

DTEK Energy Eurobonds

Loading up just before dawn

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Executive summary

We estimate the fair value of DTEK Energy's outstanding debt at 60% of par value, assuming repayment in 2017-2023 (skewed towards the last year) and a 15% discount rate. Currently, its bonds are traded at 43% of par, which promises spectacular upside. We expect most of the upside will be realized as soon as the holding is able to reach a restructuring agreement with its creditors.

Meanwhile, it would be logical to expect that DTEK will try singing the blues during the standstill/negotiation period, which may imply some short-term price risks. Among the fundamental risk factors is DTEK Energy's inability to reduce its debt by USD 436 mln via divestment of its Russian assets.

DTEK Energy (or DTEK) is among the key victims of the economic and geopolitical stress that Ukraine has undergone since early 2014, when Russia sent soldiers to occupy Ukrainian territory.

Heavy devaluation of the local currency and interruptions in DTEK Energy's coal production resulted in its EBITDA falling to USD 187 mln in 2015, or by almost 10x (in dollar terms) from 2013. Same time, its dollar-denominated net debt decreased only 12% in these two years. This led to a jump in its net Debt/EBITDA ratio from a comfortable 1.5x as of end-2013 to an awful 14.0x as of end-2015. With its increased debt burden, DTEK Energy had no other choice but to opt for debt restructuring.

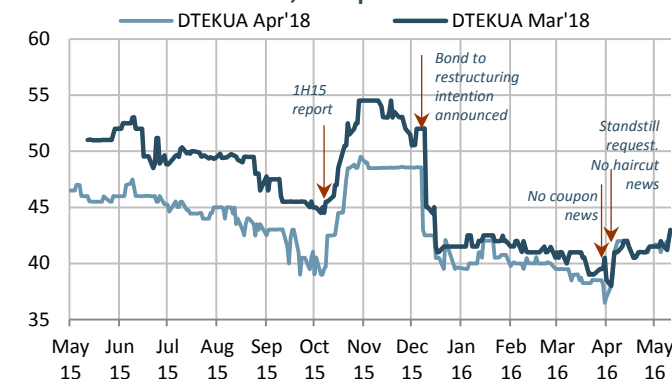
The holding was just awarded a six-month standstill from bondholders, which enables it to negotiate on a long-term restructuring of all its debts, under similar conditions, by late October. The holding preannounced no principal haircut and debt rescheduling up to 2023.

The scheduled gradual increase in household electricity rates in Ukraine (by 25% - 90% p.a. in 2015-2017) has enabled all the electricity market participants to count on price hikes for their electricity. DTEK benefited from a 24% yoy boost in thermal power plant rates in 2015, another 26% yoy increase in 4M16 and will likely enjoy some more increases during the rest of 2016.

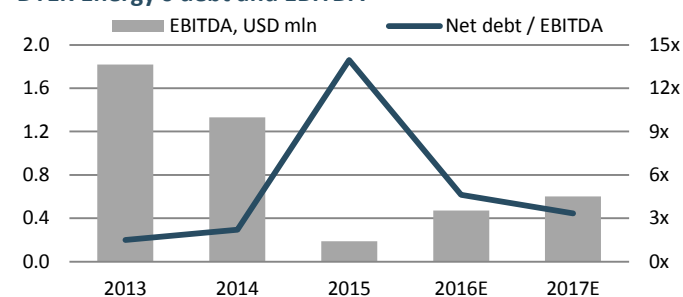
In the future, the prices of DTEK Energy's key outputs – coal and electricity generated from coal – will be linked to global market prices of coal (API2 index), which will allow the holding to boost its profit from coal sales (before May, the price was limited by the regulator) and even hedge against local currency devaluation. This became possible after the state utility regulator amended the rules of coal and power pricing in Ukraine (which takes effect gradually as of May 2016) and adjusted household power rates.

In the years to come, we estimate DTEK Energy's two flagship segments, coal and thermal power plants, will be able to generate about USD 600 mln p.a. in cash EBITDA. This estimate is based solely on the current regulatory framework in Ukraine. The risk of this regulatory framework changing for worse does exist, but we believe it's balanced with the positive risk of beneficial wholesale power market reform and the introduction of RAB-based regulation for power distribution companies (yet to be approved). With CapEx in these two segments of about USD 280 mln p.a., and other net spending of USD 20-40 mln, DTEK will be able to allocate about USD 280-300 mln p.a. to debt holders.

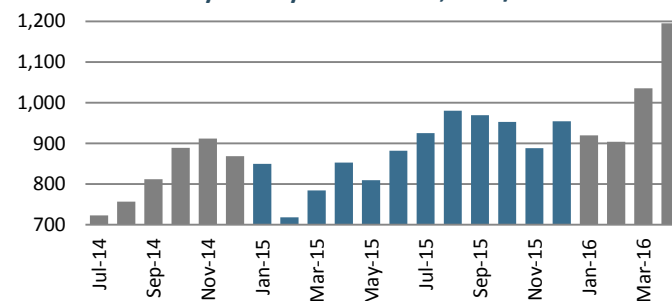
Price of DTEK Eurobonds, % of par



DTEK Energy's debt and EBITDA



Price of electricity sold by DTEK's TPPs, UAH/MWh



All the worst has already happened in 2015

DTEK Energy reported a 66% yoy decline in its EBITDA to UAH 4.1 bln in 2015, which was the result of a number of factors that should reverse themselves in the future:

- A 23% yoy decline in coal mining (due to warfare in Donbas) and a 21% yoy decline in power generation from coal. This resulted in:
 - Declining power sales and increasing fuel costs for thermal power plants by about 32%. Such cost increases weren't fully compensated by electricity price adjustments (+24% yoy only).
 - Plummeting coal mining by DTEK itself and other mines in Ukraine (-67% yoy), devastating DTEK Energy's coal trading operations.
- Increased losses of DTEK Energy's distribution segment, caused primarily by warfare in Donbas and worsened payment discipline in the ATO zone.
- Plunging electricity exports of -55% yoy, in volume terms.
- On top of that, DTEK Energy provisioned UAH 3.4 bln of trade receivables and reported a UAH 1.0 bln loss from non-recoverable VAT, which killed its reported EBITDA.

Moreover, devaluation of the local currency (and DTEK's exposure to the hryvnia) resulted in a 86% yoy plunge in DTEK's EBITDA in dollar terms in 2015.

