

## Transcript

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**OTP Bank Q3 2017 Results Call****Friday, 10 November 2017**

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Paul Formanko: Hi, everyone. Thank you very much for joining us for the last quarterly call this year. This is Paul Formanko from JP Morgan. We are very excited to have Laszlo Bencsik, Chief Financial and Strategic Officer of OTP Bank joining us from Budapest. Laszlo, over to you, please.

Laszlo Bencsik: Thank you, Paul. Good morning and good afternoon, depending on where you are. Thank you for joining us today for our third-quarter conference call. As usual, the interim report and the presentation I'm going to use is available on the website, so I hope you have been able to download it and have access to it. As usual, I'm going to go through the presentation and try to comment and also try to anticipate your questions and answer them within the presentation and, later on, you'll have a chance to ask your questions.

Starting with the presentation, on page 2 you see the total result. During the first nine months of 2017, the adjusted profit increased by 30% and the accounting profit by 21%. The adjustments were negative this year compared to last year, which was positive due to the one-off impact of the Visa transactions, but so far this year we haven't seen any extraordinary or unexpected adjustments. The adjustments were driven by the bank tax, which we more or less knew how much it was going to be.

We used to split the results between the CEE and operations in Russia and Ukraine because, in the previous years, these two regions performed very differently. This is not the case anymore. As you can see in both of these areas, we pretty much achieved similar growth results. The growth was quite evenly distributed between the two, the CEE and the Russian and Ukrainian operations. Both of them grew around 25%. Going to page three, we can look deeper into the composition of the results by group members, and if you look at the quarter-on-quarter results, it's pretty much the same as the headline figures, very similar, the second and third-quarter figures, both on the unadjusted and adjusted level.

Within this, we have a slight decrease in Hungary and Bulgaria, whereas Romania, Serbia and Montenegro, and also the Group Leasing, did much better than the first quarter. Obviously, their contributions are rather smaller than Russia and Bulgaria or Hungary. Russia was lower, but this is mostly attributable to the weaker rouble during the third quarter. In rouble terms, we also had a 5% decline, but this strong 15% decline, most of it, two-thirds of it, was explained by the weaker rouble and therefore the translation effect to our reporting currency, which is the Hungarian forint.

Ukraine grew quite nicely, quarter on quarter.

If you look at the longer-term picture, and we compare the first nine months of '17 to the first nine months of '16, then we see a 30% growth in the adjusted after-tax profits. If we are looking for the key drivers of this growth, it is obviously the Hungarian operation. In Croatia, it's mostly coming from the new acquisitions which we consolidated during the second quarter and, therefore, this event has a tremendous impact on the year-on-year comparison of our Croatian results.

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Hungarian leasing, and group leasing results, which is mostly car financing, increased quite a lot as well, and Russia did very well, 34% growth in profits. Ukraine did, as well, quite well. Unfortunately, Touch Bank accumulated larger losses this year than last year.

Page four, the one-off items, there wasn't anything material in the third quarter, so I'm not going to talk about this one.

If you flip to page five, we see the consolidated P&L numbers. Here, I have to warn you that these are unadjusted numbers, so the Splitska acquisition impact is included here, therefore it makes the line-by-line comparison of different periods somewhat misleading, and also the AXA transaction is not taken out of this. The Splitska transaction has an impact on the quarter on quarter performance as well because, as you probably remember, in the second quarter, it was included only for two months out of the three months.

If you want to see the overall picture on the group level for the first nine months, then operating profit grew by 11%, and total risk cost declined by 42%, so that's the very high-level headline story. Our operating profits are growing double-digit and despite the inclusion of Splitska, this year we booked a much lower level of risk cost than we did last year during the same period.

Going to the topic of miscellaneous items, the first one is quite important. We included this in the interim report, so you can see the same text in the report itself. We were quite careful and considerate when we wrote it, so every word has some meaning. I'm not going to read it, but I think there are some important messages I might want to emphasise here as well.

One is that we have started to follow a dynamic growth trajectory. That is actually very obvious. The year on year organic performing portfolio growth was 10%, and if we add to it the impact of the acquisitions – two of these acquisitions have already appeared in our consolidated financial numbers, and two of them, where we have made agreements but not yet financially concluded these, are still coming – the four acquisitions together will have a total impact of almost 25% compared to the end of the third quarter's volumes last year, so the combined impact is 35%, which is actually quite substantial.

Even without the two entities which we have not been consolidated yet, the organic and inorganic growth was close to 25% in the past 12 months, and this is a visible and substantial growth. There will be roughly another 10% increase if we include the other two banks which we are acquiring. So, the first important statement is that we seem to be growing fast.

The second important statement is that we believe that we are going to grow fast organically, because the environment is quite supportive, and also our intention is to continue to grow fast through further acquisitions. Therefore, we are going to allocate the capital which we generate to organic growth, new acquisitions and also we seek to continue to pay increasing levels of dividends.

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We are not touching the guidance which we made on the dividends for this year. It might not be very clear from the language of this, but if you look at the Analyst Tables, which are also available on the website, you can see that we put aside exactly the same quarterly amount for expected dividend payments as we did in the first and second quarter, and it is HUF 15.33 billion, therefore the expected amount of the dividends which the management is likely to propose to the AGM will be HUF 61.32 billion, which means a roughly 15.3% increase year on year. So, our guidance to the expected dividends for 2017 is not changing.

Then, probably the most interesting part – as so far, there is nothing new – is that if you look carefully into the known changes of regulatory requirement, and even more importantly to our peers, how they perform in terms of capital adequacy, you would realise that all of them are above the 12.5%, which we originally targeted as a CET1 ratio.

