

## Wüstenrot Hypoteční Banka

April 9, 2013

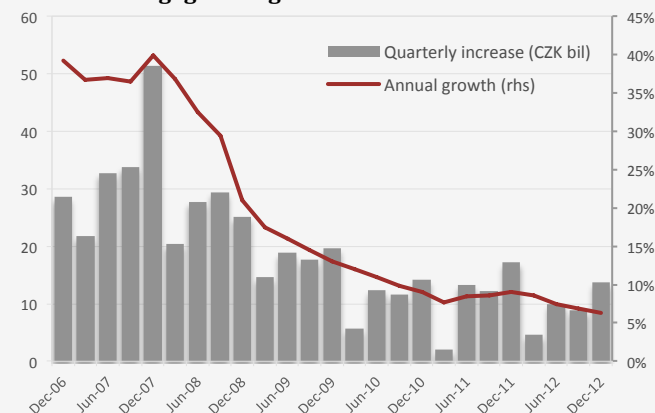
### Quarterly Analysis of Mortgage Lending

- Mortgage loan growth slowed down to 6.3% yoy, while sales of new mortgages dropped to last year's level in 4Q12.
- The top 3 banks further cemented their market position to over 65% in 2012. They sold more than 70% of the new mortgages in 4Q12.
- ČSOB is the clear winner for the year 2012, while GE Money Bank and Raiffeisenbank lost the most.
- Mortgage loans represented nearly 30% of all bank loans in 4Q12. The mortgage business generates around 15% of banks' profits.

#### Growth in mortgage loans continued to fade in 4Q12

Mortgage loans increased by 2% qoq in the seasonally strong last quarter of the year, but the overall momentum continues to deteriorate. The annual increase slowed down to 6.3% yoy and sales of new loans of CZK 34 bil were only as high as in the same quarter last year:

Chart 1: Mortgage loan growth



Source: ČNB, Helgi Analytics

Mortgage loans reached 18.1% of GDP at the end of 2012, or more than a third of bank loans when other housing loans are included. Some 14.4% of Czech households had a mortgage loan at the end of 2012, while 14.0% of residential dwellings were financed through a mortgage loan, according to our calculations.

#### The interest margin is still fat...

The average interest rate on mortgage loans continues to decline in line with the overall market trends. It reached 3.17% in 4Q12 while the average interest rate on the total mortgage loan stock remains over 4.5%. This would imply that new loans are sold with a decent 220 bp margin over a 5-year swap.

#### ...while asset quality remains strong

The share of non-performing loans remained stable throughout the year at 3.1-3.3% of total mortgage loans. This is a result of the overall low indebtedness of Czech households, strict lending procedures and only a mild fall in real estate prices. Czech housing affordability remains one of the best in Europe.

#### Mortgage business forms 15% of banks' profits

As mortgage loans have grown to a sizable amount, the business has become much more cost-efficient and profitable. We estimate mortgage business generates ROE of over 20% and contributes around 15% to the banking sector's bottom line. Raiffeisen and ČSOB seem to generate over 20% of their profits from mortgages.

#### The top 3 banks strengthened their position further

The three largest banks (ČSOB, Česká Spořitelna and Komerční banka) further cemented their market position in 2012 and in the last quarter, taking their share above the 65% threshold.

ČSOB is the absolute winner of the year 2012 and 4Q12, grabbing nearly half of the total market increase! GE and Raiffeisen, on the other hand, lost most of their market positions.



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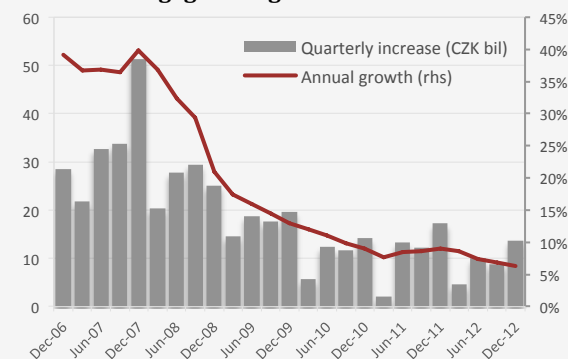
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## Growth & Market Share

### Mortgage loan growth weakens

In 4Q, the mortgage loan book grew by 2% qoq, or by CZK 13.6 bil, which brought the growth to 6.3% in the full year 2012:

**Chart 2: Mortgage loan growth**



The negative momentum is more clearly visible in the dynamics of the new loans granted. In spite of relatively strong sales in 4Q (at over CZK 34 bil), the growth of the production of new loans practically ceased during 2012:

**Chart 3: Sales of new mortgages**

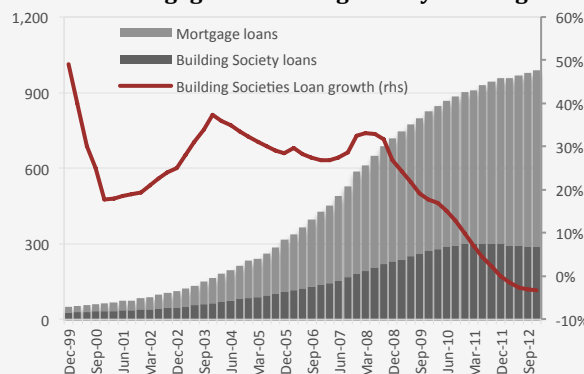


Source: ČNB, MMR, Helgi Analytics

### Lending by building societies has already fallen

The momentum deteriorated even more in the lending provided by the building societies. The market seems to be saturated (virtually every household in the Czech Republic already has a subsidised deposit savings plan), while falling interest rates on mortgage loans and cuts in government subsidies make building society loans less attractive than traditional mortgages:

**Chart 4: Mortgage vs. Building Society Lending**



Source: ČNB, Helgi Analytics

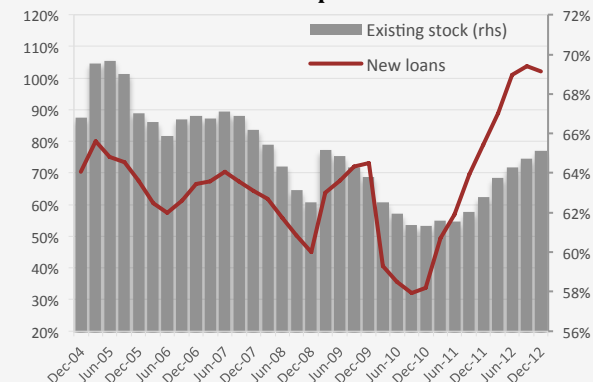
### Large banks and ČSOB are the winners in 2012

The three largest banks (ČSOB, Česká Spořitelna and Komerční Banka) further cemented their market position in 2012.

The trio had a 62.8% share of the mortgage market at the end of 2011 and closed the year 2012 with a market share of over 65%.

Their market dominance strengthened towards the end of the year, as smaller banks were unable to replace loans which matured during the year. Ultimately, the whole expansion of the mortgage loan market was generated exclusively by the three largest banks in 2012:

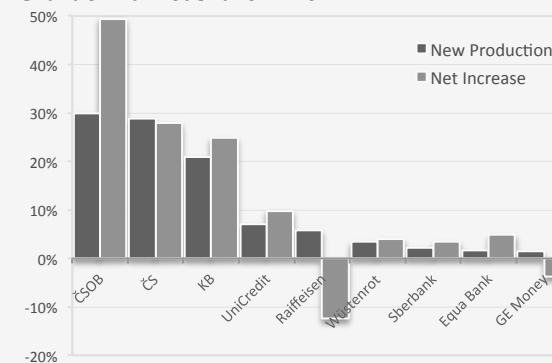
**Chart 5: Market share of top 3 banks**



Source: ČNB, Banks, Helgi Analytics

ČSOB is the absolute winner for 2012. The bank expanded its mortgage loan portfolio by CZK 12.6% in 2012, nearly twice as much as the market or its main rivals, Komerční and Spořitelna. In terms of the net growth of the mortgage loan book, the bank grabbed nearly half of the market in 2012!

