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Strategy and Finance Division

Investor Relations & DCM

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Transcript

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

Operator

Dear Ladies and Gentlemen, welcome to the OTP Group First Quarter 2023 Conference call. This conference will be recorded.

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

László Bencsik – Chief Strategic and Financial Officer

Thank you. Good morning or good afternoon depending on where you are and thank you for joining us today for this conference call. The presentation is available on the website and during the call, I'm going through it. You can also follow it online or in printed copy if you have any.

As usual, I will give a short presentation. I promise it's going to be short and then the Q&A session follows.

If we start on Page 2, the after-tax profit of the first quarter was a historic high. We have never had such a strong quarterly result. Obviously, this was largely affected by one-offs, which cancelled each other out. We accounted in the first quarter for the usual bank tax (HUF 25 billion after tax), which was introduced in 2010, and the windfall tax, the recent one, according to the original methodology which was applied last year, and it's another HUF 63 billion, so banking taxes altogether HUF 88 billion after tax.

We also had a positive effect coming from the Nova KBM acquisition, as badwill and initial risk cost, and some related items are represented by this green line here, totaling HUF 85 billion. So, these almost cancel out the special banking taxes for the first quarter.

We had one more positive one-off. You might remember that last year there was a default and resolution of Sberbank Europe, including Sberbank Hungary. We booked the expected loss last year, but that loss did not manifest, so we reversed that booking in the first quarter this year.

All in all, there's not much difference between the adjusted and the after-tax profit. The adjusted is somewhat lower.

In ROE terms, we do rather well, of low 20s territory, which is arguably better than what we originally indicated, that it might be around last year’s level, which was 18.8%. So far, better than our original expectations.

Going forward, looking at the P&L on page 3, there are some factors which you shall keep in mind when you look at our data. First of all, we consolidated NKBM starting from February. February, March include NKBM, the Slovenian Bank. Plus, there have been quite strong movements in the exchange rates, such as the HUF/EUR rate and HUF/RUB rate. In order to get a full picture, you have to look at developments without NKBM and FX-adjusted, which is the second column from the right. As you can see, total income went up 3% q-o-q, costs were flat, and operating profit improved 5% in the first quarter. The risk cost was the biggest mover of the results. It was much lower in the first quarter than in the fourth quarter last year. The portfolio across the group has been stable. Even Russia, Ukraine, where we booked larger provisions last year, seem to be doing well in terms of portfolio quality. There was really no need for further provisioning.

On this slide, you can see the net interest margin, which is probably the most interesting as we're looking at the feature of our quarterly report. There will be a slide where we detail the NIM development by entity. But overall, the group level net interest margin increased from 3.5% to 3.66%. Cost-to-income ratio remained below 50% but slightly increased compared to the average of last year.

Looking at the Hungarian performance, it's not as good as the consolidated one. Adjusted profit went down y-o-y considerably, and this was mainly because costs increased and margin contracted. This resulted in this squeeze of profits in Hungary. Q-o-q we had some improvement but that’s rather due to seasonally higher costs at year-end plus lower risk costs.

ROE, not very high, but this is obviously somewhat distorted because here the balance sheet includes all the investments in the subsidiaries. These have implications for capital as well. This is the calculated ROE. Here, you can see the one-offs, which manifested on a stand-alone or sub-consolidated level. One important factor here is that the badwill does not appear at this level. The badwill only appears on a consolidated level. That's why actually, without dividends, we see that the Core business is negative HUF 37 billion in the first quarter, as we booked the special taxes but not the badwill here.

Now turning to the other countries. I think it is very important that you see the NKBM contribution, HUF 13 billion equivalent for 2 months in terms of profit after tax. Bulgaria somewhat declined, but that's due to one factor: we had to book all the regulatory charges related to deposit protection in the first quarter in Bulgaria, in SKB (Slovenia) and in Romania, but for a smaller amount. In Bulgaria, that resulted in a HUF 9 billion cost increase compared to the previous run rate. If we adjust for that, the profit was almost as much as in the fourth quarter last year.

Strong Slovenian performance, including the new acquisition, and this is obviously going to further increase in terms of impact in the second quarter where three months of the given quarter will be accounted for. Croatia, Serbia are growing fast. Albania, Montenegro are doing well, also Moldova, surprisingly, given the situation there. In Ukraine and Russia there are very strong and stable earnings, the operating environment in both countries stabilized. Therefore, it allows this level of profitability. Portfolio qualities seem to be stable as well. Romania is the only country where we could not reach the required level of profitability and the required level of size, and there was even some decline q-o-q. If you look at the efficiency indicators, they obviously improved a lot, but that's due to the NIM expansion. More about that later on.