We continue to want to be considered as a well-capitalised group, also relative to our peers. Just because our peers are going to higher levels, I believe that we have to also target a higher level of capital adequacy. Therefore, we are adjusting this targeted level of CET1 ratio from the previously communicated, which we communicated back in 2015, April, at the AGM, which was 12.5%. Now we are going up to 15%.

This doesn't mean that we want to be exactly at that level for the foreseeable future. The ratio will oscillate, will move depending on the profits we generate and how we can incorporate the period profits into this ratio, and it will also depend on the acquisitions we are making, and the timing of these acquisitions. It's important to tell you that it's not that we are targeting a point, a number in the future; it's more a range. It's a range between 12% and 18%, and it can happen, for a period of time, that we go down as low as 12% and then we accumulate, or first we accumulate, we go up, and then go to 15%.

Regarding the acquisitions, there are two in the pipeline where we've already made the agreements. We expect the Serbian one to be consolidated during the fourth quarter this year. The Romanian one is expected to come in the first quarter.

There's a third element here on this page. It's related to an event which happened in the second quarter. We had this share-swap agreement with MOL and we extended this agreement, and changes in the agreement also happened. Therefore, the accounting treatment of this transaction changed. Already, in the closing balance sheets of the second quarter, this transaction appeared in a netted way: we netted out the assets and liability items related to this transaction, and that resulted in a smaller balance sheet at the end of the second quarter.

Due to the fact that we also had to change the accounting policy of the group, we have to make restatements regarding previous time periods and, therefore, you see the restated numbers. The P&L was not impacted, only the balance sheet, therefore the changes appear mainly in the ratios where the balance sheet is involved, most notably the net interest margin, which for a previous period goes up because the balance sheet goes down. So for last year, instead of 478 bps, which we previously reported, it was 482 bps.

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On page seven, you see a further methodology change. It's related to the unification of accounting practices across the group and making everything in better order. It does not affect the fundamentals. Basically, we reclassified certain accrued interest receivables to gross loans in the accounting balance sheet, and then, in the adjusted balance sheet we netted out the accrued interesting receivables for 90-days past-due loans with provisions. So they disappear in the numbers which we show you, they are netted out.

The impact of this on the performing loan volumes was HUF 16 billion, and you can see, on page 53 of the English interim report, in the real documents, you'll see a small table which describes, in detail, country by country, what exactly this impact was on the performing loan volumes.

On page eight, you see capital and liquidity related ratios. Our Common Equity Tier 1 ratio is down to 13.7% at the end of the third quarter, but it does not include the accumulated profits during the year. If we accumulated those, then the ratio would be 15.8%, and that's after the impact of the Splitska acquisition. If we include the accumulated period profits, minus expected dividends, then the ratio remains pretty stable compared to the end of last year. That means that our crude leverage ratio, equity over assets, remains quite high compared to our peers, at 12.7%. Liquidity position, not much change. I'm going to elaborate a bit on this because that is an interesting story what we see here developing.

On page nine, you see the overall total income development year on year and quarter on quarter. Obviously, the year-on-year numbers are somewhat misleading because the Splitska acquisition is here, so most of the growth that you see, here in Croatia – this HUF 12 billion, year on year – is coming from the Splitska transaction. So, the quarter-on-quarter numbers are probably more interesting here.

There's a decline in Hungary, overall. Bulgaria, stable. Russia, in HUF terms, declined by 3 billion, but in rouble terms it was basically flat, so that's the other number you see here, the FX adjusted. Ukraine is growing, and actually the UAH numbers grew more than the HUF numbers, so the UAH growth was 14%. Then, we have Croatia growing quite fast, quarter on quarter, but allow me to remind you that this is distorted by the consolidation of Splitska because, in the second quarter, we had it only for two months.

Net interest income, quarter-on-quarter developments: we had some decline in Hungary. Part of it is technical, HUF 0.5 billion, so half of the nominal decrease during the third quarter is actually explained by a reclassification. We moved one type of revenue from NII to fee income, so it doesn't have a substantial content. In Russia, the decrease was, again, explained by the FX weakening, the weakening of the rouble, because in rouble terms we had an increase. Ukraine, it's a base effect, in the second quarter we had one-off negatives, due to restructuring of corporate and mortgage loans, which we didn't have in the third quarter. And in Croatia, the same story continues: we have the Splitska impact.

Going to the loan volumes, I think we have a quite interesting and actually quite positive story emerging here. We went talked about the expectations for this year in March, during the conf call of the full-year last year, we guided for accelerating loan growth but still single-digit, and it seems that, at least so far, the year-on-year organic growth was 10%, so the lowest double-digit number. I think it's quite important to look across the board and to see that, for

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example, in Hungary, the organic growth itself, without the AXA acquisition, year on year was 12%, so well into the double-digit range.

Russia, very strong; Ukraine, very strong; Romania, very strong; Serbia, very strong. And Croatia, even without the acquisition was 7%, year on year. The quarterly numbers, again, obviously there is always seasonality and everything, so they are less well describing the actual fundamental changes, but they also seem to be quite promising. I think it's fair to say that the volume growth is actually somewhat stronger than we originally expected, and this is certainly good news. It's the result of the improving operating environment that we have in all of the countries where we operate at the moment. It seems that the basis of this economic growth, which is seen in these countries, seems to be a broad-based fundamental growth, and therefore we believe that this is likely to continue in the future.