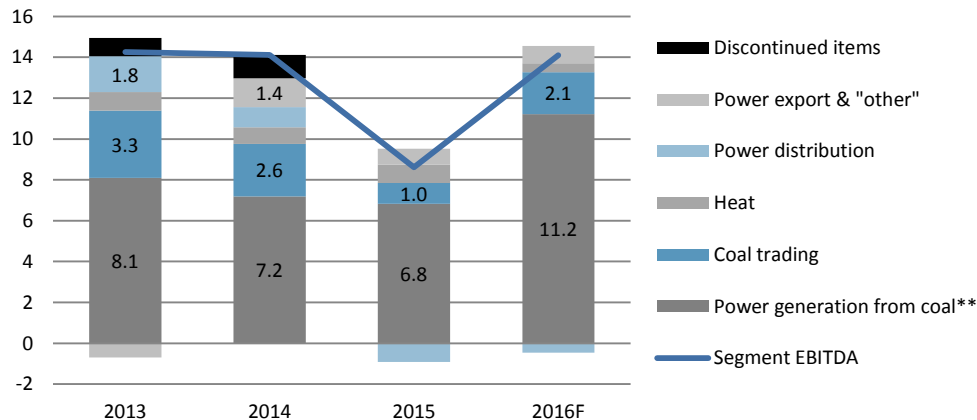
In 2016, the situation should change for much better. We forecast:

- Coal mining in the war-afflicted zone will increase by about 35% yoy (+120% yoy in 1Q16), which will allow DTEK Energy to benefit from:
 - Non-increasing coal production costs, on a scale effect;
 - An increased load on its coal-fired power plants and thus improved fuel efficiency. With minimal cost inflation at power plants, DTEK will benefit from about a 27% yoy increase in rates for generated electricity (+26% yoy in 4M16).
- More Importantly, Ukrainian coal prices will be tied to global benchmarks as of May 2016, meaning DTEK's coal business and related power-generating business will not be beholden to the volatility of the local currency any more.
- Losses at DTEK's distribution segment will be significantly reduced. Payment discipline of the wholesale market will likely improve, which will prevent high loss provisioning.

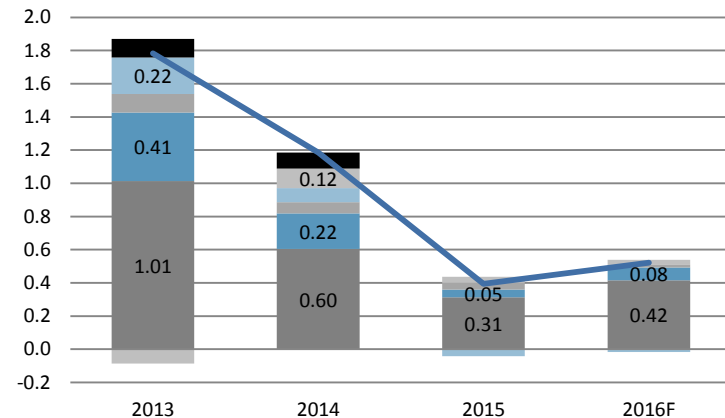
What DTEK won't be able to reverse is:

- The loss of its profitable coal-trading business, given that most of Ukraine's coal mines are left in the occupied territory, and the loss of political power by DTEK's key shareholder, which could have enabled him to trade such risky coal in Ukraine.
- Poor payment discipline for power supplied to the occupied territory on Donbas – the holding will likely continue suffering from underpayments of about UAH 0.9 bln p.a.

DTEK Energy's segment EBITDA*, UAH bln



In USD bln



Prospect of restructuring and debt valuation

Debt restructuring – yet to be agreed upon, only some parameters are known

DTEK Energy initiated a standstill agreement in late March, which has been recently approved by the majority of its bondholders. The standstill will last till Oct. 28, which buys some time for the holding to agree on a broader debt restructuring with all its creditors.

During the standstill, DTEK Energy will:

- Report monthly on its operations;
- Report quarterly on its financials and liquidity;
- Pay monthly 10% of accrued interest on all debts, and repay no debt, except the outlined *essential debt* (USD 36.1 mln outstanding as of end-1Q16). In particular, the holding is going to pay 10% of unpaid coupons on its Eurobonds in early May. The unpaid interest will be capitalized as non-interest-bearing debt;
 - The main provider of the loan that DTEK Energy defines as *essential* is Ukraine's State Savings Bank, which is a clearing operator on Ukraine's wholesale electricity market. Clearly, DTEK should not default to it.
- Pay additional interest (and repay principal) on all its debt, if its unrestricted cash for the month will exceed USD 110 mln (vs. USD 37 mln as of end-March), which is very unlikely;
- Limit CapEx to USD 30 mln per month, with the possibility to carry over the unutilized limit.

Divestment of Russian mines

On top of that, DTEK Energy announced it may enter into a deleveraging transaction to sell its Russian assets (coal mines and enrichment factories). The holding is going to sell the assets together with its debt in the amount of USD 436 mln. If successful, the deal will result in a 17% decrease in DTEK Energy's debt, from the end-1Q16 amount, to USD 2,107 mln.

We consider such a deal as a real bargain for DTEK Energy, and we don't even want to speculate on who will be a buyer of a coal asset at a multiple of over 3x EV/sales these days.

A failure to complete the deal based on the announced conditions seems to be the key risk for DTEK Energy's debt prospects.

The currently discussed parameters of a possible long-term restructuring include, according to DTEK Energy:

- **Equal treatment of all creditors** (excluding the holders of essential loans);
- **No principal haircut;**
- **Rescheduling of debt repayment up until end-2023**, with “some contractual amortization schedule including a **sizeable balloon repayment at maturity**”;
- **A reduced cash interest** on all the considered debt “until a majority of the restructured debt has been repaid”, which will be **compensated by value-recovery instruments**.
- Returning to a “contractual weighted average” pre-restructuring interest (of about 9%, we estimate) when a “majority” of debt is repaid.
- Some **restrictions** on dividends and additional indebtedness.

