MOSCOW EXCHANGE

Q2 2020 IFRS results conference call

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Moscow Exchange Speakers:

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

Participants asking questions:

- Elena Tsareva, BCS Global Markets
- Andrey Pavlov-Rusinov, Goldman Sachs
- Pawel Wieprzowski, WOOD & Company
- Sergey Garamita, Raiffeisen Centrobank
- Mike Sell, Alquity
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- Florian Gueritte, LGM

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Anton Terentiev – Director of IR

Good afternoon everyone, and welcome to Moscow Exchange's Q2 2020 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 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 should have received our press release containing the results for Q2 2020. Our management presentation is available on the Company's website in the Investor Relations section.

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

Max Lapin – CFO

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

Let's talk about the delivery on strategic initiatives first. That is page 2. First, the Exchange continues to add new products. We observe continuous expansion of the local ETF universe. Five new Russian-law ETFs began trading since the beginning of the quarter, one of which we mentioned during the previous call. One of the newly listed ETFs tracks the Russian sustainability index. It is the first ETF with an ESG focus in our offering. It helps to broaden the range of sustainability-linked products. The global demand for such products is particularly strong amidst the pandemic. As a result, 41 ETFs with a total NAV of nearly RUB 70 bln, or roughly USD 1 bln, are now available on MOEX. We continue to observe the trend of secondary MOEX listings by Russian companies incorporated abroad. Petropavlovsk, the gold miner, and Mail.ru, the internet holding, joined the real estate developer Etalon in listing their DRs on MOEX in 2020. HeadHunter has announced the intention to follow suit later this year. On the Derivatives Market, we launched three deliverable futures on equities of Sistema, X5 Retail Group and TCS Group. The latter two underscore our ability to generate additional businesses around base assets that were brought in fairly recently.

Second, we continue to work on new services. An after-hours trading session (also called the "evening session") commenced on the Equities Market in late June. The total daily trading time for equities is now 13 hours 40 minutes. This brings retail investors' experience much closer to that of online banking. Today, all constituents of MOEX Russia Index trade in after-hours. We will address this topic in more detail a bit later in the presentation. Trading of all corporate bonds and Eurobonds was successfully transferred to T+ trading mode with positive implications for liquidity. A new analytical service showing the dynamics of intraday open interest by different client groups in the most liquid futures contracts became available. Moscow Exchange began calculating and publishing the Moscow Real Estate DomClick Index based on mortgage transaction data from Sberbank. The index tracks the weighted average price per square meter of Moscow residential real estate. Over time, it will become a benchmark for structured and hedging products, including futures contracts. MOEX completed the acquisition of a 17% stake in BierbaumPro AG, the parent company of OTC FX platform NTPro. We intend to consolidate a 100% stake in the company over a period of up to three years. The partnership between MOEX and NTPro will allow us to offer clients highly flexible and advanced FX trading solutions.

Third, we continue to develop the client base and partnerships. As of the end of July, the number of unique retail clients approached 5.7 million. A more recent figure is 5.9 million, which means that 2 million new clients have joined since the beginning of the year. The total number of Individual Investment Accounts (IIAs) has passed the 2.5 million mark. The number of corporate issuers on the Bond Market continues to grow. In Q2 2020, 66 corporates, including eight newcomers, placed 155 bond issues, raising a total of RUB 702 bln. Non-state pension funds are now able to conduct deposit operations on the Money Market. This allows NPFs to place their funds at market rates and benefit from the reliability of the central counterparty. GV Gold, one of the top gold mining companies in Russia, obtained direct access to the FX and Precious Metals Markets. As of today, it is the third gold miner that has access to the Precious Metals Market. We also observed Transit 2.0, a platform for exchange of financial messages and electronic documents, gaining popularity. 11 banks and 19 corporates are using it. To sum it up, in a nutshell, we are fully on track with executing our strategy that we announced in the last quarter of 2019.

Slide 3. MOEX listings of Russian companies incorporated abroad. We have long been working to accumulate liquidity across asset classes on this platform. The best example is winning market share from the LSE in dual-listed stocks. On top of that, we attract quite a number of secondary equity listings for de facto Russian companies originally incorporated abroad. 13 such names have been listed, and 12 trade on MOEX today. The 4 charts on the slide clearly show that local volumes help boost overall liquidity in the historical context. More recently, this trend has intensified as the additional three names I already mentioned joined us in 2020 and saw an immediate surge in liquidity. The two charts on the right show how quickly this process unfolds for newcomers. Beyond liquidity, certain equities have been included in our own indices as well as the MSCI Russia Index because of the secondary listings. These are obvious success stories, and other companies are looking to follow suit.

Slide 4. The evening hours on the Equities Market. On 22 June, the day of the longest daylight, the after-hours trading session commenced on the Equities Market. Initially, the 25 most liquid stocks were included. Since 3 August, all 38 stocks of the MOEX Russia Index have become available. Later this year, ETFs will also gain admission. Retail clients like the convenience of evening trading and account for 73% of our after-hours volumes, in line with expectations. That is why we are looking to extend the book building in the Bonds Market targeting retail audience onto evening hours as well. The share of the evening session in the total equities trading volumes is already meaningful and continues to increase, hitting 6% of overall volumes in the last week. The evidence of evening trading on the FX and Derivatives Markets suggests that the corresponding share in equities might increase further to the range of 8–19%. We are contemplating the launch of morning trading sessions in these two markets, addressing the time zones of Russia's Eastern regions as well as Asian clients. We are looking into that. Furthermore, on 24 August, i.e. three days from now, we will launch after-hours trading in a selection of 19 foreign stocks, all members of the S&P 500, with Apple joining later in September due to the upcoming stock split. This list will expand to 50 foreign stocks by the end of the year. We expect healthy demand from retail investors since trading and settlement will be conducted in rubles. It is a convenient option for domestic investors. Earlier this year, we already started repo operations in foreign securities denominated in both USD and KZT, which serve as a good precursor.

