AUDIT OF BANK ANNUAL FINANCIAL STATEMENTS

The audit of 2007 financial statements in all commercial banks was conducted by independent audit companies. The auditors expressed unqualified opinions in respect to the financial statements of all banks.

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

BANK OPERATIONS

According to the audited financial statements for 1 January 2008, total assets of operating domestic commercial banks and foreign bank branches made up LTL 81 billion, increasing over the year by LTL 22.1 billion, i.e. 37.5 per cent (the increase in 2006 made up 31.4 per cent). Total loans granted to customers amounted to LTL 56.7 billion, increasing year on year by LTL 18.1 billion, or 46.9 per cent (48.9 per cent in 2006).

Deposits held with domestic banks totalled LTL 37.1 billion on 1 January 2008, increasing over the year by LTL 6.9 billion or 22.6 per cent (20.5 per cent in 2006), of which deposits of individuals made up LTL 22.7 billion, up by LTL 4.8 billion or 26.8 per cent over the year (30 per cent in 2006).

Dynamics of some asset and liability items in the banking system

No.	Balance sheet item	Amount (LTL million) 01 01 2007	Amount (LTL million) 01 01 2008	Change year-on-year (%)
1	Assets	58,913.6	80,990.3	37.5
2	Government securities	4,966	3,547.2	–28.6
3	Other debt securities	1,773.5	3,840.9	2.2 times
4	Loans to financial institutions	3,120.7	3,277.2	5
5	Loans to customers	38,641.1	56,746.2	46.9
5.1	Of which, loans to private companies	22,307	30,843.1	38.3
5.2	Of which, loans to individuals	14,712.9	23,562.6	60.1
5.2.1	Of which, housing loans	10,317.9	16,674	61.6
6	Loan impairment	374.3	449.6	20.1
6.1	Loan impairment/ granted loans, %	0.97	0.79	–
7	Deposits and letters of credit	30,297.9	37,152.4	22.6
7.1	Of which, by private companies	10,509.3	12,344.5	17.5
7.2	Of which, by individuals	17,879.1	22,678.4	26.8
8	Shareholders' equity	4,141.6	5,911.5	42.7
9	Profit (loss) for current year	667	1,156.1	–

With the competition in the banking system getting stronger, the downward trend in the concentration of the banking sector was observed in various market segments. Over the year, the market share of the three largest banks (AB SEB bankas, AB bankas Hansabankas and AB DnB NORD bankas) contracted from 69 per cent to 67.6 per cent. The marked share losses of AB SEB bankas were the largest, with its share contracting over the year by1.87 percentage points. Among the banks that increased their market share the most, Nordea Bank Finland Plc Lithuania branch was the most prominent, with the market share increase of 1.44 percentage points.

Investment in the domestic market remains among the priorities of the banks. Bank assets in Lithuania increased by LTL 19.8 billion, while foreign assets grew by LTL 2.3 billion over the year. The share of bank assets of non–residents declined over the year from 16.5 per cent to 14.8 per cent.

In the course of the year, the debt to banks and other credit and financial institutions grew by LTL 11 billion or 57.6 per cent. These funds were used to finance 50 per cent of the bank asset growth. The funds attracted from parent banks prevailed among the above–mentioned financial resources. They increased by LTL 5.7 over the year and made up LTL 17 billion on 1 January 2008. In addition, some banks also borrowed from other banks of the parent bank group. The borrowing by domestic banks from parent banks is in most cases more expensive than the average price of funds attracted in the domestic market. The funds of non–residents (including investment into capital) were used to finance 56 per cent of the bank asset growth.

BANK LOAN PORTFOLIO

The growth of the bank loan portfolio in 2007 remained strong, however, certain deceleration trends were observed in the last quarter of the year.

The annual rate of growth of the portfolio of loans granted to customers declined from 48.9 per cent on 1 January 2007 to 46.9 per cent on 1 January 2008.

According to the data of 1 January 2008, the loan portfolio of Lithuanian banks (including loans to financial institutions) accounted for 62.1 per cent of Lithuania's GDP in 2007. Lithuania is still behind its neighbouring countries both according to the rate of growth of the loan–to–GDP ratio and according to other comparative loan portfolio indicators. Bank loans made up around 106.2 per cent of GDP in Latvia, and approximately 98.3 per cent in Estonia.

