

Financial Services Overview

Banking sector. Ukraine's financial services industry accelerated its expansion in 2005, attracting growing interest from foreign investors. The banking sector's interest revenues surged by 48% y-o-y last year as retail and mortgage lending tripled. Consolidation trends in the industry became more pronounced after two of the leading banks, Aval and Ukrsibbank, were acquired by foreign strategic investors: Raiffeisen International bought a 93.5% stake in Aval for USD 1.03 bil. and BNP Paribas acquired 51% of Ukrsibbank for an undisclosed price. In February 2006, Italy's Banca Intesa announced that it had reached an agreement with the shareholders of Ukrspbank to purchase 85.4% of the bank's shares for USD 1.12 bil., implying a market capitalization of USD 1.31 bil., or 5.3x 2005 book value.

Insurance sector. Reform of the regulatory environment made the insurance market more transparent, decreasing the share of insurance companies used as tax-optimization vehicles. Our estimates show that actual insurance premiums increased by 40% y-o-y in 2005, with the market size reaching almost USD 1 bil. One of the driving forces behind this growth was new legislation passed in 2005 making auto insurance mandatory for all vehicle owners. We estimate that this law brought USD 85 mil. (30% of the 2005 y-o-y increase) in new revenues to the industry. Life insurance is yet to be required in order to take a mortgage loan, but we expect that this sub-sector of the insurance industry will also see a large jump should such legislation be passed. A number of foreign insurers entered the market through acquisitions, but more local companies are looking to establish cooperation with foreign strategic investors. Several of Europe's leading financial services companies, such as PPF Group, UNIQUA, BNP Pariba, and Fortis have announced plans to enter the Ukrainian insurance market by the end of 2006.

Leasing. In Ukraine, leasing remains underdeveloped, promising strong growth potential for large foreign players thanks to low competition and growing domestic demand for leasing services. In 2005 the country's leasing portfolio increased by 142%, reaching USD 400 mil. or 2.6% of total capex investments (far below 17% on average in the euro zone in 2004). The number of companies that provide leasing services more than doubled in 2005, reaching 106 companies. There are currently just a few strong players in the market, such as Euro Leasing, Hertz, Avis and Ilta, and they are working mainly in the car leasing sector; therefore, banks are still major players and have around a 60% market share. Based on IFC research, 13% of companies operating in Ukraine were interested in using leasing services in 2005-2006. The main reasons for unsatisfied demand are the relatively short lease terms (2-3 years), almost no presence at regional level and high interest rates, which still force companies to go for loans instead of leasing. We expect leasing to increase in 2007 as new leasing legislation is expected that will dramatically reduce taxes for leasing companies and will likely result in lower leasing costs. Cars have a 21% share of the product portfolio, while planes have a 29% share and trucks a 24% share. Driven by strong development upside and increasing demand from Ukrainian companies, multinationals are planning to enter the market as early as 2006. Because leasing remains primarily undeveloped, the pool of potential M&A targets is poor. Thus, foreign leasing companies entering the Ukrainian market continue to develop from scratch.

Financial markets. Ukraine remained among the world's best performing emerging stock markets in 2005 as local equities continued to advance at a double-digit pace. Annual trading volume on the country's principal stock exchange, PFTS, grew more than five-fold, to USD 670 mil. (this figure does not include turnover in Ukrainian ADRs and GDRs and over-the-counter deals). Last year was also marked by debut Ukrainian IPOs. In particular, real estate developer XXI Century raised USD 138 mil. and leading domestic retailer Velyka Kyshenya attracted USD 27.5 mil. from foreign investors in December 2005.

