



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

April 10, 2008

# VTB

**INVESTMENT  
ALERT**

**BUY**

**Upside: 49%**

**Target price: 0.140 RUR, \$11.52 (GDR)**

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### Stock data

Ticker	VTBR	M.Cap, \$ mn	25,789
Shares Ords'mn	6,724,138	Free Float, %	22.5%
Shares Prefs	-	Free Float, \$ mn	5,900
Bid Ords, \$	0.0038	Offer Ords, \$	0.0039
Bid Ords, RUR	0.0891	Offer Prefs, \$	0.0924

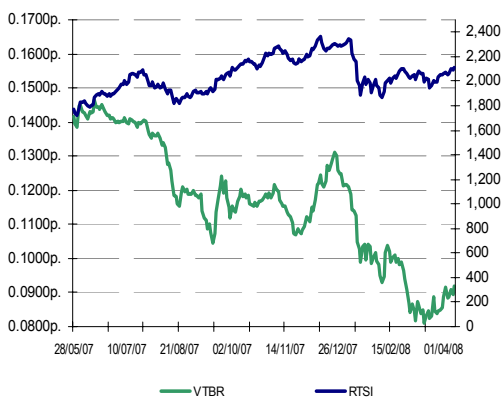
### Market performance

		1 month	6 months
Absolute	Ords		-23.5%
Relative to RTSI	Ords	-0.2%	-23.0%
Price range, \$			
High, RUR	Ords	0.092	0.131
Low, RUR	Ords	0.081	0.081

### Financials, 2007E

Assets, \$ mn	92,609	ROE	12.4%
Book Value, \$ mn	16,207	P/E	17.2
Net income, \$ mn	1,514	P/BV	1.6

### VTB – Relative performance



Source: RTS, MICEX

## 2007 IFRS financial results beat expectations

- On 10 April, VTB released its unaudited IFRS financial statements for 2007. Net profit grew by 28.4% and reached \$1.514 mn, which exceeded our forecast (\$1.316 mn) and the consensus forecast (\$1.39 mn). ROE climbed to 12.4%, also better than market expectations (11.7%).

- Meanwhile, the bank's net interest income rose by 46.5% (\$2.55 mn) on a y-o-y basis and exceeded our forecast by 3.1% and market expectations by 0.7%. Its operating income exceeded expectations by approximately 5.5-6% due to revenues from securities and currency trading. The bank's operating costs increased by 42% (on an annual basis) in 4Q07 with income growing by 33% (on an annual basis). The bank attributes such growth to investments related to the expansion of the VTB24 branch network.

- The main surprise concerned the significant reduction in the Group's tax burden from 16.5% in 3Q07 to 8.3% (!) in 4Q07. Thus, after a noticeable increase in the bank's effective tax rate in 1H07 to the industry average level of 23.5% in 2007, the Group managed to lower its 2007 tax rate to the 2006 level of 16.7%. This is the key reason, why net profit exceeded the consensus forecast by 9%, whilst PBT was only 2.4% higher than forecast.

- Growth of the bank's assets (76.7% vs. 2006) and loan portfolio (the Group more than doubled its loan portfolio in 2007) also exceeded expectations. Despite lower liquidity in the banking system, VTB increased its assets by over 25% in 4Q07 (whereas, growth for the banking sector was 12.9% in dollar terms), and its corporate deposits grew by 37%. Thus, confirming the thesis that large state-owned banks are better positioned to raise funds in conditions of lower liquidity than the banking sector in general.

- Undoubtedly, the noticeable growth of the Group's retail loan portfolio (expanding more than threefold, and thereby increasing its share in the bank's loan portfolio from 8.4% to 12.8%), has contributed to the bank's success. This is a very positive move in terms of improving the bank's interest margins over the mid-term as well as its profitability in general.

