

SINCE 1999 WHALES GROUP HAS SPECIALISED
IN SELLING AND PURCHASING OF BANKS,
MERGERS AND ACQUISITIONS, AND SETTING
UP OF BANKS, AND HAS BEEN ENGAGED IN
RESEARCH IN THIS FIELD IN RUSSIA



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THE REVIEW IS PUBLISHED EVERY YEAR
EARLY IN SEPTEMBER, AFTER COMPLETION
OF TRANSACTIONS STARTED IN THE YEAR
UNDER REVIEW



Sale and purchase transactions are concluded latent, the price and conditions of a deal can be found out from inside the transaction. For this reason the Review is based on the expert opinions of specialists, involved in the follow-through of these transactions, on interviews of bank buyers and bankers, taking part in these transactions, and their appraisal of influences on the price of a bank, on insiders' information and using published data.

NOTES

In this Review we say that the banks are sold, meaning of course the sale of a stake or shares of a bank or its partners/shareholders/founders.

Unless specified otherwise, we discuss sale of a bank license, that is the right for banking operations. The cost of assets in a transaction is evaluated separately and, by agreement of the parties, is either reimbursed by the buyer or the assets are deducted by the seller. This includes, as a rule, restructuring of a credit portfolio.

New banks are those banks that were registered less than 3 years ago. Their specific features are: (a) the founders/shareholders have no right to alienate their stakes/shares, therefore transactions are made involving stakes/shares of the founders, and (b) a bank can receive the license for operation with individuals not earlier than 2 years after its registration.

We imply that new banks are licensed to operate both in Roubles and hard currency, since licenses for operation only in Roubles are not issued at present.

Older banks are those banks, which were registered more than 3 years ago.

Showing their authorised capital, for example, as 1 million Euro we imply that it can be equal to the amount between 26 and 32 million Roubles, depending on the rate, set by the Russian Central Bank on the day when the documents of the bank are submitted for registration.



FOREWORD, OR WHALES ASHORE

When preparing the market review of sale and purchase of banks in 2003, we are facing a question on the tendencies of 2004, especially now after the events of summer 2004. It is important to the players on the market to know what is happening to their market value under new conditions, and whether banks are offered for sale at dumping prices as stranded whales. Certainly, it is still too early to come to conclusions about changes in the cost of the banking licenses and businesses in 2004; however it is worthwhile to mention a few tendencies.

Instead of selling at dumping prices, some banks (from among medium-sized ones and smaller) have withdrawn their offers; their explanation was such: until problems among banks are solved we are not ready to meet our buyer. That is only natural: it is next to impossible to sell a bank burdened with problems, except in the case when the parties have great trust in each other, because to make sure that the bank holds still a valid license by the time all procedures related to sale and purchase are completed (and this may take from 5 to 20 months), the buyer shall start to give credits to the target bank long before acquiring any rights in the latter.

The banks, which have not withdrawn their offers, consider raising the price. It is necessary to point out that some of the banks, which operations came to an end a result of the crisis, shortly before it were really marketed at a dumping price, which allowed for their bad debts ("hole" in banking jargon). From the point of view of the market their offers were quite fair and arouse a lively interest, but transactions were not concluded for lack of time and trust of the parties.

As to prices of new banks, here we see a tendency of rising prices, which is due to extension of the statutory period of registration from six to nine months and to almost unrealistic requirements to bank founders.





QUANTITATIVE CHARACTERISTICS OF THE RUSSIAN BANKING SYSTEM (DATA AS ON APRIL 1st 2004)

Number of registered credit organisations, total	1619
including banks	1566
including non-bank credit organisations	53
Number of operating credit organisations, total	1330
including banks	1277
including non-bank credit organisations	53

CREDIT ORGANISATIONS WITH A FOREIGN PARTICIPATING INTEREST

Credit organisations with a foreign participating interest, total	128
100 % foreign-owned	33
more than 50 % foreign-owned	8