Slide 5. Strengthening the team. We have said on numerous occasions that resilience of the business model allows us to take advantage of the pandemic and strengthen the team with some long-awaited hires. On the IT front, MOEX recruited MDs of IT and digital platforms. Both are new positions, since IT was a part of COO extra duties until recently. The COO's additional assignment on top of his regular duties will be digital transformation of business processes. The NCC's risk management unit will get expertise from Rinat Kirdan who is bringing years of experience with ATON and Sberbank, and supervision from Eddie Astanin, the prominent CEO of NSD and now the CEO of NCC, who is known for his ability to deliver operational excellence. Maria Krasnova is his successor at NSD and a long-standing member of the team. Our strategy requires ongoing strengthening of best-in-class compliance practices, and Irina Grekova will be doing just that. She occupies a new position also. To bolster the position of internal auditor, we hired Evgeny Zhdanov from Raiffeisenbank. He will be monitoring and helping to develop new business processes. Alexey Khavin, the mastermind behind our net interest income, will utilise his global market expertise as Head of Group Treasury and assume command of international projects. Therefore, these HR moves allow MOEX to amplify advantages of our top management veterans, carving out more focused roles for them and bringing distinguished professionals into newly created positions - as per the strategy.

These developments come hand in hand with the new long-term incentive programme (LTIP). It fully and naturally aligns the interests of shareholders and the management team for the next five years. It is based on existing shares held by MICEX-Finance and has no embedded leverage, depends on financial performance and covers 70 key employees. It is worth a meaningful (yet still modest) 0.8% of market cap and produces no dilution to existing shareholders. I hope it provides a perfectly fitting answer to the persisting question of management motivation for years to come. On a separate note, a number of participants of the previous remuneration programme went in the money on their packages following the stock price increase. These obligations might be worth another 0.2% of market cap. Overall, our existing and future equity remunerations account for roughly 1% of the market cap, which is virtually equal to the holding by MICEX-Finance. Again, this means no dilution for shareholders.

Slide 6. Q2 summary of financials. Operating income grew 8.4% YoY, and fee income surged by 22% YoY, contributing to a higher F&C share. NII declined 10% YoY, although core NII decreased to a lesser extent, by 7.3%, both on the back of declining local and global interest rates. Operating expenses amounted to RUB 4.1 bln, growing 6.8% YoY. The recurring cost-to-income ratio decreased by 0.5 p.p. YoY. Adjusted EBITDA expanded by 7.4% YoY for a margin of 72%. Adjusted net income increased by 8.6% YoY. Adjustments in the form of other operating expenses nearly exclusively come from the release of IFRS 9 provisions created in Q1 2020 because Russia's CDS rates increase affected the FVTOCI bond portfolio. As we stated during the previous earnings call, it is a purely technical non-cash provision that was virtually reversed during this quarter.

Slide 7. Diversified fee and commission income. Overall, F&C income growth of 22% YoY rests on contributions by every business line except for the Fixed Income Market where the primary market underperformed. The Top 3 leading contributors in absolute terms were the Equities Market, the Money Market and ITSLOFI, the aggregate category containing an additional 0.2% fee above the ECB rate on client balances in Euro and Swiss francs introduced in January this year. The mix continues to become better diversified as the shares of the Money Market and Depository and Settlement Services, our two largest business lines in F&C terms, decreased by 2 p.p. YoY each. Overall, we achieved an all-time high quarterly F&C income for the third reporting period in a row.

Money Market. Next slide. Fee income from the Money Market increased by 14%, surpassing the RUB 2 bln mark for the first time ever. Trading volumes increased by 22%. The YoY underperformance of fees compared to volumes is due to IFRS adjustments and lower profitability of the Credit Market. The share of higher value-added CCP-based repos, including GCC, in total interdealer repo reached an all-time high of 90% in 1H 2020. A newly launched value-added GCC repo with the Federal Treasury started to gain ground as trading volumes reached almost RUB 0.5 trn during the quarter.

Now I will talk about some recent trends in the Money Market. The average on-exchange repo term increased by 15% YoY (as shown on slide 9) mainly due to an increase in CCP repo terms. GCC repo terms added 22% YoY. The aggregate position, also known as open interest, expanded during Q2 2020 approaching the RUB 4 trn mark. Aggregate position and average repo terms are positive factors influencing the Money Market fees, which are somewhat compromised by the growing share of non-CCP repo with the Federal Treasury.

On to Depository and Settlement Services. F&C from Depository and Settlement services gained 12% YoY. The main factor behind that is the 9.3% expansion of average assets on deposit at NSD. The growth was registered across all asset classes. The discrepancy between the growth rate of the F&C income and assets is the result of business lines beyond safekeeping. These auxiliary business lines do not exhibit a distinctive trend and produce a varying impact from quarter to quarter.

