

BANKS

Pan-European Banks

Initiation of Coverage

SECTOR VIEW

New: NEUTRAL
Old: NEUTRAL

Antonio Rizzo
+44 20 7102 1435
antonio.rizzo@nomura.com
NI plc, London

Maciej Szczesny, CFA
+44 20 7102 2504
mszczesn@nomura.com
NI plc, London

Robert Law
+44 20 7102 2715
robert.law@nomura.com
NI plc, London

Jon Peace
+44 20 7102 4452
jon.peace@nomura.com
NI plc, London

Paola Biraschi
+44 20 7102 2375
pbirasch@nomura.com
NI plc, London

Marc Smart
+44 20 7103 4362
marc.smart@nomura.com
Industry Specialist

Duncan Farr
+44 20 7103 1539
duncan.farr@nomura.com
Industry Specialist

Austrian Banks

A thaw in the East

We resume coverage on Austrian banks taking a relatively more positive stance on Erste Bank (Neutral) and more negative view on Raiffeisen International (Reduce). Valuations for the two are similar and both stocks are trading in line with EU banks on P/TBV. However, we would expect the market to discriminate between the two banks by assigning a premium valuation to Erste. We regard Erste's business model as more sustainable longer term, due to its stronger market shares in its key markets, lower exposure to potentially higher risk markets, a lower loans/deposits ratio and its lower reliance on FX lending.

Improved global economic and financial market conditions are easing the pressures on the Austrian banks, even though conditions in the CEE remain challenging. On our central assumptions, NPLs will peak in 2010 and both banks will remain profitable, despite higher impairments; asset quality deterioration to date has been less than feared. Nevertheless, we believe both banks may raise additional equity to repay state capital injections; Erste's common equity Tier-1 ratio is particularly low at 4.9%.

ANY AUTHORS NAMED ON THIS REPORT ARE RESEARCH ANALYSTS UNLESS OTHERWISE INDICATED.
PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 42 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 43

October 05, 2009

Nomura International plc

<http://www.nomura.com>



Table of Contents

Investment conclusion.....	3
Capital adequacy.....	7
Capital deficit story is not fully over yet, we believe.	7
Is the capital deficit story finally over?.....	8
Internal capital generation is more likely to allow Erste to re-pay participation capital.	11
Asset quality	14
Asset quality to worsen but banks are solid enough to stand firm	14
While the macro picture is improving.....	14
..and the FX volatility is fading	15
...it is too early to call asset quality deterioration off.....	16
Operating profits vs loan loss provisions	17
Key driver: Inflow of non-performing loans.....	17
Our estimates on asset quality.....	19
How bad it could go? Stress test scenarios.....	20
Valuation.....	23
ERSTE Bank	24
Shareholder structure	24
Looking for the Achilles heel: 1) Romania?	25
2) Austria: is it a safe harbour?	27
3) Goodwill impairment?	27
4) Structured assets?	28
Erste Bank – Financial estimates	29
Erste Bank – Divisional estimates.....	30
Raiffeisen International	31
Shareholder structure	31
Looking for the the Achilles’s heel: 1) future growth highly dependent on a new funding approach.....	32
2) Ukraine ?	33
.... 3) Goodwill impairment ?	35
Raiffeisen International - Financial Estimates	37
Raiffeisen International - Divisional Estimates	38
Appendix	39
Macro and Banks data.....	39

Investment conclusion

We resume coverage on Erste Bank (EBS) with 'Neutral' and Raiffeisen International (RI) with 'Reduce' recommendations.

Even though conditions are expected to remain challenging in the CEE region, the stabilisation in the global economy and improved financial markets are reducing the pressure on the markets in which the two Austrian banks operate, as well as giving them the opportunity to strengthen their positions against the effects of the global downturn.

Although asset quality is expected to continue to deteriorate, the increase in NPLs has not been as severe as expected so far. We expect NPLs in the CEE region to peak in 2010. So far, NPL problems have reflected liquidity/refinancing pressures, in our view, and consequently have been particularly concentrated in the corporate sector. We expect weakened cash flows to become the main driver of NPLs and therefore for personal sector delinquencies to rise. Among individual markets, we continue to see greatest risks in Russia and the Ukraine followed by Hungary and Romania, whereas we are more confident over the resilience in the Czech Republic. On our central assumptions, both Austrian banks would remain profitable through the downturn; in a more stressed environment, we believe RI would be likely to face greater pressure on profitability and capital, given its higher exposure to CIS countries.

In a recent note on EMEA emerging markets, Nomura analysts commented on the prospects for improved margins in the CEE region, as higher new business spreads feed through into overall margins.

Both quoted Austrian banks received state capital over the past year. We expect this to be refinanced over the medium term through a combination of internal capital generation and private capital raisings.

Erste Bank currently has high ordinary equity leverage. The common equity Tier 1 ratio was 4.9% at the end of H1, with the common equity leverage ratio 2.5%. Raising these figures to 8% and 4% respectively would require an increase of EUR 3-3.8bn, one-third of the current market capitalisation.

RI has strong current equity ratios, including a common equity Tier 1 ratio of 7.8% and a leverage ratio of 6.1%. By international standards, it therefore currently does not appear to need capital strengthening at this stage, unless it experiences asset quality problems. However, we believe it is likely to seek to repay the participation capital it has raised, without lowering the current Tier 1 ratio, effectively strengthening its common equity ratios further.

Using a normalised cost of risk of 80bp, we would estimate normalised net income for Erste of EUR 1.3bn, or EPS of EUR 4.1. We expect this to be achieved in 2012. Diluting this for the achievement of an 8% common equity Tier 1 ratio would result in a deleveraged, normalised EPS of EUR 3.4.

Using a normalised cost of risk of 160bp at RI, we estimate normalised net income of EUR 875m, equivalent to normalised EPS of EUR 5.6. Again, we do not expect this level of EPS to be achieved before 2012.

Both banks would earn normalised RoEs of c18% on a tangible, deleveraged basis on our numbers.

The two banks have relatively similar valuations of 1.3-1.4x TBV and 7-8x normalised earnings. Both stocks are also trading in line with EU banks on tangible book in 2009 and 2010.

However, we would expect the market to discriminate between the two banks by assigning a premium valuation to Erste. At similar valuations, we would prefer Erste Bank given its more sustainable, longer term business model and lower exposure to higher risk CEE markets, despite its currently lower common equity capital ratios.

Erste has significant market shares in its key CEE markets of the Czech Republic, Romania, Hungary and Croatia. It also has much more limited exposure to markets such as Russia and the Ukraine.

By contrast, RI is more widely spread across the CEE region, with more marginal shares in all of its markets and with significant exposure to Russia and the Ukraine.

At the same time, RI has a higher loans/deposits ratio across the CEE region and a higher proportion of its loans in FX lending and will therefore face greater pressure on its business model in the future from reducing these proportions, in our view.

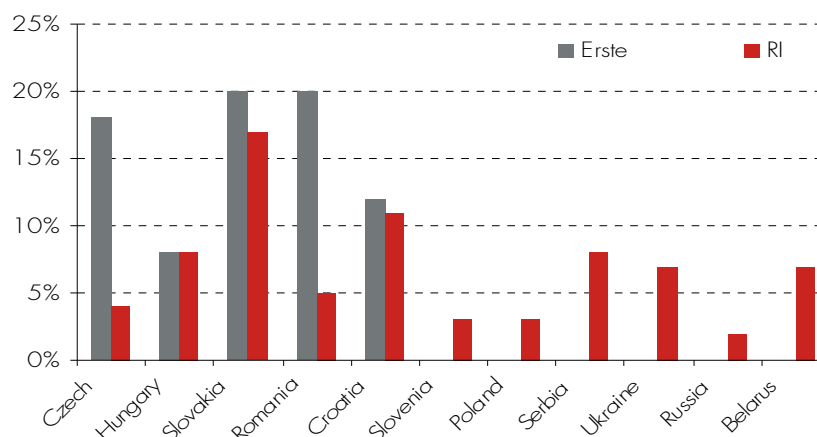
The following table compares the two groups' presences across the CEE region.

Figure 1. Austrian banks' presences in the CEE (H1 2009)

a) Exposure by country

Erste	Tangible book					Raiffeisen	Tangible book				
	(Eur m)	(Eur m)	(%)	(%)	(%)		(Eur m)	(Eur m)	(%)	(%)	(%)
Czech		16,912	37	-	70	Czech	5,751	11	7	130	
Hungary		7,192	16	65	213	Hungary	6,713	13	69	127	
Slovakia		5,579	12	19	67	Slovakia	6,128	11	1	83	
Slovenia (est)		1,500	3			Slovenia	1,178	2			
Poland		-				Poland	4,714	9			
Romania		11,063	24	50	144	Romania	4,259	8	64	132	
Croatia		4,520	10	59	48	Croatia	3,840	7	73	130	
Serbia		340	1		120	Serbia	1,746	3	84	168	
Ukraine		616	1		-	Bosnia	1,548	3			
Russia						Ukraine	4,897		68	219	
						Russia	8,421		47	155	
						Belarus	948				
Total CEE	5,952	46,155		30	115	Total CEE/CIS	4,661	53,512	44	136	

b) Market shares by total assets



Source: Central bank data, Nomura research, Company data

The following tables show the investment multiples of the two Austrian banks compared with potential peer groups, European banks with significant CEE exposure and local CEE banks.

Figure 2. Comps table

Rec.	(Eur) Price	02-Oct	Target	Upside	EPS		P/E	P/E adj.	P/E adj.	P/TB	P/TB	ROE	ROE	DPS	DPS	Market	Perf.	Perf.
					10E	11E	09E	10E	11E	09E	10E	10E	11E	2009E	2010E	Cap/bn	YTD	MTD
Erste Bank	Neutral	27.3	38.0	39%	1.98	3.13	14.7x	13.8x	8.7x	1.4x	1.3x	10.0%	14.1%	0.20	0.40	8.7	79%	0%
Raiffeisen (RIBH)	Reduce	40.1	34.0	(15%)	1.36	3.69	n.m.	29.4x	7.4x	1.3x	1.2x	4.3%	10.8%	0.00	0.20	6.2	108%	19%
European banks							18.6x	14.2x		1.6x		11.2%					49%	1%

Source: Datastream, Nomura estimates

Figure 3: Peer Group multiples

Name	P/E				P/BV		P/TBV	
	2009E	2010E	2011E	2012E	2009E	2010E	2009E	2010E
Erste Bank	14.7	13.8	8.7	6.2	1.0	0.8	1.4	1.3
Raiffeisen	84.9	29.4	10.9	7.1	1.0	1.0	1.3	1.2
Soc Gen	22.9	16.9	9.6		1.0	1.0	1.4	1.3
Alpha Bank	15.2	11.5	8.2		1.6	1.4	1.6	1.5
Eurobank	19.7	11.7	7.8		1.5	1.3	1.8	1.6
NBG	10.2	8.9	6.9		1.8	1.6	2.7	2.3
Piraeus	36.4	21.4	8.2		1.4	1.4	1.6	1.5
UC Group	17.5	15.6	10.3		0.7	0.8	1.4	1.3
Intesa	15.0	14.3	10.9		0.7	0.7	1.5	1.4
Swedbank	nm	nm			0.7	0.9	0.9	1.1
average	19.8	14.2			1.2	1.1	1.6	1.5
CEE								
Pekao	18.3	14.3	10.4		2.2	2.1	2.2	2.1
PKO BP	14.7	14.2	11.2		1.9	1.8	1.9	1.8
Komerčni	11.6	10.8	9.7		2.1	1.9	2.1	1.9
OTP	9.3	8.9	7.1		1.2	1.1	1.4	1.3
CIS								
Sberbank	102.6	19.1	7.2		1.7	1.6	1.7	1.6
VTB	nm	24.6	10.0		1.1	1.1	1.1	1.1

Source: Nomura estimates

Figure 4. Performance charts

a) Relative price performance



b) Price to book



Source: Datastream, Nomura research

Capital adequacy

Capital deficit story is not fully over yet, we believe.

Through government-backed initiatives, Austrian banks received participation capital and hybrids to boost their capitalisation levels. However, in our view, current and prospective ratios remain relatively low, particularly when compared with peers with similar level of risk profile. The ongoing review of the financial market rules by international bodies and rating agencies might put further pressure on raising the capitalisation bar.

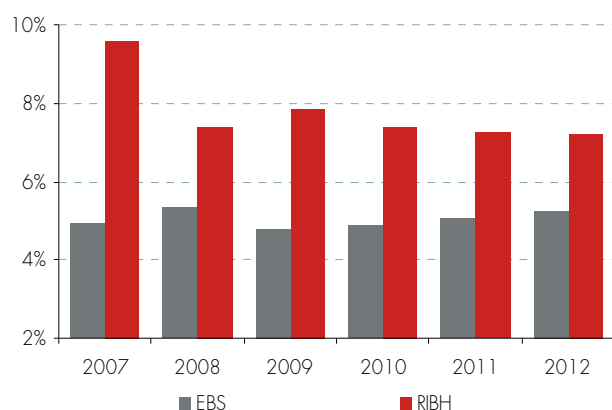
Being often systematically important players in individual CEE markets, we believe that Austrian banks would receive further capital support from authorities if needed. However, equity investors face different risks from holders of fixed-income exposure to these banks. From an equity holder's perspective, the capital enhancements initiatives provide support to the stretched capital ratios. However, the form in which this support was obtained could be perceived temporary and costly for shareholders. We believe that over the medium term, both Austrian banks should consider the re-payment of recently obtained funds through internal capital generation or by issuing new shares.

Our analysis suggests that Raiffeisen may find it more challenging than Erste to repay participation capital over the next five years, not to mention the Tier I hybrids, purely through profit retention. This is unless we are too bearish on our ROE assumption (including limited amount of dividend payout) or RWAs growth turns out to be more sluggish. RI is incurring a higher cost of its participation capital and hybrids, at 10%, against 8% for Erste, hence it results in stronger dilution to its EPS. Therefore, an equity issue could be accretive to EPS on our analysis, although ultimately the decision of whether to carry out such an issue rests with the 70% shareholder, RZB.

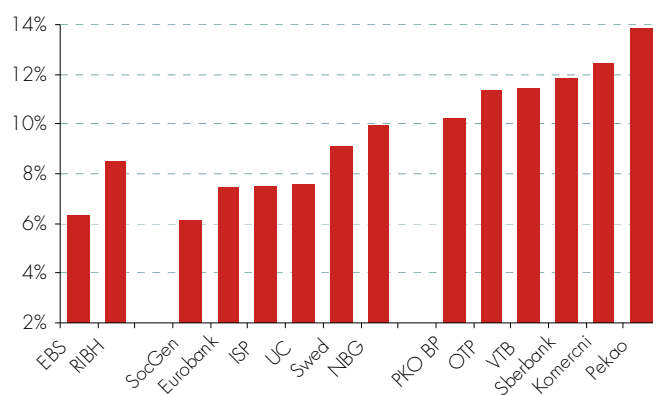
Our analysis implies that, on our base-case forecasts, Erste would also not be able to retain enough profit to re-pay its participation capital in full over the next five years. However, if the bank manages to achieve ROE at 2pp higher rate than our forecast, this becomes feasible. Also, investors should recognize that Erste's capitalisation remains lower than that of RI (partially explained by differences in geographic exposure), and the bank could consider strengthening its core Tier 1, even without re-paying participation capital in full. Nevertheless, our analysis suggests that even after the share price rally this year, a rights issue would still result in EPS dilution.

Figure 5. Capital ratios – Nomura estimates

a) Core Tier I ratio (stated)

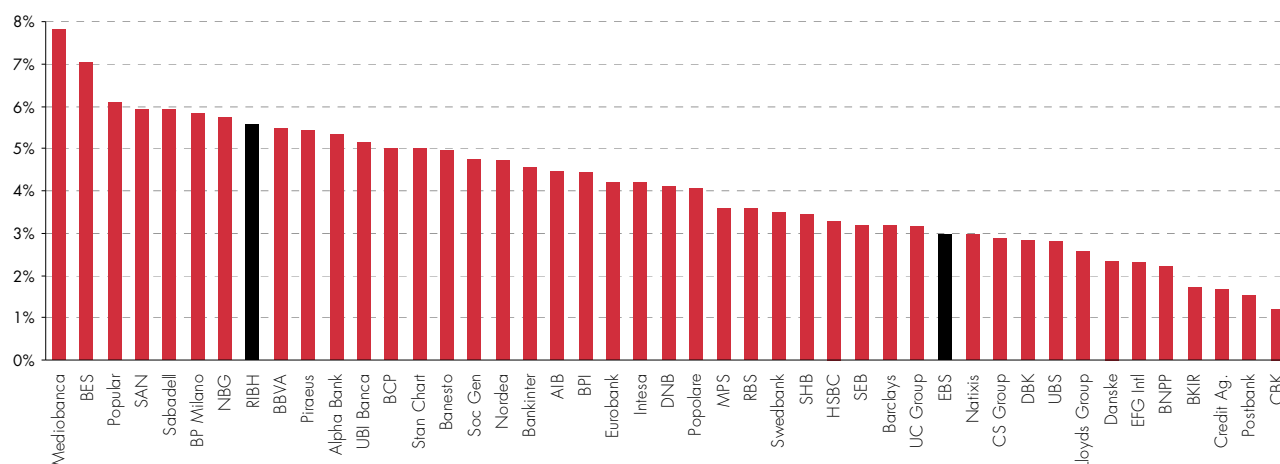


b) Peer group - Tier I ratios



Source: Nomura estimates

Figure 6. Tangible equity/tangible assets (2009E)



Source: Nomura estimates

Is the capital deficit story finally over?

