

Active Zone

The banking sector in emerging Europe is seeing some seismic shifts. Though slow and gradual, they are detectable. And as western banks crumble, new players ranging from Russian banks to private equity firms are emerging.

By Armin Haerberle and Anne-Kathrin Meves

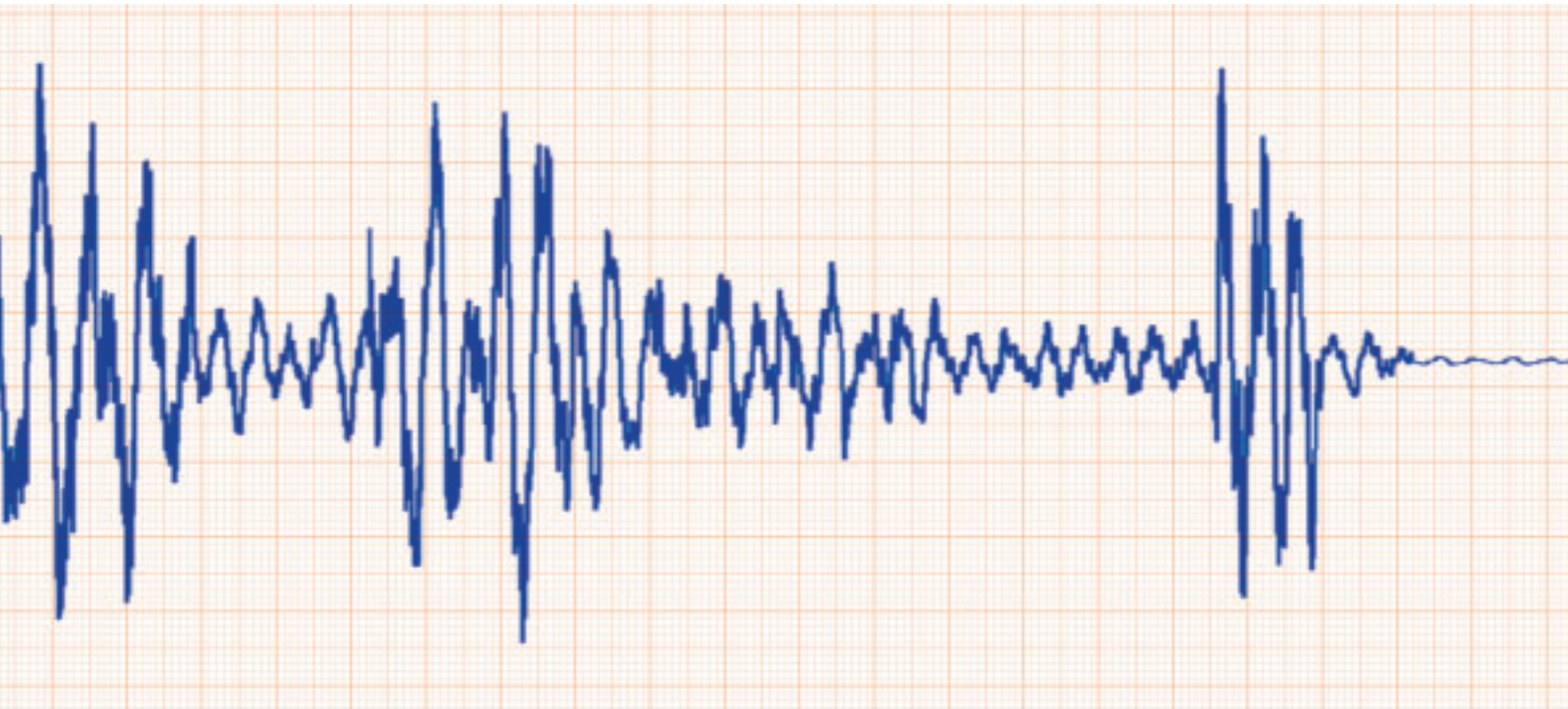
Changes have been coming thick and fast during the past few weeks in emerging Europe's banking landscape. The seismograph of negative news is moving a great deal; news of international banks pulling out of the region seems endless. The call for a new Vienna Initiative is out, but the likelihood of it coming to life is meagre. Western banks face mounting problems in their home

markets and national governments are unable to support them this time around.