**Chart 6: Market share in 2012**



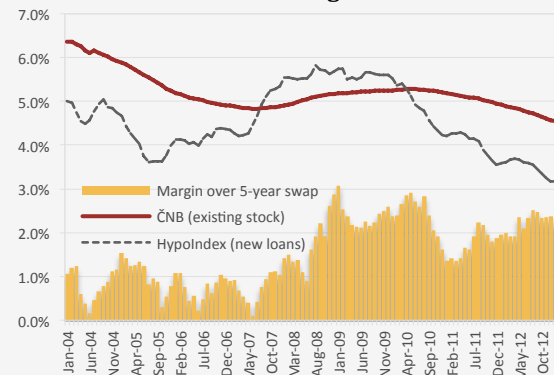
Source: Banks, MMR, ČNB, Helgi Analytics

## Interest Margins & Asset Quality

### Interest rate on new loans approaches 3.0%

The average interest rate on the existing mortgage loan book stayed just above 4.5% in 2012, down from the rate of over 7% seen in 2003. But falling interest rates and competition pressure pushed the average interest rate on new loans to 3.17% at the year's end, measured by HypoIndex (or 3.62%, according to the ČNB numbers):

**Chart 7: Interest rates & Margin**



Source: ČNB, HypoIndex, Helgi Analytics calculation (margin calculated as avg. interest rate on new loans over 5-year swap)

This would imply that new mortgage loans are sold with a solid 180 bp margin over a 5-year state bond yield (or over 220 bp over the swap rate).

### Margin pressure? What pressure?

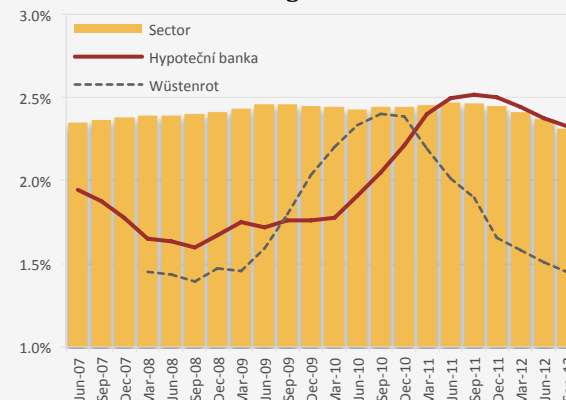
Despite the slowdown, mortgage lending still represents one of the fastest-growing businesses within the Czech banking sector. When you add the solid margins and impressive profitability (as demonstrated by Hypoteční banka's case on page 8), one would expect mortgage lending to attract small banks like bees to a pot of honey.

Not quite. The big banks increased their market share impressively last year and their dominance was most

visible towards the year's end (see page 5).

The interest risk comes from the nominal reduction of interest rates. As a large part of the mortgage loan funding comes from clients' deposits (loans to deposits account for 75% in the banking sector) and nearly half of the deposits bear no interest (i.e. offer no room for downward re-pricing), declining nominal interest rates will sooner or later eat into banks' margins and profits. That's already visible in the 3Q margin development in the banking sector (the margin dropped 5 bp qoq and nearly 20 bp yoy), but pure mortgage banks seem to be hit even more:

**Chart 8: Net interest margin**



Source: ČNB, Banks, Helgi Analytics calculation

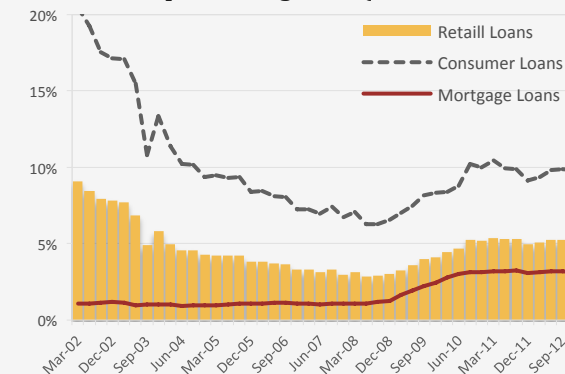
### Asset Quality

Despite all the media fuss about the economic and financial crisis, the Czech economy remains fairly solid, the banking system strongly capitalised, well funded and profitable, real estate relatively cheap and the unemployment problem manageable.

The asset quality of mortgage loans therefore remains

good. The volume of problem loans increased by CZK 22 billion in 2012, but the proportion of problem loans remained stable throughout the year at 3.1-3.2% of total:

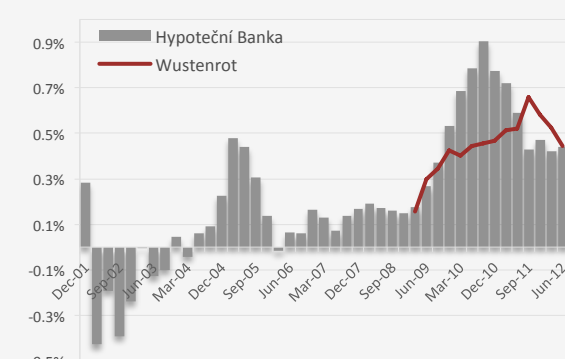
**Chart 9: Non-performing loans (as % of total loans)**



Source: ČNB, Banks, Helgi Analytics

The cost of risk (loan loss provisions to loans) has settled down at around 50 bp in the last two years, and is also 30-50% lower when compared to the banks' total loan book:

**Chart 10: Cost of risk**



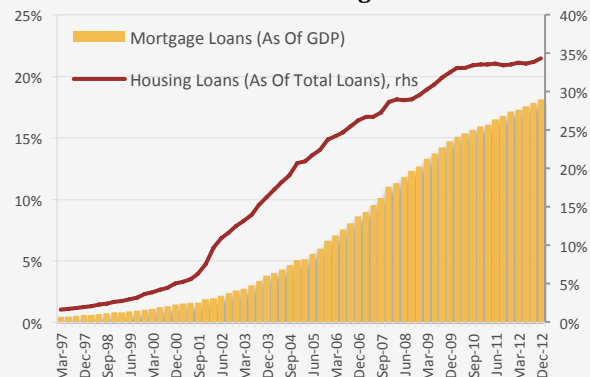
Source: ČNB, Banks, Helgi Analytics

## Penetration & House Affordability

### Mortgages represented 18% of GDP in 2012.

Residential mortgage loans increased 6.3% yoy to CZK 700 bil in 4Q12 and represented 18.1% of GDP. Together with other housing loans, the total exposure of residential housing lending represented 21% of GDP and more than a third of total bank loans:

**Chart 11: Penetration of housing loans**



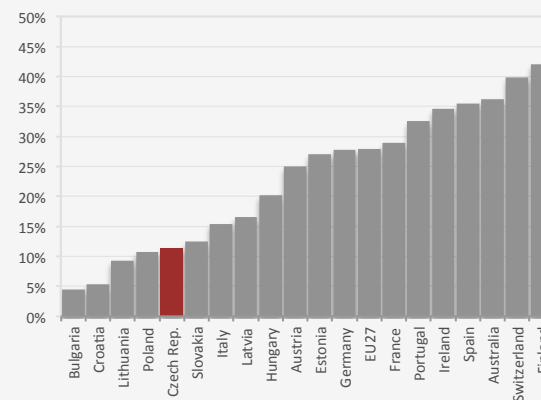
Source: ČNB, ČSÚ, Helgi Analytics

### Some 14% of households have a mortgage loan..

The penetration of housing loans has continued to grow for over 15 years now. We estimate that approximately 14% of households in the Czech Republic had a mortgage loan at the end of 2012. In addition, every fifth Czech household had a loan from a building society at the year's end.

This is still relatively little when compared to the West, where around a third of families live with a mortgage loan. Czechs own most of the dwellings they live in (80%) and there is no shortage of housing stock, so mortgage lending growth is therefore fuelled by the desire to improve living standards rather than fulfilling basic needs.

**Chart 12: Households with mortgage loan, 2010**



Source: ČNB, ČSÚ, Eurostat, MMR, Helgi Analytics

Czechs remain fairly conservative worldwide - nearly all mortgage loans are CZK-denominated and the average loan-to-value ratio accounts for only around 65%.

### Housing affordability has been improving

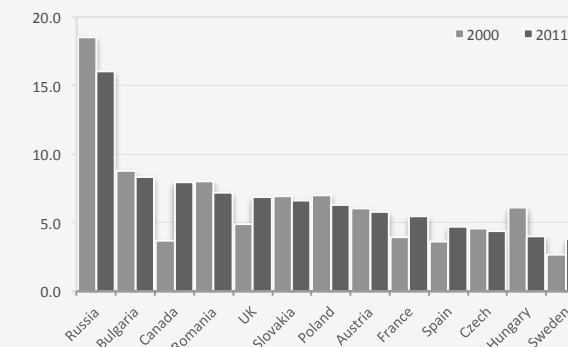
Czech real estate prices have tripled over the last decade in USD terms. The average dwelling (a 64-sqm flat) costs around USD 70,000 (or USD 1,047 per sqm) and one would pay roughly twice as much in Prague, the Czech capital city.

