SOVLINK
YOUR FIRST CALL – FOR THE SECOND TIER

September 28, 2007

VTB

Flash Note

1H07 – Mixed results

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Stock data (as of close of trading on 27 September)

Ticker	VTBR	M.Cap, $ mn	32,679
Shares Ords'mn	6,724,138	Free Float, %	22.5%
Shares Prefs	-	Free Float, $ mn	7,353
Bid Ords, $	0.0046	Offer Ords, $	0.0047
Bid Prefs, $		Offer Prefs, $	

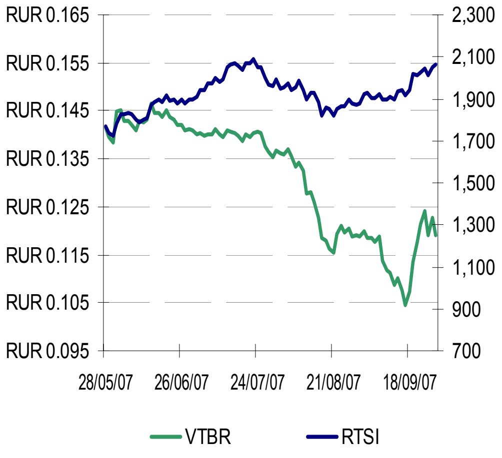
Market performance

		1 month	4 months
Absolute	Ords	-1.2%	-16.0%
Relative to RTSI	Ords	-10.0%	-32.6%
Price range, $			
High	Ords	12.40	14.66
Low	Ords	10.46	10.46

Financials, 2007E

Assets, $ mn	76,830	ROE	10.7%
Book Value, $ mn	15,820	P/E	27.9
Net income, $ mn	1,180	P/BV	2.1

VTB – Relative performance



Source: RTS, MICEX

• On 27 September VTB released its 1H07 IFRS figures. Net profit amounted to $540 mn, having dropped by 12.5% y-o-y. (However, the drop was smaller than the consensus forecast of a 17% decline to $477 mn.)

• The decrease in net profit is due to the absence of any significant non-recurring revenues from securities trading, as opposed to 1H06 – in particular, proceeds from the sale of the bank's stake in KAMAZ for $116 mn – and also due to the growth of the effective tax rate from 16 to 24%.

• On the whole, income growth – in particular net income growth – did not come up to expectations. However, income from core activities (net interest and fee and commission income) has grown significantly, which demonstrates the more stable and sound nature of the bank's operating income.

• Amongst the positive factors, we include the outstanding growth of retail loans (+62.1% YTD), which is far superior to the average growth rate of the market (23.9%). Thus, the proportion of retail loans in VTB's loan portfolio grew from 8.7% at the beginning of the year to 11%, which we consider as significant progress – since retail and SME loans are very profitable for Russian banks, and VTB hopes to raise its interest margin by increasing its retail loan share to 20-25% of its loan portfolio over the next two years. Therefore, the bank is not planning on raising its retail loan rates, despite an expected increase in funding costs.

• On the whole, we assess the bank's report as neutral. After its IPO, the bank gained momentum for rapid growth in the future; however, the results will be seen over the mid-term. For the market, the 2H07 results will have greater significance as they will include the effect of the utilisation of the capital raised and the liquidity crises on global financial markets (which may result in growing funding costs for VTB and possible losses from the revaluation of financial assets). The head of VTB, Mr A. Kostin, has promised positive results for 3Q07 and does not expect any adverse effects from the liquidity crisis on the bank's share portfolio. The results are scheduled to be released in December.

• According to Kostin, VTB is planning to propose a share swap of its shares with VTB North-West, based on terms that are close to the previously agreed terms. (Previously, the bank had agreed to exchange 1 VTB North-West share for 361 VTB shares, with a buyout price of $41.72 for opposing minority shareholders of VTB North-West.) According to the CFO, N. Tsekhomskiy, the bank has not ruled out the possibility of buying out VTB North-West's shares from minority shareholders. In our opinion, this is positive news for VTB North-West shareholders. However, the uncertainty of the time-frame and the final terms and conditions of the proposed transaction remain the key risk factors.

