



ANNUAL REPORT OF
MKB GROUP | 2018



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MANAGEMENT REPORT

MKB Bank has achieved remarkable development during the reorganization process since July 2016. The ownership structure of the Bank has changed, its capital position has been stabilised and the management has set the financial institution on a successful and profitable track. These changes have brought a considerable improvement in the Bank's general perception, its clientele has become even more stable and reliable foundations have been laid down for continued growth. Looking back, we can say that 2016 was the year in which the Group successfully embarked on its current growth path.

In addition to revitalising its conventional business divisions the Bank's development strategy comprises clear objectives in relation to its digital vision as well.

MKB Group managed to double its profit year-on-year, while successfully reducing its former non-performing portfolio in 2017. Number of customers grew, while its operation be-

came more efficient. The Bank harmonised its relationships with its subsidiaries and created new foundations for cooperating with them.

2018 saw the successful achievement of MKB Group's objectives under its strategy MKB2021, together with the performance of tasks relating to its commitments towards the EU. MKB Bank's successful digital transformation was unique in the Hungarian banking system but it also earned international recognition. The efficiency and effectiveness of the Group's operations is characterised by the fact that its profit increased considerably, exceeding the planned figures, even during the digital transformation period.

A predictable and favourable economic environment, historically record high GDP growth figures and growing retail borrowing equally contributed to the Group's generating business revenues exceeding the plan without an increase in its risk-related costs. Setting aside a certain group of (mostly one-off) items entailing operational cost increases, MKB's long term operational stability appears to be ensured. In addition to achieving business successes in 2018 MKB took a variety of actions contributing to the Group's successful



operations in the future: the branch network was rationalised and internal processes were made even more efficient.

MKB Group's sustainable development is now assured. Fulfilling the EU commitments will enable MKB Bank to be listed on the stock exchange in 2019 as an efficiently and effectively operating financial institution of a healthy structure.

MKB Group's stable and predictable performance and results were enabled by achievements such as the MKB Euroleasing Group's closing of the most successful year of its history, the outstanding international results of MKB Fintechlab as well as MKB Consulting's

and MKB-Pannónia Investment Fund Manager's performance according to their respective plans. MKB Bank's strategic partners, that is, the MKB Pension Fund and MKB-Pannónia Health and Mutual Fund also performed well.

MKB Group continues to make its best in 2019 to earn and strengthen the trust and confidence of its partners and customers, by its day-to-day operation and developments.

On behalf of MKB's Management

dr. Ádám Balog
Chairman & CEO

¹ Bank = MKB Bank, Group = companies included in MKB Bank's consolidated statements, Strategic collaborators and partners = companies cooperating with MKB Bank based on shared objectives

² Commitments comprised in the Restructuring Plan approved by the European Commission.

STRATEGIC PRIORITIES

Our ultimate goal is to ensure that MKB is a Group based on firm foundations, a financial institution with a stable and sustainable business model, maximising its utilisation of digital technologies and operating in an effective and efficient strategy, a Group that plays a dominant role in the domestic banking sector.

The Group's key objectives for 2019 include the fulfilment of the EU commitments, laying down the foundations for long term profitability and listing MKB Bank on the stock exchange.

MKB aims to continue to play a dominant role in the Hungarian financial market, in accordance with its MKB 2021 strategy, with its technical/professional experience, product range, service quality, focused business model and digital capabilities:

- one aim is to expand the Bank's retail clientele, relying on its traditionally strong corporate relationships, strategic collaborations, experience built up in the premium segment, progressive digital developments and Fintech cooperation arrangements

- another aim is to maintain a robust corporate business line based on the traditional values of the Bank, with a focus on local knowledge, responsible and professional service provision, consultancy-based sales and a drive for innovative solutions

- the members of MKB Group offer a wide range of investment banking services, including Private Banking, Fund Management, Consulting, Capital Market and Transaction Advice, Fintechlab, Venture Capital Fund Management, MFB Points and Treasury, MKB intends to maximise the benefits from cooperation within the group

- MKB Group is a universal and complex group, open to a great variety of different forms of cooperation with diverse partners, offering a remarkably wide variety of services for its customers as besides its own products and services it also offers those of its subsidiaries and partners. One of the Group's primary objectives is to intensify collaboration among its members and continue to enhance its supplementary and auxiliary services.

Tradition, Innovation and Cooperation are deemed to be our basic values.

MAIN INDICATORS

Data in HUF million, unless indicated otherwise

BALANCE SHEET	MKB Group (IFRS consolidated)			
	(million HUF)		(million EUR) ⁹	
	2017	2018	Change	2018
Total assets	2 044 987	1 857 579	-9,2%	5 778
Loans and advances to customers, o.w. ¹	858 592	895 203	4,3%	2 784
Corporate loans	617 460	615 222	-0,4%	1 914
Loans to private individuals	241 132	279 981	16,1%	871
Investments in securities	955 274	773 029	-19,1%	2 404
Customer accounts and deposits, o.w.	1 539 140	1 372 046	-10,9%	4 268
Corporate accounts and deposits	1 235 242	1 043 397	-15,5%	3 245
Accounts and deposits of private individuals	303 898	328 648	8,1%	1 022
Shareholder's equity	140 380	158 166	12,7%	492
INCOME STATEMENT				
Gross operating income ^{2,3}	80 624	76 523	-5,1%	240
General operating expenses ³	(46 654)	(50 562)	8,4%	(159)
(Impairments) / Reversal and provisions for losses	(9 611)	800	-108,3%	3
Banking tax ⁴	(4 011)	(4 375)	9,1%	(14)
Share of jointly controlled and associated companies' profit	389	2 311	494,1%	7
Profit before taxation	20 738	24 697	19,1%	77
Profit for the year	19 201	25 132	30,9%	79

MKB Group (IFRS consolidated)

(million HUF)

