

MBH Magyar Bankholding Ltd.

Consolidated report on business activities for 2020

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1. Overview of Magyar Bankholding Ltd.

On May 15, 2020 MTB Magyar Takarékszövetkezeti Bank Ltd. (MTB) and MKB Bank Plc. (MKB) signed a letter of intent to establish a joint financial holding company. On May 26, 2020 Corvinus International Investments Ltd. (Corvinus) and Budapest Bank Ltd. (BB) also joined the cooperation.

Based on the cooperation agreement the above named credit institutions formed a joint financial holding company named Magyar Bankholding Ltd. (henceforth MBH or the Company) with three equal shares of ownership.

Upon getting the license of Magyar Nemzeti Bank (Hungary's central bank), MBH started to exercise its ownership supervision function on December 15, 2020, after the dominant owners of BB, MKB and MTB transferred their shares into the joint holding company. This created the second largest banking group in Hungary, in which the Hungarian State has 30.35% share of ownership through Corvinus, the direct owners of MKB have 31.96% share of ownership, while the direct owners of MTB have 37.69% share of ownership.

At the end of 2020 the management of MBH was appointed and the elaboration process of the new financial group's five-year strategy, which takes into account the endowments of the three member banks (BB, MKB and Takarékbank, the latter as the universal commercial bank of Takarékgroup governed by MTB) and potential opportunities for synergies in the field of business and operations, has begun.

It is a prioritized task of the financial holding company to exercise prudential control and corporate governance over the three banking groups, as well as to lay out and execute the merger process intended to optimize the functioning of the three banks. The goal of the merger process, which started at the end of 2020 is to put the sustainable operation of the banking group on solid ground, exploit the synergies between the three banks to the highest possible extent, set the direction for future developments, and as a result to create one of Hungary's leading banks, which is among the most efficient, the most innovative and the most client-oriented financial institutions.

For the time being BB, MKB and Takarékbank retain their independent legal status, and will operate under separate brands until the merger process comes to its end.

The new banking group currently serves 1.4 million active household clients and 208 thousand active corporate clients. In numerous market segments MBH has a leading position. It has 925 network units nationwide, its total assets account to HUF 8424 billion on aggregate, the stock of client loans is HUF 3787 billion on aggregate and the stock of client deposits is HUF 5414 billion on aggregate.

2. The macroeconomic environment and financial markets in 2020

The economic developments of year 2020 in Hungary were heavily influenced by the coronavirus pandemic that unfolded from early March. Restrictions, aimed at minimizing human losses and avoiding the collapse of the health care system markedly reduced the level of economic activity. In the first wave of the pandemic it was not only the most directly affected services sectors, but also a good part of the productive sectors that came to a halt due to the sudden break-up of international and domestic supply chains.

Following the relatively successful protection against the first wave, with the pandemic recessing in early summer and restrictions gradually withdrawn, there was sharp correction in economic activity in the third quarter of 2020, supported by efficient fiscal and monetary policy responses, with which economic policy makers tried to dampen the extent of the economic setback and the loss of jobs as well as lay down the foundations for resuming economic growth. Despite all these efforts, the sharply forming second wave of the pandemic in the autumn together with restrictions reinstated almost pushed the most affected services sectors (tourism, entertainment etc.) to the verge of collapse again. At least, alongside elevated security proceedings the productive sectors proved to be resilient and performed at a level broadly similar to that of the same period of the previous year. GDP finally contracted by 5% last year, mostly due to sharply decreasing domestic demand, while the improvement in net export partly offset the extent of the recession.

Credit institutions were impacted by two opposing forces in the wake of the economic crisis that resulted from the pandemic. The freshly introduced credit moratorium and economic policy steps to keep up the dynamics of lending (among them relaxed banking regulations) lent support to the growth of credit, impairment and provisioning for expected future losses, however, led to a steep jump in risk costs. Due to the latter, the annual after-tax profit of the banking sector fell to less than half of 2019's HUF 500 billion. Although the dynamics of new loan disbursement markedly eased even despite the supportive economic policy / monetary policy steps, the stock of both household and corporate credit continued to increase substantially (at double-digit rates), owing to the repayment moratorium through the sharp decrease in amortization payments (close to 60% of household loans and 40% of corporate loans remained under the umbrella of the moratorium). The stock of deposits increased even more spectacularly, explained by both the foregone amortization payments and postponed consumption expenditures in the case of household deposits, while in the case of corporate deposits the abundance of loan programs at favourable conditions as well as state subsidies also contributed to growth alongside the repayment moratorium.

