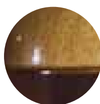
Message from the Chairman & CEO



DEAR SHAREHOLDERS,

In the past few years there's been less in the way of good news, and more about problems and challenges. So let me start this summary of the year 2010 on a cautiously optimistic note: after the global economic and financial crisis that began in 2008 and reached its low point in 2009, 2010 was clearly a year of recovery from the crisis in the central-east European region which is of primary importance for OTP Bank.

At group level, all national economies experienced positive GDP growth in the fourth quarter, and we have every hope that in 2011 all the countries of the Bank Group will embark again on a path of growth.

At the same time, the crisis showed us that the strategy of regional acquisition that OTP launched in 2001 proved to be correct: the selection of appropriate business objectives and the consistent implementation of these goals helped us to effectively offset, with the help of other subsidiaries or business lines, the temporary inability of certain group members to generate profits. It's natural that during a crisis certain priorities should be re-evaluated: previously dynamic lending gave way to stricter cost control and risk management practices as well as the implementation of effective debtor protection programmes. Stable capital positions and secure liquidity were prized much more than previously. The results of the past three years indicate that overall, OTP Bank handled the challenges of the crisis successfully, without receiving any external help or taxpayers' money. The Bank did not curtail its lending activities during the crisis; quite the opposite – it made great efforts to step them up. Meanwhile, the Bank continuously maintained its profitability and improved its capital position, liquidity and market share. I'm happy to say that Standard & Poor's, the largest debtor rating agency, acknowledged this effort in its decision of 23 March 2011 to upgrade the previous "BB+" rating of OTP Bank and OTP Mortgage Bank to BBB- which is on a par with Hungary's sovereign rating.

Overview of the financial performance and business results of 2010

In 2010 the OTP Group realised HUF 162 billion in adjusted after-tax profit, which is 7% higher than in the previous year. If we take into account the total HUF 29.5 billion in net special tax on financial institutions paid by the Hungarian group members and the impact of the HUF 15 billion goodwill write-off in Montenegro, the annual accounting profit was HUF 118 billion, which is 21% less than in 2009. In addition to the absolute amount of the profit, the contribution to the profit by the foreign subsidiaries also improved considerably: compared to the HUF 24 billion loss in 2009, the foreign subsidiaries produced HUF 17 billion in after-tax profit in 2010 on an annual basis, which played

a significant role in offsetting the negative impact of the special bank tax in Hungary and the drop in domestic profits. The profitability of the Bank Group remained stable despite the crisis; the return on equity (ROE), adjusted for the bank tax and the goodwill write-off, is close to 13%, which, compared to our regional competitors, is an excellent achievement. We should note that on the basis of the stress test that was performed by the Committee of European Banking Supervisors (CEBS) in the summer of 2010, the OTP Group was ranked the second most stable bank in Europe.

In 2010 the Group's operating profit, adjusted for individual items, stood at HUF 436 billion, which corresponds to an annual growth of 6%. In an extremely positive development, the consolidated revenue margin (8.08%) improved by 15 basis points, while the net interest margin remained at virtually the same level on an annual basis (6.16%). Operating costs in the past year grew by a mere 1%, which – considering the frequently 5% or higher inflation at group level and the weakening of the average forint exchange rate on a annual basis – is indicative of sturdy cost control. The operating cost/average assets indicator (3.62%), which is a good indicator of the efficiency of operation, improved in comparison to 2009. Drastic cuts in headcount or the closing of branches was not necessary in the subsidiaries other than that in Ukraine, which suffered significant setbacks in retail lending.

One of the negative effects of the crisis was the deterioration in the financial position of borrowers and consequently of the quality of loan portfolios. The ratio of loans that are more than 90 days overdue reached 13.7% within the total loan portfolio. However, the annual rate of deterioration diminished: while from 2008 to 2009 the indicator grew by 5.3%, it only increased by 3.9% in the past year. Risk costs continued to grow even in 2010 and reached HUF 273 billion. This amount is some HUF 200 billion higher than the "normal" amount before the crisis. At the same time, it is a positive development that the coverage by provisions of defaulting loans improved (74.4%). We believe that the normalisation of risk costs points to the likelihood of a significant increase in the Group's profits and a gradual decrease in the risk-cost rate over the coming years.

