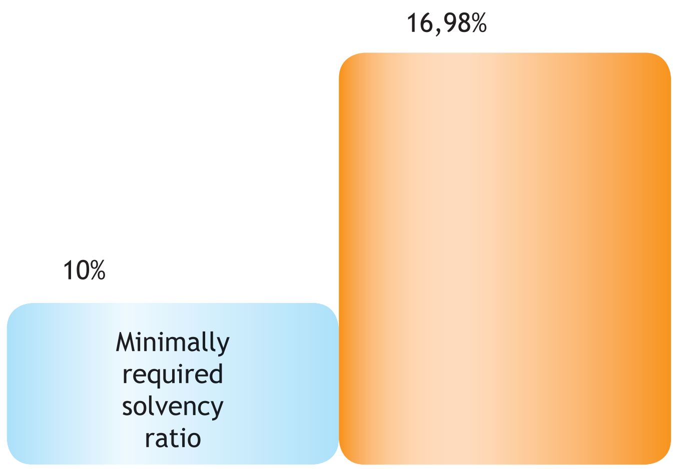
Solvency ratio

On December 31. 2011. the solvency ratio was above the statutory limit (10%), and amounted to 16.98%. Solvency ratio is the most important indicator of confidence in the bank and it serves as a protector of the deponents, creditors and business partners of the bank.

Structure of Equity to cover all risks



Solventy ratio - 31.12.2011



Equity

Total equity in 2011 amounted to 23.089 million EUR. Compared to the previous year, equity increased by 6.78%. At 31 December 2011 the nominal value of shareholders' equity amounted to 16.006 million. Shareholders' equity consists of 31,305 shares, each with a nominal value of 511.29 Euros. In terms of ownership structure, foreigners own 71% of the equity, while the remaining equity is owned by domestic entities and individuals.

Income statement

In 2011, the Bank achieved profit amounting to 1.522 million EUR. Interest income in the previous year increased by 18.38% to 11.405 million EUR as a result of increased lending activity. Fee and commission income in the previous year increased by 22.95% to 3.817 million EUR. Net fee and commission income creates 37.13% of all Bank's incomes from current operations. Other income in the previous year increased by 28.31% to 511 thousand EUR.

Operating expenses, including depreciation, amounted to 7.379 million EUR and increased by 8.09% over the previous year. The increase in costs is the result of the expansion of the branch network, employment of new staff and increase in other expenses that accompany the Bank's growth and development. Assessment of credit risk and making provisions for risky loans and the potential liabilities for the Bank, are based on the application of the principles of conservative policy and implementation of applicable laws. Total allocated reserves for assets and liabilities amounted to 5,005 million EUR as at 31 December 2011.

Distribution of profit

The Bank's management suggested to the Board of Directors to jointly propose the Shareholders' Meeting that the total profit in 2011 be used to cover the losses from the previous period.

3.] Financial Statements for the year ended 31 December 2011

ERNST & YOUNG

INDEPENDENT AUDITORS' REPORT
TO THE OWNERS OF HIPOTEKARNA BANKA A.D., PODGORICA

Report on Financial Statements

We have audited the accompanying financial statements of Hipotekarna banka A.D., Podgorica (hereinafter: the Bank), which comprise the balance sheet as at December 31, 2011, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes

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evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Podgorica, May 15, 2012
Ernst & Young Montenegro d.o.o.
Podqorica, Crna Gora

Ernst & Young Montenegro d.o.o.
Podgorica, Crna Gora

DRUŠTVO ZA REVIZIJU ERNST & YOUNG MONTENEGRO DOO PODGORICA

Stephen Fish
Partner

Draško Popović
Authorized auditor

Statement of income
for the year ended december 31, 2011

In thousands of EUR

	Notes	2011	2010
Interest income	3.1, 4a	11,405	9,634
Interest expenses	3.1, 4b	(3,873)	(3,433)
Net interest income		7,532	6,201
Provisions for losses	3.6, 5	(2,160)	(1,334)
Net income		5,372	4,867
Fee and commission income	3.1, 6a	3,817	3,105
Fee and commission expenses	3.1, 6b	(645)	(465)
Net fee and commission income		3,172	2,640
NET INTEREST, FEE AND COMMISSION INCOME		8,544	7,507
Other income, net	7	511	399
General expenses	8	(7,379)	(6,827)
NET INCOME BEFORE EXTRAORDINARY ITEMS		1,676	1,079
Extraordinary income		27	263
Extraordinary expenses		(13)	(35)
Net extraordinary income		14	228
PROFIT BEFORE TAXATION	9b	1,690	1,307
Income taxes	3.3, 9a	(168)	(15)
NET PROFIT FOR THE YEAR		1,522	1,292

The accompanying notes form an integral part of these financial statements.

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Statement of financial position as of 31 december 2011

In thousands of EUR

	Notes	2011	2010
ASSETS			
Cash and deposit accounts held with depository institutions	10	38,500	24,247
Securities available for sale, other than shares		26	42
Loans and leases	11	109,470	98,352
Securities held to maturity	12	2,569	1,093
Factoring and forfeiting		9	-
Receivables in respect of custody operations		39	23
Business premises and other fixed assets	13	1,950	1,742
Acquired assets	14	478	485
Equity investments in other legal entities	15	230	99
Other assets	16	2,641	3,190
Less: Provision for potential losses on other assets	16	(319)	(485)
Total assets		155,593	128,788
LIABILITIES			
Deposits	17	97,853	85,133
Liabilities in respect of custody operations		247	49
Loans and borrowings	18	26,887	15,000
Liabilities to the Government	19	2,889	2,716
Other liabilities	20	3,952	3,773
Provisions for potential losses on off-balance sheet exposures	21	675	494
Total liabilities		132,503	107,165
EQUITY			
Share capital	22	16,006	16,006
Share premium		7,444	7,444
Revaluation reserves		(54)	1
Accumulated loss		(306)	(1,828)
Total equity		23,090	21,623
Total liabilities		155,593	128,788
OFF-BALANCE-SHEET ITEMS	24	388,819	289,488

The accompanying notes form an integral part of these financial statements.

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Statement of changes in eqity for the year ended 31 december 2011

In thousands of EUR

	Share Capital	Share premium	Revaluation reserves	Accumulated loss	Total
Balance, January 1, 2010	16,006	7,444	-	(3,120)	20,330
The effect of reducing the market value of securities available for sale	-	-	1	-	1
Profit for the year	-	-	-	1,292	1,292
Balance, December 31, 2010	16,006	7,444	1	(1,828)	21,623
Balance January 1, 2011	16,006	7,444	1	(1,828)	21,623
Revaluation reserves – fair value adjustments of available for sale financial instruments	-	-	(55)	-	(55)
Profit for the year	-	-	-	1,522	1,522
Balance, December 31, 2011	16,006	7,444	(54)	(306)	23,090

The accompanying notes form an integral part of these financial statements.

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Cash flow statement for the year ended 31 december 2011

In thousands of EUR

	Notes	2011.	2010.
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest, fees and commissions received		16,406	11,745
Other proceeds		22	88
Interest and commission paid		(4,610)	(2,669)
Cash paid to employees and suppliers		(8,676)	(7,098)
Net cash inflow before changes in operating assets and liabilities		3,142	2,066
Changes in operating assets and liabilities			
Increase in placements to customers, net		(12,112)	(24,226)
Increase/(decrease) in other assets, net		230	335
Increase in deposits from customers		12,720	15,398
Inflow from custody operations		139	26
Decrease in other liabilities		306	(2)
Net cash inflow / (outflow) used in operating activities		4,425	(6,403)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of equipment and intangible assets		(918)	(1,155)
Net cash outflow used in operating activities		(918)	(1,155)
CASH FLOWS FROM FINANCING ACTIVITIES			
(Outflow)/ inflow from loans and borrowings		12,060	11,507
(Outflow)/ inflow from purchase and sale of securities, net		(163)	158
Inflow from equity investments in other legal entities, net		-	-
Outflow from securities held to maturity, net		(1,437)	-
Net cash generated from financing activities		10,460	11,665
Effects of foreign exchange gains and losses		286	223
Net increase in cash and cash equivalents		**14,253**	**4,330**
Cash and cash equivalents, beginning of year		**24,247**	**19,917**
Cash and cash equivalents, end of year		**38,500**	**24,247**
Components of cash and cash equivalents:			
Cash and deposit accounts held with depositary institutions	3.4, 10	38,500	24,247
		38,500	24,247

The accompanying notes form an integral part of these financial statements.

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Notes to the financial statements

1. FOUNDATION AND BUSINESS ACTIVITY

Hipotekarna banka A.D. Podgorica (hereinafter: the "Bank") was registered in 1995 as a shareholding company. The registration number of the Bank as recorded in the Central Registry of the Commercial Court is 4-0004632. The Bank is included in the Register of Security Issuers maintained by the Securities Commission under the number 3 (Decision number 02/3-1/2-01). The Bank received an operating license from the Central Bank of Montenegro; pursuant to the Decision number 26 dated November 21, 2001.

In accordance with Law on Banks, Founding Agreement, Statute and Decision of the Central Bank of Montenegro, the Bank performs depositary and crediting operations for its own account. In addition to the above, the Bank performs the following activities:

- issuance of guarantees and undertaking other off-balance sheet liabilities,
- purchase, sale and collection of receivables (factoring, forfeiting etc.),
- issuance, processing and recording of payment instruments
- payment transactions, and clearing and settlement transactions services abroad, in accordance with legal requirements regulating payment transfers,
- finance leases,
- operations involving securities, in accordance with the relevant regulations,
- trading on its own behalf and for its own account or for the account of a third party:
    - a) foreign currency trade, including exchange operations,
    - b) financial derivates,
- depo transactions,
- performing of analysis and advising on creditworthiness of legal entities and entrepreneurs and other issues related to business operations,
- rental of safety deposit boxes,
- other banking activities, additional banking activities and activities directly related to the Bank's operations, in accordance with the Statute.

The Bank's management bodies include: the Shareholders Assembly and the Board of Directors. The Board of Directors has two permanent bodies: Audit Board and

Credit Risk Management Board. The members of the Board of Directors are elected by the Bank's Shareholders Assembly. The Board of Directors has 5 (five) members the majority of which are not the Bank's employees.

The Bank is domiciled in the city of Podgorica, at 67 Josipa Broza Tita Street. At December 31, 2011, the Bank had 163 employees (December 31, 2010: 155 employees).

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.1. Basis of Preparation and Presentation of the Financial Statements

The Bank maintains its accounting records and prepares its statutory financial statements in conformity with Accounting and Auditing Law of Montenegro ("Official Gazette of Montenegro," no. 69/2005 ; no. 80/2008 and no. 32/2011) and in accordance with the Decision pertaining to the direct application of International Accounting Standards ("IAS") in Montenegro ("Official Gazette of Montenegro," numbered 69/2002). Consequently, the International Financial Reporting Standards (IFRS) are effective at the date of preparation or the financial statements for the period commencing on January 1, 2003.

The financial statements are presented in the format specified by the Central Bank of Montenegro, which in some parts differ from the presentation of certain amounts as provided in MRS1 "Presentation of Financial Statements."

