

Conference Transcription
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BUSINESS RESULTS

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Speakers: Vladimir Chubar, Eric de Beauchamp, Elena Finashina

Operator: Good day and welcome to the CREDIT BANK OF MOSCOW Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Elena Finashina. Please go ahead.

Elena Finashina: Good afternoon, ladies and gentlemen. My name is Elena Finashina and I am Director of International Business Division in charge of the IR function and I am happy to open today's discussion of CREDIT BANK OF MOSCOW 2014 Financial and Business Results. I would like to introduce my colleagues who will be commenting on recent developments of the Bank as well as addressing any questions you might have. So today here with me are Vladimir Chubar, Chairman of the Management Board of the Bank and Eric de Beauchamp, Chief Financial Officer.

Vladimir will start with a few comments on our business results and then Eric will proceed to a more detailed analysis of our financial results and afterwards we will be happy to open the Q&A session. Now I would like to turn the floor over to Vladimir.

Vladimir Chubar: Thank you, Elena. Good afternoon, ladies and gentlemen.

First of all I would like to note that 2014 was a rocky year and it wasn't easy to withstand through the tough times and to achieve positive business results in today's adverse macro environment.

CBM keeps its position among the top 15 banks in Russia by total assets while delivering sustainable business development and profitability. Our assets grew at a slower pace to compare with last year's results whilst maintaining high dynamics with year-on-year growth rate of almost 30%. Asset quality remained at a relatively good level with NPL ratio of 2.3%. We managed to keep the effectiveness of our core business which resulted in net interest income growth of almost 50% year-to-year and exceptionally high net interest margin ratio of 5.8% for 2014. Net profit dropped by 37% to RUB 5.6 billion due to a surge of provisions for loan losses and a fall in non-interest income resulted from securities portfolio revaluation and ruble depreciation during the second half of 2014.

In December of last year, the majority beneficial shareholder injected additional capital in the Bank, initially in the form of subordinated loan which was later converted into ordinary shares.

As a result of this transaction, stakes of the minority shareholders - IFC and EBRD - have been diluted slightly and now they comprise 6.9% each or 13.8% in total. Thanks to this capital injection and a subordinated Eurobond placed in the market in November 2014, CBM entered 2015 in a very good shape in terms of capital and liquidity position.

It's worth mentioning here that during the last six months all the three international rating agencies confirmed our credit ratings for several times, which we consider a good sign on the backdrop of negative trends in the market.

2014 was a fruitful year in relation to awards collected. It was a great honour for us to be awarded as the "Bank of the Year" in Russia by The Banker's experts and the "Best Bank in Russia" by Euromoney magazine, especially when the international recognition finds the Bank when the environment is not very calm.

Let's now move to **slide number 5** with a brief description of the corporate business development.

- In 2014, the Bank showed a healthy dynamics of the corporate business growth both in asset and liability side, while maintaining good diversification of the loan book by industries and by names as well.
- Almost half of the corporate loan book consists of retail and wholesale trading companies, while the Bank is also well represented in the other real sectors of the economy, mainly large caps which are well-known in the market.
- The bulk of credit exposure is working capital loans which resulted in a relatively short-term average maturity of the corporate loan portfolio - about 50% is less than one year to maturity.

Let's now move to **slide number 6** with the retail banking overview.

- The Bank demonstrated a moderate growth of the retail loan book in 2014 comparing with the previous years, but still higher than corporate, thus expanding the share of retail loans in the total loan book up to 33%.
- Target segments for the Bank are mortgage loans and consumer loans, which is obvious from the bottom-left pie-chart with the breakdown of the retail loans by type, while car loans and credit cards are not in the focus due to lower profitability in the former case and unreasonably high level of risk in the latter case.

Now I would like to pass the floor to Eric, who will provide a more detailed analysis of the Bank's financial results. Eric, please.

Eric de Beauchamp: Thank you, Vladimir, and good afternoon, ladies and gentlemen.

I suggest turning to **slide number 8** and starting our financial results review with the income and expenses dynamics.

