



**Offering of up to 2,200,000 shares**

**Price EUR 11.5 per share**

**Subscription period 11 September 2019 – 25 September 2019**

## **SECONDARY OFFERING, LISTING AND ADMISSION TO TRADING PROSPECTUS**

This Secondary Offering, Listing and Admission to Trading Prospectus (the **Prospectus**) has been drawn up and published by AS LHV Group (an Estonian public limited company, registered in the Estonian Commercial Register under register code 11098261, having its registered address at Tartu mnt 2, 10145 Tallinn, Estonia; the **Company**) in connection with the secondary offering, listing and admission to trading of up to 2,200,000 newly issued shares with the nominal value of EUR 1 (the **Offer Shares**) by the Company to the existing shareholders (the **Offering**) by virtue of a rights issue on terms and conditions as described in this Prospectus. The Offering comprises of an offering to retail investors in Estonia and of an offering to institutional investors in and outside of Estonia to qualified investors within the meaning of Article 2(e) of the Prospectus Regulation and other types of investors in reliance on certain exemptions available under the laws of each jurisdiction where the Offering is being made. A public offering will be carried out only in Estonia and there will not be any public offering in any other jurisdiction.

The shareholders of the Company entered into the shareholders list of the Company on 4 September 2019 at the end of the business day of the settlement system of the Estonian Register of Securities (the **ERS**) shall be granted a preferential right to subscribe for the Offer Shares (the **Subscription Rights**). The Offer Shares are offered for the price of EUR 11.5 per one Offer Share (the **Offer Price**), of which EUR 1 is the nominal value of one Offer Share and 10.5 is the issue premium. The Offer Shares may be subscribed for during the period commencing on 11 September 2019 and ending on 25 September 2019 (the **Subscription Period**) in accordance with the terms and conditions described in this Prospectus. The Company reserves the right to cancel the Offering or change the terms and conditions thereof as described in this Prospectus.

The Company's shares (the **Shares**) have been admitted to trading on the Baltic Main List of the Nasdaq Tallinn Stock Exchange as of 23 May 2016. In connection with the Offering, the Company has applied for the listing and admission to trading of the Subscription Rights and will apply for the listing and the admission to trading of the Offer Shares on the Baltic Main List of the Nasdaq Tallinn Stock Exchange. Trading with the Subscription Rights is expected to commence on 11 September 2019 and will conclude on 23 September 2019. It is estimated that trading with the Shares will commence on or about 14 October 2019 following the registration of the Offer Shares at the Estonian Commercial Register.

After registration of the Offer Shares with the Estonian Commercial Register, the Offer Shares will rank *pari passu* with all the existing Shares and the Offer Shares will be eligible for any dividends declared and paid on the Shares for the financial period starting on 1 January 2019, and for any dividends declared and paid for any subsequent financial period.

This Prospectus has been approved by the Estonian Financial Supervision Authority (the **EFSA**) on 9 September 2019 under registration number 4.3-4.9/3970. The Prospectus has been drawn up as

simplified prospectus for secondary issuances in accordance with Article 14 of the Prospectus Regulation No 1129/2017/EU.

**Investing into the Offer Shares involves risks inherent to investments in capital market equity instruments and risks connected with the Company's and its subsidiaries' (the Group) operations and business environment. While every care has been taken to ensure that this Prospectus presents a fair and complete overview of the risks related to the Company, the operations of the Company and its subsidiaries and to the Offer Shares, the value of any investment in the Offer Shares may be adversely affected by circumstances that are either not evident at the date hereof or not reflected in this Prospectus. The contents of this Prospectus are not intended to be construed as legal, financial or tax advice. Each prospective investor should consult its own legal advisor, financial advisor or tax advisor for such advice.**

#### **NOTICE TO ALL INVESTORS**

This Prospectus does not constitute or form part of any offer or invitation to sell or issue, or any solicitation of any offer to acquire the Subscriptions Rights or Offer Shares offered by any person in any jurisdiction in which such an offer or solicitation is unlawful, in particular in or into the Restricted Territories or the Excluded Territories. The Subscriptions Rights or Offer Shares have not been and will not be registered under the relevant laws of any state, province or territory other than Estonia and may not be offered, sold, transferred or delivered, directly or indirectly, within any other jurisdiction than Estonia, except pursuant to an applicable exemption.

Distribution of copies of the Prospectus or any related documents are not allowed in those countries where such distribution or participation in the Offering requires any extra measures or is in conflict with the laws and regulations of these countries. Persons who receive this Prospectus or any related document should inform themselves about any restrictions and limitations on distribution of the information contained in this Prospectus and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. In particular, such documents should not be distributed, forwarded to or transmitted in or into the Restricted Territories or the Excluded Territories. No action has been taken by the Company in relation to the Offer Shares or rights thereto or possession or distribution of this Prospectus in any jurisdiction where action is required, other than in Estonia. The Company is not liable in cases where persons or entities take measures that are in contradiction with the restrictions mentioned in this paragraph.

#### **INFORMATION FOR UNITED STATES INVESTORS**

The Subscription Rights nor the Offer Shares have not been approved or disapproved by any United States' regulatory authority. Neither the Subscription Rights to be issued to the existing shareholders of the Company in connection with the Offering nor the Offer Shares will be, and are not required to be, registered with the SEC under the US Securities Act of 1933, as amended (the **Securities Act**) or on a United States securities exchange. The Company does not intend to take any action to facilitate a market for the Subscription Rights and/or the Offer Shares in the United States. The Subscription Rights and the Offer Shares may not be offered, sold, resold, transferred or delivered, directly or indirectly, within the United States except pursuant to an applicable exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States.

## TABLE OF CONTENTS

1.	INTRODUCTORY INFORMATION .....	6
1.1.	Applicable Law and Jurisdiction .....	6
1.2.	Persons Responsible and Limitations of Liability .....	6
1.3.	Presentation of Information .....	6
1.4.	Documents on Display .....	8
1.5.	Accounting Principles .....	8
1.6.	Forward-Looking Statements .....	8
1.7.	Use of Prospectus .....	9
1.8.	Approval of Prospectus .....	9
1.9.	Availability of the Prospectus .....	9
2.	SUMMARY .....	10
3.	RISK FACTORS.....	17
3.1.	Introduction.....	17
3.2.	Business Risks.....	17
3.3.	Political, Economic and Legal Risks .....	22
3.4.	Risks Related to Shares, Offering and Listing .....	26
4.	TERMS AND CONDITIONS OF OFFERING.....	29
4.1.	The Offering .....	29
4.2.	Subscription Rights .....	30
4.3.	Right to Participate in the Offering .....	30
4.4.	Trading in Subscription Rights .....	31
4.5.	Offer Price .....	31
4.6.	Subscription Period .....	31
4.7.	Subscription Undertakings .....	31
4.8.	Payment .....	34
4.9.	Distribution and Allocation.....	34
4.10.	Settlement and Trading.....	35
4.11.	Return of Funds.....	35
4.12.	Cancellation of Offering.....	35
4.13.	Conflicts of Interests.....	36
4.14.	Dilution .....	36
4.15.	Listing and Admission to Trading .....	36

5.	REASONS FOR OFFERING AND USE OF PROCEEDS .....	37
6.	DIVIDEND POLICY .....	38
7.	GENERAL CORPORATE INFORMATION AND ARTICLES OF ASSOCIATION.....	39
7.1.	General Corporate Information .....	39
7.2.	Articles of Association .....	39
8.	SHARE CAPITAL, SHARES AND OWNERSHIP STRUCTURE.....	41
8.1.	Share Capital and Shares .....	41
8.2.	Shareholders of the Company .....	41
8.3.	Rights of Shareholders.....	42
8.4.	Management and Key Employees Share Option Program.....	45
9.	MANAGEMENT.....	47
9.1.	Management Structure.....	47
9.2.	Management Board.....	47
9.3.	Supervisory Board.....	48
9.4.	Other Key Executive Personnel .....	51
9.5.	Audit Committee.....	53
9.6.	Remuneration Committee .....	53
9.7.	Risk and Capital Committee.....	54
9.8.	Remuneration and Benefits.....	54
9.9.	Share Ownership .....	54
9.10.	Conflicts of Interests and Other Declarations .....	55
9.11.	Statement of Compliance with Corporate Governance.....	55
9.12.	Statutory Auditors.....	55
10.	PRINCIPAL ACTIVITIES AND MARKETS .....	57
10.1.	History and Development of Group.....	57
10.2.	Group Structure and Group Companies .....	58
10.3.	Business Segments .....	60
10.4.	Investments .....	61
10.5.	Trend Information .....	62
10.6.	Material Agreements .....	63
10.7.	Legal Proceedings.....	63
10.8.	Related Party Transactions.....	63
10.9.	Regulatory Disclosures .....	64
11.	SELECTED FINANCIAL INFORMATION .....	66

11.1.	Introduction.....	66
11.2.	Selected Historical Financial Information.....	66
12.	CAPITALISATION AND INDEBTEDNESS.....	72
13.	FINANCIAL CONDITION, RESULTS OF OPERATIONS AND OUTLOOK.....	74
a.	Financial Condition and Results of Operations.....	74
b.	Factors and Public Policies Affecting Operations.....	74
14.	UNAUDITED PRO FORMA FINANCIAL INFORMATION.....	77
15.	PROFIT FORECAST.....	83
16.	TAXATION.....	85
17.	GLOSSARY.....	87
18.	LIST OF ANNEXES.....	92

# 1. INTRODUCTORY INFORMATION

## 1.1. Applicable Law and Jurisdiction

The Prospectus has been drawn up in accordance with Regulation No 2017/1129/EU of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC (the **Prospectus Regulation**) and in accordance with Commission Delegated Regulation No 2019/980/EU of 14 March 2019 supplementing Regulation No 2017/1129/EU of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation No 809/2004/EC (the **Delegated Regulation**), in particular the Annexes 3, 12 and 20 thereof. This Prospectus has been drawn up as simplified prospectus for secondary issuances in accordance with Article 14 of the Prospectus Regulation.

This Prospectus is governed by Estonian law. Any disputes arising in connection with the Offering shall be settled by Harju County Court (*Harju maakohus*) in Estonia unless the exclusive jurisdiction of any other court is provided for by the provisions of law, which cannot be derogated from by an agreement of the parties.

Before reading this Prospectus, please take notice of the following important introductory information.

## 1.2. Persons Responsible and Limitations of Liability

The person responsible for the information given in this Prospectus is AS LHV Group (the **Company**). The Company accepts responsibility for the fullness and correctness of the information contained in this Prospectus as of the date hereof. Having taken all reasonable care to ensure that such is the case, the Company believes that the information contained in this Prospectus is, to the best of the Company's knowledge, in accordance with the facts, and contains no omission likely to affect its import.

**AS LHV Group**

**Madis Toomsalu**

*Member of the Management Board*



Without prejudice to the above, no responsibility is accepted by the persons responsible for the information given in this Prospectus solely based on the summary of this Prospectus, unless such summary is misleading, inaccurate or inconsistent when read together with the other parts of the Prospectus or it does not provide, when read together with the other parts of the Prospectus, key information in order to aid the investors when considering whether to invest in the Offer Shares.

## 1.3. Presentation of Information

Rounding of Numbers. Numerical and quantitative values in this Prospectus (e.g. monetary values, percentage values, etc.) are presented with such precision that is deemed by the Company to be sufficient in order to convey adequate and appropriate information on the relevant matter. From time to time, quantitative values have been rounded up to the nearest reasonable decimal or whole value in

order to avoid excessive level of detail. As a result, certain values presented as percentages do not necessarily add up to 100% due to the effects of rounding. Exact numbers may be derived from the Financial Statements, to the extent that the relevant information is reflected therein.

Currencies. In this Prospectus, financial information is presented in euro (EUR), the official currency of the European Union Member States in the Eurozone.

Date of Financial Information. The annual financial information included in this Prospectus has been extracted or derived from the consolidated audited financial statements of and for the year ended 31 December 2018, including the comparative financial information as of and for the year ended 31 December 2017 (the **Audited Financial Statements**) of the Group prepared in accordance with the International Financial Reporting Standards as adopted in the European Union (**IFRS**) and the Estonian Accounting Act. The Audited Financial Statements have been audited by AS PricewaterhouseCoopers. The Audited Financial Statements, together with the audit report thereon, are included in this Prospectus.

The interim financial information included in this Prospectus as of and for the six months ended 30 June 2019, including the comparative financial information as of and for the six months ended on 30 June 2018, has been extracted or derived from the unaudited condensed consolidated interim financial statements as of and for the period ended 30 June 2019 (the **Interim Financial Statements**) prepared in accordance with International Accounting Standards (IAS) 34, Interim Financial Reporting. The Interim Financial Statements have been reviewed by AS PricewaterhouseCoopers and are, together with the respective review report thereon, included in this Prospectus. The Audited Financial Statements, together with the Interim Financial Report are referred as the **Financial Statements** in this Prospectus.

In the Interim Financial Statements, the Group introduced amendments as compared to the unaudited interim financial statements for 6 months ended 30 June 2019, published on 16 July 2019 by the Company. These Interim Financial Statements replace the previously published version. Such changes are described in detail in Note 1 to the Interim Financial Statements.

Where not expressly indicated otherwise, all information presented in this Prospectus (including the consolidated financial information of the Group, the facts concerning its operations and any information on the markets in which it operates) must be understood to refer to the state of affairs as of the date of the Prospectus. Where information is presented as of a date other than the date of this Prospectus, this is identified by specifying the relevant date.

Third Party Information and Market Information. For portions of this Prospectus, certain information may have been sourced from third parties. Such information is accurately reproduced and as far as the Company is aware and is able to ascertain from the information published by such third parties, no facts have been omitted which would render the reproduced information inaccurate or misleading. Certain information with respect to the markets in which the Company and its subsidiaries operate is based on the best assessment made by the Management (as defined in Section "Glossary"). With respect to the industry in which the Company and its subsidiaries are active and certain jurisdictions in which they conduct their operations, reliable market information is often not available or is incomplete. While every reasonable care was taken to provide best possible assessments of the relevant market situation and the information on the relevant industry, such information may not be relied upon as final and conclusive. Investors are encouraged to conduct their own investigation of the relevant markets or employ a professional consultant.

Updates. The Company will update the information contained in this Prospectus only to such extent and at such intervals and by such means as required by the applicable law or considered necessary and appropriate by the Management. The Company is under no obligation to update or modify forward-

looking statements included in this Prospectus (please refer to Section “Forward-Looking Statements” below).

Definitions of Terms. In this Prospectus, capitalised terms have the meaning ascribed to them in Section “Glossary”, with the exception of such cases where the context evidently requires to the contrary, whereas the singular shall include plural and vice versa. Other terms may be defined elsewhere in the Prospectus.

Alternative Performance Measures. This Prospectus contains certain financial measures that are not defined or recognised under IFRS and which are considered to be "alternative performance measures" as defined in the "ESMA Guidelines on Alternative Performance Measures" issued by the European Securities and Markets Authority on 5 October 2015 (the **Alternative Performance Measures**). These APMs are not defined by, or presented in accordance with, IFRS. The APMs are unaudited and are not measurements of the Company's operating performance under IFRS and should not be considered as alternatives to any measures of performance under IFRS or as measures of the Company's liquidity. The Company's use and method of calculation of APMs may vary from other companies' use calculation of such measures.

References to the Company's website. This Prospectus contains references to the Company's website. The Company is not incorporating by reference into this Prospectus any information posted on such website.

#### 1.4. Documents on Display

In addition to this Prospectus, the following documents are on display:

- (i) the Articles of Association available at the website of the Company at [https://investor.lhv.ee/assets/files/AS\\_LHV\\_Group\\_Articles\\_of\\_Association-EN.pdf](https://investor.lhv.ee/assets/files/AS_LHV_Group_Articles_of_Association-EN.pdf);
- (ii) the reviewed condensed consolidated financial statements of the Group as at and for the 6-month period ended 30 June 2019 available at the website of the Company at [https://investor.lhv.ee/assets/files/LHV\\_Group\\_Interim\\_Report\\_Reviewed\\_2019\\_Q2-EN.pdf](https://investor.lhv.ee/assets/files/LHV_Group_Interim_Report_Reviewed_2019_Q2-EN.pdf);
- (iii) the audited consolidated annual report of the Group for the financial year ended on 31 December 2018 prepared for statutory purposes available at the website of the Company at [https://investor.lhv.ee/assets/files/LHV\\_Group\\_Annual\\_Report\\_2018-EN.pdf](https://investor.lhv.ee/assets/files/LHV_Group_Annual_Report_2018-EN.pdf);

Further the company announcements published by the Company via the information system of the Nasdaq Tallinn Stock Exchange available at <http://www.nasdaqbaltic.com> may be inspected.

#### 1.5. Accounting Principles

The Audited Financial Statements have been prepared in accordance with IFRS as adopted by the EU. The Interim Financial Statements have been prepared in accordance with International Accounting Standard (IAS) 34 “Interim Financial Reporting”.

#### 1.6. Forward-Looking Statements

This Prospectus includes forward-looking statements (notably under Sections “Summary”, “Risk Factors”, “Reasons for Offering and Use of Proceeds” and “Principal Activities and Markets”. Such forward-looking statements are based on current expectations and projections about future events, which are in turn made on the basis of the best judgment of the Management. Certain statements are based on the beliefs of the Management as well as assumptions made by and information currently available to the Management. Any forward-looking statements included in this Prospectus are subject

to risks, uncertainties and assumptions about the future operations of the Group, the macroeconomic environment and other similar factors.

In particular, such forward-looking statements may be identified by the use of words such as “strategy”, “expect”, “plan”, “anticipate”, “believe”, “will”, “continue”, “estimate”, “intend”, “project”, “goals”, “targets” and other words and expressions of similar meaning. Forward-looking statements can also be identified by the fact that they do not relate strictly to historical or current facts. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances, and the Company is under no obligation to, and expressly disclaims any obligation to, update or alter its forward-looking statements contained in this Prospectus whether as a result of such changes, new information, subsequent events or otherwise.

The validity and accuracy of any forward-looking statements is affected by the fact that the Group operates in a highly competitive business. This business is affected by changes in domestic and foreign laws and regulations (including those of the European Union), taxes, developments in competition, economic, strategic, political and social conditions, consumer response to new and existing products and technological developments and other factors. The Group’s actual results may differ materially from the Management’s expectations because of the changes in such factors. Other factors and risks could adversely affect the operations, business or financial results of the Group (please refer to Section 0 “Risk Factors” for a discussion of the risks which are identifiable and deemed material at the date hereof).

### **1.7. Use of Prospectus**

This Prospectus is prepared solely for the purposes of the Offering of the Offer Shares and listing and the admission to trading of the Offer Shares on the Baltic Main List of the Nasdaq Tallinn Stock Exchange. No public offering of the Offer Shares is conducted in any jurisdiction other than Estonia and consequently the dissemination of this Prospectus in other countries may be restricted or prohibited by law. This Prospectus may not be used for any other purpose than for making the decision of participating in the Offering or investing into the Shares. You may not copy, reproduce (other than for private and non-commercial use) or disseminate this Prospectus without express written permission from the Company.

### **1.8. Approval of Prospectus**

This Prospectus has been approved by the Estonian Financial Supervision Authority (the **EFSA**) on 9 September 2019 under registration number 4.3-4.9/3970. The EFSA only approves this Prospectus as meeting the standards of completeness, comprehensibility and consistency imposed by the Regulation (EU) 2017/1129 and should not be regarded as endorsement of the Company or the Offer Shares.

### **1.9. Availability of the Prospectus**

This Prospectus and its Estonian language summary will be published by means of a stock exchange release through the information system of Nasdaq Tallinn Stock Exchange. The Prospectus and its Estonian language summary are also available as of 9 September 2019 in an electronic form on the website of the Estonian Financial Supervision Authority ([www.fi.ee](http://www.fi.ee)) and on the website of the Company (<https://investor.lhv.ee/en/>). Any interested party may request delivery of an electronic copy of the Prospectus and its Estonian language summary from the Company without charge. Paper copy of the Prospectus shall be delivered to any interested parties upon request. Delivery of the Prospectus by the Company is limited to the jurisdictions in which the offering to the public is being made, i.e. to Estonia.

## 2. SUMMARY

Introduction and warnings																					
<p>This Summary (<b>Summary</b>) should be read as an introduction to Prospectus and any decision to invest in the Offer Shares by the investors should be based on consideration of the Prospectus as a whole. The information in the Summary is presented as of the Prospectus registration date, unless indicated otherwise. Civil liability in relation to this Summary attaches only to those persons who have tabled the Summary, including any translation thereof, but where the Summary is misleading, inaccurate or inconsistent when read together with the other parts of the Prospectus, or where it does not provide, when read together with the other parts of the prospectus, key information in order to aid investors when considering whether to invest in the Offer Shares. Investment into Offer Shares involves risks and the investor may lose all or part of the investment. The investor may be required under national law to bear the costs of translating the Prospectus before being able to bring a claim to the court in relation to this Prospectus.</p>																					
Name and international securities identification number (ISIN) of the Offer Shares	<b>LHV Group share, ISIN EE3100073644</b>																				
The identity and contact details of the issuer, including its legal entity identifier (LEI);	The business name of the issuer is AS LHV Group (the <b>Company</b> ). The Company is registered at the Estonian Commercial Register under registry code 11098261. The contact details of the Company are the following: address Tartu mnt 2, 10145 Tallinn, Estonia, phone +372 6 800 400, e-mail <a href="mailto:lhv@lhv.ee">lhv@lhv.ee</a> . The Company's LEI is 529900JG015JC10LED24.																				
The identity and contact details of the competent authority approving the prospectus, date of approval of the prospectus	This Prospectus has been approved by the Estonian Financial Supervision Authority (the <b>EFSA</b> ) under registration number 4.3-4.9/3970 on 9 September 2019. The contact details of the EFSA are the following: address: Sakala 4, 15030, Tallinn, Estonia, phone +372 668 0500, e-mail <a href="mailto:info@fi.ee">info@fi.ee</a> .																				
Key information on the issuer																					
<p><i>Who is the issuer of the securities?</i></p> <p>The business name of the issuer is AS LHV Group (the <b>Company</b>). The Company has been established and is currently operating under the laws of the Republic of Estonia in the form of a public limited company (in Estonian: <i>aktsiaselts</i> or AS) and is established for an indefinite term. The Company is the holding company of the group. The Company's group includes four consolidated subsidiaries (the <b>Group</b>), 100% owned AS LHV Pank, AS LHV Varahaldus, Cuber Technology OÜ and 65% owned AS LHV Finance. The Company's own operations are limited to engaging in investor relations management and ensuring necessary capitalisation for the Group companies. AS LHV Pank acts as an Estonian licensed credit institution offering banking services to corporate and retail clients. AS LHV Varahaldus operates as an Estonian licensed fund manager, managing traditional funds as well as Estonian II and III pillar pension funds. AS LHV Finance is an Estonian financial institution offering hire-purchase services in the Estonian market. Cuber Technology OÜ was established as a start-up company in 2015 with the purpose to innovate financial services using Blockchain technology, but its operations to date are very limited. The Group's reportable business segments are (i) Retail banking; (ii) Private banking; (iii) Corporate banking; (iv) Asset management; (v) Hire-purchase and consumer finance in Estonia; (vi) other activities.</p> <p>As at the date of this Prospectus, the shareholders holding over 5% of all Shares in the Company are the following:</p>																					
<table border="1"> <thead> <tr> <th>Name of Shareholder</th> <th>Number of Shares</th> <th>Proportion</th> <th>Person directly or indirectly controlling the Shareholder</th> </tr> </thead> <tbody> <tr> <td>AS Lõhmus Holdings</td> <td>3,357,920</td> <td>12.79%</td> <td>Mr Rain Lõhmus, the Chairman of the Supervisory Board of the Company</td> </tr> <tr> <td>Mr Rain Lõhmus</td> <td>2,538,367</td> <td>9.67%</td> <td>N/A</td> </tr> <tr> <td>Viisemann Investments AG</td> <td>2,111,344</td> <td>8.04%</td> <td>Mr Andres Viisemann, Member of the Supervisory Board of the Company</td> </tr> <tr> <td>Ambient Sound Investments OÜ</td> <td>1,595,620</td> <td>6.08%</td> <td>Ahti Heinla, Annika Tallinn, Jaan Tallinn, Priit Kasesalu, Toivo Annus (based on Estonian Commercial Register beneficial ownership data)</td> </tr> </tbody> </table>		Name of Shareholder	Number of Shares	Proportion	Person directly or indirectly controlling the Shareholder	AS Lõhmus Holdings	3,357,920	12.79%	Mr Rain Lõhmus, the Chairman of the Supervisory Board of the Company	Mr Rain Lõhmus	2,538,367	9.67%	N/A	Viisemann Investments AG	2,111,344	8.04%	Mr Andres Viisemann, Member of the Supervisory Board of the Company	Ambient Sound Investments OÜ	1,595,620	6.08%	Ahti Heinla, Annika Tallinn, Jaan Tallinn, Priit Kasesalu, Toivo Annus (based on Estonian Commercial Register beneficial ownership data)
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<p>In accordance with the Estonian law, the operational management of the Company is structured as a two-tier system. The Management Board is responsible for the day-to-day management of the Company's operations and is authorised to represent the Company based on the law and the Articles of Association. The Supervisory Board of the Company is responsible for the strategic planning of the business activities of the Company and for supervising the activities of the Management Board.</p> <p>As at the date of this Prospectus the Company has one member of the Management Board – Mr Madis Toomsalu. The authorities of Mr Madis Toomsalu as the member of the Management Board commenced on 5 December 2016 and will remain valid until 5 December 2021. The Supervisory Board of the Company includes seven members – Mr Rain Lõhmus (the Chairman of the Supervisory Board; since 21 May 2014), Mr Raivo Hein (since 18 January 2010), Mr Heldur Meerits (since 18 December 2008), Mrs Tiina Mõis (since 8 December 2006), Mr Tauno Tats (since 21 May 2014), Mr Andres Viisemann (since 7 September 2004) and Mr Sten Tamkivi (since 29 April 2015). The authorities of all referred persons as the members of the Supervisory Board will remain valid until 29 March 2020.</p> <p>AS PricewaterhouseCoopers (registry code 10142876; having its registered address at Pärnu mnt 15, 10141 Tallinn, Estonia) is acting as the statutory auditor of the Company for the financial years 2018 – 2019. The Audited Financial Statements have been audited, and the Interim Financial Statements have been reviewed by AS PricewaterhouseCoopers. In addition, AS PricewaterhouseCoopers, acting in line with the Delegated Regulation, has issued a report concerning the Pro Forma Financial Information included in this Prospectus. KPMG</p>																					

Baltics OÜ has been appointed to act as the statutory auditor of the Company for the three subsequent financial years (2020 – 2022). Both AS PricewaterhouseCoopers and KPMG Baltics OÜ are members of the Estonian Auditing Board.

*What is the key financial information regarding the issuer?*

The Table 1 and Table 2 set forth the key financial information as at the end of each of the financial years ended 31 December 2017 and 31 December 2018 and the six months ended 30 June 2019 and 30 June 2018 which have been extracted or derived from the Audited Financial Statements and Interim Financial Statements included to this Prospectus respectively. The information has been presented in accordance with Annex III of European Commission Delegated Regulation 2019/979/EU as deemed most appropriate in relation to the Offer Shares by the Company.

**Table 1** Consolidated Statement of Comprehensive Income

(in TEUR)	31.12.2018	31.12.2017 <sup>1</sup>	30.06.2019	30.06.2018
	<i>audited</i>	<i>audited</i>	<i>reviewed</i>	<i>unaudited</i>
Net interest income	38 151	30 361	22 572	18 407
Net fee and commission income	25 045	20 989	12 837	12 805
Foreign exchange rate gains/losses	64	265	-7	-6
Net gains from financial assets	443	979	381	248
Profit before impairment losses on loans and advances	32 358	24 785	17 276	16 018
Net profit for the reporting period	27 189	22 177	12 665	14 295 <sup>2</sup>
Total profit attributable to owners of the parent	25 237	19 603	11 788	13 474
Earnings per share	0.97	0.77	0.45	0.52

**Notes**

<sup>1</sup> In 2018 financial statements, the Group presented results of UAB "Mokilizingas", a subsidiary of LHV Pank, as discontinued operations, due to the sale of company in May 2018. Consequently, comparative data for 2017 were restated accordingly. For purposes of this Prospectus, financial data for 2017 is presented on restated basis.

<sup>2</sup> Includes profit from discontinued operations (see note 1).

**Table 2** Consolidated statement of financial position

(in TEUR)	31.12.2018	31.12.2017	30.06.2019
	<i>audited</i>	<i>audited</i>	<i>reviewed</i>
Total assets	1 677 100	1 772 856	2 374 714
Senior debt <sup>2</sup>	21 584	6 000	28 591
Subordinated debt	50 900	30 900	75 000
Loans and advances to customers	918 761	732 043	1 117 904
Receivables from customers	3 721	9 800	9 504
Deposits from customers	1 422 198	1 536 929	2 083 387
Total equity	157 763	127 955	164 539
Non-performing loans (more than 60 days past due) % of the credit portfolio	1.41%	2.41%	1.27%
Core Tier 1 CAD <sup>1</sup> (ratio, %)	14.88	14.02	12.12
CAD <sup>1</sup> (ratio, %)	20.91	18.30	19.16
Leverage ratio <sup>1</sup> (ratio) %	6.56	5.01	6.929

**Notes**

<sup>1</sup> As reported to the competent authorities and calculated in accordance with the capital requirements regulation No 575/2013/EU and (the **CRR**) and capital requirements directive No 2013/36/EU (the **CRDIV**) and other legislative acts. The ratio has not been audited.

<sup>2</sup> In the Financial Statement of the Group, senior debt is not separately reported and is included in the "Deposits from customers and loans received".

The summary of the unaudited consolidated pro forma statement of financial position as at 30 June 2019 set forth in Table 3 has not been derived from the Financial Statements and has been prepared solely for inclusion to this Prospectus. The summary of the unaudited pro forma consolidated statement of financial position as at 30 June 2019 shown in the tables below presents hypothetically the Group's financial position as though the planned acquisition of the Danske Bank A/S Estonian branch's private loans' unit consisting of mainly private loans (the **Danske Loan Portfolio**) had taken place at 30 June 2019. The unaudited pro forma financial information has been produced for illustrative purposes only and because of its nature addresses a hypothetical situation and, therefore, does not represent the Group's actual financial position or results.

**Table 3** Unaudited consolidated pro forma statement of financial position as at 30 June 2019

(in TEUR)	Group	Pro forma adjustments		Pro forma
		Danske Loan Portfolio purchase	Impairment related to Danske Loan Portfolio	
	Note 1	Note 2	Note 3	the Offering Note 4

Total assets	2 374 714	0	-1 539	25 150	2 398 325
Total liabilities	2 210 175	0	-215	0	2 209 960
Total equity attributable to owners of the parent	160 740	0	-1 324	25 150	184 566
Total equity	164 539	0	-1 324	25 150	188 365
Total liabilities and equity	2 374 714	0	-1 539	25 150	2 398 325

#### Notes

<sup>1</sup> Consolidated financial position for the Group for the period ended 30 June 2019 has been compiled based on the Interim Financial Statements.

<sup>2</sup> The purpose of the adjustment is to illustrate the effect of acquisition of the Danske Loan Portfolio as though it occurred at 30 June 2019. LHV Pank is planning to acquire the Danske Loan Portfolio for cash consideration of an estimated EUR 408 million and consequently, the transaction will cause a decrease in cash balances of the Group in central banks. There are no material costs relating to the portfolio acquisition, consequently no pro forma adjustment was calculated in that respect. The estimates are based on the best knowledge of the Management Board and represent the best estimate according to their knowledge as of the date of this Prospectus. Purchase price and the final scope of the Danske Loan Portfolio will be determined upon closing and will be calculated as the size of the portfolio minus a discount of EUR 39 million (the **Purchase Price**). The portfolio size is expected to amortise to approx. EUR 447 million by closing of the acquisition, in which case the Purchase Price will be approx. EUR 408 million. Based on initial analysis performed from the data available by Management Board, the loans will be classified as measured at amortised cost, however final analysis will be performed after completion of the transaction and certain loans may, pursuant to requirements of IFRS 9, be classified at fair value through profit or loss.

<sup>3</sup> The purpose of the adjustment is to illustrate the effect of an impairment test and the impairment charge that the Group expects to apply at inception of the Danske Loan Portfolio. Estimated impairment amount is based on the Management Board's application of the Group's Expected Credit Losses model with respect to acquired portfolio. At the date of this Prospectus the Management Board has only limited knowledge and detailed data on the acquired portfolio and the impairment charge estimate reflects the best knowledge of the Management Board in the circumstances. The Management Board does not expect the final impairment charge to be materially different than the estimate. The Group estimates an impairment charge in the amount of EUR 1 539 thousand. Tax effect (decrease of tax liabilities) in the amount of EUR 215 thousand is presented in accounts payable and other liabilities. In accordance with the laws of Estonia, no deferred tax asset is recognized in relation to the impairment charge. The effect of the impairment is recognized in equity (retained earnings).

<sup>4</sup> The acquisition of the Danske Loan Portfolio is subject to raising the additional own funds needed by the Group in relation to the transaction by this Offering. It was assumed that the gross proceeds of the Offering will amount to EUR 25.3 million and the Offering related expenses (reducing cash received and the share premium) will amount to EUR 0.15 million. There is no impact to taxes.

#### What are the key risks that are specific to the issuer?

- The Group may suffer losses from its counterparties' inability to meet its obligations to the Group companies.
- The Group's operations are concentrated to the highly competitive Estonian market, with a large portion of the loan portfolio being concentrated in the real estate, manufacturing and financial services sectors. Therefore, adverse developments or further increase of competition in Estonia or in the above sectors may have a material adverse effect on the Group.
- The Group's is exposed to market risk due to its trading and investment activities in the financial markets, primarily in interest rate products, foreign exchange and stock markets as well as from borrowing activities and other means of taking in financial resources. Further, the operations of the Group and foremost the operations of LHV Pank are inherently exposed to interest rate risk as interest rates are affected by numerous factors beyond the control of the Group companies, which may not be estimated adequately.
- Liquidity risk relates to the ability of the Group to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The Group's risk policies and internal procedures may not be adequate or sufficient in order to ensure the Group's access to funding resources when needed, to the extent needed or on favourable terms in order to ensure sufficient liquidity.
- The Group companies may not be able to raise funds from the money and capital markets on terms comparable with that of the current funding of at the expected terms, and it may have an adverse effect on the Group's business operations, its performance or its financial position.
- The Group is exposed to operational risk, which is a risk of potential loss caused by human, process or information system failures and flaws. In addition to human, process or information system failures and flaws, the operational risk embraces risk of corporate fraud and misconduct.
- The Group has developed and uses a variety of custom-made information technology systems and web-based solutions in carrying out its everyday business operations and providing services to its clients. Failures of or significant disruptions to the Group's information technology systems could prevent it from conducting its operations. Furthermore, should the Group experience a cyber-attack, significant security breakdown or other significant disruption to its information technology systems, sensitive information could be compromised.
- The results of operations of the Group companies depend highly on the ability to engage and retain qualified, skilled and experienced staff. In the highly competitive environment, the Group companies must make continuous efforts to attract new qualified personnel and motivate existing management and employees.
- The Group is exposed to losses that might arise from the pursuit of wrong strategic decisions. For reasons of corporate growth, the Group's strategic risk is estimated to exceed the strategic risk of a bank positioned in a stable stage.
- The Group may bear losses resulting from any deterioration of the Group's reputation. Reputational risk can, above all, be attributed to the materialisation of other risks, such as operational, strategic, compliance risks or exposure to civil liability.
- Each of the Group's operating segments is affected by general economic and geopolitical conditions. Furthermore, tax regimes of the geographical markets where the Group operates are from time to time subject to change, some of which may be dictated by short-term political needs and may therefore be unexpected and unpredictable.
- The Group operates in highly regulated fields of business and its operations are subject to a number of laws, regulations, policies, guidance and voluntary codes of practice, which are subject to changes. In particular, the Group is exposed to the risk that the Estonian compulsory pension funds system will be altered to allow fund investors to exit from the compulsory pension system before

retirement upon request and to further reduce the administrative fees of pension funds. The Government of Estonia has indicated an aim to adopt the possible changes by 1 January 2020 with payments out of the funds to start as of 2021. The details of the reform are still discussed however in any case such change would have a significant effect on the profitability and operations of LHV Varahaldus.

- Credit institutions and investment firms as well as their holding companies are subject to strict capital adequacy requirements subject to frequent reforms and changes.
- The Group is exposed to regulatory actions and investigations. Several local and European authorities, including financial supervision, consumer protection, anti-money laundering, tax, and other authorities, regularly perform investigations, examinations, inspections and audits of the Group's business, including, but not limited to regarding capital requirements, standards of consumer lending, anti-money laundering, anti-bribery, payments, reporting, corporate governance, etc. Any determination by the authorities that the Group has not acted in compliance with all the applicable laws and regulations could have serious legal and reputational consequences for the Group, including exposure to fines, criminal and civil penalties and other damages, increased prudential requirements or even lead to business disruption in the respective fields.
- The Group is exposed to civil liability as it operates in a legal and regulatory environment that exposes it to significant risk of claims, disputes and legal proceedings.

#### Key information on the securities

##### *What are the main features of the securities?*

The Company's registered share capital is EUR 26,254,079, which is divided into 26,254,079 ordinary shares with the nominal value of EUR 1 (the **Shares**). The Company has one class of shares. In the course of the Offering, the Company is offering up to 2,200,000 newly issued ordinary shares (the **Offer Shares**) which are of the same class. The Shares are registered in the ERS under ISIN code EE3100073644 and kept in book-entry form. The Shares are governed by the laws of the Republic of Estonia. The Shares are freely transferrable. The Shares are listed on Nasdaq Tallinn Stock Exchange as of 23 May 2016. Once the Offer Shares are registered with the Estonian Commercial Register, the Offer Shares will rank *pari passu* with all the existing Shares and the Offer Shares will be eligible for any dividends declared and paid on the Shares for the financial period starting on 1 January 2019, and for any dividends declared and paid for any subsequent financial period.

Right to Participate in Corporate Governance. The shareholders of the Company are entitled to take part in the corporate governance of such company through the general meeting of shareholders, where they can exercise their powers to decide on certain important corporate matters, such as the amendment of the articles of association, the increase and decrease of the share capital, the issue of convertible bonds, the election and removal of the members of the supervisory board and the auditor, the approval of annual reports and the distribution of profit, the dissolution, merger, division or transformation of the company, and certain other matters. Each Share entitles its holder to one vote at the Company's general meeting of shareholders (the **General Meeting**). The General Meeting is the highest governing body of the Company.

The agenda of the General Meetings is generally determined by the Supervisory Board of the Company (the **Supervisory Board**). The Management Board or one or more shareholders, whose shares represent at least one-twentieth of the share capital of the Company are entitled to request that additional items be included on the agenda of an ordinary General Meeting, if such a request is made not later than 15 calendar days before the day of the General Meeting. In addition, they can make resolution proposals on items listed in the agenda.

In order to have the right to attend and vote at a General Meeting, a shareholder must be registered in the shareholders' register on the cut-off date, which is seven days before the meeting. A shareholder whose shares are registered in the name of a nominee may exercise the voting rights only if the nominee account holder has given a power of attorney to the shareholder. A shareholder may attend and vote at a General Meeting in person or by proxy. At a General Meeting, resolutions generally require the approval of a majority of the votes represented at the meeting. However, pursuant to law or the articles of association of the Company certain resolutions require a higher majority (e.g. of two-thirds or three-quarters) of the votes represented at the General Meeting.

Right to Subscribe for New Shares. Pursuant to the Estonian Commercial Code, existing shareholders of a public limited company have, upon the increase of the share capital of the company and the issue of the new shares of the company, the preferential right to subscribe for such new shares of the company proportionally to their existing shareholding in the company. Such preferential right can be excluded by the respective resolution of the general meeting of shareholders, which requires the affirmative vote of 3/4 of the votes represented at the general meeting of shareholders.

Right to Information. Pursuant to the Estonian Commercial Code, the shareholders of a public limited company have the right to receive information on the activities of the company from the management board at the general meetings of shareholders. However, management board may refuse to give information if there is a reason to presume that this may cause significant damage to the interests of the company. In the event the management board refuses to give information, shareholders may require the general meeting of shareholders to decide on the legality of such refusal or submit a respective claim to the competent court.

Right to Dividends. All shareholders of a public limited company have the right to participate in the distribution of profit of the company and have the right to receive dividends proportionally to their shareholding in the company. Under the Estonian Commercial Code, the distribution and payment of dividends is resolved by the General Meeting. The Management Board must present a profit distribution proposal to the General Meeting together with submitting an annual report. The Supervisory Board has the right to make changes to the proposal of the Management Board before submission to the General Meeting.

According to the Company's dividend policy as approved by the General Meeting on 20 April 2016, it is the intention of the Company to distribute profit and pay dividends to shareholders in the ratio of at least 25% of the profit before taxes. The Company has paid dividends for the previous years as follows: (i) in 2017, the Company paid dividends in the net sum of 15 cents per one share; (ii) in 2018, the Company paid dividends in the net sum of 16 cents per one share and (iii) in 2019, the Company paid dividends in the net sum of 21 per one share. Such dividend policy is planned to be followed, provided that the operating needs of the Group as determined by the Supervisory Board are covered and that after the distribution of profit all Group companies comply with all internal and external capital and liquidity requirements in full. The Company reserves itself the right to reduce the amount of profit distributed and dividends paid or not to distribute profit and pay dividends if there is a credible investment opportunity, which is expected to result in significant increase of the value of the Group in a long-term perspective.

Shares in case of applicability of bail-in measures. The Company as a financial holding company and its subsidiaries are subject to the Financial Crisis Prevention and Resolution Act (the **FCPRA**) implementing the bank recovery and resolution directive (the **BRRD**) into Estonian law. This means that the EFSA may subject the Group to crisis prevention and resolution measures, if the EFSA assesses it to be likely that the financial situation of the Group may rapidly deteriorate or if it is likely that the Group is insolvent or may become insolvent in the future. If resolution measures are applied, the EFSA has a right to require in respect of the Company or its subsidiaries, inter alia, (i) the write-down or cancellation of Shares (ii) the transfer of Shares or all assets, rights and liabilities, (iii) the revocation of the subscription rights to acquire additional Shares or other instruments of ownership, (iv) the issue of new Shares or other capital instruments, (v) suspending or terminating trading or listing of Shares. Therefore, should the Group be subject to crisis prevention measures, such measures may be detrimental to the interests of the Company's shareholders and the financial situation of the Group.

*Where will the securities be traded?*

The Shares have been admitted to trading on the Baltic Main List of the Nasdaq Tallinn Stock Exchange as of 23 May 2016. In connection with the Offering, the Company will apply for the listing and the admission to trading of the Offer Shares on the Baltic Main List of the Nasdaq Tallinn Stock Exchange. It is estimated that trading with the Offer Shares will commence on or about 14 October 2019 following the registration of the Offer Shares at the Estonian Commercial Register.

*What are the key risks that are specific to the securities?*

- The price of the Shares may be subject to volatility.
- Though every effort will be made to ensure that listing and admission to trading will occur, the Company cannot provide any assurance that the Subscription Rights and the Offer Shares will be listed and admitted to trading.
- Adverse changes in the tax regime applicable in respect of transacting with the Shares or receiving dividends may result in an increased tax burden of the shareholders and may therefore have adverse effect on the rate of return from the investment into the Shares.
- The Company's ability to pay dividends in the future is not guaranteed. The payment of dividends and the amount thereof will be subject to the ultimate discretion of the majority of the Company's shareholders.
- The Company as a financial holding company and its subsidiaries are subject to the Financial Crisis Prevention and Resolution Act implementing the BRRD into Estonian law. This means that the EFSA may subject the Group to crisis prevention and resolution measures *inter alia*, (i) the write-down or cancellation of shares (ii) the transfer of shares or all assets, rights and liabilities, (iii) the revocation of the subscription rights to acquire additional shares or other instruments of ownership, (iv) the issue of new shares or other capital instruments, (v) suspending or terminating trading or listing of shares. Crisis prevention measures may also be applied to the debt obligations owed by the subsidiaries to the Company.
- Additional equity capital issuances may dilute existing shareholdings.
- Shareholders in certain jurisdictions may not be able to participate in future equity offerings.
- There is no guarantee of continued analyst research coverage for the Company.
- Although best efforts will be made by the Company to ensure that the Offering is successful, the Company cannot provide any assurance that the Offering will be successful and that the investors will receive the Offer Shares they subscribed for. The Company may cancel the Offering either in full or partly.

**Key information on the offer of securities to the public and/or the admission to trading on a regulated market**

*Under which conditions and timetable can I invest in this security?*

The Company is offering up to 2,200,000 Offer Shares to the existing shareholders (the **Offering**) by virtue of a rights issue on terms and conditions as described in this Prospectus. The Offering comprises of an offering to retail investors in Estonia and of an offering to institutional investors in and outside of Estonia to qualified investors within the meaning of Article 2(e) of the European Union Prospectus Regulation No 1129/2017/EU and other types of investors in reliance on certain exemptions available under the laws of each jurisdiction where the Offering is being made. A public offering will be carried out only in Estonia and there will not be any public offering in any other jurisdiction. For the purposes of the Offering, a person is considered to be "in Estonia" and has a right to participate in the Offering if such person has an operational securities account with the ERS and such person submits a Subscription Undertaking (as defined below) in relation to Offer Shares via that securities account.

The Company's shareholders fixed in the share register on 4 September 2019 at the end of the business day of the settlement system of the ERS shall be granted the pre-emptive right to subscribe for the Offer Shares (the **Subscription Right**). One Subscription Right per each 12 Shares shall be issued. If the number of shares held by the shareholder does not grant a whole number of Subscription Rights, the number of Subscription Rights shall be rounded to the nearest mathematical whole number, whereas fractions under one shall be rounded to one. Based on the share ledger as at 4 September 2019, the total number of Subscription Rights to be issued is 2 188 372. The Subscription Rights shall be transferred on 10 September 2019 at the latest to those securities accounts where the Shares were registered on 4 September 2019 at the end of the business day of ERS settlement system. Provided the Offering is not cancelled, each Subscription Right will entitle the investor to subscribe to and receive in allocation 1 Offer Share.

Indicative timetable of the Offering

11 September 2019	Start of Subscription Period, start of trading with Subscription Rights on Nasdaq Tallinn Stock Exchange
20 September 2019	Last date to acquire Subscription Rights from the Nasdaq Tallinn Stock Exchange allowing delivery of the Subscription Rights before the end of Subscription Period (T + 2 settlement)
23 September 2019	Trading with Subscription Rights on Nasdaq Tallinn Stock Exchange ends
25 September 2019	End of Subscription Period
On or about 26 September 2019	Announcement of the results of the Offering
On or about 1 October 2019	Settlement of the Offering (during the settlement, the Offer Shares will carry a temporary ISIN)
On or about 9 October 2019	Registration of the Offer Shares in the Estonian Commercial Register
On or about 11 October 2019	The Offer Shares will receive the permanent ISIN EE3100073644

On or about 14 October 2019

First trading day of the Offer Shares on Nasdaq Tallinn Stock Exchange

#### Trading in Subscription Rights

The Company has made an application to list and admit the Subscription Rights to trading on the Baltic Main List of Nasdaq Tallinn Stock Exchange. Trading in the Subscription Rights is expected to commence on 11 September 2019 and is expected to end on 23 September 2019. The ISIN code for the Subscription Rights is EE3700080726.

#### Offer Price

The Offer Price is EUR 11.5 per one Offer Share, of which EUR 1 is the nominal value of one Offer Share and EUR 10.5 is the issue premium.

#### Subscription Period

The Subscription Period is the period during which the persons who have the right to participate in the Offering may submit Subscription Undertakings for the Offer Shares (please refer to Section "Subscription Undertakings" below for further information). The Subscription Period commences on 11 September 2019 at 10:00 local time in Estonia and terminates on 25 September 2019 at 16:00 local time in Estonia.

#### Subscription Undertakings

The Subscription Undertakings may be submitted only during the Subscription Period. An investor participating in the Offering may apply to subscribe for the Offer Shares only for the Offer Price. All investors participating in the Offering can submit Subscription Undertakings denominated only in euro. An investor shall bear all costs and fees charged by the respective custodian of the ERS accepting the Subscription Undertaking in connection with the submission, cancellation or amendment of a Subscription Undertaking. Holders of nominee accounts are considered legal owners of the Shares and the Subscription Rights are transferred on the nominee accounts, hence the investors holding shares on nominee accounts must submit the Subscription Undertakings via nominee account holder and must ensure the Subscription Undertaking includes the number of the same securities account (nominee account) on which Subscription Rights are held. In order to subscribe for the Offer Shares, an investor must have a securities account with the ERS. Such securities account may be opened through any custodian of the ERS.

An investor wishing to subscribe for the Offer Shares should contact a custodian that operates such investor's ERS securities account and submit a Subscription Undertaking in the form set out below. Due to the technical process used in distributing the Offer Share, the Subscription Undertaking must detail the information of the Subscription Rights (and not the Offer Shares), as provided below. The Subscription Undertaking must be submitted to the custodian by the end of the Subscription Period. The investor may use any method that such investor's custodian offers to submit the Subscription Undertaking (e.g. physically at the client service venue of the custodian, over the internet or by other means).

The Subscription Undertaking for the Offer Shares must include the following information:

Owner of the securities account:	name of the investor
Securities account:	number of the investor's securities account
Custodian:	name of the investor's custodian
Security:	LHV Group share
ISIN code:	EE3700080726 <sup>(1)</sup>
Amount of securities:	the number of Offer Shares for which the investor wishes to subscribe
Price (per one offer Share):	EUR 11.5
Transaction amount:	the number of Offer Shares for which the investor wishes to subscribe multiplied by the Offer Price
Transfer of the Subscription Rights to the securities account of the investor:	1 October 2019
Type of transaction:	"purchase"
Type of settlement:	"payment free of delivery" "free of payment" (PFOD, FOP)

#### Note

(1) ISIN of the Subscription Right and not the Offer Shares should be included in the Subscription Undertaking due to the technical process applicable to offerings carried out as a rights issue.

A Subscription Undertaking is deemed submitted from the moment the registrar of the ERS receives a duly completed transaction instruction from the custodian of the respective investor. In case the investor holds Subscription Rights and exercises the right by submitting a Subscription Undertaking for the corresponding number of Offer Shares, the Subscription Rights on the investors securities account will be blocked. In case the investor does not hold Subscription Rights or wishes to subscribe for more Offer Shares than the number of Subscription Rights held by such investor, the Subscription Rights on the investors securities account will not be blocked, however no Offer Shares shall be allocated or issued to persons who do not hold Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS.

An investor may submit a Subscription Undertaking through a nominee account only if such investor authorises the owner of the nominee account to disclose the investor's identity to the registrar of the ERS in writing. The Subscription Undertakings submitted through nominee accounts will be taken into consideration in the allocation only if the owner of the nominee account has actually disclosed the identity of the investor to the registrar of the ERS in writing. Among other information it is also requested to disclose a permanent address and personal identification code in case of a natural person or a registration address for a legal entity. An investor may submit a Subscription Undertaking either personally or through a representative whom the investor has authorised (in the form required by law) to submit the Subscription Undertaking.

By submitting a Subscription Undertaking every investor:

- (i) accepts the terms and conditions of the Offering set out under this Section and elsewhere in this Prospectus and agrees with the Company that such terms will be applicable to the investor's acquisition of any Offer Shares;
- (ii) acknowledges that the Offering does not constitute an offer of the Offer Shares by the Company in legal terms or otherwise and that the submission of a Subscription Undertaking does not itself entitle the investor to acquire the Offer Shares nor result in a contract for the sale of Offer Shares between the Company and the investor;

- (iii) accepts that the number of the Offer Shares indicated by the investor in the Subscription Undertaking will be regarded as the maximum number of the Offer Shares, which the investor wishes to acquire (the Maximum Amount) and that the investor may receive less (but not more) Offer Shares than the Maximum Amount (please refer to Section "Distribution and Allocation");
- (iv) undertakes to acquire and pay for any number of Offer Shares allocated to it in accordance with these terms and conditions, up to the Maximum Amount;
- (v) authorises and instructs its custodian to forward the registered transaction instruction to the registrar of the ERS;
- (vi) authorises the custodian and the registrar of the ERS to amend the information contained in the investor's transaction instruction, including (a) to specify the value date of the transaction and (b) to specify the number of the Offer Shares to be purchased by the investor and the total amount of the transaction found by multiplying the Offer Price by the number of Offer Shares allocated to the relevant investor;
- (vii) confirms, that he/she/it is not subject to the laws of any other jurisdiction which would prohibit the placing of the Subscription Undertaking or allocation of the Offer Shares to him/her/it and represents that he/she/it is authorised to place a Subscription Undertaking in accordance with the Prospectus.

#### Payment

By submitting a Subscription Undertaking, an investor authorises and instructs the institution operating the investor's cash account connected to its securities account (which may or may not also be the investor's custodian) to immediately block the whole transaction amount on the investor's cash account until the settlement is completed or funds are released in accordance with these terms and conditions. The transaction amount to be blocked will be equal to the Offer Price multiplied by the Maximum Amount. An investor may submit a Subscription Undertaking only when there are sufficient funds on the cash account connected to its ERS securities account or its securities account to cover the whole transaction amount for that particular Subscription Undertaking.

#### Distribution and Allocation

The Company will decide on the allocation of the Offer Shares after the expiry of the Subscription Period on or about 26 September 2019. No Offer Shares shall be allocated or issued to persons who do not hold Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS. Subscription Undertakings from persons not entered on such list will be cancelled during the allocation process. Multiple Subscription Undertakings by one investor shall be merged for the purposes of allocation (except in case the investor is using a nominee structure in which case the holder of the nominee account is considered to be the legal owner of Shares).

The Offer Shares will be allocated to the investors participating in the Offering in accordance with the following principles:

- (i) all persons who hold the respective number of Subscription Rights on their securities account on 25 September 2019 at the end of the business day of the settlement system of the ERS are guaranteed to receive the respective number of Offer Shares (i.e. the smaller number of the Subscription Rights held by the investor and the number of Offer Shares subscribed for by the investor);
- (ii) if the number of Offer Shares allocated in accordance with the principle in subsection (i) above is smaller than 2,200,000, the remaining Offer Shares shall be allocated to persons who held Subscription Rights on their securities account on 25 September 2019 at the end of the business day of the settlement system of the ERS proportionally, insofar as mathematically possible, to the number of Subscription Rights held, but in a number not larger than the number of Offer Shares that they subscribed for (for avoidance of doubt, the number of guaranteed shares allocated in subsection (i) taken into account).

The Company expects to announce the results of the allocation process through the information system of the Nasdaq Tallinn Stock Exchange and at the Company's website <https://investor.lhv.ee/en/> on or about 26 September 2019.

#### Settlement

The Offer Shares will be registered in book entry form in the ERS under ISIN EE3100073644. During the settlement of the Offering, the Offer Shares will carry a temporary ISIN, which will be changed to the permanent ISIN EE3100073644 after registration of the Offer Shares in the Estonian Commercial Register. The Offer Shares allocated to investors will be transferred to their securities accounts on or about 1 October 2019 through the "free of payment" method shortly after debiting the payment for such temporary shares from the investors' account connected with the securities account through the "payment free of delivery" method.

#### Cancellation of the Offering

The Company reserves the right to cancel the Offering or change the terms and conditions thereof as described in this Prospectus.

#### Dilution

Following the completion of the Offering assuming that (i) all offered Offer Shares will be subscribed for and issued, (ii) the shareholders choose to transfer their Subscription Rights to third parties and not use those for Subscribing to any Offer Shares, (iii) such third parties will use the Subscription Rights to subscribe for the Offer Shares, the shareholdings in the Company prior to the Offering will be diluted by up to 7.7318% as a result of the Offering.

#### Why is this prospectus being produced?

The purpose of the Offering is to strengthen the capital structure of the Group and ensure stable access to additional capital to support the further growth and market position of the Group, increase the business volumes of the Group and ensure conservative capital buffer for the Group companies. The purpose of the Offering is partly also to cover the additional Tier 1 capital need of the Group triggered by the acquisition of the Danske Loan Portfolio. The Group plans to use up to EUR 10 million of the net proceeds of the Offering to cover the additional Tier 1 capital need of the Group related to acquisition of Danske Loan Portfolio while the remainder will be used for the general purpose of the Offering.

Provided that the Offering is successful and that all the Offer Shares (altogether 2,200,000 Shares) are subscribed for and issued by the Company, the expected amount of gross proceeds of the Offering is EUR 25.3 million. Expenses directly related to the Offering are estimated to be approximately EUR 0.15 million, therefore, the net proceeds of the Offering are expected to be EUR 25.15 million. The Offering is not subject to an underwriting agreement on a firm commitment basis.

## 3. RISK FACTORS

### 3.1. Introduction

Investing into the Shares issued by the Company entails various risks. Each prospective investor in the Shares should thoroughly consider all the information in this Prospectus, including the risk factors described below. Any of the risk factors described below, or additional risks not currently known to the Management or not considered significant by the Management, could have a material adverse effect on the business, financial condition, operations or prospects of the Group and result in a corresponding decline in the value of the Shares. As a result, investors could lose a part or all of the value of their investments. The Management believes that the factors described below present the principal risks inherent in investing into the Shares. The risk factors are listed in certain categories whereas the most material risk factors, based on the significance or probability, are mentioned first and the remainder of the risk factors are not presented in any order of priority.

The principles of risk management of the Group, the respective facts and figures have been described in detail in Note 3 of the Audited Financial Statements.

**This Prospectus is not, and does not purport to be, investment advice or an investment recommendation to acquire the Shares. Each prospective investor in the Shares must determine, based on its own independent review and analysis and such professional advice as it deems necessary and appropriate, whether an investment into the Shares is consistent with its financial needs and investment objectives and whether such investment is consistent with any rules, requirements and restrictions as may be applicable to that investor, such as investment policies and guidelines, laws and regulations of the relevant authorities, etc.**

### 3.2. Business Risks

Counterparty Credit Risk. Counterparty credit risk is inherent to the core operations of the Group – counterparty credit risk is the risk of potential loss which may arise from counterparty's inability to meet its obligations to the Group companies. Credit risk affects cash and cash equivalents held with third parties (such as deposits with banks and other financial institutions), bonds, derivatives, but mostly credit exposures to customers, including outstanding loans, cover for guarantees, as well as other receivables and commitments. As at 31 December 2018 the Group's total maximum credit risk exposure was EUR 1 845 million. The transaction for the acquisition of the Danske Bank A/S Estonian branch's loan portfolio (the **Danske Loan Portfolio**) will increase the LHV Pank's loan portfolio by ca 40%, thereby also increasing credit risk related to outstanding loans. Credit risk is one of the largest risks relating to the Group's operations. Although the Group makes provisions for potential credit losses in accordance with the applicable requirements, such provisions are made based on the available information, estimates and assumptions, which by definition are subject to certain amount of uncertainty. Therefore, there can be no assurance that provisions are sufficient to cover potential losses. Further, if the credit quality of loans or the financial health of any of the borrowers were to deteriorate, LHV Pank may have to make provisions which could have a material adverse impact on the financial position of the Group. The recoverability of the credit provided to customers may be adversely affected by negative changes in the overall economic, political or regulatory environment, effecting among others the ability of the counterparties to repay loans and the effectiveness of enforcement proceedings, decrease in collateral values and other circumstances beyond the control of the Group. Materialisation of credit risk may have material adverse effect on the Group's operations, financial condition and results of operations.

Concentration Risk. The operations of the Group are subject to concentration risk, which by essence is a risk arising from the overall spread of outstanding accounts over the number and variety of clients.

As at 30 June 2019, 37% of the corporate credit portfolio of LHV Pank included loans granted in real estate sector, which is traditionally the field that receives the greatest financing from commercial banks in Estonia. Due to the above concentration, the Group is significantly exposed to risks inherent the real estate sector and risk management measures applied may not be sufficient to avoid significant loan losses in case of a sharp downturn. The real estate sector is followed by companies pursuing financial and insurance services (14% of corporate credit portfolio as at 30 June 2019) and companies operating in the processing industry (14% corporate credit portfolio as at 30 June 2019). Among sectors with higher than average credit risk, accommodation and catering comprise 3%, construction 7% and transport and storage 1% of the total corporate credit portfolio. Loans to corporates comprise ca 76% of the entire credit portfolio while loans to private individuals amount to 24% of the credit portfolio. As a result of its exposure being concentrated to the above sectors, any developments adversely affecting these sectors may have material adverse effect on the Group's operations, financial condition and results of operations.

Geographical Markets Risk. The Group operates on two geographical markets – Estonia and United Kingdom, whereas most of the activities and services of the Group are concentrated to the Estonian Market. In the second quarter of 2019, the Group's revenue attributable to the Estonian market accounted for 99.9% of the Group's total revenue. Therefore, any adverse event or development in Estonia may have material adverse effect on the Group's operations, financial condition and results of operations. In addition, the Group's activities on the market of the United Kingdom are subject to large uncertainties associated with the decision of the United Kingdom to withdraw from the European Union, concerning mainly the risk of change in the legal and regulatory landscape, which may result in increasing operating and compliance requirements and costs, but also potential operating limitations, affecting both the Group and its clients or business partners.

Market Risk. Market risk arises from the Group's trading and investment activities in the financial markets, primarily in interest rate products, foreign exchange and stock markets as well as from borrowing activities and other means of taking in financial resources. Market risk is the risk of potential loss which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. The market value of financial instruments may be adversely affected by the volatility of financial markets arising from numerous market variables beyond the control of the Group. Due to such volatility, the value of the financial instruments held by the Group may decrease more than it is able to foresee, and therefore result in write-downs of certain assets. Within the Group, internal judgement and know-how is used to assess and avoid potential market losses; however, such internal judgement may turn out to be inaccurate due to changes in the financial markets not foreseen at the time of making the judgement. Despite the measures taken by the Group, the market risk may have material adverse effect on the Group's operations, financial condition and results of operations.

Foreign Currency Risk. Foreign currency risk arises primarily from the acquisition of securities denominated in foreign currencies or from foreign currency receivables and liabilities. As at 30 June 2019 3.5% of the Group's total assets bearing currency risk bore non-EUR currency risk, whereas 4.4% of the Group's total liabilities bearing currency risk bore non-EUR currency risk. Foreign exchange rates may be affected by complex political and economic factors, including relative rates of inflation, interest rate levels, the balance of payments between countries, the extent of any governmental surplus or deficit, and from the monetary, fiscal and trade policies pursued by the governments of the relevant currencies. Devaluation, depreciation or appreciation of foreign currency may have significant adverse effect on the value of the Group's assets denominated in foreign currency or increase the euro value of the Group's foreign currency liabilities. Therefore, foreign currency risk may have material adverse effect on the Group's operations, financial condition and results of operations.

Price Risk. The Group holds positions in different financial instruments, which are subject to fluctuations in market price arising from various circumstances beyond the control of the Group. In order to mitigate

the price risk, the Group has established internal rules setting forth limits to the size of trading and investment portfolios and requirements to acceptable credit quality ratings. Due to the fact that such internal rules are established based on historical market data, such rules may not be adequate or sufficient to mitigate potential losses arising from adverse changes in the market prices of the financial instruments held by the Group companies. The price risk may have material adverse effect on the Group's operations, financial condition and results of operations.

*Interest Rate Risk.* The operations of the Group and foremost the operations of LHV Pank are inherently exposed to interest rate risk. Further, approximately 60% of the loans to be acquired as part of the Danske Loan Portfolio do not include a "zero EURIBOR floor" clause, which means that LHV Pank is open to the risk of further EURIBOR decreases lowering the income from those loans, which may result in those loans producing zero per cent interest. The amount of net interest income earned by the Group companies materially affects the revenues and the profitability of the operations of the Group. Further, due to the fluctuations of market interest rates there may be a mismatch between the interest income earned from the lending and crediting operations of the Group and the interest costs paid on the interest-bearing liabilities, which may have material adverse effect on the Group's operations, financial condition and results of operations.

Liquidity Risk. Liquidity risk relates to the ability of the Group to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The Group relies on deposits from retail and corporate customers in order to service of its liquidity needs. The volume of such liquidity is, however, dependent on factors that are beyond the Group's control, such as changes in household savings ratios, the propensity to save by making bank deposits and changes in the tax regime applicable to bank deposits. The Group's liquidity and funding plan are based on assumptions on client behaviour (the deposit base and durations), especially with regard to the trend of short-term deposits. Despite such risk policies and internal procedures, the liquidity may not always be readily available. Especially in critical, exceptional situations there is risk that the relevant behavioural assumptions used for the simulation scenarios prove to be incorrect, resulting in considerable unplanned liquidity outflows. This situation may arise due to circumstances that the Group is unable to control, such as continued market disruption or loss of confidence in the financial markets. The realisation of the liquidity risk may have material adverse effect on the Group's operations, financial condition and results of operations.

Risk associated with dependence on access to funding on favourable terms. The Group's business is reliant on its ability to finance its current operations at reasonable terms. Access to, and the cost of, financing raised by the Group's companies through the money and capital markets are affected, among other things, by general interest rate levels, the situation on the financial markets, or a downturn in the performance of market participants and the Group companies' own capital adequacy and credit rating. In particular, Group's long-term strategy includes a plan to issue covered bonds on the basis of the newly adopted Covered Bond Act to replace the deposits collected via deposit platforms with covered bonds to decrease the cost of financing. The issuance of covered bonds may be delayed if the Group does not obtain the required covered bonds issuer license in the planned time, or if the related regulatory practices develop in a way not currently foreseeable. The issuance of covered bonds may be delayed also due to non-favourable conditions on the capital markets and the global economic environment. Notably, the uncertainty surrounding Brexit and whether a deal will be reached can impact the financial stability of the European Union, including on the price of funding in the international financial markets and reduce its availability. Therefore, the Group companies may not be able to raise funds from the money and capital markets at the expected terms, and it may have an adverse effect on the Group's business operations, its performance or its financial position.

Operating Risk. Operating risk is a risk of potential loss caused by human, process or information system failures and flaws. In addition to human, process or information system failures and flaws, the operating risk embraces risk of corporate fraud and misconduct. When completing transactions,

transaction limits and competence systems are used to minimise potential loss and the principle of duality is used in the Group's working procedures, according to which there should be an approval by at least two employees or units in order to carry out a transaction or procedure. Despite measures taken, the risk of human and process losses cannot be eliminated altogether. As the Group operates in a heavily regulated area of business, operating risk events may have an unusually large negative impact on the Group. The operating risk may have material adverse effect on the Group's operations, financial condition and results of operations.

Dependency on Information Technology Systems and Risk of Cyber-Attacks. The Group has developed and uses a variety of custom-made information technology systems and web-based solutions in carrying out its everyday business operations and providing services to its clients. The dependency on such systems is increasing in time with the spread of online and mobile banking services and the development of cloud computing. This means that the Group is exceedingly open to risks over which it has no control, including system-wide failures of communication infrastructure, quality and reliability of equipment and software supplied by third parties and other similar risks. Failures of or significant disruptions to the Group's information technology systems could prevent it from conducting its operations. As the GBP payments development is new, increased risks connected to information technology systems may occur at its launch. Furthermore, should the Group experience a cyber-attack, sensitive information could be compromised, which in turn could result in civil and administrative liability of the Group companies before its customers, counterparties and state authorities, as well as in a general decrease in the trustworthiness of the Group and consequently in the demand for its services. Ensuring security and reliability of information technology systems is becoming more challenging in the environment where service providers are facing increasingly sophisticated and highly targeted attacks aimed at obtaining unauthorised access to confidential and sensitive information, disable or degrade service or sabotage information systems for other purposes. The Group has made significant investments into developing well-functioning and secure information technology systems and is constantly working on improving such systems and developing adequate contingency procedures; however, the Group may, despite its efforts, fail to mitigate all risks or fail to take appropriate and effective countermeasures if its information technology systems fall under attack, which in turn may have material adverse effect on the Group's operations, financial condition and results of operations.

Dependency on Cash-Flows from Subsidiaries. The Company is the holding company of the Group and the operations are conducted through its Subsidiaries. The Company itself does not own significant assets other than investments into the Subsidiaries. Therefore, in order to be able to pay dividends to the Shareholders and meet its own obligations, the Company is dependent on the receipt of dividends, interest payments or payments from share capital decrease from its Subsidiaries, which in turn may be influenced by the need to comply with the capital adequacy ratios applicable in respect of certain Subsidiaries and subject to change from time to time. For the year 2018 the Company paid out dividends to its Shareholders in the sum of EUR 5.463 million and received dividends in the sum of EUR 4.4 million from LHV Varahaldus and EUR 2.23 million from LHV Pank. Approximately EUR 1 million of the dividend amount received from Subsidiaries was used to cover the loss of the Company on a solo level for the year 2018. Due to the expected year-by-year increasing profitability of LHV Pank the Company foresees that in the future the dividend payments of the Company will be influenced by a larger extent by the dividends received from LHV Pank and the role of LHV Varahaldus will decrease. Nevertheless, according to Estonian law, a company may only pay dividends or make other distributions if its current profits and retained earnings are sufficient for such distribution. Therefore, the Group's financial position and ability to pay dividends to its Shareholders remains dependent on the Subsidiaries' profit and financial position.

Dependency on Qualified Staff. The results of operations of the Group companies depend highly on the ability to engage and retain qualified, skilled and experienced staff. In the highly competitive

environment, the Group companies must make continuous efforts to attract new qualified personnel and motivate existing management and employees. Regulatory restrictions, such as the limits on certain types of remuneration paid by credit institutions and investment firms set forth in CRD IV<sup>1</sup> and further developed in CRD V<sup>2</sup> which will need to be transposed into national law by December 2020, could adversely affect the Group's ability to attract new qualified personnel and retain and motivate existing employees. Any loss of the services of key employees, particularly to competitors, or the inability to attract and retain highly skilled personnel may have material adverse effect on the Group's operations, financial condition and results of operations.

Strategic Risk. Strategic risk is a possible source of loss that might arise from the pursuit of wrong strategic decisions. For reasons of corporate growth, the Group's strategic risk is estimated to exceed the strategic risk of a bank positioned in a stable stage. For example, to facilitate growth, recently the Group has decided to purchase the Danske Loan Portfolio and to establish a branch in the United Kingdom to focus on servicing financial intermediaries, however the success of these strategic decisions remains unclear. The Group has developed the technical possibility to process payments in GBP via its branch in the United Kingdom, but due to legal reasons this service has not yet been launched to clients. The Group takes measures to mitigate the risk of pursuing wrong strategic directions, however despite the measures taken, the materialisation of strategic risk whether due to lack of profitability or a changed profile of risks that the Group is not able to manage at a sufficient level may have material adverse effect on the Group's operations, financial condition and results of operations.

Reputational Risk. Reputational risk is a risk of loss resulting from any deterioration of the Group's reputation. Reputational risk can, above all, be attributed to the materialisation of other risks, such as operational, strategic, compliance risks or exposure to civil liability. In addition to factors directly attributable to the Group companies and their employees, the reputation of the Group is affected by circumstances beyond the control of the Group, such as the conduct of its joint venture or business partners or information circulating in the media. Any deterioration of the Group's reputation in the eyes of customers, business partners, owners, employees, investors or supervisory authorities may have material adverse effect on the Group's operations, financial condition and results of operations.

Competitive Market. The Group operates in a highly competitive market. In addition to the licensed credit institutions and branches of foreign banks present in the geographical markets where the Group companies operate, there are market participants who are not subject to regulatory and capital requirements as burdensome as the Group companies (e.g. non-bank lenders), and who therefore may have a competitive advantage on the relevant market. Furthermore, recent trends in the crediting and lending market may be characterised by the development of new products and technological solutions, which compete with the more conservative and traditional products and services offered by the Group. Often such alternative service providers are able to offer more favourable terms, which may result in price pressure on the products and services offered by the Group. If the Group fails to respond to the competitive environment in its target markets by offering attractive and profitable product and service solutions, it may face the decrease of its market shares or the overall profitability of the Group may suffer.

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<sup>1</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

<sup>2</sup> Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures.

Exposure to Conduct of Other Market Participants. The Group's access to financing, investment and derivative transactions may be adversely affected by market practises of other market participants. Financial and securities markets are interrelated and defaults and failures to conduct sound business by other market players could lead to market-wide liquidity problems or other market-wide issues, which could adversely affect the Group companies' access to capital resources. For-example, money laundering issues in the banking sector generally and especially when relating to the Estonian and Baltic markets may adversely affect the Group companies' access to capital resources and the cost of such resources. Further, the Group companies have exposure to many counterparties arising from trading, clearing, funding or other relationships with them. Failure of such market participants to meet their obligations may result in the default of the Group companies before other counterparties and clients, which in turn may have material adverse effect on the Group's operations, financial condition and results of operations.

Control over Joint Venture. Currently, the Company holds interests in one joint venture – LHV Finance in Estonia, as the sale of the shareholding in UAB "Mokilizingas" in Lithuania was finalised in May 2018. The Company holds a 65% shareholding in LHV Finance and is therefore the controlling shareholder of the joint venture and has also executed a shareholders' agreement with its joint venture partner (please refer to Section 10.6 "Material Agreements" for further details). Although due care is taken by the Company in order to ensure effective control over LHV Finance and ensure that it is managed prudently and effectively, the operations of LHV Finance may be adversely affected by the joint venture partner of the Company. Despite the shareholders' agreement, it cannot be excluded that the joint venture partner exercises its voting rights for influencing management decisions in a direction with which the Company disagrees or fails to exercise its voting rights to adopt management decisions that in the view of the Company are necessary in the interest of LHV Finance. Furthermore, the joint venture partner may understand the terms of the shareholders' agreement differently from the Company or fail to perform the shareholders' agreement. Although the Management has high confidence and trust in its joint venture partner, such behaviour by the joint venture partner of the Company, in theory, cannot be excluded or prevented, and may have adverse effect on the financial position and results of operations of LHV Finance. This may have material adverse effect on the Group's operations, financial condition and results of operations.

### **3.3. Political, Economic and Legal Risks**

Changes in Economic Environment. Each of the Group's operating segments is affected by general economic and geopolitical conditions, the worsening of which is outside of the Group's control. Any deterioration in the economic environment of the countries where the Group operates, in particular in Estonia, where most of the Group's services and products are focused, could have a direct negative impact on the financial position and profitability of the Group. The Estonian economy is a small open economy that is closely linked to the global economy and especially the macroeconomic conditions in the Eurozone countries and Russia. Over the recent years, Estonia has come out of a long period of sub-par performance and entered into a period of strong economic growth, but the risk of overheating has also increased. There can be no assurance whether the growth of the local and global economies and improved economic conditions will continue. Adverse developments of the global and local economies and of financial markets could have a degrading effect on the Group's operations, financial condition and results of operations. Although the Group constantly monitors developments on both domestic and international markets, it is not possible to forecast the timing or extent of changes in the economic environment.

Exposure to Regulative Changes. The Group operates in highly regulated fields of business and its operations are subject to a number of laws, regulations, policies, guidance and voluntary codes of practice.

*General regulatory changes.* Considering the recent reforms and changes in the regulatory framework applicable in respect of the operations of the Group, the Group cannot predict to what extent laws and policies or their interpretations will change in the future nor the impact of such changes. In addition to numerous regulatory initiatives concerning capital adequacy requirements (CRR<sup>3</sup>/CRD IV<sup>4</sup>) and resolution framework (BRRD<sup>5</sup>/SRMR<sup>6</sup>), introduced as a result of the global financial and economic crises of 2007-2009 and the amendment proposals thereof, the recent years have seen further significant developments in the regulatory framework in the fields where the Group companies operate, such as the tightening requirements on anti-money laundering and antiterrorism financing, PSD2<sup>7</sup>, MiFID II<sup>8</sup>/MiFIR<sup>9</sup>, GDPR<sup>10</sup>, further tightening of the capital adequacy requirements from December 2020 and mid-2021 (respectively, CRD V<sup>11</sup> and CRR II<sup>12</sup>) and amendments to the bank resolution and recovery framework applicable from December 2020 (BRRD II<sup>13</sup>/SRMR II<sup>14</sup>) etc. In addition, changes in accounting standards may impact the financial situation and results presented in the financial statements of the Group. As the Group has entered to the market of the United Kingdom, it may also become subject to additional legal requirements as a result of the United Kingdom's withdrawal from the European Union, including possibly the requirement to obtain an additional activity license. Further, due to the resolution of Eesti Pank (the Bank of Estonia) to include LHV Pank as from 1 January 2018 in the list other systemically important institutions (O-SIIs), the Group has, among others, been subjected to an additional capital buffer requirement, as further described below. The Group has duly and timely complied with the new requirements, internal procedures have been introduced for the assessment, evaluation and implementation of changes in legislation; nevertheless, the Group still

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<sup>3</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the **CRR**).

<sup>4</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (the **CRD IV**).

<sup>5</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (the **BRRD**).

<sup>6</sup> Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (the **SRMR**).

<sup>7</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (the **PSD2**).

<sup>8</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (the **MI FID II**).

<sup>9</sup> Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (the **MI FIR**).

<sup>10</sup> Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (the **GDPR**).

<sup>11</sup> Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (the **CRD V**).

<sup>12</sup> Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (the **CRR II**).

<sup>13</sup> Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending the Bank Recovery and Resolution Directive as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC (the **BRRD II**).

<sup>14</sup> Regulation (EU) 2019/877 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms (the **SRMR II**).

assesses regulatory changes, both on the level of the European Union and on the level of jurisdictions where the Group companies operate, as a high risk.

*Regulatory changes related to pension funds.* The pension funds management sector has been subject to frequent regulatory changes and further changes can be expected in the future. Firstly, the fees related to compulsory pension funds have been subject to several reforms over the recent years, each decreasing the fund management or other fees relating to compulsory pension funds. In December 2018, Riigikogu (the Estonian Parliament) adopted an amendment to the law lowering the management fee thresholds of compulsory pension funds from current level of 2% to 1.2% and establishing further rules for reductions of management fees calculated on the volume of funds. The rules include (i) mandatory reduction of the management fee based on the total volume of compulsory pension funds under management through applying a minimum of 15% reduction on the management fee in case the total assets under management exceed EUR 100 million for each next asset value of EUR 100 million, but not more than to 0.4% of the fund volume and (ii) introduction of an option to apply success fee which is not subject to the mandatory reduction described above. In a longer perspective, the management fee for compulsory pension funds is intended to be decreased to the average level of European Economic Area or the Organisation for Economic Co-operation and Development (OECD) countries, i.e. to approximately 0.5-0.7%.<sup>15</sup> The exact effect of the regulation applicable to management fees of compulsory pension funds on the income of LHV Varahaldus is not clear yet as the changes were only implemented from 2 September 2019 onwards. The decrease of fees relating to compulsory pension funds would have a significant effect on the profitability and operations of LHV Varahaldus, as compulsory pension funds form the vast majority of funds managed by LHV Varahaldus. Secondly, considering that the management fees of funds managed by LHV Varahaldus are, in general, higher than the management fees of other funds of the same categories, the effect of lowering the fees is expected to affect the Group more than its competitors.

Further, the political parties forming the new Government of Estonia after the parliamentary elections in March 2019 that took office in April 2019, have politically agreed in the coalition agreement to change the Estonian compulsory pension funds system in a manner allowing fund investors to exit from the compulsory pension system before retirement upon request and to further reduce the administrative fees of pensions funds. According to the coalition agreement, the above legislative changes are aimed to be adopted by 1 January 2020. As of the date of this Prospectus, the Government of Estonia has agreed to implement the reform in accordance with the above described time schedule, with payments out of the funds to start as of 2021. The details of the legislative change are still discussed among the Government of Estonia however in any case such change would have a significant effect on the profitability and operations of LHV Varahaldus.

Maintaining Capital Adequacy Ratios. Credit institutions and investment firms must adhere to strict capital adequacy requirements subject to frequent reforms and changes.

Ensuring compliance with new rules brings about implementation costs which may impact the profitability of the Group. Recently a new legislative package for further reduction of banking risk has been adopted, which will in the main part become effective from December 2020 of mid-2021 (CRD V/CRR II/BRRD II/SRMR II). Implementation of the CRD V/CRR II requirements will cause significant changes to the procedures, rules and reporting systems applicable in the Group, as well as to the

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<sup>15</sup> Explanations to the amendment proposal of Investment Funds Act and related acts, available at <http://eelnoud.valitsus.ee/dossier/18-0566>.

calculation systems of the capital requirements applicable to the Group. It is foreseen that the direct technical cost (including salary cost of involved employees) of implementation of the above requirements will be approximately EUR 2 million.

Currently the capital of banks and investment firms in the EU is subject to the legal framework of CRR/CRD IV/BRRD and the most restrictive ratio for the Group is the minimum requirement for own funds and eligible liabilities (MREL). The ratio is a part of the crisis resolution plan provided for in the BRRD, as implemented into the Estonian laws, and obliges the banks to have sufficient own funds and unsecured long-term liabilities that can be used to cover losses under the crisis resolution plan. For LHV Pank, the EFSA has set MREL limit to 5.79% and is reviewing the level annually. At the date of this Prospectus the MREL level of the Group is ca 9.5% and the Group aims to increase it to 11-12% in the coming years to in preparation for any yet undetermined but possible future higher requirements of the EFSA. In 2017 Eesti Pank decided to include LHV Pank in the list of other systemically important institutions (O-SIIs) and the Group is therefore, as from 1 January 2018, subject to other systemically important institutions buffer of 0.5%, which from 1 January 2019 has been raised to 1% and is reviewed annually. The buffer requirement applies to the total risk exposure of systemically important institutions and must be met by common equity tier 1 own funds.

So far, the Group has complied with all applicable capital requirements. However, the capital requirements adopted in Estonia and the European Union may change, whether as a result of further changes of the EU or Estonian legislation, global standards or interpretation thereof. Such changes, either individually or in combination, may lead to unexpected increased requirements and have a material adverse effect on the business of LHV Pank and the Group as a whole. This may result in the need to increase capital, reduce leverage and risk weighted assets, modify the Group's legal structure or even change the Group's business model. Failure to comply with the capital adequacy requirements could have serious legal and reputational consequences as well as a material adverse effect on the Group's operations.

Tax Regime Risks. Tax regimes of the geographical markets where the Group operates are from time to time subject to change, some of which may be dictated by short-term political needs and may therefore be unexpected and unpredictable. For example, as a result of a separate corporate income tax (CIT) regime targeted specifically at Estonian resident credit institutions, credit institutions are required to make quarterly advance payments of income tax on the profit earned in the previous quarter while the companies operating in other sectors remain subject to the corporate income tax regime whereunder profit is subject to taxation only upon distribution. Such advance payments are made at a reduced CIT rate of 14% and the first advance payment was due on September 10, 2018. The quarterly profit of credit institutions, on the basis of which the advance CIT is calculated, is reduced by the amount of the tax-exempt dividends received by the credit institution in that quarter, as well as by the amount of loss gained during the preceding 19 quarters (loss carry forward for five years). However, the calculation of the loss carry forward can start from the second quarter of 2018, *i.e.*, credit institutions are not allowed to account for losses that had arisen prior to the second quarter of 2018. Credit institutions have the right to set-off the CIT payable from dividend distributions (including from regular dividends) or distributions from the company's equity capital, against the advance CIT payments that had been previously made to the tax authority under the above described advance payment arrangement. The advance CIT has a more significant impact on credit institutions in the active growth phase, such as LHV Pank, as it reduces the own funds of the bank. Similar changes or any other changes in the tax regimes in the jurisdictions where the Group companies operate or in the interpretation of such tax laws, regulations or treaties may have material adverse effect on the Group's operations, financial condition and results of operations.

Exposure to Regulatory Actions and Investigations. The Group provides various financial services and products and is therefore subject to extensive and comprehensive regulations imposed both through

local and through European legal acts. Several local and European authorities, including financial supervision, consumer protection, anti-money laundering, tax, and other authorities, regularly perform investigations, examinations, inspections and audits of the Group's business, including, but not limited to regarding capital requirements, standards of consumer lending, anti-money laundering, anti-bribery, payments, reporting, corporate governance, etc. Any determination by the authorities that the Group has not acted in compliance with all the applicable laws and regulations could have serious legal and reputational consequences for the Group, including exposure to fines, criminal and civil penalties and other damages, increased prudential requirements or even lead to business disruption in the respective fields. Any of these consequences may have material adverse effect on the Group's operations, financial condition and results of operations.

Contractual Risks. The operations of the Group are materially dependent on the validity and enforceability of the transactions and agreements entered into by the Group. These transactions and agreements may be subject to the laws of Estonia or to the laws of other countries where the Group companies operate. While due care is taken to ensure that the terms of these transactions and agreements are fully enforceable under the laws applicable to them, occasional contradictions and variations of interpretation may occur. Consequently, the Group companies may not be able to always enforce their contractual rights. Moreover, the legal environment where such transactions are effected and agreements are entered into, which is primarily that of the Baltic states, is subject to changes, both through the enactment of new laws and regulations and through changes in interpretation by the competent authorities and courts. Therefore, it cannot be fully excluded that certain terms of the transactions and agreements entered into by the Group companies turn out to be unenforceable, which in turn may have material adverse effect on the Group's operations, financial condition and results of operations.

Exposure to Civil Liability. The Group operates in a legal and regulatory environment that exposes it to significant risk of claims, disputes and legal proceedings. The results of such disputes are inherently difficult to predict and even the disputes themselves, not only unfavourable outcomes, may result in the Group incurring significant expenses and damages, and in negative effects on the Group's reputation, which in turn may have material adverse effect on the Group's operations, financial condition and results of operations.

### **3.4. Risks Related to Shares, Offering and Listing**

Volatility and Limited Liquidity of Securities Listed on Nasdaq Tallinn Stock Exchange. The Company will apply for the listing and admission to trading of the Subscription Rights and the Offer Shares on the Baltic Main List of the Nasdaq Tallinn Stock Exchange. Though every effort will be made to ensure that listing and admission to trading will occur, the Company cannot provide any assurance that the Subscription Rights and the Offer Shares will be listed and admitted to trading. The total trading turnover of the Baltic Main list the Nasdaq Baltic Stock Exchanges in 2018 was EUR 314 million. As at 30 August 2019 a total of 33 companies were listed on the Baltic Main List of the Nasdaq Baltic Stock Exchange. The aggregate market capitalisation of the Baltic Main list of the Nasdaq Baltic Stock Exchange was as at 30 August 2019 EUR 5.5 billion. Further, there have been only a limited number of subscription rights admitted to trading on the Nasdaq Baltic Stock Exchange and there is no precedent of active trading with such instruments in the past. Consequently, the Baltic Main List of the Nasdaq Tallinn Stock Exchange, as well as Nasdaq Tallinn Stock Exchange in general, is substantially less liquid and more volatile than established markets such as those in other countries with highly developed securities markets. The relatively small market capitalisation and low liquidity of the Nasdaq Tallinn Stock Exchange may impair the ability of shareholders and holders of Subscription Rights to sell the Shares and Subscription Rights on the Nasdaq Tallinn Stock Exchange, or could increase the volatility of the price of the Shares and the Subscription Rights. The delisting of any of the large companies listed on

the Nasdaq Tallinn Stock Exchange would be likely to have a negative effect on the market capitalisation and liquidity of the Nasdaq Tallinn Stock Exchange as a whole. Since the Nasdaq Tallinn Stock Exchange is characterised by relatively low investor activity, the impact of individual transactions on the market price of securities may be significant. Lower investor activity may lead to wider spreads between the bid and ask prices and a correspondingly lower liquidity of traded securities.

Tax Regime Risks. Adverse changes in the tax regime applicable in respect of transacting with the Shares or receiving dividends may result in an increased tax burden of the shareholders and may therefore have adverse effect on the rate of return from the investment into the Shares.

Payment of Dividends. The Company is under no lasting and definite obligation to pay regular dividends to its shareholders and no representation can be made with respect to the payment and amount of future dividends. The Management's recommendations for the distribution of profit will be based on financial performance, capital adequacy requirements, reinvestment needs and strategic considerations which may not necessarily coincide with the short-term interests of all shareholders. The payment of dividends and the amount thereof will be subject to the ultimate discretion of the majority of the Company's shareholders.

Bail-in Risk. The Company as a financial holding company and its subsidiaries are subject to the Financial Crisis Prevention and Resolution Act (the **FCPRA**) implementing the BRRD into Estonian law. This means that the EFSA may subject the Group to crisis prevention and resolution measures, if the EFSA assesses it to be likely that the financial situation of the Group may rapidly deteriorate or if it is likely that the Group is insolvent or may become insolvent in the future. Resolution measures are applied only in extraordinary circumstances, upon the fulfilment of a number of specific criteria and as a last resort. If resolution measures are applied, the EFSA has a right to require in respect of the Company or its subsidiaries, *inter alia*, (i) the write-down or cancellation of shares (ii) the transfer of shares or all assets, rights and liabilities, (iii) the revocation of the subscription rights to acquire additional shares or other instruments of ownership, (iv) the issue of new shares or other capital instruments, (v) suspending or terminating trading or listing of shares. Additionally, unless the resolution for application of crisis prevention measures provides differently, the voting rights of the Company as a shareholder of LHV Pank and the authorisation of some or all of LHV Pank's management or supervisory board members will be suspended. Crisis prevention measures may also be applied to the debt obligations owed by LHV Pank to the Company, decreasing the income of the Company. Therefore, should the Group be subject to crisis prevention measures, such measures may be detrimental to the interests of the Company's shareholders and the financial situation of the Group.

Shareholders in certain jurisdictions may not be able to participate in future equity offerings. Estonian Commercial Code provides for pre-emptive rights (in Estonian: *eesõigus*) to be granted to existing shareholders of the Company in case of future issue of shares by the Company, which can be disapplied, subject to a decision supported by a majority of at least 3/4 of the votes represented at the general meeting. However, securities laws of certain jurisdictions may restrict the Company's ability to allow participation by shareholders in future offerings. In particular, holders of the Shares in the United States may not be entitled to exercise these rights, unless the Shares and any other securities that are offered and sold are registered under the U.S. Securities Act, or the Shares and such other securities are offered pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the U.S. Securities Act. We cannot assure prospective investors that any exemption from such overseas securities law requirements would be available to enable U.S. or other shareholders to exercise their pre-emptive rights or, if available, that the Group will utilise any such exemption.

Dilution. The proportion of shareholding held by the Shareholders in the Company may be diluted if the share capital of the Company is increased and new Shares are issued in the future. In the future there

may be a need to increase the share capital of the Company and issue new Shares in order to engage additional capital into the Company. Pursuant to the Estonian Commercial Code, existing shareholders of a public limited company have, upon the increase of the share capital of the company and the issue of the new shares of the company, the preferential right to subscribe for such new shares of the company proportionally to their existing shareholding in the company. Such preferential right can; however, be excluded by the respective resolution of the General Meeting of shareholders, which requires the affirmative vote of 3/4 of the votes represented at the General Meeting of shareholders. Therefore, there can be no assurance that the Shareholders will be entitled to subscribe for the new Shares, which may be issued in the future and therefore the proportion of their shareholding in the Company may decrease in the future.

Lack of Adequate Analyst Coverage. There is no guarantee of continued analyst research coverage for the Company. Over time, the amount of third-party research available in respect of the Company may increase or decrease with little or no correlation with the actual results of its operations as Company has no influence on the analysts who prepare such reports. Negative or insufficient third-party reports would be likely to have an adverse effect on the market price and the trading volume of Shares.

Cancellation of Offering. Although best efforts will be made by the Company to ensure that the Offering is successful, the Company cannot provide any assurance that the Offering will be successful and that the investors will receive the Offer Shares they subscribed for. The Company shall be entitled to cancel the Offering on the terms and conditions described in the Section 4.12 "Cancellation of Offering". The Offering may also be cancelled in the part not subscribed for in the course of the Offering. Considering the contemplated use of proceeds from the Offering as described in Section "Reasons for Offering and Use of Proceeds", the cancellation of the Offering in the part not subscribed for in the course of the Offering may have a material negative effect on the operations of the Group as it may cause the transaction for the purchase of the Danske Loan Portfolio not to occur.

## 4. TERMS AND CONDITIONS OF OFFERING

### 4.1. The Offering

The Company is offering up to 2,200,000 new Shares with the nominal value of EUR 1 euros each (the **Offer Shares**) to the existing shareholders (the **Offering**) by virtue of a rights issue on terms and conditions as described below. The Offering comprises of an offering to retail investors in Estonia and of an offering to institutional investors in and outside of Estonia to qualified investors within the meaning of Article 2(e) of the Prospectus Regulation and other types of investors in reliance on certain exemptions available under the laws of each jurisdiction where the Offering is being made. A public offering will be carried out only in Estonia and there will not be any public offering in any other jurisdiction.

The Offering will involve the issue of new Shares in a volume corresponding to the number of the Offer Shares subscribed for in the course of the Offering and allocated to investors in accordance with the terms described in this Section 4 “Terms and Conditions of Offering”. In order to conduct the Offering and issue the respective number of new Shares, increase of share capital of the Company was decided by the General Meeting of shareholders held on 21 August 2019. According to the resolution adopted by the General Meeting of shareholders, the Management has been authorised to issue up to 2,200,000 new Shares to conduct the Offering and the shareholders of the Company entered into the shareholders list of the Company on 4 September 2019 at the end of the business day of the settlement system of the ERS (the **Record Date**) shall be granted a preferential right to subscribe for the Offer Shares (the **Subscription Rights**). Based on the share ledger as at 4 September 2019, the total number of Subscription Rights issued is 2 188 372.

The Subscription Period for the Offer Shares (as defined below) commences on 11 September 2019 at 10:00 local time in Estonia and terminates on 25 September 2019 at 16:00 local time in Estonia. The Company has made an application to list and admit the Subscription Rights to trading on the Nasdaq Tallinn Stock Exchange. Trading in the Subscription Rights is expected to commence on the Nasdaq Tallinn Stock Exchange on 11 September 2019 and is expected to end on 23 September 2019.

The list of persons holding the Subscription Rights shall be fixed on 25 September 2019 at the end of the business day of the settlement system of the ERS. Each investor holding Subscription Rights on 25 September 2019 at the end of the business day of the ERS will receive at least the number of Offer Shares corresponding to the number of Subscription Rights, provided that it has submitted a Subscription Undertaking for at least the same amount of Offer Shares in accordance with Section “Subscription Undertakings”. No Offer Shares shall be allocated or issued to persons who do not hold Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS.

If all of the 2,200,000 Offer Shares are not subscribed for using Subscription Rights due to the number of Subscription Rights being smaller than 2,200,000 (2 188 372) as a result of the exact composition of the share ledger of the Group on 4 September, the Offer Shares not subscribed for using Subscription Rights shall be allocated between investors who both (i) hold Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS, and (ii) have submitted a Subscription Undertaking for a number of shares exceeding the number of Subscription Rights held by it. Allocation of such Offer Shares shall be made on *pro rata* basis based on the number of Subscription Rights held by each investor, provided that it does not exceed the number of Offer Shares subscribed for by each relevant investor. The total amount of Offer Shares may decrease in case any part of the Offering is cancelled – please refer to Section 4.12 “Cancellation of Offering” for further details.

The Offer Shares are expected to be registered in the Estonian Commercial Register on or about 9 October 2019. After registration of the Offer Shares with the Estonian Commercial Register, the Offer Shares will rank *pari passu* with all the existing Shares.

The timetable set forth below provides certain indicative key dates for the Offering:

11 September 2019	Start of Subscription Period, start of trading with Subscription Rights on Nasdaq Tallinn Stock Exchange
20 September 2019	Last date to acquire Subscription Rights from the Nasdaq Tallinn Stock Exchange allowing delivery of the Subscription Rights before the end of Subscription Period (T + 2 settlement)
23 September 2019	Trading with Subscription Rights on Nasdaq Tallinn Stock Exchange ends
25 September 2019	End of Subscription Period
On or about 26 September 2019	Announcement of the results of the Offering
On or about 1 October 2019	Settlement of the Offering (during the settlement, the Offer Shares will carry a temporary ISIN)
On or about 9 October 2019	Registration of the Offer Shares in the Estonian Commercial Register
On or about 11 October 2019	The Offer Shares will receive the permanent ISIN EE3100073644
On or about 14 October 2019	First trading day of the Offer Shares on Nasdaq Tallinn Stock Exchange

#### 4.2. Subscription Rights

The Company's shareholders fixed in the share register on the Record Date shall be granted the Subscription Rights. One Subscription Right per each 12 Shares will be issued. If the number of shares held by the shareholder does not grant a whole number of Subscription Rights, the number of Subscription Rights shall be rounded to the nearest mathematical whole number, whereas fractions under one shall be rounded to one. For example, a shareholder holding 1-12 Shares received one Subscription Right. A shareholder holding 1000 Shares will receive  $1000:12=83.333$ , rounded to 83 Subscription Rights. Each Subscription Right will entitle the investor to subscribe to and receive in allocation 1 Share, subject to the limitations in Section 4.12 "Cancellation of the Offering".

The exact total number of Subscription Rights issued to the Company's shareholder depended on the exact share ledger of the Company on 4 September 2019. Based on the share ledger as at 4 September 2019, the total number of Subscription Rights issued is 2 188 372.

The Subscription Rights will be transferred on 10 September 2019 at the latest to those securities accounts where the Shares were registered on 4 September 2019 at the end of the business day of ERS. The Subscription Rights will be deleted from securities accounts of the shareholders following completion of the Subscription Period. If a shareholder does not exercise any or all of the Subscription Rights by submitting a Subscription Undertaking or does not sell the Subscription Rights on or prior 23 September 2019, such shareholders Subscription Rights to subscribe for Offer Shares will lapse with no value and the holder will not be entitled to compensation.

#### 4.3. Right to Participate in the Offering

The Offering is directed only to persons who hold Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS. Subscription Undertakings from persons not entered on such list will be cancelled during the allocation process.

In the course of the Offering investors may submit a Subscription Undertaking with or without holding any Subscription Rights. However, only those persons who hold the respective number of Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS and have submitted a Subscription Undertaking shall be allocated and will receive the Offer Shares. Holders of nominee accounts are considered legal owners of the Shares, hence, for the purposes of allocation, beneficiary investors receiving Subscription Rights on nominee accounts must themselves ensure that the Subscription Undertaking submitted by them details the number of the same securities account (nominee account) on which Subscription Rights are held. The Subscription Undertakings of investors not using a nominee account structure shall be merged.

The Offering comprises of an offering to retail investors in Estonia and of an offering to institutional investors in and outside of Estonia to qualified investors within the meaning of Article 2(e) of the Prospectus Regulation and other types of investors in reliance on certain exemptions available under the laws of each such jurisdiction. A public offering will be carried out only in Estonia and there will not be any public offering in any other jurisdiction. For the purposes of the Offering, a person is considered to be "in Estonia" and has a right to participate in the Offering if such person has an operational securities account with the ERS and such person submits a Subscription Undertaking (as defined below) in relation to Offer Shares via that securities account.

#### **4.4. Trading in Subscription Rights**

The Company has made an application to list and admit the Subscription Rights to trading on the Nasdaq Tallinn Stock Exchange. Trading in the Subscription Rights is expected to commence on the Nasdaq Tallinn Stock Exchange on 11 September 2019 and is expected to end on 23 September 2019. The ISIN code for the Subscription Right is EE3700080726.

