

# Vozrozhdenie Bank

Company  
Note

**BUY**

**Upside: 20%**  
**Target Price: \$64.7**

**Well-balanced business strategy, low risks**

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## Stock data

Ticker	VZRZ, VZRZP	M.Cap, \$ mn	1,282
Shares Ords	23,748,694	Free Float, %	50%
Shares Prefs	1,294,505	Free Float, \$ mn	641
Bid Ords, \$	52.86	Offer Ords, \$	54.26
Bid Prefs, \$	27.03	Offer Prefs, \$	28.02

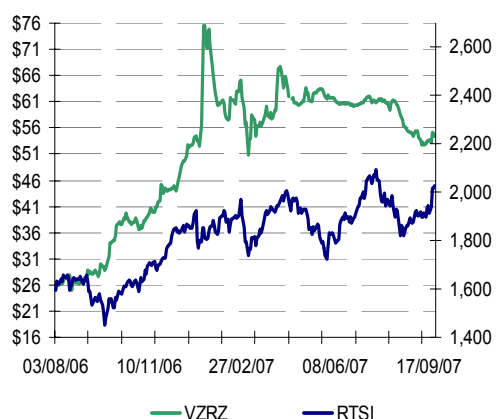
## Market performance

		1 month	6 months
Absolute	Ords	-2.3%	-6.8%
Relative to RTSI	Ords	-11.8%	-16.2%
Price range, \$			
High	Ords	56.3	67.7
Low	Ords	52.8	52.8

## Financials, 2007E

Assets, \$ mn	4429	ROE	18.6
Book Value, \$ mn	454	P/E	21.6
Net income, \$ mn	61	P/BV	2.9

## Vozrozhdenie Bank – Relative performance



Source: RTS ,MICEX

- We initiate coverage of Vozrozhdenie Bank, one of the oldest Top-30 Russian banks, by issuing a **BUY** recommendation on both its ordinary and preference shares. We believe that the bank's shares have growth potential and at the same time, also consider the bank as a defensive stock during periods of rising financial sector risks.

- The bank is customer-oriented and its strengths include a well-formulated development strategy, a high quality brand, and a high level of corporate governance and transparency.

- The bank's exposure to credit, interest and currency risks is low. It has a diversified loan portfolio, with overdue debts amounting to only 1.7% of total loans, which is considerably lower than the average for the industry, and its reserves cover debts by almost two times. Over 80% of its assets and liabilities are denominated in roubles (low currency risks). Non-interest income accounts for over 40% of its operating income (of which over one third is derived from fees and commissions), which protects the bank's cash flows over the mid-term in case of declining interest margins. The fact that the bulk of its loans have been issued to small and medium enterprises as well as the rapid growth of its retail loan portfolio, should ensure sustainable revenues and relatively high interest margins in the near future.

- The bank has a low level of dependence on foreign debts, which is of crucial importance in light of the volatility prevalent on global financial markets – 85% of its liabilities are due to customer accounts, of which 60% are retail deposit accounts. We estimate the bank's liquidity risk exposure as moderate. The bank generates high quality and sustainable operating income – over 90% consists of net interest income and fee revenues, derived from its core banking activities.

- We believe that the bank's strategy and its business model will enable it to grow successfully over the next few years, despite increasing risks in the financial sector. Key growth drivers include the high growth rates of market segments prioritised by the bank; namely, SME and retail loans, the development of regional banking services, and cross-sales amongst its corporate and retail customers. We expect the average annual growth rate (in roubles) of the bank's assets in 2007-09 will exceed 40%, compared to (an optimistic) rate of about 30% for the banking sector. We expect the bank's 2007 net profit will almost double in comparison to 2006, and its average annual growth rate to exceed 40%.

- We estimate a year-end target price of \$64.7 per ordinary share of Vozrozhdenie Bank (\$70.8 in 12 months' time), giving potential upside of 20% from the current price. Consequently, we issue a **BUY** recommendation on the bank's ordinary and preference shares.

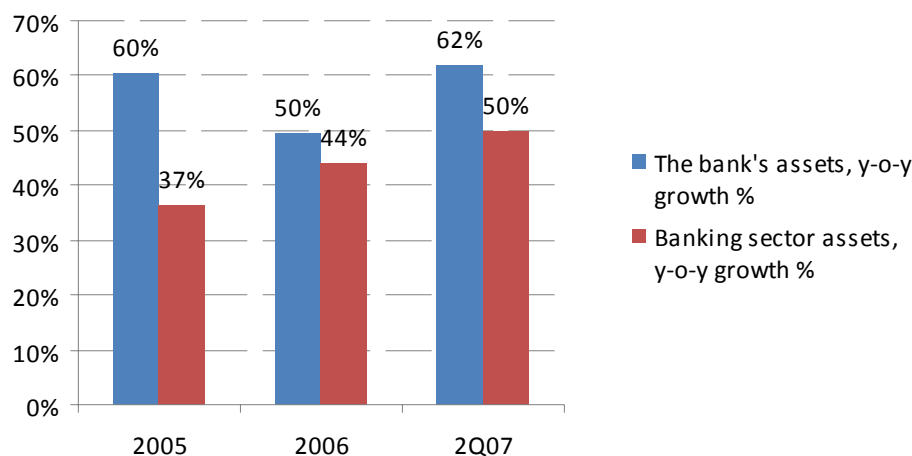
## Bank profile

Vozrozhdenie is one of the oldest Top-30 Russian banks, having survived the 1998 financial crisis. The bank has been operating for 16 years. As of 1H07, RBC rates it 24<sup>th</sup> in terms of net assets, 21<sup>st</sup> – by loan portfolio, 23<sup>rd</sup> – by equity capital, 22<sup>nd</sup> – by deposit accounts, 9<sup>th</sup> – by retail deposits, and 15<sup>th</sup> – by branch network coverage. The bank ranks 11<sup>th</sup> in terms of the number mortgages issued and 20<sup>th</sup> – in terms of their value.

Vozrozhdenie presents itself as a personal bank for corporations and individuals. Having a large clientele of over one million customers and a branch network of 162 sales offices and more than 500 ATMs, the bank considers the provision of individual services, high quality relationships with customers, and winning client loyalty as its priorities. Whilst the bank's branch network covers practically the entire European part of Russia and three cities in Siberia and the Far East, over 60% of its business is located in the Moscow region.

Over the past few years, the bank's assets have grown at a faster pace than the Russian banking sector as a whole (see Fig. 1). Management anticipates similar growth rates to continue over the next two years (2007-08).

**Fig. 1 – The bank's and the Russian banking sector's assets**



Source: Company data, Central Bank

Over the next few years, we expect the bank's assets to continue growing at a faster rate than the banking sector. Their growth is driven by the high growth rates of market segments prioritised by the bank; namely, SME and retail loans, the development of regional banking services, and cross-sales amongst its corporate and retail customers. We expect the average annual growth rates (in roubles) of the bank's assets in 2007-09 to exceed 40%, compared to (an optimistic) rate of about 30% for the banking sector.

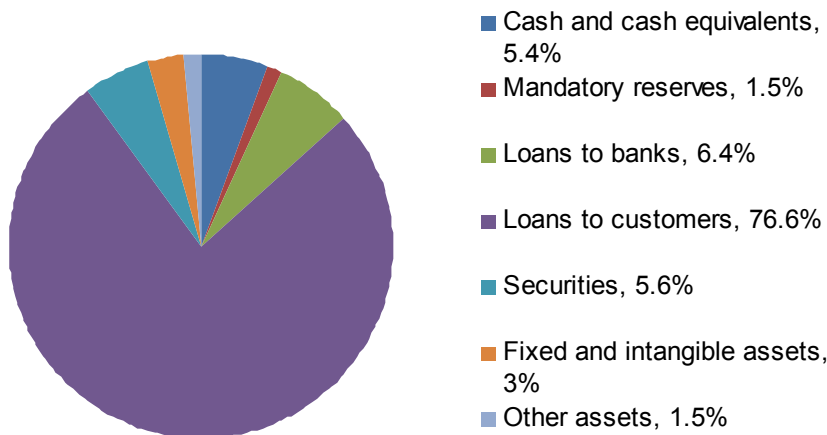
## Business strategy

The bank's business strategy focuses on 3 areas:

1. Corporate business – with priority given to small and medium enterprises
2. Banking cards – including salary-related projects
3. Retail business – deposits, mortgages, auto and consumer loans, and transfers and payments

Almost 80% of the bank’s assets consist of loans issued to customers, over 60% of which comprise loans to small and medium-size enterprises (average annual growth of 63%). The rapid growth rate of its SME and retail loan portfolios has resulted in higher loan yields and a more diversified loan portfolio.