The accounting policies adopted in the preparation and presentation of the financial statements for the year ended December 31, 2011 differ from the IFRS requirements in respect to the calculation of allowances for the impairment of financial instruments and in respect of disclosures of financial instruments in accordance with IFRS 7 "Financial Instruments: Disclosures." The Bank calculates the amount of allowance for impairment of financial instruments in accordance with the applicable Regulations of the Central Bank of Montenegro (Note 3.7). Such a policy might result in significant departures from the amounts which would be determined, had the allowances for impairment of financial instruments been estimated based on discounted expected future cash flows by applying the original effective interest rate, as required by IAS 39, "Financial Instruments: Recognition and Measurement." In addition, the Bank suspends the calculation of interest on loans classified in category C, D and E ("non-performing assets" in accordance with the Decision of the Central Bank of minimum standards for credit risk management in banks; "Official Gazette of Montenegro," no. 60/08 and no. 41/09), where the decision also regulates the risk assets classified in category E to be written off from the balance sheet and be recorded in off balance sheet as "written off loans". "

Due to the potentially significant effects of the above-described matters on reality and objectiveness of financial statements of the Bank, these financial statements cannot be described as having been prepared in accordance with International Financial Reporting Standards.

In the preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 3, which are in conformity with the accounting, banking and tax regulations prevailing in Montenegro.

The official currency in Montenegro and the Bank's functional currency is the Euro (EUR).

2.2. Use of Estimates

The presentation of financial statements requires the Bank's management to make the best possible estimates and reasonable assumptions that affect the value of assets and liabilities, as well as the disclosure of contingent liabilities and receivables as of the date of the preparation of the financial statements, and the income and expenses arising during the accounting period. Estimates and judgments relate to historical experience and other factors, including the expectations in respect to future events believed to be reasonable in the given circumstances, where the results provide goods grounds for the estimated carrying value of assets and liabilities that cannot be clearly derived from other sources. These estimations and assumptions are based on information available as of the financial statements' preparation date. However the Bank's operating results may vary from the estimated values. The most significant estimates and assumptions are made on the following balance positions:

- Provisions on loans and interest
- Provisions for deposits with other banks
- Provisions for permanent investments
- Provisions for off balance sheet items
- Provisions for severance payments
- Provisions for litigations
- The fair value of securities available for sale
- The useful life of intangible assets, property and equipment

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest, Fee and Commission Income and Expense Recognition

Interest income and interest expense are recognized in the income statement for all instruments at amortized cost using the effective interest rate method. The effective interest rate method is a method of calculating the amortized cost of a financial asset or financial liability and allocating interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument or, where appropriate, a shorter period to the present value of financial assets or financial liabilities. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of financial instrument (e.g. prepayment options) but does not consider future credit losses arising from credit risk. The calculation includes all fees and commissions paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Income from fees and commissions are generally recognized on accrual basis in the period when the services are performed. Compensations for unused lines of credit are deferred (together with related direct costs) and recognized as an adjustment to the effective interest rate on the loan.

3.2. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into EUR at the official exchange rates prevailing on the Interbank Market, at the date of each transaction.

Assets and liabilities denominated in foreign currencies are translated into EUR by applying the official exchange rates, as determined on the Interbank Market that are prevailing at the balance sheet date.

Net foreign exchange gains or losses arising upon the translation of transactions, and the assets and liabilities denominated in foreign currencies are credited or charged to the Income statement, as gains or losses due foreign exchange translation.

Commitments and contingent liabilities denominated in foreign currencies are translated into EUR by applying the official exchange rates prevailing on the Interbank Market, at the balance sheet date.

3.3. Taxes and Contributions

Income Taxes

Current Income Taxes

Income taxes are calculated and paid in conformity with the income tax regulations defined under the Montenegro Tax Law ("Official Gazette of Montenegro," no. 80/2004, 40/2008, 86/2009, 73/2010 and 40/2011) as per the effective proportional tax rate of 9% on taxable income.

A taxpaying entity's taxable income is determined based upon the income stated in its statutory statements of income following certain adjustments to its income and expenses performed in accordance with Montenegro Tax Law (Articles 8 and 9, regarding the adjustment of income and Articles 10 to 20 pertaining to the adjustment of expenses).

Capital losses may be set off against capital gains earned in the same year. In case there are outstanding capital losses even after the set-off of capital losses against capital gains earned in the same year, these outstanding losses are available for carry-forward in the ensuing 5 years.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.3. Taxes and Contributions (continued)

Income Taxes (continued)

Current Income Taxes (continued)

Montenegro tax regulations do not envisage any tax losses of the current period to be used to recover taxes paid within a specific carry back period. However, any current year losses reported in the annual corporate income tax returns may be carried forward and used to reduce or eliminate taxes to be paid in future accounting periods, but only for an ensuing period of a maximum of five years.

Deferred Income Taxes

Deferred income tax is determined using the balance sheet liability method, for the temporary differences arising between the tax bases of assets and liabilities, and their carrying values in the financial statements. The currently-enacted tax rates at the balance sheet date are used to determine the deferred income tax amount. Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for the deductible temporary differences, and the tax effects of income tax losses and credits available for carry forward, to the extent that it is probable that future taxable profit will be available against which deferred tax assets may be utilized.

Taxes, Contributions and Other Duties Not Related to Operating Results

Taxes, contributions and other duties that are not related to the Company's operating results, include property taxes, employer contributions on salaries, and various other taxes and contributions paid pursuant to republic and municipal regulations.

3.4. Cash and Cash Equivalents

For purposes of the cash flow statement, "Cash and cash equivalents" include cash and balances on the current accounts held with the Central Bank of Montenegro, including the obligatory reserve, and balances held on the accounts of other banks *in the country and abroad.*

3.5. Available-for-Sale Securities

Securities available for sale include equity instruments of other entities and debt securities.

When not able to determine market value, equity investments are recognized at cost that management considers closest to fair value.

Subsequent to initial recognition, securities available for sale are stated at fair value. The fair value of securities quoted on the stock exchange is based on their asking prices. Unrealized gains and losses from securities available for sale are recorded within revaluation reserves, until such security is sold, collected or realized in any other way or until such security has suffered permanent impairment. Upon the disposal of securities available for sale are disposed of or when their value has suffered an impairment, the accumulated fair value adjustments are recognized within equity and recorded in the income statement.

Interest income on debt securities is calculated and recognized on a monthly basis.

Dividends from securities available for sale are recognized in the income statement when the right to such receivable has been established.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.6. Loans

Loans originated by the Bank are recorded in the books of account at the moment of the transfer of funds to the loan beneficiary.

Loans originated by the Bank are stated in the balance sheet in the amount of placement originally approved less net of principal repaid and an allowance for impairment which is based on an evaluation using the methodology specified by the Central Bank of Montenegro (Note 3.7).

3.7. Allowances for Impairment and Provisions for Potential Losses

The Decision issued by Central Bank of Montenegro regarding to minimal standards for managing credit risk in banks (“Official Gazette of Montenegro,” number 60/2008 and 41/2009) i.e. in accordance with Decision on temporary measures for managing credit risk in banks (“Official Gazette of Montenegro,” number 64/2009, 87/2009, 66/2010 and 70/2010) set forth the following: elements of credit risk management, minimum criteria and manner of classifying assets and off-balance sheet items which render the Bank susceptible to interest rate risk, manner of calculation and suspension of unpaid interest, manner of determining the minimum provisions for potential losses contingent on the Bank’s exposure to credit risk. The Bank’s risk-weighted assets, within the meaning of this Decision, are comprised of loans, interest, fees and commission, lease receivables, deposits with banks, advances and all other items included in the balance sheet exposing the Bank to default risk, as well as guarantees issued, other sureties, effectuated letters of credit and approved, but undrawn loan facilities, as well as all other off-balance sheet items comprising the Bank’s contingent liabilities.

Pursuant to the aforementioned Decision, loans and other risk-weighted assets are classified into the following categories:

- A category (“Pass”) – including assets assessed as collectible in full and as agreed;
- B category (“Special Mention”) – with B1 and B2 subcategories including items for which there is low probability of loss, but which, still the same, require special attention, as potential risk, if not adequately monitored, could diminish collectability;

- C category ("Substandard assets") – with C1, C2, C3 and C4 subcategories for which there is high probability of loss, due to the clearly identified collectability issues;
- D category ("Doubtful assets") – including items the collection of which is, given the creditworthiness of loan beneficiaries, quality of collaterals, highly unlikely;
- E category ("Loss") – including the items which are uncollectible in full, or will be collectible in an insignificant amount

The estimated amount of provision for potential losses is not computed for the Bank's placements classified in the category A. The estimated reserve for potential losses is calculated as 3% of the placements classified in category B, from 15% to 50% to the placements classified into category C, 75% to the placements of category D, and 100% of the placements under category E.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.7. Allowances for Impairment and Provisions for Potential Losses (continued)

Moreover, as in accordance with the provisions of the aforecited regulation, the Bank is to suspend any accrued, uncollected interest and should terminate any further accruals of interest on its non-performing assets, with the exception of the non-performing assets that are secured by quality collateral and are in the process of collection, to the extent that such asset recoveries are anticipated within a reasonable period of time (generally defined as not exceeding three months). Following the suspension of interest accruals on non-performing assets, the Bank remains under an obligation to record the subsequent, matured interest on the same basis, on its off-balance sheet records and upon classification, designates the accrued income into E category. The Decision further prescribes that the risk-weighted assets be classified into E category be written off from the off-balance sheet records under the heading of "Loans written off."

Pursuant to the Decision, provision for potential losses contingent on assets is calculated based on the carrying value net of any deductible items of collaterals based on:

- Monetary deposits,
- Irrevocable guarantees of the Government of Montenegro and
- Irrevocable guarantees of the countries or central banks of the OESD member countries, the banks with credit rating better than A+ pursuant to the ratings of the agency Standard & Poor's, i.e., any equivalent rating of other internationally acclaimed rating agencies and legal entities whose business operations are under the control of Central Bank of Montenegro.

In accordance with amendments to the abovecited decisions on minimum standards for credit risk management in banks, the Bank has applied the following percentages and days of delay by risk categories:

	As at December 31, 2011		As at December 31, 2010	
Risk category	% reserves	Days of delay	% reserves	Days of delay
A	-	<30	-	<30
B	3	31-90	3	31-90
C1	15	91-150	15	91-150
C2	30	151-210	30	151-210
C3	50	211-270	50	211-270
D	75	271-365	75	271-365
E	100	>365	100	>365

3.8. Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity. In case the Bank sells a significant amount of held to maturity investments, the entire category is reclassified as available for sale.

After initial recognition, securities held to maturity are recorded at amortized cost using the effective interest method less any allowance or loss on impairment. Amortized value is calculated by taking into account any discount or premium on acquisition, over the period of maturity.

Income from interest expense on these instruments is calculated using the effective interest rate and showing within interest income.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.9. Business premises, other fixed assets and intangible assets

Business premises and other fixed assets are those assets whose useful life is more than one year. Business premises, other property, equipment and intangible assets at December 31, 2011 are stated at cost of goods sold less accumulated depreciation and/or amortization. Cost of goods sold represents the prices billed by suppliers together with all costs incurred in bringing the respective asset to the location and condition necessary for its intended use.

Additional costs: costs of replacing equipment parts (installation of new spare parts), the cost of repairs and general repair of business premises are recognized as increasing the present value of business premises i.e. equipment, if it is likely that on this basis to get to the inflow of future economic benefits and if those costs could be reliably measured.

The costs arising from maintenance of equipment: replacement and installation of small spare parts and supplies, as well as the costs of everyday repairs are considered expense when incurred.

Losses or gains incurred in the disposal or retirement of business premises and equipment are determined as the difference between the sales and the current value at which the business premises and equipment are lead, and recognized as the benefit or as a part of the income statement over the period in which the disposal occurred or retirements.

Intangible assets consist of software and licenses. Intangible assets acquired are capitalized at cost value of the transaction. After initial recognition, intangible assets are carried at cost value less accumulated depreciation and eventual impairment.

Costs that could be directly linked with certain software and will generate economic benefits for a period longer than one year are recorded as intangible assets. Maintenance and development of computer software are recorded as an expense as incurred.

