

**Centrenergo:**

**Turbulent times ahead**

Ukraine / Equity / Electricity

September 20, 2019

# Executive summary

## Generous dividend payer no more

During the last three years, Centrenergy earned the reputation of a generous dividend payer, as its dividend yield ranged between 4.5% and 23% in 2017-2019. However, it now looks like its dividend story is over:

- Its average achieved power price started falling fast since March 2019, eventually below the company's costs in 2Q19.
- In 3Q19-1Q20, Centrenergy's achieved power price is unlikely to be higher than in 2Q19.
- The company's 3Q19 results will likely be even more disappointing than in 2Q19.

**Ihor Kolomoisky has gained control** over the company's management, which may result in continuous pressure on the company's power rates for the mid-term:

- In September, Kolomoisky's firms reportedly have become the biggest buyers of Centrenergy's electricity at prices far below those the company achieved in 2Q19.

The planned **privatization** of Centrenergy, which could have become a value catalyst for the company, is **unlikely to happen soon**.

- Kolomoisky commented last week that it's not a good time to privatize Centrenergy.

Weakening achieved electricity prices and likely deepening losses, as well as foggy privatization prospects, make Centrenergy's **value growth prospects unclear**.

- We recommend minority shareholders to use the seasonal opportunity to quit their CEEN shares by voting against certain items at the next AGM (March-April 2020). Meanwhile, we expect prices for such an exit will likely be weaker next year than they have been in 2019 (close to UAH 15/share).

Ticker	CEEN UK
Shares, mln	369.41
Last price, UAH	10.5
MCap, UAH mln	3,879

	2018	1H19 LTM
EV/Sales	0.23	0.24
EV/EBITDA	6.8	neg
P/E	7.8	neg

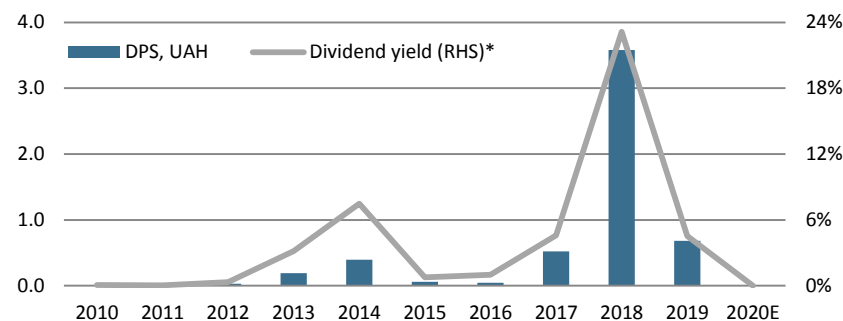
## Shareholder structure

Government	78.3%
Other	21.7%

## Share price, UAH



## Dividend history



## Key fundamentals, UAH mln

	2015	2016	2017	2018	1H19
Net revenue	6,864	10,696	10,919	14,509	7,529
Adjusted EBITDA	386	2,069	1,264	495	-205
Net profit	22	387	1,891	499	-1,197
Net debt	-336	-484	-1075	-465	-505

# EBITDA falling after 2016, net of one-offs

Centrenergó has reached record EBITDA of about USD 80 mln in 2016, gaining from the introduction of the Rotterdam Plus pricing approach on the electricity market:

- Since May 2016, Ukrainian thermal power plants got prices for their power to cover the costs of burning coal as if the coal was imported from Rotterdam (API2 Index plus coal delivery costs);
- In 2016, coal input prices (most coal was supplied from domestic mines) were significantly below the Rotterdam Plus levels.

