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Operator: This is conference # 954702.

Ladies and gentlemen, thank you for standing by, and welcome to the OTP Q2 2015 Results Conference Call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. At which time, if you wish to ask a question, you will need to press star and one on your telephone.

I must advise you that this conference is being recorded today on Friday, August 14, 2015.

I would now like to hand the call over to your first speaker today, Miss Anna Marshall. Please go ahead, madam.

Anna Marshall: Good afternoon. Thank you for joining us on this call today. This is Anna Marshall from JPMorgan. I have the pleasure of introducing today's speaker, Mr. Laszlo Bencsik, Chief Financial and Strategic Officer at OTP Bank. Laszlo, over to you.

Laszlo Bencsik: Thank you, Anna. Good afternoon or good morning, depending where you are. And thank you for joining us on this mid-August summer day on Friday. It's really warm here in Budapest. I hope you have good weather where you stay as well.

Sorry for the delayed start. The conference operator was just unable to handle our call. There was a technical problem due to which we are somewhat late. I'll try to compensate it by being faster in my presentation. And then you will have chances to ask your questions.

So hopefully you have been able to access the presentation on the website, which is uploaded. And as usual, I'm going through the most important pages, and try to explain to you the most important messages we'd like to convey.

So starting on page 2, the overall second quarter result, the accounting profit was HUF38.2 billion. We had a couple of one-offs, much smaller than in the first quarter or last year. But nevertheless, there were some.

The first item we marked here was HUF2.7 billion plus. That's a tax shield. We had to adjust the value of the Ukrainian investment in our standalone book in Hungary. It's according to local accounting standards. It did not have impact either on the consolidated or the IFRS core numbers. Nevertheless, it did have a tax impact. So it improved our tax shield by the said amount.
The item two is the bank tax we pay in Slovakia.
Item three, the further adjusted number related to the settlement with customers in Hungary; it was a negative number. I will explain what happened during the second quarter. Basically we concluded the settlement with the car loan customers and the real estate leasing customers in Hungary. They were not converted to local currency. But we did the settlement. And in case of the car loans its cost is somewhat higher than we originally expected. Plus there was another element, the tax shield on this loss. We recalculated, and apparently we ended up having a lower number than initially expected. So therefore we have this adjustment.

And the last item is that we created further provisions in Ukraine on the remaining very small loan book in Donetsk and Lugansk regions.

Going to page 3, you'll see that the adjusted consolidated profit after tax was HUF40.6 billion, considerable improvement compared to the first quarter, which was HUF28 billion. And even in the year-on-year basis there was some improvement.

This led us to close to HUF69 billion results in the first half, which is somewhat lower than a year ago.

We had one kind of one-off item, which was important to mark here, and that's the actually usual annual recurring result of the treasury share swap agreement, which we have with MOL. We received the dividends on MOL shares which we have in our books. This usually comes in the second quarter each year. So this is not going to reoccur in the following quarters during the course of this year.

And then if you look at the tax, it was relatively high. The corporate tax was HUF11 billion compared to HUF2.2 billion in the first quarter. The biggest difference is due to this tax shield on subsidiary investments. Again this is a technical difference between local accounting standards and IFRS in Hungary, and their treatment of subsidiary investments. The HUF depreciated, therefore we had a gain on this according to local currency which is not recognized in IFRS. But nevertheless we have to have the tax numbers coming from this included here. And this was negative now. So this increased our tax contributions in the second quarter.

So going down to the before tax profit without one-off items, it was HUF49 billion altogether. And if we go to the major lines, namely to total income, it was pretty consistent on a quarterly basis. There wasn't so much exchange rate difference quarter on quarter, except the strengthening of the ruble. So that was a slight decrease in net interest income. Fee and commission income did very well. And other net non-interest income was somewhat lower.

Again, these are quarterly numbers. So if you look at the year-on-year differences, there you can see a much bigger gap than actually warranted. If we were to look at the FX adjusted numbers, then actually the annual decline would have been only 4 percent as opposed to the 9 percent what we have here, i.e. a year-on-year decline in terms of total revenues. Obviously this is because the ruble and the hryvnia being much weaker this year than last year.

Operating costs, year-on-year a 5 percent decline. Again, this is primarily due to the exchange rate difference. If it was at fixed exchange rate terms, then actually there were no year-on-year difference between the second quarter this year and last year.

Finally, the risk cost is much lower than in the first quarter. The difference is coming from Russia and Ukraine. And I'm going to talk about this later on more in detail.

Page 4, the discrepancy between the CEE operations and Russia and Ukraine remain the same. So CEE countries continue to be quite profitable, whereas Russia and Ukraine were negative. However, there was significant improvement both in Russia and Ukraine, especially in Ukraine.

If you go to page 5 you see the exact numbers country by country. So overall in OTP Hungary the quarter-on-quarter number is pretty stable, and the first half number is close to HUF60 billion. This means roughly a 10 percent decline year on year, primarily due to lower revenues. But again, this is coming later on more detail.

DSK Bulgarian Bank achieved somewhat less profits in the second quarter. If you remember in the first quarter, risk cost was positive as we actually wrote back provisions. This quarter we provisioned, so we went back to kind of more normal levels of profits with risk costs. And I think if you look at the first two quarters together, it gives a better reflection on how we can expect further on the Bulgarian operation to evolve.

The other smaller banks in the CEE countries did reasonably well. All of them were positive. And we are quite hopeful that they will continue to be so.

And then we reach Russia and Ukraine. In Russia the quarterly result was minus HUF4.2 billion. Out of this minus HUF4.2 billion, HUF1 billion is attributable to Touch Bank, the new internet bank which is obviously in its early phase of operation, so only generates operational cost. We are starting to actually market this in various regions in Russia. So this is expected to contribute this year with an increase in negative numbers, as the cost of running the bank and related marketing expenses increases.

