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 9M 2017 Financial and Business Results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Elena Finashina, Head of International Business Department. Please go ahead.

Elena Finashina: Thank you very much, and good afternoon, ladies and gentlemen. We are pleased to welcome you today to the 9M 2017 Financial and Business Results call of CREDIT BANK OF MOSCOW!

We are ready to start our presentation and today Vladimir Chubar, CEO of the Bank, will give an update on the key financial and business highlights of the reporting period, also highlighting certain important events after the reporting date, and Eric de Beauchamp, Senior Vice President of the Bank, will dwell on financial performance of the Bank for the 9-month period of this year. Our presentation will be followed by a traditional Q&A session, where you are welcome to participate. Now I turn the floor over to our first speaker. Vladimir, please go ahead.

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

Having passed October 2017 which for CREDIT BANK OF MOSCOW was full of very positive transactions and events, I am happy to report on another strong quarter for the Bank and further improvement of key quality metrics.

Starting from a traditional macro review, there are no material changes to dwell on. We see certain movements with regard to the OFZ market with the international bid declining and prevailing expectations of higher yields going forward. On the rouble/dollar correlation, there has recently been an obvious diverse trend with oil prices going up and rouble weakening to some extent, which is treated by us as a definitely positive factor for the Russian economy in general.

Returning back to discussion of CBM's financial results for 9 months of 2017, I suggest that we start from slide **number 2.**

- Key metrics of financial performance of the Bank are very solid, having improved further from the previous quarter results.
- Profit has doubled comparing with similar period of the last year and arrived at more than RUB 16 billion.
- Net interest income is affected by the changing environment and tough competition and therefore has shown quite a modest growth of below 1%.
- In the meantime, net fee and commission income is on track of accelerating growth and increased by 22.6% year-on-year. Effectively, fee component contributes more and more to the operational result of the Bank in line with strategic plans of its active development.
- Net interest margin on average risk weighted assets has reached 4.3% and is stably kept at this level through 2017, while net interest margin has decreased to 2.8% as a reflection of higher competition and consistently high liquid assets portion on the balance sheet of the Bank.
- Return on average equity has improved to almost 20% and has been successfully maintained by the Bank at high teens level during this year.
- Outstanding operating efficiency of the Bank keeps on supporting its strong profits with the cost-to-income ratio being only 28%.
- Loans to customers gained 24% in volume during the reporting period, traditionally triggered by the corporate loan portfolio growth coming mostly from the existing top-quality clients, as already mentioned.
- NPL ratio dropped to 1.7% from 2.3% in the beginning of the year, while cost of risk further improved to 1.9% from 4.6% for full year 2016.
- Capital position has been significantly strengthened from the year start, which is only partly reflected in the bottom line capital ratios: Tier 1 capital ratio increase to 14.2%

from 9.4% and total capital adequacy improvement to 23.2% from 14.7% after Tier 1 and Tier 2 Eurobond issues in the first half of this year.

Let's now move to the next **slide** for the business update.

- Corporate loans expanded by 29.4% in the reporting period and reached RUB 733 billion, while retail loans showed the opposite dynamics and decreased by roughly 6%.
- Focus on corporate business growth and restrained activity in retail business have led to higher weight of corporate business in the loan book as evidenced by the left hand graph: corporate loans now make 89% of the loans versus 11% represented by retail business.
- Breakdown of corporate loans by sectors shows that the Bank currently focuses on export oriented sectors, such as oil and chemicals, and also on such sectors as financial, property rental, construction, auto and food and farm traditionally represented in the Bank's corporate loan portfolio.
- Key products in retail business remain unchanged and include cash loans and mortgages, making 73% and 22% of total retail loans, respectively.

Before I pass the floor to Eric for financial results update, I would like to draw your attention to **slide number 4** with an outline of the key events that took place in October this year.

