CONCORDE CAPITAL

Ukraine | Research
Financials | Banks
Initiating Coverage

March 21, 2012

Ukrainian Banks

Still stuck on the backstage

Ukraine's banking sector is recovering at a snail's pace. New loan origination remains muted as the overall economy is still deleveraging. Lackluster growth in core revenues this year should be just enough to offset increases in operating expenses, while improvement in bottom lines will come solely from cuts in provisions. We instate coverage of Raiffeisen Bank Aval and UniCredit's Ukrsotsbank and assign HOLD recommendations to both stocks, even though we believe they are fundamentally cheap. Hostages of the weak macro environment, the banks are unlikely to deliver any positive surprises in the near future.

Lending to stay dormant in 2012

We see Ukrainian banks' combined loan book advancing a mere 5% this year (vs. last year's 10%), driven solely by lending to corporates. Deceleration is imminent against high macro uncertainties, constrained by liquidity and a lack of creditworthy borrowers. Additionally, many banks are opting to buy government bonds to deploy free cash as bond pricing at primary auctions remains attractive.

Slashes in provisions – the only profitability driver

The end of the accelerated provisioning stage and a related slash in loan impairment charges should push banks' combined bottom line in 2012 into the black for the first time since 2008. However, we project banks' operating revenues and profit before provisions to remain little changed from 2011 as lending remains muted and pressure on interest margins is still there.

Banks cheap but no powerful price triggers in sight, HOLD

Raiffeisen Bank Aval and Ukrsotsbank, Ukraine's two most liquid banking stocks, currently trade at P/B 2012 of 0.4x and 0.3x, or with hefty 60%+ discounts to CEE peers. Our DCF-based valuation also shows that both banks are fundamentally cheap with target prices suggesting more than 100% upsides. However, we assign HOLD ratings: the banks' growth prospects for the coming years are bleak while the decrease in provisions (a one-off factor) is likely to be their only profitability driver this year and next.

Aval over Ukrsotsbank

We prefer Aval over Ukrsotsbank as the former's progress in terms of NPL provisioning has been much stronger. Aval's NPL coverage ratio is estimated at 75% while Ukrsotsbank's is close to 55%. Aval is now in a position to cut its impairment charges considerably to push its ROE into the double digits. At the same time, Ukrsotsbank still has a lot of provisioning work to do, implying its provisioning ratio will decline less considerably and ROE will stay below 5%. In addition, the prospective merger of Ukrsotsbank with UniCredit's other subsidiary in Ukraine adds uncertainty to its investment case.

Olena Zuikova
olz@concorde.com.ua

Vitaliy Vavryshchuk
vv@concorde.com.ua

Raiffeisen Bank Aval

Bloomberg	BAVL UK
Reuters	BAVL.UAX
Recommendation	**HOLD**
Price, USD	0.015
12M target, USD	0.033
Upside	123%
No of shares, mln	30,027
Market Cap, USD mln	441
52-week performance	-71%
52-week range, USD	0.015/0.054
ADT, 12M, USD mln	0.2
Free float, %	3.6%
Free float, USD mln	16

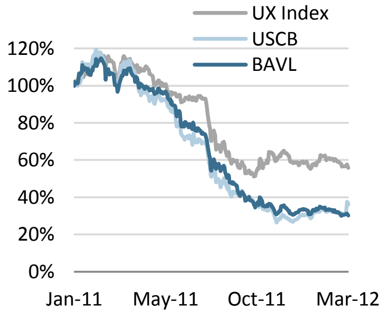
Prices as of Mar. 20, 2012

Ukrsotsbank

Bloomberg	USCB UK
Reuters	USCB.UAX
Recommendation	**HOLD**
Price, USD	0.024
12M target, USD	0.048
Upside	101%
No of shares, mln	12,695
Market Cap, USD mln	303
52-week performance	-68%
52-week range, USD	0.018/0.080
ADT, 12M, USD mln	0.5
Free float, %	4.6%
Free float, USD mln	14

Prices as of Mar. 20, 2012

Price performance, Dec. 2010 = 100%



Source: Bloomberg

BANKING SECTOR: MUDDLING THROUGH

Lending to stay weak in the mid-term

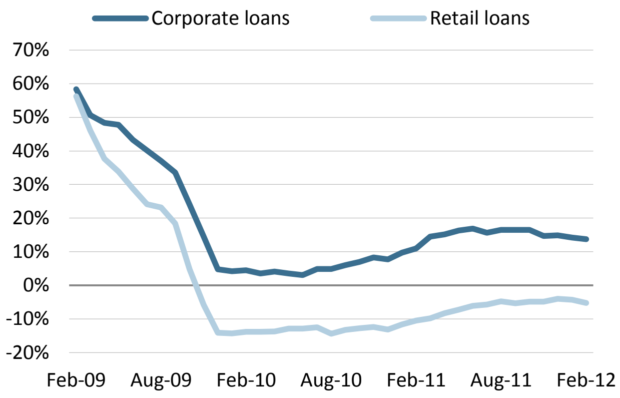
We expect lending by Ukrainian banks to remain weak in the mid-term as the overall economy is still deleveraging. Ukraine's end-2011 loan-to-GDP ratio of 60% was well above key neighboring countries (43% in Russia, 33% in Kazakhstan and 12% in Belarus); suggesting growth in loans should lag nominal GDP for the next couple of years.

We see lending increasing 5% yoy in 2012 vs. 10% yoy in 2011, with key factors behind the expected deceleration being:

- Weak liquidity due to the central bank's tight monetary policy. The NBU is likely to keep liquidity reasonably constrained at least through 2012 to prevent FX speculation and keep the hryvnya stable.
- A halt in wholesale funding from parent institutions. Foreign banks are reluctant to provide new debt to Ukrainian subsidiaries (with the exception of Russian banks) and have instructed them to up reliance on deposits.
- Lack of creditworthy borrowers – fraud and asset stripping remain widespread. Also legislation remains inefficient in terms of enforcing loan agreements and it often takes a colossal effort to foreclose on collateral.
- Deceleration in overall economic growth. Weaker growth in demand is forcing many companies to postpone their large capital investment programs. Households are less prone to borrow against higher uncertainly on future income.
- Availability of high-yield sovereign bonds. The government is paying up to 12.0% on three-month bonds and up to 14.5% on one-year bonds, which is attractive on a risk-reward basis and many banks are choosing to deploy their free cash into government securities.

