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Call (IFRS)

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CORPORATE PARTICIPANTS

Alexander Morozov *Sberbank Rossii OAO - Deputy Chairman & CFO*

Anastasia Belyanina *Sberbank Rossii OAO - Managing Director & Head, IR*

CONFERENCE CALL PARTICIPANTS

Jason Hurwitz *VTB Capital - Analyst*

Ivan Bokhmat *Barclays Capital - Analyst*

Dmitry Trembovolsky *Goldman Sachs - Analyst*

Magdalena Stoklosa *Morgan Stanley - Analyst*

Alan Webborn *Societe Generale - Analyst*

Mikhail Shlemov *UBS - Analyst*

Andrzej Nowaczek *HSBC Global Research - Analyst*

Yavuz Uzay *BofA Merrill Lynch - Analyst*

Gabor Kemeny *Autonomous Research - Analyst*

Maria Semikhatova *Citi - Analyst*

Cagdas Hatinoglu *HSBC - Analyst*

Ekaterina Belkina *Interfax - Media*

Oksana Kobzeva *Thomson Reuters - Media*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to Sberbank Group's Q2 2015 IFRS results call hosted by Alexander Morozov, Chief Financial Officer and Deputy Chairman of the Board and Anastasia Belyanina, Managing Director and head of Investor Relations. Live webcast is available and you can find the link on Sberbank.ru.

(Operator Instructions)

I must advise you that this conference is being recorded today on Thursday, August 26, 2015. I would now like to hand the conference over to Mr. Alexander Morozov. Please go ahead, sir.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Good afternoon ladies and gentlemen or good part of the day. So it's our pleasure to announce our results for the second-quarter and half of the year 2015 of Sberbank of Russia.

Broadly speaking I was a little bit surprised when my restoration service showed the consensus. Despite our previous discussions and our relatively clear guidance we formulated through our last conference call most of you were much more skeptical about our ability to restore our margin and to restore our profitability.

But if we look at results our net interest margin continues to improve and in second quarter we posted 4.2 percentage points and so it's up 50 basis points versus first quarter. We are on the way, it is not yet the end, we continue in third and fourth quarter. And again I reiterate our guidance that we will enter the next year with practically normalized net interest margin.

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We seriously improved our cost to income ratio versus first quarter. So cost to income ratio in second quarter it improved to 43.3% versus 45.8% in the first quarter. We are on the way and we undertake all the necessary steps to preserve our efficiency despite quite a volatile environment in the market.

We continue to focus on the fees and commission income which increased in the first half of the year by 17.3% y-y. And we'll continue to improve it so in our guidance we show interest rates on we remain our guidance is for net fees and commission income around 20% growth full-year.

And what's really very important for us that total comprehensive income for first half of the year remained quite stable at the level RUB152 billion versus RUB149 billion first half-year 2014. So our comprehensive income biggest part of which is in revaluation, positive revaluation of available-for-sale portfolio.

And so earnings first half of the year show we'll have to seriously improve our Tier 1 ratio which increased by 100 basis points. So equity Tier 1 ratio reached 9.6% and overall total capital adequacy ratio improved to 13.4%.

We seriously reduced our loan to deposit ratio from 110% beginning of the year to 102% as of the end of the second quarter. That was a result of our efforts to reduce our borrowings from Russian Central Bank. That was the most expensive part of our liabilities and as a result we seriously reduced our sensitivity to interest rate risk.

What else, I have to say that we continued to reduce our share of our Ukrainian subsidiary and total group assets which shrunk to 0.4% compared to 0.6% in the beginning of the year and our provision coverage for our full exposure on Ukrainian business is about 50% today. And probably last but not least our cost of risk is definitely within our guidance, noticeably better. It reached 2.6% in the second quarter and we continue to make provisions for generous quality deterioration on a quite conservative manner which gives us a chance to improve our full-year guidance.

So that's all about our main messages and now I'd like to go to our guidance. If you look at our last page of our presentation it should appear actually on our Internet site you may notice a few differences.

First of all cost of risk, clearly we expect now that cost of risk will be below 300 basis points full-year. We understand quite well quality of our portfolio and unless we face something really very, very terrible and unpredictable we believe we have everything to end of the year with cost of risk below 3%.

Return on equity, we little bit update our guidance from single-digit to high single-digit. Return on equity we believe it's achievable and we will adopt everything what's necessary.

Net interest margin, we did not change our initial forecast, moderate decline versus 2014. But I had already pointed out what we expect further improvements and recovery of our net interest margin quarter to quarter. And on a quarterly basis fourth quarter margin will be very much normalized. So we'll enter the next year with very solid numbers and very good backgrounds.

And what else, definitely core Tier 1 ratio will be above 9%. And in terms of balance sheet and capital developments balance sheet we will be very conservative on corporate loan growth, very selective, definitely we now face a deficit of good quality demand for corporate lending. At the same time we will be slightly better than the sector in terms of retail first of all because of mortgages where our market share is growing, hence we will continue to consider our prime a main product for retail.

At the same time in consumer lending and car loans we will continue to reduce portfolios in terms of results especially on consumer loans. Relative quality will a little bit deteriorate in terms of non-performing loans but just a little bit and is just a factor of our shrinking portfolio, so reduction of the size.

And on deposit growth we're faced with a flight to quality process in Russia and we expect our market share will continue to increase. By the way, as of now our market share in terms of private individual deposits is about 45%. We expect it to reach 46% by the year-end, so increased by at least 1 percentage points in terms of market share.

In terms of corporate loans now we have 32.75% our market share. We expect it will be relatively stable through the year but we haven't reduced it since the beginning of the year.

In terms of credit to private individuals, as of now our market share is slightly below 38%. It may increase a little bit by 1 percentage point more until the end of the year.

And deposits from corporate, as of now we have 21.7% of market share. I expect it to be relatively stable with potential to further increase by 1.5 percentage points until the end of the year. That's more or less our expectations, so you can easily calculate plus or minus expectations for net profit after tax, our bottom line.

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We intentionally do not give you exact number but we unlike the corporate our full-year results will not disappoint you and us as well. What is important for us that we continue to be conservative which means that we understand what's risk here, we have to create enough provisions, enough to adequate provision, adequate to invest in difficult market environment and also to enter the next year with relatively safe position in terms of already accumulated provisions on our balance sheet. And next year we'll do what's necessary from our side to return to our normal profitability expected from us and in line with our strategy.

That's all for my side and I'd like to invite you to enter the Q&A session. It will be easier for you and for us as well, more productive.

QUESTION AND ANSWER

Operator

(Operator Instructions) Jason Hurwitz, VTB Capital.

Jason Hurwitz - VTB Capital - Analyst

Good afternoon. My questions would relate to loan quality in particular.

Starting with the renegotiated loans if you could provide some color as you have in the last couple of quarters on the breakdown of the renegotiated loans in terms of the quality of those loans? And also noting that your cost of risk guidance for the full-year this year has come down if you could talk about that in the context of the recent shift in oil prices and the potential effect that that has had on the economy and whether that has already been factored into the updated guidance? Thanks.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes, oil price shift is already within our guidance. We calculated it and calculated in a stress scenario. Here are more details about our loan quality restructuring as part of our portfolio, the renegotiated loan portfolio structure.

