

16 August 2013 | 11 pages

Diversified Banks (GICS) | Banks (Citi)  
CEEMEA | Hungary

# OTP Bank Plc (OTPB.BU)

## Weak Russia, Asset Quality Woes Drive Downgrade

- Weak Russia** — OTP's Russian division earnings disappointed (1H13 ROE fell to 11% from 30% in 1H12) primarily driven by higher bad debts. Having initially blamed rising risk cost on company-specific internal issues in 1Q (e.g. the need to restructure their collections team and strategy) management now attribute deteriorating asset quality and high provisions also to a turn in the Russian retail lending credit cycle. Management indicated they will tighten credit policies and slow credit growth to c.5% but that Russian provisions are expected to stay elevated in 2H13. Moreover, the slowdown is expected mostly in higher-margin point of sale consumer loans, suggesting that margin decline can also be expected in the Russian unit. This leads us to cut our Russian divisional earnings by 74% this year, 58% next year, and 38% in 2015.
- Asset Quality Woes** — An increase in NPL formation across most of OTP's divisions and a decline in provision coverage over the quarter in 2Q was a disappointment. We now forecast a Group NPL ratio of 21.5% this year (up from 20.8% as of end 2Q13) and see NPLs peaking next year at 21.8%. As we keep coverage in a range of 79%-81% over our forecast horizon (79% at end 2Q) this prompts us to increase risk cost forecasts (to 380bp in 2013 from 353bp and to 318bp from 303bp next year).
- FX Mortgage Debt** — The government appears committed to implementing a new programme to provide relief to FX mortgage borrowers, and the banks and the government are meeting next week to attempt to hammer out a deal. Taking previous schemes as a precedent we think a worst case scenario is a Ft 104bn hit to earnings or 5% of OTP's equity, but we hope the final impact will be more benign.
- Downgrading** — We downgrade our EPS forecasts by 21% this year, 16% next year, and 8% in 2015, largely reflecting the sharp downward revision of our Russian profit forecasts, and higher provisions at other divisions as well. We lower our target price to Ft 5,135 from Ft 5,600 as a result. We continue to rate the shares Buy, but we note that our forecasts and our valuation work do not incorporate the potential impact of a new government FX mortgage relief scheme.

- Estimate Change
- Target Price Change

<b>Buy</b>	<b>1</b>
Price (15 Aug 13)	Ft4,327
Target price	Ft5,135
	<i>from Ft5,600</i>
Expected share price return	18.7%
Expected dividend yield	3.5%
<b>Expected total return</b>	<b>22.1%</b>
Market Cap	Ft1,220,576M
	US\$5,408M

### Price Performance (RIC: OTPB.BU, BB: OTP HB)



### OTP Bank Plc (HUF)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (FtM)	83,147.1	121,689.8	113,775.3	161,736.1	184,973.6
Diluted EPS (Ft)	312	457	427	607	695
Diluted EPS (Old) (Ft)	312	457	539	721	752
PE (x)	13.9	9.5	10.1	7.1	6.2
P/BV (x)	0.8	0.8	0.7	0.7	0.6
DPS (Ft)	100	120	150	200	250
Net Div Yield (%)	2.3	2.8	3.5	4.6	5.8
ROE (%)	6.1	8.3	7.3	9.8	10.4

