PKO Finance AB (publ)

Annual report for the period 2018-01-01 - 2018-12-31

(CID 556693-7461)

c/o AB 1909 Corporate Services
Norrlandsgatan 18 (Headoffice)
111 43 Stockholm (Domicile)
Sweden (Country of registration)

MANAGEMENT REPORT

The company is a wholly owned subsidiary of Powszechna Kasa Oszczednosci Bank Polski Spolka Akcyjna ("PKO Bank Polski SA").
The company is domiciled in Stockholm.

Business

The business of the company is to direcly or indirectly own, manage and trade securities and to conduct other non-licensed financial business including lending and other activities compatible therewith.

During 2008 the company has entered into a "Programme for the issuance of Loan Participation Notes". Under the Programme, the company may issue bonds (Loan Participation Notes) in series. The sole purpose of issuing each series is to finance loans to the parent company. The company charges certain rights under the loans to the parent company for the benefit of the note holders.

In accordance with the "Programme for issuance of Loan Participation Notes", four tranches of Participation Notes denominated in CHF and EUR have been issued during 2010- 2012. Additionally a bond loan for the American market was issued during 2012 based on such documentation binding on the debt market in the United States and in accordance with the Rule 144A in the US Securites Act. In January 2014 an additional bond loan has been issued in accordance with the above-mentioned programme which amounts to EUR 500 000 000. This bond repayment date is January 23, 2019.

All notes issued run with fixed interest and have been used to finance loans to the parent company on basically the same terms.

At the reporting date, there are three active tranches: Two in EUR and one in USD (for more information please refer to Notes 5 and 8).

The notes in USD and EUR are quoted on the Luxembourg Stock Exchange (LSE).

In December 2017 EUR 5 500 000 has been lent to the group company PKO Leasing Sverige AB, with the maturity date till December 2023. The interest is variable.

The financial year

The slight increase in total assets compared to 2017 is related to the strengthening of USD agains EUR between two reporting dates. At the same time the average rate for USD has weakened which explains the slightly lower Interest income. The decrease of Income before taxes in 2018 compared to 2017 mostly relates to the increase of Other external fees (for more information please refer to note 3).

The company has not had any employees.

Multiyear review (KEUR)

	2018	2017	2016	2015
Interest income	53 492	55 342	61 330	101 606
Income before taxes	132	202	259	577
Equity	6 386	6 329	717	831
Total assets	1 451 708	1 411 761	1 521 213	1 721 350

Risks and uncertainties

Market risk
The loans granted to the parent company consitute the main assets of the company and are financed by bond loans in the same currencies and with the same interest and repayment terms. The interest rates on the loans granted to the parent company are fixed as are the interest rates on the bond loans. The loans to the parent company are in all cases financed by bond loans in the same currency. All material cash at banks is held in EUR which is the reporting currency of the company.

Liquidity risks
As mentioned above the company's interest payments on the bond loans and the interest payments from the parent company occur simultaneously (actually the interest payments on the loans to the parent company occur shortly before the interest on the bond loans are due for payment). Consequently, the company will always have access to funds in order to finance its interest payments. See also note 5.

Credit and counterparty risk
PKO Bank Polski SA is the company's main borrower. The financial situation of PKO Bank Polski SA is very good (the Moody's long-term rating is A3) for which reason the credit risk of the company is deemed to be low. Additinally, PKO Bank Polski SA has issued a guarantee in order to secure all obligations of PKO Leasing Sverige AB resulting from the loan agreement with the company.
All material cash at banks is placed in SEB, Sweden.

Currency risk
The functional currency of the company is EUR. Since all material assets and liabilities are denominated in the same currency, the currency risk of the company is insignificant.

Corporate governance report

The Company has established routines in order to secure the accuracy of the financial reports which among other procedures include the audit of the Annual report by the elected auditors.

In view of the limited activities and low number of transactions the Board of Directors considers the control system described above to be appropriate.

Future activities of the company

The future activities of the company are linked to the development of the financial markets and the macroeconomic environment.