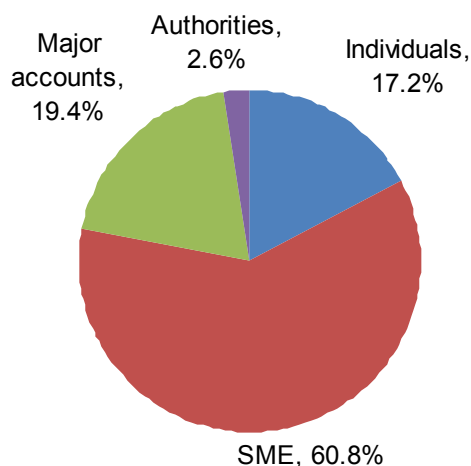
**Fig. 2 – Asset structure – 2Q07**



Source: Company data

Over the next few years, we expect the bank’s loan portfolio to continue growing at a fast pace. We expect SME loans as a proportion of its loan portfolio to gradually decline due to growing retail loans, but to stay above 50%.

**Fig. 3 – Loan structure as of July 1, 2007**

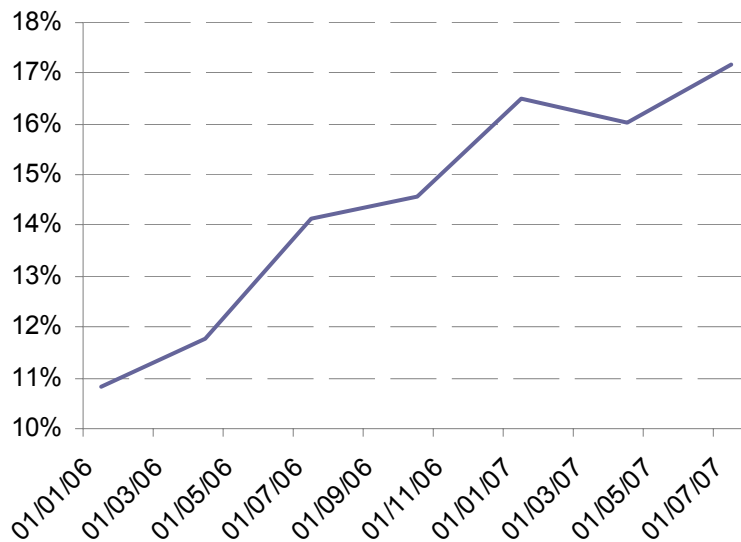


Source: Company data

As of 1H07, retail loans accounted for 17.2% of the bank’s loan portfolio with CAGR of 202% over the last three years. The bank plans to increase retail loans to 25% of its loan portfolio in 2008. Mortgages account for 49% of the bank’s retail loans – we believe that it is the most promising and protected (in terms of credit risks) segment.

**We expect the bank to implement its plan to increase retail loans to 25% of its loan portfolio by the end of 2008. Although the bank has not indicated a longer term plan beyond 2009, we expect further growth of its retail loans as a proportion of its loan portfolio to 35-37% (which corresponds to the average level for banks in Eastern Europe) – with mortgages accounting for 50% of its retail loans.**

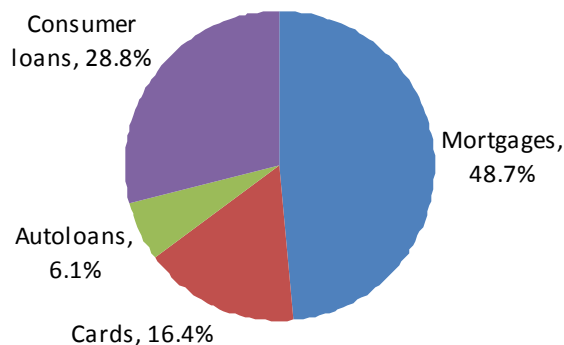
**Fig. 4 – Retail loans as a proportion of the bank’s loan portfolio**



Source: Company data

The bank adheres to a conservative credit policy. The average value of mortgages issued by the bank is \$45,000, with average maturity of 12-15 years (maximum – 30 years). For mortgages, the initial instalment ranges from 10 to 70% of the value of the property. In case another property (already owned by the borrower) is pledged against the mortgage, the mortgage may be issued without an initial instalment, with the amount of the mortgage not exceeding 90% of the estimated value of the pledged property.

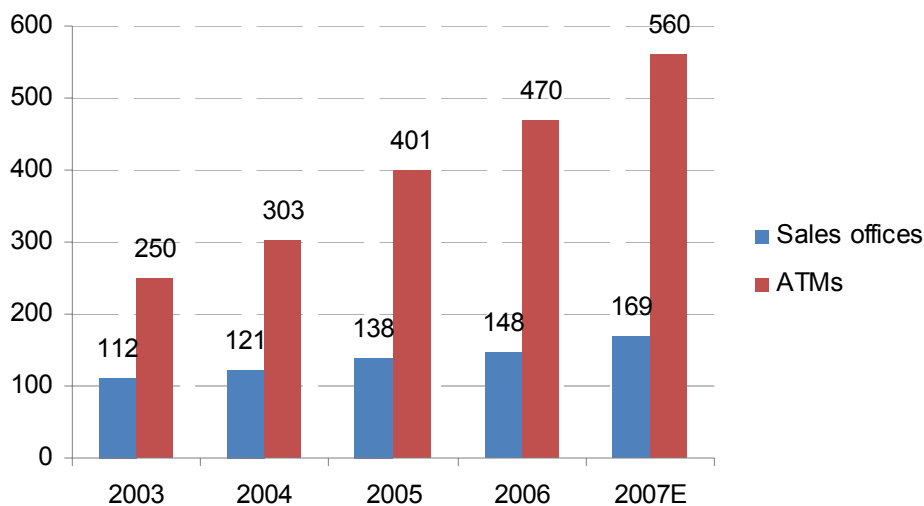
**Fig. 5 – Retail loan structure as of July 1, 2007**



Source: Company data

The bank operates in 20 of the more developed Russian regions; however, about 60% of its operations are located in the Moscow region.

**Fig. 6 – Expansion of the bank’s branch network**



Source: Company data and forecasts, Sovlink estimates

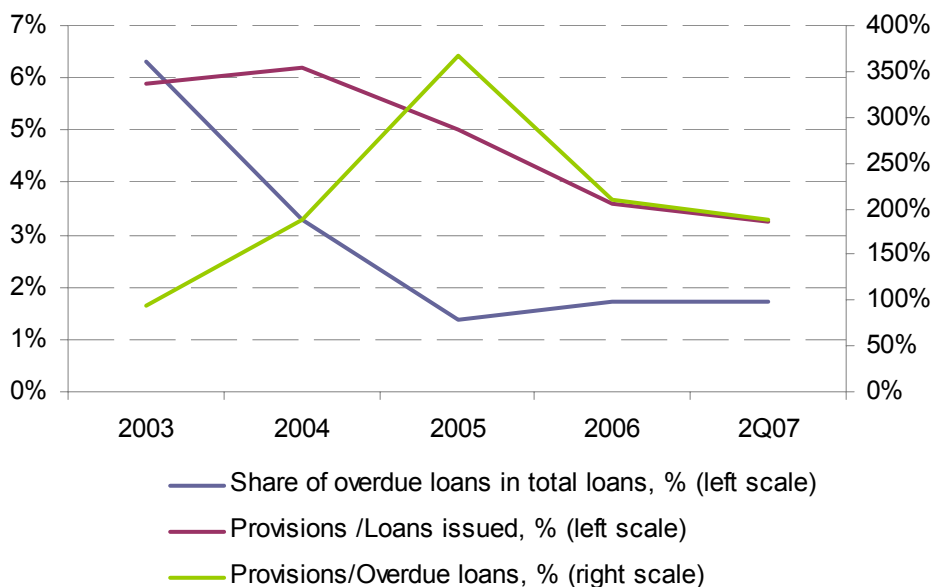
**The bank is actively developing cross-sales services amongst its customers. One example of this strategy is the implementation of salary-related projects, which allow the bank to actively attract employees of (client) companies as new retail customers.**

## Low risks

### 1. Credit risk

The bank has a high quality loan portfolio – as of July 1, 2007, problematic and non-performing loans (NPLs) amounted to only 1.7% of its loan portfolio (the same level as at the start of the year), which is significantly lower than the average industry level (2.6%). Meanwhile, the bank is gradually decreasing its NPL cover to streamline its revenues – on July 1, 2007 it was 188% versus 210% at the start of the year and 333% on July 1, 2006. However, despite lowering loan reserves from 3.6% to 3.3% of the total amount of loans issued, its loan reserves still cover NPLs by almost two times.

