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Moderator: Paul Formanko
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Operator: This is conference # 958739.

Operator: Welcome to the OTP Bank First Quarter 2016 Conference Call. At this time, all participants are in a listen-only-mode. There will be a presentation followed by a question-and-answer session. At which time, if you wish to ask a question, you will need to press star and one on your telephone.

I must advise you that this conference is being recorded today, Friday, May 13, 2016.

I would now like to hand the conference over to your speaker today, Mr. Paul Formanko. Please go ahead, sir.

Paul Formanko: Thank you, operator, and good afternoon all. Thank you very much for joining us today. This is Paul Formanko from JPMorgan and dialing in from Budapest we have with us today Mr. Laszlo Bencsik, OTP Bank's Chief Financial and Strategic Officer. Laszlo, please, over to you.

Laszlo Bencsik: Thank you, Paul. Thank you for the introduction. Good morning and good afternoon, depending where you are, and welcome on OTP Group's 2016 first quarter conference call. As usual, we have a presentation available on the website. So, hopefully, you've been able to access it and download it, and you can follow me when I go through at least the most important pages.

So, starting on page 2, you can see the quarterly results. The accounting profit was HUF34.3 billion and the adjusted profit, HUF47.6 million. We booked one item as adjustment, that's the bank tax for this year. The total annual bank tax was booked according to IFRS in the first quarter. We expect one more adjustment coming, likely to be in the second half of this year, and that is the one-off revenues from the Visa shares sales. We already communicated that the originally expected amount was EUR34.2 million, coming in as an inflow in the second quarter. Now, this has changed slightly. First of all, the expected time of this income has shifted forward somewhere to the second half of this year, and also the cash amount we are expected to receive should be higher. We don't know exactly how much higher, but the deferred part will be less which we did not quantify previously, and the upfront cash amount is going to be higher. We don't know exactly how much higher.

Next page, the P&L for the Group and breaking down different lines. First of all, you can see the corporate tax was relatively high compared to the pre-tax profit. So, we have a higher effective tax rate, mostly coming from Ukraine, but also Hungary and Romania was higher. You already saw last year that on a quarterly basis, the effective tax rate fluctuated somewhat, and this is going to be also this year. There is no reason, however to expect, on an annual basis, different effective rate than roughly 20 percent. So, these are more or less one-offs or kind of expected to reversing items related to deferred tax assets.

There were no one-off items only one with HUF0.2 billion. And in the lower section of this slide, you see the major P&L lines. I'm going to talk in detail about the various income lines and also about the costs. Some of those change because of seasonality, some of those change because of underlying business developments, which I'm going to explain later on. The very kind of striking out number is the risk costs. As you can see, the quarterly risk cost was HUF20.8 billion. I think we have not seen these levels of quarterly risk costs since 2008. So, this is a level which is, I believe, somewhat representative of the current environment and the future environment which we expect in the next couple of years, namely a reasonably relatively low risk environment, at least compared to the previous years. The risk cost rate in the first quarter was 1.3 percent on the Group level, which is indeed quite a normalized and moderate level.

Now going forward, on page 4, you see this split of the CEE countries and the Russia and Ukraine. During the previous two years, there was a huge gap between these two groups: CEE did very well, improved profits and was increasing, whereas Russia and Ukraine generated large losses, especially Ukraine, and these numbers on the slide do not include the one-offs which we booked in the eastern part of the country and Crimea for expected losses. So, even if we add those, that was even bigger, the loss in 2014 and 2015. And the good news is that the first quarter of this year was positive in Ukraine and Russia. This is in line with what we previously expected and communicated to you and this is why we are going to expect for the remaining part of this year, both of these countries providing positive results.

On page 5, you can see further details on the individual performance of the group members, Hungary being up quarter-on-quarter by 4 percent and down year-on-year by 2 percent. Bulgaria up quarter-on-quarter almost 30 percent and down 22 percent, but the first quarter last year was really exceptional because the risk cost was actually positive. So, there was a write-back. Thus, this huge difference year-on-year is more explained by that. And then we have this middle section, the smaller banks in the portfolio which contributed positively to the Group, each of them.

And then in the bottom, you see Russia and Ukraine altogether being positive and Russia in itself being positive, despite the fact that Touch Bank, which is this virtual unit which we report as such the online bank which remains negative, and actually the expectation related to Touch Bank itself is that it's going to continue to be negative for the remaining part of this year because we are still in this mode of building up this business and spending a lot on customer acquisition and having relatively large cost base, at least as long as we don't have the sufficient level of business volumes and revenues.

On page 6, we see a few miscellaneous items. The first one is the bank tax. You already saw in the first quarter results as compared to last year, there was a considerable reduction in the bank tax. Now, this we expect to continue from this year to next year, and on this page, we try to highlight the main expectations. So, basically the ratio of the bank tax is going to go down from 24 basis points to 21 basis points, and also the base of the calculation moves ahead. Therefore, the expected bank tax next year is going to be lower by HUF1.5 billion after tax. So, instead of the HUF13.3 billion which we booked in the first quarter this year, we expect HUF11.8 billion after-tax to be booked next year, that's a HUF1.5 billion decline.

There's also one more element which is revealed in the budget for next year, namely the elimination or cessation of the previous contribution tax. This is a tax which, if I remember right, started somewhere in 2006 and was related to the subsidized HUF mortgages and this was introduced by the socialist government at this time and we have been paying this extra tax. But we have reported this tax as part of expenses as general OPEX. We have not shown it as a one-off item and has been with us for 10 years now and it's going to phase out next year. So, this year, we paid HUF1.7 billion after-tax, HUF2.1 billion pre-tax, and this is an amount which will not appear next year. So the impact will be HUF1.7 billion after-tax positive impact on the bottom line and it's not going to come out of the one-offs or the adjustments. It's going to come out from the operational expenses.

