



Sberbank and the Russian banking sector

**Industry
review**

Initiation of coverage

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SBERBANK HOLD

UPSIDE 6%

TARGET PRICE \$3,670

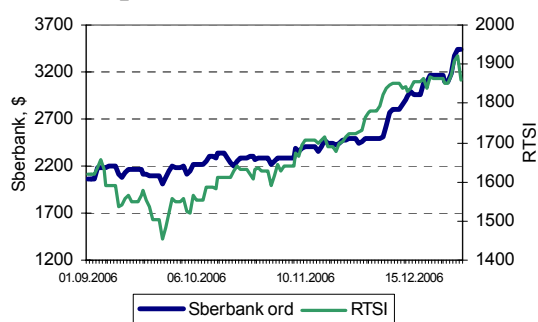
STOCK DATA

Ticker	SBER	MCap (US\$ mn)	68,730
Shares Ords	19,000,000	Free Float, %	38
Shares Pref	50,000,000	Free Float (US\$ mn)	26,100
Bid Ords (US\$)	3,430	Offer Ords (US\$)	3,480
Bid Prefs (US\$)	54.5	Offer Prefs (US\$)	58

PERFORMANCE 2006E

Assets (US\$ mn)	125,937	ROA, %	2.5%
Book value(US\$ mn)	14,288	ROE, %	22.6%
NII(\$ mn)	9,128	P/A	0.55
Net profit (US\$ mn)	3,229	PIBV	4.8
Tier 1 Capital ratio, %	11.3%	PIE	21.3

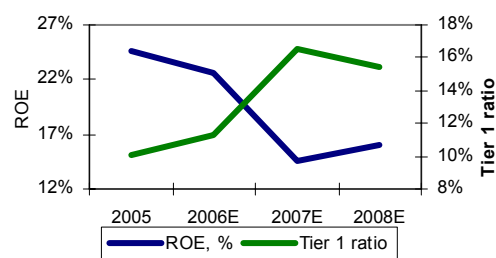
Sberbank performance vs. RTS index



Sberbank valuation

	Fair price, \$	Weights
EBO valuation	3,571	40%
Peer comparison	3,699	30%
IPO effect valuation	3,766	30%
Final price, \$	3,668	

Sberbank ROE and Tier 1 ratio, %



- The Russian banking sector has developed rapidly in recent years, reflecting improvements in the financial sector and a strengthening economy. Since 2002, Russian banks' assets have increased 3.5 times to \$466 bn at the end of 2006, jumping 37.7% in 2006 alone. The main factors contributing to this booming growth were strong economic growth, increasing disposable incomes and obvious improvements in the money management skills of the Russian populace.

- We believe that the Russian economy will continue growing at above 5% through 2010, remaining one of the most rapidly developing emerging markets. Given the low level of monetization in the economy and low penetration of banking services, we underline that banking sector will grow quickly, c30% year-on-year through 2010.

- The growth of banking assets over the last five years was mainly due to the development of retail banking. Retail loans increased from \$5 bn in 2002 to more than \$70 bn in 2006. We believe that the further development of retail banking and banking products—such as credit cards—will be key factors in growing banking assets.

- We believe that recent legislative changes—i.e. the removal of “blessing” limitations and the introduction of full ruble convertibility—will increase the Russian banking sector's appeal for non-residents.

- Sberbank is the largest Russian bank, holding 27% of Russian banking assets. It has significant advantages over any other Russian bank, with key advantages being cheap funding, a monopoly in some regions, and the largest network of branches across Russia.

- Sberbank's upcoming secondary placement will allow the bank to raise additional equity. It is extremely important for Sberbank now, because by the end of 2006 the bank utilized all available sources of capital increases—subordinated credit and asset reassessment.

- We believe that after the bank's share placement, the weight of Sberbank in MSCI indices will be increased. Sberbank currently has a weight of 5.2% in the MSCI Russia index and 0.53% in the MSCI EM index.

- We rate Sberbank shares **HOLD** with a price target of \$3670 per ordinary share.



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

February 2, 2007

Contents:

Investment case.....	3
Macroeconomics and the Russian financial sector.....	4
The Russian banking sector.....	8
Recent legislative changes.....	14
Sberbank.....	15
Appendix.....	31



Investment case

- Economic development and a maturing retail market were the basic factors contributing to the rapid growth of the Russian banking sector in recent years. These are the basic factors underlying foreign investors' high interest in Russian banks. Retail credit is developing at a clipped pace, due to increasing household incomes. Russian consumers want to buy more luxury and durable goods, and are taking more consumer credit for this. For example, retail loans increased by 52% year-on-year in 2006. Among the factors leading to the further development of the Russian banking market is the increasing needs of Russian companies to renew their capital assets, which leads to increased corporate loans.
- In 2006, the Russian banking system saw substantial growth in foreign capital, which increased from about 11% at the beginning of the year to 14.4% in November. Meanwhile, in 2005 this share almost doubled, increasing from 6%. Last year the Russian banking sector saw substantial interest from foreign investors: Bank of Moscow, Bank Vozrozhdenie, Promsviazbank and others sold minority stakes to non-residents, and we expect this trend to strengthen in 2007. It is worth noting that over the course of 2006, foreign investors started paying more for Russian banks: at the beginning of the year, Norwegian bank DnB Nor bought Monchebank (Murmansk) at a P/BV of 2.2, while in November, Nordea bought Orgresbank at a P/BV of 4.4 (**See table on p. 8**).
- We underline that Sberbank—being the largest Russian bank with the strongest position on the retail banking market—remains the main beneficiary of rapid banking sector growth. The bank's upcoming secondary placement will provide it with \$10.5–\$12 bn of additional capital, which will be enough to finance 40%+ annual asset growth over the next three years. Via its secondary placement, Sberbank will be able to solve one of its main problems—capital adequacy, which is now extremely low and prevents the bank's further development.
- In addition, the secondary placement will have some additional positive impacts on Sberbank. In the light of the expected increase of Sberbank's freefloat after the placement, MSCI intends to increase Sberbank's weight in its MSCI Russia and MSCI EM indices in February, what should provide additional demand of \$1.5 bn for Sberbank's shares.
- We note that Sberbank continues to show sound financial results. According to the bank's 9M06 financial results, net profit increased by 47% year-on-year. Net interest income increased by 35% year-on-year, but the main driver of the net profit increase remained fees and commissions (+58% year-on-year). Sberbank's announced 2006 net profit is \$3.3 bn, 51% higher year-on-year.
- Sberbank's main advantages over other Russian banks are that it has the largest network of branches across Russia, cheap funding and the highest level of people's confidence.



Macroeconomics and the Russian financial sector

Strong economic growth and the development of the retail market were the basic factors for the rapid expansion of the Russian banking sector in recent years. Since 2002, Russia's real GDP growth rate has been above 6%. In 2006, according to Ministry of Economic Development and Trade forecasts, the Russian economy increased by another 7%. We believe that the annual growth rate of Russian real GDP will exceed 6% until 2010 and Russian banking sector will grow rapidly as a result of the insufficient monetarization of the economy (banking assets to GDP) and the development of retail loans.

Key macroeconomic indicators

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E
% real GDP growth	7.30%	7.30%	7.40%	6.40%	7.00%	6.20%	5.90%	6.00%	6.00%
Nominal GDP, \$ mn	348	452	612	752	932	1,119	1,332	1,558	1,792
Gold and currency reserves, \$ bn	47.8	76.9	124.5	182.2	299	334.9	368.4	397.8	417.7
CPI, %	15.1%	12.0%	11.7%	10.9%	8.7%	9.5%	9.0%	8.5%	8.5%
RUR/USD exchange rate, year-end	31.85	29.45	27.75	28.79	26.6	25.6	25.2	24.8	24.5
Monetary base, \$bn	39	65	86	101	135	166	203	247	300
Money supply, \$bn	67	109	157	210	304	407	529	672	850
Foreign direct investments (FDI), \$bn	4	6.78	9.42	13.1	24	38.4	49.92	64.90	84.36
Budget surplus, % of GDP		1.7%	4.2%	7.5%	6.7%	7.1%	7.8%	8.4%	8.9%
Stabilization fund, \$ bn	-	-	18.8	43.0	84.0	125.9	157.4	188.9	207.8

Source: CBR, MEDT, Sovlink estimates

In 2006 the Russian economy continued to strengthen—expected real GDP growth reached 7%, increasing from 6.4% in 2004, FDI was a record \$24 bn, and inflation declined to 8.7%, a single-digit figure for the first time since the formation of the Russian Federation.

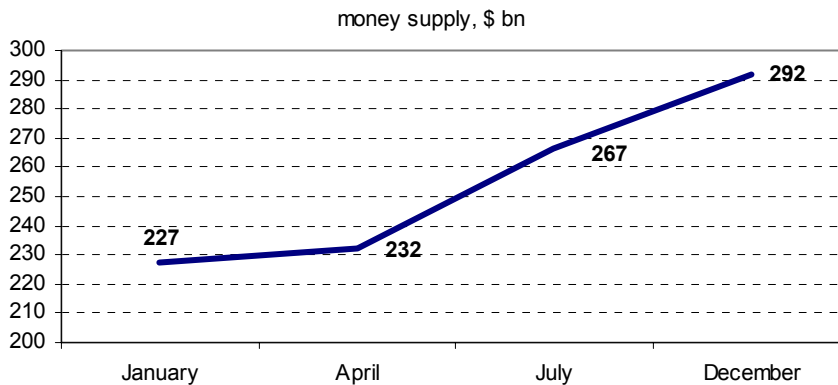
Russian gold and currency reserves reached c\$300 bn by end-2006, while the country's money supply increased by 28%.

