SPECIAL REPORT

BANKING SECTOR UPDATE

CZECH REPUBLIC

Czech bank privatization in trouble

After having waited too long to sell off the nation's top five banks, the Czech government now appears to be losing its grip on the banking privatization process.

As it prepares the privatization of the country's three largest banks—whose final sell-off it has delayed for more than a year—the government has had to scale down its price tag due to audits showing financial decay in the banks.

The financial mess has rankled the public, which is already suspicious of the state's negotiations with Japanese investment bank **Nomura** over the sale of the state's 36% stake in **Investicni a Postovni Banka (IPB)**.

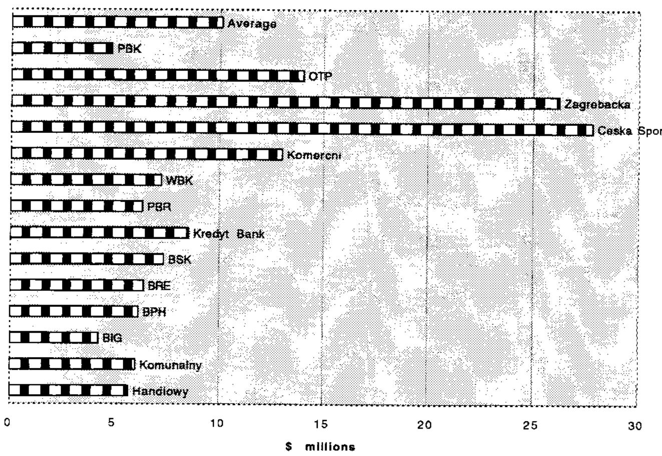
"Everybond's wondering about what [bad news] the banks will find out next," said **Wood & Co.** analyst Martin Nejedly.

Komercni Banka, the largest Czech bank, announced January 12 it must increase its loan-loss reserves by Kc 10.5 billion ($300 million) because the drop in real estate values had eroded its collateral. Komercni has had to reappraise downward the value of that collateral by 25%, according to estimates by Brno-based broker **Atlantik Financial**.

That was reportedly the first time the bank publicly admitted the low value of its collateral portfolio, and news of the provisioning pushed Komercni's stock price down more than 5%.

All banking stocks declined except for **Zivnostenska Banka**, which Nejedly said is the only major Czech bank without loan-portfolio problems. Leading retail bank Ceska sporitelna said it will also have to boost its 1996 provision level of Kc 4.7 billion ($134 million), and Investicni a Postovni Banka will beef up its Kc 8 billion ($229 million) in reserves by 50%.

EARNINGS OF LEADING CENTRAL EUROPEAN BANKS



Source: RZB

KOMERCNI SUFFERS

Komercni Banka may be suffering the most due to heavy loan exposure, which makes it very sensitive to economic developments. **Ceska Sporitelna** may be spared the worst record, since it focuses on the inter-bank market and has a comparatively small commercial loan portfolio. Czech banks have an average classified loan ratio of 27.3%. Although that's an improvement over the 29.3% at the end of 1996, the figure does not factor in the bad loans transferred onto the books of Konsolidacni Banka and Ceska Financni, two state institutions that act as dumping grounds for bad loans and bad corporate debt.

IPB's financial straits complicated negotiations between Japanese investment bank Nomura and the Czech government over the sale of the state's 36% stake in the bank. The two sides negotiated for weeks over how much of IPB's bad debt Nomura would assume.

The National Property Fund (FNM) announced January 21 that Nomura would pay Kc 2.9 billion ($82.9 million) — or Kc 147 ($4.20) per share - -and contribute Kc 6 billion ($171 million) in new capital, with an optional Kc 6 billion ($171 million) in subordinated debt. The state, however, will keep a five-year right of first refusal to buy the shares if Nomura sells. The deal awaits approval by both the Czech cabinet and top Nomura management.

That offer is a far cry from the original Kc 300 ($8.57) per share that Nomura offered in 1996. At that time, Nomura wanted a direct sale without a tender, but the Czechs declined in the hope of attracting a better price. Before striking the January 21 deal, the state had been trying to play hardball with the Japanese, such as threatening to privatize IPB another way if Nomura didn't agree on sale terms by January 15. That deadline came and went, and the state continued talks.

"Political posturing has been costing the state," said Mark Rooney, banking consultant for **Inventa Manager Program** in Prague. "The value of the banks declines every day."

AGROBANKA ROTS

The Czech National Bank (CNB) has hit snags in the sale of another bank, fifth-ranked **Agrobanka**, which has been under forced administration since since September 1996. It had suffered a liquidity crisis and a 8.7 billion Kc ($249 million) provisioning gap.

The central bank may have to liquidate Agrobanka rather than sell it to **General Electric Capital Services (GE)**, which is still demanding more concessions after receiving a 50% markdown on the price. CNB negotiators settled on a price of Kc 2.1 billion.

"We consider an agreement with General Electric as the best option, but not for any price," CNB Acting Governor Pavel Kysilka told parliament's banking commission earlier this month. But the hinted liquidation may just be a bluff, as GE was the only bidders last autumn, and can call the shots on the deal.

"But both sides know it very well. That's why General Electric tries to squeeze the price as much as possible," said chief economist Miroslav Singer of the brokerage **Expandia Finance**.

In return for the dramatic drop in price, said Agrobanka spokesman Vlastimil Nesrsta, GE dropped its demand that the CNB

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take responsibility for future Agrobanka loans that go sour, even though the central bank has already taken Kc 20 billion ($571 million) of bad loans off the bank's hands.

But GE still wants a "helicopter" clause, said Nesrsta. If GE's purchase of Agrobanka is ruled illegal in the courts, the firm would be able to fly out of the chaos by selling Agrobanka to the CNB. A group of Agrobanka's minority shareholders, who have had no power over the bank's fate since the CNB took control, plan a set of lawsuits challenging the bank sale.

The CNB's banking council directed Agrobanka administrator Jiri Klumpar and the sale's arranger, **HSBC Investment Banking**, to resume negotiations with GE. Those negotiations are now in their third month.

A liquidation would cost the CNB an estimated Kc 27 billion ($771 million), said Nesrsta. Selling the bank could still cost up to Kc 25 billion ($714 million), depending on how many bad loans the central bank recovers, he said.

The central bank split the bank last year into a "healthy" part, nicknamed **Agrobanka I**, and an "unhealthy" part, **Agrobanka II**. A CNB subsidiary, **Prvni Financni**, will help the bank by eating some Kc 20 billion ($571 million) in bad loans from the latter part.

Despite its relative "health," Agrobanka I was responsible for a third of the nearly Kc 1.8 billion ($51.4 million) that Agrobanka lost in the first 11 months of 1997.