CREDIT BANK OF MOSCOW (public joint-stock company)

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Conference Transcription

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<u>Operator:</u> Good day and welcome to the Credit Bank of Moscow: Q1 2017 Financial and Business Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Miss Elena Finashina Please, go ahead, ma'am.

<u>Elena Finashina:</u> Thank you very much. Good afternoon, ladies and gentlemen. Many thanks for joining us today for a discussion of Q12017 Financial and Business Results of CREDIT BANK OF MOSCOW. Our traditional team on the call today is represented by Vladimir Chubar, our CEO and Eric de Beauchamp, Senior Vice-President and also, myself, Elena Finashina, responsible for International Business and Investor Relations.

Vladimir will start the presentation from the discussion of key financial and business results of the first quarter of this year and Eric will provide further details of financial performance of the bank for the reporting period. Q&A session will follow afterwards and we will be happy to answer all your questions to the management. Now I would like to turn the floor over to

Vladimir.

Vladimir Chubar: Thank you, Elena. Good afternoon, ladies and gentlemen. Traditionally, opening our discussion with the macroeconomic overview, I would like to make a few remarks regarding general trends, which we observe in the market and which, we bear in mind when planning our business development going forward. Having returned to growth in the end of 2016, the Russian economy is still on a positive trend in the 1Q of 2017, even though the growth rates are relatively modest. We expect that recovery rates might gain traction in the next couple of years, supported by stronger household consumption and investments, provided that external factors are supportive as well .

Even in recent couple of years when the Russian economy was struggling, there were sectors, which were rather resistant to negative trends and those even benefiting to a certain extent from the market situation. We took a strategic decision, at that time, to focus on those sectors and managed to strengthen our market position and successfully weathered through the economic turbulence. Now as the economic conditions are improving, industrial production has turned to growth, and we see that consumer demand prospects are more optimistic. We see even more opportunities for the Bank to expand further and to contribute to the economic growth.

Now let's move to the discussion of CBM financial results which are highlighted on **Slide #2**.

First quarter of 2017 was another quarter of the core business growth and quality metrics improvement. Profits almost tripled, as compared with the similar period of the last year, reaching RUB 4.6 billion. Net interest income showed 14% growth versus first quarter of last year and reached RUB 10.4 billion. Net fee and commission gained 47.6% and arrived at RUB 3.7 billion, evidencing success of our efforts to maximize this particular source of income.

Net interest margin of 3% remained at the level of first quarter 2016, constrained by expansion of highly liquid low risk assets on the balance sheet, in line with the Bank's strategy. At the same time, net interest margin on average risk-weighted assets has improved for the same period of time, from 3.9% to 4.3%, evidencing more efficient use of funding sources, and improvement of the risk-adjusted returns.

Return on average equity improved significantly from 7% for the first quarter of last year to 17.4% for the first quarter of this year, supported by strong income generation and, traditionally, high-operating efficiency with the cost-to-income ratio of 26%. Gross loans to customers increased by 2.6% for the first three months of 2017, driven by expansion of the corporate loan book. Qualitative business expansion is the cornerstone of our strategy and the asset quality indicators evidence that CBM delivers strong results in following this strategic target.

For the reporting period, NPL ratio decreased from 2.3% to 1.9%, while cost-of-risk further decreased from 4.6% to 2.9%.

Basel III Total Capital Adequacy Ratio strengthened for the first three months of 2017, as a result of successful $600 million Tier 2 Eurobonds placement by the Bank in April of this year and reflection, thereof in the capital, as of the reporting date. Funds raised via new euro bond issuance were partly used to repurchase existing Eurobonds maturing in the next year, which were partly amortized in the capital calculation. These transactions resulted in total capital-adequacy-ratio, increasing from 14.7% to 19%, while Tier 1 capital ratio increased from 9.4% to 10.7% in the reporting period, as a result of income capitalization.

Now let's move to business highlights on the next slide, **Slide #3.**

Key driver of the loan book growth was corporate loan book expansion by 3.7%, while reduction of retail loans by 3.4% partly offset the total loan book growth level.

