AUDIT OF BANKS’ ANNUAL FINANCIAL STATEMENTS

All the domestic commercial banks’ financial statements for 2008 were duly audited by independent auditors. Annual financial statements of all the banks were given unqualified audit opinions.

Pursuant to Article 61(4) of the Law on Banks of the Republic of Lithuania, banks have to publish annual financial statements and auditor’s report within 4 months after the end of the financial year.

BANKS’ OPERATIONS

The growth rate of the banking system in 2008 was the lowest in a few recent years. Q4 was especially taut for the banking system as a decrease was registered both in client deposits with banks and banks’ assets.

According to the audited financial statements as for 1 January 2009, total assets of operating domestic commercial banks and foreign bank branches1 made up LTL 89.7 billion, a year on year increase of LTL 8.8 billion or 10.8 per cent (37.5 per cent in 2007). Total loans granted to customers amounted to LTL 71.4 billion, increasing year on year by LTL 11.3 billion or 18.8 per cent. (43.9 per cent in 2007). Deposits with banks made up LTL 38.2 billion a year-on-year decrease of LTL 1.9 billion or 4.7 per cent. (23.4 per cent in 2007). Deposits declined as a result of an LTL 2.5 billion or 19.3 per cent decrease in private enterprises' deposits and a fall of LTL 1.2 billion, nearly by a half, in deposits of government and local government enterprises. Meanwhile, despite of a slump in Q4 individual deposits grew over the year by LTL 1.5 billion or 6.4 per cent (in 2007 the growth was 26.8 per cent).

1The concept of the banking system and operating domestic commercial banks includes all commercial banks and foreign bank branches in operation during the period under review.

Dynamics of some assets and liabilities items in the banking system
LTL million

Ref. No.	Balance sheet item	2008-01-01	2009-01-01	Change year on year (%)
1	Assets	80,990.3	8,9749.2	10.8
2	Debt securities	7,400.6	5,971.5	−19.3
3	Loans to customers	60,114.1	71,440.9	18.8
3.1	to financial institutions	3,367.9	3,890.5	15.5
3.2	to private enterprises	32,032.8	37,342.6	16.6
3.3	to individuals	23,722.1	28,601.6	20.6
3.3.1	housing loans	16,651.8	20,772.4	24.7
4	Loan impairment	449.6	870.9	93.7
4.1	Loan impairment/ granted loans, %	0.74	1.2	–
5	Deposits and letters of credit	40,108.9	38,231.3	−4.7
5.1	by financial institutions	1,006.1	1,227.4	22.0
5.2	by private companies	13,145.0	10,605.8	−19.3
5.3	by individuals	22,677.7	24,138.6	6.4
6	Shareholders’ equity	5,946.0	6,778.9	14.0
7	Current year profit	1,156.1	867.3	−25.0

In 2008 the concentration of three largest banks in key markets in 2008 continued to decrease as before, while a share of their market was taken by foreign bank branches. Over the year, the asset market share of the three largest banks declined from 2 to 65.5 per cent. The concentration of banks that have occupied the largest share of loans and deposits market in 2008 went down respectively by 3.7 percentage points to 66.5 per cent and 3.8 percentage points to 66.1 per cent.

Notwithstanding a lower credit growth rate and decelerating growth of banking assets, the credit share in the asset structure kept growing further in 2008. Over the year the credit share in the assets structure grew by 5.4 percentage points to 79.6 per cent. Banks’ investments into securities have been gradually decreasing since the end of 2007 throughout entire 2008. The banks' holdings of debt securities and equities declined by LTL 1.5 billion with their share in the banks' assets structure decreasing by 2.7 per cent.

Lithuania-operating banks would concentrate their activities in 2008 within the local market – assets invested by banks in Lithuania increased over the year by LTL 10.1 billion, while foreign investments decreased by LTL 1.3 billion. Nonetheless, the major share of the banks' assets is in foreign currency-denominated asset and it continues to grow. Over the year, the asset share in foreign currencies grew from 57.3 to 64.5 per cent.