If we turn the page, there are some further details on Russia and Ukraine, as usual. There is no major change in the situation in the countries, but probably worth noting is the coverage level. Even with this strong HUF 13 billion equivalent profit and more than 40% return on equity in the first quarter, we managed to increase coverage close to 25%. This is provision over total gross loans, so gross provision coverage is quite strong.

In terms of liquidation impact on capital ratios, there is not much difference from 4Q last year. Russia contracted somewhat. We've increasing retained earnings and equity, which is a potential loss if we have to deconsolidate. At the same time, the other factor here is the exchange rate, which is important. The ruble started to weaken, and that reduced this number. The ruble rate has a potential impact on the overall level of capital ratios on a consolidated level. This is something to watch because if the ruble weakens, then it has a negative impact on our consolidated group level Common Equity Tier 1 and this has a negative impact in case of consolidation, it reduces it. Ukraine decreased to 5 bps of potential loss. That's due to the earnings, which were retained there.

The first quarter was characterized by the consolidation of NKBM. The work started to merge the entity. It usually takes 1.5 years for us to fully consolidate an entity and fully merge in case we have two entities in a country. We can expect the merger to conclude sometime during the third quarter next year.

Now if we go to the Uzbekistan story, page 7. In 2Q we expect to close the Uzbekistan deal with Ipoteka Bank. We have talked about this before, the bank has close to 8% overall market share, 30% market share in mortgage lending. It's the fifth largest bank, state-owned and the first in the line of privatization. In terms of earnings potential, as you can see the latest published data for the first half last year, was HUF 17 billion equivalent. That's the run rate of profitability for 6 months period. So at least this much should be the contribution from Ipoteka for the second half of this year should the transaction close, which we expect to be so.

Now looking at Ipoteka numbers, I think there's one unique feature, and that is the quite high loan-to-deposit ratio. It doesn't mean that we have to refinance the entity with large third-party loans. Its mortgage lending is to a large extent done by funding from various state organizations at a preferential rate. That means that the mortgages have somewhat subsidized level of interest rate. Those are large interbank liabilities. That's the line where all these factors come in. Should we buy the entity, which we will, then this is only a small amount which we have to refinance, less than USD 50 million equivalent.

The price we have not made public, but we alluded to the potential size of it in the updated guidance because we said a roughly EUR 200 million one-off positive can appear in the second quarter related to the transaction if it closes. That, again, is a combination of initial risk cost and mostly badwill, so buying the entity with badwill. At least these are the original data suggested results.

On page 8, total income. If you are looking at the q-o-q columns, it can be somewhat confusing, so I'll try to explain the meaning of the different colors and numbers. So basically, the grey ones are the ones which are related to the NKBM transaction. The total income line was impacted by HUF 23 billion income from NKBM. If you look at the q-o-q change in total income and the nominal change, HUF 23 billion out of the HUF 6 billion was the impact of NKBM. Without NKBM, the nominal change would have been minus HUF 17 billion. If we also adjust with the FX rate, then you get the second number in the last column on the right, which is 3%. So, without NKBM, the FX-adjusted overall income increased by 3%. So that's the most meaningful number. Wherever we have two numbers, the second one is the FX-adjusted. The similar logic is tracked in the following slides.

Now, a deep dive into net interest income. Again, NKBM contribution was HUF 18 billion to net interest income. In terms of movement, looking at the FX-adjusted number q-o-q, there was quite some improvement: 17% up in Bulgaria, 18% up in Slovenia, excluding NKBM. In Croatia, there was a double-digit growth in net interest income on a q-o-q level. Even Russia improved and Ukraine improved somewhat. The only exception is Hungary, where we have flattish net interest income dynamics. The explanation comes on the following slide.

On page 10 you can see the net interest margins. Again, Hungarian margin was flat. This is basically a combination of very little growth and the fact that we have a strong overweight of fixed assets in the balance sheet and therefore, the increase in the rate environment had a negative impact during 2022. There was not much rate change between the fourth and the first quarter. We had some increase in corporate loan net interest income. That provided a small improvement here in terms of 3 bps, but it's rather flat.

