

Conference Transcription

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Speaker: Vladimir Chubar

Operator

Welcome to the Credit Bank of Moscow FY 2012 Financial and Business Results conference call on 2 April 2013. Throughout today's recorded presentation, all participants will be in a listen-only mode. After the presentation there will be an opportunity to ask questions. If any participant has difficulty hearing the presentation, please press *0 on your telephone for operator assistance.

I will now hand the conference over to Vladimir Chubar.

Vladimir Chubar

Ladies and gentleman welcome to CREDIT BANK OF MOSCOW conference call and webcast to discuss our full year 2012 financial and business results. Thank you of course for joining us today. My name is Vladimir Chubar. I am Chairman of the Management Board and I will be presenting the results. Of course as far as you know this is the first time we do a conference call and please be charitable to us and don't judge us strictly if we make some mistakes. In the course of my presentation I will tell you about the key developments of the bank, then draw your attention to our businesses and financials and after this you are more than welcome to ask your questions.

Now we are moving to the presentation. On the second slide you may find the key basic facts about our bank but of course I will not talk on this slide because I think that all of you are quite familiar with CREDIT BANK OF MOSCOW. And now I will move forward to look through the key developments of the year 2012.

On slide number three you can see the key highlights for the year. Our net profits reached RUB 5.8 billion exceeding 2011 profit by almost 50%. We are in a good position in terms of efficiency with the return on equity being almost 18% and return on assets more than 2%, actually 2.1%. In 2012 our assets grew by 33% and reached RUB 309 billion while aggregate assets of Russian banks rose almost 19%. Our loan portfolio reached more than RUB 200 billion which is 26.5% higher than in 2011. The aggregate loan portfolio of Russian banks by comparison grew by only 19%. Net interest margin in 2012 grew by 0.2p-p and reached 5.2%. The main driver for this growth was the higher proportion of high return retail product in the bank's loan portfolio.

Our level of provisioning is much the same as in the previous year so cost of risk is stable at the level of 1%. Historically being a bank with a high portion of corporate loans we now intend to increase our share of retail lending. In 2012 loans to individuals grew by 69% and reached more than RUB 50 billion. At the same time retail deposits grew by 25% to RUB 107 billion.

It is very important to mention our success in the capital markets, both debt and equity. Last year was remarkable as we raised equity investment from EBRD and IFC for the total amount of RUB 5.8 billion which is about US\$200 million. IFC and EBRD each received a 7.5% share in the bank's equity.

We also managed to increase our Tier 2 capital by issuing a RUB 3 billion domestic subordinated bond. In addition we raised syndicated loan for the total amount of US\$308 million. As for this year, I mean 2013 capital market transactions, we have placed US\$0.5 billion Eurobond issue in January. It was the largest transaction in the bank's history and also we sold one more subordinated bond issue for the total amount of RUB 2 billion and proceeds of these bonds are already included in the bank's Tier 2 capital.

Also rating agencies confirmed our positive results. In 2012 Fitch upgraded our rating to BB minus. In March 2013, just a few days ago, Standard and Poor's revised our rating outlook from stable to positive with very good wording in the reasoning.

Let's now move to slide number five and discuss our business segments. Share of corporate banking in our lending business is 75% being historically our core competence, so we start with the slide on our corporate business segment where cooperation with trading companies still remains the priority for us. In 2012 loans granted to corporate clients increased by 17% and reached RUB 155 billion while deposits from corporate clients grew by 34% to RUB 82 billion.

You can see that the corporate loan portfolio is well diversified by industries with 17% coming from the consumer electronics industry, 12% from food and farm production and 11% from residential and commercial construction. For corporate deposits 71% are term deposits.

Retail business is becoming increasingly important for the bank and our strategy for 2013 is to increase share of retail loans in the portfolio to 30% and we are now moving to slide number six to discuss our retail banking. We provide banking services to almost half a million individuals through 74 offices in Moscow and Moscow region and remote channels such as mobile and internet banking. The bank's retail portfolio outpaced the sector and delivered 69% growth in 2012 while Russian banks managed to grow by 40% in terms of retail loans.