Banking Sector: Regional Growth Leader

The Ukrainian banking sector is a growth leader in the CEE region. In 2001-05, local banks increased lending to corporate and retail customers by an impressive 44% and 123% p.a. on average. In 2005 alone, loans to corporates jumped by 48%, to USD 21.6 bil., and retail lending surged by 124%, to USD 6.6 bil. At the same time, strong growth trends, in both corporate and

Ukraine

Financial services sector is growing robustly, attracting strong interest from foreign investors

2005 insurance premiums increased by 40%

Leasing is still underdeveloped, promising strong growth potential

Stock trading volume surged five-fold in 2005; debut IPOs completed

Tremendous growth potential as banking assets stood at only 53.2% of 2005 GDP...

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retail lending markets, are sustainable as the domestic banking sector's total assets stood at only 53.2% of 2005 GDP.

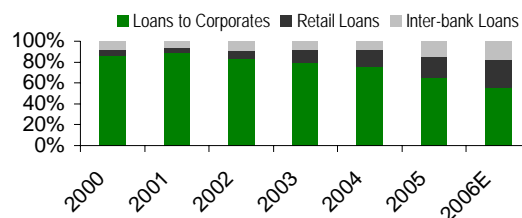
Total banking assets increased by 59%, to USD 42.4 bil., in 2005 thanks to strong growth in both corporate and retail lending. Banks' total liabilities increased by 71% y-o-y, to USD 37.3 bil., driven by a 79% surge in private deposits, to USD 14.6 bil., and an 84% increase in corporate deposits, to USD 14.6 bil. The sector's end-2005 equity totaled USD 5.0 bil., up 45% y-o-y.

...despite expanding by 59% in 2005



Loan Portfolio Composition (USD bil.)

Source: NBU, Dragon Capital



Loan Portfolio Structure

Source: NBU, Dragon Capital

Ukrainian banks increased 2005 interest revenues and expenses by 48% y-o-y, to USD 3,768 mil. and USD 2,160 mil. respectively, bringing 2005 net interest income to USD 1,608 mil. They also reported net fees and commissions of USD 1,143 mil. (up 31.8%), posting net income of USD 430 mil. (up 81% y-o-y), which implies ROA and ROE of 1.2% and 10.1% respectively.

The banking sector's 2005 NI surged 81% y-o-y, to USD 430 mil.

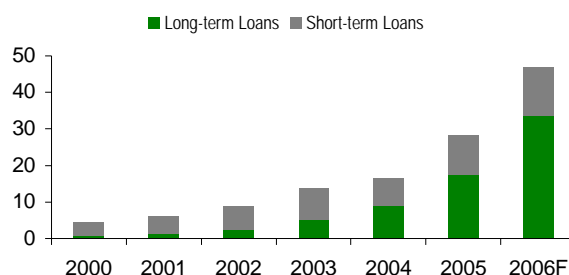
Lending boom

Ukrainian banks have sharply increased lending since the country's economic recovery began in 2000. In 2001-05, lending to corporates, retail loans and inter-bank lending expanded by an impressive 44%, 123% and 94% p.a. on average.

Retail lending is the most attractive growth segment

A stable hryvnia and relatively low inflation provided for a whopping 2,246% growth in long-term lending since 2000. As of end-2005, 72% of all short-term loans were in hryvnia, compared with 53% for long-term loans (over 1 year). Long-term loans accounted for 62% of total loans as of end-2005 compared with 18% in 2000.

Long-term loans prevail



Loan Breakdown (USD bil.)*

Note: * Gross commercial loans, excluding inter-bank: Source: NBU, Dragon Capital

Corporate lending

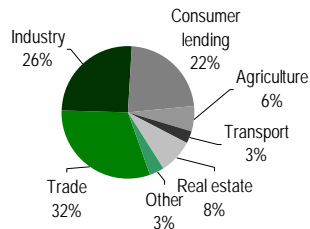
Lending to corporates still accounts for a dominant share in total bank lending. Based on 10M05 results, the most capital-demanding industry was trade, with 32% of total lending portfolio. Industry and consumer lending followed with 26% and 22% respectively. Lending for real estate and consumer finance projects increased by 84% and 102% respectively in 10M05 compared with 10M04.

