Strategy and Finance Division
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Transcript

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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Q4 2019 conference call of OTP bank.

László Bencsik (Chief Financial and Strategic Officer)

Thank you. Good morning or good afternoon, depending where you are and thank you for joining us today. It's a very hectic day on the market. I really appreciate that you took the time to listen to our presentation. As usual, the presentation is available on the website, so you can download it and hopefully you have already done it, so you can follow me when I try to present part of the pack, not the whole pack as we have introduced it a few quarters ago, I only talk about the summary slides, maybe the first 23 slides and then the rest are just details. And then we have more time for your questions.

Starting on page 2 of the presentation, I think it's fair to say that 2019 was an incredibly successful year for the OTP Group. I think this is going to be one of the years which goes into our history as one of the highlights. I don't think it's difficult to say why; on this page we tried to illustrate the most important highlights. First of all, we are growing fast: assets grew more than 33 percent, so total assets went up by one third just in one year. That was due to two things. One was the acquisition: we completed 6 acquisitions, and on top of that we were growing relatively fast organically, 15 percent year on year organic performing loan growth FX adjusted. That altogether resulted in 30 percent increase in profits, higher than 20 percent return on equity. That allowed us to increase dividends by 13 percent. That's at least what we suggest to our AGM, so that was the management's proposal to the AGM. So, heavy acquisitions, loan growth, high profitability and increasing dividends.

On page 3 you see the more detailed numbers. Two important notes here: the share of the profit contribution coming from the non-Hungarian subsidiaries is getting closer and closer to 50 percent. Last year it was 46% from the adjusted profit. This is quite strategic on our side. We want to better balance, better distribute our earnings between geographies where we are present, obviously meaning that outside Hungary should grow faster than the Hungarian business continues to grow. The other one is the one-offs, which is not much better y-o-y, but I think what is important is that magnitude wise it's similar to last year. This is the result of many different one-off items. The kind of structurally existent element has remained to be the banking tax. And then there was the effect of acquisitions and some other elements. You see more detailed information in the stock exchange report. All in all, it resulted in a low number of one-offs and adjustments.

A more interesting slide is page 4, and here you see this overall 29 percent growth in the adjusted profit year on year. I think it's quite interesting to look at the numbers without acquisitions and also to make some FX adjustments and then you see that in fact out of the 29 percent growth, 20 percent was organic. The acquisitions' contribution was just nine percentage points to the growth. The rest of the profit growth was organic. Organically the FX adjusted total income grew 12 percent and the operating costs grew 6 percent which creates a positive operating jaw and therefore operating profits increased by 19 percent organically and FX adjusted last year. I think that's a very important part of our story that the organic growth itself results in high operating profits. That is basically due to volume growth, which I'm going to talk about later on. Then maybe one more sentence on this slide: in the fourth quarter this trajectory continued: we see that organically, i.e. without acquisitions, and FX-adjusted, total income was growing 6 percent just in one quarter. And this is obviously not annualized. I think that, again, this is important; the overall numbers don't give you the full picture, because we have had so many acquisitions last year and they came in at different points of time. Just to talk about the very recent period in the last quarter, the acquired Slovenian bank in December: for that bank, we included the entire balance sheet in the closing numbers, but not the P&L. The P&L is not yet there. And the Serbian bank was acquired in September, and that appeared first time in the fourth quarter in our P&L.

On this slide, on page 5 you see more details about the one-offs. Regarding the fourth quarter, I think the more interesting part is the -HUF 4 billion item. That's basically additional tax because we had to increase the valuation of our Ukrainian business which is doing so well that we appreciated this asset in our balance sheets and therefore had to realize some tax and that's here. The effect of acquisitions, the total number is relatively small one, but this is the result of many different factors. The biggest one was obviously the badwill and the acquisition related numbers from the Slovenian bank. Just for your interest, it's important to note that we also included the expected loss related to the potential sale of our Slovakian business, because we had to basically identify this as asset for sale in our financial statements and therefore had to assume that we sold it and therefore included the potential impact in the P&L.

Page 6, that's an overview, a cross section about the profits generated within the group. On the right side you see the growth rates and there is a lot of noise here. You see that in some cases we have three different numbers depending on how we want to look at the situation. Obviously in countries where we made acquisitions, in order to have a meaningful number, it is better to look at the without acquisition number. In the case of Ukraine especially, but also to some extent in Russia, we had the impact of the exchange rate changes, primarily in Ukraine. If you really want to understand the increase of our business there, you probably want to look at the local currency number. Therefore, I'm going to talk about the last column, the numbers on the right. You see that in Hungary and Bulgaria, without acquisition and without adjustments the growth was 6 and 4 percent. It's relatively not so high, but still sizable. And then, if you look at the other markets, Croatia 17 percent, Serbia 64, Romania 63, Ukraine 27, Russia 66, Montenegro 112, growth rates without acquisitions and in local currencies. I think it shows that in these smaller markets the smaller entities did very well last year and improved a lot their profit contribution. And there's one element lower on this slide, it is the OTP Fund Management. They had an incredibly good year last year and the funds they managed by far outperform benchmarks. Therefore, they received a performance bonus at the year end. That gave a one-off big boost to our earnings in the last quarter.