Consumer loans rose by 81% and now represent 57% of our retail book. Mortgage loans grew by 36%, car loans by 78%. They now represent 21% and 22% of the retail portfolio respectively. We are the 15th largest bank in Russia in terms of our retail deposits. The bank's portfolio in retail deposits increased by 25% and reached RUB 170 billion.

The next slide represents a breakdown of the bank's income and expenses. Net interest income rose 40%, more than RUB 12 billion, driven by the expanding loan portfolio. The second largest segment of operating income is net fee and commission income, grew by 34% to RUB 3.7 billion. The major source of fee and commission income is cash collection and delivery services for our clients and other banks. Actually the share of the banks in this fee is almost 20% now and has a tendency to grow. Last year cash collection income rose beyond RUB 1 billion showing a 33% increase.

Our cost-to-income ratio is slightly more than 40% and the main drivers for cost growth are salaries and administrative expenses. Last year salaries and employment benefits including social security costs increased by 65% due to higher wages and increased number of employees. Last year our average number of employees was 3,500 people which is 36% higher than in 2011. The major driver of administrative expenses that grew 34% last year was occupancy expenses on spaces rented for payment terminals, ATMs and for offices.

Now let's move to slide number nine and look at our asset structure. It remains more or less stable with approximately 65% relating to our loan portfolio. Asset growth is slowing down although is still higher than the market. Our efficiency is really stable with return on average assets being 2.1% in 2012.

Loan portfolio quality which is presented on slide ten is on a very good level with NPLs of 90 days of the loan portfolio being only 1%. NPLs in the corporate segment are even smaller at 0.2%. NPLs by retail products are much higher than in corporate segment, namely, in consumer lending 3.6% of loans are non-performing, in mortgage 4.8%. Nevertheless, the effect of retail NPLs on total NPLs is not material due to their lower

share in total book. The provision ratio has been stable for the last two years and equals 2.3%. Cost of risk is stable at the 1% level which is in line with the provision dynamics.

Now let's move to slide number 11 and this slide represents the funding structure of the bank. We have limited dependence on market instruments with the major part of funding coming from retail deposits which were RUB 107 billion, as I mentioned before, or 40% of liabilities, and of course corporate deposits which were RUB 82 billion or 30% of liabilities. Promissory notes and bonds account for RUB 40 billion or 15% of our liabilities.

In 2012 our bank raised two issues of exchange bonds for total amount of RUB 7 billion and one sub-bond issue which was described at the beginning of the presentation. I also want to mention that our loan deposit ratio is 106.5% which is also quite good for the Russian banking system.

Before moving to equity I would like to draw your attention to the slide with the concentration of risk level. At the end of 2012 our 10 and 20 largest exposures accounted for 18% and 27% of the portfolio respectively while our 10 and 20 largest deposits represented 17% and 25% of the deposit portfolio respectively.

The bank's loan portfolio mostly consists of short-term loans. More than 60% of loans mature within 12 months and 23% are repayable in the period from one to three years. Volume of related party loans in the bank is insignificant and in 2012 accounted for 1.1% of the bank's equity.

Now let's move to slide 13 on the bank's capital. We managed significantly to improve our capital base in 2012 due to EBRD and IFC investments, subordinated bond issue and retained earnings. Tier 1 and total capital adequacy ratios grew to 13.4% and 15.8% respectively. Tier 1 capital increased by 52% to RUB 38 billion while total Basel capital rose by 53%.

These are the key highlights describing development of the bank's balance sheet and profit and loss statements. Of course I anticipate your questions regarding our forecast and targets and we prepared a brief outline of key indicators serving as a guidance for our business outlook in 2013. This can be seen on the next slide, slide number 14.

We have two scenarios of the bank's development which depend of course on the market conditions and our ability to raise future capital this year. The basic scenario is we plan a 25% growth of loan portfolio and 50% retail portfolio growth depending on the market conditions of course. We plan to increase the share of retail loans in the loan portfolio to 30%. In 2013 we also plan to open five to six new branches being focussed on Moscow and Moscow region as before. We plan to be the same Moscow based bank.

As for KPIs, we plan to keep a strong cost-to-income ratio at the level of 40% due to strict cost control. Net interest margin is targeted at about the 5% level. Actually I think it will be at the same level as it was in 2012, 5.2%. We plan to keep cost of risk below 1.5% and return on equity at 18%.