Now, the rest is just updates on the ongoing Swiss Frank mortgage conversion program in Croatia and in Romania. We are progressing with these and expect to complete them soon. There's this extra legislation in Romania related to the walkaway rights of mortgage customers. We have not seen so far any changes in customer behavior related to this and therefore, we don't see any immediate impact or expected impact on future revenues or profits. And finally, the Visa transaction which I've already talked about.

On page 7, you see the total income development on a quarterly basis. Overall, we declined by HUF5 billion, 3 percent, and here you see the composition of this. There was a bigger step in Hungary and Bulgaria, and I'm going to explain it in detail, basically regarding the NII and the fee income and the other income which components resulted in this.

Now, this is minus HUF3 billion in Russia, and this is only coming from the FX rate. In ruble terms, revenues increased by 2 percent. So, the only reason we have 10 percent lower revenues in our reporting currency, which is the Hungarian forint, is that the Ruble was very weak, especially the beginning of the year. By now, it's corrected back. So, we have seen ruble rate strengthening and actually they are back to end of last year levels. So, this is going to be a kind of opposite direction in the second quarter, if things continue as they are. So, in HUF terms, in forint terms, we're going to see similar increase due to the exchange rate dynamics in Russia.

In Ukraine, there was an intrinsic improvement, both in Hungarian forint and in local currency - later you will see the details - and also Romania, but this is due to a base effect. You might remember that last year in the fourth quarter, there were HUF1.7 billion equivalent of negative one-offs, which reduced the revenues of our Romanian bank, and these one-offs are out and therefore, we have a sizable increase of the total revenues in Romania. But again, this is related to this base impact.

Going to page 8, where you see details of the net interest income decline on a quarterly basis, which was HUF4 billion altogether in HUF of which HUF3 billion came from Hungary. Now, out of this HUF3 billion, basically around 40 percent, close to 50 percent, HUF1.3-1.4 billion is related to the revaluation of derivative instruments related to the changes in the yield curve and basically the re-pricing of the IRS swaps. So, this was a kind of one-off and there's some correction we have already seen in April and May. Consequently, this is not going to recur in the further quarters.

Russia, again as you can see, in ruble terms actually, we had 6 percent growth in net interest income as opposed to the minus 7 percent decline in HUF. So, this is just related to the FX rate. And in Ukraine, there was a reasonably strong growth, which is partially due to the fact that the intra-Group subordinated debt was converted into equity. Therefore, the cost of funding of the Ukrainian entity went lower, whereas at the same time, the corporate center revenues declined in the Group. So, it's just an intra-Group allocation effect, but also there was another third-party sub debt which was repaid. So, that's another element which reduced the cost of funding of the Ukrainian entity.

Now page 9, last time we had the conference call, we had a lengthy discussion about the expected net interest margin of the Group and especially at OTP Bank, Hungary. Both on the Group level and in OTP Hungary, we had experienced a decline in the first quarter. Hungary was 343 basis points and on the group level, the first quarter was 484 basis points, which compared to the annual 2015 NIM for the Group, which was 511 basis points, you already had 27 basis points decline. And I said that we expect on an annual basis around 20 basis points NIM decline. It's clear that due to the current rate environment expectations in Hungary, this decline seems to be higher than 20 basis points on an annual basis.

So, on the Group level, our current best estimate of the annual decline of the net interest income is around 25 basis points. And this might surprise you that we don't expect kind of larger further decline of the NIM on the Group level, and the reason is that we expect still a step down in the second quarter. But in the second half of this year, we expect improvement primarily driven by volume dynamics, especially in Hungary, and also driven by stronger ruble rate in Russia, which will have some impact already in the second quarter.

In other markets, Bulgaria, we had a margin decline which will not be so severe in the following quarters, but will probably continue. Russia was stable in HUF terms, but again, if you look at the net interest margin in ruble terms, actually the NIM improved by 180 basis points, and due to the stronger ruble in the second quarter, this is going to translate back to the Group NIM as well and hopefully, when volume dynamics turn around in the second half as usually do in Russia due to seasonality, this might even improve in terms of the share of its contribution to the overall Group NIM. So much about the margins and the expectations related to the NIM for the whole year as a guidance.

Now, talking a bit about the volumes, first of all, the loan to deposit ratio, that's another very positive event. In the first quarter this year, the previous long decline of the loan to deposit ratio turned around and the decline stopped and we actually have 1 percentage point growth in the Group level net loan to deposit ratio. And most importantly, Hungary started to grow as well, which we are quite happy about.

Now on page 11, you see the reasons for this turnaround of the previous trend of the net loan to deposits ratio, namely the volume developments in Hungary. As you can see, during the first quarter, Hungarian performing volumes increased by 2 percent. There was a 4 percent increase in consumer loans and there was a 7 percent increase in corporates, including small, large and medium size ones. And if you only look at the loans to Hungarian companies, then it was 6 percent. So, the only part which remains to decline is the mortgage group, but I will later on try to explain the very positive developments of new mortgage demand and new mortgage sales. And in general, we are quite positive about expectations related to consumer loan volumes in Hungary and to corporate loan volumes, and the new mortgage production also looks very good.

In Russia, we saw consumer volumes going down in the first quarter. This is due to two factors. One is the usual seasonality. Usually, the POS volumes are seasonally weak in the first quarter in terms of new sales and therefore, we should see a decline in volumes, but also we have not restarted with large volumes credit card sales. So, this year, we are still conservative and the cross-sales machine has not started at full speed yet. We are doing it kind of low level, being very cautious and still waiting, but this is a potential business, so we can restart soon.