- One of the most important recent capital events includes public offering of new shares by the Bank on Moscow Exchange in the amount of RUB 14.4 billion. The transaction was marketed internationally, and the majority of demand was generated by institutional investors, including international ones, supported by participation of Russian retail investors.
- Apart from that, Tier 2 capital was reinforced by subordinated deposits, while USD 25 million out of the outstanding Tier 2 Eurobonds maturing next year were repurchased to support the instrument liquidity and optimize the capital structure.
- It is important to mention that the Bank has significantly strengthened the Bank's Management Board by expertise of two new members: Alexander Kaznacheev in charge of corporate business development and Oleg Borunov in charge of investment banking. These appointments are in line with the Bank's strategy of expanding its

market share in corporate business segment as well as complementing the product range offered by the Bank to its clients.

Now I suggest that we move to financial results update. Eric, please go ahead.

Eric de Beauchamp: Thank you, Vladimir. Good afternoon, ladies and gentlemen. Let's turn to **slide number 5** with a detailed overview of the Bank's income and expenses.

- As you can see on the top-left diagram, the dynamics of operating income was flat y-o-y due to several factors. First, the net interest margin remains under pressure, as, on the one hand, the Bank is still maintaining a significant part of its assets in low-risk-highly-liquid instruments and, on the other hand, increased competition on the market put pressure on interest rates.
- The net interest margin trend is presented on the bottom-right diagram. As you can see, during the reporting period the NIM decreased from 3.6% to 2.8%. Meanwhile, the calculation of the net interest income, as a percentage of the average risk-weighted assets shows a 4.3% level, which is in line with the market average, but still lower than the previous year's 4.6% level.
- Another factor which limited growth of operating income was the decrease of other net income down to RUB 2.1 billion. One of the main reasons for such decrease comes from the expenses on the early redemption of the subordinated Eurobond due in 2018.
- On a positive side, as you can see on the bottom-left diagram, operating income was supported by a significant increase of the net fee and commission income, which now represents 22.4% of the total operating income, and grew by 23% year-on-year to reach RUB 9.7 billion, resulting from the Bank's effective strategy of developing its commission revenues.
- On the upper right diagram, operating expenses showed a 20% increase year-on-year. The growth mainly came from salary expenses which were linked with payment of annual bonuses and increase of the Bank's headcount. The cost to income ratio remained at a low level of 28.4%.

Now, I suggest turning to **slide number 6** with a breakdown of total assets.

- In the reporting period, total assets grew by 13.5%, with an increase of the share of the net loan portfolio from 39% to 44% of the assets. In absolute terms, the net loan book showed an increase of 25% in comparison to December 2016, and liquid assets, including cash and cash equivalents, due from credit institutions and the securities portfolio, grew by 6%. The loan portfolio growth was mainly driven by the increased contribution of larger corporates from the oil and chemicals segment.

- One of the main instruments of liquidity management are REPO transactions which amounted to RUB 703 billion and are backed by high quality securities that are included in the Lombard list of the Central Bank. The coverage of REPO deals by collateral is maintained at a comfortable level of 119%. Additional unused liquidity sources amounted to RUB 438 billion as of the end of September 2017.

Now, let's move to **slide number 7** on the loan portfolio quality.

- As described in the upper-left diagram, the loan portfolio coverage by impairment allowance slightly decreased to 5.6% as of the end of September as a factor of loan portfolio increasing from RUB 761 to 827 billion, coupled with an improved loan book quality.
- As shown on the upper-right diagram, the impairment allowance provides a coverage of NPL of 322%. This ratio increased significantly after the Bank restructured two corporate loans during the fourth quarter of 2016.
- The bottom-left diagram shows a steady improvement of loan quality metrics with NPL ratio amounting to 1.7%. The cost of risk decreased to 1.9%, confirming the downward trend observed since the second half of the year 2016. The related party lending is still low and stabilized at the level of 3.0% of the total gross loan book.

Now, I suggest turning to **slide 8** with more details on corporate and retail portfolio metrics.

- On the backdrop of corporate loan book growth on the left, qualitative indicators keep showing a positive trend in the reporting period. The NPL ratio continued to decrease down to a 1% level. The NPL coverage ratio of the corporate loan book increased up to 533%.
- As described in the bottom-left diagram, the cost of risk significantly decreased from 4.3% as of the end of 2016, down to 1.5% at the end of September 2017.

- On the right, the retail loan book NPL demonstrates a continuing downward trend and decreased to 7.0% at the end of September on the backdrop of loan portfolio reduction to RUB 95 billion. The cost of risk also decreased notably to 4.6% to be compared with 6.5% as of the end of last year, as a result of improvement of retail loan book quality.

