

PKO Finance AB (publ)

Annual report for the period 2016-01-01 - 2016-12-31

(CID 556693-7461)

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This document is a translation of a document originally issued in Swedish. The only binding version is the original Swedish version.

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 directly 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 Securities 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 loan is due for repayment in 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).

The financial year

In July 2016 the loan of MCHF 250 was repaid and the proceeds were used to repay the bond loans with the same amount.

The change in total assets compared to 2015 is related to the repayment of the loan as mentioned above. The change in interest income has been affected by the abovementioned repayment but also by the strengthening of the USD and CHF against EUR.

The company has not had any employees.

Multiyear review (KEUR)

	2016	2015	2014	2013
Interest income	61 330	101 606	95 750	85 714
Income before taxes	259	577	545	424
Equity	717	831	762	687
Total assets	1 521 213	1 721 350	2 825 007	2 204 490

Risks and uncertainties

Market risk

The loans granted to the parent company and that constitute the main assets of the company 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 only 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.

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.

Events subsequent to the end of the year of reporting

No material events have occurred after the end of the reporting year.

Proposal for appropriation of profits

The following profit is to be appropriated by the Annual General Meeting of Shareholders

Retained earnings	EUR	510 145
The profit of the year	EUR	<u>151 844</u>
Total profit of the year and retained earnings	EUR	661 989

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

To be carried forward	EUR	661 989
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PROFIT AND LOSS STATEMENT

Amounts in euro.	Note 1,2	2016	2015
Administration and commission revenues from the parent company		347 290	529 192
Other external expenses	Note 3	-99 510	-119 419
Operating income		247 780	409 773
Financial items			
Interest income, loans to parent company		61 329 640	101 606 101
Interest expenses, bond loans		-61 309 099	-101 439 113
Net currency effects		-9 168	559
Income before taxes		259 153	577 320
Appropriation to profit equalisation reserve		-64 644	-147 825
Current tax expense	Note 4	-42 665	-97 564
Net income		151 844	331 931

The comprehensive income of the company equals the net income.

BALANCE SHEET

Note 1, 2

Amounts in euro		2016-12-31	2015-12-31
Assets			
<i>Long-term financial assets</i>			
Loans granted to parent company	Note 5, 6	1 496 697 584	1 462 410 331
<i>Current assets</i>			
Loans granted to parent company	Note 5, 6	-	230 783 432
Receivables, parent company		792	825
Income tax receivables		32 202	-
Prepaid expenses		13 521	14 045
Accrued income, parent company	Note 7	23 332 636	26 899 241
Cash and cash equivalents		<u>1 136 389</u>	<u>1 241 674</u>
<i>Total current assets</i>		24 515 540	258 939 217
Total assets		1 521 213 124	1 721 349 548
Liabilities and equity			
Equity			
Note 9			
<i>Restricted equity</i>			
Share capital (5 000 shares)		55 474	55 474
<i>Unrestricted equity</i>			
Retained earnings		510 145	443 759
Net income		<u>151 844</u>	<u>331 931</u>
<i>Total unrestricted equity</i>		661 989	775 690
Total equity		717 463	831 164
Untaxed reserves			
Profit equalisation reserve		439 810	375 168
Liabilities			
<i>Long-term liabilities</i>			
Bond loans	Note 6,8	1 496 767 108	1 462 498 112
<i>Short-term liabilities</i>			
Bond loans		-	230 785 797
Accounts payable, parent company		792	1 649
Accounts payable, others		-	4 300
Current income tax liability		-	14 866
Accrued interest expenses		23 258 374	26 814 812
Other accrued expenses		<u>29 577</u>	<u>23 680</u>
<i>Total short-term liabilities</i>		23 288 743	257 645 104
Total liabilities		1 520 055 851	1 720 143 216
Total liabilities and equity		1 521 213 124	1 721 349 548