Around 25% out of top 100 renegotiated borrowers, what's so-called red and black zone where we have better restructuring and 75% that's green and yellow zone. That's out of our top 100 renegotiated borrowers in order to compare it apples to apples. Last time -- our last conference call those numbers were respectfully 20% around and 80%; actually, that's 25% and 75%.

So yes we see some growth in terms of red and black zone but relatively small one. And what's also important in non-performing loans if you look at our portfolio a quite substantial part of increase of non-performing loans 90-plus increase in second quarter is due to just three names: that's Ukrlandfarming, Mechel and UTAir.

Provisions for those names were created in previous time period, in previous quarters. But full effect in terms of non-performing loans we saw only in second quarter this year.

But we created provisions 60% for Mechel and for UTAir. That's enough taking into account quality of collateral we have our profit before recovery we understand and provisions for (inaudible) created say the amount 100%. So I think it's easy to calculate, but if we deduct the effect of those three companies the net input since 90-plus non-performing loans in second quarter was RUB70 billion.

If you deduct RUB70 billion out of overall RUB161 billion increase in non-performing loans in second quarter and recalculate respectively our coverage ratio would be around 130, so quite sustainable and decent level by all means. I hope I have answered your question. If not please specify and I'm ready to do more details.

Jason Hurwitz - VTB Capital - Analyst

You have. But if you could possibly breakdown, you gave us 25% and 75%. If you could provide it in terms of also the breakdown of the red and the black and the green and the yellow.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

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Until 35%.

Jason Hurwitz - *VTB Capital - Analyst*

I didn't catch that. I'm sorry.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Green zone is 40% and yellow 35%.

Jason Hurwitz - *VTB Capital - Analyst*

Perfect. Okay, thanks very much.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

And black zone just 4%.

Jason Hurwitz - *VTB Capital - Analyst*

4%.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Yes. So 21% red zone, 4% black, 40% green and 35% yellow.

Jason Hurwitz - *VTB Capital - Analyst*

Perfect. Thanks very much.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

That's our top 100 negotiated borrowers. Please more questions.

Operator

Ivan Bokhmat, Barclays.

Ivan Bokhmat - *Barclays Capital - Analyst*

Hello, thank you very much for the call. I have several questions if I may start with a general one.

We've been hearing a lot from the government that the economy has bottomed. Do you see the same reflection in your asset quality and how does this affect your planning and budgeting?

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Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

For me it's difficult to comment officials. I'm not to go in macroeconomics but definitely situation is quite difficult and that's why we are trying to be quite conservative in our scenarios. We expect that a Russian economic slowdown in the year 2015 will be less on the decline in domestic demand due to significant fall in inputs, and we at the same time expect that full-year results will be better than when it was anticipated in the beginning of the year.

As for quality of our portfolios we see stabilization with mortgages with signs of improvement of quality on the retail side on vintage basis analysis. In terms of non-performing loans and consumer loans we cannot see signs because of contraction of portfolio. So ratio is changing but on the relative terms we see some stabilization.

In terms of corporate portfolio it seems we understand now quite well problem zones. First of all construction directly or indirectly, and some within our retailers, and trading, and aviation transportation in general, plus service industry like tourism and so on.

So we see serious contraction of demand in the local market, serious reduction of input and all the industries related are definitely affected. But we do not expect a radical further deterioration of quality of the portfolios.

Ivan Bokhmat - Barclays Capital - Analyst

And would you think that the current another wave of deterioration it pushes back the recovery that you expected for 2016 a few quarters back? You did mention that you expect to return to the normal profitability. What do you mean by that?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

By what I mean the main driver of our profitability is net interest margin. We will return to our net interest margin next year around or above 5% which will be the main driver behind our profitability.

At the same time we expect that the cost of risk will continue to stabilize and may go slightly down, not substantially. Again I prefer to be on the safe side but definitely that's a chance which we might expect.

That's why now we're very conservative and say, taking into account very high volatility, we face this on foreign exchange markets and some global markets today. Nevertheless we update our full-year forecast for cost of risk so to be within or below 300 basis points this year.

Those two drivers, net interest margin increase and contraction of cost of risk, will seriously drive up our bottom line next year. Plus again we will continue to focus on fees and commission income, so for the targets to grow with the base around 20% per annum which is quite ambitious and challenging, especially taking into account the insurance products not very popular today. Hence we have to change the mix of our fees and commission baskets in our main drivers despite 20%, that's our target since we reiterate our forecast for this year to be in line with it. Next year I think it will be our target as well.

On cost to income ratio the aim for this year is to stabilize it where we have today and to drive it further down next year. In more detail to address our forecast for the next year when we present our updated view now of three years remaining for strategy relation. On our Capital Day in October and London and by the way using the opportunity I'd like to ask you to save the date, October 22, London we invite all of you to join our Capital Day where our team headed by the CEO of the bank, Mr. Gref, will present you our updated view on our strategy, where we are, what we are going to amend in our strategy and what our challenges and priorities for the remaining three years.

October 22, London. Invitations will be sent by our investor relations service.

Ivan Bokhmat - Barclays Capital - Analyst

Thank you very much. I will be looking forward to that. Maybe if I can ask another question regarding your yield and assets which has been broadly flat even year on year when we didn't have this hike in Central Bank rates.

Could you talk a little bit about why you think it stays flat? Do you see any challenges in passing higher rates on to the customers?

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Is it a question of asset quality, is it just a question of changing mix? And what should we expect going forward? Because so far your NIM improvement has been driven by improved cost of funding.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes you are right, for us it's always a trade-off between our great quality and our earnings. As today as well as in the past our first priority was quality of our portfolios. We are not ready to sacrifice it.

That's why our improvement in net interest margin in the following periods will be driven primarily by a reduction of our funding cost. So on the liability side, on asset side we should also take into account some products exchange on the retail side in favor of mortgage which is less profitable in terms of interest but at the same time much more conservative and it's much more safe in terms of risk profile.

So mortgage is our prime product. Our market share will continue to increase and portfolio will continue to increase. And consumer loans highly marginal will continue to reduce a little bit at least until the end of the year.

Ivan Bokhmat - Barclays Capital - Analyst

Okay, thank you. Maybe just one last small question. Considering where the ruble rate is right now, would you care to give an estimate of what would happen to your capital ratios under the current rate?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

If you ask me about sensitivity every RUB10 of the devaluation of Russian ruble, against those by RUB10 means for us roughly 0.6, 0.7 in terms of capital adequacy ratio. But since I will undertake separately a list of measures and also further improve our capital adequacy ratio and to mitigate potential devaluation of the Russian ruble. That's why I believe that our target and our guidance for capital adequacy ratio core equity Tier 1 ratio will be achieved anyway.

Ivan Bokhmat - Barclays Capital - Analyst

Great, thank you very much.

Operator

Dmitry Trembovolsky, Goldman Sachs.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Alexander, it's Dmitry. Thanks for the presentation. I have a couple of follow-ups.

First of all, I think there are more and more organizations right now on the market with their FX volatility, the possibility of Central Bank rate cuts is limited and there could be even rate hikes to prevent currency from further deval. In this case, how would you if that happens how that could affect your net interest margin guidance? And I will follow up then.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

1% of interest rate hike means for us in terms of marginal effect approximately RUB8 billion until the end of the year 2015 and roughly RUB25 billion, RUB26 billion on 12-month time horizon. Since I do not expect keeping timelines for the growing market immediate further reduction of interest rates, key rate by Russian Central Bank. But at the same time I do not expect any rate hike, so we do not change our overall macro view until the year-end.

