CREDIT BANK OF MOSCOW (public joint-stock company)

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Conference Transcription

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Operator: - Good day and welcome to the CREDIT BANK OF MOSCOW 9M 2018 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 from the IR team. Please go ahead.

Elena Finashina: - Thank you very much. Good afternoon, ladies and gentlemen. Many thanks for joining us today for a discussion of 3Q 2018 financial and business results of CREDIT BANK OF MOSCOW. Our key speaker today will be Eric de Beauchamp, Senior Vice President, who will present our operating results for the 9M 2018, and our CEO, Vladimir Chubar, will join us for Q&A sessions after the presentation from another location. Therefore, apologies in advance in case of any bad signal reception or interruption in the connection.

- So, now we are ready to start. Eric, please go ahead.

Eric de Beauchamp: - Thank you, Elena, and good afternoon, ladies and gentlemen. And thanks for joining us today. So, the third quarter of 2018 was full of developments both from the macro perspective, and also individually for CREDIT BANK OF MOSCOW. Geopolitical volatility having aggravated since August this year, affected market sentiment. Just in time when it seemed that Russia has coped quite well with the previous run of sanctions, new sanctions expectations led to higher volatility in the capital markets and concerns over more active economic growth and development.

- The internal economic policy in Russia once again proved to be very prudent with the Central Bank committee to inflation targeting and very cautious approach to policy easing. Russia remains resilient to external shocks thanks to strong fundamentals, even if geopolitical tensions imply downside risk for the economy going forward.

- In this unfavourable business environment, and also committed to support our debt investors, we initiated a liability management exercise in the third quarter of this year and also were very actively purchasing our bonds in the open market since August. Up to now, we purchased $140 million of subordinated bond from the market, out of which around 70 million were cancelled. This exercise helped us to support the secondary levels of assets and also to lock in a profit of about $14 million.

- Now, let's discuss in more details the performance of the Bank during the first 9 months of 2018. Please turn to slide number 2 of our webcast presentation. The net profit showed a healthy growth of 14.2% year-on-year and reached RUB18.4 billion as a result of the assets growth and further loan portfolio quality improvement.

- The net interest income increased by 16% as compared with the relevant period of 2017 following interest earning assets growth. Net fee and commission income amounted almost RUB 9 billion, which is weaker than last year due to several factors, including high competition and higher expenses on plastic card transactions. The net interest margin of 2.7% is slightly lower than in the year start as a result of lower interest rates in the economy since September 2018 and the large portion of liquid assets on the balance sheet of the Bank.
- Net interest margin on average risk-weighted assets improved from 4.3% to

4.5% year-on-year evidencing efficient business development despite tough market competition. The return on average equity reached 18.1% showing a constant progression since the beginning of the year.

- Operating efficiency traditionally outstands with a cost-to-income ratio of 28.3%. Gross loans to customers decreased in the first nine months of 2018 by 14.1% to RUB 703 billion mainly due to large redemptions by corporate clients in the first quarter of this year, as well as the transfer of one corporate loan to the “assets held for sales” category during the third quarter.

- Loan portfolio quality showed signs of gradual improvement with the NPL ratio down to 1.5% from 2.4% in the end of 2017 and the cost of risk down to 1.4% from 2.5% monthly as a result of sale and partial repayment of two large exposures.

- The NPL provisioning ratio is up to 400% in the nine-month period of 2018 versus 250% last year, reflecting better asset quality. The capital adequacy ratios remained solid with Tier 1 ratio of 15.1% and total CAR of 23.5%.

- Now let’s turn to business highlights on slide number 3. Gross corporate loans decreased by 17% in the nine months of 2018 to RUB 610 billion, due to large repayments in the first quarter, as mentioned before, and a reclassification of one large corporate loan.

- Retail loans demonstrated positive dynamics for the second consecutive quarter, reaching RUB 94 billion, which translates into a 7% growth from the year start. Due to larger weight of corporate loan in the loan book, corporate business still accounting for 87% of total loans. Top sectors in the loan book remain “crude oil production and trading” with a 22% share in total loans based from “petroleum refining” with a 16% share, residential construction standing at 9% and automotive sector making 9% as well. The retail book reflects our usual product mix: cash loans dominate with a 75% share and mortgages make 21%.