Modelling debt repayment schedule: estimated NPV of debt is 60 cents per dollar

To model how DTEK Energy's debt repayment schedule could look like, we rest on the following assumptions:

- Total debt subject to restructuring is USD 2,203 mln (as determined on slide 23);
- DTEK Energy will target full repayment of this debt by 2023, with as much as possible to be repaid in the last year, as the holding indicated (slide 5);
- DTEK Energy's average annual EBITDA will be USD 600 mln and available cash flow for debt servicing will be USD 280-300 mln p.a. (as we determined on slide 24);
- Half of the third-party lending provided by DTEK Energy (USD 407 mln total as of end-2015) will be recovered in 2023 (slide 23);
- All scheduled debts and interest will be paid in the last calendar day of each year;
- Discount rate used for calculating the cash flow to creditors is 15%;
- Debt markets will reopen for Ukrainian lenders by 2023, and DTEK Energy will be able to refinance its outstanding debt via new borrowing, so that its resulting debt/EBITDA will not exceed 1.5x. That means in 2023, it will be able to attract about USD 900 mln in new debt to refinance the remaining debt of the same amount.

We note that our EBITDA assumption is based only on DTEK's key segment, coal and power, and on the current regulatory framework. This forecast does not account for possible benefits from a reform of the wholesale power market, the introduction of RAB regulation for DisCos, as well as possible profits for DTEK Energy from its trading operations.

Based on the above assumptions, we have determined that DTEK will be able to allocate among the existing creditors:

- About USD 1,400 mln in 2023 (including USD 900 mln in new debt; USD 200 mln in debt recovered from related parties and USD 300 mln in generated free cash flow);
- About USD 300 mln in each of the years 2017-2022.

Clearly, DTEK Energy won't be willing to allocate all the generated cash flow among debt holders, so we assume less cash will be available for distribution:

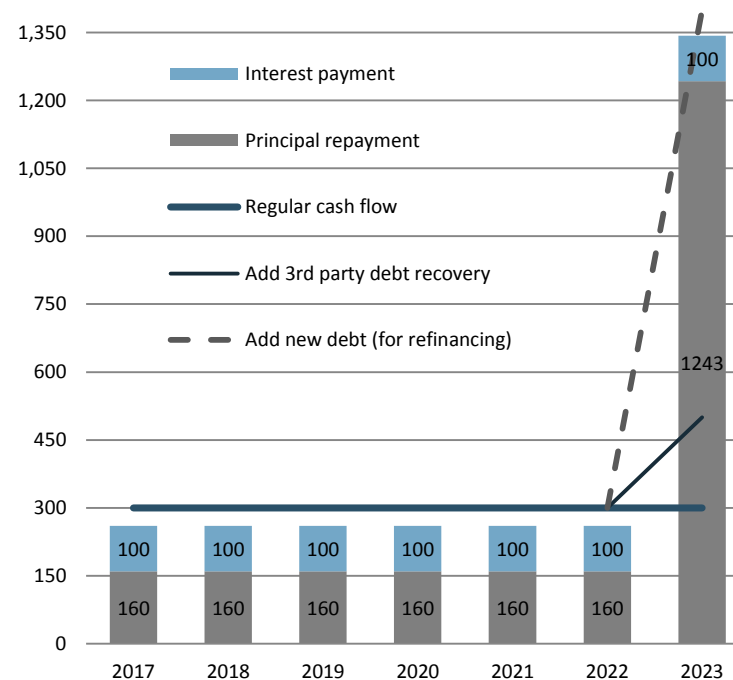
- About **USD 1,350 mln in 2023**;
- About **USD 260 mln in each of the years 2017-2022**

Based on the above assumptions, we model that DTEK Energy will:

- Repay USD 1,243 mln in debt in 2023, and USD 160 mln in each of the years 2017-2022.
- Pay USD 100 mln in interest in each of the years 2017-2023. Such interest may be explicitly agreed upon in the debt restructuring deal, or paid via value recovery instruments.

Such a schedule offers an NPV of 60.2% of the debt's par value.

Assumed cash sources and debt servicing schedule, USD bln



In a better case (USD 300 mln available in 2017-2022), we model DTEK Energy will be able to pay annually USD 130 mln in interest in 2017-2023, repay annually USD 170 mln in principal in 2017-2022 and USD 1,183 mln in 2023). Such a schedule implies an **NPV of 65.9% of par**.

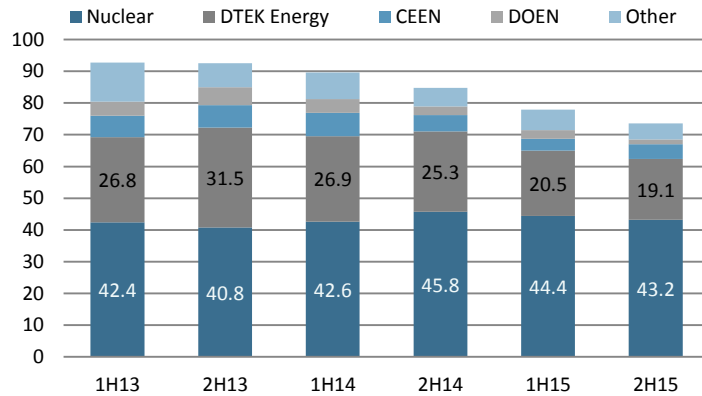
In the worst case (USD 220 mln available in 2017-2022), we model DTEK Energy will be able to pay annually USD 70 mln interest in 2017-2023, repay annually USD 150 mln in principal in 2017-2022 and USD 1,303 mln in 2023). Such a schedule implies an **NPV of 54.5% of par**.

Operations

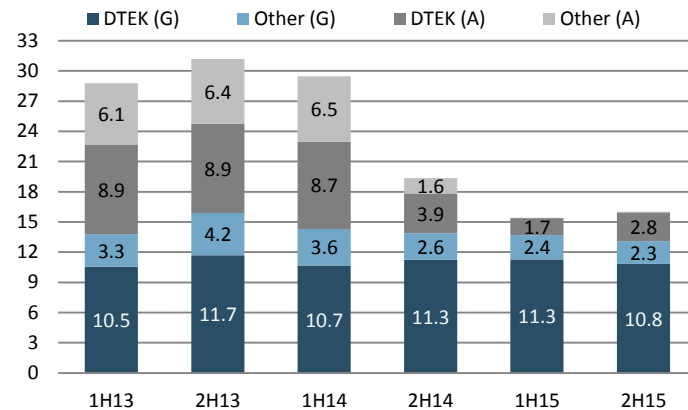
Recovery in anthracite mining expected in 2016

DTEK in Ukraine's energy sector

Electricity generation in Ukraine, TWh



Steam coal mining in Ukraine, mmt*



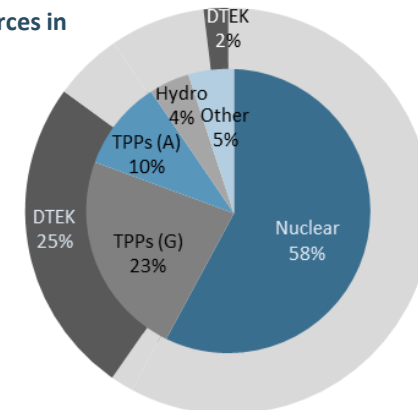
DTEK Energy is the most important player in Ukraine's coal production and power generation sector. In 2015, it accounted for:

- 85% of Ukraine's production of steam coal, and almost 100% of official production of anthracite coal;
- 26% of total power generation in Ukraine and 78% of power generation from coal.