Unfortunately, the expectation here is that the second quarter will be worse because of the change of the compulsory reserves. The amount what we have to put into reserves increased from 5% to 10% and the rate changed in a way that for one quarter of it they don't pay anything. The effective rate of this 10% reserve requirement is 9.75%, which compares to the 18% reference rate, so we are losing more than 8% on these reserves. New reserve requirement regulation came into force from April, thus the second will probably be even lower in Hungary.

Hopefully, we will see a fast normalization of the rate environment. Certainly, for the second half of the year, we expect rather rapid cuts in the reference rate. Hopefully, this will induce improvement in the Hungarian NIM. From our perspective, we expect the first cut to happen in May because today, the new inflation data came out, and it is 24%. So finally, it started to visibly decrease. Hopefully, the central bank will react to it by starting the rate cutting exercise.

In all the other countries, as you can see, net interest margin improved, and that's obviously due to the euro rate increase. Bulgaria and Montenegro are also applying to become euro countries. Basically everywhere, due to repricing on higher benchmarks, we see improvement, and that combination resulted in this slight increase in the overall consolidated NIM. Hungary was flat at a low level, and all the other countries improved quite fairly.

Now on page 11, loan volume dynamics. Not surprisingly, loan growth slowed down to close to zero. Altogether, we had 1% growth in the portfolio, and that's in line with our previous guidance of not more than 5% growth overall, 1% in one quarter. Especially, mortgage lending is weak: except for Bulgaria, there's not much growth. Hungary started to decline in terms of mortgage volumes. It's the consumer lending which is more robust. Especially in Hungary, consumer lending is still growing albeit at a much lower rate than last year, but it's still growing. In corporate volumes, there was some increase, namely in Hungary and in Bulgaria. This is related to a larger deal which was booked in these two countries related to a leasing company in Slovenia, which we refinanced.

Y-o-y changes, page 12, maybe not so interesting. I'm moving to the deposit section on page 13. No change of deposit levels on group level without the NKBM acquisition. Hungary was minus 1%, within that corporate deposit book went down, retail was flat. In fact, retail being flat meant that our market share in retail deposits increased because overall in the market, retail deposits declined in Hungary. The corporate deposit volumes are very sensitive to pricing. The fact that you see some bigger plus and minus numbers means that we optimize the funding structure in each country, and we try to minimize the corporate deposits because, by far, they are the most expensive to take, so we take as much as really is needed.

In retail, it's more flattish in Croatia. We had a somewhat bigger decline in the first quarter. That's due to two factors. One of that there was a very attractive price for retail bond program done in the first quarter which attracted retail savings and a few private banking clients migrated to banks, which provided a high deposit rate. But again, this is far more than enough for Croatia, they're quite liquid. Plus, there was another impact, namely that the euro was introduced on 1st of January, and there were a lot of deficits made to accounts, and people withdrew money in the first quarter. So that's the other technical impact here.

We included one slide with further details on deposits with the share of insured and the share of term deposits. These numbers are quite stable. We don't have a time series here but stable levels in terms of share of term deposits and the pricing level of overall deposits. For instance, Hungary q-o-q was flat, so there was no further increase in overall cost on deposits.

Going further to net fee income. This is a complicated structure to get the numbers. Without NKBM, not looking at the grey numbers, the real fundamental change can be captured in the second number in the last column. Net fee income went down by 6% q-o-q. Here, the biggest factor was the bonus payment to the fund management company in Hungary. They overperformed the market last year, therefore, in the fourth quarter, they received the bonus that's included here. Russia increased somewhat, but that's more seasonal there.

Other income: there's some cross play here between Hungary and Bulgaria. The intragroup placements and swap transactions between the entities – especially on the Bulgarian side – explain some of the changes. In Hungary, we had FX-gains and derivative gains, so the trading result is doing better in the first quarter.

Costs, page 18. We see 2-3 bigger numbers here. Hungary 25% y-o-y cost growth. That's quite strong, led by personnel expenses, but also other costs were strong. This is related to wage inflation, a slight increase in headcount and a strong increase in real estate costs and other service costs in Hungary. Just to remind you, in Hungary, today's inflation number was 24%, but the peak was 26%. Hungary has by far the highest inflation environment among the countries where we operate.

Bulgaria, 55%. Again, this is just a technical item that is coming from the increased regulatory charges for deposit protection. Albania, the legal merger happened, and that had some extra costs. Here we continue to merge the two entities. Unlike in other processes, we first did a legal merger, and the operational merger will follow. This increase will disappear as we realize the cost synergies.