#### **4.5. Offer Price**

The Offer Price is EUR 11.5 per one Offer Share, of which EUR 1 is the nominal value of one Offer Share and EUR 10.5 is the issue premium.

#### **4.6. Subscription Period**

The Subscription Period is the period during which the persons who have the right to participate in the Offering may submit Subscription Undertakings (please refer to Section 4.7 "Subscription Undertakings" for further details) for the Offer Shares. The Subscription Period commences on 11 September 2019 at 10:00 local time in Estonia and terminates on 25 September 2019 at 16:00 local time in Estonia.

#### **4.7. Subscription Undertakings**

The Subscription Undertakings for the Offer Shares by may be submitted only during the Subscription Period. An investor participating in the Offering may apply to subscribe for the Offer Shares only for the Offer Price. All investors participating in the Offering can submit Subscription Undertakings denominated only in euro. An investor shall bear all costs and fees charged by the respective custodian of the ERS accepting the Subscription Undertaking in connection with the submission, cancellation or amendment of a Subscription Undertaking.

Multiple Subscription Undertakings by one investor shall be merged for the purposes of allocation. In order to subscribe for the Offer Shares, an investor must have a securities account with the ERS. Such securities account may be opened through any custodian of the ERS. The list of banks and investment firms operating as custodians of the ERS is available on the website of the ERS <https://nasdaqcsd.com/services/services-to-account-operators/list-of-account-operators/>.

An investor wishing to subscribe for the Offer Shares should contact a custodian that operates such investor's ERS securities account and submit a Subscription Undertaking in the form set out below. Due to the technical process used in distributing the Offer Shares, the Subscription Undertaking must detail the ISIN code of the Subscription Rights (and not the Offer Shares), as provided below. The Subscription Undertaking must be submitted to the custodian by the end of the Subscription Period. The investor may use any method that such investor's custodian offers to submit the Subscription Undertaking (e.g. physically at the client service venue of the custodian, over the internet or by other means).

Holders of nominee accounts are considered legal owners of the Shares and the Subscription Rights are transferred on the nominee accounts, hence the investors holding shares on nominee accounts must submit the Subscription Undertakings via nominee account holder and must ensure the Subscription Undertaking includes the number of the same securities account (nominee account) on which Subscription Rights are held.

The Subscription Undertaking for the Offer Shares must include the following information:

<b>Owner of the securities account:</b>	name of the investor
<b>Securities account:</b>	number of the investor's securities account
<b>Custodian:</b>	name of the investor's custodian
<b>Security:</b>	LHV Group share
<b>ISIN code:</b>	EE3700080726 <sup>(1)</sup>
<b>Amount of securities:</b>	the number of Offer Shares for which the investor wishes to subscribe
<b>Price (per one Offer Share):</b>	EUR 11.5
<b>Transaction amount:</b>	the number of Offer Shares for which the investor wishes to subscribe multiplied by the Offer Price
<b>Value date of the transaction:</b>	1 October 2019
<b>Type of transaction:</b>	"purchase"
<b>Type of settlement:</b>	"payment free of delivery" "free of payment" (PFOD, FOP)

Note

(1) ISIN of the Subscription Right and not the Offer Shares should be included in the Subscription Undertaking due to the technical process applicable to Offerings carried out as a rights issue.

In case the investor holds Subscription Rights and exercises the right by submitting a Subscription Undertaking for the corresponding number of Offer Shares, the Subscription Rights on the investors securities account will be blocked. In case the investor does not hold Subscription Rights or wishes to subscribe for more Offer Shares than the number of Subscription Rights held by such investor, the Subscription Rights on the investors securities account will not be blocked, however no Offer Shares shall be allocated or issued to persons who do not hold Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS.

An investor may submit a Subscription Undertaking through a nominee account only if such investor authorises the owner of the nominee account to disclose the investor's identity to the registrar of the ERS in writing. The Subscription Undertakings submitted through nominee accounts will be taken into

consideration in the allocation only if the owner of the nominee account has actually disclosed the identity of the investor to the registrar of the ERS in writing. Among other information it is also requested to disclose a permanent address and personal identification code in case of a natural person or a registration address for a legal entity. An investor may submit a Subscription Undertaking either personally or through a representative whom the investor has authorised (in the form required by law) to submit the Subscription Undertaking.

A Subscription Undertaking is deemed submitted from the moment the registrar of the ERS receives a duly completed transaction instruction from the custodian of the respective investor.

An investor must ensure that all information contained in the Subscription Undertaking is correct, complete and legible. The Company reserves the right to reject any Subscription Undertakings, which are incomplete, incorrect, unclear or illegible, or which have not been completed and submitted during the Subscription Period in accordance with all requirements set out in these terms and conditions.

By submitting a Subscription Undertaking every investor:

- (i) accepts the terms and conditions of the Offering set out under this Section and elsewhere in this Prospectus and agrees with the Company that such terms will be applicable to the investor's acquisition of any Offer Shares;
- (ii) acknowledges that the Offering does not constitute an offer of the Offer Shares by the Company within the meaning of Section 16(1) of the Estonian Law of Obligations Act or otherwise and that the submission of a Subscription Undertaking does not itself entitle the investor to acquire the Offer Shares nor result in a contract for the sale of Offer Shares between the Company and the investor;
- (iii) accepts that the number of the Offer Shares indicated by the investor in the Subscription Undertaking will be regarded as the maximum number of the Offer Shares, which the investor wishes to acquire (the **Maximum Amount**) and that the investor may receive less (but not more) Offer Shares than the Maximum Amount (please refer to Section 4.9 "Distribution and Allocation" for further details);
- (iv) undertakes to acquire and pay for any number of Offer Shares allocated to it in accordance with these terms and conditions, up to the Maximum Amount;
- (v) authorises and instructs its custodian to forward the registered transaction instruction to the registrar of the ERS;
- (vi) authorises the custodian and the registrar of the ERS to amend the information contained in the investor's transaction instruction, including (a) to specify the value date of the transaction and (b) to specify the number of the Offer Shares to be purchased by the investor and the total amount of the transaction found by multiplying the Offer Price by the number of Offer Shares allocated to the relevant investor;
- (vii) confirms, that he/she/it is not subject to the laws of any other jurisdiction which would prohibit the placing of the Subscription Undertaking or allocation of the Offer Shares to him/her/it and represents that he/she/it is authorised to place a Subscription Undertaking in accordance with the Prospectus.

An investor may amend or cancel a Subscription Undertaking at any time before the expiry of the Subscription Period. To do so, the investor must contact its custodian through whom the Subscription Undertaking in question has been made and carry out the procedures required by the custodian for amending or cancelling a Subscription Undertaking (such procedures may differ between different custodians).

#### 4.8. Payment

By submitting a Subscription Undertaking, an investor authorises and instructs the institution operating the investor's cash account connected to its securities account (which may or may not also be the investor's custodian) to immediately block the whole transaction amount on the investor's cash account until the settlement is completed or funds are released in accordance with these terms and conditions. The transaction amount to be blocked will be equal to the Offer Price multiplied by the Maximum Amount. An investor may submit a Subscription Undertaking only when there are sufficient funds on the cash account connected to its ERS securities account or its securities account to cover the whole transaction amount for that particular Subscription Undertaking.

#### 4.9. Distribution and Allocation

The Company will decide on the allocation of the Offer Shares after the expiry of the Subscription Period on or about 26 September 2019. Offer Shares will be allocated only to those persons who hold the respective number of Subscription Rights on 25 September 2019 at the end of the business day of the settlement system of the ERS and have submitted a Subscription Undertaking. The Offer Shares will be allocated to the investors participating in the Offering in accordance with the following principles:

- (i) all persons who hold the respective number of Subscription Rights on their securities account on 25 September 2019 at the end of the business day of the settlement system of the ERS are guaranteed to receive the respective number of Offer Shares (i.e. the smaller number of the Subscription Rights held by the investor and the number of Offer Shares subscribed for by such investor);
- (ii) if the number of Offer Shares allocated in accordance with the principle in subsection (i) above is smaller than 2,200,000, the remaining Offer Shares shall be allocated to persons who held Subscription Rights on their securities account on 25 September 2019 at the end of the business day of the settlement system of the ERS proportionally, insofar as mathematically possible, to the number of Subscription Rights held, but in a number not larger than the number of Offer Shares that they subscribed for (for avoidance of doubt, the number of guaranteed shares allocated in subsection (i) taken into account).

Multiple Subscription Undertakings by one investor shall be merged for the purposes of allocation (except in case the investor is using a nominee structure in which case the holder of the nominee account is considered to be the legal owner of Shares).

Upon over-subscription of the Offering, the number of the Offer Shares will remain the same (altogether 2,200,000 Offer Shares), which will be allocated to the investors participating in the Offering in accordance with the principles described in this Section "Distribution and Allocation". The funds blocked on the investor's account will be returned in the amount corresponding to the Offer Price multiplied by the number of Shares not allocated to the specific investor as described in Section 4.11 "Return of Funds". Upon under-subscription of the Offering, the Company shall be entitled to cancel the Offering in the part not subscribed for in the course of the Offering as described in Section 4.12 "Cancellation of Offering" below. The Offer Shares subscribed for will be allocated to the investors participating in the Offering in accordance with the principles described in this Section "Distribution and Allocation".

Subscription Rights not used in accordance with this Section "Distribution and Allocation" will be cancelled.

The Company expects to announce the results of the allocation process through the information system of the Nasdaq Tallinn Stock Exchange and at the Company's website <https://investor.lhv.ee/> on or about 26 September 2019.

The Company is not aware whether major shareholders or members of the Management Board and Supervisory Board of the Company or any other key employees intend to subscribe for the Offer Shares or whether any person intends to subscribe for more than five per cent of the offer.

#### **4.10. Settlement and Trading**

The Offer Shares will be registered in book entry form in the ERS under ISIN EE3100073644. During the settlement of the Offering, the Offer Shares will carry a temporary ISIN, which will be changed to the permanent ISIN EE3100073644 after registration of the Offer Shares in the Commercial Register.

The Offer Shares allocated to investors will be transferred to their securities accounts on or about 1 October 2019 through the “free of payment” method shortly after debiting the payment for such temporary shares from the investors’ account connected with the securities account through the “payment free of delivery” method. The Offer Shares will receive the permanent ISIN EE3100073644 on or about 11 October 2019.

If an investor has submitted several Subscription Undertakings through several securities accounts belonging to it, the Offer Shares allocated to such investor are transferred to such investor’s securities accounts proportionally with the respective securities amounts set out in such investor’s Subscription Undertakings. The number of the Offer Shares to be transferred to each securities account may be rounded up or down, as necessary, in order to ensure that a whole number of Offer Shares is transferred to each securities account. If the transfer cannot be completed due to the lack of sufficient funds on the investor’s cash account, the Subscription Undertaking of the respective investor will be rejected and the investor will lose all rights to the Offer Shares allocated to such investor.

Trading with the Offer Shares is expected to commence on the Nasdaq Tallinn Stock Exchange on or about 14 October 2019.

#### **4.11. Return of Funds**

If the Offering or a part thereof is cancelled in accordance with the terms and conditions described in this Prospectus, if the investor’s Subscription Undertaking is rejected or if the allocation deviates from the amount of Offer Shares applied for, the funds blocked on the investor’s cash account, or a part thereof (the amount in excess of payment for the allocated Offer Shares), will be released by the respective custodian on or about 1 October 2019. The Company shall not be liable for the release of the respective amount and for the payment of interest on the released amount for the time it was blocked.

#### **4.12. Cancellation of Offering**

In addition to other cancellation rights, the Company has reserved the right to cancel the Offering in the part not subscribed for in the course of the Offering by way of Subscription Offers that could be satisfied according to the principles outlined in Section 4.9 “Distribution and Allocation”. Any cancellation of the Offering will be announced through the information system of the Nasdaq Tallinn Stock Exchange and at the Company’s website <https://investor.lhv.ee/>. All rights and obligations of the parties in relation to the cancelled part of the Offering will be considered terminated at the moment when such announcement is made public.

Revocation of the Offering after trading has begun is not permitted.

#### **4.13. Conflicts of Interests**

According to the knowledge of the Management, there are no personal interests of the persons involved in the Offering material to the Offering. The Management is unaware of any conflicts of interests related to the Offering.

#### **4.14. Dilution**

As at the date of this Prospectus, the number of the Shares of the Company is 26,254,079. The amount of the Offer Shares is up to 2,200,000. Therefore, the number of the Shares of the Company after the successful registration of the increase of the share capital of the Company will be up to 28,454,079, provided; however, that the number of the Offer Shares is not changed in accordance with the terms and conditions described in the Section 4.12 "Cancellation of Offering". Therefore, following the completion of the Offering assuming that (i) all offered Offer Shares will be subscribed for and issued, (ii) all shareholders choose to transfer their Subscription Rights to third parties and not use those for Subscribing to any Offer Shares, (iii) such third parties will use the Subscription Rights to subscribe for the Offer Shares, the shareholdings in the Company prior to the Offering will be diluted by up to 7.7318% as a result of the Offering. Shareholders who do not participate in the Offering have possibility to obtain economic compensation for the dilution effect by selling the Subscription Rights.

#### **4.15. Listing and Admission to Trading**

The Company intends to apply for the listing and admission to trading of all the Shares (including Offer Shares subscribed for and issued by the Company and allocated to investors as a result of the Offering) on the Main List of Nasdaq Tallinn Stock Exchange as soon as possible after the registration of the Offer Shares in the in the ERS and the Estonian Commercial Register. The Company will take all necessary measures in order to comply with the Nasdaq Tallinn Stock Exchange rules so that its application would be approved. The expected date of listing and admission to trading of the Offer Shares on the Baltic Main List of the Nasdaq Tallinn Stock Exchange is on or about 14 October 2019.

## 5. REASONS FOR OFFERING AND USE OF PROCEEDS

The purpose of the Offering is to strengthen the capital structure of the Group and ensure stable access to additional capital to support the further growth and market position of the Group, increase the business volumes of the Group and ensure conservative capital buffer for the Group companies.

Provided that the Offering is successful and that all the Offer Shares (altogether 2,200,000 Shares) are subscribed for and issued by the Company, the expected amount of gross proceeds of the Offering is EUR 25.3 million. Expenses directly related to the Offering are estimated to be approximately EUR 0.15 million comprising of legal and audit expenses and communication and marketing expenses. Therefore, the net proceeds of the Offering are expected to be EUR 25.15 million. The Group plans to use the net proceeds of the Offering in line with the overall purpose of the Offering, in particular, up to EUR 10 million of the net proceeds are planned to be used to cover the additional Tier 1 capital need of the Group triggered by the acquisition of private loans' unit of Danske Bank A/S Estonian branch as described in Section 10.4 "Investments" below (the **Danske Loan Portfolio**). Please refer to Section 14 of this Prospectus for further information about the expected impact of the acquisition of the Danske Loan Portfolio to the Group's financial position.

## 6. DIVIDEND POLICY

The Offer Shares will give rights to dividends declared by the Company (if any) for the financial year beginning on 1 January 2019 and for the subsequent financial years. The Company cannot ensure that dividends will be paid in the future, or if dividends will be paid, how much they will amount to. Resolving the payment of dividends is in the competence of the General Meeting. The payment by the Company of any future dividends and the amount thereof will depend on the Company's results of operations, financial condition, capital requirements, future prospects and other aspects.

The Management is expecting the Company to continue paying of dividends to the shareholders of the Company on an annual basis. The operations of the Group have been constantly growing over the years and been subject to rapid expansion. Such high growth and rapid expansion have resulted in the Group companies consuming more capital than they have generated internally. Such a capital deficit has been covered by engaging additional capital by increasing the share capital of the Company and issuing new Shares as well as issuing of debt instruments (bonds). Although the Management is expecting to continue the relatively high growth of the operations of the Group also over the upcoming years, the business of the Group is maturing and therefore the Management is expecting the growth rates to decrease gradually, which in turn is expected to result in the growth of internally generated capital. Given the regulated nature of the operations of the Group, the Group must ensure to stay sufficiently capitalised (including to meet the applicable capital adequacy requirements) and liquid, including maintaining adequate liquidity buffers to correspond to general risk level of operations of the Group and business segments where the Group companies operate.

According to the Company's dividend policy as approved by the General Meeting on 20 April 2016, it is the intention of the Company to distribute profit and pay dividends to shareholders in the ratio of at least 25% of the profit before taxes. The Company has paid dividends for the previous years as follows: (i) in 2017, the Company paid dividends in the net sum of 15 cents per one share; (ii) in 2018, the Company paid dividends in the net sum of 16 cents per one share and (iii) in 2019, the Company paid dividends in the net sum of 21 per one share. Such dividend policy is planned to be followed, provided that the operating needs of the Group as determined by the Supervisory Board are covered and that after the distribution of profit all Group companies comply with all internal and external capital and liquidity requirements in full. The Company reserves itself the right to reduce the amount of profit distributed and dividends paid or not to distribute profit and pay dividends if there is a credible investment opportunity, which is expected to result in significant increase of the value of the Group in a long-term perspective.

## 7. GENERAL CORPORATE INFORMATION AND ARTICLES OF ASSOCIATION

### 7.1. General Corporate Information

The business name of the Company is AS LHV Group. The Company was registered in the Estonian Commercial Register on 21 January 2005 under the register code 11098261. The Company has been established and is currently operating under the laws of the Republic of Estonia in the form of a public limited company (in Estonian: *aktsiaselts* or AS) and is established for an indefinite term.

The contact details of the Company are the following:

Address: Tartu mnt 2, 10145 Tallinn, Estonia

Phone: +372 6 800 400

Fax: +372 6 800 410

E-mail: [lhv@lhv.ee](mailto:lhv@lhv.ee)

Website: <https://investor.lhv.ee/><sup>16</sup>

The legal entity number (LEI) of the Company is 529900JG015JC10LED24. According to the latest available annual report of the Company, i.e. the annual report for the financial year ended on 31 December 2018, the field of activity of the Company was “activities of holding companies” (EMTAK<sup>17</sup> 64201). The consolidated fields of activity of the Group were “security and commodity contracts brokerage” (EMTAK 66121), “credit institutions (banks, granting loans)” (EMTAK 64191), “finance lease” (EMTAK 64911) and “fund management” (EMTAK 66301).

### 7.2. Articles of Association

The latest version of the Articles of Association of the Company was adopted by the respective resolution of the General Meeting of shareholders of the Company, dated 29 March 2017. The main terms of the Articles of Association of the Company are the following:

- (i) the minimum amount of the share capital of the Company is EUR 15,000,000 and the maximum amount of the share capital of the Company is EUR 60,000,000, whereas the share capital of the Company may be increased and decreased within the minimum and maximum amount of the share capital without amending the currently effective version of the Articles of Association of the Company;
- (ii) the Company has one type of shares only. The nominal value of the ordinary share of the Company is EUR 1 and each share grants the shareholder one vote at the General Meeting of shareholders;
- (iii) the Shares may be paid in by monetary or non-monetary contribution into the share capital as determined by the General Meeting of shareholders of the Company;
- (iv) the Shares are freely transferrable and may be pledged in accordance with applicable law;

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<sup>16</sup> The Company is not incorporating by reference into this Prospectus any information posted on the website.

<sup>17</sup> EMTAK (the Estonian Classification of Economic Activities) is the basis for determining the fields of activity of Estonian companies. EMTAK is the national version of the international harmonised NACE classification. As of 1 January 2007, the Estonian companies are, instead of providing their fields of activity in the Articles of Association, required to report them in their annual reports using EMTAK classification.

- (v) the Company may issue convertible bonds;
- (vi) the Supervisory Board comprises of five to seven members elected for a period of three years; only persons with sufficient knowledge and professional experience for the position of a member of the Supervisory Board may be elected as members of the Supervisory Board; the Articles of Association further specify the persons who may not be appointed to the Supervisory Board and such persons are (i) members of management bodies of companies competing with the Company or with a Group company, members of audit committees or other committees of a credit institution, or auditors, except for intra-group positions; (ii) persons subject to restrictions on acting as a member of Supervisory Board or as an entrepreneur, imposed by a competent court; (iii) persons whose wrongful action or failure to act has, according to a ruling of a competent court, caused damage to a legal entity, resulted in a bankruptcy of a legal entity or the revocation of an activity license or a permit issued to a legal entity; (iv) persons who have committed a criminal offence in the field of economic activity or related to acting within a professional relationship, or an offence against property (the prohibition does not extend to persons, whose punishment has been deleted from the criminal record by the time of applying to the position of the Supervisory Board member);
- (vii) the Supervisory Board resolves the appointment and recalling of the members of the Management Board and determines the strategy, general activity plan, risk management principles and annual budget of the Company and exercises regular supervision over the compliance with them; the Supervisory Board adopts resolutions in matters not placed into the competence of the General Meeting of shareholders of the Company and falling outside the everyday economic activities of the Company;
- (viii) the Supervisory Board is entitled to establish committees and determine the existence, duties and role thereof within the corporate structure of the Company; the Supervisory Board establishes the audit committee and determines the rules of procedure thereof;
- (ix) the Management Board comprises of one to five members elected for a period of five years, whereas the Articles of Association provide for restrictions of the rights of representation of the members of the Management Board – the Company may be represented by the Chairman of the Management Board acting alone (if there is more than one member in the Management Board) or two members of the Management Board acting jointly;
- (x) the financial year of the Company is the calendar year.

## 8. SHARE CAPITAL, SHARES AND OWNERSHIP STRUCTURE

### 8.1. Share Capital and Shares

The current registered and fully paid-in share capital of the Company is EUR 26,254,079, which is divided into 26,254,079 ordinary shares of the Company (the Shares) with the nominal value of EUR 1. The Shares are registered in the ERS under ISIN code EE3100073644 and kept in book-entry form.

The Shares are governed by the laws of the Republic of Estonia. The Shares are freely transferrable. The Shares are listed on Nasdaq Tallinn Stock Exchange as of 23 May 2016.

### 8.2. Shareholders of the Company

As at the date of this Prospectus, the Shareholders holding over 5% of all Shares in the Company are the following:

Name of Shareholder	Number of Shares	Proportion	Person directly or indirectly controlling the Shareholder
AS Lõhmus Holdings	3,357,920	12.79%	Mr Rain Lõhmus, the Chairman of the Supervisory Board of the Company
Mr Rain Lõhmus	2,538,367	9.67%	N/A
Viisemann Investments AG	2,111,344	8.04%	Mr Andres Viisemann, Member of the Supervisory Board of the Company
Ambient Sound Investments OÜ	1,595,620	6.08%	Ahti Heinla, Annika Tallinn, Jaan Tallinn, Prit Kasesalu, Toivo Annus <sup>18</sup>

The founders of the Group – Mr Rain Lõhmus and Mr Andres Viisemann hold, directly and indirectly through related parties, altogether approximately 32.15% of all the Shares, whereas approximately 22.46% of the Shares are held by Mr Rain Lõhmus (as natural person and through AS Lõhmus Holdings and OÜ Merona Systems) and 9.69% by Mr Andres Viisemann (through Viisemann Investments AG and Viisemann Holdings OÜ).

The Management is as at the date of this Prospectus not aware of any arrangements or circumstances, which may at a subsequent date result in a change in control over the Company.

The major Shareholders of the Company do not have voting rights different than those described in Section “Rights of Shareholders” below.

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<sup>18</sup> Based on beneficial ownership data reported to the Estonian Commercial Register.

### 8.3. Rights of Shareholders

Introductory Remarks. This Section “Rights of Shareholders” aims to provide general overview of the rights of shareholders arising from Estonian law applicable in respect of the Shareholders of the Company.

Right to Participate in Corporate Governance. The shareholders of a public limited company are entitled to take part in the corporate governance of such company through the general meeting of shareholders, where they can exercise their powers to decide on certain important corporate matters, such as the amendment of the articles of association, the increase and decrease of the share capital, the issue of convertible bonds, the election and removal of the members of the supervisory board and the auditor, the approval of annual reports and the distribution of profit, the dissolution, merger, division or transformation of the company, and certain other matters. The general meeting of shareholders is the highest governing body of a public limited company.

The ordinary general meeting of shareholders must be held once a year pursuant to the procedure and at the time set forth by the law and the articles of association. Despite the fact that according to the Estonian Commercial Code the ordinary general meeting of shareholders must be held within six months as from the end of the financial year, the Estonian Securities Market Act specifies that the audited annual report of a listed and publicly traded company must be made public within four months as from the end of the financial year. According to the Estonian Commercial Code, before the ordinary general meeting of shareholders is held, the supervisory board must review the annual report and provide the general meeting of the shareholders with a written report on the annual report, indicating whether the supervisory board approves the report or not but also providing information on how the supervisory board has organised and supervised the activities of the management of the public limited company in the respective year. In practice, the referred report is made available together with the notice on convening the general meeting of the shareholders.

An extraordinary general meeting of the shareholders must be convened in the cases set forth in the articles of association of a public limited company but also: (i) in the event where the net equity of the company decreases below the legally required minimum level, or (ii) if shareholders representing at least 1/20 of the share capital of a public limited company listed and admitted to trading on a regulated market, the supervisory board, or the auditor request that a meeting is convened or (iii) if the meeting is required in the interests of the company. The Articles of Association of the Company do not include any deviation from the applicable law with respect to when the General Meeting of shareholders needs to be convened. If the management board of a public limited company fails to convene the extraordinary general meeting within one month after the receipt of the relevant request from shareholders (or from the supervisory board or from the auditor), the shareholders (or, respectively, the supervisory board or the auditor) have the right to convene the meeting themselves.

The notice of an upcoming general meeting of shareholders must be published and disclosed to shareholders three weeks in advance. The notice on convening the general meeting of shareholders must be published in at least one national daily newspaper in Estonia and, for issuers of listed instruments, through the information system of the Nasdaq Tallinn Stock Exchange. If there is a material breach of the requirements of convening the general meeting of the shareholders, such meeting does not have the capacity to adopt resolutions, except if all shareholders participate in the meeting.

As a rule, the agenda of the general meeting of the shareholders is determined by the supervisory board. However, if the meeting is convened by the shareholders or by the auditor, the agenda is determined by them. Furthermore, the management board or the shareholders whose shares represent at least 1/20 of the share capital of a public limited company listed and admitted to trading on a regulated market may demand the inclusion of a certain item into the agenda. An item which is initially not on the agenda of a general meeting of shareholders may be included in the agenda upon the consent of at

least 9/10 of the shareholders who participate at the meeting if their shares represent at least 2/3 of the share capital of such company.

A general meeting of shareholders of a public limited company is capable of passing resolutions if more than 1/2 of the votes represented by all shares held by shareholders are present at the meeting. If this quorum requirement is not met, the management board is required to convene a new meeting not more than three weeks but not less than seven days after the date of the initial meeting. There are no quorum requirements for the newly convened general meetings of shareholders convened in such a manner.

Only those shareholders are eligible to attend and vote at a general meeting of shareholders who were on the list of shareholders as of the date falling seven calendar days before the meeting.

As a rule, the resolutions of a general meeting of shareholders require the affirmative vote of the majority of the votes represented at the meeting. Certain resolutions, such as amending the articles of association, increasing or decreasing the share capital, resolutions relating to a merger or liquidation of the company, etc., require a qualified majority of 2/3 of the votes represented at the meeting of shareholders. In addition to such resolutions, there are resolutions which require an even higher rate of affirmative votes of shareholders, such as excluding the shareholders' preferential right to subscribe for new shares upon an increase of the share capital, which requires the affirmative vote of 3/4 of the votes represented at the general meeting of shareholders, and squeeze-out of minority shares, which requires the affirmative vote of 95/100 of the votes represented at the general meeting of shareholders. Higher quorum and voting requirements compared to the ones described herein may be stipulated by the articles of association of a public limited company. The quorum and voting requirements set forth by the Articles of Association of the Company do not deviate from the ones set forth by the applicable law.

Right to Information. Pursuant to the Estonian Commercial Code, the shareholders of a public limited company have the right to receive information on the activities of the company from the management board at the general meetings of shareholders. However, management board may refuse to give information if there is a reason to presume that this may cause significant damage to the interests of the company. In the event the management board refuses to give information, shareholders may require the general meeting of shareholders to decide on the legality of such refusal or submit a respective claim to the competent court.

Right to Subscribe for New Shares. Pursuant to the Estonian Commercial Code, existing shareholders of a public limited company have, upon the increase of the share capital of the company and the issue of the new shares of the company, the preferential right to subscribe for such new shares of the company proportionally to their existing shareholding in the company. Such preferential right can be excluded by the respective resolution of the general meeting of shareholders, which requires the affirmative vote of 3/4 of the votes represented at the general meeting of shareholders.

Right to Dividends. All shareholders of a public limited company have the right to participate in the distribution of profit of the company and have the right to receive dividends proportionally to their shareholding in the company. Resolving the distribution of profit and the payment of dividends is in the competence of the general meeting of shareholders. The resolution of the distribution of profit and the payment of dividends is adopted on the basis of the approved annual report for the preceding financial year, whereas the management board is under the obligation to make a proposal for the distribution of profit and the payment of dividends in the annual report or in a separate document accompanying the annual report, whereas such a proposal of the management board is subject to a review by supervisory board, which is in turn entitled to introduce amendments to the proposal. The resolution on the distribution of profit and on the payment of dividends must include the following information – (i) the amount of net profit; (ii) the payments into statutory capital reserve; (iii) the payments into other reserves if such exist according to the applicable law or the articles of association (which is not the case for the Company); (iv) the amount of profit being distributed among shareholders; and (v) using the profit for

other purposes, if applicable. Shareholders who are entitled to participate in the distribution of profit and receive dividends shall be determined on the basis of the list of shareholders as maintained by the ERS, which is fixed on the date determined by the general meeting of shareholders resolving the distribution of profit, whereas in respect of companies listed on the Nasdaq Tallinn Stock Exchange, such date may not occur earlier than on the tenth trading day after the general meeting of shareholders. While distributing profit and making dividend payments to shareholders, a public limited company is under the obligation to treat all shareholders equally.

Right to liquidation proceeds. According to the Estonian Commercial Code, upon liquidation of the Company the assets remaining after satisfying or securing all the creditors' claims (and depositing the money for this purpose) are distributed among the shareholders *pro rata* to the nominal value or book value of their shares pursuant to the asset distribution plan prepared by the liquidators. Assets may be distributed no earlier than six months after the entry of the dissolution of the public limited company in the Estonian Commercial register and no earlier than two months after the date on which the shareholders were informed that the final balance sheet and asset distribution plan are presented to the shareholders for examination, provided that the balance sheet or asset distribution plan have not been contested in court, the action has not been heard or has not been satisfied, or if the proceeding in the matter has been concluded. According to the Estonian Commercial Code, liquidation proceeds are distributed by way of monetary payments unless the articles of association prescribe otherwise. The Articles of Association of the Company do not currently provide for any alternative forms of payment of liquidation proceeds.

Acquisition by a company of own shares. Pursuant to the Estonian Commercial Code A public limited company is entitled to acquire its own shares only if all the following conditions are met: (i) the acquisition occurs within five years after the adoption of a resolution of the general meeting of shareholders which specifies the conditions and term for the acquisition and the amounts to be paid for the shares; (ii) the sum of the nominal value of the shares held by the company does not exceed 1/10 of its share capital; and (iii) the shares are paid for from assets excluding the share capital, reserve capital and premium. Regardless of the above, a public limited company may acquire its shares by inheritance. A public limited company may also acquire its shares by a resolution of the Supervisory Board without requiring a resolution of the general meeting of shareholders if the acquisition of the shares is necessary to prevent significant damage to the company. In such case, the shareholders must be informed of the circumstances and details of the acquisition of the company's own shares at the next general meeting of shareholders. If the shares are obtained in compliance with the law but form more than 1/10 of the share capital, the excess shares must be disposed of within three years of their acquisition. In case the public limited company acquires its own shares in violation of the law, such shares must be disposed of or cancelled (by decreasing the share capital) within one year of acquisition. The rules regarding the acquisition of a company's own shares are also applied to the acquisition of a parent company's shares by the subsidiaries. In the event that a subsidiary acquires the shares of its parent company, the parent company shall be regarded as the acquiring party.

Squeeze-out rules. According to the Estonian Commercial Code, a shareholder whose shares, together with the shares of its parent undertaking and its subsidiaries, represent at least 90% of the share capital of a public limited company, is entitled to request that the general meeting of shareholders approves taking over by that shareholder of the remaining outstanding shares of the company for fair monetary compensation ("squeeze-out"). The squeeze-out must be approved at the general meeting of shareholders by at least 95% of the votes represented by the shares of the company. Squeeze-out of minority shareholders of a public limited company may also be carried out according to the Estonian Commercial Code in the course of a merger between two companies, if the surviving company owns at least 90% of the shares of the company being merged. In such a case the squeeze-out is approved if

at least 90% of the votes represented by the shares of the company are cast in favour of the relevant resolution at the general meeting of shareholders of the company being merged.

In addition to the above, a special squeeze-out regime applies to listed companies under the Estonian Securities Market Act in case a person reaches at least a 90% shareholding in a company as a result of making a voluntary or a mandatory takeover bid to the company's shareholders. In such a case the relevant acquirer may request the general meeting of shareholders of the company to be called within 3 months after the expiry of the takeover term and to vote on the takeover of the remaining shares belonging to the shareholders of the company ("squeeze-out") for a fair compensation (not being less than the takeover bid price). In such a case, a resolution on the takeover of the remaining shares of the target is adopted if at least 90% of all votes represented by all shares of the company are cast in favour of the resolution. If a squeeze-out resolution has not been passed in the abovementioned scenario, then the takeover bid term is to be extended for up to 3 months after the date of disclosure of the takeover bid results, with respect to the target persons who, within the framework of the takeover bid, did not agree to taking over their shares.

Mandatory takeover bids. The legal regime applicable to takeover bids is provided in the Estonian Securities Market Act which implements the rules stipulated in the Takeover Directive 2004/25/EC.

If a person (either directly or together with any persons acting in concert) acquires dominant influence over an Estonian listed company such person is required to make a mandatory offer to all remaining shareholders for acquisition of the shares held by them in the relevant company (i.e. mandatory takeover bid). The obligation to make a mandatory takeover bid is triggered when the acquirer (alone or together with persons acting in concert) becomes the holder of the voting rights attached to the shares of the issuer representing the majority of all votes. The obligation to make a mandatory takeover bid may be triggered also regardless of the stake acquired, if: (i) the person, as the issuer's shareholder, has the right to appoint or remove the majority of the target's supervisory council or management board members; or (ii) the person, as the issuer's shareholder, controls alone the majority of votes on the basis of an agreement with other shareholders; or (iii) the person has dominant influence or control over the issuer and the possibility to exercise it.

The mandatory takeover bid must be published within 20 days of gaining a dominant influence over the issuer. The price offered under a mandatory takeover bid must be fair, which is determined by specific parameters stipulated in the Estonian Securities Market Act and the Takeover Rules enacted by the Minister of Finance of Estonia.

#### **8.4. Management and Key Employees Share Option Program**

On 29 April 2015, the ordinary General Meeting of the shareholders of the Company resolved to approve the management and key employees share option program after the lapse of the previous share option program in the framework of which the Company issued to the employees of the Group altogether 237 594 shares of the Company. The main purpose of the 2015 share option program was to further align the long-term interests of the members of the management bodies and key employees of the Company and the Group with the long-term interests of the Shareholders. The share option program was approved for the term of 5 years. The volume of the program was up to 2% of the total number of Shares per one calendar year. The determination of the persons eligible to participate in the program and the number of options granted to such persons was placed into the competence of the Supervisory Board upon a proposal made by the Remuneration Committee (please refer to Section 9.6 "Remuneration Committee" for further details).

The main terms under which the options are granted to the members of the management and key employees are the following:

- (i) options are granted for certain number of Shares and such number is not subject to change upon an increase or decrease of the share capital of the Company (i.e. no anti-dilution protection is granted);
- (ii) option price is determined in accordance with the Black-Scholes model, whereas the input for the option price calculation is determined by the Supervisory Board;
- (iii) option is granted with the term of three years to enjoy the benefits arising from the tax exemption applicable in respect of similar programs (according to the Estonian tax laws, no income or social tax obligations arise from the exercise of employee options granted with the term of at least three years, whereas for the purposes of the tax exemption, the members of the management bodies are also considered employees);
- (iv) options are granted personally to the members of management bodies and employees and options may not be exchanged, transferred, pledged or otherwise disposed or encumbered; options are inheritable;
- (v) the exercise of the options and the issue of new Shares corresponding to the options is carried out by the increase of the share capital of the Company and by the issue of new Shares, which is subject to relevant affirmative resolution of the General Meeting of shareholders;
- (vi) the Company has retained a right to refuse to exercise options on the following grounds – (i) the General Meeting of shareholders does not adopt relevant resolution on the share capital increase; (ii) option holder's professional relationship with relevant Group company is terminated upon the initiative of the option holder or due to reasons arising from the option holder; (iii) the results of operations of the Company or a relevant Group company have significantly deteriorated, if compared to previous period; (iv) the option holder fails to comply with objectives set for his/ her position or fails to comply with the requirements applicable in respect of a member of management or employee of a credit institution; (v) the Company or relevant Group company fails to comply with applicable prudential standards or the risks of the relevant company are not adequately covered with own resources; (vi) the option is granted relying on data, which turns out to be materially inaccurate or false;
- (vii) the option program is implemented in accordance with applicable requirements and restrictions, including the restrictions arising from the Estonian Credit Institutions Act.

The Company has granted options to altogether 1,175,737 Shares during 2017 – 2019 which currently remain outstanding. The option price for altogether 365,013 options granted in 2017 is EUR 4.65 (of which EUR 1 is the nominal value of the Share and EUR 3.65 the issue premium); the option price for altogether 299,781 options granted in 2018 is EUR 5.33 (of which EUR 1 is the nominal value of the Share and EUR 4.33 the issue premium) and the option price for altogether 510,943 options granted in 2019 is EUR 4.90 (of which EUR 1 is the nominal value of the Share and EUR 3.90 the issue premium).

As of the date of this Prospectus, the Company has carried out the following issue of the shares in connection with the realisation of Company's key employees share option program:

- by the 6 July 2018 resolution the Management Board of the Company approved the issue of 249,143 shares for a total of EUR 597,943.20. The share issue was subscribed 100% by the option beneficiaries;
- by the 8 July 2019 resolution the Management Board of the Company approved the issue of 237,594 shares for a total of EUR 712,782. The share issue was subscribed 100% by the option beneficiaries.

## 9. MANAGEMENT

### 9.1. Management Structure

In accordance with the Estonian law, the operational management of the Company is structured as a two-tier system. The Management Board is responsible for the day-to-day management of the Company's operations and is authorised to represent the Company based on the law and the Articles of Association. The Supervisory Board of the Company is responsible for the strategic planning of the business activities of the Company and for supervising the activities of the Management Board.

The address of operations of the Management Board and the Supervisory Board is the registered address of the Company - Tartu mnt 2, 10145 Tallinn, Estonia.

### 9.2. Management Board

Role. The Management Board of the Company is responsible for the day-to-day management of the Company's operations, the representation of the Company and for organising its accounting. Further, according to the Estonian Commercial Code, it is the obligation of the Management Board to draft the annual reports and submit the reports to the Supervisory Board for review and to the General Meeting of shareholders for approval. The Management Board is accountable to the Supervisory Board and must adhere to its lawful instructions.

Duties. The Management Board must present an overview of the economic activities and economic situation of the Company to the Supervisory Board at least once every three months and is under the obligation to give immediate notice of any material deterioration of the economic condition of the Company or of any other material circumstances related to its operations. If the Company is insolvent and the insolvency, due to the Company's financial situation, is not temporary, the Management Board must immediately submit a voluntary bankruptcy petition in respect of the Company.

The Management Board may enter into transactions that lie outside the Company's ordinary scope of business only with the consent of the Supervisory Board. According to the Articles of Association, the consent of the Supervisory Board is required for the following transactions:

- (i) approval of annual business plan and budget;
- (ii) approval of annual report and amendment of the proposal on the division of profit made by the Management Board;
- (iii) acquisition or disposal of shareholdings in other entities;
- (iv) resolving establishment or dissolution of a subsidiary of the Company;
- (v) acquisition, disposal of an enterprise or termination of the operations thereof;
- (vi) transfer or encumbering of real estate or registered property;
- (vii) establishment or liquidation of a foreign branch;
- (viii) making investments in the amount exceeding the budget for the respective financial year;
- (ix) taking loans or assuming debt obligations in the amount exceeding the budget for the respective financial year;
- (x) granting loans or securing debt obligations not within the Company's ordinary scope of business;
- (xi) appointing and recalling a procurator;
- (xii) appointing and recalling the members of the Management Board; appointing the Chairman of the Management Board;

(xiii) determining the duties of the members of the Management Board, exercising supervision over the activities of the Management Board and determining the principles of remunerating the work of the Management Board;

(xiv) resolving the execution of a transaction with a member of the Management Board, determining the terms of such a transaction, resolving the initiation of a legal dispute against a member of the Management Board, and determining the representative of the Company in such a transaction or a legal dispute;

(xv) resolving the execution of a transaction with a shareholder of the Company, determining the terms of such a transaction, resolving the initiation of a legal dispute against a shareholder of the Company, and determining the representative of the Company in such a transaction or a legal dispute;

(xvi) appointing and recalling the members of the management bodies formed by the Supervisory Board, determining the work procedure rules of such bodies, unless the applicable law sets forth different requirements;

(xvii) resolving other matters placed into the competence of the Supervisory Board by the applicable law or the Articles of Association.

The work procedure rules, representation rights, restrictions and limitations on executing transactions in the name and on behalf of the Company, as well as the liability of the members of the Management Board are further specified by the Rules of Procedure of the Management Board approved by the resolution of the Management Board dated 20 June 2018.

Members of Management Board. According to the Articles of Association, the Management Board comprises of one to five members who are appointed by the Supervisory Board for a term of five years. As at the date of this Prospectus the Company has one member of the Management Board – Mr Madis Toomsalu. The authorities of Mr Madis Toomsalu as the member of the Management Board commenced on 5 December 2016 and will remain valid until 5 December 2021.

Mr Madis Toomsalu. Mr Toomsalu was born in 1982. Mr Toomsalu has obtained a Bachelor's degree in business management from the Tallinn University of Technology (TalTech) in 2009 and Master's degree in 2011 in public finance. Within the Group, in addition to holding the position of the member of the Management Board of the Company, Mr Toomsalu is the Chairman of the supervisory board of LHV Pank and LHV Varahaldus. Previously Mr Toomsalu has held various positions within the Group. Mr Toomsalu also acts as the member of the Management Board of non-profit organisations MTÜ FinanceEstonia.

### **9.3. Supervisory Board**

Role. In accordance with the Estonian Commercial Code, the Supervisory Board of the Company is responsible for the strategic planning of the business activities of the Company and supervising the activities of the Management Board. The Supervisory Board is accountable to the Shareholders of the Company (acting through the General Meeting).

Duties. In accordance with the Estonian Commercial Code, before the ordinary General Meeting of shareholders is held, the Supervisory Board must review the annual report and provide the General Meeting of shareholders with a written report on the annual report, indicating whether the Supervisory Board approves the report and also providing information on how the Supervisory Board has organised and supervised the activities of the Company during the year. In practice, the referred report is made available along with the notice on convening the General Meeting of shareholders. The duties of the Supervisory Board members, as well as restrictions on serving as a member of the Supervisory Board and the work procedure of the Supervisory Board are further specified with the Rules of Procedure of the Supervisory Board approved by the Supervisory Board on 20 June 2018. The main purposes of

establishing the Rules of Procedure were to ensure effective avoidance of conflicts of interests and to specify the work procedure of the Supervisory Board.

Members of Supervisory Board. According to the Articles of Association of the Company, the Supervisory Board consists of five to seven members who are appointed by the General Meeting of shareholders for a period of three years unless the General Meeting decides otherwise. The members of the Supervisory Board elect among themselves a Chairman of the Supervisory Board who is responsible for organising the activities of the Supervisory Board. The Articles of Association stipulate, that only persons with sufficient knowledge and experience may be appointed to the Supervisory Board. According to the Articles of Association, meetings of the Supervisory Board are as a general rule held once a month or according to the actual necessity, but in any case, at least once every three months. A meeting of the Supervisory Board has quorum if more than one half of the members of the Supervisory Board participate and a resolution of the Supervisory Board is adopted if more than one half of the members of the Supervisory Board who participate at the meeting vote in favour. In case of a tied vote, the Chairman of the Supervisory Board has a casting vote. As at the date of this Prospectus there are seven members in the Supervisory Board of the Company – Mr Rain Lõhmus (the Chairman of the Supervisory Board; since 21 May 2014), Mr Raivo Hein (since 18 January 2010), Mr Heldur Meerits (since 18 December 2008), Mrs Tiina Mõis (since 8 December 2006), Mr Tauno Tats (since 21 May 2014), Mr Andres Viisemann (since 7 September 2004) and Mr Sten Tamkivi (since 29 April 2015). The authorities of all referred persons as the members of the Supervisory Board will remain valid until 29 March 2020.

Mr Rain Lõhmus. Mr Lõhmus was born in 1966. He graduated from the Tallinn Technical University in 1988 where he obtained a degree in economics. In 1999, he attended the General Manager Program at the Harvard Business School. During his professional career, Mr Lõhmus has worked as an investment banker and served as a member of the Management Board of several companies, including Osaühing Zarenor Invest from 2002 until 2012. He has been engaged with the Group since its establishment in 1999 and was one of the founders thereof. Currently Mr Lõhmus serves as the Chairman of the Supervisory Board of the Company and as a member of the supervisory board of LHV Pank and LHV Finance. Additionally, he holds the position of the member of the Management Board of AS Lõhmus Holdings, OÜ Umblu Records, Osaühing Merona Systems and Zerospotnrg OÜ; and is the member of the supervisory board of Arco Vara AS, Kodumaja AS and Thermory AS. In the past he has held the position of the member of the supervisory board of Kodumajagrupi AS, AS Audentes, AB Archyvų sistemas (previously AS Arhiivikeskus) and AS LH Capital and the position of the member of the management board of OÜ Cuber Technology.

Mr Raivo Hein. Mr Hein was born in 1966. Mr Hein holds a degree in road construction from the Tallinn Technical University awarded to him in 1991. He has worked as a member of the Management Board of AS Starman (current business name Elisa Teleteenused AS) between 1997 and 1999 and again between 2001 and 2003. He was the head of the entrepreneurship department of the City of Tallinn between 2000 and 2002. Between 2000 and 2008, he served as the member of the Management Board of AS CV Keskus. Within the Group, he also serves as the member of the supervisory board of LHV Pank. In addition to his participation in the management of the Group, he is the member of the Management Board of Zerospotnrg OÜ, E-Finance OÜ, Higgsi Boson OÜ, Desoksüribonukleiinhape DNA OÜ, OÜ Kakssada Kakskümmend Volti, Lame Maakera OÜ, Kuu on Päike OÜ, Kõver Aegruum OÜ and OÜ Saarte Sillad. He is the member of the supervisory board of AS Puumarket. In the past he has acted as the member of the supervisory board of Aktsiaselts Fix Ideed Estonia, Moonfish Media OÜ and United Dogs and Cats OÜ; as the Chairman of the supervisory board of OÜ Tarbegaas and as the member of the management board of Sundog Media OÜ.

Mr Heldur Meerits. Mr Meerits was born in 1959. Mr Meerits obtained a degree in finance and credit from the University of Tartu in 1982. During his professional career Mr Meerits has worked for the

Estonian National Bank (1988 – 1991 and 1995 –1997), whereas between 1991 and 1995 he worked for the predecessor of AS Swedbank (operating under the business names AS Hoiupank and AS Hansapank). From 1999 to 2002, Mr Meerits served as a state official working for the Government Office. Since 2002, he has been engaged in investing via Amalfi AS, an investment vehicle fully-owned by Mr Meerits. Within the Group, he serves, in addition to his position as a member of the Supervisory Board of the Company, as a member of the supervisory board of LHV Pank. Mr Meerits is a member of the management board of AS Altamira and AS Amalfi and a member of the supervisory board of Kodumaja AS, AS Smart City Group and non-profit organisations SA Dharma, SA Tähelaps and SA Põltsamaa Ühisgümnaasiumi Toetusfond. In the past he has held the position of the member of the supervisory board of AS Audentes, Green Clay Manufacturing OÜ, Steri AS, Mainor Ülemiste AS, AS Ecosalvager, AS Estonian Air and the position of the member of the management board of SIA Valdemara Group, MTÜ Eesti Eraüldhariduskoolide Ühendus, AS Avatud Eesti Fond and Sihtasutus Teater NO99.

Mrs Tiina Mõis. Mrs Mõis was born in 1957. Mrs Mõis holds the degrees in econometrics and organisation of service and economic engineering from the Tallinn Technical University awarded to her in 1980. During the years 1991 to 1999 she worked as the Chief Accountant and a member of the Management Board of the predecessor of AS Swedbank (operating under the business name AS Hansapank). Since 1999, she serves as a member of the Management Board and the managing director of AS Genteel, investment vehicle fully-owned by Mrs Mõis. Within the Group, she also serves as a member of the supervisory board of LHV Pank. In addition to that, she holds the position of a member of the supervisory board of AS Baltika and Rocca al Mare Kooli Aktsiaselts. She has also held the position of the member of the supervisory board of Green Clay Manufacturing OÜ, Rocca al Mare Kooli SA, SA Tallinna Tehnikaülikooli Arengufond, AS Martinson Trigon, Rocca al Mare Kooli AS, Rocca al Mare Koolimaja AS, HTB Investeeringute OÜ, Nordecon AS and the position of the member of the management board of Tallinna Tehnikaülikooli Vilistlaskogu and Estonian Chamber of Commerce and Industry.

Mr Tauno Tats. Mr Tats was born in 1972. Mr Tats holds the Masters' degree in economic science from the Tallinn Technical University awarded to him in 2003. He is currently working as a member of the Management Board of Ambient Sound Investments OÜ. Before assuming his current position in Ambient Sound Investments OÜ, he served as the undersecretary of the Ministry of Finance. In addition to Ambient Sound Investments OÜ, he is the member of the Management Board of InkSpinFour OÜ, Balti Karjäärid OÜ, Kv1 OÜ, Kv3 OÜ, Ammende Hotell OÜ, InkSpinSix OÜ, OÜ Perila-Perjatsi Põllud ja Metsad, OÜ Paistevälja-Paistu Põllud ja Metsad, ASI Venture Holdings OÜ and non-profit organisation MTÜ Plate torn. He is also the member of the supervisory board of AS Ecomet Invest, Osaühing Eesti Killustik and EfTEN Kinnisvarafond AS. Previously he has acted as the member of the supervisory board of AS Redgate Capital and the member of the management board of OÜ TrinTau.

Mr Sten Tamkivi. Mr Tamkivi was born in 1978. He holds a Masters' degree in management from the Stanford University Graduate School awarded to him in 2013. Between 2005 and 2013 he served as a member of the Management Board of Skype Technologies OÜ. Between 2009 and 2012, he was the member of the Management Board of the Estonian Association of Information Technology and Telecommunications. Between 2009 and 2012, he worked as an advisor to the Office of the President of the Republic of Estonia. Between 2003 and 2008, he served as the member of the Management Board of Mercur ThinkTank OÜ. He holds the position of the member of the Management Board of Seikatsu OÜ, Osaluste Hellalt Hoidmise OÜ, Topia OÜ Teleport, Inc. and Eesti Startupi Juhtide Klubi MTÜ. Mr Tamkivi serves as a member of the supervisory board of ASI Private Equity AS and non-profit organisations Kristler-Ritso Eesti SA and. Previously he has acted as the member of the supervisory board of OÜ Tarkvara Tehnoloogia Arenduskeskus, and a non-profit organisation SA Poliitikauuringute

Keskus Praxis, and as the member of the Management Board of Eesti Infotehnoloogia ja Telekommunikatsiooni Liit and Skype Technologies OÜ.

Mr Andres Viisemann. Mr Viisemann was born in 1968. Mr Viisemann obtained a degree in finance from the University of Tartu in 1992. He also holds an MBA degree from one of the world's leading and largest graduate business schools INSEAD in 1997. During his professional career, Mr Viisemann has worked as an investment manager and served as a member of the Management Board of numerous companies. He has been engaged with the Group since its establishment in 1999 and was one of the founders thereof. Within the Group, he serves, in addition to his position as the member of the supervisory board of the Company, as the member of the Supervisory Board of LHV Pank and LHV Varahaldus. He also holds the position of the member of the management board of Viisemann Holdings OÜ and Viisemann Investments AG and the position of the member of the supervisory board of AS Fertilitas and non-profit organisation Rocca al Mare Kooli Sihtasutus. In the past, he has acted as the member of the supervisory board of Rocca al Mare Koolimaja AS, AS Viimsi Haigla, AS LH Capital and as the member of the management board of Pealinna Spordiklubi and OÜ Miura Investeeringud.

#### **9.4. Other Key Executive Personnel**

Mr Jüri Heero. Mr Heero is a member of the Management Board and the Head of IT of LHV Pank. Mr Heero was born in 1977. Mr Heero holds a degree in economics from the Faculty of Economics and Business Administration of the University of Tartu awarded to him in 1999. During his professional career, Mr Heero has worked as a software developer and consultant in several companies. Additionally, between 2000 and 2004, he held the position of a member of the supervisory board of AS Cognitive Dynamics, and from 2005 to 2009, he served as a member of the management board of OÜ Heero Invest. Mr Heero joined the Group in 2004 as the Head of IT and has been participating in the management of the Group since 2006. From 2006 to 2007, he served as a member of the supervisory board of LHV Pank, and since 2007, has been holding the position of a member of the management board of LHV Pank.

Mr Erki Kilu. Mr Kilu is the chairman of the management board of LHV Pank. Mr Kilu was born in 1975. He holds a Bachelor's degree in international business administration majoring in banking and finance from the Estonian Business School awarded to him in 1998, a Master's degree in business administration from the Faculty of Economics of the University of Tartu awarded to him in 2001 and a Master of Science's degree in Engineering, Conversion Master in IT from the Institute of Computer Science of the University of Tartu awarded to him in 2018. Before assuming the position of the Chairman of the Management Board of LHV Pank in 2008, Mr Kilu was the Chairman of the Management Board of SE Seesam Life Insurance Vienna Insurance Group. Within the Group, in addition to holding the position of the Chairman of the Management Board of LHV Pank, Mr Kilu serves as the Chairman of the Supervisory Board of LHV Finance and as the Member of the Supervisory board of LHV Varahaldus. He is also the Chairman of the Management Board of the non-profit organisations Estonian Banking Association and the Member of the Board of the non-profit organisation European Banking Federation.

Mr Andres Kitter. Mr Kitter is a member of the management board leading the financial intermediaries business line and also heads the UK branch of LHV Pank. Mr Kitter was born in 1978. He obtained a Master's degree from the Faculty of Economics and Business Administration of the University of Tartu in 2003. Between 2000 and 2007, Mr Kitter worked for AS SEB Ühisliising, holding several different positions in the company. Before assuming his position in LHV Pank as the Head of Retail Banking in 2013, he served as a payment operations manager and partner relations manager in Skype Technologies OÜ. In the past he has served as the member of the Management Board of Kingu OÜ.

Mr Joel Kukemelk. Mr Kukemelk is a member of the management board of LHV Varahaldus and the Fund Manager of the LHV mandatory and voluntary index pension funds. Mr Kukemelk was born in

1986. In 2010, he obtained a Master's degree (*cum laude*) in economics from the University of Tartu, specialising in finance and accounting. Additionally, Mr Kukemelk has successfully passed all three CFA® (Chartered Financial Analyst) Level I, II and III exams and is a CFA charter holder. Mr Kukemelk has been working for the Group since 2006. Before attaining his current position in LHV Varahaldus, he worked as a portfolio manager in LHV Pank. Mr Kukemelk is the member of the supervisory board of the Estonian Guarantee Fund. Previously Mr Kukemelk has also served as a management board member of Danske Capital AS during the period after the purchase of the shares of Danske Capital AS by LHV Varahaldus until the merger of the company into LHV Varahaldus in 2016.

Mrs Relika Mell. Mrs Mell is head of internal audit division of AS LHV Pank since March 2016. Mrs Mell was born in 1975. She obtained a Master's degree of Edinburgh Business School of Heriot-Watt University in 2011 and a Bachelor's degree in international business administration from the Estonian Business School in 1997. Mrs Mell is an authorised auditor since 1997. In 2002, she acquired a license of the Association of Chartered Certified Accountants and in 2004, the license "Certified Internal Auditor" from the Institute of Internal Auditors. Before joining the team of LHV Pank, between 1996 and 2016, she worked as an authorised auditor in AS PricewaterhouseCoopers.

Mr Indrek Nuume. Mr Nuume is a member of the management board and the Head of Corporate Banking of LHV Pank. Mr Nuume was born in 1976. Mr Nuume obtained a Master's degree from the Faculty of Economics and Business Administration of the University of Tartu in 2002. Before joining the team of LHV Pank, between 1998 and 2009, Mr Nuume worked for Danske Bank A/S Estonian Branch as the Head of Corporate Banking. He is also the member of the supervisory board of the non-profit organisation SA Tilisi LK Fond.

Mr Meelis Paakspuu. Mr Paakspuu is the member of the Management Board of and the Chief Financial Officer of LHV Pank. He was born in 1974. Mr Paakspuu graduated from the University of Tartu in 1996 and obtained a degree in economics. During his professional career, Mr Paakspuu has worked as the chief analyst of the Banking Supervision of Eesti Pank (i.e. the Bank of Estonia) (1996-1998) and in different positions in the treasury department of Swedbank AS (formerly AS Hansapank) including as Head of Treasury (1998-2012). Before joining the team of LHV Pank, Mr Paakspuu served as the Chief Financial Officer of DNB Pank AS from 2012 to 2015. In the past he has acted as the member of the management board of MP Advisory OÜ and Estonian Banking Association.

Mr Martti Singi. Mr Singi is a member of the Management Board and the Chief Risk Officer of LHV Pank. Mr Singi was born in 1974. He holds a Master's degree in international business administration from the Estonian Business School awarded to him in 2009. Before assuming his current position in LHV Pank in 2012, Mr Singi served at AS Swedbank as the Head of Group Credit Risk Control from 2007 to 2009 and as the Head of Risk Control from 2009 to 2012. Between the years 2000 and 2007, Mr Singi held different positions in SEB Group.

Mr Vahur Vallistu. Mr Vallistu is a member of the management board of LHV Varahaldus. Mr Vahur Vallistu was born on 1988. He has graduated from the Stockholm School of Economics in Riga and obtained an MBA degree from the University of Tartu. Mr Vallistu also has a CFA certificate. From 2011 – 2018 he worked in the project financing department of Swedbank AS and also served as a member of the corporate banking credit committee of Swedbank AS from 2018 to 2019.

Ms Kadri Kiisel. Ms Kiisel is the member of the Management Board of LHV Pank. She was born in 1981. Kadri Kiisel holds an MBA degree in finance from University of Tartu. Ms Kadri Kiisel has worked in LHV Pank since 2011 starting as the manager of LHV Pank's Tallinn branch office and continuing as the head of branches of LHV Pank in 2017. As of 2018 Ms Kiisel is a member of the management board of LHV Finance and as of August 2018 also the management board member of LHV Pank.

## 9.5. Audit Committee

Role and Duties. The Audit Committee is an advisory body to the Supervisory Board in the fields of accounting, audit, risk management, internal control and internal audit, supervision, budgeting and compliance with legal requirements. The Audit Committee is responsible for making proposals to the Supervisory Board and providing recommendations for the appointment or removal of external and internal auditors, prevention or elimination of problems or ineffectiveness in the organisation and for the compliance with legislation and good professional practice. Pursuant to the Estonian Auditors' Activities Act, the duties of the Audit Committee include monitoring and analysing the processing of financial information, the effectiveness of risk management and internal controls, the process for the audit of financial statements and the supervision over the activities of auditors.

Members of Audit Committee. According to the Rules of Procedure of the Audit Committee of the Group, as approved by the Supervisory Board on 20 February 2019, the Audit Committee of the Company consists of at least three members, whereas at least two of the members of the Audit Committee must be experts in accounting, finance or law. The members of the Audit Committee are elected for a term of one year by the Supervisory Board. Currently, the Audit Committee consists of three members – Mrs Kristel Aarna, Mr Urmas Peiker and Mr Tauno Tats.

Mrs Kristel Aarna. Mrs Aarna has a Bachelor's degree from the Faculty of Economics of the University of Tartu and Master's degree in Business Administration from the Bentley University Graduate School of Business. Mrs Aarna works as CFO of AS TV Play Baltics since 2011. Before that Mrs Aarna was working as the chief controller of Swedbank Baltic Banking. Previously she has been the head of financial advisory services at KPMG Baltics AS and worked also at Eesti Pank and CVS Caremark Corporation. She is also the owner and member of the management board of IKA Konsult OÜ.

Mr Urmas Peiker. Mr Peiker has a Bachelor's degree from the University of Tartu and Master's degree in Law from the Duke University in the USA. Mr Peiker is a co-founder of and works as the head of business development in an Estonian start-up Funderbeam. From May 2013 until October 2014, he was the head of Compliance at AS LHV Pank. Previously, Mr Peiker has worked as the head of Market Supervision Department of the EFSA, also in the European Bank for Reconstruction and Development and Morgan Stanley's.

Mr Tauno Tats. Mr Tats is the representative of the Supervisory Board in the Audit Committee. Please refer to Section 9.3 "Supervisory Board" for his *curriculum vitae* information.

## 9.6. Remuneration Committee

Role and Duties. The Remuneration Committee is a corporate governance body formed by the Supervisory Board. The Remuneration Committee was formed for the purpose of assessing the principles of remuneration applied within the Group, developing a remuneration strategy for the members of the Management Board as well as for exercising supervision over the compliance with the applicable legal requirements in respect of risk management and capital adequacy.

Members of Remuneration Committee. In accordance with the Rules of Procedure of the Remuneration Committee, as approved by the Supervisory Board on 18 January 2017, the Remuneration Committee comprises of at least three members of the Supervisory Board of LHV Pank as appointed by the Supervisory Board. Currently, the members of the Remuneration Committee are Mr Madis Toomsalu (Chairman of the Remuneration Committee), Mr Rain Lõhmus and Mr Andres Viisemann. Please refer to Section 9.2 "Management Board" and Section 9.3 "Supervisory Board" for their *curriculum vitae* information.

## 9.7. Risk and Capital Committee

Role and Duties. The Risk and Capital Committee is a corporate governance body formed by the Supervisory Board. The Risk and Capital Committee was formed for the purpose of evaluating the risk taken by Group and following the implementation of the risk policy in the companies within the Group.

Members of Risk and Capital Committee. In accordance with the Rules of Procedure of the Risk and Capital Committee as approved by the Supervisory Board on 16 January 2016 the Risk and Capital Committee comprises of at least three members of the Supervisory Board of LHV Group as appointed by the Supervisory Board. Currently, the members of the Risk and Capital Committee are Mr Rain Lõhmus (Chairman of the Risk and Capital Committee), Mrs Tiina Mõis and Mr Andres Viisemann. Please refer to Section 9.2 “Management Board” and Section 9.3 “Supervisory Board” for their *curriculum vitae* information.

## 9.8. Remuneration and Benefits

The total amount of remuneration and benefits paid to the members of the supervisory and management bodies of the Group companies during the financial year ended on 31 December 2018 was EUR 1,471 thousand (including all applicable taxes). In addition to monetary remuneration and benefits, several members of the management bodies have been issued share options under the management and key employees share option program described in detail in Section “Management and Key Employees Share Option Program”. Upon termination of their professional relationship, the members of the supervisory and management bodies of the Company are not entitled to any benefits. The Company pays to the members of the Supervisory Board remuneration in the amount of 1,500 EUR per each meeting of the Supervisory Board where the member participates. The Company has chosen not to disclose the amounts of remuneration and benefits as well as the termination compensations of each single member of the supervisory and management bodies of the Group companies in order to protect the privacy and personal rights of the relevant persons.

## 9.9. Share Ownership

As at 30 July 2019, 49.99% of all the Shares, i.e. the total number of 13,123,977 Shares were held by the members of the management bodies of the Company or the related parties thereof. The Shares and options (please refer to Section 8.4 “Management and Key Employees Share Option Program” for further details on options) owned either directly or indirectly by the members of the Management and Supervisory Board and other key executive personnel as at the date of this Prospectus have been indicted in the following table:

Name	Number of Shares	Number of Options
Mr Rain Lõhmus	6,478,005	0
Mr Raivo Hein	494,110	0
Mr Heldur Meerits	951,978	0
Mrs Tiina Mõis	999,456	0
Mr Tauno Tats	1,595,620	0
Mr Sten Tamkivi	11,180	0
Mr Andres Viisemann	2,561,090	34,269
Mr Madis Toomsalu	32,538	72,429

Mr Jüri Heero	69,064	47,772
Mr Erki Kilu	119,553	81,713
Mr Andres Kitter	26,426	44,303
Mr Joel Kukemelk	27,154	30,881
Mrs Relika Mell	490	8,377
Mr Indrek Nuume	37,269	56,137
Mr Meelis Paakspuu	5,505	44,303
Mr Martti Singi	57,846	44,303
Mr Vahur Vallistu	0	0
Ms Kadri Kiisel	5	21,903

### 9.10. Conflicts of Interests and Other Declarations

According to the knowledge of the Management, there are no known actual or potential conflicts of interest between the duties of any of the members of the Management and the Supervisory Board to the Company or to any Group company, and their private interests or other duties.

According to the knowledge of the Management, none of the members of the Management and Supervisory Board, nor any of the members of other key executive personnel as described in Section "Other Key Executive Personnel" has ever been convicted in a criminal offence or been a member of a governing body of a legal entity subject to bankruptcy or liquidation proceedings at the time of initiating the relevant proceedings. Furthermore, none of the persons referred to in this Section has ever been disqualified by a competent court from acting as a member of administrative, supervisory or management body or conducting affairs of a legal entity. The Management and Supervisory Board members of LHV Pank are subject to the assessment of suitability (fit and proper testing) conducted by the EFSA exercising supervision over the operations of LHV Pank.

### 9.11. Statement of Compliance with Corporate Governance

The Company complies with the corporate governance regime of the Republic of Estonia. Further to the compliance with the applicable laws and regulations, the Company has committed itself to adhere the highest standards of corporate governance within the Group companies for ensuring the transparent management of the Group companies and avoiding conflicts of interests. For these purposes, the Group companies have adopted work procedure rules for all corporate governance bodies to further specify the rules, requirements, limitations and liability of their members arising in general from the applicable law and the Articles of Association. The Company follows the principles of good corporate governance arising from the Good Corporate Governance Code as adopted by the EFSA and the relevant reports are published as part of the annual reports of the Company. The Good Corporate Governance Code is binding on the basis of "comply or explain principle", whereas the requirements, which are currently not fully followed by the Company have been described in the latest Good Corporate Governance Report made available as part of the audited consolidated financial statements of the Group for the year ended on 31 December 2018.

### 9.12. Statutory Auditors

According to the Articles of Association, the appointment of statutory auditors is in the competence of the General Meeting of shareholders, whereas the selection of candidates and making a proposal to

the General Meeting of shareholders is done by the Audit Committee. The General Meeting of shareholders held on 11 April 2018 appointed AS PricewaterhouseCoopers (registry code 10142876; having its registered address at Pärnu mnt 15, 10141 Tallinn, Estonia) to act as the statutory auditor of the Company for the financial years 2018 – 2019. AS PricewaterhouseCoopers is a member of the Estonian Auditing Board. The Audited Financial Statements have been audited by AS PricewaterhouseCoopers, independent auditors as stated in their report. The Interim Financial Statements included in this Prospectus have been reviewed by AS PricewaterhouseCoopers. In addition, AS PricewaterhouseCoopers, acting in line with the Delegated Regulation, issued a report concerning the Pro Forma Financial Information which is included in Section 14 "Unaudited Pro Forma Financial Information" below.

Due to the conclusion of the term of the auditing agreement with AS PricewaterhouseCoopers with finishing of the audit of the consolidated financial statements for the year ending 31 December 2019, the Company carried out a bidding process for a statutory auditor for the period 2020 – 2022 which was won by KPMG Baltics OÜ (registry code 10096082, having its registered address at Narva mnt 5, Tallinn 10117, Estonia). On 13 March 2019 the General Meeting of shareholders appointed KPMG Baltics OÜ to act as the statutory auditor of the Group for the three subsequent financial years (2020 - 2022). KPMG Baltics OÜ is a member of the Estonian Auditing Board.

## 10. PRINCIPAL ACTIVITIES AND MARKETS

### 10.1. History and Development of Group

The Group's history dates back to 1999 and by today, the Group has developed into a group of companies engaged in the provision of financial services based on local (Estonian) capital.

The Company was originally established by altogether 9 individuals and 4 legal entities, including Mr Rain Lõhmus and Mr Andres Viisemann who are continuously contributing to the management and further development of the Group. In 2006, the Company was divided in a manner that the assets and shareholdings of the Company were distributed into three different companies – the Company, AS LHV Holdings and AS LHV Professional Services. As a result of the division, the Company was held by the current key shareholders of the Company - Mr Rain Lõhmus and Mr Andres Viisemann. In the course of the division, the other previous shareholders of the Company ceased to be the shareholders of the Company and acquired shareholdings in AS LHV Holdings and AS LHV Professional Services instead. After the division, the main assets of the Company were the shareholdings in the investment firm LHV, which by today has been developed into LHV Pank, and in the asset management firm LHV Varahaldus.

The milestones in the history of the Company and the development of the Group are summarised in the following table:

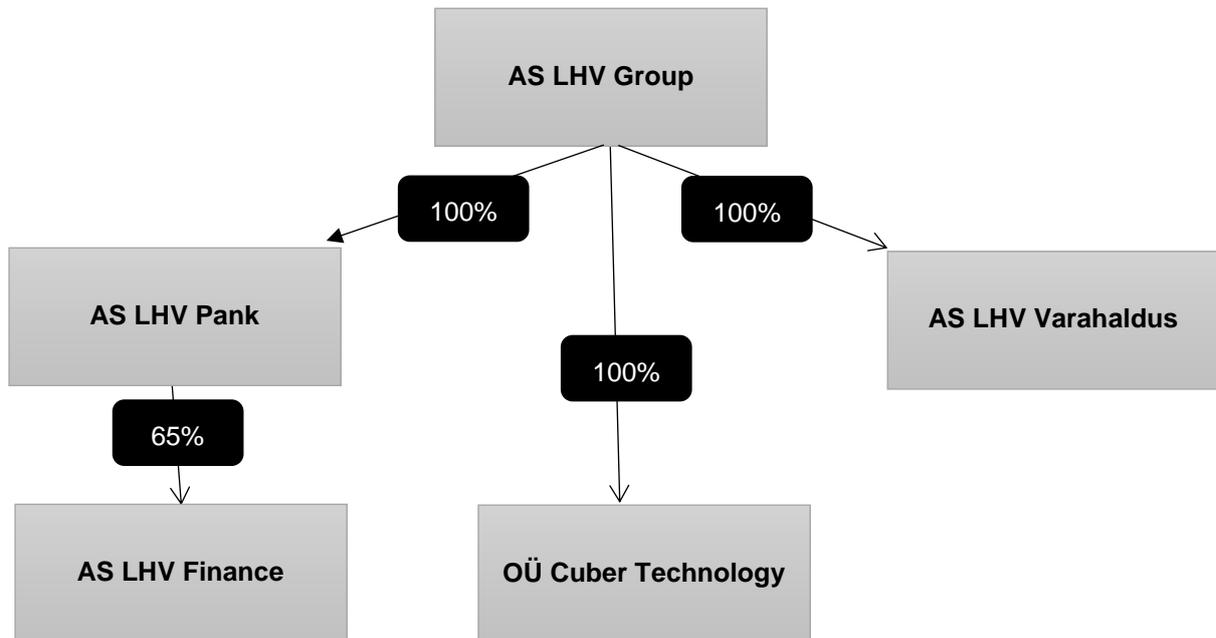
<b>Year</b>	<b>Development</b>
1999	LHV Pank was established as an investment firm, providing brokerage and portfolio management services; LHV Varahaldus was established
2002	LHV Varahaldus initiated pension funds management operations
2005	The Company was established
2009	LHV Pank obtained credit institution license and initiated depository and lending operations
2010	LHV Pank launched payments services
2011	LHV Pank launched payment cards issuing services
2013	LHV Finance was established and hire-purchase services launched; Mokilizingas was acquired
2014	LHV Pank launched payment cards acquiring services
2015	The Company became public by listing its subordinated bonds on Nasdaq Tallinn Stock Exchange; LHV Pank joined SEPA payments network as direct member and launched ATM network services
2016	LHV Varahaldus acquired Danske Capital AS, Danske Bank A/S's Estonian-established asset management company
2016	LHV Pank commenced offering of home loans to private clients
2016	LHV Varahaldus launched two passively managed pension funds – the second pillar fund LHV Pension Fund Index and the third pillar fund LHV Pension Fund Index Plus
2017	LHV Pank initiated a new line of business line and will start servicing payment service providers
2018	LHV Pank opened a branch in London, United Kingdom
2018	LHV Group sold 100% of UAB „Mokilizingas“ shares to Inbank AS

- 2018 Rating agency Moody's assigned LHV Pank a credit rating of Baa1
- 2019 LHV Pank completed the acquisition of the loan portfolio of Versobank AS (under liquidation)
- 2019 LHV Pank and Danske Bank entered into a Business Transfer Agreement of private loans of Danske Bank's Estonian branch
- 2019 Joining the Faster Payments scheme as a direct member in the United Kingdom (serving of the clients has not started yet).

## 10.2. Group Structure and Group Companies<sup>19</sup>

### Group Structure

As at the date of this Prospectus, the Group structure is the following<sup>20</sup>:



### Group Companies

**AS LHV Group.** AS LHV Group (the Company) is the holding company of the Group with limited operations of its own. The Company is engaged in investor relations management and ensuring necessary capitalisation for the Group companies. As of 30 June 2019, the total number of full-time employees amounted to 420.

<sup>19</sup> Previously LHV Group also owned 50%+1 share of UAB "Mokilizingas", a leading consumer finance services provider in Lithuania. The shares were sold to AS Inbank for the purchase price of EUR 7.5 million in May 2018.

<sup>20</sup> The Company has 100% shareholding in an Estonian private limited company (in Estonian: *osaühing* or *OÜ*) in OÜ Cuber Technology (register code in the Estonian Commercial Register 12794962, registered address Tartu mnt 2, 10145 Tallinn, Estonia). The company was established on 4 February 2015, but as of the date of this Prospectus, Cuber Technology has no operations and thus no influence on the liabilities and the results of operations of the Company or the Group.

AS LHV Pank. AS LHV Pank is an Estonian licensed credit institution offering banking services to corporate and retail clients. In addition to client service venues in Tallinn, Tartu, the bank also established a local registered branch in the United Kingdom in 2018 and is servicing clients via its London based office. Until 31 March 2016, the bank has also a presence in Latvia in the form of a local registered branch; however, the activities of the bank in Latvia were limited to investment services only and the operations were small-scale (the branch served around 500 retail customers). The branch of the bank in Latvia terminated its operations on 31 March 2016. In relation to launch of cooperation with the deposit engagement platforms Raisin in July 2018 and Deposit Solutions in June 2019, LHV Pank is also providing cross-border banking services in the form of collection of deposits from the Austrian, Belgium, German markets as of 2018 and from the Spanish and Dutch markets as of 2019. As of the 30 June 2019, EUR 242 million of term deposits have been raised through the platforms.

As of 30 June 2019, the bank employs more than 370 people and has over 179,000 customers.

By 30 June 2019, the total loan portfolio of the LHV Pank consolidation group (including LHV Finance) stood at EUR 1.1 billion and the total amount of deposits was EUR 2.1 billion. The greatest proportion of loans are in the real estate sector, an industry that is traditionally receiving the greatest share of financing by commercial banks in Estonia. As at 30 June 2019, 37% of the corporate credit portfolio of LHV Pank comprised of credit granted in the real estate sector. The real estate sector is followed by financial and insurance activities sector (14% of corporate credit portfolio) and the processing industry (14% of the corporate credit portfolio). Among sectors with higher than average credit risk, accommodation and catering comprise 3%, construction 7% and transport and storage 1% of the total corporate credit portfolio. Loans to corporates comprise ca 76% of the entire credit portfolio while loans to private individuals amount to 24% of the credit portfolio.

In February 2019, AS LHV Pank completed the acquisition of the loan portfolio of Versobank AS (under liquidation) according to the agreement made on 19 December 2018 for approximately EUR 12.2 million in the total value of EUR 13.2 million. The loan portfolio acquired consisted of loan and collateral agreements and two employees related to the portfolio. The loan portfolio contained loans to Estonian companies in the amount of approximately EUR 10.4 million as well as loans to Estonian resident private customers in the amount of approximately EUR 2.8 million. In June 2019, LHV Pank signed an agreement for the acquisition of Danske Loan Portfolio, including the loan portfolio in the amount of approx. EUR 447 million for the purchase price to be determined upon closing calculated as the size of the Portfolio minus a discount of EUR 39 million. For further information about the transaction, please refer to Section 10.4 "Investments" below.

AS LHV Varahaldus. AS LHV Varahaldus is an Estonian licensed fund manager. LHV Varahaldus is currently acting as the fund manager for ten investment funds – seven compulsory pension funds (LHV Pensionifond XS, LHV Pensionifond S, LHV Pensionifond M, LHV Pensionifond L and LHV Pensionifond XL, LHV Pensionifond Eesti, LHV Pensionifond Indeks), two voluntary pension fund (LHV Täiendav Pensionifond and LHV Pensionifond Indeks Pluss) and a UCITS investing into equity instruments (LHV World Equities Fund). Previously LHV Varahaldus also provided investment consulting services to the SEF-LHV Persian Gulf Fund, which incorporated the LHV Persian Gulf Fund (managed by LHV Varahaldus) in April 2015, however the SEF-LHV Persian Gulf Fund was closed in June 2019 due to the unfavourable changes in the political situation of the region, impacting the investments into the Persian Gulf region companies and also the size of the fund. Passively managed pension funds, compulsory pension fund LHV Pensionifond Indeks and voluntary pension fund LHV Pensionifond Indeks Pluss were launched in 2016. In March 2018, LHV launched a new pension fund, LHV Pensionifond Eesti, which invests only in Estonia.

In 2016, LHV Varahaldus acquired 100% of the shares of Danske Capital AS from Danske Bank A/S and Danske Bank A/S Estonian branch for the purchase price of EUR 10.9 million. Following receipt of

the necessary approval from the EFSA, Danske Capital AS was merged into LHV Varahaldus in 2016 and as a result of the merger, Danske Capital was dissolved, with LHV Varahaldus becoming its legal successor.

LHV Varahaldus employs 39 people. By 30 June 2019, the volume of pension assets managed by LHV Varahaldus reached almost EUR 1.3 billion, which makes LHV Varahaldus having maintained the second largest market share (29.13%) in terms of volume and in terms of customer numbers (24.77%) of the funds under management. The number of active clients of the compulsory pension funds decreased by 529 over the first half of 2019 and stands at over 177,000, which makes LHV Varahaldus the second largest compulsory pension funds manager in Estonia in terms of clients.

AS LHV Finance. LHV Finance is the subsidiary of the LHV Pank and is an Estonian financial institution offering hire-purchase services in the Estonian market. LHV Finance was established in 2013 as a joint venture in co-operation with Toveko Invest OÜ. Initially only hire-purchase services were provided, consumer loans were added to the offering in 2015. In 2017 LHV Finance started to offer rebranded targeted consumer loans (home loan and car loan). By 31 December 2018, the volume of LHV Finance's credit portfolio amounted to EUR 51.2 million and the company had over 51,000 effective credit agreements. Hire-purchase market is decreasing, and the portfolio consist approx. 70% of consumer loans.

OÜ Cuber Technology. Cuber Technology is a start-up company with the purpose to innovate financial services using Blockchain technology. As of the date of this Prospectus, Cuber Technology has no operations and therefore it is not a material Subsidiary of the Group.

### 10.3. Business Segments

Introductory Remarks. The business segments of the Group and the financial results thereof have been described in detail in Note 5 of the Financial Statements. In United Kingdom, the Group operates through its branch which is engaged in offering payment services and collecting of deposits.

Banking. The Group's main business segment is the banking services business segment, which in turn is divided into three business segments – retail banking, private banking and corporate banking. The operations of the banking business segment are carried out by LHV Pank. Retail banking segment covers all private individuals and small legal entities with credit exposure under EUR 250 thousand. Corporate banking segment covers all corporate customers and other legal entities with exposure over EUR 250 thousand. Private banking segment includes high net worth customers. As at the date of this Prospectus, LHV Pank is offering all classical banking services, such as the settlement of payments, issuing and acquiring bank cards and deposit services, financing services (loan, leasing, credit limit, overdraft, guarantee), securities brokerage and investment services.

Asset Management. The Group's second largest business segment is the asset management business segment. The asset management services are provided by LHV Varahaldus. The essence of the asset management services is fund management, mainly covering compulsory and voluntary pensions funds' management.

Hire-Purchase and Consumer Finance in Estonia. The Estonian hire-purchase and consumer finance operations are carried out by LHV Finance.

Revenues by Principal Markets. The breakdown of revenues by markets (business segments and geographical markets) where the Group companies operate is described in detail in Notes 5, 7 and 8 of the Financial Statements.

## 10.4. Investments

Introductory Remarks. The Group companies are continuously seeking for opportunities for the expansion of their business operations by investing into the organic growth but also by considering mergers and acquisitions of other market players. As a general rule, the investments made by the Group companies are financed by own funds or by additional capital engaged from the shareholders or bondholders of the subordinated bonds of the Company.

Significant Investments. During the period since the date of the Interim Financial Statements (i.e. as of 30 June 2019), the Group companies have made no significant investments. As at the date of this Prospectus, the Group companies have not made any firm commitments on significant future investment, except the significant future investments planned to be made described in further detail below.

On 5 June 2019, LHV Pank and Danske Bank A/S entered into a business transfer agreement (the **BTA**) for acquisition of the unit involved with private loans of Danske Bank's Estonian branch (the **Danske Loan Portfolio**) by the LHV Pank. Purchase price and the final scope of the Portfolio will be determined upon closing and will be calculated as the size of the Portfolio minus a discount of EUR 39 million (the **Purchase Price**). The Portfolio size is expected to amortise to approx. EUR 447 million by closing of the Transaction, in which case the Purchase Price will be approx. EUR 408 million.

According to the BTA, the closing of the transaction and acquiring the Portfolio by LHV Pank (the **Transaction**) remained subject to the following conditions (i) raising the additional own funds needed by the Group in relation to the Transaction and (ii) obtaining an approval for concentration (in Estonian: *koondumine*) from the Estonian Competition Board. The Estonian Competition Authority granted LHV Pank an approval for concentration on 19 June 2019, fulfilling one of the prerequisites for closing the Transaction. As of the date of this Prospectus, the Transaction remains subject to raising the additional own funds needed by the Group for the Transaction (please also refer to Section 5 "Reasons for Offering and Use of Proceeds"). The parties' intention is to complete the Transaction in autumn this year the earliest.

The Portfolio is expected to include credit products to approx. 10 800 Estonian private individuals of which a majority are mortgage backed home loans (97%) while the residual part are mainly other credit products. The Portfolio will also include certain employment agreements with employees needed for servicing of the Portfolio the exact number of which will be determined before closing. The Portfolio will not include bank accounts or daily banking agreements of the clients.

Due to the Transaction, the Group needs to set aside additional own funds to maintain the required capital adequacy levels as well as obtain financing for the payment of the Purchase Price for the Portfolio.

The Company has estimated that additional own funds are needed in the total amount of EUR 27 million of which at least EUR 16 million should be Tier 1 capital and EUR 11 million can be Tier 2 capital for the purposes of CRR. Group's own funds are planned to be strengthened through combination of (i) Offering of the Offer Shares under this Prospectus; (ii) Offering of bonds qualified as Tier 2 capital instruments for the purposes of CRR and (iii) Issuance of bonds qualified as Additional Tier 1 capital instruments for the purposes of CRR. The issuances of capital instruments described in (ii) and (iii) were completed in June 2019.

At signing of the BTA, up to EUR 280 million (depending on the source of financing, including also required buffers) of additional financing was estimated to be needed for payment of the Purchase Price by LHV Pank. In the short term, LHV Pank plans to finance the payment of the Purchase Price through deposits collected from the Estonian and foreign markets. During 2019, the deposits of Estonian clients have increased in a faster pace than expected and the Company anticipates that a significant part of

the transaction can be financed through the local deposits base. The remaining part is planned to be raised through deposit collecting platforms, including Raisin and Deposit Solution platform, through which deposits are collected from the German, Austrian, Dutch, Belgium and Spanish markets (resulting in an increase of the proportion of non-residents depositors). As at 31 August 2019, the deposits of LHV Pank amount to EUR 2 578 million (whereas EUR 383 million has been raised through deposit collecting platforms) which the Group estimates as sufficient to fund the payment of the Purchase Price for the Portfolio. The final Purchase Price will be determined at closing of the Transaction. In case additional financing is required, LHV Pank plans to utilise the access to Raisin and Deposit Solution deposit collection platforms. The allocation of local deposits and foreign deposits as part of financing the Purchase Price will be clear upon closing of the Transaction.

In the long term, due to the relatively high cost of the above described financing via deposits, LHV Pank is planning to replace the financing with covered bonds. The Estonian Covered Bonds Act entered into force in March 2019 enables credit institutions to issue covered bonds, subject to receipt of an additional licence from the EFSA. LHV Pank has started preparations for obtaining the above licence and aims to be ready to complete the issuance in 2020. The Company and LHV Pank are also considering other sources of financing.

Although the final scope and Purchase Price for the Portfolio will be determined upon completion, the Transaction is expected to have a significant impact on the operations and business of the Group. In particular, according to the LHV Pank's settlement analysis approximately 80% of the Portfolio clients will be new customers for LHV. Upon completion of the Transaction, the loan portfolio of LHV Pank will increase by more than 40% (as of 30 June 2019 LHV Pank's loan portfolio was EUR 1 117.9 million, of which business loans comprised EUR 844.1 million and the retail banking loans comprised EUR 273.8 million). However, due to the closing of the Transaction expected to occur in autumn 2019 the earliest, the majority of the costs related to the Transaction will be incurred within 2019 while the additional income received remains modest. Further, the discount applied on the Purchase Price of the Portfolio will need to be reflected in the financial statements throughout the maturity of the Portfolio. Due to the above reasons, the Transaction is estimated to bring about a loss of EUR 2.7 million to the Group in 2019 of which EUR 1.05 million is due to net interest income, EUR 1.54 million due to the provisioning of the Portfolio and EUR 0.12 million due to increased administrative expenses. The use of deposits as financing of the Transaction will also have a negative impact on the Group's results in 2020 and the additional profit from the Portfolio is expected to be limited to EUR 1.7 million. Starting from 2021 (subject to completion of the long-term funding plan described above), the additional profit is anticipated to increase by EUR 4 million and ROE (return on equity) of LHV Pank is expected to increase by 0.4 percentage points annually. The above estimates are based on the understanding of the Portfolio as of the date of this Prospectus and do not take into consideration the potential indirect proceeds related to the Portfolio (such as potential use of additional services of LHV Pank by the Portfolio clients). Please refer also to Section 14 "Unaudited Pro Forma Financial Information" for details about the impact of the Transaction).

The above includes current expectations as well as assumptions made by and information currently available to the Management and other forward-looking statements. The information may be subject to change and the Transaction may not realise in full or in part as described above. The Company will inform about any material changes and other important information in relation to the Transaction through the information system of the Nasdaq Tallinn Stock Exchange and through the Company's website (<https://investor.lhv.ee/en/>).

## 10.5. Trend Information

There has been no material adverse change in the prospects of the Group since 30 June 2019. The Management is not aware of any trends having material adverse effect on the operations of the Group.

The recent trends affecting the industry where the Group companies operate is described in Section “Factors and Public Policies Affecting Operations”.

### **10.6. Material Agreements**

Introductory Remarks. The Group companies are not parties to any material agreements outside of their ordinary course of business, which may result in the Group companies obtaining rights or incurring obligations which may materially affect the Group companies’ ability to perform their obligations or have a material adverse effect on the financial position or operations of the Group companies. Despite the foregoing, this Section “Material Agreements” provides a general description of the partnership agreement forming the grounds for the Group’s partnership model for LHV Finance. The level of detail of the information provided herein is limited due to the confidentiality provisions included in such agreements; however, the Management believes that the information provided is sufficient for comprehending the overall nature and essence of the agreements.

Shareholders’ Agreement regarding LHV Finance. On 23 January 2013, LHV Pank and Toveko Invest OÜ executed a shareholders’ agreement, under which the parties thereto agreed upon the incorporation of LHV Finance and the principles of their co-operation as the shareholders of LHV Finance. Among other terms, the parties to the shareholders’ agreement agreed upon the nature and essence of the business operations of LHV Finance and strategic objectives thereof, corporate governance principles, sources of financing and restrictions on the transfer of shares, customary to similar types of transactions. In the opinion of the Management, the parties’ agreements contained in the shareholders’ agreement are in compliance with market practise for similar agreements and form solid grounds for the parties’ co-operation.

### **10.7. Legal Proceedings**

In the course of its everyday business operations, the Group companies are parties to several legal and administrative proceedings. In the legal proceedings, the Group companies act, as a general rule, as plaintiffs seeking to recover debts by defaulting borrowers and other customers of the Group companies. Considering the nature of the operations of the Group companies, legal proceedings initiated for debt recovery are part of everyday business operations of the Group companies. As at the date of this Prospectus, in all on-going legal proceedings, Group companies involved are acting as plaintiffs and all such proceedings concern debt recovery. Furthermore, since LHV Pank and LHV Varahaldus operate in the fields subject to extensive legal regulation, they are subject to numerous administrative proceedings initiated primarily by the EFSA in the course of ordinary financial supervision. As of the date of this Prospectus, none of the legal or administrative proceedings to which a Group company is a party to (including any such proceedings which are pending or threatened of which the Management is aware) are considered likely to have any significant effects on the Group’s financial position and there are no legal or administrative proceedings to which a Group company has been party to (including any such proceedings which are pending or threatened of which the Management is aware) during the 12 months preceding the date of this Prospectus which may have, or have had, significant effects on the Group’s financial position or profitability.

### **10.8. Related Party Transactions**

The Group companies have entered into several agreements with related parties. All transactions with related parties executed by the Group companies are by their nature products and services offered by the Group companies to third parties on similar terms and conditions. The terms and conditions of the transactions with related parties do not deviate materially from the terms and conditions of similar transactions executed with third parties. Please see Note 19 of the Interim Financial Statements for the

details on the volumes of the related party transactions. The Group companies have not entered into material transactions with related parties after 30 June 2019.

### 10.9. Regulatory Disclosures

Introductory remarks. The Company regularly publishes announcements via the information system of the Nasdaq Tallinn Stock Exchange as required under the Nasdaq Tallinn Stock Exchange rules, Estonian Securities Market Act and Regulation No 596/2014/EU of the European Parliament and of the Council of 16 April 2014 on market abuse. Below is a summary of the information disclosed under Regulation (EU) No 596/2014/EU over the last 12 months relevant at the date of this Prospectus. In addition to the information system of Nasdaq Tallinn Stock Exchange, full announcements can be accessed on the webpage of Nasdaq Baltic at [www.nasdaqbaltic.com](http://www.nasdaqbaltic.com) and the website of the Company at <https://investor.lhv.ee/en/>.

Capital raisings. In October 2018 the Company announced of establishment of a bond program under which the Company may issue subordinated bonds in a total volume of up to EUR 45 million in the course of several issues and launched a public offering of LHV's subordinated bonds and a plan to list and admit the subordinated bonds to trading on the regulated market operated by the Nasdaq Tallinn AS. In the course of the offering, up to 16,000 subordinated bonds of LHV „LHV Group subordinated bond 28.11.2028” with the nominal value of EUR 1,000, interest rate 6.0% per annum and maturity date 28.11.2028 were offered, with the option to increase the offering volume until the issue date by EUR 4 million issue up to 4,000 additional subordinated bonds as a result of which the total number of the bonds offered in the course of the public offering may be up to 20,000 and the total volume of the offering up to EUR 20 million. The results of the offering were announced after completion of the offering period in November 2018. Public offering of AS LHV Group subordinated bonds was completed in November 2018. Since the initial issue volume of EUR 16 million was oversubscribed, LHV used its right to increase the issue volume within the maximum permitted volume, to EUR 20 million.

In April 2019, the Company announced its plan to carry out a second a subordinated bond issue within the subordinated bond programme launched in 2018. The announcement launching the offering was published in June 2019 pursuant to which the Company offered publicly up to 15,000 additional subordinated bonds "LHV Group subordinated bond 28.11.2028", but the Company had the right to increase the offering volume until issue date by EUR 5 million and issue up to 5,000 additional subordinated bonds as a result of which the total number of the bonds offered in the course of the public offering may be up to 20,000 and the total volume of the offering would rise to EUR 20 million. The offering was completed in June 2019 as the initial issue volume of EUR 15 million was oversubscribed, the Company used its right to increase the issue volume to the maximum permitted volume of EUR 20 million. Both public offerings were carried out only in Estonia.

In June 2019, the Company informed of completion of the offering of bonds belonging to the additional Tier 1 own funds (AT1 bonds) to financial institutions and proficient investors with a larger investment portfolio. The initial issue volume of EUR 15 million was oversubscribed 2 times and the Company used its right to increase the issue volume to EUR 20 million.

In July 2019, the Company published a notice calling for a special meeting of shareholders for the shareholders to approve the increase of Group's share capital by EUR 2,200,000 and other material terms and conditions of this Offering.

Moody's rating to LHV Pank. In December 2018, the Company announced of LHV Pank receiving an investment-grade credit rating with a stable outlook from Moody's Investors Service which was the first time Group entities have obtained an investment-grade rating from an international rating agency. Ratings assigned to LHV Pank by Moody's Investors Service:

- Long- and short-term counterparty risk assessment of A3(cr)/Prime-2(cr)
- Long- and short-term counterparty risk rating of A3/Prime-2
- Foreign- and local currency long-term bank deposit rating Baa1
- Foreign- and local currency short-term bank deposit rating Prime-2
- Baseline credit assessment (BCA) Baa3
- Adjusted baseline credit assessment Baa3
- The long-term deposit rating carries a stable outlook

Changes in managers of LHV Varahaldus. In February 2019, the Company announced that Mr Mihkel Oja, the previous Chairman of the Management Board of LHV Varahaldus, has informed LHV Varahaldus of his resignation from the position. Mr Mihkel Oja continued to serve as the Chairman of the Management Board until appointment of the new management board member by the Supervisory Board of LHV Varahaldus. In May 2019, the Company announced that Mr Vahur Vallistu will be appointed as the new Chairman of the Management Board of LHV Varahaldus as of 6 June 2019 and that Mr Mihkel Oja will resign after the transfer of duties in June 2019. Please refer to Section 9.4 “Other Key Executive Personnel” for more information about Mr Vallistu.

Plan to acquire private loans unit from Danske Bank A/S. In June 2019, the Company announced that LHV Pank intends to acquire the Danske Loan Portfolio. Please refer to Section 10.4 “Investments”, Section 5 “Reasons for the Offer and Use of Proceeds” and Section 14 “Unaudited Pro Forma Financial Information” for more information about the planned transaction.

## 11. SELECTED FINANCIAL INFORMATION

### 11.1. Introduction

The following tables have been extracted or derived from the Audited Financial Statements and Interim Financial Statements, respectively. The below tables present only certain selected audited consolidated financial data as of and for the year ended on 31 December 2018 and as of and for the 6-month period ended on 30 June 2019 and should be read in conjunction with the Financial Statements, in particular the notes thereto. The Audited Financial Statement have been prepared by the Group in accordance with the International Financial Reporting Standards as adopted in the European Union (IFRS) and the Estonian Accounting Act. The Interim Financial Statements have been prepared in accordance with International Accounting Standard (IAS) 34, Interim Financial Reporting.

### 11.2. Selected Historical Financial Information

#### Consolidated Statement of Profit or Loss and Other Comprehensive Income

<i>(in thousands of euros)</i>			<b>6m 2019</b>	<b>6m 2018</b>
	<b>2018</b>	<b>2017<sup>1</sup></b>	<b>ended on</b>	<b>ended on</b>
			<b>30.06.2019</b>	<b>30.06.2018</b>
	Audited	Audited	Reviewed	Unaudited
Interest income	45 622	35 494	27 177	22 070
Interest expense	-7 471	-5 133	-4 605	-3 663
<b>Net interest income</b>	<b>38 151</b>	<b>30 361</b>	<b>22 572</b>	<b>18 407</b>
Fee and commission income	32 844	26 402	17 590	16 291
Fee and commission expense	-7 799	-5 413	-4 753	-3 486
<b>Net fee and commission income</b>	<b>25 045</b>	<b>20 989</b>	<b>12 837</b>	<b>12 805</b>
Net gains/losses from financial assets measured at fair value	379	714	388	254
Foreign exchange rate gains/losses	64	265	-7	-6
<b>Net gains from financial assets</b>	<b>443</b>	<b>979</b>	<b>381</b>	<b>248</b>
Other income	905	36	16	25
Other expense	-43	-182	-23	-27
Staff costs	-15 756	-12 991	-9 435	-7 684
Administrative and other operating expenses	-16 387	-14 407	-9 072	-7 756
<b>Profit before credit losses</b>	<b>32 358</b>	<b>24 785</b>	<b>17 276</b>	<b>16 018</b>
Impairment losses on loans and advances	-4 879	-3 584	-1 649	-2 478
<b>Profit before income tax</b>	<b>27 479</b>	<b>21 201</b>	<b>15 627</b>	<b>13 540</b>
Income tax expense	-3 614	-951	-2 962	-2 569
Profit from continued operations	23 865	20 250	12 665	10 971
Profit from discontinued operations	3 324	1 927	0	3 324
<b>Net profit for the reporting period:</b>	<b>27 189</b>	<b>22 177</b>	<b>12 665</b>	<b>14 295</b>
<b>Other comprehensive income/loss:</b>				
<i>Items that may be reclassified subsequently to profit or loss:</i>				
Changes in the fair value of equity instruments measured at FVOCI	0	76	0	-112
Changes in the fair value of debt instruments measured at FVOCI <sup>2</sup>	-36	0	0	0
<i>Items that will not be reclassified to profit or loss:</i>		0	0	0

Net gains on investments in equity instruments designated at FVOCI	78			
Other comprehensive income for the reporting period	42	76	0	-112
<b>Total profit and other comprehensive income for the reporting period:</b>	<b>27 231</b>	<b>22 253</b>	<b>12 665</b>	<b>14 183</b>
<b>Total profit of the reporting period attributable to:</b>				
Owners of the parent	25 237	19 603	11 788	13 474
Non-controlling interest	1 952	2 574	877	821
<b>Total profit for the reporting period:</b>	<b>27 189</b>	<b>22 177</b>	<b>12 665</b>	<b>14 295</b>
<b>Total profit and other comprehensive income attributable to:</b>				
Owners of the parent	25 279	19 679	11 788	13 362
Non-controlling interest	1 952	2 574	877	821
<b>Total profit and other comprehensive income for the reporting period:</b>	<b>27 231</b>	<b>22 253</b>	<b>12 665</b>	<b>14 183</b>
Basic earnings per share (in euros)	0.97	0.77	0.45	0.52
Diluted earnings per share (in euros)	0.96	0.75	0.45	0.51
Basic earnings per share (in euros) from discontinued operations	0.12	0.08	0.00	0.12
Diluted earnings per share (in euros) from discontinued operations	0.13	0.07	0.00	0.11

Notes:

<sup>1</sup> In 2018 financial statements, the Group presented results of UAB "Mokilizingas", a subsidiary of LHV Pank, as discontinued operations, due to the sale of company in May 2018. Consequently, comparative data for 2017 were restated accordingly. For purposes of this Prospectus, financial data for 2017 is presented on restated basis.

