

Conference Transcription

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BUSINESS RESULTS

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Speakers: Vladimir Chubar, Eric de Beauchamp, Elena Finashina

Operator: Good day and welcome to the CREDIT BANK OF MOSCOW 3Q 2014 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, madam.

Elena Finashina: Thank you and good afternoon, Ladies and Gentlemen. Thank you very much for joining the presentation of 9M 2014 Financial and Business Results of CREDIT BANK OF MOSCOW today. As mentioned my name is Elena Finashina and I am Director of the International Business Division in charge of investor relations, and I would like to introduce our speakers today. Here with me are Vladimir Chubar, our CEO; and Eric de Beauchamp, our CFO.

We are kicking off with a short commentary on the business environment, which is to be followed by an overview of our key recent business developments as well as financial results.

Now I would like to pass the floor to Vladimir.

Vladimir Chubar: Thank you, Elena. Good afternoon, Ladies and Gentlemen. We are living through rough times accompanied by slowdown in the Russian economy, instability on capital markets, worsening banking industry landscape and volatile macro conditions. The main concerns in the eyes of the foreign investors are obviously related to political risks recently materialised, oil prices drop, ruble depreciation and impact on the population and businesses, FX liquidity, CBR policy, asset deterioration, etc. We operate in this difficult environment and in this situation we managed to maintain a good performance in the year.

I suggest turning to **slide number 4** where you can find a brief description of our business and key financial highlights.

- Currently we are servicing roughly 15,000 corporate and 780,000 retail banking clients.
- Our distribution network is still highly concentrated comparing to our peers, which results in a variety of advantages, such as centralised decision-making and risk

management procedures, reduced operating expenses, bringing higher operational efficiency.

- It's worth mentioning that our international credit ratings have been confirmed at the same level during the reporting period despite general negative trends in the rating estimations, the most recent confirmation being from Fitch Ratings at 'BB' level with a stable outlook for high quality of our loan book, comfortable capitalisation level, strong profitability, sound liquidity profile and funding structure.

Now please let's move to the **slide number 5** and we will see the Bank's developments.

- The Bank's IFRS net income increased by 13% in 9 months of 2014 to compare with the same period of 2013 and accounted RUB 6.4 billion.
- Total assets showed a 9% growth in 9 months of 2014 and amounted almost RUB 0.5 trillion.
- Gross loan portfolio increased by almost 17% up to RUB 272 billion.
- The Bank showed a slight deterioration of its loan book with NPLs standing at 2.6%.
- The Bank maintains a comfortable level of capital adequacy with capital adequacy ratio of 14.8% and Tier 1 ratio of almost 11%.
- In the second half of 2014 our Bank gained international recognition for its achievements up to date, namely CBM won award "Bank of the Year in Russia" from The Banker magazine and "Best Bank in Russia" from Euromoney.

Now I would like to pass the floor to Elena and she will comment on the Bank's business results for the reporting period. Please.

Elena Finashina: Thank you, Vladimir. Let's go through the key developments in terms of the Bank's business lines and now I suggest turning to **slide number 6** with the corporate banking overview.

- The loan book diversification by industries is healthy with the highest industry exposure being below 12%. Comparatively short contractual maturities along with synergies with cash handling bring lower level of risk and a high turnover of credit resources.
- Despite slowing down in overall business growth, CREDIT BANK OF MOSCOW continues to expand the volumes of business, albeit being more selective due to tightened risk management policy.
- As you can see on the graph here, corporate loan book has demonstrated 13% growth, which is well in line with the market, while corporate deposits have increased by 7%.

Now let's focus on retail banking business on **slide number 7**.

- Individual lending continues to outstrip corporate lending in terms of the growth rates, although has slowed down as compared with 2013 in line with deceleration in economic growth. Retail gross loan book increased by 27% during the 9 months of 2014 with its share in total loan book currently exceeding 33%.
- The Bank's target segments are consumer loans and mortgage loans, while most strict selection procedures and slowing down of activity are applied to most risky products, such as credit cards.
- Retail deposits have shown an 11% growth in the reporting period, evidencing strong reputation of the Bank in the market and high level of credibility, which is particularly valuable in the current volatile times.

