Message from the Chairman & CEO

DEAR SHAREHOLDERS,

I began my message last year with a cautiously optimistic statement, to the effect that the Central and Eastern European region, which is home to the OTP Group and accounts for its main market, was showing signs of recovery from the crisis. I am pleased to say that this assertion has been clearly borne out by the development of the macroeconomic indicators in 2011: GDP grew appreciably in every country, and the balance indicators also improved. At the same time it was also apparent that despite all the efforts being made, the global upturn was a fragile one, and that market and investor sentiment were prone to rapid and extreme changes. So under the present circumstances the main source of our optimism is that four of the 'seven lean years' are already behind us, so hopefully we are now past the halfway point.

It may be something of a cliché, but it is true that banking operations very accurately mirror the processes under way in the economy. The past four years have been about continuously meeting the challenges thrown up by the exceptionally rapidly changing regulatory environment.
We hope that decision-makers everywhere recognise the beneficial effect that a predictable economic environment has on business life, and the importance of engaging in dialogue with participants in the economy, and that accordingly the coming years will be about shared responsibility for resolving the tasks that lie ahead of us.

The effects of the global financial and economic crisis that began in 2008 continue to be felt today, albeit with varying intensity. This is precisely why I am so pleased and proud to report that the OTP Group is one of the few financial institutions that, despite all the difficulties, has retained its stable profit-generating ability, and possesses one of the highest Tier1 capital adequacy ratios in Europe, while its liquidity is secure and has improved steadily over the past few years.

On top of this, I also consider it a major achievement that our regional acquisition strategy has consistently fulfilled our initial hopes for it: the contribution of the foreign subsidiaries to profit has grown steadily, and this has effectively compensated for the fall in the profit of the Hungarian operation related to certain one-off items. Although it remains OTP Bank's firm intention to contribute with its capital and liquidity to satisfying the borrowing requirements of the domestic retail and corporate sectors, the short term prospects for growth in Hungary are limited, in contrast to the situation in some other markets.

Overview of the financial performance and business results of 2011

OTP Group achieved an adjusted after-tax profit of HUF 161.4 billion in 2011, which was slightly short of the previous year's figure. If we take into account the net HUF 17.7 billion impact of the goodwill write-offs relating to the Croatian, Serbian and Montenegrin subsidiary banks, the HUF 29 billion in special bank tax paid by the Hungarian members of the Group, and the HUF 33.6 billion loss realised on the early repayment of foreign currency mortgage loans at a fixed exchange rate in Hungary (HUF 31.6 billion of which was recognised in the 2011 accounts), the annual accounting profit was HUF 83.8 billion, which is 29% less than in 2010. The drop in accounting

profit was effectively due entirely to the loss incurred in 2011 on the early repayment of foreign currency loans, since the other adjustments unrelated to the early repayment scheme – the bank tax and goodwill write-offs – remained at approximately the same level as in 2010. In an exceptionally favourable development, the decline in performance in Hungary was effectively compensated for by the growth in the foreign subsidiary's share of profit: while in 2010 our foreign subsidiaries generated close to HUF 17 billion, in 2011 they contributed more than three times this amount, at HUF 51.3 billion, ensuring that the Group's consolidated adjusted result remained essentially unchanged from the previous year. The Bank Group's profitability has remained consistently stable throughout the crisis; the adjusted return on equity (ROE) was 11.8%, which can be regarded as excellent by international standards. Based on the stress test performed by the European Banking Authority (EBA) in the summer of 2011, OTP Group proved to be the third most stable bank in Europe.

The Bank Group's operating profit excluding one-off revenue items was HUF 436 billion in 2011, which exceeds the figure for the previous year by 1%. It is exceptionally positive that despite its already high value (8.12%), the consolidated gross margin, improved further (+9 basis points), and within this figure, the net interest margin (6.31%) grew by 15 basis points at annual level. Operating costs rose by 6% in the past year, which was primarily due to the Russian and Hungarian operations, although the strengthening of collection activity and the weak forint were also contributing factors. As a consequence of this, the operating costs/average assets ratio (3.76%) deteriorated slightly. As part of the network rationalisation drive, relatively large-scale branch closures took place in Ukraine, while the employee headcount increased significantly at Group level due to the dynamic consumer lending activity in Russia and Ukraine.

A negative side-effect of the economic crisis and the process of financial consolidation is that the rate of deterioration in loan portfolios continues to be substantial. The proportion of loans more than 90 days past due rose to 16.6% at Group level; however, the rate of deterioration is slowing from year to year. Another favourable development is that non-performing loan formation, adjusted for foreign exchange rates, shows a downward tendency, and in 2011 total risk cost fell by 11% year on year. During the crisis, the Bank Group consistently pursued a prudent provisioning policy, and as a result the provisioning coverage of bad loans improved by 2.3 percentage points on a year-on-year basis, increasing to 76.7%.

