Strategy and Finance Division

Investor Relations

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Transcript

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P R E S E N T A T I O N

Operator

Ladies and gentlemen, welcome to the OTP Bank's Fourth Quarter 2023 Conference Call. This conference will be recorded. As a reminder during the presentation all participants will be in a listen only mode. After the presentation there will be an opportunity to ask questions.

May I now hand you over to László Bencsik, Chief Strategic and Financial Officer. László, please go ahead.

László Bencsik – Chief Financial and Strategic Officer

Thank you, and good morning or good afternoon, depending on where you are. Thank you for joining us today on OTP Group's 2023 full year results presentation. As usual, the presentation that I'm going to use is available on the website for you to download, but we are also projecting it parallel to the discussion, what we have in my presentation. As usual, we go better quickly this presentation, which is in a usual structure, and then we can have Q&A.

The highlights of the group: we had a good year last year in Hungary and outside Hungary. This is probably not a surprise because most of the banks had a quite good year in 2023. But nevertheless, in terms of OTP history, I think this is a major milestone where we exceeded EUR 100 billion balance sheet and exceeded EUR 2.5 billion profit after tax. We defied our position in the region as one of the dominant multinational banking groups. Certainly, we have a unique position in a sense that we are the only one of the banking groups across the region who actually originated and come from the region. We have strong positions in 5 countries, which was strengthened last year by our second acquisition in Slovenia, and we entered a new country in Uzbekistan. At the end of January, early February this year, we signed an agreement to sell our Romanian businesses which is also a big part of the group. Strategically, it was a difficult decision to make, but I think we made the right decision. The financial impact of that decision has already been reflected in the 2023 numbers.

Profitability was good, 27% all-in compared to the around 14%, 15% expected return level, and somewhat declining expected return level given the HUF rates there, has been a strong decline in the risk-free rates. There's some normalization in the cost of capital as well. Very stable foundations in terms of liquidity and in terms of capital, both of these positions strengthened considerably last year. Liquidity coverage ratio was around 250%, that's 2.5x higher than the requirement. We managed to strengthen our capital position despite doing these two rather sizable acquisitions in Slovenia and Uzbekistan. The year-end common equity tier 1 ratio was 16.6%, and that means 20 bps improvement y-o-y, including the acquisitions that we have made. We managed to meet and exceed the MREL requirements as well, the year-end ratio was 25.1%. From January 1, the new increased requirement has been 24%. This has been a quite fast exercise because we have to issue a lot of bonds, which we didn't need for our normal business activities or from a liquidity point of view, but only for this purpose to meet these new type of capital requirements when we have met them.

Portfolio quality remains stable with decent coverage levels and lower risk costs. Overall, this is a strong picture, and we remain committed strategically to ESG's targets. Let's look at a bit into the numbers themselves in the group level.

First of all, if you just look at the bottom-line number, HUF 990 billion after-tax profit, that's almost 3x as much as in 2022. Now, on this page on the right floor corner, you can see the so-called adjustments. These items changed a lot from year to another, whereas in 2022 we had minus HUF 246 million, in 2023 it was minus HUF 18 million. The big difference in these so-called adjustments contributed most of the difference between the 2 years, or it was a major contributor. It wasn't the most, but it was a major contributor to the difference. If you go line by line, the effect of acquisitions was positive in 2023, and that's coming from the NKBM and Ipoteka acquisitions, which were both positive, and the Romanian bank sale, which had a negative impact on our P&L. We reported this when we signed a deal early February. The impact there is minus HUF 59.5 billion, and that's included in this HUF 64.9 billion positive number on the acquisition line.

The special banking taxes primarily in Hungary declined, and that's a good thing, and we expect further decline this year in 2024. Interest rate cap was extended into the end of June this year for variable mortgages and till the end of March for SMEs, so that have still these extensions cost us as one-offs, including the last one in the fourth quarter last year. Not just in Hungary, but the Serbian cap was also accounted for. The other line where there's a considerable change y-o-y is the effect of the Russian-Ukraine war in 2022, we had big losses here. In 2023, it was close to zero. The other line, we had a positive number, in last year HUF 15 billion. Out of this HUF 10 billion was related to the reversal of the provisions that we made due to reversal of the losses that we had, what we booked in 2022 due to the Sberbank default and the subsequent resolution actions. We moved the loss in 2022 and we reversed that in 2023 because it did not manifest in the end.

Now, if you look at the big one-offs with that adjustment items numbers on the last lower corner, is still quite a strong growth, 70% y-o-y growth, which was driven by various factors. Number one, we included the P&L contribution of the 2 acquisitions what we made last year, and their combined contribution was HUF 74 billion, HUF 96 million was positive at NKBM and minus HUF 22 million was Ipoteka.

Overall, if you look at the ratios, net interest margin improved from 3.5% to almost 4%, and that came primarily from countries outside Hungary, especially those in the Eurozone or quasi-Eurozone countries, and we clearly benefited from the higher euro rates, whereas we did not benefit, it's quite contrary. The extremely high rates in Hungary were negative marginally for us in Hungary. The credit risk cost rate was quite low in general, but especially compared to 2022, it was the year when the war started, and we provisioned excessively, especially in Russia and Ukraine, but in all the other countries as well because we had to increase coverage ratios for the other countries as well, given the worsening economic expectations. So that resulted in HUF 178 million risk costs in 2022. These factors did not manifest in 2023. In fact, the whole risk cost was HUF 39 billion negative. It included the HUF 52 billion risk costs that we booked during the second half of the year in Uzbekistan in Ipoteka. I'm going to talk about this in more detail later.

Looking at the consolidated P&L lines, the 28% total income growth without acquisitions and FX adjusted I think is quite good, growing organically 28%, and that resulted an 37% growth in operating profits. In just 1 year, our operating profit grew more than 1/3 organically. On a q-o-q comparison the net interest income growth was quite prominent and important.

Looking at the lower growth trend on Page 5, we love this chart apparently, it keeps coming back. I think this is important and it keeps reminding us how much we have grown over the last 7 years, we tripled the size of the group in terms of total assets. In terms of loan volumes, it was even higher growth, and we reached this above EUR 100 billion level. Put it in another context, 10 years ago in 2003, the group was EUR 10 billion altogether, so it's like 10x growth in 20 years. Another very important change in the structure of the group that now kind of 2/3 of the group is coming from outside Hungary, both in terms of profits and in terms of exposures.

