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OTP Bank 2Q 2017 Results Call

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Paul Formanko: Hello, everyone, and thank you very much for joining us today. This is Paul Formanko from JP Morgan in London and from Budapest we have Laszlo Bencsik, Chief Financial and Strategic Officer of OTP Bank. Hi, Laszlo; over to you, please.

Laszlo Bencsik: Thank you, Paul, thank you for the kind introduction. Good morning or good afternoon, depending where you are on this warm summer August Friday. Thank you for joining us today and we are going to talk about the second quarter results of OTP Group in 2017. As usual, the presentation which I'm going to use is available on the website so I hope you have been able to download it and you can follow me going through some of the pages which I would like to highlight and provide you with some comments, and then as usual you will have the opportunity to ask questions.

Jumping into the presentation, starting on page two, you'll see the high-level summary of our first-half results. On a year on year comparison, accounting profit-wise we increased 26% and the adjusted profits improved by 39%. The adjustments in this half of the year were negative altogether, whereas in the base period last year they were positive due to the Visa transaction results which we obviously did not have this year, so this year the adjustments consist of two items. One is the banking tax and the other major item is the one related to the consolidation of the newly-acquired Splitska banka. I'm going to elaborate a bit more on this topic later on in the presentation.

Overall this is a quite decent result, I would say. If you look at our accounting return on equity, for the second quarter it was more than 22% and for the first half it was 18.5%. Just to remind you, we originally targeted above 15% return to equity on 12.5% Common Equity Tier 1 ratio basis. If you recalculate the return on equity on the basis of equity which is equivalent to the 12.5% Common Equity Tier 1 ratio, then the return on equity would have been 26.1% in the second quarter and 22.3% in the first half of this year, which are, I think, quite decent and good numbers given the typical profitability of universal banks in Europe at this period of the cycle.

Going to the more detailed level of explanation of our results on a group member basis, you can see on page three that the adjusted consolidated profit of 78.3 billion and its decomposition for the second quarter. As you can see, Hungary did quite well, improving on a quarterly basis more than 20%. Bulgaria was more or less stable, slight decrease on a quarterly basis; Russia and Ukraine doing decent performance. Then we have Croatia, which did extraordinarily well. Obviously this number includes the Splitska banka results for May and June, for the two months' results which were HUF 4.6 billion and include a one-off 1.7 billion other provision release which happened in these two months. So there was a one-off positive on top of including the Splitska results, so it's unlikely that we will have similarly good results for the following quarters because we had this 1.7 billion one-off in this number.

Romania, Slovakia and Serbia did somewhat less well. That's due to basically methodology change which we applied regarding those real estates which we get possession of through non-performing retail exposures and we accelerated the provisioning of these real estates in a one-off way, changing the methodology, how we provision for these, increase the provisioning and that resulted in negative profits in Romania and Serbia. These two entities, other than these one-offs, do reasonably well and should come back to proper levels of profitability or the expected level of profitability for the remaining part of the year.

Now on page four you see the one-offs and, as I've said, the biggest item in the second quarter was related to the acquisition of Splitska banka and this positive HUF 3.2 billion after tax number includes all the elements - there's a very long list of the adjustments on top of the badwill which we had to account for when opening the initial balance plus doing the purchase price allocation and the cumulative results of all these elements ended up being 3.2 billion after tax plus.

Within this number we highlighted two elements. These are the customer base value adjustment and the fair value adjustment of loans. These two together were 6.8 billion after tax and this is going to be amortised over time during the next couple of years. Therefore we decided to highlight this because on this slide we will have a reversal of this amount during the next seven to ten years. Therefore it was, I think, a good practice to show them directly.

The minus 0.8 billion which you also see here as a negative amount, that's due to the revaluation of the investments in our subsidiaries in Hungary. That obviously doesn't have a P&L impact other than the tax implications: when we increase the value of one investment by decreasing the previously accounted-for impairment, then we have a tax commitment coming from these accounting actions.

Going to page five, you see the P&L lines. It's quite encouraging to see that especially on the total income line we see a quarterly and yearly growth of 8% and 13%. I will talk about this, but obviously part of this improvement is coming from again the impact of the acquisition, the two-month effect of Splitska banka in May and June and that had a positive impact on the net interest income, the fee income so basically all income lines, plus there were some technical details which I'm going to share with you regarding the net fees and commission income which resulted in part of this improvement on a quarter on quarter basis.

The total risk cost is the other line which deserves particular attention given the particularly low level of risk cost which we booked in the second quarter. This was due to some favourable developments, namely in Hungary, but on the other hand we also had one-off negatives, as I just told, in case of Romania and Serbia especially.

Regarding our capital position, the Common Equity Tier 1 ratio, the reported one at the end of the second quarter was 14.1%, but this does not include the interim earnings minus the expected dividends. If we adjust with these numbers then it would have been at 15.4%, this is a number which can be compared to the fully-loaded year-end number of 15.8%.

The ratio includes the entire impact coming from the Splitska acquisition. Altogether this reduced our Common Equity Tier 1 ratio by 1.4 percentage points, and as I'm going to talk about it, we have signed agreements regarding two more acquisitions, one in Romania and the other one in Serbia. We expect these to be consolidated hopefully by year-end, so during the first quarter, but for sure the first quarter next year the latest. The expected impact on the Common Equity Tier 1 ratio of the consolidation of these two entities together is less than one percentage point negative.