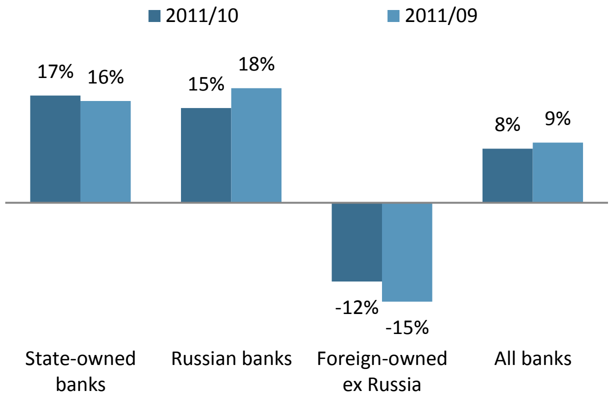
The increase in lending this year will be driven solely by loans to corporates (projected to rise 7% yoy). The retail portfolio should remain flat this year following three consecutive years of declines as maturing mortgages are being replaced with new consumer loans. We see corporate portfolios expanding more at state banks (largely on loans disbursed to state-owned companies) and at Russian banks, which continue to fight aggressively for market share.

Loan portfolio, yoy (UAH-based)



Source: NBU, Concorde Capital

Change in banking sector gross loans (UAH-based)



Source: NBU, Concorde Capital

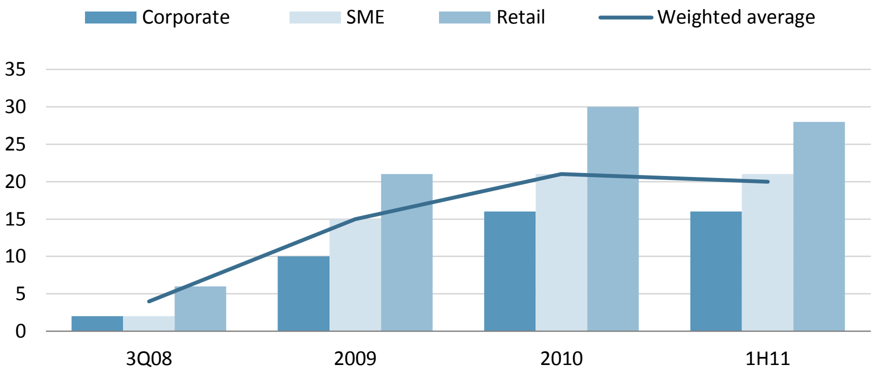
The share of FX corporate loans fell from 51% in January 2009 to 36% in February 2012. The retail sector saw a comparable decline, with the share of FX loans now close to 56%. This trend has positive implications as hryvnya loans have lower credit risk. We expect banks' FX loan portfolios to continue shrinking in 2012.

Progress in loan quality still poor

NPLs (loans past due by 90 days or more) peaked at about 21% at end-2010 according to Fitch Ratings (based on data for 14 Fitch-rated banks) and declined marginally to 20% at end-1H11. The quality was worst in the retail segment where NPLs were above 25% while corporate NPLs were close to 15%. Loan quality also differs considerably across banks: Privatbank reported NPLs at 5.8% of gross loans as of end-1H11 while Raiffeisen Bank Aval's NPLs stood at 34%.

We think loan quality is unlikely to improve substantially this year and believe that only 20-30% of current NPLs are potentially recoverable. The bulk will have to be written off or sold to collection agencies at deep discounts. The banking sector's end-2011 loan loss reserve was 18%, which means banks have already covered most of their past and prospective loan losses with provisions.

NPLs (loans overdue 90 days or more), % of gross loans*

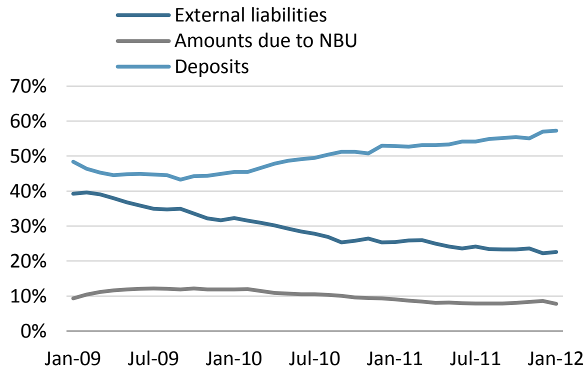


**14 Fitch-rated banks*
Source: Fitch Ratings

Funding structure shifting to deposits

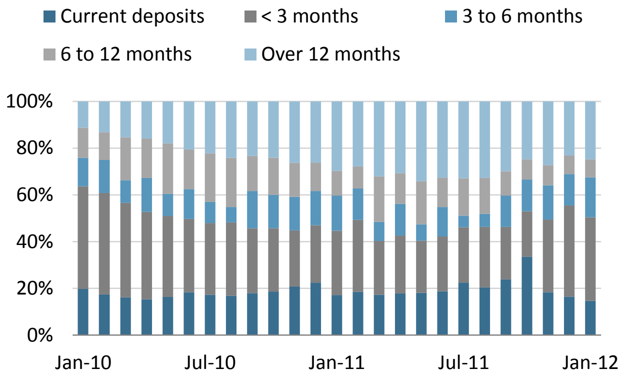
Banks continued to replace external wholesale funding with client deposits in 2011. As of end-2011, banks' gross external debt was USD 25 bln, down 40% from the peak four years ago. We expect the trend to continue this year as EU banks reduce exposure to the risky Ukrainian market. The share of external obligations fell from 40% of total non-equity funding of banks as of February 2009 to 23% in February 2011 while the share of deposits rose from 43% two years ago to 58%. We expect the sector's loan-to-deposit ratio to move 9 pp lower yoy to nearly 153% by end-2012 (vs. the peak of 210% in late 2008). Overall, a higher reliance on deposits implies a more diversified funding base and lower exposure to the global debt market. On the flipside, most deposits are short-term (the share of deposits with maturities of more than six months was just 33% of newly-attracted facilities in January) and their stability remains vulnerable to changes in consumer sentiment.

