

Moscow Exchange Q3 2016 Financial Results Conference Call

Event date: 9 November 2016

Increases in fee and commission income from the Money Market, Fixed Income Market, Derivatives Market and Depository & Settlement Services partially offset lower interest income and allowed the company to maintain its best-in-class EBITDA margin.

Investor Relations contacts

Sergey Klinkov, Director of Investor Relations

Tel: **+7495 705 96 01**

Email: **ir@moex.com**

Speakers:

- Sergey Klinkov, Head of IR
- Evgeny Fetisov, CFO

Participants asking questions:

- Svetlana Aslanova, VTB Capital
- Armen Gasparyan, Renaissance Capital
- Andrey Klapko, Gazprombank
- Anil Sharma, Morgan Stanley
- Andrey Pavlov-Rusinov, Sberbank
- Ivan Kachkovski, Deutsche Bank
- Nikita Blokhin, J.P. Morgan

SERGEY KLINKOV – *Director of Investor Relations, Moscow Exchange*

Good afternoon, and welcome to the Moscow Exchange Q3 2016 financial results conference call. As usual, after the prepared remarks, we will have a Q&A session. Today we have on the call Evgeny Fetisov, CFO of Moscow Exchange.

Before we get started, I would like to remind you that certain statements in this presentation and during the Q&A session may relate to future events and expectations and, as such, constitute forward-looking statements. Actual results may differ materially from those projections. The company does not intend to update these statements to reflect events occurring after the date of the call, prior to the next conference call. By now, you all should have received our press release containing the results of Q3 2016. Our management presentation is available on the Company's website in the IR section. I will now hand the call over to Evgeny Fetisov, MOEX's CFO. Evgeny, please go ahead.

EVGENY FETISOV – *CFO, Moscow Exchange*

Thank you, Sergey, and thank you all for joining us today to discuss Moscow Exchange's results. I would like to start with slide 2. Before we go to the financials and key developments in Q3 2016, I will take a moment to highlight different macro environment and financial market indicators for 9M compared to

the last year, so that you can put our results in a broader context. Major macro indicators showed negative dynamics. GDP fell by 0.4% in Q3 2016. The budget deficit of 9M 2016 grew by 143% YoY, foreign trade declined by 17% YoY. Growth of the budget deficit, productivity in government bond placements, and the decreasing volume of export and import transactions drove demand for FX down. The interest rate environment has changed substantially. The average Mosprime rate declined by 0.9 p.p., which was favourable for new placements on the Fixed Income Market, though put some pressure on the interest income. A significant drop in volatility has been a more prominent change. The volatility of the MICEX Index fell from 2.1% in Q3 2015 to 1.7% in Q3 2016. We saw demand for Russian equities, which took the MICEX Index 19% higher in Q3 2016. The volatility of the USD/RUB exchange rate fell from 6.7% in Q3 2015 to just 1.1% in Q3 2016, which is historically the lowest volatility for the last several years.

Let us move to slide 3. Let me first cover some of the most important highlights in Q3 2016 and recent months. I will start with the most recent corporate events. On 2 September 2016, an EGM approved corporate restructuring. We will consolidate two MOEX subsidiaries, MICEX Stock Exchange and MB Technologies, into the parent company. The aim is to optimise our corporate structure, simplify customer interaction with MOEX, and reduce costs. In July, the Bank for International

Settlements (BIS) assigned the highest rating to the Russian financial market infrastructure. The BIS analysed the legislative framework for operations of CSDs and CCPs and acknowledged that Russian financial market infrastructure ranks amongst the best in the world. This is positive news for Russia as a whole, and we, as an important part of the Russian financial market infrastructure, take at least some of the credit for it. A dialogue with the authorities aimed at the introduction of best global practices in Russia is a component of our long-term strategy to bring the Russian financial market infrastructure on a par with advanced global markets.

Also, SWIFT assigned Premier certification status to the Service Bureau of NSD. This makes NSD Service Bureau the first bureau in Eastern Europe to receive this status.