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We believe that looking forward into the year 2016 we should expect anyway a reduction of interest rates and stabilization of interest rate environment on lower levels. But sensitivity is I gave you 1 percentage point is roughly RUB25 billion RUB26 billion on annual horizon.

Dmitry Trembovolsky - Goldman Sachs - Analyst

So this interest income guidance which you have in your presentation at the end of it, it is based on what level of Central Bank rates by the end of the year?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

More or less stable as it is today. At the same time I do not exclude, but we will see a little bit later, but still we see a further rate cut. If in case we see a rate hike but in relative terms it will not affect us seriously.

Now we see this reduced our dependency on money from Russian Central Bank. We actually have as of today slightly more than RUB1 trillion instead of RUB3.5 trillion taken from Russian Central Bank a year ago and we have capacity to replace it in full if necessary.

So we have further focus to further reduce our interest rate risk embedded. So we manage the situation and we take it under control.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Okay. Let just make sure I understood you well. So in the net interest income guidance which I think you have as a model increase you assumed that interest rates stay where they are, that they are not going down until the end of the year?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Okay. And so if interest rates do go down does it present an upside risk to your guidance of moderate decline then?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

I prefer to be always on the conservative side. And again, related now a little bit expectations in terms of bottom line, as far as I understand, if I understood in the right way consensus, and as also interpreted the mean showed to me by my IR people, so I'm not ready now to further increase our forecast for full-year. We assume unpredictability related to different parts of the world, not only Ukraine, but I prefer to be conservative.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Sure. I'm not asking you whether you can increase the guidance. I'm just trying to make sure that the moderate decline of net interest margin that you have in your page 27 is related to the flat interest rates. And if they are lower than --

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Okay. I understand the question. If you ask me about our guidance, moderate decline versus 2014 on average, but at the same time if you look on a quarterly basis, then quarter-to-quarter year 2015 our net interest margin would continue to recover.

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And toward the fourth-quarter year 2015, in terms of net interest margin. Will be very much comparable, maybe not the same exactly but very much comparable with net interest margin year 2014, okay?

Dmitry Trembovolsky - Goldman Sachs - Analyst

That's clear. But the only thing I'm trying to also understand, this guidance is based on flat interest rates by the Central Bank until the end of the year or it assumes some decline? That's what I'm trying to understand.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

It makes no big difference for us. Okay? So we seriously reduce the sensitivity to interest rate by reducing money taken from Russian Central Bank and we seriously increased our deposits taken from our core customers and so we see now flight to quality.

So I intentionally mentioned our existing market shares among them, our market share on deposits from private individuals. We expect further increase of our market share and we have now quite growing bargaining power on our side to further reduce our funding costs.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Okay. So in other words if interest rates stay where they are and even if they modestly increase you're quite positive that you can achieve the guidance that you have presented?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes. Correct.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Okay. That's what I wanted to -- that's great. All right, thank you. One other thing --

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Sorry, sorry might I interrupt you. Having said that I'd like to say that we it should be a relatively moderate hike. And if you face with something absolutely unpredictable in the way you faced last year, so high by 5%, 10% definitely it will affect us negatively but we do not expect it now.

Dmitry Trembovolsky - Goldman Sachs - Analyst

No of course. Understood.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

In order to avoid misunderstanding.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Sure. Okay. My other question was about renegotiated loans just to follow up on what my colleagues have been asking.

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Page 21 you have quite sizable increase in NPLs in total gross renegotiated loans from 6.8 to 9.2. Does that include these three companies that you've mentioned previously or not?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Some of them.

Dmitry Trembovolsky - *Goldman Sachs - Analyst*

Some of them. So partially this increase is due to the sort of one-offs that you mentioned but some of that is just genuine kind of deterioration of the renegotiations?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Yes, absolutely correct. We definitely see some deterioration of our quality.

That's inevitable on the background of macro we have now in Russia, it is inevitable. But further deterioration is moderate.

Dmitry Trembovolsky - *Goldman Sachs - Analyst*

Understood.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

At the same time if you look at our provisions created since the beginning of the year, now a RUB1 billion and equivalent. Let's say RUB81 billion, sorry, higher than first half of the year 2014, that's quite big number.

Dmitry Trembovolsky - *Goldman Sachs - Analyst*

Okay. And can I ask you if you feel more stress in your ruble book or in your FX book at the moment?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

In terms of FX I can say every devaluation of Russian ruble by RUB1 per dollar leads for me to make additional provisions in the amount of RUB4 billion on the balance sheet of Russia. So as a result of our provisions for foreign exchange loans are provisions made in Russian rubles our base currency. So devaluation leads to the necessity for additional provisions

Anastasia Belyanina - *Sberbank Rossii OAO - Managing Director & Head, IR*

If your question was regarding, it's Anastasia, more stress in ruble book or FX book?

Dmitry Trembovolsky - *Goldman Sachs - Analyst*

Correct, yes, yes, I understand that mechanically you have to create more provisions because obviously NPLs cannot increase in ruble terms. I'm just trying to understand whether the loans that you've disbursed in FX are now their quality is worse or better than the loans you have disbursed in rubles after deval?

Anastasia Belyanina - *Sberbank Rossii OAO - Managing Director & Head, IR*

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Yes of course depending on the ruble devaluation adds up to FX book that's why stress is higher.

Dmitry Trembovolsky - Goldman Sachs - Analyst

Right. I see. Okay, thank you very much.

Operator

Magdalena Stoklosa, Morgan Stanley.

Magdalena Stoklosa - Morgan Stanley - Analyst

Good afternoon. Thank you very much for the conference call. I've got a couple of questions.

I'm going to focus on the margin first. Your cost of retail deposits went up in the quarter and so could you give us a color as to the reasons why and where do you think that's going forward? So that's my first question on margin.

And second, your corporate loans are expected to grow quite nicely in the second half of the year. Could you give us more detail on your pipeline?

Are we talking working capital loans or are you seeing a little bit more demand for investment loans? So that's the margin.

And if I may I'm just going to have one more question about asset quality. Because of course I understand that the provisioning we are putting through now are very much the general deterioration, of course chunky corporate provisions but also Ukraine.

You have mentioned right at the beginning of the call that your Ukrainian exposures are covered at about 50%. And I'm just curious with what is going on at the moment where do you think you should be in terms of Ukrainian coverage over let's just say the next couple of quarters? Thank you very much.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Okay. If I understood correctly there were three questions: Ukraine deposits on retail, cost of our deposits, and a pipeline on corporate loans.

On pipeline we are very selective with working capital facilities, first of all, and the Russian exporters – that's our prime focus. I'd like to say that we face, repeated again, that we face with the deficit of good quality demand. We do not set any specific target for the market share on corporate loans and corporate lending and we are not ready to sacrifice the quality.

So we will try to streamline our internal processes to be more competitive in terms of convenience for some of our customers in terms of providing them with short-term working capital facilities. I think if we are successful in doing that, we may noticeably increase our market share in relatively short-term and quite safe lending, in which our market share up to date is relatively small.