Structure of banks' liabilities



Source: NBU, Concorde Capital

New deposits by maturity

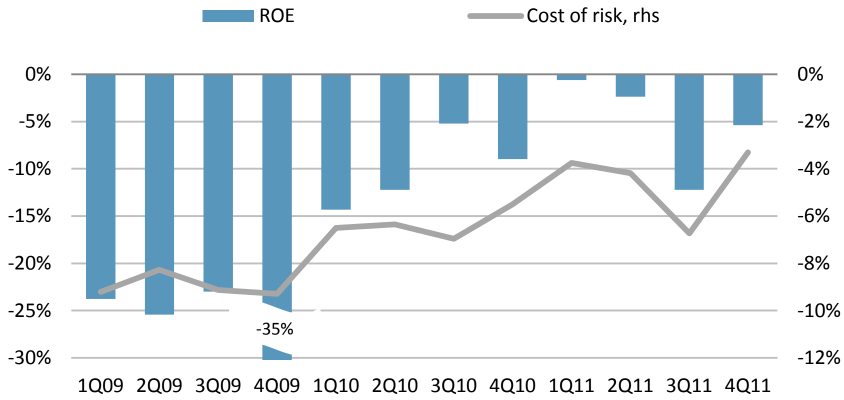


Source: NBU, Concorde Capital

Core earnings to stay low, profitability to improve on lower cost of risk

We see banks' core earning expanding only marginally this year, by 5-7%, due to weak lending and pressure on interest margins. Room for further cost optimization is limited, implying banks' operating expenses are likely to grow broadly in line with inflation. All in all, we expect the sector's profit before provisions to remain virtually unchanged in 2012 on a year-on-year basis. Banks are still likely to improve profitability this year on a decline in the cost of risk. As banks have already covered the bulk of their loan losses, they are now in a position to slash provisions. We expect their combined bottom line will turn positive (albeit marginally) for the first time since 2008.

Banking sector ROE vs. cost of risk



Source: NBU, Concorde Capital

TWO INVESTABLE STOCKS, DIFFERENT INVESTMENT CASES

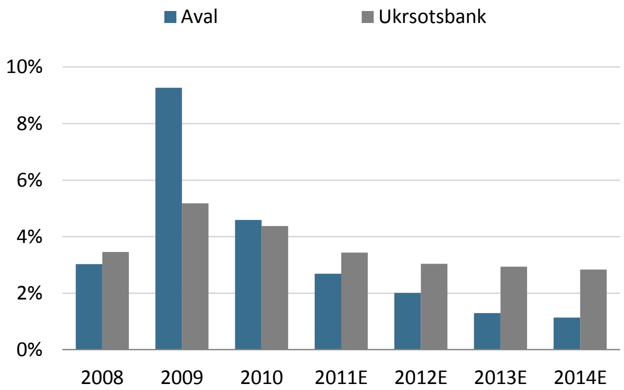
The two investable stocks in the Ukrainian banking sector are Raiffeisen Bank Aval (BAVL UK) and Ukrsotsbank (USCB UK). We prefer Aval over Ukrsotsbank since the former has pursued a more aggressive provisioning policy so far and has brought its NPL coverage ratio to around 75% while the ratio for Ukrsotsbank is about 55%. We think Ukrsotsbank's profitability will remain low for the next couple of years on heightened provisions while Aval can now decrease provisions and report a ROE of 12% in 2012.

Summary of key ratios and financials

	ROE		Cost/Income		NIM		LLR/Gross loans		CAR (Basel 1)	
	2011E	2012E	2011E	2012E	2011E	2012E	2011E	2012E	2011E	2012E
Raiffeisen Bank Aval	10.4%	11.9%	57.9%	59.9%	7.6%	7.2%	25.2%	26.3%	21.2%	22.9%
Ukrsotsbank	4.4%	4.7%	45.5%	48.1%	6.5%	6.2%	19.4%	21.6%	27.8%	28.1%

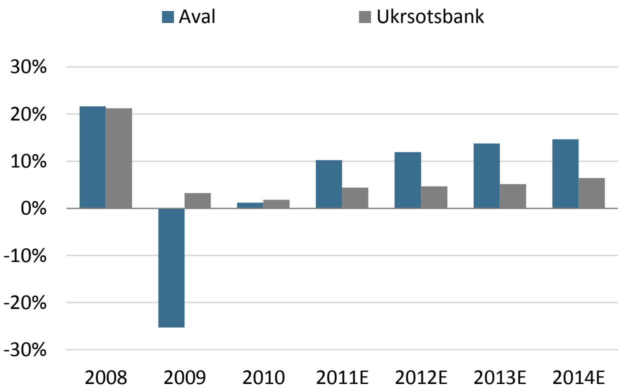
Sources: Company data, Concorde Capital

Cost of risk



Sources: Company data, Concorde Capital

ROE



Sources: Company data, Concorde Capital

VALUATION SUMMARY

Raiffeisen Bank Aval and Ukrsotsbank trade at 60%+ discounts to their CEE peers based on P/B 2012 multiple. Nevertheless, we give little credit to this metric: delinquent loans at both banks are still not adequately provisioned, and this implies their book values are overstated. Our target prices are based solely on DCF, which takes into account only future net income (which in turn takes into account additional needs for provisions).

Our target prices of USD 0.033/share for Aval and USD 0.048/share for Ukrsotsbank imply 100+% upsides for both stocks. Despite that, we rate both stock HOLD as the banks are unlikely to deliver any positive surprises this year against the backdrop of a weak macro environment.