### Simon Nellis

+44-20-7986-4012  
simon.nellis@citi.com

### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2011	2012	2013E	2014E	2015E
<b>Valuation Ratios</b>					
P/E adjusted (x)	13.9	9.5	10.1	7.1	6.2
P/E reported (x)	13.9	9.5	10.1	7.1	6.2
P/BV (x)	0.8	0.8	0.7	0.7	0.6
P/Adjusted BV diluted (x)	0.8	0.8	0.7	0.7	0.6
Dividend yield (%)	2.3	2.8	3.5	4.6	5.8
<b>Per Share Data (Ft)</b>					
EPS adjusted	312	457	427	607	695
EPS reported	312	457	427	607	695
BVPS	5,303	5,667	5,967	6,416	6,900
Tangible BVPS	4,365	4,775	5,074	5,524	6,008
Adjusted BVPS diluted	5,302	5,666	5,967	6,416	6,900
DPS	100	120	150	200	250
<b>Profit &amp; Loss (Ftm)</b>					
Net interest income	630,892	650,319	654,034	677,742	727,222
Fees and commissions	143,280	151,570	164,104	172,917	182,963
Other operating Income	38,082	42,664	43,069	40,132	41,561
<b>Total operating income</b>	<b>812,254</b>	<b>844,553</b>	<b>861,207</b>	<b>890,790</b>	<b>951,746</b>
Total operating expenses	-376,013	-394,890	-425,401	-436,138	-458,537
<b>Oper. profit bef. provisions</b>	<b>436,242</b>	<b>449,664</b>	<b>435,806</b>	<b>454,652</b>	<b>493,210</b>
Bad debt provisions	-234,039	-253,692	-246,102	-213,821	-221,755
Non-operating/exceptionals	0	-391	0	0	0
<b>Pre-tax profit</b>	<b>202,203</b>	<b>195,580</b>	<b>189,704</b>	<b>240,832</b>	<b>271,455</b>
Tax	-71,527	-72,488	-67,248	-78,012	-85,289
Extraord./Min. Int./Pref. Div.	-47,529	-1,402	-8,680	-1,084	-1,192
<b>Attributable profit</b>	<b>83,147</b>	<b>121,690</b>	<b>113,775</b>	<b>161,736</b>	<b>184,974</b>
Adjusted earnings	83,147	121,690	113,775	161,736	184,974
<b>Growth Rates (%)</b>					
EPS adjusted	-20.1	46.4	-6.5	42.2	14.4
Oper. profit bef. prov.	1.4	3.1	-3.1	4.3	8.5
<b>Balance Sheet (Ftm)</b>					
<b>Total assets</b>	<b>10,200,527</b>	<b>10,113,466</b>	<b>10,460,295</b>	<b>11,026,834</b>	<b>11,697,354</b>
Avg interest earning assets	9,368,687	9,522,449	9,649,902	10,084,927	10,680,189
Customer loans	8,047,470	7,547,047	7,800,740	8,212,491	8,790,612
Gross NPLs	1,335,917	1,442,646	1,677,159	1,790,323	1,889,982
<b>Liab. &amp; shar. funds</b>	<b>10,200,527</b>	<b>10,113,466</b>	<b>10,460,295</b>	<b>11,026,834</b>	<b>11,697,354</b>
Total customer deposits	6,398,853	6,550,708	6,758,897	7,089,411	7,442,697
Reserve for loan losses	1,061,452	1,154,176	1,324,647	1,410,361	1,504,593
Shareholders' equity	<b>1,412,709</b>	<b>1,508,770</b>	<b>1,588,945</b>	<b>1,708,681</b>	<b>1,837,655</b>
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	6.1	8.3	7.3	9.8	10.4
Net interest margin	6.73	6.83	6.78	6.72	6.81
Cost/income ratio	46.3	46.8	49.4	49.0	48.2
Cash cost/average assets	3.8	3.9	4.1	4.1	4.0
NPLs/customer loans	16.6	19.1	21.5	21.8	21.5
Reserve for loan losses/NPLs	79.5	80.0	79.0	78.8	79.6
Bad debt prov./avg. cust. loans	3.0	3.3	3.2	2.7	2.6
Loans/deposit ratio	125.8	115.2	115.4	115.8	118.1
Tier 1 capital ratio	13.3	16.1	16.5	17.4	18.4
Total capital ratio	17.2	19.7	20.0	20.8	21.7

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CitiRsch.DataServices.Global@citi.com



## Earnings Revisions

Figure 1. OTP Group – Summary Changes to Earnings Model (Ftm)