- Taking into consideration the challenging conditions in the Russian banking sector, especially in the second half of the year, the Bank showed positive dynamics and demonstrated strong performance with a growth of operating income of 15% on a year-

to-year basis. The growth was triggered mainly by a sharp increase of net interest income by 1.5 times up to RUB 25 billion. This became possible mainly due to expanding corporate and retail loan portfolios, as well as an adjustment of interest rates on the corporate loan portfolio after the revision of the Central Bank's key rate. The growth of net interest income for the period ended 31st December resulted in delivering net interest margin of 5.8%.

- Net fee and commission income increased by 13% compared to 2013, reaching RUB 7.3 billion. It was mainly a result of the growth of commissions from plastic cards activities and an increase of the commissions from guarantees and letters of credit as well as commissions on settlement and wire transfers.
- The decrease of return on equity and return on assets to 10.1% and 1.1% respectively was driven by the contraction of net income to RUB 5.6 billion. The decline of the net profit level was mainly due to the increase of provisioning for loan impairment, the negative revaluation of the securities portfolio, and the negative impact of ruble weakening against US dollar during the fourth quarter of 2014.
- Operating expenses grew by 22% in the reporting period up to RUB 9.5 billion with the cost to income ratio being stably low at a level of 33.7% at the end of last year.

Now let's move to **slide number 9** and review the Bank's asset structure.

- For the year 2014, the assets grew by 29% to reach a level of RUB 585 billion. For the same period the growth of net loan portfolio, which is now representing 65% of the Bank's total assets, amounted 22%.
- In the fourth quarter of 2014 on the backdrop of uncertainty in Russian economy and market turbulence, CREDIT BANK OF MOSCOW managed to enhance its liquidity cushion up to 30% of total assets, which includes cash on hand, due from banks with maturity of less than one month and the trading book.

The **slide number 10** provides key loan portfolio metrics.

- In the fourth quarter of 2014, the level of NPL90+ decreased slightly to 2.3%, which was based on the decrease in non-performing loans in the Bank's corporate loan portfolio to a level of 0.4%. This decrease was the result of the repayment of one loan previously accounted as non-performing.
- The Bank maintains sufficient loan loss provision ratio of 4.1% and comfortable NPL coverage ratio of 178% with an increased cost of risk of 3.3% which remains at healthy level in the Russian banking sector. The growth of provisions was driven by the worsening economic conditions and complicated market environment together with CREDIT BANK OF MOSCOW traditionally conservative provisioning policy.
- Concentration on largest borrowers increased slightly during the year, however, they are still at a comfortable level with Top-10 and Top-20 largest borrowers representing respectively 20% and 30% of the gross loan portfolio.
- Related party lending remained at a non-material level which is 0.9% of total equity.

The next **slide number 11** provides a detailed analysis of the Bank's corporate and retail loan portfolios' quality.

- During the year 2014, the quality of corporate loan portfolio was maintained at a high level, however, the loan loss provisions increased, resulting in the growth of cost of risk up to 2%. At the same time, corporate loan book is well secured with 57% of net corporate loan portfolio being collateralized by real estate, liquid securities and other high-quality collateral.
- The cost of risk in retail loan book also showed an upward movement in 2014, reaching the level of 5.9%. Among the factors lying under such deterioration we see both the negative macro environment and maturing retail loan book, giving the slowdown of its growth to 30% in 2014 from almost 100% in 2013. Despite the negative dynamics, CREDIT BANK OF MOSCOW demonstrates relatively good performance in terms of retail loan book, mainly based on an accurate and conservative customer selection.

The following **slide, number 12**, focuses on the funding structure of the Bank.

- The Bank's funding base is very well diversified with corporate and retail customer deposits representing 33% and 31% of total liabilities respectively. Despite turbulence on the markets, the Bank's deposit base remained stable and demonstrated a 22% growth on a year-on-year basis.
- Funding from CBR constitutes around 2% of the total liabilities, which is far below the potential amount which can be attracted under the existing limits and repo agreements.
- Total amount of bonds issued increased to RUB 114 billion, mainly due to several transactions in the course of the year: the Bank issued domestic senior bonds for the total amount of RUB 22 billion and one subordinated Eurobond for RUB 5 billion.
- The Bank also executed several market transactions after the reporting date. Namely, in March 2015 the Bank repaid the first tranche of syndicated loan raised in March 2014 and placed senior domestic bonds with a nominal value of RUB 3 billion.