Another negative impact of the crisis was the significant drop in the demand for loans, which was indicated by stagnating and sometimes decreasing volumes. We consider it a considerable achievement that we managed to bring a halt to this process, and starting from the second half of 2010 the loan portfolio, if adjusted for exchange rates, began to grow. The deposit portfolio, adjusted for exchange rates, remained virtually unchanged on an annual basis. The consolidated net loan/deposit indicator (110%) improved by 5%.

Within the Bank Group, the adjusted profit on operations in Hungary fell by 20% on an annual level in 2010 and profits including the bank tax and the effect of the goodwill write-off fell by 44%. We should note that in Hungary the OTP Group paid an enormous amount, a total of HUF 41 billion, in extra bank tax in 2010 to the Hungarian budget in the context of its social solidarity contributions. In addition to this and the negative impact of the goodwill write-off the Bank implemented promotional interest rate cuts for 2010 to diminish the repayment burden on foreign currency mortgage borrowers, which also had a negative impact on profits. Another important factor for profits was the roughly 60% increase in risk costs compared to 2009 as a result of the accelerated deterioration in the portfolio. However, in contrast with 2009, when the overdue loan portfolio was the result of the deteriorating macroeconomic environment, in 2010 the portfolio deteriorated primarily owing to the considerable weakening of the forint compared to the Swiss franc. In the context of the debtor protection programme that was launched in 2009, by year-end 2010 OTP had entered into a mutual agreement with approximately 50,000 retail customers who were having serious payment difficulties, thereby providing a temporary solution for the most difficult period of the crisis.

Although the Bank had to carry the burden of the bank tax in addition to the serious negative effects of the past three years of the crisis, it never abandoned its intention to increase its lending activities despite the crisis and thereby to help launch the Hungarian economy on a path of sustained growth as soon as possible. In the area of home and mortgage loans the Bank increased its new placements by 60%, considerably

increased its market share from 15% to 29% by year-end 2010 and acquired an approximately 50% share in personal loans. The Bank's performance in corporate lending is even more outstanding: in its micro and small-enterprise lending it exceeded the 5% growth it achieved in 2009, increasing its portfolio by 7% over the past year, while lending to medium-sized and large companies expanded by 1%. This is especially remarkable if we consider that in 2010, the corporate lending market contracted by 7% overall. In addition, the Bank's market share in the area of retail savings remained stable in the past year, which is also an excellent result. In 2010 Fund Management realised a HUF 7.5 billion after-tax profit, while assets under management grew by 21% and the company retained its market leading position with a share of some 33%. The HUF 4.1 billion negative result of the Merkantil Group was primarily caused by an increase in the costs of risk and the deteriorating domestic market environment.