Peer comparison summary*

			P/B		P/E		ROE	
			2011E	2012E	2011E	2012E	2011E	2012E
Raiffeisen Bank Aval	Ukraine	BAVL UK	0.4	0.4	4.5	3.5	10.4%	11.9%
Premium/(discount) to mean			-63%	-64%	-55%	-56%	-3.2pp	-2.3pp
Ukrsotsbank	Ukraine	USCB UK	0.4	0.3	8.4	7.5	4.4%	4.7%
Premium/(discount) to mean			-70%	-68%	-16%	-6%	-9.3pp	-9.5pp
PKO BP	Poland	PKO PW	1.7	1.5	10.8	9.8	16.6%	16.3%
Bank Pekao	Poland	PEO PW	1.8	1.7	13.5	12.6	13.3%	13.7%
BRE	Poland	BRE PW	1.4	1.3	13.0	11.8	11.4%	11.9%
BZ WBK	Poland	BPH PW	0.7	0.6	14.1	10.6	4.5%	5.4%
OTP Bank	Hungary	OTP HB	0.7	0.7	7.9	5.7	10.4%	12.1%
BRD-Groupe Soc Gen	Romania	BRD RO	1.1	1.0	16.6	7.7	14.9%	14.8%
Komercni Bank	Czech Rep.	KOMB CP	1.7	1.6	10.9	10.2	16.1%	16.5%
Raiffeisen Bank International	Austria	RBI AV	0.6	0.6	7.4	5.5	8.6%	10.6%
Vozrozhdenie Bank	Russia	VZRZ RM	0.8	0.7	9.4	6.1	9.0%	12.4%
VTB	Russia	VTBR LI	1.2	1.1	8.0	7.4	16.0%	15.9%
Sberbank	Russia	SBER RU	1.8	1.5	7.1	7.1	27.3%	21.9%
Kazkommercbank	Kazakhstan	KKB LI	0.5	0.5	9.3	6.2	5.4%	7.4%
Halyk Savings Bank	Kazakhstan	HSBK LI	1.0	0.9	7.5	5.4	12.9%	15.1%
Akbank TAS	Turkey	AKBNK TI	1.5	1.3	11.3	9.8	13.7%	14.3%
Turkiye Garanti	Turkey	GARAN TI	1.4	1.3	9.3	8.2	16.3%	16.8%
Turkiye Is Bankasi	Turkey	ISCTR TI	1.0	0.9	8.2	7.1	12.6%	13.1%
Tapi Kredi	Turkey	YKBNK TI	1.1	1.0	8.0	6.8	15.2%	15.7%
Halk Bankasi	Turkey	HALKB TI	1.5	1.3	7.5	6.7	21.8%	20.6%
Bank of Georgia	Georgia	BGEO LN	1.2	1.0	6.4	5.3	19.5%	17.2%
Mean			**1.2**	**1.1**	**10.0**	**8.1**	**13.7%**	**14.2%**

**Data as of March 20, 2012*

Source: Bloomberg, Concorde Capital

BANKS IN FOCUS

Raiffeisen Bank Aval

Profitability bolstered by a slash in provisions

USCB UK	Current:	USD 0.015	HOLD
	Target:	USD 0.033	

- Profitability should increase this year thanks to a decline in the cost of risk (seen at 2.0% in 2012E vs. 2.7% in 2011E and 4.6% in 2010). With a slash in impairment charges, operating profits should feed into the bottom line, with 2012 ROE expected at 12%.
- We see Aval's net loans expanding a mere 2% yoy. Management's focus will remain solely on asset quality and working out delinquent loans.
- Loan quality stabilized in 2011, with NPLs staying at 33-34% of the total portfolio. NPL coverage is now close to 75%, which implies accelerated provisioning is nearing an end.
- Raiffeisen Group confirmed it remains committed to developing its banking business in Ukraine. We expect Aval to enjoy parent support, even though its reliance on wholesale funding from the Group is set to be reduced.
- Funding structure improved in the last couple of years, with its net loan-to-deposit ratio dropping from over 200% three years ago to 120% as of end-2011E. The shift to deposits will depress NIM, which we expect to narrow by 0.4 pp yoy to 7.2% in 2012.

Bank description

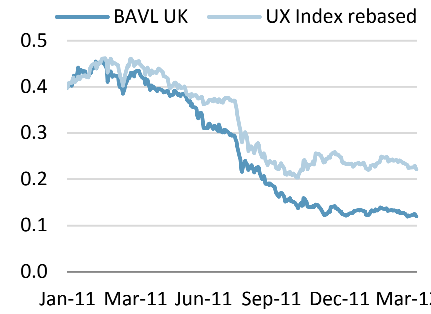
Ukraine's #4 largest bank and #2 largest private bank, with total end-2011 assets of USD 6.4 bln (4.9% of sector assets). 96%-owned by Austria's Raiffeisen Bank International. The bank has extensive retail network with 934 outlets across Ukraine. Lending portfolio is diversified: corporate loans account for 54% of total lending volumes. Funding base is dominated by retail deposits (33% of non-equity funding) and interbank loans from its parent and IFIs (30% of funding). Enjoys strong support from shareholders as well as the EBRD and IFC, which jointly have committed USD 370 mln in equity and subordinated loans to support the lender's regulatory capital in the last couple of years.

Selected financials (USD mln) and ratios, IFRS

	2010	*2011E*	*Chg,yoy*	*2012E*	*Chg, yoy*
Net interest income	446	464	4%	439	-5%
Net fees & commission	214	193	-10%	236	22%
Profit before provisions	293	277	-6%	271	-2%
Net provisions expense	-269	-148	-45%	-112	-24%
Net income	11	99	832%	126	27%
Net loans	4,253	4,089	-4%	4,176	2%
Total assets	7,132	6,766	-5%	6,909	2%
Client deposits	3,424	3,404	-1%	3,620	6%
Total liabilities	6,233	5,770	-7%	5,786	0%
Total equity	899	996	11%	1,124	13%
ROE	1.2%	10.4%	9.2 ppt	11.9%	1.4 ppt
ROA	0.2%	1.4%	1.3 ppt	1.8%	0.4 ppt
Net interest margin	7.1%	7.6%	0.5 ppt	7.2%	-0.4 ppt
Cost/income ratio	55.6%	57.9%	2.3 ppt	59.9%	2.0 ppt
Cost of risk	4.6%	2.7%	-1.9 ppt	2.0%	-0.7 ppt
LLR/gross loans	22.7%	25.2%	2.5 ppt	26.3%	1.1 ppt
Equity/assets	12.6%	14.7%	2.1 ppt	16.3%	1.5 ppt
BIS Total CAR	18.7%	21.2%	2.5 ppt	22.9%	1.6 ppt