Monetary indicators, 2006, \$ bn

	January	April	July	December
Gold and currency reserves	182	206	251	289
Monetary base	110	77	90	132
Money supply	227	232	267	292
Net foreign assets	183	204	234	246

Source: CBR

Money supply in 2006



Source: CBR

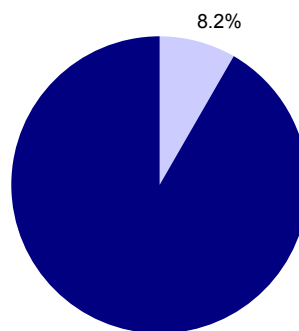
The Russian economy is becoming more monetized, which creates more favorable conditions for banking activities.

Further, at the beginning of 2007, CBR officials claimed that the refinancing rate could be lowered to 10% from the current 11%, what will make financing for banks cheaper and increase the banking multiplier.

We assume a slowdown in Russian economic growth in 2007—to 6.2%—as a result of the decline in oil prices. The planned increases in energy and utility tariffs in Russia at the beginning of 2007 will increase inflation to 9.5%, forcing the Central Bank to intensify its anti-inflationary policies. This will be achieved most easily by pursuing a strong ruble policy. Foreign investment into Russia should continue at a healthy pace in 2007, thanks to a strong ruble and strong economic growth backed by domestic consumption. This should support growth in industrial production, personal incomes, and GDP.

Despite obvious improvements in recent years, the Russian banking sector still remains rather underdeveloped compared to the banking sectors in other European countries and most emerging markets. The 80 largest banks in the world have a capitalization of \$4,000 bn, or 17.7% of global market capitalization. (At the same time, public oil companies have a capitalization of \$2,500 bn). Traded Russian banks make up just 8.2% of the Russian market's total capitalization.

Banking sector share in the total capitalization of the Russian market

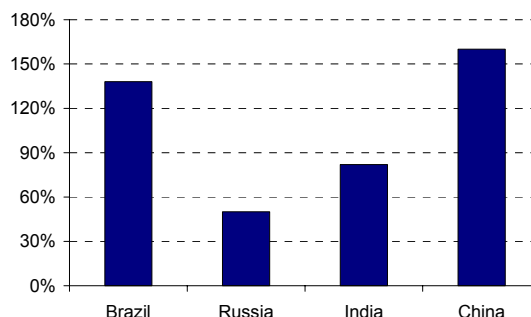


Source: Sovlink estimates

The Russian banking sector is characterized by a relatively low level of penetration. Banking assets as a percentage of GDP reached 50% in 2006—up from 42% two years ago, but still the lowest among BRIC countries—and is significantly lower than the assets/GDP ratio for the Eastern European banking sector, 90%. The Russian banking sector is currently experiencing booming development as a consequence of the rapid growth of the Russian economy and likely increases in the retail sector and retail banking.



Banking assets/GDP ratio, 2006



Source: World Bank, Sovlink estimates

Recent improvements in the Russian financial sector

Between 2002–06, the Russian financial sector came noticeably closer to developed economies, where most transactions are made through the banking system, not in cash. This was due to increasing consumer confidence in the banking system, after the approval of the Deposit Insurance Law, and rapid growth in the retail sector, and—as a result—demand for retail loans. Russians are gradually beginning to engage in civilized financial culture and use credit to buy durable goods and credit cards for non-durables.

One of the serious improvements in the financial system implemented by the Russian government in 2006 was the introduction of full ruble convertibility from July 1. All previous restrictions on currency inflows and outflows were abolished.

At the end of 2006, Finance Minister Alexei Kudrin announced that his ministry expected a net capital inflow of \$23–25 bn in 2006, considerably more than the \$13 bn in 2005 and \$9.5 bn in 2004. We expect that the amount of foreign direct investment in the Russian economy will increase to \$38 bn in 2007, which is underpinned by the growth and investment attractiveness of the Russian economy. Important events for the Russian economy in 2006 were the completion of bilateral negotiations on Russia's entering the WTO and the repayment of \$23 bn in debt to the Paris club. Russia's external debt is now below 5% of GDP.

In 2006 Russia continued to accumulate gold and currency reserves, which reached \$299 bn by the end of the year, making Russia's reserves the third-largest in the world (Japan is first, with China second). Due to increasing commodity prices, Russia is accumulating dollar inflows from commodity exports in three places: its gold and currency reserves, the stabilization fund and the budget surplus.

We expect the stabilization fund to be above \$200 bn by 2010, and the budget surplus at that time will reach 9% of GDP. We anticipate the federal budget surplus to be \$62 bn in 2006.

Growth of real disposal incomes in Russia has exceeded the rate of inflation over the last five years, which has resulted in bettering people's wellbeing. This in turn led to growth in consumer spending and better money management skills among the Russian people.

We note that high commodity prices remain the basis of the Russian economy's prosperity, and dependence on oil prices is extremely high. This creates additional risks for the further development of the Russian banking sector, as it mainly depends on the development of the whole economy and—in particular—on the improvement of personal welfare of the Russian people.

Another important feature of the Russian banking sector is its rather low penetration. In this report, we compare the Russian banking sector to both developed economies and emerging markets.

Russia has very low level of charge card usage, which is the consequence of the rather low financial knowledge of the Russian people. Only about 5% of the population has a banking card, and most of them are debit.



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Over the last five years, the Central Bank of Russia undertook substantial attempts to increase the stability of the banking sector and raise people's confidence in it. From 2003, the Central Bank began to follow a stricter policy towards commercial banks. The process of tightening banking supervision was accompanied with the revocation of banking licenses. As such, 30 licenses were revoked in 2004, 46 in 2005, and over 50 in 2006.

Simultaneously, the Central Bank's requirements for newly-established banks have also been strengthened. From January 2007, newly-established banks should have capital of €5 mn.

The Central Bank's capital adequacy requirement for Tier 1 Capital is 11%, which—compared to the 8% used by the Basel Committee—is quite conservative.

The Federal Deposit Insurance Agency was established in 2003, and the Deposit Insurance Law came into effect. Originally, deposits up to Rb 100,000 were insured, but this sum increased to RUR 190,000 in 2006. In December, 2006 it was announced that this amount will be increased to RUR 300,000 by March, 2007.



The Russian banking sector

The positive dynamics of the commodities markets and real GDP growth in the last few years have facilitated an increase in corporate and consumer loans. We estimate that Russian banking system assets increased by 40% in 2006 (in comparison with 36% in 2005).

The increases in Russia's credit ratings were an additional factor in the rapid growth of the Russian banking sector in recent years.

In 2006, Russia's gold and currency reserves increased by 64% to about \$300 bn, the Stabilization Fund rose by 95% to \$84 bn, and Russia paid off its debt to the Paris Club. These all increased the stability of the Russian financial system and the attraction of the Russian banking sector.

The development of the Russian banking sector in 2006 was connected with foreigners' increasing interest toward Russian banks. Their high interest in the Russian banking sector is due to:

1. Rapid economic growth, which leads to an increase of corporate and retail loans;
2. Increasing needs of Russian companies to renew their capital assets, which leads to increased corporate loans;
3. The quick development of the retail credit market, given increasing real household incomes. Russian consumers want to buy more luxury and durable goods, and are taking more consumer credit for these purposes. For example, retail loans increased by 52% year-on-year in 2006.

During 2006, the Russian banking system experienced substantial growth of foreign capital: from about 11% at the beginning of the year to 14.4% in November. We note that this is after nearly doubling from 6% in 2005.

The most noticeable purchases of Russian banks by foreigners in 2006

Date	Target	Buyer	Stake bought	Deal value, \$ mn	P/BV
November	Orgresbank	Nordea (Sweden)	75%	314	4.4
July	Investsberbank	OTP Bank (Hungary)	96.4%	477	3.9
June	Rosbank	Societe Generale (France)	10%	377	4.5
June	International Moscow Bank	Unicredit (Italy)	23%	395	3.6
February	Impexbank	Raiffeisen (Austria)	100%	550	2.9
January	Monchebank (Murmansk)	DnBNOR (Norway)	97.3%	21	2.2

Sources: Expert, company data, Sovlink estimates

It is worth noting that during 2006 foreign investors steadily paid more for Russian banks: at the beginning of the year, Norwegian bank DnB Nor bought Monchebank (Murmansk) at a P/BV of 2.2, while Nordea bought Orgresbank in November at a P/BV of 4.4.

Further, in 2006 Bank of Moscow, Bank Vozrozhdenie, Promsvyazbank and other Russian banks sold minority stakes to non-residents—we expect this trend to strengthen.

Russia's entrance into the WTO will be accompanied by some important restrictions on foreign presence in the Russian banking sector: an official limit of 50% on foreign capital presence in the Russian banking sector, and a prohibition on establishing branches in Russia. From the position of the Russian government, a scenario where many non-resident portfolio investors own minority stakes in Russian banks is preferable



to a situation where many Russian banks are owned by foreign strategic investors.

