



Sberbank

**Investment
Alert****BUY****Upside: 35%****Target Price: \$4.95**

1Q07 IFRS results

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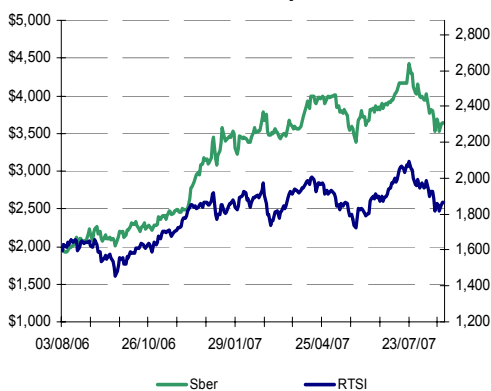
Ticker	Sber	M.Cap, \$ mn	78,792
Shares Ords '000	21,586,948	Free Float, %	40
Shares Pref '000	1,000,000	Free Float, \$ mn	31,516
Bid Ords, \$	3.70	Offer Ords, \$	3.72
Bid Prefs, \$	2.68	Offer Prefs, \$	2.75

Market performance

		1 month	6 months
Absolute	Ords	-15.3%	-1.3%
Relative to RTSI	Ords	-6.3%	2.3%
Price range, \$			
High	Ords	4.30	4.42
Low	Ords	3.53	3.39

Financials, 2007E

Assets, \$ mn	192,593	ROE	23.0%
Book Value, \$ mn	25,229	P/E	18.5
Net income, \$ mn	4,258	P/BV	3.1

Sberbank – Relative performance

Source: RTS

• On August 24, Sberbank published its 1Q07 IFRS results. We view the bank's decision to start publishing quarterly IFRS results positively – as they give a timely and more accurate picture of its operating and financial performance. However, the bank's 1Q07 results are unlikely to significantly influence the market, as expectations are focused on the way in which the bank will utilize the \$8.8 bn raised via its SPO at the end of the first quarter, and which the bank had not utilized in 1Q07.

• On the whole, the key indicators of the report were quite close to expectations based on the previously published RAS results. Net profit (RUR 26.78 bn) was slightly above the consensus forecast (of about RUR 25 bn) and RAS results (RUR 25.93 bn).

• However, we were disappointed to see that the bank's loan portfolio in 1Q07 grew by only 3.9% with loans as a proportion of assets declining from 73% at the end of 2006 to 67%. Based on its RAS results (which showed that the bank's net loan portfolio increased in 1Q07 by 11.7%), we had anticipated much stronger growth. At the same time, securities as a proportion of assets rose from 13.7% to 17.9%, whilst investments in discount debt securities of the Bank of Russia have more than tripled since the end of 2006.

• The reduction of loans as a proportion of assets, together with declining interest rates on the loans issued due to increased competition resulted in a noticeable decline in asset yield (from 12.1% in 2006 to 11.3%). At the same time, debt financing costs increased from 4.5% in 2006 to 4.7%. As a result, the net interest spread decreased from 7.7% in 2006 to 6.6% in 1Q07, and the net interest margin from 7.5% to 6.6% – which was expected based on the RAS results.

• Interest income grew by 31% in comparison to 1Q06; however, due to interest expenses growing at an even faster rate (+50%), net interest income growth was – as we expected – quite modest (+19%). Fee and commission income growth of 28% met our expectations based on RAS results. However, it clearly lags the average annual growth rate of about 40% between 2004-06. Net operating income grew by 19%. The bank's high net income growth (+34%) is largely due to the fact that the bank was able to limit the growth of its non-interest expenses – operating expenses only increased by 12%, and the cost/income ratio dropped from 53.1% in 1Q06 to 51.7% in 1Q07.

• The 1Q07 results have not changed our assessment of Sberbank's fundamental value, since – by the end of the year – we anticipate more active use of the capital raised via the SPO in March, which should enable the bank to overcome the weak growth of its loan portfolio in 1Q07. Consequently, we reiterate our **BUY** recommendation on the bank's ordinary shares with a target price of \$4.95, which gives potential upside of 35% from the current market price.



On August 24, Sberbank published its 1Q07 IFRS results – and announced that it will from now onwards publish its IFRS results on a quarterly basis. We view the bank's decision to start publishing its IFRS results on a quarterly basis positively – as they give a timely and more accurate picture of its operating and financial performance..

On the whole, the **key indicators of the report were quite close to expectations based on the recently published RAS results**. The bank's assets grew by 13.6% (versus 13.5% according to RAS results), equity – by 83.3% (78.8%), retail deposits – by 6% (5.9%), and corporate deposits – by 11.6% (10.9%). Net profit (RUR 26.78 bn) was slightly above the consensus forecast published by Interfax (RUR 26.78 bn) and RAS results of RUR 25.93 bn.

