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Moderator: Paul Formanko
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Operator: Ladies and gentlemen, thank you for waiting and welcome to the OTP Bank 3Q quarterly conference call. At this time, all participants are in a listen only mode. There will be a presentation followed by a question and answer session, at which time, if you wish to ask a question, you will need to press star one on your telephone.

I must advise you that this conference is being recorded today, Friday, the 14th of November, 2014.

I would now like to hand the conference over to your first speaker today, Paul Formanko. Please go ahead, sir.

Paul Formanko: Good afternoon. This is Paul Formanko from the JPMorgan bank team in London. Thank you, everyone, for dialing in. It is our great pleasure to host this call.

Joining us from Budapest is Mr. Laszlo Bencsik, Chief Financial and Strategic Officer. Laszlo, over to you, please.

Laszlo Bencsik: Thank you for joining us today on the third quarter results presentation of OTP Group. As usual, we have the presentation available on the website. So, hopefully, you have been able to access it and it's in front of you. As usual, I'm quickly going through the presentation and then you will have chances to ask questions.

So, jumping on to page 2, where you can see the overall results, the third quarter accounting profit was HUF 34.1 billion, a remarkable improvement compared to the second quarter, which was not surprising. Obviously, during second quarter we had to book substantial one-off losses stemming from the Supreme Court decision and the subsequent regulatory changes in Hungary.

In this quarter, we somewhat adjusted that number, which originally was HUF 176.1 billion in the second quarter. We made the calculations more accurate, plus we included the legislation developments which so far have been revealed and therefore adjusted that expected loss figure downwards by HUF 7.7 billion, after tax. So, now the expected loss after tax is HUF 168.4 billion.

It's still not a final number. I will talk about the details a bit later, how we foresee this process going forward and eventually conclude somewhere during the first half next year.

There was one more adjustment related to our operations in Ukraine. In the third quarter it was HUF 6.8 billion negative, which is the after-tax impact of the provisioning we made in the Donetsk and Luhansk regions, where normal banking activity is not possible due to the special circumstances stemming from the conflict, the military conflict between Russia and Ukraine.

We believe that it's actually right to show this as an adjustment, as an one-off event, because it has no relationship with the normal activities in Ukraine, and in this sense, it's similar to the Crimea losses, which we booked in the second quarter this year. And, hopefully, there won't be any new kind of further adjustment in Ukraine, and the rest of the country will continue on a reasonably normal path of development.

So, therefore, the balance of the adjustments was close to zero, it was HUF 0.6 billion during the third quarter. Therefore, the accounting profit was quite close to the adjusted after-tax profit, as well, which was HUF 33.5 billion.

As usual, we listed some one-off items and the tax. As you see, the effective tax rate was somewhat higher than during the second quarter, and this resulted in HUF 43.3 billion before-tax profit without one-off items, and on that line, we had a quarter-on-quarter development of minus 6 percent, and if you look at the first nine months, then actually there's a 20 percent decline year on year.

The next page details this number, and tries to explain the reasoning behind the P&L items.

So, on page 3, you can see this HUF 43.3 billion profit before tax without one-off items, and if you look at the total revenue line, it's 1 percent down, quarter by quarter, and the first nine months is by 3 percent down.

Within this, the biggest change happened on the line of other non-interest-income, both the nine months, year-on-year number, and the quarter-on-quarter number declined substantially by more than 25 percent.

Just to remind you, on this line we typically book the sovereign bond portfolio revaluation results, and during the third quarter it was actually a very small number. For instance, in the second quarter this was a much bigger item.

So, the decline on this line is related to this type of results.

If you look at the net interest income on a quarterly basis, it's fairly stable. It's even increased somewhat. Year on year, obviously, there's a decline. Having said that, part of the decline is due to the fact that the ruble and hryvnia depreciated considerably to the forint, in which we show our numbers. So, part of this decline is attributable to the hryvnia and ruble currency weakenings.

If you look at the operating cost line, the first nine months year-on-year figure is minus 2 percent, quarter-on-quarter minus 1 percent. Now, again, if you look at the first nine months year on year, the 2 percent decline is partly attributable to the same reason, a weaker hryvnia, and ruble, whereas quarter on quarter there wasn't so much change in these currencies, so that's more a real kind of stability of operating costs.

The risk cost line, quarter on quarter, increased by 3 percent, and the first nine months figures also increased by 9 percent. You will see later on that this is mostly due to Ukraine and Russia, whereas in other countries, risk cost really moderated and reached levels which are more similar to normal economic activity and operation.

As you can see on this page, in the bottom half where we detail the Hungarian P&L figures, the core results quarter on quarter increased by 8 percent, the first nine months, year on year, by 13 percent, and the biggest contributing factor was the risk cost. You can see the nine months figure by 46 percent lower than last year. Even quarter on quarter we achieved a 33 percent decline.

So, the Hungarian portfolio is actually doing very well, whereas there's a slight decline in the total income, especially on the other non-interest-income line. Obviously, what I talked about related to the sovereign debt portfolio evaluation result that happened in the second quarter and didn't really happen in the third quarter at OTP Core, so those changes actually show up here in the Core numbers.

Operating costs remained flat, year on year, for the first nine months. That's, I think, an achievement, and quarter on quarter there's even some decline.

Paul Formanko: Sorry. Sorry to interrupt, Laszlo. This is Paul Formanko here. There is some interruption, again, on the microphone. Could you, perhaps, keep a little bit more distant from the microphone so that we could hear you better. We're just hearing from the clients, that they cannot hear very well.

Laszlo Bencsik: Is this better now?

Paul Formanko: Yes. Yes, it is.

Laszlo Bencsik: OK.

Paul Formanko: Thank you very much. Let's continue.

Laszlo Bencsik: There's something going on with the line.

So, if you go to page 4, where we have the most important indicators depicting our Group level performance, I think the most interesting is the upper middle part where you can see the total income margin and the net interest margin, which declined during the third quarter. We're quite used to have a level above 8 percent in terms of total income margin for many years, and now it's actually dropped below 8 percent. Likewise, the Group level net interest margin declined somewhat.

