# MOSCOW EXCHANGE

## 4Q AND FY 2018 IFRS RESULTS

**March 6, 2019**

**Moscow Exchange speakers:**

- Max Lapin, CFO
- Anton Terentiev, Director of IR

**Participants asking questions:**

- Andrew Keeley, Sberbank CIB
- Andrey Klapko, Gazprombank
- Sergey Garamita, Raiffeisen Centrobank
- Mikhail Shlemov, VTB Capital
- Andrey Pavlov-Rusinov, Goldman Sachs
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**Anton Terentiev:**

Good afternoon, everyone, and welcome to Moscow Exchange's FY and 4Q 2018 IFRS Results Conference Call. As usual, after the prepared remarks, we will have a Q&A session. Today, we have on the call our CFO, Max Lapin.

Before we start, I would like to remind you that certain statements in this presentation and during the question-and-answer 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 should have received our press release containing the results for 4Q and FY 2018.

And I will now hand the call over to Max Lapin. Max, please go ahead.

**Max Lapin:**

Thank you, Anton. And thank you, all, for joining us today to discuss Moscow Exchange's financial results.

Let me start with a summary of deliveries on strategic business initiatives since the beginning of the fourth quarter. *First, we expanded the product range.* Five new currency pairs started trading on the FX Market. These include the JPY/RUB pair and four USD-linked pairs. We also admitted three currencies to trading with partial collateral — the Kazakh Tenge, the Turkish Lira and the Belarusian Ruble – with settlement in Russian rubles. As a result, it is now possible to trade FX swaps on these currencies.

Options on US500 index futures were launched on the Derivatives Market. We introduced underlying futures earlier in 2018. In 4Q 2018, ADTV of the futures surged fourfold QoQ to exceed RUB 0.5 bln. It allowed us to expand the offerings to include options.

On the Fixed Income Market, an inaugural placement of green bonds took place. Going forward, MOEX intends to create a Sustainable Finance Sector on the Securities Market. The first ever securitized bonds backed by loans to small and medium enterprises, partially guaranteed by Russia's SME Corporation, were listed in the Growth Sector.

Sunflower seeds started trading on the Commodities Market, bringing the total number of traded soft commodities to six. Following the adoption of regulation for Russian-law ETFs, five such products have been launched. Four of them have emerged since the beginning of the fourth quarter. Three are tracking bonds, including Eurobonds, and another one is focused on U.S. technological stocks. Two analytical data products – Aggregated Netflow and TimeStamps – are now offered to HFT and algorithmic traders. On the Money Market, all market participants can now settle repo through CCP in foreign currency. Previously, this opportunity was only available to proprietary trading desks of credit institutions.

*Second, we continue to work on new services.* The technological development of the Marketplace platform was completed as planned. Adoption of the law that enables the use of the Marketplace platform is underway. As a part of the project, NSD will become a financial transactions registrar (FTR). In this capacity, NSD successfully recorded a test transaction.

MOEX's FX Market participants obtained access to global OTC liquidity pools in EUR/USD and GBP/USD through links with the key global FX trading platforms. The IQS, Indicative Quotation System, on the Derivatives Market became available to end clients of brokers, increasing its user base. Online client registration was opened on the Equities, Fixed Income and FX markets. It enables end clients to start trading minutes after opening an account with a broker or a bank.

NSD continued to test the applicability of blockchain to its services. It successfully applied this technology to repo with CMS. It also participated in a trial ICO that took place in the Regulatory Sandbox, acting as custodian for digital assets.

NSD's Price Centre started calculating theoretical fair prices for Russia's Finance Ministry Eurobonds. NSD also presented Transit 2.0 – a platform for exchanging financial documents and messages between banks and corporates.

*Third, we continue to develop the client base and partnerships.* Russian Corporates continued to raise debt on MOEX. In total, 111 corporate issuers tapped the market in 2018. 38 of them, more than 1/3, were new to the public bond market. They placed 324 bond issues, excluding overnight bonds.

Another welcome development was continued growth in the number of individual investment accounts, or IIAs. The number of IIAs almost doubled during the year from 302,000 last year to 598,000 at the end of 2018. As of the beginning of March 2019, the figure was even higher at 674,000, indicating growth acceleration.

The number of corporates on the FX and Money Markets reached 36 and 113, respectively. In total, some 80 corporates were onboarded during the past year.

MOEX signed MoUs with Shenzhen Stock Exchange, Shanghai Clearing House and China International Capital Corporation. These MoUs allow for the creation of trading links and cross-listing of instruments.

*Now I would like to give an update on the UCP.* In November, the second and final stage of UCP-related tariff increases came into force as planned. It applied to all accounts. Therefore, we now consider the UCP project fully delivered. We saw strong growth in usage in the last quarter when the share of fee income generated by the UCP accounts in total fee income more than doubled quarter-on-quarter and went to 19 percent. Of course, the onboarding process is still underway as some participants need to reconfigure their internal processes.

