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**Meeting with URALSIB Bank's management**

On March 7, URALSIB Bank's management met analysts to discuss the bank's 2007 RAS results. At the meeting, management also highlighted issues concerning the establishment and development of JSC FC URALSIB, a diversified financial holding.

At first glance, the bank's 2007 RAS results are not particularly encouraging. The bank's net profit is almost 80% lower in comparison to 2006, due to a drastic reduction of profits from securities trading, higher growth of expenses and the high profit taxes on the sale of a large block of shares by the bank. This resulted in minimal net profits at the end of the year and a severe reduction in its ROE. As a result of the low profits earned in 2007 and the payment of dividends for 2006, the bank's equity capital contracted by approximately 1% last year.

RUR mn	2007	2006	2007/2006, %
Balance sheet profit	4,725	6,517	-27.5%
Net profit	1,245	5,624	-77.9%
Assets	353,698	289,268	22.3%
Equity	41,145	41,435	-0.7%
ROA	1.1%	1.8%	
ROE	8.9%	12.0%	
Net interest margin	5.9%	6.8%	
Cost/Income	76.0%	62.0%	
Bank's regular income/ administrative expenses	102%	98%	

Meanwhile, according to the bank's management, the company's financial results have been impacted by the process of optimizing its asset structure. Traditionally, securities accounted for a large part of the bank's asset structure (including LUKOIL stock). In early 2007, securities accounted for 17% of the bank's assets. Furthermore, a significant part of the bank's revenues was made up of volatile revenues from securities trading. At the beginning of 2007, in the background of increasing turmoil on global financial markets, the bank decided to modify its asset structure (by reducing the proportion of securities and increasing the share of its loan portfolio). It also decided to increase the proportion of regular income and reduce costs (helped by a switch to a single IT-platform).

By the end of 2007, it reduced its securities portfolio by 37%, with its share in the bank's assets declining from 17% to 9% – with a further decline in January. However, management reduced the bank's securities portfolio by selling part of it in an unfavourable market environment. In addition, in 1H07 the bank's operating expenses (including payroll expenses) surged higher, which led to a RUR3.6 bn loss for the bank for that period. However, in 2H07, the bank managed to improve its performance due to the redistribution of its assets (a reduced share of securities and an increased share of its loan portfolio), which enabled the bank to increase its net interest income by 77% and to reduce its payroll expenses. This enabled the bank to earn a profit of RR1.2 bn by the end of the year. (The bank's IFRS consolidated report is expected to show an increase in net profit of about RR700 bn due to the performance of the bank's leasing company.)

As a result of asset redistribution and given the 22% growth of its assets, the bank managed to increase its loan portfolio by 34% and retail loans by 72%, which is far ahead of the market. The trend of the bank's regular income (net interest and fee and commission income) is favourable, which is also attributed to the streamlining of its allocations for loan impairment provisions. As opposed to 2006, in 2007 the bank's regular income was slightly higher than its administrative expenses. Nevertheless, expenses increased at a rapid rate due to the modernization of the bank's regional network, acquired as a result of the acquisition of new banks and the cost of shifting to a modern, unified IT platform.



RUR mn	2007	2006	2007/2006, %
Net interest income	12,231	10,063	21.5%
Provisions for loan impairment	(2,415)	(3,948)	-38.8%
Net interest income after provision for loan impairment	9,816	6,114	60.5%
Net fee and commission income	5,417	4,312	25.6%
Net income from securities trading	4,033	6,378	-36.8%
Operating income (before provision for loan impairment)	19,721	17,139	15.1%
Operating expenses	(14,996)	(10,622)	41.2%
Bank's regular income/administrative expenses	102%	98%	