On Page 6, we start a few pages detailing the Hungarian performance. If you just look at the bottom-line number, there is a 10x improvement compared to 2022. It's safe to say that most of the changes come from the so-called adjustment items. I am going through them one by one. The windfall tax is the profit tax declined, as you can see here. The special bank tax increase, that keeps increasing. By the way, this is the tax which have been with us since 2010. So you could argue why we put it into the adjustments and the one-offs, and we are reconsidering this. I don't want to scare you, but starting from 2024, we are going to substantially reduce these adjustment items, and will reserve this category all items, which are related to the actual buying or selling of assets of banks, or other assets, and everything else will go into the normal profit. So, we are not going to show this special items. But more about this when we present the first quarter.

So, the special bank tax, which was introduced in 2010. That keeps increasing because the tax basis is related to the sub-consolidated Hungarian assets what we have. Since those are growing, this number is growing, and will continue to grow in the future. For this year, we expect around HUF 30 billion, whereas for the windfall tax, which was introduced in 2022, and already decreased from the 2022 level to the HUF 36 billion in 2023. It is going to decrease, and this is in the legislation actually further down to possibly around HUF 6.5 billion, assuming that we are going to buy the necessary government bonds, and we intend to reduce it down to this level.

On the interest rate gap here, we talk about that. There was no negative effect coming from the Russian war. But on the other hand, we had a big plus. Now, this is confusing because these are items which don't appear typically on the consolidated level. HUF 80 billion of this is specific to the stand-alone view of the Hungarian bank. This is related to the investments into the subsidiaries, and the value of these investments, and the impairment reversals on these investments into subsidiaries, including the reversal of revaluation impact on the Romanian bank. On a consolidated level, the sale of the Romanian bank had a negative P&L impact because we sold it at 0.7x local book, right? Value below the local book, which we had in Romania. But in the Hungarian book, the book value, the asset, the value of the investment of the Romanian subsidiary was much less, was already impaired compared to the book value of the Romanian bank. The sales price was actually higher than the value of the Romanian bank in our books in Hungary. So, we had to book on the Hungarian stand-alone bank level HUF 37 billion plus. There were other impairment reversals on investments to subsidiaries, including our Serbian bank, HUF 21 million. All these together added up to HUF 80 billion plus on the Hungarian numbers and not in the consolidated one. So that's somewhat confusing, but I hope it was clear.

There's another technical element, which we talk about when we detail the other income development in the group, but maybe it's worth talking about here. The accounting treatment of the subsidized retail structures like the Baby shower and the CSOK subsidized mortgage structure is such that we have to fair value adjust them. When there are strong movements in the rate environment and/or they change the subsidy structure of the newly issued loans, we have to revalue the existing quite big book. This positive revaluation last year was HUF 87 billion, and after tax it was HUF 79 million. Out of this HUF 303 billion adjusted profit in Hungary, which grew 18% compared to 2022, HUF 79 million related to this. That was a one-off boost, and it is not unique to OTP. For example Erste Bank, a few days ago published their numbers, and they reported that they booked

HUF 43 billion plus due to this fair value adjustment as evaluation of subsidized loans. These 2 banks together, OTP and Erste in Hungary booked HUF 130 billion as one-off, accounting policy related positive number. So we estimate that maybe the whole banking sector might have booked around HUF 200 billion positive last year. This is actually a very substantial boost to the earnings of the Hungarian banking sector and unlikely to be repeated, put it this way this year.

If you look at the quarterly developments of the NIM, there is a strong improvement here. The NIM y-o-y actually declined because in this very high-rate environment, this is not what we optimize our balance sheet for. You can see that after the rate environment started to fall, starting from the 2Q 2023, there has been a reasonably strong improvement in the net interest margin. Part of the improvement in 4Q was technical. We also talk about this in this presentation later on. So basically, 26 bps out of this 60-bps improvement in the 4Q was related to one-off technical ones. If we exclude them, the net interest margin in one quarter improved from 2.2% to 2.55% and this improvement is structural and it is going to stay with us, not going to go away. This was the most exciting part of the fourth quarter result in Hungary, these were the more exciting developments that really the Hungarian net interest margin started to react positively to the changing rate environment.

A few more words about Hungarian volumes and business trends on Page 7. Looking at the mortgage market, there was a big decline in overall disbursement. The market level overall disbursements declined by 50%. They went down from HUF 1.2 trillion to HUF 600 billion in 2023. Our newly disbursed volumes also declined, but only by 31%. The decline is in our case was much less than the decline on the market. Therefore, not surprisingly, that our market share in new production did grow last year. The stock volume growth, in our case, were 4% compared to the market growth of 1.3%, so we outgrew the market last year. Now, there is even bigger outperformance of the market of OTP last year as in consumer loans. So, if you look at cash flow disbursement, our market share has increased even more considerably. By the end of the year, in the 4Q, we reached 45% market share, which is on the not subsidized market base, cash loan, and new disbursements. In terms of volume growth, overall stock volume growth grew 16%, whereas the market was growing by 7%.

Now, some words about the exciting retail segment, the retail deposits. This was quite problematic last year and very painful for us actually because current account volumes on the entire market declined by HUF 1 trillion in the first 10 months. This was given our above 40% market share in retail current accounts was particularly hurting our profitability. It was one of the reasons why our margins went low in the first half of the year. The good news is that in the last 2 months, in November and December, there was HUF 500 billion increase. The decrease in retail current account volumes turn around at the end of the year. That was the reasons behind the improving net interest margin in Hungary, next to the lower interest rate environment. It was a specific market situation in Hungary. There was a very strong reallocation of funds by retail clients and retail government bonds, and mutual funds increased considerably why bank deposits decline. But nevertheless, in this declining retail deposit market, we managed to increase our market share y-o-y last year slightly.

Corporate story is somewhat different in our case. Our corporate volumes declined last year. But if you have a closer look at previous year's growth, in 2022 we grew 32%, and most of this growth was in the second half of 2022. The market in 2022 grew by 15%. Our growth rate was more than twice than the market. Basically our clients refinance the loan demand, and we were willing to do that. We provided them with the loans where they demanded. Therefore, there's a timing of these loans, much more was done in the later part of 2022 than on the market level, and therefore, less was left for 2023. Obviously, the GDP decline and the high-rate environment contributed to the overall slow growth of the market. But this is clearly an item where we expect improvement this year. We are hopeful that loan growth is going to come back, and this is what we prepared for in terms of corporate. Despite the overall decline in volumes in our case, we have been active in distributing the subsidized structures, which kept existing. So, we had more than 40% market share in the disbursement of subsidized volumes.

