



Sberbank

Company
Note**BUY****Upside: 32%****Target Price: \$4.95****Analyst: Olga Belenkaya**

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Stock data

Ticker	Sber	M.Cap, \$ mn	80,735
Shares Ords '000	21,586,948	Free Float, %	40
Shares Pref '000	1,000,000	Free Float, \$ mn	32,294
Bid Ords, \$	3.74	Offer Ords, \$	3.76
Bid Prefs, \$	2.72	Offer Prefs, \$	3.00

Market performance

		1 month	6 months
Absolute	Ords	-8.0%	9.7%
Relative to RTSI	Ords	-3.9%	9.1%
Price range, \$			
High	Ords	4.42	4.42
Low	Ords	3.72	3.38

Financials, 2007E

Assets, \$ mn	192,593	ROE	23.0%
Book Value, \$ mn	25,229	P/E	18.9
Net income, \$ mn	4,258	P/BV	3.2

Betting on quality

- We revised Sberbank's target price, taking into consideration the changes in the forecast growth of the Russian economy and banking sector and the bank's 1H07 RAS financial statements.

- The Russian banking sector continues to grow at a faster pace than the economy as a whole. Nevertheless, the Russian banking system's penetration level in the economy (especially household finance) is still low relative to the developed and many emerging markets. Consequently, the SME and retail credit sectors (in particular, mortgages, credit cards and auto credits) offer the most attractive prospects in the near future.

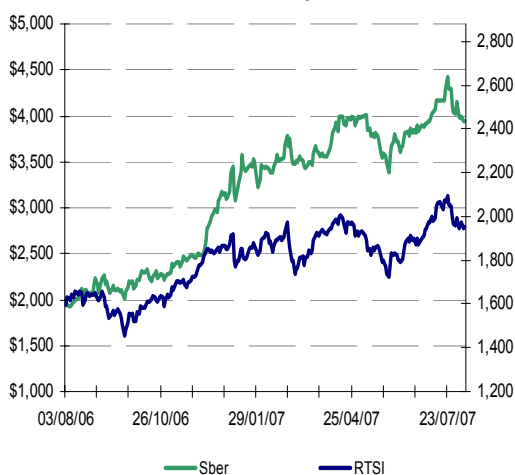
- In our opinion, due to its low initial level, the household credit boom may continue for another 1-2 years with relatively low risks. Subsequently, the sector is likely to face significant hurdles, which will lead to lower growth rates and may expose previously concealed risks.

- We would like to stress the following risks, in particular: macroeconomic instability, the lack of long-term resources within the country and the dependence on international capital markets, liquidity pressure, the risk of deteriorating asset quality as the result of underestimating credit risks during the credit boom, and lower interest margins.

- In our opinion, in the mid-term, universal banks – with high-quality brands, diversified credit portfolios and sources of capital, the ability to rely on the support of vigorous key shareholders, and less dependence on international capital markets – will be better protected from these risks. Sberbank is an excellent example of a bank that meets these requirements.

- The capital raised (about \$8.8 bn) via the bank's SPO in 1Q07 forms the basis for supporting the high growth rates forecast for Sberbank between 2007-10. We expect the bank's assets to grow by about 30% CAGR during this period. Sberbank's unified branch network (of about 20,000 offices) covers the whole country and provides the bank with a unique competitive advantage in rapidly expanding new banking services throughout Russia (retail credit, including mortgages, auto crediting etc). At the same time, the bank also offers credit to the corporate sector, including financing investment and infrastructure projects, which allows it to benefit not only from the consumer boom but also from the modernization of the Russian economy.

- Taking the above into consideration, we have raised the year-end target price of Sberbank's ordinary shares from \$4.85 to \$4.95, which offers upside of 32% from the current price. Accordingly, we reiterate our **BUY** recommendation on the bank's ordinary shares.

Sberbank's – Relative performance

Source: RTS



Market conditions

The global financial markets are once again in a volatile state. Credit spreads are widening, and investors are questioning the unjustifiably low risk premiums that have been prevalent over the last years. Against the background of the mortgage loans crisis in the USA, which was triggered by the sub-prime sector (for instance, the bankruptcy of American Home Mortgage, which specialised in granting credits to low and moderate-risk borrowers) and the deterioration of capital raising conditions, companies operating in the financial sector throughout the world are coming under pressure. Even though there appear to be no reasons (on fundamental grounds) for concern about the Russian banking sector so far, we would like to point out the difficulties that could arise as a result of its fairly high growth rate forecast over the next few years, as well as the risks which are likely to arise as the Russian financial sector starts offering more sophisticated services and becomes better integrated with the Russian economy and the global financial markets.

We expect that the market will gradually move towards balancing the sector's growth potential and prospective rate of return with its risk exposure. Until now, in our view, only the first two factors were taken into account, and risks were dismissed as insignificant. This review focuses on analysing the Russian banking sector's risks, and places a higher value on a well-balanced development strategy with priority being given to asset quality and diversified funding sources. In our opinion, Sberbank's business model effectively combines a policy to maintain high business growth rates over the next few years – based on the boom in the Russian economy and growing demand for financial services by corporate and retail clients – with a flexible, conservative credit policy, its ability to rely on the capital of its retail clients, and the support of its principal shareholder (the state).