During the reporting period, we focused on meeting higher demand for funding from our large customers from target economic sectors. Sectoral strategy remains unchanged with the key industries presented by oil and chemicals, property rentals, financial, and food and farm products, as per the pie chart on this slide. The loan book is well diversified with each industry forming below 25% of total exposure to corporate clients.

We remain cautious on the retail business side, so far with the retail loan book slightly decreasing, which resulted in retail business partner's loan book shrinking to 14% of total loans. When it comes to retail business, cash loans and mortgages are still a priority for us, forming 73% and 22% of gross retail of the loan book, respectively. Now I would like to pass the floor to Eric, for further comments on the Bank's financial results. Eric, please go on.

Eric de Beauchamp: Thank you, Vladimir, and good afternoon, ladies and gentlemen. I would like to draw your attention on **Slide #4** with a detailed overview of the Bank's income and expenses dynamics.

The total operating income grew by 15% year-on-year from RUB 12.4 billion for the first quarter of 2016, to RUB 14.3 billion in the first quarter of 2017. The major part, 72% of the operating income is represented by net interest income, which grew by 14% year-on-year to RUB 10.4 billion.

This growth of operating income was also supported by a significant increase of the net fee and commission income. The net interest margin remains under pressure, as the Bank's still maintaining a significant part of its assets in low risk, highly liquid instruments. A deeper analysis of the interest margin net interest income to the average liquid assets shows 4.3 level which is in line with the Russian market standards of universal banks operating mainly on the corporate loan segment.

The net fee and commission income grew by 48%, year-on-year to RUB 3.7 billion or roughly 26% of the total operating income. The main source of net fee and commission income were represented by guarantee and the letter of credits, currency exchange and brokerage operations and commissions on plastic cards. On the upper right diagram, operating expenses showed a moderate 13% increase year-on-year. The Bank's still keeping operating under control with a cost-to-income ratio of 26% for the reporting period.

Now I suggest turning to **Slide #5**, with a breakdown of total assets. Total assets, as of the end of March 2017 were represented by the loan portfolio with a 42% share, showing an increase of 3% points in comparison to December of 2016, by liquid assets with a 56% share, including cash and cash equivalents, due from credit institution and the securities portfolio.

The year-to-date decrease of total assets by 5%, down to RUB 1.5 trillion was mostly due to a temporary slowdown of our activity on the repo markets and, thus, bringing it to a decrease of our liquidity buffer. The Bank's primary focus remain on asset quality, therefore, the accumulated strong liquidity cushion was placed in highly liquid, low-risk instruments, such as top quality securities 89% of which are included the CBR Lombard List.

Now let's move to **Slide #6** on the loan portfolio quality.

As described in the upper-left diagram, loan portfolio coverage by

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impairment allowance was stable since the beginning of the year 2017 with a level of 6.1% at the end of March. The impairment allowance provides coverage of NPLs of 325%, which is shown on the upper-right diagram. This ratio increased significantly after the Bank restructured two corporate loans during the fourth quarter of 2016. NPL ratio decreased down to 1.9%, confirming downward trend observed since the beginning of 2016.

The cost-of-risk decreased from 4.6% for the FY 2016 to 2.9% at the end of March 2017 confirming an improvement of asset quality in the most recent loan vintages. The related party lending is still low representing 3.4% of the total gross loan book as of the end of March of 2017.

Now I suggest turning to **Slide #7** with more details on corporate and retail loan portfolio metrics.

On the backdrop of moderate growth of corporate's loan book on the left, qualitative indicators keeps showing a positive trend in the reporting period. NPL ratio is down to 0.9% and cost-of-risk down to 2.5%. The NPL coverage ratio of the corporate loan book increased significantly up to 657%, as previously explained. The retail loan book NPL reached 7.9%, on the backdrop of loan portfolio reduction to RUB 97 billion. The cost-of-risk showed a decreasing trend reaching 5.1% level, to be compared to a 6.5% figure, at the end of 2016.

The next **slide #8** illustrates the funding structure of the Bank. Total liability has decreased by 6% during the first quarter of 2017 to RUB 1.4 trillion. Customer accounts represented the main source of funding with a 55% share in total liabilities, and showing a 10% growth during the first quarter of 2017. The spending from CBR and the deposit by credit institutions decreased during the reporting period and represented a 35% share in total liabilities, the bulk of this amount being linked with repo transactions. The bonds repayments schedule is well-balanced with the next international debt repayments being due in 2018.

