

Banking on the Russia Risk You Know

By Catrina Stewart
Staff Writer

In an uncertain world of debt write-downs and jettisoned CEOs, leading foreign lenders are finding it can be better to bank on the Russian risk you know than the subprime exposure you don't.

Indeed, for some of them, the contrast with Russia has never seemed greater, where the prospects for growth -- either organic or acquisition-driven -- stand in welcome relief to the turmoil back home.

But the window of opportunity for new entrants to the market could be closing. While Russian banks are seen as more attractive than ever before, the number of good-sized banks up for grabs is limited, while those looking to go it alone through organic growth may have missed the boat, foreign lenders say.

Citibank, whose U.S. parent Citigroup found itself minus both \$11 billion in write-downs and CEO Chuck Prince in rapid succession, has built up a substantial growth platform in Russia during its 13-year presence here and is pursuing almost 100 percent organic expansion.

Mark Robinson, CEO of Citibank Russia, said new entrants now had little choice but to consider an acquisition. "If I was coming into Russia now, I would say I don't think I have any choice," he said. "They need to get a critical mass of people."

But Robinson noted that acquisition opportunities were confined to a relatively few of the larger banks. "After the top 30, the banks drop off very quickly in terms of size," he said. "We can grow faster by putting money into an organic strategy."

Johann Jonach, CEO of Raiffeisenbank in Russia, agreed that going it alone was more difficult now.

"If you want to become a universal bank and a more significant player [in Russia], I think it is too late to start from scratch," he said in a recent interview.

Analysts say the route to take depends on how quickly the foreign banks want to grow here. If they have the luxury of time, organic growth can be a preferable strategy to acquisitions.

"It's always a tradeoff," said Mikhail Galkin, banking analyst at MDM Bank. "When you buy a bank, you buy market share, clients and relationships. On the other hand, you have to pay a high price, which [in Russia] varied from three to five times book value prior to the global turmoil. There is also the issue of integration, which can be a nightmare."

Last week Raiffeisen, the largest foreign lender in the country, had particular reason to be happy about its Russian and East European business, with third-quarter profit up 51 percent on the back of car and home loans in the region, while it reported no significant exposure to the U.S. subprime meltdown.

Raiffeisen acquired Impexbank last year and is still integrating the smaller player into its structure. But on the plus side, the Austrian lender boasted at the time that Impexbank saved it four years of organic growth.

"International banks are keen on growing organically because their biggest cost is setting up," said Mark Rubinstein, banking analyst at Metropol. "Once they have all that in place, it is not that expensive to grow."

Russia has seen several new entrants in the past 18 months, and Central Bank figures put foreign ownership in the sector at 20 percent, a figure that includes the portfolio investors who hold shares in state-owned Sberbank and VTB following their IPOs. Strip them away, and analysts say the real figure is around 15 percent.

Natalya Orlova, banking analyst at Alfa Bank, said that given the continuing expected domination of the sector by state lenders, foreign ownership of banking assets would only increase to 20 percent to 25 percent within the next five years.

Also, mergers and acquisitions activity will stall until the situation in the sector becomes clearer and growth figures more predictable, Orlova said. That might not be until the middle of 2008, she said.

Belgium's KBC, another bank actively pursuing acquisitions in Eastern Europe, has led the recent charge in Russia, paying \$1 billion to acquire mid-sized lender Absolut Bank.

Societe Generale last year took a 20 percent stake in Vladimir Potanin's Rosbank in two separate transactions. It has the option to buy another 30 percent by the end of 2008 for a further \$1.7 billion on top of the \$600 million it has already paid.

Analysts said, however, that foreign buyers were overpaying for their assets. KBC bought Absolut at a "very expensive" 3.8 times book value, Rubinstein said.

Some analysts said valuations had ceased to be the stumbling block for potential buyers, as the Russian market is too big to ignore, and it is one of the few countries that still offers the chance to become a significant player.

"I think the valuation is much less of an issue than the strategic importance of buying a bank in Russia," said Bob Kommers, analyst at UBS. "More important is the size of the market and the fact that it is fragmented, which means that it is possible for all new entrants to achieve a meaningful position."

Analysts have suggested that tougher market conditions in the wake of the U.S. subprime crisis could present opportunities. Troika Dialog last week acquired an 8 percent stake in Ursa Bank, a Siberian regional lender with a high exposure to overseas debt markets, in what some saw as a move to take advantage of a funding shortfall.

"Any bank that is not state-controlled in the top 20 is potentially for sale. The problems in the international credit markets may ... accelerate the need for funding from strategic buyers rather than from bond markets," Kommers said.

For some banks, however, it could be the only way in. Since getting a banking license here can take one to two years, buying an "entry ticket" through a small acquisition and then pursuing organic growth can look more attractive, Orlova said.

Global banking giant HSBC, which obtained its retail banking license in May, is one of the few new entrants seeking to grow here without acquisitions.

"If anyone can, they can," Kommers said.

Of course, there can also be unpleasant post-acquisition surprises.

Germany's Commerzbank received a reminder of the challenges of doing business in the country when Promsvyazbank, in which it holds a 15 percent stake, was raided Oct. 31.

Commerzbank bought a stake from the Ananyev brothers in 2006 and had the option to increase its stake at the start of this year. Talks did not result in a deal, however. A source close to the German lender said the two parties had failed to agree on a price.

Promsvyazbank is seeking to list in London, Vedomosti reported recently, and one banker speculated in the newspaper that Commerzbank might sell all or part of its stake.

"We are open to all options," said Beate Schlosser, a spokeswoman for Commerzbank. "But we think that our stake in Promsvyazbank is a good investment."

But the risks of doing business here are now increasingly understood. Russian banks, particularly those with a regional reach, remain extremely attractive, and the country is still underbanked.

"The banking sector is still in its infancy here," said Peter Halloran, president of the Pharos Fund. "The consumer in Russia is still not leveraged, and mortgages are [about] 1 percent of GDP."

But the easier growth seen in the last couple of years will soon become a thing of the past, as a combination of less accessible overseas funding and a natural correction of the market kick in, analysts said. While growth in terms of assets is expected to reach 40 percent this year, it is expected to start to slow by 2 to 5 percentage points per year from 2008, Metropol's Rubinstein said.

"Growth will come down," Raiffeisen's Jonach said. "This is partly because of the changed situation in financial markets. We do not think we will see the rapid growth rates we had in 2004 and 2005."