Now I suggest moving on to financial performance of the Bank and therefore I pass the floor to Eric, who will provide details on dynamics of the key financial metrics. Please, Eric.

Eric de Beauchamp: Thank you, Elena. Good afternoon, Ladies and Gentlemen.

So let's turn to **slide number 9** and start our financial performance review from income and expenses dynamics.

- The main driver of 30% increase in operating income became net interest income growth of almost 50% year-on-year resulting in a solid net interest margin of 5.4% over the nine month period of 2014. The main drivers were the repricing on the corporate loan book as well as the increased share of retail lending.
- Net fee and commission income growth was primarily due to increase of commissions from operations with plastic cards and from other settlement operations, which expand in line with the Bank's strategic focus on their developments.
- Operating expenses grew by a lower rate of 22% comparing with operating income, resulting in a cost-to-income ratio decrease to 31% for the 9 months of 2014.

Assets structure and asset growth dynamics are presented on **slide 10**.

- The Bank has accumulated a significant liquidity buffer with cash on hand, as well as trading book consisting of highly-liquid debt securities accounting altogether for 24% of total assets.
- Loan portfolio amounts to 72% of total assets being the main driver of the asset growth.

Let's go through the key loan portfolio metrics on **slide number 11**.

- Non-performing loans demonstrated an upward trend during 2014 reaching 2.6% of the total gross loans at the end of the 3Q. The bulk of growth occurred during the 3rd quarter mostly due to one of the large corporate borrowers showing signs of impairment which is clearly illustrated on the upper right-hand graph on this slide: level of corporate non-

performing loans increased from 0.25% at the end of June to 0.83% at the end of September 2014.

- The Bank maintains a sufficient loan loss provision level of 3.6% of the loan growth portfolio and a comfortable NPL coverage ratio of 140%. At the same time the cost of risk increased up to 2.7%, which still remains relatively healthy. The increase in provisioning level resulted from the deterioration of market environment and the deceleration of the economic growth coupled with the Bank's conservative provisioning policy.
- Concentrations remained at a stable level in terms of the top 10, top 20 largest exposures, the related party lending level decreased to 1.1% of the Bank's equity.

The next slide, **number 12**, provides a detailed breakdown of the Bank's well diversified funding structure.

- Customer accounts, representing 70% of liabilities and consisting mainly of term deposits, showed 9% growth in the nine-month period of 2014, which was in line with the total assets dynamics.
- Forming 18% of liabilities, wholesale funding demonstrates a well-balanced maturity structure with the bulk of foreign currency repayments being due in 2018.

The Bank's capital position at the end of September is shown on the **slide number 13**.

- IFRS capital adequacy ratio was maintained at a comfortable level of 14.8% and Tier 1 ratio at the level of 10.8%. The Russian accounting standards capital ratios are well above regulatory minimum with N1.0 ratio at 12.3% and N1.1 and N1.2 ratio at the level of 8.1%.
- The Bank's profits consistently contribute to Tier 1 capital keeping the Bank's capital position stable.

These were the main highlights of the Bank's financial and business results in the nine-month period of 2014. Thank you very much for your attention. Now we suggest moving forward to the Q&A session.

Q&A

Operator:

Thank you, sir. If you would like to ask a question at this time please press the star or asterisk key followed by the digit 1 on your telephone. 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. We will pause for just a moment to allow everyone to signal. As a reminder it's *1 to ask a question.

We now have our first question. It comes from Magdalena Stoklosa of Morgan Stanley. Your line is open, please go ahead.