Talking about growth ratios, especially in retail: probably a better gauge for the activity and the level of demand is the growth of new disbursements opposed to the stock volumes themselves. Here, you see the new disbursements levels in the year-on-year comparison for the first nine months, and actually, these numbers are even higher than the stock growth numbers. In some cases, especially Hungarian mortgages, Bulgarian mortgages, Romanian mortgages and some in the cash loan line seem to be quite promising and quite substantial numbers.

Going to deposits, this is interesting because we haven't talked a lot about deposit growth during the last couple of years, it hasn't been as important. We are somewhat surprised, this is a surprise to us as well: the growth rate of deposits, without any acquisition, the year-on-year growth of the total group deposits base was 10%. There's seasonality in the third quarter, and in one quarter we just had 5%, but on a year on year comparison basis, this seasonality cancels out. 14% growth in Hungary, 6% in Bulgaria, Russia, 7%, Ukraine, 11% Romania, 4%— it seems evenly distributed across the group but quite strong in Hungary and Bulgaria.

That's interesting because let me remind you that net loan to deposit ratio is 69% at the group level, so less than 70%, which means that we have 40% more deposits than loans, and, therefore, if we had the same growth rate in loans and deposits, volume-wise, deposits grow much more. The difference between deposit to loan volumes increased during last year.

It has obvious implications. It has implications on the NII and on the interest margin and on the balance sheet, because if you have a growing deposit base, the balance sheet is going to grow and, therefore, our interest margin is going to decrease faster, compared to not having so much deposit growth, so not having deposit growth at all. The reason is that we are so liquid that the return on these extra deposits is small. It's marginally positive, so they contribute to net interest income, but these volumes actually have a small net interest margin and, therefore, their contribution to the group net interest margin is negative.

If this continues, then what we are going to see is somewhat higher than originally expected NII numbers and higher balance sheet, but also, on the other hand, lower net interest margin. All in all, this is positive, so we view it as a very positive event because NII is growing and, therefore, marginal cost of deposit gathering is actually very low. So this translates to bottom-line, marginal nominal growth as well. Similarly importantly, it suggests that our customers

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seem to like us, and even in this very low interest environment, they bring their saving to us, despite they get don't pretty much anything, especially in the lower-rate countries like Bulgaria or Hungary.

Some further thoughts on the net interest margin development. First of all, if you compare the year-on-year numbers, last year the restated number, which is 482 bps, and if you look at the first nine months of 2017, it's 462 bps, then the difference is 19 basis points. I'm sure that you remember that we guided for 15-20 basis points difference on a yearly basis. There's one very important element here, and that's the acquisition of Splitska. The Splitska entity has a lower margin than the average of the group, so when we consolidated this, it had a negative impact. If we look at the numbers without the Splitska acquisition, so if you took out the impact of the Splitska acquisition, the difference would have been only 12 basis point; without that the decline in the margin was only 12 basis points.

If you look at the quarter-on-quarter difference, it is actually quite visible, a decline of 24 basis points. If we try to understand the components of this decline, again we have to talk about the impact of the Splitska acquisition and consolidation. It was 14 basis points negative, so that leaves us with 10 basis points which we have to explain with other effects.

One important factor is the weaker rouble. The Russian bank has a much higher level of NIM than the rest of the group and, therefore, its contribution to the group level NIM is quite dependent on the exchange rate. Since the FX rate was weaker in the third quarter than in the second quarter, the contribution was negative, and this was, numerically, ten basis points. By these two, the 14 and the 10 bps, we explain the 24 bps decline; the remaining two factors balanced each other: roughly 10 basis points minus and 11 basis points plus.

The 10 basis points minus was due to especially Hungary and Russia, because there was a decline in the NIM, but in Ukraine we had a slight growth; on the other hand, Russia and Hungary was growing faster than the rest of the group and they still had higher margins, and therefore there was this composition effect, that higher-margin parts of the portfolio grew more than lower-margin parts, and that improved the margin by 11 basis points.

If you want to understand the quarter-on-quarter change in the net interest margin, hopefully this decomposition of the change might help you to understand the intrinsic drivers. Further explanation is provided on page 15, on the margin development in the six main parts of the portfolio.

As you can see, there were some technical events here and there, for instance in Hungary. I already mentioned the reclassification from NII to fee income. In Russia, there's an interesting technical effect coming from the fact that we have a cross-financing relationship with Russia that's somewhat complicated in structure, where they deposit certain amounts here and similar amounts, we put back to Russia. And that actually increases the Russian balance sheet, what we show you. So if you look into the analyst tables, you see that liabilities to financial institutions is actually growing; this is an intergroup liability but, on the asset side, we have similar numbers, and this is increasing, so that has a dilution effect, it reduces the net interest margin because it increases the balance sheet.

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Croatia was under the impact of the Splitska transaction, the third-quarter - fourth-quarter comparison will be the first one where we'll see a clear picture of how the two entities that we have in Croatia are behaving and how the behaviour changes on a quarterly basis.

In Romania, there was, as well, a group financing event here, due to the local liquidity requirements, regulatory requirements. We had to increase the funding from the group and that increased their balance sheet total, and therefore reduced the margin. It had a ten basis points impact on their NIM. The rest, basically, was fundamental and related to the pricing and volume factors within each of these entities.

Net fee and commission income, there's one item you might remember, in the second quarter we had this HUF 1.3 billion plus when we booked the Compensation Fund-related tax deduction in the financial transaction tax. This didn't happen in the third quarter, so quarter on quarter it actually resulted in a HUF 1.3 billion negative impact. On the other hand, we had this HUF 0.5 billion boost to fee income in the Core division, due to the reclassification I mentioned, and the rest is basically related to fundamental factors.