LIQUIDITY & SELF FINANCING	2017	2018
Loans-to-Deposits (LTD) Ratio ²	55,8%	65,2%
CAPITAL MANAGEMENT		
Capital adequacy ratio	15,7%	17,9%
PORTFOLIO QUALITY		
Total Risk Weighted Assets (RWA) ⁵	930 751	920 824
Non-performing exposure ratio (NPE) ^{2,6}	6,9%	5,8%
NPE coverage ^{2,6}	72,1%	71,9%
NPE coverage incl. collateral ^{2,6}	95,2%	93,4%
PROFITABILITY		
After tax ROAE ²	14,2%	16,8%
After tax ROAA ²	0,9%	1,3%
EFFICIENCY AND OPERATION		
Cost to Income Ratio, adjusted (CIR) ^{2,7}	55,6%	55,7%
Number of employees, FTE, eop ⁸	1 953	1 958
Number of branches	69	51

1 net amounts
2 data not represented in MKB's Financial Statements
3 adjusted for bank tax
4 banking tax was reported in 2017 annual report without banking tax allowance donation
5 including operational and market risk
6 according to CRR 178., default rating based, includes off balance sheet items
7 adjusted for one-off items
8 FTE, eop
9 HUF/ EUR exchange rate: BS: 321,51; PL: 318,87

OPERATING ENVIRONMENT

INTERNATIONAL MACROECONOMIC ENVIRONMENT

Economic growth rates of developed countries – particularly those of the eurozone, and the USA – have, in recent years, reached and even exceeded the level that may be considered as sustainable in the long term; owing to the advanced stage of the business cycle a slow-down in the main economic centres may be regarded as a natural phenomenon. Moreover, certain trade policy developments may render growth perspectives even gloomier. Growth in the eurozone gradually decelerated in 2018, but the lower GDP figure of the last quarter was partly a result of certain one-off factors whose disappearance may be followed by a modest bounce-back in economic growth in 2019.

Inflationary processes in developed markets were driven by international oil price trends. Consequently, the rate of inflation in the eurozone reached and even exceeded the Central Bank's target of 2% in the second half of 2018, but the inflation indicators reflecting the basic trend referred to a modest price pressure.

Despite the advanced stage of the business cycle the ECB did not start to tighten monetary policy in 2018, owing, primarily, to the heterogeneity of the eurozone. The market participants' expectations concerning the ECB's first interest rate increase have gradually shifted to the first half of 2020, due to the disclosure of data on weaker economic performance. Nonetheless, policy rates may remain at their current levels at least until the summer of 2019, according to ECB's communication.

HUNGARIAN MACROECONOMIC ENVIRONMENT

2018 was a year of dynamic economic growth in Hungary – the second half of the year brought about some outstanding growth rates. Hungary's economy grew by as much as 5% year-on-year in Q4 2018, bringing the country's GDP growth rate near a 14-year high. Hungary's economy expanded by 4.8% in 2018, 0.7 percentage point higher than in 2017.

The domestic economic cycle entered its mature phase in that the easy-to-absorb labour supply has run out and the utilisation of the capacities of the machinery and equipment in place cannot be increased materially either. Consequently, economic growth in the short and medium term will be determined by the improvement of productivity.

Annual average inflation was 2.8% in 2018, showing an increase in the inflationary pressure in comparison with the average of 2.4% recorded in 2017. The increase of wages is expected to continue in 2019 as a result of the tight labour market and the two-year wage agreement concluded at end-2018, and the wage increase is bound to affect prices too, which may be counteracted by the lowering of employer contribution rates from mid-2019. Inflationary expectations, which play an important role in pricing decisions, continue to be anchored at low levels. Accordingly, domestic inflation should end up near the 3% target of the central bank.

In September 2018 the National Bank of Hungary (MNB) set about transforming its mone-

tary policy instruments, indicating that it has geared up for gradually and prudently normalising the monetary policy. In addition to the three-month commercial bank deposit facility the tools applied in order to cut long term rates (IRS and the mortgage bond purchase programme aimed at achieving monetary policy goals) were also phased out by the end of 2018, therefore the role of the policy instrument was taken over by the mandatory reserve.

Although internal processes are indicative of a likelihood of the application of stricter domestic monetary policy conditions, there will be no external pressure on the MNB until the ECB starts raising its rates. In accordance with global and regional trends domestic short term interbank rates may gradually rise in 2019, while the domestic policy rate is expected to be increased only after 2019.

The growth of employment and wages is likely to slow down somewhat in 2019, which may entail a decrease in the rate of increase of consumption as well. As a result of this and of the projected deceleration of the expansion of investments the dynamic of domestic economic growth is expected to be less vigorous in 2019.

OVERVIEW OF THE BANKING SECTOR³

The domestic banking system is benefiting from the prevailing general economic stability and has clearly embarked on a growth path. This is reflected by a trend of sustainable expansion in corporate and retail lending. At the same time, the sector is also characterised by a massive liquidity surplus. Another favourable trend is a

significant decrease in the proportion of non-performing loans, a trend that has been enabled by a boosting macroeconomic environment, portfolio cleansing processes taking place in the sector, the significantly higher quality of new lending transactions and the expanding credit portfolios.

Despite the fact the operations of credit institutions continued to be highly profitable in 2018, with outstanding ratios by international comparison, their profitability has fallen short of what they achieved in 2017 according to preliminary nonconsolidated data. The banking sector's outstanding 2017 performance was mainly caused by one-off items – primarily the significant volume of reversed impairment costs – which are not sustainable in the long term, therefore a certain bounce-back is natural. While credit institutions' gross operating income – driven by gains on financial transactions – increased, as a result of the combined effects of cost increases (primarily as a consequence of the growth in IT costs entailed by conformity to regulatory requirements as well as the increase in the cost of human resources in line with the dynamic of wages in the labour market) and the decrease in the reversal of impairments and provisions as a consequence of the financial institutions' running out of reversible portfolios the sector's total profit after taxes have fallen short of the amount recorded in 2017. The processes taking place in the banking sector in the prevailing environment of fierce competition, such as digitalisation, operational efficiency improvement, economies of scale and enhanced process efficiency, are equally aimed at maintaining and even improving the sector's profitability.