Proposal for appropriation of profits

The following profit is to be appropriated by the Annual General Meeting of Shareholders		
Retained earnings	EUR	781 681
The profit of the year	EUR	57 054
Total profit of the year and retained earnings	EUR	838 735

The Board of Directors proposes that the profit is appropriated as follows:

To be carried forward	EUR	838 735

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PROFIT AND LOSS STATEMENT

Amounts in euro.	Note 1,2	2018	2017
Administration and commission revenues from group companies		181 128	248 716
Other external expenses	Note 3	-258 699	-102 298
Operating income		***-77 571***	***146 418***
Financial items			
Interest income		53 492 330	55 342 357
Interest expenses, bond loans		-53 271 179	-55 270 687
Net currency effects		-11 723	-15 640
Income before taxes		***131 857***	***202 448***
Appropriation to profit equalisation reserve		-45 062	-49 853
Current tax expense	Note 4	-29 741	-32 903
Net income		***57 054***	***119 692***

The comprehensive income of the company equals the net income.

BALANCE SHEET

Amounts in euro		2018-12-31	2017-12-31
	Note 1, 2		
Assets			
Long-term financial assets			
Loans granted to group companies	Note 5, 6	926 179 885	1 387 699 690
Current assets			
Loans granted to group companies	Note 5, 6	500 807 867	816 000
Income tax receivables		166 444	104 694
Prepaid expenses		13 103	13 397
Accrued income, group companies	Note 7	22 392 848	21 921 436
Cash and cash equivalents		2 148 081	1 205 289
Total current assets		525 528 343	24 060 816
Total assets		**1 451 708 228**	**1 411 760 506**
Liabilities and equity			
Equity	Note 9		
Restricted equity			
Share capital (500 000 shares)		5 547 358	5 547 358
Unrestricted equity			
Retained earnings		781 681	661 989
Net income		57 054	119 692
Total unrestricted equity		838 735	781 681
Total equity		**6 386 093**	**6 329 039**
Untaxed reserves			
Profit equalisation reserve		**540 911**	**495 850**
Liabilities			
Long-term liabilities			
Bond loans	Note 6,8	922 344 391	1 383 067 006
Short-term liabilities			
Bond loans		499 992 470	-
Accounts payable, parent company		813	837
Accounts payable, others		465	6 250
Current income tax liability		-	-
Accrued interest expenses		22 319 869	21 850 057
Other accrued expenses		123 216	11 467
Total short-term liabilities		522 436 833	21 868 611
Total liabilities		**1 444 781 224**	**1 404 935 617**
Total liabilities and equity		**1 451 708 228**	**1 411 760 506**

Cash-flow statement

Amounts in EUR	2018	2017
Operating activities		
Interest and other payments from parent company	52 416 539	54 846 478
Income taxes	-104 740	-115 313
Interest payments on bond loans	-52 034 184	-54 528 365
Payments to suppliers, remunerations to directors	-137 148	-108 039
Other interest income	-5 690	-13 811
Loan granted to group company	-	-5 500 000
Repayment of loans from parent company	816 000	-
Cash flow from operating activites	**950 777**	**-5 419 050**
Financing activities		
Issue of new shares	-	5 491 884
Cash flow from financing activities	**0**	**5 491 884**
Cash flow of the period	**950 777**	**72 834**
Opening cash balance	1 205 289	1 136 389
Currency difference in cash balance	-7 985	-3 934
Closing cash balance	**2 148 081**	**1 205 289**

REPORT ON CHANGES IN EQUITY

	Share capital	*Retained earnings*	*Net income*	*Total equity*
Amount 2017-01-01	55 474	510 145	151 844	717 463
Retained earnings		151 844	-151 844	0
Issue of new shares	5 491 884	0		0
Net income			119 692	119 692
Amount 2017-12-31	5 547 358	661 989	119 692	6 329 039
Amount 2018-01-01	5 547 358	661 989	119 692	6 329 039
Retained earnings		119 692	-119 692	0
Net income			57 054	57 054
Amount 2018-12-31	5 547 358	781 681	57 054	6 386 093

The shares have no nominal values and are fully paid.

