

Credit Opinion: Vostochny Express Bank

Vostochny Express Bank

Khabarovsk, Russia

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	B3/NP
NSR Bank Deposits -Dom Curr	Baa2.ru/--
Bank Financial Strength	E+

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Key Indicators

Vostochny Express Bank

	[1]2009	2008	2007	2006	2005	Avg.
Total assets (US\$ million)	1731.56	1097.89	1028.65	362.63	85.37	861.22
Shareholders' Equity (US\$ million)	245.09	194.61	110.86	57.66	21.11	125.87
Return on average assets	0.19	2.77	5.87	15.17	22.76	9.35
Recurring earnings power [2]	6.83	10.26	4.82	5.75	0.96	5.72
Net interest margin	11.66	16.54	12.75	16.43	3.58	12.19
Cost/income ratio (%) [3]	57.20	55.05	72.22	78.62	94.68	71.55
Problem loans % gross loans	7.60	5.85	9.66	12.78	3.19	7.82
Equity % Assets	14.15	17.73	10.78	15.90	24.73	16.66

[1] As of December 31. [2] Preprovision income % average assets. [3] Non-Interest Expense % Operating Income.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a Bank Financial Strength Rating (BFSR) of E+ to Vostochny Express Bank (VE), which translates into a Baseline Credit Assessment (BCA) of B3. The rating reflects the high level credit risks stemming from VE's focus on the riskiest segment of the retail loan market - unsecured consumer lending.

The rating also incorporates the risks associated with the operating and regulatory environment in Russia. At the same time, the rating is supported by VE's (i) established regional franchise on the Far East of Russia as well as its expanding geographical coverage, (ii) adequate liquidity, and (iii) adequate capitalisation.

VE's long- term ratings carry a stable outlook.

VE's B3 global local currency (GLC) deposit ratings do not impute any support considerations and therefore are at the same level as the BCA.

Credit Strengths

- Improving territorial presence along with a well-established regional retail franchise in its home region

- Adequate liquidity and capitalisation to date

Credit Challenges

- Tight credit environment continues to exert pressure on the bank's financial fundamentals

-High exposure to unsecured consumer lending

-Growth strategy through M&A could be a source of additional credit and operational risk

Rating Outlook

VE's long- term ratings carry a stable outlook.

What Could Change the Rating - Up

Any potential upgrade of VE's ratings will be contingent on the bank's ability to materially strengthen its franchise, while also demonstrating a sustained track record of improvement in financial fundamentals.

What Could Change the Rating - Down

Downward pressure could be exerted on VE's ratings by any material adverse changes in the bank's risk profile, particularly significant impairment of the bank's liquidity position, and any failure to maintain control over its asset quality. Negative pressure could be exerted on VE's credit ratings if its growth strategy - via merging with smaller and potentially weaker banks - were to result in weakening asset quality and financial metrics.

Recent Results and Company Events

VE's total assets, as reported under consolidated IFRS at 31 December 2009, increased to RUB52.4 billion (US\$1.7 billion) compared to RUB34.1 billion (US\$1.029 billion) at YE2008. The bank posted a net profit of RUB80 million for 2009, compared to RUB849 million in 2008.

As a result of VE's growth strategy through M&A, during H2 2009 two small regional banks - Dvizhenie and Kamabank (none rated) - have merged with VE.

Based on end-Q3 2009 financial statements, the total assets of Dvizhenie and Kamabank stood at RUB1.6 billion and RUB4.2 billion, respectively.

The consolidated IFRS for 2009 reflects the combined entity's financials.

DETAILED RATING CONSIDERATIONS

Detailed considerations for VE's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's assigns a BFSR of E+ to VE. The rating reflects the high level of credit risks stemming from the bank's focus on the riskiest segment of the retail loan market - unsecured consumer lending. The rating also incorporates the risks associated with the operating and regulatory environment in Russia. At the same time, the rating is supported by VE's (i) established regional franchise in its home region as well as its expanding geographical coverage, (ii) adequate liquidity, and (iii) adequate capitalisation .

As a point of reference, the assigned BFSR is one notch lower than the D- unadjusted outcome of Moody's bank financial strength scorecard, reflecting the fact that the scorecard is favoured by financial fundamentals .