Erste Bank had a common equity Tier 1 ratio of 4.9% and a leverage ratio of 2.5% at the interim stage. It would therefore need to strengthen its equity base by EUR 3.8bn to achieve an 8% common equity Tier 1 ratio and EUR 3bn for a 4% leverage ratio. These figures represent 30-40% of the current market capitalisation.

RI had a common equity Tier 1 ratio of 7.8% and a leverage ratio of 6.1% at the interim stage. It is therefore in a stronger stated capital position than Erste and does not appear to need capital strengthening from a capital perspective, unless it incurs asset quality problems.

In addition to strengthening the overall equity capital ratios of both groups and meeting likely higher capital ratio requirements for banks generally, measures to raise ordinary equity capital would reduce the continuing asset quality risks we analyse in the next section

of this note and could allow repayment of state injected capital. As such, higher capital ratios could enhance the groups' valuations and at least partially offset the apparent dilution involved.

Furthermore, the current trend towards localization of capital is likely to increase the capital requirements of international banks, such as Erste and RI. Regulators are likely to seek local incorporation of foreign banks' businesses and at the very least, separate and clearly identified local capital for activities not locally incorporated. This is likely to increase capital requirements and reduce RoEs for banks with large international operations. The two Austrian banks already have much of their activities in locally incorporated subsidiaries, which we believe will become the norm for the industry. However, even for these two groups capital requirements seem only likely to increase.

Both Austrian banks under our coverage entered the credit crunch with one of the most leveraged balance sheets, particularly when compared with their Emerging European peers. It comes as no surprise to us that they opted to utilize the support package offered by the Austrian authorities.

As part of moves to strengthen the common equity base, both banks are likely to seek to repay the participation capital.

Towards the end of 2008, Austrian government designed a EUR 100bn (36% of GDP) support plan for banks, which included EUR 75bn guarantee scheme for interbank lending and bond issuance and EUR 15bn for capital injections – in the form of participation capital. So far, Austrian banks have already utilized half the available amount. In Figure 7, we highlight the key characteristics of the participation capital. Of particular note is the loss-absorption feature of these instruments, which we think has been perceived as market friendly by investors. Critically, the regulator also cleared the way for the participation capital to be counted as Tier 1 capital.

Figure 7. Austrian participation capital

Instrument	* Non-convertible, * Non-voting securities * Core-Capital Securities * Non-cumulative * Loss absorption up to the full nominal amount in case of common capital reduction	
Completion time / Issue Amount / Issue Price	ERSTE Bank EUR 1,760m. EUR 1,000 million in March 2009 with Austrian Government; EUR 540m with private/institutional investors	Raiffeisen Int'l EUR 600m from parent RZB
Maturity	Perpetual	
Repurchase	ERSTE Bank ERSTE has the right to repay all or some of the securities at any time at 100% of the issue price until December 2019; thereafter 150%	Raiffeisen Int'l Repayment at any time with AGM approval
Conversion option	Non-convertible	
Coupon/Dividend	ERSTE Bank Coupon is 8% p.a. of the Issue Price from Jan 2009 until December 2014 : 8.5% in 2015; : 9% in 2016. 9.75% in 2017- from 2018 and thereafter the dividend increases 1% each year the dividend is capped in any case at Euribor 12M + 10% p.a.	Raiffeisen Int'l Coupon is 10% p.a. of nominal value payable from 2010 for 5 years. Thereafter step-up. The payment ranks senior
Financial impact	EPS dilution for common shareholders Coupon is not tax-deductible.	
Ranking	Pari passu with ordinary shares	

Source: Nomura research

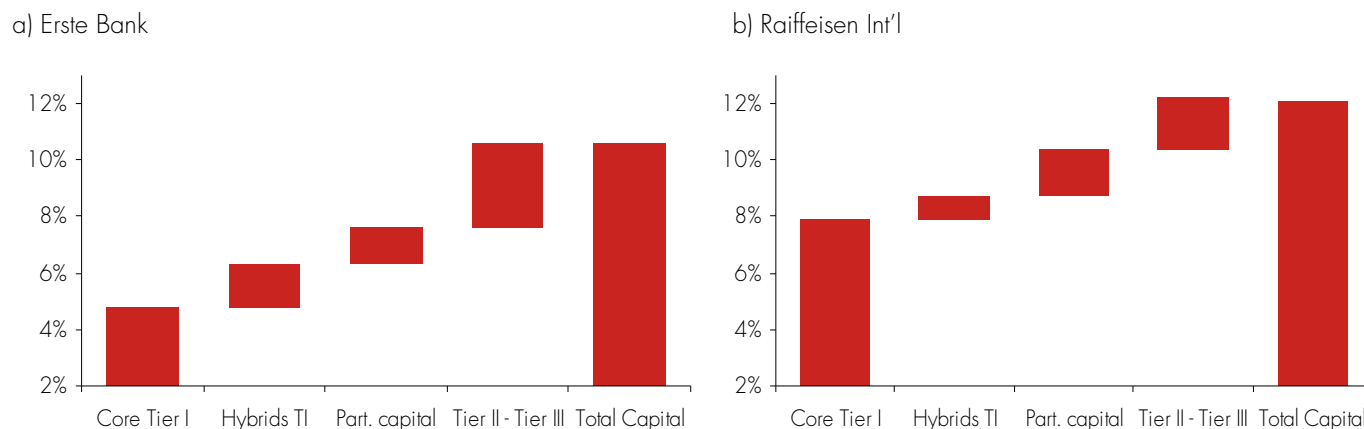
Erste Bank has used close to its entire limit on participation capital. The bank has raised EUR 1.75bn, of which 30% came from private sources. This capital will cost Erste 8% annually for the next five years followed by a fairly steep step-up and will be incurred from retained earnings. In addition, Erste is in the process of topping up its participation capital with hybrid Tier 1 in the amount of EUR 940m from government, the cost of which will impact net interest income of the bank.

RI, which is not operating under banking license, is receiving the participation capital of EUR 600m and hybrid Tier 1 of EUR 650m from its parent RZB instead of the Austrian government. Given that RI has set a limit on participation capital at EUR 1.5bn, we believe that further capital injections by RZB are likely. We note that RZB decided to charge RI a premium of 200bp on top of the cost it is incurring on the EUR 2.5bn participation capital it took from the Austrian government. This leaves RI with a higher cost of new capital, at 10%, than that paid by Erste. In our view, such a policy is unlikely to be perceived as market friendly by the minority investors.

As we show in Figure 8, capital injections have boosted Erste's and RI's Tier 1 ratio to 7.3% and 8.5% respectively. We would note that it still stands lower than for most of the banks that operate in similar geographic area (see Figure 3). In addition, 33% and 18% of Tier 1 capital respectively is in non ordinary equity form.

Given that the participation capital cost steps up significantly after five years, we believe the banks will want to refinance this within that period— most likely with common equity.

Figure 8. Capital after participation capital (2009E)



Source: Nomura estimates

Internal capital generation is more likely to allow Erste to re-pay participation capital

As described earlier, the step-up in interest cost of participation capital makes newly obtained funds only a temporary solution for Erste and Raiffeisen, in our opinion. We believe that, over the next five years, both banks are likely to consider full repayment. The first and most straightforward way to achieve this would be to utilize internal capital generation. Here, we assume that following such re-payment, each bank would still want to maintain Core Tier 1 ratio on at least the level of 1H 09.

Our analysis suggests that both Erste and Raiffeisen may not be profitable enough to be able to repay participation capital organically, not to mention hybrid Tier 1. However, we also believe that Erste is much closer to such aim.

We forecast aggregate profits of EUR 6.1bn for Erste over the next five years, an average return on core equity (ROCE) of 12%. This would be sufficient to rebuild capital ratios and repay state capital. However, there would be limited ability to grow the balance sheet and/or pay dividends. On our forecasts for dividend payments and RWA growth, the bank would have to generate 14% ROCE in order to retain enough profit to be able to repay the participation capital organically. On the other hand, we estimate aggregate profits of EUR 2.7bn at RI, an 8% ROCE. It would need to generate 11% to re-pay its participation capital, and fund RWA growth and dividend payments.

We have included a sensitivity analysis – see Figure 10, to illustrate alternative potential options.

On our estimates, if Erste's RWAs grew by 2pp lower CAGR over the next five years, the bank could repay its participation capital organically. On the other hand, RI would be able to repay the participation capital only by reducing its RWA growth to a five-year CAGR of 4% from 9% we assume in our forecasts.

Figure 9. Repayment ability

a) Erste

(Eur m)	2009	2010	2011	2012	2013	Avg	CAGR %
Profits	591	630	995	1392	1908		
Div payout	(64)	(97)	(149)	(229)	(350)		53%
Div payout ratio	10.76%	20.17%	22.36%	21.70%	18.34%	19%	
Retained earnings	527	533	846	1163	1558		
RWA	134,133	146,959	161,012	176,409	193,278		10%
Core Capital	8,413	8,838	9,530	10,539	12,700		
Core Tier I	6.27%	6.16%	6.13%	6.11%	6.57%		
Implied capital need to fund the growth		1,026	1,124	1,232	1,350		
Net surplus from capital generation		-493	-278	-68	208		
ROCE %	7%	7%	10%	13%	15%	11%	
Minimum level of CT I to repay the participation capital and to maintain 2009 capital level					7.18%		
Minimum avg. ROCE % to repay the participation capital					13%		

b) Raiffeisen

(Eur m)	2009	2010	2011	2012	2013	Avg	CAGR %
Profits	73	211	572	870	961		
Div payout	0	-32	-114	-174	-189		
Div payout ratio	0.0%	15.0%	20.0%	20.0%	19.7%	15%	
Retained earnings	73	180	458	696	772		
RoRWA	0.11%	0.29%	0.71%	0.97%	1.00%	0.62%	
RWA	67,648	73,211	80,240	89,315	96,460		9%
Core Capital	5,875	6,086	6,625	7,379	7,948		
Core Tier I	8.69%	8.31%	8.26%	8.26%	8.24%		
Implied capital need to fund the growth		445	562	726	572		
Net surplus from capital generation		-265	-104	-30	200		
ROCE %	1%	3%	9%	12%	12%	8%	
Minimum level of CT I to repay the participation capital and to maintain 2009 capital level					9.31%		
Minimum avg. ROCE % to repay the participation capital					11%		

Source: Nomura estimates

Our previous analysis suggests that both Austrian banks might not be able to repay the participation capital and/or hybrids organically. Therefore, we think it is reasonable for investors to assume the possibility of an ordinary share issue at some point in the coming years.

Because RI is incurring a higher cost of its participation capital, it comes as no surprise that the threshold at which re-placing this capital with ordinary share issue is lower than for Erste. On our estimates, even at the current stock price level, RI could see accretion to its 2010 EPS if it issued new ordinary shares for the purpose of re-paying its participation capital, partly because, in the short term profitability is below a normalized level. Such a share issue would still be dilutive if we considered our forecasts further out. In Erste's case, a capital increase would be dilutive even initially, in our view.

Figure 10. EPS sensitivity analysis* – Rights issue dilution/accretion vs Capital enhancements

ERSTE	2010	Price (Eur)					RIBH	2010	Price (Eur)				
		25	30	35	40	45			30	35	40	50	55
New capital (Eur m)	1225	-8,7%	-6,2%	-4,3%	-2,8%	-1,6%	New capital (Eur m)	400	1,8%	3,3%	4,4%	6,0%	6,6%
	1750	-10,7%	-7,3%	-4,8%	-2,8%	-1,2%		600	3,2%	5,3%	7,0%	9,3%	10,2%
	2000	-11,5%	-7,8%	-5,0%	-2,8%	-1,0%		1000	5,7%	9,0%	11,6%	15,5%	17,0%
	2500	-13,1%	-8,8%	-5,5%	-2,8%	-0,6%		1250	7,0%	11,0%	14,2%	19,0%	20,9%
	2700	-13,7%	-9,2%	-5,6%	-2,8%	-0,5%		1500	8,2%	12,9%	16,6%	22,3%	24,5%

Source: Nomura estimates *Assuming full repayment of capital enhancement and 20% price discount

Lastly, we should also consider that a potential rights issue would have consequences on tangible book multiples. We believe the market is willing to discount a rights issue for banks showing weak levels of core capital ratios. The following table shows the impact of rights issues at a 20% discount to market, equal to the amount of participation capital and hybrids received by the banks. As both banks currently trade about TBV, rights issues would be moderately TBV enhancing.

Figure 11. P/B dilution in case of rights issue

	ERSTE	RIBH
2009 Tangible Book (per share, Eur)	19.03	31.45
2010 Tangible Book (per share, Eur)	20.81	32.58
2010 Tangible Book - Diluted (per share, Eur)	21.43	32.95
2010 Tangible book dilution/accretion %	3%	1%
2010E P/B not diluted	1.31x	1.23x
2010E P/B Fully diluted	1.28x	1.22x

Source: Nomura estimates

Asset quality

Asset quality to worsen but banks are solid enough to stand firm

Based on our NPL and provisioning forecasts, we run a stress test scenario on bank balance sheets to conclude that the operating profitability, over the cycle for Austrian banks, will be solid enough to offset the increasing levels of loan loss provisions. However, under a more extreme scenario than our current forecasts, the net profits and, in turn, the capital of RI, might be under pressure, given its greater exposure to the higher risk markets in the CEE and CIS. On the contrary, we feel comfortable with the Erste's asset quality which, although likely to deteriorate further, will likely be offset by a solid stream of operating profits and as the bank is more heavily exposed to countries likely to be relatively less affected by the downturn.

In our analysis, we also try to assess whether the macro situation remains a key risk for the region where both Erste and RI operate. Although a pick-up in FX volatility could still affect banks, we believe that the normalizing macroeconomic picture will overall ease the pressure on asset quality from 2011 onwards. We also focus on the NPL inflow which, in our view, remains a key indicator for banks' asset quality trends. For both Austrian banks, the NPL inflows remain sustained, in particular for Erste, and we expect this to remain so until the end of 2010.

While the macro picture is improving...

Although there are macro signals that the turning point of the economic depression is close, we believe it is still premature to call the bottom of the credit cycle at the end of 2009. Moreover, there is usually a lag between real economy performance and asset quality development. We expect six-to-eight months of continued asset quality deterioration after a positive change in economic trends. Based on this assumption, we have modeled our estimates assuming high level of NPLs and provisioning till 2010 and a gradual recovery in 2011.

The economic and credit crisis has rapidly developed in Eastern Europe, even though with some lag and with different forms country by country. However, macro estimates seem to discount the peak of the crisis in 2009 for the region. Our economists (see *2011: so near yet so far*, 31 July, Nomura global economics) believe that CEE4 countries will deliver GDP growth of 2% and 3% in 2010E and 2011E respectively; the EEMEA region should do slightly better, 2.3% and 3.4% in the next two years.

Figure 12. GDP and Unemployment: Austria and CEE

	%	2007	2008	2009	2010	2011	2012
Austria	GDP growth	3.5	2.0	-4.0	-0.3	1.6	2.0
	Unemployment	4.4	3.9	5.3	6.4		
Czech R.	GDP growth	6.0	2.8	-3.4	0.8	2.5	3.5
	Unemployment	6.6	5.4	9.5	10.0	9.0	
Slovak R.	GDP growth	10.4	6.4	-4.7	1.9	5.2	4.4
	Unemployment	11.0	9.6	12.4	12.5	12.1	11.7
Slovenia	GDP growth	6.8	3.5	-2.7	1.4	3.7	3.7
	Unemployment	4.9	4.5	6.2	6.1		
Hungary	GDP growth	1.1	0.5	-6.7	-0.9	3.2	3.8
Poland		6.7	4.8	-0.7	1.5	4.0	4.4
Romania		6.2	7.1	-6.0	2.8	5.0	7.2
Bulgaria		6.2	6.0	-6.5	-2.5	2.0	4.0
Croatia	GDP growth	5.5	2.4	-3.5	0.3	2.5	4.0
Ukraine		7.9	2.1	-14.0	2.7	4.4	5.1
Russia		8.1	5.6	-6.5	1.5	3.4	4.5

Source: IMF, Nomura research

..and the FX volatility is fading

Significant currency movements threaten the asset quality of foreign currency loans, as it affects the ability of the borrower to service the debt, in addition to reducing the euro value of the banks' investments in CEE subsidiaries.

Until now, the negative effects of the FX volatility have been mitigated by the decreasing interest rates environment and by the stricter lending criteria applied to borrowers in foreign currency in the past. However, given the geographical exposures to riskier countries, we believe RI is more exposed to FX risk than Erste. Being exposed to SEE and CIS, we believe RI is exposed to Hungary, Romania and Ukraine where FX loans are over 60% of the total loan book.