Page 7, you see the acquisitions we have made in 2017 and 2019. You know this slide pretty well, there is nothing new on that, except the one that the Slovenian bank is shown on this page.

The following page, page 8 shows you a few metrics about this Slovenian bank, where it is on the market. With its 8.5 percent market share it is number four, but the second and the third banks are in the same ownership, so they are most likely to merge, and at that point of time, we will become number three. So, it's an okay position. It's a meaningful size. Having said that, we have always been indicating that we find this market quite attractive. Therefore, if there were further acquisition opportunities, we would consider them. Having said that, there is none at the moment, it is not an immediate opportunity or concern for us.

Related to acquisitions it's worth looking at page 9 which shows our capital position. At the end of the year, the Common Equity Tier 1 and the Tier 1 ratios were 13.9%, so close to 14 and the capital adequacy ratio was 16.3%.

Another important point to note on this page, on the lower right corner you see the actual capital requirements, there were some changes, namely two. So, our other systemically important buffer increase from the 1st of January by 50 basis points and went up to 2 percentage points. And there was a new SREP ratio. We already talked about this, it has been announced earlier. It increased slightly and it stands at 117.25 percent. If you apply these numbers then the Tier1 target, which is for us obviously the most important target, is comfortably kept above the regulatory requirement of 11.8 percent. Then there's another interesting set of numbers, up in the right corner showing the capital generation and also, how this capital was consumed during the year. We generated from earnings 4.4% capital, and everything here is in Tier 1 ratio terms. The acquisitions consumed 4.2 percentage points, organic growth consumed 1.7 percentage points, while the dividend what we proposed another 70 basis points and there were changes in the regulatory environment, the risk weights of sovereign and the IFRS 9 transitional rules impact, so there was another 40 bps minus. That's how we ended up at this 13.9 at the end of the year. I think the most important from a forward-looking perspective is this 4.4 percentage point organic capital generation what we made last year.

Page 10, it is an overview of the most important business indicators. We already talked about the profit, but I think it's important to look at this page where we show that the total contribution of the new acquisitions which we made last year was HUF 29 billion. So, within the total adjusted profit this was the nominal number which came from the new acquisitions. Now obviously these new acquisitions came at different points of time during last year. The first one was the Bulgarian one coming in January. In that case the entire year's profit was included last year, but Albania happened in the second quarter. Montenegro and Moldova in the third quarter. And Serbia, which was quite a big entity, at the end of the third quarter, so P&L-wise it was only included in the fourth quarter. The last acquisition in Slovenia was not included at all P&L-wise last year. That means that there's a spillover effect coming from the acquisitions made last year just by nature, i.e. their inclusion in the group for the entire year creates an uplift for their profit contribution.

And then obviously margins, margins have been probably one of the most discussed topics during the last couple of years. What happened in the fourth quarter was that there was some bouncing back. We indicated in the third quarter that some of the decline which we saw from Q2 to Q3 was due to technical elements effecting Q3. And then indeed, there was some turnaround. We ended up in the fourth quarter margin without acquisition at 4.25% and with acquisitions at 4.06%. There are some more details about this later on. The fourth quarter loan growth was as strong as in the third quarter, 5% quarter on quarter.

Page 11, the FX adjusted quarterly growth without acquisition was 4 percent, you see the numbers. Maybe page 12 is more interesting where we talk about the year on year dynamics. Altogether we grew 15 percent year on year in terms of performing loans, FX adjusted. I think there are some interesting numbers on this page. First of all, the Hungarian consumer book grew 81 percent. A big chunk of this growth came from this new baby loan, this subsidized structure we talked quite a lot during the previous call. Having said that, the underlying market-based product growth was also sizable, 27 percent during the year. On a quarterly basis, it was 2 percent. So, it certainly slowed down, but nevertheless continued to grow despite the fact that this very attractive, subsidized structure was widely available last year starting from the third quarter.

Another important number, I think, on this page is the housing loan growth in Hungary, which was 12 percent last year. We finally got to the double-digit territory and this has been quite strong and quite robust so far. Now, other countries have done quite remarkably, as well. Again, without acquisitions, Bulgaria 11 percent, Croatia 6, Serbia 9. Romania, I think had quite a remarkable growth rate, 19 percent organically. This is the result of the new strategy that we started beginning of last year, also we appointed a new management team and they really accelerated the growth of the franchise we have there. Ukraine, 27 percent. That goes in line with the improving environment, which you see in Ukraine last year, which results in quite a robust volume growth. Having said that, the downside is that the margins declined. Russia 12 percent, Montenegro 22. The only country which did not grow was Slovakia, which is not a good news in itself. But the somewhat better news is that we agreed to sell this bank: we signed in February the share purchase agreement and the plan to dispose this asset during the course of this year when the buyer receives all the regulatory approvals. Again, the potential P&L effect and equity impact has already been booked at the end of last year. What we can expect from this transaction is improved capital adequacy because when the transaction is closed, RWAs will be lower.

