Ukrainian Banks – Eurobond issuers

On the bright side of the fixed income universe

March 4, 2016

Executive summary

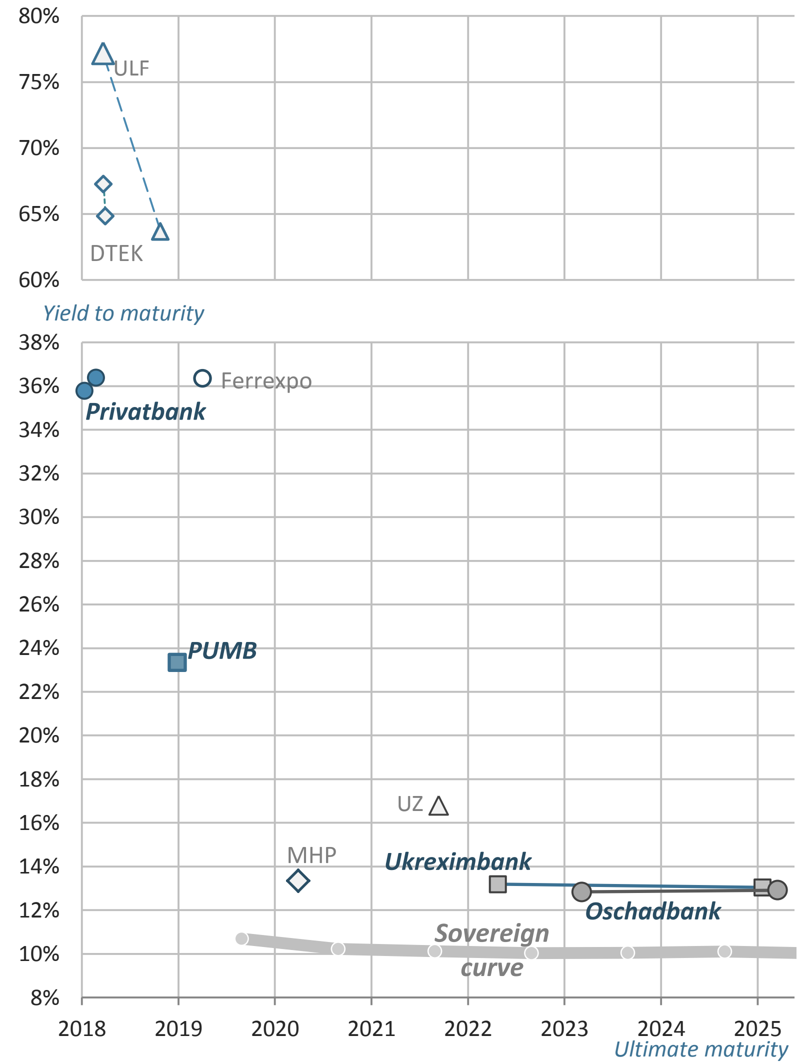
Amid all the risks of the Ukrainian financial sector, four of seven Eurobond-issuing banks survived, now representing the bright (low-yield) side of the Ukrainian Eurobond universe. These surviving banks have passed the stress tests of the central bank (the NBU) and have already approved their program of capitalization for the next three years, which indicates both bank owners and the NBU have a common vision on how the banks will survive in the coming years.

Importantly, the banks have currently enough funds to smoothly repay the upcoming bond tranches, so we estimate their default/restructuring risks as low. That said, we believe the prices of their Eurobonds (except Privatbank) mostly reflect investors' desired levels of return and liquidity risks.

We believe the banking bonds offer good returns as compared to their risks:

- **The risks held by state Oschadbank and Ukreximbank**, which are state agents and enjoy full support from the government, **are no larger than the sovereign risk** – we see a potential for their bond yields to decrease in the short term. Choosing between two, we like the diversified and less-exposed-to-scandals **Ukreximbank**. We believe EXIMUK 10-30 bps spreads to OSCHAD bonds are not justified.
- **PUMB** (First Ukrainian International Bank) is the brightest spot among the fixed income instruments controlled by Rinat Akhmetov (who also controls DTEK and Metinvest). Perhaps high yield of PUMBUZ is attributable to the negative halo over Akhmetov's other assets. The approaching repayment time of the PUMB Eurobond (the ten-payment period starts in September 2016) and the lack of progress in foreign currency deposits build up (at least as of the latest reporting date, end-3Q15) implies some liquidity risk for the bank. However, we see the bank, whose cash balance (as of last report) fully covers all its bond liabilities, is capable of repaying the debt. In our view, the PUMBUZ bond **offers the best composition of return and risk of all Ukrainian banks**. The key problem is the bond is illiquid.
- **Privatbank** also looks able to smoothly repay its two nearest Eurobonds in late 2017-early 2018. However, before the repayment happens, the bank has to do hard work to improve the reliability of its entire corporate loan portfolio by forcing its clients to bring hard collateral, based on our findings. This process itself is related to a lot of counterparty risks, which could make the bank's bonds volatile before they mature. That said, we see the default risk of PRBANK bonds as low, but this paper only could appeal to **those who are ready to tolerate the price risk.**

Yield map of Ukrainian Eurobonds, March 4, 2016



Source: Bloomberg

Trends in the banking sector

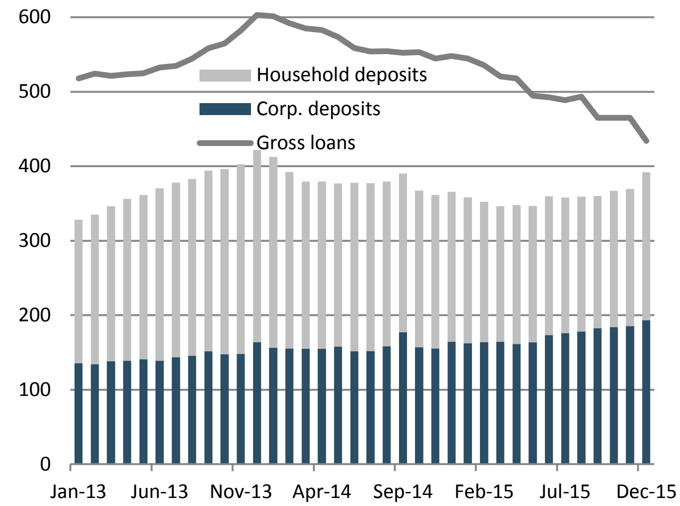
Ukraine's banking sector was among the biggest victims of the financial crisis in Ukraine, triggered by the Russian military aggression that started in 1Q14 and trade hostilities that began in mid-2013 and became aggravated after Jan. 1, 2016.

Most of the banks' troubles stemmed from weakened payment discipline of borrowers and flight of household foreign-currency deposits. As a result of the crisis and subsequent clean up efforts of the central bank, more than a third of banks left the market since the beginning of 2014. Most of the remaining banks faced a need to increase their capital adequacy.

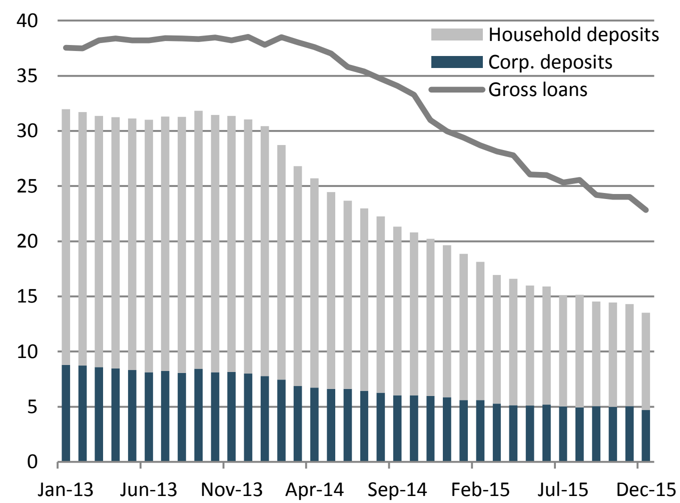
The banking system's increased risks resulted in an outflow of 58% of foreign-currency deposits since mid-2013 and the outflow had not yet stopped as of the end of 2015. This limited ability to timely repay foreign debt obligations forced the banks to initiate restructuring talks with international creditors.

At the same time, the bank's deposits in local currency have stabilized as of mid-2015 and have even grown since then. The system's liquidity in the local currency has remained solid.

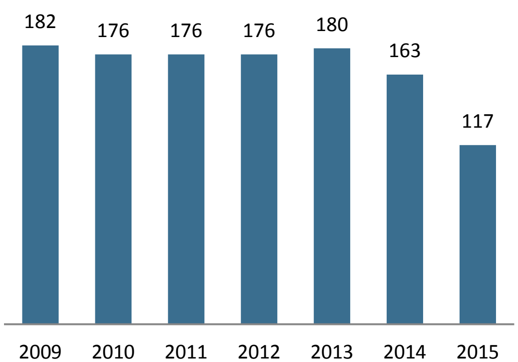
Ukraine loans and deposits in local currency, UAH bln*



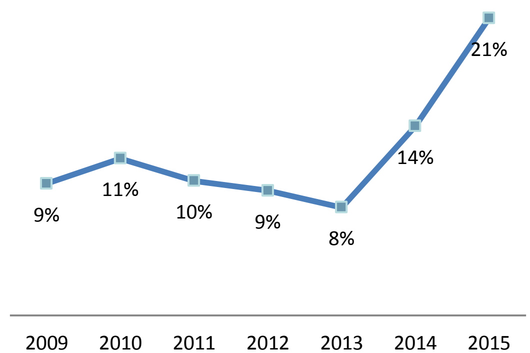
Loans and deposits in foreign currency, USD bln equivalent*



Number of banks in Ukraine, eop



Share of overdue loans in portfolio, eop*



** Data for the survived banks*
Source: NBU, Concorde Capital research

The covered banks: big & exposed to related parties

The four covered banks in this report are among the leaders in Ukraine's banking system, accounting aggregately for about a half of its assets and liabilities.