The next **slide, number 9,** illustrates the funding structure of the Bank.

- Total liabilities increased by 11% during the first 9 months of 2017 to RUB 1.6 trillion. Deposit base showed positive dynamics in the reporting period. Corporate deposits grew by 54% to RUB 677 billion. At the same time, retail deposits increased by 13% to RUB 282 billion at the end of September 2017.
- Deposits by credit institutions, including deposits by CBR, were mainly represented by REPO transactions, while securities provided as collateral under REPO amounted to RUB 516 billion and the value of these securities comprised 113% of the underlying value of such deals. Deposits by the CBR decreased notably due to slowed down business of our subsidiary, SKS Bank, which is mainly dealing with the CBR on the liabilities side.
- Bonds repayment schedule is comfortable for the Bank, with the bulk of international debt due after the year 2020.

Now let's proceed to the **final slide, number 10**, on the Bank's capital.

- The year 2017 was very active for the Bank in terms of capital raising, with significant transactions closed this year:
  - A Tier 2 Eurobond in April for USD 600 million;
  - A perpetual Tier 1 Eurobond in May for USD 700 million;
  - Two subordinated deposits were included in Tier 2 capital in October for a total amount of RUB 22 billion;
  - And, finally, a 14.4 billion RUB SPO on the Moscow Stock Exchange was completed in October, not reflected yet in the 9-month IFRS statements.
- Besides this, our N1.1 capital adequacy ratio was additionally supported by the inclusion of Russian accounting net profit into core capital in October 2017, which will

be reflected accordingly as of 1st of November.

– As a result, the bank will close the current year with comfortable capital position, allowing to fulfill the buffers applicable to the systemically important banks from next year, and to ensure further business growth.

These were the main highlights of the Bank's financial and business results for 9 months of 2017. 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, please signal by pressing star one on your telephone keypad. If you're using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that is star one to ask a question. We will just pause for a moment to allow everyone an opportunity to ask their questions.

We'll take our first question from Yulia Di Mambro, from Federated Investors. Please go ahead.

Yulia Di Mambro: Hi, thank you very much for the presentation. I have two quick questions please. Firstly, on the deposit inflow that you're seeing in the quarter. Could you please give us a little bit more colour in terms of whether this was new money coming in, into the banking system, or if it was corporate switching out of other banks? And generally, how is the situation in the market in terms of deposit flows, at the moment? So that's my first question.

Vladimir Chubar: Yulia, can we answer one by one? It will be easier not to forget.

Yulia Di Mambro: Yes of course, sure. Yes of course.

Vladimir Chubar: If I understand your question correctly, you're asking about the third quarter or you're asking more about tendencies we see now in October for example? Or both?

Yulia Di Mambro: Both please.

Vladimir Chubar: Okay, in terms of the third quarter, if the question is about if it's new money, or money coming from another bank, it's not easy to comment because every money which are coming into the Bank are new for us. If you're asking about the depositors, we're seeing new depositors, old depositors increasing their deposits, new depositors coming into the Bank, both in corporate and retail segments. So, it's not easy to comment on this. If you're asking about October, we'll be neutral in terms of October deposits. In November the situation is also stable. So, in terms of October figures, I think that within the next few days there will be information on the website of the Central Bank of Russia with all the forms and statements. I think it's better to wait, because we are still now in a quiet period after the SPO we made. It looks like 40 days or something like this should be without us. So, I think that anyway ee are neutral.

Yulia Di Mambro: Great thanks very much. And my second question is on your capital. So, after you got additional subordinated deposits in from one of your corporate depositors, your total capital ratio looks quite high now, so do you have any plans to maybe take out some of the Tier 2 bonds that you have outstanding, like for 2027 for example? Or maybe if you can't take them out, do you know if your shareholder has any plans to buy more?

Vladimir Chubar: In terms of your question, so we have no plan to buy back any bonds now. We did some with the bonds-2018 as I said. In terms of the bonds we issued this year, we don't have any plans because we think that the current capital structure is solid and all the current depositors and subordinated depositors and holders of the subordinated bonds should be happy with the current capital structure. At the same time, we think that potentially it can happen, but we didn't make any decision until this time.

