Ukraine / Banking

Aval

Company Profile

BUY

02 Aug 2005 USD 0.06

12m Target USD 0.07

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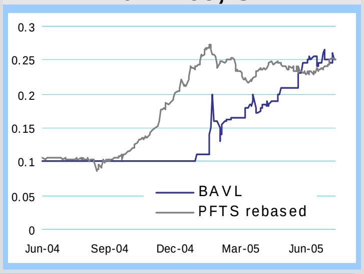
Ukraine's #2 bank, expected to be acquired by an international major by year end, promising moderate upside. We initiate coverage issuing a BUY recommendation

BAVL Bid-Price, UAH



Market Information	
PFTS	**BAVL**
Bloomberg	**BAVL UZ**
No of Shares, mn	9,950
Market price, USD	0.06
MCap, USD mn	597
Free Float, %	10%

Stock Ownership	
Management	**<50%**
Employees	**12%**
Other	**38%**

Ratios 2004	
Net Int. Margin	6.0%
ROE	22.5%
Capital Adequacy	10.1%
Cost/Income	86.2%

A leader of the Ukrainian banking sector. Aval, with total assets of USD2.1 bln, has a 8.8% share of total banking assets in Ukraine and ranks #2. Hit by deposit withdrawals in the political crisis of late 2004, Aval in 2005 has recovered very quickly. During first five months, the bank's assets grew 19.2%, outpacing the industry average of 15.5%. The bank has been able to maintain strong operational results, with 2004's ROA and ROE at 1.7% and 22.5% respectively, well above the industry average.

Maturity mismatches. Currently Aval faces the problem of lacking medium and long-term funding sources to match its increasingly longer assets (mortgage and consumer loans). While assets with 1-5 year maturities constitute ~25% of total earning assets, the bank's liabilities with the same maturity account for only ~4%.

Easy access to foreign financing. Aval is one of the few Ukrainian banks to have easy access to financing and syndicated loans from global banks to improve capital efficiency and meet NBU requirements. We expect the maturity mismatch risk will be mitigated via long-term debts from international organizations.

International banks target Aval. In February 2005, Aval began official talks with Raiffeisenbank on sale of control in the bank. If the deal is successful, Raiffeisen group will gain a leading position in the Ukrainian banking sector with almost a 11.6% share of total banking assets. Aval in turn will benefit from Raiffeisen's management expertise, advanced banking technology and additional capital.

KEY FINANCIAL DATA, USD mn

	Assets	Net Loans	Total Revenue	Net Income
2004	2142	1496	244	33
2005E	3052	2164	291	40
2006E	3934	2932	364	53
Spot Exch Rate	5.05			

KEY RATIOS

	P/E	P/BV	P/Assets	P/Deposits
2004	18.1	3.6	0.3	0.4
2005E	15.3	2.3	0.2	0.2
2006E	11.3	1.5	0.2	0.2

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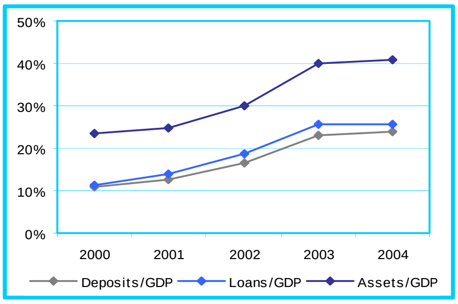
Industry Background

Fast Growth

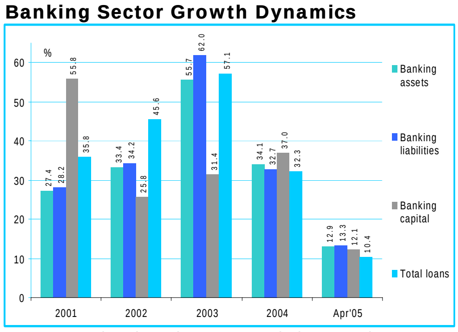
The banking sector in Ukraine has almost doubled in size over the last two years. Total net assets during the 2001-04 period, loans and deposits in Ukrainian banks increased almost four fold. The pace of growth was several times higher than in other economic sectors.

Banking Assets, Deposits & Loans, % of GDP



Source: National Bank, State Statistic Committee, Concorde Capital calculations

Banking Sector Growth Dynamics



Source: National Bank, State Statistic Committee, Concorde Capital calculations

The banking sector in Ukraine has performed well compared to other countries in Central and Eastern Europe (CEE). With an average asset growth rate of 38.3%, Ukraine's banking sector has been the fastest growing in CEE, outpacing Romania and Bulgaria at 20% and 25%, respectively. Overall deposit and lending growth in Ukraine is significantly higher than in CEE. For 2000-03, the compound average growth rates in lending and deposits were 56.8% and 56.5% respectively – compared to a 12% CAGR in CEE countries.

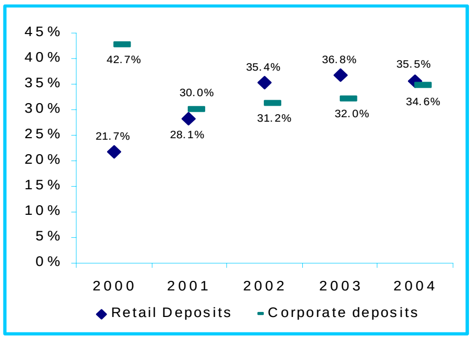
Despite rapid growth, it is still a great deal of potential...