Ukraine has lost control over all its mines producing anthracite coal after Russia occupied part of Donbas. Seven of the 14 thermal power plants (TPPs) operational in Ukraine are designed to burn this type of coal. Currently, DTEK is the only official producer of anthracite coal in the occupied territory. Its production capacity is enough to fully satisfy anthracite needs of all Ukrainian power plants. In fact, DTEK supplies its mined anthracite mainly for its three TPPs, while four other anthracite-burning power plants are focusing on coal from sources other than DTEK.

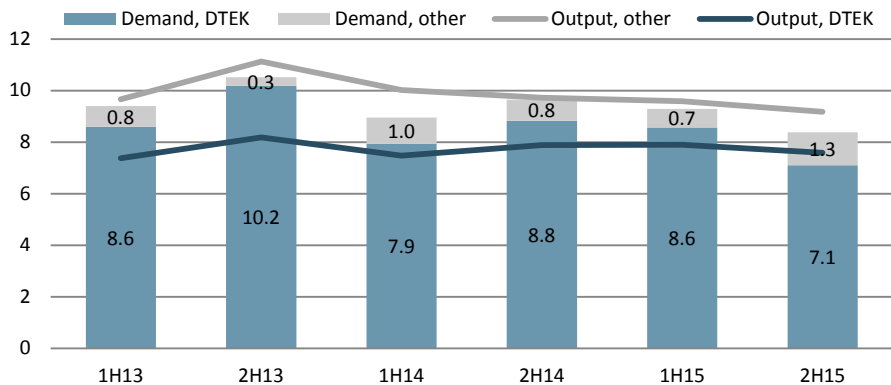
DTEK is currently self-sufficient in own coal, which enables it to benefit from full vertical integration of its coal and electricity generating divisions. At the same time, DTEK's TPPs located in western Ukraine are buying coal from the state mines located nearby (see the map on the next slide). DTEK has reported that it makes payments to the state coal holding with its own coal, mined in eastern Ukraine.