And then, in Romania and Croatia, you see this quite large decline, especially mortgages. This is related to the conversion in both of these countries. In Romania and in Croatia, we have ongoing programs to convert the Swiss Frank mortgages into local currencies or euro, and this conversion is coupled with discount on principle, and this is the result of these declines on volumes.

On page 12, you see the deposit dynamics in the first quarter, minus 1 percent. This is what we are quite comfortable with. Certainly, we don't want to increase deposit volumes on the Group level, given level of excess liquidity. So, this is not a strategic priority at the moment.

Now, going back to the other items of the revenues, namely the net fee and commission income, this declined on a quarter-on-quarter basis by 11 percent, which is equivalent to HUF4.4 billion. Now, this decline is usually seasonal. Each year we see this difference and seasonal decline in the first quarter which comes from two sources; one is that usually spending and card usage activity is much lower in January than in December and the other one is the calendar effect.

This year is a longer year, but February is a shorter month, plus there is a peculiar item in Hungary which appears every year in the first quarter and this is the financial transaction tax related to card transactions, which you have to pay in a lump sum in the first quarter; it was around HUF1.6 billion, and so this is something which always appears as a negative item in the first quarter. It did last year as well and this year, and therefore again creates the difference between the fourth quarter and the first quarter, and it should actually create a positive difference in the second quarter as increase should be expected there.

Therefore on this page, we're actually comparing net fee and commission income to the first quarter last year. So instead of quarter-on-quarter, we compare year-on-year numbers, and here you see a quite healthy trend, 4 percent growth, mostly driven by the Hungarian business, 7 percent which is actually fundamental, mostly related to POS transaction revenues to card usage, card-related transaction revenues, which have gone up.

Also when the new loan origination picks up eventually in Hungary and starts to grow, this should contribute positively further to this number, and to some extent it's already there. We have good growth in Bulgaria, 9 percent and then in Russia in ruble terms, the growth was 7 percent. Again, we have this translation FX conversion impact to local currency, which makes this number negative; otherwise it was actually 7 percent positive. In Ukraine, we have growth. So this is a revenue line where we see quite positive trends.

Other net non-interest income improved quarter-on-quarter. In Hungary, it was supported by FX gains and gains on other securities. In Bulgaria, the negative is related to this intragroup swap deal, which kind of usually introduces a quarterly fluctuation. And then Romania, I already referred to this line, this HUF1.7 billion improvement, which is entirely related to the base effect which appear in the fourth quarter last year due to one-off items which we described on this page.

The cost dynamics, again usually, there is a seasonality in the first quarter. So, on a quarter-on-quarter comparison, we improved by 13 percent, which is nominally HUF12.7 billion. Nevertheless, this is not a very meaningful comparison there on this slide. You see the year-on-year numbers and year-on-year developments, both in nominal terms and FX adjusted. So, nominally, there was 1 percent decline and FX adjusted, there was 1 percent growth, which was partially driven by the Hungarian increase. There was 2 percent increase in Hungary, which is related to this contribution to different funds and authorities. We've talked about this before and we expect the contributions to the deposits and securities protection funds and to the resolution fund to increase and we book it quarter-by-quarter gradually. So, this is an increase, which appeared and also other taxes increased and went up in Hungary. There was an increase in amortization in Bulgaria and there is more of it.

In Russia, by the way even FX adjusted, we've had 15 percent decline year-on-year. This is the result of the cost reduction program, the project which we concluded last year, which reduced our cost base in Russia considerably, and this actually contributes to a large extent to our improvement in the profitability of the Russian bank.

Page 16, we are starting to dig deeper into some selected group members' situation starting with Hungary. So, on page 16, you see the OTP Core P&L

items. I've already talked about basically each of these slides. So, I'm not going to repeat it.

On page 17, you see a macro slide, which potentially needs some elaboration. The GDP growth number came out this morning at 9 o'clock. That was actually after we produced this slide, so, this 2.1 percent GDP growth expectation might look ambitious given the 0.9 percent year-on-year first quarter growth, and I would agree that this is indeed ambitious and it's only kind of a higher end of the potential spectrum of GDP growth, which we might experience this year. Nevertheless, we expect improvement in the second half of this year.

Let me just elaborate a bit more. We have two opposing trends manifesting this year. One is the decline in the EU transfers and funds to Hungary, which is quite severe compared to last year, which was really a peek and boo and which is much lower than what we expect in 2017 and 2018. So this is a kind of cyclical effect of the EU transfers utilization, and this then slides to lower level of investments and CapEx. Therefore, you see a lower level of expected investments to GDP. This has an impact on the construction sector. There was a quite sizable decline actually in the construction sector quarter-on-quarter in the first quarter, and this is due to the decline of the EU funds.

On the other part, it's related to export growth. And as you can see, we expect a moderation in the growth rate of exports, and that's due to the fact that the Eurozone demand is somewhat lukewarm potentially driven by Chinese demand. So, with a German demand in terms of production goods and exports from Hungary was weaker, and this is effective while the other weak sector in the first quarter was the production sector. So these are the kind of negatives within the positive side.

We expect quite agile growth in household consumption. It can even be higher than this 3.6 percent what we highlighted here given the quite strong real wage growth. We expect 4.8 percent real wage growth and all the other positive incentives, which are given to the retail sectors and also the speeding up of retail lending. We see first quarter consumer loans were quite strong and you see 4 percent growth in just one quarter. This somewhat positively surprises us as well. So we are just modifying and increasing our own expectations and plans internally regarding how much we should sell, for instance, in the consumer loans, but also in mortgages. So there are very clear signs of increasing consumption, which actually translate by the way to higher consumer loan growth than we originally expected.