- Despite the deterioration in market conditions, the VTB Group managed to considerably expand its market share in major segments. The Group's income structure is gradually improving – income from the bank's principal activities in 2007 accounted for 82% of its operating income vs. 73.5% in 2006. Yet, VTB's performance is still highly sensitive to market factors. Nevertheless, the bank has managed to do well so far, and support from the central bank and other state institutions regarding liquidity in the banking sector (from which large state-run banks are expected to benefit) will probably compensate for the deteriorating funding terms in the market.

- We estimate a year-end fair value of **\$0.0058 per ordinary share (RR 0.140)**, and **\$11.52 per share for VTB's GDRs** and reiterate our **BUY** recommendation. **Based on the bank's final financial statements and updated forecasts for the financial sector, we may revise our target price.**



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On 10 April, VTB released its unaudited IFRS financial statements for 2007. The Group's net profit grew by 28.4% to \$1.514 mn, which significantly exceeded our forecast (\$1.316 mn) and the consensus forecast (\$1.39 mn). The bank's ROE climbed to 12.4%, which also beat market expectations of 11.7%. Overall, for most of the year, forecasts of the bank maintaining its net profit level of 2006 level were considered extremely optimistic by the market, since key non-recurring transactions accounted for about 26% of the bank's income in 2006 and their recurrence in 2007 was not considered likely, given the significant deterioration of market conditions.

The main surprise concerned the significant decrease of the Group's tax burden from 16.5% in 3Q07 to 8.3% (!) in 4Q07. Thus, after a noticeable increase of the bank's effective tax rate in 1H07 to the industry average level of 23.5%, the Group succeeded in reducing its tax rate for 2007 to the 2006 level of 16.7%. This is the key reason why net profit exceeded 9% compared to the consensus forecast, whilst PBT was only 2.4% higher than forecast. During the conference call, management attributed this to non-taxable income from currency transactions and the fact that the bank did not make any tax payments on the proceeds from the sale of EADS shares in 4Q07.

Growth of the bank's assets (76.7% vs. 2006) and loan portfolio (the Group more than doubled its loan portfolio in 2007) also exceeded expectations. Despite lower liquidity in the banking system, VTB increased its assets by more than 25% in 4Q07 (compared to overall growth of 12.9% in dollar terms for the banking sector), and increased its corporate deposits by 37%. The growth was boosted by soaring customer accounts (85% p.a. and 28% in 4Q07), and primarily corporate deposits, which more than doubled in 2007 and increased by 37% in 4Q07. Besides, VTB issued debt securities amounting to \$4.35bn in October-December and increased its bank deposits by \$5.5bn. Thus, confirming the thesis that large state-owned banks are better positioned to raise funds in conditions of tightening liquidity than the banking sector in general.

Undoubtedly, the noticeable growth of the Group's retail loan portfolio (expanding more than threefold, and thereby increasing its share in the bank's loan portfolio from 8.4% to 12.8%), has contributed to the bank's success. The growth of the Group's retail loans exceeded both our and the market's expectations by 6-7%. This is a very positive move in terms of improving the bank's interest margins over the mid-term as well as its profitability in general. This is a very positive shift towards mid-term improvement of the net interest margin and the rate of returns in general.

Meanwhile, the bank's net interest income (\$2.556mn) jumped by 46.5% on a y-o-y basis and exceeded our forecast by 3.1% and market expectations by 0.7%. However, q-o-q growth was moderate (13%), due to a reduction in provisions for loan impairment from 2.8% as of 01.10.2007 to 2.5%, and the Group's adjusted net interest income grew by 27% in 4Q07. The Group failed to fully pass on its increased borrowing costs to its customers (taking out loans), which explains why its interest margin dropped in 4Q07 vs. 3Q07 (from 4.7% to 4.5%, according to our estimates, and from 4.9% to 4.6% according to the bank's estimates). Yet, in late 2007 – early 2008 VTB raised rates on all types loans issued by it, including mortgages (approximately by 1.5 p.p.) and consumer loans (by more than 2 p.p.) – which, despite increasing borrowing costs, should have a positive effect on its margins.