SPECIFIC FEATURES OF THE RUSSIAN BANKING SYSTEM

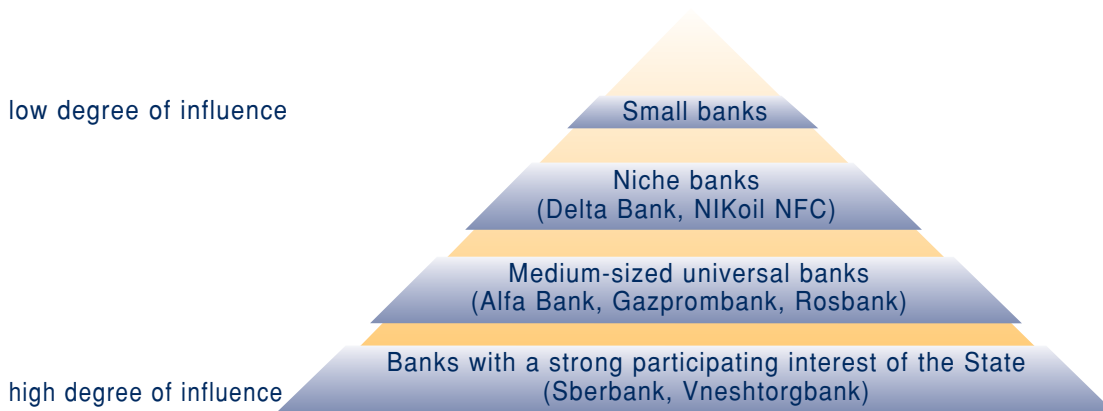
- Domination of the Russian Savings Bank (Sberbank)
 - 40% of the deposit amount and balances in settlement accounts
 - 2/3 of the amount of deposits of private individuals
- 80% of bank assets are owned by 102 banks as on January 1st 2004 (compared to 76 banks on January 1st 2001)
- High degree of market fragmentation
 - there are no banks in which a share of the total amount of extended loans or received deposits is more than 6 %
- Low presence of foreign banks
 - less than 10 % of the Russian banking system
- Concentration of the banking business on separate enterprises and sectors of economy (mining and export of mineral resources)
- Insufficient reliability of accounting.



4 MAIN SEGMENTS OF THE RUSSIAN BANKING SYSTEM

BY DEGREE OF THEIR INFLUENCE ON THE RUSSIAN ECONOMY

(100% foreign-owned banks are not taken into account)



"The structure of a banking sector shall be determined by the market and not by the Central Bank. Our task is to make the banking sector more stable and strong. We are not going to impose any structure on the economy".

Andrei Kozlov, Deputy Chairman, the Russian Central Bank.

BANKING STRATEGY 2004-2008

- Developed by the Central Bank
- The task is evolution of the Russian banking system
- The logic behind this strategy – only those banks remain, which have the trust of the Central Bank and the clientele, thus reserve requirements are liberalised, and credits become cheaper.

Main points of the strategy:

- More rigorous supervision (without setting up any special supervising authority)
- Revoking licenses from weaker banks
- Ban on setting up universal state banks
- Withdrawal of the State from the capital of banks.

Forecast for 1 January 2009

- Assets - 56-60% of GDP
- Capital - 7-8% of GDP
- Credits - 26-28% of GDP.



TRENDS IN THE DEVELOPMENT OF THE RUSSIAN BANKING SYSTEM 5

- Rapid growth, outpacing the rates of growth of the economy: during January-September 2003 bank assets increased by 16%, while the GDP growth in a year was 6.7%.
- The analysis of other developing markets shows that Russia is now at the start of the rapid growth curve, and there is a potential of doubling total assets in the next 5 years.
- Shrinking share of the State in authorised capitals of credit organisations.
- Growing stability of the banking business, and the resulting loss of superprofits: the return on capital in 2003 was 16.5 % against 18 % in 2002.
- Lower margin in the segment of crediting the biggest borrowers.
- Considerable increase of the share of retail business, deposits of private individuals as a result of macroeconomic stability and growing income of the population (13.4 % in 2003).
- The amount of loans to individuals went up by 130 % in 2003. The potential of the market becomes evident if we compare the share of credits to individuals in the Russian GDP, which is 2 %, to the same in Eastern Europe - 30 %, and in Western countries - 120 %.
- The rate of growth of deposits of private individuals is twice as high as that of the funds of legal entities, despite of export revenues – 37 % and 18 % accordingly. The ratio of deposits of private individuals to aggregate banking assets has reached only 26 % (50 billion US Dollars), in developed countries it is 70-80 %.
- Active bank penetration to the market of bonded stock, both foreign and domestic.
- The aggregate capital has grown by 30 % in 2003.
- More mergers and acquisitions.
- Growing proportion of foreign banks: despite extremely low deposit rates (2-3 % per annum), two foreign banks are already among the top 10 by amount of deposits of private individuals – Raffeisen Bank and IMB, Citibank is coming close to them.
- Specialisation of small and medium-sized banks by niches.
- Smaller number of banks servicing one financial and industrial group.
- Development of general-purpose banks into "financial supermarkets", emerging new products.