Magdalena Stoklosa: Thank you very much, good afternoon to everyone. I have two questions and almost by definition they are more about your prospects than about the nine months delivery. So really two things: first, how do you assess your margin trajectory going forward, including of course an increase of funding, including, I assume, also interest rate hikes by the Central Bank, which the markets seem to be expecting already for next year and also what you can do from a kind of re-pricing of the asset like this, so on a kind of a six-month view, if you could give us your take on your margin development, so that's my first question. Of course the second question is about the corporate asset quality. How damaging do you think are going to be the most recent ruble devaluations and also what seems to be the expectations of recession into next year? Thank you.

Vladimir Chubar: Thank you, Magdalena, for the questions, it's Vladimir. First of all, regarding the first question, our expectation is that the margin will be at the level of the third quarter or higher because, of course, you're absolutely right, the level of the pricing on our liability side is increasing now due to the CBR's decision and higher expectations of our lenders. This is absolutely true, but, at the same time, we are moving this repricing to our customers, so that's why the margin for the third quarter is higher than the same margin for the second quarter and the first quarter, so our expectation that it will be even maybe higher than the third quarter. Anyway, we will see because any forecast now is not so easy to make in the current environment.

In terms of deterioration of the corporate book, of course, although any forecast now is not so easy to give, but, anyway, we see that it can be some possible issues for the Russian borrowers, for the Russian companies because of devaluation of Russian ruble and what we see now that some clients of our Bank who were already working with US dollars as the currency of the loans, now they are in the process of thinking about to move the currency to Russian rubles, so it doesn't mean there are some immediate problems for these customers because a big part of these customers are exporters and also importers, so that's why they somehow try to move these forex risks to their customers. In this case we can also come, of course, to the problem with the decreasing of the consumer demand, so that's why, of course, there can be some issues in this way. So now there's no immediate comment, but as a trend, as a tendency, of course, it can be in a decrease, but nothing dramatic what we see now at this moment.

Magdalena Stoklosa: Vladimir, I just want to follow up on the margin side. So really just two additional questions: one, whether you are actually seeing any acceleration of the re-dollarization of the retail deposits over the last six weeks? So that's one question. Second, given that you're able to reprice your

corporate loans or you seem to be able to reprice your corporate loans and kind of stem the impact of the increased cost of funds. On average what is your marginal corporate rate for one year ruble money at the moment?

Vladimir Chubar: In terms of changing of the rates in a deposit portfolio the answer is simple: there are no changes. We really expected about three, four months ago it can be, but it's still the same portion of forex deposits in the structure for all deposits of the Bank. To be honest, for me it's kind of a surprise because we were expecting the same as it was in 2008 but still the same portion of about 15%-16% is foreign currencies and another part is Russian rubles if you talk about private depositors. Among the corporate depositors the majority, almost all the deposits are in the form of Russian rubles still so there is no inflow of USD or euro deposits. This is number one question. What was the second question? Please remind me.

Magdalena Stoklosa: On average what do you charge for your one year ruble corporate money? I know of course it's a question across the kind of risk buckets as well, but on average given that you are able to re-price your corporate loans to offset your increases in funding, what's the marginal corporate rate?

Vladimir Chubar: In terms of the corporate rate, what we see now on average, of course it depends on the quality of the customer definitely and the rates now are different, so we have the borrowers with the rates of 12% and 13% in Russian rubles still because they are super-liquid, super-quality related to government or to big Russian group of companies and for some borrowers we increased, like new loans can be at a rate of 16% or 17% in the Russian rubles.

Magdalena Stoklosa: Ok.

Vladimir Chubar: But it's a big difference. If it was maybe half year ago, the difference between the rates for different customers was 2% or 3% maximum, now it can be up to 5% from minimum to maximum.

Magdalena Stoklosa: Can I just ask, I know I'm holding the line so I'm sorry, but my last question is going to be when you weigh the two things that are happening, you are increasing corporate rates for new loans. You are offsetting your own increase in cost of funding from one side but we are also heading into probably a more challenging macro environment. Where do you think is the point where you would kind of consider not raising corporate rates anymore because you would kind of assume that the moment you raise the rate, three months later that particular loan comes back to you as an NPL. I'm simplifying but where is the kind of, where is in your mind the balance between the level of repricing and where the corporate cycle would become much more challenging than so far?

