Focus	Scope	Sector	Analyst
Ukraine	**Debt market**	**Banks**	**Mykhaylo Demkiv**

Ukreximbank

Eurobond restructuring offer

WEDNESDAY, 22 APRIL 2015

Ukreximbank seeks to extend EXIMUK15 by seven years with no haircut and with a higher coupon rate. As the current proposal is significantly more appealing to the bondholders, the high probability of reaching an agreement should open talks for other bond restructurings. If no extension or restructuring is achieved, this could result in a default.

Eurobond restructuring offer

Ukreximbank submitted a second offer to extend the maturity of its US$750m Eurobond by three months as the previous offer was not accepted due to the lack of the two-thirds quorum mandated to vote. The adjourning meeting, scheduled for 27 April 2015, will now require a quorum of only one-third of the outstanding debt (US$250m) instead of two-thirds (US$500m) with 75% of those present to vote in favour for the resolution to pass. The main purpose of this postponement is to gain extra time to negotiate a much longer reprofiling.

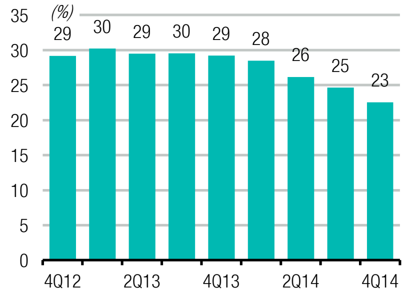
The bank seeks a seven-year extension. Half of the principal (US$375m) is due in three years on 27 April 2019 with the remainder be paid in six equal instalments beginning on 27 October 2019. The bank also has offered to increase the coupon rate from the current 8.375% to 9.625%, effective 27 April 2015.

The restructuring terms will also add a new event of default to the current terms. The bank will be in default should local FX bonds exceed 12.5% of its total assets. According to our estimates, total domestic FX government bonds comprise 21.1% of the bank's total assets as of March 2015.

IMF requirement. The IMF program's balance of payments objective, known as Target 1, is the key driver of the restructuring. The aim is to save US$15.3bn in public sector financing from external debt payments on the sovereign, sovereign-guaranteed and state-owned entities. As Ukreximbank falls into the third category, it is ineligible for a haircut of principal that would be granted to institutions in the first two categories.

The bank itself has only part of the US dollar liquidity necessary for the repayment. According to our estimates, although Ukreximbank has at least US$0.5bn of cash, much of this amount might have restricted use. As we estimate that US$1.4bn, a significant portion of its FX-denominated assets, is comprised of local government bonds, the repayment of the Ukreximbank Eurobond in 2015-2018 would violate the IMF EFF Target 1.

Regulatory capital adequacy ratio (UAS)



Source: Bloomberg.

Key financials and ratios

	2013 IFRS	2014 IFRS	3Q14 UAS	3Q14 UAS
Financials (UAHm)				
Assets	93,275	123,530	131,527	126,000
Loans	41,625	49,974	51,088	52,094
Deposits	41,461	61,995	74,025	60,126
Equity	17,611	11,576	13,971	13,536
Net % income	3,945	2,668	4,117	4,629
Net com income	370	429	535	589
Operating inc.	4,471	2,524	7,633	8,258
PPI	3,120	-1,011	6,108	6,448
LLP	-2,786	-11,431	-9,944	-17,197
Net income	201	-11,249	-3,892	-9,806
Ratios (%)				
Tier 1 ratio	23.7	12.1	N/a	N/a
CAR	28.9	17.8	24.6	22.6
Equity-to-assets	18.9	9.4	10.6	10.7
Net loan-to-deposit	100.4	80.6	69.0	86.6
Cash-to-liabilities	12.0	15.0	12.3	13.4
ROAA	0.2	-10.4	-3.5	-8.3
ROAE	1.1	-77.1	-22.8	-61.5
Net % margin	5.7	3.0	4.4	4.7
NII-to-op income	88.2	106.1	53.9	56.1
Cost-to-income	30.2	140.9	20.0	21.9
LLR	17.4	31.7	24.8	32.0
NPLs	31.1	48.4	N/a	N/a
NPL coverage	55.9	65.5	N/a	N/a

Notes: P&L figures and ratios are on a 12-month annualised basis; CAR – capital adequacy ratio (Basel IFRS accounts and NBU R2 UAS accounts); PPI – pre-provision income LLP – loan loss provision; ROAA and ROAE – return on average assets and equity, respectively; NII – net interest income; LLR – loan loss reserves; NPL – non-performing loans (>90 days overdue). Sources: Bank data, ICU.

