



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

March 31, 2008

Vozrozhdenie

FLASH
NOTE

BUY

Upside: 21%

Target Price (2008-year end): \$72.1

Analyst: Olga Belenkaya

belenkayao@sovlink.ru

Excellent 2007 results

Stock data

Ticker	VZRZ, VZRZP	M.Cap, \$ mn	1,408
Shares Ords	23,748,694	Free Float, %	40%
Shares Prefs	1,294,505	Free Float, \$ mn	564
Bid Ords, \$	59.11	Offer Ords, \$	59.53
Bid Prefs, \$	24.45	Offer Prefs, \$	25.51

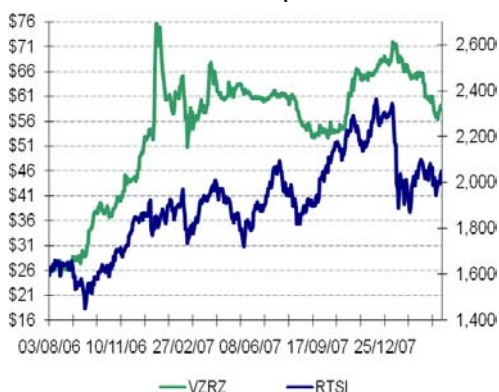
Market performance

		1 month	6 months
Absolute	Ords	-9.5%	11.0%
Relative to RTSI	Ords	-7.9%	12.1%
Price range, \$			
High	Ords	65.1	71.8
Low	Ords	56.5	52.7

Financials, 2007

Assets, \$ mn	4537.8	ROE	21
Book Value, \$ mn	484.3	P/E	18.9
Net income, \$ mn	74.5	P/BV	2.9

Vozrozhdenie – Relative performance



Source: RTS, MICEX

- On March 31, Vozrozhdenie bank released its IFRS results for 2007. Net profit amounted to RR1.9 mn (a 138% increase on a y-o-y basis) and was 21% higher than our estimates, although the actual results in terms of core income and cost items did not vary in excess of 5% from our forecasts. ROE amounted to 21% vs. 18.2% in 2006.

- The bank's net interest income soared by 60%, and net fee and commission income jumped by 46% as a result of increased basic banking operations. Operating income grew by 54%, with the level of non-interest income accounting for the usual 43% of total income (which protects the bank's profits against a decline in interest margin).

- Growth of the bank's loan portfolio almost came to a standstill in 4Q07, with loans as a proportion of assets dropping from 76.6% in mid-2007 to 70% by the end of the year. This is due to a slowdown in the growth of the bank's funding base, and also because of a need to significantly build up a liquidity cushion against the deteriorating market conditions.

- On the whole, interest rates on loans were raised more than those for deposits at the end of last year, which enabled the bank to derive higher interest margin of 6.1% vs. 6% (although a moderate decline was anticipated last year). According to management, the trend for higher rates on loans is still in place, and the bank will be able to retain and even increase its net interest margin. Yet, management holds a more conservative view for 2009.

- Despite a credit crunch on the global capital markets, the bank managed to raise a syndicated loan for \$59 mn at 6M Libor+1.8%, which amounts to about 4.2% in nominal terms (vs. approximately 6M Libor+1.2% = 6% in October 2007), with a 2-year maturity. Given the unfavourable market conditions, an issue of Rouble bonds has been delayed.

- By the end of the year, the bank came close to attaining its mid-term cost efficiency targets (Its Cost/Income ratio was reduced to 62.7% vs. an average annual ratio of 60-62%) and ROE (reached 21% vs. a target 20-25%).

- In 2008, management expects the bank's assets to grow by a further approximately 35%, the loan portfolio – by at least 30%, and its deposit base – by 19-25%. The bank has a solid liquidity capital reserve, sufficient capital, and its funding structure and revenues are protected against the deteriorating conditions on capital markets.

- We view the bank's 2007 financial results positively and consider that it performed well against an overall liquidity crunch in the banking sector. Based on our valuation model, we currently estimate a year-end target price for Vozrozhdenie bank's ordinary shares of **\$72.1**, offering potential upside of 21% from the current price, which implies a **BUY** recommendation. However, we will revise our fair value estimate for the bank's shares after adjusting our valuation model.

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

research@sovlink.ru



On March 31, Vozrozhdenie bank released its IFRS results for 2007. Net profit amounted to RR1.9 mn (a 138% increase on a y-o-y basis) and was 21% higher than our estimates, although in terms of core income and cost items, the actual results did not vary in excess of 5% from our forecasts. This is explained by the fact that the proportion of non-recurring income (from foreign currency trading and other operating income) grew significantly in the structure of the bank's operating income in 4Q07. Such non-recurring items accounted for 6.9% of the operating income vs. 3.7% in 2006. On the whole, such impressive financial results were attained due to a steady growth of net interest income (+ 60%) and net fee and commission income (+ 46%) due to a growing number of retail and SME customers using the bank's products.

