



Ukraine / Banking

Factorial Bank

Primed for Acquisition

BUY

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Market Information

Bloomberg	FKTB UZ
No of Shares, mln	62.1
Market price, USD	1.03
Market price, diluted, USD	0.71*
MCap, USD mln	63.6
Free float	9.9%
FF MCap, USD mln	6.4

* An additional share issue was approved at the bank's AGM on Feb. 16, 2007. The bank will issue 40 mln new shares at par USD 0.198, which would increase its charter fund by 64% to USD 20.2 mln. The subscription period is May 16 – Jun. 12, 2007. The ex-right date is May 16.

Stock Ownership

UPEC group	41.1%
Two individuals	39.5%
Institutional investors	9.9%
Other	9.4%

Ratios, 2006

Net Interest Margin	2.4%
Net Margin	6.9%
ROE	3.3%
Cost/Income	87%

12M Target

Undiluted
USD 1.37

Diluted*
USD 0.91

Factorial Bank, a mid-size commercial bank, is being prepared for sale to a strategic investor. With the bank sitting on the cusp of acquisition cross-hairs that are increasingly moving toward smaller targets and the new management's work already materializing in the form of IFRS accounting and doubled earnings in 2006, we initiate coverage with BUY recommendation and set our twelve-month target at USD 1.37 per share.

M&A activity moving down the tiers

Foreign ownership in the Ukrainian banking sector has increased fourfold over the past two years to 36% of total sector assets at the end of 2006. On top of that, we estimate foreigners will lock up about USD 20 bln in Ukrainian banking assets over the next two years, which will bring foreign ownership closer to the current average in CEE. As the first and second banking tiers are being exhausted of acquisition targets, buying activity is moving down the tiers and focusing on mid-size banks. Just last month, the acquisition of Ukraine's 63rd largest bank by assets posted at P/B multiple of 4.0x - in line with the average acquisition price paid for Ukraine's Top-30 banks.

Factorial Bank: Feasible acquisition target

With its position in the middle of Ukraine's banking universe, a favorable location in industrial Kharkiv region, a local branch network of 44 outlets and doubling growth in its retail arm, we expect Factorial to land on the short-list of many strategic investors quite soon. Factorial's current owners, associated with the Kharkiv-based UPEC business group, decided to capitalize on the bank's regional franchise and are targeting the sale of the controlling stake within the next twelve months. We estimate the bank will be sold in the range of 3.5-4.0x P/B.

New management to ensure execution

Previously captive, as most mid and small size Ukrainian banks, and with material imbalances in operating performance, Factorial Bank is currently on the way to evolving into a valuable acquisition candidate. High profile professionals took charge in 2005 with an agenda of cleaning up the bank's financials, streamlining its operations and setting up for a take-over. Big-4 audited IFRS accounting and more than doubled earnings in 2006 were the most eye-catching results.

Key Financials, USD mln

	Loans	Deposits	Equity	Net income	P/E	P/B	P/Loans	P/Deposits
2006	86	132	19	0.6	105.8	3.7	0.7	0.5
2007E	128	170	28	1.1	75.2	3.1	0.5	0.4
2008E	168	214	33	1.5	40.1	2.6	0.3	0.3

Spot exchange rate: 5.05

No End to Banking Takeovers

Sector with rare growth: assets doubling every two years

The hunt for local banks in recent years is understandable, especially for foreign banks in saturated markets – the Ukrainian banking sector has a track record of asset growth with a 54% CAGR over 2003-2006.

Retail banking has been the main driving force, with loan growth of 124% CAGR over 2003-2006. Ukrainian banks reaped the benefits from increases in real disposable income and consumer loans, posting unparalleled growth in net income (44% CAGR in 2003-2006). Similarly, ROE improved from 8% in 2002 to 13.5% in 2006.

Evolution of the Ukrainian banking sector

	2002	2003	2004	2005	2006
Key financials, USD mln					
Total assets	12.0	18.8	25.3	42.4	67.4
Total loans	7.8	12.5	16.5	28.2	48.6
Retail loans	0.6	1.7	2.8	6.6	15.4
Total deposits	7.3	11.3	15.3	26.5	36.2
Retail deposits	3.6	6.0	7.8	14.4	21.0
Equity	1.9	2.4	3.5	5.0	8.4
Net income	0.1	0.2	0.2	0.4	0.8
Growth, % yoy					
Total assets	33%	57%	35%	67%	59%
Total loans	47%	61%	32%	71%	73%
Retail loans	136%	173%	65%	139%	135%
Total deposits	44%	55%	36%	73%	37%
Retail deposits	70%	68%	29%	85%	46%
Equity	25%	29%	44%	45%	67%
Net income	28%	21%	53%	80%	91%
Ratios					
ROA, %	1.3	1.0	1.1	1.3	1.6
ROE, %	8.0	7.6	8.4	10.4	13.5
Net interest margin, %	6.0	5.8	4.9	4.9	5.3
Capital adequacy ratio, %	18	15	17	15	14
Banking penetration					
Assets/GDP	28%	38%	39%	50%	67%
Loans/GDP	18%	25%	25%	33%	48%
Retail loans/GDP	1%	3%	4%	8%	15%
Deposits/GDP	17%	23%	24%	31%	36%

Source: National Bank of Ukraine, Concorde Capital

M&A Congestion

Foreign ownership in the sector increases four-fold

Foreign banks have notably accelerated their penetration into Ukraine. In 2005-06 foreigners took control over twenty Ukrainian banks and gained 36% of the market by assets as of the end of last year, from just 8% in 2004.

The last two years (2004-2006) have been marked by a frenzy of M&A activity and private placement deals. Many banks are eager to establish a presence here and have participated in multiple tenders to even their luck after several failed attempts. The tender for Ukrsofsbank, Ukraine's sixth largest bank by assets, attracted about 20 foreign participants.

