

The Role of Private Equity Funds in Stability Renewal

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Outline

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Emerging Europe Growth Fund II, LP	\$390 million
Emerging Europe Growth Fund I, LP	\$132 million
Western NIS Enterprise Fund	<u>\$150 million</u>

- Investors: US, Western Europe, IFIs
- Investment Region: Ukraine, Moldova, Belarus
- Investment horizon: up to five years
- Current new investment size: \$15-40 million
- Ability to attract investments from third parties

Value Added Investments

- Transparent relationships with our portfolio companies based on mutual trust and respect
- International standards of corporate governance, management, and reporting
- Invest based on business fundamentals
- Focus energy on strategic development and growth
- Orientation on profitable exit

Stability: Investor View Before the Crisis

- Focus on growth
 - ❑ Capturing market share
 - ❑ Growing the balance sheet
 - ❑ Every customer is a good customer
 - ❑ Expanding branch network
- Focus on [quick] sale
 - ❑ Price/Book multiple as a transaction driver
 - ❑ Ukrainian market viewed as a “must have” for Western European banks
 - ❑ Global asset price bubble caused by excess liquidity
 - ❑ Use of high leverage by banks worldwide
- Result: unsustainable market
 - ❑ Fragmented
 - ❑ Over-branched in many regions
 - ❑ Questionable assets

As boundless optimism and quick profit opportunities gave way to...

Stability Redefined

- Industry landscape has changed
 - ❑ Re-pricing of risk globally and locally
 - ❑ Reduced lending - > Shrinking balance sheets
 - ❑ Low transparency in restructuring operations and reserving policies

- The role of the government has changed
 - ❑ Emergence of state-owned banks, growing government influence
 - ❑ Stronger regulatory framework, i.e. restrictions on operations
 - ❑ Higher capital requirements -> lower margin -> lower ROE

- Overall strategy has changed
 - ❑ Focus on [quality] earnings
 - ❑ Focus on portfolio quality
 - ❑ Identifying niche market share and staying focused
 - ❑ Importance of cross-selling
 - ❑ Control of devaluation and deposit flight risks
 - ❑ Cost-controls, procedures, IT

...a changed view of how to think about a portfolio bank....

What Should Winning Banks Do

- Market strategy for healthy banks
 - ❑ Focus on portfolio quality: RISK MANAGER IS KING
 - ❑ Capture best customers within chosen market segments
 - ❑ Demonstrate stability

- Management priorities
 - ❑ Understand product and customer profitability
 - ❑ Focus on capitalization
 - ❑ Focus on liquidity
 - ❑ Improve corporate governance / mid-level management team
 - ❑ Improve collections
 - ❑ Hedge currency exposure to the extent possible

- Prepare for a protracted de-leveraging cycle

Investors have a different message at the Board level, and...

What Should Regulators Do

➤ Build credibility

- Build confidence in deposit insurance
- Communicate quickly and widely
- Deal fairly

➤ Cleanse the system

- Make sure banks' Balance Sheets do not have dead loans
- Develop a bankruptcy process
- Create a workable framework for collections agencies
- Separate banks into good and bad
- Develop transparent recapitalization and/or temp support mechanisms

➤ Encourage consolidation

... a message of urgency for the regulators.

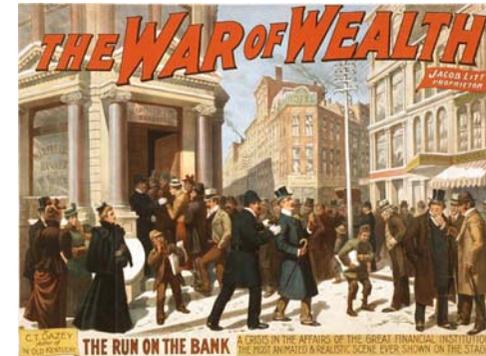
Where Can We Turn for Lessons?

- Argentina: 2001-2002
 - ❑ A decade of strong growth helped by fixed exchange rate is interrupted by global recession leading to large current deficits
 - ❑ Deposit freezes led to street violence and government ouster

- Sweden: 1992
 - ❑ Sweden's banking crisis was resolved by government's taking on "bad assets". All shareholders were diluted.
 - ❑ A case study in transparency

- Japan: Late 1980s
 - ❑ An asset bubble and government's failure to clean banks' balance sheets led to a "lost decade"

- US "Bank Holiday": 1933
 - ❑ All banks were closed for five days; only good ones re-opened. The confidence in the system was restored



Broadway 1896

Our Expectations

- Ukraine will remain a “must have” market, especially for banks from countries that are major trading partners and banks with CEE retail strategy
- US will lead the global recovery
- Multiples will come down globally

- What can go wrong
 - ❑ Quantitative easing leading to runaway inflation and more deposit runs
 - ❑ Deteriorating portfolio quality, no Chapter 11 framework, and no government “bad banks” lead to dead banks (Japan)
 - ❑ Untested deposit insurance scheme leads to a further loss of credibility in the system
 - ❑ Budget deficits cause IMF to withdraw its support, leading to more difficulties in attracting foreign investors and slower growth