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Bank Vozrozhdenie – TP revision

Hold

Target price: US\$ 28
Upside: 29%

Stock data

Ticker	VZRZ	M.Cap \$ mn	522
Shares Ords	23748694	Free Float, %	40
Shares Pref	1294505	Free Float, \$ mn	209
Bid Ords, \$	21.3	Offer Ords, \$	21.9

Market performance

		1 month	6 months
Absolute	Ords	-20.4%	-40.8%
Relative to RTSI	Ords	-18.9%	-22.9%
Price range, \$			
High	Ords	26.9	37.3
Low	Ords	20.9	20.9

Financials, 2011E

Assets, \$ mn	5723	P/E	10.1
Book value, \$ mn	583	P/BV	0.9
Net income, \$ mn	52	ROE	8.6

Relative performance



Source: RTS

We updated the target price for Bank Vozrozhdenie (VZRZ), taking into consideration 9M11 IFRS results and management outlook from the conference call.

Key changes include – 1) higher cost of risk in 4Q11 and 2012; 2) stronger NIM outlook in 2011 and marginally tighter NIM in 2012 due to rising cost of funds; 3) stronger F&C income; 4) lower terminal ROE (16% vs 18% in previous model)

The bank's liquidity position and FX exposure are well-balanced, provisioning policy is prudent and conservative. However, expected worsening in market liquidity situation, risks of assets' quality deterioration and weaker credit demand may pressure bank's ROE in 2012. We expect the situation to improve in 2013.

Lowering the **target price** of Bank Vozrozhdenie **from \$32 to \$28** we notice that 29% upside to current market price imply a recommendation "Buy". However, we reiterate the "**Hold**" recommendation, as we think that investments in the bank's shares may become more relevant after uncertainty about economy and banking sector forecasts diminishes.

The bank now trades at 0.9 BV 2011E, however one-digit ROE limits the attractiveness of shares. We suppose that in mid-term ROE may return to 15-20% - in favorable economy conditions, which will lead to higher valuation. However as we consider a moderately unfavorable scenario, bank Vozrozhdenie's ROE in next 2 years is expected to remain lower than the sector average.

Among the possible market price catalysts we can mention upside risks for macro environment, success in cost optimization process, possible bank SPO in 2H12 and M&A news.

We updated the target price for Bank Vozrozhdenie (VZRZ), taking into consideration 9M11 IFRS results and management outlook from the conference call.

Key changes in the model

1. **Loan book.** We slightly lowered our 2011 loan growth forecast from 23% to 21%, taking into account modest credit growth in 3Q11 and bank's forecast of large loans repayments in 4Q. As we expect moderate worsening of macro conditions, we expect slower loan book growth in 2012 – 15% (unchanged, corresponds to management's upper estimate in the baseline scenario) and in 2013 – to 18% (previous forecast 19%).
2. **Net interest margin.** In 3Q11 (IFRS) bank managed to raise NIM to 5.4% (by bank's methodology – to 4.6% to average assets) due to the minimal cost of funding. Therefore we are increasing NIM outlook for 2011 from 4.9% to 5.0%. However in 4Q the deposit rates markedly increased - bank twice raised interest rates on retail deposits (150-200 bp for ruble deposits, 100 basis points - the currency). The bank mentions that it will affect P&L only since Feb 12. The supportive factors for NIM are – more effective assets mix and a turn in rates on loans which began to rise since August. However, the market liquidity situation continues to deteriorate and banks now have to compete for funds which implies that liabilities may be reprised more rapidly than assets, and NIM may come under pressure. Deputy chairman of the bank A. Shalimov said that NIM may decrease by 20-30 bps in 1H12.

We take into account the risks of higher funding costs in 2012 and expect NIM in 2012 to stay flat to 2011 – around 5.0%, which is 40 bps below 3Q11 level. The NIM on average assets will lower from current 4.6% to 4.5% in 2012, however, it will be higher than on average in 2011 (4.2%). We remain convinced of further moderate NIM increase to 5.1% in 2013 (4.7% on average assets).