Power generation by sources in Ukraine, 2015**

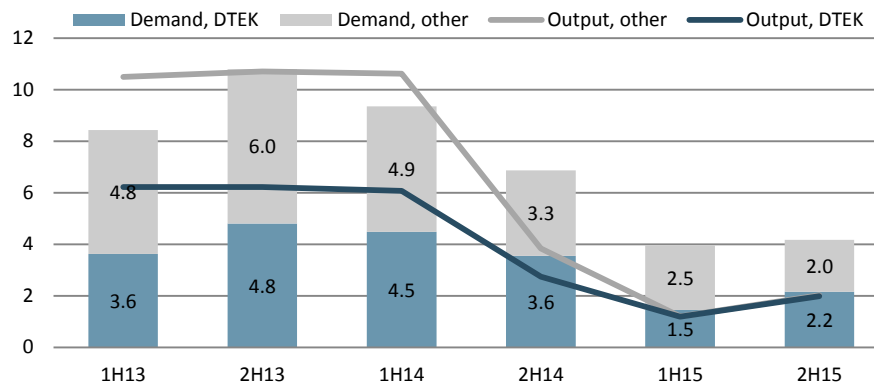


Ukraine steam coal market in 2015

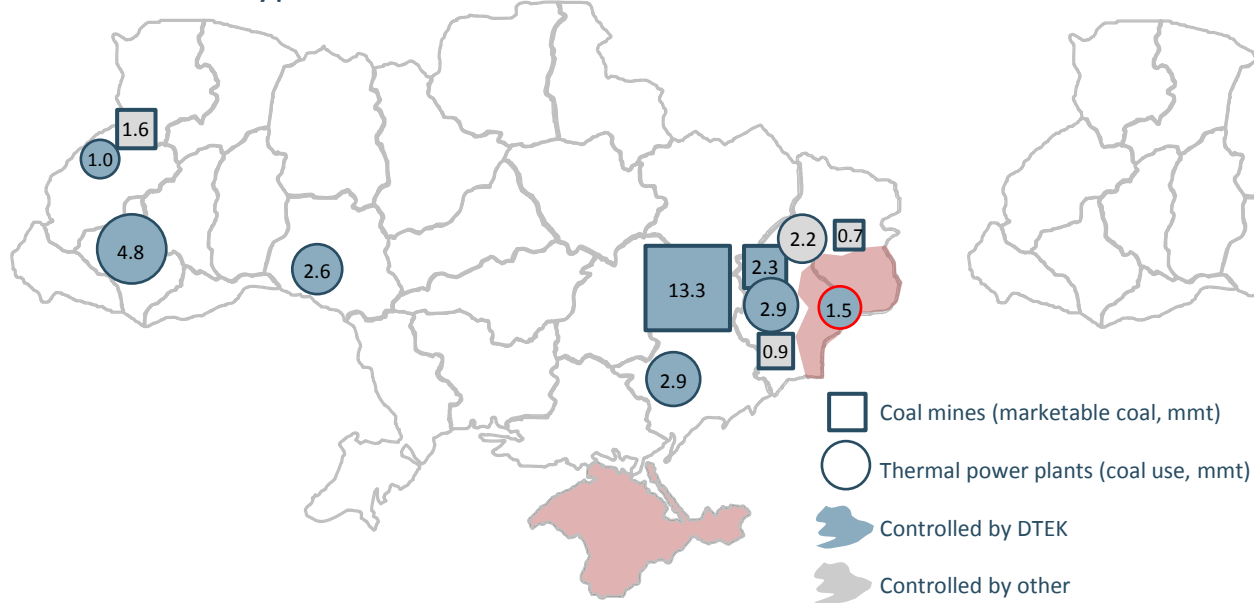
Hard steam coal balance in Ukraine, mmt



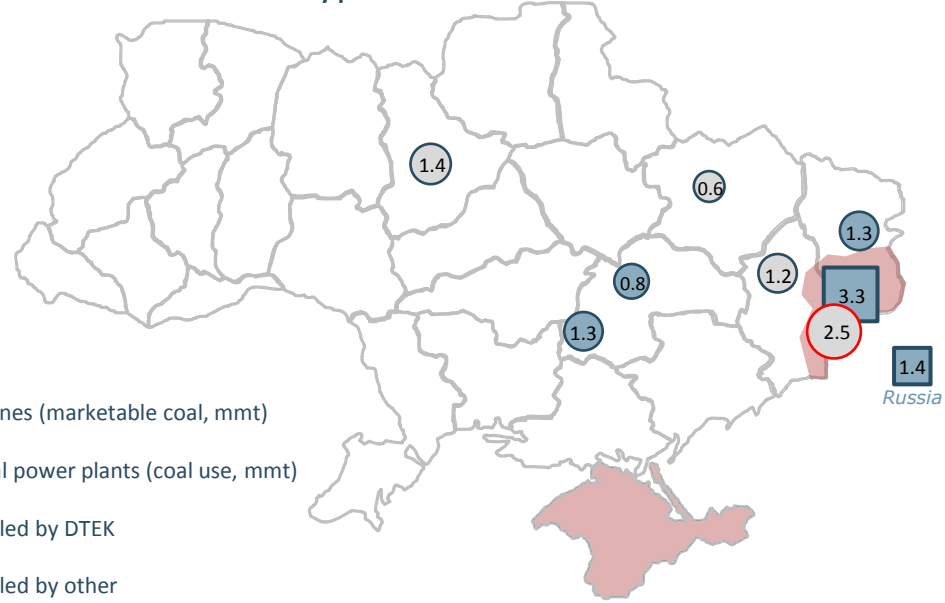
Anthracite & lean coal balance in Ukraine, mmt



Hard steam coal - key producers and consumers in 2015



Anthracite & lean coal - key producers and consumers in 2015



DTEK production cycle: the Russian occupation complicates a lot

Broadly speaking, DTEK Energy is a holding that consists of three major separate businesses that are not interconnected:

- Mining of anthracite coal (grade A and T) and production of electricity from this coal for sale to the wholesale market;
- Mining of hard steam coal (grades G, DG) and production of electricity from this coal for sale to the wholesale market;
- Purchase of electricity from the wholesale market to transmit and sell to end-users.

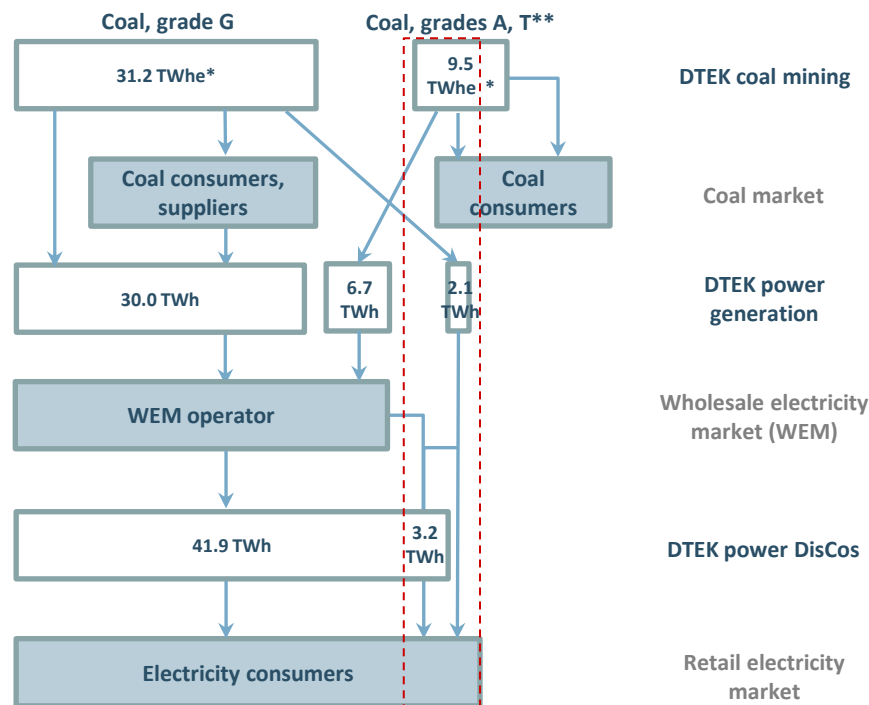
Other business include: coal, gas and power trading, production of electricity from natural gas, heat production and distribution.

As can be seen from the patterns below, the **Donbas war factor heavily affected** only one of DTEK's core production chains – all coal mines producing A and T grades of coal are currently located on the occupied territory of Donbas.

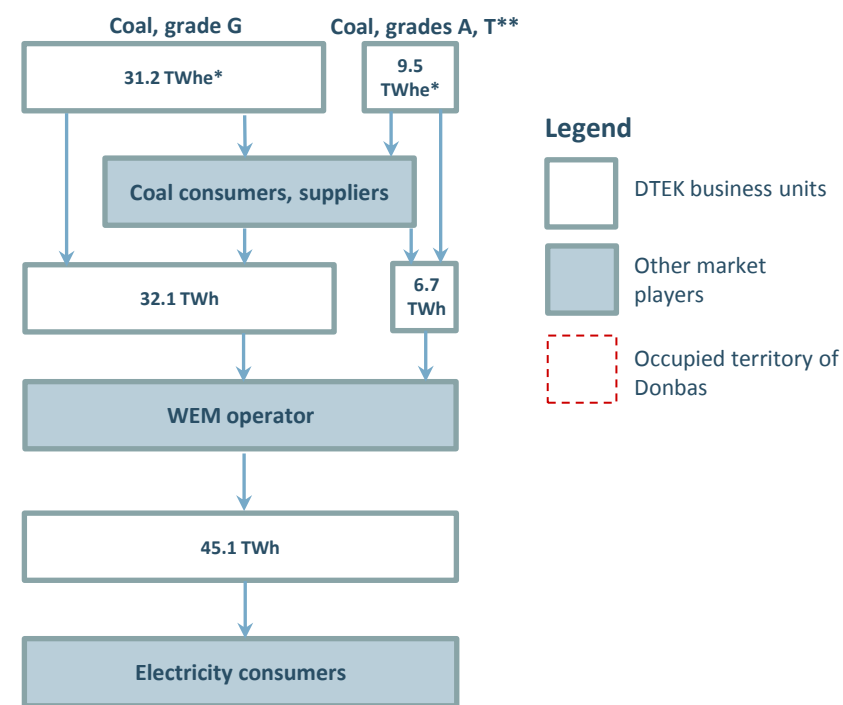
DTEK's other losses due to Russian aggression are:

- Its Zuyivska Power Plant (consuming G-grade coal), which is located on the occupied territory and has to buy coal from beyond. Since May 2015, this TPP has to sell its power to the occupied territory by itself, bypassing the wholesale market;
- The part of the service area of DTEK's three distribution companies (DisCos) is located on the occupied territory of Donbas. In 2015, DTEK also lost Krymenergo, the DisCo operating in occupied Crimea.