As for optimistic scenario it depends on our ability to raise future capital as I said before and under these circumstances we will be able to increase the overall loan portfolio by 35%, retail loan portfolio by 70%, and to keep return on equity at 20% level, I think 20% plus. Other business indicators and KPIs will remain the same as on the basic scenario.

I think that's all from my side on the presentation. Thank you very much for your attention and now we can move to Q&A session.

Operator

Thank you. If any participant would like to ask a question, please press *1 on your telephone. If you wish to cancel this request, please press *2.

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

OK. The first question comes from Shree Pandit from the Royal Bank of Scotland. Please go ahead.

Shree Pandit - Royal Bank of Scotland

Hi, I just wanted to know the impact of Basel III implementation on bank's capital. Will the bank be required to raise any additional capital to meet Basel III requirements?

Vladimir Chubar

Yes, thank you very much for the question. I can tell just a few words of course about this. The Basel III requirement will be implemented this year by our Central Bank and I am just happy to say that all these changes will have very low effect on our bank. The influence will be first of all of course – if we talk about the retail loans – the provisioning level will reduce our N1 ratio (the basic ratio for Russian banking system) by just 0.1%. Another step from our Central Bank is to add weight from these loans on the capital. It will give another 0.1% decrease to our N1 ratio. And the last part is the new requirement to calculate the market risk. As we have about 20% of our balance sheet in the bond portfolio this will give us another 0.4% decrease of our N1.

Actually this market risk was reported to Central Bank in February already and now if you could see for example our N1 as of 1 March it is already there. We are waiting to see the additional weight from the retail loans on the N1 ratio. It will be from 1 July and I just can repeat that the influence will be very low. Also I want to tell you about this. This can be the chance for our bank because our strategy in terms of the retail business is a little bit different from the monoliners as you know other guys like Home Credit Bank, Oriental Express and other.

Actually what is the main driver to increase this weight from these loans? Of course this is the rate. This is the rate, the efficient rate for your borrower. Actually the average rate in our bank at this very moment in consumer lending is about 25%, 27% with all the fees included, all the commissions, all the insurance fees. It means that for us the influence will be very low; for other banks, the names I mentioned before, this influence will be very high.

Also what is very important to say is the monoliners, the same Home Credit and Oriental Express, have only cash loans in the portfolio. We have quite diversified portfolio, we have mortgage loans, we have car loans and from these assets we also have lower impact, lower weight on the capital. And this will be also quite supportive for N1 ratio.

Also just maybe a few words about retail strategy. Last year – maybe not, it was in the beginning of this year – we decided to decrease our activity in the car loans because we understood that the pressure from the banks, I mean mono banks like BMW Bank, like Mercedes Bank, Toyota Bank in Russia started to be quite high. We are not going to be one of these runners in this trip to provide our borrowers with the rate in Russian roubles like 10%, 11%, no. Of course we will have this product in the line, in the product line, but we are not going to push sales of this product through the cash loans and so on.

Just once again to answer your question the influence on our bank from Basel III will be insignificant. Thank you very much.

Shree Pandit - Royal Bank of Scotland

Thank you.

Operator

Thank you. The next question comes from Olga Veselova from Bank of America Merrill Lynch. Please go ahead.

Olga Veselova - Bank of America Merrill Lynch

Thank you. Good evening, I have a couple of questions. Do you think the bank's shift towards retail will stimulate growth of cost of risk going forward? I see your outlook for this year of cost of risk one-half is slightly higher than last year's level. What level of cost of risk you consider as normalised or comfortable for the bank in consumer retail? This is my first question. I will ask the second later.

Vladimir Chubar

Yes, OK. Thank you for the question. First what I think about the retail business. Of course if we are going to increase – and we are going to increase – the share of retail lending, of course there will be impact and increase in the cost of risk. Just a few words about the cost of risk in terms of the retail loan. It will be about 3.7%, 3.5%; of course it depends on the strategy of our bank. The total amount of risk which we have just implemented in the budget of the bank is 1.4%. It's total cost of risk.

Olga Veselova - Bank of America Merrill Lynch

All right, and 3.7% - you would think this is the normalised level for the bank?