However, **we were disappointed to see that the bank's loan portfolio in 1Q07 grew by only 3.9% with loans as a proportion of assets declining from 73% at the end of 2006 to 67%**. Based on the RAS results (the bank's net loan portfolio increased in 1Q07 by 11.7%), we had anticipated much stronger growth. Retail loans also grew at a slow pace (+3.6%) – which was, however, in line with expectations. Despite the generally sluggish dynamics of retail and corporate loans issued to non-financial institutions by Russian banks in 1Q07 (about 8%), Sberbank lagged the market, which resulted in a further decline of its market share in both the retail and corporate loan sectors (see Table 1). At the same time, securities as a proportion of assets rose from 13.7% to 17.9%, whilst investments in discount debt securities issued by the Bank of Russia have more than tripled since the end of 2006.

The reduction of loans as a proportion of assets, together with declining interest rates on the loans issued due to increased competition resulted in a noticeable decline in asset yield (from 12.1% in 2006 to 11.3%). At the same time, debt financing costs increased from 4.5% in 2006 to 4.7%. This is mainly due to higher fees for servicing retail deposits (from 5.9% in 2006 to 6.3%), as well as the higher amount of foreign loans issued during the past year (In May and November 2006, the bank raised \$500 mn and \$750 bn respectively by issuing Eurobonds, and in October it issued a \$1.5 bn syndicated loan). As a result, the bank's net interest spread decreased from 7.7% in 2006 to 6.6% in 1Q07, and its net interest margin – from 7.5% to 6.6% – which was expected based on the RAS results.

Interest income grew by 31% in comparison to 1Q06, versus growth of 26.4% under RAS. However, interest expenses grew at a significantly faster pace – by 49.8%. A substantial part (78.6%) of Sberbank's interest expenses consisted of interest on retail time deposit accounts, which increased by 47% in comparison to 1Q06. This was due to time deposit accounts as a proportion of retail deposits increasing from 90% at the end of 2006 to 91%, as well as the higher interest rates paid on retail deposit accounts over the past year in order to prevent further declines in Sberbank's market share in this vital sector. The growth in interest expenses matched expectations based on RAS figures (48.4%). As a result, net interest income growth was, as we expected, quite modest (+19.4%) versus 13.6% according to RAS.

The bank decided to lower its excessively conservative impairment provisions for loans. At the end of 2006, its reserves were 3.5 times greater than the amount of its non-performing loans (NPLs) – as of March 31, 2007, they were covered 3.1 times. These allowed the bank to increase its net interest income (after including impairment provisions for loans) by 25% and at the same time preserve the high quality of its loan portfolio.

Fee and commission income grew by 28%, in line with our expectations based on RAS figures – clearly lagging the 2004-06 growth rates of about 40% per annum. Net operating income grew by 19%. **The bank was able to limit its non-interest expense growth**, with operating expenses growing by 12%, and the cost/income ratio dropping from 53.1% in 1Q06 to 51.7% in 1Q07 and from 54.2% for 2006. As a result, profit before tax increased by 28%. The bank's effective tax rate in 1Q07 was only 20% versus 24% in 1Q06, which allowed its net profit to grow significantly (34%).

Although the SPO in late March, which enabled the bank to raise RUR 230 bn, and thereby considerably increase its assets and equity capital, the growth was only reflected on paper – as the new capital only appeared at the end of 1Q07 and had not been utilized when the accounts were prepared for the first quarter. Naturally, it resulted in reducing the bank's ROE – from 30.9% in 2006 to 24.5% in 1Q07. ROA, however, increased slightly – from 2.8% to 2.9%.

The bank's 1Q07 IFRS results show fairly weak growth in the bank's loan portfolio during the first quarter, a reduction in its net interest margin, and slower fee income growth. (Whilst the last two factors were expected, the stagnation in the growth of its loan portfolio turned out to be an unpleasant surprise). Amongst the positive factors, we note that the bank was able to operate more efficiently by lowering its reserves for bad debts (which were excessively conservative) and by limiting the growth of its operating expenses. Consequently, we reiterate our **BUY** recommendation on the bank's ordinary shares with a target price of \$4.95, which gives potential upside of 35% from the current market price.



For the moment, the bank's 1Q07 results are unlikely to significantly influence the market, as market expectations are focused on the way in which the bank will utilize the \$8.8 bn raised via its SPO at the end of the first quarter, and which therefore had not been utilized during the first quarter.

The 1Q07 IFRS results have not affected our assessment of Sberbank's fundamental value ("Sberbank – Betting on Quality" published on August 13, 2007), since – by the end of the year – we anticipate more active use of the capital raised via the SPO in March, which should enable the bank to overcome the weak growth of its loan portfolio in 1Q07. Furthermore, the bank's 2Q07 RAS results indicate that securities continue to make up a significant portion of its assets and a downward interest margin trend – in this context we hope that the 2Q07 IFRS report will help us form a clearer idea of the key indicator trends.

