



Sberbank

Company
Note**BUY****Upside: 44%****Target price: \$4.97****Analyst: Olga Belenkaya**

belenkayao@sovlink.ru

Stock data

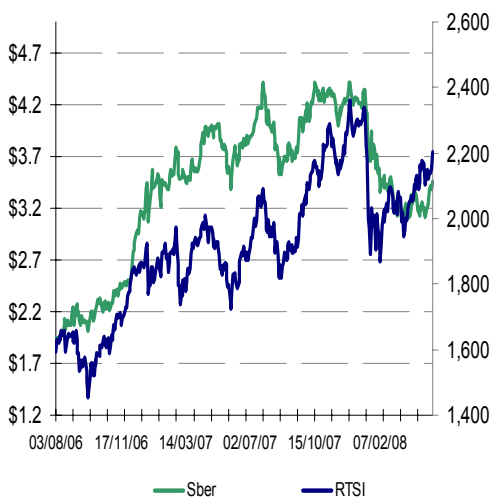
Ticker	Sber	M.Cap, \$ mn	74,690
Shares Ords '000	21,586,948	Free Float, %	40
Shares Pref '000	1,000,000	Free Float, \$ mn	29,876
Bid Ords, \$	3.38	Offer Ords, \$	3.49
Bid Prefs, \$	2.10	Offer Prefs, \$	2.17

Market performance

		1 month	6 months
Absolute	Ords	3.0%	-20.4%
Relative to RTSI	Ords	-1.7%	-16.9%
Price range, \$			
High	Ords	3.46	4.42
Low	Ords	3.11	3.10

Financials, 2008E

Assets, \$ mn	269,050	ROE	20.2%
Book Value, \$ mn	31,123	P/E	13.2
Net income, \$ mn	5,655	P/BV	2.4

Sberbank – Relative performance

Source: RTS

Target price revision

- We revised our Sberbank valuation model based on the bank's 2007 IFRS reports, and its 1Q08 operating results. Our model also takes into account a conference call held on 29 April and management's 2008 forecasts.
- We have lowered our year-end target price for the bank's ordinary shares by 2.0% from **\$5.07 to \$4.97** and reiterate our **BUY** recommendation. Our year-end target price revision is due to more conservative net profit forecasts and a slightly lower anticipated terminal ROE.
- Although the new management team has made numerous statements concerning changes in the bank's strategy, such as expansion in the CIS, CEE and Asia, and the development of an investment banking unit – these are too general to be included in the model. We expect that the bank's strategy will be clearer by the end of the year, when the transitional period is over and a mid-term plan is in place. The adjustments in our model are mostly technical in nature.
- We increased the bank's net interest margin forecast for 2008 from 6.4% to 6.6% (the 2007 level). This is due to, firstly, higher forecast interest rates (against escalating inflation and barriers for corporate clients to the capital markets), and, secondly, positive changes in the bank's funding structure stemming from extremely rapid growth of less expensive corporate deposits. Accordingly, we have raised our net interest and operating income forecasts. We anticipate operating income to grow at 27.8% CAGR through 2008-10 and 17.8% CAGR through 2011-15. In 2008, we estimate operating income to grow at 32-33%.
- Nevertheless, as the bank's IFRS report showed, its operating income growth rates surpassed management's most aggressive preliminary forecasts. Yet, management's 2008 forecasts do not rule out the possibility of expenses growing by 35% (at the same pace as in 2007) vs. growth of 20% estimated in January. According to the bank's deputy head Anton Karamzin, the effect from the cost-reduction measures may be evident only in 2009. This - as well as high inflation expectations - have led us to adjust our operating expenses forecasts for both 2008 (from 22% to 35%) and 2009-10 (from 20-21% to 22-24%).
- As a result of these adjustments, the bank's net income forecast was lowered by 4.8% and 3.7% for 2008 and 2009 respectively, and by 2.3% and 1.7% for 2010 and 2011 respectively. According to our adjusted estimates, the bank's net IFRS profit will reach RR137bn in 2008 (+29% y-o-y), and its net profit CAGR will be 28% through 2008-10.
- At current prices, we find Sberbank an attractive investment target, with potential upside exceeding 40%. Given the increasing interest in the banking sector recently, we hope that the bank will succeed in (at least) realizing some of its potential in the short term.