• Taking into account, Kostin's recent statement in which he assumed personal responsibility to achieve management's aim of increasing the bank's market capitalisation, as well as the importance of a successful (or at least breakeven) "people's IPO" ahead of the elections, it appears that the bank will do all in its power to attain positive results at the end of Q3 and Q4. We believe that management's previous net profit forecast of $1.18 bn in 2007 - equal to the bank's net profit in 2006 – will be met. However, this may be achieved as a result of some significant non-recurring revenue transactions (such as assets sales). Consequently, in our opinion, investors should hold their VTB shares over the next few months. Although we do are not issuing a formal recommendation on VTB, our market multiple valuation implies a fair value of 0.14 roubles ($0.0056) per ordinary share.

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On 27 September, the VTB Group released its report its 1H07 IFRS figures. The bank's net profit for H1 amounted to $540 mn, which was 12.5% lower than in 1H06. (However, the drop was smaller than the consensus forecast of a 17% decline to $477 mn.)

The comparative decline in the bank's net profit is due to the absence of any major non-recurring revenues from securities trading during 1H07 as opposed to 1H06 – in particular, proceeds from the sale of the bank's stake in KAMAZ for $116 mn – and also due to the growth of the effective tax rate from 16 to 24% (caused by the gradual replacement of non-taxable income from the revaluation of currency positions and securities trading by interest and fee and commission income).

On the whole, the bank's income growth did not come up to expectations. Thus, the yield from interest-bearing assets contracted due to the faster growth of securities (with relatively low yields) as a proportion of the bank's assets and escalating competition resulting in lower loan rates. At the same time, interest expenses grew rapidly, resulting in the bank's 1H07 net interest income growing at a slower pace than the consensus forecast (26% vs. a forecast rate of 35-40%). Moreover, in 2Q07, growth slowed to 16% vs. projected growth of 30%. (We note that in 1Q07, the bank's net interest income grew at a much more impressive rate of 41%.) The bank's net interest margin was substantially lower y-o-y, dropping from 4.4% to 3.9% according to our estimates, and from 4.5% to 4.1% according to VTB's data. The bank managed to partially compensate for lower net interest income by reducing its loan impairment provisions, which enabled it to increase its net interest income after provisions by 41.9%.

The significant growth of the bank's net fee and commission income (+65.8%) is mainly due to a non-recurring event – commission income from the appointment of a depositary bank for its IPO – without which the growth would have been more a moderate 30.4%. Nevertheless, fee and commission income as a proportion of operating income is growing – from 12.5% at the end of 1H06 to 14.8% (excluding non-recurring commission income). On the whole, the proportion of the bank's income from its core activities, (namely, net interest and fee and commission income), jumped from 60% to 73% which demonstrates the more stable and sound nature of the bank's operating income.

On the whole, actual operating income ($1,477 mn) lagged the consensus forecast of $1,549 mn. In comparison to 1H06, operating income grew by merely 14.2%. The bank's operating expenses were in line with market expectations (+40%) and their growth is attributed to the expansion of the group's branch network, including personnel and marketing costs. The bank's profit before tax fell by only by 3.5% vs. 1H06; however, as we stated above, its net income was affected more adversely due to a higher effective tax rate.

The bank's assets grew by 26.4% YTD (versus a consensus forecast of 34%) and 46% y-o-y (versus a consensus forecast of 55.1%). Loans issued as a proportion of the bank's assets dropped slightly (from 56 to 54%), as the bank's assets soared due to the IPO, but most of the capital raised was invested temporarily in securities (an increase of 57% from the beginning of the year). The growth of the bank's loan portfolio in Q2 accelerated to 12.3% and reached the average market level (+22% since the beginning of the year and 50.6% y-o-y).

We consider the outstanding growth of the bank's retail loan portfolio (+62.1% from the beginning of the year), which is almost three times as fast as the market average (23.9%) amongst the more positive features of the 1H07 report. Thus, the proportion of retail loans in VTB's loan portfolio grew from 8.7% at the beginning of the year to 11%, which is significant progress – since, these retail and SME loans are very profitable for the bank.

The quality of the bank's loan portfolio also improved, with NPLs declining from 2.1% in late 2006 to 1.8%, allocations to reserves were reduced from 3.2 to 3.0%, the bank's NPL cover ratio rose to 1.7 (vs. 1.5 at the end of 1Q07).

We also found moderate improvements in the bank's funding structure. Since the beginning of the year, customer accounts have grown by 25.5% (vs. growth of 22.2% for the Russian banking sector), including retail deposit growth of 21.2% (versus 14.6% for the whole market). The proportion of customer accounts within liabilities grew from 45% at the beginning of the year to 49%. The expansion of the customer accounts base is very important for the bank, since foreign borrowings account for a large part of its funding sources (amounting to about 25% of its liabilities), which leads to higher risks during periods of volatility on global capital markets. However, by Q2 the rate at which customer accounts were growing slowed down, possibly due to the bank's lower need for them in light of its IPO and the more favourable situation on foreign debt markets.

