

Zelensky vs. Akhmetov

Another one bites ...

Ukraine | Politics | Fixed Income

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Summary

The conflict between Ukraine's richest businessman, Rinat Akhmetov, and president Volodymyr Zelensky entered into its hottest stage to date in late November and early December. It became another reason (after the risk of Russian aggression against Ukraine) for the depreciation of Akhmetov-related assets, bonds of solely-owned DTEK Group (DTEKUA, DTEREN, DTEKOG) and steel holding Metinvest (METINV), in which Akhmetov is a majority shareholder.

Akhmetov was always able to find compromise with top politicians

Tension between the richest Ukrainian and power brokers is not new – Akhmetov had low times under every president since 2005. But he has always managed to find a compromise or common ground with governments under each president of Ukraine. In our view, this was possible due to Akhmetov's employing the best talents in the industries of his presence, its business groups investing a lot in lobbying and, not least, him offering his media (and at times, aligned political) resources to help power brokers.

Will this time be different?

Base-case: Peaceful resolution of the conflict, again

Taking into account Akhmetov's history of relationships with top power brokers, it is likely that this time won't be different. Therefore, our base-case scenario is - no matter how deep the conflict between him and Zelensky, ultimately the businessman will be able to at least calm the conflict, or even find some common interest with Zelensky.

This scenario rests on the assumption that Zelensky is highly concerned about his acceptance rating. A long-lasting battle with Akhmetov would eventually drag the president deeper into scandals and kill his support among voters. Also, amid the constant risk of intensified Russian aggression against Ukraine, Zelensky might feel a need to consolidate all the pro-Ukraine forces, including those aligned with Akhmetov.

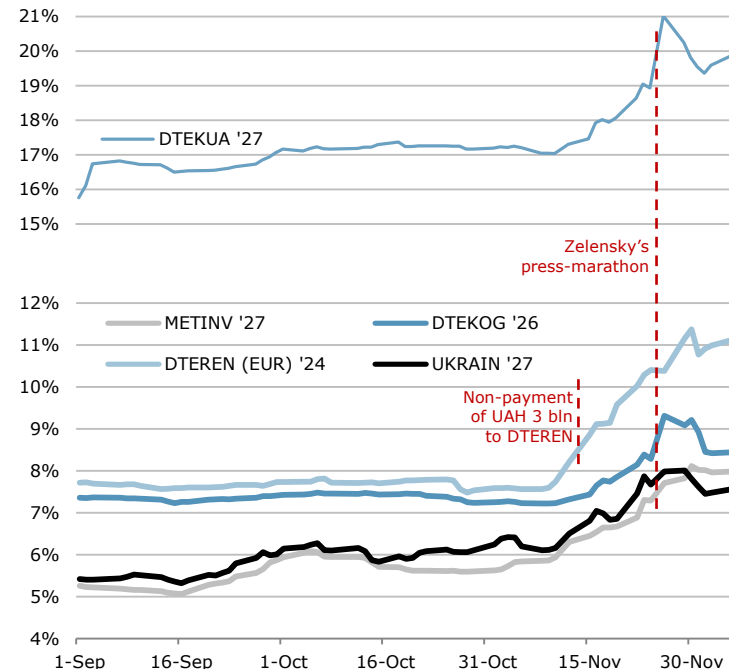
Sooner or later, therefore, Zelensky will have to accept Akhmetov's peace offer. The conflict might hit new extremes in the near term, but sometime in 2022, it will be over.

Alternative scenario

The conflict won't calm down. We can emphasize two possible reasons for that:

- 1) Zelensky will find solid support in his fight with Akhmetov from Ukraine's Western partners. The West's silence on the government's rude attacks supports this scenario. Moreover, the conflict might be a part of a broad battle of the West with Ukraine's oligarchy.
- 2) Akhmetov won't seek a peaceful solution of the conflict, e.g. because he is personally insulted by the rude behavior of Zelensky and his entourage, or because he is interested in destabilizing Ukraine. Such assumptions look fantastic by themselves, and they need Akhmetov's surety he has enough power to go to the end - collectively making such reasoning unrealistic.

YTM of selected bonds



For those looking at Ukraine's fixed income universe these days:

- **Our base-case scenario implies there is a good entry point into Akhmetov-related bonds.** Although in this note we dedicate more space to an alternative scenario, we believe this one is much more likely.
- Those not ruling out **the alternative scenario** should be **careful** while investing or keeping Akhmetov-related bonds.