At the beginning of the next year, MOEX will launch a new Listing Council, which will include experts on listing-related issues. We hope that the introduction of this council will extend the expertise and strengthen the reputation of listing on MOEX, bringing more listings to the Securities Market. We continue expanding our product offering as well as our client base. In Q3 2016, an asset management company obtained direct access to the Securities and FX Markets for the first time ever. In the Fixed Income Market, we launched ultra-short-term bonds. The new product addresses the needs of issuers and investors that were not previously covered. MOEX recently increased the dedicated capital of

NCC to RUB 9.5 bn and issued a guarantee of RUB 5 bn to its Default Fund. The purpose of these steps is to implement a new CCP safeguard structure, aligned with IOSCO requirements. Prior to that, another layer of NCC's "default waterfall" – collateral for stress – was introduced.

Now let me walk you through the recent change of fees in the Derivatives Market that came into effect on 3 October 2016. The new fees were introduced to harmonise the Derivatives Market with the other MOEX markets, to raise the effective yield back and link it to the value of underlying assets, as well as to simplify tariffs and make them more transparent. There are two main changes. First, fees now depend on futures prices and option premiums. Before the change, fees were quoted as fixed ruble amount per contract. Second, fees for all contracts of the same type are now set using the same base fee level. Prior to 3 October, the fee for each contract was set on an individual basis. We also introduced a marketing period of one year for options and two marketing programmes for futures – one for futures on USD/RUB and the other for commodities futures, oil (Brent) and gold, to be more specific, – that reward the most active liquidity providers.

Let us turn to ultra-short-term bonds (slide 5). Another development I would like to share with you is the recent introduction of the so-called ultra-short-term bonds. We are strong believers in further bond market development and we are putting significant effort into

growing the Russian bond market. In October, we introduced a new product, one-day bonds, which combine the securities form and the money market nature. By doing that, we expanded available options for Russian banks to manage their liquidity positions. The new product allows market players to use on-exchange infrastructure for bond placements, clearing and settlement, which means there is no need to have bilateral credit lines. It also provides the ability to trade lower board lots as compared to the interbank money market, and has no interest rate risk and a limited liquidity risk compared to the traditional bond market. At the end of October, VTB Bank pioneered the product, meeting the demand of market participants for liquidity available after the close of the interbank money market. These participants can buy one-day VTB bonds, which are more profitable compared to other options – deposits with the CBR. Next day they receive their money back by noon through the exchange infrastructure. The programme started quite well as we saw increased demand for VTB bonds. Going forward, we see a strong potential in the development of this product when other banks start using it for liquidity management.

Now let us move on to our financial results. In Q3 2016, fees grew by 4% YoY, posting another quarter of growth, while operating income declined by 3% YoY due to a net interest income decrease of 8% YoY. The share of fees and commissions increased and contributed 44% of operating income in Q3

2016 vs 41% in Q3 2015. Operating costs grew by 19.8% YoY, mostly due to increased D&A expenses (+29.3%) and higher spending on maintenance of equipment and software (+47.8%). The cost to income ratio increased to 27.6%. Total EBITDA was RUB 8.4 bn, EBITDA margin was at a solid level of 77.9%. Due to a net income decline of 10% YoY and an increase in equity of 13% YoY, ROE fell by 5.7 p.p. to 21.8%. The cash position increased by 14.3% YoY to RUB 78.7 bn at the end of Q3 2016.

Now I would like to walk you through the markets to give you an overview of the key operational developments. FX Market: trading volume in the FX Market fell by 17% YoY to RUB 79 trln due to muted FX rate volatility vs the high base of Q3 2015. Spot trading declined by 23% YoY, and swap trading fell by 14% YoY. MOEX continued to enjoy a market share of more than 50% on the FX Market vs OTC trading volumes.

Money Market: Money Market trading volumes including REPO with the CBR and Federal Treasury with collateral management through NSD increased by 63% YoY to RUB 101.5 trln. The growth was mostly driven by the strong performance of REPO with the CCP, with its trading volumes growing by 158% YoY. The share of REPO with the CCP in total on-exchange REPO trading volumes reached 62%.

