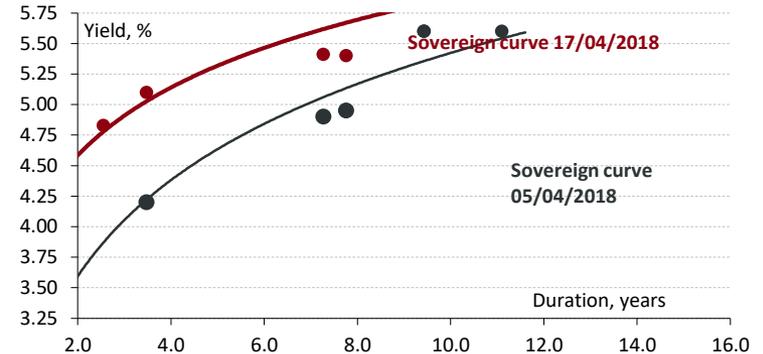


Russian Debt Market: Sanctions Risks vs Strong Local Bid

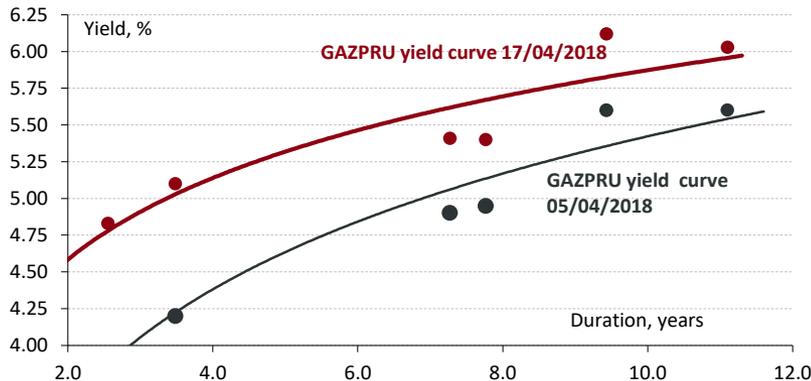
- RU Eurobonds suffered from severe sell-off
- M/t issues were hit the most rising in yield by 60-70 bp
- Premium for duration fell to historical lows
- Though there was marginal recovery...
- ...yields are still much higher than before April 6
- Corporate bonds were under pressure also
- Corporate Eurobonds underperformed Sovereign issues...
- ... on a fear of sanctions expansion on other names

RU Sovereign yield curve elevated by 50-70 bp



Source: Bloomberg, BCS GM

GAZRRU USD yield curve



Source: Bloomberg, BCS GM

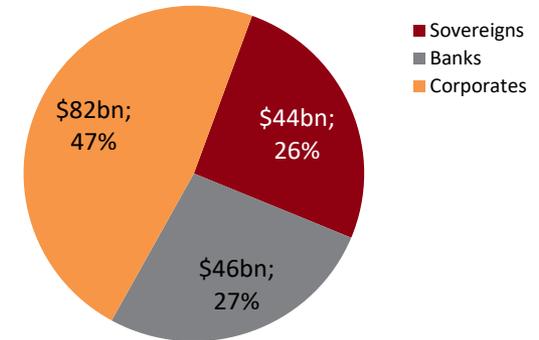
Russia 47-Russia 23 yield spread chart



Source: Bloomberg, BCS GM

- Currently, total volume c**\$172bn** with corporate segment dominating
- Volume has been shrinking since 2014, though placements volume doubled y/y in 2017
- Buybacks of Eurobonds by issuers (c**\$7bn** in 2017) put additional pressure on market size and liquidity
- In 2018, market size expected to squeeze further as redemptions will prevail over placements
- Bank segment pressured, as state-owned banks under sanctions
- Credit metrics of Russian issuers are quite strong, and risks of default and restructuring are limited
- Supply deficit of new issues and constrained liquidity of secondary market provide strong demand for new placements
- The share of foreign investors in RU Sovereign Eurobonds has fallen to **37.9%** as of end-2017 vs 76% at the beginning of 2012