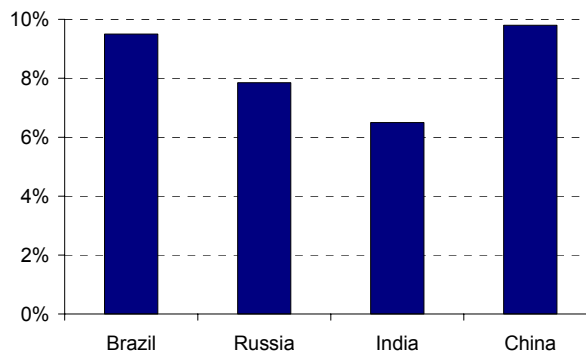
The Russian banking sector has four distinctive features:

1. It is unsaturated compared to developed markets;
2. A high level of credit rates on corporate and consumer loans—combined with the ability to attract cheap money on foreign markets—provides Russian banks with high margins;
3. Russian banking legislation includes some protective restrictions on foreigners’ presence in the Russian banking sector, one of which is that foreign banks are not permitted to open subsidiaries in Russia;
4. The Russian banking sector now is currently seeing the booming expansion of foreign banks in Russia.

Russian banks are now valued higher than banks in developed markets like the USA and Western Europe. The Russian P/BV ratio for the sector is 3.5, compared to 2.5 for Western Europe. Russian banks are more expensive than European because of booming growth of retail banking and restrictions on foreign banks’ activity in Russia.

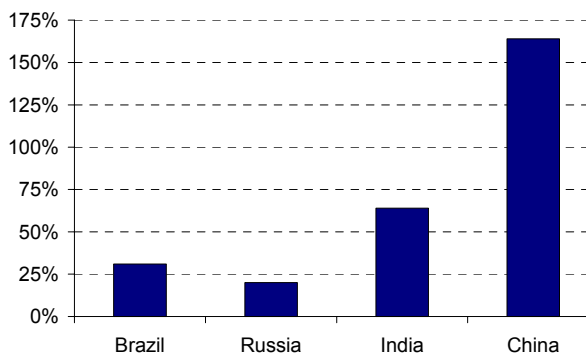
Some segments of the Russian banking sector have considerable growth potential, as they are comparatively undervalued to emerging markets.

Retail loans/GDP ratio, 2006



Source: World Bank

Banking deposits/GDP ratio, 2006



Source: World Bank



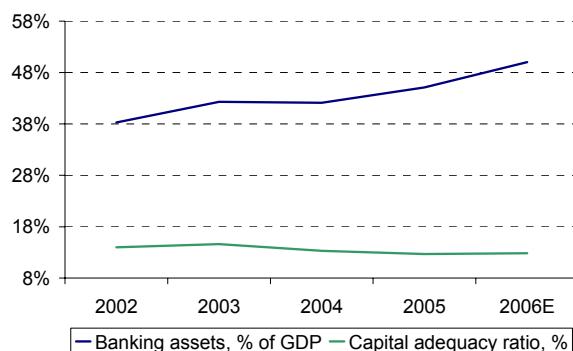
Banks' presence on the security market

Sberbank accounts for about 8% of the capitalization of the Russian security market, which is quite low compared to other emerging markets. For example, in Eastern European countries, banks make up 14%–18% of overall market capitalization. Moreover, aside from Sberbank, the Russian market is markedly absent of liquid banking shares, as all other Russian banks have quite small freefloats. The very low liquidity of banking shares (excluding Sberbank) creates the conditions for a deficit of banking shares on the Russian market. This situation will be considerably improved after the placements of Sberbank and VTB, but until then, the easiest way for portfolio investors to enter the Russian banking sector is through buying Sberbank shares.

Further development

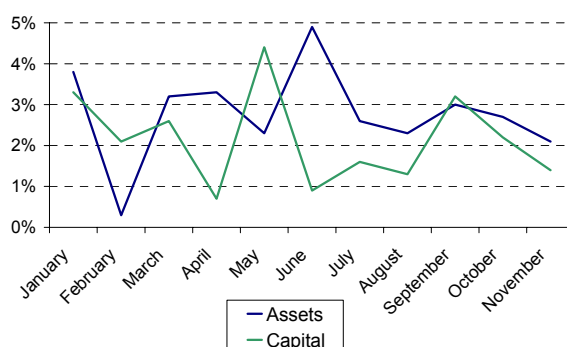
We note that capital adequacy has become the main problem for further development of the Russian banking sector. The average capital adequacy ratio for the sector dropped to 11.9% in 2006, from 12.7% in 2005. This ratio remains above the CBR's required 10% and well-above Basel II standards (4% for Tier 1 capital and 8% for Tier 2 capital), but we note that this ratio has come near a critical level, which prevents Russian banks from further development.

Banking assets, % of GDP and capital adequacy ratio of the Russian banking sector



Source: CBR, Sovlink estimates

Banking assets and capital monthly growth rates in 2006, %



Source: CBR, Sovlink estimates

The diagram above shows that the average monthly growth rate of banking assets exceeded the growth rates of capital in 2006, and this became the tendency. During the rapid growth of assets, the Russian banking system began to face problems related to the lack of capital. In 2006, growth in banking assets exceeded capital growth by 9.5 ppt (37.7% vs. 28.2%).



Russian banking sector development

	2002	2003	2004	2005	2006E	2007E	2008E	2009E	2010E
Assets, \$bn	130	190	257	339	466	653	882	1164	1513
Assets growth rate, %		46.1%	35.2%	31.7%	37.7%	40%	35%	32%	30%
Banking assets, % of GDP	38.3%	42.3%	42.1%	45.1%	50.0%	58.4%	66.2%	74.7%	84.4%
Capital, \$bn	22	31	36	47	60	87	117	152	198
Capital, % GDP	5.4%	6.2%	5.6%	5.7%	6.4%	7.8%	8.8%	9.8%	11.1%
Capital-to-assets ratio, %	14.0%	14.6%	13.3%	12.7%	12.8%	13.3%	13.3%	13.1%	13.1%
Loans, \$ bn	56.4	91.1	140.1	189.4	255.7	358.0	494.1	667.0	880.5
Loans growth rate, %		61.6%	53.7%	35.2%	35.0%	40%	38%	35%	32%
Retail loans, \$ bn	5	9	20	41	73	124	205	329	493
Retail loans growth rate, %		104%	113%	104%	80%	70%	65%	60%	50%
Retail loans-to-GDP ratio, %	1.3%	2.1%	3.3%	5.4%	7.8%	11.1%	15.4%	21.1%	27.5%
Deposits of physicals, \$bn	32.3	51.5	71.2	95.7	130.1	179.5	240.6	312.7	406.6
Deposits growth rate, %		59.5%	38.2%	34.3%	36.0%	38.0%	34.0%	30.0%	30.0%
Securities, \$ bn	24.5	34.0	39.2	53.5	74.8	101.8	137.4	182.7	243.1
Securities growth rate, %		38.9%	15.1%	36.5%	40.0%	36.0%	35.0%	33.0%	33.0%
Securities of banks to GDP, %	7.0%	7.5%	6.4%	7.1%	8.0%	9.1%	10.3%	11.7%	13.6%
Securities-to-assets ratio, %	18.8%	17.9%	15.2%	15.8%	16.0%	15.6%	15.6%	15.7%	16.1%

Source: CBR, Sovlink estimations

The banking sector in Russia is highly concentrated: the five largest banks control 43.1% of the sector's assets. The largest 20 banks control 73.5% of total assets.

In 2005 the Russian banking sector's assets increased by 36.6% while capital rose by just 31.2%. This dynamic leads to reduced capital adequacy ratios. In 2006 these tendencies continued: we expect that assets will increase by 38%, while capital will increase only by 29%.

As in 2005, credit operations were the basis for bank's asset growth in 2006. Retail loans demonstrated rapid growth, growing 90% in 2005, and another 80% in 2006E.

Although the monetization of the Russian economy (banking assets to GDP) is increasing, the capital adequacy ratio (capital to assets) for the whole banking sector is decreasing. Thus, the problem of capital adequacy became one of the main restrictions for the further development of the Russian banking sector.

The Russian banking sector is characterized by high operating profit ratios and net interest margins. High margins in the Russian banking sector are due to a maturity mismatch of assets and liabilities—banks tend to borrow short-term money at low rates and lend long-term money at high rates.

We expect net interest margins in the Russian banking sector to gradually decrease in 2006–10 due to increasing competition between Russian banks and from foreign entrants. The Russian corporate sector is trying to find access to cheap international funding rather than take more expensive loans from Russian banks. Corporate loans are being substituted for cheaper domestic bonds, Eurobonds and syndicated loans.

Banking services currently have a rather low level of penetration in Russia. We anticipate that in the next few years Russians will increase borrowing and begin to utilize banking products, as the country's financial culture develops.

In the last five years, banking asset growth was mainly due to the development of retail banking. Retail loans increased from \$5 bn in 2002 to more than \$70 bn in 2006. We believe the key driver of further growth of the Russian banking sector will be retail banking.



The Russian retail banking system remains underdeveloped compared to developed and emerging markets. According to our estimates, retail loans will account for 15.6% of total banking assets and 28.6% of total loans in 2006.

The key driver for further increases of retail banking will be penetration to Russian regions, where banking is quite underdeveloped compared to Moscow

The outlook for traded Russian banks

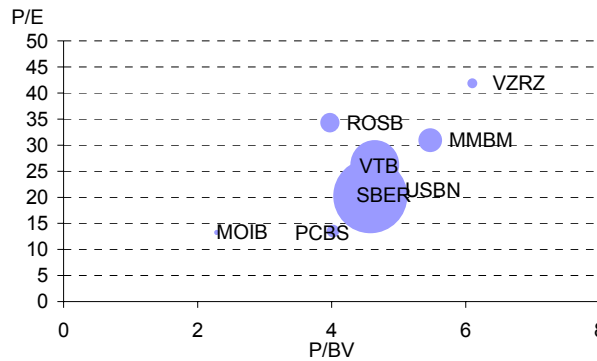
Russian traded banks make up just 8.2% of total market capitalization, and Sberbank takes 76% of this. Sberbank's assets exceed the total assets of the next ten largest banks.