Vladimir Chubar: I can remind you that even in 2008 sometimes the rates were more than 20% in Russian rubles.

Magdalena Stoklosa: 20%, yes, I remember that.

Vladimir Chubar: Of course, even higher, so even for the best borrowers it was 20%. Now it's not so easy to answer and I really prefer not to answer because it's like trying to make any forecast for the future and with the current environment I really can't answer you. So we are now managing the Bank everyday so we are just trying to work with the current customers. New risk appetite is much lower than it was before even three, four months ago, so the main idea now is to support the current customer base, to refinance them if they need this from other banks because sometimes the banks don't like to work with the customers not only because of the customer problems, let's say like this. That's why now it's very important as I said a lot of times to support your customer base and if you believe in the customer, just give him liquidity to support the business, so like this.

Magdalena Stoklosa: It's understandable. Thank you so much.

Vladimir Chubar: Thank you, Magdalena. Thank you, bye.

Operator: As a reminder at this time it's *1 to ask a question from your telephone keypad. We can now take our next question, it comes from Olga Veselova from Bank of America. Your line is open, please go ahead.

Olga Veselova: Thank you, thank you for the call. I have a couple of questions, Vladimir. One is about the regulation. You now have seen the Central Bank maximum levels of interest rates on retail loans. What portion of retail loans do you have above this cap? We've discussed this in the past but the levels have changed, so if you have any, what is your strategy? This is my first question. My second question is about the trend in asset quality in consumer segment. Do you see impact on customers' payment discipline and also on ability to pay due to the ruble weakness? My third question is about the changes in the management team. I remember we discussed it at one of the previous calls. How do you progress with the replacements and do you have any plans for replacements or you think the team is fully formed? Thank you.

Vladimir Chubar: Thank you, Olga. First of all your first question in terms of the...there were a lot of questions and I didn't make any comments on this, so the first question was about the interest rates...

Olga Veselova: Interest rates published by the Central Bank.

Vladimir Chubar: First of all we see now no immediate impact on the Bank because of the new regulation and I cannot comment now really what portion of our borrowers will be hired in this threshold from CBR, but as I discussed this with my colleagues, it's absolutely not material.

Your second question in terms of the NPLs of the private borrowers also. So we see now that the quality of the book is quite stable. You can see it also from our financials that cost of risk for the biggest portion of the private loans, consumer loans, the cost of risk has just increased a little bit from 6.3% to 6.4% in the third quarter, so if you ask me about the current environment, so we didn't see some dramatic changes and any links between ruble devaluation and NPLs, so discipline to pay, there's no link because, first of all, of course, as you know, I think, that we never like to give the FX loans, so like USD loans to our private borrowers and that's why there's no impact from this side. In terms of instability in Russian economy and maybe some problems with unemployment rate can go higher etc, so also there's no impact, maybe because we have the strategy of "one city, one region", Moscow is our home market. That's why Moscow will feel all these problems maybe in half a year, one year but not the first region to feel this.

Your last question about the management, so the team now is, how to say, completed, let's say it like this. So we are now of course every time we like to have new professionals in the Bank but if you're asking about the top management level, there's no immediate need for the Bank to hire people here.

Olga Veselova: Very clear, thank you.

Vladimir Chubar: Thank you Olga.

Operator: As a final reminder today, it's *1 from your telephone keypad if you would like to ask a question. Our next question comes from Mikhail Nikitin of VTB Capital. Your line is open, please go ahead.

Mikhail Nikitin: Yes, hello and thanks for the call. Just a couple of quick questions. The first one is would you, given your FX liquidity position, would you consider buying now some of your Eurobonds because, as we speak, it's traded at 85, maybe 90 in terms of price? Second question on your subordinated debt issue in November, the ruble one, what's the impact on capital ratios? Thanks.