As far as we understand, neither of the two banks under coverage has in place significant hedges on capital invested in foreign subsidiaries. Erste mainly hedges dividends from foreign subsidiaries, while RI, which closed ineffective hedging positions on capital invested in Ukraine and Belarus in 2008, is affected by the currency volatility burden in Ukraine. Although FX volatility has substantially decreased in Q3, we still expect some movement in comprehensive income, mainly due to exchange differences and, in turn, total equity.

Figure 13a. FX loans exposure by country

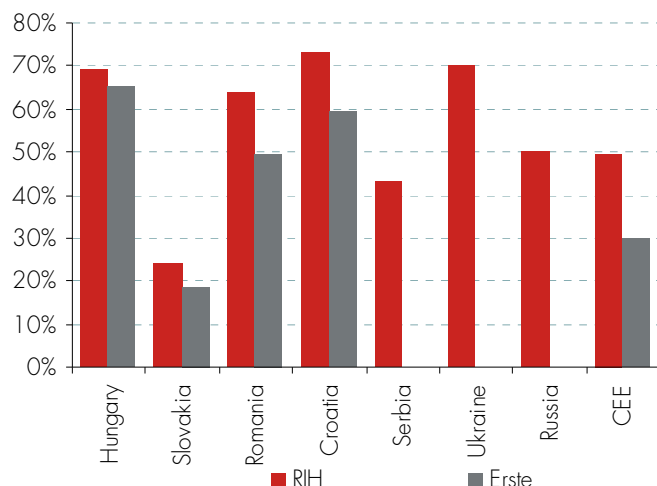
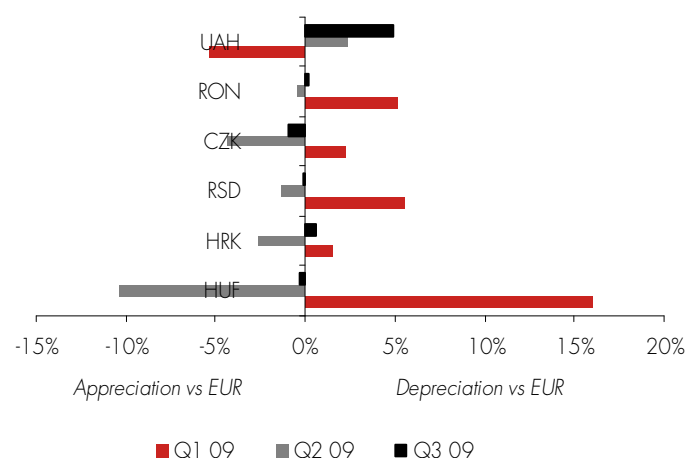


Figure 13b. Currency volatility vs EUR Q1, Q2 and Q3



Source: Company data, Nomura research, Datastream

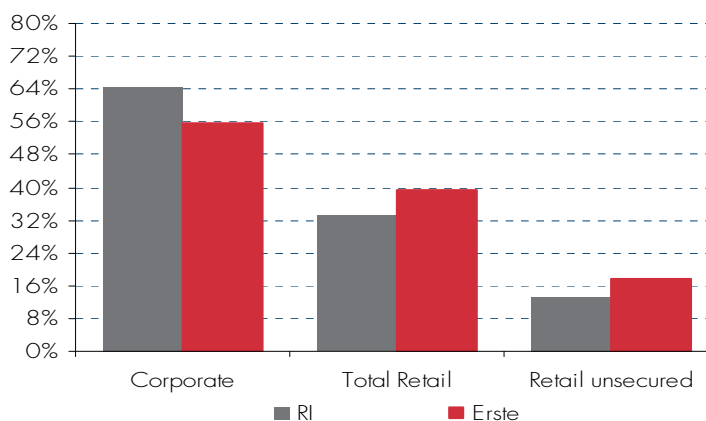
...it is too early to call asset quality deterioration off

While the asset quality of the EMEA banks (see report *EEMEA Banks: As rate cuts end, our views reshuffle* 1 October) started to deteriorate in 2H 2008, so far the cycle has been much milder than most investors anticipated at the beginning of 2009. Lower-than-expected loan loss charges in 1Q and 2Q results season have been among the key triggers of the current stock price rally, we believe. It is also probable, we think, that for many banks in 2Q 09 investors saw a peak in loan loss charges. However, we do not expect the cost of the credit risk to move back to pre-credit crunch levels anytime soon. The NPL ratio for the region may be rising at a slower pace, but we would not expect it to peak before mid-2010.

In our view, unemployment rates will be a key macro driver for estimating the asset quality deterioration in CEE. In more detail, we have seen the liquidity shortage affect mainly corporates which have found it difficult to finance their ordinary business. With credit markets recovering, the sluggish economic environment and a higher cost of funding will likely continue to put pressure on corporates. However, we would expect these factors to have a milder impact on NPL evolution for corporates, which in our view should peak before the retail NPLs. We expect increasing unemployment to put pressure on retail NPLs and this should be protracted over time. Moreover, within the retail book, we expect unsecured retail lending to suffer the most and more than mortgages, which still benefit of a benign interest rate environment.

A bullish argument for RI might be that given its predominantly corporate exposure, its NPLs should reach the peak before Erste. However, we think this is only partially true. In our calculations, the retail unsecured lending is only slightly higher for Erste than RI (see chart below). Nevertheless, we note that >50% of Erste's retail unsecured book is generated in Austria which we believe carries less risk than CEE's portfolio. To reinforce this view, we also highlight that a significant portion of unsecured lending in Austria is overdraft whereas for CEE countries credit cards play a bigger role.

Figure 14. Loan book breakdown 2008



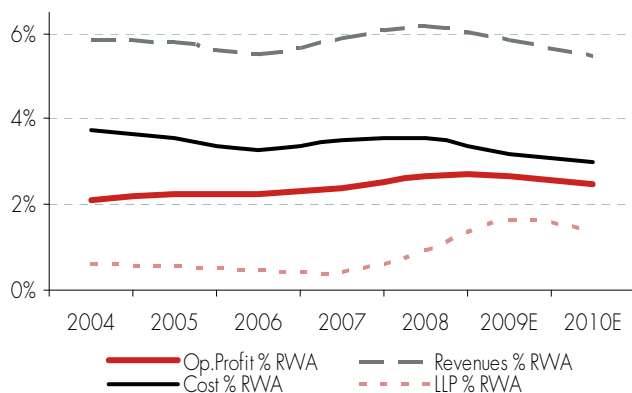
Source: Company data, Nomura research

Operating profits vs loan loss provisions

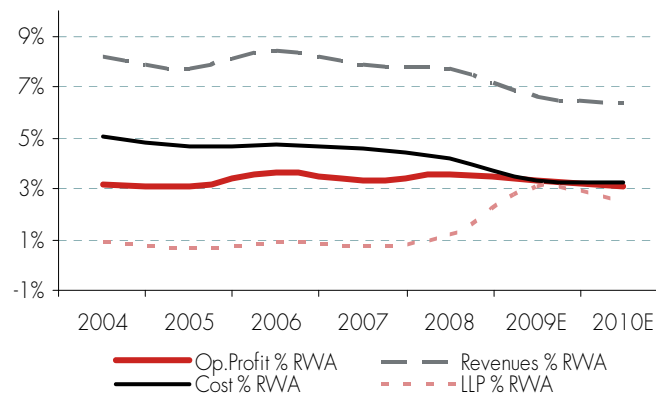
As we expect the negative credit cycle to persist for the rest of H209 and in 2010, we continue to forecast a significantly negative impact on net profit of high loan loss provisions. However, in relative terms, we expect Erste's core revenues to offset better than RI the negative pressure on credit charges. We also believe the geographic exposure towards Central Europe put Erste in a better position in terms of provisioning and core earnings generation.

Figure 15. Profitability breakdown

a) Erste Bank



b) Raiffeisen Int'l



Source: Nomura estimates, Company data

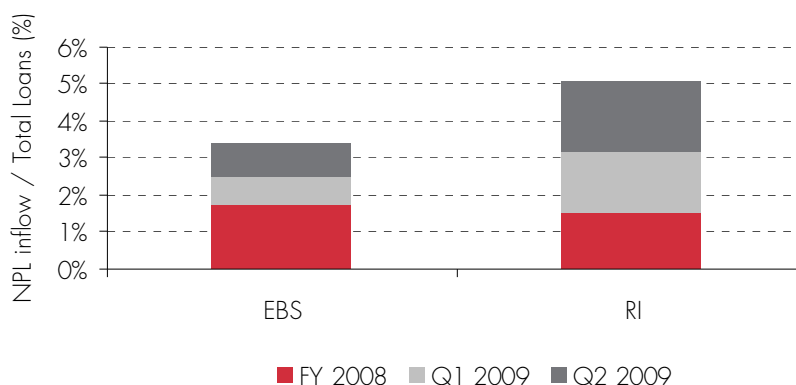
Datastream; Note: Right side Depreciation vs EUR,

Key driver: Inflow of non-performing loans

We regard the key measure of asset quality as the inflow of NPLs gross of write-offs. We expect this to peak in 2010 for the two Austrian banks.

The following chart sets out our assumptions for NPL formation at the two banks, relative to total loans.

Figure 16. NPL formation

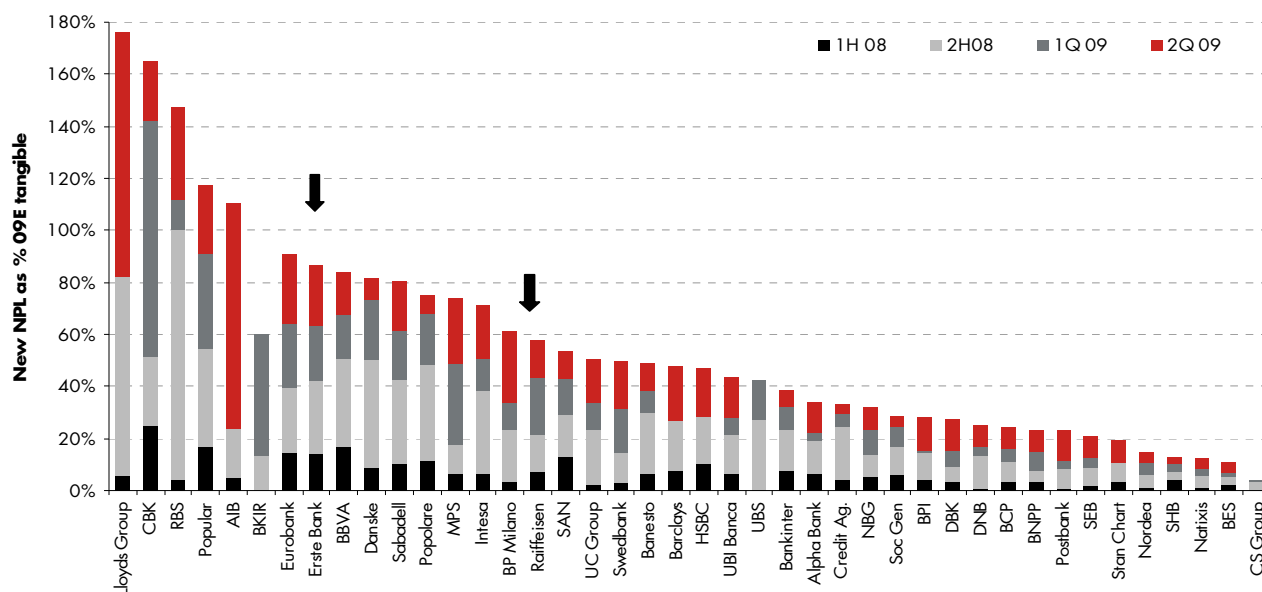


Source: Company data, Nomura research

On our estimates, the decline in NPLs inflow will start in 2011E as the economy is expected to recover. However, after two years of loan book restructuring and write-offs, both Erste and RI should build-up their coverage ratios and we would expect loan loss charges not to fall sharply in the coming years.

Within the pan-European sector, Erste currently shows a relatively high level of NPLs inflow as percentage of tangible book, and higher than Raiffeisen. However, this result must be read in conjunction with the relatively lower tangible equity base of Erste compared with Raiffeisen and the fact that Erste fully consolidates several Austrian savings banks even though it only holds minor equity stakes.

Figure 17. NPL formation – European banks



Source: Company data, Nomura research

Our estimates on asset quality

In the figures below, we show our forecasts for NPL ratios, coverage and cost of risk. The main drivers for our projections are:

- 1) Further asset quality deterioration mainly in CEE and CIS
- 2) We expect the corporate loan book to be hit first, while the impact of the negative credit cycle on the retail loan book should be protracted over time. For this reason, Raiffeisen's NPL curve might peak and flatten earlier than Erste given its predominantly corporate exposure.
- 3) The cost of risk should remain sustained over the cycle to enable coverage ratios to reach comfortable levels
- 4) At this stage, we do not include in our NPL assumptions benefits stemming from the loan book restructuring. For instance, Raiffeisen restructured 4% of its retail book and 12% of corporate loans as at the end of June. This business practice might artificially lower the NPL ratio in the short term.

At the H1 stage, Erste had NPLs of EUR 8.2bn (6.3% of loans) and a coverage ratio of 53%. Unprovided NPLs therefore represented 64% of TBV. We estimate a peak NPL figure of EUR 10.3bn in 2010, 9.5% of loans. The group is generating pre provisions profits equivalent to 2.3% of loans, allowing it to charge this level of impairments, before incurring losses.

RI had EUR 3.6bn of NPLs (6.8% of the book) at the first half stage, with a coverage of 69%. Unprovided NPLs were 28% of TBV. We expect NPLs to peak at EUR 5.8bn (10.1% of loans) in 2010, implying EUR 2bn of inflows over the next 18 months. The group is generating pre provision profits equivalent to 4.2% of the loan book.

Figure 18. Asset quality estimates

a) Raiffeisen Int'l

NPL ratio by region	Q4 2008	Q1 2009	Q2 2009	FY 2009E	FY 2010E	FY 2011E	FY 2012E
Central Europe	3,1%	4,1%	5,5%	7,0%	9,0%	8,4%	7,5%
Southeastern Europe	2,3%	4,2%	5,3%	6,5%	7,4%	7,0%	6,5%
CIS	6,1%	10,6%	15,7%	21,0%	20,0%	16,0%	14,0%
Russia	1,9%	3,3%	7,3%	8,0%	12,0%	10,5%	9,0%
Group	3,1%	4,8%	6,8%	8,6%	10,1%	9,1%	8,1%
Coverage %	Q4 2008	Q1 2009	Q2 2009	FY 2009E	FY 2010E	FY 2011E	FY 2012E
Central Europe	71%	63%	57%	54%	56%	63%	72%
Southeastern Europe	93%	69%	67%	65%	65%	69%	75%
CIS	82%	71%	62%	60%	75%	100%	115%
Russia	209%	148%	108%	100%	100%	120%	130%
Group Total	92%	76%	69%	64%	69%	81%	90%
Cost of Risk (bp, ann.)	Q4 2008	Q1 2009	Q2 2009	FY 2009	FY 2010E	FY 2011E	FY 2012E
Central Europe	201	169	203	200	190	120	100
Southeastern Europe	166	273	289	310	230	190	150
CIS	715	724	925	890	600	450	350
Russia	362	494	713	650	620	380	270
Group Total	279	313	384	379	309	213	166

b) Erste bank

NPL ratio by region	Q4 2008	Q1 2009	Q2 2009	FY 2009E	FY 2010E	FY 2011E	FY 2012E
Austria	6,4%	6,8%	7,0%	7,50%	8,50%	8,00%	7,50%
CEE	4,0%	4,8%	5,9%	8,56%	10,46%	9,22%	7,80%
C&IB	3,1%	3,4%	4,3%	5,50%	7,00%	6,50%	6,00%
Group	5,3%	5,7%	6,3%	7,94%	9,48%	8,73%	7,92%
Coverage %	Q4 2008	Q1 2009	Q2 2009	FY 2009E	FY 2010E	FY 2011E	FY 2012E
Austria	53%	51%	50%	50%	48%	52%	55%
CEE	81%	72%	63%	56%	55%	66%	73%
C&IB	58%	61%	60%	55%	55%	65%	70%
Group	60%	56%	53%	51%	51%	58%	63%
Cost of Risk	Q4 2008	Q1 2009	Q2 2009	FY 2009	FY 2010E	FY 2011E	FY 2012E
Austria	65	63	92	84	78	62	57
CEE	105	163	256	241	199	144	109
C&IB	83	141	115	140	135	100	65
Group	89	122	167	160	142	107	85

Source: Company data, Nomura estimates

How bad it could go? Stress test scenarios

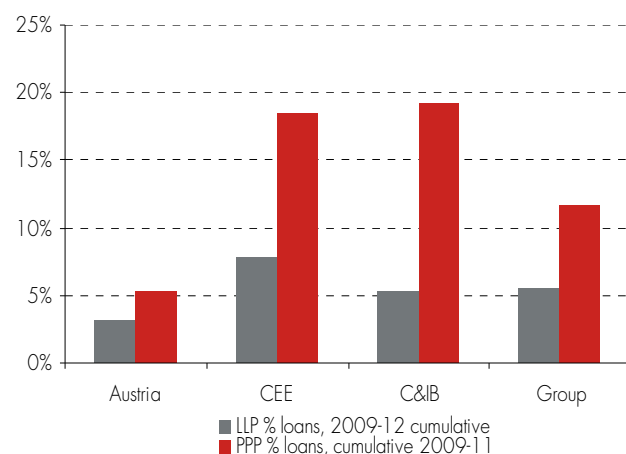
Given the still challenged outlook in Eastern Europe, we aim to assess the potential downside risks for our estimates and what levels of buffer the Austrian banks have to shelter their balance sheets in a worst-case scenario.

