Ukraine / Banking

Ukrsotsbank

The Right Bank At The Right Time

BUY

17 Mar 2006 USD 0.25

12m Target USD 0.45

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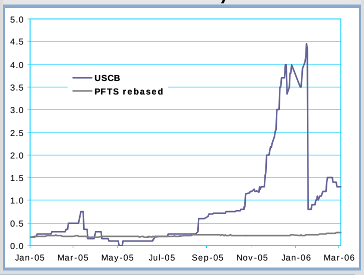
Banca Intesa has acquired a 88% stake in Ukrsotsbank, Ukraine's 4th largest bank in terms of assets. Along with the benefits associated with this acquisition, Ukrsotsbank is expected to post even stronger growth and profitability in 2006-08. We initiate coverage with a BUY recommendation.

USCB Bid-Price, UAH



Market Information

PFTS	**USCB**
Bloomberg	**USCB UZ**
No of Shares, mln	3,700

The bank's shareholders will approve the results of an additional 3 bln share issue at their EGM on March 24, 2006

Market price, USD	0.25
MCap, USD mln	925
Free Float,	4%

Stock Ownership

Banca Intesa	88%
Tempsford Investments	7.6%
Other	4.4%

Ratios 2005E

Net Interest Margin	5.6%
Net Income Margin	15.7%
ROE	13.8%
Cost/Income	71.6%

Raising The Bar For A Strategic Acquisition. On February 15, 2006 Banca Intesa, Italy's second-largest bank, won a tender for Ukrsotsbank with an offer of USD 1.16 bln for a 88% stake. If we use Ukrsotsbank's reported book value, USD 263.4 mln, this would translate into **a P/B multiple of x5.0 – the highest price ever paid for a Ukrainian bank.**

Ukrsotsbank: A Market Leader. Ukrsotsbank is one of Ukraine's top banks. With total assets of USD 2.1 bln (market share of 5.0%) at the end of 2005, a loan portfolio of USD 1.37 bln (5.2%) and customer deposits of USD 1.63 bln (5.7%), Ukrsotsbank is Ukraine's 4th largest bank. In 2006-08 we expect Ukrsotsbank to maintain its leading position by growing at 36% CAGR bringing its end of 2008 total assets to USD 5.08 bln, loan portfolio to USD 3.55 bln (+38% CAGR) and customer deposits to USD 3.79 bln (+33%). We estimate Ukrsotsbank's total income to reach USD 480 mln (+64%) and net income to grow to USD 105 mln (+64%) in 2008, implying a net margin of 21.9% and ROE of 22%.

Low-Cost Deposit Base. One of Ukrsotsbank's strengths is its sizeable demand deposit base which cost the bank far less than the average market cost - 1.6% as opposed to 5.0% for industry. In 2005 the demand deposits portion of the bank's total liabilities was 37%, above the market average of 27%. Ukrsotsbank has been increasing its demand deposits at a higher than market average rate, which makes us believe the bank will continue to benefit from its low-cost deposit base by maintaining the share of current accounts in its total liabilities at ~ 30% in 2006-08.

Foreign Borrowings On The Rise. To improve its liability structure, the bank has increased its efforts to raise foreign debts by drawing syndicated loans and making Eurobond placements. The share of foreign borrowings in the bank's liabilities grew from 1.2% in 2004 to 9% in 2005 and is expected to increase to 17% in 2007, replacing more expensive domestic debts.

Focused On Retail. Ukrsotsbank's management has put particular emphasis on the further expansion and enhancement of the bank's market share in the higher-yield retail segment. Ukrsotsbank's consumer lending grew at 302% CAGR in 2001-05 and represented 42.2% of the bank's gross loan portfolio.

KEY FINANCIAL DATA, USD mln

	Assets	Net Loans	Total Revenue	Net Income
2004	1307.6	720.5	111.8	21.1
2005E	2019.2	1359.7	152.7	24.0
2006E	3033.3	2067.0	236.4	41.4
Spot Exch Rate	5.05			

KEY RATIOS

	P/E	P/BV	P/Loans	P/Deposits
2004	43.9	6.0	1.3	0.9
2005E	38.4	4.8	0.7	0.6
2006E	22.4	3.1	0.4	0.4

Ukrsotsbank: The Center Of Attention

Italians Gain Stronghold In Ukraine's Top-5

On February 15, 2006 Banca Intesa, Italy's second-largest bank, won a tender for Ukrsotsbank with an offer of USD 1.16 bln for a 88% stake. If we use Ukrsotsbank's reported book value, USD 263.4 mln (including this year's upcoming emission of USD 60 mln), this would translate into **a P/B of x5.0** – the highest price ever paid for a Ukrainian bank.

Recent M&A Deals In Ukraine's Banking Sector

Date	Buyer	Target	Acquired Stake	P/E	P/BV
Feb-06	**Banca Intesa (Italy)**	**Ukrsotsbank**	**USD 1.16 bln for 88% stake**	**56.7**	**5.0**
Jan-06	Vneshtorgbank (Russia)	Mriya	USD 70 mln for 98% stake	9.2	1.6
Dec-05	BNP Paribas (France)	Ukrsibbank	~USD 350 mln for 51% stake	61.8	3.6
Aug-05	Raiffeisen International	Aval	USD 1028 mln for 93.5%	26.4	3.1
Apr-04	PKO Bank Polski (Poland)	Kredit Bank	USD 30 mln for 66.65%	30.5	1.6
Jan-05	Vilniaus Bankas (Lithuania) (member of SEB group)	Azhio	EUR 23.2 mln for >90%	24.5	1.5

Ukrsotsbank's former owners were able to rake in such a high return for the following reasons:

1) **Market Share.** Ukrsotsbank is one of Ukraine's undisputed market leaders. With total assets of USD 2.1 bln (market share of 5.0%), a loan portfolio of USD 1.37 bln (5.2%) and customer deposits of USD 1.63 bln (5.7%), Ukrsotsbank has maintained its position as the fourth largest bank for the last three years.

2) **The Last Shot At The Top-10.** Ukrsotsbank was the last chance to buy a top-10 Ukrainian bank for the next 1-2 years. Privatbank (ranked #1 in terms of assets) and Bank Nadra (#9) have no plans to sell a major stake to a strategic investor in the near future. The other two state-owned banks, Ukreximbank and Oschadbank (ranked #6 and #7), are long-term privatization targets.

3) **Tough Bidding.** The saturation of the CEE banking sector for further acquisitions and the desire to get into the rapidly growing and high potential market makes the competition much stiffer in the bidding process for Ukrainian banks. About 15 global banking majors participated in the bidding for Ukrsotsbank.

The Bank Among Ukrainian Banks

Strong Market Position & Growth

For the past few years, Ukrsotsbank's growth rates have outpaced the whole banking system in addition to banks in the top-10 group. The bank's total asset growth was 55% CAGR for 2002-05, above the industry average of 45% and 1.6 times higher than the 33% achieved by top-10 banks. This growth pace allowed the bank not only to solidify its position in the top-10 but also to expand its market share (see the table below) and improve its rating from #6 as of January, 2003 to #4 by the end of 2005.