PROMISING PRODUCTS

- Deposits of private individuals
- Mortgages
- Factoring
- Private banking (wealth management)
- Credit cards
- Multi-currency deposits





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- Mobile banking
- Highly automated mini branches
- ATMs with extended functions
- Service packages, made up for groups of clients
- Brokerage services, pension funds, selection of a management company
- Real estate evaluation and management
- Life, health and real estate insurance
- Accumulation life insurance.

MAIN COMPLAINTS ABOUT RUSSIAN BANKS:

- No intermediation – intersectoral movement of savings and their transformation into investments
- Poor transformation of liquidity (transformation of short-term deposits into long-term credits)
- Unwilling to accommodate with loans even circulating assets of enterprises
- Low public confidence.

WHAT IS A POTENTIAL OF FOREIGN BANKS?

- Monopolisation of key branches of economy has resulted in the following: after grasping the flow of funds of one big client, a bank can lead an easy life and do not care so much about attracting new clients and its efficiency
- Undercapitalisation of Russian banks does not give a possibility to finance large industrial clients (guidelines set by the Central Bank)
- Foreign banks have cheaper credit resources available
- Strategic management, unification of business processes in all branches, up-to-date automated control systems, unification of risk management, highly qualified staff in specialised areas – these are the traditional advantages of a Western bank.





- Aim to prevent the entry in the Russian banking system by non-residents with an unstable financial position and/or of ill reputation
- Same requirements to the minimum amount of the charter capital at the level of 5 million euro both for resident founders and for non-residents
- No quotas of involvement of the foreign capital in the Russian banking system (Formerly this quota was equal to 12 %. Abolished as from 04.11.2002).

INVOLVEMENT OF THE FOREIGN CAPITAL IN THE RUSSIAN BANKING SYSTEM (OFFICIAL POSITION)

- Foreign capital with a good reputation is recognised to be an important factor in development of the Russian banking system (including introduction of modern banking technologies, new financial products, culture of banking corporate management and the like)
- Recognition of the foreign capital as a factor, contributing to development of competition in banking.

FACTORS WHICH IMPEDE THE DEVELOPMENT OF THE RUSSIAN BANKING SYSTEM

Externally:

- Slow structural changes in the economy
- Low liquidity
- Undercapitalisation
- Insufficient reliability of accounting in many Russian entities and poor clarity in most of them
- Low level of the economy monetisation.

Internally:

- Poor management in many credit organisations
- Low efficiency of risk management systems and of internal control
- Vague property structure
- Underdeveloped modern banking technologies.

MARKET ANALYSIS

OF SALE AND PURCHASE OF RUSSIAN BANKS

Bulls begin and win

Early 2003, same as the beginning of the preceding year, was marked by expectations of forcing small and medium-sized banks out of the market and consequent decline in prices for bank licenses. Same as in the previous years, these expectations did not come true, and prices were growing steadily. The market of bank sales is expanding, and is likely to expand further due to increase in money supply, although today would-be buyers are seeking not to control it, as was the case before, but to profit by it.

Prices in the segment of older Moscow banks with hard-currency licenses rose by 54 % against 12 % in 2002. Prices in the segment of Moscow banks with general licenses went up from 30 % in 2002 to 38.5 %. Prices for new banks with the authorised capital of 5 million Euro rose by 22 %, and for new banks with the authorised capital of 1 million Euro prices increased by 25 % against 36 % in 2002. Great changes have taken place in the segment of old regional banks with hard-currency licenses: the rise in prices was only 7 % against 40 % in 2002, for regional rouble banks the growth was equal to 0 % against 66.6 % in 2002. In recent years acquisition of this type of banks has been a kind of business: following the purchase the bank was transferred to Moscow, received a hard-currency license and was sold. However, a project of this kind required financial resources and time exceeding those needed for registration of a bank, and the final sale price was less by US\$ 250000, thus there was no growing demand and prices remained stable.