Net fee and commission income jumped higher by 58.7% (\$557 mn) in 2007, which was 1.1% lower than our estimate, but close to the consensus forecast (-0.2%). Excluding non-recurring income and a one time depository fee, growth of the bank's net fee and commission income amounted to 48%. We were quite surprised that given the aggressive expansion of the bank's business, its net fee and commission income dropped by 2.7% in 4Q07 in comparison to 3Q07 (due to income stagnation and growth of fee and commission expenses by 24%).

Thus, revenues from the bank's main activities are almost in line with expectations. However, operating income exceeded expectations by approximately 5% due to securities and currency trading. Overall, operating income grew by 32.8% over the year and only 6% over 4Q07/3Q07.

After an increasing by only 8% in 3Q07, operating costs jumped higher by 37% in 4Q07 in comparison to 3Q07 and exceeded our expectations by 4.8%, and market estimates by 3%. Operating costs grew by 42% in, with payroll and administrative expenses growing at the same pace. The bank's cost/income ratio deteriorated (growing from 42.1% in 2006 to 45.7% in 2007, according to our estimates, and from 50.8% to 53.6% according to the bank's estimates) – the bank's mid-term target aims at a figure not exceeding 50%. The bank attributes the rapid growth of its expenses to its investments related to the expansion of the VTB 24 branch network.



PBT grew by 29.6% in 2007, exceeding the consensus forecast by 2.4%. However, the quality of earnings improved – non-recurring transactions account for 17% (\$316 mn) of revenues compared to 29% in 2006. This includes proceeds of \$161mn from the sale of the bank's stake in EADS, a one-time commission of \$57 mn for depository services and sales proceeds of \$98 mn from the sale of subsidiaries. The Group does not expect any large non-recurring income in 2008 and is counting on generating profit growth from its core activities.

We note that VTB is gradually reducing the proportion of shares and derivatives in its securities portfolio in order to minimize its exposure to market volatility. Nevertheless, the bank suffered a (RAS) loss of over RR6 bn in January 2008 as a result of a lower revaluation of its securities portfolio. However, management expects to make up for weak results in 1Q08 in 2Q08.

Thus, VTB managed to exceed most of its operational and financial targets and considerably expand its market share in major business segments despite the deterioration in market conditions. The Group's revenue structure is gradually improving – income from principal activities accounted for 82% of operating income in 2007 vs. 73.5% in 2006. However, VTB's performance is highly sensitive to market conditions (borrowings and bank deposits account for about 48% of its liabilities, securities account for about 14.5% of its assets, and the Group will have to redeem Eurobonds in 2008-09). Nevertheless, the bank has done well so far, and plans to raise new borrowings in the international markets and increase its deposit base and expects the central bank and other state institutions to invest in the bank deposits of (primarily) large state-run banks – together, this will probably compensate the deteriorating funding terms prevalent in the market.

### The Group's plans up to 2010

- To maintain growth rates at levels above the general level of the Russian market in both, the corporate and retail segments;
- To strengthen its market position in the investment business sector;
- To expand the share of its retail business in the bank's loan portfolio to 25-30%;
- To maintain its net interest margins at the current level;
- To boost its fee and commission income growth rates;
- To maintain its cost/income ratio at a level not higher than 50% (according to VTB's estimates);
- To raise ROE to 15-20%.

In 2008, VTB intends to, at the very least, maintain its net interest margin and reduce its cost/income ratio.