On retail deposits, first of all, now increase that we see in terms of cost of individual term deposits, results from maturing of previously taken achieved deposits maturing against deposits which was wrapped up in year 2013, 2014 for two years, three years maturity. And now those are maturing and interest rates prevailing to date on new deposits are higher.

But at the same time, taking into account that our price points at the highest interest we pay effective interest today. But in some six-months time, deposits, we believe, short most probably, and definitely fourth quarter we see change of a trend, hence, since that time, relatively fast and continuous improvement, I mean – reduction of cost of funds from private individuals. That's how we see it, so what we have today – that's probably the big or near to the big, near to the maximum.

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The last question about Ukraine, a very good question, whether we see the necessary level of provisions. We will continue to increase it from what we have today, to what level – it's now difficult to say, but at least by 10, 15 additional basis points percentage points. But for sure everything will depend on further development of situation in Ukraine.

We will closely monitor it as we do it today. And if we have to take some serious and difficult decisions, we see what is available for that. So we will try to accommodate the issue this year anyway.

Magdalena Stoklosa - Morgan Stanley - Analyst

Okay, perfect. Can I just have one very short question on Ukraine as well of course?

The recapitalization of the banking system is a part of the IMF program. Do you actually envision having to recapitalize your subsidiary there? Because I think in the first cut of decisions you did not have to but I just wonder what are the potential contingency plans going forward?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

We didn't get any requirements from National Bank of Ukraine to recapitalize our bank. So we are in-line with local regulations and as of now we have no plans to inject additional capital into Ukraine, as of today.

Magdalena Stoklosa - Morgan Stanley - Analyst

Okay. Thank you very much.

Operator

Alan Webborn, Societe Generale.

Alan Webborn - Societe Generale - Analyst

Hi, good afternoon. Thanks for the call. Just a quick question, you've been talking about a dearth or an absence of good quality lending opportunities in the corporate sector.

Could you perhaps put a little bit more color? I know you've talked about the industries you say that are difficult. But is it a question of good quality borrowers simply not borrowing or relying on current resources disinvesting or is it a general deterioration in the quality of the corporate sector?

Just to have an understanding of how your direct corporate clients are faring in what clearly is quite a difficult economic environment and your view on that would be most useful. Thank you.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

A number of good customers were postponing their investment decisions and their investment projects, on one hand. On the other hand, quite a lot of quite a big number of customers since initially faced with economic difficulties I would say financial situation don't allow us to extend lending facilities.

So we'll be selective. That's what I can say. If we see really good quality demand, we have enough liquidity and capital, and we are ready to lend money but the situation uncertainty with economic forecast prevails over the markets today.

Alan Webborn - Societe Generale - Analyst

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And if I may ask has your scoring for want of a better word been stable or have you become clearly you must have become very risk-averse in the first quarter, have you become slightly less risk-averse? Is there any trend in that direction in terms of the lending that you're doing at the moment or are you still in the same sort of thought process and caution that you were in the first quarter of the year?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

We definitely now became much more selective now, if you compare where we are today and where we were three years ago. But at the same time we are slightly more optimistic when we were let's say in the beginning of the year in January, beginning of February so in the first quarter. So the situation now is much more stable from some point of view, but high level of indebtedness of companies now, of companies related to raw materials sector, and serious drop in commodities prices in the world seriously limits our ability to radically increase our exposure.

At the same time we have a number of opportunities like state-related business, like food production, like machinery, machinery, you know, it's very specific industry in Russia with definitely state support. And so these areas we will continue to increase our lending to because it's quite safe quality in this area, quality of work rates is improving and we feel ourselves okay, so we will be selective.

We will reduce our exposure on construction in any force, but that's not only on services, and some commodity-related business. At the same time, we will increase foods machinery and even today energy sector and telecoms will fill themselves quite well.

Alan Webborn - Societe Generale - Analyst

That's helpful. Thank you.

Operator

Mikhail Shlemov, UBS.

Mikhail Shlemov - UBS - Analyst

Good evening. Thank you very much for the conference call. I have a couple of questions please.

The first one actually is relating to the asset quality and the cost of risk. If I remember correctly in the earlier discussions you are noting that the cost of risk is likely to peak in Q3. I would like to check if this expectation is still valid.

And the second is a little bit of a more big picture question related to the deleveraging which is currently you are going through as well as the whole economy. Just like as far as Sberbank is concerned any just like particular level where you would feel a deleveraging lack of the quality demand on the loan side and does the inflow of deposits which you continue to see would actually lead you to look at the possibility to returning capital to the shareholders especially once you hit your capital adequacy targets? Thank you.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes, we will look for the third quarter if we passed the pick cost of risk, unless we face with some new tremendous deterioration here or there. And say after that we may see some stabilization or relaxation of our cost of risk gradually, not very fast but gradually.

We feel this is now the year 2016 but do not expect us to immediately come back to cost of risk 100 basis points. It's impossible, we'll be quite conservative and reduction will take place very gradually, slowly, at least first few quarters.

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Secondly if -- your second question was about our ability to employ our capital. I think what we as management we committed to deliver to our shareholders economic value added on capital employed. And we have really calculated now a strategy and financial model what it means exactly in terms of numbers, in terms of net bottom line we should deliver.

We are going to present our view where we are and what we are going to deliver so on our Capital Day in London on October 22. I believe that we have a number of opportunities today and list of challenges which require capital on the one hand and again capital creation, on the other hand, open for us an opportunity to employ that capital. And as we mentioned a number of times we see we are going to come back to our normal dividend policy and normal dividend payments.

Mikhail Shlemov - UBS - Analyst

Thank you, that's clear. Alexander, if I may then follow up on the dividend since you mentioned it.

Just like I think earlier talked about that the 10% Tier 1 capital is required basically to return to the normalized dividend policy. Would you please specify on type this is under Basel I Tier 1 ratio or we should look at the IFRS core Tier 1?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

IFRS ratio on the one hand and regulatory ratio on the other hand we are more stressed in Russia in terms of regulatory requirements. So Russian standards but at the same time our dividends yield policy is based on IFRS as you well know.

Mikhail Shlemov - UBS - Analyst

Okay. So basically one is 10% under Basel I is hit, you can pretty much return to 20% payout, right?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes, as of now we put in our model a return back to 20% payout ratio starting from the next year.

Mikhail Shlemov - UBS - Analyst

Okay, that's clear. Thank you.

Operator

Andrzej Nowaczek, HSBC.

Andrzej Nowaczek - HSBC Global Research - Analyst

Thank you. I first want to ask a follow-up question on your market loan growth expectation, single-digit growth in corporate loans. Is this in constant currency or do you include the ruble devaluation in it?

Anastasia Belyanina - Sberbank Rossii OAO - Managing Director & Head, IR

Hi, this is Anastasia here. So we use the internal ratios that we have in the base case scenario given where the world price is and our expectations towards GDP that we apply in all the forecasts that we present you.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

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Definitely all numbers are in base currency in Russian rubles and some devaluation is within these numbers definitely.

Anastasia Belyanina - *Sberbank Rossii OAO - Managing Director & Head, IR*

Yes, it's factored in all right.