The two acquisitions I've mentioned; one in Romania, Banca Romanesca, previously owned - or currently still owned by National Bank of Greece, having 1.7% market share and we expect that with this acquisition we can jump up on the ladder in Romania to be number eight, and we make a material, substantial step towards our goal in Romania to become a sizeable bank which provides the required economies of scale for our operation there, so we're quite happy about this. We believe that we create value by this acquisition given the price we pay and given the potential we identify there.

Very similar situation in Serbia on page eight; we are acquiring Voyvodanska Banka from the same seller, by the way, National Bank of Greece. In this case the difference is that Voyvodanska Banka is much bigger than our operation in Serbia. Obviously we are quite small there, it's by far the smallest loan book we have in the group there, so this is going to definitely change our market positioning in the country and make our size meaningful, and the level of operation much more efficient. By this acquisition we will potentially reach the threshold of 5% market share and get to 5.7%, but this is a much smaller market than the Romanian one.

These two deals are in line with our acquisition strategy, which we have talked about a lot during the last couple of years, that we want to improve our market position in the existing markets where we operate, and especially where we don't have the required size to perform at the level of profitability which we expect from our group members.

On page nine we tried to highlight the importance of this acquisition story because it might have not come through entirely. In fact the four acquisitions including the AXA one which we did last year, including Splitska which we consolidated in the second quarter this year, and also including these two more, Banca Romanesca and Voyvodanska Banka, which are not in our books but will be there hopefully by the end of the year. If we add together the performing loan volumes of these four entities and compare it to the beginning of 2016 OTP Group performing loan volumes, then the increase which they bring to the Group is 26%. So, these four acquisitions increased our performing loan volumes by more than one quarter; the gross volumes increased somewhat less, as you can see, 23%.

I believe this is already a material improvement in our operations and in the potential to generate revenues within the Group. Just to put it into perspective, during the same time period the organic growth of the book was 8%, so our performing volumes have grown by 8% during this 18 months since the beginning of 2016.

A bit more details on the different P&L lines. The overall total income, as you can see, the quarterly change, the plus 16 million came from Hungary and from Croatia and not surprisingly, the Croatian improvement is basically linked to the acquisition of Splitska banka.

Moving more into details and looking at the net interest income on page 11, you see the same pattern: over HUF 5 billion nominal improvement, 4% improvement on a quarterly basis. Splitska was contributing to it; basically the entire improvement on a Group level was driven by the Splitska acquisition, because we had a slight improvement in Hungary but for instance Russia was somewhat weaker, but that's partially attributable to the weaker rouble exchange rate.

If you go even one level lower and look into the components of the net interest income, namely the net interest margin and the volume dynamics, then we reach page 12 where we detail the net interest margin developments of the Group and the more important Group members. As you can see, the NIM for the second quarter was 4.63 and this level is still, I think, within the range which we indicated at the beginning of the year. We suggested that we expected the NIM to contract on year on year basis (from 2016 to 2017) between 15 to 20 basis points. I think that the development we have seen so far suggests that this is indeed the likely scenario for this year. The second quarter was 15 basis points lower than the last year on year but the first quarter was better.

If we go to the biggest entities, basically Hungary, we see some further contraction here in the margin. This is primarily the spill-over effect from the first quarter because the repricing of the loan book is typically quarterly and therefore there's a time lag compared to the actual decrease of the base rate. In fact the base rate decreased from quarter to quarter only by three basis points, so that did not have a material impact, but the base rate decrease was much bigger in the first quarter and the last quarter last year, and therefore we had this time lag, at least three months, the way they build into the overall margin in Hungary.

Therefore we expect the further margin compression to be less and less as we go ahead and as we see the business volumes growing and the very low-return liquid assets to disappear from our balance sheet in Hungary.

The good news is in Bulgaria that the quarterly NIM compression was very modest. A similar force is in play here as well as in Hungary, so the business volumes started to grow and therefore the balance sheet becomes more efficient. Particularly in Bulgaria we have quite a large amount of liquidity being invested in a very low or even at negative rates and a growth in business volume substitutes that and improves the return on that part of the liquidity.

Russia; we do experience a continuous margin pressure there and Romania was fairly stable. In Ukraine, due to the currency and policy changes and the improving environment we see lower and lower margins there as well.

Turning to the volumes dimension of the story, on page 13 you see the performing loan volume growth. On the upper part of the chart you see the quarterly results; on the lower part you see the annual growth rates. The quarterly growth of the total portfolio without the impact of the acquisition was 3% and the annual growth was 8%. I think these are quite positive numbers. The guidance we gave at the beginning of the year was that we expected the loan growth to accelerate compared to last year but still remain single-digit. Last year the annual growth was 6.3% and we already have 8% after this first half. It seems that the economic environment and customer demand is growing ,so I think it's fair to expect the second half to be at least as dynamic, even somewhat more dynamic than the first half of this year.

Looking at the individual entities, in Hungary 3% growth in the second quarter and 10% annual growth; I think that's a strong number. As you can see, it's primarily driven by consumer and corporate lending still, and mortgage volume grows on a quarterly basis for zero, but on a yearly basis we have had 2% growth.