In our analysis, we find the aggregated income buffer (pre-provision profits) for the next four years to exceed the expected loan loss charges, for both banks. It is evident from the figure below that the profitability power is much stronger in the case of Erste, which in our view can easily offset the expected asset quality deterioration. In fact, for Erste we estimate additional cumulative loan loss charges of 5.5% (on total loans) in the next four years against a cumulative pre-provision profits buffer of 12%. For this reason, we remain comfortable on the asset quality evolution through the cycle for Erste.

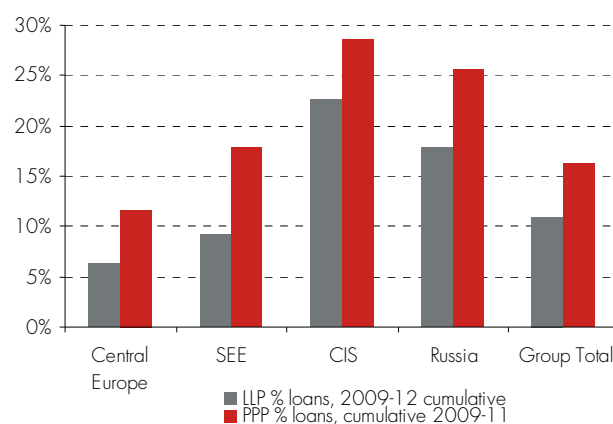
In the case of RI, we expect the cumulative operating profits to exceed loan loss charges of the next four years by a lower amount compared with Erste. In particular, in CIS and Russia - where according to Moody's, we should still expect 10% and 15% of additional NPLs from the current levels - the operating income generated might just be enough to break-even.

Figure 19. Cumulative loan loss charges 2009-12E and Profitability absorption

a) Erste bank



b) Raiffeisen Intl.



Source: Nomura estimates

As the outlook for the next four years remains uncertain, it would be appropriate to run a stress test scenario to verify the balance sheet strengths under more extreme asset quality assumptions.

In the tables below, we show for both banks what would be the profit absorption capability, at different levels of NPL ratios and by geography. We believe RI is able to absorb up to 20% of NPLs through the cycle across all the divisions. At a stress level of 30% NPL ratio, most of the divisions are generating losses for a theoretical amount of 69% on tangible equity. In our stress test, we applied a similar level of NPL ratio for all the divisions, although there is likely to be a wide divergence between regions. While a 30% NPL ratio could still be a realistic forecast in Russia and Ukraine, figures are unlikely to be as high in Central Europe. In conclusion, even though in a worst-case scenario RI's capital adequacy might be under pressure, we still expect the bank to weather the current economic turmoil. As shown in the table, under our scenario RI's operating profits are expected to exceed by 1.4x the cumulative loan loss charges at group level, 1.1x in CIS and 1.4x in Russia.

Figure 20. Operating profits vs Loan loss charges. Raiffeisen International

Operating Profits vs Loan loss charges	Additional NPLs					Nomura's scenario
	5%	10%	15%	20%	30%	
Central Europe	3.8x	1.9x	1.3x	1.0x	.6x	1.8x
Southeastern Europe	5.2x	2.6x	1.7x	1.3x	.9x	1.9x
CIS	6.6x	3.3x	2.2x	1.6x	1.1x	1.3x
Russia	4.5x	2.3x	1.5x	1.1x	.8x	1.4x
Group Total	4.2x	2.1x	1.4x	1.1x	.7x	1.5x

Source: Nomura estimates

The results of our stress test on Erste's loan book reinforce our view on the balance sheet strength of the bank. In CEE, Erste is able to absorb the asset quality deterioration up to a very extreme assumption of 30% NPL ratio. In our estimates, we expect the operating profits to be over 2x the cumulative loan loss charges in the riskiest divisions, CIB and CEE. In conclusion, we believe Erste is well positioned to withstand the asset quality deterioration by leveraging its relatively solid profitability power and leading position in Austria and Central Europe.

Figure 21. Operating profits vs Loan loss charges. ERSTE Bank

Operating Profits vs Loan loss charges	Additional NPLs					Nomura's scenario
	5%	10%	15%	20%	30%	
Austria	2.1x	1.0x	.7x	.5x	.3x	1.7x
CEE	6.0x	3.0x	2.0x	1.5x	1.0x	2.4x
C&IB	6.9x	3.5x	2.3x	1.7x	1.2x	4.0x
Group	4.4x	2.2x	1.5x	1.1x	.7x	2.2x

Source: Nomura estimates

Valuation

We value the two banks using a two-stage residual income model. The total value of a bank is calculated as the sum of its equity and present value of its residual incomes, i.e. returns it generates over its cost of equity. In the first stage, we calculate residual incomes based on our detailed four-year earnings forecasts for the bank. In the second stage, we calculate the terminal value by assuming a constant growth rate of 5% in the residual income beyond the fourth year. Finally, we come up with a 12-month target price by multiplying the per-share fair value by the cost of equity. For RI, we assume a cost of equity of 13%, based on risk-free rate of 7.4%, equity risk premium of 5.5% and beta of 1.1. For Erste we assume a cost of equity of 11%, based on risk-free rate of 4.9% and beta of 1.1. We calculated the risk-free rate using the weighted average of the government benchmark yields by country of exposure. We exclude participation capital from the equity base and its cost from the adjusted earnings we use for valuation.

We notice both stocks are trading in line with EU banks on tangible book in 2009 and 2010. However, we would expect the market to discriminate between the two banks by assigning a premium valuation to Erste. We believe the market is not taking into account the higher ROE that Erste should be able to generate vs RI in the next three years for shareholders. Moreover, we estimate a fair value of EUR 38 for Erste which implies potential upside of 39% from the current market price.

On the contrary, we do not see any upside from current RI's valuation as we assign a fair value of EUR 34. We believe the return for investors in the next three years will not exceed the required cost of equity. Consequently, to justify the current valuation, we would need to discount normalised earnings in our fair value which is too premature to assume at this stage of the cycle.

Figure 22. Valuation

a) Erste Bank

	2009E	2010E	2011E	2012E	Terminal
Net profit	589	629	992	1388	1457
ROE	7,29%	7,5%	11,1%	14,2%	13,3%
Dividend paid	-206	-64	-127	-223	
Dividend Payout	35%	10%	13%	16%	62%
BoP Equity	8.079	8.362	8.927	9.792	10.957
CoE	10,9%	10,9%	10,9%	10,9%	10,9%
Equity cost	-884	-915	-977	-1072	-1199
Excess Equity Return	-295	-287	15	316	258
Discount factor	0,98	0,88	0,79	0,71	
Present Value	-288	-252	12	225	3.094
Equity invested	8.079				
PV of excess	2.792				
Value of equity	10.871			Potential	
Number of shares (mn)	318	Target Price		Upside	
Value per share	34,2	38,0		39%	
Multiples implied by valuation					
	2009E	2010E	2011E	2012E	
P/E	18,5	17,3	11,0	7,8	
P/BV	1,35	1,30	1,22	1,11	

Source: Nomura estimates

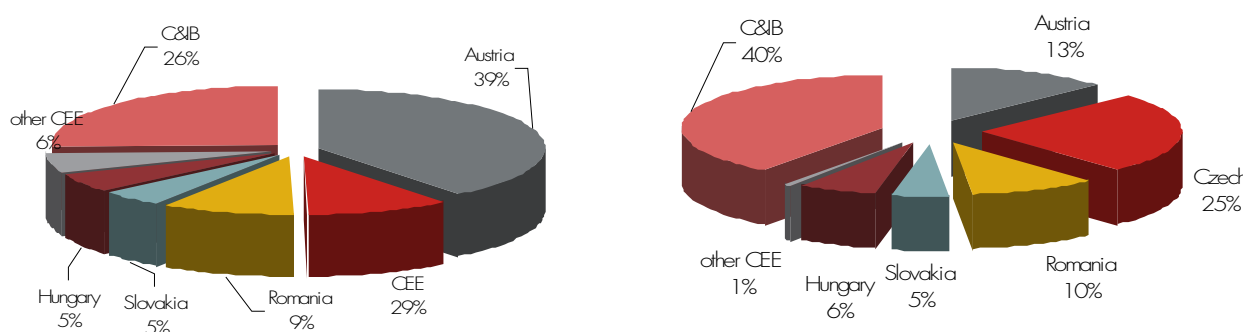
b) Raiffeisen Int'l

	2009E	2010E	2011E	2012E	Terminal
Net profit	73	211	571	868	914
ROE	1,30%	3,9%	10,2%	14,2%	13,4%
Dividend paid	0	-32	-114	-174	
Dividend Payout	0	15%	20%	20%	60%
BoP Equity	5.595	5.394	5.585	6.124	6.818
CoE	13,2%	13,2%	13,2%	13,2%	13,2%
Equity cost	-652	-711	-736	-807	-898
Excess Equity Return	-579	-500	-165	61	16
Discount factor	0,97	0,86	0,76	0,67	
Present Value	-562	-429	-125	41	139
Equity invested*	5.595				
PV of excess	-936				
Value of equity	4.659			Potential	
Number of shares (mn)	155	Target Price		Upside/downside	
Value per share	30,1	34,0		-15%	
Multiples implied by valuation					
	2009E	2010E	2011E	2012E	
P/E	64,1	22,1	8,2	5,4	
P/BV	0,83	0,86	0,83	0,76	

ERSTE Bank

Unlike RI, Erste bank generates part of its net profits in Austria. We expect 13% of the bank's total net profit stemming from Austrian activities in retail and SME. It is important to highlight that Erste Bank consolidates several Austrian savings banks in which it holds a minority stake because the savings banks operate under a cross-guarantee system, meaning that the participating savings banks mutually guarantee each others' customer deposits up to 100%. Given the full consolidation of the savings banks, the net profit generated by the division is negligible – as most of the profit before tax goes to minorities – and in our view it barely justifies the capital absorption and the risk implied by the cross-guarantee scheme. As a result, the loan and RWA exposure in Austria and the relative profitability diverge significantly.

Figure 23. Erste Bank, geographical exposure by RWA and Net profit 2010E



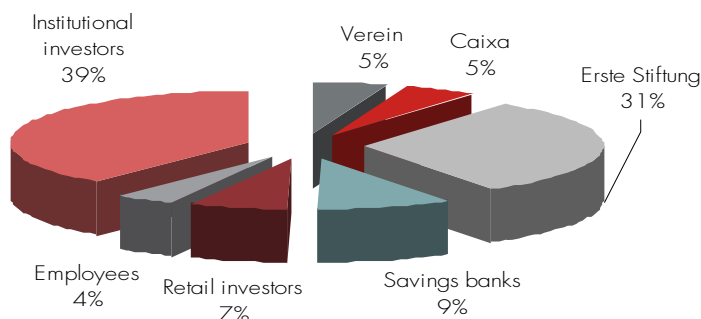
Source: Nomura estimates

In addition to a presence in Austria, Erste Bank's business differentiates itself from RI for the expansion strategy in Eastern Europe. Erste Bank enjoys a more concentrated presence in Central Europe where it is a leading player with dominant market shares in three of the seven countries in which it is present, namely the Czech Republic, Slovakia and Romania. Erste usually aims for 100% ownership of its CEE subsidiaries.

Shareholder structure

Some 30% of Erste Bank is owned by a foundation – Die Oesterreichische Spar-Casse Privatstiftung. The CEO, Mr Treichl, is chairman of the managing board of the foundation. The foundation has been diluted in recent years (it held 34% at the end of 2003) and will be eventually diluted further with the SIFs exchange of BCR shares into Erste shares. The SIFs are Romania's state funds which were put in place after the fall of communism and which hold still around 30% of BCR. Under the EUR 3.75bn acquisition deal to buy BCR, Erste had three years to list the Romanian bank to give minority shareholders an exit option. However, due to current economic circumstances and equity shares fall, the parties are willing to postpone the listing. The foundation has also stated that it does want to keep at least 25% ownership of the group. Austria Verein, which holds 4.9% of the group, is also a foundation which belongs to Uniqa, a listed Austrian insurance company.

Figure 24. ERSTE Bank – shareholders' structure



Source: Company data, Nomura research

Criteria, the investment vehicle of Barcelona's based mutual bank La Caixa, has announced the increase of its stake in Erste over 5% and the intention to grow further in accordance with Erste's foundation. Criteria is willing to raise the stake to 10% in the medium term and eventually 20%, subject to Erste foundation's approval. This might represent a safety net in case of unexpected share price drop. We believe Criteria's investment is a likely move given this it tends to own >20% in its financial investments and one of its current goals is to increase the exposure of its investment portfolio in favour of financial institutions. However, we could argue that a stronger position of Criteria within the shareholders' base would imply a more active role in the governance of Erste as it aims to extract synergies in the long term from its strategic holdings. In conclusion, we would see the build up of Criteria's stake in Erste as a positive catalyst for the stock.

Looking for the Achilles heel: 1) Romania?

Erste Bank enjoys a leading position in the Romanian banking market with ca. 20% market share. Given the bleak economic scenario in the country, we expect the NPL ratio to reach 12% in 2009 with a falling coverage from >100% in 2008 to 56% this year. The cost of risk is also forecast at high 350bp in 2009 vs 116bp in 2008. Despite the negative impact on asset quality stemming from the economic downturn, the strength of the BCR franchise in the domestic market should allow it to weather the current recession. We expect the profitability to remain low in the next two years on increasing loan loss charges but the operating income should remain solid. The H1 09 numbers recently disclosed reinforced our view with NII and total operating income relatively stable.

Hit but profitable during the downturn

Figure 25. Erste Bank – Romania division

Romania	2008A	2009E	2010E	2011E	2012E
Eur m					
Net Interest Income	742	771	786	846	926
Net fee and commission income	236	161	165	175	189
Net trading result	27	10	12	14	16
Operating income	1.005	941	964	1.035	1.131
Operating expenses	-458	-412	-416	-441	-472
Operating result	548	530	548	594	660
Risk provisions for loans	-121	-397	-364	-265	-220
Pre-tax profit	440	193	224	369	479
Taxes on income	-73	-31	-36	-63	-81
Minority interests	-120	-55	-64	-104	-135
Net profit after minorities	240	107	124	202	262
Balance sheet					
Gross loans to customers	11.009	11.669	12.603	13.863	15.527
Customer deposits	7.303	7.669	8.282	8.945	9.839
Average attributed equity	474	597	645	709	794
Average risk-weighted assets	10.051	10.502	11.343	12.477	13.974
Key ratios					
NIM (RWA- average)	7,98%	7,50%	7,20%	7,10%	7,00%
Cost of risk (bp)	116	350	300	200	150
NPLs ratio	5%	12%	14%	13%	11%

Source: Nomura estimates, company data

Nomura economics

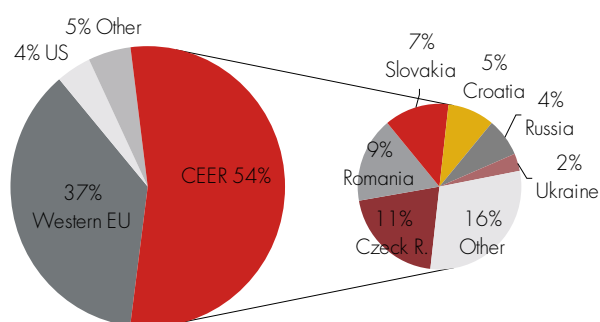
The hard landing of the economy is evident by the magnitude of the GDP contraction in 2009. Nomura's emerging market economists expect the GDP to decline to -6% in 2009 and recover in 2010, +2.8%. We here include an abstract of the Nomura Global economics view on Romania *Common shocks, different outcomes* published in July 2009.

"Until recently, Romania was one of the fastest-growing economies in Emerging Europe, with average annual GDP growth of about 6.5% during 2003-08. However, cheap credit and strong capital inflows in conjunction with EU membership fuelled domestic demand and led to overheating. The growth of domestic demand outstripped that of GDP, leading to a dangerous build-up of external imbalances. This manifested itself in a widening current account deficit, which quadrupled from 3.3% of GDP in 2002 to 13.5% of GDP in 2007 before easing slightly to 12.3% of GDP last year. In addition, the benign global backdrop during the boom years led to excessive foreign currency borrowing, which accounts for about half of private domestic credit. (...) The adverse shocks that hit the economy at the onset of the crisis – vanishing external demand and shrinking capital inflows – have continued to exert significant pressure, limiting prospects for a bounce in sentiment. As a result, GDP contracted by a larger-than-expected 6.2% in the year to March as consumption and investment weighed heavily on growth. Romania's first-quarter growth performance looks even more dismal when set against the 9% average growth during the first three quarters of 2008. Even more important, the implied growth reversal in 2009 would be among the largest in Emerging Europe. Forward-looking indicators as consumer confidence and economic sentiment do not seem to signal a meaningful recovery in the months ahead. We, therefore, forecast that GDP will contract by 6% in 2009, with significant negative contributions from consumption and investment as domestic demand pares excesses and a positive contribution from net exports as import compression more than offsets declines in exports. We expect a fragile recovery in 2010 on the back of modest contributions from domestic demand."