Depository and Settlement Services: the average amount of assets under custody at the

National Settlement Depository increased by 13% YoY to RUB 33.1 trln. The increase in assets under custody was driven by increased market capitalisation of the Equities Market, and new bond placements, both by the government and Russian companies.

Derivatives Market: trading volumes contracted by 5% YoY on the back of lower volatility, mainly in USD/RUB. Futures trading volumes were down 5% YoY primarily driven by lower activity in FX futures, while options volumes showed solid growth of 15% YoY. Futures on commodities continued to be one of the best performing products, posting a growth of 246% YoY in Q3 alone.

Fixed Income Market: trading volumes in the Fixed Income Market grew by 17% YoY in Q3 2016 and amounted to RUB 3.2 trln. Volumes of new on-exchange placements grew by 38% YoY. Volumes of corporate placements grew by 15% YoY, while new placements of government bonds grew by 93% YoY. Overall, lower interest rates and easier access of Russian corporates to public debt are beneficial for the new placements. Secondary trading volumes grew by 11% YoY driven by active OFZ trading, which is the result of the shift to the T+1 regime last year.

Equities Market: secondary trading volumes in equities declined by 10% YoY due to lower velocity on the back of subdued stock market volatility. At the same time, the retail investor base in the Equities Market continued to grow. The number of active retail investors grew by

17% YoY driven by the growth in Individual Investment Accounts and investors' search for yields amid lower deposit interest rates.

In Q3 2016, fee and commission income across all of our markets grew by 4% YoY and reached RUB 4.7 bn. Fees and commissions from the Money Market grew by 22% YoY. The Money Market contributed 25% of total fee and commission income. Fee and commission income from FX Market declined by 19% YoY, consistent with the decline in the FX trading volumes. The Derivatives Market brought around 10% of total fee and commission income and showed growth of 8% YoY. Fees and commissions from the Fixed Income Market increased by 22% YoY driven by growing secondary volumes and active new placements in the lower interest rate environment. The Equities Market experienced a decline of 13% in fees and commissions on the back of lower trading volumes. Income from depository and settlement services grew by 8% YoY thanks to the higher volume of assets under custody, which increased by 13%. Other fee and commission income was up by 24% YoY and reached RUB 468 m thanks to an increase in listing fees (+67% YoY), higher sales of software and information services (+20% YoY), and increased revenues from information services (+6% YoY).

Interest income: our investment portfolio declined by 28% YoY due to lower average market participant balances placed with NCC, especially client balances denominated in

rubles and in dollars. On average in Q3 2016, around 50% of client balances were denominated in euros and 34% in dollars, with most client balances coming from FX Market participants. The average effective yield of the investment portfolio increased to 3.1 p.p. from 2.4 p.p. in the same period last year thanks to the higher proportion of ruble assets and gains from security sales. Interest and other finance income declined by 8% YoY to RUB 6 bn due to the contraction of the investment portfolio, which was partially offset by the change in its currency composition towards ruble investments.

Operating expenses: OPEX increased by 19.8% YoY and amounted to RUB 2.9 bn due to the growth in administrative expenses associated with implementation of the CAPEX programme. Administrative expenses grew by 32.6% YoY driven by increased D&A expenses and higher spending on maintenance of equipment and software, which was put into operation in Q2 and Q3 2016. Personnel costs increased by 8.4% YoY to RUB 1.4 bn due to higher payroll taxes and selective salary increases. Headcount stayed at the same level as a year ago. In Q3 2016, it was 1,634, and one year ago it was 1,640. Personnel costs accounted for 48% of total costs. Overall, the 9M costs growth was 11.1%, slightly below our FY guidance of 12–14%.

That concludes our opening comments and now I would like to open up call for any

questions. Thank you very much for your attention. We are ready to take questions.