Despite rapid growth in recent years, Ukraine's banking segment still has a great deal of potential. For a example, deposit as a percentage of GDP, in Ukraine, 23.2%, is far below 44% in CEE and 73% in the EU. Lending is similar, 25.7%, roughly one-fourth of the average level in the euro area and lower than the 34% in CEE countries. Considering total banking assets, the difference is even more striking: Ukrainian banking assets are about 40% of GDP, much less than average 74% in CEE and 201% in the euro area which clearly signals a great deal of catch-up potential.

Retail Segment Is A Key Growth Driver

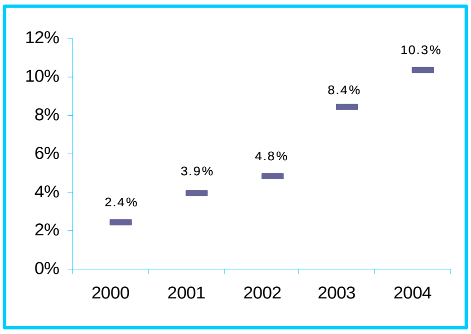
Fast growth rates of banking sector achieved in recent years were mainly due to rapidly expanding corporate lending (41.4% CAGR in 2001-04) but retail segment takes a more significant role. Lending to private customers demonstrates a significantly outpacing rates of expansion over corporate segment: 98.5% CAGR in 2001-04. The overall growth potential in retail segment becomes obvious when compared with Euro zone and CEE countries, where lending to private customers is at about 50% and 12.4% of GDP respectively, while in Ukraine this indicator is around 4.0% of GDP.

Retail & Corporate Deposits/Total Liabilities



Source: National Bank

Retail Loans/Total Assets



Source: National Bank

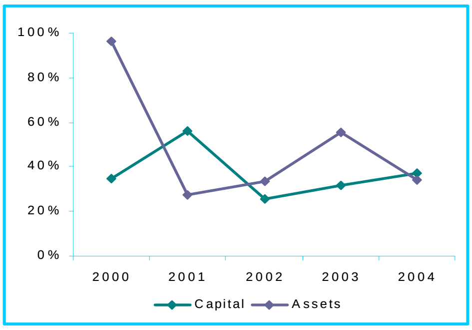
In 2002 deposits from private customers became a main source of funds for Ukrainian banks reaching a 35.4% share in total banks' liabilities exceeding the corporate deposits share of 31.2%. The smaller share of retail deposits in banks' liabilities in 2004 is explained by massive deposit withdrawals caused by political crisis during last two months of 2004. However in 2005 the Ukrainian banks quickly restored the growth rates of retail deposits. For the first five months of 2005 banks increased their retail deposit base by 28% that is equal to the growth rate for the whole last year.

Capital Sufficiency Is Under Constant Pressure

Rapid assets growth exert pressure on capital sufficiency…

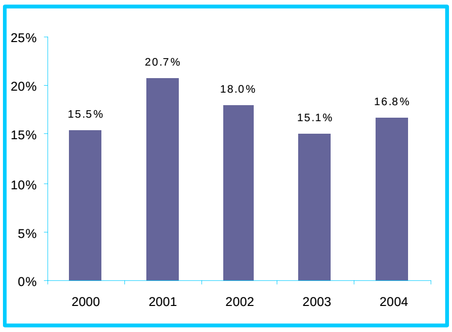
The rapidly growing assets (37.4% CAGR in 2001-04) continuously exert pressure on banks' capital sufficiency. The whole Ukrainian banking system demonstrates a cyclical pattern of development: period of rapid assets growth is followed by period when banks have to limit their lending activity and increase the capital base to meet National Bank's requirements (a min capital adequacy ratio of risk-weighted assets).

Capital & Assets Growth Dynamics



Source: National Bank, Concorde Capital calculations

Capital Adequacy Ratio Dynamics



Source: National Bank

Internal sources are insufficient to match assets growth…

In March 2004 the National Bank of Ukraine (NBU) required commercial banks to maintain a minimum capital adequacy ratio of 10% (8% in 2003) of risk-weighted assets. Three main sources are used by Ukrainian banks to increase its capital and thus to support the further business development: share emissions, retained earnings and subordinated debt. It is a common practice for Ukrainian banks to hold regular additional share emissions (from one to three times a year) and use retained profits to rise their capital sufficiency. However these sources are extremely insufficient to match rapid increase in assets. Debts on subordinated terms attracted from foreign credit institutions is not easily available for many Ukrainian banks and can be considered only as a temporary measure to meet NBU's capital requirements. Under these circumstances attraction of strategic foreign investor, able to provide sufficient capital, becomes very topical for many Ukrainian banks. Even NBU, recognizing the seriousness of undercapitalization, recently recommended Ukrainian banks to attract foreign shareholders more actively in order to support their required level of capitalization.

Foreign Banks Eye Ukraine

Due to the remarkable performance achieved in recent years, Ukrainian banking sector has become an object of close attention from the side of foreign banking institutions both from Europe and CIS. Foreign banks' interest in Ukrainian market has notably increased this year with several large European banking groups have announced their plans to enter Ukrainian market. The process of foreign banks enter into Ukrainian market both through acquiring the stakes in local banks and opening their own structural divisions actively began in 2004 and will intensify in coming years.