2) Austria: is it a safe harbour?

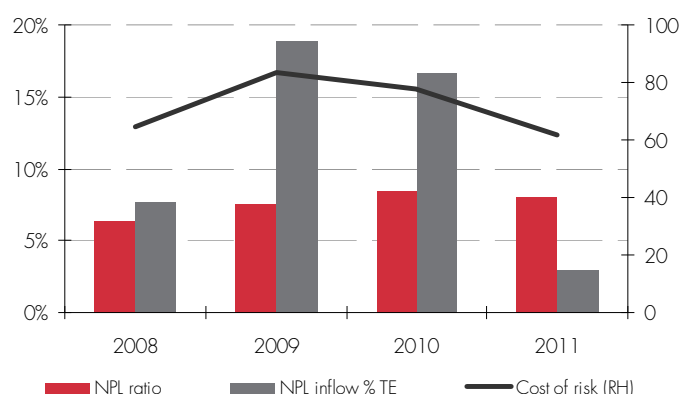
The Austrian economy outperformed western peers before the crisis owing to its close links with the booming CEE region. Nevertheless, this former stimulus has now turned into a potential drag, as the outlook for emerging Europe has deteriorated. According to the OECD, GDP will contract 4.4% in 2009 and will improve gradually in 2010 towards a flat growth rate. For Erste, while the Austrian business has been seen as a 'safe harbour', offering shelter during the crisis and the CEE turbulence, we believe this is only partially true. Erste, unlike RI, as a leading player in the domestic market has to face the significant GDP drop in Austria, in addition to the asset quality worsening in CEE. We assume the NPL ratio in Austria reaches 7.5% this year for Erste and overall the loan portfolio in the domestic market is expected to deteriorate 5% from the 2008 level and to be spread over the next three years. In particular, based on our estimates for Erste in Austria, the NPL inflow as percentage of tangible equity ratio is expected to peak in 2009, to remain high throughout 2010 and to decrease in 2011 and 2012.

Figure 26. Foreign claims of Austrian Banks



Source: BIS, Nomura research

Figure 27. ERSTE – Austrian business

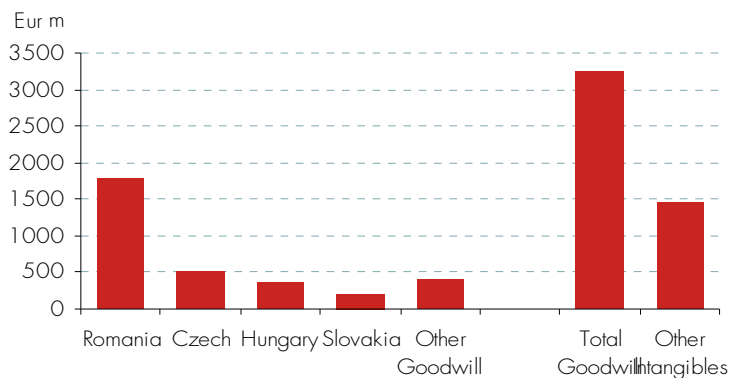


Source: Company data, Nomura research

3) Goodwill impairment?

Erste wrote down EUR 570m (gross) of goodwill at the end of 2008. The bank booked EUR 480m goodwill write-down for the Romanian subsidiary, while it wrote down entirely the goodwill in Serbia and Ukraine, EUR 87m. Currently, BCR goodwill and brand represent more than 50% of total intangible assets of the group. Following last year's write-down, BCR still represents 55% of the group's goodwill. The impairment test on intangibles and goodwill is usually carried out at the end of the year, unless specific and unexpected situations arise. Even though the management does not foresee additional write-downs on the Romanian goodwill, we highlight the risk embedded in the relevant amount of goodwill related to BCR which represents some 13% of total equity.

Figure 28. Erste Bank – Goodwill



Source: Company data, Nomura research

4) Structured assets?

Erste bank is not invested in US subprime but currently holds a portfolio of ABS/CDO with a market value of EUR 1.6bn and EUR 2.8bn face value. The US cash-CLO assets represent ca. 36% of the total portfolio by market value and have been recently impacted by Moody's downgrades. An additional source of risk of the portfolio is the exposure to UK CMBS (ca. EUR 300m) given the impact of the crisis on this asset class; however, the management believes that a potential impairment would not significantly impact the P&L. The amount of impairments since the beginning of the crisis have been negligible, EUR 6m, reflecting the overall limited size of the portfolio, the rating and the stabilization of prices in the market. Erste did not take advantage of the IAS 39 amendments and – in our opinion – we will continue to see some volatility on the P&L and in the equity base due to MTM movements of the AFS reserve, EUR -88m in Q109 vs EUR +45m in Q209.

Erste Bank – Financial estimates

ERSTE Bank							
Eur m	2007A	2008A	2009E	2010E	2011E	2012E	CAGR 09-12
Net Interest Income	3,946	4,913	4,964	5,378	5,873	6,481	9%
Net fee and commission income	1,858	1,971	1,798	1,823	1,895	2,002	4%
Net trading result	351	115	567	363	332	342	-16%
Total Revenue	6,155	6,999	7,328	7,563	8,100	8,824	6%
Operating expenses	-3,642	-4,002	-3,962	-4,128	-4,352	-4,629	5%
Operating Income	2,513	2,997	3,366	3,435	3,749	4,195	8%
Risk provisions for loans and advances	-455	-1,071	-2,071	-1,950	-1,595	-1,397	-12%
Other operating result	-165	-1,349	-249	-244	-224	-214	-5%
Pre-tax Profit	1,893	576	1,046	1,241	1,930	2,584	35%
Taxes on income	-367	-177	-295	-349	-511	-653	30%
Net Income	1,526	399	751	892	1,419	1,930	37%
Post-tax profit from discontinuing ops	28	640	0	0	0	0	
Minority interests	-375	-179	-67	-123	-286	-402	82%
Net Attributable Income (stated)	1,179	860	684	769	1,133	1,528	31%
Net profit adjusted for participation capi	1,151	220	589	629	992	1,388	33%
EPS	3,73	2,71	2,16	2,43	3,57	4,82	31%
EPS adjusted	3,64	0,69	1,86	1,98	3,13	4,38	33%
DPS	0,75	0,65	0,20	0,40	0,70	0,95	68%
BVPS (stated)	26,66	25,48	26,30	33,61	36,34	40,00	15%
Tangible BVPS (EUR)	16,62	17,65	19,03	20,81	23,54	27,21	13%
Main Balance Sheet Measures							
Shareholders' equity (ex min.)	8,452	8,079	10,122	10,687	11,552	12,717	8%
Gross Loans	113,950	126,185	132,902	142,380	154,926	172,819	9%
Customer deposits	100,116	109,305	117,432	123,992	130,983	138,714	6%
Total assets	200,519	201,441	212,643	227,808	247,882	276,510	9%
Risk-weighted assets (average)	95,785	104,478	116,827	124,939	135,438	150,304	9%
P&L Ratios:							
NIM on avg. assets	1,74%	2,44%	2,40%	2,44%	2,47%	2,47%	1%
Cost income ex trading gains - %	60%	58%	59%	57%	56%	55%	-2%
Effective Tax Rate	19%	31%	28%	28%	26%	25%	-4%
RoRWA	1,23%	0,82%	0,59%	0,62%	0,84%	1,02%	20%
RoA	0,59%	0,43%	0,32%	0,34%	0,46%	0,55%	20%
ROE (annualised) - %	14%	10%	8%	7%	10%	13%	19%
ROE adjusted - %	23%	4%	10%	10%	14%	17%	19%
Asset Quality							
NPL ratio (gross)	4,51%	5,28%	7,94%	9,48%	8,73%	7,92%	0%
Coverage ratio	69,20%	59,62%	51,32%	50,51%	57,94%	62,77%	7%
Capital - Group:							
Core Tier I	4,95%	5,33%	6,27%	6,16%	6,13%	6,11%	-1%
Tier 1 (incl. gov., incl. market & ops)	6,09%	6,40%	7,91%	7,69%	7,54%	7,38%	-2%

Source: Nomura estimates, Company data

Erste Bank – Divisional estimates

Austria	2008A	2009E	2010E	2011E	2012E
Eur m					
Net Interest Income	1.591	1.535	1.652	1.837	2.034
Net fee and commission income	674	657	669	689	724
Net trading result	33	70	37	37	37
Operating income	2.298	2.262	2.358	2.563	2.795
Operating expenses	-1.574	-1.566	-1.645	-1.727	-1.831
Operating result	725	696	713	836	964
Risk provisions for loans	-368	-525	-519	-441	-442
Pre-tax profit	116	100	114	315	442
Taxes on income	-25	-25	-29	-82	-115
Minority interests	-40	-1	-1	-106	-168
Net profit after minorities	55	74	84	128	159
Balance sheet					
Gross Loans to customers	60.796	64.820	68.821	73.841	81.663
Customer deposits	55.883	61.085	64.693	67.928	71.324
Average attributed equity	1.226	1.554	1.638	1.754	1.933
Average risk-weighted assets	40.044	40.859	43.418	46.596	51.553
Key ratios					
NIM (RWA- average)	4,16%	3,80%	3,92%	4,08%	4,14%
Cost of risk (bp)	65	84	78	62	57
NPLs ratio	6,37%	7,50%	8,50%	8,00%	7,50%

CEE (aggregated)	2008A	2009E	2010E	2011E	2012E
Eur m					
Net Interest Income	2.724	2.778	2.910	3.151	3.472
Net fee and commission income	988	855	854	886	934
Net trading result	81	92	91	100	110
Operating income	3.793	3.724	3.855	4.137	4.517
Operating expenses	-1.894	-1.816	-1.888	-2.014	-2.172
Operating result	1.898	1.908	1.966	2.123	2.345
Risk provisions for loans	-441	-1.117	-981	-773	-654
Pre-tax profit	1.229	734	943	1.328	1.679
Taxes on income	-239	-157	-186	-271	-342
Minority interests	-168	-58	-93	-147	-193
Net profit after minorities	825	519	664	910	1.144
Balance sheet					
Gross Loans to customers	45.292	47.482	50.987	56.383	63.292
Customer deposits	45.000	44.882	47.356	50.610	54.417
Average attributed equity	2.211	2.753	2.957	3.276	3.683
Average risk-weighted assets	37.103	38.706	41.597	46.044	51.684
Key ratios					
NIM (RWA- average)	7,86%	7,33%	7,25%	7,19%	7,11%
Cost of risk (bp)	105	241	199	144	109
NPLs ratio	3,95%	8,56%	10,46%	9,22%	7,80%

C&B and Markets	2008A	2009E	2010E	2011E	2012E
Eur m					
Net Interest Income	724	743	865	934	1.024
Net fee and commission income	299	269	283	302	327
Net trading result	19	410	240	200	200
Operating income	1.042	1.423	1.388	1.437	1.550
Operating expenses	-369	-384	-399	-415	-432
Operating result	673	1.039	989	1.022	1.119
Risk provisions for loans	-177	-325	-346	-277	-197
Pre-tax profit	441	684	613	715	891
Taxes on income	-98	-150	-135	-157	-196
Minority interests	-22	-32	-29	-33	-42
Net profit after minorities	321	501	449	524	654
Balance sheet					
Gross Loans to customers	21.812	24.647	26.619	28.748	31.911
Customer deposits	6.375	9.563	10.041	10.543	11.070
Average attributed equity	1.826	2.771	2.993	3.233	3.588
Average risk-weighted assets	23.918	33.274	35.935	38.810	43.079
Key ratios					
NIM (RWA- average)	3,02%	2,60%	2,50%	2,50%	2,50%
Cost of risk (bp)	83	140	135	100	65
NPLs ratio	3,12%	5,50%	7,00%	6,50%	6,00%

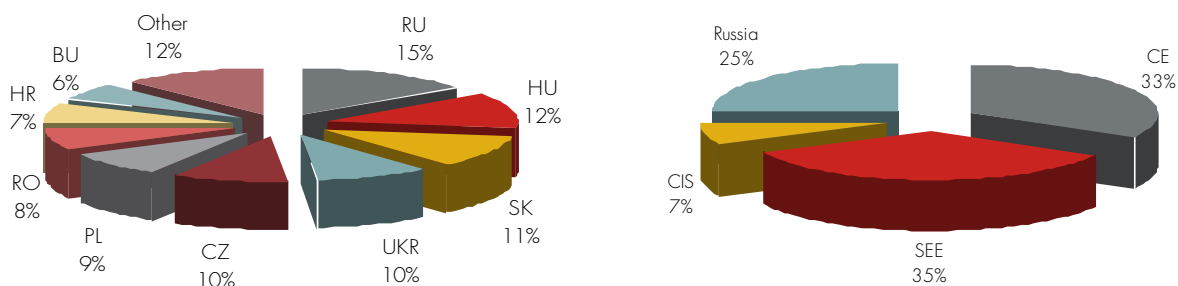
Czech Rep.	2008A	2009E	2010E	2011E	2012E
Eur m					
Net Interest Income	1.093	1.041	1.090	1.200	1.347
Net fee and commission income	425	416	425	437	455
Net trading result	3	30	15	17	19
Operating income	1.520	1.488	1.530	1.654	1.821
Operating expenses	-746	-717	-745	-797	-869
Operating result	774	771	784	857	952
Risk provisions for loans and advances	-117	-268	-233	-197	-168
Pre-tax profit from continuing operations	440	413	492	620	754
Taxes on income	-90	-83	-98	-130	-158
Minority interests	-10	-10	-12	-15	-18
Net profit after minorities	350	321	382	475	578
Balance sheet					
Gross Loans to customers	16.233	17.207	18.583	20.813	23.935
Customer deposits	23.474	23.004	23.925	25.360	26.882
Average attributed equity	834	998	1.078	1.207	1.388
Average risk-weighted assets	12.028	12.045	13.008	14.569	16.755
Key ratios					
NIM (RWA- average)	9,53%	8,65%	8,70%	8,70%	8,60%
Cost of risk (bp)	76	160	130	100	75
NPLs ratio	3,51%	5,50%	7,00%	6,00%	5,00%

Source: Nomura estimates, Company data

Raiffeisen International

Raiffeisen International is a subsidiary of RZB (Raiffeisen Zentralbank Oesterreich AG), the central institute of the co-operative banking sector in Austria. RZB listed 30% of RI in April 2005. RI is a holding of CEE-banks with presence in 15 countries divided into four geographical divisions: CE, SEE, CIS and Russia. RI historically focused on corporate banking and in recent years has been developing a retail base in the region.

Figure 29. Raiffeisen - Geographical exposure by loans and net profit 2011E

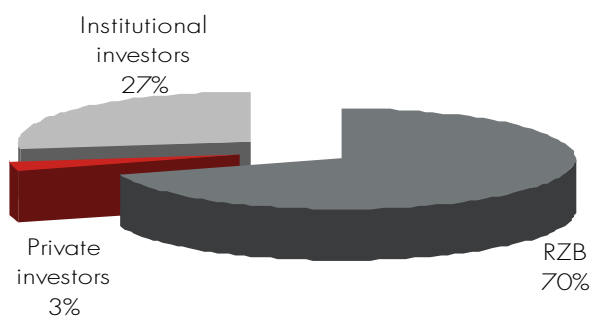


Source: Company data, Nomura estimates

Shareholder structure

RI is majority owned by RZB (Raiffeisen Zentralbank Oesterreich AG), the central institute of the Austrian co-operative banking sector. The parent bank has not made any statements as to the exact level to which it would accept a dilution of its holding. However, a big part of the RI funding is provided by the parent and the recent EUR 0.6bn injection of participation capital could eventually lead to an increase of the holding in the future if it is ultimately converted into ordinary equity.

Figure 30. ERSTE Bank – shareholders' structure



Source: Company data, Nomura research

Looking for the Achilles' heel: 1) future growth highly dependent on a new funding approach

Although the government support and the relative stabilisation of capital markets have eased the short-term pressure on funding and liquidity, we believe analysis of the funding structure provides us with a key indicator for the bank loan growth potential. We believe that in the medium-long term, the loan growth in CEE countries will remain an issue and RI's business model, which fuelled growth in the region using parent's funding and corporate deposit, will need to be revised. RI is facing the current economic crisis with a relatively high loan to deposit ratios, reliance on FX lending and less diversified funding sources.

We expect RI (and Erste) to keep shrinking its loan book in order to reverse the funding gap trend. The management aims to self-fund its growth in each country implying a loan to deposit ratio close to 100% in the long term. We believe this is a desirable but challenging target especially in countries with a high percentage of FX lending.