Now, actually, especially in case of the net interest margin, most of the difference can be explained by the changes in total assets. As you can see on the same page, deposit volumes increased by 7.3 percent during the third quarter. This happened primarily in Hungary and in Bulgaria.

In Hungary, the reason was that the mutual funds and the money market funds deposited more to the banking sector due to certain changes in legislation, plus there was a seasonal increase in municipality deposits. But also, in Bulgaria at DSK Bank and in Ukraine there was an unusually strong increase in deposit volumes.

Therefore, what happened actually at end-September was that total assets increased, and that increased the average assets during the quarter and thus technically reduced the net interest margin. If this increase in total assets at the end of September had not happened, then the net interest margin at the Group level would be have been 18 basis points higher.

So, all in all, from the net interest margin perspective on a quarterly basis, there was 26 basis points decline and out of this 18 basis points decline was actually attributable to this technical change, i.e. due to the increase of the period-end total assets.

Portfolio deterioration slowed down somewhat. The FX-adjusted number was HUF 52 billion during the third quarter, the NPL ratio stood at 21.8 percent, and the coverage ratio was 84.4 percent, slightly increased.

Then we have two pages, miscellaneous items, and obvious that the most important lines of this is the changes in legislation which is ongoing in Hungary. And there are actually two streams of this process.

One is related to the Supreme Court decisions back in July. There were two decisions, just to remind you, which were negative for the banking sector. One was related to the FX conversion margin, which the court regarded as void, and the other one was a presumed unfairness of the unilateral contract amendments. We challenged these assumptions on the court, and the first level hearing was interrupted because the judge actually appealed to the constitutional court.

We just got the decision of the constitutional court this week that rejected the first instance court's appeal and therefore the procedure will continue on the first instance and probably will be accelerated.

In the meantime there is more clarity on exactly how we have to calculate the due amounts to customers, and the methodology here is the principal repayment or principal reduction type. You might remember that during the summer we had two theoretical options. One was that this kind of claim by the customers can be interpreted as kind of illegal use of funds by the banks, or it can be interpreted as an early repayment of the loans and therefore reduces the principal.

Unfortunately the second interpretation became the one which we have to follow and that actually results in higher losses. Just to remind you, at the end of the second quarter we provisioned for the extreme loss scenario, so our provisioning actually included or assumed this worst outcome of the two possible calculation methodologies.

Then, two more things happened. The so-called Fair Banking Act proposal came out recently which rules on the consumer loan contracts how they should be structured. For the future, it recognizes only two types of consumer loan or customer loan pricing for retail customer loan pricing. It is either fixed or a benchmark-based variable type of loan.

And then, finally, last weekend there was an agreement between the banking association and the Ministry of Economics and that agreement decided about the exchange rate, at which the FX mortgage loans will be converted into HUF, the local currency. And these rates were set at 309, HUF/EUR, and 256.5 HUF/CHF.

These rates are actually quite close to the market rates at this point of times, so conversion at this rate doesn't mean technically any material losses for the banking sector, and this is very important.

Then, after this agreement, as early as Monday this week, the central bank actually provided the banking sector with the necessary euro-linked funds to cover the position which opened in their balance sheets due to these presumed conversion to local currency. This is not yet the legislation, but we expect the legislation proposal to be published on Monday next week, and then the parliamentary vote will come soon.

So this, at the moment, is not formally decided. The agreement between the banking sector and the Ministry of Economics, plus the transaction with the central bank were subject to the approval of this new legislation.

There's one part of the puzzle which we still don't know, and that is the exact interest rate of the new HUF loans. Possibly the legislation proposal on Monday will rule on this. So far, we have calculated with the scenario under which we have to continue with the same rates as what we have after applying the Supreme Court decisions. So, after unilateral changes are reversed, we basically go back to the original contractual terms, and then we transform it into a variable rate mortgage loan.

But this is not clear yet. It may or may not be the final legislative solution for the pricing.

Certainly, I don't think that we will be allowed to have a higher interest rate than this one, so the risk is rather on the downside risk, i.e. the rates have to be somewhat lower than that.

The timing is such that we will have to calculate and technically convert the FX mortgages into HUF at the 1st of February next year, and then calculate the exact amount due back to customers, and then notify customers between March and April, and then the settlements will happen subsequent to that.

There might be changes in case the legal procedures take longer. It might happen in our case, because our case was actually forwarded to the constitutional court, therefore, in our case, there might be some delay compared to other banks in the procedure, but then, we'll have, basically, two months after the final legal decision is made to settle with customers.

So, that is about the Supreme Court decisions and the FX mortgage conversion case. At the moment, the volumes that we are talking about and which are subject to conversions are the FX mortgages, including home equity loans, and excluding, for instance, car financing and FX consumer loans.

So, these are only the mortgage loans, housing purpose and home equity type mortgages in FX, which in case of the Hungarian banking sector is basically Swiss franc, but there was euro and some small amount of Japanese yen loans, as well.

Moving on to the other topic which is important for us at the moment, it's Ukraine. We indicated after the second quarter conference call that losses might be up to HUF 30 billion for the whole year, and apparently three quarter losses, if we include the one-offs in the Crimea and in Donetsk/Luhansk were already HUF 37 billion. So, we are over this HUF 30 billion level, therefore, we have to update this forecast, and today we expect that losses potentially will be exceeding HUF 50 billion for this year.

And the other guidance we gave was related to Russia. Earlier this year we expected improvements during the course of the year, and until the last quarter this year we expected the bank to turn to profitable, or, at least, to breakeven again.

Unfortunately, it seems clear that this is not going to happen and the Russian bank will continue to be loss making during the last quarter this year, as well. The details I'm going to elaborate later on.