Structure of Eurobonds issuers



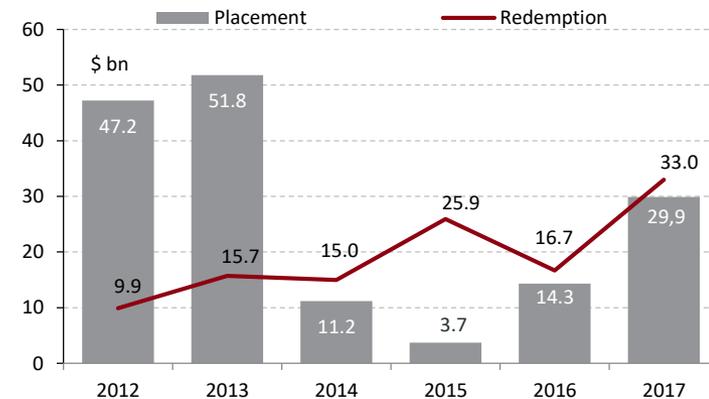
Source: Bloomberg, BCS GM

Share of foreign investors in RU Sovereign Eurobonds (%)



Source: CBR

Eurobonds placements and redemptions

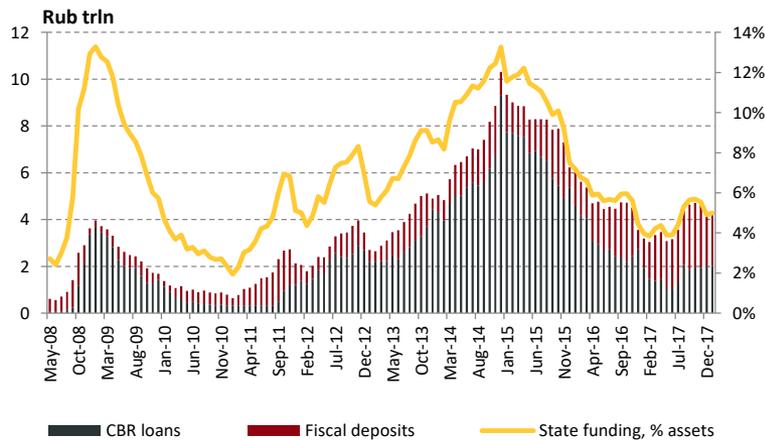


Source: Bloomberg, BCS GM

High liquidity supports RU debt market

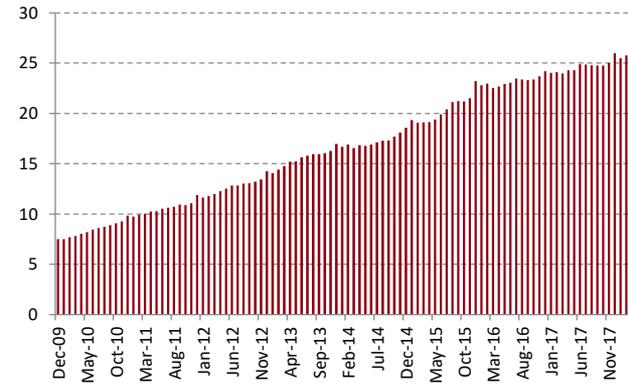
- **Liquidity** is abundant, LTDs near historical lows
- **Excessive FX liquidity:** LTD c60%
- **Bank demand** for FX assets is high given excess of FX liquidity
- **Retail deposits** are rising
- **Rb25tn** of retail deposits could be partially shifted to securities markets