Austria's regulator already created legislation for its banks, many of which are important players in emerging Europe, prohibiting them lending more than 110 per cent of their local deposits in local markets. Even if, in many cases, that limit is not surpassed due to the deleveraging of the last two years, the rule will structurally limit the credit supply in a region that is notoriously short of deposits. Sweden also

took a hard line on its banks in recent weeks, which is likely to affect their non-home market lending.

But the effects are not restricted to lending alone. Instead, the list of western banks scaling back their presence in the region is growing fast. At the end of October, Barclays announced it will offload its Russian retail segment to focus on investment banking. In September, Nomura gave notice it was closing investment banking there. In June, HSBC sold its



Russian retail business to Citi; GE Money Bank and Swedish Svenska Handelsbanken pulled out as well, and Rabobank gave up its retail license in 2010.

Yet, local executives are relaxed. Michael Shneyderman, CEO of Rosvodokanal, a major water utility, says he deals primarily with Russian banks anyway, “so the situation with Western banks pulling out doesn’t affect us very much.” Alexey Kornya, CFO of MTS, adds, “we basically stopped working with international banks” (see interview on pages 26-28).

Spreading shockwaves

While the Russian banking sector has always been considered tricky, the wavering of western banks has long since spread to other countries in the region. In Poland alone, eight banks are up for sale, including Bank Millennium (currently owned by Banco Comercial Portugues, BCP), KredytBank (owned by KBC), and BPH Bank, a subsidiary of GE Money Bank. In Hungary, MKB Bank (currently Bayern LB) and Budapest Bank (GE Money Bank) are both for sale; in Serbia,

Romania and Russia at least nine more institutions in total are also on the market.

It is not surprising that latecomers especially are pulling out of local banking markets, many of whom paid astronomical prices for the businesses a couple of years ago. “From 2005 to 2008 many banks rushed head over heels into the region, paying up to 4 times equity capital

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for tiny businesses in places such as Kazakhstan or Ukraine,” says Igor Strehl, CEO of VTB’s subsidiary VTB Austria. “However, the retreat has been speeding up recently, at least among those banks for whom Russia was not a core market, whereas dedicated emerging European players remain committed,” says Gleb Shpilevoy, analyst at Raiffeisen Bank International (RBI).

Is this just a light tremor or will it become an earthquake with the potential to reshape the financial landscape of the region? In many cases, local banks and new players are happy to buy what western banks leave behind. Santander sold its Russian retail business to Russia’s Orient Express Bank in December 2010. Barclays is reportedly selling its retail business to Kazakhstan’s biggest lender Kazkommertzbank. Chinese banks are considering bidding on Poland’s Millenium Bank, as are private equity funds.

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The latter are rarely seen in the European banking market so far, but due to the current financial crisis they could become a much more important force, as Artur Kluz, partner at Metropolitan Capital Solutions in Warsaw, points out. There are some examples of PE funds investing in the Polish banking sector including in such outlets as MeritumBank with total assets of PLN 700 million (EUR 160m) and 53 per cent owned by Innova Capital, 22 per cent by Wolfensohn Capital Partners and the ERBD, respectively, or FM Bank with assets of PLN 300 million, owned by Abris Capital Partners and >>

■ Possible M&A candidates in the mid- to long-term perspective (selection)

