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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 1Q 2015 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. Please go ahead.

**Elena Finashina:** Good afternoon, ladies and gentlemen. So my name is Elena Finashina and I am Director of International Business Division, and by tradition I am opening today's webcast for CREDIT BANK OF MOSCOW 1Q 2015 Financial and Business Results. I would like to start from a brief introduction of my colleagues who will be commenting on recent developments as well as answering your questions. So today here with me are Vladimir Chubar, our Chairman of the Management Board; and also Eric de Beauchamp, Chief Financial Officer.

Today Vladimir will start with a general overview on the sentiment in the market and with a few comments on our business results, and then Eric will dwell on the financial results of the Bank. As usual we welcome any questions from your side on our financial results after the presentation when we open the Q&A session.

Now I would like to turn the floor over to Vladimir. Please.

**Vladimir Chubar:** Thank you, Elena. Good afternoon, ladies and gentlemen. Thank you all for joining today's call on CREDIT BANK OF MOSCOW 1Q 2015 Financial Results.

First of all, I would like to give a few comments on the operational environment and then proceed with a more detailed business overview.

Although the panic calmed down in the beginning of the year after a very high market volatility and uncertainty in the 4Q 2014, Russian banking system is still living in a very harsh business climate. There can be distinguished a whole number of problem spots Russian banks are facing but, in general, macroeconomic slowdown is the fundamental reason of the overall weakness of the system. Good news is that the Government and CBR render high level of support to the Russian banking system and we see that in successive steps they seem to move towards reversing the trend.

Now let's move to our presentation, starting with **slide number 4**. The key point on this slide I would like to draw your attention to is a drop in net income for the period down to RUB 300 million to compare with RUB 1.9 billion for 1Q 2014 and RUB 1.7 billion for the 1Q 2013. You can see it in the Income Statement table on the right-hand side. The reason is in so-called "scissor-effect" when:

- First, on the one hand, we see a slight decrease in net interest income due to increased interest expense, and;
- On the other hand, we see an impact from the doubled newly created provision for loan impairment, in line with our conservative estimations of further macro development.

It is hard to predict particular problems which the Bank may face in the course of the year but we are very cautious in regard to our loan book in order to avoid unexpected losses, which is especially topical in today's economic situation.

On **slide number 5** there is a brief description of corporate banking business development.

- Key point here is that corporate business was the main driver of the loan book as well as deposit book growth in 1Q 2015. We forecast that this trend will be maintained till the end of this year.
- Such factors as good diversification focus on short-term lending and synergies with the cash handling business provided the basis for good asset quality of our corporate loan book. In terms of risk management, we closely monitor businesses of our corporate customers, which is very important in such challenging times.

Now I suggest turning to **slide number 6**.

- Retail lending demonstrated slight decrease in the 1Q of this year, which resulted from the tightening of the customer screening criteria and reduced volume of new loans generation on the backdrop of the worsening macroeconomic situation.
- Retail lending will not be the key driver for total loan book growth in 2015 with a primary focus on quality of individual customers in target segments: mortgage loans and unsecured cash loans.
- It is worth mentioning here that in the 1Q 2015 the Bank optimized its multichannel distribution network by closing several unprofitable branches and decreasing the number of payment terminals and ATMs.

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

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

Now let's turn to **slide number 8**, where you will find details of the income and expenses dynamics.

- Operating income increased by 12% y-o-y and amounted to RUB 7.1 billion mainly due to gains from foreign-exchange operations resulting from the expanded net FX position in the balance sheet in the 1Q 2015. Operating income growth rates were diminished as a result of net interest income decrease. This was triggered by higher funding costs which grew faster than interest income leading to reduction of net interest margin to 3.7%.
- Fee and commission income decrease was primarily due to reduction of income from insurance contracts processing caused by a slowdown in retail lending. The main source of fee and commission income in the 1Q of this year are commissions from plastic cards which increased by 24% y-o-y and amounted to RUB 0.4 billion.
- Despite the growth of operating expenses by 15% to RUB 2.2 billion in comparison with last year, which was primarily the result of increase in volume of activity of the Bank, the cost to income ratio went down to 29.3% being one of the lowest among peers.
- The decrease of return on assets and return on equity to 0.2% and 1.9% respectively was driven by the contraction of the net interest income after provisions to RUB 0.3 billion. As you can see on the bottom right hand side, the main negative pressure on the net interest income after provisions is represented by an increased cost of funding as well as higher loan loss provisions.

**Slide number 9** provides a breakdown of the Bank's assets:

- Since the end of 2014, the Bank has adopted a very cautious approach regarding assets' quality instead of focusing on high growth rates. As a result, reduced growth rates of the loan portfolio, together with a decline of cash and cash equivalents, led to a decrease of total assets by 0.5% to roughly RUB 582 billion.
- The net corporate loan portfolio stood at RUB 265 billion which is 3% more than at the end of 2014. The net retail loan portfolio decreased by 2% to RUB 118 billion due to conservative risk management policies and lower approval rates on loan applications, as well as reduced demand on retail credit products from customers with good credit history.
- The Bank feels comfortable with the current liquidity cushion which is comprised of cash on hand, due from banks with maturity of less than one month and the trading book. This liquidity cushion as of today represents 29% of total assets.