Intense competition for Ukrainian banking assets has been reflected in the prices foreigners are ready to pay to enter the local market. Having started with the acquisition of a 90% stake in Azhio Bank by Vilnius Bankas (Lithuania) (member of the SEB group) for EUR 23.3 mln, which implied a P/B multiple of 1.5x, multiples climbed to a maximum of 5.9x P/B (post-money) when Raiffeisenbank-Ukraine was acquired by OTP Bank (Hungary) for USD 833 mln.

Recent M&A deals in the Ukrainian banking sector

Date	Buyer	Target	Price and acquired stake	P/B
Jan-07	Swedbak (Sweden)	TAS-Commertzbank	USD 753 mln for ~100%	4.6
Jan-07	Volksbanken (Austria)	Bank Electron	USD 74 mln for ~98%	4.0
Dec-06	Getin Holding (Poland)	Bank Prykarpattya	USD 22.4-25.6* mln for 81.9%	3.5-4.0
Aug-06	PPF Group (Czech Rep)	Privatinvestbank	USD 15.2-20.2* mln for 100%	1.5-2.0
Jul-06	PPF Group (Czech Rep)	Agrobank	USD 26-32* mln for 100%	2.0-2.5
Jul-06	EFG Eurobank (Greece)	Universalny	USD 30-40* mln for 99.3%	2.0-2.7
Jul-06	Erste Bank (Austria)	Prestige Bank	USD 35.3 mln for 50.5%	1.2
Jul-06	Russian Standard	Avtoinveststoybank	USD 9-10* mln for a <50%	1.1-1.3
May-06	OTP Bank (Hungary)	Raiffeisenbank-Ukraine	USD 833 mln for 100%	5.9
Mar-06	Credit Agricole (France)	Index Bank	USD 257 mln for 98%	5.5
Feb-06	Banca Intesa (Italy)	Ukrsotsbank	USD 1.16 bln for 88%	5.0
Jan-06	Vneshtorgbank (Russia)	Mriya	USD 70 mln for 98%	1.6
Dec-05	BNP Paribas (France)	Ukrsibbank	-USD 350 mln for 51%	3.6
Aug-05	Raiffeisen International	Aval Bank	USD 1.028 bln for 93.5%	3.1
Apr-04	PKO Bank Polski (Poland)	Kredyt Bank	USD 30 mln for 66.65%	1.6
Jan-04	SEB group (Sweden)	Azhio Bank	EUR 23.3 mln for >90%	1.5

Source: Concorde Capital

Some deals demonstrated relatively low multiples, which in essence reflected the price for the banking license since the banks involved were established recently and did not have much of a track record.

Intense acquisitions will persist

Foreign ownership is still far from the levels in other parts of CEE, such as the 71% of banking assets that foreigners control in Poland, 80% in Hungary and 95% in the Czech Republic. Thus, we believe the acquisition phase is far from over. We estimate foreign banks will lock up around USD 20 bln in assets during the next two years, which will bring foreign ownership closer to the average in other CEE countries.

The newcomers, previously unsuccessful bidders and those eager to cement their presence in Ukraine will keep the market hot. Below we list foreign banks that might be active in M&A activity in the next year:

Societe Generale (France) – unsuccessfully targeted Ukrsibbank;

UniCredit Group (Italy) – already controlling two mid-size Ukrainian banks, HVB and Unicreditbank, and is geared up for further growth;

Erste Bank (Austria) – recently acquired a 51% stake in small Prestige Bank. Likely to expand further through acquisitions;

FinansBank (Turkey) – persistent bidder for a Ukrainian bank. Opened a representative office in Ukraine as a first step in establishing its presence;

Bank of Moscow (Russia) – bidder for Ukrsotsbank; opened a representative office in Ukraine as part of its expansion strategy;

Sberbank (Russia) – this Russian state-owned bank has ambitious expansion plans;

Greek banks - the National Bank of Greece, Emporiki and Piraeus Bank are actively bank hunting;

Citigroup – announced intentions to develop its retail arm in

Ukraine through acquisitions in addition to its corporate-focused subsidiary Citibank-Ukraine;

Hypo-Alpe Adria (Austria) – considering expansion into Ukraine through the acquisition of a mid-size banks;

KBC Group (Belgium) – considering to a return the Ukrainian market, after it sold its stake in Kreditbank in 2004.

In addition to foreign M&A action, we also expect top-tier Ukrainian banks to expand their branch networks and regional presence through consolidation.

Equity placements moving in support

Since late 2005, the owners of Ukrainian banks started to bring sizeable blocks of shares to the market through private placements. Typically, these shares have been from mid-size banks, since equity placement is an attractive source of financing and is often used to test the bank's market value for a future IPO or strategic sale. The stakes placed varied from 7% to 20%, with attracted amounts ranging from USD 9.6 mln to USD 53.5 mln.

Private placements in the Ukrainian banking sector

Date	Target	Acquired stake	pre-money P/B	post-money P/B
Aug-06	Nadra Bank	USD 45 mln for 6.74%	5.0	4.1
Apr-06	Ukrinbank	USD 36 mln for 20%	8.9	2.3
Apr-06	Rodovid Bank	USD 37 mln for 19%	5.4	2.8
Mar-06	Megabank	USD 19 mln for 20%	4.3	3.0
Oct-05	Forum	USD 20 mln for 10%	3.0	2.4

Source: Concorde Capital

Post-money P/B multiples applied at placement have been mirroring M&A valuations, moving from 2.4x which was applied for Bank Forum in October 2005 to 4.1x at the placement of 7% of Ukraine's ninth largest bank by assets – Nadra.

Mid-size banks in the spotlight

After the acquisitions of Aval, Raiffeisenbank-Ukraine, Ukrsibbank and Ukrsootsbank, there are still several top-10 banks that were not among those up for sale in recent years. Two of them are state-owned banks, Ukreximbank and Oschadbank, which are likely to be privatized in the longer-term. There are no indications that the other remaining privately-owned heavyweights will even be potential acquisition targets in the near future.