Country	Target (current owner/investor)	Total assets (in EUR bn)
Poland	Bank Millennium (BCP)	11.6
	KredytBank (KBC)	10.8
	BPH Bank (GE Money Bank)	9.4
	PKO BP (Polish government)	44.6
Romania	Banca Transilvania (Bank of Cyprus, EBRD et al.)	5.0
	CEC	5.1
	Volksbank Romania (OVAG)	4.6
Serbia	AIK Banka (ATE)	1.3
	Komercijalna Banka (EBRD, Serbian gov't et al.)	2.4
	KBC Serbia (KBC)	0.3
	Privredna Banka Beograd	n.a.
Slovenia	Cacanska Banka	n.a.
	Nova Ljubljanska Banka	14.6
	Gorenjska Banka (Sava insurance group)	2.0
	Banka Celje (NLB)	2.6
Russia	Faktor Banka (NKBM)	1.1
	Bank Khanty Mansiysk (Nomos)	4.2
	Absolut Bank (KBC)	2.7
Hungary	Home Credit Et Finance Bank	2.7
	MKB Bank (Bayern LB)	9.8
	Budapest Bank (GE Money Bank)	3.3

Source: CEE Banking Sector Report, RBI

the International Financial Corporation. Though a lot depends on legislation and availability of funds for PE firms, Mr Kluz is sure that PE firms will become more important players in the region's banking market.

The most active player in recent years, however, has been Sberbank. The Russian heavyweight has been at the epicentre of many deals already. It recently signed a co-operation with Japan's Mizuho Corporate Bank to serve Japanese clients in Russia and bought the Russian unit of Germany's insurance giant Allianz as well as Troika Dialog, a Russian investment bank. Between 2006 and 2010, it acquired Texakabank in Kazakhstan, NRB in Ukraine and BPS Bank in Belarus.

This was all in the CIS realm, considered by many to be Sberbank's home turf. Things started getting interesting in July though, when Austria's OVAG, the central institution of the country's Volksbanken (co-operative savings banks) sold its international operations, VBI, to Sberbank. The deal included nine entities in the Czech and Slovak Republics, Hungary, Ukraine

and some of the Balkan states, but not Romania (carved out from the deal). That was just for starters. Sberbank is really interested in Poland, where it is said to be targeting Alior bank, a smaller player, and Turkey, where it has an eye on Deniz Bank, a large one.

Getting serious

It certainly makes sense for a Russian player to expand in a region with close economic ties to Russia. And it is about time they started to. "Compared to the other BRIC states, Russian banks lag a good deal behind," says Jean-Marc Velasque of VELHON Partners, a consultancy. According to their research, Sberbank has spent just EUR 1.5 billion on acquisitions, only one-third of which was for foreign businesses. Its Chinese counterpart, ICBC, has spent more than EUR 4.5 billion to acquire and develop foreign subsidiaries in the same period of time.

But the bank finally seems to be serious about international expansion. It

wants to generate at least 5 per cent of its net income from international operations by 2014, more than twice as much as today. That might not sound like a lot, but it is. According to a Sberbank post-acquisition presentation, the nine VBI entities it took over generated a combined net income of just EUR 22 million in 2010. That is a mere 0.2 per cent of Sberbank's net income (combined net interest income and net fees and commissions) of RUB 470 billion or roughly EUR 11.25 billion that year. The Russians clearly cannot count on just this outlet to achieve their international growth targets, or, as Gunter Deuber, head of CEE research at (RBI) says, "Sberbank's acquisition of VBI is really more a market research project than a substantial commitment."

In fact, for Sberbank, a 5 per cent target means approximately EUR 560 million net income from international operations. This is, for instance, the entire net income that Poland's third largest bank, BRE Bank, generated in 2010 (PLN 2.5 billion or EUR 550m). In other words, Sberbank's plans could easily have a big impact on the region's wider banking system should the bank decide to go for its 5 per cent target, e.g. via a larger acquisition.

VTB, Russia's second largest bank with net profits of RUB 53.6 billion in the first six months of 2011, is also on a buying spree. At the moment, it is choking heavily on the takeover of Bank of Moscow (BoM) from earlier this year. Just after the takeover, EUR 5.3 billion were missing and it is questionable whether the figures on the recent IFRS report are correct. BoM might turn out to have more similarities with an abyss than a strategic investment for some time to come. But VTB is not shell-shocked. Instead, its investment banking unit VTB Capital hired Atanas Bostandjiev, a former partner of Goldman Sachs, in November to boost its international expansion. Since its foundation in 2008, it has quickly become one of the dominant investment banks in Russia and the CIS, but has almost no footprint beyond its home turf. The new

boss now wants to generate one third of the bank's revenues from international activities within three years, up from less than ten per cent last year.