<sup>2</sup> FVOCI = Assets to be measured subsequently at fair value through other comprehensive income.

Consolidated Statement of Financial Position

<i>(in thousands of euros)</i>	As at	As at	As at
	31.12.2018	31.12.2017	30.06.2019
	Audited	Audited	Reviewed
<b>Assets</b>			
Due from central bank	639 862	920 714	1 067 924
Due from credit institutions	25 791	26 312	21 981
Due from investment companies	17 005	14 186	9 104
Available-for-sale financial assets	0	775	0
Equity instruments at fair value through other comprehensive income	298	0	298
Financial assets at fair value through profit or loss	46 856	55 859	119 164
Loans and advances to customers	918 761	732 043	1 117 904
Receivables from customers	3 721	9 800	9 504
Other financial assets	2 936	2 289	2 850
Other assets	1 651	1 516	1 820
Tangible assets	1 135	1 421	5 135
Intangible assets	15 470	4 327	15 416
Goodwill	3 614	3 614	3 614
<b>Total assets</b>	<b>1 677 100</b>	<b>1 772 856</b>	<b>2 374 714</b>
<b>Liabilities</b>			
Deposits from customers and loans received	1 443 782	1 542 929	2 111 978
Financial liabilities at fair value through profit or loss	11	2	9
Accounts payable and other liabilities	24 644	71 070	23 188

Subordinated debt	50 900	30 900	75 000
<b>Total liabilities</b>	<b>1 519 337</b>	<b>1 644 901</b>	<b>2 210 175</b>
<b>Owner's equity</b>			
Share capital	26 016	25 767	26 016
Share premium	46 653	46 304	46 653
Statutory reserve capital	3 451	2 471	4 713
Other reserves	2 090	1 449	2 865
Retained earnings/ accumulated deficit	75 430	44 071	80 493
<b>Total equity attributable to owners of the parent</b>	<b>153 640</b>	<b>120 062</b>	<b>160 740</b>
Non-controlling interest	4 123	7 893	3 799
<b>Total equity</b>	<b>157 763</b>	<b>127 955</b>	<b>164 539</b>
<b>Total liabilities and equity</b>	<b>1 677 100</b>	<b>1 772 856</b>	<b>2 374 714</b>

### Consolidated Statement of Cash Flows

<i>(in thousands of euros)</i>			6m ended	6m ended
	2018	2017 <sup>1</sup>	on 30.06.2019	on 30 June 2018
	Audited	Audited	Reviewed	Unaudited
<b>Cash flows from operating activities</b>				
Interest received	45 007	34 215	26 761	21 256
Interest paid	-6 781	-4 496	-4 154	-2 718
Fees and commissions received	32 844	26 400	17 590	16 291
Fees and commissions paid	-7 799	5 412	-4 753	-3 486
Other income received	891	-133	-50	27
Staff costs paid	-14 647	-11 861	-8 463	-6 757
Administrative and other operating expenses paid	-13 415	--13 107	-7 040	-6 340
Income tax	-3 070	-951	-2 962	-1 938
<b>Cash flows from operating activities before change in operating assets and liabilities</b>	<b>33 030</b>	<b>24 655</b>	<b>16 929</b>	<b>16 335</b>
<b>Net increase/(decrease) in operating assets:</b>				
Net increase/(decrease) in financial assets held for trading at fair value through profit or loss / Net acquisition/disposal of trading portfolio	0	278	46	-49
Net increase/(decrease) in financial assets at fair value through profit or loss	-115	0	0	0
Loans and advances to customers	-199 259	-190 320	-206 197	-57 819
Mandatory reserve at central bank	1 094	-7 639	-5 584	-1 086
Security deposits	-647	-1 348	86	-58
Other assets	-597	177	-152	-552
<b>Net increase/(decrease) in operating liabilities:</b>				
Demand deposits of customers	-105 458	785 454	367 882	17 888
Term deposits of customers	-9 316	-25 052	292 858	-12 034
Loans received	16 250	6 000	10 000	0
Repayments of loans received	-722	-779	-2943	0
Financial liabilities held for trading at fair value through profit and/or loss	8	-207	-2	5
Other liabilities	-38 413	45 217	-833	-46 828

Discontinued operations	-121	-5 330	0	-270
<b>Net cash generated from/(used in) operating activities</b>	<b>-304 415</b>	<b>631 106</b>	<b>472 090</b>	<b>-84 468</b>
<b>Cash flows from investing activities</b>				
Purchase of tangible and intangible assets	-3 450	-1 368	-5 934	-1 084
Disposal of subsidiaries, net of cash disposed	5 046	0	0	5 046
Proceeds from disposal and redemption of investment securities available at fair value through other comprehensive income	520	100	0	-112
Net changes of investment securities / investments at fair value through profit or loss	9 473	19 962	-72 819	2 825
<b>Net cash flow from/(used in) investing activities</b>	<b>11 589</b>	<b>18 694</b>	<b>-78 753</b>	<b>6 675</b>
<b>Cash flows from financing activities</b>				
Paid in share capital (incl. share premium)	598	823	0	0
Paid dividends	-5 295	-3 804	-6 664	-5 295
Subordinated loans received	20 000	0	40 000	0
Repayments of the subordinated loans received	0	0	-15 900	0
<b>Net cash from financing activities</b>	<b>15 303</b>	<b>-2 981</b>	<b>17 436</b>	<b>-5 295</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>64</b>	<b>254</b>	<b>-7</b>	<b>-6</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>-277 459</b>	<b>647 073</b>	<b>410 766</b>	<b>-83 094</b>
Cash and cash equivalents at the beginning of the period	945 837	298 764	668 378	945 837
<b>Cash and cash equivalents at the end of the period<sup>1</sup></b>	<b>668 378</b>	<b>945 837</b>	<b>1 079 144</b>	<b>862 743</b>

#### Notes

<sup>1</sup>The cash and cash equivalents at the end of the period differ from cash and cash equivalent positions presented in the condensed consolidated interim statement of financial position of the Group by the minimum reserve amount kept in central bank. A bank's minimum reserve requirement is set for six-week maintenance periods and is calculated as minimum of 1% of certain liabilities. The level of reserves is calculated based on the bank's balance sheet before the start of the maintenance period. The central bank pays banks interest on their minimum reserve holdings – the interest rate is equivalent to the main refinancing operation rate.

#### Consolidated Statement of Changes in Equity

<i>(in thousands of euros)</i>	Share capital	Share premium	Reserve capital	Other reserves	Retained earnings	Total	Non-controlling interest	Total equity
<b>Balance as at 01.01.2017</b>	<b>25 356</b>	<b>45 892</b>	<b>1 580</b>	<b>1 244</b>	<b>28 335</b>	<b>102 407</b>	<b>5 319</b>	<b>107 726</b>
Paid in share capital	411	412	0	0	0	823	0	823
Transfer to statutory reserve capital	0	0	891	0	-891	0	0	0
Dividends paid	0	0	0	0	-3 804	0	0	-3 804
Share options	0	0	0	129	828	957	0	957
<i>Profit for the year</i>	0	0	0	0	19 603	19 603	2 574	22 177
<i>Other comprehensive income</i>	0	0	0	76	0	76	0	76
Total comprehensive income for 2017	0	0	0	76	19 603	19 679	2 574	22 253
<b>Balance as at 31.12.2017</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>44 071</b>	<b>120 062</b>	<b>7 893</b>	<b>127 955</b>
Changes in initial application of IFRS 15	0	0	0	0	10 617	10 617	0	10 617
<b>Restated balance as at 01.01.2018</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>54 688</b>	<b>130 679</b>	<b>7 893</b>	<b>138 572</b>

Paid in share capital	249	349	0	0	0	598	0	598
Disposal of subsidiary	0	0	0	0	0	0	-4 550	-4 550
Transfer to statutory reserve capital	0	0	980	0	-980	0	0	0
Dividends paid	0	0	0	0	-4 123	-4 123	-1 172	-5 295
Share options	0	0	0	599	608	1 207	0	1 207
Profit for the year	0	0	0	0	25 237	25 237	1 952	27 189
Including changes on initial application of IFRS 9	0	0	0	0	-731	-731	-18	-749
Other comprehensive profit	0	0	0	42	0	42	0	42
Total comprehensive income for 2018	0	0	0	42	25 237	25 279	1 952	27 231
<b>Balance as at 31.12.2018</b>	<b>26 016</b>	<b>46 653</b>	<b>3 451</b>	<b>2 090</b>	<b>75 430</b>	<b>153 640</b>	<b>4 123</b>	<b>157 763</b>
<b>Restated balance as at 01.01.2019</b>	<b>26 016</b>	<b>46 653</b>	<b>3 451</b>	<b>2 090</b>	<b>75 430</b>	<b>153 640</b>	<b>4 123</b>	<b>157 763</b>
Transfer to statutory reserve capital	0	0	1 262	0	-1 262	0	0	0
Dividends paid	0	0	0	0	-5 463	-5 463	-1 201	-6 664
Share options	0	0	0	775	0	775	0	775
Profit for the year	0	0	0	0	11 788	11 788	877	12 665
Other comprehensive profit	0	0	0	0	0	0	0	0
Total comprehensive income for 2018	0	0	0	0	11 788	11 788	877	12 665
<b>Balance as at 30.06.2019</b>	<b>26 016</b>	<b>46 653</b>	<b>4 713</b>	<b>2 865</b>	<b>80 493</b>	<b>160 740</b>	<b>3 799</b>	<b>164 539</b>

### Key Ratios and Indicators

In the opinion of the Management Board, those key ratios and indicators are the most appropriate ratios and indicators, considering the markets where the Group companies operate. The Management Board believes these ratios and indicators provide useful information for the purposes of evaluating the profitability of the operations of the Group, considering the business volumes of the Group companies.

<i>Unaudited</i>	<b>As at 31.12.2018</b>	<b>As at 31.12.2017</b>	<b>As at 30.06.2019<sup>16</sup></b>	<b>As at 30.06.2018<sup>16</sup></b>
Core Tier 1 CAD %	14.88	14.02	12.12	14.07
Tier 1 CAD %	14.88	14.02	13.99	14.07
CAD %	20.91	18.30	19.16	18.07
MREL % <sup>2</sup>	11.43	7.78	9.64	8.4
Leverage ratio %	6.56	5.01	6.929	6.02
LCR % <sup>3</sup>	148.5	121.3	201.8	126.8
NSFR % <sup>3</sup>	147.6	140.8	175.2	154.7
Return on equity (ROE) % <sup>1,4</sup>	18.4	17.6	15.0	20.7
Return on assets (ROA) % <sup>5</sup>	1.6	1.6	1.25	1.63
CFROI % <sup>6</sup>	25.4	22.6	N/A <sup>15</sup>	N/A <sup>15</sup>
Cost to income ratio % <sup>7</sup>	48.3	54.4	51.7	46.3
Net interest margin (NIM) % <sup>8</sup>	2.34	2.66	2.23	2.13
Spread % <sup>9</sup>	2.32	2.62	2.23	1.86
Loan to asset % <sup>10</sup>	55.24	41.61	47.57	44.63
Loan to deposits % <sup>11</sup>	65.14	48.00	53.49	50.33
Price to earnings ratio <sup>12</sup>	9.75	13.56	11.41	11.72
Dividend to net profit ratio % <sup>13</sup>	21.6	21.0	22	21.2
Dividend per share <sup>14</sup> (EUR)	0.16	0.15	0.11	0.12

Notes:

<sup>1</sup> Return on equity is calculated based on LHV Group net profit and equity attributable to owners of the parent and does not include non-controlling interest. Capital adequacy levels are calculated as reported in COREP report as at end of each year

<sup>2</sup> MREL = (own funds + qualifying liabilities) / total liabilities - qualifying liabilities) \* 100

<sup>3</sup> LCR, NSFR are calculated as reported in COREP report as of end of each year

<sup>4</sup> Return on equity (ROE) = net profit (attributable to owners of the parent) / average equity (attributable to owners of the parent) \* 100

<sup>5</sup> Return on assets (ROA) = net profit / average assets \* 100

<sup>6</sup> CFROI = Operating profit / capital (average)

<sup>7</sup> Cost to income ratio = total operating expenses / total income \* 100

<sup>8</sup> Net interest margin (NIM) = net interest income/average interest earning assets \* 100 (annualised)

<sup>9</sup> Spread = yield on interest earning assets – cost of interest-bearing liabilities

<sup>10</sup> Loan to asset = net loans / total assets \* 100

<sup>11</sup> Loan to deposits = net loans / deposits \* 100

<sup>12</sup> Price to earnings ratio = share price/net profit/number of shares (average)

<sup>13</sup> Dividend to net profit ratio = dividend/net profit

<sup>14</sup> Dividend per share = dividend payment during calendar year / number of shares at moment of payment

<sup>15</sup> Only calculated on an annual basis

<sup>16</sup> All ratios have been annualised

The above table includes key regulatory ratios as reported to the competent authorities and calculated in accordance with the CRR and CRDIV and other legislative acts (Core Tier 1 CAD%, Tier 1 CAD %, CAD %, MREL %, Leverage ratio, LCR %, NSFR %) and certain data which the Company considers to constitute alternative performance measures (the **APMs**) for the purposes of the European Securities Markets Authority (the **ESMA**) Guidelines on Alternative Performance Measures. These APMs are not audited nor defined by, or presented in accordance with, IFRS and should not be considered as alternatives to any measures of performance under IFRS or as measures of the Group's liquidity. The Company's use and method of calculation of APMs may vary from other companies' use and calculation of such measures.

## 12. CAPITALISATION AND INDEBTEDNESS

Capitalisation. The following table sets forth the consolidated total capitalisation of the Group as of 30 June 2019. The information has been derived from the unaudited Interim Financial Statements. The table should be read and interpreted in conjunction with the Interim Financial Statements presented elsewhere in this Prospectus and annexed to this Prospectus. The Group's consolidated capitalisation and indebtedness will be significantly impacted by the Offering and the use of proceeds. Please refer to Section 5 "Reasons for Offering and Use of Proceeds" for further details.

(thousands of EUR)

<b>Total current debt (maturity up to one year)</b>	<b>As at 30.06.2019</b>
<b>Total current debt</b>	<b>2 091 003</b>
Guaranteed	686 338
Secured	0
Unguaranteed/unsecured	1 404 665
Subordinated debt	0
<b>Non-current debt</b>	
Total non-current debt	119 172
Guaranteed	20 984
Secured (TLTRO funding from ECB)	0
Unguaranteed/unsecured	23 188
Subordinated debt	75 000
<b>Equity</b>	
Share capital	26 016
Share premium	46 653
Statutory reserve capital	4 713
Other reserves	2 865
Retained earnings / accumulated deficit	68 705
Non-controlling interest	3 799
Net profit for the reporting period	11 788
<b>Total equity</b>	<b>164 539</b>

Indebtedness. The following table indicates the indebtedness of the Group as at 30 June 2019. The information has been derived from the unaudited Interim Financial Statements. The table should be read and interpreted in conjunction with the Interim Financial Statements presented elsewhere in this Prospectus and annexed to this Prospectus.

(thousands of EUR)

<b>Current assets</b>	<b>As at 30.06.2019</b>
<b>Liquidity:</b>	
Cash	305
Cash equivalents	1 067 619
Trading securities	119 164
<b>Total liquidity</b>	<b>1 187 088</b>
<b>Current financial receivables</b>	<b>319 408</b>
<b>Total current assets</b>	<b>1 506 496</b>
<b>Current financial debt (maturity up to one year):</b>	
Current debt	2 091 003
Current portion of non-current debt	0
Other current financial debt	23 118
<b>Total current financial debt</b>	<b>2 114 191</b>

<b>Net current financial indebtedness</b>	<b>607 695</b>
<hr/>	
Non-current financial indebtedness:	
Non-current bank loans	20 984
Bonds issued	0
Other non-current loans	75 000
<b>Non-current financial indebtedness</b>	<b>95 984</b>
<b>Net financial indebtedness</b>	<b>703 679</b>
<b>Indirect and contingent indebtedness:</b>	
Performance guarantees	14 606
Financial guarantees	9 888
Unused loan commitments	198 715
<b>Total indirect and contingent indebtedness</b>	<b>223 209</b>

Working Capital Statement. In the opinion of the Management, the Group's working capital is sufficient to cover the Group's foreseeable obligations for a period of at least 12 months following the date of this Prospectus.

The working capital of a company represents the difference between the company's current assets and current liabilities. As at 30 June 2019, the net current total consolidated working capital of the Group was EUR -584 thousand. The largest subsidiary of the Group, LHV Pank, is a credit institution that is mainly funded from the deposits. In case of credit institutions, the working capital information does not represent the actual liquidity situation, as the essence of banking activity is to collect deposits with a shorter term and lend out the deposits for longer maturities. Regulatory requirements established under the CRR address the liquidity requirements for credit institutions and their groups through certain liquidity ratios (LCR and NSFR) which the Group fulfils with significant buffers. The aim of the LCR standard is to ensure that the Group has an adequate amount of unencumbered assets of high quality and liquidity that could be monetised without incurring material losses to meet a liquidity requirement in a 30-day stress scenario. The output of the standard is the ratio of liquid assets to stress scenario liquidity requirement, which has a limit of 100%. The Group's liquidity coverage ratio level as at 30.06.2019 was 201.8% (31.12.2018: 148.5%). The objective of the NSFR is to ensure that the Group has adequate stable funding sources to finance longer-term assets. The Group's NSFR level as at 30.06.2019 was 175.2% (31.12.2018: 148%). The net stable funding ratio will be imposed as 100% minimum requirement from the year 2018.

No Material Adverse Change. There has been no material adverse change in the Group's financial position since 30 June 2019.

## 13. FINANCIAL CONDITION, RESULTS OF OPERATIONS AND OUTLOOK

### a. Financial Condition and Results of Operations

Detailed information on the financial condition and results of operations of the Group has been provided in the Financial Statements annexed to this Prospectus.

### b. Factors and Public Policies Affecting Operations

Introductory Remarks. The operations and financial condition of the Group are affected by numerous factors. The factors of particular importance, in the opinion of the Management, are outlined below. However, the impact of these and other factors may vary significantly in the future.

Macroeconomic Environment. The operations of the Group are materially affected by the macroeconomic environment in the main geographical markets where the Group companies operate, i.e. Estonia and United Kingdom.<sup>21</sup> Macroeconomic factors such as GDP growth, inflation rates, interest rates and currency exchange rates, as well as unemployment rates, average income levels and the general financial situation of consumers and businesses, together with various other factors, have a material impact on the operations of the Group.

Although the current economic environment may be described as growing, 2018 was marked by the continued existence of geopolitical risks to the fore, the growth slowdown in the world economy, rising interest rates, surging equity and market volatility. In May 2019, the European Central Bank and the European Systemic Risk Board have assessed the risks to the financial sector of the euro area and of the European Union as quite high.<sup>22</sup> According to Estonian Central Bank, in 2018, the GDP of Estonia increased 3.9% compared to an increase of 4.7% in 2017 and 2.6% in 2016.<sup>23</sup> The high employment rate and structural labour shortage are fuelling a wage growth beyond the growth in productivity; the fragility of the external environment and labour market restrictions have kept investments in noncurrent assets at a 20-year low. Although the current environment has suited well for the Group, further developments in the economic climate may result in fluctuations in the results of operations of the Group. Please refer to Section 3.3 “Political, Economic and Legal Risks” for further discussion on the potential impact of the overall macroeconomic environment to the results of operations of the Group.

Despite the overall positive macroeconomic outlook, the European banks’ return on equity is in many cases still below their cost of equity suggesting that some banking models are not sustainable.<sup>24</sup> That said, in case of a slowdown in economic growth, the banks’ revenues may come under further pressure.<sup>25</sup> According to the European Banking Authority, the average percent of the restructured loans and loans overdue for more than 90 days of the big banking groups in the European Union was 14.5 in

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<sup>21</sup> Until 2016, the Group also operated on the Latvian market and until 2018, also on the Lithuanian market. Please refer to Section 10.2 “Group Structure and Group Companies” for further details.

<sup>22</sup> Bank of Estonia. Financial Stability Review 1/2019, p 16. Available at: <https://eestipank.ee/en/publication/financial-stability-review/2019/financial-stability-review-12019>

<sup>23</sup> Bank of Estonia. Annual indicators for Estonia. Available at: <http://statistika.eestipank.ee/#/en/p/MAJANDUSKOOND/r/2053/1902>

<sup>24</sup> European Central Bank. Financial Stability Review, May 2019. Available at: <https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr201905~266e856634.en.html#toc3>

<sup>25</sup> EBA, Risk Dashboard Q1 2019, page 4. Available at: <https://eba.europa.eu/documents/10180/2854739/EBA+Dashboard+-+Q1+2019.pdf/ebb7b4d1-09c3-49c3-93a2-71e758d99fe8>

the first quarter of 2019.<sup>26</sup> The wide scope of identified misconduct practices and high misconduct costs at several banks also remain as concerns. Developments in international financial markets undoubtedly affect Estonian and United Kingdom financial markets and may have adverse effect to the operations of the Group.

Changes in Regulatory Environment. The operations of the Group are subject to extensive legal regulation on both levels – on the level of the European Union and on the level of jurisdictions where the Group companies operate. Material changes in such regulations may have a significant impact on the results of operations of the Group companies. In particular, the Group is subject to strict capital adequacy requirements which will be further tightened after the application of the CRD V and CRR II reform package adopted in May 2019 which will apply from December 2020 and mid-2021. The CRD V also introduces an authorisation requirement for financial holding companies such as the Company which means the Company will need to obtain authorisation from the EFSA in accordance with Article 21(a) of CRD V, unless an exemption is applicable, by the end of the transition period foreseen under the same directive. The operations of the Group companies may be also influenced by changes in other fields of law applicable in respect of either the Group companies or the clients and co-operation partners of the Group companies. As the Group has entered to the market of the United Kingdom, it may also become subject to additional legal requirements as a result of the United Kingdom's withdrawal from the European Union, including possibly the requirement to obtain an additional activity license. Changes in the tax regime of Estonia as the main geographical market may have significant impact of the results of operations of the Group companies.

LHV Varahaldus is increasingly influenced by the continuous changes to the Estonian compulsory pension funds system. In December 2018, changes to the Estonian Investment Funds Act were adopted by the Riigikogu (the Estonian Parliament) changing materially the the terms of the actively managed pension funds by affecting the investment restrictions and fee structure of the funds. The fixed management fee is lowered considerably, reducing fixed costs for pension savers, and a performance fee is introduced. As a result of the legislative change, the investment restrictions are also relaxed, creating additional investment opportunities for pension funds, *inter alia* into local assets which are predominantly non-listed and which LHV Varahaldus hopes will offers attractive long-term investment opportunities for the compulsory pension funds. However, the political parties forming the new government in Estonia after the parliamentary election in March 2019 that took office in April 2019 have further agreed to change the Estonian compulsory pensions fund system further in a manner allowing the fund investors to exit from the system before retirement upon request and to further reduce the fees of pensions funds. There is currently no further information available about the details of the possible legislative change however such change would have a significant effect on the profitability and operations of LHV Varahaldus. Please refer to Section 3.3 "Political, Economic and Legal Risks" for discussion in further detail.

Competitive Markets. The level of competition has a material impact on the Group's results of operations. Estonian banking market as the main market of the Group may be characterised by intense competition. There are altogether nine licensed credit institutions in Estonia, and a further eight<sup>27</sup>

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<sup>26</sup> EBA, Risk Dashboard Q1 2019, page 9, Available at: <https://eba.europa.eu/documents/10180/2854739/EBA+Dashboard+-+Q1+2019.pdf/ebb7b4d1-09c3-49c3-93a2-71e758d99fe8>

<sup>27</sup> Danske Bank A/S Estonian branch is due to close its branch in October 2019 as a result of the precept of the Estonian Financial Supervision Authority, dated 19 February 2019.

branches of foreign credit institutions operate in the Estonian banking market.<sup>28</sup> What is more, over 300 other financial institutions from the European Union can provide cross border banking services in Estonia. There have been significant changes in the Estonian banking market in 2019, in the first quarter Luminor Bank AS completed the cross-border merger of the Latvian and Lithuanian banks into the Estonian entity as a result of which the assets of the Estonian banking sector increased by 40% to EUR 36 billion. LHV Bank's share by assets is 4.9% as of the same date. As at the end of January 2019, the banks had assets 145% of GDP, which places Estonia closer to the average ratio in the European Union.<sup>29</sup> The banking sector in Estonia is highly concentrated. As at the end of 31 December 2018, three large banks, which are subsidiaries of foreign banks, hold a 82% combined market share in loans and 84% combined market share in deposits. Respective market shares of LHV Bank were 5% and 8%. Regardless of the tense competition situation, the volume of the LHV Bank's loan portfolio increased by 28% while the volume of deposits decreased by 7% in the year 2018. In the current record-low, negative interest rates, it is a challenge to maintain or grow its market position for any market participant, including the bank.

The Estonian asset management market is relatively young and is rapidly growing. The total value of public pension and investment funds at the end of 2018 was EUR 4.5 billion.<sup>30</sup> The growth of the sector is driven by the mandatory pension funds, which are also the largest business segment of the Estonian asset management market. As of the end of December 2018, LHV Varahaldus belongs among the two largest players of the sector, holding a 27% share of the asset management market.<sup>31</sup> Mandatory pension funds in Estonia are managed by altogether five licensed fund managers. The market share of LHV Varahaldus on the compulsory pension funds market is 30% and 11% on the voluntary pension funds market as of the end of 2018.<sup>32</sup> There are altogether 17 local licensed fund managers in Estonia and 58 market participants providing fund management services cross-border.

Quality of Credit Portfolio and Impairment Charges. The results of operations may be materially affected by the quality of the credit portfolio and impairment charges. The amount of impairment provisions allocated for impairment losses depends on the expected recovery ratios and the value of available collateral. There are several criteria for a loan to be considered individually impaired. The Group's internal default definition is in line with the generally accepted definition of the default criteria, such as payment delay more than 90 days on any material credit obligation, distressed restructuring of the credit obligation, and specific credit adjustment due to significant perceived decline in the credit quality since inception, significant financial difficulties of the obligor or likely bankruptcy process, etc. As a part of the risk analysis, the Group is regularly performing stress tests and sensitivity analysis regarding the credit risk and its components (such as PD, LGD). The collective impairment credit assessment of the Group is based on the historical loss rate and credit rating. The credit quality of the Group has a more detailed coverage in Note 3 (Section 3.2.2) of the Financial Statements.

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<sup>28</sup> Statistics of the Bank of Estonia. Available at: <http://statistika.eestipank.ee/failid/mbo/kras.html>.

<sup>29</sup> Statistics of the Estonian National Bank. Available at [http://www.eestipank.ee/sites/eestipank.ee/files/publication/ep\\_fsy\\_2015\\_2\\_eng\\_a.pdf](http://www.eestipank.ee/sites/eestipank.ee/files/publication/ep_fsy_2015_2_eng_a.pdf)

<sup>30</sup> Estonian Financial Supervision Authority. The Estonian financial services market as at 31 December 2018, p 9. Available at [https://www.fi.ee/sites/default/files/turg%20seisuga%202018\\_31\\_12\\_inglise.pdf](https://www.fi.ee/sites/default/files/turg%20seisuga%202018_31_12_inglise.pdf)

<sup>31</sup> Estonian Financial Supervision Authority. The Estonian financial services market as at 31 December 2018, p 10. Available at [https://www.fi.ee/sites/default/files/turg%20seisuga%202018\\_31\\_12\\_inglise.pdf](https://www.fi.ee/sites/default/files/turg%20seisuga%202018_31_12_inglise.pdf)

<sup>32</sup> Estonian Financial Supervision Authority. The Estonian financial services market as at 31 December 2018, p 11. Available at [https://www.fi.ee/sites/default/files/turg%20seisuga%202018\\_31\\_12\\_inglise.pdf](https://www.fi.ee/sites/default/files/turg%20seisuga%202018_31_12_inglise.pdf)

## 14. UNAUDITED PRO FORMA FINANCIAL INFORMATION

Introduction. The unaudited consolidated pro forma financial information (the **Unaudited Consolidated Pro Forma Financial Information**) presented in the table below comprises the unaudited pro forma consolidated statement of financial position of the Group as at 30 June 2019 and the explanatory notes. The unaudited pro forma consolidated statement of financial position as at 30 June 2019 shown in the tables below presents hypothetically the Group's financial position as if the planned acquisition of the Danske Loan Portfolio (please refer to Section 10.4 "Investments" for further details) had taken place at 30 June 2019. The Unaudited Consolidated Pro Forma Financial Information has been prepared in accordance with the principles described in Annex 20 to the Delegated Regulation. The Unaudited Pro Forma Financial Information is accompanied by a report from independent auditors, AS PricewaterhouseCoopers.

The Unaudited Pro Forma Financial Information presented in the table below is based on the Interim Financial Statements included in Annex 1 of this Prospectus and has been prepared in accordance with the accounting policies adopted by the Group and described in the Group's Interim Financial Statements and the Audited Financial Statements. The Unaudited Pro Forma Financial Information presented below has been prepared solely for inclusion in this Prospectus and for illustrative purposes and due to its nature presents a hypothetical situation as if the acquisition of the Danske Loan Portfolio has taken place on the assumed date. The Unaudited Pro Forma Financial Information does not present the actual results and financial standing of the Group for the presented period, had the transaction discussed really taken place on the assumed date; and does not determine the results and financial standing in any future periods. The Unaudited Pro Forma Financial Information should be analysed together with the information contained in Section 11 "Selected Financial Information" of this Prospectus and the Financial Statements.

The assumptions forming the basis for the pro forma adjustments are discussed in the explanatory notes. The unaudited pro forma adjustments presented below are based on information available and specific assumptions which, in the Company's opinion, are justified in the circumstances.

The acquisition of the Danske Loan Portfolio will not be accounted for as a business acquisition, but as an asset acquisition. As a result, for the purposes of preparing the unaudited consolidated pro forma financial information, the Company concluded that no pro forma income statement can be prepared. Due to the nature of the transaction, the acquired asset does not constitute a business or a legal entity for which a historical financial information was, or could be, prepared for any period. Unless otherwise stated, the pro forma adjustments discussed below will have a continuing impact on the Group.

Unaudited consolidated pro forma statement of financial position as at 30 June 2019

	The Group	Pro forma adjustments			Pro forma
		Danske Loan Portfolio purchase	Impairments related to Danske Loan Portfolio	The Offering	
<i>(in thousands of euros)</i>	Note 1	Note 2	Note 3	Note 4	
<b>Assets</b>					
Due from central bank	1 067 924	-408 000		25 150	685 074
Due from credit institutions	21 981				21 981
Due from investment companies	9 104				9 104
Equity instruments at fair value through other comprehensive income	298				298

Financial assets at fair value through profit or loss	119 164				119 164
Loans and advances to customers	1 117 904	408 000	-1 539		1 524 365
Receivables from customers	9 504				9 504
Other financial assets	2 850				2 850
Other assets	1 820				1 820
Tangible assets	5 135				5 135
Intangible assets	15 416				15 416
Goodwill	3 614				3 614
<b>Total assets</b>	<b>2 374 714</b>	<b>0</b>	<b>-1 539</b>	<b>25 150</b>	<b>2 398 325</b>
<b>Liabilities</b>					
Deposits from customers and loans received	2 111 978				2 111 978
Financial liabilities at fair value through profit or loss	9				9
Accounts payable and other liabilities	23 188		-215		22 973
Subordinated debt	75 000				75 000
<b>Total liabilities</b>	<b>2 210 175</b>	<b>0</b>	<b>-215</b>	<b>0</b>	<b>2 209 960</b>
<b>Equity</b>					
Share capital	26 016			2 200	28 216
Share premium	46 653			22 950	69 603
Statutory reserve capital	4 713				4 713
Other reserves	2 865				2 865
Retained earnings	80 493		-1 324		79 169
<b>Total equity attributable to owners of the parent</b>	<b>160 740</b>	<b>0</b>	<b>-1 324</b>	<b>25 150</b>	<b>184 566</b>
Non-controlling interest	3 799				3 799
<b>Total equity</b>	<b>164 539</b>	<b>0</b>	<b>-1 324</b>	<b>25 150</b>	<b>188 365</b>
<b>Total liabilities and equity</b>	<b>2 374 714</b>	<b>0</b>	<b>-1 539</b>	<b>25 150</b>	<b>2 398 325</b>

#### Notes

- (1) Consolidated financial position for the Group for the period ended 30 June 2019 has been compiled based on the Interim Financial Statements.
- (2) The purpose of the adjustment is to illustrate the effect of acquisition of the Danske Loan Portfolio as though it occurred at 30 June 2019. LHV Pank is purchasing the Danske Loan Portfolio for cash consideration of an estimated EUR 408 million and consequently, the transaction will cause a decrease in cash balances of the Group in central banks. There are no material costs relating to the portfolio acquisition, consequently no pro forma adjustment was calculated in that respect. The estimates are based on the best knowledge of the Management Board and represent the best estimate according to their knowledge as of the date of this Prospectus. Purchase price and the final scope of the Danske Loan Portfolio will be determined upon closing and will be calculated as the size of the portfolio minus a discount of EUR 39 million (the Purchase Price). The portfolio size is expected to amortise to approx. EUR 447 million by closing of the acquisition, in which case the Purchase Price will be approx. EUR 408 million. Based on initial analysis performed from the data available by Management Board, the loans will be classified as measured at amortised cost, however final analysis will be performed after completion of the transaction and certain loans may, pursuant to requirements of IFRS 9, be classified at fair value through profit or loss.

- (3) The purpose of the adjustment is to illustrate the effect of an impairment test and the impairment charge that the Group expects to apply at inception of the Danske Loan Portfolio. Estimated impairment amount is based on the Management Board's application of the Group's Expected Credit Losses model with respect to acquired portfolio. At the date of this Prospectus the Management Board has only limited knowledge and detailed data on the acquired portfolio and the impairment charge estimate reflects the best knowledge of the Management Board in the circumstances. The Management Board does not expect the final impairment charge to be materially different than the estimate. The Group estimates an impairment charge in the amount of EUR 1 539 thousand. Tax effect (decrease of tax liabilities) in the amount of EUR 215 thousand is presented in accounts payable and other liabilities. In accordance with the laws of Estonia, no deferred tax asset is recognized in relation to the impairment charge. The effect of the impairment is recognized in equity (retained earnings).
- (4) The acquisition of the Danske Loan Portfolio is subject to raising the additional own funds needed by the Group in relation to the transaction by this Offering. It was assumed that the gross proceeds of the Offering will amount to EUR 25.3 million and the Offering related expenses (reducing cash received and the share premium) will amount to EUR 0.15 million. There is no impact to taxes.



## **Independent auditor's report on the compilation of pro forma financial information included in a prospectus**

### **To the Management Board of AS LHV Group**

We have completed our assurance engagement to report on the compilation of pro forma financial information of AS LHV Group (the „**Company**” and together with its consolidated subsidiaries the „**Group**”) (“**Unaudited Pro Forma Financial Information**”) prepared by the Management Board of the Company. The Unaudited Pro Forma Financial Information consists of (i) the introduction; (ii) the unaudited pro forma statement of financial position of the Group as at 30 June 2019, and (iii) the related explanatory notes. The applicable criteria on the basis of which the Management Board of the Company has compiled the Unaudited Pro Forma Financial Information have been specified in Annex 20, section 1 and 2 of the Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004 (“**Prospectus Regulation**”) and in the recommendations issued by the European Securities and Markets Authority (“**ESMA**”) (the “applicable criteria”).

The Unaudited Pro Forma Financial Information has been compiled by the Management Board of the Company to illustrate the impact of the acquisition of the Danske Bank A/S Estonian branch's loan portfolio, described in section 10.4 „Investments” of this Prospectus („**Transaction**”), as if the Transaction had taken place at 30 June 2019. As part of this process, information about the Group's financial position has been extracted by the Management Board of the Company from the Group's condensed consolidated interim financial statements as at and for the 6 months period ended 30 June 2019 on which a review report has been published.

### **The Management Board's Responsibility for the Pro Forma Financial Information**

The Management Board of the Company is responsible for compiling the Unaudited Pro Forma Financial Information on the basis of the applicable criteria.

### **Our Independence and Quality Control**

We have complied with the independence and other ethical requirements of the Code of Ethics for Professional Accountants (Estonia) issued by the International Ethics Standards Board for Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Our firm applies International Standard on Quality Control (Estonia) 1 and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.



## **Our responsibility**

Our responsibility is to express an opinion, in accordance with the requirements set in the section 3 of the Annex 20 of the Prospectus Regulation, about whether the Unaudited Pro Forma Financial Information has been compiled, in all material respects, by the Management Board of the Company on the basis of the applicable criteria.

We conducted our engagement in accordance with International Standard on Assurance Engagements (Estonia) (ISAE) 3420 – „Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus”, issued by the International Auditing and Assurance Standards Board. This standard requires that the practitioner comply with ethical requirements and plan and perform procedures to obtain reasonable assurance about whether the Management Board of the Company has compiled, in all material respects, the Unaudited Pro Forma Financial Information on the basis of the applicable criteria.

For purposes of this engagement, we are not responsible for updating or reissuing any reports or opinions on any historical financial information used in compiling the Unaudited Pro Forma Financial Information, nor have we, in the course of this engagement, performed an audit or review of the financial information used in compiling the Unaudited Pro Forma Financial Information.

The purpose of pro forma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the Group as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. Accordingly, we do not provide any assurance that the actual outcome of the Transaction as at 30 June 2019 would have been as presented.

A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material respects, on the basis of the applicable criteria involves performing procedures to assess whether the applicable criteria used by the Management Board of the Company in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and obtain sufficient appropriate evidence about whether:

- the related pro forma adjustments give appropriate effect to those criteria; and
- the pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information.

The procedures selected depend on our judgment, taking into account our understanding of the nature of the company, the event or transaction in respect of which the Unaudited Pro Forma Financial Information has been compiled, and other relevant engagement circumstances.

The engagement also involves evaluating the overall presentation of the pro forma financial information.

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



## Opinion

In our opinion:

- a) the Unaudited Pro Forma Financial Information has been properly compiled on the basis stated; and
- b) such basis is consistent with the accounting policies of the company.

In accordance with item 1.2 of Annex 3 to the Prospectus Regulation, we accept responsibility for this report, constituting a part of the Prospectus, and declare that we have applied due diligence in order to ensure that the information contained in the report is, to our best knowledge, true, fair and consistent with the actual state, and that nothing was omitted that might affect its significance. This declaration has been included in this Prospectus in accordance with the requirements of item 1.2 of Annex 3 to the Prospectus Regulation.

A handwritten signature in blue ink, appearing to read 'Ago Vilu', is written over a light blue horizontal line.

Ago Vilu  
Auditor's certificate no.325

5 September 2019

AS PricewaterhouseCoopers,  
Pärnu mnt 15, 10141 Tallinn

## 15. PROFIT FORECAST

Introductory remarks. In February 2019, the Group published its financial plan for 2019 and five-year financial forecast for the period 2019-2023. In July 2019, the financial plan for 2019 and the financial forecast for the period 2019-2023 was updated to reflect the results of half-year of 2019, possible effects of the acquisition of the Danske Loan Portfolio from Danske Bank A/S, increased loan volumes and deposits and effects of the lower EURIBOR. The financial forecast also includes a profit forecast for the same period (the **Profit Forecast**) as defined in the Prospectus Regulation. The Management Board believes the Profit Forecast continues to be valid at the date of this Prospectus.

Basis of preparation. The Profit Forecast has been compiled on the basis of the assumptions stated below and, on a basis consistent with the accounting policies of the Group, which are in accordance with IFRS and are those which the Group anticipates will be applicable for the financial year ending 31 December 2019. The Management Board has prepared the Profit Forecast on the basis of (i) the audited consolidated financial statements contained in the Group's Audited Financial Statements for the period ended on 31 December 2018 (ii) the Interim Financial Statements for the 6-months period ended on 30 June 2019. The Profit Forecast has not been reviewed or audited by independent auditors.

Profit Forecast. According to the Profit Forecast, the Group expects to earn a net profit of EUR 25.6 million in 2019 which is EUR 1.8 million less than based on the profit forecast published in February 2019. The decrease is attributable to the one-off expenses related to the purchase of the Danske Loan Portfolio and the effects of raising more expensive financing via the deposit collection platforms Deposit Solution and Raisin for completion of the transaction.

In 2020, the net profit is forecasted to reach 39.2 million. The forecast takes into consideration the effects of a lower EURIBOR but expects higher interest income from an increased loan portfolio and a decrease of financing costs as a result of issuing covered bonds which are planned to be used as replacement for the deposits collected via deposit platforms.

In 2021, the net profit is forecasted to reach EUR 50 million. The forecast takes into consideration the effects of a lower EURIBOR but expects higher interest income from an increased loan portfolio and a decrease of financing costs as a result of issuing covered bonds which are planned to be used as replacement for the deposits collected via deposit platforms.

Financial results (thousands of EUR)	2019	2020	2021	2022	2023
Profit before taxes	29 631	45 178	58 525	71 033	84 572
Income tax expense	4 059	5 973	8 494	9 913	12 049
<b>Net profit, incl.</b>	<b>25 572</b>	<b>39 204</b>	<b>50 031</b>	<b>61 119</b>	<b>72 523</b>
attr. to shareholders	23 482	36 980	47 472	58 315	69 559

Assumptions. The Profit Forecast has been prepared relying on the assumptions described below which are categorised as factors falling outside the influence or control of the Management Board and the factors within the influence and control of the Management Board:

(a) Factors outside the influence or control of the Management Board.

The Management Board assumed that during the period covered by the Profit Forecast (i.e. 2019 - 2023), there will be:

- Stable economic environment, no material change, particularly in geographical markets in which the Group operates, to the current prevailing global macroeconomic and political conditions;

- Continuing of growth in business volumes, no material changes in market conditions within the financial services industry in respect of customer demand or the competitive landscape;
- no material changes in relevant exchange rates as compared with the average foreign exchange rates assumed in the Profit Forecast;
- no material changes in the Group's labour costs driven by external parties or regulations;
- no material changes in inflation, interest or tax rates in the Group's principal markets compared with forecasts;
- no adverse event that will have a material impact on the Group's financial performance;
- no change in legislation, tariffs or regulatory environment in the Group's principal markets that materially impact its operations or the accounting principles or standards it follows (which are material in the context of the Profit Forecast);
- no other issue material to the Profit Forecast beyond those issues already known to the Management Board at the current time will arise in respect of the Group's contracts, relationships or obligations.

(b) Factors within the influence or control of the Management Board:

- During the period covered by the Profit Forecast, there will be no material deterioration in the Group's relationship with customers and suppliers in a manner that is material in the context of the Profit Forecast;
- The Group will not execute any additional acquisitions or disposals that are material in the context of the Profit Forecast (considering any potential related transaction or abortive costs);
- There will be no material change in the current key management of the Group.

(c) In the opinion of the Management Board, the main uncertain assumptions that could change the Profit Forecast significantly are:

- Change in macroeconomic environment. The Profit Forecast is prepared, and the credit impairments are estimated, assuming continuing of the current macroeconomic situation (i.e. that it will not improve or decline and remains similar). In case the macroeconomic situation deteriorates significantly the credit risk will start to increase and higher credit impairments will be required.
- Change in interest rate levels. The Group is impacted by ECB's decisions on interest rate levels, as LHV Pank collects deposits at positive interest rates but deposits liquidity at rates set by the ECB. In the Profit Forecast it is assumed that ECB sets the rates in line with the current market's expectation and the yields will remain negative throughout the forecasting cycle. In case the interest rates would increase instead, it would generate additional income for the Group.
- Political and legal risks. The Profit Forecast takes into consideration all current known upcoming changes in regulations, except the Profit Forecast does not consider the possible effects of the currently discussed changes to the Estonian compulsory pension pillar system as the details of the reform remain under discussion (for further information, please refer to Section 3.3 "Political, Economic and Legal Risks" of this Prospectus). However, as banking and asset management are both heavily regulated sectors, new significant changes in regulations/legislations could arise during the Profit Forecast period, which could trigger a significant change in certain business lines profitability.

## 16. TAXATION

Introductory Remarks. This Section is meant to give an overview of the tax regime applicable to the shareholders and the Company. The below summary is in no way exhaustive and is not meant to constitute professional advice to any person. In order to establish particular tax consequences of the Offering or the ownership of the Shares, each individual investor is strongly encouraged to seek specialist assistance. Furthermore, the tax laws of the investor's jurisdiction may also have an impact on the income received from the Shares.

Corporate Income Tax. The system of taxation of corporate income currently in force in Estonia differs from the traditional model of corporate income taxation in that it shifts the point of corporate taxation from the moment of accrual to the moment of distribution. Therefore, in Estonia corporate income tax is charged only on the distributed profit with the reinvested profits remaining untaxed until distribution. Corporate income tax is charged on profit distributions such as dividends, payments in the course of the reduction of share capital and redemption of own shares, as well as on implicit distributions such as fringe benefits, gifts and donations, expenditures and payments not related to the business activities of a company.

All of the above profit distributions are normally taxed at the rate of 20/80 (25%) of the net amount of the distribution, i.e. 20% of the gross amount of the distribution, whereas, as a rule, the corporate income tax charged on the above profit distributions is payable only at the company level with the company being responsible for calculating, declaring and paying of the respective corporate income tax (regular profit distributions are an exception and are taxed differently – please see below for details). Corporate income tax imposed on distributed profit is not a withholding tax and thus is not influenced by the applicable international tax treaties. Payments made in the course of the reduction of share capital and redemption of shares are taxable at the company level only to the extent such payments exceed the monetary and non-monetary contributions previously made by the shareholders into the company.

Upon the repeated distribution of dividends by an Estonian resident legal person on the account of the dividends derived from a resident company of the European Economic Area contracting state (including Estonia) or Switzerland, the repeated distribution of dividends shall be exempt from income tax, provided the distributing company held at least 10% of the shares or votes in the company from which the underlying dividends were derived at the time of deriving the dividends. The latter restriction should be taken into account by an Estonian resident investor when deciding on whether to acquire the Shares as a natural or a legal person.

Regular profit distributions. From January 1, 2018 a special taxation regime and a reduced corporate income tax rate of 14% has been introduced with respect to the so-called regular dividend payments and other profit distributions. According to the new regime, if the profit distributed in a calendar year is smaller than or equal to the average distributed profit of the previous three calendar years in which the Estonian resident company has paid corporate income tax, then such profit shall be subject to taxation at a reduced corporate income tax rate of 14% from gross amount of distribution or 14/86 from the net amount of the distribution. The amount of distribution exceeding the average distributed profit of the previous three calendar years is taxable at the regular corporate income tax rate of 20%.

2019 is the first year when the Estonian resident legal person can apply the reduced 14% corporate income tax rate in respect of 1/3 of the taxable profit distributed in 2018. If the profit distributions taxable at a reduced corporate income tax rate of 14% are paid to a natural person (resident or non-resident), then such distributions will be also subject to personal income tax at a reduced rate of 7% (withholding tax).

Dividend tax. In Estonia dividends paid by an Estonian resident legal person are normally exempt from taxation at the level of the recipient, regardless of whether the recipient is a natural or a legal person, an Estonian resident or a non-resident person (no classical dividend tax). Therefore, as a rule, taxation takes place only at the level of the Estonian legal person making the distribution. However, if the recipient is a non-resident person, then the dividends received from the Estonian legal person may be taxed with dividend tax in the person's respective country of residence. In order to establish particular tax consequences arising in the non-resident person's country of residence, investors are advised to seek specialist assistance.

In connection with the enacting of a special tax regime for regular profit distributions by Estonian resident companies, starting from 1 January 2018, a reduced personal income tax rate of 7% has also been introduced with respect to dividends or other profit distributions that have been taxed at company level as regular profit distributions. The said personal income tax rate of 7% functions as a withholding tax, which is withheld from individuals (both resident and non-resident) who have received dividends taxed at a reduced corporate income tax rate of 14%.

Capital Gains from Sale or Exchange of Shares. Gains realised by an Estonian resident individual upon the sale or exchange of securities (including the Shares) are subject to income tax at the rate of 20%. Payments received by an Estonian resident individual in the course of the reduction of share capital or redemption of shares are also taxable as capital gains, if the amount of the received payment exceeds the acquisition cost of the relevant shareholding, except to the extent such payment has been already taxed at the company level. Since all earnings of resident legal persons, including capital gains, are taxed only upon distribution, capital gains accruing to resident legal persons are not subject to immediate taxation. As a rule, capital gains received by non-residents from the sale or exchange of securities are not taxed in Estonia (except for certain securities related to the Estonian real estate). Non-resident shareholders receiving capital gains from the sale or exchange of the Shares may be subject to declaring and paying income tax in their respective countries of residence. For the purposes of capital gains taxation, the gain derived from the sale of securities (including the Shares) is the difference between the acquisition cost and the sales price of such securities. The gain derived from the exchange of securities is the difference between the acquisition cost of securities subject to exchange and the market price of the property received as a result of the exchange. The expenses directly related to the sale or exchange of shares may be deducted from the gains.

Investment Account. Estonian resident individuals may postpone the taxation of their investment income by using an investment account for the purposes of making transactions with certain financial assets (including the Shares). An investment account is a monetary account opened with a European Economic Area or the Organisation for Economic Co-operation and Development (OECD) member state credit institution, through which the transactions with the financial assets, taxation of income from which (e.g. capital gains, etc.) a person wants to postpone, shall be made. The moment of taxation of the financial income held on an investment account is postponed until such income is withdrawn from the investment account (i.e. the amount withdrawn from the account exceeds the amount which had been previously paid in to the account). Therefore, financial income held at the investment account may be reinvested tax-free until it is withdrawn from the account.

## 17. GLOSSARY

Term	Definition
<b>Alternative Performance Measures</b>	shall mean financial measures that are defined as alternative performance measures in the "ESMA Guidelines on Alternative Performance Measures" issued by the European Securities and Markets Authority on 5 October 2015.
<b>Articles of Association</b>	shall mean the Articles of Association of the Company effective as at the date of this Prospectus.
<b>Audited Financial Statements</b>	shall mean the consolidated audited financial statements of the Group of and for the year ended 31 December 2018 prepared in accordance with the IFRS and the Estonian Accounting Act appended to this Prospectus as Annex 2.
<b>BRRD</b>	shall mean the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.
<b>Company</b>	shall mean AS LHV Group, an Estonian public limited company, registered in the Estonian Commercial Register under register code 11098261, having its registered address at Tartu mnt 2, 10145 Tallinn, Estonia.
<b>CRD IV</b>	shall mean an EU legislative package covering prudential rules for banks, building societies and investment firms. CRD IV includes the following legislative acts - the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD) and the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (CRR).
<b>CRR</b>	shall mean the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.
<b>Cuber Technology</b>	shall mean Cuber Technology OÜ, an Estonian private limited company, registered in the Estonian Commercial Register under register code 12794962, having its registered address at Tartu mnt 2, 10145 Tallinn, Estonia.
<b>Danske Loan Portfolio</b>	private loans' unit of Danske Bank A/S Estonian branch intended to be acquired by LHV Pank pursuant to the Business Transfer Agreement concluded with Danske Bank A/S on 5 June 2019.

<b>Delegated Regulation</b>	Commission Delegated Regulation No 2019/980/EU of 14 March 2019 supplementing Regulation No 2017/1129/EU of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation No 809/2004/EC.
<b>EBA</b>	shall mean the European Banking Authority, an independent EU Authority which works to ensure effective and consistent prudential regulation and supervision across the European banking sector established by the Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC.
<b>ERS</b>	shall mean the Estonian Register of Securities, operated by Nasdaq CSD SE Estonian branch, registered in the Estonian Commercial Register under register code 14306553, having its registered address at Maakri 19/1, 10145 Tallinn, Estonia.
<b>EUR</b>	shall mean the official currency of Eurozone countries, including Estonia, Latvia and Lithuania, the euro.
<b>Eurozone</b>	shall mean the economic and monetary union (EMU) of the European Union member states, which have adopted euro as their single official currency.
<b>Excluded Territories</b>	Australia, Canada, Hong Kong, Japan, South Africa and any other jurisdiction where the distribution of this Prospectus and/or the transfer of Subscription Rights and/or the Offer Shares would breach applicable law.
<b>FCPRA</b>	shall mean the Financial Crisis Prevention and Resolution Act (in Estonian: <i>finantskriisi ennetamise ja lahendamise seadus</i> ), implementing the BRRD into Estonian law.
<b>Financial Statements</b>	shall mean the Audited Financial Statements and the Interim Financial Statements as included in this Prospectus as Annex 1 and Annex 2.
<b>EFSA</b>	shall mean the Estonian Financial Supervision Authority, a financial supervision institution with autonomous competence and a separate budget which conducts supervision over credit institutions, insurance companies, insurance intermediaries, investment firms, management companies, investment and pension funds as well as the payment service providers, e-money institutions and the securities markets that have been authorised by the Financial Supervision Authority in the name of the state and which is independent in its activities and decisions.
<b>GDP</b>	shall mean gross domestic product, the market value of all officially recognised final goods and services produced within a country in a year, or another given period of time.

<b>General Meeting</b>	shall mean the General Meeting of shareholders of the Company, the highest governing body of the Company.
<b>Group</b>	shall mean the Company and all its subsidiaries.
<b>IFRS</b>	shall mean the International Financial Reporting Standards as adopted by the European Union.
<b>Interim Financial Statements</b>	shall mean the unaudited condensed consolidated interim financial statements of the Group as of and for the period ended 30 June 2019, prepared in accordance with International Accounting Standards (IAS) 34 “Interim Financial Reporting” appended to this Prospectus as Annex 1.
<b>Institutional Offering</b>	shall mean the offering of the Offer Shares in and outside Estonia to qualified investors within the meaning of Article 2(e) of the Prospectus Regulation and other types of investors in reliance on certain exemptions available under the laws of each jurisdiction where the Offering is being made, which does not constitute a public offering of the Offer Shares in any jurisdiction, except Estonia.
<b>LHV Finance</b>	shall mean AS LHV Finance, an Estonian public limited company, registered in the Estonian Commercial Register under register code 12417231, having its registered address at Tartu mnt 2, 10145 Tallinn, Estonia.
<b>LHV Pank</b>	shall mean AS LHV Pank, an Estonian public limited company and licensed credit institution, registered in the Estonian Commercial Register under register code 10539549, having its registered address at Tartu mnt 2, 10145 Tallinn, Estonia.
<b>LHV Varahaldus</b>	shall mean AS LHV Varahaldus, an Estonian public limited company and licensed fund manager, registered in the Estonian Commercial Register under register code 10572453, having its registered address at Tartu mnt 2, 10145 Tallinn, Estonia.
<b>Management</b>	shall mean the Management Board and the Supervisory Board of the Company.
<b>Management Board</b>	shall mean the Management Board of the Company.
<b>MEUR</b>	shall mean millions of euro.
<b>Mokilizingas</b>	shall mean UAB “Mokilizingas”, a Lithuanian private limited company, registered in the Lithuanian Commercial Register under register code 124926897, having its registered address at Lvovo g. 25, Vilnius, Lithuania.
<b>Nasdaq Tallinn Stock Exchange</b>	shall mean the only regulated market operated by Nasdaq Tallinn AS (register code 10359206).

<b>Offer Price</b>	shall mean the final price per each Offer Share, which shall be a fixed price of EUR 11.5.
<b>Offer Shares</b>	shall mean up to 2,200,000 Shares that are being offered to investors in the course of the Offering.
<b>Offering</b>	shall mean the Retail Offering and the Institutional Offering together.
<b>Prospectus</b>	shall mean this document, including the registration document of the Company and the securities notes of the Shares.
<b>Prospectus Regulation</b>	Regulation No 2017/1129/EU of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC.
<b>Restricted Territories</b>	member states of the European Economic Area (excluding Estonia).
<b>Retail Offering</b>	shall mean the offering of the Offer Shares to institutional and retail investors in Estonia, which is a public offering of securities within the meaning of the Estonian Securities Market Act.
<b>Section</b>	shall mean a section of this Prospectus.
<b>Share</b>	shall mean the ordinary shares of the Company with the nominal value of EUR 1, registered in the ERS under ISIN code EE3100073644.
<b>Shareholder</b>	shall mean natural or legal person(s), holding the Share(s) of the Company at any relevant point of time.
<b>Subscription Period</b>	shall mean the period within which investors will have the opportunity to submit Subscription Undertakings starting from 11 September 2019 (included) and ending on 25 September 2019 (included).
<b>Subscription Undertaking</b>	shall mean the order submitted by an investor for the purchase of the Offer Shares in accordance with the terms and conditions of the Offering.
<b>Subsidiaries</b>	shall mean LHV Pank, LHV Varahaldus, LHV Finance and Cuber Technology.
<b>Supervisory Board</b>	shall mean the Supervisory Board of the Company.
<b>Summary</b>	shall mean the summary of this Prospectus.
<b>TEUR</b>	shall mean thousands of euro.
<b>Tier 1</b>	shall mean Tier 1 capital, core capital of a bank that includes equity capital and disclosed reserves, as further specified in the CRR.
<b>Tier 2</b>	shall mean Tier 2 capital, supplementary capital of a bank that includes items such as revaluation reserves, undisclosed reserves, general

	provisions, hybrid instruments and subordinated term debt, as further specified in the CRR.
<b>UCITS</b>	shall mean undertakings for the collective investment in transferable securities, i.e. are investment funds regulated at EU level mainly by the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

## 18. LIST OF ANNEXES

Annex 1 – Interim Financial Statements

Annex 2 – Audited Financial Statements

## **COMPANY**

AS LHV Group

(Tartu mnt 2, 10145 Tallinn, Estonia)



## **LEGAL COUNSEL TO COMPANY**

Advokaadibüroo Ellex Raidla Advokaadibüroo OÜ

(Roosikrantsi 2, 10119 Tallinn, Estonia)



## **AUDITORS**

Aktsiaselts PricewaterhouseCoopers

(Pärnu mnt 15, 10141 Tallinn, Estonia)



# Interim Report January – June 2019

## Summary of Results

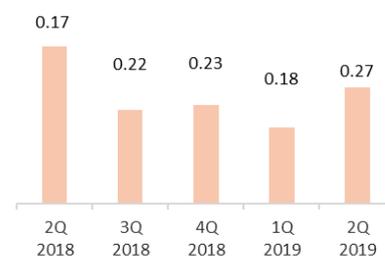
### Q2 2019 in comparison with Q1 2019

- Net profit EUR 7.7 m (EUR 5.0 m), of which EUR 7.1 m (EUR 4.7 m) is attributable to owners of the parent
- Earnings per share EUR 0.27 (EUR 0.18)
- Net income EUR 18.4 m (EUR 17.4 m)
- Operating expenses EUR 9.4 m (EUR 9.1 m)
- Loan provisions EUR 0.7 m (EUR 1.0 m)
- Income tax expenses EUR 0.7 m (EUR 2.3 m)
- Return on equity 18.1% (12.2%)
- Capital adequacy 19.2% (18.3%)

Profit by quarters



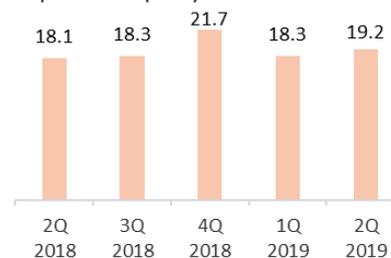
Basic earnings per share



Return on equity



Capital adequacy



### Q2 2019 in comparison with Q2 2018\*

- Net profit EUR 7.7 m (EUR 10.0 m), of which EUR 7.1 m (EUR 9.5 m) is attributable to owners of the parent
- Earnings per share EUR 0.27 (EUR 0.37)
- Net income EUR 18.4 m (EUR 17.0 m)
- Operating expenses EUR 9.4 m (EUR 7.8 m)
- Loan provisions EUR 0.7 m (EUR 1.6 m)
- Income tax expenses EUR 0.7 m (EUR 0.6 m)
- Return on equity 18.1% (27.7%)
- Capital adequacy 19.2% (18.1%)

Earnings per share and return on equity ratios are based on the profit attributed to the shareholders and equity of AS LHV Group and do not include non-controlling interest.

\*In accordance with IFRS, the proceeds and expenses of the discontinued operations have been separated from the corresponding income and expense items of the current and previous periods of the income statement and shown in a separate line on the income statement. The data with discontinued operations are presented in the LHV Factsheet

## Managing Director's Statement

Dear investor in LHV,

For LHV, the second quarter was the most active quarter with all-time best results. On the basis of the performed activities we will be able to offer our customers better service and our investors a growth in value in the future as well.

During the quarter we announced the acquisition of the Danske private customers' portfolio; as at the moment of closing the deal in November, the size of the portfolio was ca EUR 450 million. To conduct the transaction and ensure the growth of the existing portfolio, we raised capital through subordinated loans and bonds qualifying as Tier I own funds, totalling EUR 40 million. At the same time, we redeemed the previous subordinated bonds. We also increased the volume of deposits involved from Germany through the deposit marketplace, to ensure smooth closure of the Danske deal.

During the quarter, we technically joined the real-time pound payment system of the United Kingdom. Legally, we can start offering payments to fintech companies from August. Together with the bank accounts, virtual IBAN, liquidity loans and currency exchange, the real-time pound payments ensure us complete service in the fintech companies' business line. In the Estonian customers business line, we announced the fivefold increase in the number of our ATMs, as LHV will become a new partner to Luminor in the common ATM network, replacing its former partner, Danske Bank. In addition to investments in Baltic equities, we now offer our investors a possibility to also invest in other foreign shares via mobile bank and to get an overview of alternative investments via internet bank. During the quarter, the new Chairman of the Management Board of LHV Varahaldus, Vahur Vallistu, also started to work, whose duty is to strengthen the capability of OTC investments. We also finished the app "My Pension", which enables one to notably better analyse the future of pension investments.

Not a bad result for one quarter. Especially as in terms of continued business activity, this was the best quarterly result ever. We were most definitely supported by the favourable business environment, yet I also believe that we have made the right choices and put in good work to achieve it. Our Estonian-wide strategy has proven its worth. Being able to issue home loans in all the bigger cities in Estonia, soon having ATMs in basically every corner of Estonia and at the same time offering the most favourable everyday banking service, we are accessible to a larger number of customers and this ensures us growth. We will keep our activities simple and efficient in the future as well.

The quarterly growth of our business volumes was fast and broad-based. In Q2, the number of bank customers increased by nearly 8,600. Several activity indicators, including salary receipts, the number of customers with assets and payments, use of cards, acceptance of card payments and number of new investment contracts reached record levels.

Loans grew by EUR 127 million during the quarter, now amounting to EUR 1.1 billion. Deposits demonstrated a record growth of EUR 516 million, out of which prefunding of Danske transaction through deposit platforms in amount of EUR 231 million. The volume of funds grew by EUR 36 million. LHV's profit for Q2 was EUR 7.7 million.

The total volume of investment funds managed by LHV Varahaldus exceeded EUR 1.29 billion by the end of Q2. LHV's actively managed pension funds still have the lowest price risk related to stock exchanges, as the focus is primarily on making OTC investments.

Touching the acquisition of Danske private persons' portfolio briefly, as a result of this, LHV's loan portfolio will grow by more than 40%, while ensuring the expected return on equity. The business plan does not assume any other services to be used by the customers. Yet, LHV will get 6 500 completely new customers. By including the existing home loan of LHV, the most favourable everyday banking in Estonia, the best service and domestic service provider in one formula, we hope to see a large number of them as our active future customers. In addition, the decrease of capital cost starting from 2022, assumed in the business plan, is important, which comes from changes in the regulations. Another important factor of the business plan concerns the effective life of loan agreements. As most of the rate of return of the given portfolio derives from the purchase allowance of EUR 39 million, we have accordingly recognised it in income due to the low interest rates of the portfolio over a longer period compared to the effective life of an average loan agreement at the market. This is a conservative assumption, since in the case of amendments in the agreement, the agreement-related allowance is immediately recognised in income. It is likely that recognising the allowance in revenues will therefore be notably less "linear" and with higher weight in the following years.

In connection with the Danske transaction, we will raise new capital within the share issue in the autumn. Raising the capital is also important for securing the growth of our previous business, as with this quarterly report we confirm that we are ahead of our volume forecast. Although the terms and conditions of involving the capital have to be approved by the LHV's general meeting of shareholders, we will most likely prefer the current shareholders in the share issue.

## Business environment

LHV's growth trends are supported by the Estonian business environment. The economic growth has been solid, depending largely on the economies of our neighbouring countries. Internal risks are managed by the balance budget, low public sector debt and positive foreign balance with the main source of tension being the availability of labour. Also, the credit market has remained strong. All of the main credit products, incl. corporate loans and home loans, are growing. The financial health of households is on the strong side, the loan-to-deposit ratio is improving.

Against the background of a stable economic environment and strong credit market, the sector is increasingly influenced by various regulatory issues, of which the intention to demolish II pillar is one of the most relevant. There is still a lack of clarity with regard to the plan, which has been growing in the minds of a couple of persons and completely without analysis so far. If the purpose is reasonable coping of Estonian people after retirement, together with a better pension, then the proposals made will not lead us closer to the goal.

The politicians have great interest in deciding over the accumulated 4 billion euros, but only owing to the fact that this 4 billion exists. It exists because it has been saved. It is ironic that in making the accusation of an insufficient rate of return, productivity is not being improved, but instead, the message that we need to save is destroyed and the development of Estonian capital and capital markets reversed.

When looking for a parallel regarding the voluntary saving argument, those who made this proposal do not recommend using it for unemployment insurance premiums. By the end of 2019, the Unemployment Insurance Fund has accumulated a reserve of EUR 850 million, which is saved through premiums amounting to 1.6% paid by the employee and 0.8% by the employer, calculated from the gross salary. Although these reserves are not invested and accordingly, these do not earn any return, this is an important part of the state budget. Probably it is namely why the nonexistent rate of return of the measure that effectively increases labour taxes was not remembered and we are not hearing any proposals about making it voluntary.

Wealth is a relative concept and asset-based measurement is applied to it. There is no wealthy country or person who has not achieved their wealth through investing or saving. In addition Estonia is one of the most banking-orientated countries in Europe and when demolishing the only institutional investor with sufficient scale regarding pension funds, the capability of funding large projects is reduced, which regrettably is already evident today.

In conclusion, when previously instead of today's consumption, the goal was to save for the future, according to the current unanalysed proposals, society is directed towards consuming more today on account of the future. This will be paid by the next generation together with tax increases. This cannot be a goal.

One should be able to make a difference between the input and goal.

## Financial results

The group's consolidated profit of Q2 of 2019 was EUR 7.7 million, increasing by EUR 2.7 million when compared to the previous quarter which was influenced by income tax payment on dividends, and decreasing by EUR 2.4 million when compared to Q2 of the previous year which was influenced by the sell of Mokilizingas.

The return on equity belonging to LHV's shareholders was 18.1% in Q2 of 2019, having increased compared to Q1 of 2019 (12.2%) by 5.9 percentage points; the reason being tax expense related to the dividends last quarter.

The group's consolidated net loan portfolio grew by EUR 127 million during the quarter (EUR 72 million in Q1 of 2019) and the consolidated deposits increased by EUR 516 million (compared to the growth of EUR 145 million in Q1 of 2019). At the same time, the deposits related to payment intermediaries increased by EUR 8 million (growth of EUR 33 million in Q1 of 2019).

The group's own funds increased by EUR 27.0 million when compared to the previous quarter and risk-weighted assets increased by EUR 95.7 million; the Tier 1 and total capital adequacy ratios at the end of the quarter were 14.0% and 19.2%, respectively. The change in own funds was affected by the involvement of capital from Q1 of 2019 in the group's own funds and the bond issue.

In Q2 the bank's profit on the consolidated level was EUR 5.9 million, which is EUR 1.7 million higher than the previous quarter (EUR 4.2 million in Q1 of 2019). Over the quarter, the number of customers increased by nearly 8,600 (in Q1 of 2019, by 9,500), causing the total number of the bank's customers to exceed the threshold of 179,000.

In Q2 the bank's loan portfolio grew by EUR 127 million (in Q1 of 2019, EUR 72 million), nearing EUR 1,118 million. Among the loans, entrepreneurship loans grew the most. The cost of the loan allowance amounted to EUR 0.7 million in Q1, which is EUR 0.3 million less than in the previous quarter.

The deposits of the bank's customers increased by EUR 481 million in Q2, of which the deposits of payment intermediaries grew by EUR 8 million and the deposits of the remaining customers by EUR 473 million. By the end of Q2, the total deposit volume reached EUR 2,065 million.

In Q2, Varahaldus earned a profit of EUR 2.1 million (in Q1 of 2019, EUR 1.2 million). The fee and commission income of Varahaldus increased by EUR 0.1 million when compared to the previous quarter, to EUR 3.6 million. The operating expenses of Varahaldus remained at the same level as the previous quarter.

The total volume of funds managed by LHV grew by EUR 36 million over the quarter (by EUR 43 million in Q1 of 2019). The

number of active clients of the 2nd pillar decreased by 72 over the quarter (by 457 in Q1 of 2019). By the end of the quarter, the number of active 2nd pillar customers exceeded 177 thousand.

Madis Toomsalu

## Table of contents

<b>Financial Summary</b> .....	<b>6</b>
<b>Operating Environment</b> .....	<b>7</b>
<b>Financial Results of the Group</b> .....	<b>9</b>
<b>The Group's Liquidity, Capitalisation and Asset Quality</b> .....	<b>10</b>
<b>Overview of AS LHV Pank Consolidation Group</b> .....	<b>12</b>
<b>Overview of AS LHV Varahaldus</b> .....	<b>15</b>
<b>CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS</b> .....	<b>16</b>
Condensed Consolidated Interim Statement of Profit or Loss and Other Comprehensive Income .....	16
Condensed Consolidated Interim Statement of Financial Position.....	17
Condensed Consolidated Interim Statement of Cash Flows.....	18
Condensed Consolidated Interim Statement of Changes in Equity.....	19
Notes to the Condensed Consolidated Interim Financial Statements .....	20
NOTE 1 Accounting Policies .....	20
NOTE 2 Business Segments.....	21
NOTE 3 Risk Management .....	24
NOTE 4 Breakdown of Financial Assets and Liabilities by Countries.....	24
NOTE 5 Breakdown of Assets and Liabilities by Contractual Maturity Dates .....	25
NOTE 6 Open Foreign Currency Positions.....	26
NOTE 7 Fair Value of Financial Assets and Liabilities.....	27
NOTE 8 Breakdown of Loan Portfolio by Economic Sectors.....	28
NOTE 9 Net Interest Income .....	29
NOTE 10 Net Fee and Commission Income.....	29
NOTE 11 Operating Expenses.....	30
NOTE 12 Discontinued operations .....	30
NOTE 13 Balances with the Central Bank, Credit Institutions and Investment Companies .....	30
NOTE 14 Deposits of Customers and Loans Received .....	31
NOTE 15 Accounts payable and other liabilities.....	31
NOTE 16 Contingent Liabilities .....	32
NOTE 17 Basic Earnings and Diluted Earnings Per Share.....	32
NOTE 18 Capital Management .....	33
NOTE 19 Transactions with related parties .....	34
NOTE 20 Tangible and intangible assets .....	35
NOTE 21 Subordinated debts .....	35
NOTE 22 Loans and advances to customers .....	36
<b>Shareholders of AS LHV Group</b> .....	<b>37</b>
<b>Supervisory Boards and Management Boards of AS LHV Group and its Subsidiaries</b> .....	<b>38</b>
<b>Signatures of the Management Board to the Condensed Consolidated Interim Report</b> .....	<b>39</b>

# Financial Summary

<b>Business volumes</b> EUR million	<b>Q2 2019</b>	<b>Q1 2019</b>	<b>Quarter over quarter</b>	<b>Q2 2018</b>	<b>Year over year</b>			
Loan portfolio	1 117.9	990.7	13%	776.5	44%			
Financial investments	119.5	26.2	356%	54.1	121%			
Deposits of customers	2 083.4	1 567.0	33%	1 542.8	35%			
incl. deposits of financial intermediates	235.1	226.8	4%	470.4	-50%			
Equity (including minority interest)	164.5	156.4	5%	143.4	15%			
Equity (owners' share)	160.7	153.2	5%	140.4	14%			
Volume of funds managed	1 293.4	1 257.4	3%	1 166.6	11%			
Assets managed by bank	1 161.7	1 228.5	-5%	1 375.1	-16%			
<b>Income statement</b> EUR million	<b>Q2 2019</b>	<b>Q1 2019</b>	<b>Quarter over quarter</b>	<b>Q2 2018*</b>	<b>Year over year</b>	<b>6M 2019</b>	<b>6M 2018*</b>	<b>Year over year</b>
Net interest income	11.63	10.95	6%	9.41	24%	22.58	18.41	23%
Net fee and commission income	6.61	6.23	6%	7.22	-8%	12.84	12.81	0%
Other financial income	0.20	0.18	11%	0.34	-41%	0.38	0.25	52%
Total net operating income	18.44	17.36	6%	16.97	9%	35.80	31.47	14%
Other income	0.02	-0.02	NA	0.00	NA	0.00	0.00	NA
Operating expenses	-9.40	-9.11	3%	-7.77	21%	-18.51	-15.44	20%
Loan losses	-0.70	-0.95	-26%	-1.60	-56%	-1.65	-2.48	-33%
Income tax expenses	-0.70	-2.27	-69%	-0.63	11%	-2.97	-2.57	16%
Discontinued operations	0.00	0.00	NA	3.08	-100%	0.00	3.32	NA
Net profit	7.66	5.01	53%	10.05	-24%	12.67	14.30	-11%
Including attributable to owners of the parent	7.10	4.69	51%	9.53	-25%	11.79	13.48	-13%
<b>Ratios</b> EUR million	<b>Q2 2019</b>	<b>Q1 2019</b>	<b>Quarter over quarter</b>	<b>Q2 2018*</b>	<b>Year over year</b>	<b>6M 2019</b>	<b>6M 2018*</b>	<b>Year over year</b>
Average equity (attributable to owners of the parent)	157.0	153.4	3.5	137.6	19.4	157.2	130.3	26.9
Return on equity (ROE), %	18.1	12.2	5.9	27.7	-9.6	15.0	20.7	-5.7
Return on assets (ROA), %	1.5	1.1	0.4	2.2	-0.7	1.25	1.63	0.4
Interest-bearing assets, average	2 059.8	1 715.3	344.5	1 800.8	259.0	1 993.0	1 728.7	264.0
Net interest margin (NIM) %	2.26	2.55	-0.29	2.09	0.17	2.23	2.13	0.1
Price spread (SPREAD) %	2.22	2.51	-0.29	2.06	0.16	2.23	1.86	0.4
Cost/income ratio %	50.9	52.6	-1.7	39.8	11.1	51.7	46.3	5.4
Profit attributable to owners before income tax	7.8	6.7	1.1	10.2	-2.4	14.5	15.8	-1.3

## Explanations to ratios (quarterly ratios have been expressed on an annualised basis)

Average equity (attributable to owners of the parent) = (equity as at the end of the reporting period + equity as at the end of the previous reporting period) / 2

Return on equity (ROE) = net profit for the quarter (share of owners of the parent) / average equity (attributable to owners of the parent) \* 100

Return on assets (ROA) = net profit for the quarter (share of owners of the parent) / average assets \* 100

Net interest margin (NIM) = net interest income / interest-bearing assets, average \* 100

Price spread (SPREAD) = interest yield from interest-bearing assets – cost of external capital

Interest yield from interest-bearing assets = interest income / interest-bearing assets, average \* 100

Cost of external capital = interest expenses / interest-bearing liabilities, average \* 100

Cost/income ratio = total operating cost / total income \* 100

\*From the reference data the revenue and expenses of discontinued operations are separated

## Operating Environment

The beginning of this year surprised with faster than expected growth in many economic regions. This way, the economic growth in the USA accelerated to 3.2% and in the Eurozone to 1.2%. The growth is based on domestic demand, as trading has slowed down everywhere due to the intense conflict in the trade relationships between the USA and the rest of the world. Looking forward, we still expect a slowdown in the global economic growth. At its summer session, the US Federal Reserve lowered the growth expectations for this year to 2.1%; the European Central Bank estimates average economic growth to remain at 1.2% in the Monetary Union. In China, the growth should remain slightly above 6%.

Also, the economy of trading partners relevant for Estonia continued to be strong in the first quarter, although it shows signs of cooling like the rest of the world. At the Swedish construction market, the signs of stagnation have been visible for a long time; now the growth of the building sector has also slowed down in Finland and Latvia. The economic growth is still supported by private consumption thanks to the fast salary growth; however, the economy of all our close neighbours is largely dependent on export and the insecurity of global trade will sooner or later have an impact on all countries with an open economy.

The economy of the Eurozone grew by 1.2% in Q1 of 2019 year-on-year. The growth remained at the same level as the end of last year. Weakening of the euro exchange rate at the beginning of the year reversed at the beginning of May, when the exchange rate started to rise again. On the one hand, this is a sign of a better than expected state of economy of the Eurozone. On the other hand, a more expensive currency causes more problems for companies who depend on export. The unemployment rate has dropped to 7.5% and similarly to Estonia, several sectors suffer from serious shortages of labour supply. Inflation slowed to 1.2% at the beginning of the summer, mainly due to the slower rise of energy prices. Core inflation has remained relatively unchanged at around 1%. At the same time, wage growth has somewhat accelerated, indicating a stronger price pressure in the future.

The European Central Bank will continue its supportive monetary policy for some time. The outgoing President of the European Central Bank, Mario Draghi, has expressed in his latest speeches that the ECB still has tools for stimulating the economy, if necessary. Christine Lagarde, who has been appointed as his successor, is also known for being rather supportive of lenient monetary policy. Accordingly, we may be quite sure that given the current nervous economic environment, the ECB will not start tightening the monetary policy in any way, but we can expect even more steps in the autumn towards a more lenient monetary policy. The Estonian economy grew by 4.5% in the first quarter, which was above the expectations. The greatest contribution came from

the processing industry, with investments increasing by nearly half year-on-year. The growth was broad-based, supported more than the others by information and communications, professional, research and technical activities and trade. Such rapid growth was really surprising as it was already known beforehand that the construction volumes in the first quarter did not grow. Export of goods and services grew at slightly less than 5%, while the entire growth came from the export of goods, which was unusual. Export of services decreased 0.4% year-on-year. The last time the export of services decreased was three years ago, in Q1 of 2016. It was also unusual (yet, truly positive) that the export of goods was very broad-based and was not entirely based on the export of fuel or electronics, as has been the case in recent years.

The price increase has been slower in the first half of 2019 compared to the last year. The main reasons are the lower oil price on global markets compared to last year and receding of the impact of the increase in alcohol excise tax. The price increase has been upheld by the rise in the prices of electricity and solid fuels, which pushes up the expenditures made by the consumers on housing. Also, the prices of fresh vegetables have had an upsurge. In the second half of the year, inflation should slow down even more. The contribution of food to the price increase will decrease, as the weather conditions have most definitely been more favourable for the farmers this year and the harvest accordingly better. The oil price will most likely remain lower year-on-year, and in addition, the price increase will definitely be inhibited by the recently adopted lower alcohol excise tax. According to the forecast of Eesti Pank published in June, the Estonian economy will grow by 3.3% this year. Further rapid economic growth is inhibited by the high conjuncture related supply-side restrictions (lack of available resources) but also the deceleration of external demand. The main growth engine is domestic demand, led by private consumption and investments. The positive contribution of investments is also restored, which was negatively influenced by a high comparison base last year. From the risks, we could consider the most important to be developments in the external environment, which could be negatively influenced above all by declined demand caused by trade restrictions and the related insecurity when making investments. Within Estonia, it is primarily necessary to deal with the improvement of competitiveness and favour the re-learning of employees and the movement to sectors offering higher added value. There are still a lot of industries with low production in Estonia, which will most likely disappear with the continual increase of labour costs in the next few years.

LHV expects the economic growth to slow down in the second half of the year, close to the long-term sustainable potential level. The shortage in available resources will continue to increase the

significance of the ability of businesses to adapt and be successful in raising productivity, which is why it is necessary to vigorously continue making smart investments. First and foremost it is important to achieve long-term sustainable economic growth that is in balance between the various sectors. In terms of economic sectors, the risks are above average in the building sector, accommodation and catering sector, and transport and storage. LHV is still conservative with regard to the real estate market, monitoring the local and Scandinavian market, with increased attention on developments in Sweden. Regarding rental cash flow projects, there is a risk that there will not be enough demand to absorb the volumes being developed in the near future, so that corrections will take place in rental prices or vacancy rates. A positive trend worth highlighting is the funding environment that is still favourable. The increase in the amount outstanding from credit institutions still remains rapid. The demand for loans of households is strong, led by home loans and car leasing. For new home loans, the average interest rate has

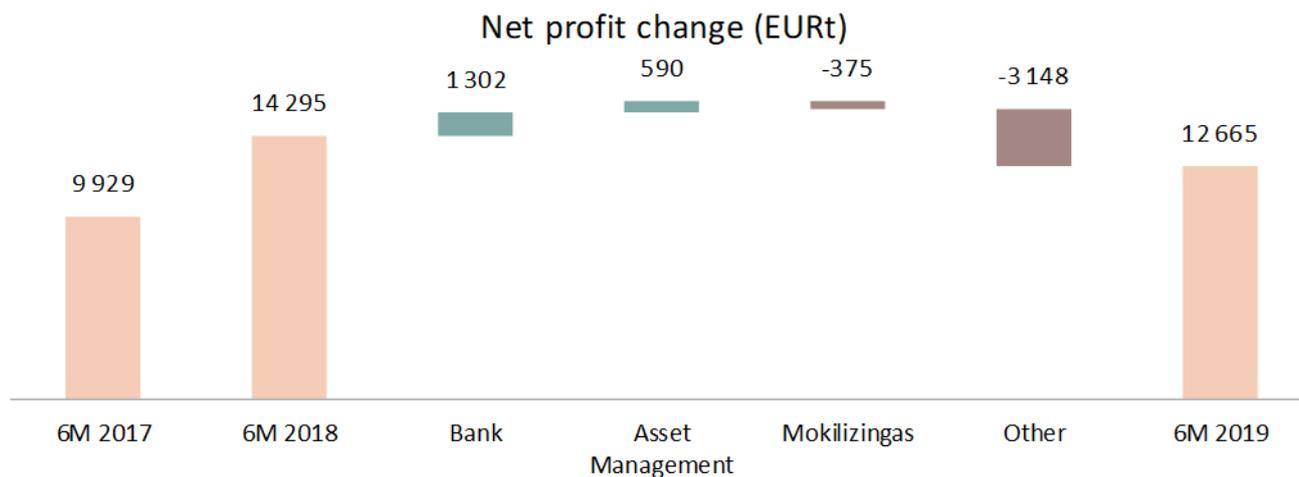
started to increase slowly. Due to the surrounding insecurity and relatively high own funds, the loans taken by corporate entities are more modest than those of households. The ratio of loans to deposits and the proportion of overdue loans in the loan portfolio are at post-crisis low levels. Historically low interest rates and strong competition between banks offer possibilities to local enterprises and they should be taking more advantage of them. LHV wishes to make a big and effective contribution to the finding and supporting of new growth sources, offering entrepreneurs long-term co-operation and thinking involving the creation of value.

## Financial Results of the Group

Compared to Q1 2019, the Group's net interest income increased in Q2 by 6%, standing at EUR 11.6 (Q1: 11.0) million. Net fee and commission income increased by 6% and stood at EUR 6.6 (Q1: 6.2) million. In total, the net income of the Group increased by 6% in Q2, compared to Q1, amounting to EUR 18.4 (Q1: 17.4) million, with expenses increasing by 3% and amounting to EUR 9.4 (Q1: 9.1) million. The Group's operating profit for Q2 amounted to EUR 8.4 (Q1: 7.3) million. The loss from loan impairments mounted to

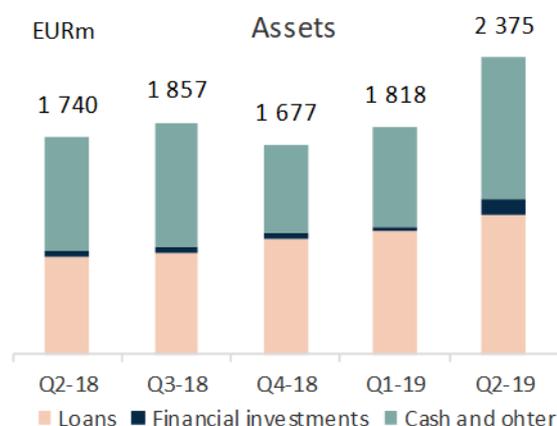
EUR 0.7 million in Q2 (Q1: 1.0). The Group's total profit for Q2 amounted to EUR 7.7 million (Q1: 5.0). Compared to Q2 2018, the Group's net interest income increased by 24% and net fee and commission income decreased by 8%.

In terms of business entities, AS LHV Pank posted in Q2 a consolidated profit of EUR 5.9 million and AS LHV Varahaldus a profit of EUR 2.1 million. The AS LHV Group on solo bases posted a profit of EUR 1.9 million due to dividends paid by LHV Pank.



The Group's volume of deposits as at the end of Q2 amounted to EUR 2 083 (Q1: 1 567) million, of which demand deposits formed EUR 1 672 (Q1: 1 423) million and term deposits EUR 411 (Q1: 144) million.

As at the end of Q2, the volume of loans granted by the Group amounted to EUR 1 118 (Q1: 991) million, increasing in Q2 by 13%. Compared to Q2 2018, the volume of the Group's deposits has increased by 35% and the volume of loans by 44%.



## The Group's Liquidity, Capitalisation and Asset Quality

As at 30 June 2019, the Group's own funds stood at EUR 204.1 million (31 December 2018: EUR 183.3 million). LHV Group own funds are calculated based on regulative requirements. In Q2 the level of own funds changed by including the Q1 profit to own funds and by issuing the subordinated bonds.

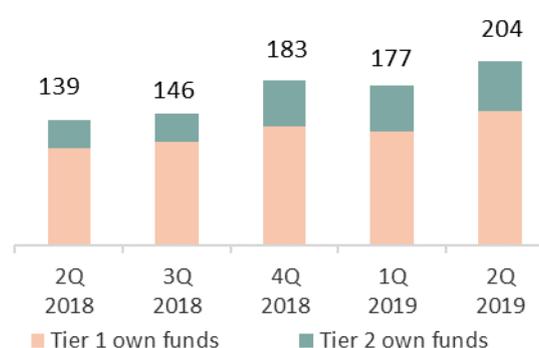
Compared to Group's internal capital adequacy ratio target 15.5%, the Group is well capitalised as at the end of the reporting period, with the capital adequacy ratio amounting to 19.2% (31 December 2018: 21.7%). In addition to total capital adequacy targets the Group has also set internal targets for the core Tier 1 capital adequacy ratio to 10.4% and Tier 1 capital adequacy ratio to 12.10%. Bank of Estonia informed on 17th of April 2018 that from 1st of January 2019 O-SII buffers for LHV Group will increase by 0.5%. LHV internal capital targets take it into account.

In the end of 2017 Estonian Financial Supervision Authority new prudential ratio - the minimum requirement for own funds and eligible liabilities (MREL), which is valid from 1st of January 2018. This ratio is included into resolution plan and LHV has to keep enough own funds and qualifying liabilities which can be used to cover losses in resolution planning. Minimum requirement was set at 5.79% and will be reviewed annually by Estonian Financial Supervision Authority. Group has set internal MREL minimal target at 6.08%. As of June 30 the MREL ratio was 9.64% (31st of December 2018 11.43%).

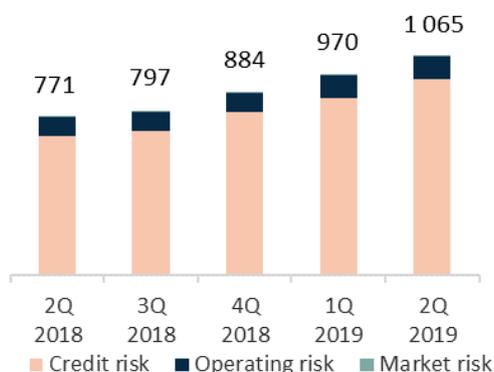
The Group's liquidity coverage ratio (LCR), as defined by the Basel Committee, stood at 201.8 % as at the end of June (31 December 2018: 148.5%). Banks liquidity situation changed in Q2 due to high deposit growth. Financial intermediates deposits in Bank are covered 100% with liquid assets. Excluding the financial intermediates deposits the Groups LCR is 343.0% (31.12.2018: 235.3%). The Group recognises cash and bond portfolios as liquidity buffers. These accounted for 51% of the balance sheet (31 December 2018: 43%). The ratio of loans to deposits stood at 51% as at the end of the second quarter (31 December 2018: 64%). Group's maturity structure is presented in Note 5.

The Group's credit quality was good. As at the end of June, provisions for estimated loan losses amounted to EUR 11.8 million in the balance sheet, i.e. approximately 1.0% of the loan portfolio (31 December 2018: EUR 10.3 million, 1.1%). Estimated loan losses make up 87.2% (31 December 2018: 66.5%) of the portfolio of loans overdue for more than 90 days. The increase in overdue loans is related to few clients.

### Own funds



### Risk-weighted assets

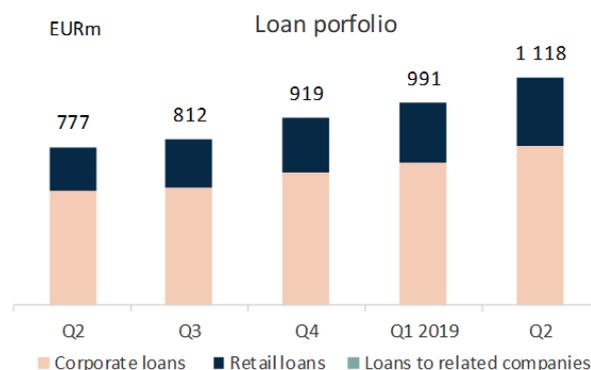


EUR thousand	30.06.2019	Proportion	31.12.2018	Proportion
Loans to customers	1 129 661		929 037	
including overdue loans:	23 660	2.1%	22 483	2.4%
1-30 days	6 584	0.6%	6 142	0.7%
31-60 days	2 715	0.2%	709	0.1%
61-90 days	882	0.1%	177	0.0%
91 and more days	13 478	1.2%	15 454	1.7%
Impairment of loans	-11 757	-1.0%	-10 276	-1.1%
Impairment % of loans overdue for more than 90 days	87.2%		66.5%	

<b>Capital base</b>	<b>30.06.2019</b>	<b>31.12.2018</b>	<b>31.12.2017</b>
Paid-in share capital	26 016	26 016	25 767
Share premium	46 653	46 653	46 304
Statutory reserves transferred from net profit	4 713	3 451	2 471
Other reserves	78	78	36
Retained earnings	68 705	50 193	24 468
Intangible assets (subtracted)	-19 030	-19 084	-7 940
Net profit for the reporting period	2 618	25 237	19 603
Other adjustments	-688	-194	0
<b>Tier 1 capital</b>	<b>129 065</b>	<b>132 350</b>	<b>110 709</b>
Additional Tier 1 capital	20 000	0	0
<b>Total Tier 1 capital</b>	<b>149 065</b>	<b>132 350</b>	<b>110 709</b>
Subordinated debt	55 000	50 900	30 900
<b>Total Tier 2 capital</b>	<b>55 000</b>	<b>50 900</b>	<b>30 900</b>
<b>Net own funds for capital adequacy</b>	<b>204 065</b>	<b>183 250</b>	<b>141 609</b>
<b>Capital requirements</b>			
Central governments and central bank under standard method	929	938	945
Credit institutions and investment companies under standard method	6 869	5 376	6 950
Companies under standard method	703 425	579 836	428 428
Retail claims under standard method	146 510	133 250	144 237
Public sector under standard method	147	125	185
Housing real estate under standard method	56 535	39 903	20 039
Overdue claims under standard methods	8 857	10 142	20 956
Investment funds' shares under standard method	7 788	7 963	6 281
Other assets under standard method	19 805	10 557	13 824
<b>Total capital requirements for covering the credit risk and counterparty credit risk</b>	<b>950 865</b>	<b>788 090</b>	<b>641 845</b>
Capital requirement against foreign currency risk under standard method	3 955	3 957	3 551
Capital requirement against interest position risk under standard method	0	32	412
Capital requirement against equity portfolio risks under standard method	951	704	585
Capital requirement against credit valuation adjustment risks under standard method	14	41	15
Capital requirement for operational risk under base method	109 545	91 575	75 999
<b>Total capital requirements for adequacy calculation</b>	<b>1 065 330</b>	<b>884 399</b>	<b>722 407</b>
<b>Capital adequacy (%)</b>	<b>19.16</b>	<b>21.70</b>	<b>19.60</b>
<b>Tier 1 capital ratio (%)</b>	<b>13.99</b>	<b>15.67</b>	<b>15.32</b>
<b>Core Tier 1 capital ratio (%)</b>	<b>12.12</b>	<b>15.67</b>	<b>15.32</b>

## Overview of AS LHV Pank Consolidation Group

- (Net) growth in loan volume EUR 127 million
- Net profit EUR 5.9 million
- (Net) growth in deposits EUR 507 million



EUR million	Q2 2019	Q1 2019	Change %	Q2 2018	Change %	From the beginning of 2019	From the beginning of 2018	Change %
Net interest income	11.84	11.24	5%	9.60	23%	23.08	18.79	23%
Net fee and commission income	3.01	2.70	11%	3.80	-21%	5.71	6.05	-6%
Other financial income	0.13	-0.01	NA	0.25	-48%	0.12	0.18	-35%
Total net operating income	14.98	13.93	8%	13.65	10%	28.91	25.03	16%
Other income	0.05	-0.01	NA	0.03	55%	0.04	0.06	-34%
Operating expenses	-7.74	-7.51	3%	-6.29	23%	-15.25	-12.38	23%
Loan losses	-0.70	-0.95	-27%	-1.60	-56%	-1.65	-2.48	-33%
Income tax expenses	-0.70	-1.29	-46%	-0.63	10%	-1.99	-1.47	35%
<b>Net profit</b>	<b>5.89</b>	<b>4.17</b>	<b>41%</b>	<b>5.16</b>	<b>14%</b>	<b>10.06</b>	<b>8.79</b>	<b>15%</b>
Loan portfolio	1 118	991	13%	777	44%			
Financial investments	112	19	504%	46	143%			
Deposits of customers incl. deposits of financial intermediates	2 090	1 583	32%	1 555	34%			
Subordinated liabilities	64	37	73%	20	220%			
Equity	143	129	11%	115	24%			

Q2 was successful in terms of business volumes. LHV Bank generated EUR 11.8 million in net interest income and EUR 3.0 million in net fee and commission income. In total, the bank's net income amounted to EUR 15.0 million, expenditure to EUR 7.7 million and loan provisions to EUR 0.7 million. The net profit of LHV Pank amounted to EUR 5.9 million in Q2. This constitutes a 41% increase from Q1 (4.2) and a 14% increase from Q2 2018 (5.2). Net interest income increased 5% compared to previous quarter. Net fee and commission income increased 11% compared to Q1. Net operating income increased by 8% compared to previous quarter. In Q2 other financial income amounted to EUR 0.1 million (Q1: 0.01 million).

Securities brokerage fees, transaction fees and fees from cards are greatest contributor to fee and commission income. The quarterly profit before taxes was EUR 6.6 million and net profit

EUR 5.9 million. As at the end of the quarter, the net profit exceeded the financial plan by EUR 0.8 million.

The increase in net interest income stems from the growth in business volumes. By the end of Q2, the total volume of the bank's loan portfolios amounted to EUR 1 118 million (Q1: EUR 991 million). The volume of portfolios grew 13% over the quarter.

The corporate credit portfolio containing loans and guarantees grew by EUR 228.7 million (+39%) over the year and by EUR 81.6 million (+11%) in a quarterly comparison. The greatest source of growth was loans for real estate activities, which is traditionally the most financed field by commercial banks, having grown by EUR 86.3 million (+42%). Strong commercial real estate projects generating rental income were the main source of the growth. This was followed by loans issued to the processing industry, which

grew by EUR 35.6 million (+49%) year-on-year. The loans granted in the agriculture, forestry and fishing sectors grew by EUR 32.2 million (+297%) year-on-year.

Compared to the first quarter of 2019, the portfolio growth was driven most by loans and guarantees issued to the agriculture, forestry and fishing sectors (EUR 26.2 million; +156%), followed by the financial and insurance sector (EUR 26.2 million; +30%) and real estate sector (EUR 11.3 million; +4%).

The most corporate loans were granted in the real estate sector, which makes up 37% of the bank's corporate loan portfolio. The biggest part of real estate loans was granted to high-quality projects generating rental income; a significantly smaller part went to property development. Most of the financed development properties are in Tallinn, and in other bigger cities of Estonia, and projects in the vicinity of Tallinn make up 7% of all development projects. Upon funding the new developments in Tallinn, LHV's market share was nearly one fifth at the end of the 2nd quarter of 2019. LHV's property development portfolio is also well-positioned in the event of changing market trends – the financed developments are in good locations and the risk and planned price ratio for the projects remains at an average of 55%.

After the real estate sector, the most credit has been issued to companies in the financial and insurance activities sector (14% share) and the processing industry (14% share). Among sectors with higher than average credit risk, accommodation and catering comprise 3%, construction 2%, and transport and storage 1% of the total portfolio volume.

The bank's business volumes continued rapid growth in the second quarter. Over the quarter, the number of bank customers increased by 8,600, reaching 179,000. New record levels were achieved in customer activity. The volume of deposits and loans reached a record high level. The deposit volume grew by EUR 507 million and the loan volume by EUR 127 million. The deposit volume reached EUR 2.1 billion and the loan volume EUR 1.1 billion by the end of the quarter. The deposits of regular customers grew by EUR 268 million, those of the financial intermediaries by EUR 8 million and deposits involved through deposit marketplaces by EUR 231 million. The bank has launched cooperation with both of the bigger deposit marketplaces in Europe - Raisin and Deposit Solution, through which EUR 242 million of term deposits were involved as at the end of the quarter. The number of deposits involved during the quarter was higher than usual, to ensure the availability of sufficient funding for purchasing the Danske Bank private loan portfolio. As at the end of the quarter, the bank held funds exceeding EUR 1.0 billion with the European Central Bank. Corporate loans grew by EUR 78

million and retail loans by EUR 49 million. The quarterly profit before taxes was EUR 6.6 million and net profit EUR 5.9 million. At the end of the quarter, the bank prematurely redeemed the subordinated bonds in the amount of EUR 8 million and increased its share capital by EUR 10 million, issued bonds belonging to Tier I own funds (AT1) in the amount of EUR 14.5 million and subordinated bonds of EUR 20.5 million in order to strengthen the bank's capital base for the increase of business volumes and purchase of the private loan portfolio of Danske Bank.