MKB expects demand for loans and willingness to borrow to remain high in 2019; these

are expected to be driven on the retail side by growing consumer confidence, continued improvement in growth expectations and a rise of real wages, while in the corporate segment the trend should be supported by capacity-increasing investments in response to the sector's running out of available resources.

Similarly to 2018 the participants of the sector will be facing a variety of challenges in 2019 again, as a result of the growing intensity of

pricing competition and the preparations for a cycle of growing interest rates. In addition to the public dues levied on the sector and besides the requirements of the PSD2 and Mifid2 directives, the implementation of the Instant Payment System requires the banking system to make massive investments.

PERFORMANCE OF MKB GROUP IN 2018



Similarly to years 2016 and 2017 MKB Group successfully achieved its financial objectives in 2018.

The stability of MKB Group's financial and business foundations is ensured by its liquidity, the structure of its funds and balance sheet as well as the performance of the business lines.

The Group's regulatory capital grew by 50% during the past three years.

Its profit after tax amounted to HUF 25.1 billion in 2018, therefore in spite of the EU commitments – having a profound effect on the Bank's operation – the successfully implemented high priority projects such as the replacement of the core IT system and developments required for regulatory compliance (e.g. IFRS transformation) as well as the growing competition the Group managed to add another 31% to its profit after taxes (2017: HUF 19.2 billion).

The Group's gross operating income still fell short of the amount recorded in 2017, primarily as a result of the decreased profit on the securities and derivatives portfolio (regarded as a temporary phenomenon with a view to the expected rise in yields), which is heavily exposed to trends in market rates. The net interest income grew by 4.4% to HUF 41.3 billion while the fee and commission income dropped, primarily as a result of the decrease in commissions on securities transactions, to HUF 25.9 billion in 2018.

The replacement of the core IT system as part of the digital transformation, the closure of the Employee Stock Ownership Plan (ESOP) before the originally scheduled date and the one-off effects the organisational and branch network rationalisation raised the Group's operating cost to HUF 52.9 billion and brought its cost/income ratio⁴ (CIR) to 64.3% (the CIR calculated without the one-off items amounting to HUF 7 billion was 55.7%).

³ Source: MNB

⁴ adjusted for bank tax and jointly controlled and associated companies' profit



The planned improvement of the portfolio quality, taking place in several phases and the success in build up a healthy portfolio – in which the proportion of non-performing loans in the corporate segment more than 90 days past due came close to the average of the banking sector while the corresponding portfolio in the retail segment will follow suit in 2019 as a result of the continued working out of non-performing loans – made a major contribution to the 2018 profit, resulting in the release of risk costs in an amount of HUF 0.8 billion. The ratio of ‘non-performing’ exposures⁵ dropped from 6.9% at end-2017 to 5.8% (2016: 11.7%).

The Group’s 2018 total assets dropped to HUF 1,857.6 billion, constituting a significant decrease – brought about intentionally, in accordance with the EU commitments – relative to the HUF 2,045.0 billion recorded at end-2017. On the assets side the net customer loan portfolio increased in comparison to 2017 by 4.3% to HUF 895.2 billion in the wake of the portfolio cleansing process, in line with the restric-

tions prescribed in the EU commitments. At the same time, the Bank is now also managing the structure of its liabilities more effectively.

In the wake of a third year of balanced and profitable operation the Group has a stable capital position, with a 17.9% capital adequacy ratio in 2018, providing a suitable foundation and capital buffer for meeting the increased capital adequacy ratio requirement of 2019. At December 31, 2018, as an actual figure of Regulatory capital of the MKB Group was HUF 164.9 billion based on Basel III IFRS under Supervisory Regulation. Risk-weighted assets including operational and market risk was HUF 920.8 billion at the end of 2018.

The subsidiaries – MKB Euroleasing, MKB Consulting, MKB-Pannónia Fund Manager, MKB Fintechlab – and the Bank’s strategic partners – MKB Pension Fund and MKB-Pannónia Health and Mutual Fund – also contributed to the stable and predictable operation of MKB Group.

PERFORMANCE OF THE INDIVIDUAL BUSINESS LINES⁶

RETAIL SEGMENT

The developments in line with strategic priorities in 2018 were aimed at increasing the number of customers, lending and the business line’s market share. In addition to organic growth MKB laid particular emphasis on its corporate relationships, its strategic cooperation with its subsidiaries and maximising the benefits from synergies in relation to MKB Pension Fund, MKB-Pannónia Health and Mutual Fund and MKB-Euroleasing.

Developments took place on a continuous basis to improve the efficiency of internal and external processes, intensive product developments resulted in an expanding product range and administrative processes were rendered quicker and more convenient by digital services, including continued development of the mobile banking application and the digitisation of the branch office network. It was in parallel with the replacement of its account management system that MKB Bank introduced the digital signature option at its branch offices, a major step towards paperless processes. Particular emphasis was laid on providing sales staff members with continued training, thereby strengthening the consultative advisory services provided at the branch units. The combination of these developments guarantees improved customer experience for customers doing business at branch offices as well as in the digital space.

In 2018, MKB carried out major upgrades and renovations on its physical network. Three branch offices were completely refurbished.

In our Váci Street Headquarters we have established a competence centre for small enterprises and modernized our branches in Budapest and in a rural mall.

To drive changes in customers’ habits, enhance cost effectiveness and ensure sustainable profitability our network’s operations were improved considerably. In addition to the already wide range online business options, bound to expand further in the future, MKB Bank provides personnel customer service in 51 branch offices across Hungary.

Our Key Partner Programme – in which preferential terms and conditions are offered for employees of our partners – has been renewed and the number of cooperation arrangements has increased. In the context of the Programme, MKB sets up off site facility at contracted employees’ premises to provide their employees with financial advice at their own workplace.

2018 saw the establishment of our Direct Sales Force Network, providing for nationwide presence. By proactively approaching customers as MKB’s own agents at the events of the Key Partner Programme and other external activities the salespersons belonging to the network made a major contribution to the business line’s customer acquisition and loan disbursement results.