Andrzej Nowaczek - *HSBC Global Research - Analyst*

Will then if it is factored in then the reported number in the second half should be in double digits December to June or else you don't expect any underlying loan growth in the remainder of the year. I'm asking and I suppose others are asking because it's been disappointing so far.

We believe in July under your Russian accounting standards corporate loan book shrank by 4%. So what is really going to change this?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Again we are selective and if we have a chance to a little bit reduce our portfolio, at the same time improve the quality, then we come to the markets – some or part of exposure we do not like, we use that opportunity. For us market share in terms of corporate lending is not the target itself.

What's important for us is quality and profitability. So if we are missing a little bit our forecast for corporate credits growth but at the same time we profile the quality of our portfolio – I think it's not really a bad thing.

At the same time what's really priority for us – that's mortgage development, mortgage market where quality is credit driven, that's good, and where our market share is increasing, we are the main provider of mortgage to the Russian market. We are actually -- we became the main car loans bank for Russia, so that's also quite good predictable quality. So that's the sort of strategy.

On the corporate side we are trying to reduce our concentration risk on our asset side. We are trying to reduce our exposure on some industries like, first of all, construction and we will continue to be selective.

Do not expect us very high growth in second half of the year. We try in our guidance, we a little bit amended our full-year forecast in terms of corporate, slightly slower than the sector. That's instead of in-line with the sector.

So it means that we do not expect that our market share at the end of year will be the same as it was beginning of the year. Full-year results will be some reduction in our market share in terms of corporate lending but definitely increasing in market share on the retail side.

Andrzej Nowaczek - *HSBC Global Research - Analyst*

That's clear. Thank you. And maybe on update on the IRB approach adoption.

I believe you said last time that was to be signed off by the CBR shortly. Has it been signed off and do you still expect 60 bps from early next year?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

We are in very productive discussion with Russian Central Bank. We expect them to announce changes to its regulations within the next couple of months. So maybe before just of October.

It will take some additional time, maybe half a year to complete some formalities. So we still have a chance to start supply IRB approach middle of the next year, not just of February, that's already not possible now, it's really late.

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Central Bank may be delayed but we still have a chance to start it in July 1 at the earliest and the latest January 1, 2017. We will update you on that matter at our Capital Day in London by that time definitely Central Bank will clear out timelines for IRB implementation in Russia.

Andrzej Nowaczek - HSBC Global Research - Analyst

That's perfect. I think you just answered my first question at the same time. Thank you very much.

Operator

Yavuz Uzay, Merrill Lynch.

Yavuz Uzay - BofA Merrill Lynch - Analyst

Thank you very much for the presentation. I have three questions and then a sector-wide additional question after the bank-specific questions. The cost of risk guidance you give for, the renewed cost of risk guidance you give for the full year below 300 basis, what's the underlying GDP growth and year-end ruble exchange rate assumption?

Can you repeat please? I think I missed that. That's one question.

The other question is, sorry, maybe we can take one by one is better.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Okay. Underlying assumptions for GDP growth minus 3 percentage points and 3, 3.5 and inflation around 11.5%, 12%. And as for foreign exchange rate, frankly speaking what we see now I think that's just normal volatility.

And it's not everything – it depends on oil price which we see by year-end. But I see no reason for further serious devaluation of Russian ruble even in current market economic environment.

Yavuz Uzay - BofA Merrill Lynch - Analyst

The reason I was asking was when we looked at the seven-month Russian accounting standard results there was an increase in provisioning because of the weaker ruble. And if you look at how the ruble moves since the end of July there's been further movement.

So should we expect this to be reflected to your provisioning through the rest of the year if the ruble stays at this level at 70? Because your budget is not made using a year-end exchange rate of 70, right? Probably more like 60.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes, correct. But since what we stipulate now and articulate as our guidance below 300 basis points already includes existing prevailing foreign-exchange rate and our best view as for the year-end.

So it definitely to assess especially in Russian accounting standards our profitability and say it will be seen as soon as in our August numbers which will be published just in a few days. Definitely in August we have to create quite in Russian standards quite substantial additional provisions --

Yavuz Uzay - BofA Merrill Lynch - Analyst

To reflect the RUB70 exchange rate.

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Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Exactly, exactly. But at the same time in our guidance cost of risk below 300 basis points that's already in.

Yavuz Uzay - *BofA Merrill Lynch - Analyst*

Okay. The other question --

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

We have some flexibility there and again we prefer to be on the relatively safe side. On the other hand, if we see further deterioration of macroeconomic situation it's actually what we see let's say RUB100 per dollar which me personally I do not believe it, I see no grounds for that at all absolutely. So, but what will be slightly different strategy, it may require us to reconsider our view, but as of now I see no potential for what level of deterioration situation.

Yavuz Uzay - *BofA Merrill Lynch - Analyst*

Okay. Then the other question is about other income includes everything, that includes currency trading, securities trading, everything combined and if I look at all the income you generate on top of net interest income and fee income it was a total of around zero for the full-year 2014 because fourth-quarter 2014 was a big negative and then in the first half you had RUB70 billion. So what kind of other income should we forecast for the full-year 2015 and what kind of run rate should we expect into 2016 is the other question?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

To be precise year 2014 that was roughly plus 6 and year 2015 first quarter 35.1 and second quarter 34.6 if I'm not mistaken, correct?

Yavuz Uzay - *BofA Merrill Lynch - Analyst*

Yes, yes. That's the number.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Yes, so that's quite stable. What we did before the sharp devaluation of the Russian ruble last year, we closed our open currency position related to our investments into our subsidiary banks abroad.

We got permission from the Russian Central Bank, and so it was changed in the regulation. So Russian Central Bank a little bit updated Russian regulation and put it in-line with international standards, which allowed us to close our short foreign-exchange position last year, which the fact we have now a balance sheet was one part of the answer. The other part of the answer is yes -- we are focusing on what I can sense we closely monitor our foreign-exchange translation gains and accounting items. So I do not expect high volatility on that item.

Yavuz Uzay - *BofA Merrill Lynch - Analyst*

So for the full-year 2015 if we doubled the first half it's a realistic full-year forecast?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

I think it will be if it's more modest, not same, exactly same numbers, but trend is exactly right.

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Yavuz Uzay - BofA Merrill Lynch - Analyst

Okay. And then I have two more short questions.

One of them is if you incorporate all what you said about 2016 expectations you said net interest margin will be above 5% for the full-year 2016. That means like compared to what you expect to achieve in fourth quarter should we expect a flat margin into 2016?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

To be precise, if I'm not mistaken, I mentioned to be around or not less than 5 percentage points. Okay? So whether it will be just the 5 or 5.15 I cannot say now but for the next year for the sake of the modeling I would suggest 500 basis points full-year net interest margin.

Yavuz Uzay - BofA Merrill Lynch - Analyst

Okay. So do you mean you do not expect margin to decline a lot from where we achieved fourth quarter during the year, so flattish versus what we achieved in fourth quarter is a realistic number?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

More or less yes.

Yavuz Uzay - BofA Merrill Lynch - Analyst

Yes. And then you said that cost of risk will normalize only slowly, so we expect some decline, some decline in cost of risk during 2016. So if you incorporate all your expectations in 2016 what is a realistic return on equity target for you in 2016?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Let me answer your question when we present our updates in our strategy when we are in London, okay? We need a little bit more time to just examine capital policy scenarios and to look into more details on our credit portfolio and specifically address the pace of our stabilization of custom risk when we are in London in the second half of October this year. The trend is clear but the pace is yet to be defined.