Vladimir Chubar: Thank you first of all for the questions. In terms of our current bonds in the market, so if you're asking about the decision to buy them from the market, there is no decision like this. Of course we are looking at what is happening now. In terms of sub-bonds of course we cannot support them definitely; in terms of the senior bonds more decisions like this to buy them from the market, so we see that there is of course some trends which are not positive, which are negative, but maybe in the future we will decide. In terms of your second question, the impact will be, it's easy to calculate, 1% in terms of the capital adequacy ratio but we are now in progress with the CBR to register, so not yet.

Mikhail Nikitin: But it will be registered by the year end?

Vladimir Chubar: We expect, yes.

Mikhail Nikitin: So they're very timely, even with this coupon it's now not that high given what's happened. Ok, thanks for your answer. Thank you.

Vladimir Chubar: Thank you, bye.

Operator: We can now take our final question. It comes from Nick Dimitrov of Morgan Stanley. Your line is open, please go ahead.

Nick Dimitrov: Hi there, a quick question. Can you, guys, chat a little bit about your loan growth expectations in light specifically of your capital ratios and the fact that profitability is becoming increasingly more challenged? You have been growing very fast until now but if you look at your earnings coming down and your capital ratios coming under pressure, I would argue that we're going to probably see slowdown in your loan growth. Am I correct here or...?

Vladimir Chubar: Hi, Nick, thank you for the question. So first of all the growth until this time was in line with the market, maybe a little bit faster, and of course some growth we have not only because of the growth of the book but also because of the revaluation of Russian ruble and of course some loans you have in US dollars; but if you're asking about the future forecast, of course, as I told just maybe five minutes ago, there is no strategy now to have huge inflow of new customers. The main idea now is to support the current customer base and to select from the market the best names and also to give them money, so that's why somehow you are correct that there's no strategy to grow the same as it was even until this time of the year or as it was even last year. So risk appetite of the Bank now is lower than it was in the middle of the year or in the beginning of this year. That's all, thank you.

Operator: Would you like to take another question?

Nick Dimitrov: Yes, this is going to be my final question. I was looking at the change of your quarterly numbers and I noticed that the provision expense increased by about 80% quarter-over-quarter, which is a fairly high number, but at the same time your operating expenses declined by about 30% so that took away a lot of the hit, however a lot of these are not sustainable specifically decreasing your expenses to such a rate going into the future. Can you give me some colour in terms of where do you see your opex going in the coming quarters and maybe even provision expense which I know is very hard in the current challenging environment?

Vladimir Chubar: Sorry, the first question was about what is our expectation in terms of the operational expenses, yes?

Nick Dimitrov: Correct, because I saw that they declined by about 30% quarter-over-quarter which is a fairly drastic decline.

Vladimir Chubar: Yes. First of all in terms of the operational expenses, what's the biggest part? Of course the biggest part is the salaries. Now of course as we are now drawing, there will be no increase in terms of the salaries and all the expenses linked with this, the taxes etc. In terms of the other expenses there are also rental payments for our offices, so there is also no strategy to grow in a number of the offices. We'd just like maybe to change a couple of them, the place of the offices, maybe to close one or two, so also we are not expecting the increase in the number of the offices. In terms of other expenses, the result of some seasonal effect of the commercial expenses which is advertising normally, so in the second quarter it was more commercial expenses and in the third quarter a little bit less. Last quarter also will be more expensive in this way, let's say like this, and there will be higher expenses for the advertising, but in general we are not expecting a kind of increase in this area, maybe a decrease a little bit.

In terms of NPLs you're absolutely right, the third quarter will increase our provisioning level and it was because of course in the current environment we decided to be more conservative and also expectations for the future to be more conservative to provide this area with bigger numbers. So as I answered one of the first questions we don't see now any dramatic expectations in terms of the NPLs and in terms of the provisions, but the overall decision is to be more conservative.

Nick Dimitrov: Ok, thank you.

Vladimir Chubar: Thank you, Nick. Bye.

Operator: We can now take our next question. It comes from Greg Palfy of Pala Assets. Your line is open, please go ahead.

