

Credit Rating Announcement

28 November 2023

Scope affirms OTP Bank's BBB+ issuer rating and changes the Outlook to Stable from Negative

The change in Outlook reflects the ongoing resilience of the group's operating performance and the declining exposure to Hungarian sovereign risk.

Rating action

Scope Ratings GmbH (Scope) has today affirmed OTP Bank nyrt.'s issuer rating of BBB+, changing the Outlook to Stable from Negative.

Scope has also affirmed the ratings on the following debt categories and changed the Outlook to Stable from Negative:

- Senior unsecured debt rating of BBB+
- Senior unsecured (subordinated)¹ debt rating of BBB
- Tier 2 debt rating of BB+

Rating rationale

The change in Outlook to Stable from Negative is driven primarily by the resiliency of OTP's operating performance. In the first nine months of 2023, the group reported a very high return on equity (32.8%, 29.8% net of one-offs), well above the inflation rate in Hungary. Excluding the effect of acquisitions, revenues grew more than operating expenses on the back of widening spreads, greater volumes, and higher fees. The net result benefitted from a cost of risk close to zero thanks to low default rates and the release of impairment reserves accumulated during the pandemic. Management expects continued strong operating performance in 2024, although it has not provided explicit guidance.

The rating action also considers the group's growing international footprint, with Hungarian exposure accounting for a declining share of both revenues and assets (less than 40%). This reduces OTP's exposure to country-specific risks, including sovereign risk. As of September 2023, the group had a concentrated, yet manageable, exposure to the Hungarian sovereign; the domestic bond portfolio accounted for less than 80% of the group's CET1 capital and had an average maturity of around three and half years.

OTP's ratings are based on the group's resilient business model, with a dominant market position in Hungary and a high degree of geographic diversification. Broad geographic diversification counterbalances the moderate volatility in the group's Hungarian operations and provides higher margins and opportunities for

growth in less developed banking markets. In 2023, the group entered the Uzbek market by acquiring Ipoteka Bank, the country's fifth largest financial institution.

The ratings also consider OTP's appetite for further acquisitions. Scope acknowledges the group's strong execution record and the boost these acquisitions provide to OTP's growth. Nevertheless, acquisitions, especially when there are many, also pose potential risks.

The 'developing' long-term sustainability assessment reflects the group's ongoing efforts in the ESG and digital areas (ESG factor). Following the pandemic, the group has increased its digitalisation efforts, aiming to provide market-leading digital solutions and to increase group-wide efficiency. The group has also launched an ESG strategy which contains interim goals for 2025. Scope notes that regarding ESG matters, the group may face increasingly higher expectations and stricter regulations as it becomes a larger and more relevant player in the euro area.

OTP exhibits superior earnings generation compared to national and international peers. Profitability is driven by comparatively high interest margins and economic growth in the CEE region, as well as by the group's market power in most of the countries in which it operates. From 2016 to 2022, its return on equity averaged around 16%.

Scope expects the group to continue delivering excellent results. There are nevertheless several downside risks that could impact OTP's earnings, including further government interventions, higher-for-longer inflation and interest rates, and spillovers from geopolitical issues affecting public confidence, the economy and financial markets.

As of Q3 2023, the group's Stage 3 loan ratio stood at 4.3%, a historical low. So far, high inflation, growing borrowing costs and the economic slowdown have not impacted asset quality. OTP has been able to reverse some of the provisions accumulated during the pandemic which were never used.

The highest non-performing loan ratios are recorded in Russia (14.6%) due to characteristics of the loan book, and Ukraine (22.1%), due to the war. Since the beginning of the conflict, the group has maintained operations in both countries, while reducing net intragroup funding, particularly towards its Russian subsidiary. The group has estimated that the capital impact of a disorderly exit from both countries would be minimal at 27 bps as of Q3 2023. However, Scope highlights that the presence in Russia remains a source of potential reputational and legal risks.

High capital buffers and a solid funding profile are additional strengths supporting OTP's ratings. Strong earnings generation allows the group to grow both organically and through M&A, while preserving healthy buffers to solvency requirements. Given the group's growth strategy, share buybacks and dividends are not a priority.

OTP is primarily funded through deposits thanks to its strong positioning in retail markets, especially in Hungary and Bulgaria. The group's subsidiaries are funded in their respective local currencies, minimising currency mismatches between assets and liabilities. Since 2022, the group has increased the issuance of bonds on international markets to fulfil its MREL requirements.

One or more key drivers for the credit rating action are considered ESG factors.

Rating-change drivers

The Stable Outlook reflect Scope's view that OTP's credit profile will remain stable in the next 12-18 months.

What could move the rating up:

- Evidence that the group's sustainability related efforts provide a competitive advantage compared to peers.

What could move the rating down:

- A material deterioration in the group's asset quality or earnings, which could stem from a recession in the CEE region.
- Erosion of the group's capital position, potentially due to significantly lower profitability and severe credit deterioration.
- A substantive increase in exposure to domestic sovereign risk, possibly from a materially larger portfolio of Hungarian government bond holdings

Overview of rating construct

Operating environment: Moderately supportive

Business model: Resilient

Initial mapping refinement: Low

Initial mapping: bbb-/bbb

Long-term sustainability (ESG-D): Developing

Adjusted anchor: bbb-

Earnings capacity and risk exposures: Supportive

Financial viability management: Comfortable

Additional rating factors: Neutral factor

Stand-alone assessment: bbb+

External support: Not applicable

Issuer rating: BBB+

1. This category includes debt statutorily issued as non-preferred senior.

Stress testing & cash flow analysis

No stress testing was performed. No cash flow analysis was performed.

Methodology

The methodology used for these Credit Ratings and/or Outlooks, (Financial Institutions Rating Methodology, 7 February 2023), is available on <https://scoperatings.com/governance-and-policies/rating-governance/methodologies>.

Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on <https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales>. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit

Rating performance report at <https://scoperatings.com/governance-and-policies/regulatory/eu-regulation>. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): <http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at <https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales>. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on <https://scoperatings.com/governance-and-policies/rating-governance/methodologies>.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.

The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, and Scope Ratings' internal sources.

Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting these Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.

Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and Outlooks and the principal grounds on which the Credit Ratings and Outlooks are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and/or Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and/or Outlooks are UK-endorsed.

Lead analyst: Alessandro Boratti, Senior Analyst

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The Credit Ratings/Outlooks were first released by Scope Ratings on 15 November 2021. The Credit Ratings/Outlooks were last updated on 6 December 2022.

Potential conflicts

See www.scoperatings.com under Governance & Policies/Regulatory for a list of potential conflicts of interest disclosures related to the issuance of Credit Ratings.

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bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

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