	2013E	2013E		2014E	2014E		2015E	2015E		2016E	2016E	
	OLD	NEW	chg	OLD	NEW	chg	OLD	NEW	chg	OLD	NEW	chg
Net Interest income	672,329	654,034	-2.7%	714,297	677,742	-5.1%	763,107	727,222	-4.7%	821,384	784,613	-4.5%
Non-interest income	195,514	207,173	6.0%	206,484	212,949	3.1%	218,736	224,419	2.6%	232,479	238,275	2.5%
Revenue	867,843	861,207	-0.8%	920,780	890,690	-3.3%	981,843	951,641	-3.1%	1,053,862	1,022,888	-2.9%
Costs	-412,573	-425,401	3.1%	-439,270	-436,138	-0.7%	-469,705	-458,537	-2.4%	-502,718	-487,868	-3.0%
Operating profit	455,270	435,806	-4.3%	481,511	454,552	-5.6%	512,137	493,105	-3.7%	551,144	535,020	-2.9%
Provisions	-229,794	-246,102	7.1%	-203,928	-213,821	4.9%	-224,433	-221,755	-1.2%	-245,099	-239,221	-2.4%
<b>Net Profit, stated</b>	<b>143,492</b>	<b>113,775</b>	<b>-20.7%</b>	<b>191,908</b>	<b>161,736</b>	<b>-15.7%</b>	<b>200,331</b>	<b>184,974</b>	<b>-7.7%</b>	<b>215,066</b>	<b>204,087</b>	<b>-5.1%</b>
<b>Net Profit, adjusted</b>	<b>143,492</b>	<b>113,775</b>	<b>-20.7%</b>	<b>191,908</b>	<b>161,736</b>	<b>-15.7%</b>	<b>200,331</b>	<b>184,974</b>	<b>-7.7%</b>	<b>215,066</b>	<b>204,087</b>	<b>-5.1%</b>
<b>Attributable EPS (Ft)</b>	<b>539</b>	<b>427</b>	<b>-20.7%</b>	<b>721</b>	<b>607</b>	<b>-15.7%</b>	<b>752</b>	<b>695</b>	<b>-7.7%</b>	<b>808</b>	<b>766</b>	<b>-5.1%</b>
<b>Reported EPS (Ft)</b>	<b>539</b>	<b>427</b>	<b>-20.7%</b>	<b>721</b>	<b>607</b>	<b>-15.7%</b>	<b>752</b>	<b>695</b>	<b>-7.7%</b>	<b>808</b>	<b>766</b>	<b>-5.1%</b>
DPS (Ft)	150	150	0.0%	200	200	0.0%	250	250	0.0%	300	300	0.0%
Weighted Average Shares (m)	266	266	0.0%	266	266	0.0%	266	266	0.0%	266	266	0.0%
<b>Key Balance Sheet Items:</b>												
Loans	6,568,395	6,550,980	-0.3%	6,908,069	6,880,760	-0.4%	7,393,212	7,368,581	-0.3%	7,946,282	7,927,530	-0.2%
Assets	10,471,567	10,460,295	-0.1%	11,134,474	11,026,834	-1.0%	11,854,203	11,697,354	-1.3%	12,626,066	12,487,937	-1.1%
Deposits	6,788,445	6,758,897	-0.4%	7,158,848	7,089,411	-1.0%	7,548,079	7,442,697	-1.4%	7,982,907	7,831,592	-1.9%
Equity	1,618,662	1,588,945	-1.8%	1,768,570	1,708,681	-3.4%	1,912,901	1,837,655	-3.9%	2,057,966	1,971,742	-4.2%
BVPS (Ft)	6,078	5,967	-1.8%	6,641	6,416	-3.4%	7,183	6,900	-3.9%	7,728	7,404	-4.2%
TBVPs (Ft)	5,186	5,074	-2.2%	5,749	5,524	-3.9%	6,291	6,008	-4.5%	6,836	6,512	-4.7%
<b>Key Ratios:</b>												
ROE	9.2%	7.3%		11.3%	9.8%		10.9%	10.4%		10.8%	10.7%	
ROA	1.39%	1.11%		1.78%	1.51%		1.74%	1.63%		1.76%	1.69%	
NIM on Avg Assets	6.53%	6.36%		6.61%	6.31%		6.64%	6.40%		6.71%	6.49%	
NIM on AIEA	6.96%	6.78%		7.04%	6.72%		7.06%	6.81%		7.12%	6.89%	
Cost/Income	47.5%	49.4%		47.7%	49.0%		47.8%	48.2%		47.7%	47.7%	
Provisions/Avg Loans	3.53%	3.80%		3.03%	3.18%		3.14%	3.11%		3.20%	3.13%	
Effective Tax Rate	23.0%	20.1%		20.0%	20.3%		19.9%	20.7%		19.8%	20.7%	
Equity/Assets	15.5%	15.2%		15.9%	15.5%		16.1%	15.7%		16.3%	15.8%	
Loans/Assets	62.7%	62.6%		62.0%	62.4%		62.4%	63.0%		62.9%	63.5%	
Loans/Deposits	96.8%	96.9%		96.5%	97.1%		97.9%	99.0%		99.5%	101.2%	
Tier I, Group	16.4%	16.5%		17.0%	17.4%		17.5%	18.4%		17.9%	19.3%	
Tier II, Group	3.4%	3.5%		3.2%	3.4%		3.0%	3.3%		2.9%	3.2%	
CAR, Group	19.8%	20.0%		20.3%	20.8%		20.6%	21.7%		20.8%	22.5%	