An increasing number of signs emerge that allow assuming that the further development of the loan market may be less rapid. The forecast of a slowdown in growth rates of the bank loan portfolio is also supported by the bank crediting liabilities growing at slower rates than the loan portfolio. Their volume declined by LTL 0.9 billion in the last quarter of the previous year.

Domestic banks have been granting loans more cautiously for some time already and have tightened the conditions for the granting of loans. The requirements for the loan collateral and the residual income of the borrower after loan servicing were tightened.

The growth of the bank loan portfolio has been quite balanced for several consecutive years: new loans spread almost evenly among businesses and households. Unlike earlier, the largest share of loans was granted to individuals (LTL 8.8 billion) and, to a slightly lesser extent, to private enterprises (LTL 8.5 billion) in 2007. According to the data of 1 January 2008, loans to private enterprises accounted for 54.3 per cent of bank loans granted to customers, whereas loans to individuals made up 41.5 per cent (of which, housing loans accounted for 29.4 per cent of the bank loan portfolio).

Housing loans continued to prevail among loans granted to individuals in 2007, while their annual growth rate was 61.6 per cent, slightly higher than a year ago. As a matter of fact, a quite strong deceleration of the growth of housing loans was observed in the last quarter of the previous year. In the second half of the year, owing to the increase in the interest rate spread of VILIBOR and EURIBOR, loans in foreign currency (mostly in euro) started to prevail, while the volume of loans in litas even declined in the last quarter.

On 1 December 2008, housing loans in Lithuania made up 17.2 per cent of the projected GDP for 2007, while in Latvia and Estonia the analogous indicator was twice higher.

The indicators that characterise the loan portfolio quality remain sufficiently good. The ratio of loan impairment (specific provisions) to loan portfolio went down (improved) from 0.97 per cent to 0.79 per cent in the course of the year. Meanwhile, the amount of loans with regular payments delayed for 60 days and more went up over the year by LTL 218 million or 53.9 per cent. The ratio of these loans to the loan portfolio increased over the year from 0.97 per cent to 1.04 per cent.

COMPLIANCE WITH PRUDENTIAL REQUIREMENTS

The housing loan crisis that originated in the US and affected the markets of most countries did not have a significant effect on liquidity in the banking system of Lithuania. According to the data for 1 January 2008, the liquidity ratio of the banking system stood at 43.5 per cent and exceeded the minimum established by the Bank of Lithuania by 13.5 percentage points. Liquid assets of banks accounted for 21.9 per cent of total assets.

The capital adequacy ratio of the banking system grew by 0.15 percentage points over the year and made up

10.90 per cent on 1 January 2008. The capital base of the banking system amounted to LTL 6.2 billion, and Tier I capital comprised its largest share at LTL 4.4 billion. The capital allocated for amortising the risk of the banking book comprised LTL 4.6 billion, while the capital allocated to reduce the risk of the trading book made up only LTL 115 million.

As on 1 January 2008, domestic banks could assume additional asset risk for the amount of LTL 18.5 billion (i.e. LTL 6 billion more than a year ago) or additionally reduce the value of loans by LTL 1.7 billion, i.e. increase the current loan impairment 4 times, without violating the capital adequacy ratio.

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

SHAREHOLDERS' EQUITY

Shareholders' equity grew by LTL 1.8 billion in 2007 and amounted to LTL 5.9 billion on 1 January 2008. The largest impact on its growth was made by the record profit of LTL 1.1 billion earned in 2007 (according to the audited data, it exceeded the result of the previous year by as much as 71 per cent or LTL 475.3 million).