Cash-flow statement

Amounts in EUR	2016	2015
Operating activities		
Interest and other payments from parent company	63 516 839	106 095 390
Income taxes	-95 514	-180 715
Interest payments on bond loans	-63 161 905	-105 493 628
Payments to suppliers, remunerations to directors	-92 952	-98 716
Repayment of loans from parent company	230 982 500	1 215 660 000
Cash flow from operating activities	231 148 968	1 215 982 331
Investing activities	-	-
Financing activities		
Dividend	-265 545	-262 857
Repayment of bond loans	-230 982 500	-1 215 660 000
Cash flow from financing activities	-231 248 045	-1 215 922 857
Cash flow of the period	-99 077	59 474
Opening cash balance	1 241 674	1 179 282
Currency difference in cash balance	-6 208	2 918
Closing cash balance	1 136 389	1 241 674

REPORT ON CHANGES IN EQUITY

	<i>Share capital</i>	<i>Retained earnings</i>	<i>Net income</i>	<i>Total equity</i>
Amount 2015-01-01	55 474	378 045	328 571	762 090
Retained earnings		328 571	-328 571	0
Dividend (EUR 50,70 per share)		-262 857		-262 857
Net income			331 931	331 931
Amount 2015-12-31	55 474	443 759	331 931	831 164
Amount 2016-01-01	55 474	443 759	331 931	831 164
Retained earnings		331 931	-331 931	0
Dividend (EUR 53,11 per share)		-265 545		-265 545
Net income			151 844	151 844
Amount 2016-12-31	55 474	510 145	151 844	717 463

The shares have no nominal values and are fully paid. The number of shares (5 000) is unchanged since 2014-01-01.

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 foreseeable future.

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

Note 2 Important accounting principles.

None of the standards, changes and interpretations that entered into force after January 1, 2016 have had any material impact on the financial reports. None of the IFRS or IFRIC-interpretations that have not yet entered into force are expected to have any material impact on the company.

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 :

	2016-12-31	2015-12-31
	EUR	EUR
1 SEK =	0,1044	0,10904
1 CHF =	0,93115	0,92346
1 PLN =	0,2264	0,23558
1 USD =	0,94901	0,91516

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 liabilities

Assets and liabilities are reported at acquisition cost and nominal value respectively if nothing else is stated.

The loans granted to the parent company 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 parent company 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.

For other financial assets and liabilities it is the opinion of the company that the reported values constitute 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 adjustments in reported values in the next reporting period was made during 2016.

Note 3 Other external expenses

	<u>2016</u>	<u>2015</u>
Audit fees KPMG	11 070	17 068
Remunerations to directors	17 970	17 441
Expenses, group companies	9 593	16 681
Administration fees	48 696	49 110
Other external fees	8 502	12 066
Bank fees	<u>3 679</u>	<u>7 053</u>
<i>Total other external expenses</i>	99 510	119 419

The remuneration paid to the Board of Directors in 2016 amounted to 16 992 and in 2015 to 17 103.
As in 2015 there are two males and one female in the Board of Directors.

Note 4 Reconciliation of effective tax

	<u>2016</u>	<u>2016</u>	<u>2015</u>	<u>2015</u>
	(%)		(%)	
Income before tax but after appropriations		194 509		429 495
Tax according to current tax rate	22,00%	42 792	22,00%	94 489
Non-deductible expenses				435
Non-taxable income				-4
Flat-rate interest on profit equalisation reserve		380		336
Tax relating to earlier years				
Currency effects		-507		2 308
Reported effective tax	21,93%	42 665	22,72%	97 564

Note 5 Loans granted to parent company

<i>Issued</i>	<i>To be repaid</i>	<u>2016-12-31</u>	<u>2015-12-31</u>	<u>2016-12-31</u>	<u>2015-12-31</u>
		<i>Currency of denomination</i>		<i>Reporting currency</i>	
2011-07-07	2016-07-07	-	249 911 672 CHF	-	230 783 432
2012-07-25	2022-07-25	€ 49 371 534	€ 49 258 225	49 371 534	49 258 225
2012-09-26	2022-09-26	\$998 567 123	\$998 257 558	947 604 035	913 565 386
2014-01-23	2019-01-23	€ 499 722 015	€ 499 586 720	<u>499 722 015</u>	<u>499 586 720</u>
Total				1 496 697 584	1 693 193 763