The good news is that Bulgaria started to grow so the last quarter was 2% plus. Russia is still seasonally weak, so the second quarter has never brought us growth so far. Only the corporate volumes started to grow, which is good news because it is in our focus to not radically but in a meaningful way improve and increase our corporate activities in Russia to complement the primary retail business what we have there.

Touch Bank improved and continued to grow its loan base. We had positive revenues in the second quarter. As you could see in the P&L numbers it was still loss-making overall, but less negative than in the first quarter. Ukraine growing 5% quarterly, very good number; Romania 5%, again decent growth and I'd like to also highlight the 7% growth which we had in Serbia in the second quarter and obviously this phenomenal improvement in Croatia due to the consolidation of Splitska banka.

If you want to gauge the level of demand and the actual sales activity which we do across geographies then probably page 14 is a better proxy to assess that, because this shows of our sales activities, so the newly-disbursed loan volumes. As you can see, the growth rates here are much higher than the stock volume growth rates. These are the numbers which reflect the increase in demand even if they don't translate immediately to similarly high-growth volume numbers in our portfolios. Particularly strong is the Hungarian mortgage, cash loan and Bulgarian mortgage, the Ukrainian consumer lending, Romanian mortgage and consumer lending, Croatian consumer lending, Serbian mortgage loans, Montenegrin mortgage loans and Russian cash loans, so in each country we had this one retail product segment where we are growing quite fast in terms of our new productions and this obviously reflects the economic situation in these countries, basically in all countries. Most importantly in our biggest markets, in Hungary and Bulgaria, we see strong GDP growth, strong consumption growth, increasing real wages, and reviving residential but also non-residential real estate developments and the real estate market itself growing.

Deposits; quarterly flat and on a yearly basis 8% plus. We are happy about this because that shows that our customers trust us and obviously generates other customer relationships and other type of fee and revenues and also cross-sell opportunities, but we don't make money on deposits in the current rate environment. Certainly from a liquidity point of view this is not required, to increase deposit volumes but nevertheless they continue to increase, which shows how attractive we are towards our clients when they choose their banks.

Net fee and commission income; an interesting line in his quarter because the growth here was quite extraordinary: HUF 9.2 billion or 21% in just one quarter. Basically two sources of this growth; one is easier to explain; it's the acquisition of Splitska banka and you can see that the Croatian line increased by 1.9 billion, which is obviously related primarily to the acquisition of Splitska. But again this is only the two-month results, it's only May and June because we consolidated at the beginning of May, so only two months' results were included from Splitska.

Now, the other bigger - and this is 5.7 billion nominal increase on a quarterly basis in Hungary. We tried to explain the sources of this improvement here on the right side of the page. The summary is that out of the 5.7, 1.5 was attributable to increasing business activity, transactions and increasing fee revenues; the other 4.2 were related more to technical events and when we look at the quarter on quarter difference, because in the first quarter we had a one-off negative, the transaction tax for card transactions was accounted for in one lump-sum amount in the first quarter, which was 1.6 billion. It did not appear in the second quarter. And, there's another technical element here.

The contribution into the Compensation Fund which is related to the Quaestor losses, we had to book the full annual expected payment in the first quarter. It's fully compensated through tax, nominal tax reduction and the tax which was reduced in this case was the transaction tax, so we had extra negative 1.3 billion in the first quarter and a positive 1.3 billion when we got the tax relief in the second quarter, so this adds up to HUF 2.6 billion difference between the two quarters.

I hope this was relatively clear but it's also written down here. The ongoing effect is that basically out of these technical elements the impact for the third quarter will be that the third quarter will be 1.3 billion less because we're not going to have the reduced level of transaction tax in the third quarter.

Other net non-interest income - some improvement in Hungary and Bulgaria, and also the usual suspect: Splitska banka consolidation.

Page 18; operating costs. Here we have the impact of Splitska banka, and you can see the other banks as well. If you take out the impact of the acquisition then the FX-adjusted growth of the operating cost was 2.5% in the first half year on year. We suggested that we expect between 3 and 4% annual growth in operating expenses without any acquisition effect. In the first half of the year compared to the base period, i.e. the first half of last year the increase was 2.5% on an FX-adjusted basis, so we are around the number which we suggested before.

Let me elaborate a bit more on some of the bigger group members, starting with Hungary. Here on page 19 you see the P&L lines. I've talked about all these already, especially the net fee and commission income, where you see this quite high growth on a quarter on quarter basis. I hope I managed to explain what happened there.

On page 20 you see the potentially more interesting developments in terms of the business activity. I have already talked about the increase in disbursements for mortgages, which was plus 31% first half year on year basis. New applications growth was even higher; that always suggests further growth potential in the disbursements in the future periods. Our market share stabilised around 29% in terms of new mortgage loan contractual amounts and we managed to further increase our market share in total household savings, which is a very good result given the level of competition. I think this is a very good proxy too, which shows how well our efforts are received amongst our clients and we try to improve our services and products which we provide them.

Corporate loan market share seemed to reach a plateau around this 14.5% after this incredible growth which we saw between 2008 and 2016. We don't push so much for further market share growth. First of all, the underlying market itself is growing quite fast, so even if our market share is stable we are growing close to 10%. But more importantly the margin environment is such that aggressively acquiring new market share means that we would have to go into pricing levels which we don't believe are justified. Therefore we expect this market share level to stabilise.