The expansionary monetary policy of the Hungarian central bank (which stretched its balance sheet total by 65% by means of securities purchases, offering long-term fixed rate loans to the banking sector and also enhancing the stock of foreign assets) created a liquidity boom in the financial markets. A major part of this liquidity surplus found its way into the central bank's deposit facilities, another part financed the lending activity and the securities purchases of the banking sector.

The central bank reduced the base rate in two steps to 0.6% in the course of the year, nevertheless, reacting partly to the marked depreciation of the Forint, it raised the interest rate on its one-week deposit facility to 0.75% in September (and went on to disburse covered long-term loans to the banking sector also at that rate), and hence short-term interbank rates also adjusted to this rate level. The Forint depreciated markedly, by almost 10% vis-à-vis the Euro during 2020.

3. Balance sheet and P&L developments for year 2020

As of December 15, 2020 the MBH started effective operation, but December 31, 2020 is considered the actual acquisition date. As a result of the acquisition the current year's consolidated statement of profit or loss and other comprehensive income includes the profit or loss and other comprehensive income of MBH and MTB Group. The previous year's comparative information in the financial statements represent the MTB Group.

3.1. Balance sheet structure (IFRS, consolidated)

At the end of 2020 MBH's consolidated total assets according to International Financial Reporting Standards (IFRS) amounted to HUF 8.388 billion. On the asset side, the most important item is financial assets measured at amortized cost (HUF 6,052 billion), including loans and advances. The value of the latter amounted to HUF 4,017 billion at the end of 2020. On the liabilities side, financial liabilities valued at amortized cost (HUF 7,643 billion) should be highlighted, which includes the stock of deposits amounting to HUF 5,406 billion at the end of the period. Total shareholders' equity amounted to HUF 558 billion at the end of 2020. In accordance with Point 11.1 of Chapter 2 of the investment and syndicate agreement, the cost of the investments of the three subsidiary banking groups measured at HUF 743 billion (the contribution value) was calculated as the mean value of the evaluation band determined in the evaluation report, which was prepared in the autumn of 2020 based on the consolidated business plan of the Company set up by EY, also taking account for synergy effects. The HUF 199 billion difference between the contribution value and the calculated costs of the three subsidiary banking groups is recorded as other reserves among equity items.

Table 1: MBH's balance sheet (consolidated data in HUF million)

	31 December 2020	31 December 2019
Assets		
Cash and cash equivalents	773 941	101 712
Financial assets measured at FVTPL	171 401	62 918
Financial assets measured at FVTOCI	1 064 428	394 973
Financial assets measured at AC	6 051 906	1 760 626
Other financial assets	2 949	3 119
Investments in subsidiaries, jointly controlled entities and associates	13 241	7 338
Property, plant and equipment	99 073	47 234
Goodwill	94 422	1 453
Intangible assets	54 511	6 587
Current income tax assets	1 900	318
Deferred tax assets	12 714	2 520
Other assets	45 905	15 439
Non-current assets held for sale	1 700	4 452
Total assets	8 388 091	2 408 689
Liabilities		
Financial liabilities measured at FVTPL	49 124	11 273
Financial liabilities measured at AC	7 642 768	2 254 876
Other financial liabilities	5 989	3 311
Subordinated liabilities	44 724	-
Provisions	13 040	9 428
Current tax liabilities	835	-
Deferred tax liabilities	2 117	1 867
Other liabilities	71 228	32 478
Liabilities associated with non-current assets held for sale	-	292
Total liabilities	7 829 825	2 313 525
Equity		
Share capital	56 400	3 390
Capital reserve	491 600	3 479
Accumulated other comprehensive income	(858)	12 034
Retained earnings	238 579	29 984
Reorganization reserve	(275 470)	-
Treasury shares	-	(3 212)
Non-controlling interests	48 015	49 489
Total equity	558 266	95 164

3.2. P&L developments (IFRS, consolidated data)

The Holding's pre-tax profit in 2020 was a loss of HUF 6.1 billion, while the after-tax profit for the current year was a loss of HUF 4.5 billion. The total comprehensive income in 2020 amounted to a loss of HUF 9.6 billion.

Table 2: MBH's P&L statement (consolidated data in HUF million)

	2020	2019
Net interest income	67 225	61 301
Net income from commissions and fees	50 361	52 147
Gain/(loss) on financial assets and liabilities	3 470	6 685
Impairment and provision for credit risk	(18 525)	7 593
Result of trading activity and fair value measurement	4 424	6 791
Other income/(expense), net	5 760	5 451
Operating expense	(115 290)	(135 862)
Net modification gain/(loss)	(4 025)	
Investments in subsidiaries, joint ventures and associates (impairment)/reversal of impairment	(1 457)	(26)
Share of jointly controlled and associated companies' profit	(2)	412
Gains or (-) losses on non-current assets and disposal groups classified as held for sale, non-discontinued operations	1 918	(109)
Profit/(loss) before tax	(6 141)	4 383
Income tax income/(expense)	1 613	(2 151)
Profit/(loss) for the financial year	(4 528)	2 232
Of which: profit of the owners of the parent company	(1 676)	12 944
Of which: profit of the non-controlling interests	(2 852)	(10 712)

