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Speakers: Vladimir Chubar, Eric de Beauchamp, Sergey Lukyanov

Operator: Good day and welcome to the Credit Bank of Moscow 1H 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: Good afternoon, ladies and gentlemen. It's my pleasure to welcome you to today's call. I am Sergey Lukyanov, responsible for investor relations, and I will moderate today's telephone conference. 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 remarks of the bank's business development. Afterwards, Eric de Beauchamp will proceed with detailed analysis of financial result. All your questions and comments are welcome after the presentation when we'll open the Q&A session. And now, I would like to turn the floor over to Vladimir.

Vladimir Chubar: Thank you, Sergey. Good afternoon, ladies and gentlemen. Starting with the brief macroeconomic outline, I would like to point key trends which affected Russian banking sector in 1H 2016. On the backdrop of much less volatile oil price, Russian economy showed signs of stabilisation and, according to Russian government and some analysts, entered the turn of economic cycle and stays at the waiting condition. Russian banking sector remains, so far, full of liquidity fed by decreasing interest rates which was additionally supported by monetary policy easing plan implemented by CBR with a key rate gradual decrease.

On the other hand, Russian Eurobonds' secondary yields are back to early 2014 - lows which coupled with increased investor's appetite for Russian credit, opened the door for Russian issuers to international capital markets. Meanwhile, a track record of Russian Eurobond new issues totaled USD 6 billion year-to-date, already exceeding full-year 2015 volumes.

All this led to an increased competition among banks for prime-quality borrowers and, at the same time, very selective approach in relations to lower-quality corporates.

In this context, Credit Bank of Moscow showed good financial results delivering increased incomes and high operating efficiency. Key financial highlights are presented on **slide number 2**.

- Reported net profit for six months of 2016 amounted RUB 5.1 billion, year-on-year growth resulted from net interest income growth and net fee and commission income growth based on significantly increased business volume.
- Net interest margin remained stable year-on-year at the level of 3.5%.
- Return-on-equity reached double-digit, 10.7%.
- Outstanding operating efficiency was proven by a record-low cost to income ratio of 22.5%.
- Total assets and gross loan book zero growth was savoured by improved asset-quality indicators in the first half 2016: NPL ratio decreased to 5.0% and cost-of-risk ratio decreased to 5.2%. Strong capital base gives the room for further business development.

Let's now move to **slide number 3** on key business highlights.

- Corporate lending with focus on larger high quality borrowers slowed down in the first half of this year due to selective approach to new exposure remains a key driver of the loan portfolio growth.
- Diversification by industries and strategic synergy with the cash handling business form the basis of sustainable risk management structure, enabling to maintain stable quality of corporate loan book.

- Retail loan portfolio decreased by 7% in the first half of this year due to tightened lending standards coupled with a drop of demand in retail lending. At the same time, one of our target segments, mortgage lending, showed 11% growth in the reporting period, increasing its share in total gross retail loan book up to 21%.
- Retail banking business' key priorities in 2016 are to establish an efficient branch network in Moscow and Moscow region and to further develop alternative channels of distribution aiming to strengthen customer base primarily on the liability side.

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

Eric de Beauchamp:

Thank you, Vladimir, and good afternoon, ladies and gentlemen.

So I would like to draw your attention on **slide number 4**, which provides a detailed overview of the bank's income and expenses dynamics.

- Operating income picked up by 96% year-on-year, to 29.1 billion RUB on the back of net interest income, net fee and commission income and other income growth. The main growth in absolute terms came from net interest income which doubled from RUB 10.4 billion to RUB 20.5 billion. Interest income from loan portfolio ...
- Yes, so we were on slide number 4 and I was commenting on the fee and commission income which grew by 47% year-on-year to RUB 6.3 billion. The structure of fee and commission income has undergone changes with cash handing fees becoming the main component of the fee income with a 20% share after the acquisition of INKAHRAN.
- Net interest margin stayed stable year-on-year at the level of 3.5%, being in line with the market trend. During the first half of 2015, the net interest margin was under pressure due to tightened monetary policy and sharp increase of CBR key rate in late 2014. While in the first half of 2016, net interest margin was constrained by the bank's conservative policy in terms of liquidity management.

Now, I suggest turning to **slide number 5** and review the asset structure.