The next page is about the composition of the NII and net interest margin development. There's no new item here. Basically just an update on the information, what we shared in the previous two quarters. I don't think there's much to say about the share.

On Page 10, we have details about the performance of part of the group, which is outside Hungary. That was really a success story last year. With the exception of Ipoteka, our new acquisition, all these banks were contributing strongly to overall profitability. You can see the ROE numbers and the nominal volumes as well. I think it is impressive, especially Bulgaria exceeding the HUF 200 billion profit after tax level, very good improvement y-o-y. Slovenia, we rank NKBM on board, HUF 130 billion, and Serbia was also very strong. A few years ago, Serbia was tiny in our case. But having done the successful acquisitions, it's one of the strongest contributors, overall group ever profits. Russia and Ukraine – after the less good performance in 2022 – were strong profit contributors in 2023. In case of Ukraine, the 50% corporate tax rate was introduced at the end of the year. So, the fourth quarter was loss-making because it was retrospectively applied. So we had to pay taxes 50% on profit for the whole year, and we had to account for these additional taxes for the entire year in the fourth quarter. But even after this 50% corporate tax, the profit after tax remained HUF 45 billion which is quite remarkable given the situation, the war in the country. Now, the good news is that this 50% is not going to stay with us in 2024, it's going to be 25%. This was one-off high rate. We are usually quite critical of these bank levies and additional bank taxes. But if there's ever a situation where extra bank tax is warranted, it's the case of Ukraine. I think it is quite understandable that the tax is somewhat higher in these difficult times.

A bit about the situation in Uzbekistan. So we have two slides detailing there. We are learning this country and the bank. So we have more information q-o-q. Hopefully, we can give you better and better picture of what is going on, and maybe more intelligent answers to your questions. So where we stand now? Just showing you the performance of the second half of last year. So in terms of volumes, corporate volumes declined by 38% in 6 months. This was due to the fact that the migration to Stage 3. So these are performing loans, performing Stage 1 and 2 loan volumes declined by 38% due to migration to Stage 3. Due to the fact that we seriously strengthen and made more conservative lending standards as well. So not much new lending was done in corporate. In contrast to that, in retail, we were growing quite fast. Mortgages grew 15% in 6 months and consumer loans by 120%, more than doubled. I mean, these are not annualized growth rates. This is actual period-on-period growth in 6 months. That's actually the core of our strategy in the country. Just to remind you, the reason we brought this bank was not to grow so much in corporate, but we wanted to capture the opportunity in retail segment in Uzbekistan. That's why we brought Ipoteka Bank. Ipoteka actually means mortgage. So it's a primary mortgage bank, and they have like 20 plus percent market share, 25-ish percent market share in the country's suite.

The core focus of our strategy, the retail segment was actually growing quite fast. It continues from the volume levels, what we have there, potential quality demand is almost unlimited, and continues to grow. The only limitation to growth is really local currency liquidity. Unfortunately, the monetary policy environment is extremely tight. I mean the base rate is 15%. The inflation is much lower than 10%. There's just not enough. There's a very tight local currency liquidity level in the system and that's the biggest impediment to growth. Swap markets are not available in the local currency. It is not that we would want to do that, but it's not quite possible to finance any local currency growth from injecting liquidity into the country. So the only limitation to growth on the retail loan side is really the deposit development. The good news is that we actually managed to grow deposits relatively strongly in the second half of last year. Corporate deposits grew by 23%, and household deposits by 15%. These numbers are not annualized. These such as end of period growth range. What's happening here? We are obviously improving the activities and the sales, techniques, and tools of the bank, and there's very strong digital share of the new floor. For instance, out of the consumer loan sales, so the cash loans worth. As you can see, in the fourth quarter, we actually sold 77% of the cash loans digitally and when we brought the bank in the second quarter, it was only 40%.

Much larger volume was sold and a much larger share of those were actually sold through digital channels. This is without actually replacing the app, what they originally had. We made some tweaks and quick fixes, but a big step-up in the quality of the digital services that we provide will come when we completely replace the current digital front-end, and that's going to happen somewhere at the end of this year. So, this is even work in progress on the development.

Now what happened in the corporate portfolio and quality. First of all, it's clear that the Stage 3, overall increase was the result of the corporate portfolio deterioration. The retail portfolio remained quite stable, as you can see on this chart, the retail Stage 3 ratio hardly changed or even declined. But the big increase was it was corporate and micro small. Now on this slide, you can actually see the industry split. So most of the Stage 3 ratios. So that's of the Stage 3 loan. So more than half of these loans, which defaulted are in the cotton textile industry segment. There's another big share in fisheries and in the agricultural sector and the others are quite small. Now what happened? Apparently, cotton prices collapsed. If you compare the peak in 2Q 2022 to the low in second quarter 2023, then the price difference was actually not 30%, but 50. So cotton prices fall by 50% in 1 year. On top of that, they had a very cold winter. The winter of 2023 was the coldest in the last 50 years in Uzbekistan. This situation is exacerbated by the fact that there was not enough gas supply and gas subsidies were reduced. So they could not heat these kind of fish lakes or ponds where they grow the fishes, and they could not heat these greenhouses where they grow fruits and vegetables and things like that. So, the more limited the gas supply, and more expensive the gas is, not possible to provide a right heating for what they needed in the fisheries and the agricultural sector, and also the weather conditions in the cotton industry resulted in unprecedented losses. So in a way, it turns out that we seem to be unlucky with the timing of this acquisition because we just managed to buy this bank in diverse external conditions here. So our understanding is improving day by day of what's happening exactly with these clients, and this is where we are at the moment. So these are probably the strongest drivers.