Forecasts for the banking sector

1. Upside

At the end of 2006, the consolidated assets of the banking sector accounted for 52.4% of GDP (+44% y-o-y), credits and other invested funds amounted to 35.2% of GDP (+48% over the year), retail deposits – 14.2% of GDP (+37.7% over the year), and corporate deposits – 17.1% of GDP (+54.8%). The banking sector's growth indicators over the last few years have consistently surpassed the growth of the Russian economy, and are a reflection on the economy's growing monetisation, personal income growth, the strengthening of the rouble, greater confidence in the banking system, and the growing demand for financial products and services. The Russian banking sector is one of the leading banking sectors in the CEE in terms of growth.

Meanwhile, the penetration level of the Russian banking system in the Russian economy is still low in comparison to its peers in both the emerging and developed markets – with the retail credit and mortgage sectors being the least developed segment. Taking into consideration the high projected growth rates for the economy and personal income, we see significant upside in the banking sector in the near future.

We assume that by 2010 Russia will have an assets/GDP ratio of 88% (the same as Poland and Brazil), a retail credits/GDP ratio of 21.6% (the same as Slovenia, Lithuania, Bulgaria, and Hungary), retail loans will amount to 35% of total loans, with mortgages accounting for 32% of total retail loans (the average level for East European countries). By 2015, Russia is expected to reach the same level as the more developed East European countries (Hungary, Croatia, the Czech Republic, and Slovenia).



Table 1 – Banking sector indicators

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
GDP, RUR bn	21,615	26,781	31,235	35,827	40,750	45,960	51,634	58,044	64,951	72,466	80,664
GDP, growth rates	6.4%	6.7%	7.0%	6.7%	6.3%	6.1%	5.9%	5.7%	5.5%	5.5%	5.5%
GDP, \$ bn	764	985	1212	1427	1617	1771	1916	2111	2345	2597	2871
GDP per capita, \$ '000	5.34	6.91	8.54	10.09	11.47	12.6	13.65	15.07	16.76	18.59	20.58
Inflation	9.0%	8.5%	7.8%	7.2%	6.7%	6.3%	5.9%	5.5%	5.0%	4.5%	9.0%
\$ exchange rate - end of period	28.8	26.3	25.2	25.0	25.4	26.5	27.4	27.6	27.8	28.0	28.2
Average \$ exchange rate	28.31	27.18	25.77	25.1	25.2	25.95	26.95	27.5	27.7	27.9	28.1
Assets of banking sector, RUR bn	9,750	14,046	19,383	25,585	32,749	40,609	48,731	57,503	67,278	78,043	89,749
Assets of banking sector, growth rates	36.60%	44.10%	38%	32%	28%	24%	20%	18%	17%	16%	15%
Assets of banking sector/GDP	45.10%	52.40%	62.10%	71.40%	80.40%	88.40%	94.40%	99.10%	103.60%	107.70%	111.30%
Loans and other invested funds, RR bn.	6,370	9,439	13,120	17,450	22,510	28,138	34,047	40,515	47,606	55,460	64,057
Loans/assets, %	65%	67.20%	67.70%	68.20%	68.70%	69.30%	69.90%	70.50%	70.80%	71.10%	71.40%
Loans, growth rates, %	42.70%	48.20%	39.00%	33.00%	29.00%	25.00%	21.00%	19.00%	17.50%	16.50%	15.50%
Retail loans, RR bn.	1,179	2,065	3,408	5,112	7,259	9,945	12,630	15,661	19,106	22,736	26,829
Retail loans, growth rates, %	91%	75%	65%	50%	42%	37%	27%	24%	22%	19%	18%
Retail loans, % GDP	5.40%	7.70%	10.90%	14.30%	17.80%	21.60%	24.50%	27.00%	29.40%	31.40%	33.30%
Retail loans/credit portfolio	18.50%	21.90%	26.00%	29.30%	32.20%	35.30%	37.10%	38.70%	40.10%	41.00%	41.90%
Mortgages, RUR bn	122	350	700	1,226	2,022	3,134	4,232	5,459	6,714	8,057	9,390
Mortgages/Retail loans	10%	17%	21%	24%	28%	32%	34%	35%	35%	35%	35%
Retail deposits, RUR bn	2,755	3,794	5,083	6,710	8,589	10,822	13,419	16,371	19,645	23,378	27,586
Retail deposit growth rates	39%	38%	34%	32%	28%	26%	24%	22%	20%	19%	18%
Retail deposits, % GDP	12.7	14.2	16.3	18.7	21.1	23.5	26	28.2	30.2	32.3	34.2
Funds of enterprises and organizations, RUR bn	2,953	4,571	6,399	7,999	9,599	11,327	13,252	15,373	17,678	20,153	22,773
Funds of enterprises and organizations, growth rates	49%	55%	40%	25%	20%	18%	17%	16%	15%	14%	13%
Funds of enterprises and organizations, % GDP	13.6	17.1	20.5	22.3	23.6	24.6	25.7	26.5	27.2	27.8	28.2

Source: Central Bank data, Sovlink estimates

Please note that the forecast figures beyond 2009-10 could be impacted by short-term volatility. Despite the fact that the potential upside of the Russian banking and financial sectors is indeed very high, there are certain risks associated with both macroeconomic factors and the stability of the financial system, which could result in temporary deviations from the long-term positive trend.