Table 1 – Income statement, RUR mn

	2007 (actual)	2007 (our forecast)	2007 (consensus forecast)	2006	2007/ 2006, %	Difference of 2007 results from our forecast, %	4Q07	4Q06	4Q07Q /4Q06
Interest income	9,745	9,846		6,278	55%	-1.0%	2,844	1,898	50%
Interest expenses	-4,175	-4,376		-2,794	49%	-4.6%	-1,179	-766	54%
Net interest income	5,570	5,471	5,543	3,484	60%	1.8%	1,665	1,132	47%
Net fee and commission income	3,011	2,907		2,068	46%	3.6%	951	522	82%
Operating income	8,262	7,918		5,359	54%	4.3%	2,700	1,804	50%
Operating expenses	-5,732	-5,843		-4,243	35%	-1.9%	-1,770	-1,482	19%
PBT	2,530	2,075		1,084	133%	21.9%	930	290	221%
Net profit	1,904	1,577	1,808	801	138%	21%	688	186	270%

Source: Company data, SOVLINK estimates

The bank's assets increased by 52% in 2007, which is close to our forecasts. However, the growth of the bank's loan portfolio has been slightly slower than our expectations and the consensus forecast.

Table 2 – Balance sheet summary, RUR mn

	As of 01.01. 2008 (actual)	As of 01.01.2008 (our forecast)	As of 01.01.2008 (consensus)	Difference from forecast	As of 01.10. 2007	As of 01.01. 2007	Change over the year, %	Changes in 2007 / 9M07, %
Assets	111,404	111,608	111,000	-0.2%	100,277	73,426	51.7%	11.1%
Loan portfolio (gross)	80,951	87,552	85,321	-7.5%	79,831	54,380	48.9%	1.4%
Loans as % of assets	73%	78%	77%		77%	71%		
Retail loans	16,765	17,948		-6.6%	15,234	8,982	86.7%	10.0%
Share in loan portfolio	21%	21%			19%	16.5%		
SME loans	48,491	53,407		-9.2%	48,683	34,353	41.2%	-0.4%
Share in loan portfolio	59.9%	61.0%			61.0%	63.2%		
Retail deposits	49,696	50,921		-2.4%	44,909	37,785	31.5%	10.7%
As a share of customer accounts	61%	62%			59.20%	62.3%		
Equity	11,890	11,448		4%	11,202	5,509	116%	6%

Source: Company data, SOVLINK estimates

The bank is still ahead of the Russian banking sector in terms of asset growth (52% vs. 44%); however, it is losing ground in terms of the growth of its loan portfolio (49% vs. 53%). Table 2 shows that growth of the bank's loan portfolio almost stopped in 4Q07. SME loans also declined slightly. A reduction of loans as a part of the bank's assets is due to the bank's need to significantly build up a liquidity cushion as protection against the deteriorating market conditions. The share of loans (net) in the bank's assets shrank from 71.1% at the beginning of 2007 and 76.6% as of 01.07.2007 to 70.1% by the end of the year, whereas the share of liquid assets (cash and cash equivalents) climbed to 11.9% from an average of 5-8%. The portion of securities and accounts with other banks also grew. We consider that this is quite reasonable given the credit crunch, which has persisted since last autumn.



SME loans account for the bulk of the bank's loan portfolio (it is stable at about 60%). Retail loans continue to grow rapidly: with annual growth of almost 87% vs. 57% for the market. The share of retail loans in the loan portfolio expanded to 21% vs. 19% at the beginning of the year. Mortgages as a portion of retail loans also continue to grow (52.7% vs. 46.2% at the beginning of the year). The share of retail loans in the bank's loan portfolio is shrinking – from 33% to 26% – giving way to credit cards (which grew from 13% to 16.4%).

However, the upward trend of overdue loan payments (from 1.8% to 2.5% of the loan portfolio at the beginning of the year) is worrying. Yet, this is still a quite low level, which also reflects the bank's fairly conservative approach in recording bad loans in its financial statements. In case of any delays in payment of the loan of at least one day, Vozrozhdenie, as opposed to most banks, records the whole amount as overdue and increases its loan impairment provision accordingly.

A significant share of such overdue loans is covered through the sale of collateral (with the discount of the loan amount on the collateral totalling 30-50%). The bank introduced a new classification of bad loans, distinguishing between "overdue, but not depreciated loans" (1.92%) and "overdue and depreciated loans" (0.6%). According to management, provisions for loan impairment are sufficient and will not be increased in the near future.