NOTES

Note 1 Basis for the preparation of the report

The annual report is prepared in accordance with the Annual Accounts Act and recommendation number 2 from the Financial Reporting Council (RFR 2); Reporting for legal entities. RFR 2 obligates the company to apply International Financial Reporting Standards (IFRS) as adopted by the European Union, to the extent this is possible within the framework of the Annual Accounts Act and taking into account the connection between accounting and taxation. The recommendation indicates exceptions and additions that are needed in relation to IFRS.

The Annual report is based on the assumption of going concern during a forseeable future.

The functional currency is EUR which also is the reporting currency.

Note 2 Important accounting principles.

New and revised standards – applicable 1 january 2018:
None of the new applicable IFRS or IFRIC interpretations effective for the financial year starting 2018-01-01 has had any material impact of the annual report of the financial reports of the Company.

IFRS 9 "Financial instruments", addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: Amortized cost, fair value through OCI and fair value thrrough P&L. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. There is now a new expected credit losses model that replaces the incurred loss impairment model used in IAS 39. For financial liabilities there were no changes to classification and measurement except for the the recognition of changes in own credit risk in other comprehensive income, for liabilities designated at fair value throught profit or loss.
IFRS 9 relaxes the requirements for hedge effectiveness by replacing the bright line hedge effectiveness tests. It requires an economic relationship between the hedged item and hedging instrument and for the "hedged ratio" to be the same as the one management actually use for risk management purposes. Contemporaneous documentation is still required but is different to that currently preapred under IAS39. The company is subject to making allowances for expected credit losses. The estimated credit loss in PKO Finance AB is however not material, why such allowance is not presented.

The objective of IFRS 15 "Income for agreements with customers" is that company should report income in order to describe the transfer of agreed goods or services with an amount which reflects the remuneration which the company expect in exchange for these goods and services. The standard has not had any effect on the Company.

Set out below are new and amended standards and interpretations which have been published but comes into effect later than 2019-01-01
At the time of preparing the financial statements as of 31 December 2018 a number of standards and interpretations which are to take effect 2019 or later. None of these is expected to have a significant effect on the annual financial statements of PKO Finance AB, but are described in summary below anyway:

According to IFRS 16, "Lease agreements" the lesses should report assets and liabilites related to all leaseagreements with exception for leaseagreements with a term shorter than 12 months and/or agreements relating to lesser amounts. IFRS 16 replaces IAS 17 and applicable interpretations. The standard is applicable from 2019. The Company has no leased assets and is for this reason not affected.

There are no other IFRS-standards or IFRIC-interpretations which has no yet come into force that are expected to have a material impact on the statutory annual report of PKO Finance AB (publ).

The company is recognised as one business segment.

Foreign currency

Transactions in other currencies than EUR have been valued at the exchange rate which prevailed on the day of transaction. As at the reporting date all assets and liabilities denominated in other currencies than EUR have been valued using the exchange rate prevailing on the reporting date according to Oanda.
The following rates have been used :

	2018-12-31	2017-12-31
	EUR	EUR
1 SEK =	0,09728	0,10158
1 PLN =	0,23219	0,23926
1 USD =	0,87356	0,8347

Reporting of revenues and expenses

Interest income and expenses are reported in accordance with the effective interest method. Other revenues are reported at the time of earning and to the extent it is probable that the future economic benefits will be made available to the company and that the revenues can be estimated in a reliable way.

Valuation of assets and liabilites

Assets and liabilites are reported at aquision cost and nominal value respectively if nothing else is stated.

The loans granted to group companies and the bond loans have been reported in accordance with the effective interest method which means that the difference between discounted (recorded) value and the nominal values of the loan and the bond loan are amortized over the term of the respective loans. These amortizations are included in reported interest income/expenses which for this reason reflect the effective interest of the respective loans.

In those cases when it can be expected that the impairment exists, the value of the asset is decreased by an relevant amount of an impairment allowance.

Income tax

Reported income taxes include taxes that are to be paid or received relating to the reported period and adjustments regarding earlier periods. Tax-liabilities/receivables are valued at the amounts, that, in the opinion of the company are expected to be paid to or received from the tax office. Taxable income can differ from income before taxes as reported in the profit and loss statement as this income excludes revenues and expenses that are taxable or deductible in other periods and it also excludes revenues and expenses that permanently are non-taxable or deductible.
In accordance with RFR2 no deferred tax liability relating to the company's untaxed reserves is reported.