DTEK value chain in 2015



How it could look without occupation



DTEK operations on the occupied territory

DTEK Energy is still operating three large coal mines and one power plant on the occupied territory of Donbas. It also operates Dontetskoblenergo, PES-Energougol and Power Grid – power distributing companies with operations in the partially occupied Donetsk region. All the assets operational on the occupied territory have been re-registered by DTEK on the unoccupied territory of Ukraine.

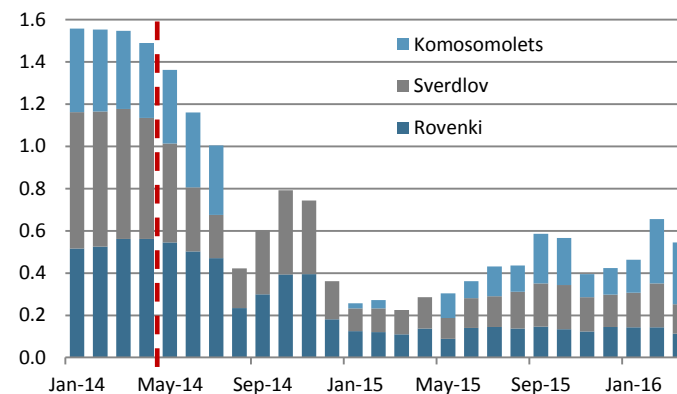
Of all of DTEK Energy’s assets, updated operational information only exists for its occupied mines. As can be seen in the chart on the right, the mines were able to partially restore their output in late 2015. In fact, those three mines are the only official miners of anthracite and lean coal in Ukraine right now. The mines are working at about 1/3 of their production level achieved before the occupation occurred. If the de-escalation in Donbas continues, these mines have a good chance to significantly restore their output in 2016.

The key hopes for mining recovery lie in restoring railway routes that would enable DTEK Energy to boost its coal supplies from the occupied territory. In 2014, due to damaged roads, the occupied mines increased their coal stockpiles by more than 1.7 mmt, while last year they fell by about 0.9 mmt, which unfroze a significant portion of working capital for DTEK (about UAH 1 bln).

Much less clarity exists on the operation of DTEK’s Zuyivska power plant, located on the occupied territory. This TPP has not sold electricity to Ukraine’s power market since mid-May 2015, based on a Ukrainian government resolution. It has to find consumers for its power on the occupied territory by itself. A lot of industrial consumers related to Akhmetov’s business empire (mostly Metinvest assets) are consumers of Zuyivska electricity, according to DTEK. There is no public information about the rates at which this TPP sells its power, nor on collection rates for supplied electricity.

Even less information exists on operations of DTEK Energy’s power distribution business on the occupied territory, except some news on equipment damage and human losses related to warfare. The UAH 0.9 bln in negative EBITDA generated by DTEK’s power distribution business in 2015 is a primarily consequence of its operations in Donbas, we estimate. On top of that, DTEK Energy reported that UAH 0.94 bln of end-2015 receivables were from clients in the war zone, and payment discipline in the territory was as low as 35.7%. DTEK does not expect this ratio to improve in the mid-term, providing the war does not end.

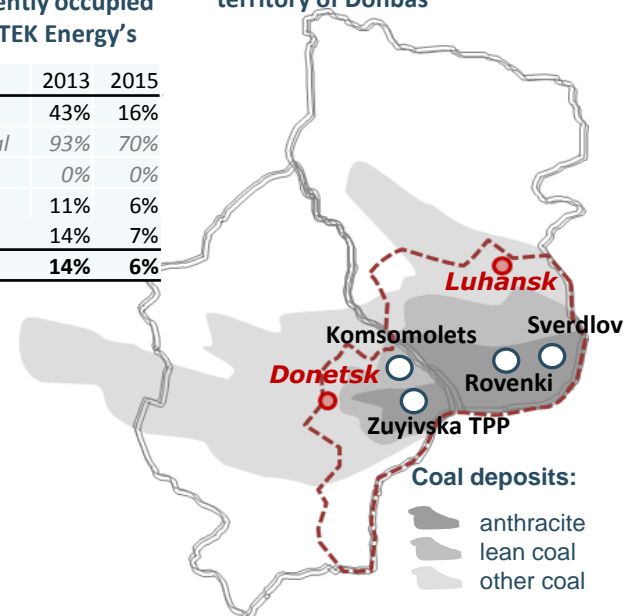
Monthly coal output by current war-exposed mines, mmt



Contribution of currently occupied area of Donbas to DTEK Energy’s results:

	2013	2015
Coal mined	43%	16%
- Anthracite & lean coal	93%	70%
- Other coal	0%	0%
Power generated	11%	6%
Power distributed	14%	7%
Total revenue	14%	6%

DTEK assets on the occupied territory of Donbas



Distribution of energy generated in Ukraine: TPPs' share stabilized at 30%

The official electricity statistics in Ukraine suggest power generated by TPPs decreased 25% yoy in 1Q15 and another 14% yoy in 1Q16.

The fall in 1Q15 was solely attributable to geopolitical and economic factors:

- Decreasing overall power demand in Ukraine and a decreasing share of “expensive” electricity supplied by Ukrainian TPPs;
- Decreasing regional demand for electricity in easternmost Ukraine, where TPPs are the only power sources.