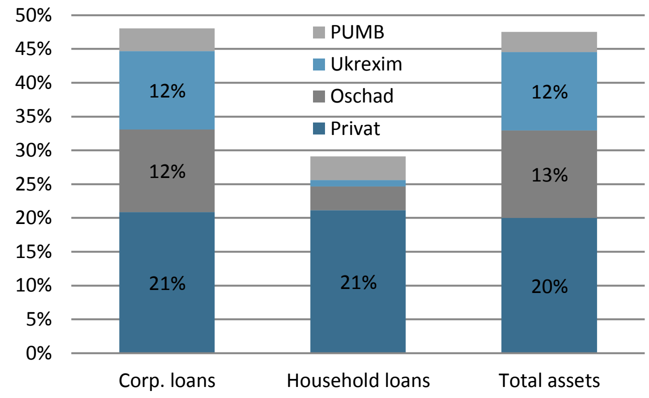
With their dominating market share, three of them – Privatbank, Oschadbank and Ukreximbank – are considered by the National Bank of Ukraine (NBU) to be systemically important banks. This designation does not offer any benefits to the banks, except on a public relations level. Their importance means their liquidity and capital adequacy requirements will be tougher than for other banks.

All of the covered banks, except Ukreximbank, are focused on attracting household deposits, while all the banks allocate among corporate borrowers more than 80% of their loan books.

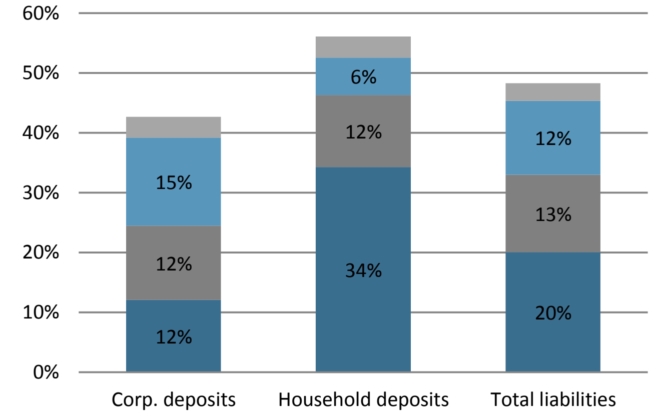
Ukreximbank, as is suggested by its name, is heavily exposed to foreign currency operations, with about 70% of its financial assets and liabilities being in foreign currencies. The rest of the covered banks have comparable or below-market exposure in foreign currency loans and deposits.

All the covered banks have the backing of related parties – large oligarchs or the state, as well as being exposed to lending to the related parties. For the state banks, tight cooperation with the state provides additional guarantees on their prompt support in case of emergency. For the private PUMB and Privatbank, with their key shareholders being in conflict with the key powerbrokers in Ukraine, the related parties are more of a risk than a benefit.

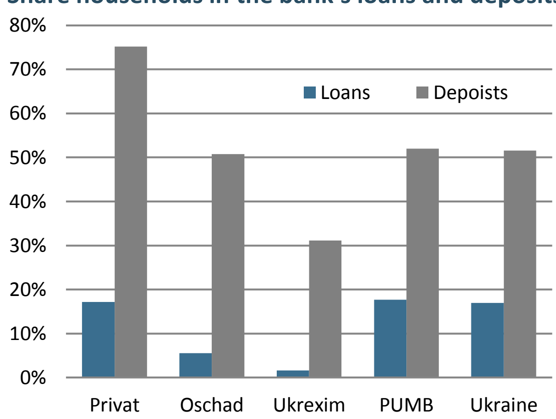
Share of the banks in Ukraine system's assets, end-3Q15



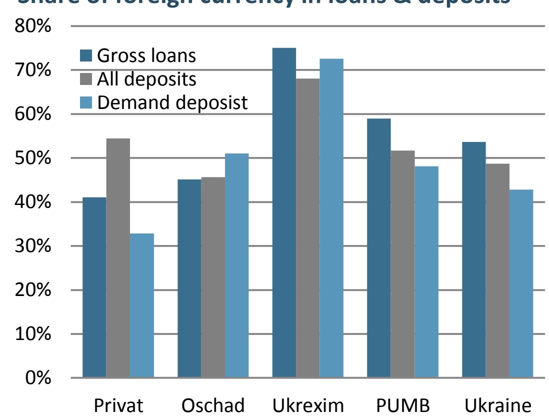
Share of the banks in the system's liabilities, end-3Q15



Share households in the bank's loans and deposits



Share of foreign currency in loans & deposits



Source: NBU, bank data, Concorde Capital calculations

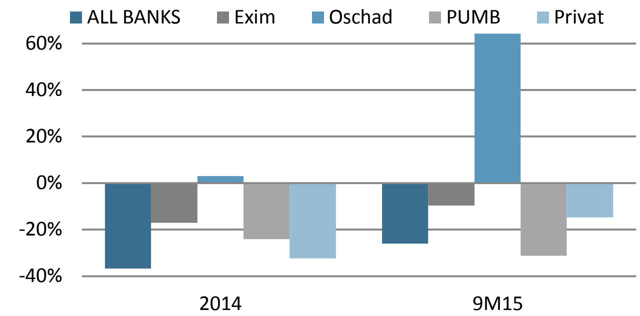
Trends in the covered banks: deposits and capital contributions

Like the entire banking system, the banks were losing their deposit base in foreign currency, although the speed of the outflow was below the market average. The decline was much less for the state banks, which are considered to be more safe in Ukraine. Oschadbank was able to significantly increase its dollar deposit base in 2015, though solely due to almost tripled corporate accounts. The deposits in local currency are remaining more or less flat at the covered private banks, and are steadily growing in state banks.

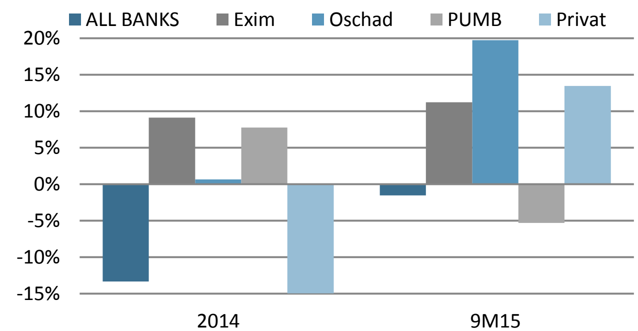
All the banks except PUMB faced a need to increase their equity as a result of stress-testing in 2014. The results of new stress testing performed in 2015 are not publicly available, but we assume all the banks will have to increase their equity based on them.

- Ukreximbank and Oschadbank enjoyed a capital contribution from the state amounting to UAH 5.0 bln and UAH 11.6 bln, respectively, after their 2014 stress-testing. Following new stress tests in 2015, the banks received UAH 9.3 bln and UAH 5.0 bln in 2016, respectively, and further capital increases are possible in 2017 and 2018 based on those tests.
- Privatbank shareholders contributed UAH 4.9 bln into its equity in 2014-2015, and reportedly committed to add more in 2017-2018, following the results of their 2015 stress-testing. Fear was sparked by the bank's main shareholder on its possible capital needs in the coming three years, which range from UAH 15 bln to UAH 128 bln. The unresolved problem of the bank's capitalization is its key risk, as of today.
- PUMB did not report on any capital contribution following the 2015 stress testing. If there would be a need for additional capital, we expect the bank's main shareholder would provide it by converting deposits into equity, we expect.

Foreign currency deposits change

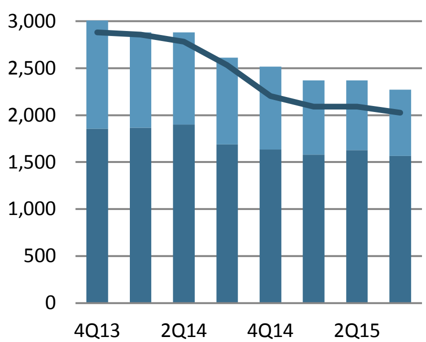


UAH deposits change

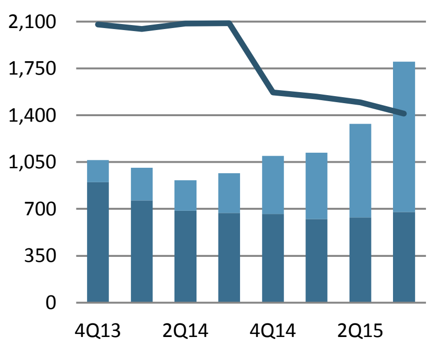


Foreign currency loans and deposits, USD mln:

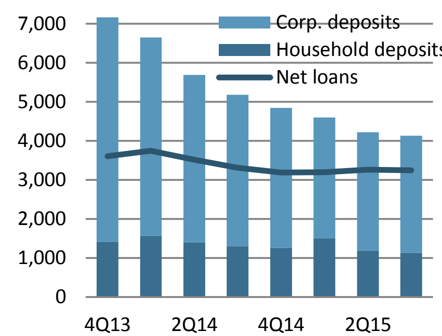
Ukreximbank



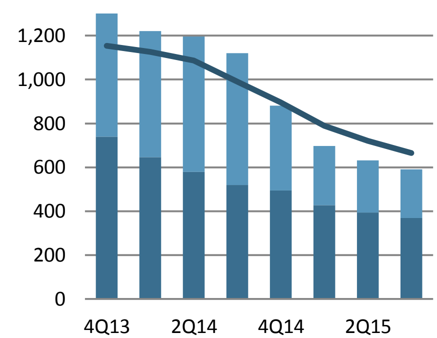
Oschadbank



Privatbank



PUMB



Source: NBU, bank data, Concorde Capital calculations

Eurobond restructuring: postponements in hopes of better times; eased schedule

All the covered banks completed the restructuring of their Eurobonds in late 2014-2015, thus having extended their repayment, as well as smoothing out their repayment schedules.

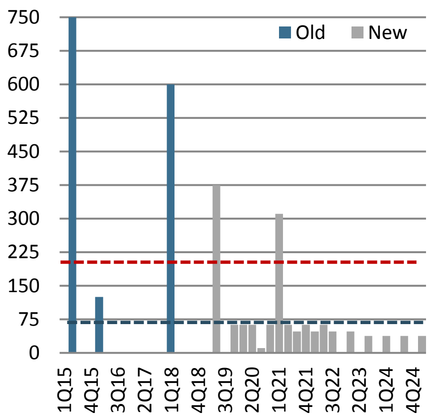
The smoothest schedule of bond repayment was reached by PUMB, which will have to repay USD 19.7 mln quarterly between September 2016 and December 2018. At the same time, the bank's maturity extension was the shortest.

