Strategy and Finance Division

Investor Relations

OTP BANK
4Q 2024 Conference call
Transcript

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PRESENTATION

Operator

Ladies and gentlemen, Welcome to the fourth quarter 2024 conference call of OTP Bank. Please note that this conference will be recorded. (Operator Instructions)

May I now hand you over to Laszlo Bencsik, Chief Financial and Strategic Officer. Laszlo, you may begin.

László Bencsik – Chief Financial and Strategic Officer

Thank you very much. Good morning or good afternoon, depending on where you are, and thank you for joining us today for OTP Bank's 2024 annual results presentation. We are going to follow the usual format so the presentation is available on the website, which you can download, or alternatively we are also showing it in parallel with the conference call. I'm going to make a short presentation, hopefully, and then you'll have a chance to ask your very valuable questions.

Let's start with page 2. The highlights have not changed that much. We have updated them so dominant position in Central Eastern Europe, leading position in 5 countries or second position and fourfold increase in the last 10 years through organic growth and a total of 14 acquisitions, actually 13 bank acquisitions and one portfolio acquisition in the last 10 years. This has resulted in a portfolio that is 44% eurozone plus ERM II, which is Bulgaria.

By the way, the good news about Bulgaria is that there now seems to be an unambiguous commitment from both sides to adopt the euro from the first of January. That's now our strong assumption that it will happen, and we are preparing very strongly for that event and 76% within the EU. So a fairly diversified, and I think from a risk/return perspective, optimal group positioning. Profitability continues to be strong. Slightly down y-o-y if you adjust the 2023 numbers.

But nevertheless, I think there has been a much bigger adjustment in the cost of capital given the normalisation of the interest rate environment across the Group, very strong liquidity position, very stable and strong capital position as you can see from these numbers. The quality of the portfolio has continued to improve, with the Stage 3 ratio down 70 bps y-o-y to 3.6%, and we remain committed to our ESG goals.

On page 3. You can see some more details of our financial performance. Total profit exceeded 1 trillion forints. That's 1,076 billion forints. If we adjust 2023 for the clearly one-off impact of the two acquisitions, the one we made which had a positive contribution, and the planned sale of the Romanian bank which had a negative contribution in 2023, and then compare it to that basis, so the y-o-y improvement was 19%.

We ended up with this return on equity of 23.5%, which is a little bit lower than the adjusted 24.9% in 2023. But that's mainly because our leverage has come down. I think we are one of the least leveraged banks in Europe. Our leverage ratio is actually well above 10%. Of course this is also reflected in the very high capital ratio.

This decline on return on equity is attributable mostly to the denominator, the increase in equity and the decrease in leverage. Net interest margin improved. So that was one of the biggest improvements during 2024. You will see later in the presentation that this is almost exclusively due to the improvement in the Hungarian, the Core Hungarian net interest margin. On top of the margin improvement, we also had loan growth of 9%.

These, together, contributed to roughly 17% increase in revenues and total cost growth of 11%, so the cost-to-income ratio decreased to 41.3%, which is a record low in our recent or not even so recent history. Risk cost rates were pretty much similar to the 2023 level, the same ballpark. The Stage 3 ratio went down to 3.6%. Now these good numbers, again Hungary last year, there's increasing contribution coming from the improved margin.

But overall, the structure of the group is such that most of the profit is coming from outside Hungary. So almost 70% was attributable to outside Hungary operations this year.

Next page, you can see page 4, the P&L lines. In 2023, we acquired two banks, one was in January so that doesn't disturb so much the numbers. But the Ipoteka acquisition was actually at the end of the first half.

Plus in July 2024 August, we sold one of our businesses, namely Romania. Therefore, there's some noise in these unadjusted numbers. If you adjust them and we take out Uzbekistan from 2023 and 2024, so two years, and Romania from 2023 and 2024, then you actually have there y-o-y organic and FX-adjusted growth rates. That is slightly less revenue growth, 15% compared to 17%, which is the unadjusted growth. Profit after tax growth is only 10% if we look at the numbers from this perspective as opposed to almost 20% when we take into consideration the Uzbekistan acquisition, Ipoteka Bank and also the sale of our business in Romania.

If you look at quarterly numbers, which were not so much affected by acquisitions or divestitures, there was a good 5% growth in terms of revenues. I think the cost growth is usually seasonally high but maybe not as high as it used to be. Therefore, the cost-to-income ratio in the fourth quarter went up only to 42%. In the third quarter, it was only 38%. So that shows that the level of improvement in our efficiency ratio is due to the last couple of years' strong organic and inorganic growth rates.

A few words about Hungary specifically and our core operations there on page 5. I think the most notable improvement here is in the net interest margin, the yearly average went up from 2.3% to 2.9%. It's a huge improvement. There are two important factors here: one is that the rate environment went back to the range for which we optimize the balance sheet or the asset liability position.

You may remember that beginning of 2023 first half, the rate environment in Hungary was about 18%. A few years ago, maybe four years ago, it was more like 30, 50 bps. But now we are back to 6.5%, which is well within the range for which we optimize the balance sheet impact. This is a convenient rate environment in a sense for us. Therefore, the net interest margin went back to the levels where it used to be before this extreme rate hike.

The other very unique and actually very negative development was between mid-2022 to mid-2023. You might remember in that period, retail deposits actually declined in Hungary, which has been unheard of for the last 35 years in Hungary. In just one year in the market, there was more than 10% decline. Our market share went up, but nevertheless, our volumes went down as well.

That was obviously very negative for our NIM in Hungary. But that also recovered starting from the second half of 2023. Actually, in 2024, we saw a quite healthy Hungarian retail deposit growth. That factor as well recovered and contributed to improved margins in Hungary. Unfortunately, these special levies and policy costs, so to say, have remained quite elevated in Hungary and even the worse news is that we have already talked about, that this year we are going to pay even more than last year.