Yavuz Uzay - BofA Merrill Lynch - Analyst

Yes, fair enough. Fair enough.

And one final question I have is this. When we were looking at the seven-month results of the Russian banking sector you had RUB92 billion net income in the first seven months cumulative but the rest of the sector had RUB58 billion of net loss.

Last year, however, the sector created close to RUB600 billion of net income of which you made half of it. So there's a big change in the balances in the banking sector. What does it mean for you, so in terms of your future profitability or future role in the Russian economy, does that change your position, does that change your strategy at all?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Thank you very much for that question. It's a really a very good question.

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When we met in London when we presented our five-year strategy three years ago we promised you to focus now on market share in terms of net profit after tax and to increase it from 40%, 40%-something we had at the time to 50%. And the fact that we did it this year and it's now at least it's about 100% our market share in terms of net profitability.

So we are a little bit ahead of our own scale. And since we see an opportunity and stress at the same time, definitely we think consolidation in Russian banking and flight to quality. We see more and more new customers in our offices and more and more businesses coming to us from smaller competitors and less successful competitors which gets us additional bargaining power and allows us to be more selective in what we are doing.

At the same time again for us priority first of all create quality, secondly that's profitability. And say only after that we look after some specific goals and market shares.

Yavuz Uzay - BofA Merrill Lynch - Analyst

The reason I'm asking is like most of us in our valuation models assume you going back to 17%, 16.5%, 17% sustainable return on equity. It is one of the highest return on equities in the entire global emerging market banking universe. Does this shifting picture in relative fortunes of the Russian banking players, does it create a threat on your ability to go back to 16%, 17%, 18% return on equity?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Again I return to the financial model for the remaining part of our strategy for the next few years when I present the model in London. It will be part of our Investor Day so I will update all our assumptions and share with you our view how we see it.

We believe in today's situation we are well prepared for that situation and we really take all necessary steps from our side, from management side to in order to not disappoint our shareholders. I am trying to choose my words but I hope you understand my position. I don't want to anticipate some important messages we are going to share with you in London.

Yavuz Uzay - BofA Merrill Lynch - Analyst

No, no, very clear. Very clear. Thank you very much.

Operator

Gabor Kemeny, Autonomous Research.

Gabor Kemeny - Autonomous Research - Analyst

Hi, it's Gabor. Thanks for the call. My first question is on margins.

You mentioned that your Central Bank funding is the number one margin driver. And you said you could replace most of this short-term funding with cheaper funds. Can you give us an update where do you stand on this?

I think you had about RUB1.5 trillion of this short-term Central Bank money at the end of June. So what is the amount now and are you expecting to replace it with deposits or are there other attractive funding sources for you?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

As of now it's about something like 7.9% of our total liabilities. And I mean state funding and in absolute terms money from Central Bank is something like RUB1.3 trillion. So already a smaller amount than it used to be at the end of the second quarter.

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We will continue to reduce it gradually, taking into account that our interest rate risk profile, we are not in a hurry on the ground of reducing of cutting interest rate. But in case we change the terms we have the possibility to replace that money from Central Bank by core deposits much faster, faster accelerated way.

Simply we are on the way. I believe that by the year-end that absolute amount of money taken from Russian Central Bank and in terms of percent, in terms of sharing our liabilities, we'll seriously reduce it from existing levels.

Gabor Kemeny - Autonomous Research - Analyst

Okay, that's very helpful. And the other question is on credit quality.

So when you expect to stay below 3% provisioning what do you expect in terms of total coverage? Maybe if you could give us a little color on this. So do you think you will need to reduce coverage to stay below 3%?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Sorry but I don't want to go too much into details into that level of detail at least now. Taking into account very high volatility on foreign exchange rate and taking into account what we are in the process of quite productive discussion with regards to the destiny of some of our biggest exposures on number of big names, including Mechel, now it's a little bit early so to give any guidance as for the coverage.

Because even on the Mechel itself we might seriously change the duration and the probability, the case with Mechel will be resolved end of the year and is very high. It will be resolved for us, I mean, for Sberbank of Russia.

Gabor Kemeny - Autonomous Research - Analyst

No, I understand you want to be cautious at this stage.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

So we provide additional details and more color. As for the coverage, immediately if we see some problems there but as a matter we do not target any specific coverage.

Like right now, our coverage a little bit reduced since previous quarter. But what was driven mostly by the fact that just three of the borrowers mentioned at the beginning of our conversation, let's say to the areas of non-performing loans 90-plus, at the same time provisions were an adequate level were created much earlier.

So coverage was affected heavily in the second quarter but credit quality was not changed seriously. So we should be very careful with this direction.

Gabor Kemeny - Autonomous Research - Analyst

Okay, that's very clear. And just a quick follow up on your comment on the CBR funding on the short-term Central Bank funding. So when you say your margins could recover to 5%, do you assume that this CBR funding goes to zero or maybe you could just give us an estimate what do you assume there?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

We assume further reduction of the funding from Russian Central Bank but not to zero. Economically it makes no sense for us because some bank funding we use as just a stabilization of our short-term attractions or short-term funds from markets.

So I don't expect it will be zero. It may be zero but we have not specifically targeted it. But it will be I think definitely below RUB1 trillion.

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Gabor Kemeny - *Autonomous Research - Analyst*

Okay, that's helpful. Thank you.

Operator

Maria Semikhatova, Citibank.

Maria Semikhatova - *Citi - Analyst*

Yes, thank you. I have a couple of questions. First on cost of risk, could you provide the number what was the contribution of Ukraine to cost of risk in the second quarter?

And also just can you confirm that I understood it correctly that the contribution of these three borrowers that became NPLs in the second quarter to cost of risk was effectively immaterial in the second quarter? That would be my first question.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

Okay, Ukraine account it's roughly to 0.60, so 60 basis points. And yes as a matter of fact these three borrowers on our cost of risk in second quarter was immaterial, you are right.

Maria Semikhatova - *Citi - Analyst*

I see. Thank you. And the other is a different question. Maybe you could comment on the performance of your subsidiaries in Turkey and Eastern Europe.

I believe the segmental breakdown is not really representative because of some derivative operations that you're accounting for in that division. And also just maybe you can share some comments on the strategy going forward because we've seen some reports that the bank is looking to exit certain markets in Eastern Europe.

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

We will more specifically address that topic, our new strategy, when we are in London. As for the results of our subsidiaries, we are very proud of our results of DenizBank in Turkey, despite very difficult environments Turkey is faced with now, we are performing decently well.

In Eastern Europe we are in the red, we are in negative numbers which is expected, unfortunately. And it will be difficult for us to show positive results this year. It's not yet the evening, is not yet the end of the year but we forecast different opportunities to improve the profitability but Eastern Europe is quite difficult area now to work as some of us know.

As for Belarusian, Kazakhstan despite the turbulence of the market we are performing decently well. The main driver in all our subsidiary banks was DenizBank Turkey.

Maria Semikhatova - *Citi - Analyst*

Okay, thank you for the comments.