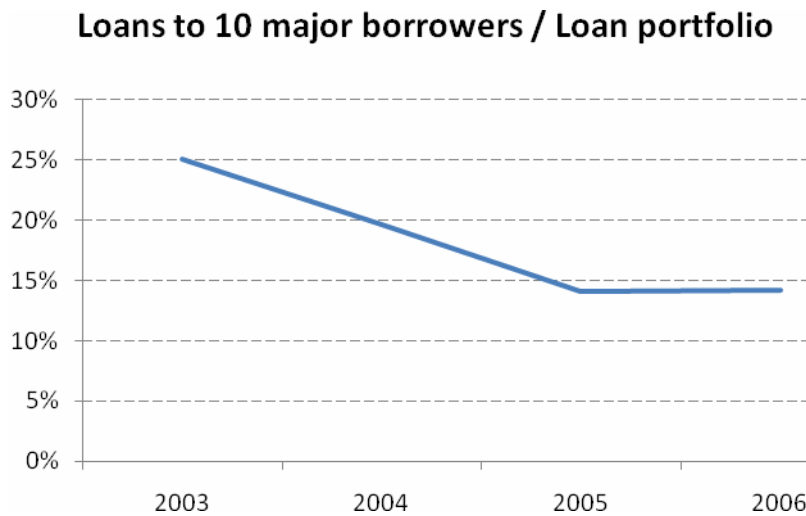
**Fig. 7 –Credit risk**



Source: Company data, Sovlink estimates

The bank has diversified its credit risk by reducing the aggregate proportion of its 10 principal borrowers in its loan portfolio.

**Fig. 8 – Loan portfolio diversification**



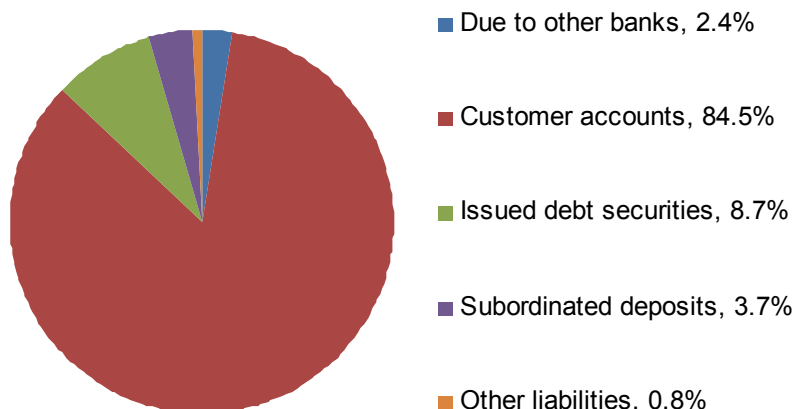
Source: Company data, Sovlink estimates

**We expect the quality of the bank’s loan portfolio to remain high. At the same time, in our opinion, the proportion of problematic loans will grow at a moderate rate, typical for the Russian banking sector. We expect the bank’s NPLs to increase from 1.7 to 2.7% by the end of 2012. However, the bank will maintain adequate bad debt reserves amounting to 3.5 to 3.7% of total loans.**

**2. Dependence on foreign financing**

On the whole, the bank’s funding structure is secure and resistant to the worsening situation in global capital markets as 85% of its liabilities are based on customer accounts, of which 60-62% are retail deposit accounts.

**Fig. 9 – Structure of the bank’s liabilities – 2Q07**



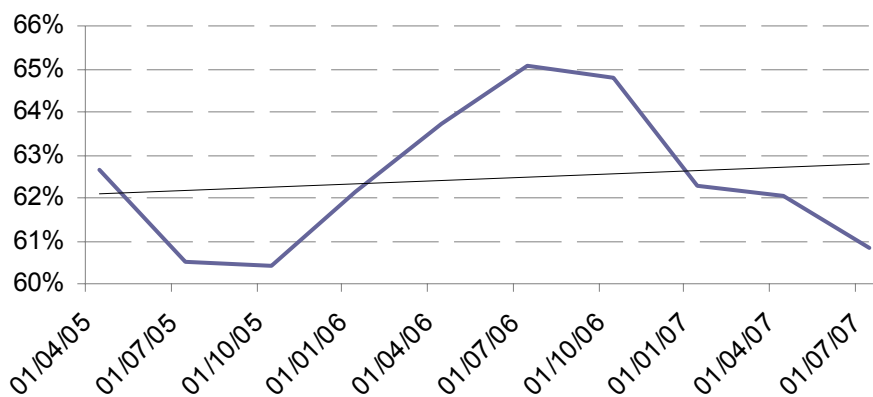
Source: Company data, Sovlink estimates

**Fig. 10 – Customer account structure as of July 1, 2007**



Source: – Company data

**Fig. 11 – Retail deposits as a proportion of total deposits**



Source: Company data

A significant portion (43%) of the bank’s sources of capital is based on current accounts and demand deposits, resulting in potential liquidity gap risks. However, according to the bank’s management, the withdrawal of funds from these accounts is minimal (maximum 10% p.a.). Nonetheless, the bank is trying to diversify its funding structure, and plans to increase its borrowings from capital markets up to 10% of its total borrowings.

In March, the bank issued its first rouble bond with a maturity of three years for an amount of RUR 3 bn (\$115 mn) at nominal value with a coupon rate of 8.95%. At the time of issue, it had one of the lowest coupon rates in Russia amongst issues of similar structure and maturity by comparable banks. Furthermore, in order to enhance the financing of foreign trade transactions of its customers, the bank raised a \$50 mn revolving syndicated loan facility with a maturity of one year from an international bank consortium headed by the Bank Austria Kreditanstalt and Landesbank Berlin.



The bank neither issued, nor plans to issue Eurobonds in the near future. At the same time, in early September, the Bank of Russia registered the issue of the second tranche of rouble bonds by Vozrozhdenie Bank for an amount of RUR 5 bn with a maturity of three years. Gazprombank and Citibank have been appointed as arrangers of the issue. As was previously reported, the bank intends to issue a second bond through public subscription before the end of the year. However, the bank has the right to issue the bond during the next 12 months, and in case domestic liquidity levels remain unfavourable, it may postpone the issue until the situation improves.

In addition, the bank is planning to raise a syndicated loan for \$100 mn before the end of the year, with a maturity of two years at a rate of 1.2% above LIBOR. Bank Austria Kreditanstalt and Landesbank Berlin have been mandated to arrange the loan. They acted as book-runners for the bank's previous loan for \$50 mn raised in March.

We expect that in the mid-term, the bank will maintain its share of borrowings on the capital markets (excluding subordinated loans) at about 10% of its total borrowings. We expect customer accounts as a proportion of the bank's liabilities will not fall below 80% and will tend towards 85-90%, of which at least 60% will be retail deposits.