PRICE DYNAMICS

2001-2003

Location	Licenses	Term of operation	Price, thousand \$ 2001	Price, thousand \$ 2002	Price, thousand \$ 2003
Moscow	Hard currency	old	580	650	1000
Moscow	Hard currency	new (authorised capital= € 1 million)	500	680	850
Moscow	Hard currency	new capital= € 5 million)	-	780	950
Moscow	General	old	1000	1300	1800
Moscow	Rouble	old	320	400	-
Region 2-4	Hard currency	old	300	420	450
Region 2-4	Rouble	old	150	250	250





In the banking sector property has actively changed hands. In 2003 up to 23 % of banks changed their owners. Among the causes the following can be pointed out: shaking confidence in future security of small and medium-sized banks; inefficiency of old management teams of the time of "Red Directors" has now transformed into a problem of low efficiency of the younger breed of managers, who spin out to the curb if they do not come to be the best. Darwinian evolution consequences do not always correspond to managerial talents of bankers: often managers explain their inefficiency by conservatism of the owner, who does not permit to develop new products, caters only for his own interests, is slow in decision making, enforces management to undertake risky operations, treats the bank as one of his pocket structures. It turns out that the banks suffer from poor corporate management and consequently fall in the trap of personal problems of the owner. And what if on top of that come communication problems of several owners? Does it follow from the above that the quality of management and banking knowledge resources, but not material wealth, become a critical competitive advantage? The market's positive response to this question will signify movement in the same direction with the leading world markets.

WHO BUYS BANKS?

Back in 2002 a typical purpose of purchasing a bank was to invest money of an industrial and financial group, sometimes funds of the State budget with a view, first of all, to control them, and deriving a profit came next. The second purpose by occurrence was a purchase of the license by a team of the managers, who have broken away from a bank with a part of its business. In the third place were purchases by what was called a "financial company" in the 90s, which in reality was an uncertain number of legal entities set up to render, as a matter of fact, banking services with the aim to evade restrictions, imposed on banking operations.

"Buyer-2003" was a big Russian bank, a foreign bank of "second rank", an industrial and financial group with a team of managers (or vice versa), going into this narrow niche with the aim to get profit.

Still the most secure way to buy a bank was to have it registered, because there were no chances to make the seller reimburse the damage in case drawbacks of the purchase were discovered after the transaction had been concluded. That was the way followed by foreign banks, as well as those who could do without a license for operation with individuals.

It is worthy of note that both buyers and their aims have changed: they are much better prepared, have clearly defined purposes and requirements. There are more buyers ready to accept the risks of an older bank so as to receive an instrument for operation with individuals. Many of them discussed purchasing for operation not only with mortgages, but also with other instruments, exotic for Russia in 2003.

TWO BIGGEST TRANSACTIONS IN 2003

- ▶ 1. 100 to 200 million US dollars is estimate by the market of the transaction, in which Interros Holding bought OVK Financial Group, which emerged from SBS-AGRO. OVK - Mutual Loan Society Group - has come into existence in 1999 on the remnants of affiliates of SBS-AGRO Bank. It comprises 7 banks with 47 affiliates and 325 branches all over the country, 300 ATMs; Cash-Collection Company, non-state Pension Fund, Insurance and Audit companies. The aggregate assets of seven banks of the group, according to Interfax, amounted at the time of purchase to 14.2 billion Roubles (approximately ranking 37th in the list by assets), capital – 2.6 billion Roubles, deposits of natural persons - 4.7 billion Roubles.

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Originally It was announced that Rosbank- the financial centre of Interros and the country's 9th bank – and OVK would merge. However, actually it was a purchase, and OVK business was transferred to Rosbank. On completing what was planned, Rosbank can become the second largest retail bank of Russia, second only to Sberbank.

- ▶ 2. Purchase by NIKoil Financial Group of UralSib banking group. Now UralSib Bank has 17 affiliates and seven daughter banks. All in all, UralSib banking group comprises about 300 offices in 70 cities of the country, and it services more than 2 million people and more 65,000 corporate clients.

SPRINT - 2003

The shortest time periods in 2003 for purchasing a bank (the time is calculated from the day of the first negotiations between a buyer and a seller until the day when the signing rights of the new CEO are confirmed by the Accounts Centre of the Russian Central Bank and includes completion of all procedures, registration, and approvals of purchase and sale transactions) were:

A new bank in Moscow - 5 months

An old bank in Moscow - 7 months

A regional bank - 9 months.

WHAT INFLUENCES THE PRICE OF A BANK?

It is known that the market price is determined by the motivation of a typical seller and buyer. The investment price depends on the individual requirements of the investor to the object of investment.

In this market it is practically impossible to determine the price by evaluating the costs. Two methods dominate here: comparative (market) method and revenue method – estimate of the ability to bring in revenue in future (loss of profits, because the project of the purchaser lays idle, also comes here).