- Now, I would like to draw your attention to slide number 4 with a detailed overview of the Bank’s income and expenses that showed positive dynamics during the first three quarter of 2018. As you can see at the top-left diagram, operating income increased by 8% year-on-year, generally reflecting a business expansion. The increase was attributable to net interest income that demonstrated a sound growth to reach an amount of RUB 36.6 billion mainly due to the increase of the share of RUB denominated assets in total assets, which on average earned higher interest. At the same time, net fee and commission income slightly decreased from RUB 9.7 billion for nine months of 2017 to RUB 8.9 billion in 2018, mainly due to the drop in currency exchange commission and commissions from guarantees and letters of credits. The “Other net income” decreased from RUB 2.1 billion as of September 2017 to RUB 1.3 billion after the Bank saw that its leading subsidiary, CBM Ireland Leasing Limited, which resulted in a lower operating lease income.

- On the bottom left diagram, we see that the net fee and commission income decreased by 9% year-on-year. Increased competition made the expansion of fee and commission income more challenging for the Bank, with a decrease of currency exchange and brokerage commissions and the fees from guarantees and letter of credit. Fee and commission expenses were under pressure due to a sharp increase of expenses linked with plastic cards loyalty programmes that surged from RUB 72 million to RUB 377 million between September of 2017 and 2018. The Bank implemented new loyalty programmes with cashback, which will boost plastic card business in the medium-term horizon.
- As you can see on the upper right diagram, operating expenses increased by

8% year-on-year, the growth being mainly due to remuneration expenses. Administrative expenses remained at the level of September 2017 while other expenses decreased to RUB 0.8 billion. On the bottom right diagram, you can see a non-significant decrease of the net interest margin year-on-year while the net interest income to average risk-weighted assets ratio increased over the reporting period to 4.5%, reflecting a good performance of the corporate lending activities.

- Now, I suggest turning to slide number 5 with the breakdown of total assets. In the reporting period, total assets increased by 3% to RUB 1.9 trillion. Liquid assets, representing 64% of total assets, increased by 14% year-to-date, which was driven by enlarged interbank balances up to RUB 972 billion, with the prevailing share of REPO transactions and by the growth of security portfolio up to RUB 200 billion. As of 1st November, the total amount of unused liquidity sources represented the profitable buffer of roughly RUB 600 billion which components are detailed of the bottom right pie chart.

- Classic lending business demonstrated negative dynamics with the net loan book decreasing by 14% in the reporting period. It was mainly driven by the effect of big repayments outstepping new loans already in the 2018. The net retail loan portfolio demonstrated a slight increase to RUB 87 billion as the Bank decided to be more active in this segment.

- Now, let's move to slide number 6 on the loan portfolio quality. The portfolio risk metrics has surged from stability to sustainable improvement. On the upper right diagram, the amount of NPL was RUB 11 billion remaining at the level of June 2018. The loan loss provision decreased from RUB 46 billion to RUB 43 billion in the reporting period. The NPL coverage soared from 254% to 403% due to an efficient work connected with problem loans and redemption of the

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large corporate loan during the 1H 2018.

- The bottom left diagram reflects some positive trend in NPL dynamics that further decreased from 1.6% to 1.5% as of September of 2018. The cost of risk increased from 0.9% to 1.4% during the third quarter as a result of the creation of additional loan provision on a number of corporates with two large corporates making half of the additional jobs. The bottom right diagram depicts traditionally low level of related party lending which was at the level of 3.5% of total gross loan portfolio at the end of September 2018.

- Now, I suggest turning to slide 7 with more details of the corporate and retail portfolio metrics. Resulted from several big redemptions, corporate gross loan book decreased from RUB 731 billion to RUB 610 billion in the reporting period, with the general improvement of loan portfolio quality, which was evidenced by NPL ratio decreased to 1% and the cost of risk decreased to 1.3%. On the right, the retail loan book NPL ratio decreased to 4.9%. The cost of risk demonstrated positive dynamics decreasing notably to 2% in the third quarter compared to 3.9% one year earlier.

- The next slide, number 8, illustrates the funding structure of the Bank. Total liabilities were stable year-to-date at the level of RUB 1.7 trillion. Total customer deposits, accounting for 61% of total liabilities, demonstrated a significant growth of 15% boosted by business expansion on the corporate side and by the acquisition of the deposit base of the bank Sovietsky on the retail side. Deposits by credit institutions were mainly represented by repo transactions, which accounted for 88% of overall interbank balances. Wholesale debt repayment schedule is very comfortable with the bulk of international debt due after the year 2020.
- Now, let's proceed to the final slide, number 9, the Bank's capital. In the course

of the third quarter, the Bank optimized its capital structure by partial redemption of subordinated Eurobonds and with the issuance of the RUB 5 billion perpetual domestic bond. A very cautious approach to new loan origination coupled with redemptions enabled to maintain a strong capital position. CBM was the seventh largest bank in Russia basing on the capital as of 1st October 2018. The regulatory minimums, including buffers applicable for Systemically Important Banks, were by far overtopped with N1.1 ratio amounting 8.7%, N1.2 ratio - 12.4% and N1.0 - 21.2% as of 1st October.