The financial transaction tax rates were increased in 2024 summer. The windfall tax was also extended last year into this year. Unfortunately, we have to increase our extra contributions to the budget this year.

There was another one-off, this HUF 112 billion, which only occurred in Hungary. This is really an accounting number when we concluded the merger in Slovenia, we had to mark-to-market the book value of the investment in the first acquisition, SKB Bank in Slovenia. That increase in the valuation of that asset created a one-off result, which only appeared in the Hungarian book. That was obviously during the consolidation, so it cancels out. This is something you have to correct the Hungarian numbers, in order to have a clear picture.

Two more important items to understand regarding Hungarian profitability development. First the fair value adjustment on the subsidized products in Hungary, and the impairment on the Russian bonds, which we have in the Hungarian books. We have not implemented corrections.

The adjusted number is HUF 270 billion, which doesn't include these two items, the HUF 23 billion plus and the minus HUF 34 billion. But nevertheless these were significant numbers in this mark-to-market type fair value adjustment on the subsidised loans. In 2024, it was HUF 23 billion plus, which was actually a much lower number, than what we did in 2023. In 2023, it did not appear as an adjustment either. But the nature of the uplift from this fair value adjustment was much smaller in 2024 than in 2023. Plus, we had this negative item due to the encouragement of our supervisor in Hungary, which we agreed with because we always like to be more conservative on provisioning than less conservative. We increased provisions for the Russian bonds, and the impact of that was HUF 34 billion negative last year.

Two words about the segment's performance in Hungary. Retail did very well. Especially retail lending was strong. Contractual amounts of mortgages more than doubled compared to 2023. We can obviously see 2023 was a rather low number. But nevertheless, the recovery was faster and potentially stronger than we originally expected. The other good news was that despite actually quite high basis in 2023, there was a further 65% growth in the contractual amounts of cash loans. This is a quite profitable product. The good news is that we managed to increase our market share in this cash loan segment, close to 50%, which is a very formidable achievement. In the meantime, we continued to increase our market share in retail deposits. In Hungary, that's the other quite profitable product, retail deposits, because the interest rates are actually quite low on this.

This was one of the issues back in 2023 that there was not much corporate loan demand, and loan volumes actually declined in 2023. Now in 2024 and especially the last quarter, as you will see in the detailed volume dynamics pages, they started to increase. So there appears to be a trend, a change, a turning point in the overall trend of this segment. The total Hungarian numbers did not increase last year because we had one loan where the client actually paid back, which was not to a Hungarian client, it was a Slovenian one and a quite large exposure which was paid back.

But if we adjust with that, then actually we had 5% growth last year in corporate loans which is, again, a very positive development and hopefully will continue into this year and this positive trend will last. At the same time, we managed to slightly improve our market share in loans to Hungarian corporates. As you can see, it was 19.5%, the second highest closing level ever.

After this short summary about the Hungarian situation, let's have a look at the foreign, outside Hungary operations and their results. In terms of profit contribution improvement, most importantly, ROEs tend to be quite positive. We have the Eurozone or quasi-Eurozone countries at the top, Bulgaria, Slovenia, Croatia. Given the cost of capital in the Eurozone countries, and the risk profile, there hit quite admirable levels of return on equity. Serbia did again very well after 2023, 2024 was a very strong year. We have strong growth and the new strategic focus on deposit collections and transactions and so on and so on. This seems to pay out.

Uzbekistan, 30% return on equity. Obviously, the rate environment here is much higher and the cost of equity is much higher. But nevertheless, from our perspective this is a quite good number given that this was the first full year after the acquisition. Already in the first year after the acquisition, we made 30% ROE despite the fact that we had strong operational challenges. We had to work very hard to improve the operational, especially IT environment in the bank in order to make it capable to service the very high level of volumes, which are potentially possible given the strong demand in the market, especially consumer loans.

These results we achieved despite of the fact that we had to rein in or limit in a way our lending activities in consumer loans because of these operational weaknesses, which we managed to improve after a lot of extra cost and extra investments. We are starting this year with a much better level of operational capabilities, and I expect a step up in our ability to sell new consumer loans. Hopefully, there will be another step up somewhere in the second half of this year. Then I think we will have fully caught up with the service leaders in the market.

Ukraine again did very well despite the 50% corporate tax rate. Just like in 2023, in 2024, the corporate tax rate was doubled from 25% to 50% at the end of the year. By the way, if you look at the quarterly numbers, you will see that due to this, and only due to this, actually Ukraine was negative because we had to book this additional tax for the entire year in the fourth quarter. Even our smaller businesses have been doing reasonably well or actually quite well, close to or above 20% ROEs, Montenegro, Albania, Moldova.

If we look into NII improvement, 20% FX-adjusted. A very strong growth in Hungary, as you can see.

Potentially more interesting is the NIM, the net interest margin development, as you can see on the following page. In fact, if you compare the quarters to the last period from 2023 with the last period of 2024, the margins are remarkably similar. This y-o-y improvement actually happened back during 2023. Most of the margin improvement actually happened between the first quarter and the last quarter of 2023.

During 2024, the margin has been pretty stable with some internal changes, with only minor internal changes and adjustments to some factors or margins. There were some further improvements in Hungary, as you can see. Whereas primarily in the Eurozone countries: Bulgaria, Slovenia, Croatia, but I would add here Montenegro as well to some extent and even Serbia, where quite sizable shares of the volumes are in euro denomination, we see a margin erosion. That's due to the lower euro rate environment.