OPERATOR

Thank you. Ladies and gentlemen, we will now begin the Q&A session. As a reminder, if you wish to ask a question, please press “*1” on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the “#” key. Your first question comes from Svetlana Aslanova. Please go ahead.

SVETLANA ASLANOVA – *VTB Capital*

Good evening. I have a couple of questions to clarify something that you said before. On the effective yield on your investment portfolio: you said that this increase in the effective yield was due to a higher proportion of rubles and gains from securities sales. Shall we then assume that, given all being stable in Q4, this effective yield may go down, if there are no gains from AFS (available-for-sale) securities posted during the quarter? That will be my first question. The second question is on your personnel costs. You mentioned that the increase was due to salary increases. Within your guidance for the total OPEX growth of 12–14% for FY 2016, what would be your guidance for the personnel costs growth? Thank you.

EVGENY FETISOV – *CFO, Moscow Exchange*

Thank you for the questions. Regarding the question on the effective yield, if we have no sales of this securities portfolio, no other changes in the composition of the portfolio and no changes in the interest rates, then yes, that would imply a lower effective yield as we would only get the interest income. That could be seen from our reporting.

On the personnel costs, we do not have any guidance for the separate line, however, the selective increases, which we have mentioned, would normally account for 3–4% of the total personnel costs growth. We aim to keep costs at the below-inflation level for the personnel as well. That is what we have been doing in the previous years and 2016 should not be an exception.

SVETLANA ASLANOVA – VTB Capital

Okay, thank you very much.

OPERATOR

Thank you. Your next question comes from Armen Gasparyan. Please go ahead.

ARMEN GASPARYAN – Renaissance Capital

Thank you, gentlemen. This is Armen Gasparyan from Renaissance Capital. My first question is on the new tariff structure on the Derivatives Market. What magnitude of increase in the blended rate should we anticipate as a result of this new tariff

structure? The second question is whether this trading gain on sales of AFS securities should lead to a sharper decline in the effective yield on the ruble balances in Q4. I understand you replaced the bonds with low-yielding bonds. The third question is to clarify the following. I understand that you charge clients who place Euro balances with you. Is this charge classified as an interest income or a fee income in your financials? Thank you.

EVGENY FETISOV – CFO, Moscow Exchange

Answering your first question on the yields, we expect that there will be a meaningful increase in the effective fees and commission on the Derivatives Market. Judging from the October data, the effective yield could increase as much as 50%. That is what we are seeing right now. Again, this is just one-month data, so we need to see how that translates into the actual numbers going forward. Again, it depends on a) the structure of trading between different products and b) the share of scalper deals, or deals with rebates. But so far, I would say, the impact is meaningful.

On the portfolio, there has been some reshaping of the securities portfolio or changes in the securities portfolio performed by the Treasury and, as a result, some realisation of the P&L, which was previously reflected in the capital on our balance sheet. If you look at the interest income line, I think we should say again that this is a normal level that we will see

this quarter and the interest rates are still reasonably high. So, we will just take the market rate which is prevailing right now. I guess you can calculate it based on the Q3 numbers.

ARMEN GASPARYAN – *Renaissance Capital*

Okay.

EVGENY FETISOV – *CFO, Moscow Exchange*

On Euro balances, this number is not seen in reports. It is just netted against the fees and commissions that we pay on the client balance.

ARMEN GASPARYAN – *Renaissance Capital*

Thank you. Evgeny, one more question: are there any updates on the retail investor classification initiative by the CBR?

EVGENY FETISOV – *CFO, Moscow Exchange*

There has been a discussion with the professional market community and the Russian National Association of Securities Market Participants (NAUFOR), so it looks like the overall requirements are getting softer or not as strict as they have been before. Basically, all the existing clients will continue to operate as they did. As for new clients, they

will be classified or, say, put into different buckets. They will be able to access all instruments after passing an online exam on the MOEX's website, so we will be acting as a neutral party in the overall scheme. Again, this is a preliminary view of the discussion. After passing this exam, they will be able to access required instruments. However, the idea is to let them manage risks in a proper way, so that they can trade for a longer period and gain profit from their investments.