Although the Bank's capital and liquidity position theoretically permit more active lending, owing to the fact that the crisis has made customers more cautious, and due to the fall in demand, the consolidated loan portfolio, adjusted for foreign exchange rate changes, shrank by 2% in 2011. The loan portfolio was also negatively impacted by the scheme allowing the early repayment of foreign-currency mortgage loans at a fixed exchange rate in Hungary, an opportunity that was taken by almost 20% of OTP customers, with the volume of these prepayments amounting to HUF 217 billion. Of this, a HUF 110 billion negative impact on the volumes was already reflected in the 2011 year-end balance sheet. Adjusted for foreign exchange rate movements, deposits grew by 1%, and as the combined effect of this and the factors described above, the Bank Group's net loan-to-deposit plus retail bonds ratio went down to 104%.

Within the Bank Group, in 2011 the adjusted profit of the Hungarian operations was 22% lower than the result of the previous year. The profit figure including the impact of the bank tax, the goodwill write-offs and the early repayment of foreign currency mortgage loans in Hungary, however, fell by a significantly greater extent than this. The decrease in profit, which was strongly influenced by these one-off items, was offset to a certain extent by an 11% decrease in the cost of risk in 2011. The quality of the portfolio continues to show a worsening tendency, as the proportion of non-performing loans reached 13.6%, and the quality of mortgage loans witnessed an especially marked deterioration, partly due to the early repayment of FX mortgages by customers with good payment discipline.

Despite all of the Bank's efforts, apart from the growth in the micro and small business segment, a fall was observed in the case of the other segments. Although the market shares achieved in terms of new sales are extremely impressive

(mortgage loans: 29%, personal loans: 50%), the disbursed volumes declined in year-on-year terms.

Among the important subsidiaries in the Hungarian group, OTP Fund Management realised an after-tax profit of HUF 3.3 billion, which is less than half the 2010 figure. The substantial fall in income was partly due to the state takeover of private pension fund assets, and partly a consequence of the statutory reduction of the asset management fees. Merkantil Group once again realised a profit in 2011: the bulk of the HUF 2.2 billion in after-tax profit can be attributed to a 34% decrease in the cost of risk.

Due to a combination of the regional acquisition strategy pursued last year, the focused utilisation of resources and a quick response to market opportunities, the foreign subsidiaries' contribution to the consolidated after-tax profit has grown steadily, and in 2011 some 32% of the generated adjusted profit originated from abroad.

The Russian subsidiary bank doubled its 2010 profit on the back of an outstanding, 61% expansion in retail consumer loans. All the profitability and efficiency ratios improved, besides which the bank maintains its stable position in the market for consumer goods financing loans. The Bulgarian subsidiary's HUF 12.7 billion after-tax profit was 30% short of the previous year's figure as a result of the substantial rise in the cost of risk; however, the bank's operating profit remains stable and indeed has improved, while its cost-efficiency is the best in the whole Group. The Ukrainian subsidiary's after-tax profit for the year was HUF 5.1 billion, with the 43% drop resulting from the higher cost of risk and the increased tax burden that resulted from a change in legislation; the pre-tax profit almost doubled. At the same time, the consumer goods financing business launched in March 2011 is growing dynamically and, due to this and the 12% expansion in the corporate portfolio, the several-year decline in loan volumes finally came to an end.
The combined loss generated by the smaller subsidiary banks decreased significantly in parallel with the stabilisation of the operating environment; the aggregate HUF 31.5 billion negative profit figure of 2010 improved to HUF 11.2 billion. Within this figure, the Croatian subsidiary continued to produce a positive after-tax result and the Romanian subsidiary was profitable again, while the Slovakian, Serbian and Montenegrin subsidiaries realised losses that, while differing in degree among the individual banks, were nevertheless smaller than those of 2010.

In 2012 substantive credit growth is expected primarily in the case of Russian and Ukrainian consumer loans, as well as in respect of Hungarian corporate placements, specifically in the agricultural sector. The gross margin should remain stable at Group level, but in Hungary it is expected to narrow. As the leading financial institution in Hungary's banking system and the most liquid stock on the Budapest Stock Exchange, the price of OTP shares correlates closely with the market's perception of Hungary, and accordingly in recent years the share price has been less indicative of the Bank Group's fundamental performance and much more a reflection of the steady worsening in investor perception of Hungary's sovereign risk. At the end of 2011 the closing price of OTP shares was HUF 3,218, compared to HUF 5,020 a year earlier.