We revised our valuation model for Sberbank, based on its 2007 IFRS reports and its operating results for 1Q08. Our model also takes into account a conference call held on 29 April and management's forecasts for 2008.

Table 1 – 1Q08 (RAS) results

RUR, bn	01.04.2008	01.01.2008	01.04.2007	YTD, %	y-o-y growth, %	Banking sector, YTD, %
Assets	5,244.75	4,920	3,975.72	6.6%	31.9%	6.0%
Equity	727.5	667.4	602.1	9.0%	20.8%	7.0%
Loan portfolio (including interbank credit)	4,455.9	4,103.9	2,901.3	8.6%	53.6%	12.7%
Corporate loans (w/o interbank credit)	3,329.8	3,076.7	1,998.9	8.2%	66.6%	10.1%
Retail loans	1,013	947	718.9	6.9%	40.9%	7.7%
Customer accounts	4,160.3	3,943.1	3,104.2	5.5%	34.0%	5.3%
Retail deposits	2,746	2,656.2	2,147.7	3.4%	27.9%	3.0%
Corporate deposits	1,414.3	1,286.9	956.5	6.5%	47.9%	6.6%

Source: Company reports, CBR, SOVLINK estimates

In 1Q08, the bank's growth rates were almost in line with those of the market, yet fell behind the market in terms of its loan portfolio. Nevertheless, both corporate and retail loans growth more than doubled compared to 1Q07. Net profit grew by 39.3%, which, according to the bank, is due to an increase in interest and non-interest income stemming from expanding operations and changes in accounting rules effective since January 1, 2008.

Principal adjustments

Although the new management team has made numerous statements concerning changes in the bank's strategy, such as expansion in the CIS, CEE and Asia, and the development of an investment banking unit – these are too general to be included in the model. During the teleconference, the bank's deputy head Anton Karamzin did not disclose any details of their new strategy. He only stated that the bank's strategy would be shaped during 2008. Nevertheless, media statements made by the bank's spokespersons concerning their forecasts until 2014 (expansion of Sberbank's share in the banking sector and attaining annual net profit of at least \$10bn) are on the whole in line with our momentum forecast. We expect that the bank's strategy will become clear up by the end of the year, when the management's transitional period is over and the bank's mid-term strategy is in place. The adjustments we made to our model are mostly technical in nature.

1. Changes in customer accounts: decline in the growth of household deposits and a shift towards less expensive corporate deposits.

Based on Sberbank's 2007 results, there was an increase in corporate deposits as a proportion of customer accounts. Whilst retail deposits grew by 31%, corporate deposits soared by 53. In 1Q08 the trend persisted – the bank's retail deposits grew by only 3.4%, whereas corporate deposits grew by 6.5%.

Currently, there is a general tendency towards a slowdown in the inflow of retail deposits in the banking sector (see Table 1), driven by a decreasing propensity to save as a result of high inflation rates and relatively low deposit rates. At the same time, the inflow of corporate deposits in the largest state-run banks has been accelerating since the outbreak of the credit crisis. This trend is further underpinned by state support and a wider range of corporate finance services, as well as the recent unveiling of state corporation funds by the Ministry of Finance, which may now be placed with the banks. Although Sberbank raised its rates on ruble deposits to attract retail customers, we expect corporate deposits to grow faster than retail deposits. **We lower the growth rates for retail deposits from 35% to 30% and raise the growth rates for corporate deposits from 35% to 40%.** In 2009, we expect retail and corporate deposit growth rates to level out at 29-30%.