Russian banking sector multiples, 2006E

	P/BV	P/A	P/E	M.cap	BV	Assets	NI
	\$ mn						
Sberbank	4.58	0.52	20.3	68,730	14,288	125,937	3,229
Bank of Moscow	5.47	0.44	31.0	7,140	990	12,200	175
Uralsib	4.91	0.65	20.2	6,677	1,360	10,250	330
Rosbank	3.97	0.45	34.3	4,694	950	8,450	110
PSB	4.02	0.41	13.5	2,068	555	5,409	165
Vozrozhdenie	6.10	0.51	41.9	1,234	199	2,365	29
MIB	2.28	0.22	13.3	341	99	1,013	17
VTB	4.64	0.61	26.3	29,947	6,450	48,800	1,140

Source: Company data, Sovlink estimates

Russian banks P/E and P/BV, 2006E



Source: Sovlink estimates

The diagram above shows that the cheapest bank is Moscow Industrial Bank, while the most expensive is Vozrozhdenie.

We believe that the Duma's approval of amendments to the banking law which give residential and non-residential investors equal rights in buying shares of Russian banks will result in a reassessment of the Russian banking sector and will spur non-residential demand for Sberbank considerably. Net foreign capital inflow to the Russian economy in 2006 may exceed \$30 bn due to the elimination of restrictions on capital activities from July, 2006. This is also a factor leading to the reassessment of the Russian banking sector.



Further developments

The reasons for rapid growth of the banking sector in 2006 were the same as in the previous year: GDP growth, increased monetary supply, and increased real disposal incomes. Despite substantial growth rates, the Russian banking sector remains underdeveloped compared to developed economies.

The ratio of the Russian banking sector's net assets to GDP for 3Q06 was 55%, while the ratio of capital to GDP was 6.6%. For full-year 2006, we expect this to reach 60%, while capital to GDP should reach 7%.

The most underdeveloped segments of the Russian banking sector are retail banking and banking products, such as credit cards. Most of the Russian population's financial knowledge remains extremely low, especially for regional inhabitants. Most Russians do not know about the Deposit Insurance System and are afraid of banking products.

The ratio of retail loans to GDP reached 10% by end-2006, while in European countries the amount of retail loans exceeds GDP by several times. Retail banking in Russia undoubtedly has solid growth potential, but it is necessary to understand that in the near term it will be restricted by the low financial knowledge of the population and high domestic interest rates.

A feature of the Russian banking system is that during substantial asset growth it began to face problems concerning equity financing. In the recent past, Russian banks increased their capital by retained earnings, reassessment of assets and other ways. By 2006, these ways of raising capital were insufficient and banks began to experience a lack of capital.

The Russian banking sector is rather concentrated: Russia's 50 largest banks control over 75% of assets. The remaining 25% is controlled by more than 1,000 small and medium-sized banks, most of them captive. We expect that in 2007 we will see a number of mergers and acquisitions among small and medium-sized banks, which will be necessary for their survival in a time of increasing competition in the banking sector.

Due to high competition and the increasing share of foreign players in the Russian banking sector, we expect that segments such as retail banking will experience a reduction in profitability.

The average P/BV multiple for traded Russian banks rose from 3 at the beginning of the year to about 4 by the end of the year.

Among the key drivers for the expected rapid growth of banking assets are the planned placements of Sberbank, VTB and Gazprombank in 2007.

Retail banking is another key driver of the rapid growth of banking assets. Retail loans have increased 16 times since 2002, doubling in 2003 and 2004. In 2006 retail loans grew "only" 80%—we expect this to stabilize at 75% in 2006–10. The rapid growth of retail loans mainly came from auto and consumer lending.

In addition to retail banking, the mortgage market and credit cards seem rather interesting. The overwhelming growth of real estate prices in the last four years has made real estate a speculative instrument. Many Russians have taken advantage of mortgage financing for real estate purchases.

As Russia's financial culture improves, banking services find themselves more and more in demand. For example, the amount of banking cards issued in Russia increased from 5,000 in 2002 to more than 2 mn by end-2006.



Recent legislative changes

Until 2007, foreign investors had some restrictions on purchasing Russian banks' shares. If non-residents wanted to buy any amount of shares of a Russian bank, the shares should pass the so-called procedure of "blessing"—getting permission from the Central Bank. At the same time, domestic investors were required to notify the Central Bank in case of the purchase of 5%–20% stakes in a bank, and apply for permission to purchase more than 20% of a bank's shares.

From January of this year, resident and non-resident investors were given equal rights: now both are required to notify the Central Bank when purchasing more than 1% of a bank's shares and only need to be "blessed" when purchasing more than 10%.

Changes in bank ownership regulations

Before 2007			Current		
	Residents	Non-residents	Residents and non-residents are equal		
<5%	-	Blessing	<1%	-	-
5%-20%	Notifying CB	Blessing	1%-10%	Notifying CB	Notifying CB
>20%	Blessing	Blessing	>10%	Blessing	Blessing

Source: CBR

We believe that the approval of these changes will induce foreign investors to increase their stakes in Russian banks. Potential non-resident minority shareholders will benefit most from the changes.

From the position of the Russian authorities, a scenario where many non-residential portfolio investors own minority stakes in Russian banks is preferable to a situation where a large number of Russian banks are owned by foreign strategic investors.

Nevertheless, some restrictions on the activity of foreign banks in the Russian banking market remain:

1. A quota of 50% on foreign participation in the Russian banking system;
2. Foreign banks are not permitted to open subsidiaries in Russia;
3. Foreign participation in the Russian banking sector is permitted only in the form of creating new banks or buying existing Russian banks.

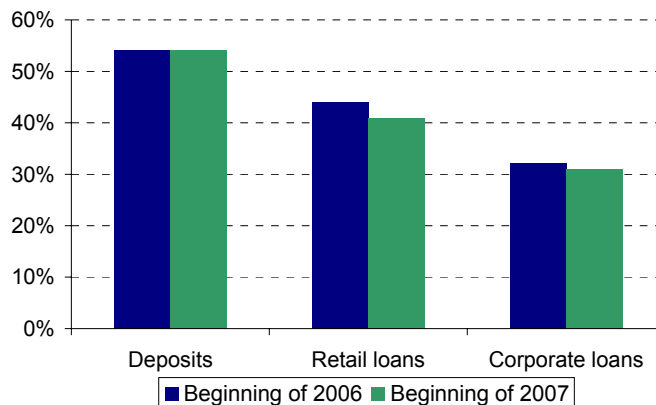


Sberbank

Overview

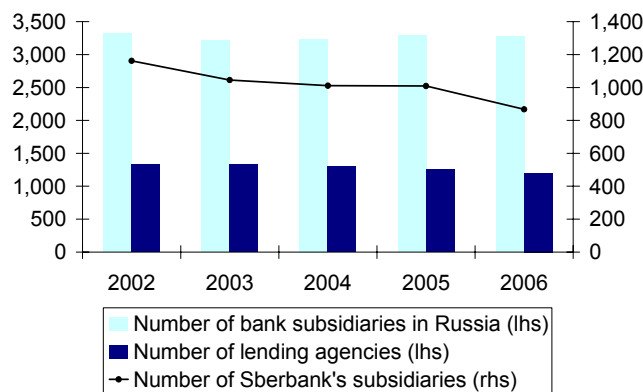
Sberbank is the largest Russian bank and has the strongest position on the Russian banking market, due to controlling the largest network of branches and enjoying the highest level of trust from the populace. Sberbank controls more than half the deposits of the Russian banking sector, more than 40% of the retail loan segment and one-third of the corporate loan market.

Sberbank's share of the main segments of the banking market



Source: Company data, Sovlink estimates

Sberbank's share of the main segments of the banking market

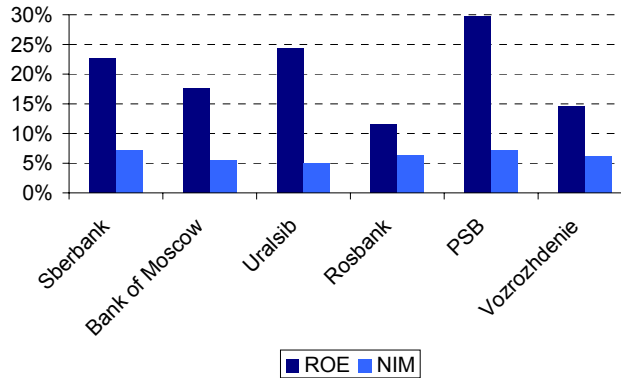


Source: Company data, Sovlink estimates

Sberbank is the largest bank in Russia, with assets more than 2.5 times higher than the second-largest Russian bank, VTB. Sberbank's 20,000 branches is more than 15 times (!) higher than the bank with the second-most developed regional network, Uralsib. In many regions Sberbank has a regional monopoly on banking services.