In addition to the Direct Sales Force Network and the Key Partner Programme the Bank relies on external sales channels as well in selling its products. All of these provided effective support enabling MKB to become a dominant player

⁵ NPE ratio: includes off-balance sheet exposures as well

⁶ Source: MNB, KAVOSZ, Eximbank, MFB, MKB’s calculation

in the domestic market as regards the sale of mortgage loans and small corporate products. In 2018 the Bank continued to strengthen and enhance its relationships with loan intermediaries and even made efforts to improve its partners' customer experience by developments in its external sales channels. To boost intermediary satisfaction and the efficiency of day-to-day cooperation in December 2018 we opened our Mortgage Loan Partner Centre in Budapest. The primary aim of opening the Centre was to ensure both professional service provision and partner-oriented operations. The lessons drawn from the operation of the Mortgage Loan Partner Centre will be useful input to the establishment of additional centres in the future.

MKB Plaza, the Bank's retail loyalty programme has, since 2018, been providing its services for customers through an upgraded website and mobile application. MKB Plaza is now available for the customers of MKB Euroleasing as well; thus the entire clientele of the MKB Group has access to 150 types of discounts and preferential terms and conditions offered by nearly 100 service providers. The success of the loyalty programme is proven by the fact that the number of registered customers more than doubled in the span of just one year, to over 70,000.

MKB achieved impressive results in loan disbursement: during the last three years⁷ the amount of retail housing loans disbursed by the Bank increased by 206%, while the overall growth of this particular market segment was only 134%. There was an even more dynamic increase in the segment of personal loans: the total amount disbursed by MKB increased by 472%, in contrast to the 248% overall expansion of the segment during the same period.

The portfolio of retail assets managed by the Bank⁸ at the end of the year exceeds HUF 780 billion. The structure of savings changed slightly: the proportion of government securities and deposits increased somewhat, while that of investment funds and bonds diminished.

MKB SZÉP CARD

The MKB SZÉP Card product continued its impressive performance in 2018. It became a popular and versatile means of payment that can be used conveniently on a daily basis. As a result of certain regulatory changes only the SZÉP Card remains in the favourable tax category, therefore this already popular form of fringe benefit is likely to become even more popular in the future.

The number of card holders increased by some 10% in 2018, to over 240,000 by the end of the year. The HUF 15.6 billion employer contribution transferred to MKB SZÉP Card owners in 2018 was 2.5% up year-on-year, while the ratio of their use had increased by 5.9%, in an amount of HUF 15 billion.

In the wake of regulatory changes both the procedure whereby SZÉP Cards are applied for and the process whereby the benefit is transferred by employers changed considerably from 2 January 2019. Accordingly, MKB Bank Zrt. has taken over the services of issuing and keeping records of SZÉP Cards and has concluded account contracts with about 200,000 customers.

MKB SZÉP Card holders can now make payments to about 22,500 contracted service providers with their cards.



DIGITAL PRODUCTS AND CHANNELS

Digitalisation transforms the banking industry, as well. Banks and customers have no other choice but understand, adopt and apply this new way of thinking. Digital products and channels render day-to-day banking processes easier, they bring down the prices of services and drive competition among banks.

In 2018 MKB Bank fully implemented its digital transformation project, turning the Bank, by the end of a three-year period, into a digital player of its sector, one that is now a dominant player even at a European level. By replacing the core system the Bank established the digital architecture of the future, making it possible to continue the development of its services and improve its customers' positive experiences during the coming decade. The services linked to MKB's new digital core system are gradually integrated in the financial institution's day-to-day operations.

MKB introduced its mobile application, started its online bank account opening option and introduced the contactless payment method, and it also renewed its portal prior to the digital transformation. Through the Digital Branch Office service the customer can be provided with personalised information concerning mortgage loan or investment products simply and conveniently, online.

The introduction of the biometric signature function in our branch office network is a major step towards paperless banking.

The Bank sees great potential in robotisation as well, therefore it has introduced a variety of robotised functions in its day-to-day activities.

⁷ In January to December 2018, relative to January to December 2015.
⁸ Deposits + bonds + investment funds + government securities

MKB regards the enabling of what is called open banking not only because this is necessary for legal compliance but also because of the major potentials lying in this system. New solutions enabled by the new technology make it possible to provide customers with increasingly personalised services in the future. After thorough preparations in 2018 MKB Bank was among the first institutions at the beginning of 2019 – in accordance with the relevant EU directive⁹ – to open its APIs (Application Programming Interface), enabling new secure fintech developments aimed at making it even more easy for customers to do business with the Bank. At the same time, MKB is working on additional digital developments for both its retail and its corporate customers, which will be compatible with the new PSD2 requirements as well. MKB Fintechlab, supporting product and service development with new, innovative partners, is a key partner in these efforts.

CORPORATE AND INSTITUTIONAL CUSTOMERS

MKB's permanent strategic objective is to maintain a strong corporate business line, based on our traditional strengths. The corporate business line is focused on local knowledge, professional service provision, advice-based sales and the provision of innovative solutions.

What MKB sells to its customers is not simply a variety of products but complex business solutions and advice, setting up complex credit facilities and satisfying special banking needs when necessary. MKB can provide effective and efficient solutions to all participants of the corporate segment, regardless of customer size.

To continue the development of the customer life-cycle based approach the Bank devoted

major resources in 2018 to further optimising the product development processes and models, as well as to developing digitised solutions.

Despite major limitations and restrictions entailed by the EU commitments, maintaining portfolios continue to be crucial for MKB Bank in the large corporate business line, thereby keeping up the strong market positions and the diversified loan portfolios and avoiding the build-up of material risk, industry or customer concentrations.

Small and medium-sized (SME) customers continued to be a key segment for the Bank in 2018. The advisory model was further developed, new financing programmes were introduced for such customers and product penetration was further increased. The introduction of the NHP¹⁰ Fix programme was also of outstanding importance: to make it possible for the programme to be available from the first days of 2019 we embraced major developments last year. Meeting the new additional requirements of the guarantee institutions was paramount: the Bank is continuously fine tuning its SME financing possibilities to make sure that the options enabled by the programmes are available primarily for those SMEs that are most in need of them.