In terms of capital adequacy and liquidity, our capital ratios went down due to the NKBM transaction. That's quite visible here. We expect another 30 bps impact from the Ipoteka transaction, which should happen in the second quarter. But of course, in the meantime, we expect to generate earnings. So hopefully part of it will be compensated by retail earnings in the second quarter. We do quarterly reviews and incorporate the quarterly results in the consolidated capital ratio. Liquidity remains robust, the LCR ratio was close to 200%. Net stable funding ratio was close 140%. We sit on 12 billion liquid assets in euro terms.

Let's move to the next page. This is the usual portfolio quality. Stage 3 ratio continued to decline. There's not much to talk about here because portfolio quality is, again, quite robust even in countries like Russia and Ukraine. There's not much to report here.

Just a bit more color on the Hungarian situation. As you can see, mortgage lending dampened. Applications went down by almost 80% compared to the first quarter last year, which was a very strong quarter, by the way, in terms of base since that was the time for the green housing loans. Nevertheless, this is the picture. Mortgage lending is at a very low level in Hungary. Consumer lending is still okay: there's some growth, as you can see, 2% growth on a quarterly basis on the consumer loan side in terms of cash loan volumes.

Overall retail savings: our market share somewhat declined, but more importantly, in retail deposits, so actual deposits, our market share increases, and our volumes were flat. It means that overall in the market, there's actually a negative trend of retail deposits. People, due to the high inflation, are living off their savings and reduce them. That's one factor. The other factor is that they migrate their savings to bonds, to typically sovereign bonds. We have somewhat lower market share in that segment than other players.

In terms of the subsidized retail structure, the baby loans are getting less and less since the eligible client base is running out. The green loan program, as you can see the seasonality of last year, was very strong in the first quarter. It is still some going on in terms of issuance, but the program closed at the beginning of the second half of last year. Our market share was very high, 42%, much higher than our usual market share in mortgages.

Corporate slowed down as well. We had a very strong year last year, 32% overall growth, and they started to slow down considerably in the 4Q last year and actually slowed down to 3% in the 1Q. This was characterized by one big deal mostly. There may be much less growth for the remaining part of the year. There are two subsidized structures, the Széchenyi Card and the Baross Gabor Loan Program, both quite active and so are clients.

There's the usual ESG informational rating. The rating of Sustainalytics keeps improving. There were improvements in terms of ESG riskiness, this is something we strategically focus on and keep as a very important factor of our efforts.

Now in terms of the macro, Hungary has the lowest expected growth, even lower than Russia and Ukraine this year. Due to very high inflation and the very high-rate environment, which resulted in substantial drop in consumption, in new investments, there's a break on the Hungarian economy as they try to moderate inflation to more palatable level. We expect this effort to be successful, and we expect inflation to go below 10% by year-end. Obviously, the reduction will accelerate in the second half of the year. Inflation really started to pick up a year ago in April or May, and then skyrocketed during the summer up to 26% year-end last year. So compared to that base, we expect 9.3% inflation.

The rate environment we expect to drop below 10% by year-end from which we will benefit in a meaningful way. Our sensitivity to the HUF rate is HUF 15 billion NII per 1 percentage point. This is true until 13% level, from which there's less than that: only HUF 6 billion to 1 percentage point.

This is the Hungarian situation. Other countries show somewhat higher growth potential and much lower inflation levels for this year. Something we should keep looking at. But in these countries, we see a stable operating environment. We don't see increasing risk or concentrations of risk. Even Moldova is doing okay where we had quite a big drop in the GDP. Then Ukraine, huge drop last year and some improvement this year. As you could see, we have positive earnings in these countries.

Now finally, page 26. When the pending acquisition of Ipoteka goes through, there will be a one-off badwill impact of around EUR 200 million. The next point here is the net interest margin. As I indicated, the Hungarian Core net interest margin might not improve in the second quarter. Rather, we expect a decline in 2Q. From that level, if rate cuts manifest, you should see an improvement. But in 2Q Hungary will not be better than in 1Q. We do expect some improvement in the other countries. Nevertheless, it may not be enough to compensate for the group-level NIM. The group-level NIM will be potentially impacted here as well.

