CREDIT BANK OF MOSCOW

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Conference Transcription
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Conference title: CREDIT BANK OF MOSCOW: 1H 2013 FINANCIAL & BUSINESS RESULTS
Conference Time: 17:00 Moscow Time
Speakers: Vladimir Chubar, Reinhard Stary, Eric de Beauchamp

Operator: Ladies and gentlemen, welcome to the Credit Bank of Moscow First Half 2013 financial and business results held on the 22nd of August, 2013.

Throughout today's conference, all participants are in a listen-only mode. After the conference, there will be an opportunity to ask questions. If any of the participants have difficulties hearing the presentation, please, press the star, followed by the zero on your telephone for operator assistance.

I would now like to turn the conference over to your host, Mr. Reinhard Stary. Please, go ahead, sir.

Reinhard Stary: Good afternoon, ladies and gentlemen. Welcome to our first half year's earnings announcement conference call. I'm Reinhard Stary, and with me are Vladimir Chubar, our Chairman, and Eric de Beauchamp, our Chief Financial Officer.

Most of you are already familiar with our bank. But, for those of you who joined our call today the first time, allow me to make some brief introductory comments along with the first slide.

We are a 21-year-old commercial bank with a strong presence, operating in Moscow and Moscow region, providing a full range of banking services to corporate clients and retail customers. It is our strategic ambition to be regarded as the leading commercial bank in the region with international reach in the area of trade finance.

I already outlined on our last call in early June this year when I say leading this doesn't necessarily refer to pure size. It rather refers to our ambition and strategy to be highly regarded by all our stakeholders, customers, employees, as well as shareholders and bondholders.

The continuous successful execution of this strategy is now once more evident in the very solid half year key performance indicators explained on this slide; namely, our growing net assets, our balanced and growing loan portfolio, and our strong net interest margin, and return on equity, on which we will comment in further detail.

Let us proceed now to slide **number 5** of our presentation on key developments. Before I will hand over to Vladimir, who will give you an update on our business, let me briefly comment on those key highlights of the Bank's development in the first half of 2013, as well as some subsequent events which we deem important to mention.

- Profit for the six months of 2013 reached RUB3.8 billion rubles, which is nearly 80% higher than the last year's result of the same period.

- The bank's assets grew 16.5% in first half of 2013 and amounted to RUB360 billion in total. This is in line with our long-term strategy of steady growth supported by sound quality metrics at the same time. Compared with the 7% average growth rate of the Russian banking sector according to Central Bank of Russia statistics, we outpaced the market more than twofold.

- Our gross loan portfolio as the main driver of the asset growth expanded by 27% and reached RUB263 billion. Comparing to the Russian banking sector aggregate loan book dynamics in the first half of this year, our bank, as now already kind of its tradition, has been outperforming the average market growth of around 8%, significantly. At the same time, we maintained a record-low level on nonperforming loans, indicating a high-quality of the loan portfolio.

- Our profitability ratios are consistently at a good level, bringing Credit Bank of Moscow into line with the most profitable and effective Russian banks. Our return on equity of above 18%, return on assets of 2.3%, and a net interest margin of 5.2% are all best in class.

- During the first half of 2013, gross loans to individuals grew by roughly 31% and totaled RUB66 billion. Retail deposits grew by 15% up to RUB123 billion. While our bank historically was focusing on corporate business, our half year results demonstrate our success in increasing our focus on the retail lending segment, which, at end of first half of 2013 year reached already 25%. As for individual customer accounts, we maintain a position of top 15 Russian banks in terms of volume of individual deposits.

- As we already discussed on our Q1 earnings call three months ago, during the first half of 2013, Credit Bank of Moscow was actively engaged in very successful capital market transactions, as listed on this slide here.

- As a subsequent event, after the half year closing, in July, the bank's shareholders decided to increase our share capital by placement of additional shares by way of closed subscription amongst current beneficiaries of the bank. The purchase of the new shares will be partly financed by repayment of the subordinated debt to the majority shareholders. This subordinated debt was fully repaid in August 2013. Following a series of related transactions, in the second half year of 2013, no changes in the current shareholder structure are expected.

- First half of 2013 was marked by positive actions from international rating agencies, as listed on the slide. And we trust that these positive events definitely underpin the successful development of the bank and its reinforced position in the market.

It's now my pleasure to turn the floor to Vladimir, followed by Eric, who will guide you through the recent financial performance. After, we will be happy to take your questions. Over to you, Vladimir.

