AVESTA INVESTMENT GROUP

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Results of 2023

Dear Clients and Friends,

As we approach the year-end and festive season, we would like to provide you with a summary of the main trends and events that have affected Uzbekistan's economy and business landscape, as well as some insights into what we can expect in 2024.

The 2023 was a challenging year for Uzbekistan in terms of **macroeconomics and budget management**. While the government focused on areas such as education, healthcare, infrastructure, and support for private entrepreneurship through subsidized loans, direct subsidies, and salary increases, the growing budget deficit forced the economic block of the government to cut expenses, cancel subsidies, and push the private sector towards the transparency. Additionally, the country continued to face a growing trade deficit, lower levels of remittances due to the depreciation of the ruble and problems in Russia, increased interest rates, uncertain geopolitical situations, and even minor downgraded corporate ratings. These challenges highlight the importance of addressing the budget deficit problem during this active investment stage.

One positive trend is that after securing political stability, the government has started **implementing painful reforms** that were postponed for the last 3-4 years due to COVID and the geopolitical situation. For example, tariffs for all types of utilities (gas, electricity, water, solid waste) and transportation have increased by 50-100%, with changes applicable to retail customers starting in 2Q2024. Bringing tariffs to at least breakeven could help cut budget expenses by approximately $2 billion annually. The more importantly in this situation, it is crucial to control and coordinate utility companies' expenses to ensure effective CAPEX and modernization. The government's ability to learn from past mistakes and reconsider the cost of wrong decisions and lack of strategic planning is a positive step, as it will be difficult to convince people to do another round of tariff increases in a few years, if the funds will be wasted due to corruption and poor planning.

Another trend in Uzbekistan is the continued **development of renewable energy** projects, including wind and solar power. The announced projects have a total capacity exceeding 10GW, with most expected to be commissioned during 2024-2025. This development will require significant investments and import in technology, engineering staff, and know-how. The government has recognized the problem of the low conditions of the grids and plans to invest heavily in improving the situation and decreasing transportation losses by almost half. Private investments from international players are also pushing the government towards legal reforms in the electricity and gas distribution system. A new wholesale market system is expected to be implemented in 2024, allowing private generators to sell electricity to large consumers and dealers.

Uzbekistan recently returned to the **international debt market** with the successful placement of Eurobonds for $1 billion, including USD and UZS-denominated issues. The UZS-denominated issue was considered green bonds, a symbol of successful implementation of the SDG agenda. Uzbekistan has prepared a Sustainable report, issued green bonds, become a regional leader in renewable energy, and introduced the OECD Green Growth Indicators System. It’s not just a beautiful marketing step, but a critical requirement of the current ecological conditions in the region with the high impact of possible water shortage, low air quality, the Aral Sea problem, and many other issues. Energy and resource-saving technologies are the key priority for new projects and governmental initiatives.

On the **business side**, several significant and successful M&A transactions have taken place, including the purchase of the controlling stake in Ipotekabank JSC (IPTB) by Hungarian OTP Bank, consolidation of the remaining 49% of the payment service PayMe by

Georgian TBC, merging of the UZUM ecosystem and Click payments, and privatization of Ferganaazot JSC by Indorama. These transactions are not the only signals of growing interest from international companies in Uzbekistan. The number of employees in the offices of all international financial institutions and development banks in Tashkent, audit, law and advisory companies, as well as the opening of new offices of international brands and companies, is also increasing. However, bad transactions are also happening, affecting many other companies considering entering Uzbekistan. Therefore, such transactions as the privatization of Kvarts JSC (KVTS), Uzbekkhimmash JSC (UZHM), and others should not happen again.

The **real estate market** has been an attractive area for investors, despite a slight decrease in rental yield and occupancy following the return of the main wave of migrants from Russia and Belarus to their homes or to other countries. However, real estate price indexes have shown strong growth, ranging between 15-35%, particularly in Tashkent. Notable deals and developments include the opening of the Trilliant business center and InterContinental Hotel in Tashkent, the acquisition of the Carrefour retail chain by Kazakh Magnum, and the upcoming opening of TashkentCity Mall, the largest trading center in Central Asia spanning 130k sq.m., along with a complex of four office buildings covering nearly 300k sq.m.