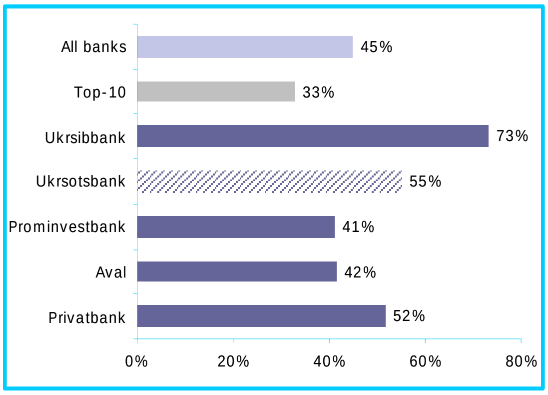
Top-13 Ukrainian Banks*

Rank	Bank	Total Assets	*% of all Ukr*	Loan Portfolio	*% of all Ukr*	Total Deposits	*% of all Ukr*	Capital	*% of all Ukr*
1	Privatbank	4,308,222	10.3%	2,789,305	10.6%	3,316,743	11.5%	443,817	8.9%
2	Aval	3,761,479	9.0%	2,372,129	9.0%	2,962,266	10.3%	340,927	6.9%
3	Prominvestbank	2,849,677	6.8%	2,085,927	7.9%	2,524,854	8.8%	267,236	5.4%
4	**Ukrsotsbank**	**2,102,141**	**5.0%**	**1,376,725**	**5.2%**	**1,630,890**	**5.7%**	**200,620**	**4.0%**
5	Ukrsibbank	2,083,826	5.0%	1,467,519	5.6%	1,079,787	3.8%	185,107	3.7%
6	Ukreximbank	2,026,585	4.9%	1,372,651	5.2%	1,006,710	3.5%	208,429	4.2%
7	Oshadbank	1,858,460	4.4%	315,370	1.2%	1,617,852	5.6%	151,480	3.0%
8	Raiffeisenbank	1,376,755	3.3%	1,112,196	4.2%	673,828	2.3%	122,366	2.5%
9	Nadra	1,156,738	2.8%	801,407	3.1%	666,275	2.3%	107,681	2.2%
10	Brokbisnesbank	931,412	2.2%	536,911	2.0%	664,079	2.3%	118,391	2.4%
11	Finansy & Credit	863,615	2.1%	605,618	2.3%	618,459	2.2%	95,443	1.9%
13	Ukrprombank	802,551	1.9%	679,268	2.6%	626,189	2.2%	124	0.0%
6	Ukrsotsbank (Jan 1, 2003)	628,854	4.9%	365,231	4.2%	379,022	5.2%	78,472	4.2%

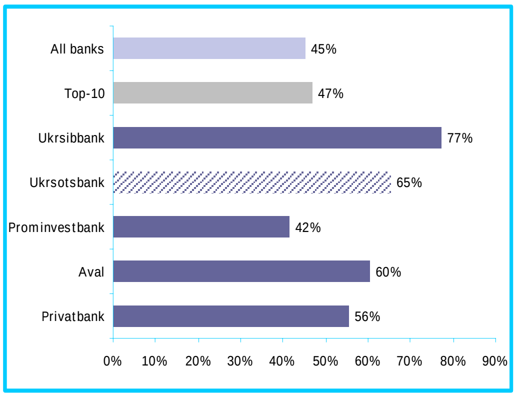
Source: the National Bank, Concorde Capital estimates
** As of December 31, 2005*

The growth of the bank's balance sheet was primarily due to the rapid expansion of its loan portfolio. For the last four years Ukrsotsbank has increased its loan book by almost five times (69% CAGR for 2002-05, above the industry average of 45%) to reach USD 1.37 bln, representing 5.2% of the total loans in the banking system.

Asset Growth, CAGR 2002-05



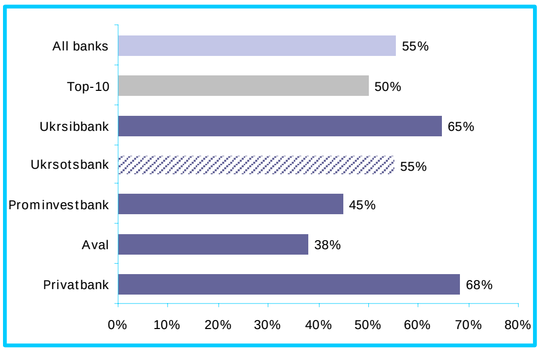
Loan Portfolio Growth, CAGR 2002-05



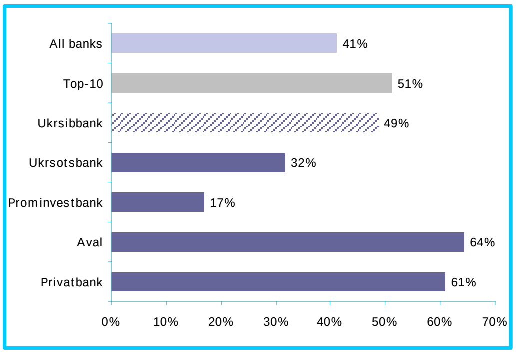
Source: the National Bank, Company data, Concorde Capital estimates

To support further lending, Ukrsotsbank has maintained the rapid growth of its deposit base. During 2002-05 funds on deposit accounts with the bank grew at 55% CAGR, in line with the industry average and marginally above of 49% posted by other top-10 banks. By the end of 2005 Ukrsotsbank accounted for 5.7% of the total deposits in the system.

Customer Deposit Growth, CAGR 2002-05



Capital Growth, CAGR 2002-05

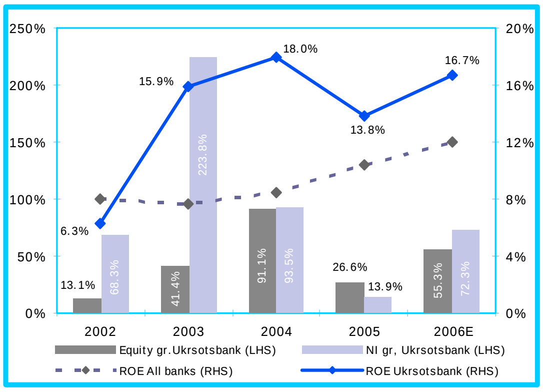


Source: the National Bank, Company data, Concorde Capital estimates

Profitability Enacted

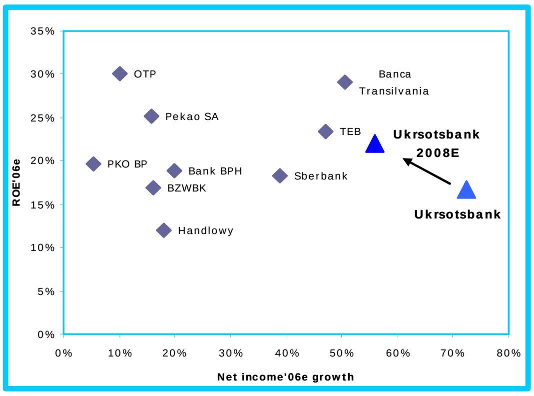
Ukrsotsbank's above-average asset expansion was accompanied by robust net income growth: 86.2% CAGR for 2002-05E. These fast net income growth rates allowed Ukrsotsbank to expand its NI margin substantially, from a modest 4.8% in 2002 to 15.7% in 2005E (the industry average was 5.9% and 13.6%respectively). As a result the bank's ROE in 2003-05 stayed above the industry average level: 13.8% vs. 10.4% in 2005E. We expect Ukrsotsbank's performance to improve even more this year, and forecast the bank's total revenues to be USD 236.4 mln (+54.8 yoy) and operating income at USD 72.6 mln (+67.5% yoy). The bank's net income is expected to reach USD 41.8 mln (+72.3% yoy) implying an NI margin of 17.5% and ROE of 16.7%, bringing it closer to its CEE peers' average ROE of 21.5%.

