

Conference Transcription

Date of conference: November 30, 2015

Conference Time: 17:00 Moscow Time

Conference title: CREDIT BANK OF MOSCOW: 3Q 2015 FINANCIAL &
BUSINESS RESULTS

Speakers: Vladimir Chubar, Eric de Beauchamp, Elena Finashina

Operator: Good day and welcome to the CREDIT BANK OF MOSCOW 9M 2015 Financial and Business Results Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Elena Finashina. Please go ahead.

Elena Finashina: Thank you very much. Ladies and gentlemen, welcome to CBM's 9M 2015 results announcement call. My name is Elena Finashina and as Director of International Business Division responsible for investor relations, it's my pleasure to traditionally introduce our speakers on today's webcast and conference call. So Vladimir Chubar, our CEO, will open today's call with a brief outline of the current operating environment and recent trends in the corporate and retail business of the Bank. Eric de Beauchamp, Senior Vice President of the Bank, will get into discussion afterwards to proceed with the detailed financial results analysis. You are very welcome to address any questions to our speakers after the presentation when we kick off the Q&A session. Now I would like to pass the floor to Vladimir.

Vladimir Chubar: Thank you, Elena. Dear colleagues, thank you for joining us today at CREDIT BANK OF MOSCOW 9M 2015 financial results announcement.

First of all, a few words about current challenging operating environment. Negative macroeconomic factors are still in force and continue to restrain economic development and business activity, but at the same time, we see some positive spots in the economy:

- Local food and farm producers gained from imports substitution programs;
- FX-denominated revenues of Russian exporters resulted in excessive liquidity which was placed in top Russian banks, both state-owned and privately-owned;
- Beginning from February, CBR has been following its consistent policy for key rate easing.

These factors accelerated decrease of interest rates which, in turn, became the basis for further economic development, anticipated by the market.

Now I would like to bring your attention to **slide number 4**.

The Bank has reached a milestone volume of total assets - over RUB 1 billion, which was driven mostly by the inflow of liquidity from corporate customers, operating in the industries which were mentioned above. These deposits were placed in top-quality asset classes, like REPO transactions with top financial institutions, backed by highly liquid blue-chip securities.

On the next **slide number 5** a detailed description of corporate business development is presented.

- Corporate loan portfolio grew by 50% since year-end 2014 mainly due to inflow of big names operating in different sectors of economy, such as food and farm products, oil and industrial chemicals and other - they were respectively classified in IFRS accounts. Loan portfolio maintained good diversification with the largest industry's share below 15%.
- Concerning our latest business developments - in November we closed the deal with Rosbank for the purchase of INKAKHRAN, one of the leaders in the Russian cash handling market. This acquisition is in line with our strategy and will result in strengthening of our positions in the market.

Now I suggest moving to **slide number 6** with an overview of retail banking business.

- Retail lending slowed down this year due to increased risks in this segment together with lower demand as compared with the previous years. Focus on cash loans and mortgage loans led to increase of their share in total retail portfolio, and now they constitute 75% and 17% respectively.
- Recovery in the mortgage lending which we saw in the 3Q was additionally encouraged by the government program for State Support for Mortgage Lending launched earlier this year.

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

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

Let's start our financial performance review from income and expenses dynamics presented on **slide number 8**.

- The operating income increased by 7% to RUB 23.9 billion due to the growth of other net income, mainly supported by foreign exchange gains.

- The net interest income of RUB 17.7 billion stood at the level of previous year, limited by increased funding costs reflected in the growth of interest expenses by 85% to RUB 43.4 billion. At the same time, interest income was growing at a slower pace, driven mainly by the increase of income from corporate banking business by 54% year-on-year, reaching RUB 33 billion or 55% of the total interest income.
- Other operating expenses grew up by 8% to RUB 7.4 billion, primarily as a result of rising provisions for impairment of other assets up to RUB 0.7 billion. In parallel, the Bank continued to optimize the number and locations of its branches that led to a decrease of administrative expenses and to a lowest among peers cost to income ratio of 28.1%.
- The drop in return on equity and return on assets levels to 3.0% and 0.3% respectively was driven by the downturn of the net income to RUB 1.5 billion. The decline in net profit was the result of an increase in loan loss provisions by more than two times to RUB 14.6 billion.

Now let's move to **slide number 9** and review the Bank's asset structure.

