

Conference Transcription
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RESULTS

Speakers: Vladimir Chubar, Eric de Beauchamp, Sergey Lukyanov

Operator:

Good day and welcome to the Credit Bank of Moscow First Quarter 2016 Financial and Business Results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr Sergey Lukyanov. Please go ahead, sir.

Sergey Lukyanov:

Thank you very much, Gail. Good evening, ladies and gentlemen. Today we are happy to host the conference call on Credit Bank of Moscow's First quarter 2016 Financial and Business Results. I am Sergey Lukyanov, in charge of Investor Relations, and I'm happy to present today's speakers.

Here with me are Vladimir Chubar, Chief Executive Officer, and Eric de Beauchamp, Senior Vice President. Vladimir Chubar will open today's call with key financial highlights of the first quarter of 2016 and a brief outline of business development. Afterwards, Eric de Beauchamp will proceed with a detailed analysis of financial results. All your questions and comments are very welcome after the presentation when we open the Q&A session.

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

Vladimir Chubar:

Thank you, Sergey. Dear ladies and gentlemen, the first quarter of 2016 turned out to be rather stable for the Russian banking sector, with an emergent trend for accumulating of excessive FX liquidity in the system. Coupled with a continued recession of Russian economy, and a very limited number of good credit profiles in the market, this led to a visible drop of interest rates and an increased competition among banks for top tier borrowers.

Against this backdrop, international capital markets with a very strong demand for Russian debt and record low level of yields remained untapped by Russian issuers, especially financial institutions, with only few exceptions from real sector of economy.

While on the subject of Credit Bank of Moscow, on slide number 3 is a brief outline of financial results for the first three months of 2016. A sharp growth of business during the previous year produced almost double net interest income and net fee and commission income. Coupled with an improved operational efficiency with the cost-to-income ratio dropping below 25%, and stable asset quality, this resulted in net income growth by almost six times year on year and return on equity and return on assets reaching 7.1% and 0.5% respectively.

At the same time, remaining generally in line with the market, net interest margin shrank from 3.8% to 3.1% year on year. This was mainly caused by an enlarged share of liquid assets on balance sheet, which from one side brings us into a safe position in the case of macroeconomic instability, and from the other side gives room for further growth in terms of lending.

Now let's move to slide number 4 on key business highlights. Corporate banking business remains the key driver for loan portfolio growth in 2016. But it slowed down to compare with the previous year due to a selective approach to new exporters with a strong focus on quality of borrowers.

Synergy with the cash handling business, which is a valuable advantage from a risk management perspective, coupled with a good diversification by industries, enable us to keep this risk under control.

Retail banking business key priorities for 2016 are to establish an efficient branch network in Moscow and Moscow region and to further develop alternative channels of distribution aiming to strengthen our customer base primarily on the liability side.

In the first quarter of 2016, the retail loan book decreased by 2% due to

tightened lending standards and strong focus on target market segments: consumer loans and the mortgage loans. At the same time, mortgage loan book standalone showed a 9% increase during the quarter, consequently increasing its share in gross retail loan book up to 20%.

Now I suggest moving further. Eric will provide details on the bank financial results. Eric, please.

Eric de Beauchamp:

Thank you Vladimir, and good afternoon ladies and gentlemen. I suggest turning to slide number 5, where details of the income and expenses dynamics are presented. The operation income increased by 74% year on year up to RUB 12.4 billion. It was mainly driven by a substantial growth in the net interest income, which went up by 84% to RUB 9.1 billion. The expansion of the bank's core business, corporate lending, during the second half of 2015 triggered up the growth of interest income by 46% year on year up to RUB 27.5 billion, whereas interest expenses went up only by 32%, reaching RUB 18.3 billion.

At the same time, the strong growth of cash position in the balance sheet slightly restrained the increase of the net interest margin, which was of 3.1% for the first quarter of 2016. The fee and commission income also showed positive dynamics increasing by 77% year on year to RUB 3 billion, mostly due to the growth of commission from cash sending business up to RUB 0.6 billion, mainly as a result of the strategic acquisition of Inkakhran in November 2015, one of the largest cash sending companies in Russia.

Operating expenses demonstrated lower growth rates relative to operating income, increasing by only 44% year on year to RUB 3.1 billion due to a jump in salaries and administrative expenses, most part of which came from the consolidation of Inkakhran. As a result, the bank significantly improved its operating efficiency during the reporting period, which is reflected in the cost-to-income ratio at a record low level of 24.5%.

