CREDIT BANK OF MOSCOW

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Conference Transcription

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Speakers: Vladimir Chubar, Eric de Beauchamp, Elena Finashina

Operator: - Good day and welcome to the CREDIT BANK OF MOSCOW 1H 2018 financial and business results conference. Today's call is being recorded. At this time, I would like to turn the conference over to Elena from Investor Relations. Please go ahead.

Elena Finashina: - Thank you very much and good afternoon, ladies and gentlemen. We are pleased to welcome you to the 6 months 2018 financial and business results call of CREDIT BANK OF MOSCOW, and in the course of our presentation today, our CEO, Vladimir Chubar will give an update on the key financial and business highlights of the reporting period. And Eric de Beauchamp, Senior Vice President of CBM, will dwell on financial performance of the Bank for the 6 month period of this year. Our presentation will be followed by a usual Q&A session, and you are very welcome to ask your questions to our speakers. Now I turn the floor over to our first speaker, so Vladimir, please go ahead.

Vladimir Chubar: - Thank you, Elena. Good afternoon, ladies and gentlemen, and thank you for joining us today.

- We have passed the middle of the year, and its first half was already full of different types of activities for us. The start of the year was quite positive from the international capital markets perspective, and allowed us to strengthen our position as the most active international debt borrower from the CIS. We also were awarded by credible international financial resources as the Best Bank in Russia, and for Best Banking Corporate Governance in Russia. Later on in a year certain degree of market volatility has materialised with new geopolitical pressures, which still set the tone in the financial market. In this unstable environment, and also guided by our willingness to support our debt investors, we initiated 2 liability management exercises, ensuring better liquidity for our bonds.

- Our financial performance for the first 6 months of 2018 is solid, and being part of the Russian banking sector, our performance is certainly subject to market trends dominating in the economy. Thebanking sector growth is moderate and is held back by sluggish investments and production, which translates into poor demand for loans by corporates. We see similar downtrend in our loan portfolio, which is also reinforced by tougher competition for the high quality names and limited risk appetite for the rest of the market. We project that similar trends will dominate in the nearest future, and lending growth this year will be close to zero in real terms. In this challenging operating environment we try to focus on developing new effective products, unique product propositions for all clients and increasing the quality of our services, which is to drive client loyalty and to cement our strong positions in the market against competition.

- Now, let's discuss in more details the performance of the bank in the 1H 2018. Let's turn to slide number 2 of our webcast presentation. Net income increased by 10% year-on-year and reached RUB11 bln following loan portfolio quality improvement and assets growth. High operating efficiency traditionally contributes to the net income growth with the cost to income ratio of 31.3%. Net interest income increased by 15% as compared with the first half year results of 2017 based on expansion of interest earning assets. Our net fee and commission income decreased year-on-year by 16.7% to RUB 5.7 bln as a result of high competition and lower fees from documentary transactions and currency exchange. Net interest margin is down to 2.7% constrained by falling interest rates in the economy and highly liquid balance sheet of the Bank, while net interest margin on average risk-weighted assets demonstrated slight improvement to 4.5% versus 4.3% a year ago. Return on average equity returned to high teens level and reached solid 16.5%. Gross loans to customers decreased in the first 6 months of 2018 by almost 13% to a bit more than RUB 700 bln, actually at RUB 712.9 bln mainly due to large redemptions by corporate clients in the first quarter of this year, while in the second quarter loans regained 2.7% versus the first quarter results. Loan portfolio risk metrics keep improving with the NPL ratio down to 1.6% from 2.4% in the end of 2017 and cost of risk down to 1.1% from 2.5% mostly as a result of sale and partial repayment of 2 large exposures. NPL provisioning ratio increased from 250% in 2017 to more than 400% in the 1H 2018 in line with the positive NPL dynamics. Capital adequacy ratios remained strong with Tier 1 ratio of almost 15% and Total capital adequacy ratio of 23.5%.

- Now, let's turn to business highlights on **slide number 3**. Gross corporate loans reduced by 15% in the first half of 2018 to RUB 623 bln due to large repayments in the first quarter, while retail loans changed the traditional downward trend and increased slightly by 2% to RUB90 bln. Corporate loans still make over 87% of total loans. Top sectors in the loan book remain crude oil production and trading making 24% of total loans, petroleum refining with 16% share, residential construction extended at 9% and automotive sector making 8%. No shifts in the retail loan book product mix: cash loans dominate with a 73.2% share followed by mortgages making 22.5%. Our strategic pillars in further business development remain unchanged: the cornerstone of potential growth is corporate business supplemented by retail business platform, while IB segment drives both FI business development and ensures synergies with corporate and retail businesses.