These are the three major factors. One is gradual improvement in Hungary in margins; and on the other hand, the headwind and pressure on the euro-related part of the business. Thirdly, there was a favourable composition effect given the higher growth rates in the higher-margin countries. All these three factors together resulted in a pretty flat fourth quarter y-o-y group margin level of 4.27%. The following page further illustrates this.

On page 11, you can see that if we compare the 2023 average margin to the 2024 average margin, almost all of the improvement came from the Hungarian Core. That improvement actually happened between the first quarter and the fourth quarter in Hungary in 2023. During 2024, there was quite much smaller change as you saw on the previous page. In terms of sensitivity in rates, there was a further small decline in the euro rate sensitivity. So now it's around EUR 90 million annual NII in case of 100 bps decline in the euro rate.

Now technically, this number will probably not go so much lower. It's likely that it's going to stabilize at this level. Because we are less concerned given the last few weeks' developments, especially the last week development about the risk of the euro rate to drastically collapse, I think that risk has decreased given the new initiatives what we see across Europe. We believe that's fundamentally a good thing. HUF rate sensitivity remains quite low. It's immaterial around this 6.5% rate level where, structurally, obviously higher is marginally better at these levels.

Page 12. You can see the performing loan development, 9%. In 2023 we had 6%, so considerable improvement compared to last year. I think almost each country is a very positive story.

In fact, it's Slovenia where the loan portfolio didn't grow. But to be honest, the most profitable consumer loans actually grew 10% and the much, much less profitable corporate portfolio declined. Corporate margins are very, very, very tight in Slovenia.

In Uzbekistan, still at the beginning of the year, we had some corporate loan migration to Stage 3 bucket and, therefore, the performing loan volume declined. Overall, we have a decline here. Despite some growth in consumer loans, again, this is not the full potential of the market. We had to somewhat limit our organic growth in consumer loans in Uzbekistan. Having said that, mortgage growth was reasonably strong.

But going back to the higher growth market. Hungary mortgages, especially 13%, very strong dynamics again y-o-y. New production growth was more than 2 times. Consumer grew 10%. That's also okay.

Then we have Bulgaria, very strong on the retail front. Croatia, again very strong on the retail front. Serbia, very strong. Montenegro, very strong. In fact, we restarted lending or refocused our activities to lending in Ukraine and from a low basis but already last year, we achieved 20% loan growth in consumer, in retail, it was 50%. In Albania, after the merger, which was completed at the end of 2023, in 2024 we 100% refocused on our business activities, clients and sales. That resulted in this close to 20% growth. If you look at the quarterly growth rates, we can see that in one quarter, loan volumes grew 3%. That means that there is some acceleration in the rate of

growth. This 9% annual growth accelerated during the course of the year, and the fourth quarter was actually 3%, just quarterly growth.

If we look at deposits, page 14. You can see that overall deposit growth was 6%, and that pretty much kept our net loan-to-deposit ratio flat y-o-y. Overall, for the whole group, it's 74%, as you can see at the bottom of the table. From a profitability point of view on a group level, probably the single most important driver was this 10% growth in Hungary. This is potentially the most important indicator across all the numbers where we have described profitability within the group.

That was a very welcome return to the previous old trend after, again, this ditch in second half 2022 and first half of 2023. I think it's worth mentioning Serbia, 17%, and Uzbekistan, Ipoteka, 48%. In Serbia back in 2021 year-end, the net loan-to-deposit ratio was 135%. This has gone down to 96%. At the same time, profitability improved considerably.

This is the strategic refocusing there, which I mentioned, more of transactions accounts, salary clients and fee revenues, which resulted in a much healthier balance of deposits and loans and made this a self-sustaining business and also actually contributed positively to profitability. In Uzbekistan, close to 50% growth. You probably remember that when we acquired this bank and even end of the first quarter last year, so just a year ago, the loan-to-deposit ratio was closer to 300%, more than 280%. This has come down to 178%, this is healthy and very much welcomed development. Not so much on a quarterly basis here, but if we go to page 16. Fee income, above 10% growth actually, it's 13%. Strong across the board I think it's a very healthy, in general, trend we're quite happy about.

Other income, not much growth. In fact, page 17, flat y-o-y. Again, this is mostly due to this fair value adjustment. As I mentioned when I talked about the Hungarian business, the fair value adjustment in Hungary on the subsidized loan was considerably less in 2024 than 2023, and that resulted in other income decrease, as you can see, quite substantial decrease in Hungary. But all the other units in the group managed to almost counterbalance that, including the one-off impact coming from the sale of our business in Romania.

Operating costs, 11% growth, which is, I think, a pretty good achievement actually given that inflation is still strong. But more importantly, wage inflation was last year still strong. Obviously, we have been growing also fast and in some countries like, I mean, Uzbekistan, namely, we have strong investments into the operations of the bank. So that was another factor, which increased somewhat the costs. Risk cost, page 19, somewhat potentially higher, and certainly the fourth quarter was higher than what was expected by market participants.

But this was not so much the credit risk. It was more the other risk. The credit risk cost and the credit risk cost rate were, as you can see, almost flat last year. But the increase came from this other risk cost, namely the provisioning for the Russian bonds, which in 2024 altogether in Hungary and in Bulgaria was HUF 45 billion. I mean, that actually increased the amount of provisions behind these loans to almost HUF 100 billion. It's HUF 98 billion provisions. In a good scenario, if sanctions are lifted on the Russian sovereign debt, then potentially these provisions could be partially or entirely released. So that's a potential upside. But obviously, that's a big if.

There was another larger one-off provisioning in Serbia to one specific client at the end of the year. Close to HUF 14 billion risk cost was attributed to this exposure. Other than that, more or less stable environment, obviously, in countries where we had strong growth like in Russia, we had to increase provisions. Likewise, Bulgaria has strong volume growth, resulted in a meaningful level, I would say. Provisioning 40 bps I wouldn't say is high, but it's certainly higher than the previous year's rather negative levels.