The longest extension was reached by state Ukreximbank and Oschadbank, although the amounts of their first payments under the schedule remain relatively high, accounting for more than 8% of their current level of foreign currency assets. However, this does not affect their capacity to repay the bonds, which depends mostly on the state's backing.

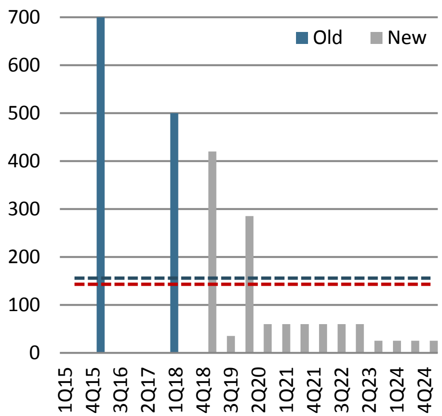
Privatbank's extension wasn't as long as for the state banks, though the amounts of future payments under the bonds are much easier, given the value of the bonds and the amounts of the bank's foreign currency assets. Nevertheless, its repayment schedule for the five months of Sep'17-Feb'18 (with USD 375 mln due) is a bit tougher than the original schedule of Sep'15-Feb'16 (USD 350 mln). Hopefully by that time, dollar liquidity in the banking system and the bank's individual liquidity will be much better than in 2015.

Repayment schedule of Eurobonds – before and after the restructuring*:

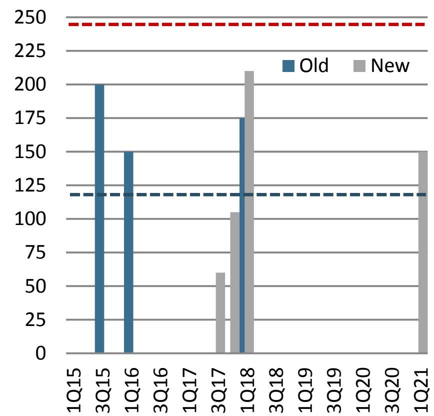
Ukreximbank



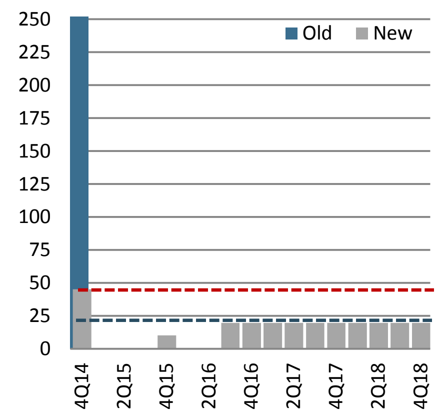
Oschadbank



Privatbank



PUMB



** Dark blue line corresponds to 10% of the bank's 3Q15 cash balance; red line corresponds to 5% of the bank's 3Q15 foreign currency assets*
Source: Bank data, Concorde Capital calculations

Capacity to repay Eurobonds looks solid

At this stage, it looks like all the covered banks will be able to smoothly repay their Eurobond obligations in line with their updated schedules. On the one hand, their dollar liquidity is continuing to shrink as they are still suffering from the continuing outflow of dollar deposits. On the other hand, they have enough time to change their policy and attract more dollar deposits. On top of that, their overall liquidity remains strong, with cash balances (as of the latest reporting date, end-3Q15) exceeding the amount of nearest quarterly payments under the Eurobonds by 7-20 times. At least, this suggests all the banks are able to purchase enough dollars for debt repayments, if they need to, providing there won't be deterioration of ForEx market conditions in Ukraine in the future.

After the rescheduling of USD 207 mln in Eurobonds in late 2014, **PUMB** suffered from an outflow of USD 267 mln in foreign currency deposits in 9M15. The rescheduling, therefore, allowed the bank to smoothly repay the deposits last year, without changing its deposit policy or entering the ForEx market.

The upcoming repayments of Eurobonds (USD 19.7 mln per quarter starting September 2016) will demand more active efforts to attract foreign-currency deposits, or will force the bank to enter the ForEx market. Both ways to accumulate dollars for the upcoming repayments are possible, and we do not expect the bank will face any troubles with their implementation. In particular, to repay smoothly its Eurobonds, PUMB should increase its dollar deposits by 3% each quarter, which does not look impossible.

Outflow of dollar deposits from **Oschadbank** and **Ukreximbank** was minimal, but we do not expect they will use deposits to repay their Eurobonds – the bonds' amounts outstanding are still too high for the banks to service. However, we see two viable sources for the state banks' Eurobonds repayments:

- Future capital contributions from international financial organizations like the EBRD and ICF, whom the Ukrainian government is going invite into the banks' equity on a two-year horizon.
- Recently contributed equity from the state, in the form of local bonds whose face value is linked to U.S. dollars. The face value of bonds contributed to Ukreximbank is close to USD 375 mln equivalent, or the size of the first, largest payment on its Eurobonds in 2019. For Oschadbank, the recent capital injection covers only half of its nearest bond repayment.

For **Privatbank**. It's not a big issue to repay its nearest Eurobonds, which collectively account for 8% of its foreign currency assets.

Moreover, the bank's shareholders are reportedly ready to contribute capital in the years 2017-2018, which could serve as a primary source for repaying the nearest bonds due this period.

However, in our view, Privatbank has many more risks (which might affect its bond prices) in the short term rather than in the mid-term. Refer to the bank's profile (p. 19) for more details.

State banks do not feel deficit of funding

The below data suggests state banks are enjoying a better life in Ukraine these days:

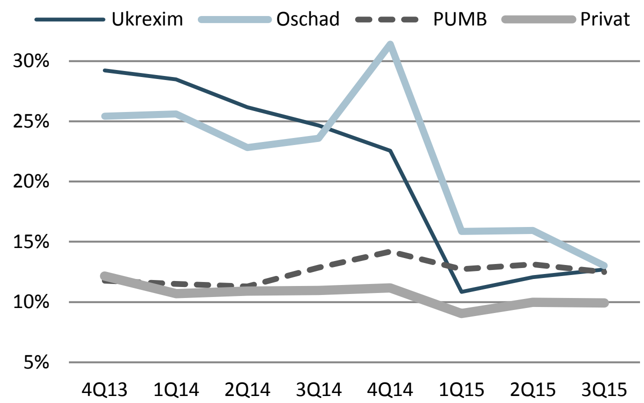
- They feel no deficit of liquidity and enjoy their status of safer banks for deposits – as a result, their interest rates on 12M deposits are much smaller than for the covered private banks.
- State banks were able to form large loan loss provisions in 2015 as the government was all too generous to fill their capital gaps. On a negative side, the unlimited state support creates a moral hazard risk for the banks.

Privatbank is at the other extreme to the state banks, having to offer much higher interest rates to the market. Moreover, it has no ability to increase its loan loss provisions as its shareholders are not ready to contribute capital that would cover the provisioning losses.

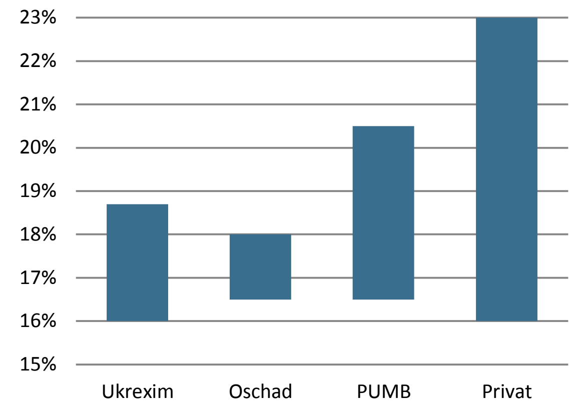
NPL (90+ days) as % of gross loans (IFRS)

	2013	2014	1H15
PUMB	14.0%	18.2%	23.1%
Oschadbank	10.8%	17.9%	n/a
Privatbank	4.6%	5.6%	8.0%
Ukreximbank	n/a	n/a	n/a

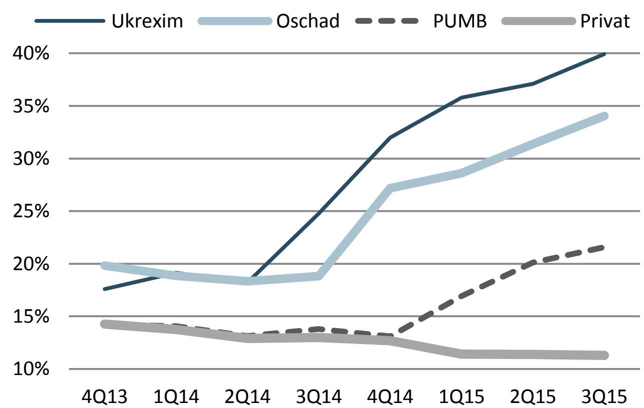
Capital adequacy ratio (local standards)



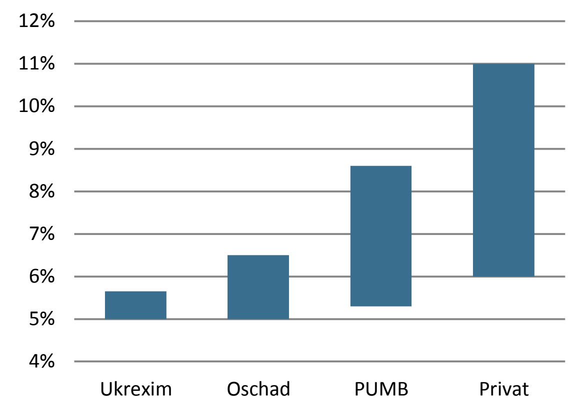
Term deposit rates in UAH, 1M – 12M*



Loan loss provisions as % of gross loans (local standards)