If you look at the bank's ability to monitor and collect and do work out of corporate loans, and we compare that to the levels that we have in the other parts of the group, there's a huge difference. So there's an enormous improvement opportunity and potential in basic risk management and portfolio management practices of the bank. We have started to do that improvement since we took over the bank, but it takes some time. So we are making progress on that side. Hopefully, there will be visible results of these improvements in the policies, procedures, people, everything basically related to managing existing problematic portfolios, where it takes some time. Unfortunately, the relatively low level of this preparedness during last year, and these negative external environmental factors resulted in this deterioration. Now, if you look at coverage ratios, they don't provide you the full picture, because when we buy something, we have to net provisions to gross loans. So in the opening balance sheet at the end of the 2Q last year provisions were already netted out. So what you can see in the balance sheet of the bank is the net amount of these nonperforming loans. Therefore, the previously created provisions disappear. There's a difference between the reported net coverage level and the actual coverage, which compares the total provisions on the loan to the total exposure of the loan. The latter one is adjusted, is higher. So in fact, provisioning level is 56% on the Stage 3 corporate loans, which is in line with the other levels in the group. If all goes well, we are actually hopeful that there might be some revisions or provisions later on from this. It was about Uzbekistan and Ipoteka.

Maybe a few thoughts, but not much about the P&L lines in a cross-section view. I already talked about the one-off technical items regarding the HUF in Hungary in 4Q, which was part of the story of this strong q-o-q growth in NII. In Ipoteka, we had a reclassification which caused the decline on a q-o-q basis in an NII, without the reclassification the NII would have improved by 3%.

Net interest margins next page, 14, reflect the same story. Part of this large improvement in Hungary was related to one-offs, but even without one-offs, it was strong. Otherwise, across other fronts typically improvement in margins due to the rate environment.

Page 15, q-o-q loan growth. The previous momentum was capped to 1%. If you look at the y-o-y growth, 6% organic and 20% including acquisitions. I think the most remarkable set of number here is Bulgaria, 20% growth and especially mortgage is 23% growth. The market is growing fast, and that's coming from two factors: one is that the country is doing well. Actually three: companies doing well, penetration ratios are low, but that's an interesting third factor, and this is something we could learn from in other countries. In Bulgaria, interestingly, retail loans are all variable. The benchmark of these variable retail loans is officially published by the Central Bank, and it is the average rate of the retail deposits. This industry structure there resulted in an interesting situation that, deposit beta was close to 0. The deposit rates did not increase despite a much higher rate environment. Therefore, the variable stock rates, consumer and mortgage rates did not increase. The new production rates did not increase. Probably, we have one of the lowest mortgage rates in Bulgaria across Europe. The margins are quite strong, and we don't have to be afraid that if deposit repricing happens, then we lose margins or lose NII because the benchmark of the variable retailers is the average retail deposit rate on the Bulgarian market. I'm not sure whether this was designed with purpose, but it has been served for quite a long time for last 10, 15 years, and basically, all the banks have these structures. This specific feature resulted in much higher growth in Bulgaria, which is a quasi-Eurozone country. They are joining the Eurozone January next year. They are already in ERM II. So it's basically interest rate wise, it's just a kind of a euro rate environment. Now that's just a small flavour on the situation there. Deposits, there was a very important development on the q-o-q numbers. Unless the Hungarian retail deposits, they went up by 2%. The previous 3 quarters last year, they were negative, that was extremely painful. So that's a nice development. I hope this is going to continue.

Otherwise, the y-o-y change level, next Page 18. Overall growth was 7% without acquisitions. So, higher growth rate than loans and therefore, actually loan-to-deposit ratio group level slightly decline, and general strong growth, except Hungary. As you can see on a yearly comparison basis, the retail growth in Hungary deposits was negative despite the fact that in 4Q, there was a 2% increase.

Fee income. Despite low volume growth in Hungary and loans, and also a negative deposit growth, retail deposit growth, and declining GDP, we had 11% growth in fee income due to inflation. Obviously, despite a recession and declining GDP, nominal GDP, increased and fee income tend to grow with nominal GDP growth. The other two strong growth rates in Russia, that's related to the deposit volume increase and in Hungarian fund management. A huge increase happened in assets under management, where retail deposits were negatively affected by the very high-rate environment and the very high yields on the retail government bonds and money market funds. Obviously, fund management and fund managers benefited a lot. A lot of retail savings move from bank deposits to meet your funds and therefore, our fund management company, which is the largest in the country, had a pretty good year.

On this other income line, you see this strong growth in case of Hungary, HUF 74 billion y-o-y growth, as we wrote it down in the comment section here on this page, and I have already talked about this. In 2023, we had HUF 87 billion plus revaluation result related to this fair value adjustment of loans. In Russia, the conversion revenue was strong. So that was strong to reach out as well.

Operating costs, unfortunately, not just revenues increase, but costs as well quite considerably. Not surprisingly, Hungary was quite high in terms of operating expenses growth, driven primarily by personnel expenses, 30% y-o-y growth. That was due to the high inflation and high wage inflation. We had to keep pace with a very tight job market in last year. There seems to be, from our perspective, some improvements. So I think this very tightly labour market is getting a bit relaxed and hopefully, we can much better control in the future, the increase of personnel expenses, especially in Hungary. The Albanian strong growth y-o-y is due to the new acquisitions, that includes the acquisition.

Risk costs. Typically, positive or small negative numbers, write-backs, except Ipoteka, I have already talked about that. So that was due to this corporate deterioration Stage 3 growth.

Overall portfolio quality, Page 23. Pretty stable y-o-y improvement in terms of the Stage 3 ratio. The growth in the second half was due to Uzbekistan and Ipoteka Stage 3 ratio was going up a lot and we kept our high provision levels we get last year.

Capital composition of the change of the common equity Tier 1 ratio. It increased last year by 20 bps, and there was a strong positive contribution from earnings, and 1.3 percentage points was used for the acquisitions. In fact, here you have a negative number for the Romanian bank, but hence actually close the transaction, the all-in number will be positive on a common equity Tier 1 is 43 bps and on the capital adequacy ratio is 52 bps.

In terms of capital adequacy ratios, these are higher than the requirements. Page 25. There's nothing new here.

Page 26 shows the MREL requirement in the year-end number, so we met the requirements. In order to meet the requirements, we obviously issued a lot of bonds and did some bilateral deals.

As you can see on Page 27. So more than EUR 2 billion prevalence was issued last year, including the bilateral deals. These are decent and good levels compared to the market and the market environment, but from our internal management point of view, these are very high rates and very high cost of funds. So the small MREL exercise is really expensive for us, and it's hurting us actually a lot because our cost of funding related to the MREL instruments is probably higher than some of the Western European banks.