Now I suggest turning to slide number 6 and review the bank's asset structure. The bank's total assets increased by 13% from the beginning of 2016, reaching RUB 1.4 trillion. Under the current macroeconomic conditions,

the bank continues to increase its liquidity cushion, which represented 54% of total assets as of the first quarter of 2016.

The majority of these liquid assets include a portfolio of corporate bonds with high credit ratings as well as reverse repo conventions with highly liquid securities as collateral. A major part of the securities are included in the Central Bank's Lombard list.

The bank's net loan portfolio stood at the level of December 2015, representing 43% of total assets. The net retail loan portfolio slightly decreased by 2% to RUB 108 billion, which reflects the bank's tight selection of criteria of individual clients in order to maintain a healthy portfolio quality.

Moderate demand from large corporates impacted net corporate loan portfolio, which remained at the level of last year with RUB 484 billion, or 35% of total assets.

The next slide, number 7, provides a review of the bank's key loan portfolio metrics. During the first quarter of 2016, the total NPL ratio increased by 0.3 p.p. to 5.4% due to the movement of several corporate borrowers to the 90 days of default category. The bank increased its loan-loss-provision ratio and NPL coverage ratio up to 6.5% and 122% respectively as a result of a conservative provisioning policy of the backdrop of complicated market environment. At the same time, the cost of risk demonstrated a positive trend by moving down by almost 0.9% to 4.5%.

The level of related party lending remains non-material at the level of 0.13% of the gross loan portfolio.

The next slide, number 8, provides analysis of the bank's corporate and retail loan portfolios quality. The quality of corporate loan book remains stable, with NPL ratio moving up slightly to 4.7% on the backdrop of flat growth in the first quarter of 2016.

NPL coverage ratio was maintained at a safe level, increasing up to 132%. The cost of risk on the corporate loan book moved down by 1.7% to 4.1%, reflecting the bank's positive outlook on the quality of its corporate loan

book.

The level of the non-performing loans in the retail loan portfolio remained stable at 8.1% as at the end of March 2016, with the cost of risk increasing up to 6.4%. A significant portion of non-performing loans came from mortgages, which at the same time are safely collateralised with LTV ratios being far below 100%.

The following slide, number 9, gives a brief overview of the liabilities breakdown. The bank's funding structure did not change much during the last quarter, with RUB 906 billion, or 71% of total liabilities, being represented by customer deposits.

Deposits from credit institutions increased by 2.7 times to RUB 226 billion during the first quarter, including short term repo deals. The bank has a comfortable bonds repayment schedule, with only RUB 12 billion of domestic bonds due in 2016.

Now, let's proceed to the final slide, number 10, where the bank's capital position is presented. The bank's capital remains strong, which is evidenced by a Basel 3 total capital adequacy ratio of 16% and tier 1 capital liquidity ratio of 9.2% by the end of March 2016. Capital adequacy ratios under Russian accounting standards remain at a comfortable level, with N1.0 ratio of 15% and N1.1 and N1.2 ratios of 8.1%.

At this point, I suggest finishing our 2016 three months result presentation. Thanks for your attention, and let's proceed to the Q&A session.

Operator:

Thank you. If you wish to ask a question at this time, please press *1 on your telephone keypad. Please ensure that the mute function of your telephone is switched off to allow your signal to reach us. Again, please press *1 on your telephone. We will pause just for a moment to allow everybody to signal.

We will now take our first question from Konstantin Rozantsev from JP Morgan. Please go ahead, your line is open.

Konstantin Rozantsev:

Hello. Thank you very much for the presentation. Just a quick question on the

Q1 2016 accounts. So we've noted that there has been a marked increase in liquid assets and interbank borrowings during the quarter. Could you please clarify the reason for this increase? Would you consider any buy backs of publicly traded securities, publicly traded bonds at the moment?

Vladimir Chubar: Hello. Thank you for the question. You mean our bonds or more bonds from the market? Like other issuers?

Konstantin Rozantsev: No no, the company's bonds. Your bonds.

Vladimir Chubar: No, we answered the same question. Just answering the question, we don't have plans now to buy any bonds issued by our bank before. So if it was your question.

Konstantin Rozantsev: So the first part of the question was, could you please confirm the reason for the accumulation of liquidity. So we spotted there is quite a significant increase in liquid assets and interbank borrowings. Could you please confirm the reason for that?