Greg Palfy: Hi, thank you very much for giving me the chance. I have three or four questions. Just going back to the gross loans, do you have any figure for the end of '14 and also maybe for '15? The second one would be just a really simple question about the cash, which percentage of cash held in hard currency and just regarding any financial asset which are encumbered, if you can comment what percentage...

Vladimir Chubar: Greg, maybe I will answer one by one. The first question, could you please repeat it?

Greg Palfy: The first question was just the gross loan figure, what do you expect for the end of '14 and maybe for '15, end of '15?

Vladimir Chubar: In terms of '14, we expect for all the year I think that will be about 20% for all the year. Next year I cannot comment. I know it's not right words in English, it's not forecastable, absolutely. We try to not even budget in December for the next year, it's moving because of a lot of moving parts in the Russian economy, ruble exchange rates etc. But in general we don't expect some huge speed of growth of the Bank.

Greg Palffy: For the retail part of the gross loans, what would be the year-on-year increase?

Vladimir Chubar: As we see now the majority will come from the corporate because in the retail we just need maybe to reevaluate the risk, to look at the changing environment and to understand what will be the next steps from the CBR etc. etc., so the growth will come definitely more from the corporate side.

Greg Palffy: Ok. Second question was the percentage of cash held in hard currency?

Vladimir Chubar: What do you mean by this question?

Greg Palffy: I mean if one looked at the cash balance, I'm just wondering, what percentage is in ruble and what is in euros or dollars?

Vladimir Chubar: Ok, so about how much we have in Russian rubles and how much in...you mean in the assets, just the structure?

Greg Palffy: Just on the balance sheet, in cash.

Vladimir Chubar: My colleagues will check now the exact figures but we can move now to another question and we will come back to this one.

Greg Palffy: Sure. Regarding July, I heard rumours or maybe lobbying by the banking sector that the rule that from January 1st the 5.5% ratio will be 6% for the Tier 1 and I heard it could be pushed out to July 1st. Is there any, what's the latest plan by the CBR?

Vladimir Chubar: It was about the liquidity, so Basel III in terms of the liquidity, but in terms of the capital ratios. Actually as I've heard it is almost decided to be moved to 1st July, you're absolutely right which I really can comment as very good decision of CBR because of the current situation in the market will be very supportive for the banks, for all the banks in the banking system to move this.

Greg Palffy: So you can confirm it will be moved, ok. Just regarding the repos. I am just wondering if you can comment on the percent of financial assets or other assets that are encumbered because of the repo between you and the CBR?

Vladimir Chubar: At the current moment the position is almost free, so all the bonds we have on the assets, bonds of other issuers, almost free of the repo at the current moment.

Greg Palffy: Ok. Free of repos, ok.

Vladimir Chubar: Maybe 10% just booked in the CBR for the repo operations. Coming back to your question in terms of the asset structure, so we can just comment on the loan book.

Elena Finashina: We can provide you with comments on the split of the loan portfolio by currency which is at hand right now. So hard currency makes around 15% - 16% of the total loan book.

Greg Palffy: 15%?

Vladimir Chubar: Yes. If we move to all the assets, my expectations are a little bit lower even on this figure.

Greg Palffy: 15%, ok. Originally I asked for the cash, so in terms of just cash balance, but that's also good info.

Vladimir Chubar: I think we have your information or you can send to our IR people the question, we can give you exact figure, not roughly.

Greg Palffy: Ok. Just the last question, if the CBR goes ahead with the 200 basis point increase next week, how much would you pass on to the customers?

Vladimir Chubar: It depends on the customer of course, but anyway we will move some rates of the customers definitely, but it depends on the discussion with the customer and it depends on other products we have with the customer, so it's a very complex question. Anyway of course we will react.

Greg Palffy: Ok, alright. Thank you very much.

Vladimir Chubar: Thank you very much.

Operator: We have no further questions at this point so at this stage I would like to hand the call back to the speaker for any additional or concluding remarks. Thank you.

Vladimir Chubar: Thank you very much for this call and we will hear you in I think three months, maybe a little bit more. Thank you very much. Bye.

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