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

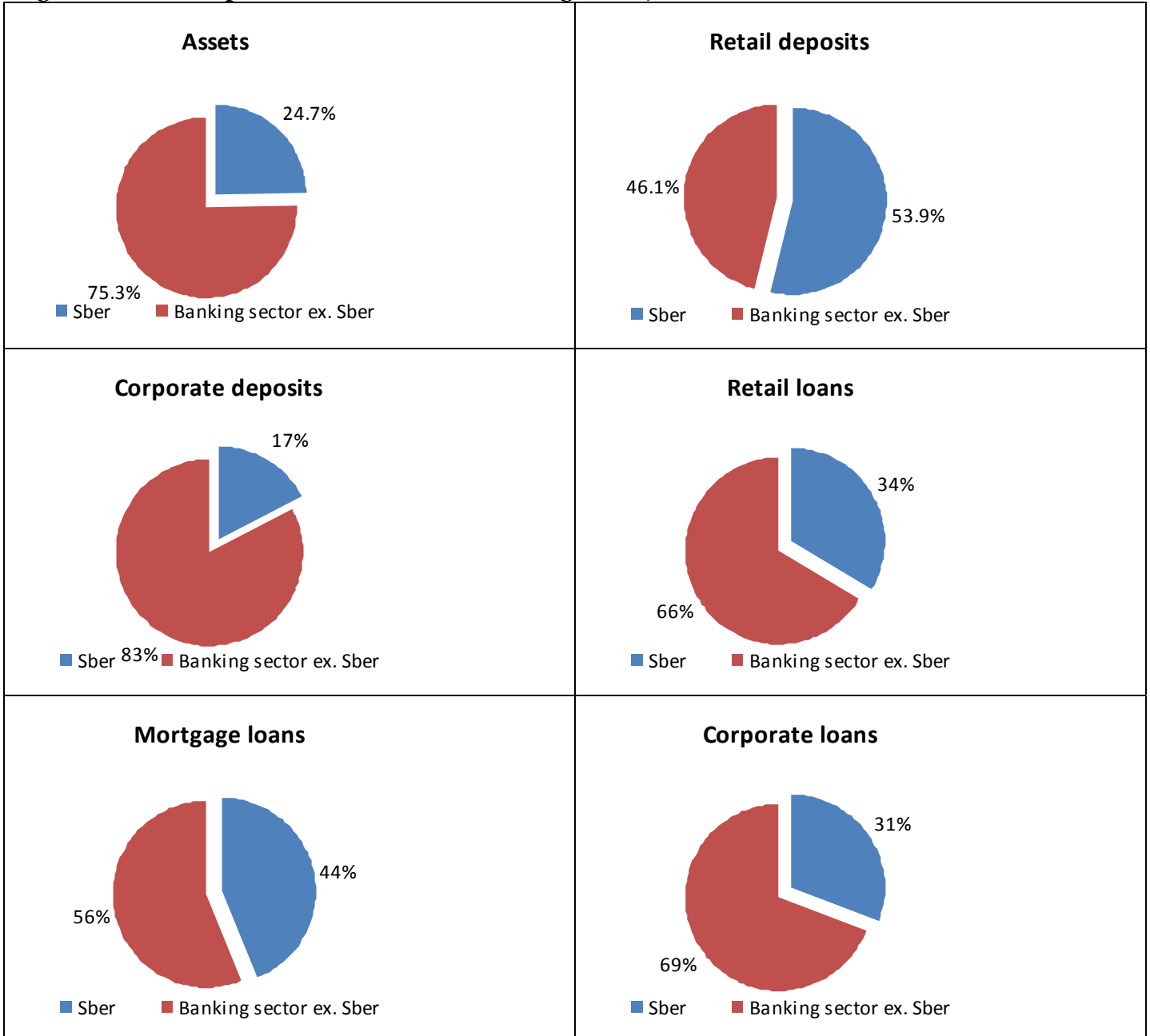
August 13, 2007

Conclusions: Over the next 1-2 years, the banking sector will maintain its impressive retail credit growth rate (with the highest growth rates expected in the mortgages and credit card segments), as well as the current growth rates for small and mid-size business loans. We believe that due to the low initial level of retail loans, they may continue to grow rapidly at relatively low risk. At the same time, due to the higher return they offer in this segment, they will attract the interest of foreign banks. **After the completion of this phase**, the banking sector is likely to encounter significant restrictions to continue growing rapidly, with the emergence of previously hidden risks. **During this phase, universal banks – with a quality brand, diversified sources of capital and credit portfolios, which are least dependent on global capital markets and enjoy the luxury of being able to rely on their key shareholders for support – the state or a large western financial group – will be valued at a significant premium.** Sberbank is a classic example of a bank that meets these criteria.