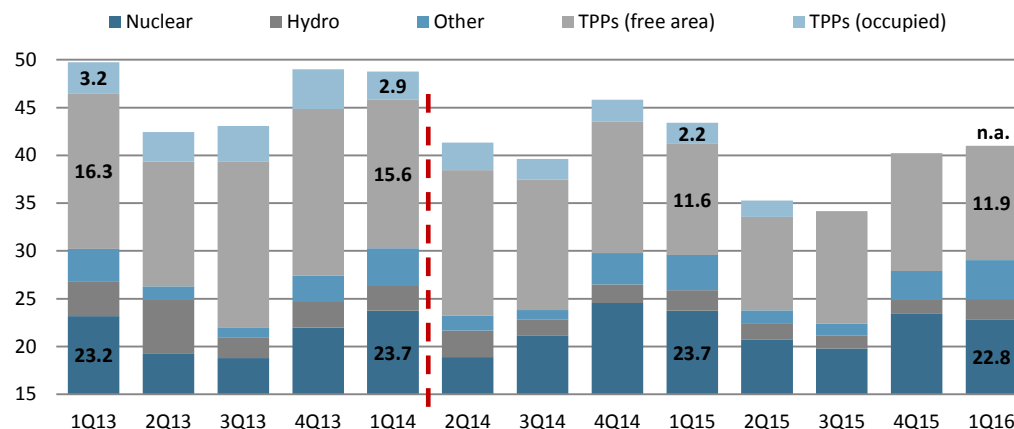
At the same time, the yoy decrease in TPPs' output in 1Q16 is solely explained by a statistical effect, namely the exclusion of TPPs located in the war zone from Ukraine's electricity statistics (since July 2015). In fact, the TPPs located on the non-occupied territory of Ukraine boosted their power output by 3% yoy in 1Q16.

We believe the TPPs working on the non-occupied area reached their minimum market share in 2015, which is 28%-34% of total power generated, depending on seasonal factors. This share is unlikely to decrease in the near future, as TPPs play an important role in smoothening daily power consumption peaks in Ukraine's energy system, unlike nuclear power plants that only provide base-load electricity.

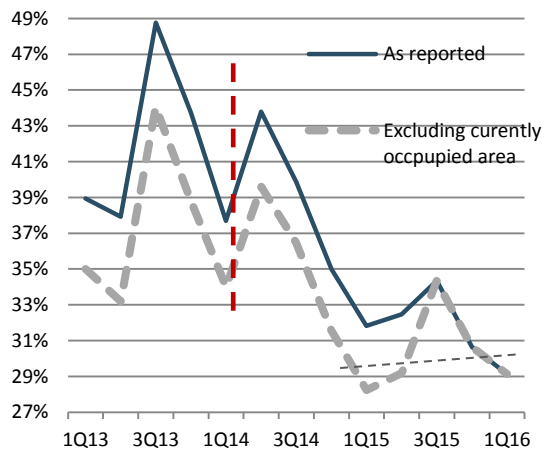
That said, we do not expect significant declines in overall TPP output in 2016, given that industrial production is recovering in Ukraine, and thus demand for electricity from industries has stabilized. At the same time, we expect some decline in power consumption by households (currently consuming about 35% of electricity in Ukraine), as increased residential power rates will stimulate energy-saving efforts. Also, we expect an increased share of TPPs burning anthracite, at the expense of TPPs burning hard coal.

We forecast DTEK's TPPs will reduce their power generation by 5% yoy in 2016. On top of that, we expect DTEK's TPPs will decrease their power output by about 4%, on average, in 2017-2023.

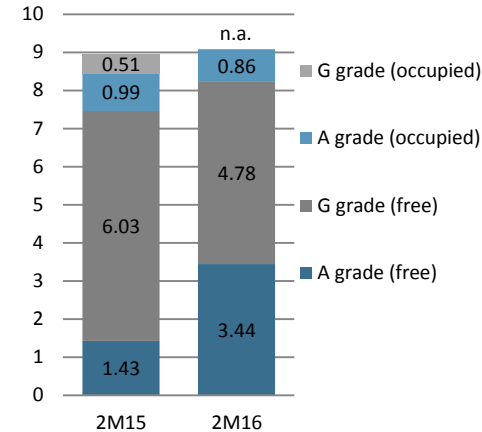
Power generated by sources, as reported officially, TWh



Share of TPPs in Ukraine's electricity balance



Power generated by TPPs (TWh) depending on coal grade and location



DTEK Energy key operating data

	2013	2014	2015	2016F	2017-2023 avg. est
ROM coal mining, mmt	41.4	37.1	28.7	28.8	26.8
- Ukraine, hard coal	22.2	21.9	22.0	20.5	20.5
- Ukraine, anthracite	17.8	12.6	4.7	6.3	6.3
- Russia, anthracite	1.4	2.6	2.0	2.0	-*
Est. marketable coal output, mmt	29.4	26.4	20.4	20.4	19.0
- Ukraine, hard coal	15.8	15.6	15.6	14.5	14.5
- Ukraine, anthracite	12.6	8.9	3.3	4.5	4.5
- Russia, anthracite	1.0	1.8	1.4	1.4	-*
Coal sold to third parties, mmt	8.3	5.5	4.2	3.8	3.5
Coal bought from third parties, mmt	7.9	7.7	1.4	1.2	1.0
Use of coal by DTEK TPPs, mmt	25.6	23.4	19.3	18.2	17.1
^ Hard coal	17.7	15.9	15.9	13.8	12.8
^ Anthracite	8.0	7.5	3.4	4.4	4.3
* Own coal	20.8	18.5	17.9	17.2	na
* Third party coal	4.8	4.9	1.4	1.0	na
Power generation, TWh	58.2	52.2	41.0	38.9	37.3
- From hard coal	37.6	33.1	31.4	27.5	26.5
- From anthracite	16.9	15.7	6.7	8.7	8.5
- From natural gas	3.8	3.3	3.0	2.7	2.3
Supply of generated power, TWh	53.3	47.8	37.7	35.7	na
^ From hard coal	34.4	30.0	28.8	25.3	24.2
^ From anthracite	15.4	14.3	6.1	8.0	7.8
* From all types of coal	49.8	44.3	35.0	33.3	32.0
^ From natural gas	3.3	2.9	2.7	2.5	na
^ From wind	0.3	0.7	-	-	-
* Supply to WEM	53.3	47.8	36.4	33.9	na
* Supply to the occupied Donbas	-	-	1.2	1.8	na
Supply of generated heat, TWh	18.7	15.5	14.4	13.5	na
- From coal	1.3	1.2	1.0	0.9	na
- From natural gas	17.4	14.3	13.4	12.6	na
Power distribution, TWh	56.9	53.8	45.1	42.0	na
Dniprooblenergo	22.6	23.0	21.7	20.8	na
Power grid	11.3	9.5	8.2	7.4	na
Donetskoblenergo & PES Energougol	9.6	8.1	6.7	5.1	na
Kyivenergo	8.9	8.9	8.5	8.7	na
Krymenergo	4.5	4.3	-	-	-