Foreign banks hoping to acquire a Ukrainian peer are focusing their attention on second and third-tier banks. Recognized banking institutions such as Societe Generale, FinansBank and the Bank of Moscow, which were unsuccessful in previous tenders are very likely to enter the Ukrainian market through the acquisition of a mid-size local bank.

Given the absence of opportunities to purchase larger banks, foreign banks are expected to tighten their focus on mid-size banks, which will provide their new owners with several practical benefits:

- fast exposure to the market without the need for resource-consuming branch network construction and significant bureaucratic barriers; and
- before considering substantial investments into expansion, the bank can test its ability to compete and perform on the new market.

Factorial Bank: Feasible Acquisition Target

Bank for sale

Established in 1991, the bank became a member of the Kharkiv regional UPEC business group. Since banking is not its core business and market conditions in the Ukrainian banking sector are favorable - UPEC Group's shareholders decided to sell the bank to a strategic investor in 2007.

Universal bank with solid clientele

Factorial Bank is a fully licensed and certified universal banking institution that provides a full range of traditional banking services to more than 50,000 individuals and 6,000 corporate clients. It has been operating in Ukraine for fifteen years.

Strong in the middle

With total assets of USD 155 mln at the end of 2006, Factorial Bank is Ukraine's 58th largest bank in terms of assets, 61st in terms of loan portfolio and 55th in terms of equity. According to NBU classifications, Factorial Bank is a mid-size bank (3rd tier) and is in the largest 30% of Ukrainian banks.

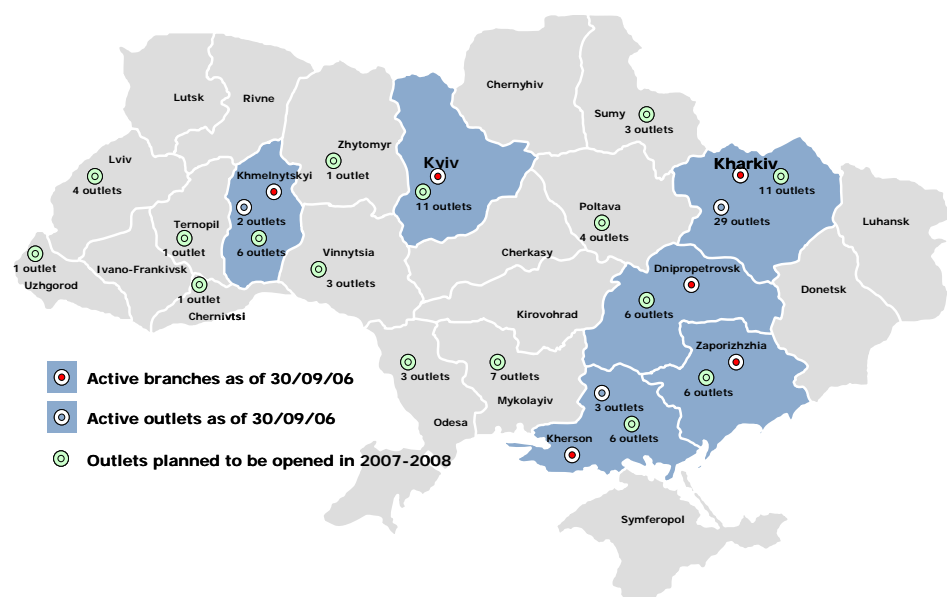
NBU classification of Ukrainian banks

TIERS	Total Asset Limits, USD	Number of Banks in TIER
TIER 1	>500 mln	15
TIER 2	260 - 500 mln	19
TIER 3	80 - 260 mln	25
TIER 4	<80 mln	110

Source: National Bank of Ukraine

Established regional network

The bank's current network is comprised of seven branches in different regions of Ukraine and 34 outlets, 29 of which are located in Kharkiv. The bank plans to expand its branch network to 80 outlets by mid-2008.



Source: Company management

Strategic location

Factorial Bank is headquartered in the industrially-developed Kharkiv region, which has a population of 2.8 mln and accounts for 10% of the country's GDP. As regional markets are rapidly becoming a key source of growth for businesses, top domestic banks have aggressively started to roll-out networks there to capitalize on low penetration by banking services and higher growth in disposable income.

The proximity of Kharkiv region to Russia makes the bank attractive for Russian banks (such as Sberbank and the Bank of Moscow), which have already participated in tenders for Ukrainian banks and might consider a regional banks as a launching platform for operations in Ukraine.

Regional beauty contest: Why Factorial?

For a potential strategic investor that is considering entering the region, Kharkiv offers a wide choice of banking assets. We will take a quick look to the region's banking landscape and define Factorial's position among its local peers.

The region is covered by the branch networks of several top-tier banks. Though, the possibility of acquiring these banks is not available anymore - they have either been sold to major European banks in the last 16 months or are not being offered for sale.

Top banks in Kharkiv region

Bank	Rank by assets	Assets	Loans	# of outlets in Kharkiv
Privat	1	6,689	5,697	40
Aval	2	5,500	4,304	29
Ukrsibbank	3	4,430	3,606	64
Ukrsotsbank	6	3,472	2,513	33
Nadra	9	2,038	1,435	11

Source: National Bank of Ukraine

Seven local banks currently operate in the region, representing other potential acquisition targets. Factorial is the second-largest regional bank by assets and is ahead of other banks in terms of the number of Kharkiv-based outlets. In total outlets, Factorial trails only for Megabank with its 170 outlets throughout Ukraine.