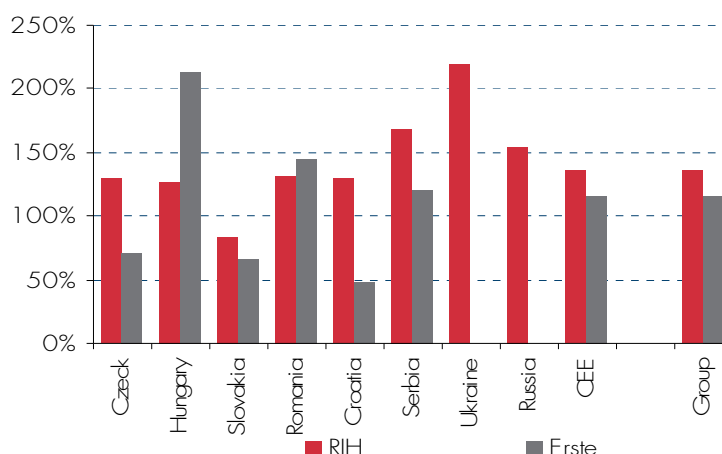
Loan to deposit ratio

Although, at group level, the loan to deposit ratio of RI is just below the EU average – 127% vs 130% - the situation varies across countries, as showed in the chart below. We believe regulators might look to impose a ceiling on loan to deposit ratios; consequently, EU banks, including Erste and RI, will compete for deposit market shares with an inevitable negative impact on NIM.

Deposit growth

The current reliance on deposit is similar for both RI and Erste, just below 60% on total liabilities. However, RI's reliance on corporate deposits which, we consider more volatile than retail, is higher than Erste. Moreover, the retail deposit growth in CEE remains strong, while on the corporate side we expect to see sluggish deposit growth since corporates might still have difficulty accessing financing.

Figure 31. Loan to deposit ratios – by country



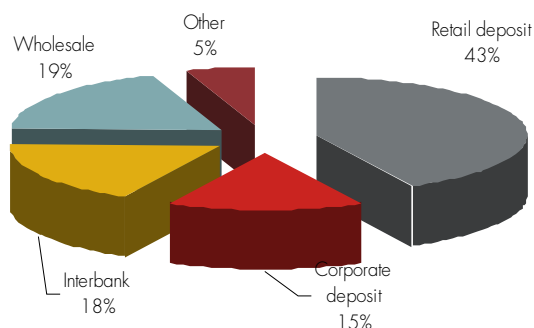
Source: Nomura research, Company data

Wholesale funding sources

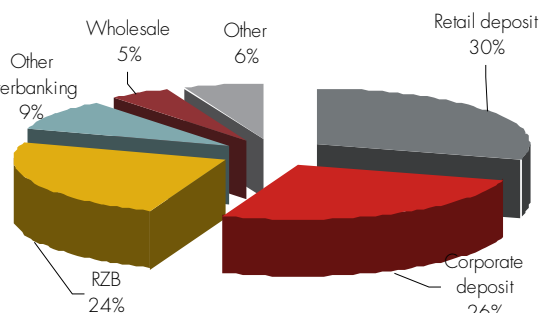
Although the wholesale funding weight (on total liabilities) is nearly equal for the two banks, we calculate that 24% of RI's external financing needs are provided by the parent RZB which offered shelter and fed RI's funding needs during the crisis. Erste's funding is more diversified; the higher component of traditional wholesale funding has been maintained during the liquidity crisis by taking advantage of government guaranteed bonds and the issuance of covered bonds.

Figure 32. Liabilities breakdown

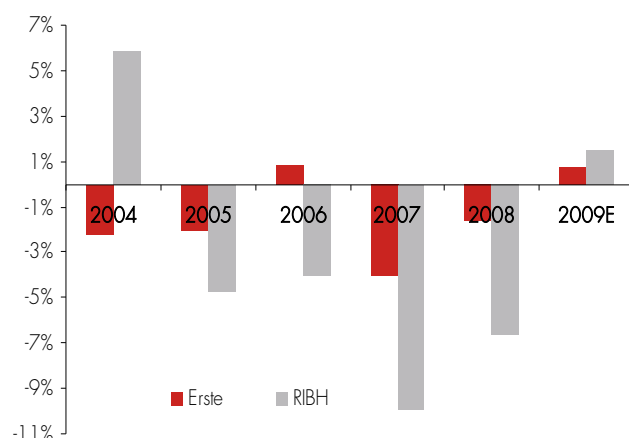
a) Erste Bank



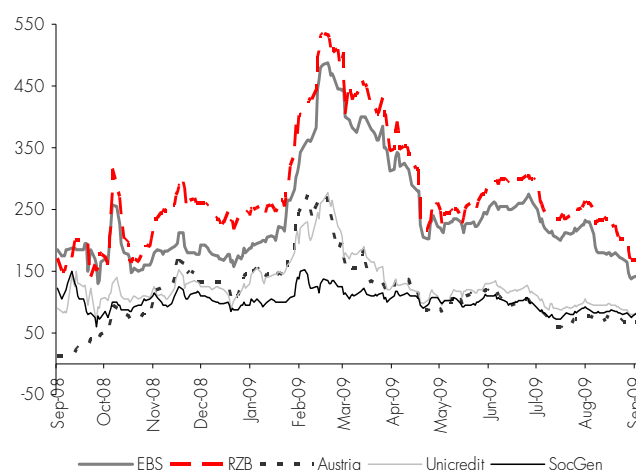
b) Raiffeisen Int'l



Source: Company data, Nomura research

Figure 33. Funding Gap (% of Total Liabilities)

Source: Company data, Nomura research, Datastream

Figure 34. CDS 5yrs (bp)**2) Ukraine?**

Ukraine's economy is headed for a contraction of 14% to 15% this year, according to the World Bank and the IMF. The country is surviving on a US\$ 16bn IMF lifeline while a gradual recovery is expected in 2010. RI is present in the Ukraine through Bank Aval which currently manages a loan book of EUR 4.9bn, a 7% market share. Although RI remains the number two player by loans and deposits in Ukraine, it has shrunk the total exposure to the country by reducing assets, branches and employees. Since September, Bank Aval reduced by 10% its workforce, 8% its branch network and 30% the total assets (in euros).

In Ukraine, RI reported losses in the last three quarters and we expect this trend to continue given the high level of provisioning. On our estimates, the CIS division, which includes Ukraine and Belarus (EUR 1.3bn assets), will remain a drag on RI's profitability as we forecast losses this year and a gradual recovery in 2010.

NPL ratio: headache

Even though the central bank intervention seemed to have worked relatively well in H109 without causing any additional burden on the system, the macroeconomic situation remains uncertain. Bank Aval's NPL ratio reached 18% in June. In the CIS division, the NPL ratio was 6% in 2008 and we estimate 21% in 2009 with Ukraine's ratio being above this level. We expect the NPL inflow to reach 15% of tangible equity at the end of 2009. The position is also affected by trends in the local currency, which depreciated against the EUR and US\$ by 5% and 4% in the first part of Q309.

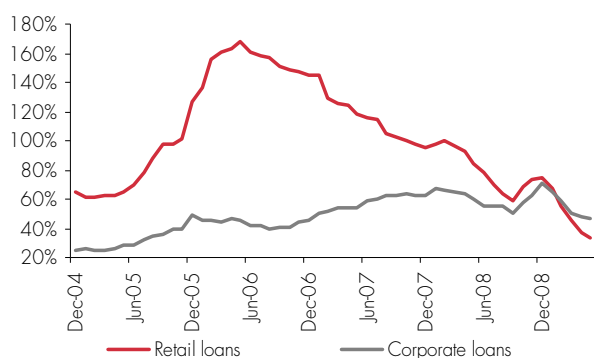
Bank vs customers: sharing the burden

RI's management disclosed an extensive restructuring initiative of the loan book. At the group level, 4% of the retail book and 12% of the corporate has been proactively restructured by the bank. In Ukraine, 27% of the retail book and 35% of corporate was restructured. There is a similar trend in the Russian corporate book. While we think these initiatives are welcomed by the regulators as necessary, and while also being positive for the bank in the long term, they do represent a cost for the shareholders. The bank and in turn its shareholders are effectively sharing the burden of the economic situation with their customers. In the short term, the impact will be probably visible on the top line more than measured by NIM, given the falling loan base.

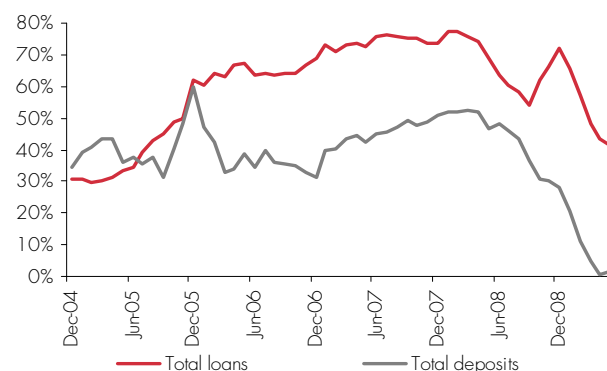
RI does not expect a full recovery to happen before 2011; however, we might be close to a trend inversion. It is important to look for the bottom, for the inflexion point for the market to assess a more realistic recovery scenario for Ukraine and Russia, in particular.

Figure 35. Ukraine - banking system trends

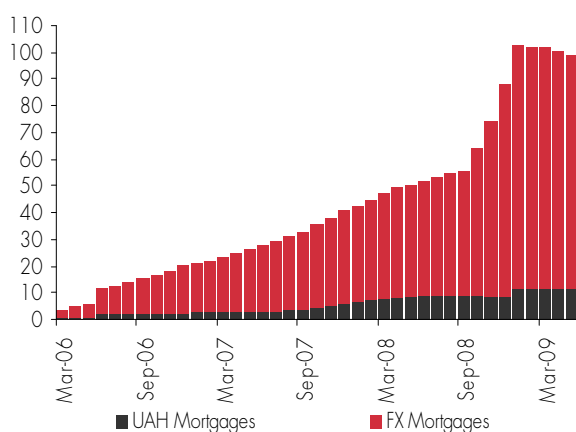
a) Retail vs Corporate growth (y-o-y %)



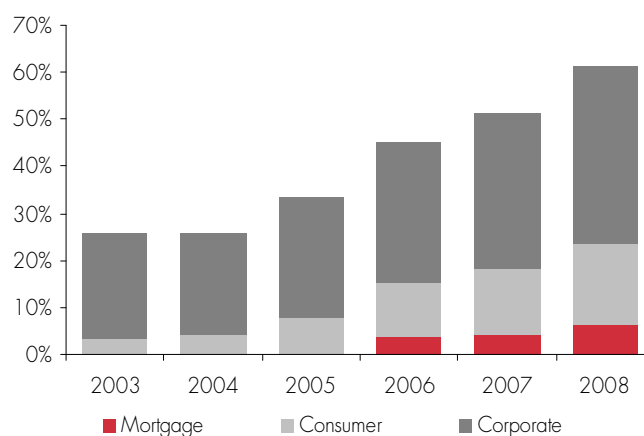
b) Total loans vs deposit growth (y-o-y %)



c) Currency split of mortgages (UAH bn)



d) Loan to GDP by type



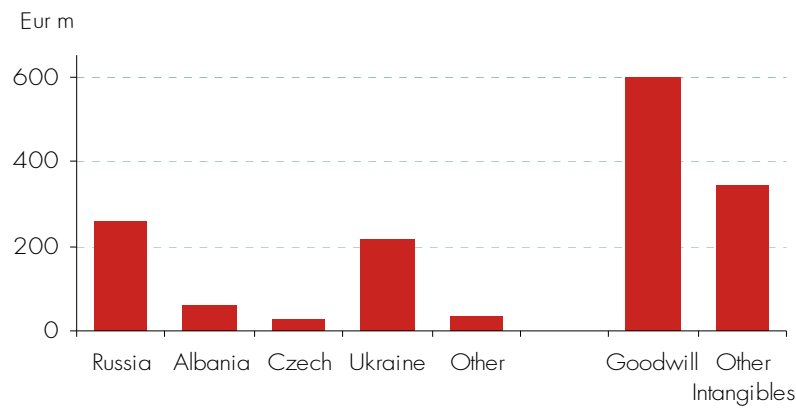
Source: Central bank, Nomura research

.... 3) Goodwill impairment?

RI carries EUR 595m of goodwill mostly related to the banks acquired in Ukraine and Russia. In particular, over the last few quarters, some international banks present in the CIS region carried out additional impairment tests on their holdings, some booking write-downs. Recently, BNP Paribas wrote down the value of its stake in Ukrsibbank by EUR 123m, purging its books of the remaining goodwill associated to the bank. Intesa Sanpaolo and Unicredit adopted a similar approach at the end of 2008 regarding their subsidiaries in the country.

On the contrary, RI did not write down the value of its goodwill. Although we appreciate it is not straightforward to compare the goodwill accrued by different banks, we might expect more clarity by the end of 2009 when a new impairment test should be carried out.

Figure 36. RI – Goodwill breakdown



Source: Company data, Nomura research

Raiffeisen International - Financial Estimates

Raiffeisen International							
EURm	2007A	2008A	2009E	2010E	2011E	2012E	CAGR 09-12
Net Interest Income	2.419	3.232	3.156	3.018	3.200	3.630	5%
Net commission income	1.250	1.496	1.192	1.212	1.279	1.390	5%
Trading profit	128	168	242	273	299	331	11%
Other operating income	-39	-46	63	-12	-24	-24	-172%
Total income	3.757	4.851	4.653	4.491	4.755	5.328	5%
General administrative expenses	-2.184	-2.633	-2.329	-2.300	-2.474	-2.768	6%
Total Costs	-2.184	-2.633	-2.329	-2.300	-2.474	-2.768	6%
Operating Income	1.573	2.218	2.325	2.192	2.281	2.560	3%
LLP	-357	-780	-2.140	-1.746	-1.292	-1.107	-20%
Other operating profit / loss	-5	-16	0	0	0	0	
Pre-tax Profit	1.211	1.421	185	445	989	1.453	99%
Income taxes	-264	-351	-44	-107	-237	-349	99%
Net Income	947	1.070	141	339	751	1.105	99%
Income from disposal of group assets	27	8	0	0	0	0	0%
Minority interests	-132	-96	-48	-68	-120	-177	55%
Net Attributable Income (stated)	841	982	93	271	631	928	115%
EPS	5,44	6,35	0,60	1,75	4,08	6,00	115%
EPS adjusted	5,27	6,30	0,47	1,36	3,69	5,61	128%
DPS (EUR)	0,93	0,93	0,00	0,20	0,74	1,12	
Equity per share	37,68	36,18	38,75	39,99	43,47	48,34	8%
Tangible equity per share	32,78	32,23	31,45	32,58	35,89	40,57	9%
Total assets	72.743	85.397	80.653	84.486	92.553	102.936	8%
Main Balance Sheet Measures							
Consolidated Equity	5.828	5.595	5.994	6.185	6.724	7.477	8%
Gross Loans	48.880	57.902	55.130	57.776	63.343	70.354	8%
Deposits from customers	40.457	44.206	42.880	45.024	47.275	49.639	5%
RWAs	53.964	72.085	67.648	73.211	80.240	89.315	10%
P&L Ratios:							
NII/Total assets	3,76%	4,09%	3,80%	3,65%	3,62%	3,71%	
C/I ratio (incl. other profit/loss)	58,1%	54,3%	50,0%	51,2%	52,0%	52,0%	
Effective Tax Rate	22%	25%	24%	24%	24%	24%	
RoRWA	1,6%	1,6%	0,1%	0,4%	0,8%	1,1%	
RoA	1,16%	1,24%	0,11%	0,33%	0,71%	0,95%	
ROE (on equity incl.profit)	16,6%	17,2%	1,6%	4,4%	9,8%	13,1%	
ROTE adj.	19,2%	19,4%	1,5%	4,3%	10,8%	14,7%	
Asset Quality							
Cost of Risk (bp)	85	146	379	309	213	166	
NPL coverage	105,1%	92,2%	64,4%	69,5%	80,7%	89,8%	
Gross NPLs/loans	2,1%	3,1%	8,6%	10,1%	9,1%	8,1%	
Capital - Group:							
Core Tier I	9,60%	7,42%	8,69%	8,31%	8,26%	8,26%	
Tier 1 ratio	10,53%	8,11%	10,39%	9,88%	9,69%	9,55%	

Source: Nomura estimates, company data

Raiffeisen International - Divisional Estimates

Continental Europe						South-Eastern Europe					
	2008A	2009E	2010E	2011E	2012E		2008A	2009E	2010E	2011E	2012E
Eur m						Eur m					
Net Interest Income	1,025	986	965	1,016	1,138	Net Interest Income	947	916	917	981	1,125
Net fee and commission income	568	426	448	483	522	Net fee and commission income	463	398	418	460	506
Net trading income	56	95	80	80	86	Net trading income	57	95	105	117	129
Other operating income	-19	35	-10	-10	-10	Other operating income	-1	35	5	5	5
Total income	1,629	1,542	1,483	1,569	1,736	Total income	1,466	1,444	1,444	1,563	1,765
General administrative expenses	-930	-818	-810	-843	-893	General administrative expenses	-773	-719	-747	-837	-963
Operating Income	699	724	673	727	843	Operating Income	693	725	697	726	803
LLP	-265	-502	-484	-329	-301	LLP	-159	-505	-380	-341	-300
Profit before tax	442	222	189	398	542	Profit before tax	534	220	317	386	502
Balance sheet						Balance sheet					
LOANS to customers	25,363	24,856	26,099	28,708	31,579	LOANS to customers	16,629	15,964	17,081	18,789	21,232
Average equity	2,607	2,482	2,606	2,867	3,154	Average equity	2,072	1,868	2,142	2,356	2,663
Risk weighted assets (Credit risk)	23,533	22,276	23,390	25,728	28,301	Risk weighted assets (Credit risk)	18,939	16,986	19,473	21,420	24,205
Key ratios						Key ratios					
Margin (on AA)	3.14%	2.80%	2.76%	2.70%	2.75%	Margin (on AA)	3.96%	3.70%	3.65%	3.60%	3.70%
NPLs ratio	3.23%	7.00%	9.00%	8.40%	7.50%	NPLs ratio	2.30%	6.50%	7.35%	7.00%	6.50%
cost of risk (% Loans)	0.81%	2.00%	1.90%	1.20%	1.00%	cost of risk (% Loans)	0.67%	3.10%	2.30%	1.90%	1.50%