ROE, Equity & NI Dynamics



Source: the National Bank, Company data

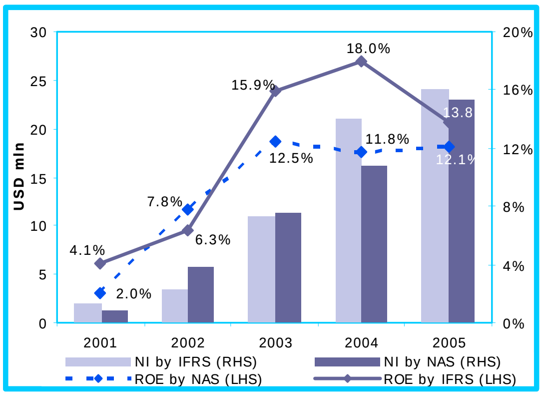
USCB's ROE'06e & NI'06e growth vs. Peers



Source: ING, Concorde Capital

IFRS/NAS convergence to cause modest NI growth in 2005.

USCB's ROE & NI as to IFRS/NAS



Source: Company data, Concorde Capital

We estimate Ukrsotsbank's end of 2005 net income, based on IFRS, at USD 24 mln, implying moderate growth of 13.9% yoy (2004 NI by IFRS was USD 21.1 mln). At the same time the bank reported USD 22.9 mln of 2005 NI, according to national accounting standards (up 41.1% yoy from 2004 NI of USD 16.2 mln as to NAS).

The major discrepancies between IFRS and NAS for Ukrsotsbank arise from stricter requirements for loan loss provisions and different methodologies and treatment applied in deferred tax calculation under IFRS. As a result, Ukrsotsbank reported higher net income and lower equity under IFRS than with NAS in 2004. In 2001-03 the IFRS/NAS discrepancy had little impact on the bank's financials, but in 2004 this discrepancy became quite material, resulting in substantial differences in NI reported: USD 21.1 mln under IFRS and USD 16.2 mln under NAS.

1. **Loan Loss Provisions.** The discrepancy in the calculation of loan loss provisions (LLP) was a key factor that caused the difference in net income reported in 2004 under IFRS and NAS. While the LLPs for IFRS were USD 2.3 mln, provisions made, according to NAS, were five times higher at USD 11.9 mln. The difference came from the USD 7.7 mln write off made under IFRS, a large amount of which was a recovery of previously (1999-2000) written-off loans.

2. **Fixed Asset Revaluation.** In 2003 Ukrsotsbank changed its accounting policy regarding the carrying value of property (buildings). Prior to 2003, property was carried at a depreciated cost. As of December 31, 2003, it carried at a revalued amount, representing fair value less and subsequent accumulated depreciation and impairment losses. Fixed asset revaluation at USD 16.1 mln and USD 69.4 mln made in 2003 and 2004 respectively led to a deferred tax asset that IFRS charged USD 4.0 mln and USD 3.9 mln respectively for. As a result, IFRS adjusted income tax expenses for the corresponding periods downward by the relative amounts.

We estimate Ukrsotsbank's net income for 2005 to be USD 24 mln, assuming there will be no substantial discrepancy in loan loss provisions under IFRS and NAS. However, as the bank did not make any revaluation of its fixed assets in 2005 we expect no impact on income tax expenses in this regard.

Stable margins

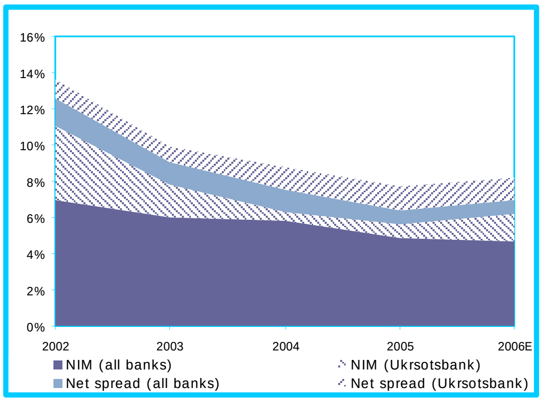
For the past five years Ukrsotsbank has been able to maintain net interest margins (NIM) and net interest spreads above the market average: 5.6% and 6.9% vs. 4.7% and 5.5% respectively. The major reasons for the resilience of bank's margins were:

1) its improving asset mix: the share of loans among the bank's total interest earning assets has been steadily increasing from 61% in 2002 to 89% in 2005, driven by robust growth (+207% CAGR 2002-05) in higher-yield retail loans;

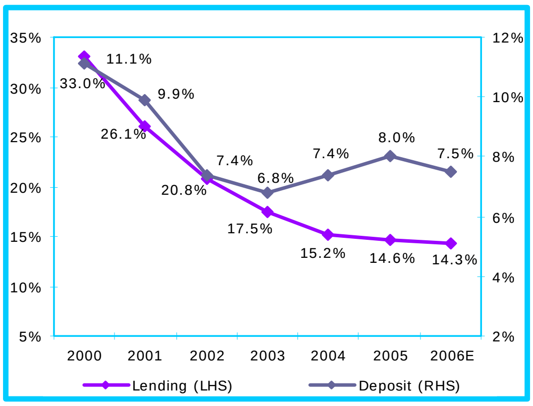
2) low cost funding base: Ukrsotsbank has a sizeable portion of demand deposits (36.2% of total liabilities – one of the highest in the industry), that cost the bank 1.6% on average, far below the market average ~5%, resulting in lower than total deposit costs (7.0% versus the market average of 7.4%);

3) the bank's ability to swiftly re-price its interest earning assets by switching from lower-yield securities to better yielding retail loans. The securities portfolio share in the bank's interest earning assets decreased sharply from 25.5% in 2002 to 5.8% in 2005.

NIM & Net Spread: USCB vs The Market



Market Average Interest Rates



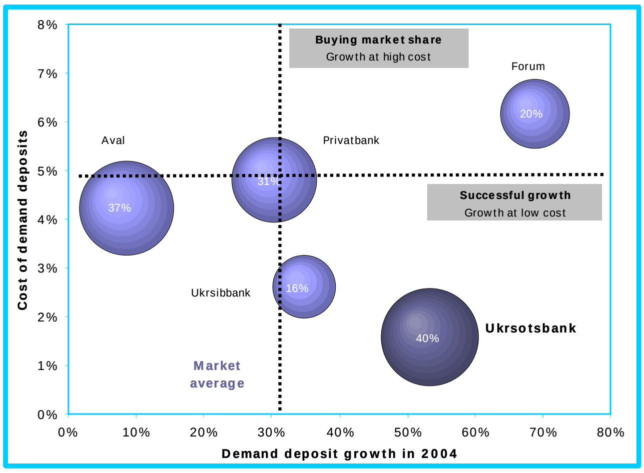
Source: the National Bank, Company data, Concorde Capital estimates

