



Sberbank

**Investment
Alert****HOLD****Upside: 13%****Target Price: \$4.95****Analyst: Olga Belenkaya**
belenkayao@sovlink.ru**Stock data**

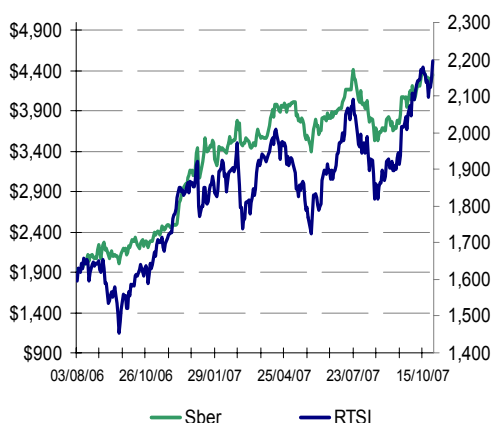
Ticker	Sber	M.Cap, \$ mn	94,119
Shares Ords '000	21,586,948	Free Float, %	40
Shares Pref '000	1,000,000	Free Float, \$ mn	37,648
Bid Ords, \$	4.35	Offer Ords, \$	4.37
Bid Prefs, \$	2.88	Offer Prefs, \$	2.97

Market performance

		1 month	6 months
Absolute	Ords	8.4%	9.8%
Relative to RTSI	Ords	1.3%	-2.1%
Price range, \$			
High	Ords	4.42	4.42
Low	Ords	4.02	3.39

Financials, 2007E

Assets, \$ mn	192,593	ROE	23.0%
Book Value, \$ mn	25,229	P/E	22.8
Net income, \$ mn	4,258	P/BV	3.8

Dynamics of Sberbank's shares vs. RTS index

Source: RTS

2Q07 IFRS results: expenses grow faster than revenues

• On 26 October, Sberbank released its 1H07 IFRS financial results as well as its 3Q07 RAS results. In our opinion, its 1H07 results are quite ambiguous. The bank managed to slightly improve its interest and fee income figures. However, these gains were cancelled out by its growing operating costs.

• On the whole, the bank's 1H07 key indicators were quite close to our expectations. However, its net profit of RUR 47.99 bn was 1% lower than our forecast of RUR 48.6 bn and 6.8% below the consensus forecast of RUR 51.3 bn. In comparison to 1Q07 (q-o-q) net profit in 2Q07 declined by 21%, and growth slowed to 24% in comparison to 2Q06 vs. 34% in 1Q07/1Q06.

• The bank managed to halt the decline that occurred in Q1 in its interest margin, although the preliminary RAS figures (which had been published earlier) had indicated that the decline would continue during this period. Thus, the bank's net interest income growth in 2Q07/2Q06 increased to 27% vs. 19% in 1Q07/1Q06, and given very small provisions for loan losses, the bank's net interest income growth amounted to an impressive 42%. Net fee and commission income also grew significantly y-o-y in 2Q07 to 33% vs. 27.6% in 1Q07, which matched our expectations. As a result, operating income soared to 32% vs. 19% in the previous quarter.

• In 2Q07, we were disappointed by the significant growth in operating expenses. The cost/income ratio deteriorated considerably from 51.7% in 1Q07 to 63.4% in 2Q07. In 1H07, the cost/income ratio rose to 58% vs. 54.6% in 1H06.

• In 2Q07, the bank's asset (8.8%) and loan portfolio (8.7%) growth lagged average market rates of 10.3% and 11.4% respectively. In 1H07, Sberbank's share of assets in the banking sector as well as in the retail loans and retail deposits markets declined slightly – however, it managed to improve its positions in the corporate segment.

• The company's 3Q07 RAS report painted a less optimistic picture of the company's financial performance in Q3. Net profit for 9 months 2007 was 22% higher than for 9 months 2006, however 3Q07/3Q06 growth slowed to 8%. Amongst its positive factors, we note that as a result of a restructuring of assets, securities as a proportion of total assets fell by almost 50%, whereas the bank's loans/assets ratio jumped from 75% to 82%. Hence, we expect the bank's assets to yield higher returns.