Kharkiv-based banks, as of Dec. 31, 2006*

Bank	Rank by assets	Assets	Loans	Corp Loans	Retail loans	Deposits	Equity	# of outlets	# outlets in Kharkiv
Megabank	46	221.9	147.4	115.1	32.3	164.5	37.2	170	16
Factorial Bank	58	158.9	88.9	57.5	31.3	132.3	19.3	44	29
Basis	64	133.5	82.2	68.3	13.9	98.3	16.1	29	23
Golden Gate	74	109.4	91.1	56.3	34.8	92.6	15.0	14	6
Inprombank	75	108.7	83.1	65.4	17.7	85.7	18.7	15	7
European Bank	67	129.7	76.3	56.0	20.2	72.8	19.0	22	7
Mercury	79	100.1	72.6	49.8	22.8	78.6	12.9	20	17
Region-Bank	145	30.5	23.7	19.2	4.5	19.3	8.8	9	8

Source: National Bank of Ukraine

Note: All figures in USD mln

The short-list of Factorial's main competitors boils down to Megabank, the largest Kharkiv-based bank, and Basis Bank, its closest rival.

We consider Megabank a relatively low threat to Factorial's plans.

Megabank plays on a higher field, considering its size and retail network. Its management is confident that it will continue adding value during at least the coming year to demand a sizeable premium at exit. After a successful equity placement in April 2006 with a post-money P/B of 2.7x, we believe Megabank's owners will be targeting an exit close to 4.0x P/B. Factorial will be seeking less demanding valuations, leaving room for a strategic acquirer to invest the difference in retail at their own discretion.

Basis Bank, though Factorial's closest rival, is noticeably smaller. More importantly, Basis is a key financial part of a medium-size local business group associated with Kharkiv's governor and is exposed to certain political risks. **We believe the possibility of Basis Bank's sale in the next 12-18 months is remove.**

Pre-Sale Polishing

Executive task force

To dress the bank for a future sale, Factorial's shareholders hired a team of banking professionals with a proven track record in recognized banking institutions who are known for their ability to successfully implement efficient business-projects. The new management team took charge of the bank in 2005 with the main task of setting up for take-over. Four key positions were assumed by newcomers – CEO, 1st Deputy CEO, Deputy CEO and Deputy CEO/Head of VIP-business.

Alexander A. Korotin, CEO

Korotin started his banking career in 1999 with PrivatBank. By 2004 he had held various management positions in PrivatBank's Donetsk branch. In 2004 Korotin joined TAS-Kommerzbank to set up its field operations in Donetsk. In late 2004 he accepted an offer to head TAS-Kommerzbank's branch in Kharkiv. In early 2005 Korotin took up his position at Factorial Bank. Korotin holds a degree in Applied Mathematics from Donetsk State University (1995) and a degree in Economics from the International University of Finance (2001).

Factorial Bank is in a stage of structural transformation while the management team gets things in order. The new team's goal of preparing the bank for take-over has led them to clean-up the financials, streamline operations and ensure transparency. A *carte-blanche* was conferred on the management, allowing for fully independent decision-making to avoid shareholder interference in operational issues.

Our personal interviews with Factorial's four new managers convinced us they possess a strong executive capability to deliver fast and tangible results.

Big-4 audited IFRS financials

In cleaning up the bank's financials, the first step was a 2005 financial statement audit in accordance with IFRS by Deloitte & Touche. On Nov. 22, 2006, the auditor's preliminary report was made available, revealing several important adjustments to the 2005 financial statements. In total, the auditors' adjustments resulted in an increase of Factorial Bank's equity by USD 2.4 mln, bringing it to a value of USD 20.1 mln. This was the result of a PP&E revaluation, namely in the appreciation of real estate. The balance sheet total was reduced by Deloitte & Touche to USD 114 mln by netting-off mutually offsetting loans and deposits as of the end of 2005. The transaction does not compromise the quality of the bank's equity and the upward adjustment described above has a sound economic basis.

Improved asset mix

To purge the balance sheet, a considerable amount of accounts receivable for securities were converted in 2006 into interest-bearing loans and cash, which allowed for higher liquidity and asset quality. Factorial's balance sheet still contains sizeable amounts of securities (22% of the bank's assets as of Oct. 1, 2006), which are represented by shares and debt securities, with a certain portion falling on securities of related parties. However, the auditors acknowledge reasonable basis for their valuation.

Cleaning up loans

Loan classification principles were revised in 2005. A more prudent approach sharply decreased standard category loans and shifted toward watch and sub-standard categories. In 9M06, portfolio quality improved with the share of standard loans constant and watch loans increasing to 56% from 40% in 2005, mainly at the expense of sub-standard loans. The share of non-performing loans in the portfolio has constantly decreased from 11% in 2004 to 3% as of Oct. 1, 2006.

Loan portfolio quality, USD ths

Category	2003	2004	2005	9M2006
Total loans portfolio	29,374	41,052	73,519	86,402
Standard	15,446	32,456	14,726	20,906
% of loans portfolio	53%	79%	20%	24%
Watch	14	221	29,703	48,393
% of loans portfolio	0%	1%	40%	56%
Sub-standard	13,120	3,563	24,430	14,573
% of loans portfolio	45%	9%	33%	17%
Doubtful	715	3,851	2,591	523
% of loans portfolio	2%	9%	4%	1%
Loss	78	961	2,069	2,007
% of loans portfolio	0%	2%	3%	2%
Loans provision	1,263	2,604	2,879	2,657

Source: Company data

Earnings more than doubled in 2006

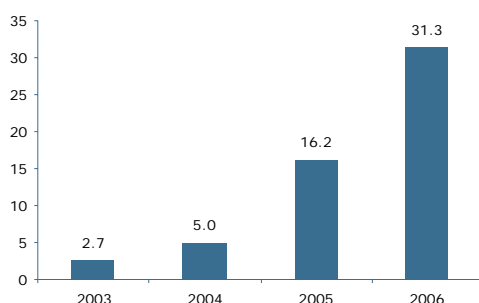
In order to boost profitability, the bank focused more on higher-margin retail products and at the same time improved its deposit base by increasing the number of lower-cost current accounts. The strategy resulted in net interest margin (NIM) improvement to 2.4% in 2006 compared to 1.9% a year earlier. Higher margins helped boost net interest income (NII) (+70% yoy in 2006 after just a 25% yoy increase in 2005) and strongly contributed to total revenue growth in 2006 by 43% yoy against a 0.2% yoy decrease a year earlier.