- The Bank's total assets increased by 71% from the beginning of 2015, exceeding RUB 1 trillion, thanks to a significant growth of the net corporate loan portfolio by 48%, reaching RUB 381 billion. This growth was mainly realized on the sectors of oil and industrial chemicals, and food and farm products.
- The retail loan portfolio continued to narrow during the 3Q 2015 and amounted to RUB 117 billion, which is 3% lower than at the end of 2014. This trend is a result of declining loan demand of high-quality retail borrowers along with stricter scoring requirements to potential customers.
- The other items that generated assets growth were due from credit institutions and cash and cash equivalents that all together increased by 190% and amounted to RUB 364 billion. The majority of term deposits are receivables secured by highly liquid securities that are included in the Central Bank's Lombard list under reverse REPO agreements.

The **slide number 10** provides key loan portfolio metrics.

- In the 3Q 2015, the total NPL ratio is stable at a level of 4.9%. This level, however, exceeds the NPL level at the end of 2014 and is mainly the result of the worsening financial position of a large corporate borrower from the oil and gas infrastructure sector.
- The Bank increased its loan loss provision ratio to 5.2% as a result of a complicated macro environment together with a conservative provisioning policy.
- Largest borrowers' concentration went up relatively to the end of 2014 with exposures of 25% and 39% on TOP-10 and TOP-20 customers respectively. The level of related party lending remained low and represented 1.6% of the total Bank's equity.

The next **slide - number 11** - provides analysis of the Bank's corporate and retail loan portfolio quality.

- The growth of corporate NPLs during the reporting period to 4.5% as well as the slight increase on the cost of risk level to 4.5% are explained by the general deterioration of financial condition of some of the Bank's large borrowers as a result of the

macroeconomic downturn. Non-performing loans are fully covered by provisions, with a NPL coverage ratio of 105%.

- The quality of retail loan book improved relatively to the end of 2014, with NPL and cost of risk ratios of 6.2% and 4.2% respectively.

The funding structure of the Bank is covered on **slide number 12**.

- The Bank's funding base is very well-diversified, with significant share of corporate and retail customer deposits which now represent 47% and 20% of total liabilities, increasing by 152% and 16% respectively. The growth of corporate deposits to RUB 432 billion is explained by the attraction of the term deposits from a large corporate customer.
- Deposits by the Central Bank represent a significant part of the Bank's funding with an amount of RUB 176 billion or 19% of total liabilities. These funds are secured by highly liquid rated debt securities under a REPO agreement.
- The Bank has a comfortable debt repayment schedule with only RUB 25 billion to be repaid in 2016, all of which is denominated in roubles.

Now let's move to **slide number 13** where the Bank's capital position is presented.

- The Bank's capitalization level remains strong, which is evidenced by Basel III total capital adequacy ratio of 16.0% and Tier 1 capital adequacy ratio of 9.6% at the end of September 2015.
- Capital adequacy ratios under Russian accounting standards remain at a comfortable level with N1.0 ratio of 14.7% and N1.1 and N1.2 ratio of 8%.

At this point, I suggest finishing our 2015 9M results presentation. Thank you for your attention and now let's proceed to the Q&A session.

Operator:

Thank you. Ladies and gentlemen, if you would like to ask a question over the telephone at this time, please press the star or asterisk key followed by the digit 1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered, you may remove yourself from the queue by pressing *2. Again, please press *1 to ask a question.

Our first question today comes from Yulia di Mambro from Barclays.

Yulia di Mambro:

Good afternoon. Thank you very much for the presentation. I have three questions if I may: one on asset quality, one on liquidity and one on capital please. So firstly on asset quality, could you please tell us a bit more about the asset quality trends that you're seeing? If we look at your total NPL ratio, it looks broadly stable at 4.9% but if we look at all of the problem loans including impaired ones and past due by less than 90 days, it looks like you saw an over 50% increase in balances in the quarter and does this relate to a specific exposure or is this a broader trend, and what

do you expect in terms of asset quality next year? So that's my first question. My second question on the liquidity is that your –

Vladimir Chubar: Sorry for interrupting you. Yes, I think it's better one by one because...

Vladimir Chubar: Yes, in terms of the asset quality, I can say it's more stable than negative trend we see now. In terms of the new names, what was the increase, the first increase was because of the Transaero case. We have this borrower in the portfolio; I think you're quite familiar with the situation which was happening the last couple of months. This is number one. Number two is one more borrower of CBM, it's a company Center Obuv, so this is a shoe retailer, also they have some issues now. We even decided to go to the court with the company, so just one more name. Two major names what we see now.