ARMEN GASPARYAN – *Renaissance Capital*

Right. But would that be fair to say that as of now you do not expect any material impact on your financials from that?

EVGENY FETISOV – *CFO, Moscow Exchange*

In that respect, that will be a reasonable assumption to make.

ARMEN GASPARYAN – *Renaissance Capital*

Thank you, Evgeny.

OPERATOR

Thank you. Your next question comes from Andrey Klapko. Please go ahead.

ANDREY KLAPKO – *Gazprombank*

Hello, Evgeny and Sergey. Thank you for your presentation. My question will be about the average fees and commissions across the lines. I noticed that the average fees have dropped across all the key segments in Q3 2016 – equities, bonds, Money Market and FX Market – and that was the first time I saw this happen. Are there any specific reasons behind that? Should we expect the average margin for fees and commissions to drop further or is it just a coincidence? Thank you.

EVGENY FETISOV – *CFO, Moscow Exchange*

Thank you for your question, Andrey. There are no changes in the actual fees and commissions. Most of the changes are the changes in the structure of instruments in a particular product class, e.g. between swaps and spots or futures. Actually, there has been some shortening of the REPO terms. I can look up the numbers, but I think it has come down from 3.9 days to 3.2 days on average [versus Q2 2016], resulting in a lower effective yield. For REPO, we also had a higher base last year, with one-year longer-term REPO deals outstanding, which affected the effective yield throughout 2015. Without that, the picture would look, I would say, more normal. Otherwise we shouldn't be expecting any major changes in the infrastructure.

ANDREY KLAPKO – *Gazprombank*

Thank you very much, Evgeny. Very much appreciated.

OPERATOR

Thank you. Your next question is coming from Anil Sharma. Please go ahead.

ANIL SHARMA – *Morgan Stanley*

Hi, guys. I am not sure I completely understood the derivatives pricing. If we take the value traded for Q3, what would the revenue number be given the new pricing structure?

EVGENY FETISOV – *CFO, Moscow Exchange*

I am sorry, Anil. I am not sure I understand the question. The actual changes in the fees came into effect on 3 October. They will not be applied retroactively.

ANIL SHARMA – *Morgan Stanley*

Sure, I understand that. What I am trying to gauge is the percentage change potential to your revenue – whether it is up or down. In Q3, the value traded in the Derivatives Market, I think, was RUB 403 bn. If you apply the new pricing structure to that value traded, what would the revenue number for derivatives be?

EVGENY FETISOV – *CFO, Moscow Exchange*

I do not have the numbers in front of me right now. What we see is that the effective yield on the Derivatives Market for the first month after the changes is more than 50% higher than in the previous month. That should give a good sense of the effect on the market.

ANIL SHARMA – *Morgan Stanley*

Okay, I understand. That's helpful. Thank you.

OPERATOR

Thank you. There are no further questions on the phone lines. Please continue.

OPERATOR

We have more questions coming through. The next one is coming from Andrey Pavlov-Rusinov. Please go ahead.

ANDREY PAVLOV-RUSINOV – *Sberbank CIB*

Good afternoon, gentlemen. Thank you for the presentation. I have a couple of questions. First, I see that you have spent RUB 2.6 bn on CAPEX in 9M 2016. Can you give us an update on your FY guidance with this respect and maybe your guidance for the next year, if you have any view on that? The second question is basically a follow-up on the derivatives pricing change. We have seen a drop in the derivatives volumes in October. I understand it is just one month but still the drop was substantial, more than 20%. Do you

attribute it to the implementation of the new tariff structure or is it just a volatility effect? Have you run any sensitivities on how the new pricing structure would affect the trading volumes?

EVGENY FETISOV – *CFO, Moscow Exchange*

As for the CAPEX guidance that we have been given recently, the last number that we have announced was RUB 3.6 bn. I would say it is likely to be slightly less but no more than RUB 3.6 bn for this year. For the next year, we have been discussing the number with investors and it is on the scale of RUB 2.5–3 bn. I think we will aim to stick to that number so that our CAPEX is within the D&A number.