Over 2003-2005 Factorial Bank's financial performance was rather poor and below the sector average as a result of inefficient policies and a relative imbalance in banking assets and liabilities, which was inherited from the bank's former management (the bank borrowed fairly expensively and invested it into inefficient and unprofitable areas, in particular through loans to corporate clients where margins are much lower compared to retail banking).

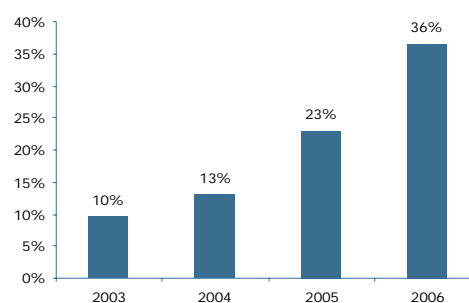
Expansion to higher-return retail

As early as 2005, the bank's strategy of diversifying into retail was already starting to pay off. Factorial's retail loan portfolio skyrocketed upward by 225% yoy in 2005, compared to 83% yoy growth in 2004. During 2006 loans to individuals almost doubled and accounted for 36% of the bank's total loans.

Retail loans, USD mln



Retail/Total loans



Source: Company data

Another 46 branches and outlets are scheduled to open in 2007 and 36 in 2008. At the same time, geographical coverage is projected to extend into 17 regions from the 7 regions it currently covers.

The bank's new management has worked out its a retail-oriented "Deferred Payment" program, under which the bank concluded agreements with Kharkiv regional finance companies System Loan and Inter Finance Ukraine, which will provide for the expansion of the bank's major products by opening new points of sale in retail chains and trade outlets in Kharkiv and other cities.

The new management's focus on retail (consumer & mortgage loans) is going to make up about half of total loan growth in 2007 (+49%) and advance the retail to 43% of the bank's lending.

Lowering costs on the liability side

The bank is set to reduce its liability costs through optimizing the customer deposits structure. The large industrial potential of Kharkiv region and corresponding solid business concentration allows Factorial Bank to attract relatively cheap corporate resources. Factorial Bank's corporate clients include national and leading regional companies, which operate in retail trade, chemicals, machine building, communications and infrastructure. Its strategic partners are the following companies: MKS, Elektroland, Specvuzavtomatika, Stirol, IFK and Nemiroff.

Over 2006 Factorial intensified efforts to raise funds from corporate clients in its current accounts. Current account funds cost the bank two times less than term deposits. Last year, the share of current accounts in the bank's total customer funds doubled to 21% or USD 27.4 mln. Growth of USD 11.3 mln (+156% yoy) in corporate current accounts was behind this deposit mix improvement.

Strengthening its funding base

10% Private placement

In December 2006, Factorial's owners placed a 10% stake in the bank with institutional investors. The funds raised in amount of USD 5.8 bln will finance the bank's retail network expansion and building up its retail loan portfolio.

64% Capital increase

To gear up the bank for further lending growth, Factorial is also going to increase its charter fund by 64% or USD 7.9 mln. The bank plans to issue 40 million ordinary shares at par of USD 0.198. The additional share issue will be on the agenda of its AGM that is scheduled for March 16, 2007.

Valuation

Peer comparison

	Price, USD	MCap, USD mln	P/E			P/B*		
			2006	2007E	2008E	2006	2007E	2008E
CEE Peers								
PKO BP	16.6	16,528	25.1	23.4	21.2	5.1	4.8	4.5
Pekao SA	84.8	14,131	23.6	20.7	18.6	4.5	4.2	3.9
Bank BPH	332.3	9,530	19.6	27.7	26.1	4.1	4.2	4.1
BZWBK	84.6	6,142	27.9	23.1	20.6	5.1	4.5	4.0
OTP	45.1	12,691	13.2	12.6	11.4	3.7	3.0	2.5
Komercni Banka	167.3	6,356	15.3	14.4	13.5	2.5	2.3	2.1
Sberbank	3,660.0	72,465	24.7	22.2	19.4	6.5	5.0	3.9
Average			17.5	20.6	18.7	3.7	4.0	3.6
Ukrainian peers								
Ukrgazbank	1.20	360	59.1	36.9	25.5	4.0	3.1	2.7
Ukrsotsbank	0.67	2,490	43.7	31.1	22.6	6.8	4.2	3.9
Forum	10.90	1,221	222.1	122.1	64.3	8.7	5.0	4.7
Rodovid Bank	1,500	525	117.6	76.1	47.7	7.6	3.5	3.3
Megabank	1.20	138	61.8	40.6	26.0	3.7	3.5	2.2
Raiffeisen Bank Aval	0.18	3,578	53.4	29.8	21.0	6.1	3.7	3.2
Average			92.9	56.1	34.5	6.1	3.8	3.3
Factorial Bank	1.03	64	105.8	75.2	40.1	3.7	3.1	2.6
Implied Price by CEE peers avg., USD			0.17	0.28	0.48	1.15	1.47	1.57
Premium/(Discount)			505%	265%	115%	0%	-22%	-27%
Implied Price by Ukraine's peers avg., USD			0.90	0.77	0.88	1.91	1.40	1.45
Premium/(Discount)			14%	34%	16%	-40%	-18%	-21%