All in all, if you look at portfolio quality for the whole group, there was improvement. The Stage 3 ratio went down from 4.3% to 3.6%, which is positive. If you take out the high provisioning level and high Stage 3 ratio level of countries Ukraine, Russia, Uzbekistan, then the ratio for year-end was actually lower than 3% without these three countries. There is a negative event, so to say, it's not a trend, it's just an event. In the last quarter, there was an increase in the Stage 3 ratio primarily driven by Slovenia and Bulgaria. In both of these countries, we adjusted the IFRS 9 models and the methodologies to somewhat more conservative. The expectation of our colleagues is that these increases in Stage 2 volumes are not going to migrate or are not expected to migrate into Stage 3.

So that's more conservative view on the existing level of risk in the portfolio. Coverage ratios remain strong, as you can see, where the biggest differences can be observed between the different banks, it's the performing loans. Stage 1 and Stage 2 loans provisioning and coverage levels. It's close to 2% for us and some of our competitors are much, much lower levels. Even if you take out provisions from the countries where we have higher level of coverage like Russia, Ukraine, Uzbekistan, the remaining part of the group which is just Central Eastern Europe, was 1.4%. Performing loans coverage is typically 2 times or even much more than our typical competitors.

Capital, page 21. We closed the year with 18.9% Common Equity Tier 1 and Tier 1 ratio, and the MREL ratio went up to 30%. I think very comfortable levels of capital. Having said that, there are some items we have to consider in order to have the full picture. As you can read on this page, the last bullet point in the right lower corner explains the impact of Basel IV implementation starting from 1 January 2025. The impact was 85 bps. That's the decline in the Common Equity Tier 1 and Tier 1 ratios from end of December to 1 January, due to

regulatory changes, namely, the implementation of Basel IV. This is going to be reflected in the first quarter numbers. There's another expected remaining Basel IV impact, another 1.7% potential increase in risk weighted assets. But this is going to impact the numbers only in 2030, so five years from now.

Having said that, if we had to implement everything now on 1 January, there would have been an additional 1.7% increase in our RWA, which translates into 30 bps potential decline in Common Equity Tier 1. That would be the fully loaded immediate Basel IV impact, 85, which we actually realized plus 30.

There's another element here, which is not on the page, but you can see in our report, that we still have a transitional factor here, an uplift coming from the transitional measures. That's 40 bps. These transitional measures will phase out during this year. The year-end numbers this year will include another 40 bps negative. I'm sorry if it's too complicated, but what I wanted to say that the fully loaded impact of Basel IV, what happened 1 January, the additional one which is going to happen in 2030, plus the existing transitional measures phasing out during this year, this fully loaded effect would be 155 bps negative. So, the fully loaded number year-end last year was 17.35% compared to the 18.9%, which was actually the reported fact.

You can also see here on this page, it's probably better explained in a way visually, the drivers behind the increase last year. By far, the biggest impact was coming from the eligible profit. Obviously, that includes the proposed dividend payment, so those are deducted from these numbers, and 3.2 percentage points coming from profit. Then there was this uplift from the selling of the Romanian business. We are more or less hedged from a capital perspective on the FX-impact. The net impact was zero. Then risk-weighted assets, this 9% performing loan volume growth y-o-y consumed 1.1 percentage point of the Common Equity Tier 1 ratio and then some other smaller impacts. This is the total decomposition of the change.

Liquidity. We can see our liquidity ratios here. 270% liquidity coverage ratio. That basically technically means EUR 19 billion equivalent of liquidity buffer above the 100% minimum LCR requirement, so quite comfortable.

You see the call date profile to the remaining bonds. We have done actually calls already during the year, a quite moderate HUF 276 million coming and HUF 1.1 billion coming next year. It's a relatively modest maturity profile, what we have. We issued in January a very successful Tier 2 instrument in dollar, as you can see on this page. We may issue in the second half of the year a further MREL eligible, potentially senior preferred bonds. But this is not yet decided and sure it will depend on the business dynamics and other numerical factors.

After talking about the past, maybe a few words about what we expect in the future. Overall, our expectations tend to be optimistic. In almost all the countries where we operate, we expect GDP growth to accelerate. For Hungary, we put the government expectation, which is 3.4%. Typically, market participants expect and project less, around 2.5%. But even if it's 2.5%, it's considerably more than the 0.5% what we had last year and the actual recession that we had in 2023. No matter who you look at and listen to, the expectation is that economic activity is going to accelerate. In Bulgaria the latest number came out just today, the official number came out for 2024. That was much more than market expectations. The Bulgarian GDP growth last year was 2.8%. The fourth quarter was actually very strong. We probably have to upgrade our expectations probably to the range of 3.5%, 4%. Bulgaria finally firmly expected to join the Eurozone, which we believe is going to be very positive for the country beginning of next year. But in all the other markets, we see potential improvements, maybe except Uzbekistan, which is a slight slowdown. But the slowdown is to 5.8%, which is still a very admirable level of growth rate.

So overall, we expect improvements in the operating environment. This expectation does not include major changes in the environment. I think the major changes we expect to be definitely positive. In fact, our expectation is that much sooner than later, we expect to see an end to the war in Ukraine and settlement there. That overall can have a very substantial positive impact, primarily on Ukraine obviously, but also in the countries in Central Eastern Europe, which would be close and potentially participating in the strong expected development and investments in Ukraine. Most likely as well the war discount, which was priced into our valuation when the war started in 2022, will also considerably decline further. In any case, that would be a very positive development. There's another potential positive impact here. We started to accelerate actually during this week. We finally reached the realization and started to see some signs. Our interpretation of the development in Europe is that it seems that Europe is finding its way back to realizing and recognizing its own interest and maybe even act upon its own interest, which is certainly a very positive development and can fundamentally turn around the expectations and the story about core Europe. So that's a potential third positive impact from a resolution and settlement in Ukraine.

