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 Quarter 1, 2018 Financial and Business Results call. Today's conference is being recorded. At this time, I would like to turn the conference over to Elena. Please go ahead.

Elena Finashina: - Thank you very much. Good afternoon, ladies and gentlemen. We are pleased to welcome you today to the first quarter 2018 Financial and Business Results call of Credit Bank of Moscow. As part of our active investor communication programme, our speakers, Vladimir Chubar, CEO and Eric de Beauchamp, Senior Vice President are in the US today attending regular investor conference arranged by one of the investment banks. For this reason, our team is split today and connected to the call from different locations. Therefore, we would like to apologize in advance in case of any delays in transmission or in our answers during the Q&A session. We suggest that we hold an efficient Q&A session today and conclude our call within an hour from now due to further tight schedule of my colleagues. So, we are ready to start our presentation now, and I am happy to pass the floor to Vladimir Chubar, who will give an update on the key financial and business results for the reporting period. Vladimir, please go ahead.

Vladimir Chubar: - Thank you, Elena. Good afternoon, ladies and gentlemen. It is my pleasure to host our first quarter 2018 results call from Miami today. I hope you all enjoy the approaching summer. Thanks for your time today with us. The first month of 2018 were full of new challenges for Russian financial and corporate sectors in general and those challenges come from both immediate local operating environment and also from outside of Russia. We strongly believe that regardless of the macro and political background, the best thing a public company can do in all times is being transparent and maintaining efficient communication with its stakeholders. This is the reason why we continuously keep active dialogue open with our investors and also why we connect from Miami to this call today. The very start of the year was quite positive for capital raisings by Russian companies and allowed to use this window of opportunities to place senior Eurobonds for half a billion dollars at the lowest ever rate for CBM, and also to sign an international syndicated loan facility for $400 million.

- Our performance in general in the first quarter was seasonally a bit weaker than traditionally in the rest of the year. Also, impacted by one off negative effect from the implementation of IFRS 9. Asset quality in general is improving and our strategic focus remain the same, being an important bank partner for large corporates, developing broader range of products and facilities to serve any sophisticated need and also to reload our retail business development. Now, let’s move to our presentation.

- I suggest that we start from slide **number 2**. Net interest income increased by almost 25% as compared with the first quarter results of 2017 based on expansion of the Rouble-denominated assets generating higher income. Net fee and commission reached RUB 2.8 billion and is somewhat lower than last year as a result of high competition putting pressure on the fee levels and also significant one-off gains in the first quarter of 2017. Profit in the first quarter of 2018 is RUB 2.3 billion which is weaker than last year as a result of FOREX revaluation derivatives due to local currency volatility. Net interest margin has been stable in the area of 3% during the recent year constrained by higher liquidity buffer in the assets and downward trend in the interest rates while net interest margin on average risk weighted assets showed solid improvement of 5% versus 4.3% a year ago. Lower return equity of almost 7% is a reflection of weaker profit in the first quarter. Operating efficiency is still one of the strongest in the banking sector with the cost-to-income ratio being 40%. Gross loans to customers decreased by 15.3% from the end of 2017 mainly due to large redemptions by corporate clients and also sale of several exporters, which has already been publicly commented by us before.

- NPL ratio is stable at 2.4% even on the backdrop of large redemptions. Cost of risk has improved significantly to 0.6% from 2.5% in 2017, and so did the NPL provisioning ratio to almost 300% from 250%. Ratios strengthening stemmed from the loan portfolio reduction. As already mentioned, implementation of IFRS 9 had one-off negative effect on the balance sheet via routine earnings. Equity decreased by 4% to RUB 170 billion from RUB 177 billion. Capital adequacy ratios remained strong tier-one ratio of 15.6% and total capital adequacy ratio of 25% almost.