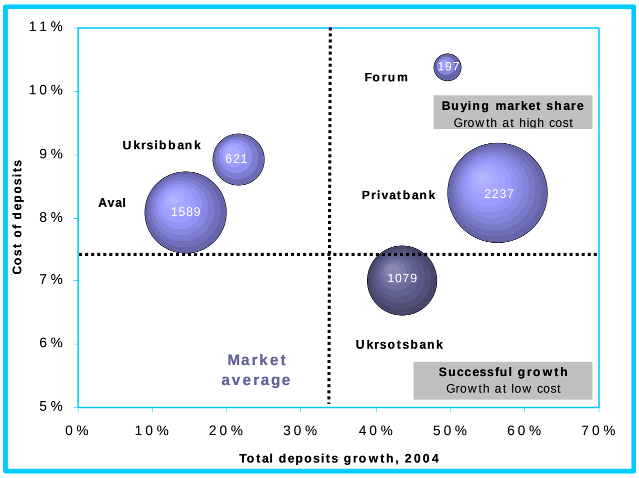
In 2005 Ukrsotsbank's NIM and net spreads slipped to 5.6% and 6.9% respectively from 6.3% and 7.6% in 2004, in line with market trends. In addition to the general market tendency that saw decreasing NIM and net spreads, the political turmoil at the end of 2004 distorted the downward trend of average deposit interest rates, causing them to increase in 2004-05, while average lending rates continued to decline. We expect market average deposit rates to start declining again in 2006 due to the elimination of political uncertainty after the Parliamentary elections in March as well as to increased price competition, in particular from foreign banks. That will positively affect the margins of Ukrainian banks. Additionally, Ukrsotsbank's NIM will also improve due to the continued rapid growth in retail loans (+75% yoy), its stable current deposit base and low-cost foreign borrowings. We estimate the bank's NIM to reach 6.2% in 2006.

Ukrsotsbank: Milking Its Demand Deposit Base

One of Ukrsotsbank's strengths is its funding base structure. In Ukraine, having a diversified deposit base with a sizeable portion of demand deposit accounts (DDA) (the most low-cost resource for banks) is one of the keys to success. Ukrsotsbank meets this criteria: as of end-2005 the bank was ranked fifth with USD 696 mln in demand deposits and a market share of 6.9%. Although this percentage has gradually decreased (from 69% in 2000 to 37% in 2005) Ukrsotsbank's DDA share in total liabilities still remains one of the largest in Ukraine and is far above the industry average of 27%.

Ukrsotsbank's Funding Strength





Source: the National Bank, Company data, Concorde Capital
Bubble size indicates DDA share in total liabilities

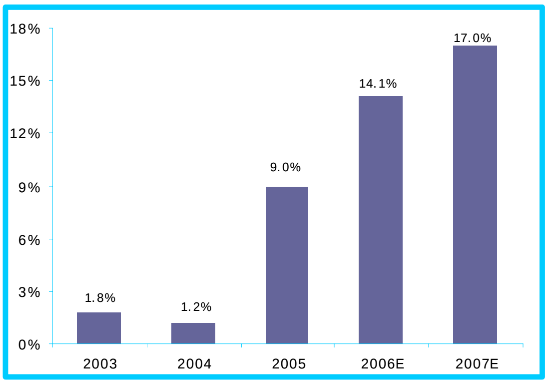
Bubble size indicates total deposit amounts, USD mln

Additionally, Ukrsotsbank has a considerable advantage over the market and other large universal banks (Privatbank, Aval, Ukrsibbank) with its ability to attract demand deposits at a lower than average cost (1.6% versus ~5.0% for the industry in 2004) and higher growth rates (53.4% yoy versus 31.8%). The successful growth of low cost DDAs, resulted in Ukrsotsbank's total deposit costs (7.0% in 2004) being lower than the market average (7.4%) while its growth continued to outpace the industry (43.5% yoy versus 35.2%). We expect Ukrsotsbank to increase its current accounts at 26.7% CAGR in 2006-08 and maintain their share in total liabilities at 30%. Given DDA's low-cost nature these will continue to be an important crutch for the bank's margins.

Foreign Borrowings To Replace Domestic Debts

Currently, one of the main problems faced by Ukrainian banks, is the lack of long-term sources of funding to match their increasingly longer assets (mainly due to the rapid expansion of consumer lending). Funds attracted on the domestic market are not able to fill the maturity gap: the average deposit in Ukraine reaches maturity at ~ 6 months, while loans are granted for 2-3 years on average. Ukrsotsbank's balance sheet also posts disproportions in maturity. While assets with more than one year maturity were USD 388 mln as of the end of 2004 (29.6% of total assets), the bank's liabilities with the same maturity were USD 35.4 mln (3.1% of total liabilities) resulting in a liquidity gap for the period of USD 352.6 mln. As a result Ukrainian banks go abroad for additional funds by drawing syndicated loans and Eurobond placements. In 2005 Ukrainian banks raised ~USD 1.3 bln on foreign capital markets and this amount is expected to double in 2006. However it should be mentioned that only a few Ukrainian banks (from top-10 and several second-tier banks) enjoy easy access to cheap and long-term foreign borrowings.

USCB's Foreign Borrowings/Total liabilities



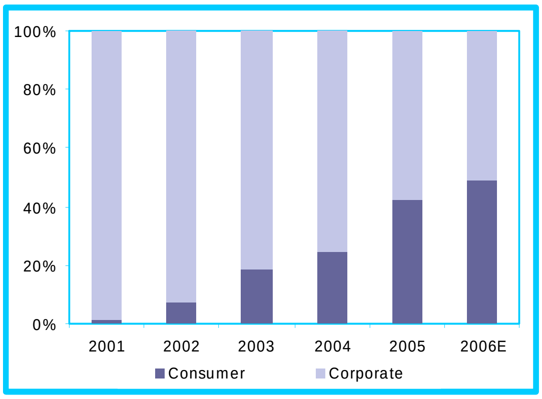
Source: Company's data, Concorde Capital estimates

Ukrsotsbank made its first foreign borrowing in 2003, when it drew a USD 13 mln syndicated loan for six months at LIBOR+4%. In 2004 the bank borrowed USD 45 mln for six months at LIBOR+3.5% (the National Bank's discount rate was 9.0%). In September, 2005 the bank extended this facility for one year, increased the amount to USD 80 mln and reduced the rate to LIBOR+3% (the NBU's rate was 9.5%). In addition to syndicated loans, in May, 2005 Ukrsotsbank placed USD 100 mln 3-year Eurobonds at 9%. The borrowings brought the share of funds due to foreign banks in Ukrsotsbank's liabilities to 9% in 2005 (1.2% in 2004). Given the management's plans to take USD 300 mln (USD 150 mln in syndicated loans and USD 150 mln of Eurobonds) in 2006, we estimate the share of foreign debts in the bank's liabilities to increase to 17% this year. After being acquired by Banca Intesa, Ukrsotsbank can expect its risk ratings to improve and as a result for more favorable conditions during future borrowings: at a lower cost and for a longer period. A sizeable portion of foreign debts will positively affect Ukrsotsbank's margins by replacing higher-cost domestic borrowings and filling in the maturity gap.