- Now, I pass the floor to Eric for traditional review of financial results in detail. Eric, please go ahead.

Eric de Beauchamp:

- Thank you, Vladimir, and good afternoon ladies and gentlemen. So now I would like to draw your attention on **slide number 4** with a detailed review of the Bank's income and expenses that showed positive dynamics in the 1H 2018.

- As you can see on the top-left diagram, operating income increased by 3% year-on-year, generally reflecting a business expansion. This increase was attributable to the net interest income, that demonstrated a sound growth of RUB 3.1 bln year-on-year due to the increase of the share of RUB denominated assets in total assets, which on average generate higher interest. At the same time net fee and commission income slightly decreased from RUB 6.9 to RUB 5.7 bln between June 17 and June 18, mainly due to the drop in currency exchange commission and commission from guarantees and letters of credit.

- In the 1H 2018 the Bank reported other net loss in the amount of RUB 400 mln, which resulted from currency revaluation on derivative financial instruments due to the volatility of the FOREX market. On the opposite, some income was generated from the Bank trading some of its loans on the market. On the bottom left diagram, we see that the net fee and commission income decreased by 17% year-on-year. Increased competition made the expansion of fee and commission income more challenging for the Bank, but as we expected cash handling commission recovered compared to the 1Q 2018. Currency exchange commission decreased year-on-year as 2017 figures were boosted by a significant one-off transaction. Commission from guarantees and letters of credit decreased mainly due to the switch to less risky types of guarantees which are generally less profitable, namely guarantees on VAT reimbursement.

- As you can see on the upper right diagram, operating expenses increased by 9% year-on-year. The growth is mainly due to the remuneration expenses, that increased to RUB 6.1 bln on the backdrop of payment of annual bonuses and general business development that implied attraction of highly qualified headcounts from the market. Administrative expenses remained at the level of the 1H 2017, while the other expenses slightly decreased to RUB 500 mln.

- The net interest margin trend is presented on the bottom right diagram. Net interest margin at the end June 2018 remained stable year-on-year at the level of 2.7%, as the Bank is still maintaining a high proportion of highly liquid assets on the balance sheet. The ratio of net interest income divided by the average risk-weighted assets increased over the reporting period to 4.5% reflecting quality business expansion.

- Now I suggest turning to **slide number 5** with a breakdown of total assets. In the reporting period, total assets were maintained roughly at the level of December 2017 showing an increase of 2% to RUB 1.9 tln. Liquid assets, representing 64% of total assets, increased by 13% year-to-date, which was driven by enlarged interbank balances up to RUB 971 bln, with a prevailing share of REPO transactions and by growth of securities portfolio up to RUB 206 bln. Debt securities pledged under reverse REPO transactions formed 72% of unused liquidity sources available from the CBR. Coupled with unpledged on-balance sheet portfolio of Lombard list securities, loans eligible for pledge to the CBR, and eligible for pledge OFZ securities received from the Deposit Insurance Agency in 2015, all these formed solid liquidity buffer which exceeded RUB 550 bln at the end July 2018.

- Classic lending business demonstrated negative dynamics with the net loan book showing a cumulative decrease of 13% in the reporting period. It was mainly driven by the effect of big repayments outstripping new loans origination in the course of the third semester. But it also worth mentioning that during 2Q 2018 net loan portfolio increased by RUB 21 bln to RUB 667 bln, and the net loan portfolio demonstrated positive dynamic for the first time since 2015, going up by RUB 4 bln compared to the 1Q 2018.

- Now, let's move to **slide number 6** on the loan portfolio quality. The portfolio risk metrics have served from stability to sustainable improvement. On the upper left diagram, loan portfolio coverage by impairment allowance decreased to 6.5%, on the backdrop of the loan portfolio increase to RUB 713 bln, and the loan loss provision decrease due to the disposal of NPL loans. On the upper right diagram, the amount of NPL decreased from RUB 17 to RUB 11 bln during the second quarter. The loan loss provision decreased from RUB 48 to RUB 46 bln. A significant decrease of NPLs was mainly attributable to the disposal from one corporate customer that resulted in provisional decrease. NPL coverage ratio increased from 288% at the end of 2017 to 408% at the end June 2018 which was in line with positive dynamics in NPLs.

- The bottom left diagram reflects decrease of NPL from 2.4% to 1.6% at the end June. The cost of risk increased from 0.6% to 1.1% at the end June 2018 which resulted from the creation of additional loan loss provision on two corporate customers. The bottom right diagram depicts traditionally low level of related party lending which was at the level of 3.3% of total gross loan portfolio at the end of the reporting period.