Now let's move to **slide number 10** which covers key loan portfolio metrics:

- During the 1Q 2015 non-performing loans were increasing moderately reaching 2.4% of the total loan gross portfolio due to deterioration of the financial condition of several large corporate borrowers. Worsening macroeconomic conditions also influenced retail

customers, that resulted in the growth of non-performing loans from 6.3% as of the end of last year up to 6.7%.

- Following conservative provisioning approach, the Bank's loan loss provision ratio was increased to 4.8%, NPL coverage ratio - to 201%. The growth of the cost of risk up to 4.6% reflects the complicated market environment of the beginning of 2015, but remains on the lower range of the market.
- Concentrations on top-10 and top-20 customers remain stable at 21% and 33% respectively. Related party lending went up to 2.5% of total equity at the end of the 1Q.

Now let's move to **slide number 11**, which focuses on the quality of corporate and retail portfolios:

- During the 1Q 2015 the quality of corporate loan portfolio stood at a high level with NPL ratio of 0.4%. At the same time, the loan loss provisions increased during the reporting period resulting in a cost of risk increase up to 3.8%.
- On the retail loan portfolio side the cost of risk increased up to 6.3% in comparison with 5.9% at the end of 2014. But despite maturing of the retail loan book and complicated macroeconomic conditions, the Bank still managed to maintain a good quality of retail portfolio paying high attention to customer selection and maintaining a ratio of NPL coverage by provisions around 100%.

**Slide number 12** provides a detailed breakdown of the Bank's funding structure:

- The main source of funding remains customer accounts, representing 71% of total liabilities and consisting mainly of term deposits. The division in terms of corporate and retail deposits is 39% and 32% of total liabilities respectively. During the 1Q 2015 corporate deposits demonstrated an 18% growth on quarter-to-quarter basis, whereas retail deposits increased by 2%.
- Funding from the Central Bank of Russia decreased during the 1Q and now constitutes less than 1% of total liabilities.
- The total amount of bonds issued increased to RUB 119 billion after the placements of domestic bonds in March 2015 in a total amount of RUB 3 billion.

The Bank's capital position is shown on **slide number 13**.

- The total capital level according to Basel III standards increased to RUB 92 billion, with a capital adequacy ratio at the level of 15.8% and Tier 1 ratio - 10.4%. Capital adequacy ratios under Russian accounting standards remain at a comfortable level: N1.0 ratio - 13.1% and N1.1 and N1.2 - 8.2% as of 1<sup>st</sup> May 2015.

At this point I suggest finishing our 2015 1Q results presentation. Thank you 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 the asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Again please press \*1 to ask a question. We will pause for just a moment to allow everyone to signal.

We will now take the first question from Denis Poryvai from Raiffeisen Bank. Please go ahead.

**Denis Poryvay:** Hello, thanks for the presentation. I have a couple of questions. The first one regarding quality of your portfolio. Given that small and medium size enterprises, which dominated in your credit portfolio and very dependent on turnover of imported goods, which are currently shrinking, what are your expectations on dynamics of your credit quality of portfolio in the second and third quarter of this year. Don't you expect some deterioration of it or stabilization?

The second question regarding Uralsib and it's known from mass media that you are considering these transactions and my question is regarding what is your value you see in this transaction and how are you going to incorporate this business in your bank? Don't you consider to remake your strategy giving this transaction? Any details would be very welcome. Thanks.

**Vladimir Chubar:** Thank you for the questions. I will start my answer from the second question. Actually yes, you're absolutely right, there is some kind of information in the media for last couple of weeks. First of all, there's no discussion between CREDIT BANK OF MOSCOW and Uralsib. There is more discussion between two shareholders, let's say like this, so Mr. Avdeev and Mr. Tsvetkov, that's why I can't really comment on this question. I know some details of course but in general. First of all, there's an idea of Roman to think about this, so that's why I just really confirm that they are talking to each other, but it's still 50/50, my personal view.

In regard to your first question about the quality of the loan book, I just can start like this: first of all, it was fair to say about CBM that we are SME bank maybe five years ago, two years ago. Now we have most our business activity and lending activity in the corporate book, more to the corporate customers, so now we are more like medium enterprises and corporate clients' bank. Now if I can answer your question about the decrease of the import goods etc., there is no influence I see at the moment.

**Denis Poryvay:** Ok. What are your expectations on your quality? Don't you expect some lower spending on your provisioning for impairment loans going forward or stabilization at this level?

**Vladimir Chubar:** Unfortunately, we just a couple of hours ago distributed the information about the possible IPO of CBM, I just cannot give you any comments about the forecasting. I'm sorry.