Other than that, the bank itself made minus HUF3.2 billion, which was a considerable improvement compared to the first quarter. Now there was an intrinsic improvement, but part of this big change was due to the fact that we adjusted the methodology of provisioning for loans over one year delinquency. We used to provision 100 percent for these loans, which you could argue was too conservative. And now that we see that the peak is over and that new formation and risk cost might actually start to decline, we decided to adjust this methodology and go for a very precise one, where we exactly provision as much for these loans, as needed according to the expected recovery based on recent market figures, and also how much we can sell these for in line with our own relevant experience.

So this altogether resulted in HUF3.2 billion after tax positive impact. Without this methodology change the Russian loss would have been HUF7.4 billion. But even from HUF11.5 billion to HUF7.4 billion, it is considerable improvement. And we are hopeful that the remaining two quarters will bring small, but gradual improvement in the profitability of Russia.

Ukraine, there was a much bigger improvement. And it even became positive. This is due to the fact that the currency appreciated somewhat. And we automatically provision according to the currency movements. So when it weakened a lot in the first quarter, we immediately provisioned. And when it strengthened during the course of the second quarter, we immediately wrote back some provisions. That resulted in this very low level of provisioning, and therefore positive results in Ukraine.

This unfortunately doesn't mean that for the rest of the year we can expect similarly good results in Ukraine. Unfortunately we continue to expect sizable losses and further provisioning coming in Ukraine. Therefore the second half of this year might not be as good as the first half.

Page 6 you see the total income numbers, again, quite stable on a quarterly basis. Hungary was actually improving, and details will come later. DSK went somewhat lower. This is due to the other non-interest income being lower in the second quarter than in the first quarter. Basically there was some treasury loss from the government bond portfolio due to the Greek events. The Bulgarian bond prices weakened.

Russia overall quarterly improvement, which is partially fundamental, partially due to the exchange rates. The ruble appreciated in the second quarter compared to the first. And therefore in HUF terms the actual improvement quarter on quarter was 23 percent. But if you look in ruble terms, it was only 3 percent. Nevertheless, this is a good result given that the performing loan volumes declined by 12 percent in one quarter. So despite this decline, we managed to more or less keep revenues flat.

In Ukraine after the very strong first quarter revenues we had a much lower revenue number. This is partially coming from net interest income erosion, and also other non-interest income going lower. In the first quarter we had a big FX gain, which we did not have in the second quarter.

The rest of the group basically doing reasonably well, with quarter-on-quarter improvement in Croatia, Romania, Montenegro and Serbia, as well.

Going to page 7, net interest income, these are the year-on-year and quarter-on-quarter changes. So again, quarter-on-quarter, you see an improvement here in Russia. But this is due to the FX strengthening. As you can see, without that it would have been flat. And Ukraine going lower by HUF5 billion, which is a substantial decrease. This is fundamentally due to our renewed efforts to restructure the FX mortgages. So we are doing restructuring in a big way, and therefore during this restructuring we also convert the dollar mortgages into local currency.

Now obviously this restructuring is negative NPV, as we give discounts and the net interest margin of these loans is also negative. And we have to book everything when we do the restructuring. So for the entire difference in the net present value of these loans, we have to book immediately when we do the restructuring. Therefore it's actually quite a high number what we see in this period. But this is actually a number which reflects the entire lifetime of these loans, and the expected difference in NPVs.

There wasn't much change in the remaining part of the portfolio.

Page 8, net interest margins, Hungary flat, Bulgaria pretty much flat, improvement in Russia. By the way, part of this improvement is due to again this methodology change where we changed the provisioning. Because it also impacts to some extent the level of provisioning on the accrued interest income, as well. So, roughly 1 percentage point of the improvement here is attributable to this methodology change. The rest is in fact related to business events.

You'll see later on how the pricing of deposits and loans shape up in Russia. We're certain that in deposit pricing we are over the peak. So from the second half we expect term deposit rates to be lower, and certainly the asset-liability structure of the bank improved a lot during the second quarter. We got rid of deposits which we didn't need. And we got rid of financial assets which we didn't need. Therefore we have a much more effective balance sheet today.

Ukraine, big decline, but again this is under the impact of this restructuring and the one-off net present value adjustment which we made. Therefore it's not really an ongoing level of margins.

Page 9, the net-loan-to-deposit ratio, group level further decreased. We are down to 73 percent, which is very far from being optimal, and it's not an efficient balance sheet what we have today. But nevertheless, this reflects the business situation.

Hungary is especially low, close to 50 percent. It was I think 15 years ago where we were at this level in Hungary. But as you can see Russia as well down to 100 percent, and even Ukraine is getting close to 100 percent. So the leverage is getting smaller and smaller across the board.

Page 10 you can see the performing loan volume developments during the second quarter. And the most important events happened obviously in Russia and Ukraine, where we continued to have a further decline in loan volumes, 12 percent in each case. And these are FX-adjusted numbers.

In Russia we expect a slowdown of this decline during the third and fourth quarter, though the decline will continue. But the pace will be somewhat slower.

DSK increased. Hungary is getting down practically to zero, so we are getting closer and closer to an inflection point where finally the long period of negative loan growth ends in Hungary. It did not happen during the second quarter. But it was related to the continuous events in the settlement with customers. It had an impact on the car financing volumes, basically, in Hungary. And corporate volumes generally in Hungary were somewhat weaker in the second quarter. We pretty much managed to keep the volumes flat.
And there's nothing tremendously important or exciting to be reported around the rest of the group either.