The affordability of housing has been improving since 2008, when real estate prices started falling. To buy an average-sized flat now would take an average earner over four annual gross salaries. This puts the Czech Republic among the cheapest places in Europe in terms of residential housing, alongside Hungary, or Sweden, for example.

Large differences remain within the country, however. While a citizen of Prague has to put aside about eight annual salaries to buy an average flat, it takes slightly

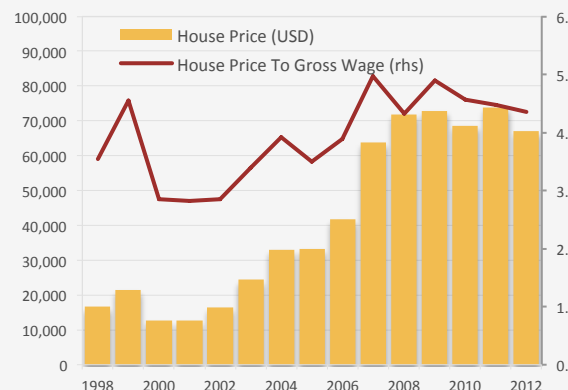
more than two years to save for a flat in Ústí nad Labem or in Ostrava.

**Chart 13: House Affordability, International (years)**



Source: ECB, ČNB, Eurostat, Statistical Offices, Helgi Analytics  
When looking back, housing affordability in the Czech Republic has improved to the level last seen in 1999:

**Chart 14: House Affordability, Czech Republic (years)**



Source: ČNB, ČSÚ, Helgi Analytics

## Game Of Mortgage Thrones – Top 4 Banks

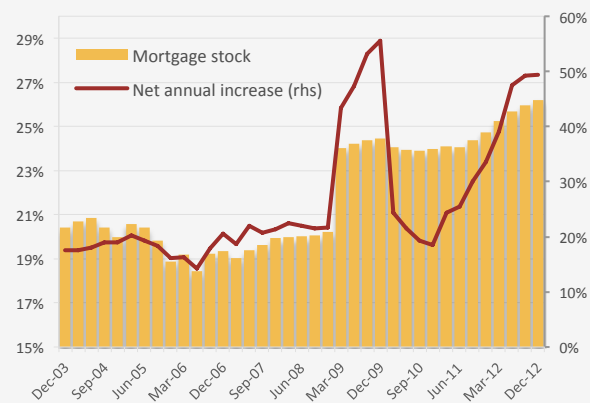
Here, we provide a short overview of the main mortgage players and their performance in 2012 and 4Q. Ultimately, we try to point out the biggest gains and losses on the mortgage chessboard in the last 12 months. We describe each bank's performance in more detail at the end of the report (starting on page 11).

### ČSOB - the undisputed King

ČSOB (or its subsidiary Hypoteční Banka) is the absolute winner of the year 2012. It strengthened its market position by 1.5% to 26.2% and granted over CZK 36 bil of new loans, or 30% of last year's total. Hypoteční's financials suggest that the mortgage business forms around 20% of ČSOB's overall profitability.

The fourth quarter's numbers, however, imply increasing pressure from Česká Spořitelna, which sold 1,259 mortgages more than ČSOB. A new challenger for 2013?

**Chart 15: ČSOB's market position**



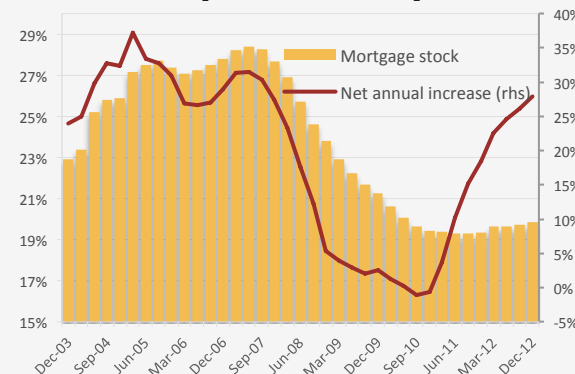
Source: ČSOB, ČNB, Helgi Analytics

### Česká Spořitelna – the 2013 challenger?

Česká Spořitelna has gradually been regaining some of the position it lost to ČSOB in 2007-2009. In the last year, the bank has increased its market share by 0.5% to 19.9%. The bank was particularly strong in the last quarter, when it sold 30% of the market's new loans.

Partly because of the bank's relatively weak position in the mortgage business and the strong profitability of its other operations, we estimate Česká Spořitelna's mortgage business only contributes some 12% to the overall bottom line.

**Chart 16: Česká Spořitelna's market position**

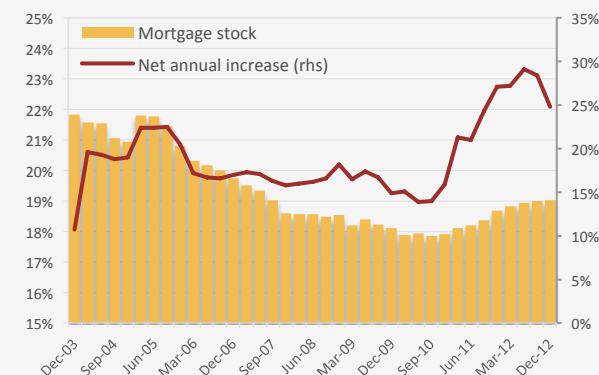


Source: ČS, ČNB, Helgi Analytics

### Komerční Banka – running out of steam?

Similarly to Česká Spořitelna, Komerční Banka has been gaining market share in mortgage lending since the end of 2010. In 2012, the bank gained 30 bp and held 19% of the market at the end of the year. Unlike its two bigger sisters, however, Komerční's momentum weakened towards the year's end. In 4Q, the bank sold 18% of the new mortgages, compared to the 30% of Česká Spořitelna and 27% of ČSOB.

**Chart 17: Komerční Banka's market position**

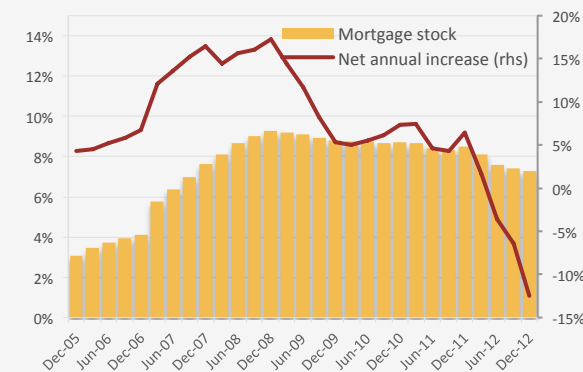


Source: KB, ČNB, Helgi Analytics

### Raiffeisenbank – shaken, but alive

The bank's market position has been weakening since the end of 2008 partly on the back of the bank's weak funding and capital constraints. In 1H12, the bank sold only 3% of the market's new loans, but recovered to a 9% share at the end of the year:

**Chart 18: Raiffeisenbank's market position**



Source: Raiffeisenbank, ČNB, Helgi Analytics



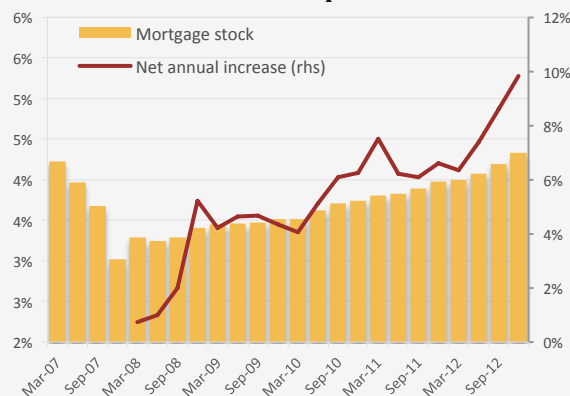
## Game Of Thrones – Other Banks

### UniCredit – attack from the second row

Following the digesting of the merger of three different banks (UniCredit, HVB and Živnostenská Banka), UniCredit has been increasingly targeting the retail segment.

As shown below, the bank has gone a different way from its peer Raiffeisenbank – a more stable and balanced one. UniCredit has been increasing its share by 30 bp a year in the last two years and granted nearly 10% of the new loans in 2012:

**Chart 19: UniCredit's market position**



Source: UniCredit, ČNB, Helgi Analytics

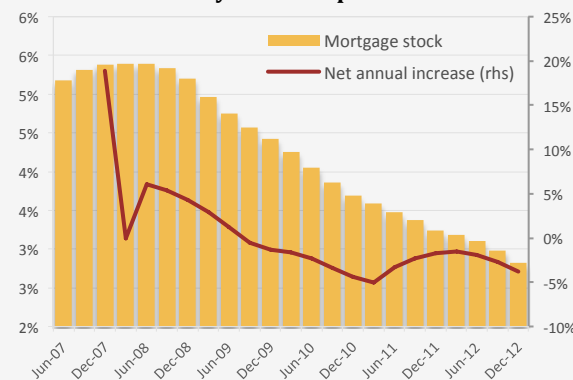
### GE Money Bank – giving up?