- Total assets showed only a slight growth of 1%, amounting to RUB 1.2 trillion and at the end of June 2016, the net loan book representing 47% of total assets. Tightened loan origination standards coupled with difficult macroeconomic environment led to a controlled slowdown of the loan portfolio. The bank's primary focus remains on asset quality and strong liquidity cushion, the highly liquid assets accounting for 50% of total assets.
- Due from credit institution item is mainly represented by reverse repo transactions backed by highly liquid debt securities while major part of security portfolio is included in the CBR Lombard List.

Now, let's move to the next slide, **number 6**, and go into details of the loan portfolio quality.

- Following a conservative approach in terms of loan provisioning the Bank allocated substantial part of the operating income to additional loan loss provision which coupled with efficient problem loans management resulted in an improvement of the loan portfolio risk metrics.
- NPL ratio went down to 5%, driven by the decline of NPL on both corporate and retail loan book.
- This decrease coupled with a growth of loan loss provision up to 7.4% of the gross loan portfolio resulted in an NPL coverage ratio increase up to 148%.
- The cost of risk decreased from 5.4% for the full-year 2015 to 5.2% for the first half of 2016.
- The related party lending level is still immaterial with related party loans representing 0.64% of the total gross loan as of the end of June 2016.

The next slide, **number 7**, provides a detailed overview of corporate and retail loan portfolio metrics.

- Growth of corporate loans remained almost flat since the beginning of 2016, amounting to RUB 509 billion. Corporate NPL ratio decreased slightly from 4.5% at the end of 2015 to 4.4% at the end of June 2016. The cost of risk moved

down to 5%. NPL coverage ratio increased up to 167%.

- Retail loan book NPL ratio stabilised at the level of 7.9% on the backdrop of loan portfolio reduction by 6% to RUB 112 billion year-to-date. The cost of risk grew up to 6.1%. NPL coverage increased from 96% to 99%. A substantial part of NPL came from mortgage loan which are comfortably collateralised by liquid real estate, taking into account that the loan-to-value ratio is far below 100% while NPLs in cash loans and credit cards are fully covered by provisions.

Moving on to the next **slide number 8** suggest analysing the funding structure.

- Funding base during the first half of 2016 did not undergo considerable changes with sustainably growing customer accounts remaining the main source of funding with an 84% share in total liabilities. Bonds issued decreased by RUB 14 billion to RUB 107 billion mostly due to the foreign exchange revaluation effects. Bonds repayment schedule is comfortable for the bank with only a RUB 7 billion denominated domestic bonds production maturing in 2016 while the bulk of debt is due in 2018.

Now, let's proceed to the last **slide number 9** on the bank's capital.

- The Bank maintains strong capital position in the first half of 2016 which gives a solid base for further business development.
- Capital adequacy ratio stayed at comfort level during the reporting period. The IFRS Basel III total capital adequacy ratio increased up to 17.6% and the tier 1 capital adequacy ratio increased up to 10.6%.
- Capital adequacy ratios under Russian standards are far above threshold values with N1.0 ratio at 14.8% and N1.1 and N1.2 ratios at 8%.

These were the main highlights of the bank's financial and business results for the first half of 2016. Thank you very much for your attention. And now, let's proceed to the Q&A session.

Operator:

Thank you. Ladies and gentlemen, if you wish to ask a question at this time, please press *1 on your telephone keypad. Please make sure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Again, please

press *1 if you wish to ask a question.

We will take our first question from Alan Webborn from Societe Generale. Please go ahead. The line is open.

Alan Webborn:

Oh hi, good afternoon. Thanks for the call. Two questions if I may. Firstly, could you talk us through the sort of the balance sheet shifts between the Q1 and Q2 just to give us an idea of what you've been doing in terms of managing the balance sheet? Because that looked as if there have been one or two reasonably, you know, large shifts between the end of Q1 and the end of Q2, so we sort of understand what you're – you've been doing. That would be the first one.

And the second one, could you provide a little bit more colour on what's been going on in the corporate risk costs and what you've been doing there in Q2 and what we should think about in terms of, you know, guidance for the full-year and given the fact this sort of corporate cost of risk did seem to be a little bit above, I think, what you've previously guided for the full year? And, really, any other colour you can give us about the sort of second half of the year. Now, you're halfway through and how you feel, you know, the businesses going and whether, you know, for example, we should start to see a bit more grace in the corporate book as the second half progresses. Thank you.