Term deposit rates in USD, 1M – 12M*



** Currently available deposits with monthly interest payments and no right of early repayment. Lower bounds of the bars show rate for 1 month, upper – for 12 months*
Source: Bank data, Concorde Capital calculations

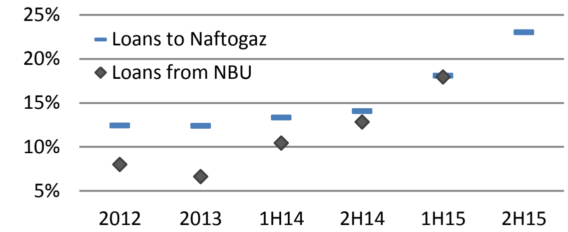
Bank profiles

State banks: strategy revision on the horizon

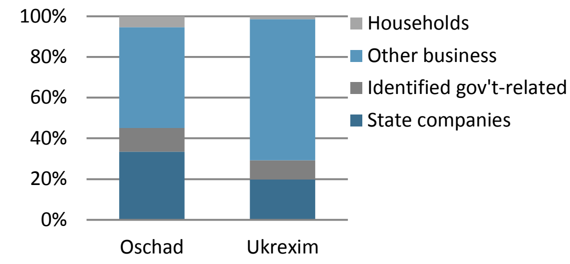
The two biggest state-controlled banks historically were special-purpose vehicles of the state and lenders to businesses close to power brokers. In particular:

- Both banks played an active role in filling Ukraine's gross reserves by placing their Eurobonds and using the proceeds to purchase local state dollar bonds.
- The banks are the biggest holders of local gov't bonds, thus playing a role in supporting the state budget.
- Oschadbank was actively involved in financing the natural gas of monopoly Naftogaz. It positions this as "commission business" (the bank is just an intermediary between the NBU and Naftogaz) - as most of the loans to Naftogaz were refinanced by the NBU. While in 2012-2013 such business brought good "commission" to the bank (as the difference between the interest received from Naftogaz and the interest paid to the NBU), last year the "commission margin" decreased to a couple of basis points (see the chart to the left).
- Both banks allocate about 10% of their gross loan book to finance state enterprises other than Naftogaz.
- On top of that, at least 10% of the bank's loan book was earlier allocated to finance the businesses of the entourage of former President Viktor Yanukovych, including Kliuyev's solar energy projects, the Creative Group and Lauffer Group food holdings. We believe those are the tip of the iceberg – info on such loans reached the media because of their large size and the inability (or refusal) of borrowers to service them.
- Fortunately for them, all the risks and losses from the above operations of the banks are being covered by the state with its readiness to contribute capital. In the last two years, the government contributed about UAH 31 bln into the banks' equity, which amounts to about 2% of Ukraine's state debt.

Oschadbank's effective interest rates

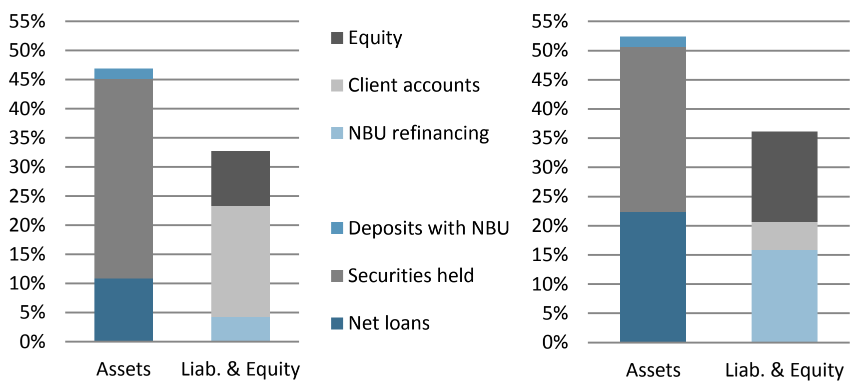


Structure of gross loan portfolio, end-2014



Exposure to the state entities as % of total assets, end-2014:

Ukreximbank **Oschadbank**



With such a heritage, the banks clearly need a radical revision of their asset management policies, and the process seems to have been started – in February 2015, the Cabinet approved a reform strategy of state banks that includes:

- Higher independence of the banks from policy makers by including only independent directors (not gov't officials) on their boards.
- The sale of about 20% of the banks' stakes to IFIs or a high-profile investors by mid-2018, followed by a possible decision by mid-2020 to sell more stakes.
- A bigger focus on client segments that "will allow maximizing the banks' value." This refocusing does not mean radical change in their target borrowers' profiles – the banks should concentrate on the segment where they have "strong sides, the strategic assets that cannot be copied by competitors." However, here the key hopes here are in a radical revision of the management of credit risks.

Therefore, the key positives of the strategy, if it's implemented, are related to isolating the banks' businesses from politics, improved control of the board over management and improved risk control.

Source: Bank data, Concorde Capital research

State banks: shareholder support is the key source of Eurobond repayments

State support of the banks is the backbone of their stability

The Ukrainian government contributed UAH 11.6 bln into the equity of Oschadbank in 2014, primarily to offset its losses generated in Crimea. The state also increased the equity of Ukreximbank by UAH 5.0 bln in 2014.

In 2016, the government ruled to increase the equity of Oschadbank and Ukreximbank by UAH 5.0 bln and UAH 9.3 bln, respectively. These contributions were prompted by stress-testing done by the NBU in 2015. In our view, this is only part of the total three-year capital increase plan following the NBU's test. Therefore, we expect the banks will receive another portion of capital contributions in 2017 and/or 2018.

Capital contributions may serve as source of Eurobond repayment

Importantly, the recent capital increase was made in form of UAH-denominated bonds whose par value is adjustable to U.S. dollars. This means the bonds are hedged against the devaluation of the Ukrainian currency. The NBU stressed it won't purchase these bonds from the banks, thus most likely the banks will keep them in their portfolio for the mid-term. We expect Oschadbank and Ukreximbank will sell the bonds in order to accumulate cash for Eurobond repayments when they are due.

The recent capital injection in Ukreximbank, in the equivalent of USD 375 mln, fully covers its nearest and biggest Eurobond tranche (USD 375 mln in 2Q19, or 25% of all Eurobonds outstanding).

The recent capital injection in Oschadbank (USD 200 mln) covers its nearest and biggest Eurobond tranche (USD 420 mln in 2Q19, or 32% of all Eurobonds outstanding) by 48%.

Importantly, Ukraine is planning to sell at least a 20% stake in the banks to an IFI or a high-profile international bank in mid-2018, or just before the nearest payment on their Eurobonds. We believe the sales will be made in the form of an additional equity placement (cash in) and the contributed money will also be used to repay the nearest bond tranches.

That said, it looks like the banks will have enough external sources to smoothly repay their nearest and biggest Eurobond tranches.

Mid-term positives: improved corporate governance, risk management

The government's strategy to reform the state banks, if realized, will isolate the banks from politics by introducing independent board members, as well as improve their risk-management policy. Theoretically, this will allow the banks to better concentrate on profit generation and avoid big losses in the future, to the benefit of all their stakeholders.

State banks: Oschadbank (State Savings Bank of Ukraine)

Bank profile

Oschadbank is Ukraine's second-biggest bank by assets, as of end-3Q15. Emerging from the ruins of the Soviet savings bank, it remains a fully state-controlled institution that is focused on retail deposits (ranked second by household money attracted). It has the biggest retail network in Ukraine. The bank is an important lender to state institutions, with 47% of its total assets (as of end-2014) lent to the government and state companies.

Benefiting from its status as safest deposit institution

Being the only bank whose household deposits are 100% guaranteed by the state, the bank is enjoying its status as the safest bank. For this reason, its deposit base continued growing during the last two years, despite a significant deposit outflow in the system. This plays to support the bank's liquidity and makes it one of the safest investments in Ukraine's fixed income universe.

Strategy revision: no radical changes in lending priorities

According to the reform strategy of the state banks, Oschadbank has to concentrate its lending efforts on households, small and micro business; and on large business in the areas of utility, farming and infrastructure. That means little revision of its target borrowers – the "target" segments account for almost 60% of the bank's gross loan portfolio currently. Notably, its biggest borrower Naftogaz (whose gas sector seems not to be on the bank's priority list) will likely stay with the bank over the next four years (the agreements for UAH 15.9 bln in loans have been extended till 2020).

Most risks related to Russian aggression already provisioned

Gross loans to Crimean borrowers accounted for 11% of the bank's portfolio as of end-2014, and the bank has fully provisioned them as of the year end. Gross loans to borrowers in the Donbas region accounted for just 3% of the bank's portfolio. They are very likely to be more than offset by the deposit base in Donbas.

Key short-term risk: debt of Creative

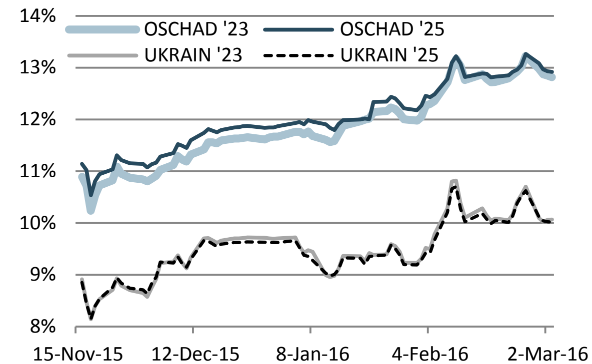
Oschadbank is the biggest lender to Creative Group (about USD 280-300 mln), which is currently in default, according to media reports. The group's collateral under the loan is very unlikely to cover the debt – Creative's biggest asset, the Ellada sunflower oil plant, was just sold by Ukrgazbank for USD 96 mln. A possible need to write down the loan could create large losses for the bank, which, however, won't affect its liquidity. However, a scandal might affect the bond prices, we believe.

