

## Conference Transcription

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BUSINESS RESULTS

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Speakers: Vladimir Chubar, Elena Shved

**Operator:** Good day, ladies and gentlemen and welcome to the CREDIT BANK OF MOSCOW first half 2014 Financial and Business Results Conference Call. Today's conference is being recorded. At this time I'd like to turn the conference over to Vladimir Chubar. Please go ahead sir.

**Vladimir Chubar:** Thank you. Good afternoon ladies and gentlemen. Thank you for joining today's call. I am Vladimir Chubar, CEO of CREDIT BANK OF MOSCOW and I will present our financial results for the first half of 2014. Along with me is Elena Shved, Head of the Financial Division.

Unfortunately my usual co-speaker CFO Eric de Beauchamp won't be able to participate in today's announcement call due to a business trip.

First of all I would like to make a brief outline of CREDIT BANK OF MOSCOW recent business development and after that Elena will comment on financial results.

For objective reasons Russian banking sector was among the most suffering industries from the adverse effect caused by several waves of Western sanctions aimed to reduce business activity of a number of government bodies but obviously set off a negative chain reaction throughout the whole market. This resulted in detrimental macroeconomic trends, which, together with the complex political situation and possibility of further set of sanctions, forms a very rough environment making market participants to review their forecasts for downgrade.

At the same time, it's worth noting that changes in the industry landscape, which became a challenge for Russian banking sector, obviously opened an opportunity for banks, not directly exposed to economic sanctions, to sidestep their peers and expand their market shares.

Against this backdrop CREDIT BANK OF MOSCOW continues its sustainable growth with a focus on robust risk management and an adopted strategy which has already proved its efficiency and resilience to the market shocks. Our geographical concentration and strategic focus on retail and wholesale trading sector, referring to short-term lending, are distinctive business features which we see as the basis for our further growth.

Let's go to slide **number 5** which provides us with an overview of the Bank's key developments in the first half of 2014:

- The Bank's net income for the six month period of 2014 reached RUB 4.2 bn, which is 10.9% higher than last year's result for the same period. Operational efficiency retained at a healthy level.
- Expanded loan portfolio was the main driver of asset growth with the loan book quality maintained at a high level relative to the average performance of Russian banking sector with NPL ratio of 1.9%.
- It's worth mentioning here that CREDIT BANK OF MOSCOW closed its debut mortgage-backed bonds deal in June.

Let's now move to **slide number 6** with an overview of corporate banking business of the Bank:

- Corporate business is a core business for the Bank representing 67% of the Bank's lending business and providing 56% of loan portfolio revenues.
- Lower dynamics of our corporate portfolio growth in the first half of 2014 stems from tightened risk management policy and being more selective in terms of new and already existing customers.
- Loan portfolio is well diversified by industries with the largest exposures to commercial construction, food and farm, electronics and metallurgy.
- The Bank is mainly focused on short-term lending, therefore mainly employing high turnover of credit resources.

Now let's move to **slide number 7** which covers retail banking business of CREDIT BANK OF MOSCOW:

- Retail banking book expanded up to 33% of total loan book and comprises mainly of consumer and mortgage loans which together amount to 87% of the total retail loan book.
- On the deposit side CBM continues to attract retail customers, currently being 11th largest bank in terms of retail deposits in Russia.
- Our network is developing on an ongoing basis making it more convenient for our customers to use any of the Bank's services.

If you have any questions about our business development, you may ask them at Q&A session at the end of our presentation and now I suggest moving to the next part - Financial performance - to discuss our first half 2014 financial results in more detail. Elena, please...

**Elena Shved:** Thank you, Vladimir. Good afternoon, ladies and gentlemen.

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

- As evidenced by left upper graph, the growth of operating income is based on an increase of net interest income by 41% up to RUB 10.9 bn. Loan portfolio sustainable growth together with expanding retail lending became the main drivers of interest income growth.
- One of the main sources of fee and commission income growth was 2.5 times increase of commission income from plastic cards, based on the development of this business segment in the Bank during last years.
- Return on assets and return on equity continued to retain at above-the-market average, while net interest margin, driven by increase in volume of lending operations, also stands at a healthy 5.1%.
- Operating expenses grew by 37% in the reporting period with salaries and employment benefits up by 33% and administrative expenses up by 39%. Fundamental reason for such an increase is general development of the business of the Bank.
- Operating efficiency maintained at a high level with cost to income ratio being one of the lowest among the peers at the level of 34%.

Now let's move to the next slide, **slide number 10**, which gives us a review of the Bank's asset structure, which remains quite stable with 71% referring to loan portfolio book.

- The Bank's assets increased by 7% in the first half of 2014 and by 58% from the beginning of 2013 thus continuing to grow above the market average.
- Our asset development is traditionally based on expanding corporate and retail loan books, which grew by 9% and 19% respectively in the first half-year of 2014.