Similarly to Česká Spořitelna, GE Money Bank gave up on mortgage lending in 2008, handing over its share mostly to ČSOB's Hypoteční Banka. From having 5.4% at the end of 2008, GE Money held only 2.8% of the Czech mortgage lending market at the end of 2012.

The change in the bank's strategy can be nicely seen when mortgage loans are compared to the development in household deposits and consumer lending – the bank

has increased its market share by 2% and 3%, respectively, since 2008.

**Chart 20: GE Money's market position**



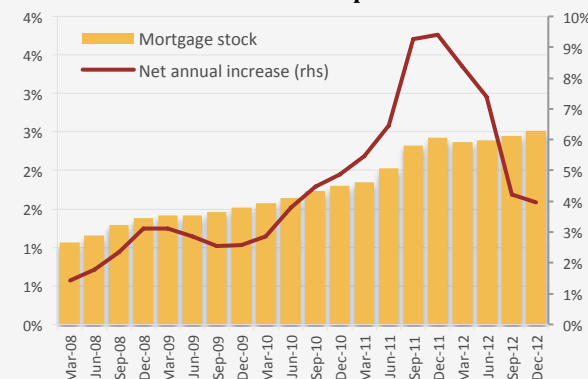
Source: GE Money Bank, ČNB, Helgi Analytics

### Wüstenrot – the little one behind

Wüstenrot Hypoteční banka has been one of the banks filling up the space emptied by GE Money or Česká Spořitelna. Despite being a relatively small player, it has gradually increased its market share from around 1% in 2007 to 3% at the end of 2012.

The comparison of financials between Hypoteční Banka and Wüstenrot provides a pretty interesting picture of how economies of scale work. While Hypoteční's efficiency improved to around 15-20% in terms of cost to income and adjusted ROE amounts to 20-30%, Wüstenrot "struggles" with a cost-to-income ratio of around 50% and its ROE hardly exceeds the 10% threshold.

**Chart 21: Wüstenrot's market position**

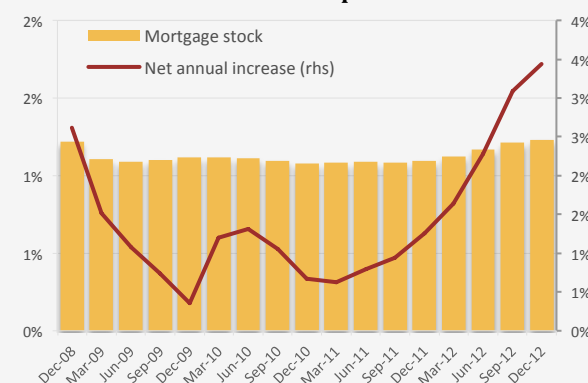


Source: Wüstenrot Hypoteční Banka, ČNB, Helgi Analytics

### Sberbank – the dark horse?

Sberbank took over Volksbank's operations only last year, so historical numbers seem to be less relevant than Sberbank's future plans. And this is something we will have to wait a couple of quarters for, given Sberbank's lack of a track record in the CEE region.

**Chart 22: Sberbank's market position**



Source: Sberbank, ČNB, Helgi Analytics

## Mortgage Loans – Key Financials

**Table 1: Key characteristics of Czech housing lending**

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
Housing Loans (CZK bil)	730,152	743,389	755,666	772,866	777,424	787,414	796,247	809,971
Mortgage Loans (CZK bil)	612,933	630,244	642,738	659,001	665,431	677,000	686,841	700,488
Building Society Loans (CZK bil)	297,527	299,037	299,440	297,653	292,845	291,221	289,901	287,847
Housing Loans (As % Of GDP)	19.2%	19.5%	19.7%	20.1%	20.2%	20.4%	20.7%	21.0%
Mortgage Loans (As % Of GDP)	16.1%	16.5%	16.8%	17.2%	17.3%	17.6%	17.8%	18.1%
Building Society Loans (As % Of GDP)	7.8%	7.8%	7.8%	7.7%	7.6%	7.6%	7.5%	7.5%
Average interest rate (existing stock)	5.29%	5.29%	5.22%	5.13%	5.02%	4.91%	4.81%	3.56%
Average interest rate (new loans)	4.55%	4.43%	4.38%	3.98%	3.94%	3.97%	3.83%	3.63%
Mortgage (As % Of Total Loans)	28.1%	28.5%	28.5%	28.6%	28.9%	28.9%	29.3%	29.7%
NPLs (As Of Mortgage Loans)	3.2%	3.2%	3.3%	3.1%	3.1%	3.2%	3.2%	3.2%
NPLs (As Of Housing Loans)	3.3%	3.3%	3.4%	3.2%	3.3%	3.4%	3.4%	3.4%
Mortgage Loan Contracts	515,678	535,691	552,741	572,633	589,723	608,785	625,680	646,228
Avg. Size Of Mortgage Loan (CZK '000)	1.19	1.18	1.16	1.15	1.13	1.11	1.10	1.08
Households With a Mortgage Loan	11.6%	12.1%	12.4%	12.8%	13.2%	13.6%	13.9%	14.4%
Residential Dwellings With a Mortgage Loan	11.3%	11.7%	12.0%	12.4%	12.8%	13.2%	13.6%	14.0%
Building Society Loan Contracts	985,221	981,359	973,450	956,659	939,557	927,360	913,424	894,358
Avg. Size Of Building Society Loan (CZK '000)	0.302	0.305	0.308	0.311	0.312	0.314	0.317	0.322
Households with a Building Society Loan	22.2%	22.1%	21.9%	21.4%	21.0%	20.7%	20.3%	19.9%
Building Society Deposit Contracts	4,757,301	4,663,792	4,592,720	4,550,468	4,491,711	4,403,435	4,329,383	4,316,999
Avg. Size Of Building Society Deposit (CZK '000)	0.431	0.434	0.432	0.453	0.456	0.458	0.462	0.481
Households With Building Society Deposits	107%	105%	103%	102%	100%	98%	96%	96%
Loans To Deposits (Of Building Societies)	70.1%	70.2%	71.1%	68.7%	68.4%	68.6%	68.8%	66.9%

Source: ČNB, ČSÚ, MMR, Ministry of Finance, Association of Building Societies, Helgi Analytics

## Four Lessons From Hypoteční Banka's Financials

Hypoteční Banka is the largest player on the Czech mortgage lending market, with a share of over 25%. Luckily, it is a pure mortgage player, which gives us plenty of useful information about the mortgage business. We therefore use Hypoteční Banka's financials to analyse the whole mortgage market in the Czech Republic.

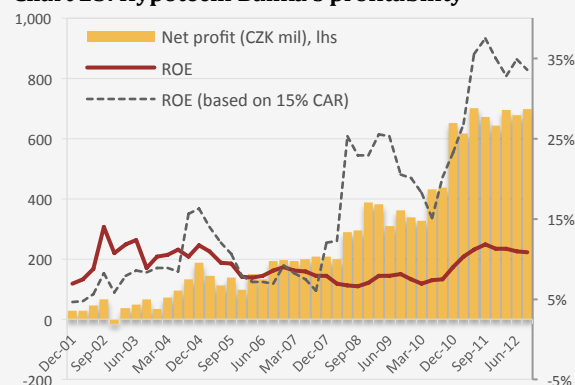
Here are the main conclusions from the exercise:

### Lesson 1: Mortgage lending is highly profitable

Hypoteční Banka has been showing a fairly lousy ROE of less than 10% since 2005. This is highly misleading, as the bank's capital adequacy ratio (CAR) has been kept at 40-50% since 2008, when a hefty share capital increase was made. When the CAR is "adjusted" to 15% (in line with the banking sector), Hypoteční's ROE jumps to a more realistic 20-30%.