Consequences: corporate deposits are less expensive than retail deposits. According to the bank, retail loan servicing costs amounted to 5.8% in rubles and 5.3% in foreign currency in 2007, whereas servicing costs for corporate deposits equaled 3% in rubles and 4.1% in foreign currency. **The expansion of corporate deposits in the bank's portfolio should have a positive impact on its borrowing costs, thus partially offsetting higher deposit rates as a result of competition for customer accounts in the market.** On the whole, we forecast an increase in the bank's borrowing costs from 4.8% to 5.3-5.4% in 2008.

2. **Crediting** - We forecast the bank's assets and loan portfolio to grow by 33%, which is in line with the bank's forecasts (30-35%). Following a temporary decline from 26% to 24%, the share of retail loans in the portfolio will start to grow again and reach, according to our estimates, 25% by the end of the year. The bank's more expensive retail loans will grow gradually, which is also due to the bank's improved technology and the launch of a credit card project. Yet, given escalating inflation (14% p.a.) and barriers facing Russian companies in accessing capital markets, Sberbank is well positioned to moderately raise its rates on corporate loans. In 2008, the bank's asset yield, according to our estimates, will grow from 11.2% to 11.6%.
3. **Given these factors and management's positive expectations, we believe the bank will maintain its high net interest margin (of 6.6% in 2007) in 2008**, compared to our previous estimate of 6.4%. The bank's net interest margin will then gradually decline over the next few years.

Given higher interest margin estimates, **we raise the bank's net interest income by 3.9% in 2008, 1.7% in 2009 and 3-4% subsequently.**

4. We forecast operating income to grow at 27.8% CAGR through 2008-10 and 17.8% CAGR through 2011-15. In 2008, according to our estimates, the bank's operating income will grow at 32-33%. Given the expansion of Sberbank's operations on the stock market, we believe the share of its non-core operating income (gains from securities trading, currency transactions, etc.) will account for 10% of its operating income (in our previous model we predicted it to shrink to 5%).
5. As the 2007 report showed, cost-reduction remains Sberbank's sore spot. In 2007, growth of operating costs (35%) beat preliminary (extremely aggressive) management forecasts (30%, given average annual growth rates of 26%). Whereas earlier management had forecast a slowdown in operating costs to 20% p.a. for 2008, during the bank's recent teleconference, the deputy head of the bank, Anton Karamzin, stated that expenses could continue to grow at 35% given a comparable anticipated growth in revenues. He believes that the impact of cost-reduction measures is likely to be seen only in 2009. This, as well as high inflation expectations, led us to upwardly **adjust operating costs forecasts for both 2008 (from 22% to 35%) and 2009-10 (from 20-21% to 22-24%)**. Subsequently, however, we anticipate a considerable slowdown in the bank's expenses growth rate, although the bank's cost/income ratio, according to our estimates, will be above 50% in the mid-term.
6. **After our adjustments, we lowered our net income forecast by 4.8% and 3.7% in 2008 and 2009 respectively, and by 2.3% and 1.7% in 2010 and 2011 respectively. Our adjustments beyond 2011 are negligible and range within 1%. We estimate the bank's 2008 IFRS net profit, to reach RR137 bn (vs RR144 bn in our previous model), which corresponds to growth of 29% vs. 2007.** Please note that the head of the bank, German Gref, estimates the lower threshold of the bank's RAS net profit at RR130 bn, and, after the shift to accrual accounting, does not expect RAS and IFRS results to differ significantly. According to our estimates, net profit will grow at 28% CAGR through 2008-10.



Ordinary shares valuation

As in our previous model, we estimate the fair value of Sberbank's ordinary shares based on Gordon's modified growth model (target P/BV) ($P/BV = (ROE-g) / (r-g)$). We still forecast terminal ROE rate (g) at 6%, and use a discount rate of 11.46%. However, we lower terminal ROE from 20% to 19.5% as a result of more conservative net profit estimates.

	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Shareholders' equity	24,920	31,123	37,441	43,245	49,399	58,646	69,658	82,400	97,095
Net profit	4,165	5,655	7,143	8,587	10,128	11,909	13,763	15,681	18,081
Equity value			11.46%	11.46%	11.46%	11.46%	11.46%	11.46%	11.46%

Then, applying the Gordon model we calculate target P/BV-2010 at 2.47. Taking budgeted BV-2015 at \$97.095 mn, we estimate Sberbank's fair value at P-2015=\$240.091 mn.