And the other thing is the housing construction and the housing market, which is really booming. So actually year-on-year Budapest was the highest-growing real estate price city in Europe. So this has been a quite good investment if you bought something a year ago in Budapest.

And as you can see on this page, the number of new housing construction permits started to steeply increase and if you annualize the first quarter numbers, then we get to 19,000, which is compared to last year figures of 12,500. There's a considerable increase. And actually, we expect an accelerating trend quarter-on-quarter. So the annual number is probably going to be definitely higher than this 19,000.

So these are the two factors; internal consumption growing more than expected, household sector growing, new construction growing, whereas on the other side, EU funds are less and therefore, construction industry somewhat slower or declining plus the EU demand is somewhat less.

There's another element here, the fiscal spending is increasing and there have been different programs announced and there seem to be definitely sizable room in the budget to increase spending, and we expect the government to do so and this will have impact already in the second half of this year, but most importantly next year. So the expectations for next year certainly don't change. We do expect at or above 3 percent growth for 2017 and also for 2018, and growth might be somewhat less than 2 percent this year. So that's the overall kind of macro, which might be for you as an insight.

Page 18, you see the activities in different segments in Hungary. Mortgage applications continued to grow. Number of new applications year-on-year increased by almost 70 percent, actually by 69 percent. Our share is still around 25 percent. We target 26.5 percent this year. So, this is a prescribed stretched target we try to achieve throughout this year as well. At corporate, we are quite strong. You've seen the numbers, so we grew by 7 percent performing and actually 8 percent gross loans, which increased our market share to 14.5 percent. We've never seen these levels before, and we are quite happy with that. And this is a strategy to continue to try to grow in corporate, which seems to be again more active than previously expected.

And these are just few highlights probably during the next session, the next conf call, we will elaborate more on these developments. We already told last year that we started a new program to enhance our services to our customers in Hungary through digitalization and new digital services and also improve our internal efficiency on working through digitalization, and these are some of the new services, which came out already to the market.

We launched just one-and-a-half months ago a discount program, for customers who are OTP clients using bank cards and eligible to that and we are recruiting retailers who are quite keen to join us. We already had Tesco joining us and MOL, which is the oil company; DM, that's kind of drugstore and white goods chain, and this is about discounts and write-backs. And already, we almost have 100,000 clients registered and using this after one month.

We have this Simple application, which again, I think, next time I will give you more information on this. This is very exciting and this is growing very fast. This is kind of a metro application, through which different services are available; for instance, you can buy cinema tickets in almost 100 percent of the cinemas, you can buy tickets online by selecting the seat yourself and you actually have the ticket. You can do parking by just clicking three times, and it finds your location and you can order cabs and you can order food and buy tickets to various concerts and all the festivals which are organized in Hungary.

There is a new online account opening for SMEs, which immensely simplify and fasten the process. We have a new payment engine for the utility bills. We have mobile POS application to make card acceptance cheaper for our corporate clients, and so on and so on.

So, we're quite active in coming out to the market with new innovations in terms of services and we believe that the next couple of years in Hungary will be about actually market development because volume growth started and we have already launched a lot of new type of services and applications for our customers. And there's a lot in the pipeline, which will come out during the next 1.5 years. So, we believe that we can further improve our market positioning in the country.

The next slide is Bulgaria, I think I mostly touched up this part. There was a decline in the total income due to the lower-margin environment and lower net interest margin. Risk cost was quite favorable, HUF1.5 billion; the risk cost rate 0.5 percent. I think this is the level where we should be or this is a potential level where we could be in the future, I would rather say that, given the risk environment in the country. And as you can see, we have improvement in corporate and SME loans especially both in mortgages and consumer loans, new sales increased.

And then a few words about Russia on page 21, Russia started to do well. It makes profits. Again in HUF terms, it's not so spectacular, but the ruble just weakened. In ruble terms, the improvement is even stronger and a key driver here is obviously the risk cost. On page 21 in the lower right corner, you see the risk cost rates by the major products we have. POS is down to 7 percent, that's quite good. This is hopefully the level, which we will see in the future.

Credit cards, still high and we hope that this is going to continue to go down. But again in credit cards, we really don't have new vintages. So, we technically stopped credit card selling at the beginning of 2015, and we haven't really restarted it in a larger scale. So, this is all the problems of the old vintages and the old loans. And once we restarted this business with the previous magnitude, which given the seemingly improving environment in Russia especially starting from the second part of this year, it might come sooner than we originally expected. Cash loans, I mean, below 10 percent risk cost rates. So this is okay. At this level, this is a reasonably profitable product.

Page 22, so you see the market dynamics. POS sales were RUB11 billion in the first quarter, which is quite a spectacular growth compared to last year, which was RUB8 billion in the first quarter and getting close to the 2014 numbers, which were RUB12 billion. So it seems clear that last year was the bottom of the cycle and this year at least in POS, we can do better.

Also in this slide, you can see that we haven't really restarted the credit cards. They continue to decline the volumes and the cash loan is somewhat more active than last year and very important factor for performance here is on this slide as well. That's the cost of deposits, which went up to quite a some extent last year and now started to normalize back.

So now the total cost of deposits is down to 7.9 percent, so below 8 percent, and this is due to the phasing out of the very expensive term deposits, which we had to make last year, and these were typically 12 months or six months term deposits. And as they phase out from our books, we expect further improvement in the cost of deposits and therefore in the margins in Russia.