Source: Company Data, Concorde Capital

Share price performance*



** Hereafter, share prices as of March 20, 2012*

Source: Bloomberg

Market data

Bloomberg	BAVL UK
Current price, USD	0.015
MCap, USD mln	441
Free float, %	3.6%
Free float, USD mln	16
Common shares outstanding, mln	30,027
Common shares per DR	na
Change from 52W low, %	-73%
Change from 52W high, %	-1%
1M change, %	-11%
3M change, %	-4%
12M change, %	-71%

Source: Bloomberg

Ownership structure

Raiffeisen Group	96.4%
Free float	3.6%

Source: Company data, Concorde Capital

Multiples and per-share data

	2011E	*2012E*
P/E	4.5	3.5
P/B	0.4	0.4
P/PPOP	1.6	1.6
BPS, USD	0.033	0.037
EPS, USD	0.003	0.004
DPS, USD	0.000	0.000

Source: Bloomberg, Company data, Concorde Capital

Valuation

We apply a 2% company-specific risk premium when estimating Raiffeisen Bank Aval's cost of equity to account for its extensive exposure to FX assets. We set our 12-month target price at UAH 0.26 (USD 0.033) /share, based on DCF.

COE assumptions

	2012	2013	2014	2015	2016	2017
Cost of equity	**18.0%**	**18.0%**	**18.0%**	**18.0%**	**18.0%**	**18.0%**
Gov't Eurobond yield	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%
Equity risk premium	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Company-specific premium	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%

Source: Concorde Capital

DCF model, UAH mln unless otherwise specified

	2012E	2013E	2014E	2015E	2016E	2017E
Net income	992	1,232	1,526	1,895	2,142	2,420
RWA	49,748	53,254	58,410	65,085	73,546	83,107
Change in RWA	2,201	3,506	5,157	6,675	8,461	9,561
Targeted Tier 1 ratio (marginal capital charge)	10%	10%	10%	10%	10%	10%
Net income retention	0	0	0	0	274	956
FCF to shareholders	992	1,232	1,526	1,895	1,867	1,464
COE	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Discount factor	0.85	0.72	0.61	0.52	0.44	0.37
Discounted FCF to shareholders @ March-2013	841	885	929	978	816	542
Terminal value						10,054

Sum of discounted FCF (2013-17)	4,150
Discounted terminal value	3,724
Bank value @March-2013	7,874
Implied FV / YE12 B	0.9
Number of shares @ March-2013	30,027mln
Value per share, UAH	0.26
Value per share, USD	0.03
Terminal value assumptions	
Perpetuity growth rate	3.0%
COE in perpetuity	18.0%

Source: Concorde Capital

Sensitivity of value per share, UAH

		Perp. growth rate				
		1%	2%	3%	4%	5%
COE	16%	0.27	0.28	0.28	0.30	0.31
	17%	0.26	0.26	0.27	0.28	0.30
	18%	0.25	0.25	**0.26**	0.27	0.28
	19%	0.24	0.24	0.25	0.26	0.27
	20%	0.23	0.23	0.24	0.25	0.26

Source: Concorde Capital

Raiffeisen Bank Aval, IFRS

Income statement, USD mln

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Interest income	1,222	976	840	761	746	772	837	928
Interest expense	-522	-472	-394	-297	-307	-315	-338	-371
Net Interest Income	701	504	446	464	439	457	499	557
Net fees & commission income	218	146	143	164	186	209	236	268
Net other non-interest income	112	25	71	29	50	39	40	42
Total Non-Interest Income	330	171	214	193	236	247	277	309
Total operating revenues	1,031	674	660	657	676	704	775	867
Personnel costs	-265	-161	-181	-198	-212	-229	-247	-267
Other operating expenses	-242	-184	-186	-182	-192	-206	-223	-241
Total operating costs	-507	-344	-367	-380	-405	-436	-470	-509
Profit/(loss) before provisions	523	330	293	277	271	269	305	358
Net provision expense	-227	-632	-269	-148	-112	-76	-72	-69
Pre-tax income/(loss)	297	-303	24	129	159	192	233	289
Income tax benefit/ (expense)	-78	66	-13	-30	-33	-37	-40	-49
Net income/(loss)	218	-237	11	99	126	156	193	240

Balance sheet, USD mln

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Cash and cash equivalents	309	278	300	248	256	308	340	377
Amounts due from credit institutions (incl. NBG)	893	859	912	815	818	859	902	947
Loans to clients, net	6,996	5,219	4,253	4,089	4,176	4,502	5,042	5,778
Loans to individuals	4,356	3,672	3,276	3,514	3,730	3,991	4,391	4,917
Loans to legal entities	3,063	2,562	2,225	1,954	1,936	2,072	2,279	2,552
Allowance for loan impairment	-423	-1,015	-1,248	-1,379	-1,491	-1,561	-1,628	-1,691
Fixed income securities	115	130	1,046	1,016	1,071	1,125	1,181	1,240
PPE and intangible assets	421	380	412	391	375	375	404	436
Other Assets	53	130	208	206	213	228	244	261
Total Assets	8,788	6,997	7,132	6,766	6,909	7,396	8,113	9,040
Client deposits	3,389	3,328	3,424	3,404	3,620	3,950	4,383	4,938
Legal entities	1,015	1,036	1,285	1,445	1,593	1,832	2,126	2,466
Individuals	2,375	2,292	2,139	1,959	2,026	2,117	2,257	2,472
Amounts due to credit institutions	4,020	2,438	2,438	1,998	1,798	1,798	1,888	2,021
Domestic debt securities	94	24	3	3	0	0	0	0
Eurobonds	0	0	0	0	0	0	0	0
Subordinated debt	141	297	297	297	297	297	297	297
Other liabilities	69	58	71	68	70	73	76	79
Total liabilities	7,764	6,145	6,233	5,770	5,786	6,119	6,644	7,334
Total equity	1,024	852	899	996	1,124	1,277	1,468	1,705
Liabilities & equity	8,788	6,997	7,132	6,766	6,909	7,396	8,113	9,040