Other comprehensive income	2020	2019
Other comprehensive income that may not be recognized in profit or loss in subsequent periods	(255)	2 350
<i>Change in fair value of equity instruments measured through other comprehensive income</i>	(309)	2 350
<i>Income tax on non-reclassifiable items</i>	54	-
Other comprehensive income that may be recognized in profit or loss in subsequent periods	(4 767)	4 932
<i>Profit/(loss) of hedging instruments recognized in equity</i>	2 051	(7 035)
<i>Other debt instruments at fair value through other comprehensive income</i>	(6 821)	12 173
<i>Income tax on items that can be reclassified to profit or loss</i>	3	(206)
Total comprehensive income for the year	(9 550)	9 514
Of which: total comprehensive income of the owners of the parent company	(6 595)	20 275
Of which: total comprehensive income of the non-controlling interests	(2 955)	(10 761)

4. MBH's business performance

Based on its total assets of HUF 8,388 billion, MBH was the second largest domestic banking groups in 2020, almost twice as large in size than the third largest banking group. The growth rate of its total assets was the most dynamic in the Hungarian banking sector, resulting mostly from active participation in central bank and government programs helping corporate clients and households, but the sharpest increase in the stock of deposits across the entire banking last year sector also reflects the strong confidence of clients towards MBH and its member banking groups.

4.1 Retail business activity

At the end of 2020 the members of MBH managed deposits for 1.6 million and loans for 650 thousand of clients. One in six forints of loans last year was managed by an MBH member bank. The Group has a major share in providing financial services for rural households.

In order to increase sales numerous campaigns were launched in 2020 by the members of MBH, with micro- and SME lending and account openings, households' mortgage loans, consumer loans and Baby-in-waiting loans as well as incentives for the sale of savings products being in the focus. Sales results in the wake of these campaigns vastly contributed to increases in the stock of mortgage and consumer loans as well as the stock of managed savings products.

MBH put special emphasis on home lending, it was also active in mediating the Family Home Creation Support product and extending loans associated to them. As for Baby-in-waiting loans, 18% of total placements in 2020 were accounted for by the Group.

MBH maintains the widest branch network: at the end of 2020 it had 929 units, roughly half of the total domestic network. The continuous access to financial services provided by branches, the smooth operation of cash circulation especially in smaller settlements was an important factor in the pandemic environment and posed a significant, but well-managed challenge for the member banks of MBH.

MBH provides wide-ranging Cafeteria services for its clients and employees. The servicing of one of the most important health funds and pension funds is also done by the Company, and the SZÉP Card (Széchenyi Recreation Card) product, which had special importance during the pandemic when tourism and hospitality services faced a crisis, is also available at the Group (with 230 thousand active users).

On securities accounts managed by the Group there is HUF 1,200 billion kept in the form of government securities. This is 13.4% of the total stock of government securities offered to households, which is made even more impressive by the fact that a large share of these papers are not held at banks but at the State Treasury.

4.2 Corporate business activity

With regard to its 21.3% market share MBH is the largest corporate lender in Hungary. MBH has a vital role in providing financial services needed for the growing business activity of domestic enterprises, and it also took its share in helping the corporate sector overcome the crisis.

30% of the contracted (and in most part disbursed as well) volume under the Funding for Growth Scheme refinanced by the central bank and available at very favourable conditions was mediated by the member banks of MBH (total demand from clients amounted to HUF 821 billion, of which HUF 702 billion was successfully contracted). The central bank awarded a prize for MBH in January 2021, as the largest mediator of FGS products.

The Széchenyi Card portfolio was enlarged with new products in 2020 and the volume of new disbursements sharply increased. With regard to Széchenyi Card products that were available before 2020 (Széchenyi Overdraft loan, Széchenyi Agrarian loan, Széchenyi Investment loan, Széchenyi Self-fund Supplementing loan, Széchenyi Pre-financing loan) MBH was a dominant market player by a market share of 73% (HUF 149 billion) in 2020.

It also acquire a substantial, 35% share (HUF 120 billion) in the placement of newly introduced Széchenyi Card products (Széchenyi Liquidity loan, Széchenyi Job Protection loan, Széchenyi Investment Plus loan).

MBH also secures the widest network of MFB Points; this translated into 474 venues in 2020. In a unique way, a separate Agrarian Division was formed by the Company to better serve agrarian clients.