Qualitative Factors (70%)

Factor 1:Franchise Value

Trend: Improving

Headquartered in the City of Khabarovsk in Russia's Far East region, VE is a full-service retail bank, mainly focusing on unsecured loans. With total assets of RUB52.4 billion (US\$1.7 billion) at YE2009, VE was ranked 56th by Interfax among all Russian banks. In recent years, VE has, through an organic and M&A growth strategy, significantly improved its territorial coverage and established a visible regional franchise.

The bank's operations are mainly concentrated in Russia's Far East regions and Eastern Siberia where VE has good brand recognition, operates the second-largest retail distribution network and has the second-largest retail loan portfolio. As a result of VE's regional expansion through M&A activities in 2009, the bank is expected to further improve its regional presence and further increase distribution capacities.

VE's branch network currently comprises 11 regional branches and over 400 offices located in Russia's Far East, Central and North Western regions, in Moscow, Saint- Petersburg, and Perm.

As of 31 December 2009, over 88% of the bank's loan portfolio consisted of unsecured consumer loans, and over 96% of its customer deposits were held by individuals.

VE's score for franchise value is C-

Factor 2: Risk Positioning

Trend: Neutral

VE is effectively controlled by two groups of shareholders - Mr. Igor Kim together with his partners in banking business, and Mr. Sergey Vlasov (VE's CEO).

VE's risk positioning is supported by good granularity of the loan book as the bank mainly services individual clients, with almost 90% of all loans not exceeding US\$4,000. Nonetheless, we are of the opinion that VE has a high appetite for credit risk, reflected by the bank's aggressive growth strategy in recent years in its home region and outside of its boundaries, and by its emphasis on the riskiest segment of the retail loan market - unsecured consumer lending. We also note that its new pursuit of growth via merging with smaller and potentially weaker banks could be a source of additional credit and operational risk.

A relatively advanced scoring model, based on a large customer database, aids manageability of the high level of credit risks. The effectiveness of the systems is reflected by its adequate asset quality for a consumer finance business, considering the currently weak economic conditions.

VE scores E for risk positioning.

Factor 3: Regulatory Environment

Refer to Moody's Banking System Outlook on Russia, published in October 2009, for information on this factor.

Factor 4: Operating Environment

Trend: Neutral

This factor is common to all Russian banks. Moody's assigns an E+ score for the overall operating environment in Russia. Refer to Moody's Banking System Outlook on Russia, published in October 2009, to obtain a detailed discussion on the operating environment.

Quantitative Factors (30%)

Factor 5: Profitability

Trend: Neutral

In 2009, VE posted net income of RUB80 million (US\$2.6 million), which translated into RoAA of 0.18% and RoE of 1.1% (2008: 2.68% and 13.9%, respectively). VE's profitability was on weakening trend during 2009. The bank's net interest margin declined to 11.3% as at YE 2009, from 15.9% as at YE 2008. The main reason for the decline was increasing cost of funding coupled with significant growth of costly retail deposit base, which doubled during 2009. In addition, the bank's bottom-line profitability was negatively affected by increased loan loss provisions.

We expect that stabilisation of loan loss provisions along with increasing business volumes and margins will result in visible improvement in VE's profitability in the medium term.

The score for profitability is A

Factor 6: Liquidity

Trend: Neutral

VE has maintained adequate liquidity positions supported by its growing customer base along with an adequate level of liquid assets. VE's funding base mainly consisted of retail deposits which doubled during 2009 and accounted for 82% of the bank's total liabilities (2008: 49.6%).

VE scores D+ for liquidity.

Factor 7:Capital Adequacy

Trend: Weakening

VE's shareholder equity stood at RUB7.4 billion at YE2009 and funded 14% of the bank's total assets (2008: 16%). The bank's adequate capital adequacy (The Tier 1 capital ratio was 17.7% as of YE2009) is likely to be sufficient to absorb credit losses which could materialise as a result of expected asset quality deterioration in the medium term.

