



Banking sector in South East Europe: Low penetration levels provide basis for strong growth rates in the coming years

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Sector stabilised after several years of turmoil. Entrance of foreign players boosting confidence in the banking market

Catch-up potential to result in above-average growth rates for the next decade

Romanian BRD GSG, Banca Transilvania and Serbian AIK Banka are top picks

After several years of turmoil in the 90'ies, the banking sector in South Eastern Europe[1] has stabilised. This is because a number of measures have been put in place, including the separation of commercial banks from the central bank, liberalisation of interest rates, cleaning up of loan portfolios, restructuring and privatisation of state banks and their enterprise borrowers, and the opening up of the banking system to private and foreign entities at an early stage of the transition process.

Foreign-owned banks account for the vast majority of the region's banking assets and provide a competitive benchmark for the remaining domestically-owned banks. The EU accession process increased the legal and political security within many SEE countries and has further stimulated economic growth.

Sector overview

The current market sentiment for the banking sector is still dominated by the US sub-prime crisis and its effects on the global economy in general and the banking sector in particular. Unlike many US and Western European players, SEE banks are not at all involved in any sub-prime or sub-prime related investments and therefore need no writing-off of their assets. On the funding side, however, the crisis has affected the liquidity of the EUR currency. The 3M Euribor (for instance) has increased by 63bp to 4.355%, from 3.725% at the beginning of 2007, and during December even reached a >100bp spread. Therefore, funding has become an issue over the last couple of months, in order to secure asset growth at a reasonable price.

"We looked at the loan to deposit ratios of the different banking markets to divide the markets, which are more securely funded, from those that are more stretched" says Günter Hohberger, banking sector equity analysts at Erste Bank and co-author of the report. In 2006, the SEE markets showed a wide range of funding quality, from a 61% loan/deposit ratio in Albania to 108% in Croatia and 107% in Serbia.

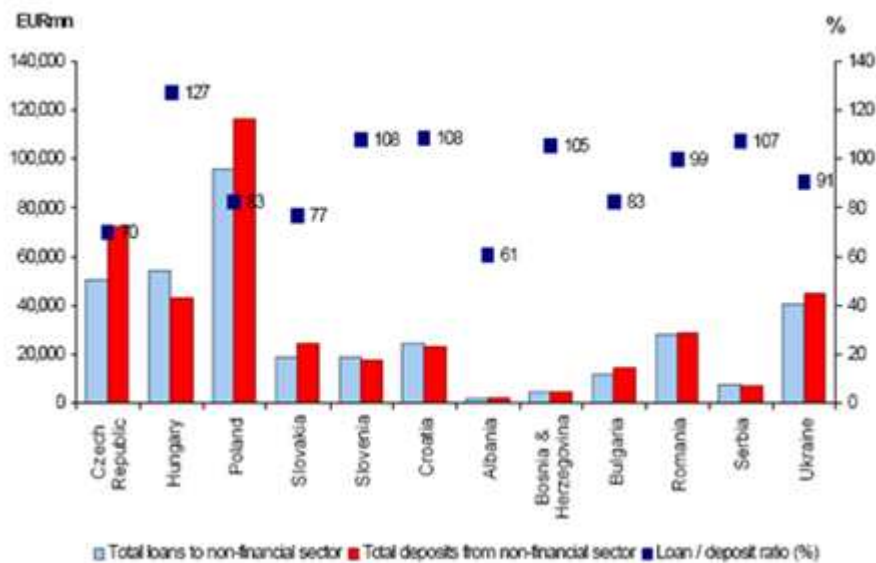
"Looking at loan growth in 2007, we are impressed by the rates in Romania (+64% y/y) and Bulgaria (67% y/y), which were mainly driven by households in Romania (+83% y/ y) and private enterprises in Bulgaria (+77% y/y)", says Hohberger. "However, the deposit growth was not able to compete with the asset growth and, therefore, the loan to deposit ratio increased significantly in both countries. The main reason for the strong demand for loans was the more than 80% increase of FX lending (from a very low level), driven by the cheaper money in Euro and Swiss francs", adds Hohberger.