If we flip to page 11, we see the deposit numbers. It's minus 1 percent. Again, we reached the level where it's really not our intention to increase further deposit volumes. Nevertheless the year-on-year improvement is 9 percent. In Russia, we started to adjust the deposit base to the new volume of loans. And therefore you see this decline.

In Ukraine we are quite happy to increase deposit volumes. That's pretty much the only country where we try to maintain or even increase deposit volumes, in order to further decrease the outstanding group funding.

Operating costs on a year-on-year basis demonstrate a 5 percent decline. But again, if you take an FX-adjusted number, then it was basically flat. There's some decrease in Russia, even FX-adjusted, which is the result of the cost-cutting exercise and efforts that we have been doing there. And the only country where we had an increase, it was Romania. And that's because of the acquisition at the end of the first quarter; we included the newly acquired Millennium Bank in our Romanian numbers. So this increase was due to that acquisition.

Going back to OTP Hungary, the core operation as usual, I'm going to say a few words about Hungary, Bulgaria, Russia and Ukraine, the most important four operations within the Group.

So the before tax profit without one-off items, there was some improvement quarter on quarter. Net interest income remained reasonably stable, and there was a good increase in fees and commissions. This is partially due to the fact that in the first quarter we had HUF1.6 billion negative item which we booked. This is related to the transaction tax, which we have to pay in one amount for the full year for credit cards. And this is not a recurring item over the year. So this did not appear in the second quarter. So the improvement of HUF1.6 billion is explained by that. The rest is basically related to normal business. There's some seasonality. But also we see an increasing transactional current account activity in Hungary. And you'll see later on that our actual market share in retail savings increased.

Other non-interest income improved. In the first quarter, if you remember, we had FX losses, which turn into positive in the second quarter. So in the first quarter we had minus HF3.7 billion, in the second quarter plus HUF1 billion. And that's the most important contributor in this improvement here.

A few more details on our Hungarian business results, mortgage lending continues to accelerate. I wouldn't use the word strong. Because compared to previous years, it's still weak. But the level of year-on-year change is actually quite promising. And it should continue. Our market share is stable from new production, 27 percent. And our market share from household savings, which I mentioned earlier, is close to 30 percent. And this is basically driving the fee income growth in Hungary.

The other side is the corporate one. We continued to increase our corporate market share on the lending side. It's up to 13.3 percent. We remain very active in the Funding for Growth scheme, the refinanced structure provided by the Central Bank. And we are quite happy with our SME volumes, which is the most dynamic part of the corporate portfolio in Hungary. During the first six months the volume growth was already 8.3 percent. And this is again a strategically important segment for us.

Now if you look at the settlements and how it evolves in Hungary, we concluded the steps which were related to the second quarter. And there's only one remaining element: it's the settlement related to the HUF consumer loans. This is going to be a smaller amount in terms of the amount which we have to settle with customers. We provisioned HUF12 billion for this.

But the operational effort we have to do is nevertheless enormous. So far related to the FX contracts, we have sent out 400,000 letters. Now related to these HUF loans, despite the fact that the volume to be settled with customers is much smaller, we are going to send out 600,000 letters. And these are not small letters. They are very fat envelopes with 15-20 pages inside with very detailed calculations related to these loan contracts. So you can imagine the operational burden on the bank in Hungary, like sending out these letters, printing them, calculating these and so on and so on, it's a lot of effort and a lot of additional cost as well. So this is contributing to our cost base in Hungary.

Very few words about Bulgaria, consistent pretty good performance, I would say. We see improvement on the business activity front. Our corporate market share is increasing. Our retail activity is increasing. And the profitability looks sound. And we did provision, despite the fact that there was no portfolio deterioration during the second quarter. As a result, the coverage levels actually came back to the end of last year levels. Because at the end of the first quarter we somewhat dipped down. But we are back to 91 percent, which is I think, a very high level, and very conservative level of provisioning.

Russia, margins improved, total income margin and net interest margin as well. I have already touched upon this before. The important part on this slide is the risk cost rate. And you have two sets of numbers for the second quarter. The first set is the unadjusted number. And the second set is the adjusted number, with the methodologies change, which we did during the second quarter. So if we had not done it, the ratios would have been such what you see in the last column, which actually shows some improvement in credit cards and cash loans, while POS loans demonstrate pretty much stable levels compared to the first quarter.

Overall, what you will see is that the 90-days-plus portfolio generation is worsening, peaked and reached the very high level in 2Q. But in the brackets in 30-days past due and 60-days past due, we have already seen improvement in May and June. Therefore we do believe that the peak is over, and that during the next two quarters we'll see gradual decrease in the 90-days migration and increase, therefore a further decline in the risk cost rates in Russia.

Maybe going to page 19, skipping 18, you see here the volume dynamics. POS loans, which at the moment seem to be the safest and most profitable product to sell, started to increase in the second quarter. And we are quite hopeful that for the remaining part of the year they can continue to grow. I have to add that the recent developments were not positive in Russia in terms of the macro environment. Certainly, the lower oil price and weaker ruble cast another shadow on the potential future development of the Russian economy. But nevertheless we believe that we can continue to increase POS lending.

Credit cards remain zero, so we basically don't do it, or very small amount we started to do over the summer. And we are very conservative in cash loan disbursement, as well.

Deposits declined in line with the decline in loan volumes. And here you can see the deposit rates at the bottom of the chart. The new term deposit rates - whereas they were up to 20 percent at the end of last year, beginning this year - now they are down to below 11 percent. So we pay 10.6 percent across the terms.

A few words about Ukraine, in fact the most important development is on page 20. And it's down in the lower left corner. The Group exposure dropped further by HUF20 billion. So we managed to further reduce the overall risk related to Ukraine.

Page 21, you see that in Donetsk Lugansk the net loan volumes have further declined. And it's only HUF1.5 billion now.