Now, there's good news: the calculation of the windfall tax changed. For the first 6 months of the year, it is calculated in the same method as it was done last year. But for the second half of the year, the calculation methodology changed, and it is basically pre-tax earnings adjusted with dividends received and the extra taxes. The percentage of that is the new tax, which in our case results in HUF 28 billion less tax. We are going to book this adjustment in 2Q. So that will be a plus HUF 28 billion pre-tax number in 2Q.

As for the others, like risk profile, cost efficiency, volume growth, we keep the previous guidance: stable risk profile, pressure on cost efficiency and cost-to-income ratio and organic performing loan growth not more than 5%. And the ROE around last year. Here, I think, you should note that the first quarter was much better than last year. Last year, on average, we had 18.8%. First quarter was 22-23%. Our first quarter performance was somewhat better, and there might be some potential here to even achieve more than last year.

So that's the short summary of the situation, and I'm sure you have some questions, so please ask them.

QUESTIONS AND ANSWERS

Operator

The first question is from Gabor Kemény from Autonomous Research.

Gabor Kemény – Autonomous Research

I'd like to pick up on your last point when you noted that there could be some upside to the ROE guidance. Can you just talk a bit about this further, where could the upside potentially come from?

László Bencsik – Chief Strategic and Financial Officer

Risk costs.

Gábor Kemény – Autonomous Research

That is indeed what we saw in 1Q. Yes, my other question would be a broader one. Where would you see the earnings share, the contribution of the Hungarian business relative to the current businesses going forward, in a normalized rate and inflation environment, if we don't assume more acquisitions beyond Ipoteka, so maybe next year?

László Bencsik – Chief Strategic and Financial Officer

In the first quarter, the volume share of the Hungarian business from loans was 30%, for instance. The share of adjusted earnings of the Hungarian entity was around 30%. Hungarian margins should improve in a lower rate environment if rates normalize.

Then the subsidiary rates, I mean, it's a question of how fast they develop. Next year, I don't know what the euro rate is going to do. Maybe there will not be so much normalization or reduction until we have the current level of rate environment in the euro-related countries. In Hungary, we see a fast decline in the rate and therefore our NIM to improve somewhat. That suggests that Hungarian share could increase during the second half of this year.

Next year, again, if Hungarian margin improves, it can provide a boost. But in terms of underlying business, if you exclude the margin from the equation and just look at the fundamentals, volumes, and sales and so on, then I don't see any leverage in Hungary. If you look at the macro data, it's going to be challenging on the budget as well. The inflation, which is coming down from a very high level. So given the more challenging macro perspectives in Hungary, the underlying businesses can grow bigger and faster outside Hungary than in Hungary, especially if you consider Ipoteka, there's a huge growth potential there.

Operator

The next question is from an attendee joined via phone.

Robert Brzoza – PKO PB Securities

This is Robert Brzoza from PKO BP Securities. I have a question regarding the outlook for the NII in Hungary. Basically, you sound more cautious this quarter. A quarter ago, you said you expect the NII to improve compared to 4Q 2022. Also, you alluded to the changed expectations regarding the interest rate outlook in Hungary, where during the call, you discussed the lower income from the reserve requirement. So basically, my question is, what's the major reason behind the change in this stance? The additional one is, is there a need at OTP Core to adjust upwards the pricing for deposits, given what you said on the smaller competitors attracting depositors away, as I've understood, from the bank?

László Bencsik – Chief Strategic and Financial Officer

That comment was related to Croatia, regarding deposits. In Hungary and in Croatia, we decided not to increase the deposit rates. In Hungary, the average overall level of deposit costs or average interest on deposits somewhat declined due to combination effect.

The quarterly NIM improved from the fourth quarter, but that improvement was not as strong. It was only 3 bps. In the second quarter, we are going to see two new factors. One, the reserve requirements reducing NII, through the change in the reserve requirement. Hopefully, the rate cuts can start as early as this month. If the rate cuts start, then this can be positive. We expect the change in the reserve requirements outweigh the short-term impact of the rate cuts.

So overall, 2Q might be the bottoming out. From there, we expect improvement. If the rate goes down to the level where we expect, close to 10% or below 10% by year-end. These are the most important factors here. It's not repricing of deposits; it's the reserve requirement change and when exactly the rate cut starts to happen. We expected that somewhat earlier in our previous expectations when we talked about the NIM development potential in Hungary. But again, q-o-q, there was some improvement, but not much.

Robert Brzoza – PKO PB Securities

Right. If I may continue with the outlook regarding the cost of risk. Do you think there's potential for provisioning charges to improve potentially? Is it coming more from decreased NPL formation across the board? Or there are better opportunities for write-backs and NPL sales, which is the dragging force behind it?

