

Ukrainian Stock Market: Performance in 2011 and Outlook for 2012

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The Ukrainian stock market has long been known for its roller-coaster moves. At least once every five years Ukrainian equities rank among the best performers in the world; yet, the same applies to the downside movements. In 2004, Ukraine's PFTS Index rose a stellar 204%; in 2008 it slid down by 74%. In 2011, the Ukrainian stock market continued to show volatile trends; and as of November, the PFTS Index lost 42% hitting the bottom levels unseen since late 2009. Such steep swings in the value of Ukrainian equities are driven primarily by the market's poor liquidity, which, however, is likely to improve along with still ailing corporate and public governance.

Rising market profile impaired by persisting problems

One of the remarkable events on the Ukrainian stock market was the emergence of local retail investors whose number exceeded ten thousand at the end of 2011. This became possible thanks to the launch of the anonymous order-driven market by the Ukrainian Exchange in 2009, which quickly prevailed over the stagnating quote-driven system relied on by the PFTS Exchange. Taking advantage of the low-cost online trading, local investors began filling the gap left by foreign institutional investors, who fled the Ukrainian stock market during the 2008 financial crisis. Equity trading volumes began to recover, while the paid market-making program offered by the Ukrainian Exchange softened the market volatility. Yet, in August 2011 the fledgling stock market again nearly failed the test posed by the unraveling European credit crisis. In a matter of

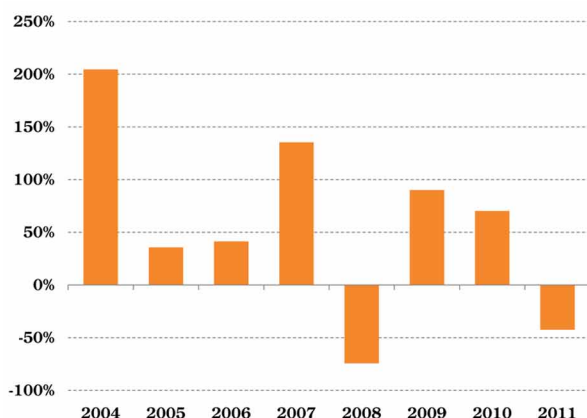
several weeks, the main Ukrainian equity index lost over 50%, while the average daily stock trading volume plummeted by 70% from UAH 87m in 1Q 2011 to UAH 27m in October 2011. Although the withdrawal of a number of market-makers from the exchange-sponsored quotation program and the panic selling by most market players contributed to the market evaporation, the roots of the problem lie deeper.

Only ten of 189 companies quoted on the Ukrainian Exchange are actually listed. The rest are just admitted to trading. This illustrates the core problem plaguing the country's stock market – the inferior corporate and public governance. The management and majority shareholders of most of the Ukrainian quoted companies have little interest in raising the share value of their companies. Shares in such companies are commonly admitted to trading on broker rather than the

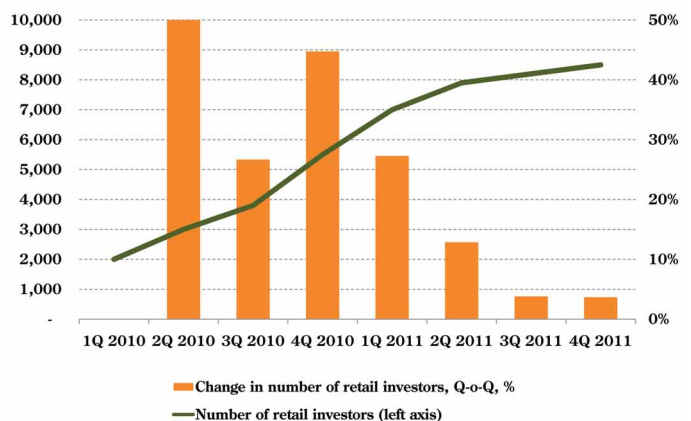
company request. Unlisted corporations have few requirements to information disclosure, while their management tends to ignore minorities and equity analysts. Many of such companies engage in heavy transfer-pricing, which allows their majority shareholders to move profits to offshore tax shelters outside of the minorities' and Ukrainian tax authorities' reach.

This abusive corporate government practice would not thrive without the government 'blessing'. Having failed to enforce the corporate law, which made it mandatory for all Ukrainian public companies to get a stock exchange listing, the government silently approved the continued exodus of capital from Ukraine. No wonder that a growing number of Ukrainian corporations choose to take public their offshore-registered holding entities, which serve as profit centers, on foreign stock exchanges.