Now let's proceed to the final **slide #9**, on the Bank's capital.

The Bank reinforced its capital position with the following capital adequacy ratios. The IFRS Basel III total CAR amounted to 19%, and Tier 1 capital ratio to 10.7%, at the end of March 2017. As of 1 May 2017, the capital liquidity ratio under the RAS were far above regulatory minimum with N1.0 ratio of 14.9%, and N1.1 and N1.2 issues of 7.3%. These were the main highlights of the Bank's financial and business results for the first quarter of 2017. Thank you very much for your attention. Now let's proceed to the Q&A session.

Operator: Thank you. If you would like to ask a question, please signal by pressing *1 on your telephone keypad. If you're using a speakerphone, please, make sure your mute function is turned off to allow your signal to reach our equipment. Again, press *1 to ask a question. We will now take our first question from

Stephane Suchet from Credit Suisse. Please, go ahead.

Stephane Suchet: Hello. Thank you very much for the presentation. Two quick questions, if I may. The first one on the cost-of-risk. Would it be possible to know what the cost of risk will be, excluding the negative impact of IFRS9, at Q1 '17 and, secondly, would it possible to get the impaired loan ratio, if possible at Q1 '17? Thank you.

Eric de Beauchamp: Okay. So starting from the end, so the internal ratio is about 7% at the end of March, and the regarding your first question on IFRS9 only from the beginning of next year, so from the first quarter of 2018. So as of today, you cannot see the full impact. But to be on the safe side, we decided, even back from 2016 to start creating, additional provision, so called management provision on some customers, in order to avoid a jump in provisioning during the first quarter of 2018 to be implemented at the end of this year.

Stephane Suchet: Perfect. Thank you very much.

Operator: We will now take our next question from Andrew Keeley from Sberbank. Please, go ahead.

Andrew Keeley: Hi, good afternoon. My first question's on your fee income. I mean it was extremely strong first quarter. I'm wondering whether you think this kind of year-on-year growth is sustainable, kind of, through the rest of this year? And I noticed that there was very strong growth in the currency exchange and brokerage segment. So could you perhaps give us a little bit of color about

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what this includes and, you know, it is a fairly new area and what's changed? Thank you.

Eric de Beauchamp: Yeah. So, in fact, as we mentioned previously the fee and commission income is very crucial for us, I mean to maintain, at least, between 25% and 30% of the total net income to diversify, our source of revenues. Yes, you will notice that definitely during the first quarter, we had the second biggest source of fee and commission income was due to currency exchange and brokerage operations. I would say we are, definitely - additional operations from a corporate customer on these activities. Coupled with the launch of MKB exchange which is a remote platform used by our corporate customers to make online currency exchange operations. So this one - this amount is high for the first quarter, but it's small, a kind of seasonal effect, so we don't expect that this type of commission will be so high in the next quarters. But at least the target remains to maintain 25% to 30% of total revenues in net exchange commission revenues.

Andrew Keeley: Okay. Thank you. My second question is on your loan growth outlook. Obviously, the first quarter, you had pretty strong growth on the corporate side and similar, kind of, level of contraction on the retail side. I'm just wondering, I mean generally what your kind of gross outlook is for corporate and retail for this year. I mean do you see - clearly, you sound more optimistic on the outlook for the corporate sector? I'm wondering whether this is across all of the main segments in which you operate or are there certain segments, in particular, where you see more potential for growth?

And is it not the case that you're not really seeing that corporates are kind of still deferring demand in the expectation of interest rates coming down more strongly, perhaps in the second of the year? And I guess on the retail side, I'm interested in why you're still so kind of cautious on this space? Do you think that, the process of household deleveraging, this perhaps needs to go further? That the consumer is still not really in a very good shape for you to start accelerating lending in this segment? Thank you.

Eric de Beauchamp: So starting with retail, so as you saw in the figures, there's a very good and predictive trend on the cost-of-risk, but now we see that the new vintages are better than the previous year. As you can see also if you look at these particular products or the only products we have been pushing on are mortgages because, mortgage products with a very good profile of customer risk.