Sberbank has the highest NIM among Russian banks, and one of the highest ROEs



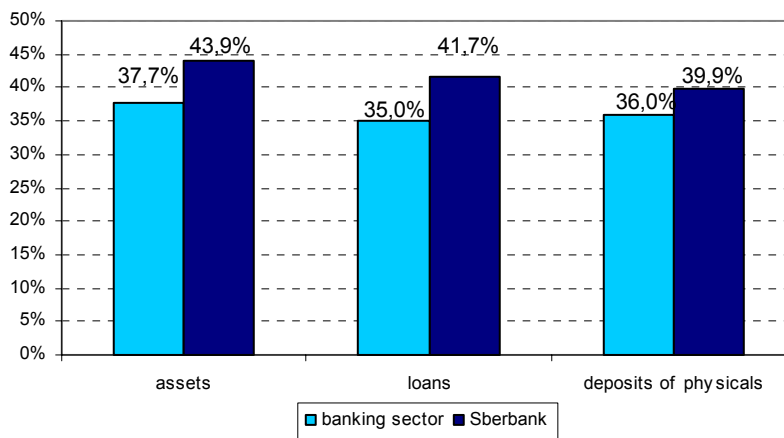
Source: Company data, Sovlink estimates

Sberbank has four unique advantages over other Russian banks:

1. It has the largest system of branches in Russia;
2. It enjoys the highest level of confidence among the Russian people;
3. It is a regional monopolist in a number of districts;
4. It has access to cheap funding.

In 2006 Sberbank could demonstrate rapid growth rates in most segments of Russian banking market.

Asset and deposit growth rates, 2006



Source: CBR, Company data

We expect that the further development of banks' credit operations will be boosted by retail loans. This is currently the most profitable kind of banking activity, as it has higher margins than other kinds of loans.

As Sberbank has the strongest position in retail banking among Russian banks, it will see sustainable benefits as the retail sector develops. Nevertheless, due to the high attractiveness of retail banking, we expect competition to strengthen.

The second-best sector after retail banking is mortgage lending, where Sberbank also has a strong presence. In 2006 this sector also developed rapidly due to increasing accessibility of mortgage lending. Higher competition between key players on the mortgage market led to a decline in upfront payments and a decrease in interest rates.



The most important issue for investors considering purchasing of stake in a Russian bank is the bank’s retail business strength. Sberbank has the most developed retail banking business among all Russian banks and is positioned as the “people’s” bank.

Sberbank is the most likely Russian bank to keep its high margins, due to the rapid development of lucrative retail banking and mortgage loans. A considerable step on the way to the development of retail banking in Russia was the passage of the Credit History Bill in 2005. The bill’s main aim is to create a central source of information about clients’ credit histories and, ultimately, to reduce credit risks.

Sberbank’s main disadvantage is the relatively low quality of its asset base. Owing to a large number of regional outlets, Sberbank services a large amount of low-income clients and pensioners. These clients have a poor financial knowledge and retail banking is unfamiliar to them.

From 2002–06, Sberbank was losing market share in retail loans, dropping from 68% in 2002 to 37% in 2006, mainly because of increased competition in this segment. Foreign players and retail banks (i.e. Russian Standard, Home Credit, etc.) focus solely on this segment and managed to increase their performance on the retail market. Nevertheless, Sberbank maintains the largest portfolio of retail credit and has the strongest position on the retail banking market.

Retail loans, \$ bn

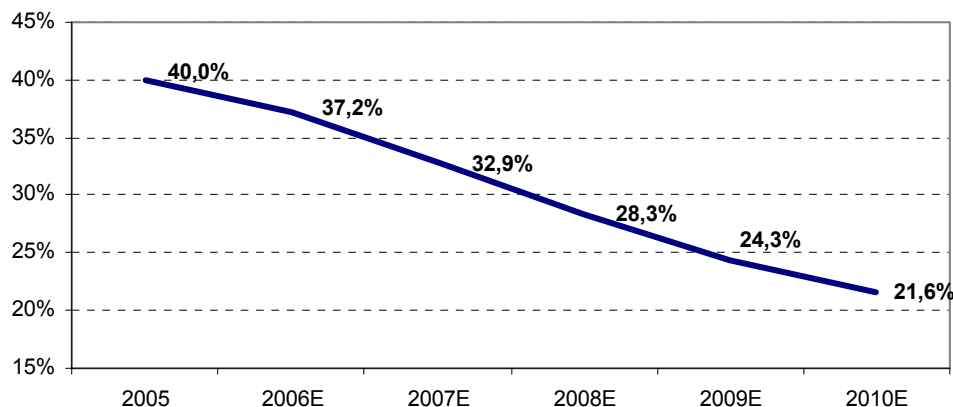
	2005	2006E	2007E	2008E	2009E	2010E
Sberbank	16	27	41	58	80	106
Overall	41	73	124	205	329	493

Source: CBR, Sberbank, Sovlink estimates

The bank’s disadvantages are the relatively low quality of its asset base, which will result in a further loss of position on the retail market, and large staff and administration costs as a consequence of having the largest branch network.

We expect Sberbank to continue losing market share in the retail segment because of the rapid development of small retail-oriented banks.

Sberbank’s retail market share



Source: Company data, Sovlink estimates

It is too early to speak about a shift in retail banking from Moscow to Russia’s regions, but we expect that this will happen in the near future. When this happens, Sberbank will have a competitive advantage over all other Russian banks, due to possessing the largest network of regional outlets.



At the end of 2006, Sberbank had utilized all available sources of raising capital, save issuing new shares. The bank reassessed its fixed assets and subordinated debt to raise its Tier 2 capital. According to CBR norms, Tier 2 capital cannot exceed 50% of Tier 1 capital. As such, the only way for Sberbank to raise additional capital is to issue new shares—expected in 1Q07.

Sberbank's capital adequacy ratio

	2005	2006E	2007E	2008E	2009E	2010E
Equity, \$mn	8,795	14,288	30,677	38,907	49,459	62,608
Assets, \$mn	87,489	125,937	184,910	251,909	338,628	448,142
Capital adequacy ratio, %	10.1%	11.3%	16.6%	15.4%	14.6%	14.0%

Source: Sberbank, Sovlink estimates

9M06 financial results

Sberbank reported strong quarterly results in 2006. The achievement of better results and increasing margins became possible in 2006 due to a balanced asset structure and an increasing share of high-yielding retail loans. The retail business accounted for about 22% of total assets in 3Q06, up from 19% at end-2005.

The retail segment is very profitable, as interest on Sberbank's retail loans is roughly 20% compared to 11% on corporate loans. Moreover, we expect that Sberbank will benefit most from the further boom in retail banking.

Sberbank's balance sheet, \$ mn

	9M05	% of assets	9M06	% of assets	growth rate, %
Assets	81,296		118,026		45.2%
Cash	1,422	1.7%	1,847	1.6%	29.9%
CBR deposits	2,248	2.8%	3,047	2.6%	35.5%
Required reserves	1,898		2,716		43.1%
Funds in other banks	77	0.1%	903	0.8%	1073%
Trading securities	7,175	8.8%	13,529	11.5%	88.5%
Loans	59,187	72.8%	86,960	73.7%	46.9%
Investment securities	2,363	2.9%	2,272	1.9%	-3.8%
Other securities	4,907	6.0%	3,617	3.1%	-26.3%
PPE and intangible assets	3,294	4.1%	5,135	4.4%	55.9%
Interest requirement	57	0.1%	80	0.1%	41.5%
Other assets	566	0.7%	626	0.5%	10.6%

Source: Sberbank, Sovlink estimates

Sberbank's 9M06 results showed an accelerating asset growth rate—the bank's assets increased by 45.2% year-on-year, exceeding the 43.9% growth during 2005 as a whole. This rise was mainly due to the rapid growth of loans (47%), especially in the retail segment. Sberbank's loans-to-assets ratio increased from 72.8% in 9M05 to 73.7%.

We expect that retail loans will be the main factor for Sberbank's further asset growth. We forecast that the bank's retail loans-to-assets ratio will increase to 23.7% by 2010 from the current 21.6%, while Sberbank's corporate loans-to-deposit ratio will decrease to 26% by 2010 from the current 33%.



Sberbank's asset base

	2005	2006E	2007E	2008E	2009E	2010E
Assets	87,489	125,937	184,910	251,909	338,628	448,142
growth rate, %		43.9%	46.8%	36.2%	34.4%	32.3%
Loans	64,116	90,858	130,034	177,575	235,010	301,924
growth rate, %		41.7%	43.1%	36.6%	32.3%	28.5%
loans-to-assets, %	73.3%	72.1%	70.3%	70.5%	69.4%	67.4%
Retail loans	16,255	27,204	40,917	58,159	79,768	106,320
growth rate, %		67.4%	50.4%	42.1%	37.2%	33.3%
retail loans-to-assets, %	18.6%	21.6%	22.1%	23.1%	23.6%	23.7%
Corporate loans	47,861	63,655	89,117	119,416	155,241	195,604
growth rate, %		33.0%	40.0%	34.0%	30.0%	26.0%
corporate loans-to-assets, %	54.7%	50.5%	48.2%	47.4%	45.8%	43.6%
Securities	13,021	16,496	21,536	26,056	32,213	39,829
growth rate, %		26.7%	30.6%	21.0%	23.6%	23.6%
securities-to-assets, %	14.9%	13.1%	11.6%	10.3%	9.5%	8.9%

Source: Sberbank, Sovlink estimations

Liabilities and equity

In 9M06, the bank's liabilities grew by 44.4% year-on-year, not because of deposits, but from issued debt securities and funds from other banks.

A good indication of the bank's development was the rapid growth of loans (+47%) in comparison with deposits (42.7%).