Share capital

Reported share capital corresponds to registered nominal value.

Estimation of fair value

Fair value of the loans granted to the parent company and of the bond loans have been calculated based on listed value on the Luxembourg and Zurich stock exchanges according to Bloomberg as at the reporting date.

Fair value of the loan granted to another group company than the parente company has been calculated based on that the reported value constitutes the best possible estimate of fair value, considering that the loan was granted shortly before the balance sheet date on arms-lenghts terms.

For other financial assets and liabilities it is the opinion of the company that the reported values constitue the best possible estimate of fair value, since these assets and liabilities are short-term and have high liquidity.

Estimations and assumptions

In preparing the report the company has made estimates and assumptions. Actual results may differ from these estimates. Estimates and assumptions are reviewed on an ongoing basis and recognized prospectively.
No estimations and assumptions which could result in material adjustements in reported values in the next reporting period was made during 2018.

Note 3 Other external expenses

	2018	2017
Audit fees KPMG	26 421	9 142
Remunerations to directors	25 206	20 068
Expenses, group companies	9 888	9 888
Administration fees	55 897	32 185
Other external fees	133 819	27 187
Bank fees	7 468	3 828
Total other external expenses	258 699	102 298

The remuneration paid to the Board of Directors in 2018 amounted to 23 687 and in 2017 to 18 757
As in 2017 there are two males and one female in the Board of Directors.
Other external fees include external legal and advisory fees.

Note 4 Reconciliation of effective tax

	2018	2018	2017	2017
	(%)		(%)	
Income before tax but after appropriations		86 795		152 595
Tax according to current tax rate	22,00%	19 095	22,00%	33 571
Non-decuctible expenses		10 370		0
Non-taxable income				-40
Flat-rate interest on profit equalisation reserve		356		332
Tax relating to earlier years				
Currency effects		-80		-960
Reported effective tax	34,27%	29 741	21,56%	32 903

Note 5 Loans granted to group companies

		2018-12-31	2017-12-31	2018-12-31	2017-12-31
Issued	*To be repaid*	*Currency of denomination*		*Reporting currency*	
2012-07-25	2022-07-25	€ 49 597 534	€ 49 484 534	49 597 534	49 484 534
2012-09-26	2022-09-26	$999 067 123	$998 817 123	872 714 351	833 674 215
2014-01-23	2019-01-23	€ 499 991 867	€ 499 856 941	499 991 867	499 856 941
2017-12-28	2023-12-25	€ 4 684 000	€ 5 500 000	4 684 000	5 500 000
Total				1 426 987 752	1 388 515 690

Note 6 Financial assets and liabilities - information according to IFRS 7

Information on fair values

	2018-12-31 Reported value	2018-12-31 Fair value	2017-12-31 Reported value	2017-12-31 Fair value
Loans to parent company incl. accrued interest income	1 444 695 625	1 463 240 131	1 404 915 100	1 477 079 427
Loans to other group companies incl. accrued interest income	4 684 976	4 666 419	5 500 382	5 500 382
Accrued administrative fee, parent company	0	0	21 644	21 644
Cash and cash equivalents	2 148 081	2 148 081	1 205 289	1 205 289
Bond loans incl. accrued interest expenses	1 444 656 730	1 463 168 128	1 404 917 063	1 477 030 061

Book values are reasonable approximations of fair values in the cases where no fair values are reported for financial instruments above since their terms are short. The information above that relates to Loans and Bond Loans belongs to level 1 in the fair-value hierarchy and have been valued to the latest market value noted on the Luxembourg stock exchange. The Loans to the Parent company are valued at the same value since the parent company loans are pledged as security for the bond loans. The fair value for the loan to the other group company PKO Leasing Sverige AB is estimated using yield curve and margin model.

Structure of maturity for financial debts

	Book value 2018-12-31	Maturities up to one year	Maturities between one and five years	Maturities over five years
Loans to group companies	1 426 987 752	500 807 867	926 179 885	-
Bond loans	1 422 336 861	499 992 470	922 344 391	-

	Book value 2017-12-31	Maturities up to one year	Maturities between one and five years	Maturities over five years
Loans to group companies	1 388 515 690	816 000	1 386 279 690	1 420 000
Bond loans	1 383 067 006	-	1 383 067 006	-

The amounts relate to contractual non-discounted payments.