Now on to the FX Market on slide 11. FX market fees increased by 14% YoY in elevated volatility. Spot volumes added 31% YoY, while swap volumes contracted by 16%. The higher share of spot trading is a primary explanation of effective fee dynamics. The number of active clients approached 293,000 at the end of Q2 2020. It is a four-fold YoY increase, with retail clients being among key contributors to this growth. MOEX's Q2 2020 market share vs onshore OTC added additional 4.3 p.p. QoQ to reach 50%, as the demand for CCP services remains strong. The impact of corporates with direct access to the FX Market continues to grow as their ADTV expanded twofold YoY.

Slide 12, Equities Market. The Equities Market continued to perform strongly despite the volatility decline from the highs of Q1 2020. Fee income from the Equities Market rose 81% YoY, following a similar increase in trading volumes. The insignificant discrepancy between fees and volume dynamics was due to the tariff structure that provides incentives for higher volumes traded. We observed the same effect in Q1 2020. Therefore, a number of clients generated sufficient volumes to get into a lower tariff bracket. Volatility nearly tripled YoY. Velocity of trading volumes almost doubled YoY, largely contributing to the volume growth. It comes as no surprise that participation of retail clients is growing on the Equities Market contributing to the velocity increase. MOEX's market share growth vs the LSE in trading of dual-listed stocks also improved by 10pp YoY, reaching an all-time high of 77%.

IT services, Listing and Other Fee Income (ITSLOFI) on page 13. The line added a solid 49% YoY. Listing fees grew by 31% as clients paid extra fees for accelerated placements and did pre-registration of issues. Information Services fees increased by 14% supported by contributions from the audit of information use and weakening ruble. Sales of software and technical services were up by 8.4% YoY. As in the previous quarter, other fee and commission income was largely driven by additional fees for recording individual clearing collateral on EUR and CHF client balances. These fees were introduced at the beginning of the year. During the quarter, additional fees produced RUB 171 mln of income. However, the line would have still expanded a respectable 23% even without these new fees.

Derivatives Market, page 14. The Q2 performance of the Derivatives Market resembled that of Q1 since the factors in play remained the same. Fee income from derivatives increased by 30% YoY. Trading volumes of on-exchange contracts were up by 42% YoY on the back of elevated volatility. The main growth driver for volumes both in absolute and relative terms were FX futures adding 81% YoY. Open interest fell by 11% YoY. The discrepancy between volumes and fees is yet again due to a shift in the mix in favour of less profitable FX and index derivatives, IFRS adjustments and a lower share of options.

Fixed Income Market. The Bond Market was the only business line showing a decrease in fees YoY, although it is still an 8% QoQ improvement. We observed an 18% YoY increase in secondary market activity. Primary placements were down 14% YoY due to the uncertain economic outlook. However, we hope that by the end of Q3 2020 or early Q4 2020, DCM activity will pick up and the primary market will start performing amid the low interest rate environment. The discrepancy between the fees and volume dynamics comes from a lower share of primary market volumes and a slightly lower fraction of corporate placements in the primary market structure.

Interest and Finance Income, slide 16. NII decreased by 10% YoY in line with expectations. Excluding the effect of portfolio revaluation, core NII was down by 7.3% YoY. The negative factor of a decline in interest rates offset the corresponding growth of USD and RUB client balances following the spike in market volatility. Towards the end of the quarter, client balances returned to normalised levels. The effective yield predictably narrowed by 0.6 p.p. as the investment portfolio added 22% YoY. The client funds' currency mix changed in favour of USD due to the additional fees on EUR balances. As you can see from the chart that the share of EUR balances almost halved, while the USD share more than doubled YoY. As for the investments, FX deposits and current accounts remain the largest constituent of the portfolio, whereas relatively small shares of RUB deposits and RUB securities remain the most profitable in terms of yield.

Operating Expenses (excl. provisions). Operating expenses in Q2 2020 increased by 6.8% YoY. Personnel expenses growth of 17% YoY was the main driver behind OPEX dynamics. Such acceleration in personnel expenses decomposes into three components: 7 p.p. come from a higher headcount (mainly due to the implementation of the Marketplace project), 6 p.p. from measured salary revisions and the remaining 3.5 p.p. are pandemic-related premiums. D&A costs decreased by 7.4%. The remaining administrative expenses were virtually flat, adding only 1.8% YoY. Charity expenses amounted to RUB 58 mln on the back of anti-pandemic donations. As we had announced earlier, the savings incurred from cancellations of business travel and marketing events went to charitable donations aimed at combating the pandemic.

On the OPEX outlook. You already see that its growth approached the normalised run rate in Q2 2020. However, this fall we are set to incur additional expenses. First, we are launching the Marketplace, which will require extra funding. Second, we will do some of the office improvements, starting a transition to a flexible shareable office while the bulk of our personnel is working from home. That said, 2H 2020 spending will be elevated, returning to a normalised OPEX run rate as we enter 2021. Hence, we update the OPEX guidance to 7.0–8.5% from 6.0–8.5%. Remember, we communicated before that the lower end of the guidance range was dependent on the timing of the Marketplace launch. As it is happening, the Marketplace is being launched, the previous lower end is no longer relevant.