Vladimir Chubar:

Thank you for your question. I want to start with your last question about the second half of the year. So what we've seen now, and I mentioned this in my speech in the first half of this call that we see now quite a high competition for the good corporate borrowers. And, to be honest, we didn't predict this in the very beginning of this year. And in the end of last year, when we made our project for this year, we expected a bit less competition.

What we see now, that the top borrowers, the good borrowers, they started to use this opportunity to decrease their cost of funding to decrease the prices for their loans. Some of them decided to go to the borrowing market, so they issued – we have seen a number of issues from the top qualities borrowers and sometimes even the rate was lower than 10%, I mean Russian rubles, of course, the same for U.S.

dollars, bilateral lending. If we talk about – so also good Russian borrowers, bilateral lending, now, it's our average rates what we see their request from our own customers, less than 5% very often, sometimes even less than 4% if we talk about ten or like two, three, four, five years. And to be honest also, there's almost no difference if you talk with your client in terms of ten or – so two years are almost the same as four years. Every new client, it's a new story. So there is no some key line, what you can see with every client. So every client, a new story of relations, new story of rates and et cetera, et cetera.

In terms of cost of risk and other ratios, I can tell you that, yes, we've seen a bit growth in second quarter of this year in terms of corporate cost of risk. My current view that is was just a one-off, so it's not like a tendency for the next period of time especially for the second half of this year. We just decided to be a bit more conservative in terms of provisions and it was quite a big discussion inside the bank with our risk management people that maybe now it's time to try to be more conservative to cover our portfolio with more provisions about maybe the next year if the situation will be the same and if we will not see any turbulence once again. As we've seen last year and a year ago, we can just decrease these provisions.

In terms of corporate the key answer in terms of the corporate lending is the competition and risk appetite after a number of defaults we saw in our portfolio and in the market. During the last year, our risk appetite became lower than it was before and sometimes we decided that it's better not to proceed with the client if we see some potential risk or even there is no risk but there is some like kind of gut feeling, you know.

Alan Webborn:

Okay. So if the view that we should – the message we should take is that – I think a little bit earlier in the year clearly – you were particularly cautious about growing your retail book and really you've been saying, “Well, let's just keep it stable. We're very cautious but there's more –”

Vladimir Chubar:

About the retail, yeah.

Alan Webborn:

Yeah, yeah. But you have previously said for corporate you were more optimistic. I mean, is the right message to take from your words today is that perhaps, you know, you should be – you know, it's going to be a little bit more difficult to grow the corporate book in the short term if the competitive situation that you're seeing at the moment continues? Is that right?

Vladimir Chubar:

No, the key question is what is the level of margin we'd like to see. Of course, now, there is a lot of possibilities to grow, to be honest. So we see a lot of good borrowers, who really like to take money from our bank, but at the same time, we are more thinking about the deposit base, about the price of deposit base and we really expect that it will be – the trend of decrease in the price of this deposit base will be a bit faster.

So at the same time – I can tell you that like 50%, you are right about your understanding. We were more optimistic in the very beginning of this year about the corporate loan book. But at the same time, I can tell you, maybe about a month ago, we started to see that there is a number of new potential transactions, new potential clients in the corporate lending kind of scope. We see that now it's increasing and maybe one month-and-a-half, two months, I was really more pessimistic in terms of the growth but now I am more optimistic. So, you know, now it's kind of time of maybe changing of trend but I'm just – I just like to say about this more – like more careful that just – maybe just the trend but maybe no.

Alan Webborn:

Okay. That's very helpful. Thanks for your explanation.

Vladimir Chubar:

Thank you.

Operator:

We will now take our next question from Henrique Morato from Aberdeen Assets Management. Please go ahead. The line is open.

Henrique Morato: Hi there. Thanks for taking my question. My question is, if you go on slide 9, you see that there's a significant decline on the trading book of risk credit assets. I was just trying to combine that 10 – roughly 10% decline with the flat loan book that you show on your balance sheet. So I'm just trying to understand whether there's been a big shift in terms of the risk you have on your books or whether there's more to that, something like a regulatory change or anything like that? Just trying to understand where the decline in risk credit assets is coming from because that's helping your capital ratios quite a bit. That would be my first question.

Vladimir Chubar: Thank you for your question. I just want to understand what you mean. I just want to see this slide first of all. Yeah, and could you please repeat?

Henrique Morato: Sure.

Vladimir Chubar: Yeah.