Deposits were quite strong in the last quarter as well, and over the whole course of the year, as you can see on page 14. We had overall year on year 11 percent growth organically in deposits. But in terms of volumes, it was pretty similar to the organic long growth, which was HUF 1,252 billion and the deposit as you can see on this slide was HUF 1,219 billion. That means that the nominal growth of loans and deposits was pretty much the same. Therefore we kept our nominal liquidity position, this kind of high excess liquidity volume pretty much at the same level.

Talking a little bit about margins, page 15, the fourth quarter without acquisition number was 4.25%. The reported one was 4.06 percent. And here we tried to illustrate the difference between the two and the contribution of the units that we acquired last year. Bulgaria, Serbia and Slovenia contributed negatively, because Slovenia was included in the closing balance sheet, not in the opening balance sheets of the fourth quarter. So it has some impact. In fact, if we had included the entire Slovenian bank in the fourth quarter, then the margin would have been 4%. This is roughly what the baseline is for this year, for 2020, this kind of

4%, including all the acquisitions that we have done so far. So, the fourth quarter net interest margin, should we have included for the whole quarter the Slovenian business, was 4%.

Now, this without acquisition number at the end of the third quarter was 4.17%. So, there was an eight basis points increase in the without acquisition margin, and in the with acquisition reported number there was seven basis points increase, from 399 to 406 bps, and on the group level roughly half of that increase, 4 basis points came from the Hungarian Core margin improving.

You can see on the following page, on page 16, how the Hungarian margin improved from 277 to 286 bps, it is basically 8 basis points improvement. Here you see which elements were more technical and which elements were more fundamental. The first two were rather inter-group or technical. The third one, i.e. the lower repo volumes, this goes up and down each quarter, there's not necessarily a direction here. Then the last two are more fundamental: one is the increasing share of household loans, the strong growth of retail loans, especially the baby loan contributed to margins positively. And then, on the level of OTP Core, the non-interest-bearing assets increased and that had a negative contribution.

On page 17 you see the margin development for some of the other important banks within the group. Bulgaria was stable quarter on quarter, Croatia was stable. Romania went lower, it's basically due to us being quite aggressive in deposit gathering. And this is not because we need so much liquidity, but because we tried to boost and increase the number of customers we have. So, this is primarily to get new clients in and later cross sell to them other products. In Ukraine, we see a decline. Obviously, the Ukrainian rate environment has changed a lot last year. I mean, there was 4.5 percentage point cut in the base rate. That obviously had an impact on our NIMs in Ukraine. It resulted in the margin contraction. But obviously, the upside is that this was also accompanied by higher volume growth.

Page 18, portfolio quality continued to improve. You see the Stage 3 ratio, there was another step down to 5.9 percent. The Stage 3 ratio is a similar matrix to the previously used NPL ratio. If you look at the 90-days past due number, which, for many years used to be the matrix we looked at until IFRS9 came into the picture, that was lower than 5 percent. It was already 4.2 percent for the Group at the end of 2019. You can also see the coverage ratios here, what we show on the slide is the own coverage of the Stage 3 loans. So, these are the provisions dedicated to loans which are in Stage 3. Some of you might remember that for many years we calculated the coverage as total provisions divided by 90 days past due loans and that number at the end of last year was, as you can see in the title sentence on this slide, 128.3 percent. So, that's when you have total provisions divided by 90 days past due loans.

There's another bit of information which you might find interesting on this page. I am sure many of your questions will refer to the potential short term impact of the economic environment what we see very recently. Just one number, which might be interesting, that's our exposure to the industries which are potentially the most immediately and the largest exposed to the recent events, and that's hotels, accommodation, airlines, airlines manufacturing, shipping and transportation and tour operations. These industries all-in exposure, including on and off balance sheet, is 2.9 percent of our total corporate exposure. That's roughly 0.8 billion euro. So, that's our total exposure to these industries, which are the most likely to be exposed to events which happen around Europe at the moment.

As usual, just a few words about our Hungarian performance, which is, as of now, still the biggest part of the business, because still slightly more than 50 percent of our profits come from Hungary. In retail, as you can see on page 19, we think we have continued to do quite well, and that's we measure in market share. Our market share from new mortgage loan production was 31.6 percent last year. That's a sizable increase on the previous year. Having 30 percent of the market, it's not very easy to increase market share, because everybody tries to compete and get market share from you. So, I think this is quite remarkable that we not only maintained this level, but managed to improve. And likewise, in household savings there was a slight increase in our market share. Our market share in new cash loans was 39 percent, and that does not include the baby loans, where it was even higher. It was close to 45 percent as you can see on the next page.

This baby loan, which is obviously contributing substantially to our volumes and earnings starting from last year, as expected, the production in this product started to decrease in the fourth quarter. So, this subsidized product is basically a boon, and therefore we expected the demand to be front-loaded. But, that is still coming in, so it is continuing into this year.