CAPEX for the quarter amounted to RUB 850 mln spent on acquisition of software licenses and IT development. We updated our CAPEX guidance to RUB 2.3–2.7 bln from RUB 2.0–2.5 bln due to the same factors that affect OPEX.

In conclusion, let me address the upcoming launch of the Marketplace project. In early September, it will start operating in a limited functionality for 'friends & family'. A month later, the trial mode will kick in and the service will become available to all interested users. We have 14 banks ready to go into the trial mode, including some of the Top 10 names. The figure is up from just eight in the beginning of the year. The trial mode offers a limited selection of deposit types. However, all deposit types covered by the applicable legislation will become available by the end of the year. Going forward, we will be progressing towards a complete range of financial products that banks offer – like insurance, bonds and loans – as well as connecting more banks. The onboarding to the platform at this stage implies a courier visiting a customer at home, which is a well-known and convenient process. Therefore, it does not affect the onboarding speed. A lower client acquisition cost compared to banks' own solutions is an important and distinctive feature of the platform. To sum it all up, we are fully on track to launch the Marketplace a few months after the delivery of the applicable legislation, in line with our prior communication and ahead of our internal KPI.

This concludes my overview of a very solid Q2 2020 and we are now ready to take questions.

Anton Terentiev – Director of IR

Operator, let us do the Q&A.

Operator

Thank you, ladies and gentlemen, we will now begin the Q&A session.

The first question comes from the line of Elena Tsareva, BCS GM. Please ask your question.

Elena Tsareva – BCS Global Markets

Good afternoon. Thank you for the presentation and congratulations on strong results. I have several questions. I will ask them one by one, if I may. My first question is about the changes in your team that you mentioned, especially in the press release about the operational processes at NCC. I understand that the team is further strengthened and there could be some changes in operating efficiency. Could you please tell us what kind of strategy will be implemented at NCC? Will it somehow release any capital position or change the efficiency of the capital position going forward or somehow affect the dividend policy? This is my first question.

Max Lapin – CFO

Elena, that is a wonderful question. We call this initiative Further Operational Excellence or, in Russian, "operatsionalizatsia" of NCC. The logic is simple. NCC as the clearing centre and central counterparty carries a lot of risk and has to manage a lot of risk that happens just because of the role of the central counterparty.

For this one, a traditional waterfall, risk waterfall, exists. On top of that, we decided that we would like to get more expertise in pure risk management to strengthen the team and risk management of NCC, to avoid potential reserves in the future. So, it is like a precautionary measure to move better into the project as we add new products under the NCC clearing solution.

The second part of the logic in operations excellence: we want more people who know how to build better processes and streamline them leading to a better time-to-market solution or better efficiency of the processes, as well as specifying, nailing down the responsibilities. The business is growing more complex. So, we have to review the responsibilities of the team. On top of that, we are adding compliance officers, just to be compliant with, say, FATCA, as NCC became a member of FATCA. I hope this answers your question.

Elena Tsareva – BCS Global Markets

Yes, Maxim. I understand this is not implying any potential capital efficiency improvement. Nothing in relation to potential release of equity, right?

Max Lapin – CFO

If you are talking about, let us say, capital release – no. We are already pretty streamlined with the capital. We paid out the full dividend for 2019. Our capital position is good. We have robust risk management, but we are not trying to release additional capital because of the operational efficiency. The operational efficiency is mostly about preventing any potential extra reserves in the future. We want to have better predictability of the business.

Anton Terentiev – Director of IR

I shall add that the capital adequacy of NCC has just been battle-tested by the elevated volatility and by a pretty sharp increase in client balances nominated in FX. As we progressed through this March–April volatility, I personally was enjoying as I could see how all the constructions, all the frameworks that we had put in place at NCC were actually put to good use. NCC went through this uncertainty period with flying colours essentially. This time, we can only look back and say that we did great calculations about NCC's capital, and we will continue with it.

Elena Tsareva – BCS Global Markets

Thank you very much for this answer. My second question is about your revenue structure. Given your long-term target of 70% of revenue coming from F&C, we have seen over several recent quarters that the share has sharply increased to 67%. It feels that it is quite a good combination if you see this share above your target of 70% of revenue coming from fees and commissions, given you have this Marketplace initiative and you have longer trading hours, which is also helpful in terms of fee and commission generation. Do you feel like this target of 70% will be exceeded? How do you treat it?

Max Lapin – CFO

70%, Elena, is quite an old target. We had it in mind, like, five years ago. Eventually, we are coming close. The 70% target has a controllable and not quite controllable component. The controllable component is about our efforts to grow fees and commissions, which we do and which we did this year. Our strategy aims for a five-year CAGR of at least 10%. We are in line with the strategy.

The interest rate environment is not that predictable. We are living so far in a relatively low interest rate environment, but we are still generating decent net interest income. Technically, we can go above 70%. Mathematically, there will always be some share of net interest income, even a noticeable share. But this year, we are happy that we are approaching 70%. So far, it is 67%, as you noted. Technically, it is possible to shoot above 70% in fees and commissions.

Elena Tsareva – BCS Global Markets

Understood. Thank you. So, you feel comfortable if your share goes above 70%, right?

Max Lapin – CFO

We are comfortable because it goes above for a reason that we control as we develop new business and generate fees and commissions, making our top line more predictable than before. Of course, we are happy about it.