Romania has been in the limelight due to its high C/A deficit and the resulting implications for its banking industry. As for the deficit itself, the analysts of Erste Bank stick to their previous view: the situation is admittedly severe, but not as bad as it might look. The structure of the deficit still appears to be solid, with FDI and remittances backing it and consumption on a declining trend.

Banking penetration rates CEE(2)

In many CEE countries, the low penetration of loans provides the basis for the strong lending growth rates in the coming years. The

Loans, deposits, loan/deposits ratio (right scale) in 2006

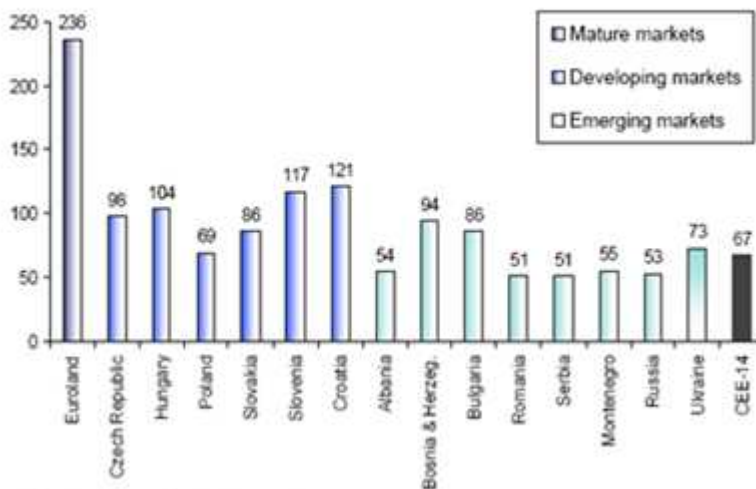


Source: National Banks, Erste Bank Research

co-author of the report.

Another aspect on which analysts of Erste Bank insist is deposit growth, which would play a crucial role in the funding of SEE banks. "While the deposits are already at a relatively high level in countries like the Czech Republic and Croatia, in the emerging banking markets, a significant amount of money is still stored in under mattresses. We expect commercial banks to continue to replace piggy banks as confidence in the banking market rises", states Gernot Jany.

Total assets to GDP in % (2006 data)



Source: National Banks, Erste Bank Research

main drivers for the loan growth in most of the countries are mortgage and consumer loans - a consequence of decreasing unemployment rates, rising GDP per capita and subsequently growing demand for consumer goods and housing.

"We expect all CEE countries to make use of their catch-up potential, resulting in above-average growth rates for more than ten years. Just look at banking sector assets to GDP, total loans to the non-financial sector to GDP or total deposits from the non-financial sector to GDP to see this impressive potential", says Gernot Jany, banking sector equity analysts at Erste Bank and

Following conclusions from the peer group valuation and regression analysis the analysts of Erste Bank point out the following banks in SEE:

BRD GSG(3) - one of the most profitable banks in CEE with ROE 2008e of 25.5%. Currently the BRD GSG share trades at more than 20% discount to the peer group median in terms of P/E 08e, which looks very attractive. AIK Banka(4) - trading currently at 17% discount (based on P/E 08e) and Banca Transilvania(5), which in their view deserves a higher premium than the current 5% due to the strong growth prospects (CAGR 06-09e of 22.5%).

Komercijalna Banka(6), which trades at very high premiums to the peer group of some 30% in terms of P/BV 08. Due to its low profitability of 10% (ROE 07e), they would not see this premium as justifi-fied.

- (1) South-Eastern Europe banking markets covered by this report comprise Albania, Bosnia & Herzegovina, Bulgaria, Croatia, Montenegro, Romania and Serbia (with market data including Kosovo).
- (2) CEE includes here despite of the Czech Republic, Hungary, Poland, Slovakia, Slovenia and Croatia also Albania, Bosnia & Hercegovina, Bulgaria, Croatia, Montenegro, Romania, Serbia and Ukraine.
- (3) 58,32% of BRD GSG owns French Société Générale, rest is free float.

- (4) 20,32% of AIK Banka owns the Greek ATE Bank, 13,03% IRVA Investicije, 66,6% free float.
- (5) 15% of Banka Transilvania owns EBRD, 85% free float.
- (6) 40,31% of Komercijalna Banka owns the Serbian state, 25% EBRD, rest is free float.