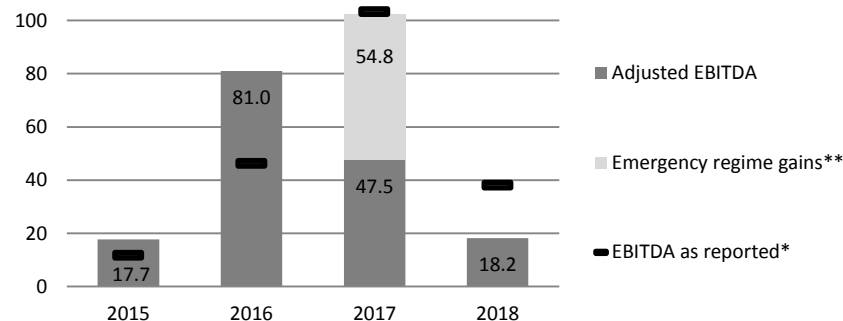
Since 2017, coal prices have been gradually increasing in Ukraine, which resulted in Centrenergó's reduced profitability.

A bright spot in this profit-declining trend was the period of March-July 2017, when the company temporarily benefited from the emergency on the domestic power market:

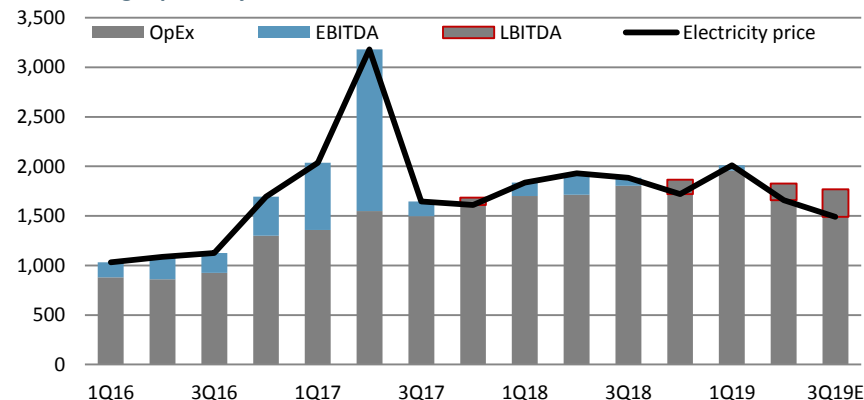
- A sharp decline of anthracite supplies from the occupied regions of Ukraine resulted in a coal deficit and forced anthracite-burning thermal power plants to work in extraordinary mode. This work was generously compensated with high power prices (see next slide for more details).
- Two out of Centrenergó's three thermal power plants were designed to burn anthracite coal.

In 2Q19, the company generated negative EBITDA due to weak power rates, and in 3Q19 its losses from operations are likely to increase.

## Evolution of Centrenergó EBITDA, USD mln



## Centrenergó quarterly fundamentals, UAH/MWh



## Centrenergó fundamentals, UAH mln

	2015	2016	2017	2018	1H19
<b>Net revenue</b>	<b>6,864</b>	<b>10,696</b>	<b>10,919</b>	<b>14,509</b>	<b>7,529</b>
EBITDA as reported*	257	1183	2748	1037	-1231
% of sales	4%	11%	25%	7%	-16%
<b>Adjustments</b>	<b>129</b>	<b>886</b>	<b>-1,485</b>	<b>-542</b>	<b>1026</b>
Emergency regime gain			-1,457**		
Receivables/payables writeoff	-5	902	-423	-6	1,026
Legal provisions	154	-194	396	-453	
VAT gains/losses	-19	177		-83	
<b>Adjusted EBITDA</b>	<b>386</b>	<b>2,069</b>	<b>1,264</b>	<b>495</b>	<b>-205</b>
% of sales	6%	19%	13%	3%	-3%
<b>Net profit</b>	<b>22</b>	<b>387</b>	<b>1,891</b>	<b>499</b>	<b>-1,197</b>
% of sales	0%	4%	17%	3%	-16%

# Good times of high power rates for Centrenergy fading?

## Power prices are not growing any more in 2019

The two periods when Centrenergy generated high profits in the last three years were periods of high power prices:

- 2Q16-3Q18, after the introduction of the so-called Rotterdam Plus approach on the wholesale market, which resulted in higher achieved electricity prices for all thermal power plants in Ukraine.
- March-June 2017, when Ukraine's electricity sector was working in emergency mode due to the deficit of anthracite coal (sharp decline of supplies due to the introduced embargo on coal deliveries from occupied Donbas).