- Now, let’s discuss business highlights on **slide number 3**. Gross corporate loans reduced by 17% in the first quarter this year and reached RUB 607 billion on the back of large repayment as mentioned before while retail loans ended up in the first quarter almost flat to the year end results. Corporate loans dominate and loan book making 87%. Sector breakdown of corporate loans has not changed significantly with crude oil production and trading making 22% of total loans, petroleum refining had 17% share. Residential construction standing at 10% followed by automated sector and food and farm making 8% and 6% respectively. In retail business, our priorities remained unchanged with the cash loan and mortgages forming 72% and 23% of total retail loans respectively. Our strategic pillars in further business development remained the same. Key business growth driver is the corporate business supplemented by retail business, which is to return to grow shortly. New investment banking segment is to reinforce both business segments in the bank and also to ensure synergetic effect on the holding level. Now, Eric will take the floor to provide a detailed financial result for you. Eric, please go ahead.

Eric de Beauchamp: - Thank you, Vladimir. Good morning, ladies and gentlemen. I would like to draw your attention on **slide number 4** with an overview of the bank's income and expenses. As you can see on the **top left diagram**, net interest income increased by 25% year on year to RUB 13 billion with increase of the share of Rouble-denominated assets in total assets which on average earned higher interest. At the same time, net fee and commission income decreased from RUB 3.7 billion from the first quarter of 2017 to RUB 2.8 billion for the first quarter of 2018, mainly due to the drop in currency exchange commission, commission from guarantee and cash commissions. Other net loss comprised RUB 6.2 billion which resulted from currency revaluation of derivative financial instruments due to the volatility of USD-Rouble fixed rate during the first quarter of 2018. Due to this FX revaluation effect, operating income decreased year on year from RUB 14.3 billion down to RUB 9.6 billion.

- On the **bottom left diagram**, we see that the net fee and commission income decreased by 26% year on year. Increased competition made the expansion of fee and commission income more challenging for the bank, but we expect recovery on some of the components with cash earning for instance is based on increased volume of business. Currency exchange commission decreased due to, on one hand, the decreased volatility of national currency in the reported period. And on the other hand, the significant one-off effect that we saw back in the first quarter of 2017.

- Commission from guarantee and letter of credit decreased mainly due to the switch to less risk types of guarantees, which generally is less profitable. As you can see on the **upper right diagram**, operating expenses increased slightly by only 4% year on year to RUB 3.9 billion. The growth was mainly due to remuneration expenses but increased to RUB 2.5 billion on the backdrop of general business development that implied attraction of highly qualified head counts from the market. Administrative expenses remained at the level of the first quarter of 2017, while other expenses decreased to immaterial RUB 0.2 billion. Net interest margin trend is presented on the **bottom right diagram**. Net interest margin for the first quarter of 2018 remained stable year on year at the level of 3% with right proportion of high liquid asset in the balance sheet of the bank. The net interest income to average risk-weighted assets ratio increased over the reporting period of 5% reflecting the effect of massive redemptions in the loan portfolio.

- Now, I suggest turning to **slide number 5**, with the breakdown of total assets. In the reporting period, total assets were maintained roughly at the level of at the end of 2017, with an immaterial decrease of 1% to RUB 1.8 billion. Liquid assets representing 64% of total assets, increased by 9% year to date, which was mainly driven by enlarged inter-bank balances up to RUB 909 billion with a prevailing share of REPO transactions. Debt securities pledged under reverse REPO protection formed 76% of unused liquidity tools available for the CBR. Unpledged REPOs placed on balance sheet portfolio of Lombard list securities, loans eligible for pledge to the CBR and eligible for the pledge of securities received from the Deposit Insurance Agency in 2015 from liquidity portfolio which exceeded RUB 500 billion as of 1st May, 2018. Classic lending business demonstrated negative dynamics with a net loan book decrease by 16% in the reporting period; it was mainly driven by the effect of big repayments outstripping new loan origination in the course of the first quarter.

- Now, let's move to **slide number 6**, on the loan portfolio quality. At the **upper left diagram**, the loan portfolio coverage by impairment of allowance increased to 7% on the backdrop of the loan portfolio decrease to RUB 694 billion. At the upper right diagram, the amount of NPL decreased from RUB 20 billion to RUB 17 billion during the first quarter. The loan loss provision decreased from RUB 50 billion to RUB 48 billion. The significant decrease of NPL was mainly attributable to the repayment of one big corporate from infrastructure and construction sector. Loan loss provision decreased relative from the redemption of several large corporate loans. NPL coverage ratio increased from 253% at the end of last year to 287% at the end of the first quarter; it was in line with the positive dynamics in NPL. The **bottom left diagram** reflects the cost of risk decreased from 2.5% at the end of last year to 0.6% at the end of the first quarter, which mainly resulted from the recovery of loan loss provision in the reporting period. The **bottom right diagram** depicts traditionally low level of related party lending, which was at the level of 3.2% of total gross loan portfolio at the end of March.