Depreciation is provided for on a straight-line basis to the cost of business premises and other fixed assets in order to write them off over their expected useful lives. Depreciation is calculated using the following prescribed annual rates:

Items	Depreciation rate (%)	Rate recognized in taxable income (%)
Buildings	2.00	5.00
Motor vehicles	15.00	15.00
Furniture and equipment	15.00 - 20.00	20.00
Computers and computer equipment	33.33	30.00
Intangible assets	20	30.00

In accordance with Article 13 of the Income Tax Law (“Official Gazette of Montenegro” nos. 65/01, 12/02 and 80/04, “Official Gazette of Montenegro”, nos. 40/08, 86/09 , 73/10 and 40/11) the method of calculating depreciation for tax purposes is different from the method of calculating depreciation for accounting purposes. The depreciation of buildings for tax purposes is calculated using the proportional method, while all other items, amortization of other fixed assets worth more than EUR 300, including the applications software, is calculated using digressive method for the entire year, regardless of the activation date.

The calculation of depreciation of business premises and other fixed assets commences when an asset is placed into use.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.10. Equity

The Bank's equity includes share capital, share premium, the Bank's reserves, as well as retained earnings (accumulated loss).

The share capital of the Bank is formed from the assets invested by the founders and shareholders of the Bank in the pecuniary or non-pecuniary form. The Law on Securities sets forth that securities are dematerialized and exist in an electronic form in the system of the Central Depositary Agency. The excerpt obtained from the Registry of the Central Depositary Agency is the only and exclusive proof of ownership over securities.

Bank's own funds, in accordance with the Decision on capital adequacy ratio (Official Gazette of Montenegro no. 38/11) are:

1) the basic elements of its own funds, which are included in the calculation of capital;
2) additional elements of its own funds, which are included in the calculation of supplementary capital I, and
3) an additional element of its own funds, which are included in supplementary capital II.

The basic elements of own funds of a bank are:

1) paid up share capital at nominal value, excluding cumulative preferred shares;
2) share premium paid;
3) reserves that are formed at the expense of its profit after tax (legal, statutory and other reserves);
4) Retained earnings from previous years;
5) profit in the current year for which the meeting of shareholders decided to be included in the capital;
6) capital gain on the sale and purchase of own shares.

Additional elements of the bank's own funds which are included in supplementary capital I have:

1) the nominal amount of cumulative preferred stock;
2) the amount of general reserves, up to 1.25% of total risk weighted assets;
3) subordinated debt, for which the conditions provided for are in this Decision;
4) hybrid instruments for which the conditions provided for are in this Decision;
5) the revaluation surplus.

Subordinated debt for which the conditions provided for by this Decision may be treated as an additional element of its own funds to be included in bank's supplementary capital II, if:

1) the debt is fully paid;
2) Bank does not guarantee the repayment of debt in any form;
3) in the event of bankruptcy or liquidation, subordinated debt and other obligations shall be paid only after payment obligations to other creditors;
4) the contract contains a clause prohibiting the payment of principal and interest, even after the maturity of debt, if the payment of the amount of own funds falls below the prescribed level;
5) the maturities of long term pre-determined, is longer than two years and may not be repayable before the agreed maturity date;
6) subordinated debt is a written agreement signed by the conditions in points. 2-5 of this article contains a note that subordinated debt cannot be considered a deposit.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.11. Employee benefits

Employee taxes and contributions for social security

Pursuant to the regulations effective in Montenegro, the Bank has an obligation to pay contributions to various state social security funds. These obligations involve the payment of contributions on behalf of an employee, by the employer, in an amount calculated by applying the specific, legally-prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on their behalf to transfer the withheld portions directly to the appropriate government funds. These contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

Retirement benefits or other long-term employee benefits

In accordance with the Collective Bargaining Agreement, the Bank is under obligation to pay retirement benefits to an employee upon his/her regular retirement in the amount of 6 net average salaries earned by the Bank's employees in the month in which payment is made. The Bank's financial statements as of and for the year ended December 31, 2011 include provisions calculated by an independent certified actuary, based on the estimated present value of assets to be used for retirement benefits payable to vesting employees.

3.12. Fair Value

Međunarodni standardi finansijskog izvještavanja predviđaju objelodanjivanje pravične (fer) vrijednosti finansijskih sredstava i finansijskih obaveza u napomenama uz finansijske izvještaje. Za navedene potrebe, pravična (fer) vrijednost je definisana kao iznos za koji se neko sredstvo može razmijeniti, ili obaveza izmiriti, u transakciji između dobro obaviještenih i voljnih strana, međusobno suočenih. Obaveza Banke je da objelodani sve informacije u vezi sa poštenom (fer) vrijednošću sredstava, potraživanja i obaveza za koje postoje raspoložive tržišne informacije i za koje se identifikuje materijalno značajna razlika između knjigovodstvenih vrijednosti i poštene (fer) vrijednosti.

In accordance with International Financial Reporting Standards, the fair value of financial assets and liabilities should be disclosed in the Notes to the Financial Statements. For these purposes, the fair value is defined as an amount at which an asset can be exchanged, or a liability settled, between knowledgeable willing parties in an arm's-length transaction. The Bank should disclose the fair value information of those components of assets and liabilities for which published market information is readily available, and for which their fair value is materially different from their recorded amounts.

In Montenegro, sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables, investments and other financial assets or liabilities, for which published market information is presently not readily available. Fair value cannot readily be determined in the absence of active capital and financial markets, as generally required under the provisions of IFRS/IAS. In the opinion of the Bank's management, the reported carrying amounts are the most valid and useful reporting values under the present market conditions in accordance with the accounting regulations of Montenegro and regulations of the Central Bank of Montenegro governing the financial reporting in banks.

4. INTEREST INCOME AND EXPENSE

a) Interest Income

In thousands of EUR

	2011	2010
Deposits with:		
- foreign banks	86	51
- Central bank	13	11
	99	62
Loans to:		
- corporate customers	8,109	6,463
- retail customers	3,195	3,109
	11,304	9,572
Repurchase operations	2	-
	11,405	9,634

b) Interest Expenses

In thousands of EUR

	2011	2010
Deposits with:		
- financial institutions	565	885
- state organisation	40	61
- corporate customers	777	837
- retail customers	1,451	1,314
- other	132	86
	2,965	3,183
Loans and other borrowings		
- financial institutions	840	192
- state organisation	68	58
	908	250
	3,873	3,433

5. PROVISIONS FOR LOSSES

a) Charge for the year

In thousands of EUR

	2011	**2010**
Net, provisions / (reversal of provisions):		
- deposits in foreign banks	3	4
- loans and leases	1,846	1,220
- interest receivables	232	147
- country risk	(40)	45
- other receivables of the debtor who has started a process of reorganization	(126)	(112)
- other receivables	(7)	7
- employee benefits (note 20)	9	3
- off-balance sheet items	160	20
- operating risk	83	-
	2,160	1,334

5. PROVISIONS FOR LOSSES (continued)

b) Movements on the accounts of allowance for impairment of bad debts and provisions

In thousands of EUR

	Loans and leases (note 11)	Interest (note 16)	Country risk (note 16)	Other receivables from the debtor who has started a process of reorganization (note 16)	Repossessed assets (note 16)	Other receivables (note 16)	Operating risk (note 21)	Off-balance sheet items (note 21)	Total
Balance, January 1, 2010	2,085	6	9	247	-	1	300	195	2,843
Charge for the year	1,220	147	45	-	-	11	-	20	1,443
Reversal of provisions	-	-	-	(112)	-	-	-	-	(112)
Provisions used	-	-	-	-	-	-	(21)	-	(21)
Transfer to off-balance sheet items	(648)	(143)	-	-	268	6	-	-	(517)
Balance, December 31, 2010	2,657	10	54	135	268	18	279	215	3,636
Charge for the year	1,846	232	-	-	-	3	83	160	2,324
Reversal of provisions	-	-	(40)	(126)	(8)	2	-	-	(172)
Provisions used	-	-	-	-	-	-	(62)	-	(62)
Transfer to/from off-balance sheet items	(492)	(229)	-	-	-	-	-	-	(721)
Balance, December 31, 2011	4,011	13	14	9	260	23	300	375	5,005

6. FEE AND COMMISSION INCOME AND EXPENSE

a) Fee and Commission Income

In thousands of EUR

	2011	2010
Loan origination fees	838	707
Fee and commission income from off-balance-sheet operations	511	348
Fee and commission income from payment transfers	1,669	1,530
Fee and commission income from brokerage services	4	4
Fee and commission income from custody services	22	12
Fee and commission income from credit cards	235	181
Other fee and commission income	538	323
	3,817	3,105

b) Fee and Commission Expenses

In thousands of EUR

	2011	2010
Fees and commissions payable to the Central Bank	179	159
Fee and commission expense from other banks	73	70
Fee and commission for deposit insurance	313	187
Other fee and commission expense	80	49
	645	465

7. OTHER INCOME, NET

In thousands of EUR

	2011	2010
Net gains on unrealized and realized foreign exchange fluctuations	286	223
Collected receivables previously written off	132	83
Income from trading securities	71	88
Gains on acquired assets sold, net	8	5
Miscellaneous income	14	-
	511	399

8. GENERAL EXPENSES

In thousands of EUR

	2011	2010
Net salaries	1,941	1,684
Taxes and contributions on salaries	1,309	1,181
Meals and transport	31	47
Remunerations to the members of the Board of Directors and Audit Board	78	91
Severance payments for voluntary leave	18	27
Costs for processing center services	62	60
Business trip expenses	74	75
Entertainment	106	95
Rentals	831	1,010
Maintenance of property and equipment	336	269
Depreciation and amortization charge:		
- property, plant and equipment (note 13)	483	368
- intangible assets (note 16)	287	238
Security services costs	287	223
Insurance premiums	47	63
Taxes	198	67
Advertising	204	250
Professional services costs	267	211
CDA and brokerage services costs	19	30
Telecommunication and postage	207	174
Electricity, fuel and water charges	62	57
Office material	127	83
Temporary engagement compensations	25	47
Sponsorship	148	92
Migration expenses	-	25
Write off bad debt receivables	-	32
Cost reduction - adjustments to fair value	41	-
Bills and checks expenses	31	30
Miscellaneous expenses	160	298
	7,379	**6,827**

9. INCOME TAXES

a) Components of Income Taxes

U hiljadama EUR

	2011	**2010**
Current income tax expenses	177	-
Deferred income tax expenses	(9)	15
	168	**15**

9. INCOME TAXES (continued)

b) Reconciliation of total amount of income tax stated in the income statement with the amount of profit before tax multiplied by prescribed tax rate is as follows

In thousands of EUR

	2011	**2010**
Net profit before tax	1,690	1,307
Income tax at the statutory tax rate of 9%	152	118
Unrecognized tax assets arising from tax loss carry forwards	-	(121)
Tax effect of expenditures not recognized for tax purposes	21	3
Other	(5)	15
Tax effects on the income statement	168	15
Tax effects on the income statement	9.94%	1.15%

c) Deferred Tax Liabilities

Deferred tax liabilities as at December 31, 2011 in the amount of EUR 21 thousand (December 31, 2010: EUR 26 thousand) (Note 20) are associated with the taxable temporary differences arising between the tax base at which business premises and other fixed assets are recognized in the tax balance and the carrying value of such assets in Bank's financial statements.

10. CASH AND DEPOSIT ACCOUNTS HELD WITH DEPOSITORY INSTITUTIONS

In thousands of EUR

	2011	2010
Cash on hand:		
- in EUR	1,824	1,626
- in foreign currency	297	103
Gyro account	7,145	6,928
Correspondent account with foreign banks	13,817	8,961
Obligatory reserves with the Central Bank of Montenegro	6,684	3,444
Time deposits with foreign banks	8,378	3,015
Deposit for guarantees	36	-
Deposits with domestic banks	319	170
	38,500	24,247

10. CASH AND DEPOSIT ACCOUNTS HELD WITH DEPOSITORY INSTITUTIONS (continued)

Obligatory reserves with the balance as of 31 December 2011. was allocated in accordance with the Decision of the Central Bank of Montenegro on Banks' Required Reserves with the Central Bank of Montenegro (Official Gazette no. 35/2011 of 1 July 2011.).