One of the most positive developments in 2010 was that the performance of the Russian, Bulgarian and Ukrainian businesses, which are decisive in terms of the consolidated profit position, was excellent. The aggregate after-tax profit of the three subsidiaries, that together represent 30% of the Bank Group's loan portfolio, was HUF 48 billion, which corresponds to 30% of the consolidated adjusted profit. The after-tax profit of the Russian subsidiary, owing to carefully planned and executed business policies and more favourable macroeconomic conditions, grew considerably, more than six-fold. The HUF 20.5 billion profit is the result of continuous improvements in the net interest margin (14.3%) owing to the profitability of retail consumer loans and the stable risk cost rate (5.6%). Within retail consumer loans, consumer goods loans grew by 58%, card loans by 73%, and personal loans by 124%.
The improvement in profits was also extraordinary in Ukraine where, owing to a significant reduction in risk costs, the subsidiary, after an approximately HUF 44 billion loss in 2009, realised HUF 9 billion in profit in 2010 and corporate lending started to grow again in the second half of 2010. While the credit portfolio, adjusted for exchange rates, fell, the volume of deposits grew by 4% and, as a result, the bank's net loan/deposit ratio improved even further (283%).
The profit of the Bulgarian subsidiary, despite a considerable increase in risk costs, was stable, and exceeded HUF 18 billion. Owing to a carefully planned deposit pricing policy, the bank's interest margin improved. The bank's cost efficiency continues to be excellent; its 36.1% cost/income ratio is the lowest in the group.
As far as the performance of smaller subsidiaries is concerned, only the Croatian bank had positive results, while the Slovakian, Serbian, Romanian and Montenegrin subsidiaries sustained losses to varying degrees. This was primarily the consequence of the deteriorating quality of the portfolio caused by the unfavourable operating environment and the dramatically increased risk costs since the improvement of the operating profit was remarkable in the case of several banks.

We believe that the performance of the foreign group members will continue to improve in 2011, and we expect an outstanding increase in profits from our Russian bank. The OTP Group is present in nine countries, and in 2011 we expect improvements in the economic and operating environment in each country, the positive effects of which will probably be apparent in the performance of the banks as well.

As a bank that plays an influential role in the Hungarian banking system, the OTP stock price closely correlates with Hungary's perception in the market because its possibilities and performance are largely defined by the macroeconomic environment. Although a country's perception is a lot more than what is reflected in a CDS-spread, for example, the correlation between the Bank's share price and the Hungarian sovereign risk premium is telling. In the spring of 2010 the OTP share price stood at HUF 7,400 while the Hungarian CDS spread fell below 200 bp. But it's not only the absolute value of the share price that is indicative; in comparison with its regional peers OTP Bank was the only bank whose share price reached and even exceeded the pre-crisis level. However, after 25 March, owing largely to negative developments and investor skittishness related to the eurozone and, to a lesser extent, to the market's lack of confidence in the economic policies of the new Hungarian government, the share price fell significantly, and reached a low point at HUF 4,500 at the end of August, while the CDS spread climbed to nearly

400 bp. Finally, after a closing price of HUF 5,456 in 2009 the share price stood at HUF 5,460 at the end of 2010.

Since taking office in May 2010, the government has taken or announced several measures that clearly point in the right direction and in the mid-term aim at setting the country on a long-term sustainable growth path through structural reforms and at the same time at gradually reducing the fiscal deficit and the national debt in proportion to GDP. Owing to the changes in taxation, a drastic cut in spending and other structural reforms, the Hungarian economy will likely be able to catch up with the other countries of the region. A few measures, such as the bank tax which is exceptionally high even by European standards, will naturally have a negative effect on the Bank's profits, but we understand that it serves the purpose of strengthening the country's financial stability.

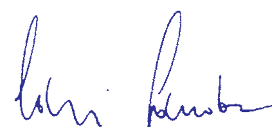
Besides contributing fully, by means of its liquidity and capital strength, to energising domestic retail and corporate lending, the Bank demonstrated corporate responsibility in other areas as well. In addition to the debtor protection programme and the interest reduction measures mentioned above, the Bank gave HUF 500 million last year to help the victims of the summer flood that caused tremendous damage and an additional HUF 100 million to the victims of the red sludge disaster in the fall. Furthermore, in December 2010 the Bank forgave the debt of 40 customers who were in an exceptionally difficult situation and in the case of close to 50 other customers the Bank agreed to pay the monthly instalments for the customers on a temporary basis.