In 2008, with deposits going down regardless of continued growth of loans, banks have financed their activities by borrowing in the interbank market. Holdings of parent banks and other banks within the group of the parent bank went up during the year by LTL 10.7 billion to reach 38.4 billion on 1 January 2009 or 46.3 per cent of total liabilities. Such structure of liabilities was the result for non-resident share within the banks' liabilities went up from 45.3 to 52.2 per cent.

BANK LOANS' PORTFOLIO

In 2008, banking system's loan portfolio gain was the lowest in recent three years. As mentioned above, the loan portfolio for 2008 grew by LTL 11.3 billion (18.8 per cent), a slump of LTL 7.0 billion compared to 2007. The loan portfolio growth decelerated markedly in Q1 last year with the banks' loan portfolio decreasing by LTL 0.7 billion in December. The deceleration was largely driven by shrinking loan flow to private enterprises and special provisions that have been made.

In 2008, the loan distribution among businesses and households was very much similar to that in the previous year between businesses and households making up respectively LTL 5.3 billion and LTL 4.9 billion. However, unlike in previous periods, loans to central government institutions was higher (LTL 0.6 billion). On 1 January 2009, loans to private enterprises accounted for 52.3 per cent of the portfolio of loans to banks' clients, while loans to individuals accounted for 40.0 per cent (of which lending for house purchase accounted for 29.1 per cent of the banks' loan portfolio).

The growth of interest rates on litas loans supported continued growth of lending in foreign currencies, the trend that began in the second half of 2007: the amount of loans in foreign currency grew by LTL 12.7 billion in 2008, while the amount of loans in litas declined by LTL 1.4 billion. On 1 January 2009, loans in national currency accounted for 35.4 per cent of the loan portfolio, i.e. a decrease of 9.0 percentage point year on year

As a result a slowdown in the country's economic growth and banks' more conservative attitude towards credit risk assessment with respect to connected borrowers four major indicators that show the quality of banking loan portfolio deteriorated during the course of 2008. The loan impairment (special provisions) to loan portfolio ration climbed (deteriorated) over the year from 0.74 to 1.2 per cent, while the loans with initial payments overdue for 60 days and more to total loan portfolio ratio went up over the year from 1.03 to 1.14 per cent.

The impaired loans to loan portfolio ratio increased over the year from 1.52 to 3.41 per cent, and the non-performing (impaired loans and loans with initial payments overdue for more than 60 days) went up from 2.55 to 4.55 per cent.

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

Notwithstanding continued turmoil in the global financial markets that caused problems for attracting funds and boosted borrowing costs, the Lithuanian banks' liquidity ratio remained quite stable throughout 2008 and a little bit higher than the required ratio. As of 1 January 2009, the banking system's liquidity ratio was 39.02 per cent which was nearly 9 percentage points above the minimal ratio set by the Bank of Lithuania. Over the year, current liabilities of the banking system rose by LTL 2 billion and liquid assets declined by LTL 1 billion accounting for 19 per cent of total assets. As of 1 January 2009, 85.8 per cent of the banking system's assets were under control of banks managed by parent institutions.

Capital base used to calculate the banking system's capital requirement grew by LTL 1 billion LTL 1 billion to

LTL 7.2 billion on 1 January 2009. The growth of capital base, excluding authorised capital increase by extra contributions cases, was driven by banks received loans as well as inclusion of subordinated loans and including the audited current year profit into Tier I capital. Capital adequacy ratio grew over the year by 2 percentage points, from 10.9 to 12.90 per cent. (the minimum required ratio is 8 %).

Over the year, capital need for covering market risk climbed by LTL 157 million to LTL 4.8 billion. The largest share of capital requirement (LTL 4.1 billion) was made of capital allocations for mitigating credit risk (alongside with the capital requirement for transitional period). Meanwhile, capital allocations for mitigating market and operational risks amounted respectively to LTL 170 million and LTL 277.6 million.

All banks were in compliance with the prudential requirements set by the Bank of Lithuania.

