VTB

Flash Note

Surprisingly strong 9M07 results

Analyst: Olga Belenkaya
belenkayao@sovlink.ru

Stock data

Ticker	VTBR	M.Cap, $ mn	33,351
Shares Ords'mn	6,724,138	Free Float, %	22.5%
Shares Prefs	-	Free Float, $ mn	7,503
Bid Ords, $	0.0049	Offer Ords, $	0.0050
Bid Prefs, $	-	Offer Prefs, $	-

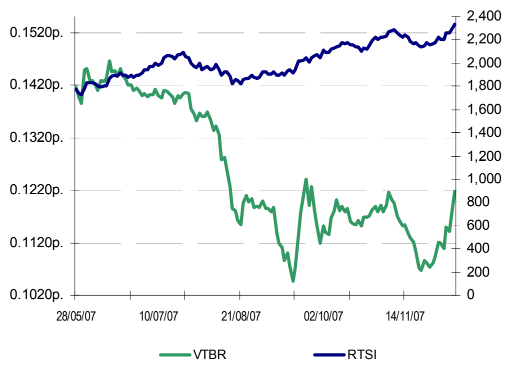
Market performance

		1 month	6 months
Absolute	Ords	4.0%	-14.6%
Relative to RTSI	Ords	1.0%	-44.2%
Price range, $			
High	Ords	12.18	14.66
Low	Ords	10.68	10.46

Financials, 2007E

Assets, $ mn	78,605	ROE	11.4%
Book Value, $ mn	16,226	P/E	25.2
Net income, $ mn	1,332	P/BV	2.1

VTB – Relative performance



Source: RTS, MICEX

• On 10 December, the VTB Group released its preliminary consolidated 9M07 IFRS report. The final results will be published on 21 December 2007. The Group's net profit of $1,051 mn for 9M07 was 28.8% higher than for 9M06 – much higher than our estimates ($812 mn) and the consensus forecast ($814 mn). Net profit growth excluding non-recurring income ($172 mn for 9M06 and $137 mn for 9M07) increased by 41.9%.

• The Bank managed to considerably improve its ROE (12.4% vs. 10.3% in 1H07) and ROA (2.3% vs. 1.7% in 1H07) figures.

• VTB continues to outperform the market in terms of its growth rates, with growth of its assets, loan portfolio and corporate deposits exceeding our forecasts – which were more optimistic than consensus forecasts. The bank's loan portfolio grew during the quarter at an impressive 25.9% and for the first time ever its loans as a percentage of assets exceeded 60%. Furthermore, the bank improved the quality of its loan portfolio, with the proportion of troubled loans declining to 1.5% from 2.1% at the beginning of the year and 1.8% at the end of 1H07. Although retail loans grew the fastest, (with their share in the bank's assets portfolio rising to 12.1% vs. 8.4% at the beginning of the year), corporate loans made an even greater contribution to the expansion of the bank's loan portfolio in 3Q07.

• The Group expects to increase its assets by 55-60%, its loan portfolio by 75-80% and net profit by 10-15% by year-end (in comparison to 2006 results). The figures are substantially higher than our preliminary estimates. Yet, given the strong 9 month results and the aggressive expansion strategy pursued by the Group in recent months, they appear to be attainable.

• On the whole, we positively value the Group's results for 9 months 2007. However, we note that such impressive net profit figures are not only due to the bank's core activities, but also to non-recurring factors such as a lower loan impairment allowance, noticeable reduction in the growth of operating costs, lower effective tax rate, one-off gains from currency and securities' transactions, and the sale of Novosibirskvneshtorgbank.

• We believe that these reports and the new ambitious assessment of the bank's 2007 performance may result in the revaluation of the bank's target price on the market. Our fair value price, based on market multipliers values the bank's shares at about 14 kopecks ($0.0056) per share.

Tel.: +7 495 967 1300
Fax: +7 495 967 1311

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Thus, management's forecasts of positive results in 3Q07 have turned out to be accurate. It was the first this year when the VTB Group's financial results showed significant improvement in its financial results in comparison to the previous year, which had been significantly boosted by non-recurring income from securities trading. Net profit growth excluding non-recurring income ($172 mn for 9M06 and $137 mn for 9M07) increased by 41.9%. The Group reported proceeds from the sale of Novosibirskvneshtorgbank ($62 mn), the sale of an associated company ($18 mn) and the depository fee in relation to its IPO ($57 mn) as non-recurring income for 9M07. The bank managed to considerably improve its ROE (12.4% vs. 10.3% in 1H07) and ROA (2.3% vs. 1.7% in 1H07) figures.

Net interest income reached $1,732 mn (+46.2% on a y-o-y basis) having beaten our expectations of 6.4% and the consensus forecast of 5.4%. The bank's interest margin in comparison to 1H07 rose due to a higher proportion of retail and SME loans in its loan portfolio, higher interest rates on its corporate loans, and the weak impact (to date) of the global financial crisis on VTB's borrowing costs.