In June, the bank and Danske Bank signed an agreement, under which the bank acquires the installation of Danske Bank related to Estonian private persons. In essence, the installation consists of the private loan portfolio amounting to approximately EUR 470 million. With the transaction, the bank will take over the servicing of nearly 10,800 private customers. Home loans comprise ca 97% of the loan portfolio volume to be purchased. According to the bank, it is a well secured and strong credit portfolio. Since the interest rates of the granted home loans were in essence close to the cost price, the transaction was only possible thanks to purchasing the portfolio at a discount. The bank and Danske Bank agreed on the transaction price, according to which a EUR 39 million discount is deducted from the portfolio volume as at the closure of the deal. Considering the continuing amortisation of the loan portfolio as well, the estimated price of transaction will be ca EUR 410 million. The transaction is to be completed this fall. As a result of the transaction, the bank's loan portfolio will increase by ca 40% and the importance of retail banking in the total lending business of the bank will rise notably. For the bank, the transaction means the involvement of a significant volume of deposits and raising additional capital through three different capital instruments. The latter is divided between bonds and share capital. Aimed at financing the future home loan portfolio of the bank with covered bonds, the bank started with the application process for an additional activity licence for covered bonds.

At the end of the quarter, the bank signed an agreement with Luminor Bank, Danske Bank and Worldline, according to which the bank will step in as the new partner of Luminor Bank in the common AMT network, replacing the former partner, Danske Bank. The common network will be served by the bank. This means, that for the customers of the bank, the ATM network will grow by a factor of five, to 125 ATMs, from the current 25. The expanded network will significantly improve the bank customers' access to cash withdrawal. Previously, the expansion of the ATM network brought new private as well as business customers to the bank. Reconfiguration works of the common network ATMs for connecting to the bank's network and updating of their appearance are to be performed in the third quarter.

This quarter saw the development of several new services for investing customers. An option of conducting transactions besides the Baltic shares, also with those of foreign stock

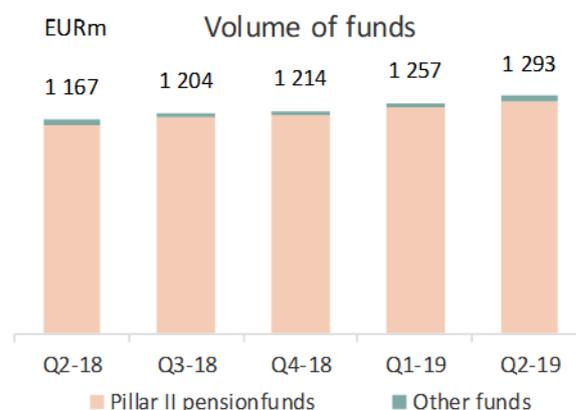
exchanges and ETFs, was added to the Mobile Bank. Convenience and speed are the benefits working in favour of the Mobile Bank, which are very important when it comes to trading. Besides, the customers can view graphs with price information in the Mobile Bank. More than half of the bank's investing customers hold foreign shares or index funds and therefore, development of the new service was important for a lot of customers. Another important innovation was displaying the information of alternative placements in the consolidated view of Internet Bank. First, the investment information of EstateGuru and Coinbase investments was displayed to customers. Adding alternative investments to the summary view, that is investments in crowdfunding and

cryptocurrencies, means that the customer is able to conveniently view their stock exchange and OTC transactions, while also having a quick and comprehensive overview of their investment portfolio. In addition, the customer is able to see their available cash balance on the platform. In the near future, the opportunity to view information about other bigger alternative investment platform accounts will also be added.

For the third time, the bank won the innovation award of the Banking Association, this time for the Entrepreneur Account. Also, Euromoney named the bank as the best bank in Estonia for the second year in a row.

## Overview of AS LHV Varahaldus

- The quarterly profit was EUR 2.1 million
- The volume of funds is EUR 1 293 million, growth of EUR 36 million
- Number of active customers at the end of June 177,402; -72 compared to Q1
- Premature redemption of Tier 2 bonds in June (issue volume EUR 550 thousand 5 years ago)



EUR million	Q2 2019	Q1 2019	Change %	Q2 2018	Change %	6M 2019	6M 2018	Change %
Net fee and commission income	3.61	3.52	3%	3.42	6%	7.13	6.76	5%
Net financial income	0.03	0.15	-80%	0.05	-40%	0.18	-0.01	NA
Operating expenses	-1.05	-1.03	2%	-0.95	11%	-2.08	-1.99	5%
Depreciation of non-current assets	-0.46	-0.45	2%	-0.45	2%	-0.91	-0.9	1%
<b>Profit</b>	<b>2.13</b>	<b>2.19</b>	<b>-3%</b>	<b>2.07</b>	<b>3%</b>	<b>4.32</b>	<b>3.86</b>	<b>12%</b>
Financial investments	7.8	7.7	1%	8.2	-5%			
Subordinated liabilities	1.6	2.1	-24%	2.1	-24%			
Equity	26.0	25.0	4%	24.0	8%			
Assets under management	1 293.4	1 257.4	3%	1 166.6	11%			

In Q2, the operating income of LHV Varahaldus was EUR 3.6 million, a total of EUR 7.1 million in H1. Cost base remained at a similar level as Q1 - at EUR 1.5 million. As further additional cost, amortisation of the investment of the mobile app "My Pension" began in June – Estonia's first comprehensive pension app was launched on 3 June. Profit before income tax was EUR 2.1 million in Q2; total profit for 6 months was EUR 4.3 million, being +12% more compared to the first half of 2018.

In May, the new terms and conditions of pension funds, entering into force in September, were approved, which ease the investment restrictions and enable earning of the success fee; at the same time, the fixed management fee rates for LHV's bigger funds will be lowered to 0.72%, from 1.20%. Therefore, the actively managed funds of LHV Varahaldus plan to keep in focus, besides public market instruments, the investments in OTC-traded assets as well, above all in domestic assets, and concentrate on earning the long-term success fee.

Movement of stock markets was more volatile in Q2 compared to Q1. In May, the stock markets experienced a downward adjustment; yet, by the end of June, the main indexes regained

their record levels or were close to these. For example, LHV Pensionifond Indeks demonstrated the best result at the Estonian pension market with +15.2% growth in H1. The price risk related to stock exchanges is lower in actively managed LHV pension funds with the focus being on OTC-traded assets with a long-term stable rate of return.

At the end of June, LHV Varahaldus liquidated the Persian Gulf Fund; the volume of AUM of the fund at the moment of closure was EUR 4.5 million. The LHV's mobile app "My Pension" launched in June has been downloaded for more than 13 thousand times in the first month. From 6 June, Vahur Vallistu took up the duties of the CEO; on 19 June, Mihkel Oja left the organisation and from that date onwards, the Management Board of LHV Varahaldus continues with two members – Vahur Vallistu and Joel Kukemelk.

## CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### Condensed Consolidated Interim Statement of Profit or Loss and Other Comprehensive Income

<i>(in thousands of euros)</i>	Note	Q2 2019	6M 2019	Q2 2018	6M 2018
<b>Continuing operations</b>					
Interest income		14 264	27 177	11 184	22 070
Interest expense		-2 637	-4 605	-1 776	-3 663
<b>Net interest income</b>	9	<b>11 627</b>	<b>22 572</b>	<b>9 408</b>	<b>18 407</b>
Fee and commission income		9 126	17 590	9 149	16 291
Fee and commission expense		-2 514	-4 753	-1 934	-3 486
<b>Net fee and commission income</b>	10	<b>6 612</b>	<b>12 837</b>	<b>7 215</b>	<b>12 805</b>
Net gains from financial assets measured at fair value		190	338	326	254
Foreign exchange rate gains/losses		12	-7	9	-6
<b>Net gains from financial assets</b>		<b>202</b>	<b>381</b>	<b>335</b>	<b>248</b>
Other income		17	16	18	25
Other expense		0	-23	-15	-27
<b>Total other income</b>		<b>17</b>	<b>-7</b>	<b>3</b>	<b>-2</b>
Staff costs	11	-4 882	-9 435	-3 938	-7 684
Administrative and other operating expenses	11	-4 519	-9 072	-3 836	-7 756
<b>Total expenses</b>		<b>-9 401</b>	<b>-18 507</b>	<b>-7 774</b>	<b>-15 440</b>
<b>Profit before impairment losses on loans and advances</b>		<b>9 057</b>	<b>17 276</b>	<b>9 187</b>	<b>16 018</b>
Impairment losses on loans and advances	22	-698	-1 649	-1 596	-2 478
<b>Profit before income tax</b>		<b>8 359</b>	<b>15 627</b>	<b>7 591</b>	<b>13 540</b>
Income tax expense		-697	-2 962	-631	-2 569
<b>Net profit for the reporting period from continued operations</b>	2	<b>7 662</b>	<b>12 665</b>	<b>6 960</b>	<b>10 971</b>
<b>Profit from discontinued operations</b>	12	<b>0</b>	<b>0</b>	<b>3 080</b>	<b>3 324</b>
<b>Net profit for the reporting period</b>	2	<b>7 662</b>	<b>12 665</b>	<b>10 040</b>	<b>14 295</b>
<b>Other comprehensive income/loss:</b>					
Items that may be reclassified subsequently to profit or loss:					
Changes in the fair value of debt instruments measured at FVOCI					
		0	0	-6	-112
<b>Total profit and other comprehensive income for the reporting period</b>		<b>7 662</b>	<b>12 665</b>	<b>10 034</b>	<b>14 183</b>
<b>Total profit of the reporting period attributable to:</b>					
Owners of the parent		7 097	11 788	9 525	13 474
Non-controlling interest		565	877	515	821
<b>Total profit for the reporting period</b>	2	<b>7 662</b>	<b>12 665</b>	<b>10 040</b>	<b>14 295</b>
<b>Total profit and other comprehensive income attributable to:</b>					
Owners of the parent		7 097	11 788	9 519	13 362
Non-controlling interest		565	877	515	821
<b>Total profit and other comprehensive income for the reporting period</b>		<b>7 662</b>	<b>12 665</b>	<b>10 034</b>	<b>14 183</b>
Basic earnings per share (in euros)	17	0.27	0.45	0.37	0.52
Diluted earnings per share (in euros)	17	0.27	0.45	0.36	0.51

The Notes on pages 20 to 36 are an integral part of the condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statement of Financial Position

<i>(in thousands of euros)</i>	Note	30.06.2019	31.12.2018
<b>Assets</b>			
Due from central bank	4, 5, 6, 13	1 067 924	639 862
Due from credit institutions	4, 5, 6, 13	21 981	25 791
Due from investment companies	4, 6, 13	9 104	17 005
Equity instruments at fair value through other comprehensive income	4, 6, 7	298	298
Financial assets at fair value through profit or loss	4, 6, 7	119 164	46 856
Loans and advances to customers	4, 6, 8, 22	1 117 904	918 761
Receivables from customers		9 504	3 721
Other financial assets		2 850	2 936
Other assets		1 820	1 651
Tangible assets	20	5 135	1 135
Intangible assets	20	15 416	15 470
Goodwill		3 614	3 614
<b>Total assets</b>	<b>2</b>	<b>2 374 714</b>	<b>1 677 100</b>
<b>Liabilities</b>			
Deposits of customers and loans received	14	2 111 978	1 443 782
Financial liabilities at fair value through profit or loss	6	9	11
Accounts payable and other liabilities	15	23 188	24 644
Subordinated debt	6, 21	75 000	50 900
<b>Total liabilities</b>	<b>2</b>	<b>2 210 175</b>	<b>1 519 337</b>
<b>Owner's equity</b>			
Share capital		26 016	26 016
Share premium		46 653	46 653
Statutory reserve capital		4 713	3 451
Other reserves		2 865	2 090
Retained earnings		80 493	75 430
<b>Total equity attributable to owners of the parent</b>		<b>160 740</b>	<b>153 640</b>
Non-controlling interest		3 799	4 123
<b>Total equity</b>		<b>164 539</b>	<b>157 763</b>
<b>Total liabilities and equity</b>		<b>2 374 714</b>	<b>1 677 100</b>

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The Notes on pages 20 to 36 are an integral part of the condensed consolidated interim financial statements.

## Condensed Consolidated Interim Statement of Cash Flows

<i>(in thousands of euros)</i>	Note	Q2 2019	6M 2019	Q2 2018	6M 2018
<b>Cash flows from operating activities</b>					
Interest received		13 917	26 761	11 594	21 256
Interest paid		-2 333	-4 154	-1 981	-2 718
Fees and commissions received		9 127	17 590	9 149	16 291
Fees and commissions paid		-2 514	-4 753	-1 934	-3 486
Other income received		48	-50	20	27
Staff costs paid		-4 368	-8 463	-3 508	-6 757
Administrative and other operating expenses paid		-3 546	-7 040	-3 107	-6 340
Income tax		-697	-2 962	0	-1 938
<b>Cash flows from operating activities before change in operating assets and liabilities</b>		<b>9 634</b>	<b>16 929</b>	<b>10 233</b>	<b>16 335</b>
<b>Net increase/decrease in operating assets:</b>					
Net increase/(decrease) in financial assets at fair value through profit or loss		1	46	-31	-49
Loans and advances to customers		-129 814	-206 197	-21 003	-57 819
Mandatory reserve at central bank		-4 199	-5 584	748	-1 086
Security deposits		120	86	-111	-58
Other assets		273	-152	-53	-552
<b>Net increase/decrease in operating liabilities:</b>					
Demand deposits of customers		249 267	367 882	-171 045	17 888
Term deposits of customers		266 727	292 858	-11 526	-12 034
Loans received		10 000	10 000	0	0
Repayments of the loans received		-2 943	-2 943	0	0
Financial liabilities held for trading at fair value through profit and loss		-25	-2	-368	5
Other liabilities		853	-833	-2 720	-46 828
Discontinued operations		0	0	244	-270
<b>Net cash generated from/used in operating activities</b>		<b>399 894</b>	<b>472 090</b>	<b>-195 632</b>	<b>-84 468</b>
<b>Cash flows from investing activities</b>					
Purchase of non-current assets		-885	-5 934	-512	-1 084
Disposal of subsidiary, net of cash disposed	12	0	0	5 046	5 046
Proceeds from disposal and redemption of investment securities at fair value through other comprehensive income		0	0	-6	-112
Net changes of investment securities at fair value through profit or loss		-93 089	-72 819	3 348	2 825
<b>Net cash flows from/used in investing activities</b>		<b>-93 974</b>	<b>-78 753</b>	<b>7 876</b>	<b>6 675</b>
<b>Cash flows from financing activities</b>					
Dividends paid		0	-6 664	-4 123	-5 295
Subordinated loans received		40 000	40 000	0	0
Repayments of the subordinated loans received		-15 900	-15 900	0	0
<b>Net cash flows from/used in financing activities</b>		<b>24 100</b>	<b>17 436</b>	<b>-4 123</b>	<b>-5 295</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	6	<b>12</b>	<b>-7</b>	<b>9</b>	<b>-6</b>
<b>Net increase/decrease in cash and cash equivalents</b>		<b>330 032</b>	<b>410 766</b>	<b>-191 870</b>	<b>-83 094</b>
Cash and cash equivalents at the beginning of the period		749 112	668 378	1 054 613	945 837
<b>Cash and cash equivalents at the end of the period</b>	13	<b>1 079 144</b>	<b>1 079 144</b>	<b>862 743</b>	<b>862 743</b>

The Notes on pages 20 to 36 are an integral part of the condensed consolidated interim financial statements

## Condensed Consolidated Interim Statement of Changes in Equity

<i>(in thousands of euros)</i>	Share capital	Share premium	Statutory reserve capital	Other reserves	Retained earnings	Total equity attributable to owners of LHV Group	Non-controlling interest	Total equity
<b>Balance as at 01.01.2018</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>44 071</b>	<b>120 062</b>	<b>7 893</b>	<b>127 955</b>
Changes in initial application of IFRS 15	0	0	0	0	10 617	10 617	0	10 617
<b>Adjusted balance as at 01.01.2018</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>54 688</b>	<b>130 679</b>	<b>7 893</b>	<b>138 572</b>
Disposal of subsidiary	0	0	0	0	0	0	-4 550	-4 550
Transfer to statutory reserve capital	0	0	980	0	-980	0	0	0
Dividends paid	0	0	0	0	-4 123	-4 123	-1 172	-5 295
Share options	0	0	0	530	0	530	0	530
<i>Profit for the reporting period</i>	0	0	0	0	13 474	13 474	821	14 295
<i>Other comprehensive loss</i>	0	0	0	-112	0	-112	0	-112
Total profit and other comprehensive income for the reporting period	0	0	0	-112	13 474	13 362	821	14 183
<b>Balance as at 30.06.2018</b>	<b>25 767</b>	<b>46 304</b>	<b>3 451</b>	<b>1 867</b>	<b>63 059</b>	<b>140 448</b>	<b>2 992</b>	<b>143 440</b>
<b>Balance as at 01.01.2019</b>	<b>26 016</b>	<b>46 653</b>	<b>3 451</b>	<b>2 090</b>	<b>75 430</b>	<b>153 640</b>	<b>4 123</b>	<b>157 763</b>
Transfer to statutory reserve capital	0	0	1 262	0	-1 262	0	0	0
Dividends paid	0	0	0	0	-5 463	-5 463	-1 201	-6 664
Share options	0	0	0	775	0	775	0	775
<i>Profit for the reporting period</i>	0	0	0	0	11 788	11 788	877	12 665
<i>Other comprehensive income/loss</i>	0	0	0	0	0	0	0	0
Total profit and other comprehensive income for the reporting period	0	0	0	0	11 788	11 788	877	12 665
<b>Balance as at 30.06.2019</b>	<b>26 016</b>	<b>46 653</b>	<b>4 713</b>	<b>2 865</b>	<b>80 493</b>	<b>160 740</b>	<b>3 799</b>	<b>164 539</b>

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The Notes on pages 20 to 36 are an integral part of the condensed consolidated interim financial statements

# Notes to the Condensed Consolidated Interim Financial Statements

## NOTE 1 Accounting Policies

The condensed consolidated interim financial statements have been prepared in accordance with the international financial reporting standard IAS 34 "Interim Financial Reporting", as adopted by the European Union, and consists of condensed consolidated financial statements and selected explanatory notes. The accounting policies and methods of computation used in the preparation of the interim report are the same as the accounting policies and methods of computation used in the annual report for the year ended 31 December 2018, which comply with the International Financial Reporting Standards, as adopted by the European Union (IFRS EU), with the exception of accounting principles changed as of 1 January 2019 in related to newly enforced IFRS EU standards. The changes in accounting principles are disclosed in Note 1, subsection "Changes in accounting policies".

These condensed consolidated interim financial statements have been reviewed, not audited and do not contain the entire range of information required for the preparation of complete financial statements. The condensed consolidated interim financial statements should be read in conjunction with the Annual Report prepared for the year ended 31 December 2018, which has been prepared in accordance with the International Financial Reporting Standards (IFRS EU).

The financial figures of the condensed consolidated interim financial statements have been presented in thousands of euros, unless otherwise indicated. The interim financial statements have been consolidated and include the results of AS LHV Group and its subsidiaries AS LHV Varahaldus (100% interest), AS LHV Pank (100% interest), OÜ Cuber Tehnology (100% interest) and AS LHV Finance (65% interest). As of March 31 2018 the quarterly report included also the results of UAB Mokilizingas (50% interest+1 share).

### *Changes and amendments to already published financial statements*

When preparing these condensed consolidated interim financial statements, the Group introduced amendments to the financial information disclosed for the period ended 30 June 2019 presented in the condensed consolidated interim financial statements as compared to already published on 16th of July condensed consolidated interim financial statements for the period ended 30 June 2019. Therefore, these condensed consolidated interim financial statements replace the previously published version. The amendments did not affect profit for the reporting period, total assets, total liabilities or total equity. The key amendments relate to:

- correction of comparative period in the Condensed Consolidated Statement of Changes in Equity.
- inclusion of detailed description of new accounting standard IFRS 16 applied from 1 January 2019 (Note 1).
- inclusion of 6m 2019 and 6m 2018 period results in segment reporting (Note 2).
- inclusion of following notes:
  - Tangible and intangible assets (Note 20);
  - Subordinated debts (Note 21);
  - Loans and advances to customers (Note 22).

### *Changes in accounting policies*

The Group has adopted IFRS 16, Leases for the first time starting from 01.01.2019. The other new standards that became effective since 1 January 2019 have had no impact on the 6-month interim financial report of the Group. The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model.

Lessees will be required to recognise:

- (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and
- (b) depreciation of lease assets separately from interest on lease liabilities in the income statement.

IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

The group has adopted IFRS 16 Leases retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period as permitted under the specific transition provisions in the standard.

On adoption of IFRS 16, the group recognised tangible assets and lease liabilities in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17 Leases.

The Group leases various properties. Rental contracts are typically made for fixed periods of up to 5 years but as a rule, include extension and termination options. Lease terms are negotiated on an individual basis and may contain a wide range of different terms and conditions.

The Group recognises leases as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use.

Lease liabilities were recognized as present value of lease payments. The right-of use assets were measured at the amount equal to the lease liability, as no adjustments to right of use assets were necessary. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life or the lease term on a straight-line basis.

Lease liabilities include the net present value of the following lease payments:

- fixed payments, less any lease incentives receivable.
- variable lease payment that are based on some kind an index (for example inflation, Euribor).
- amounts expected to be payable by the lessee under residual value guarantees.
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option.

The lease payments are discounted using the interest rate implicit in the lease, if it is readily determinable, or the Group's incremental borrowing rate. The alternative interest rate is the rate of interest that a lessee would have to pay to borrow, over a similar term and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

Short-term leases are leases with a lease term of 12 months or less. Low value assets comprise IT-equipment and small items of office furniture. In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option or not to exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). The management reviews the assessment if a significant event or a significant change in circumstances occurs which affects the probability of using options and that is within the control of the management. Alternatively, the extension period of the contract has changed (for example, Group has exercised an option, which initially was considered reasonably uncertain or has not exercised an option, which was initially considered reasonably certain).

According to the contracts, Group has not granted any residual value guarantees in the end of the contract.

On applying the standard as at 01.01.2019, the lease payments were discounted at the Group's incremental borrowing rate of 2.25% on average.

The Group has used the following practical expedients permitted by the standard:

- the accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases.
- lease agreements for low value assets are excluded.
- the exclusion of initial direct costs for the measurement of the rightof-use asset at the date of initial application.

The group has also elected not to apply IFRS 16 to contracts that were not identified as containing a lease under IAS 17 and IFRIC 4 Determining whether an Arrangement contains a Lease. As the result of application, the Group's total assets in the statement of financial position as at 01.01.2019 increased 4 042 thousand euros and liabilities increased 4 042 thousand euros.

## NOTE 2 Business Segments

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The Group divides its business activities into segments according to its legal structure, except LHV Pank divides its business activities by 3 main business segments: retail banking, private banking and corporate banking. The business segments form a part of the Group, with a separate access to financial data and which are subject to regular monitoring of operating profit by the Group's decision-maker. The Management Board of AS LHV Group has been designated as the decision-maker responsible for allocation of funds and assessment of the profitability of the business activities. The result posted by a segment includes revenue and expenditure directly related to the segment.

The revenue of a reported segment includes gains from transactions between the segments, i.e. loans granted by AS LHV Pank to other group companies. The division of interest income and fee and commission income by customer location has been presented in Notes 9 and 10. The breakdown of interest income by customer location does not include the income from current accounts, deposits and investments in securities. The Group does not have any customers, whose income would account for more than 10% of the corresponding type of revenue.

	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Hire-purchase and consumer finance in Lithuania	Other activities	Intra-segment eliminations	Total
<b>Q2 2019</b>									
Interest income	3 868	276	8 547	0	2 681	0	1 427	-2 535	14 264
Interest expense	-702	0	-1 531	-41	-425	0	-2 473	2 535	-2 637
<b>Net interest income</b>	<b>3 166</b>	<b>276</b>	<b>7 016</b>	<b>-41</b>	<b>2 256</b>	<b>0</b>	<b>-1 046</b>	<b>0</b>	<b>11 627</b>
Fee and commission income	4 673	390	315	3 605	143	0	0	0	9 126
Fee and commission expense	-2 343	0	-8	0	-162	0	-1	0	-2 514
<b>Net fee and commission income</b>	<b>2 330</b>	<b>390</b>	<b>307</b>	<b>3 605</b>	<b>-19</b>	<b>0</b>	<b>-1</b>	<b>0</b>	<b>6 612</b>
<b>Net income</b>	<b>5 496</b>	<b>666</b>	<b>7 323</b>	<b>3 564</b>	<b>2 237</b>	<b>0</b>	<b>-1 047</b>	<b>0</b>	<b>18 239</b>
Net gains from financial assets	43	0	0	73	0	0	86	0	202
Administrative and other operating expenses, staff costs	-4 499	-274	-1 828	-1 510	-557	0	-716	0	-9 384
<b>Operating profit</b>	<b>1 040</b>	<b>392</b>	<b>5 495</b>	<b>2 127</b>	<b>1 680</b>	<b>0</b>	<b>-1 677</b>	<b>0</b>	<b>9 057</b>
Impairment losses on loans and advances	-200	0	-431	0	-67	0	0	0	-698
Income tax	-174	-37	-486	0	0	0	0	0	-697
<b>Net profit</b>	<b>666</b>	<b>355</b>	<b>4 578</b>	<b>2 127</b>	<b>1 613</b>	<b>0</b>	<b>-1 677</b>	<b>0</b>	<b>7 662</b>

	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Hire-purchase and consumer finance in Lithuania	Other activities	Intra-segment eliminations	Total
<b>6M 2019</b>									
Interest income	7 380	574	16 158	0	5 251	0	2 617	-4 803	27 177
Interest expense	-1 292	0	-2 931	-83	-750	0	-4 352	4 803	-4 605
<b>Net interest income</b>	<b>6 088</b>	<b>574</b>	<b>13 227</b>	<b>-83</b>	<b>4 501</b>	<b>0</b>	<b>-1 735</b>	<b>0</b>	<b>22 572</b>
Fee and commission income	8 817	754	612	7 126	281	0	0	0	17 590
Fee and commission expense	-4 414	0	-20	0	-314	0	-5	0	-4 753
<b>Net fee and commission income</b>	<b>4 403</b>	<b>754</b>	<b>592</b>	<b>7 126</b>	<b>-33</b>	<b>0</b>	<b>-5</b>	<b>0</b>	<b>12 837</b>
<b>Net income</b>	<b>10 491</b>	<b>1 328</b>	<b>13 819</b>	<b>7 043</b>	<b>4 468</b>	<b>0</b>	<b>-1 740</b>	<b>0</b>	<b>35 409</b>
Net gains from financial assets	39	0	0	265	0	0	4 477	-4 400	381
Administrative and other operating expenses, staff costs	-8 890	-554	-3 775	-2 993	-985	0	-1 317	0	-18 514
<b>Operating profit</b>	<b>1 640</b>	<b>774</b>	<b>10 044</b>	<b>4 315</b>	<b>3 483</b>	<b>0</b>	<b>1 420</b>	<b>-4 400</b>	<b>17 276</b>
Impairment losses on loans and advances	-273	0	-1 158	0	-218	0	0	0	-1 649
Income tax	-323	-71	-836	-972	-760	0	0	0	-2 962
<b>Net profit</b>	<b>1 044</b>	<b>703</b>	<b>8 050</b>	<b>3 343</b>	<b>2 505</b>	<b>0</b>	<b>1 420</b>	<b>-4 400</b>	<b>12 665</b>
<b>Total assets 30.06.2019</b>	<b>1 435 527</b>	<b>134 796</b>	<b>765 034</b>	<b>29 831</b>	<b>57 213</b>	<b>0</b>	<b>153 026</b>	<b>-200 713</b>	<b>2 374 714</b>
<b>Total liabilities 30.06.2019</b>	<b>1 600 808</b>	<b>345 897</b>	<b>256 400</b>	<b>3 687</b>	<b>46 322</b>	<b>0</b>	<b>75 453</b>	<b>-118 392</b>	<b>2 210 175</b>

	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Hire-purchase and consumer finance in Lithuania	Other activities	Intra-segment eliminations	Total
<b>Q2 2018</b>									
Interest income	2 548	331	6 145	0	2 246	0	1 692	-1 778	11 184
Interest expense	0	0	-1 059	-42	-305	0	-2 148	1 778	-1 776
<b>Net interest income</b>	<b>2 548</b>	<b>331</b>	<b>5 086</b>	<b>-42</b>	<b>1 941</b>	<b>0</b>	<b>-456</b>	<b>0</b>	<b>9 408</b>
Fee and commission income	3 040	316	1 676	3 415	125	0	577	0	9 149
Fee and commission expense	-1 745	0	-31	0	-141	0	-17	0	-1 934
<b>Net fee and commission income</b>	<b>1 295</b>	<b>316</b>	<b>1 645</b>	<b>3 415</b>	<b>-16</b>	<b>0</b>	<b>560</b>	<b>0</b>	<b>7 215</b>
<b>Net income</b>	<b>3 843</b>	<b>647</b>	<b>6 731</b>	<b>3 373</b>	<b>1 925</b>	<b>0</b>	<b>104</b>	<b>0</b>	<b>16 623</b>
Net gains from financial assets	-3	0	0	89	0	0	249	0	335
Administrative and other operating expenses, staff costs	-2 983	-254	-1 663	-1 396	-518	0	-957	0	-7 771
<b>Operating profit</b>	<b>857</b>	<b>393</b>	<b>5 068</b>	<b>2 066</b>	<b>1 407</b>	<b>0</b>	<b>-604</b>	<b>0</b>	<b>9 187</b>
Impairment losses on loans and advances	21	0	-1 493	0	-121	0	-3	0	-1 596
Income tax	-169	-41	-365	0	0	0	-56	0	-631
Discontinued operations	0	0	0	0	0	3 080	0	0	3 080
<b>Net profit</b>	<b>709</b>	<b>352</b>	<b>3 210</b>	<b>2 066</b>	<b>1 286</b>	<b>3 080</b>	<b>-663</b>	<b>0</b>	<b>10 040</b>

	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Hire-purchase and consumer finance in Lithuania	Other activities	Intra-segment eliminations	Total
<b>6M 2018</b>									
Interest income	5 044	625	11 710	0	4 469	0	4 145	-3 923	22 070
Interest expense	0	0	-1 985	-84	-583	0	-4 934	3 923	-3 663
<b>Net interest income</b>	<b>5 044</b>	<b>625</b>	<b>9 725</b>	<b>-84</b>	<b>3 886</b>	<b>0</b>	<b>-789</b>	<b>0</b>	<b>18 407</b>
Fee and commission income	5 864	639	1 695	6 754	251	0	1 088	0	16 291
Fee and commission expense	-3 139	0	-58	0	-249	0	-40	0	-3 486
<b>Net fee and commission income</b>	<b>2 725</b>	<b>639</b>	<b>1 637</b>	<b>6 754</b>	<b>2</b>	<b>0</b>	<b>1 048</b>	<b>0</b>	<b>12 805</b>
<b>Net income</b>	<b>7 769</b>	<b>1 264</b>	<b>11 362</b>	<b>6 670</b>	<b>3 888</b>	<b>0</b>	<b>259</b>	<b>0</b>	<b>31 212</b>
Net gains from financial assets	-6	0	0	65	0	0	2 367	-2 178	248
Administrative and other operating expenses, staff costs	-5 918	-518	-3 126	-2 882	-1 049	0	-1 949	0	-15 442
<b>Operating profit</b>	<b>1 845</b>	<b>746</b>	<b>8 236</b>	<b>3 853</b>	<b>2 839</b>	<b>0</b>	<b>677</b>	<b>-2 178</b>	<b>16 018</b>
Impairment losses on loans and advances	453	0	-2 709	0	-190	0	-32	0	-2 478
Income tax	-169	-41	-365	-1 100	-838	0	-56	0	-2 569
Discontinued operations	0	0	0	0	0	3 324	0	0	3 324
<b>Net profit</b>	<b>2 129</b>	<b>705</b>	<b>5 162</b>	<b>2 753</b>	<b>1 811</b>	<b>3 324</b>	<b>589</b>	<b>-2 178</b>	<b>14 295</b>

<b>Total assets 30.06.2018</b>	<b>1 046 276</b>	<b>98 245</b>	<b>557 591</b>	<b>28 262</b>	<b>45 518</b>	<b>0</b>	<b>107 113</b>	<b>-143 225</b>	<b>1 739 780</b>
<b>Total liabilities 30.06.2018</b>	<b>1 159 023</b>	<b>250 438</b>	<b>185 640</b>	<b>3 853</b>	<b>36 948</b>	<b>0</b>	<b>31 192</b>	<b>-70 753</b>	<b>1 596 340</b>
<b>Total assets 31.12.2018</b>	<b>1 005 454</b>	<b>94 412</b>	<b>535 836</b>	<b>31 193</b>	<b>51 383</b>	<b>0</b>	<b>127 748</b>	<b>-168 926</b>	<b>1 677 100</b>
<b>Total liabilities 31.12.2018</b>	<b>1 105 619</b>	<b>238 898</b>	<b>177 086</b>	<b>2 610</b>	<b>39 577</b>	<b>0</b>	<b>51 380</b>	<b>-95 834</b>	<b>1 519 337</b>

### NOTE 3 Risk Management

The group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The condensed interim financial statements do not include all financial risk management information and disclosures required in the annual financial statements; they should be read in conjunction with the group's annual financial statements as at 31 December 2018.

There have been no major changes in the risk management department or in any risk management policies since the year end.

### NOTE 4 Breakdown of Financial Assets and Liabilities by Countries

<b>30.06.2019</b>	<b>Estonia</b>	<b>Latvia</b>	<b>Lit- uania</b>	<b>Finland</b>	<b>The Nether- lands</b>	<b>Ger- many</b>	<b>Other EU</b>	<b>USA</b>	<b>UK</b>	<b>Other</b>	<b>Total</b>
Due from banks and investment companies	1 039 016	0	0	0	0	0	11 058	8 616	38 501	1 818	<b>1 099 009</b>
Financial assets at fair value	88 228	770	17 243	0	0	13 202	16	3	0	0	<b>119 462</b>
Loans and advances to customers	1 087 866	165	122	1 439	1	117	26 736	245	0	1 213	<b>1 117 904</b>
Receivables from customers	9 495	1	5	0	0	0	0	0	0	3	<b>9 504</b>
Other financial assets	109	0	0	0	0	0	0	2 741	0	0	<b>2 850</b>
<b>Total financial assets</b>	<b>2 224 714</b>	<b>936</b>	<b>17 370</b>	<b>1 439</b>	<b>1</b>	<b>13 319</b>	<b>37 810</b>	<b>11 605</b>	<b>38 501</b>	<b>3 034</b>	<b>2 348 729</b>
Deposits of customers and loans received	1 530 458	10 714	2 306	3 512	282	239 380	263 907	1 124	0	60 295	<b>2 111 978</b>
Subordinated debt	75 000	0	0	0	0	0	0	0	0	0	<b>75 000</b>
Accounts payable and other financial liabilities	19 785	0	4	27	0	0	13	3	3	0	<b>19 835</b>
Financial liabilities at fair value	9	0	0	0	0	0	0	0	0	0	<b>9</b>
<b>Total financial liabilities</b>	<b>1 625 252</b>	<b>10 714</b>	<b>2 310</b>	<b>3 539</b>	<b>282</b>	<b>239 380</b>	<b>263 920</b>	<b>1 127</b>	<b>3</b>	<b>60 295</b>	<b>2 206 822</b>

Unused loan commitments in the amount of EUR 198 715 thousand are for the residents of Estonia.

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31.12.2018	Estonia	Latvia	Lit- huania	Finland	The Nether- lands	Ger- many	Other EU	USA	UK	Other	Total
Due from banks and investment companies	650 321	0	0	0	0	0	13 599	16 541	0	2 197	682 658
Financial assets at fair value	8 392	772	17 242	0	0	1	20 704	43	0	0	47 154
Loans and advances to customers	886 881	52	10 561	1 524	1	6	18 432	175	0	1 129	918 761
Receivables from customers	3 706	1	5	0	0	0	0	0	0	9	3 721
Other financial assets	111	0	0	0	0	0	0	2 825	0	0	2 936
<b>Total financial assets</b>	<b>1 549 411</b>	<b>825</b>	<b>27 808</b>	<b>1 524</b>	<b>1</b>	<b>7</b>	<b>52 735</b>	<b>19 584</b>	<b>0</b>	<b>3 335</b>	<b>1 655 230</b>
Deposits of customers and loans received	1 154 012	10 041	951	3 414	576	13 274	220 173	3 085	0	38 256	1 443 782
Subordinated debt	50 900	0	0	0	0	0	0	0	0	0	50 900
Accounts payable and other financial liabilities	21 381	0	4	27	0	0	13	3	0	0	21 428
Financial liabilities at fair value	11	0	0	0	0	0	0	0	0	0	11
<b>Total financial liabilities</b>	<b>1 226 304</b>	<b>10 041</b>	<b>955</b>	<b>3 441</b>	<b>576</b>	<b>13 274</b>	<b>220 186</b>	<b>3 088</b>	<b>0</b>	<b>38 256</b>	<b>1 516 121</b>

Unused loan commitments in the amount of EUR 188 841 thousand are for the residents of Estonia.

## NOTE 5 Breakdown of Assets and Liabilities by Contractual Maturity Dates

30.06.2019	On demand	0-3 months	3-12 months	1-5 years	Over 5 years	Total
<b>Liabilities by contractual maturity dates</b>						
Deposits from customers and loans received	1 672 159	53 659	365 185	20 711	3 637	2 115 350
Subordinated debt	0	1 244	3 731	19 900	87 263	112 138
Accounts payable and other financial liabilities	0	19 835	0	0	0	19 835
Unused loan commitments	0	198 715	0	0	0	198 715
Financial guarantees by contractual amounts	0	9 888	0	0	0	9 888
Foreign exchange derivatives (gross settled)	0	15 764	0	611	0	16 375
Financial liabilities at fair value	0	9	0	0	0	9
<b>Total liabilities</b>	<b>1 672 159</b>	<b>299 113</b>	<b>368 916</b>	<b>41 222</b>	<b>90 899</b>	<b>2 472 309</b>
<b>Financial assets by contractual maturity dates</b>						
Due from banks and investment companies	1 099 009	0	0	0	0	1 099 009
Financial assets at fair value (debt securities)	0	0	101 739	7 262	2 223	111 225
Loans and advances to customers	0	74 051	204 768	801 781	204 739	1 285 339
Receivables from customers	0	9 504	0	0	0	9 504
Other financial assets	2 850	0	0	0	0	2 850
Foreign exchange derivatives (gross settled)	0	15 764	0	611	0	16 375
<b>Total financial assets</b>	<b>1 101 859</b>	<b>99 319</b>	<b>306 508</b>	<b>809 654</b>	<b>206 962</b>	<b>2 524 302</b>
<b>Maturity gap from financial assets and liabilities</b>	<b>-570 300</b>	<b>-199 794</b>	<b>-62 408</b>	<b>768 432</b>	<b>116 063</b>	<b>51 993</b>

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31.12.2018	On demand	0-3 months	3-12 months	1-5 years	Over 5 years	Total
<b>Liabilities by contractual maturity dates</b>						
Deposits from customers and loans received	1 304 239	24 949	94 113	16 780	4 390	1 444 471
Subordinated debt	0	832	2 496	13 311	59 426	76 065
Accounts payable and other financial liabilities	0	21 428	0	0	0	21 428
Unused loan commitments	0	188 841	0	0	0	188 841
Financial guarantees by contractual amounts	0	9 314	0	0	0	9 314
Foreign exchange derivatives (gross settled)	0	18 559	0	610	0	19 169
Financial liabilities at fair value	0	11	0	0	0	11
<b>Total liabilities</b>	<b>1 304 239</b>	<b>263 934</b>	<b>96 609</b>	<b>30 701</b>	<b>63 816</b>	<b>1 759 299</b>
<b>Financial assets by contractual maturity dates</b>						
Due from banks and investment companies	682 658	0	0	0	0	682 658
Financial assets at fair value (debt securities)	0	20 690	0	15 845	2 161	38 696
Loans and advances to customers	0	63 584	198 293	634 077	154 853	1 050 807
Receivables from customers	0	3 721	0	0	0	3 721
Other financial assets	2 936	0	0	0	0	2 936
Foreign exchange derivatives (gross settled)	0	18 559	0	610	0	19 169
<b>Total financial assets</b>	<b>685 594</b>	<b>106 554</b>	<b>198 293</b>	<b>650 532</b>	<b>157 014</b>	<b>1 797 987</b>
<b>Maturity gap from financial assets and liabilities</b>	<b>-618 645</b>	<b>-157 380</b>	<b>101 684</b>	<b>619 831</b>	<b>93 198</b>	<b>38 688</b>

It is possible to take a short-term loan from the central bank against the security of the majority of instruments in the bond portfolio. All cashflows from financial assets and –liabilities except derivatives include all contractual cash flows.

## NOTE 6 Open Foreign Currency Positions

30.06.2019	EUR	CHF	GBP	SEK	USD	Other	Total
<b>Assets bearing currency risk</b>							
Due from banks and investment companies	1 041 189	2 847	44 511	997	3 708	5 757	1 099 009
Financial assets at fair value	101 606	0	0	1	17 853	2	119 462
Loans and advances to customers	1 116 324	6	0	479	979	116	1 117 904
Receivables from customers	7 732	3	1 286	26	0	457	9 504
Other financial assets	741	0	0	0	2 109	0	2 850
<b>Total assets bearing currency risk</b>	<b>2 267 592</b>	<b>2 856</b>	<b>45 797</b>	<b>1 503</b>	<b>24 649</b>	<b>6 331</b>	<b>2 348 729</b>
<b>Liabilities bearing currency risk</b>							
Deposits from customers and loans received	2 016 990	2 801	45 571	7 844	31 103	7 669	2 111 978
Financial liabilities at fair value	0	0	0	0	3	6	9
Accounts payable and other financial liabilities	18 306	69	354	198	375	533	19 835
Subordinated debt	75 000	0	0	0	0	0	75 000
<b>Total liabilities bearing currency risk</b>	<b>2 110 296</b>	<b>2 870</b>	<b>45 925</b>	<b>8 042</b>	<b>31 481</b>	<b>8 209</b>	<b>2 206 823</b>
Open gross position derivative assets at contractual value	611	0	0	6 673	7 205	1 886	16 375
Open gross position derivative liabilities at contractual value	15 764	0	0	0	611	0	16 375
<b>Open foreign currency position</b>	<b>142 143</b>	<b>-14</b>	<b>-127</b>	<b>134</b>	<b>-238</b>	<b>8</b>	<b>141 906</b>

31.12.2018	EUR	CHF	GBP	SEK	USD	Other	Total
<b>Assets bearing currency risk</b>							
Due from banks and investment companies	651 175	2 224	18 319	2 536	1 430	6 973	<b>682 658</b>
Financial assets at fair value	22 750	0	1 174	1	23 230	0	<b>47 154</b>
Loans and advances to customers	902 843	0	14 707	220	957	34	<b>918 761</b>
Receivables from customers	2 802	0	374	42	0	503	<b>3 721</b>
Other financial assets	840	0	0	0	2 096	0	<b>2 936</b>
<b>Total assets bearing currency risk</b>	<b>1 580 410</b>	<b>2 224</b>	<b>34 574</b>	<b>2 799</b>	<b>27 713</b>	<b>7 511</b>	<b>1 655 230</b>
<b>Liabilities bearing currency risk</b>							
Deposits from customers and loans received	1 356 671	2 194	41 600	6 363	29 297	7 657	<b>1 443 782</b>
Financial liabilities at fair value	0	0	0	0	3	8	<b>11</b>
Accounts payable and other financial liabilities	15 299	50	2 238	410	120	3 311	<b>21 428</b>
Subordinated debt	50 900	0	0	0	0	0	<b>50 900</b>
<b>Total liabilities bearing currency risk</b>	<b>1 422 870</b>	<b>2 244</b>	<b>43 838</b>	<b>6 773</b>	<b>29 420</b>	<b>10 976</b>	<b>1 516 121</b>
Open gross position derivative assets at contractual value	610	0	9 166	3 973	2 186	3 234	<b>19 169</b>
Open gross position derivative liabilities at contractual value	18 559	0	0	0	610	0	<b>19 169</b>
<b>Open foreign currency position</b>	<b>139 591</b>	<b>-20</b>	<b>-98</b>	<b>-2</b>	<b>-130</b>	<b>-232</b>	<b>139 108</b>

## NOTE 7 Fair Value of Financial Assets and Liabilities

The Management Board of the Group has determined the fair value of assets and liabilities recognised at amortised cost in the balance sheet. To determine the fair value, future cash flows are discounted based on the market interest curve.

The below table provides an overview of the assessment techniques, which depend on the hierarchy of assets and liabilities measured at fair value:

	Level 1	Level 2	Level 3	30.06.2019	Level 1	Level 2	Level 3	31.12.2018
<b>Financial assets at fair value through profit and loss</b>								
Shares and fund units*	479	7 449	0	<b>7 928</b>	510	7 590	0	<b>8 100</b>
Equity instruments at fair value through other comprehensive income	0	0	298	<b>298</b>	0	0	298	<b>298</b>
Bonds at fair value through profit and loss	111 225	0	0	<b>111 225</b>	38 697	0	0	<b>38 697</b>
Interest rate swaps and foreign exchange forwards	0	11	0	<b>11</b>	0	59	0	<b>59</b>
<b>Total financial assets</b>	<b>111 704</b>	<b>7 460</b>	<b>298</b>	<b>119 462</b>	<b>39 207</b>	<b>7 649</b>	<b>298</b>	<b>47 154</b>
<b>Financial liabilities at fair value through profit and loss</b>								
Interest rate swaps and foreign exchange	0	9	0	<b>9</b>	0	11	0	<b>11</b>
<b>Total financial liabilities</b>	<b>0</b>	<b>9</b>	<b>0</b>	<b>9</b>	<b>0</b>	<b>11</b>	<b>0</b>	<b>11</b>

\*Shares and fund units include the Group companies' AS LHV Varahaldus investment into pension fund units in the amount of EUR 7 449 (31.12.2018: 7 590) thousand. Pursuant to the Investment Funds Act, the mandatory shares of LHV Varahaldus as the management company is 0.5% of the number of units in each of the mandatory pension fund managed by it.

Hierarchy levels:

1. Level 1 – the price quoted on active market
2. Level 2 – a technique which uses market information as input (rates and interest curves of arms-length transactions)
3. Level 3 – other methods (e.g. discounted cash flow method) with estimations as input

Bid price has been used to assess the fair value of the bond portfolio and net asset value of the fund units has been used as

the basis for shares and fund units valuation. LHV Varahaldus pension fund units are considered as level 2, as there is no active market.

Interest rate swaps are instruments, where the fair value is determined via the model-based approach by using the inputs available on the active market. The fair value of such non-market derivatives is calculated as a theoretical net present value (NPV), by using independent market parameters and without assuming

the presence of any risks or uncertainties. The NPV is discounted by using the risk-free profitability rate available on the market.

As at 30.06.2019 the fair value of corporate loans and overdraft is EUR 7 626 thousand (0.98%) higher than their carrying amount (31.12.2018: 319 thousand, 0.05% lower). Loans are issued in the bank's business segments on market conditions. Therefore, the fair value of retail loans does not materially differ from their carrying amount as at 30 June 2019 and 31 December 2018. In determining the fair value of loans, considerable management judgements are used (discounted cash flow method with current market interest is used for the valuation). Loans issued are thus categorised under hierarchy level 3.

Lease interest rates offered to customers generally correspond to interest rates prevailing in the market for such products. Considering that the interest rate environment has been relatively stable since the Group started to provide leasing, consequently the fair value of lease agreements does not materially differ from their carrying amount. As significant management judgment is required to determine fair value, leases are classified as level 3 in the fair value hierarchy. Leveraged loans, hire-purchase and credit cards granted to customers are of sufficiently short-term nature and they have been issued at market terms, therefore the fair market rate of interest and also the fair value of loans do not change significantly during the loan term. The effective interest rate of consumer loans issued is at the same level as the interest rate of the loan product offered in the market and it can be stated that the carrying amount of loans does not significantly differ from their fair value. The fair value level of leveraged loans,

hirepurchase, credit cards and consumer loans is 3 as significant judgmental assumptions are used for the valuation process.

Other receivables from customers, along with accrued expenses and other current receivables have been generated in the course of ordinary business and are subject to payment over a short period of time. Their fair value does not thus differ from the carrying amount. These receivables and payables do not bear any interest. The fair value of accounts payable, accrued expenses and other payables is determined based on hierarchy level 2.

Customer deposits with fixed interest rates are mostly short-term with the deposits priced pursuant to market conditions. The majority of the customer deposits include demand deposits. The fair value of the deposits determined via discounting future cash flows does not thus materially differ from the carrying amount. In determining the fair value of customer deposits, considerable management judgements are used. Customer deposits are thus categorised under hierarchy level 2.

During the reporting period subordinated loans in the amount of EUR 40 000 thousand were received. From all the subordinated loans received EUR 20 000 thousand were received in November 2018 and EUR 15 000 thousand were received in October 2015. Subordinated loans were issued on market terms and considering the movements in loan and interest market, we can say that the market conditions are similar as they were when issuing the subordinated loans so that the fair value of the loans does not materially differ from their carrying value. In determining the fair value of loans, considerable management judgements are used. Subordinated debt are thus categorised under hierarchy level 3.

## NOTE 8 Breakdown of Loan Portfolio by Economic Sectors

	30.06.2019	%	31.12.2018	%
Individuals	273 827	24.2%	214 702	23.1%
Real estate activities	295 766	26.2%	246 930	26.6%
Manufacturing	113 561	10.1%	98 073	10.6%
Arts and entertainment	38 492	3.4%	34 582	3.7%
Financial activities	93 375	8.3%	95 697	10.3%
Wholesale and retail trade	44 199	3.9%	24 378	2.6%
Administrative and support service activities	57 547	5.1%	39 808	4.3%
Transportation and storage	10 419	0.9%	11 076	1.2%
Agriculture	49 804	4.4%	20 231	2.2%
Other service activities	7 261	0.6%	25 669	2.8%
Construction	57 218	5.1%	35 808	3.9%
Information and communication	2 996	0.3%	4 115	0.4%
Professional, scientific and technical activities	37 890	3.4%	18 779	2.0%
Education	2 107	0.2%	2 391	0.3%
Other sectors	45 198	4.0%	56 798	6.1%
<b>Total</b>	<b>1 129 660</b>	<b>100%</b>	<b>929 037</b>	<b>100%</b>
Impairment	-11 756		-10 276	
<b>Total loan portfolio</b>	<b>1 117 904</b>	<b>100%</b>	<b>918 761</b>	<b>100%</b>

## NOTE 9 Net Interest Income

<b>Interest income</b>	<b>Q2 2019</b>	<b>6M 2019</b>	<b>Q2 2018</b>	<b>6M 2018</b>
From balances with credit institutions and investment	97	152	43	58
From debt securities	63	136	37	73
Leasing	663	1 309	733	1 298
Leverage loans and lending of securities	113	215	110	242
Consumer loans	1 708	3 254	1 248	2 443
Hire purchase	973	1 996	998	2 027
Corporate loans	8 938	16 775	6 946	12 832
Credit card loans	200	399	188	374
Mortgage loans	901	1 637	386	699
Other loans	608	1 304	495	2 024
<b>Total</b>	<b>14 264</b>	<b>27 177</b>	<b>11 184</b>	<b>22 070</b>
<b>Interest expense</b>				
Deposits of customers and loans received	-953	-1 503	-418	-802
Balances with the central bank	-821	-1 407	-826	-1 796
Subordinated liabilities	-863	-1 695	-532	-1 065
including loans between related parties	-104	-193	-88	-176
<b>Total</b>	<b>-2 637</b>	<b>-4 605</b>	<b>-1 776</b>	<b>-3 663</b>
<b>Net interest income</b>	<b>11 627</b>	<b>22 572</b>	<b>9 408</b>	<b>18 407</b>
<b>Interest income on loans by customer location (interest on bank balances and bonds excluded):</b>				
Estonia	14 103	26 889	10 890	21 416
Lithuania	0	0	214	523
<b>Total</b>	<b>14 103</b>	<b>26 889</b>	<b>11 104</b>	<b>21 939</b>

## NOTE 10 Net Fee and Commission Income

<b>Fee and commission income</b>	<b>Q2 2019</b>	<b>6M 2019</b>	<b>Q2 2018</b>	<b>6M 2018</b>
Security brokerage and commissions paid	779	1 307	1 916	2 555
Asset management and similar fees	4 323	8 498	4 158	8 005
Currency exchange fees conversion revenues	349	843	354	662
Fees from cards and payments	2 906	5 418	2 157	3 948
Other fee and commission income	772	1 524	564	1 121
<b>Total</b>	<b>9 126</b>	<b>17 590</b>	<b>9 149</b>	<b>16 291</b>
<b>Fee and commission expense</b>				
Security brokerage and commissions paid	-123	-244	-136	-275
Expenses related to cards	-935	-1 709	-650	-1 212
Expenses related to acquiring	-952	-1 769	-719	-1 255
Other fee and commission expense	-504	-1 031	-429	-744
<b>Total</b>	<b>-2 514</b>	<b>-4 753</b>	<b>-1 934</b>	<b>-3 486</b>
<b>Net fee and commission income</b>	<b>6 612</b>	<b>12 837</b>	<b>7 215</b>	<b>12 805</b>
<b>Fee and commission income by customer location:</b>				
Estonia	9 109	17 542	9 102	16 199
Luxembourg	17	48	47	92
<b>Total</b>	<b>9 126</b>	<b>17 590</b>	<b>9 149</b>	<b>16 291</b>

## NOTE 11 Operating Expenses

	Q2 2019	6M 2019	Q2 2018	6M 2018
Wages, salaries and bonuses	3 811	7 340	3 056	5 962
Social security and other taxes*	1 071	2 095	882	1 722
<b>Total personnel expenses</b>	<b>4 882</b>	<b>9 435</b>	<b>3 938</b>	<b>7 684</b>
IT expenses	653	1 297	507	1 007
Information services and bank services	198	418	165	311
Marketing expenses	468	1 176	385	902
Office expenses	158	301	140	288
Transportation and communication expenses	64	117	53	105
Staff training and business trip expenses	263	385	124	313
Other outsourced services	821	1 580	811	1 576
Other administrative expenses	805	1 463	565	1 137
Depreciation of non-current assets	964	1 989	737	1 422
Operational lease payments	67	153	293	577
Other operating expenses	58	193	56	118
<b>Total other operating expenses</b>	<b>4 519</b>	<b>9 072</b>	<b>3 836</b>	<b>7 756</b>
<b>Total operating expenses</b>	<b>9 401</b>	<b>18 507</b>	<b>7 774</b>	<b>15 440</b>

\*lump-sum payment of social, health and other insurances

## NOTE 12 Discontinued operations

	Q2 2019	6M 2019	Q2 2018	6M 2018
Other financial income	0	0	2 949	2 949
Net interest income	0	0	424	1 619
Net fee and commission income	0	0	314	956
Personnel expenses	0	0	-140	-535
Operating expenses	0	0	-313	-1 131
Impairment losses on loans	0	0	-86	-390
Income tax expenses	0	0	-68	-144
<b>Net profit from discontinued operations</b>	<b>0</b>	<b>0</b>	<b>3 080</b>	<b>3 324</b>

## NOTE 13 Balances with the Central Bank, Credit Institutions and Investment Companies

	30.06.2019	31.12.2018
Demand and term deposits with maturity less than 3 months*	31 085	42 796
Statutory reserve capital with the central bank	19 865	14 280
Demand deposit from central bank*	1 048 059	625 582
<b>Total</b>	<b>1 099 009</b>	<b>682 658</b>

\*Cash and cash equivalents in the Statement of Cash Flows

1 079 144 668 378

The breakdown of receivables by countries has been presented in Note 4. Demand deposits include receivables from investment companies in the total amount of EUR 9 104 thousand (31 December 2018: EUR 17 005 thousand). All other demand and

term deposits are held with credit institutions and the central bank. The minimum reserve requirement as at 30 June 2019 was 1% (31 December 2018: 1%) of all financial resources (customer deposits and loans received). The reserve requirement is to be

fulfilled as a monthly average in euros or in the foreign financial assets approved by the central bank.

The material changes in the balances of term and demand deposits are described in more detail in management report.

## NOTE 14 Deposits of Customers and Loans Received

Deposits/loans by type	Financial				30.06.2019
	Individuals	intermediates	Legal entities	Public sector	
Demand deposits	474 715	235 057	955 432	6 800	1 672 004
Term deposits	287 996	0	120 423	2 235	410 654
Loans received	0	0	28 586	0	28 586
Accrued interest liability	583	0	150	1	734
<b>Total</b>	<b>763 294</b>	<b>235 057</b>	<b>1 104 591</b>	<b>9 036</b>	<b>2 111 978</b>

Deposits/loans by type	Financial				31.12.2018
	Individuals	intermediates	Legal entities	Public sector	
Demand deposits	374 491	193 893	727 803	7 935	1 304 122
Term deposits	57 605	0	54 456	5 734	117 795
Loans received	0	0	21 528	0	21 528
Accrued interest liability	197	0	131	9	337
<b>Total</b>	<b>432 293</b>	<b>193 893</b>	<b>803 918</b>	<b>13 678</b>	<b>1 443 782</b>

LHV Pank signed an unsecured 10-year loan agreement with the European Investment Fund (EIF) in the amount of EUR 12.5 million to increase the borrowing possibilities of small and medium-sized enterprises. As at 30.06.2019, the Bank had utilized 12 250 thousand euros of the loan amount and repaid the principal in the amount of EUR 1 442 thousand euros. From

Nordic Investment Bank possible 20 000 thousand euro loan the Bank had utilized 20 000 thousand euros as of 30.06.2019 and repaid the principal in the amount of EUR 2 222 thousand euros. The nominal interest rate of the deposits of customers and loans granted equals to their effective interest rate, as no other significant fees have been implemented.

## NOTE 15 Accounts payable and other liabilities

Financial liabilities	30.06.2019	31.12.2018
Trade payables and payables to merchants	2 334	2 153
Other short-term financial liabilities	3 200	1 925
Lease liabilities	3 553	0
Accrued interest on subordinated loans	423	314
Payments in transit	10 034	16 800
Financial guarantee contracts issued	291	236
<b>Subtotal</b>	<b>19 835</b>	<b>21 428</b>
Performance guarantee contracts issued	263	243
Tax liabilities	1 066	1 218
Payables to employees	1 859	1 488
Other short-term liabilities	165	276
<b>Subtotal</b>	<b>3 353</b>	<b>3 216</b>
<b>Total</b>	<b>23 188</b>	<b>24 644</b>

Payables to employees consist of unpaid salaries; bonus accruals and vacation pay accrual for the reporting period and the increase in liabilities is caused by the increase in the number of employees during the year. Payments in transit consist of foreign payments

and payables to customers related to intermediation of securities transactions. All liabilities, except for financial guarantees, are payable within 12 months and are therefore recognised as current liabilities.

## NOTE 16 Contingent Liabilities

<b>Irrevocable transactions</b>	<b>Performance guarantees</b>	<b>Financial guarantees</b>	<b>Letter of credit</b>	<b>Unused loan commitments</b>	<b>Total</b>
Liability in the contractual amount as at 30 June 2019	14 606	9 888	4	198 715	<b>223 213</b>
Liability in the contractual amount as at 31 December 2018	11 927	9 314	55	188 841	<b>210 137</b>

## NOTE 17 Basic Earnings and Diluted Earnings Per Share

In order to calculate basic earnings per share, net profit attributable to owners of the parent has been divided by the weighted average number of shares issued. The dilution effect when calculating the Diluted earnings per share comes from the share options granted to management and key employees.

	<b>Q2 2019</b>	<b>6M 2019</b>	<b>Q2 2018</b>	<b>6M 2018</b>
Total profit (incl. discontinued operations) attributable to owners of the parent (EUR thousand)	7 097	11 788	9 525	13 474
Total profit attributable to owners of the parent from continuing operations (EUR thousand)	7 097	11 788	6 445	10 150
Weighted average number of shares (in thousands of units)	26 016	26 016	25 767	25 767
Basic earnings per share (EUR)	0.27	0.45	0.37	0.52
Basic earnings per share from continuing operations (EUR)	0.27	0.45	0.25	0.39
Basic earnings per share from discontinued operations (EUR)	0.00	0.00	0.12	0.13
Weighted average number of shares used for calculating the diluted earnings per shares (in thousands of units)	26 609	26 609	26 274	26 238
Diluted earnings per share (EUR)	0.27	0.45	0.36	0.51
Diluted earnings per share (EUR) from continuing operations	0.27	0.45	0.25	0.39
Diluted earnings per share (EUR) from discontinued operations	0.00	0.00	0.11	0.12

## NOTE 18 Capital Management

The goal of the Group's capital management is to:

- ✓ ensure continuity of the Group's business and ability to generate return for its shareholders;
- ✓ maintain a strong capital base supporting the development of business;
- ✓ comply with capital requirements as established by supervision authorities.

The amount of capital that the Group managed as of 30.06.2019 was 204 065 thousand euros (31.12.2018: 183 250 thousand euros). The goals of the Group's capital management are set based on both the regulative requirements and additional internal buffer.

The Group follows the general principles in its capital management:

- The Group must be adequately capitalized at all times, ensuring the necessary capital to ensure economic preservation and enables financing of new profitable growth opportunities;
- The main focus of the capital management is on tier 1 own funds, because only tier 1 own funds can absorb losses. All other capital layers in use are dependent of tier 1 own funds volume;
- Capital of the Group can be divided in two: 1) regulative minimum capital and 2) capital buffer held by the Group. In order to reach its long-term economic goals the Group must on one hand strive towards proportional lowering of the regulative minimum capital (through minimizing risks and high transparency). On the other hand, the Group must strive towards sufficient and conservative capital reserve, which will ensure economic preservation even in the event of severe negative risk scenario;
- The risk appetite set by the Group is an important input to capital management planning and capital goal setting. Higher risk appetite requires maintaining higher capital buffer.

<b>Capital base</b>	<b>30.06.2019</b>	<b>31.12.2018</b>
Paid-in share capital	26 016	26 016
Share premium	46 653	46 653
Reserves	4 713	3 451
Other reserves	78	78
Accumulated loss	68 705	50 193
Intangible assets (subtracted)	-19 030	-19 084
Profit for the reporting period	2 618	25 237
Other adjustments	-688	-194
<b>Total Core Tier 1 capital</b>	<b>129 065</b>	<b>132 350</b>
Additional Tier 1 capital	20 000	0
<b>Total Tier 1 capital</b>	<b>149 065</b>	<b>0</b>
Subordinated liabilities	55 000	50 900
<b>Total Tier 2 capital</b>	<b>55 000</b>	<b>50 900</b>
<b>Total net own funds</b>	<b>204 065</b>	<b>183 250</b>

The Group has complied with all capital requirements during the financial year and in previous year.

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## NOTE 19 Transactions with related parties

In preparing the financial statements of the Group, the following entities have been considered related parties:

- owners that have significant impact on the Group and the entities related to them;
- members of the management board and legal entities controlled by them (together referred to as management);
- members of the supervisory board;
- close relatives of the persons mentioned above and the entities related to them.

Transactions	Q2 2019	6M 2019	Q2 2018	6M 2018
<b>Interest income</b>	<b>17</b>	<b>34</b>	<b>16</b>	<b>30</b>
incl. management	9	18	8	16
incl. shareholders that have significant influence	8	16	8	14
<b>Fee and commission income</b>	<b>10</b>	<b>10</b>	<b>2</b>	<b>4</b>
Incl. management	0	0	0	0
incl. shareholders that have significant influence	10	10	2	4
<b>Interest expenses from deposits</b>	<b>20</b>	<b>20</b>	<b>10</b>	<b>18</b>
incl. management	0	0	2	2
incl. shareholders that have significant influence	20	20	8	16
<b>Interest expenses from subordinated loans</b>	<b>104</b>	<b>193</b>	<b>88</b>	<b>176</b>
incl. management	2	4	2	4
incl. shareholders that have significant influence	102	189	86	172

Balances	30.06.2019	31.12.2018
<b>Loans and receivables as at the year-end</b>	<b>3 283</b>	<b>3 328</b>
incl. management	2 457	2 079
incl. shareholders that have significant influence	826	1 250
<b>Deposits as at the year-end</b>	<b>13 473</b>	<b>33 509</b>
incl. management	480	222
incl. shareholders that have significant influence	12 993	33 287
<b>Subordinated loans as at the year-end</b>	<b>8 741</b>	<b>5 904</b>
incl. management	168	135
incl. shareholders that have significant influence	8 573	5 769

The table provides an overview of the material balances and transactions involving related parties. All other transactions involving the close relatives and the entities related to members of the management board and supervisory board and the minority shareholders of the parent company AS LHV Group have occurred according to the overall price list. The management and shareholders with significant influence include also their related entities and persons.

Loans granted to related parties are issued at market conditions.

In Q2, salaries and other compensations paid to the management of the parent AS LHV Group and its subsidiaries totalled EUR 386 thousand (Q2 2018: EUR 342 thousand), including all taxes. As at 30.06.2019, remuneration for June and accrued holiday pay in the amount of EUR 95 thousand (31.12.2018: EUR 91 thousand) is reported as a payable to management. The Group did not have

any long-term payables or commitments to the members of the Management Board and the Supervisory Board as at 30.06.2019 and 31.12.2018 (pension liabilities, termination benefits, etc.). In Q2 2019, the remuneration paid to the members of the Group's Supervisory Board totalled EUR 27 thousand (Q2 2018: EUR 7 thousand).

Management is related to the share-based compensation plan. In Q2 2019 the share-based compensation to management amounted to EUR 185 thousand (Q2 2018: EUR 136 thousand). The Group has signed contracts with the members of the Management Board, which do not provide for severance benefits upon termination of the contract. In any matters not regulated by the contract, the parties adhere to the procedure specified in the legislation of the Republic of Estonia.

## NOTE 20 Tangible and intangible assets

<i>(in thousands of euros)</i>	Tangible assets	Right of use assets	Total tangible assets	Intangible assets	Costs incurred for the acquisition of customer contracts	Total intangible assets
<b>Balance as at 31.12.2017</b>						
Cost	4 078	0	4 078	8 058	10 618	18 676
Accumulated depreciation and amortisation	-2 657	0	-2657	-3 731	0	-3 731
<b>Carrying amount 31.12.2017</b>	<b>1 421</b>	<b>0</b>	<b>1 421</b>	<b>4 327</b>	<b>10 618</b>	<b>14 945</b>
Purchase of non-current assets	396	0	396	1 236	0	1 236
Capitalized selling costs	0	0	0	0	1 818	1 818
Write-off of non-current assets	-5	0	-5	0	0	0
Depreciation/amortisation charge	-510	0	-510	-1 031	-1 431	-2 462
Assets of discontinued operations	340	0	340	371	0	371
Amortisation of discontinued operations	-168	0	-168	-304	0	-304
<b>Balance as at 31.12.2018</b>						
Cost	4 129	0	4 129	15 324	12 436	27 760
Accumulated depreciation and amortisation	-2 994	0	-2 994	-10 859	-1 431	12 290
<b>Carrying amount 31.12.2018</b>	<b>1 135</b>	<b>0</b>	<b>1 135</b>	<b>4 465</b>	<b>11 005</b>	<b>15 470</b>
Changes in accounting policies	0	4 042	4 042	0	0	4 042
Purchase of non-current assets	651	0	651	447	795	1 242
Depreciation/amortisation charge	-264	-429	-693	-569	-727	-1 296
<b>Balance as at 30.06.2019</b>						
Cost	4 781	4 042	8 823	15 771	13 231	29 002
Accumulated depreciation and amortisation	-3 259	-429	-3 688	-11 428	-2 158	-13 586
<b>Carrying amount 30.06.2019</b>	<b>1 522</b>	<b>3 613</b>	<b>5 135</b>	<b>4 343</b>	<b>11 073</b>	<b>15 416</b>

## NOTE 21 Subordinated debts

Subordinated debts (in thousands of euros)

	Year of issue	Amount	Interest rate	Maturity date
	2015	15 000	6.5%	October 29, 2025
	2018	20 000	6.0%	November 28, 2028
	2019	20 000	6.0%	November 28, 2028
	2019	20 000	8.0%	Perpetual
Subordinated debt as at 30.06.2018		30 900		
Subordinated debt as at 31.12.2018		50 900		
Subordinated debt as at 30.06.2019		75 000		

During the reporting period subordinated loans in the amount of EUR 40 000 thousand were received and subordinated loans in the amount of EUR 15 900 thousand (maturity date June 20, 2024) were redeemed.

## NOTE 22 Loans and advances to customers

<i>(in thousands of euros)</i>	<b>30.06.2019</b>	<b>31.12.2018</b>
<b>Loans to legal entities</b>	<b>855 833</b>	<b>714 335</b>
incl. corporate loans	717 110	624 425
incl. retail loans	21 606	16 200
incl. leasing	53 948	44 277
incl. overdraft	54 749	23 846
incl. leveraged loans	2 974	1 997
incl. hire-purchase	292	249
incl. credit card loans	354	274
incl. credit letters	4 800	3 067
<b>Loans to individuals</b>	<b>273 827</b>	<b>214 702</b>
incl. hire-purchase	15 743	17 501
incl. mortgage loans	149 084	101 009
incl. consumer loans	41 601	33 989
incl. private loans	39 472	37 884
incl. leasing	18 655	15 888
incl. leveraged loans	2 365	1 733
incl. credit card loans	6 725	6 579
incl. overdraft	28	43
incl. study loan	154	76
<b>Total</b>	<b>1 129 660</b>	<b>929 037</b>
Impairment provisions	-11 756	-10 276
<b>Total</b>	<b>1 117 904</b>	<b>918 761</b>

Changes in impairments in 6M 2019	Corporate loans		Retail loans	Consumer loans	Credit cards	Hire-purchase		Leveraged loans	Other loans incl. mortgage		Credit letters	Total
	incl. overdraft						Leasing					
Balance as at 1 January	-8 751	-184	-568	-27	-140	-467	-3	-36	-100	-10 276		
Impairment provisions/reversals set up during the year	-1 146	-42	-115	-28	21	-129	-2	-19	-20	-1 480		
Written off during the reporting period	0	0	0	0	0	0	0	0	0	0		
<b>Balance as at June 30 2019</b>	<b>-9 765</b>	<b>-357</b>	<b>-683</b>	<b>-56</b>	<b>-119</b>	<b>-596</b>	<b>-5</b>	<b>-54</b>	<b>-120</b>	<b>-11 756</b>		

The impairment losses on loans and advances have decreased in 6m 2019 compared to 6m 2018 mainly due to the significant decrease of individual provisions for corporate loan portfolio. ECL on comparative basis has increased due to the fact that we have had significant growth of loan portfolios. There have not been major changes in ECL stagings of the loans as at 30 June 2019 compared to 31 December 2018. The overall credit quality of loan portfolios have not changed significantly.

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 PricewaterhouseCoopers, Tallinn

## Shareholders of AS LHV Group

AS LHV Group has a total of 26 016 485 ordinary shares, with a nominal value of 1 euro.

**As at 30 June 2019, AS LHV Group has 6 045 shareholders:**

- 13 104 340 shares (50.37%) were held by members of the Supervisory Board and Management Board, and related parties.
- 12 912 145 shares (49.63%) were held by Estonian entrepreneurs and investors, and related parties.

**Top ten shareholders as at 30 June 2019:**

Number of	Participation	Name of shareholder
3 357 920	12.9%	AS Lõhmus Holdings
2 538 367	9.8%	Rain Lõhmus
2 111 344	8.1%	Viisemann Investments AG
1 595 620	6.1%	Ambient Sound Investments OÜ
1 210 215	4.7%	OÜ Krenno
999 456	3.8%	AS Genteel
951 978	3.7%	AS Amalfi
722 297	2.8%	OÜ Kristobal
636 260	2.5%	SIA Krugmans
589 177	2.3%	OÜ Bonaares

### Shares held by members of the Management Board and Supervisory Board

Madis Toomsalu holds 24 397 shares.

Rain Lõhmus holds 2 538 367 shares, AS Lõhmus Holdings 3 357 920 shares and OÜ Merona Systems 581 718 shares.

Andres Viisemann holds 4 909 shares. Viisemann Holdings OÜ holds 433 055 shares and Viisemann Investment AG holds 2 111 344 shares.

Tauno Tats does not hold shares. Ambient Sound Investments OÜ holds 1 595 620 shares.

Tiina Mõis does not hold shares. AS Genteel holds 999 456 shares.

Heldur Meerits does not hold shares. AS Amalfi holds 951 978 shares.

Raivo Hein does not hold shares. OÜ Kakssada Kakskümmend Volti holds 490 190 shares, Astrum OÜ holds 250 shares and Lame Maakera OÜ holds 3 670 shares.

Sten Tamkivi holds 355 shares. OÜ Seikatsu holds 10 825 shares.

## Supervisory Boards and Management Boards of AS LHV Group and its Subsidiaries

### AS LHV Group

Supervisory board: Raivo Hein, Rain Lõhmus, Heldur Meerits, Tiina Mõis, Tauno Tats, Andres Viisemann, Sten Tamkivi

Management board: Madis Toomsalu

### AS LHV Varahaldus

Supervisory board: Erki Kilu, Madis Toomsalu, Andres Viisemann

Management board: Vahur Vallistu (since 6 June 2019), Joel Kukemelk, Mihkel Oja (until 19 June 2019)

### AS LHV Pank

Supervisory board: Raivo Hein, Rain Lõhmus, Heldur Meerits, Tiina Mõis, Madis Toomsalu, Andres Viisemann

Management board: Jüri Heero, Erki Kilu, Andres Kitter, Meelis Paakspuu, Indrek Nuume, Martti Singi, Kadri Kiisel

### AS LHV Finance

Supervisory board: Erki Kilu, Rain Lõhmus, Veiko Poolgas, Jaan Koppel

Management board: Kadri Kiisel

### OÜ Cuber Tehnology

Management board: Jüri Laur

## Signatures of the Management Board to the Condensed Consolidated Interim Report

The Management Board has prepared the summary of results for January to June 2019 period the condensed consolidated interim financial statements of AS LHV Group for the 6-month period ended 30 June 2019.

The management board confirms that according to their best knowledge the interim report presents a fair view of LHV Group AS's assets, liabilities, financial position and profit or loss of the issuer and the entities involved in the consolidation as a whole and contains a description of the main risks and doubts. The Condensed Consolidated Interim Financial Statements have been prepared according to the principles of the International Accounting Standard IAS 34 "Interim Financial Reporting".

5.09.2019



**Madis Toomsalu**



## **INDEPENDENT AUDITOR'S REPORT ON REVIEW OF CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

To the Shareholders of AS LHV Group

### **Introduction**

We have reviewed the accompanying condensed consolidated interim statement of financial position of AS LHV Group and its subsidiaries (together – the “Group”) as at 30 June 2019 and the related condensed consolidated interim statements of profit or loss and other comprehensive income and cash flows for the three-month and six-month periods then ended, and condensed consolidated interim statement of changes in equity for the six-month period then ended, and the related explanatory notes. Management Board is responsible for the preparation and presentation of these condensed consolidated interim financial statements in accordance with International Accounting Standard 34, 'Interim Financial Reporting', as adopted by the European Union. Our responsibility is to express a conclusion on these condensed consolidated interim financial statements based on our review.

### **Scope of review**

We conducted our review in accordance with International Standard on Review Engagements (ISRE) (Estonia) 2410, 'Review of Interim Financial Information Performed by the Independent Auditor of the Entity'. A review of condensed consolidated interim financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial statements are not prepared, in all material respects, in accordance with International Accounting Standard 34, 'Interim Financial Reporting' as adopted by the European Union.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Ago Vilu', written over a light blue horizontal line.

Ago Vilu  
Auditor's certificate no.325

A handwritten signature in blue ink, appearing to read 'Verner Uibo', written over a light blue horizontal line.

Verner Uibo  
Auditor's certificate no.568

5 September 2019

AS LHV Group  
Consolidated Annual Report 2018

(Translation of the Estonian original)

**Consolidated Annual Report 01.01.2018 – 31.12.2018**

Legal name	<b>AS LHV Group</b>
Commercial Registry no.	<b>11098261</b>
Legal address	<b>Tartu mnt 2, 10145 Tallinn</b>
Phone	<b>(372) 6800400</b>
Fax	<b>(372) 6800410</b>
E-mail	<b>lhv@lhv.ee</b>
Main activities	<b>Activities of holding companies</b> <b>Banking</b> <b>Security brokerage</b> <b>Financial advisory</b> <b>Finance lease and other lending</b>
Management Board	<b>Madis Toomsalu</b>
Supervisory Board	<b>Rain Lõhmus</b> <b>Andres Viisemann</b> <b>Tiina Mõis</b> <b>Heldur Meerits</b> <b>Raivo Hein</b> <b>Tauno Tats</b> <b>Sten Tamkivi</b>
Shares	<b>Listed on the Nasdaq Tallinn Stock Exchange</b>
Auditor	<b>AS PricewaterhouseCoopers</b>

## Table of contents

<b>Statement of the Managing Director</b>	<b>4</b>
Business environment	7
<b>Management report</b>	<b>10</b>
Governance of the Group	15
Financial results	19
Corporate Governance report	29
Social responsibility in LHV	38
<b>CONSOLIDATED FINANCIAL STATEMENTS</b>	<b>49</b>
Consolidated statement of profit or loss and other comprehensive income	49
Consolidated statement of financial position	50
Consolidated statement of cash flows	51
Consolidated statement of changes in equity	52
Notes to the consolidated financial statements	53
NOTE 1 General information	53
NOTE 2 Summary of significant accounting policies	54
NOTE 3 Risk management	74
NOTE 4 Significant management estimates and assumptions	124
NOTE 5 Business segments	124
NOTE 6 Subsidiaries and goodwill	126
NOTE 7 Net interest income	128
NOTE 8 Net fee and commission income	129
NOTE 9 Operating expenses	130
NOTE 10 Due from central bank, credit institutions and investment companies	130
NOTE 11a Available-for-sale financial assets	131
NOTE 11b Equity and debt instruments at fair value through other comprehensive income	131
NOTE 12 Financial assets and liabilities at fair value through profit or loss	132
NOTE 13 Loans and advances to customers	133
NOTE 14 Receivables from customers	134
NOTE 15 Other assets	134
NOTE 16 Tangible and intangible assets	135
NOTE 17 Deposits from customers and loans received	136
NOTE 18 Accounts payable and other liabilities	136
NOTE 19 Operating lease	137
NOTE 20 Subordinated debts	137
NOTE 21 Shareholders' equity in the public limited company	138
NOTE 22 Assets under management	140
NOTE 23 Contingent assets and liabilities	140
NOTE 24 Transactions with related parties	141
NOTE 25 Basic earnings and diluted earnings per share	143
NOTE 26 Discontinued operations	143
NOTE 27 Separate financial statements of parent company	144
<b>Signatures of the management board to the consolidated annual report</b>	<b>147</b>
<b>Independent Auditor's Report</b>	<b>148</b>
<b>Proposal for profit distribution</b>	<b>155</b>
<b>Signatures of the supervisory board to the annual report</b>	<b>156</b>
<b>Allocation of income according to EMTA classificators</b>	<b>157</b>

# Statement of Managing Director

Dear LHV investor,

LHV has had a strong, industrious year. A year characterised by good results, a strong growth in customer base, various new products and recognitions. At the beginning of July, LHV was declared the best Estonian bank by the international Euromoney magazine. This was a follow-up to the title of the best private banking service provider, awarded to LHV by Euromoney at the beginning of the year.

The recognition, as well as the achievements described below, must be attributed to the 380 staff members of LHV. Our employees are making a daily effort to further enhance the position of LHV as an Estonian capital-based company in the local financial services market, while also contributing to LHV's success as an exporter of financial services. We take pride in our supportive working environment, as evidenced by the highest ever results of the end-of-year employee satisfaction survey.

LHV posted record-breaking results in all business areas in 2018. LHV Bank's customer numbers grew by 28 thousand, and the volume of loans by EUR 199 million to EUR 919 million. Even though the total volume of deposits of LHV Bank decreased by EUR 99 million, the volume of standard customer deposits grew by EUR 314 million, if we do not include the planned reduction in the volume of deposits of financial intermediaries. Pension funds grew by EUR 115 million, amounting to EUR 1,204 million as at the end of the year. We also achieved record levels of customer activity in payments, card transactions and conclusion of new investment agreements.

LHV's net profit amounted to EUR 27.2 million in 2018. This constitutes a EUR 5.0 million increase from last year, generating a 19.3% return on equity before taxes and an 19.0% return on equity on net profit basis for the shareholders of LHV. We exceeded our financial forecasts by EUR 1.1 million. Profit was supported by customer activity and revenue from capital market transaction consulting. Business volumes and profits increased in all core business areas.

Corporate banking witnessed a one-third growth in business loans. Our loan stock has shown the swiftest growth on the market. We are able to make progressively better offers for large loan amounts. The economic environment has remained favourable, but we continue monitoring domestic and external economic developments affecting Estonian enterprises. More than in previous periods, corporate banking results were affected by write-downs associated with a single customer. Nonetheless, this is no

characterisation of the surrounding business environment and cannot be deemed an indication of our loan portfolio, which continues to stand strong.

To enhance corporate banking offers, we started to contribute trade-financing products at the beginning of the year. Above all, mention must be made of factoring. Our pursuit of growth in business volumes requires a credit rating. At the end of the year, Moody's gave LHV Bank a credit rating of Baa1. A credit rating will ensure the acceptability of the guarantees provided by LHV Bank to guarantee beneficiaries beyond Estonian borders. We also concluded a EUR 20 million agreement with the Nordic Investment Bank, aiming to improve the credit capacity of small and medium-sized enterprises.

In retail banking, we focused on housing loans, enhancement of investment services and development of customer-oriented services. As a major innovation, we implemented the e-identification system, which allows customers to open a bank account via internet bank, without leaving the comfort of their home. We also expanded LHV's ATM network, which now includes 21 ATMs all over Estonia. We will continue installing new ATMs in 2019.

In our housing loan offers, we focused on big-city customers who value a smooth, swift and collaborative service. The housing loan portfolio grew by EUR 61 million, amounting to EUR 139 million as at the end of the year. We offer housing loans at a price, which serves to secure the return on equity promised to the shareholders.

At the end of August, we launched the Youth Bank offer, providing a specially designed youth card, student loan and micro-investment service. Our micro-investment service targets all those, who wish to start investing without any previous knowledge in the field, favourably, with low-level regular contributions and a near-zero time cost. We contributed to the launch of mTasku (a new payment platform developed by Telia) and launched the health and home repair loan.

In the business area of financial institutions, we focused on searching new customers and expanding the product portfolio. There is great interest in flexible banking services among financial institutions, with new customers constantly joining up. Nonetheless, the process of becoming a customer takes time - on the one hand, financial institutions must often complete a time-consuming licence application procedure; on the other hand, we pay special attention to AML and KYC principles. Our business in United Kingdom is profitable, with revenue generated from

payments, currency exchange, card payment mediation, credit services and maintenance fees.

The total volume of investment funds managed by LHV Asset Management exceeded EUR 1.2 billion in 2018. A bulk of the fund volume is composed of actively managed pension funds, where LHV's investment strategy clearly differs from that of competing pension funds.

2018 was a difficult year for investors, with only a few markets generating a positive yield. European shares lost 10.6% and developing markets 10.3% of their value. LHV has previously decided to direct pension investments in alternative asset categories and the local market. This choice can be attributed to the elongated rise in international securities markets, which LHV Asset Management deems too expensive to invest in. The chosen strategy helped LHV to maintain the assets of the actively managed funds in 2018, with the corresponding yield falling between -0.1% and 1.1%. These yields are among the highest in actively managed funds on the market.

The amendment of the Investment Funds Act in December 2018 will have a significant effect on the fee structure of pension funds. Fixed fees will be significantly lowered, while providing the option of earning a performance bonus. At the same time, investment restrictions will be significantly eased, allowing funds access to a wider range of investment strategies. A majority of the amendments will enter into force in September 2019.

Other highlights of the year included the first publication of LHV's five-year financial forecast in February 2018, alongside the annual financial plan. The financial plan was corrected in May, with profit targets raised. We succeeded in achieving our objectives, and exceeded the planned profit by EUR 1.1 million.

In May, we disposed the Lithuanian consumer credit company UAB Mokilizingas. The value of the shares held by LHV amounted to EUR 7.5 million, with a total of approximately EUR 3 million earned in profit from the transaction.

The issue of LHV Group's subordinated bonds was carried out at the end of the year. There was great interest in the bonds, with the issue volume thus raised to EUR 20 million. The subscription volume was the highest ever among our capital engagements. A total of 1,700 investors subscribed to LHV's bonds in the total amount of more than EUR 51 million. The bonds formed a part of our EUR 45 million bond programme aimed at securing LHV's growth targets.

## Business environment

Our greatest concern with respect to the long-term economic outlook lies in the difference in the dynamics of different European regions, as well as over-regulation, which adds to stagnation. There is no reward without risk – it is the core principle of market economy. The ever-increasing tendency to avoid risk and produce red tape is bound to hamper potential development and curb revenues. Our concerns are further fuelled by the fact that Europe is falling behind, compared to United States and China.

In the short-term perspective, however, the base scenario still revolves around an annual economic growth of a few percentages in the euro area. LHV's trends of growth are also supported by the Estonian economic environment. The Estonian economy has shown good growth, with domestic risks mitigated by the balanced state budget, low public sector debt and positive external balance.

We are waiting for the economy to slowly gain momentum. Nonetheless, it is becoming increasingly difficult to make any forecasts with regard to the surrounding economies. The trench tactics used in the trade wars, the ever-increasing volatility in the stock markets and the rise in the risk premiums of the sovereign bonds of developing markets are a cause for concern. The greatest problem with Europe lies in its failure to raise interest rates before the potential economic cooling, and to carry out the reforms required for improving the long-term outlook of weaker markets. With the Estonian economy being wide open to changes in the external environment, these trends will have a direct impact. Domestic risks include the tensions brewing on the labour market, albeit these can be alleviated by economic cooling, as well as the unstable tax environment and growing risks in the construction and trade sector.

The money laundering scandals involving some of the market participants have cast shadow on the financial sector in 2018. The isolation of the incident and its limitation to only a few market players is evident in the Basel Institute's money laundering risk table, where Estonia ranks second. Nonetheless, Estonia has suffered reputation damage. This is bound to complicate access to financing for the financial sector, scale down the interest of correspondent banks and affect potential credit ratings.

Against such backdrop, the credit market, nonetheless, stands strong. All major credit products, including corporate loans and housing loans, are increasing. The financial health of households remains strong, with the loan-to-deposit ratio improving. The share of overdue loans has dropped below 1%, largely covered by write-downs.

## Strategy and the future

LHV has built its strategy around Estonia as the domestic market, where LHV will focus on providing the best banking services and the best yield for pension funds. We wish to reach out to a growing number of customers, who value the importance of Estonian capital in the provision of local financial services. We will conduct our business in a manner, which ensures that the ever-increasing efficiency would be manifested in a lower cost-income ratio and that the shareholder would be provided with a 20% return on equity before taxes. Alongside Estonia, we will also search for new business opportunities on foreign markets, and have become an exporter of financial services. We have had a strong start in United Kingdom, where our business is now profitable.

As regards private customers, we will focus on expanding the customer base and enhancing customer activity. Our focus lies on major Estonian cities, targeting active customers who prioritise electronic channels. We make an effort to attract young people as customers of LHV. We are laying greater emphasis on customer activity. We wish to engage customers who have opened a current account in LHV, whose salary is transferred to the LHV account and who uses the LHV bank card for his or her daily financial affairs. In the area of payments, we will start offering instant payments in euros. In the area of credit products, we will focus on swift decision-making. In the area of investment products, we are making an effort to enhance the visibility of our products and will only issue housing loans on conditions securing an excellent cost-income ratio and the desired return on equity for the shareholders.

As regards corporate customers, we will focus on boosting the loan portfolio and the share of trade financing. We will focus on customers in search of a bank that understands the nature of their business and is able to provide the required financing structure. We will continue the single-level decision-making process, where all decisions are made locally, swiftly and in a flexible manner.

In the area of financial institutions, we will continue to add to the product portfolio. We will join the real-time GBP payment system, making LHV one of the first banks in the world to provide both EUR and GBP payments in real time. We will continue providing account services, payments, card payment acceptance, loans and currency exchange services. We will expand our customer base by continuing to offer tailor-made solutions. Even though our office is located in London, the business of financial institutions often has a cross-border nature. We will therefore also seek out customers in other European capitals.

As regards pension funds, our priority is to generate the best yield for the pension fund customer. We are currently in the process of changing our investment strategy, focusing more on over-the-counter private investments.

On a more practical scale, we have established our goals for the next few years as follows. We endeavour:

- to serve as the best financial service provider to private customers and SMEs who wish to save and invest financial assets;
- to be the most collaborative financial service provider for international financial institutions;
- to serve as an attractive and recognised employer, offering progress, self-fulfilment and growth;
- to do business in such a way as to ensure a 20% return on equity;
- to become Estonia's most valuable publicly traded company.

LHV has more than 5,600 shareholders as at the end of the year, with more than 4,800 keeping their LHV shares in LHV Bank. All shareholders have the possibility to contribute to the rise in LHV's value by actively using LHV's services. It would be an honour, if also the remaining 800 shareholders kept their shares in LHV Bank.

Madis Toomsalu

# Business environment

According to the forecast published by the Organisation for Economic Co-operation and Development in November 2018, global economic growth will decelerate to 3.5% in 2019 and 2020. The upturn of trading, which has so far supported the recovery, has stopped and the global purchasing managers' index (PMI), which recognises the evaluation of the operating environment of the companies, is decreasing. The plunge of the oil price which began towards the end of 2018, is negatively affecting countries dependant on the export of the commodity, providing relief for the importers affected by the appreciation of the US dollar. The situation continues to improve on the labour market and the pace of wage growth is finally rising. Economic growth is less balanced compared to recent years – there are clearly major economies distinguishing, where the upward cycle has already peaked.

The values of increased assets illustrate the current expansive monetary policy, in which the investors have accepted an increasingly lower expected long-term rate of return. The central banks of developed countries led by the US are changing course, as a result of which there are new signs of a turning liquidity offer. The volatility of stock markets has significantly increased, as well as the differences in the interest rates of bonds with varying degrees of risk. The currencies of developing countries are under pressure. Risks with a negative impact on the global economy, led by a protectionist economic policy, have increased. Altogether, we may expect a slowdown of economic growth in the developed countries during the next year close to the long-term sustainable level, which is clearly lower compared to the decade preceding the financial crisis.

Eurozone economic growth decelerated in the second quarter to 2.1%. The economic growth based on domestic demand was broad-based, however we can still spot some weakness in export over recent quarters. The growth of industrial production has entangled compared to the beginning of the year, the problems in the automotive industry have had a negative impact. A decline of sentiment may be noticed in indicators that reflect the confidence of various sectors. The big picture of the economy is still good and the growth positive regarding all countries. The economies of Finland and Sweden, the countries that are independently the biggest export targets for Estonia, grew 2.4% and 1.6% in the third quarter respectively. This year, the deceleration of Finnish economic growth is expected which is mainly due to the decrease of external demand. The growth rate of import will, on the contrary, remain basically at the same level as the previous year, which is still in favour of Est-

nian trade. The economic and import growth of Sweden is also decelerating but remains favourable to Estonia. Riksbank (the central bank of Sweden) has also taken a direction towards the increase of interest rates, which cools the economy but could have a positive effect on Estonian exporters through the appreciated Swedish krona.

The growth of the Eurozone's consumer prices has remained, for more than six months, at the level of 2.0% set by the European Central Bank, even though the core inflation is the lowest. According to the current plan, the exit from the current expansive monetary policy will be extremely slow – the bond purchasing programme was terminated in December 2018 and the interest rates shall not be increased before autumn of next year. According to the consensus expectations, the economic growth of the Eurozone shall drop to 1.9% in 2019. Since there are various headwinds blowing from export markets, the role of domestic demand and private consumption will become even more important. Consuming is supported positively by an increase in the labour force participation rate and the continuing decrease in the unemployment rate, which is also speeding up wage growth. At the same time, a looser budget policy is expected from the governments. Risks inside and outside the union have increased – the impact of the normalisation of monetary policy on stock and bond markets, the protective economic policy of the USA, the uncertainty accompanying the current Brexit process, increasing discontent and the populism in Italy and France. Next spring we will see the European Parliament elections, which will add even more tension.

Estonian economic growth accelerated in the third quarter of 2018 to 4.2%. The result was rather exceptional in the big picture since the indicators characterising the growth of economic activity weakened during the same period in Estonia and elsewhere. However, the economic picture was not as strong on a broad basis any more. Export growth decelerated significantly and the growth was led by domestic demand. As for the areas of activity, the growth was relatively uneven – almost half of the economic growth came from the construction and real estate sector. From the positive side, the investments showed signs of recovery, led by the investments of companies which is important for maintaining competitiveness. The inflationary pressure, which affects consumers negatively, is one of the highest of the Eurozone.

The bigger picture still remains good, which is also confirmed by the new outlook of the economic environment published by the Estonian Institute of Economic

Research in October 2018. Estonian experts assess the economic climate to be good and outlook stable. The Economic Sentiment Index has slightly declined, however it remains higher compared to the long-term average. The picture is also strong by sectors, with only the service sector having a more negative attitude compared to the long-term average. Lack of skilled labour, but also little innovation and decreasing international competitiveness are pointed out as the main factors obstructing business. Private consumption is strong, supported by high confidence and the improved financial situation of families.

According to the forecast published by the Bank of Estonia, the economic growth of Estonia will decelerate to 3.2% in 2019. Further rapid economic growth is hindered by the high conjuncture related supply-side restrictions (lack of available resources) but also the deceleration of external demand. The main growth engine is domestic demand, led by private consumption and investments. Private consumption is still supported by the strong growth of salary and employment. In addition, the inflation rate should marginally decrease, which is aided by the stabilisation of energy prices and the major impact of tax increases remaining in the earlier years. The positive contribution of investments is also restored, which was negatively influenced by a high comparison base last year. The volume of research and development activity is growing fast and capital investment into products related to the right of use of intellectual property is becoming increasingly important. From the risks, we could consider the most important to be developments in the external environment, which could be negatively influenced above all by declined demand caused by trade restrictions and the related insecurity when making investments and the impacts related to the tightening of monetary policy. Within Estonia, it is primarily necessary to deal with the improvement of competitiveness and favour the re-learning of employees and the movement to sectors offering higher added value. There are still a lot of industries with low production in Estonia which will most likely disappear with the continual increase of employment expenses in the next few years.

Over the next twelve months, LHV is expecting a continuation of positive trends in the Estonian economy. Economic growth will decelerate close to the long-term sustainable

potential level. The shortage in available resources will continue to increase the significance of the ability of businesses to adapt and be successful in raising productivity, which is why it is necessary to vigorously continue making additional investments. First and foremost, it is important to achieve long-term sustainable economic growth that is in balance between the various sectors.

In terms of economic sectors, the risks are above average and might overheat in the building sector, accommodation and catering sector, and transport and storage. LHV is still conservative with regard to the housing market, monitoring the local and Scandinavian market, with increased attention on developments in Sweden. Regarding rental cash flow projects, there is a risk that there will not be enough demand to absorb the volumes being developed in the near future, so that corrections will take place in rental prices or vacancy rates.

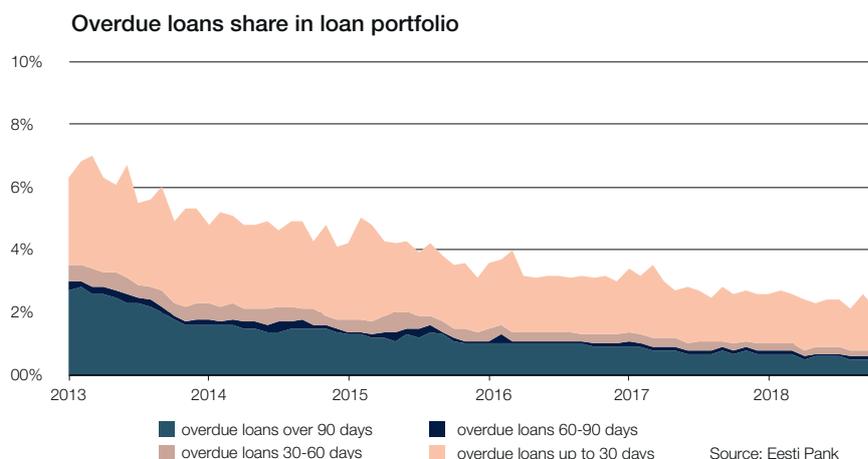
As a positive note, we could highlight the still favourable financing environment, which will be influenced most in the coming years by the tightening monetary policy of developed countries. The increase of the amount outstanding from credit institutions still remains rapid. The demand for loans of households is strong, led by housing loans and car leasing. For new housing loans, the average interest rate which has started to increase is standing out. Due to poor investment activity and relatively high own funds, the loans taken by corporates are more modest than that of households. The ratio of loans to deposits and the proportion of overdue loans in the loan portfolio are at the post-crisis low levels. Historically low interest rates and strong competition between banks offer possibilities to local enterprises and they should be taking advantage of them more. LHV wishes to make a big and effective contribution to the finding and supporting of new growth sources, offering entrepreneurs long-term co-operation and value-creating involved thinking.

## Key economic indicators of Estonia\*

						Eesti Pank forecast		
	2013	2014	2015	2016	2017	2018E	2019E	2020E
Nominal GDP (EUR billion)	18.89	19.76	20.25	21.10	23.62	25.62	27.38	28.89
GDP volume**	1.4%	2.8%	1.4%	2.1%	4.9%	3.6%	3.2%	2.3%
Private consumption expenditures***	3.8%	3.3%	4.7%	4.4%	2.6%	4.3%	3.9%	3.2%
Government consumption expenditures	1.9%	2.7%	3.4%	1.9%	0.6%	-0.5%	1.2%	0.3%
Fixed capital formation	-2.8%	-8.1%	-3.3%	-1.2%	12.5%	1.3%	5.3%	3.2%
Exports	2.3%	3.1%	-0.6%	4.1%	3.5%	1.5%	1.8%	3.5%
Imports	3.2%	2.2%	-1.4%	5.3%	3.6%	6.1%	3.9%	3.6%
CPI	2.8%	-0.1%	-0.5%	0.1%	3.4%	3.5%	2.6%	2.1%
Unemployment rate (% of the labour force)	8.6%	7.4%	6.2%	6.8%	5.8%	5.8%	6.7%	6.9%
Current account (% of GDP)	-0.4%	0.9%	2.2%	1.9%	3.3%	0.5%	-1.0%	-1.0%
Budget balance (% of GDP)****	-0.2%	0.7%	0.1%	-0.3%	-0.4%	0.5%	0.5%	0.3%

\*\* Numbers reported are annual rates of change in per cent, if not noted otherwise; \*\* GDP and its components are chain-linked; \*\*\* including NPISH; \*\*\*\* the budget balance forecast considers only those measures on which sufficient information was available at the date of the forecast.