The obligatory reserve is made by applying a rate of 9.5% of the base which consists of demand deposits and deposits with agreed maturity up to one year, or up to 365 days, and the rate of 8.5% of the base comprised of deposits with agreed maturity over one year, or over 365 days. On deposits with agreed maturity over one year with an option clause termination of the deposit within less than one year, or within less than 365 days, the rate of 9.5% is applied.

Calculated required reserves allocated to the reserve requirement account in the country and / or the accounts of the Central Bank of Montenegro abroad. In accordance with this decision, the Bank may reserve 25% holding in the form of treasury bills issued by Montenegro. In 25% of total allocated funds required reserves, Central Bank of Montenegro pays interest at a rate of 1% per annum and payable until the eighth month for the previous month. Required reserves are held in euro.

Correspondent accounts and deposits with foreign banks as of December 31st December 2011. amount to EUR 22,230 thousand (31 December 2010: EUR 11,973 thousand).

On December 31, 2011, deposits with foreign banks were EUR 8,378 thousand and refer to three deposits placed with Probanka D.D. Maribor, Abanka Vipa D.D. Ljubljana and Banca Monte Dei Pashi di Siena S.p.A., with maturity range period from January 04, 2012 to February 16, 2012 and interest rate range from 0.19% to 1.85%.

11. LOANS AND LEASES

	2011	2010
	In thousands of EUR	
Matured loans:		
- state-owned corporate entities	206	-
- privately-owned corporate entities	1,318	1,865
- non-profit organizations	11	810
- retail customers	833	851
- other	13	9
Short-term loans:		
- privately-owned corporate entities	29,351	26,358
- non-profit organizations	833	119
- municipalities (public organisations)	34	85
- corporate entities with majority state-ownership	1,464	3,317
- retail customers	3,394	2,065
- other	-	434
Long-term loans, including current portions:		
- privately-owned corporate entities	49,520	39,332
- corporate entities with majority state-ownership	5,111	3,523
- non-profit organizations	5	49
- retail customers	20,883	22,158
- municipalities (public organisations)	505	34
	113,481	101,009
Minus: Allowance for impairment (note 5)	(4,011)	(2,657)
	109,470	98,352

Short-term loans to corporate entities with majority state-ownership are approved for current assets and mature over the period from 3 to 12 months, while long-term loans are approved for the period from 12 to 180 months and are mostly relate to corporate entities involved in trade, transport, warehousing, postal services and telecommunications and civil engineering. Short-term loans to corporate entities are mostly approved at an interest rate ranging between 4% and 15% annually (for credit cards rate is up to 20.98%) and the same interest rate is applied to long-term loans. If the customer takes a loan based on 100% of the time deposit, interest rate is a deposit/passive interest of + 2% -4%. The interest rate on loans approved to customers whose guarantees are realized ranged from 19.5% to 23.25% per annum.

11. LOANS AND LEASES (continued)

Short-term loans to retail customers are approved from one to twelve month maturities. Long-term loans to retail customers encompass loans for the renovation of housing and business premises, loans for the purchase of consumables and other purposes, approved for the period from 13 months to 20 years, at an interest rate ranging from 0.9% to 2% on monthly basis.

The geographic risk concentration within the customer loan portfolio mainly includes customers domiciled in Montenegro and Republic of Croatia.

The concentration of total gross loans to customers per separate fields of industry is as follows:

In thousands of EUR

	2011	**2010**
Agriculture, hunting and fishing	1,300	1,000
Civil engineering	4,897	4,094
Energy and mining	3,514	64
Trade	32,603	28,948
Services, tourism, accommodation industry	5,368	1,967
Transport, warehousing, postal services and communication	14,591	11,347
Administration and other public services	795	3,800
Real estate trade	2,694	3,209
Banks and other financial institutions	1,377	742
Retail customers	25,185	25,491
Other	21,157	20,347
	113,481	101,009

12. SECURITIES HELD-TO-MATURITY

Securities held to maturity as at December 31, 2011 in the amount of EUR 2,569 thousand (December 31, 2009: EUR 1,093 thousand) relate to treasury bills of the Government of Montenegro, whose expiry term is February 28, 2012 and June 27, 2012. Treasury bills earned interest rate of 3.35% per annum. The total nominal value at December 31 2011 amounts to EUR 2,600 thousand.

13. BUSINESS PREMISES AND OTHER FIXED ASSETS

The movements for 2011 and 2010 are shown in the following table:

In thousands of EUR

	Buildings	Computer equipment	Other equipment	Construction in progress	Total
Cost					
Balance, January 1, 2010	377	725	1,373	138	2,613
Additions	1	60	-	594	655
Transfers	-	213	492	(705)	0
Sales and disposals	-	(42)	(52)	-	(94)
Balance, December 31, 2010	378	956	1,813	27	3,174
Additions	-	-	-	719	719
Purchases	-	98	682	-	780
Sales	-	-	(208)	(726)	(934)
Disposals	-	(29)	(40)	-	(69)
Balance, December 31, 2011	378	1,025	2,247	20	3,670
Accumulated depreciation					
Balance, January 1, 20010	45	621	474	-	1,140
Charge for the year (note 8)	8	106	254	-	368
Sales and disposals	-	(42)	(34)	-	(76)
Balance, December 31, 2010	53	685	694	0	1,432
Charge for the year (note 8)	8	140	335	-	483
Sales	-	-	(134)	-	(134)
Disposals	-	(29)	(32)	-	(61)
Balance, December 31, 2011	61	796	863	0	1,720
Net book value:					
- December 31, 2011	317	229	1,384	20	1,950
- December 31, 2010	325	271	1,119	27	1,742

At December 31, 2011 the Bank has no assets pledged to serve as collateral for timely and regular repayment of loans and other liabilities.

14. ACQUIRED ASSETS

Acquired collaterals as at December 31, 2011 amounted to EUR 478 thousand (December 31, 2010: EUR 485 thousand) and totally relate to acquired collaterals that are expressed in the value of total outstanding receivables. As of December 31, 2011 The Bank has shown impairment of acquired value of these collaterals in the amount of EUR 260 thousand (Notes 5 and 16).

15. EQUITY INVESTMENTS IN OTHER LEGAL ENTITIES

In thousands of EUR

	2011	2010
Investment in banks and other financial institutions:		
- Tržište novca A.D., Beograd	2	2
- S.W.I.F.T. SRL	6	5
	8	7
Investments in companies abroad:		
- Imlek A.D., Beograd	34	-
- Naftna industrija Srbije („NIS“) A.D., Novi Sad – Republic of Serbia	28	47
	62	47
Investments in domestic companies:		
- Bridgemont D.O.O., Podgorica	2	2
- Jugopetrol A.D. Kotor	14	-
- Crnogorski Telekom A.D, Podgorica	121	32
- Zetatrans A.D , Podgorica	3	3
- Prenos A.D., Podgorica	7	5
- Kontejnerski terminal i generalni tereti A.D., Bar	4	-
- Barska plovidba A.D., Bar	2	-
- Fond zajednickih ulaganja Moneta A.D.	1	-
- Autoremont A.D.	6	-
- Kombinat aluminijuma Podgorica A.D., Podgorica	-	2
- Luka Bar A.D., Bar	-	1
	160	45
	230	99

16. OTHER ASSETS

	In thousands of EUR	
	2011	**2010**
Interest receivables	803	952
Fee and commission receivables	129	147
Intangible assets	550	705
Accruals	475	566
Advances paid	11	80
Other receivables from the debtor in the process of reorganization	28	449
Receivables for reimbursements of costs	138	89
Receivables from employees	141	135
Other receivables	366	67
	2,641	3,190
Allowance for potential losses contingent on other assets		
- interest (note 5)	13	10
- country risk (note 5)	14	54
- other receivables from the debtor in the process of reorganization (note 5)	9	135
- acquired assets (note 5)	260	268
- other receivables	23	18
	319	485
	2,322	2,705

16. OTHER ASSETS (continued)

The movements on intangible assets for 2011 and 2010 were as follows:

	In thousands of EUR	
	2011	2010
Cost of goods sold		
Balance, January 1,	1,345	968
Additions	139	390
Disposals	(76)	(13)
Balance, December 31,	1,408	1,345
Accumulated depreciation		
Balance, January 1,	640	413
Charge for the year (note 8)	287	238
Disposals	(69)	(11)
Balance, December 31,	858	640
Net book value		
- December 31,	550	705

At December 31, 2010, intangible assets in the amount of EUR 550 thousand mainly related to investment in software totaling EUR 233 thousand, the license in the amount of EUR 114 thousand and leasehold improvements in the amount of EUR 204 thousand.

17. DEPOSITS

	In thousands of EUR	
	2011	2010
Sight deposits:		
- government agencies	1,136	1,732
- funds	35	34
- municipalities (public organizations)	85	72
- corporate entities with majority state - ownership	1,572	6,109
- privately-owned companies	22,528	15,511
- banks	198	165
- other financial institutions	294	925
- non-profit organizations	1,305	2,303
- retail customers	12,547	11,111
- other	50	42
Short-term deposits:		
- government agencies	700	1,240
- funds	2,000	800
- corporate entities with majority state - ownership	797	639
- privately-owned companies	10,762	11,518
- banks	-	2,725
- other financial institutions	5,205	6,636
- non-profit organizations	194	682
- retail customers	25,430	19,452
Long-term deposits:		
- government-owned corporate entities	700	-
- privately-owned companies	2,390	781
- non-profit organizations	23	23
- other financial institutions	275	121
- retail customers	9,627	2,512
	97,853	**85,133**

Sight deposits placed by retail customers denominated in EUR are deposited at the interest rate ranging from 0.1% to 1% annually. Retail sight deposits in foreign currency are deposited at an interest rate ranging from 0.1% to 1% annually, depending on the currency.

Short-term and long-term deposits of retail customers denominated in EUR are placed at an interest rate ranging from 0.2% to 7% annually, depending on the amount of deposit being placed and chosen savings arrangement (up to EUR 5 thousand, from EUR 5 thousand to EUR 50 thousand and over EUR 50 thousand). Short-term and long-term deposits of retail customers in foreign currencies are placed at an interest rate ranging from 1.2% to 3% annually, depending on the currency.

Short-term deposits of corporate entities denominated in EUR are placed at interest rates ranging from 0.2% to 7% annually, depending on the depositing period and the amount of deposit being placed (up to EUR 50 thousand, from EUR 50 thousand to EUR 100 thousand and over EUR 100 thousand). Short-term deposits of corporate entities in foreign currencies are deposited at interest rates ranging from 1% to 2%. Long-term deposits of corporate entities were placed at an interest rate ranging from 0.2% to 7% annually, depending on the depositing period and currency.

Sight deposits of corporate entities, public and other organizations bear interest at the rate ranging from 0% to 2.25% annually.