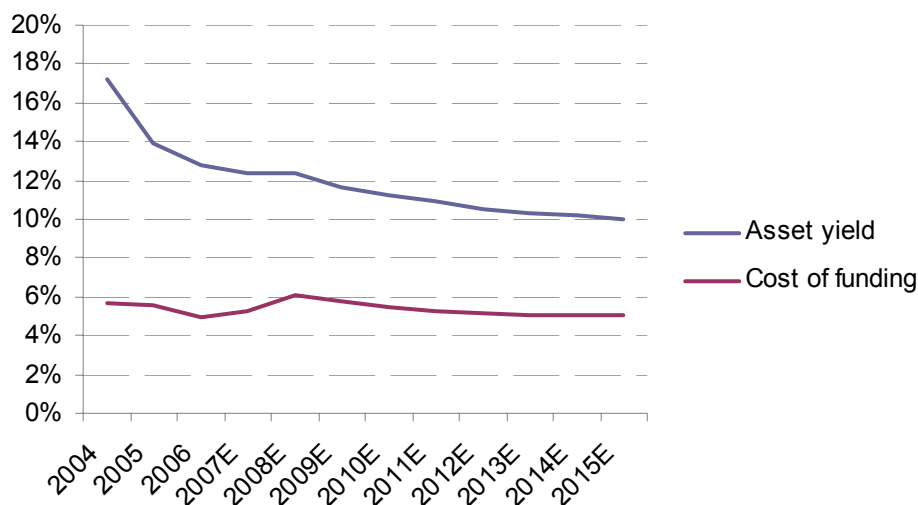
### **3. Risk of lower interest margin**

As already mentioned, retail deposits (17.2%) and SME loans (60.8%) dominate the bank's loan structure. These loans generate the biggest revenues for the bank and enabled the bank to attain a high asset yield of 13% in 2006, and 12% in 1H07. At the end of 2006, the bank enjoyed the highest net interest spread (7.8%) and net interest margin (7.1%) amongst large Russian banks. In 1H07, these indicators dropped to 6.9 and 6.8% respectively, but remain very attractive.

In the next few years, we expect a reduction in the bank's interest margin, with the rate of change depending on the level of competition on the retail and corporate loans markets, as well as increasing funding costs. In our model, we took into account the possible increase of funding costs due to the crisis on global financial markets, which is expected to result in lower risk tolerance of investors and higher risk premiums. Whilst the bank is funded principally by customer accounts (implying that higher interest rates for debt instruments will not cause a significant growth in expenses), in case of an overall deficit of long-term funding and Russian banks targeting lower levels of foreign debts, there is a possibility of stronger competition emerging for customers. In turn, this would mean higher costs for servicing deposit accounts. We estimate the value of the bank's cost of funding will rise by 0.4 p.p. on average in 2007 and 0.8 p.p. in 2008. However, we anticipate a gradual reduction in funding costs in future based on the (probable) easing of monetary policy by leading global central banks and the gradual stabilisation of financial markets.

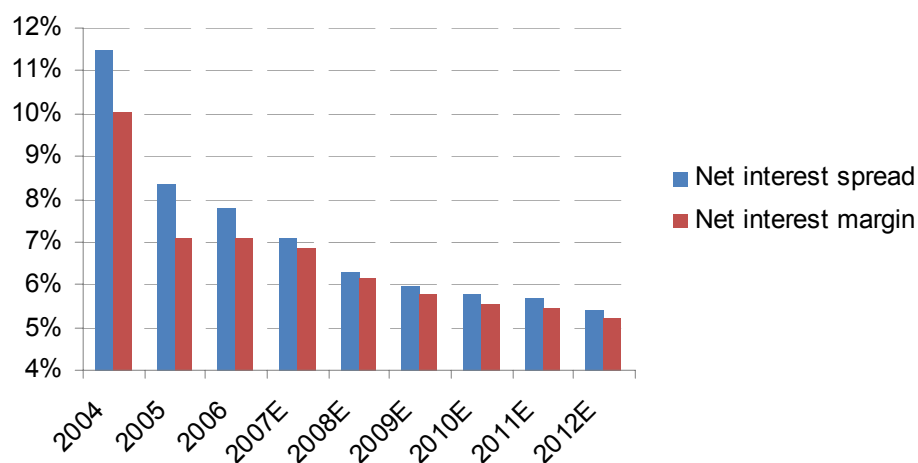
The bank's strong positions in the most profitable credit segments (retail loans and SME) are expected to mitigate the adverse effect of growing funding costs on its interest margins. At the same time, higher competition in this sector restricts the bank's opportunities to increase its interest rate charges on loans in response to the rising cost of capital. On the contrary, despite the recent mortgage crisis in the US, resulting in lower liquidity on both foreign and domestic markets, the bank relaxed its terms for issuing mortgages in mid-August, and cut rates on its rouble auto loans by 2 p.p. in mid-September. With respect to interest margin, in our opinion, severe pressure could be exerted on mortgages over the next 1-2 years. Nevertheless, in case of an overall increase in borrowing costs, the bank will probably be able to partially eliminate the effect by moderately increasing the cost of loans issued to corporate customers. We expect the bank's net interest margin to fall by approximately 1 p.p. in 2007-08 in comparison to 2006.

**Fig. 12 – Asset yield and funding costs**



Source: Company data, Sovlink estimates

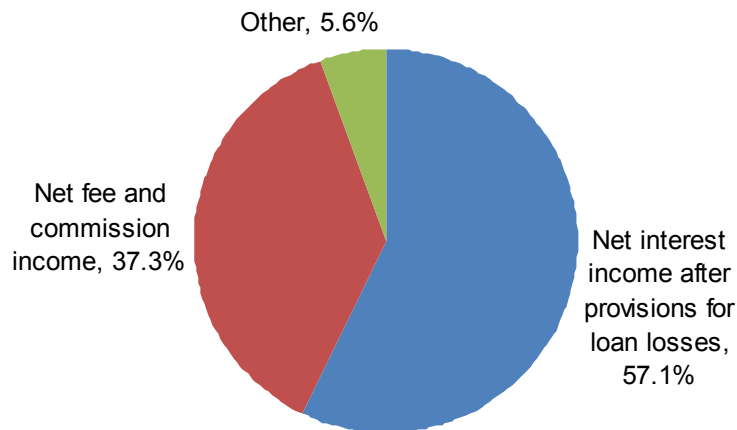
**Fig. 13 – Net interest margin and net interest spread**



Source: Company data, Sovlink estimates

We note that a high proportion of the bank's operating income (about 40%) consists of non-interest income which protects the bank's revenues from the risk of lower interest spreads in future. Its non-interest income consists mainly of fee and commission revenue (amounting to one third of its operating income). In turn, fee revenue consists of settlement fees and fees for cash services and credit/debit card operations.

**Fig. 14 – Operating income structure as of July 1, 2007**



Source: Company data

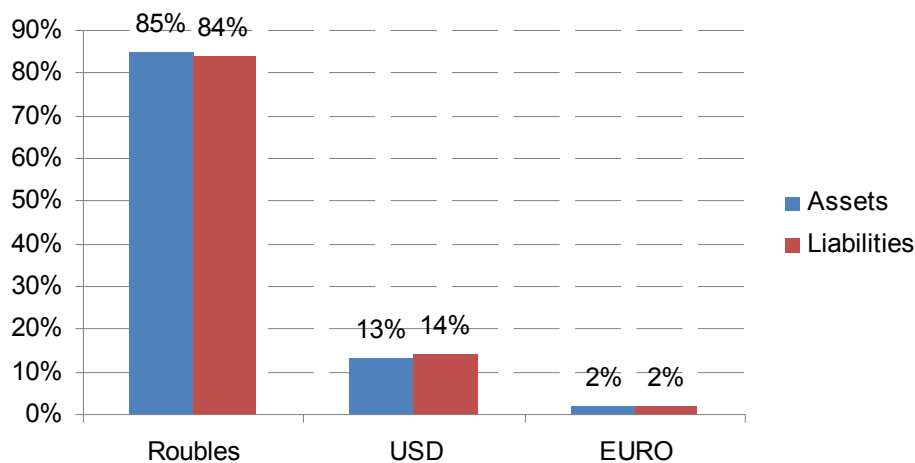
Taking into account the planned expansion of its branch network (the bank is planning to establish 10-15 new branches annually), its active involvement in the growing number of salary card transactions and the higher amount of non-cash payments for services by retail customers, we believe that the bank will be able to maintain the high growth rates of its fee revenues in future.

We expect the structure of the bank’s operating income to protect its growth rates from the risks of rising funding costs. In our opinion, the average annual growth of operating income between 2007-09 will be 36.5%.

#### 4. Currency fluctuation risks

The currency structure of the bank’s assets and liabilities is perfectly matched (see Fig. 15). About 85% of the bank’s assets are held in rouble instruments and are funded by rouble funds.