The Group strives to serve its clients by the optimal financing solutions: it was the largest provider of leasing solutions by a 30% market share in 2020. Within this MBH is market leader in financing agrarian equipment (35% market share), cars (33% market share) and commercial vehicles (23% market share).

9.4% of total annual factoring turnover was provided by MBH's subsidiaries in 2020.

In the day-to-day servicing of the smallest municipalities financial needs the member banks of MBH are the most active (serving more than 1200 municipalities, 40% of the nationwide total), whereas MBH provides one-seventh of municipalities' loans from banks.

5. Human resources policy

During the second half of 2020 the top management of MBH was appointed. The work of the top management is supported by senior staff from the three member banks selected through internal applications in cooperation with international consultancy agencies.

As part of the merger process intended to optimize the functioning of the member banks, a dedicated team named "Targeted organizational and operating model" was set up at the end of 2020. The tasks of this team are to specify the organizational structure and headcount that secures the preparation and the execution of the future strategy, to identify pivotal employees, to select the MBH's middle management and experts, to harmonize/establish the strategic goals of the top management of MBH and that of its member banking groups, to develop the system aimed at keeping pivotal employees at MBH, to reconcile remuneration policies and compensation schemes in two phases, as well as to perform normal HR-related tasks for MBH.

6. The strategic goals of MBH

The MBH's goal is to establish a fully integrated, uniformly governed bank through the merger of the three member banks by the middle of 2023, which is going to build on the inevitable strengths of BB, MKB and Takarékbank all, just as their leading positions in various market segments. In the meantime, it will rise to face the challenges posed by rapidly changing customer needs, the unprecedented pace of technological developments, the intensifying competition or even the recent pandemic.

Major strategic goals, directions:

- The most client-oriented bank in Hungary, which has a favourable value proposition for all Hungarian citizens and corporate entities.
- Active contribution to the development of Hungary's economy by supporting the most prospective segments like young persons, SMEs and agribusinesses and by preserving the commitment towards local communities.
- The creation of the most up-to-date technological background and digital channels in banking environment within the CEE region.

- The widest branch network in Hungary even on a long-term horizon, which secures nationwide coverage and contributes to quality, value based servicing of clients by efficient functioning.
- Building an innovative organization and corporate culture, through which the staff can enjoy special attention and opportunities for continuous development of skills.

7. Corporate social responsibility

Being a socially responsible institution the Company donated HUF 1 billion to support the Government's anti-pandemic efforts in 2020. MBH also joined the "Jótett Bank" project initiated by the presidency of the Hungarian Banking Association, which aimed at a sector-level cooperation of credit institutions against the pandemic. The member banks of MBH are characterized by supporting sports and charitable activities, unique financial education and sustainable CSR programs. These also actively contribute to keeping the pandemic's adverse impacts under control.

8. Services provided by an audit company

According to the audit contract for 2020, the audit company's fee is HUF 40 million excl. VAT. Under the heading of other services Deloitte network charged MBH directly HUF 88.6 million excl. VAT, while indirectly (through subsidiaries) HUF 667 million excl. VAT. A major part of the latter will eventually be borne by the affected subsidiaries, who will be invoiced in 2021 and the following years.

9. Major post balance sheet day events

On March 24, 2021 MBH approved the five-year business strategy leading up to the merger of BB, MKB and Takarékbank. The bank thus created strives to become the most state-of-the art banking institution of Hungary, which introduces flexible, cutting edge digital solutions that are also competitive in an international context. The new 5-year strategy has no impact on the Company's financial statements for 2020 and does not contradict the investment and syndicate agreement in any way. With the integration of BB, MKB and Takarékbank Hungary's households and enterprises will be served by a unified credit institution from 2023, which aims to transform the traditional image of banks. MBH declared that alongside its newly adopted business strategy it is going to reinvest any profit realized on consolidate level into the running and development of the new banking group. The new large bank will operate the widest branch network even after the restructuring, it remains committed to serve the inhabitants of smaller settlements, and it will become a decisive market player through strong digital focus.

Following the emergence of the coronavirus pandemic a repayment moratorium extending to previously disbursed loan contracts was introduced on March 19, 2020. Originally, the moratorium was declared to last till the end of December 2020, but due to the prolonged state of the pandemic, the moratorium was extended by the Government till June 30, 2021 with unchanged conditions.

In May 2021, the Government announced the extension of the moratorium by further two months. The expected impact of the payment moratorium extension is assessed based on methods used in previous phases of the program, in addition to monitoring the customer's willingness to pay, monitoring customer account turnover, direct customer inquiries, targeted questionnaires and other published data. As a result, the necessary modification loss will be accounted for on the portfolios affected by the extended payment moratorium. Related regulations have not been published yet, however the Group is continuously examining the prospective effects of the payment moratorium.