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

As Reinhard already outlined, I am glad and really proud at the same time to announce the outstanding results for the first half of this year. And I want to say a few words about our recent developments. This year, we continued to expand our business with a focus on the quality of assets and no unreasonable risk exposures. Credit Bank of Moscow now ranks among Russia's top 20 financial institutions in terms of asset volume, being in top 15 by equity size and net profit, and in top 10 by profitability and efficiency ratios. We are a universal bank servicing both corporate and individual customers but at this stage corporate banking still remains our core business line in terms of share in assets and total revenues.

Slide number 7 gives us a corporate banking overview on assets and liability side.

- Corporate banking represents 75% of our lending business, confirming my statement that this segment is core for us, bringing the bulk share in profits. The loan portfolio is well diversified with a maximum share of 16% granted to electronics, appliances, and computer retailers.

- In the structure of corporate customer deposits, term deposits prevailed with a share of 73%, which increased from 70% as at the yearend 2012.

- The largest part of our corporate client base is trade companies and retailers. They are represented in a majority of economic sectors.

- As you will see from our financial statements, the bank has a strong foothold in the niche of short-term lending, being focused on high-turnover of credit resources.

- One of our key strengths is the leading position in cash collection and delivery in Moscow region and in Russia, which allows us to maintain a stable, corporate franchise and to have a good insight into our borrowers' cash flows.

Let's now move to **slide 8,** which contains information on our retail banking.

- The importance of this business line is constantly increasing due to our strategic focus on the retail lending. As I already said during our last call, we plan to increase the share of loans to individuals in our total loan portfolio up to 50% in the long-term perspective. Current share is slightly above 25%. And, as I mentioned before, we target to increase this share until the end of this year, up to 30%.

- CBM's branch network is comprised of 61 offices and 17 operational cash desks in Moscow and the Moscow region. Our branch network was ranked by RBC rating as one of the most efficient ones. We are number five among the top 50 banks by loan origination per outlet, number eight by deposit portfolio per outlet, and number nine by net assets per outlet. At this very moment, we have around 700 ATMs and 4,400 payment terminals and permanently are developing our network to be convenient for our customers. In March, our bank and Alfa-Bank fully united their payment device networks by signing strategic cooperation agreement, unique for the Russian market of financial and credit services.

- Target segments in retail lending for us are consumer loans and credit cards. Share of these products in total loans is stably increasing and now comprises 64%. The number of issued plastic cards is close to 1 million, also showing steady growth.

After this general overview of our business development, I would like to turn the floor over to Eric de Beauchamp, our CFO, who will discuss the financial results of the Bank for the first six months of this year in more detail.

Eric de Beauchamp: Thank you, Vladimir. I am happy to present some financial results of Credit Bank of Moscow for the first half of year 2013 and elaborate on the most material trends.

Let's start with slide number 10 and start our financial performance review from income/expenses dynamics.

- The bank is keeping its operational efficiency at an impressive level with a cost/income ratio having shown tremendous improvement in the first half of 2013 and arriving at a 32.8% versus 40.5% at the year's start.

- Return on assets and return on equity, as mentioned by my colleague, continue to retain at the levels above-the-average, while net interest margin, driven by increase in the volume of lending operations, also stands at a healthy 5.2%.

- Net fee and commission income, which is the second-largest driver for the operating income growth, showed a 72% rise to RUB2.8 billion. The major sources of fee and commissions income are insurance contracts on retail loans, cash collection, and delivery services, operations, as well as commissions on issued guarantees on letter of credit. Insurance contracts processing fees, being the key driver of the significant rise of fee and commission income, increased by four times in comparison with the first half of 2012. Aiming to proactively develop this particular source of income, we expect to show further strong results in the future.

- The main drivers of cost growth are salaries and administrative expenses. In the first half of the year 2013, salaries and employment benefits, including social security costs, increased by 27% versus first half of the previous year due to increased headcount combined with salaries adjustments to the market.

Now let me move to slide 11 and look at our asset structure. It remains more or less stable with more than 71% relating to our loan portfolio. Assets are showing a 17% growth from the year's start, a bit higher than the market average.

Loan portfolio quality, which is presented on slide 12, demonstrates strong metrics with the share of loans overdue for more than 90 days maintaining at a safe level of 1.1% of the total loan portfolio.