In terms of the next year, to be honest, I don't like to answer the question because it's not possible to predict every time. We hear it every conference and every time my answer is the same because next year, we are not only thinking about what will be the plan, what will be the budget for the next year because in the current circumstances and the current environment, which is changing every day, almost every day, because of different reasons including geopolitical reasons, not an easy question about the next year. But I can tell you that of course we try, when we budget in our Bank, we try to be more pessimistic and include more negative trends in the budget just to be on the safe side.

Yulia di Mambro: Great, that's very helpful, thank you. So secondly on liquidity, so you saw this big deposit inflow in the quarter, so your loan to deposit ratio is now significantly below 100%. What are your plans for this liquidity and was it in FX or was it in roubles?

Vladimir Chubar: The majority of the increase was in foreign currency. In terms of the liquidity, so the liquidity now is very good and you're absolutely right about loan to deposit ratio, which is quite low, which is let's say not normal for our Bank but at the same time I can tell you that we use this money to buy different instruments from the market – top instruments from the market. First of all, Eurobonds, second we bought several syndications of top Russian companies and also we lend this money to a number of the Russian leaders, Russian corporate leaders like blue-chip companies also. So quite safe way of using this money. The majority of these instruments can be refinanced in CBR. That's why we feel ourselves quite comfortable in terms of the liquidity position.

Yulia di Mambro: Great, thank you and just to clarify, that's already happened or are you just planning to do this?

Vladimir Chubar: It happened, I can tell you that by now, by today it's happened.

Yulia di Mambro: Great, and my last question is on capital. So your Tier 1 ratio declined by 100 basis points from the quarter and it looks like it's on the back of a 20% increase in RWAs. Is that due to foreign exchange or did your loan book increase or was there some negative credit migration?

Vladimir Chubar: No, I didn't catch the question, so why we had a decrease in capital adequacy ratio, what's the reason?

Yulia di Mambro: Yes, there's a big increase in RWAs, that's due to FX?.

Vladimir Chubar: No, it's just – yes, yes. Yes, so RWA just increased because of the organic growth of the business. I cannot tell you now because I didn't count it before, what was the reason, I mean how much was the increase because of the foreign currency revaluation, but I think that the majority because of the growth.

Yulia di Mambro: Great, thank you very much.

Vladimir Chubar: Yes, thank you.

Operator: Ladies and gentlemen, as a reminder, to ask a question in today's conference call please press *1. We will now take a question from Denis Poryvay from Raiffeisen Bank.

Denis Poryvay: Hello. In the third quarter, you received significant inflow of corporate money and it's indicated in your statement it's from one corporate name in about RUB 200 billion, it's equivalent. And the question is what is the notional currency of this flow and what do you expect regarding this money? Are they short-term or do they remain on the balance sheet a long period, for example a year, or in December we will see outflow of this money? And that's the first question; the second question is regarding corporate quality. As we see NPL from 1 to 90 days is growing as well as not past due but impaired loans. What are your expectations regarding migrations of these loans into bad loans going forward? So, and in this respect it's interesting how you're going to replenish your capital, Tier 1 capital if this problem appears in the future. Thanks.

Vladimir Chubar: Okay, one by one, in terms of the deposit growth, I can tell you that the tenors are quite comfortable. I cannot disclose it because of relations with our clients, but in general I can tell you it's quite comfortable tenors which are giving us comfort in terms of planning our liquidity and placing this money into quite interesting and midterm assets.

The question number two in terms of the quality of the book, somehow I answered this question in the very beginning of the Q&A session. Also, we expect that some of these bad loans which

are not overdue but are somehow NPLs will come to the overdue, but at the same time, I can tell you, even if there are loans which are not in overdue part of the report, they also have not standard level of provisioning. In terms of the capital, we think that current operational efficiency of the Bank can help us to cover all these issues with NPLs in the corporate book within next year, because, as you saw, cost to income ratio just 28%, which means that 72% of our income, we can use to cover the issues with NPLs.

Denis Poryvay: And the one question regarding your capital. If you think that you are okay on your capital and haven't received support from DIA, quite cheap capital, do you plan any buyback in your, for example, subordinated debt? There is a lot of absorption which is currently trading in the market, with the yield exceeding your return on equity. So it would be logical to consider this thing.

Vladimir Chubar: Thank you for the question. So logical, maybe it's a good word but the logic is that the capital now is quite expensive in the market and of course we received this capital from DIA but at the same time, as you saw, we showed quite a good growth and we think that we can continue to grow, maybe not so rapidly as it was last nine months but we like to continue it.