M&A Deals In 2004

Buyer	Target	Acquired stake	P/E	P/BV
PKO Bank Polski (Poland)	Kredit Bank	USD30 mln for 66.65%	30.5	1.6
Bank NRB-Ukraine (structural division of Russian bank)	Energobank	21.88%		
Turanalem (Kazakhstan)	Transbank	USD17.9 mln for 10%	282.1	15.9
Vilniaus Bankas (Lithuania) (member of SEB group)	Azhio	EUR23.2 mln for >90%	24.5	1.5

Announced Plans Of Foreign Banks As To Ukraine

Bank	Country	Comments
Vneshtorgbank	Russia	Opened its structural division in March, 2005 - Vneshtorgbank (Ukraine). Plans an acquisition of medium-sized Ukrainian bank in 2006.
Bank Of Moscow	Russia	Opens structural division Bank Of Moscow (Ukraine) by the end of 2005.
Alfa Bank	Russia	The most probable buyer of Ukrsotsbank (fourth-largest Ukrainian bank in terms of assets). The deal can be completed by September, 2005.
Commertzbank	Germany	Plans to upgrade its representative office to structural division - Commertzbank (Ukraine)
BNP Paribas	France	To open a representative office in 2005
Erste Bank	Austria	Targets Oshadbank (Saving bank)
Banka Intesa	Italy	Considers acquisition of Ukrainian bank in 2005-06
Raiffeisenbank	Austria	Since February, 2005 in talks with Aval on buying control stake in the bank
Finansbank	Turkey	Opens structural division by the end of 2005

Aval On The Front Line

Strong Leading Position

The second-largest Ukrainian bank…

Aval is the second-largest Ukrainian bank in terms of assets, capital and lending activity and has an extensive corporate and retail client base. During 2001-04 Aval showed remarkable assets growth rates: 37.4% CAGR that match industry average growth. The achieved growth rate was mainly due to the rapid expansion in lending activity at 66.1% CAGR in 2001-04, far above industry average growth of 42.3% CAGR.

The principal strengths of Aval are cash management, trade finance and electronic banking. In addition Aval has a unique position in Ukraine which is determined by the special mission assigned to the bank by the Ukrainian government with regard to service the national telecommunication industry and postal system as well as customs.

Comparison Table Of Top-10 Ukrainian Banks

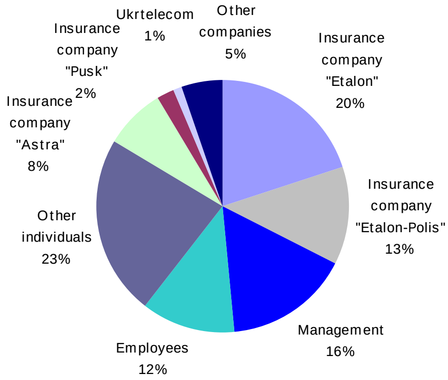
	2004					
	Total Assets	***% of all Ukr***	**Loan Portfolio**	***% of all Ukr***	**Capital**	***% of all Ukr***
Privatbank	2765	*10.9*	1607	*10.5*	275.9	*7.9*
Aval	***2235***	***8.8***	***1523***	***9.9***	***245.6***	***7.1***
Prominvestbank	1998	*7.9*	1417	*9.2*	219.9	*6.3*
Ukrsotsbank	1332	*5.3*	748	*4.9*	171.5	*4.9*
Ukrsibbank	1071	*4.2*	644	*4.2*	139.8	*4.0*
Ukreximbank	998	*3.9*	663	*4.3*	115.8	*3.3*
Oshadbank	956	*3.8*	305	*2.0*	66.9	*1.9*
Raiffeisenbank	831	*3.3*	608	*4.0*	66.7	*1.9*
Nadra	733	*2.9*	466	*3.0*	69.1	*2.0*
Brokbisnesbank	522	*2.1*	330	*2.1*	71.9	*2.1*

Source: National Bank, Concorde Capital calculations

The largest independent bank…

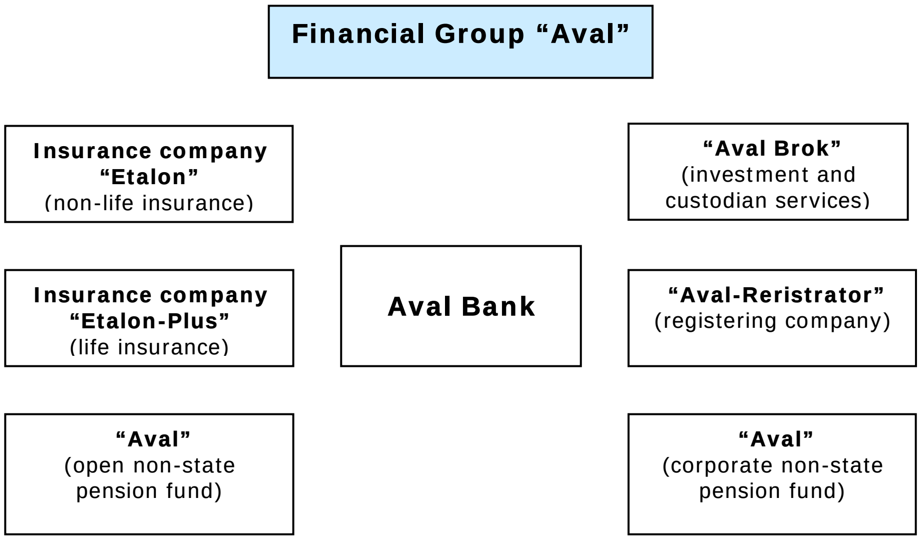
Aval is the biggest publicly traded Ukrainian bank and not affiliated with any business groups. The bank has a diversified client base that includes some of the biggest Ukrainian corporations, although Aval remains independent of its largest clients. Alal's shares are distributed among 120,000 of individuals and a group of companies. Aval's management holds a major stake in the bank through 16% stake in the share capital and affiliating companies.