Demand for state funding low



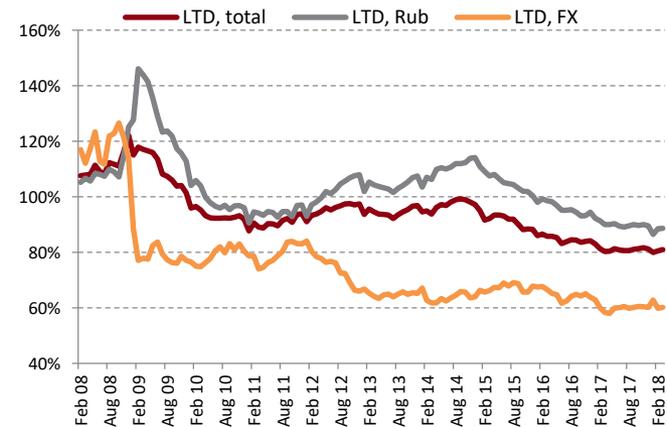
Source: CBR

Retail deposits, Rb trln



Source: CBR

LTD near historical lows

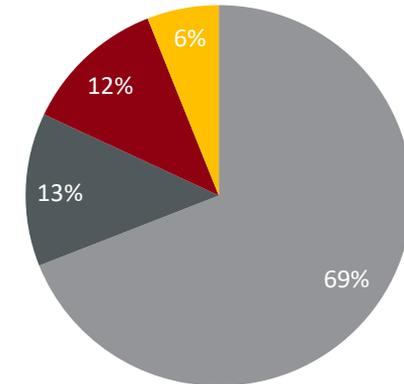


Source: CBR

- **Banks play more active role** on bond market given excess of liquidity in the banking system
- **Low demand for loans from RU corporates** due to decrease of investment programs
- **Pension funds** focus mainly on bonds
- **Retail money** are to play a more significant role on the securities market:
 - Special broker accounts with tax exemption
 - Special OFZ considered by the government
 - Local bonds in USD with min lot of \$1K (vs \$200K for Eurobonds) have been introduced
 - Deposit rates are going down, investors are seeking higher yields

Individuals' savings structure*

■ Bank deposits ■ Cash ■ Securities ■ Other

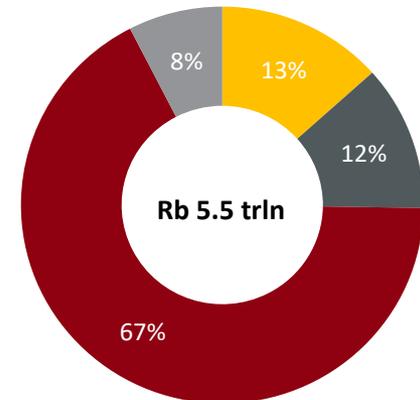


*as of end 2016

Source: MOEX

Pension system asset allocation*

■ Cash ■ Shares ■ Bonds ■ Other

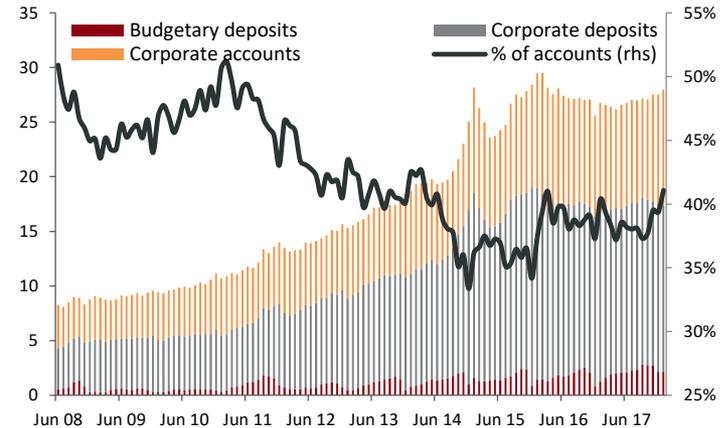


* As of end 9m17

Source: MOEX

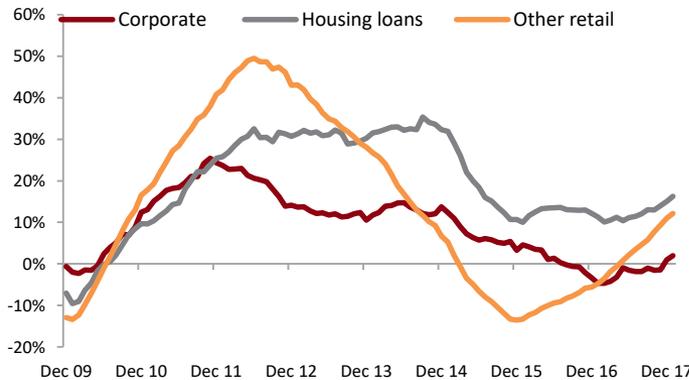
- **Corporate loan growth** is close to zero
- **Economic activity pick-up is very mild**, resulting in modest demand for corporate loans
- **High real interest rates** constrain rise in corporate loans
- **Companies increased proportion of accounts vs term deposits**
- **Strong growth of deposits** and current accounts since 2014 indicates a shift towards “saving” model