OTP Bank's professional achievements and fundamentally excellent performance has been acknowledged by the international press for years: in 2010 Global Finance selected OTP Bank as the best bank in Hungary for the 13th time, and the Bank was awarded the title of Bank of the Year by financial journals such as The Banker, Euromoney and EMEA Finance. In addition, The Banker named OTP Private Bank as the financial institution that offers the best private banking services in Hungary and Ukraine. In Bulgaria, DSK Bank was chosen by The Banker as Bank of the Year, and Finance Central Europe awarded it the title of Best Bulgarian Bank of the Decade. These acknowledgments are important for us because they confirm that our Bank was extremely successful even during the crisis and they reassure our retail, corporate and municipal customers that they have selected the right partner to help manage their finances.

Now that we have navigated through the crisis successfully, we are optimistic about the year ahead. We have the necessary stable capital and liquidity. Our proposal to pay dividends reflects the conviction of the management that the Bank Group's countries have put the worst of the crisis behind them and risk costs will soon start to fall. But at the same time there are still serious risk factors around, and the regulatory requirements have become stricter, which means that the Bank has lower than optimal leverage. Consequently, dividend payments will also be moderate.

With the easing of the crisis the Bank will focus on balanced growth, and owing to its excellent capital strength it may be capable of performing new regional acquisitions, especially in those markets where business size is less than optimal. Central and eastern Europe is recovering from the crisis at a pace that is faster than expected, partly owing to the fact that the region's financial system was relatively resilient, it required virtually no external capital injection and the national debt is significantly lower than in developed countries, and both decision-makers and societies at large agreed to accept painful but necessary structural reforms. Consequently, the long-term prospects for the region are good.

I am convinced that the Bank Group passed a difficult test with flying colours in the face of the extraordinary challenges of the economic and financial crisis and this will provide a foundation for remaining the leading services provider in Hungary and one of the most influential ones in the region. We have shared the difficulties in the past and I hope we will share successes in the future. The management and the employees of the Bank will be working with this objective at the fore.



Dr. Sándor Csányi
Chairman & CEO

Macroeconomic and financial environment in 2010

MACROECONOMIC AND FINANCIAL TRENDS IN HUNGARY

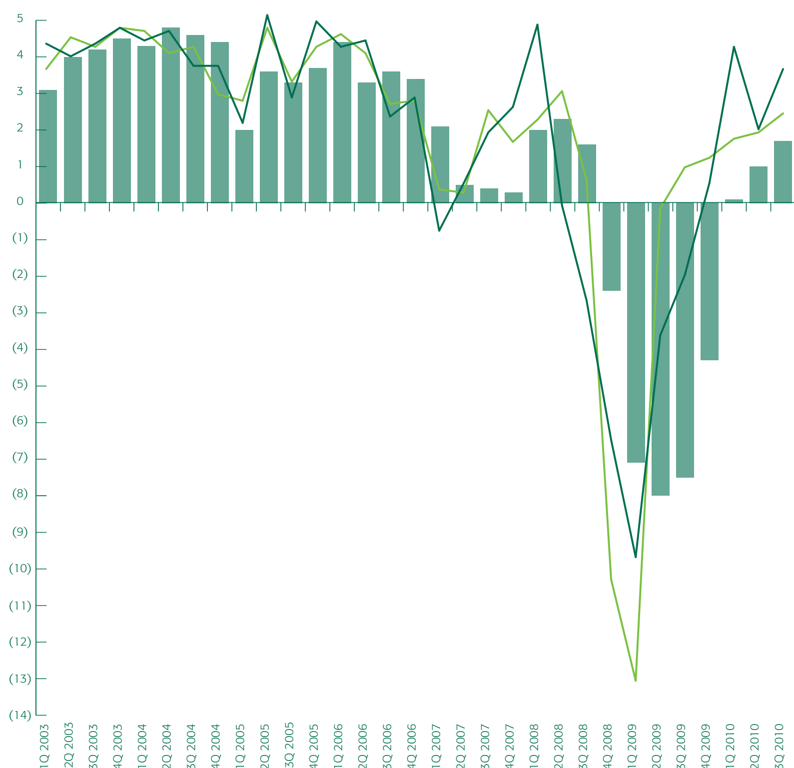
In 2010 the Central and Eastern European region began its recovery, following the major downturn of 2009. By spring 2010, in most countries of the region the balance-of-payments adjustment programs had come to a halt or slowed considerably, and the foreign demand stimulated by the upswing in recovering developed markets had a favourable impact on the performance of export-driven economies. This, after the slump of 2009, led to GDP growth in the majority of the countries, although domestic demand – consumption and investment – continued to contract in most countries.