Sberbank's liabilities, 9M06

	9M05	% of liabilities	9M06	% of liabilities	% chg. y-o-y
Total equity and liabilities	81,296		118,026		45.2%
Liabilities	73,925		106,731		44.4%
CBR credits	0	0.0%	0	0.0%	
Funds from other banks	3,403	4.6%	5,226	4.9%	53.6%
Deposits	66,540	90.0%	94,934	88.9%	42.7%
Deposits from retail customers	47,786	64.6%	67,814	63.5%	41.9%
Corporate accounts	18,754	25.4%	27,120	25.4%	44.6%
Issued debt securities	2,297	3.1%	4,425	4.1%	92.7%
Interest liabilities	605	0.8%	833	0.8%	37.6%
Other liabilities	917	1.2%	1,171	1.1%	27.7%
Reserves on accidental loss	163	0.2%	142	0.1%	-12.6%

Source: Company data, Sovlink estimates

Sberbank's equity, 9M06

	9M05	% of equity	9M06	% of equity	% chg. y-o-y
Equity	7,371		11,295		53.2%
Share capital	35	0.5%	2,244	19.9%	6333.5%
Share premium	195	2.6%	209	1.8%	7.2%
Revaluation of fixed assets	1,292	17.5%	314	2.8%	-75.7%
Deferrals	605	8.2%	1,079	9.5%	78.3%
Funds and retained earnings	4,769	64.7%	6,937	61.4%	45.5%
Earnings	1,686	22.9%	2,483	22.0%	47.2%



Source: Company data, Sovlink estimates

Sberbank's off-balance liabilities, 9M06

	9M05	9M06	% chg. y-o-y
Off-balance liabilities	10,077	20,394	102%
Irrevocable liabilities	9,365	19,210	105%
Guarantees issued	712	1,184	66%

Source: Company data, Sovlink estimates

The bank's off-balance liabilities doubled year-on-year in 3Q06, mainly due to irrevocable liabilities.

Income statement

Sberbank's 9M06 results showed a solid net income increase of 47.2%, due to a 35% increase of interest income and 58.3% growth in fees and commissions income. In 2005 fees and commissions grew by only 41%.

According to the bank's 9M06 results, interest income accounted for 59.7% of the bank's operating income, fees and commissions accounted for 14.2%, fixed instruments for 6.5%, and securities for 2.2%.

Sberbank's P&L, \$ mn

	3Q05	% of operating profit	3Q06	% of operating profit	% chg.y-o-y
Interest profit	5,960	59.7%	8,044	59.7%	35.0%
Profit from fixed income instruments	944	9.5%	881	6.5%	-6.7%
Profit from securities	294	2.9%	301	2.2%	2.3%
Profit from currency and precious metal transactions	24		224		832%
Profit from currency revaluation	191		-101		n/m
Fees and commissions	1,205	12.1%	1,908	14.2%	58.3%
Other	-201		-305		n/m
Operating profit	9,980		13,472		35.0%
Interest expense	2,305	23.1%	3,097	23.0%	34.4%
Staff costs	2,250	22.5%	3,055	22.7%	35.8%
Reserves for accidental loss	-561		-569		n/m
EBT	2,357		3,348		42.1%
Income tax	670		865		29.1%
Net profit	1,686		2,483		47.2%
ROA	2.07%		2.10%		
ROE	22.9%		22.0%		
Loan/Deposit ratio	88.9%		91.6%		

Source: Company data, Sovlink estimates



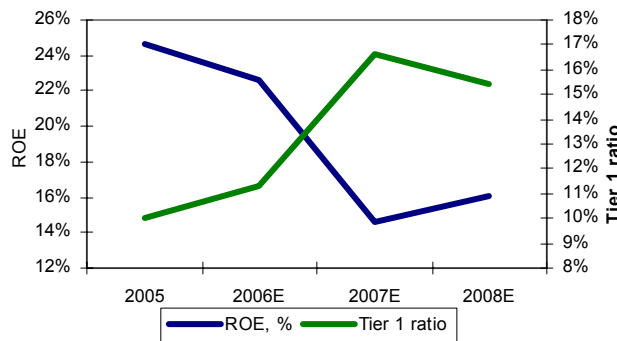
Sberbank income statement, \$ mn

	2005	2006E	2007E	2008E	2009E	2010E
Interest profit	8,048	10,599	13,657	17,213	21,247	25,767
Profit from fixed income instruments	1,128	1,320	1,452	1,597	1,757	1,932
Profit from securities	613	717	789	867	954	1,050
Interest expense	3,052	3,694	4,802	5,762	6,914	8,297
Fees and commissions	1,826	2,355	3,203	4,292	5,666	7,366
Staff costs	3,031	3,850	4,620	5,497	6,487	7,525
Net profit	2,170	3,229	4,476	6,244	8,285	10,630
ROA, %	2.48%	2.56%	2.42%	2.48%	2.45%	2.37%
ROE, %	24.7%	22.6%	14.6%	16.0%	16.8%	17.0%
Loan/Deposit ratio, %	91.0%	92.6%	96.4%	95.8%	94.6%	92.8%
Capital adequacy ratio, %	10.1%	11.3%	16.6%	15.4%	14.6%	14.0%
NIM, %	7.9%	7.2%	6.1%	5.6%	5.1%	4.6%

Source: Sberbank, Sovlink estimates

We expect that due to increasing competition—especially in the retail banking segment—Sberbank’s margins will steadily fall in the next five years. We expect the bank’s ROE to drop to 17% and NIM to decrease to 4.6% in 2010.

Sberbank’s ROE and Tier 1 ratio



Source: Company data, Sovlink estimates

We believe that Sberbank currently has a balanced structure of assets, which allows the bank to maintain its high growth rates. We stress that under high competition in the sector, further asset increases will require the bank’s margins to lower.

An additional driver for Sberbank’s share price is continuing ruble appreciation. We expect real ruble appreciation to reach 4% in 2007 and 2% in 2008. As Sberbank works exclusively on the domestic market, ruble appreciation has a strong positive impact on the bank’s valuations.

The bank’s well-balanced loan portfolio will be the key driver of further rapid asset growth. We expect that due to increasing competition on the corporate loan segment—because of cheaper international funding, domestic bonds, Eurobonds and syndicated loans—Sberbank will make retail banking a priority for further development. Mortgage loans and financial products such as credit cards are also potential directions of development.



Sberbank is currently the banking sector’s traded heavyweight, and will strengthen its position in 2007 due to a planned secondary placement. Sberbank plans to issue 3.5 mn shares from its 10 mn shares of authorized capital. At the end of December, 2006, the bank announced that shares would be sold at above \$3000 per share, and that no split would take place before the placement. Shares will be sold not only to institutional investors, but also to retail investors. The Central Bank will participate in the placement and support demand, if it will be insufficient.

At the end of December, 2006, Finance Minister Alexei Kudrin (who is a member of Sberbank’s supervisory board) announced that Sberbank’s placement would take place before VTB’s IPO, and that half of the placement would be sold to Russian investors, and half to foreigners.

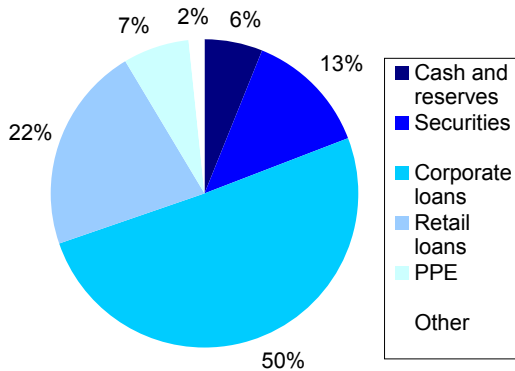
The final decision about the placement’s parameters assumes that a maximum 3.5 mn shares will be sold, and that a split will not be made. Sberbank’s placement is planned to be partially a “people’s” placement, as was done with Rosneft’s IPO; however, given that Sberbank’s share price is high, it will not be affordable to a wide range of Russians.

The main effect of the placement is to raise capital, which will allow the bank to increase its assets. Additional effects are increased liquidity and a likely boost of Sberbank’s weight in MSCI indices.

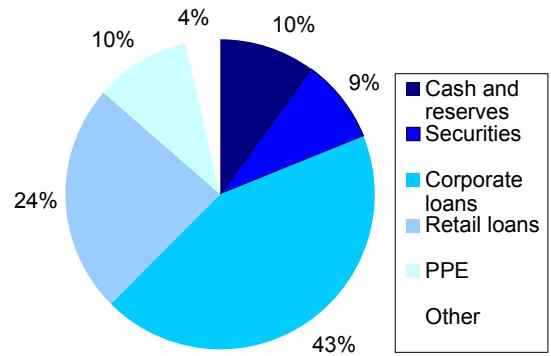
Given that the bank plans to sell 3.5 mn shares for at least \$3,000 each, the minimal amount of the placement will be \$10.5 bn—quite a large amount for the domestic market.

Because of Sberbank’s advantages over other Russian banks, we believe should trade at a premium to the average P/BV ratio in the Russian banking sector. Considering the current equity valuations of Russian banks, the distinctive features of Russian banking system and its risks, we think that fair P/BV multiples are 4.0–4.5 for the Russian banking sector and 5.0–5.5 for Sberbank.