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

Information on fair values

	2016-12-31	2016-12-31	2015-12-31	2015-12-31
	Reported value	Fair value	Reported value	Fair value
Loans to parent company incl. accrued interest income	1 519 955 958	1 575 221 550	1 720 008 575	1 784 607 710
Accrued administrative fee, parent company	74 262	74 262	84 428	84 428
Cash and cash equivalents	1 136 389	1 136 389	1 241 674	1 241 674
Bond loans incl. accrued interest expenses	1 520 025 482	1 575 221 550	1 720 098 721	1 784 607 710

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 and Zurich stock exchanges. The Loans are valued at the same value since the parent company loans are pledged as security for the bond loans.

Structure of maturity for financial debts

	Book value 2016-12-31	Maturities up to one year	Maturities between one and five years	Maturities over five years
Loans to the parent company	1 496 697 584	-	499 722 015	996 975 569
Bond loans	1 496 767 108	-	499 742 607	997 024 501

	Book value 2015-12-31	Maturities up to one year	Maturities between one and five years	Maturities over five years
Loans to the parent company	1 693 193 763	230 783 432	499 586 720	962 823 611
Bond loans	1 693 283 909	230 785 797	499 617 333	962 880 779

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, parent company

	2016-12-31	2015-12-31
Accrued interest income	23 258 374	26 814 812
Accrued administrative fee income	74 262	84 429
<i>Total accrued income, parent company</i>	23 332 636	26 899 241

Note 8 Bond loans

<i>Issued</i>	<i>Due for repayment</i>	2016-12-31	2015-12-31	2016-12-31	2015-12-31
		<i>Currency of denomination</i>		<i>Reporting currency (EUR)</i>	
2011-07-07	2016-07-07	-	249 914 392 CHF	-	230 785 797
2012-07-25	2022-07-25	€ 49 374 315	€ 49 261 507	49 374 315	49 261 507
2012-09-26	2022-09-26	\$998 567 123	\$998 316 438	947 650 186	913 619 272
2014-01-23	2019-01-23	€ 499 742 607	€ 499 617 333	<u>499 742 607</u>	<u>499 617 333</u>
Total				1 496 767 108	1 693 283 909

Note 9 Parent company

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

Note 10 Related party transactions

	<u>2016</u>	<u>2015</u>
<i>Cash flow items</i>		
Interest and other payments from parent company	63 516 839	106 095 390
Repayment of loans, parent company	230 982 500	1 215 660 000
Dividend	-265 545	-262 857
<i>Balance sheet items</i>		
Receivables, parent company	792	825
Accounts payable, parent company	792	1 649
Loans, parent company	1 496 697 584	1 693 193 763
Accrued income, parent company	23 332 636	26 899 241
<i>Profit-and loss items</i>		
Interest income, parent company	61 329 640	101 606 101
Administration and commission revenues the parent company	347 290	529 182
Remunerations to other group companies	9 593	16 681

Note 11 Proposal for appropriation of profits

The following profit is to be appropriated by the Annual General Meeting of Shareholders		<u>2016</u>	<u>2015</u>
Retained earnings	EUR	510 145	443 759
The profit of the year	EUR	<u>151 844</u>	<u>331 931</u>
Total profit of the year and retained earnings	EUR	661 989	775 690

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

Distributed as dividend to the share holder	EUR	0	265 545
To be carried forward	EUR	<u>661 989</u>	<u>510 145</u>
	EUR	661 989	775 690

Note 12 Pledged assets and contingent liabilities

	2016-12-31	2015-12-31
Pledged assets		
Loan parent company	1 519 955 958	1 720 008 575
Contingent liabilities	None	None

Note 13 Events subsequent to the end of the financial year

There have been no significant events.

Stockholm 2017-02-10

Artur Osytek
Chairman

Magnus Sundström
Managing Director

Iwona Jankowska
Board Member

Our audit report was issued 2017-02-17
KPMG AB

Tobias Palmgren
Authorized auditor