Focus On High Return Retail Products

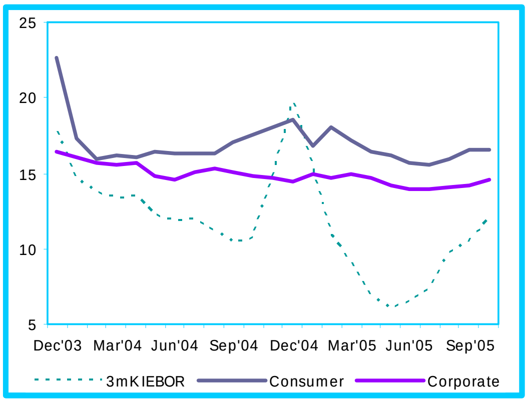
Although corporate banking has traditionally been a core business segment for Ukrsotsbank, over the last five years the bank has significantly increased its retail banking activities. During 2001-05 retail loans grew by 302% CAGR, far above the industry average of 122%. As of December 31, 2005 the bank's retail loans amounted to USD 598 mln (42.2% of its gross loan portfolio), which makes Ukrsotsbank the fourth-largest lender to private customers in Ukraine. Ukrsotsbank's management has put emphasis on the further expansion and enhancement of the bank's market share in the retail segment.

Ukrsotsbank's Loan Portfolio Breakdown



Source: Company data

Average Lending Rate Dynamics, %



Source: the National Bank, Reuters

The decision to make the rapid switch to retail was fueled by the higher-margins this segment offers in contrast to the corporate sector, which is approaching saturation. Since 2004 the average margin for retail loans (rate spreads over 3mKIEBOR, our proxy for a market rate) widened from 2.2% to 4.7%. In the corporate segment margins showed less growth from 1.6% to 2.7%. According to Ukrsotsbank's management retail products are currently the most profitable segment of the bank's activity. Thus, in 2004 retail banking represented ~42% of the bank's total operating revenue, while its share of retail loans in it s gross loan portfolio was 25%.

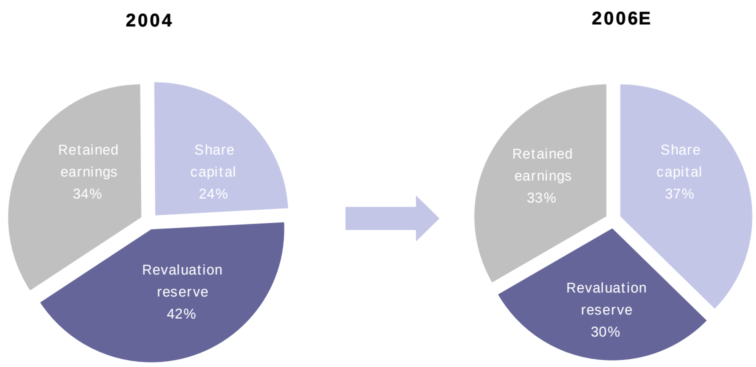
The rapid increase of high return products in the banks lending structure (consumer loans), combined with low-cost liabilities (due to the large portion of current accounts and the increasing share of foreign borrowings) give Ukrsotsbank its competitive advantage.

Improved Capital Structure Equals Further Growth

Unlike other Ukrainian banks that hold additional share emissions on an annual basis, Ukrsotsbank has not changed its share capital since 2000. As of December 31, 2005 the bank had share capital of USD 14 mln (700 ths shares at a par value of USD 0.02), not including inflationary adjustments of USD 24 mln regularly made under IFRS since 2000. In 2000-2002 retained earnings were the largest part of Ukrsotsbank's capital.

In 2003-05 the growth of the bank's capital was supported by a substantial increase in revaluation surpluses caused by the change in accounting policy regarding the carrying of property value (buildings). Prior to 2003, property was carried at depreciated cost. Since 2003, property started to be carried at a revalued amount, representing fair value less any subsequent accumulated depreciation and impairment losses. By the end of 2004 around 42% fell to the share of fixed assets revaluation, while the share capital accounted for 24% and 8.6% if inflationary adjustment to be excluded. A the same time the average ratio of share capital/total capital for banking industry was 63%.

Ukrsotsbank's Shareholders' Equity Structure



Source: Company data, Concorde Capital

The bank's minor portion of share capital and excessive reliance on non-cash items (revaluation surplus) is not a reliable equity structure for a bank of Ukrsotsbank's size and growth rates.

To improve the bank's capital structure, on December 2, 2005 the majority shareholders agreed on a five-fold increase in the bank's share capital or by USD 60 mln through an additional share issue of 3 bln shares at par value of USD 0.0198.

Related Party Transactions Not A Factor

As part of the Interpipe business group, Ukrsotsbank serves the assets of its major shareholder, Ferrotrade International, which is also associated with Interpipe Corporation. All outstanding balances and income/expense items for the year with related parties are indicated in the table below:

Related parties transactions, USD ths

	2004	weight, %	2003	weight, %	2002	weight, %
Loans	35727.5	5.0%	3657.6	0.7%	8.3	0.003%
Other assets	32.6	0.3%	3202.8	18.2%	1239.4	6.9%
Current accounts	63776.6	14.0%	2964.2	1.0%	1340.9	0.5%
Deposits	85178.7	13.7%	2773.5	0.6%	28.5	0.02%
Other liabilities	148.1	0.9%	1.9	0.01%	653.8	9.0%
Interest income	2545.7	2.1%	160.2	0.2%	173.9	0.3%
Interest expense	3094.9	4.4%	28.9	0.1%	20.6	0.1%
Commission income	500.9	0.9%	477.1	1.1%	220.5	0.7%
Other income	509.8	22.8%	-	-	-	-

Source: Company data

Outstanding loans to related parties as of December 31, 2004 comprised mainly loans to Interpipe Corporation for a total net amount of USD 15 mln, OJSC Zaporizhya Aluminum Plant for USD 7.9 mln and CJSC Aerosvit for USD 5.8 mln. According to auditors' reports these loans were fully secured and granted at market rates.

As the table shows, the share of related parties in the bank's operations grew considerably in 2004, in particular in its deposit base. This increase was largely due to Interpipe Group's purchase of Kryvoryzhstal (KSTL). The acquisition brought all of KSTL's accounts to Ukrsotsbank. By the end of 2005 after KSTL's reprivatization the company closed its accounts with Ukrsotsbank, lessening the share of related party accounts to an estimated 7%. Moreover, the bank was able to offset this outflow from other sources - total deposits increased by 50% in 2005.

Following the departure of KSTL, the only other possible risk to the bank's accounts is Nikopol Ferroalloy. However, the maximum erosion of total deposit base due to possible NFER's exit would not exceed 5%. Overall, we don't believe the change in ownership will have a major impact on the bank's operations – and do not expect any significant outflow of funds belonging to the companies associated with USCB's previous owner. The impact, if any, on the bank's performance will be marginal.