We conducted an analysis of November and December 2018 trading data to gauge the effects of the UCP on trading volumes, fee income, client balances and interest income. The tariff change effect is naturally in line with our original expectations. If we extrapolate November and December data onto the full year of 2018, the positive tariff effect would amount to 5.1 percent of full-year trading fees and commissions.

As for client balances, so far the UCP's key impact was on euro-denominated balances. The combined effect of UCP on USD and RUB balances was an outflow of around 5%. And we found that the annualized effect of higher trading volumes alone would have added 2.4% to full-year trading fee income. This positive effect of higher trading volumes on fees roughly cancels out the negative effect of lower client balances.

The magnitude of both the trading volume and client balance effects has been, so far, at about half our original expectation. But the important thing is that they were meant to cancel each other out and they do.

As we mentioned previously, the Derivatives Market is the centerpiece of the UCP project. As much as 40% of total Derivatives Market volumes and fees are now coming from UCP accounts. Statistically, a UCP user tends to increase its derivatives trading volumes by 16% after opening a UCP account. This highlights the success of the project. However, we have not found significant changes in FX and Money Market volumes by UCP uses. We will continue to assess this as we amass a longer period's worth of data.

*MOEX Marketplace.* Let me present the customer experience and functionality provided by the newly created retail deposit platform. It incorporates several solutions created by MOEX. The customer journey begins at a financial services aggregator's website, which allows customers to compare and select products. Upon the choice of a deposit, a customer proceeds to the MOEX Marketplace. We, therefore, receive leads generated through seamless integration.

Customers sign up using personal login names and passwords from the State Services Portal, gosuslugi.ru, which has more than 65 million users. The next step is a one-time biometric identification. This goes either through the National Unified Biometric system operated by Rostelecom or offline with the assistance of a courier.

The MOEX platform receives customers' personal data from the state portal at the part of the KYC (Know Your Customer) process. Then a customer and bank e-sign a term deposit contract on the Marketplace using the personal account interface. The Marketplace platform automatically provides banks with customer data and verifies contracts. Customers transfer money to the deposit account through the CBR's National Payment System and NSD's Payment System. We expect the CBR Faster Payment System, FPS, to connect in 2Q 2019.

The platform provides customers with transparent and detailed information on every transaction. Then the platform notifies customers and the FTR about the new deposits made. FTR's records are stored at NSD and covered by the DIA, the state Deposit Insurance Agency. Customers can access their deposits and make transactions using the Marketplace's personal account interface. These include additions, withdrawals or terminations. Essentially, the Marketplace platform serves as an internet bank and performs transactions in real-time.

The commercial launch is planned upon adoption of the law enabling the use of the Marketplace platform.

*Next slide, MOEX OTC platforms and solutions.* We continue to develop solutions tailored to the needs of our clients beyond electronic order books on the FX, Derivatives and Fixed Income Markets. These include standardized OTC derivatives cleared by the CCP, as well as OTC trading solutions for regular on-exchange derivatives, trading links with global FX liquidity pools for non-ruble FX pairs and the OTC bond market platform. Three of these four solutions were launched only last year, in 2018. Correspondingly, client onboarding continues. OTC initiatives focus not only on professional market participants but on corporates as well.

This brings us to the next slide: *Corporates on the FX and Money Market.* 2018 was the second year of MOEX providing corporates direct access to the FX and Money Market. This slide presents a clear trend in this area. MOEX attracted some 80 new corporates during the year across the two markets. The corresponding ADTV in the FX market was up 59% YoY, while deposits with the CCP surged 3.5x on the back of the total GCC market performance, which was up 3.7x.

We will continue to connect new categories of clients with the aim of increasing the total count by 50-60 more names. We are developing both on-exchange and OTC solutions to fulfill client's needs in a more comprehensive way.

This concludes the thematic portion of our presentation for today.

*And now let us move to financials.* In 2018, operating income grew 3.5% YoY. Fee and commission income increased 11.5% YoY, representing 60% of operating income in 2018 and 63% in 4Q 2018.

Net interest and finance income, NII, declined by 7.1% YoY in 2018, but core NII excluding realized gains and losses on the investment portfolio was only down by 2.9% YoY, signifying its stabilization.

Operating expenses, excluding provisions, increased 7.6% YoY. At the beginning of 2018, we adjusted amortization schedules for particular intangible assets. This resulted in an additional amortization expense for the year of RUB 0.3 billion. Without this effect, OPEX growth for the year would have been only 5.1%.

Among other accounting changes that took place in 2018 was the introduction of IFRS 9, which led to the creation of allowance for expected credit losses on our securities portfolio. Movements in this allowance added RUB 118 million to our operating income for the year. In 2018, we also recognized 2 instances of one-off expenses. In particular, in 2Q 2018, we recorded a one-off expense provision related to a lawsuit filed by a bankruptcy manager of a defaulted market participant. After winning the cassation court in November, we made a partial reversal of the original provision reducing it by 75%, or by RUB 655 million.
EBITDA for the year adjusted for the IFRS 9 effect and one-off expenses increased by 2.2% YoY. The EBITDA margin was 71.9%. Net income adjusted for the amortization increase, IFRS 9 effect and one-off expenses added 2.5%.