And finally, there's a positive feedback to the Group. We were subject to the AQR and the EBA stress test and the results were quite satisfactory for us, obviously, not very surprising, given the very strong capital position of the Bank. If you flip one page forward, then you'll see on page 7 that OTP Bank came as 22nd out of the 123 European banks under the stress test scenario regarding the Common Equity Tier1 ratio. And with this, we actually compare quite favorably with other regional banking groups.

If we go to page 8, then we have more details on the regional distribution within the Group of this HUF 33.5 billion adjusted after-tax profit what we achieved during the third quarter. And the picture didn't change much from the second quarter in the sense that the CE countries are doing very well. Obviously, Hungary and Bulgaria are the leaders, the flagships, in this group.

Both countries managed to improve their earnings quarter on quarter, Hungary with HUF 35 billion, Bulgaria with HUF 12 billion. But the smaller banks in our portfolio managed to continue to contribute positively to the Group level results, too which is a good news, because if you recall the last 3-5 years, each year we had some of these subsidiaries being in red, and sometimes their contribution was materially negative to the Group. Now these times are apparently over, and now year to date their contribution is positive.

So, the Central/Eastern European countries in our group seemed to perform very well.

Unfortunately, this is offset by the negative performance of Russia and Ukraine. In both countries the quarterly results were massively negative. In Russia, we have HUF 5.7 billion loss, and in Ukraine HUF 10.9 billion, and in Ukraine this HUF 10.9 billion is without the one-off items. So, this does not include the Donetsk and Luhansk losses. If you included that, then the total losses would have been HUF 18 billion.

Going forward, page 9 you see the total income and the overall development of loan and deposit portfolios. This is the third quarter result, and you see the year-on-year and quarter-on-quarter changes.

Year on year, actually, there are some remarkable performances in the Group. I would count here Bulgaria, certainly, 14 percent increase, Romania, 16 percent; Slovakia 20 percent, Croatia, 21 percent, but, obviously there we have to think about the impact of the acquisition. Without the merger, the result would have been only 6 percent, but even that implies a y-o-y growth.

And in Hungary, there's some decline. I explained at the beginning that lower income was related to the other non-interest income line primarily.

And then we have Russia and Ukraine declining income contribution to the total Group. Here you can see the potential impact of the currency devaluation, because in case of Russia in Hungarian forint the decline was 10 percent, but if you look at the ruble figures, then it was only 5 percent, and in case of Ukraine, the decline in HUF was 37 percent, but if you look at the decline in hryvnia, i.e. the local Ukrainian currency, then the decline was only 7 percent.

The following page shows the net interest margin development across the Group. Slight decline in Hungary, but, again, as I just said, most of that can be explained by the jump at the end of September, in total deposits, and, therefore, a sharp increase in total balance sheet. If this jump had not happened, then the net interest margin in Hungary would have decreased only by 6 basis points compared to the 23 which actually happened here.

Russia we have a decline likewise in. Unfortunately, these are more fundamental events what happened there. Their problems come from actually three angles. One is the increase in cost of funding. So, deposit rates started to increase in both countries, and, therefore, our cost of funds became more expensive.

And the increasing share of non-performing loans reduced the interest-bearing assets, plus volumes declined, as well. Especially in Ukraine, we have a decline in the overall volumes.

Bulgaria was stable, quarter on quarter.

Turning to the volume dynamics, here on page 11 you see the loan-to-deposit ratios. They are reaching really low levels now, and the decline was actually quite sharp. Just in one quarter the net loan to deposit ratio declined by 9 percentage points and now is down to 79 percent, so, it's below 80 percent.

For all Group members we had a similar story, i.e. declining loan-to-deposit ratios. So, deleveraging actually continues, which is not necessarily what we like, because at these levels our balance sheet is not quite optimal.

On the following page you see the loan volume development. These ratios are FX-adjusted and reflect the gross loan volume changes. In case of Ukraine and Russia realizing that the gross loan volumes actually don't give you necessarily the right picture of exactly what's going on and certainly is distorted by the large share of non-performing loans, we included the performing loan portfolio changes. So, this is the less-than-90 days past due loans growth dynamics and the last column on this page is Croatia, without the acquisition.

Some numbers I like to explain a little bit, namely Hungary, where we continue to see portfolio erosion in consumer loans and mortgages. This is due to the fact that the old stock is still bigger than the new sales, despite the fact that new sales started to increase quite rapidly. I'll show you those figures later on.

And regarding the corporate portfolio we have two categories. One is a broader category of corporate loans, which includes municipality loans, but also those loans which are to customers outside Hungary, typically project finance deals, what we previously booked into our Hungarian books. We don't extend that type of loans any more, and we don't book them in Hungary, so they decline. Also, municipality loans declined substantially in Hungary due to this consolidation initiated by the government.

But if you only look at the loans originated to Hungarian corporates, then we see increases, both on a quarterly basis, and on a year-on-year basis, 1 percent quarterly, and 3 percent year on year.

I think the other interesting part is Russia. In Russia, the gross loan volumes increased by 7 percent year on year, but if you look at the performing part, there the increase is actually 3 percent. So, despite all the hardships and negative changes in the operating environment, it still grew, albeit at a much lower rate than we used to see before.

And in Ukraine, despite the fact that the gross volumes year on year remained more or less stable, only 1 percent negative, if you look at the performing loan volume dynamics, it was minus 10 percent.

The rest of the Group actually did very well. Romania grew by 2 percent, year-on-year; Slovakia was increasing; Serbia was increasing, too and Bulgaria remained pretty much stable.

On page 13 you see the deposit volumes, and, again, there was a remarkable increase just in one quarter, 7 percent. And, as you can see, it's almost across the board, not just one country. Obviously, by volumes, the biggest impact came from Hungary, as you can see there, 9 percent increase, which was entirely due to the corporate sector. Again here the most important factor is the deposits coming from fund managers, and also the municipality deposits.

There is a very positive development in Russia and Ukraine. Despite of the problems in each country we have seen deposit inflows during the third quarter, quite strong ones, 6 percent in Russia, and 5 percent in Ukraine, which, in fact, shows that our customers trust our banks in these countries, and our subsidiaries are regarded as trusted players at those markets in this troubled time.