The bank has low dependency on the debt markets (less than 10% of external financing), which is extremely important given the credit crunch in the global financial markets. In March, the bank managed to raise \$59 mn (after increasing it from \$50 mn) via a syndicated loan, at 6M Libor+1.8% (about 4.2%). Given the unfavourable market conditions, an issue of Rouble bonds for RR5bn has been delayed for the time being. The bank has no market debt maturing before the end of 2008. Customer accounts constitute about 82% of its liabilities, of which retail deposits account for 60%. The bank's loan portfolio is covered by its deposit base (with a Loans / Deposits ratio of 96%). Moreover, after the SPO in spring 2007, the bank has a fairly impressive capital adequacy ratio (12.9% for tier 1 capital and 15.9% on its entire capital). Hence, currently, there is no need to raise more capital. Management might address this issue in 2009, based on the development forecasts of the bank and the banking sector on the whole.

The bank has improved its performance indicators (Table 3). On the whole, interest rates on loans were raised more than those for deposits at the end of last year, which enabled the bank to attain a higher interest margin of 6.1% vs. 6% (although a moderate decline was anticipated last year). According to management, the trend for higher rates on loans will continue for the time being, and the bank will be able to retain and even increase its net interest margin. However, we have a more conservative forecast for 2009.

By the end of the year, the bank came close to attaining its mid-term cost efficiency targets (its Cost/Income ratio was reduced to 62.7% vs. an average annual ratio 60-62%) and its ROE (reached 21% vs. a target of 20-25%).



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

March 31, 2008

Table 3 – Performance indicators

	2007	2006	4Q/07	4Q/06
Asset yield	12.3%	12.7%	12.6%	13.4%
Funding costs	-5.1%	-4.9%	-5.1%	-4.9%
Net interest spread	7.2%	7.8%	7.5%	8.5%
ROE	21.0%	18.2%	23.8%	13.7%
ROA	2.1%	1.3%	2.6%	1.1%
Cost / Income	62.7%	73.8%	62.5%	85.8%

Source: Company data, SOVLINK estimates

Management’s forecasts for 2008

Growth of assets	– 35%
Growth of loan portfolio –	over 30%
Including corporate loans	– 28%
Retail loans	– 60%
Growth of borrowings	– 30%
Including corporate deposits –	19%
Retail deposits –	20-25%
New mid-term efficiency targets:	
Cost/Income	55-58%
ROE	20-25%

According to management, a liquidity cushion will be maintained for some time (to cover the anticipated peak quarterly VAT payments in April, and Cabinet reshuffle in May), and subsequently, in case of improving market conditions, may be invested in expanding the bank’s loan portfolio. Besides, the management considers that the increase in corporate deposits may be even higher, provided the financing programmes announced by the government are initiated (which was not taken into account in our conservative forecast).

In conclusion, we positively view the bank’s 2007 IFRS financial results and consider the bank has performed well, taking into consideration the liquidity crunch prevalent in the banking sector. We will revise the fair value of the bank after making the required adjustments in the valuation model.



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:	Target price 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

©2008 Sovlink LLC. The information in the enclosed Report (the "Information") is not an advertisement for any security or particular issuer and should not be interpreted as such. The Information is intended solely for the personal use of Sovlink LLC's clients or other parties pre-agreed to with Sovlink LLC. The Information is not intended for use by citizens of the USA or legal entities registered in the USA. Nothing contained in the Information is, or should be interpreted as being information intended for an undetermined audience.

The Information is exclusively of an informational/analytical nature, and should not be interpreted as a recommendation to take any particular investment action. The Information should not be relied upon as a justification for the execution of any transactions, and should not be referred to as such. Sovlink LLC takes no responsibility for any actions taken on the basis of the Information. The enclosed Report does not contain an offer or an invitation to make an offer to buy or sell any securities or any options, futures or other derivatives related to such securities.

This Report does not have regard to any specific investment objectives, financial situation and the particular needs of any specific person who may receive this Information. Investors should seek financial advice regarding the appropriateness of investing in any securities mentioned and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities, if any, may fluctuate and that each security's price or value may rise or fall. Accordingly, investors may earn less than originally invested. Past performance is not necessarily a guide for future performance. Foreign currency exchange rates may adversely affect the value, price or income of any security mentioned in the Report. Please bear in mind that investment activity in emerging markets is very risky, and investors should conduct their own due-diligence prior to making an investment decision.

The individual(s) responsible for the preparation of this Report (the Author(s)), or Sovlink LLC may hold short- and long-term positions in any of the securities mentioned in the Report, and may take part in investment activities with companies mentioned in the Report.

In preparing this Report, the Author(s) assumed that the issuers mentioned in the Report disclose information in the amount and under the procedure stipulated by the securities legislation of the Russian Federation for issuers who publicly place securities.

This Report and the Information is based exclusively on publicly-available information, which is deemed to be reliable, however Sovlink LLC makes no representation that this Information is accurate or comprehensive, and it should not be relied upon as such. Sovlink LLC makes no representation that this Report has been released to all readers simultaneously, nor that Sovlink LLC will update this material on a regular basis, or that it will correct inaccuracies contained in this Report.