Page 21 is the corporate highlights in Hungary. I think the most important one is the market share. We have 15.7% market share out of loans to Hungarian companies. The trajectory, I think, is quite remarkable. We managed to further increase this and if you look back the last twelve years, I think this is also quite impressive that we more than doubled our market share in Hungary.

Now, our expectations. Obviously the future is always uncertain, and in this very specific environment I must say there is even more uncertainty than usual. So, what I tell you here is our best estimate or guess for what we expect might happen during the course of this year. First of all, the one-offs: the one-offs have their nature that they are one-offs and not always, or only part of them are foreseeable. So, we see two quantifiable one-offs coming. One is the bank tax which has been with us for already ten years now, so it is not surprising, and it is slightly increasing. And the reason is that it is based on our Hungarian balance sheet, the sub-consolidated balance sheet two years back. Since we started to grow a few years ago, this increased the base, so it increases somewhat year on year. The other one is the acquisition related one-offs witch primarily come from the badwill amortization; part of the badwill is amortized, when in the purchase price allocation for instance, we have to increase the customer value and that is amortized over certain years. But most importantly, we include here the costs of the integration projects, and we are running at the moment three integration projects: one in Bulgaria, one in Serbia. These two are quite sizeable. And then the third one is in Montenegro. Until we close them, these costs are going to stay with us.

Then the loan growth. So far, we have seen a very dynamic market in January, February and this week. Yesterday I was calling around my colleagues in the group retail and corporate and asking what they see in terms of loan demand. They told me that they don’t see any change, they saw quite robust loan demand and customer activity. So, that was as of yesterday. Our expectation is that obviously, due to the repercussions of the situation, we are going to face potentially one quarter, which is going to be weak and that is the second quarter of this year. Most likely loan demand and loan growth will drop. It is hard to tell to what extent, but I think it is almost definite that it is going to drop. Our expectation is that basically things will come back to normal starting from the third quarter and then in the second half of the year we might even see a bounce back, but at least the normal growth trajectory, which should be somewhere above 10% annualized.

So, that is the overall expectation. For the whole year we have been quite positive, and we expect a supporting environment. The only snag on this picture is this kind of unfortunate event which is happening now globally.

Then the other factors which are certainly very interesting, starting with the NIM. I am sure you will all have your questions related to this. Honestly, in this environment and given that we are talking about a few basis points, so the NIM changes either plus or minus what we have had during the last couple of quarters were in the magnitude of basis points, and with the level of uncertainty in the environment, it gets very difficult to have a short-term guidance on NIMs. But I think the safest bet to say is that probably the net interest margin erosion will continue. The most important factors influencing it are our margins in Ukraine, because I assure you that in Ukraine, we started from a very high base and this started to decrease quite fast last year. How much it is going to decrease depends on the risk perception on the markets and that is hard to gauge. The other one is the Hungarian rate environment, which from the NIM prospective is positive that it increased a lot, and Bubor is 60 or 65 bps today. Last year at the beginning of the year, in 2019, January, February, I told you that we were expecting the Bubor to go up to the level of the base rate, up to maybe 90 basis points. And then it didn't happen last year and then in the second half of last year, closer to the end of the year, at the last confcall I probably said that we don't expect so much increase in the Bubor. And now the Bubor increases. So, this illustrates the difficulty of foreseeing these changes. But a higher Bubor is obviously better for our margins. And higher yield curve in general is better for the margins, because we have to replace some of the Government Bonds that will expire and so on and so on. So, this replacement yield is also somewhat better.

Then credit risk and the risk cost rate. The baseline assumption is that the risk cost rate should somewhat increase coming purely from the fact that the write backs, or the positive contribution coming from the previously defaulted loans due to the workouts we do, get year by year less and less. It doesn't disappear, but it doesn't grow, nominally it gets less and less. But there is even a bigger impact here that proportionally it gets smaller and smaller because we only have this in Hungary, and the group expanded fast compared to last year. So, its nominal value and its proportion decreases as well. If our macro scenario holds that the slowdown will be only temporary and short term, impacting the second quarter then there may not be necessarily fundamental effects on the actual credit loss of these adverse effects in the second quarter.

Costs. In our budget, we have 6% year on year and FX adjusted growth, but here, in order to make this number, this year on year growth meaningful, obviously we have to adjust somehow with acquisitions. This 6% is defined in a way that we increase the base: if you take the actual non-interest expenses last year, and you add to it the period when the acquired banks were not in the group – their non-interest expenses during this period are very different by each bank, and in the case of Slovenia it is the entire year – then you get to an adjusted baseline cost, which is HUF 620 billion for 2019. On that basis we expect more or less 6% FX-adjusted cost growth. Now this 6% is obviously in line with the overall positive expectations and with the environment where we have only slowed down in are our activities in the second quarter only, and therefore there is no need and there is no reason to start to try to adjust the cost base, because then we continue to grow with the previously high trajectory starting from the second half of the year.