18. LOANS AND BORROWINGS

In thousands of EUR

	Period (Year/ Month)	Anally interest rate	December 31, 2011	December 31, 2010
Obligations to foreign creditors				
The European Fund for Southeast Europe ("EFSE") Montenegro B.V.	5g	5.43%	5,000	3,000
European Investment Bank ("EIB")	12g	4.032%	2,499	2,600
EIB	12g	3.923%	1,400	1,400
EIB	12g	3.604%	4,000	4,000
EIB	12g	3.168%	2,010	2,010
EIB	12g	3.019%	1,990	1,990
EIB	12g	3.841%	3,101	-
EIB	12g	3.181%	899	-
Podravska Banka D.D. Koprivnica	6m	4.25%	2,000	-
Probanka D.D. Maribor	3m	3.72%	2,988	-
Banca Monte Dei Paschi Di Siena Sp	10m	4.529%	1,000	-
			26,887	**15,000**

During 2010 and 2011, EFSE approved to the Bank a loan in the amount of EUR 5,000 thousand with an interest rate of 5.43% for the period of five years, with a grace period of 12 months i.e. till March 22, 2012. In the period until December 31, 2011, the Bank used EUR 5,000 thousand. The loan is repaid in equal semi-annual installments. In accordance with the provisions of the agreement concluded with EFSE, the Bank is obliged to keep its business results within certain financial indicators – debt covenants. At December 31, 2011, the Bank's financial ratios are in line with the terms delineated in the relevant agreements. As at December 31, 2011, the Bank's exposure amounted to EUR 5,000. The loan approved to the Bank is for the purpose of financing sub loans for development of small and medium enterprises (SME), on condition that an individual sub loan does not exceed EUR 100 thousand, or total amount of approved sub loans to the group of related party entities does not exceed EUR 300 thousand.

As at December 31, 2011, the Bank had liabilities towards the EIB based on long-term loans totaling EUR 15,899 thousand (December 31, 2010: EUR 12,000 thousand). EIB approved the Bank a loan in the amount of EUR 16,000 thousand and Bank's commitments arising thereof amounted to EUR 15,899 thousand as of December 31, 2011. Loans are granted to promote the development of SME in Montenegro, with a grace period of maximum 2 years. Loans are repaid in semi-annual annuities. As collateral against these commitments, the Bank provided the guarantee of the Government of Montenegro.

19. LIABILITIES TO THE GOVERNMENT

In thousands of EUR

	Period (Year/ Month)	Anally interest rate	December 31, 2011	December 31, 2010
Investment and Development Fund of Montenegro	5-10	1.75%-7.5%	2,368	2,195
Directorate for development of small and medium-sized enterprises	4-8	0-1%	521	521
			2,889	**2,716**

At December 31, 2011, the amount of EUR 2,889 thousand owed to the Government of Montenegro is associated with payables in the amount of EUR 2,368 thousand arising from long-term borrowings from the Investment and Development Fund of Montenegro for financing small and medium enterprises with a grace period from 1 to 2 years, and payables arising from long-term borrowings in the amount of EUR 521 from the Directorate for development of small and medium-sized enterprises with a grace period from 12 to 18 months.

20. OTHER LIABILITIES

In thousands of EUR

	2011	2010
Liabilities for accrued interest	1,193	1,263
Deferred loan origination fees	823	732
Accounts payable (suppliers)	247	149
Tax payables	206	53
Deferred tax liabilities (Note 9)	21	26
Liabilities for advance collection of loans	1,065	1,439
Provisions for employee benefits	65	57
Other liabilities	334	54
	3,952	3,773

As of December 31, 2011, provisions for employee benefits in the amount of EUR 66 thousand are calculated as present value of future expected retirement benefits to employees after they fulfill conditions.

The present value of expected future cash payments towards the employees qualified to receive retirement benefits is determined in accordance with actuarial estimation principles of an independent certified actuary as at December 31, 2011. Technical bases applied in calculating the present value of expected future retirement benefits include implementation of the following:

a. cumulative figures, prepared in accordance with the calculated possible age of the population of the Republic of Montenegro included in the population census dating from 1980 to 1982, and
b. annual interest rates of 12% used to discount future retirement payments to employees.

The movements on provisions for employee benefits are as shown in the following table:

In thousands of EUR

	2011	2010
Beginning of the year	57	54
Provisions for the period (Note 5)	9	3
End of the year	66	57

21. PROVISIONS FOR POTENTIAL LOSSES CONTINGENT ON OFF-BALANCE SHEET CREDIT EXPOSURES

In thousands of EUR

	2011	2010
Provisions for losses contingent on:		
- off-balance sheet items (Note 5)	375	215
- operational risk	300	279
	675	494

22. SHARE CAPITAL

At December 31, 2011 and 2010, the Bank's share capital was comprised of 31,305 ordinary shares with the par value of EUR 511.29. The Law on Banks ("Official Gazette of Montenegro," no. 17/2008, 44/2010, and no. 40/2011) defines that the minimum cash amount of initial capital may not be less that EUR 5,000 thousand. At December 31, 2011, the Bank's capital complied with the prescribed minimum capital requirements.

The ownership structure of the Bank's share capital as of December 31, 2011 and 2010 was as follows:

	2011			2010		
Shareholder	Number of shares	In thousands of EUR	% share	Number of shares	In thousands of EUR	% share
Allegro S.a.r.l. Luxembourg	5,281	2,700	16.87%	-	-	-
Flandria Participations Financieres	-	-	-	5,000	2,556	15.97%
Cerere s.r.l	4,360	2,229	13.93%	4,360	2,229	13.93%
Gorgoni Antonia	3,131	1,601	10.00%	3,131	1,601	10.00%
Gorgoni Lorenzo	2,591	1,325	8.28%	2,591	1,325	8.28%
Todorović Miljan	2,316	1,184	7.40%	2,316	1,184	7.40%
Others	13,626	6,967	43.53%	13,907	7,111	44.43%
	31,305	**16,006**	**100%**	**31,305**	**16,006**	**100.00%**

23. COMPLIANCE WITH THE REGULATIONS OF THE CENTRAL BANK OF MONTENEGRO

The Bank is required to maintain certain ratios pertaining to the volume of its activities and composition of risk assets in compliance with the Law on Banks and regulations of the Central Bank of Montenegro.

In accordance with the Decision on Capital Adequacy in Banks ("Official Gazette of Montenegro," no. 38/2011), the Bank's capital is comprised of the Bank's core capital and supplementary capital, minus deductions. The Bank's capital as of December 31, 2011 amounted to EUR 22,540 thousand (December 31, 2010: EUR 20,916 thousand).

The Bank's core capital formed in accordance with the Decision on Capital Adequacy in Banks, as of December 31, 2011 amounted to EUR 22,540 thousand (December 31, 2010: EUR 20,916 thousand). The Bank's capital as of December 31, 2011 is comprised of the following components: paid-in share capital at nominal value, collected share premiums and current year retained earnings as decreased by the amount of prior period losses and amount of intangible assets.

As of December 31, 2011 the Bank has supplementary capital in the amount of EUR (54) thousand that refers to revalorization reserve from fair value adjustments of available for sale financial instruments.

Risk-weighted balance sheet assets and off-balance sheet items formed pursuant to the Decision on Capital Adequacy in Banks, as of December 31, 2011 amounted to EUR 106,740 thousand (December 31, 2010: EUR 108,477 thousand). In accordance with the Decision on Capital Adequacy in Banks of the Central Bank of Montenegro, the Bank is under obligation to maintain the minimum capital adequacy ratio of 10%. The solvency ratio calculated by the Bank as of December 31, 2011 amounted to 16.98% (December 31, 2010: 15.54%) and it is greater than statutory minimum.

At December 31, 2011, none of the Bank's ratios departed from the minimum legal requirements set forth by the Central Bank of Montenegro.

24. OFF-BALANCE SHEET ITEMS

In thousands of EUR

	2011	2010
Guarantees, sureties and irrevocable commitments::		
Guarantees to corporate entities:		
- payment guarantees	16,327	16,212
- performance bonds	3,721	1,047
- other types of guarantees	8,034	6,338
Commitments arising from undrawn loans	4,342	2,476
Letters of credit	-	96
Other off-balance sheet items:		
- commission banking services	131	131
- custody services	83,584	13,614
- collaterals	269,274	246,954
- written-off loans receivables	2,576	1,819
- current contract for foreign currency transactions / prompt sale of foreign currencies	830	801
	388,819	**289,488**

25. RELATED PARTY TRANSACTIONS

The Law on Banks ("Official Gazette of Montenegro," no. 17/2008, 44/2010 and no. 40/2011) defines that significant influence on the Bank's operations is by those persons appointing at least one representative in the Board of Directors or some similar board, either through shareholding, through agreement with the owners or otherwise. In accordance with the Law on Banks, related party transactions are presented in the following tables:

In thousands of EUR

	December 31, 2011	December 31, 2010
Receivables		
- Miljan Todorovic	1	-
	1	-
Payables		
A vista deposits:		
- Montenegro berza	10	-
- Miljan Todorović	5	-
- Sigilfredo Montinari	1	-
- Gorgoni Lorenzo	15	12
	31	12
Term deposits		
- Miljan Todorovic	360	530
- Montenegro berza	-	59
	360	589
Total payables	**391**	**601**

Expenses from transactions with related parties during 2011 amounted to EUR 67 thousands (2010: EUR 95 thousands), while income amounted to EUR 30 thousand.

As at December 31, 2011, receivables from employees amounted to EUR 1,595 thousand (at December 31, 2010: EUR 1,249 thousand), which refer to the approved loans, claims for overdraft on bank accounts and credit cards.

During 2011, total gross remunerations paid to persons with special authorities and responsibilities amounted to EUR 594 thousand (2010: EUR 556 thousand).

26. LIQUIDITY GAP BETWEEN FINANCIAL ASSETS AND LIABILITIES

The Bank is exposed to daily calls on its available cash resources which influence the available cash resources held on the current accounts or from deposits. The Bank does not maintain cash resources 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.

The Bank's liquidity as its ability to settle its outstanding liabilities depends on the balance sheet structures on one side, and compliance between cash inflows and outflows on the other side.

The contractual maturities of the Bank's asset and liability components as of December 31, 2011 were as follows:

In thousands of EUR

	Up to one month	From 1 to 3 month	From 3 to 6 month	From 6 to 12 month	From 1 to 5 years	Over 5 years	Total
Financial assets							
Cash and deposit accounts with depository institutions	34,986	3,478	-	36	-	-	38,500
Assets for trade and available for trade, no shares	26	-	-	-	-	-	26
Loans and other receivables	7,892	12,313	13,304	24,249	43,053	12,670	113,481
Securities held to maturity	-	1,094	1,475	-	-	-	2,569
Other financial assets including investments in shares	1,813	-	-	11	483	-	2,307
Total	44,717	16,885	14,779	24,296	43,536	12,670	156,883
Financial liabilities							
Deposits	21,351	31,818	11,224	22,346	9,668	1,446	97,853
Obligations based on loans and other borrowings	1,000	5,613	161	957	9,316	9,840	26,887
Obligations to the Government	145	50	76	183	1,869	566	2,889
Other financial liabilities	981	228	361	401	879	286	3,136
Total	23,477	37,709	11,822	23,887	21,732	12,138	130,765
Maturity gap:							
- December 31, 2011	21,240	(20,824)	2,957	409	21,804	532	26,118
- December 31, 2010	11,240	(10,189)	(595)	1,556	21,140	526	23,678
Cumulative GAP:							
- December 31, 2011	21,240	416	3,373	3,782	25,586	26,118	
- December 31, 2010	11,240	1,051	456	2,012	23,152	23,678	
% of total source of funds:							
- December 31, 2011	16.2%	0.3%	2.6%	2.9%	19.6%	20.0%	
- December 31, 2010	10.7%	1.0%	0.4%	1.9%	22.0%	22.5%	

26. LIQUIDITY GAP BETWEEN FINANCIAL ASSETS AND LIABILITIES (continued)

The contractual maturities of the Bank's asset and liability components as of December 31, 2010 were as follows:

In thousands of EUR

	Up to one month	From 1 to 3 month	From 3 to 6 month	From 6 to 12 month	From 1 to 5 years	Over 5 years	Total
Financial assets							
Cash and deposit accounts with depository institutions	22,741	1,506	-	-	-	-	24,247
Assets for trade and available for trade, no shares	42	-	-	-	-	-	42
Loans and other receivables	8,500	15,310	13,703	20,970	32,486	10,040	101,009
Securities held to maturity	-	1,093	-	-	-	-	1,093
Other financial assets including investments in shares	1,962	-	-	74	484	-	2,520
Total	33,245	17,909	13,703	21,044	32,970	10,040	128,911
Financial liabilities							
Deposits	21,444	27,830	13,650	18,863	2,928	418	85,133
Obligations based on loans and other borrowings	-	-	-	101	6,692	8,207	15,000
Obligations to the Government	90	31	59	96	1,706	734	2,716
Other financial liabilities	471	237	589	428	504	155	2,384
Total	22,005	28,098	14,298	19,488	11,830	9,514	105,233
Maturity gap:							
- December 31, 2011	11,240	(10,189)	(595)	1,556	21,140	526	23,678
- December 31, 2010	8,166	(7,664)	466	(786)	20,871	801	21,854
Cumulative GAP:							
- December 31, 2011	11,240	1,051	456	2,012	23,152	23,678	
- December 31, 2010	8,166	502	968	182	21,053	21,854	
% Od ukupnog izvora sredstva							
- December 31, 2011	10.7%	1.0%	0.4%	1.9%	22.0%	22.5%	
- December 31, 2010	10.5%	0.6%	1.2%	0.2%	27.0%	28.0%	

The Bank's liquidity, as it's ability to settle it's outstanding liabilities is depending of the balance sheet structures on the one side and of compatibility of assets inflows and outflows on the other side.