• On the whole, despite the ambiguous results of Sberbank's interim reports, we anticipate that year-end net profits will exceed management's forecasts of RUR 100 bn and amount to RUR 107-108 bn (which is only marginally lower than our forecast of RUR 109 bn, used in our valuation model). The bank's main advantages include solid reserves, which can support the bank against the key risk factors – credit, liquidity, currency, and access to funding sources – which is of primary importance, given the moderate decline forecast for the financial sector. Accordingly, taking into account the rise in the bank's share price, we lower our recommendation from BUY to **HOLD** on the bank's ordinary shares and reiterate our year-end target price of **\$4.95** per common share, which gives potential upside of 13% from the current price. We maintain our **BUY** recommendation on the bank's preferred shares, and reiterate our year-end target price of \$3.96. (We are waiting for more detailed explanations of the results during the meeting with the bank's management later this week.)



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YOUR FIRST CALL – FOR THE SECOND TIER

October 29, 2007

On October 26, Sberbank published its quarterly IFRS report for 2Q07 and its 3Q07 RAS report. On the whole, the **key balance sheet indicators in the 2Q07 IFRS report were quite close to our expectations. At the same time, net profits (RUR 47.99 bn) were 1% lower than our forecasts and 6.8% lower than the consensus forecast.** In comparison to 1Q07, net profits (q-o-q) fell by 21% – although, we note that Sberbank usually has better results in the first quarter in comparison to the second quarter. However, net profit growth in Q2 slowed to 24% vs. 34% in Q1 on a y-o-y basis.

On the whole, the bank's interim results are not that bad. The bank managed to halt the decline that occurred in Q1 in its interest margin. In Q2, despite a moderate increase in borrowing costs (from 4.7% to 5%) due to higher costs for servicing corporate term deposits and own debt securities, the bank maintained its interest margin at almost the same level as in Q1 (6.6%), although RAS data for the same period had implied that it would fall further. In our view, this is due to higher returns from loans (from 12.5% to 12.8%) – which is probably due to the slightly higher proportion of retail loans in the bank's loan portfolio. The growth of borrowing costs was restricted by a higher share of cheaper corporate deposits in the bank's liabilities (rising from 25.9 to 27.7%, whereas the proportion of expensive retail deposits dropped from 64.3% to 62.9%). However, according to its 9 month RAS results, these ratios returned to their former levels in Q3. As a result, the bank's net interest income in 2Q07 increased by 27% vs. 2Q06 and by 19% in comparison to 1Q07, which surpassed both the consensus forecast and our estimates. Another supporting factor was the rapid decline in loan impairment provisions in Q2 compared to 2Q06, which resulted in adjusted net interest income increasing by 42%. In Q2, the bank also benefited from higher net fee and commission income, which increased to 33% from 27.6% in 2Q06 – close to our expectations. As a result, operating income grew at a considerably higher rate of 32% vs. 19% in the previous quarter.

In 2Q07, we were disappointed by the significant growth in operating expenses, which include administrative and managerial costs and wages and salaries. Following a sudden drop in Q1 to 12%, operating costs in Q2 jumped to 38% at a faster rate than operating income, which grew by 32%. As a result, the bank's cost/income ratio deteriorated from 51.7% in 1Q07 to 63.4% in 2Q07. At the end of H1, the cost/income ratio rose to 58% vs. 54.6% in 1H06. Unfortunately, the interim financial reports do not show the structure of the operating expenses, which makes it difficult to determine the reasons for such rapid growth. We are waiting to hear management's comments during their meeting with analysts scheduled for 31 October.