Having said that, we still focus very much on the micro and small companies: this is an area where we continue our efforts to increase our market share and to capture new clients, because here the margins are still quite attractive and new customer acquisitions seem to be profitable. As you can see, the year to date growth here, so in the first six months – and this is not annualised – we grew by 9.8%.

Going to page 21, you see this new development in the Hungarian market during the previous quarter. This was one of the interesting developments we talked about. This is this so-called customer-friendly housing loan, and here you see the details of the structure. We have got approval from the central bank, so now we have an approved product with this label, and we are going to bring it to the market in the second half of August. The overall expectation is that given the current structure of this programme it may not have a major impact on the pricing of the new loans, because already the market is not very far from these levels or close to these levels of margins, namely the 3.5% in certain segments obviously, especially in the bigger cities and better-credit-risk-profile customers.

Therefore the impact is expected to be that we might see bigger demand due to the central bank marketing this structure and working and convincing the potential customer base to take a mortgage loan, so the potential positive impact from this could be that we see higher demand for mortgage loans than without this programme.

A few words on Bulgaria. The return on equity was 22% in the first half of this year; I think that's a quite decent result and the other quite promising development is the margin; as you can see here, the net interest margin compression was relatively small compared to the previous period and the quality of the portfolio is quite good. On a credit risk cost basis we had a writeback, so the credit risk cost was positive. The total risk cost was still negative, because we had other risk costs which were not related to credit risk.

Russia: stable quarterly profits, year on year improving volumes, respectable level of return on equity of above 22%. Risk cost was more or less at the level where we expected it to be. On the next page, on page 24 you see new disbursement volume changes compared to last year. In POS loan disbursements, in the second quarter we were 18% up compared to last year, and in cash loans we were 89% up compared to the similar period last year. Again, Russia is looking better and better. GDP started to grow last year, but consumption only started to grow this year. We expect acceleration in GDP growth and continuation of consumption and retail sales growth. Real wages started to grow, so it seems that the adjustment phase to this lower level of oil price is more or less over and from now on we should expect continuous improvement. We don't expect a spectacular, whopping growth or bouncing-back, but rather a steady, gradual improvement which, nevertheless, should result in higher demand for consumer loans. Therefore we are relatively optimistic in terms of our volume growth potential.

Having said that, the other side of the coin is that the competition is strong and the intrinsic risk mitigates; therefore pricing is going lower and lower, and there's a pressure on APRs in Russia due to this. I think it's quite normal that a lower-risk environment goes together with somewhat lower APRs and interest rates of our loan products.

Croatia; magnificent growth in business volumes and market share due to the consolidation of Splitska banka into our numbers and also you see the P&L numbers here. I more or less told the story line-by-line before and you can also see the, in the text version of our interim report you see further detail, you find further detail on how Splitska contributed to the second-quarter results. Again there was a one-off in terms of risk costs. As you can see, the overall risk cost was positive in the second quarter, which was primarily due to a 1.7 billion one-off writeback which occurred on the other risk cost line in the second quarter.

Going back to the group-level numbers, the portfolio quality, the 90+ days past-due ratio dropped down to 12.2%; coverage still strong, close to 98% and as you can see on the following chart on page 27, the portfolio deterioration remained moderate. We had a one-off impact coming from the consolidation of Splitska. On a net-net basis we included the non-performing loans of Splitska banka and that increased our volumes, as you can see here, in Croatia; we highlighted it with of light-blue colour.

In other markets, as usual the highest deterioration volume happened in Russia, but it's in line with what we expected. In other countries it's relatively moderate, around zero numbers. Potentially the only one which is outside the range where we feel comfortable is Slovakia, where it increased by three billion.

Now, the risk cost rate; these portfolio quality dynamics resulted in a quite low level of risk cost rate in the second quarter: on the group level it was 35 basis points; in the first quarter it was 65. That means that the first half risk cost rate was 50 basis points. Our indication at the beginning of the year was that we expected less than last year; last year was 114 basis points, so 1.14% risk cost rate. I think it's quite obvious now that we are going to have a considerably lower level than we had last year, which is good news and it basically represents the very positive developments in the economic environment where we operate.

That's pretty much the overall general presentation I wanted to share with you. The final page is a disclaimer; draw your attention to those lines as well. So, thank you for listening and then, operator, please open the floor for questions.

Operator: Of course, Laszlo. Ladies and gentlemen, you now have the opportunity to ask your questions. To register your question, you may do so by pressing * followed by 1 on your telephone keypad now. If you change your mind please press * followed by 2. When preparing to ask your question please ensure your phone is unmuted locally.

Our first question is from Alan Webborn from Societe Generale. Alan, please go ahead.

Alan Webborn: Hello, good afternoon, thanks for the call. It was noticeable that your volumes were quite good in Hungary in the second quarter and I wondered whether you felt that the end of the sort of Funding for Growth scheme sort of deadline, from what you refer in your statements, did have a positive impact on the sort of volumes that you were doing in the second quarter. I think the contract had to be signed on the end of the first quarter so I wondered whether you thought that was impacting, I suppose, the SME corporate volumes and how you're thinking about those for the rest of the year. I mean, that would be one thing that was interesting.

Secondly, in Russia have you seen any difference in sort of liquidity? I mean, I noticed a bit of an outflow in the second quarter. With what's been happening amongst some of the smaller Russian banks, how do you feel your funding is behaving in Russia? That would also be helpful.