The authorised registered (share) capital of the banking system went up by LTL 408 million to LTL 3.1 billion in 2007. The increase in the authorised capital was registered by the following banks: AB PAREX bankas (LTL 65 million by additional contributions and LTL 53 million, of which LTL 45.3 million by additional contributions and LTL 7.7 million by conversion of a subordinated loan), AB Sampo bankas (LTL 70 million by additional contributions), AB bankas Snoras (LTL 54.9 million from bank funds and LTL 41.2 million by additional contributions), AB DnB NORD bankas (LTL 52 million by additional contributions), AB Šiaulių bankas (LTL 40 million by additional contributions and LTL 12 million by using share premium) and AB Ūkio bankas (LTL 20 million by additional contributions).

The share of the authorised capital held by non–residents declined by 2.3 percentage points to 87.6 per cent over the year. The Scandinavian capital prevailed in the banking system of Lithuania.

Several banks increased their capital base in 2007 by obtaining permissions of the Board of the Bank of Lithuania to include a certain part of the audited profit for current year and newly received subordinated loans in the capital base. Permissions to include a part of the profit for current year in the capital base were issued to three banks, which included the total amount of LTL 155.2 million into the capital base. In the course of the year, five banks increase the capital base by newly received subordinated loans (LTL 701.6 million in total).

PROFITABILITY AND BUSINESS EFFICIENCY

According to the data of audited financial statements of banks for 1 January 2008, all domestic banks were profitable in 2007, with the exception of Balti Investment Grupi Pank AS branch (the loss of LTL 4.1 million) and MP Investment Bank hf Baltic branch (the loss of LTL 1.1 million) that started their operation only last year.

The total audited profit of the banking system for 2007 was LTL 1,156 million, 73 per cent higher than in 2006, when the banking system of Lithuania earned a profit of LTL 667 million. The profit of the banking system of Lithuania has been growing consistently for the sixth consecutive year.

Profitability and business efficiency indicators of operating banks

No.	Bank	Profit for current year (LTL million)	
		01 01 2007	01 01 2008
1.	AB DnB NORD bankas	56.2	107.9
2.	AB Ūkio bankas	47.4	82.7
3.	AB SEB bankas	285.5	496.1
4.	AB Šiaulių bankas	13.7	27.2
5.	AB bankas Snoras	51.9	71.7
6.	UAB Medicinos bankas	3.5	5.56
7.	AB PAREX bankas	4.9	0.04
8.	AB bankas Hansabankas	179.5	314.3
9.	UAB Sampo bankas	23.3	35.6
	TOTAL banks:	**665.9**	**1,141.2**
10.	Bayerische Hypo– und Vereinsbank AG Vilnius branch	1.5	–
11.	Nordea Bank Finland Plc Lithuania branch	–0.3	19.1
12.	AS "UniCredit Bank" Lithuania branch	–	1.1
13.	MP Investment Bank hf. Baltic branch	–	–1.1
14.	Balti Investeeringute Grupi Pank AS branch	–	–4.1
	Total foreign bank branches:	**1.2**	**14.9**
	TOTAL:	**667.0**	**1,156.1**

The growth of bank profit in 2007 was determined by the increase in volumes of bank operations and a rise in net interest income, which in its own turn was stipulated by a rapid growth of the bank loan portfolio and a widening of the real interest margin. Compared to 2006, the largest increase was recorded in the following components in 2007:

- net interest income rose by LTL 603 million or 51.5 per cent;
- net income on services and commissions grew by LTL 148 million or 29.6 per cent;
- income on equity securities increased by LTL 66 million;
- 19.8 per cent higher income from foreign exchange operations and operations with financial derivatives also made a positive impact.

Several factors that reduced bank profitability could also be pointed out. The largest increase on the expenditure side was recorded in operating expenses (LTL 244 million or 31.1 %), among which, the largest growth was registered in wage–related expenses (LTL 160 million or 33.8 per cent) and expenses on the rent of premises and maintenance (LTL 30 million or 28.8 %). The growth of the said expenses was driven not only by the expansion of the network of most banks, but also by the marked wage growth observed in the whole economy, which also affected the banking sector. With the increase in the number and volume of bank operations and bank profitability, the amount of taxes paid by banks went up by LTL 124 million or 76.1 per cent and made up LTL 287 million.