Page 28. There's not much change on this page, improving ratings, continuously improving ratings on ESG dimension, which is in line with our strategies.

Now, a few words about what we expect for this year. Now obviously, in most of the countries where we operate, we expect a better operating environment. It's just that the growth rate might slow down somewhere in certain countries like Montenegro, Ukraine, Russia, but marginally, they are also improved. But regarding the biggest countries from our perspective, especially in Hungary, where after the recession last year, we expect that GDP growth will come back. Our expectation is 2.5%. The government expects more than 4%. So they are right and there's an upside there. But Bulgaria, strong Slovenia accelerate, and Croatia are extremely strong. The last quarter last year is very promising. So I think there's some upside potential in that growth rate. Serbia doing very well. Albania extremely well. Montenegro, Uzbekistan, above 5% growth. In Russia, and Ukraine, in our forecast, we did not expect much change in the operating environment. I hope that the war ends sooner than later, and then if that happens or at least freezes the actual military activity, and then we could expect a much, much higher growth, especially in Ukraine than this. Romania improving, but that's partly more relevant for us given that we sell the bank. We expect the transaction to close actually quite soon. The buyer is Banca Transylvania, and they seem to be strongly supported by the local supervisors. We expect a quite swift closing of this transaction. Moldova, speeding up. It's amazing how fast they brought down inflation for high level, and also the rate environment high collapse. So that's in itself a very interesting story.

So before going into the expectations of this year, just a quick look at what we indicated for last year. We delivered what we indicated. So all these points, which were included in our guidance last year, developed according to the guidance, so that's good. Then looking at what we indicate for this year.

Given that all operating environment improves, GDP growth improves in most of the countries where we operate. We expect a lower rate environment, much lower in Hungary than last year and certainly, especially in the second half of the year, decreasing rate environment in the Eurozone and Eurozone-related countries. Lower inflation. We are hopeful that this is going to translate into somewhat higher loan demand. I think it's unlikely that we return the year of 2021 or 2022 levels. So it will take probably more than 1 year to do that. But hopefully, we can improve on the last year growth rate, which was 6%.

Net interest margin, we indicated here maybe flat compared to last year. This is the line where there's considerable positive risk. There's an upside potential in this, given that rates seem to stay somewhat higher, and longer, and also the very favourable developments in the Hungarian retail deposit current account numbers. So there might be some upside here, but we remain cautious with the guidance. Cost-to-income ratio may be around 45%. Portfolio risk profile similar to last year. So here, I think we are reasonably convinced that the operating environment improves, and the current quality of the portfolio is quite stable and good. If there's further improvement, we don't see why the underlying portfolio quality should deteriorate. Overall, in Uzbekistan, we also expect improvement. The exact risk cost rate is more difficult to project. It might be somewhat higher than last year, but the important factor is that regarding the underlying portfolio quality we don't expect it to be different from what we have had recently, and that's quite a strong performance.

Now, as we keep accumulating earnings and increase capital. The leverage is going to be lower this year than last year, and that's going to have a negative impact on ROEs. So maybe ROE will be lower somewhat than last year. Dividends. The current indication is HUF 150 billion, and this is the number which is going to be decided on the Board Meeting on the 20th of March, and then suggested to the annual general meeting. We already started to buy back our own shares. Early February, the National Bank approved a program of HUF 60 billion equivalent of share buyback. So far, by the end of yesterday, we brought back less than HUF 6 billion, so that's kind of 90% of this is still coming, and we are doing this gradually. So, I think when you look at return to shareholders this year, you probably want to add the two together HUF 150 billion and HUF 60 billion. I cannot exclude, and I don't want to exclude the probability that there will be other phases of this share buyback. So our internal decision was on the HUF 60 billion, and we received approval for HUF 60 billion. But once we buy back the stock, we will review the capital situation of the group and make a decision accordingly on potential future buybacks.

There are some future MREL at least. We did one MREL, additional MREL bond in late January this year, already EUR 600 million. Probably, there will be add one more and maybe two more during the year. That also depends on our volume growth in new loans. So that was the presentation I wanted to make. The disclaimers are also important. So please have a look at them. Then I would like to open the floor for questions. So please ask your questions.

Q U E S T I O N S A N D A N S W E R S

Operator

The first question is from the analyst of Goldman Sachs, Mikhail Butkov.

Mikhail Butkov – Goldman Sachs

Good evening. Thank you very much for the presentation. I have a couple of questions. First was on the risk profile of the portfolio. You mentioned in the outlook, you expect it to be broadly unchanged in 2024. But just to clarify, it's not connected to the cost of risk outlook itself because it was strong in 2023 with this 16 basis points. What could speak for stable cost of risk maybe or the increase for the next year? Then the question is also on Uzbekistan. You described in detail the challenges, the weather challenges last year. Assuming that these challenges will not continue into 2024 would you expect cost of risk and provisions to be at more of the normalized level in that business? There are some additional internal surprises, which you identified and can result in somewhat similar hikes at some point during the year? The final question is on dividends. Yes, you have commented your reason on the dividend payments previously and on the capital allocation policy as well. But is there any change so far given that you made progress on MREL? Are there maybe any inorganic growth opportunities, which you see currently? So yes. Thank you.

László Bencsik – Chief Financial and Strategic Officer

The risk cost rate, the 16 basis points last year, that's quite low, right? But for a number of years, we had like 20, 30 basis point levels. Except in 2020 when we had the COVID-related additional provisioning, and in 2022 when we had the war-related provisioning. So in 2018, we had 23 basis points in 2019: 28, in 2021: 30, in 2023: 16. So I think 16 is a lower end. I think it's likely that it's going to be higher than 16. But we are pretty confident that we don't expect portfolio quality to behave differently than last year, which was quite a good kind of behaviour, except in Uzbekistan, where we do expect improvement. The second half of last year we had 10% risk cost rate. In Ipoteka, the 1Q will be considerably less than that. Then for the remaining quarters, there will be further gradual improvement. That's what our expectation. During the course of this year, we should reach a normal level, which is closer to the group average, much closer. But this takes time because we really have to establish the whole risk management process in the bank. There might be positive surprises coming from Uzbekistan during the second half of the year in terms of portfolio quality, because my personal view is that maybe some of these Stage 3 loans might be recover and we might find solutions together with other banks and the government to address this problem. So Uzbekistan is special in this sense, but regarding the rest of the group we expect similar portfolio quality development. The risk cost rates on top of that depends on two factors: one is growth, so the higher the volume growth, the higher the risk costs because for the new ones that produce, you have to create provisions for the performing loans. The other one is forward expectations regarding the economic environment.