	Price, USD	MCap, USD mln	P/Loans			P/Deposits		
			2006	2007E	2008E	2006	2007E	2008E
CEE Peers								
PKO BP	16.6	16,528	0.9	0.8	0.7	0.6	0.6	0.6
Pekao SA	84.8	14,131	1.2	1.1	1.0	0.8	0.8	0.8
Bank BPH	332.3	9,530	0.8	0.7	0.7	0.8	0.7	0.7
BZWBK	84.6	6,142	1.2	1.0	0.9	0.8	0.8	0.8
OTP	45.1	12,691	0.6	0.5	0.4	0.5	0.5	0.4
Komercni Banka	167.3	6,356	0.7	0.6	0.5	0.3	0.3	0.3
Sberbank	3,660.0	72,465	0.8	0.6	0.5	0.7	0.6	0.5
Average			0.8	0.8	0.7	0.6	0.6	0.6
Ukrainian peers								
Ukrgazbank	1.2	360	0.9	0.6	0.4	1.0	0.7	0.6
Ukrsotsbank	0.7	2,490	1.0	0.6	0.5	1.1	0.8	0.6
Forum	10.9	1,221	1.2	0.7	0.5	1.5	0.9	0.6
Rodovid Bank	1,500.0	525	1.2	0.7	0.5	1.3	0.8	0.5
Megabank	1.2	138	1.0	0.6	0.4	0.7	0.4	0.3
Raiffeisen Bank Aval	0.2	3,578	0.9	0.5	0.4	1.3	0.8	0.5
Average			1.0	0.6	0.4	1.1	0.7	0.5
Factorial Bank	1.03	64	0.7	0.5	0.3	0.5	0.4	0.3
Implied Price by CEE peers avg., USD			1.05	1.56	1.96	1.28	1.66	1.93
Premium/(Discount)			-6%	-17%	-28%	-35%	-36%	-39%
Implied Price by Ukraine's peers avg., USD			1.43	1.30	1.28	2.44	1.99	1.73
Premium/(Discount)			-28%	-21%	-20%	-58%	-49%	-41%

Source: Bloomberg, PFTS, Concorde Capital

* P/B calculation for Ukrainian banks only accounts for officially announced share capital increases

Dividend discount model

As usual, we supplemented our multiples analysis with a DDM approach (benchmarking to 12% CAR) to gauge FKTB's fair price.

We assumed that the bank will be acquired closer to the end of the year, so that the first results of the acquisition will become visible starting in 2008. We differentiate two scenarios, depending on the new owner's strategy. Key value drivers will be the rate of penetration into retail and the extent cheaper financing from the parent will be available.

The first, rather conservative, scenario foresees retail growth aligned with the sector average at 21% CAGR over 2008-2016, while in the second case retail expansion is foreseen above the sector average during 2008-11, supported by the higher portion of funds provided by the parent company or borrowed from abroad. We believe the second strategy is the most likely to be pursued.

The valuation range is quite narrow: USD 1.36 to USD 1.40 per share.

Key assumptions

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Sector										
Growth in Retail Loans, yoy	84%	46%	31%	24%	19%	17%	15%	14%	13%	13%
Retail/Total Loans	38%	41%	43%	44%	45%	47%	48%	50%	52%	54%
Factorial Bank										
Case #1. Retail growth in line with sector										
Growth in Retail Loans, yoy	85%	46%	31%	24%	19%	17%	15%	14%	13%	13%
Retail/Total Loans	44%	49%	51%	53%	55%	56%	56%	57%	58%	59%
Yield rate	12.6%	12.3%	11.5%	10.7%	10.2%	9.8%	9.5%	9.2%	9.0%	8.9%
Cost rate	8.7%	8.2%	7.8%	7.2%	6.9%	6.6%	6.4%	6.1%	5.9%	5.8%
Case #1. Retail growth above the sector										
Growth in Retail Loans, yoy	85%	60%	40%	32%	21%	17%	15%	14%	13%	13%
Retail/Total Loans	44%	51%	55%	59%	60%	61%	62%	63%	64%	65%
Yield rate	12.6%	12.3%	11.5%	10.8%	10.3%	10.0%	9.8%	9.6%	9.3%	9.1%
Cost rate	8.7%	8.1%	7.7%	7.1%	6.7%	6.5%	6.3%	6.0%	5.8%	5.7%

DDM valuation summary: Benchmarking to total CAR of 12%

Case #1.

Valuation date: Feb. 27, 2007

For the purposes of forecasting, local currency is used (UAH mln)

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E			
Target Total Capital	117	134	165	194	221	251	282	314	344	379			
CAR	12%	12%	12%	12%	12%	12%	12%	12%	12%	12%			
Cash flow to Equity	29.1	13.4	14.4	12.8	13.5	14.9	24.8	35.0	46.0	52.3			
Discount rate	13%	13%	13%	12%	12%	12%	11%	11%	11%	10%			
Discounted CF to Equity	29.6	12.1	11.4	9.0	8.5	8.4	12.4	15.8	18.7	19.2			
Terminal Value	250	282								Discount Rate to Perpetuity	10%		
Equity Value	378	427									Perpetuity Growth Rate	3.0%	
per Share, USD	1.21	1.36										Implied Exit P/E Multiple	x9.1

Case #2.

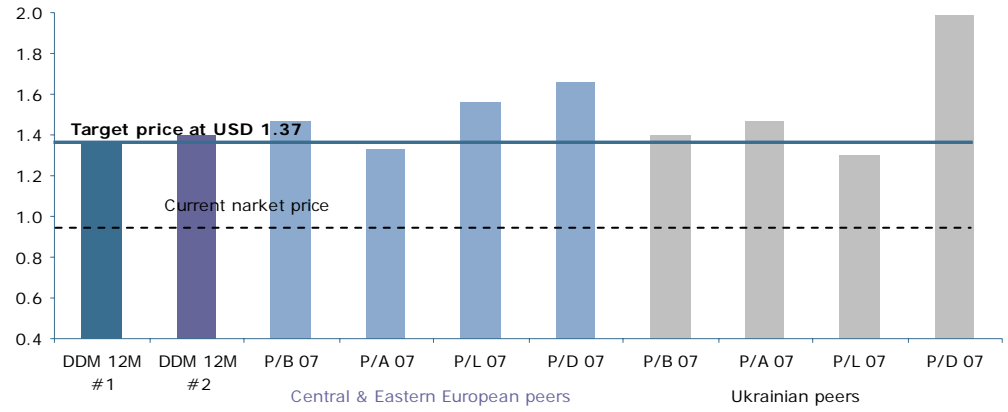
Valuation date: Feb. 27, 2007

For the purposes of forecasting, local currency is used (UAH mln)