**Denis Poryvay:** Ok, thanks.

**Operator:** As a reminder, to ask a question please press \*1. There are currently no questions queued.

We now have a second question from Nick Dimitrov from Morgan Stanley. Please go ahead.

**Nick Dimitrov:** Hi there. Just a quick question on the NPL ratio. There is as you put it a moderate deterioration but I just want to get some color: did you, guys, sell any non-performing loans and what is your charge-off rate in the quarter as well?

**Vladimir Chubar:** I'm sorry, could you please repeat the end of your question?

**Nick Dimitrov:** Sure, whether you sold any non-performing loans in the quarter in order to have this mild deterioration in NPLs and what is the actual charge-off rate as well, or the write-off rate?

**Vladimir Chubar:** As far as I remember we didn't sell any huge assets, so maybe just a small amount was sold.

**Eric de Beauchamp:** It's not about sales, it's more about write-offs that we had during the 1Q in fact. So you have the figure in the accounts. We had RUB 1.3 billion of write-offs, of which roughly RUB 1 billion was on retail and the rest on corporate.

**Nick Dimitrov:** Ok, excellent. One other question regarding your margins, so we do see a very pronounced margin compression. Net interest margin went from 4.8% to 3.7% and this is obviously because of the higher cost of funding. Considering what's happening in terms of the Central Bank of Russia cutting interest rates, do you think that the worst is over in Q1 and can you give us some guidance on your net interest margin?

**Vladimir Chubar:** Yes, I can just say that the worst is over, so we see now that the margin is just coming back to the normal levels. So my expectation here, I think I can comment about expectations about the margin, I think that we are just coming back now to the normal levels we saw last years. Let's say what we call "scissors effect" we just pasted in the 1Q. It was really dramatic and what CBR is doing now we think is really good, so they are trying to push the banks to start their credit activity and it's really good for the macro economy. This is my general comment.

**Nick Dimitrov:** Ok, thank you. One last question, as you said there have been rumors in the press regarding potential acquisitions, you can't comment, but just from a strategic point of view, if you, guys, consider to engage in some kind of acquisition or sanitation of a bank as you call it, do you think that...obviously regulators will have to sign off on it, right, but do you think that they are going to also engage in that transaction either providing cheap funding or capitalizing the bank that's about to be acquired or how

do you think about these things strategically? You don't have to comment necessarily on a certain transaction of course.

**Vladimir Chubar:** There are fewer transactions without any additions from CBR if you ask about this, what we see now. In general if there will be some let's say additions from CBR, it's good, but as far as I know Roman, he didn't think about this.

**Nick Dimitrov:** Ok, excellent. Thank you.

**Vladimir Chubar:** Thank you.

**Operator:** We will now take our next question from Andrew Keeley from Sberbank. Please go ahead.

**Andrew Keeley:** Hi, thanks for the call. I'm just wondering, Vladimir, first your comment in terms of seeing the worst being over in terms of the net interest margin, whether you share this view in terms of asset quality and the cost of risk outlook for the second quarter and beyond? Thank you.

**Vladimir Chubar:** I can say just about the 2Q, so I personally do not expect any deterioration, which will be higher for example than in the 1Q than what I see now. We still have a couple of weeks until the end of this quarter and now in the Russian banking system and Russian economy, things can happen very rapidly, so that's why my expectations are quite conservative but in general nothing dramatic.

**Andrew Keeley:** Ok, thank you. Just another question in terms of...you mentioned about the positive impact from Central Bank rate cuts. How do you feel about the key rates and the way that feeds through to your pricing, we're now at a kind of level where the demand from borrowers and the demand from corporates is going to start picking up and I suppose the appetite also on your part in terms of increasing lending. Have you been seeing any pick-up in terms of activity in the second quarter and do you just feel we're kind of now at a kind of key rate level that demand should start coming through more strongly I guess from here and the third quarter? Thank you.

**Vladimir Chubar:** To be honest we saw good demand even in the first quarter with the rates we saw in the first quarter. That's why the majority of our customers didn't stop the activity and we also saw a lot of new customers coming from the other banks and we refinanced some of them. That's why I cannot say that there is just the start of the credit activity. It's maybe one more step to increase it from the previous levels, from the levels of the first quarter, but it's not like just some huge jump, no.

**Andrew Keeley:** Ok. Can you give any guidance at all about what kind of a loan growth on the corporate and the retail side you're expecting for this year?

**Vladimir Chubar:** Unfortunately no. I gave some comments on the previous call, so in general like this.

**Andrew Keeley:** Ok, alright. Thank you.

**Vladimir Chubar:** Thank you. Thank you very much.

**Operator:** As a reminder to ask a question please press \*1. There are currently no questions queued.

As there are no further questions I would like to hand the call back to the speaker for any additional or closing remarks.

**Elena Finashina:** Thank you very much for being with us today for the announcement of our 1Q results. Please feel free to ask any additional questions you might have to our IR team. Thank you very much and goodbye.

**Vladimir Chubar:** Thank you.

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