- These were the main highlights of the Bank's financial and business results for 3Q 2018. Thank you very much for your attention. And now, let's proceed to the Q&A session.

Operator: - Thank you. Ladies and gentlemen, the question-and-answer session will be conducted electronically. If you would like to ask a question, please press star one on your telephone keypad. Please ensure that the mute button on your telephone is switched off to allow your signal to reach our equipment. We will take questions in the order received and we will take as many as time permits. If you find that your question has been answered, you may remove yourself from the queue by pressing star two.

- Again, please press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal. We will now take our first question from Alan Webborn from Societe Generale. Please go ahead.

Alan Webborn: - Hi. Thanks for taking the time to talk to us today. A couple of questions from me if I may. I think at the 1H stage you talked about the potential for I think you called it opportunistic lending in the second half of the year, which you sort of felt might get you back to a sort of near flattish, you know, year-on-year loan growth, but clearly with the sort of sale of the – that relatively big loan that you've reclassified in Q3, that doesn't look as if you're going to really get there even though there's possibly underlying being a little bit of volume growth.

- So, could you talk us through your attitude to particularly the corporate side to, you know, the opportunities in the market, I mean is this Q3 reflective of the rather difficult and more volatile market conditions in terms of the ruble and everything else that we saw in parts of Q3? And do you feel now in a slightly, you know, rising interest rates environment that there's opportunity to do a little bit more lending towards the end of the year? That would be interesting.

- And I think sort of in the second quarter also on retail, you saw a little bit of an uptick. That seems to have reversed a bit in Q3. So, can you just talk a little bit about the loan dynamics and where you think we will – you will get that at year end?

- I think also at the H1 stage, you felt that margins would be flattish across the second half of the year versus the first half. Do you think that's still likely? And I think also on the cost of risk, I think you could well be, you know, quite a bit below the run rate of your sort of better than 2% risk costs. And do you feel, you know, there is – are there any risks ahead that would not make you be a little bit more optimistic on that front? That would be very helpful, thank you.

Vladimir Chubar: - Hi, Alan, this is Vladimir Chubar. I'm just connected to the call. And actually sorry for – if there will be some noise. I am just in the car. So, answering your questions regarding the growth in the corporate book, you're absolutely right about the third quarter. The third quarter was really – there were some unexpected turbulence on the currency exchange rate and some unexpected turbulence, general market situation. And we as – you are absolutely correct,

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you said that we expected a bit more optimistic growth in second half. I think that it will be a more flat second quarter – I mean second half will be more flat. And of course, there is some potential deals we see now on the table but we're not sure that all of them will happen. And also, you're absolutely correct to say that we potentially might sell some of the, let's say, not easy assets. And it also can create some decrease of the loan book. But on the opposite, it will create much healthier structure, much healthier figures in terms of quality of the book.

- If we are talking about the next year, we also did let's say – thinking that it can be growth in a range of 10%, and it will depend of course on many manufacturers and – you know, that are working in Russia and being Russian bank with all the potential market turbulence, you never know. But our will, so we want to grow. We see that there is enough sources for this but for us, of course the risk management is the key. And this is actually the first, second and the third question we're asking ourselves, what is the risk. And if we see that potential outcome from the transaction will be less – will be more negative, of course, we are not coming in the deals like this.

- But in general, there are some growth points we see also for us. Actually, I think some of you may know that there were some changes in the regulation for the construction companies, for the companies who are working in residential construction, and now this business is much more safe both for the retail customers, for the customers who are buying these apartments, and as well for the Banks. And actually, it can drive extra demand from the construction sector. And I just want to repeat that it will be much more safe as well for the banks because all the money from the retail customers, from the buyers of these apartments, they will go to the banks and it will create more transparent structures in every project.

- It also can create more demand for the mortgages. And just now moving to your question about the retail segment, about retail growth, I can tell that we see that potentially it can grow even quicker than we did this year. Actually, I think that up to 20-25% can grow next year in the retail segment in lending. Of course, once again I am saying that if we see the risk is not comfortable for us, of course, we will just keep our hands off in terms of the growth. To the question about the cost of risk, yeah, we expected 2%, now it's lower. We see that it can be even lower because we don't see any risky loans which can bother us in the future and which can create extra provisions in the Bank.

- And there was one more question from you, I forgot.