Henrique Morato: So on slide 9, you see that risk credit assets, the trading book – the banking book, sorry, declined from 749 to 685. So that's roughly a 10% decline. But if you look on your balance sheet, your loan book is flat. So I'm just trying to understand whether you – there was just a change in mix of loans or whether there's more to that and there's a regulatory change that could have changed the risk factors and therefore impact the overall amount of risk credit assets and the reason I'm asking this question is because, obviously, your capital ratios look a lot better this quarter but that was mainly driven by the decline in risk credit assets. So that's why I'm asking.

Vladimir Chubar: Okay. So I will pass this question to Eric. So he will answer.

Eric de Beauchamp: Yeah. So far there was no regulatory change, not at all. It's more a thing just of the securities portfolio that we have in the asset. So the share of, you know, OFZ and triple B counterparties increased. Due to that, of course it is the most – let's say, that's the bulk of the effect. At the same time, the total amount of securities decreased. So I mean, you have the double effect which brings the decrease that you can see on slide 9.

Henrique Morato: Okay. But I thought that would be on the trading book not on the banking book, but maybe that's on the banking book for – I don't know. That stuff you just mentioned, is that on the banking book or trading book?

Vladimir Chubar: You know, just maybe we – there was a decrease of some – you know, maybe report operations or something like this because we don't see these changes.

Henrique Morato: Okay.

Vladimir Chubar: Okay. Maybe – you know, maybe we just can look more deep in our books and we can announce for you just maybe by e-mail, if you have your e-mail. If not –

Henrique Morato: Yeah

Vladimir Chubar: – you can send your question to our IR e-mail. It's on the website.

Enrique Moreco: Sure, sure. No problem. Okay

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press star one on your telephone keypad. Our next question is from Yulia di Mambro from Barclays. Please go ahead. Your line is open.

Yulia di Mambro: Hi. Thanks very much for the presentation. I just have one question, please. What are your thoughts on prefunding some of your 2018 maturities? You have a senior Eurobond maturing in 2018 and you also have a Tier II security. Your liquidity position is clearly very strong so you don't necessarily need to prefund them to redeem them unless you expect loan growth to pick up quite a lot. So if you could share your thoughts on sort of your Eurobond issuance plans for this year and maybe next year as well, that would be great. Thanks.

Vladimir Chubar: Thank you for your question. As we answered last call, the answer is the same. So at this moment, we don't have any plans to go in Eurobond market. And in terms of also kind of the buyback of the current instruments, we also don't think about this. So maybe in the next year, we'll think about this. I mean, about the issuance of new instruments. But currently, you know, with all the pressure CBR to USD and so like foreign currency funding, I mean, in terms of mandatory reserve, et cetera, et cetera, the prices, what we see now in the market, at what level we see that

currently trade our current instruments, we don't see that we need to go to the market because it's quite expensive.

Yulia di Mambro: Thank you. Just a follow up question please on the FX reserves and the CBR potentially trying to trade some of the excess liquidity out of the system, what have they done so far and what sort of changes are you seeing in the banking system in general?

Vladimir Chubar: You mean because of these steps from CBR? Or what do you mean?

Yulia di Mambro: Yes, yes, the CBR

Vladimir Chubar: Yes. So what they did, they decided just to decrease the influence of foreign currencies in Russian banking system or in Russian banking system. That's why they did the steps. So what we see now, that the prices of USD financing just decreased, all the banks decided to decrease rates for deposits. I mean, of course retail deposits and the corporate deposits and also it's – this is number one. Number two, that what we see now, that for example, in my view that the banks just should do this, should decrease cost of funds in USD because on the other hand, we don't see a big number of customers to whom we can give this USD funding, USD loans. So that's why I think it was kind of a good step from CBR what they did. And it's good that they said about this before so – in advance. It wasn't just like from tomorrow. So they said about this in the very beginning of this year that they would make something against USD and – first of all USD and of course Euro influence on Russian banking system.

Yulia di Mambro: Great. Thanks very much.

Vladimir Chubar: Thank you.

Operator: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press *1 on your telephone keypad.

As we have no further question, I would like to turn the call over our host for any additional or closing remarks.

Sergey Lukyanov: We would like to thank you for your attention and participation. If you will have any questions on Credit Bank of Moscow business and financial performance, let me just remind you that our investor relations team will be happy to assist. Our contacts are presented at our homepage.

Eric de Beauchamp: Thank you very much.

Vladimir Chubar: Thank you. Bye.

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