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E				
Target Total Capital	117	134	165	194	221	251	282	314	344	379				
CAR	12%	12%	12%	12%	12%	12%	12%	12%	12%	12%				
Cash flow to Equity	29.1	9.1	7.4	4.2	10.7	15.2	26.7	37.9	47.3	57.0				
Discount rate	13%	13%	13%	12%	12%	12%	11%	11%	11%	10%				
Discounted CF to Equity	29.6	8.2	5.9	2.9	6.8	8.5	13.4	17.1	19.3	20.9				
Terminal Value	271,946	307,299									Discount Rate to Perpetuity	10%		
Equity Value	389,280	439,886										Perpetuity Growth Rate	3.0%	
per Share, USD	1.24	1.40											Implied Exit P/E Multiple	x8.8

Valuation summary

We set the twelve-month target at USD 1.37 per share, which implies a 34% upside to the current market price.



Appendix 1

UAS financial statements

Income statement summary, USD mln

	2005	2006	2007E	2008E	2009E	2010E	2011E
Interest Income	10.9	14.0	18.1	22.3	26.3	29.6	32.6
Interest Expense	(9.2)	(11.2)	(13.5)	(16.1)	(19.2)	(21.4)	(23.5)
Net Interest Income	1.7	2.8	4.6	6.2	7.0	8.2	9.1
Net Fee & Commission Income	2.3	3.7	4.9	6.9	9.4	12.3	15.4
Net Trading Income	0.7	0.8	1.0	1.2	1.4	1.7	2.0
Other Income	1.5	1.3	1.2	0.9	1.2	1.6	1.9
Total Revenue	6.1	8.7	11.7	15.2	19.1	23.8	28.4
Operating Expense	(5.2)	(7.6)	(9.6)	(12.2)	(14.2)	(16.0)	(18.1)
Operating Income	0.8	1.1	2.2	3.0	4.9	7.8	10.4
Provision for Loan Losses & Other	(0.4)	(0.4)	(0.7)	(1.0)	(1.3)	(1.5)	(1.7)
PBT	0.4	0.7	1.5	2.0	3.6	6.2	8.7
Income tax	(0.2)	(0.1)	(0.4)	(0.5)	(0.9)	(1.6)	(2.2)
Net Income	0.2	0.6	1.1	1.5	2.7	4.7	6.5

Balance sheet summary, USD mln

	2005	2006	2007E	2008E	2009E	2010E	2011E
Cash	1	3	5	6	10	11	13
Balances with NBU	7	7	9	13	16	19	22
Due from Banks	13	12	24	23	32	33	36
Total Customers' Loans	71	86	128	168	208	249	290
Securities	27	30	10	12	14	16	18
PP&E, net	10	15	21	28	31	33	35
Other Assets	7	6	8	8	9	9	7
Total Assets	137	159	205	258	319	371	420
Due to Banks	15	4	3	6	9	5	0
Total Customers' Deposits	101	132	170	214	264	314	365
Other Liabilities	3	3	3	4	5	6	6
Total Liabilities	119	140	177	225	279	325	372
Shareholders' Equity	18	19	28	33	40	45	49
Total Liabilities & Equity	137	159	205	258	319	371	420

Appendix 2

IFRS financial statements

Balance sheet summary, USD mln

	2004	2005
ASSETS:		
Cash and balances with the National Bank of Ukraine	2.5	8.1
Loans and advances to banks, less allowance for impairment losses	9.2	4.6
Loans to customers, less allowance for impairment losses	39.3	72.1
Investments available for sale, less allowance for impairment losses	3.5	3.4
Investment property	0.7	1.4
Tangible and intangible assets, less accumulated depreciation and amortization	11.4	18.0
Current income tax asset	0.0	0.0
Other assets, less allowance for impairment losses	5.5	6.4
TOTAL ASSETS	72.1	114.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Loans from the National Bank of Ukraine	0.8	0.0
Loans and advances from banks	9.1	6.6
Customer accounts	45.2	84.0
Current income tax liability	0.0	0.0
Deferred income tax liability	1.7	3.2
Other liabilities	0.2	0.2
Total liabilities	57.1	94.0
SHAREHOLDERS' EQUITY:		
Share capital	13.1	13.8
Tangible assets revaluation reserve	0.0	4.3
Retained earnings	1.9	2.0
Total shareholders' equity	15.0	20.1
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	72.1	114.1

Income statement summary, USD mln

	2004	2005
Interest income		12.3
Interest expense		(9.2)
NET INTEREST INCOME BEFORE PROVISION		3.1
Initial recognition adjustment on financial instruments		(0.1)
Provision for impairment losses on interest bearing assets		(1.4)
NET INTEREST INCOME		1.7
Net gain on foreign exchange operations		0.6
Net gain on investments available for sale		0.9
Fee and commission income		1.5
Fee and commission expense		(0.1)
Net gain on revaluation of investment property		0.7
Other income		0.4
NET NON-INTEREST INCOME		4.0
OPERATING INCOME		5.7
OPERATING EXPENSES		(5.4)
OPERATING PROFIT		0.2
Provision for impairment losses on other transactions		(0.0)
Provision for guarantees and other commitments		(0.0)
PROFIT BEFORE INCOME TAX		0.2
Income tax expense		(0.2)
NET PROFIT		0.03