So the actual provision coverage on performing loans, which will be probably the strongest driver of the risk cost rate this year will depend on the expectation at the end of this year on primary GDP growth trajectories for 2025 and 2026. Those can move the risk cost rate with a couple of tens of basis points, right, up and down. So that's much more difficult to actually forecast. I don't want to give point estimate of the risk cost rate. I think what we can say is that the risk profile of the portfolio will be similar. I think it's quite unlikely that we're going to have less than 16 basis points. So it will probably somewhat more, but how much honestly, I don't think it makes a lot of sense to give a very precise point estimate. So that was the risk cost question.

Second question was regarding Uzbekistan and risk cost there. I have already talked about this.

The third question, dividends and organic opportunities. As usual, we keep our eyes open, and we look into every meaningful opportunity that comes up in the countries where we are interested. And then we will see. We are not going to buy something just in order to buy something that's for sure. It's pretty much impossible to tell when the next acquisition is going to be. There's nothing in the pipeline, which would be as advanced that something could be expected immediately. But even today, we are looking into some opportunities. But it may take years to buy another bank, it may be actually within this year. I don't know. So that's quite hard to tell. We remain to be strongly motivated to continue the growth strategy what we have executed so far. So the management is quite motivated to continue acquisitions. We have capital to do that. I think, demonstrated that we have skills and experience to do acquisitions and to successfully include those new acquisitions into the group, especially given our track record during the last 7 years. So the intention, the ability, the skills, the capital is there. It just depends on the opportunities and the opportunities don't depend on us. So it's hard to tell. But nothing immediate, I would say.

Gábor Kemény – Autonomous Research

Hello. First question is on your ROE guidance, please. The way you phrased the ROE guidance, I think you said that ROE may decline driven by the decline in leverage. Now, can we take this as that you do not expect profits to decline significantly. Would that be a fair interpretation? Then moving to the expected decline in leverage. Or in other words, how do you think about capital distribution from here. The question I would have here is at what stage would you decide? Would you make a decision on doing another share buyback? A slightly technical question I have is whether you are planning to cancel the shares you buy back? Then I will have a final question a little later. Thank you.

László Bencsik – Chief Financial and Strategic Officer

Yes, your interpretation of our guidance is a potential interpretation regarding the ROEs. I mean, we carefully phrased these questions to leave some room open for analysts to shine and add value here. So I think it makes sense, what you said. In terms of capital distribution, potential other share buybacks. As I mentioned, once we conclude with the HUF 60 billion buyback, we will reassess the situation. Our capital situation, potential acquisition opportunities. As I said, it is possible that there will be another phase. So, we chose this gradual progress in buybacks. One of the reasons is that you have to deduct the entire amount. So once we got an approval for a certain amount to be brought back on that day, we have to deduct the entire amount from the regulatory capital, and that immediately increases the MREL issuance requirements, right?

So, if you look at our capital adequacy ratio, Tier 1 ratio, common equity Tier 1 ratio, we are very comfortably above regulatory requirements. We are above regulatory requirements in terms of MREL requirements. But in order to remain at that level, we will have to continue to issue MREL eligible bonds, which, as I explained, we consider extremely expensive. So every share buyback we do, we have to substitute that with newly issued MREL bonds or vice versa. The less we buy back, the last we have to issue in terms of bonds. So that's one consideration as well. Obviously, cost of capital is much higher than the cost of these MREL bonds, from an equity investor perspective, it's obvious what we should do, and we understand that, and we respect that, and we act accordingly. But it's not cost-free, so to say, right, to do more buybacks. Cancelling the shares, it's the same. First, we have to buy them back, and then we make a decision on this internally, what we're going to do. We have not addressed that question yet. But once we conclude with one batch of buybacks, we will consider the question of potentially cancelling them. That's another long process. You need regulatory approval. You actually need AGM approval for cancelling shares. So whereas we have an AGM decision, which gives the board the opportunity to buy back more shares. For cancelling shares, there has to be an AGM shareholders' meeting decision to do that. So management is not entitled to decide on it.

Gábor Kemény – Autonomous Research

Okay. Thank you. Just a quick one on Hungary NII, the outlook here. So, if we exclude the one-offs you indicated in 4Q, I think if this 4Q would be annualize on a clean basis, it would be above HUF 500 million. And if we put on that, this kind of quicker growth you indicate for this year for the group, maybe somewhere on the high single digits. Would that be a fair outlook for your Hungarian NII in your view?

László Bencsik – Chief Financial and Strategic Officer

Yes. I think that's a good approach. I'm sure there will be discussions coming, but I pre-end them. So, the NII sensitivity or the interest rate sensitivity. Especially in HUF the yield curve is steeply declining. So I think the right question is, what is the expected NII development y-o-y, assuming the current yield curve. That means that by year-end in HUF, we get to in terms of the 3 months Interbank benchmark to go down to around 5.1%, and in terms of Euro rate to go down to 2.65%, the 3 months Euribor, as a kind of current implied expectation in the yield curve. So, if the rate environment develops, according to the current expectations implicit in the current yield curves of HUF and the Euro, then HUF NII ceteris paribus is expected to increase y-o-y by 30%. The Euro NII is expected to increase by 4%, and the two together by 13%. So if nothing happens, no volume growth, nothing else, just the rate environment changes according to the expectations, implicit in the yield curve, we expect on a group level a 13% improvement y-o-y in NII, in the case of HUF and EUR volumes together.

And in HUF, this is much better, much more. It's actually 30%. And that is partially reflected in the fourth quarter number. Now, on top of that, there's another level of interest rate sensitivity. What happens if there is a further shift in the yield curve? So what is the year-end 3-month benchmark in HUF will not be 5.1%, but 1 percentage more or 1 percentage less. So that's another question, right? The answer to that is that in HUF, it doesn't matter much. So actually, our interest rate sensitivity to changes in the expectation. So, I'm not talking about the expected development, but changes compared to the expected development are relatively marginal and small. So, if the year-end reference rate, 3-months, BUBOR will be, 5.5% instead of 5.1%, or 4.8%. It doesn't really matter; we expect the same growth in annual NII. There will be a marginal difference. Whereas in EUR, there's a big difference. So any additional movement in the rate environment. So let's say, by year-end, the 3-months Euribor is going to be lower than 2.65, what is implied in the current yield curve, then actually, we lose EUR 16 million per 10 basis points on annual basis. So if it's 2.55, then it's EUR 16 million less. Then the growth is obviously less in EUR rate. So we still have quite a strong sensitivity to the EUR rate development, but if the EUR rate develops according to the expectations implicit in the current yield curve, then the EUR-based NII will still continue to grow y-o-y by 4%. I'm not sure, was that clear?