### Positive changes

1. More stable revenue structure: the regular income/administrative expenses ratio climbed from 98% to 102%.
2. Changes in asset structure: the proportion of loans rose from 52% to 57%, whereas the portion of the bank's securities portfolio was reduced from 17% to 9%, which made the bank's revenues less sensitive to the turmoil on the stock market. The bank attributed its RR1.1 bn loss in January to a depreciation of the value of its securities portfolio, despite the fact that its share in the bank's assets, as of February 1, 2008, had once again contracted.
3. Changes in the structure of the bank's loan portfolio: the share of retail loans increased significantly from 26% to 34%, whereas the share of mortgages jumped from 11% to 44%. SME loans account for 80% of the bank's corporate loan portfolio, whilst the share of microcredits and credits to small businesses grew from 10% to 18%. This should positively influence the bank's portfolio returns and its interest margin. The bank has moderate credit risk with non-performing loans amounting to 2.4% of loans issued, and provisions for loan impairment cover greater than 182%.

### Strengths and competitive advantages

1. Diversified regional network (the second largest after Sberbank and Rosselkhozbank)
2. Diversified structure of assets and liabilities (key accounts and borrowers account for a maximum of 20% of customer accounts and the loans issued by the bank).
3. Robust loans/deposits ratio of 93%, given an average ratio of 109% for Russian banks. The bank has not issued bonds or Eurobonds, with borrowings on foreign markets amounting to 19% of its liabilities.
4. Potential for cross-selling due to the diversified holding structure of FC URALSIB (banking sub-holding, insurance, leasing, asset management, and investment banking).

### Weaknesses:

1. Historically, FC URALSIB has developed extensively via mergers and acquisitions, which resulted in the emergence of duplicate functions in the holding structure and reduced the effectiveness of management. In 2007, the company started improving the management and increasing the efficiency of the holding company – however, the process could take a long time to complete.



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**Plans for 2008**

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Asset growth	40-50%
Loan portfolio growth	50%
Corporate loans	about 50%
Retail loans	80%
ROE	18%
ROA	2%
Cost/Income	60%
Cost/Assets	4.7% (similar to 2007)

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The bank's major plans in the retail sector are linked to the continued promotion of mortgages, car loans (including bank-agent services), issuance of credit cards and the promotion of a pilot project for the issuance of social cards in Bashkiria and the Ivanovo region, which it later plans to replicate across the whole country. Regarding its corporate loans, the bank plans to continue increasing the share of high-yielding microcredits and credits in its portfolio to small businesses.

The bank's funding policy provides for an increase in the traditionally low proportion of retail deposits, the maintenance of its share of corporate deposits, and raising a \$3.8 bn loan on foreign markets (of which \$800-1,000 mn will be new borrowings).

**Capitalization plans**

As of the end of 2007, FC URALSIB (beneficiary owner Nikolay Tsvetkov) holds more than 90% of the bank's equity, the Bashkiria Government 8.4% and it has a free float of 1.2%.

At the moment, FC URALSIB is considering the following three scenarios:

1. Organic growth together with an increase of capital of the existing shareholders and subordinated loans
2. Organising an IPO for FC URALSIB
3. Engagement of a strategic investor (for FC URALSIB as a whole, and for specific sub-holdings) – or a combination of a strategic investor as well as an IPO.

No decision has been reached yet. Most probably, corporate measures to implement (one of) these plans will be taken in 2009. FC URALSIB does not intend to convert its subsidiaries' shares (including URALSIB Bank) to a single share in the near future.

**We positively view the bank's strategy, which aims to reduce its dependency (with respect to its assets and income) on financial markets, the rapid growth of its retail loans portfolio, and the measures undertaken to reduce costs and increase the bank's transparency. Nevertheless, in our opinion, the bank's plans to expand its loan portfolio by 50% in 2008 appear to be overly optimistic, given the difficult position of the banking sector and the risks of not being able to raise the funds required. Consequently, we have our doubts regarding management's plans to double the bank's ROE in 2008. Also, we are concerned about the bank's ability to reduce its traditionally high operating expense growth rates.**



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## STOCK RATING POLICY

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<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>	Target price at or below current price levels

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