Page 24, our formal guidance. As you can see, again, we expect a somewhat better operating environment. Therefore, the expectation regarding loan growth is that it's going to be somewhat higher than what we had in 2024. We expect higher performing loan growth than 9%. I think it's fair to expect more or less stable margin. It has been quite stable during the course of 2024, and we have same expectations for 2025. Cost-to-income ratio might somewhat increase. We still expect especially wage inflation to continue. Portfolio quality, again, especially if we talk about the loan portfolio quality, it seems to be stable. We don't expect strong deterioration here or worsening compared to what we saw last year. Altogether, again, we seem to be on a higher

leverage this year than last year. Certainly, increasing equity volumes, so this may lead to somewhat lower return on equity numbers.

Our current proposal for dividends is HUF 270 billion, which is a substantial increase compared to what we paid last year. Last year, remember, we paid HUF 150 billion. But there will be a Board of Directors meeting in March, and that forum is going to decide about the formal proposal to the shareholders through our AGM. That formal proposal will appear with all the other AGM materials on the 3rd of April.

Finally, we included some specific language regarding capital matters. First one is related to buybacks. We have done actually three rounds of buybacks starting from beginning of last year, two last year and already one this year. Each of them was HUF 60 billion. This process may continue, and it's also subject to regulatory approval, obviously. This is what we can say about this or want to say on this. We'll continue to announce these specific buyback packages once they are approved by the National Bank. Despite these buybacks, the accumulated amount of shares is still quite low. We decided not to formally address the opportunity to cancel or not cancel these shares. So that remains open, and we are not making a proposal this time.

In terms of capital adequacy targets, it's a difficult topic because we operate on a much higher level than the regulatory requirements. From a modelling perspective or a fact-based analysis perspective, there's no real reason to keep these high levels.

The reason we are tempted to have much higher buffers than would be warranted is due to the fact that we want to be considered well capitalized. That consideration is typically established in comparison with others, with our peers. We think that the optimal level of capital adequacy is not so much compared to the actual regulatory requirements but more to the comparable banks to us.

Compared to them, we want to be considered as well capitalized and strongly capitalized. That usually is established on a Common Equity Tier 1 and Tier 1 ratio basis. That's an anchor for us where others are.

In terms of allocation of capital, clearly, first priority is organic growth, profitable organic growth, where we continue to explore potential value-creating M&A opportunities. There's nothing new about this. We have been doing this for the last 25 years. Altogether, we acquired actually 25 banks during this period, 14 during the last 10 years. But in this 25-year period, we had nine years where we didn't buy anything between 2006 and 2015. It can easily happen that despite our efforts to find these value-creating opportunities for number of years, we may not find any. That's perfectly fine and okay from our perspective. We don't feel to be pressured to do acquisitions just for the sake of acquisitions. In terms of utilization of AT1 or additional Tier 1, and we haven't used this instrument for a long time. This is what we label as a reserve for potential higher or bigger acquisition opportunities. The size of the bucket at the moment is now roughly, it's close to HUF 500 billion. The unfilled part of the Tier 2 bucket is another HUF 100 billion. Altogether, these two, HUF 600 billion. That's EUR 1.5 billion. That's our fundamental reserve for potential larger acquisitions. So should there be a larger opportunity where we could only pay with using these instruments, we would use these instruments to their full extent. These are some thoughts on capital and capital strategy.

Final stage disclaimers are particularly important given that we actually shared our expectations for this year with you on page 26. Read the disclaimers. With this, I'd like to finish the presentation and invite you to ask your questions.

QUESTIONS AND ANSWERS

Operator

The first question is from Máté Nemes, UBS.

Máté Nemes – UBS

I have three questions, please. The first one is about the euro business and specifically the interest rate sensitivity to the higher long-end yields, a steeper yield curve, in essence, just building on the back of what you are witnessing in the past couple of days. First of all, is there any way for you to quantify this for us? Secondly, what is this mainly through, the longer-dated part of your euro rate hedges or fixed-rate securities portfolio? If you can talk a little bit about the channel here.

The second question would be on potential tariffs. I wanted to check whether potential tariffs are impacted or reflect in any way in your GDP growth scenarios or your Stage 2 provisioning as of today? If not, is there any way to get a sensitivity on this one?

The last question is on dividends and capital allocation. It's very helpful to get this additional slide 25. You also mentioned that it is possible that you will not find suitable M&A targets for an extended period. In that case, how long are you willing to tolerate quite elevated CET1 ratios even after Basel IV impact just given the fact that you're generating something around 400 bps gross capital build organically before distributions? Even on a net basis, you're looking at roughly a good 50, 100 bps build just based on your targets. So it seems like you're building capital organically quite fast. How long are you willing to wait for M&A? What would be your decision process around higher distributions?

László Bencsik – Chief Financial and Strategic Officer

Steeper euro curve, obviously, we can model this. I don't know what the exact impact is if the 5- and 10-year points move up by 50 bps. It's complex because then, obviously, there's an immediate potential impact if you reprice the entire portfolio. But we have typically the euro assets, fixed assets, what we bought, they are in the hold-to-maturity portfolio. We are not going to mark-to-market them. The P&L impact in case of yield curve steepening is not going to manifest in the short-term profits. Obviously, you could still recalculate, if we were to buy or replace the entire portfolio, what would be the immediate negative impact and the potential positive. But given that we also have, that the sensitivity is directionally different. If the long end goes up, then the immediate effect is potentially negative. But our earnings expectations are positive. Because the long end goes up because we expect the rate environment in the future to be higher, right, than our previous expectation. If we were to do actually a modelling of our earnings for the next 10 years, then I'm not so sure whether the impact would be positive or negative. I would rather say positive. In general, in a higher rate environment, within given boundaries, we tend to do better long term than in a lower rate environment. If you look at the long enough time frame, then we do better in a higher rate environment. That's very clear.