Current accounts show companies have unused cash



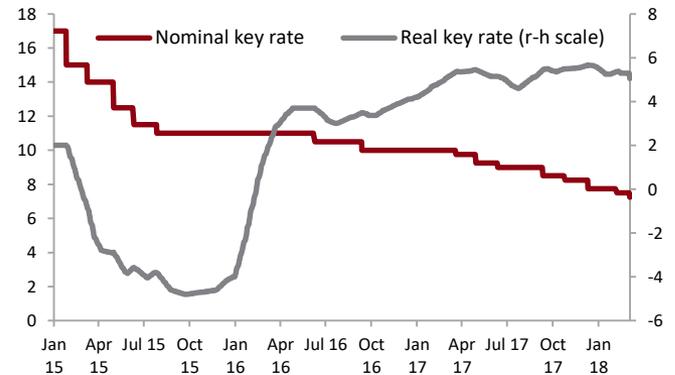
Source: Bloomberg

Corporate loan growth close to zero



Source: Bloomberg

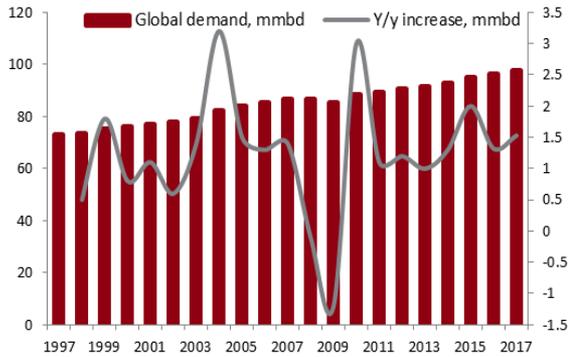
Key rate cut lags decrease in inflation



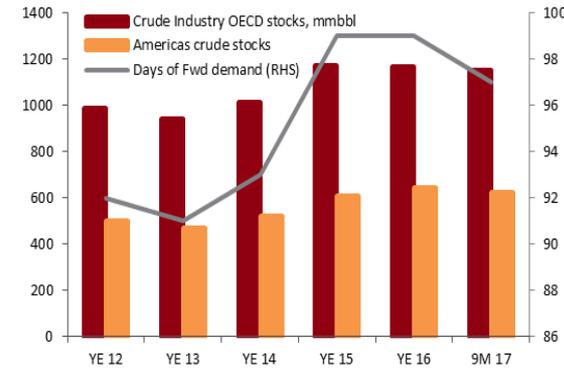
Source: Bloomberg, CBR, BCS GM

We project gradual rebound in Brent to c\$75/bbl by 2020

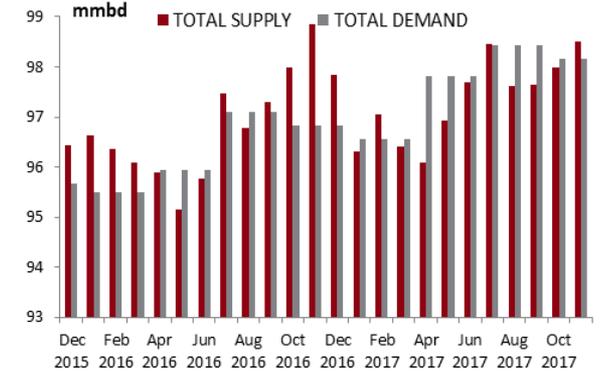
Demand to rise 1.3mmbd q/q on average



Inventories are just 10% above normal level

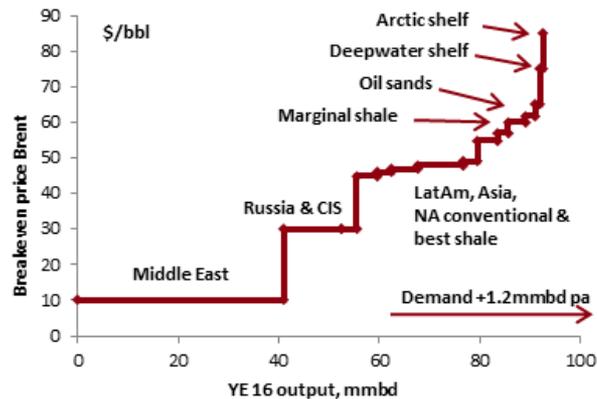


Global oil market was balanced over past 2 quarters

