

# VAB Bank Eurobond

## Last chance to play the narrowing spread

### Spread over sovereign curve still too wide

VAB '14 is the highest yielding Eurobond in Ukraine's corporate universe at 20.5% with a 1,412 bp spread over the sovereign curve, and we see it as one of the last opportunities to play narrowing spreads. Given comparable issues are trading at significantly smaller spreads (F&C '14 at 1,094 bps and FUIB '14 at 739 bps), we anticipate the VAB'14 narrowing to the 1,000-1,100 bps level, implying a price increase in the range of 9-14%.

### Principal shareholder steps up

VAB Bank shareholders approved a UAH 156 mln (USD 20 mln) increase in the bank's equity capital to UAH 1.129 bln at an August 2 AGM. As a result, Netherlands-based private equity investor Kardan (via TBIF Financial Services Fund) upped its stake from 63% to 71.3%, with Ukrainian businessman Sergiy Maksimov now left holding 27.3%. An additional capital injection could be approved at the next EGM on September 9, with a subsequent increase in Kardan's stake. The firm announced plans in January to increase its stake to 98% by buying out Maksimov for EUR 24 mln.

The new capital should bring VAB's CAR to 17.3% from 14.7% at end-1H10 (vs. the required 10% and sector average of ~20%), other factors remaining constant.

We anticipate the bank will benefit from having Kardan as majority shareholder, as they are expected to take an active role in management. Kardan develops emerging market businesses, mainly in Central and Eastern Europe, and controlled total assets of EUR 6.3 bln as of end-1Q10. We are confident Kardan will encourage timely payment of all debt service obligations.

### 1H10 results: Funding structure improves

Retail deposits at VAB increased by 30% in 1H10 (by USD 72 mln) vs. the industry average of 13.8%, affirming customer confidence in the bank. Deposits effectively replaced short-term interbank borrowing (down by 62%, to USD 24 mln), and allowed the repayment of USD 20 mln in debt to the central bank, reducing VAB's total outstanding debt to USD 114 mln, most of which matures in December 2010.

Overall, VAB has lower aggregate debt than most local peers with outstanding Eurobonds (see Exhibit 1), which should have a positive impact on its ability to meet debt service obligations. Currently available cash of USD 111 mln is more than sufficient to meet annual coupon payments of USD 11.8 mln through at least 2011.

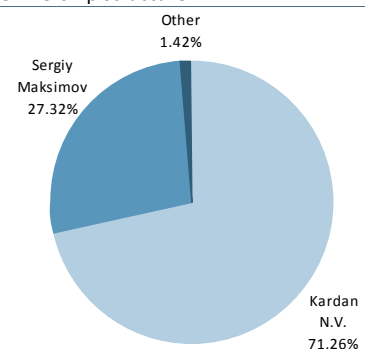
VAB posted a USD 26 mln loss in 1H10 (vs. USD 9 mln loss in 1H09) on the back of a deteriorating interest rate margin (one of the downsides of increased reliance on more expensive consumer deposits) and an additional USD 20 mln in NPL provisions.

The bank classified 39% of outstanding loans as impaired as of end-2009 (according to IFRS filings). However, no details were provided regarding the definition of "impaired." Consequently, it is difficult to compare the figure with NPLs at other banks or the sector average (as definitions vary across Ukrainian banks).

<b>Report date</b>	<b>30 Aug 2010</b>
Bloomberg	VABANK 10 ½ 14
ISIN	XS0303241615
Ratings (S/M/F)	na/Caa1/na
Price*	75.1
YTM*	20.5%, s.a.
Maturity date	June 14, 2014
Type	Bullet
Amount outstanding	USD 112.5 mln
Coupon	10.5%
Frequency	Quart.