In Russia the exchange rate has some play here, and it explains 10 percentage points out of the 15% weakening. In Croatia the number is somewhat under the impact of the acquisition and consolidation of the acquisition. Other non-interest income, the only interesting event happened in Hungary, but that event was, again, in the second quarter when we had a one-off gain on real estate investment fund unit sales. That was not occurring in the third quarter.

Going to operational costs, the exchange rates have an impact here, and also there's seasonality, so the best number to look at is probably the first nine months figure, year on year, FX adjusted comparison. Again, in order to get a clear picture, we have to take out the impact of the Splitska acquisition. The growth of operating costs was 3.8%, again, FX adjusted, first nine months, year on year without the Splitska acquisition.

Hungary was actually pretty good, as the growth was only 1%, so quite flat. In Bulgaria we have growing costs, in Russia we have growing costs, in Ukraine and across the board we do see wage inflation and also we are investing heavily in digital transformation in all of these countries, which has an impact on cost growth. But so far, we have remained in the range that we indicated at the beginning of the year. We said that we expected the operating expenses growth to be between 3% to 4%, FX adjusted. We are in this range: the number for the first nine months is 3.8%.

Leaving behind the overall group-level perspective and talking a bit more about the individual units in the group, starting with the biggest one, the Hungarian Core. I've pretty much elaborated on the individual lines of the P&L, so I'm not going to go into details on page 19. What we see overall, is that the year on year first nine months operating profit grew by 6%, and risk cost became a much bigger positive number. Already last year, we had positive risk cost in Hungary, and this year it's an even larger number. These two factors together, plus the lower corporate tax rate, because the tax rate was cut at the beginning of this year, resulted in this quite promising 39% after-tax profit growth, year on year.



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Next page, page 20, there's a little bit more about where we stand in terms of our retail and corporate businesses in Hungary, and the good news is that our quite high market share in new mortgage production remained quite high – 28% – and we are continuously increasing market share in retail savings. Our corporate market share seemed to stabilise at this 14% level, and we have fast-growing corporate volumes. Going back to the page where we showed the performing volume growth in Hungary, the year-on-year number was close to 20%, so this is a very dynamic part of our operation at the moment in Hungary.

Bulgaria was doing reasonably well. If you look at the operating profits at the quarter-on-quarter level, this was basically flat. We had slightly higher risk cost in the third quarter than in the second quarter, so that resulted in somewhat lower profit overall, but the return on equity for the first nine months stood at 21%. I think this is a good number. The NIM decline on the quarter-on-quarter basis was relatively moderate with 5 basis points.

The Russian numbers are not tremendously meaningful in a quarter-on-quarter comparison, because the average rouble rate was weaker by 10% in the third quarter than in the second. In fact, the overall profit in RUB terms also declined by 5%, so there is a small decline in the nominal profits in local currency terms as well in Russia, due to somewhat lower revenues than in the second quarter. If you look at the volume growth, I think these are very promising numbers and it's quite a rapidly growing operation that we have. If you look at the POS, 22% year-on-year growth, cash loans, 37%, while other loans, which is basically SME and corporate, grew by 40%, so even this small part of our operation started to grow. The previously rapid decline of the credit card volumes also slowed down, there was an 8% decline during the last 12 months.

The risk cost has stabilised, this is good news; even a slight further improvement in the risk cost rate, primarily driven by the strong volume growth, and, therefore, the ratio is getting smaller as the denominator is growing fast.

In Russia, as we have seen in the net interest margin numbers, we have a dynamically growing portfolio, but on the other hand, the NIM is going lower and lower. Even if you take into consideration the impact of this technical element of intergroup liquidity transfers, then there's an intrinsic decline in the NIM due to price competition and lower and lower APRs of new volumes.

Ukraine: star performer of this year. Return on equity comfortably above 40%. Profits grew even on a quarterly basis. Net interest margin was stable and volumes grew rapidly, this seems to be a good story and we hope that this good story will continue to be a good story for a long period of time, and the environment is going to remain stable in Ukraine.

Given the restructurings and the changes we have made in the portfolio and the content of our business in Ukraine, we believe that we are much more resilient than we used to be to any potential negative event in the economy, which we don't foresee but might happen. Even if that happens, the impact on us should be much less negative than it used to be.



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Croatia, from now on we are going to talk about this country, as it grew to one of the biggest contributors to the group, at least in terms of the size of its loan book. It's very close to the levels that we have in Bulgaria. But, these numbers and time-series comparisons are not very meaningful, because the content of these numbers changed so much, so it's more of a story that's emerging for the future.

We have quite high expectations towards our teams who are working very hard to merge these two entities. Now, you see aggregated numbers of our two banks, but these are still two separate entities. We are working very hard to finalise the merger as early as possible. This is not an easy task, given the size of these banks, but we do have experience in doing this. You probably remember, not very long ago, we did a similar exercise in Croatia when we acquired Banco Popolare, and we had a similar exercise, a few years ago, in Romania, when we acquired Millennium BPC's subsidiary there. We do have a robust skill and capability to run these integration and merger processes, and it's going quite smoothly. I do believe that this is going to be done on time and according to expectations.

Going back to the group level and elaborating a little bit about the risk profile of the group portfolio, on page 26, you see the risk cost rate, which is obviously quite low, and also the 90-days past-due ratio, which is down to 11.2%. In Hungary, we are below 10%, but also in Bulgaria below 10%, so gradually but steadily we are getting closer to the normal, good-years, expected levels of non-performing or 90-days past-due ratios.

Coverage remains strong at 95% – total provisions per 90-days past-due loans.