The bank gradually, although quite slowly, has started to use the capital (almost \$9 bn) raised via its SPO at the end of 1Q07. The growth of the bank's assets (8.8%) and loan (8.7%) portfolios has lagged behind the market average of 10.3% and 11.4%, respectively. Whilst the bank's asset growth rate almost met our expectations, based on the RAS report, the growth of its loan portfolio was slightly below the figures forecast. Following a decline in Q1 (from 73% to 67%), loans as a proportion of the bank's assets did not grow in Q2, which restricted the profitability of the bank's assets. The bank's retail loans also grew at a very modest pace (with retail loans as a proportion of the bank's loan portfolio increasing slightly from 26.1% to 26.6%); given the increased competition in the market, this resulted in further reduction of Sberbank's market share in this segment. The bank's market share in the retail deposit sector also declined moderately from 54.1% to 53.7%. However, Sberbank managed to improve its position in the corporate market sector (refer to Table 5).



Table 1 – IFRS balance sheet summary, 1H07 – RUR mn

	As of 01.07.2007	Consensus	SOVLINK estimates	Difference bt. SOVLINK estimates and actual	As of 01.04.2007	At the beginning of 2007	Changes during 1H07 %	Changes in 2Q07 vs 01.07.2006 (y-o-y), %	Changes in 1Q07 (q-o-q), %	Changes in 2Q07 (q-o-q), %
Assets	4,282,732	4,234,155	4,279,593	0%	3,936,856	3,466,673	24%	47%	13.6%	8.8%
Loans and advances to customers	2,870,620	2,974,459	2,907,304	-1%	2,641,201	2,541,617	13%	40%	3.9%	8.7%
As a % of assets	67.0%				67.1%	73.3%				
Retail loans (net)	762,617				689,490	665,221	15%	45%	3.6%	10.6%
As a % of loan portfolio	26.6%				26.1%	26.2%				
Securities	751,511				706,118	474,686	58%	45%	48.8%	6.4%
As a % of assets	17.5%				17.9%	13.7%				
Retail deposits	2,333,678		2,333,644	0%	2,168,640	2,046,035	14%	36%	6.0%	7.6%
As a % of liabilities	62.9%				64.3%	64.8%				
Corporate deposits	1,034,641		1,028,297	1%	873,586	782,789	32%	59%	11.6%	18.4%
As a % of liabilities	27.7%				25.9%	24.8%				
Equity	577,865	576,297	568,604	2%	565,539	308,524	87%	120%	83.3%	2.2%

Source: Company data, SOVLINK estimates



Table 2 – IFRS Income statement summary, 1H07

	1H07	Consensus	SOVLINK estimates	Difference bt. SOVLINK estimates and actual	1H06	1H07/1H06, changes %	1Q07	1Q06	1Q07/1Q06, changes %	2Q07	2Q06	2Q07/2Q06, changes %
Interest income	192,373		186,860	3%	144,182	33%	90,765	69,536	30.5%	101,608	74,646	36%
Interest expenses	-81,387		-81,277	0%	-54,041	51%	-38,190	-25,491	49.8%	-43,197	-28,550	51%
Net interest income	110,986	108,221	105,583	5%	90,142	23%	52,575	44,045	19.4%	58,411	46,097	27%
Net interest income after provisions for loan impairment	110,584				82,707	34%	52,947	42,235	25.4%	57,637	40,472	42%
Net fee and commission income	29,022		28,665	1%	22,217	31%	13,500	10,584	27.6%	15,522	11,633	33%
Operating income	146,761		140,747	4%	116,938	26%	69,052	58,050	19.0%	77,709	58,888	32%
Operating expenses	-85,319		-76,351	12%	-67,886	26%	-35,523	-31,798	11.7%	-49,796	-36,088	38%
Profit before tax	61,442		64,395	-5%	49,052	25%	33,529	26,252	27.7%	27,913	22,800	22%
Net profit	47,991	51,539	48,651	-1%	37,037	30%	26,777	19,939	34%	21,214	17,098	24%