Now Ukraine, nothing spectacular happened actually, except that there were no negative one-offs. And if there are no negative one-offs in Ukraine, then Ukraine is doing reasonably okay and produces positive results as it did last year in the second quarter. If you remember last year's second quarter, Ukraine was positive because that was a quarter where there was no FX devaluation, and we didn't provision extra for the old volumes and as long as there is no further stronger devaluation of the currency and no major disruption on the market or in the prevailing conditions around us. This is what we expect in Ukraine, a moderate, but growing profit. And in fact our vulnerability to exchange rate changes has been reduced considerably. There is hardly anything left from the previous dollar-based mortgage book and our corporate lending is mostly in local currency, as well. So, we are reducing fast our exposure to FX risk in the country stemming from FX assets we have.

Page 25, the summary about the risk indicators. So the risk cost rate on group level was down to 131 basis points, very good level. We're quite happy with it whereas the portfolio, the NPL ratios stayed flat. Coverage slightly declined, but this is again mostly due to the weaker ruble and hryvna rates in the first quarter and therefore there is smaller contribution of the very high coverage level of Ukrainian and Russian non-performing portfolios for the overall coverage level and the group level.

Now, Page 26, you see the portfolio worsening dynamics. The good thing is that Russia was only HUF17 billion. Usually, the first quarter is worse than the other quarters; that's the usual seasonality if nothing else happens because we have a high level of new origination in the last quarter and then the high level of defaults in the first quarter, but now it was quite a mild increase. We had some corporate defaults in Hungary and in Romania. These were the other two countries where there was material deterioration of the portfolio.

Page 27 shows the risk cost rates by countries. So, Hungary was down to pretty much zero; Bulgaria 0.5 percent; Russia came down to 10 percent overall; and Ukraine is down to 4.4 percent. And this is pretty much the entire presentation in terms of guidance and forward-looking statements. I've already said that we are modifying our guidance related to net interest margin. We expect around 25 basis points decline over the whole year compared to last year, as opposed to the original guidance, which was around 20 basis points. And the other guidance we said was related to this return on equity expectation for 2017. And we continue to believe that we are on the right track to achieve that given that the without bank tax return on equity during the first quarter was 15.5 percent, already this quarter, so this actually makes us feel confident that we can potentially deliver on this target.

And basically that was a formal presentation, and I'm more happy to try to answer your questions. So operator, please open the floor for questions.

Operator: Certainly. As a reminder, if you wish to ask a question, please press star and one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the hash key.

Your first question comes from Pawel Dziedzic from Goldman Sachs. Please go ahead.

Pawel Dziedzic: Good afternoon and thank you for the presentation. Just few quick questions from my side. The first one is on loan growth. So you stated clearly that you're expecting inflection point in mortgage lending in Hungary, but could you perhaps comment what sort of growth rates you are thinking about in one, two-year's time? And also separately, do you think that the strong growth in commercial lending, so both SMEs and corporates this quarter is sustainable? Were there any large ticket transaction that can perhaps distort a little bit of growth rates for the last three months?

Then I have a question on your operating expenses. You mentioned that the performance in Hungary, Russia and Romania as well were very good. Should we look at those as a sustainable run-rate going forward or whether any seasonal effect that could perhaps be taken into account? And also where do you see any cost saving potential across the group at this stage? And I leave it with that. Thank you.

Laszlo Bencsik: Thank you for the questions. So, mortgages: our original expectation for this year was still declining mortgage volumes. Given the higher-than-previously expected demand what we see today in Hungary, it might happen that somewhere potentially closer to the end of this year, we might be able to stop the decline of the portfolio in mortgages, that would be fantastic.

Consumer book: this 4 percent q-o-q growth, well, I don't think that we are going to grow each quarter by 4 percent. This is partially related to the base effect at the end of the year. There was a drop in the consumer loan volumes due to the fact that the bonuses were paid in December and that was kind of one-off decline, but certainly what we see now is well above our expectations in terms of the potential new sales we can do and therefore, again we don't expect quarterly 4 percent growth, but we expect quarterly growth in this portfolio.

Corporate book: yes, there were obviously bigger tickets and these bigger tickets are always kind of either they come or not, I mean you can't take them granted, but the pipeline is strong. We don't expect quarterly 7 percent or 8 percent growth in corporate loans, but we expect further growth in corporate volumes in Hungary, that's clear.

Now your question related to OPEX, each year, we have this seasonality, right. If you look back to the last couple of years, you always see this seasonality and the OPEX in the first quarter is lower and then, the subsequent quarters increased, whereas the last quarter is a kind of spike and a higher number. Therefore, I suggested to compare the first quarter this year rather to last year first quarter and the growth was 1 percent FX adjusted.

So, I think this is a number, meaning the FX adjusted one, we have 1 percent overall growth in OPEX. I would stick to our previous guidance on this when we said that we expected similar FX adjusted growth this year what we had last year, so potentially around 2-3 percent.

Cost saving potentials, this is not what we are focusing on at the moment. There're always opportunities here and there, and even we do have cost reduction initiatives, currently this is not the main target. We see in Hungary a reviving environment coupled with increasing demand. We are very hopeful that Russian demand for loans will increase as the Russian environment improves. Let me remind you that last year we made a huge cost reduction program in Russia. Certainly, we would be actually quite happy to increase the cost base in Russia, if it is coupled with sizable volume growth.

Likewise, Ukraine, we did a very drastic cost reduction program in Ukraine. This is not very evident, if you look at the numbers we have here, but given the level of inflation during the last three years, which was close to 100 percent, then actually keeping the levels is a big achievement in Ukraine. So this is not our main focus. We do still expect realizing all the cost synergies from the acquisition in Romania, so that's ongoing throughout this year, and there will be some late impact from this in terms of improvement, but other than that no major changes in terms of cost efficiency improvements expected. We are actually kind of switching our mindset into a growth mode, which makes us actually much happier than just cutting costs.

Pawel Dziedzic: And that's very helpful. So in other words, we should not look into 1 percent decline, FX adjusted this quarter as a run rate, you would rather stick to 2 percent, 3 percent increase going forward as indicated previously?