- Now, I suggest turning to **slide number 7** with more details on corporate and retail portfolio risk metrics. Resulted from several big redemptions, corporate gross loan book decreased from RUB 731 to RUB 623 bln in the reporting period with the general improvement of loan portfolio quality which was evidenced by NPL ratio decrease to 1.0%, and cost of risk decrease to 0.8% which is detailed on the bottom left diagram. On the right, the retail loan book NPL ratio remained at the level of 5.7%. The cost of risk demonstrated positive dynamics decreasing notably to 1.9% during the 2Q 2018 compared with 3.9% at the end of last year.

- The next **slide, number 8**, illustrates the funding structure of the Bank. Total liabilities were stable year-to-date at the level of RUB 1.8 tln. Total customer deposits accounting for 55% of total liabilities were flat year –to-date with enlarged share of retail deposits which demonstrated stable growth on the backdrop of expanded in 2016-2017 branch network. Retail deposits increased from RUB 291 to RUB 317 bln during the first half of the year. Deposits by credit institutions were mainly represented by REPO transactions which accounted for 86% of overall interbank balances. Due to banks also contained term deposits, current accounts and the syndicated loan we attracted in March. Wholesale debt repayment schedule is very comfortable for the Bank, with a bulk of international repayments being due after the year 2020.

- Now, let's proceed to the final **slide, number 9**, on the Bank’s capital. The Bank still maintains a very comfortable capital position by the end June 2018, and a very cautious approach to new loan origination coupled with significant redemptions and a large bulk of low risk REPO deals on the balance sheet enables to retain a strong capital position. CBM is the 6th largest bank in Russia by the amount of capital as at 1st July 2018. The regulatory minimums including buffers applicable for systemically important banks, were by far overtopped with N1.1 amounting 8.6%, N1.2 - 12.1%, and N1-0 - 20.6%.

- These were the main highlights of the Bank's financial and business results for the first six months of 2018. Thank you very much for your attention, and now let's proceed to the Q&A session.

Operator: - Thank you. If you would like to ask a question today, please press star one on your touchtone telephone. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, it's star one to ask a question. And I do have a question that comes from Maria Gancheva from HSBC.

Maria Gancheva: - Yes, hi, good afternoon, thank you very much for your presentation. I have joined halfway through, so if you have actually answered that, please excuse me. But I have seen you have a decrease in your loan portfolio, and you're saying it's due to some redemption. Is this a trend we're going to be seeing for this year, and what is the plan for – basically, what is the strategy for growth for this year? There has been an article this morning actually in the press saying a lot of banks have been exposed to retail lending and growing unsecured loans. I think you have stressed enough that that's not your strategy but just want to confirm. Thank you.

Vladimir Chubar: - Hey Maria, nice to hear you, thanks for the question. Actually, we discussed this when we announced the first quarter results. There was repayment of a couple of big loans, and actually, we're not expecting that it's a trend, so it was really one off, so we're not expecting the same decrease, let's say, in the third and fourth quarter. And as you can see in our IFRS, many years, there is a trend, which is in the middle: It can go down a bit and after this, in the third and fourth quarter, we are expecting the growth of the loan book, if I'm saying about the corporate business. You are absolutely right about retail, so we have some issues for the retail, the rate of lending four years ago – three, four – five – four or five, six years ago, so of course now we'll be down with this. And as we now did the same growth in the second quarter, of course it's low result, but we're not expecting that we will come back the same raising nice figures like 50% or 70% growth in the retail lending as we have let's say five years ago.

Maria Gancheva: - Okay, thank you. If I may just ask one more follow-up question. Obviously everybody is very nervous in the market about tomorrow and possible sanctions on the sector. I do understand the talk is about the state-owned banks, but just any sort of prospective results you guys may have on possible sanctions and what that could mean for the sector, will be much appreciated.

Vladimir Chubar: - Thank you for this question. Now we didn't hear any noise, any information public, unpublic, rumours, anything about CBM. There was only one mistake in Russian press a couple of days ago when a group of people, they missed the name, Bank of Moscow and CREDIT BANK OF MOSCOW which is okay. Sometimes it happens, but it was the only signal, we have heard about this, more like a big mistake. Actually, they changed in their information. So, we didn't hear anything. Of course, now, as I said, we're very open to our investors. It's more and more casino, so many issuers, many companies, many banks in Russia can just think that they can be next target, but in our case I think that if you're talking about tomorrow, I didn't hear anything. Over the next one year or two or three, I don't know what will be the geopolitical situation in general, that's why it's hard to comment on this. Maybe all Russia will be under the US sanctions and nobody knows.