Sberbank – First among equals – its position in the Russian banking sector, 2006

Fig. 1 – Sberbank's position in the Russian banking sector, 2006



Source – Company data, Central Bank data

**SWOT - analysis**

Strengths	Weaknesses
The leader of the Russian banking sector, the largest universal bank in Central and Eastern Europe with a global brand and unique position as the largest retail bank in Russia (holding over 50% of total retail deposits).	A relatively high level of operating expenses (Cost/Income ratio in 2006 grew from 51.6% to 54.2%) in comparison to 40% for European banks.
Diversified credit portfolio (71% – corporate loans, 26% – retail, with 45% of its corporate loans portfolio consisting of loans granted to key accounts and the rest – to small and medium-size businesses).	Loss of market share in retail loans
High growth rate in the most dynamically developing and profitable bank loan sectors – retail loans and loans to small-size businesses. Strong market share in the retail loan sector (34%) including mortgages (about 45%).	Lagging the banking sector in some rapidly growing retail credit niches (auto credits, credit cards, etc).
High confidence level amongst the population, reliance on depositors' funds as a fairly stable funding source – retail deposits account for about 65% of Sberbank's liabilities. Thus, the bank is well protected against deteriorating financing terms on the global financial markets.	A relatively high proportion of retail deposits relative to other funding sources.
Support of its strategic partner – the state.	
Well-developed infrastructure (especially retail outlets covering the entire country).	
Conservative credit policy, high quality credit portfolio (overdue loans accounted for 1.1% of total loans as of the beginning of 2007 against 1.4% for the banking sector as a whole, its reserves covered NPLs by 346% against 319% for the banking sector as a whole.	
Financing of large investment (including infrastructure) projects. As of January 1, 2007 the Bank's investment finance loan portfolio amounted to 460.1 bn roubles (accounting for 23.5% of its corporate credit portfolio).	
Opportunities	Threats
Equity increase of \$8.8 bn in 1Q07 will enable the bank to enjoy an average annual growth rate of more than 30% over 3 years, benefiting from the growth of the Russian economy and the development of the financial sector.	Tougher competition from the largest Russian banks (primarily, VTB, which is planning to increase its retail market share to 10-15%) and from subsidiaries of western banks may result in further reduction in Sberbank's interest margins.
A unified network of about 20,000 branches covering the entire country has created a unique competitive advantage for Sberbank in the rapid expansion of new banking products (retail loans including mortgages, auto loans, etc) in the regions. The bank derives stable and growing fee income from traditional banking services (e.g. retail bill payments) due to the striking growth in personal incomes and a rising economy.	Risks of deteriorating financing terms for banks on global capital markets due to the mortgage market crisis in the US and growing credit spreads. (Sberbank does not plan to issue Eurobonds this year.)
Development of new financial products (mobile banks, credit cards, etc – to be launched next year).	Shares of financial institutions may come under pressure for some time due to unfavourable global capital market trends.



Valuation model

Basic assumptions of the model

1. We anticipate Sberbank's share as a proportion of the banking sector's aggregate assets to stabilise at 25-26%. Over the next 3 years (2007-09), we expect Sberbank's assets to grow at an average annual rate in excess of 30%, after which growth will slow down as a result of the expected gradual decline in the growth rate of the economy, banking services saturating the market, and increased competition in the banking sector.

Table 2 – Sberbank's forecast asset growth

RUR bn	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Banking sector assets	9,750	14,046	19,383	25,585	32,749	40,609	48,731	57,503	67,278	78,043	89,749
Sberbank's assets	2,513	3,467	4,853	6,454	8,198	10,165	12,198	14,516	17,129	20,041	23,247
Sberbank's assets, growth rates	31%	38%	40%	33%	27%	24%	20%	19%	18%	17%	16%
Sberbank's share	25.8%	24.7%	25.0%	25.2%	25.0%	25.0%	25.0%	25.2%	25.5%	25.7%	25.9%

Source: Company data, Sovlink estimates

2. We assume that Sberbank's loan portfolio as a % of its total assets will increase from 73% to 80-81%, with its retail loan portfolio growing at the fastest rate. In June, A. Aleshkina, the bank's first deputy chairperson, said that the bank will maintain its strict approach in assessing the creditworthiness of clients before granting loans. According to her, as of April 1, 2007, emergency loans accounted for 69% of the bank's retail credit portfolio, mortgages – 22.1%, auto loans – 1.5% and other loans – 4.8%. According to Sberbank's forecasts, its mortgages may double in size this year, with 30% of its retail loans consisting of mortgages. Over the next few years, the bank aims to maintain a share of 30-40% of the total retail credit market and plans to win 35% of the corporate loans market by 2008.