**Fig. 15 – Currency structure of assets and liabilities as of 31.03.2007**



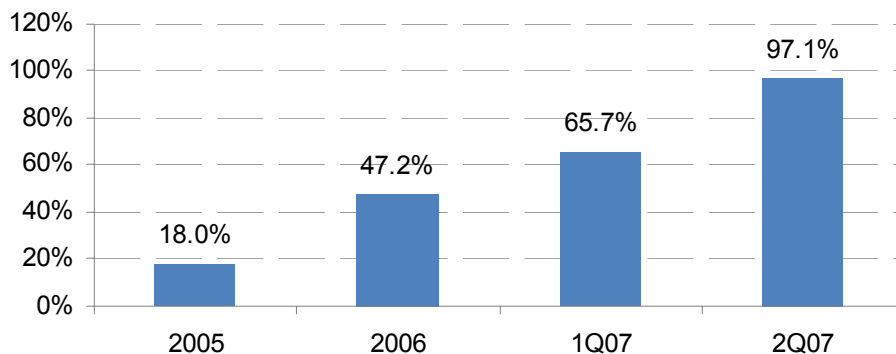
Source: Company data

The bank's strategy provides considerable security against the principal risks (the quality of its loan portfolio, the reduction of interest margin, currency fluctuations, and the reliability of funding sources). However, there remain certain liquidity risks related to an overall deficit of long-term debt instruments in Russia and the peculiarities of Russian laws, which allow for the early withdrawal of retail term deposits.

## Financial results

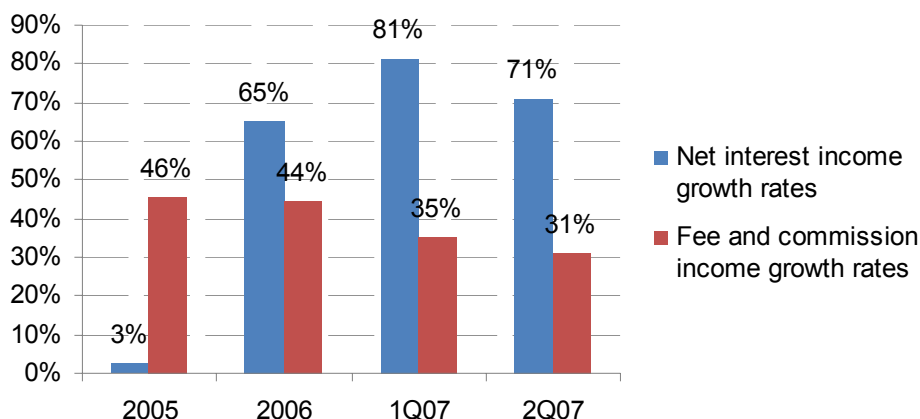
We view the bank's 1H07 financial results published in early August positively. They demonstrate sustainable growth of the bank's business, its low credit risks, a moderate increase in profitability and improved performance indicators.

**Fig. 16 – Net profit trend, y-o-y**



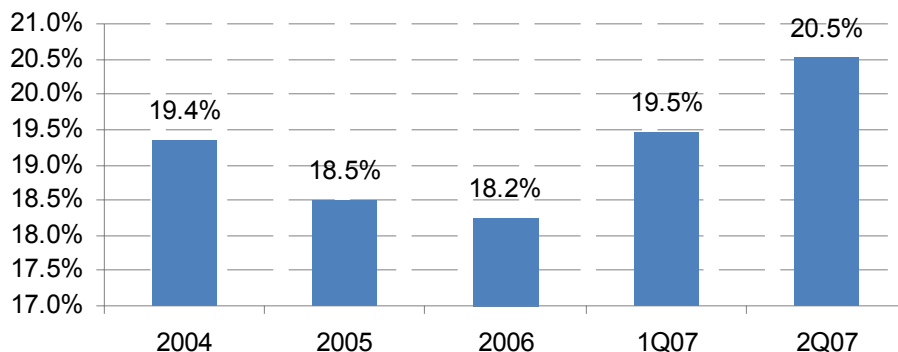
Source: Company data

**Fig. 17 – Net interest income and net fee and commission revenue**



Source: Company data

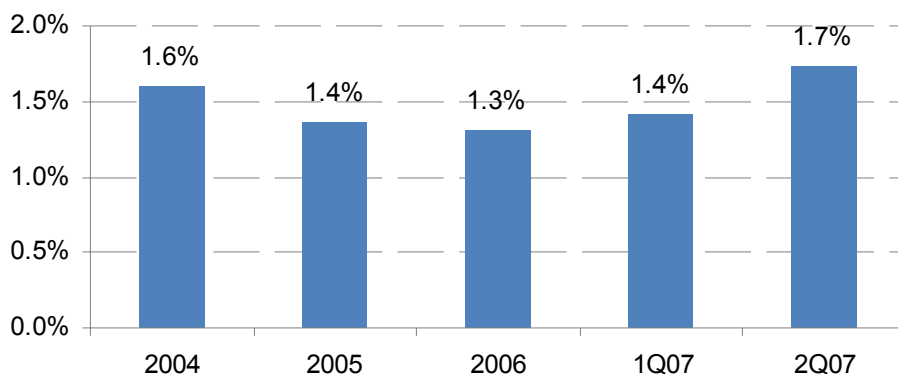
**Fig. 18 – Return on equity**



Source: Company data, Sovlink estimates

The bank's mid-term target ROE is 20-25%.

**Fig. 19 – Return on assets**

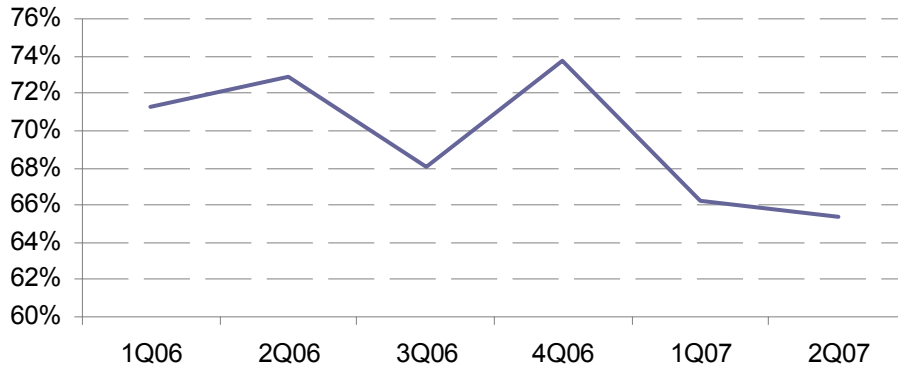


Source: Company data, Sovlink estimates

The bank's rising returns on assets are due to its rapidly growing net interest income triggered by an increase in the number of performing assets, as well as the steady growth in net fee revenues. **Income from its principal activities (net interest income + net fee and commission revenue) accounts for 90% of the bank's operating income, which demonstrates the high quality and sustainability of the bank's revenues.**

The significant improvement in the bank's cost/income indicator is amongst the key items on the bank's 1H07 balance sheet. The bank managed to trim down its extremely high cost/income ratio of 72.9% for 1H06 (72.3% for the whole of 2006) to 65.3%. A high level of non-interest expenses is one of its main weaknesses and which also limits its profitability. It is mainly due to the massive regional expansion of the bank, increasing staff numbers and investment in modern technology. The bank's mid-term goal is to reduce its cost/income ratio to 60-62%, which corresponds to our expectations.

**Fig. 20 – Cost/Income**

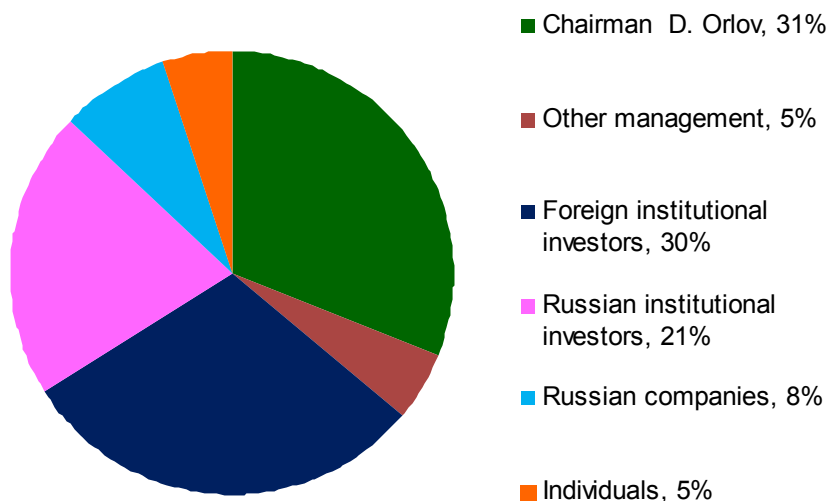


Source: Company data, Sovlink estimates

## Shareholders equity and corporate governance

In 2Q07, Vozrozhdenie Bank raised \$177 mn by completing its 20th offering of ordinary shares to investors. Management holds a 36% stake in the bank, and Russian and foreign institutional investors – 51%. The bank’s free float of about 50% is traded freely on Russian stock exchanges, while 2.3% of the bank’s shares are traded on German stock exchanges via GDRs.