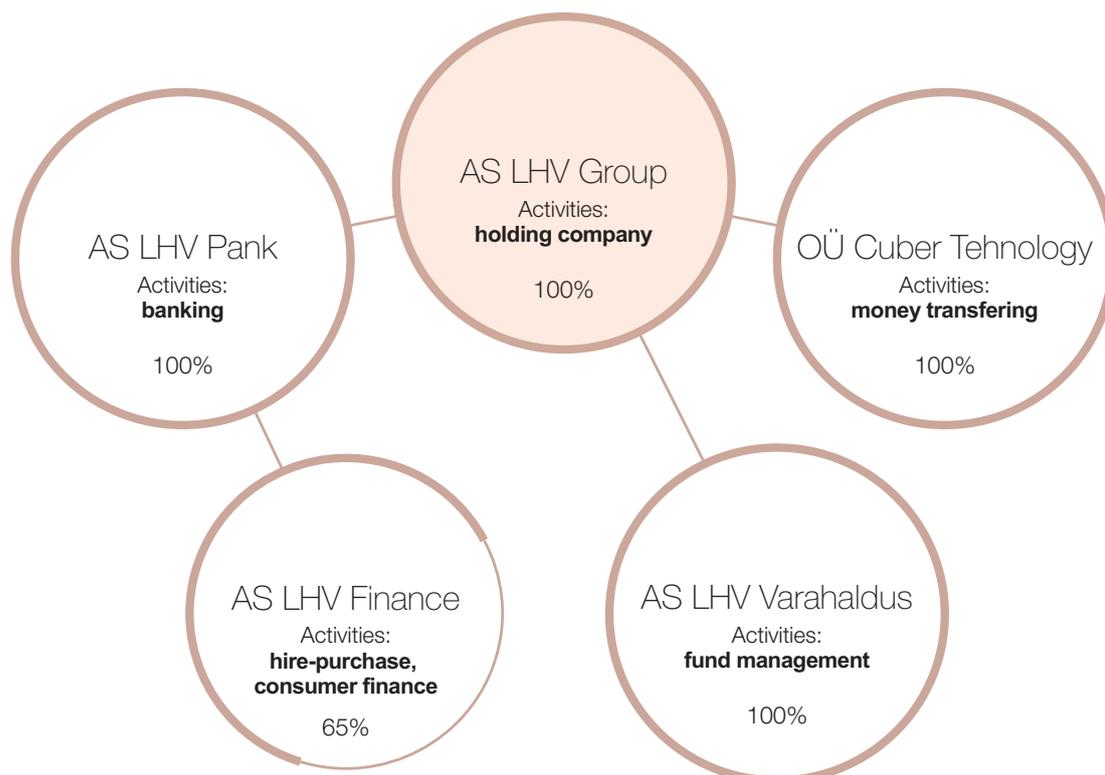
Sources: Eesti Pank, Statistics Estonia\*



# Management report

AS LHV Group (hereinafter: the Group or LHV) is the biggest domestic finance group and capital provider in Estonia. The main subsidiaries of AS LHV Group are AS LHV Pank (hereinafter: the Bank) and AS LHV Varahaldus (hereinafter: LHV Varahaldus). LHV was established in 1999 by people with long experience in investing and entrepreneurship.

LHV-s offices for client servicing are located in Tallinn and Tartu, also London office was opened in 2018. Over 370 people work in LHV. Over 192 000 customers use banking services offered by LHV and the LHV's pension funds have over 201 000 clients.



## Operating principles

The mission of LHV is to help create local capital and to support the development of local entrepreneurship.

LHV concentrates on active and independent customers with an entrepreneurial mind-set. For private consumers LHV offers high quality universal banking services. For corporate clients LHV offers flexible and suitable financing and managing of everyday financial operations.

The products and services provided by LHV are simple, transparent and appropriate. Client interaction is mainly conducted using modern electronic communication channels. Costs avoided will reach the clients of LHV through affordable cost of everyday service.

LHV was created as a partnership and partnership is the central way of growing LHV's business. New initiatives will be implemented faster and more successfully when partners have same interests and long-term support of each other.

LHV is public company, which is listed on the Tallinn Stock Exchange since May 2016, so all clients and partners of LHV may be owners of LHV.

## Key events in 2018:

- **LHV Bank**

Moody's Investors Service gave the bank an investment grade rating of Baa1, with a stable outlook.

- **LHV Varahaldus**

LHV Varahaldus started a new pension fund, which invests purely into Estonia – LHV Pensionifond Eesti.

- **Disposal of UAB Mokilizingas**

In May LHV sold its 50% ownership in UAB Mokilizingas receiving EUR 2.9 million extraordinary profit.

## Shares and bonds issued by LHV

Over the last years LHV has been capitalized, being a rapidly growing local retail bank with clear niche towards financial intermediates. The profits and investments of LHV are not only contributable to the share price, but also part of the dividends and interest paid to subordinated bonds. LHV has several securities outstanding:

Name	ISIN	Issuer	Outstanding amount	Maturity	Listing
Common share	EE3100073644	AS LHV Group	26 016 485	-	Nasdaq Tallinn main list
Subordinated bond	EE3300110741	AS LHV Group	15 000 000	29/10/2025	Nasdaq Baltic bond list
Subordinated bond	EE3300110550	AS LHV Group	15 900 000	20/06/2024	Nasdaq Baltic bond list
Subordinated bond	EE3300111558	AS LHV Group	20 000 000	28/11/2028	Nasdaq Baltic bond list

There is only one class of shares issued by LHV, each share gives 1 voting right. The shares of LHV Group is traded on NASDAQ Tallinn main list since May 2016. Since then, the share price has risen by 34%, reaching EUR 9.4 by the end of 2018. In 2018, the lowest traded price was 9.2 euros and the highest 11.4 euros. Based on the stock price, LHV's market value was EUR 245 million. In respect of dividend policy, LHV strives to achieve long-term dividend growth without negatively impacting the group's targeted capital ratios. The annual dividend together with dividend related

taxes shall correspond to 25 per cent of pre-tax profit. Each year's dividend is assessed in the light of prevailing economic conditions and the Group's earnings, growth possibilities, regulatory requirements and capital position. In addition, LHV has made a conservative decision not to have trading positions in LHV shares nor take them as collateral. In case of exercising share option programs, the shareholders have delegated the right of issuing new shares to the Supervisory Board.

**LHV share price development**



During 2018, 1.0 million shares in the amount of EUR 11.16 million changed the owner on the stock exchange, which makes 11.2 euros for the average trading price.

At the end of 2018, LHV Group had 5 615 shareholders, of whom 86.2% were also customers of LHV Bank. They were followed by Swedbank customers (9.6%) and SEB customers (3.8%). 74.9% of the shares belonged to enterprises and 25.1% to private individuals. Among the shareholders, the Estonian residents or their related companies, who own 99.9% of the shares, are clearly dominant.

LHV has had three subordinated debt issues on Nasdaq Tallinn Stock Exchange. The maturity of the first bond is in 2024, the second in 2025 and latest bond issued in November 2018 with maturity in 2028. The new bond issued is to strengthen the LHV Group capitalization and allows with prior acceptance from Estonian FSA potential buy-back of 2024 bonds in June 2019. Bond trading in Nasdaq Baltics bond list is very limited, as most of investors have "invest and keep" strategy. The total turnover in 2018 was EUR 1.78 million.

At the end of the year 2018, LHV Group had almost 1 000 bondholders, 70% of them were also customers of LHV Pank. They were followed by the customers of Swedbank at 15% and SEB at 11%. Of the investor base, 68% were companies and 32% were private individuals. 99.8% of bond investors were Estonian residents or their related companies.

AS LHV Group has 26 016 485 common shares with par value of 1 euro. As at 31.12.2018, the distribution of shares was as follows:

- 13 104 054 shares (50.4%) belonged to the members of the Supervisory Board and Management Board and to their related parties.
- 12 912 431 shares (49.6%) belonged to Estonian entrepreneurs and investors and to their related parties.

### Market share

LHV has not set a specific target for market share, the goal is profitable growth combined with taking advantage of opportunities offered by the market. Every year, LHV has set the goal to grow faster than the market and thereby increase its market share. In terms of new clients, the goal is to increase the client portfolio that the growth would be higher than the number of children born each year. In recent years, we have almost doubled this target.

LHV market share differs in large scale between products: in pension products we have 27% market share and from another side only 1% market share in some newer products like mortgages, despite the fact that from new sales the market share in that is close to 10%. Based on Bank of Estonia calculation of systematic importance LHV scored 718 points equaling 7,18% of overall market share. We see that LHV is able to increase its market share to 8% in 2019.

### Remuneration policy

The remuneration principles for LHV Group and its affiliated companies are described in the internal Remuneration Policy.

In LHV, there are no regional differences in the remuneration principles. The most significant difference between group companies is that LHV Varahaldus has no remuneration committee and has separate disclosure requirements.

The purpose of establishing remuneration principles within LHV is the organisation of fair, motivating and transparent remuneration in accordance with the law. A broader goal of the remuneration policy is the recruitment of employees

### Ten biggest shareholders as at 31.12.2018:

Number of shares	Percentage	Name of the shareholder
3 357 920	12.9%	AS Lõhmus Holdings
2 538 367	9.8%	Rain Lõhmus
2 111 344	8.1%	Viisemann Investments AG
1 595 620	6.1%	Ambient Sound Investments OÜ
1 210 215	4.7%	Krenno OÜ
999 456	3.8%	AS Genteel
951 978	3.7%	AS Amalfi
722 297	2.8%	Kristobal OÜ
636 260	2.5%	SIA Krugmans
589 177	2.3%	Bonaares OÜ

with the capabilities, skills and experience necessary to implement the strategy, to reconcile the interests of employees and shareholders, to motivate the employees and to ensure effective risk management for growing business activities. The remuneration system consists of basic remuneration, compensations and employee benefits. LHV does not provide employees with services at a lower than the market price, does not make payments to a third pillar pension fund at the expense of the employer and does not provide benefits such as a company car, a mobile phone or a laptop for personal use.

The general remuneration strategy is to ensure a motivating pay to achieve long-term goals, creating a strong link between remuneration and the financial results of LHV. When measuring the key quantitative and qualitative results and assessing the risk, LHV shall be governed by the following principles:

- Performance criteria are in line with sound and effective risk management principles. The performance criteria established by LHV must keep in mind the long-term interests of LHV, including not stimulate excessive risk-taking or sale of unsuitable products.
- The performance criteria must not merely contain performance efficiency indicators (e.g. profit, revenue, profitability, expenditure and volume indicators) or market-based indicators (e.g. stock price or bond yield) but must also be adjusted with risk-based indicators (e.g. capital adequacy, liquidity).
- The criteria used for measuring risks and results shall be as closely related to the decisions of the staff member, whose results are being appraised, as possible, and should ensure that the process of the establishment of the remuneration would have an appropriate impact on the staff member's profes-

sional behaviour. In the interest of long-term goals, the assessment and control of risk behaviour will take place at an individual employee level.

- A good balance of both quantitative and qualitative as well as absolute and relative criteria shall be used in the specification of the performance criteria.
- Quantitative criteria shall cover a sufficient period of time, so as to consider the risks taken by the staff members or business units. The criteria shall be risk-adjusted and contain economic efficiency indicators.
- Examples of qualitative criteria include achievement of strategic objectives, customer satisfaction, adherence to the risk management policy, adherence to internal or external rules of procedure, management skills, creativity, motivation and co-operation with other business units and the internal control function.

LHV's recruitment strategy is to find, engage and keep the best people of the labour market. In determining remuneration, LHV is rather willing to make exceptions than restrict its choices with strict remuneration intervals for a specific position. To keep its employees, LHV will develop its benefits and compensations in cooperation with its employees. In determining remuneration, the following is taken into account:

- Commitment and results of the employee,
- Workload,
- Responsibility,
- The required level of education,
- Management level,
- Intensity of work,
- The necessary knowledge and experience for the position,
- The existence of additional benefits,
- The situation in the labour market,
- The pay level of the geographical location,
- The level of criticality of the position

The determination of the amount of remuneration must be objective. The remuneration is paid according to the work done and its value, not according to the personality, gender, age, origin, etc. of the employee.

LHV applies a general principle that employees should not use personal hedging strategies or remuneration and liability insurance, which would undermine the effectiveness of the hedging of risks integrated into the Remuneration Policy. In the decisions made on remuneration policy, the financial situation and sustainability of the capital base

of LHV are taken into account.

LHV carries out regular self-assessment, the purpose of which is to identify all employees whose professional activities affect or may affect the risk profile of LHV significantly. These specified groups of employees are listed in the table below together with ratios between variable and basic remuneration in 2018.

<b>Specified group of employees</b>	<b>Ratio in 2018</b>
Senior management	0.91
Staff performing control functions	0.24
Employees with significant impact on the credit risk position (the nominal value of transactions made by the employee is at least 0.5% of LHV Tier 1 own funds and is in the amount of at least EUR 5 million)	0.53

Self-assessment is carried out once a year at the beginning of the financial year. The assessment covers both the past period (including financial results, risk analysis) and takes into account the forthcoming financial year. The specified group of employees that are determined in the course of the self-assessment are required, within one calendar year after exercising the options, to keep the underlying LHV shares in their own possession and to not sell them, or to encumber in any form (including pledge). The specified group of employees are forbidden to transfer the risk of the decline of the share price to other parties, for example, through insurance or certain type of financial instruments. Self-assessment is carried out by taking into account the degree of complexity, performance indicators and structure of LHV. The competence lies on the Management Board, who will conduct the analysis in the form of a discussion at a board meeting. The self-assessment is initiated by the Human Resources department, the compliance of the process and results are assessed by the department of Compliance Control, whose representative is also present at the self-assessment. The Remuneration Committee reviews annually the qualitative and quantitative criteria related to the employee and the self-assessment process, which is used for decision-making. The results of the self-assessment are independently reviewed by the internal audit, the results are summarized and presented to the Supervisory Board.

## Share options

In 2014, the general meeting of shareholders of AS LHV Group approved the criteria for the granting of share options to the Management Board members and key employees. The aim of issuing share options is to align the interests of Management Board members and employees more effectively with the interests of shareholders and customers. Another objective is to offer a system of compensation on the labour market that is equal to competitors and comprehensive

As part of the program, there is an annual performance pay added to basic salary, the amount or issue of which corresponds to the fulfilment or non-fulfilment of individual and LHV objectives. The objectives of the program are:

- ensuring a competitive remuneration, to be attractive in the labour market;
- keeping and motivating key personnel through creating a relationship of ownership;
- reconciling the interests of shareholders and employees;
- increasing company value through performance management.

The instruments of performance pay under the option program are 100% equity options. The term of share options is 3 years from the moment the options were granted. The three-year vesting period before issuance of shares gives the opportunity to evaluate the results in the long run. It is not possible to take the specified amount in cash in lieu of share options. Share options are issued annually in the amount of up to maximum 2% of the total number of LHV shares. LHV has the right to refuse to exercise and issue equity options to the entitled person, in whole or in part, if:

- LHV General Meeting or the Supervisory Board under the instructions from the General Meeting does not adopt the decision on the increase of LHV share capital and issuance of shares;
- the Management Board member agreement or the employment relationship of the person entitled to receive options has ceased at the initiative of the person entitled to receive options or in pursuant to § 88 of the Employment Contracts Act or, if the Employment Contracts Act is amended, on an analogous basis, however, based on the decision of the Supervisory Board it is possible to make exceptions to the applicability of this paragraph;
- the financial results of LHV or its relevant subsidiary have substantially deteriorated compared to the previous period;

- the person entitled to receive options no longer meets the performance criteria or does not meet the requirements prescribed by law to the head or an employee of a credit institution or a fund management company;
- LHV or its relevant subsidiary no longer meets the prudential regulations or the company's business risks are not adequately covered by own funds;
- the issuance of options has been determined based on information, which proved to be substantially misstated or incorrect.

Similarly to 2014, share options were annually issued from 2015 to 2018. In 2018, the options issued in 2015 were fully exercised. Next share options issue could be in 2019 based on Supervisory Board decision.

The granting and size of share options was dependent upon the successful achievement of operational targets of the overall company and the targets of individual Management Board members and employees. In the beginning of 2018 the share options were granted for 70 people in the amount of 1 458 thousand euros. In the beginning of 2017 the share options were granted for 69 people in the amount of 1 573 thousand euros. In the beginning of 2016, the share options were granted for 49 people in the amount of 826 thousand euros. In 2015, the share options were granted for 48 people in the amount of 681 thousand euros. In 2014, the share options were granted for 35 people in the amount of 645 thousand euros. The company entered into share option agreements with the members of the Management Board and employees for a three-year term for the granting of share options. Share options issued in 2014 were exercised in 2017 where shares with nominal value of 1 euro can be acquired for 2 euros per share. Share options issued in 2015 can be exercised between the period of 01.05.2018-31.07.2018 and shares with nominal value of 1 euro can be acquired for 2.4 euros per share. Share options issued in 2016 can be exercised between the period of 01.05.2019-31.07.2019 and shares with nominal value of 1 euro can be acquired for 3 euros per share. Share options issued in 2017 can be exercised between the period of 01.05.2020-31.07.2020 and shares with nominal value of 1 euro can be acquired for 4.65 euros per share. Share options issued in 2018 can be exercised between the period of 01.05.2021-31.07.2021 and shares with nominal value of 1 euro can be acquired for 4.87 euros per share.

# Governance of the Group

## Supervisory board



**Rain Lõhmus** is a founder of LHV and the chairman of the Supervisory Board of AS LHV Group and a member of the Supervisory Boards of AS LHV Pank and AS LHV Finance. In addition, he belongs to the Supervisory Boards of AS Arco Vara, AS Hortes and Thermory AS. He is the owner and member of the Management Board of AS Lõhmus Holding and the owner of OÜ Mersona Systems. Additionally, he is the Management Board member and one of the owners of Zerospotnrg OÜ and Umblu Records OÜ. Rain Lõhmus graduated from the Tallinn University of Technology (TalTech) and the management program of Harvard Business School. Rain Lõhmus and the persons related to him (Lõhmus Holdings OÜ, OÜ Merona Systems) own altogether 6 478 005 shares, representing 24.9% of all shares.



**Raivo Hein** is a member of the Supervisory Boards of AS LHV Group and AS LHV Pank. Also, he belongs to the Supervisory Board of AS Puumarket. He is the owner and a member of Management Board of OÜ Kakssada Kakskümmend Volti and a Management Board member of OÜ Saarte Sillad and several other companies established for the management of personal investments. Raivo Hein graduated from the Tallinn University of Technology (TalTech). Raivo Hein does not own shares of AS LHV Group. The persons related to him, OÜ Kakssada Kakskümmend Volti, Lame Maakera OÜ and Astrum OÜ own altogether 490 110 shares of AS LHV Group.



**Heldur Meerits** is member of the Supervisory Boards of AS LHV Group and was member of Supervisory Board of AS LHV Pank till 23d of December 2018. He also belongs to the Supervisory Boards of the enterprises Kodumaja AS and AS Smart City Group and the foundations SA Põltsamaa Ühisgümnaasiumi Toetusfond, SA Dhama and SA Tähelaps. Heldur Meerits is also the owner and a member Management Board of the companies established for the management of personal economic interests, AS Amalfi and AS Altamira. Heldur Meerits graduated from the Faculty of Economics and Business Administration of the University of Tartu. Heldur Meerits does not own shares of AS LHV Group. AS Amalfi owns 951 978 shares of AS LHV Group.



**Tiina Mõis** is a member of the Supervisory Boards of AS LHV Group and AS LHV Pank. She also belongs to the Supervisory Boards of AS Baltika and Rocca al Mare Kooli SA. She is the owner and the Management Board member of AS Genteel. Tiina Mõis graduated from the Tallinn University of Technology (TalTech). Tiina Mõis does not own any shares of AS LHV Group. AS Genteel owns 999 456 shares of AS LHV Group.



**Sten Tamkivi** is a Supervisory Board member of AS LHV Group. He belongs to the Supervisory Boards of ASI Private Equity AS and Kistler-Ritso Eesti SA. In addition, he is the owner and the Management Board member of Seikatsu OÜ and Osaluste Hellalt Hoidmise OÜ and the Management Board member of Topia OÜ. Sten Tamkivi graduated from the Stanford University Graduate School of Business. Sten Tamkivi and the person related to him, Seikatsu OÜ, own altogether 11 180 shares of AS LHV Group.



**Tauno Tats** is a Supervisory Board member of AS LHV Group. Also, he is a member of the Supervisory Boards of EFTEN Kinnisvarafond AS, AS Ecomet Invest and OÜ Eesti Killustik and a member of Management Board of Ammende Hotell OÜ. He is a Management Board member and one of the owners at Ambient Sound Investments OÜ as well as a Management Board member of companies established for the management of investments of the aforementioned companies. Tauno Tats graduated from the Tallinn University of Technology (TalTech). Tauno Tats does not own shares of AS LHV Group. Ambient Sound Investments OÜ owns 1,595,620 shares of AS LHV Group.



**Andres Viisemann** is a founder of LHV and the manager of LHV pension funds. He is a member of the Supervisory Boards of AS LHV Group, AS LHV Pank and AS LHV Varahaldus. He also belongs to the Supervisory Boards of AS Fertilitas and Rocca al Mare Kooli SA. He is also the owner and member of the Management Board of Viisemann Holdings OÜ. Andres Viisemann graduated from the University of Tartu and obtained a Master's degree at INSEAD in International Business Management. Andres Viisemann and the persons related to him (Viisemann Investments AG, Viisemann Holdings OÜ) own altogether 2 549 308 shares, representing 9.8% of all shares. Due to his position as the head of LHV pension funds, Andres Viisemann is entitled to a total of 34,505 shares of AS LHV Group for the options issued in 2016, 2017 and 2018.

#### Management board



**Madis Toomsalu** is a member of the Management Board of AS LHV Group and the chairman of the Supervisory Boards of AS LHV Pank and AS LHV Varahaldus. He is also member of the Management Board of MTÜ FinantseEstonia. Madis Toomsalu has obtained a Bachelor's degree in business management from the Tallinn University of Technology (TalTech) in 2009 and a Master's degree in 2011 in public sector finance. Madis Toomsalu owns 24 397 shares of AS LHV Group. Madis Toomsalu is entitled to a total of 46 979 shares of AS LHV Group for the options issued in 2016, 2017, 2018.

# Committees formed on Supervisory Board level

## Audit Committee



**Kristel Aarna** works as CFO of AS TV Play Baltics since 2011 and before that was the chief controller of Swedbank Baltic Banking. Previously she has been the head of financial advisory services at KPMG Baltics AS and worked also at Eesti Pank and CVS Caremark Corporation. She is also the owner and the member of the Management Board of IKA Konsult OÜ. Kristel Aarna has a Bachelor's degree from the Faculty of Economics of the University of Tartu and Master's degree in Business Administration from the Bentley University Graduate School of Business. Kristel Aarna does not have any shares of AS LHV Group.



**Urmas Peiker** is a co-founder of and works as the head of business development in an Estonian start-up Funderbeam. From May 2013 until October 2014, he was the head of Compliance at AS LHV Pank. Previously, Urmas Peiker has worked as the head of Market Supervision Department of the Financial Supervision Authority, also in the European Bank for Reconstruction and Development and Morgan Stanley's. Urmas Peiker has a Bachelor's degree from the University of Tartu and Master's degree in Law from the Duke University in the USA. Urmas Peiker does not have any shares of AS LHV Group.



**Tauno Tats** (Supervisory Board member of AS LHV Group)

## Remuneration Committee



**Madis Toomsalu** (Management Board member of AS LHV Group, chairman of the Supervisory Board of AS LHV Pank and AS LHV Varahaldus)



**Rain Lõhmus** (chairman of the Supervisory Board of AS LHV Group, member of the Supervisory Board of AS LHV Pank and AS LHV Finance)



**Andres Viisemann** (member of the Supervisory Board of AS LHV Group, AS LHV Pank and AS LHV Varahaldus)

## Risk and Capital Committee



**Rain Lõhmus** (chairman of the Supervisory Board of AS LHV Group, member of the Supervisory Board of AS LHV Pank and AS LHV Finance)



**Tiina Mõis** (member of the Supervisory Boards of AS LHV Group and AS LHV Pank)



**Andres Viisemann** (member of the Supervisory Boards of AS LHV Group, AS LHV Pank and AS LHV Varahaldus)

## Supervisory and management boards of the subsidiaries

### AS LHV Pank

Supervisory Board: Madis Toomsalu (chairman, until 05.12.2021), Raivo Hein (until 20.09.2022), Heldur Meerits (until 23.12.2018), Tiina Mõis (until 31.12.2019), Rain Lõhmus (until 31.12.2019), Andres Viisemann (until 20.09.2022)

Management Board: Erki Kilu (chairman, until 20.09.2022), Jüri Heero (until 20.09.2022), Andres Kitter (until 20.09.2022), Meelis Paakspuu (until 20.09.2022), Indrek Nuume (until 20.09.2022), Martti Singi (until 20.09.2022), Kadri Kiisel (until 20.09.2022)

### AS LHV Finance

Supervisory Board: Erki Kilu (chairman, until 24.08.2023), Rain Lõhmus (until 24.08.2023), Veiko Poolgas (until 24.08.2023), Jaan Koppel (until 24.08.2023)

Management Board Kadri Kiisel (until 05.02.2023)

### AS LHV Varahaldus

Supervisory Board: Madis Toomsalu (chairman, until 04.12.2021), Erki Kilu (until 28.04.2022), Andres Viisemann (until 28.04.2022)

Management Board: Mihkel Oja (chairman, until 09.10.2022), Joel Kukemelk (09.10.2022)

### Cuber Tehnology OÜ

Management Board: Jüri Laur (without a term)

# Financial results

EUR million	2014*	2015*	2016*	2017*	2018*
<b>Volume of deposits</b>	<b>457</b>	<b>633</b>	<b>778</b>	<b>1 543</b>	<b>1 444</b>
incl. financial intermediates deposits	0	0	32	607	194
<b>Volume of net loans</b>	<b>316</b>	<b>410</b>	<b>538</b>	<b>732</b>	<b>919</b>
<b>Volume of assets</b>	<b>556</b>	<b>757</b>	<b>935</b>	<b>1 773</b>	<b>1 677</b>
<b>Volume of funds</b>	<b>504</b>	<b>570</b>	<b>974</b>	<b>1 103</b>	<b>1 214</b>
<b>Volume of custody accounts</b>	<b>586</b>	<b>1 253</b>	<b>1 072</b>	<b>1 287</b>	<b>1 486</b>
Net interest income	20.3	23.2	30.0	35.5	39.8
Net fee income	12.8	14.7	19.2	22.2	26.0
Net financial income	0.5	0.4	1.3	1.0	3.4
Net income	33.6	38.3	50.5	58.7	70.0
Expenses	21.7	24.1	28.9	31.9	33.8
<b>Profit before credit losses</b>	<b>11.9</b>	<b>14.3</b>	<b>21.7</b>	<b>26.6</b>	<b>36.2</b>
<b>Loan provision</b>	<b>2.6</b>	<b>1.4</b>	<b>1.5</b>	<b>3.2</b>	<b>5.3</b>
<b>Tax expense</b>	<b>0.5</b>	<b>0.9</b>	<b>0.3</b>	<b>1.2</b>	<b>3.8</b>
<b>Profit</b>	<b>9.7</b>	<b>14.8</b>	<b>19.9</b>	<b>22.2</b>	<b>27.2</b>
net profit attributable to owners of the parent	9.2	13.7	17.8	19.6	25.2

\*includes discontinued operations

The Group's pre-tax profit for 2018 amounted to EUR 30.9 million and net profit totalled EUR 27.2 million. Pre-tax profit is 32% more than a year before. Net interest income grew 12% and net fee income increased 17%. Financial income increased by 246% mainly due to the gain from disposal of UAB Mokilizingas. The Group's net income was EUR 70.0 million and increased by 20% compared to the previous year. From income increase 3.0 million are related to sale of Mokilizingas, remaining increase is related to higher business volumes. Operating expenses amounted to 33.8 million euros and increased by 6% over the year. Most of the cost increase has been related higher business volumes and increased number of employees to offer that. The Group achieved the financial forecast published at the beginning of 2018.

By the end of December, the total volume of the Group's loan portfolio less impairments amounted to EUR 919 million (December 2017: EUR 732 million). The volume of portfolio increased 26% in a year. In the loan portfolio, the majority is corporate loans that increased 30% in a year to EUR 664 million (2017: EUR 510 million). The portfolio of retail loans increased 15% in a year, amounting to EUR 265 million (2017: EUR 230 million).

The volume of Group's deposits decreased 6% in a year and totalled EUR 1 444 million by the year-end (2017: EUR

1 543 million). The share of demand deposits of all deposits remained the same and was 92% (31.12.2017: 92%).

AS LHV Bank's as largest business units net profit for 2018 was EUR 18.4 million, growing 2.9 million compared with previous year. Loans to clients increased by EUR 199 million reaching EUR 919 million. During the year, payment intermediates deposits decreased by EUR 413 million, whereby core banking customers' deposits increased by EUR 314 million reaching EUR 1 448 million by the end of year. Client number increased by 28 thousand.

In 2018 LHV Asset Management earned net profit in amount of EUR 6.8 million, which is EUR 1.0 million more than previous year. Number of second pillar pension funds clients increased by 1.0 thousand to 178 thousand. Net fee income decreased by EUR 0.6 million to EUR 13.9 million. Behind the increase is growth in AUM, what compensated the decrease in management fees. Business expenses decreased by EUR 0.8 million to EUR 5.8 million in 2018. In addition LHV Asset Management decreased share capital by EUR 1.2 million (2017: 15.5) million and paid dividends for 2017 in amount of EUR 4.4 (2017: 5.8) million. LHV Group as a separate entity earned a profit of EUR 11.7 (2017: 2.7) million, due to the fact that the subsidiary LHV Varahaldus and LHV Pank paid dividends to LHV Group and UAB Mokilizingas was sold.

During the year LHV Bank registered branch in UK. LHV did not acquire new subsidiaries. In May 2018 UAB Mokilizingas was sold and this resulted in extraordinary profit of EUR 3.0 million. Due to that also financial plans were renewed for 2018.

### Key figures

EUR million	2014	2015	2016	2017	2018
Core Tier 1 CAD %	17.58	15.97	15.10	14.02	14.88
Tier 1 CAD %	17.58	15.97	15.10	14.02	14.88
CAD %	22.82	23.36	20.70	18.30	20.91
MREL %	15.72	14.49	12.25	7.78	11.43
leverage ratio %	6.92	6.84	6.96	5.01	6.56
LCR %	190.0	271.6	221.5	121.3	148.5
NSFR %	-	-	-	140.8	147.6
return on equity (ROE) % *	21.4	21.8	20.7	17.6	18.4
return on assets (ROA) %	2.00	2.3	2.4	1.6	1.6
CFROI %	26.4	25.9	23.9	22.6	25.4
cost to income ratio %	67.5	62.8	57.2	54.4	48.3
net interest margin (NIM) %	3.50	3.62	3.60	2.66	2.34
spread %	3.44	3.55	3.52	2.62	2.32
loan to asset %	57.42	54.54	57.86	41.61	55.24
loan to deposits %	69.68	66.91	69.68	48.00	65.14
price to earnings ratio	-	-	13.29	13.56	9.75
dividend to net profit ratio %	-	-	26.7	21.0	21.6
dividend per share	-	-	-	0.15	0.16

### Explanations

\* Return on equity is calculated based on LHV Group net profit and equity attributable to owners of the parent and does not include non-controlling interest.

capital adequacy levels are calculated as reported in COREP report as at end of each year

MREL = (own funds + qualifying liabilities) / total liabilities \* 100

LCR, NSFR are calculated as reported in COREP report as of end of each year

return on equity (ROE) = net profit (attributable to owners of the parent) / average equity (attributable to owners of the parent) \* 100

return on assets (ROA) = net profit / average assets \* 100

CFROI = Operating profit / capital (average)

cost to income ratio = total operating expenses / total income \* 100

net interest margin (NIM) = net interest income/average interest earning assets \* 100

spread = yield on interest earning assets – cost of interest bearing liabilities

loan to asset = net loans / total assets \* 100

loan to deposits = net loans / deposits \* 100

price to earnings ratio = share price/net profit/number of shares (average)

dividend to net profit ratio = dividend/net profit

dividend per share = dividend payment during calendar year / number of shares at moment of payment

### Liquidity and capitalization

The liquidity coverage ratio (LCR) of the Group, calculated according to the definitions of the Basel Committee, was 148.5% at the end of December (31.12.2017: 121.3%; 31.12.2016: 221.5%). The liquidity situation of the Group has not changed, as the depletion of the LCR is caused by deposits made by financial intermediaries, which are 100% covered by liquid funds. As at 31.12.2018, the Group's LCR is 235.5%, if the deposits from financial intermediaries are not taken into account. The Group considers cash in the central bank and in other credit institutions and bond portfolios to be included in its liquidity buffer, that accounted for 43% of the total of the statement of financial position (31.12.2017: 57%). The Group's loan-to-deposit ratio at the end of 2018 was 64% (31.12.2017: 48%).

The Group's level of own funds as at 31.12.2018 was EUR 183.3 million (31.12.2017: EUR 141.6 million). Compared to the internal capital adequacy target of 15.50%, the Group is well capitalised as at the end of the reporting period. The level of capital adequacy was 20.91% (31.12.2017: 19.6%) and Tier 1 capital ratio was 14.88% (31.12.2017: 15.3%), well above the regulatory requirement of 11.3% (31.12.2017: 10.4%).

The Group uses the standard method for the calculation of credit risk and market risk capital requirements and the basic indicator approach for the calculation of operational risk capital requirements. The Group has complied with all capital requirements during the financial year and in previous year.

Each year, an internal capital adequacy assessment process (ICAAP) is performed, the goal of which is to identify potential capital needs in addition to regulatory capital requirements.

Leverage ratio, calculated according to Basel Committee on Banking Supervision requirements, as at 31.12.2018 was 7.31% (31.12.2017: 5.83%). Leverage ratio is calculated as Group's total Tier 1 own funds divided by Group's total risk exposure measure (incl. risk position on assets and off the balance sheet liabilities). As at the end of the reporting period, the leverage ratio is the arithmetic mean of the monthly leverage ratios over the last quarter.

On December 2017, the Financial Supervision Authority introduced a new prudential regulation for LHV Group, a minimum requirement for own funds and eligible liabilities (MREL). The ratio is a part of the crisis resolution plan and obliges LHV to have sufficient own funds and unsecured long-term liabilities that can be used to cover losses under the crisis resolution plan. The minimum requirement for MREL ratio is set at 5.79% and it is reviewed annually by the Financial Supervision Authority. At the end of the year, LHV Group had the ratio at the level of 11.43% (2017: 7.78%) and it contains an adequate buffer for the growth plans of 2019. On the other hand, it forces LHV to change its existing policy of financing by deposits and the Group will also include liabilities in the form of bonds or loans, which qualify for MREL, in order to manage the ratio.

<b>Capital base</b> (in EUR thousands)	<b>31.12.2018*</b>	<b>31.12.2018</b>	<b>31.12.2017</b>
Paid-in share capital	26 016	26 016	25 767
Share premium	46 653	46 653	46 304
Statutory reserves transferred from net profit	3 451	3 451	2 471
Other reserves	78	78	36
Accumulated profit/(deficit)	50 193	50 193	24 468
Intangible assets (subtracted)	-19 084	-19 084	-7 940
Profit for accounting period	25 237	25 237	19 603
Deductions	-194	-194	0
Dividend offer (including income tax)	-6 708	0	0
<b>Total Tier 1 capital</b>	<b>125 642</b>	<b>132 350</b>	<b>110 709</b>
Subordinated debt	50 900	50 900	30 900
<b>Total Tier 2 capital</b>	<b>50 900</b>	<b>50 900</b>	<b>30 900</b>
Exceeding limitations of subordinated debts and preference shares	0	0	0
<b>Net own funds for capital adequacy calculation</b>	<b>176 542</b>	<b>183 250</b>	<b>141 609</b>
<b>Capital requirements</b>			
Central governments and central bank under standard method	938	938	945
Credit institutions and investment companies under standard method	5 376	5 376	6 950
Companies under standard method	579 836	579 836	428 428
Retail claims under standard method	133 250	133 250	144 237
Public sector under standard method	125	125	185
Housing real estate under standard method	39 903	39 903	20 039
Overdue claims under standard method	10 142	10 142	20 956
Investment funds' shares under standard method	7 973	7 973	6 281
Other assets under standard method	10 557	10 557	13 824
<b>Total capital requirements for covering the credit risk and counterparty credit risk</b>	<b>788 090</b>	<b>788 090</b>	<b>641 845</b>
Capital requirement against foreign currency risk under standard method	3 957	3 957	3 551
Capital requirement against interest position risk under standard method	32	32	412
Capital requirement against equity portfolio risks under standard method	704	704	585
Capital requirement against credit valuation adjustment risks under standard method	41	41	15
Capital requirement for operational risk under base method	91 575	91 575	75 999
<b>Total capital requirements for adequacy calculation</b>	<b>844 399</b>	<b>884 399</b>	<b>722 407</b>
<b>Capital adequacy (%)</b>	<b>20.91</b>	<b>21.70</b>	<b>19.60</b>
<b>Tier 1 Capital Ratio (%)</b>	<b>14.88</b>	<b>15.67</b>	<b>15.32</b>

\*audited numbers which include the dividend offer

## Financial plan

Starting from 2018 LHV has published financial plan for next five years. As the forecast horizon is long, then only the first year should be taken commitment, remaining four years as guideline where LHV sees it's business to develop.

Assumptions behind the financial plan

Biggest assumption is regarding the macroeconomic situation, where we knowledgeable to not plan major changes to present the actual development of LHV without significant effects of economic environment. In addition, we consider competition to remain similar to current situation.

two largest changes taken into account: already known changes in legislation and market view regarding interest rates. Based on this plan interest rates will start raising in 2020 and will have positive impact to years 2021-2023. This plan LHV continues to have three business arms, from which Estonian banking and asset management arms two are solid already now, where the share of payment intermediates business line will start increasing.

**Profita and loss statement**

EURm	2019	2020	2021	2022	2023
Net interest income	48	61	77	91	112
Net fee and commission income	25	29	32	36	41
Net gains from financial assets	0	0	0	0	0
Other income	0	0	0	0	0
<b>Total revenue</b>	<b>73</b>	<b>90</b>	<b>109</b>	<b>127</b>	<b>153</b>
<b>Total operating expenses</b>	<b>-33</b>	<b>-37</b>	<b>-42</b>	<b>-47</b>	<b>-51</b>
Amortization	-3	-4	-4	-4	-4
Impairment losses on loans and advances	-4	-6	-8	-10	-11
<b>Earning before income tax</b>	<b>32</b>	<b>42</b>	<b>55</b>	<b>67</b>	<b>87</b>
Income tax	-2	-2	-3	-3	-3
Advance income tax	-3	-4	-6	-7	-9
<b>Net profit</b>	<b>27</b>	<b>36</b>	<b>46</b>	<b>57</b>	<b>74</b>
Profit attributable to non-controlling interest	2	2	2	3	3
<b>Profit attributable to owners of the parent</b>	<b>25</b>	<b>34</b>	<b>44</b>	<b>55</b>	<b>71</b>

**Balance sheet**

EURm	2019	2020	2021	2022	2023
Cash and cash equivalents	837	965	1 133	1 287	1 396
Financial assets at fair value	85	105	112	112	112
Loans grante (net)	1 181	1 448	1 786	2 094	2 409
Long-term financial investments	7	8	6	7	7
Other assets	27	32	34	36	38
<b>Total assets</b>	<b>2 138</b>	<b>2 558</b>	<b>3 071</b>	<b>3 535</b>	<b>3 963</b>
Deposits from customers	-1 863	-2 195	-2 561	-2 951	-3 313
Loans received	-32	-82	-182	-207	-207
Subordinated loans	-55	-60	-65	-65	-65
Other liabilities	-6	-7	-8	-9	-9
<b>Total liabilities</b>	<b>-1 957</b>	<b>-2 345</b>	<b>-2 817</b>	<b>-3 232</b>	<b>-3 595</b>
<b>Equity</b>	<b>-180</b>	<b>-213</b>	<b>-254</b>	<b>-303</b>	<b>-368</b>
<b>Total liabilities and equity</b>	<b>-2 138</b>	<b>-2 558</b>	<b>-3 071</b>	<b>-3 535</b>	<b>-3 963</b>

**Financial and operational ratios**

	2019	2020	2021	2022	2023
ROE from profit attributable to the owners of parent	15.4%	17.8%	19.3%	20.1%	21.7%
ROE from pretax profit attributable to the owners of the parent	18.3%	20.8%	22.8%	23.5%	25.4%
C/I	50%	46%	43%	40%	36%
L/D	63%	66%	70%	71%	73%
Risk cost	0.4%	0.5%	0.5%	0.5%	0.5%
EPS (EUR)	0.97	1.28	1.63	2.01	2.59
Dividend (EURt)	5 463	5 513	7 187	9 422	11 431
DPS (EUR)	0.21	0.21	0.27	0.35	0.42
T1	13.7%	14.0%	14.5%	15.3%	16.5%
CAD	19.0%	18.9%	19.1%	19.3%	20.0%

## Sensitivity analyses

LHV has two major business lines: banking and asset management. These business lines are very different in their sensitivities to different risk factors.

Bank is clearly procyclical, meaning that its results are directly affected by macroeconomic developments. In general, there are three major components effecting Bank's results:

- **Interest rate**
- **Credit losses**
- **Personnel cost**

Every 100 bps increase in interest rates will increase LHV interest income by EUR 1 million within first 12 months. Interest rate decrease by similar level will reduce LHV interest income by EUR 0.3 million.

Credit losses are dependent on economic situation. LHV has knowledgeable credit risk management and does not allow excess risk in any of the economic sectors. Still quick growth hides the credit losses as significant part of portfolio is not matured yet. For understanding the actual levels of credit losses, LHV calculates the credit risk in addition to current portfolio also to 12 month old portfolio. LHV has had very few defaults in history and only real credit losses bank has had have been related rather with fraud, not with wrong credit decisions.

Personnel cost is the biggest cost base for the bank and equals around 50% of the total costs. LHV has the internal policy to follow the market levels in compensation packages. LHV offers its services mainly through electronic channels. To offer these services effectively LHV has made a decision to develop systems in-house. As a result the IT team is almost 25% of the total personnel. Salary levels for IT personnel has been increasing and seems to increase in nearest future more than for other personnel segments, then LHV has forecasted higher salary growth than competitors.

Asset management is almost insensitive to macroeconomic developments. The results are depending on two major items:

- **Pension fund management**
- **Political risk**

Pension fund management is key for results. Starting from Q4 2019 the calculation of fund management fees will be changed to performance bonus principle. The target is to beat the agreed benchmark. LHV has outperformed all our competitors over the last 10 years.

Another large risk side of the asset management is political risk. In every year during the last 5 years there has been some changes in the pension funds management fee calculation. LHV has been successful of managing these changes and being able to deliver good result despite of the constant changes in legislation.

# Overview of the Group's subsidiaries in 2018

## AS LHV Pank consolidation group

LHV's mission is to help raise Estonian capital. LHV's vision is focused on Estonia where people and businesses dare to think big, engage in enterprise and invest in the future. The values of LHV are simplicity, support, performance.

LHV Bank (hereinafter the Bank) is the largest domestic bank. The Bank focuses on active and independent customers with an entrepreneurial mind-set. For private customers, the Bank mainly offers services related to the safeguarding and growing of savings. For business customers, the Bank offers flexible and appropriate financing, along with the management of daily financial affairs. The Bank's products and services are simple, transparent and relevant. Modern-day electronic means of communication are used for customer relations. The cost optimization is reflected in the affordable prices of the Bank's everyday services.

The Bank has representative offices in Tallinn, Tartu and London. The Bank has more than 350 staff members, with more than 160,000 customers using the Bank's services. The Bank consolidates a 65% subsidiary AS LHV Finance, engaged in consumer financing (hereinafter the Group).

### Business activities

The number of new customers grew at an unprecedented speed in 2018. Customer numbers grew by 28,000, year-over-year, with the bank's customer base reaching 160,000. The year saw a record-breaking growth in customer activity. The bank participated in the IPO of the Port of Tallinn as co-organiser of the retail offer, with a half of the subscribers of the Port of Tallinn originating from LHV Bank.

Deposit volumes decreased by 7%, amounting to EUR 1,444 million by the end of the year. Standard customer deposits grew by 33% to EUR 1,250 million, with the deposits of financial institutions shrinking by 68% to EUR 194 million. A cooperation agreement was concluded with the deposit engagement platform Raisin, aiming at engaging longer-term deposits beyond the borders of Estonia. At the end of the year, the bank entered into a loan agreement with Nordic Investment Bank with the aim of expanding the eligible liabilities forming the basis for MREL.

The bank's loan stock grew by 26%, year-over-year, amounting to EUR 919 million. Corporate loans grew by

30% to EUR 651 million and retail loans by 44% to EUR 268 million. Housing loans remained the greatest contributor to retail loans, followed by leasing, private loans, small loans and hire-purchase.

The bank posted a profit of EUR 20.9 million, before taxes. Profit was positively affected by the increase in commission fees from the realisation of institutional banking transactions, and negatively by the impairment of a corporate loan. New credit loss principles were fully adopted at the beginning of the year in accordance with IFRS 9. This had a minor impact on the impairment of loans. The bank was subjected to the advance income tax liability in April, charged directly to expenses. Net profit for the year amounted to EUR 18.4 million.

The Financial Supervision Authority submitted its annual supervisory assessment and the additional own funds requirement in the capital adequacy calculations. Changes were introduced in both the composition of and the requirements for additional own funds, compared to last year. Considering the larger systemic risk buffer imposed on the bank as of 1 January 2019, the Supervisory Board decided to set the minimum own funds ratio at 15.50%. At the beginning of the year, the bank's share capital was increased by EUR 10 million. At the end of the year, the bank issued new subordinated bonds of AS LHV Group in the total amount of EUR 10 million, with the aim of strengthening the bank's capital base for expanding business volumes.

Moody's Investors Service gave the bank an investment grade rating of Baa1, with a stable outlook. It was the first time ever for the bank to receive a credit rating from an international rating agency. In establishing the rating, Moody's took account of the bank's strong capitalisation and profitability, which balances the bank's aggressive growth and the relatively recent loan portfolio. The credit rating will help international business pursuits, facilitating correspondent relations with other banks, cooperation with international institutions in the provision of financing solutions or guarantees to customers, and enhancing the options of trade financing.

At the end of the quarter, the bank and AS Versobank (under liquidation) entered into a contract, pursuant to which the bank will acquire EUR 18.4 million worth of AS Versobank's loan stock. The exact price will be determined based on the claims outstanding as of 1 January 2019. The price depends on outcome of due diligence process. The price will be paid

in lump sum upon completion of the transaction. The loan portfolio will be acquired as a loan stock company, consisting of loan and collateral agreements and two employees associated with the portfolio. The claims arising from the loan portfolio against Estonian corporate customers amount to nearly EUR 17 million, and the claims against Estonian-resident private customers to nearly EUR 3 million. Pursuant to the contract, the acquisition transaction is scheduled to be completed on 15 February 2019, with the satisfactory results of the audit of the loan portfolio serving as the precondition for completion of the transaction.

The auditor has provided other assurance services to the bank in 2018, as required by the Credit Institutions Act and the Securities Markets Act.

### Development activities

Major new products included the launch of factoring services in the first half of the year and the provision of Youth Bank services in the second half of the year, consisting of the purchase-insured debit card with discounts of various partners, the state-secured student loan and micro-investment services.

At the end of the year, the bank joined the EBA Clearing Instant Payments real-time euro payment system, adopting the transcript payments system and real-time incoming euro payments. Real-time outgoing euro payments will be adopted at the beginning of next year.

Minor innovations included launch of the small payment option, the option of withdrawing cash with a bank card in stores, e-identification of adult private customers for opening a bank account with an ID-card, Mobile-ID or Smart-ID via the internet bank, the LHV car insurance in cooperation with Compensa, consisting of the LHV motor third party liability insurance, LHV casco insurance and LHV super casco insurance, as well as the purchase and sale of Baltic shares via mobile bank.

### Organisation

The bank's organisational structure was divided into three major business areas: retail banking, corporate banking and financial institutions, and three major supporting areas: IT, financial management and support services, and risk management. Human resource management, and marketing and communication were the activities pursued across the bank.

In the middle of the year, a new member was introduced in the bank's management board, in charge of the retail banking area. The former head of the retail banking area moved on to manage the financial institutions area and head the UK

branch. Consequently, the bank's organisational structure was changed, especially with regard to retail banking and financial institutions.

Four major product management areas were created during the year: customers and channels, investment, financing and payment services. The aim of creating the product management areas was to centralise the management of similar products at a level lower than the management, and to improve the cooperation between product management and development in specific product groups.

On January 28 2018, the UK's financial supervision authority made a positive decision with regard to the establishment of the branch in United Kingdom. The branch in UK was officially opened in London on March 19. With the UK leaving the EU, we initiated the process of registering the branch as a branch of a third-country bank in the financial supervision authorities of both Estonia and United Kingdom.

Year-over-year, the bank's employee numbers grew by 57 to 377 (including passive and part-time staff members), including 35 staff members of LHV Finance. In full time equivalents, the number of active employees amounts to 345, compared to 288 in end of 2017.

The bank received several recognitions during the year. At the beginning of the year, the bank's private banking service won international acclaim, with Euromoney declaring LHV Bank the best private banking service provider in Estonia. In the middle of the year, Euromoney declared LHV Bank the best bank in Estonia.

### Sponsorship

The bank takes its social responsibility seriously. Within the limits of our available resources, we support enterprises and initiatives that contribute to the development of the Estonian society. When it comes to sponsorship projects, the bank prefers long-term dedication and cooperation. The bank stands ready to contribute to the pursuit of innovative ideas which help to advance Estonian life.

The bank's long-term partners include Estonian Football Association, Estonian Optimist Class Association, Estonian Gazelle Movement, Estonian Entrepreneur of the Year competition, Estonian Music Days and the Enn Soosaar Foundation.

**Financial results**

EUR million	2018	2017	change
Net interest income	39.02	31.13	25%
Net fee and commission income	11.10	7.70	44%
Net gains from financial assets	0.47	0.68	-31%
Total net operating income	50.59	39.51	28%
Other income	0.95	0.01	94%
Operating expenses	-25.74	-20.42	26%
Income tax expense	-2.51	0.0	-
Credit losses	-4.88	-3.58	36%
Net profit	18.41	15.52	19%

**Volumes**

EUR million	31.12.2018	31.12.2017	change
Loan portfolio	918.8	719.4	28%
Bond portfolio	39.0	50.0	-22%
Deposits	1 444.0	1 551.0	-7%
Equity	125.6	99.5	26%
Number of customers holding assets in the bank	161 357	133 655	21%

## AS LHV Varahaldus

AS LHV Varahaldus is a fund management company with 2 UCITS, 7 mandatory and 2 voluntary pension funds under management as at the end of the year. The organisational structure of LHV Varahaldus consists of four units: the investment management, risk management, operations and sales unit.

In 2018, the assets under management grew from EUR 1 103 million to EUR 1 214 million. The growth was based on the organic growth of the mandatory funded pension system in Estonia. The majority of the assets under management are in the mandatory pension funds. LHV is an active fund manager, making also investments into alternative asset classes and non-listed securities. Such investments are mostly local and as a result LHV's pension funds are the largest by investments into the Estonian investment market.

In March LHV started a new pension fund, which invests purely into Estonia. But in order to offer clients a wider choice, LHV is offering also passively managed mandatory and voluntary pension funds since 2016, which invest only in the largest global markets. The number of funds under management did not change in 2018, as even LHV started a new mandatory pension fund, it also merged two voluntary pension funds in the end of February.

2018 was a difficult year for investors, as only a few markets ended the year with a positive return. For instance, in euro terms European equities lost on average -10.6% of their value, emerging markets lost -10.3% and the Estonian stock market, although better than previously mentioned regions, ended the year with -6.4%. Bond indices offered some protection from the negative stock markets in 2018 as Bloomberg Barclays Euro Aggregate Bond Index returned +0.4% in euros. For euro-based investors a positive contributor was US dollar, which strengthened against euro +4.7%. In this environment LHV's five actively managed pension funds (ex the new fund founded in 2018) managed to protect savings with annual returns between -0.1% and +1.1%. These were the best results among actively managed mandatory pension funds in Estonia. In comparison, LHV's passive fund tracking global and emerging market stock indices and developed market real estate indices lost -5.4% of its unit value.

The number of clients who save with LHV mandatory pension funds increased slightly over the year. 178 thousand participants have directed their monthly pension contributions to one of the LHV's pension funds, which gives a market share of 25.2%. In terms of assets under management, LHV's market share is 30.2% in the mandatory pension market.

In December the parliament decided to make amendments into the Investment Funds Act. The amendments will have a significant effect on pension funds, as well as fund management companies. Main changes are related to the fee structure of the mandatory pension funds – fixed management fee will be reduced significantly, but a performance related success fee introduces simultaneously. At the same time investment rules are relaxed, so that pension fund managers have wider opportunities to set their investment strategies. Most of the changes come into effect in September 2019.

The net profit of LHV Varahaldus was EUR 6.8 million in 2018, an annual increase by EUR 1.0 million. The profit was affected by dividend income tax in amount of EUR 1.1 million (EUR 1.0 million in 2017). Net fee and commission income increased by EUR 0.6 million to EUR 13.9 million. Operating expenses decreased by EUR 0.9 million and amounted to EUR 5.8 million. LHV Varahaldus achieved lower operating expenses due to the reduction of the cost of purchased services. LHV Varahaldus paid EUR 4.4 million in dividend and reduces the share capital by EUR 1.2 million in 2018.

### Financial results

EUR million	2018	2017	change
Net fee income	13.9	13.3	5%
Other financial income	-0.2	0.2	-200%
Total net operating income	13.7	13.5	1%
Operating expenses	-5.8	-6.7	-13%
Income tax expenses	-1.1	-1.0	10%
Net profit	6.8	5.8	17%
Assets under management	1 214	1 103	10%
Number of clients in pension funds (thousands)	201	202	-0.5%

# Corporate Governance report

This report is presented in accordance with the Accounting Act of the Republic of Estonia and provides an overview of the governance of AS LHV Group (hereinafter: LHV) and compliance of governance with the advisory guidelines Corporate Governance Recommendations of the Financial Supervision Authority and Nasdaq Tallinn Stock Exchange. LHV adheres to the Corporate Governance Recommendations, unless specified otherwise in this report.

## 1. General meeting

LHV is a public limited company, with its governing bodies being the General Meeting of Shareholders, the Supervisory Board and the Management Board.

The General Meeting, where shareholders can exercise their rights, is the highest governing body of LHV. The primary duties of the General Meeting include amendment of the Articles of Association, increase and decrease of share capital, decisions on issuance of convertible bonds, election of and extension of the powers of Supervisory Board members, premature removal of Supervisory Board members, approval of the annual report and profit allocation, approval of the share option programme and establishment of terms and conditions for the realisation of options, determination of the number of auditors, appointment and recall of auditors and other decisions within the competence of the General Meeting, as provided by law and the Articles of Association.

A resolution on amendment of the Articles of Association shall be adopted if at least two-thirds of the votes who participate in the meeting are in favour. A resolution on amendment of the Articles of Association shall enter into force as of the making of a corresponding entry in the commercial register. The resolution of the General Meeting on the amendment of the Articles of Association, minutes of the General Meeting and the new text of the Articles of Association shall be attached to the application filed with the commercial register.

A shareholder has the right to participate in the General Meeting, address the General Meeting with regard to items on the agenda, ask relevant questions and make proposals.

The Management Board calls the General Meeting. The annual General Meeting, with the approval of the annual report on the agenda, is held at least once a year. The Management Board calls the annual General Meeting within six months after the end of the financial year at the latest. The Management Board gives at least three weeks'

notice of the annual or special General Meeting.

The agenda of the General Meeting, proposals of the Management Board and Supervisory Board, draft resolutions and other relevant materials are made available to the shareholders prior to the General Meeting. Materials are made available on LHV's website. Shareholders are given the opportunity to ask questions about items on the agenda before the General Meeting, with the questions and responses published on LHV's website.

The list of shareholders entitled to participate in the General Meeting is established based on the share register seven days before the General Meeting.

One annual General Meeting of shareholders was held in 2018. No special General Meetings were held. The annual General Meeting of shareholders was held on April 11, 2018, where the Annual Report 2017 was approved and profit for the financial year 2017 was distributed, including the payment of dividends was decided. In addition, an overview of the financial results and the business environment of the first two months of 2018 was given and an auditor was appointed for the financial years 2018-2019. The General Meeting was held in the Estonian language.

The Annual General meeting of 2018 was chaired by Daniel Haab, Head of Legal Department of AS LHV Pank, who introduced the procedure of the General Meeting and the procedure for asking questions regarding the company's activities from the Management Board.

In 2018, member of the Management Board Madis Toomsalu, Chairman of the Supervisory Board Rain Lõhmus, members of the Supervisory Board Andres Viisemann, Tiina Mõis, Raivo Hein, Sten Tamkivi and Tauno Tats; Andres Viisemann and Heldur Meerits were represented by a power of attorney. Also, the auditors of the financial year 2017, and the auditor's candidate for the financial years 2018-2019, Ago Vilu and Verner Uibo, attended the annual General Meeting.

None of the shareholders hold any shares, which would grant them special control rights or voting rights. LHV is not aware of any agreements in place between shareholders that would address the coordinated exercise of shareholder rights.

Shareholders with significant influence are Rain Lõhmus and the persons related to him (24.9%) and Andres Viisemann and the persons related to him (9.8%).

## 2. Management board

### 2.1. Membership and duties of the Management Board

The Management Board is a governing body of LHV, representing and managing LHV. The members of the Management Board are elected and removed by the Supervisory Board. In order to elect a member of the Management Board, the candidate's written consent is required. Persons with knowledge and experience sufficient for participating in the work of the Management Board and for fulfilling the duties of a member of the Management Board and who correspond to the requirements, arising from the LHV's Articles of Association, rules of procedure of the Management Board and other internal rules of procedure and legislation, shall be appointed members of the Management Board. Before the appointment, the individual suitability of the person for the position is assessed pursuant to the LHV's procedure on the assessment of the members of the management body and key personnel, following the criteria established in the guidelines on the assessment of suitability of the financial Supervision Authority, considering also the specific nature of LHV's business operations. According to the referred procedure on the assessment of suitability, also the collective suitability of Management Board as the governing body is assessed in respect of the available sufficient knowledge, competence, managerial skills and diversity in business areas important for LHV.

Pursuant to the Articles of Association of LHV, the Management Board consists of one to five members. A member of the Management Board is appointed for a term of five years, unless otherwise decided by the Supervisory Board. An extension of the term of office of a member of the Management Board may not be decided before one year before the scheduled end of the term of office and for a longer period than the maximum period prescribed in the law or the Articles of Association. If the Management Board of LHV has more than two members, the Supervisory Board must appoint the Chairman of the Management Board. The Chairman of the Management Board organises the work of the Management Board. The Supervisory Board may remove a member of the Management Board regardless of the reason. A member of the Management Board may resign from the board, regardless of the reason, informing the Supervisory Board thereof. The rights and obligations arising from a contract concluded with a member of the Management Board shall expire in accordance with the contract.

The LHV Management Board currently consists of a single member and Madis Toomsalu serves as the member of the Management Board. The Supervisory Board has entered into a Management Board member contract with Madis Toomsalu. The Supervisory Board establishes the remuneration principles for Management Board members and sets the severance compensation policy for premature termination of the Management Board member contract.

The authority of the member of the Management Board shall continue until December 5, 2021.

The Management Board makes everyday management decisions at its own discretion, governed by the best interests of LHV and its shareholders, and not their personal interests. The duties of the Management Board member include day-to-day management of LHV, representation of the company, management of LHV's operations in foreign markets and investor communication, coordination of the development of LHV's strategy and its implementation by serving as an active chairman of the Supervisory Boards of the major subsidiaries of LHV.

The Management Board shall ensure the functioning of adequate risk management and internal control within LHV, depending on the business area pursued by LHV. LHV's internal control system covers all activities carried out by the Supervisory Board, management and staff members of LHV with the aim of ensuring efficiency of operations, adequate risk management, reliability and accuracy of internal and external reporting, correspondence to reality and unconditional compliance with all legal acts. The internal control system covers all business, support and control units.

The objective of risk management within LHV is to recognise, correctly measure and manage the risks. On a wider horizon, the objective of risk management is to enhance corporate value by minimising loss and reducing volatility of results.

Risk management is based on a strong risk culture and is built on the principle of three lines of defence, with the first line of defence, i.e. business areas, being responsible for risk-taking and day-to-day management of risks. The second line of defence, i.e. the risk management area, is responsible for developing risk management methods and reporting on risks. The third line of defence, i.e. internal audit, exercises independent supervision over the entire organisation.

### 2.2. Remuneration principles of the members of the Management Board

The purpose of establishing remuneration principles within LHV is the organisation of fair, motivating and transparent remuneration in accordance with the law.

Competence for the establishment of remuneration principles and remunerations for members of the Management Board shall lie with the Supervisory Board. The Remuneration Committee shall review the basis for the remuneration

of the Management Board on an annual basis. In assessing the activities of the members of the Management Board, the Remuneration Committee shall, above all, consider the professional duties of the Management Board member, their activities, the activities of the entire Management Board as well as LHV's financial position, the current status of and outlook for business operations in comparison with companies operating in the same sector of economy.

The remuneration payable to a member of the Management Board, including the options programme, must motivate the individual to operate within the best interests of LHV. The basic salary and remuneration principles of members of the Management Board shall be set forth in the employment contract or Management Board member contract concluded with the respective persons. The principles of remuneration of the Management Board or staff members engaged in internal control and risk management shall ensure their independence and objectivity in the performance of their risk management/internal control duties. The remuneration of this staff shall not depend on the results posted by the units supervised. The objectives shall be described on the level of individual staff members.

When measuring the key quantitative and qualitative results and assessing the risk, LHV shall be governed by the following principles:

The performance criteria established by LHV must not stimulate excessive risk-taking or sale of unsuitable products.

The performance criteria must not merely contain performance efficiency indicators (e.g. profit, revenue, profitability, expenditure and volume indicators) or market-based indicators (e.g. stock price or bond yield) but must also be adjusted with risk-based indicators (e.g. capital adequacy, liquidity).

The criteria used for measuring risks and results shall be as closely related to the decisions of the staff member, whose results are being appraised, as possible, and should ensure that the process of the establishment of the remuneration would have an appropriate impact on the staff member's professional behaviour.

A good balance of both quantitative and qualitative as well as absolute and relative criteria shall be used in the specification of the performance criteria.

Quantitative criteria shall cover a sufficient period of time, so as to consider the risks taken by the staff members or business units. The criteria shall be risk-adjusted and contain economic efficiency indicators.

Examples of qualitative criteria include achievement of strategic objectives, customer satisfaction, adherence to the risk management policy, adherence to internal or external rules of procedure, management skills, team-work, crea-

tivity, motivation and co-operation with other business units and the internal control function.

LHV applies the long-term incentive (LTI) plan, i.e. the options programme. An annual performance pay shall be added to the basic salaries of Management Board members, top managers and key personnel included in the options programme (including staff members equivalent to the Management Board members), the amount and disbursement of which corresponds to the achievement or non-achievement of individual targets or LHV's targets. The basis for establishment of performance pay in the options programme shall be objective and justifiable, with the time period for which performance pay shall be paid previously determined. The performance pay instruments consist fully of stock options.

Severance compensation payable to a member of the Management Board shall correspond to their previous work results. No severance compensation shall be paid, if this damages the interests of LHV. The size of the severance compensation shall correspond to the results achieved over time, and to the remuneration received.

In 2018, salaries and other compensations paid to the management of LHV and its subsidiaries totalled EUR 1,471 thousand (2017: EUR 1,371 thousand), including all taxes. The remuneration/salaries and compensations of the members of the Management Board of LHV subsidiaries are included in the above total sum, whereas as at the end of 2018, the Management Board of AS LHV Pank included seven members, AS LHV Finance (subsidiary of AS LHV Pank) one member, AS LHV Varahaldus two members and OÜ Cuber Technology one member. Also, the sum includes the salaries and compensations of a 3-member Management Board of UAB Mokilizingas, the majority shareholding of which was transferred in May 2018. Currently, the Management Board of LHV contains one member and the remuneration paid to the member of the Management Board, Madis Toomsalu, under the contract of the member of the Management Board for 2018 is also included in the above total sum. The member of the Management Board of LHV, Madis Toomsalu, can receive as performance pay for the options issued in 2016, 2017 and 2018, 46,979 shares of AS LHV Group; there are no additional bonuses and benefits applicable to the member of the LHV's Management Board.

### 2.3. Conflicts of interests

The members of the Management Board submit a declaration of economic interests and conflicts of economic interests once a year. There have been no conflicts of interest; accordingly, the respective improvement measures have not been applied.

Transactions between LHV and the members of the Management Board, their close relatives or related persons and the terms and conditions thereof must be previously approved by the Supervisory Board. In 2018, no such transactions were concluded between the members of the Management Board, their close relatives or related persons and LHV; also, there are no such valid contracts from earlier periods.

Madis Toomsalu is not a Management Board member or Supervisory Board member in any other issuer. Management Board members of LHV have not been granted authority to issue or buy back shares.

### 3. Supervisory Board

#### 3.1 Membership and duties of the Supervisory Board

The Supervisory Board is a governing body of LHV, planning the activities of LHV, organising the management of LHV and conducting supervision over the activities of the Management Board. The Supervisory Board determines and regularly reviews LHV's strategy, the general plan of action, risk management principles and the annual budget. The Supervisory Board has five to seven members. The members of the Supervisory Board are appointed for a term of three years. The members of the Supervisory Board elect amongst themselves the Chairman of the Supervisory Board, who organises the activities of the Supervisory Board. Election and extension of the mandate of the Supervisory Board members is within the competence of the General Meeting of Shareholders.

Persons with knowledge and experience sufficient for participating in the work of the Supervisory Board and fulfilling the duties of a member of the Supervisory Board and who correspond to the requirements, arising from the Articles of Association, rules of procedure of the Supervisory Board and other internal rules of procedure and legislation, shall be appointed members of the Supervisory Board. Before the appointment, the individual suitability of the person for the position is assessed pursuant to the LHV's procedure on the assessment of the members of the management body and key personnel, following the criteria established in the guidelines on the assessment of suitability of the Financial Supervision Authority, considering also the specific nature of LHV's business operations. According to the referred procedure on the assessment of suitability, also the collective suitability of the Supervisory Board as the governing body is assessed in respect of the available knowledge, competence, managerial skills and diversity in business areas important for LHV.

The members of the Supervisory Board of LHV are Rain Lõhmus (Chairman), Andres Viisemann, Tiina Mõis, Heldur

Meerits, Raivo Hein, Tauno Tats and Sten Tamkivi. The term of office of Supervisory Board members is set to expire on 29 March 2020.

A total of eleven ordinary meetings of the Supervisory Board were held in 2018 and twice, the decisions were approved electronically. Andres Viisemann, Tiina Mõis and Raivo Hein participated in all meetings of the Supervisory Board in 2018. Rain Lõhmus, Sten Tamkivi and Tauno Tats were absent on one occasion, Heldur Meerits on three occasions. All members of the Supervisory Board participated in more than half of the meetings of the Supervisory Board.

The Supervisory Board has formed three committees, charged with the task of advising the Supervisory Board in issues related to audit, remuneration and risk, as described in clauses 3.3-3.5 of this report.

During the meetings, the Supervisory Board received regular overviews of LHV's and its subsidiaries' operating and financial results, the activities, developments and results of the related areas. Risk reports and internal auditor's reports were quarterly reviewed. In the beginning of the year, the Supervisory Board approved the Annual Report 2017, Management Report and proposal of profit distribution and made a proposal to pay dividends in the net sum of 16 cents per share. The financial and capital plan, capital targets, as well as the 5-year financial forecast and the financial calendar were approved for the year 2018. In August, most of the meeting focussed on the discussions over the strategy of LHV and its subsidiaries. During the year, dozens of procedures, policies and internal rules of LHV and its subsidiaries were reviewed, updated and approved. The procedure rule of the Remuneration Committee was reviewed and amended and the mandate of the members of the remuneration Committee were extended. The pricing of options and issuing of share options for the results of the year 2017, and realisation of options were approved. A consent was given for increasing the share capital of AS LHV Pank and reducing the share capital of AS LHV Varahaldus. The share capital of LHV was increased in connection with the realisation of options programme. The LHV's bond programme and the initial public offering of LHV's subordinated bonds planned under the programme were approved.

#### 3.2. Remuneration principles of the Supervisory Board and conflicts of interest

The size of remuneration and its procedure of payment to the members of the Supervisory Board is decided by the General Meeting, considering, i.a. the duties of the Supervisory Board and their extent, as well as the participation at the Supervisory Board meetings and the activity of the Supervisory Board as a governing body. Additional remuneration

neration may be determined to a member of the Supervisory Board in connection with their participation in the activity of the Audit Committee or any other body of the Supervisory Board.

The General Meeting of Shareholders has resolved to establish for the Supervisory Board members a gross remuneration of 500 euros per each meeting of the Supervisory Board, where the member participates. The remuneration payable to the Supervisory Board member is paid out on the next working day following the Supervisory Board meeting. No separate additional pay or performance pay or additional bonuses or benefits have been established.

In 2018, the total sum of remuneration paid to the LHV's Supervisory Board was 35 500 euros, inclusive of all taxes, out of which, 5 000 euros to the Chairman of the Supervisory Board Rain Lõhmus, 5 500 euros to the members of the Supervisory Board Andres Viisemann, 5 500 euros to Tiina Mõis, 4 000 euros to Heldur Meerits, 5 500 euros to Raivo Hein, 5 000 euros to Sten Tamkivi and 5 000 euros to Tauno Tats.

For reasons of clarity, LHV considers it important to note that in case of the Supervisory Board member Andres Viisemann, LHV applies the LTI plan, i.e. the option programme based on his activity as the head of pension funds in LHV's subsidiary AS LHV Varahaldus. The LTI instrument includes 100% share options. Andres Viisemann is entitled to a total of 34 505 shares of AS LHV Group for the options issued in 2016, 2017 and 2018.

Once a year, the members of the Supervisory Board submit a declaration of economic interests and conflicts of economic interests. No significant transactions were concluded between LHV and its Supervisory Board members, their close relatives or related parties in 2018. Also, there are no such valid contracts from earlier periods. There has been no conflict of interest; accordingly, no respective improvement measures were applied.

### 3.3 Audit committee

The Audit Committee is formed by Supervisory Board as an advisory body for monitoring the effectiveness of accounting and reporting (including budgeting process), audit, risk and capital management, internal control system and internal audit, also compliance with regulations. The Audit Committee is governed, in its activities, primarily by the Auditors Activities Act and the rules of procedure established by the Supervisory Board of LHV.

One of the objects of the Audit Committee is to monitor and analyse the processes, which must ensure accurate and efficient preparation of monthly reports and the annual accounts, the efficiency of an internal audit as a process in examining the LHV Group companies' annual accounts

and independence of an audit firm and a sworn auditor representing an audit firm on the basis of law and the compliance of their activities with the requirements of the Auditors Activities Act.

The Audit Committee is responsible for making proposals to the Supervisory Board and providing recommendations for appointment or removal of the audit company, appointment or removal of the internal auditor, prevention or elimination of problems or inefficiencies within the organisation, and compliance with legal acts and good practice.

The Audit Committee consists of a minimum of three members. Members of the Audit Committee are appointed by the Supervisory Board for a term of three years, with the aim of ensuring diversity of competences and independence of committee members. The persons elected to the Audit Committee shall be those, who are sufficiently independent of LHV in order to fulfil their role in an efficient way and at least two of whom shall be experts in accounting, finance or law; also, compliance to the requirements of LHV's internal procedure rules and legislation is important. LHV's employee, member of the Management Board, an internal auditor, a procurator or a person providing the audit auditing service shall not be a member of the Audit Committee. In order to elect a member of the Audit Committee, the candidate's written consent is required. The size of remuneration paid to the members of the Audit Committee is decided by the Supervisory Board of LHV.

The members of the Audit Committee are Kristel Aarna, Tauno Tats and Urmas Peiker (Chairman). The mandate of the Audit Committee is valid until March 31, 2020. More detailed information on the members of the Audit Committee is presented in the Annual Report, section "Corporate Governance of LHV Group". LHV's Audit Committee members are paid a monthly gross remuneration of 500 euros.

Pursuant to the rules of procedure, the Audit Committee gathers for meetings at least on a quarterly basis, but in 2018, the Audit Committee has gathered for meetings on nine occasions.

At seven meetings, representatives of the risk management department gave the members of the Audit Committee an overview of the various risk management topics, bank and group risk exposures, and indicators and measures used to monitor and manage them – as well as the transition process to IFRS 9 and anti-money laundering, management of IT risks and compliance and data protection.

In most of the meetings, the issues raised by the internal audit, above all in connection with various audit reports were discussed in addition to other topics. The internal auditor gave an overview of the concluded audits. The Audit

Committee has reviewed all the reports prepared by the internal audit and discussed the observations made, and the Audit Committee has formulated its views on the observations. In two meetings, the internal audit work plan was discussed. Also, the external auditor participated in three meetings during the year. In February, the external auditor gave an overview of the 2017 annual report audit process and the findings; in October, the 2018 financial audit plan and during the last meeting, of the findings made during the interim audit. During the year, the Audit Committee also confirmed and approved specific additional services provided by an external auditor.

### 3.4 Remuneration Committee

The Remuneration Committee is a body formed jointly by the Supervisory Bodies of LHV and AS LHV Pank for the development, implementation and supervision of the remuneration strategy of the employees and members of the Management Board of the mentioned companies. One of the tasks of the Remuneration Committee is to evaluate the impact of any remuneration-related decision on adherence to the requirements established for the management of risks, own funds and liquidity.

The Remuneration Committee conducts supervision over the remuneration of Management Board members and staff members of LHV, evaluates implementation of the remuneration policy at least on an annual basis and, where necessary, proposes to update the remuneration principles and prepares the related draft resolutions for the Supervisory Board.

The Remuneration Committee consists of a minimum of three members, who shall be elected from among the members of the Supervisory Board. The members of the Remuneration Committee are appointed and removed by the Group's Supervisory Board. A member of the Remuneration Committee shall be appointed for a term of one year. A member of the Remuneration Committee can be re-elected and their mandate extended unlimited times. The persons elected to the Remuneration Committee shall be those, who have sufficient and relevant knowledge, proficiency and work experience in the area of remuneration policy and practices, risk management and control. The size of remuneration payable to the members of the Remuneration Committee is decided by the Supervisory Board.

Members of LHV's Remuneration Committee are Rain Lõhmus, Andres Viisemann and Madis Toomsalu (Chairman) whose mandate is valid until May 21, 2018. More detailed information on the members of the Remuneration Committee is presented in the Annual Report, section "Corporate Governance of LHV Group". No remuneration is paid to the members of the Remuneration Committee.

The Remuneration Committee met once in February 2018, when the Chairman of the Committee was elected, remuneration policy and strategic principles for remuneration, market comparison, critical positions and planned positions for 2018 were reviewed. The committee discussed and made a proposal to the Supervisory Board with regard to the recipients of share options and the related amounts for the results posted in 2017, as well as with regard to the pricing of share options and the share options of resigning staff members. The remuneration system, the goals and salaries of the members of the Management Board, incl. of LHV and its subsidiaries, and the principles for remuneration of the members of the Management Board and persons who were equal to the members of the Management Board were reviewed.

### 3.5 Risk and capital committee

The Risk and Capital Committee is a functional body of LHV, the task of which is advising the Supervisory Board and Management Board of LHV with regard to risk management principles and risk tolerance, assessing the risks taken by LHV and monitoring implementation of the risk policy within LHV Group companies. The Risk and Capital Committee also carries out supervision of the implementation of risk management principles by the Management Board in accordance with the instructions given by the Supervisory Board, checks that the probability and timing of risk, capital, liquidity and revenue is taken into account in remuneration principles, and that the business model and risk management principles are taken into account in the fees established for customers.

The Risk and Capital Committee shall consist of a minimum of three members, who shall be elected from among the members of LHV Supervisory Board, whereas the committee members shall include the Chairman of LHV Supervisory Board. The persons elected to the Risk and Capital Committee shall be those, who have sufficient knowledge, skills and experience, in order to understand and monitor on a continuous basis the risk management principles and risk tolerance in LHV Group companies. The competence, rights, operating principles and remuneration payable to the members of the Risk and Capital Committee shall be determined by the Supervisory Board of LHV.

Rain Lõhmus (Chairman), Andres Viisemann and Tiina Mõis serve as members of the Risk and Capital Committee, whose mandate is indefinite. More detailed information on the members of the Risk and Capital Committee is presented in the Annual Report, section "Corporate Governance of LHV Group". No remuneration is paid to members of the Risk and Capital Committee.

Four regular meetings of the Risk and Capital Committee were held in 2018, reviewing regular risk reports and loans

with high risks. During the meetings, the market risk and liquidity risk assessment principles, RAROC model, as well as the organisation of LHV information security, compliance risks and their management, the new guidelines of the Financial Supervision Authority on the anti-money laundering and terrorist financing and the structure of LHV's AML system and the occurred cases were examined. The IFRS 9 and SREP report and their impact were also reviewed.

#### **4. Cooperation of Management Board and Supervisory Board**

The Management Board and Supervisory Board work in close co-operation to best protect the interests of LHV. The co-operation is, above all, based on an open exchange of views between as well as within the Management Board and the Supervisory Board.

The Management Board and the Supervisory Board joint their efforts to lay out the objectives and strategy of LHV. In the management of LHV, the Management Board is governed by the strategic instructions given by the Supervisory Board. The Management Board regularly discusses strategic management issues with the Supervisory Board within the framework of an open dialogue. The Board is invited to participate in monthly meetings of the Supervisory Board.

The Management Board regularly informs the Supervisory Board of the key circumstances regarding the activity plans and business activities of LHV, the risks involved and management of such risks.

No conflicts of interests occurred in the financial year 2018; accordingly, no respective improvement measures were applied.

#### **5. Disclosure of information**

LHV treats all shareholders equally and notifies all shareholders of relevant essential circumstances accordingly, ensuring equal and quick access to the respective information. Information is disclosed in accordance with the rules set forth for publicly traded companies.

LHV contributes actively to the development of good relations with the investor community and to raising the awareness of investors. LHV has set up an investor relations website, making all documents and information available to the shareholders in accordance with the Corporate Governance Recommendations and statutory requirements. LHV is the biggest and the only member of the Baltic market, who publishes monthly financial results, the detailed financial plan of the following year and the five-year

financial forecast on its website. The website of LHV shows also the financial calendar of the current and following year, containing the publication dates of the annual report and interim reports and the date of the Annual General Meeting of Shareholders. The disclosed information is available on the website in the Estonian, English and Russian language. LHV also discloses its annual plans and monthly results via the stock exchange announcements.

LHV organises quarterly investor meetings and web-seminars, the summaries of which can be reviewed via the website of LHV. Additional meetings with analysts and presentations and press conferences aimed at analysts, investors or institutional investors are made in accordance with the need and wishes of interest groups. On its website, LHV explains its goals, directions and opinions in terms of possible trends, regulatory or business environment changes. LHV aims at being open to questions, transparent and report of its activities to investors.

LHV's dividend policy is available on LHV's website, stipulating the dividend payment principles, according to which the key precondition for payment of dividends includes external and internal regulatory capital standards, which have to be met in a sustainable manner. LHV may decide to waive dividend payment under the corresponding growth and/or investment plans. Where the preconditions are met, LHV shall pay a minimum of 25 per cent of the shareholders' profit before taxes in dividends, income tax included.

#### **6. Financial reporting and auditing**

LHV publishes its annual report on an annual basis. The annual report is audited, and approved by the Supervisory Board and confirmed by the General Meeting.

The number of auditors is determined and the auditors appointed by the General Meeting of shareholders. The General Meeting also establishes the procedure for remuneration of auditors. Auditors are appointed for a single audit or for a specified term.

At the end of 2017, the Management Board, in cooperation with the Audit Committee organised a tender for selecting the auditor. Within the tender, LHV met with and requested bids from four major internationally recognised companies. When selecting the auditor, the practical work experience, skills and knowledge, trustworthiness, clear communication and offered terms and conditions of cooperation compared to market conditions and criteria, arising from the specific nature of LHV's business operations were assessed. As a result of the tender, AS PricewaterhouseCoopers was chosen and appointed the company's auditor at the Annual General Meeting of Shareholders held on April, 11, 2018. A two-year contract was entered into

with AS PricewaterhouseCoopers for the audit of the financial years 2018-2019. The total sum paid or payable for the services provided by the auditor in 2018 is 170 thousand euros.

During 2018, the auditor has rendered contractual services to LHV consolidation group companies, including audits of the annual accounts of group companies and reviews of the profits disclosed in quarterly financial statements, translation services, tax advisory services, advisory services related to the planned amendments to the Investment Funds Act and other assurance services, which are required to be performed by auditors according to Credit Institutions Act, Securities Market Act and Investment Funds Act. All the services provided were pre-approved by Audit Committee and are permitted services under non-audit EU regulation.

Transactions with related parties are disclosed in Note 24 to the annual accounts.

#### **Declaration of conformity**

LHV adheres to the Corporate Governance Recommendations, with the exception of the following instructions and recommendations for the reasons stated below:

*"1.3.3. Issuers shall make participation in the General Meeting possible by means of communication equipment (Internet) if the technical equipment is available and where doing so is not too cost prohibitive for the Issuer."*

Observation of the General Meeting and participation thereof has not been made possible by means of communication equipment. There has been no need, no corresponding requests and no suitable solution for such a facility. Nonetheless, LHV stands ready to ensure participation of shareholders at the General Meeting via secure electronic means (without being physically present at the general meeting), with the corresponding option added to the Articles of Association of LHV.

*"2.2.1. The Management Board shall have more than one (1) member and a Chairman elected by its members."*

*The Management Board or Supervisory Board shall establish an area of responsibility for each member of the Management Board, defining as clearly as possible the duties and powers of each board member. The principles for co-operation between members of the board shall also be established."*

*The Chairman of the Supervisory Board shall conclude a contract of service with each member of the board for discharge of their functions."*

The Management Board of LHV has one member. LHV is a

holding company without any day-to-day operational business activities. Thus, a single member of the Management Board ensures sufficient and comprehensive management of LHV. The major subsidiaries of LHV have management boards consisting of several members.

*2.2.7. Basic wages, performance pay, severance packages, other payable benefits and bonus schemes of a Management Board member as well as their essential features (incl. features based on comparison, incentives and risk) shall be published in clear and unambiguous form on website of the Issuer and in the Corporate Governance Recommendations Report. Information published shall be deemed clear and unambiguous if it directly expresses the amount of expense to the Issuer or the amount of foreseeable expense as of the day of disclosure."*

*The Chairman of the Supervisory Board shall present the essential aspects of the Management Board remuneration and changes in it to the General Meeting. If the remuneration of some of the Management Board members has occurred on a different base, then the General Meeting shall be presented the differences together with the reasons therefore."*

LHV discloses the total sum of remuneration paid to Management Board members in Note 24 to the annual accounts, highlighting in the Corporate Governance Recommendations Report additionally the number and membership of the persons included in the total sum. LHV does not disclose the remuneration of individual members of the Management Board because this constitutes personal data, the disclosure of which is not unavoidably necessary for evaluation of the operations and management quality of LHV.

*"3.2.2. At least half of the members of the Supervisory Board of the Issuer shall be independent. If the Supervisory Board has an odd number of members, then there may be one independent member less than the number dependent members."*

Within the meaning of the Corporate Governance Recommendations, only Sten Tamkivi is an independent member of the Supervisory Board of LHV. LHV is in the stage of active development and growth, where it has preferred people of long-term management skills and banking experience as members of the Supervisory Board. These people are also the largest shareholders of LHV. LHV believes that, as members of the Supervisory Board, the largest shareholders are best motivated to contribute to the management of LHV and its development over the long-term horizon. Based on objective and certified data, it still has been confirmed that at least half of the Supervisory Board members are not majority shareholders of LHV, have no right in any way to determine the majority of the

LHV Management or Supervisory Board members and do not exercise control over LHV in any other way, they are not bound with LHV by material business interest, they are not related to a shareholder of LHV who exercises control over LHV, they are staff members of LHV or partners or key personnel of the partner; accordingly, LHV does not consider it necessary to apply any corrective measures and assesses the Supervisory Board of LHV as collectively suitable, including in terms of independence, in the existing membership.

*“Pursuant to subsection 24<sup>2</sup> (4) of the Accounting Act, a large undertaking whose securities granting voting rights have been admitted for trading on a regulated securities market of Estonia or another Contracting State shall describe in the corporate governance report the diversity policies carried out in the company’s Management Board and senior management and the results of the implementation thereof during the accounting year. If no diversity policies have been implemented during the accounting year, the reasons for this should be explained in the corporate governance report.”*

LHV has not deemed it necessary to implement a diversity policy, as LHV is governed in the recruitment of staff and management members by the best interests of LHV – the education, skills and previous experience of the person on

a gender neutral on non-discriminatory basis and upon need, compliance to statutory requirements.

Tiina Mõis serves as a member of the Supervisory Board of LHV and as a member of the Risk and Capital Committee, and Kristel Aarna as a member of the Audit Committee. Together with the management members, LHV’s subsidiaries engage a total of 67 middle-level managers of whom 21 are women.

# Social responsibility in LHV

AS LHV Group (hereinafter LHV) is committed to doing business in a sustainable and socially responsible manner. To do this, on a daily basis we think more broadly than just about LHV's own business concerns. We contribute to Estonia – the local economy, society and community around LHV. We wish to influence the development of the Estonian financial market and banking in a positive direction. Responsibility also manifests itself in our goal to be the best employer to people working for LHV. We are a partner who thinks together with you, understands the need of the opposing party and offers a forward-looking service.

The preparation of the social responsibility report is guided by the principles of international standards as well as the UN Sustainable Development Goals (SDG). In view of sustainable development and social responsibility, we have analysed the following focus areas of corporate social responsibility that are the most important for LHV, and shown the relevant key areas: economic and capital market development, sustainable and responsible business, LHV as the best working environment. The strategic starting points of LHV's social responsibility and sustainable activities as well as responsible management in LHV have also been introduced. Reducing environmental impacts and supporting the social environment are also important.

## Strategic starting points

LHV's mission is to help raise Estonian capital. Our vision is focused on Estonia, where people and businesses dare to think big, engage in enterprise, and invest in the future.

According to our vision:

- Estonian people and companies dare to do great things, grow boldly and set high goals. Their way of thinking and acting is vast, crossing the boundaries of the state and outdated concepts. Estonian people invest in the Estonian economy.
- Estonian companies are also able to use external labour and new technology, sell their products and services worldwide. They are the biggest employers in Estonia and play an important role in shaping Estonian life and politics. Companies have the opportunity to prefer financial services based on Estonian capital. Estonian products and brands are known in the world for their high quality.
- The Estonian state and people are proud of their companies and entrepreneurs, and LHV is considered to be a "local" with an important role in the Estonian economy and society.

## LHV values are simplicity, support, performance.

We are guided by these values in our actions and in our behaviour as an organisation towards our main stakeholders.

### • Simplicity

The product range is defined from the customer's point of view; pricing is transparent and easy to understand for the customer; customer service is built on customer comfort and daily behavioural patterns; we are constantly looking for opportunities and technologies to simplify our daily banking.

We talk about things as they are; we strive to make it easy for colleagues to do their job.

Flat organisation and compact team; we focus on these aspects where we can be the best on the market.

LHV's reports are transparent; LHV brand and strategy are easy to understand, relevant and distinct from the market; investments in LHV are easy.

### • Support

We listen to the customer and consider his/her needs in our solutions; we are easily accessible to the customer; we advise, but do not make decisions for the customer; we treat the customer as an equal partner with whom we have a joint business; if the customer feels that the bank is wrong, we do not justify ourselves but find/seek a solution.

We enable to take risks, make mistakes upon deciding and learn from mistakes; we are open and balanced in giving feedback; we believe that more valuable people are those who have time for their loved ones.

We support those who are committed to their actions. Partnership is central to growing the business of LHV.

### • Performance

All the products we offer must create clear added value for our customers; when investing our customer's funds, our goal is to achieve a better return than that of the market.

We boldly sell the products we believe in; we exceed customer expectations; we value simple and effective solutions.

We strive for more profitability than foreign banks.

## Responsible management

We believe that an ethical and appropriate course of action will ensure success in the long term. Therefore, all LHV's managers and employees must behave ethically and responsibly. LHV's Code of Ethics is the foundation of LHV's various policies, internal procedure rules and procedures regulating the specifics of adherence to the Code of Ethics. In our activities, we are guided, above all, by the principle of legality, good practice and common sense.

The internal rules of LHV have been prepared based on the principles of responsibility, among other things. The management principles of LHV are set out in the Corporate Governance Policy and other policies of different areas. The basic principles of governance are better described in the "Best Practice of Corporate Governance".

The risk management and analysis of own activities are essential parts of LHV's responsible management system. In risk management, we take into account credit risks, liquidity risks, market risks, financial crime risks and operational risks.

In December 2018, the credit rating agency Moody's confirmed to LHV Bank an investment grade credit rating of Baa1, confirming a sustainable strong financial profile and its ability to serve the commitments taken.

The LHV management structure is organised in an easy-to-understand manner and includes transparent and understandable lines of responsibility. The Supervisory Board, the Management Board and subdivisions pay attention to risk analysis and mitigation. We have three lines of defence for risk monitoring and risk control. The internal control framework covers well-functioning independent risk management, compliance checks and staff performing audit functions. Management has established the necessary committees to advise on risk management. The company gives a comprehensive overview of the risks in the annual "Risk and Capital Report of AS LHV Group".

The important role of responsible management is coordinated with legislation and sector-specific rules. LHV is precise and cooperative in dealing with regulators and monitoring agencies. We comply with all obligations and accountability arising from the law.

The LHV Group is regulated by about 500 legal acts on nearly 17,500 pages. The rules are constantly changing – there are on average 10-15 changes in the legal framework concerning LHV each month. We have acknowledged the complexity of the legal environment, which is why the Management Board and the Supervisory Board are given regular reviews of the changes. In our business development, we try to find a balance between requirements and opportunities – a high level of awareness and a risk-based

approach enable better decisions to be made. LHV's compliance work is focused on the future, we are working on possible changes as early as possible to avoid the later realisation of risks.

## The promotion of the Estonian economy and capital market

The better the Estonian economy, the higher the quality of life in Estonia is. The role of banking is to be the blood circulation of the economy, to support and promote it through the transfer of capital. LHV involves capital from Estonian depositors and pension collectors, helps to raise it and directs it into the Estonian economy. We are aware of the role of LHV as an influencer in the domestic economy.

LHV's mission is to help raise Estonian capital. Therefore, we apply our strategic strengths – investment and entrepreneurial experience – in order to enable the growth of a modern and viable financial group based on Estonian capital, that helps Estonian companies and people save their money and invest. Internationally LHV is cooperating partner for companies developing financial technology.

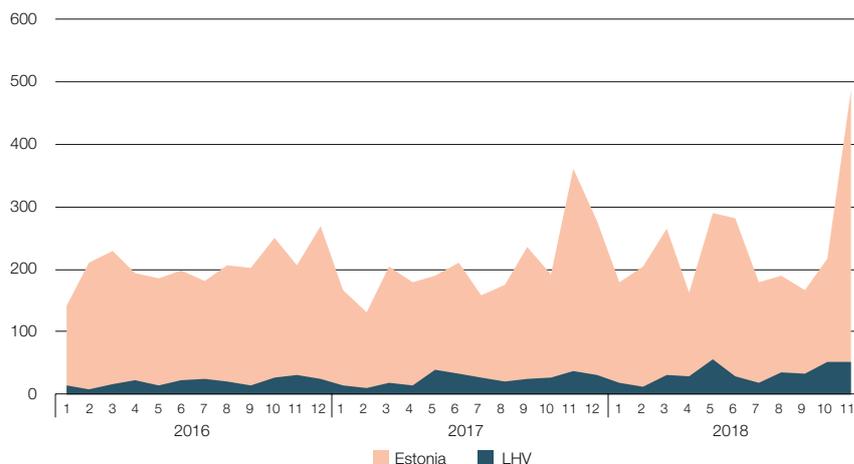
We want to have an impact on Estonian entrepreneurship as well as on the financial behaviour of the people of Estonia towards smarter management through our best market-knowledge, activity and services.

## We promote the Estonian credit market

As a local financial group, we are aware of our role in promoting the economy. We bring capital from Estonian depositors by directing it to Estonian companies.

In 2018, we upgraded our product portfolio. We added trade financing products. Together with Kredex, we can offer credit to companies that do not have enough guarantee to borrow. In cooperation with the European Investment Fund and the Nordic Investment Bank, we have improved the credit facilities of small and medium-sized enterprises. In addition, in 2018, we launched Student Loan for private customers, and we also started offering insurance products to loan customers.

### Turnover of loans to non-financial corporations by industry (in million EUR)



Increase in market share of LHV loans, which shows the increase in LHV's role in financing Estonian companies.

The role of LHV in financing business plans of Estonian companies has grown rapidly. We are a caring financial partner for Estonian companies. We have the competence and desire to focus on the plans of Estonian companies and provide them with support in financing these plans. As an intermediary of domestic capital, we are a clear market alternative for companies.

#### We contribute to the development of banking

We create and develop our services based on the principles of open banking. We aim to develop the Estonian business environment and B2B cooperation by enhancing partnership, innovation and transparency. We promote innovation and the provision of innovative solutions. For example, the salary payment opportunity brought to the market with the Tax and Customs Board is an initiative created for individual-based microenterprises to reduce paperwork and simplify business operations.

LHV has constructive cooperation and competition with other actors in the financial market. AS LHV Bank (hereinafter LHV Bank) is an active member of the Estonian Banking Association, AS LHV Varahaldus (hereinafter LHV Varahaldus) is an active member of the Association of Managing Companies; additionally, we cooperate with other financial service providers within the framework of the non-profit association FinanceEstonia. We contribute to cross-sectoral issues, such as the sharing of money wisdom in Estonia, law making, the adaptation of regulations, prevention of money laundering and the fight against terrorist financing, and the organisation of payments.

In 2018, Erki Kilu, Chairman of the Board of LHV Bank, was elected Chairman of the Board of the Estonian Banking Association. LHV is represented in the work of all 30 units/

workgroups of the Banking Association. Six units are led by LHV.

#### We develop financial services through the servicing of financial technology companies

In 2018, we continued the development of a new business line, which is to provide financial intermediaries with service. In March, we opened a branch in the UK to better serve European financial sector innovators.

We are a contributing partner to innovative financial technology companies who often lack the opportunity to find partners in the international banking market. We provide banking services to companies that aim to increase the speed, convenience, and availability of financial services through technological innovation regardless of where they operate.

The development of banking and financial technology is essential as new service providers bring a new level of quality of service to a client, making it more available and affordable. Therefore, we contribute to the growth of competition and help to expand opportunities. We provide banking infrastructure to innovative and technology-intensive companies and are part of the European community of financial technology innovators.

#### We export financial services

Through the establishment of the UK branch, LHV has become a financial services exporting company. This brings income from abroad to Estonia, which will benefit our shareholders. Operating on the international market and in London is developing our people who can now work in a more competitive environment.

### We contribute to the development of Estonian capital markets

The shares of LHV group are listed on the Nasdaq Tallinn Stock Exchange. The company has over 6,000 equity or bond investors. As a publicly traded company, we aim to set an example of how a regulated market can be used to raise capital and, on the other, how to operate openly, transparently, and manage investor relations in the best possible way. We would like as many clients and partners as possible to be shareholders and investors in LHV and to participate in the building of our shared business.

In 2019 Nasdaq gave LHV Group award for the best investor relation in the Baltics.

For better communication with investors:

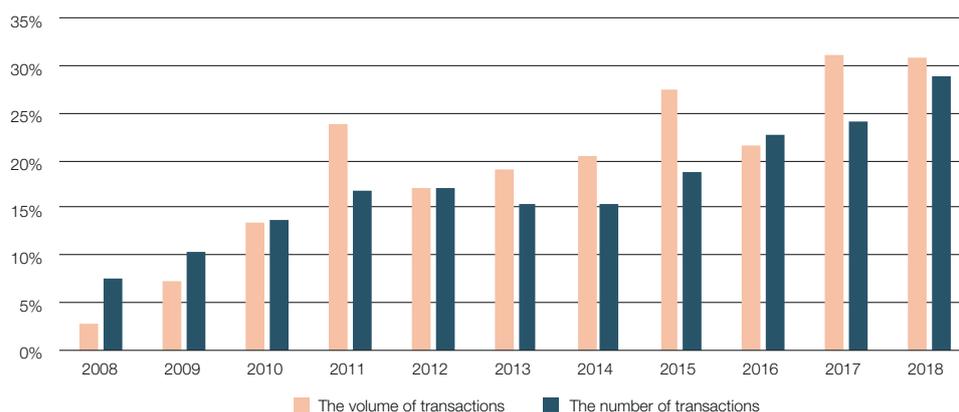
- we will issue a financial forecast for the company for a one-year and a five-year period, so that small investors also have the best knowledge of future plans;
- we publish monthly economic results in addition to quarterly results;
- we organise investor meetings open to all interested parties to comment on the results every quarter;
- we have created an investor.lhv.ee website for investors, which we have built so that the information that is important for investors is equally convenient and easily accessible for everyone.

The goal is to be open to questions, to be transparent and to report to our investors on our activities. We explain our goals to the public. The "Best Practice of Corporate Governance" also provides further details on the fundamentals of information disclosure.

As the institutional brokerage, LHV Bank helps Baltic companies to engage funds from investors. For example, in 2018, we helped AS Tallinna Sadam to carry out an initial public offering to retail investors. We also helped other Baltic companies to raise money from the public market and advised them on important transactions.

LHV Bank is the leading market participant on the Baltic stock exchanges. Our daily brokerage activities as well as our efforts to set an example, contribute to the functioning of Estonian capital markets. In 2019, LHV Bank received the "Best Stock Exchange Member of the Year" award of the NASDAQ Baltic Stock Exchanges. In terms of trading activity of exchange members, we have become the market leader in the Baltics, both in terms of volume of transactions and the number of transactions. We prepare and publish analyses about stock companies in the Baltics. We are market makers for 9 publicly traded companies.

### LHV market share by year



Development of LHV brokerage market share in the Baltic markets (Baltic main list and additional list in shares; First North list)

### Development of Estonian companies through pension fund investments

LHV pension funds play an increasingly important role in financing Estonian companies, the aim of which is to become Estonia's most important institutional investor. LHV Varahaldus increases the number of pension fund customers and the volume of assets which are used for investments.

LHV's pension funds have invested a considerable portion of the clients' pension assets in Estonia and the Baltic countries, in Estonian real estate, enterprises and forest. In 2018, LHV Varahaldus made positive investment decisions in Estonia in the amount of 150 million euros (in 2017, the amount was 170 million euros). We invested in residential real estate as an institutional investor to develop the local rental market. We also invested in the growth of domestic Alexela to become the largest gas station chain in Estonia. In 2018, we created a new pension fund LHV Pensionifond Eesti, which only invests in Estonia.

Like before, we also developed the Estonian capital market as new investment instruments were created as a result of investments. We search for and analyse local investment opportunities. We also create such opportunities ourselves.

After the implementation of changes in pension fund investment conditions in September 2019, LHV's actively managed pension funds aim to earn 7% return per year to be able to earn success fees with all the actively managed funds.

