

Research Update:

Russia-Based Bank Vozrozhdenie Affirmed At 'BB-/B' On Bank Criteria Change; Outlook Stable

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Overview

- Following a review of Bank Vozrozhdenie under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have affirmed our 'BB-/B' ratings and 'ruAA-' Russia national scale rating on Bank Vozrozhdenie. The outlook is stable.
- Our ratings on Bank Vozrozhdenie reflect our 'bb' anchor for a commercial bank operating only in Russia, the bank's moderate business position, moderate capital and earnings, adequate risk position, average funding, and adequate liquidity.
- The stable outlook reflects our view of a material possibility that Bank Vozrozhdenie's creditworthiness will remain stable over the next 12 months, with the continuing improvement of the bank's asset quality and profitability balancing its still pressured business position and declining capitalization.

Rating Action

As we previously announced, on Dec. 9, 2011, Standard & Poor's Ratings Services affirmed its 'BB-' long-term and 'B' short-term counterparty credit ratings on Russia-based Bank Vozrozhdenie. The outlook is stable.

At the same time, the 'ruAA-' Russia national scale rating was affirmed.

Rationale

Standard & Poor's bases its ratings on Bank Vozrozhdenie on the bank's "moderate" business position, "moderate" capital and earnings, "adequate" risk position, "average funding", and "adequate" liquidity, as our criteria define these terms. The bank's stand-alone credit profile (SACP) is at 'bb-'.

Under our bank criteria, we use the Banking Industry Country Risk Assessment's economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating (ICR). The anchor for a commercial bank operating only in Russia is 'bb', based on an economic risk score of '7' and an industry risk score of '7'.

The economic risk score reflects Russia's only moderate growth prospects, moderate pace of credit expansion, the economy's moderate level debt. It also reflects our view of very high credit risk in the economy, due to foreign

currency lending, the poor credit standing of the nonexport economy, and Russia's weak and arbitrary legal system. The industry risk score is based on deficiencies we observe in Russia's bank supervision; the dominance of state-owned banks, which unfavorably distorts competition for private-sector banks; and risky bank funding markets, characterized by a lack of long-term financing in rubles and the prevalent use of foreign currency. Nonetheless, bank funding has improved since 2008, due to a significant increase in retail deposits and the Russian Central Bank's regular and effective liquidity support operations.

Bank Vozrozhdenie's "moderate" business position is based on its limited franchise and competitive pricing pressure from larger banks, although it has a good and loyal client base in the Moscow region. With total assets of Russian ruble (RUB) 176.7 billion (about \$5.5 billion) as of Sept. 30, 2011, Bank Vozrozhdenie ranks among the 30 largest financial institutions in Russia. It focuses mainly on corporate and retail lending and funds its operations chiefly through retail deposits. Increased market competition has led to the worsening of the bank's market position and lower margins. This is partly due to what we regard as management's cautious and risk-averse approach after the 2008 financial market crisis in Russia. We consider the stability and professionalism of the management team as a positive factor.

Our "moderate" assessment of capital and earnings reflects the balance between our view of the bank's satisfactory capital and earnings structure and our projection that the risk-adjusted capital (RAC) ratio (before adjustments for diversification) will fall to a range of 5% to 6% within the next 12 to 18 months. We also expect Bank Vozrozhdenie's earnings capacity remaining limited. The bank is planning to expand its business, but we do not anticipate that the existing owners would support this growth with additional capital injections. The bank's earnings power is pressured by market competition, but the earnings structure is healthy, with about 57% of revenues coming from interest income and 38% from fees and commissions. We expect the bank's profitability to improve in the future, due to the growth of earning assets and optimization of operating expenses.

In our view, Bank Vozrozhdenie's risk position is "adequate". The bank showed an adequate track record of loss experience during the economic downturn in 2008-2009. The current performance of Bank Vozrozhdenie's loan portfolio is in line with peers'. The ratio of nonperforming loans to total loans was at 8.3% as of Sept. 30, 2011. Credit costs went down to 1.7% in the first nine months of 2011 from their peak of 4.9% in 2009. We think that the bank's portfolio performance will continue to improve in the future, with the gradual workout of existing nonperforming loans. We note, however, that the loan book remains highly concentrated, with the 20 largest borrowers representing 30% of total loans and 2.3x the bank's equity as of Sept. 30, 2011.

Bank Vozrozhdenie's funding is "average" and its liquidity is "adequate", in our opinion. The bank's well-developed retail branch network provides it with a stable base of core retail deposits. The gradual increase of funding base in 2010-2011 was accompanied by a decline in the cost of liabilities, which we

view as positive. The bank's loans-to-deposits ratio has increased over the past three years, but was still a satisfactory 98.9% as of Sept. 30, 2011. Cash and equivalents comprised about 14% of Bank Vozrozhdenie's total assets on the same date, which also contributes to our assessment of the liquidity position as "adequate".

In our view, Bank Vozrozhdenie has low systemic importance in the Russian banking system. Therefore based on our view of the low likelihood of external support, we have not added any notches of uplift to the SACP.

Outlook

The stable outlook reflects our belief that Bank Vozrozhdenie's asset quality and profitability will continue to show slight improvements. However, we believe its capitalization will likely decline and its business position will remain under pressure.

We could lower the rating if we see sustained weakness in earnings that would reflect a continued erosion of the bank's competitive position and capitalization to "weak" levels (a RAC ratio of less than 5%). Negative rating actions could also follow a sharp deterioration of asset quality, due to a rise in the bank's risk appetite and an increase in single-party loan concentrations, which are already at high levels. Negative trends in Bank Vozrozhdenie's funding position, especially an outflow of customer deposits, could also lead to a downgrade.

We could raise the rating if we saw significant improvements in the bank's capitalization, with the RAC ratio staying higher than 7%, either through capital injections or improved internal capital generation. We may also consider a positive rating action if we saw a strengthening of the bank's business position, with material improvements in its market share, particularly in customer deposits, or if we saw further strong improvements in the bank's risk position, including a material reduction of single-party loan concentrations.

Ratings Score Snapshot

Issuer Credit Rating	BB-
SACP	bb-
Anchor	bb
Business Position	Moderate (-1)
Capital and Earnings	Moderate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	0
GRE Support	0

Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- BICRA On Russia Revised To Group '7' From Group '8', Nov. 9, 2011
- Group Rating Methodology For Banks, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011

Ratings List

Ratings Affirmed

Bank Vozrozhdenie

Counterparty Credit Rating

Foreign Currency

BB-/Stable/B

Russia National-Scale Rating

ruAA-/---/--

Certificate Of Deposit

BB-/B

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Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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