If you go to page 27, you can see the quarterly deterioration of these portfolios, the increase of the 90-days past-due loans. Basically, we have two countries where this volume increased with a material number: Russia, where it's business as usual, and in Croatia, where a large part of this increase is related to this one conglomerate which started to be non-performing in Croatia in the first half of the year, and then appears gradually in our non-performing volumes.

Finally, you have two pages which detail more the risk ratios of these five bigger entities of the group. I don't think there are any surprising or new elements here.

That was the presentation I wanted to give you about the overall results. I'm very happy to try to answer your questions, so please, operator, open the floor for questions.

Operator: Our first question is from Anna Marshall from JP Morgan. Anna, your line is now open.

Anna Marshall: Good afternoon, thank you for the presentation. A couple of questions, please. Firstly, on dividends, regarding your guidance of seeking to increase the annual dividend amount, does this imply the continuation of existing mid-teens growth pace, which you also intend to show in 2017, or an acceleration actually? Second question on the capital. Thank you for providing the target capital level and range, where it could fluctuate in, but could you please clarify what the minimum regulatory requirement is, and what is the level of the management buffer that you are assuming?

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The final question on M&A. Now that you've announced the continuation of the inorganic growth strategy, what would be the key countries of interest? Is there any change in this, given that you've completed, recently, acquisitions, or announced acquisitions, in Croatia, Romania and Serbia? Thank you.

Laszlo Bencsik: The dividend guidance, I tried to be as clear as I could. The guidance for expected dividend payments, after the financial year of 2017, doesn't change. It remains as it was, the HUF 61.32 billion, that's what we are putting aside on a quarterly basis for expected dividend payments. That's the only concrete guidance and numeric guidance that we can say. What I've said is that the intention is to continue to increase dividends in the future, subject to acquisitions and the profitability of the group, but we don't have a numeric guidance on the future increase of dividends. It can be less or more than the rate of increase was in the last couple of years.

Capital requirements, there are parts of it which are clear. The buffers have been communicated, more or less I think, publicly by the Hungarian Central Bank, how they are going to be phased in. We have not communicated our SREP ratio, what we can say is that the CET1 range that we suggest will start at 12%; that should be above what the regulatory requirement is, otherwise we were unable to go there. So, because we haven't communicated the SREP ratio, I can't give you an exact number for our capital requirement for the future, but I can say that if we are in this range, then we should be able to fulfil the regulatory requirements as well.

Your third question, the primary target countries remain unchanged. We want to continue to grow within the current footprint of the group, especially in countries where we still are not as big or strong as we'd like to be, or as strong and big as it is required to deliver the required levels of returns. We are also very happy to grow in countries where we are already delivering these returns, for instance in Bulgaria, or Hungary, although it's less likely that we can acquire anything sizeable, given our current position, it'd probably be difficult. But in countries like Bulgaria, where we are already big, we do want to further grow through acquisitions.

This is also true for the countries where we have recently made acquisitions, like Serbia or Croatia or Romania. We don't want to talk about countries like Slovakia where we haven't done anything, and we should if you want to turn around this bank as well. So, the target countries haven't changed, we still have a strong preference for the countries where we are present and where we operate.

Anna Marshall: Thank you.

Operator: Our next question is from Pawel Dziedzic from Goldman Sachs. Pawel, your line is now open.

Pawel Dziedzic: Thank you for the presentation. I will start with a few follow-up questions. On capital and M&A first, can you remind us what is the capital consumption related to pending acquisitions in Romania and Serbia? Also, what is the IFRS 9 impact, so we can better understand where your fully-loaded pro forma capital ratio currently is?

Then, on your M&A plans, you mentioned the countries remain unchanged, but how do you think about the pace and scale of this external growth from here on? In your presentation, you referred to 25% boost in your portfolio over the last 12 months. How realistic is it that we're going to see a similar, very robust, pace of growth over the

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next years? Are constraints here purely capital related, or perhaps you are taking into consideration multiple integration processes run at the same time as something that, perhaps, feature in the way you think about capital deployment? I guess I'm trying to understand, if you look at your strategic plans for the next two, three, four, five years, how much bigger you would like OTP group to be, and how big a role M&A will play in that? Thank you.

Laszlo Bencsik: First of all, we have already said that we expect the impact of the two banks which we have not incorporated as less than 1% of the Common Equity Tier 1 ratio, so that's the expected impact, including everything.

This is a very difficult question, and obviously I don't have the answer because the level of M&A activity we can conduct in the future depends not only on our intentions but also on what is for sale and at what price.

What we can say is that we do have the appetite to conduct further acquisitions. Obviously, everything is subject to price. It's not only important that there are assets for sale which are attractive, but they also have to come at a price which we consider reasonable and value-creating. I think there's a recent example in Bulgaria where we lost to another competitor in the case of a very desired asset. The United Bank of Bulgaria, it's public that we also bid for this asset and we were outbid by another competitor by quite a big margin.

Even if there are attractive assets for sale, it doesn't mean that we are going to buy them, if we're not able to buy them at the price that we believe is reasonable.

The best answer I can give you is that I don't know. But if you assume that pricing of assets is not going to change in the next one or two years in the region, and we can continue to have deals at this pricing level that we have done recently, and that these types of assets are coming to the market at these levels of valuations, then I think we've proved that we can provide the necessary capital to do so. If you look at our CET1 ratio, despite all these acquisitions, it remains relatively stable, despite the fact that we had to also allocate capital to 10% organic growth and we intend to increase the expected level of dividends compared to last year. What I've tried to explain here is that the strategy going forward is not very different from what we have done. These are exactly the things that we have recently done, and the numbers seem to work, so we are quite happy to continue this.

