VTB: Q4 2010 results OK, stay long after the recent market correction

VTB reported full-year results last week and hosted a conference call for investors and analysts. On 31 December 2010, the group obtained control of TransCreditBank (TCB), whose results were consolidated in the full-year financial statement with immediate effect on the balance sheet metrics. Although VTB will not consolidate Bank of Moscow this year, we continue to view the credit risk of both banks as being closely associated. BKMOSC 15s remains our preferred exposure to the Russian quasi-sovereign bank space, given its high carry and medium duration as well as potential to become VTB risk upon likely consolidation in 2012. Our buy recommendation on VTB remains unchanged. Speculation that the government may relinquish its controlling stake after 2013 are still premature, and the bonds should trade tighter than those of other quasi-sovereign banks with weaker stand-alone fundamentals, such as RSHB and VEB.

The changes in the balance sheet setup were mainly driven by the consolidation of TCB. In Q4, gross loans increased by 9.4% (2.1% w/o TCB). Deposit growth was stronger both stand-alone (5.3%) and accounting for the addition of TCB (20.3%) and contributed to the noticeable decline in L/D. The Tier 1 ratio was 12.4%, down from 13.9% at end-Q3 2010 largely on TCB consolidation effect.

Asset quality metrics improved qoq, but the devil is in details. According to our calculations, NPLs at VTB were flat on a stand-alone basis as the small increase was offset by a RUB 4.7 bn write-off. TCB reported NPLs at 3.6% of gross loans at end-2010, well below the NPL ratio for VTB on a stand-alone basis, and their contribution to the NPL pool of the group was rather negligible (3%). This makes us conclude that the improvement in the headline NPL ratio on the group level was driven by the base effect. Renegotiated loans recorded a 12% decline due to repayments and additions from TCB were at modest RUB 2 bn. Interest income accruals were negative for the first time since Q2 2008. Although accruals dynamics was generally positive in H2 2010, we would like to see another couple of quarters with cash collections exceeding interest income from the P&L, given the huge size of accruals accumulated since the onset of the crisis (we estimate them at 15.3% of end-2010 Tier 1 equity on pre-tax basis).

Probably the biggest surprise is that VTB will not consolidate Bank of Moscow this year. According to management, VTB still does not control the municipal lender, since it is not able to vote with its indirect stake in the bank held through the 25%+1 share in Metropolitan Insurance Group. Nor does it have full control in the board of directors. VTB started a due diligence process in the bank and, upon its completion, plans to negotiate with minorities and work out an integration plan for Bank of Moscow. Meanwhile, Bank of Moscow will be accounted using the equity method. The resulting impact on the Tier 1 ratio will be rather minimal and management expects it to remain around 12% at year-end.

Eurobond issuance plans remain unchanged. Management confirmed the earlier voiced intention to diversify the investor base by issuing in exotic currencies such as Chinese yuan and Singapore dollar. However, the bank also plans to tap the market with USD-denominated paper, which is in line with our expectations. In our view, supply is likely to be front-loaded as rate hike speculations may emerge in the USA towards the end of the year and drive up yields on investment grade bonds.