Tariffs, and that's incredibly difficult question what you asked, a relevant one but incredibly difficult. Even keeping track of just the actual tariff rates and customs rates in different countries, US customs is difficult. The potential impact, again, very difficult. I mean historically, the experience is obviously very negative with tariffs. We certainly don't believe that you can increase wealth overall by increasing tariffs. It's quite the opposite. Therefore, we still struggle actually to fully believe that we are going to live in a world where tariffs between strong trading partners and strong geopolitically aligned strong trading partners are going to be very high.

It is still a difficult thing to digest. In a way, yes, they include in general terms but technically, this is not a doomsday scenario, where we're going to have 25% tariffs in all global trade, which would result in an overall global GDP downward adjustment and potential other very negative ramifications. This is clearly not the worst-case scenario, what we showed here. These are our expectations for this year, assuming certain level of impact coming from the higher tariffs with not fully destructive scenario.

Our clients are typically not exporters to the US. We are typically not financing the large European multinationals. Therefore, on specific client level, actually the potential exposure to these tariffs is reasonably low. The trade links and especially in our client base are fundamentally domestic or related to core Europe.

Your third question, the targeted level of common equity CET 1 and Tier 1 and how much dividends we're going to pay.

The intention is not to pile up large reserves, capital reserves, other than what is considered to be well capitalized. I think if you just look at our comparable regionally active banking groups, I don't know, Erste, Raiffeisen, UniCredit, Intesa, KBC, look at their Tier 1 ratio. We potentially want to look better and higher somewhat in Tier 1 ratio terms.

This Basel IV impact, we don't know how much they're going to be impacted. But even at the end of this year, we don't want to keep much more capital than what needed is for that level of Tier 1, right, which fulfils this target or

desire to remain to be considered very well capitalized. The specific reserves for potential larger acquisitions, as again we said on this page, they are the unutilized alternative Tier 1 and Tier 2 buckets.

Máté Nemes – UBS

Thank you, László.

Operator

Gábor Kemény, Autonomous Research

Gábor Kemény – Autonomous Research

Hi Laszlo. A few questions from me, please. The first one is on your net interest margin guidance. Would it be possible to split this out. How you expect the NIM to develop in Hungary and how are you expect the foreign business? Specifically in Hungary, you point out that the development of retail deposits is a big lever of the NIM. We actually saw the retail deposits going up in the fourth quarter. So what is the chance that we will see a further NIM expansion at OTP Core?

My other set of questions would be around again on capital deployment. Just staying with the buybacks, you managed to complete the first buyback of the year, and it was approved early in the year very quickly. Can you help us size the scope for share buybacks for this year? Maybe you can touch on what was the logic around paying a premium for a relatively larger block of shares back in February?

My last is a broader question and actually a follow-up to your previous comments on running with a higher capital ratio for possibly longer. Shall we think about this as an ROE drag longer term? In other words, is it a base case that we will see a lower ROE again next year because of leverage falling? Or do you see any different scenarios?

László Bencsik – Chief Financial and Strategic Officer

The NIM, last year was interesting and a good guidance for what can happen during this year. So if you compare the 4Q 2023 margin, which was on page 10 actually, to 4Q 2024, on the group level, it was stable. Hungarian margin improved somewhat, not a lot, 19 bps. In most of the other banks and especially the euro-driven banks, there was some decline. In fact, this can continue into this year. Maybe some further improvement in Hungary based on what you just mentioned, increasing retail deposits, and potentially further compression in the euro-related margins across the group plus maybe higher growth in countries with higher margins, for instance, Uzbekistan or Ukraine potentially, can further contribute positively to the NIM.

Buyback, I mean, we decided to provide you with this guidance. I don't feel comfortable telling more because we carefully worded these sentences. What we can say that we may continue to buy back during the course of this year and if we do and if we receive an approval from the National Bank, we'll announce that tranche on the day when we receive the approval. Excuse me not to elaborate on the potential size and so on. We were not prepared to give numeric guidance on the potential size of the scope of potential future buybacks. Maybe you can infer something from what we have done.

The guidance is just: our leverage ratio is above 10% and it's double the European requirement. This is not optimal, certainly. The intention is not to sit on unnecessary levels of capital. Once we see how others cope with Basel IV and the impact on them and we will have a clear picture, and then we will again follow our competitors. I mean, in an ideal environment our competitors should go down by a couple of percentage points.

To be honest, I don't understand this, why European banks tend to have a competition who has a higher capital ratio. We are still small compared to the large banking groups in Europe, especially in terms of size, but profit is getting there. We are labelled as potentially higher risk, which may or may not be true. But therefore, we are certainly not the anchors. We don't believe that we are the benchmarks for other European groups when they consider where to position their capital ratios. We may get there in a few years. But today, we are clearly not a benchmark. We have to adapt and adjust to others. To be honest, I struggle to understand why the European banking sector is so much above the regulatory expectations. I don't understand this.

Gábor Kemény – Autonomous Research

No, that's all fair. Thank, thanks for the colour.

Operator

(Operator Instructions)

Simon Nellis – Citigroup

I was hoping you could just help me out with the capital walk in the fourth quarter. Did you deduct the new buyback, I think the HUF 60 billion, from CET1? I guess, there is a large dividend deduction in the quarter. But it seems like your core Tier 1 went up more than earnings once adjusted for these items. So just wondering what's driving that?