Laszlo Bencsik: Yes.

Pawel Dziedzic: Thank you.

Operator: Thank you. Your next question comes from the line of Simon Nellis, Deutsche Bank. Please go ahead.

Simon Nellis: Hi, Mr. Bencsik. It's actually Citibank, but that's okay. Yes, my first question would be just on the margin outlook in Hungary. I think you did mention that you're looking for a bit larger contraction, but could you give us some steer on where the margin in Hungary this year is expected to go and actually also in Bulgaria, there was a pretty steep drop, so maybe a little more on those two markets? And then maybe I can ask my other questions afterwards?

Laszlo Bencsik: In Hungary there was indeed a steep drop. It went down to 3.43 percent. And the second quarter will be even lower, so there we expect further drop and then starting from the second half of this year, we expect the volume growth to counterbalance the pressure on the margin. By volume growth, I mean the asset base remaining the same, but kind of converting our liquid reserves into loans, so basically increasing the margin on the asset side by doing more lending. The expectation for Hungary is that the second quarter will be further down and the second half of the year should actually show some improvement, at least that's the current expectation what we have. And if this happens then on a yearly basis, we might expect something similar to the first quarter level.

Simon Nellis: For the full year?

Laszlo Bencsik: Yes.

Simon Nellis: Right, in Hungary, okay. And for the group, you're basically guiding for around 25 basis points?

Laszlo Bencsik: Yes.

Simon Nellis: Okay.

Laszlo Bencsik: Overall, year-on-year decline. So, that's not compared to first quarter. That's compared to last year.

Simon Nellis: Right. And can you give us a little color on the yield on the existing mortgages, kind of the back book and what the yield is on the new production that you're doing? And maybe also give us some color on the yields in Hungary on corporate, consumer and mortgages? I'm trying to figure out as the expected growth in mortgage, what's that actually going to do to your margin and likewise, is fast growth that you are seeing in corporate that really help or is that much lower margin business than what you have historically done?

Laszlo Bencsik: You don't seem to believe me, right? I just told you --

Simon Nellis: Kicking with higher, right, so to speak.

Laszlo Bencsik: The yield of the new production in mortgages is very similar to the yield on the converted mortgages, right.

Simon Nellis: Okay. And what's that exactly?

Laszlo Bencsik: Around 4.5 percent, and this is the spread actually. So, this is not the yield. This is the spread. And then it's certainly lower than the very old subsidized HUF mortgages, which have been declining for the last 10 years now. So, this is something which is not a new development. As for the corporate spreads, large corporate spreads are around 2 percent. SME spreads, well, they actually should increase because for the last two years, we mostly sold loans under this lending for growth program where the spread was capped at 2.5 percent.

Now, this is phasing out. It's existing, but the new volumes are quite small. So, the actual market rates are somewhat higher than 2.5 percent spread. So, the micro, small, medium spreads of new production actually increased compared to what we saw during the last two years, and large corporates between 1 percent to 2 percent spread.

Simon Nellis: Right. And on the consumer side, just finish it off.

Laszlo Bencsik: Consumer is really juicy. So, that's a very good business.

Simon Nellis: Okay. And then maybe one last question just on Touch Bank. You mentioned in the past that you were thinking of rolling it out elsewhere. Is that happening or what's the …

Laszlo Bencsik: No, not yet. First, we want to see this to succeed, right.

Simon Nellis: Right. Thanks so much.

Laszlo Bencsik: Thank you.

Operator: Thank you. Your next question comes from the line of Gabor Kemeny, Autonomous Research. Please go ahead.

Gabor Kemeny: Thank you. My first question on Romania, I think you mentioned that 20 percent of your clients decided not to participate in this FX conversion scheme. I recall you assumed more like 100 percent participation when you set aside the provisions for this scheme. So, do you have some room for provision write-backs here. And secondly, maybe if you can follow up on the profitability of the overall Hungarian business, how would you expect the overall profitability of OTP Core to evolve from here? I mean, your provisioning was not too far from zero in the first quarter. I guess, you mentioned that loan growth could accelerate somewhat in the second half. You are not really targeting cost growth. If we put these together, it could be helpful if you could give us a sense how the overall profitability of this business could develop.

Laszlo Bencsik: So, regarding Romania, yes, when you do these voluntary programs, there is always a certain share of customers who don't want to do it. Now, there can be two reasons why they don't participate. One is that they don't want to do it because they go to court and they try to have a larger discount by going through at least a legal process. And then, you have another type of customers, who don't care either because they don't care or because the volume of the loan is so small that it's not worth going to the branch and do the paperworks.

Now obviously for those clients who proceed with the legal action, we do have to have the provision there. The very reason we did this program was that there had been a very considerable threat that a very large proportion of our clients actually go through the legal process and we might lose actually much more than the discount we gave to these customers, right.

So I believe it's quite reasonable to keep the provisions for those clients who decide to pursue legal actions against the bank. And for those customers who just don't do anything, yes, we will release provisions probably, but we don't know it yet. So this is not going to happen in the second quarter. Maybe by the end of the third quarter we are going to have a clear picture. When the program is over we will see exactly which clients are going to proceed with legal actions, right. So not in the second quarter and not in the third quarter, but probably at the end of the third quarter, we might be in a position to reassess the situation.

Core profitability I already said what we expected for the margin. Volume growth should happen this year. It already happened during the first quarter and seeing the market demand, it should continue during the course of this year. It's going to be still low-single-digits, lower than 5 percent overall growth in the volumes in Hungary, but it might be actually higher, so the second half might be higher. I really don't know because we were positively surprised actually by the first quarter, especially the consumer loan developments and the current demand for consumer loans, that clearly exceeded our previous expectations. So, I don't know actually. It might continue to surprise us positively, because there's a strong real wage growth and the mood is relatively good. Real estate price is going up and so on and so on. So this might increase spending.