In terms of the buyback, at this very moment we don't have decisions like this, so maybe in the future, maybe yes, maybe no, but we discussed this several times in the Bank and with our Supervisory Board, they also asked this question a couple of times. But at the same time, at this moment we didn't decide this. Thank you.

Operator: As a reminder, to ask a question please press *1 on your telephone keypad. We will now take a question from Marina Vlasenko from Pioneer Investments.

Marina Vlasenko: Hello, thank you very much for the call. I wanted to ask a couple of questions. So the first one is on the margin dynamics, how much recovery do you expect in the Q4 and maybe next year, what's the potential for the margin?

Vladimir Chubar: In terms of the margin, we expect the margin will be not lower than plus figures. Of course, it can be some pressure from the new, from the increase of the balance sheet which you saw in the 3Q because this money, these deposits we placed in a very high-quality instruments and that's why of course the margin can decrease a bit because of this reason. But at the same time, we see now a decrease in average deposit rates which is a bit faster than a decrease in average asset rates. So that's why we expect that the margin will be in the 4Q not lower than in the nine months of this year.

In terms of the next year, my answer is the same that we plan one figure, but at the same time, the reality is showing us absolutely different. I can tell you maybe that the margin also will be

not lower than this year, we expect like this. My gut feeling is that next year will be more competitive here in terms of the lending, so the high-quality and mid-quality corporate borrowers. That's why the banks will have to fight for the borrowers and they will have to decrease the margins for these reasons. But just maybe it will be an absolutely different situation because we will have something else in geopolitical situation or in Russian economy. We will see.

Marina Vlasenko: Thank you, and I wanted to ask about the Q4 because obviously you said you don't want to predict anything on the asset quality side but two months already past, so just only a couple of weeks left for some business activity, you know, to continue. So maybe you can give a little bit guidance at least for this year on what's going on with the asset quality and profitability.

Vladimir Chubar: In terms of the profitability, you know, we think that this year, of course the profitability of the business will be much lower than the previous years because of the macro situation because of the NPLs we see in the portfolio. I think that operational efficiency, as I told just before, will help us a lot and we can cover all the provisions this year with our operational efficiency. In terms of the new NPLs, as for now, I personally don't see some new big issues, some new big problems in the portfolio comparing to the nine months of this year.

Marina Vlasenko: And provisioning, cost of risk, are you creating additional provisions this quarter as long as the NPLs are not increasing?

Vladimir Chubar: Could you please repeat the question?

Marina Vlasenko: What about provisions? How are you reacting to this? If your NPL ratio is not growing, do you increase provisions this quarter to create some cushion or do you keep them flat. What kind of dynamics do you see on the cost of risk?

Vladimir Chubar: Okay. My expectation that – well, not like expectation, my preference – of course is better to have the cushion than not to have it, in the current circumstances. That's why it's better to be more conservative than neutral or positive. That's my answer.

Marina Vlasenko: Okay.

Eric de Beauchamp: That's why I was mentioning during the presentation if you look at the slide number 10 with the LLP coverage ratio, we had a ratio of 4.8% at the end of December 2014, at the end of June also and at end of December, it's 5.2%. So I mean, we continue to increase the coverage with the provisions.

Marina Vlasenko: And in Q4 as well, correct?

Eric de Beauchamp: Yes.

Marina Vlasenko: Okay, thank you.

Operator: Once again, to ask a question please press *1 on your telephone keypad. We will now take a question from Andrew Keeley from Sberbank. Please go ahead.

Andrew Keeley: Good afternoon, thank you for the call. I just have a question in terms of your asset quality. I see that the cost of risk in retail lending seems to have been improving in the 3Q. I'm just wondering whether you think this trend will continue in the 4Q and into next year, and could you give a little bit of detail about what asset quality trends you're seeing in retail in mortgages and consumer loans? Are you seeing kind of any different dynamics between those two segments? Thank you.

Vladimir Chubar: In terms of the retail business, as we decided to have more restrictions for the new borrowers and we decided to concentrate more on the corporate lending because of kind of crisis in retail lending in Russia. That's why you saw first of all a decrease in the portfolio. In terms of decrease of cost of risk, I think that Eric will answer this question, but I can tell you my feelings about this. So the retail business in our bank, of course, we would like to keep it, but at the same time we would like to wait maybe one or two quarters just to understand what is the new reality in terms of the retail lending because there is are several opinions in the Bank now about this business line. So before we will make a final decision about where to go, we would like to have more statistics of last events in this business in terms of the NPLs and migration. So Eric will answer about the cost of risk.