Maria Gancheva: - Okay, thank you very much.

Vladimir Chubar: - Thank you.

Operator: - Our next question comes from Alan Webborn from Societe Generale.

Alan Webborn: - Hi, thanks for the time. It's clear that in the second quarter, your net interest income came down materially, and the margin as I calculated has also come down quite a bit. I mean is there – is the key to a level where you think your margin and your baseline is likely to be, or do you think there are some exceptional elements that have pushed down the numbers in the second quarter? That was my first question. I guess the second question was if you're displaying –

Vladimir Chubar: - Can we start with the first ?

Alan Webborn: - Yeah

Vladimir Chubar: - But it's better one by one, because otherwise I will forget about the first question.

Alan Webborn: - Okay, no worries.

Vladimir Chubar: - I will try to answer, if my colleagues want to add something, because we are in a different location, so maybe my colleagues will add something. So, first of all, net interest margin and net income. The margin of course, you're absolutely correct that the usual way of margin was a bit lower than the usual figures, and now it's 2.7, 2.8. But at the same time, net interest margin on risk-weightedassets has increased from 4.3 to 4.5% which is the reflection of the increased volume of the REPOs. So our IB team is working hard and that's why you saw a slight decrease of the net interest margin in the usual way of counting, and at the same time, just to repeat once again, they increased from 4.3 to 4.5% net interest margin on risk-weighted assets.

- In terms of the trends and something like this, you know of course, there is some pressure on the margin in the Russian banking sector; of course, the last let's say month was not easy for the curve of Russian instruments. First of all of course I am saying about the government debt because the pressure from potential sanctions has been altered, that's why of course it came to some correction in the rates. And as you saw of course the Russian Central Bank didn’t change the key rate for two or three times, and first, this is a signal that potentially, the rates can be more stable. We are not expecting decrease of the rates, so at the same time, still I want to say – I want to repeat once again what I said in the beginning of my speech today, that there is the pressure from the competition, and of course the borrowers, they're very – they're like confronting of the offers from the bank and of course it's not an option but unformal auction of the offers. That is why of course there can be some pressure on net interest margin but we’re not expecting that it will be lower, so we are expecting more flat, if you ask about margin.

Alan Webborn: - Okay, could you – I noticed that there's the growth in risk-weighted assets in the second quarter was somewhat higher than sort of lending growth. Could you explain the dynamics there?

Vladimir Chubar: - Dynamics where? In the loan growth or where?

Alan Webborn: - In risk–weighted assets.

Vladimir Chubar: - I know we are expecting it should be quite stable, and of course, it should be much more in line with the loan growth because if are saying about the part of the balance sheet which is investment business: REPOs and interbank. Of course, in this situation, there is much more – the huge part of the deals they have no pressure on capital, that's why, of course, there's no growth of the risk-weighted assets. But in terms of the loan growth, until the end of this year, I can repeat what I said answering the first question, we are not expecting some growth, but at the same time, the first quarter was a one off, so now we are expecting we will be more flat. At the same time, I want to say that we are working now on a couple of the loans which were included in the list of the impaired loans. And potentially of course if we will be lucky – more lucky in this situation. Of course, it can be decrease of the loans, but at the same time, it will be much more material effect from the other metrics. I mean like NPL, cost of risk, so it would be much more positive. But in terms of other loans, usual loans, stable. So we're not expecting, you know.

Alan Webborn: - Okay, what else did I want to ask? Could you explain the dynamics of the trading book, or the trading line in Q2? I mean obviously you have that big FX derivative loss in the first quarter, and now you have got quite a big profit on that line, and other two sort of netting each other off, or is the profit coming from somewhere else?

Vladimir Chubar: - No, we just – what we explained. After the first quarter, when there was a really big – it's not a loss but negative result, let's say like this. It's just what we expected, what we almost promised that it will come back to the normal figure, so it's just on this.

Alan Webborn: - Okay.

Vladimir Chubar: - First

Alan Webborn: - All right

Vladimir Chubar: - The August – and because of the rates, because of the key, not key, because of the rates and the curve in the government instruments. Of course, because of this, it can be potentially some more negative results in the trading moves of all the banks because many banks have – also they're on the balance sheet, and of course, it can be an issue. But also it's a one off, and it's much more, it's much more the mirror of all the geopolitical situation which is happening now.