Vladimir Chubar

This is normal level. It will be normal level of course in terms of increasing the retail lending. But I think that, you know, this is the budget. Because I also have the results for the first quarter, very, very preliminary result but still. We started to increase the retail banking, the retail lending, and I can tell you that the cost of risk is quite the same as it was before without any tendency to grow. It means that maybe we will keep the cost of risk and the retail lending at the same level as it was in 2012, it was a little bit higher than 3%, it was 3.1%.

Olga Veselova - Bank of America Merrill Lynch

Great, I see, thank you. Thank you and also here is this question while we are discussing this. Have you made analysis of your clients, what portion of the revenue is spent on interest payments if there was such analysis just out of interest?

Vladimir Chubar

Please once again the question, just –
[participants clarify the question]

Vladimir Chubar

Client income, sorry, because I tried to understand if it is about our bank. Yes, normally we prefer to see that the client spends about half of the income to repay our loan or all the loans but sometimes we see 70%, sometimes we see 30%, it depends on the

amount of course. If there is just RUB 15,000 of income of course just half or a little bit less. If there is RUB 300,000 as income for the individual of course even 60% will be fine. It depends on the clients and it depends on the individual.

Olga Veselova - Bank of America Merrill Lynch

All right, thank you. My last question is about your loan growth targets in retail. I think most of the banks guide willingness to move towards retail this year and your guidance is one of the most aggressive I must say. What strategy really do you use to compete in retail? Is this lower rates primarily or it's a combination of lower rates plus lower fees or it's non-pricing competition, so what would be your strategy here?

Vladimir Chubar

First of all, of course it depends on what banks you want to compare us with. If you want to compare us with Home Credit for example or Oriental Express, of course it is the price - because our price, our rates are quite low if you compare to these guys. But of course this is not the main idea. The main idea is the cross selling between the corporate business and the retail business because last year was very good in terms of our involvement in this and we started to sell our retail loans to the employees of our corporate customers. Also we started to sell this loan to our established clients, we started to give them offers for example to take loans and so on and so on.

It is very important to have good penetration of retail business in the corporate business and I just can tell you that about 75% of new loans we give every day are given to the customers from this group. And the rest 25% of course - this is the people from the street and that's why we are totally sure that the recovery will be on a good level: because very often we can see the salary of these people, very often we can see their payments through our payment terminals and so on and so on because number one idea is to avoid fraud. This is a very big problem in the Russian retail banking and with our strategy we are absolutely sure that there is a very, very low level of fraud in our portfolio. We are not only sure, we can see this also from our figures.

Olga Veselova - Bank of America Merrill Lynch

All right, thank you. Thank you for this. I am asking relative not to specialised consumer lenders but relative to Sberbank and VTB, large federal players. If you could guide us how your effective interest rates look like relative to the effective interest rates of Sberbank, for example?

Vladimir Chubar

I can tell you that we have almost the same rate as Sberbank. We just - a few weeks ago we made a research, our internal research, and we just realised that we have quite the same rate as Sberbank but of course Sberbank is a very big player on this market although I can tell you that even Sberbank cannot cover all the landscape. They cannot cover all the field and of course we can find our client, we can find our client base. That's why I am absolutely sure that the pricing won't be the main issue, it won't be the main driver.

The main driver is the service and we want to be close to the clients. That's why we have a lot of branches in Moscow and in Moscow region. We have a lot of payment terminals, we have more than 4,000 payment terminals, more than Sberbank in Moscow and with this payment terminals our clients can repay the loan 24 hours a day, very easily. Of course we have very good remote system, I mean internet system for priority individuals. It was awarded as number one or number two, something like this. Also the service has the main effect if you want to have your client as your partner and we do

not have the strategy just to give the money to the client and just wait for the repayment. We have the strategy to be the part of his wallet. Sorry to say this but we just want to know everything about the client and we also want him to think of us as a partner, as his home bank. This is the main idea.

Olga Veselova - Bank of America Merrill Lynch

Great. Thank you, Vladimir.

Operator

Thank you. The next question comes from Denis Poryvay from Raiffeisen Bank. Please go ahead.