Yulia Di Mambro: Great thank you very much.

Vladimir Chubar: Thank you.

Operator: Our next question comes from Henrique Morato from Aberdeen Asset Management.

Henrique Morato: Hi guys, congrats on the results and thanks for the call. Quick two questions. First, I mean on the, you mentioned several times you know, increasing your loan book to exporters mainly in the oil and gas sector. It looks like quarter-on-quarter it was a pretty big increase, I mean RUB 100 billion. If you could just comment on whether this is a particular borrower or is a number of borrowers, and whether you're gaining market share from competitors or whether this is companies actually starting to borrow again to invest? So that's the first question.

Vladimir Chubar: Hi, thank you for the question. Look, in terms of the growth, it's most of course it's more refinancing, because what we see now that mostly the companies are not very active in terms of investing more money, and in terms of borrowing money for some fresh projects. But at the same time of course, some of the money we lent our borrowers for some new projects. In terms of number of the borrowers, it's a number of different borrowers. So, it's not like one or two or three borrowers, but at the same time, of course there is some kind of concentration on the particular names, because as you know, Russian sector of exporters in this area and companies in this area are quite concentrated.

Henrique Morato: The second question is, could you comment on the name, I mean, I think Eric commented that you know, the market is very competitive, and you've seen some pressure. Could you just comment from a different angle? I mean, in April - March, you raised USD 1.3 billion. I mean how much is that having an impact on your name, if any at all? And if it's having an impact, when should we expect that impact to go away?

Vladimir Chubar: If we are talking about Tier 1, the interests are not going through the net interest margin. And in terms of Tier 2, it was not very material. So, we're now thinking that it was the main pressure from this side. The main pressure, and net interest margin is coming from first of all, from the competition and from the decrease in margin because some of the banks, some of the lenders are also quite active. And the second of course is that as you saw we increased the volume of the REPO transactions on the balance sheet and that's why of course it also had an effect on our net interest margin, if we are not counting it with the risk-weighted assets.

Henrique Morato: Yep, cool. Thank you very much.

Vladimir Chubar: Thanks.

Eric de Beauchamp: Thank you, bye.

Operator: As a reminder, if you wish to ask a question, please press star one. We will now take our next question from Alvin Chew of Trend Capital.

Alvin Chew: Hi Vladimir and hi Eric, how are you? Just only got one question. I saw that the fair value of your securities covering the, I mean several securities that service collateral on the reverse REPO, I mean the coverage ratio has dropped to like 104% from 122%. Could you give us a little bit more colour as to the reasons behind this drop in term of the coverage ratio? Thank you.

Vladimir Chubar: If I understand your question correctly, I will check with my colleagues. Yeah, it looks like, because the discount is lower now, maybe that was the reason. If we understand your question correctly.

Alvin Chew: So the discount is lower now.

Vladimir Chubar: Yeah...we should check. It’s better if you just send the question to me or to Eric.

Alvin Chew: Okay. Alright, thanks.

Vladimir Chubar: Thank you.

Operator: And as a reminder, press star one if you wish to ask a question. Our next question comes from Nick Dimitrov of Morgan Stanley.

Nick Dimitrov: Hi there, I have a couple of quick questions. The first one is going to be, can you chat a little bit about your plans about the senior bonds that mature on February first next year?

Vladimir Chubar: Nick, thank you for the question. I was expecting something like this. So, we are thinking about this now, and it looks like the market potentially can be good. We'll see. Anyway, until this time we didn't make any decisions, and if we make some, of course you will see us on the screen. But in terms of the amount we should repay in February, it's not material in terms of our current liquidity. So, we're absolutely fine with this just pay, without any refinancing. But in terms of just being on the market with the senior debts, and make one more deal with a longer curve, so why not? We'll see. But still not any decisions.

Nick Dimitrov: Okay, thank you. The next question is going to be on your increasing exposure to the oil and gas sector. It is currently 38% of your total loan book. Do you guys have like an internal risk limit or are we going to continue to see your exposure to oil and gas grow? How do you manage risk there?