Aval's Ownership Structure, as of Dec-31



Source: Company's data

Aval is a major part of financial group “Aval”:



Market Share And Competition

Competition is quite strong…

The Bank faces competition from a number of existing participants in the banking sector in Ukraine, particularly Privatbank and UkrSotsbank. Set forth below is a description of the Bank's principal competitors:

- *Privatbank*. Headquartered in Dnipropetrovsk, with branches in Russia, Kazakhstan, Moldova and Cyprus, Privatbank is among the five best known banks in Ukraine and is the largest bank in terms of banking assets, customer deposits and loans, based on statistics from the NBU. As at 31 December 2004, it had total assets of USD2.7 bn according to the NBU. It is the largest issuer of bank cards in Ukraine and has the second largest network of branches. It also has the largest network of ATMs. Its principal businesses are corporate and retail banking. Privatbank can be considered as the most serious competitor to Aval.

- *UkrSotsbank*. UkrSotsbank is the fourth largest bank in Ukraine in terms of assets, based according to the NBU, and has an extensive network of branches throughout Ukraine. As at 31 December 2004, it had total assets of USD1.3 bn as to the NBU estimation. In addition to providing a range of retail and corporate banking services, it is one of the leading underwriters of domestic bonds.

- *Other banks*. The largest in Ukraine branch network of Oshadbank (Saving bank) makes it one of Aval’s main competitors with respect to retail banking. However currently Oshadbank (100% state-owned) could not be considered as a strong competitor to Aval as the bank lacks of sufficient management quality and clearly defined strategy. In 2004 Oshadbank considerably lost its market share in terms of assets to 3.8% from 5.6% in 2003.

Prominvestbank could be considered as one of the bank’s major competitors in corporate banking services.

Political crisis resulted in market share lost in 2004…

Aval has somewhat lost its market share in 2004 to 8.8% from 9.9% in 2003 in terms of assets, due mostly to end of year events. During political instability in November-December 2004 Aval had to discard new loan projects in order to keep up with increased current payments caused by massive deposit withdrawals. As a result the share of retail deposits in total bank’s liabilities fell to 42.3% from 45.1% in 2003. Private deposit withdrawals affected all banking system. However many banks were able to offset the lost of retail deposits by growth in corporate ones and thus not only to preserve their shares in the market but even increase it. Thus Privatbank managed to increase notably its corporate deposit base by 91% rising its share to 27% of total liabilities (19% in 2003) that was more than enough to offset a 6% fall in retail deposit share. Due to this Privatbank was able to extend further its lending activity and outpace Aval gaining a leading position in the market having achieved a 10.9% market share (9.6% in 2003).

However in 2005 as the crisis passed and deposit of population started to grow again, Aval quickly restored its operations volume. During first five months of 2005 Aval's assets grew by 19.2%, outpacing industry average of 15.5% mostly due to growth in loan portfolio by 24.4% to USD1861 mln.

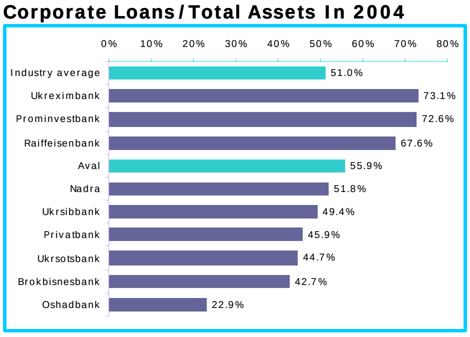
Corporate Banking Is The Core Business

Strong positions in corporate segment…

Corporate lending has been always a traditional business segment for Aval. Loans to companies represented 56% of total bank's assets. Aval with corporate loans of USD1254 mln as of December 2004 is the third-largest corporate lender in Ukraine. Currently Aval services around 214,000 of corporate clients. Among them are such big names as Ukrainian Mobile Communications (UMC), Coca-Cola Beverages, McDonald's Ukraine Ltd., Zepter International Ukraine, Gillette Ukraine, Obolon brewery and Avon Cosmetics.

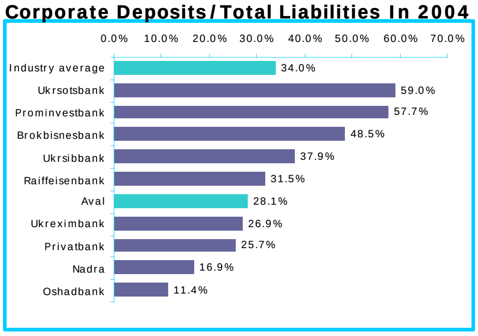
Aval closely co-operates with Ukrainian government entities. The bank is servicing accounts of Ukrtelecom (the national monopoly of fixed-line telecommunication services), UkrPoshta (Ukrainian post) and State Customs Authority.

Corporate Loans/Total Assets In 2004



Source: National Bank, Association of Ukrainian banks

Corporate Deposits/Total Liabilities In 2004



Source: National Bank, Association of Ukrainian banks

Strong Focus On Retail Banking

Aval gaining a strong focus on retail segment…

Although Aval traditionally orients its lending activity on corporate clients, the retail segment starts to play more and more important role in bank's operations. According to Aval's strategy, development of the consumer lending will be the priority during the next years.

Over 2001-04 period Aval extended its lending activity to private customers significantly – 123% CAGR, above the industry average of 98.5%. As of December 2004 the bank's retail loans amounted to USD360 mln (22.3% of gross loan portfolio), which makes Aval the second-largest lender to private customers in Ukraine. Additionally Aval is one of the leading banks providing salary payments projects, one of the third-largest issuer of credit/debit cards and has the second-largest ATMs network in the country.