Alan Webborn: - It was on – just on margin trends.

Vladimir Chubar: - Which trends?

Alan Webborn: - Margin, net interest margin.

Vladimir Chubar: - Margin, yeah, yeah.

Alan Webborn: - However, you like –

Vladimir Chubar: - Flattish, the same flattish because we – as you see that even with the current increase in the key rates of the CBR, we don't see that it can create some extra margin in the midterm horizon. Maybe in a half year, yes, but not just now. But I think that will be somehow in the figures.

Alan Webborn: - Okay. And perhaps just as a follow-up, how do you feel the development of the CIB, of the corporate investment banking business is going within this

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environment?

Vladimir Chubar: - Actually, not bad. We did the great results this year in organising the deals, organising the issuing of the bonds of our customers and the team did very good job for more than 14 or 15 deals they closed just this year. And we are expecting that it will be the same active as well next year. In terms of other activities they have, they created much more business in terms of the interbank – I mean in terms of their relations with the international banks, in terms of their relations with the local financial companies, financial brokers, so in terms of diversification. So, this is the job they've done. And actually, we really – I really appreciate the job the team did this year.

- In terms of the profit, extra profit we have, I cannot disclose the figures now because just I don't remember exactly the figures about investment banking, but I think we will disclose them on the year end. And one more thing which is good thing about this kind of business, it's cooperation they created between corporate business and investment banking because it's more and more cross-sale between these two lines – these two business lines which really make me happy.

Alan Webborn: - Super, thanks a lot.

Vladimir Chubar: - Thank you very much.

Operator: - As a reminder, to ask a question in today's question-and-answer session, please press star one. Please ensure your mute button is turned off to allow your signal to reach our equipment. From Pharo Management, we will take our next question from Henrique Morato. Please go ahead.

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Henrique Morato: - Hi, thanks for taking my question. It's a quick one. First is just congrats on the numbers. On the profitability, I wanted to understand a bit better. In your slide when you showed the pool of highly liquid assets that you have, despite these very large and growing shares of liquid assets you've been managing to keep very high profitability, cost of retail improved and also your efficiency is very good. But I wanted to understand a bit better, I mean what is the average yield you're currently getting on this pool of liquid assets? Any figures, even if they're not precise, would be quite helpful for me to understand the main drivers of profitability here.

Vladimir Chubar: - Henrique, nice to hear you, as usual, on the question side. So, look, the answer to your question, the average margin in this business is 1%, just a little bit less than 1%. So, it's near 1% because first of all, we see more competition. And if we see more competition we should answer, we decide that for us the volume is more important in terms of the business logic and in terms of the liquidity logic. And, of course, in this case, we should answer – in answering, we make some margins a bit less. In terms of the other parts of the business which making the margin, in the corporate side, it's also quite stable figures we are making. And as you're absolutely correct, you said that cost of risk is improving and actually even better than we expected for this year.

Henrique Morato: - Okay. Do you – I mean in terms of maintaining this level of profitability, what other main threats do you – when you think of profitability, what are the main threats? Is it on the corporate side or more on the competition of interbank deposits in these highly liquid assets?

Vladimir Chubar: - I think I need to ask for the translation from my colleagues in Moscow for this question, please. Elena or Eric, please, can you translate for me the question? Can you guys hear me?

Elena Finashina: - [Foreign Language].

Vladimir Chubar: - Yeah.

Elena Finashina: - [Foreign Language].

Eric de Beauchamp: - [Foreign Language].

Elena Finashina: - [Foreign Language].

Vladimir Chubar: - [Foreign Language].

Eric de Beauchamp: - [Foreign Language].

Vladimir Chubar: - Okay. Yeah, yeah, okay. So, in a corporate business of course is competition. Yeah, so the competition is much more about this, it's not about the rates or the relations. Their relation to the corporate customers is great and we feel ourselves as big competitor. But at the same time, it's also about pricing. And the good thing – when CBR increased the rate, the good thing that average rates are growing and in this area we feel ourselves much more comfortable with the growing rates.

- Saying about the investment bank and about the liquidity and all the stuff like this, I think that the only thing I can say, it's also more about the competition because, as I said in the beginning of answering your question about liquid assets, it's also about competition. And before, when we just started to grow this business some years ago, the margin even was close to 3%. And of course, now more players see this business as a good one, a good source of profit with a very good ROE. Of course, they are coming, they are stepping in and they are trying to beat us. But at the same time, I just want to repeat, we were just the first mover and that's why of course we have some advantage in terms of the relations with the parties, established lines and all the stuff like this.