But also, in other markets, as you can see, deposit volumes increased, too.

Page 14 is about the operating cost development, which year on year reflects a small decline of 2 percent. But, again, here we have to take into account the weakening of the ruble and the hryvnia effect.

If you look at the HUF figures, then Russia declined by 5 percent, and Ukraine by 31 percent respectively, but on the right side you see our remarks: if we look at the numbers in ruble terms, then actually they increased by 1 percent, and in hryvnia terms by 2 percent.

But what is important, I think, is, for instance, the Hungarian situation where year on year we managed to reduce somewhat the operating costs. This is, obviously, partially attributable to the cost reduction initiatives we have taken during the course of this year in Hungary.

Talking about Hungary, you have the usual few pages elaborating the Hungarian part of the story.

First, the macro situation. Today the GDP growth figures came out for the third quarter. In case of Hungary it was 3.2 percent, which is actually better than most of the expectations out there in the market. Obviously, it's a lower number versus the second quarter, which was 3.9 percent, but we warn you that that 3.9 percent included some one-offs, and the base was lower. This 3.2 percent is actually quite close to our expected annual GDP growth, which is a robust figure, especially if you compare it to previous years.

Basically, on all fronts, if you look at the array of indicators, one can see positive developments and they are trending upwards for better. Most importantly for us, for instance, household consumption is steadily growing due to higher real wages growth.

Inflation recently dropped below zero. This we expect to come back and start to increase during the course of next year. The base rate stays at 2.1 percent. We expect it to remain there 'til the end of next year.

Budget deficit, which is not on this page, is below 3 percent.

The only negative which you could name, after the indicators, I think, is the FDI, which is, unfortunately, still negative.

How it translates into banking activity and demand? On page 16 you can see in the left upper corner the way mortgage demand is going up and our sales accelerate.

If we compare the first nine months, then the growth of new mortgage loan disbursements were up by 31 percent, but if we compare to the third quarter to the third quarter last year, then the growth was actually 42 percent. So, that definitely shows an acceleration in demand, which is a very positive development, and goes hand in hand with the GDP growth and the growing real wages, and the revival of the Hungarian real estate sector.

In corporates, we continue to be active, as I said earlier. If you look at the Hungarian corporate clients, our volumes grew by 3 percent. Unfortunately, the market itself continued to decline, and if you look at the market without OTP then the decline was 7 percent year-on-year.

Now, obviously, this led to us further increasing our market share in corporate lending in Hungary. It was 12.8 percent at the end of the third quarter. Our market share was strong, as well, in total household savings, which went up to 28.4 percent, and it has been growing since 2012, which is actually a quite positive trend, because it shows the strength of our franchise in Hungary.

On page 17, you see some more details on the retail segment in Hungary, notably the consumer loans, which I haven't talked about so far. There our market share continues to be stable at about 40 percent.

And the good news here, as well, that new disbursement volume started to grow, and we see much more activity on the markets, as well.

So, overall, there's a very clear increase in retail demand, at least in Hungary, which is, actually a very positive precursor for next year, and we hope that such positive trend will continue next year.

Obviously, there will be a one-off decline in volumes because, as I've said, it's now sure that we have to reimburse customers in the form of principal reduction, so loan volumes of the entire banking sector will have a one-off drop at the beginning of February next year.

But despite that, I believe that the demand growth will continue next year, as well, and, hopefully, sooner or later it will translate into higher corporate loan volumes, as well, in Hungary.

Going to page 18, there the Russian subsidiary unfolds in four slides. Again, here we included the performing volumes, so the less than 90 days past due volumes. Here you can clearly see that the POS volumes declined during the course of this year, and the credit cards and cash loans continue to grow, albeit by a much lower speed than they used to, and, certainly, in case of credit cards, by much lower pace than the market continued to grow.

By the way, the markets are still showing gross loan volumes, because we don't have data on the NPLs regarding the entire sector.

Looking at the sector, and the players similar to us, namely focusing on consumer lending, it's obvious to see that the problems are not specific to our bank, but are typical across the whole sector.

And if you look at the retail developments of the different players, then, really, it's clear that the pace with some of them is actually much higher with us. Unfortunately, here we don't have all the recent data for the third quarter, only for the second quarter or the first half of this year. From unofficial kind of rumors and market intelligence, we actually think that the situation didn't improve much for our competitors, either.

If you go to page 20, there you see more details on the loan volume dynamics, and I think the most interesting here is the POS. As you've seen before, the overall performing volumes declined. In fact, we slowed down new issuance last year, and part of the fact that now we have reasonably decent NPLs and acceptable levels of risk is mainly due to our efforts through which we started slowing down origination already last year.

The question here will be the last quarter, whether we'll be able to surpass last year's figures and at the same time keep the same portfolio quality. We are certainly not willing to relax the portfolio quality requirements, but our objective is to be higher by volumes than we were during the last quarter last year. Hopefully, this is going to happen and then the POS business, from our perspective, will be more or less on track, both in terms of risk cost and in terms of volume dynamics, as well.

Deposit growth in Russia typically happened in ruble terms, both in the retail, and in corporate, which is OK for us, because pretty much all of our loans, with a very small exception, are in local currency, in rubles.

Then, potentially, the most important slide is page 21 explaining the risk cost rates and the coverage of the three different sub-segments within consumer loans in Russia. And, as you can see, the POS risk-cost rate continued to decline and now is down to 10.6 percent. Earlier we indicated that it might go down as low as 10 percent by the end of the year. It can actually happen, and this improvement can continue during the course of this year.

Unfortunately, where we don't have any improvement are the credit cards and the cash loan segments. As you can see from, the portfolios continued to require high risk cost, and, therefore being loss making. So, the fact that we are not making any profits in Russia, and the fact that we are making losses, in fact, comes from these two portfolios. If we didn't have them, then the POS business in its own would actually be profitable.

Now we are fighting with quality problems of the older vintages where we have less impact on portfolio quality and on client behavior, because the newer vintages, especially in cash loans, seem to be much better.