**Fig. 21 – Shareholder equity structure**



Source: Company data

According to the bank’s management, no new SPOs are scheduled before 2009.

In our opinion, the bank’s corporate governance and transparency level is amongst the highest for Russian public banks. In 2006, S&P rated Vozrozhdenie Bank as the most transparent Russian bank in relations with its

shareholders. The board of directors includes 12 members, 5 of whom are independent. The bank also has an audit committee. The corporate governance code was developed with the assistance of the IFC. The bank publishes financial reports under IFRS on a quarterly basis and holds conference calls for investors. The bank's IR department maintains communicates openly with analysts and willingly provides informational support.

**SWOT - analysis**

<b>Strengths</b>	<b>Weaknesses</b>
Distinct development strategy, high-quality brand, and loyalty to customers.	Traditionally, high operating costs (cost/income ratio). This is due to massive investments in the expansion of retail branches, implementation of cutting-edge technologies, and increase in staff numbers. The high costs affect the bank's profitability. However, 1H07 results reveal remarkable progress in cost reduction.
Asset growth rates are significantly higher than average industry indicators and returns are moderate – over the past few years, its ROE has varied between 18-19%.	
Low dependence on foreign borrowings – about 85% of its liabilities are based on customer accounts, of which over 60% are retail deposits.	
Low credit risks – the proportion of overdue loans is lower than the industry average and bad debt reserve cover is almost two times – and almost no currency risks as over 80% of the bank's assets and liabilities are denominated in roubles.	
40% of its operating income is non-interest revenue (with fee revenues accounting for more than one third of operating income) which hedges the bank's cash flows over the mid-term in case of declining interest margins.	
The bank's high proportion of SME loans, as well as the fast growth rate of its retail loan portfolio should ensure sustainable profits and a relatively high interest margin over the next few years.	
Extensive branch network, strong position in the mortgage sector.	
High level of corporate governance	
<b>Opportunities</b>	<b>Threats</b>
High growth potential of the bank's priority businesses (retail loans and SME) due to strong macroeconomic indicators and growing retail and corporate demand for banking services.	Higher cost of borrowing due to crisis on global financial markets and lower risk tolerance of investors and lenders.
The bank is planning to tangibly improve its profitability and performance indicators in the mid-term (to raise ROE to 20-25%, and reduce its cost/income ratio to 60-62%). Recent figures demonstrate remarkable progress in moving towards these goals.	44% of the bank's funding sources are based on its current and demand deposit accounts. This could lead to liquidity gap risks. However, according to the bank's management, the outflow of funds from such accounts is minimal (at most 10% p.a.).
Significant growth potential of regional banking business.	Shares of financial institutions may be under pressure for some time due to unfavourable trends on global financial markets.
Raising additional capital will enable the bank to sustain high growth rates over the next few years. We also positively view the bank's increased borrowings on debt capital markets (up to 10% of its liabilities), which will improve its financing structure and narrow the liquidity gap in its long-term funding.	
Given the volatility of financial markets, the low level of the bank's debt financing and its high-quality loan portfolio, leads us to view its shares as a good defensive security.	

## Financial indicators

**Table 1 – Income statement, RUR mn**

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Interest income on loans	3,481	4,074	6,082	9,595	14,138	18,194	22,763	28,040	33,272
Interest income on securities	47	81	196	251	339	452	522	551	630
Interest expenses	-1,474	-2,044	-2,794	-4,376	-7,270	-9,455	-11,764	-14,326	-17,115
<b>Net interest income</b>	<b>2,054</b>	<b>2,111</b>	<b>3,484</b>	<b>5,471</b>	<b>7,207</b>	<b>9,190</b>	<b>11,521</b>	<b>14,264</b>	<b>16,788</b>
Provisions for loan losses	-467	-247	-393	-935	-1,213	-1,604	-1,769	-2,144	-2,452
<b>Net interest income after provision for loan impairment</b>	<b>1,587</b>	<b>1,864</b>	<b>3,091</b>	<b>4,535</b>	<b>5,993</b>	<b>7,587</b>	<b>9,752</b>	<b>12,120</b>	<b>14,337</b>
Net fee and commission income	983	1,432	2,068	2,907	4,040	5,231	6,352	7,626	8,950
<b>Operating income</b>	<b>2,748</b>	<b>3,744</b>	<b>5,359</b>	<b>7,918</b>	<b>10,674</b>	<b>13,636</b>	<b>17,132</b>	<b>21,006</b>	<b>24,773</b>
Operating costs including wages and salaries	-2,258	-3,037	-4,243	-5,843	-7,608	-9,449	-11,719	-14,122	-16,607
<b>Profit before tax</b>	<b>507</b>	<b>707</b>	<b>1,084</b>	<b>2,075</b>	<b>3,066</b>	<b>4,187</b>	<b>5,413</b>	<b>6,885</b>	<b>8,166</b>
Profit tax	-46	-163	-283	-498	-736	-1,005	-1,299	-1,652	-1,960
<b>Net profit</b>	<b>461</b>	<b>544</b>	<b>801</b>	<b>1,577</b>	<b>2,330</b>	<b>3,182</b>	<b>4,114</b>	<b>5,232</b>	<b>6,206</b>
<b>Dividend payments</b>	<b>-11.5</b>	<b>-11.4</b>	<b>-13.0</b>	<b>-14.5</b>	<b>-14.5</b>	<b>-14.5</b>	<b>-14.5</b>	<b>-14.5</b>	<b>-14.5</b>
<b>Retained earnings</b>	<b>450</b>	<b>533</b>	<b>788</b>	<b>1,562</b>	<b>2,316</b>	<b>3,168</b>	<b>4,100</b>	<b>5,218</b>	<b>6,192</b>

Source: Company data, Sovlink estimates

**Table 2 – Balance sheet, RUR mn**

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Cash and cash equivalents	3,964	8,478	6,105	6,696	8,532	11,348	14,526	16,374	13,754
Mandatory reserves	579	923	1,099	2,790	4,654	6,190	6,603	8,187	9,825
Securities	523	2,342	4,236	5,804	7,757	10,316	10,564	11,462	13,754
Loans to other banks	946	3,078	5,732	6,920	8,532	10,316	10,564	13,099	15,719
Loans and advances to customers	22,055	30,774	52,426	84,663	120,221	162,130	212,391	265,214	323,225
Fixed assets	1,691	1,972	2,597	3,348	3,878	4,127	5,282	6,550	7,860
Other assets	869	1,542	1,231	1,387	1,560	1,901	4,172	6,599	8,845
<b>Total assets</b>	<b>30,627</b>	<b>49,109</b>	<b>73,426</b>	<b>111,608</b>	<b>155,134</b>	<b>206,329</b>	<b>264,101</b>	<b>327,485</b>	<b>392,982</b>
Bank credits and deposits	323	113	418	1,678	1,705	1,910	2,456	3,049	3,652
Retail deposits	15,018	24,924	37,785	50,921	70,778	97,411	125,260	155,495	186,237
Corporate deposits	9,396	15,188	22,889	31,210	47,185	64,941	83,506	103,663	124,158
Own debt securities	2,187	4,131	4,087	12,087	16,771	19,100	23,333	28,965	34,691
Other borrowings									
Subordinated loans	698	1,223	2,467	3,004	4,264	5,730	9,824	12,196	14,607
Other liabilities	274	257	271	1,260	1,421	1,910	1,228	1,524	1,826
<b>Total liabilities</b>	<b>28,023</b>	<b>45,836</b>	<b>67,917</b>	<b>100,159</b>	<b>142,124</b>	<b>191,003</b>	<b>245,607</b>	<b>304,892</b>	<b>365,171</b>
<b>Total shareholders' equity</b>	<b>2,604</b>	<b>3,273</b>	<b>5,509</b>	<b>11,448</b>	<b>13,010</b>	<b>15,326</b>	<b>18,494</b>	<b>22,594</b>	<b>27,812</b>