Annual fee income growth came in at 11.5%, above the 4Y CAGR. The fee growth was delivered in a cost-efficient way, as the cost-excluding-D&A-to-fee-income ratio declined. The calculation does not include one-off operating provisions.

In 2018, we saw increases in every major fee income line. Among stand-alone business units, the Money Market, as well as the Depository and Settlement Services, made the biggest contributions to fee income in absolute terms, yet the Equities and Derivatives Markets showed the highest growth rates in percentage terms. As a result, fee income remained well diversified.

In 2018, NII declined 7.1% YoY. However, stripping out the effect of realized losses from revaluation of the investment portfolio, the core NII declined only 2.9% YoY. The average funds available for investment declined by 10.5% YoY.

*Money Market.* 2018 Money Market fee income increased 13% YoY, despite a slight decline in trading volumes on the back of lower activity in interdealer repo and repo with the CBR. Growth in trading volumes of GCC repo and a slight extension of the average repo term supported fees.

In 4Q 2018, fees and commissions increased 13% YoY, while trading volumes were up by 8%. Among the factors that supported the effective fee in the market were the growth of the GCC repo, extension of average repo terms and the UCP-related tariff increase for all types of repo with the CCP that took place in November. On the flip side, we had some negative IFRS accruals from longer-term deals that mitigated the positive impact.

The average repo term in 4Q 2018 was 3.8 days, which is 0.8 days longer than in 4Q 2017.

*Depository and settlement.* In 2018, income from depository and settlement services added 8%, whereas assets on deposit grew by 16%. The discrepancy in growth rates was mostly due to repo with the CMS through NSD, where volumes more than halved in 2018. This led to a decrease in fees from clearing and collateral management services.

In 4Q 2018, fees increased 14% YoY, while average assets on deposit grew 12% YoY. Unlike the rest of the year, in the last quarter we observed healthy YoY growth in fees from repos with CMS, despite lower trading volumes. The reason was an increase in the average repo term.

*FX Market.* Annual fees from the FX Market were up 4% against flat trading volumes in 2018. In 4Q 2018, the picture was similar: fees increased 5% YoY and overall trading volumes were nearly unchanged. The structure of trading volumes shifted in favor of the spot segment, which saw volumes advance by 11%. Swap and forward volumes declined.

In 4Q 2018, we continued to observe elevated activity in non-USD pairs. For instance, EUR/RUB volumes added 21% YoY.

*Let us now look at IT services, listing and other fee income*. Income from this segment increased by more than 21% in

4Q 2018, and a similar increase was reported for the full year.

In 4Q 2018, listing fees declined 7% YoY as the average issue size in the primary bond market continued to grow. Data sales increased 2% YoY, while sales of software and technical services added 21% YoY. Other fee and commission income increased more than twofold YoY; the growth of this line was explained by strong growth of fees from the Commodities Market, which in the fourth quarter of 2018 made up more than 75% of other fee income.

*Derivatives.* The Derivatives Market was one of the fastest-growing segments in 2018. Thanks to the improvement of the mix, fees increased by 15%, while trading volumes added 6%.

4Q 2018 saw 24% growth in trading volumes and a 20% increase in fees. The result incorporates the shift towards commodity and single-stock derivatives. The full-fledged introduction of the UCP had a positive effect on trading volumes and commissions from the Derivatives Market. However, negative IFRS accruals from longer-term contracts negated the positive impact on the effective fee level.

*Fixed Income Market.* In 2018, the Fixed Income Market saw an increase in fee and commission income of 10%, while volumes were up by 28%. In 4Q 2018, however, trading volumes were down by 4%. This was due to lower secondary trading volumes. Quarterly fee income declined 26% YoY on the back of lower trading volumes and a high proportion of shorter-term instruments in the primary market. The latter included corporate commercial paper and central bank bonds.

*Equities Market.* Equities Market fee income for the year increased 20% on the back of strong trading volumes. In 4Q 2018, fee growth was 14% and trading volumes were up by 18%. Higher equity price levels supported trading volumes.

In the last quarter, as well as throughout 2018, we observed a continuing shift of trading volumes of dual-listed stocks to MOEX. By way of illustration, in 2018 MOEX's share versus LSE was 63%. A year earlier, that number was at 58%.

*Operating expenses.* In 4Q 2018, OPEX increased by 7.8% YoY. This was slightly above the growth for the first nine months of the year due to seasonality. The year-over-year OPEX growth was largely driven by D&A, including the previously mentioned change in amortization terms. Professional services, which includes storage cost of the Soft Commodities Market also increased at a higher rate than other OPEX lines. Personnel cost increased by 7.9% YoY.

Total OPEX adjusted for the change in amortization schedule was up by only 5.6% in 4Q 2018.