In 3Q07, VTB's expenses grew significantly, as a result of allocations to loan impairment provisions with an almost threefold increase in comparison to 1Q07 and 2Q07 – due to the sharp rise of its loan portfolio. However, given the lower loan impairment allowance (from 3% as of 30 June to 2.8% of the bank's loan portfolio), which we expected, but which the market appears to have overlooked – the bank's net interest income after provisions grew by 69.6% on a y-o-y basis, which exceeded our forecast by 1.8%. Net fee and commission income amounted to $414 mn (a 56.8% increase on a y-o-y basis), meeting the consensus forecast and exceeding our estimate by 1.2% – excluding non-recurring fee and commission income, it grew by 35.2%. Operating income grew by 41.9% and reached $2,570 mn having exceeded our forecasts by 7.8%. However, the figure was moderately lower than the consensus forecast. We expected to see a larger proportion of core income items (net interest income after provisions and fee and commission income) in the bank's operating income. However their contribution contracted to 67.5% as compared to 73% in 6M07 as a result of non-recurring currency and securities' transactions in 3Q07.

Thus, despite excellent net interest and fee and commission income, as well as decreasing provisions for loan impairment, the Group's operating income came in slightly behind consensus. The main reason for the remarkable growth of the bank's net profits is explained primarily by the lower than expected growth of its non-interest expenses – even though for 9M07 they grew faster than operating income as a result of the active expansion of the bank's retail network (46% vs. 41.9%), such growth was 2% lower than our forecast and 3% lower than the consensus. In 3Q07, the bank's operating expenses grew by only 8% against 2Q07 on a q-o-q basis. At the moment, it is difficult to assess the sustainability of such a slowdown, since the Group's aggressive development strategy envisages a noticeable increase in its payroll costs as a result of opening new branches and the development of an investment banking unit from scratch. In addition, the Group managed to reduce its effective tax rate to 16.5% in 3Q07 as compared to 25.9% in 2Q07. This is due to revenues from currency transactions being exempt from taxation.

VTB's growth rates continue to outperform the market (Table 4). Regarding the bank's balance sheet figures, we note that the growth of its assets, loan portfolio and corporate deposits exceeded our forecasts (Table 2) – even though our forecast was more optimistic than the consensus forecast. The bank's loan portfolio grew at an impressive 25.9% over the quarter and for the first time ever its loans as a percentage of assets exceeded 60%. Furthermore, the bank improved the quality of its loan portfolio, with the proportion of troubled loans declining to 1.5% from 2.1% at the beginning of the year and 1.8% at the end of 1H07. Although retail loans grew the fastest, (with their share in the bank's assets portfolio rising to 12.1% vs. 8.4% at the beginning of the year), corporate loans made an even greater contribution to the expansion of the bank's loan portfolio in 3Q07.

The Group's funding structure continues to improve. Customer accounts as a proportion of the bank's total liabilities remains above 49% vs. 44% at the beginning of the year, with quarterly growth of deposit accounts equalling 15.3%. The bank has significantly narrowed the gap in its corporate deposits by increasing the share of corporate deposits by 19% in 3Q07 and by 52% since the beginning of the year. At the same time, the volume of bank deposits and other borrowings jumped by 60.7% in 3Q07, which compensated for the lower volume of securities issued. In

August-September, VTB raised two bridge loans, which in October were replaced with new issues of Eurobonds. The loan of RUR 17 bn granted by the central bank and approved by VTB's Supervisory Board was almost fully utilized during 4Q07. The bank aims to reduce its dependence on foreign borrowings by prioritising the expansion of its corporate deposit portfolio (which is preferred over the more expensive retail deposits).

We positively value the Group's 9M07 results. However, we note that such impressive net profit figures are not only due to the bank's core activities, but also to non-recurring factors such as a lower loan impairment allowance, noticeable reduction in the growth of operating costs, lower effective tax rate, one-off gains from currency and securities' transactions, and the sale of Novosibirskvneshtorgbank.

VTB's management has confirmed its intention to sell its non-core assets (a 5% stake in EADS, a 10.5% stake in Alrosa and other assets valued at about $100 mn). Its stake in EADS and Alrosa could be sold by the year-end. The bank plans to sell its stake in EADS to the United Aircraft Corporation (UAC), with VEB arranging the deal. We positively view management's plans to dispose of the bank's non-core assets, although, in our opinion, it will not significantly impact the Group's value. According to Nikolai Tsekhomsky, member of VTB's board, the proceeds from the sale of these assets will not exceed $300 mn.

During a teleconference, VTB's CFO, Tsekhomsky reported:

1. The Group expects to increase its assets by 55-60%, its loan portfolio by 75-80% and net profit by 10-15% by the year-end. The figures are much higher than our preliminary estimates. Yet, given the strong results for 9M07 and the aggressive expansion strategy pursued by the Group during the year, they appear to be attainable. These ambitious plans may lead to a revaluation of the bank's target price by the market.

2. VTB is considering a 4.5% interest margin ratio and a cost/income ratio of 50% as its mid-term target. According to Mr. Tsekhomsky, the unusually high (for VTB) interest margin achieved by the bank in 3Q07 (4.9% according to VTB's data vs. 4.7% forecast by us) cannot be sustained.