Risk cost, I've said it before, as I expect structurally lower level of risk costs not just for this year, but for the next period in Hungary, which might be next two or three years, even more. It may not be zero, but it should certainly be low and I don't see any reason why it should be high number. The cost base, we have already touched upon, so these are more or less the moving parts. As I said we expect further decrease in the margin in the second quarter. So revenues might decrease in second quarter and then hopefully and hopefully the revenue trend bottoms out in the second quarter this year; that would be our kind of optimistic expectation. And then, we should see revenue growth driven by volume growth, despite the lower interest rate environment.

Gabor Kemeny: That's very clear and I guess that the risk environment is very benign and you have a high NPL coverage. Can you give us any sense where maybe a range where this -- where would you see your provisioning in the, let's say, two years? I mean, in the domestic business?

Laszlo Bencsik: Sure. I don't see why the risk cost rate should be higher than 50 basis points. So, it's somewhere between zero and 50 basis points. We will see. The other question is, how much we can recover? Because seeing the strong development in the real estate market, we're certain about positive developments. For many years, there was a moratorium on foreclosure, right? So, it was fairly difficult to work out the non-performing mortgage portfolio and the market was also quite sluggish. Now, this has changed a lot, and now we have a very dynamic real estate market where prices are going up and there are no further restrictions on foreclosures or doing proper work out in this area.

So again, this can be a rather positive surprise if we manage to have higher recoveries on the mortgage portfolio than the original provision. And if that happens, then we might be able to actually write back provisions and risk costs can even be positive. But what I can say officially about the level of provisions is that it's adequate and proper and in line with our expectations to eventual credit losses. But there can be a positive surprise seeing the developments in the environment.

Gabor Kemeny: And when you say up to 50 basis points, you don't assume any substantial write backs there?

Laszlo Bencsik: Certainly, no. If you look at the portfolio, it's not deteriorating, technically. And then there are possible write-backs. On the other hand, we find it prudent to have some levels of provisioning. And there's IFRS 9 coming in 2018. So, there can be other factors. But, I think, what I can say for certain, I expect a lower risk environment in Hungary and I don't see any reason why it should change for the next two years or three years. Elections come in 2018. So, next year will be quite strong in terms of GDP as well as 2018. So, we are going to see, I believe, two very dynamic and prosperous years in the country in which case, risk costs should be quite low.

Gabor Kemeny: I have one final question. I think you accrued about HUF13 billion for dividend payment in the first quarter. Could this be any kind of indication of how management thinks about the dividend payout next year?

Laszlo Bencsik: Yes. If you multiply it by four, then you roughly get to the number which is our initial thinking about the potential levels of dividends. But obviously, this is not final. This is just an indication, but I think a good indication.

Gabor Kemeny: Okay. Thanks very much.

Operator: Your next question comes from the line of Alan Webborn, Societe Generale. Please go ahead.

Alan Webborn: Thanks for the call. Could you put a little bit of color on where the sort of corporate lending demand is coming from? Is it more private, large corporates? Is it investment loans? Is it states? Just to give an idea as to where that's coming from.

And you started the call by telling us that you're revising down your GDP because of this sort of maybe EU investment hiatus, and I just wondered, should we be a little concerned that's being a sort of rush and there could be a little more caution as if -- at least in the short term, the economy is weakening. So, that would be really helpful to understand what the corporate lending dynamics are looking like, in Hungary in particular.

And secondly, perhaps a little bit of a view in terms of how the competitive environment is developing. You paint a quite positive picture of the dynamics of the banking economy and you talk about juicy consumer margins. Then, capital tends to move to where juicy margins are. Do you feel there is more competition coming in in unsecured retail or anywhere else in your major markets, particularly again in Hungary? That would be interesting to hear your view on that.

And I guess finally, where are you sort of from an investment perspective in your digitalization process? The sort of back-end and front-end -- you put a lot of impressive applications on your slide, but I wonder where the Group is in terms of where it want it to be and when it gets to a point where that investment can start paying dividends in terms of cost efficiencies? Again, your view on where you are in that process would be helpful.

Laszlo Bencsik: Related to corporate: the micro and small growth was 2 percent in the first quarter. So, that's just the very plain vanilla lending to micro and small corporates, and there is no one-off there. And so this is what we expect to continue pretty much, and as a quarterly growth, 2 percent, this is already very strong. There were some large corporate deals. There was one big commercial factoring deal, for instance. This is one of the particular business lines which we are trying to develop strategically, I mean the commercial factoring. So, it was a mix.

The kind of underlying growth was roughly 2 percent, and then it went up to 7 percent by some bigger tickets, but these bigger tickets, they don't come every quarter. Therefore, I said that it's obvious that we are not going to grow by 7 percent, 8 percent quarterly because then the annual growth rate would be, well, I don't know. So, this is not going to happen, clearly. But a good 6 percent to 8 percent, overall 10 percent growth in corporate, that should be possible.

Now, the corporate lending dynamics, around 6 percent to 8 percent growth in micro, small, which is the kind of less volatile part, and then on top of that, it can be pretty much around 10 percent, anything plus/minus, depending on the other corporate and kind of large corporate growth. It can be actually double-digit growth for the full year.

Again, the bigger tickets in the first quarter were partially commercial, partially related to kind of state enterprise funding. This is as well, a developing area because quite a number of utilities, energy companies and so on now belong to the state sector. So, really big ticket investments and developments are expected on that front. By the way, a huge share of the funding of the corporate sector is done cross-border. So, the structure of the large corporate lending in Hungary is such that a large share of corporate lending is not done through the Hungarian banking sector, but rather through group funding from the parent companies somewhere in Europe, typically.