And could you talk a little bit about the provisioning in Bulgaria? Sorry if I've missed it but the sort of future, general, I think, general provisions for sort of future obligations; could you talk a little bit about what they were? And that would be great, thank you.

Laszlo Bencsik: Okay. So volume growth in Hungary - and your question referred more to the corporate growth which was 4% in one quarter and the annual growth year on year was 17% which is indeed, I think, quite decent dynamics. I wouldn't say there's any connection with the Funding of Growth programme or the ending of this programme. We had used up our allocated amounts well before the formal ending of the programme, so what you see here is pretty much the ongoing growth in a normal way of operation mode in corporate. The market is quite strong, you can see that our market share is not growing, so this is basically just growing together with the market, which is fine. I don't see any reason why it would substantially be different in the coming periods either.

Liquidity in Russia is not at all a problem for us. We have now two sources of funding from deposits; one is the traditional bank we have and the other one is Touch Bank and they're obviously very price-sensitive so the amount of deposits we collect is very sensitive to the deposit rate. On page 24 of this presentation you can see the deposit rates, so the deposit rate of the entire deposit stock went down from 5.8 to 5.5 in the second quarter and term deposit rates for the whole stock also decreased from 8.2 to 7.9, and the deposit volumes remained stable on a quarter on quarter basis.

This is okay because the volume growth has not started and we still have liquidity reserves, so honestly we don't see any reason to worry regarding our ability to collect more deposits if needed when we will see higher volume growth, so it's pretty much subject to deposit pricing.

Provisioning in Bulgaria; basically each period we have another round of consideration where we can further increase our conservativeness in terms of provisioning. We looked with a fresh eye on the potential legal claims which we might get in a very negative or adverse scenario, so we looked at our potential in this area and then we provisioned accordingly. But there's nothing new, so nothing new emerged, and this is related to already existing potential legal claims which have not materialised and probably they will not but...

Alan Webborn: Sorry, could I ask, are they sort of consumer protection-related or just something entirely different?

Laszlo Bencsik: Let's say, distantly related to that.

Alan Webborn: Okay. All right, that's super, thank you.

Laszlo Bencsik: Thank you.

Operator: Our next question is from Gabor Kemeny from Autonomous Research. Gabor, please go ahead.

Gabor Kemeny: Hi. A couple of questions on Hungary and mortgages, firstly on the customer-friendly mortgage product. I understand that you see a potential positive impact from increasing demand and you are saying that the average market price is already close to the proposed spread limit but I guess the MMB's idea is to increase competition in the mortgage market so you are clearly in a very strong position now in this market, number one mortgage lender, your margins are well above the average. I wondered, what strategy would you want to follow if competition increased from here?

And secondly also on the mortgages, you showed that the new origination increased at more than 30%. Still the mortgage book just sort of stabilised in net terms. At what stage do you think this higher lending activity will turn into net loan growth?

Laszlo Bencsik: Competition has been very strong and has increased gradually over the last three, four years. If you look at the margin of new mortgage loan production in Hungary, it has declined substantially during the last three years, so even without this measure of the central bank we would have further pressure on pricing. I think that's normal and this is the environment we are used to, I don't think it requires any specific strategy.

This is not the average of the new production, but what I wanted to say is that for certain customer groups we already provide this level of margin even without this new regulation, especially in larger cities where the collateral value is higher and more stable and also for customers who have higher income and therefore lower risk. So, in certain segments of the market we have already seen these levels of pricing.

Maybe competition will further increase because this is going to draw the attention of potential customers to comparing even more prices which are available on the market; that can be. One thing is for sure; I don't think it will reduce demand, so if anything, demand is going to increase because of this. That's the very likely positive impact and honestly, competition is quite strong in pricing anyway. We will see how much it's going to further impact the pricing of the different players in Hungary.

Volume growth; we are hopeful that this is soon going to be very visible; hopefully already in the third quarter this year you will be able to see the actual volume growth in mortgages, so I hope you won't have to wait too long.

Gabor Kemeny: Okay, that's helpful and finally on the Hungarian asset quality, I recall on the previous call you mentioned that provisioning could stay very low in Hungary and you could potentially have further writebacks until the NPR ratio drops to like 4, or 5%. Now you are at 8% so would you expect these asset quality trends, these provisioning trends to prevail, what we've seen in the last couple of quarters?

Laszlo Bencsik: Even within the context of the Hungarian portfolio quality, I think the second quarter was exceptionally good, so in a likely scenario we will not have such a good result on this line in Hungary as we had in the second quarter. Nevertheless, the environment has not changed and it's still very favourable, and we previously provisioned quite conservatively, and we do see the benefits now of that previous practice and if anything the environment continues to improve.

It's likely that we will have continuous writebacks in Hungary, but maybe not at a level what we had in the second quarter - maybe not at the level what we had in the first quarter.

Gabor Kemeny: Okay, thank you.

Laszlo Bencsik: Thank you.

Operator: Our next question is from Andrzej Nowaczek from HSBC. Andrzej, please go ahead.

Andrzej Nowaczek : Thank you. In the press release you mentioned a top-up in provisions for the Croatian borrower but this is not obvious looking at the accounts. Was there perhaps an adjustment to Splitska's NAV done before the consolidation? And also were there provision releases from other exposures in Croatia in Q2?