Source: Company Reports and Citi Research Estimates

Figure 2. OTP Group – Changes to Divisional Net Profit Forecasts (Ftm)

	2013E	2013E		2014E	2014E		2015E	2015E		2016E	2016E	
	OLD	NEW	chg	OLD	NEW	chg	OLD	NEW	chg	OLD	NEW	chg
OTP Core	102,898	109,612	7%	129,735	126,085	-3%	130,943	129,442	-1%	133,151	131,436	-1%
Russia	56,466	14,613	-74%	58,879	24,850	-58%	58,946	35,938	-39%	67,579	46,308	-31%
Ukraine	1,529	2,072	35%	2,525	7,181	184%	3,046	10,517	245%	4,643	11,749	153%
Bulgaria	28,760	34,545	20%	31,555	34,652	10%	35,019	36,705	5%	39,434	40,126	2%
Romania	-2,579	-3,467	34%	709	-284	-140%	2,226	2,359	6%	3,088	3,225	4%
Serbia	-3,946	-3,051	-23%	-2,749	-2,460	-11%	-2,178	-1,874	-14%	-1,554	-1,235	-21%
Croatia	3,255	3,113	-4%	3,283	3,283	0%	3,311	3,311	0%	3,340	3,340	0%
Slovakia	95	223	134%	715	325	-55%	771	480	-38%	867	680	-22%
Montenegro	-766	43	-106%	-540	-43	-92%	-268	246	-192%	392	923	136%
Leasing/Insurance/AM/Corporate Centre	-2,831	-2,831	0%	-1,695	-1,695	0%	-1,890	-1,890	0%	-2,090	-2,090	0%
<b>Profit, before adjustments</b>	<b>182,881</b>	<b>154,871</b>	<b>-15%</b>	<b>222,416</b>	<b>191,893</b>	<b>-14%</b>	<b>229,926</b>	<b>215,234</b>	<b>-6%</b>	<b>248,849</b>	<b>234,462</b>	<b>-6%</b>
Adjustments	-29,174	-41,218	41%	-29,074	-29,074	0%	-29,069	-29,069	0%	-29,063	-29,063	0%
<b>Net Profit before minority interest</b>	<b>153,708</b>	<b>113,654</b>	<b>-26%</b>	<b>193,342</b>	<b>162,820</b>	<b>-16%</b>	<b>200,858</b>	<b>186,166</b>	<b>-7%</b>	<b>219,786</b>	<b>205,399</b>	<b>-7%</b>
Minority interest	-985	-985	0%	-1,084	-1,084	0%	-1,192	-1,192	0%	-1,311	-1,311	0%
<b>Net Profit Attributable to Shareholders</b>	<b>152,722</b>	<b>112,668</b>	<b>-26%</b>	<b>192,258</b>	<b>161,736</b>	<b>-16%</b>	<b>199,666</b>	<b>184,974</b>	<b>-7%</b>	<b>218,474</b>	<b>204,087</b>	<b>-7%</b>

Source: Company Reports and Citi Research Estimates

Our full divisional earnings model is available on request.