And this is not going to be channeled through the Hungarian banking sector, that's clear. It will remain as cross-border lines. So, the kind of larger ticket growth potential is in the state-owned sector, which actually increased a lot during the last couple of years. I don't know how much you follow the process, but they basically re-privatized the utility sector mostly, and there are large investment plans.

By the way, the fiscal room is huge for state development. If you look at the budget, it looks phenomenal, and certainly the next few years will provide opportunity to more spending and still keeping fiscal deficit below 2.5 percent.

Now, on competitive dynamics, I would describe the environment as healthy in terms of competition. Everyone is trying to grow and compete, but we don't see crazy behavior, neither in pricing nor in risk taking. How long it's going to last? I do not know. Certainly, we have two type of players in Hungary. Some of them have already kind of doing okay returns or coming back to okay levels of profitability. And then, we have some which are still not doing very well. Part of them are state-owned like MKB, part of them are not state-owned, but there is clearly a big appetite for profits and returns as opposed to market share, I would say. And given the losses during the last couple of years, I think now certainly there is a strong desire to recover at least part of those losses for our competitors. This makes us somewhat hopeful that no one will start a crazy price competition or something like that, and I certainly don't expect new players, at least short-term, to come to the market. But this is obviously hard for us to judge how the competitive dynamics is going to evolve in the future.

Digitalization, again I think next time, I'll elaborate more on this topic because this is something we are very excited about and devoting a lot of effort, energy and money to develop various digital services and to actually make an internal digital transformation as well because we are working on two fronts. Obviously, one is the external part, the services we provide to our customers, and the other front is the internal processes, how we manage and conduct business internally. And on both fronts, there are a number of initiatives. We have more than 100 different individual projects under this umbrella only in Hungary, and some of the results are already out in the market, so you see that.

And I think, I will try to be more specific on this and prepare a few slides about this for the next presentation. But clearly, this is something where we focus, and we have a program which we laid down in the beginning of last year and we are executing it. So, we know where we're growing and we believe that this is going to elevate our service level to a different platform and our target is clearly to continue to stay ahead of the competition in Hungary.

Alan Webborn: Okay. That was very interesting. Thank you very much.

Operator: Thank you. Your next question comes from the line of Stefan Maxian, RCB. Please go ahead.

Stefan Maxian: Thank you. Good afternoon. Just a few questions from my side. First, you talked about this stronger corporate loans in Hungary, and with regard to the larger tickets as well. Why has been the fee line actually -- the corporate fee line in Hungary a bit weaker, if you look at the year-on-year development? Has there been a special reason for that?

The second on AXA actually, can you give us more clarity when you expect closing of this? And if there would be some -- maybe give a little bit of guidance, if there are some special costs related to that, or if we might even see a positive consolidation effect as you brought that portfolio quite cheaply.

And then just for clarification on the Visa Europe transaction, what is -- again, I don't know if I got it right, what's the amount that you will book in the P&L later this year and how much of that has been already accounted for in equity last year via revaluation gains?

Laszlo Bencsik: So, corporate fee, I see this number on page 13 of the interim report. I have to check. I mean, there is no obvious answer I can give you at the moment. I have to check this. I think, there is some one-off or irregular item behind this because there is no obvious reason. We are going to check it and come back to this, okay?

Stefan Maxian: Okay.

Laszlo Bencsik: Regarding AXA, we are going to conclude the transaction by the end of this year. And what we have said was that we expect the volumes will increased by 20 percent, the mortgage volumes. Obviously, there are some repayments by that time, so the performing volumes are a bit lower. Consequently, it's somewhat less than 20 percent. And what we expect is an increase from then on in the revenues. Honestly, we haven't communicated the structure, how this is set up and how exactly the pricing is done. So, if you excuse me, I'm not going to elaborate on this. But once we close the transaction, it's going to be more or less obvious with what discount and what pricing parameters we acquired that portfolio.

Visa Europe, the P&L impact is going to come somewhere during the second half of this year. It appeared in the comprehensive income during the fourth quarter last year, so it's part of the equity. And the amount is this, what we said, EUR34.2 million. This is what we booked into the equity and it will appear in the P&L somewhere during the second half of this year. This was the initial amount which we were told we would get as an initial cash payment and this is the amount which is going to increase because it's structured in a way that there's an initial payment and then there is an earn-out component. And the earn-out component is going to be less and the initial payments will be more, but we don't know yet how much more and much less. So, it should be more than EUR34.2 million, but we don't know how much more. It's already in the equity since the fourth quarter last year and it's going to come through the P&L somewhere in the second half of this year.

Stefan Maxian: And maybe one final clarification, you talked about this special tax that is booked in OPEX and that should disappear from next year on, right?

Laszlo Bencsik: Yes.

Stefan Maxian: So, that will be HUF1.7 billion lower OPEX from the special tax?

Laszlo Bencsik: No, that's actually the after-tax impact. So, there will be HUF2.1 billion lower OPEX, and the bottom line after-tax impact will be HUF1.7 billion.

Stefan Maxian: All right. Thank you.

Laszlo Bencsik: Thank you.

Operator: Thank you. There are no further questions at this time, please continue.

Laszlo Bencsik: Okay. Well, thank you very much. Thank you for joining us today. Thank you for your interest. I wish you all the best, and I hope you'll join us during the second quarter conference call, which will be on 12 August. I wish you all the best and a good vacation if you go for the summer, and thank you again for joining us. Bye-bye.

Operator: And that concludes our conference for today. Thank you all for participating. You may all disconnect.

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