VALUATION

Dividend Discount Model

Best Case

Cash Flow To Shareholders: Total CAR Of 12%, UAH ths

We use local currency for our forecasts (UAH ths)

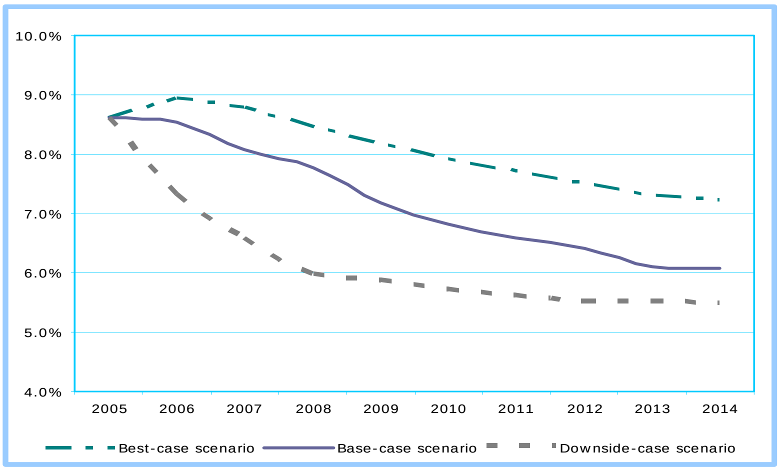
	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Target Total Capital	1,482,516	2,017,847	2,504,532	3,053,264	3,653,038	4,286,068	4,949,081	5,632,246	6,319,482
CAR	12%	12%	12%	12%	12%	12%	12%	12%	12%
Cash flow	134,865	241,581	273,088	277,809	557,711	918,610	1,274,140	1,497,455	1,637,181
Discount rate	13.3%	12.9%	12.4%	12.0%	11.5%	11.1%	10.8%	10.4%	10.0%
Discounted CF	120,568	190,552	190,762	172,620	309,522	457,233	570,541	605,452	599,724
Valuation date	17-Mar-06	17-Mar-07							
Terminal Value	8,824,516	10,015,825				Discount Rate to Perpetuity			10.0%
Equity Value	**12,041,488**	**13,647,348**				Perpetuity Growth Rate			3.0%
per Share	**USD 0.64**	**USD 0.72**				Imlied Exit P/E Multiple			10.4x

We use the Dividend Discount Model to gauge the intrinsic value of Ukrsotsbank. We apply capital adequacy requirements (CAR) to determine the residual earnings available for distribution to shareholders. While the National Bank requires CAR of 10%, we set a target CAR of 12% (minimal CAR required by EBRD from Ukrainian banks). We assume Ukrsotsbank will maintain its 12% CAR level during the 9-year forecast period. In parallel we made calculations benchmarking a certain percentage of net income for dividends.

We take a 13.3% cost of equity (CoE) for 2006 (which implies a 7% equity premium over a 6.3% yield for Ukrainian Eurobonds maturing in 2013). Through the 9-year forecast period, CoE will decrease to 10%.

We have worked out three main scenarios for the bank's operations during forecast period, with interest spread as comprehensive indicator reflecting the influence of different market forces on Ukrsotsbank's fair value, to get an average-weighted target price.

USCB's Spread Over Forecast Period



	12month fair value	Weight
Base-case scenario	0.46	0.5
Best-case scenario	0.68	0.25
Downside-case scenario	0.31	0.25
Weighted average		**0.48**

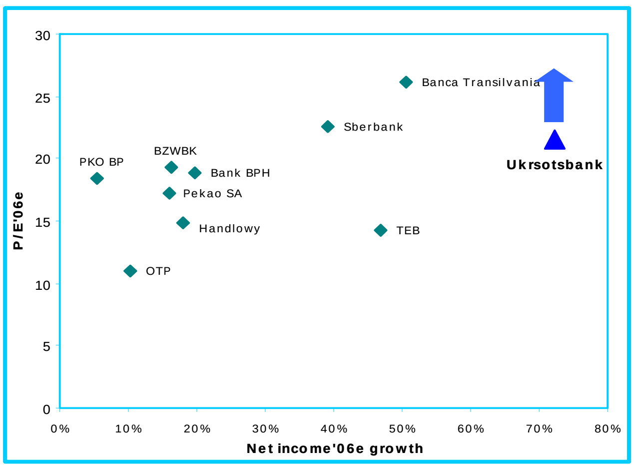
Peer Comparison

	Country	Mkt price, USD	Mcap, USD mln	P/E			P/B			P/Operating income		
				2004	2005E	2006E	2004	2005E	2006E	2004	2005E	2006E
Ukrsotsbank	***Ukraine***	***0.25***	***925***	***43.9***	***38.4***	***22.4***	***6.0***	***4.8***	***3.1***	***34.0***	***21.3***	***12.7***
PKO BP	Poland	10.4	10460	22.0	19.4	18.4	4.1	3.8	3.5	17.6	15.6	14.8
Pekao SA	Poland	55.6	9340	22.1	19.9	17.2	3.8	3.6	3.4	19.7	16.7	14.4
Bank BPH	Poland	246.8	7150	30.3	22.7	18.9	3.9	3.6	3.4	22.7	17.9	15.0
BZWBK	Poland	49.0	3608	25.8	22.4	19.3	3.8	3.4	3.1	20.3	18.1	15.3
Handlowy	Poland	22.1	2916	22.1	17.4	14.8	1.5	1.8	1.7	16.1	14.7	12.7
Millenium	Poland	2.0	1793	23.7	10.1	22.4	2.9	2.5	2.7	neg	23.3	17.9
OTP	Hugary	34.8	9211	13.8	12.1	11.0	4.5	3.5	3.0	12.5	10.4	9.2
Komercni Banka	Czech Rep	147.4	5683	15.2	14.7	15.2	3.0	2.6	2.4	11.1	10.8	11.5
Banca Transilvania	Romania	0.5	1158	56.2	39.4	26.2	11.5	8.9	6.6	43.9	34.6	23.0
TEB	Turkey	22.6	1311	51.3	21.0	14.3	4.4	3.7	3.0	22.4	16.3	12.5
Sberbank	Russia	1500.0	28497	8.2	31.4	22.6	5.2	4.5	3.8	32.1	24.8	17.9
Peers' average				**26.4**	**21.0**	**18.2**	**4.4**	**3.8**	**3.3**	**21.8**	**18.5**	**14.9**
Peers' median				**22.1**	**19.9**	**18.4**	**3.9**	**3.6**	**3.1**	**20.0**	**16.7**	**14.8**
Premium/ (Discount)				66%	83%	23%	36%	25%	-8%	56%	16%	-15%
Implied Price, USD				0.15	0.14	0.20	0.18	0.20	0.27	0.16	0.22	0.29
Upside (Downside)				-40%	-45%	-19%	-27%	-20%	9%	-36%	-13%	17%