Hypoteční Banka's net profit has jumped more than three times since 2007, which already tells us something:

**Chart 23: Hypoteční Banka's profitability**



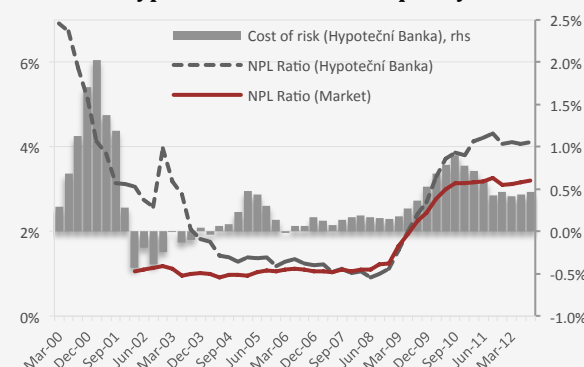
Source: Hypoteční Banka, ČNB, Helgi Analytics

### Lesson 2: Mortgage lending is safe

As already shown above, the asset quality of mortgages is very good. At the end of 2012, non-performing loans accounted for only 3.2% of total mortgage loans.

Hypoteční Banka has been gaining market share over the last 18 months, so its asset quality has deteriorated more than that of the market. Still, the bank's cost of risk has stayed below 50 bp of average loans, a clear sign of the bank is not having a problem with asset quality:

**Chart 24: Hypoteční Banka's asset quality**



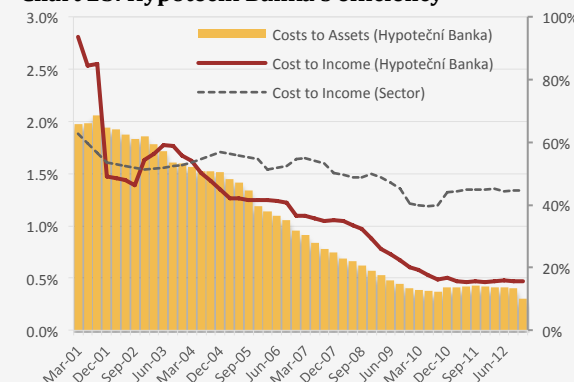
Source: Hypoteční Banka, ČNB, Helgi Analytics

### Lesson 3: Mortgage lending is cost-efficient

Mortgage lending could be extremely cost-efficient once it crosses a certain volume of loans. Although Czech banks already belong among the most efficient in the CEE region (with costs to income at below 50%), Hypoteční Banka is a different species.

From costs representing over 80% of income when the business started in 2000, the bank's ratio has dropped below 20% now. Although one might argue about efficiency gains from being in the ČSOB family, the numbers speak for themselves:

**Chart 25: Hypoteční Banka's efficiency**

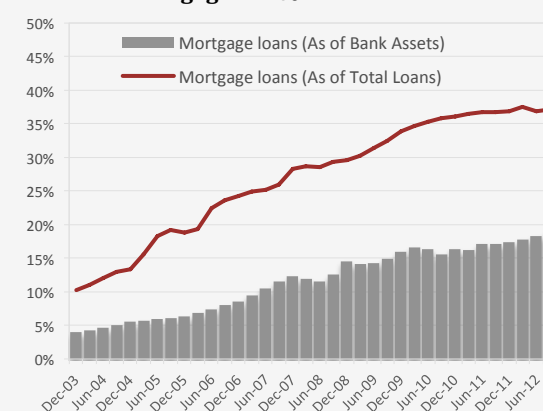


Source: Hypoteční Banka, ČNB, Helgi Analytics

### Lesson 4: Mortgages drive banking growth

Mortgage loans have grown by an impressive 27% a year in the last decade, being the single biggest driver of asset growth. Despite the weakening momentum, mortgages are still the main engine of the sector's growth:

**Chart 26: Mortgages as % of bank loans and assets**



Source: ČNB, Helgi Analytics

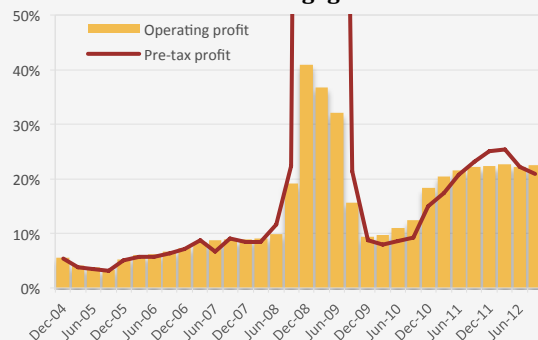


## Mortgage Business Forms 15% of Banks' Profits

### Mortgages generate over 20% of profit in ČSOB

As mortgage business has grown to a sizable amount and profitability has jumped, Hypoteční banka has an important contributor to the overall profitability of ČSOB, Hypoteční's sole owner. In 2012, the mortgage business generated 22% of ČSOB's operating profit and 21% of its pre-tax profit, by our calculations:

**Chart 27: Profit from mortgages at ČSOB**



Source: ČSOB, Hypoteční banka, Helgi Analytics

With enough imagination, the HB example could be applied to other banks, to see how much of their profit comes from the mortgage lending business. We therefore take HB's financials as a benchmark and apply them to the other banks. The key assumptions are presented as a percentage of average mortgage loans:

**Table 2: Hypoteční Banka's assumptions**

	2009	2010	2011	2012
Average yield*	5.0%	5.2%	5.1%	4.8%
Net interest margin*	2.1%	2.6%	2.8%	2.6%
Revenue margin*	2.3%	2.9%	3.0%	2.9%
Cost to income	20.3%	16.7%	15.5%	15.6%
Cost of risk*	0.53%	0.77%	0.47%	0.47%
Effective tax rate	20.1%	19.2%	19.1%	19.1%
<b>Net profit*</b>	<b>1.07%</b>	<b>1.31%</b>	<b>1.70%</b>	<b>1.60%</b>

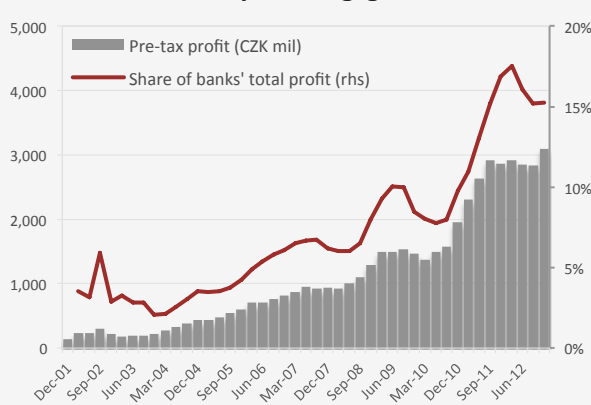
Source: Hypoteční Banka, Helgi Analytics, \* as of mortgage loans

However, we make one adjustment to reflect HB's unique position in the market. We add a 5% "premium" to the cost-to-income assumption for the two other large banks (Spořitelna and Komerční) to reflect Hypoteční's superior economies of scale, a further 15% addition for the mid-sized banks (UniCredit and Raiffeisenbank) and a further 10-15% surcharge for the other banks (to reflect the fact that Wüstenrot has been operating with a cost to income ratio of 40-50% in the last years).

As a result, we assume a cost-to-income ratio of 21% for Komerční and Spořitelna on their mortgage business in 2012, 36% for UniCredit and Raiffeisenbank and 40-50% for the remaining banks, for example, rather than the 16% achieved by Hypoteční Banka.

**We guesstimate that mortgage lending generated 15% of the total profit of the Czech banking system in 2012, three times as much as five years ago. Also, mortgage business generates ROE of more than 20%:**

**Chart 28: Profitability of mortgage loans**

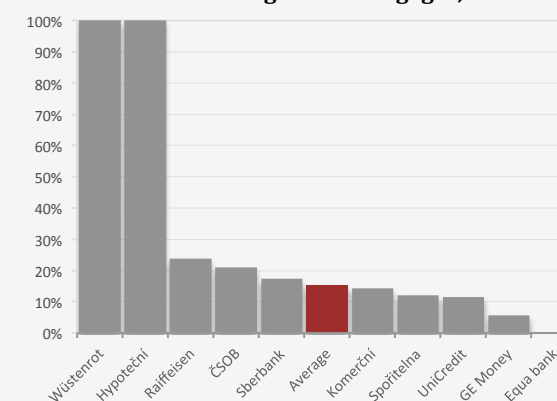


Source: Hypoteční Banka, ČNB, Helgi Analytics

ČSOB seems to have the largest share of profit coming from the mortgage lending business within the top 3 banks. It's more than 20%, according to our estimates. On the other hand, Česká spořitelna seems to generate only 12% from mortgages.