In the mid-term, we expect Sberbank's share of retail credits as a proportion of its credit portfolio to continue growing and stabilising at 45% in 2015, with mortgage credits increasing to 35-36% of its retail portfolio. This matches our forecasts for the Russian banking sector as a whole and the current credit portfolios of East European banks.

Table 3 – Sberbank's loan portfolio

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Sberbank's net loan portfolio, RUR bn	1,787	2,542	3,660	4,959	6,397	8,029	9,715	11,609	13,757	16,164	18,831
Sberbank's net loan portfolio, \$ bn	62.08	96.52	145.23	198.37	251.86	302.97	354.55	420.62	494.84	577.29	667.78
Growth rates	38.0%	42.0%	44.0%	36.0%	29.0%	26.0%	21.0%	19.5%	18.5%	17.5%	16.5%
Loans/Assets	71.0%	73.0%	75.0%	77.0%	78.0%	79.0%	80.0%	80.0%	80.0%	81.0%	81.0%
Loans to corporate clients, market share, %	31.2%	30.8%	32.5%	33.7%	33.7%	33.8%	33.0%	32.1%	32.4%	32.3%	32.3%
Retail loans/loans, %	24.9%	26.2%	28.0%	30.0%	33.0%	36.0%	39.0%	42.0%	43.0%	44.0%	45.0%
Retail loans, market share, %	39.7%	33.5%	31.1%	30.0%	30.0%	30.0%	30.9%	32.1%	31.9%	32.2%	32.5%
Mortgage/retail loans	15%	22%	30%	34%	36%	36%	36%	35%	35%	35%	35%
Mortgage, market share	59%	44%	45%	43%	38%	34%	33%	32%	32%	32%	32%

Source: Company data, Sovlink estimates

3. Due to the greater security of mortgage credit, the credit rate for such loans (on average, 10-14% in roubles and 9-12% in foreign currency) is significantly lower than for emergency loans (15-17.5%). Furthermore, as we



mentioned earlier, banks are actively lowering mortgage and some other retail credit rates due to increased pressure from their competitors. Thus, the expected increase of mortgage loans in the bank's loan portfolio may lead to lower overall interest margins and profitability from interest earning assets.

- According to Ms. Aleshkina, Sberbank is expecting its retail deposits to grow by 25-30% during 2007, (which is close to our forecasts). We believe that, over the next few years, Sberbank will retain its share of the retail deposits market at over 50%; however, its market share will gradually decline. Retail deposits currently amount to 65% of the bank's liabilities and we expect them to remain at this level in the mid-term.

Table 4 - Sberbank's retail deposits

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Retail deposits with Sberbank, RUR bn	1,514	2,046	2,670	3,498	4,477	5,596	6,911	8,328	9,911	11,695	13,683
Growth rates	26%	35%	31%	31%	28%	25%	24%	21%	19%	18%	17%
Market share	55.0%	53.9%	52.5%	52.1%	52.1%	51.7%	51.5%	50.9%	50.4%	50.0%	49.6%

Source: Company data, Sovlink estimates

- We believe that after significantly increasing its capital and assets as a result of the SPO held earlier this year, the downward trend of lower relative operational expenses will speed up. The cost/income ratio over the mid-term should drop below 50%, however the potential for it to decline further is restricted by the bank's huge branch network and the necessity of hiring and providing advanced training for personnel in order to offer a broader range of products and services through its branches. A relatively high level of operating expenses has always been Sberbank's weak spot and improving it will enhance the bank's profitability.

Table 5 - Operating expenses

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Operating expenses /assets ratio	5.2%	4.9%	4.4%	3.9%	3.7%	3.60%	3.55%	3.50%	3.45%	3.40%	3.35%
Cost/Income	51.6%	54.2%	52.7%	-50.0%	-49.2%	-49.3%	-49.3%	-48.9%	-49.2%	-49.3%	-49.4%

Source: Company data, Sovlink estimates

In addition, the Bank plans to reduce its bad debt provision – and the high quality of its credit portfolio allows it to do so without significantly increasing its risks. This will also boost its net interest income.

- Sberbank's management expects 2007 net profits of 100 bn roubles. Our estimate is more optimistic and predicts (IFRS) profits of 109 bn roubles. According to our forecasts, the bank's ROE rate will be 20-23%, which is quite a good level for the Russian banking sector – before the SPO, Sberbank's ROE was over 30%.