## Estimated Worst Case Impact of FX Mortgage Conversion

We outline below a revised estimate of what we assess, in the worst case, to be the impact of the Hungarian Government's recent plans to provide relief to FX mortgage borrowers. We think the most negative outcome would be a forced conversion of all FX mortgages into HUF at a favourable rate of 180 CHF:HUF (the same rate used when the government forced banks to allow early repayment of FX mortgages). Following statements of the government we now assume that any new efforts to reduce the FX mortgage burden will apply only to FX mortgage loans excluding FX home equity loans. We additionally assume that 30% of OTP's FX mortgage book in Hungary are home equity loans (vs. the sector average of 51%), that the FX mortgage NPL ratio is 31%, and that provision coverage of FX mortgages stands at 58%. As we illustrate below, we estimate that in this worst case scenario the negative impact to OTP would be a Ft 110bn pre-tax hit to earnings.

**Figure 3. OTP Group – Impact of Forced Conversion of FX Mortgages (ex home equity loans) at a Favourable Exchange rate of CHF:HUF 180 (Ftm)**

Favourable rate CHF:HUF (Ft)	180.0
CHF:HUF at end 2Q13 (Ft)	240.3
Spot CHF:HUF now (Ft)	241.4
% of mortgage book that are home equity loans (estimate)	30%
FX mortgage NPL ratio (estimate)	31%
Coverage (estimate)	58%
Retail FX mortgages, end 2Q13	747,907
of which non home equity loans	523,535
FX mortgage provisions, end 2Q13	-94,132
Net FX mortgage loans, end 2Q13	429,404
in CHFm	1,787
in HUFm at spot	431,441
in HUF at favourable rate	321,704
<b>Estimated Haircut (pre-tax impact)</b>	<b>109,737</b>
in %	26%
Current Profit Forecast, 2014E	161,736
Equity, 2014 Current Forecast	1,708,681
PBT, 2014E	240,832
Special tax	-29,174
Impact of Haircut	-109,737
PBT	101,921
Tax rate	20%
Tax	-26,219
Profit post haircut	75,702
Hit to 2014E Earnings	-86,034
<b>Decline to 2014 Earnings</b>	<b>-53%</b>
Equity 2014, post Hit	1,622,648
<b>Change in Equity</b>	<b>-5%</b>

Source: Company Reports and Citi Research Estimates

## Target Price cut to Ft 5,135

We continue to value the bank under the assumption that excess equity is returned to shareholders above an optimal 14.5% Basel 3 tier 1 ratio. Following the downward revision to our earnings estimates we cut our target price to Ft 5,135 from Ft 5,600 but as this still suggest over 20% upside we retain our Buy rating on the shares. We again stress that our valuation work, and hence our target price, does not account for any potential Hungarian Government scheme to provide relief to FX mortgage borrowers.

**Figure 4. OTP Group – Warranted Equity Valuation Adjusted for Excess Equity (Ft)**

Target B3 core tier 1	14.5%
Excess equity in 2015e (Ftm)	197,458
Excess Equity Per Share	741
Discounted to one year from now	613
Cost of funding	6%
Cost of replacing excess equity (post-tax) (Ftm)	9,478
2015E adjusted earnings (Ftm)	175,496
2015E adjusted tangible equity (Ftm)	1,402,591
2015E adjusted ROTE	12.5%
2015E COE	12.8%
Growth	2.0%
Target P/TBV multiple	0.97
2015E TBVPS, adjusted	5,267
2015E Target Value Per Share	5,126
Months to Discount	17
Discounted Value Per Share	4,322
+ Excess capital per share, discounted	613
+ 2013E DPS, discounted	0
+ 2014E DPS, discounted	200
<b>Target Price</b>	<b>5,135</b>
Upside / (Downside)	18.7%
Dividend Yield	3.5%
<b>Estimated Total Return</b>	<b>22.1%</b>
Forecast 2013E P/E @ Target	12.0
Forecast 2013E P/BV @ Target	0.86
Forecast 2013E P/TBV @ Target	1.01

Source: Citi Research estimates

## OTP Bank Plc

### Company description

OTP is Hungary's leading bank with c30% retail deposit market share as of end-2011. The bank has expanded throughout the CEE region, acquiring operations in Slovakia, Bulgaria, Romania, Croatia, Serbia, Ukraine, Russia and Montenegro. Across its network, OTP has c 11 million customers and approximately 1,601 branches.

### Investment strategy

OTP has weathered the financial crisis admirably and is coming out of the crisis better capitalised than it went into it. Following a number of years of heavy provisioning, we think the asset quality outlook is poised to turn given decelerating NPL formation and strong provision coverage. We rate the shares Buy (1).