For instance, what we sold since May seemed to show very good profile characteristics, but the older portfolios continue to deteriorate with a much higher rate than what we previously expected.

And this is, I'm afraid, is linked to the overall environment in Russia. The fact that the economic conditions don't improve, and recent developments make us believe that it's unlikely that in a very short term, namely in this quarter and the last quarter this year, we can have material changes in the trajectory of these two portfolios.

Therefore, we actually believe that we are going to remain in red in the fourth quarter, as well, in Russia.

A few words about Ukraine. I'm sure you follow the news, as well, and the ongoing conflict in the eastern part of the country. Also, during the course of last week, somewhere mid last week, the Ukrainian National Bank stopped managing the exchange rate. So, it went into free float, and it was actually a precipitous free decline at start, and then some subsequent strengthening.

But now the currency is free-floating, which, in itself, is a good thing because in a commodity-driven country managed exchange rates rarely lead into long-term stable developments. But, certainly, we have to get used to or have to deal with volatile FX environments, and, potentially weaker currency in the short term.

The good thing is that the supranational organizations' support seems to be very strong and IMF continues to stand behind the country, and seems willing to commit to further financial help to continue to support the country.

There was another development, actually two more very important developments, recently. One was the agreement between Ukraine and Russia regarding the gas supply for the winter. There was a very substantial risk, if it didn't happen. It would have been very difficult for Ukraine for the winter, but it did happen, and there was a price reduction what they received at the end. So, this is a rather positive development.

The other one was, obviously, the elections, where the pro-European parties had a landslide combined victory.

On page 23, you can see the remaining net loan portfolios in Donetsk and Luhansk. In Crimea, it's close to zero. It's less than HUF 1.5 billion and it's related to two corporate clients.

But in Donetsk and Luhansk, despite the very hard provisioning we have done so far, there's still, all together, HUF 22 billion equivalent of net loan volumes, so loans which we have not provisioned for yet.

And it's clear that we will have to continue to increase our levels of provisioning in Donetsk and Luhansk by the end of the year. So, I think it's quite fair to expect further one-off losses in Donetsk and Luhansk, because we will continue to increase the provisioning in these two regions.

I'm not suggesting that we will go up to levels at which we are in Crimea, because the nature of the situation is somewhat different. Just to remind you, in the Crimea basically we are not allowed to do banking. That's not the case in Donetsk and Luhansk. In Donetsk and Luhansk, the normal economic activity is missing at the moment, but there's obviously a hope that some level of normal economic activity will be restored and therefore banking will actually restart.

Nevertheless, it's clear that we will have to provision somewhat more.

And, finally, a section about the risk cost and portfolio dynamics. Portfolio deterioration was lower than in the second quarter. It was HUF 52 billion. Coverage went up to close to 85, right now it's 84.8 percent.

On page 25, you see the portfolio deterioration by countries. Not surprisingly, the biggest new flows came from Russia and Ukraine. In Russia it has increased to historic highs at HUF 29 billion in 3Q, while the rest of the Group basically was close to zero, or even negative, so portfolios improved. In Hungary it was only HUF 6 billion.

On page 26 you see the risk cost ratios for the largest four countries. The good news is that in Hungary and Bulgaria we are close to a kind of normalized level. At third quarter, Hungary was 70 basis points. The last time we showed these levels of numbers was prior to the crisis in 2004-2005, and Bulgaria is also quite good at 1.1 percent.

But it didn't improve in Russia, and it didn't improve in Ukraine, either.

On page 28 you see the restructured volumes. There has been quite some time since we have not talked about these, because they lost relevance. Now they gain relevance again, but only in Ukraine.

So, as you can see, in Ukraine the restructured retail share of the portfolio started to increase, and now it's at 6 percent of the retail portfolio.

Finally, two pages on capital and liquidity. Capital adequacy ratio, Common Equity Tier1 ratio improved during the third quarter. The Common Equity Tier1 is at 14.5% and here you can see the country-by-country numbers.

It's clear that in Russia and Ukraine, sooner or later, we will have to take actions to stabilize their capital situation. In Russia, it's going to happen through providing subordinated debt, while in Ukraine, we are still exploring the right tools to do it.

Finally, there's one page on liquidity. There's not much to say about this, actually. We are very liquid. It's not surprising that the net loan-to-deposit ratio is below 80 percent, so we don't have any liquidity concerns.

So, pretty much, this was the formal presentation I wanted to make, and now I would like to ask you to open the floor for questions. So, please, operator, take over and participants ask question.

Operator: Thank you very much, sir. As a reminder, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced.

And your first question comes from the line of Gabor Kemeny. Please ask your question, sir.

Gabor Kemeny: Hi, it's Gabor. Firstly, in Russia, can you give us an idea about how the ruble depreciation could impact your operating profits here? I mean, do you hedge your revenues, or at least part of your revenues? Can you give us an idea about this?

Laszlo Bencsik: The short-term impact is quite positive, because we are loss making, so, if you translate the ruble losses into our reporting currency, which is Hungarian forints then, actually, we've got a smaller loss. It could be interpreted as a joke, but that's what's happening.

Our loan book there, as I've said, it's almost only rubles. So, we certainly don't have the type of problems that we had in Ukraine or, for instance, in Hungary, related to FX mortgages.

The consumer loan book in Russia is in rubles. So, there's no short-term negative impact, so to say.

The ruble depreciation, I believe, is basically linked to the oil price decline, and it's kind of rebalancing the ruble revenues of Russia from the sales of natural resources, and, in this sense, again, has a short-term stabilizing impact on the economy.

Obviously, this will eventually translate into higher inflation, higher cost of funding and therefore, lower corporate profits, which, eventually, can lead to higher rates of unemployment and so on, but those are longer-term potential impacts.

So, the short-term impact for us is basically positive, because our losses, actually are smaller in HUF terms and there aren't obvious negative short-term impacts on the economy itself.