Financial ratios

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Growth								
Assets	0%	-20%	2%	-5%	2%	7%	10%	11%
Net loans	-3%	-25%	-19%	-4%	2%	8%	12%	15%
Deposits	-24%	-2%	3%	-1%	6%	9%	11%	13%
Profit/(loss) before provisions	80%	-37%	-11%	-6%	-2%	-1%	14%	17%
Net income/(loss)	44%	nm	nm	832%	27%	24%	24%	24%
Profitability								
ROAE	21.6%	-25.3%	1.2%	10.4%	11.9%	13.0%	14.1%	15.1%
ROAA	2.5%	-3.0%	0.2%	1.4%	1.8%	2.2%	2.5%	2.8%
Interest spread	7.0%	6.8%	7.1%	7.5%	7.0%	6.9%	6.9%	6.9%
Net interest margin	7.3%	7.1%	7.1%	7.6%	7.2%	7.2%	7.2%	7.3%
Total operating revenues / average assets	11.7%	8.5%	9.3%	9.5%	9.9%	9.8%	10.0%	10.1%
Liquidity								
Net loans / total assets	80%	75%	60%	60%	60%	61%	62%	64%
Interest earning assets / total assets	91%	89%	87%	88%	88%	88%	88%	88%
Net loans / client deposits	206%	157%	124%	120%	115%	114%	115%	117%
Client deposits / total liabilities	44%	54%	55%	59%	63%	65%	66%	67%
Efficiency								
Cost/income ratio	49.2%	51.1%	55.6%	57.9%	59.9%	61.9%	60.6%	58.7%
Operating cost / average total assets	5.8%	4.4%	5.2%	5.5%	5.9%	6.1%	6.1%	5.9%
Asset quality								
Cost of risk	3.0%	9.3%	4.6%	2.7%	2.0%	1.3%	1.1%	1.0%
Reserve for loan losses / gross loans	5.7%	16.3%	22.7%	25.2%	26.3%	25.7%	24.4%	22.6%
Capital								
Equity to assets	11.6%	12.2%	12.6%	14.7%	16.3%	17.3%	18.1%	18.9%
BIS total capital adequacy	21.3%	18.6%	18.7%	21.2%	22.9%	23.7%	24.2%	24.6%
Per share								
BPS, USD	0.042	0.028	0.030	0.033	0.037	0.043	0.049	0.057
EPS, USD	0.009	-0.009	0.000	0.003	0.004	0.005	0.006	0.008
DPS, USD	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Source: Company data, Concorde Capital

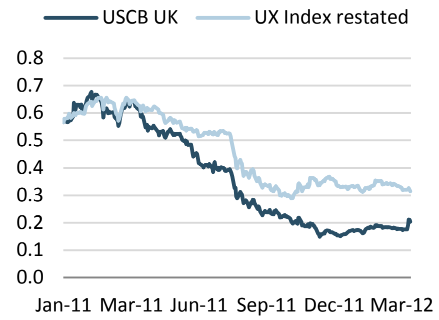
Ukrsotsbank

Profitability held back by impairment charges

USCB UK	Current:	USD 0.024	HOLD
	Target:	USD 0.048	

- Profitability should remain restricted by heightened cost of risk. We project the bank will continue sending the bulk of its operating profits to loan loss reserves and its ROE will stay below 5% in 2012.
- NPLs likely recovered marginally last year to 36-37% of gross loans, with end-2011 NPL coverage ratio estimated at 55%. We think the bank should go further to bring that level to at least 80%, implying low profitability this year and next.
- We project net loans will remain virtually flat in 2012 and core earnings will only be driven by net fees & commission income (+16% yoy).
- Loan-to-deposits ratio improved by an estimated 40 pp to 163% in 2011 and we see the ratio at 147% at end-2012. At the same time, deposit pricing is not aggressive and the bank relies mainly on reputation and brand recognition to attract new customers.
- Ukrsotsbank plans to increase share capital, subject to approval at an AGM on April 20. We relate this either to the prospective merger with UniCredit Bank Ukraine or as a signal that UniCredit is seeking to attract a new strategic investor to Ukrsotsbank.
- The announced merger with UniCredit Bank Ukraine (#31 domestically by assets) adds uncertainty for Ukrsotsbank as there is no clarity on the timing and terms of the prospective deal.

Share price performance *



** Hereafter, share prices as of* March 20, 2012
Source: Bloomberg

Bank description

Ukraine's 5th largest bank, with end-2011 assets of USD 5 bln (3.8% market share). Local subsidiary of Italy's UniCredit Group, which controls a 95.4% stake in the bank. Large retail network of 424 outlets across Ukraine. UniCredit and IFIs account for over 33% of Ukrsotsbank's funding base, with retail and corporate deposits holding 32% and 21% shares, respectively, of end-2011 liabilities. Loan portfolio is equally split between retail and corporate facilities.

Market data

Bloomberg	USCB UK
Current price, USD	0.024
MCap, USD mln	303
Free float, %	4.6%
Free float, USD mln	14
Common shares outstanding, mln	12,695
Common shares per DR	na
Change from 52W low, %	-70%
Change from 52W high, %	28%
1M change, %	5%
3M change, %	24%
12M change, %	-68%

Source: Bloomberg

Ownership structure

UniCredit Group	95.4%
Free float	4.6%

Source: Company data, Concorde Capital

Selected financials (USD mln) and ratios, IFRS

	2010	*2011E*	*Chg,yoy*	*2012E*	*Chg, yoy*
Net interest income	317	290	-9%	272	-6%
Net fees & commission	61	65	7%	76	16%
Profit before provisions	231	204	-12%	191	-6%
Net provisions expense	-211	-157	-26%	-140	-11%
Net income	14	36	154%	40	11%
Net loans	3,879	3,643	-6%	3,688	1%
Total assets	5,197	4,879	-6%	4,963	2%
Client deposits	1,923	2,242	17%	2,511	12%
Total liabilities	4,389	4,039	-8%	4,083	1%
Total equity	808	840	4%	879	5%
ROE	1.9%	4.4%	2.5 ppt	4.7%	0.3 ppt
ROA	0.3%	0.7%	0.4 ppt	0.8%	0.1 ppt
Net interest margin	6.7%	6.5%	-0.2 ppt	6.2%	-0.2 ppt
Cost/income ratio	40.2%	45.5%	5.3 ppt	48.1%	2.6 ppt
Cost of risk	4.4%	3.4%	-0.9 ppt	3.0%	-0.4 ppt
LLR/gross loans	15.8%	19.4%	3.6 ppt	21.6%	2.2 ppt
Equity/assets	15.5%	17.2%	1.7 ppt	17.7%	0.5 ppt
BIS Total CAR	25.2%	27.8%	2.6 ppt	28.1%	0.4 ppt