*CAPEX and OPEX guidance.* CAPEX for 2018 was RUB 2 bln, right at the lower end of our guidance range. In 2019, we expect total CAPEX in the range of RUB 2.4-2.7 bln, roughly evenly split between maintenance and development. The Marketplace, our single biggest project for 2019, is penciled in at around RUB 0.35 billion.

OPEX growth for the full year 2018 came within the original guidance of 7-9% and closer to the lower end of that range. In

2019, we expect expenses to grow 9-12%. This will include organic growth of 6 to 7 percentage points spurred by increases in VAT and social charges.

Another 2-3 percentage points will come from ongoing projects such as the development of services for corporates, soft commodities and bond market development, what we call bondization.

On top of that, 1-2 percentage points will be represented by new strategic projects such as the Marketplace and individual pension capital.

Before turning to your questions, I would like to touch on the dividend decision. The Supervisory Board today voted to recommend the DPS of RUB 7.7 per share. This constitutes a payout ratio of 89% of the reported net income for 2018. I hope you all are reasonably happy with this decision. Thank you.

**Anton Terentiev:**

We are ready to accept questions.

**Operator:**

The first question comes from the line of Andrew Keeley. Please go ahead.

**Andrew Keeley:**

Good afternoon. Thank you for the call. I have a couple of questions. First of all, on your capital position of NCC, can you give us an update on what your target minimum capital level is for 2019? Thank you.

**Max Lapin:**

The NCC capitalization (N1 CCP ratio) as of 1 January 2019 stood around 150% of its regulatory minimum. The regulatory minimum is 100%. The comfort level introduced by the Supervisory Board is 120%. So that means NCC is decently capitalized. Looking ahead to the year, we think it will be around that number, give or take.

And the second question is?

**Andrew Keeley:**

Sorry, Maxim, do you have a ruble number? I mean, before you gave a RUB 55 billion target for year-end '18. Do you have a similar ruble number for this year?

**Max Lapin:**

Yes, we do. Let me just double-check it quickly. I'll be back in a minute. But let me take the second question first.

**Andrew Keeley:**

OK, sure. You mentioned, basically, kind of strong and sustainable fee income growth. And I'm just wondering, looking at trading volumes so far this year, they've been pretty weak across the board. And I'm just wondering, does this concern you at all in terms of your thoughts for the fee income outlook? Thank you.

**Max Lapin:**

Not all volumes are created equal. Let's say, while we see declines in repos with the CBR (the repos with the CBR are among the cheapest volumes that we can get on the repo market), volumes of more expensive products surge. The same thing is happening on the Derivatives Market, where volumes of single-stock and commodity derivatives, which are the most expensive of all, are picking up. A relatively similar thing is happening in the FX Market where we have seen the spot volumes perform better than swap and forward volumes. That means that even if the unweighted sum of all volumes is decreasing, the product mix change is positive.

Speaking about the NCC capital position, the NCC capital position as of 1 January 2019 was at RUB 65.7 bln. We think that it will stay roughly the same throughout the year. The capitalization of NCC is adequate at the moment.

**Andrew Keeley:**

OK. Thank you. And just a final question. In terms of your depository and settlement income, that was a strong number, it seemed, in the final quarter. Do you see this strong growth as sustainable? And maybe could you give us a bit more color on the main drivers behind that?  Thank you.

**Max Lapin:**

I will take the first part of the question and then Anton will add the color. Overall, depository and settlement fees are a function of the size of assets in the economy, but some fluctuations may occur. Longer-term, I would be looking at depository and settlement as the function of, let's say, trading volumes themselves on Moscow Exchange.

Anton?

**Anton Terentiev:**

Yes, Andrew, so you are looking at the effective fee from depository and settlement and you're probably wondering why it's a little bit higher than expected. So, it's linked to repo with CMS through NSD. It's one of the business lines that remained muted throughout the year, but in the second half of the year, volumes somewhat rebounded. And there, tariffs work in the same way as on the on-exchange Money Market, meaning that fee for a transaction equals the 1-day tariff rate multiplied by the term. And we observed the term increase in the CMS repo in the fourth quarter.

And as for sustainability in this particular line, we analyzed the structure and we found out that in 3Q 2018 and in 4Q 2018, the structures of the demand, structures of this market were quite substantially different. So, I would not be relying too much on the continuation of the CMS repo performance.

**Andrew Keeley:**

OK. Thank you very much. Thank you.

**Operator:**

Thank you for your question.  Your next question comes from the line of Andrey Klapko. Please ask your question.

**Andrey Klapko:**

Good day, gentlemen.  Thanks for the call.  I would be thankful if you could elaborate on your strategy of the investment portfolio management in 4Q, considering the volatility of the rates and volatility on the bond markets. I noticed that overnight deposits grew quite a bit on your balance sheet, while investments in securities have dropped. So was it an effect of the volatility of the markets or something else? And I would also be thankful if you could answer, how did you manage the inflow of the euro-denominated client funds in the period? Thanks.