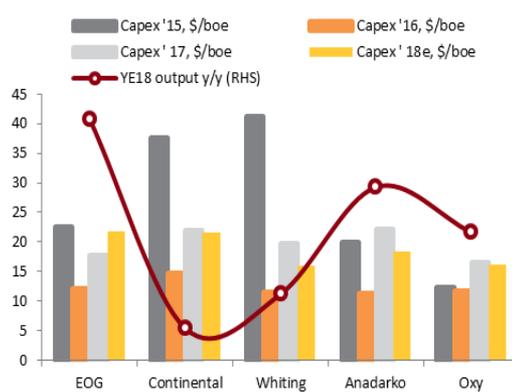


Source: IEA, BCS

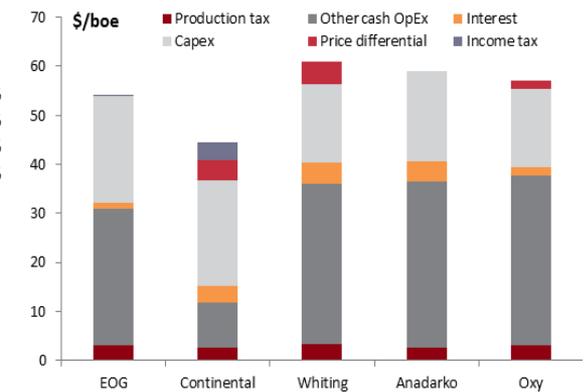
Global cost curve points to \$75-80/bbl in 2020



Higher output levels require higher capex /boe



TCC of best US shale plays are c\$54/boe



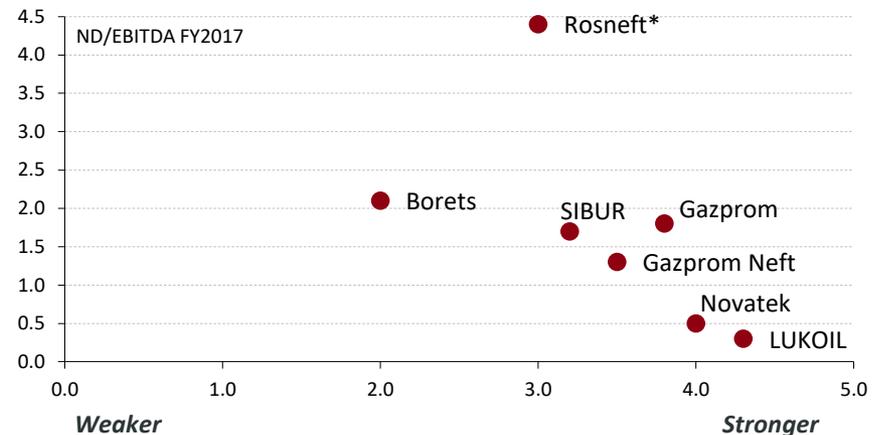
Source: company data, BCS

Issuer	Moody's/S&P/Fitch
LUKOIL	Baa3/BBB/BBB+
Novatek	Baa3/BBB-/BBB
Gazprom	Baa3/BBB-/BBB-
Gazprom Neft	Baa3/BBB-/BBB-
SIBUR	Baa3/NR/BB+
Rosneft	Baa3/BB+/NR
Borets	Ba2/BB-/BB-

LUKOIL: Credit quality strong, credit ratings above sovereign. Strongest name in RU Eurobonds space. Attractive should premium to sovereign exceeds 30 bp.