Finally a few words about the risk costs, overall and the portfolio quality, NPL ratio in the 90-days-plus-due ratio remains stable, 18.4 percent. But obviously there was some noise in these numbers due to the settlement in Hungary. We also included the numbers without settlement impact in Hungary.

Coverage is strong, getting closer to 90 percent, and if you go to page 23, then you can see the quarterly development of the portfolio deterioration. It was zero in Hungary. It was zero in Bulgaria. Not zero, but relatively moderate in Ukraine, and it was very high in Russia.

Again, just to remind you: these numbers are FX-adjusted, and the FX rate we used is the 2009 year-end rates. Therefore they are somewhat inflated in terms of the Russian deterioration. So if you use the current exchange rate, then it was only been HUF 32 billion, as opposed to HUF38 billion. But nevertheless, the HUF38 billion is the comparable figure to previous quarters. So we keep this FX-adjusted number across the time horizon.

On page 24 you see the risk parameters for the four biggest operations in the Group. I think what is interesting is the Hungarian and Bulgarian risk cost rates over the first half of 2015. So if you take the average then in Hungary it was 0.6 percent, 60 basis points, which is an improvement to last year, which was 80 basis. And in Bulgaria it was 100 basis points.

In these two countries we are getting to a territory which we believe is likely to be representative for this period, where we have reviving economies.

Page 26 you can see the restructured amounts across the board, across the Group. And here I'd like to draw your attention to the Ukrainian increase in restructured volumes, which is starting to be again a bigger number. This is related obviously to the FX mortgages, which is by the way, not a very big amount.

And the last page is actually our guidance. We thought it would be good to give you some hints on how we see this year short-term performance up until the end of the year. Just because the second quarter was actually strong, very strong, due to basically no or very low risk cost in Ukraine, Ukraine was positive. However, we don't believe that this positive Ukrainian profit number is reflecting well the expected future development for the rest of this year.

For the second half we expect further strong provisionings in Ukraine. So, Ukraine will continue to be negative. And therefore, it's going to have a strong impact on the Group level performance as well. But by the end of the year, we hope that we fully provision everything which we can imagine. And our imagination is getting more and more vivid, as we have these recent experiences.

But what's happening that a couple of corporate situations have started to deteriorate, which we were hopeful that they would be able to recover and survive these difficult times. And we have increasing signals coming from a group of corporate clients that unfortunately it's not the case. And it's actually likely that we will have to provision for those clients bigger amounts for the rest of the year. But given the environment, and the more than 10 percent GDP fall, I think this is not very surprising for you.

Russia should continue to perform better. But they have to adjust back with this impact of the methodology change. So compared to the HUF7 billion, which is the adjusted loss in Russia, we should see better numbers in the third and fourth quarter. And this eventually leading us to more or less breakeven by the end of the year.

And then the other thing is that we expect higher operating costs during the course of the second half. This is partially seasonal. But this is also related to Touch Bank in Russia which is scaling up, and therefore as it usually happens with internet banks at the beginning, you only have costs. And revenues come later. So this will have a negative contribution in Russia to the overall OpEx.

And then we launched various digital transformation projects, especially in Hungary, which adds to some extent to the costs. And year on year there's also this contribution to the different funds, the Deposit Protection Fund and the Restructuring Fund and the Securities Protection Fund. We talked about it in quite a detailed manner during the 1Q conference call. But basically we expect this to be HUF7 billion for the full year in Hungary. Last year it was HUF3.6 billion. So this is something as well which contributes to the higher OpEx.

Therefore for the entire year, the expectation is that we are not going to have higher consolidated adjusted after tax profits than in 2014. So the level of this line is unlikely to be higher than 2014. And we'd also like to reiterate our forecast for 2017, which we made at the AGM. So that doesn't change, and that remains in place.

So that was pretty much what I intended to say. And I'd like to give you the floor for asking questions, if you have any. So please, Operator, open the floor for questions.

Operator: And as a reminder, if you wish to ask a question, you can press star and one on your telephone.

And so we have the question coming from Ivan Bokhmat from Barclays. Please ask your question, Ivan.

Ivan Bokhmat: Hello. Thank you very much. I have several questions, if I may go one by one, please. Firstly, if we can just touch upon your 2015 guidance and the net profit outlook with the slowdown in the second half. Could you please elaborate on exactly what could be driving that? And is anything other than Ukraine that could kind of bring the run rate down a bit?

Laszlo Bencsik: It's Ukraine, and it's the overall increase in operating costs due to seasonality. And these are the two factors. And also Bulgaria, we don't expect the risk cost to go down to zero, where it was in the first quarter.

Ivan Bokhmat: This was my second question, on the risk costs in Bulgaria and Hungary. I remember a few months ago you were talking about them potentially going towards zero in these two markets because of the strong macro. Yet now it seems like in the first half the run rate, it was in my calculations 75 bps in

Hungary and around 100 in Bulgaria. Can I ask you if anything changed there, or how do you now think about the kind of the full-year performance and going forward?

Laszlo Bencsik: There's still a chance that these ratios can go down to zero, as they sometimes go quarter by quarter. So what I said was that the risk cost rate will normalize down in these markets to 60 basis points, even below. And it can happen, as it can go down to zero risk cost rate. It's still a possibility. But this is not likely to happen during the remaining part of this year.

Ivan Bokhmat: So we should think of this run rate that we saw in the first half as a correct indication for the second half risk costs?

Laszlo Bencsik: Yes.

Ivan Bokhmat: OK. Then maybe moving on to the Ukraine a little bit. So you mentioned that the issues could be partly on the corporate side, partly on the FX mortgages. I don't know if you could put some numbers behind those exposures, like on the corporate side. Or in the mortgages, I can see the restructured portfolio is around HUF16 billion right now. I mean out of the mortgage book, how much more do you think you need to restructure? And what impact would that have?