**Anton Terentiev:**

Look, Andrey, broadly speaking, the approach is unchanged. All these things we have seen before. We had a set of measures, a set of tools for every currency. Plus, we utilize FX swaps to optimize our allocation. As for inflows, depending on the timing of these incoming funds, we can either allocate them to the interbank market or into securities. No miracle has occurred, and the strategy is unchanged.

**Andrey Klapko:**

OK. And what was the reason for this healthy growth of overnight deposits on your balance sheet?

**Anton Terentiev:**

On the balance sheet, you're seeing just a snapshot for one day. Things are changing every day. We have to look at averages, and for the average, I can tell you that approach is unchanged. But on any particular date, including the end of the year, you can see fluctuations. But they average out throughout the month or throughout the quarter.

**Andrey Klapko:**

And the second question is about the average fee margin on the equity side: it was down a little bit in 4Q. Was there any particular reason for that?

**Anton Terentiev:**

For equities, it is usually linked to the market structure. Sometimes we have slightly more institutions that pay higher fees. Sometimes, we have a little bit more retail activity, sometimes not. Sometimes, we maybe have a little bit more high-volume or high turnover traders. So, I can tell you that this fluctuation of equity effective fees is within the bounds you've observed over the last several quarters. So, no particular drivers there. It's just volatility.

**Andrey Klapko:**

Okay, thanks a lot.

**Operator:**

The next question is from the line of Sergey Garamita.

**Sergey Garamita:**

Yes, thank you, everyone, for the presentation and congratulations on the improved dividends. I have two questions. My first question pertains to this dividend issue. The dividend of RUB 7.7 per share: does it imply the same risk scenario, which implies the same amount of cash reserves at NCC in case of new sanctions? And can we see any risks throughout 2019 for lowering dividends, in case of the sanctions? The same issue as in September 2018. Could we see something like that happen?

And my second question regards the UCP guidance. On the slide, you basically gave an extrapolated effect from higher volumes of like 2.4% for the full year. Can we take it as a full-year guidance for 2019 from UCP? And how does it fit the trading dynamic throughout like January and February 2019? Basically, we saw a decline in February statistics.

**Max Lapin:**

Thank you, Sergey. Going back to the dividend decision logic. As per our dividend policy, we are looking into a relatively simple, far more simplistic formula for assessing the size of the potential dividend. Let's take net income, let's see whatever CAPEX we've outlined for this year, plus whatever potential risks are out there, reinstated by the D&A we had for the year, and some adjustments, if we are planning strategic projects or deals. This roughly drives us to a number pretty much in line with the proposed dividend amount. So that's the logic, how it has been calculated. If you compare that logic with the September decision, in September, we had been anxious about the anticipated sanctions, about those that were anticipated in November. They didn't quite happen. So, our NCC is quite capitalized. In September, we thought of it as of postponing the dividend until the end of the year. Now we’re paying back in full, including what we might have expected from the September decision. So that means that the dividend payout resembles what it was last year. And it just confirms my statement earlier that NCC is decently capitalized for the existing stress test scenario we talked about so much during the fall.

Now getting back to the UCP question of 2.4% volume impact, the UCP works in the following way: We're looking into the behavior of those who adopted the UCP and those who did not. We see that those two cohorts behave differently. The volumes effect that we extrapolated here is just from two months of trading in November and December after we had hiked up the fees. When we annualize the number, it is just for your convenience. But annualizing numbers from two months and using that as guidance would be unreliable. So, I would not be relying on that number as guidance for the year. I was talking about that number as outlining the impact of the UCP.

**Anton Terentiev:**

And I shall add that, we told, at least twice throughout the presentation, that the effect from volumes and the effect from declining client balances are netting each other out, or canceling each other out, on the P&L level. So, you'll get more or less the same result but a different mix between fees and NII.

**Max Lapin:**

So, all in all, that means that the UCP project could be quantified as 5% impact on the top line via pricing, while the mix between NII and fees and commissions is moving towards a more strategic business line of fees and commissions, which makes us kind of a more predictable exchange. But the magnitude of that switch or shift might be bigger when more participants adopt the UCP. I hope this answers the question.

**Sergey Garamita:**

Yes, thank you, but can I just clarify, do I get it clear that, basically, this 2.4% figure is just a bit of understatement, that the result could be even higher? Also, regarding this stress case scenario, do I get this clear that this stress case was basically mitigated, that's why we saw a dividend of RUB 7.7 per share? And, basically, if we see a similar scenario in the future, the dividend could be cut? Or do we assume that the NCC is packed to the fullest and whatever scenario there may be in the future regarding sanctions, the dividends would be stable from now on? Just to be clear.

**Anton Terentiev:**

Yes, regarding the 2.4% figure, I understand your view is correct. It's an extrapolation from November-December figures. As we mentioned, the effect from these two months was around half of the planned. And that corresponds to the degree of onboarding and to the degree of Derivative Market usage by UCP accounts. This effect will grow over time as more clients onboard, as more clients switch on to UCP. But it shows that it's been coherent with NII performance. So probably these two effects will grow but they will be synchronized to a major extent.