Regarding the capital and dividends, we maintain this Common Equity Tier 1 and Tier 1 ratio range mid-point of 15%. And we propose to increase dividend payments compared to the previous year by 13%, and that means 248 forints per share and altogether represents HUF 69.44 billion. We believe that this is an important signal to the market, that parallel to this very fast, extensive growth that we had last year, including the six acquisitions and the organic growth, we are able and committed to increase the volume of the amount of dividends. I hope you take it as a positive sign for the future.

That was in brief the overall presentation I intended to give here. There are very useful slides in this pack which detail in a cross-section manner as usual with some notes and remarks. The net interest income, the net fee income, the total income, the other income, the operating cost dynamics and also the portfolio quality change dynamics across the group. Please, have a look at them, but I am not going to talk about these now in detail. So I would like to propose to start with the Q&A part of this session, so operator, please open the floor for questions.

Q&A

Operator

Thank you, ladies and gentlemen, we will now begin our question and answer session. If you have a question for our speaker, please dial 0 and 1 on your telephone keypad now to enter the queue.

One moment, please, for the first question. And the first question is from Sam Goodacre, from JP Morgan. Your line is now open, please go ahead.

Sam Goodacre (JP Morgan)

Good afternoon, László, thanks very much for the call. I have got three questions. The first one is on your Hungarian corporate loan growth. We have seen that it is slowing sequentially, but, you know, 18% year on year growth, it remains very high. So could you let us know perhaps the sensitivity around that this year, given the slowing economy and the MinFin's recent curb to GDP expectations? And also just the general current market developments? How that may effectively impact your corporate loan disbursements. The second question again on Hungary, and it is related to the point you mentioned about gaining market share across various products. Would you let us know, sort of generalizing here, who you are taking share from, what sort of players you are taking share from. And could you comment more broadly on the competitive dynamic in Hungary? And in the third and final question is related to acquisitions. There have been press reports, as we are all aware, about something in Romania and then an unknown market in the eastern part of the region. Could you give us a little bit more color on acquisitions, particularly in light of the fact that your excess capital is not obviously as high as it was at some point? That's great. Thank you.

László Bencsik

Hungarian corporate growth, 18%. Indeed it started to be lower than in the previous years, but this is just gravitating towards the trend line, towards the mean, and also the base is increasing, so if you look at the housing loan growth it is accelerating, and corporate is going somewhat lower. And both of those get closer to this mid-teens number, which is pretty much the overall underlying growth rate in in the region. But this is obviously higher than the market for us, and it shows that we seem to have an edge in terms of our capacity to sell. Also in corporate, the strength of the franchise and the size of the franchise is strong; this is going back to the fact that we did not cut our franchise, the branches and physical presence and RMs and so on and so on a few years ago, so we continue to dominate this market in this way. If you ask, what I can say is that the first two months were strong: yesterday I was calling around colleagues in Hungary and in the region and asking about loan growth and they said that it was strong. So far we haven't seen any indication of lower demand or economy slowing down in the markets where we operate. Now this obviously may and probably will change in the second quarter, and honestly I would not dare to say to which extent, and what exactly is going to happen, but our expectation is that in any case, it is going to be a short term, temporary situation after which we expect a bounce back so then we should get back to 10 plus growth rates including the Hungarian corporates. Even more interesting here has been the margin, because one of the reasons we grew less last year than two years ago was that margins became thinner and tighter and were less attractive for us. Now this might change. The current events may change somewhat the risk perception and the expected returns on lending in these countries, including Hungary, and might result in somewhat higher, and from our perspective, more sustainable product spreads or new sales spreads.

As for market share, I don't think any player being particularly weak or giving up on the Hungarian market, so I don't see anyone losing ground in a big way. Therefore it is not that we are gaining and there is another one losing its edge. I think it is bits and pieces from different players. Having said that, these market share changes that I highlighted, like 1 percentage point during the year, I think it is very positive from our perspective because it shows a positive trend, but it doesn't mean that from one year to another the market positions of players were reshuffled or changed substantially. That just doesn't happen. So, I would not pinpoint any competitor being particularly strong or weak. I think it is just in general, marginally, gradually we are gaining more ground.

Acquisitions, indeed, we talked about this Romanian opportunity, where we made a bid and we are waiting for the decision of the seller, if we are the one to buy or not. The other unknown opportunity is unknown. I can't tell anything about that. If that satisfies, but that is what I can say. Okay?

Sam Goodacre (JP Morgan)

I appreciate that. Thanks, László, have a great weekend.

László Bencsik

Thanks. Thank you. You, too.

Anna Marshall (Goldman Sachs)

Good afternoon. Thank you for the presentation. Two questions, please. First, regarding the developing situation on the coronavirus. You have indicated your exposure to kind of what you believe are likely to be the most vulnerable sectors, but within your geographic reach, do you have any preliminary thoughts on which countries are likely to be most impacted, say, due to their trade linkages and so on? And in any of these countries, do you expect, and especially with the focus on Hungary, do expect any movements on the monetary or fiscal policy sized, especially also in the context of the recent move of Bubor? And my second question was on capital. Your risk credit - asset density has increased to above 70%. Just wanted to check if there was anything special driving that or just changing the mix and if you have any measures to optimize it. Thank you.