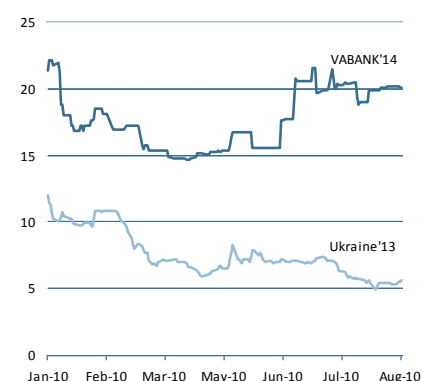
\*Price, YTM as of Aug. 27, 2010, mid-price

### Ownership structure



Source: VAB Bank

### VABANK'14 vs. Ukraine'13 YTM. %



Source: Bloomberg

VAB appears to be effectively managing its assets as it reduced its gross loan portfolio by 2.5% over 1H10. This decrease, coupled with increasing client deposits, allowed VAB to improve its Loans/Deposits ratio to a pre-crisis level of 167% compared to 210% as of end-2009.

### High potential return compensates for risks

While we are positive on VAB 14's spread over the sovereign yield curve narrowing, low liquidity could prevent narrowing in the nearest term. Deteriorating profitability (VAB's interest margin has dropped to 2.1% in 2H09-1H10) could also create financial pressure that would make it difficult to meet debt service payments in the medium term. Moreover, VAB must repay UAH 0.9 bn (USD 114 mln) to the central bank in 4Q10.

However, we think the risks are offset by increased support from Kardan, an overall moderate level of debt compared to its peers and growing customer confidence that is likely to contribute to funding base stability. We anticipate a potential total return of some 12-15% over a three to four month horizon.

## Exhibits

Exhibit 1. Outstanding bank debt, 1H10 (based on UAS financials)

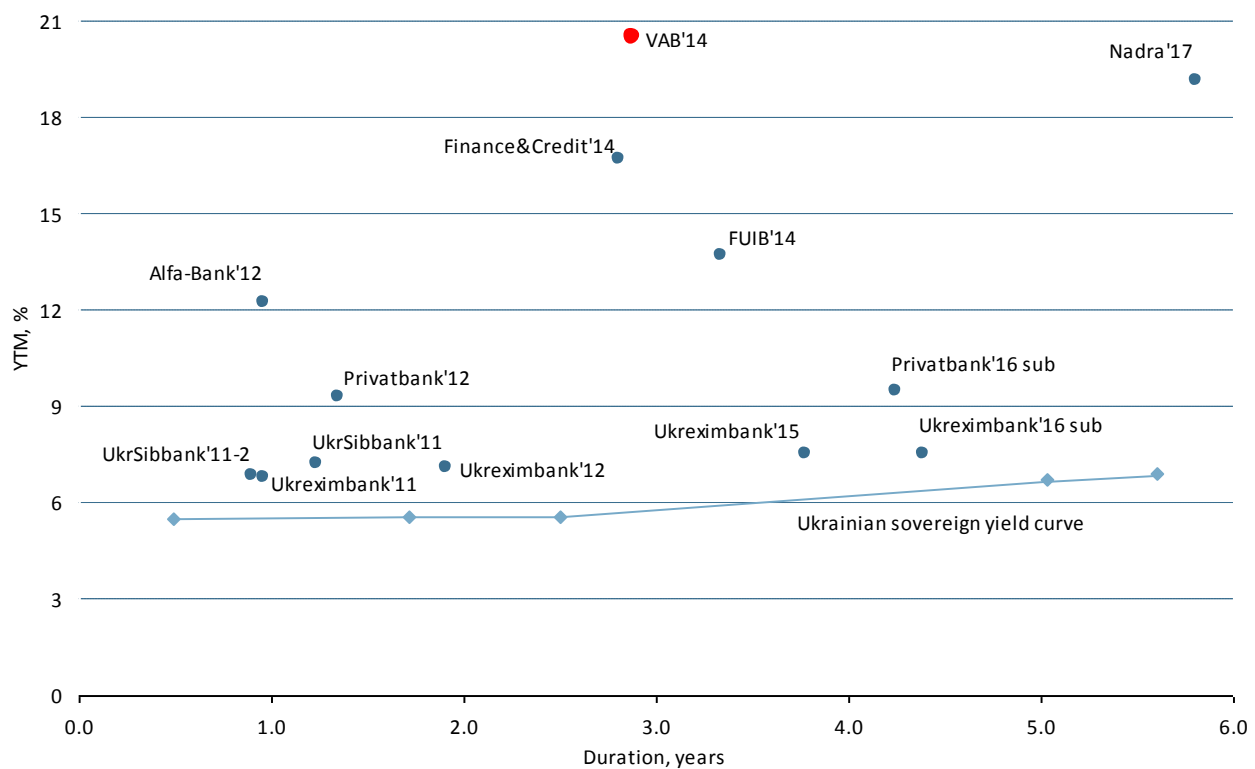
	Privatbank	Alfa-Bank	F&C	FUIB	VAB
Total Debt (% of Assets)*	24%	50%	52%	44%	38%
Incl. debt securities outstanding (% of Assets)	7%**	25%	3%	12%	13%
Incl. loans from NBU (% of Assets)	9%	6%	26%	10%	13%
Cash (% of Assets)	16%	19%	10%	19%	12%
USD mln	1,985	648	272	418	111
Loans/Deposits	138%	281%	225%	195%	167%
Loan loss provisions/total loans (UAS)	18%	24%	7%	22%	15%
CAR (NBU rules)	11.6%	15.9%	11.6%	18.4%	14.7%
Pre-provision ROA (4q rolling)	5.5%	4.1%	n/a	0.8%	-0.2%
Assets, USD bln	12.3	3.4	2.6	2.2	0.9