- Now, if you could turn to **slide number 7** with more details of the corporate and retail loan of portfolio risk metric. Resulted from several big redemptions, corporate gross loan book decreased from RUB 731 billion to RUB 607 billion in the reporting period with general improvement of loan portfolio quality, which was evident on hand by NPL ratio decrease to 1.8% and cost of risk ratio decreased to 0.3%, which is shown in the bottom left diagram. **On the right**, the retail loan book NPL ratio increased to 7.1% about the first quarter of 2018 on the backdrop of controlled slowdown in retail lending which led to a further loan portfolio redemption to RUB 87 billion. The cost of risk on the opposite demonstrated positive dynamics decreasing notably to 2% during the first quarter to be compared with 3.9% in 2017.

- **<u>The next slide</u>**, **<u>number 8</u>**, illustrates the spending structure of the bank. Total liabilities were stable year-to-date at the level of RUB 1.7 trillion. Total customer deposits accounting from 55% of total liabilities were flat year-to-date with enlarged share of retail deposit, which demonstrated stable growth on the backdrop of expenses in 2016 and 2017 in branch network. Retail deposits increased from RUB 291 billion as at the end of last year to RUB 307 billion at the end of March 2018. Deposits by credit institutions were mainly accounted by REPO transactions which accounted for 83% of overall inter-bank balances. Due to banks also contain some deposits, current accounts and syndicated loans attracted in March. The debt repaying on schedule is comfortable with bank of international debt due after the year 2020. In February 2018, the bank issued senior Eurobonds in the amount of 500 million USD. The proceeds of replacement were used for repayment of 500 million senior Eurobonds which were issued in 2013.

- Now, let's proceed to the **<u>final slide</u>** and **<u>number 9</u>** on the bank's capital. Due to a number of productions on capital increase accomplished in the course of 2017, the bank reached very comfortable capital position by the end of last year. Very cautious approach to new loan origination coupled with significant redemption led to a further improvement of capital ratios at the end of the first quarter. Minimums including buffers applicable to systemically important banks were by far overtopped with 811 amounting at 9%, 812 12.7% and 810 21.7% as of the 1st May, 2018.

- These were the main highlights of the bank's financial and business result for the first quarter 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 question, please signal pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question. And we will pause for just to moment to allow everyone an opportunity to signal for questions. And we will take our first question from Henrique Morato with Aberdeen Asset Management.

Henrique Morato: - Hi, hello. Thanks for the call. Just a couple of questions from me. Could you please just comment a little bit more on the FX loss, what were the derivatives. I mean, it doesn't look like the currency was that volatile during the first quarter, so just any caller would be interesting. And then the second question would be on asset quality.

Vladimir Chubar: - Sorry, let me start with the first one – because it will be easier for us, not to forget the first one. Thanks for the question and for the call. In terms of your question about the FX revaluation. There was no huge volatility, you know, with the rules we have in RAS which are to IRFS, there is – on the last day of every quarter, we should use CBR rate, and sometimes CBR rate can be different from the rate in the market or the rate which was in your swap or other derivative. I can tell you my projections for this year with this figure. So, from this RUB 6 billion negative result, 3 billion is one off and other 2 billion, we are expecting that they will not be our losses, just technical revaluation which will come to the zero result when derivatives will be finished. Our expectation that the full-year result with this figure will be around RUB 6 billion; so, the exact figure we will see now, if there will be no huge, let's say, changes in the currency. But I can tell you once again, so we are not having any open positions, it is much more technical result, and so I give you my projections until the end of this year.

Henrique Morato: - Okay. Thanks, and then the second question – yeah, it was just on – you know, maybe it has got to do with IFRS 9, I'm not sure, but previously when you reported your breakdown of your loan book in terms of asset quality, there was line that said 'not passed due but impaired,' that line has now gone down to zero. And I just wanted to understand if you could give any guidance on that, that would be great.