The following forecasts are based on the assumptions stated above:

Table 6 – Income statement, \$ mn

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Interest income on loans	7,638	10,632	14,863	19,972	25,182	29,843	34,073	38,965	44,466	50,966	58,099
Interest income on securities	1,035	1,055	1,338	1,658	1,825	2,090	2,329	2,632	3,010	3,401	3,819
Interest expenses	-3,149	-4,490	-6,528	-9,115	11,613	13,931	15,686	17,546	19,982	23,076	26,556
Net interest income	5,524	7,197	9,673	12,515	15,394	18,002	20,717	24,051	27,493	31,290	35,362
Provisions for bad loans	-692	-510	-772	-1,313	-1,769	-1,949	-1,939	-2,135	-1,907	-2,009	-2,082
Net interest income adjusted for potential impairment of assets	4,831	6,687	8,901	11,202	13,625	16,053	18,777	21,915	25,586	29,281	33,280
Fees	1,264	1,842	2,662	3,605	4,653	5,663	6,641	7,774	9,142	10,661	12,328
Other income	1,040	821	1,144	1,464	1,808	2,148	2,514	2,936	3,435	3,950	4,511
Operating income	7,135	9,351	12,707	16,272	20,085	23,864	27,932	32,625	38,163	43,893	50,118
Operating expenses including wages and salaries	-4,040	-5,340	-7,104	-8,785	10,757	12,737	14,729	17,000	19,707	22,648	25,803
Profit before tax	3,095	4,011	5,603	7,486	9,329	11,126	13,202	15,625	18,456	21,245	24,315
Tax	-771	-965	-1,345	-1,797	-2,239	-2,670	-3,169	-3,750	-4,430	-5,099	-5,836
Net profit	2,325	3,047	4,258	5,690	7,090	8,456	10,034	11,875	14,027	16,146	18,479

Source: Company data, Sovlink estimates



Table 7 – Balance sheet, \$ mn

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Cash and cash equivalents	4,285	6,449	6,163	7,746	8,714	9,590	10,239	11,045	12,323	14,315	16,487
Obligatory reserves	1,973	2,959	5,594	8,231	10,592	12,800	15,082	17,879	21,005	24,454	28,216
Securities	13,517	18,028	26,770	33,566	39,375	44,113	48,971	56,276	64,079	71,932	80,788
Credits granted to other banks	901	1,568	1,926	2,582	3,227	3,836	4,452	5,259	6,161	7,157	8,244
Credits and advances to clients	62,080	96,529	145,235	198,368	251,865	302,970	354,552	420,620	494,848	577,294	667,777
Fixed assets	3,711	4,756	5,778	6,455	8,069	9,590	11,130	13,149	15,404	17,894	20,609
Other assets	824	1,373	1,127	1,250	905	695	766	1,714	2,325	2,696	2,250
Total assets	87,292	131,662	192,593	258,198	322,747	383,594	445,193	525,941	616,146	715,741	824,371
Bank credits and deposits	865	1,703	2,510	3,411	4,297	5,113	5,921	7,001	8,197	9,502	10,911
Retail deposits	52,598	77,707	105,955	139,912	176,267	211,188	252,250	301,759	356,509	417,676	485,215
Corporate deposits	18,993	29,730	43,333	56,784	71,538	83,654	97,087	111,323	125,996	142,609	160,005
Own debt instruments	3,018	4,699	6,360	8,641	10,886	12,953	11,842	14,003	17,486	20,270	22,550
Other borrowings	2,187	4,076	6,695	15,463	20,054	25,905	25,658	30,339	35,518	41,174	47,282
Subordinated loans	1,021	1,021	1,021	1,021	1,021	1,021	1,021	1,021	1,021	1,021	1,021
Other liabilities	583	1,008	1,490	2,163	2,417	1,024	953	1,313	1,711	1,196	434
Total liabilities	79,266	119,945	167,364	227,394	286,480	340,858	394,732	466,759	546,438	633,449	727,419
Total equity	8,026	11,718	25,229	30,804	36,267	42,737	50,462	59,182	69,707	82,293	96,952

Source: Company data, Sovlink estimates

Table 8 – Financial ratios

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
EPS	122	160	225	301	375	447	531	628	742	854	978
BVS	432	586	1,335	1,630	1,919	2,261	2,670	3,132	3,689	4,354	5,130
P/E	37.01	28.24	20.2	15.12	12.13	10.17	8.57	7.24	6.13	5.33	4.66
P/BV	10.7	7.3	3.4	2.8	2.4	2.0	1.7	1.5	1.2	1.0	0.9
ROE	34.5%	30.9%	23.0%	20.3%	21.1%	21.4%	21.5%	21.7%	21.8%	21.2%	20.6%
ROA	3.0%	2.8%	2.6%	2.5%	2.4%	2.4%	2.4%	2.4%	2.5%	2.4%	2.4%
Operating costs/assets	5.2%	4.9%	4.4%	3.9%	3.7%	3.6%	3.6%	3.5%	3.5%	3.4%	3.4%
Cost/Income	-51.6%	-54.2%	-52.7%	-50.0%	-49.2%	-49.3%	-49.3%	-48.9%	-49.2%	-49.3%	-49.4%
Fee/operating income	18.3%	19.7%	21.0%	22.2%	23.2%	23.7%	23.8%	23.8%	24.0%	24.3%	24.6%

Source: Company data, Sovlink estimates



Company valuation

We evaluated Sberbank's shares based on Gordon's modified model (target P/BV) ($P/BV = (ROE-g)/(r-g)$). We have used a terminal growth rate (g) of 6% and ROE of 20%.