Not that easy

There is no doubt that new players are taking the stage. But there are a number of caveats still. Market observers say that Russian investment banks already bid very aggressively (and successfully) for bond placement deals in the region, but are not necessarily good at nursing the market afterwards. This will have to change if they want to attract regular mandates. In addition, Sberbank and VTB alike are used to operating in a vast country and whether they will be able to cope with relatively small markets is debatable. "Most markets in the region range from 1.5 million to 10 million customers, so efficiency gains and optimisation are very hard to achieve," Denis Bugrov, a Sberbank board member, warned at a banking conference in Frankfurt in November.

They might also face a lot of reservations there. "Russian banks may not always be welcome in other parts of emerging Europe," says Mr Velasque, "and local politicians could see Sberbank and VTB not necessarily with benevolence." A local banker in Poland says, people would never deposit in a Russian bank – never. And in the Czech Republic, the treasurer of a major manufacturer states that Sberbank's VBI acquisition did raise quite a lot of eyebrows with locals, even if it made sense from a business perspective.

And when it comes to the opportunities that arise from distressed sales by western banks, it is worth remembering that, "Russian banks are not exactly good turnaround managers," as Mr Deuber says. "Buying ailing banks and turning them into a success story is not necessarily what Sberbank is best at." VTB's BoM disaster is a blaring example.

Russia's giants may benefit less from sales by western banks than one might expect. While cutting back on ordinary jobs, Sberbank has also signed a contract with INSEAD business school to train 500 of its top executives until June 2012. And it hired Alessandro Profumo, former CEO of UniCredit, earlier this year to advise it on its international expansion.

With western banks shaken and in many cases crumbling, corporate executives would be well advised to watch these developments carefully. "We keep a close eye on this and the options that might arise from it, but we don't actively push our relations with Russian banks at the moment," says the senior executive of a major German car manufacturer in the region. Even if his company has no such



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plans at the moment, "in the long run, the option to get financing in ruble directly from a Russian bank might become attractive," he adds.

But this is not only about rubles in the long run. In the short run, US-dollars are even more important. Eurozone banks can hardly get hold of them these days and companies such as EADS are concerned about their customers' ability to get any dollar financing at all (see interview pages 58-60). Backed by a dollar-generating natural resource economy, Russian banks face no such problems. In September, for instance, J.P. Morgan provided Sberbank with a five year, USD 100 million trade finance loan to support its pre-export finance for a client in the oil and gas sector.

"This comes at a time of uncertainty about the availability of liquidity in

Europe and is testimony to our trusted relationship with Sberbank," says Jeremy Shaw, head of J.P. Morgan's EMEA trade finance business. Compare this with the emergency measures taken by various central banks, led by the US Fed and the ECB, in late November to collectively pump US dollars into the dollar-strapped European banking system.

After twenty years of emerging Europe largely being considered the natural habitat of western banks, the region has become an active zone again with tectonic movements that cannot be ignored. The changes are slow and gradual, but they are detectable. New players are emerging, ranging from local private equity firms to Chinese and, more importantly, Russian banks.

Even if the success of their expansion still faces many contingencies – from basic know-how to negative sentiments – their potential benefits to companies are becoming clearer. Thanks to trade ties, transaction banking with a Russian bank makes sense; for investment banking, players such as VTB and Troika Dialog now have a track record and in the long run, ruble and even dollar financing from a Russian bank could become an interesting option for a growing number of companies.

"In five to seven years, Russian banks will be a significant force in the wider region, not in the least due to their huge and largely healthy balance sheets that are a big advantage compared to their western competitors," says Mr Deuber. He is seconded by Mr Velasque, who also thinks that in a few years, "Sberbank will be a major player in Poland and other countries in the region." Regional CFOs should start making up their minds on how to react to these seismic shifts. Though they seem to be just minor movements so far, they could well be the tremors building up to a major earthquake. ||

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