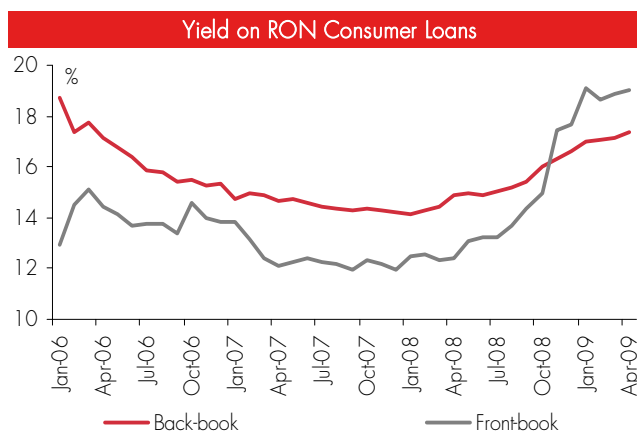
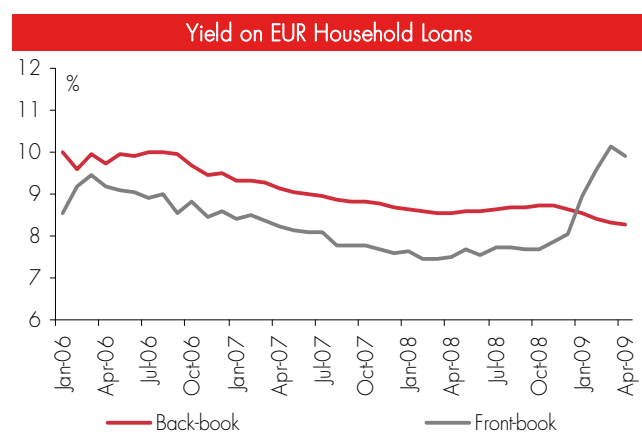
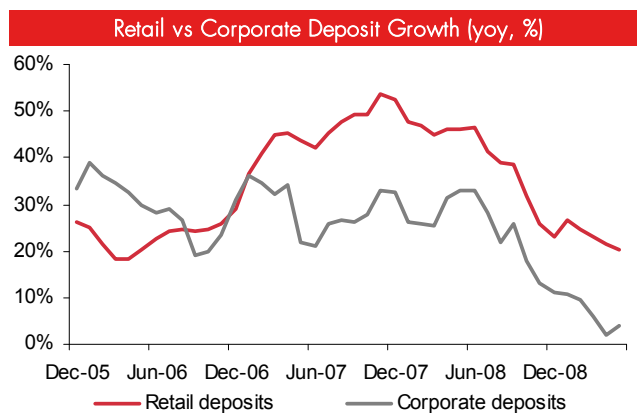
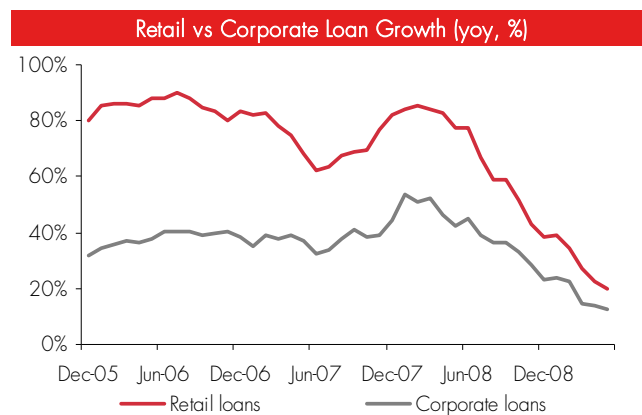
Russia						CIS					
	2008A	2009E	2010E	2011E	2012E		2008A	2009E	2010E	2011E	2012E
Eur m						Eur m					
Net Interest Income	764	807	757	799	929	Net Interest Income	533	537	502	527	561
Net fee and commission income	223	190	186	191	210	Net fee and commission income	234	175	158	142	149
Net trading income	102	10	40	46	53	Net trading income	59	65	71	78	86
Other operating income	-20	-10	-10	-10	-10	Other operating income	-20	20	20	8	8
Total income	1,069	997	972	1,026	1,182	Total income	805	796	750	755	804
General administrative expenses	-456	-419	-386	-444	-533	General administrative expenses	-397	-317	-301	-295	-325
Operating Income	613	577	587	582	649	Operating Income	408	479	449	460	479
LLP	-175	-570	-511	-331	-263	LLP	-181	-562	-371	-292	-242
Profit before tax	438	7	76	252	386	Profit before tax	227	-83	78	167	237
Balance sheet						Balance sheet					
LOANS to customers	9,381	8,161	8,325	9,074	10,435	LOANS to customers	6,510	6,119	6,242	6,741	7,078
Average equity	1,204	1,145	1,245	1,357	1,561	Average equity	760	787	802	866	910
Risk weighted assets (Credit risk)	11,103	10,406	11,322	12,341	14,192	Risk weighted assets (Credit risk)	6,960	7,151	7,294	7,877	8,271
Key ratios						Key ratios					
Margin (on AA)	5.63%	5.60%	5.40%	5.40%	5.60%	Margin (on AA)	6.92%	6.90%	6.60%	6.60%	6.60%
NPLs ratio	1.90%	8.00%	12.00%	10.50%	9.00%	NPLs ratio	6.14%	21.00%	20.00%	16.00%	14.00%
cost of risk (% Loans)	1.29%	6.50%	6.20%	3.80%	2.70%	cost of risk (% Loans)	2.35%	8.90%	6.00%	4.50%	3.50%

Source: Nomura estimates, Company data

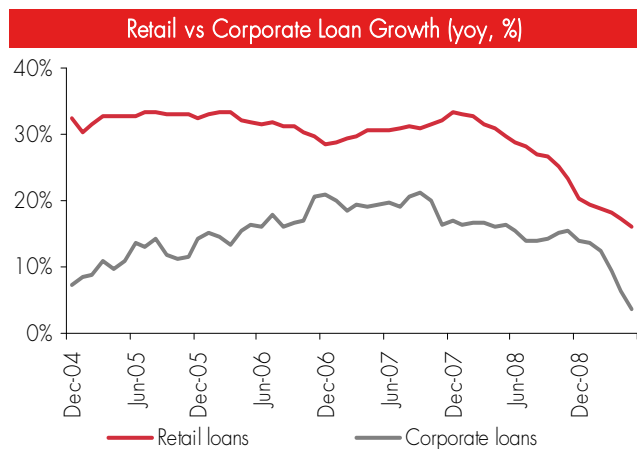
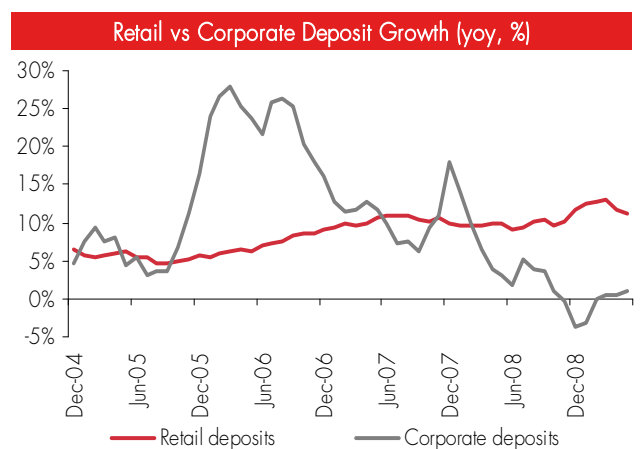
Appendix

Macro and Banks data

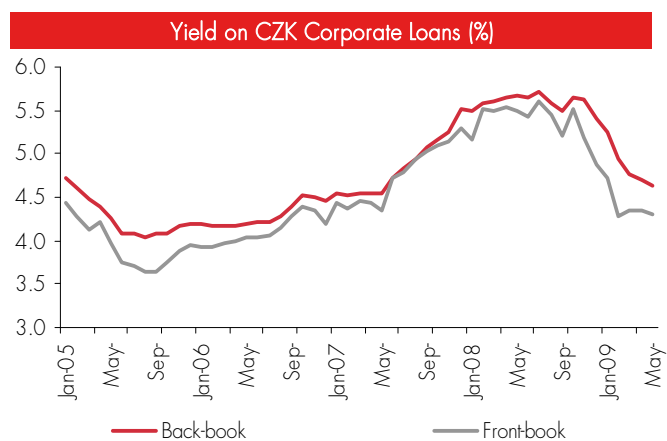
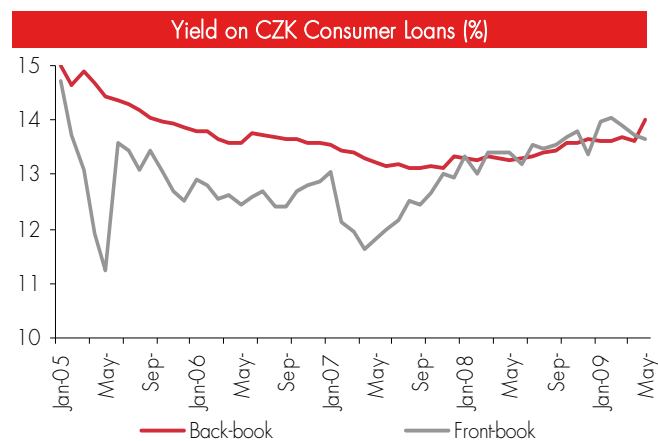
a) Romania



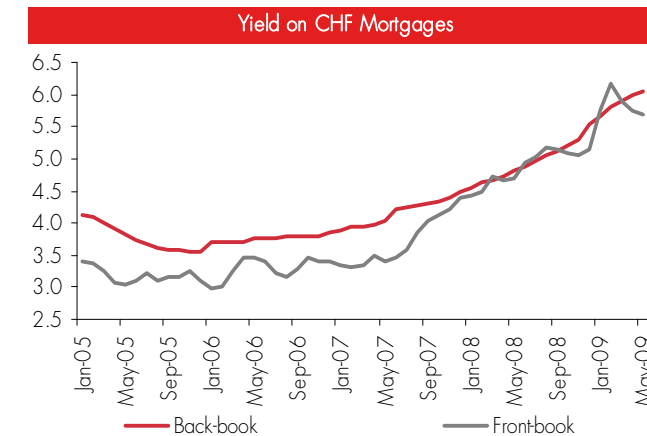
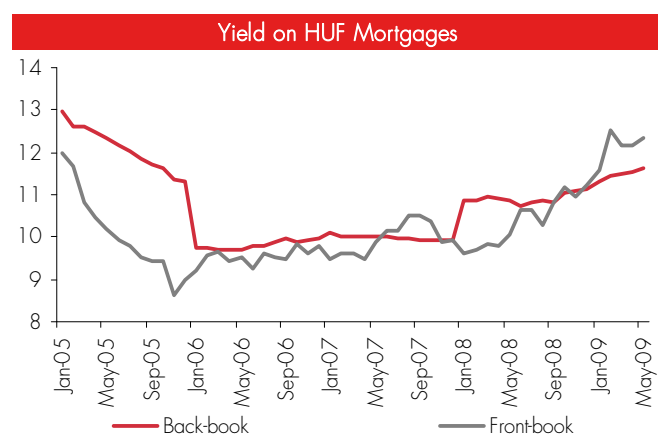
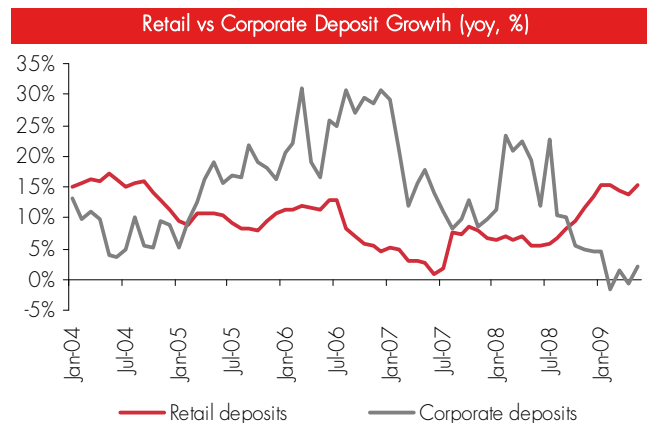
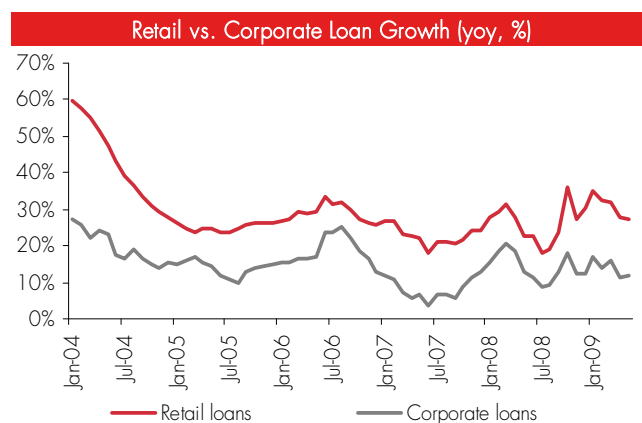
b) Czech Republic



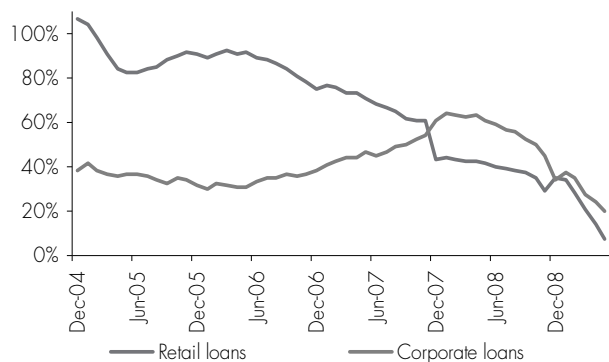
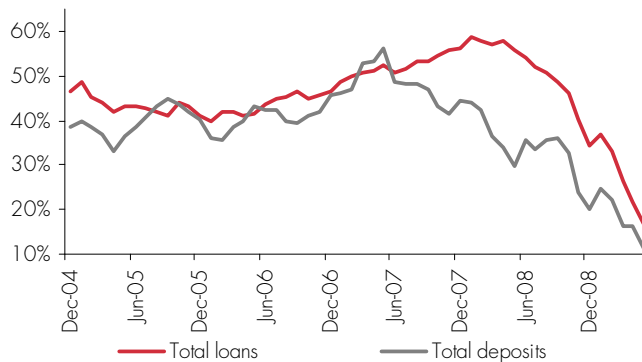
Source: Central banks, Nomura research



c) Hungary



Source: Central banks, Nomura research

d) Russia**Retail vs. Corporate loan Growth (yoy, %)****Total loan and deposit growth (yoy, %)****Yield on RUB Loans****Yield on USD Loans**

Source: Central banks, Nomura research

Industry Specialists are senior employees within Nomura who are responsible for the sales and trading effort in the sector for which they have coverage.