Gábor Kemény – Autonomous Research

Yes. Extremely helpful clarification. Thank you.

Operator

Thank you. The next question is from the analyst of J.P. Morgan Securities, Mehmet Sevim.

Mehmet Sevim – J.P. Morgan

Good afternoon. Thanks very much for the time. Actually, it wasn't that clear to me. I think or a bit more than me. So if I may just follow-up on that. So basically, if I understand it correctly, what you're saying is no matter what happens to 3-month BUBOR in Hungary, we will see NII 30% up this year, excluding volume impact. Is that correct? Because if that's.

László Bencsik – Chief Financial and Strategic Officer

In Hungary.

Mehmet Sevim – J.P. Morgan

HUF related. Yes.

László Bencsik – Chief Financial and Strategic Officer

Only part of the Hungarian NII, right?

Mehmet Sevim – J.P. Morgan

Yes, yes. Of course. So if you then add volume growth to that then, basically, we're looking at a higher level, essentially overall?

László Bencsik – Chief Financial and Strategic Officer

Yes.

Mehmet Sevim – J. P. Morgan

Okay. Great. Thank you so much for the clarification. So if I may ask a couple of questions on Uzbekistan. You talked about the really interesting growth trends there and how that's limited by local currency liquidity. What you know so far and taking into account all the limitations there, what kind of growth volumes should we expect there for the next few years, maybe at a subsidiary level there? Secondly, adjustment items, you made an interesting comment that you may move those back to recurring lines now. Could you give us some more information on that? So would that be for 2024? Is that in the ROE? I assume reported ROE guidance. Maybe separately, like-for-like, what kind of one-offs would you see this year? And how would you expect that to evolve in 2024 versus 2023? Thank you.

László Bencsik – Chief Financial and Strategic Officer

Regarding Uzbekistan, as I try to explain, we see almost unlimited growth potential, quality growth potential in retail lending, especially in consumer loans. Now, where the problem is and the limitation to this growth is the availability of local currency liquidity, which is very tight on the market due to very tight monetary policy. So basically, our growth in retail lending is limited by our ability to grow local currency deposits, or and potential sources of local currency wholesale funding. Here, we are talking to IFIs. But again, there's just not enough local currency in circulation. Therefore, that's a clear limit. So, really it depends on the monetary policy and the Central Bank, how much we can grow. But ultimately, for a longer time horizon is huge, right? Multiples of the current retail loan volumes can be, especially in consumer lending can be generated in the next couple of years easily.

So it is a high potential environment. Regarding the structure adjustments. We have received different feedback related to how we present the numbers. We have had a certain approach so far. We are going to try some different approach starting from 2024, starting from the first quarter this year in presenting the numbers. So we are going to have less adjustment numbers. So, we will save the adjustments for really acquisition-related. So bad wills, one-off risk costs at the time of acquisition or results from selling. Everything else will be in the normal profit line, so to say. The expectation for these types of one-offs is 0. We don't have any process, any acquisition process in a stage that we could say that for sure, we are going to have an acquisition this year, and that's also true for selling other than the Romanian bank, which we already included in terms of the financial impact on the P&L.

So in this sense, in the new structure, we don't expect actually one-offs. So there will be the adjusted and the non-adjusted number will be the same. If you talk about the content on the adjustments, what we did last year and how we expect them to develop this year, I can maybe share some views.

I think I mentioned this, the Hungarian taxes are the big one-off items or adjustment items. We have been showing in the current structure of the last year structure. So the windfall tax is going to drop down potentially to HUF 6 billion after tax from HUF 36 billion, what you can see on Page 6 of this presentation, maybe it's worth going there with the slide, Page 6. So, the windfall tax last year was HUF 36 billion, after tax we expect this line to go down to HUF 6 billion. That's in the legislation. In the first quarter, we had to book HUF 12 billion after tax, and then if you buy enough government bonds to fulfil the requirements, which we intend to, then once we do that, we can reduce the tax burden from HUF 12 billion to HUF 6 billion. So by year-end, on this slide, we expect HUF 6 billion as opposed to HUF 36 billion in 2023.

The normal bank tax is going to increase because, the tax base is the total assets of our Hungarian operations, and that keeps increasing. So this we expect to be close to HUF 30 billion as opposed to 2024.

Rate caps. The two rate caps, the SME rate cap expires at the end of March this year, and we don't expect further extension of the SME rate cap. It basically loses its relevance. The cap level is 7.7%, and the current base rate is 9%. By end of May, the reference rate definitely will be lower than the cap. So it's going to lose its relevance and we don't expect it to be extended. However, retail mortgage, variable mortgage cap, there's a cap on the benchmark is at 2%. So that 2% benchmark cap is going to be relevant in the second half of the year, because we expect the BUBOR benchmark to go down between 5% and 5.5%, and therefore, it remains relevant. If you assume and there's some probability, I must submit that it will be extended till the end of the year with a 6 month-period, the variable mortgage cap, then the cost of that would be EUR 6.5 billion after tax. So in this interest rate cap extension line instead of the '24, bad case scenario is EUR 6 billion. The good scenario is 0, and then we have to weigh the probabilities of those two.

In fact then the other two lines are probably not so much relevant on this slide, but we might go to Page 3, where we have the consolidated numbers. So we had, adjustments, 18, effect-to-effect. So effect of acquisitions, the expectation here is that this is the normal cost of the continuing merger projects, and that's basically, Slovenia, where we expect the merger to happen somewhere end of the summer, maybe early September. So this should be a low negative number. Then bank tax rate cap, I talked about Russian war effects, we don't expect much. We included here in 2022 was the Russia sovereign bond-related provisions what we made. We slightly increased these provisions in case of the overdue ones. That is the 2.8%, what you see here. I think my best estimate is that there will not be further changes in the provisioning levels going forward. On the other lines I don't expect much because 2023, HUF 15 billion plus was coming primarily from this. As I said, the reversal of the loss that we booked in 2022 regarding the Sberbank default in Hungary. So that was the expectations regarding the adjustment items in the structures that we have been using and what we still use in this presentation.