We have applied an equity discount rate of 11.2%.

Russia-30 YTM	6.15%
Historical risk premium (1929-2005) for investments on the US stock markets	4.36%
Sovereign risk premium for Russian equities based on Russia's sovereign rating and adjustments for excessive risk of investment in equities rather than Eurobonds	1.65%
Russian equity risk premium	6.0%
Beta	0.84
Risk premium for investments in the company	5.05%
Cost of equity	11.2%

Source: Cbonds, Damodaran, Sovlink estimates

Applying the Gordon model, we obtained a forecast PBV of 2.69 in 2015. Inserting the bank's 2015 projected book value of \$96,952 mn, we calculated a fair market value of \$261,105 mn for Sberbank at the end of 2015.

After discounting the bank's projected 2015 fair value to the end of 2007, we obtain a fair market value of \$111,695 mn, with a target price per ordinary share of \$4.95 as of the end of 2007.

Return on equity in future periods	20.0%
Growth in future periods	6.0%
Target P/BV-2015	2.69
Fair market value in 2015, \$ mn	261,105
Cost of equity, %	11.20
Fair M.Cap at the end of 2007, \$ mn	111,694

Ordinary shares after additional issue, mn	21,587
Preferred shares, mn	1,000
Total shares, mn	22,587
Target price of 1 ordinary share, \$	4.95

Target price of 1 ordinary share at the end of 2007, \$:	4.95
Market value of 1 ordinary share (10.08.2007)	3.74
Upside, %	32%
Recommendation	BUY



Valuation of preferred shares

After the SPO, the discount of preferred against ordinary shares increased significantly – from an average discount of 17% in 2006 to 25-27%. This can partly be explained by the reduction of the proportion of preferred shares to less than 5% of the bank's total equity capital and the loss of liquidity of preferred shares in comparison to ordinary shares. Following the share split, ordinary shares became 1,000 times cheaper, and the preferred shares lost their advantage of being affordable to the retail investor. In due course, the bank may decide to convert the preferred shares, which now amount to less than 5% of the bank's equity capital. However, this is only an assumption and has not been confirmed by management. Nevertheless, we find the current discount to be excessively high. In our view, it may drop to 20% (due to the lower liquidity of preferred shares) over the mid-term, and therefore we have used a discount of 20% to calculate their fair value.

Table 9 – Fair value of Sberbank's preferred shares

Fair value of 1 preferred share as of the end of 2007, \$	3.96
Market value of 1 preferred share as of 10.08.2007, \$	2.80
Upside, %	41%
Recommendation	BUY

Accordingly, we reiterate our **BUY** recommendation on both the ordinary and preferred shares of Sberbank.



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Comparison with emerging market peers

Bank	Ticker	Country	M.Cap, \$ mn	ROE, %		P/E			P/BV		
				2006E	2007E	2006E	2007E	2008E	2006E	2007E	2008E
Sberbank	SBER	Russia	83,751	31%	23%	27.49	19.67	14.72	7.15	3.32	2.72
Bank of Moscow	mmbm	Russia	7,644	20%	19%	36.95	26.87	21.73	6.30	4.28	3.60
Vozrozhdenie	VZRZ	Russia	1,497	19%	20%	50.81	23.23	16.70	7.16	3.29	2.77
Rosbank	ROSB	Russia	4,933	12%	15%	35.23	25.24	19.73	4.63	3.19	2.76
VTB	VTBR	Russia	33,621	19%	12%	28.52	24.56	16.71	4.81	2.13	1.90
Russian peer average				20%	18%	35.80	23.92	17.92	6.01	3.24	2.75
Discount (-)/premium (+)						-23%	-18%	-18%	19%	2%	-1%
EM-peers											
Bank Pekao	PEO PW	Poland	15,470	21%	21%	26.9	21.1	18.3	5.1	4.5	4.1
Komerčni Bank	KOMB CP	Czech Republic	7,079	18%	20%	17.5	14.3	12.7	2.9	2.7	2.5
BPH	BPH PW	Poland	9,848	19%	21%	24.1	17.3	17.3	4.1	3.7	3.5
OTP	OTP HB	Hungary	15,531	28%	26%	17.4	13.5	11.9	3.8	3.0	2.5
BRE	BRE PW	Poland	5,686	18%	22%	41.9	24.5	21.6	6.3	5.0	4.1
Bradesco	BBDC3 BZ	Brazil	48,827	23%	27%	21.0	12.7	10.6	4.2	3.3	2.8
Halyk Bank	HSBK KZ	Kazakhstan	6,807	33%	29%	32.2	19.0	12.3	7.2	-	-
Kazkommertsbank Industrial & Commercial	KKGB KZ	Kazakhstan	7,958	16%	17%	36.0	20.2	-	3.8	3.1	-
Bank of China	601398CH	China	213,723	-	13%	32.7	24.5	18.7	4.7	4.2	3.9
ICICI Bank	ICICIBC IN	India	20,564	14%	13%	37.6	20.7	16.1	4.0	2.4	2.2
Bank of China	3988 HK	China	156,738	13%	13%	29.2	23.3	17.8	3.3	2.9	2.9
Banco do Brasil	BBAS3 BZ	Brazil	35,374	32%	25%	12.7	13.4	10.8	3.6	2.8	2.4
Malayan Banking	MAY MK	Malaysia	13,749	16%	18%	18.3	15.4	13.8	2.9	2.7	2.5
State Bank of India		India	18,458	16%	16%	14.8	11.9	10.1	2.1	1.9	1.6
Akbank	AKBNK TI	Turkey	15,961	25%	25%	14.5	9.0	8.2	2.7	2.6	2.3
Emerging markets average				21%	20%	25.1	17.4	14.3	4.0	3.2	2.9
Discount (-)/premium (+)						9%	13%	3%	77%	4%	-5%