PFTS Index Change



Number of Retail Investors is Rising



Scarcity of local institutional investors

In their public statements, the owners of Ukrainian foreign-listed companies mention low trading volumes on the Ukrainian stock exchanges among the main reasons for going public in Warsaw, London or Frankfurt as opposed to Kyiv. Even with the growing retail investor base, local equities rarely turn more than USD 10m a day. Trading volumes should significantly improve with the arrival of local institutional investors to the stock market. At the end of 2011, the number of the registered institutional accounts on the Ukrainian Exchange approached 2000, more than a third of which, we estimate, are Ukrainian brokers. The long-awaited pension reform now scheduled for the next two years should boost the number of local institutional investors and help improve the overall market liquidity. As a result of the pension reform, Ukrainians will be required to contribute part of their pension taxes to private pension funds, which will in turn invest these contributions in the local stock market. While some government officials cite the lack of quality investment instruments on the local stock market as the reason for the delay in the pension reform, we believe that in the market economy, which Ukraine claims to be developing, demand should come first. Adequate supply of quality investment instruments will follow shortly as local funding is a far cheaper and more sustainable alternative compared to foreign sources of capital.

Foreign companies to be listed in Ukraine

In 2011, the National Depository of Ukraine initiated changes to the Ukrainian legislation allowing foreign-

listed securities to be admitted for trading on Ukrainian exchanges. The Securities and Exchange Commission of Ukraine supported the Depository's initiative. The nearly completed draft law on foreign-listed securities trading in Ukraine should become effective in early 2012. Assuming that the National Bank of Ukraine will not object to foreign securities trading for hryvnia in Ukraine, the supply of quality investment instruments on the local market should widen. Among the first entrants will be the shares of the Luxembourg-registered and London-listed Myronivsky Hliboproduct, whose CEO Yuriy Kosyuk already expressed interest in gaining a foothold on the Ukrainian stock market. Ukrainian Eurobonds, which could be listed on the local exchanges by Ukrainian brokers, should also become attractive instruments for Ukrainian institutional and retail investors. We believe that the expansion of investment targets available for local investors will speed up the growth of local retail and

institutional players in Ukraine and accelerate the long-awaited pension fund reform.

Outlook for 2012

The direction of the Ukrainian stock market development in 2012 will depend much on the global trends. With the resolution of the European debt crisis and positive corporate earnings flow, the Ukrainian stock market can demonstrate a return of close to 100%. At the end of 2011, foreign institutionals resumed buying Ukrainian equities propping up the liquidity and inspiring more local retail investors to enter the market. This favorable momentum should be supported by the government, which, in effort to increase its budgetary revenues, is likely to continue closing tax loopholes and tightening regulations to minimize transfer pricing. With the first round of pension reform to be completed in late 2012, we might see the first true IPOs on the Ukrainian stock market already in 2012 - 2013.

Average Daily Stock Turnover (excl. REPO)

Year	Turnover (USD)	UAH/USD (Avg)
2004 (PFTS)	522,531	5.32
2005 (PFTS)	2,664,791	5.10
2006 (PFTS)	5,015,012	5.05
2007 (PFTS)	8,335,009	5.05
2008 (PFTS)	9,783,411	7.70
2009 (PFTS)	2,494,747	8.04
2009 (UX)	1,887,677	8.04
2010 (UX)	5,823,343	7.96
2011 (UX) est	6,643,173	7.98

Source: PFTS, UX, Foyil estimates

Ukrainian Stock Market: Results for 9M2011

In January – September 2011, Ukraine's stock market saw high level of activity: the trading volume amounted to UAH 183bln, which was more than in the same period of 2010 by UAH 104 bln (in January - September 2010 it made UAH 78 bln).

By volume the most active trading was in state bonds – UAH 76.48 bln or 41.78% of the total trading volume; this was followed by shares – 65.90 bln UAH or 36.01% of the total turnover.

During nine months of 2011, SSMSC registered 462 share issues in the amount of UAH 46.26 bln. In comparison with the relevant period in 2010, the volume of registered share issues increased by UAH 19.37 bln. Besides, SSMSC registered 138 corporate bond issues in the amount of UAH 24.85 bln, which is UAH 21.02 bln more than for the same period of 2010.

Dmytro Teveliev, Chairman of SSMSC, commented: "Ukrainian stock market is reacting to the negative news from the external financial markets. But statistics and analytical data characterising the domestic securities market show its moderate growth over the level of 2010. I hope that the regulator's initiatives on enhancing the market development will encourage growth of both qualitative and quantitative indicators of our stock market".

Press release by the Securities and Stock Market State Commission of Ukraine dated 26.10.2011