Source: Company data, SOVLINK estimates

Table 3 – Profitability indicators, %

	1H07	1H06	1Q07	2Q07
Asset yield	11.4%	11.9%	11.3%	11.4%
Cost of liabilities	-4.8%	-4.5%	-4.7%	-5.0%
Net interest spread	6.6%	7.4%	6.6%	6.5%
Net interest margin	6.6%	7.5%	6.6%	6.6%
Net operating income after provisions / Net operating income	75.3%	70.7%	76.7%	74.2%
Net fee and commission income / Net operating income	19.8%	19.6%	19.6%	20.0%
ROE	21.7%	30.0%	24.5%	14.8%
ROA	2.5%	2.7%	2.9%	2.4%
Cost / Income	58.0%	54.6%	51.7%	63.4%

Source: Company data, SOVLINK estimates



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October 29, 2007

Table 4 – Sberbank's share in major market segments

	At the end of 2006	At the end of 1Q07	At the end of 2Q07
Assets	24.7%	25.2%	24.9%
Equity	18.2%	28.6%	24.8%
Retail loans	33.5%	32.1%	30.8%
Corporate loans	30.8%	29.5%	30.6%
Retail deposits	53.9%	54.1%	53.7%
Corporate deposits	17.5%	16.5%	17.6%

Source: Company data, SOVLINK estimates

The bank's 1H07 IFRS report reflects a moderate growth in the bank's loan portfolio in 2Q07, significant improvement in both net interest and fee income growth was cancelled out by even faster growth in its operating expenses.

However, the bank's 9 month 2007 RAS report is less optimistic about the bank's financial performance in Q3. According to the RAS report, the bank's net profits in January-September 2007 grew by 22% in comparison to the same period in 2006. However, a comparison of Q3 results with 3Q06 figures shows growth of only 8%. This is due to very low net profits in July-August when the bank's net profit fell far behind its average monthly figures. (In contrast, net profits in September rose considerably.) Management has stated that the significant drop in its net profits in July-August was due to higher provisions against potential loan losses as a result of changes in the CBR's Regulation No. 254-P on the creation of provisions for possible loan losses, loans and similar debts for credit institutions, which came into force on 1 July. Besides, starting from 1 July, the CBR increased the allocation rates for mandatory reserves for banks, which also squeezed resources available for issuing loans – as of 11 October, these ratios were temporarily relaxed in order to avoid a liquidity crunch, which should have a positive impact on the bank's profits in Q4. The bank's growth in assets in Q3 was insignificant; however, amongst the positive factors we include the restructuring of assets – which resulted in the proportion of securities in the bank's assets being halved, whereas loans as a proportion of assets increased from 75% to 82%. Hence, we believe that the bank's asset yield will improve – at the earliest, the effect will be noticeable in 4Q07, but more likely in 2008.



Table 5 – RAS balance sheet summary for 9 months 2007, RUR bn

Balance sheet indicators, RUR bn	As of	As of	As of	As of	Changes for	Changes for	Changes for	Changes for	Changes for
	01.10.2007	01.07.2007	01.04.2007	01.01.2007	9 months to 01.10.07, %	9 months to 01.10.2006 (y- o-y), %	1Q07 (q-o-q), %	2Q07 (q-o-q), %	3Q07 (q-o-q), %
Assets	4,371	4,290	3,946	3,478	26%	39%	13.5%	8.70%	1.9%
Net loan portfolio	3,599	3,220	2,925	2,619	37%	55%	11.7%	10.10%	11.8%
As a % of assets	82.3%	75.1%	74.1%	75.3%					
Securities	418	741	698	482	-13%	-20%	45.0%	6%	-43.7%
As a % of assets	9.6%	17.3%	17.7%	13.9%					
Retail deposits	2,435	2,311	2,148	2,029	20%	34%	5.9%	7.60%	5.4%
As a % of liabilities	64.7%	62.3%	63.8%	64.1%					
Corporate deposits	1,022	1,059	900	812	26%	41%	10.9%	17.70%	-3.6%
As a % of liabilities	27.2%	28.6%	26.7%	24.8%					
Equity	610	581	578	323	89%	102%	78.8%	0.50%	5.0%

Source: Company data, SOVLINK estimates

Table 6 – Financial performance according to RAS figures for 9 months 2007, RUR mn.