There's obviously one constraint, and that's the ability to run the due diligence but, more importantly, merger processes properly. There's clearly a limit on that. But so far, we don't feel that we are overstretched. It's unlikely that everything will come at the same time so, again, this depends on timing, how assets come to the market or how they don't come to the market. I can tell you that so far it's working. 20%-plus growth of the performing portfolio seems to be possible, and this is the level we are also capable of continuing with merging these entities.

Obviously, it's probably easier to merge one big than four, five smaller ones, so it's a complex question and I don't have a clear answer to that, but the intention is to continue on the trajectory we've started, and so far it seems to work. I hope that the environment will continue to be supportive of it.

Pawel Dzedzic: Can I just clarify, the 20% growth of performing portfolio, you mean for the group as a whole, that's including organic and external growth?

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Laszlo Bencsik: If you look back, the year-on-year growth on the group level was 23%. Out of this 23%, 10% was organic, 13% was due to the acquisitions. The additional two will contribute roughly 10%, so if we had the other two already consolidated, we would have another 10% growth.

Pawel Dziedzic: That's very clear. One follow-up question on your availability of capital. You made a statement in a presentation about the leverage ratio which is much above your peers. When you did your capital planning, you gave a range on core tier 1, but is there any element of lowering density of risk-weighted assets that could potentially release capital that can be used elsewhere, or that's not the case that is in your plans?

Laszlo Bencsik: Due to the fact that all of our assets are in Central Eastern Europe, and part of it in Russia and Ukraine, and especially the Russian portfolio is clearly a high-risk portfolio, and the Ukrainian one. I think there's a reason why our leverage ratio is somewhat higher than our peers, who have a much bigger share of their assets in the Eurozone. So, no, it's not that we have hidden large reserves. It's not the case, unfortunately.

Pawel Dziedzic: Thank you very much.

Operator: Our next question is from Mate Nemes from UBS. If you'd like to go ahead?

Mate Nemes: Thank you for the presentation and taking my questions. I have three of them. Firstly, on cost of risk, obviously we are seeing a very favourable environment, especially in Hungary and Bulgaria, and I was wondering if you would comment on the outlook, near-term and medium-term outlook, on risk costs in these countries. Looking at NPL ratios and the stock of NPLs in these two countries, there's clearly some call for further releases or the favourable trends to continue?

Secondly, on operating expenses in Hungary, your OPEX will increase only 1% year on year in the first nine months, so it looks like, actually, the wage inflation, or salary inflation in the country hasn't affected it too much, or you were able to offset that. Would you expect this still to kick in, potentially, in the next few quarters, and if yes, what mitigating measures do you have for that?

Finally, a follow-up question on IFRS 9. I noticed you mentioned that the impact could be relatively moderate here, but if you could be a little bit more specific? Is this moderate compared to the EBA guidance of up to 40, 50 basis points, or is this within the guidance? Thank you.

Laszlo Bencsik: Cost of risk, very short-term, meaning the fourth quarter, if you look back, maybe ten years, there tends to be a seasonality. Usually, the fourth quarter is higher than the previous ones. I don't know how much it's going to be, because if I knew then we should have already provisioned for this, but it's quite likely that the fourth quarter risk costs will be materially higher than the third quarter. That's the very short-term expectation.

Longer-term, there are two factors. One is the ongoing normal level of risk cost, which should be quite low if the economic environment continues to be as it is today. We have a very supportive, very favourable environment in all of the countries where we operate so, therefore, the ongoing normal risk costs should be quite low, and most of this

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should come, if I use IFRS 9 terms, from stage one type of provisioning, where we will provision for the performing volumes, the expected one-year loss.

If you look at the portfolio deterioration numbers, for an extended period of time we have seen very low levels of portfolio worsening and deterioration, and quite a low of actual defaults, so, again using IFRS 9 terms, migration from stage one to stage two is actually very low, and migration from stage two to stage three is even lower. So most of the risk costs we are going to see, assuming a similar operating environment in the coming years, will come from the stage-one type of provisioning. So that's the fundamental, underlying part.

On top of that, again assuming the same supportive environment, as we reduce the level of non-performing or stage three loans, it can happen that we will be able to further release provisions, compared to what we have created. This is obviously impossible to forecast or even guide for, because if I knew how much we are going to release from these provisions, then we should do it now, because then that should be the expected level. So, honestly, I don't know.

You can run different scenarios, and the better the environment the more it's going to be, but it's not going to be evenly distributed, that's for sure, because a big chunk of the release volumes, for instance in Hungary, is coming from individual corporate cases, which is impossible to forecast. So, this second type of impact is probably going to be there; I don't know how much, but it's not going to be evenly distributed between quarters.

Regarding the Hungarian OPEX, two important remarks here. One is that the social contribution tax was cut in Hungary by 5 percentage point at the beginning of this year, so that reduced the personnel expenses, and we had a 5% increase of salaries at the non-managerial level in the third quarter, so we are following the wage inflation in the financial sector. What we see is that the financial sector wage inflation is less than the average of the market, and we try to match the one which is representative for the financial sector. So, we had a general 5% increase for the staff in the third quarter.

All in all, for this year, we had the positive impact of the social continuation tax cut. By the way, this is going to continue next year, so there will be another 2.5 percentage point decrease next year, which is going to have some positive impact.

Therefore, I don't think it's fair to expect this low level of operating expenses growth for the foreseeable future in Hungary. To some extent, we have to follow the wage inflation, and we're quite busy with our digital transformation. We are not talking about astronomical numbers here, but we increased our spending, part of it is in OPEX, part of it is CAPEX, and we also hire more people, especially in IT. So this is going to kick in, and next year we'll see a somewhat higher increase in OPEX. Before you ask how much, we have not finalised our budgeting for next year, so the guidance for next year will come at its usual time, which is when we talk about the full-year results in early March.