Akhmetov vs. Ukrainian presidents: Brief history

Akhmetov's relationships with all the former presidents had good times and in some cases bad times. Below we highlight the most remarkable events to illustrate this.

President Leonid Kuchma (1994-2004): Mostly good

Akhmetov emerged as a top businessman under the Kuchma presidency, and no significant conflicts can be remembered. Late in the Kuchma era (2004), Akhmetov managed to take part in the privatization of Krasnodon-Coal (by 2016, part of Metinvest, located on uncontrolled territory), Pavlograd-Coal (a major part of DTEK Energy now), as well as parts of Ukrudprom (state iron ore holding, from which Metinvest's key iron ore assets have been spun off). Also in 2004, Akhmetov and Pinchuk privatized Kryvorizhstal for UAH 4.3 bln.

President Viktor Yushchenko (2005-2010): Bad - to good - to bad, depending on who is Prime Minister

The start of Yushchenko's presidency was a bad time for Akhmetov, which is mostly due to the prime-ministership of Yulia Tymoshenko (Jan-Sept 2005). During this time, Akhmetov lost his stake in Kryvorizhstal (the government re-sold it to Mittal Steel for UAH 24.2 bln the same year). A smaller problem was Akhmetov's emerging DTEK being "punished" in autumn 2005 as the work of its power plants was limited due to the "deficit" of hard steam coal.

Later on, when Viktor Yanukovich became PM (Aug. 2006 – Dec. 2007) Akhmetov managed to punish the companies involved in that limitation. The Yanukovich prime-ministership period was marked as Akhmetov's best times under Yushchenko (among others, he took control over power GenCo Dniproenergo in a questionable debt-to-equity swap).

As Tymoshenko replaced Yanukovich in Dec. 2007, Akhmetov's relations with the government worsened - the privatization of Dniproenergo was canceled in courts, but Akhmetov was able to retain control of Dniproenergo and ultimately win a court battle under the next president.

Notably, the two-year period with Tymoshenko as PM (Dec. 2007 - Jan. 2010) was a dark period for Akhmetov, but he was able to survive and protect his assets while "investing" into Yanukovich, who beat Tymoshenko at the 2010 presidential elections.

President Viktor Yanukovich (2010 – 2014): Unclear to very good

There was some tension between Akhmetov and the government in early Yanukovich times, but very soon the relationship improved. In 2011-2012, Akhmetov privatized stakes in GenCos Zakhidenergo and the last part of Dniproenergo, and large power distribution companies (Dniiproblenergo, Kyivenergo, Donetskoblenergo). Also, he took control over Ukrtelecom which was privatized in 2011 by a third party.

President Petro Poroshenko (2014-2019): Very bad to very good

Under the first two years of Poroshenko's presidency, Akhmetov had bad times with a nadir in late 2015. In the worst times of mid-2015, assets of Naftogazvydobuvannia (now part of DTEK Oil & Gas) were frozen due to a criminal investigation. Also, in September 2015, the Anti-Monopoly Committee initiated an investigation into possible abuse of market power by DTEK Energy.

However, Akhmetov was able to find common ground with the government in late 2015 or early 2016. The arrest of the gas assets was fully removed in January 2016, and in March-April 2016 the power sector regulator approved a new questionable pricing rule for electricity known as Rotterdam Plus (which benefited DTEK Energy). In 2018, the Anti-Monopoly Committee decided that DTEK had no market power on electricity market.

President Volodymyr Zelensky (since May 2019): Neutral - to bad - to ... ?

Taking into account the above experience, we see the further development of relationships between Akhmetov and Zelensky could follow the Poroshenko scenario of 2016-2019 (base-case) or the Tymoshenko scenario of 2008-2009. Below is more discussion about these scenarios.

Zelensky vs. Akhmetov: Fight for money and love

Ukrainian media have highlighted three events that caused Akhmetov to initiate pressure on Zelensky:

1. **The increase of railway rates for iron ore and coal** in August 2021: by 8% from August and 20% from January 2022. The increase hit DTEK Energy and Metinvest, as they are the biggest ore and coal transport clients. Akhmetov's lobby couldn't block the increase.
2. Law #5600 discussed in Summer and adopted in December – **the increase of the iron ore extraction tax** affecting Metinvest.
3. **Law on oligarchs** (introduction of an official oligarchs list six months after the law's validation) – voted in late September and came in force in early November. According to local media, the law irritated Akhmetov, who sees a risk to his relationships with international creditors by being on the official list of oligarchs.