Now let's move to **slide number 13** which provides information on the Bank's capital position.

- At the end of December 2014 the Bank attracted two subordinated loans for a total amount of RUB 10 billion. One was included into the Tier 2 capital, the other, from the majority shareholder, into Tier 1 capital as this subordinated debt was initially structured as a first step of the potential Tier 1 capital investment. In February 2015, the Bank completed the transaction of the subordinated loan conversion into share capital.
- These subordinated loans act to reinforce the Bank's capital position increasing Total Capital Adequacy Ratio calculated in accordance with Basel III standards up to 15.8%, and Tier 1 Capital Adequacy Ratio up to 10.5% at the end of the year.
- Under Russian accounting standards, the N1.0 capital adequacy ratio reached a comfortable level of 14.1% as of 1st April 2015.

So these were the main highlights of the Bank's financial and business results for the year 2014. 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 at this time please press the star or asterisk key followed by the digit 1 on your telephone. If you find that your question has already been answered you may remove yourself

from the queue by pressing *2. Again please press *1 to ask a question. We will pause for just a moment to allow everyone to signal.

Our first question comes from Mikhail Nikitin of VTB Capital. Please go ahead.

Mikhail Nikitin: Yes, good afternoon. Thanks for the call. I have a sort of a forward-looking question on what's happening to the margins after the reporting date. I mean what kind of effect you expect for the first quarter or possibly second quarter as well, given that deposit rates and the costs of ruble funding in general, are obviously very high now. How does that translate into P&L and capital please? And given these pressures, what do you expect, maybe another loss-making quarter, maybe more? Thank you.

Vladimir Chubar: So thank you for the question. It's Vladimir Chubar. So first of all of course you're absolutely right, it was a big jump of the rates in Russian rubles started from 17th December last year. We felt this also in our deposit book, but somehow we were able to transfer part of this jump to the borrowers. Of course mainly to the corporate borrowers. And of course due to the fact that first quarter we were over-liquid, also it was the fact why we feel that in the first quarter of 2015, we will see a decrease of the margins or in general the margin will be lower.

In terms of the next years, next quarters – second, third quarter – my comment is like this, that we now managed to decrease, dramatically decrease the rates for the deposit book both on the corporate side and on the retail side because in December, we mainly took deposits from the customers for the tenor up to three months. So we feel that margin will come back to the normal levels in the second quarter.

Mikhail Nikitin: So you don't expect any losses for 2015 and given obviously that your loan book has been kind of re-priced quite, you know, quickly...

Vladimir Chubar: I can, yes, I can answer like this. So we don't expect the losses because of the re-pricing of the deposit book or loan book. Mainly of course it can happen because of the macro situation and because we really can't expect even now what will happen with part of the borrowers in the second quarter, third quarter and by the end of the year.

Mikhail Nikitin: Okay, thank you. Thank you.

Vladimir Chubar: Thank you.

Operator: Our next question comes from Olga Veselova of Bank of America. Please go ahead.

Olga Veselova: Thank you. My first question is your loan growth outlook. Sorry if I missed it but what would you expect for corporate loans and retail loans dynamics for the full year this year? Thank you.

Vladimir Chubar: So this question is quite – it's not easy to answer because of uncertainty in Russian economy as you know. But in general, we feel that the retail book will be flat or we will see a slight decrease of the retail book; in terms of the corporate and the general loan book of the Bank we will see 15%, maybe a little bit more than 15% growth. 15%.

Olga Veselova: Okay, thank you. My second question is about structure of your borrowing from the Central Bank, if you could share with us the breakdown by currency, in rubles and in foreign currency if that's possible. Thank you.

Vladimir Chubar: As far as I remember, the majority is in rubles. On 1st April. Or you need on 1st January?

Olga Veselova: Whichever you have.