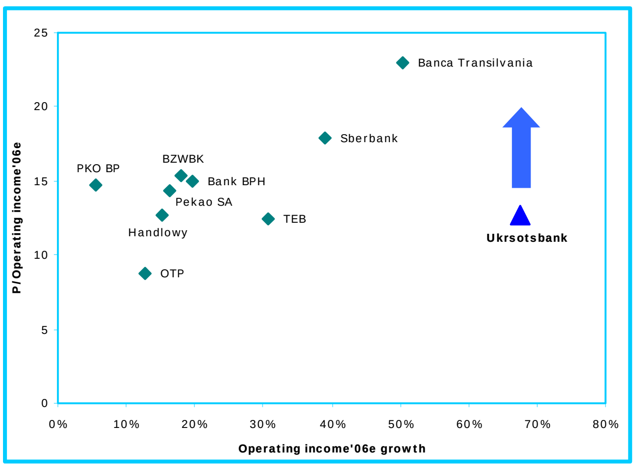
	Country	Mkt price, USD	Mcap, USD mln	P/Assets			P/Loans			P/Deposits		
				2004	2005E	2006E	2004	2005E	2006E	2004	2005E	2006E
Ukrsotsbank	***Ukraine***	***0.25***	***925***	***0.7***	***0.5***	***0.3***	***1.3***	***0.7***	***0.4***	***0.9***	***0.6***	***0.4***
PKO BP	Poland	10.4	10460	0.4	0.4	0.4	0.8	0.8	0.7	0.5	0.4	0.4
Pekao SA	Poland	55.6	9340	0.5	0.5	0.5	1.1	1.1	0.9	0.7	0.6	0.6
Bank BPH	Poland	246.8	7150	0.4	0.4	0.3	0.8	0.7	0.6	0.7	0.6	0.6
BZWBK	Poland	49.0	3608	0.4	0.4	0.4	0.8	0.8	0.7	0.6	0.6	0.5
Handlowy	Poland	22.1	2916	0.3	0.3	0.3	1.0	0.9	0.9	0.5	0.5	0.5
Millenium	Poland	2.0	1793	0.3	0.3	0.2	0.8	0.6	0.5	0.4	0.4	0.4
OTP	Hugary	34.8	9211	0.5	0.4	0.3	0.8	0.6	0.5	0.7	0.6	0.5
Komercni Banka	Czech Rep	147.4	5683	0.3	0.3	0.3	0.9	0.7	0.6	0.4	0.4	0.4
Banca Transilvania	Romania	0.5	1158	1.3	0.7	0.5	2.5	1.2	0.7	1.9	1.1	0.7
TEB	Turkey	22.6	1311	0.4	0.4	0.3	1.1	0.7	0.5	0.8	0.6	0.4
Sberbank	Russia	1500.0	28497	0.4	0.3	0.3	0.6	0.5	0.4	0.5	0.4	0.3
Peers' average				**0.5**	**0.4**	**0.3**	**1.0**	**0.8**	**0.6**	**0.7**	**0.6**	**0.5**
Peers' median				**0.4**	**0.4**	**0.3**	**0.8**	**0.7**	**0.6**	**0.6**	**0.6**	**0.5**
Premium/ (Discount)				51%	19%	-7%	26%	-12%	-30%	25%	1%	-16%
Implied Price, USD				0.17	0.21	0.27	0.20	0.28	0.35	0.20	0.25	0.30
Upside (Downside)				-34%	-16%	7%	-21%	14%	42%	-20%	-1%	19%

In contrast to DDM valuation, peer comparison analysis implies a moderate upside for Ukrsotsbank (with only the P/E comparison out of step). We attribute this to the fact that valuation based on peer average multiples is “short sighted”: it fails to capture the extended period of robust “catch-up” growth USCB has ahead of it compared to its peers’ who have reached a more mature stage. Thus Ukrsotsbank’s net income is expected to grow by 63.7% CAGR in 2006-08, along with its operating income by 163% and assets (36%). These growth rates are unachievable for the company’s more mature CEE peers who passed the stage of rapid expansion years ago. We set a 12months target as scenario weighted derived from DDM valuation at USD 0.45.

P/E vs Earnings Growth (‘06)*

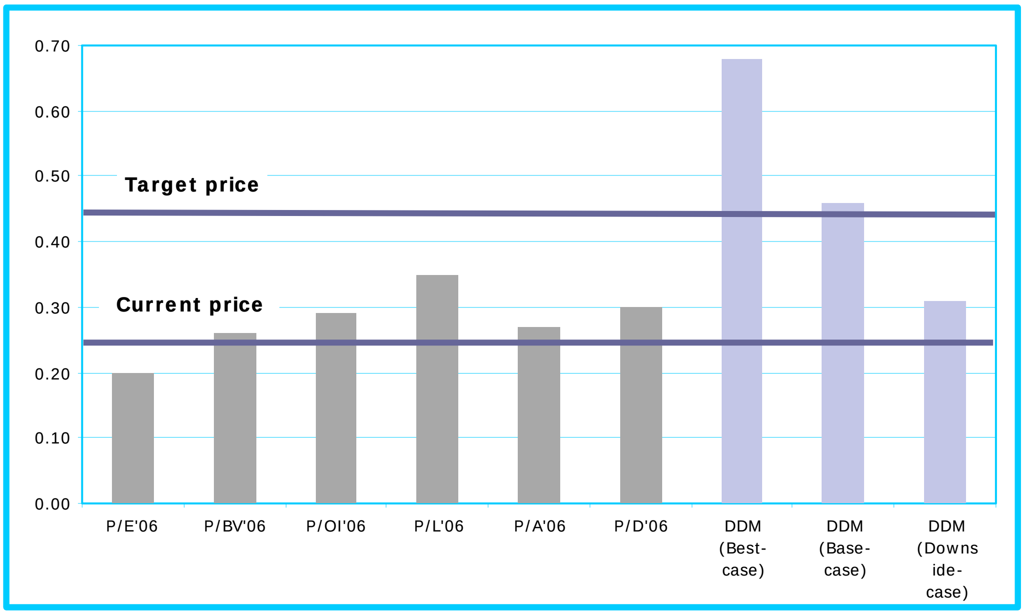


P/Operating Income vs Oper.Inc.’06 growth



Source: ING, Merrill Lynch, Concorde Capital

Valuation Summary, USD



Financial Statements*

Balance Sheet Summary, USD ths

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
ASSETS											
Cash	86,504	117,424	148,175	165,662	189,769	208,294	217,127	220,912	218,299	249,503	281,067
Balances with the National Bank of Ukraine	83,930	146,780	205,165	301,204	303,630	370,301	434,254	504,943	582,130	665,340	749,513
Due from other banks	152,250	81,158	121,332	166,883	203,383	246,945	293,673	342,889	394,288	448,886	503,837
Loans and advances to customers	720,509	1,359,716	2,067,004	2,850,314	3,554,202	4,309,207	5,175,466	6,111,190	7,098,911	8,117,605	9,143,873
Debt securities	94,512	108,227	166,832	229,463	279,651	339,549	403,800	471,473	542,146	617,218	692,776
Property and equipment	157,830	190,575	301,555	426,280	513,810	650,670	759,134	852,001	941,563	1,032,319	1,122,085
Other assets	12,057	15,289	23,248	32,258	40,118	48,648	58,362	68,827	79,861	91,276	102,775
TOTAL ASSETS	**1,307,592**	**2,019,169**	**3,033,312**	**4,172,063**	**5,084,564**	**6,173,615**	**7,341,815**	**8,572,236**	**9,857,197**	**11,222,146**	**12,595,926**
LIABILITIES											
Due to the National Bank of Ukraine	25,209	7,836	8,739	9,621	10,438	11,221	11,951	12,668	13,364	14,033	14,664
Due to the other banks	20,583	169,222	395,602	663,334	678,962	834,607	1,069,630	1,242,088	1,347,169	1,429,714	1,491,387
Total customer's deposits	1,078,381	1,630,890	2,279,613	3,012,037	3,795,379	4,628,765	5,428,171	6,311,785	7,276,620	8,316,754	9,368,915
Other liabilities	29,804	16,818	47,355	59,484	71,602	84,522	98,875	114,304	130,600	147,539	164,772
TOTAL LIABILITIES	**1,153,977**	**1,824,766**	**2,731,309**	**3,744,475**	**4,556,381**	**5,559,115**	**6,608,626**	**7,680,845**	**8,767,753**	**9,908,040**	**11,039,738**
TOTAL EQUITY	**153,615**	**194,403**	**302,003**	**427,588**	**528,182**	**614,500**	**733,189**	**891,391**	**1,089,444**	**1,314,106**	**1,556,189**
TOTAL LIABILITIES & EQUITY	**1,307,592**	**2,019,169**	**3,033,312**	**4,172,063**	**5,084,564**	**6,173,615**	**7,341,815**	**8,572,236**	**9,857,197**	**11,222,146**	**12,595,926**