Gabor Kemeny: OK. And when would you expect your Russian business to break even if the current conditions, let's say, prevail?

Laszlo Bencsik: That's a difficult question. Again, what we know is that the POS part of our business is OK and making profits and the problems remain in cash loans and in credit cards.

In cash loan, the improvement will eventually happen as the older portfolios will phase out. Credit cards is a more difficult issue because it's, obviously, a revolving credit line.

I don't think it would be prudent to give you a very precise estimate. At least, we don't expect further strong deterioration from what we have today, short term. That's what I can say.

And then, what's going to happen next year, technically, improvement should happen, but our business is subject to the changes in the operating environment, which is by far not as negative as one would think, I believe.

I mean, for instance, the GDP continued to grow. On a year-on-year basis it was still growing by 0.7 percent. So, there's no recession there yet.

I don't think we are prepared, at this point of time, to give you a very precise expectation in terms of the Russian business, but certainly next year, during the course of next year, we expect improvement.

I can tell you that we decided to launch a drastic cost reduction program. It's clear that the sales activities will not go back to the pre-crisis levels and we certainly have to scale back those parts of the business which are less profitable at the moment and certainly we have to do a lot in terms of making the headquarters more efficient.

So, what we are doing now is a quite substantial cost reduction program which will unfold during the course of next year and certainly help to improve the profitability of the Bank. I do hope that during the course of next year we will break even, hopefully sooner than later; but exactly when, I wouldn't dare to give you a forecast on.

Gabor Kemeny: OK. That's very clear. And finally on Bulgaria, obviously, following the results in Q3, your provisioning came down again. Now, how shall we think about your provisioning in Bulgaria going forward? I mean, a large part of your book is consumer lending here. Most of your new lending is also in consumer. Do you think you can sustain the 3Q levels of provisioning in the next few quarters?

Laszlo Bencsik: We have always been conservative in Bulgaria, and given the extraordinary level of profitability actually we have room to be conservative.

By the way, the consumer loan portfolio quality is exceptionally good in Bulgaria, the risk cost rates there are typically better than mortgage risk cost rates in some other countries, and not worse than the mortgage risk cost rates in Bulgaria. So, the fact that we do consumer lending there, is certainly not the type of consumer lending what we are doing in Russia.

I don't see fundamental reason regarding portfolio quality for materially increasing provisioning there. We might use, time to time, the opportunity to further increase coverage in order to be even more conservative; but the fundamental portfolio dynamics are quite favorable, I would say.

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

Operator: Your next question comes from the line of Marcin Jablczynski. Please ask your question.

Marcin Jablczynski: Good afternoon, Marcin Jablczynski. I would have two questions, the first one on deposits. Your deposit growth was mainly in the corporate sector, which probably is a little bit pricing-sensitive. Did you have any action on purpose to collect corporate deposits in the third quarter? And, if so, what is the reason behind that? Is it linked to either the Hungarian regulatory changes or maybe some kind of M&A activity that you plan to do? That's my first question.

Laszlo Bencsik: No, no. That's related to two factors. The Hungary municipality deposits increased. That's a usual seasonal development. Each year in September municipality deposits go up.

The other one was related to the fund managers, they usually keep certain part of their funds in bank deposits and certain part in short-term papers and also in National Bank deposits. By a regulatory action they cannot deposit with the Central Bank now, so they either have to buy government bonds or they have to deposit with banks.

This is just technical reallocation which was not initiated by us, and certainly we did not stimulate it by pricing. We didn't change our pricing at all. What happened was that due to certain policy changes initiated by the National Bank, the fund managers were not able to allocate their funds to National Bank 2-week short-term papers, because that facility ceased to exist; therefore, they had to reallocate their portfolios and they started to allocate more to banks.

And OTP being one of the largest and most stable banks in Hungary, certainly took a sizeable share of these reallocated funds. But this was certainly not due to changing our pricing, or not related to any acquisition type of thing what you suggested.

Marcin Jablczynski: OK. Thank you very much. I now have a second question regarding the FX conversion and the potential P&L impact for you. Obviously you seem to be provisioned well enough for the unilateral changes and the spread.

But my question is, given the fact that 50 percent of your FX mortgages are in a 5-year fixed scheme, with obviously resulting separate loan accounts which accumulated the difference on the capital part of repayments, would there be any sort of P&L impact from either conversion or, later, on the different interest rate that you will need to be using on the HUF-denominated new lines?

Laszlo Bencsik: Yes. We talked about this during the second quarter results conference call. And then I said that, if the conversion happens and we have to settle, and the settlement with customers will be in the form of principal reduction – i.e. we don't pay back them cash, but we reduce their exposures – then this obviously would have an impact on next year net interest income, or interest income, because we would have lower volumes.

Plus, the interest rates would be lower because, due to this reverse unilateral change of conditions, the interest rates would be lower, too. I said during the second quarter conference call that the total annual impact of these two for the FX mortgages would be roughly HUF 10 billion on an annual basis.

This number hasn't changed. But this number is based on the assumption that the HUF rates won't be lower than the original contractual rates of the FX mortgages in percentage terms. And this is not sure yet, because the legislation which will deal with this problem is coming out next Monday.

Marcin Jablczynski: OK. That's fair enough. Thank you. Thank you very much.

Laszlo Bencsik: … actually, it's going to be somewhat different, and this number will be more than HUF 10 billion – I mean, the decline in revenues.

Marcin Jablczynski: Yes. I guess we'll see on Monday by how much. Thank you very much. Thank you, Laszlo.

Operator: Once again, it's star one to ask a question. And you have one more question. This one comes from the line of Lukasz Janczak. Please ask your question.

Lukasz Janczak: Thank you very much for the presentation. I have just two questions. First, on dividend, do you think you may somehow pay dividend next year, even despite you will likely post a net loss this year?

And the second question is on the banking sector, because Hungarian government is saying that it wants to have control over 50 percent of the total banking assets in Hungary that there is some services, even informed that Prime Minister Orban said it's up to 60 percent, 66 percent.