But still, no, I mean we are not, let's say in a position to push more on retail. We want to get, let's say a confirmation of this trend, and after reinforcement of its liquidity and then we don't exclude I mean to start increasing our retail exposure again.

Vladimir Chubar: We still feel, let's say some pain from '13, '14, of new loans and older troubles we had from this good time. So as I said on a couple of the previous calls, we are now much more really like to increase our activity in retail lending. So we started to do it from the beginning of May. It's not something dramatic or something very big increase. But honestly speaking, it may be from month-to-month, we'll see what will be the impact and what will be the vintages of the very new generation. So, and maybe we can just make more and more activity in this area.

Eric de Beauchamp: Yes, and on corporate, so corporate has been the driver of the loan book growth, I mean in 2016, '15. So we see, let's say improvements in the economic environment, which is a good sign. We anticipate for this year corporate loan goes a little bit higher in 2016, and definitely it's more dynamic that's the average for the market.

Andrew Keeley: Thank you. Are there any particular segments where you're kind of most positively see the strongest growth potential?

Vladimir Chubar: This kind of the segments you see now on the top in our pie chart, so the big sector, oil and chemicals, so mainly export companies. This is number one. Of course, now we are not so positive as when, for example, three months ago, in this sector because some of these guys came to the market - I mean to the Eurobond market. so this market took some part of their demand. And in terms of other sectors, food farm and actually retailers are really diversified by many sectors in our different industries, but at the same time, we see some kind of recovery. And the first quarter of this year was as usual, actually, of course, not so good because, you know that in Russia there's the big holidays and the same second quarter. But in comparison with the previous years, we see that there is a positive signal. So I think that it also can be some demand from this area.

Andrew Kelley: Okay. Thanks very much.

Operator: We will now take our next question from Alan Webborn from Société Générale. Please, go ahead

Alan Webborn: Hi, thanks for the call. Following on from that, I think you sort of gave indications that you've had the corporate loan book could grow by about 15% this year, having seen, sort of, Q1 and obviously there are pluses and minuses in terms of industry demand. But I mean is that still a sort of ballpark figure of what you think you can achieve this year? That would be interesting. Do you think things are getting better from when you were talking to us in March or are they about the same? That would be interesting.

Secondly, I think you gave some guidance on margins, talking about margins being above 3% for 2017 and, obviously, you've made an improvement from where you were in Q4. Does that guidance remain the same and could you possibly help us understand the impact of the number of capital market operations that you've made across the first part of the year, in particular, the latest AT1 and how we should think of that in terms of your ability to - does the margin go down? Does the margin go up?

I mean how should we think about that in terms of the overall funding cost of the bank going forward? That would also be helpful. And I guess, do you see - I think you've talked in the past about the competition levels in corporate being very tough, and the state banks being your main competitors and has that changed at all? Do you think there's any - is it simply that there's a bit more demand? Is there any change in the competitive environment? Is it better? Is it worse? That would also be helpful. Thank you.

Eric de Beauchamp: I guess we're getting the loan book growth for this year. Unfortunately, we have to be quite accurate with all the forward statements that we do on the bank, as you can imagine. That definitely we still have the same pace of growth and we definitely believe we can do it. Once again, I mean the environment is positive. We see quite a dynamic demand from a corporate customers.

So, yes, the growth would be in line with our previous statements. Regarding the NIM, you see that during the first quarter, so we had let's say an increase of the loan book in the total assets. But as I was just mentioning during the presentation, that we have the liquidity buffer that puts pressure on the margin. That is why we did, let's say calculation of the liquid assets to show that you should take together the loan book separately without the repo transaction effect and the cost for the liquidity buffer. Then we work with 4.3% margin, which is a very good figure. In fact, in comparison with other banks operating in the mainly with corporate customers. Of course, the competition remains tough. We have especially state-owned banks, putting pressure on credit rates on the markets. But the idea is to continue to focus on the sector which are benefiting from ruble devaluation, from the sanctions for many of the exporters, and it's just the reason why we need to solid funding, I just want to point out that AT 1 is capital, so definitely it has a cost. But we should also consider rates of an additional capital for the bank and compare it with the cost of equity. I'd say if you look from these points, the transaction was successful and, let's say the level of rate is also really good for the Bank.