27. INTEREST RATE RISK

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest rate risk requires special treatment under the existing local circumstances of frequent interest rate movements, and irregular capital supply and demand. Interest rate risk is unfavourable when there is fluctuation in the price of a loan in relation to the level of the effective interest rates on deposits, and the potential of a reduction in the optimal difference between the average interest rates applied to loans on one side, and to deposits on the other.

The table below shows the Bank's exposure to interest rate risk as of December 31, 2011.

In thousands of EUR

	Up to one month	From 1 to 3 month	From 3 to 6 month	From 6 to 12 month	From 1 to 5 years	Total
Interest rate sensitive assets						
Interest-bearing deposits in other institutions	6,571	3,478	-	-	-	10,049
Interest bearing securities	-	1,094	1,475	-	-	2,569
Loans and other receivables	7,892	12,313	13,304	24,249	55,723	113,481
Other interest-bearing assets	803	-	-	-	-	803
Total	15,266	16,885	14,779	24,249	55,723	126,902
% of the total interest-bearing assets	12.03%	13.31%	11.65%	19.11%	43.91%	100.00%
Interest rate sensitive liabilities						
Interest-bearing deposits	11,346	11,366	15,070	27,794	24,574	90,150
Interest-bearing borrowings	1,146	5,663	236	1,139	21,592	29,776
Total	12,492	17,029	15,306	28,933	46,166	119,926
% of the total interest-bearing liabilities	10.42%	14.20%	12.76%	24.13%	38.50%	100.00%
Interest rate exposure:						
- December 31, 2011	2,774	(144)	(527)	(4,684)	9,557	6,976
- December 31, 2010	2,527	7,434	(3,481)	(3,013)	9,674	13,141
Cumulative GAP:						
- December 31, 2011	2,774	2,630	2,103	(2,581)	6,976	
- December 31, 2010	2,527	9,961	6,480	3,467	13,141	

27. INTEREST RATE RISK (continued)

Izloženost riziku od promjene kamatnih stopa na dan 31. decembra 2010. godine prikazana je u sljedećoj tabeli:

In thousands of EUR

	Up to one month	From 1 to 3 month	From 3 to 6 month	From 6 to 12 month	From 1 to 5 years	Total
Interest rate sensitive assets						
Interest-bearing deposits in other institutions	2,367	1,506	-	-	-	3,873
Interest bearing securities	-	1,093	-	-	-	1,093
Loans and other receivables	8,500	15,310	13,703	20,970	42,526	101,009
Other interest-bearing assets	975	-	-	-	-	975
Total	11,842	17,909	13,703	20,970	42,526	106,950
% of the total interest-bearing assets	11.07%	16.75%	12.81%	19.61%	39.76%	100.00%
Interest rate sensitive liabilities						
Interest-bearing deposits	9,226	10,444	17,125	23,787	15,511	76,093
Interest-bearing borrowings	89	31	59	196	17,341	17,716
Total	9,315	10,475	17,184	23,983	32,852	93,809
% of the total interest-bearing liabilities	9.93%	11.17%	18.32%	25.57%	35.02%	100.00%
Interest rate exposure:						
- December 31, 2010	2,527	7,434	(3,481)	(3,013)	9,674	13,141
- December 31, 2009	6,136	2,757	(1,539)	(3,452)	14,330	18,232
Cumulative GAP:						
- December 31, 2010	2,527	9,961	6,480	3,467	13,141	
- December 31, 2009	6,136	8,893	7,354	3,902	18,232	

28. CURRENCY RISK

The following table summarizes the net foreign currency position of the Bank as of December 31, 2011. The Bank takes on exposure resulting from fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The management establishes limitations on the exposure levels per currencies and aggregately, and monitors such exposure on regular basis.

28. CURRENCY RISK (continued)

In thousands of EUR

	RSD	USD	GBP	CHF	Other	Total
Assets in foreign currencies	-	7,256	69	138	19	7,482
Liabilities in foreign currencies	-	7,450	67	137	3	7,657
Net foreign exchange position:						
- December 31, 2010	-	(194)	2	1	16	
- December 31, 2009	-	(165)	24	3	11	
% of first- tier capital:						
- December 31, 2010	-	(0.83%)	0.01%	0.00%	0.07%	
- December 31, 2009	-	(0.71%)	0.10%	0.02%	0.05%	
Aggregate open position:						
- December 31, 2011	(175)					
- December 31, 2010	(127)					
% of first-tier capital:						
- December 31, 2011	(0.75%)					
- December 31, 2010	(0.54%)					

29. LEGAL PROCEEDINGS

As of December 31, 2011, the Bank is defendant in a certain number of legal proceedings, initiated by retail and corporate clients. Total amount of litigation is EUR 28 thousand. The final outcome of the ongoing legal proceedings is uncertain. However, the Bank's management as well as legal consultant does not expect negative outcome of such litigations as well as material affects on financial statements as of December 31, 2011.

Total amount of litigations in which the Bank acts as prosecutor as of December 31, 2011 is EUR 1,856 thousand.

30. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the annual net gain that is attributable to holders of ordinary shares, divided by the weighted average number of ordinary shares that were outstanding during the period. The Bank is registered as a limited company whose share capital is consisting of 31.305 ordinary shares. Earnings per ordinary share at December 31, 2011 was equal to EUR 0.05 thousand (December 31, 2010: EUR 0.04 thousand).

31. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of balance sheet items denominated in foreign currencies, into EUR as at December 31, 2011 and 2010 were as follows:

	December 31, 2011	December 31, 2010
USD	0.7729	0.7530
CHF	0.8226	0.8016
GBP	1.1972	1.1625

32. EVENTS AFTER THE BALANCE SHEET DATE

There were no significant events after balance sheet date which would require disclosure in the notes to the Bank's financial statements for 2011.

Signed on behalf of Hipotekarna Banka AD Podgorica

A. ANALYSIS TO FINANCIAL STATEMENTS

I Introduction

Financial Statements of Hipotekarna banka A.D., Podgorica (hereinafter the „Bank“), which were subject of audit have been prepared in accordance with Accounting standards and regulations of Montenegro and regulations of Central Bank of Montenegro governing financial reporting of banks. The prescribed forms of financial statements were submitted in due time to the Central Bank of Montenegro.

II Income statement and balance sheet analysis

Detailed analysis of the balance sheet and income statement is provided within Notes from 4 to 31 to the financial statements.

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK

I Quality of the bank's asset

Classification of asset and the corresponding balance sheet items, in terms of determining asset quality, was carried out in accordance with the Decision of the classification of bank assets, provisions and reserves for loan losses issued by the Central Bank of Montenegro (,,Official Gazette of Montenegro", no. 60/2008 and 41/2009) and the Decision of the Central Bank of Montenegro on temporary measures for managing credit risk in banks ("Official Gazette of Montenegro" no. 64/2009, 87/2009, 66/2010 and 70/2010). On the basis of classification performed and in accordance with internal policies, the Bank has made provisions for potential losses as at December 31, 2011 in amount of EUR 5,005 thousand (December 31, 2010: EUR 3,636 thousand).

Based on audit procedures performed on a sample basis and related to risk classification, the auditor has not found any differences related to the risk classification of the clients that is performed in accordance with the relevant Decisions of the Central Bank of Montenegro.

Classification of the Bank is verified by auditors on a sample covering 52.21 % of the total credit risk exposure at December 31, 2011 (excluding loans granted to retail customers).

Available information on indicators of business of the debtor are taken into account when determining the classification of assets and the required reserves for potential losses of the Bank, as well as the quality of debt service, renewal of loans to the same debtors during the year, the quality of the collection instruments and evidence of credit and interest charges in 2011 and up to day of preparing financial statements for 2011.

Summing up the results of a quality of balance sheet and off-balance sheet assets of the Bank from the point of payment collection and the need to create reserves for the provision of the Bank from potential losses in accordance with the stated approach, the following relations and parameters were provided:

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

I Quality of the bank's asset (continued)

- Risk-weighted balance sheet and off-balance sheet assets of the Bank as of December 31, 2011 and 2010 consists of the following:

In thousand of EUR

	2011			2010		
	Amount	In %	Formed reserve	Amount	In %	Formed reserve
Loans	113,481		4,330	101,009		3,142
Less: Loans secured by cash deposit	(9,652)			(5,176)		-
	103,829	72.44	4,330	95,833	76.90	3,142
Accrued interest	803	0.56		950	0.76	
Other asset items	9,118	6.36		3,698	2.97	
Taken over and potential obligations	29,576	20.64	675	24,135	19.37	494
Total exposure to risk	143,326	100.00	5,005	124,616	100.00	3,636

- As at December 31, 2011, the structure of the Bank's investments made by risk categories after decreased for cash deposits is as follows:

In thousand of EUR

Category	Loans	Accrued interest	off-balance sheet records	Total	In %
A	35,995	234	17,145	53,374	39.80
B	57,942	475	11,735	70,152	52.31
C	8,981	-	543	9,524	7.10
D	911	-	153	1,064	0.79
	103,829	709	29,576	134,114	100.00

- As at December 31, 2010, the structure of the Bank's investments made by risk categories after decreased for cash deposits is as follows:

U hiljadama EUR

Category	Loans	Accrued interest	off-balance sheet records	Total	In %
A	45,576	482	14,940	60,998	51.34
B	42,945	379	7,151	50,475	42.49
C	6,910	6	10	6,926	5.83
D	402	-	-	402	0.34
	95,833	867	22,101	118,801	100.00

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

Risk-weighted balance sheet and off-balance sheet assets comprising the total sum of assets classified from the point of collection, as at December 31, 2011, represented 53.92% (December 31, 2010: 67,64% total assets (before impairment for loan loss provisions and impairment losses on other assets).

The loan policy of the Bank is in compliance with the Decision of the Central Bank of Montenegro on minimum standards for the management of loans concentration and doing business with related entities.

II
Equity and adequacy of equity

As of December 31, 2011 and 2010 the share capital of the Bank comprises of 31,305 common shares with nominal value of EUR 511.29.

As of December 31, 2011, uncovered loss amounted to EUR 307 thousand (December 31, 2010: 1,828 thousand).