Apart from the relatively stronger position of ČSOB in mortgage lending (with a 26% share of the market versus the 20% share of Česká), Česká Spořitelna benefits from stronger profitability elsewhere (such as on its cheaper deposit base):

**Chart 29: Profit coming from mortgages, 9M2012**



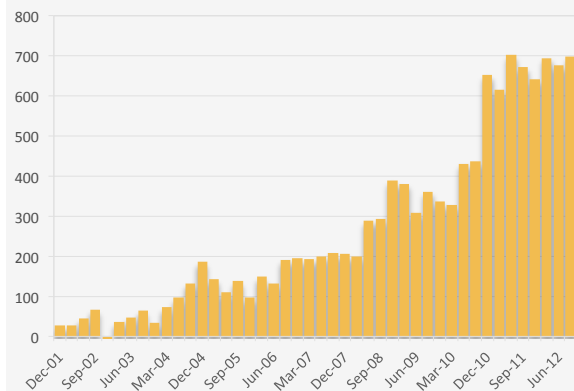
Source: ČNB, Banks, Helgi Analytics

The 24% profit contribution of Raiffeisenbank seems to be the most interesting feature within the mid-sized banks. With a 10% market share of residential mortgage lending and 44% of the bank's total loans coming from this area, Raiffeisenbank seems to be the one most exposed to residential mortgage lending on the Czech market.

The detailed assumptions and ratios for each bank's mortgage business could be found in the company section on page 14.

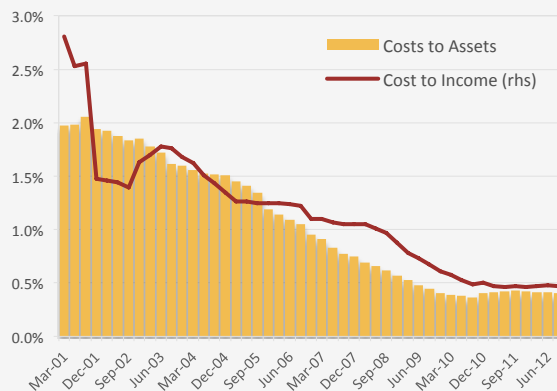
## Hypoteční Banka – The Ultimate Benchmark

**Chart 30: Net profit (CZK mil)**



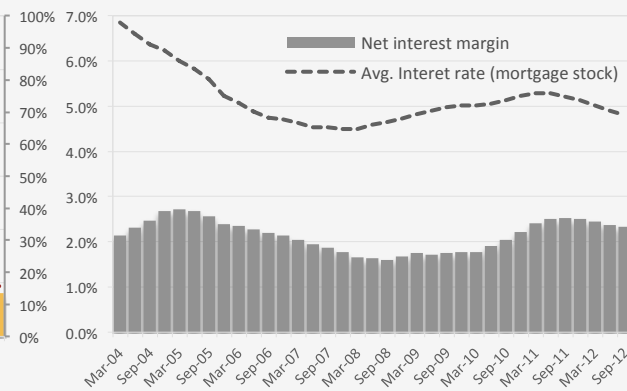
Source: ČSOB, Hypoteční banka, Helgi Analytics

**Chart 31: Cost efficiency**



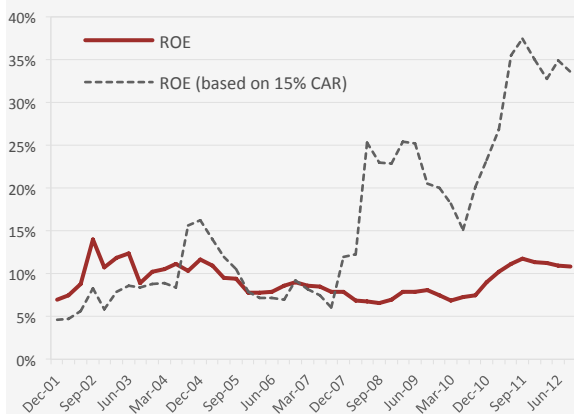
Source: ČSOB, Hypoteční banka, Helgi Analytics

**Chart 32: Net interest margin**



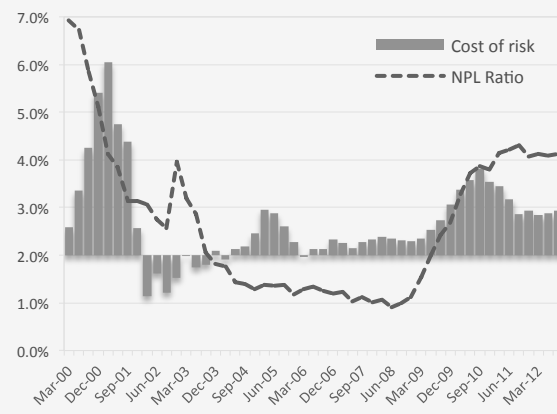
Source: Hypoteční Banka, Helgi Analytics

**Chart 33: ROE**



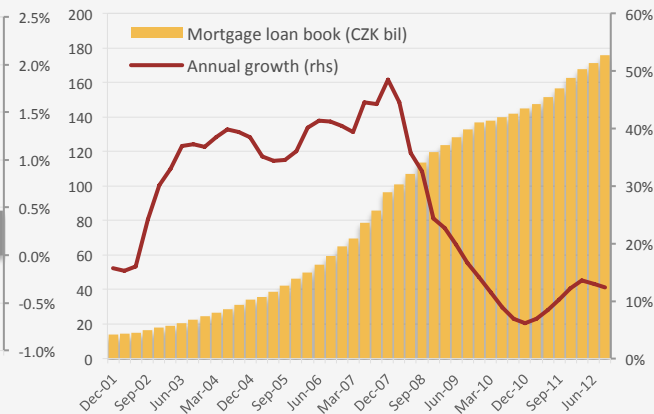
Source: Hypoteční Banka, Helgi Analytics

**Chart 34: Asset quality**



Source: Hypoteční Banka, Helgi Analytics

**Chart 35: Volume and momentum**



Source: Hypoteční Banka, Helgi Analytics

## Hypoteční Banka – Key Figures

**Table 3: Key characteristics of Hypoteční Banka's housing lending**

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12
Mortgage Loans (CZK bil)	147.5	151.5	156.3	162.8	167.6	171.2	175.6
Mortgage Loans (As % Of Assets)	88.7%	89.2%	89.3%	89.9%	88.5%	88.0%	88.6%
Market Share in Mortgage Loans	24.1%	24.0%	24.3%	24.7%	25.2%	25.3%	25.6%
Market Share in New Mortgage Production (ČSOB)	30.0%	29.1%	28.8%	27.8%	29.3%	30.8%	30.2%
Market Share in Net Mortgage Increase (ČSOB)	22.0%	24.0%	28.6%	32.6%	38.3%	42.0%	43.6%
Net Interest Margin (As % Of Total Assets)	2.40%	2.50%	2.52%	2.50%	2.44%	2.37%	2.33%
Avg. Yield On Mortgage Loans	5.29%	5.29%	5.22%	5.13%	5.02%	4.91%	4.81%
Cost To Income	15.6%	15.3%	15.6%	15.5%	15.6%	15.8%	15.6%
Costs To Assets	0.41%	0.42%	0.43%	0.42%	0.41%	0.41%	0.40%
Cost Of Risk	0.72%	0.59%	0.43%	0.47%	0.42%	0.44%	0.47%
NPLs (As % Of Total Loans)	4.14%	4.22%	4.31%	4.07%	4.12%	4.08%	4.12%
Provisions (As % Of NPLs)	33.7%	33.2%	33.5%	34.7%	35.3%	37.2%	38.5%
Hypoteční Banka's Operating Profit (CZK mil)	1,007	996	962	1,016	1,048	1,008	1,070
- As % Of ČSOB's Operating Profit	20.8%	23.1%	22.0%	23.5%	22.0%	21.4%	23.0%
Hypoteční Banka's Pre-tax Profit (CZK mil)	762	876	829	786	859	836	870
- As % of ČSOB's Pre-tax Profit	17.0%	31.8%	26.2%	30.4%	18.3%	18.5%	20.5%
ROE*	24.7%	29.5%	32.4%	32.6%	33.5%	32.4%	31.7%
ROE (ČSOB)	20.8%	19.8%	19.5%	18.2%	18.8%	20.5%	21.1%

Source: ČNB, ČSÚ, MMR, Ministry of Finance, Association of Building Societies, Helgi Analytics

