

May 03, 2012

Ukrsotsbank

Downgrade on upcoming 45% share capital increase

Ukrsotsbank's upcoming capital increase implies the stakes of non-participating minority shareholders will be diluted by 1.45x. At the same time, we think the new equity injection adds little value to the bank's business. We downgrade our target price for Ukrsotsbank from UAH 0.38/share to UAH 0.28/share. We also note high risk of a reduction in stock liquidity – the dilutive share issue and share buyback might squeeze free float from 4.6% currently to 1.5%. The stock is trading at 2012E P/B of 0.46x, a 51% discount to peers. We maintain our HOLD recommendation on the stock, but think risk-averse investors eligible to sell their shares to the issuer should use this opportunity.

Upcoming capital increase implies 1.45x dilution of minorities

Ukrsotsbank's AGM on April 20 approved a share capital increase: the bank will issue 5,708 mln new shares or 45% of the current number. Current shareholders have a pre-emptive right to buy new shares on a pro-rata basis; applications should be submitted over June 25-July 16, 2012. The ex-rights date is April 20. The bank will sell shares at UAH 0.22/share, which is more than par value of UAH 0.10/share and above the current market price of UAH 0.213/share, which leads us to believe minority shareholders will not subscribe. The bank plans to raise USD 157 mln, boosting equity by 19%. UniCredit Group, the majority owner, will reportedly convert USD 150 mln in subordinated debt into equity.

Equity injection value destructive for minorities, TP revised down 27%

As Ukrsotsbank remains well capitalized (CAR was 12.6% at end-1Q12, according to NBU methodology), we do not believe the upcoming capital increase is badly needed, especially as it only improves the structure of regulatory capital and will have a minor effect on total CAR. We think the issuance of new shares is value destructive for minority shareholders – we estimate BPS will decline 19% as a result of the deal. Our revised DCF-model, which accounts for the effects of the deal, suggests a new target price of UAH 0.28/share (down from UAH 0.38/share), implying 31% upside to the current market. We maintain our HOLD recommendation.

Ukrsotsbank 1Q12 UAS-based financials unimpressive

Ukrsotsbank's 1Q12 financials were expectedly weak – operating profit declined 9% yoy and the bank kept sending it into loan loss reserve almost in full. Net loans added a mere 0.5% in 1Q12, in line with our expectations.

Temporary put option to support the price until May 20

The AGM approved a share buyback offer at UAH 0.22/share for minorities that voted against the capital increase. Applications must be submitted by May 20. Shareholders representing 2.4% of total ordinary shares (over 50% of free float) voted against the deal, implying these shares will not flood the market at below UAH 0.22/share until expiration of the put option. We estimate the stock's free float might decline from the current 4.6% to 1.5% following the share buyback and dilution. We raise our company-specific premium (for cost of equity calculation) 1 pp to 4% to account for expected reduction in liquidity.

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| | |
|-----------------------|-------------|
| Bloomberg | USCB UK |
| Reuters | USCB.UAX |
| Recommendation | HOLD |
| Price, USD | 0.027 |
| 12M target, USD | 0.035 |
| Upside | 31% |

| | |
|--------------------------|------------|
| Current # of shares, mln | 12,700 mln |
| Diluted # of shares, mln | 18,408 mln |
| Market Cap, USD mln | 336 |
| ADT, 12M, USD mln | 350 |
| Free float, % | 4.6% |
| Free float, USD mln | 15 |
| Change from 52W low, % | 51 % |
| Change from 52W high, % | -62 % |
| 1M change, % | -1 % |
| 3M change, % | 14 % |
| 12M change, % | -61 % |

Prices as of Apr. 28, 2012

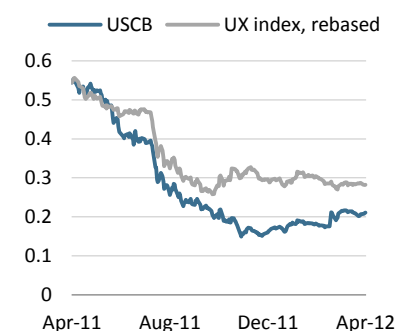
Source: Bloomberg

Ownership structure

| | |
|-----------------|-------|
| UniCredit Group | 95.4% |
| Free float | 4.6% |