Source: Company data, Sovlink estimates



Table 3 - Income statement, \$ mn

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Interest income on loans	121	144	224	372	563	722	877	1,040	1,210
Interest income on securities	2	3	7	10	14	18	20	20	23
Interest expenses	-51	-72	-103	-170	-290	-375	-453	-532	-622
<b>Net interest income</b>	<b>71</b>	<b>75</b>	<b>128</b>	<b>212</b>	<b>287</b>	<b>365</b>	<b>444</b>	<b>529</b>	<b>610</b>
Provisions for loan losses	-16	-9	-14	-36	-48	-64	-68	-80	-89
<b>Net interest income after provision for loan impairment</b>	<b>55</b>	<b>66</b>	<b>114</b>	<b>176</b>	<b>239</b>	<b>301</b>	<b>376</b>	<b>450</b>	<b>521</b>
Net fee revenue	34	51	76	113	161	208	245	283	325
<b>Operating income</b>	<b>95</b>	<b>132</b>	<b>197</b>	<b>307</b>	<b>425</b>	<b>541</b>	<b>660</b>	<b>779</b>	<b>901</b>
Operating costs including wages and salaries	-78	-107	-156	-227	-303	-375	-452	-524	-604
<b>Profit before tax</b>	<b>18</b>	<b>25</b>	<b>40</b>	<b>81</b>	<b>122</b>	<b>166</b>	<b>209</b>	<b>255</b>	<b>297</b>
Profit tax	-2	-6	-10	-19	-29	-40	-50	-61	-71
<b>Net profit</b>	<b>16</b>	<b>19</b>	<b>29</b>	<b>61</b>	<b>93</b>	<b>126</b>	<b>159</b>	<b>194</b>	<b>226</b>
<b>Dividend payments</b>	<b>-0,4</b>	<b>-0,4</b>	<b>-0,5</b>	<b>-0,6</b>	<b>-0,6</b>	<b>-0,6</b>	<b>-0,6</b>	<b>-0,5</b>	<b>-0,5</b>
<b>Retained earnings</b>	<b>16</b>	<b>19</b>	<b>29</b>	<b>61</b>	<b>92</b>	<b>126</b>	<b>158</b>	<b>194</b>	<b>225</b>

Source: Company data, Sovlink estimates

Table 4 – Balance sheet, \$ mn

	2004	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
Cash and cash equivalents	143	294	232	266	341	447	548	598	498
Legal reserves	21	32	42	111	186	244	249	299	356
Securities	19	81	161	230	310	406	399	418	498
Loans issued to other banks	34	107	218	275	341	406	399	478	570
Loans and advances to customers	795	1,069	1,991	3,360	4,809	6,383	8,015	9,679	11,711
Fixed assets	61	68	99	133	155	162	199	239	285
Other assets	31	54	47	55	62	75	157	241	320
<b>Total assets</b>	<b>1,104</b>	<b>1,706</b>	<b>2,789</b>	<b>4,429</b>	<b>6,205</b>	<b>8,123</b>	<b>9,966</b>	<b>11,952</b>	<b>14,238</b>
Bank loans and deposits	12	4	16	67	68	75	93	111	132
Retail deposits	541	866	1,435	2,021	2,831	3,835	4,727	5,675	6,748
Corporate deposits	339	528	869	1,238	1,887	2,557	3,151	3,783	4,498
Own debt instruments	79	143	155	480	671	752	880	1,057	1,257
Other borrowings									
Subordinated loans	25	42	94	119	171	226	371	445	529
Other liabilities	10	9	10	50	57	75	46	56	66
<b>Total liabilities</b>	<b>1,010</b>	<b>1,592</b>	<b>2,579</b>	<b>3,975</b>	<b>5,685</b>	<b>7,520</b>	<b>9,268</b>	<b>11,127</b>	<b>13,231</b>
<b>Total shareholders' equity</b>	<b>94</b>	<b>114</b>	<b>209</b>	<b>454</b>	<b>520</b>	<b>603</b>	<b>698</b>	<b>825</b>	<b>1,008</b>

Source: Company data, Sovlink estimates

**Table 5 – Financial ratios**

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E
EPS	1.02	1.42	2.55	3.88	5.29	6.65	8.15	9.48
BVS	6.06	10.08	19.13	21.91	25.41	29.39	34.72	42.43
P/E	67.9	44.3	21.3	14.1	10.3	8.2	6.7	5.8
P/BV	11.5	6.2	2.9	2.5	2.2	1.9	1.6	1.3
ROE	18.5%	18.2%	18.6%	19.1%	22.5%	24.3%	25.5%	24.6%
ROA	1.4%	1.3%	1.7%	1.7%	1.8%	1.7%	1.8%	1.7%
Operating costs/assets	76.1%	73.8%	66.0%	64.0%	62.0%	62.0%	61.0%	61.0%
Fees & commission/ operating income	38.2%	38.6%	36.7%	37.8%	38.4%	37.1%	36.3%	36.1%
Net interest income (after loan impairment provisions)/ operating income	49.8%	57.7%	57.3%	56.2%	55.6%	56.9%	57.7%	57.9%
Net interest income/ operating income	56.4%	65.0%	69.1%	67.5%	67.4%	67.2%	67.9%	67.8%
Equity/assets	6.7%	7.5%	10.3%	8.4%	7.4%	7.0%	6.9%	7.1%
Equity + subordinated loans/ assets	9.2%	10.9%	12.9%	11.1%	10.2%	10.7%	10.6%	10.8%
Provisions/loans	5.0%	3.6%	3.3%	3.3%	3.4%	3.4%	3.5%	3.6%
Asset yield	13.9%	12.7%	12.3%	12.4%	11.7%	11.2%	10.9%	10.6%
Cost of liabilities	-5.6%	-4.9%	-5.3%	-6.1%	-5.7%	-5.4%	-5.2%	-5.1%
Interest rate on loans	14.9%	14.2%	13.5%	13.4%	12.6%	11.9%	11.5%	11.1%
Interest rate on deposits	-5.3%	-4.7%	-4.8%	-5.5%	-5.2%	-5.0%	-4.7%	-4.6%
Net interest spread	8.3%	7.8%	7.1%	6.3%	5.9%	5.8%	5.7%	5.4%
Net interest margin	7.1%	7.1%	6.8%	6.2%	5.8%	5.5%	5.5%	5.2%
Cost/income	76.1%	73.8%	66.0%	64.0%	62.0%	62.0%	61.0%	61.0%

Source: Company data, Sovlink estimates



## Valuation of ordinary shares

We have calculated the bank's fair value based on the excess income model (EBO). We assume a ROE rate of 23%, which falls in the middle of the mid-term target range of the bank (20-25%) and is slightly lower than our ROE forecast for the bank. We use a terminal growth rate of 6% (which matches our general forecast for the banking sector). We apply an equity discount rate of 12.54%.