While the first two items are a zero-sum game (Akhmetov loses what the state or state companies gain), the third item does not look so, at least from Akhmetov's perspective. By introducing a list of oligarchs, Zelensky might or might not have some electoral gains, while the official oligarchs will likely suffer from risks and potential losses due to the expected increase in the cost of borrowing. Ukraine's economy, therefore, might suffer in the short-term. This decision looks irrational to Akhmetov.

For Akhmetov, therefore, it was **vital to show that the law on oligarchs won't bring any electoral benefits to Zelensky**. Perhaps this motivated Akhmetov to start an active **anti-Zelensky PR campaign**:

- In early October, Akhmetov's TV channels started actively criticizing Zelensky's every step.
- Zelensky's electoral support fell significantly in October, which his entourage linked to Akhmetov's PR attacks (which might be an exaggeration).

Zelensky's reaction was asymmetric:

- On Nov. 11-15, the government did everything to not allow DTEK Renewables to receive a UAH 3 bln repayment of Guaranteed Buyer's debt, in rude violation of the Cabinet's resolution and electricity market rules.
- On Nov. 24, pro-Zelensky MPs announce a boycott of Akhmetov's TV channels.
- On Nov. 26, Zelensky ran a press marathon where he openly stated that Akhmetov might be involved in an possible coup d'état. The same day, Akhmetov had to comment that this is "absolute lie."
- On Dec. 1, Energy Ministry initiated a draft law on temporary state administration at electricity companies that threaten the stability of power supply, clearly targeting DTEK-related companies.
- On Dec. 2, the Prosecutor General expressed her annoyance of Akhmetov's TV attacks on Zelensky and promised to personally promote "about 200" criminal cases related to Akhmetov companies.

What is remarkable about Zelensky's attacks:

- Many attackers explicitly link their initiatives to Akhmetov's PR campaign.
- There is no apparent reaction of Ukraine's Western partners to the government's violations of rules and rights.

What's next: Base case – Peaceful resolution

Our base-case scenario is Akhmetov will be able to offer a peaceful resolution of the conflict with the government. This might happen in the upcoming days, weeks or months. However, this scenario does not exclude the chance of a new escalation in upcoming days/weeks. This scenario rests on the assumptions that:

- Zelensky is highly concerned about his electoral rating (this might look like a simplification, but we believe this is a reasonable one). A long fight with Akhmetov will likely destroy his rating – Akhmetov will use any chance to show the incompetence of the Zelensky administration, and the reasons for that won't have to wait long.
- Akhmetov remains interested in a peaceful solution. For many his businesses, it is vital to keep good relations with power brokers. Also, he is unlikely to feel enough power to win the battle with state machine which proved its ability to play with no rules (such ability is not available for Akhmetov).

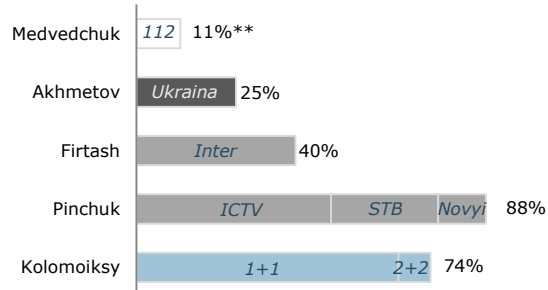
Large opposition TV can kill Zelensky's rating. Despite increasing digital penetration and the massive appearance of internet and social media, TV channels remain powerful in Ukraine. The TV space can be divided by four nearly equal groups (anti-Zelensky of Akhmetov, pro-Zelensky of Kolomoisky, and the broadly neutral of Pinchuk and Firtash – see the explanation at the right).

While most groups of TV channels were neutral to Zelensky up until late Summer (except small pro-Poroshenko channels), active critics from Akhmetov's Ukraina and Ukraina-24 channels since late September seem to have had a visible negative effect on Zelensky's rating. If Akhmetov's channels continue their job, Zelensky's image might fade further, even if the three other TV groups won't join Akhmetov. For Akhmetov, there is nothing to lose in a PR battle (his image is not great), but he has all means to tar Zelensky. Sooner or later, this might force Zelensky to stop the war.