Source: Company Data, Concorde Capital

Multiples and per-share data

	2011E	*2012E*
P/E	8.4	7.5
P/B	0.4	0.3
P/PPOP	1.5	1.6
BPS, USD	0.066	0.069
EPS, USD	0.003	0.003
DPS, USD	0.000	0.000

Source: Bloomberg, Company data, Concorde Capital

Valuation

We apply a 3% company-specific risk premium when estimating Ukrsotsbank's cost of equity – 2% to account for its extensive exposure to FX assets and 1% to reflect risks related to a prospective merger with UniCredit Bank Ukraine. We set our 12-month target price at UAH 0.38 (USD 0.048)/share.

COE assumptions

	2012	2013	2014	2015	2016	2017
Cost of equity	**19.0%**	**19.0%**	**19.0%**	**19.0%**	**19.0%**	**19.0%**
Gov't Eurobond yield	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%
Equity risk premium	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Company-specific premium	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%

Source: Concorde Capital

DCF model, UAH mln unless otherwise specified

	2012E	2013E	2014E	2015E	2016E	2017E
Net income	318	367	488	1,130	1,507	1,795
RWA	31,562	34,281	38,270	43,266	48,206	53,797
Change in RWA	728	2,719	3,989	4,995	4,940	5,592
Targeted Tier 1 ratio (marginal capital charge)	8%	8%	8%	8%	8%	8%
Net income retention			0	0	0	618
FCF to shareholders	318	367	488	1,130	1,507	1,177
COE	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Discount factor	0.84	0.71	0.59	0.50	0.42	0.35
Discounted FCF to shareholders @ March-2013	267	259	289	563	632	414
Terminal value						7,577

Sum of discounted FCF (2013-17)	2,158
Discounted terminal value	2,668
Bank value @March-2013	4,827
Implied FV / YE12 B	0.7
Number of shares*	12.695mln
Value per share, UAH	0.38
Value per share, USD	0.05

Terminal value assumptions	
Perpetuity growth rate	3.0%
COE in perpetuity	19.0%

** Based on the current number of shares*
Source: Concorde Capital

Sensitivity of value per share, UAH

		Perp. growth rate				
		1%	2%	3%	4%	5%
COE	17%	0.39	0.40	0.42	0.43	0.45
	18%	0.37	0.38	0.40	0.41	0.43
	19%	0.35	0.37	**0.38**	0.40	0.41
	20%	0.34	0.35	0.36	0.38	0.40
	21%	0.32	0.34	0.35	0.36	0.38

Source: Concorde Capital

Ukrsotsbank, IFRS

Income statement, USD mln

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Interest income	869	734	620	539	525	543	587	657
Interest expense	-466	-376	-303	-250	-253	-268	-295	-330
Net Interest Income	403	358	317	290	272	275	292	326
Net fees & commission income	118	67	61	65	76	91	108	121
Net other non-interest income	83	27	9	20	20	23	27	31
Total Non-Interest Income	201	94	70	85	96	114	135	153
Total operating revenues	605	452	387	374	368	389	427	479
Personnel costs	-139	-69	-76	-85	-87	-89	-95	-103
Other operating expenses	-102	-72	-79	-85	-89	-98	-106	-115
Total operating costs	-240	-140	-155	-170	-177	-188	-201	-218
Profit/(loss) before provisions	364	311	231	204	191	201	226	261
Net provision expense	-186	-280	-211	-157	-140	-144	-152	-91
Pre-tax income/(loss)	179	31	21	47	51	57	73	170
Income tax benefit/ (expense)	-48	-9	-6	-11	-11	-11	-12	-27
Net income/(loss)	131	22	14	36	40	47	62	143

Balance sheet, USD mln

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Cash and cash equivalents	125	101	121	72	68	129	157	205
Amounts due from credit institutions (incl. NBG)	320	301	589	400	397	443	494	550
Loans to clients, net	5,549	4,499	3,879	3,643	3,688	3,929	4,356	4,895
Loans to individuals	2,611	2,314	2,205	2,290	2,473	2,745	3,088	3,459
Loans to legal entities	3,197	2,714	2,402	2,233	2,233	2,344	2,579	2,836
Allowance for loan impairment	-260	-530	-728	-880	-1,018	-1,160	-1,311	-1,400
Fixed income securities	30	43	123	232	256	281	323	372
PPE and intangible assets	352	381	418	454	470	480	510	543
Other Assets	36	69	67	77	85	93	102	113
Total Assets	6,412	5,395	5,197	4,879	4,963	5,356	5,943	6,677
Client deposits	1,855	1,545	1,923	2,242	2,511	2,855	3,248	3,695
Legal entities	893	584	680	950	1,063	1,191	1,334	1,494
Individuals	961	960	1,243	1,292	1,447	1,664	1,914	2,201
Amounts due to credit institutions	3,193	2,371	2,180	1,519	1,291	1,291	1,420	1,562
Domestic debt securities	80	6	8	0	0	0	0	0
Eurobonds	410	411	0	0	0	0	0	0
Subordinated debt	150	254	254	250	250	250	250	250
Other liabilities	89	81	25	29	32	35	39	42
Total liabilities	5,776	4,668	4,389	4,039	4,083	4,431	4,956	5,549
Total equity	636	727	808	840	879	925	986	1,128
Liabilities & equity	6,412	5,395	5,197	4,879	4,963	5,356	5,943	6,677