Vladimir Chubar: Now we have a number of the reported transactions on our balance sheet on the asset side which are linked number of the clients we have and to finance these transactions we can take money everywhere. So we can take money on interbank market or we can take money from our clients. And the fact that this money sometimes, the funding can be sure, so we use this money only for highly liquid assets, like for short term repo transactions or with highly liquid instruments.

Konstantin Rozantsev: Ok. But what was the reason for that, if you could confirm?

Vladimir Chubar: The reason for what? Just for this increase? We are just making some profit on it.

Konstantin Rozantsev: Ok. Sure. Understood. Thank you.

Operator: As a reminder, if you wish to ask a question, please press *1 on your

telephone.

We have a question from Magdalena Stoklosa from Morgan Stanley. Please go ahead, your line is open

Magdalena Stoklosa: Thank you very much. Good afternoon. A very quick question from me on where do you think we are currently in the asset quality cycle? We have seen your trends, but I'm just kind of more interested in your view 12 months forward. Where do you see the most risk, particularly within your corporate portfolio? Where do you actually feel quite comfortable with it, because of course we have seen your coverage increasing and so forth? So how would you give us a little bit more colour about one, where do you see we are? Are we peaking in terms of non-performing loans? Two, are there any residual kind of pressure points? And three, where do you expect your cost of risk for let's just say 12 months out to actually stabilise at?

Vladimir Chubar: Hello Magdalena, so thank you for your question. First of all, in terms of our feelings in terms of NPLs, as I said on the last call, we feel kind of at the bottom for the retail segment. Now this feeling is much stronger. We think that mid-year will be this real bottom. We just expect this in terms of cost of risk, in terms of NPLs for the retail segment. Of course, if you talk about the corporate business, it's more unexpectable because there is less diversification, higher concentration. That's why we cannot say that it is the bottom or not. But I can tell you that the last couple of months, maybe even more, like 3 months, we didn't see any new big names just jumping to NPLs in the corporate segment. So all this just lets us see that maybe it's also kind of a bottom and now we can just maybe in a couple of months, 3-4 months, we can start the cycle and there will be some decrease of NPLs and cost of risk in terms of the corporate business.

Your question about the cost of risk forecast for next 12 months, we think that 4, maybe 4.5% is a target we see now. It's for total portfolio. For corporate and for retail segment.

Magdalena Stoklosa: Thanks. Thanks very much. Are there any sectors which you would have been kind of a little bit more cautious on? I think that's what's been coming up in

the kind of financial discussions was very much still metals and mining, commercial real estate, even some kind of transport companies. Would that be the same kind of sensitivities that you would see in the market?

Vladimir Chubar:

So, look. If you talk about the general market, of course metals and mining is something which is like also under control for the banks, but in our portfolio, I can tell you honestly, in terms of all the main sectors, it looks like we've already found all the problems. So of course I cannot tell you we have a crystal ball and there will be no new problem loans in the future, but from all the old-style portfolio which was built until end of 2014, now we found all the problems, all the problem loans.

Of course, if you talk about the construction, also we are very selective, and we were very selective in this area of corporate business, and also that's why we don't see any problems in the future. In terms of transportation, of course Transaero is in the mind of every Russian banker who was involved in this company. But maybe we said last call that we made 100% for this loan, for Transaero, in our 2015 IFRS report. So we don't see any further increase of provisions in this area.

We think there can be some increase in terms of car dealers because we have some exposure on number of the Russian car dealers and so most of them are Moscow-based, which is good, but also there are car dealers which are not very good because you know now there is a tendency of decrease of buying new cars, etc. etc. So maybe we expect some increase of provisions here.

In general, all other sectors, almost all of them are in the same shape.

Magdalena Stoklosa:

Thanks very much, Vladimir. Now, just my last one to understand also your thoughts about volumes next year. Because effectively, we're still in a shallow, but a recession, and at least according to our economist, we're looking at a quarterly bottom, probably by the third quarter. So we will see some kind of GDP pick up from there. The long volumes are broadly flat in your kind of numbers.

What do you see in terms of this? What sort of loan growth in the second half of the year, maybe first year of 2016 would you see returning?

Vladimir Chubar:

As I said in my speech before, in the first part of the call, we see some higher competition from more banks for top tier borrowers, and that's why sometimes we have to think not only about the pipeline of the future transactions, but also we have to think about keeping old customers in our portfolio, because sometimes they can receive better offers in terms of the rates from other banks, and that's why we have to answer. And all these answers, they immediately have an influence on our net interest margin.