Source: Bloomberg, Sovlink estimates

Our peer comparison shows that in comparison to its Russian peers, Sberbank is trading at a discount with respect to its P/E ratio and on a similar level to its peers in terms of its P/BV ratio with respect to 2007-08 forecasts. In comparison to its emerging market peers, Sberbank is trading at a slight premium with respect to 2007 forecast ratios, and at the same level with respect to 2008 forecasts.

Conclusions:

1. The Russian banking sector continues to grow at rates, which are considerably higher than the rates at which the economy is expanding. Nevertheless, the level of integration of the Russian banking system in the economy is still low, in comparison with developed and many developing countries, which should also lead to high growth rates over the mid-term. The most promising sectors in the near future are retail loans including mortgages, credit cards, auto loans, as well as credits to small and medium-size businesses. We assume that by 2010 Russia will have an assets/GDP ratio of 88% (the same as Poland and Brazil), a retail loans/GDP ratio of 21.6% (the same as Slovenia, Lithuania, Bulgaria, and Hungary) and retail loans will make up 35% of its loan portfolio, with mortgages accounting for 32% of its total retail loans (the average level in East European countries). By 2015, Russia is expected to be amongst the most developed East European countries (Hungary, Croatia, the Czech Republic, and Slovenia)
2. We believe that due to Russia's relatively low current level of retail loans, the retail loan sector is likely to continue expanding at a rapid pace over the next 1-2 years and at the same time maintain its relatively low risk levels. Due to the higher return retail loans offer in comparison to other types of loans, foreign banks will also be drawn to the retail loan sector. Subsequently, this sector is likely to encounter significant growth restrictions, with the emergence of previously concealed risks.



3. We single out the following key risks - macroeconomic instability, deficit of long-term resources within the country and dependence on global capital markets, reduced liquidity, asset depreciation due to underestimating credit risks during the credit boom, and lower interest margins in the banking sector.
4. In the mid-term, universal banks – with a quality brand, diversified sources of capital and credit portfolios, which are least affected by the global capital markets and, if necessary, are able to rely on the support of key shareholders (the state or large western financial groups) – will be best protected against these risks. Sberbank is an excellent example of a bank that meets these requirements.
5. The capital raised (about \$8.8 bn) via the SPO in 1Q07 has laid the foundation for the prospect of Sberbank's business growing at a rapid pace through 2007-10. We anticipate the bank's assets to grow at an average annual rate of about 30% during this period, which is comparable to the projected growth rates of the Russian banking sector as a whole.
6. In our view, Sberbank's principal strengths include: a high quality brand both in Russia and globally, flexibility, uniquely extensive branch network covering the entire country, a diversified credit portfolio, a conservative credit policy, low dependence on global financial markets (as 90% of its liabilities consist of customer accounts), low political risks, and the support of its key shareholder – the state.
7. Against an overall positive background, it should be noted that increased competition in the most promising and profitable retail credit sector has significantly reduced Sberbank's market share in this sector during the past year. The bank's attempts to slow the pace at which it is losing market share in this sector is likely to force the bank to continue lowering the interest rate on many of its retail loan products. At the same time, borrowing conditions in the global markets are tightening and the recent Libor increase has raised the cost of debt for floating interest rate loans. In its turn, this will exert pressure on the bank's interest margins. Another factor for lower returns in future is related to the stricter monetary policy of the Central Bank – in particular, the increase in the obligatory reserve levels from 3.5% to 4-4.5% of liabilities as of July 1, 2007. The Central Bank has indicated that this may be further increased in future. Nevertheless, according to our forecasts, Sberbank's return on equity over the period up to 2015 will range within 20-25%, which is lower than in 2006 but is quite positive in comparison to the industry average in Russia and other emerging markets.



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STOCK RATING POLICY

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
SELL:	Fair value at or below current price levels

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