Operator

Cagdas Hatinoglu, HSBC.

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Cagdas Hatinoglu - HSBC - Analyst

Good afternoon. Thank you very much for the presentation. I have three related questions about your capitalization.

So your Tier 1 ratio and total capital ratio both improved under IFRS without the [liquidity]. But as you also mentioned that you are going through more stress under IAS, Tier 1 ratio is down to 8.6% as of the end of June from 8.9% in March and it's further down to 8.2% as of end of July.

I know there are different accounting standards and IAS is based on consolidated accounts. But could you please give some color on the reasons behind the divergence between the two in the second quarter? That's my first question.

The second one is at what level of Tier 1 under IAS would you feel uncomfortable and think of utilizing Tier 2 conversion to Tier 1, too?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

The difference exists definitely because in Russia is Basel III and for Russian bank, and IFRS only for Russian business which is about 80% actually of our group assets, and 20% - that's outside of Russia. Because of the relation of the Russian ruble, that portion now is noticeably higher than it used to be and on group IFRS it's Basel I. So definitely it's different methods of calculation of capital adequacy ratio.

We have to be compliant on a standalone basis and with Basel III in Russia. And we also report group numbers and group ratios to the Russian Central Bank according to Basel III. But in our IFRS reporting we actually disclose and calculate our costs according to Basel I.

So I'm sorry your second question was -- could you remind me?

Cagdas Hatinoglu - HSBC - Analyst

Yes, so to what level of Tier 1 under IAS would you feel sort of uncomfortable and think of utilizing the Tier 2 conversion to Tier 1 I believe there's some RUB500 million available for you to convert to Tier 1 from Tier 2.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

We would not exclude it. Actually that subordinated loan, which was previously taken year 2008 and 2009, we consider Tier 2 Russian banking regulators, Central Bank of Russia has recently amended regulation introducing new concept of perpetual which didn't exist in the past, which theoretically opens the way for conversion from Tier 2 to Tier 1.

But what will take time and what discussion we have just started so we believe that option exists is on the table. We have it in the pocket if and when it is necessary.

Cagdas Hatinoglu - HSBC - Analyst

Okay, thank you very much. And one more question, I kind of missed the number. What was the capital sensitivity, the FX volatility, could you please remind us?

Anastasia Belyanina - Sberbank Rossii OAO - Managing Director & Head, IR

Can you repeat, sorry, can you say it again?

Cagdas Hatinoglu - HSBC - Analyst

What was the FX volatility effect on your capital, the sensitivity of the capital to the FX volatility?

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Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Okay, RUB10 devaluation, the ruble's devaluation affect us by 0.6%, 0.7%. So 60, 70 basis points in terms of capital adequacy ratio.

Cagdas Hatinoğlu - HSBC - Analyst

That's perfect. Thank you very much. Thanks.

Operator

Ivan Bokhmat, Barclays.

Ivan Bokhmat - Barclays Capital - Analyst

Hi, thank you. I just wanted to ask a small question regarding your mortgage book.

We're starting to hear news reports of real estate prices coming down particularly in Moscow and Moscow region. Could you maybe give us an update on the loan to value in your current portfolio and the levels that you are using right now for new lending?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Loan to value in our portfolio is improving, actually is around 65%, 67%.

Ivan Bokhmat - Barclays Capital - Analyst

And the new lending being lower on LTV?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

Yes, yes certainly.

Anastasia Belyanina - Sberbank Rossii OAO - Managing Director & Head, IR

The down payment for new issuance is over 30% compared to roughly 27% we had in 2014.

Ivan Bokhmat - Barclays Capital - Analyst

Okay, thank you.

Operator

There are no further questions on the English line at this time. So we will now switch to Russian.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

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Before we switch to Russian I'd like to thank all the participants who joined on our conference call today. Thank you very much for being with us and we appreciate your feedback off-line, your questions and comments. For us it's very, very important to collect your opinions and your questions before London in order to allow us to prepare better for Q&A session in London on October 22.

Please save the date. Invitations will be sent later on. Thank you.

Operator

(Operator Instructions) (interpreted) (inaudible)

Unidentified Participant

(interpreted) Hello. Hello, Alexander. Thank you for the presentation.

I've got a couple of questions for you. Today when I look through your reports by IFRS on assets there was a reduction by 6% over the first half. Why did it happen?

Such a reduction in asset, doesn't it mean that the bank is reducing its presence in the Western or Eastern Europe? Or does it mean that assets have been affected by provisions?

And my second question is as you talked to the analysts use that you hoped with Mechel as far as I understood will become better. Am I right? Did I understand you correctly that the situation with Mechel will be resolved?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) As to reduction in assets there are changes in the exchange rate. As of the beginning of the year and as of June there has been some appreciation of the ruble and this affected our net assets. Plus of course obviously less demand for loans, quality demand.

This resulted in a reduction in the portfolio on corporate lending. This is the second factor which is also affected and brought about a reduction.

In principle there has been nothing horrible in the reduction of our assets. They went down and they went up again.

As to your second question on Mechel, as I said we are in a process of a constructive negotiation. And we believe that there will be a positive outcome to them in the near future as soon as they are completed and it is possible we will make a special announcement on that. Today it will be premature to do that.

Unidentified Participant

(interpreted) You mentioned by the end of the year but it was on Mechel.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Yes it was, yes.

Unidentified Participant

(interpreted) And we may think that there might be a positive decision -- you may come to a positive decision by the end of the year. Is that right?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

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(interpreted) Yes, we may -- yes we would very much positive decision if it is a constructive dialogue. Well it goes without saying.

Unidentified Participant

(interpreted) Can you disclose any details, is it about selling the debt?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) No, no details. We cannot do that. You know our policy.

Until we enter into all relative documents and before disclosure we will not give out any comments or details on specific deals. If you're interested in these questions you may address your questions to Mr. Poletaev and he will answer you within the terms of his reference. Today we're discussing results for the second quarter and I would like to ask everyone so that we focus on these issues.

Unidentified Participant

(interpreted) Okay, thank you very much.

Operator

(interpreted) (inaudible), RBC.

Unidentified Participant

(interpreted) Well further information what you told us concerned, the question is about the scenario for the ruble falling to RUB100 per dollar which you think almost impossible. And specify did you make any stress test by request of the CBR or was it the initiative of Sberbank? And second can you share --

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Actually we don't know anything about any stress test. The Central Bank or any other authority did not contact us with any kind of request to make this test. I don't know and no one knows about such stress test. So this information is just a rumor and I will not comment on rumors.

Unidentified Participant

(interpreted) So Sberbank just wanted to test whether Sberbank when the ruble gets to such a mark and how will Sberbank live through it?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Maybe I didn't say it correctly. I didn't say we would make any stress test. I said that me personally I think that this scenario is most likely impossible.

That's what I said. When do stress test using figures which may only be possible and the figure of RUB100 I think it's economically impossible, well at least as of now. It's not in any other our scenarios.

Unidentified Participant

(interpreted) Another question then, it seems (inaudible) with Transaero provided some other business plan, some new business plans. Can you expand on that?

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Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Well all the details of specific customers and on the commercial activities should be all questions like that should be addressed to Mr. Alexander Baziyan, and they will be readdressed, redirected to the corresponding specialist because we do not comment on the activities of our specific customers.