Source: Company data, Concorde Capital

Price performance, UAH per share



Source: Bloomberg

Valuation

We apply a 4% company-specific risk premium (vs. 3% previously) when estimating Ukrsotsbank's cost of equity to account for the prospective reduction in liquidity of the bank's shares, its extensive exposure to FX assets and risks related to a prospective merger with UniCredit Bank Ukraine. We set our 12-month target price at USD 0.035/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 | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% | 5.5% |
| Company-specific premium | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% |

Source: Concorde Capital

DCF model, UAH mln unless otherwise specified

| | 2012E | 2013E | 2014E | 2015E | 2016E | 2017E |
|---|--------|--------|--------|--------|--------|--------|
| Net income | 347 | 428 | 551 | 1,193 | 1,336 | 1,503 |
| RWA | 31,630 | 34,398 | 38,438 | 43,486 | 48,478 | 54,101 |
| Change in RWA | 796 | 2,768 | 4,040 | 5,048 | 4,992 | 5,623 |
| Targeted Tier 1 ratio (marginal capital charge) | 8% | 8% | 8% | 8% | 8% | 8% |
| Net income retention | | | 0 | 0 | (35) | (450) |
| FCF to shareholders | 347 | 428 | 551 | 1,193 | 1,301 | 1,053 |
| COE | 19.0% | 19.0% | 19.0% | 19.0% | 19.0% | 19.0% |
| Discount factor | 0.91 | 0.77 | 0.64 | 0.54 | 0.46 | 0.38 |
| Discounted FCF to shareholders @ May-13 | 317 | 329 | 355 | 646 | 592 | 403 |
| Terminal value | | | | | | 7,232 |

| | |
|---------------------------------|-------|
| Sum of discounted FCF (2013-17) | 2,326 |
| Discounted terminal value | 2,768 |
| Bank value @May-13 | 5,093 |
| Implied FV / YE12 B | 0.6 |

| | |
|----------------------------|-----------|
| Number of shares @ May-13* | 18,408mln |
| Value per share, UAH | 0.28 |
| Value per share, USD | 0.035 |

Terminal value assumptions

| | |
|------------------------|-------|
| Perpetuity growth rate | 3.0% |
| COE in perpetuity | 18.0% |

* Diluted number of shares. Source: Concorde Capital

Sensitivity of value per share, UAH

| | Perp. growth rate | | | | | |
|-----|-------------------|------|------|-------------|------|------|
| | 1% | 2% | 3% | 4% | 5% | |
| COE | 16% | 0.28 | 0.29 | 0.30 | 0.31 | 0.33 |
| | 17% | 0.27 | 0.28 | 0.29 | 0.30 | 0.32 |
| | 18% | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 |
| | 19% | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 |
| | 20% | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 |

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 | -248 | -258 | -286 | -321 |
| Net Interest Income | 403 | 358 | 317 | 290 | 277 | 285 | 301 | 336 |
| 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 | 373 | 398 | 437 | 489 |
| 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 | 196 | 211 | 236 | 271 |
| Net provision expense | -186 | -280 | -211 | -157 | -140 | -144 | -152 | -91 |
| Pre-tax income/(loss) | 179 | 31 | 21 | 47 | 56 | 67 | 83 | 180 |
| Income tax benefit/(expense) | -48 | -9 | -6 | -11 | -12 | -13 | -13 | -29 |
| Net income/(loss) | 131 | 22 | 14 | 36 | 44 | 54 | 70 | 151 |