László Bencsik – Chief Strategic and Financial Officer

Stable quality.

Operator

The next question is again from an attendee joined via phone.

Olga Veselova – Bank of America Securities

This is Olga Veselova from Bank of America. I have several questions. One is about your sensitivity to lower benchmark rates. You mentioned HUF 15 billion and HUF 6 billion to falling rates, so different in light of the policy rates. Could you please confirm if this is valid for falling rates, and are we talking about sensitivity to BUBOR or the sensitivity to deposit rate? This is my first question.

László Bencsik – Chief Strategic and Financial Officer

The sensitivity is HUF 15 billion per 1 pp. It's related to the benchmark rate, which is 18%, the overnight deposit rate.

Olga Veselova – Bank of America Securities

Right. Okay. It's deposit rate. Perfect. You mentioned that at some point, it will fall from 15 to 6. At what level does it fall to that?

László Bencsik – Chief Strategic and Financial Officer

When it goes over 13%, right? When the reference rate catches up with the base rate.

Olga Veselova – Bank of America Securities

That's clear. My second question is about your cost of risk, which was a very positive surprise for us in the first quarter numbers. You had mentioned that the asset quality outlook is stable. How shall we think about the cost of risk outlook going forward from the 1Q level?

László Bencsik – Chief Strategic and Financial Officer

Well, again, we don't see portfolio deterioration. It can stay at a lower level. But it's a big portfolio, and there's a lot going on macro-wise in these countries. I cannot exclude a scenario where it starts to increase from the level we had in the first quarter. Nevertheless, I think it should not be higher than last year levels overall. So, no visible signs of this deterioration.

Olga Veselova – Bank of America Securities

Great. Okay. My third question is about Hungarian interest rate caps. Could you just please update us on any conversations about potential expansion of interest rate caps?

László Bencsik – Chief Strategic and Financial Officer

I'm not aware of any discussions here other than us trying to argue for not to apply it further. There are some messages sent through the media. Bankers complaining and then the ministry people arguing back. But so far, there's no clear indication of where these rates might go.

Olga Veselova – Bank of America Securities

Right. Excellent. And I have a last question. This one is less technical, bigger picture, holistic question. The historic OTP was good in M&A and grew very well organically. Now organic domestic growth is negative in real terms, and the latest M&A was outside of CEE. Could you share with us what's your strategy for the next, not year, but maybe years? Where do you want to grow going forward?

László Bencsik – Chief Strategic and Financial Officer

We have a strong preference for growing in countries where we are present. I think that that's, by far the strategic priority. Then opportunistically, we keep our eyes open for other jurisdictions. First of all, we would like to grow in the countries where we are present.

Operator

The next question is from Tejkiran Kannaluri Magesh – WhiteOak Capital.

Tejkiran Kannaluri Magesh – WhiteOak Capital

Just wanted to understand more about the Magyar Bankholding that is expected to be live in May of this year. From your perspective does that change any of your assessment of the competitive dynamics of the Hungarian market in terms of loans, deposits, market shares and the pricing of your deposits? How are you looking at the Magyar Bankholding Corporation? What is your evaluation of this?

László Bencsik – Chief Strategic and Financial Officer

Well, in general, we welcome consolidation in the market. That creates better competitive dynamics. We consider it, from our perspective, better if a new entity is created, as opposed to one of our foreign competitors buying up all its assets.

Tejkiran Kannaluri Magesh – WhiteOak Capital

Just a follow-up to that. But another entity that could compete with you on market share, could they start writing larger corporate loans? Would they be able to attract deposits at more favourable rates? Is there any chance you see this could affect the competitive dynamics of the market? That’s my last question.

László Bencsik – Chief Strategic and Financial Officer

Usually, less players mean better competitive conditions, not worse. We are typically more conservative in every pricing instance than our competitors. We are always typically more expensive than competitors, and we can do that because we are bigger than the rest. If there’s another big entity, they can potentially also have this pricing power more. And that should, in our view, ease competition, not to increase, but we will see.

Operator

The next question is from Weronika Lurka from Morgan Stanley.

Weronika Lurka – Morgan Stanley

This is Weronika from Morgan Stanley. I have two questions. The first question is regarding the loan growth outlook in Hungary. So how do you see the outlook for loan growth? Could there be any positive surprises?