For other information concerning risks in financial instruments please refer to the Management report under "Risks and Uncertainties".

Note 7 Accrued income, group companies

	2018-12-31	2017-12-31
Accrued interest income	22 392 848	21 899 792
Accrued administrative fee income	0	21 644
Total accrued income, group companies	22 392 848	21 921 436

Note 8 Bond loans

Issued	*Due for repayment*	2018-12-31 *Currency of denomination*	2017-12-31 *Currency of denomination*	2018-12-31 *Reporting currency (EUR)*	2017-12-31 *Reporting currency (EUR)*
2012-07-25	2022-07-25	€ 49 599 315	€ 49 486 815	49 599 315	49 486 815
2012-09-26	2022-09-26	$998 771 073	$998 771 073	872 745 076	833 712 653
2014-01-23	2019-01-23	€ 499 992 470	€ 499 867 538	499 992 470	499 867 538
Total				1 422 336 861	1 383 067 006

Note 9 Parent company

The company is a wholly-owned subsidiary of Powszechna Kasa Oszczednosci Bank Polski Spólka Akcyjna, Warsaw, Poland with corporate identity number 525-000-77-38.

Note 10 Related party transactions

	2018	2017
Cash flow items		
Interest and other payments from parent company	52 416 539	54 846 478
Loan granted to group company	-	-5 500 000
Repayment of loans from group companies	816 000	
Issue of new shares	-	5 491 884
Balance sheet items		
Loans granted to group companies - current assets	500 807 867	816 000
Accounts payable, parent company	813	837
Loans granted to group companies - long term financial assets	926 179 885	1 387 699 690
Accrued income, group companies	22 392 848	21 921 436
Profit-and loss items		
Interest income, group companies	53 492 330	55 356 805
Administration and commission revenues	181 128	248 716
Remunerations to parent company	9 888	9 888

Note 11 Proposal for appropriation of profits

		2018	2017
The following profit is to be appropriated by the Annual General Meeting of Shareholders			
Retained earnings	EUR	781 681	661 989
The profit of the year	EUR	57 054	119 692
Total profit of the year and retained earnings	EUR	838 735	781 681
The Board of Directors proposes that the profit is appropriated as follows:			
Distributed as dividend to the share holder	EUR -		-
To be carried forward	EUR	838 735	781 681
	EUR	838 735	781 681

Note 12 Pledged assets and contingent liabilities

		2018-12-31	2017-12-31
Pledged assets			
Loans, group companies	EUR	1 444 695 625	1 404 050 145
Contingent liabilities			
Other	EUR	62 384 456	55 310 610

In the beginning of 2018 it was discovered that a strict application of current income tax rules for companies with EUR as their reporting currency, possibly could have the effect that the fluctuations of the exchange rates SEK/EUR during the period between the disbursements and repayments of the intergroup loans are differently taxed than if the same loans had been made by a company with SEK as reporting currency. In the opinion of the company such different tax treatment is however not probable since it would be in violation with the purpose of applicable EU-legislation. The company has asked for a tax ruling regarding this matter.
The reported value represents potential tax on currency effects of repayment of loans.
The capital gain has been calculated based on the exchange rate at the reporting date or at the repayment date compared to the currency rate at the date of the loan disbursment. The loans have been made to group companies, mostly to the parent company.
Taking into account that the potential future tax effect depends on the development of exchange rates information of the exposures have been reported as contingent liabilities based on the fact that it is unlikely that the tax effect will be realized. The parent company has issued a Gurantee for share capital cover to the company.

Note 13 Events subsequent to the end of the financial year

In January 2019 the EUR 500 000 000 loan was repaid by the parent company and the EUR 500 000 000 bond loan was repaid to the bondholders.

Stockholm 2019-02-15

Artur Osytek
Chairman

Magnus Sundström
Managing Director

Iwona Jankowska
Board Member

Our audit report was issued 2019-02-19
KPMG AB

Tobias Palmgren
Authorized auditor