Laszlo Bencsik: Indeed, when we consolidated Splitska, the opening balance sheet and the purchase price allocation; during that we allocated extra provisions to certain exposures, especially corporate exposures in Splitska. Then what happened during May and June, the writeback you see in that period was an off-balance-sheet item, a guarantee and there was a provision on that guarantee and the guarantee expired during these two months, and therefore automatically the provision related to that was released so that's what happened. But this is unrelated to the asset provisioning what we made for other exposures when we consolidated the bank.

Andrzej Nowaczek : But can you just confirm that when you said extra provisioning you meant both in the existing Croatian business and in Splitska?

Laszlo Bencsik: Our existing business, OTP Banka Croatia had negative risk costs or kind of usual level of risk costs in the second quarter and then in Splitska we had this one-off during May and June which was related to an off-balance-sheet item which was a guarantee and the guarantee expired and therefore automatically the provision behind this, which was created before the acquisition was released.

Andrzej Nowaczek : Okay, and I have another question. This is on the value of collateral in your non-performing book. We know your cash coverage is very high but what about collateral?

Laszlo Bencsik: The loan to value of the Hungarian mortgage book, if that's what you are looking for, is 52%.

Andrzej Nowaczek : But you - mortgages wouldn't necessarily be the biggest chunk of your NPLs - or would they? - in Hungary.

Laszlo Bencsik: I mean, pretty much. In the presentation on page 29 you see the 90-plus due ratios in the Hungarian business; mortgages - it's 9.8%; corporate 5.4, consumer 12.3. So, this is potentially the biggest stock of the NPLs. If you just look at the NPL loan to value level in Hungary, so the 90 days past due stock loan to value in Hungary is 78%.

Andrzej Nowaczek : Okay, that's very helpful, thank you.

Laszlo Bencsik: Thank you.

Operator: Our next question is from Olga Veselova from Bank of America and Merrill Lynch. Olga, please go ahead.

Olga Veselova: I have several questions. My first question is about your minimum comfortable CET1 ratio. In the past I understand you announced it at 12.5%. Do you stick to this target or you may change it, and if yes, which factors would impact your minimum comfortable CET1?

Laszlo Bencsik: This is going to be something we should talk about, as I said it earlier, during the conf call after the third quarter because this should be within the scope of our capital strategy update and review and pretty much linked to what we plan to do with the excess capital and how much excess capital we have and so on and so on. I wouldn't like to pre-empt that, especially because we haven't finalised our internal thinking on this, but I promise that we are going to come back on this during our next conf call and in November when we report the interim results. But it's a fair question.

Olga Veselova: So let me then, without asking your number, ask you if you look at it as a minimum regulatory capital plus some management buffer or you look at it as what you have minus potential assets which you want to dispose. What's your approach to looking at it?

Laszlo Bencsik: Obviously the regulatory requirements plus a buffer is one way of looking at this. The other benchmark we usually look at is how our peers and competitors behave and what levels they target or where they are, because we have always said that we like to be well-capitalised, and appear in the peer group as a well-capitalised bank. But again, forgive me for not being very detailed on this and not giving you the answers what you ask for. This is a very fair question, but I would just like to ask you to postpone it until our next discussion when I will be able to tell you the result of our internal thinking and strategic review process.

Olga Veselova: I appreciate that. My second question is about your fee income growth. I understand the explanation which you gave us, so it was strong due to the specific factors but even if I exclude the specific factors fee growth was still very strong in Hungary. It was also strong in some other regions, like in Russia. What is your fee income outlook for the full year and possibly for the next year, could you give it to us?

Laszlo Bencsik: Indeed. If you take out all these technical details then the nominal growth was 1.5 billion on a quarterly basis, which is like 5% just in one quarter. This is linked to the economic activity of our clients. We see increasing consumption, increasing real wages, even higher increase in nominal wages and circulation of the monetary base, so it's related to transaction volumes going up and up and up.

I think this is likely to be a trend going forward as long as disruption does not happen in this market; if for example the payment infrastructure changes or something like that, that might disrupt this. But other than that, I think the fundamental transaction fee revenues which we generate should continue to increase.

Olga Veselova: So would you think that plus 5% per quarter is more or less sustainable for the next several quarters?

Laszlo Bencsik: I wouldn't dare to promise that and it's also seasonal, but this is certainly a strong contributor to our revenue growth, right.

Olga Veselova: Okay. Thank you. And my last question is - sorry - about the Ukraine again. So your NPLs are falling, your coverage is rising. I understand there was a specific reason for not releasing provisions in the second quarter but given that your coverage is pretty comfortable versus the peers', let's say there is room to come back to releases in the next quarters or it's still premature and for now cost of risk will remain pretty erratic in this region.

Laszlo Bencsik: Yes, Ukraine is what it is and I have to remind you that this is a high coverage ratio, but the coverage which you see here is based on the total provisions divided by the more than 90 days past due loans. Part of the problem in Ukraine is not visible from the 90+ loans, from the default rates because this is related to restructured amounts in corporate. In retail the restructured ratio is quite small, but in corporate it's still there. That's the portfolio which is the most vulnerable to changes in the economic environment, because if it continues to improve then these corporates will perform wonderfully, but if there's another shock to the economy then they turn into a very difficult situation and in that case the provisions which you have behind these loans are quite justified.