Eric de Beauchamp: - Yeah. So, as you mentioned, you saw that from the first quarter of this year, we switched IFRS 9. But in terms of presentation of the accounts rate, quite a number of significant change including in the portfolio, but not – I mean the category which is impaired, not value loans has disappeared, and you have expected losses for the credit portfolio and corporation. So, the presentation has changed.

Henrique Morato: - Okay, that's fine, I might have to follow up off line with some questions to understand this. But this fine, thanks.

Eric de Beauchamp: - I think the best thing is to – off line, I mean to give you some details by category because it is quite challenging when you look at it for the first time. Just on IFRS 9, the second remark, there was, let's say, a one-off impact, let's say, when we switch from 1st January, which was – you can see the – the liquid of retail earnings – I mean, let's say from January, we start loan loss position based on the new standard.

Vladimir Chubar: - To any investor who wants to have some clarification on IFRS 9 or of course any other questions or topics, feel free to contact our IR team because – so, of course, we have done a great job coming to new standard and, of course, we will be happy to share and to maybe go deeply to all the figures and to explain much more what was the transition result, in which areas, etc.

Henrique Morato: - That is fine, thank you very much.

Vladimir Chubar: - Thank you.

Operator: - And we will take our next question from Alan Webborn with Societe

Generale.

Alan Webborn: - Yeah, hi, thanks for taking the time to do this call today. Obviously, the first question is, IFRS 9 or not, your cost of risk is dimensionally lower in the first quarter than it has been over the last four quarters. And clearly, I am interested to know whether is there a positive IFRS 9 related one-off impact in your risk cost in the first quarter. I mean, you are normally able to give us some sort of view of where you think risk costs are going, and presumably you don't think they are going stay down at 60 bps on the corporate portfolio. So, can you try and put this sort of new reporting in a little bit at least into perspective and how we should think about the sustainable cost of risk of the bank going forward. That was the first thing.

Vladimir Chubar: - Thank you Alan for the question, so good question actually. Of course, there was much more the result from transition to IFRS 9. And, of course, that many changes we have now in our portfolio – I mean in our provisioning came from IFRS 9. So, our expectation until the end of this year is the same 2% as I said before, I mean cost of risk. So, of course 0.6% is, just want to repeat once again, there was much more the one-off situation because of IFRS 9.

Alan Webborn: - Okay, that's helpful. And as far as the second part is, there clearly again some interesting seasonal dynamics in the loan book. So, do you have a view of where you think loan book on the corporate side potentially could be this year? I mean we are hearing from some of your peers that there is a little bit more activity coming through, there is a slow improvement and particularly past the elections a feeling that there are more deals to be done; and how do you feel about this sort of the underlying dynamics of the corporate book going forward. And if I remember rightly, a quarter or two ago, you were talking at least and thinking about whether to revamp the retail strategy. To my knowledge, you haven't done that and certainly for the progression of the retail book in Q1 would not suggest it. And so, where are you in terms of that development? Thanks.

Vladimir Chubar: - Okay. Starting from the corporate side. As I said in our presentation, there was just number of the big deals which finished in the first quarter and a couple of exposures were sold. So, it also was mentioned in our PR/IR activity. In terms of our projection, so we don't see that it will be some kind of big systemic growth in our loan book, let's make it this way. So, end of the quarter is kind of the zero level for us now because as I said some one-off in the first quarter.

- From the beginning of the second quarter, we are expecting small growth of around 5-10%, and potentially it can be higher even there will be some kind of opportunistic deals in which we can participate and in which we can lend to our borrowers. But it will be much more bigger tickets than for example SME lending. In terms of small companies and medium companies, we see their activities, but unfortunately the quality of incoming application is not very good, and our old usual suspects, our old customers are still our customers. So, we would like to work with them. But honestly speaking, as I said, the quality of new portfolio is not very good. In terms of retail business, you are absolutely correct, I said this on the last call which was just a couple of months ago about the new retail strategy, it is almost done. So, we are expecting to deliver it probably deliver in the next couple of months. And you will see it is also on the second quarter result in terms of lending activity. And in even the first quarter was more positive than before because the decrease of the loan book was much smaller than for example last year.