And I wonder, what is your impression about how Hungarian government may perceive OTP from the ownership point of view? So, what can be treatment against OTP in terms of, it is Hungarian or it's not? Thank you.

Laszlo Bencsik: The answer to the second question is very easy – yes, OTP is considered to be a Hungarian bank by the government, and more specifically by the prime minister. So, he has repeatedly confirmed that he considers OTP as Hungarian bank.

And when he talks about 50 percent, or 60 percent, or whatever percent, of the banking sector to be in Hungarian hands, he always does include OTP as Hungarian bank.

Lukasz Janczak: OK. And what – yes, but can you explain what might be the reason behind such view, that OTP is a Hungarian bank? I don't know – it's about the shareholder structure, or the anchor investor, or some – what is your view on this?

Laszlo Bencsik: Decisions are made in Hungary. The management is Hungarian. The Board is Hungarian. The owners are not Hungarian. It's very clear. I mean, more than 50 percent of our owners are foreign institutional investors.

Lukasz Janczak: Yes. True.

Laszlo Bencsik: But, I don't know. What is the nationality of Coca-Cola? Or, you could name many companies which are listed. We certainly regard ourselves as being Hungarian despite the fact that we are owned by shareholders who are not Hungarian.

Lukasz Janczak: (True). OK. That's clear. OK.

Laszlo Bencsik: The other question regarding the dividend – we have not addressed this question. The final decision will be made by the AGM and once we see the year-end figures and the final results of this year, which is actually in every sense an extraordinary year, then we will think it over. So far we have not changed our expectations to dividend payments.

Lukasz Janczak: OK. Thank you very much.

Operator: Your next question comes from the line of Daniel Cowan. Please ask your question.

Daniel Cowan: Good afternoon. I've got a couple of questions, please. The first one is on the cash position. It looks like you've got, now, about HUF 2 trillion in cash, which is presumably due to the abolition of the 2-week notes.

Is that just a simple booking exercise, or will that cash ultimately be reallocated to a more profitable use, thereby sort of helping that interest margin in the future? That's my first question.

Laszlo Bencsik: Well, this is just a technical reclassification. Because the 2-week bonds now became deposits with the Central Bank. So, the actual volume hasn't changed so much; and the rate on this hasn't changed much. So, it's just the technical form of these liquidity reserves.

We kind of self-constrain ourselves, because the alternative would be to buy Hungarian government bonds; but we do want to limit the exposure to the Hungarian sovereign to some extent, and therefore we don't put our entire liquidity reserves into Hungarian sovereign bonds, but we try to be extra cautious and keep a sizeable volume at the Central Bank, which we consider actually a safer place than taking sovereign risk.

Daniel Cowan: Understood. Thanks. And the second question is, for the treatment of the compensation, understand that there's some clarity now on how performing loans will be treated.

But how – do you have any clarity on what will happen with non-performing loans? Because there's some interesting text in the Central Bank's Financial Stability Review which suggests there may be some room for provision write-backs at some point, if the compensation can be deducted from interest and arrears, and fees and arrears. Have you got any clarity on that? Anything you can help us with?

Laszlo Bencsik: The non-performing loans, especially those ones which are over 1 year delinquency, i.e.in the workout phase, these customers will have a claim on the banks as well as other customers.

The impact of the unilateral changes of conditions and the FX margins which we charge from these customers, we have to pay back. So, their exposure to the Bank will be lower as well. Therefore, our claim will be lower.

Now, this will not have an impact on the net value of these loans, right? Because these loans are provisioned, and it's unlikely that the compensation will be so much that it will be more than the provisioning. The level of provisioning is related to the expected recovery, right? Which is in case of mortgages, is typically linked to the perceived value of the collateral. So, that doesn't change.

What is going to change however is the overall claim which will be lower, because that's how the compensation will technically happen. And the provisions will go lower as well. But most likely the net volumes will not change. Therefore, there won't be a P&L impact for these loans.

Daniel Cowan: OK. Thanks very much.

Operator: Your next question comes from the line of Claudio Bassi. Please ask your question.

Claudio Bassi: I have noticed that you've had a significant decline in mortgages in Russia. Could you comment maybe on the health of the demand there, and how do you see the pricing going forward?

Laszlo Bencsik: This is a negligible amount. So, I think it's potentially 2 percent or 3 percent of our total loan book in Russia. And we are not selling mortgages for many years now, so I'm not up to date on the mortgage market in Russia.

We haven't been selling this product for many years, and the volumes what we have today are really small. I would say insignificant. So, the large decline is due to the fact that the amount itself is so small that it doesn't really count.

Claudio Bassi: OK. Thank you.

Operator: The next question comes from the line of Stefan Maxian. Please ask your question.

Stefan Maxian: A few questions. One refers to the risk cost in Hungary. You said already that in Bulgaria the low risk cost could continue for the next quarter. Do you see a similar development in Hungary, actually, now going on?

Laszlo Bencsik: I don't see fundamental reasons for structurally higher risk cost. I mean, time to time, we might have an increase in corporate coverage on certain corporate non-performing loans; but I don't see new problem loans coming in, and certainly the retail segment seems to perform very well.

And if you think about what's going to happen for instance, the FX mortgage holders' monthly loan servicing will decline between 20 percent, 30 percent. So, there will be a substantial decline in their loan servicing burden. And at the same time, the economy is growing, real wages are increasing and consumption is growing. So, I don't see why this trend should not continue.

Stefan Maxian: All right. And maybe sticking to that, I mean, the – I think one intention of the government is to increase competition among banks after conversion of the mortgage loans. What would be your scenario? I mean, do you expect especially the state-controlled banks to push for lower pricing? Would you think that overall margins would get under pressure in such a scenario?

Laszlo Bencsik: Well, at the moment there's only one state-owned bank, with a sizeable retail operation. There's the Hungarian Development Bank and Eximbank, they do have some corporate activity, but that is more related to the Central Bank's Lending for

Growth Program, which, by the way, was extended. I forgot to mention that. It was extended to the end of next year.