Mehmet Sevim – J.P. Morgan

That's super. Thank you, Laszlo. If I may very quickly go back to the NII sensitivity comments that you made. Again, you mentioned if the current yield curve doesn't change, then the group level NII would grow 13% without volume growth. So that obviously would imply that NIMs would go up further. So how should we reconcile with your flattish NIM guidance for the group for this year? What different assumptions do you have there in addition to this, that basically keep NIMs flat at the group level?

László Bencsik – Chief Financial and Strategic Officer

Yes. I mean, the problem is that the NIM is over total assets. There's a lot of noise there.

Mehmet Sevim – J.P. Morgan

Okay. So not directly comparable, I assume, but we should expect at least 13% NII growth?

László Bencsik – Chief Financial and Strategic Officer

Yes. But I suggested. I also said that there might be some positive risk in the guidance related to the NIM.

Mehmet Sevim – J.P. Morgan

That's super helpful. Thank you very much.

Operator

Thank you. The next question is from Máté Dudás on behalf of Erste Asset Management.

Máté Dudás – Erste Asset Management

Hello. My first question is regarding the Ipoteka Bank. As we have already past 2 months of this year, do you see already further drove down needs for Ipoteka? Or do you think that you are ready with the write-downs? And the other question would be, do you already use some artificial intelligence? Or do you plan to use it anywhere? That's it.

László Bencsik – Chief Financial and Strategic Officer

The normalization of the risk costs in Uzbekistan will be gradual. So we expect a step down in the risk cost rate compared to the 10% last second half of last year. We expect the first quarter to be much better than that, and then further improvement should happen in the second quarter. According to what we see, we will get to a more normalized level by the second half of the year. So this cost will be somewhat more elevated than the normalized expectations in the first quarter.

AI, yes, I mean, this is a very exciting development. We actually develop our in-house language model. So we do an in-house ChatGPT type of solution. We have in Hungary, but probably in all Central Eastern Europe, we have one of the very few supercomputers, and definitely the strongest in Hungary by far. So that's quite a big initiative. So if all goes well, quite soon we are going to have our own proprietary AI solution because the problem with the open-source solution is that bank security is hard to be productive.

If you want to use these language models in your actual banking services, providing banking services, you get to bank security, data protection question immediately, which is very difficult to fix. So we hope that we are going to develop a solution soon, which we can broadly use in our services. So yes, quite heavily in AI capabilities.

Máté Dudás – Erste Asset Management

Okay. Thank you very much.

Operator

The next question is from Simon Nellis of Citigroup.

Simon Nellis – Citigroup

Sorry, I was on mute. Thanks. I just have one last one on that side. The sharp rise in Stage 2 loans over the quarter. If you could elaborate on that? If that's of any concern or is it mostly because of methodology changes, I think I saw that was the case, particularly in Bulgaria. Thank you.

László Bencsik – Chief Financial and Strategic Officer

Yes. It's mostly methodology plus.

Simon Nellis – Citigroup

It's quite a large rise in Croatia though as well. Was there anything that we should be concerned about there?

László Bencsik – Chief Financial and Strategic Officer

I am not aware.

Simon Nellis – Citigroup

Okay. Thank you. That's it for me.

Operator

The next question is from attendee joining via phone. I open the line; you will receive an automatic message about it.

Robert Brzoza – PKO

Hello. Good afternoon, everyone. Can you hear me?

László Bencsik – Chief Financial and Strategic Officer

Yes.

Robert Brzoza – PKO

Thanks for the presentation. Congratulations on the results. This is Robert Brzoza. I'm sorry, I'm returning back again to the topic of NII in Hungary specifically. Could you please provide us more colour on the quite substantial quarterly increase in the NII in Hungary, already excluding the one of that you described in the report. I'm mostly interested whether this was coming from the deposit side. You alluded to an increase in overnight deposits in the retail segment in Hungary, or whether that was coming from the repricing of subsidized loans, which I believe is ongoing and should also let next year to a lift up in the NII core OTP, or whether there were any other factors at play, which, as I understand, these factors would be sustainable going forward later into this year? Thank you.

László Bencsik – Chief Financial and Strategic Officer

What we have additionally is the deposit cap. They are all different caption policy interventions into our pricing. But there's a corporate deposit cap as well, a policy cap. And that started to be effective by November, December. I don't know how long it's going to be effective, but that was another kind of boost. But other than that, it's just the factors that you explained.

Robert Brzoza – PKO

All right. Thank you.

Operator

Thank you. The next question is from Ulle Adamson – T. Rowe Price.

Ulle Adamson – T. Rowe Price

Hi. Can I ask, do you plan any issuance at the subsidiary level in the Eurobond market. So for example, either in Uzbekistan to finance growth or in Slovenia for MREL requirements? Thank you.

László Bencsik – Chief Financial and Strategic Officer

Yes. Slovenia, NKBM is going to probably issue more. Uzbekistan, we will see there's a bond which matures next year. So I'm sure we will try to renew that. We are trying to figure out potential ways to get local currency cost funding even in Uzbekistan, but that's difficult. We don't so much need for dollar, because we don't want to grow so much in all our lending. Retail lending is in local currency, and it should continue to be in local currency. So our liquidity needs are primary in local currency. That's not an international market, right? So it has to be some special solution with IFIs, or I don't know with the government. This work is in progress. But the existing bond when it matures. I think it will be likely that we will do the reissuance and we'll try to renew that.

Ulle Adamson – T. Rowe Price

Very clear. Thank you.

László Bencsik – Chief Financial and Strategic Officer

Thank you.

Operator

Thank you. As there are no further questions, I hand back to the speaker.

László Bencsik – Chief Financial and Strategic Officer

Okay. Thank you very much for listening to the presentation and thank you very much for your very good questions. I think the next stock exchange report will come out on the 10th of May. So I hope you will join us for that occasion as well. And until then, all the best, and goodbye.

Operator

Thank you for your participation. The fourth quarter 2023 conference call is closed now. Goodbye.

Note: unabridged transcript with minor English stylistic corrections.