Bank's own funds as at December 31, 2011 amounted to EUR 22,540 thousand (December 31, 2010: EUR 20,916 thousand).

The core equity of the Bank established in accordance with the Decision on Adequacy of equity of the Bank ("Official Gazette of Montenegro" no. 38/2011) as at December 31, 2011 amounted to EUR 22,594 thousand. The core equity of the Bank as at December 31, 2011 constitutes the essential elements of its own funds: share capital paid at nominal value, collected share premium and the amount of net profit from the current year, less the amount of uncovered loss from previous years and the amount of intangible assets.

As at December 31, 2011, the Bank has supplementary capital in the amount of EUR 54 thousand which refers to revalorisation reserves from fair value adjustments of available for sale financial instruments.

Risk-weighted balance sheet and off-balance sheet assets, formed in accordance with the Decision on Adequacy of equity of the Bank at December 31, 2011 amounted to EUR 106,740 thousand (As at December 31, 2010: EUR 108,477 thousand).

Capital required for market risk at 31 December 2011 amounts to EUR 70 thousand, for operational risk EUR 1,380 thousand, for country risk EUR 584 thousand and other risks EUR 567 thousand.

In accordance with the Decision on Adequacy of equity of the banks, the Bank is in obligation to maintain a minimal level of solvency ratio of 10%. The solvency ratio of the Bank, as at December 31, 2011 amounted to 16.98% (as at December 31, 2010: 15.54%) and is higher than prescribed minimum.

As at December 31, 2011 no indicators of Bank's business deviated from prescribed minimum as required by legislation Central bank of Montenegro.

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

III Liquidity of the bank

Liquidity risk management is defined by the Procedure for managing liquidity risk which defines that the responsibilities in managing the Bank's liquidity bear the following authorities of the Bank:

- Management of the Bank
- Asset and liability Committee (ALCO)
- Payments and funds management department, other Bank's departments and services

The Bank maintains its liquidity by constantly monitoring the alignment of resources and placements in order to be able to settle on mature date all its commitments and commitments of its depositors, while at the same time the Bank is trying to meet the needs of the founder and business customers in approving the loans, i.e.

to adjust maturities of loans with borrower's needs.

Liquidity of the Bank as at December 31, 2011 and 2010 can be closely looked from the following indicators:

					2011	2010
Loans / Deposits	=	113,481 / 97,853	x100		115.97%	118.65%
Cash and deposit accounts held with depository institutions / Deposits	=	38,500 / 97,853	x100		39.35%	28.48%
Cash and deposit accounts held with depository institutions / Total assets	=	38,500 / 155,593	x100		24.74%	18.83%
Cash and deposit accounts held with depository institutions / Short-term liabilities	=	38,500 / 92,815	x100		41.48%	28.90%

Maturity alignment of financial assets and Bank's liabilities as at December 31, 2011 has been shown in note 26 to the financial statements.

IV Interest rate risk

Existing interest rates are determined by a Decision on the interest rate. This decision defines the basic goals and guidelines for interest rate policy, principles and methods of determining the interest rates, by which the Bank arranges agreements, calculate and charge interest on loans and other receivables, i.e. pays on deposits and other funds received.

The Bank is exposed to various risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. As a result of such changes, an interest margin of the Bank could be increased, but also decrease and loss in a case of unexpected interest rate fluctuation can occur.

Interest rate risk as at December 31, 2011 is shown in note 27 to the financial statements.

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

IV Interest rate risk (continued)

In accordance with the policy for managing market risks, the Bank controls the risk of interest rate fluctuations by establishing internal limitations for the ratio of total bank exposure to interest rate changes.

Defining the limits, boundaries are established for the level of exposure to interest rate risk in the following manner, and in accordance with the Policy of managing market risks in Hipotekarna Banka A.D., Podgorica:

- The average interest margin must not fall below 40% of the average lending interest rates.
- The Bank follows and establishes the average lending and deposit interest rates, by putting the ratio of earned interest income for the reference period with an average interest bearing assets for the reference period to determine the average lending interest rates, as well as by putting in relation actual interest expense for the observed period with an average interest bearing liabilities for the reference period in order to establish the average deposit interest rate. The difference got by subtracting the average deposit interest rate from the average lending interest rate, represents the interest margin, which must not fall below 40% of the average lending interest rate, calculated in the aforecited manner.
- The aforecited calculation is done for a particular month, as well as cumulatively for the period from the beginning of the year until the reference period, according to provided data, movement of average lending and deposit interest rates and movement of the interest margin for the reference month and period can be followed.

In a case that an average interest margins fall under 40% of the average lending interest rates, Risk management department, i.e. Risk monitoring and reporting department will inform the ALCO Committee, which is obliged to recommend measures for maintaining operations within the defined limits:

- The total annual cumulative difference for the position in EUR must not exceed 45% of total assets, i.e. 45% of total liabilities,

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

- The total semi-annual cumulative difference for the position in EUR must not exceed 36% of total assets, i.e. 36% of total liabilities,
- The total annual and semi-annual cumulative difference for the position for particular currencies must not exceed 9% of total assets, i.e. 9% of total liabilities,
- Observed aggregation for the position in all currencies, the total annual cumulative difference must not exceed 54% of total assets, i.e. 54% of total liabilities,
- Observed aggregation for the position in all currencies, the total semi-annual cumulative difference must not exceed 45% of total assets, i.e. 45% of total liabilities.

IV Interest rate risk (continued)

Lending interest rates applied to loans granted to corporate entities during 2011 are as follows:

Type of a loan	Interest rate per a year
Overdraft	8.50 - 14.0
Cash loans	4.75 - 15.0
Revolving loans	4.0 – 14.0
Loans for payment obligations to the suppliers	10.5 - 14.0
Factoring loans	11.5 - 15.0
Car loans	11.0 - 14.0
Refinancing loans to other bank liabilities	10.5 - 14.0
Loans based on 100% time deposit	pasivna kamatna stopa + 2.0 - 4.0
Loans for financing export receivables	10.0 - 13.5
Loans to financing the purchase of equipment	10.0 - 13.5
Loans to financing and adoption of business premises	10.0 - 13.5
Loans to financing the purchase of fixed assets	10.0 - 13.5
Loans for the preparation of tourist season	13.0
Mortgage loans	**12.5 - 15.0**

Lending interest rates applied to loans granted to retail customers during 2011 are as follows:

Type of a loan	Interest rate
Cash loans	0.9 - 1.5 p.m.
Mortgage loans	0.95 - 1.5 p.m.
Loans for renovation and construction	1.0 - 1.1 p.m.
Car loans with the deposit of 20%	1.1 - 1.4 p.m.
Loans for tourism development	1.0 - 1.2 p.m.
Loans for marines	1.0 - 1.2 p.m.
Loans for students	1.0 - 1.2 p.m.
Loans for retired	0.95 - 1.2 p.m.
Customer loans	0.9 - 1.4 p.m.
Overdraft	10.5 - 14.6 p.a.
Sprint loans	0.95 - 1.5 p.m.
Agricultural loans	1.1 p.m.
Loans for the purchase of goods	0.9 - 1.2 p.m.
Lombard loans on collateral securities	1.0 - 1.2 p.m.
Lombard loans based on collateral of term deposits of 100%	+2.5 p.m. to deposit interest rate

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

IV Interest rate risk (continued)

Deposit interest rates which were applicable on corporate entities during 2011 are as follows:

Deposit type	Interest rate per a year
Demand deposits to corporate entities	0.1 - 1.0
Time deposits in dollars - USD	1.2 - 2.0
Time deposits in euros - €	0.2 - 7.0
Time deposits in foreign currencies (AUD,CAD,CHF,GBP)	1.0 - 2.0

Deposit interest rates which were applicable on retail customers during 2011 are as follows:

Deposit type	Interest rate per a year
Children's savings Mravac - term cumulative savings	3.0 - 7.0
Term cumulative savings	3.0 - 7.0
Term savings in $, Term cumulative savings in $, Children's savings Mravac - term cumulative savings in $, Rent savings in $	1.2 - 2.0
Term savings in €	0.2 - 7.0
Term savings, Term cumulative savings, Children's savings Mravac - term cumulative savings, Rent savings - in foreign currencies (AUD, CAD, CHF, GBP)	1.2 - 2.0
Rent savings	3.0 - 7.0
Demand deposits	0.1 - 1

V Currency risk

The Decision issued by the Central Bank of Montenegro regarding minimal standards for management of credit risks in banks establishes the following limits regarding the open foreign currency position:

- Individual open position at the end of the day for the currencies of daily exchange rate on the reference list of the European Central Bank - max 15% of the core capital.
- The aggregate open position at the end of the day for the currencies of daily exchange rate on the reference list of the European Central Bank - max 20% of the core capital
- The net open positions at the end of the day for other currencies, may amount to no more than 5% of the core capital on an individual basis (currencies which are not at the reference exchange rate list of the European Central Bank)
- The net open positions at the end of the day for other currencies, may amount to no more than 10% of the core capital on an aggregate basis.

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

V Currency risk (continued)

As at December 31, 2011, foreign currency exposure of the Bank was as follows:

In thousands of EUR

	RSD	USD	GBP	CHF	Other	Total
Assets in foreign currencies	-	7,256	69	138	19	7,482
Liabilities in foreign currencies	-	7,450	67	137	3	7,657
Net foreign exchange exposure:						
- December 31, 2011	-	(194)	2	1	16	
- December 31, 2010.	-	(165)	24	3	11	
% of first-tier capital:						
- December 31, 2011	-	(0.83%)	0.01%	0.00%	0.07%	
- December 31, 2010.	-	(0.71%)	0.10%	0.02%	0.05%	
Aggregate open position:						
- December 31, 2011	(175)					
- December 31, 2010.	(127)					
% of first-tier capital:						
- December 31, 2011	(0.75%)					
- December 31, 2010.	(0.54%)					

VI
Country risk

In accordance with the Decision of the Central Bank of Montenegro on methodology for measuring country risk in the banks ("Official Gazette of Montenegro" no. 60/2008 and 40/2011), the Bank has adopted a Policy and Procedures of country risk management. Country risk presents a probability of incurring losses to the Bank, due to the inability to collect receivables from entities outside Montenegro because of political, social and economic reasons of the country where the seat of the debtor is.

Country risk as at December 31, 2011 was calculated using the current methodology Rating of debtor countries. Country risk management policy defines the following percentages of reserves in line with the "rating" of land the bank has exposure to (Standard & Poors):

Risk categories	Risk weight
Non-risk countries	0%
Low-risk countries	50-100%
Medium-risk countries	150-250%
High-risk countries	minimum 300%

As at December 31, 2011, the Bank has presented income from cancellation of reserves from the Bank's exposure to country risk in the amount of EUR 14 thousand (December 31, 2010: EUR 54 thousand).

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

VII Operational risk

In accordance with the Decision of the Central Bank of Montenegro on minimum standards for operational risk management in banks ("Official Gazette of Montenegro" no. 24/2009), which was adopted at the Council meeting of the Central Bank of Montenegro, held on February 23 and 24, 2009 the Bank has adopted a Policy for managing operational risk.

Operational risk is defined as the risk of loss due to improper or inappropriate conduct and actions of employees, inadequate and / or errors in processes and organization, inadequate and / or errors in systems and infrastructure or due to external factors and influences.

In accordance with the Decision of the Central Bank of Montenegro, the Bank is obliged to inform the Central Bank of losses arising from operational risk exceeding 1% of venture capital, at the latest within eight working days from the date of loss.

As at December 31, 2011, the provisions for operational risk amount to EUR 300 thousand (December 31, 2010: EUR 279 thousand).

VIII Internal control and intenal audit system

Organizational structure of the Bank establishes levels and lines of authority and responsibility with a clear delimitation between the function of management and leadership function. The management bodies are: the Assembly of the Bank and the Board of Directors of the Bank.