Lending to corporates dominates

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Due to increasing competition, corporate lending has started to become more specialized. Agio Bank, recently acquired by Swedish SEB, and ProcreditBank are among the few banks which are providing credit mainly to small and medium business. While the SME segment has proven to be highly profitable, it also requires greater operational expertise and flexibility in order to manage a higher number of smaller-sized loans. Thus, ProCreditBank was able to increase net interest income by 67%, to USD 15.4 mil., in 2005, outperforming industry growth of 48%. On the other hand, Agio Bank only raised net interest income by 10% last year.

Corporate lending business becomes segmented



Loan Breakdown by Sector (10M05)

Note: * Gross commercial loans, excluding inter-bank; Source: NBU, Dragon Capital

Consumer lending

In 2005 retail lending accelerated by an impressive 124%, to USD 6.4 bil., rising to 20% of the sector's overall loan portfolio from 15% in 2004.

Retail lending accelerated by 124%

Mortgage lending was an even more dynamic segment in 2005 as Ukrainian banks more than tripled their mortgage portfolio, to USD 2.1 bil. Its share of GDP increased from 1% to 2.5%, which still provides a big upside for further growth. Privatbank is the largest bank in Ukraine, so its leadership in consumer and mortgage lending is not surprising. A developed branch network is key to success in this business.

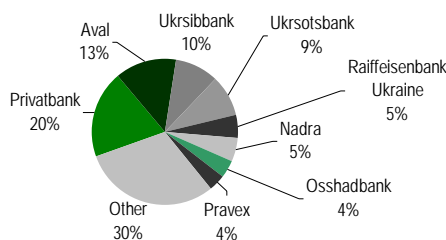
Mortgage lending more than tripled

The top-5 players in the retail lending sector have a 57% market share. In the mortgage lending sector, the top-5 banks control almost 64% of the market. These two banking sub-sectors are expected to grow considerably over the next few years due to an increasing middle class and a still relatively low base. By the end of 2005, only 14 banks had a mortgage portfolio of more than USD 20 mil.

Clear positioning becomes key to success...

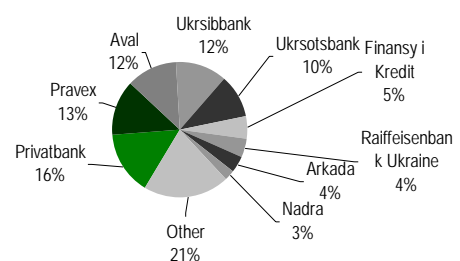
Banks increasingly tend towards specialization and no longer try to encompass a full range of banking services. For example, Pravex Bank, being only 24th in terms of assets, is 8th by retail lending volume and 2nd by mortgage lending in Ukraine. The International Mortgage Bank (IMB) is another good example. Launched just a year ago with one outlet in Kyiv, IMB was able to gain a 0.5% market share in the mortgage segment thanks to clear positioning and well-developed product portfolio. Specialization is thus a good strategy for smaller banks seeking to gain market share in a particular segment.

...especially for smaller banks



Retail Loans Breakdown (2005)

Source: Banking Association of Ukraine, Dragon Capital



Mortgage Loans Breakdown (2005)

Source: Ukrainian Mortgage Association, Dragon Capital estimates

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Industry Trends and Forecast

Looking ahead, we expect the strong earnings growth witnessed by the sector in 2004 and 2005 to continue through 2008. Although the central bank's recent attempts to tighten liquidity in the sector, along with political uncertainty ahead of parliamentary elections and weaker macroeconomic environment, might put short-term pressure on banks' margins, we believe strong growth trends in the sector are quite sustainable in the medium-to-long run, being pushed mainly by the retail segment. In 2006, we expect the banking sector's net interest income to increase by up to 40% y-o-y, in line with growth in net fees and commissions, to USD 2.2 bil., and net profit to total USD 0.6 bil. The sector's ROE is expected to stay around last year's average of 10%.