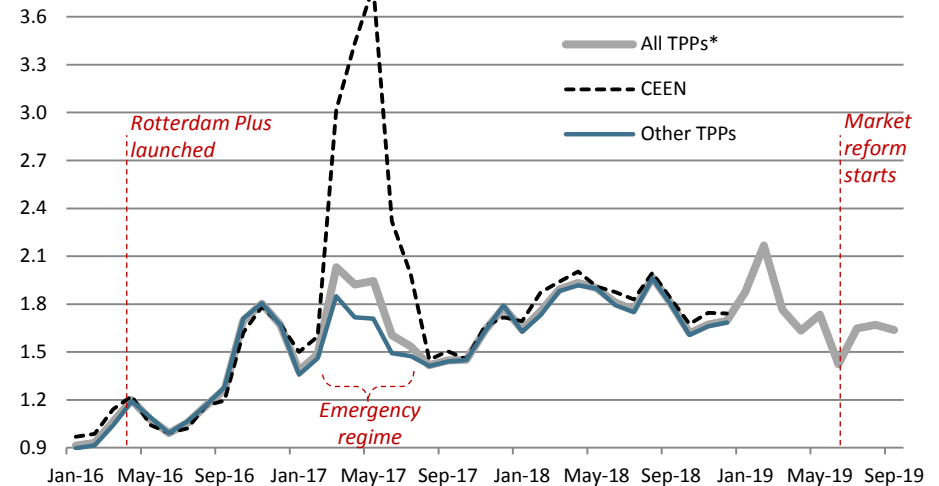
## Since 4Q18, power prices for thermal power plants have stopped growing.

- Since the API2 coal index stopped growing in October 2018, there were few reasons for Ukraine thermal power plants' electricity prices to grow in 2019.
- In 2Q19, the price on the wholesale market reached a level that did not cover Centrenergy's production costs.

## In 3Q19-1Q20, prices are unlikely to be higher for Centrenergy than in 2Q19:

- On the new "liberalized" market introduced in July, prices in the most transparent segments (day-ahead and intraday markets) are capped at about UAH 1.70/kWh, which should result in an average achieved price for Centrenergy's electricity in this period at a level not higher than 2Q19 (about UAH 1.66/kWh). This should keep Centrenergy's profit weak till 1Q20, unless a radical cost reduction is achieved.
- With the new market's introduction, Centrenergy (as well as other market players) was allowed to sell its electricity based on bilateral contracts with consumers. Most electricity has been sold by Centrenergy by bilateral contracts since 3Q19. As fragmented data from the market suggest, Centrenergy's achieved prices in this segment are even weaker than on the day-ahead market (see next slide for more details).

Achieved price for electricity, UAH/kWh



# New market + new corporate issues = weak Centrenergy fundamentals

## Kolomoisky has taken control over the company's operations, "working to reduce power prices"

Ukrainian media reported in July that people loyal to Ihor Kolomoisky replaced those loyal to former power brokers in Centrenergy.

- Kolomoisky confirmed such rumors in his interview with the BiznesCensor news site published in late August, stating that "professional and understandable to us people" entered the company, mentioning Volodymyr Potapenko, who was appointed acting CEO by the supervisory board on June 26.

The new Centrenergy CEO has reportedly concluded electricity sale contracts with Kolomoisky's enterprises.

- In his interview to the liga.net news site in September, Kolomoisky confirmed that his enterprises are the biggest consumers of electricity supplied by Centrenergy.