Now as for NCC capital, since the previous stress test, we accumulated profits. That's point number 1. Point number 2, before the dividend is distributed and this will happen upon its adoption by the AGM, the AGM will be in late April, we'll accumulate more profits on top of that, which makes us comfortable on capital adequacy side of NCC. Does that answer the question?

**Sergey Garamita:**

Yes, thank you.

**Operator:**

The next question is from the line of Mikhail Shlemov.

**Mikhail Shlemov:**

If I can have 3 questions or actually one-by-one. The first one, or actually continuing with the topic of UCP and actually moving to the part related to the ruble and the U.S. dollar client balances, which were so far affected by the tune of 5%. To what extent do you think we have seen the full effect of this balances dilution in your view? And given that so far they have been approximately 5% and you are estimating that the positive volume increase has been 2.4%, are you in general satisfied with the UCP project's impact on the P&L?

**Max Lapin:**

Wonderful question. OK. So, the impact of the UCP on the volumes of trading and the volumes of client balances is a function of the adoption rate of the UCP itself, which is not yet in full. So, what we have seen so far, the results approach the robust adoption that allows almost – let's say just below – half the volumes in the Derivatives Market to be traded from the single UCP account. So that adoption is already pretty high, but it could grow. That means that the positive effect on the volumes we have been talking about while answering the previous question and the negative effect of the client balances, they both could go up, which brings me back to the modeling we performed at the beginning of the project. At the beginning of the project, we went client-by-client, and double checked with clients whenever possible the potential expectation of the

UCP project's impact on their trading volumes and the client balances that they hold. In our model, we had those two effects almost equal to one another to the margin of error. What makes us happy about the UCP project is that the reality matches our expectations. So once the adoption of the UCP goes up, those two effects will continue to cancel each other out. But they are likely to be bigger. So, the impact on volumes might be bigger than what we mentioned before, and the impact on the balances might be bigger than what we mentioned before.

**Anton Terentiev:**

So, you might see – 5% might turn into 10%. But this will probably be the cap for this estimate, that it goes from 5% to 10%. Might go from 5% to 7%, to 8%, but probably 10% is the cap we see at the moment.

**Max Lapin:**

This brings us to the final part of your question. What's the impact of the UCP on the bottom line of the business? Let's say that, since the two effects are canceling out one another, it's roughly 5% of the fee and commission income – because the pricing [tariff increase] impact is around 5%. And we take the pricing impact home. It's our effective profit from the project. That's it.

**Mikhail Shlemov:**

OK, that's helpful. But just like, on the bottom line, it's rough and it brings me to the conclusion after listening to your explanations again, that the ultimate bottom line impact is likely negligible and we are getting just like revenue mix improvement. If I am getting you right?

**Max Lapin:**

Two things. We are getting the revenue mix improvement, higher fees and commissions at the expense of lower net interest income. But higher fees and commissions are also higher because of the 5% average impact via the pricing hikes.

**Mikhail Shlemov:**

OK, I think that's helpful. If I can move to the second question, and that's actually regarding the operating expenses and the revenue trends. Once I'm looking at your 2019 guidance, it seems like we are going to have another year of negative operating jaws with the cost-income ratio rising actually. How do we think about the longer-term dynamics of the cost-income ratio, operating efficiency in general… where should we see this trend normalizing?

**Max Lapin:**

That's an amazing question. I think I would like to take you back to slide 8 that we have in the presentation. That's one of the key slides, in my view as the CFO, because it shows, in a simplified form, the cash cost of fees and commissions, which have been improving all the time. When I go back to the slide you're talking about, slide 19, yes, it seems that we have a higher range than usual. That might be a little bit conservative or pessimistic. But look, the organic part of it is 6-7%, that's on the existing business as a base. What we have, or are likely to have, is expansion, let's say, in soft commodities.

And when I outlined the business of how the Soft Commodities Market works, I mentioned that around half of the revenues from soft commodities are pass-through costs. So, when the Soft Commodities Market expands, it generates for us a pretty neat margin, but half of the [reported] fee income are reimbursable, transferable costs, which drive up the cost base. So that means that costs might grow faster than you have usually seen before. Then, we are investing in a couple of strategic projects that will not quite deliver revenues in 2019 but are likely to be a way to tap into a way bigger market starting 2020. We usually do not capitalize all costs from the development of new projects because those are mostly software development costs, they are usually expensed right away. Other companies usually would have those 1 or 2 percentage points in the CAPEX, while in our case, some of that falls into OPEX.

I think that for this year, the operating jaws are likely to stay in the positive range, not be negative because that's our aspiration. We do not provide explicit guidance for fees and commissions because a lot of macro impacts are there. But our historical trend was in the range of, say, low double digits in fees and commissions. So, we are likely to still maintain that and continue with the positive operational jaws going forward.