Risks remain on par with sovereign level

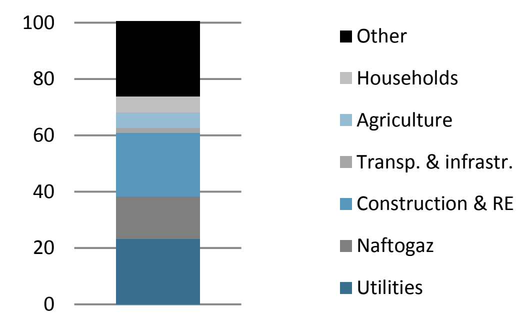
Given the bank's status as the government's agent, we believe its bonds bear the same risk as Ukraine's sovereign Eurobonds. Its bonds' current spread to sovereign curve, about 250-260 bps, looks too high. We are bullish on OSCHAD bonds, while at the same time consider them to be only the second-best opportunity after EXIMUK.

	OSCHAD 03'23	OSCHAD 03'25
Price, % of par, Mar. 4	84.11	82.70
Implied YTM	12.9%	12.9%
Outstanding, USD mln	700	500
Repayment, USD mln:	**420:** Mar'19	**250:** Mar'20
	8 x **35 S/A**: Sep'19 - Mar'23	10 x **25 S/A**: Sep'21 – Mar'25
Coupon	9.38% / SA	9.63% / SA
Fitch / S&P / Moody's	CCC/na/Caa3	CCC/na/Caa3

Eurobond yields to maturity



Gross loan portfolio, UAH bln, end-1H15



Source: Bloomberg, bank data, Concorde Capital research

Oschadbank financial summary, IFRS

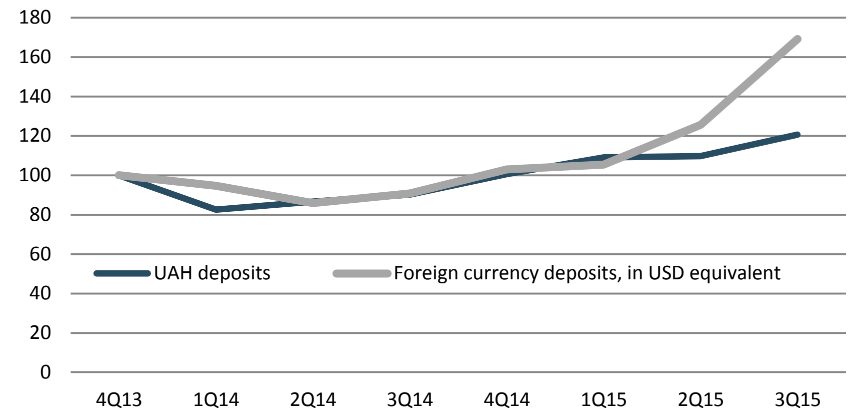
Balance Sheet, UAH mln

	2013	2014	1H15
Cash	2,336	4,533	4,908
Due from banks	10,219	8,022	22,121
Net loans	70,236	70,236	65,143
- Related parties	*27,928*	*27,928*	*22,205*
- Individuals	*2,759*	*2,521*	*2,600*
Gross loans	94,260	94,260	100,658
- Related parties	*31,479*	*31,479*	*26,427*
Net as % of gross	*75%*	*75%*	*65%*
Securities portfolio	33,210	33,210	37,093
- Related parties	*30,634*	*30,654*	*34,914*
PP&E	3,375	3,375	3,333
Other assets	4,938	4,938	6,176
Total assets	**124,314**	**124,314**	**138,774**
Due to banks	14,732	3,594	4,720
Due to NBU	9,346	18,582	18,507
Client accounts	46,409	56,209	70,344
- Current accounts	*17,847*	*21,693*	*33,791*
Eurobonds outstanding	9,786	19,340	25,798
Subordinated debt	840	1,657	2,150
Other liabilities	10,728	5,695	7,448
Total liabilities	**82,495**	**105,077**	**128,967**
Equity	**19,204**	**19,237**	**9,808**
CAR	**24.7%**	**18.6%**	**9.2%**

P&L summary, UAH mln

	2013	2014	yoy
Interest income	11,218	13,697	22%
Interest costs	-5,715	-8,387	47%
Net interest income	**5,503**	**5,310**	**-4%**
Loan loss provisions	-2,438	-9,663	296%
Net fees and commissions	1,232	1,260	2%
ForEx operations	51	-3,331	n/m
Operating costs	-3,481	-4,230	22%
Profit before tax	925	-10,115	n/m
Net profit	**710**	**-10,015**	**n/m**

Change of deposit base (local accounting standards), 4Q13 = 100



Source: Bank data

State banks: Ukreximbank (Ukrainian State Export-Import Bank)

Bank profile

Ukreximbank (EXIMUK) is the third biggest by assets in Ukraine, as of end-3Q15. During the last couple of years, it swapped the 2nd and 3rd rank with its peer, State Savings Bank. It's also the sector's biggest holder of corporate accounts (15% of the sector) and in particular, the biggest holder of foreign currency accounts (23%). The bank is almost entirely focused on corporate clients and servicing export-import operations. It is also the biggest holder of the government's local bonds.

Exposure to foreign currency is both a strength and weakness

The bank has high exposure to foreign currency as 63% of its end-3Q15 assets were denominated in foreign currency.

As an institution focused on financing export and import operations, the bank is exposed to the risks of its major clients: both Ukraine's major exporters (suffering from weak global commodity prices and trade restrictions imposed by Russia) and major importers (which suffer decreased domestic demand for their goods) are currently not in the best shape.

As a positive externality of large exposure to foreign currency operations, the bank has more dollar liquidity to service its international obligations as compared to its peer, Oschadbank, whose Eurobond debt is comparable.

Losses from war are not disclosed, as well as other things

The bank does not disclose any numbers on the assets left or losses incurred in Crimea or the occupied part of the Donbas region of Ukraine. While its Crimean business shouldn't have been high, we believe its exposure to Donbas, as the key export-oriented region of Ukraine, could be significant.

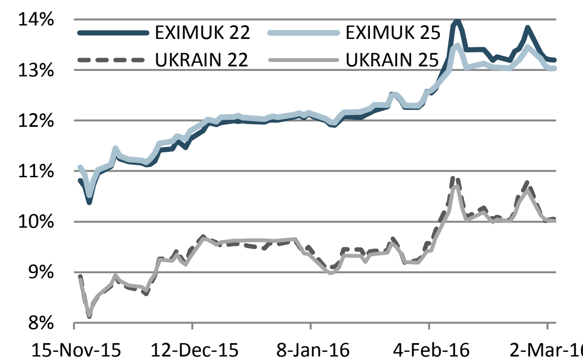
Actually, the war-torn losses are just an indicator of the banks incomplete financial disclosure. Ukrexim has the poorest reporting practices of all the covered banks, with no interim IFRS reports among the most critical.

Its risks remain on par with sovereign, look smaller than for Oschadbank

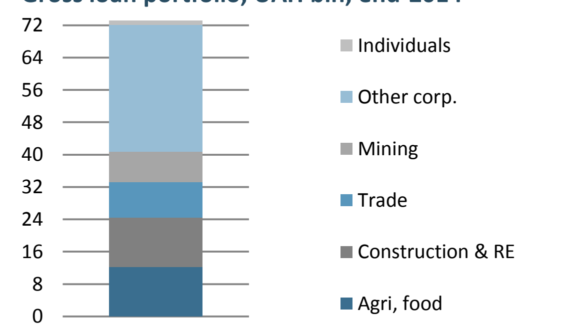
The bank's status of a government agent does not differ from that of Oschadbank. Therefore, we believe EXIMUK's credit risk is the same as for Ochadbank. The bank seems to have been less involved in financing the assets of the Yanukovych entourage (as cases reported by the media suggest), thus the price of EXUMUK bonds could be less prone to the risks of credit scandals. That said, we believe the bank's Eurobonds deserve a negative spread to Oschadbank's paper, while currently they trade at a positive 10-30 bps spread.

	EXIMUK 04'22	EXIMUK 01'25
Price, % of par, Mar. 4	85.30	82.97
Implied YTM	13.2%	13.0%
Outstanding, USD mln	750	600
Repayment, USD mln:	**375**: Apr'19	**300**: Jan'21
	6 x **62.5 S/A:** Oct'19 – Apr.'22	8 x **37.5 S/A:** Jul'21 – Jan'25
Coupon	9.63%/SA	9.75%/SA
Fitch / S&P / Moody's	CCC/na/Caa3	CCC/na/Caa3

Eurobond yields to maturity



Gross loan portfolio, UAH bln, end-2014



Source: Bloomberg, bank data, Concorde Capital research

Ukreximbank financial summary, IFRS

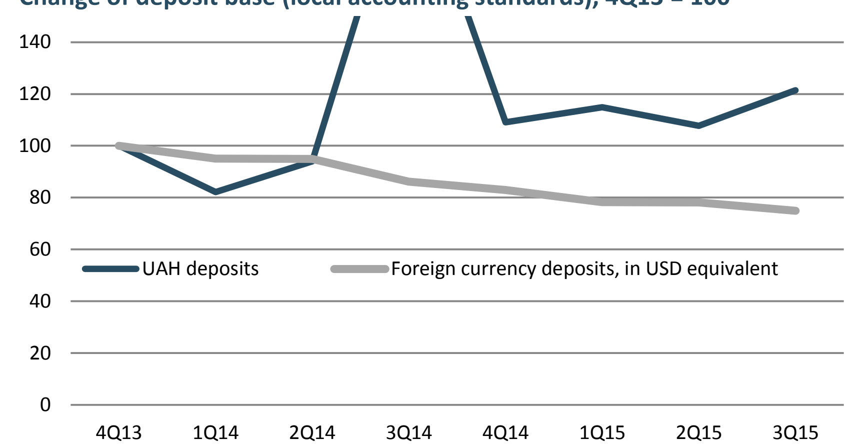
Balance Sheet, UAH mln

	2013	2014	yoy
Cash	8,321	14,661	76%
Due from banks	1,747	4,097	135%
Net loans	41,625	49,974	20%
Gross loans	50,384	73,161	45%
- Related parties	*10,070*	*14,963*	*49%*
- Individuals	*738*	*1,002*	*36%*
Securities portfolio	34,488	47,939	39%
- Related parties	*27,355*	*42,288*	*55%*
PP&E	2,287	2,252	-2%
Other assets	4,807	4,607	-4%
Total assets	**93,275**	**123,530**	**32%**
Due to banks	8,156	16,556	103%
Due to NBU	9,223	5,249	-43%
Client accounts	41,461	61,995	50%
- Current accounts	*9,882*	*15,255*	*54%*
Eurobonds outstanding	13,519	21,764	61%
Subordinated debt	3,112	6,140	97%
Other liabilities	8,348	16,807	101%
Total liabilities	**75,663**	**111,955**	**48%**
Equity	**17,612**	**11,575**	**-34%**
CAR	**28.5%**	**17.8%**	**-10.7pp**