Balance sheet, USD mln

| | 2008 | 2009 | 2010 | 2011E | 2012E | 2013E | 2014E | 2015E |
|--|-------|-------|-------|-------|--------|--------|--------|--------|
| Cash and cash equivalents | 125 | 101 | 121 | 72 | 79 | 147 | 183 | 239 |
| 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 | 4,973 | 5,375 | 5,969 | 6,711 |
| 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 | 100 | 100 | 100 | 100 |
| Other liabilities | 89 | 81 | 25 | 29 | 32 | 35 | 39 | 42 |
| Total liabilities | 5,776 | 4,668 | 4,389 | 4,039 | 3,933 | 4,281 | 4,806 | 5,399 |
| Total equity | 636 | 727 | 808 | 840 | 1,040 | 1,094 | 1,162 | 1,312 |
| Liabilities & equity | 6,412 | 5,395 | 5,197 | 4,879 | 4,973 | 5,375 | 5,969 | 6,711 |

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% | -4% | 8% | 12% | 15% |
| Net income/(loss) | 95% | -83% | -36% | 154% | 21% | 23% | 29% | 117% |
| Profitability | | | | | | | | |
| ROAE | 21.2% | 3.3% | 1.9% | 4.4% | 4.7% | 5.1% | 6.2% | 12.2% |
| ROAA | 2.1% | 0.4% | 0.3% | 0.7% | 0.9% | 1.0% | 1.2% | 2.4% |
| 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% | 6.3% | 6.2% | 6.1% | 6.0% |
| Total operating revenues / average assets | 9.6% | 7.7% | 7.3% | 7.4% | 7.6% | 7.7% | 7.7% | 7.7% |
| 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% | 64% | 67% | 68% | 68% |
| Efficiency | | | | | | | | |
| Cost/income ratio | 39.7% | 31.1% | 40.2% | 45.5% | 47.4% | 47.1% | 46.1% | 44.6% |
| Operating cost / average total assets | 3.8% | 2.4% | 2.9% | 3.4% | 3.6% | 3.6% | 3.5% | 3.4% |
| 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% | 20.9% | 20.3% | 19.5% | 19.5% |
| BIS total capital adequacy | 15.2% | 22.7% | 25.2% | 27.8% | 28.4% | 26.9% | 24.4% | 23.4% |
| Per share | | | | | | | | |
| BPS, USD | 0.059 | 0.057 | 0.064 | 0.066 | 0.056 | 0.059 | 0.063 | 0.071 |
| EPS, USD | 0.012 | 0.002 | 0.001 | 0.003 | 0.002 | 0.003 | 0.004 | 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

Analyst certification

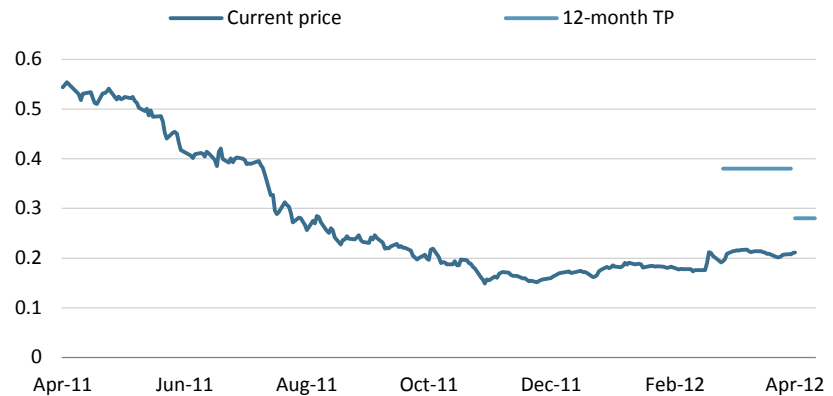
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UkrSotsbank: Rating history

| Date | 12M target price, USD | Market price, USD | Rating | Action |
|-------------|-----------------------|-------------------|--------|------------|
| 21-Mar-2012 | 0.048 | 0.024 | Hold | Initiating |
| 03-May-2012 | 0.035 | 0.027 | Hold | Maintain |

Source: Concorde Capital

Target prices vs. share performance, UAH per share



Source: Bloomberg, Concorde Capital

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