Deposits from private customers is the major source for Aval to fund its operations. For the last four years Aval increased its retail deposit base by more than nine times to USD989 mln in 2004 that represent 62.2% of its total deposit base. Currently Aval is the second-largest bank in Ukraine in generating funds from population.

In recent years Aval invested a critical amount of funds in expansion its distribution channels with technologically advanced methods such as internet banking, mobile banking and PC banking.

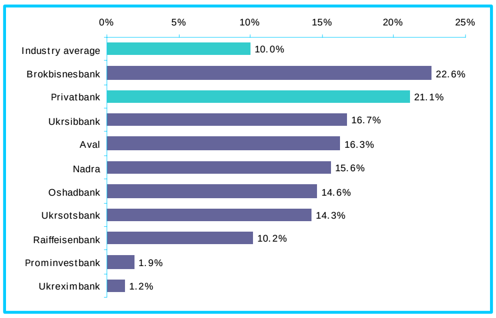
Aval has a strong presence in the regions: the bank's branch network is the third-largest in the country (1400 branches and outlets). Along with great experience in retail banking development and the bank's franchise, which is among most widely recognized in the country, Aval will be able to benefit significantly from fast growing consumer lending market.

Customer Deposit Structure, USD mln

	2004	%	2003	%	2002	%
Government bodies	42	2.7	155	11.1	247	26.8
Individuals	989	62.2	817	58.9	434	47.1
Corporates	558	35.1	415	30	243	26.1
Amounts due to customers	**1589**	**100**	**1387**	**100**	**921**	**100**

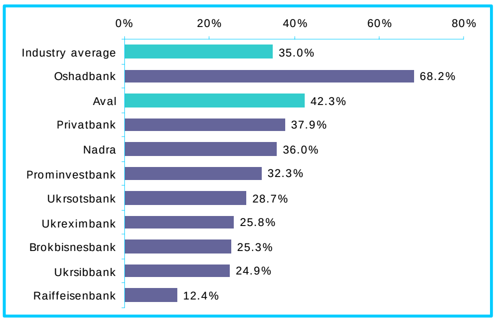
Source: Company's data

Retail Loans/Total Assets In 2004



Source: National Bank, Association of Ukrainian banks

Retail Deposits/Total Liabilities In 2004



Source: National Bank, Association of Ukrainian banks

Financial Review

The bank's total assets amounted to USD2.1 bn as of December 31, 2004 that represent 9% share in total banking assets in Ukraine (ranked #2). The bank's assets have grown considerably – 37.5% CAGR in 2001-04 that is almost equal to industry average growth of 37.6% CAGR.

Aval's Asset Structure

	1Q2005	%	2004	%	2003	%
Cash and Due from NBU	400.9	*16.3*	202.2	*9.4*	121.9	*6.7*
Amounts due from other banks	183.1	*7.4*	178.8	*8.3*	243.1	*13.4*
Net loans to customers	1571.6	*63.9*	1496.0	*69.8*	1231.3	*68*
Investment securities	47.6	*2.0*	57.9	*2.7*	50.5	*2.8*
Property and equipment	175.9	*7.2*	176.0	*8.2*	123.0	*6.8*
Other	79.5	*3.2*	31.1	*1.6*	42.5	*2.3*
Total assets	**1458.5**	***100***	**2142.1**	***100***	**1812.2**	***100***

Source: Company's data

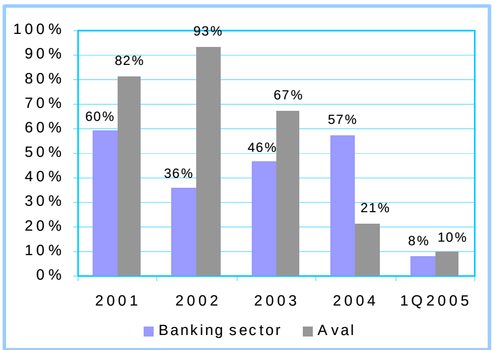
The bank's securities portfolio consists mainly of corporate bonds (USD49 mln), ~40% of which are collateralized by the National Bank (NBU). Amounts due from banks fell by 27% in 2004 in the result of crisis of liquidity. Around 50% of amount due from other banks are distributed among three banks that represents considerable concentration risk for the bank. Due to the revaluation of fixed assets (took place in early January 2004) by ~USD30 mln and some new acquisitions fixed assets grew significantly in 2004.

Loan Expansion Drives The Asset Growth

Balance sheet growth was primarily fuelled by a significant expansion in lending activity…

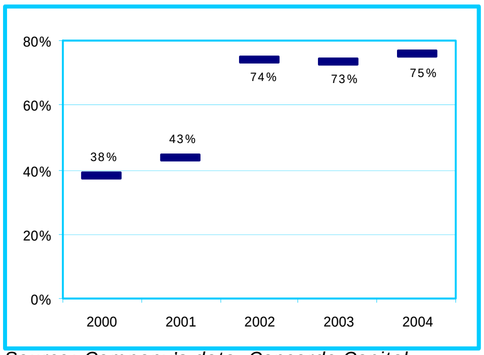
The bank's balance sheet growth was mainly fuelled by a significant expansion in lending. For 2001-04, the gross loan portfolio (GLP) demonstrated a considerable growth rates at 63.3% CAGR, above banking sector average growth of 49.4%. As of December 31, 2004 the bank's GLP amounted to USD 1615.2 mln that represents ~70% in total assets.