On top of that, lobbyists of Akhmetov could find an approach to the Zelensky administration and offer his some kind of deal (as it allegedly happened with the previous president, Poroshenko).

Also, against the threat of Russian aggression, the president might feel a need to unite all the pro-Ukrainian sources inside the country, including those aligned with Akhmetov.

Top-8 "news TV sources" by poll, 2021* (USAID-Internews poll)

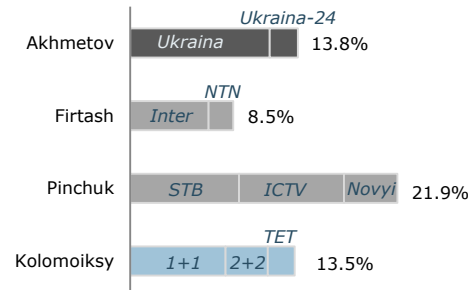


Disposition of the Ukrainian TV market

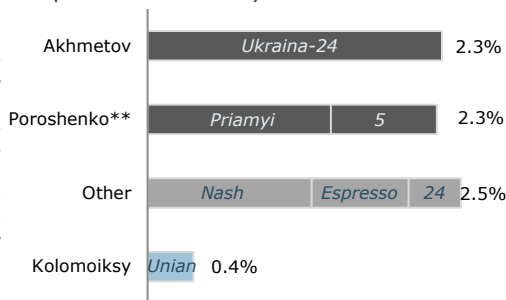
Ukraine's TV market can be split into the following camps of about equal influence on the population:

- **Channels actively criticizing the government:** Akhmetov's universal channel Ukraina and news-only Ukraina-24 are the most powerful here. Also, there are news-only channels Priamiy and the 5, the popularity of which lags significantly. They were recently sold by Poroshenko.
- **Channels that clearly support Zelensky** against Akhmetov – those owned by Ihor Kolomoisky. The flagship channel 1+1 is one of the most popular.
- **Channels of Viktor Pinchuk** – collectively most popular. Pinchuk has few reasons to take government's side in the conflict: 1) he values the investment climate – the one that Zelensky is destroying by attacking Akhmetov, 2) he does not look happy with the oligarch law, too, 3) he might be the next target once Akhmetov loses his battle.
- **Channels of Dmytro Firtash** and Serhiy Lyovochkin (flagship Inter). They have their own agenda – promoting Opposition Block for Life party and its leader Yuriy Boyko. Unlikely to take any position.

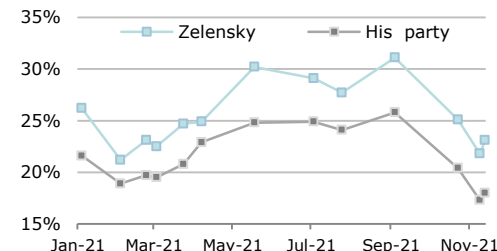
Top-10 TV channels by audience, Oct. 2021 (Nielsen-Ukraine research)



Top-7 news-only TV by audience, Oct. 2021 (Nielsen-Ukraine research)



Percent of decided voters who vote for (Rating Group polls)



The electoral rating of Zelensky and his party reached lows in November which had not been seen since the strict quarantine measures in Feb-Mar 2021.

It's not necessarily the criticism spread by Akhmetov's channels since October that has contributed to this result, but Zelensky's entourage believes it had.

* Respondents were asked to name up to three TV channels whose news they see most frequently.

** Medvedchuk's TV channels were closed in February 2021 due to local sanctions. Poroshenko officially sold his TV channels in November 2021.

Sources: Above listed sources, Detector.media, Concorde Capital calculations

What's next: Alternative scenario – No peace: Background

Another scenario, which does not look unlikely, is that the war between Zelensky and Akhmetov will go on or even intensify, bringing more losses to both Zelensky (potential electoral losses) and Akhmetov (at least - lower bond prices for related companies, at most – heavy cash and/or asset losses).

The key assumption under this scenario is that the fight with Akhmetov is not Zelensky's war, but a part of a global war against Ukrainian oligarchy. This looks like part of a conspiracy theory, but still not unrealistic one.