	2007 9 months	2006 9 months	2007 9 months / 2006 9 months	1Q07	1Q06	1Q07/ 1Q06	2Q07	2Q06	2Q07/ 2Q06	3Q07	3Q06	3Q07/ 3Q06
Interest income	276,005	215,045	28.3%	86,302	68,297	26.4%	90,475	68,054	32.9%	99,228	78,694	26.1%
Interest expenses	-123,796	-82,806	49.5%	-37,112	-25,009	48.4%	-41,240	-27,084	52.3%	-45,444	-30,713	48.0%
Net interest income	152,210	132,240	15.1%	49,191	43,288	13.6%	49,235	40,970	20.2%	53,784	47,982	12.1%
Net fee and commission income	65,349	51,016	28.1%	18,582	14,506	28.1%	22,455	17,249	30.2%	24,312	19,261	26.2%
Operating income	203,963	171,199	19.1%	71,245	59,327	20.1%	73,972	58,023	27.5%	58,746	53,849	9.1%
Operating expenses	-94,552	-81,677	15.8%	-31,873	-23,609	35.0%	-36,634	-31,748	15.4%	-26,045	-26,320	-1.0%
Profit before tax	109,411	89,522	22.2%	33,033	26,415	25.1%	36,395	27,186	33.9%	39,983	35,921	11.3%
Net profit	81,229	66,386	22.4%	25,931	21,755	19.2%	27,550	18,959	45.3%	27,748	25,672	8.1%

Source: Company data, SOVLINK estimates

Table 7 – Profitability indicators, %

	2007 9 months	2006 9 months	1Q07	1Q06	2Q07	2Q06	3Q07	3Q06
Asset yield	10.3%	11.2%	10.2%	11.7%	9.5%	10.7%	9.9%	11.4%
Cost of liabilities	4.9%	4.4%	4.6%	4.4%	4.8%	4.4%	5.0%	4.6%
Net interest spread	5.4%	6.8%	5.5%	7.3%	4.7%	6.3%	5.0%	6.8%
Net interest margin	5.7%	6.9%	5.8%	7.4%	5.1%	6.5%	5.4%	6.9%
ROE	23.2%	31.8%	23.0%	32.8%	19.0%	27.3%	18.6%	35.4%
ROA	2.8%	3.1%	2.8%	3.3%	2.7%	2.7%	2.6%	3.4%

Source: Company data, SOVLINK estimates

On the whole, despite the ambiguous results in Sberbank's interim reports, we expect its year-end net profits will exceed management forecasts of RUR 100 bn and will amount to RUR 107-108 bn (which is slightly lower than our



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YOUR FIRST CALL – FOR THE SECOND TIER

October 29, 2007

forecast of RUR 109 bn used in our valuation model). According to Vedomosti, Sberbank's First Deputy Chairman, Ms. Aleshkina has stated that net profit forecasts for the year are being revised and will amount to at least RUR 110 bn. One of the bank's main advantages lies in its solid growth reserves – \$9 bn of equity capital raised via the SPO, which offers support against the key risk factors – credit, liquidity, currency, and access to funding sources – which is of primary importance, given the moderate decline forecast for the financial sector. Accordingly, taking into consideration the increase in the bank's share price, we lower our recommendation from BUY to **HOLD** on the bank's ordinary shares and reiterate our year-end target price of **\$4.95** per common share, which gives potential upside of 13% from the current price. We maintain our **BUY** recommendation on the bank's preferred shares, and reiterate our year-end target price of \$3.96. (We are waiting for more detailed explanations of the results during the meeting with the bank's management later this week.)



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YOUR FIRST CALL – FOR THE SECOND TIER

October 29, 2007

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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