The average sale price of Centrenergy by bilateral contracts have been set at UAH 1.29/kWh in September (or 22% below the price achieved by the company in the weak 2Q19), local media reported, citing the results of tenders completed by Centrenergy in late August.

- In the August interview, Kolomoisky stated that the key goal of President Zelensky is to lower electricity prices, adding that Centrenergy's acting CEO Potapenko "is working to fulfill this goal."

***The key takeaway from such developments is Centrenergy is unlikely to generate any significant profit as long as Kolomoisky is in charge.***

## On the new electricity market

**Before the introduction of the power market reform** in 2019, Ukrainian thermal power plants (TPPs) were selling all their produced electricity to a **single wholesale market operator**. TPPs' achieved prices were mostly uniform across the sector, while some of TPPs were being paid additional premiums for capacity, reserves and for working in changeable mode.

**Since July 2019, a new electricity market model was introduced** in Ukraine, based on which TPPs are able to **sell electricity in various ways**:

### On a day-ahead market and intraday market

#### Prices

For 3Q19-1Q20, prices in this segment are capped at UAH 0.96/MWh for off peak times and UAH 2.05/kWh for peak times. On average, in July and August, prices in these segments amounted to UAH 1.65/kWh and UAH 1.67/kWh, respectively, or close to the average level seen for TPPs in weak 2Q19 (UAH 1.60/kWh).

#### Volumes

In this segment, TPPs sold just **20%** of the electricity they produced in August, we calculate based on segment operator data.

### On a balancing market and market of additional services

#### Prices

For 3Q19-1Q20, prices are capped at the level of 115% of the day-ahead market rates.

#### Volumes

Less than 5% of electricity generated, we estimate.

### By bilateral contracts with consumers

#### Prices

There is only fragmented information about prices in this segment. Based on media reports, Centrenergy has contracted to sell electricity in September for an average price of UAH 1.29/kWh.

#### Volumes

Over 75% of electricity produced by TPPs.

If the information above is correct, the average price of Centrenergy's electricity would be less than UAH 1.40/kWh in September, which is not enough to cover the company's costs (at least UAH 1.65/kWh, we estimate).

# Privatization prospects: now unclear

**Centrenergo was on the short list of companies that had been prepared for privatization in 2015-2019. It's possible that the company will drop off this list for 2020 and on.**

- Centrenergo was closest to being privatized in December 2018, when the state announced a tender to sell its 78.3% stake for a starting price of UAH 5.98 bln (or UAH 20.7 per share). However, the announced tender failed to occur as the State Property Fund disqualified the only likely bidder, a company related to Vitaliy Kropachev (who allegedly controlled Centrenergo's operations at that time).
- Another privatization tender at that starting price is unlikely to occur as:
  - Kropachev lost his control over the company and apparently his interest in it as well.
  - No one else expressed his interest in buying the company at that price in 2018.
  - The starting price, as determined by an EY evaluation, is only valid for 12 months, and this term should expire in October. To announce the next tender, a new valuation should be made.
- Moreover, given that Kolomoisky has taken control over the company, its privatization is not likely in the mid-term:
  - Kolomoisky told the liga.net news site last week that he does not view a soon privatization of Centrenergo as a good idea.
  - Kolomoisky is reportedly "milking" the company on both the cost side (by supplying it coal, as Kropachev reportedly used to do) and the revenue side (by purchasing its electricity for his ferroalloy plants, what Kropachev did not do).
  - Therefore, for as long as Kolomoisky is interested in electricity supplied by Centrenergo, and as long as he has some influence on Ukrainian power brokers, the privatization of Centrenergo is unlikely.
- One can argue that new Ukrainian government is not always listening to Kolomoisky, which is true. However, in our view, Kolomoisky's influence is high in many areas of the Ukrainian economy, and Centrenergo looks to be one of them. Recent proof for that is the Cabinet's Sept. 18 decision to confirm the candidacy of Volodymyr Potapenko (the person "understandable" to Kolomoisky) as acting CEO of Centrenergo.

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