In the framework of the Széchenyi Programme the Bank managed to further expand its lending portfolio in 2018: new disbursements grew by 9.1% to HUF 41.7 billion, with which it maintained its significant – 18.6% – market share. As one of the elements of opening towards the agricultural sector – by continuously optimising and enhancing the available options – MKB participated in the financing of the Agricultural Rural Development Programme. We have been traditionally closely cooperating with Eximbank to maximise the number of customers provided with funding:

⁹ PSD2 (the revised Payment Services Directive)
¹⁰ Funding for Growth Scheme of the central bank

in 2018 the Bank achieved a 15.1% market share of the disbursements refinanced by Eximbank, in terms of the number of transactions.

MKB has been supporting businesses in their efforts at improving their competitiveness and the effective utilisation of funds by providing useful information and face-to-face advice through the network of MFB Points which have been in operation since July 2017: in 2018 funds of a total of HUF 4.6 billion were reserved through MKB's MFB Point network.

The provision of services for small enterprises was also supported by the Bank by developing an own agent network of nationwide coverage.

INVESTMENT SERVICES

MKB Group provides a wide range of investment banking type services, including Treasury services (trading on commission, custody services and sales), fund management, capital market and transaction consultancy, Private Banking, tender drafting and project management consultancy as well as venture capital fund management, a service launched in 2018.

In addition to its funds offering a wide variety of investment opportunities, MKB Pannónia Investment Fund Manager offered the products of five foreign and three domestic partners for the various customer segments. In addition to the investment funds sold by the company, the range of its investment products was widened by the offering of structured bonds and certificates as well.

MKB Bank is a primary and contracted dealer of institutional and retail government securities. The Government Debt Management Agency rewarded the Bank's activities as a distributor

in 2018 by awarding it the 3rd position in the "Primary Dealer of the Year" competition.

Similarly to previous years, in 2018 MKB Bank, as a member of the Budapest Stock Exchange, recorded the second largest turnover in the forward forex section on the Exchange.

At the end of the previous year MKB became a Nominated Advisor (NOMAD) on XTend, the BSE's newly formed SME market. Its regular analysis and price listing activity was launched in regard to the Alteo and the Masterplast stocks. Moreover, MKB has been providing regular analysis coverage for the BIF stocks as well since July 2018.

MKB's Capital Market and Transaction Consulting division carried out the first successful capital raising transaction (Megakrán) on Xtend. The new type of capital raising transaction, a success for SMEs, which was something of a novelty, was a major step forward in the development of the entire Hungarian capital market.

In 2018 MKB Private Banking expanded the portfolio of assets under its management at a rate nearly twice as the average growth rate in the market, securing a market leader position in its own segment. The division is managing assets worth a total of HUF 545 billion. At the same time, the average volume of the portfolios managed by the division is also outstanding, over HUF 300 million, the highest average per-customer amount of assets managed by service providers associated with banks. Another Private Banking consultation unit was set up in the town of Nyíregyháza, and at the same time the professional workshop supported in close cooperation with MKB Pannónia Fund Manager is also highly popular. As a result of the increased effectiveness of the work organisation and the service providing model which is always focused on customers' interests, the customer satisfaction indicator improved considerably in comparison to 2017. Pioneering in inno-

vation, a decision making system, which is quiter unparalleled in the domestic market – the robot advisor – will ensure continued improvement in the standards of professional service provision in the Private Banking business.

The Premium investment service involves the provision of personalised investment advice based on sample portfolios, together with a broad product range and individual products, as well as consultancy with our highly trained professionals. The total customer portfolio under management in the Premium investment service launched in 2016 increased to HUF 107 billion by end-2018, while the average per-customer portfolio exceeds HUF 30 million. MKB aims to continue to improve the quality of the priority service – based on customers’ needs surveyed –, and to launch a vigorous acquisition campaign. To this end, the Bank is reconsidering the value proposition, the service level and the service provision model for the segment.

The experts of the Analysis Centre have been supporting the activities of the MKB Group and

its customers for nearly 4 years now. The expert team’s macroeconomic, stock market as well as money and capital market analyses make a crucially valuable contribution to the successfulness of the investment services of the MKB Group.

SERVICE QUALITY AND CUSTOMER SATISFACTION

MKB Bank focuses its operations on enhancing customer experience as one of its key strategic objectives. The Bank maintains continuous dialogue with its customers, monitoring their satisfaction. It was to this end that the Bank set up at the end of 2017 the on-line panel called MKB Dialog, in order to ensure that customer’s opinions are integrated in the Bank’s day-to-day operations, whether regarding the introduction of new products or even new on-line solutions.

Customer satisfaction is one of the most important determinants of MKB’s operations.

SUBSIDIARIES/STRATEGIC ARRANGEMENTS AND PARTNERS

The range of MKB’s own banking products and services is supplemented by those provided by its subsidiaries and partners. The key objectives include maintaining or enhancing the

market positions of the subsidiaries engaged in business activities, increasing cooperation among the members of the Group and strengthening the auxiliary financial services.

SUBSIDIARIES¹¹

MKB-EUROLEASING GROUP

As one of the top three leasing companies in Hungary MKB-Euroleasing is a highly active and dominant market participant in car financing, in financing large commercial vehicles and in financing agricultural and general purpose machines.

The company managed to continue building its diversified portfolio in 2018, an effort lunched in 2016.

The primary goal of last year was to further strengthen the long-term profitability of MKB-Euroleasing Group, in addition to the planned increase in volume, the focus has shifted towards more profitable transactions. The strategy was more successfully implemented than had been expected originally, as the volume of new financing transactions increased by a mere 2 percent year-on-year – with a slightly decreasing average transaction size – but the profit generating capability of the newly contracted portfolio was 10% higher than that of the transactions concluded in 2017.

MKB-Euroleasing’s strategic goal is to retain the already secured market share, provide for a stable market presence and continued acquisition of customers in segments of higher profitability.