Laszlo Bencsik: It's basically the mortgage group, which is causing us troubles. Apparently there's a strong political pressure in terms of restructuring. You might have heard that the Parliament actually approved very extreme measure, kind of forced conversion, which the President has not approved.

So the biggest banks prepared a voluntary program which they are going to provide to their customers. So this is a situation which will continue to put burden on us. The net FX mortgage book in Ukraine is HUF34 billion. And then the corporate exposure…But I don't think it would be good to give more information than what I have done. So if you put together what I said now and the previous forecast that Ukraine and Russia together, the loss will not be higher this year than last year, then at least you can get a relative proxy where you can expect Ukraine to be during the second half of the year.

But I don't know exactly the figures. I mean if I knew them, then we would have provisioned at the end of the second quarter. So it's not something I know and I'm not telling you. But we have to look at how things develop during the course of the second half, and how these corporates actually behave.

On top of that IMF is conducting through the National Bank in Ukraine, an asset quality review. And the stress test, this might also result in further provisioning requirements towards our bank.

Ivan Bokhmat: OK. Thanks. I suppose when you mentioned that the loss is not going to be bigger, you're referring to the reported numbers, excluding those provisions for East Ukraine and Crimea.

Laszlo Bencsik: Yes.

Ivan Bokhmat: OK. Thank you. And then maybe my last question, so you've alluded to the 2015 and 2017 numbers. Do you have any thoughts on how 2016 would shape up? Maybe should the exit result of the year be indicative of the performance in 2016, whether you think there are still some big stumbling blocks.

Laszlo Bencsik: The intention is to finish the provisioning in Ukraine during this year. So we will not leave anything unprovisioned in Ukraine by the end of the year. That I can promise. Therefore, if there's no further deterioration in the environment, so if there's no further stress in Ukraine and the currency remains flat and there's no further GDP decline, I mean usually the expectations for next year GDP in Ukraine is plus zero. That we do share. But this is going to happen after more than 10 percent GDP decline during the course of this year.

So if that happens next year, if there's no further GDP decline and the currency does not substantially weaken - some weakening might happen but not substantial -, then it's reasonable to assume that we won't have more losses in Ukraine next year.

Obviously that means that we'll have sizable provisioning during the course of this year.

Ivan Bokhmat: OK.

Laszlo Bencsik: Russia, again we expect quarterly improvement during the remaining part of this year. It's hard to tell what's going to happen in the light of the recent developments in Russia, the lower oil price, the weakening currency again to which extent it's going to impact the economy. But even now we don't believe that this should result in further GDP decline next year.

So we are quite hopeful that the GDP decline in Russia will stop around 4 percent, and next year we're going to have again zero or even plus 1 percent GDP growth. In which case there's no reason why we should continue to have losses in Russia either.

Ivan Bokhmat: OK. Thank you very much. And sorry. I just remembered one more rather technical question. So in Ukraine the restructurings that you're doing, this quarter it was reflected through the NII. Could you quantify how much was the impact of restructuring?

Laszlo Bencsik: Basically the entire reduction in the quarter-on-quarter NII was due to this.

Ivan Bokhmat: HUF4.5 billion, more or less?

Laszlo Bencsik: Yes, yes.

Ivan Bokhmat: OK. Thank you.

Operator: Thank you very much. And we have the next question which is coming from Gabor Kemeny from Autonomous Research. Gabor, your line is open.

Gabor Kemeny: Hi. It's Gabor from Autonomous. Thanks for the presentation. My first question would be on your acquisition plans. I saw some comments this morning that you might be interested in buying something in Balkan countries. Can you – I mean given the risks that you face in Ukraine and Russia, do you think this could be a this-year story, a story for 2015? And what would be your priorities in terms of maybe geographies, profile size, if you could comment on this?

Laszlo Bencsik: Well we have not made it a secret that our intention is to grow through acquisitions in these countries. So we have just done one in Romania and another one in Croatia. And we continue to search for opportunities. And certainly Romania, Bulgaria, Serbia we would look into every asset coming to the market.

Gabor Kemeny: OK. Anything …

Laszlo Bencsik: I don't think the situation in Russia or Ukraine would hinder our intentions. Because we feel that both Russia and Ukraine is under control. And the exposure to Ukraine is going further down. And by the end of the year, these two entities will be fully under control and should not continue to contribute losses to the Group. And in any case, they will be substantially smaller by the end of the year than they were just a year ago. And not to talk about 2008, when Ukraine was huge.

Now if you look at group exposure, Ukraine is a fraction of where it was a few years ago. But it's still painful on the P&L side. But from a substantial hit on the Group, or the sustainability of the Group is really minimal now.

Gabor Kemeny: Can you repeat your last sentence, please?

Laszlo Bencsik: The negative impact of Russia and Ukraine on the P&L on a quarterly basis is quite painful. But the potential loss in a very adverse scenario related to Ukraine or Russia is really small. So for instance if we had write-off Russia and Ukraine, for both entities today, the impact on the common equity tier 1 ratio would be less than 1 percent. It's around 70-75 basis points negative.

Gabor Kemeny: OK. So this does not prevent you from …

(Crosstalk)

Laszlo Bencsik: Organically we can accumulate similar size of equity in two quarters. Actually in this quarter the increase was 30 basis points for CET1. So this is not a material threat. Therefore, I don't think that our growth strategy in the CEE region should be heavily influenced by the events in Russia or Ukraine.

Gabor Kemeny: OK. And would you potentially look at the subsidiaries of any Greek banks in these countries, in these Balkan countries?

Laszlo Bencsik: Yes.