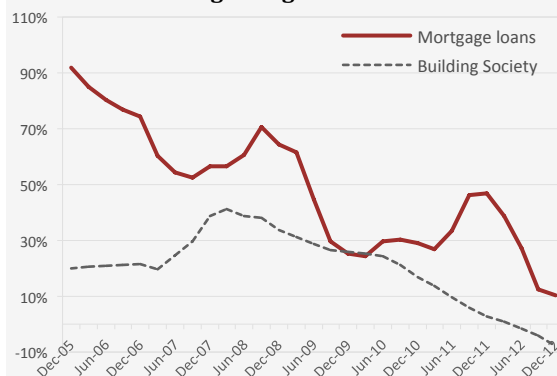
\*Adjusted to put Hypoteční Banka's capital adequacy ratio in line with the market

## Wüstenrot Hypoteční Banka

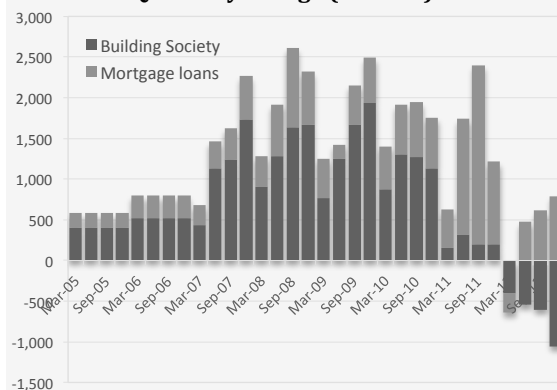
### Wüstenrot continues to build its market share...

Wüstenrot's mortgage loans increased by an impressive 4.7% qoq and over 10% yoy for the full year. On the other hand, Wüstenrot's building society lending has dropped nearly 8% yoy, the most among the five building societies:

**Chart 36: Housing loan growth**



**Chart 37: Quarterly change (CZK mil)**



Source: Wüstenrot, RSS, Helgi Analytics

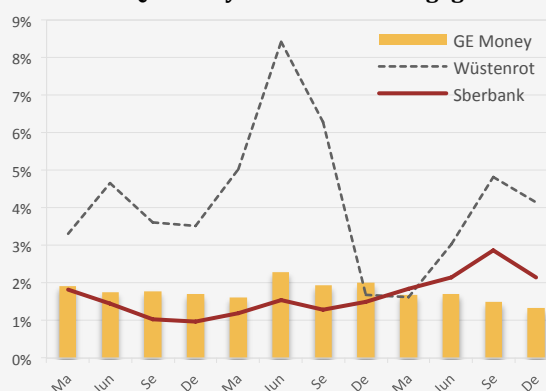
### ... but from a very low starting-point

Although Wüstenrot has been growing more than twice as fast as the overall market over the last five years, its late arrival in the mortgage business a decade ago means the bank still occupies only 2.5% of the market. While not bad as such (the bank held only 1.5% of the market in 2009), it remains well below the share the bank holds in the building society business (10.5%) and represents only a tenth of the figure for the other only pure mortgage player on the market – Hypoteční Banka.

The slowdown of the overall market growth (from 20-30% a year to 6% now) also makes it more difficult for Wüstenrot to catch up with the bigger players.

In 4Q, the bank sold 3.4% of the new production and held 4% of the net increase in the mortgage loan stock. This is a respectable achievement, though somewhat lower than in the previous quarters. In 2011, the bank was selling 5-6% of the new loans, for example:

**Table 38: Quarterly sale of new mortgage loans**



Source: Banks, MMR, Helgi Analytics

### Lack of scale hurts profitability

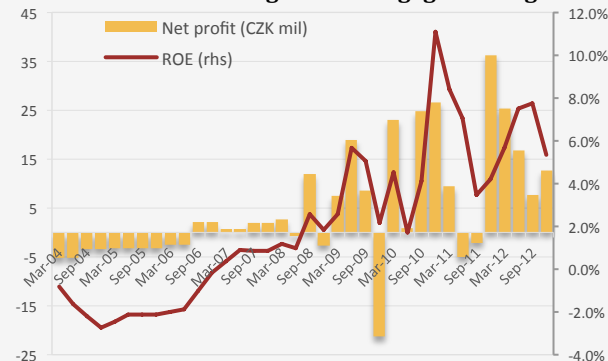
The relatively small market share and a lack of scale as a result make the biggest (though not the only one, obviously) difference when compared to Hypoteční Banka, in our view.

While interest margin and asset quality numbers seem comparable between the two banks, the cost side makes the biggest difference in our view:

- ✓ Wüstenrot operates with a cost-to-income ratio of around 45-55%, compared to the less than 16% of Hypoteční Banka
- ✓ Costs represent 0.4% of average assets at Hypoteční Banka, compared to 0.9% at Wüstenrot and 1.6% of the market, on average

As a result, Wüstenrot achieves ROE in single-digit territory, while Hypoteční banka has been enjoying profitability implying ROE of over 30% (when adjusted for its hefty overcapitalisation):

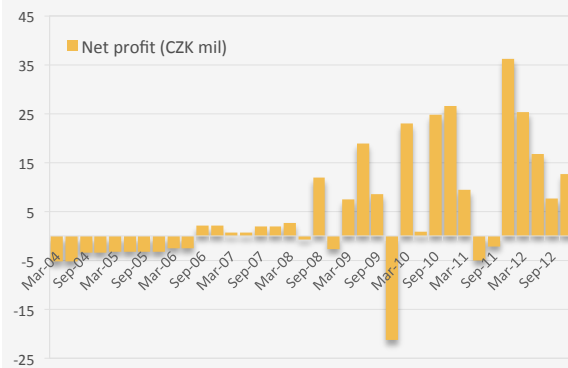
**Chart 39: Profit coming from mortgage lending**



Source: Hypoteční Banka, Wüstenrot, Helgi Analytics

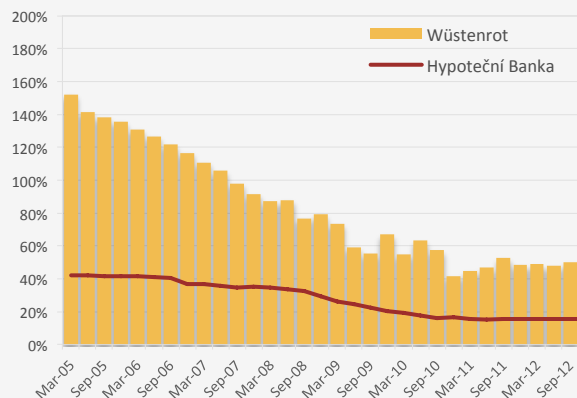
## Wüstenrot Hypoteční Banka

**Chart 40: Net profit from mortgages**



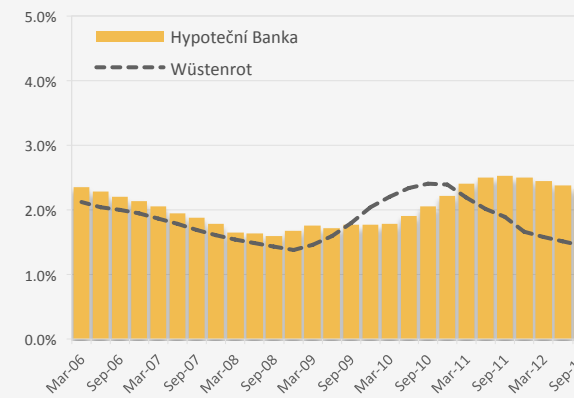
Source: Wüstenrot, Hypoteční banka, Helgi Analytics

**Chart 41: Cost to Income**



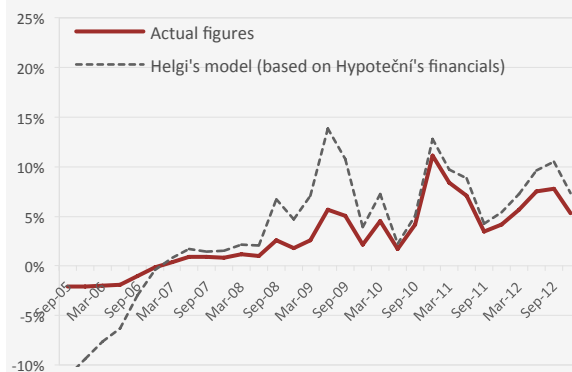
Source: Wüstenrot, Hypoteční banka, Helgi Analytics

**Chart 42: Net interest margin**



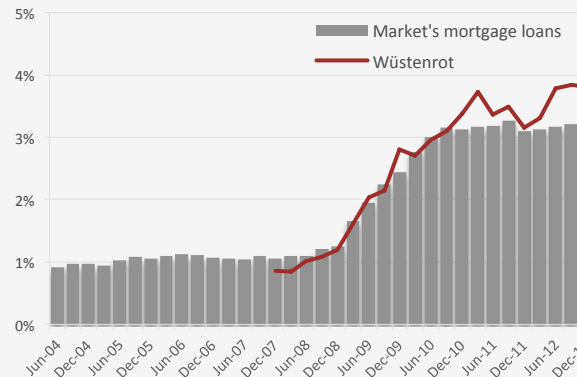
Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