László Bencsik

Thank you. The first question is very difficult to answer. You know these countries quite well. These small countries in CEE are typically directly linked to core Europe, to Germany, Austria and so on. So anything happening there obviously has a direct implication on, especially industrial production in these countries. And then some of the countries, like Albania is very much exposed to Italy. So, if you just take a snapshot picture of what happens today, it is probably Italy that is most effected out of developed Europe, and Albania is the economy closest to Italy. And then we have Russia, Ukraine, where the commodity price changes have different impacts. Obviously, in Russia, the oil price is going down, commodity prices are going down. This is going to have some effect on Russia. Ukraine is more difficult to gauge because if oil and energy prices are going down, it is basically good for Ukraine. But if other commodities go down, as well it is not so good. But honestly, we are not in the mindset of thinking long-term here. We believe that it is most likely to be a short-term event, maybe taking two, three months and then from that perspective, the question is which are the industries which are immediately exposed to these short-term effects. Therefore we listed these industries. In our case, it is the hotel industry, the tourism, especially in Croatia, Montenegro and in Bulgaria, where we finance some of the hotels and that is the bulk of this amount that I just told you. Typically, these are summer destinations, and then the question is whether this event is going to last into the summer or not. If it goes away in 2, 3 months, so that means March, April, May, then by June we may come back to normal and therefore occupancy rates during the summer might be back to quite normal. Even in that scenario, the profitability of these industries will be hit, but probably they will go down to their fixed cost or variable cost levels, and have big discounts and kind of last-minute offers. In this scenario, basically the hotels which generate most of the revenues during the summer, which are the hotels we finance typically, would not be heavily impacted. But I think it is incredibly early to have any well-funded judgments or assessment of the impacts, what will come, so I wouldn't try to do that.

The second question. Yes, in Hungary the Bubor increased. It started to increase before these events happened in Europe. It came from the fact that inflation went above the target range of the central bank and the currency started to weaken and therefore, it was pretty much imperative for the central bank to take actions to moderate inflation. They started more than months ago to allow the Bubor to increase and I think this is just a quite normal action from the central bank which follows primarily inflation. Now, if you look around the globe, what we see is rate cuts. If economies slow down, then we should expect a lower rate environment. That does not lead into the direction of higher rate environment. So, inflation will moderate soon in Hungary, we will see how much. If the central bank continues to follow inflation, I don't see any reason why the rate environment should be higher than what it is now.

RWA density. We acquired banks, so basically we converted pretty much cash into loans, into customer volumes and that increased the RWA. It wasn't actually cash, it was typically securities, Government Bonds, but they had zero risk weights. So that's a kind of structural change in the RWA. We have more customer volumes than before because of the acquisitions and also due to the organic growth. But the kind of big step ups are basically due to the acquisitions, when we bought these banks, customer volumes increased. Maybe we are moving into more efficient balance sheets, because that also means that our loan to deposit ratios are somewhat increased and so on. If that satisfies you, I hope.

Anna Marshall (Goldman Sachs)

Yes. Thank you very much.

László Bencsik

Okay. Thank you.

Hai Thanh Le Phuong (Concorde Securities)

Hi there. Congrats for the decent results. Just two questions from my side. The first one is on the Russian net interest margin. So, we have seen some pickup or pick up in the last quarter due to deposit rate cuts. Shall we expect more to come? And more positive impact to come for this year? And my second question is on credit costs. As you said that if the virus impact is for two to three months, that shouldn't be a problem. But what if it takes longer, for example, for half a year, do you expect some recalibration in your IFRS9 model, the parameters and shall it trigger more risk cost in the second or third quarter?

László Bencsik

Russian NIMs on deposits, yes we adjusted the deposit rates. I think, what we have seen in the Russian NIM in this quarter, well, deposits were important. But the longer-term development in the NIM, the negative development which has already lasted for a couple of quarters, was due to basically lower APRs. And that came from the regulator forcing us to have lower APRs, and also from competition. I think it is a big question, what is going to happen on that market related to the competitive environment. Structurally, I don't think that margins will start to grow in Russia. Unfortunately, that is not our expectation. Even keeping margins relatively stable would be a good result.

The answer to your second question is yes. Yes, we do have to make adjustments, if GDP growth expectations change substantially and in a way that it is not just very short term – but we really expect a different scenario –, then we will have to provision and increase coverages based on our macro models. It is also very clear that the longer this situation lasts, the more underlying credit problems we will face everywhere where this situation is.

Hai Thanh Le Phuong (Concorde Securities)

OK. Thank you.

Gábor Kemény (Autonomous Research)

Hi. I have a couple of questions. First one is on your provision guidance. You mentioned that you would expect then a normalization in your credit costs, even in the base case. Would you be able to give us any indication of the magnitude of the increase you would expect in your provision charges in the base case scenario? The other question is on the Hungarian margins. So you have a guidance for the group, which is some further erosion in 2020, in your margins. If we just look at Hungary, how do you expect the Hungarian NIM to evolve from here given the higher Bubor rate we have? And just lastly, on the baby shower loans, would you assume that the demand was probably frontloaded here in case of the baby shower loans in the second half of 2019 and if we go into 2020 shall we expect retail lending to stall down potentially?