As for the Derivatives Market, we think there are two factors. One is the overall lower volatility in the underlying assets. That is one factor affecting the trading volumes in derivatives. The other one is that high frequency traders may be readjusting their algorithms, and that may affect the volumes, although we do not have a precise number saying that we know by how many percentage points the change in the trading volumes could be attributed to the changes in the fee structure. Overall, we think the market will adjust and, with the return of volatility, we will see an increase in the fees and commissions and presumably trading volumes as well.

ANDREY PAVLOV-RUSINOV – *Sberbank CIB*

Okay, that is clear. Thanks.

OPERATOR

Thank you. Your next question is coming from Ivan Kachkovski. Please go ahead.

IVAN KACHKOVSKI – *Deutsche Bank*

Hello, gentlemen. I have a question about the interest income. We see that the interest income alone, without gains from securities, is RUB 5 bn for the quarter. What is the breakdown between the ruble and FX parts within that interest income? Not in the funds but the exact income. Thank you.

EVGENY FETISOV – *CFO, Moscow Exchange*

I am afraid I do not have this number handy, so we will need to talk to you offline. We normally do not disclose it as a split. As you may remember, we have both securities and swaps in our portfolio. So there is no clear split between a particular instrument and the interest income. We definitely know how much we get from a particular security but then there is a shift between the currencies paid on the side of the swap deal that we take.

IVAN KACHKOVSKI – *Deutsche Bank*

Clear, thanks. Just one more question about the OPEX growth guidance for the year. Does it still stand unchanged?

EVGENY FETISOV – *CFO, Moscow Exchange*

We still look at 12–14%. I think we will stick to that number for now.

IVAN KACHKOVSKI – *Deutsche Bank*

Okay, thanks very much.

OPERATOR

Thank you. Your next question is coming from Nikita Blokhin. Please go ahead.

NIKITA BLOKHIN – *J.P.Morgan*

Thank you for the opportunity to ask you a question and congratulations on good results. My question is the following. Could you please provide any update on interim dividend or whether one-off profit distribution is under consideration? Thank you.

EVGENY FETISOV – *CFO, Moscow Exchange*

Thank you for the question, Nikita. The new dividend policy provides for interim dividends, however, as of now, the Board has not discussed this yet. We will have a Board meeting in December. If that is up for discussion, you will know by that time.

NIKITA BLOKHIN – J.P.Morgan

Okay, thanks.

OPERATOR

Thank you. Your next question is coming from Svetlana Aslanova. Please go ahead.

SVETLANA ASLANOVA – VTB Capital

Thank you. I have a technical follow-up question. If we are talking about changes in the average REPO maturity on the Money Market, which segment of the Money Market actually contributed to this shortening? Would it be REPO with the CCP or inter-dealer REPO? I am trying to understand which segment we should follow up in the future in order to assume further changes in maturity.

EVGENY FETISOV – CFO, Moscow Exchange

Thank you for the question, Svetlana. The shortening of the REPO terms came from the REPO with the CBR. It was down from 11.3 to 7.6 days, whereas REPO with the CCP went down from 2.3 to 2.2 days [vs Q2 2016].

SVETLANA ASLANOVA – VTB Capital

Okay. So the main effect came from REPO with the CBR.

EVGENY FETISOV – CFO, Moscow Exchange

That is correct.

SVETLANA ASLANOVA – VTB Capital

Thank you.

OPERATOR

Thank you. There are no further questions on the phone lines. Please continue.

SERGEY KLINKOV – Director of Investor Relations, Moscow Exchange

Alright, if we have no further questions at this moment, I think we may conclude the call. Thank you everyone for participating, I hope we have managed to cover all the topics that you have been interested in. If not, please feel free to follow up. Just call me directly or send me an e-mail. Thank you once again for your participation.