3. **Provisions.** The bank significantly increased cost of risk in 3Q11 – to 2.1% (9M11 1.7%), explaining it with rising uncertainty. Management assumes a seasonal decline in 4Q charges in provisions due to the expected large repayments of loans. In 2012, the bank does not exclude some (non-significant) deterioration in asset quality, cost of risk is not expected to exceed 2% in the baseline scenario - close to the average level in 2011 (1.7-1.8%).

In accordance with the rising credit risks and the bank's conservative provisioning policy, we are increasing the forecast for cost of risk: 2011 – to 1.7% (prev. 1.5%), 2012 – to 1.8% (prev. 1.4%), while lowering the 2013 CoR outlook to 1.5% (prev. 1.7%).

4. **Net fees&commissions.** Taking into account strong growth of F&C in 9M11 (21%), driven by cash collection, currency commissions and cash transactions, we are increasing our outlook for 2011 from 18% to 21%, in 2012 – from 15% to 17%. Bank's F&C share in operating income (37%) is the highest among Russian banks, providing support even in case of tighter NIM.
5. **Operating costs.** We like the success in cost control in 3Q11, and decline of FY11 growth forecast from 20% to 17%. In 2012 management expects continued progress as a result of the project cost optimization in collaboration with PwC – however the results will be seen mainly since 3Q12. We suppose that the expenses growth will slow down in 2012 to around 14%, but expect significant improvement in Cost/Income ratio only since 2013. This forecast imply upside risks in case the bank will achieve more success in the costs optimization.
6. As a result of the changes in our model, we marginally cut our **net income** forecast in 2011 by 1% (to 1509 mln Rub), while forecast for 2012 is lowered by 8% and for 2013 – raised by 10%.

	Old forecast, mln Rub	New forecast, mln Rub	Chg, %
2011F	1,531	1,509	-1%
2012F	2,061	1,887	-8%
2013F	2,484	2,726	10%

Valuation

We estimate the fair value of Vozrozhdenie shares based on the modified Gordon model (target P/BV) ($P/BV = (ROE-g) / (r-g)$). We continue to assume a 6% terminal growth rate (g) but we are lowering the terminal ROE rate from 18% to 16%, as expected ROE-13 is about 13%. The discount rate is left at 15%.

	2007	2008	2009	2010	2011F	2012F	2013F
Shareholders' capital, \$mln	484	513	539	553	583	617	726
Net income, \$ mln	74	126	38	19	52	59	85
Cost of equity, %						15.0%	15.0%

Thus, when applying the Gordon model we obtain a target P/BV-2013 of 1.1. Taking the forecast BV-2013 of \$726 mln, we assign to Bank "Vozrozhdenie" a fair value at the end of 2013 at P-2013=\$806 mln.

Terminal ROE	16%
Terminal growth rate	6,0%
Target P/BV-2013	1.1
Fair MCap (P-2013), \$ mln.	806
Discount rate	15%
Fair MCap at the end of 2011, \$mln	610

Ordinary shares, mln	23.7
Preferred shares, mln	1.3
Fair value of 1 ordinary share at the end of 2011, \$	24.3
Fair value of 1 ordinary share in 12M, \$	27.7

Fair value of 1 ordinary share in 12M, \$:	27.7
Market price of 1 ordinary share (30.11.2011 r.)	21.4
Upside, %	29%
Recommendation	Hold

We are lowering the target price of Bank Vozrozhdenie from \$32 to \$28 and 29% upside to current market price imply a recommendation "Buy". However, we think that investments in the bank's shares may become more relevant after uncertainty about economy and banking sector forecasts diminishes. The bank now trades at 0.9 BV 2011E, however the one-digit ROE limits the attractiveness of shares. We suppose that in mid-term ROE may return to 15-20% - in favorable economy conditions, which will lead to higher valuation. However as we consider a moderately unfavorable scenario, bank Vozrozhdenie's ROE in next 2 years is expected to remain lower than the sector average, therefore we assign **recommendation «Hold»**.