László Bencsik – Chief Strategic and Financial Officer

I don’t think this year will bring positive surprises in loan growth. Hopefully, by next year, we’re going to see single-digit rate numbers and then we can expect again a revival of lending activity.

Weronika Lurka – Morgan Stanley

Great. The second question is regarding your acquisition in Uzbekistan. Could you provide us with some more color about your expectations for Uzbekistan and the key drivers that make this acquisition attractive for you?

László Bencsik – Chief Strategic and Financial Officer

It's a large country, with 36 million people and growing fast, quite young population, underpenetrated and underserved in terms of banking services and growing fast. The GDP growth is expected to be around 5%.

We expect very fast growth of the banking markets in Uzbekistan, and we would like to take our share from that and benefit from being the first in the line of privatization of state-owned banks. So that's the underlying rationale. Last published data was for the first half last year. There, they made roughly USD 50-ish million in 6 months and of ROE of 22-23%. So at least this much should come from them as first contribution for a 6-month contribution this year.

Weronika Lurka – Morgan Stanley

Just to understand what the competitive environment is in Uzbekistan at the moment and where you see the most potential to improve Ipoteka operations?

László Bencsik – Chief Strategic and Financial Officer

In terms of digitalization, they have quite good infrastructure services, and there's one online player, named Click and the TBC Bank is present with primarily online value proposition. These are the 2 strong retail digital players. Ipoteka is the #5 bank, and the first 4 are also state-owned. They are much bigger in corporate lending, and they are financing state-owned corporates. That's a different segment strength than what Ipoteka has.

Our objective is not to be strong in lending to state-owned companies. We want to focus on the retail. Ipoteka has 30% market share in mortgages, so that's potentially a big area where we see market opportunity, given the very fast urbanization and large programs to build new housing for the growing population. I'd say the function of the retail and the mortgages and transactional services, consumer loans.

Operator

The next question is from the attendee joined by phone. (Operator Instructions).

Jovan Sikimic – Raiffeisen Bank International

Many questions already answered, but I would have 2 to 3 if I may. If you could elaborate a bit on deposit pricing in some countries. You mentioned Hungary and Croatia, but how is it going in Bulgaria and in other bigger countries like Serbia, Slovenia. How do they compare to the previous quarter, is there any type of pickup there?

László Bencsik – Chief Strategic and Financial Officer

Yes. It's also Romania where we see strong deposit competition in terms of pricing. The other countries, not so much.

Jovan Sikimic – Raiffeisen Bank International

Okay. You mentioned Romania and the scale there. We all noticed. But what is your strategy there? Let's assume, there is no M&A in the next 3 to 5 years. Would you consider exiting the country or whatsoever there?

László Bencsik – Chief Strategic and Financial Officer

This is difficult question. We have tried several things in Romania, but we have so far limited results. We have a strong operation there. We invested a lot during the last couple of years. It's now robust and strong, but it's a very competitive market. I think we have to carefully consider what we do there. It is a very attractive market, not an easy situation for us, and we try to figure out new ways to solve this situation.

Jovan Sikimic – Raiffeisen Bank International

Okay. One last, if I may. You have not included any explicit wording on Russia-Ukraine outlook. But I hope that given the robust results in 1Q that wording is similar to the last one, so expecting better profit compared to the last year.

László Bencsik – Chief Strategic and Financial Officer

Quite strong in both countries. The only problem is that the equity is locked there. We cannot take out dividends from Ukraine, and we haven't figured how to take our dividends from Russia. So that's the only problem. The earnings are locked there.

Operator

The next question is from Simon Nellis Citigroup.

Simon Nellis – Citigroup

First question is on the integration of NKBM and SKB. Could you elaborate on that and what kind of synergy you expect and how long that whole process will take. That would be my first question. Second, just following up on Russia, we heard that Raiffeisen is looking to potentially spin off their Russian business by the end of this year. Do you see any opportunity to also exit? Then last, if you could just comment, sorry if I missed this during the presentation, on potential extensions of some of the regulatory measures, windfall tax. In addition, we hear the same for rate caps in the second half of the year.

László Bencsik – Chief Strategic and Financial Officer

Integration process, usually it takes 18 months. We target maybe 30%, 40% of the smaller entity as a potential cost synergy. We use consultants, obviously, and some additional IT costs usually emerge, but it's not large and the savings are much bigger.