**Chart 43: ROE**



Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

**Chart 44: Asset quality (NPL Ratio)**



Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

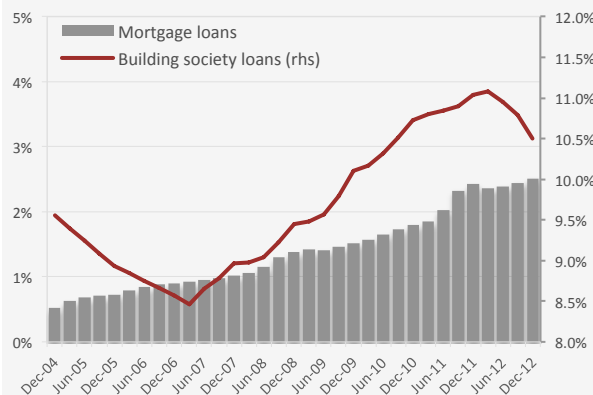
**Chart 45: Volume and momentum**



Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

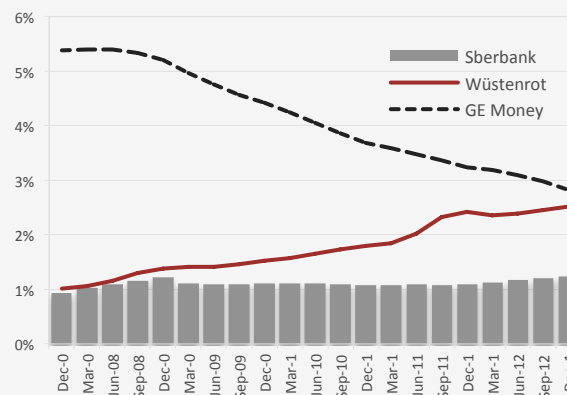
## Wüstenrot Hypoteční Banka

**Chart 46: Market share – existing stock**



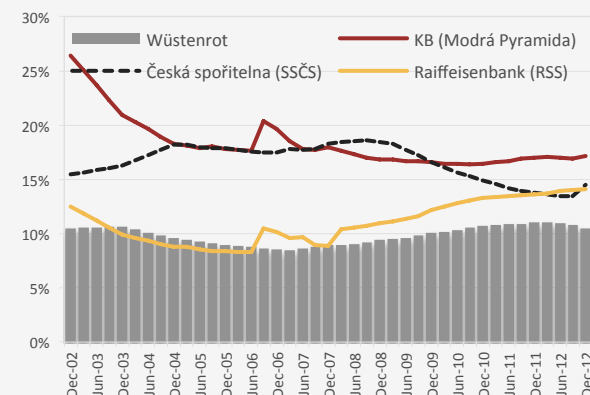
Source: Wüstenrot, Hypoteční banka, Helgi Analytics

**Chart 47: Mortgage loans – existing stock**



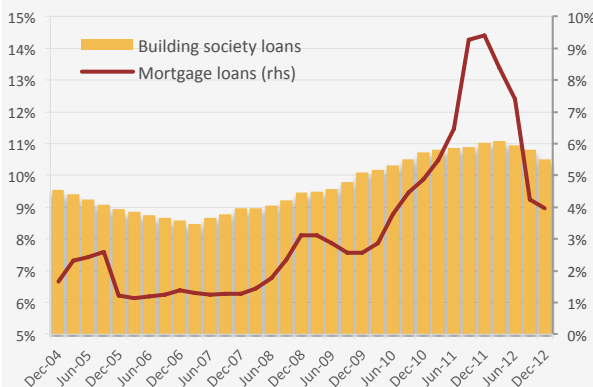
Source: Wüstenrot, Hypoteční banka, Helgi Analytics

**Chart 48: Building Society loans – existing stock**



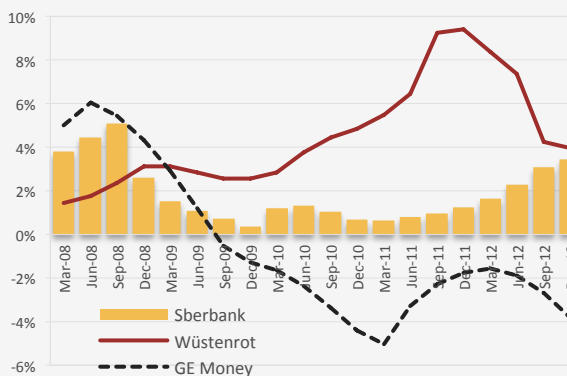
Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

**Chart 49: Market share – new loans**



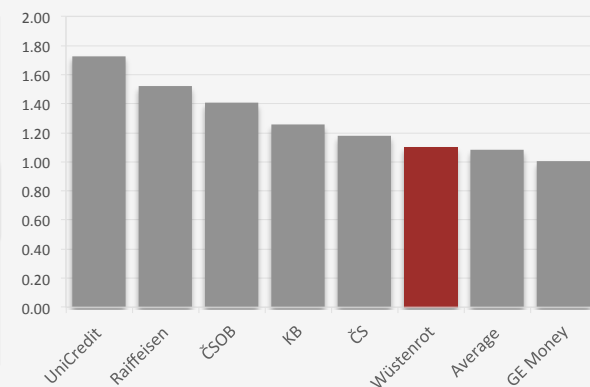
Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

**Chart 50: Mortgage loans – new loans**



Source: Wüstenrot, Hypoteční Banka, Helgi Analytics

**Chart 51: Avg. Size of Mortgage Loans (CZK mil)**



Source: Wüstenrot, Hypoteční Banka, Helgi Analytics



## Wüstenrot Hypoteční Banka – Key Figures

**Table 3: Key characteristics of Wüstenrot's housing lending**

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
Housing Loans (CZK bil)	43.5	45.2	47.6	48.8	48.2	48.1	48.1	47.8
Mortgage Loans (CZK bil)	11.3	12.8	15.0	16.0	15.7	16.2	16.8	17.6
Building Society Loans (CZK bil)	32.1	32.4	32.6	32.8	32.4	31.9	31.3	30.2
Mortgage Loans (As % Of Assets)	79.1%	83.8%	90.8%	82.2%	78.3%	79.4%	82.8%	87.4%
Building Society (As % Mortgage Loans)	283%	254%	218%	206%	206%	197%	186%	172%
Market Share in Housing Loans	6.0%	6.1%	6.3%	6.3%	6.2%	6.1%	6.0%	5.9%
Market Share in Mortgage Loans	1.85%	2.02%	2.33%	2.42%	2.36%	2.39%	2.45%	2.51%
Market Share in Building Society Loans	10.8%	10.9%	10.9%	11.0%	11.1%	11.0%	10.8%	10.5%
Market Share in New Mortgage Production	4.2%	5.5%	6.0%	5.3%	4.5%	3.1%	2.7%	3.4%
Market Share in Net Mortgage Increase	5.5%	6.5%	9.3%	9.4%	8.4%	7.4%	4.2%	4.0%
Net Interest Margin (As % Of Total Assets)	2.19%	2.01%	1.89%	1.65%	1.58%	1.51%	1.45%	1.44%
Avg. Yield On Mortgage Loans	4.92%	4.77%	4.66%	4.95%	4.92%	4.92%	4.92%	4.55%
Cost To Income	45.1%	46.8%	52.6%	48.6%	49.0%	47.9%	50.3%	52.0%
Costs To Assets	0.89%	0.91%	0.88%	0.83%	0.86%	0.86%	0.91%	0.83%
Cost Of Risk	0.47%	0.51%	0.52%	0.66%	0.58%	0.52%	0.44%	0.45%
NPLs (As % Of Total Loans)	3.7%	3.4%	3.5%	3.2%	3.3%	3.8%	3.8%	3.8%
Provisions (As % Of NPLs)	21.6%	23.7%	25.2%	33.0%	33.3%	29.9%	30.5%	35.2%
ROE	8.4%	7.1%	3.4%	4.2%	5.6%	7.5%	7.8%	5.3%
ROA	0.5%	0.4%	0.2%	0.2%	0.3%	0.4%	0.4%	0.3%

Source: ČNB, ČSÚ, MMR, Ministry of Finance, Association of Building Societies, Wüstenrot, Helgi Analytics

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