Projected financial position, mln Rub

Balance, mln Rub	2008	2009	2010	2011F	2012F	2013F
Cash and equivalents	28,490	34,101	32,151	27,042	24,013	22,713
Mandatory reserves	155	868	1,072	1,983	2,201	2,498
Securities	11,401	11,068	15,869	16,766	18,010	18,170
Loans to banks	2,032	6,363	5,860	901	4,002	4,543
Loans and advances to customers	94,575	85,205	104,046	126,448	144,715	170,953
Premises and equipment	3,234	3,102	3,132	3,065	3,202	3,407
Other assets	1,324	4,896	4,028	4,076	3,969	4,844
Total assets	141,211	145,603	166,158	180,281	200,112	227,128
Due to banks	21,360	4,368	7,772	8,096	8,634	8,780
Retail deposits	51,837	68,564	85,251	88,661	100,187	118,221
Corporate customers funds	38,499	44,565	45,083	51,395	56,534	62,753
Debt instruments in issue	5,913	6,364	5,794	6,086	8,095	8,372
Other borrowed funds						
Subordinated loans	4,464	4,578	4,293	4,228	4,228	4,228
Syndicated loans	3,337	-	-	-	-	-
Other liabilities	736	878	1,105	3,460	2,207	1,835
Total liabilities	126,146	129,317	149,298	161,926	179,885	204,189
Shareholders' equity	15,065	16,286	16,860	18,355	20,227	22,939

Projected income statement, mln Rub

	2007	2008	2009	2010	2011F	2012F	2013F
Interest income	9,745	14,511	16,954	14,138	13,953	17,411	20,697
Interest expenses	-4,175	-6,017	-8,628	-8,109	-6,706	-8,940	-10,633
Net interest income	5,570	8,494	8,326	3,075	7,247	8,471	10,064
Provisions charges for loans impairment	-885	-2,199	-4,752	-1,872	-2,206	-2,683	-2,673
Net interest income after provision charges	4,685	6,295	3,574	1,203	5,041	5,788	7,392
Net fee&commission income	3,011	4,128	3,729	3,935	4,747	5,548	6,525
Operating income	8,262	11,131	8,244	8,027	10,287	11,935	14,517
Operating expenses	-5,732	-7,029	-6,325	-7,180	-8,401	-9,577	-11,109
Pre-tax profit	2,530	4,102	1,919	726	1,887	2,359	3,408
Income tax expense	-626	-965	-702	-145	-377	-472	-682
Net income	1,904	3,137	1,217	581	1,509	1,887	2,726

Projected financial ratios

	2007	2008	2009	2010	2011F	2012F	2013F
Asset yield	12.2%	13.9%	15.1%	4.9%	9.5%	10.2%	10.5%
Cost of funding	-5.0%	-5.4%	-6.9%	-5.9%	-4.4%	-5.3%	-5.6%
Net interest spread	7.2%	8.5%	8.2%	-0.9%	5.2%	4.9%	4.9%
Net interest margin	7.0%	8.1%	7.4%	2.5%	5.0%	5.0%	5.1%
ROE	21.9%	23.3%	7.8%	3.5%	8.6%	9.8%	12.6%
ROA	2.1%	2.5%	0.8%	0.4%	0.9%	1.0%	1.3%
Cost/Income	62.7%	52.7%	48.7%	72.5%	67.2%	65.5%	55.5%
P/E	8.2	5.4	16.1	32.3	10.1	8.9	6.2
P/BV	1.3	1.2	1.1	1.1	0.9	0.8	0.7

Sources: company data, Sovlink

Stock recommendations

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

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