In Russia, we continue to explore strategic opportunities. But there is a ban on selling these assets. It's actually very difficult to do so. Nevertheless, we continue to look at various options. But the underlying scenario is that we continue, and the business is doing okay. We are a tiny player in Russia, focusing on consumer lending. We are very far from being systemic and we hope this is acceptable for every party because selling the assets seems to be quite difficult.

Measures in Hungary, we don't know. I think there's some reason to be potentially concerned that they might be extended. I mean, the question is with what conditions. So certainly, the rate cap, my hunch would be that it is going to be extended, but hopefully at a higher level than today. The tax, that's a longer story because it is for next year. There's a bad track record with the previous tax, which was introduced for 3 years, and then it still stays with us. Not sure.

Operator

The next question is from attendee joined by phone. (Operator Instructions)

Iuliana Golub – Goldman Sachs

This is Iuliana Golub from Goldman Sachs. Two questions, please. I was wondering about your MREL strategy going forward. I appreciate the clear guidance you have given us on issuance plans for this year. But would there be any plans to issue senior non-preferred at any point in time beyond 2023? The second question is on the Slovenian subsidiary. It will have an independent MREL requirement. So just to confirm, you will apply a multiple point of entry resolution strategy there?

László Bencsik – Chief Strategic and Financial Officer

Yes, at least for this year and next year, the NKBM entity is going to be separate from the rest of the group. It's still a question mark what the treatment of the entity after the merger will be, but most probably it will stay outside as well, as a multiple point of entry subgroup within the single point of entry group.

As for the issuance, for this year we indicated that it is senior preferred. It seems that we can fulfil the subordination criteria and requirements by doing those. So, no visible plan for non-preferred.

Operator

The next question is from Mehmet Sevim, JP Morgan Securities.

Mehmet Sevim – JP Morgan Securities

I have 2 main questions, please. One on deposit betas in Hungary specifically. It seems that the retail segment is repricing a lot slower than the corporate segment, which of course, makes sense. But are there any reasons specific to Hungary that are keeping retail betas at these low levels, you think? How do you see repricing evolve from here? You mentioned earlier in the comments that deposits aren't really what will cause the margins to go down from here. But could you see a scenario where this becomes a pressure point later in the year?

Second question, if I may. This is on cost of risk in Ukraine, which declined quite visibly this quarter. In fact, it was the lowest since the start of the war. But still, there was some visible increase in Stage 3 loans at the same time. So how should we think about provisioning and asset quality dynamics in Ukraine specifically in the remainder of the year?

László Bencsik – Chief Strategic and Financial Officer

Retail deposit pricing remains very low and overall deposit pricing did not change q-o-q. The reason for that was that there's a lot of liquidity. Each bank is quite liquid and there are the levies and windfall taxes. Everyone must pay high taxes, and in order to earn enough to pay them, there's a strong incentive to make profits. We don't have new players. Each bank which operates in the market has a quite robust own portfolio. These portfolios will be immediately repriced if they start to increase the rates much more than competition. It seems that everyone is aware of the potential dynamics, should someone start a deposit price war. But obviously, we don't know whether this is going to happen or not. This is obviously up to each player individually what they do.

Yes, so Ukrainian asset quality, the portfolio is quite okay. In general, we also have higher coverage on Stage 2. The Stage 3 migration, to be frank, I don't know exactly what happened. Just checking. But overall, Ukrainian asset quality seems robust and stable, which is in a way surprising. I think the interesting part is that we had increasing coverage with low provisioning. There, what happened was that the portfolio declines.

Mehmet Sevim – JP Morgan Securities

Very clear. If I may, is it reasonable to expect that these levels of cost of risk will remain for the foreseeable future? Given we were close to 3% this quarter, but last year was obviously significantly higher.

László Bencsik – Chief Strategic and Financial Officer

Yes. I got the figures. The Stage 3 ratio in Ukraine went up from 18.1% to 22.6%.

Now here, it's also that the overall portfolio keeps declining, and it declines fast. So, part of this is explained by that, so it's just the denominator getting smaller and smaller. Whether it can be characteristic for the whole year, at least just for the 2Q, it seems to be characteristic.

Operator

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

László Bencsik – Chief Strategic and Financial Officer

Okay. Thank you very much. Thank you for joining us today and thank you for your very good questions. Let's come back to the 10th of August when we discuss the 2Q results. Until then, wish you all the best. Goodbye.

Operator

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

Note: unabridged transcript with minor English stylistic corrections.