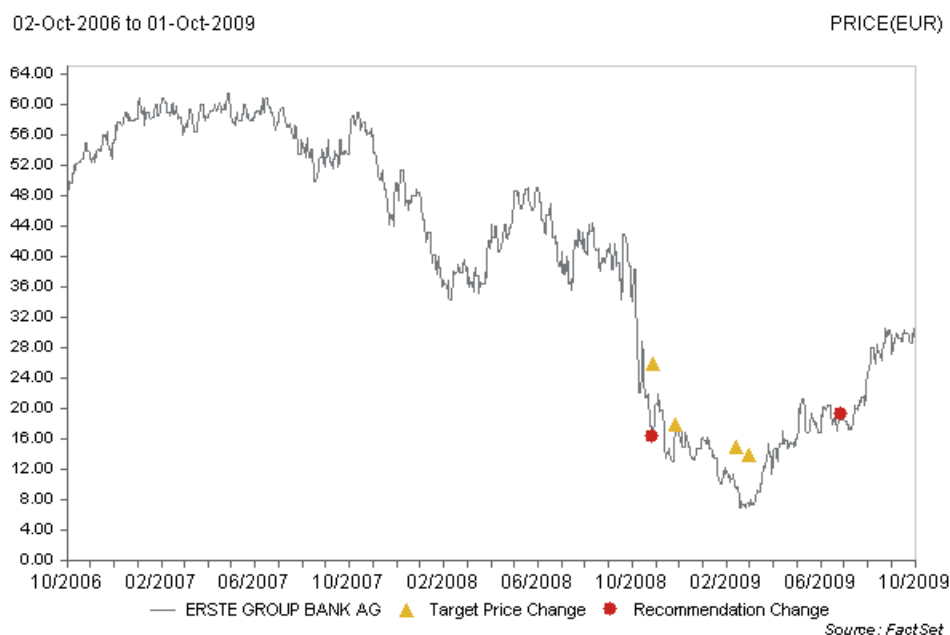
Analyst Certification:

I, Antonio Rizzo, hereby certify (1) that the views expressed in this Industry Report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Industry Report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Industry Report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Important Disclosures:

Erste Bank (ERST.VI)**EUR 27.34 (02-Oct-2009)****Neutral / Neutral**

Rating and Price Target Chart:



Currency=EUR

Date	Closing Price	Rating	Price Target
29-Jun-09	19.20	Rating Suspended	
02-Mar-09	7.25		14.00
12-Feb-09	9.50		15.00

Date	Closing Price	Rating	Price Target
25-Nov-08	17.50		18.00
27-Oct-08	16.25		26.00
27-Oct-08	16.25	Buy	

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE BACK PAGE.

Nomura International plc or an affiliate in the global Nomura group is a market maker or liquidity provider in the securities / related derivatives of the issuer.

Valuation Methodology: We value Erste using a two-stage residual income model. Total value of a bank is calculated as the sum of its equity and present value of its residual incomes, i.e. returns it generates over its cost of equity. In the first stage, we calculate residual incomes based on our detailed four-year earnings forecasts for the bank. In the second stage, we calculate the terminal value by assuming a constant growth rate of 5% in the residual income beyond the fourth year. Finally, we come up with a 12-month target price by multiplying the per-share fair value by the cost of equity. For Erste we assume a cost of equity of 11%, based on risk-free rate of 4.9% and beta of 1.1.

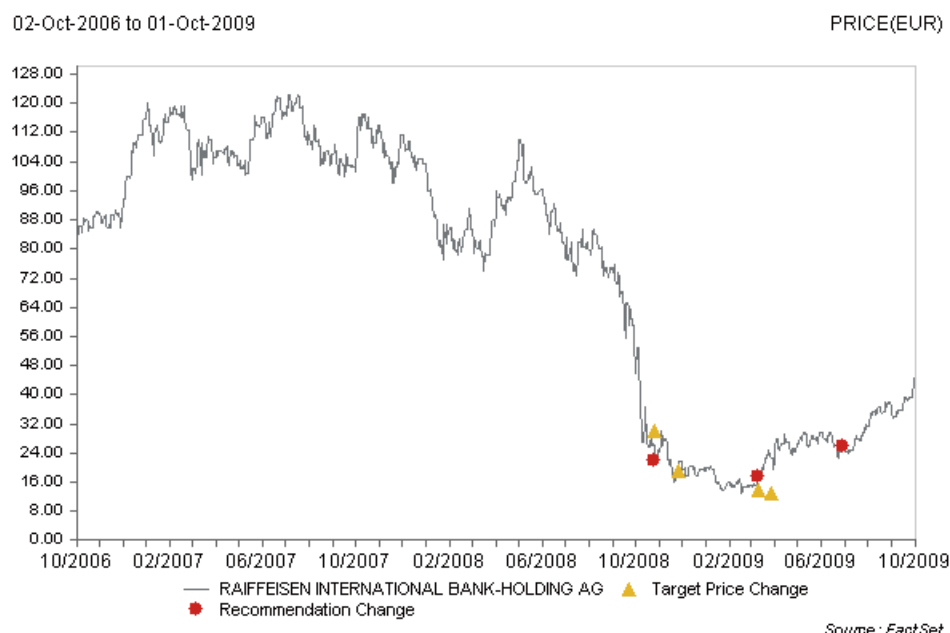
The benchmark index for this stock is Dow Jones STOXX® 600 Banks.

Risks Which May Impede the Achievement of the Price Target: Erste Bank's operating performance is highly affected by the economic and political development in the CEE region. The bank holds a leading position in Central Europe with large market share in Czech Republic and Romania in particular. As a result, Erste Bank is particularly vulnerable to market sentiment in respect of CE and SEE countries' economic and political concerns.

Important Disclosures Continued:

Raiffeisen International Bank (RIBH.VI) EUR 40.10 (02-Oct-2009)**Reduce / Neutral**

Rating and Price Target Chart:



Currency=EUR

Date	Closing Price	Rating	Price Target
29-Jun-09	25.59	Rating Suspended	
27-Mar-09	22.65		13.00
11-Mar-09	17.35		14.00
11-Mar-09	17.35	Reduce	

Date	Closing Price	Rating	Price Target
26-Nov-08	21.00		19.00
27-Oct-08	21.90		30.00
27-Oct-08	21.90	Neutral	

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE BACK PAGE.

Valuation Methodology: We value the two banks using a two-stage residual income model. Total value of a bank is calculated as the sum of its equity and present value of its residual incomes, i.e. returns it generates over its cost of equity. In the first stage, we calculate residual incomes based on our detailed four-year earnings forecasts for the bank. In the second stage, we calculate the terminal value by assuming a constant growth rate of 5% in the residual income beyond the fourth year. Finally, we come up with a 12-month target price by multiplying the per-share fair value by the cost of equity. For Raiffeisen, we assume a cost of equity of 13%, based on risk-free rate of 7.4%, equity risk premium of 5.5% and beta of 1.1.

The benchmark index for this stock is Dow Jones STOXX® 600 Banks.

Risks Which May Impede the Achievement of the Price Target: Given its pure focus on emerging markets, Raiffeisen International's operating performance is highly affected by the economic and political development in the CE, SEE and CIS regions. With the CIS having become increasingly important, it is particularly vulnerable to market sentiment in respect of these countries' economic and political concerns, in particular Russia and Ukraine.

Important Disclosures Continued:

Mentioned Company	Ticker	Price	Price Date	Stock / Sector Rating
Erste Bank	ERST.VI	EUR 27.34	02 Oct 2009	Neutral / Neutral
Raiffeisen International Bank	RIBH.VI	EUR 40.10	02 Oct 2009	Reduce / Neutral

All share prices mentioned are closing prices unless otherwise stated.

Rating and target price changes

	Rating Old	New	Target Price Old	New
ERST.VI	Rating Suspended	Neutral	N/A	EUR 38.00
RIBH.VI	Rating Suspended	Reduce	N/A	EUR 34.00

Erste Bank: We value Erste using a two-stage residual income model. Total value of a bank is calculated as the sum of its equity and present value of its residual incomes, i.e. returns it generates over its cost of equity. In the first stage, we calculate residual incomes based on our detailed four-year earnings forecasts for the bank. In the second stage, we calculate the terminal value by assuming a constant growth rate of 5% in the residual income beyond the fourth year. Finally, we come up with a 12-month target price by multiplying the per-share fair value by the cost of equity. For Erste we assume a cost of equity of 11%, based on risk-free rate of 4.9% and beta of 1.1.

The benchmark index for this stock is Dow Jones STOXX® 600 Banks.

Raiffeisen International Bank: We value the two banks using a two-stage residual income model. Total value of a bank is calculated as the sum of its equity and present value of its residual incomes, i.e. returns it generates over its cost of equity. In the first stage, we calculate residual incomes based on our detailed four-year earnings forecasts for the bank. In the second stage, we calculate the terminal value by assuming a constant growth rate of 5% in the residual income beyond the fourth year. Finally, we come up with a 12-month target price by multiplying the per-share fair value by the cost of equity. For Raiffeisen, we assume a cost of equity of 13%, based on risk-free rate of 7.4%, equity risk premium of 5.5% and beta of 1.1.

The benchmark index for this stock is Dow Jones STOXX® 600 Banks.

ISSUER SPECIFIC REGULATORY DISCLOSURES

Online availability of research and additional conflict-of-interest disclosures:

Nomura Japanese Equity Research is available electronically for clients in the US on NOMURA.COM, REUTERS, BLOOMBERG and THOMSON ONE ANALYTICS. For clients in Europe, Japan and elsewhere in Asia it is available on NOMURA.COM, REUTERS and BLOOMBERG.

Important disclosures may be accessed through the left hand side of the Nomura Disclosure web page <http://www.nomura.com/research> or requested from Nomura Securities International, Inc., on 1-877-865-5752. If you have any difficulties with the website, please email researchportal@nomura.co.uk for technical assistance.

The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by Investment Banking activities.

Distribution of Ratings:

Nomura Global Equity Research has 1613 companies under coverage.

36% have been assigned a Buy rating which, for purposes of mandatory disclosures, are classified as a Buy rating; 33% of companies with this rating are investment banking clients of the Nomura Group*.

41% have been assigned a Neutral rating which, for purposes of mandatory disclosures, is classified as a Hold rating; 61% of companies with this rating are investment banking clients of the Nomura Group*.

21% have been assigned a Reduce rating which, for purposes of mandatory disclosures, are classified as a Sell ratings; 6% of companies with this rating are investment banking clients of the Nomura Group*.

As at 30 June 2009.

*The Nomura Group as defined in the Disclaimer section at the end of this report.

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America for ratings published from 27 October 2008:

The rating system is a relative system indicating expected performance against a specific benchmark identified for each individual stock. Analysts may also indicate absolute upside to price target defined as (fair value - current price)/current price, subject to limited management discretion. In most cases, the fair value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as discounted cash flow or multiple analysis, etc.

Stocks:

- A rating of "1", or **"Buy"**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
- A rating of "2", or **"Neutral"**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
- A rating of "3", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
- A rating of **"RS-Rating Suspended"** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.

Benchmarks are as follows: **United States:** S&P 500, MSCI World Technology Hardware & Equipment; **Europe:** Please see valuation methodologies for explanations of relevant benchmarks for stocks (accessible through the left hand side of the Nomura Disclosure web page: <http://www.nomura.com/research>); **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia.

Sectors:

- A **"Bullish"** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months.
 A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.
 A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.

Benchmarks are as follows: **United States:** S&P 500; **Europe:** Dow Jones STOXX® 600; **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009:

Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Price Target – Current Price) / Current Price, subject to limited management discretion. In most cases, the Price Target will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.

- A rating of "1", or **"Buy"** recommendation indicates that potential upside is 15% or more.
- A rating of "2", or **"Neutral"** recommendation indicates that potential upside is less than 15% or downside is less than 5%.
- A rating of "3", or **"Reduce"** recommendation indicates that potential downside is 5% or more.
- A rating of **"RS"** or **"Rating Suspended"** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company.
- Stocks labeled as **"Not rated"** or shown as **"No rating"** are not in Nomura's regular research coverage.

Sectors:

- A **"Bullish"** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
 A **"Neutral"** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
 A **"Bearish"** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008):

Stocks:

- A rating of "1", or **"Strong buy"**, indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.
- A rating of "2", or **"Buy"**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "3", or **"Neutral"**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
- A rating of "4", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "5", or **"Sell"**, indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.
- Stocks labeled **"Not rated"** or shown as **"No rating"** are not in Nomura's regular research coverage. Nomura might not publish additional research reports concerning this company, and it undertakes no obligation to update the analysis, estimates, projections, conclusions or other information contained herein.

Sectors:

- A **"Bullish"** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.
 A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.
 A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Japan:** TOPIX; **United States:** S&P 500, MSCI World Technology Hardware & Equipment; **Europe,** by sector — *Hardware/Semiconductors:* FTSE W Europe IT Hardware; *Telecoms:* FTSE W Europe Business Services; *Business Services:* FTSE W Europe; *Auto & Components:* FTSE W Europe Auto & Parts; *Communications equipment:* FTSE W Europe IT Hardware; **Ecology Focus:** Bloomberg World Energy Alternate Sources; **Global Emerging Markets:** MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008:

Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

- A rating of "1", or "**Strong buy**" recommendation indicates that upside is more than 20%.
- A rating of "2", or "**Buy**" recommendation indicates that upside is between 10% and 20%.
- A rating of "3", or "**Neutral**" recommendation indicates that upside or downside is less than 10%.
- A rating of "4", or "**Reduce**" recommendation indicates that downside is between 10% and 20%.
- A rating of "5", or "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

A "**Bullish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.

A "**Neutral**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.

A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Price targets

Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimate

DISCLAIMERS

This publication contains material that has been prepared by the Nomura entity identified on the banner at the top or the bottom of page 1 herein and, if applicable, with the contributions of one or more Nomura entities whose employees and their respective affiliations are specified on page 1 herein or elsewhere identified in the publication. Affiliates and subsidiaries of Nomura Holdings, Inc. (collectively, the "Nomura Group"), include: Nomura Securities Co., Ltd. ("NSC") Tokyo, Japan; Nomura International plc, United Kingdom; Nomura Securities International, Inc. ("NSI"), New York, NY; Nomura International (Hong Kong) Ltd., Hong Kong; Nomura Singapore Ltd., Singapore; Nomura Australia Ltd., Australia; P.T. Nomura Indonesia, Indonesia; Nomura Malaysia Sdn. Bhd., Malaysia; Nomura International (Hong Kong) Ltd., Taipei Branch, Taiwan; Nomura International (Hong Kong) Ltd., Seoul Branch, Korea; or Nomura Financial Advisory and Securities (India) Private Limited, Mumbai, India (Registered Address: 2nd Floor, Ballard House, Adi Marzban Path, Ballard Pier, Fort, Mumbai, 400 001; SEBI Registration No:- BSE INB011299030, NSE INB231299034, INF231299034).

This material is: (i) for your private information, and we are not soliciting any action based upon it; (ii) not to be construed as an offer to sell or a solicitation of an offer to buy any security in any jurisdiction where such offer or solicitation would be illegal; and (iii) based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such.

Opinions expressed are current opinions as of the original publication date appearing on this material only and the information, including the opinions contained herein, are subject to change without notice. If and as applicable, NSI's investment banking relationships, investment banking and non-investment banking compensation and securities ownership (identified in this report as "Disclosures Required in the United States"), if any, are specified in disclaimers and related disclosures in this report. In addition, other members of the Nomura Group may from time to time perform investment banking or other services (including acting as advisor, manager or lender) for, or solicit investment banking or other business from, companies mentioned herein. Further, the Nomura Group, and/or its officers, directors and employees, including persons, without limitation, involved in the preparation or issuance of this material may, to the extent permitted by applicable law and/or regulation, have long or short positions in, and buy or sell, the securities (including ownership by NSI, referenced above), or derivatives (including options) thereof, of companies mentioned herein, or related securities or derivatives. In addition, the Nomura Group, excluding NSI, may act as a market maker and principal, willing to buy and sell certain of the securities of companies mentioned herein. Further, the Nomura Group may buy and sell certain of the securities of companies mentioned herein, as agent for its clients.

Investors should consider this report as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision.

NSC and other non-US members of the Nomura Group (i.e., excluding NSI), their officers, directors and employees may, to the extent it relates to non-US issuers and is permitted by applicable law, have acted upon or used this material prior to, or immediately following, its publication.

Foreign currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk.

The securities described herein may not have been registered under the U.S. Securities Act of 1933, and, in such case, may not be offered or sold in the United States or to U.S. persons unless they have been registered under such Act, or except in compliance with an exemption from the registration requirements of such Act. Unless governing law permits otherwise, you must contact a Nomura entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.

This publication has been approved for distribution in the United Kingdom and European Union as investment research by Nomura International plc ("NIPc"), which is authorised and regulated by the U.K. Financial Services Authority ("FSA") and is a member of the London Stock Exchange. It does not constitute a personal recommendation, as defined by the FSA, or take into account the particular investment objectives, financial situations, or needs of individual investors. It is intended only for investors who are "eligible counterparties" or "professional clients" as defined by the FSA, and may not, therefore, be redistributed to retail clients as defined by the FSA. This publication may be distributed in Germany via Nomura Bank (Deutschland) GmbH, which is authorised and regulated in Germany by the Federal Financial Supervisory Authority ("BaFin"). This publication has been approved by Nomura International (Hong Kong) Ltd. ("NIHK"), which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NIHK. Neither NIPc nor NIHK hold an Australian financial services license as both are exempt from the requirement to hold this license in respect of the financial services either provides. This publication has also been approved for distribution in Singapore and Malaysia by Nomura Singapore Limited and Nomura Malaysia Sdn Bhd respectively. NSI accepts responsibility for the contents of this material when distributed in the United States.

No part of this material may be (i) copied, photocopied, or duplicated in any form, by any means, or (ii) redistributed without the prior written consent of the Nomura Group member identified in the banner on page 1 of this report. Further information on any of the securities mentioned herein may be obtained upon request. If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this publication, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Additional information available upon request.

NIPc and other Nomura Group entities manage conflicts identified through the following: their Chinese Wall, confidentiality and independence policies, maintenance of a Stop List and a Watch List, personal account dealing rules, policies and procedures for managing conflicts of interest arising from the allocation and pricing of securities and impartial investment research and disclosure to clients via client documentation.

Disclosure information is available at the Nomura Disclosure web page: <http://www.nomura.com/research>