We are quite cautious in releasing provisions even if the immediate economic environment is supportive, but part of our corporate portfolio is vulnerable and fragile, and therefore we try to keep the provisions there as long as we can justify it in front of the tax authorities and our auditors.

Olga Veselova: Thank you very much.

Laszlo Bencsik: Thank you.

Operator: As a reminder, ladies and gentlemen, if you'd like to register a question please press * followed by 1 on your telephone keypad now. Our next question is from Anna Marshall from JP Morgan. Anna, please go ahead.

Anna Marshall: Good afternoon. A couple of questions on Russia, please. Firstly, could you provide an update on Touch Bank; specifically sort of when do you expect to become profitable, are you happy with how this project is going, do you sort of plan to expand it, etc?

Second question on Russia; you've mentioned that you're happy with a high corporate lending growth there and that you want to add it to your mix but do you plan any dramatic changes in your asset mix in the country, are you sort of rethinking your strategy there?

And maybe actually one more question on group loan growth as well so the dynamics for this year are expected to be quite strong clearly but what is your expectation going forward in 2018 and which countries in particular do you expect to see the strongest dynamics? Thank you.

Laszlo Bencsik: Touch Bank; difficult question. We have mixed feelings. If you ask if we are happy, we are not entirely happy. In the first quarter we had a big advertisement campaign; that was the reason behind the higher operating cost and we managed to increase volumes and we had a quite large amount of new customers and new loan volumes especially, but the quality of those were not exactly what we are very happy with, so we adjusted back. It's basically a trial and error what we do.

Being very honest, I can't promise you when it's going to break even. We see improvement, so if you look at the revenues and the operating results, if you exclude this large campaign - I mean, relatively large compared to the size of the operation - then it's improving, so we see marginal improvement. We try everything to turn it into a shape where it breaks even.

But we have to learn how to be successful in this environment. Acquiring digital banking clients in the digital world is a different business than serving multi-channel clients better and better through multi-channel service lines and improving for example your mobile banking offering to your existing clients. That's a whole different industry and we admitted that we have to learn how to be successful in that area and that's primarily the reason why we decided to enter this segment, in order to develop our skills and understanding how you can build up a profitable customer base purely through digital customer acquisition.

And no matter how much you like, I can't tell you honestly that we have already cracked this problem. We're still learning and trying and adjusting our products, services and the way we market these. We are starting new partnerships with other players, and we are quite hopeful that they will bring in better and larger customer base, so that's one avenue we are following and there are other initiatives.

We developed an in-house banking, digital banking platform there, so it's the development of the Russian team. We are going to use that platform and IT solution in the bank itself so there's already developing levels of IT synergies between what we do in Touch Bank and other parts of the organisation, so that's another way to benefit from the investment there.

So, we have mixed feelings, but we are still hopeful that we will be able to succeed in this segment. If we do then this would be a tremendously powerful strategic tool, not just because of the size and the potential in the Russian market, but if we learn how to do this, how to be successful in digital customer acquisition, then this skill and the whole architecture and platform can be exported and used in other markets, which could give us a huge leverage. There's still a lot to do in order to get there.

Corporate growth in Russia; in fact when we had a major review of our Russian strategy two years ago this was one of the elements we decided on, that we wanted to improve our corporate activities in Russia. Now we are seeing the first signs that in the second quarter the loan volumes started to grow from a very low basis, by the way. Certainly we are not going to transform the bank into a corporate bank, so it's going to remain primarily a retail bank focusing on consumer lending.

As a complementary business line we would like to further develop the corporate business as well. This can balance to some extent the margin pressure in the consumer lending side. This doesn't mean that we fundamentally change the strategy because this bank has always had corporate business; it was just not very visible and not very dynamically growing during the last, let's say, five, six years.

The last question was related to group level volume growth…

Anna Marshall: Yes, and in terms of countries sort of which are likely to see the strongest dynamics so you've mentioned that so far this year you've had quite strong loan growth so on an underlying basis - but what are your expectations for next year basically?

Laszlo Bencsik: Okay. I can just go back to what I said, that our original forecast for this year was stronger than last year growth but still single-digit. I think this is still the case. It would be a positive surprise to achieve double-digit growth for this year.

I think if you look more into next year and the coming years, the market volume growth expectations are double-digit in number of countries, especially in Hungary, Bulgaria. Consumer loans in Russia can start to grow again quite dynamically. We haven't done the budgeting for next year, but especially in retail in Bulgaria, Hungary, Romania, Russia, Ukraine, Serbia we expect for next year double-digit growth numbers for the market. These are just our expectations; we will see what's going to happen. We have not done our budgeting for next year, so we don't have yet the exact targets. It's very clear that potentially with the exception of Slovakia all the other markets where we are present are accelerating in terms of retail lending.

The only reason why Slovakia is not is just that it has been so strong during the last five, eight years, so Slovakia was growing easily double-digit in retail when the rest of the region was flat or contracting. So that from our market growth expectation, it's a very attractive picture what we see forming, but it would be still too early to have a specific guidance for next year growth of our volumes.

Anna Marshall: Okay, great, thank you.

Laszlo Bencsik: Thank you.

Operator: Our next question is from Margarita Streltses from UBS. Margarita, please go ahead.