Consequences of no resolution. Should a resolution fail to be passed, authorities have stated that Ukreximbank will probably default on the repayment due on 27 April. Otherwise, the bank is ready to pay the coupon in full (US$31.4m). In our view, Ukreximbank will chose to default on its obligations if an extension is not approved or if a restructuring is not reached.

Two other outstanding securities - Subordinated Eurobonds due February 2016 and the Eurobonds due January 2018 - are currently outside the restructuring process. However, the IMF program specifically includes both of them in Target 1. Because of this, we do not expect principal repayments of these securities prior to 2019.

Ukreximbank financials

Record loss. The bank finished 2014 with a UAH9.8bn net loss in accordance with local accounting standards (UAH11.2bn according to the IFRS), attributable mostly to the deterioration of the loan portfolio (UAH11.4bn of loan provisioning expenses) and losses from the FX devaluation (UAH4.3bn).

The share of bad credit exposure has reached 34.0% in 4Q14 with LLR coverage of 71.9% which has been rising for nine consecutive quarters.

Moderate liquidity drain. Ukreximbank in 2014 lost deposits: down 0.6% YoY in the corporate sector and 13.1% YoY in the retail sector, net of the revaluation effect. This result is much better than the sector's average declines of 9.4% YoY and 29.4% YoY, respectively. While the bank managed to increase local currency outstanding by UAH1.bn (+9.1% YoY), FX deposits shrank by US$0.5bn (-17.0%). The outflow of hard currency from deposit accounts has continued in 1Q15.

In addition, the bank has decreased the amount due to foreign banks, including the outstanding corresponding accounts. In our opinion, the ongoing hard currency drain weakens Ukreximbank's ability to repay the Eurobond.

Securities exposure. Local government bonds comprise 28.8% of Ukreximbank's total assets, according to our estimates. This ratio has been constantly growing due to the revaluation effect as nearly 75% of the portfolio is denominated in FX. However, the bank has little possibility to sell these bonds on the secondary market due to the limited amount of FX liquidity in other Ukrainian banks. In addition, Ukreximbank owns nearly 40.4% of the total outstanding local government bonds in foreign currency, according to our estimates.

Government support. Ukreximbank has received a UAH5.0bn capital inflow in December to cover incurred losses and to bolster the bank's capitalization. As of December 2014, the capital adequacy ratio was 22.6%, in accordance with local accounting standards, and 18.5%, in accordance with IFRS. Authorities have expressed their willingness to provided additional support to Ukreximbank if required. However, this assistance can be UAH-denominated, avoiding any strain on its ability to repay its FX obligations.

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Disclosures

ANALYST CERTIFICATION

This research publication has been prepared by the analyst(s), whose name(s) appear on the front page of this publication. The analyst(s) hereby certifies that the views expressed within this publication accurately reflect her/his own views about the subject financial instruments or issuers and no part of her/his compensation was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views within this research publication.

EQUITY RATING DEFINITIONS

Buy: Forecasted 12-month total return greater than 20%

Hold: Forecasted 12-month total return 0% to 20%

Sell: Forecasted 12-month total return less than 0%

Note: total return is share price appreciation to a target price in relative terms plus forecasted dividend yield.

DEBT RATING DEFINITIONS

Buy: Forecasted 12-month total return significantly greater than that of relevant benchmark

Hold: Forecasted 12-month total return is in line with or modestly deviates from relevant benchmark

Sell: Forecasted 12-month total return significantly less than that of relevant benchmark

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