Financial ratios

	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Growth								
Assets	5%	-16%	-4%	-6%	2%	8%	11%	12%
Net loans	15%	-19%	-14%	-6%	1%	7%	11%	12%
Deposits	-42%	-17%	24%	17%	12%	14%	14%	14%
Profit/(loss) before provisions	154%	-15%	-26%	-12%	-6%	5%	12%	16%
Net income/(loss)	95%	-83%	-36%	154%	11%	16%	33%	132%
Profitability								
ROAE	21.2%	3.3%	1.9%	4.4%	4.7%	5.2%	6.5%	13.5%
ROAA	2.1%	0.4%	0.3%	0.7%	0.8%	0.9%	1.1%	2.3%
Interest spread	5.7%	6.3%	6.3%	6.1%	5.8%	5.7%	5.5%	5.5%
Net interest margin	5.8%	6.6%	6.7%	6.5%	6.2%	6.0%	5.9%	5.9%
Total operating revenues / average assets	9.6%	7.7%	7.3%	7.4%	7.5%	7.5%	7.6%	7.6%
Liquidity								
Net loans / total assets	87%	83%	75%	75%	74%	73%	73%	73%
Interest earning assets / total assets	92%	90%	88%	88%	87%	87%	87%	87%
Net loans / client deposits	299%	291%	202%	163%	147%	138%	134%	132%
Client deposits / total liabilities	32%	33%	44%	55%	61%	64%	66%	67%
Efficiency								
Cost/income ratio	39.7%	31.1%	40.2%	45.5%	48.1%	48.2%	47.1%	45.5%
Operating cost / average total assets	3.8%	2.4%	2.9%	3.4%	3.6%	3.6%	3.6%	3.5%
Asset quality								
Cost of risk	3.5%	5.2%	4.4%	3.4%	3.0%	2.9%	2.8%	1.5%
Reserve for loan losses / gross loans	4.5%	10.5%	15.8%	19.4%	21.6%	22.8%	23.1%	22.2%
Capital								
Equity to assets	9.9%	13.5%	15.5%	17.2%	17.7%	17.3%	16.6%	16.9%
BIS total capital adequacy	15.2%	22.7%	25.2%	27.8%	28.1%	26.5%	24.0%	22.9%
Per share								
BPS, USD	0.059	0.057	0.064	0.066	0.069	0.073	0.078	0.089
EPS, USD	0.012	0.002	0.001	0.003	0.003	0.004	0.005	0.011
DPS, USD	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

Source: Company data, Concorde Capital

Analyst certification

We, Olena Zuikova and Vitaliy Vavryshchuk, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Raiffeisen Bank Aval: Rating history

Date	*12M target price, USD*	*Market price, USD*	*Rating*	*Action*
21-Mar-2012	0.033	0.015	Hold	Initiating

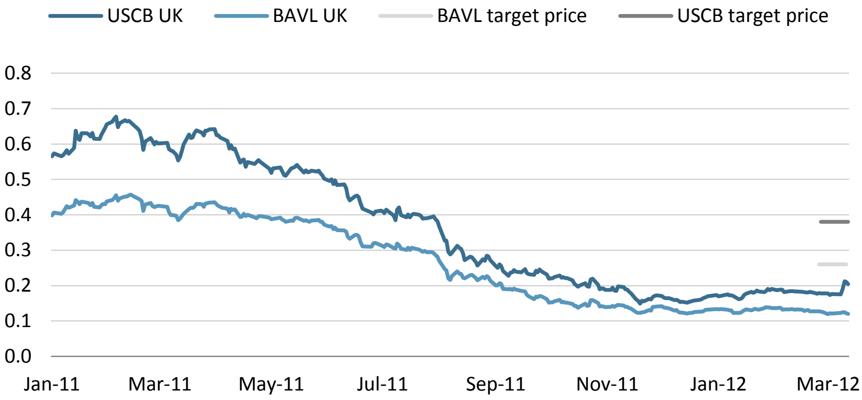
Source: Concorde Capital

Ukrsotsbank: Rating history

Date	*12M target price, USD*	*Market price, USD*	*Rating*	*Action*
21-Mar-2012	0.048	0.024	Hold	Initiating

Source: Concorde Capital

Target prices vs. share performance, UAH per share



Source: Bloomberg, Concorde Capital

Investment ratings

The time horizon for target prices in Concorde Capital's research is 12 months unless otherwise stated. Concorde Capital employs three basic investment ratings: Buy, Hold and Sell. Typically, Buy recommendation is associated with an upside of 20% or more from the current market price; Sell is prompted by downside from the current market price (upside <0%); Hold recommendation is generally for limited upside within 20%. Though investment ratings are generally induced by the magnitude of upside, they are not derived on this basis alone. In certain cases, an analyst may have reasons to establish a recommendation where the associated range given above does not correspond. Temporary discrepancies between an investment rating and its upside at a specific point in time due to price movement and/or volatility will be permitted; Concorde Capital may revise an investment rating at its discretion. A recommendation and/or target price might be placed Under Review when impelled by corporate events, changes in finances or operations. Investors should base decisions to Buy, Hold or Sell a stock on the complete information regarding the analyst's views in the research report and on their individual investment objectives and circumstances.

Contacts

CONCORDE CAPITAL
2 Mechnikova Street, 16th Floor
Parus Business Centre
Kyiv 01601, Ukraine
Tel.: +380 44 391 5577
Fax: +380 44 391 5571
www.concorde.ua
Bloomberg: TYPE CONR <GO>

CEO
Igor Mazepa im@concorde.com.ua

SALES

Head of Sales & Trading
Luba Yurchyk ly@concorde.com.ua

International Sales & Trading
Katerina Shevchenko ksh@concorde.com.ua
Marina Martirosyan mm@concorde.com.ua
Rostyslav Shmanenko rs@concorde.com.ua

RESEARCH

Head of Research
Alexander Paraschiy ap@concorde.com.ua

Agriculture, Consumer
Yegor Samusenko syg@concorde.com.ua

Economics
Svetlana Rekrut sr@concorde.com.ua

Machinery
Roman Dmytrenko rd@concorde.com.ua

Utilities, Telecommunications
Alexander Paraschiy ap@concorde.com.ua

Fixed income, Energy
Vitaliy Vavryshchuk vv@concorde.com.ua

Metals & Mining
Roman Topolyuk rt@concorde.com.ua

Financials
Olena Zuikova olz@concorde.com.ua

Corporate governance, Politics
Brad Wells bw@concorde.com.ua

Editor
Brad Wells bw@concorde.com.ua