Having discounted the 2008 year-end value, we obtain P-2008=\$112.345 mn, with a year-end target price of \$4.97 per share (vs. our previous target price of \$5.07, which is 2% higher than our current target price), offering potential upside of 44%. Accordingly we reiterate our **BUY** recommendation.

Terminal ROE rate	19.5%
Terminal growth rate	6.0%
Target P/BV-2015	2.47
Equity fair value (P-2015), \$ mn	240,091
Discount rate	11.46
Equity fair value by the end of 2008, \$ mn	112,345
Ordinary shares after SPO, mn	21,587
Preferred shares, mn	1,000
Total shares	22,587
Fair value of 1 ordinary share by the end of 2008, \$	4.97
Total, Fair value of 1 ordinary share by the end of 2008, \$:	4.97
Market value of 1 ordinary share (07.05.2008)	3.46
Upside, %	43.8%
Recommendation	BUY

Preferred shares valuation

We continue to use a discount of 40% in estimating the fair value of the bank's preferred shares. (Although the discount dropped to 37.5% before the closure of the register to pay dividends, we do not regard this decline as a sustainable trend). Hence, we estimate the year-end **fair value of the bank's preferred shares at \$2.98**.

Fair value of Sberbank preferred shares

Fair value of 1 preferred share by the end of 2008, \$	2.98
Market value of 1 preferred share as of 07.05.2008, \$	2.16
Upside, %	38.2%
Recommendation	BUY

Thus, we reiterate our **BUY** recommendation on both Sberbank's ordinary and preferred shares.



Table 2 – Budgeted income statement, RUR mn

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Interest income on loans to customers	214,275	284,174	383,320	572,097	714,050	877,377	1,069,001	1,251,815	1,451,008	1,660,156	1,884,649
Interest income on securities	29,299	28,668	36,234	44,590	50,665	62,343	73,065	91,228	110,374	129,096	148,263
Interest income on loans to other banks	1,948	4,804	9,112	725	1,042	1,228	1,298	1,437	1,716	2,028	2,372
Interest expenses	-89,149	-122,030	-175,905	-267,484	-336,465	-411,283	-497,899	-588,204	-690,214	-799,975	-906,259
Net interest income	156,373	195,616	252,761	349,929	429,292	529,665	645,464	756,275	872,885	991,305	1,129,026
Provisions for loan impairment	-19,602	-13,851	-17,633	-33,338	-32,291	-37,467	-49,354	-55,427	-62,276	-66,787	-73,991
Net interest income after provisions for loan impairment	136,771	181,765	235,128	316,590	397,001	492,198	596,110	700,848	810,608	924,518	1,055,035
Net fee & commission income	35,783	50,076	65,875	83,815	105,607	132,009	163,691	201,340	245,635	297,218	356,661
Operating income	201,995	254,160	335,513	444,895	558,454	693,563	844,223	1,002,431	1,173,603	1,357,484	1,568,551
Operating costs, including payroll	-114,373	-145,140	-195,764	-264,281	-327,709	-399,805	-479,766	-561,326	-651,138	-748,809	-853,642
PBT	87,621	109,020	139,749	180,613	230,745	293,758	364,457	441,105	522,465	608,675	714,909
Profit tax	-21,814	-26,216	-33,260	-43,347	-55,379	-70,502	-87,470	-105,865	-125,392	-146,082	-171,578
Net profit	65,808	82,804	106,489	137,266	175,366	223,256	276,987	335,240	397,073	462,593	543,331