László Bencsik

In the baseline scenario the risk cost rate may increase more than it increased last year. So, last year on group level it only increased from twenty-three basis points to twenty-eight. So, this year we expect somewhat more in the baseline scenario, a bigger increase.

Hungarian margins, this is a difficult territory. On one side, we have to replenish the maturing bonds and part of it is the retail bonds which were repurchased. So, that has a negative impact. On the other hand, if the Bubor stays as it is today, then it is going to have a roughly HUF 5 billion positive impact on this year's NII, and more than 10 billion next year. So, a lot depends on the Bubor, but also on the yield curve as a whole, because the five and 10 year benchmarks are very important here; and then, most importantly, loan growth, which was your third question. So, to be on the safe side, we decided to say that you may expect further margin erosion. There can be positive surprises on that front, should the rate environment be different and loan growth continue to be relatively strong. I would put it this way. But to be conservative with the guidance, we decided to say maybe further erosion is expected, and that applies also to Hungary.

Baby loans, yes, obviously, there was front-loading and already you can see from the difference between the third and fourth quarter numbers that they went down in the fourth quarter. It was 124 in the third quarter, and it was 85 billion in 4Q, I mean the new production. And we expect, quarter by quarter, lower and lower numbers here. So indeed, this boost that we received in Hungary from the baby shower loans line is going to be somewhat less. But overall we expect mid-teens growth rate for the market in retail, because the housing loan growth has already reached a level, kind of teens, what we had passed last year, and again, up until yesterday, it remained quite strong. Now, again, the only thing I can say for the remaining of the year is what I have said, that we expect slowdown in new production and loan demand, at least, I mean definitely in the second quarter and then the baseline expectation is that everything goes back to normal by the third quarter and we should get back to mid-teens, around 15% overall retail growth rate in Hungary.

Gábor Kemény (Autonomous Research)

That's useful color. Thank you, László.

László Bencsik

Thank you.

Andrzej Nowaczek (HSBC)

Thanks for the presentation. I just want to follow up on economic outlook. There are very few questions left, but if there was a prolonged global slowdown, would you expect governments to introduce any external stimulus measures, any subsidies? Not just the Hungarian government but across the region? Thank you.

László Bencsik

Probably, yes. But I still haven't thought a lot about this. Look, I think one factor is very important here, or actually many. If you look back to ten years ago, twelve years ago, when there was a big global recession. And then the CEE countries reacted very differently. So, if you look at how, if you just compare Poland, Slovakia and Hungary, they had very, very different trajectories. Slovakia continued to grow, almost as if nothing happened. Poland slowed down, but it didn't go through recession. Hungary went into very deep and protracted recession. And the reason was that the economy was very vulnerable, and it was exposed to FX risk. We had these huge FX loans in the economy and very high level of government debt to GDP. The indebtedness was short term. And then we had a very inefficient state sector and high level of deficit. Now, this is exactly the opposite of what we have today, for instance, in Hungary. So, the first remark I would have, that, in itself, it may be very different how a global slowdown and recession may impact these economies. And we saw it during the previous global recessionary environment that if a country was managed well, then they could easily be countercyclical and sail through without a major harm. So, that is the first thing. The second thing is that obviously if you just take the Hungarian situation, there is just so much more room to maneuver now since there are no new FX loans in retail hands and the foreign owned share of the sovereign debt is much smaller and the FX content of it is also lower. Plus, the budget is in good shape, so I would say, there is certainly room for measures to boost the economy and to moderate any negative impact coming from outside. But honestly, this has not been discussed yet, I would say, or I am not aware of this and then I very much hope that we are not going to get into that situation and this is not our expectation that we are getting into that situation, where it would be relevant. But we will see.

Andrzej Nowaczek (HSBC)

Okay. Thank you very much.

László Bencsik

Thank you.

Simon Nellis (Citibank)

Hi, László. Thanks for the call. My first question would be just on provisioning in Hungary. You continue having quite nice write backs. Would you expect then, to your baseline scenario, that provisioning will turn negative in Hungary this year?

László Bencsik

No, we don't expect that.

Simon Nellis (Citibank)

Okay, so you still see further provision write backs in Hungary.

László Bencsik

Yes.

Simon Nellis (Citibank)

Okay. And then the 12 billion effect from acquisitions that you are guiding for this year. Can you just elaborate a bit on what is that? Is that mostly restructuring costs or there is something else in that number?

László Bencsik

Yes, it is restructuring costs and the amortization of certain parts of the badwill, where we are accounting (01:15:16 unclear)

Simon Nellis (Citibank)

Will that amortization feed into further years?

László Bencsik

Yes, some of it will, yes, some elements are amortized for three to five years, but the most of it is related to integration related expenses.