Elena Tsareva – BCS Global Markets

Thank you. And another question. Given that currently there are some changes of Russia's tax agreements with some countries like Cyprus or the Netherlands and that you are already seeing a lot of companies getting listed on MOEX, do you feel like this kind of change may just increase the number of companies listed on MOEX and delisted from other domiciles?

Anton Terentiev – Director of IR

Let me handle that question, Elena.

Max Lapin – CFO

Yes, please.

Anton Terentiev – Director of IR

We discussed that with my colleagues from the tax department because we got that question from one of the investors. Basically, these two things are not linked to each other at all. The two factors that drive secondary listings on Moscow Exchange are the hunt for better liquidity and the strive to get into the index, be it our own index or MSCI Russia. These are the factors. The taxation factors will not work, because we are doing secondary listings of DRs. It is just a situation where the legal structure remains unchanged. And to accommodate any change in the taxation regime, it will probably take a change in the legal structure. So that is why these things are not from the same field, so to speak.

Elena Tsareva – BCS Global Markets

Thank you very much. That is it from me.

Operator

Thank you. The next question comes from the line of Andrey Pavlov-Rusinov, Goldman Sachs. Please, ask your question.

Andrey Pavlov-Rusinov – Goldman Sachs

Max, Anton, hi. Thanks for the presentation and congratulations on the strong results. My first question is about the dynamics of your net interest income. Essentially, we have seen a very strong quarter here with RUB 3.8 bln core NII. Obviously, the volatility and higher client balances helped you. But at the same time in the same quarter we saw rates coming down quite substantially, maybe even more noticeably in the USD space with LIBOR contracting by almost 100 bps. So, could you please elaborate what helped you generate such growth? Also, could you help us understand how we should expect this line to go in the future quarters? Will you be able to slow down the imminent contraction in the yields by locking in some rates in your bond portfolio? How quickly should we expect your effective rates to catch up with what the market is implying? This was my first question and I will ask my second question later.

Max Lapin – CFO

Thank you. Getting back to our discussion of Q1 results, we mentioned that RUB 3 bln a quarter seems to be a new norm for the rest of the year for the given amount of client balances. The client balances increase was the pure reason for outperformance of the expectation that we had in Q2. This outperformance is driven by the portfolio increase in Q2 due to the volatility. As I have mentioned, nowadays the client balances are back to normal. So, this normalisation process happened way faster than it did in the previous cycle. In the previous cycle, it took us three years to get back to normality. Now it took us about three months. So, our net interest income is back to normal trend, give or take, around RUB 3-something billion a quarter of core NII for 2H 2020. To sum it up, it usually takes around one year for the impact of the fall in interest rates to be fully reflected in our net interest income. So, our net interest income is predictably going smaller. The larger chunk of net interest income is coming from rubles. We have rubles both as our own capital and client funds. Rubles are highly likely to have way better rates than dollar or euro. They are generating a large, predictable chunk of net interest income. I would note that ruble client balances are quite stable because they are used not only for collateral, but for settlement purposes as well. Therefore, with the given amount of trading volumes, the settlement is a proportion of that, while our capital is also denominated in rubles. Therefore, we will have a sizeable net interest income, but it will go down following the rates with approximately one-year lag. You would ask me, "Max, what is the potential for investment revaluation reserve?" Investment revaluation reserve is prominently noted in our IFRS balance sheet. If you go to the balance sheet in our IFRS, there is a line closer to the end of the Equity section, which shows the investment revaluation reserve to the tune of RUB 2 bln. So, as at the end of June, we have approximately RUB 2 bln investment revaluation portfolio reserve, but it does not mean we are going to sell it. We are usually holding the portfolio to maturity, utilising potentials for realising investment revaluation reserve only when a strong opportunity presents itself. But, technically, we have a positive investment revaluation reserve as of 30 June.

Anton Terentiev – Director of IR

Andrey, let me give you a look from a slightly different angle. You asked us why we had that high NII growth in Q2. That was purely driven by higher balances. Remember, we had an elevated volatility period and client balances were up strongly. That did create a lot of support because we still make substantial money on USD balances. If you asked us about the composition of NII for Q2, I would say we had around 70% coming from rubles, roughly 29% from dollars and 1% from euro. So, dollars still make a lot of sense, and dollar client balances essentially doubled in Q2 vs Q1. And now, like Max said in his speech, at the end of Q2 we are fully back to normalised client balances as they were in Q1. Which brings us back to the conversation that Max is referring to – the one we had at the beginning of the year with FY 2019 results when we outlined this vision of RUB 3.0–3.5 bln of core NII a quarter. Why is that so, since the rates are so much lower? Because our core NII – and we are talking about the vision for core NII outside of any realised gains – is fully determined by the composition of the portfolio. Because whatever is happening to the rate and all the revaluation Max was talking about – these go into capital. They are separate and do not show up on the P&L. They only show up on the P&L when we rebalance the portfolio. And we did not rebalance the portfolio much, as we said during the previous call. We actually have a little bit of revaluation gain this time because at the end of Q1 we put together a tactical position in Eurobonds and we realised it in Q2. Aside from that trade, the portfolio remains as it was at the beginning of the year. Then, this new rate environment is gradually feeding into our NII, as bonds are naturally expiring or redeeming. We have to buy new ones, as previous ones get redeemed. Getting back to the RUB 3.0–3.5 bln core NII range, the run rate now stands somewhere in the middle and we are gradually drifting towards the lower end of that core NII range, which is RUB 3 bln. Does it make sense?