**Anton Terentiev:**

Yes, and I shall add that, if you just compare the magnitude of the fees with magnitude of the operating expenses, then fees are like RUB 23-24 bln, and OPEX is like RUB 14.5 bln. Even if we assume for simplicity 10% growth in operating expenses, it's going to be extra RUB 1.4-1.5 bln. But if you assume a 10 percent growth on the fee level, that is going to bring you RUB 2.3-2.4 bln. So, this is how you can look at it. This is not a dramatic thing if OPEX goes up, let's say, 9 or 10%. Cost-income ratio, if you measure it against fees, will still be fine.

**Max Lapin:**

If I may take you back to slide 18: the total OPEX growth on the slide is 7.8% YoY. Two percentage points of that are just the amortization schedule change for intangible assets – namely, the client base, which is effectively goodwill from the merger back in 2011. So, it's a purely accounting change to speed up the amortization of the client base acquired during the merger. So that explains how we come to the adjusted total OPEX growth of 5.6%.

If I go one step further and take the Soft Commodities Market, the grain market out of this, because the grain market has reimbursable costs, which show up as both revenues and costs. We get revenues and then half of those revenues are actually a reimbursable, pass-through cost, then the total OPEX net of the Soft Commodities Market would be around, let's say, 5%. That shows our cost discipline.

I as the CFO have regular monthly reviews of all cost items that we incur here at the Exchange. And it's my personal goal and KPI to compress the costs the best I can. So, when I apply the range itself, it's kind of budgeted tolerance, but my personal KPI endeavor is to have savings on that budgeted tolerance.

OK, and I believe you had a third question as well?

**Mikhail Shlemov:**

Thank you very much for the explanation. So perhaps in terms of something which we can put into the model, perhaps, coming back to slide 8, to which you were referring in terms of the cost to fee income ratio. Perhaps you could share with us a target range of costs to fees which you are actually keeping in mind, not for 2019 even, but over the 3-year horizon?

**Max Lapin:**

OK, let me excuse myself here for one simple reason. As you know from the agendas of the Supervisory Board, we have been discussing the company strategy for almost a year already with the Supervisory Board. And it's ripe. We will be publishing the new strategy this year. So, in my guidance, there is an item, some impact of the new strategy that we are looking into. I think I'd be rather more ready to discuss this during the year, a little bit later.

As for the practicality of your model, I would look at the model of the business as it is now. You would look at positive operating jaws between costs and revenues, as they've been before. So the cost of 6-7% for the business as it is, while revenues growth is usually in low double-digits. Whatever costs are shown here are for the incremental revenues we are trying to achieve either this year with the Soft Commodities on top of what we had before, or in 2020, with projects like the Marketplace and individual pension capital.

**Mikhail Shlemov:**

OK, that's helpful. Thank you. And the last question is actually regarding the dividend policy. As you were already explaining the logic behind the dividend decision, is it right to assume that we should see a return to the interim dividend payment after the second quarter results this year?

**Max Lapin:**

Well, the dividend decision is the Supervisory Board's decision.

**Anton Terentiev:**

This has to be addressed by the new strategy as well. And that's how we shall think about it.

**Mikhail Shlemov:**

OK, when should we expect to see this strategy update to be published?

**Max Lapin:**

I cannot tell you the precise date so far. Definitely this year, though it might sound a little bit vague. I think earlier than later.

**Mikhail Shlemov:**

OK, will be waiting for an update. Thank you so much for your answers.

**Max Lapin:**

You're welcome.

**Operator:**

Thank you for your question. The next question is from the line of Andrey Pavlov-Rusinov. Please ask your question.

**Andrey Pavlov-Rusinov:**

Good afternoon, gentlemen. Thanks very much for the presentation and congratulations on the results and the dividends. I have several questions. First of all, I would like to understand the interest income dynamics and it would be great if you could highlight to us what we should expect in terms of the ruble yields of your portfolio given that, despite the increase in the market rates in 4Q 2018, we didn't see the same increase in your ruble yield, implied ruble yield, in 4Q 2018. So obviously, there is a lag in the repricing of your securities portfolio. So, should we expect, assuming there are no further rate hikes or rate cuts by the central bank, should we expect your effective ruble yields to go up in the first quarter or maybe in the second quarter?

That's my first question and then I have a couple of others.

**Anton Terentiev:**

Andrey, let me take that one.

On the ruble side, if you take the entire amount of rubles that we invest, which are client rubles and our own rubles, then out of this portion, maybe 40% is the money market instruments and another 60% will be securities. So, for money market instruments, repricing happens more or less simultaneously with the rate change. For the other 60%, there is obviously a lag like you have fairly pointed out. Plus, there are fixed coupon instruments and there are floating coupon instruments, with coupons sometimes being reset after the rate change. So, we have seen this lag before and will continue seeing this lag, but ultimately, all rates translate into the portfolio. That's how I can answer that question.

**Andrey Pavlov-Rusinov:**

OK. Thank you. And then the second question is about your OPEX guidance. Obviously, kind of appreciative of all the different factors. Can you maybe give us some more granular explanation, do you expect all these new effects and spending plans to kick in already from the first quarter or will it be unevenly distributed throughout the year, so the growth basically of the 9 to 12% should it be applied essentially equally quarter-wise or may be skewed to the second half of the year?