So, the program continues. And that sets pretty much benchmarking in the corporate lending sphere, regardless whether it's a state-owned bank providing the loans.

Now, in the retail, there's only one state-owned bank which is sizeable and does retail activity. They were Bayerische Landesbank’s former subsidiary, MKB. And that bank is structurally loss-making.

I doubt that they are in a position to be even more aggressive in pricing. They have traditionally been quite aggressive. If they become more aggressive, they'll be making even more losses. I don't think it is the intention of the government to own a structurally loss-making bank.

So, I don't really see that competition pressure is coming from the government-controlled institutions. As for other market players? Well, I don't know. I have no idea what strategies they will choose for next year.

Stefan Maxian: All right. And do you see any chance of a reduction in the bank tax after conversion settlement?

Laszlo Bencsik: I don't think an outright decrease will happen. Maybe some decreases might be linked to certain activities, I don't know; someone lending more, or the kind of reward for that lending activity could be translated into lower bank tax, … something like that. But I don't really expect an overall reduction of the bank tax next year, unfortunately.

Stefan Maxian: All right. Thank you. And one final question, which refers to your capital sensitivity to the ruble and the hryvnia. I think, like – is it right to say, OK, your capital sensitivity goes more or less one on one with your equity in those two subsidiaries?

Laszlo Bencsik: No. Actually, it's true for Russia and for ruble, but for hryvnia it's not. Because we have FX loans in Ukraine, both performing and non-performing. And certainly, the risk cost is closely correlated with the FX rate, and therefore (has) an impact on that. So, certainly in case of hryvnia, we have a substantially larger exposure to the FX rate than in case of ruble.

Stefan Maxian: Right. OK. Thank you.

Operator: The next question comes from the line of Margarita Streltses. Please ask your question.

Margarita Streltses: Thank you very much for the presentation. Most of my questions have been answered. I just have one left. You were saying that at some stage you would need to sort out the capital situation in the Ukraine, and I was just wondering if you have an estimate of potentially how much more of the support the Ukraine may need from you, and if you can just quantify the latest intra-Group exposure to the Ukraine, please.

Laszlo Bencsik: The latest exposure – the goodwill, we wrote off. The investment is HUF 60 billion net. But this is deducted, so you don't see that in the consolidated books. That's just only stand-alone. And then, again, we don't have any more goodwill.

And the total Group funding is HUF 185 billion, and then we have HUF 32 billion sub-debt. So, roughly HUF 210 billion is our exposure to Ukraine. Now, technically, what's going to happen is that we will reduce the Group funding and convert that into equity. So, I don't expect the Group exposure to increase. Part of the Group funding might translate into equity.

In terms of the Bank, it hasn't been needed yet. So, still at the end of the third quarter, the capital adequacy of the Bank was 13.6 percent. But in the foreseeable future I think we will have to move, potentially in the last quarter, and convert some of the Group funding to equity in Ukraine as well.

Margarita Streltses: Thank you.

Operator: And your last question comes from the line of Hugo Swann. Please ask your question.

Hugo Swann: Thanks for the presentation – very helpful. And I wonder whether you could briefly outline whether you're going to be able to offset some of the NIM impact on the deposit flows in some of your subsidiaries at a Group level. Some of the – you said it's seasonal municipality deposits. I wonder whether that – you were able to take any other action to try and offset some of the less seasonal flows. Thank you.

Laszlo Bencsik: The municipality deposits are cyclical, so they will go down by the end of the year as they spend their money. As for the funds deposits, we do have margin on that, to some extent. Certainly, we have taken actions across the Group, potentially with the exception of Russia and Ukraine, to re-price our deposits, the direction is to lower deposit rates.

It has been very successful, or not successful enough, if you take a different point of view, because we have managed to reduce substantially our deposit rates in all of these countries; but deposit volumes did not decrease.

At the beginning of the year when we decided on the desirable across-the-board deposit levels in the CEE countries, we expected certain deposit volume decline. Now, quite the opposite happened. And to some extent – in Hungary it was due to this technical event as and the funds reallocated their managed funds. But in other countries, for instance in Bulgaria, we very considerably re-priced the deposit volumes, and despite of that deposits actually increased.
So, we will continue to decrease deposit rates in the CEE countries, and then I don't know what's going to happen with the volumes, because so far volumes have been quite resistant to interest rate reductions. Actually, their reaction was the opposite to what we expected. But there's certainly further room to decrease the cost of funding, and therefore somewhat mitigate the NIM reduction which is happening.

Hugo Swann: OK. Thank you. So, we should think about some of those deposit inflows as remaining sticky, but you being able to offset the NIM impact over a couple of quarters. Does that sound fair?

Laszlo Bencsik: The main impact, we will not be able to fully offset, because it's unlikely that we can generate the same NIM on these new deposits, right? The NII impact was not negative, actually. The NIM went down, but the NII didn't, due to this deposit increase, right?

So, in a sense, it's kind of different optics. But at the end, what matters is not the NIM, but the NII, because that's the income what we have. We won't be able to fully counterbalance it, because it would mean that these extra deposits, we actually place with similar margin assets, as the average asset margin in the balance sheet – that's unlikely, right?

But we certainly don't intend to lose anything on these extra deposits. Therefore, the NII impact will not be negative. But what we are doing, we continue to try to reduce deposit rates across the CEE countries, with the exception of Russia and Ukraine, where the situation is quite different.

But in these countries, we will continue to decrease deposit rates, which will improve and potentially help the NII to increase, and certainly will have some impact on the NIM as well.

Hugo Swann: Great. Thank you.

Operator: OK. There are no further questions on this time, sir.

Laszlo Bencsik: Then, thank you very much. Thank you for participating on this conference call, and thank you for your patience to listen to my presentation, and your very good questions.

I hope you will join us when we will have our year-end conference call somewhere in March – early March. And I wish you all the best, and goodbye.

Operator: That does conclude our conference for today. Thank you for participating. You may all disconnect. Speakers, please stand by.

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