Then also on the risk-weighted asset growth, it was 5% in the quarter. Why was it so strong? I think loan growth was below that. That's my first question.

László Bencsik – Chief Financial and Strategic Officer

The recent buyback was approved in January so that was certainly not deducted. The dividend deduction increased because previously we used a much lower number, in line with European regulation. If a bank doesn't have a formal approved dividend policy, then you have to deduct the previous year's average. There was this increase in the expected dividend payments and therefore the deduction from capital due to the fact that now we have a management proposal actually which is formal.

Risk-weighted assets growth, loan growth was actually 3%, right, in one quarter. This is like FX-adjusted and maybe the FX component was contributing to somewhat higher than the performing loan growth. I don't know other factors. FX was probably between the HUF rate weakened pretty much, like 3%, 4%, during the last quarter. That obviously translates into higher HUF-denominated risk-weighted assets. I think the difference between the 3% loan growth and the 5% was probably coming from this.

Simon Nellis – Citigroup

Okay. My other question is on Serbian risk cost. You flagged some issues with a large corporate client. If you could elaborate a bit on that.

László Bencsik – Chief Financial and Strategic Officer

I mean, due to bank secrecy, I obviously cannot name the client.

Simon Nellis – Citigroup

Is this not linked, I guess, to the political unrest there?

László Bencsik – Chief Financial and Strategic Officer

No, it's not related to the political unrest at all. But it's related to other more geopolitical considerations, I would say.

Simon Nellis – Citigroup

So do you think you'll have to continue provisioning on that exposure?

László Bencsik – Chief Financial and Strategic Officer

Fundamentally, no.

Simon Nellis – Citigroup

Then just maybe last on M&A. So the transaction in the Baltic markets, is that pretty much off the table now? Or what's the latest on that?

László Bencsik – Chief Financial and Strategic Officer

Yeah. I think enough time has passed more than that it's fair to say what you, so I think your assessment is fair.

Operator

(Instructions.)

Gábor Bukta – Concorde Securities

I have a question regarding the windfall tax in Hungary for 2025. So you're guiding around HUF 54 billion in windfall tax. So another HUF 54 billion may be deductible this year. I'm just wondering how much Hungarian government bonds have been purchased so far.

László Bencsik – Chief Financial and Strategic Officer

Yeah. We believe we have fulfilled the criteria to qualify for the reduction in the windfall tax. This number, HUF 54 billion expected payment, reflects the current situation.

Gábor Bukta – Concorde Securities

So does it mean that the bond portfolio was lifted by around HUF 500 billion in notional value?

László Bencsik – Chief Financial and Strategic Officer

Yes.

Operator

Mehmet Sevim, JP Morgan.

Mehmet Sevim – JP Morgan

I have a couple of questions, please. Just on Hungary, do you see risk for any additional government measures this year considering this is the re-election year or anything else, any signals that you can share with us?

Secondly, just on Bulgaria. You mentioned the Eurozone entry hopefully from the 1 January, next year. What sort of impact should we expect from that? I think maybe a bit positive on the liquidity side because the reserve requirements, maybe, I don't know, negative on fees. How should you – how would you see the developments there next year following the Eurozone entry?

Maybe thirdly, just the buyback that you did earlier this year. This is already completed. Is that fair to assume? So it seems like it went a lot faster than the other two that you did earlier in the year. So could you give us any colour on that front?

László Bencsik – Chief Financial and Strategic Officer

Policy measures, we hope not. Having said that, this is not something where we – it's not in our hands, right? There are two initiatives, what we heard about for potential proposals from the government. One is that they want to consolidate the deposits of the municipalities, and they want the treasury to keep those. That can potentially reduce our municipality deposits in Hungary. There are discussions at the moment of this proposal between the Banking Association and the Minister of Finance. If it happens, it is negative. It is marginally negative. It wouldn't be a huge impact, but it is clearly negative.

The other one is the Minister of Finance started to talk about last two days that the fee levels are potentially high for banking in Hungary, and the transaction tax is also uniquely high. There's some obviously truth in that, compared to the other countries in the region, the clients pay more for transactional services. But there are these excessive, huge especially transaction-related levies where we have to pay. So that's the reason, obviously. There might be some discussion about that as well. This is potentially a negative risk but there's nothing concrete. It's really fresh, there was just a comment from the Minister the last two days. There might be some discussions again in the Banking Association regarding this. Indeed I don't want to deny that this is a risk. Policy risk is potentially one of the biggest risks in across the group, and it's, I think, specific to Hungary or specifically concentrated around Hungary, I would say.

Eurozone entry in Bulgaria, I mean, the primary impact, as you just said, the reserve requirement is going to go down to the European level, to 1%, which is going to be a one-off positive. But I think we expect a more fundamental positive impact here. That is related to the overall business climate and business development. If you take the Croatian example, the impact of the Eurozone and the euro accession was quite positive. We are talking, I mean, really accelerated the growth. The risk profile improved considerably. Investments increased. Market sentiment improved. I think people still don't see the upside potential here and we are certainly fundamentally more optimistic on the impact than people in Bulgaria, to be honest.

I mean, yes, there will be a one-off positive which will be mitigated by somewhat lower revenues as we lose the FX conversion margin. But the positive impact from the lower reserve requirement will be bigger. But beyond that, the overall expectation which should manifest over a number of years is a much higher and more positive trajectory for the country overall. Don't forget that the leverage in Bulgaria is extremely low. The debt to GDP ratio is around 25%. And once they are in the Eurozone, I think they can start infrastructural developments in the country which should have been done during the last 20 years and has not been done. I see a big upside there in the next three to five years.