P&L summary, UAH mln

	2013	2014	yoy
Interest income	9,244	10,096	9%
Interest costs	-5,299	-7,419	40%
Net interest income	**3,945**	**2,677**	-32%
Loan loss provisions	-2,780	-11,431	311%
Net fees and commissions	370	430	16%
Operating costs	-1,358	-3,535	160%
Profit before tax	333	-12,442	n/m
Net profit	**201**	**-11,249**	**n/m**

Change of deposit base (local accounting standards), 4Q13 = 100



Source: Bank data, Concorde Capital research

PUMB (First Ukrainian International Bank)

Bank profile

PUMB is ranked 10th by assets in Ukraine as of end-3Q15, sliding from its 9th position as of end-2013. Over the last three years, it merged with two other banks that were controlled or had been acquired by its owner Rinat Akhmetov (Dongorbank and the retail bank Renaissance Capital). PUMB specializes in corporate lending (90% of its loan portfolio) while its deposit base is split nearly 50/50 between the corporate and retail sectors. About a quarter of its depositors are related parties, according to the bank. PUMB employs the best quality investor relations standards among Ukrainian banking issuers, according to our research.

Bond restructuring came on time in 2014

The bank executed a successful restructuring of its USD 252 mln Eurobond maturing in late 2014, making just a USD 44 mln cash repayment and having received the consent of bondholders to prolong the maturity of its Eurobond. That was made on time, given PUMB's foreign currency liquidity deteriorated in 4Q14: foreign currency deposits fell by USD 150 mln in 4Q14 and by USD 267 mln in 9M15.

The bad news is the end-9M15 currency deposit base covers its outstanding Eurobonds by only 2.9x (vs. 3.9x as of end-9M14). However, the bank's stretched bond repayment schedule (USD 19.7 mln quarterly starting in Sept.'16) looks affordable at the moment: the bank only needs to increase its deposit base by about 3% qoq to accumulate enough money to repay the bond tranches.

Related parties were the core supporters of PUMB liquidity

The share of related parties was 23.1% in the bank's total deposit base as of end-1Q15, meaning that they are key contributors to the bank's liquidity. Their share decreased from 26.9% as of end-2014, although the deposits were nearly flat qoq at UAH 6.8 bln (or 1.5x more than the bank's total equity). The related party deposits can be converted into subordinated debt or equity should PUMB need a capital increase this year. The key question here is what's the share of currently troubled related parties – DTEK and Metinvest – in PUMB's deposit base (in May 2015, the bank's management estimated their total contribution at below UAH 1 bln).

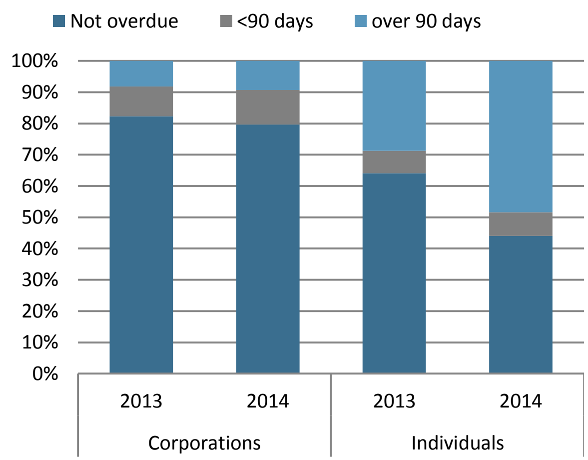
Although the bank itself sees little risk that the exposure of related parties to its deposit base can decrease, we believe the liquidity and debt troubles that have affected DTEK and Metinvest might have a negative impact on PUMB's liquidity as well.

	PUMBUZ 12'18
Price, % of par, Mar. 4	75.55
Par, USD	95.2
Implied YTM	23.1%
Outstanding, USD mln	197.6
Repayment, USD mln	**19.76** in last day of each 10 quarters: 3Q16 – 4Q18
Coupon	11.0%, Quarterly
Fitch / S&P / Moody's	NR / na / WR

Bank ownership structure

Rinat Akhmetov	99.91%
Other	0.09%

Credit quality of gross loans



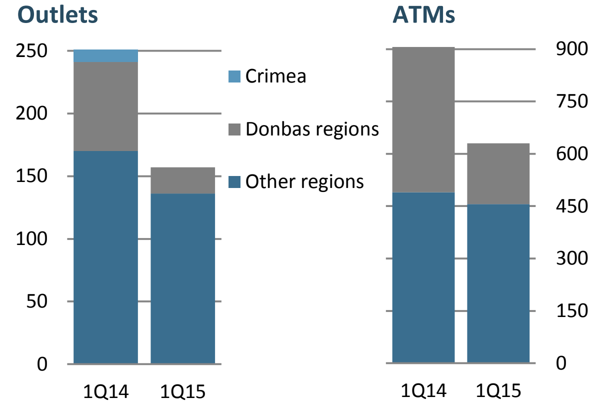
Source: Bloomberg, bank data, Concorde Capital research

Conflict in the east: doesn't look loss-making to the bank despite its high exposure to Donbas

Before Russia's military occupation of the industrial parts of the Donetsk and Luhansk regions (collectively known as Donbas), PUMB was concentrating its business on this very region, with 29% of its outlets and 46% of its ATMs located there. However, according to the bank's financial reports, its exposure to the occupied areas of Donbas is not that significant. Moreover, it reportedly has more liabilities than assets in the occupied areas of Ukraine:

- PUMB generated 14% of its total interest income in 2014 (in the period before the occupation) from its business currently located in the occupied territory. PUMB also states that a large part of businesses has shifted to the area controlled by the Ukrainian government and is being serviced there. Its net loans in occupied zone amounted to UAH 2.2 bln as of end-2014 (7.7% of the total), according to the bank.
- At the same time, occupied Donbas contributed UAH 5.0 bln to PUMB's deposit base (17.3%) as of end-1Q15. This number is consistent with the 16.9% contribution of this area to PUMB's total interest costs incurred in 2014, before the occupation.
- The bank's Crimean business was insignificant: it generated 0.65% of PUMB's interest income and 0.04% of its interest costs before the occupation in 2014.

PUMB units by regions of Ukraine, eop:



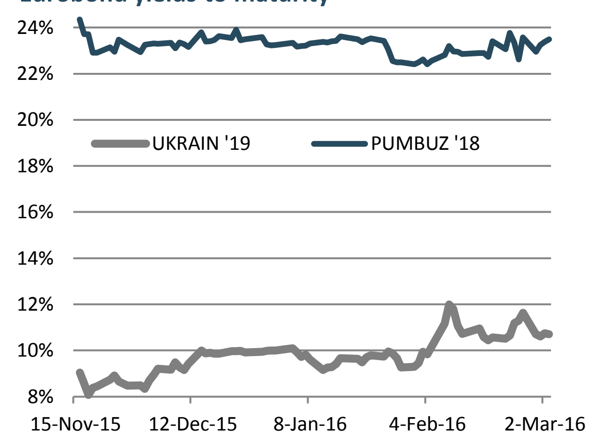
View on bonds: smoothened repayment schedule looks affordable, bond looks underpriced

The repayment schedule of the restructured Eurobond – with ten USD 19.7 mln quarterly payments starting in September – looks doable right now. At this stage, we see little risk that the bank won't be able to service its Eurobond.

Now as the payment periods are approaching, it would be more important to look at the bank's liquidity position in the upcoming months. Unfortunately, the latest available data (end-September 2015) looks not much helpful. At that date, the bank had a cash balance (USD 236 mln equivalent) that covers all the Eurobond payments. We do not expect a worsening of the bank's liquidity position in the upcoming quarters, though we expect that the bank will have to sacrifice interest margin to accumulate more dollar liquidity.

PUMB notes, yielding 23.5% to their maturity at their current price, look like the best combination of return and risk in Ukraine's fixed income universe. The main drawback of PUMB bonds is their extremely low liquidity.

Eurobond yields to maturity



Source: Bloomberg, bank data, Concorde Capital research

PUMB financial summary, IFRS

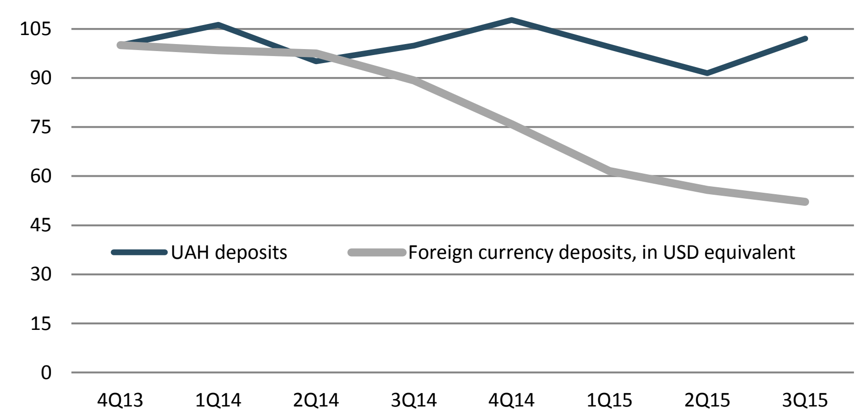
Balance Sheet, UAH mln

	2013	2014	1H15
Cash	1,337	1,054	1,148
Due from banks	3,733	3,998	3,330
Net loans	21,863	28,356	27,567
- Related parties	*703*	*1,689*	*n/a*
Gross loans	24,592	33,445	35,646
- Related parties	*705*	*1,691*	*n/a*
- Individuals	*6,826*	*7,584*	*7,809*
Net as % of gross	*89%*	*85%*	*77%*
PP&E	1,247	1,366	1,339
Other assets	3,979	2,658	1,784
Total assets	**32,159**	**37,432**	35,168
Due to other banks	1,353	244	215
Due to NBU	1,063	1,190	485
Client accounts	21,068	26,273	24,408
- Current accounts	*8,585*	*11,149*	*11,130*
- Related parties	*4,249*	*7,140*	*n/a*
Eurobonds outstanding	1,989	3,273	4,341
Subordinated debt	529	493	492
Other liabilities	1,938	671	355
Total liabilities	**26,587**	**31,900**	**30,296**
Equity	**5,572**	**5,532**	**4,871**
CAR	**24.4%**	**17.4%**	**16.4%**