Denis Poryvay - Raiffeisen Bank

Hello, thanks for your good presentation and congratulations with quite strong results. I have a couple of questions. First of all regarding corporate loans for fourth quarter, they decreased by 6% or about RUB 10 billion and I would like to know the reason behind it and do you see some recovery in the months of this year for corporate loans? Would you please provide some information regarding the structure of these loans? Is it SME or financing of working capital etc and what is the average yield on these kind of assets?

The second question is –

Vladimir Chubar

OK, let's go question by question because... OK, the first one was about the fourth quarter in terms of the corporate lending, yes?

Denis Poryvay - Raiffeisen Bank

Yes.

Vladimir Chubar

Speaking of corporate lending, yes of course you are absolutely right and as I started my presentation I mentioned that we are the same bank for the retailers, for the distributors, for the corporate clients from this industry. And I think you know that fourth quarter is very active for these guys and actually December, New Year sales and so on and so on. That's why of course a lot of retailers repay their loans sometimes in advance, sometimes quite close to year end. Of course in December there was some repayment.

Also this is not like a tendency because for example I can tell you also some preliminary figures of first quarter just to – sorry, that is very, very preliminary but OK. Total amount of the growth in terms of all assets was about RUB 15 billion or about 5% growth. Total loan book grew by RUB 26 billion and actually 14% was growth of corporate lending, even more than 14%, and just 7% for the retail business. It's the same here: retail business, retail banking and retail lending in the first quarter is not very big because this is the January vacation, all people get some New Year bonuses and so on and so on. March was very good for retail lending but for example January and February were not so good. So, answering your question, this is just like a seasonal effect.

Denis Poryvay - Raiffeisen Bank

OK, yes this is the answer. I would like to know what are the corporate bonds. Is it for financing of working capital, SME, etc and what is the yield on these loans, average?

Vladimir Chubar

Yes, I can tell you that for example if you talk about working capital... normally we have about 50% of trading companies, retail chains as our customers and of course normally they ask about working capital loans with the average tenor less than one year. And the rate is absolutely different. It depends on the quality. I cannot just give you the figure in terms of the average rate for the retailers but it can be from 8% for example if there is a loan for year-to-date. Of course we also provide such loans to our customers and if it's one year it can be 12%, 13%, 14%. It depends on the quality because we also have a special system to understand what is the good rate for the client because of the risk management level, because of his internal rating in our bank and also – yes, that was the question.

Denis Poryvay - Raiffeisen Bank

OK, and what do you mean it depends on collateral?

Vladimir Chubar

It depends not on the collateral because you know in my bank the main idea is, we started to look at the clients but not at collateral. We look at the business of the client: if the business is good, if there is a tendency that for the next five years there will be no problem as we see it, there will be no problems with the client. Of course after this we will look at the collateral but collateral is never number one approach for example to understand the risk level of the client.

Denis Poryvay - Raiffeisen Bank

OK.

Vladimir Chubar

Of course – I am sorry I just want to finish my answer - if you talk about the retailers normally they do not have hard collateral as real estate. Of course some of them have warehouses and they have stores and so on and so on but normally they have goods in these warehouses and we use them of course as a collateral. We use personal guarantees, we use cash in the account. We use the cash collection as a very good tool to monitor the risk of the client, but this is a different approach. And of course if you talk about other guys like producers, like developers and so on, of course the collateral is very important in terms of understanding the risk level of the client. It depends on the client all the time.

Denis Poryvay - Raiffeisen Bank

OK, and as you said the bulk of your retail clients are coming from your corporate business with some similar projects etc. This year do you plan to increase your retail banking activity also through resource of clients or are you going to come out to street and marketing etc?

Vladimir Chubar

The basic scenario for this year is to have about 75% as I told – as I answered before the same question - 75% to the groups number one and two. What are the groups? Group number one, this is our clients, this is our established clients. If we see that this

is our client, he repays all the time his loan by the schedule and so on and so on we are ready to provide him with an additional loan. This is the first group.

The second group, this are employees of our corporate clients and also the loyal customers of our corporate clients because we can also see that, sometimes we can see the client base of our corporate clients. So 75% will go to this group and the rest 25% will go to the street. But this street also is not just a street. This is selling through the remote channel of internet. There are also applications from our payment terminals and so on and so on.

Denis Poryvay - Raiffeisen Bank

OK, and what do you think would be the expansion planned for this year or what is the net interest margin – what is your target for this indicator?