Despite the historically relatively strong internal capital generation capacity, the decrease in capitalisation levels had been expected as the bank has been growing its loan portfolio at a relatively rapid pace. In our view, future capital increases will be mainly dependent on continuing shareholder support and VE's ability to raise capital through the sale of additional shares.

The bank scores A for capital adequacy, with a weakening trend.

Factor 8:Efficiency

Trend: Neutral

Given its retail focus, VE has historically displayed comparatively moderate efficiency indicators, with the cost-to-income ratio reported at 57.0% as at YE2009 (YE2008: 55%). However, the cost-to-average assets ratio has notably improved, decreasing to 8.9% from 12.2% over the same period. We expect VE's efficiency ratios to further improve in the medium term as a result of the expected increase of revenues and cost-cutting measures. We also expect that the bank will begin to benefit from economies of scale. However, if the bank continues its regional expansion and M&A activity, the associated costs will likely remain a constraining factor for efficiency in the medium term.

VE scores C for efficiency

Factor 9:Asset Quality

Trend: Neutral

Despite VE's focus on the high-risk segments of lending to individuals, the share of non-performing loans (defined as loans overdue for at least 90 days) remains adequate for a consumer lending business, considering the currently weak operating environment. The level of loans overdue for more than 90 days stood at 7.6% of the gross loan portfolio as at YE2009.

Provisioning coverage (of loans overdue by more than 90 days) was maintained at 90% - remained slightly lower than we would expect for a bank operating in the riskiest segment of unsecured consumer lending.

The bank's score for asset quality has been downwardly adjusted to E+, to reflect the risks associated with the bank's ongoing expansion and VE's focus on the high-risk segments.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns global local currency (GLC) deposit ratings of B3/Not Prime to VE, in line with its Baseline Credit Assessment. Moody's has not assessed any probability of systemic support as VE's position on the Russian market is not sufficiently significant to warrant any systemic support in the case of need. Although Moody's believes VE could potentially benefit from shareholder support in the case of need, the ability and willingness of the shareholders to support the bank is very difficult to estimate, and is thus excluded from our considerations.

Foreign Currency Deposit Rating

VE's foreign currency deposit ratings of B3/Not Prime are at the same level as its GLC deposit ratings.

Foreign Currency Debt Rating

The bank's foreign currency debt rating of B3 is at the same level as its GLC deposit rating.

National Scale Rating

VE is rated Baa2.ru by Moody's Interfax on Russia's National Rating Scale. National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Vostochny Express Bank

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (70%)						E+	
Factor: Franchise Value						C-	Improving
Market Share and Sustainability				x			
Geographical Diversification					x		
Earnings Stability	x						
Earnings Diversification [2]							
Factor: Risk Positioning						E	Neutral
Corporate Governance [2]					x		
- Ownership and Organizational Complexity					x		
- Key Man Risk					x		
- Insider and Related-Party Risks							
Controls and Risk Management					x		
- Risk Management					x		
- Controls				x			
Financial Reporting Transparency			x				
- Global Comparability		x					
- Frequency and Timeliness				x			
- Quality of Financial Information			x				
Credit Risk Concentration	x						
- Borrower Concentration	x						
- Industry Concentration	x						
Liquidity Management				x			
Market Risk Appetite	x						
Factor: Operating Environment						E+	Neutral
Economic Stability					x		
Integrity and Corruption					x		
Legal System				x			
Financial Factors (30%)						C	
Factor: Profitability						A	Neutral
PPP % Avg RWA - Basel I	7.90%						
Net Income % Avg RWA - Basel I	2.90%						
Factor: Liquidity						D+	Neutral
(Mkt funds-Liquid Assets) % Total Assets			0.61%				
Liquidity Management				x			
Factor: Capital Adequacy						A	Weakening
Tier 1 ratio (%) - Basel I	17.50%						
Tangible Common Equity / RWA - Basel I	17.50%						
Factor: Efficiency						C	Neutral
Cost/income ratio			61.49%				
Factor: Asset Quality						D	Neutral

Problem Loans % Gross Loans				7.70%		
Problem Loans % (Equity + LLR)				32.00%		
Lowest Combined Score (9%)					D	
Economic Insolvency Override					Neutral	
Aggregate Score					D-	
Assigned BFSR					E+	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information

[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

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