Alan Webborn: Okay. But does the 3% margin minimum still hold true? I mean I know it's capital, but nevertheless, there's an ongoing cost, and as I understand it, you're going to account for it within the sort of the net interesting lines. So just in terms of it's an extra cost, but you feel that it's worth, clearly from a capital perspective, one that was worth taking? But does your guidance change as a result of it? That was my question, really.

Vladimir Chubar: The guidance is the same. So we didn't change it.

Alan Webborn: Thank you.

Vladimir Chubar: Thank you, too.

Operator: As a reminder if you'd like to ask a question, please star one on your

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telephone keypad. We will now take our next question from Olga Naydenova from BCS Capital. Please, go ahead.

Olga Naydenova: Hello. Thank you very much for the call. Could you please give us some color on the increase of your impaired not past due portfolio which seems to have responded quite substantially and also for your short-term overdue, increasing your short-term overdues, what's driving that? And yeah, any color would be helpful.

Eric de Beauchamp: Yes, during the first quarter of 2017, we had an increase of loan not past due, but impaired allowance from RUB 30 to RUB 49 billion. So the RUB 19 billion increase was due to one customer, which was the pre-puts on the watch list, and in this category due to the worsening of the financial situation, this customer which is operating in the oil and chemical sector.

Olga Naydenova: I'm sorry. In what?

Eric de Beauchamp: Operating in the oil and chemical sector.

Olga Naydenova: Okay, and the increase in overdues was also in that segment, from the same borrower or that is different?

Eric de Beauchamp: That is different, and in this portfolio there is only one single exposure which brings this increase.

Olga Naydenova: Okay. Thank you very much.

Operator: We will now take our next question from Gregory Palffy from Pala Assets. Please, go ahead.

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Gregory Palffy: Hi, thanks for taking my question. On the operating lease income, can you just say something about it? Is this a recurring income that's going to be shown in the income statement? The other question, I guess, many people could be interested in the share issue. If you could shed some light on how the talks are going and when you do expect, maybe in late summer, share issue? Thanks.

Vladimar Chubar: We'll start from the last question. So what we said before is actual, so we don't want to say anything else. In terms of your first question, could you please repeat because we heard it was about operating lease, but we didn't understand the question?

Gregory Palffy: Yes. I thought it's a new line item in the P&L and I haven't seen it before. Maybe I'm wrong and I apologize if I am. I just seen this 415 million there. I'm just wondering if that's going to continue coming in?

Eric de Beauchamp: Yes, you're right. So, in fact, this operating lease income, so we're not in the first quarter of 2016 because it started from April '16, and it's from the leasing of six commercial planes, Boeing planes. I mean we got as a collateral from a former customer of the bank. In fact, we got these planes, signed a nine-year leasing contract with one of the leading Russian airlines and from '16 you can see in the P&L this was a stable source of income.

Gregory Palffy: So it's going to be coming in every quarter, this amount, roughly?

Eric de Beauchamp: Exactly. Exactly, a fixed amount of quarter paid in dollars.

Gregory Palffy: It's in dollars, okay. And can you just state your N1.1 as of 1 May? It was 7.3% as of the end of the March, right?

Eric de Beauchamp: 7.3% as of 1 of May.

Gregory Palffy: Oh, 7.3% as of the start of May?

Eric de Beauchamp: Yeah, 1 May. But it's - so it's Russian standard ratio, so the impact of the Tier 1 issue on that is not included yet. Because we went formally for the Central Bank to authorize us to increase and get permission. It's kind of a formal process, but I mean we should receive this before the end of the month, of May.

Gregory Palffy: And what was N1.1 as of end of March or 1 April?

Vladimir Chubar: 1 April, 7.5%

Gregory Palffy: Thanks.

Eric de Beauchamp: Thank you, much.

Operator: This concludes the Q&A session. I would like to turn it back to the host for any additional or closing remarks.

Elena Finashina: Dear all, thank you very much for taking your time to be with us today on this call. Our Investor Relations team is at your disposal for any further questions which you might have. So please get in touch with us. Thank you very much, and we wish you a very nice rest of the day.

Vladimir Chubar: Thank you very much for the call.

Operator: This concludes the call. Thank you for your participation. You may now disconnect.