Andrey Pavlov-Rusinov – Goldman Sachs

That was very comprehensive and absolutely helpful. Thanks a lot for such a detailed answer. My second question is regarding your Marketplace project. First of all, I just wanted to understand a bit better your cost guidance. Is there a kind of slight increase in the lower bound related to the staff that you are hiring to support the development of the Marketplace? Would there be any costs associated with taking clients into the Marketplace – identification of those clients or some running costs related to the potential growth in volumes? Also adjacent to that, could you please indicate if you are expecting any revenues to come from the marketplace in 2H 2020? Do you have any early thoughts about a potential upside on the revenue for the next year? Thank you.

Max Lapin – CFO

Thank you, Andrey. When we were publishing our previous guidance, we mentioned that its lower end range of the range – 6% – implied that the Marketplace project got delayed yet one more time. But it did not. Instead, it sped up because of the legislation. We decided to let it launch this September in a limited mode. That means that the lower option we had in the previous guidance (that the Marketplace gets delayed till the end of the year) did not materialise. Things got better. Therefore, we are starting to incur both types of expenditures: additional staff that we are hiring and marketing expenses that will be required in 2H 2020 to get the B2C project up and running. So, it is predictable. It resembles the discussion that we had at the strategy presentation last year, when we mentioned that with Marketplace, we would have to somewhat spend upfront to get revenues later. It is a kind of an investment project. So, we are a little bit front-loading our expenses at the moment, and revenues will come later. When the project goes live, the question is how quick the ramp-up period will be. Then, we will see the revenues. The revenue and price structure for the Marketplace is in place. It covers onboarding expenses. We will not be doing onboarding at a pure loss, no way. There is an onboarding charge on the bank. If the client of the platform is profitable for the bank because the bank is not using extra-add money to get the client, it is profitable for us. We will hammer out the final pricing structure later in the year. So, let us talk about the particular revenues of the Marketplace project later when the project goes live, but our ambition stays the same. With the Marketplace project, we want to create a business line similar in size with the existing F&C business lines. It has to be sizeable. We are working on that. I hope this answers your question.

Andrey Pavlov-Rusinov – Goldman Sachs

Yes, absolutely. Thanks a lot.

Anton Terentiev – Director of IR

I shall continue on the Marketplace because we have a family of questions on the Marketplace from our webcasting interface coming from Pawel Wieprzowski of WOOD & Company. His first question is as follows: When do you expect the required legislation for the platform to be passed? Could you please repeat when you expect the full operationality of the platform a few months after passing the law? So, Pawel, the law is already in place. The next step for us, legally, is to get the licence of an electronic platform compliant with the law, and then we can start. I think it is going to happen quite soon. Full operationality of the platform is probably a state that we can expect by the end of the year.

The second question. Will you benefit in any way from the platform during the period of limited operations, starting early September? If so, do you have any considerations on the possible impact on the top line? That is what Max has just said. Let us not rush into revenue conversation. Let us look at the onboarding. We will update you on tariffs and revenues as it comes live, and we will just have to publish them on our website.

The third question. Given such an impressive development of retail client base, have you recently performed any estimates of what may be the impact of the Marketplace project on your top line? Yes, we perennially assess and reassess the Marketplace project, but it has no connection to this retail boom that you are talking about. The retail boom is in financial products as clients are onboarding on the market. The Marketplace will start with deposits. So, we are tapping a different pool of assets. I do not think we have much of a cross-reading between the current surge in retail activity and the Marketplace. So, let us give this project a go and see some early results before we judge.

The fourth question from Pawel. Given the current level of client balances and interest rates, what is the expectation of core NII? That is what we have just said. The broad vision is the run rate of RUB 3.0–3.5 bln a quarter.

The fifth question. Do you have any estimates on the possible number of retail investor accounts that can be reached in the long term? I think I have read in the press that it could be something like 15 mln. Since we are already approaching 6 mln, then 7 mln is possible by the end of the year, if this rate persists, which means that 15 mln long-term looks valid. But that is what I read in the press.

I think we can move on to the next question that we have in the queue.

Operator

Thank you. The next question comes from the line of Sergey Garamita, Raiffeisen Bank. Please, ask your question.

Sergey Garamita – Raiffeisen Bank

Thanks for the presentation and congratulations on great results. Actually, many questions from my list were already answered. What is left is probably on the Money Market. Could you provide guidance on the split of the OPEX growth related to the Money Market? What share of this increase is attributed to some variable costs that will probably go down next year (marketing, etc.), and what is obviously going to stay? That is my first question. The next question is on interest income. Many things were already said, but I wanted to understand better. There is a very sharp increase in USD client balances, while USD rates are almost 0%. Are you planning to introduce a similar fee to euro balances, which you charge 0.2%, to compensate for USD and interest income going down later on or not? My third question is just to clarify all these staff changes, new hires, etc. At this point in time, do you still have the estimate of required capital at RUB 51 bln or so, have you changed it? Could you clarify this as well? Thank you very much.