**Asset breakdown
2006**



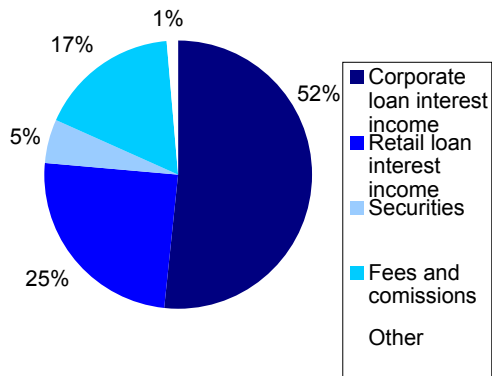
2010E



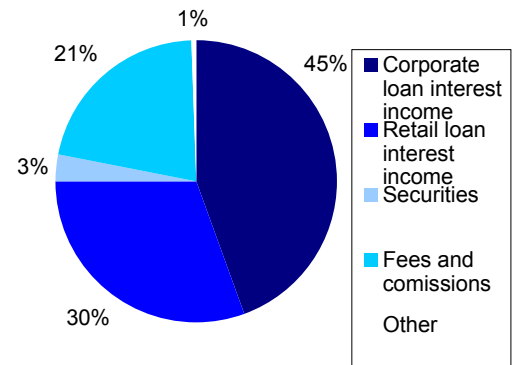
Source: Company data, Sovlink estimates



**Income breakdown
2006**



2010E



Source: Company data, Sovlink estimates

Sberbank's secondary placement

On January 29, Sberbank officially started its secondary placement procedure. The bank intends to issue 3.5 mn new shares and attract \$10.5–12 bn.

The placement is an essential step in the further development of Sberbank. Because of substantial asset growth in 2006, Sberbank now has a lack of capital. Moreover, by the end of 2006, the bank had utilized all available sources of increasing capital—subordinated credit and asset reassessment.

The question about the placement is not corporate, but political, and it is obvious that this decision should be approved by the Kremlin. The political significance of Sberbank's placement is emphasized by the fact that the largest state-owned Russian companies now need cheap money to finance large acquisitions and huge investment programs. If the placement is successful, it should give the green light to the IPOs of other Russian banks, firstly VTB. Due to these placements, the Russian banking system will be able to raise capital, increase credit, and make it cheaper.

At the end of November, 2006 Minister of Finance Alexei Kudrin claimed that government intended to keep control over Sberbank and VTB until 2012 at least. The government has announced that it will purchase 892,601 shares of Sberbank during the secondary placement, meaning that the government will lower its stake to 55.3% from its current 60.57%. According to Sberbank President Andrei Kazmin, the placement price will not assume a discount to the market price, and the final offering price will be fixed on February 20–22 after all bids have been collected.

The shares are to be offered on the Russian market at a single price for all categories of buyers:

1. Buyers with pre-emptive rights (as of December 21, 2006);
2. Institutional investors with competitive bids;
3. Private investors with non-competitive bids.

Non-competitive bids of up to Rb 1 mn will be satisfied in full. The price will be fixed by the Supervisory Board following the results of investors' tenders. Sberbank will then satisfy bids in the following order: pre-emptive right bids, private investors' bids, and finally competitive bids above the announced placement price.



Why is the placement so important for Sberbank?

Central Bank norms set the capital adequacy ratio at 11% (the minimum ratio for participants of the Deposit Insurance System). At the beginning of November, 2006, Sberbank's capital adequacy ratio was 12%, and this low level became Sberbank's main obstacle in expanding its operations. Moreover, by December, Sberbank exhausted all of its resources of raising capital—subordinated loans and asset reassessments.

As an effect of the share placement, we estimate that Sberbank will be able to raise its outstanding loans by \$20 bn in 2007 and by \$30–\$32 bn in 2008.

Because of a substantial increase of cheap loans to state-owned corporations, Sberbank's capital adequacy ratio decreased to the almost critical level of 12% and impeded the bank's development.

Effects from Sberbank's expected increased weighting in MSCI indices

We expect that the removal of banking share blessing and Sberbank's upcoming share placement will lead to an increase of the bank's weight in MSCI indices. Sberbank currently has a 5.2% weighting in the MSCI Russia index and a 0.53% weighting in the MSCI EM index. These weights were determined on the assumption of Sberbank having a freefloat of 20%, as this was the amount of shares foreigners were allowed to own before the removal of the blessing requirement. Now, MSCI could increase Sberbank's estimated freefloat to 37%–39%, which could double its weighting in indices.

Valuation

We apply three methods to find the fair value of Sberbank's shares: an EBO model, a peer comparison and the P/BV method. We note that we use Sberbank's post-placement number of shares in our valuation.

EBO model method

The EBO (Edwards-Bell-Ohlson) model is a sort of discounted cashflow method based on discounting economic income for shareholders. Under this approach, the value estimate is based on the current book value of equity (which makes this method the most appropriate for the valuation of a bank), plus the present value of all expected future excessive earnings (i.e. any earnings above and beyond the required rate of return on investments.)

Our model is based on forecasting Sberbank's balance sheet and income statement. According to our estimates, Sberbank's book value will see booming growth in 2007 due to its share placement, then its book value growth rate will stabilize at 27%.

We expect Sberbank's ROE to drop from 22.6% in 2006 to 14.6% in 2007 because of rapid capital growth. From 2007, we expect Sberbank's ROE will steadily rise to 19% in 2016.

Because of the substantial fall of ROE in 2007, the amount of SVA (Shareholders Value Added) in 2007 will be considerably lower than in 2006, but then it will gradually increase to \$4,247 mn in 2016.

Discounted SVA for the period under review is \$6,859 mn. Our calculation of terminal value was based on the Gordon method. While estimating it, we proceed from a terminal growth rate of 4.5%. Our basic terminal growth rate for other industries is 3%, but we consider that the banking sector will be able to demonstrate stronger dynamics. Given this, our estimation of terminal value is \$36,085 mn. We have adjusted this amount to Sberbank's current book value, adding \$14,288 mn, and to the amount of cash (\$10,000 mn) and securities (\$16,000 mn).



Finally, we reach a fair value of the bank of \$83,233 mn, or \$3,571 per ordinary share and \$58.4 per preferred share.

Income statement forecasts, \$ mn

	2005	2006E	2007E	2008E	2009E	2010E
Interest income	8,048	10,599	13,657	17,213	21,247	25,767
Corporate loans	5,634	7,153	8,941	10,908	13,089	15,328
Loans to SME	3,099	3,951	4,938	6,025	7,230	8,531
Loans to large corporations	2,535	3,202	4,002	4,883	5,859	6,797
Retail loans	2,414	3,446	4,716	6,305	8,158	10,439
Mortgages	483	763	1,106	1,549	1,982	2,538
Auto loans	72	84	97	113	131	152
General needs loans	1,859	2,584	3,489	4,605	5,987	7,663
Credit cards	0	15	24	38	58	86
Profit from fixed income instruments	1,128	1,320	1,452	1,597	1,757	1,932
Profit from leasing operations	0	0	0	0	0	0
Interest expenses	3,052	3,694	4,802	5,762	6,914	8,297
Net profit from securities	613	717	789	867	954	1,050
Net profit from currency and precious metal transactions	-4	-6	-6	-6	-6	-6
Net profit from currency revaluation	183	192	201	211	222	233
Fees and commissions	1,826	2,355	3,203	4,292	5,666	7,366
Other	-308	-500	-500	-500	-500	-500
Staff costs	3,031	3,834	4,601	5,476	6,461	7,495
Reserves for accidental loss	-1,204	-1,565	-2,034	-2,604	-3,281	-4,101
EBT	3,070	4,264	5,907	8,237	10,927	14,016
Income tax	900	981	1,418	1,977	2,622	3,364
Net profit	2,170	3,283	4,489	6,260	8,304	10,652
ROA	2.48%	2.61%	2.43%	2.49%	2.45%	2.38%
ROE	24.7%	23.0%	14.6%	16.1%	16.8%	17.0%
Loan/Deposit ratio	91.0%	92.6%	96.4%	95.8%	94.6%	92.8%
Capital adequacy ratio	10.1%	11.3%	16.6%	15.5%	14.6%	14.0%

Source: Company data, Sovlink estimates

EBO model

	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Risk free rate (30-year Russia Eurobonds)	5.9%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%	5.65%
β coefficient	1.14	1.25	1.25	1.2	1.15	1.1	1.05	1	1	1	1	1
Market premium	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Re	11.6%	11.9%	11.9%	11.65%	11.40%	11.15%	10.90%	10.65%	10.65%	10.65%	10.65%	10.65%
BV, \$ mn	8,795	14,288	30,677	38,907	49,459	62,608	80,138	102,576	131,298	168,061	213,438	271,066
Earnings, \$ mn	2,170	3,229	4,476	6,244	8,285	10,630	13,819	17,964	23,353	30,359	39,467	51,307
ROE, %	24.7%	22.6%	14.6%	16%	16.8%	17.0%	17.2%	17.5%	17.8%	18.1%	18.5%	18.9%
SVA, \$ mn	284	345	120	275	443	620	877	1,233	1,667	2,251	3,095	4,247
SVA discounted, \$ mn			108	220	321	406	523	672	821	1,002	1,245	1,544

Source: Sovlink estimates



EBO model (continued), \$ mn

terminal growth rate, %	4.5%
TV	36,086
Sum of SVA	6,860
Cash	10,000
Securities	16,000

Source: Sovlink estimates

Fair value derivation

SV, \$mn	83,234
Number of ordinary shares	22,500,000
Number of preferred shares	50,000,000
Fair value of ordinary share, \$	3,571
Fair value of preferred share, \$	58

Source: Company data, Sovlink estimates

Peer comparison method

Emerging markets valuation comparison

	P/BV	P/A	P/E
Turkey	4.60	0.45	17.79
Poland	1.28	0.14	11.27
Brazil	7.47	0.79	39.42
Argentina	7.61	1.27	70.12
India	7.72	0.43	56.37
China	3.32	0.13	29.74
Average	5.33	0.54	37.45
Sberbank	5.34	0.51	19.65

Source: Company data, Sovlink estimates

Sberbank ordinary share valuation, based on average EM multiples

P/BV	P/A	P/E	Average
2,805	2,942	5,351	3,699

Source: Company data, Sovlink estimates

We based our peer comparison on average country multiples. We examined the banking sectors of emerging and developed markets. We note that P/BV differs considerably from country to country, which can be fully explained by the difference in ROE, r and g for particular countries:



Given

$$P = \text{Div}/(r-g) \text{ (or } P = \text{NI} \cdot (1-RR)/(r-g))$$

$$g = RR \cdot ROE$$

$$\text{and } BV = \text{NI}/ROE,$$

where

Div – amount of dividend

r – required rate of return

g – growth rate

NI – net income

RR - retention rate

ROE – return on equity

we get the following formula for P/BV:

$$P/BV = (ROE-r)/(r-g)+1$$

Therefore, the difference in P/BV for different countries can be explained by two things: the difference between ROE and r (the rate of excessive profit for shareholders that we used in our EBO model) and between r and g.