**Table 1 – Financial results, \$ mn**

	2007	Our forecast	Consensus	Difference from our forecast	Difference from consensus	2006	2007 / 2006, %	4Q07	4Q06	4Q07/ 4Q06, %
Interest income	5,387	5,450	5,284	-1.2%	1.9%	3,637	48.1%	1,744	1,057	65.0%
Interest expenses	(2,831)	(2,971)	(2,746)	-4.7%	3.1%	(1,892)	49.6%	(920)	(497)	85.1%
Net interest income	2,556	2,479	2,539	3.1%	0.7%	1,745	46.5%	824	560	47.1%
Net interest income after provision for loan impairment	2,030	2,007		1.1%		1,303	55.8%	653	491	33.0%
Net fee and commission income	557	563	558	-1.1%	-0.2%	351	58.7%	143	87	64.4%
Operating income	3,732	3,545	3,533	5.3%	5.6%	2,810	32.8%	1,162	999	16.3%
Operating expenses	(1,948)	(1,859)	(1,892)	4.8%	3.0%	(1,370)	42.2%	(659)	(487)	35.3%
Profit before tax	1,819	1,686	1,777	7.9%	2.4%	1,404	29.6%	505	470	7.4%
Net profit	1,514	1,316	1,389	15.0%	9.0%	1,179	28.4%	463	363	27.5%

Source: Company data, SOVLINK estimates



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**Table 2 – Balance sheet, \$ mn**

	As of 31.12.2007 (actual)	Our forecast	Consensus	Difference from our forecast	Difference from consensus	Change(in 2007), %	Change for 4Q07 (QoQ), %	Change for 3Q07 (QoQ), %	Change for 2Q07 (QoQ), %	Change for 1Q07 (QoQ), %
Assets	92,609	82,273	81,493	12.6%	13.6%	76.7%	24.7%	12.1%	17.9%	7.2%
Loans to customers (gross)	60,021	53,516	51,718	12.2%	16.1%	98.5%	29.5%	25.9%	12.5%	8.3%
Loans in assets, %	63.2%	63.3%	62.4%	-0.1%	1.3%					
Retail loans	7,682	7,171	7,229	7.1%	6.3%	203.3%	36.8%	36.8%	35.6%	19.5%
As % in loan portfolio	12.8%	13.4%	14.0%	-4.5%	-8.4%					
Customer accounts	37,098	32,514	33,324	14.1%	11.3%	85.6%	28.3%	15.3%	7.3%	17.0%
Retail deposits	10,683	10,989	11,366	-2.8%	-6.0%	45.8%	10.9%	8.5%	12.1%	8.1%
Corporate deposits	26,415	21,525	19,961	22.7%	32.3%	108.6%	36.9%	19.0%	4.8%	22.1%
Equity	16,501	16,029		2.9%		136.0%	3.8%	4.4%	113.0%	2.2%

Source: Company data, SOVLINK estimates

**Table 3 – Profitability ratio, %**

	2007	2006	2007Q4	2006Q4	2007Q3
Asset yield	9.0%	9.5%	9.5%	9.6%	9.1%
Cost of liabilities	-5.1%	-5.0%	-5.6%	-4.6%	-5.1%
Net interest spread	3.9%*	4.5%	3.9%	5.1%	4.0%
Net interest margin	4.3%*	4.6%	4.5%	5.1%	4.7%
Net interest income after provisions / Net operating income	54.4%	46.4%	56.2%	49.1%	46.9%
Net fee and commission income / Net operating income	13.4%	12.5%	12.3%	8.7%	13.4%
ROE	12.4%	19.2%	11.4%	22.0%	14.1%
ROA	2.2%	2.6%	2.2%	2.9%	3.1%
Cost / Income	45.7%	42.1%	49.4%	45.6%	36.7%

According to Sovlink estimates (4.1%), and VTB estimates (4.4%)

Source: Company data, SOVLINK estimates

**Table 4 – VTB and market trends for 2007**

Growth at the beginning of the year, %	Banking sector	VTB
Assets	54.6%	76.7%
Equity	69.3%	136.0%
Corporate loans	45.9%	100.1%
Retail loans	68.4%	203.3%
Retail deposits	45.2%	45.8%
Corporate deposits	58.8%	108.6%

Source: Company data, SOVLINK estimates



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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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