### We grow money wisdom and investor knowledge

As a leader of the investor community, LHV takes responsibility for sharing money wisdom and advancing investor education. We contribute through the following activities:

- We organise regular, free-of-charge "Investor School" seminars for those interested in investing. In 2018, the "Investment School" seminars were attended more than 4,700 times (3,400 in 2017). We also continued organising "Investor Meets" seminars, allowing heads of publicly traded companies to meet investors.
- We organise the yearly stock market game "Ärihai". In 2018, there were 2 600 investment enthusiasts who took part in the game (the number of participants was 818 in 2017). We had a special focus on young people.
- We cooperate with other Estonian financial institutions and participate in money wisdom promotion month organised by the Estonian Banking Association.
- We have set up and we manage a library of investment and economic literature. Our libraries in Tallinn and Tartu hold about 1,000 different publications that

are available to lend to our clients.

- LHV manages the LHV financial portal and the forum set up for discussing investment-related subjects and sharing information. We create content that would interest Estonian investors.
- In 2018, we launched a micro-investment product suitable for beginning with investments.
- Since 2007, we have published the free-of-charge journal "Investeeri", addressing various topics related to entrepreneurship and investing. In 2018, the journal published four editions.
- As a contributor, we helped launch a new economic news portal Rahageenius, which is designed primarily to make economic content accessible and understandable to ordinary consumers.

Our goal is to continue to actively share investment knowledge and to increase the number of investment seminar visitors to 5,000 per year.

### Sustainable business

LHV wants to do its daily business in a way that is sustainable in the long run and based on responsible decisions. We are not only concentrating on maximising short-term profits, but also keep in mind the long-term, mutually beneficial relationships with the market and customers.

### Keeping a cohesive and supportive partnership with customers

For our clients, we are a partner who is reflective, understands the needs of our clients, and offers the most advanced banking services and the best service. In relations with all stakeholders, we consider partnership, honesty, goodwill, engagement and transparency, and at the same time trust to be important. The purpose of adherence to the principle of social responsibility is to create long-term value for LHV's counterparties, and focus on the customer and his/her needs in our business activities.

We want to service our clients and communicate with them soundly, kindly and politely. Our respect for our clients is reflected in understanding the client's needs, in our responsibility, in our availability to our clients as well as in our effective administration.

We organise regular internal training sessions and the necessary certification to provide the best customer service. We have developed a customer service textbook to provide the best service. In February 2018, we organised an in-house service month for LHV, where we paid attention to good service and organised evaluations more than usual. We have taken various steps with client engagement.

- In 2018, Euromoney recognised LHV Bank as the best bank in Estonia. This world's leading economic magazine also recognised LHV's private banking service as the best in Estonia.
- According to the research company DIVE, LHV's service was the best in the Estonian banking sector in 2016 and 2017, and we managed to maintain an excellent level in 2018 (result 91% of maximum, while our goal was >90%).
- Over the year, we organised internal mystery shopping events, the result of which was very good, averaging 90% (the target was 95%).
- During the year, we asked 16,770 LHV customers who contacted the LHV customer support for feedback on our service. 40.6% of respondents gave their feedback. As a result, more than 90% (target >90%) of customers were satisfied with the service and solving their issue (6,166 respondents were positive on the service and 643 respondents said the service was deficient or they were dissatisfied).

All client complaints and proposals are registered and taken into account when organising the bank's work. In 2018, LHV Bank registered 338 customer complaints (309 in 2017). Complaints were solved efficiently, transparently and quickly. The customers' complaints and suggestions should be treated as important feedback which draws our attention to the shortcomings of our products, services and customer service, and to enhance quality accordingly.

We have organised client satisfaction surveys and developed our services in line with our clients' wishes. We have created convenient and diverse communication channels for communication. The official channels include phone, e-mail and live chat; information and feedback can be shared on social media channels and through the LHV

financial portal. The attraction and retaining of our cooperation partners is based on the same general principles as client communication.

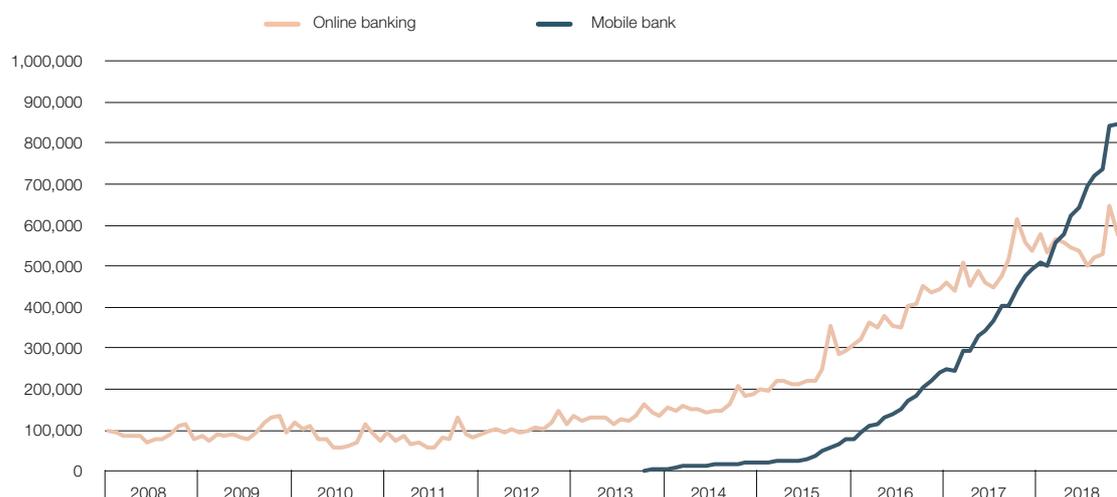
We conduct regular surveys to understand the community's mindset and LHV's role in society. We also participate in analysis and research projects across the banking sector. In 2018, LHV conducted a Brand Survey to better understand the reputation of LHV in society and to map expectations towards LHV. The survey confirmed that:

- Awareness of LHV as a provider of financial services is high and has improved compared to the past (97% of assisted recognition; goal to improve the result of >87%);
- Satisfaction of LHV pension fund customers with their pension fund manager and collection result is high (62%; 73% in 2016);
- Satisfaction with LHV Bank is higher than for other banks (82% do not see the need for changing their bank services provider);
- Recommendation index in the sector is high (55);
- LHV Bank is rather perceived as a local, simple, modern, customer-centred, reliable and important bank.

### We provide accessible and affordable electronic service

When providing services, LHV deliberately focuses on electronic service channels, which helps customers to access services as easily as possible, saving the environment, resources, manpower, etc. Also in 2018, we prioritised the development of electronic service channels. In addition to online banking, the mobile bank channel has grown significantly both in terms of importance and user activity.

### LHV online banking and mobile bank usage activity by login



Electronic channels provide significant added value to target customers. LHV customers can use services, sign agreements, and make transactions by using electronic identification and signing possibilities. For customers, this reduces the time spent, helps save on transport, etc.

### **We offer quality services that meet the needs of the target group**

We focus on active and independent customers with an enterprising frame of mind. LHV wants to be the best financial services provider for private individuals who are accumulating and investing in financial assets and companies in need of financing. LHV Bank and LHV Varahaldus have created the products offered to their customers in view of the long-term needs of the customers. LHV Bank has focused on providing private customers and small and medium-sized enterprises with the best banking services. The main activity of LHV Varahaldus is offering the best pension funds to provide our customer with a long-term pension savings service.

Through the years, LHV has developed almost all the financial products needed by their customers to help them manage their money. We do not charge excessive service fees from our customers, the pricing is clear and transparent. For example, LHV Pank offers free European payments to their customers.

At the end of the year LHV Pank joined the real time euro payment system, which makes settlements more convenient for the customers and enables the development of new financial services.

In 2018, the selection of retail financing products offered to companies was supplemented. We improved our corporate loan options. We improved our electronic communication channels, ATM network and access to cash and launched LHV Youth Bank at the end of August.

LHV Youth Bank was the first time for us to focus on the young segment. These are clients we wish to engage in the long term by offering support to them; by means of help and guidance we can provide our new generation of clients with the necessary financial knowledge and experience to make them more knowledgeable in money matters in the future. Most of our services offered to young people are free. Youth Bank started with LHV Youth Card offering various discounts and micro investment, which makes it easy to start saving and investing. We also started offering student loans for young people to finance their education.

In order to contribute to the health of our young clients, in autumn we started our cooperation with the health app Sweatcoin.

LHV Varahaldus offers a wide selection of pension funds to the customers. In 2018, the pension fund LHV Pensionifond Eesti was added to the selection.

### **We respect regulations and ethics**

**Responsible loaning** – LHV cares about the business and living environment and strives to minimise any negative impacts of its activities and processes. LHV's credit policy stipulates that LHV makes it their goal to operate in a socially responsible manner, setting an example to both its employees and the general public. All credit decisions are governed by the principle that LHV does not finance counterparties whose activities are liable to cause disproportionate damage to the environment or do not comply with the principles of social responsibility. When financing payment transactions, we make sure that they are not in violation of the tax law in their intent or meaning.

LHV Bank is governed by the responsible lending principle.

We make sure that loan product advertising targeting our consumers is responsible and balanced and does not encourage the customer to make financial decisions that may prove harmful to them. This is also evident in LHV's high credit quality. When engaging in loan relations, the client can assess the suitability of the loan or credit relationship for their loan interest and financial situation and consider the risks.

**Prevention of money laundering and terrorism** – We are exemplary in respecting all requirements for identifying clients and the parties related thereto by understanding their activities. LHV Pank takes a risk-based approach in its operations and makes it a principle to know its customers. This means the requirement of identifying the customers, knowing the origins of their assets and, in certain cases, wealth, and understanding the reasoning behind the formation of business relations. We also monitor our clients' activities to identify operations raising a suspicion of money laundering or terrorist financing. LHV's client acceptance principles define what kind of clients LHV Pank does not wish to engage in client relations with.

LHV Pank enforces international financial sanctions and does not offer services to entities subject to them.

LHV Pank pays particular attention to the clients who offer financial services to their own clients. When providing services to such clients, the same due diligence measures as those used in the provision of correspondent banking services are implemented.

We have continued to increase our anti money laundering and terrorist financing team, which is active in both LHV Pank as well as the bank's external initiatives. LHV's

employees are leading both AML and compliance control working groups in the Estonian Banking Association. Through the said working groups, but also other channels, we provide our input to the legislative process, help to develop good banking practices, and are active in the development of a whole anti money laundering and terrorist financing system. For example in 2018, through the Estonian Banking Association we participated in the drafting of AML recommendations for the Ministry of Economic Affairs and Communications, development of E-residence in various working groups, drafting the shared due diligence measures for the banking sector, etc.

We also engage in active cooperation with our supervisory bodies. In 2018, we integrated the FICO Tonbeller Siron information system to facilitate anti money laundering and terrorist financing monitoring and Accuity Compliance Link for the online screening of payments into our systems.

**Ethical and honest business which respects human rights** – we believe that being ethical, honest, corruption-free and law-abiding is the key to long-term success. This is why all the executives and employees must follow the guidelines laid down in LHV's principles of ethics and ensure that the agreed values are followed in real-life situations. LHV's new employees will be acquainted with all the important principles when they assume their new position.

In all our operations we take care to respect international norms, human rights, data protection regulations, legal acts and rules applicable in the financial sector. LHV's main site of operations is Estonia, where the generally recognised basic human rights are protected, and LHV's practices in this are no different from the general practices of the banking market. We make sure that basic rights are protected both within LHV as well as in our relations with third parties.

In our daily work and interactions with our partners we are responsible, professional, honest and respectful. We acknowledge that our actions have an impact. We base our actions on our values with both LHV's internal target groups as well as internal parties.

At LHV we do not only follow the law by its word, but also intent. We strive to understand the reasoning and background of norms. Taking advantage of legislative gaps is not considered acceptable at LHV.

**Honest competition** – when communicating with competitors and supervisory authorities, we keep in mind that all market participants and supervisors pursue market stability and endeavour to remain trustworthy in the eyes of the customers. We are accurate, honest and respectful

towards our competitors, and avoid talking poorly of them in any way. We abide by the principles of fair competition, and only use legal and ethical means for gaining a competitive edge. Any agreements or concerted practices between market participants, which have the restriction of competition as their object or effect are prohibited.

**Honest and transparent marketing and communication** – LHV Bank abides by the generally accepted marketing principles and does not use information that is inaccurate or attacks their competition in their advertising. We ensure that any information provided to customers, including all marketing materials, is factually correct, easily understandable and competent, and draws sufficient attention to the potential risks and costs related to the service. LHV has compiled their advertising content guidelines. LHV has internal control measures to make sure that their advertising is in compliance with the law and its internal regulations.

Any stock exchange announcements, press releases and statements published by LHV are accurate and timely, without distorting any facts. Our statements aim to give a true and fair view of LHV Bank's financial position, economic results and cash flows. We comment and provide information on topics related to LHV's business activities. In 2018, we informed the public with 48 stock market announcements and 37 press releases.

**Protection of a banking secret** – LHV's operations are based on the trust of our customers, supervisory authorities and the society. Clients' assets and personal information are reliably protected at LHV. We treat all the information related to our customer, including the fact that they are our bank's customer, as a banking secret. LHV's employees are not permitted to disclose client-related information treated as a banking secret to persons who are not entitled to such information.

LHV's staff members apply measures to ensure that customer data are kept confidential, including legally required security measures for the protection of personal data and prevention of the processing of personal data by unauthorised persons.

In 2018, the position of Head of Information Security was formed at LHV Bank and even more focus than before is being put on information security. We have also taken the direction of informing our clients and the public in matters related to information security. In the Banking Association, we engage in cooperation with other banks in presenting topics related to information security.

**Protection of insider information** – as a publicly traded company, LHV treats all of its investors equally. In compli-

ance with the Estonian stock exchange legislation, the European Union legislation and Nasdaq Tallinn Stock Exchange rules, we have established the rules for the management of insider information, that all the employees and executives of LHV must follow. The rules lay down the principles for the maintenance and disclosure of insider information and prohibitions and restrictions in making transactions with the Group's securities.

As a publicly traded company, LHV has also heightened expectations towards its employees' personal transactions. In order to protect LHV's trustworthiness, the company has established rules for personal securities transactions, which rule out conflicts of interest and making transactions using information not available to the public.

Regulations for the management of a conflict of interest are in place for avoiding and managing conflicts of interest.

### **We strive to guarantee employee satisfaction**

There are more than 380 people working at LHV who form a community that is one of the company's most important assets. LHV's goal is to be the best employer so that each person working in the company may contribute to the development of the company and feel the importance of their contribution. We strive for an honest, open and supportive internal climate.

In the selection of LHV's employees and executives, LHV is always guided from LHV's best interests and therefore makes the choices in a gender neutral and non-discriminatory manner based on the person's education, skills and prior experience and, if necessary, requirements arising from the respective legislation. LHV has not found it necessary to implement any diversity policies. Also counting the Management Board, the companies of LHV employ 67 executives of whom 21 are women.

### **Satisfaction and regular feedback**

We have developed various measures to get feedback from our employees and encourage in-house communication.

Every two years, we hold employee satisfaction surveys. In 2018, the satisfaction survey was filled in by 290 employees, which is 79% of the whole staff. The overall result of the survey was 6.2 points (out of 7). We have fulfilled our goal of improving this score. It was 6.0 points in 2016, 5.8 points in 2014 and 5.7 points in 2012 and 2010. Outstanding scores of 6.4 points (out of 7) were given to direct supervisors. The survey confirmed that our human resource policies are moving in the right direction and in general, employee satisfaction continues to soar.

When comparing the answers of men and women, it is clearly evident that the results are similar. There is no difference between how men and women perceive the situation in the company. Looking by age brackets, the results are similar, although younger people tend to give higher scores. By seniority, satisfaction is highest among the newest employees.

The overall recommendation index reaches a record high of 71%. In 2016, the result was a solid 62%, but the goal was to improve it further. 222 of the employees rated the question of whether they would recommend LHV to their friends as a good employee with 9 or 10 points out of 10. A growing enterprise has room for improvement in the field of internal communication and the flow of information, which was also revealed in the survey. We will focus on it more in the next few years.

Satisfaction was also evident in the voluntary staff turnover, which in 2018 was low at 7% (9% in 2017).

We take employees' suggestions into account in our management decisions. To make changes within the company, we organise workshops for our employees. We also hold various workshops and courses to develop our executives and get feedback from them.

Employees can give their input and contribute to the development of the company at meetings and strategy days. We collect feedback from new employees at the end of the probationary period and take it into account in the organisation of their future work.

Becoming and being an owner of LHV is favoured. There is an option programme available for executives and key employees. It is a long-term performance pay programme (at least 4 years in the case of executives) integrating the interests of the owners and the performance pay receivers, enabling one to focus on long-term outcomes while bearing all the risks in mind.

Our goal is to give the employees of LHV the best possible work environment, which takes the employees' needs into account.

### **Contributions to development and health**

We contribute to the individual development of our people. LHV's training department is guided by a person-centred approach, based on the personality needed to improve skills, motivation, qualifications, including providing training, teaching materials etc. If necessary, we offer professional rotation within LHV. We have developed a new internal training programme, including thorough training for new employees and language courses. In 2018, changes were made in the new employee training programme, for it to be

more easily comprehensible, focusing more on the most important basics and also covering unguided communication as a social component.

The professional requirements and instructions are documented in the internal procedure rules that are available to everyone. We have devised a special development programme for executives.

LHV contributes to the physical and mental health of its employees. We support the sports initiatives of our employees (football, basketball, volleyball, squash, tennis, badminton, public sports events) and offer sporting benefits (sports expenses, rehabilitation). In 2018 the quarterly sports and health benefits were increased to 100 euros. The usage rate of the benefits in the 2nd half of 2018 was as follows: AS LHV Pank 76%; AS LHV Varahaldus 80%; AS LHV Finance 70%.

We reimburse dental care. We provide vaccinations. LHV has an outstanding occupational health package. LHV belongs to a network of employers engaged in promoting their employees' health. We take into account occupational health considerations using eye strain relieving computer screens, 100% adjustable chairs and desks, and, if necessary, provide people with assistive devices. In the office, we have healthy and natural carpeting with high wool content.

A work environment council operates at LHV, including the representatives of both the employer and the employees.

We emphasise occupational safety. All worksites have undergone risk analysis. On each floor of the offices, there are first aid assistants who have received the required training, and those responsible for fire safety.

In April we had a Health Week, promoting healthy lifestyle habits among our employees and holding courses and joint events.

More than before, LHV has been focusing on the mental health of employees. All employees of LHV have the option of using a therapist's service for counselling in personal or work-related issues. In addition to the above, we have started with mindfulness courses.

For the second year in a row, we successfully carried out our Winter Office project, enabling 130 employees to spend a bit of time working remotely in Portugal. Employees were granted workstations and part of their transportation costs was covered. The winter office has received positive feedback and the project will continue next year.

We try to take the personal needs of people working at LHV into consideration. For example, we can accommodate students with part-time working hours or, if possible, flexible working hours. Every tenth employee has started at LHV as an intern – we offer students the opportunity to

continue working for us. In 2018 we hosted 15 interns, of whom 8 continued to work at LHV. Students also have the opportunity to be a job shadow at LHV.

To ensure a good work-life balance, we value family life: upon the birth of a child, fathers are also granted 15 days' leave, employees receive monetary bonuses when their child starts school and can work reduced hours on their child's birthday and get a day off work for marriage. We offer a childbirth allowance and a death grant. We have special events for employees with families: family days, children's Christmas party. In our remuneration policy, we are objective and unaffected by the employee's person. If required for the positions, we always check compliance with the entry criteria.

Our goal is increasing the job satisfaction of LHV's employees and motivating them, raising their competence (knowledge, skills, experience and capacity), guiding the development of staff satisfaction and fostering the feelings of solidarity and pride.

### **Preservation of the natural environment**

The impact of LHV's activity on the natural environment is limited due to the organisation of our operations. LHV Group companies are located in two places of business, in the centre of Tallinn and Tartu. In 2018, an office in London was added to our work sites. LHV is also renting a smaller office space in Telliskivi Street in Tallinn. At the moment, their importance is rather small.

As a matter of principle, we do not manage a broad office network. We also offer our services through electronic channels, which, among other things, reduces the impact of our activities on the natural environment.

In recent years, we have made several decisions in the direction of having less environmental impact. In this way, we have reduced the use of paper in LHV's activities (the transition to paperless document management, the provision of electronic customer agreements and the so-called FollowMe Printing System solution). We separate the waste paper from other household waste. We have also replaced the use of water machines in our offices with drinking tap water. To reduce the transport volumes, LHV has developed solutions for holding meetings through electronic communication, for example, administration between Tartu and Tallinn is mostly carried out by electronic means.

The office opened in 2018 in the United Kingdom is located in London in the newly opened White Collar Factory building, which has been constructed by environmental guidelines, using passive energy and smart energy-conservation solutions. It is also a work environment putting

focus on employee welfare, granting opportunities for exercise and a healthy lifestyle.

Due to the internationalisation of LHV's business operations, work-related international travel increased at LHV in 2018. In total, LHV's employees travelled 1,028,247 flight kilometres on 821 planes.

### Supporting the social environment

In addition to the aforementioned activities supporting the Estonian economy and society, LHV does its best in supporting endeavours and initiatives contributing to the growth of Estonian society. In our sponsorship projects, we prefer long-term and substantial cooperation. We are willing to contribute to the development of Estonian society and to the realisation of innovative ideas that help to make life in Estonia better.

### Estonian culture and society

Estonian Music Days – from 2016, we are supporting Estonia's oldest music festival, and presenting Estonia's new musical composition award Au-tasu. In 2018, the award for the best new work went to Erkki-Sven Tüür.

**Enn Soosaar Foundation – with LHV's support, the awarding of an annual prize – named in honour of Enn Soosaar – “Ethical Essay-Writing Prize” began in 2012.** In 2018 the award went to Marju Lepajõe.

Intsikurmu Music Festival in Põlva – we supported the music festival for the third time.

We were the main sponsor for the student conference “Awesome day at school” with 1,300 participants.

### Sport and a healthy lifestyle

The Estonian Football Association – LHV Pank has been the main sponsor of the Association and the Estonian National Team since 2010. In addition, we have created the support system of LHV's Football Card that earned a record amount of 79 766 euros for Estonian football clubs in 2018. The Football Card system enables us to unite and maintain the football community.

Estonian Optimist Class Association – we have helped to ensure the sustainability of Estonian sailing for more than ten years. The activities of the association were revived in 2007 when active work started again, sparking interest in sailing among children.

Running events – we supported organising LHV's health run and walk series. Health Run is a unique event series in Estonia, lasting from spring to autumn and giving the

chance to challenge oneself on different terrains. This year's series had 17 different running tracks, 3 of them completely new. This year there were 268 teams participating in the series and 211 runners competing individually. The 1,559 participants managed to cover 101,628 kilometres in total.

We organise a corporate football event, the LHV Cup. It took place for the second time in 2018 with 100 amateur athletes participating.

### Economy and Entrepreneurship of Estonia

Estonian Entrepreneur of the Year competition – we have been one of the main sponsors of the Estonian Entrepreneur of the Year competition since 2012. In 2018, the entrepreneurs of the year were Martin and Markus Villig.

The Gazelle movement – LHV is the sponsor of the Gazelle movement. The movement supports and acknowledges rapidly growing Estonian companies.

Tallinn Restaurant Week – we have been supporting the initiative of the Estonian Restaurant Association since its beginning in 2011. Tallinn Restaurant Week aims to popularise and promote eating out as an opportunity to obtain a cultural experience and socialise.

We supported the organising of the tech conference Latitude59 for the second time in a row.

We issued export grants in cooperation with Tallinn Creative Incubator. LHV's award was earned by OÜ Triibuvineer.

We support many smaller local initiatives with our knowledge, LHV's thematic gifts, advice and performances by our people. We participate in fairs, cooperate with universities, also within the framework of internship programmes. We belong to the Estonian Association of Information Technology and Telecommunications, the Estonian Chamber of Commerce and Industry and the Estonian Employers' Confederation. We also consider it essential to help Estonian producers and companies through our procurement and cooperation relations. LHV knowledgeably uses the products and services of Estonian entrepreneurs (from office coffee to Estonian design and work clothes).

# CONSOLIDATED FINANCIAL STATEMENTS

## Consolidated statement of profit or loss and other comprehensive income

<i>(in thousands of euros)</i>	Note	2018	2017
<b>Continuing operations</b>			
Interest income		45 622	35 494
Interest expense		-7 471	-5 133
<b>Net interest income</b>	5,7	<b>38 151</b>	<b>30 361</b>
Fee and commission income		32 844	26 402
Fee and commission expense		-7 799	-5 413
<b>Net fee and commission income</b>	5,8	<b>25 045</b>	<b>20 989</b>
Net gains from financial assets measured at fair value	5, 11,12	379	714
Foreign exchange rate gains/losses		64	265
<b>Net gains from financial assets</b>	5	<b>443</b>	<b>979</b>
Other income		905	36
Other expense		-43	-182
Staff costs	9	-15 756	-12 991
Administrative and other operating expenses	9	-16 387	-14 407
<b>Profit before credit losses</b>		<b>32 358</b>	<b>24 785</b>
Impairment losses on loans and advances	5,13	-4 879	-3 584
<b>Profit before income tax</b>		<b>27 479</b>	<b>21 201</b>
Income tax expense	5,6	-3 614	-951
<b>Profit from continuing operations</b>	5	<b>23 865</b>	<b>20 250</b>
<b>Profit from discontinued operations</b>	26	<b>3 324</b>	<b>1 927</b>
<b>Profit for the year</b>		<b>27 189</b>	<b>22 177</b>
<b>Other comprehensive income/loss:</b>			
Items that may be reclassified subsequently to profit or loss:			
Changes in the fair value of available-for-sale financial assets	11a	0	76
Changes in the fair value of debt instruments measured at FVOCI	11b	-36	0
Items that will not be reclassified to profit or loss:			
Net gains on investments in equity instruments designated at FVOCI	11b	78	0
<b>Total profit and other comprehensive income for the year</b>		<b>27 231</b>	<b>22 253</b>
<b>Total profit attributable to:</b>			
Owners of the parent		25 237	19 603
Non-controlling interest		1 952	2 574
<b>Total profit for the year</b>	5	<b>27 189</b>	<b>22 177</b>
<b>Total profit and other comprehensive income attributable to:</b>			
Owners of the parent		25 279	19 679
Non-controlling interest		1 952	2 574
<b>Total profit and other comprehensive income for the year</b>		<b>27 231</b>	<b>27 232</b>
Basic earnings per share (in euros)	25	0.97	0.77
Diluted earnings per share (in euros)	25	0.96	0.75
Basic earnings per share (in euros) from continuing operations	25	0.85	0.69
Diluted earnings per share (in euros) from continuing operations	25	0.83	0.68

Notes on pages 53 to 146 are an integral part of the consolidated financial statements.

## Consolidated statement of financial position

(in thousands of euros)

	Note	31.12.2018	31.12.2017
<b>Assets</b>			
Due from central bank	10	639 862	920 714
Due from credit institutions	10	25 791	26 312
Due from investment companies	10	17 005	14 186
Available-for-sale financial assets	11a	0	775
Equity instruments at fair value through other comprehensive income	11b	298	0
Financial assets at fair value through profit or loss	12	46 856	55 859
Loans and advances to customers	13	918 761	732 043
Receivables from customers	14	3 721	9 800
Other financial assets	15	2 936	2 289
Other assets	15	1 651	1 516
Tangible assets	16	1 135	1 421
Intangible assets	16	15 470	4 327
Goodwill	6	3 614	3 614
<b>Total assets</b>	<b>5</b>	<b>1 677 100</b>	<b>1 772 856</b>
<b>Liabilities</b>			
Deposits from customers and loans received	17	1 443 782	1 542 929
Financial liabilities at fair value through profit or loss	12	11	2
Accounts payable and other liabilities	18	24 644	71 070
Subordinated debt	20	50 900	30 900
<b>Total liabilities</b>	<b>5</b>	<b>1 519 337</b>	<b>1 644 901</b>
<b>Equity</b>			
Share capital	21	26 016	25 767
Share premium	21	46 653	46 304
Statutory reserve capital	21	3 451	2 471
Other reserves	11,21	2 090	1 449
Retained earnings		75 430	44 071
<b>Total equity attributable to owners of the parent</b>		<b>153 640</b>	<b>120 062</b>
Non-controlling interest	6	4 123	7 893
<b>Total equity</b>		<b>157 763</b>	<b>127 955</b>
<b>Total liabilities and equity</b>		<b>1 677 100</b>	<b>1 772 856</b>

Notes on pages 53 to 146 are an integral part of the consolidated financial statements.

## Consolidated statement of cash flows

(in thousands of euros)

	Note	2018	2017
<b>Cash flows from operating activities</b>			
Interest received		45 007	34 215
Interest paid		-6 781	-4 496
Fees and commissions received		32 844	26 400
Fees and commissions paid		-7 799	-5 412
Other income received		891	-133
Staff costs paid		-14 647	-11 861
Administrative and other operating expenses paid		-13 415	-13 107
Income Tax		-3 070	-951
<b>Cash flows from operating activities before change in operating assets and liabilities</b>		<b>33 030</b>	<b>24 655</b>
<b>Net increase/(decrease) in operating assets:</b>			
Net increase/(decrease) in financial assets held for trading at fair value through profit or loss		0	278
Net increase/(decrease) in financial assets at fair value through profit or loss		-115	0
Loans and advances to customers		-199 259	-190 320
Mandatory reserve at central bank		1 094	-7 639
Security deposits		-647	-1 348
Other assets		-597	177
<b>Net increase/(decrease) in operating liabilities:</b>			
Demand deposits of customers		-105 458	785 454
Term deposits of customers		-9 316	-25 052
Loans received		16 250	6 000
Repayments of loans received		-722	-779
Financial liabilities held for trading at fair value through profit or loss		8	-207
Other liabilities		-38 413	45 217
Discontinued operations		-121	-5 330
<b>Net cash from/(used in) operating activities</b>		<b>-304 415</b>	<b>631 106</b>
<b>Cash flows from investing activities</b>			
Purchase of tangible and intangible assets	16	-3 450	-1 368
Disposal of subsidiaries, net of cash disposed	6	5 046	0
Proceeds from disposal and redemption of investment securities at fair value through other comprehensive income	11	520	100
Net changes of investment securities at fair value through profit or loss	12	9 473	19 962
<b>Net cash from/(used in) investing activities</b>		<b>11 589</b>	<b>18 694</b>
<b>Cash flows from financing activities</b>			
Paid in share capital (incl. share premium)	21	598	823
Paid dividends	21	-5 295	-3 804
Subordinated loans received	20	20 000	0
<b>Net cash from financing activities</b>		<b>15 303</b>	<b>-2 981</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>		<b>64</b>	<b>254</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>-277 459</b>	<b>647 073</b>
Cash and cash equivalents at the beginning of the year	10	945 837	298 764
<b>Cash and cash equivalents at the end of the year</b>	10	<b>668 378</b>	<b>945 837</b>

Notes on pages 53 to 146 are an integral part of the consolidated financial statements.

## Consolidated statement of changes in equity

<i>(in thousands of euros)</i>	Share capital	Share premium	Statutory reserve capital	Other reserves	Accumulated deficit/retained earnings	Total	Non-controlling interest	Total equity
<b>Balance as at 01.01.2017</b>	<b>25 356</b>	<b>45 892</b>	<b>1 580</b>	<b>1 244</b>	<b>28 335</b>	<b>102 407</b>	<b>5 319</b>	<b>107 726</b>
Paid in share capital	411	412	0	0	0	823	0	823
Transfer to statutory reserve capital	0	0	891	0	-891	0	0	0
Dividends paid	0	0	0	0	-3 804	0	0	-3 804
Share options	0	0	0	129	828	957	0	957
Profit for the year	0	0	0	0	19 603	19 603	2 574	22 177
Other comprehensive income	0	0	0	76	0	76	0	76
Total profit and other comprehensive income for 2017	0	0	0	76	19 603	19 679	2 574	22 253
<b>Balance as at 31.12.2017</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>44 071</b>	<b>120 062</b>	<b>7 893</b>	<b>127 955</b>
Changes in initial application of IFRS 15 (Note 2.1 (a))	0	0	0	0	10 617	10 617	0	10 617
<b>Restated balance as at 01.01.2018</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>54 688</b>	<b>130 679</b>	<b>7 893</b>	<b>138 572</b>
Paid in share capital	249	349	0	0	0	598	0	598
Disposal of subsidiary	0	0	0	0	0	0	-4 550	-4 550
Transfer to statutory reserve capital	0	0	980	0	-980	0	0	0
Dividends paid	0	0	0	0	-4 123	-4 123	-1 172	-5 295
Share options	0	0	0	599	608	1 207	0	1 207
Profit for the year	0	0	0	0	25 237	25 237	1 952	27 189
including changes on initial application of IFRS 9 (Note 2.1 (a))	0	0	0	0	-731	-731	-18	-749
Other comprehensive income	0	0	0	42	0	42	0	42
Total profit and other comprehensive income for 2018	0	0	0	42	25 237	25 279	1 952	27 231
<b>Balance as at 31.12.2018</b>	<b>26 016</b>	<b>46 653</b>	<b>3 451</b>	<b>2 090</b>	<b>75 430</b>	<b>153 640</b>	<b>4 123</b>	<b>157 763</b>

Additional information on equity is provided in Note 21.

Notes on pages 53 to 146 are an integral part of the consolidated financial statements.

# Notes to the consolidated financial statements

## NOTE 1 General information

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These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by European Union for the year ended 31 December 2018 for AS LHV Group and its subsidiaries AS LHV Pank, AS LHV Finance (subsidiary of AS LHV Pank), AS LHV Varahaldus and OÜ Cuber Technology (hereinafter referred together as “the Group” or “LHV”). AS LHV Group holds 65% interest in LHV Finance through AS LHV Pank. AS LHV Group held 50% + 1 share interest in UAB Mokilizingas till end of April 2018 (the financial results of the first 4 months are shown as discontinued operations in the current report).

AS LHV Group is a limited liability company incorporated in and domiciled in Estonia. The address of its registered office is Tartu mnt 2, Tallinn. AS LHV Group is a holding company, whose subsidiary AS LHV Pank provides banking, financial advisory and securities brokerage services to customers in Estonia and in UK. There are offices for client servicing in Tallinn and Tartu and also London branch was opened in 2018. AS LHV Finance offers hire-purchase services

to merchants and consumer finance. AS LHV Varahaldus offers fund management services for pension funds and other funds to clients in Estonia. As at 31.12.2018 the Group employed 395 full-time employees, incl. 23 non-active (31.12.2017: 365 employees, incl. 16 non-active).

The consolidated annual report (incl. financial statements) was approved by the management board on 18h of February 2019. Rain Lõhmus, who owns 24.9% of the voting rights and Andres Viisemann, who owns 9.8% of the voting rights (see also Note 21), have significant influence over AS LHV Group.

The consolidated annual report approved by the management board shall be authorised for approval by the supervisory board and shareholders. The shareholders have the right not to approve the consolidated annual report while the supervisory board does not have that right.

## NOTE 2 Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented and to all the consolidated group entities, unless otherwise stated.

### 2.1 Basis of preparation

The consolidated financial statements of the Group for the financial year 2018 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The financial statements have been prepared under the historical cost convention, except as disclosed in some of the accounting policies below, such as: “financial assets and liabilities at fair value through profit or loss”, including derivatives and assets held for trading.

The preparation of consolidated financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 4.

The financial year started at 1 January 2018 and ended at 31 December 2018. The financial figures have been presented in thousands of euros unless referred differently in specific disclosures.

Certain new IFRS amendments to existing standards and the interpretations of the standards have been published by the time of compiling these financial statements, which became mandatory for the Group's reporting periods beginning on or after 1 January 2018. The overview of these standards and the potential impact of applying the new standards and interpretations are stated below.

#### (a) Adoption of new or revised standards and interpretations

The following new or revised standards and interpretations became effective for the Group from 1 January 2018.

**IFRS 9, Financial instruments** (effective for annual periods beginning on 1 January 2018). LHV has not restated the comparative figures for 2017 in the 2018 annual report as simplified application of IFRS 9 was implemented by management. Key features of the new standard are as follows:

- Financial assets are required to be classified into three measurement categories
- assets to be measured subsequently at amortised cost (AC)
- assets to be measured subsequently at fair value through other comprehensive income (FVOCI)
- assets to be measured subsequently at fair value through profit or loss (FVPL).

The classification and measurement requirements in IFRS 9 state that financial assets should be classified as and measured at, amortized cost, fair value through profit and loss or fair value through other comprehensive income. The classification of a debt instruments is dependent on the business model for the portfolio where the instrument is included and on whether the asset cash flows are solely payments of principal and interest (SPPI). In order to assess the business model, LHV has divided its financial assets into portfolios and/or sub-portfolios based on how groups of financial assets are managed together to achieve a particular business objective. If a debt instrument is held to collect, it may be carried at amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held in a portfolio where an entity both holds to collect assets' cash flows and sells assets may be classified as FVOCI. Financial assets that do not contain cash flows that are SPPI must be measured at FVPL (for example, derivatives). Embedded derivatives are no longer separated from financial assets but will be included in assessing the SPPI condition.

Investments in equity instruments are always measured at fair value. However, management can make an irrevocable election to present changes in fair value in other comprehensive income, provided the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are presented in profit or loss.

Requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

There were no significant changes in the measurement of financial instruments compared to IAS 39. No significant impact was on LHV's financial position, financial performance or equity in the period of initial application from classification and measurement changes. See also transition table below.

The impairment requirements in IFRS 9 are based on an expected loss model as opposed to the current incurred loss model in IAS 39. The scope of IFRS 9 impairment requirements is also broader than IAS 39, IFRS 9 requires all assets measured at amortized cost and fair value through other comprehensive income, as well as off-balance commitments including guarantees and loan commitments, to be included in the impairment test. The assets to test for impairment will be divided into three groups depending on the stage of credit deterioration. Stage 1 includes assets where there has been no significant increase in credit risk, stage 2 includes assets where there has been a significant increase in credit risk and stage 3 includes defaulted assets. Significant assets in stage 3 are tested for impairment on an individual basis, while for insignificant assets a collective assessment is performed. In stage 1, the provisions should equal the 12 month expected loss. In stage 2 and 3, the provisions should equal the Lifetime expected losses.

One important driver for size of provisions under IFRS 9 is the trigger for transforming an asset from stage 1 to stage 2. The transition to IFRS 9 brought the change in loan provisions in the amount of EUR 749 thousand. For assets to be recognized going forward, changes to the lifetime Probability of Default (PD) will be used as the trigger. In addition customers with forbearance measures and customers with payments more than thirty days past due will also be transferred to stage 2.

The provisions under IFRS 9 will be calculated as the exposure at default times the probability of default times the loss given default. For assets in stage 1 this calculation will only be based on the coming 12 months, while it for assets in stage 2 will be based on the expected lifetime of the asset.

For assets where there has been a significant increase in credit risk, LHV currently holds provisions based on the losses estimated to occur during the period between the date when the loss event occurred and the date when the loss event is identified on an individual basis, while IFRS 9 will require provisions equal to the lifetime expected loss. When calculating lifetime losses under IFRS 9, including the staging assessment, the calculation should be based on probability weighted forward-looking information.

Impairment calculations under IFRS 9 will require more experienced credit judgement by the reporting entities than required by IAS 39 previously and a higher subjectivity is thus introduced. The inclusion of forward looking information adds complexity and makes provisions more dependent on management's view of the future economic outlook. It is expected that the impairment calculations under IFRS 9 will be more volatile and pro-cyclical than under IAS 39, mainly due to the significant subjectivity applied in the forward-looking scenarios.

The main change to the general hedge accounting requirements is that the standard aligns hedge accounting more closely with the risk management activities, these changes will not have direct effect on LHV, as LHV is currently not using hedge accounting. Same time we see that the regulation changes will generate some new possibilities to LHV to start using hedge accounting for reducing volatility in financial statements for positions which are hedged with ones treated differently in accounting.

The following table reconciles the carrying amounts of financial assets, from their previous measurement categories in accordance with IAS 39 into their new measurement categories upon transition to IFRS 9 on 1 January 2018:

<i>(in thousands of euros)</i>	Note	Measurement category		Carrying value per IAS 39 (closing balance at 31 December 2017) (a)	Impairment allowance per IAS39 (closing balance at 31 December 2017) (b)	Effect Remeasurement (c)	Carrying value per IFRS 9 (opening balance at 1 January 2018) (a+c)	Impairment allowance per IFRS 9 (opening balance at 1 January 2018) (b+c)
		IAS 39	IFRS 9			ECL		
Due from credit institutions	10	L&R	AC	26 312	0	0	26 312	0
Due from investment companies	10	L&R	AC	14 186	0	0	14 186	0
Due from central bank	10	L&R	AC	920 714	0	0	920 714	0
<b>Total cash and cash equivalents</b>				<b>961 212</b>	<b>0</b>	<b>0</b>	<b>961 212</b>	<b>0</b>
Debt instruments	11	AFS	FVOCI (mandatory)	555	0	0	555	0
Debt instruments	12	FVTPL	FVTPL (mandatory)	49 239	0	0	49 239	0
<b>Total debt instruments</b>				<b>49 794</b>	<b>0</b>	<b>0</b>	<b>49 794</b>	<b>0</b>
Equity instruments	11	AFS	FVOCI (voluntary)	220	0	0	220	0
Fund units	12	FVTPL	FVTPL (mandatory)	6 620	0	0	6 620	0
<b>Total equity instruments</b>				<b>6 840</b>	<b>0</b>	<b>0</b>	<b>6 840</b>	<b>0</b>
Loans and advances to customers	13	L&R	AC	732 043	-8 125	-693	731 387	-8 818
Receivables from customers	14	L&R	AC	9 800	0	0	9 800	0
Other financial assets	15	L&R	AC	2 289	0	0	2 289	0
<b>Total financial assets</b>				<b>1 761 978</b>	<b>-8 125</b>	<b>-693</b>	<b>1 761 136</b>	<b>-8 818</b>
Loan commitments	23			0	0	-20	0	-20
Financial guarantees	23			0	0	-36	0	-36

**Prepayment Features with Negative Compensation, Amendments to IFRS 9** (effective for annual periods beginning on 1 January 2018) The amendments enable measurement at amortised cost of certain loans and debt securities that can be prepaid at an amount below amortised cost, for example at fair value or at an amount that includes a reasonable compensation payable to the borrower equal to present value of an effect of increase in market interest rate over the remaining life of the instrument. In addition, the text added to the standard's basis for conclusion reconfirms existing guidance in IFRS 9 that modifications or exchanges of certain financial liabilities measured at amortised cost that do not result in the derecognition will result in an gain or loss in profit or loss. Reporting entities will thus in most cases not be able to revise effective interest rate for the remaining life of the loan in order to avoid an impact on profit or loss upon a loan modification. The Group applied the amendment to the standard together with IFRS 9. The guidance for changing the standard has been taken into account when assessing whether the cash flows from financial assets meet SPPI requirement.

**IFRS 15, Revenue from contracts with customers** (effective for annual periods beginning on 1 January 2018). The new standard introduces the core principle that revenue must be recognised when the goods or services are transferred to the customer, at the transaction price. Any bundled goods or services that are distinct must be separately recognised, and any discounts or rebates on the contract price must generally be allocated to the separate elements. When the consideration varies for any reason, minimum amounts must be recognised if they are not at significant risk of reversal. Costs incurred to secure contracts with customers have to be capitalised and amortised over the period when the benefits of the contract are consumed. It had the largest impact on AS LHV Varahaldus, where sales costs from previous years were capitalised and amortized over the expected lifetime of the customer contract, which in the case of pension funds is above 20 years. Previously, under IAS 18, the expenses were allowed to be capitalised only until the customer had first opportunity to change pension fund, ie the time period was shorter than 1 year. This effect significantly increased LHV Varahaldus' own funds at the moment of adoption of this IFRS standard. As at 1 January 2018, the Group's retained earnings through

LHV Varahaldus was increased by the sales costs incurred and capitalized until the end of 2017 in the amount of EUR 10 617 thousand and the assets was increased in the same amount. From 1 January 2018, the sales expenses have been recognized as intangible assets and in the income statement, the sales expenses will be replaced with depreciation costs from client contracts. See more information in Note 9.

**Revenue from Contracts with Customers** - Amendments to IFRS 15 (effective for annual periods beginning on 1 January 2018).

The amendments do not change the underlying principles of the standard but clarify how those principles should be applied. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract; how to determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and how to determine whether the revenue from granting a licence should be recognised at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new standard. The new standard did not have material impact on the Group's financial statements.

#### (b) New accounting pronouncements

Certain new or revised standards and interpretations have been issued that are mandatory for the Group's annual periods beginning on or after 1 January 2019, and which the Group has not early adopted.

**IFRS 16, Leases** (effective for annual periods beginning on or after 1 January 2019). The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. All leases result in the lessee obtaining the right to use an asset at the start of the lease and, if lease payments are made over time, also obtaining financing. Accordingly, IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Lessees will be required to recognise: (a) assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value; and (b) depreciation of lease assets separately from interest on lease liabilities in the income statement. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently. Starting from 1 January 2019, EUR 4 042 thousand will

be recognized on the Group's statement of financial position as assets and liabilities, thus increasing the total of the statement of financial position of the Group.

**Annual Improvements to IFRSs 2015-2017 cycle** (effective for annual periods beginning on or after 1 January 2019; not yet adopted by the EU).

The narrow scope amendments impact four standards. IFRS 3 was clarified that an acquirer should remeasure its previously held interest in a joint operation when it obtains control of the business. Conversely, IFRS 11 now explicitly explains that the investor should not remeasure its previously held interest when it obtains joint control of a joint operation, similarly to the existing requirements when an associate becomes a joint venture and vice versa. The amended IAS 12 explains that an entity recognises all income tax consequences of dividends where it has recognised the transactions or events that generated the related distributable profits, eg in profit or loss or in other comprehensive income. It is now clear that this requirement applies in all circumstances as long as payments on financial instruments classified as equity are distributions of profits, and not only in cases when the tax consequences are a result of different tax rates for distributed and undistributed profits. The revised IAS 23 now includes explicit guidance that the borrowings obtained specifically for funding a specified asset are excluded from the pool of general borrowings costs eligible for capitalisation only until the specific asset is substantially complete. The Group is currently assessing the impact of the new amendments.

**Amendments to the Conceptual Framework for Financial Reporting** (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The revised Conceptual Framework includes a new chapter on measurement; guidance on reporting financial performance; improved definitions and guidance - in particular the definition of a liability; and clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting. The Group is currently assessing the impact of the new amendment.

**Definition of a business – Amendments to IFRS 3** (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The amendments revise definition of a business. A business must have inputs and a substantive process that together significantly contribute to the ability to create outputs. The new guidance provides a framework to evaluate when an input and a substantive process are present, including for early stage companies that have not generated outputs. An organised workforce should be present as a condition for classification as a business if there are no outputs. The defi-

inition of the term 'outputs' is narrowed to focus on goods and services provided to customers, generating investment income and other income, and it excludes returns in the form of lower costs and other economic benefits. It is also no longer necessary to assess whether market participants are capable of replacing missing elements or integrating the acquired activities and assets. An entity can apply a 'concentration test'. The assets acquired would not represent a business if substantially all of the fair value of gross assets acquired is concentrated in a single asset (or a group of similar assets). The Group is currently assessing the impact of the new amendment.

**Definition of materiality – Amendments to IAS 1 and IAS 8** (effective for annual periods beginning on or after 1 January 2020; not yet adopted by the EU).

The amendments clarify the definition of material and how it should be applied by including in the definition guidance that until now has featured elsewhere in IFRS. In addition, the explanations accompanying the definition have been improved. Finally, the amendments ensure that the definition of material is consistent across all IFRS Standards. Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. The Group is currently assessing the impact of the new amendment.

There are no other new or revised standards or interpretations that are not yet effective that would be expected to have a material impact on the Group.

## 2.2 Consolidation

The 2018 consolidated financial statements include the financial statements of AS LHV Group (parent company) and its subsidiaries AS LHV Pank, AS LHV Finance (subsidiary of AS LHV Pank), AS LHV Varahaldus and OÜ Cuber Technology. AS LHV Group holds 65% interest in LHV Finance through AS LHV Pank. Until May 2018 AS LHV Group held 50% + 1 share interest in UAB Mokilizingas.

Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The acquisition method of accounting is used to account for the acquisition of subsidiaries (except for acquisitions among enterprises under common control) and business operations. The cost of an acquisition is measured as the fair

value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange. Transaction costs incurred for issuing equity instruments are deducted from equity; transaction costs incurred for issuing debt are deducted from its carrying amount and all other transaction costs associated with the acquisition are expensed. According to the acquisition method, the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary are recognized at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest.

The Group measures non-controlling interest that represents present ownership interest and entitles the holder to a proportionate share of net assets in the event of liquidation on a transaction by transaction basis, either at: (a) fair value, or (b) the non-controlling interest's proportionate share of net assets of the acquiree. Non-controlling interests that are not present ownership interests are measured at fair value.

Goodwill is measured by deducting the net assets of the acquiree from the aggregate of the consideration transferred for the acquiree, the amount of non-controlling interest in the acquiree and fair value of an interest in the acquiree held immediately before the acquisition date. Any negative amount ("negative goodwill") is recognised in profit or loss, after management reassesses whether it identified all the assets acquired and all liabilities and contingent liabilities assumed, and reviews appropriateness of their measurement.

Intercompany transactions balances and unrealised gains on transactions between group companies are eliminated; unrealised losses are also eliminated unless transaction provides evidence of an impairment of the asset transferred.

Revenues and expenses of the subsidiaries acquired within the financial year are consolidated into the Group's statement of profit or loss and other comprehensive income starting from the date of acquisition to the end of the financial year. Result of operations of subsidiaries disposed of during the year are consolidated into Group's statement of profit or loss and other comprehensive income from the beginning of the financial year until the date of disposal.

Pursuant to the Accounting Act of the Republic of Estonia, information of the unconsolidated financial statements (primary statements) of the consolidating entity (parent company) shall be disclosed in the notes to the consolidated financial statements. In preparing the primary financial statements of the parent company, the same accounting policies have been used as in preparing the consolidated financial statements. The accounting policy for accounting subsidiaries has been amended in the separate primary financial statements disclosed as supplement-

tary information in the Annual Report in conjunction with IAS 27 "Separate Financial Statements".

In the parent separate primary financial statements, disclosed in these consolidated financial statements (see Note 27), the investments into the shares of subsidiaries are accounted for at cost less any impairment recognized.

Non-controlling interest is that part of the net results and of the net assets of a subsidiary, which is attributable to interests, which are not owned, directly or indirectly, by the Group. Non-controlling interest forms a separate component of the Group's equity. Non-controlling interest in the consolidated statement of financial position is disclosed separately from the equity attributable to the shareholders of the parent company. In consolidated statement of profit or loss and other comprehensive income, non-controlling interest share of profit is disclosed separately from owners of the parent.

## 2.3 Associates

An associate is an entity over which the Group has significant influence but which it does not control. Generally, significant influence is assumed to exist when the Group holds between 20% and 50% of the voting rights. The Group does not have any associate as at 31.12.2018 and 31.12.2017

In the consolidated financial statements, investments in associates are accounted for using the equity method. Under this method, the investment is initially recognized at cost which is thereafter adjusted for post-acquisition changes in the investor's share of the investee's equity (changes both in the profit/loss of the associate as well as other equity items) and with elimination or depreciation/amortisation of the differences between fair values and carrying amounts of the investee's assets, liabilities and contingent liabilities as determined in the purchase analysis. Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of impairment of the assets.

When the Group's share of losses in the associate accounted under the equity method exceeds the carrying amount of the associate, the carrying amount of the investment is reduced to zero and such long-term loans granted to the associate that in substance form a part of the investment are written down. Further losses are carried off-balance sheet. When the Group has guaranteed or incurred obligations on behalf of the associate, the respective liability

as well as the loss under the equity method are recorded in the statement of financial position. Other receivables from the associate are recorded at amortised cost less a provision for impairment.

An investment in the assets and liabilities of the acquired associate and goodwill that arose on acquisition is presented as a net amount in the statement of financial position line "Investments in associates".

At the end of each reporting period, it is assessed whether there is any indication that the recoverable amount of the investment has fallen below its carrying amount. If any such indications exist, an impairment test is performed. To determine the recoverable amount of the investment, the principles described in section 2.10 are used.

## 2.4 Foreign currency translation

### (a) Functional and presentation currency

The functional and presentation currency of entities in the Group is euro.

### (b) Foreign currency transactions and balances

Foreign currency transactions are recorded based on the foreign currency exchange rates of the European Central Bank prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the end of the reporting period. Non-monetary financial assets and liabilities measured at fair value denominated in foreign currencies are translated into euros based on the foreign currency exchange rates of the European Central Bank prevailing at the fair value measurement date. Gains and losses on translation from monetary assets and liabilities are recorded in the statement of profit or loss under the line "Foreign exchange rate gains/losses". Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss in the statement of profit or loss under the line "Foreign exchange rate gains/losses".

## 2.5 Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, demand deposits with central bank and other banks and investment companies, term deposits with original maturities of three months or less, that are available for use without any restrictions and which are subject to an insignificant risk of changes in value.

## 2.6 Financial assets

*Accounting policies from 1 January 2018*

### Initial recognition and derecognition

Financial assets are recognised on the statement of financial position when the Group becomes a party to the contractual provisions of the instrument and are measured at fair value on initial recognition. Transaction costs are included in the fair value on initial recognition except for financial assets at fair value through profit or loss where transaction costs are expensed in profit or loss. Financial assets at fair value are recognised on the statement of financial position on trade date. Financial assets measured at amortised cost are recognised on trade date.

Financial assets are derecognised when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Group has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership, but not retaining control.

Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

### Subsequent measurement

The Group classifies and subsequently measures its financial assets in the following categories: financial instruments at fair value through profit or loss; fair value through other comprehensive income and amortised cost. The classification will depend on if the financial asset is a debt instrument, an equity instrument or a derivative.

#### Debt instruments (Loans and debt securities)

The classification is based on a combination of assessing the business model for managing the financial assets and whether the contractual cash flows consist of solely payments of principal and interest ('SPPI'). The business

model assessment is performed for homogenous portfolios/products identified based on how the business is managed in the divisions of the Group. The assessment is based on reasonable scenarios taking into consideration how the portfolio is evaluated and reported to management; the risks affecting the performance of the portfolio and how these risks are managed; how managers are compensated; and the frequency, value and timing of sales including the reasons for the sales. In determining if the cash flows consist solely of principal and interest, the principal is defined as the fair value of the debt instrument at initial recognition, which can change over the life if there are repayments or capitalisation of interest. Interest cash flows are consistent with components per a basic lending arrangement including consideration for time value of money, credit risk, liquidity risk as well as administrative costs and profit margin. If there are contractual features introducing an exposure to other risks or volatility, it is not considered to consist of solely payments of principal and interest. SPPI tests are performed as a part of new product approval tests. In implementation of IFRS 9 SPPI was applied to 22 larger products carried at amortised cost. All products except one remained in accounting with same treatment. With remaining one – margin loan, the product conditions were changed before 1 January 2018 so that one functionality was taken out of the product and then product also passed SPPI. Therefore, all the LHV products remained with same accounting treatment as before.

Debt instruments are presented in the statement of financial position line items: Due from central banks, credit institutions and investment companies; Loans and advances to customers; Financial assets at fair value through other comprehensive income; Financial assets at fair value through profit or loss; Receivables from customers and Other financial assets, and include instruments in the following measurement categories.

Fair value through profit or loss: Debt instruments are classified in this category if not meeting the criteria for amortised cost or fair value through other comprehensive income. This is the case if the business model is held for trading; where financial assets are considered held for trading if they are held with the intention to be sold in the short-term and for the purpose of generating profits. Debt instruments are mandatorily measured at fair value through profit or loss if the assets are managed and evaluated on a fair value basis or the assets are held with an intention to sell, or alternatively, if the cash flows do not consist of solely payments of principal and interest.

Fair value through other comprehensive income: Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to both hold assets to collect contractual cash flows and

to sell the assets (b) the contractual cash flows consist of solely payments of principal and interest. The assets are measured at fair value and gains and losses arising from changes in fair value are reported in other comprehensive income and accumulated in equity. The cumulative gain or loss is reclassified from equity to profit or loss upon derecognition of the debt instrument. Interest is calculated by applying the effective interest method on interest-bearing financial assets and expected credit losses are recognised in profit or loss.

**Amortised cost:** Debt instruments are classified in this category if both of the following criteria are met (a) the business model objective is to hold assets to collect contractual cash flows and (b) the contractual cash flow characteristics consist of solely payments of principal and interest. The gross carrying amount of these assets is measured using the effective interest method and adjusted for expected credit losses.

#### Equity instruments

Equity instruments are per default classified as financial assets at fair value through profit or loss. An irrevocable election can be made on initial recognition to classify equity instruments (not held for trading) at fair value through other comprehensive income.

#### Derivatives

Derivatives are classified as fair value through profit or loss (held for trading).

#### Modification

The Group may renegotiate loans and modify contractual terms. If the new terms are substantially different from the original terms, the Group derecognises the original financial asset and recognises a new asset. The Group also assesses whether the new financial asset is credit-impaired at initial recognition. If the terms are not substantially different, the modification does not result in derecognition

and the Group recalculates the gross carrying amount based on the new cash flows using the original effective interest rate of the financial asset and recognises a modification gain or loss.

#### Reclassification

In rare circumstances debt instruments (financial assets) excluding those designated at fair value through profit or loss on initial recognition, can be reclassified if there has been a change in the business model for managing the financial asset.

#### Write-off

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event.

Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovery.

If it is not feasible or economically reasonable for the Group to take measures to recover the claims that are being discounted, the claim is assessed as non-performing and is removed from the statement of financial position. If an irrecoverable claim is received subsequently, receipts are recognized as income.

At least one of the conditions has to be filled to declare claim irredeemable based on the product class.

IFRS 9 category	Class (applied by the Group)		31.12.2018
		Loans and advances to banks and investment companies	682 658
Amortised cost	Loans and advances to customers	Loans to legal entities	705 186
		Loans to individuals	213 575
		Other receivables	3 721
		Other financial assets	2 936
<b>Financial assets</b>	Financial assets at fair value through profit and loss	Mandatory measurement at fair value through profit or loss	
		Shares and fund units	510
		Listed bonds	38 697
		Derivatives	59
	Pension fund units	7 590	
Equity instruments at fair value through other comprehensive income	Investment securities	Unlisted shares	298

#### Accounting policies until 31 December 2017

The Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss
- held-to-maturity financial investments
- available-for-sale financial assets
- loans and receivables

The classification depends on the purpose for which the financial assets were acquired. Management of the Group determines the classification of its financial assets at initial recognition.

IAS 39 category	Class (applied by the Group)		31.12.2017	
		Loans and advances to banks and investment companies	961 212	
Loans and receivables	Loans and advances to customers	Loans to legal entities	542 913	
		Loans to individuals	189 130	
		Other receivables	9 800	
<b>Financial assets</b>		Other financial assets	2 289	
	Financial assets at fair value through profit and loss	Securities held for trading	Shares and fund units	430
			Listed bonds	49 138
			Derivatives	30
		Designated as at fair value through profit or loss upon initial recognition		
		Pension fund units	6 261	
Available-for-sale financial assets	Investment securities	Listed bonds	555	
		Unlisted shares	220	

#### (a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include

- financial assets held for trading (incl. derivatives)
- financial assets classified at fair value through profit or loss at inception

A financial asset is classified as **held for trading** if acquired or incurred principally for the purpose of selling or repur-

chasing it in the near term. Derivatives are classified as held for trading unless they are designated as hedges.

Regular way purchases and sales of financial investments are recognised at the trade date in the statement of financial position.

Financial instruments included in this category are initially recognised at fair value; transaction costs are taken directly

to the profit or loss. After initial recognition, financial assets in this category are measured at fair value. Interest income is calculated based on financial assets' amortised cost using the effective interest rate method and is recorded within interest income in the statement of profit or loss. Changes in fair values of these financial assets are recognised consistently, either as a profit or loss in the statement of profit or loss of the reporting period under "Net gains/losses from financial assets measured at fair value". In accounting for financial assets at fair value through profit or loss, the change in the value of assets between the trade date and the settlement date are taken to profit or loss, similarly to the recognition of similar assets in the ownership of the Group. Dividend income on financial assets measured at fair value through profit or loss are recognised in the line "Dividend income" of the statement of profit or loss when the right to receive dividends by the Group is established.

In case of listed securities (i.e. the securities which have an active market), the current bid price is considered as the fair value of investments. To estimate the fair value of investments not actively traded in the market, alternative methods such as the price of recent transactions (under market conditions), the discounted cash flow method or option valuation models are used.

Derivative financial instruments (futures, forward, swap and option contracts) are initially recognised in the statement of financial position at fair value at the trade date and are subsequently valued at fair value through profit or loss. If derivatives are quoted on an active market, market value is used as the fair value. Otherwise, the valuation techniques are used to estimate the fair value. Gains and losses from derivatives are recognised as income or expense of the period in the statement of profit or loss under "Net gains/losses from financial assets measured at fair value". Derivatives are carried in statement of financial position as assets, if their fair value is positive and as liabilities, if their fair value is negative. The fair values of derivative assets and liabilities recorded in the statement of financial position are not netted. The Group does not use hedge accounting to account for its derivative financial instruments.

Financial assets designated at fair value through profit or loss at inception - securities are classified into this group, if the Group has upon initial recognition designated the securities to be recorded as at fair value through profit or loss and as a result the changes in the fair value of these securities are consistently recognised in the profit or loss of the reporting period in the statement of profit or loss.

Financial assets and financial liabilities are designated at fair value through profit or loss when certain investments, such as debt or equity investments, are managed and evaluated

on a fair value basis in accordance with a documented risk management or investment strategy and reported to key management personnel on that basis.

Refer to Note 3.5 for fair value of financial assets.

#### **(b) Held-to-maturity financial investments**

Held-to-maturity financial investments are financial instruments quoted in an active market with a fixed due date and which the management board of the Group has an intention and opportunity to hold until their maturity. They do not include:

- investments designated as fair value through profit or loss upon their initial recognition;
- investments classified as available-for-sale assets;
- investments, which meet the criteria of loans and receivables.

These investments are initially recognised at fair value, plus all directly attributable transaction costs incremental to their acquisitions and they are subsequently measured at amortised cost using the effective interest rate method. Interest income on held-to-maturity investments is included within interest income in the statement of profit or loss. Impairment losses are deducted from the carrying amount of the investments and the impairment charge is recorded in the statement of profit or loss.

#### **(c) Available-for-sale financial assets**

Available-for-sale financial assets are financial instruments which the Group intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices. Investment securities available-for-sale are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss. Other changes in fair values of these financial assets are recognised in other comprehensive income.

#### **(d) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables to customers are recorded when the Group advances money to purchase or originate an unquoted non-derivative receivable from a customer due on fixed or determinable dates, and has no intention of trading the receivable. Loans and receivables are initially recognised at fair value plus transaction costs, and are derecognised only when they are repaid or

written-off. After initial recognition, the Group recognises loans and receivables at amortised cost (less principal repayments and any potential impairment losses, if necessary) and calculates interest income on the receivable in subsequent periods using the effective interest method. In case of credit cards, the borrower's actual use of limit is recorded in the statement of financial position.

Finance lease transactions are lease transactions under which all significant risks and rewards from using the assets are immediately transferred from the Group to the lessee. Legal ownership of assets is transferred to the customer at the end of the lease term. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property and the present value of minimum lease payments (plus any unguaranteed residual value of the leased asset). Each lease payment received from the lessee is allocated between the receivable and finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return. When there are service fees and initial direct costs attributable to the conclusion of lease agreements, they are included in the calculation of the effective interest rate of the lease and calculation of a finance lease receivable. The basis for assessing receivables is the timely fulfilment of contractual obligations, the estimated market price of the leased asset and excess collateral, the financial position and reliability of the customer. Impairment of receivables reduces the respective asset category in the statement of financial position.

Loans restructured because of significant changes in contract terms are recognised as new loans when a new loan has been issued, incl. refinancing an existing loan or increasing an existing loan for payment of the loan principal, interest, overdue penalties or other fees related to it. Loans which include a change in other contractual terms as a result of deterioration of the customer's credit quality do not qualify for derecognition.

Trade receivables arise from provision of services to the customers and are initially recognised at fair value plus transaction costs and subsequently measured at amortised cost using the effective interest method (less repayments and a provision for incurred impairment losses).

The impairment of loans and advances is assessed in accordance with the principles described in clause 2.7.

## 2.7 Impairment of financial assets carried at amortised cost

Accounting policy from 1 January 2018

### Measurement

The impairment requirements are based on an expected credit loss (ECL) model. The guiding principle of the ECL model is to reflect the general pattern of deterioration or improvement in the credit quality of financial instruments.

All financial assets measured at amortised cost and fair value through other comprehensive income, as well as lease receivables, financial guarantees contracts, contract assets and certain loan commitments are in scope for expected credit loss.

ECLs on financial assets measured at amortised cost and lease receivables are presented as allowances, i.e., as an integral part of the measurement of those assets in the statement of financial position. The allowance reduces the gross carrying amount. ECLs on loan commitments and financial guarantee contracts are presented as provisions, i.e., as a liability, in the statement of financial position. Adjustment to the loss allowance and provision due to changes in ECLs is recognised in the statement of profit or loss as net expected credit losses.

The assessment of credit risk, and the estimation of ECL, shall be unbiased and probability-weighted, and shall incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. LHV uses both models and expert based individual assessments for calculating ECLs.

The ECL model has a three-stage approach based on changes in the credit risk. A 12-month ECL (Stage 1) applies to all items, unless there is a significant increase in credit risk since initial recognition. For items where there is a significant increase in credit risk (Stage 2) or in default (Stage 3), lifetime ECL applies.

### Significant increase in credit risk

At the end of each reporting period the Group performs an assessment of whether credit risk has increased significantly since initial recognition. The assessment of whether there has been a significant change in credit risk is based on quantitative and qualitative indicators. Indicators include payments that are past due >30 days and <90 days and financial assets that have been classified as watch-list or with forbearance measures (loans whose contractual terms have been revised due to the customer's financial difficul-

ties). A quantitative indicator is calculated based on the change in lifetime probability of default (PD) by comparing the scenario-weighted lifetime PD at the reporting date with the scenario-weighted lifetime PD at initial recognition. In case there has been a significant increase in credit risk since initial recognition, an allowance for lifetime ECL shall be recognised and the financial instrument is transferred to Stage 2. The approach is symmetrical, meaning that in subsequent reporting periods, if the credit quality of the financial instrument improves such that there is no longer a significant increase in credit risk since initial recognition, the financial asset moves back to Stage 1.

### Definition of default

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

### Quantitative criteria

The borrower is more than 90 days and over 10 euros past due on its contractual payments. The threshold of 10 euros is put in place with debt management procedures that is a trigger for debt collection activities and also indicated as materiality threshold in Definition of Default.

### Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The following circumstances are considered as indicators for the customer not to pay the debt in full:

- Non-accrued status is applied to the contract
- Specific credit adjustments has been formed due to the decline in the credit quality
- Sale of credit obligation with economic loss higher than 5 %
- Distressed restructuring measures have been applied to the contract resulting with diminished financial obligation higher than 1 %
- It is becoming probable that the borrower will enter bankruptcy or has filed for bankruptcy
- a customer's resources of cash flow are no longer available to meet the payments of instalments
- The Group has called any collateral including a guarantee.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management

purposes. Financial instruments in default are in Stage 3. All financial assets in Stage 3 are considered credit-impaired.

### Modelling

The ECL is calculated as a function of the probability of default (PD), the exposure at default (EAD) and the loss given default (LGD), as well as the timing of the loss. The Group's IFRS 9 methodology for ECL measurement is based on existing internal scoring and rating models.

PD represents the likelihood that a loan will not be repaid and will go into default in either a 12-month or lifetime horizon. The expected PD for each individual instrument incorporates a consideration of past events, current market conditions and reasonable and supportable information about future economic conditions. LHV uses existing scoring and rating models that are adjusted according to specific IFRS 9 requirements. The models are calibrated based on a combination of asset class and product type.

EAD represents an estimate of the outstanding amount of credit exposure at the time a default may occur. For off-balance sheet amounts, EAD includes an estimate of any further amounts to be drawn at the time of default. LGD is the amount that may not be recovered in the event of default. LGD takes into consideration the amount and quality of any collateral held. LHV uses existing LGD models adjusted to meet IFRS 9 requirements. When measuring ECL, LHV uses the maximum contractual period during which LHV is exposed to risk.

### Forward-looking information

The Group uses internally developed macroeconomic forecasts as the basis for the forward-looking information incorporated in the ECL measurement. In order to ensure an unbiased estimation of credit losses under IFRS 9, at least three scenarios shall be used. One of the scenarios shall be the base case scenario, representing the most likely outcome, which is also applied in the regular financial planning and budgeting process, while other case scenarios shall represent more optimistic or pessimistic outcomes.

Forecasts are developed internally in the Credit Management Department that consults with the experts from Risk Control Unit, business and finance. As available without undue cost, external experts and externally developed 'benchmark forecasts' should be consulted. The referred benchmark forecasts include but are not limited to World Economic Outlook by the IMF, European Economic Forecasts by the European Commission and Economic Forecasts by Bank of Estonia. The scenarios shall be approved by the Risk and Capital Committee.

Scenarios are developed for a time horizon over which reliable projections can be made, typically for a time horizon of 3 years. At minimum, selected macro indicators have to be forecasted for a period of two years following the current year. In general, scenarios are reviewed on a quarterly basis. In case of significant changes in the macro-economic environment and outlook, the scenarios shall be updated.

### Individual assessments and Management's judgement

The Group uses both models and expert based judgement in order to determine ECLs. The degree of judgement that is required to estimate ECL depends on the model outcome, materiality and the availability of detailed information. The model provides guidance and transparency as to how economic events could affect the impairment of financial assets. Expert based judgement may be applied to the modelled outcome to incorporate an estimated impact of factors not captured by the model. Such individual ECL assessments may be applied to significant exposures at a counterparty level. These assessments are decided by the Credit Committee. In addition there may be a need for adjustments at a portfolio level, which is decided by the Risk and Capital Committee.

### Accounting policy until 31 December 2017

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Group determines that, no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics, and collectively assesses them for impairment.

The Group assesses the risks taking into consideration all known information about the solvency of the customer and whether there are any objective circumstances indicating impairment (the customer's financial difficulties, bankruptcy or inability to meet its obligations to the Group).

Corporate loans, overdrafts and leases are assessed individually, primarily based on the overdue status of loan and realisable of related collateral, if any. Other criteria used to determine whether there is objective evidence that an impairment loss has occurred are financial position of the company, industry situation, reliability of the borrower, the competence of its management and other factors. Margin

and repo loans secured by debt or equity securities both to legal as well as private individuals are assessed individually, using primarily the market value of collateral as the basis. Consumer loans, mortgage loans, credit card loans and hire-purchase loans are assessed as a group. Private individuals are assessed in terms of their timely fulfilment of obligations, solvency, value of the collateral, age, education, length of employment, savings habits and other factors impacting credit risk.

For the purposes of a collective evaluation of impairment, financial assets are grouped based on similar credit risk characteristics. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Future cash flows in a group of financial assets that are collectively evaluated for impairment, are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods, and to remove the effects of past conditions that do not exist currently. The Group regularly reviews future cash flow assessment methods and assumptions, in order to reduce potential differences between loss estimates and actual losses.

If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. The renegotiated asset is then derecognized and a new asset is recognized at its fair value only if the risks and rewards of the asset substantially changed. This is normally evidenced by a substantial difference between the present values of the original cash flows and the new expected cash flows.

Impairment losses are always recognised through an allowance account to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. Any impairment losses are charged to statement of profit or loss line "Impairment losses on loans and advances".

If, in a subsequent period, the amount of the impairment

loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year. The reversal of the impairment loss is recognised as income in the line "Impairment losses on loans and advances" in the statement of profit or loss.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent receipts of amounts previously written off are recognized in the income statement as a deduction from impairment charges.

Interest income on loans is presented on the statement of profit or loss under "Interest income".

## 2.8 Tangible fixed assets

Tangible fixed assets are non-current assets used in the operating activities of the Group with a useful life of over one year. An item of tangible fixed assets is initially recognised at its cost which consists of the purchase price (incl. customs duties and other non-refundable taxes) and other expenditures directly related to the acquisition that are necessary for bringing the asset to its operating condition and location. Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to operating expenses during the reporting period in which they are incurred.

An item of tangible fixed assets is carried in the statement of financial position at cost less any accumulated depreciation and any accumulated impairment losses. Depreciation is calculated on a straight-line basis. The annual depreciation rate for computers, furniture and fixtures is 33%, for improvements of rental space either 20% p.a. or amortization throughout the rental period, depending on which is shorter. Depreciation is calculated starting from the month of acquisition until the carrying amount reaches the residual value of the asset. In case the residual value is greater than the carrying amount of the asset, no further depreciation expense is calculated.

The appropriateness of the assets' residual values, depreciation methods used and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. The Group performs an impairment test when there are

circumstances indicating impairment. Where an asset's carrying amount is greater than its estimated recoverable amount (higher of an asset's fair value less costs to sell or its value in use), it is written down immediately to its recoverable amount recognising an impairment loss in the statement of profit or loss for the reporting period.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in operating expenses or other income in the statement of profit or loss for the reporting period.

## 2.9 Intangible assets

Intangible assets are identifiable, non-monetary assets without physical substance and currently comprise of acquired software licences. An intangible asset is initially measured at cost, comprising of its purchase price and any directly attributable expenditure on preparing the asset for its intended use. After initial recognition, an intangible asset is carried at its cost less any accumulated amortisation and any accumulated impairment losses. Amortisation is calculated on a straight-line basis, except client agreements (see below). The annual amortisation rate for purchased licenses is 33%.

From 1 January 2018 due to the initial application of IFRS 15, sales costs for the acquisition of new clients is capitalised. Based on the simplified application method of the new standard chosen by management, comparative figures are not amended and full impact of previous periods is recognised on 1 January 2018 as increase in assets and retained earnings in amount 10 618 thousand euros. In addition, there are client agreements from business combination recorded as intangible assets, see Note 16. The amortisation method for client agreements is the diminishing balance method. The annual amortisation rate for purchased client agreements is 12% of the residual value of those assets. At the end of each reporting period, the appropriateness of amortization rates, methods and residual values is assessed. The Group reviews intangible assets for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's fair value less costs to sell and value in use.

## 2.10 Impairment of assets

Assets that have indefinite useful lives (including goodwill) are not subject to amortization but they are tested annually for impairment, by comparing their carrying amounts with their recoverable amounts.

Assets with an unlimited useful life and depreciable assets are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. In the event of such circumstances, the recoverable amount of the asset is assessed and is compared with the carrying amount.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount of the asset is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit).

Impairment losses are recognized in statement of profit or loss.

At the end of each following reporting period, assets that have been written down are assessed to determine whether their recoverable amount has increased (except for impairment losses of goodwill that are not reversed). If the impairment test indicates that the recoverable amount of an asset or asset group (cash-generating unit) has increased above its carrying amount, the previous impairment loss is reversed up to the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognised for the asset in prior years. Reversals of impairment losses are recognized in the statement of profit or loss as a reduction of the impairment loss.

## 2.11 Loan commitments, Financial guarantees and performance guarantees

The Group issues commitments to provide loans. These commitments are irrevocable or revocable only in response to a material adverse change. Such commitments are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the commitment, except for commitments to originate loans if it is probable that the Group will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination; such loan commitment fees are deferred and included in the carrying value of the loan on

initial recognition. At the end of each reporting period, the commitments are measured at (i) the remaining unamortised balance of the amount at initial recognition, plus (ii) the amount of the loss allowance determined based on the expected credit loss model, unless the commitment is to provide a loan at a below market interest rate, in which case the measurement is at the higher of these two amounts. The carrying amount of the loan commitments represents a liability. For contracts that include both a loan and an undrawn commitment and where the Group cannot separately distinguish the ECL on the undrawn loan component from the loan component, the ECL on the undrawn commitment is recognised together with the loss allowance for the loan. To the extent that the combined ECLs exceed the gross carrying amount of the loan, they are recognised as a liability.

The Group issues financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties, and carry the same credit risk as loans. Financial guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of the financial guarantee. At the end of each reporting period, the financial guarantees are measured at the higher of (i) the amount of the loss allowance for the guaranteed exposure determined based on the expected loss model and (ii) the remaining unamortised balance of the amount at initial recognition. In addition, an ECL loss allowance is recognised for fees receivable that are recognised in the statement of financial position as an asset.

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. Performance guarantees are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight-line basis over the life of the contract. At the end of each reporting period, the performance guarantee contracts are measured at the higher of (i) the unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the contract at the end of each reporting period, discounted to present value. Where the Group has the contractual right to revert to its customer for recovering amounts paid to settle the performance guarantee contracts, such amounts will be recognised as loans and receivables upon transfer of the loss compensation to the guarantee's beneficiary.

## 2.12 Financial liabilities

The Group classifies financial liabilities either:

- a) financial liabilities measured at fair value through profit or loss
- b) financial liabilities measured at amortised cost
- c) financial guarantee contracts and loan commitments

Recognition of a financial liability (derivative) at fair value through profit or loss is disclosed under accounting policy 2.6.a. All other financial liabilities are subsequently measured at amortised cost using the effective interest method. Transaction costs are included in the calculation of the effective interest rate. The difference between the proceeds (less transaction costs) and redemption value are recognised in the statement of profit or loss during the term of the instrument, using the effective interest rate. Interest costs are included in the statement of profit or loss line "Interest expenses".

Deposits from customers are initially recorded on their settlement date at their fair value less transaction costs and are subsequently measured at amortised cost using effective interest method in the statement of financial position line "Deposits from customers and loans received", accrued interest liabilities are included in the same line. Interest expense is recognised in the statement of profit or loss line "Interest expense" on the accrual basis.

Loans received, debt securities issued and similar subordinated debts are initially recognised at fair value, less transaction costs (cash received less transaction costs). The subordinated debts are those liabilities, which in case of a liquidation of a credit institution or declaration of bankruptcy, are settled after the satisfaction of the justifiable claims of other creditors. Other financial liabilities (trade payables, accrued expenses and other borrowings) are initially recognised at fair value less transaction costs and are subsequently carried at amortised cost.

Financial liabilities are derecognised when they are extinguished (ie. when the obligation specified in the contract is discharged, cancelled or expired).

## 2.13 Payables to employees

Payables to employees include unpaid salary accruals and a vacation pay accrual calculated in accordance with employment contracts and the laws in force in employee residential country as at the end of the reporting period. The liability related to the payment of a vacation pay accrual together with social security and unemployment insurance payments is included within current liabilities in the state-

ment of financial position and as staff costs in the statement of profit or loss.

Social security tax includes payments to the state pension fund. Group has neither existing legal nor constructive obligations to make pension or similar payments supplementary to social security tax.

## 2.14 Share-based payments

AS LHV Group operates a share-based compensation plan, under which the company receives services from group employees as consideration for equity instruments (options) of LHV Group. The fair value of the employee services received in exchange for the grant of the options is recognised during the share-based compensation program as group's staff expense and as an increase in the equity (other reserves). The total amount to be expensed is determined by the fair value at the time of issuing the options. The fair value of the options granted:

- including any market performance conditions influencing the share price (e.g. LHV Group share price);
- excluding the impact of any service and non-market performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period).

At the end of each reporting period, the Group revises its estimates of the number of options that are expected to vest based on the vesting conditions (other than market conditions). It recognises the impact of the revision to original estimates, if any, in the statement of profit or loss, with a corresponding adjustment to equity.

When the options are exercised, LHV Group issues new shares.

The grant by LHV Group of options over its equity instruments to the employees of subsidiary undertakings in the group is treated as a capital contribution. The fair value of employee services received, measured by reference to the grant date fair value, is recognised over the vesting period as an increase to investment in subsidiary undertakings, with a corresponding credit to equity in the parent entity accounts. According to the contractual conditions of the share options there are no social security tax charges when exercising the options after the 3-year period.

## 2.15 Provisions and contingent liabilities

Liabilities arising from an obligating event before the end of the reporting period that have either a legal basis or that have arisen from the Group's current operating practice (legal or constructive obligation) that require probable outflow of resources, the realisation of which is probable (it is more likely than not that an outflow of resources will be required to settle the obligation) and the amount of which can reliably be estimated but for which the timing or amount are not definitely known are recognised as provisions in the statement of financial position. The provisions are recognised based on the management's estimates regarding the amount and timing of the expected outflows. A provision is recognised in the statement of financial position in the amount which according to the management is necessary as at the end of the reporting period for the meeting of the obligation arising from the provision or transfer to the third party. The provision expense and an expense from the change in the carrying amount of provisions are included within expenses in the reporting period. Provisions are not set up to cover future operating losses.

When it is probable that a provision will be realised later than 12 months after the end of the reporting period it is recorded at discounted value (present value of expected outflows), unless the discounting effect is immaterial.

Other contingent liabilities (guarantees, except financial guarantees, and other commitments) the realisation of which is less probable than non-realisation or related costs cannot be determined reliably, that in certain circumstances may become obligations, are disclosed in the notes to the financial statements as contingent liabilities. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits has become probable on a portfolio basis. If it becomes probable that an outflow of future economic benefits will be required for an item or portfolio of items previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made).

## 2.16 Distinction between short- and long-term assets and liabilities

Assets from which resources are expected to flow to the Group within 12 months are recognised as current assets. The portion of assets with expected inflows later than 12 months after the end of the reporting period is recognised as non-current assets (see Note 3.4).

Liabilities are classified as current when they are due within twelve months after the end of the reporting period or if the Group does not have an unconditional right to defer the payment for later than 12 months after the end of the reporting period. Loans received with due date within 12 months after the end of the reporting period which are refinanced as non-current after the end of the reporting period but before the financial statements are authorised for issue, are recognised as current. Loans received that the lender has the right to recall at the end of the reporting period due to breaches of contractual terms are also classified as current.

For all long-term assets and liabilities, the long-term portion is separately disclosed in respective disclosure to these financial statements (see Note 3.4).

## 2.17 Revenues and expenses

Accounting policy from 1 January 2018

The effective interest method is applied to recognise interest income and interest expenses in profit or loss for financial assets and financial liabilities measured at amortised cost or debt investments at fair value through other comprehensive income.

The effective interest method is a method of calculating the gross carrying amount of a financial asset or the amortised cost of a financial liability and of allocating interest income and interest expenses. The effective interest rate is the rate that discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial instrument. When calculating future payments, all payments included in the terms and conditions of the contracts, such as advance payments, are taken into consideration. The calculation of the effective interest rate includes fees that are an integral part of the effective interest rate. However, expected credit losses are not taken into account.

If a financial asset subsequently has become credit impaired the interest income is recognised applying the effective interest rate to the amortised cost, i.e. gross carrying amount adjusted for the loss allowance. In case a financial asset is credit-impaired at initial recognition, the expected credit losses are included in the estimated cash flows to calculate a credit adjusted effective interest rate which then is applied to recognise the interest income.

### Fee and commission income

The recognition of revenue from contracts with customers is reported as fee and commission income. This does not

apply for revenue from leasing contracts or financial instruments and other contractual obligations within the scope of IFRS 9 Financial Instruments.

Fees that are included in the calculation of the effective interest rate of a financial instrument measured at amortised cost, such as loan origination fees, are allocated over the expected tenor of the instrument applying the effective interest method and presented in Net interest income.

Fee and commission income is recognised to depict the transfer of promised services to the customers in an amount that reflects the consideration to which LHV expects to be entitled in exchange for the service.

Fee and commission income is recognised over time on a straight line basis as the services are rendered, when the customer simultaneously receives and consumes the benefits provided by the Group's performance. Variable fees are recognised only to the extent that management determines that it is highly probable that a significant reversal will not occur.

Other fee and commission income is recognised at a point in time when the Group satisfies its performance obligation, usually upon execution of the underlying transaction. The amount of fee or commission received or receivable represents the transaction price for the services identified as distinct performance obligations.

The major types of fees are described below.

Fee and commission income for asset custody and asset management to customers is recognised as revenue over the period in which the services are provided. Performance based fees are recognised when it is highly probable that a significant reversal of recognised revenue will not occur, which is most often when the performance criteria are fulfilled.

Brokerage fees, commission and fees from negotiating a transaction for a third party, such as arrangement of acquisitions or purchase or sale of a business, are recognised on completion of the transaction.

Expenses that are directly related to the generation of fee and commission income are recognised as fee and commission expense.

### Net financial income

Gains and losses arising from changes in fair value of financial assets and liabilities measured at fair value through profit or loss are reported under the item Net gains from financial assets. For financial liabilities designated at fair value through profit or loss the change in fair value relating to change in own credit risk is accounted for in other comprehensive income.

### Dividend income

Dividends are recognised when the entity's legal right to receive payment is established.

*Accounting policy until 31 December 2017*

Revenues and expenses are recorded on an accrual basis. Revenue is recognised when it is probable that the economic benefits associated with the transaction will be received by the Group, the amount of the revenue can be measured reliably and services were rendered by the Group. Revenue earned in the ordinary course of business is recognised at fair value of the fee received or receivable. Expenses are recognised when the Group has obligation to pay for the expense and/or the Group has received goods or services, and the latter occurs at an earlier date.

Fee and commission income (incl. custody and portfolio management fees) are recognised on an accrual basis when the service has been provided and the Group has a right of claim to the receivable. Commissions and fees arising from provision of advisory services to third parties (purchase or sale of businesses, acquisitions, etc.) are generally recognised upon completion of the underlying transaction or when service is provided over a longer period of time, based on the stage of completion method. Portfolio management, other consultation fees and management fees related to investment funds are recognised according to the agreement, usually over the period during which the service is provided. The same principle is applied to wealth management, financial planning and custody services that are continuously provided over an extended period of time. Performance linked fees or fee components are recognised when the performance criteria are fulfilled or based on the stage of completion. Other one-off service revenues and other revenues are recognised on an accrual basis at the moment of executing the respective transaction.

**Fee and commission expenses** are recognised after the service has been received and when the liability has incurred.

Interest income and expense is recognised in the statement of profit or loss for all financial instruments carried at amortised cost using the effective interest method or for debt securities measured at fair value through profit or loss. Transaction costs of debt securities measured at fair value through profit or loss is recognised as part of effective interest method. Loan commitment fees that are directly related with the undrawn portion of the loan commitment and which changes based on the portion of the unused commitment are recognised as interest income during the period when draw down is available.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability

and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future impairment losses. The calculation includes all significant fees 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.

When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flows discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

**Dividend income** is recognised when the legal right to receive dividends is established and inflow of economic benefits are probable.

## 2.18 Asset management services

The Group is engaged in providing asset management services (Note 22). Such assets have been given to the Group to be managed by third parties and these assets are recorded off-balance sheet. Service fees are derived from management of such assets and no associated credit and market risks arise for the Group.

## 2.19 Leases - Group as the lessee

Leases of tangible fixed assets where the lessee acquires substantially all the risks and rewards of ownership are classified as finance leases. Other leases are classified as operating leases.

Payments made under operating leases are charged to the statement of profit or loss on a straight-line basis over the lease term. The Group primarily uses an operating lease for renting the premises. A rental expense is recognised in the statement of profit or loss as "Administrative and other operating expenses". In addition, since 1 January 2019 the IFRS 16 Leases will apply to the Group's financial reporting.

IFRS 16, applicable to annual periods beginning on 1 January 2019 or after that date, eliminates the classification

of leases as either operating leases or finance leases, as required by IAS 17, and, instead, introduces a single lease accounting model. Impact of IFRS 16 on the financial statements is disclosed in note 2.1 (b).

## 2.20 Taxation and deferred income tax

### Corporate income tax in Estonia

Estonian companies generally do not pay corporate income tax on profits on a current basis. Tax is paid on distributions of profit, either formal (dividends, other payments from equity) or deemed (non-business expenses, transfer pricing adjustments, certain payments to tax havens, etc.). Dividends and other profit distributions are subject to corporate income tax at the rate of 20/80 on the net amount. Starting from 2019, regular dividend payments will be subject to corporate income tax at the reduced rate of 14/86 to the extent of the average dividend distribution of three preceding years. The first year to be taken account is 2018. Corporate income tax arising from dividend distributions is recorded as a liability and income tax expense when the dividends are declared. The tax becomes due to the tax authorities on the 10th day of the month following the dividend payment.

Starting from second quarter of 2018 credit institutions are obliged to pay advance income tax of 14% on quarterly profits under IFRS. The tax becomes due to the tax authorities on the 10th day of the third month following the quarter. Advance income tax paid is non-refundable and thus recorded as income expense, but can be used to reduce income tax payable on future dividend distributions.

### Corporate income tax in other countries

In accordance with the local income tax laws, the net profit of companies located in United Kingdom and Lithuania that has been adjusted for the permanent and temporary differences as stipulated by law is subject to corporate income tax.

Corporate income tax rates	2018	2017
Latvia	20%	15%
Lithuania	15%	15%
United Kingdom	19%	19%

Deferred income tax is calculated on all significant temporary differences between the tax bases of assets and liabilities and their carrying values in the consolidated statement of financial position. The main temporary differ-

ences arise from depreciation and tax loss carry-forwards. Deferred tax balances are measured at tax rates enacted or substantively enacted at the end of the reporting period which are expected to apply to the period when the temporary differences will reverse or the tax loss carry-forwards will be utilised. Deferred tax assets and liabilities are netted only within the individual companies of the Group. Deferred tax assets for deductible temporary differences and tax loss carry-forwards are recorded only to the extent that it is probable that future taxable profit will be available against which the deductions can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

A deferred income tax liability in respect of the Group's available equity which would accompany the payment of available equity as dividends, is not reported in the statement of financial position. The maximum amount of income tax payable, which would arise from paying out the retained earnings as dividends, is disclosed in the Note 21 to the financial statements.

## 2.21 Offsetting

Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position only when there is a legally enforceable right to offset the recognized amounts, and there is an intention to either settle on a net basis, or to realize the asset and settle the liability simultaneously. More detailed information in Note 3.10.

## 2.22 Statutory reserve capital

Statutory reserve capital is formed from annual net profit allocations to comply with the requirements of the Commercial Code. During each financial year, at least one-twentieth of the net profit shall be transferred to the statutory reserve, until the reserve reaches one-tenth of share capital. Statutory reserve may be used to cover a loss, or to increase share capital. Payments to shareholders from statutory reserve are not allowed.

## 2.23 Discontinued operations

A discontinued operation is a component of the Group that is classified as held for sale, and represents a separate major line of business or geographical area of operations and is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations. Non-current asset or disposal group is classified as held for sale when their carrying amount is to be covered principally through a sale transaction rather than through continuing use, and the sale is considered highly probable. The disposal group is recognized at carrying amount or fair value less costs related to the transaction of sale, depending on which is lower. Earnings and cash flows of discontinued operations, if any, are disclosed separately from continuing operations with comparatives being re-presented. Intergroup transactions between discontinued and continuing operations are eliminated depending on whether the transactions will continue after the transaction of sale.

NOTE 3 Risk management

Risk is defined as a potential negative deviation from expected financial results. LHV encounters several risks in its day-to-day operations. The objective of risk management at LHV is to recognise these risks, to measure them appropriately, to manage and to report them. More broadly, the aim of risk management is to increase the value of LHV by minimising losses and reducing the volatility of results. Risk management at LHV is based on a strong risk culture and is built on the principle of three lines of defence where the first line of defence, the business units, are responsible for taking risk and for day-to-day management. The second line of defence, the risk management division, is responsible for the development of risk management methodologies and for the reporting of risks. The third line of

defence, the internal audit, conducts independent supervision over the entire group. Risk management principles, requirements and areas of responsibility are described in risk management policy. The principles and objectives of capital management are described in internal documents (capital management policy and capital objectives). More detailed risk management processes are described in the policies of the respective field.

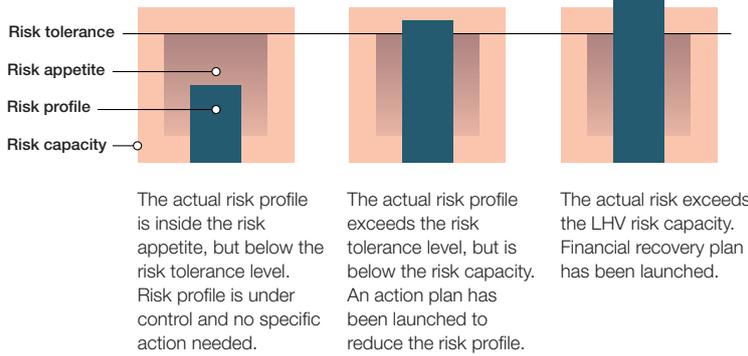
Under the leadership of the Risk Management Unit, LHV has developed a group-wide risk appetite framework, approved by the Supervisory Board. The framework includes quantitative risk tolerance levels by main risks.

**Risk framework**



The risk appetite reflects LHV's willingness to take risks in order to achieve its business goals. LHV has defined the limit of the risk appetite as risk tolerance – the maximum level of risk that LHV is willing to take in order to achieve its goals. Risk capacity is defined as the greatest risk that LHV

can withstand. The figure on the next page illustrates the three different risk profile levels to levels of risk tolerance and briefly describes the activities in these situations.



**Risk capacity** – the maximum damage that LHV can withstand. Financial recovery plan has been launched to overcome the risk.

**Risk tolerance** – the maximum risk that LHV is prepared to take to achieve its goals. When exceeding the risk tolerance level the activities at enterprise level will be launched to reduce the risk profile.

**Risk appetite** is the recommended level of risk that LHV plans to take to implement its plans and goals. Risk appetite reflects the desired risk profile. The maximum risk appetite is defined as a risk tolerance.

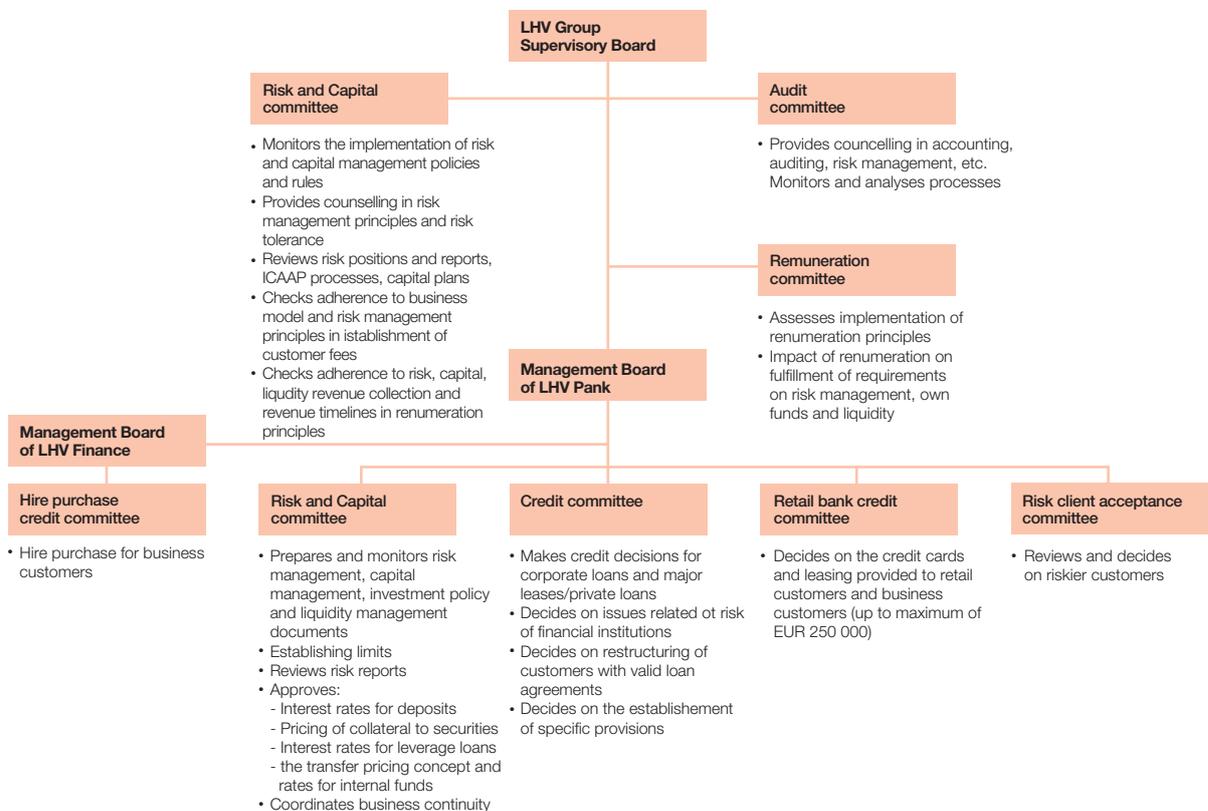
**Risk profile** – combination of the real risks of LHV resulting from the nature, scale and complexity of our activities and the operation environment.

As seen from the figure, if the actual risk profile remains within the limits of the risk appetite, it is a foreseeable situation and no further action is needed. If the actual risk profile exceeds the risk tolerance level, an action plan is put in place to reduce the risk profile. It is also necessary to inform the Supervisory Board in that case. The management of LHV risk profile and ensuring it stays within the limits of the risk appetite is the responsibility of the first line of defence, while independent monitoring and reporting is the responsibility of the risk management unit. Within the framework of the financial recovery plan, LHV has developed early warning indicators with thresholds and corre-

sponding measures.

In accordance with risk management policy, the risk tolerance levels must be specified at minimum for capital risk, credit risk, market risk, operation risk, liquidity risk and anti-money laundering risk. The levels of risk tolerance are described in each of the respective risk policies, which are approved at Supervisory Board level. Detailed instructions and guidelines are described in the policies.

LHV has a system of committees and decision-making competencies. The functions of the main committees are shown in the figure below.



As part of the risk policy framework, LHV has developed a risk reporting process. The table below gives an overview of the main reports prepared by the risk management department, which are presented to the governing bodies and their reporting frequency.

Governing body	Members	Title of the report	Report frequency	Coverage of risks
Supervisory board of the Group	All the members of the supervisory board of the Group	Risk report	Quarterly	Credit risk, market risk, interest risk, of liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Compliance overview	Monthly	Compliance risk
		ICAAP report, ICAAP macro scenario, SREP report	Once a year	All the risks
Supervisory board of the Pank	All the members of the supervisory board of the Pank	Risk report	Monthly	Credit risk, market risk, interest risk, of liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Risk management overview	Once a year	All the risks
		ICAAP report, ICAAP macro scenario, SREP report	Once a year	All the risks
Risk and Capital Committee of the Group	Rain Lõhmus, Andres Viisemann, Tiina Mõis	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
		Problematic loan clients	Quarterly	Credit risk
Audit committee	Kristel Aarna, Urmas Peiker, Tauno Tats	Risk report	Quarterly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, monitoring of legislation
CEO of the Group, Chairman of the Supervisory Board of the Pank	Madis Toomsalu	Risk report	Monthly	Credit risk, market risk, interest risk, The liquidity risk, operation risk, anti-money laundering risk, compliance risk, monitoring of legislation
Risk Capital Committee of the Pank	Management board members of the Pank, Tiit Meidla, Romet Enok	Risk report	Monthly	Credit risk, market risk, interest risk, liquidity risk, operation risk, anti-money laundering risk, compliance risk, monitoring of legislation
		Business continuity test and planning	After every test	Operation risks
		Risk self-assessment	After assessment	Operation risks
Management Board of the Pank	Management board members of the Pank	Compliance overview	Once in a year	Compliance risks
		Anti-money laundering overview	Once in a year	Anti-money laundering risks
		Monitoring of legislation	Monthly	Compliance risks
		Compliance audit	After every audit	Compliance risks
		ICAAP report, ICAAP macro scenario, SREP report	Once a year	All the risks

LHV has established a risk management policy, which sets the risk management framework. Separate policies are set for major risk categories. The risks are analysed and monitored and reported to different levels on a monthly and quarterly basis. The risk report, which is compiled on a monthly basis, presents information by type of risk. The

risk report also includes information on capital adequacy. It allows getting a regular overview of all the important risks at the company level and to monitor their development, identify bottlenecks, and react promptly.