P&L summary, UAH mln

	2013	2014	yoy
Interest income	3,573	4,989	40%
Interest costs	-1,848	-2,644	43%
Net interest income	**1,725**	**2,345**	36%
Loan loss provisions	-556	-2,863	415%
Net fees and commissions	775	834	8%
Operating costs	-1,389	-1,560	12%
Profit before tax	688	-173	n/m
Net profit	**555**	**-136**	**n/m**

Change of deposit base (local accounting standards), 4Q13 = 100



Source: Bank data, Concorde Capital research

Privatbank

Bank profile

Privatbank is the largest Ukrainian bank by assets, loan portfolio, deposits and network of ATMs. It holds 24% of the banking system's total client accounts, 34% of retail accounts and has provided 21% of the loans in Ukraine's banking system as of end-3Q15. It also has some operations in Latvia, Cyprus, Italy and Portugal. Privatbank completed sales of its banks in Georgia and Russia in 2014-2015. While 75% of its deposits come from individuals, it deploys 83% of its loan portfolio to corporate clients.

Insufficient capital is the biggest risk

The bank's key weakness is a high risk of insufficient capital, which seems to be rooted in its careless work with its borrowers. In particular, the bank's key shareholder, Igor Kolomoisky confessed that the NBU estimates its capital gap in the range of UAH 15-128 bln, likely being determined by stress testing that the NBU performed in mid-2015. In his interview to liga.net, the bank's CEO did not deny this estimate, only explaining that the difference stems from the possible change in estimation/recognition of collaterals for the loans. Filling the gap will require structuring the loans under new rules, according to the CEO. He added that the bank will have to shift its focus on hard collaterals.

All this implies the bank has a practice of taking something else than tangible assets as collateral for nearly all its corporate loans – corporate rights and other illiquid assets. In particular, a UAH 128 bln in the bank's losses would have appeared if it provisioned at least 82% of its gross corporate loans (UAH 174 bln as of end-1Q15), instead of 8% (provisioned at that date, based on local standards reporting). The implications are:

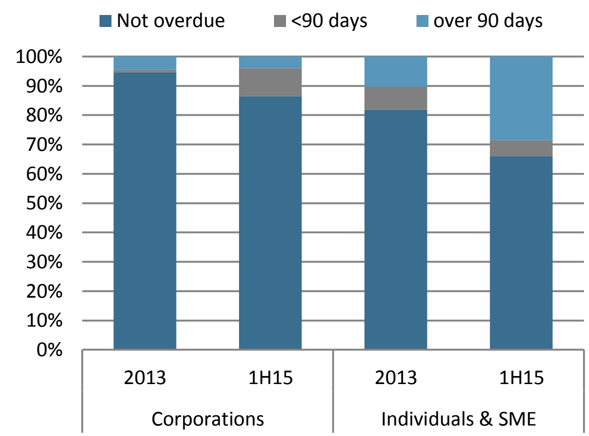
- Most of Privatbank's corporate borrowers seem to have poor financial positions (or are employing very poor reporting practices), even though they continue to almost ideally service their debt, as can be seen from the chart at the right;
- Privatbank will have a large task at hand in renegotiating almost all its loan agreements with commercial borrowers to comply with new NBU rules. That task does not seem impossible, although execution risks, counterparty risks, as well as credit risks related to such work should not be ignored.

	PRBANK 01'18	PRBANK 02'18
Price, % of par, Mar. 4	67.95	66.09
Implied YTM	35.0%	36.4%
Outstanding, USD mln	200	175
Repayment, USD mln:	**60:** Sep'17 **35:** Oct'17 **35:** Nov'17 **35:** Dec'17 **35:** Jan'18	**175:** Feb.'18
Coupon	10.25%	10.88%
Fitch / S&P / Moody's	CCC/na/WR	CCC/na/Cau

Bank ownership structure

Igor Kolomoisky	49.99%
Gennady Bogolyubov	41.59%
Other	8.42%

Credit quality of loans



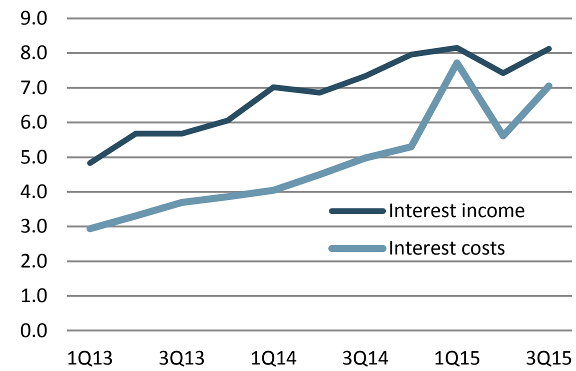
Source: Bloomberg, bank data, Concorde Capital research

Approval of capitalization plan by the NBU reduces risk

Ukraine central bank reported on Feb. 19 that it approved the capitalization plans of all the top-10 Ukrainian banks, which suggests Privatbank found common ground with the regulator. The capitalization plans are being designed for the next three years, following the results of the 2015 stress tests, according to NBU.

Privatbank's CEO said in early February that the bank's shareholders will be ready to contribute equity in 2017-2018, which means they do not intend any capital injections this year. That means short-term risks for the bank remain, especially taking into account the large task the bank will have to perform in order to improve the quality of collaterals for most of its corporate loans. In case of delay or failure in its work with borrowers, the risk of the bank's capital insufficiency would increase, which, in the worst case, could lead to its nationalization. While at this stage such risk does not look material, it should not be completely ruled out. At the same time, we see a high chance even under the worst-case outcome that the bank will be able to smoothly service its Eurobonds in 2017-2018.

Net interest income (under UAS), UAH bln



Liquidity seems to have improved recently, at the cost of higher interest

The bank was clearly suffering from a liquidity crisis in 2014 and 1H15, when it had to increase borrowing from the central bank by UAH 14.8 bln and UAH 9.6 bln, respectively. The end-1H15 refinancing from the NBU reached UAH 27.9 bln, or 11% of the bank's total assets. The interest rates on NBU refinancing reached prohibitive levels of 31.5% in the second quarter of 2015 – far above the bank's deposit rates. High refinancing rates forced the bank to more aggressively attract retail deposits, resulting in its hryvnia deposit base rising by 14% (UAH 9.2 bln) in September, as compared to March. Since May 2015, the bank has ceased tapping refinancing loans, and was even able to repay UAH 1.1 bln to the NBU in January 2016. Privatbank is going to fully repay the NBU refinancing in three years, according to its CEO.

Expectedly, as the bank is fighting a liquidity crisis, its net interest income more than halved (-57% yoy to UAH 3.3 bln in 9M15). Even worse result could emerge in the later quarters, we expect.

Loan-embedded options: hedge against devaluation, or a tool to draw profits

Privatbank issued loans of about UAH 89 bln (as of end-1H15) with embedded currency derivatives linked to the UAH/USD exchange rate. As the dollar strengthened significantly vs. the Ukrainian hryvnia, the bank generated UAH 23 bln in income from the revaluation of these derivatives in 2014-1H15. A fly in the ointment is that the bank discounts total gain from the derivatives by 82% (to UAH 27 bln as of end-1H15), which means it sees a high risk of derivatives repayment. Any increase of this risk (discount) measure, or any default on the derivatives, could negatively affect the bank's P&L and capital in the coming quarters. However in the best case scenario, proceeds from the derivatives could serve as a significant source of liquidity for the bank in 2016-2017.

Source: Bloomberg, bank data, Concorde Capital research

Exposure to occupied regions: losses unlikely

The bank's Crimean subsidiary had UAH 6.3 bln in net loans (UAH 7.5 bln in gross loans) and UAH 0.6 bln in other assets as of end-November 2014. This was more than offset by UAH 8.2 bln in deposits of Crimean residents (5.4% of all the bank's deposits). Privatbank reportedly sold its Crimean subsidiary to a related company for no cash in late 2014.

The bank's Donbas exposure looks even smaller – it reported just UAH 2.3 bln in gross loans issued to the residents of the occupied territory of Donbas (only to individuals and SME). Privatbank did not report the amount of deposits attracted from the occupied territory, and didn't report whether it's servicing such deposits. Assuming deposit amounts there were proportional to the population (as is the case for Crimea, which accounted for 5.2% of Ukraine's population), we estimate Privatbank was able to attract in occupied Donbas 7-8% of its total deposits (about UAH 11 bln).

Exposure to related parties: seems to be higher than reported

Privatbank reported UAH 24.4 bln in gross loans to related parries as of end-1H15, or 12% of its gross loan portfolio. At the same time, we suspect that exposure of the bank's gross loan portfolio to related parties (the companies linked to Kolomoisky) might be much higher.

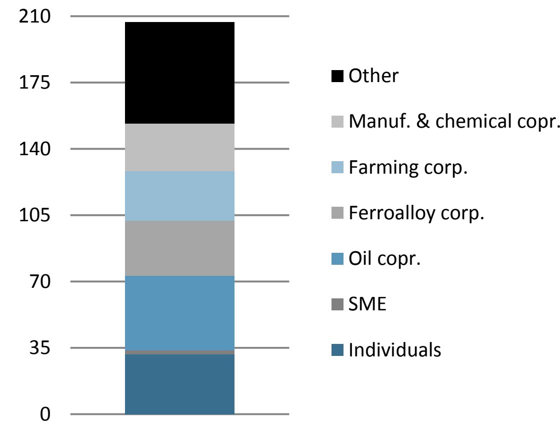
In particular, the companies of the so-called Privat Group are dominant players in industries in which 43% of the bank's gross loan portfolio has been allocated: ski resorts, football clubs, airlines, ferroalloy businesses, and the trading of oil & oil products. It's very hard for us to believe that Privatbank is actively providing loans to Privat Group's key competitors in these sectors. On the other hand, not all the businesses known as Privat Group necessarily have a formal affiliation with Privatbank or Kolomoisky.