Max Lapin – CFO

Good questions, Sergey. First, fixed and variable costs. Pure variable costs amount to approximately 10% of the overall costs that we have. We are largely a fixed cost type of company. Variable costs that we have are mostly expenditures on commission income: the pass-through recommissions from the services that we outsource in the financial market and then charge the clients accordingly. Some market-making fees can also be roughly considered to be variable expenses. They together comprise around 10% of our overall expenditures. I would rather talk about our expenses as project expenses and ongoing business support expenses. This year, we are talking about project expenses. Our Marketplace is a driving factor of the expansion in the project costs. I would not call project costs pure variable expenses, because it is not the case. Therefore, I would be looking at our cost line in OPEX as development costs passing through the OPEX. That is what is happening. In a nutshell, as per our strategy, fees and commissions should go faster than OPEX. We have got to have positive operating jaws. As per management KPIs, we have the cost-to-fee income ratio as the KPI, and it has quite a heavy share in the weight of KPIs for the company, extending beyond the top management to all personnel and key banking subsidiaries. So, it is important for us.

Talking about the commission on USD clearing accounts. The story with euro and Swiss francs was as follows. Since rates were negative or close to zero, we started to charge a clearing fee to offset costs of service on such clearing accounts. Someday, it might happen if dollars get very cheap. It is not off the table. It is a possible opportunity, but our dollars are still generating some positive yields.

Estimate on the required capital. The estimate on the required capital remains unchanged since the last call. It is the same number. We did not have any regulatory changes and I am not expecting any regulatory changes going forward.

Anton Terentiev – Director of IR

Yes, Sergey, let me reiterate three things. First, Max said in his intro speech that we were planning to get normal OPEX run rate by the end of this year, entering 2021. Which means we recognise that we will have somewhat elevated second half spending partially because we had some savings in Q1 and Q2 as well. We will spend these savings in the second half of the year and then we will get back to normal OPEX run rate as we enter 2021.

Then, to the point on USD rates. They are actually non-zero. We are still getting very reasonable contribution from USD when we talk about out NII structure. This is because we are still getting positive rates from our counterparties locally and we still get meaningfully positive USD rates on Eurobonds of either sovereign or quasi-sovereign top-notch Russian issuers. So local USD rates are non-zero.

And then on the required capital. Remember, we spoke about it on multiple occasions: the best proxy for capital is the amount of FX client balances. We have just seen these FX client balances go through the roof. We were utilising that capital to a pretty complete extent, I would say, just a couple of months ago. That is why I said, answering Elena's question, that we had come through this volatility with flying colours when we talk about NCC's capital and NCC's risk management. The market has just proven that we need to keep that capital.

Sergey Garamita – Raiffeisen Bank

Yes, I understand. I was talking not about decreases, but possible increases, but Max has already answered it. Thank you.

Operator

Thank you. The next question comes from the line of Mike Sell from Alquity. Please ask your question.

Mike Sell – Alquity

Given the increasing geopolitical risks we are seeing, the tension between Russia and America in terms of sanctions, does that have any bearing at all on your business, and indeed could it actually be a positive as more companies do more things onshore?

Max Lapin – CFO

On the one hand, if you look back at what happened in 2015, we had quite an inflow of OTC deals back onshore, and it helped us. So, we had a more noticeable chunk of business going home. That also happens with dual-listed stocks which migrate from LSE to Moscow. Speaking of sanctions, we have the same stance on sanctions as we had a year, two and three years ago. Economies do better without sanctions in general. For exchanges, in the short-term sanctions or any nervousness in the market generate volatility, which helps with short-term blips in revenues, upticks in revenues. In the midterm it is self-normalised, but in the long term, the absence of sanctions eventually helps. For us, for the exchange, we see more positives than negatives in this equation.

Mike Sell – Alquity

Thank you.

Operator

Thank you. The next question comes from the line of Andrew Keeley from Sberbank. Please ask your question.

Andrew Keeley – Sberbank

Good afternoon. Thank you for the call. A couple of questions. First, on your Marketplace. I think you mentioned that there were 14 banks or so that have signed up. I am wondering if you could provide any colour on any of those. Do they include any of the top 10 retail deposit players? Any additional information on that would be helpful. And I am wondering how much of an obstacle do you see in the lack of legislation on biometric identification in this whole process? Do you have any idea when that may actually pass or you do not really see it as a big issue now? I will ask the other question afterwards.

Max Lapin – CFO

Wonderful. I will talk about the law first, then I will switch to the banking roster. We have the law on digital platform passed, so we can start the project and we will. The onboarding process will happen in the same manner as other banks do, as a one-off physical interaction with the customer to check the passport details. The digital ID will present itself as an opportunity in the future. Let us wait and see how it plays out. But without a law on digital ID, we still have a law on marketplace that allows us to go forward. As for the 14 banks on the platform, we have real good names, big names of banks that do not have very developed retail footprint among the top-notch banks. And we have a range of mid-tier banks that want to substitute their physical branches with the Marketplace solution. Anton, can we disclose the names of the banks on this call?

Anton Terentiev – Director of IR

We would be rushing by disclosing names of the banks. One hint that we gave in the speech is that we had some names from the top 10. We have both smaller banks, and some larger banks. Let us launch. This will happen soon. You will see the roster. It is not going to be secret very, very soon. We just do not want to front-run the thing, but there will be big banks, top 10 banks, and there will be smaller banks.