Source: Deloitte & Touche, Preliminary Auditors' Report

Appendix 3

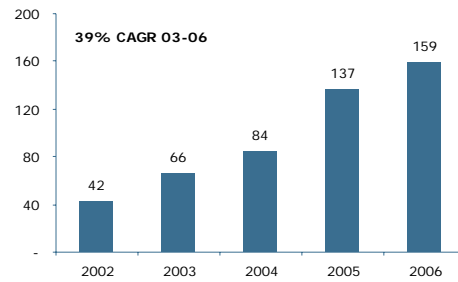
Growth rates and key ratios

	2006	2007E	2008E	2009E	2010E	2011E
Profit and Loss Growth						
Net interest income	76%	65%	31%	14%	16%	11%
Net commissions income	69%	36%	40%	36%	31%	25%
Trading income	28%	20%	19%	20%	20%	15%
Total income	48%	36%	28%	26%	24%	20%
Operating income	39%	97%	37%	64%	59%	33%
Net income	166%	84%	36%	77%	75%	39%
Balance Sheet Growth						
Net Loans	29%	50%	30%	24%	20%	16%
<i>Corporate loans</i>	6%	30%	19%	17%	15%	13%
<i>Retail loans</i>	104%	85%	45%	31%	24%	19%
Average interest earning assets	40%	21%	25%	26%	21%	16%
Total Assets	23%	30%	25%	24%	16%	13%
Customer deposits	39%	30%	25%	23%	19%	16%
<i>Corporate deposits</i>	47%	30%	24%	20%	15%	13%
<i>Retail deposits</i>	30%	30%	26%	27%	23%	20%
Average interest bearing liabilities	44%	23%	26%	25%	20%	16%
Book Value	15%	46%	17%	22%	13%	7%
Key Ratios						
Net interest margin	2.4%	3.2%	3.4%	3.1%	3.0%	2.8%
Net income margin	6.9%	9.4%	9.9%	14.0%	19.7%	22.8%
ROA	0.4%	0.6%	0.6%	0.9%	1.4%	1.6%
ROE	3.3%	4.7%	4.9%	7.3%	10.9%	13.8%
Cost / Income	87%	82%	80%	74%	67%	64%
Net interest income/Total Revenue	33%	40%	41%	37%	34%	32%
Loans/Assets	54%	62%	65%	65%	67%	69%
Loans/Deposits	65%	75%	78%	79%	79%	79%

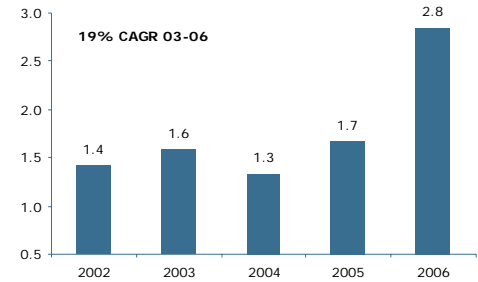
Appendix 4

Factorial Bank's operating performance*

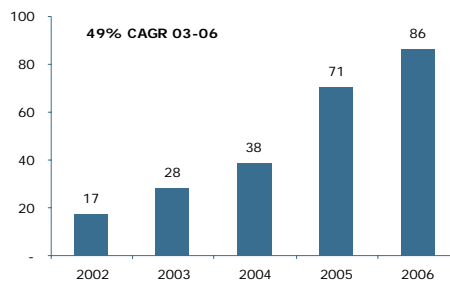
Assets



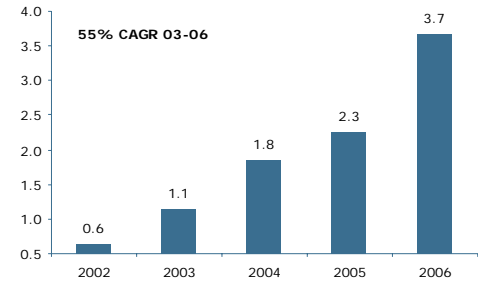
Net interest income



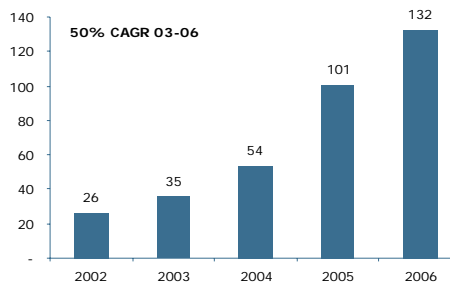
Loans



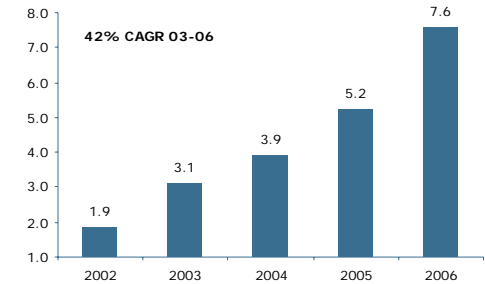
Fee income



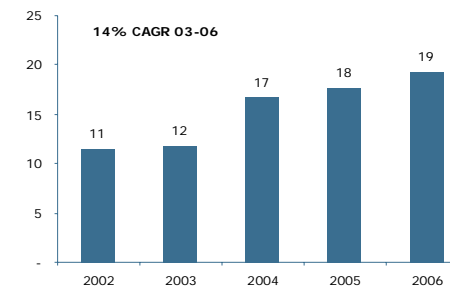
Customer deposits



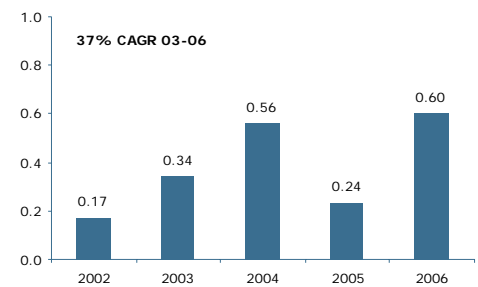
Operating expenses



Equity



Net income



Source: Company data

* All figures in USD mln

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