Your last question was the IFRS 9 impact. It's expected to be moderate. In our case, it will very probably be below the EBA overall guidance.

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Mate Nemes: Thank you, that is very clear.

Operator: Our next question is from Andrzej Nowaczek from HSBC. If you'd like to go ahead?

Andrzej Nowaczek: Thank you. I'd like to ask about the latest credit quality developments in Croatia. We have one very large company in trouble, but I can imagine, also, many other larger or smaller companies who do business with it, suppliers etc, so are you seeing any widespread debt-servicing problems in Croatia, or are you expecting to see a worsening picture, much like the situation in Montenegro some years back when there was also one large company accounting for a huge chunk of the economy? And this is what you are alluding to by saying there were several corporate defaults in Croatia, or is there something else, unrelated?

Laszlo Bencsik: We don't see this domino effect or spill-over from this event because, first of all, the operation of this entity continues – they are under administration but they continue to operate. I think the impact is reasonably well contained.

This season was fabulous. I just remind you that we are very much a regional bank, and even more a regional bank now than we used to be, covering the coastal region. The tourism business was fabulous during the summer, and tourism revenues came in big numbers and there were a lot of tourism-related investments. This part of the economy doesn't seem to have any impact coming from this unfortunate event. I think the situation is very, very different from other situation, what happened in other countries, where the overall economic environment was more negative, for instance what you referred to in Montenegro.

Andrzej Nowaczek: Okay, thank you.

Operator: Our next question is from Olga Veseolva from Bank of America Merrill Lynch. If you'd like to go ahead?

Olga Veseolva: Thank you very much. My question is about margin. Do you think that the margin erosion will evolve next year, and how do you think it will evolve in your home market? Do you see a risk that the National Bank will produce more customer-friendly products next year, similar to what was already introduced in summer or in the third quarter? Also, how do you think the National Bank will motivate banks to provide more mortgages at fixed interest rates in the long run? Thank you.

Laszlo Bencsik: Expected margin development, allow me not to elaborate too much on this because the intention now is not to give specific guidance for next year, we are going to do that during our next event, when we talk about the overall results of this year. That's what we usually do. We always give guidance about a given year when we talk about the results of the full previous year.

I'm not aware of new, customer-friendly type of initiatives by the central bank. Price competition is quite intense in Hungary, and even without this customer-friendly product or label, there's an intense price competition and we see APRs contracting, to some extent. We had seen that before this was introduced.

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The central bank publicly expressed that they would favour more fixed-type mortgage loans to come to the market, and I'm sure that they will try to provide positive or negative incentives to increase their share in the new production of mortgage loans in Hungary. I don't know what's going to happen. I can only hope that these incentives will rather be positive than negative.

There's nothing wrong with fixed mortgages, so we are quite open to do that. We already have a ten-year product, we just introduced a five-year product, a 20-year product, so we have these products, we're quite happy to sell them. In fact, if you don't look at the product level, but the overall net interest margin level contribution, then it's bigger from a fixed loan than from a variable. I don't know if the central bank is going to have any action on this front, and I don't know what that action is going to be, but I agree with you that it can happen. Having seen how active they've been and how proactive they've been so far – and, I would say, quite positively proactive – this can easily happen.

Olga Veseolva: Thank you. My second question is on capital. In your presentation, you mentioned there are two reasons for your higher internal CET1 target, or limit. One is peers and the other is regulations, and the question is on the latter, on the regulation. In which countries where you operate do you see increasing capital requirements now, because I thought they are broadly flattish, across the board? Thank you.

Laszlo Bencsik: Fundamentally, we had this phasing in of the buffers, the capital conservation buffers, and the local SIFI; we have 2% local SIFI additional capital requirements, which if being phased in, we have a capital conservation buffer which is phasing in. Obviously, if Basel IV is going to come at any time, then this is again going to have an expected negative impact. There, we have less clarity, especially related to the timing, that's another factor we have to take into consideration when we think in the longer term. So, it's not specific to any country, and this guidance is on the group level, not on a specific-country level, so this is the overall group capital adequacy.

Olga Veseolva: I see, thank you.

Operator: Our next question is from Gabor Kenny from Autonomous Research. If you'd like to go ahead?

Gabor Kemeny: Hello. A couple of questions, please. Firstly, a clarification on your capital guidance. You talk about raising the annual dividends, potentially, later on, so should we assume that the first time you will consider changing or raising your dividend pay-out will be from the 2018 profit, or would you think about some form of capital return in the meantime, for example share buy-backs, if your M&A prospects allowed?

Secondly, on Hungarian NII, I understand it's a bit too early to comment on the 2018 outlook, and there are many moving parts in the margins here, but if we just look at the first nine months, your NII was roughly flat in Hungary, even though your loan book expanded quite a bit. So, just directionally, going forward, do you think that loan growth will eventually translate into significant NII growth?

Laszlo Bencsik: Again, please allow me to refrain from direct forecasts relating to next year. It depends on the level of volume growth; it can happen. In an optimistic scenario, that can be expected.



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Regarding share buy-backs and other potential equity-related transactions, we don't rule them out, but this is not something which is in the focus of our thinking. The focus of our thinking is related to this growth strategy which we try to pursue. Therefore, as we indicated, there's a preference to spend the capital which is generated on acquisitions above what is needed for organic growth.