Banks to maintain profitability achieved in 2005

We expect domestic banks to maintain strong lending growth in 2006-07 on the back of the continuing economic expansion and growing disposable incomes. Retail lending currently stands at only 8.1% of GDP (far below 58.5% on average in the euro zone), representing the most attractive growth segment in the Ukrainian banking sector.

Growth rates are sustainable

Consolidation in the banking sector will continue as a number of banks from the top ten list are currently negotiating with foreign acquirers. Corporate lending will offer more client-oriented solutions including relatively undeveloped products like factoring. As consumer retail remains the fastest growing segment and continues to offer immense growth potential, banks are expected to focus, in particular, on credit card business, regional expansion and the launch of new sales points at retail outlets. Competition for the most mobile and financially savvy part of the middle class will increase. Once bank deposits become less attractive for consumers, with foreign banks' expansion set to reinforce this trend, local banks will try to offer alternative investment opportunities, such as investment funds or corporate securities.

Competition will increase, stimulating new client-oriented solutions

Ukraine's Top 27 Banks*

Bank	Headquarters	Net Assets (USD mil.)	Change (y-o-y; %)	Equity (USD mil.)	Change (y-o-y; %)	Net income (USD mil.)	Change (y-o-y; %)	ROE (%)
	Dniprope							
Privatbank	trovsk	4,368	58%	450	63%	94	204%	6.5%
Bank Aval	Kyiv	3,814	71%	346	41%	4	12%	0.3%
Prominvestbank	Kyiv	2,889	45%	271	23%	44	90%	4.5%
Ukrsotsbank	Kyiv	2,131	60%	203	19%	23	44%	3.1%
Ukrsibbank	Kyiv	2,113	98%	188	34%	11	50%	1.7%
Ukreximbank	Kyiv	2,055	106%	211	82%	36	110%	5.5%
							1,231	
Oshchadbank	Kyiv	1,884	100%	154	129%	4	%	0.9%
Raiffeisenbank Ukraine	Kyiv	1,396	68%	124	85%	17	286%	4.3%
Bank Nadra	Kyiv	1,173	60%	109	58%	5	14%	1.5%
Brokbusinessbank	Kyiv	944	83%	120	67%	4	64%	1.0%
Finance and Credit	Kyiv	876	103%	97	169%	3	21%	1.1%
Ukrprombank	Kyiv	814	82%	125	9%	5	94%	1.0%
Forum Bank	Kyiv	743	116%	73	78%	6	81%	2.8%
	Donetsk,							
FUIB	Kyiv	708	90%	97	30%	11	65%	3.2%
Khreschatyk	Kyiv	623	76%	48	40%	4	83%	2.5%
Kredytprombank	Kyiv	575	119%	67	68%	6	101%	2.6%
ING	Kyiv	512	70%	44	36%	10	128%	6.6%
Ukrgazbank	Donetsk	473	76%	43	53%	3	38%	2.3%
VABank	Kyiv	466	91%	59	244%	3	99%	2.0%
Pivdenny	Odesa	456	52%	52	67%	5	51%	3.0%
Industrial								
Export Bank	Kyiv	439	103%	37	64%	3	128%	2.7%

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Dongorbank	Donetsk	424	53%	59	39%	15	66%	7.3%
Alfa-bank	Kyiv	422	122%	40	-28%	1	163%	0.3%
Pravex-Bank	Kyiv	420	36%	35	28%	4	154%	3.1%
Kredyt Bank								
Ukraine	Lviv	402	58%	31	12%	2	42%	1.8%
TAS-								
Commerzbank	Kyiv	401	126%	53	105%	2	7%	1.2%
Mriya	Mriya	382	101%	45	87%	8	33%	5.7%

Note: * Ranked by end-2005 total assets; Source: Banks, NBU, Dragon Capital