Gross Loan Portfolio Growth



Source: Company's data, Concorde Capital calculations

Gross Loan Portfolio / Total Assets



Source: Company's data, Concorde Capital calculations

Loan portfolio quality appears to be strong…

Despite concerns that quick loan portfolio would lead to deterioration of assets quality, Aval has been able to maintain an acceptable quality level of its loans. As of December 31, 2004 non-performing loans (NPL) amounted to USD51.7 mln that represent a 3.2% (down from 4.0% in 2003) share of GLP, which is equal to market average. Loan loss provisions (LLP) as of December 31, 2004 were two times higher than NPL and amounted to USD119 mln that accounts for 7.4% share of GLP. The bank's strategic goal is to rise LLP share in gross loan portfolio to 10% till 2006. In short-run perspective this will lead to some decrease in margins. However in case the bank is able to keep the level of NPLs at current level, the large portion of decreased income will be reversed in future periods.

However, being one of the largest banks servicing export/import operations, Aval has a large portion of contingent trade-related liabilities. Its off-balance sheet contingent exposure amounted to USD137 mln in 2004 and rapidly grew to USD292 mln as of

June 1, 2005 (15.7% of GLP). Provisions under these instruments at USD0.36 mln are definitely insufficient to cover the possible default risks. However the bank's management does not plan to increase further its contingent liabilities and is going to limit their share to 14-15% of GLP.

Liquidity

NBU's liquidity ratios are above the required levels…

Aval's liquidity ratios (acid, current and short-term liquidity) were above NBU requirements:

Ratios	required by NBU	Dec'2003	May'2004	Dec'2004
Acid Test	20%	35.1	39.0	39.3
Current Ratio	40%	43.0	45.4	53.4
Short-term Ratio (1 year)	20%	21.5	22.3	25.3

Source: Concorde Capital data

Aval became a net bank-to-bank market borrower on the Ukrainian interbank market in 2004. "Due to banks/Due from banks" ratio equaled to 1.36 as of the end of 2004 (0.47 in 2002 and 0.86 in 2003). As of May 2005 the ratio further deteriorated to 1.87 in the course of attracting of USD145 mln in syndicated loan and 2-year deposit from Standard Bank and Merrill Lynch.

the bank may face the liquidity problems in the future caused by maturity differences in assets and liabilities. The bank is constantly in the search of short-term money instead of issuing a longer-term debt instruments. Aval's management doesn't consider issuance of 5-7 year Eurobonds at the moment, initially planned for this year; the bank opts to refinance itself with short-term syndicated loans and 2-3 year term deposits from institutional investors.

Liability maturity is lagging behind assets…

Currently the main problem for Aval is lack of medium and long-term funding sources to match its increasingly longer assets (mortgage and consumer loans). Although the share of long-term loans in GLP increased to 44% in 2004 from 33.8% a year earlier and term deposits account for ~47% (49% in 2003) of total deposits, disproportion in maturities is observed. While assets with 1-5 year maturity constitute around 25% of total earning assets, bank's liabilities with the same maturity account for only ~4% of total earning liabilities.

We expect Aval to be able to fill this maturity gap in 2005-06 due to the drawing of long-term debts from international financial organizations. Aval is one of few Ukrainian banks having easy access to international financial organizations. The bank regularly draws syndicated loans from large international banks as well as attracts debts on subordinated terms to improve capital efficiency and meet NBU's requirements. In February 2005 Aval received a subordinated debt from International Financial Corporation (IFC) in the amount of USD20 mln on 5-year tenor and in June Aval signed another agreement with IFC on USD50 mln subordinated debt with maturity 7 years. The bank also received another loan from IFC in the amount of USD15 mln with maturity in June 2009.

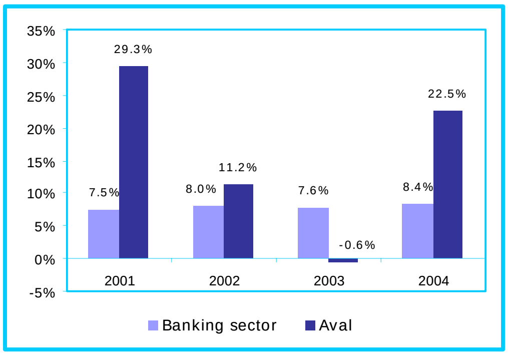
Revenues And Profitability

Aval demonstrated high profitability performance in 2004: net income was USD32.9 mln compared to loss of USD7.0 mln in 2003. Negative net income was registered after restatement of audited financials in 2004. Before restatement was made Aval posted net income of USD12.8 mln. Such decrease in income can be largely explained by bad-debt write-offs in the amount of USD7.8 mln made in 2004 but to be acknowledge in 2003 results. In addition corrections towards increase in overheads were made.

Profitability is among the highest in the industry…

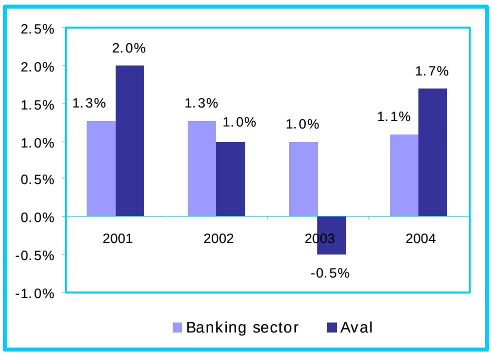
Aval's ROE in 2004 at 22.5% and ROA 1.7% were among the highest in Ukrainian banking sector and far above the industry average of 8.4% and 1.1% respectively. The rise in profitability can be explained by growth of commission income by 48.4% to US$141.8MM and interest income by 31.6% to USD233 mln. Network rationalization and strict cost control introduced by the bank in 2004 resulted in moderate growth of operating expenses by 8.3%, despite network expansion. Cost/income ratio fell to 87.7% of total income in 2004 from 101% in 2003, above industry average of 93%.