There's a valid question: what happens if we can't do any acquisitions, either because there's nothing for sale or it comes at a price which is not justifiable? Then we would have to think about how to get to the range or the targeted level, and share buy-backs would be something to consider, should that happen. But again, we are not in that discussion mode, we are not in that story. The underlying story we want to pursue in the coming period of time is not this one; it's the one which we indicated.

Gabor Kemeny: Okay, that's helpful, thanks.

Operator: The next question is from Alan Webborn. Alan, your line is now open.

Alan Webborn: Hello, good afternoon, thanks for the call. I remember, I think at the last presentation, you expressed some frustration about the progress at Touch Bank, and it doesn't look as if it's got any better. What's your view in terms of why it's not able to attract the clients that you want to attract? It's going on for some time now, it doesn't look as if you're particularly expanding the business. Have you thought more about the future and what you do with that?

The second was a more broad question. You're clearly very intent on buying lots of bank branches in your region, and your expanding region, at a time when bank branch footfall falling away very sharply and the take-up of mobile and digital banking is very fast, yet, it's not something that appears to be particularly at the forefront of your strategy. Does it, therefore, makes sense to keep adding bank branches that you may well have to shut down in a couple of years' time? How do you think about that in terms of your acquisition strategy?

At the moment, it just seems to be adding physical presence, and I do wonder whether that's the right thing to be doing as we look five years ahead, given how rapidly the take-up of, particularly, modern retail banking and SME banking is happening in the region. I'd be interested in your thoughts versus your strategy on that, thank you.

Laszlo Bencsik: Touch Bank, we are still not happy with the performance. Having said that, the recent results, they started to be present at one of the large retailers in Russia, and our product is sold at that retailer and it's doing actually very well. The rate of customer acquisition speeded up incredibly; we still don't know how profitable these customers are going to be. This means that there is a deviation from digital customer acquisition, because it means that we use an agent or a partner to acquire digital customers for us, but this is physical.

Honestly, we are still struggling with this, and trying to decide what is the right course of action. This decision hasn't been made. We'd love to make this a success story. On the other hand, it's loss-making and there's only a certain time we are willing to remain loss-making. So far, the fundamental strategy is to try to make it work as it is, but we have obviously various alternatives regarding this activity.

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One thing is we've learned a lot already. Two, we developed the digital front end which is proprietary and excellent. Within the group we have our proprietary front-end system, which is in-house developed, and have amazing capabilities compared to what we have in the other entities within the group.

We are not buying branches, we are buying customer relationships and existing volumes. Closing branches is actually quite easy; what is difficult is to acquire stable customer relationships. So far, there have been very few examples, at least in this part of the world, where a bank could build up a stable, profitable customer base without branch presence. Even the early examples like mBank in Poland, at some point they just went deeply into branch presence as well. Alior was another success story in Poland. They started with a branch strategy, building branches, and pretty much the only visible positive example is Tinkoff in Russia, that managed to build up a customer base digitally, but they already had an established brand and they used other sales channels as well.

Still the name of the game is multichannel banking, and it's still extremely difficult to acquire new customers if you don't have branch presence. It's quite difficult to acquire new customers anyway. I don't know how long it's going to be like that, but once you have your customers who you are serving and you have your customer relationships, you keep improving that customer relationship by providing more and more convenient means to banking, and that means better and better digital and remote services, and also leaving it open to provide a physical contact possibilities. That's very clear. That's the multichannel strategy, how it evolves. We understand that and we are investing heavily into this.

What we do through the acquisitions, we are acquiring a customer base, customers relationships and existing volumes. Branch closure is not tremendously difficult, technically, if customers don't require the branches anymore. We don't see a contradiction here. We believe that digital is extremely important at the moment, in serving existing multichannel customers, and we are investing heavily on this front.

There's a big question mark for us whether it's going to be the dominant business model to only acquire customers digitally. This is the experiment we have in Russia, digital customer acquisition without branches. That's where we have headaches and we are struggling to find the right approach to succeed, but we keep very hard and, certainly, we are learning a lot. But it's not that there are a number of banks popping up all around us taking huge market shares being only digital. This is not happening.

Alan Webborn: I suppose when you mention the potential to do further external growth in a market like Bulgaria, where you would hardly say you don't have presence, that seems to be somewhat counterintuitive to the further development of multichannel and, particularly, digital banking. One can understand that in a market where you feel that you simply don't have enough brand awareness at a national level, but in a bigger market, does that still really make sense?

Laszlo Bencsik: I didn't get the gist of your question. Are you questioning potential acquisition in countries like Bulgaria or our digital strategy?

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Alan Webborn: I'm questioning that where you already have a significant and large presence, does it make sense? Now the world is changing, and quite rapidly [sound slip 01:33:11] adding where you already have critical mass. I think people wouldn't question in a smaller market, where you are sub-scale, but where you are not sub-scale, buying another bank seems to be somewhat counterintuitive to the way the market is going. I was interested that you mentioned Bulgaria when you were talking about potential targets.

Laszlo Bencsik: If you want to grow your market share, it's extremely difficult without acquisitions. Plus there are huge cost synergies. Even if you assume the current and the future business model, how you serve these clients, either it's multichannel or digital only, there are cost synergies to be realised.

Alan Webborn: Thank you.

Operator: There are no further questions on the phone lines. I'll hand the presentation back to you, gentlemen.

Laszlo Bencsik: Thank you very much. Thank you for attending this conf call. Thank you for very good questions. I hope you will join us when we talk about the annual results on the 2<sup>nd</sup> March, next year. Till then, I wish you all the best, a good weekend and good day. Thank you very much. Goodbye.