In the car financing and the agricultural machine financing segments MKB-Euroleasing is one of the two largest market participants.

MKB CONSULTING

As a member of the MKB Group, MKB Consulting became a major player in the tender and consulting market by the end of the third year after its establishment.

The effectiveness of the Company’s activities in the tender business is indicated by the fact that its key corporate customers were granted a total of HUF 12.5 billion financial assistance through tenders in research, development and innovation, while as many as 460 customers in its small business portfolio received financial assistance in a total amount of HUF 2.7 billion.

¹¹ Source: Hungarian Leasing Association, BAMOSZ, MKB’s calculation



In its advisory business line MKB Consulting performs activities in fund raising for a variety of institutions, including towns with county right, the Budapest Stock Exchange (BÉT), equity fund managers and even MKB Group itself.

It was with the help of its advisory experience that MKB Consulting participated – in the context of the Modern Towns Programme – in working out the urban development ideas and concepts of towns with county right as well as in elaborating their financing models.

In 2018 MKB Consulting provided financial advisory services, in connection with capital programmes, for venture capital funds and other market participants, by working out business plans for funds focusing on certain priority target areas, together with the associated investment strategies, as well as by providing expert assistance to the launching of funds, inter alia.

MKB Consulting also took part, as a strategic partner of BÉT, in the latter's training and stock exchange preparatory projects.

MKB INKUBÁTOR KFT - MKB FINTECHLAB

We believe that large companies and start-ups complement each other, therefore MKB was the first domestic financial institution to engage the world of start-ups, technology and innovation. MKB Fintechlab – also as the Bank's innovation laboratory and start-up incubator – has by now become a dominant participant of fintech innovation in both the domestic and the international arena. MKB Fintechlab has become capable of doing business with start-ups operating in the world's fintech capitals as well.

MKB Fintechlab is supporting the implementation of the MKB Group's strategy in three key

areas: it is building up a community around the MKB Group of entities pioneering in innovation, its incubation programme fosters start-ups and it searches for and builds up valuable partnerships for the MKB Group.

MKB Fintechlab consolidated and strengthened its international positions in 2018 and today it is operating as the leading fintech knowledge centre of the Central and Eastern European region. Start-ups from 6 countries participated in the 2018 spring incubation programme; as many as 110 start-ups from 15 countries have registered for the 2019 programme.

In November 2018 Fintechlab and Oracle together organised the first fintech hackathon in Hungary and the Central and Eastern European region. A total of 15 new innovative business solutions were created in the open banking competition and the participants successfully tested MKB Bank's new digital system.

Three innovative partnerships, created by MKB Fintechlab, were integrated in MKB Bank's day-to-day operations last year, of which mention should be made in particular of the robot-advisor developed by Blueopes for MKB Private Banking.

MKB-PANNÓNIA INVESTMENT FUND MANAGER

2018 was a busy year in all segments of the Company's operations: focus was laid in the first half of the year on the streamlining of internal processes, while in the second half emphasis was laid on tightly controlled management of market processes. Last year characterized by marked volatility and – in certain markets – plummeting prices. The year's performance was dominated by decreasing prices in developed stock markets in the fourth quarter, poor performance of the developing stock markets in the second half and

a temporary faltering of the Hungarian government security market in the first half of the year.

Despite the deteriorating external environment the Fund Manager made major efforts to keep up its product development processes, launching four special funds in 2018, to be followed by additional ones in 2019.

The total value of the assets managed by the Fund Manager is nearly HUF 600 billion, therefore, with its 7.4% market share the Company continues to rank among the Top 5 participants of the domestic fund and asset management market.

SOLUS CAPITAL VENTURE CAPITAL FUND MANAGER

In recent years MKB has, started working on creating the organisational requisites for capital investment activities. It has established the company called MKB Venture Capital Fund Manager and acquired a shareholding in Solus Capital Venture Capital Fund Manager, putting in place the framework required for efficient capital raising activities.

It was in August 2018 that Solus launched Solus I Venture Capital Fund, aiming to facilitate investments contributing to both regional development and the technological modernisation of the SME sector. The Capital Fund makes investments in small and medium-sized enterprises outside the Central Hungary Region that are capable of rapid growth through intelligent technology innovation. The capital fund established with nearly HUF 13 billion in registered capital, with funding – in the context of the S3 Venture Capital Programme – by MFB and other private investors, carried out 3 successful venture capital investment transactions in 2018.





STRATEGIC COOPERATION ARRANGEMENTS AND PARTNERS¹²

MKB PENSION FUND

MKB Pension Fund operates with one of the most favourable conditions applied by the leading domestic funds; its robust technical/professional track record, stable and prudent operation and skilled asset manager team, as well as its long term investment results guarantee for the savings of its members. The Voluntary segment of MKB Pension Fund, with a history of 24 years, had nearly 83,000 members and managed more than HUF 132 billion worth of assets at the end of 2018. With its stable 10% market share it is the 5th largest participant of the domestic market. Its Private segment had an approximately 3,800 members and managed HUF 18.9 billion in assets at the end of 2018.

The individual contributions of its members increased by 2% in 2018, while employers paid 4% more than in the previous year. This

is a clear indication of the members' conscious and steady commitment to pension savings. By choosing the fund facility customers access significant benefits. Enabled by low costs, tax-free yields and tax benefits provided by the state they can accumulate substantial amounts even without any financial expertise to supplement their pensions, contributing to the maintenance of the standards of living they secured themselves during their economically active years. The Fund lays particular attention to maximising the satisfaction of customer requirements, therefore it is constantly seeking for and applying new and innovative solutions, as a result of which it further enhanced the functions offered by the Personal storage space and Electronic business through continued developments in 2018. The features of these services enable users to simply and quickly view the data stored in the system, monitor the increase of their savings, the annual account history and

the current portfolios. The Employer portal offers efficient administrative solutions by enabling electronic administrative procedures.