- Nonperforming loans in the corporate segment are even smaller and stand at 0.09% as at the reporting date, having decreased slightly from the preceding 0.1%.

- Retail loans are considered riskier assets, and NPLs on retail products are much higher than the corporate segment; namely, 4.1% at the end of second quarter. Nevertheless, the effect of retail NPLs on total NPLs is not material due to the lower share in the total book. Retail NPLs also stand below the market average.

- In the first half of 2013, an upward trend is observed for the cost of risk being 2.4% and loss provision ratio being 2.6%, which is a result of the bank heading towards retail book share increase in the total loan portfolio. Active penetration into retail segment being a part of the bank's strategy implies higher risk, therefore, the Bank keeps to more conservative provisioning policy in order to ensure additional comfort for the potential risk. In terms of cost of risk, the bank is also well positioned versus competitors.

The following slide, number 13, presents the funding structure of the Bank.

- The major part of funding is coming from retail deposits, which were RUB123 billion, or roughly 40% of liabilities. And corporate deposits, which, coupled with retail deposits, makes 64% of liabilities. Retail deposits represent a steadily growing and stable part of the bank funding with the average retail deposit term equaling roughly two years.

- Deposits by corporate customers decreased by 4% during the first half of 2013 due to seasonal factors of this line item.

- Promissory notes and bonds account for over RUB74 billion, or roughly 23% of liabilities. In the first half of this year, Credit Bank of Moscow realized a couple of successful transactions in the open market, which are subordinated domestic bond and Eurobond issues, as well as a senior Eurobond. These borrowings serve as a stable long-term funding source of the bank and partially replaced funds raised from corporate clients.

Before moving to the Bank's equity, I would like to draw your attention on slide 14 with concentration risk levels.

- At the end of the first half of 2013, our 10 and 20 largest exposure in asset accounted for 16% and 24% of the portfolio, respectively, while our 10 and 20 largest deposits represented 17% and 23% of the deposit portfolio, respectively, both showing downward trends.

- Short-term loans traditionally prevail in the loan portfolio, which is evidenced by the bottom, left graph on slide 14. About 62% of loans mature within 12 months, and 19% are repayable in a period from one to three years.

- Volume of related party loans in the Bank is insignificant and accounted for 0.9% of the Bank's equity versus a 1.1% level at the end of 2012.

Now let's move to slide 15 on the bank's capital.

- The Bank's capitalization level is very strong, which is evidenced by total capital adequacy ratio being 19.1% as of 30th of June.

- Tier 2 capital base was supported by domestic, subordinated bond issue, the proceeds of which were reflected in the capital in March 2013, as well as Eurobond issue, included in the Tier 2 capital in May 2013.

- Net income earned by the Bank in the first half of 2013 was capitalized in full in line with the dividend policy.

- As also mentioned by my colleagues before, following resolution of the Bank's shareholders of the capital increase, in the second half of 2013, we expect further strengthening of the capital structure, at the same time not resulting in any shareholder structure change.

These were the key highlights describing development of the bank's balance sheet and P&L statements in the first six months of 2013. Thank you for your attention. Now we suggest moving to the Q&A session.

Operator: Thank you. And the first question comes from Dmitry Polyakov from CIB Sberbank. Please, go ahead.

Dmitry Poliakov: Yes. Hello. It's Dmitry Polyakov from Sberbank CIB.

My first question is regarding the quality of your unsecured consumer loan portfolio because there's so much noise in the market regarding that. And could you, please, elaborate on what trends you observe and, basically, how you're trying to defend your portfolio against deterioration? And what were the origination trends in the second quarter? Do you see some deterioration on the quality of the applicants? Just any color would be welcome.

And my second question is regarding the sustainability of this insurance fee, because I understand that this issue is a bit challenging from a legal standpoint because these fees are not included in the APR for the loan, and, therefore, you know, because there's a lot of discussion about disclosure of the cost of credit to the customers. Do you think that the authorities might at some point pay more stringent attention to these fees? Thank you.

Eric de Beauchamp: Relating to the cost of risk on retail loans, as we saw an increase during the first half of the year. As a difference to other banks, we keep a very conservative approach in the way we select our customers. And, in fact, if you look at the origination of customers, a major part consists of, let's say, employees of customers of our corporate team. So it allowed us to have the risk under control and to select customers.

So, structurally, considering that the part of retail loans in the whole portfolio is increasing and, as Vladimir mentioned, we should reach almost 30% at the end of the year, we anticipate a slight increase of the cost of risk in December but which is under control, once again.