Vladimir Chubar: No, now I can just tell you that, on the 1st April, we had very small amounts from the CBR. It's maybe RUB 2-3 billion, and just a little part of this was in foreign currency, just about \$3 million. We tested this repo auction in the last year.

Olga Veselova: That's great, thank you and my very last question is your latest changes in criteria of retail loans, have you loosened criteria recently after tightening them last quarter and have you cut interest rates on retail loans recently? Thank you.

Vladimir Chubar: To be honest, I didn't understand the question.

Olga Veselova: Yes, what were the latest changes of criteria on retail loans, I mean in March, have you...

Vladimir Chubar: You mean risk management in retail lending?

Olga Veselova: Yes. Yes I remember you have tightened criteria in the fourth quarter visibly.

Vladimir Chubar: Yes, yes...

Olga Veselova: As everyone did of course. So have you loosened them this year or not yet? And also have you cut your interest rates on retail loans recently?

Vladimir Chubar: Yes, so look, in general of course we came back, almost came back to the normal life. Of course the criteria are still very tough for the customers. So, but we try to work like in a normal life, but we see the shortage of the potential clients even in our internal client base. So people we would like

to give money, they don't like to take them with the current rate we are ready to provide them.

Olga Veselova: Okay.

Vladimir Chubar: But I think that maybe next 2-3 months this situation will come back because we will re-price our new loans for the retail customers. Of course we will look at the decisions of the CBR in terms of the key rate.

Olga Veselova: Thank you.

Operator: As a reminder, ladies and gentlemen, to ask a question please press *1. Our next question comes from Viacheslav Gorbatenko of HSBC. Please go ahead.

Viacheslav Gorbatenko: Good afternoon and thank you for the presentation. Could you please comment regarding the government RUB 1 trillion capitalisation program? Do you plan to use this support tool, in which amount and what terms? Thank you.

Vladimir Chubar: So absolutely, official answer, we are looking at this possibility but we have no decision yet. We are discussing this with the shareholders. No other questions – or no other comments.

Viacheslav Gorbatenko: Thank you.

Operator: Our next question comes from Yulia Safarbakova of BCS. Please go ahead.

Yulia Safarbakova: Yes, hello, thank you very much for the presentation. Actually one question is already answered but I have some more. Could you please give us any colour on your projections for this year? What growth rates do you expect or what cost of risk do you target? Thank you.

Vladimir Chubar: In terms of the growth rates, as I said just a little bit before, in terms of the retail book - flat or a little bit decreased, in terms of the corporate book and overall portfolio - 15% growth. In terms of the cost of risk – unexpected to be honest. We have some figures in our budget but I really don't like to disclose them because it's not easy to expect this figure.

Yulia Safarbakova: Okay but can you give us any colour on what is going on as of now in your quality – we saw increase in restructured loans. Is this trend continuing?

Vladimir Chubar: Of course this year is very tough for all the banks in terms of the corporate lending first of all, and we feel some pressure in the first quarter in terms of the overdue of the corporate book but it's not dramatic, it's manageable. As I am personally involved in a big part of these borrowers and I can

comment that the biggest part of these overdues are manageable. So in some cases we are working closely with the collateral. In some cases we feel that customers can go out of these problems with our support. So in general, first quarter is not easy. I think second quarter also we will need to work hard with the borrowers but from the second half of the year, we expect that this big wave of the issues with the corporate borrowers we'll pass.

Yulia Safarbakova: Yes, thank you.

Vladimir Chubar: Thank you.

Operator: Our next question comes from Mariya Gancheva of HSBC. Please go ahead.

Mariya Gancheva: Yes, hi, good afternoon. I have a few follow-up questions and if we could just look a little bit into the NPLs, that obviously year-on-year look quite a bit higher which is common for the industry but is this a trend in terms of new NPL formations coming forward for Q1-Q2 and where do you see this ending for the year of 2015? And just on top of this, do you actually see further provisioning necessary or you would say you're comfortable at this level?

Vladimir Chubar: So it seems to me I have just answered somehow on this question. So first of all, as I said, in terms of the NPLs and overdue, in general, first and second quarter are quite tough. In terms of the provisioning of course we like to be conservative in terms of provisioning, so my forecast for this year is that the big part of the operational profit will come to the provisioning, but not to the losses. So we will see. Any forecasts here I cannot give you, absolutely.