Simon Nellis (Citi Bank)

Okay.

László Bencsik

This number should be up to a kind of low single digits in 2021-22.

Simon Nellis (Citibank)

Okay. That is very useful. Yes, the next question is just on your provision charge this year, I think around almost 40% was non-loan related. Can you just indicate what were the main non-loan related provisions that you had to create? Or we can take this offline and just the outlook, if that is one-off in nature, or if that going to continue going forward.

László Bencsik

Well, typically off-balance-sheet exposures, what we have there, but let me see… I will have a look, okay, and then let you know.

Simon Nellis (Citibank)

Okay, great. And then just the last one is on the OTP Fund Management. Obviously, they are very positively levered to strong performance, but given where markets are going, is there any negative impact? I mean, are there like high watermarks for some of the funds? Would you see a particularly bad result this year if markets continue to head down like they are?

László Bencsik

No, they have a bonus structure, so if they outperform the benchmarks with a certain number, then they get a bonus. And that is what happened last year. Now, benchmarks have not been doing very well this year either, so, I mean it is their relative performance that matters.

Simon Nellis (Citibank)

Okay. So, there is no negative correlation, I think I understand.

László Bencsik

I think it is quite unlikely that they will receive similar level of bonus. It hasn't been so high. Never. Typically it is like two, three, four, five billion forint. Last year was more than ten, so last year was exceptionally good for them. I don't think this is going to be repeated. But, more years than not they received a bonus during the last 10 years. It doesn't turn to negative and then it's always compared to benchmarks. So the benchmarks to do badly, then they can theoretically do well.

Simon Nellis (Citibank)

That’s very clear. That’s all for me. Thank you.

László Bencsik

Thank you.

Operator

There are currently no further questions, so as a reminder, if you would like to ask the question, please press 0 and 1 on your telephone keypad now.

And we received another question from Stefan Maxian, RCB Vienna. Your line is now, please go ahead.

Stefan Maxian (RCB Vienna)

Hello. Two questions from my side. First, regarding the Slovakian bank sale, if you could point out roughly what would be the effect on risk weighted assets or the Common Equity Tier 1 ratio. And the second, maybe on the fee and commission outlook. Could you roughly tell a little bit more about your outlook for the distribution fees on the retail bonds? I think they were reduced from this year. How much that effect would be? And if you would assume any impact from PSD2 or from the new SEPA regulation going forward. Thank you.

László Bencsik

So, the Slovakian risk-weighted assets, the impact of selling the Slovakian bank is around plus 15 bps, depending exactly when it happens and how big the Common Equity Tier1 ratio will be at that time, it is roughly fifteen basis points. Your other question was related to the distribution fees.

Stefan Maxian (RCB Vienna)

Yes. So in general, a little bit about the fee outlook, like what would be the base effect, potentially, of lowered distribution fees for these retail bonds, or how do you think will they impact next year's results compared to these 2019 results?

László Bencsik

Yes, indeed, there is another cut here in the distribution fees. It can amount to a low single-digit HUF billion decrease, year on year, on distribution fees.

Stefan Maxian (RCB Vienna)

And apart from that, do you see any impact already or would you expect any impact from PSD2 regulation on fees or do you see any impact of this new SEPA regulation now being effective since December?

László Bencsik

No, so far, no.

Stefan Maxian (RCB Vienna)

OK.

László Bencsik

There was a big event here, you may or may not hear about it, is that we introduce instant payment. As of morning, last Monday, the entire banking sector switched into an instant payment mode, so all electronic payments are now instantly transferred in five seconds and it is 7/24. I do not think it is going to have any impact. The pricing has not changed. So customers do not have to pay more or less for this. And I do not expect a surge in transactions in short term. But certainly it is a much more convenient service we provide now. And customer to customer payments can be done in a much more convenient way. So, that might have some kind of long-term positive impact on actual transaction volumes. And it was an enormous effort to make this. I mean, imagine, the core systems of banks in Hungary are obviously not real time, right? These are bad systems, with given operating hours and we had to create a kind of layer around these, I mean, couple of dozen of systems, which creates this customer experience, which is kind of real time balance and real time account to account transfers service. So, for us, this was much bigger than the PSD2. So, there was a much bigger change and much bigger development, and it went extremely well, given the fact that from one day to another this reached the entire pay. Pretty much 90 percent of the transaction volume switched to this channel automatically from Monday morning.

Stefan Maxian (RCB Vienna)

OK. Thank you.

Operator

There are currently no questions, so I hand back to László Bencsik for closing remarks.

László Bencsik

Thank you very much. So thank you for joining us today. That was a great pleasure to have you. And thank you for your very good questions. It's a hectic day, so I really appreciate that you devoted the time to this confcall. And I hope we will see you back on 8 May when we present first quarter results and by that time, I think we will know much more about the immediate effect of the environment around us, the changes in the environment. So thank you again. I wish you all the best. Have a very nice and relaxing weekend. Thank you. Bye-bye.

Note: unabridged transcript with minor English stylistic corrections.