Quality of loan portfolio retains on sustainable level which is proven on **slide number 11**.

- Marginal increase of non-performing loans' share in gross loan portfolio up to 1.9% is explained by an increase of share of retail loan book. However, it is obvious from the above left-hand graph, provisions fully cover non-performing loans with loan loss provisions ratio at a high level of 3.1%, at the same time avoiding over-provisioning.
- Active penetration into retail segment on a backdrop of negative macroeconomic environment is expressed in retail NPLs ratio of 5.3%, which is in line with the market. Corporate NPLs increased slightly on less than 10 basis points for the first six months of 2014 and now reach 0.25%.
- Cost of risk remains well below 3% having reduced on more than 10 basis points for the last quarter to 2.2%. The main driver was decreasing retail segment where we have introduced more conservative approach to customer selection due to macroeconomic instability.
- Largest borrowers' concentration remained unchanged from the year-end 2013 with exposures of 17% and 28% on Top-10 and Top-20 loans respectively.

- Related party lending still remains nonmaterial.

Now let's proceed to **slide number 12**.

- CBM's funding base is well-diversified with significant share of customer deposits representing 69% of total liabilities with almost 50/50 split between retail and corporate customers.
- A hallmark to be mentioned here is a debut mortgage securitisation of RUB 3.7 bn in total and 25 years to maturity which the Bank successfully completed in June.
- The Bank also executed several transactions on capital markets after the reporting date. In July it placed two 5-year domestic bond issues in the total amount of RUB 10 bn and also redeemed its \$200 mln 3-year Eurobond issue in August.

Now let's move to **slide number 13** on the Bank's capital position.

- The Bank's capitalisation level remains strong which is evidenced by IFRS Basel III Total Capital Adequacy ratio of 14.3% and Tier 1 capital ratio of 10.5% at the end of the first half of 2014.
- According to Russian accounting standards capital adequacy ratios maintained well above regulatory minimum requirements with total capital ratio of N1.0 at a level of 12% at the end of August.
- The Bank's net income was retained as part of the capital in the first half of the year and potentially even with only retaining the annual net income, CBM is still capable of strong further growth and development.

At this point I suggest finishing our first half 2014 results presentation. Thank you for your time and attention and now let's proceed to the Q&A session.

**Operator:**

Thank you. Ladies and gentlemen, to ask a question please press \*1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Once again press \*1 to ask a question. We'll now pause for a moment to allow everyone to signal. As a reminder to ask a question at this time please press \*1. We will now take our first question from Mikhail Nikitin from VTB Capital. Please go ahead.

**Mikhail Nikitin:**

Yes, good afternoon Elena and Vladimir, many thanks for the call. I noted an increase in restructured loans over the past six months and they are still relatively low but I just wanted to ask if you could tell us about the nature of these restructured loans, why they are increasing? My second question would be regarding the cost of risk in the unsecured retail. Again it was fairly low compared to levels reported by other banks but what are your

expectations for the second half both in terms of growth in consumer loans and in terms of potential costs? Thank you.

**Vladimir Chubar:** As I understood, there are two questions, first of all about the restructured loans.

**Mikhail Nikitin:** Yes.

**Vladimir Chubar:** Ok. In terms of restructured loans, my view is that we cannot call them really restructured, but we came to an agreement with our auditors that it is better to show this loan as restructured. There is a company working in Moscow region, they are developers, and they have several projects, and there was a possibility of refinancing this loan in other bank, and we decided to keep this client with CREDIT BANK OF MOSCOW, and, technically, yes, technically it was like a restructuring of the loan, but due to the very good quality of the customer and good interest rate we decided to show this in this view as a restructured loan.

**Mikhail Nikitin:** Just a change in terms and conditions, right, not even impaired, right?

**Vladimir Chubar:** This loan in my view and the view of my risk management, my colleagues in the Bank, this loan is not impaired but due to technical reasons we had to move this loan to the restructured loans. And second question, could you please repeat it once again?

**Mikhail Nikitin:** What you are seeing currently in unsecured retail, do you expect any increase in the cost of risk in the consumer lending segment? What's your expectation for the second half both in terms of growth, because your portfolio has grown rather faster than many peers; and in terms of potential rise in cost of risk and NPLs?

**Elena Shved:** I will try to answer on these questions. First, our projections of growth of unsecured lending for the end of this year. We expect that our retail loan portfolio's increase will be up to 30% but, as we mentioned on our previous call, the maximum level of cost of risk for retail was in the first quarter of 2014, and now we expect it to stabilize because we introduced a very conservative approach to retail lending in the first quarter.

**Mikhail Nikitin:** Right, so it's going to be like maybe 5% annualised, the provisioning charge but not higher?

**Elena Shved:** For cost of risk not higher than 6%.

**Vladimir Chubar:** I am happy to, maybe, underline once again that if we compare the second quarter to the first quarter, in the second quarter we've seen a little bit decreasing cost of risk for the retail portfolio which really proved the right way of new standards of underwriting, which we implemented. Thank you.