At the end of 2011 the Hungarian prime minister announced that the country would resume negotiations with the IMF/EU, with a view to reaching a future credit agreement. Overall, the markets reacted positively to the news, and in the first two months of 2012 the forint was one of the best-performing emerging market currencies, and all this had a beneficial effect on OTP's share price too. The prospects for further improvement are largely dependent on whether an agreement is reached with the European Union regarding a number of Hungarian statutory provisions that have been criticised, and on the adoption of a predictable economic policy that even after the phasing out of the crisis taxes – including the highest bank tax ever seen in Europe – can ensure a public finance deficit of less than 3% and a sustainable reduction of the state debt underpinned by structural measures. I firmly believe that the Government is committed in this respect, and will do everything it can to reach agreement with the IMF/EU as soon as possible.

In what was clearly a positive development for the bank sector, in December 2011 the

Government and the Banking Association came to an agreement on the complex management of the existing problems associated with retail foreign currency mortgage lending. As a part of this, the two parties succeeded in drawing up a relatively long-term solution that not only reduces customers' payment obligations in a predictable manner, and could even improve the quality of the banks' loan portfolios, but also shares the resulting burdens over the long term between the customer, the Government and the banks.

One of the great lessons of the current crisis is that although the market players, the political decision-makers and regulators bear differing degrees of responsibility for the problems that have arisen, they can only be resolved jointly, through effective cooperation. Moreover, the alternative to relatively weak, loose regulation is not over-regulation. The measures implemented must not only deal with the problems of the moment, but must also put in place the frameworks for future sustainable growth.

For many years OTP Bank has taken on an active role in the promotion of corporate social responsibility. In addition to the retail debtor protection program, which is still available, it was the first to offer a solution to Hungarian municipalities for the management of their increased foreign currency debt burdens. Besides this, every year it makes a substantial contribution to financially supporting the Hungarian film industry and other branches of the arts, and spectator sports.

OTP Bank's outstanding professional achievements were acknowledged through numerous awards from the international financial press: Global Finance named OTP best bank in Hungary for the 14th time, and it has also earned the title of Bank of the Year from the financial periodicals The Banker, Euromoney and EMEA Finance. In addition, the Banker once again named OTP Private Banking the best private bank in the region. The Bulgarian subsidiary DSK Bank won the Global Finance Bank of the Year award in 2011. The stream of accolades not only confirms that we are on the right track, but also obliges us to continue providing our customers with reliable, excellent quality services in the future as well.

The year 2012 will not be an easy one: the economic and financial consequences of the crisis are placing heavy burdens on society, while its capacity to bear them is finite. The year 2012 will be about gradual consolidation, and not a quickening of growth. The problems of Europe, specifically those of the eurozone, indicate that new methods need to be applied – methods that not only enable the equilibrium problems to be effectively managed but that help establish the conditions required for future growth. Although the Central and Eastern European region has been severely affected by the capital and liquidity problems of the Western European banks, the region has fundamentally succeeded in meeting these challenges.

In this situation I believe that the various strengths that have been built up by the Bank Group over the past years – such as efficient and profitable operation, strong capital and stable liquidity – are now of greater value than ever, and at the same time provide an opportunity, through the efficient allocation of resources, to prepare for more dynamic growth in the future. Since increasing capital strength to a secure level was one of our key priorities regardless of the regulatory expectations in this regard, for years the Bank did not pay dividends to its shareholders. In respect of the 2010 financial year, however, more than HUF 20 billion was paid out in dividends, and I am hopeful that the dividends paid in respect of 2011 will be greater still. Naturally, we continue to seek out attractive targets for acquisition, since our ultimate purpose is to ensure the most efficient return on equity, and to continuously increase shareholder value.

For this I ask you for your support and trust, and from my colleagues, the same dedication that has helped the Bank to remain consistently profitable despite the crisis, and to maintain its outstanding market position and reputation.