Bank is managed by the General Executive Director of the Bank.

The Bank, as a separate organizational unit, organized Internal Audit department. Internal audit department performs its activities in accordance with the internal audit procedures and annual plan of activities.

In accordance with these internal procedures the internal audit activities include but are not limited to:

- Compliance with relevant rules, guidelines, instructions and standards;
- Evaluation of the reliability of rules and division of duties within the banking operations;
- Review and estimation of effectiveness and benefits of financial and administrative controls;
- Monitoring the adequacy, reliability, safety integrity of accounting and other management information systems;
- Review of effectiveness and efficiency of banking operations;
- Testing the validity of measures used to achieve banking operations;
- Test and evaluation of the adequacy and effectiveness of internal control system;
- Review of application and effectiveness of risk management procedures and assessment of the methodology of risk assessment;
- Assessment of information systems, with special emphasis on electronic information systems and banking application;

B. REVIEW AND EVALUATION OF QUALITY AND FINANCIAL POSITION OF THE BANK (continued)

VIII Internal control and intenal audit system (continued)

- Assessment of the accuracy and reliability of accounting financial statements;
- Assessment of the banking system in the determination of capital in relation to the estimated risk;
- Testing of transactions and functioning of specific internal control procedures;
- Adherence to legal and statutory regulations, code of ethics, implementation of policies and procedures;
- Conducting special investigations.

When reporting to the Bank's management, internal audit operates independently in order to establish and report on the adequacy, reliability and effectiveness of controls used by the Bank's risk management, which has a preventive effect on achievement of the objectives of banking, and reporting whether the banking resources are used efficiently and effectively in achieving the objectives of banking.

C. REVIEW OF BANK'S ORGANIZATIONAL STRUCTURE

The Bank performs its activity in central office in Podgorica and branch offices in Podgorica, Bijelo Polje, Budva, Nikšić, Bar, Herceg Novi, Berane, Kotor and Ulcinj, as well as in branches in Podgorica, Tivat, Tuzi and Cetinje.

The Bank carries on business activities through the following bodies and organizational components:

1. **Assembly of Shareholders**

2. **The Board of Directors**
   - 2.1 The Audit Committee
   - 2.2 Credit Risk Management Committee
   - 2.3 Internal Audit Department
   - 2.4 Department for monitoring compliance with regulations
   - 2.5 The authorized person for the prevention of money laundering and terrorist financing.
   - 2.6 Head of Information Systems Security

3. **Chief Executive Officer**
   - 3.1 Administrative and HR Service
   - 3.2 Payments and fund management
   - 3.3 Domestic payments
   - 3.4 International Payments
   - 3.5 Fund management service
   - 3.6 Custody service
   - 3.7 Brokerage service sector

4. **Executive Director of Commercial Affairs**
   - 4.1 Commercial Sector
   - 4.2 New products development Service and Marketing
   - 4.3 Business Network

5. **Risk Management Executive Director**
    5.1 Risk Management Sector
    5.2 Loan Analysis Sector
    5.3 Sector for managing risk assets
    5.4 Risk monitoring and reporting sector
    5.5 Loan portfolio control department

C. REVIEW OF BANK'S ORGANIZATIONAL STRUCTURE (continued)

6. **Executive Director of Finance and Informatics**
    6.1 Division of Finance and Informatics
    6.2 Accounting and Reporting
    6.3 Department of General Affairs
    6.4 Service Billing
    6.5 IT Department

As of December 31, 2011, the Bank had 163 employees (December 31, 2010: 155 employees).

Qualification structure of the Bank, as at December 31, 2011 and 2010 were as follows:

	No. of employees	In %	No. of employees	In %
Masters	6	4	4	3
University degree (four years)	78	48	75	48
College degree (two years)	17	10	15	10
Bachelor	12	7	9	6
High school degree	50	31	52	33
Qualified	-	-		
	163	100	155	100

C. REVIEW OF BANK'S ORGANIZATIONAL STRUCTURE

The members of Board of Directors as at December 31, 2011 were:

Name	Function
Sigilfredo Montinari	President
Božana Kovačević	Vice president
Snježana Pobi	Member
Renata Vinković	Member
Esad Zaimović	Member

The members of Credit Risk Management Committee, as at December 31, 2011 were:

Name	Function
Renata Vinković	President
Esad Zaimović	Member
Snježana Pobi	Member

The members of the Audit Board, as at December 2011, were:

Name	Function
Marko Žigmund	President
Božana Kovačević	Member
Jovan Papić	Member

NAs at December 31, 2011 the Chief Executive Officer was Mr. Esad Zaimović.

As at December 31, 2011 Chief Internal Auditor was Mr. Veselin Ivanović.

D. REPORT IN SHORT FORM

In accordance with the Decision on Reports which banks submit to the Central Bank of Montenegro, the report in a short form consists of Auditor's opinion on financial statements of the bank, Income Statement and Balance Sheet, data on the composition of the Board of Directors, the Committee on Credit Risk Management and Supervisory Committee, information about the Chief Executive Officer and Internal Auditor of the Bank and data on performance indicators.

ERNST & YOUNG

INDEPENDENT AUDITORS' REPORT
TO THE OWNERS OF HIPOTEKARNA BANKA A.D., PODGORICA

Report on Financial Statements

We have audited the accompanying financial statements of Hipotekarna banka A.D., Podgorica (hereinafter: the Bank), which comprise the balance sheet as at December 31, 2011, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with the Law on Accounting and Auditing and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Podgorica, May 15, 2012

Ernst & Young Montenegro d.o.o.

Podqorica, Crna Gora

Ernst & Young Montenegro d.o.o.
Podgorica, Crna Gora

DRUŠTVO ZA REVIZIJU ERNST & YOUNG MONTENEGRO DOO PODGORICA

Stephen Fish
Partner

Draško Popović
Authorized auditor

Statement of income
for the year ended december 31, 2011

In thousands of EUR

	Notes	2011	2010
Interest income	3.1, 4a	11,405	9,634
Interest expenses	3.1, 4b	(3,873)	(3,433)
Net interest income		7,532	6,201
Provisions for losses	3.6, 5	(2,160)	(1,334)
Net income		5,372	4,867
Fee and commission income	3.1, 6a	3,817	3,105
Fee and commission expenses	3.1, 6b	(645)	(465)
Net fee and commission income		3,172	2,640
NET INTEREST, FEE AND COMMISSION INCOME		8,544	7,507
Other income, net	7	511	399
General expenses	8	(7,379)	(6,827)
NET INCOME BEFORE EXTRAORDINARY ITEMS		1,676	1,079
Extraordinary income		27	263
Extraordinary expenses		(13)	(35)
Net extraordinary income		14	228
PROFIT BEFORE TAXATION	9b	1,690	1,307
Income taxes	3.3, 9a	(168)	(15)
NET PROFIT FOR THE YEAR		1,522	1,292

The accompanying notes form an integral part of these financial statements.

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

Statement of financial position as of 31 december 2011

In thousands of EUR

	Notes	2011	2010
ASSETS			
Cash and deposit accounts held with depository institutions	10	38,500	24,247
Securities available for sale, other than shares		26	42
Loans and leases	11	109,470	98,352
Securities held to maturity	12	2,569	1,093
Factoring and forfeiting		9	-
Receivables in respect of custody operations		39	23
Business premises and other fixed assets	13	1,950	1,742
Acquired assets	14	478	485
Equity investments in other legal entities	15	230	99
Other assets	16	2,641	3,190
Less: Provision for potential losses on other assets	16	(319)	(485)
Total assets		155,593	128,788
LIABILITIES			
Deposits	17	97,853	85,133
Liabilities in respect of custody operations		247	49
Loans and borrowings	18	26,887	15,000
Liabilities to the Government	19	2,889	2,716
Other liabilities	20	3,952	3,773
Provisions for potential losses on off-balance sheet exposures	21	675	494
Total liabilities		132,503	107,165
EQUITY			
Share capital	22	16,006	16,006
Share premium		7,444	7,444
Revaluation reserves		(54)	1
Accumulated loss		(306)	(1,828)
Total equity		23,090	21,623
Total liabilities		155,593	128,788
OFF-BALANCE-SHEET ITEMS	24	388,819	289,488

The accompanying notes form an integral part of these financial statements.

These financial statements are approved by management of Hipotekarna banka A.D., Podgorica, on 16 January 2012 in Podgorica.

DATA ON COMPOSITION OF BOARD OF DIRECTORS, CREDIT RISK MANAGEMENT COMMITTEE, SUPERVISORY COMMITTEE, CHIEF EXECUTIVE OFFICER AND CHIEF INTERNAL AUDITOR OF THE BANK

As at December 31, 2011 the members of Bank's Board directors were:

Name	Function
Sigilfredo Montinari	President
Božana Kovačević	Vice President
Snježana Pobi	Member
Renata Vinković	Member
Esad Zaimović	Member

As at December 31, 2011 the members of Bank's Board directors were:

Name	Function
Renata Vinković	President
Esad Zaimović	Member
Snježana Pobi	Member

The members of the Audit Board, as at December 31, 2011 were:

Name	Function
Marko Žigmund	President
Božana Kovačević	Member
Jovan Papić	Member

As at December 31, 2011 the Chief Executive Officer was Mr. Esad Zaimović.

As at December 31, 2011 the Chief Internal auditor was Mr. Veselin Ivanović.

BANK'S PERFORMANCE INDICATORS AS AT DECEMBER 31, 2011

Bank's performance indicators as at December 31, 2011 and 2010 were as follows:

Indicators	2011	2010
Core equity	EUR 22,594 thousand	EUR 20,916 thousand
Additional equity	(54) thousand	-
Bank's funds	EUR 22,540 thousand	EUR 20,916 thousand
Weighted balance sheet assets	EUR 106,740 thousand	EUR 108,477 thousand
Solvency ratio	16,98%	15.54%
Return on average assets	1.07%	1.13%
Return on average equity	6.81%	6.16%

4.] About the Bank

Bank's management and organizational structure

Board of directors
Sigilfredo Montinari, Chairman
Božana Kovačević, Deputy Chairman
Snježana Pobi, Member
Renata Vinković, Member
Esad Zaimović, Member

Audit Board
Marko Žigmund, Chairman
Božana Kovačević, Member
Jovan Papić, Meber

Credit Risk Board
Renata Vinković, Chairman
Esad Zaimović, Member
Snježana Pobi, Member

Bank's Executives
Esad Zaimović CEO
Aleksandar Mitrović
Jelena Vuletić
Ana Golubović

Chief Internal Auditor
Veselin Ivanović

AML officer
Mirjana Jovanović

Administrative service and Human Resources
Boban Ličina

Compliance
Slavko Rakočević

Security of IT system
Haris Dizdarević

Divisions
Payment operations and Treasury, Nataša Lakić
Finance and IT
Risk, Goran Smolović
Commercial

Retail Network

P O D G O R I C A – Head offi ce, Josipa Broza Tita, No. 67
P O D G O R I C A, Slobode No. 19
P O D G O R I C A – Vektra, Bulevar revolucije, No. 2A
P O D G O R I C A - Blok VI, Djoka Mirasevica M3
TUZI, Tuzi bb
N I K Š I Ć, Save Kovacevica No. 6
BIJELO POLJE, Slobode bb
B A R, Marsala Tita, No. 15
B U D V A, Mediteranska, No. 4
C E T I N J E, Bajova, No. 74
K O T O R, Shopping Center Kamelija - Trg Mata Petrovica
T I V A T, 21. novembra, No. 21
HERCEG NOVI, Njegoseva, No. 52
B E R A N E, Mojsija Zecevica bb
U L C I N J, 26. novembra bb