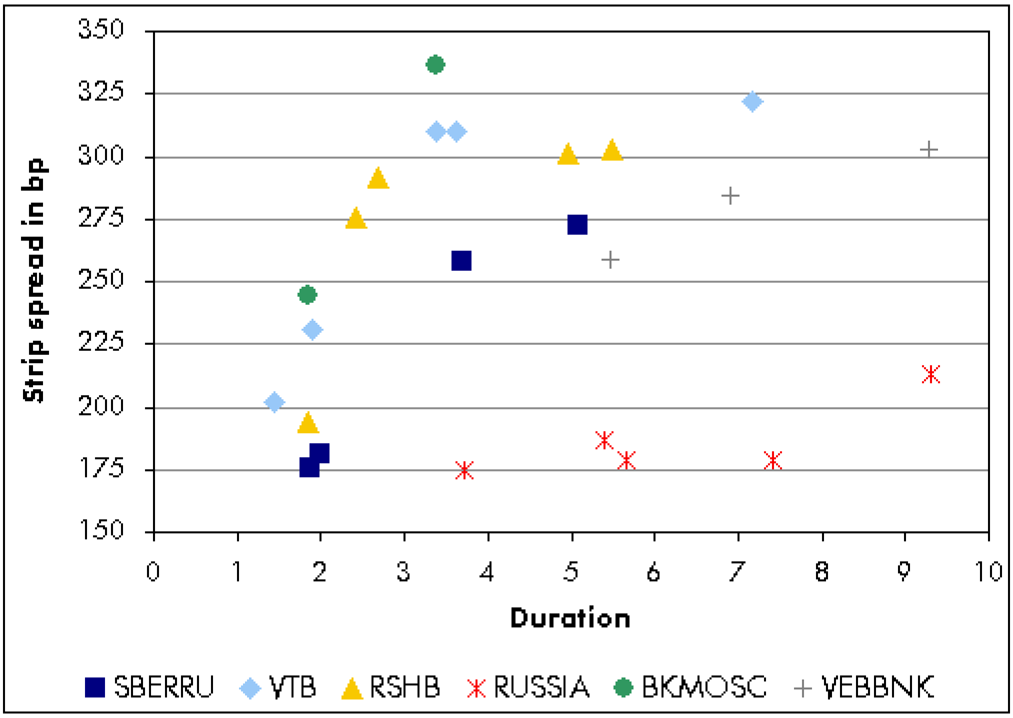
Key financial ratios

	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010
Net interest margin	5.3%	5.2%	5.4%	5.0%	4.5%
Interest income / average earning assets	11.0%	10.4%	10.3%	9.7%	8.8%
Interest income / average interest bearing liabilities	6.4%	5.8%	5.6%	5.2%	4.6%
F&C / avg earning assets	0.7%	0.6%	0.8%	0.7%	0.8%
Recurring earnings / avg earning assets	3.2%	3.1%	3.6%	2.9%	2.3%
Cost / income ratio	52.5%	38.5%	45.6%	44.4%	46.7%
Opex / avg earning assets	2.8%	2.8%	2.7%	2.8%	3.0%

RoAA	-1.2%	1.8%	1.2%	1.5%	1.6%
RoAE	-8.0%	11.9%	8.3%	10.2%	11.4%
Loans / deposits ratio	147.2%	147.4%	151.2%	137.5%	125.9%
Net loans / total assets	64.0%	68.1%	70.4%	67.4%	64.9%
Cash and due from banks / total assets	16.8%	13.4%	11.3%	11.7%	14.6%
Securities / total assets	11.5%	10.1%	9.2%	11.2%	10.9%
Provision burden	64.1%	41.4%	25.9%	31.1%	27.6%
Cost of risk	4.3%	2.7%	1.7%	1.9%	1.6%
NPLs / gross loans	9.8%	10.2%	9.5%	9.5%	8.6%
Corporate NPLs / corporate loans	10.3%	10.5%	9.5%	9.6%	8.8%
Retail NPLs / retail loans	7.4%	8.6%	9.2%	8.8%	7.8%
Renegotiated / gross loans	11.8%	12.9%	10.7%	11.0%	8.8%
LLRs / gross loans	9.2%	9.8%	9.3%	9.6%	9.0%
LLR / NPLs	94.5%	96.1%	98.2%	101.6%	103.7%
LLRs / NPLs + rescheduled	42.8%	42.5%	46.1%	47.0%	51.3%
II accruals	6.8%	19.1%	21.1%	1.0%	-8.4%
Tier 1 ratio	14.7%	16.1%	14.1%	13.9%	12.4%
Total capital adequacy ratio	20.9%	22.4%	19.5%	19.0%	16.8%
Free capital	66.0%	67.5%	62.5%	57.6%	54.8%

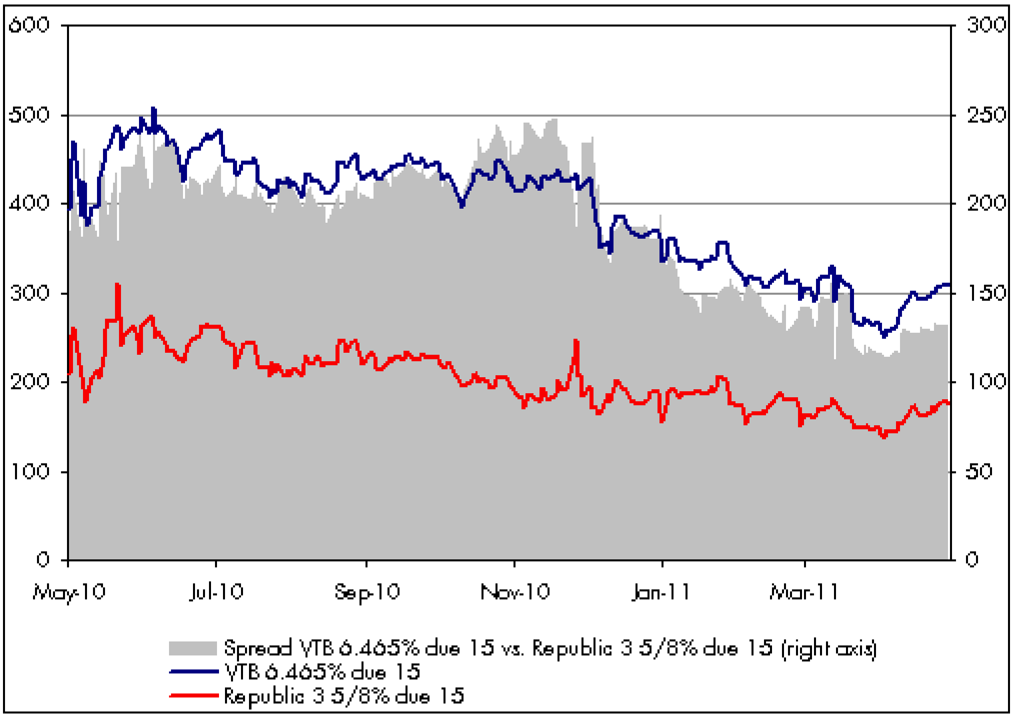
Source: Company data, Raiffeisen RESEARCH

Peer group valuation



Source: JP Morgan, Raiffeisen RESEARCH

VTB vs. sovereign



Source: JP Morgan, Raiffeisen RESEARCH