**Mikhail Nikitin:** Thank you.

**Operator:** As a reminder, to ask a question at this time please press \*1 on your telephone keypad. Our next question comes from Ksenia Mishankina from UBS. Please go ahead.

**Ksenia Mishankina:** Hi, this is Ksenia Mishankina from UBS. Thank you for the presentation, I just have a quick question – what are your projections in terms of loan growth for the full year, this year and next year? Thank you.

**Vladimir Chubar:** Could you please repeat the question because the connection wasn't very good?

**Ksenia Mishankina:** Ok sure. What are your projections for the loan growth for 2014 full year and next year 2015?

**Elena Shved:** Our projection for 2014 for total loan portfolio is about 20% and in 2015 about 15-20%. And the main reason for this is the need for new capital injections.

**Vladimir Chubar:** So this question is...a lot of people asked me this question last month or two months. It's not so easy to give any forecasts due to the current geopolitical situation, macroeconomic situation, we will see. But CREDIT BANK OF MOSCOW really is not suffering a lot from all the last changes in macroeconomy, in, just want to repeat, the geopolitical situation. We tried to benefit a little bit from this, gaining some new clients from the market, but the real limit for every bank is the capital, and, as you know CREDIT BANK OF MOSCOW, normally we have quite good levels of capital adequacy ratios for Russian standards, for international standards. For example, we have now more than 12% so-called N1.0 under the new standards, so the level is healthy. But, of course, if you want to grow more than, let's say, 15-20% which is our normalised RoE, we need some new capital, new money and, as you see now, the markets are really closed for the Tier 1, absolutely closed for Tier 2, maybe there will be some small windows but we cannot really have any forecasts for this now. That's why we can limit our growth only with the 15% which is the level of our RoE, 15-20%.

**Ksenia Mishankina:** Ok, thank you. In terms of NPLs, what are your forecasts for the next years?

**Vladimir Chubar:** For the next years?

**Ksenia Mishankina:** Well, by the end of the year and then the next year.

**Vladimir Chubar:** Quite the same level as we have now and any other forecasts are not ready to be given for the next year, for example, because we are still budgeting

it. And the same, this situation is changing so rapidly that any forecast will not be very fair.

**Ksenia Mishankina:** Ok, thank you very much.

**Operator:** As a reminder to ask a question at this time please press \*1 on your telephone keypad. Our next question comes from Maxim Mishin from Merrill Lynch. Please go ahead.

**Maxim Mishin:** Hello, it's Maxim Mishin. I just have two small questions. The first one is on provisions, how do you explain its rise in the first half? And the second one on the FX rate of ruble, what's the impact on your results?

**Vladimir Chubar:** Could you please repeat the first question to understand it clearly?

**Maxim Mishin:** Sure. How do you explain the rise in provisions in the first half?

**Elena Shved:** We introduced in the first quarter of 2014 new methodology for corporate lending, and in the fourth quarter of 2013 – new methodology for retail lending. So, it is based on probability of default for each loan and is based on Basel III standards. Based on these terms, we see that the level of our cost of risk for retail loans increased a little bit because we tried to predict every possible default in retail loans for this period, and in corporate loans we see that the level of provisioning is decreasing due to this methodology because we were over-provisioned in 2013 and now, as we have also mentioned, we expect that the level of cost of risk will be stable for the next period.

**Vladimir Chubar:** Of course the main reason, if we see the tendency...I cannot say that I really expect the tendency will be very good, so, as we said a little bit before, we expect a stabilization of current levels of cost of risk and NPLs and, of course, if there will be a higher deterioration of the Russian macroeconomy, it will impact the levels of NPLs and cost of risk of any bank in Russia. We cannot say that we will be absolutely aside of this.

**Maxim Mishin:** That's clear, thank you. The second question on weaker ruble exchange rate, did you estimate somehow an impact on your results?

**Vladimir Chubar:** I can answer in two ways. First of all about the Bank. So for us there will be no influence because we have no open positions, this is first. And second, in terms of the clients. Of course, some of them are benefiting from this, these are mainly exporters. Some of them have some decreasing of their results. But normally we have more clients from the first group than from the second group because, normally, if the company is working only in Russia and with the Russian rubles, we never provide them with FX financing, if to say about the direct impact. Indirect impact, of course, can be different for any customer but we didn't expect any possible problems or losses because of ruble rate.

**Maxim Mishin:** Thank you very much, that's clear.

**Operator:** There are no further questions over the telephone at this time. I will now hand you back to the host for any additional or closing remarks.

**Vladimir Chubar:** Thank you very much for the call. We will hear from you in three months with our third quarter results. Thank you very much for your time.

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