Table 1 - Sberbank's share in major market segments

	At the beginning of 2006	At the end of 2006	At the end of Q107
Assets	25.8%	24.7%	25.2%
Equity	18.6%	18.2%	28.6%
Retail loans	39.7%	33.5%	32.1%
Corporate loans	31.2%	30.8%	29.5%
Retail deposits	55.0%	53.9%	54.1%
Corporate deposits	18.1%	17.5%	16.5%

Source: Central Bank, Company reports, Sovlink estimates

Table 2 – IFRS balance sheet summary, 1Q07 – RUR mn

	As of 31.03.2007	At the beginning of 2007	Changes in 1Q07 (YTD), %
Assets	3,936,856	3,466,673	13.6%
Loans to clients	2,641,201	2,541,617	3.9%
As a % of assets	67.1%	73.3%	
Securities	706,118	474,686	48.8%
As a % of assets	17.9%	13.7%	
Retail deposits	2,168,640	2,046,035	6.0%
As a % of liabilities	64.3%	64.8%	
Corporate deposits	873,586	782,789	11.6%
As a % of liabilities	25.9%	24.8%	
Equity	565,539	308,524	83.3%

Source: Company reports, Sovlink estimates

Table 3 – IFRS Income Statement summary, 1Q07

RUR, mn	1Q07	1Q06	1Q07/1Q06, %
Interest income	90,765	69,536	30.5%
Interest expenses	-38,190	-25,491	49.8%
Net interest income	52,575	44,045	19.4%
Net interest income after allocation to bad debts reserves	52,947	42,235	25.4%
Net fee and commission income	13,500	10,584	27.6%
Operating income	69,052	58,050	19.0%
Operating expenses	-35,523	-31,798	11.7%
PBT	33,529	26,252	27.7%
Net profit	26,777	19,939	34.3%

Source: Company reports, Sovlink estimates



Table 4 – Profitability indicators, %

	1Q07	2006
Asset yield	11.3%	12.2%
Debt financing costs	-4.7%	-4.5%
Net interest spread	6.6%	7.7%
Net interest margin	6.6%	7.5%
Cost/Income	51.7%	54.2%
ROE	24.5%	30.9%
ROA	2.9%	2.8%

Source: Company reports, Sovlink estimates

Table 5 – RAS balance sheet summary, RUR bn

	As of 01.07.2007	As of 01.04.2007	At the beginning of 2007	Changes in 1H07 (YTD), %	Changes by 01.07.2006 (y-o-y), %	Changes for 1Q07 (q-o-q), %	Changes for 2Q07 (q-o-q), %
Assets	4,290.05	3,946.48	3,477.59	23.4%	46.2%	13.5%	8.7%
Net loan portfolio	3,219.70	2,925.00	2,619.03	22.9%	49.5%	11.7%	10.1%
As a % of assets	75.1%	74.1%	75.3%				
Securities	741.34	698.34	482.26	53.7%	47.8%	45.0%	6.0%
As a % of assets	17.3%	17.7%	13.9%				
Retail deposits	2,311.11	2,147.70	2,028.57	13.9%	35.9%	5.9%	7.6%
As a % of liabilities	62.3%	63.8%	64.1%				
Corporate deposits	1,059.48	900.08	811.77	30.5%	60.7%	10.9%	17.7%
As a % of liabilities	28.6%	26.7%	24.8%				
Equity	580.95	577.81	323.23	79.7%	108.3%	78.8%	0.5%

Source: Company data, Sovlink estimates

Table 6 – Financial performance, RUR mn

	1H07	1H06	1H07/1H06, %	1Q07	1Q06	1Q07/1Q06, %	2Q07	2Q06	2Q07/2Q06, %
Interest income	176,777	136,351	29.6%	86,302	68,297	26.4%	90,475	68,054	32.9%
Interest expenses	-78,352	-52,093	50.4%	37,112	25,009	48.4%	41,240	27,084	52.3%
Net interest income	98,426	84,258	16.8%	49,191	43,288	13.6%	49,235	40,970	20.2%
Net fee and commission income	41,037	31,754	29.2%	18,582	14,506	28.1%	22,455	17,249	30.2%
Operating income	145,217	117,351	23.7%	71,245	59,327	20.1%	73,972	58,023	27.5%
Operating expenses	-68,508	-55,358	23.8%	31,873	23,609	35.0%	36,634	31,748	15.4%
PBT	69,428	53,600	29.5%	33,033	26,415	25.1%	36,395	27,186	33.9%
Net profit	53,481	40,714	31.4%	25,931	21,755	19.2%	27,550	18,959	45.3%

Source: Company data, Sovlink estimates

Table 7 – Profitability indicators, %

	1H07	1H06	1Q07	1Q06	2Q07	2Q06
Asset yield	9.9%	11.1%	10.2%	11.7%	9.5%	10.7%
Debt interest	4.7%	4.3%	4.6%	4.4%	4.8%	4.4%
Net interest spread	5.3%	6.7%	5.5%	7.3%	4.7%	6.3%
Net interest margin	5.5%	6.8%	5.8%	7.4%	5.1%	6.5%
ROE	23.7%	30.5%	23.0%	32.8%	19.0%	27.3%
ROA	2.8%	3.0%	2.8%	3.3%	2.7%	2.7%

Source: Company data, Sovlink estimates



Recommendations for securities

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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