\* (Due to banks+Due to NBU+Debt securities issued+Other liabilities)/Assets

\*\* Does not include Privat'16 Eurobonds, which are accounted for as subordinated debt

Source: Company data, Concorde Capital estimates

Exhibit 2. Eurobond yield map as of 27/08/2010



Source: Bloomberg

## VAB Bank financials, UAS

### Balance sheet

	2008		2009		1H10	
	USD mln	% of Assets	USD mln	% of Assets	USD mln	% of Assets
Cash&Cash equivalents	87	8.7%	84	9.3%	110	12.3%
Due from banks	71	7.0%	47	5.2%	19	2.1%
Corporate loans	556	55.2%	544	59.7%	531	59.4%
Retail loans	260	25.9%	229	25.1%	211	23.7%
Loans loss provision	-39	-3.9%	-94	-10.4%	113	12.6%
Other	72	7.1%	101	11.1%	135	15.1%
<b>Total assets</b>	<b>1,006</b>	<b>100.0%</b>	<b>911</b>	<b>100.0%</b>	<b>893</b>	<b>100.0%</b>
Due to banks	272	27.1%	209	23.0%	160	17.9%
Corporate deposits	205	20.4%	125	13.7%	130	14.6%
Retail deposits	289	28.7%	243	26.6%	314	35.2%
Debt securities issued	10	0.9%	124	13.6%	112	12.5%
Subordinated debt	20	2.0%	63	7.0%	43	4.8%
Other	93	9.2%	62	6.8%	67	7.5%
<b>Total liabilities</b>	<b>889</b>	<b>88.3%</b>	<b>827</b>	<b>90.7%</b>	<b>826</b>	<b>92.5%</b>
Share capital & Share premium	44	4.4%	68	7.5%	68	7.6%
Retained earnings	10	1.0%	-45	-4.9%	-62	-7.0%
Other	63	6.3%	61	6.7%	62	6.9%
<b>Total equity</b>	<b>117</b>	<b>11.7%</b>	<b>84</b>	<b>9.3%</b>	<b>67</b>	<b>7.5%</b>

### Income statement

	2008	2009	1H09	1H10
	USD mln	USD mln	USD mln	USD mln
Net interest income	41	38	24	3
Net fee income	23	17	8	7
SG&A	-56	-53	-27	-26
Provisions accumulation	-27	-59	-17	-20
Other, net	18	10	3	10
<b>Net income</b>	<b>0</b>	<b>-48</b>	<b>-9</b>	<b>-26</b>

### Selected ratios

	2008	2009	1H10
Loans loss provisions/total loans	4.8%	12.2%	15.2%
Loans/Deposits	165%	210%	167%
Interest Rate Margin		4.5%	2.1%
Cost/Income		97%	159%
Cost/Avg Assets		5.3%	5.4%
Pre-provision RoA		1.1%	-0.2%
ROA		-5.1%	-7.3%
ROE		-48.5%	-74.9%

Source: VAB Bank, NBU, Concorde Capital calculations

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