The growth rates of operating costs were lower than those of income, thus creating favourable conditions for the rise of business efficiency of banks. The ratio of fixed expenses to the profit from the principal activity, which serves as the banking system efficiency indicator, declined (improved) over the year by 5.1 percentage points to 39.9 per cent on 1 January 2008, representing the proportion of the profit (net income) earned by banks from the principal activity, which was used to cover operating and amortisation expenses.

In 2007, the amount of income per one bank employee was LTL 470 thousand, which was 35.2 per cent higher than in 2006. Moreover, one bank employee serviced bank assets in the amount of LTL 7.7 million on average, which was 18.6 per cent higher than in 2006.

Due to the increase of the share of more profitable, but riskier assets by banks, the return on assets of the banking system went up from 1.32 per cent to 1.71 per cent over the year, whereas the return on equity rose from 20.3 per cent to 25.9 per cent.

On 1 January 2008, the real interest margin of the banking system made up 2.82 per cent.

OPERATIONS OF THE CENTRAL CREDIT UNION OF LITHUANIA

The assets of the Central Credit Union of Lithuania (CCUL) increased by 29 per cent in 2007 to LTL 141.6 million and on 1 January 2008 reached the highest level from the start of its operations.

This resulted to the largest extent from the growth of deposits of credit union members, the main source of financing of the CCUL. Deposits grew by 27.1 per cent and made up LTL 124.6 million on 1 January 2008. Over the year, the loan portfolio grew by 59.1 per cent to LTL 49.3 million. Its quality remains good. Currently there are no loans with regular payments overdue by more than 60 days.

In 2007, the CCUL helped solving short–term liquidity problems of three credit unions by granting loans from the Liquidity Support Reserve, whereas in 2006 the loans for such purpose were granted to four unions. According to the data as of 1 January 2008, one credit union used the loan from the Liquidity Support Reserve.

After the members of the CCUL redeemed the whole additional share from the Government of the Republic of Lithuania in the second quarter of 2007, the additional share capital (LTL 5.3 million) belongs to 59 credit unions, members of the CCUL.

According to the audited financial statements, the CCUL earned a profit of LTL 714 thousand in 2007, almost twice higher than in 2006, when a profit of LTL 393 thousand was earned.

In 2007, the CCUL complied with all prudential requirements set by the Bank of Lithuania.

OPERATIONS OF CREDIT UNIONS

On 1 January 2008, there were 67 credit unions in Lithuania, with the total of 83,437 members. Only one credit union was established in 2007.

Development of the main items of the consolidated balance sheet of credit unions

No.	Balance sheet item	Amount (LTL thousand)		Change year-on-year (%)
		01 01 2007	01 01 2008	
1.	Assets	461,842.2	655,150.9	41.9
2.	GS	11,228.5	20,701.9	84.4
3.	Loans granted	305,111.8	455,311.7	49.2
4.	Specific provisions on loans	984.5	1,649.2	67.5
5.	Deposits	370,853.1	518,203.0	39.7
5.1	Of which, by members and associated members of credit unions	367,408.2	512,831.1	39.6
6.	Share capital	46,589.4	67,921.7	45.8
7.	Profit (loss) for current year	2,272.7	2,722.4	–

Credit union further expanded their activities last year:
- assets increased by 41.9 per cent and on 1 January 2008 made up 0.81 per cent of total assets of operating banks. The assets of the largest Panevėžio credit union made up almost LTL 72 million and accounted for 11 per cent of total assets of credit unions on 1 January 2008;
- granted loans increased almost 1.5 times and made up 69 per cent of total assets. on 1 January 2008, 50 credit unions held specific provisions for loans (LTL 1,649.2 thousand);
- investment in government securities increased 1.8 times;
- deposits grew by 39.7 per cent, of which the largest share (99%) were deposits of members;
- the share capital of credit unions increased 1.5 times.

59 credit unions earned a profit, while 8 credit unions incurred a loss in 2007.

According to the statements checked by credit union inspectors (independent auditors) and approved by general meetings of the members, credit unions earned the profit of 2,722.4 thousand in 2007.

As in the previous years, the main source of credit union income was interest income, which comprised 90 per cent of total income. Interest expenses and operating expenses accounted for the largest share of expenses, 46 per cent and 41.8 per cent, respectively.