Yes, the buyback was completed. We did a one bigger transaction. To be honest, we are very happy to see the share price much higher than a year ago. But that also means that the same amount we spend much faster than we spent last year. So that actually creates in nominal value-wise more buyback potential or opportunity because we don't want to move the market so much. Its neutral buyback amount can be a much bigger one than a year ago when the share price was lower.

Mehmet Sevim – JP Morgan

Okay. Can I just ask if you have an indication of the size of those municipality deposits in your balance sheet? Can I assume these are all in current account?

László Bencsik – Chief Financial and Strategic Officer

No, no, they are not. These are not very cheap deposits. These are not like Hungarian retail deposits. That's actually very competitive market. There are few competitors, but they are very fierce.

The total amount is close to HUF 500 billion. But they are not taking away the entire amount. This is fluid and there's a discussion at the moment actually between the Banking Association and the government. In a bad case scenario, it's going to be implemented in 4Q. They announced this now but it's going to be implemented from October. Therefore, the impact, if any, will be relatively modest on this year. We may potentially lose by the end of this year, fully implemented, HUF 250 million, HUF 300 billion of municipality deposits.

Operator

The next question is from an attendee joined via phone.

Jovan Sikimic – BHF ODDO

It's Jovan from BHF ODDO. If you can hear me just a question maybe on loan growth outlook breakdown by country for 2025. I mean, you mentioned 9% the targeted level. So what would you expect maybe particularly from key countries' perspective like Slovenia, Hungary, but also Bulgaria, Croatia, Serbia? Which outlook for corporate business have you baked in, in your target?

László Bencsik – Chief Financial and Strategic Officer

Last year, we had 9% growth, and the guidance is that this year might be somewhat higher. Regarding the corporate sector, we expect to be stronger this year than last year. In some countries like Hungary, Slovenia, even Bulgaria, we're not very strong or rather weak in terms of corporate demand. In Hungary the fourth quarter started to show some signs of demand. Certainly, in this market, some improvement, we expect. Having said that, we don't expect major improvements, so I don't expect to double our last year 9% growth. So we are not talking about that. There can be marginal improvement compared to the 9% that we had last year and indeed, this is our expectation. But this is more across the board and includes, for instance, Uzbekistan where consumer lending should grow much more than the 8% last year. Definitely in Uzbekistan, we expect acceleration. Also in Ukraine, we expect continuous stronger growth. It's from a low base and on the group, level is a small amount. But in terms of growth rate, there's some acceleration expected there.

Overall, certainly, Slovenia was not strong last year. Corporate margins were low, and we were busy with the merger. We finished the merge at the end of August, and we have a new CEO joining us in a month. In a way, we were busy last year with the merger, which was very, very successful, on time, on budget approved by ECB and so on. We are waiting for a very talented new CEO to join us quite soon. I mean, it's not just the market it's also, from our perspective, we expect more agility and business focus this year than what we projected last year. But the rest of the countries should either continue as they have done last year or marginally somewhat improve given the marginally somewhat better operating environment expectations that we have.

Operator

The next question is from Beata Fojcik.

Beata Fojcik – S&P Global Market Intelligence

I wanted to ask for your outlook on your Russian business because I saw in the presentation that Russia did very well in terms of ROE, lending growth, deposits. If the sanctions, and I know this is a big if, but if the sanctions are lifted, do you expect further strong growth in the country? My other question would be if the sanctions are lifted in Russia, would you consider adjusting the business model in the country, for example, going back to corporate lending or maybe increasing the number of branches and basically bolstering up your business in the country?

László Bencsik – Chief Financial and Strategic Officer

We don't speculate on this, to be honest. That's not in our focus at the moment. We are trying to do the best what we can do in the current very difficult environment in a way. That is basically a threefold strategy.

Primary most important one is to fulfil every rule and regulation, especially sanctions.

Then again, we stopped a number of activities, among them corporate lending. We reduced the scope and then we tried to reduce our exposure as much as we can. In our understanding, the only way to reduce your exposure

is by taking money out. Our bank has been paying dividends, and altogether, RUB 42 billion has been paid during the last two years in ruble. This, we try to continue to do.

If the environment changes, then we will look around and assess that environment. I don't want to fantasize, right? Because this is something we don't know. I think it's too early to think about that. In a way, I think we are doing now what this bank has been always doing strong. That is basically consumer lending. The fact that we discontinued corporate lending actually helped the institution to focus its resources and activities and management attention to 100% consumer lending. That is doing actually very well. I don't feel particular urgency, even if sanctions are lifted, to go back to corporate lending. I don't think we will ever be a major bank in Russia.

This consumer lending business, that's what the bank is good at and has been good at and serving retail clients. I mean, we are actually very happy that during these difficult years, the last couple of years, the bank achieved a remarkable advancement and improvement in digital services. So now, 70% to 80% of the sales are purely digital and they really caught up with the rest of the market, which is quite advanced in terms of digital services to retail. I think this is probably the most strategic development there, fast to improve our digital capabilities and retail banking service levels. Really, we don't spend our time and energy on figuring out what to do in a scenario which we don't know.

But hopefully, I mean, the situation will improve and then we will have more options and more possibilities and the valuation of the business, what we have there, might improve. Those are good things. Is that okay as an answer?

Beata Fojcik – S&P Global Market Intelligence

Yes.

Operator

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

László Bencsik – Chief Financial and Strategic Officer

Thank you very much. Thank you for your interest. Thank you for participating on this call and thank you for your very good questions. I hope you will join us during our next location in early May when we present the first quarter results.

Until then, I wish you all the best, and goodbye.

Operator

Thank you for your participation. The fourth quarter 2024 conference call is closed now.

Note: unabridged transcript with minor English stylistic corrections.