So I cannot tell you it's kind of a war with other banks, but competition will be higher. At the same time, maybe now we see a bit better situation in terms of interest from the borrowers for taking new loans. For example, if we can compare this with for example half a year ago, I think that the second quarter will be not very good in terms of the growth of the corporate portfolio. So what we will see in the third and fourth quarter, we are trying to predict that there will be some growth, but at the same time, also we have pressure from FX rate, because as you saw, part of our portfolio is FX-denominated, so dollars and euros, and of course our IFRS (report) is in Russian roubles and it also has an influence on our numbers.

So in general, as I said on the last call when somebody asked me about the forecast for this year, we are expecting something a bit faster than market, than the banking system. So I can just repeat this forecast. And you know that the first quarter is usually not very active, we have very long holidays, we have less demand from our customers. Second quarter is better, but third and fourth quarter is the most active period of the year, when our customers are seeking for new loans.

Magdalena Stoklosa:

Yes, yes, absolutely. Thank you very much for the colour. Thanks.

Vladimir Chubar:

Thank you.

Operator:

As a reminder, if you wish to ask a question, please press *1 on your telephone.

We have our next question from Nick Dimitrov from Morgan Stanley. Please go ahead, your line is open.

Nick Dimitrov:

Hi guys. Just a couple of questions. So I remember that last time, when we talked about your Q4 earnings, one issue that came up was your depositor concentration. Can you provide us with some colour regarding what are the latest developments and how you manage the depositor concentration?

Vladimir Chubar:

You mean the deposit side, yeah?

Nick Dimitrov

Correct. Yes.

Vladimir Chubar:

Ah, ok. So now that the concentration is as we see a bit less, but it's still, I don't like the word "an issue", but it's a question we are asking ourselves, if it's high or low, but we see that now it's quite manageable in terms of the concentration on the deposit side.

Now, currently, the main question for us is: what we have on the asset side? So how we can manage this? Is it below the sum of, for example, some deposits which can go out from the bank? How we can manage it? So we can answer very easily that now we have no issues with this. We have a number of very liquid assets on the balance sheet. But in terms of the one year horizon, we will see because as you know, we have a number of the big depositors and I cannot tell you that I know their plans for the next one year and two years, so we are like working with them on 3-6 months horizon normally. We have a number of different deposits, and as I said on the last call, some of them for one year, some of them much longer, some of them for 3 months. So I'm telling this.

Nick Dimitrov:

Got it. And do you mind providing us some numbers regarding, let's say, the top 20 depositors account for whatever percentage of your total deposits, for example?

Vladimir Chubar:

Now it's about 70%.

Nick Dimitrov:

70%. Ok. Ok. And what about top 10?

Vladimir Chubar: You know, I think it is better if we just answer it to you directly. I have your e-mail.

Nick Dimitrov: Ok, that's fine.

Vladimir Chubar: I'll just have the figure. Ok?

Nick Dimitrov: Ok. That sounds good. And my next question is going to be, so I'm looking into your capital ratios under the Russian accounting standards, and total capital declined from 16.1% to 15% as of May 1st. I should probably know this, but what is the driver for the decline?

Vladimir Chubar: As you know, we have a number of the subordinated transactions in our capital, so that's why we have some decrease, because the Russian rouble became stronger, and that's why.

Nick Dimitrov: Oh, ok.

Vladimir Chubar: Yeah. That was the main driver.

Nick Dimitrov: So it was pure FX?

Vladimir Chubar: We have \$800 million as a sub-debt.

Nick Dimitrov: Right, right, ok.

Vladimir Chubar: For our capital. So that's why. It's only this reason.

Nick Dimitrov: Ok. Got it. Excellent. Thank you.

Vladimir Chubar: Thank you.

Operator: As a reminder, if you wish to ask a question, please press *1 on your telephone. There are currently no questions over the phone.

As a final reminder, if you wish to ask a question, please press *1 on your telephone keypad.

As there are no further questions in the queue, that will conclude today's Q&A session. I would now like to turn the call back to Mr. Lukyanov for some additional or closing remarks.

Sergey Lukyanov:

Ladies and gentlemen, thank you for attending the conference, and we are looking forward to hear from you on the next call on our first half 2016 results which we will publish in August/September. Thank you very much. Bye.

Eric de Beauchamp:

Thank you. Bye.

Operator:

Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation, you may now disconnect.