Gabor Kemeny: OK. That's helpful. And secondly on loan growth, you were hopeful, I remember, that the Hungarian loan growth could turn positive. Do you see this happening in the second half of this year? And how would you think about the lending trends in Hungary?

Laszlo Bencsik: The second quarter was minus 1 percent, which is actually close to zero. And when it's almost at zero, than it's quite close to being positive. So we are in a territory where it can happen in any quarter, basically.

Having said that, there will an additional potentially HUF10 billion impact coming from the settlement related to the HUF loans in Hungary during the third quarter. So that's another kind of headwind. But this is the last kind of headwind we have to pass.

But we are down to basically zero or minus zero growth, and it can easily turn to positive during the course of this year.

Gabor Kemeny: Yes. And how would you think about the overall NII evolution in Hungary this year? So it seems to me that – so do you think it would decline after the HUF10 billion? What is implied by the FX loan settlement? Or could this even be potentially more or less depending on volume?

Laszlo Bencsik: It's going to be more, obviously. If you look at the first half, then the decline was HUF7 billion, so year on year the first half. The annual impact of this settlement is HUF10 billion. But on top of that we have lower volumes. And we have a lower interest rate environment. So there's potentially another – let's say HUF5 billion expected decline on the year-on-year basis.

So I think that what you see in terms of difference between last year in the first half is probably reasonable to expect for the entire year.

Gabor Kemeny: That's helpful. Thanks very much.

Operator: Thank you. And the next question is coming from Andrzej Nowaczek. Andrzej, please ask your question.

Andrzej Nowaczek: Thank you. I have a follow-up question on loan growth outlook in Hungary. There seems to be an incentive embedded in the special bank tax formula, as the more you lend, the less you pay. How do you think this is going to impact loan growth rates in the sector?

Laszlo Bencsik: It should have a positive impact. Now the problem is at the moment nobody knows how much. We only know how much is the maximum deduction. And I think everyone knows his own entity's number. But we don't know the competitors' numbers. Therefore we have no idea how much we can reclaim. And no one knows.

But directionally it should have a positive impact, especially given the amount of gain you can get from this if you are much more active than the others. So directionally it should have a positive incentive. But I don't think it is such yet. Because nobody knows where the basis is.

Andrzej Nowaczek: OK, thanks. And then a more general question, there doesn't appear to be any correlation between loan demand and GDP growth in the Hungarian market. So now that the GDP growth is slowing, you wouldn't expect this to have a negative impact on loan demand, would you? And if not or yes, if so, then what really needs to happen for loan demand to start rising in Hungary?

Laszlo Bencsik: Well I think fundamentally it's going to be driven by mortgage development, and especially housing loans development and demand. And for that you need to see transaction volumes increasing, residential construction to start increase. And you have to see residential house prices to go up.

Now we see all these indicators started to increase. I mean if you look at the housing loan penetration in Hungary, it's 10 percent of GDP. So it's a bit low, actually. So there's certainly room from a penetration point of view to grow. And the indicators which are typical drivers of housing purposes mortgage lending are looking better and better.

So I think it's just time. And plus the nominal level of interest rates is also quite attractive. So this should happen. It's just a question of time.

I don't think there will a substantial increase in consumer lending or home equity loans. Because that is typically what is used for kind of smoothing consumption and bridging difficult years where the overall view is optimistic. So, long term being optimistic, short term negative, people usually take consumer loans.

I don't think this is the case. So therefore I expect lower growth for that segment. Also, if you look at consumption-related penetration levels, these are pushing the loans, including home-equity loans, when these are at the level of the regional peers. So there doesn't seem to be a penetration gap related to Hungary.

So the driver is going to be housing loans. And the other question is the corporate sector. In Hungary the structure of the corporate lending is such that the overall indebtedness of the corporate sectors is relatively high. It's 80 percent, close to 80 percent of GDP. But only a fraction of this is related to the Hungarian banking sector. So if you look at the bank loans penetration, corporate bank loans penetration to GDP, it's only 20-21 percent.

So that means that a big chunk of the economy is not financed by the local banking sector. And this is understandable, given the high share of exports and exports related to industrial production, namely car production and electronics production, which the multinationals finance themselves within their group and not from new investments and scaling up production from their groups, and not from locally.

So therefore if you see exports growing, they don't translate necessarily into higher loan volumes, because these can happen through intragroup financing from these multinationals. So where we do expect growth is the SME sector, so the small-caps and mid-caps in Hungary who do not have these global parents backing them up with lending.

And in that segment we do see growth. If we look at our numbers, we have had more than 8 percent growth during the first six months of this year. And this is certainly an important segment for us. The other important segment for us where we are growing is the agricultural segment. But the problem is that they are smaller numbers in the total corporate book.

And then the other two big parts which actually generate bank loan volumes is the state sector and the state sector companies loans, which is there. I mean the question is just how much you want to take part in that. And finally the real estate, the commercial real estate development projects, which have not started yet.

If you look at the utilization rates of office spaces, it's around 85 percent at the moment. The experience is usually that when you get to 90 percent, then you start seeing a lot of new projects starting in building commercial real estate and offices. But this hasn't started. We expect this – the utilization rates will possibly get up to 90 percent by next year. So these are the fundamental drivers in corporate lending.

I'm not sure if this was a sufficient answer …

Andrzej Nowaczek: No complaints, Laszlo. Thank you very much. But still the bottom line is, would you be disappointed if loan growth by December of next year in Hungary is less than 10 percent?

Laszlo Bencsik: It is going to be definitely less than 10 percent. So next year there won't be a 10 percent growth in Hungary. That's for sure. So it's going to be less than 10 percent. It's going to be low single digits, as I said before. We will reach 10 percent growth rate in 2-3 years in Hungary, rather 3 than 2.