### Valuation

We value OTP using a standard warranted equity valuation methodology adjusted for excess equity. Based on our assumption that the bank returns excess capital above a B3 core equity tier 1 of 14.5% in 2015, that our estimated 2015E return on tangible equity adjusted for excess equity of 12.5% is sustainable, a cost of equity of 12.8% and a perpetual growth rate of 2%, we arrive at a fair value of Ft 5,135.

### Risks

The key risk to our target price is weaker growth than anticipated in OTP's key markets, which would be bad for business activity and risk cost. A significant weakening of the HUF vs. the CHF, given the bank's large exposure to CHF mortgages and car loans to unhedged Hungarian retail clients, would also be negative for the shares. The Russian division's niche franchise in consumer lending is potentially under pressure from new players. Additionally, the Hungarian government could also come up with schemes to reduce the exposure of FX debt in the banking sector that may require the banks to incur losses.

## Appendix A-1

### Analyst Certification

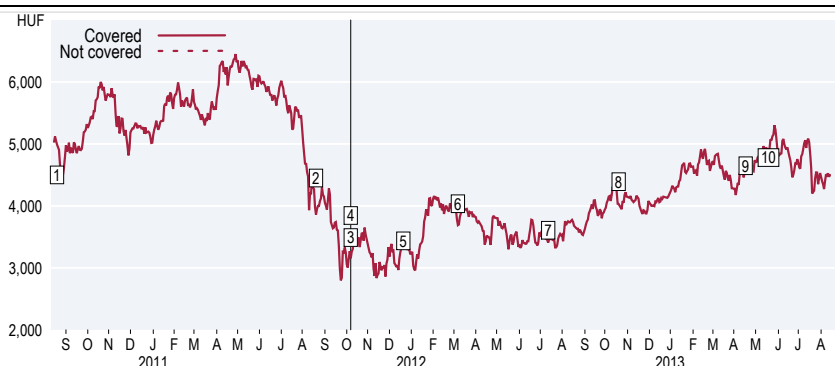
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## IMPORTANT DISCLOSURES

### OTP Bank Plc (OTPB.BU)

#### Ratings and Target Price History Fundamental Research

Analyst: Simon Nellis



	Date	Rating	Target Price	Closing Price
1	19-Aug-10	*1M	*5,996.00	4,990.00
2	19-Aug-11	1M	*5,338.00	3,860.00
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*1	5,338.00	3,154.00

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	21-Dec-11	1	*4,500.00	3,355.00
6	7-Mar-12	*2H	*4,450.00	3,689.00
7	12-Jul-12	2H	*4,015.00	3,408.00
8	19-Oct-12	*3	*3,950.00	4,030.00

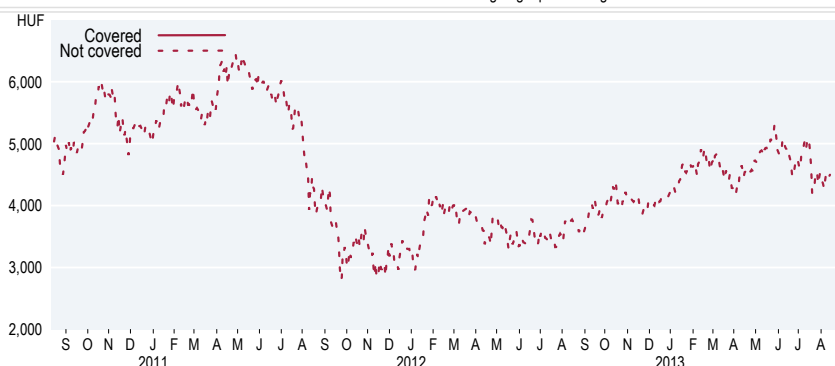
	Date	Rating	Target Price	Closing Price
9	17-Apr-13	*1	*5,460.00	4,550.00
10	20-May-13	1	*5,600.00	4,900.00

Rating/target price changes above reflect Eastern Standard Time

### OTP Bank Plc (OTPB.BU)

#### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Simon Nellis



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2013

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
48%	40%	12%	6%	88%	6%
53%	50%	45%	58%	51%	49%



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