### 3.1 Capital management

The goal of the Group's capital management is to:

- ensure continuity of the Group's business and ability to generate return for its shareholders;
- maintain a strong capital base supporting the development of business;
- comply with capital requirements as established by supervision authorities.

The Group considers net own funds as capital. The amount of capital that the Group managed as at 31.12.2018 was EUR 183 444 thousand (31.12.2017: EUR 141 609 thousand). The goals of the Group's capital management are set based on both the regulative requirements and additional internal buffer.

The Group follows the general principles in its capital management:

- The Group must be adequately capitalized at all times, having necessary capital to ensure economic preservation and enabling financing of new profitable growth opportunities;

- The main focus of the capital management is on tier 1 own funds, because only tier 1 own funds can absorb losses. All other capital layers in use are dependent of tier 1 own funds volume;
- Capital of the Group can be divided into: 1) regulated minimum capital and 2) capital buffer held by the Group. In order to reach its long-term economic goals the Group must on one hand strive towards proportional lowering of the regulated minimum capital (through minimizing risks and high transparency). On the other hand, the Group must strive towards sufficient and conservative capital reserve, which will ensure economic preservation even in the event of severe negative risk scenario;
- The risk appetite set by the Group is an important input to capital management planning and capital goal setting. Higher risk appetite requires maintaining higher capital buffer.

#### Own funds

(in thousands of euros)

	31.12.2018	31.12.2017
Paid-in share capital	26 016	25 767
Share premium	46 653	46 304
Statutory reserves transferred from net profit	3 451	2 471
Other reserves	78	36
Accumulated profit/(deficit)	50 193	24 468
Intangible assets (subtracted)	-19 084	-7 940
Net profit for accounting period	25 237	19 603
<b>Total Tier 1 own funds</b>	<b>132 544</b>	<b>110 709</b>
Subordinated debt	50 900	30 900
<b>Total Tier 2 own funds</b>	<b>50 900</b>	<b>30 900</b>
<b>Total net own funds</b>	<b>183 444</b>	<b>141 609</b>

The net capital of a credit institution at any time shall be equal to or exceed the minimum amount of share capital prescribed in the Credit Institutions Act (EUR 5 million). In 2014, the capital of banks and investment firms in the European Union became subject to a legal framework (CRD IV/CRR), largely based on the Basel III framework that was agreed in the Basel Committee on Banking Supervision. The objective of the framework is to strengthen the resilience of the financial sector to adverse economic shocks and thereby ensure an adequate and sustainable financing

of the economy. Significant changes implemented by the new requirements include the requirement for credit institutions to maintain a higher level and quality of capital than before and a unified framework for designing liquidity buffers. The capital requirements directive also define measures for macro-financial supervision that member states can use to control the behaviour of credit institutions in amplifying the cycles and to alleviate risks arising from market structure.

The regulation, which is directly applicable in the member

states, obligates all credit institutions operating in the European Union (including their consolidating holding companies) and investment firms to maintain 4.5% of Common Equity Tier 1 (CET 1) and 6.0% of Tier 1 Capital against risk assets. The overall Capital Adequacy Requirement (CAD), including both Tier 1 and Tier 2 capital, remains at the existing 8.0% level.

In addition to the main requirements based on uniform rules, the directive defines the principles for forming capital buffers. In Estonia, in addition to the baseline capital requirements, credit institutions have been subjected to capital maintenance and systemic risk buffers, which are 2.5% (imposed by the Financial Supervisory Authority),

1.0% (imposed by Estonian Central Bank) and systematically importance buffer (imposed by Financial Supervisory Authority), respectively. In 2018 the grouping of capital requirements changed and SREP buffers were moved to higher capital buffers, meaning that first bank will breach other buffers before SREP buffers. Breaching each buffer triggers different actions from regulators side and first one in list is set by Estonian Central Bank triggering limitation of ECB transactions.

The latter is also subject to the specific supplementary Pillar 2 requirement applicable to credit institutions. An overview of capital requirements is provided in the table below:

Requirements	CET1	Tier 1	CAD
Base capital requirement	4.50%	6.00%	8.00%
Pillar 2 capital charge	0.39%	0.52%	1.53%
Non-resident financial intermediates deposits*	0.28%	0.28%	0.28%
Total SREP capital requirement	5.17%	6.80%	9.81%
Capital conservation buffer	2.50%	2.50%	2.50%
Systemically importance buffer	1.00%	1.00%	1.00%
Systemic risk buffer	1.00%	1.00%	1.00%
Contra cyclical buffer	0.00%	0.00%	0.00%
<b>Capital requirements total</b>	<b>9.67%</b>	<b>11.30%</b>	<b>14.31%</b>

\* Capital charge is volatile and calculated as 0.2% from non-resident financial intermediates deposits. Here volumes in financial plan is used for ratio calculation

	CET1	Tier 1	CAD
Capital requirements valid from August 2017*	7.92%	9.42%	11.42%
Capital requirements valid from October 2016*	8.00%	9.50%	11.50%

\* In addition to base requirement Pillar II requirement and systematically importance requirement were separately added. Starting from mid 2018 all these components are inside capital requirements.

Capitalization levels have been increased not due to riskiness of the bank, but because of the increasing market share of the bank. In 2018 LHV was considered as one of four systematically important bank in Estonia. This decision has increased capital buffers by 0.5% from 1st of July 2018 and by another 0.5% from 1st of January 2019. LHV has been keeping conservative approach in capital management and keeps additional internal buffers compared to regulatory ones.

Internal capital adequacy targets for 2019 are as follows:

- Core Tier 1 capital adequacy 10.40% (10.49% in 2018)
- Tier 1 capital adequacy 12.10% (12.21% in 2018)
- Total capital adequacy 15.50% (15.06% in 2018)
- Leverage ratio 3.50% (not changed)
- MREL ratio 6.08% (not changed)

Each year, the Group's supervisory board confirms the goals of capitalization and the target level of capital adequacy to cover potential risks arising from fast growth. Each year, an

internal capital adequacy assessment process (ICAAP) is performed, the goal of which is to identify potential internal capital needs in addition to regulatory capital requirements.

Capital adequacy and the use of regulatory capital are monitored by the Finance Department. Reports about the compliance with prudential and capital requirements for covering the risks are submitted regularly to supervision authorities. LHV uses standard method for calculating capital requirements for credit and market risk and basic indicator approach calculating operational risk capital requirement.

The own funds of LHV Varahaldus as the fund manager need at any given time exceed the minimum amount of share capital laid down in the Investment Funds Act (EUR 3 million). Starting from January 10th 2017, the net own funds of a fund manager have to be 0.5% of the market value of managed pension funds with the market value less than EUR 1 billion and 0.02% of the market value of managed pension funds with the market value more than EUR 1 billion. The Group and its subsidiaries have complied with all capital requirements during the financial year and in previous years.

## 3.2 Credit risk

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises from cash and cash equivalents, derivatives and deposits with banks and other financial institutions, debt securities, but mainly from credit exposures to customers, including outstanding loans, given guarantees, other receivables and commitments.

Credit risk is one of the largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. In order to evaluate credit risk, Group analyses the operations and financial position of its customers and business partners. After approving the credit, the solvency of the customer and the value of the collateral are regularly monitored. The credit risk management and control are centralised in a credit risk management unit which reports regularly to the Management Board and Supervisory Board.

### 3.2.1 Distribution of credit risks

The Group classifies the financial assets exposed to credit risk in the following key categories:

- a) due from central bank and credit institutions (referred to as "banks" in the tables) and investment companies

- b) debt securities and derivatives
- c) leveraged loans (loans secured by debt or equity securities)
- d) corporate credit portfolio, including
  - loans and overdrafts
  - financial guarantees
  - warehouse financing
  - factoring
  - leasing
  - unused loan commitments
- e) retail credit portfolio, including
  - mortgage loans (home and private loans)
  - consumer loans without collateral
  - hire-purchase
  - credit cards and overdrafts to individuals
  - leasing
  - retail loans and overdrafts to SMEs
  - financial guarantees to SMEs
  - unused loan commitments

### Maximum exposure to credit risk

(in thousands of euros)

	Note	31.12.2018	31.12.2017
Due from banks and investment companies	10	682 658	961 212
Available for sale financial assets	11a	0	555
Debt instruments at FVOCI	11b	298	0
Financial assets at fair value (debt securities)	12	38 458	49 168
Loans and advances to customers	13	918 761	732 043
Receivables from customers	14	3 721	9 800
Other financial assets	15	2 936	2 289
<b>Total financial assets</b>		<b>1 646 832</b>	<b>1 755 067</b>
Exposures related to off-balance sheet items, excluding performance guarantees	23	198 210	185 622
<b>Total maximum exposure to credit risk</b>		<b>1 845 042</b>	<b>1 940 689</b>

### 3.2.2 Credit risk measurement

For all loan products, except leverage loans, LHV uses either rating or scoring systems to assess customer credit risk, as outlined in the table below. All credit products have application models, whose outputs are used for making

credit decisions. There are also portfolio scoring models developed and models to cover the dimensions of Loss Given Default (LGD) and Credit Conversion Factor (CCF).

Portfolio	Segment	Definition	PD	LGD	CCF/EAD
Corporate	Corporate exposures	Loans to companies with total exposure to LHV >= EUR 250,000	Rating system	Model	Model or fix. parameter
Retail	SME, incl. micro enterprises	Loans to companies with total exposure to LHV < EUR 250,000	Scoring models		
	Private mortgage	All mortgage loans to private individuals	Scoring models		
	Private consumer	All consumer financing products and car leasing to private individuals	Scoring models		

#### (a) Due from banks and investment companies

Management estimates that the credit risk exposure from cash and cash equivalents, held at the central bank, other correspondent banks and investment institutions has inherently low credit risk. Loans and advances to central bank, credit institutions and investments companies are

not overdue, and are also unsecured. The funds of the Group according to ratings given by Standard & Poor's or equivalent (central bank without a rating). In case there are ratings available from more than one rating agency, the average, or the most conservative rating is used. The positions are held as follows:

#### Rating

(in thousands of euros)

	Credit institutions	Investment companies	Total 31.12.2018	Credit institutions	Investment companies	Total 31.12.2017
Central bank (The Bank of Estonia)	639 862	0	639 862	920 714	0	920 714
AA- to AA+	209	0	209	2 321	0	2 321
A- to A+	11 352	0	11 352	8 856	0	8 856
BBB to BBB+	5 661	16 505	22 166	6 294	14 116	20 410
B to B+	0	500	500	0	0	0
Non-rated	8 569	0	8 569	8 841	70	8 911
<b>Total (Note 10)</b>	<b>665 653</b>	<b>17 005</b>	<b>682 658</b>	<b>947 026</b>	<b>14 186</b>	<b>961 212</b>

Non-rated credit institutions are local Estonian or subsidiaries of large EU banks or financial institutions without external credit rating, however management considers their credit quality to be good based on available market information. Management has assessed that the ECL from credit institutions and investment companies exposures is immaterial due to the strong ratings of corresponding parties, their financial position and also due to the positive economic outlook in short-term perspective, as the Group holds only very liquid positions with the counterparties. See also note 3.2.4.3 for additional information.

#### (b) Debt securities and derivatives

The Credit Committee sets limits for taking credit risk associated with debt securities considering the issuer's rating. The Risk Capital Committee or authorised employees make decisions regarding investments within the limits set.

No principal and accrued interest receivables arising from debt securities are overdue. The bonds have no collateral.

The Group's derivatives, debt securities at fair value through profit or loss (FVTPL) and available-for-sale (AFS) or fair value through other comprehensive income (FVOCI) according to ratings given by Standard & Poor's or equivalent:

#### Ratings distribution

(in thousands of euros)

	Mandatory FVTPL			Foreign exchange forwards	FVOCI	Total 31.12.2018
	Investment portfolio	Liquidity portfolio	Trading portfolio			
AAA	0	18 439	0	0	0	18 439
A- to A+	18 006	0	0	0	0	18 006
AA- to AA+	0	1 229	0	0	0	1 229
Non-rated	0	0	1 023	59	0	1 082
<b>Total (Note 11,12)</b>	<b>18 006</b>	<b>19 668</b>	<b>1 023</b>	<b>59</b>	<b>0</b>	<b>38 756</b>

## Ratings distribution

(in thousands of euros)

	FVTPL					Total 31.12.2017
	Investment portfolio	Liquidity portfolio	Trading portfolio	Foreign exchange forwards	AFS	
AAA	0	29 869	0	0	0	29 869
A- to A+	18 223	0	1 046	0	555	19 824
Non-rated	0	0	0	30	0	30
<b>Total (Note 11,12)</b>	<b>18 223</b>	<b>29 869</b>	<b>1 046</b>	<b>30</b>	<b>555</b>	<b>49 723</b>

Debt securities classified as FVTPL is based on the management assessment of the instrument's business model and how management monitor these investments. Therefore, fair value through profit or loss measurement basis was applied at the application of IFRS 9 as at 1 January 2018.

Debt securities classified as FVOCI was based on the management assessment of the instrument's business model. Therefore, fair value through other comprehensive income measurement basis was applied at the application of IFRS 9 as at 1 January 2018. During 2018, these investments were disposed and the year end balance is 0 euros.

## (c) Other receivables

### Credit quality of other receivables

(in thousands of euros)

	31.12.2018	31.12.2017
Receivables (not overdue)	3 498	9 392
Receivables (overdue)	223	408
incl. receivables from individuals	196	215
incl. receivables from legal entities	27	193
<b>Total (Note 14)</b>	<b>3 721</b>	<b>9 800</b>

As at 11 February 2019, other receivables of EUR 205 thousand euros are uncollected and in previous years, the Group has not written off any receivables. Other financial assets (see Note 15) in amount EUR 2 936 thousand (31.12.2018: EUR 2 289 thousand) are guarantee deposits on the Baltic stock exchanges held to guarantee securities trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions. The Group considers the counterparties credit risk as very low.

## (d) Leveraged loans

The Bank issues margin loans secured by debt or equity securities to its customers, i.e. financial leverage. The maximum amount of the loan depends on the market value of the assets held as collateral in the investment account, and on the general limit set by the Bank, which is currently EUR 100 thousand (or an equivalent in a foreign currency) per customer. Granting loans above the threshold assumes an analysis of the overall financial situation of the client and the portfolio offered as collateral by the customer and the decision is within the competence of the Credit Committee. The Group has set sufficiently conservative limits to the

ratio of the loan and the collateral assets value. The list of acceptable marketable financial instruments and the levels of the required collateral are published on the Bank's website [www.lhv.ee](http://www.lhv.ee).

## (e) Corporate credit portfolio

Corporate credit portfolio customers are evaluated on individual basis. Each customer is assigned a credit rating between 1 and 13, where 1 means the lowest probability of default and 13 indicates insolvency. Credit rating is assigned to a customer considering combination of financial status and business risk.

The specific financial ratios and business risk aspects considered depend on the rating model used: corporate, commercial real estate, residential development, and commodity. Credit rating is assigned by credit analyst and confirmed by Head of Credit Analysis Department, but final decision of risk taking is the unanimous decision by the Credit Committee.

After issuing the loan, follow-up monitoring is performed at least quarterly for each customer's financial position. At least annually all client ratings are reviewed. Clients with significant increase in credit risks are listed in watchlist. The financial position, liquidity and collateral value of watchlist clients is thoroughly monitored more frequently. See Note 3.2.4. for more detailed information on the credit quality of loans.

## (f) Retail loans to SME's

In 2016, the Group started offering micro loans. The loan is aimed to micro enterprises in the growth stage and the maximum loan amount is up to EUR 25 000.

In addition to micro loans, the retail banking segment also includes other corporate credit commitments in the

amount of up to EUR 250 thousand. Credits below EUR 250 thousand are analysed with a more cost-efficient scoring process. The scoring process is carried out at the time of loan application and it is one of the criteria for issuing the loan.

Financial data and information on payment behaviour of the company is used when calculating the probability of default (PD). The structure of assets and liabilities are taken into account, also the profitability and cash flow ratios.

Retail loans of legal entities are included in the retail loans financial statement line item.

See Note 3.2.4. for more detailed information on the credit quality of loans.

**(g) Consumer loans without collateral and hire-purchase**

Group offers consumer loans and hire-purchase through its subsidiary LHV Finance in Estonia. The maximum loan amount is up to EUR 15 000 and hire purchase up to EUR 20 000. Hire purchase service is offered through merchant partners. Scoring model are used to assess the customer's credit behaviour. The scoring is made at the time the application is filed and is one of the criteria for issuing a credit.

The Group has entered into agreements where most overdue consumer loans and hire purchase agreements are sold – usually when loans reaching overdue at least of 79 days.

See Note 3.2.4. for more detailed information on the credit quality of loans.

**(h) Credit cards**

The Bank issues credit cards and Partner credit cards in cooperation with Tallinna Kaubamaja. Similarly to consumer loans and hire purchase most overdue loans are sold when overdues breach 79 days.

See Note 3.2.4. for more detailed information on the credit quality of loans.

**(i) Student loans**

In 2018, the Group started offering student loans. The loan is aimed to students to cover costs during their studies. The maximum amount of state secured student loan is EUR 2 000 per academic year.

See Note 3.2.4. for more detailed information on the credit quality of loans.

**(j) Mortgage loans**

In 2013, Group started to offer on a limited basis mortgage loans (private loans) to customers in the Tallinn and Tartu region only. In autumn 2016, Group started offering the

mortgage loan (home loans) to a large scale of retail clients without regional limits within Estonia. The maximum loan amount is in line with the regulations set by Central Bank of Estonia.

See Note 3.2.4. for more detailed information on the credit quality of loans.

**(k) Leasing**

The Bank offers leasing products for individuals and legal entities. The creditworthiness of customers is assessed by using a rating model for clients with exposure of more than EUR 250 thousand and scoring models for clients with exposure of less than EUR 250 thousand. Rating model is the same which used for assessment of creditworthiness of corporate credit portfolio customers.

See Note 3.2.4. for more detailed information on the credit quality of loans.

**Risk concentration**

Several tolerance limits that are regularly monitored and reported have been introduced in Group's Credit Policy to control and hedge concentration risk. These limits are set for overall credit portfolio and separately for the largest – corporate credit portfolio. The most significant metrics and limits measured at the last day of each quarter are as follows:

- a) The share of small financing in the Group's total credit portfolio
- b) The share of financing non-domicile customers in the Group's total credit portfolio
- c) The share of shadow banking financing compared to net owned funds
- d) The share of ten largest credit customers compared to net owned funds
- e) The share of financing the higher risk rating classes compared to the total corporate credit portfolio
- f) The share of financing the catering and construction sector compared to the total corporate credit portfolio
- g) The share of financing outside of Estonia (incl. financing in EU countries and UK).

Distribution of assets and liabilities by geographic region is presented below. As at 31.12.2018, the loans issued to 8 customers (2017: total 8) had a large risk exposure, i.e. more than 10% of the net own funds (NOF) of Group either individually or via group risk, totalling 111% of NOF (2017: 111%).

The Group has invested in the debt securities of 2 issuers (2017: 2) with a large risk exposure, totalling 21% of NOF (2017: 33%). Of customer deposits, the deposits of 3 (2017: 3) customers have a high risk concentration, which amounts to 89% (2017: 425%) of NOF. Group has drastically reduced the larger depositor's volumes and replaced

these deposits with retail deposits. There are 6 clients holding more than 1% of all deposits (2017: 4). Their total deposits amount was EUR 189 million (2017: 615). Share of Top 20 depositors was 20.5% as of 31.12.2018 compared to more than 50% as end of 2017.

### 31.12.2018

(in thousands of euros)

	Note	Estonia	Latvia	Lithuania	Finland	Nether-lands	Ger-many	Other EU	USA	Other	Total
Due from banks and investment companies	10	650 321	0	0	0	0	0	13 599	16 541	2 197	<b>682 658</b>
Financial assets at fair value	11, 12	8 392	772	17 242	0	0	1	20 704	43	0	<b>47 154</b>
Loans and advances to customers	13	886 881	52	10 561	1 524	1	6	18 432	175	1 129	<b>918 761</b>
Receivables from customers	14	3 706	1	5	0	0	0	0	0	9	<b>3 721</b>
Other financial assets	15	111	0	0	0	0	0	0	2 825	0	<b>2 936</b>
<b>Total financial assets</b>		<b>1 549 411</b>	<b>825</b>	<b>27 808</b>	<b>1 524</b>	<b>1</b>	<b>7</b>	<b>52 735</b>	<b>19 584</b>	<b>3 335</b>	<b>1 655 230</b>
Deposits from customers and loans received	17	1 154 012	10 041	951	3 414	576	13 274	220 173	3 085	38 256	<b>1 443 782</b>
Subordinated debt	20	50 900	0	0	0	0	0	0	0	0	<b>50 900</b>
Accounts payable and other financial liabilities	18	21 381	0	4	27	0	0	13	3	0	<b>21 428</b>
Financial liabilities at fair value	12	11	0	0	0	0	0	0	0	0	<b>11</b>
<b>Total financial liabilities</b>		<b>1 226 304</b>	<b>10 041</b>	<b>955</b>	<b>3 441</b>	<b>576</b>	<b>13 274</b>	<b>220 186</b>	<b>3 088</b>	<b>38 256</b>	<b>1 516 121</b>

### 31.12.2017

(in thousands of euros)

	Note	Estonia	Latvia	Lithuania	Finland	Nether-lands	Ger-many	Other EU	USA	Other	Total
Due from banks and investment companies	10	919 599	47	2 528	0	0	0	3 051	28 152	7 835	<b>961 212</b>
Financial assets at fair value	11, 12	7 466	779	17 456	0	0	29 867	1 064	2	0	<b>56 634</b>
Loans and advances to customers	13	650 871	3 644	46 269	998	91	42	26 580	45	3 503	<b>732 043</b>
Receivables from customers	14	8 481	372	947	0	0	0	0	0	0	<b>9 800</b>
Other financial assets	15	109	0	0	0	0	0	0	2 180	0	<b>2 289</b>
<b>Total financial assets</b>		<b>1 586 526</b>	<b>4 842</b>	<b>67 200</b>	<b>998</b>	<b>91</b>	<b>29 909</b>	<b>30 695</b>	<b>30 379</b>	<b>11 338</b>	<b>1 761 978</b>
Deposits from customers and loans received	17	848 642	5 024	825	2 717	12 505	632	639 608	2 855	30 121	<b>1 542 929</b>
Subordinated debt	20	30 900	0	0	0	0	0	0	0	0	<b>30 900</b>
Accounts payable and other financial liabilities	18	60 382	3 047	3 360	27	0	0	13	3	0	<b>66 832</b>
Financial liabilities at fair value	12	2	0	0	0	0	0	0	0	0	<b>2</b>
<b>Total financial liabilities</b>		<b>939 926</b>	<b>8 071</b>	<b>4 185</b>	<b>2 744</b>	<b>12 505</b>	<b>632</b>	<b>639 621</b>	<b>2 858</b>	<b>30 121</b>	<b>1 640 663</b>

### Distribution of loans granted by industry (gross):

(in thousands of euros)

	31.12.2018	%	31.12.2017	%
Individuals	214 702	23.1%	191 744	25.9%
Real estate	246 930	26.6%	197 697	26.7%
Manufacturing	98 073	10.6%	68 252	9.2%
Art and entertainment	34 582	3.7%	29 292	4.0%
Financial services	95 697	10.3%	78 113	10.6%
Wholesale and retail	24 378	2.6%	21 112	2.9%
Administrative activities	39 808	4.3%	33 947	4.6%
Transport and logistics	11 076	1.2%	5 876	0.8%
Agriculture	20 231	2.2%	8 717	1.2%
Other servicing activities	25 669	2.8%	15 485	2.1%
Construction	35 808	3.9%	19 421	2.6%
Information and communication	4 115	0.4%	8 439	1.1%
Professional, scientific and technical activities	18 779	2.0%	13 958	1.9%
Education	2 391	0.3%	2 218	0.3%
Other areas at activities	56 798	6.1%	45 897	6.2%
<b>Total (Note 13)</b>	<b>929 037</b>	<b>100%</b>	<b>740 168</b>	<b>100%</b>

### Loans and advances (incl. loan commitments and guarantees)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and the passage of time. The assessment of credit risk of a portfolio of assets entails further estimations as to the likelihood of defaults occurring, of the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). This is similar to the approach used for the purposes of measuring Expected Credit Loss (ECL) under IFRS 9. Refer to note 3.3.2 for more details.

### Credit risk grading

The Group uses internal credit risk grading that reflect the assessment of the probability of default of individual counterparties. The Group use internal rating models tailored to the various categories of counterparty. Borrower and loan specific information collected at the time of application (such as disposable income, and level of collateral for retail exposures; and turnover and industry type for wholesale exposures) is fed into this rating model. This is supplemented with external data such as credit bureau scoring information on individual borrowers. In addition, the models enable expert judgement from the Credit Risk Officer to be fed into the final internal credit rating for each exposure. This allows for considerations which may not be captured as part of the other data inputs into the model.

The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade. For example, this means that the difference in the PD between rating grade 4 and 5 is lower than the difference in the PD between a 7 and 8.

The following are additional considerations for each type of portfolio held by the Group:

### Retail

After the date of initial recognition, for retail business, the payment behaviour of the borrower is monitored on a periodic basis to develop a behavioural score. Any other known information about the borrower which impacts their creditworthiness – such as unemployment and previous delinquency history – is also incorporated into the behavioural score. This score is mapped to a PD.

### Corporate

For corporate business, the rating is determined at the borrower level. A relationship manager will incorporate any updated or new information/credit assessments into the credit system on an ongoing basis. In addition, the relationship manager will also update information about the creditworthiness of the borrower every year from sources such as public financial statements. This will determine the updated internal credit rating and PD.

### Treasury

For debt securities in the Treasury portfolio, the credit standing of the security is determined on the basis of the ratings of external rating agencies. These ratings are continuously monitored and updated. The PD's associated with each rating are mapped to LHV's rating scale.

As LHV doesn't have a significant market risk portfolio then LHV measures concentration in other two key areas: liquidity risk and credit risk.

### Liquidity Risk

As LHV keeps its liquid assets mainly in cash in ECB then concentration risk in liquidity risk concerns mostly funding risks. 98% of LHV funding is in the form of deposits and therefore the most important metrics to measure concentration risk concerning liquidity is deposit concentration (Note 3.2.2. Risk concentration).

### Credit Risk

The Group's rating method used for evaluating the PD of corporate loans consists of a total of 13 credit ratings where 1 stands for the lowest and 13 for the highest credit risk. Ratings 1 and 2 are attributed only based on average ratings of rating agencies Fitch, Moody's and Standard &

Poor's, and are subject to the Group's financial analysis as necessary.

The master scale assigns each rating category a specified range of probabilities of default, which is stable over time.

Thus, ratings 1 and 2 are attributed only to international enterprises, organisations, local governments and countries whose solvency has been confirmed by the rating agencies with their investment grade rating. Also rating classes 3 -13 are partly based on the evaluation of rating agencies, although this category includes mainly Estonian enterprises that do not have an international rating.

The group's internal rating scale for corporate loans and mapping of external ratings:

### LHV rating

	LHV description	PD%	S&P	Moody's
1	Investment grade	0.03	AAA	Aaa
2		0.05	AA+	Aa1
3		0.10	AA, AA-	Aa2, Aa3
4		0.20	A+,A,A-	A1,A2,A3
5		0.30	BBB+	Baa1
6		0.40	BBB	Baa2
7		0.50	BBB-	Baa3
8		1.00	BB+,BB	Ba1,Ba2
9		2.50	BB-	Ba3
10	Non-investment grade	5.00	B+	B1
11		10.00	B,B-	B2,B3
12		30.00	CCC/C	Caa
13	Default	100.00	D	C

The rating methods are subject to an annual validation and recalibration so that they reflect the latest projections in the light of all actually observed defaults.

All retail loans have a behavioural score. This score is mapped to a PD. Retail loans are divided into three groups:

investment grade, special monitoring and default. Investment grade is allocated when the loan is not overdue as at balance sheet date. Special monitoring status is allocated when the loan has overdue status and default status is based on the definition of default principle.

### 3.2.3 Expected credit loss measurement

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

A financial instrument that is not credit-impaired on initial recognition is classified in 'Stage 1' and has its credit risk continuously monitored by the Group.

If a significant increase in credit risk ('SICR') since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired. Please refer to note 3.2.3.1 for a description of how the Group determines when a significant increase in credit risk

has occurred.

If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'. Please refer to note 3.2.3.2 for a description of how the Group defines credit-impaired and default.

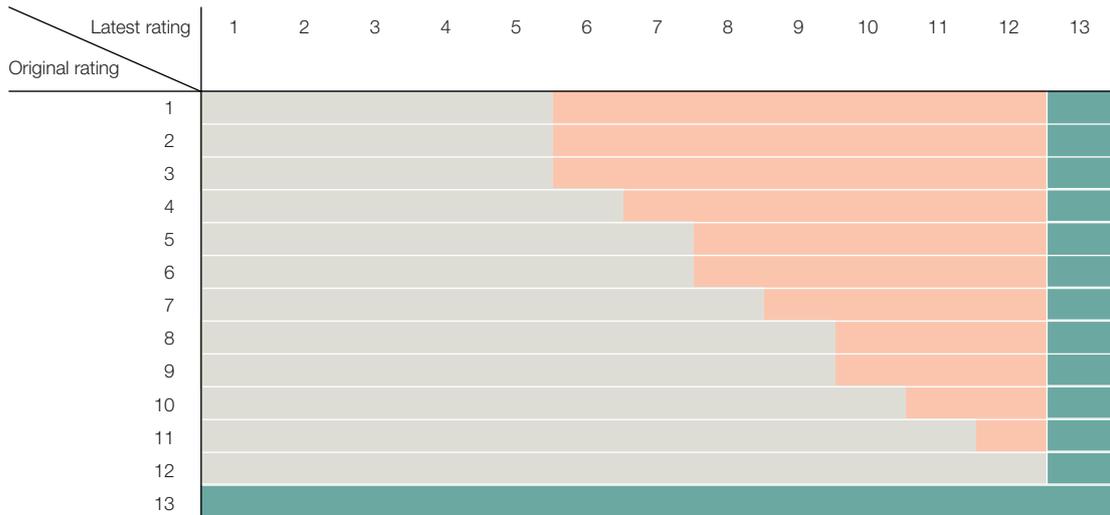
Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime expected credit losses that result from default events possible within the next 12 months. Instruments in Stages 2 or 3 have their ECL measured based on expected credit losses on a lifetime basis. Please refer to note 3.2.3.3 for a description of inputs, assumptions and estimation techniques used in measuring the ECL.



To illustrate the application of these thresholds, take for example a 3-year retail business loan agreement initiated on 13th February 2018 which at initial recognition had a Lifetime PD of 3.36 % and was expected to have a residual Lifetime PD of 2.76% ten months later at the current reporting date. If at the current reporting date the loan has a current lifetime PD of 8.86% then this exceeds the expected PD of 2.76% by more than the threshold shown

above. Therefore a significant increase in credit risk has occurred.

Legacy portfolio – corporate contracts initiated before 1st January 2018



These thresholds have been determined by assessing how the Lifetime PD moves prior to an instrument becoming delinquent. The Lifetime PD movements on instruments which do not subsequently become delinquent have also been assessed, to identify the „natural“ movement in Lifetime PD, which is not considered indicative of a significant increase in credit risk. The average maturity of the corporate portfolio is short, namely 2.7 years.

**Qualitative criteria**

Qualitative criteria is applied in SICR calculation to legacy retail portfolio that was initiated before 2018. For the current portfolio, the qualitative criteria is included in the PD calculation and therefore included in the SICR calculation through Lifetime PD.

Due to the average short maturity of the legacy portfolio (1.75 years) it was not practical to go back to history to predict initial PDs for the contracts initiated before the of 1st December, 2017 and therefore the application PD or rating PD were used as initial PDs for legacy portfolio.

Retail legacy portfolio – private person contracts initiated before 1st January 2018

If the borrower meets one or more of the following conditions, then there is significant increase in credit risk:

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or
- The customer has had more than one payment alert or tax debt over the last 12 months
- In case of home or private loan the contract LTV >100% is also considered.

Retail legacy portfolio – business contracts initiated before 1st January 2018

If the borrower meets one or more of the following conditions, then there is significant increase in credit risk:

- At the report date the contract is over 30 days past due with more than 10 euros
- The contract has been overdue over 30 days and in the amount of more than 10 euros more than once over the last 12 months or

- The customer has had more than one payment alert or has had at least four incidents of tax debt in the amount of over 640 euros over the last 12 months.

The assessment of SICR incorporates forward-looking information (see note 3.2.3.4. for further information) and is performed on a quarterly basis. The criteria used to identify SICR are monitored and reviewed periodically for appropriateness by the independent member of Credit Risk team.

**Backstop**

A backstop is applied and the financial instrument considered to have experienced a significant increase in credit risk if the borrower is more than 30 days past due on its contractual payments.

The Group has used the low credit risk exemption for cash and nostro accounts fulfilling the liquidity portfolio criteria in the year ended 31 December 2018.

The following tables show the impact on the 31 December 2018 ECL allowance of changing the PD thresholds for SICR. Increases in ECL (positive amounts) represent higher impairment allowances that would be recognised.

<b>Product</b> <i>(in thousands of euros)</i>	<b>+10% Change in SICR</b>	<b>-10% Change in SICR</b>
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	-3	3
Hire-purchase	0	0
Credit cards	0	1
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

**Product**

*(in thousands of euros)*

	<b>SICR with 0.5% threshold</b>	<b>SICR with 1.5% threshold</b>
Leveraged loans	NA	NA
Corporate loans	NA	NA
Retail loans to SMEs	0	0
Consumer loans	0	0
Hire-purchase	0	0
Credit cards	0	0
Mortgage loans	0	0
Private loans	0	0
Leasing	0	0

As evidenced by above tables, changing SICR by +/- 10% or changing the 100bps threshold to 50bps or 150bps have limited impact to the overall ECL of the Group.

**3.2.3.2 Definition of default and credit-impaired assets**

The Group defines a financial instrument as in default, which is fully aligned with the definition of credit-impaired, when it meets one or more of the following criteria:

**Quantitative criteria**

The borrower is more than 90 days and over 10 euros past due on its contractual payments. The threshold of 10 euros is put in place with debt management procedures that is a trigger for debt collection activities and also indicated as materiality threshold in Definition of Default.

**Qualitative criteria**

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. The following circumstances are considered as indicators for the customer not to pay the debt in full:

- Non-accrued status is applied to the contract
- Specific credit adjustments has been formed due to the decline in the credit quality
- Sale of credit obligation with economic loss higher than 5 %
- Distressed restructuring measures have been applied to the contract resulting with diminished financial obligation higher than 1 %

- It is becoming probable that the borrower will enter bankruptcy or has filed for bankruptcy
- a customer's resources of cash flow are no longer available to meet the payments of instalments
- The Group has called any collateral including a guarantee.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss given Default (LGD) throughout the Group's expected loss calculations.

For applying the default status a customer based approach is used for wholesale and contract based approach is used for the retail portfolio.

An instrument is considered to no longer be in default when it no longer meets any of the default criteria for the probation period of corresponding to the reason of default. The shortest probation period of three months is applied to the contracts that defaulted due to filling the quantitative criteria from the date the criteria is no longer met.

Loans under distressed restructuring are considered to require particular attention in the reclassification to non-defaulted status because the assessment of days past due is based on the modified payment arrangement and the exposure cannot stop being restructured by the time it is fully repaid. Therefore the probation period for these loans is defined as at least 1 year from the latter of:

- the moment of extending the restructuring measures;
- the moment when the exposure has been classified as defaulted; or
- the end of grace period included in the restructuring arrangements.

### 3.2.3.3 Measuring ECL - Explanation of inputs, assumptions and estimation techniques

The aim of the ECL model is to calculate the 12-month and lifetime expected credit losses that:

- are unbiased, i.e. do not include any conservatism or optimism;
- are probability-weighted amounts that are determined by evaluating three provisioning scenarios (base scenario, upside scenario and downside scenario);

- reflect the time value of money;
- use reasonable and supportable information about past events, current conditions and forecasts of future economic conditions.

The Group's ECL model follows widely accepted sum of marginal losses approach, whereby ECLs are calculated as the sum of the marginal losses occurring in each time period (month) from the reporting date. The marginal losses are derived from individual risk parameters (PD, LGD, EAD) that estimate exposures and losses in the case of default and the marginal probability of default for each period (the probability of a default in time period X conditional upon an exposure having survived to time period X).

#### ECL calculations are based on four components:

Probability of Default (PD) is an estimate of the likelihood of default over a given time horizon.

Exposure at Default (EAD) is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected draw-downs on committed facilities.

Loss Given Default (LGD) is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that LHV would expect to receive, including from any collateral. LGD is expressed as a percentage of the EAD.

Discount factor is used to discount an expected loss to a present value at the reporting date.

Mathematically, the ECL amount for prediction horizon T (12 months or lifetime, depending on whether 12-month or lifetime ECL estimates are concerned) is expressed as follows:

$$ECL_T = \sum_{t=1}^T PD_t * LGD_t * EAD_t * d_t$$

Where:

- $t = 0, \dots, T$  – a one month period within the prediction horizon T; for a 12-month ECL estimate, T = 12 months; for a lifetime ECL estimate, T = expected life of the lending exposure;
- $PD_t$  – marginal PD for month t;
- $LGD_t$  – LGD as estimated for month t;
- $EAD_t$  – exposure amount, incl. expected drawdowns of undrawn commitments, at month t;
- $dt$  – discount factor for month t.

The discount rate represents the effective interest rate ("EIR") for the financial instrument or an approximation thereof.

A simplified example of the calculation logic is illustrated in table below. Note that in this example for secured

loans, LGD is directly derived from the collateral value and as a simplification, fair value is assumed to be constant. However, ECL model takes into account the possible decrease of collateral fair value over time through different scenarios.

	31/01/2018	28/02/2018	31/03/2018	30/04/2018	31/05/2018	30/06/2018	31/07/2018	31/08/2018	30/09/2018
(1) Exposure (EAD)	4000	3500	3000	2500	2000	1500	1000	500	0
(2) Marginal PD	0.40%	0.38%	0.36%	0.34%	0.32%	0.30%	0.28%	0.26%	0.24%
(3) Collateral value	2000	2000	2000	2000	2000	2000	2000	2000	2000
(4) Potential loss amount [Max (0;1-3)]	2000	1500	1000	500	0	0	0	0	0
(5) Expected marginal loss [2*4]	8	5.7	3.6	1.7	0	0	0	0	0
(6) Expected marginal loss, discounted	7.97	5.65	3.56	1.67	0	0	0	0	0
Lifetime ECL at 31.12.2017 [Sum(6)]	18.85								

Note. Discounting is done, assuming current reporting date 31.12.2017 and a 5% discount rate.

For the defaulted exposures, ECL is computed as:

$$ECL_T = \sum_{t=1} LGD_t * Exposure_t * d_t$$

As can be concluded, the key issue in ECL modelling is to transform the available risk parameter values into forward looking PiT estimates and 'feed' them into the expected credit loss calculation formula.

Each of the risk dimensions (PD, LGD, EAD) is covered with the internally developed rating- and scoring models. These models have been developed for the business- and credit management.

### IFRS 9 parameters

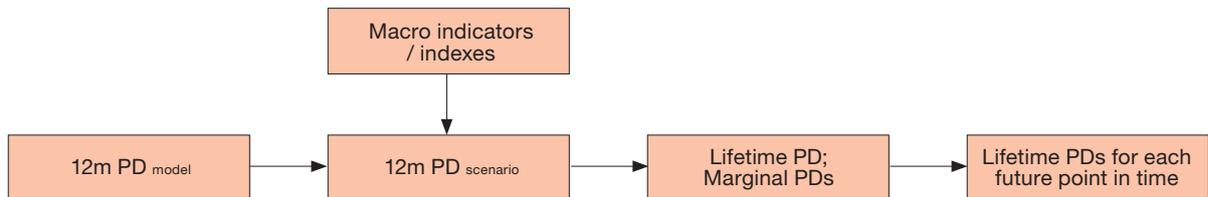
<b>Definition of Default</b>	<ul style="list-style-type: none"> <li>90 days past due</li> <li>Unlikely to pay without the bank turning to recourses such as selling collateral</li> </ul>
<b>PD</b>	<ul style="list-style-type: none"> <li>12-month PD; lifetime PD broken down further into marginal probabilities for sub-periods</li> <li>Forward looking PiT estimate, reflecting assessment of current and future economic conditions, and a range of possible future outcomes</li> <li>No regulatory floors or margins of conservatism applied</li> </ul>
<b>LGD</b>	<ul style="list-style-type: none"> <li>Neutral PiT projections</li> <li>Consider current and future economic conditions, and a range of possible future outcomes</li> <li>Recoveries discounted, using EIR as discount rate</li> <li>No regulatory floors or margins of conservatism applied</li> </ul>
<b>CCF/EAD</b>	<ul style="list-style-type: none"> <li>Reflects expected changes in the balance outstanding over the lifetime of the lending exposure, incl. scheduled loan payments and prepayments</li> </ul>
<b>ECL</b>	<ul style="list-style-type: none"> <li>PV of cash shortfalls. For Stage 1 exposures, 12-month PD is used. For stage 2 exposures, lifetime PD is used. For Stage 3 exposures, PD = 100%</li> </ul>

The following paragraphs outline how the existing underlying models are leveraged off for the ECL measurement. Each risk dimension in detail is discussed in the following chapters.

### 3.2.3.3.1 'Feeding' PDs from underlying rating and scoring models into ECL model

The transformation of the model PD (PD<sub>model</sub>) is performed in the following flow:

Instead of the historically based or long run average 12-month PDs (model PDs), forward looking 12-month and lifetime PiT estimates and marginal PDs are required for the IFRS 9 expected credit loss calculation.



Firstly, model PD is re-calibrated to the forward looking 12-month PiT estimate, given the defined macro scenario (12m PD<sub>scenario</sub>). Selected macro indicators, transformed into macro indexes, serve as inputs for this purpose.

of conservatism, or through the cycle (TtC) or downturn adjustments.

Next, forward looking 12-month PiT estimate is converted to lifetime PD and marginal PDs. This is done using the segment-specific standard default curve which gives the timing of the expected defaults for the remaining life of an exposure.

### 3.2.3.4 Forward-looking information incorporated in the ECL model

In order to incorporate forward looking information into the ECL measurements and capture a range of possible outcomes for the future conditions, probability-weighted ECL amounts based on the three provisioning scenarios (base, upside and downside) are calculated. Among others, this approach enables to reflect non-linear relationships between alternative scenarios and the ECL.

Lastly, lifetime PDs for each of the future points in time till the end of the expected life of the exposure are calculated.

### 3.2.3.3.2 'Feeding' LGDs from underlying models into ECL model

Mathematically:

$$ECL = p_{base} * ECL_{base} + p_{up} * ECL_{up} + p_{down} * ECL_{down}$$

In LGD dimension, the use of the underlying LGD models differs for secured and unsecured lending exposures.

Where:

$p_{base}$ ,  $p_{up}$ ,  $p_{down}$  – probabilities of the base, upside and downside scenarios respectively;

As IFRS 9 parameter should take into account the expected drop in the exposure amount over time, LGD for the secured part of the secured loans is directly calculated from the estimated fire-sale price of the collateral; no input from the underlying LGD models is used.

$ECL_{base}$ ,  $ECL_{up}$ ,  $ECL_{down}$  – expected credit loss amounts calculated for each of the defined scenarios.

LGDs from the underlying LGD models 'feed' into the ECL calculation for the unsecured exposures and unsecured parts of the secured exposures.

ECLs for each of the defined scenarios are derived based on the general formula, using scenario specific risk parameter values. Probability-weighted lifetime PD estimates for the purpose of assessing significant increase in credit risk are calculated in the same way:

Further, macroeconomic scenarios are incorporated into both secured and unsecured LGDs as applicable for the defined provisioning scenarios.

$$PD = p_{base} * PD_{base} + p_{up} * PD_{up} + p_{down} * PD_{down}$$

### 3.2.3.3.3 'Feeding' CCF estimates from underlying models into ECL model

Where:

$PD_{base}$ ,  $PD_{up}$ ,  $PD_{down}$  – lifetime PD estimates corresponding to each of the defined scenarios

Internal CCF estimates feed directly to the ECL model and are used in the EAD. No further adjustments are needed for the CCF as the internal estimates do not include margins

### 3.2.3.4.1 Selected indicators for private person credit portfolios

Selected macro indicators for private person credit portfolios and relative importance of each of the indicators are shown in table below:

	Mortgage	Consumer financing, fixed rate	Consumer financing, floating (incl. leasing)
Wage growth, %	17%	22%	18%
Unemployment rate, %	33%	44%	36%
Houseprice index growth, %	8%	0%	0%
Inflation rate, %	8%	11%	9%
Euribor, 6m	17%	0%	18%
Bank lending margins	17%	22%	18%
TOTAL	100%	100%	100%

Note. Relative importance of each of the indicators is calculated based on the indicator 'weights'.

### 3.2.3.4.2 Selected indicators for companies

A wide range of macroeconomic and industry sector-specific indicators was considered for companies. The analysis was conducted based on the two industry breakdowns:

- 1) broad industry sector level based on letter codes / alphabetical branch of the NACE Rev.2 classification, and
- 2) sub-sectors based on lower level numerical codes of the NACE Rev.2 classification.

The following conclusions were drawn from the analysis:

All sectors have been affected by the same credit cycle and have experienced major sector-wide financial difficulties at the same time. Despite of that, there are certain idiosyncratic differences between the industry sub-sectors e.g. in manufacturing

There are only a few variables that 'work'; the variables that have explanatory power, tend to 'work' similarly for most of the industry sectors:

GDP growth which explains the general state of economy,

Change in turnover,

Change in number of persons employed.

Change in an industry sector's profit/loss was also tested, but tends to be too volatile for drawing conclusions on substantial change in default risk.

A few macro indicators are significant to certain industry sectors, sub-sectors and/or groupings of sub-sectors even if correlations are difficult to show due to low numbers of observations and/or because of relatively short observation period. E.g.:

Export conditions for export-oriented industries such as: metal products, chemical products and electrical equipment;

Population growth and income growth for residential real estate;

Household consumption growth for industries that are oriented to internal consumption such as retail trade.

In conclusion, gross value added by industry sectors was selected as the indicator for companies, this given several considerations:

Observed correlation with the considered proxies for default rates;

GDP, which is close indicator to the gross value added, is the preferred approach for the industry;

It is easier to project for a macro economist than alternative indicators.

#### Economic variable assumptions

Macroeconomic scenarios (forecasts) and its indicators (incl. corporate portfolio PD and LGD estimates) are developed at least once a year and which are developed internally in the Credit Management Department that consults with the experts from Risk Control Unit, business, finance and external experts.

Macro developments are monitored on a quarterly basis as new macroeconomic data becomes available. Forecasts are updated as necessary in order to ensure timely inclusion of new forward-looking information into the ECL estimates.

Developed provisioning scenarios and significant updates to the scenarios are approved in the Risk and Capital Committee.

The most significant period-end assumptions used for the ECL estimate as at 31 December 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

**Valid at 31.12.2018**

	Base scenario		Downside scenario		Upside scenario	
	2019E	2020E	2019E	2020E	2019E	2020E
<b>General macro-financial indicators</b>						
Real GDP growth, %	3.0%	2.9%	1.0%	0.9%	4.0%	3.9%
Household consumption, %	3.9%	3.0%	2.0%	1.0%	4.5%	3.5%
Government consumption, %	0.8%	0.7%	0.7%	0.6%	1.2%	1.0%
Gross fixed capital formation, %	4.4%	4.2%	2.0%	1.9%	8.0%	8.0%
Exports of goods and services, %	3.8%	3.8%	0.5%	0.3%	4.3%	4.3%
Imports of goods and services, %	4.0%	3.9%	1.0%	0.7%	4.8%	4.8%
Nominal GDP, EURm	27 051	28 614	26 161	26 919	27 722	29 875
GDP deflator, % change	3.2%	2.8%	2.5%	2.0%	3.9%	3.7%
Consumer price growth, %	3.0%	2.6%	2.1%	1.7%	3.5%	3.5%
Unemployment rate, %	4.6%	4.5%	5.5%	5.9%	4.5%	4.5%
Change in employment, %	0.8%	-0.1%	0.0%	-0.3%	1.1%	0.3%
Net monthly wage growth, % (nominal)	6.0%	5.2%	3.0%	2.5%	7.5%	6.0%
House price index growth, %	3.4%	3.2%	-4.0%	-4.1%	4.4%	4.2%
Euribor 6m	-0.2%	0.2%	-0.2%	0.2%	-0.1%	0.3%
Bank lending margins on new loans	2.0%	2.0%	2.3%	2.5%	2.0%	2.0%

**Nominal growth**

	Base scenario		Downside scenario		Upside scenario	
	2019E	2020E	2019E	2020E	2019E	2020E
<b>Gross value added by sectors, y-o-y growth rates</b>						
Total - all NACE activities	6.3%	5.7%	3.5%	3.1%	8.0%	7.8%
Agriculture, forestry and fishing	10.0%	10.0%	5.0%	5.0%	14.0%	14.0%
Industry (except construction)	5.0%	4.3%	2.8%	2.2%	6.2%	5.5%
Industry, except construction and manufacturing (mostly energy related)	5.0%	3.0%	4.8%	2.8%	6.0%	4.0%
Manufacturing	5.0%	4.7%	2.1%	2.0%	6.3%	6.0%
Construction	9.0%	5.0%	-6.0%	-4.0%	12.0%	11.0%
Wholesale and retail trade, transport, accomodation and food service activities	5.0%	4.8%	1.5%	0.5%	6.5%	6.5%
Information and communication	14.1%	14.0%	14.1%	14.0%	15.8%	15.8%
Financial and insurance activities	6.0%	6.0%	3.5%	3.5%	9.0%	9.0%
Real estate activities	3.3%	3.3%	-1.0%	-5.0%	3.8%	3.8%
Professional, scientific and technical activities; administrative and support service activities	7.0%	6.0%	5.0%	4.0%	9.0%	8.0%
Public administration, defence, education, human health and social work activities	6.0%	6.0%	9.0%	9.0%	8.0%	8.0%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies	7.0%	6.5%	4.5%	4.0%	9.0%	8.5%

The weightings assigned to each economic scenario at 31 December 2018 were as follows:

**Valid at 31.12.2018**

	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

The most significant period-end assumptions used for the ECL estimate as at 1 January 2018 are set out below. The scenarios "base", "upside" and "downside" were used for all portfolios.

**Valid at 01.01.2018**

	Base scenario		Downside scenario		Upside scenario	
	2018E	2019E	2018E	2019E	2018E	2019E
<b>General macro-financial indicators</b>						
Real GDP growth, %	2.5%	2.5%	0.4%	0.4%	3.8%	3.8%
Household consumption, %	3.0%	3.0%	2.0%	2.0%	4.0%	4.0%
Government consumption, %	1.0%	1.0%	1.0%	1.0%	2.0%	2.0%
Gross fixed capital formation, %	6.0%	6.0%	0.0%	0.0%	8.0%	8.0%
Exports of goods and services, %	5.0%	5.0%	2.0%	2.0%	7.0%	7.0%
Imports of goods and services, %	6.0%	6.0%	3.0%	3.0%	8.0%	8.0%
Nominal GDP, EURm	24 434	25 949	23 621	24 297	24 832	26 804
GDP deflator, % change	3.8%	3.6%	2.5%	2.5%	4.2%	4.0%
Consumer price growth, %	3.3%	3.3%	2.0%	2.0%	3.5%	3.5%
Unemployment rate, %	5.4%	5.4%	6.0%	7.0%	5.0%	5.0%
Change in employment, %	0.2%	0.0%	0.0%	0.0%	0.5%	0.5%
Net monthly wage growth, % (nominal)	6.0%	6.0%	4.0%	4.0%	7.0%	7.0%
House price index growth, %	3.0%	3.0%	-10.0%	-10.0%	5.0%	5.0%
Euribor 6m	-0.3%	-0.1%	-0.3%	-0.3%	-0.2%	0.0%
Bank lending margins on new loans	1.8%	1.8%	2.4%	2.6%	1.8%	1.8%

**Nominal growth**

	Base scenario		Downside scenario		Upside scenario	
	2018E	2019E	2018E	2019E	2018E	2019E
<b>Gross value added by sectors, y-o-y growth rates</b>						
Total - all NACE activities	6.3%	6.4%	2.8%	3.1%	8.2%	8.2%
Agriculture, forestry and fishing	1.8%	2.0%	-9.1%	0.3%	5.4%	5.7%
Industry (except construction)	11.9%	8.0%	6.5%	4.5%	14.7%	9.5%
Industry, except construction and manufacturing (mostly energy related)	10.0%	9.6%	10.2%	10.0%	11.8%	11.4%
Manufacturing	7.4%	7.5%	0.4%	2.5%	10.4%	8.9%
Construction	2.5%	2.3%	-10.0%	-10.0%	4.2%	5.6%
Wholesale and retail trade, transport, accomodation and food service activities	6.2%	6.9%	2.4%	2.4%	8.4%	9.1%
Information and communication	10.6%	10.2%	10.6%	10.2%	12.4%	12.0%
Financial and insurance activities	7.4%	8.4%	-2.5%	-5.2%	10.4%	11.3%
Real estate activities	3.0%	3.0%	-5.0%	-5.0%	5.0%	5.0%
Professional, scientific and technical activities; administrative and support service activities	7.2%	7.0%	2.4%	2.4%	9.0%	7.7%
Public administration, defence, education, human health and social work activities	6.2%	5.9%	13.8%	10.4%	6.7%	6.7%
Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies	6.2%	5.9%	2.4%	2.4%	6.4%	6.1%

The weightings assigned to each economic scenario at 1 January 2018 were as follows:

**Valid at 01.01.2018**

	Base scenario	Downside scenario	Upside scenario
Weights of economic scenarios	65%	25%	10%

Other forward-looking considerations not otherwise incorporated within the above scenarios, such as the impact of any regulatory, legislative or political changes, have also

been considered, but are not deemed to have a material impact and therefore no adjustment has been made to the ECL for such factors. This is reviewed and monitored for appropriateness on a quarterly basis in Risk and Capital Committee.

### Sensitivity analysis

The most significant assumptions affecting the ECL allowance are as follows:

#### Retail portfolio

- Unemployment rate
- Wage growth
- Euribor
- Bank lending margins
- GDP

#### Corporate portfolio

- Estimated portfolio PiT PD values for each scenario
- Estimated LGD impact on downside scenario

The table below illustrates the impact of changing scenario weights of positive and negative scenarios to the portfolio as it was at 31 December 2018.

<i>(in thousands of euros)</i>	65-5-30	65-15-20
	(base/up/down)	(base/up/down)
Change in scenario weights	265	-265

Set out below are the changes to the ECL as at 31 December 2018 that would result from reasonably possible changes in these parameters from the actual assumptions used in the Group's economic variable assumptions (for example, the impact on ECL of increasing the estimated unemployment rate by X% in each of the base, upside, downside scenarios):

*(in thousands of euros)*

	Impact of increase	Impact of decrease
Unemployment rate +/-1%	37	-24
Wage growth +/- 5%	-35	27
Euribor +/-0.5%	1	-1
Bank lending margins +/-0.5%	62	-50
Consumer price growth +/-1%	-13	8
House price index +/- 2%	0	0
Gross value added by sectors, yoy growth rates +/- 5%	-24	27

The Group has performed stress test scenarios when PD and LGD estimations will both increase by 0.5. The impact of the described stress test to impairments is aggregated in the table below. The table includes loans, which have collective impairment and which have material balances and potential impact.

*(in thousands of euros)*

	Impact on loss allowances
LGD negative 0.88	260
LGD negative 1.0	-246
Average PiT PD -0.5%	-843
Average PiT PD +0.5%	814

### 3.2.4 Credit risk exposure

#### 3.2.4.1 Maximum exposure to credit risk – Financial instruments subject to impairment

The following tables contain an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

Information on how the Expected Credit Loss (ECL) is measured and how the three stages above are determined is included in note 3.2.3. „Expected credit loss measurement“.

#### Corporate Credit portfolio

As at 31.12.2018, the group-based impairment reserve makes up 1.4% of corporate loans and overdraft and the related interest receivables (31.12.2017: 0.5%).

#### Distribution of corporate loans and overdraft by internal ratings

31.12.2018

<i>(in thousands of euros)</i>	Total	Grading
4 low credit risk	1 162	
5 low credit risk	31 936	
6 low credit risk	103 019	
7 medium credit risk	155 855	
8 medium credit risk	180 376	
9 heightened credit risk	116 164	Investment grade
10 high credit risk	38 407	
11 high credit risk	3 121	
12 non-satisfactory rating	5 807	Special monitoring
13 insolvent	12 425	Default
<b>Total</b>	<b>648 271</b>	

In very limited cases, customer's with rating in investment grade are selected for special monitoring. There were no such customers as at 31.12.2018.

#### 2018 ECL staging

<i>(in thousands of euros)</i>	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	471 744	603	0	0	<b>472 348</b>
Special monitoring	135 723	27 775	0	0	<b>163 498</b>
Default	0	0	12 045	380	<b>12 425</b>
<b>Gross carrying amount</b>	<b>607 468</b>	<b>28 378</b>	<b>12 045</b>	<b>380</b>	<b>648 271</b>
Loss allowances	1 973	1 107	5 486	186	<b>8 751</b>
<b>Carrying amount</b>	<b>605 495</b>	<b>27 272</b>	<b>6 560</b>	<b>194</b>	<b>639 520</b>

For off-balance sheet exposures related with corporate credit portfolio, a provision of EUR 128 thousand was recorded as of 31.12.2018.

#### Corporate factoring

As at 31.12.2018, the group-based impairment reserve makes up 3.3% of corporate factoring portfolio and the related interest receivables.

#### 2018 ECL staging

<i>(in thousands of euros)</i>	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	2 654	0	0	0	<b>2 654</b>
Special monitoring	0	412	0	0	<b>412</b>
Default	0	0	0	0	<b>0</b>
<b>Gross carrying amount</b>	<b>2 654</b>	<b>412</b>	<b>0</b>	<b>0</b>	<b>3 067</b>
Loss allowances	21	79	0	0	<b>100</b>
<b>Carrying amount</b>	<b>2 633</b>	<b>333</b>	<b>0</b>	<b>0</b>	<b>2 966</b>

## Retail loans

As at 31.12.2018, the group-based impairment reserve makes up 1.1% of retail loans and related claims (31.12.2017: 1.1%). Credit decision is done by the majority decision of the Retail Banking Credit Committee.

### Retail loans to SMEs

#### 2018 ECL staging

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	14 966	1 043	0	0	16 009
Special monitoring	0	0	0	0	0
Default	0	0	191	0	191
<b>Gross carrying amount</b>	14 966	1 043	191	0	16 200
Loss allowances	31	54	98	0	184
<b>Carrying amount</b>	14 935	988	93	0	16 016

For off-balance sheet exposures related with retail credit portfolio, a provision of EUR 19 thousand was recorded as of 31.12.2018.

### Private loans

#### 2018 ECL staging

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	35 248	2 516	0	0	37 764
Special monitoring	0	0	0	0	0
Default	0	0	146	16	163
<b>Gross carrying amount</b>	35 248	2 516	146	16	37 927
Loss allowances	8	0	1	0	10
<b>Carrying amount</b>	35 239	2 516	145	16	37 917

### Student loans

#### 2018 ECL staging

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	76	0	0	0	76
Special monitoring	0	0	0	0	0
Default	0	0	0	16	0
<b>Gross carrying amount</b>	76	0	0	0	76
Loss allowances	0	0	0	0	0
<b>Carrying amount</b>	76	0	0	0	76

### Consumer loans

PD and LGD values are updated at least once a year with new historical data in order to maintain adequate provision levels on portfolio. If necessary, additional impairments will be made in the statement of financial position. If non-per-

forming or doubtful loan recovery is neither economical nor practical to continue, the loan is written off as irrecoverable.

As at 31.12.2018, the group-based impairment reserve makes up 1.7% of consumer loans and the related interest receivables (31.12.2017: 3.4%).

#### 2018 ECL staging

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	29 427	4 372	0	0	<b>33 799</b>
Special monitoring	0	0	0	0	<b>0</b>
Default	0	0	190	0	<b>190</b>
<b>Gross carrying amount</b>	<b>29 427</b>	<b>4 372</b>	<b>190</b>	<b>0</b>	<b>33 989</b>
Loss allowances	213	267	88	0	<b>568</b>
<b>Carrying amount</b>	<b>29 214</b>	<b>4 105</b>	<b>102</b>	<b>0</b>	<b>33 421</b>

For off-balance sheet exposures related with consumer credit portfolio, a provision of EUR 0 thousand was recorded as of 31.12.2018.

### Hire purchase

Similarly, to other homogenous portfolios, provisions are made based on the same framework as consumer loans.

As of 31 December 2018, the group-based impairment reserve amounted to 0.8% of hire-purchase portfolio (31.12.2017: 1.2%).

#### 2018 ECL staging

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	16 507	1 191	1	0	<b>17 699</b>
Special monitoring	0	0	0	0	<b>0</b>
Default	0	1	50	0	<b>51</b>
<b>Gross carrying amount</b>	<b>16 507</b>	<b>1 192</b>	<b>51</b>	<b>0</b>	<b>17 750</b>
Loss allowances	55	46	39	0	<b>140</b>
<b>Carrying amount</b>	<b>16 452</b>	<b>1 146</b>	<b>12</b>	<b>0</b>	<b>17 610</b>

### Credit cards

Provisions for potential credit losses are made based on the same framework as the consumer loans. The framework is based on PD, LGD and EAD indicators. As of 31 December 2018, the group-based impairment reserve amounted to 0.4% of credit card loans and related receivables (31.12.2017: 1.9%).

#### 2018 ECL staging

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	6 221	605	7	0	<b>6 833</b>
Special monitoring	1	7	0	0	<b>7</b>
Default	1	10	2	0	<b>12</b>
<b>Gross carrying amount</b>	<b>6 223</b>	<b>621</b>	<b>9</b>	<b>0</b>	<b>6 853</b>
Loss allowances	6	18	3	0	<b>27</b>
<b>Carrying amount</b>	<b>6 217</b>	<b>603</b>	<b>6</b>	<b>0</b>	<b>6 826</b>

For off-balance sheet exposures related with credit cards portfolio, a provision of EUR 1 thousand was recorded as of 31.12.2018.

## Mortgage loans

The provisions are made based on the same framework as for consumer loans. As of 31 December 2018, the group-based impairment amounted to 0.03% of mortgage portfolio (31.12.2017: 0.3%).

### 2018 ECL staging

(in thousands of euros)	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	93 158	7 851	0	0	101 009
Special monitoring	0	0	0	0	0
Default	0	0	0	0	0
<b>Gross carrying amount</b>	93 158	7 851	0	0	101 009
Loss allowances	19	7	0	0	26
<b>Carrying amount</b>	93 139	7 844	0	0	100 983

## Leasing

The leasing provisioning is done based on Leasing scoring models. The provisions are made based on the same framework as for consumer loans. As of 31 December 2018, the group-based impairment reserve amounted to 0.8% of leasing portfolio (31.12.2017: 0.3%).

### 2018 ECL staging

(in thousands of euros)	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	53 810	3 874	0	0	57 684
Special monitoring	0	2 198	0	0	2 198
Default	0	0	284	0	284
<b>Gross carrying amount</b>	53 810	6 071	284	0	60 165
Loss allowances	92	312	63	0	467
<b>Carrying amount</b>	53 717	5 760	221	0	59 698

## Leveraged loans

The Bank had no impaired leveraged loans as at 31.12.2018 and 31.12.2017.

The impairment reserve amounted to 0.08% of the leveraged loans portfolio

### 2018 ECL staging

(in thousands of euros)	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased or Initiated Credit Impaired	Total
<b>Credit grade</b>					
Investment grade	3 730	0	0	0	3 730
Special monitoring	0	0	0	0	0
Default	0	0	0	0	0
<b>Gross carrying amount</b>	3 730	0	0	0	3 730
Loss allowances	3	0	0	0	3
<b>Carrying amount</b>	3 726	0	0	0	3 726

### 3.2.4.2 Credit quality of financial assets as of 31.12.2017

#### Credit quality of loans and advances to customers and off-balance sheet liabilities

#### Loans and advances to customers

31.12.2017

(in thousands of euros)

	Neither past due nor impaired	Past due, but not impaired	Individually impaired	Total	Collective impairment	Individual impairment	Net
<b>Loans to legal entities</b>							
Corporate loans	443 822	3 766	9 160	<b>456 748</b>	-2 161	-1 518	<b>453 069</b>
Retail loans	13 049	581	26	<b>13 656</b>	-155	0	<b>13 501</b>
Overdraft	34 309	0	4 883	<b>39 192</b>	-122	-793	<b>38 277</b>
Hire-purchase	268	0	1	<b>269</b>	-3	-1	<b>265</b>
Leveraged loans	4 547	0	0	<b>4 547</b>	0	0	<b>4 547</b>
Leasing	31 603	2 170	67	<b>33 840</b>	-140	-614	<b>33 086</b>
Credit cards	172	0	0	<b>172</b>	-4	0	<b>168</b>
<b>Loans to individuals</b>							
Consumer loans	31 120	0	3 354	<b>34 474</b>	-1 169	-86	<b>33 219</b>
Hire-purchase	50 101	6 772	454	<b>57 327</b>	-824	-30	<b>56 473</b>
Leveraged loans	2 621	0	0	<b>2 621</b>	0	0	<b>2 621</b>
Leasing	11 147	236	19	<b>11 402</b>	-19	-7	<b>11 376</b>
Mortgage loans	77 471	169	0	<b>77 640</b>	-243	0	<b>77 397</b>
Credit cards	7 523	0	676	<b>8 199</b>	-231	-5	<b>7 963</b>
Overdrafts	77	1	3	<b>81</b>	0	0	<b>81</b>
<b>Total (Note 13)</b>	<b>707 830</b>	<b>13 695</b>	<b>18 643</b>	<b>740 168</b>	<b>-5 071</b>	<b>-3 054</b>	<b>732 043</b>

Overdue loan amounts include the total amount of the loans, not only the amount of overdue instalments.

There are several criteria for the loan to be considered individually impaired. Group's internal default definition is in line with the generally accepted criteria for definition of default: such as payment delay more than 90 days on any material credit obligation, distressed restructuring of the credit obligation, specific credit adjustment due to significant perceived decline in credit quality since inception, significant financial difficulties of the obligor or likely bankruptcy process, etc.

As part of risk analysis, the Group is regularly performing stress tests and sensitivity analysis regarding credit risk and its components (such as PD, LGD). Collective impairment credit assessment of the Group is based on historical loss rate and credit rating.

#### Distribution of corporate loans and overdraft by internal ratings

31.12.2017

(in thousands of euros)

	Neither past due nor impaired	Past due but not impaired	Individually impaired	Total
4 low credit risk	794	0	0	794
5 low credit risk	18 637	0	0	18 637
6 low credit risk	113 983	0	0	113 983
7 medium credit risk	126 335	0	0	126 335
8 medium credit risk	139 264	0	0	139 264
9 heightened credit risk	44 452	0	0	44 452
10 high credit risk	23 649	0	0	23 649
11 high credit risk	6 898	3 716	0	10 613
12 non-satisfactory rating	4 119	50	0	4 169
13 insolvent	0	0	14 043	14 043
<b>Total</b>	<b>478 131</b>	<b>3 766</b>	<b>14 043</b>	<b>495 940</b>

Distribution of internal ratings for other loan products:

- Excellent – leveraged loans secured by debt or equity securities and loans with very low business risk.
- Very good – loans with lower business risks and no past due payments.
- Good – loans with lower business risks and past due payments up to 30 days.
- Satisfactory – loans with average business risk and up to 60 days past due.
- Weak or doubtful – loans carrying higher business risk, past due more than 60 days and portfolio in proceedings by the bailiff.

**As at 31.12.2017**

(in thousands of euros)

	Retail loans	Leveraged loans	Credit cards	Leasing	Consumer loans	Hire-purchase	Over-draft	Mortgage loans	Total
<b>Neither past due nor impaired</b>									
Excellent	0	7 168	0	0	0	0	0	0	7 168
Good and very good	13 049	0	7 695	42 750	31 120	50 369	77	77 471	222 531
<b>Past due but not impaired</b>									
Good	481	0	0	1 725	0	5 202	0	169	7 577
Satisfactory	61	0	0	664	0	1 266	1	0	1 992
Weak or doubtful	39	0	0	17	0	304	0	0	360
<b>Individually impaired</b>									
Good	0	0	78	0	2 160	52	0	0	2 290
Satisfactory	0	0	221	0	623	51	0	0	895
Weak or doubtful	26	0	377	86	571	352	3	0	1 415
<b>Total</b>	<b>13 656</b>	<b>7 168</b>	<b>8 371</b>	<b>45 242</b>	<b>34 474</b>	<b>57 596</b>	<b>81</b>	<b>77 640</b>	<b>244 228</b>

**Structure of past due but not impaired loans according to past due time** (loans, which have overdue interest or principal payments as at the end of the reporting period,

are divided in past due categories according to the past due time from the earliest outstanding payment):

**As at 31.12.2017**

(in thousands of euros)

	Corporate loans (incl. overdraft)	Retail loans	Leasing	Hire-purchase	Overdraft to private individuals	Mortgage loan	Total
<b>Past due receivables</b>							
1-30 days	56	481	1 725	5 202	0	169	7 633
31-60 days	3 710	61	664	1 266	1	0	5 702
61-90 days	0	39	17	304	0	0	360
91-180 days	0	0	0	0	0	0	0
181-360 days	0	0	0	0	0	0	0
more than 360 days	0	0	0	0	0	0	0
<b>Total</b>	<b>3 766</b>	<b>581</b>	<b>2 406</b>	<b>6 772</b>	<b>1</b>	<b>169</b>	<b>13 695</b>

**Structure of individually impaired loans according to past due time** (loans, which have overdue interest or principal payments as at the end of the reporting period, are

divided in past due categories according to the past due time from the earliest outstanding payment):

**As at 31.12.2017**

(in thousands of euros)

	Corporate loans (incl. overdraft)	Retail loans	Leveraged loans	Credit cards	Leasing	Hire-purchase	Consumer loans	Overdraft to private individuals	Total
No payments over deadline	0	0	0	0	0	12	37	0	49
<b>Past due receivables</b>									
1-30 days	0	0	0	78	0	40	2 123	0	2 241
31-60 days	0	0	0	221	0	51	623	0	895
61-90 days	0	0	0	115	0	35	268	0	418
91-180 days	12 664	26	0	176	78	161	159	3	13 267
181-360 days	0	0	0	60	7	37	88	0	192
More than 360 days	1 379	0	0	26	1	119	56	0	1 581
<b>Total</b>	<b>14 043</b>	<b>26</b>	<b>0</b>	<b>676</b>	<b>86</b>	<b>455</b>	<b>3 354</b>	<b>3</b>	<b>18 643</b>

### Impact to impairment as at 31.12.2017

(in case PD and LGD levels will increase by 10%)  
(in thousands of euros)

	Balance as at 31.12.2017	Impairment with increased PDs and LGDs	Impact to impairment booked
<b>Loans to legal entities</b>			
Corporate loans (incl. overdraft)	495 940	-5 056	-462
Leasing	33 840	-783	-29
Retail loans	13 656	-188	-33
<b>Loans to individuals</b>			
Consumer loans	34 474	-1 509	-254
Hire-purchase	57 327	-1 015	-161
Mortgage loan	77 640	-294	-51
Leasing	11 402	-31	-5
Credit card loans	8 199	-277	-41
<b>Total</b>	<b>732 478</b>	<b>-9 153</b>	<b>-1 036</b>

#### 3.2.4.3 Maximum exposure to credit risk – Financial instruments not subject to impairment

Financial assets kept in fair value are by definition not subject to impairment, their changes in credit risk is automatically accounted through market value changes.

In addition some accounts carrying smaller credit risk are not part of impairment calculation:

- **Cash and balances with central bank**
- **Nostro accounts**

Both of these account types carry very limited amount of credit risk and maturity tenor is general is just 1 day. Cash and central bank balances are limited per currencies – only currencies bank is active are allowed. Nostro accounts are subject to credit risk limits, all counterparts have to minimally have investment grade rating. In case counterparts rating is lowered below investment grade, the nostro account will not qualify for having balances by the end of banking day.

#### 3.2.4.4 Collateral

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation.

The Group prepares a valuation of the collateral obtained as part of the loan origination process. This assessment is reviewed periodically. The valuations of the market value of collaterals are based on the principle of conservatism, which takes into account the type of collateral, the location, the likelihood of realization and liquidity.

Expert evaluations are used to evaluate immovables. In order to ensure that market values are up to date, the individual assessments of commercial real estate are updated at least once a year. In the case of residential and other homogeneous types of real estate, statistical indexation models are also used for regular re-evaluation.

The principal collateral types for loans and advances are:

- Mortgage
- Guarantee of KredEx Fund or Rural Development Foundation
- Deposit
- Marketable securities
- Rights of claims
- Commercial pledge
- Pledge of shares
- Pledge of claim
- Surety of private person or legal entity
- Machinery and equipment

The preferred collateral is where there is no strong correlation between the client's default risk and value of the collateral. In general, the pledged assets need to be secured, the life of the collateral needs to be longer than the due date of the loan and the market value of the collateral needs to exceed the outstanding loan balance.

Unsecured loan can be issued to private customers up to a specified amount. For corporate customers this is only allowed when cash flow forecast shows stable and significantly strong cash flows and/or customer's credit risk is valued to be low.

The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

Mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in low loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is EUR 101 009 thousand as at 31 December 2018.

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held in order to mitigate potential losses are shown below:

**31.12.2018**

(in thousands of euros)

	Gross exposure	Impairment allowance	Carrying amount	Fair value of collateral held
<b>Credit-impaired assets</b>				
Loans to corporate entities:				
- Large corporate customers	380	(186)	194	194
<b>Total credit-impaired assets</b>	<b>380</b>	<b>(186)</b>	<b>194</b>	<b>194</b>

In the table below, collateral information of loans and advances are disclosed based on the collateral type and carrying value or fair value of collateral held if it is lower.

The under-collateralised amount is presented as "Unsecured loans".

**Loans against collateral as at 31.12.2018**

(in thousands of euros)

	Corporate and retail loans (including overdraft)	Leveraged loans	Credit cards, consumer loans, overdraft to private individuals	Leasing	Hire-purchase	Mortgage loans	Total
Listed securities	0	3 730	0	0	0	0	3 730
Unlisted equity securities	21 257	0	673	0	0	0	21 930
Mortgages, real estate	333 498	0	28 224	0	0	100 281	462 003
Guarantee of KredEx and Rural Development Foundation	4 395	0	0	0	0	0	4 395
Pledges of rights of claim	35 250	0	0	0	0	0	35 250
Deposits	3 168	0	1 654	0	0	0	4 822
Leased assets	53 309	0	0	41 033	0	0	94 342
Others	25 136	0	7 390	0	0	0	32 526
Unsecured loans	191 525	0	40 904	19 132	17 750	728	270 039
<b>Total</b>	<b>667 538</b>	<b>3 730</b>	<b>78 845</b>	<b>60 165</b>	<b>17 750</b>	<b>101 009</b>	<b>929 037</b>

**Loans against collateral as at 31.12.2017**

(in thousands of euros)

	Corporate and retail loans (including overdraft)	Leveraged loans	Credit cards, consumer loans, overdraft to private individuals	Leasing	Hire-purchase	Mortgage loans	Total
Listed securities	0	7 168	0	0	0	0	7 168
Unlisted equity securities	36 603	0	0	0	0	0	36 603
Mortgages, real estate	233 876	0	0	0	0	77 640	311 516
Guarantee of KredEx and Rural Development Foundation	4 410	0	0	0	0	0	4 410
Pledges of rights of claim	15 163	0	0	0	0	0	15 163
Deposits	3 262	0	0	0	0	0	3 262
Leased assets	0	0	0	45 242	57 596	0	102 838
Others	90 915	0	81	0	0	0	90 996
Unsecured loans	125 367	0	42 845	0	0	0	168 212
<b>Total</b>	<b>509 596</b>	<b>7 168</b>	<b>42 926</b>	<b>45 242</b>	<b>57 596</b>	<b>77 640</b>	<b>740 168</b>

Collaterals for leveraged loans are monitored on a daily basis and, if collateral value is falling, immediate measures are taken to avoid credit losses. As of 31 December 2018 and as of 31 December 2017, all leveraged loans are over-collateralized. Consumer loans and credit card loans are issued without collateral and risk mitigation is done by regular monitoring of clients payment behaviour. Leasing and mortgage loans are all over-collateralized. The Group monitors customers in arrears of leasing, hire purchase, mortgage loans and overdraft to private individuals on regular basis.

In relation to under-collateralized corporate loans, it should be taken into consideration, that the Group has assessed the market value of certain collaterals conservatively (personal sureties, commercial pledges). Under-collateralized loans are mainly considered to bear higher risk, for which the Group carries out monthly monitoring in credit committee, in order to mitigate potential credit losses. Under-collateralized loans include contracts with more than 90 days overdue totalling EUR 13 592 thousand (2017: EUR 1 383 thousand) euros with a collateral value of 7 172 thousand (2017: EUR 0 thousand) euros.

(in thousands of euros)

	Over-collateralized loans		Under-collateralized loans	
	Carrying value	Fair value of collateral	Carrying value	Fair value of collateral
<b>As at 31.12.2018</b>	<b>364 598</b>	<b>616 532</b>	<b>564 439</b>	<b>294 379</b>
Corporate and retail loans (including overdraft)	236 687	397 060	430 851	239 326
Leveraged loans	3 730	6 293	0	0
Credit cards, consumer loans, overdraft to private individuals	37 846	100 820	40 999	74
Leasing	0	0	60 165	41 033
Hire-purchase	0	0	17 750	0
Mortgage loans	86 335	112 359	14 674	13 946
<b>As at 31.12.2017</b>				
Corporate loans and overdraft	<b>208 356</b>	<b>552 362</b>	<b>301 002</b>	<b>175 873</b>

### 3.2.5 Loss allowance

The loss allowance recognised in the period is impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent „step up“ (or „step down“) between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, as well as releases for financial instruments de-recognised in the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular update of inputs to models;

- Impacts on the measurement of ECL due to changes made to models and assumptions;
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis;
- Foreign exchange retranslations for assets denominated in foreign currencies and other movements; and
- Financial assets derecognised during the period and write-offs of allowances related to assets that were written off during the period (see note 3.3.6.).

The following tables explain the changes in the loss allowances between the beginning and the end of the annual period due to these factors.

### Corporate loans and overdraft

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Loss allowance as at 1 January 2018</b>	1 112	1 241	2 199	0	4 552
<b>Movements with P&amp;L impact</b>	-226	226	0	0	0
Transfers:					
From Stage 1 to Stage 2	-227	227	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	1	-1	NA	0	0
New financial assets originated or purchased	1 165	86	0	186	1 437
Changes in PDs/LGDs/EADs	192	-455	3 091	0	2 828
Changes to model assumptions and methodologies	28	24	0	0	52
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	10	0	10
FX and other movements	0	0	0	0	0
<b>Total net P&amp;L charge during the period</b>	<b>1 159</b>	<b>-119</b>	<b>3 101</b>	<b>186</b>	<b>4 327</b>

### Other movements with no P&L impact

Transfers:

From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	115	0	115
<b>Loss allowance as at 31 December 2018</b>	<b>2 271</b>	<b>1 122</b>	<b>5 299</b>	<b>186 284</b>	<b>8 879</b>

### Retail loans to SMEs

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Loss allowance as at 1 January 2018</b>	131	0	0	0	131
<b>Movements with P&amp;L impact</b>	-148	49	99	0	0
Transfers:					
From Stage 1 to Stage 2	-49	49	NA	0	0
From Stage 1 to Stage 3	-99	NA	99	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	20	1	0	0	21
Changes in PDs/LGDs/EADs	46	3	-1	0	48
Changes to model assumptions and methodologies	1	1	0	0	2
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	1	0	1
FX and other movements	0	0	0	0	0
<b>Total net P&amp;L charge during the period</b>	<b>-81</b>	<b>54</b>	<b>99</b>	<b>0</b>	<b>72</b>

### Other movements with no P&L impact

Transfers:

From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	25	0	25
<b>Loss allowance as at 31 December 2018</b>	<b>50</b>	<b>54</b>	<b>99</b>	<b>0</b>	<b>203</b>

### Consumer loans

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Loss allowance as at 1 January 2018</b>	442	0	0	0	442
<b>Movements with P&amp;L impact</b>	-219	133	86	0	0
Transfers:					
From Stage 1 to Stage 2	-133	133	NA	0	0
From Stage 1 to Stage 3	-86	NA	86	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	212	32	1	0	245
Changes in PDs/LGDs/EADs	-223	102	2	0	119
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	0	0	0
FX and other movements	0	0	0	0	0
<b>Total net P&amp;L charge during the period</b>	<b>-230</b>	<b>267</b>	<b>89</b>	<b>0</b>	<b>126</b>

### Other movements with no P&L impact

Transfers:

From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	0
<b>Loss allowance as at 31 December 2018</b>	<b>212</b>	<b>267</b>	<b>89</b>	<b>0</b>	<b>568</b>

### Hire-purchase

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Loss allowance as at 1 January 2018</b>	99	5	3	0	108
<b>Movements with P&amp;L impact</b>	-38	21	17	0	0
Transfers:					
From Stage 1 to Stage 2	-21	21	NA	0	0
From Stage 1 to Stage 3	-17	NA	17	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	70	8	11	0	89
Changes in PDs/LGDs/EADs	-77	11	9	0	-57
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	0	0	0
FX and other movements	0	0	0	0	0
<b>Total net P&amp;L charge during the period</b>	<b>-44</b>	<b>40</b>	<b>36</b>	<b>0</b>	<b>32</b>

### Other movements with no P&L impact

Transfers:

From Stage 2 to Stage 3	NA	-8	8	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	0
<b>Loss allowance as at 31 December 2018</b>	<b>55</b>	<b>46</b>	<b>39</b>	<b>0</b>	<b>140</b>

### Mortgage loans

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Loss allowance as at 1 January 2018</b>	32	0	0	0	32
<b>Movements with P&amp;L impact</b>	0	0	0	0	0
Transfers:					
From Stage 1 to Stage 2	0	0	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	42	3	0	0	45
Changes in PDs/LGDs/EADs	-58	5	0	0	-53
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	0	0	0
FX and other movements	0	0	0	0	0
<b>Total net P&amp;L charge during the period</b>	<b>-16</b>	<b>9</b>	<b>0</b>	<b>0</b>	<b>-7</b>

### Other movements with no P&L impact

Transfers:

From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	0
<b>Loss allowance as at 31 December 2018</b>	<b>17</b>	<b>9</b>	<b>0</b>	<b>0</b>	<b>26</b>

### Leasing

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Loss allowance as at 1 January 2018</b>	233	0	0	0	233
<b>Movements with P&amp;L impact</b>	-268	238	30	0	0
Transfers:					
From Stage 1 to Stage 2	-238	238	NA	0	0
From Stage 1 to Stage 3	-30	NA	30	0	0
From Stage 2 to Stage 1	0	0	NA	0	0
New financial assets originated or purchased	43	7	0	0	50
Changes in PDs/LGDs/EADs	85	67	33	0	185
Changes to model assumptions and methodologies	0	0	0	0	0
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Unwind of discount	0	0	0	0	0
FX and other movements	0	0	0	0	0
<b>Total net P&amp;L charge during the period</b>	<b>-140</b>	<b>312</b>	<b>63</b>	<b>0</b>	<b>235</b>

### Other movements with no P&L impact

Transfers:

From Stage 2 to Stage 3	NA	0	0	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
Financial assets derecognised during the period	0	0	0	0	0
Write-offs	0	0	0	0	0
<b>Loss allowance as at 31 December 2018</b>	<b>92</b>	<b>312</b>	<b>63</b>	<b>0</b>	<b>467</b>

Significant changes in the gross carrying amount of financial assets that contributed to changes in the loss allowance were as follows:

- Changes in loss allowances of corporate loan portfolio explained in detail in table below

The following table further explains changes in the gross carrying amount of the portfolio to help explain their significance to the changes in the loss allowance for the same portfolio as discussed above:

### Corporate loans and overdrafts

(in thousands of euros)

	Stage 1 12-month ECL	Stage 2 Lifetime ECL	Stage 3 Lifetime ECL	Purchased Credit Impaired	Total
<b>Gross carrying amount as at 1 January 2018</b>	<b>456 747</b>	<b>25 150</b>	<b>14 043</b>	<b>0</b>	<b>495 940</b>
<b>Movements with P&amp;L impact</b>					
Transfers:					
From Stage 1 to Stage 2	-11 244	11 244	NA	0	0
From Stage 1 to Stage 3	0	NA	0	0	0
From Stage 2 to Stage 3	NA	-3 415	3 415	0	0
From Stage 3 to Stage 2	NA	0	0	0	0
From Stage 2 to Stage 1	2 208	-2 208	NA	0	0
Financial assets derecognised during the period	45 325	4 479	5 298	0	55 102
New financial assets originated or purchased	204 715	2 066	0	380	207 161
Modifications of contractual cash flows of financial assets	0	0	0	0	0
Changes in interest accrual	367	20	0	0	387
Write-offs	0	0	115	0	115
FX and other movements	0	0	0	0	0
<b>Gross carrying amount as at 31 December 2018</b>	<b>607 468</b>	<b>28 378</b>	<b>12 045</b>	<b>380</b>	<b>648 271</b>

The Group considers the loan as non-performing and assesses impairment when the loan payments have not been collected by the due date and/or the expected cash flows from the realization of collateral are not sufficient for covering the carrying amount of the loan principal and interest payments.

The Group evaluates these loans individually. In case of individual evaluation, the amount of the impairment loss is the difference between the carrying value of the receivable and expected cash flows discounted at the effective interest rate. In 2018, the Group provisioned corporate loans in the total amount of EUR 4 303 thousand (2017: EUR 2 267 thousand).

Loan customers with ratings of 10-13 are subject to more frequent monitoring during which the solvency of the borrower is evaluated. In case of a deterioration of payment behaviour, the requirement for individual provisioning is evaluated, considering, among other factors, the collat-

eral of the loan, therefore some loans are not individually impaired, because they are sufficiently secured. The ratings-based rate of the collective provisioning is applied to those loans.

In addition to loans issued, loan agreements have been concluded and signed for the unused loan commitment amount of EUR 188 841 thousand at 31.12.2018 (31.12.2017: EUR 179 572 thousand).

In the following table there are presented unused portions of corporate loans and financial guarantee limits. In addition to that as at 31.12.2018 the Group has also committed to grant mortgage loans, hire-purchase loans, consumer loans, overdraft loans and credit card loans to individuals in total amount of EUR 41 430 thousand (31.12.2017: EUR 48 899 thousand). All uncommissioned loans available to individuals have at least investment grade scoring as at the end of each reporting period.

### Credit quality of off-balance sheet liabilities

(unused loan commitments for corporate loans and financial guarantees)

(in thousands of euros)

	31.12.2018	31.12.2017
5 low credit risk	5 302	5 632
6 low credit risk	17 202	13 135
7 medium credit risk	25 997	25 582
8 medium credit risk	71 244	57 446
9 heightened credit risk	25 142	28 932
10 high credit risk	10 534	4 176
11 high credit risk	17	342
12 payments are delayed	604	0
13 payments are delayed	0	760
Non-rated (retail clients)	737	719
<b>Total</b>	<b>156 780</b>	<b>136 724</b>

The total amount of undiscounted expected credit losses at initial recognition for purchased or originated credit-impaired financial assets recognised during the period was EUR 186 thousand.

### 3.2.6. Write-off policy

The Group writes off financial assets, in whole or in part, when it has exhausted all practical recovery efforts and has concluded that there is no reasonable expectation of recovery. The write-off represents a derecognition event.

Indicators that there is no reasonable expectation of recovery include (i) ceasing enforcement activity and (ii) where the Group's recovery method is foreclosing on collateral and the value of the collateral is such that there is no reasonable expectation of recovery.

If it is not feasible or economically reasonable for the Group to take measures to recover the claims that are being discounted, the claim is assessed as non-performing and is removed from the statement of financial position. If an irrecoverable claim is received subsequently, receipts are recognized as income.

At least one of the conditions has to be filled to declare claim irredeemable based on the product class.

#### Credit cards and hire purchase

There has been no significant contribution in 12 months since the client's insolvency (default) and the court proceedings relating to arrears have terminated to the Group's detriment or the client fails to comply with the court decision

A bankruptcy has been announced to the client or the client has been declared insolvent

The court confirms the debt restructuring plan (the claim recognized in the plan is less and the actual claim)

Criminal proceedings have been initiated in relation to issued credit or fraud has been used to obtain credit

The customer is dead and after the inventory of the estate bankruptcy is declared

The client forwarded to the bailiff has a foreign address or none at all.

### Leasing, private and business loans

The client does not voluntarily reimburse the Group's claim risen from the difference of original claim and the realization of the collateral.

### 3.2.7. Modifications of financial assets

The Group sometimes modifies the terms of loans provided to customers due to commercial renegotiations, or for distressed loans, with a view to maximising recovery.

Such restructuring activities include extended payment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset (refer to note 2.6). The Group monitors the subsequent performance of modified assets. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more. The gross carrying amount of such assets held as at 31 December 2018 was EUR 0 thousand.

The Group continues to monitor if there is a subsequent significant increase in credit risk in relation to such assets through the use of specific models for modified assets.

There were no such financial assets with lifetime ECL whose cash flows were modified during the period.

### 3.3 Market risk

Market risk arises from the Group's trading and investment activities in the financial markets from interest rate products, foreign exchange and stock markets as well as lending activities and collecting financial resources. Market risk is a potential loss, which may arise from unfavourable changes in foreign exchange rates, prices of securities or interest rates. Internal judgement is used to assess potential losses. In order to mitigate market risk, conservative limits have been established for the trading portfolio and open foreign currency exposures.

LHV Varahaldus invests most of its available resources into his own managed pension funds. The management of LHV Varahaldus is responsible for monitoring of the market risk.

#### 3.3.1 Foreign currency risk

Foreign currency risk may arise from acquisition of securities mostly denominated in foreign currencies or foreign currency receivables and liabilities. The Treasury of the Bank is responsible for daily monitoring of open foreign currency positions. The Group's foreign currency risk management is based on market +risk policies, limits and internal procedures. The internal limits for open foreign currency positions are proposed by Risk Control unit and Treasury and the limits are set internally by Risk and Capital Committee. The limits set by the Committee are maximum nominal limits in euro equivalent with a respect to the Group's net own funds. Limits imposed on individual currencies are in line with the boundaries proposed by the Bank of Estonia. If the open currency position exceeds the limits set by the Committee, measures are immediately implemented to close or reduce such positions (hedging the risk with relevant instruments, such as foreign currency forwards or futures).

A sensitivity analysis has been performed for the effect of possible reasonable changes attributable to open currency positions on statement of profit or loss, with the assumption of other conditions remaining constant.

#### Impact on statement of profit or loss

(in thousands of euros)

	2018	2017
USD exchange rate +/- 10%	+/-13	+/-16
SEK exchange rate +/- 10%	+/-0	+/-4
GBP exchange rate +/- 10%	+/-10	+/-1
CHF exchange rate +/- 10%	+/-2	+/-1

#### Open currency exposures

The following tables present the risks arising from open currency exposures. Assets and liabilities denominated in foreign currencies have been presented in euro equivalent in respective columns, according to the exchange rate prevailing at the end of the reporting period. Derivatives reported at fair value in the statement of financial position have been included at contractual amounts under off-balance sheet assets and liabilities. Open currency exposure and the volume of financial assets and liabilities of the Group at the end of the reporting period do not significantly differ from the average exposure during the year. The balances of total assets and total liabilities bearing currency risk do not include currency futures at their fair value, but they are shown here at their full contractual cash flow amounts as off-balance sheet assets and liabilities; also, the table does not include the assets (tangible and intangible assets) and liabilities (provisions) not bearing currency risk and equity

### 31.12.2018

(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
<b>Assets bearing currency risk</b>								
Due from banks and investment companies	10	651 175	2 224	18 319	2 536	1 430	6 973	682 658
Investments in debt and equity securities	11b, 12	22 750	0	1 174	1	23 230	0	47 154
Loans and advances to customers	13	902 843	0	14 707	220	957	34	918 761
Receivables from customers	14	2 802	0	374	42	0	503	3 721
Other financial assets	15	840	0	0	0	2 096	0	2 936
<b>Total assets bearing currency risk</b>		<b>1 580 410</b>	<b>2 224</b>	<b>34 574</b>	<b>2 799</b>	<b>27 713</b>	<b>7 511</b>	<b>1 655 230</b>

### Liabilities bearing currency risk

Deposits from customers and loans received	17	1 356 671	2 194	41 600	6 363	29 297	7 657	1 443 782
Financial liabilities at fair value	12	0	0	0	0	3	8	11
Accounts payable and other financial liabilities	18	15 299	50	2 238	410	120	3 311	21 428
Subordinated debt	20	50 900	0	0	0	0	0	50 900
<b>Total liabilities bearing currency risk</b>		<b>1 422 870</b>	<b>2 244</b>	<b>43 838</b>	<b>6 773</b>	<b>29 420</b>	<b>10 976</b>	<b>1 516 121</b>

Open gross position derivative assets at contractual value		610	0	9 166	3 973	2 186	3 234	19 169
Open gross position derivative liabilities at contractual value		18 559	0	0	0	610	0	19 169
<b>Open foreign currency position</b>		<b>139 591</b>	<b>-20</b>	<b>-98</b>	<b>-2</b>	<b>-130</b>	<b>-232</b>	<b>139 108</b>

### 31.12.2017

(in thousands of euros)

	Note	EUR	CHF	GBP	SEK	USD	Other	Total
<b>Assets bearing currency risk</b>								
Due from banks and investment companies	10	922 431	2 587	28 237	892	1 359	5 706	961 212
Financial assets at fair value	11, 12	21 998	0	0	4	34 603	29	56 634
Loans and advances to customers	13	730 165	0	4	14	1 832	28	732 043
Receivables from customers	14	9 357	7	204	11	145	76	9 800
Other financial assets	15	288	0	0	0	2 001	0	2 289
<b>Total assets bearing currency risk</b>		<b>1 684 239</b>	<b>2 594</b>	<b>28 445</b>	<b>921</b>	<b>39 940</b>	<b>5 839</b>	<b>1 761 978</b>

### Liabilities bearing currency risk

Deposits from customers and loans received	17	1 457 593	2 534	33 134	3 558	42 646	3 464	1 542 929
Financial liabilities at fair value	12	0	0	0	1	1	0	2
Accounts payable and other financial liabilities	18	63 596	66	259	82	54	2 775	66 832
Subordinated debt	20	30 900	0	0	0	0	0	30 900
<b>Total liabilities bearing currency risk</b>		<b>1 552 089</b>	<b>2 600</b>	<b>33 393</b>	<b>3 641</b>	<b>42 701</b>	<b>6 239</b>	<b>1 640 663</b>

Open gross position derivative assets at contractual value		699	0	4 959	2 763	3 615	450	12 486
Open gross position derivative liabilities at contractual value		11 787	0	0	0	699	0	12 486
<b>Open foreign currency position</b>		<b>121 062</b>	<b>-7</b>	<b>10</b>	<b>43</b>	<b>155</b>	<b>51</b>	<b>121 315</b>

### 3.3.2 Price risk

Financial instruments bearing price risk at Group are securities held in the trading portfolio and investment portfolio (Note 11, 12). At the Group, limits are set for the size of the trading portfolio and acceptable credit quality ratings are specified for debt securities in the investment portfolio. The risk management unit monitors the compliance with limits.

Pursuant to the Investment Funds Act, the minimum shares of LHV Varahaldus as the management company is 0.5% (according to the Investment Funds Act in force until 9 January 2017, it was 1%) of the number of units in each of the mandatory pension fund managed by it. Based on historical performance and volatility of the pension fund unit NAV changes, the price changes should remain +/- 10% in the next 12-month period with the most likely change +/-5% and the impact to statement of profit or loss is presented in the next table.

LHV Varahaldus invests the remaining available assets in euros, to ensure liquidity and to not bear investment risk.

Bank does not hold significant amounts of equity securities in its position (see Note 12), due to which the sensitivity to change in the market value of these positions is marginal.

Bank's debt securities portfolio recognised at the market price is short-term and of high quality, therefore, the effect of the changes in market risk premiums on the market value of the debt security portfolio should remain at around 1.0% (2017: 1.0%).

Sensitivity analysis of the impact to net result from the risk exposures of the Group's largest entity AS LHV Pank against reasonable possible change (in thousands euros):

#### Impact on statement of profit or loss

(in thousands of euros)

	2018	2017
Equity securities and fund units +/-10%	+/-51	+/-43
Mandatory pension fund units +/-5%	+/-380	+/-313
Debt securities (FVTPL) +/-1.0% (+/-1.0%)	+/-387	+/-491

#### Impact on other comprehensive income

(in thousands of euros)

	2018	2017
Debt securities (AFS) +/-1.0% (+/-1.0%)	+/-0	+/-6
Equity securities (FVOCI/AFS) +/-10%	+/- 30	+/- 22

### 3.3.3 Interest rate risk

Interest rate risk reflects the mismatch in the statement of financial position items and the off-balance sheet items when interest rate repricing periods, volumes or the underlying interest rate of assets, liabilities and derivatives do not correspond exactly. Group's interest rate risk management is based on risk policies, limits and internal procedures resulting in identification of all significant sources of interest rate risk and balanced risk taking. Interest rate risk is measured through various scenario analyses by calculating several net interest income scenarios and comparing the difference between these scenarios. The basic measures of interest rate risk uses two scenarios – an increase and a decrease of interest rates to measure the effect on the Group's net interest income for a 12-month period. Internal limits for interest rate risk management are set by AS LHV Pank's Risk and Capital Committee and the operational risk management is the Treasury's responsibility.

The goal of monitoring, measuring and managing interest rate risk is to evaluate the profitability of the Group's interest-bearing products, to forecast interest income and to set limits for risk management in order to prevent significant reduction of income through limitation of risks in three aspects:

- cash flow interest rate risk whereby in case of a 1% change in market interest rates, a change in annual net interest income is limited as compared to the estimated actual;

- sensitivity of interest income based on the duration of positions in the statement of financial position;
- fair value interest rate risk whereby in case of a 1% change in market interest rates, a change in the Group's economic value is limited (fair value of assets and liabilities is determined by discounting the future cash flows at the market rate of interest).