Regarding the insurance revenues, insurance revenues grew a lot during last year, at least four times from the 1H 2012. We consider that it will remain a stable and sustainable source of revenue for the bank. And, considering that we have low customer rates, for us it's a very good way to diversify sources of revenue, not only to realize margin but also to have additional commissions. So this will be a stable source of revenues for us in the years to come.

Dmitry Poliakov: Okay. Thank you.

Operator: Thank you. If anybody else would like to ask a question, you may now press the star, followed by the one on your telephone. And, if you wish to cancel the request, please, press the star, followed by the two.

The last question currently comes from Sergey Gorelov from [… Securities]. Please, go ahead.

Sergey Gorelov: Yes. Vladimir, thank you very much for the presentation. I have two short questions.

The first one is: Could you, please, comment on the net income guidance for 2013?

And the second question is: Do you plan to attract any other wholesale funding in 2013? Thank you.

Vladimir Chubar: Thank you for the question. Yes. First of all, our expectation for this year is around RUB7.5 billion to RUB8 billion. We don't expect any problems with this target.

About our activity on international and local markets, after our very successful track record in first half of this year, we do not plan any activity on international markets until the end of this year. On local markets, we're now thinking about one or two local issues of Russian bonds nominated in Russian rubles. But we will see, first of all, what will be the market situation; second, what will be the demand from the businesses for the funding; and, number three, and number three is very important for us also, the pricing. Now we try to position ourselves on the market as a very good borrower. And, as we see now, pricing is going down. The interest rates on the local markets are going down now, so it can be a good market for us, maybe September or maybe October. Thank you.

Operator: Thank you. If anybody else would like to ask a question, you may now press the star, followed by the one on your telephone. And, if you wish to cancel the request, please, press the star, followed by the two.

Thank you. And the next question comes from Denis from Raiffeisen Bank. Please, go ahead.

Denis Poryvay: Hello. Thanks for presentation. I have one question regarding common additional share issue. What increase in your Tier 1 capital adequacy ratio do you expect from this transaction given all other conditions being equal? Thanks.

Vladimir Chubar: About this transaction, first of all, we expect that we can close this transaction until the end of this quarter. I mean third quarter. So now we are in CBR with the documents. And, after this, of course, we can do this.

Second, I think you mean the covenants in terms of Russian regulation?

Denis Poryvay: Right.

Vladimir Chubar: Yeah. First of all, our total N1.1 in terms of Basel 3 will be around 8.5%. So N1.2 will be the same because, after this transaction will be no sub-debt, which is good for core capital. And the old N1 will be around 14% to 15%. Of course, it will depend on the activity on the asset side until the end of this quarter. But we expect very strong figures. And with these good covenants, we feel ourselves very comfortable until the end of the year in terms of assets growth and in terms of generation of profit.

Denis Poryvay: A second question. Given your plan to increase your retail banking business in your portfolio, what net interest margin do you expect to see?

Vladimir Chubar: General margin until the end of the year will be not more than 5.3% or 5.5% because, on one hand, we have retail lending with a very good margin, but, on the other hand, we have corporate lending. And I think you all know that, at this very moment, the tendency is that margin in corporate business is going down, not very fast, but the tendency takes place. So we think that retail lending margins will compensate the decrease in the corporate lending margins. So we expect around 5.3% or 5.5%, not more.

Our main strategic focus is on retail banking. At the same time, it is very important to keep our share in the corporate banking market. That's why we're ready to further support our corporate customers. And we are ready to further increase our market share in corporate banking. So, for us, for our highly effective business model, it's not a big deal to decrease the margin in a corporate business to expand our market share and wait one or two years till it will be “the year of banks” again, when banks can dictate their rates. So, it's very important to have a well-established customer base to work with. Thank you.

Denis Poryvay: Okay. Thank you.

Operator: Thank you. Ladies and gentlemen, there seem to be no further questions at present time, I would like now to give the line back to your host for any closing remarks for the conference call.

Reinhard Stary: If there are no further questions, we thank all of you for the attention and wish our friends in Asia a good night and all the rest a good day or evening. We look forward to be with you again at our quarterly call in November.

Operator: Thank you, ladies and gentlemen. That does conclude the Credit Bank of Moscow first half 2013 financial and business results. Thank you for your participation and you may now disconnect.

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