Due to the significant increase in the bank's share capital in May 2007, which had clearly not had the time to affect the growth of the bank's 1H07 net income, the bank's ROE plummeted to 10.3% vs. 20.7% in 1H06. However, the high 1H06 ROE includes one-time transactions – excluding these one-time transactions, the bank's 2006 ROE falls to 13%.

Thus, overall, we consider the bank's report as neutral. As a result of the IPO, the bank gained momentum for future rapid growth, however, the results will be seen over the mid-term. For the market, the 2H07 results will have greater significance as they will include the effect of the utilisation of the capital raised and the liquidity crises on global financial markets (which may result in growing funding costs for VTB and probable losses from the revaluation of financial assets). The head of VTB, Mr A. Kostin, has promised positive results for 3Q07 and does not expect any adverse effects from the liquidity crisis on the bank's share portfolio. The results are scheduled to be released in December.

In addition to the 1H07 report published on 27 September, VTB was also in the news as it was singled out for criticism by Prime Minister Zubkov for refusing to issue loans to Russian companies. He highlighted the case of a paper products manufacturer in the Penza region, to whom VTB declined to issue a loan at 14% over a period of several months; as a result, the manufacturer raised the required funds via a Czech bank at 4.5% p.a. Zubkov instructed the Minister of Finance, Alexey Kudrin, to look into cases where Russian banks have refused to grant loans to Russian companies, who have then been forced to resort to foreign credit institutions. This incident might have been one of the factors for the subsequent drio in the bank's share price. Kostin promised to address the problem; however, he added that VTB would only work with customers on market terms. In our view, this incident is unlikely to have any serious repercussions on VTB.

During management's recent press-conference and conference call, the following comments were made by the CEO, Mr. A. Kostin and the CFO, Mr. N. Tsekhomskiy:

1. *The bank's plans regarding its funding structure and the impact of the liquidity crunch on the bank*
   Whilst VTB has not ruled out the possibility of applying for foreign loans later this year, nonetheless, it plans to increase customer accounts as a proportion of its liabilities. The bank is ready to borrow funds only at a reasonable cost. Previously, management had stated that the bank plans to increase its borrowings to $5 bn (gross, including refinancing of existing debt) by the end of the year and expected the bank's cost of debt to increase by 1 p.p. Now, VTB's CFO, N. Tsekhomskiy, mentioned that the cost of raising capital for VTB during the liquidity crisis has not changed significantly from the previous period. Management does not expect the credit crunch to negatively affect the bank's equity portfolio value.

2. *The bank's interest rates policy*
   According to Kostin, the bank does not plan to raise interest rates on retail loans, but will try to select the most attractive corporate clients. During the conference call, Tsekhomskiy said that, taking into account the global credit crunch, VTB has already raised the rates on its corporate loans. At present, the key priority for VTB is to increase its market share in the retail loans sector. According to Tsekhomskiy, the bank hopes to increase the proportion of retail loans in its credit portfolio to 20-25% over two years, which will result in higher interest margins and profitability.

   In our opinion, the bank may even benefit from the liquidity problems prevalent in the market, (which have had a greater negative impact on smaller banks) due to its easier access to a broader funding base.

3. *Postponed merger with VTB North-West (formerly, PSB)*
   According to Mr. Kostin, VTB is planning to renew its proposal of a share swap of VTB North-West's shares with VTB's shares, on terms close to those previously agreed. (Previously, the bank had proposed exchanging 1 VTB North-West share for 361 VTB shares, with a buyout price of $41.72 for opposing minority shareholders of VTB North-West). According to Tsekhomskiy, the bank has not ruled out the possibility of buying out VTB North-West's shares from minority shareholders. In our opinion, this is positive news for VTB North-West shareholders. However, the uncertainty of the time-frame and the final terms and conditions of the proposed transaction remain the key risk factors.

4. *The bank plans a series of asset sales before the year-end*
   Previously Kostin had stated that the bank plans to sell its stake in EADS, valued at about $1 bn in July 2007. During the press conference, he said that the deal will not be affected by any political pressure and will be transacted at an attractive price for the bank. The most probable buyer is the United Aircraft Corporation. VTB also plans to sell stakes in some of its foreign subsidiaries. In September, VTB already sold 97.58% of NovosibirskVTB for $105 mn.