Mariya Gancheva: Okay, fair enough and just in terms of capital, there have been quite a few transactions happening in the past few months to strengthen the total capital. Do you find yourself comfortable with Tier 1 capital at 10.5% or is there anything in the pipeline for further strengthening this?

Vladimir Chubar: To be honest, I am quite comfortable with the current level of our capital adequacy ratios, both under IFRS and RAS. As you know, under RAS we are very well capitalized. In terms of the future transactions, at this moment I just can say that we are working with the DIA, so we think that in the next maybe few weeks we will come to the final decision to participate or not in this program. But until this very moment, there is no decision made yet. In terms of other ideas, no.

Mariya Gancheva: Okay, fair enough and final question, which probably doesn't concern you that much given how much you hold in dollars but I assume you have some CBR repo rate facilities that you might have undertaken. Do you see that affecting you with the hike in the rate?

Vladimir Chubar: You mean...in which currency?

Mariya Gancheva: The FX repo rate hike.

Vladimir Chubar: I didn't catch the question, sorry.

Mariya Gancheva: It's regarding the CBR FX repo rate hike.

Vladimir Chubar: Yes. Yes, yes...

Mariya Gancheva: Do you see any effect in your accounts?

Vladimir Chubar: For the Bank you mean? For CBM?

Mariya Gancheva: For yourselves.

Vladimir Chubar: Because I didn't hear you well, sorry, so there is like some problems on the line.

Mariya Gancheva: Yes, so for the bank, for CREDIT BANK OF MOSCOW.

Vladimir Chubar: Ah no, so as we didn't involve in this lending from CBR, from the borrowing from CBR, no. In general what CBR is doing, they are trying to decrease the pressure on ruble in terms of the situation that ruble become more strong and strong, and that's why of course if they like to do it, they're absolutely right what they're doing but in terms of any impact on the Bank, I mean on the CREDIT BANK OF MOSCOW, I don't see any big impact to be honest.

Mariya Gancheva: Okay, thank you. Thank you very much.

Vladimir Chubar: Thank you.

Operator: As a reminder, to ask a question please press *1. We have no further audio questions at this time. We have one question from Vadim Davidov of Sberbank. Please go ahead.

Vadim Davidov: Hello, thank you very much for the presentation. Just one question. Could you please elaborate a little bit more on key drivers for sales and employment benefits and administrative expenses because actually they grew roughly by 20% this year? And secondly, the key drivers for fees and commission expense which actually seems to have grown by 100% this year. Thank you.

Vladimir Chubar: Okay, so I will pass this question to Eric.

Eric de Beauchamp: So on the fee and commission income, you should look at the definite expenses increased quite a lot, but you should, let's say, compare them with the income, fee and commission income on plastic cards. But when you look at the total fee and commission income, you have acquiring fees which increased a lot in the income part and on the expense part, it's the commission that we pay to the card operators which are Visa and MasterCard. In fact, if you look at the – you should take these two numbers together, both fee and commission income on plastic cards and fee and commission expenses, settlement and wire transfer, if these are the figures you are referring to.

Regarding the expense, the increase of general expenses, it was mainly due to headcount I would say. So it's the increase of headcount during the year and also the occupancy cost, so in occupancy cost we have the rent of branches, in fact, we have let's say changes, optimization of the branches network which means closing let's say less efficient and opening new branches more efficient in a good location. So these, let's say, also are the costs in 2014.

Vadim Davidov: So does this mean that part of capital expenditures are embedded into administrative expenses?

Eric de Beauchamp: No, it's rent and you know, let's say, repairs, etc. It's not a significant part of those expenses in fact.

Operator: I will now hand the call back to your speakers.

Elena Finashina: Dear ladies and gentlemen, thank you very much for your attention. Thank you for being with us and please feel free to contact us if you have any further questions via email or by phone. Thank you for your attention.

Vladimir Chubar: Thank you very much.

Operator: That will conclude today's conference call. Thank you for your participation ladies and gentlemen, you may now disconnect.