The statement of financial position and margins on assets and deposits are assumed to be constant over time. The deposits interest rates did not change in 2018 remaining at the level of up to 1.0% (up to 1.0% in 2017).

The interest rates for leveraged loans granted are changed at most once a month according to fluctuations in market interest rates. In 2018, the interest rate on loans received for specific purposes was around 1.0% (2017: 1.0%). The effective interest rate of subordinated debts entered into in 2014 was 7.44% and the effective interest rate of subordinated debts entered into in 2015 was 6.5%, the effective interest rate of subordinated debts entered into in 2018 was 6.0%. The information about subordinated debt contractual interest rates is provided in Note 21.

As at 31.12.2018, stress tests were performed to the biggest interest sensitive subsidiary of the group: AS LHV Pank. An increase of 1 percentage point in interest rates would affect the Bank's annual net interest income

and profit by EUR +10 263 thousand (2017: EUR +5 584 thousand). In the same time, a decrease of 1 percentage point in interest rates would affect the Bank's annual net interest income (profit) by EUR -1 657 thousand (2017: EUR -1 567 thousand). A 1 percentage point increase in market interest rates would raise the Bank's economic value, i.e. equity, by EUR +11 437 thousand (2017: EUR+7 520 thousand). A 1 percentage point decrease in market interest rates would affect the Bank's economic value (equity) by EUR +25 265 thousand (2017: EUR +16 639 thousand). Effect on the Group's economic value is positive since the Group has invested in short-term assets, the loans granted to customers are largely based on the 6-month Euribor, the level of which does not fall below 0% according to loan agreements, and due to the longer-term nature of the demand obligations, the average duration of interest-bearing assets is shorter than the average duration of interest-bearing liabilities.

When calculating the effects of the change in the net interest income on profit and the simulation of the change in the economic capital, in the case of a decline in interest rates, the terms of loan contracts are taken into account and the assumption is made, that the interest rates of the deposits involved will not become negative. When simulating the

increase in interest rates, the bank has followed the principles of conservatism – despite the fact that the market levels of derivative transactions give rise to a presumption, that in the next two years the market interest rates on term deposits will not drastically change, which could result in a significant amount of cash being transferred from demand deposits to term deposits – we have presumed, that the ratio of demand deposits to term deposits becomes equal.

Demand deposits have a duration of 2 years due to their behavioural nature.

The interest rate of demand deposits is not sensitive to market rate fluctuations.

The table below shows the structure of the interest-bearing assets and interest-bearing liabilities of LHV Group grouped by the recalculation dates of interest rates at the principal amounts of receivables and liabilities. Leveraged loans are treated as a one-month product maturing at the next interest fixing date.

### 31.12.2018

(in thousands of euros)

	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair- ments	Total
<b>Financial assets</b>									
Due from banks and investment companies	10	682 658	0	0	0	<b>682 658</b>	0	0	<b>682 658</b>
Financial assets at fair value (debt securities)	11, 12	20 546	0	15 031	2 000	<b>37 577</b>	1 120	0	<b>38 697</b>
Loans and advances to customers	13	391 815	486 576	45 087	16 770	<b>940 248</b>	2 667	-11 501	<b>931 414</b>
<b>Total</b>		<b>1 095 019</b>	<b>486 576</b>	<b>60 118</b>	<b>18 770</b>	<b>1 660 483</b>	<b>3 787</b>	<b>-11 501</b>	<b>1 652 769</b>
<b>Financial liabilities</b>									
Deposits from customers and loans received	17	110 719	111 503	1 221 205	18	<b>1 443 445</b>	337	0	<b>1 443 782</b>
Subordinated debt *	20	0	0	0	50 900	<b>50 900</b>	314	0	<b>51 214</b>
<b>Total</b>		<b>110 719</b>	<b>111 503</b>	<b>1 221 205</b>	<b>50 918</b>	<b>1 494 345</b>	<b>651</b>	<b>0</b>	<b>1 494 996</b>
<b>Net interest sensitivity gap</b>		<b>984 300</b>	<b>375 073</b>	<b>-1 161 087</b>	<b>-32 148</b>	<b>166 138</b>			

**31.12.2017**

(in thousands of euros)

	Note	Up to 3 months	3-12 months	1-5 years	Over 5 years	Subtotal	Accrued interest	Impair- ments	Total
<b>Financial assets</b>									
Due from banks and investment companies	10	961 212	0	0	0	<b>961 212</b>	0	0	<b>961 212</b>
Financial assets at fair value (debt securities)	11, 12	0	29 715	15 834	2 000	<b>47 549</b>	2 144	0	<b>49 693</b>
Loans and advances to customers	13	299 246	382 016	41 528	14 851	<b>737 641</b>	2 527	-8 125	<b>732 043</b>
<b>Total</b>		<b>1 260 458</b>	<b>411 731</b>	<b>57 362</b>	<b>16 851</b>	<b>1 746 402</b>	<b>4 671</b>	<b>-8 125</b>	<b>1 742 948</b>
<b>Financial liabilities</b>									
Deposits from customers and loans received	17	553 360	96 246	893 085	0	<b>1 542 691</b>	238	0	<b>1 542 929</b>
Subordinated debt *	20	0	0	0	30 900	<b>30 900</b>	210	0	<b>31 110</b>
<b>Total</b>		<b>553 360</b>	<b>96 246</b>	<b>893 085</b>	<b>30 900</b>	<b>1 573 591</b>	<b>448</b>	<b>0</b>	<b>1 574 039</b>
<b>Net interest sensitivity gap</b>		<b>707 098</b>	<b>315 485</b>	<b>-835 723</b>	<b>-14 049</b>	<b>172 811</b>			

\* The contractual term of subordinated debts received in 2018 is 10 years and the interest rate is fixed at 6.0%. The contractual term of subordinated debts received in 2015 is 10 years and the interest rate is fixed at 6.5%. The contractual term of subordinated debts received in 2014 is 10 years and the interest rate is fixed at 7.25%.

### 3.4 Liquidity risk

Liquidity risk relates to the solvency of the Group to meet its contractual obligations on time and it arises from differences between maturities of assets and liabilities. The Group's liquidity management and strategy is based on risk policies, resulting in various liquidity risk measures, limits and internal procedures. As per policy statements, the Group's liquidity management reflects a conservative approach towards liquidity risk. The liquidity risk management includes stress testing and business continuity plan for liquidity management. Stress testing framework includes a survival period metrics, which represents a combined liquidity risk scenario, including both idiosyncratic and market-wide stress. Internal metrics are complemented by the Basel III metrics - the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) which the Group is fully compliant with as of 31.12.2018 and 31.12.2017. The aim of the LCR standard is to ensure that the Group has an adequate amount of unencumbered assets of high quality and liquidity that could be monetised without incurring material losses to meet a liquidity requirement in a 30-day stress scenario. The output of the standard is the ratio of liquid assets to stress scenario liquidity requirement, which has a limit of 100%. The Group's liquidity coverage ratio level as at 31.12.2018 was 148.5% (31.12.2017: 121%).

The objective of the NSFR is to ensure that the Group has adequate stable funding sources to finance longer-term assets. According to the proposals published in the banking regulation and the banking committee of Basel in

October 2014, the Group's NSFR level as at 31.12.2018 was 148% (31.12.2017: 141%). The net stable funding ratio will be imposed as 100% minimum requirement from the year 2018.

The Treasury of the Bank is responsible for the management of liquidity risk. In order to hedge liquidity risk, the probable net position of receivables and liabilities by maturities is regularly monitored and adequate amounts of liquid assets are kept in each time period, also the concentration of the Group's liabilities by maturities is monitored. To enable covering unexpected monetary outflows, the Group holds a liquidity buffer. The liquidity buffer consists of cash and deposits with the central bank and liquid securities held by the Treasury, which can be readily sold or used as a collateral in funding operations with the central bank. The Group has a sufficient supply of liquid resources to enable issuing standby loans. As at 31.12.2018 and 31.12.2017, the Group does not have any debts past due.

Short-term loans can be obtained from the central bank, secured by the majority of instruments from the debt securities portfolio.

The following tables present the distribution of financial assets and liabilities, excl. derivatives, by due dates and by future contractual undiscounted cash flows and in a separate column the statement of financial position balance is disclosed. In the maturity analysis, the cash flows are split into the maturity buckets in which the cash flows occur (including interest cash flows). Explanation of the fair value of these financial assets and liabilities is presented in Note 3.6.

### 31.12.2018

(in thousands of euros)

	Note	On demand	Up to 3 months	3-12 Months	1-5 Years	Over 5 years	Carrying amount	Total
<b>Liabilities by contractual maturity dates</b>								
Deposits from customers and loans received	17	1 304 239	24 949	94 113	16 780	4 390	1 444 471	1 443 782
Subordinated debt	20	0	832	2 496	13 311	59 426	76 065	50 900
Accounts payable and other financial liabilities	18	0	21 428	0	0	0	21 428	21 428
Unused loan commitments	23	32 259	156 582	0	0	0	188 841	0
Financial guarantees by contractual amounts	23	0	9 314	0	0	0	9 314	0
Foreign exchange derivatives (gross settled)		0	18 559	0	610	0	19 169	0
Financial liabilities at fair value	12	0	11	0	0	0	11	11
<b>Total liabilities</b>		<b>1 336 498</b>	<b>231 675</b>	<b>96 609</b>	<b>30 701</b>	<b>63 816</b>	<b>1 759 299</b>	<b>1 516 121</b>
<b>Assets held for managing liquidity risk by contractual maturity dates</b>								
Due from banks and investment companies	10	682 658	0	0	0	0	682 658	682 658
Financial assets at fair value (debt securities)	11, 12	0	20 690	0	15 845	2 161	38 696	38 697
Loans and advances to customers	13	0	63 584	198 293	634 077	154 853	1 050 807	918 761
Receivables from customers	14	0	3 721	0	0	0	3 721	3 721
Other financial assets	15	2 936	0	0	0	0	2 936	2 936
Foreign exchange derivatives (gross settled)		0	18 559	0	610	0	19 169	0
<b>Total assets held for managing liquidity risk</b>		<b>685 594</b>	<b>106 554</b>	<b>198 293</b>	<b>650 532</b>	<b>157 014</b>	<b>1 797 987</b>	<b>1 646 773</b>
<b>Maturity gap from assets and liabilities</b>		<b>-650 904</b>	<b>-125 121</b>	<b>101 684</b>	<b>619 831</b>	<b>93 198</b>	<b>38 688</b>	

### 31.12.2017

(in thousands of euros)

	Note	On demand	Up to 3 months	3-12 Months	1-5 Years	Over 5 years	Carrying amount	Total
<b>Liabilities by contractual maturity dates</b>								
Deposits from customers and loans received	17	1 409 662	37 104	90 332	3 335	2 864	1 543 297	1 542 929
Subordinated debt	20	0	532	1 596	8 511	35 554	46 193	30 900
Accounts payable and other financial liabilities	18	0	66 832	0	0	0	66 832	66 832
Unused loan commitments	23	29 815	149 757	0	0	0	179 572	0
Financial guarantees by contractual amounts	23	0	5 999	0	0	0	5 999	0
Foreign exchange derivatives (gross settled)		0	11 825	0	661	0	12 486	0
Financial liabilities at fair value	12	0	2	0	0	0	2	2
<b>Total liabilities</b>		<b>1 439 477</b>	<b>272 051</b>	<b>91 928</b>	<b>12 507</b>	<b>38 418</b>	<b>1 854 381</b>	<b>1 640 663</b>
<b>Assets held for managing liquidity risk by contractual maturity dates</b>								
Due from banks and investment companies	10	961 212	0	0	0	0	961 212	961 212
Financial assets at fair value (debt securities)	11, 12	0	180	30 952	17 005	2 084	50 221	49 693
Loans and advances to customers	13	0	55 668	171 720	488 968	95 517	811 873	732 043
Receivables from customers	14	0	9 800	0	0	0	9 800	9 800
Other financial assets	15	2 289	0	0	0	0	2 289	2 289
Foreign exchange derivatives (gross settled)		0	11 825	0	661	0	12 486	0
<b>Total assets held for managing liquidity risk</b>		<b>963 501</b>	<b>77 473</b>	<b>202 672</b>	<b>506 634</b>	<b>97 601</b>	<b>1 847 881</b>	<b>1 755 037</b>
<b>Maturity gap from assets and liabilities</b>		<b>-475 976</b>	<b>-194 578</b>	<b>110 744</b>	<b>494 127</b>	<b>59 183</b>	<b>-6 500</b>	

The following table presents the distribution of assets and liabilities by classification of current and non-current.

(in thousands of euros)

	Note	31.12.2018	31.12.2017
<b>Current assets</b>			
Due from central bank	10	639 862	905 339
Due from credit institutions	10	25 791	40 498
Due from investment companies	10	17 005	15 375
Available-for-sale financial assets	11a	0	555
Financial assets at fair value through profit or loss	12	20 392	30 427
Loans and advances to customers	13	225 036	239 615
Receivables from customers	14	3 721	9 800
Other assets	15	1 651	1 516
<b>Total current assets</b>		<b>933 458</b>	<b>1 243 125</b>
<b>Non-current assets</b>			
Available-for-sale financial assets	11a	0	220
Equity instruments at FVOCI	11b	298	0
Financial assets at fair value through profit or loss	12	26 464	25 432
Loans and advances to customers	13	693 725	492 428
Other financial assets	15	2 936	2 289
Tangible assets	16	1 135	1 421
Intangible assets	16	15 470	4 327
Goodwill	6	3 614	3 614
<b>Total non-current assets</b>		<b>743 642</b>	<b>529 731</b>
<b>Total assets</b>	<b>5</b>	<b>1 677 100</b>	<b>1 772 856</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Deposits from customers and loans received	17	1 422 988	1 536 883
Financial liabilities at fair value through profit or loss	12	11	2
Accounts payable and other liabilities	18	24 644	71 070
<b>Total current liabilities</b>		<b>1 447 643</b>	<b>1 607 955</b>
<b>Non-current liabilities</b>			
Deposits from customers and loans received	17	20 794	6 046
Subordinated debt	20	50 900	30 900
<b>Total non-current liabilities</b>		<b>71 694</b>	<b>36 946</b>
<b>Total liabilities</b>	<b>5</b>	<b>1 519 337</b>	<b>1 644 901</b>

### 3.5 Fair value of financial assets and financial liabilities

#### 31.12.2018

(in thousands of euros)

	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value	Difference
<b>Financial assets at fair value through profit or loss</b>							
Shares and fund units*	12	510	7 590	0	8 100	8 100	0
Equity instruments at fair value through other comprehensive income	11b	0	0	298	298	298	0
Debt securities at fair value through profit or loss	12	38 697	0	0	38 697	38 697	0
Interest rate swaps and foreign exchange forwards	12	0	59	0	59	59	0
<b>Total financial assets at fair value through profit or loss</b>		<b>39 207</b>	<b>7 649</b>	<b>298</b>	<b>47 154</b>	<b>47 154</b>	<b>0</b>
<b>Financial liabilities at fair value through profit or loss</b>							
Interest rate swaps and foreign exchange forwards	12	0	11	0	11	11	0
<b>Total financial liabilities at fair value through profit or loss</b>		<b>0</b>	<b>11</b>	<b>0</b>	<b>11</b>	<b>11</b>	<b>0</b>
<b>Financial assets at amortised cost</b>							
Due from other banks	10	639 862	0	0	639 862	639 862	0
Due from credit institutions	10	25 791	0	0	25 791	25 791	0
Due from investment companies	10	17 005	0	0	17 005	17 005	0
Loans and advances to customers	13	0	0	924 825	924 825	918 761	6 064
Receivables from customers	14	3 721	0	0	3 721	3 721	0
Other financial assets	15	2 936	0	0	2 936	2 936	0
<b>Total financial assets at amortised cost</b>		<b>689 315</b>	<b>0</b>	<b>924 825</b>	<b>1 614 140</b>	<b>1 608 076</b>	<b>6 064</b>
<b>Financial liabilities at amortised cost</b>							
Deposits from customers and loans received	17	0	0	1 443 926	1 443 926	1 443 782	144
Subordinated debt	20	0	0	51 475	51 475	51 214	261
Accounts payable and other liabilities	18	21 428	0	0	21 428	21 428	0
<b>Total financial liabilities at amortised cost</b>		<b>21 428</b>	<b>0</b>	<b>1 495 401</b>	<b>1 516 829</b>	<b>1 516 424</b>	<b>405</b>

Total net gain recognised in OCI for level 3 financial assets amounted to EUR 42 thousand.

**31.12.2017**

(in thousands of euros)

	Note	Level 1	Level 2	Level 3	Total fair value	Carrying value	Difference
<b>Financial assets at fair value through profit or loss</b>							
Shares and fund units*	12	430	6 261	0	<b>6 691</b>	<b>6 691</b>	<b>0</b>
Available-for-sale debt securities	11	555	0	220	<b>775</b>	<b>775</b>	<b>0</b>
Debt securities at fair value through profit or loss							
Interest rate swaps and foreign exchange forwards	12	49 138	0	0	<b>49 138</b>	<b>49 138</b>	<b>0</b>
exchange forwards	12	0	30	0	<b>30</b>	<b>30</b>	<b>0</b>
<b>Total financial assets at fair value through profit or loss</b>		<b>50 123</b>	<b>6 291</b>	<b>220</b>	<b>56 634</b>	<b>56 634</b>	<b>0</b>
<b>Financial liabilities at fair value through profit or loss</b>							
Interest rate swaps and foreign exchange forwards	12	0	2	0	<b>2</b>	<b>2</b>	<b>0</b>
<b>Total financial liabilities at fair value through profit or loss</b>		<b>0</b>	<b>2</b>	<b>0</b>	<b>2</b>	<b>2</b>	<b>0</b>
<b>Financial assets at amortised cost</b>							
Due from other banks	10	920 714	0	0	<b>920 714</b>	<b>920 714</b>	<b>0</b>
Due from credit institutions	10	26 3120	0	0	<b>26 312</b>	<b>26 312</b>	<b>0</b>
Due from investment companies	10	14 186	0	0	<b>14 186</b>	<b>14 186</b>	<b>0</b>
Loans and advances to customers	13	0	0	741 340	<b>741 340</b>	<b>732 043</b>	<b>9 297</b>
Receivables from customers	14	9 924	0	0	<b>9 800</b>	<b>9 800</b>	<b>0</b>
Other financial assets	15	2 289	0	0	<b>2 289</b>	<b>2 289</b>	<b>0</b>
<b>Total financial assets at amortised cost</b>		<b>973 425</b>	<b>0</b>	<b>741 340</b>	<b>1 714 641</b>	<b>1 705 344</b>	<b>9 297</b>
<b>Financial liabilities at amortised cost</b>							
Deposits from customers and loans received	17	0	0	1 543 083	<b>1 543 083</b>	<b>1 542 929</b>	<b>154</b>
Subordinated debt	20	0	0	31 994	<b>31 994</b>	<b>31 110</b>	<b>884</b>
Accounts payable and other liabilities	18	66 832	0	0	<b>66 832</b>	<b>66 832</b>	<b>0</b>
<b>Total financial liabilities at amortised cost</b>		<b>66 832</b>	<b>0</b>	<b>1 575 077</b>	<b>1 641 909</b>	<b>1 640 871</b>	<b>1 038</b>

\*Shares and fund units include the Group's subsidiary AS LHV Varahaldus investment into pension fund units in the amount of EUR 7 590 thousand (31.12.2017: EUR 6 261 thousand) euros. Pursuant to the Investment Funds Act, the mandatory shares of LHV Varahaldus as the management company is 0.5% (until 09.01.2017 1%) of the number of units in each of the mandatory pension fund managed by it.

The management board of the Group has assessed the fair value of assets and liabilities carried at amortized cost in the statement of financial position. For estimating fair value, the future cash flows are discounted based on the market interest yield curve.

**Levels used in hierarchy:**

1. Level 1 – quoted prices in active market
2. Level 2 – valuation technique based on observable market data as inputs (rates and interest curves from similar transactions)
3. Level 3 – other valuation techniques (as example discounted cashflow method) with significant unobservable inputs

### Valuation explanations

Shares and fund units - Level 1 – quotes from active market. Level 2 - AS LHV Varahaldus' investments into pension fund units have quoted prices from the market, however the market is inactive and therefore these are classified as level 2 investments.

Equity instruments at fair value through other comprehensive income - the shares of Visa are not traded on an active market, therefore their value is based on market information on similar transactions and management estimates

Debt securities at fair value through profit or loss - Quotes from active market

Interest rate swaps and foreign exchange forwards - mainly positive market value of derivative contracts such as interest rate swaps, foreign exchange swaps and forwards. Markets supply observable inputs to the valuation model, which is used for establishing the fair value. The fair value for such over-the-counter derivatives is calculated as a theoretical net present value (NPV), based on independently sourced market parameters, assuming no risk and uncertainties. Market observable zero coupon yield curve is used for discounting in NPV calculations.

Due from other banks - Very liquid and short-term

Due from credit institutions - Very liquid and short-term

Due from investment companies - Very liquid and short-term

Loans and advances to customers – Long-term, significant level of judgements. Fair value of loans have been calculated using the average interest rate of past 6 months prior to balance sheet date

Receivables from customers - Short-term receivables

Other financial assets - Short-term deposits

Deposits from customers and loans received - customer deposits and loans received with fixed interest rates are primarily short-term and pricing of the deposits is subject to market conditions; as a result, the fair value of deposits determined using the discounted future cash flows do not significantly differ from their carrying amount

Subordinated debt - Bonds are listed, but liquidity is too low for using directly the market quotas. In addition, LHV is not allowed to buy these bonds back without FSA approval for every trade

Accounts payable and other liabilities - Short-term payables

For the term structure of financial assets and financial liabilities, refer to Note 3.4.

### 3.6 Operational risk

Operational risk is a potential loss caused by human, process or information system flaws. When completing transactions, transaction limits and competence systems are used to minimise potential losses and the segregation of duties principle is used in the Group's working procedures, according to which there should be an approval by at least two employees or units in order to carry out a transaction or procedure.

The information received from monitoring operating risk helps to gather initial information to secure capital adequacy of the Group and to evaluate capital requirements. The analysis of cases collected into the database enables the Group to identify the flaws in business processes, avoid making mistakes in the future and mitigate possible risks or define the terms of their acceptance. The risk control manager of Group is responsible for collecting information.

Compliance control and internal audit department have an important role in evaluating, monitoring and mitigating the operating risk. The main task of the Compliance Officer is to evaluate the activities of the Group in accordance with legislation, the supervision guidelines of the Financial Supervision Authority and procedure rules of the Group. Internal audit is an independent and objective function, assuring and consulting activity that is targeted at improving the Group's performance, processes and adding value. Internal audit helps achieving the goals of the Group, using a systematic and disciplined approach to assess and increase the efficiency of the risk management, control and organisational management process.

### 3.7 Compliance risk

Risk of compliance is the existing or potential risk to income and capital as a consequence of a failure to comply with laws, guidelines, standards or ethical principles. The realization of a risk may result in fines, claims, loss in reputation, termination of contractual relationships and, in revocation of the licence.

The aim of managing compliance risk is to prevent the negative consequences from materializing.

Considering the volume and pace of changes to regulatory requirements LHV assesses compliance risk to remain high.

In order to manage the risk, the compliance function assesses changes to regulatory environment, evaluates their potential impact, informs management of changes and participates in the implementation thereof.

Monthly overviews to management include information collected from various sources, including supervisory

guidelines, EU, UK and Estonian regulatory acts. Board members take responsibility in implementing identified changes. In addition, the compliance function keeps track of all regulatory requirements applicable to LHV group entities.

The biggest challenges that faced LHV in 2018 from regulatory perspective were implementation of MiFID II, IFRS 9, GDPR and changes to reporting requirements (AnaCredit), PSD 2, PRIIP regulation, 4MLD and guidelines issued for its implementation.

Considering recent events, incl. the cases of Danske and Versobank, LHV continues to pay particular attention to AML related measures.

### 3.8 Anti-money laundering

Structure of money laundering and terrorist financing risks

- Money laundering and terrorist financing risk. The risk that bank products or services will be used for money laundering or terrorist financing, which may be expressed through realization of compliance and/or reputational risk.
- Compliance risk. The risk that the Group will not be able to comply with obligations imposed by the regulations on money laundering and terrorist financing (especially the implementation of due diligence measures), which may lead to a fine or a revocation of a license.
- Reputational risk. The risk that the reputation of the Group is damaged by the actual or suspected involvement of money laundering or terrorist financing, as well as the realization of the compliance risk, and which may have a significant negative financial impact (loss of profit, decrease of value, etc.).
- Concentration risk. The risk that the structure of customers and their assets are significantly related to the criminal activities, which may express in realization of compliance and reputational risk.
- Group can be affected also by liquidity risk through realization and escalation of above-mentioned risks.

#### AML/CTF Governance

LHV has established internal AML/CTF governance system, which is based on three lines of defence principle where all defence lines are committed to actively mitigate ML/TF risk guided by risk-based approach. Risk based approach is based on risk assessment of products, services and clients and on risk-based monitoring. It is supported by

high awareness and commitment from all employees and management built on awareness rising, information sharing and training and supported by appropriate reporting.

Management and Supervisory Board of LHV Group and LHV Bank have strong commitment towards implementing, maintaining and developing AML/KYC regime all over Group entities. There have been at least yearly updates in AML/CTF Policy and Customer Acceptance Principles. In addition, all internal AML/CTF procedures are constantly updated.

Beside updating internal regulations also strong focus is set on technical capabilities to prevent and detect money laundering, terrorist financing, financial fraud and international financial sanctions. One highlight in 2018 was started the implementation of two dedicated software solutions for screening and monitoring. Both tools are well-known trademarks in their area and will be fully implemented in first half of 2019. LHV uses Accuity's Compliance Link for screening and FICO Tonbeller's Siron for monitoring and risk segmentation. Additionally Bank has established cooperation with external experts with aim to continuously develop its analytical capabilities.

Not only there have been investments in to IT, but also to human resources. As regulations and expectations towards depth of KYC measures are constantly growing, then Group has significantly increased resources in that area. Comparing to 2017 Group has more than doubled number of employees directly involved with AML measures. Number of employees dealing directly with AML and KYC is planned to be increase in coming years.

### AML/KYC measures

LHV main principles:

- strong on-boarding customer due diligence supported by Customers Acceptance Principles;
- conservative approach towards risk segmentation;
- regular customer due diligence and enhanced customer due diligence;
- robust risk based monitoring;
- screening of customers and transactions towards International financial sanctions lists and other sources (incl. US OFAC list);
- strong top and middle management commitment;
- regular training of employees;
- ongoing communication and cooperation with FIU and other relevant stakeholders;
- active participation in setting industry's best practices.

LHV has implemented four levels of customer

acceptance in on-boarding stage:

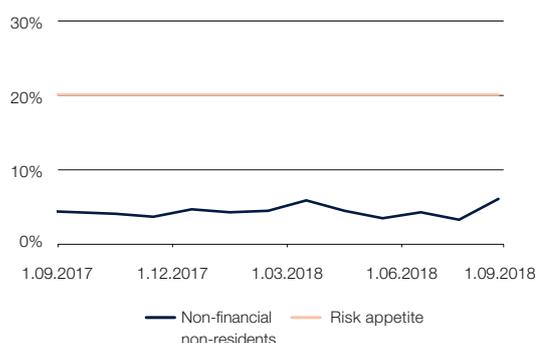
- Customer relationship manager
- Customer relationship manager and approval by senior employee (4-eye principle)
- Risk Customer Acceptance Committee
- Management Board

Combination of risk indicators determine with each customer which acceptance level is required.

Beside conservative and risk-based on-boarding procedures, also risk-based monitoring is implemented and regular updating of KYC information is carried out.

LHV has set risk tolerance towards non-resident legal customers' deposits outside of non-financial and non-governmental sectors to 20%. In reality, those numbers are significantly lower:

### Non-resident deposit ratio



One of first risk indicators is country and jurisdiction risk. LHV has four risk categories for countries which are based on money laundering and terrorist financing risks. Even EU member countries are not categorized in same way, but have different risk categories depending on their risks.

LHV welcomes country's e-resident program, but all e-residents are still non-residents and require similar KYC measures as set to all other non-residents.

### Financial intermediaries

LHV is accepting as customers modern financial intermediaries or so called fin.tech companies who provide financial services to their customers. As such service providers are potentially presenting higher money laundering and terrorist financing risk, then Group has dedicated special attention and measures to service such customers. There are dedicated customer managers having area related competence. AML team is always keeping eye on new trends and threats coming from that sector and KYC measures are constantly updated. Group has taken approach that all customers from fin.tech sector have to have same AML/KYC measures in place as does banking sector.

During on-boarding and continuous KYC, Group assesses customers business model, team, AML/KYC measures, technical capabilities for screening and monitoring, customer focus, customer risk segmentation, limit policy, source of funds and etc. LHV carries out on-site visits to ensure that declared activities are really implemented and working. Special and continuous attention is set on financial activities of those customers.

### Country

Through geographical location and historic connections there has been strong pressure from CIS countries to use neighbouring countries financial system as route for their finances to Western Europe. Recent public information demonstrates that there have been lack of strong KYC measures at least in two banks. Related to poor KYC measures that have led to the potential money laundering has

FSA withdrew a license from one bank in Estonia. Same reasons are behind of closure of non-resident business in one Scandinavian bank's branch and limiting services in retail business.

Estonia adopted new AML/CTF law in the end of 2017. New law is based on fourth EU AML directive, but covers partially also requirements from fifth EU AML directive as well. FSA has adopted new AML guideline for financial sector based on new legislation. New FSA's guideline is more detailed than previous ones and includes sample list of high risk situations financial industry should focus on. In general Estonian AML/CTF regulation is aligned with EU and FATF principles and is covering all new requirements (f.e. domestic PEP's, register of beneficial owners, national and industry level risk assessment and etc.).

## 3.9. Other risks

### 3.9.1 Strategic and business risk

Strategic risk is expressed mainly in wrong strategic decisions. Strategic risk is mitigated through well-considered business plans and analyses. In addition, members of both LHV Bank's and LHV Group's management (both Management Board and Supervisory Board) have long-term experience in the banking sector and/or entrepreneurship. Prior to entering new markets and sectors, professionals in the field will always be involved and a thorough analysis will be carried out.

### 3.9.2 Risk on reputation

Risk on reputation is defined as a risk, which arises from a loss of reputation for clients, business partners, owners, investors or supervisors. Risk on reputation is usually a result from realization of other risks (for example operational risk or strategic risk). In order to mitigate the risk on reputation, LHV regularly carries out risk management trainings and also the framework of risk management is constantly improved which will provide a strong risk culture.

### 3.9.3 Country risk

Similarly to the risk on reputation, the country risk is usually expressed through another risk (operational risk, credit risk, strategic risk). In addition to Estonia, LHV is preparing to start a business in the United Kingdom.

### 3.10 Offsetting assets and liabilities

The group has offset the following assets and liabilities.

	Gross amounts before offsetting in the statement of financial position	Offsetting	Net amount of exposure presented in the statement of financial position	Related arrangements not set off in the statement of financial position		Net amounts
				Financial instruments	Cash collateral received	
<b>31.12.2018</b>						
<b>ASSETS</b>						
Derivatives	59	0	59	0	0	0
<b>LIABILITIES</b>						
Derivatives	11	0	11	0	0	0
<b>31.12.2017</b>						
<b>ASSETS</b>						
Prepayments to merchants for registered customer contacts	3 716	-3 449	267	0	0	267
Due from investment companies	20 628	-20 625	3	0	0	3
Derivatives	30	0	30	0	0	0
<b>LIABILITIES</b>						
Payables to merchants	9 413	-3 449	5 964	0	0	5 964
Payables to investment companies	20 625	-20 625	0	0	0	0
Derivatives	2	0	2	0	0	0

## NOTE 4 Significant management estimates and assumptions

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In accordance with IFRS, several financial figures presented in the financial statements are strictly based on critical accounting estimates and assumptions made by management, which affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities presented in the financial statements at the end of the reporting period, and the reported amounts of income and expenses of subsequent reporting periods. Although these estimates have been made to the best of management's knowledge and their judgement of current events, the actual outcome may ultimately not coincide with them and may significantly differ from these estimates. Management's estimates have been applied to valuation of loans, receivables and investments (Notes 10, 11, 12, 13 and 14) and the determination of useful lives of tangible and intangible assets (Note 16).

Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the circumstances. Changes in management's estimates are reported prospectively.

### EXPECTED CREDIT LOSS MODEL

The most significant management estimates and assumptions are related with the new financial instrument standard IFRS 9, namely the criteria for SICR, calculation of PD and LGD, business model and SPPI assessment for classification of financial assets. Please see more information in Note 3.2 and below.

When calculating expected credit loss (ECL) there are a number of key concepts that require a high level of judgement. Estimating expected credit loss is, by its very nature, uncertain and the accuracy of these estimates depends on many factors, e.g. macroeconomic forecasts and involves complex modelling and judgements. The assessment of significant increase in credit risk is a new concept under IFRS 9 Financial Instruments and will require significant judgement. At the end of each reporting period the Group shall perform an assessment of whether credit risk has increased significantly since initial recognition by considering the change in the risk of default occurring over the remaining life of the financial instrument, using key risk indicators that are used in the Group's existing risk management processes. Another area requiring significant judgement is the incorporation of forward-looking information and macroeconomic scenarios. IFRS 9 requires an unbiased and probability-weighted estimate of credit losses by evaluating a range of possible outcomes that incorporates forecasts of future economic conditions. LHV uses internally developed macroeconomic forecasts as the basis for the forward-looking information in the ECL measurement. LHV uses both models and expert based judgement in order to determine ECLs. The objective of applying expert based judgement is to incorporate the estimated impact of factors not captured in the modelled ECL. The degree of judgement that is required to estimate expected credit losses depends on the outcome from calculations, materiality and the availability of detailed information. The models, assessment and assumptions are regularly reviewed by the risk organisation of the Group and approved by the Group Risk Committee.

## NOTE 5 Business segments

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Bank divides its business activities by 3 main business segments: retail banking, private banking and corporate banking. The business segments form a part of the Group, with a separate access to financial data and which are subject to regular monitoring of operating result by the Group's decision-maker. The full planning and KPI setting is done on segments level. For each of the segment full statement of financial position and profit and loss statement is prepared. In addition to these high-level segments, Group has planning/measurement on department level. Grouping is done based on the client/product base, where similar departments are grouped under one segment. Private banking covers high net worth customers, who's main product is investments. Retail banking segment covers all private individuals and small legal entities with credit exposure under EUR 250 thousand. This is the regular universal banking segment offering payments, cards, credits etc. Corporate banking segment covers all corporate customers and other legal entities with credit exposure over EUR 250 thousand. The main products are

credits and payments. Asset management is the pension management segment covering pension second and third pillar. Hire-purchase unit in Estonia is separate legal entity covering small loan business to private individuals. These portfolios are relatively small, but due to clients different payment history these segments have to be looked separately. The management board of AS LHV Group has been designated as the decision-maker responsible for allocation of funds and assessment of the profitability of the business activities. The result posted by a segment includes revenue and expenditure directly related to the segment.

The revenue of a reported segment is based on the revenue per financial statements and includes gains from transactions between the segments, i.e. loans granted by AS LHV Pank to other group companies. The division of interest income and fee and commission income by customer location has been presented in Notes 7 and 8. The Group does not have any customers, whose income would account for more than 10% of the corresponding type of revenue.

<b>31.12.2018</b> (in thousands of euros)	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Other activities	Intra-segment eliminations	Total
Interest income incl.	9 780	1 164	25 359	0	9 380	6 845	-6 906	45 622
External interest income	6 802	0	24 125	0	9 380	5 315	0	45 622
Internal interest income	2 978	1 164	1 234	0	0	1 530	-6 906	0
Interest expense	0	0	-4 401	-168	-1 234	-8 574	6 906	-7 471
<b>Net interest income</b>	<b>9 780</b>	<b>1 164</b>	<b>20 958</b>	<b>-168</b>	<b>8 146</b>	<b>-1 729</b>	<b>0</b>	<b>38 151</b>
Fee and commission income	12 964	1 292	1 910	13 942	517	2 219	0	32 844
Fee and commission expense	-6 953	0	-65	0	-553	-228	0	-7 799
Dividend income	0	0	0	0	0	6 578	-6 578	0
<b>Net fee and commission income</b>	<b>6 011</b>	<b>1 292</b>	<b>1 845</b>	<b>13 942</b>	<b>-36</b>	<b>8 569</b>	<b>-6 578</b>	<b>25 045</b>
<b>Net income</b>	<b>15 791</b>	<b>2 456</b>	<b>22 803</b>	<b>13 774</b>	<b>8 110</b>	<b>6 840</b>	<b>-6 578</b>	<b>63 196</b>
Net gains from financial assets	-15	0	0	-25	0	483	0	443
Administrative and other operating expenses, staff costs	-12 495	-986	-5 503	-5 823	-2 058	-4 416	0	-31 281
Profit before credit losses	3 281	1 470	17 300	7 926	6 052	2 907	-6 578	32 358
Impairment losses on loans and advances	351	0	-5 027	0	-171	-32	0	-4 879
<b>Profit before tax</b>	<b>3 632</b>	<b>1 470</b>	<b>12 273</b>	<b>7 926</b>	<b>5 881</b>	<b>2 875</b>	<b>-6 578</b>	<b>27 479</b>
Income tax	-479	-84	-987	-1 100	-838	-126	0	-3 614
<b>Profit from continuing operations</b>	<b>3 153</b>	<b>1 386</b>	<b>11 286</b>	<b>6 826</b>	<b>5 043</b>	<b>2 749</b>	<b>-6 578</b>	<b>23 865</b>
<b>Total assets</b>	<b>1 005 454</b>	<b>94 412</b>	<b>535 836</b>	<b>31 193</b>	<b>51 383</b>	<b>127 748</b>	<b>-168 926</b>	<b>1 677 100</b>
<b>Total liabilities</b>	<b>1 105 619</b>	<b>238 898</b>	<b>177 086</b>	<b>2 610</b>	<b>39 577</b>	<b>51 380</b>	<b>-95 834</b>	<b>1 519 337</b>

The geographical distribution of Group's interest income and its breakdown by products are presented in Note 7.

<b>31.12.2017</b> (in thousands of euros)	Retail banking	Private banking	Corporate banking	Asset management	Hire-purchase and consumer finance in Estonia	Other activities	Intra-segment eliminations	Total
Interest income incl.	7 509	1 018	19 567	2	8 201	4 640	-5 443	35 494
External interest income	5 710	0	18 471	2	8 201	3 110	0	35 494
Internal interest income	1 799	1 018	1 096	0	0	1 530	-5 443	0
Interest expense	0	0	-3 720	-168	-1 095	-5 593	5 443	-5 133
<b>Net interest income</b>	<b>7 509</b>	<b>1 018</b>	<b>15 847</b>	<b>-166</b>	<b>7 106</b>	<b>-953</b>	<b>0</b>	<b>30 361</b>
Fee and commission income	10 529	988	1 094	13 293	485	13	0	26 402
Fee and commission expense	-4 188	0	-301	0	-688	-236	0	-5 413
Dividend income	0	0	0	0	0	3 803	-3 803	0
Net fee and commission income	6 341	988	793	13 293	-203	3 580	-3 803	20 989
<b>Net income</b>	<b>13 850</b>	<b>2 006</b>	<b>16 640</b>	<b>13 127</b>	<b>6 903</b>	<b>2 627</b>	<b>-3 803</b>	<b>51 350</b>
Net gains from financial assets	-22	0	0	294	0	707	0	979
Administrative and other operating expenses, staff costs	-10 353	-1 094	-4 995	-6 663	-1 668	-2 771	0	-27 544
<b>Profit before credit losses</b>	<b>3 475</b>	<b>912</b>	<b>11 645</b>	<b>6 758</b>	<b>5 235</b>	<b>563</b>	<b>-3 803</b>	<b>24 785</b>
Impairment losses on loans and advances	-719	0	-2 234	0	-631	0	0	-3 584
Profit before tax	0	0	0	-951	0	0	0	-951
Income tax	0	0	0	-951	0	0	0	-951
<b>Profit from continuing operations</b>	<b>2 756</b>	<b>912</b>	<b>9 411</b>	<b>5 807</b>	<b>4 604</b>	<b>563</b>	<b>-3 803</b>	<b>20 250</b>
<b>Total assets*</b>	<b>1 061 023</b>	<b>99 630</b>	<b>565 451</b>	<b>19 128</b>	<b>43 255</b>	<b>97 496</b>	<b>-129 257</b>	<b>1 756 726</b>
<b>Total liabilities*</b>	<b>1 189 006</b>	<b>256 916</b>	<b>190 442</b>	<b>2 586</b>	<b>33 149</b>	<b>31 198</b>	<b>-66 899</b>	<b>1 636 398</b>

\*Total assets and total liabilities differ from the amounts recorded in consolidated statement of financial position due to elimination of discontinued operations (see also note 26). The geographical distribution of Group's interest income and its breakdown by products are presented in Note 7.

## NOTE 6 Subsidiaries and goodwill

As at 31.12.2018, the Group's subsidiaries, which have been consolidated in these financial statements include:

- AS LHV Pank  
(Estonia, ownership interest 100%);
- AS LHV Varahaldus  
(Estonia, ownership interest 100%);
- Cuber Technology OÜ  
(Estonia, ownership interest 100%);
- AS LHV Finance (Estonia, ownership interest 65% through AS LHV Pank).

AS LHV Pank paid EUR 325 thousand euros of monetary contribution for 65% of ownership in LHV Finance and a non-controlling interest paid EUR 175 thousand euros of monetary contribution for 35% of ownership. The contribution of the non-controlling interest has been reflected in the consolidated statement of financial position on the line "Non-controlling interest".

As at 31.12.2018 and 31.12.2017, the Group does not have any associates.

As at 31.12.2018, goodwill in amount EUR 3 614 thousand in the consolidated financial statements of AS LHV Group consists of:

- positive goodwill which had arisen on the acquisition of the ownership interests in AS LHV Varahaldus in the amount of EUR 482 thousand;

As at 31.12.2017, the Group had 2 subsidiaries that had non-controlling interests that were material to the Group. After selling UAB Mokilizingas in 2018, there is only AS LHV Finance left as at 31.12.2018.

- positive goodwill which had arisen after the conclusion of a purchase contract of AS LHV Varahaldus entered into in 2009 in the amount of EUR 562 thousand;
- positive goodwill which had arisen on the acquisition of the ownership interests in Danske Capital AS by AS LHV Varahaldus in the amount of EUR 2 570 thousand.

Impairment tests were performed as at 31.12.2018 and as at 31.12.2017. The cash-generating unit of goodwill is AS LHV Varahaldus. The calculation of the value in use is based on the following assumptions:

- the volume of assets under management is expected to increase by 16% per annum (2017: by 15%);
- increase of income of fund manager is expected to be average of -10% per annum (2017: 8%);
- due to the economic environment, growth of 2% in indirect costs is expected per annum (2017: 6%);
- the discount rate used is 15% (2017: 15%).

When using the main assumptions, the management used previous years' experience and its best estimate in respect of probable expectations. Expectations are more conservative due to the changes in the market situation and legislation. Based on the results of the impairment test performed as at 31.12.2018 and 31.12.2017, the recoverable amount of cash generating unit is higher than its carrying amount, as a result of which no impairment losses have been recognized.

Set out below are the summarised financial information for each subsidiary. The information disclosed is the amount before inter-company eliminations.

<b>Summarised statement of Financial Position</b>	<b>UAB Mokilizingas</b>		<b>AS LHV Finance</b>
	<b>31.12.2017</b>	<b>31.12.2018</b>	<b>31.12.2017</b>
Loans and advances to customers and other current assets	53 915	51 338	43 209
Non-current assets	239	45	46
Current liabilities	8 727	1 996	2 192
Non-current liabilities	36 700	37 581	30 957
<b>Total net assets</b>	<b>8 727</b>	<b>11 806</b>	<b>10 106</b>

<b>Summarised statement of Profit or Loss and Other Comprehensive Income</b>	<b>UAB Mokilizingas</b>		<b>AS LHV Finance</b>
	<b>2017</b>	<b>2018</b>	<b>2017</b>
Total net interest and fee income	6 332	8 110	6 902
Profit before income tax	2 224	5 881	4 604
Income tax expense	-297	-838	0
Profit from discontinued operations	0	0	0
<b>Net profit</b>	<b>1 927</b>	<b>5 043</b>	<b>4 604</b>
Total comprehensive income	1 927	5 043	4 604
Profit and other comprehensive income allocated to non-controlling interests	963	1 765	1 612

<b>Summarised statement of Cash Flows</b>	<b>UAB Mokilizingas</b>		<b>AS LHV Finance</b>
	<b>2017</b>	<b>2018</b>	<b>2017</b>
Cash generated from operations	-4 114	-1 188	-1 788
Interest paid	-919	-1 215	-1 103
Income tax paid	-297	-838	0
Net cash generated from/(used in) operating activities	-5 330	-3 241	-2 891
Net cash generated from/(used in) investing activities	0	-28	-26
Net cash generated from/(used in) financing activities	6 195	3 274	2 917
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>865</b>	<b>5</b>	<b>0</b>
Cash and cash equivalents at beginning of year	1 859	0	0
Cash and cash equivalents at end of year	2 724	5	0

NOTE 7 Net interest income

<b>Interest income</b> (in thousands of euros)	<b>Note</b>	<b>2018</b>	<b>2017</b>
Corporate loans		27 048	21 703
incl. loans to related parties	24	31	27
incl. stage 3 interests*		340	421
Hire purchase		4 055	4 128
Consumer loans		5 313	4 018
Leasing		2 439	1 845
incl. loans to related parties	24	4	6
Private loans		1 514	1 161
Mortgage loans		1 769	640
Leveraged loans and lending of securities		456	147
From debt securities		136	206
incl. debt securities available-for-sale	11a	0	24
incl. debt securities at FVOCI	11b	13	0
incl. debt securities at fair value through profit or loss	12	123	182
Credit card loans		770	694
From balances with credit institutions and investment companies		141	41
Other loans		1 981	857
<b>Total</b>		<b>45 622</b>	<b>35 494</b>
<b>Interest expense</b>			
Deposits from customers and loans received		-1 880	-1 224
incl. deposits from related parties	24	-42	-41
From balances with central bank		-3 360	-1 773
Subordinated debt	20	-2 231	-2 136
incl. loans from related parties	24	-357	-336
<b>Total</b>		<b>-7 471</b>	<b>-5 133</b>
<b>Net interest income</b>		<b>38 151</b>	<b>30 361</b>
<b>Interest income of loans by customer location</b> <b>(interests from bank balances and debt securities not included):</b>			
(in thousands of euros)		2018	2017
Estonia		44 822	34 307
Lithuania		523	940
<b>Total</b>		<b>45 345</b>	<b>35 247</b>

\*As most of the stage 3 loans are sold to debt collectors, the stage 3 interests are marginal in all loan portfolios except corporate loans.

NOTE 8 Net fee and commission income

<b>Fee and commission income</b>	<b>Note</b>	<b>2018</b>	<b>2017</b>
Security brokerage and commission fees		3 687	3 081
incl. related parties	24	11	11
Asset management and related fees		16 371	14 983
Incl. funds managed by the Group*	24	13 922	13 275
Currency exchange fees		1 639	977
Fees from cards and settlements		8 766	5 875
Commission fees from partners		0	0
Fees from consumer loans and hire purchase		518	485
Other fee and commission income		1 863	1 001
<b>Total</b>		<b>32 844</b>	<b>26 402</b>
<b>Fee and commission expense</b>			
Security brokerage and commission fees paid		-544	-64
Expenses related to cards		-2 765	-2 026
Expenses related to acquiring		-2 834	-1 982
Transaction costs		-468	-301
Costs related to ATM-s		-649	-203
Other fee expense		-539	-837
<b>Total</b>		<b>-7 799</b>	<b>-5 413</b>
<b>Net fee and commission income</b>		<b>25 045</b>	<b>20 989</b>

\* Commission fees from pension and investment funds are calculated as a fixed percentage of total assets of the fund and varies between 0.39% -2% p.a. Starting from September 2019 the funds fixed commission fees will decrease, but funds will be allowed to take success fee.

<b>Fee and commission income by customer location:</b>	<b>2018</b>	<b>2017</b>
Estonia	32 677	26 123
Latvia	0	50
Lithuania	0	71
Other	163	202
<b>Total</b>	<b>32 884</b>	<b>26 446</b>

## NOTE 9 Operating expenses

<i>(in thousands of euros)</i>	2018	2017
Wages, salaries and bonuses	12 190	9 873
Social security and other taxes*	3 566	3 118
<b>Total staff costs</b>	<b>15 756</b>	<b>12 991</b>
IT expenses	2 322	1 743
Information services and banking services	625	567
Marketing expenses	2 023	3 656
Office expenses	677	456
Transportation and communication costs	225	222
Training and travelling expenses of employees	626	475
Other outsourced services	3 136	2 807
Other administrative expenses	2 304	1 949
Depreciation	2 972	1 297
Operating lease payments	1 153	1 027
Other operating expenses	324	208
<b>Total other operating expenses</b>	<b>16 387</b>	<b>14 407</b>
<b>Total operating expenses</b>	<b>32 143</b>	<b>27 398</b>

\* lump-sum payment of social, health and other insurances.

The average number of employees working for LHV Group in 2018 was 366 (2017: 357).

From 2018, the sales costs of pension fund client agreements have been capitalised as intangible assets based on their expected lifetime of customer relationship, ie 20 years. Previously, the sales costs were recorded in "Marketing expenses" line item between 2002 to 2017, see also notes 2.1 (a), 2.9, 16 and 21. Under IAS 18, these costs

were not capitalised as the expenses were allowed to be capitalised only until the customer had first opportunity to change pension fund, ie the time period was shorter than 1 year.

If these sales costs would have been recorded as costs and not capitalised as per IAS 18, the "Marketing expenses" would have been EUR 1 818 thousand higher.

## NOTE 10 Due from central bank, credit institutions and investment companies

<i>(in thousands of euros)</i>	31.12.2018	31.12.2017
Demand and term deposits with maturity less than 3 months *	42 796	40 498
Statutory reserve capital at central bank	14 280	15 375
Demand deposit from central bank *	625 582	905 339
<b>Total</b>	<b>682 658</b>	<b>961 212</b>
* cash and cash equivalents in the statement of cash flows	668 378	945 837

Distribution of receivables by countries is presented in Note 3.5. Mandatory banking reserve as at 31.12.2018 was 1% (2017: 1%) of all financial resources collected (deposits from

customers and loans received). The reserve requirement is to be fulfilled as a monthly average in euros or in the foreign securities preapproved by the central bank.

NOTE 11a Available-for-sale financial assets

As of 31.12.2017 the Group had VISA shares in the amount of EUR 220 thousand. As of 31.12.2017 the Group had also available-for-sale debt securities portfolio consisting of bonds in the amount of EUR 555 thousand. The balance

of other reserves in equity as at 31.12.2017 is EUR 36 thousand, see also Note 21.

In 2017, no gains or losses arose from the sale of debt securities.

<b>Available-for-sale financial assets 31.12.2016</b>	<b>799</b>
Proceeds from disposal and maturities of assets available-for-sale	-124
Interest income (Note 7)	24
Revaluation of available-for-sale assets	76
<b>Available-for-sale financial assets 31.12.2017</b>	<b>775</b>

NOTE 11b Equity and debt instruments at fair value through other comprehensive income

<b>Equity instruments 31.12.2017</b>	<b>0</b>
Reclassification on 1 January 2018	220
Revaluation of equity instruments	78
<b>Equity instruments 31.12.2018</b>	<b>298</b>

On 1 January 2018, the VISA shares were recorded as fair value through other comprehensive income, which is irrevocable election by management as these shares are not held for trading.

On 1 January 2018, debt securities classified as FVOCI was based on the management assessment of the instrument's business model. Therefore, fair value through other comprehensive income measurement basis was applied at the application of IFRS 9.

As of 31.12.2018 the Group has VISA shares in the amount of EUR 298 thousand. The balance of other reserves in equity as at 31.12.2018 is EUR 78 thousand, see also Note 21.

<b>Debt instruments 31.12.2017</b>	<b>0</b>
Reclassification on 1 January 2018	555
Proceeds from disposal and maturities of assets available-for-sale	556
Interest income (Note 7)	17
Revaluation of debt instruments	-16
<b>Debt instruments 31.12.2018</b>	<b>0</b>

NOTE 12 Financial assets and liabilities at fair value through profit or loss

<b>Mandatory measurement as fair value through profit or loss:</b>	<b>31.12.2018</b>
Shares and fund units	510
Debt securities	38 697
Fund units	7 590
incl. investments in managed pension funds	7 590
Foreign exchange forwards	59
<b>Total financial assets</b>	<b>46 856</b>
Interest rate swaps and foreign exchange forwards	11
<b>Total financial liabilities</b>	<b>11</b>
<b>Securities held for trading:</b>	<b>31.12.2017</b>
Shares and fund units	430
Debt securities	49 138
<b>Designated as at fair value through profit or loss upon initial recognition:</b>	
Fund units	6 261
incl. investments in managed pension funds	6 261
Foreign exchange forwards	30
<b>Total financial assets</b>	<b>55 859</b>
Interest rate swaps and foreign exchange forwards	2
<b>Total financial liabilities</b>	<b>2</b>
<b>Financial assets at fair value through profit or loss 31.12.2016</b>	<b>75 391</b>
Net changes of investment securities at fair value through profit or loss	-19 962
Interest income (Note 7)	182
Revaluation	248
<b>Financial assets at fair value through profit or loss 31.12.2017</b>	<b>55 859</b>
Net changes of investment securities at fair value through profit or loss	-10 335
Interest income (Note 7)	123
Revaluation	1 209
<b>Financial assets at fair value through profit or loss 31.12.2018</b>	<b>46 856</b>

Bid price is the fair value of investments in the case of publicly listed securities (Note 3.6). In 2018, a gain of EUR 407 thousand was recognised on the revaluation of debt securities (2017: EUR 440 thousand). No profit or loss arose on the revaluation of interest rate swaps in 2018 (2017: loss EUR 0 thousand).

The volume of pension and investment fund assets managed by the Group as at 31.12.2018 was EUR 1 214 million (31.12.2017: EUR 1 103 million).

NOTE 13 Loans and advances to customers

<i>(in thousands of euros)</i>	31.12.2018	31.12.2017
<b>Loans to legal entities</b>	<b>714 335</b>	<b>548 424</b>
incl. corporate loans	624 425	456 748
incl. retail loans	16 200	13 656
incl. leasing	44 277	33 840
incl. overdraft	23 846	39 192
incl. leveraged loans	1 997	4 547
incl. hire-purchase	249	269
incl. credit card loans	274	172
incl. credit letters	3 067	0
<b>Loans to individuals</b>	<b>214 702</b>	<b>191 744</b>
incl. hire-purchase	17 501	57 327
incl. mortgage loans	101 009	77 640
incl. consumer loans	33 989	34 474
incl. private loans	37 884	0
incl. leasing	15 888	11 402
incl. leveraged loans	1 733	2 621
incl. credit card loans	6 579	8 199
incl. overdraft	43	81
incl. study loan	76	0
<b>Total</b>	<b>929 037</b>	<b>740 168</b>
incl. related parties (note 24)	3 328	2 820
Impairment provisions	-10 276	-8 125
<b>Total</b>	<b>918 761</b>	<b>732 043</b>

As at 31.12.2017, leverage loans included repo loans in the amount of EUR 778 thousand. The fair value of collaterals for repo loans as at 31.12.2017 was EUR 1 832 thousand.

As at 31.12.2018, there were no repo loans.

<b>Changes in impairments in 2018</b>	Corporate loans incl overdraft	Retail loans	Consumer loans	Credit cards	Hire-purchase	Leasing	Leve-raged loans	Other loans incl mortgage	Credit letters	Total
<b>Balance as at 1 January</b>	<b>-4 594</b>	<b>-155</b>	<b>-1 255</b>	<b>-240</b>	<b>-858</b>	<b>-780</b>	<b>0</b>	<b>-243</b>	<b>0</b>	<b>-8 125</b>
Impairment provisions/ reversals set up during the year	-4 272	-54	226	47	91	183	-3	207	-100	-3 675
Incl Changes in initial application of IFRS 9	-403	-46	-53	-2	-50	-158	0	0	0	-712
Written off during the year	115	25	25	10	4	120	0	0	0	299
Discontinued operations	0	0	436	156	623	10	0	0	0	1 225
<b>Balance as at December 31</b>	<b>-8 751</b>	<b>-184</b>	<b>-568</b>	<b>-27</b>	<b>-140</b>	<b>-467</b>	<b>-3</b>	<b>-36</b>	<b>-100</b>	<b>-10 276</b>

<b>Changes in impairments in 2017</b>	Corporate loans incl overdraft	Retail loans	Consumer loans	Credit cards	Hire-purchase	Leasing	Leve-raged loans	Other loans incl mortgage	Total
<b>Balance as at 1 January</b>	<b>-2 338</b>	<b>-101</b>	<b>-1 599</b>	<b>-118</b>	<b>-1 223</b>	<b>-219</b>	<b>0</b>	<b>-143</b>	<b>-5 741</b>
Impairment provisions set up during the year	-2 257	-54	-196	-157	-843	-570	0	-100	-4 177
Written off during the year	1	0	540	35	1 208	9	0	0	1 793
<b>Balance as at December 31</b>	<b>-4 594</b>	<b>-155</b>	<b>-1 255</b>	<b>-240</b>	<b>-858</b>	<b>-780</b>	<b>0</b>	<b>-243</b>	<b>-8 125</b>

Impairment losses accumulated during the year differ from the amount of impairment losses recognized in the statement of profit or loss, that have been written off earlier as

uncollectible claims. These receipts were recorded among impairment losses in the statement of profit or loss.

Net and gross investments on finance leases according to remaining maturity	Gross investment	Unearned future interest income	Impairment loss provision	Present value of lease payments receivable
up to 1 year	19 135	-1 710	-134	17 291
1-5 years	43 901	-2 535	-319	41 047
over 5 years	1 880	-39	-14	1 827
<b>Total as at 31.12.2018</b>	<b>64 916</b>	<b>-4 284</b>	<b>-467</b>	<b>60 165</b>
up to 1 year	15 846	-1 274	-635	13 937
1-5 years	32 406	-1 756	-142	30 508
over 5 years	820	-20	-4	796
<b>Total as at 31.12.2017</b>	<b>49 072</b>	<b>-3 050</b>	<b>-780</b>	<b>45 242</b>

For credit risk exposures and loan collateral, see Note 3.2.  
 Distribution of loans granted by currencies is disclosed in Note 3.3.  
 Distribution of loans granted by maturity is disclosed in Note 3.4.  
 The geographical distribution of loans granted is disclosed in Note 3.5.  
 For interest income on loans granted, see Note 7.

## NOTE 14 Receivables from customers

<i>(in thousands of euros)</i>	31.12.2018	31.12.2017
Asset management fees from customers	1 412	1 179
incl. related parties (Note 24)	1 227	1 156
Other fees for providing services to customers	2 309	7 302
Payments in transit	0	6
Other receivables	0	1 313
<b>Total</b>	<b>3 721</b>	<b>9 800</b>

All fees are collected within 12 months of the end of the reporting period and are considered as current asset.

## NOTE 15 Other assets

<i>(in thousands of euros)</i>	31.12.2018	31.12.2017
<b>Financial assets</b>		
Guarantee deposits of Baltic stock exchanges	11	9
Guarantee deposits of VISA and MasterCard	2 925	2 280
<b>Subtotal</b>	<b>2 936</b>	<b>2 289</b>
<b>Non-financial assets</b>		
Prepayments to Financial Supervision Authority	476	446
Tax prepayments	0	10
Repossessed assets	0	22
Prepayments to merchants for registered customer contracts	0	52
Other prepayments *	1 175	986
<b>Subtotal</b>	<b>1 651</b>	<b>1 516</b>
<b>Total</b>	<b>4 587</b>	<b>3 805</b>

\* Prepayments include office rent, insurance, communication services, periodicals and training.

Prepayments are expected to be received or used within 12 months of the end of the reporting period, and are therefore considered current assets. Guarantee deposits on the Baltic stock exchanges are held to guarantee securities

trading activity on the stock exchanges of Tallinn, Riga and Vilnius and the deposits of VISA and MasterCard to guarantee credit card transactions, and should therefore both be considered non-current assets.

NOTE 16 Tangible and intangible assets

<i>(in thousands of euros)</i>	Tangible assets	Intangible assets	Costs incurred for the acquisition of customer contracts	Total intangible assets	Total
<b>Balance as at 31.12.2016</b>					
Cost	3 521	7 210	0	7 210	10 731
Accumulated depreciation and amortisation	-2 330	-2 710	0	-2 710	-5 040
<b>Carrying amount</b>	<b>1 191</b>	<b>4 500</b>	<b>0</b>	<b>4 500</b>	<b>5 691</b>
Purchase of non-current assets	618	848	0	848	1 466
Depreciation/amortisation charge	-327	-1 021	0	-1 021	-1 348
Non-current assets sold	-61	0	0	0	-61
<b>Balance as at 31.12.2017</b>					
Cost	4 078	8 058	0	8 058	12 136
Accumulated depreciation and amortisation	-2 657	-3 731	0	-3 731	-6 388
<b>Carrying amount 31.12.2017</b>	<b>1 421</b>	<b>4 327</b>	<b>0</b>	<b>4 327</b>	<b>5 748</b>
IFRS15 first time adoption	0	0	10 618	10 618	10 618
<b>Corrected carrying amount 31.12.2017</b>	<b>1 421</b>	<b>4 327</b>	<b>10 618</b>	<b>14 945</b>	<b>16 366</b>
Purchase of non-current assets	396	1 236	0	1 236	3 450
Capitalized selling costs	0	0	1 818	1 818	0
Write-off of non-current assets	-5	0	0	0	-5
Depreciation/amortisation charge	-510	-1 031	-1 431	-2 462	-2 972
Assets of discontinued operations	340	371	0	371	711
Amortisation of discontinued operations	-168	-304	0	-304	-472
<b>Balance as at 31.12.2018</b>					
Cost	4 129	15 324	12 436	27 760	31 889
Accumulated depreciation and amortisation	-2 994	-10 859	-1 431	12 290	-15 284
<b>Carrying amount</b>	<b>1 135</b>	<b>4 465</b>	<b>11 005</b>	<b>15 470</b>	<b>16 605</b>

Tangible assets include computer technology and office equipment, furniture, capitalized costs of office renovation. Intangible assets include licences, client contracts and development costs.

In 2018 and 2017, there was no indication of impairment of tangible and intangible assets.

## NOTE 17 Deposits from customers and loans received

### 31.12.2018

(in thousands of euros)

	Individuals	Financial intermediates	Legal entities	Public sector	Total
Demand deposits	374 491	193 893	727 803	7 935	1 304 122
Term deposits	57 605	0	54 456	5 734	117 795
Loans received	0	0	21 528	0	21 528
Accrued interest liability	197	0	131	9	337
<b>Total</b>	<b>432 293</b>	<b>193 893</b>	<b>803 918</b>	<b>13 678</b>	<b>1 443 782</b>
incl. related parties (Note 24)	1 091	0	32 417	0	33 508

### 31.12.2018

(in thousands of euros)

Demand deposits	278 430	606 600	518 346	6 203	1 409 579
Term deposits	51 075	0	70 221	5 816	127 112
Loans received	0	0	6 000	0	6 000
Accrued interest liability	144	0	87	7	238
<b>Total</b>	<b>329 649</b>	<b>606 600</b>	<b>594 654</b>	<b>12 026</b>	<b>1 542 929</b>
incl. related parties (Note 24)	2 022	0	20 973	0	22 995

In 2017, a loan received from the Rural Development Foundation in the amount of EUR 778 thousand was returned. LHV Pank concluded an unsecured 10-year loan agreement with the European Investment Fund (EIF) in the amount of EUR 12.5 million to increase the credit facilities of small and medium-sized enterprises. As at 31.12.2018, the Bank had used EUR 12 250 thousand of the loan amount.

The nominal interest rates of most deposits from customers and loans received equal their effective interest rates as no other significant fees have been paid.

Distribution of deposits from customers and loans received by currency is presented in Note 3.3.

Distribution of deposits from customers and loans received by maturity is presented in Note 3.4.

Distribution of deposits from customers and loans received by geography and Risk concentration is presented in Note 3.2.2.

## NOTE 18 Accounts payable and other liabilities

(in thousands of euros)

Financial liabilities	Note	31.12.2018	31.12.2017
Trade payables		2 153	8 507
Payables to merchants		0	439
Other short-term financial liabilities		1 925	1 878
Accrued interest on subordinated loans	20	314	210
Payments in transit		16 800	55 661
Financial guarantee contracts issued		236	137
<b>Subtotal</b>		<b>21 428</b>	<b>66 832</b>
<b>Non-financial liabilities</b>			
Performance guarantee contracts issued		243	159
Tax liabilities		1 218	700
Payables to employees		1 488	1 238
incl. related parties	24	91	84
Other short-term liabilities		276	2 141
<b>Subtotal</b>		<b>3 216</b>	<b>4 238</b>
<b>Total</b>		<b>24 644</b>	<b>71 070</b>

Payables to employees consist of unpaid salaries, bonus accruals and vacation pay accrual for the reporting period and the increase in liabilities is caused by the increase in the number of employees during the year. Payments in transit consist of foreign payments and payables to customers related

to intermediation of securities transactions, for which the customer's current account have been debited. All liabilities, except for financial guarantees, are payable within 12 months and are therefore recognised as current liabilities.

## NOTE 19 Operating lease

The Group leases office premises under the operating lease terms. All lease agreements are cancellable upon the consent of both parties. The minimum unilaterally non-cancellable lease payable in the next period are disclosed in

the table below. In 2018, the operating lease payments for office premises were in the amount of EUR 1 153 thousand (2017: EUR 1 170 thousand).

<i>(in thousands of euros)</i>	Up to 1 year	1 to 5 year	Total
Non-cancellable lease payables as of <b>31.12.2018</b>	987	3 525	<b>3 525</b>
Non-cancellable lease payables as of <b>31.12.2017</b>	1 195	2 152	<b>3 347</b>

## NOTE 20 Subordinated debts

According to the Groups operations, only subordinated debts are recognized as loans received in the statement of cash flows, as other loans are received as part of ordinary business operations. The current note contains changes in subordinated debts, including monetary or non-monetary movements and effects of foreign exchange rates, if they have occurred during the reporting period or the reference period.

The Group has received subordinated debts in order to increase long-term capital. In the case of default of the Group, the subordinated debts are repayable after all other debts have been paid, but before debts to shareholders are paid. The balances of subordinated debt as at the end of each reporting period is disclosed in the table below.

### Subordinated debts

*(in thousands of euros)*

	Year of issue	Amount	Interest rate	Maturity date
	2014	15 900	7.25%	June 20, 2024
	2015	15 000	6.5%	October 29, 2025
	2018	20 000	6.0%	November 28, 2028
Subordinated debt as at 31.12.2016		30 900		
Subordinated debt as at 31.12.2017		30 900		
Subordinated debt as at 31.12.2018		50 900		

Interest expenses on subordinated bonds for each reporting period and accrued interest liabilities as at the end of each reporting period is disclosed in the table below. Interest liabilities are accounted in the statement of financial position using the effective interest rate.

### Accrued interest on subordinated debt

*(in thousands of euros)*

<b>Accrued interest on subordinated debts as at 31.12.2016 (Note 18)</b>	<b>210</b>
Interest calculated for 2017 (Note 7)	2 136
Paid out during 2017	-2 136
<b>Accrued interest on subordinated debts as at 31.12.2017 (Note 18)</b>	<b>210</b>
Interest calculated for 2018 (Note 7)	2 231
Paid out during 2018	-2 127
<b>Accrued interest on subordinated debts as at 31.12.2018 (Note 18)</b>	<b>314</b>

NOTE 21 Shareholders' equity in the public limited company

**Transactions with share capital and share premium**

	Time	Share price	Number of shares	Share premium	Total
<b>Share capital as at 31.12.2016</b>			<b>25 356</b>	<b>45 892</b>	
Paid in share capital	July 2017	2.0	411	412	823
<b>Share capital as at 31.12.2017</b>			<b>25 767</b>	<b>46 304</b>	
Paid in share capital	July 2018	2.4	249	349	598
<b>Share capital as at 31.12.2018</b>			<b>26 016</b>	<b>46 653</b>	

Share capital is paid in full through cash contributions. The nominal value of the shares is 1 euro and as at 31.12.2018 the number of shares amounted to 26 016 485 (31.12.2017: 25 767 342). Each share gives one vote to the shareholder at the general meeting.

According to AS LHV Group's articles of association, the minimum share capital is EUR 15 million and the maximum share capital is EUR 60 million (31.12.2017: EUR 15 and EUR 60 million).

Rain Lõhmus who owns 24.9% of the voting rights and Andres Viisemann who owns 9.8% of the voting rights in AS LHV Group have significant influence over the company (31.12.2017: 25.14% and 9.87%).

In the reporting year, the Group paid dividends to shareholders of 0.16 (2017: 0.15) EUR per share, amounting to a total of EUR 4 123 (2017: 3 803) thousand.

As at 31.12.2018, the retained earnings of the Group totalled EUR 75 430 thousand (31.12.2017: EUR 44 071 thousand). As of 31.12.2018 it is possible to pay out dividends in amount EUR 60 426 (2017: 35 257) thousand. Part of the potential dividends (1/3 from dividends paid out in 2018) would be taxed at a preferential rate of 14/86 and the remaining part 20/80. The related income tax charge

would be EUR 15 004 (2017: 8 814 with 20/80 tax rate) thousand.

**Statutory reserve capital in equity is as follows:**

*(in thousands of euros)*

<b>Statutory reserve as at 31.12.2016</b>	<b>1 580</b>
Transferred from 2016 net profit	891
<b>Statutory reserve as at 31.12.2017</b>	<b>2 471</b>
Transferred from 2017 net profit	980
<b>Statutory reserve as at 31.12.2018</b>	<b>3 451</b>

On 1 January 2018, due to the initial application of IFRS 15, sales costs related with new client agreements from 2002 to 2017 that previously were recorded as "Marketing expenses" in Operating expenses in gross amount EUR 17 109 thousand and with accumulated depreciation of EUR 6 401 thousand, were capitalised. Therefore, as at 01.01.2018 the carrying amount of EUR 10 618 thousand were recorded in retained earnings, see also notes 2.1 (a), 2.9, 9 and 16.

Other reserves in the consolidated statement of Changes in Equity consist of:

*(in thousands of euros)*

	31.12.2018	31.12.2017
Revaluation reserve of available-for-sale securities	0	36
Revaluation reserve of equity instruments at fair value through other comprehensive income	78	0
Reserve of share options granted to staff	2 012	1 413
<b>Total</b>	<b>2 090</b>	<b>1 449</b>

The Group is granting share options to the members of the Management Board and employees considered as such and department managers and employees considered as such of group companies that are part of AS LHV Group.

	Number of shares	Strike price per share (EUR)	Weighted average share price of the exercise period	Expiry year	Number of people to whom the share options were granted
<b>Outstanding amount of share options at 31.12.2013</b>	<b>0</b>				
Granted amount during the period	411 336	2.0		2017	35
<b>Outstanding amount of share options at 31.12.2014</b>	<b>411 336</b>				
Granted amount during the period	278 594	2.4		2018	48
<b>Outstanding amount of share options at 31.12.2015</b>	<b>689 930</b>				
Granted amount during the period	270 330	3.0		2019	48
Cancelled amount during the period	-62 183				
<b>Outstanding amount of share options at 31.12.2016</b>	<b>898 077</b>				
Granted amount during the period	364 990	4.65		2020	69
Exercised amount during the period	-411 336		10.23		
<b>Outstanding amount of share options at 31.12.2017</b>	<b>851 731</b>				
Granted amount during the period	299 781	5.33		2021	72
Exercised amount during the period	-278 594		10.93		
<b>Outstanding amount of share options at 31.12.2018</b>	<b>872 918</b>				

The Group may issue share options for the results of 2018. The vesting period for all share options in the option program is 3 years. The right to subscribe will occur on the first day of the exercising period. In 2018, share options issued in 2015 were fully exercised.

The members of the Management Board and employees do not have the possibility to take the specified amount in cash in lieu of the share options. Share options cannot be exchanged, sold, pledged or encumbered. Share options can be inherited. The contract for share options will expire upon premature termination of the employment contract on the employee's initiative, for which exceptions can be made by the Supervisory Board of AS LHV Group or the Remuneration Committee based on the decision of the Supervisory Board, and upon extraordinary termination of the employment contract by the employer due to reasons resulting from the employee. According to the Credit Institutions Act the Supervisory Board of AS LHV Group can reduce the number of share options issued or cancel the share options if the overall financial results of the Company have significantly deteriorated compared to the previous period, the member of the Management Board or employee no longer meets the performance criteria, the

Company no longer meets the prudential regulations or the Company's business risks are not adequately covered by Company's own funds or the performance fee has been determined based on information, which proved to be substantially misstated or incorrect.

Total expenses arising from share-based payment transactions amounted to EUR 1 208 (2017: 959) thousand.

NOTE 22 Assets under management

**AS LHV Pank, operating as an account manager for its customers, has custody of or intermediates the following customer assets:**

<i>(in thousands of euros)</i>	31.12.2018	31.12.2017
Cash balance of customers	9 773	10 266
Securities of customers	1 383 157	1 193 235
incl. shareholders of the parent company and related entities (Note 24)	156 961	168 637
<b>Total</b>	<b>1 392 930</b>	<b>1 203 501</b>

Asset management fees for the management of these assets have been in the range of 0.015 – 0.025 % p.a. (for respective income, see Note 8).

The monetary funds of the customers who use the platform of an active securities trader or the trading system LHV Trader offered by the Bank, have been recognised as off-balance sheet assets. Due to the nature of the system, the Bank has deposited these funds in personalised accounts with its partner and as the monetary funds of these customers are not used for business purposes by the Bank (they cannot be lent to other customers or used as collateral), therefore the monetary funds are recognised as off-balance sheet assets. The Bank earns commission and interest income on intermediation of transactions in these accounts similarly to customers' accounts reflected in the Group's financial statement. The Bank has

provided contractual guarantees to its partner in respect of LHV Trader accounts, guaranteeing potential losses to be incurred from financing of the transactions executed by customers intermediated by itself (leveraging), with the primary collateral being the securities used as collateral for leveraged loans. The customer has similar guarantee to the Bank and therefore, the Bank has in substance transferred the guarantee to end customer. To avoid potential losses, the Bank has a daily practice to monitor the potential decrease of collateral and deficiency of customer accounts. In its current practice, no such losses in respect of which the guarantee provided by the Bank would apply have incurred and the Bank has not paid any compensation relating to the guarantee.

NOTE 23 Contingent assets and liabilities

<b>Non-cancellable agreements</b>	Performance guarantees	Financial guarantees	Letters of credit	Unused loan commitments	Total
Liability in contractual amount 31.12.2018	11 927	9 314	55	188 841	210 137
Liability in contractual amount 31.12.2017	10 129	5 999	51	179 572	195 751

With the initial application of IFRS 9, financial guarantees and unused loan commitments are subject to ECL, see also note 3.2 for more information.

Tax authorities have the right to review the company's tax records for up to 5 years after submitting the tax declaration and upon finding errors, impose additional taxes, interest and fines. The tax authorities have not performed any tax audits at the Group during 2017-2018. The Group's management estimates that in 2019 there are no such circumstances which may lead the tax authorities to impose significant additional taxes on the Group.

Performance guarantees are contracts that provide compensation if another party fails to perform a contractual obligation. Such contracts do not transfer credit risk. The risk under performance guarantee contracts is the possibility that the insured event (i.e. the failure to perform the contractual obligation by another party) occurs. The

key risks the Group faces are significant fluctuations in the frequency and severity of payments incurred on such contracts relative to expectations. The Group uses historical data and statistical techniques to predict levels of such payments. Claims must be made before the contract matures and most claims are settled within short term. This allows the Group to achieve a high degree of certainty about the estimated payments and therefore future cash flows. The Group manages such risks by constantly monitoring the level of payments for such products and has the ability to adjust its fees in the future to reflect any change in claim payments experience. The Group has a claim payment requests handling process, which includes the right to review the claim and reject fraudulent or non-compliant requests. The exposure and concentration of performance guarantees expressed at the amounts guaranteed is as follows:

<b>According to sectors</b>	<b>31.12.2018</b>	<b>31.12.2017</b>
Construction	6 594	7 083
Water supplies	2 600	1 237
Manufacturing	623	212
Professional, scientific and technical activities	1 157	708
Other areas at activities	953	889
<b>Total</b>	<b>11 927</b>	<b>10 129</b>

<b>According to internal ratings</b>	<b>31.12.2018</b>	<b>31.12.2017</b>
5 low credit risk	257	346
6 low credit risk	1 799	3 722
7 medium credit risk	6 055	3 938
8 medium credit risk	1 622	374
9 heightened credit risk	625	621
10 high credit risk	187	84
11 high credit risk	0	0
12 non-satisfactory rating	21	16
13 non-satisfactory rating	405	605
Non-rated *	956	423
<b>Total</b>	<b>11 927</b>	<b>10 129</b>

Performance guarantees are over-collateralised as at each reporting date. Therefore, the Group has not borne any losses from performance guarantee contracts neither in 2018 nor in previous period.

## NOTE 24 Transactions with related parties

In preparing the financial statements of the Group, the following entities have been considered related parties:

- owners that have significant impact on the Group and the entities related to them;
- members of the management board and legal entities controlled by them (together referred to as management);
- members of the supervisory board;
- close relatives of the persons mentioned above and the entities related to them.

<b>Transactions</b>	<b>Note</b>	<b>2018</b>	<b>2017</b>
<b>Interest income</b>	<b>7</b>	<b>67</b>	<b>63</b>
incl. management		29	27
incl. shareholders, their related entities and close relatives that have significant influence		38	36
<b>Fee and commission income</b>	<b>8</b>	<b>11</b>	<b>8</b>
incl. management		2	2
incl. shareholders, their related entities and close relatives that have significant influence		9	6
<b>Interest expenses from deposits</b>	<b>7</b>	<b>42</b>	<b>41</b>
incl. management		2	1
incl. shareholders, their related entities and close relatives that have significant influence		40	40
<b>Interest expenses from subordinated debt</b>	<b>7</b>	<b>357</b>	<b>336</b>
incl. management		7	7
incl. shareholders, their related entities and close relatives that have significant influence		350	329

<b>Balances</b>	<b>Note</b>	<b>31.12.2018</b>	<b>31.12.2017</b>
<b>Loans and receivables as at the year-end</b>		<b>3 328</b>	<b>2 820</b>
incl. management	14	2 079	1 736
incl. shareholders, their related entities and close relatives that have significant influence	14	1 250	1 084
<b>Deposits as at the year-end</b>		<b>33 509</b>	<b>22 995</b>
incl. management	17	222	283
incl. shareholders, their related entities and close relatives that have significant influence	17	33 287	22 712
<b>Subordinated debt as at the year-end</b>		<b>5 904</b>	<b>4 999</b>
incl. management	20	135	104
incl. shareholders, their related entities and close relatives that have significant influence	20	5 769	4 895

The table provides an overview of the material balances and transactions involving related parties. All other transactions involving the close relatives and the entities related to members of the management board and supervisory board and the minority shareholders of the parent company AS LHV Group have occurred in the course and on the terms of ordinary business. There are no doubtful debts or provisions recorded for related parties.

Loans granted to related parties are issued at market conditions.

As at 31.12.2018 and 31.12.2017, the management did not have term deposits and the interest rate on demand deposits corresponds to the terms applicable to customers.

The subordinated debts received in November 2018 have the interest rate of 6.0%. The subordinated debts received in October 2015 have the interest rate of 6.5%. The subordinated debts received in June 2014 have the interest rate of 7.25%, refer to Note 20.

In 2018, salaries and other compensations paid to the management of the parent AS LHV Group and its subsidiaries totalled EUR 1 471 thousand (2017: EUR 1 371 thousand), including all taxes. As at 31.12.2018, remuneration for December and accrued holiday pay in the amount of EUR 91 thousand (31.12.2017: EUR 84 thousand) is reported as a payable to management (Note 18). The Group did not have any long-term payables or commitments to the members of the management board and the supervisory board as at 31.12.2018 and 31.12.2017 (pension liabilities,

termination benefits, etc.). In 2018, the remuneration paid to the members of the Group's supervisory board totalled EUR 37 thousand (2017: EUR 39 thousand).

The Group has signed contracts with the members of the management board, which do not provide for severance benefits upon termination of the contract. In any matters not regulated by the contract, the parties adhere to the procedure specified in the legislation of the Republic of Estonia.

Management is involved with share option program. In 2018, the share options were granted to the members of the management board in the amount of EUR 497 thousand (2017: EUR 420 thousand).

Information on assets of related parties held as an account manager is presented in Note 22.

## NOTE 25 Basic earnings and diluted earnings per share

In order to calculate basic earnings per share, net profit attributable to owners of the parent has been divided by the weighted average number of shares issued.

	2018	2017
Profit (incl. discontinued operations) attributable to owners of the parent (in thousands of euros)	25 237	19 603
Profit attributable to owners of the parent from continuing operations (in thousands of euros)	21 913	17 676
Weighted average number of shares (in thousands of units)	25 892	25 562
Basic earnings per share (EUR)	0.97	0.77
Basic earnings per share from continuing operations (EUR)	0.85	0.69
Basic earnings per share from discontinued operations (EUR)	0.12	0.08
Weighted average number of shares used for calculating the diluted earnings per shares (in thousands of units)	26 373	26 049
Diluted earnings per share (EUR)	0.96	0.75
Diluted earnings per share (EUR) from continuing operations	0.83	0.68
Diluted earnings per share (EUR) from discontinued operations	0.13	0.07
<b>Weighted average number of shares used as the denominator (in thousands of shares)</b>	<b>2018</b>	<b>2017</b>
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	25 892	25 562
Adjustments for calculation of diluted earnings per share:		
Share options	481	488
Weighted average number of ordinary shares and potential ordinary shares used as the denominator in calculating diluted earnings per share	26 373	26 049

## NOTE 26 Discontinued operations

In Q1 2018 LHV was approached by Inbank with initiative to purchase UAB Mokilizingas shares from LHV. By that time Mokilizingas was not any more strategic investment for LHV as company was restructured and profitability increased. Still it required similar focus compared to much larger business lines.

On May 23, 2018 LHV and Inbank reached an agreement, according to which Inbank paid EUR 2.9 million for the 50%+1

share of UAB Mokilizingas. All loans to Mokilizingas were refinanced as well, partially covered with EUR 25 million short-term bridge loan from LHV Pank.

UAB Mokilizingas statement of financial position is disclosed in Note 6. The table below summarises the financial results of UAB Mokilizingas for 2017 and for the first 4 months of 2018 until disposal of the subsidiary.

	2018	2017
Net interest income	1 619	5 142
Net fee and commission income	956	1 190
Personnel expenses	-535	-1 673
Operating expenses	-1 131	-2 866
Impairment losses on loans	-390	431
Income tax expenses	-144	-297
<b>Subtotal</b>	<b>375</b>	<b>1 927</b>
Other financial income (gain on disposal)	2 949	0
<b>Profit from discontinued operations</b>	<b>3 324</b>	<b>1 927</b>

<b>Summarised statement of Financial Position</b>	30.04.2018	31.12.2017
Loans and advances to customers and other current assets	67 477	53 915
Non-current assets	222	239
Current liabilities	6 897	8 727
Non-current liabilities	51 700	36 700
<b>Total net assets</b>	<b>9 102</b>	<b>8 727</b>

NOTE 27 Separate primary financial statements of parent company

In accordance with the Estonian Accounting Act, information on the separate primary financial statements of the parent of the consolidation group shall be disclosed in the notes to the financial statements.

**Statement of profit or loss and other comprehensive income of the parent**

<i>(in thousands of euros)</i>	2018	2017
Interest income	1 530	1 530
Interest expense	-2 231	-2 136
<b>Net interest expense</b>	<b>-701</b>	<b>-606</b>
Dividends received	6 578	3 803
Net gains from investments to associates	6 400	0
<b>Net gains/losses from financial assets</b>	<b>12 978</b>	<b>3 803</b>
Operating expenses	-666	-471
<b>Profit for the year</b>	<b>11 611</b>	<b>2 726</b>
<b>Total profit and other comprehensive income for the year</b>	<b>11 611</b>	<b>2 726</b>

**Statement of financial position of the parent**

<i>(in thousands of euros)</i>	31.12.2018	31.12.2017
<b>Assets</b>		
Due from banks and investment companies	21 565	11 018
Loans granted	32 288	22 286
Other receivables and assets	75	6
Investments in subsidiaries	73 811	64 955
<b>Total assets</b>	<b>127 739</b>	<b>98 265</b>
<b>Liabilities</b>		
Accrued expenses and other liabilities	136	60
Subordinated debt	51 214	31 110
<b>Total liabilities</b>	<b>51 350</b>	<b>31 170</b>
<b>Equity</b>		
Share capital	26 016	25 767
Share premium	46 653	46 304
Statutory reserve capital	3 451	2 471
Other reserves	2 012	1 413
Accumulated deficit	-1 744	-8 860
<b>Total shareholders' equity</b>	<b>76 388</b>	<b>67 095</b>
<b>Total liabilities and equity</b>	<b>127 739</b>	<b>98 265</b>

**Statement of cash flows of the parent**

<i>(in thousands of euros)</i>	2018	2017
<b>Cash flows from operating activities</b>		
Interest received	1 530	1 530
Interest paid	-2 231	-2 136
Administrative and other operating expenses paid	-583	-441
<b>Cash flows from operating activities before change in operating assets and liabilities</b>	<b>-1 284</b>	<b>-1 047</b>
<b>Adjustments</b>		
Investments in subsidiaries from share options	-1 156	-938
<b>Net increase/(decrease) in operating assets and liabilities:</b>		
Net increase/(decrease) of other receivables	-74	-2
Net increase/(decrease) of other liabilities	1 308	944
Discontinued operations	2 454	0
<b>Net cash from/(used in) operating activities</b>	<b>1 248</b>	<b>-1 043</b>
<b>Cash flows from investing activities</b>		
Loans granted	-10 000	0
Capital repayments from subsidiaries and associates	1 200	6 600
Capital contributions to subsidiaries and associates	-10 000	-3 000
Proceeds from disposal of subsidiary, net of cash received	5 046	0
<b>Net cash from/(used in) investing activities</b>	<b>-13 754</b>	<b>3 600</b>
<b>Cash flows from financing activities</b>		
Subordinated loans received	20 000	0
Paid in to share capital (incl. share premium)	598	823
Dividends received	6 578	3 803
Dividends paid	-4 123	-3 803
<b>Net cash from financing activities</b>	<b>23 053</b>	<b>823</b>
<b>Increase/(decrease) in cash and cash equivalents</b>	<b>10 547</b>	<b>3 380</b>
Cash and cash equivalents at the beginning of the financial year	11 018	7 638
<b>Cash and cash equivalents at the end of the financial year</b>	<b>21 565</b>	<b>11 018</b>

**Statement of changes in shareholders' equity**

(in thousands of euros)

	Share capital	Share premium	Statutory reserve capital	Other reserves	Accumulated loss/retained earnings	Total
<b>Balance as at 01.01.2017</b>	<b>25 356</b>	<b>45 892</b>	<b>1 580</b>	<b>1 283</b>	<b>-7 720</b>	<b>66 391</b>
Paid in share capital	411	412	0	0	0	823
Dividends paid	0	0	0	0	-3 803	-3 803
Transfer to statutory reserve capital	0	0	891	0	-891	0
Share options	0	0	0	130	827	957
Total other comprehensive income for 2017	0	0	0	0	2 727	2 727
<b>Balance as at 31.12.2017</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 413</b>	<b>-8 860</b>	<b>67 095</b>
Carrying amount of holdings under control and significant influence	0	0	0	0	-64 117	-64 117
Value of holdings under control and significant influence under equity method	0	0	0	36	117 048	117 084
<b>Adjusted unconsolidated equity as at 31.12.2017</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 449</b>	<b>44 071</b>	<b>120 062</b>
<b>Balance as at 01.01.2018</b>	<b>25 767</b>	<b>46 304</b>	<b>2 471</b>	<b>1 413</b>	<b>-8 860</b>	<b>67 095</b>
Paid in share capital	249	349	0	0	0	598
Dividends paid	0	0	0	0	-4 123	-4 123
Transfer to statutory reserve capital	0	0	980	0	-980	0
Share options	0	0	0	599	496	1 095
Total other comprehensive income for 2018	0	0	0	0	11 611	11 611
<b>Balance as at 31.12.2018</b>	<b>26 016</b>	<b>46 653</b>	<b>3 451</b>	<b>2 012</b>	<b>-1 856</b>	<b>76 276</b>
Carrying amount of holdings under control and significant influence	0	0	0	0	-72 859	-72 859
Value of holdings under control and significant influence under equity method	0	0	0	78	150 145	150 223
<b>Adjusted unconsolidated equity as at 31.12.2018</b>	<b>26 016</b>	<b>46 653</b>	<b>3 451</b>	<b>2 090</b>	<b>75 430</b>	<b>153 640</b>

Adjusted unconsolidated equity is the maximum amount that can be distributed to shareholders' according to Estonian legislation.

# Signatures of the management board to the consolidated annual report

The management board has prepared the management report and the consolidated financial statements of AS LHV Group for the financial year ended 31 December 2018.

The management board confirms that the management report on pages 4 to 48 provides a true and fair view of the business operations, financial results and financial condition of the parent company and the entities included in consolidation as a whole.

The management board confirms that according to their best knowledge the consolidated financial report on pages 49 to 146 presents a fair view of the assets, liabilities, financial position and profit or loss of the issuer and the entities involved in the consolidation as a whole according to the International Financial Reporting Standards as they are adopted by the European Union and contains a description of the main risks and doubts.

18.02.2019



**Madis Toomsalu**



# ***Independent auditor's report***

## ***To the Shareholders of AS LHV Group***

(Translation of the Estonian original)\*

### ***Report on the audit of the consolidated financial statements***

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#### ***Our opinion***

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of AS LHV Group and its subsidiaries (together the Group) as at 31 December 2018, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Our opinion is consistent with our additional report to the Audit Committee.

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#### ***What we have audited***

The Group's consolidated financial statements comprise:

- the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2018;
- the consolidated statement of financial position as at 31 December 2018;
- the consolidated statement of cash flows for the year then ended;
- the consolidated statement of changes in equity for the year then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

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#### ***Basis for opinion***

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report.

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

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#### ***Independence***

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Auditors Activities Act of the Republic of Estonia. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the Auditors Activities Act of the Republic of Estonia.

To the best of our knowledge and belief, we declare that non-audit services that we have provided to the Group are in accordance with the applicable law and regulations in the Republic of Estonia and that we have not provided non-audit services that are prohibited under § 59<sup>1</sup> of the Auditors Activities Act of the Republic of Estonia.

The non-audit services that we have provided to the Group, in the period from 1 January 2018 to 31 December 2018, are disclosed in the management report.

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## ***Our audit approach***

### ***Overview***



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#### ***Materiality***

Overall group materiality is EUR 1,370 thousand, which represents 5% of profit before income tax.

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#### ***Audit scope***

A full scope audit was performed by PwC Estonia for all Group entities covering substantially all of the Group's consolidated assets, liabilities, revenues and expenses.

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#### ***Key audit matter***

Impairment of loans and advances to customers

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As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the consolidated financial statements. In particular, we considered where the Management Board made subjective judgments; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

### ***Materiality***

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the consolidated financial statements.

Based on our professional judgment, we determined certain quantitative thresholds for materiality, including the overall group materiality for the consolidated financial statements as a whole as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.



<b>Overall group materiality</b>	EUR 1,370 thousand
<b>How we determined it</b>	5% of profit before income tax
<b>Rationale for the materiality benchmark applied</b>	We have applied this benchmark, as profit before tax is the key measure used both internally by management and, we believe, externally by shareholders in evaluating the performance of the Group.

### **Key audit matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<b>Key audit matter</b>	<b>How our audit addressed the key audit matter</b>
<p><b>Impairment of loans and advances to customers</b> (refer to Note 2 “Summary of significant accounting policies”, Note 3.2 “Credit risk” and Note 13 “Loans and advances to customers” for further details)</p> <p>As at 31 December 2018 loans and advances to customers amounted to EUR 918.8 million and related impairment loss for 2018 amounted to EUR 4.9 million.</p> <p>We focused on this area because management makes complex and subjective judgments over both timing of recognition of impairment and the estimation of the size of any such impairment, using complex models with subjective inputs. Furthermore, due to implementation of IFRS 9 from 1 January 2018, the accounting policies and methods applied on impairment calculation have changed as compared to prior years.</p> <p>IFRS 9 has introduced a 3-stage Expected Credit Loss (ECL) model. ECL calculations are forward-looking and probability-weighted, based on complex modelling and subjective inputs determined by the management. Key areas requiring significant management judgements and modelling in calculating ECL include:</p> <ul style="list-style-type: none"> <li>the criteria for assessment of significant increase in credit risk for corporate and retail products (Note 3.2.3.1) for determining loan exposures in stage 1 and stage 2;</li> <li>the modelling and calculation of key parameters of the ECL model, including</li> </ul>	<p>We assessed whether the Group’s accounting policies and methodology applied for the calculation of impairment of loans and advances to customers are in compliance with IFRS 9.</p> <p>We assessed the design and operating effectiveness of key controls over ECL data and respective calculations. This included controls over the allocation of assets into stages, data accuracy and completeness, credit monitoring and overdue loans monitoring. We have also assessed the IT general controls over relevant systems.</p> <p>In addition, we tested the design and operating effectiveness of the credit file periodic review and rating assessment, and monitoring of collateral controls for corporate loans. We determined that we could rely on these controls for the purposes of our audit.</p> <p>We performed detailed testing over:</p> <ul style="list-style-type: none"> <li>the completeness and accuracy of data used in the ECL calculation system;</li> <li>the compliance of key inputs used in the ECL calculation system with IFRS 9 methodology;</li> <li>the accuracy and compliance of 12-month and lifetime ECL calculations with IFRS 9 methodology;</li> <li>the accuracy of discounting in the ECL system;</li> <li>the accuracy and completeness of data used for staging of loans;</li> <li>the internal assignment of credit ratings for</li> </ul>

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probability of default (PD), loss given default (LGD) and exposure at default (EAD) (Note 3.2.3.3);

- incorporating forward-looking information into ECL model and the indicators selected for corporate and retail products; estimating those indicators for reliable future period and for three different scenarios (base, upside and downside scenario) with different probabilities (Note 3.2.3.4); and
- ensuring completeness of the customer accounts that are included in the expected credit loss calculation.

For defaulted corporate loans, an individual impairment is calculated based on the exposure and realisable value of the collateral at the balance sheet date.

corporate loan customers, which serve as inputs into the corporate loan ECL model;

- the correctness of information on collaterals and their values in the loan systems, which serve as an input into the ECL model; and
- the completeness of loans subject to stage 3 assessment and related ECL calculations.

We have assessed the reasonableness of key assumptions made by management, which serve as critical inputs in the ECL model, such as weights of different scenarios, corporate portfolio point in time PD estimate, key forecasts of macroeconomic information and multipliers used for different scenarios.

We performed analytical procedures to evaluate the ECL of different products through the year.

We have audited the results of back-testing performed by management and agree with their assessment that the impairment provisions have been adequate, in all material respects, in the prior period.

In case of some impairment provisions, we formed a different view from that of the management, but the differences were within a reasonable range of outcomes in the context of the overall loans and advances and the uncertainties disclosed in the financial statements.

As a result of our work, we noted no material exceptions.

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### ***How we tailored our audit scope***

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the consolidated financial statements as a whole, taking into account the structure of the Group, the accounting processes and controls, and the industry in which the Group operates.

After the disposal of Lithuanian subsidiary in 2018, the remaining Group subsidiaries mostly operate in Estonia. A full scope audit was performed by us for the following Group entities covering substantially all of the Group's consolidated statements of financial position and profit or loss:

- AS LHV Group;
- AS LHV Pank, including its branch in the UK and subsidiary AS LHV Finance; and
- AS LHV Varahaldus.



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## ***Other information***

The Management Board is responsible for the other information contained in the consolidated annual report in addition to the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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## ***Responsibilities of the Management Board and those charged with governance for the consolidated financial statements***

The Management Board is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as the Management Board determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Management Board is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Management Board either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

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## ***Auditor's responsibilities for the audit of the consolidated financial statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management Board.
- Conclude on the appropriateness of the Management Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



## ***Report on other legal and regulatory requirements***

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### ***Appointment and period of our audit engagement***

We were first appointed as auditors of AS LHV Group, as a public interest entity, for the financial year ended 31 December 2009. Our appointment has been renewed by tenders and shareholder resolutions in the intermediate years, representing the total period of our uninterrupted engagement appointment for AS LHV Group, as a public interest entity, of 10 years. In accordance with the Auditors Activities Act of the Republic of Estonia and the Regulation (EU) No 537/2014, our appointment as the auditor of AS LHV Group can be extended for up to the financial year ending 31 December 2028.

AS PricewaterhouseCoopers

A handwritten signature in blue ink, appearing to read 'Ago Vilu', written in a cursive style.

Ago Vilu  
Certified auditor in charge, auditor's certificate no.325

A handwritten signature in blue ink, appearing to read 'Verner Uiibo', written in a cursive style.

Verner Uiibo  
Auditor's certificate no.568

19 February 2019

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*\* This version of our report is a translation from the original, which was prepared in Estonian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.*

# Proposal for profit distribution

The management board of LHV Group proposes to the General Meeting of Shareholders to distribute the profit of the financial year 2018 as follows:

- transfer EUR 1 262 thousand to statutory reserve capital;
- pay dividends EUR 0.21 per share in the total amount of EUR 5 463 thousand; related income tax would be EUR 1 245 thousand;
- transfer the profit for reporting period attributable to shareholders of the parent in the amount of EUR 18 512 thousand to retained earnings.

# Signatures of the supervisory board to the annual report

The supervisory board has reviewed the annual report which consists of the management report and the financial statements, the independent auditor's report and the profit distribution proposal, and approved it for presentation at the general meeting of shareholders.

18.02.2019

Chairman of the supervisory board:

Rain Lõhmus



Members of the supervisory board:

Raivo Hein



Heldur Meerits



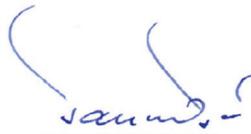
Tiina Mõis



Sten Tamkivi



Tauno Tats



Andres Viisemann



## Allocation of income according to EMTA classifiers

### Consolidated:

EMTAK	Activity	2018	2017
66121	Security and commodity contracts brokerage	5 111	4 010
64191	Credit institutions (banks) (granting loans)	56 974	49 091
64911	Finance lease	2 439	1 845
66301	Fund management	13 942	13 293
	<b>Total income</b>	<b>78 466</b>	<b>68 239</b>

### Unconsolidated:

EMTAK	Activity	2018	2017
64201	Activities of holding companies	1 530	1 530
	<b>Total income</b>	<b>1 530</b>	<b>1 530</b>