Gazprom: One of the rare state-owned companies not sanctioned with low probability of being sanctioned due to global importance. We favor mid-duration (2Y-4Y) notes, given attractive premium to other Tier1 papers.

Relative credit quality of issuers (BCS evaluation)



* 9M17

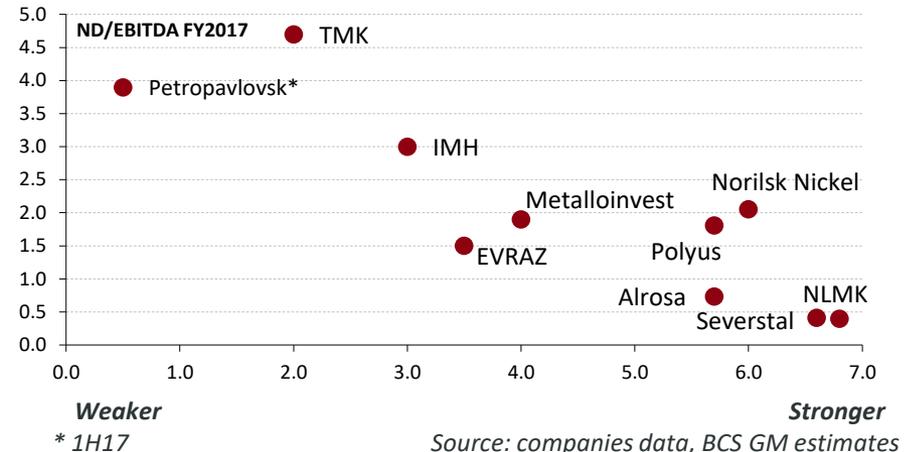
Source: companies data, BCS GM estimates

Rosneft & Gazprom Neft a disappearing species. Being under sanctions, neither company can issue Eurobond. However, each has strong access to local bond market and substitute foreign debt by issuing RUB bonds.

M&M: Top choice and key risks

Issuer	Moody's/S&P/Fitch
NLMK	Baa3/BBB-/BBB-
Severstal	Baa3/BBB-/BBB-
Norilsk Nickel	Baa3/BBB-/BBB-
Alrosa	Baa3/BB+/BB+
Polyus	Ba1/BB-/BB-
Metalloinvest	Ba2/BB/BB
EVRAZ	Ba3/BB/BB-
TMK	B1/B+/NR
IMH	B2/B/B
Petropavlovsk	NR/B/B-

Relative credit quality of issuers (BCS evaluation)



Low risk of being sanctioned:

Norilsk Nickel: We view current weakness in GMKNRM Eurobonds as a buying opportunity. Given high global market share (10% in Nickel and c40% in palladium) we see sanctions risk close to zero due to global importance

Credit rating upgrade possible:

IMH (Koks): We expect credit rating upgrade of IMH on strong FY 2017 IFRS results, rising coal prices, low refinancing risks. To note, US import duties don't apply for pig iron

Negative reaction on sanctions:

All Eurobonds of M&M segment suffered from sanctions of April 6 as investors seem to be guessing "who is next". Premium of IG Eurobonds to GAZPRU curve rose to 50-80 bp while all RU IG papers used to trade flat. Certain names even rose in yield to distressed levels. Should risk of sanctions expansion go away, gradual recovery expected

- Imposed sanctions provoked sell-off in both sovereign and corporate segments of Russian Eurobonds
- Strong local demand due to liquidity excess in Russia is supportive for Russian debt market
- Total volume of Russian Eurobonds is shrinking, rising supply unlikely
- Share of foreign investors in RU Sovereign Eurobonds has fallen significantly since 2014
- Low risk of oil price decline are supportive for Russian economy
- Sell-off created buying opportunities in papers of the companies with strong credit quality and low sanctions risks: Gazprom, Norilsk Nickel, IMH
- Should risk of sanctions expansion go away, gradual recovery expected



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