MKB-PANNÓNIA HEALTH AND MUTUAL FUND

MKB-Pannónia Health and Mutual Fund has been one of the largest, best-performing funds for 21 years. The Fund closed another highly successful year in 2018 as well: its assets grew by 30% to HUF 15.6 billion, therefore with its 23.7% market share it is the largest participant of the health funds' market. The Fund's membership also increased by a dynamic 13%, to a total of 210,000 by the end of the year, making it the third largest health and mutual fund in Hungary. The substantial growth was partly a result of the merger of Dimenzió Voluntary Health and Mutual Fund

into MKB-Pannónia Health and Mutual Fund with effect from 1 January 2018. The merger enabled the utilisation of additional synergetic effects and expanded the Fund's service portfolio, making it possible to further raise its standards of customer experience.

The popularity of the fund is clearly indicated by a hitherto unprecedented 30% increase in individual contributions, along with a 19% increase in employer contributions year-on-year.

The Fund has a total of 15,500 contracted partners across Hungary, of which nearly 9,000 also accept payment with MKB Health Fund cards.

The Fund continues to aim at providing a social service package with a healthcare element, supported by state tax refunding as well.

¹² Source: Association of Mutual Funds, MNB, MKB's calculation

HUMAN RESOURCES

Similarly to previous years, MKB was facing challenges stemming from constantly increasing competition in the labour market in 2018. The Bank provided the retaining and motivating its highly qualified workforce as well as the hiring high quality human resources in a sustainable way. Particular attention was paid to strengthening atypical and flexible forms of employment, along with talent fostering.

MKB Bank's HR Directorate continued to improve the efficiency of the human policy systems and processes in 2018. Significant progress was made in the digitisation of processes as well, turning a number of HR processes into digital functions, replacing paper-based work processes.

The employee value proposition was enhanced by creating conditions for flexible work performance, and satisfaction surveys as well as feedback from the labour market have shown that the possibility of flexible working hours have become equivalent for employees to financial benefits, therefore the introduction of the option of working from home became one of the most important tasks for the HR division in 2018.

A talent management programme overarching the whole of the company, including the subsidiaries as well, was introduced, offering a complex range of development and training options in order to retain Top talents and key professionals as well as to ensure management succession.

2018 was the "Year of Health" at MKB Bank.

The mental and physical health of the employees is key to balanced high standard work,

therefore year 2018 saw particular emphasis being laid on the provision of active assistance to MKB Group employees in their efforts aimed at preserving and improving their health. More than a thousand participants of the Family Sports Day organised as part of the Year of Health took the opportunity to have a go at games and sports activities and contests, and access more than 10 different health tests during the event. A series of screening checks was launched in the autumn, for all employees of the Bank, free of charge.

The Group's employees have access to a wide range of different sports activities through 18 departments operated by the MKB Sports Club, which was reorganised in 2016. The sports facilities of the central buildings were extended and enhanced. The recreational and community rooms are open to the employees' children as well.

The Bank was inspired by its corporate values and its commitment to healthy life and physical activity to present all this to its customers and the general public as well. This is why in June 2018 we launched our #20minutehealth programme. With its campaign, bolstered by television ads and active social media support, MKB drew attention to the importance of a healthy lifestyle, as an enterprise that is fully committed to the development of the Hungarian society. Our aim is to increase the number of people devoting at least 20 minutes each day to the maintenance and improvement of their spiritual and physical health.

As the campaign's slogan goes:

"Health is the best investment!"



AWARDS AND RECOGNITIONS

13 MARCH: **THE JOINT AGRICULTURAL VOCATION- AL ORIENTATION PROGRAMME OF MKB BANK AND MEGFOSZ EARNS HIGH PRO- FILE RECOGNITION**

It was in 2013 that the German-Hungarian Chamber of Industry and Commerce (DUIHK) established its Vocational Training Award. The award is handed over in three categories – Motivation, Cooperation and Innovation – each year to outstanding projects and initiatives making a major contribution to practice-oriented vocational training in Hungary, setting an example for others to follow.

In 2018 MEGFOSZ (the Hungarian Association of Agricultural Equipment and Machinery Distributors) also entered the contest with MKB Bank's support and professional cooperation, with its programme entitled "Legyél Te is mezőgépező!" ("Be an agricultural engineer") and its game entitled "Mezőgépezők" ("Agricultural Engineers").

The success of the programme earned a special award from the German-Hungarian Chamber of Industry and Commerce on 8 March 2018.

19 MARCH: **THE DIGITAL PRODUCT FIRST INTRODUCED BY MKB BANK EARNED "BEST OF SHOW" AWARD AT ONE OF THE WORLD'S LARGEST FINTECH EVENTS.**

Finovate (launched in 2007 in the USA) is the world's only series of demo-focused conferences where international exhibitors pres-

ent the most innovative financial and banking technologies to regulators, financial investors, industry analysts and, of course the media.

MKB Bank already developed a number of its digital solutions such as MKB MobilApp and MKB NetBANKár, with the help of a Hungarian fintech company called W.UP. A real-time solution called Sales.Up, designed for use in the banking sector, is the result of the latest cooperation between the two organisations. The solution detects customer's financial situations and responds to them by working out real-time proposals and recommendations.

After the presentation of the system the international profession gave unanimously the "Best of Show" award to MKB Bank's Sales.Up demonstration.

12 JUNE: **11TH HUNGARIAN PRIVATE BANKING CONFERENCE – STAGED BY BLOCHAMPS CAPITAL:**

The Private Banking profession recognised MKB's activity in 2018 through three awards: "Business Line Developer of the Year Award" "Per Capita Asset Managed Award – 2nd position" and "Junior Private Banker of the Year – Gábor Major (Pécs)".

19 SEPTEMBER: **INSIDE ITB 2018 – SZAFARI**

ITBUSINESS Award – in the Project development category.

8 NOVEMBER: **MKB ELECTED THE FINTECH BANK OF 2018**

MKB earned recognition as the "FinTech Bank of the Year" at the E-Banking Summit held in Budapest. The award goes to the bank that has done the most to promote integration and cooperation between the FinTech industry and the banking system.