Margarita Streltses: Hi, thank you very much for taking my question. Just a couple of follow-ups from me, please. On net interest margin development in Hungary, I think we've seen this year that this has been developing a bit better than you have initially guided, but looking more in the longer term, how do you see the margin developing? Do you see the market interest rates have been bottoming out at these levels and we're probably going to see some expansion or you don't expect any changes until we’re going to see interest rate hikes maybe in the next year or two? So if you can give us a bit longer-term perspective on that, that would be helpful.

And also you've mentioned Slovakia in your last answer and I was wondering on that. This is probably the only country, if we exclude Montenegro and Ukraine, so one of the Central European countries, where you didn't undertake any expansion yet and where loan volumes are coming down a little bit, whereas for most of your peers this is one of the key engines of growth still despite the expansion in the past few years. So how are you looking into Slovakia from a strategic point of view, are you looking to expand there, are you happy with your positioning or any other colour you can give us? Thank you.

Laszlo Bencsik: Thank you. Rate environment in Hungary; I hope it's bottoming out. The base rate has been stable at 90 basis points, but it's not any more very much effective. What is effective is the interbank rate, which is the reference rate for our variable loans; it has been around this 15 basis-point level for a while now. I very much hope that it's not going to decrease further, but in fact this is up to the central bank because the central bank is indirectly managing the interbank rate as well through changing the available local currency on the market through swaps.

This is up to the policies of the central bank. Honestly I'm quite sceptical about a base rate increase in the foreseeable future, I don't think this is going to happen during the next two years. In a scenario which would be good for us we might see increase in the reference rate; so at the best scenario from our point of view the interbank rate might start to increase slowly during the next few years and get closer to the base rate.

It can happen that there might be a cut in the base rates as well. If the currency remains on the strong side then even that can happen, that they have a cut on the base rate. But this is again not really effective on us any more, or it has a small impact because the amount we can deposit at the central bank at the base rate is quite limited and there's a cap on that and it continues to decrease.

Slovakia; indeed that's a good question strategically. We have either been able to move ahead in other countries with acquisitions or we have seen very nice turnarounds like in Russia and Ukraine, and even in Montenegro we have plans to still growth through acquisitions and there are opportunities. Slovakia is the country where we haven't been able to organically grow our market share or provide the required level of profitability. This is a market where it's not obvious what bank could be for sale, so intention is not always enough, especially if you want to acquire banks There is a prerequisite that there should be a sell-side as well, and it's not there in Slovakia. It's a very concentrated market with very strong players who are obviously the well-known names in the region, and they indeed do very well there and this has been a fast-growing, low-risk market for the last ten years, and we haven't been really able to monetise that yet in terms of required levels of returns.

We are still struggling, we are too small, we are struggling with the economies of scale and we are struggling with very strong competitors who have large market shares and control client relationships, and moving clients from those banks to us is extremely difficult. It's quite a challenging environment from a strategic point of view, I must admit. That's where we are at the moment.

Margarita Streltses: Okay, thank you very much.

Laszlo Bencsik: Thank you.

Operator: Our next question is from Simon Nellis from Citigroup. Simon, please go ahead.

Simon Nellis: Hi, it's Simon Nellis from Citigroup. Just a quick question on the capital impact of your recent acquisitions; are you able to disclose what that will be? And also just on integration costs, if you can disclose what the cost of integrating the two new units and maybe Splitska Bank as well; do you expect any costs from integrating that business?

Laszlo Bencsik: The Splitska impact was 1.4% on the Common Equity Tier 1 ratio; it's already included. The combined Common Equity Tier 1 ratio impact of the two other acquisitions which we have not consolidated yet, is probably less than one percentage point, the two together.

Simon Nellis: Right.

Laszlo Bencsik: Cost of transformation; in the case of Splitska the transformation costs which could be made part of the initial adjustment of value we did, so the potential reorganisation cost is already included in the numbers that we presented in the second quarter, but obviously it's not all comprehensive, so there will be further costs and especially it will take time until we can realise the cost synergies.

So, the question is more when we can do that, and in case of Splitska it's at least one year until we merge the two entities and start to realise and see some of the cost synergies. The earliest it can happen is the second half of next year. We shouldn't see large operating cost increases because of the merger process because the expected big one-offs have already been accounted for.

Simon Nellis: Okay, thanks very much.

Laszlo Bencsik: Thank you.

Operator: As a final reminder, ladies and gentlemen, if you'd like to ask any further questions please press * followed by 1 on your telephone keypad now. We have a question from Stefan Maxian from RCB. Stefan, please go ahead.

Stefan Maxian: Just one question remaining actually; can you give us an update on IFRS9 impact on capital?

Laszlo Bencsik: We expect this to be quite moderate.

Stefan Maxian: Right, so moderate means that you have already like front-loading provisions or just a range like, I don't know, 40bps like some others, or even below?

Laszlo Bencsik: We expect this to be a small amount compared to the level of provisions we have.

Stefan Maxian: Okay, all right, thank you.

Laszlo Bencsik: Thank you.

Operator: We currently have no further questions so I'll hand back to you, Laszlo.

Laszlo Bencsik: Thank you very much. Thank you for joining us today and thank you for very good questions. I hope I managed to answer them in reasonable way. I wish you a very happy remaining summer, a very nice weekend, very good day and I hope you join us during our next conference call when we discuss the third quarter results on 10th November this year. Thank you very much again and goodbye.