**Max Lapin:**

I'd rather plan like escalating through the year because not all of those initiatives are picking up simultaneously. So, I would allocate a little bit more for the second part of the year than the first part of the year.

**Andrey Pavlov-Rusinov:**

OK, clear. Thanks. And by the way, on some of the projects that you mentioned and undergoing ones, for example, the bondization, could you maybe highlight what actually you've been investing in at the moment, especially given the fact that the bond market seems to be weak on secondary trading volumes and whether you are making any efforts to reenergize the activity there?

**Anton Terentiev:**

So, this is about the OTC platform. That's on slide 5. So that platform was created at the end of the year 2018. And this platform will be developed further and will be upgraded further. And on Slide 5, we outline some of the plans that we see for this platform and this will require some investments.

**Andrey Pavlov-Rusinov:**

OK. And that should help the volumes in the Fixed Income Market, it will right?

**Anton Terentiev:**

This should help us tap into sections of the bond markets that we have no presence in at the moment. In particular, Eurobonds. So, we have discovered this year, and historically it’s been like that, that our electronic order books do not fit everybody. They are not universal solutions. Sometimes you have to introduce an OTC component to the offering. And as you see on this slide, out of these four OTC platforms, three were delivered this year.

And there are more coming up. So, for instance, we don't expect that, let's say, euro or dollar trading volume will be superior to the offshore market here on the Exchange. That's why we create those links. We also understand that sometimes a corporate wants to buy, let's say, $10 million, $20 million with rubles in one go, in one click, in one deal and doesn't want to wait to accumulate this amount in the market as the FX rate goes up and down. So, for that matter, we are thinking to develop RFS [Request for Stream] services there.

And the same applies to the OTC bond platform. Sometimes in less liquid instruments or, let's say, instruments which don't even have a listing on Moscow Exchange, you would like to stay anonymous while seeking for the matching party in the market, and an electronic order book does not allow you to do that all the time. So, this is the logic behind all of these initiatives.

**Andrey Pavlov-Rusinov:**

OK, thanks so much, that's really very clear. And I also have a small question about your client balances. Basically, you mentioned that the effect of the UCP is more pronounced in the euro client balances than the U.S. dollar or ruble ones. But essentially, we've seen slightly different dynamics in 4Q 2018 and also in January and February 2019. So, should we essentially treat it as some other factors, essentially clients optimizing their balances from U.S. dollars to euros aside from the UCP? So essentially those who are not in the UCP yet? So, there are, basically, conflicting factors?

**Max Lapin:**

Precisely.

**Andrey Pavlov-Rusinov:**

OK, then essentially you think that going forward, as the UCP adoption continues, the euro balances would be experiencing more impact, right?

**Max Lapin:**

Let's say that whenever we've been modeling on our side the sensitivity of balances, it turns out that the differential between interest rates on different currencies has the highest explanatory power. Surprisingly let's imagine the ECB hikes the euro rate. Euros get more expensive, therefore their use as collateral will have a higher opportunity cost. That means that euro balances will be optimized down versus other balances. That sensitivity is one of the highest.

We do not like to provide any guidance on client balances or their structure by currency. It's out of our control because, according to our collateral management policy, if you have euros, dollars, rubles, they are accepted, just haul them in and start to trade, they are major currencies, they are accepted. But whatever the structure is, the clients are smart, they are optimizing the opportunity cost of the collateral.

**Andrey Pavlov-Rusinov:**

OK, thanks a lot. And just a final small question. I think on the slides you mentioned that the effect on the costs from the commodities was about RUB 60 million in 4Q 2018 but what was the revenue contribution from commodities?

**Max Lapin:**

Net contribution from commodities was around like RUB 115 million [for 2018] off the top of my head, that's the net impact, net of transferable costs.

**Andrey Pavlov-Rusinov:**

OK. Thanks a lot. That's all my questions. Thank you.

**Operator:**

Thank you for your question. The next question is from the line of Svetlana Aslanova.

**Svetlana Aslanova:**

Yes, hello, thank you. I have a small question. On your slide 4, where you discuss the Marketplace, you mentioned that you are waiting for the adoption of the law enabling the use of this Marketplace platform. Could you please remind us when do you expect the adoption of this law?

**Anton Terentiev:**

Well, our best guess is the second quarter of this year.

**Svetlana Aslanova:**

OK, thank you.

**Operator:**

Thank you for your question. There are no further questions at this time. Please continue.

**Anton Terentiev:**

OK. Maybe we can wait for some 30 seconds if anyone has some clarifying questions and then we'll just wrap it up.

**Operator:**

As a reminder, it is "star" and "one" on your telephone if you wish to ask a question.

**Anton Terentiev:**

All right. Ladies and gentlemen, that concludes our call. Thank you very much everybody for active participation, for good insightful questions, and looking forward to reconnecting with all of you at our next conference call. Thanks a lot and have a good evening.