Andrzej Nowaczek: So that raises the question of how we get to the 12.5 percent CET1 ratio that's behind your ROE targets?

Laszlo Bencsik: You will see.

Andrzej Nowaczek: OK. Thanks so much.

Operator: Thank you. As a reminder, you can still press star and one if you wish to ask a question or simply make a comment.

And we have one more question coming from Alan Webborn from Societe Generale. Alan, your line is open.

Alan Webborn: Hi. Good afternoon. Thanks for the call. I think you mentioned in your half-year report that the low interest-rate environment in Hungary is having a negative impact on margins. I mean is that sort of – is that done or will it continue to be negative as we go through the remainder of the year? And is there anything you can do to offset that? Or is it really just waiting for interest rates to pick up a little bit? So just a feeling of how you're managing that would be useful.

Secondly, the methodology change on Russia, did you just decide to do it in Q2, or was there a sort of – a little bit more of rationale other than reducing the provisioning charge in Q2 in terms of doing when, as you say, Russia is now looking worse than it's looking better. So was it the time to become less conservative? I'd be interested to know what your view is on that.

And I guess sort of lastly, in the Ukraine, you did say in an answer to an earlier question that you didn't know what the impact was going to be of the mortgage issue on corporates, and therefore you couldn't provision for Q2. Is there something that's happened to basically force your hand to say it's going to be worse? Is it the parliamentary issue? Is it what the politicians are pushing you to do? Is that something that's happened since the end of June, which is why you're becoming more cautious? Thank you.

Laszlo Bencsik: OK. So the first question we have reached the bottom of the pit in terms of interest rates, so the final cut was done. It's down to 1.35%. The Monetary Council announced that they were not going to decrease the rate further down. They also expressed their opinion that the rates might stay at this level for a longer period of time. But they clearly indicated that they were not going to further reduce the base rate. Therefore the pressure, the margin pressure coming from the base rate decline is over.

Russian methodology, what happened was that the portfolio deterioration trend turned around in May. You don't see that in the 90-days-plus new development, because that still increased. But the earlier vintages, the 30-day, 60-day vintages started to look much better. And now we pretty much believe that we have a strong grasp on the portfolio.

At least that was in May and June, when we made this methodology change. And we decided to take out this extra conservative measure in expectation of improving portfolio qualities.

Now the recent oil price development and the weakening of the ruble happened during the last two-three weeks. So certainly we did not know that in May when we decided on this methodology change.

By the way, I think this gives a somewhat better representation of the portfolio quality. So ultimately if I had to choose this, it's probably a more precise methodology and gives better reflection of the quality of the book. Marginally the situation turned worse, and expectations worsened. But it's still within the range where we believe that things are manageable and under control.

So that means that we are not going to go back to the previous methodology in the third quarter just because it got weaker, and we might expect somewhat higher GDP decline this year than originally expected.

Ukraine, I just felt compelled to share with you my expectations basically for the remaining of the year. Because someone looking at the second quarter numbers in Ukraine being positive might conclude that now everything is over and the bright future has started. It has not. And this is perfectly in line with what I have said before related to Ukraine.

So I was not expecting a trend up this year with HUF10 billion loss, right, where we stand at the moment now.

Alan Webborn: Clearly.

Laszlo Bencsik: There is run event which made me say that. It's the sign that due to the technicalities of our provisioning methodology, this had to happen in the second quarter. And there was no sufficient further evidence to provision. But we expect this to come.

Alan Webborn: OK. That's helpful. Thank you.

Laszlo Bencsik: Nothing has changed fundamentally though.

Operator: Thank you. And we have one more question which is coming from Ivan Bokhmat. Ivan, your line is open, please.

Ivan Bokhmat: Hi. Thank you. Just wanted to ask some follow-ups. I mean firstly on the additional cost burden that you alluded to, I understand that there is some seasonality clearly in the second half. But what I wanted to understand is whether you think that we should be still observing the same trend of costs going down year on year. It's been a 6 percent decline in the first half of the year. Should the same trend maintain in the second half of 2015? Or are we looking more or less on a flat level because of those one-offs you mentioned?

Laszlo Bencsik: This 6 percent decline is due to FX impacts. If you look at the FX adjusted development of the OpEx, then it is actually zero. So that's what I said. If you go to page 12, here you have the second quarter. But the first half is not very different.

So the second quarter year on year was minus 5 percent. But if you adjust by the FX then there was zero difference. So it's basically ruble and hryvna being weaker, and therefore they result in lower costs and therefore lower revenues as well in HUF terms.

In Hungary we managed to keep costs under control, despite the fact that we have to pay this additional contribution to the different protections funds, and despite the fact that we have an enormous, it's really an enormous operational burden that we have to manage during this year related to the settlement with customers.

At the end we will send out 1 million letters to customers. And each letter is 15-20 pages to generate this, and then we have customers coming to the branches asking for information and complaining and so on, and so on. So there's a huge operational burden coming from this in Hungary. So that's part of the reasons why Hungary is not going down.

Ivan Bokhmat: No. I fully agree with that. I'm just – it would appear that the year-on-year base would still be favorable for the second half 2015 versus second half 2014, considering the big decline in the currency mainly happened in December and January.

Laszlo Bencsik: Overall, we are going to have a lower level of nominal costs year on year. That's quite likely.

Ivan Bokhmat: OK. Thanks. That's helpful. And the second question, I just wanted to get a little more understanding on the accounting rules for the capital in Hungary standalone business. And there's also – it's mentioned in the statement that it may be reversed.