Although such indicators as management quality, level of corporate management are still underestimated by the market, we can forecast a further rise in value of intellectual capital as the aggregate knowledge of the whole staff of an organisation, ensuring its competitiveness. The organisational structure, that is an artificially created form of managing the use of knowledge, is also part of the intellectual capital. The complexity of such estimation is evident – the intellectual capital is a form of "the knowledge of the past", which cannot be evaluated in quantity and its transfer to the purchaser cannot be guaranteed.

In 2003 location and regional specifics were still key parameters in determining the price.



RATING OF THE REGIONS ACCORDING TO THE BUYERS' DEMAND:

1. Moscow
2. Moscow Region
3. Central Russia
4. Siberia
5. Far East
6. Russian Republics (except for pp. 7-8)
7. Tartarstan, Bashkortostan
8. Caucasian Republics

Most of the transactions of purchasing regional banks were not related to expansion to the regions, but were due to lower prices. These banks were bought to transfer them to other regions, thus such factors as available premises and clientele lost their importance. When buying Moscow banks with a small number of corporate clients, these clients were also of little importance, because the seller was unable to guarantee that the clients would stay after they found out that the bank had changed hands. The sale of a bank as a business (and not as a license) is worth to consider if it has more than 10,000 clients.

What makes a bank more attractive?

- Correspondent accounts in foreign banks
- SWIFT, Reuters
- Issue of plastic cards
- License to operate in precious metals
- Western management
- International Accounting Standards
- Audit by Big 4
- Extensive network of branch offices with a large number of clients in every branch
- Recent report of the Central Bank supervisors not containing any directives
- Disclosure of the real causes of sale.

Banks gave preference still to sales and purchases instead of mergers and acquisitions, and that took less time and reduced costs.

You can get a much lower price if partners/shareholders of a bank are in conflict or just do not coordinate their actions.

In cases when banks own the capital of other non-bank financial organisations and vice versa, foundation and financial documents of bank-affiliated companies can be misleading for the purposes of nominally unrelated credits. These circumstances lead to incomplete reflection in bank reports of risks in jumbo crediting and credits to involved parties, which makes it difficult to determine a fair price and can result in termination of the transaction.

If a bank is taken to court as a defendant, and a court judgement is still pending, this shall be no obstacle to a good bargain, if the essence of the action does not infringe on property rights, the amount in controversy is not critical, the seller displays its competence in conducting the case, and the amount of possible damage through an adverse judgement is placed on deposit until the dispute is settled.



GENERAL TENDENCIES, influencing the climate of transactions and the height of the barrier for entry into the market of banking services in Russia

In a number of aspects the market exhibits some specific tendencies.

In 2003 we have noted a paradoxical, at first glance, tendency of lower activity of part of the banks and expansion of the market. In our view, the capacity of the market of sale and purchase, as well as mergers and acquisitions, has increased appreciably. The total estimated market value of all transactions has sharply grown.

The peculiar feature has become a growing transparency of the transactions, which was due to the choice of a more optimal organisational, legal, tax and financial structures of the transaction.

In 2003 a number of the factors still prevailed, which hampered the reorganisation of the Russian banking system as well as active mergers and acquisitions of banks. No changes have been introduced in the legislation, which could permit efficient mergers and acquisitions, but the market, certainly, finds a way out of every deadlock, for example, banks and companies make additional issues of shares and exchange the shares of their affiliated structures. Rosbank, the main financial structure of Interros Holding, which had bought OVK Bank and for a long time had asserted that the merger of banks was pending, in the end performed simply and unpretentiously: initiated the change of signboards on OVK offices and suggested that the clients should transfer their accounts to Rosbank.

Still declared void are the obligations of the seller to reimburse the damage if, after completion of the transaction, obligations are revealed, which the buyer has not been aware of.

An important factor, which affects the transactions on mergers and acquisitions, is still a low level of absolute indices of the Russian economy. Western financial institutions still expressed their fears over possible purchases of Russian banks. However it is expected, that Russia's orientation to become a member of the European Union will boost activity in the field of mergers and acquisitions. Stronger competition will probably promote consolidation in many markets that will lead to growing number of the transactions.

The analysis of practice of mergers and acquisitions of the US companies has shown, that for 40 % of these companies acquisitions served as the basis of the strategy of expansion, for 35 % - acquisitions combined with internal expansion, and only in 25 % of these companies the increase of their price was wholly due to internal factors. This is the reason to believe that the Russian banking system will also make use of mergers and acquisitions as one of the most powerful and efficient mechanisms for growth.