Aval's ROE vs. Industry Average



Source: Company's financials, National Bank Concorde Capital calculations

Aval's ROA vs. Industry Average



Source: Company's financials, National Bank Concorde Capital calculations

Discrepancy between IFRS and Ukrainian standards causes a difference in bank's profits…

The considerable discrepancy between International Financial Reporting Standards (IFRS) and Ukrainian ones (UAR) with regard to profits results in huge differences in Aval's results. While Ukrainian accounting standards register only USD3.0 mln were earned in 2004, according IFRS Aval's net income was USD32.9 mnl. Such a huge difference in Aval's case may be explained by capital distribution in form of purchase of credit insurance from shareholders (Aval has four insurance companies among its shareholders), which IFRS recognized as capital distribution and not operational costs. Aval's management usually uses this scheme to optimize its corporate tax payments.

Capitalization Adequate

Capitalization is adequate but under the constant pressure…

The rapidly growing assets (37.4% CAGR in 2001-04) continuously exert pressure on bank's capital sufficiency that is a common problem for all Ukrainian banks. During 2004 the National Bank of Ukraine required banks to maintain a minimum capital adequacy ratio (CAR) of 10% of risk-weighted assets. By the of the year 2004 Aval's risk based capital ratio according to Ukrainian standards was 10.07% that was marginally above the required minimum.

Capital sufficiency will improve in 2005-06…

Throughout 2004 the bank managed to increase the share capital by USD42 mln by the way of 1) issuance of the new shares for USD37.7mln that is a common practice for Ukrainian banks (Aval holds additional share emissions on the annual basis); 2) net fixed assets revaluation by USD24 mln and 3) net income for 2004 of USD32 mln. In 2004 the bank distributed USD62 mln to shareholders (insurance companies) in the form of payments of insurance premiums for credit default insurance.

We expect the bank to improve its capital adequacy to 11% in 2005. In order to support the bank's growing lending activity and to improve capital sufficiency in December 2004 Aval announced additional issue of shares for USD100 mln at par value of USD0.02, to be fully subscribed by the end of August, 2005.

Subordinated debts attracted from IFC in 2005 in total amount of USD70 mln will also improve Aval's capital sufficiency.

A Strategic Foreign Partner

The efforts made by senior management and owners of Aval to expand its capital base with simultaneous asset growth evidence about commitment of shareholders to further bank's developing. However, the owners seem to understand that further development of the bank is possible only with involvement of large international bank, able to provide sufficient capital.

In February 2005 Aval started official talks with Raiffeisenbank on sale of the control stake in the bank. Previous talks with EBRD did not finish successfully. According to the claims of Raiffeisenbank (Ukraine) CEO made on July 20, 2005 the deal will be probably completed by December 2005.

If the deal is successful, Raiffeisen group (RZB) will gain a leading position in the Ukrainian banking sector. After acquiring Aval, Raiffeisen’s banking assets in Ukraine will total nearly USD 3.5 bln which is almost a 11.6% share of the total banking assets in Ukraine. In addition, Aval’s well-developed branch network with more than 1400 outlets, will provide Raiffeisen with a strong presence in Ukraine’s regions. In this case, Raiffeisen’s only strong competitor in Ukraine will be the current leader Privatbank. The bank (part of the Privat business group) has assets of ~USD 3.2 bln or a 11% share of Ukraine’s total banking assets and the second-largest branch network with 1,845 of outlets.

We estimate the deal will be made at USD630 mln for ~90% stake (P/E x 16.2, P/Total Revenues x 2.2; P/BV x 3.7).

Relative Valuation

	Country	Mkt price, USD	Mcap, USD mln	P/E 2004	P/E 2005E	P/E 2006E	P/BV 2004	P/BV 2005E	P/BV 2006E
Aval	***Ukraine***	***0.06***	***597***	***18.1***	***15.3***	***11.3***	***3.6***	***2.3***	***1.5***
Bank Pekao	Poland	21.9	7011	18.0	16.5	14.1	3.1	2.9	2.6
Bank Handlowy	Poland	41.8	2858	23.4	18.8	16.6	1.6	2.1	2.0
OTP	Hungary	35.6	10005	14.6	13.3	11.4	4.7	3.8	3.1
Komercni Banka	Czech Rep.	124.5	4760	13.5	12.7	13.1	2.7	2.3	2.1
Garanti	Turkey	2.5	5191	15.5	11.5	8.5	2.2	1.7	1.4
Yapi Kredi Bank	Turkey	4.4	3305	NM	22.2	12.2	1.0	2.2	1.1
Mean				**17.0**	**15.8**	**12.7**	**2.5**	**2.5**	**2.1**
Median				**15.5**	**14.9**	**12.6**	**2.4**	**2.2**	**2.1**
Premium/ (Discount)				7%	-3%	-11%	41%	-9%	-26%
Implied Price, USD				0.056	0.062	0.067	0.043	0.066	0.081
Upside (Downside)				-6%	3%	12%	-29%	10%	35%