Dr. Sándor Csányi
Chairman & CEO

Macroeconomic and financial environment in 2011

MACROECONOMIC AND FINANCIAL TRENDS IN HUNGARY

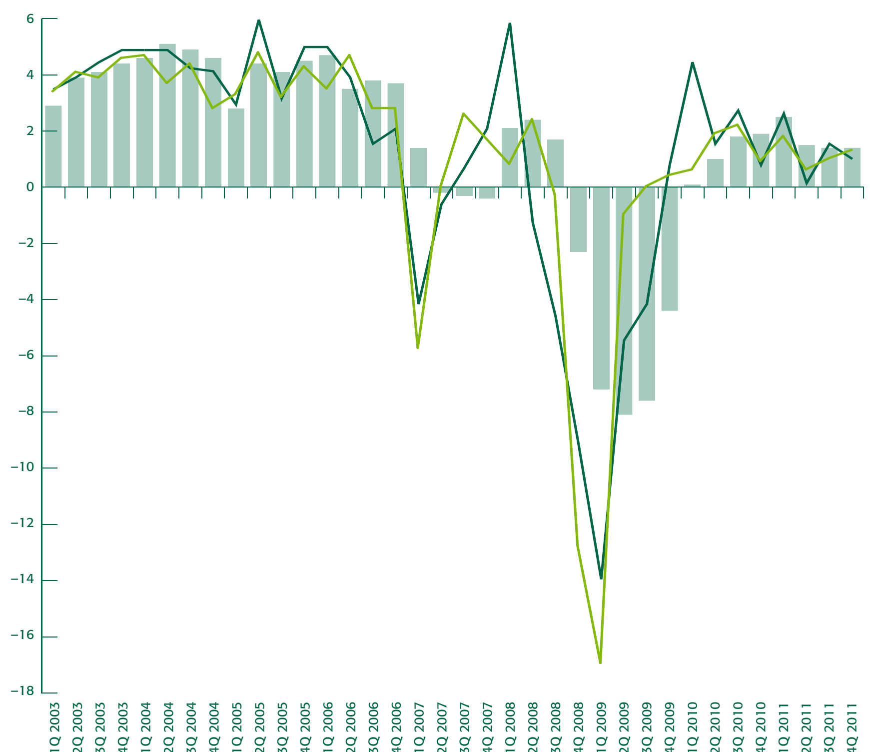
In 2011 the Central and Eastern European region continued its recovery following the major contraction of 2009. The performance of the export-driven economies generally continued to benefit from external demand, and there was real GDP growth even in the region's countries where economic growth had still been negative in real terms in 2010 (Romania, Croatia).

Although following on from a weak performance in 2009, Hungary was still roughly mid-field in the regional rankings in 2010, in 2011 we were once again bringing up the rear, with GDP growth in real terms of just 1.7%. Internal demand still made a negative contribution to growth: retail consumption stagnated, while capital expenditure fell by 5.4%. Last year, once again, it was external demand that helped push the change in real GDP into positive territory, through a 8.4% expansion in exports.

The public finance balance closed with an approximately 3.5% surplus in 2011. The positive balance resulted from the fact that the accumulated assets of private pension fund members returning to the state system (9.7% of GDP) appeared as a one-off revenue item in the budget. Without the revenue from pension assets and other one-off items (VAT rebate due to the decision by the European Court of Justice, capital injections for the state railway MÁV, national airline MALÉV and the Hungarian Development Bank,

Changes in real GDP

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



as well as sector-based special taxes), the public finance deficit could have been higher than 5%.

In 2011 there was a slight improvement in the income position of households. The rate of increase in nominal gross wages (3.3%) fell short of inflation (3.9%), and thus gross real wages decreased by 0.6%, but the number of employed rose by more than 30,000, while the unemployment rate declined from 11.2% to 10.9%. As a consequence of the reduction in personal income tax, nominal household disposable income rose by 6.4%, which represented a 2.4% increase in real terms. Companies, however, besides having to contend with a lack of internal demand, continued to be burdened by various sector-based special taxes (levied on the financial, energy, telecom and retails sectors).

Inflation remained above the central bank's target, averaging 3.9% over the year as a whole. The base interest rate remained static at 6% for almost the entire year, but at the end of the year it was raised in two stages, to 7%, after the forint weakened for a sustained period to a level of over 300 against the euro.

Bank activity continued to be weak in 2011, on both the demand and the supply side. In addition to the special tax on banks, the net HUF 259 million (370 billion x 0.7) loss resulting from foreign currency loan redemptions made an additional capital injection unavoidable; the Western European parent banks have raised the capital of their subsidiaries by a total of around HUF 340 billion since the announcement of the scheme to allow loan redemptions at a fixed exchange rate. Despite the increase in capital, lending capacity – especially in the corporate sector – deteriorated considerably.

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

Exports, which had shot up in 2010, carried on increasing throughout the region (with the exception of Croatia), albeit at a slower rate than in 2010. Besides this, internal demand remained very strong in Ukraine and Russia (household consumption expenditure grew by 11.4% in Ukraine), and accordingly it was also here that GDP growth was the highest, at 5.2% and 4.3% respectively. In the majority of the countries the budget deficit also declined; however, in several countries a further correction is still needed.

With respect to the region as a whole, credit flow to households, which had declined by 0.1% in 2010, showed a 0.3% increase last year; but there was considerable deviation between the individual countries. While net new lending to households reached 2.8% of GDP in Russia and 2.4% of GDP in Slovakia, in Montenegro, Ukraine and Croatia, and in Hungary too, households repaid more credit than they received in the form of new loans. In the case of corporate loans, however, net new lending – as in 2010 – was again positive in most of the countries of the region, with Hungary and Montenegro once again the exceptions.

Bank sector retail loans as a percentage of GDP