In terms of the stock market, there have been two significant structural changes. **Firstly,** the National Agency for Perspective Projects (NAPP) became the regulator of the capital and insurance market in September, in addition to the crypto market which NAPP had almost established and regulated from the beginning. By the end of the year, NAPP also gained regulation over e-commerce and lotteries. The main positive factor is the independence and nominal absence of conflict of interest for NAPP, whereas the Ministry of Economy and Finance was both regulating the market and owning shares of big state-owned enterprises. Currently, the new regulator is scrutinizing legislation and the market to catch up with the real situation, and 2024 will be important in terms of active legislative changes. So far, we have seen a focus on consolidating the market, introducing automation, simplifying processes, and gradually increasing control and responsibility for market participants.

Secondly, the approval of a roadmap to establish connectivity between the local market and international infrastructure, which will allow foreign investors to invest directly in local state debt securities in the first stage, and later into corporate bonds and equities. Discussions and promises had been made for the last few years, but now the government has signed a document with detailed instructions and approved steps to be taken. The first real results may be expected from the first half of 2025.

In 2024, we anticipate several key trends in Uzbekistan. **Firstly,** there will be mounting pressure on inflation and currency due to high inflation and FX depreciation against the USD in neighboring countries and main trading partners (Russia, China, Kazakhstan, Turkiye). Remittances will decrease due to the economic situation in Russia, which covers 70-80% of inflows to Uzbekistan. Gold production will remain second after remittances main source to cover the trade deficit. The foreign trade deficit will remain significant due to the active modernization process in the economy and massive capital expenditures for state strategic projects (water treatment facilities, thermo and hydropower stations, trans country auto and railroads, healthcare and educational infrastructure). However, with the launch of large gold, copper, uranium, and steel facilities, we may expect a slight decrease in imports and growth in high-value-added products export from 2025.

Secondly, the Central Bank will maintain a high level of the key rate, keeping deposit and borrowing rates high. Broad money base will be kept low due to inflation targeting policy and fighting the "shadow" economy. The government will keep artificially lowered inflation and currency rates by spending reserves and increasing gold sales as it still needs significant investments in infrastructure projects and will not scare foreign investors with volatility.

Thirdly, we expect growing activity in the private equity market and an increase in the number of direct debt investments into private companies. Companies will look for alternative sources outside Uzbekistan due to high rates and low liquidity in the banking

sector. IFIs and DBs will be key players in the first years of this process, providing additional long-term funding to private companies and holdings with whom they already had a relationship or started the process in 2023. The rest companies will focus on structuring transparent bankable structures of their groups and introducing IFRS reporting, ESG practices, and proper corporate governance mechanisms to pass high-level compliance by potential foreign investors.

Fourthly, we anticipate consolidation in finance, insurance, e-commerce, and fintech markets due to growing legal requirements and active competition from incoming international projects. Smaller players will be driven out of the market, and middle players will consolidate to gain larger positions.

Fifthly, growing competition for available funding in the finance market and broader economy will stimulate the above-mentioned processes of consolidation and private debt and equity deals.

Lastly, E-commerce and fintech could be a one of the most interesting sectors in Uzbekistan, which will form a new requirements to other sectors, such as IT&telecom (access to internet in the regions), banking (fintechs will run for on-line banking licenses and participate in deposit taking process), retail (wider usage of BNPL and credit sale schemes), logistics and real estate (last-mile delivery and A-class storages will become the edge of the competition between the companies).

Producing **forecasts** is a challenging task, but we aim to provide an accurate direction for the main indicators. **GDP growth** forecasts are expected to remain between 5.5-5.6% (State 5.6-5.8%, IMF 5.5%, ADB 5.6%, EBRD 6.5%, WB 5.6%), although there is potential for faster growth if global market conditions improve, such as lower interest rates, peaceful geopolitical situations, and lower oil prices. However, **inflation** forecasts by the Central Bank (8-9%) may be difficult to achieve due to pro-inflation pressures. We believe that inflation will decrease to a high single-digit parameter in line with the IMF and WB forecasts. The **FX rate depreciation** will remain consistent with or slightly lower than inflation rates, not exceeding 10% in 2024. Higher depreciation rates could pose a significant challenge in maintaining lower inflation, so we anticipate that the government will continue to sell gold to cover the trade deficit.

We predict a moderate growth in coupon rate yields for local corporate bonds, with **AWACRI** increasing from 21.1% to 22-23% due to more active issuance by smaller private companies, particularly in the finance and leasing segment.

Stock prices may hopefully improve from their current low levels after two years of unimpressive results, as businesses' financial results continue to grow, albeit not at previous rates. Several local blue-chip companies have significant events and plans that could result in significant improvements in profits and margins. Additionally, a few new names could enter the market, along with improved liquidity for existing stocks.

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