Eric de Beauchamp: Yes, in fact on retail the strategy now is to maintain the portfolio at the current level, which means not stopping production, to continue to grant credit to top-quality customers. In fact when you look at the new production and the quality, it's even better that what we had in the past because we are extremely selective on the customers. On top of this, the second part of the strategy is to replace, let's say, high-risk products by low-risk products and if you look at the growth of portfolio per product, you will see that we increased mortgage loans for instance, and we increased cash loans. Mortgage loans, which have a cost of risk which is close to 1%, I mean by changing the mix of products – the product mix on the portfolio – we also maintain that level of cost of risk under control.

Andrew Keeley: Okay, thank you. That's clear, thank you. And in terms of your corporate cost of risk, I may have missed this earlier. Could you tell us, the two borrowers that you mentioned that you had trouble with in the 3Q, can you tell us what share of the cost of risk they accounted for and are those exposures now fully provisioned?

Vladimir Chubar: You mean Transaero and Center Obuv?

Andrew Keeley: Yes.

Vladimir Chubar: If I look at Transaero, I can tell you the provisions level is now 50%. So if not 100%. We expect this situation can go different ways absolutely because it's not under control of any bank now because there is a number of lenders and that's why the fact that large event that – in the quarter it was a decision to move discussion about this to December. So for me it's more because nobody can understand what to do now. So we expect that it can be some recovery from this loan.

In terms of Center Obuv, what is the rate now? In terms of Center Obuv, there are no figures now in our hand but it looks like it was 20-30% from my mind. But in terms of the Center Obuv, we are much more comfortable with the schedule and with the plan of recovery of this loan. So we expect that this situation is more under control than Transaero.

Andrew Keeley: Okay. All right, thank you and I know you're a bit cautious about kind of commenting on next year but I do wonder if you can give us your kind of initial sense of what kind of lending growth on retail and corporate you would – it would be in your provisional kind of budget plans for next year?

Vladimir Chubar: In terms of the retail, we don't expect a big growth in this portfolio. Maybe it will be as this year, or maybe even lower, like general figures, you know. If you talk about the corporate business, it's also quite a tricky question because now we feel ourselves that we can grow. We feel ourselves that there is a room in the market for development of this business. There are the good borrowers which are knocking our door and asking for the loan, but at the same time, we'd like to understand if there will be any other issues in Russian economy which can move some parts of the borrowers to suffer, you know. So in general, I think that it can be like average growth of the top Russian banks, maybe even a bit faster. But in terms of the figures, we don't have budget now so we have it but it's not approved. That's why it is not easy to share any figures.

Andrew Keeley: And sorry, on retail did you mean basically, essentially, a flat kind of loan book – roughly at the same kind of absolute level as this year, was that what you...?

Vladimir Chubar: Yes, we can say kind of flat, maybe a bit increased, but so as I told you, it's not major business line for the next year. It was good business line for the last three years. I think it's when we increased the share of this business in our loan book, but now we like more to concentrate more on the risk side in this business and to decide which way to go, but the main driver will be the corporate book.

Andrew Keeley: Okay, thank you and if I can ask just one final very brief question, in terms of your thoughts on kind of costs next year, in terms of staff costs, how do you see this? Do you think that given the strong fall that we've had in the rouble over the last year, will there be kind of increases in salaries or is that something that you're not kind of considering? And I mean do you generally – would that be kind of balanced by some headcount cuts? So generally what are your thoughts on the kind of growth in staff costs?

Vladimir Chubar: You know, normally we use kind of inflation increase for the staff costs, but you will see increase because of acquisition of INKAKHRAN because you know, the cash handling business is very expensive in terms of the costs but it will be more technical increase. In terms of the other increase, we do not expect some cuts in the number of the people who work in the Bank for the next year but at the same time, the increase of number of people will be very, how to say, slow, let's say like this. But in terms of the salaries, as I told you, kind of inflation rate because it's natural, you know, because there is still competition on the market for the good people, for the good bankers, that's why we have to work with this and to live with this, that's why natural increase we will see next year.

Andrew Keeley: Okay, Vladimir, Eric, thank you very much.

Vladimir Chubar: Thank you.

Operator: Once again, to ask a question please press *1 on your telephone keypad. We currently have no further questions. Thank you. As we have no further questions, I would like to turn back the call over to your hosts for any additional or closing remarks.

Elena Finashina: Well, we would like to thank you for being with us today here on the call and please feel free to follow up with any further questions with our IR team. Thank you very much. Bye bye.

Vladimir Chubar: Thank you. Bye.

Eric de Beauchamp: Thank you, bye bye.

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