Risk-free rate in Russia	5.95%	Russian-30 YTM
Risk premium for investments on the US stock markets	4.36%	Historical for the period from 1929 to 2005
Sovereign risk premium for Russian equity	1.65%	Based on the sovereign credit rating of Russia and adjustments for excessive risk of investments in shares as opposed to Eurobonds
Russian equity risk premium	6.0%	
Beta	0.93	
Risk premium for investment in the company	5.59%	
Liquidity premium	1.00%	
Cost of equity	12.54%	

Source: Cbonds, Damodaran, Sovlink estimates

	2006	2007E	2008E	2009E	2010E	2011E	2012E
Stockholders' equity, \$ mn	209	454	520	603	698	825	1 008
Net profit	29	29	93	126	159	194	226
Equity value			12.54%	12.54%	12.54%	12.54%	12.54%
Excess income			<b>36</b>	<b>61</b>	<b>83</b>	<b>107</b>	<b>122</b>
Periods			1	2	3	4	5
Present value of excess income			32	48	58	66	68

Terminal ROE	23.0%
Terminal growth rate	6.0%
Present value of excess income in forecast period, \$ mn	272
Value of excess income in terminal period, \$ mn	1,612
Present value of excess income in terminal period, \$ mn	893
Fair value of equity at the end of 2007, \$ mn	<b>1,620</b>
Number of ordinary shares, mn	23.74
Number of preferred shares, mn	1.29
Total number of shares, mn	25.04
Fair value of 1 ordinary share at the end of 2007	64.7
Fair value of 1 ordinary share in 12 months	70.8

Total, fair value of 1 ordinary share at the end of 2007, \$:	64.7
Market price of 1 ordinary share (on 02.10.2007)	54.1
Upside, %	20%
Recommendation	<b>BUY</b>

We estimate a year-end target price of \$64.7 per ordinary share of Vozrozhdenie Bank (\$70.8 in 12 months' time), giving potential upside of 20% from the current price. Consequently, we issue a **BUY** recommendation on the bank's ordinary shares.

### Valuation of preferred shares

The bank's preferred shares trade at a discount of 45-50% to ordinary shares, due to their significantly lower liquidity. Whilst the discount is significantly higher than the market average (about 25%), we do not expect it to substantially drop in the near future, and therefore our fair value of the bank's preferred shares is based on a discount of 45%.

Fair value of 1 preferred share at the end of 2007, \$	<b>35.6</b>
Market price of 1 preferred share on 02.10.2007, \$	27.7
Upside, %	<b>28%</b>
Recommendation	<b>BUY</b>

We estimate a year-end fair value of \$35.6 per preferred share, giving potential upside of 33%. Consequently, we also issue a **BUY** recommendation on the preferred shares of Vozrozhdenie Bank.

## 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	90,456	31%	23%	29.69	21.24	15.90	7.72	3.59	2.94
Bank of Moscow	mmbm	Russia	5,980	20%	19%	28.90	20.03	14.27	4.93	3.35	2.82
<b>Vozrozhdenie</b>	VZRZ	Russia	1,320	19%	20%	44.79	21.57	14.22	6.31	2.91	2.54
Rosbank	ROSB	Russia	4,558	12%	15%	32.56	23.33	18.23	4.28	2.95	2.55
VTB	VTBR	Russia	32,948	19%	12%	27.95	27.48	17.51	4.71	2.09	1.89
<b>Average</b>				<b>20%</b>	<b>18%</b>	<b>32.78</b>	<b>22.73</b>	<b>16.03</b>	<b>5.59</b>	<b>2.98</b>	<b>2.55</b>
<b>Discount (-) / premium (+)</b>						<b>37%</b>	<b>-5%</b>	<b>-11%</b>	<b>13%</b>	<b>-2%</b>	<b>0%</b>
<b>EM-peers</b>											
Bank Pekao	PEO PW	Poland	16,030	21%	21%	27.8	21.0	18.5	5.2	4.6	4.2
Komercni Bank	KOMB CP	Czech Republic	8,318	18%	20%	20.6	16.5	14.7	3.4	3.1	2.8
BPH	BPH PW	Poland	10,136	19%	22%	24.8	17.4	17.7	4.2	3.8	3.6
OTP	OTP HB	Hungary	14,529	28%	24%	16.3	13.5	11.9	3.5	2.7	2.3
BRE	BRE PW	Poland	6,041	18%	22%	44.5	25.2	22.2	6.7	5.1	4.1
Bradesco	BZ	Brazil	54,452	23%	28%	23.4	14.4	12.1	4.7	3.6	3.1
Halyk Bank	HSBK KZ	Kazakhstan	4,993	33%	30%	23.6	14.6	10.3	5.2	3.9	2.7
Kazkommertsbank	KKGB KZ	Kazakhstan	5,175	16%	0%	23.4	0.0		2.5		
Industrial & Commercial Bank of China	601398CH	China	281,368		14%	43.1	28.9	21.5	6.2	5.3	4.9
ICICI Bank	IN	India	26,019	14%	12%	47.6	26.2	20.5	5.1	2.5	2.2
Bank of China	3988 HK	China	179,773	13%	13%	33.5	26.7	20.4	3.7	3.3	3.0
Banco do Brasil	BBAS3 BZ	Brazil	37,329	32%	24%	13.4	13.7	10.5	3.8	3.2	2.7
Malayan Banking	MAY MK	Malaysia	12,543	16%	18%	16.7	12.5	11.5	2.6	2.2	2.0
State Bank of India		India	23,870	16%	16%	19.1	16.1	13.6	2.8	2.4	2.1
Akbank	AKBNK TI	Turkey	23,143	25%	26%	21.1	12.4	12.0	3.9	2.8	2.4
<b>Emerging markets average</b>				<b>21%</b>	<b>19%</b>	<b>26.6</b>	<b>17.6</b>	<b>14.8</b>	<b>4.2</b>	<b>3.4</b>	<b>2.9</b>
<b>Discount (-)/premium (+)</b>						<b>68%</b>	<b>22%</b>	<b>-4%</b>	<b>49%</b>	<b>-13%</b>	<b>-13%</b>

Source: Bloomberg, Sovlink estimates

In 2006, Vozrozhdenie Bank traded at a substantial premium to the average industry level in terms of P/E and P/BV indicators. With respect to 2007 forecasts, the bank is trading close to comparable Russian companies, and with respect to its 2008 earnings forecast the bank is trading at a discount of almost 11% to its Russian peers. In comparison with banks in emerging markets, Russian banks appear to be slightly overvalued in terms of expected net profits in 2007 and undervalued in terms of book value. This also holds true for Vozrozhdenie Bank. Nonetheless, with respect to 2008 forecasts, the bank's shares are traded at a discount to its emerging market peers.

## Conclusion

1. We view the bank's current financial results and development strategy positively. The bank enjoys sustainable high growth rates, which are significantly superior to the industry average, low risks and high level of corporate governance. The bank's only weakness concerns its extremely high operating expenses. At the same time, these excessive expenses are due to the bank's investments in business development, service quality, and attracting and ensuring the loyalty of its customers.

2. At the same time, the bank is planning to substantially improve its profitability over the mid-term (by raising its ROE to 20-25% and reducing its cost/income ratio to 60-62%). The bank's 2Q07 interim report shows the significant



progress made – its ROE rose to 20.5%, and its cost/income ratio dropped to 65.3%. We believe that if management achieves its cost reduction plans, they will become the bank's key value driver.

3. The bank has low credit, interest and currency risks. The bank has a diversified loan portfolio with the proportion of overdue debts accounting for only 1.7% of its total loans, which is considerably lower than the industry average – furthermore, the bank's bad debt reserves cover its overdue debts by almost two times. Over 80% of its assets and liabilities are denominated in roubles (low currency risks). Non-interest income accounts for more than 40% of the bank's operating income (of which over one third consist of fees), which protects its cash flows over the mid-term in case of declining interest margins. The bulk of its loans to small and medium enterprises, as well as the rapid growth of its retail loan portfolio should ensure sustainable income and a relatively high interest margin for the next few years.

4. The bank has a very low level of dependence on foreign debts (85% of its liabilities are based on customer accounts, of which 60% are retail deposits), which is of crucial importance due to the volatility prevalent on global financial markets. None the less, the bank could face certain liquidity risks, due to the large proportion (43%) of current and demand deposit accounts in its liabilities – the bank is addressing this issue by diversifying the structure of its liabilities by increasing the proportion of debt instruments (predominantly denominated in roubles) to 10% (as targeted by management) of its total liabilities.

5. In our view, the strategy and business model of the bank will enable it to grow successfully over the next few years, despite the increasing level of risk prevalent in the financial sector. The bank's growth is driven by the high growth potential of the market segments prioritised by the bank – namely, the SME and retail loans sector, the development of regional banking services, and the cross-sales of its products amongst corporate and retail customers. We forecast the average annual growth rates (in roubles) of the bank's assets in 2007-09 will exceed 40%, compared to (an optimistic) rate of about 30% for the banking sector. We expect the bank's 2007 net profit to almost double in comparison with 2006, and its average annual growth rate to exceed 40% over the next two years.

## STOCK RATING POLICY

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

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