This presentation of the P/BV coefficient allows us to see that high P/BV ratios are explained by premiums given for two factors: a large rate of excessive profits and high growth rates.

Both of these factors are high in emerging markets and low in developed markets, which is why P/BV ratios are much higher for the banking systems of Brazil, India and Russia than for banks in the USA, Germany and France.

As such, we believe that the most appropriate peer comparison valuation of Sberbank is a valuation relative to average emerging market coefficients.

Developed market valuation comparison

	P/BV	P/A	P/E
Switzerland	3.09	0.42	44.70
Spain	2.70	0.14	18.67
Germany	2.39	0.05	26.09
France	2.46	0.11	18.80
Canada	2.99	0.16	21.39
Australia	3.19	0.20	21.97
USA	2.00	0.18	18.74
Average	2.69	0.18	24.34
Sberbank	5.34	0.51	19.65

Source: Company data, Sovlink estimates



Sberbank peer valuation comparison

Bank	Country	P/BV	P/A	P/E
Sberbank	Russia	5.34	0.51	19.66
Bank of Moscow	Russia	5.47	0.44	30.95
Uralsib	Russia	4.91	0.65	20.23
Rosbank	Russia	3.97	0.45	34.33
PSB	Russia	4.02	0.41	13.53
Vozrozhdenie	Russia	6.10	0.51	41.85
MIB	Russia	2.28	0.22	13.26
VTB	Russia	3.71	0.49	21.02
Investbank	UAE	6.94	1.69	31.98
Union National Bank	UAE	7.61	1.14	34.54
Finansbank	Turkey	5.82	0.54	20.42
Akbank	Turkey	3.90	0.46	17.27
Turkiye Garanti Bankasi	Turkey	3.58	0.34	18.37
Banque de Tunisie	Tunisia	3.31	0.56	26.82
PKO Bank	Poland	4.39	0.42	22.09
Bank Pekao	Poland	3.68	0.50	20.06
Bank Leumi Le-Israël	Israel	6.78	0.40	50.09
Bank Hapoalim	Israel	7.16	0.44	40.34
Arab Bank	Jordan	2.93	0.32	27.23
Banco Bradesco	Brazil	9.30	0.87	34.22
Uniao de Bancos Brasileiros	Brazil	7.47	0.83	43.17
United Overseas Bank	Singapore	3.05	0.32	27.14
RHB Capital	Malaysia	4.38	0.27	76.53
Unicredito Italiano	Italy	1.48	0.07	22.29
EFG Eurobank Ergasias	Greece	2.49	0.19	16.09
Deutsche Bank	Germany	1.45	0.04	11.75
BNP Paribas	France	1.37	0.05	10.28
Societe Generale	France	1.73	0.06	10.26
Barclays	UK	1.11	0.03	7.46
Bank Austria Creditanstalt	Austria	1.90	0.09	14.09
Royal Bank of Canada	Canada	3.74	0.18	25.09
TD Banknorth	USA	1.14	0.23	26.88
M&T Bank Corp	USA	2.26	0.24	17.00
Commerce Bancorp	USA	2.89	0.17	23.60

Source: Bloomberg, Sovlink estimations

The effect of the secondary share offering on Sberbank's valuations

While estimating the effects of Sberbank's upcoming share offering, we proceed from the maximum announced amount—3.5 mn shares.

The main purpose of the share issue is to raise additional equity for the bank. Currently, the low value of Sberbank's own equity is the main restrictive factor for further growth of the bank's operations—its capital adequacy ratio is approaching the lowest level allowed by the CBR.



We estimated the effect of the share issue on Sberbank's fair value by using the P/BV approach. We proceeded from the conservative assumption that Sberbank will not put the whole amount of the placement towards an equity increase, but only 75%.

Valuation of placement effect

% of IPO used on BV increase	50%	75%	100%
P/BV	Fair value of Sberbank's ordinary shares		
2	3,484	3,597	3,710
2.5	3,597	3,766	3,935
3	3,710	3,935	4,161

Source: Sovlink estimates

Due to the effect of the additional share issue, Sberbank's 2007E P/BV ratio should decrease to 2.5 from its current 5.3. We estimate Sberbank's share price after the placement, using our forecasted P/BV of 2.5 and a BV increase of 75% of the placement amount.

Finalizing our estimations, we assign different weights for each valuation method used.

Final price derivation

	Fair value, \$	Weight	Final fair valuation, \$
EBO valuation	3,571	40%	
Peer comparison	3,699	30%	3,670
IPO effect valuation	3,766	30%	

Source: Sovlink estimates

We note that the valuation of a bank relies upon a set of factors not included in the valuation of its current and further profitability.

Firstly, these factors include the analysis of the bank's regional penetration, the bank's share on different segments of the market and estimations of its further dynamics. Then, there is an estimation of various risks inherent to the banking business: the stability of liabilities, capital adequacy, the extent of asset diversification, etc. A final estimation should also include some specific factors such as government support, reputation history, and professionalism of the management team.

Currently, the average P/BV ratio for the Russian banking sector is 4.5 (Sberbank's is 4.6), while for US and Western European banks it is 2.0–2.5. The difference is explained by higher interest margins and growth rates.

The growth rate of developed economies' banking sectors is 5%–10%, whereas it exceeds 30% for the Russian banking sector and even 50% for retail banking. Secondly, Russian banks' net interest margins (NIM) exceeds European banks' NIMs by 3–4 times.

Finally, valuing banks depends on sector regulation and existing restrictions. The more liberal the national banking sector and the less restrictions it has for foreigners, the higher its valuation will be. For example, the Chinese banking sector, despite its high margins and growth rates, has an average P/BV of 2.2 because of its restrictions for foreigners.



Valuation of preferred shares

In order to value Sberbank's preferred shares, we proceed from the assumption that they have less economic value than ordinary shares. We value Sberbank's preferred shares by applying two discounts: 5% for lack of voting rights and 5% for liquidity. Nevertheless, we do not exclude the possibility of preferred shares being included in MSCI indices, suggesting that the discount could be lowered to 5% in the future.

Given the 10% discount and 50x difference in nominal value between ordinary and preferred shares, we derive a fair value for preferred shares at \$66 per share.

Risks

The main market risk for the Russian banking sector is the deterioration of the development of the Russian economy. At the end of December, 2006, the Ministry of Economic Development and Trade increased its GDP growth forecast for 2007 from 6% to 6.2%, from 5.8% to 5.9% for 2008 and from 5.9% to 6.0% for 2008. The ministry also raised its real disposable income forecast. From the ministry's point of view, consumer demand will be the main driver of further economic growth, along with investments and export earnings.

Another risk for Sberbank is the expected strengthening of competition in the retail banking. Sberbank's main advantage is that it has the largest branch network in Russia.



Appendix

Russian banks liability structure, 2005–06

	2005	2006
Funds and bank's profit	14.1%	13.5%
Accounts of other banks	1.6%	1.3%
Credit from residents	3.1%	3.1%
Credit from non-residents	7.2%	8.0%
Deposits (residential and non-residential)	27.7%	28.3%
Funds attracted from residents	25.0%	25.9%
Funds attracted from non-residents	2.8%	4.4%
Issued debt instruments	9.0%	7.7%
Other liabilities	9.4%	7.8%

Source: CBR, Sovlink estimates

Russian banks' asset structure, 2005–06

	2005	2006
Cash and precious metals	2.8%	2.7%
Accounts in Central Bank	9.7%	7.0%
Corresponding accounts in lending agencies	3.2%	2.6%
Securities	15.2%	15.8%
Credits for residential lending agencies	3.2%	3.2%
Credits for residential banks	2.7%	3.6%
Credits for consumers	8.7%	12.1%
Credits for non-financial residential entities	44.1%	42.2%
Credits for non-residential legal entities	1.7%	1.7%
Credits for residential financial organizations (ex.- banks)	1.6%	1.6%
Fixed assets and intangible assets	3.0%	2.8%
Other assets	4.1%	4.7%

Source: CBR, Sovlink estimates



STOCK RATING POLICY

STRONG BUY:	Target price offers upside of over 100%; confidence level – high
STRONG BUY (SPEC):	Target price offers upside of over 100%; confidence level – low
BUY:	Target price offers upside of between 25% and 100%; confidence level – high
BUY (SPEC):	Target price offers upside of between 25% and 100%; confidence level – low
HOLD:	Target price offers upside of less than 25%
SELL:	Target price at or below current price levels

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