Vladimir Chubar

My personal target is 5.5 but in the budget it's 5.2, I can tell you this.

Denis Poryvay - Raiffeisen Bank

OK.

Vladimir Chubar

I want to increase it, and of course the number one idea for me is the retail lending: we want to increase it up to 30%, but then and of course we work with interest expenses. As I just mentioned, S&P just upgraded us (not the rating but our outlook from stable to positive) and also you maybe saw the very good performance on secondary markets of our Eurobond, our general Eurobond gives 1% decrease on the funding cost. It means that the market said OK, yes, we like you, we want to see you once again maybe within the next half year.

I think that also what will be good for us, not only for us but for all the Russian banking system, as you know from 1 July there will be a new head of Central Bank and all the people, all the people generally, people from the Central Bank have the same idea that we can see some decrease of the rates from Central Bank and this can give also some - this will have some impact on all the pricing in the Russian banking system. Of course I think that we will see decreasing rates in retail deposits and I am sure that even the Cyprus story will not have real influence on the Russian local rouble market and bond market also.

Denis Poryvay - Raiffeisen Bank

OK, thank you.

Operator

Once again, if you would like to ask a question, please press *1 on your telephone.

We have a question from Andrew MacFarlane from Mitsubishi. Please go ahead.

Andrew MacFarlane - Mitsubishi

Yes, hi. Thanks for taking the question. Just I think you just touched on that at the end of that last answer there. Just on the sort of fixed income side, you issued obviously in January the US dollar bond. What is your current strategy in terms of the funding side

there? Do you think you will continue to look at foreign currency bonds? Is that something you are looking into especially with the funding costs you were talking about?

And then secondly just talking about capital, obviously your capital is at a very good level. Do you have like a minimum level you are sort of happy with? You said the Basel III impact would be relatively small. And is there sort of minimum level you guys would look at and then any excess on that, what would you sort of plan to do with that? Thanks.

Vladimir Chubar

OK, thank you for the question. I start from your question about the minimum level for capital adequacy ratio. Of course we live in Russia, I think you know this, and of course, we have our Central Bank and we also have the Basel. In terms of the Central Bank N1, the minimum level in the bank, the minimum management level in the bank, is 11% and I think you know that the minimum level from the Central Bank is 10%. But for me, I try to keep it not less than 11.5% all the time.

If we talk about Basel, if we talk about the IFRS requirements, it's very easy because we have the norm that all the Tier 1 and Tier 2 capital adequacy ratio cannot be less than 12%, this is the requirement. But I see that this level will be not less than 13%, it will be more than 13% all the time. If you talk about the Tier 1 level I think that for me quite comfortable level is 9% to 10%. But now we see about 13% I think we will decrease this level this year to 11.5% to 12% because this way we can increase ROE to 20% which is also the task from my shareholders and I think... Yes this is the answer.

Your first question was about our USD bonds and the funding plans. Can you maybe repeat what is the main idea of your question in terms of this?

Andrew MacFarlane - Mitsubishi

It was just what your strategy was going forward. So probably in the US dollar issue I mean... will you continue to look at issuing further bond? Do you think... is that in US dollars?

Vladimir Chubar

Yes. I can just answer this, in the budget for this year there is no other issues in US dollars on the Eurobond market.

Andrew MacFarlane - Mitsubishi

OK, great. That's fine, thanks.

Vladimir Chubar

In Russian roubles... we plan to have two transactions in Russian roubles I think in the second quarter – sorry, the second half of the year.

Andrew MacFarlane - Mitsubishi

OK, great. Thank you very much.

Vladimir Chubar

Also there was one more question about the funding cost. Maybe you also can repeat it or I answered it already?

Andrew MacFarlane - Mitsubishi

No, I think you have answered it. No, thank you, that's fine.

Operator

Thank you. Once again, if you would like to ask a question, please press *1 on your telephone. OK, we have no more questions.

Vladimir Chubar

OK. Thank you very much for joining us today and I hope to hear you once again in the next quarter, after we distribute our first quarter results which I think – not I think, I just saw them preliminarily – will be also quite good. Thank you very much.

Operator

Thank you. This concludes the conference call. Thank you for participating. You may now disconnect.

END OF CONFERENCE