	Country	Mkt price, USD	Mcap, USD mln	P/Assets 2004	P/Assets 2005E	P/Assets 2006E	P/Loans 2004	P/Loans 2005E	P/Loans 2006E	P/Deposits 2004	P/Deposits 2005E	P/Deposits 2006E
Aval	***Ukraine***	***0.06***	***597***	***0.3***	***0.2***	***0.2***	***0.4***	***0.3***	***0.2***	***0.4***	***0.2***	***0.2***
Bank Pekao	Poland	21.9	7011	0.4	0.4	0.4	0.9	0.8	0.7	0.6	0.5	0.5
Bank Handlowy	Poland	41.8	2858	0.3	0.3	0.3	0.9	0.9	0.8	0.6	0.5	0.5
OTP	Hungary	35.6	10005	0.5	0.4	0.3	0.8	0.6	0.5	0.7	0.6	0.5
Komercni Banka	Czech Rep.	124.5	4760	0.3	0.2	0.2	0.8	0.7	0.6	0.3	0.3	0.3
Garanti	Turkey	2.5	5191	0.3	0.2	0.2	0.7	0.5	0.4	0.4	0.3	0.3
Yapi Kredi Bank	Turkey	4.4	3305	0.3	0.2	0.1	0.4	0.4	0.2	0.3	0.3	0.2
Mean				**0.3**	**0.3**	**0.3**	**0.7**	**0.7**	**0.5**	**0.5**	**0.4**	**0.4**
Median				**0.3**	**0.3**	**0.3**	**0.8**	**0.6**	**0.6**	**0.5**	**0.4**	**0.4**
Premium/ (Discount)				-19%	-32%	-40%	-46%	-58%	-63%	-21%	-43%	-50%
Implied Price, USD				0.074	0.088	0.099	0.112	0.142	0.161	0.076	0.105	0.120
Upside (Downside)				23%	47%	66%	87%	136%	168%	27%	75%	100%

As our valuation is based on financial reporting prepared in accordance with IFRS. We believe that P/E and P/B ratios are a reliable starting point for determining the target price. We would prefer to see clear signs of the bank solving the existing maturity mismatch risk before relying more on the second group ratios. Our conservative twelve-month target is USD 0.07.

Financial Statements

Income Statement Summary, according to IFRS

	2002	2003	2004	2005E	2006E
Interest Income	136.8	177.4	233.1	291.3	364.2
Interest Expense	70.2	90.0	131.3	177.3	221.6
Net Interest Income	**66.6**	**87.4**	**101.7**	**114.0**	**142.5**
Net Non-Interest Income	**68.4**	**95.9**	**141.8**	**177.2**	**221.6**
Total Revenues	**134.9**	**183.4**	**243.5**	**291.3**	**364.1**
Operating Expense	74.5	118.6	128.7	145.6	163.8
Other Operating Expense	18.2	19.2	47.4	60.0	90.0
Loan Loss Provisions	22.0	48.7	20.9	30.0	35.0
Profit Before Tax	**20.2**	**-3.2**	**46.7**	**55.6**	**75.3**
Tax	9.4	3.5	13.8	16.7	22.6
Net Income	**10.9**	**-7.1**	**32.9**	**38.9**	**52.7**

Balance Sheet Summary, according to IFRS

	2002	2003	2004	2005E	2006E
Cash and due from the National Bank of Ukraine	92	122	202	430	450
Amounts due to other banks	98	243	179	188	206
Gross Loans	796	1332	1615	2352	3222
Loan Loss Reserve	61	100	119	188	290
Net Loans	**735**	**1231**	**1496**	**2164**	**2932**
Investment Securities	43	51	58	55	70
Fixed Assets	88	123	176	185	241
Other Assets	26	42	31	30	35
Total Assets	**1082**	**1812**	**2142**	**3052**	**3934**
Due to the National Bank of Ukraine	14	75	133	13	20
Due to other banks	42	209	245	345	362
Due to customers	921	1388	1589	2418	3144
Other Funding	9	15	9	11	15
Total Liabilities	**986**	**1687**	**1975**	**2787**	**3541**
Total Equity	**96**	**125**	**167**	**265**	**393**
Total Liabilities & Total Equity	**1082**	**1812**	**2142**	**3052**	**3934**

Key Ratios

	2001	2002	2003	2004	2005E	2006E
Total Assets Growth	58.6%	13.6%	67.4%	18.2%	42.5%	28.9%
Customer Loan Growth	89.7%	97.2%	67.4%	21.5%	44.6%	35.5%
Customer Deposit Growth	59.2%	8.8%	50.4%	14.5%	52.2%	30.0%
Customer Loans/Deposits	44.0%	79.7%	88.7%	94.2%	94.2%	89.5%
Loans/Total Assets	39.1%	68.0%	67.9%	69.8%	70.9%	74.5%
Equity/Total Assets	6.8%	8.9%	6.9%	7.8%	8.7%	10.0%

Source: Concorde Capital

	2002	2003	2004	2005E	2006E
Net interest margin	8.0%	7.0%	6.0%	5.5%	5.1%
Net spread	8.9%	7.7%	6.8%	6.6%	5.9%
Net interest income/Total income	49.3%	47.6%	41.7%	39.1%	39.1%
Non interest income/Total income	50.7%	52.4%	58.3%	60.9%	60.9%
ROA	1.0%	-0.5%	1.7%	1.5%	1.5%
ROE	11.2%	-0.6%	22.5%	18.0%	16.0%
Cost/Income	85.0%	101.0%	86.2%	80.9%	79.0%
Capital Adequacy Ratio	9.20%	9.35%	10.1%	11.0%	12.0%

Source: Concorde Capital

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