Source: Company data, Concorde Capital forecasts

Income Statement Summary, USD ths

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Interest income	122,739	178,003	278,990	395,012	502,380	608,707	725,391	828,755	936,278	1,039,921	1,118,933
Interest expense	(69,982)	(107,790)	(159,341)	(221,632)	(275,431)	(325,082)	(379,725)	(425,798)	(466,049)	(503,186)	(533,691)
Net interest income	**52,757**	**70,214**	**119,648**	**173,380**	**226,949**	**283,625**	**345,666**	**402,957**	**470,228**	**536,735**	**585,242**
Net fee & commision income	50,981	65,859	94,474	146,679	213,332	266,608	324,926	378,780	442,015	504,531	549,817
Net trading income	5,823	12,234	16,739	23,701	30,143	36,522	43,523	49,725	56,177	62,395	67,136
Net other operating income	2,227	4,450	5,580	7,900	10,048	12,174	14,508	16,575	18,726	20,798	22,379
Net non interest income	**59,031**	**82,543**	**116,794**	**178,280**	**253,522**	**315,304**	**382,957**	**445,080**	**516,917**	**587,724**	**639,332**
Total income	**111,788**	**152,757**	**236,442**	**351,660**	**480,471**	**598,929**	**728,623**	**848,037**	**987,145**	**1,124,459**	**1,224,574**
Operating expenses	**(84,592)**	**(109,423)**	**(163,836)**	**(237,965)**	**(311,497)**	**(351,007)**	**(385,268)**	**(389,188)**	**(411,105)**	**(466,061)**	**(508,089)**
Operating income	**27,196**	**43,334**	**72,606**	**113,696**	**168,974**	**247,923**	**343,355**	**458,849**	**576,040**	**658,398**	**716,484**
Provision for loan losses	(2,300)	(11,331)	(17,315)	(24,003)	(28,208)	(34,382)	(41,294)	(48,759)	(56,640)	(64,768)	(72,956)
Other provisions	340	(72)	(124)	(201)	(316)	(479)	(678)	(921)	(1,166)	(1,333)	(1,445)
Profit before income tax	**25,236**	**31,931**	**55,167**	**89,492**	**140,450**	**213,061**	**301,383**	**409,169**	**518,234**	**592,297**	**642,083**
Income tax expenses	(4,158)	(7,915)	(13,792)	(22,373)	(35,113)	(53,265)	(75,346)	(102,292)	(129,559)	(148,074)	(160,521)
Net income	**21,078**	**24,016**	**41,375**	**67,119**	**105,338**	**159,796**	**226,037**	**306,877**	**388,676**	**444,223**	**481,562**

Source: Company data, Concorde Capital forecasts
** according to IFRS*

Growth Rates & Key Ratios, USD ths

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Profit and Loss											
Net interest income	52,757	70,214	119,648	173,380	226,949	283,625	345,666	402,957	470,228	536,735	585,242
Net commissions income	50,981	65,859	94,474	146,679	213,332	266,608	324,926	378,780	442,015	504,531	549,817
Trading income	5,823	12,234	16,739	23,701	30,143	36,522	43,523	49,725	56,177	62,395	67,136
Total income	111,788	152,757	236,442	351,660	480,471	598,929	728,623	848,037	987,145	1,124,459	1,224,574
Profit before tax	25,236	31,931	55,167	89,492	140,450	213,061	301,383	409,169	518,234	592,297	642,083
Net income	21,078	24,016	41,375	67,119	105,338	159,796	226,037	306,877	388,676	444,223	481,562
P&L Growth											
Net interest income	15.1%	33.1%	70.4%	44.9%	30.9%	25.0%	21.9%	16.6%	16.7%	14.1%	9.0%
Net commissions income	17.2%	29.2%	43.4%	55.3%	45.4%	25.0%	21.9%	16.6%	16.7%	14.1%	9.0%
Total income	23.6%	36.6%	54.8%	48.7%	36.6%	24.7%	21.7%	16.4%	16.4%	13.9%	8.9%
PBT	62.2%	26.5%	72.8%	62.2%	56.9%	51.7%	41.5%	35.8%	26.7%	14.3%	8.4%
Net profit	93.6%	13.9%	72.3%	62.2%	56.9%	51.7%	41.5%	35.8%	26.7%	14.3%	8.4%
Balance Sheet											
Net Loans	718,613	1,359,716	2,067,004	2,850,314	3,554,202	4,309,207	5,175,466	6,111,190	7,098,911	8,117,605	9,143,873
Average interest earning assets	837,252	1,256,678	1,937,469	2,786,942	3,618,807	4,438,323	5,350,531	6,359,460	7,434,375	8,556,828	9,702,552
Total Assets	1,304,150	2,019,169	3,033,312	4,172,063	5,084,564	6,173,615	7,341,815	8,572,236	9,857,197	11,222,146	12,595,926
Customer deposits	1,075,543	1,630,890	2,279,613	3,012,037	3,795,379	4,628,765	5,428,171	6,311,785	7,276,620	8,316,754	9,368,915
Average interest bearing liabilities	987,256	1,487,591	2,269,372	3,220,892	4,110,621	5,008,927	6,025,015	7,074,781	8,142,521	9,243,771	10,367,161
Book Value	153,211	194,403	302,003	427,588	528,182	614,500	733,189	891,391	1,089,444	1,314,106	1,556,189
B/S Growth											
Net Loans	38.8%	89.2%	52.0%	37.9%	24.7%	21.2%	20.1%	18.1%	16.2%	14.4%	12.6%
Average interest earning assets	15.5%	50.1%	54.2%	43.8%	29.8%	22.6%	20.6%	18.9%	16.9%	15.1%	13.4%
Total Assets	38.7%	54.8%	50.2%	37.5%	21.9%	21.4%	18.9%	16.8%	15.0%	13.8%	12.2%
Customer deposits	43.9%	51.6%	39.8%	32.1%	26.0%	22.0%	17.3%	16.3%	15.3%	14.3%	12.7%
Average interest bearing liabilities	16.3%	50.7%	52.6%	41.9%	27.6%	21.9%	20.3%	17.4%	15.1%	13.5%	12.2%
Book Value	90.6%	26.9%	55.3%	41.6%	23.5%	16.3%	19.3%	21.6%	22.2%	20.6%	18.4%
Key Ratios											
Non interest income/Total income	52.8%	54.0%	49.4%	50.7%	52.8%	52.6%	52.6%	52.5%	52.4%	52.3%	52.2%
Net interest income/Total income	47.2%	46.0%	50.6%	49.3%	47.2%	47.4%	47.4%	47.5%	47.6%	47.7%	47.8%
Net interest margin	6.3%	5.6%	6.2%	6.2%	6.3%	6.4%	6.5%	6.3%	6.3%	6.3%	6.0%
Cost / Income ratio	75.7%	71.6%	69.3%	67.7%	64.8%	58.6%	52.9%	45.9%	41.6%	41.4%	41.5%
ROA	1.9%	1.4%	1.6%	1.9%	2.3%	2.8%	3.3%	3.9%	4.2%	4.2%	4.0%
ROE	18.0%	13.8%	16.7%	18.4%	22.0%	28.0%	33.5%	37.8%	39.2%	37.0%	33.6%

Source: Company data, Concorde Capital estimates

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