SHAREHOLDERS' EQUITY

Bank (less foreign bank branches) shareholders' equity increased in 2008 by LTL 858 million (14.5%) to LTL 6.8 billion on 1 January 2009. In 2008, the growth of shareholders' equity was driven by earnings that made up LTL 875 million, and contained by an LTL 44 million impairment of banks' financial assets (securities) available for sale.

The authorised registered (share) capital of the banking system went up in 2008 by LTL 431 million LTL 3.5 billion on 1 January 2009. In 2008, 5 out of 9 banks registered increase of their authorised capital.

Over the year, the non-residents-controlled share of authorised capital fell by 2.5 percentage point to 85.1 percent of the authorised capital on 1 January 2009. As before, the Lithuanian banking system was dominated by Scandinavian capital.

A few banks have drawn on the Bank of Lithuania resolution of 6 November 2008 „On amending accounting policy to implement the European Commission's Regulation of 15 October 2008 adopting amendments to IAS 39 and IFRS 7 on reclassification of financial assets out of category of „traded" and „held-for-trading" into category „loans" and „amounts receivable" or „assets held until maturity". After assets reclassification the revaluation reserve of assets in category „traded" grew by LTL 209 million which had an effect on the capital base of the banking system.

PROFITABILITY AND BUSINESS EFFICIENCY

The audited annual financial statements of banks showed 7 domestic banks and 2 foreign bank branches earned profit in 2008, whereas 2 banks and 5 foreign bank branches carried losses. Total earnings of the domestic banks in 2008 was lower than in 2007, at LTL 867.3 million. All the banks' profit was earned in the first three months of the year, while the banking system ended Q4 2008 in red (loss made up LTL 171.1 million).

Profit of Operating Banks
LTL million

Ref. No.	Bank	Profit
1.	AB DnB NORD bankas	70,7
2.	AB Ukio bankas	57,4
3.	AB SEB bankas	347,7
4.	AB bankas FINASTA	–3,9
5.	AB Siauliu bankas	17,5
6.	AB bank SNORAS	22,0
7.	UAB Medicinos bankas	6,0
8.	AB PAREX BANKAS	–23,5
9.	Swedbank, AB	381,1
	TOTAL (banks):	**875,0**
10.	AS "UniCredit Bank", Lithuanian branch	4,0
11.	MP Investment Bank hf., Baltic branch	–3,4
12.	Branch of Balti Investeeringute Grupi Pank AS	–0,6

Ref. No.	Bank	Profit
13.	Allied Irish Banks, p.l.c., Lithuanian branch	–4,0
14.	Danske Bank A/S, Lithuanian branch	–17,3
15.	Skandinavska Enskilda Banken AB, Vilnius branch	–3,9
16.	Nordea Bank Finland Plc, Lithuanian branch	17,4
	Total (foreign bank branches):	**–7,7**
	TOTAL:	**867,3**

Net interest income that was the major driving force for the banking system profitability in 2008 made up LTL 341.9 million, an increase of 21 per cent compared to 2007. Net interest income growth was affected by income interest which increased faster than interest expenses, as well as decelerating loan portfolio growth rate.

Net income from services and commissions made up LTL 44.2 million, an increase of 6.8 per cent compared to 2007. The net result of the banks' operations was strongly influenced by income of one-off nature, received from subsidiaries as dividends or from the sale of those subsidiaries. Total income of this type amounted to LTL 135 million in 2008.

The result of the banks' operations worsened in 2008 largely due to impairment of loans, which grew significantly in recent period, and provisions for off-balance items. The banks' losses due to a decline in value and specific provisions were LTL 483.3 million, five times higher compared to 2007. Operational expenses of banks grew by LTL 130.9 million or 12.2 per cent over the year. Major share of operational expenses accounted for staff costs which hiked 11.2 per cent over the year.

Due to unfavourable situation in the global capital and money markets, the share of banks-held commercial equity and debt securities-related instruments and associated financial derivatives were loss-generating; consequently, banks' income from financial instruments was lower by LTL 130 million year on year.