Henrique Morato: - Okay, great. Thank you.

Vladimir Chubar: - Thank you very much. Have a good day.

Operator: - Once again, to ask a question in today's Q&A, please press star one on your telephone. Please ensure that the mute button on your telephone is turned off to allow your signal to reach our equipment. We will now take our next question from Magnus Scherman from Reorg. Please go ahead.

Magnus Scherman: - Yeah, thanks for taking my question. I wanted to get a sense of the growth in the retail space. Are you looking at Russian Standard Bank and the whole situation there potentially taking on some of the asset value from – if that were to go into a bankruptcy? Thank you.

Vladimir Chubar: - Hi, Magnus. If you want to ask us about another bank, I think it's not very good idea because first of all, we are not looking at the Russian Standard and our profile in terms of lending in the retail side, it's absolutely opposite to the profile of Russian Standard. So, sorry for

Magnus Scherman: - Okay, and –

Vladimir Chubar: - – answering like this but I cannot help you answer – yeah.

Magnus Scherman: - That's okay. I just wanted to know if that had changed from previously. Thank you.

Vladimir Chubar: - Yeah, okay, thank you.

Operator: - Once again, to ask a question, please press star one. We will take our next question from Nick Dimitrov from Morgan Stanley. Please go ahead.

Nick Dimitrov: - Hi, there. Just a quick question from me on that large corporate that was reclassified to help with sale. Can you give us more colour in terms of what industry was that company, the level of provisioning, was it prior to that in stage 2, has the transaction closed considering the fact that we are almost two months into Q4? I mean any thought would be appreciated. Thank you.

Vladimir Chubar: - Hi, Nick. Nice to hear you and thank you for the question. And, actually, using the momentum, I just wanted to say good words in terms of the Thanksgiving Day today in US. To all the investors who, like you, participated on our call even being maybe not in the office. And answering the question, it's a good question. The loan which is for sale in the IFRS, this is the loan from the stage 3. The provisioning in this loan, if I'm not mistaken, it's about 40%. And the Bank will not have any losses from this deal, so the discount will be even less than the provision level, the current provision level. And the area is the oil refinery.

Nick Dimitrov: - Okay, the oil sector. Okay, got it, excellent. Thank you.

Vladimir Chubar: - Thank you as well. Once again, congratulations.

Operator: - Once again, if you would like to ask a question, please press star followed by the one on your telephone. We will now take our next question from Tolu Alamutu from Exotix Capital. Please go ahead.

Tolu Alamutu: - Good afternoon. Apologies, my line got dropped a bit earlier. So, I just wanted to confirm some figures that you mentioned regarding the subordinated bond buybacks. Did you say that you had bought back $140 million and cancelled $70 million of that and booked a profit of $40 million? I just wanted to confirm if that's correct.

- And then a second related question. Obviously, you had I think at least two bonds, one in ruble and one in dollars mature quite recently and they're both subordinated. I just wanted to know whether there are any plans to maybe replace those securities or whether you're comfortable with your current capital levels. Thank you.

Vladimir Chubar:

- Hi, thank you for the question. Look, in terms of the buyback we've done – on the buyback procedure, official procedure, the amount was 50 million. And another 90 million we bought on the secondary markets after the official process was closed. Actually, as we confirmed, let's say, promised what we are going to do. This is number one.

- Number two, in terms of the bonds, which we just paid back, actually we paid back just about $80 million, which is honestly not very material amount. In terms of the coming back to the market, the usual answer, so we don't have any plans like this now. We see that the current prices level is really unfair and we don't think that we meet the capital or the funding on such high rates which is once again really unfair and absolutely don't reflect any fundamentals of the Bank.

- In terms of the capital, you asked if we are comfortable with the current capital. We are absolutely comfortable with the current capital adequacy ratios and levels because, first of all, it's more – much more than enough in terms of the capital requirements from Russian CBR point of view and all that – all the ratios and covenants. And second, it's also even enough for the potential growth which I mentioned answering the previous questions. So, I think the most likely answer is no in terms of the potential deals.

Tolu Alamutu: - Great. Thank you very much.

Vladimir Chubar: - Thank you.

Operator: - No further questions remaining in the queue. That will conclude today's question-and-answer session. I would like to turn the call back to Elena for any additional or closing remarks.

Elena Finashina: - Dear all, thank you very much for your time on this call today. And as usual, if you have any questions left on the 3Q performance of the Bank, please feel free to contact our IR team. Thank you very much and have a good rest of the day.

Vladimir Chubar: - Thank you. Thanks to all. Bye.

Elena Finashina: - Bye-bye.

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