5. *Net income*
   During the conference call, Tsekhomskiy did not make any precise earnings forecasts for 2007, but stated that he does not expect net profit to be lower than it was in 2006. In 2006, the bank earned net income of $1,179 mn and had previously forecast net income of $1,180 bn for 2007.

6. Tsekhomskiy stated that the bank does not have any immediate plans to buy back its own shares.

7. Management plans to present the bank's 1H07 financial results via a road-show for investors in the near future.

Taking into account, Kostin's recent statement in which he assumed personal responsibility to achieve management's aim of increasing the bank's market capitalisation, as well as the importance of a successful (or at least breakeven) "people's IPO" ahead of the elections, it appears that the bank will do all in its power to attain positive results at the end of Q3 and Q4. We believe that management's previous net profit forecast of $1.18 bn in 2007 - equal to the bank's net profit in 2006 – will be met. However, this may be achieved as a result of some significant non-recurring revenue transactions (such as assets sale). Consequently, in our opinion, investors should hold their VTB shares over the next few months. Although we are not issuing a formal recommendation for VTB shares, our market multiple valuation implies a fair value of 0.14 roubles ($0.0056) per ordinary share.

Table 1 – Balance sheet summary, $ mn

	On 01.07.07	Consensus	Difference	On 01.04.07	On 01.01. 07	Changes in 1H07 – YTD, %	Changes in 1H07 (y-o-y), %	Changes in 1Q07 (q-o-q), %	Changes in 2Q07(q-o-q), %
Assets	66,223	70,294	-5.8%	56,153	52,403	26.4%	46.1%	7.2%	17.9%
Loans to customers	35,693	36,063	-1.0%	31,697	29,262	22.0%	50.6%	8.3%	12.6%
As a % of assets, %	53.9%			56.4%	55.8%				
Retail loans	4,106			3,027	2,533	62.1%		19.5%	35.6%
As a % of loan portfolio	11.5%			9.5%	8.7%				
Customer accounts	25,083			23,381	19,988	25.5%	34.9%	17.0%	7.3%
Retail deposits	8,876			7,918	7,326	21.2%		8.1%	12.1%
Shareholders' equity	15,216	15,272	-0.4%	7,143	6,992	117.6%	161.0%	2.2%	113.0%

Source: Company data, Sovlink estimates

Table 2 – Income statement summary, $ mn.

	1H07	Consensus	Difference	1H06	1H07 vs. 1H06	1Q07	1Q06	1Q07 vs. 1Q06	2Q07	2Q06	2Q07 vs. 2Q06
Interest income	2,235			1,638	36.4%	1,066	729	46.2%	1,176	913	28.8%
Interest expenses	-1,231			-844	45.9%	-580	-384	51.0%	-651	-460	41.5%
Net interest income	1,004	1,077	-6.8%	794	26.4%	486	345	40.9%	525	453	15.9%
Net interest income after provisions for loans impairment	864			609	41.9%	424	251	68.9%	447	362	23.5%
Net fee & commission income	267			161	65.8%	92	81	13.6%	175	80	118.8%
Operating income	1,477	1,549	-4.6%	1,293	14.2%	674	656	2.7%	803	637	26.1%
Operating costs	-809			-577	40.2%	-365	-264	38.3%	-444	-313	41.9%
Pre-tax income	659			683	-3.5%	313	375	-16.5%	346	308	12.3%
Net income	504	477	5.7%	576	-12.5%	232	334	-30.5%	272	242	12.4%

Source: Company data, Sovlink estimates

Table 3 – Ratio analysis, %

	1H07	1H06	1Q07	1Q06
Asset yield	8.7%*	9.3%	9.3%	
Cost of funding	-5.2%	-4.9%	-5.0%	
Net interest spread	3.5%**	4.4%	4.3%	4.0%
Net interest margin	3.9%***	4.5%	4.2%	4.1%
Net interest income after provisions / Operating income	58.5%	47.1%	62.9%	38.3%
Net fee & commission income / Operating income	14.8%	12.5%	13.6%	12.3%
ROE	10.4%	20.8%	13.1%	24.6%
ROA	1.7%	2.8%	1.7%	3.4%
Cost/Income	50.0%****	39.0%****	49.6%	35.2%

** Company data: 9.1%,** Company data 3.9%, *** Company data 4.1%, 56.4% and 46%, respectively.*

Source: Company data, Sovlink estimates

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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