Operator

(interpreted) (inaudible), Newspaper.

Unidentified Participant

(interpreted) Good afternoon, good evening Alexander. You said that there are three problem borrowers for which you required RUB90 billion of reserves in the second quarter.

Did I get it right? And it was Transaero, Mechel and UTair these three.

And second question, you said that you can't track the amount of funding from the CBR which has RUB1.3 trillion. What was the indicated by the start of the year? What was the share and the volume you said three years ago and can you maybe make a more updated more of provide updated info?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) No, I just said that there was a change to RUB1.3 trillion. As far as the influence of three borrowers is concerned I said that the initial provisioning had to be done these borrowers which were in a situation of overdues in the second quarter. So on the first question we have a figure from the CBR by the end of the year RUB3.027 trillion, that was in December, and the official figures for June 30, RUB1.53 trillion and now RUB1.3 trillion so it is shrinking.

Turning back to the borrowers, one more time, I will say that we are following – the conservative policy when we form our reserve, our provisions. So we create provisions when we see a problem and not when they are already in the NPL 90-plus.

In a number of cases, including Mechel, the decision for provisioning for additional provisioning was taken before the borrower went into a 90-plus overdue. That's why we have a temporal difference between us creating new provisioning and the time going into overdue.

So the provisions were created from Mechel last year, but it was not last year that it went overdue, only in the second quarter this year. So that's why the ratio of provisioning created for 90-plus NPL changed.

The same applies to UTair, which I mentioned. I just wanted to specify, so if we take these three clients, than the decrease of current ratio will be very low.

Unidentified Participant

(interpreted) And I'm not talking about the current ratio, I was asking about the fact that the level of NPL in the second quarter grew by 1 percentage point which is a considerable growth for Sberbank. So I thought it was connected to these three problem borrowers or how else can you explain this growth of NPLs in the credit portfolio in the second quarter?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Yes, of course because they went to NPL 90, plus overdue. And these three specific borrowers yes, yes, I was just for them and the others.

But you see NPL grew RUB160 billion and 136 of them are corporate customers, and 70 out of them are these three borrowers. So more than half of the NPL growth in corporate.

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Unidentified Participant

(interpreted) Thank you. Understood.

Operator

(interpreted) (inaudible)

Unidentified Participant

(interpreted) Good evening. Thank you for this opportunity.

I would just like to specify before you announced the sum of RUB700 billion that can be moved to provisioning but current results we see that it could be higher. So what are your expectations on increasing the provisioning of Sberbank in the second half of the year?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

(interpreted) Well the only thing I can say is repeat the forecast which I made, the cost of risk calculated as the number of provisioning, the amount of provisioning compared to the average credit portfolio. So it will be 300 basis points by the year-end. The specific figure of provisioning I can't name it because it depends on further the portfolio and other factors.

So we are targeting the cost of risk now, not the absolute size of provisions. I think it's a rather correct way to do it.

Unidentified Participant

(interpreted) Can I specify another thing? I think you mentioned its plan on going back to the 20% dividends payment from the net income, can you say if this forecast is real by year-end 2015?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

(interpreted) Well, we mentioned this at our AGM we said that we could go back to the normal practice of 20% dividends payment starting from 2016.

Unidentified Participant

(interpreted) So these plans remain the same?

Alexander Morozov - *Sberbank Rossii OAO - Deputy Chairman & CFO*

(interpreted) Yes, they are still current.

Unidentified Participant

(interpreted) Thank you. Understood.

Operator

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(Operator Instructions) (interpreted) Ekaterina Belkina, Interfax.

Ekaterina Belkina - Interfax - Media

(interpreted) Good evening. As I remember in September the bank will have to repay CHF400 billion in the Swiss currency. Did you make a prepayment for that because the currency rates changed, so are you planning for this in the third quarter, the repayment of this?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Well, in May we repaid \$1.5 billion of the syndicated loan and the same at the beginning of June, after the reporting period. So we repaid more than 3 billion. So in Swiss francs they will be repaid by September 14.

The reality of the Swiss market is that the Swiss investors don't like prepayments. It's not a standard practice of the Swiss markets. And that's why the repayment will be made exactly on the date of repayment.

Unidentified Participant

(interpreted) Thank you, understood.

Operator

(interpreted) Ms. Kobzeva, Reuters.

Oksana Kobzeva - Thomson Reuters - Media

(interpreted) Good evening. Mr. Morozov I would like to ask the following. What you said to analysts about the fact that you are working on strengthening the capital and meaning that you're going to go away from the effect that the ruble devaluation has on the capital, so what actions are you foreseeing?

Do you mean just the discussion on converting the subordinated from the second level to the first to Tier 1? Also did you assess the possible painfulness for you if the Central Bank doesn't prolong its special rate?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) Well you can see on our reports we're going to continue working in this direction. We are working on our equity, so our income will be considered part of our capital adequacy.

So what we see with the securities in the IFRS portfolio we think well there are actually some other measures, I don't want to announce them prematurely, measures directed at decreasing the risk-weighted assets indicator and strengthening of the capital by increasing the income.

So as a whole the plans are complete for this year and we did not think that the measures of the Central Bank would continue for any time, so we thought we would be able to suggest our CIR without any special conditions. Of course there is serious volatility on the market, on the FX market but still it's not the end of the year yet. And it can still change because we remember that at the end of last year on some days the rate went even higher than it is now.

So it's up there with the Russian ruble beforehand. So in this extent the decision taken by the Central Bank, it is the Central Bank's prerogative so we will accept it just as something that exists and then we will act considering our possibilities and our plans. And we'll do what depends on us and the actions of the Central Bank is just an additional input that is either there or not.

Oksana Kobzeva - Thomson Reuters - Media

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(interpreted) And about the special rate?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) That's what I was saying when I answered your question.

Oksana Kobzeva - Thomson Reuters - Media

(interpreted) So you meant it would not continue but for you is it a sore point or not? Can you evaluate it in rubles?

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) No, I'm not going to evaluate it right now. I cannot but if it is taken then we'll just deal with it.

Oksana Kobzeva - Thomson Reuters - Media

(interpreted) Yes, thank you.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) I said already that RUB10 of devaluation is 60 to 70 basis points, 0.7 to our capital adequacy and then you can calculate. If the rate devalue is from 60 to 70 then 0.7% change to CIRs so we are compensating that through other measures. So that's that.

Operator

(interpreted) Ladies and gentlemen, thank you for your questions. There are no further questions. Now the floor to Mr. Morozov.

Alexander Morozov - Sberbank Rossii OAO - Deputy Chairman & CFO

(interpreted) I would like to thank all the journalists who took part in this conference. I know your headlines often focus on negative points saying that income fell two times compared to last year, although it grew compared to the first quarter of this year. But that's I think is a peculiarity of our journalism.

So we actually improved, and I hope you will see positive aspects in addition to the negative ones. From our Sberbank side we will do our best for you as a journalist and as our customers to be satisfied with our services and with our results.

So we will do our best to satisfy you and to see positive headlines in the newspapers about Sberbank and then we will be happy as well just as you are. Thank you and have a nice evening.

Operator

(interpreted) Ladies and gentlemen, we are now ending the conference now and thank you for participating. Goodbye.

Editor

Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the company sponsoring this event.

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