3. VTB is planning to further reduce its loan impairment provisions, and considers a provision equal to 1% of its loan portfolio to be adequate.

4. The VTB Group has every chance to consolidate its 95% stake in VTB North-West – an offer to minority shareholders remains valid until 14 December. In theory, this could be followed by a compulsory buyout of the remaining minority shareholders. However, for the bank, the legal procedure applicable to consolidation, after the forthcoming amendments to the laws on joint-stock companies, remains a priority. Given the current market price of over 11.6 kopecks for VTB's shares, the share swap offer is more profitable for VTB North-West's minority shareholders than the buyout offer.

Table 1 – Financial performance, $ mn

	9M07	Our forecast	Consensus	Difference from our forecast	Difference from consensus	9M06	9M07 / 9M06, %	3Q07	3Q06	3Q07 / 3Q06, %
Interest income	3,643	3,577	3,588	1.9%	1.5%	2,580	41.2%	1,408	942	49.5%
Interest expenses	(1,911)	(1,948)	(1,945)	-1.9%	-1.8%	(1,395)	37.0%	(680)	(551)	23.4%
Net interest income	1,732	1,628	1,643	6.4%	5.4%	1,185	46.2%	728	391	86.2%
Net interest income after provision for loan impairment	1,377	1,353		1.8%		812	69.6%	513	203	152.7%
Net fee and commission income	414	409	414	1.2%	-0.1%	264	56.8%	147	103	42.7%
Operating income	2,570	2,383	2,592	7.8%	-0.9%	1,811	41.9%	1,093	518	111.0%
Operating costs	(1,289)	(1,315)	(1,329)	-2.0%	-3.0%	(883)	46.0%	(480)	(306)	56.9%
Profit before tax	1,314	1,068	1,088	23.0%	20.7%	934	40.7%	655	251	161.0%
Net profit	1,051	812	814	29.5%	29.2%	816	28.8%	547	240	127.9%

Source: Company data, SOVLINK estimates

Table 2 – Balance sheet summary, $ mn

	As of 01.10. 2007 (actual)	Our forecast	Consensus	Difference from our forecast	Difference from consensus	As of 01.07.07	At the beginning of 2007	Change for 9M07, %	Change for 3Q07 (q-o-q), %	Change for 2Q07 (q-o-q), %	Change for 1Q07 (q-o-q), %
Assets	74,255	73,431	71,797	1.1%	3.4%	66,223	52,403	41.7%	12.1%	17.9%	7.2%
Loans to customers (gross)	46,345	44,573	43,036	4.0%	7.7%	36,811	30,235	53.3%	25.9%	12.5%	8.3%
Loans as % of assets	60.6%	59.0%	58.4%	2.8%	3.9%	53.9%	55.8%	8.6%			
Retail loans	5,617	5,705	5,220	-1.5%	7.6%	4,106	2,533	121.8%	36.8%	35.6%	19.5%
As % in loan portfolio	12.1%	12.8%	12.1%	-5.3%	-0.1%	11.2%	8.4%				
Customer accounts	28,923	28,075	27,884	3.0%	3.7%	25,083	19,988	44.7%			
Retail deposits	9,630	9,787	9,953	-1.6%	-3.2%	8,876	7,326	31.4%	8.5%	12.1%	8.1%
Corporate deposits	19,293	18,289	18,214	5.5%	5.9%	16,207	12,662	52.4%	19.0%	4.8%	22.1%

Source: Company data, SOVLINK estimates

Table 3 – Profitability indicators, %

	9M07	9M06	1H07	1H06	1Q07	1Q06
Asset yield	9.0%	9.3%	8.7%	9.3%	9.3%	
Cost of liabilities	-5.1%	-5.1%	-5.2%	-4.9%	-5.0%	
Net interest spread	3.9%*	4.2%	3.5%	4.4%	4.3%	4.0%
Net interest margin	4.3%*	4.3%	3.9%	4.5%	4.2%	4.1%
Net operating income after provisions / Net operating income	53.6%	44.8%	58.5%	47.1%	62.9%	38.3%
Net fee and commission income / Net operating income	13.9%	14.6%	14.8%	12.5%	13.6%	12.3%
ROE	12.4%	19.0%	10.4%	20.8%	13.1%	24.6%
ROA	2.3%	2.5%	1.7%	2.8%	1.7%	3.4%
Cost / Income	44.1%	40.4%	50.0%	39.0%	49.6%	35.2%

Source: Company data, SOVLINK estimates
**According to our estimates, according to VTB – 4.1% and 4.4%, respectively*

Table 4 – VTB and banking sector growth in 9M07

Growth from the beginning of the year, %	Banking sector in general	VTB
Assets	37.0%	41.7%
Equity	56.0%	127.3%
Loans to customers	28.1%	53.9%
Retail loans	48.7%	121.8%
Retail deposits	28.6%	31.4%
Corporate deposits	42.6%	52.4%

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

SOVLINK LLC
Tel.: +7 495 967 1300
Fax: +7 495 967 1311

Kremlin Embankment 1, building 2,
Moscow 119019, Russia
www.SOVLINK.ru
research@SOVLINK.ru