Source: Company data, SOVLINK estimates

Table 3 – Budgeted balance sheet, RUR mn

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Cash and current assets	123,369	169,805	242,231	261,227	225,700	315,980	391,815	391,815	373,008	525,941	663,782
Mandatory reserves	56,809	77,915	56,790	140,212	201,994	266,112	326,869	393,753	468,673	550,253	639,518
Securities	389,154	474,686	503,339	685,720	1,003,111	1,263,920	1,658,684	1,990,421	2,424,552	2,739,278	3,191,259
Loans to other banks	25,932	41,276	5,071	13,061	16,719	21,065	26,121	31,345	37,301	43,828	51,060
Loans and advances to customers	1,787,288	2,541,617	3,921,546	5,222,916	6,639,569	8,374,019	10,300,043	12,463,052	14,893,347	17,499,683	20,387,131
Fixed assets	106,850	125,216	146,850	169,797	208,981	231,719	287,331	344,797	410,309	482,113	561,662
Other assets	23,726	36,158	52,981	37,736	63,185	59,851	69,642	57,423	43,211	73,125	35,658
Total assets	2,513,128	3,466,673	4,928,808	6,530,671	8,359,258	10,532,666	13,060,505	15,672,606	18,650,402	21,914,222	25,530,068
Bank credits and deposits	24,912	44,836	80,321	109,729	133,921	169,349	199,061	210,326	232,971	253,284	271,348
Retail deposits	1,514,302	2,046,035	2,681,986	3,486,582	4,497,691	5,757,044	7,253,875	8,849,728	10,531,176	12,426,788	14,539,342
Corporate deposits	546,806	782,789	1,195,634	1,697,800	2,207,140	2,758,925	3,310,711	3,906,638	4,570,767	5,302,090	6,123,914
Own debt securities	86,890	123,729	163,827	213,683	245,523	282,249	351,283	420,652	532,504	623,469	678,371
Other borrowings	62,964	107,332	112,025	201,147	260,403	348,107	468,378	560,869	648,990	759,853	881,882
Subordinated loans	29,393	26,880	25,064	24,779	25,062	26,542	27,920	28,737	29,451	30,115	30,676
Other liabilities	16,793	26,548	32,754	41,508	70,343	66,074	98,214	44,775	94,901	87,811	86,837
Total liabilities	2,282,059	3,158,149	4,291,611	5,775,229	7,440,082	9,408,290	11,709,441	14,021,724	16,640,761	19,483,410	22,612,370
Total shareholders equity	231,069	308,524	637,197	755,442	919,176	1,124,376	1,351,064	1,650,882	2,009,641	2,430,812	2,917,698

Source: Company data, SOVLINK estimates



Table 4 – Financial ratios

	2005	2006	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
EPS	122.01	160	220	299	378	454	536	630	728	830	957
BVS	431.90	586	1,319	1,647	1,981	2,288	2,614	3,103	3,686	4,360	5,138
P/E	31.87	24.32	17.94	13.21	10.46	8.70	7.38	6.27	5.43	4.76	4.13
P/BV	9.23	6.3	2.9	2.4	2.0	1.7	1.5	1.3	1.1	0.9	0.8
ROE	34.5%	30.9%	22.7%	20.2%	20.8%	21.3%	21.9%	22.0%	21.5%	20.6%	20.1%
ROA	3.0%	2.8%	2.6%	2.4%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%
Asset yield	12.9%	12.2%	11.2%	11.6%	11.0%	10.6%	10.3%	9.9%	9.6%	9.3%	9.1%
Cost of liabilities	-4.5%	-4.5%	-4.8%	-5.4%	-5.1%	-4.9%	-4.8%	-4.6%	-4.5%	-4.5%	-4.3%
Net interest margin	7.7%	7.2%	6.6%	6.6%	6.2%	6.0%	5.8%	5.6%	5.4%	5.2%	5.0%
Operating costs / assts	5.2%	4.9%	4.7%	3.9%	3.7%	3.6%	3.55%	3.50%	3.45%	3.40%	3.35%
Cost / Income	51.6%	54.2%	55.4%	55.3%	55.5%	54.7%	53.7%	53.1%	52.7%	52.6%	52.0%
Fee & commission income / operating income	18.3%	19.7%	19.6%	18.8%	18.9%	19.0%	19.4%	20.1%	20.9%	21.9%	22.7%

Source: Company data, SOVLINK estimates



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

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