Andrew Keeley – Sberbank

Okay. Fair enough. We will wait for that. Thank you. The second question is on your plan to launch US equities trading. Just interested in your thoughts on how confident you are that brokers and investors will switch from trading US equities on St Petersburg Exchange to Moscow Exchange? What do you see your relative competitive advantages in this area are? Do you have any initial revenue expectations from the US equities trading? Just any early thoughts.

Max Lapin – CFO

Great question. Look, not every brokerage house, not every bank allows clients to trade on the St Petersburg exchange. So, we are launching on the Moscow platform. Let us say, one of the bigger and greener banks will be more interested in trading international stocks on the Moscow platform for better clearing and custody solutions. We have a fully-fledged, reliable, robust custody and clearing solutions. That is one of the major reasons.

In reference to the amount of trading, we have been looking into the sheer size of international stocks already trading in Russia. We think that we will have a relatively sizable part because of the new clients that are not yet trading on the St Petersburg exchange because of the lack of such access through their brokerage accounts, but they will have the opportunity at the Moscow Exchange. Our internal guesstimate is roughly the same as we have with the evening trading hours. We have mentioned before that other markets have like 8% to 19% of volumes in evening trading hours. We have so far already reached 6% additional volumes in evening trading hours. We think a similar estimate or guesstimate is applicable to international stocks trading on the Moscow platform.

Andrew Keeley – Sberbank

Okay. Thank you. It is good to have a big green support for you.

Max Lapin – CFO

Yes. I also believe in big green support in this case.

Anton Terentiev – Director of IR

Yes. And I also wanted to add a quick argument that the trading will be held in rubles, which is more convenient for locals.

Andrew Keeley – Sberbank

Okay, thanks Anton.

Anton Terentiev – Director of IR

All right. Let me then read out loud a couple of questions that are coming through the webcasting interface from Florian Gueritte, LGM. The first question is, what is the market share of deposits that the Marketplace can achieve in the long run? And do we expect to gain market share from SOE banks?

Generally, the figure we use in modelling is something like 3% of the market share, and this is a very long-term target. It will take not a year or two, but many years will pass before we reach that 3% market share out of the RUB 31 trln market. When we talk about the competition in terms of who we will compete with, we are not targeting SOE banks specifically. But we understand that if clients are looking for better deposit terms, then smaller banks naturally have advantage because bigger banks have cheaper funding, so the Marketplace will help smaller banks solidify their footprint.

And the next question is, how would you judge the success of the Marketplace? Which KPIs do we use? And what metrics do we plan to reach to breakeven or earn a 15%-plus IRR? That is a question for Max.

Max Lapin – CFO

I am talking about our investment policy. Our WACC, weighted average cost of capital, is, give or take, floating around 13%. It depends on the model we use. Internally, we are happy with products and projects that generate north of 15%. For us, the limiting factor is not the amount of projects, not the lack of selection or the lack of project diversity. It is the lack people to get them done. By lack of people to get them done I mean that we are roughly a little bit less than 2,000 people. But we are outsourcing and looking to have more than 2,000 people. We are growing. We are hiring to make new products and new projects. Our limiting factor is the headcount that we have to develop new products and projects. We have a lot of ideas. We are pushing them forward. But generally, our internal outlook is north of 15%.

Anton Terentiev – Director of IR

I understand that everyone is anxious to get their hands on the modelling, but let us just observe how the onboarding process starts, because the onboarding will start from zero. And we will have to accumulate a certain audience before we are getting statistics and are in a position to draw some conclusions. And that also comes back to Andrew's question on the onboarding through courier identification, whether it slows down the process. The answer I have from my colleagues – no, it does not. It does not slow down the process because you have to onboard with the platform once, either through biometry or through the courier identification. You have to deposit this biometry, you have to go physically and get this biometry collected or otherwise, a person comes to your home and does all the work, which is equivalent. Once you are on-boarded on the platform, then you can use its benefits fully, but you do need to onboard.

Max Lapin – CFO

We do a check-up within the company on an annual basis. It is called post-investment monitoring, in which we look on the onboarding or ramp up speeds of the projects that we have launched previously. Usually, it takes a year or two for clients to take pace of the project and then they start to skyrocket. The previous examples were the Money Market with the CCP that we created, it was boiling slowly for a couple of years, and then it shot through the roof. The same thing is happening with the onboarding of corporates onto FX and Money Market. I think with the Marketplace, it will be relatively clear a year or year and a half down the road. That is like a boiling phase, and after that, we will be able to provide expectations on the overall market share and the growth dynamics. The good news about the Marketplace project is that its overall developing cost (including CAPEX) is, give or take, less than a monthly net income of the company. In a month, we generate more net income than the two-year development cost of the Marketplace project. Therefore, it is still relatively not that heavy a project in terms of overall volume of expenditures on it.

Anton Terentiev – Director of IR

We are ready to take more questions.

Operator

Dear speakers, there are no further questions at this time. Please continue.

Anton Terentiev – Director of IR

All right. I will start to wrap it up. If a question pops up, I will let it go. Thank you, everybody. I think we are a bit quicker today compared to the last time. Thank you for good insightful questions, and we hope to keep you happy with the delivery on our projects and strategic initiatives, and looking forward to reconnecting with all of you during our Q3 IFRS conference call. Thank you.

Max Lapin – CFO

Thanks, everyone.