Vladimir Chubar: The risk is managed very simple, because it's the particular borrower and, as you know, this sector is much more linked to the quasi-sovereign risk and if we assure that the borrower is fine, the borrower is close to the quasi-sovereign risk, we are thinking much more about the particular borrower. But at the same time, you're absolutely right, and we have limits on borrowers from this sector which are not linked to the export or which are not link to quasi-sovereign risk, and of course for this borrows we have internal limits and we still have some room for the borrowers like this.

Nick Dimitrov: So we shouldn’t be necessarily surprised to see that exposure grow from current levels?

Vladimir Chubar: It depends on the quality of every particular borrower. And if for example one of the top five Russian oil and gas companies will ask for the extra financing, I think that will be not the question of the limit for such sector. It will be much more the questions about the particular borrower and its project we can finance, and the rate, and the tenor rate. It's complicated discussion all the time.

Nick Dimitrov: Okay. And going back to your net interest margin, can you give us some guidance? I understand there is a lot of pressure obviously, some of it was very difficult, but when you look forward right, what are your expectations for NIM? Do you see normalisation and if you see normalisation, at what levels?

Vladimir Chubar: Some calls ago I said that normal level is 3% but at that time I didn't expect that we would be more active in terms of the investment business. And as I just said, that we hired the new head of this new business for us, which is also, will be more with the international angle. We potentially can't see some decreasing of net interest margin, if we are not making any calculation with the risk-weighted assets, without risk-weighted assets it can be lower, but only in the case if we see that some transactions will have low pressure on the capital. So, in this case yes, potentially it can be lower. But I think that current level it's kind of stable. Because also, quite close to the some levels we have in REPO deals, so that's why we are not expecting it should be let's say lower, but it's also not easy to predict, because potentially the pressure which can be from some other banks also can be high. But as you know, we lost couple of the banks, in the forms they've been before. And we're expecting that it will make competition a bit lower.

Nick Dimitrov: Okay. Got it. And do you mind walking us again through the calculations of your N1.1 ratio currently 6.9 as of October 1st? You did talk previously about incorporation of the profits from the first several months I believe through October, where are we in that process? Has there been any changes with regard to your equity raised 14.4 billion? And what do you expect that ratio is going to look like at November 1st or December 1st as well?

Vladimir Chubar: We're not expecting that 1st of December will be lower than 1st of November. I don't see why.

Nick Dimitrov: Okay, December 1st you said it's going to be lower than November 1st?

Vladimir Chubar: Yeah, because November 1st is already included, so the profit and SPO is already included. I think that we will disclose this, not we, CBR will disclose the figures in the next few days and you will see it - anyway yeah, but I think in terms of the 1st of December, if you compare 1st of December with 1st of November, there will be I think, it will be not lower for sure.

Nick Dimitrov: Okay got it, excellent, thank you.

Vladimir Chubar: Thank you so much.

Operator: Our next question comes from Oksana Reinhardt of Unicredit. Please go ahead.

Oksana Reinhardt: Hallo, thank you very much for wonderful presentation. I have a question on your partnership with Rosneft. I understand that you got subordinated deposit and I would guess that some of your REPO transactions and some of your lending book is also connected to the entity. Can you give us more colour on this, and is there any risk of sanctions in connection to your affiliation to Rosneft? Thank you.

Vladimir Chubar: Hello, thank you for the question. If you're asking about this risk, we of course, it's only, can be a decision of you know, which entity - If this risk is high or low. Currently we don't see any deals or transactions or some relations which can bring us to this risk and to this status. At the same time, of course we read a lot about news from another side of the ocean. It can be some new restrictions, it can be some new analysis, but currently we don't see any risk of this. If it's based on the current transactions we have, on the current relations.

Oksana Reinhardt: Okay I understand. Thank you.

Vladimir Chubar: Thank you.

Operator: This concludes today's question and answer session. At this time I would like to turn the conference back to our host for any additional or closing remarks.

Elena Finashina: Dear ladies and gentlemen, thank you very much for your attention and time to attend this call today. Our IR team can follow up with any updates if necessary. And now we wish you very nice end of the day. Thank you very much.

Vladimir Chubar: Thank you very much.

Eric de Beauchamp: Thank you.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.