Alan Webborn: - Okay, that's helpful. So, then maybe just one final question in terms of your salary costs. And is this mainly related to further development of the investment banking or are there other elements to it?

Vladimir Chubar: - You are absolutely correct saying this. The big part of this came from the new business line, which we are expecting will be very good this year in terms of profitability. And, of course, there is some natural growth in the salaries because of inflation, because usually it is beginning of the year when we are rechecking our salaries to see if they are fine with the market. But we are not expecting some huge changes in our salary policies.

Alan Webborn: - Okay, that is really helpful. Thank you.

Vladimir Chubar: - Thank you as well. As I see, there are no other questions in the line. So, if nobody wants to ask any other questions, I think we can finish the call. No, there are some other questions are coming. We can start with the first.

Operator: - And we will take our next question from Nick Dimitrov with Morgan Stanley.

Nick Dimitrov: - Hello, can you guys hear me?

Vladimir Chubar: - Yeah, we can hear you fine.

Nick Dimitrov: - Hi good morning, just a quick question. I just want to make sure that I understood it correctly. So, the FX losses are broken down into two, right? You said the three billion is one off, so that's the real economic loss. The other three billion is noneconomic. In other words, there is going to be a reversal towards the gain on the other side, correct?

Vladimir Chubar: - Yes, this is correct, absolutely. So, I just want to repeat once again. We are expecting the same six billion until the end of this year, so we are not expecting this figure to be decreased, it is same, it is like minus. And three billion is really just, let's say technical revaluation, it's not losses.

Nick Dimitrov: - Got it. And my other question is going to be on those large payments. When I was looking to your industry breakdown, it seems like there was a very steep decline in lending in the crude oil production and trading segment and petroleum refining. So, both contracted by about 20 something percent. What is driving the contraction and do the sanctions have anything to do with this?

Vladimir Chubar: - It is not linked to sanction, just was the repayment day of one big loan and it was repaid. We are expecting potentially this client can come to us once again and with a new contract. It is a trader who is working in oil reselling. So, potentially it can be. So, it is not linked to sanctions at all. It's just usual way of doing business. And somebody offered a better price to this customer, so I know who actually, and potentially we are expecting that we can also start to work again with this guy.

Nick Dimitrov: - All right, got it. Thank you so much.

Vladimir Chubar: - Thank you as well.

Operator: - And we will take our next question from Ruslan Gadeev with RBI.

Ruslan Gadeev: - Yeah, many thanks. I just have one question please. Could you please comment on the significant inflow of current account from related party, please, do you see it as a sustainable source now, so because the financial shows like RUB 42 billion, almost RUB 43 billion. So, it would be great to hear something on that one. Thank you.

Vladimir Chubar: - I am sorry. Can you say it again a bit more louder because we hear you very bad?

Ruslan Gadeev: - Yeah, sure. Just a question concerning the inflow in the current accounts from a related party. So, as I see from the financials, the figure is quite large, almost RUB 43 billion.

Vladimir Chubar: - Yeah, as you know, there was a nongovernment pension fund in the structure of our holding company, Rossium, and in the very end of March, they received – money came from the new contracts they made last year, and it was really one-off, so because of this money, they just were on our accounts in the bank from first to second quarter, and all this money just went to their investments in the very beginning of the second quarter. So, it is one-off and we are not expecting that it will be until the end of the year with such a big figure. So, potentially within one year, in the very end of the first quarter 2019, it can be once again the same because they are receiving this money in the very end of the quarter and they just technically cannot invest all of them to the new – let's say to the market.

Ruslan Gadeev: - Okay, that's it. Many thanks.

Vladimir Chubar: - Thank you. I am sorry, but we have to finish our call now because we have the meeting starting in a couple of minutes on the conference here in Miami. So, for those who wants to ask the questions and didn't have a chance to do it because of our timeline, please contact our IR team or us here in Miami if you are here personally. So, once again, thanks for the call, thanks for being with us and just hear you soon and maybe see you soon. Thank you.

Operator: - And that does conclude today's conference. Thank you for your participation. You may now disconnect.