After the weak performance of 2009, in 2010 Hungary came halfway up the rankings for the region in terms of growth, with a 1% expansion in real GDP. Domestic demand continued to have a negative effect on growth: household consumption fell by 3.2% and investments by around 3%. However, owing to the re-emergence of foreign demand, export expansion of more than 10% (10.7%) helped to push the overall rate of growth into positive figures.

Based on the central budget balance it appeared likely that the 3.8% target deficit for 2010 had

Changes in real GDP

Annual growth of GDP
Quaterly growth of GDP – annualized (HCSO)
Quaterly growth of GDP – annualized (OTP)



been achieved; however, based on the preliminary financial accounts of the National Bank of Hungary (MNB), the public sector borrowing requirement of the fourth quarter (excluding MNB transactions) was 4.4% in 2010.

The income positions of both the corporate and household sectors developed unfavourably again in 2010. The rate of growth in nominal gross wages (2.4%) lagged behind inflation (4.9%), with the result that gross real wages fell by 2.4%. Although the unemployment rate rose from 10.0% to 10.9%, this was primarily due to an increase in the activity rate, while the number of employed actually rose. Overall, the available nominal income of households increased by 1.5%. In real terms, however, this actually represented a 3.2% decrease. Besides the lack of domestic demand, companies were also hit by sector-specific special taxes (on the financial, energy, telecom and retail sectors).
Inflation remained above the central bank's target, averaging 4.9% over the year as a whole; but in the last quarter the base interest rate, which had stood at 5.25% since April, was raised in November and December (and also in January of this year) by 25 basis points on each occasion, before the inflation data for January was judged sufficiently favourable to end the cycle of interest rate increases.

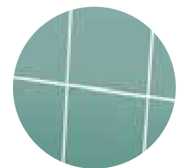
Bank activity continued to be weak in 2010, on both the demand and the supply side. Due to the deterioration in the asset portfolio and the special tax levied on banks, in all likelihood the Hungarian bank sector will have made a loss in 2010. In the third quarter the bank sector sustained a loss of HUF 60 billion (without OTP, the loss would have been almost HUF 90 billion). In the first half of 2010, based on balance sheet total some 20% of the bank sector was loss-making, but due to the bank tax payable in the second half of the year this proportion is almost certain to have risen since then. In order to

stabilise their capital position, those banks that had become loss-making were forced to cut back on their credit offerings. As a consequence of this, lending activity in Hungary fell behind that of other countries in the region, and even at the end of the year retail and corporate net credit flows were in the negative range.

Macroeconomic and financial trends in the countries of OTP Bank's foreign subsidiaries

Trends similar to those observed in Hungary also played out in the other export-driven countries of the region, with growth mainly assisted by the resurgence in external demand. Besides this, Ukraine and Russia also witnessed a recovery in domestic demand, while Slovakia only witnessed a slight decline, which also led to higher overall growth in these countries, coming in at around 4%. The worries that had arisen in several developed countries regarding the high level of state debt and the unsustainable trend in public borrowing did not materialise in most of the region's countries, due to their low ratios of state debt to GDP.

Retail loan portfolios, which had typically stagnated or declined in 2009, did not grow by any significant extent last year either, but in several countries the penetration-to-GDP ratio did increase. In Hungary this only occurred as a result of the revaluation of Swiss franc-denominated loans, which was an important factor in Serbia too, alongside government loan subsidies. The rise in penetration in Slovakia, however, was clearly due to the positive flows.



Bank sector retail loans as a percentage of GDP