MKB Bank – which carried out a comprehensive digital system replacement in 2018 – was the first Hungarian financial institution to earn this recognition because it has been a constant advocate of effective cooperation with the domestic and international fintech industry and at the same time successfully implementing such cooperation in practice.

4 DECEMBER: **FINANCIAL TIMES: MKB BANK AMONG EUROPE'S DIGITAL CHAMPIONS!**

The Financial Times has just released "Europe's 100 digital champions", a collection of the continent's most exciting digital entrepreneurs and businesses, naming 20 participants champion in each of five different categories. The list was published in Hungary by forbes.hu.

In the "corporate digital transformation" category the list comprises twenty businesses of various sizes, with MKB Bank among them, as the only Hungarian company. One feature shared by each of the businesses concerned is that they have been intensively applying digital technology for a while in order to change the foundations of their operations.

6 DECEMBER: **MÁRK HETÉNYI ELECTED MEMBER OF THE PRESIDENCY OF THE ARTIFICIAL INTELLIGENCE COALITION**

The purpose of the Artificial Intelligence Coalition (AI Coalition) formed in October 2018 in the context of the Digital Welfare Programme (DWP) is to drive Hungary to the European vanguard in the development and use of artificial intelligence and to turn Hungary into an important member of the international AI community. The AI Coalition elected its presidency of eight members – including Márk Hetényi – at its first plenary session on 29 November 2018.



SOCIAL RESPONSIBILITY

Collection of donations, charity activities

Companies have an impact on the life of society through their activities therefore MKB Bank, as a traditional and dominant participant of the domestic financial sector, performs extensive donation and charity activities.

As a financial institution responsible for the community MKB is actively devoted solving social issues. This is why it launched its fundraising project in 2018, called MKB Jótéví Program (MKB Benefactor Programme), which started its activities by collecting donations for the Age of Hope Child Protection Foundation.

In the context of the programme series MKB provided assistance to the activities of different organisations in need each month, from the autumn of the previous year, by way of a variety of donations.

MKB Bank pays particular attention to providing assistance to children in need, children facing difficulties and children with health problems, therefore its charity activities are focused on children and disadvantaged families.

The Bank has a very long history of success-

ful cooperation with International Children's Safety Service, an organisation devoted to helping children facing disadvantages in life. It was 21 years ago, in 1977 that MKB Bank launched its scholarship programme to help children of excellent performance at school but facing social disadvantages. Initially 20 children were granted scholarship each year. This number has been gradually increased and now as many as 100 children are provided with scholarship under the programme. The bank awards children with a diploma who have won its scholarship, in a high profile event at the beginning of each school year. In addition to the scholarship programme, the MKB Christmas Children's Gala is a predominant event of the cooperation between the financial institution and International Children's Safety Service, staged for the 24th time in 2018.



ANNEX: KEY FINANCIAL RATIOS OF THE MKB GROUP

Data in HUF million, unless indicated otherwise

STATEMENT OF THE FINANCIAL POSITION OF THE MKB GROUP

ASSETS	2017	2018
Cash reserves	31 599	19 240
Loans and advances to banks	78 017	63 610
Derivative financial assets	19 757	17 914
Securities	955 274	773 029
Loans and advances to customers	858 592	895 203
Non-current assets held for sale and discontinued operations	21 648	4 238
Other assets	27 308	21 699
Current income tax assets	161	2
Deferred tax assets	3 312	5 814
Investments in jointly controlled entities and associates	2 643	4 687
Intangibles, property and equipment	46 676	52 143
TOTAL ASSETS	2 044 987	1 857 579

LIABILITIES	2017	2018
Amounts due to other banks	239 312	214 340
Deposits and current accounts	1 539 140	1 372 046
Derivate financial liabilities	43 366	31 608
Other liabilities and provisions	49 837	48 425
Current income tax liabilities	16	16
Deferred tax liabilities	5	2
Issued debt securities	10 624	4 974
Subordinated debt	22 307	28 002
TOTAL LIABILITIES	1 904 607	1 699 413
EQUITY	2017	2018
Share capital	100 000	100 000
Treasury Shares	(5 550)	(1 987)
Reserves	40 381	58 166
TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE BANK	134 831	156 179
Non-controlling interests	5 549	1 987
TOTAL EQUITY	140 380	158 166
TOTAL LIABILITIES AND EQUITY	2 044 987	1 857 579

THE PROFIT/LOSS OF THE MKB GROUP

	2017	2018
Interest income	56 245	57 806
Interest expense	16 665	16 486
NET INTEREST INCOME	39 580	41 320
Net income from commissions and fees	28 846	25 908
Other operating income / (expense), net	10 219	7 222
Impairments / (Reversals) and provisions for losses	9 611	(800)
Operating expenses	48 685	52 864
Share of jointly controlled and associated companies' profit	389	2 311
PROFIT BEFORE TAXATION	20 738	24 697
Income tax (income) / expense	1 537	(435)
PROFIT FOR THE YEAR	19 201	25 132

MKB GROUP'S CAPITAL ADEQUACY RATIO

	2017 Basel III IFRS	2018 Basel III IFRS
Share capital	100 000	100 000
Outstanding share capital	100 000	100 000
Reserves	37 124	56 688
Intangible assets	(12 567)	(19 398)
AVA - additional valuation adjustments	(464)	(421)
ADDITIONAL TIER 1	-	-
TIER 1: NET CORE CAPITAL	124 093	136 869
Subordinated debt	22 307	28 002
TIER 2: SUPPLEMENTARY CAPITAL	22 307	28 002
REGULATORY CAPITAL	146 400	164 871
Risk-weighted assets (RWA)	750 832	743 016
Operational risk (OR)	173 370	168 511
Market Risk position (MR)	6 549	9 297
TOTAL RISK WEIGHTED ASSETS	930 751	920 824
Regulatory capital / Total assets	7,16%	8,89%
Tier1 ratio	13,33%	14,86%
CAPITAL ADEQUACY RATIO	15,73%	17,90%