Case study: “Chronicles of global war against Ukrainian oligarchy”*

- One of Ukraine's richest men, Dmytro Firtash, was arrested in Austria in March 2014** as a part of a U.S. investigation. Thus, one oligarch was neutralized with U.S. involvement.
- Further on, in 2016, president Poroshenko, backed by strong support of the West (this time, the IMF), initiated a battle with another influential rich man, Ihor Kolomoisky. The fight peaked in late 2016 with the nationalization of Kolomoisky's Privatbank. The move was generously cheered up by the IMF, which provided a loan tranche to Ukraine in 2017 despite the government's meeting only 3 out of 11 official structural benchmarks under the IMF program. While Kolomoisky was able to find common interests with today's president Zelensky, his influence has been significantly limited due to multiple criminal investigations in the U.S.
- Some smaller tycoons, including Kostiantyn Zhevago and Oleh Bakhmatyuk, have been also effectively neutralized by Ukrainian law enforcement bodies and have to live abroad. Another powerful person, pro-Russian politician and businessman Viktor Medvedchuk, is under Ukrainian sanctions and criminal prosecution.
- **At the moment**, the two most powerful rich men in Ukraine are Akhmetov and Kolomoisky. For Zelensky, it is not comfortable to openly fight Kolomoisky, whose contribution to the president's electoral success was significant. Moreover, Kolomoisky is already suffering from the U.S. pressure. Therefore, the next logical target in this “global fight” with Ukrainian oligarchy is Rinat Akhmetov.

Notably, there were no reaction of Ukraine's western partners to the government's recent act related to Akhmetov and his assets, even though some of the steps were beyond decorum.

- At the least - by expressing no concerns over the government's rude violations of the rules, the West is encouraging the government to continue the battle.
- At the most, this confirms this conspiracy theory, meaning that the West will prevent Zelensky from making peace with Akhmetov.

Another premise for this scenario is that it might happen that Akhmetov's PR attacks won't harm Zelensky's rating further (but only in the case that his government does not do things worth criticizing – which is not very likely).

* Note that this case study contains some simplifications of things that border on manipulations.

** The first powerful person neutralized by the U.S. was Pavlo Lazarenko, former PM, arrested in New York in 1999.

Source: Concorde Capital Research

What's next: Alternative scenario – No peace: Outcomes for Akhmetov

Sub-scenario A: Frozen conflict

The battle will be limited by PR attacks and petty mischief from both sides, with no new crossing of red lines.

For Akhmetov-related bonds, this will imply some price risks, especially for:

- DTEK Energy (DTEKUA) which might further suffer from price caps and other regulatory limitations on the electricity or coal market.
- DTEK Renewables (DTEREN) might suffer from output limits and payment discriminations like those happened in November.
- Metinvest (METINV) and DTEK Oil & Gas (DTEKOG) can suffer from continuous talks on possible production tax increases.
- DTEK Energy and Metinvest might suffer from talks or actions aimed at increasing railway freight rates. Also, such increases are likely to become very regular.
- For all the companies: regular visits of law enforcement bodies and various state inspectors.
- Plus some of the items from sub-scenario B.

In general, the scenario resembles Akhmetov's relationship with the government under Tymoshenko's prime-ministership of 2008-2009 (cold war, Akhmetov is protecting his assets while "investing" into the next president).

Sub-scenario B: Fight till the end

The rival parties will cross all the possible red lines, damaging each other heavily along with the Ukrainian economy and investment climate. The full realization of such a sub-scenario is not likely, though some of the events listed below still could happen:

- For DTEK Energy:
 - Adoption of the law on temporary administration for "risky" power companies, followed by the introduction of state control in some of them (read "their destruction by crooked state managers").
 - New life for the nearly closed Rotterdam Plus court case, which might end up in multi-billion hryvnia claims against DTEK Energy.
- For DTEK Energy, Metinvest and Uktelecom: the reversal of privatization tenders that happened in 2004-2012.
- For DTEK Renewables: regular non-payments from the state for green electricity (discrimination).
- For DTEK Oil & Gas: purchase of all the gas by the state at low regulated prices.
- For Metinvest: regular non-reimbursements of export VAT (discrimination).
- For other assets: sanctions against TV channels, pressure on banks.

The above list does not include Akhmetov's possible responses. Thus far, our assumption is that he won't be able to act beyond the law (unlike his opponents). But creativity of his managers should not be ignored. Clearly, his companies are likely to apply to various courts to protect their rights and demand compensation. Regardless, for Akhmetov, it is much better to seek a peaceful solution.

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