The decline in banks' earnings led to a significant decrease in many profitability and operational efficiency indicators of banks over the year. Both indicators, return on equity (ROE) and return on assets, worsened in all the banks if compared to 1 January 2008. As of 1 January 2009, the banking system's ROE declined by 12.4 percentage points, from 25.9 per cent to 13.5 per cent, while ROA fell by 0.7 percentage points, from 1.71 per cent to 1.01 per cent.

Last year, the turmoil in the global financial markets pushed the recourse borrowing costs up leading to the growth of interest expenses on interest paying liabilities by 1.1 percentage points to 3.91 per cent. Meanwhile, the income on interest generating assets was growing slower as a result of a decrease in real interest margin by almost 0.8 percentage point to 2.07 per cent.

CENTRAL CREDIT UNION OF LITHUANIA

In 2008, assets held by the Central Credit Union of Lithuania declined by LTL 4.3 million or 3 per cent, to LTL 137.3 million on 1 January 2009 .

This was due to a fall of deposits in Q4 2008 of credit union members, the main source of financing of the CCUL. Most of the CCUL members are farmers' credit unions the cash flows of which depend on seasonal factor and timely payments for agricultural output.

In 2008, the CCUL's loan portfolio grew by 65.7 per cent to LTL 81.7 million. Its quality remains good. No impairment losses regarding regular payments overdue by more than 60 days have been registered by the CCUL as of 1 January 2007.

In 2008, the CCUL helped solving short-term liquidity problems of eleven credit unions by granting liquidity loans, whereas in 2007 loans to support liquidity were granted to three unions. According to the data as of 1 January 2009, ten credit unions have drawn on liquidity loans.

As the volume of credit union operations expanded, the Liquidity Maintenance Reserve formed of the contributions by the CCUL members, as well as Stabilization Fund, increased on 1 January 2009 to LTL 5.7 million and LTL 3.9 million.

According to the audited financial statements, the CCUL‘s earnings made up in 2008 LTL 599 thousand, a decline of 16.1 per cent compared to 2007 (LTL 714 thousand).

In 2008, the CCUL complied with all prudential requirements set by the Bank of Lithuania.

OPERATIONS OF CREDIT UNIONS

On 1 January 2009, there were 67 credit unions in Lithuania, which had almost 96 thousand members.

Development of credit union system’s assets and liabilities item
LTL million

Ref. No.	Balance sheet item	2008-01-01	2009-01-01	Change year on year (%)
1.	Assets	655,2	794,8	21,3
2.	T-bonds	20,7	23,3	12,5
3.	Loans granted	455,3	591,9	30,0
4.	Specific provisions on loans	1,6	5,2	3.1 times
5.	Deposits	518,2	596,1	15,0
	Of which, by members and associated members of credit unions	512,8	591,1	15,3
6.	Share capital	67,9	92,5	36,1
7.	Profit (loss) for current year	2,7	0,7	–

Credit unions further expanded their activities last year. In 2008:
- assets increased by 21.3 per cent and on 1 January 2009 made up 0.89 per cent of total assets of operating banks. The assets of Panevėžys credit union, the largest one, made up almost LTL 79 million on 1 January 2009, and accounted for 10 per cent of total assets of all credit unions.
- granted loans increased by 30 per cent to 74 per cent of total assets. on 1 January 2009, special provisions for loans (LTL 5.2 million) were made by 53 credit unions;
- investments in Government securities increased by 12.5 per cent;
- deposits grew by 15 per cent, of which the largest share (99%) accounted for the deposits of their members;
- the share capital of credit unions grew by 36.1 per cent.

In 2008, 47 credit unions were operating profitably, while 20 credit unions were in red.

According to the statements checked by credit union inspectors (independent auditors) and approved by general meetings of the members, the earnings of credit unions made up 0.7 million in 2008 .

As in previous years, interest income was the main source of income for credit unions, accounting for 89 per cent of total income. Interest and operating expenses accounted for the largest share of expenses, 486 per cent and 34.8 per cent, respectively.