Laszlo Bencsik: Yes. I mean if you look at the CRD and the applicable sections in the CRD, then it actually says that core capital elements of investments should not be deducted unless the local regulator requests so. And then we started to discuss this with the regulator. Discussions have not concluded. But since there's no indication yet formally from the Central Bank, how they are going to treat this, we just go by the word of the legislation. And we did not include it in the second quarter capital calculations.

I don't know what the outcome is going to be. Therefore we made this remark and footnote and everything.

Ivan Bokhmat: And does it affect your decision-making anyway, like on dividends on …

Laszlo Bencsik: It gives – it does if it remains as it does today, it has to impact. It creates somewhat more room on the consolidated level. Because the standalone capital is not going to be a bottleneck.

The other impact is that if we had to increase more capital within the Group, if we had to reallocate more capital within the Group, for instance from Hungary to Ukraine or anywhere, then it wouldn't have much impact on the standalone capital adequacy.

But this is not something which is high on the agenda either. There's no major impact at the moment. We have been managing the group level capital adequacy anyway. So that's the number we kind of follow. And this is the number which is the most important for the regulator as well. So the regulator is obviously looking at the group level consolidated number as well.

Ivan Bokhmat: All right. And since you mentioned that, you still have negative equity for the Ukrainian business overall?

Laszlo Bencsik: Yes. The bank continues to have positive equity, and the factoring company and the leasing company have negative equity. But they are not regulated in the way the bank is supervised. And there are no capital requirements as such. But eventually we have to fix it. And that means that we have to convert part of the funding in the factoring company to equity. It's the same story what I explained in the previous conference call.

The technical barriers to do that, if we were to do it now with the current conditions, then we would leave ourselves exposed to FX risk for a couple of months, which we don't want to do. But we hope that we can get a technical solution approved by the regulators in Ukraine which would allow us to fix this problem. But it does not have any impact on the activities of the bank and the treatment of the bank in terms of its solvency position.

Ivan Bokhmat: Presumably you'd want to wait until the debt restructuring is completed in Ukraine?

Laszlo Bencsik: No. Again, the situation is not different if you do it or if you don't, because if you look at the factoring company on the asset side, it has the nonperforming loans, which it acquired from our bank. And in the liabilities side you have funding from the Group, from our Group, and you have equity which is negative at the moment.

So anyway, we bear the full risk of this entity. So it doesn't really matter in which form.

Ivan Bokhmat: OK. This makes sense. Thank you very much for the time. I've asked a lot of questions.

Operator: Thank you. And we have here more questions and the next is coming from Stefan Maxian from RCB. Please ask your question.

Stefan Maxian: Hello. Thank you. Just a few minor questions. One is regarding the impact on NII in the Ukraine, I mean that we had now from the restructuring. Should we consider this as a one-off, or is this like the new run rate that we see there?

And the other was just you were stating about deposit insurance, I think it was deposit insurance in Hungary relating to additional cost burden in the second half of the year, if you could give that number again. Because I think I didn't get it right.

And the third question refers to your M&A activity. You said you would look at assets in Serbia, Bulgaria and Romania. Would you still consider also M&A activity outside your core region, or is that off the agenda at the moment? Thank you.

Laszlo Bencsik: The Ukrainian NII, it's not the new norm. There's not so much we can restructure, because there's not much left from these loans. This is one thing. The other thing, this was the bigger batch which we book now according to these rules. So this is not going to be as low as in the second quarter.

What I said related to these protection funds was that this year, the entire year we expect this to be around HUF7 billion. And last year at was HUF3.6 billion. So that's the kind of year-on-year impact of these protection funds.

The M&A activity outside the current group, we never say never. But there's nothing I could report about at the moment.

Stefan Maxian: All right. Thank you.

Operator: Thank you. And we have one more question which is coming from Margarita Streltses from UBS. Margarita, your line is open, please.

Margarita Streltses: Hi. Thank you very much for the presentation. One question from me on Bulgaria, please. The provisions there were also quite volatile. And I was just wondering what in your view is the normalized level for the remainder of the year, and maybe for 2016 as well. And then I have one more question.

Laszlo Bencsik: It's going to be between 50 and 100 basis points.

Margarita Streltses: OK, is the normalized level, right?

Laszlo Bencsik: No. This is the level for the rest of the year. This is what you asked for.

Margarita Streltses: Yes. OK. And also I'm just trying to kind of reconcile your comments about the basically second half of the year being similar or worse to the first half. And basically just trying to incorporate all trends together, and including all your comments, it still seems that the second half is not really going to be significantly worse than the first. I was just trying to think what exactly am I missing? Is it a very significant increase in the Ukrainian provisions that probably I underestimate, or any other significant negative, which we should expect in the second half compared to the first?

Laszlo Bencsik: It seems I was not successful in conveying this hint that Ukraine can be a bigger loss in the second than in the first half. I mean this is certainly the biggest change. I mean in the first half we had HUF10 billion loss. And for the second half, my expectation is that the second half will be worse. And the overall guidance was that the adjusted after tax profit, we don't expect to be higher than last year. So last year was HUF118 billion.

Now Hungary can be somewhat lower during the second half because of costs. Bulgaria might be somewhat lower than the first half. And Russia should be better.

Margarita Streltses: OK. That's clear. Thank you very much.

Operator: Thank you. It seems that we don't have any more questions at this point, so please continue.

Laszlo Bencsik: Thank you very much. Thank you for joining this conference call. Thank you for your really good questions. And sorry for the technical problems we incurred. I hope you have a very good remaining part of the summer, and I'm sure a lot of you will head off to the vacation or part of the vacation, at least. So enjoy the rest of the summer. And I hope you will join us in our next conference call on the 13th of November, I believe, about the third quarter results. So again, thank you very much, and goodbye.

Operator: And so that does conclude our conference for today. Thank you all for participating. You may now disconnect.

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