The bank has taken commitments to the NBU to decrease its exposure to related parties (in three years) and plans to bring it to compliance with NBU rules (related loans are no more than 10% of regulatory capital) in one year, its CEO said.

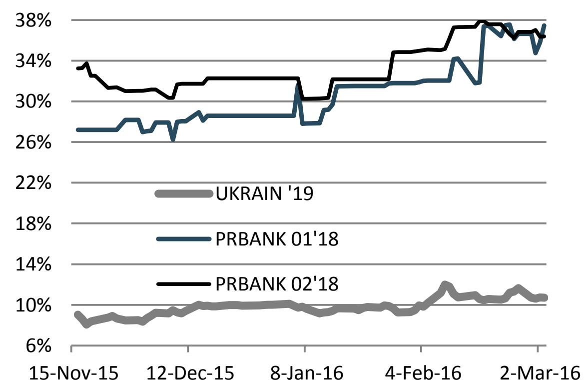
2018 Eurobonds: default risk looks low, price risk is still high

It's not a big deal for Privatbank to repay its USD 375 mln Eurobonds, which mature in September 2017-February 2018. However, the key risk for the bond stems from an unresolved capitalization issue. If its plan fails to go smoothly in 2016, its bond prices can suffer. However, with yields of 36%-37% to their maturity, the bonds could still be attractive to those ready to take short-term price risks.

Gross loan portfolio, end-1H15, UAH bln



Eurobond yields to maturity



Source: Bloomberg, bank data, Concorde Capital research

Privatbank financial summary, IFRS

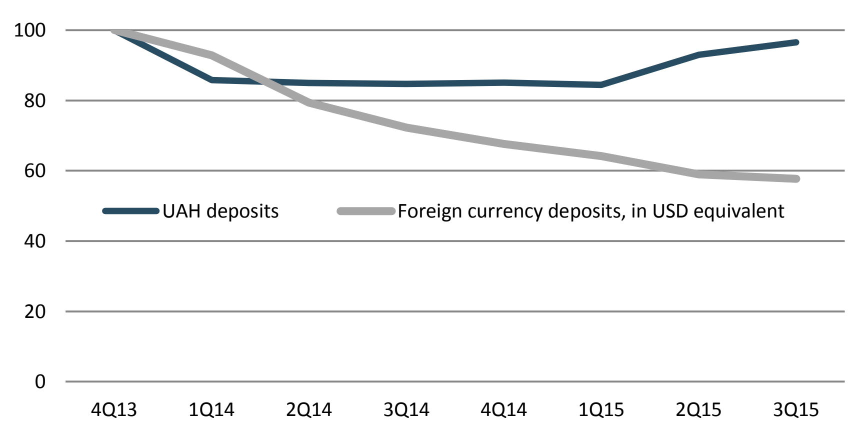
Balance Sheet, UAH mln

	2013	2014	1H15
Cash	21,827	17,801	26,638
Due from other banks	25,247	17,366	8,810
Net loans	139,663	161,830	182,659
Gross loans	*161,003*	*183,635*	*206,701*
- Individuals	*34,616*	*30,385*	*31,451*
- Related parties	*9,617*	*18,530*	*24,442*
Net as % of gross	*87%*	*88%*	*88%*
Loan-embedded derivatives	3,816	19,978	26,950
PP&E	4,004	4,098	4,141
Other assets	3,013	7,963	4,524
Total assets	**197,570**	**229,036**	**253,722**
Due to other banks	3,758	3,279	3,098
Due to NBU	3,473	18,357	27,926
Client accounts	150,888	152,053	174,809
- Current accounts	*41,208*	*46,009*	*56,230*
Eurobonds outstanding	2,989	5,874	7,938
Subordinated debt	3,308	5,450	8,615
Other liabilities	10,330	18,290	3,126
Total liabilities	**174,746**	**203,303**	**225,512**
Equity	**22,824**	**25,733**	**28,210**
CAR (Basel)	**15.6%**	**13.7%**	n/a

P&L summary, UAH mln

	2013	2014	yoy
Interest income	23,144	25,624	11%
Interest costs	-14,429	-18,366	27%
Net interest income	**8,715**	**7,258**	**-17%**
Loan loss provisions	-3,891	-4,689	21%
Net fees and commissions	3,671	3,558	-3%
Gain from embedded derivatives	332	6,722	n/m
Operating costs	-8,259	-9,948	20%
Profit before tax	1,491	149	-90%
Net profit	**1,307**	**247**	**-81%**

Change of deposit base (local accounting standards), 4Q13 = 100



Source: Bank data, Concorde Capital research

Disclaimer

THIS REPORT HAS BEEN PREPARED BY CONCORDE CAPITAL INVESTMENT BANK INDEPENDENTLY OF THE RESPECTIVE COMPANIES MENTIONED HEREIN FOR INFORMATIONAL PURPOSES ONLY. CONCORDE CAPITAL DOES AND SEEKS TO DO BUSINESS WITH COMPANIES COVERED IN ITS RESEARCH REPORTS. AS A RESULT, INVESTORS SHOULD BE AWARE THAT CONCORDE CAPITAL MIGHT HAVE A CONFLICT OF INTEREST THAT COULD AFFECT THE OBJECTIVITY OF THIS REPORT.

THE INFORMATION GIVEN AND OPINIONS EXPRESSED IN THIS DOCUMENT ARE SOLELY THOSE OF CONCORDE CAPITAL AS PART OF ITS INTERNAL RESEARCH COVERAGE. THIS DOCUMENT DOES NOT CONSTITUTE OR CONTAIN AN OFFER OF OR AN INVITATION TO SUBSCRIBE FOR OR ACQUIRE ANY SECURITIES. THIS DOCUMENT IS CONFIDENTIAL TO CLIENTS OF CONCORDE CAPITAL AND IS NOT TO BE REPRODUCED OR DISTRIBUTED OR GIVEN TO ANY OTHER PERSON.

CONCORDE CAPITAL, ITS DIRECTORS AND EMPLOYEES OR CLIENTS MIGHT HAVE OR HAVE HAD INTERESTS OR LONG/SHORT POSITIONS IN THE SECURITIES REFERRED TO HEREIN, AND MIGHT AT ANY TIME MAKE PURCHASES AND/OR SALES IN THEM AS A PRINCIPAL OR AN AGENT. CONCORDE CAPITAL MIGHT ACT OR HAS ACTED AS A MARKET-MAKER IN THE SECURITIES DISCUSSED IN THIS REPORT. THE RESEARCH ANALYSTS AND/OR CORPORATE BANKING ASSOCIATES PRINCIPALLY RESPONSIBLE FOR THE PREPARATION OF THIS REPORT RECEIVE COMPENSATION BASED UPON VARIOUS FACTORS, INCLUDING QUALITY OF RESEARCH, INVESTOR/CLIENT FEEDBACK, STOCK PICKING, COMPETITIVE FACTORS, FIRM REVENUES AND INVESTMENT BANKING REVENUES.

PRICES OF LISTED SECURITIES REFERRED TO IN THIS REPORT ARE DENOTED IN THE CURRENCY OF THE RESPECTIVE EXCHANGES. INVESTORS IN FINANCIAL INSTRUMENTS SUCH AS DEPOSITORY RECEIPTS, THE VALUES OR PRICES OF WHICH ARE INFLUENCED BY CURRENCY VOLATILITY, EFFECTIVELY ASSUME CURRENCY RISK.

DUE TO THE TIMELY NATURE OF THIS REPORT, THE INFORMATION CONTAINED MIGHT NOT HAVE BEEN VERIFIED AND IS BASED ON THE OPINION OF THE ANALYST. WE DO NOT PURPORT THIS DOCUMENT TO BE ENTIRELY ACCURATE AND DO NOT GUARANTEE IT TO BE A COMPLETE STATEMENT OR SUMMARY OF AVAILABLE DATA. ANY OPINIONS EXPRESSED HEREIN ARE STATEMENTS OF OUR JUDGMENTS AS OF THE DATE OF PUBLICATION AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART WITHOUT PRIOR PERMISSION IS PROHIBITED.

NEITHER THIS DOCUMENT NOR ANY COPY HEREOF MAY BE TAKEN OR TRANSMITTED INTO THE UNITED STATES OR DISTRIBUTED IN THE UNITED STATES OR TO ANY U.S. PERSON (WITHIN THE MEANING OF REGULATION S UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”)), OTHER THAN TO A LIMITED NUMBER OF “QUALIFIED INSTITUTIONAL BUYERS” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) SELECTED BY CONCORDE CAPITAL.

THIS DOCUMENT MAY ONLY BE DELIVERED WITHIN THE UNITED KINGDOM TO PERSONS WHO ARE AUTHORIZED OR EXEMPT WITHIN THE MEANING OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (“FSMA”) OR TO PERSONS WHO ARE OTHERWISE ENTITLED TO RECEIVE THIS DOCUMENT UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005, OR ANY OTHER ORDER MADE UNDER THE FSMA.

Contacts

2 Mechnikova Street, 16th Floor
Parus Business Centre
Kyiv 01601, Ukraine
Tel.: +380 44 391 5577
Fax: +380 44 391 5571
www.concorde.ua
Bloomberg: TYPE CONR <GO>

CEO
Igor Mazepa im@concorde.com.ua

SALES & TRADING

Alexandra Kushnir ak@concorde.com.ua
Marina Martirosyan mm@concorde.com.ua
Yuri Tovstenko ytovstenko@concorde.com.ua
Alisa Tykhomirova at@concorde.com.ua

RESEARCH

Head of Research
Alexander Paraschiy ap@concorde.com.ua

Macro, Utilities, Financial, Consumer
Alexander Paraschiy ap@concorde.com.ua

Basic Materials, Consumer
Roman Topolyuk rt@concorde.com.ua

Editor, Politics
Zenon Zawada zzawada@concorde.com.ua