Eric de Beauchamp: - And in fact, and also on this – on this line, so we have, let's say, double effects. First, let's say, a negative effect from the re-evaluation of the assets and liabilities, which are in our currency, and also for the second quarter, significant positive financial results on some derivative transactions, so that's why on some derivative instruments we have – we cover the potential loss of the first quarter. The recovery, you can see at the end June, the impact.

Alan Webborn: - Thank you

Operator: - And our next question comes from Nick Dimitrov from Morgan Stanley.

Nick Dimitrov: - Hey guys, I have a couple of quick questions. So the first one is going to be on your core equity tier 1 under Russia accounting standards. It's been trending down for about four months, and if you can give us an idea what that capital ratio is going to be including or incorporating some of the profits from the most recent quarter. And also if you can give us some kind of colour regarding the sensitivity of core equity tier 1, with regards to FX volatility, for example a 10% rouble devaluation will put pressure on capital by whatever number of basis points.

Vladimir Chubar: - Thanks for the question. If you don't mind, I will pass this question to Elena Shved, she's on line, I'm hoping she will answer.

Elena Shved: - Hello everybody, yes, of course, we do such stress tests for sensitivity. As for now, each 10% in FX devaluation for rouble gives us 0.15% additional for N1.1 ratio decrease. But as of today, we didn't have any significant share of our assets with big pressure on capital because as you know, our REPO deals have zero weight on capital. For that reason only loans give us some additional weight. For that reason, there is no any significant impact.

Nick Dimitrov: - Thank you, and my next question is going to be – so your NPLs declined because there was a sale of an NPL by a large borrower. Can you give us some colour in terms of what sector that borrower was in or what industry?

Vladimir Chubar: - Colleagues, can you comment on this please?

Elena Shved: - There were several borrowers, they were not from one sector, there were several sectors. A lot of loans, we looked to our NPLs in corporate, they were all provisioned by 100%, so for that reason, we sold some of them. Also it was one big borrower from NPLs, it was from trading sector.

Nick Dimitrov: - Okay, and my last question is going to be – I was looking into your operating expenses on a quarter over quarter basis, and they did increase quite sharply, and the big driver there was expenses on labour, salaries. What's driving that and is it a one-off thing?

Elena Shved: - It was one-off, it was the bonuses for 2017 year. It was the – they were paid in April, so it was one-off.

Nick Dimitrov: - Okay, all right, thank you.

Operator: - And just a reminder, it's star one if you would like to ask a question today. We have a question from Janna Anikina from BCP securities. Please go ahead.

Janna Anikina: - Hi, thank you so much for presentation and taking call questions. Regarding your CT1 capital level, we see that it grew to 8.6% under Russian accounting standards with a minimum being 8% for systemically important banks like yourself. Could you please remind us what is the trigger for your perpetual bonds write-offs?

Vladimir Chubar: - Hello, thank you for the question. First of all, for this year the minimum level is 7%, and from the next year it will be 8% from 1st January.

Janna Anikina: - All right, thank you.

Vladimir Chubar: - The minimum levels for the perpetual instruments in Russia is 5.125.

Janna Anikina: - So it's for all perpetual instruments, not specifically to your bank, right?

Vladimir Chubar: - Yes

Janna Anikina: - Right, and the minimal for CT1 is 4.5?

Vladimir Chubar: - Yes, correct, 4.5.

Janna Anikina: - Okay, all right thank you so much for your time.

Vladimir Chubar: - So it's slightly above the minimum, thank you.

Janna Anikina: - All right, and just to clarify, CT1 at this point is 8.6 it's like very tiny numbers here, or eight, I can't see it.

Vladimir Chubar: - Could you repeat the question please.

Janna Anikina: - Your CT level as June 30th of this year, is it 8 or 8.6, the numbers are very small in the presentation, I can't see it.

Vladimir Chubar: - 8.6.

Janna Anikina: - 8.6, thank you so much.

Eric de Beauchamp: - 8.6%, yes, 8.6.

Janna Anikina: - Thank you, thank you for clarifying, thank you.

Eric de Beauchamp: - You're welcome.

Operator: - And that's all the time we have for questions today. Speakers, I'll turn the conference back over to you. That's all the time we have for questions. Please go ahead with your closing remarks.

Elena Finashina: - So thank you very much for taking your time to attend this call today. Our IR team can follow-up in case of any further questions. So we all wish you a very pleasant rest of the day. Thank you.

Vladimir Chubar: - Thank you very much.

Operator: - And that does conclude our conference today. Thank you for your participation, you may now disconnect.