Regulatory framework

Coal and power pricing significantly improves

Electricity rates for TPPs: growth used to be limited by the regulator

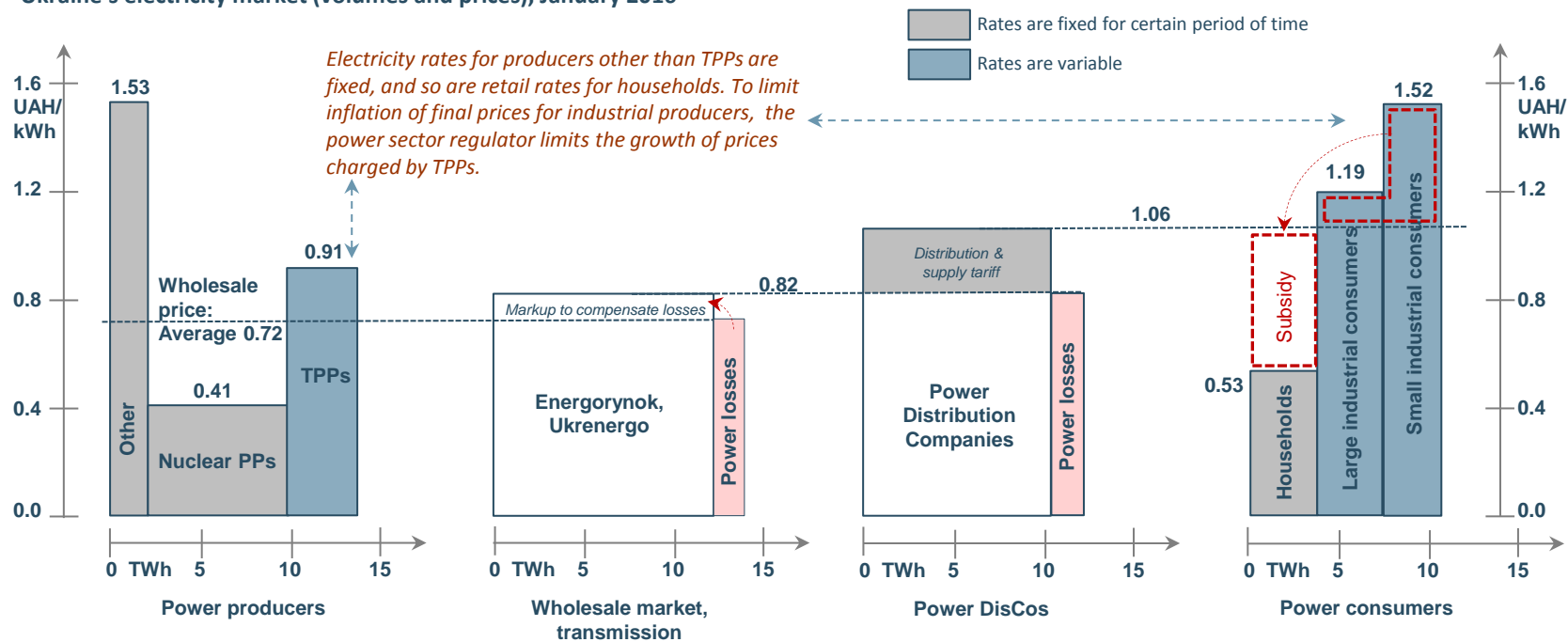
DTEK's key profit-generating direction is coal mining and electricity production from this coal. Profit from this business heavily depends on the electricity prices set by DTEK's thermal power plants (TPPs).

In Ukraine, all the electricity produced by TPPs is sold to the wholesale electricity market (WEM). The price should be based on market principles. However, the sector regulator has the authority to impose caps on this price for the stated purpose of preventing inflated electricity prices for final consumers. In fact, Ukrainian TPPs suffer from a government policy of limiting the growth of retail electricity prices for industrial consumers.

Currently, industrial consumers are covering the costs to produce and supply electricity, as well as partially subsidize the low rates charged to households. To limit the burden for industrial consumers, the regulator tends to limit the growth of the wholesale price. The easiest way to do this is to limit the prices charged by TPPs.

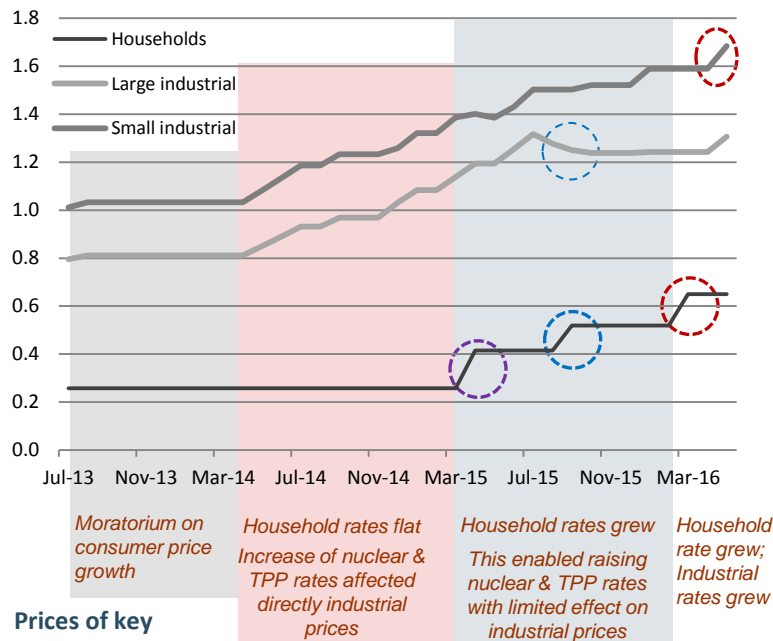
The higher the household rates, the smaller is the cross-subsidy pressure on industrial consumers. The reduced cross-subsidy in turn enables higher producer rates, including TPPs. This is what is happening in Ukraine now.

Ukraine's electricity market (volumes and prices), January 2016

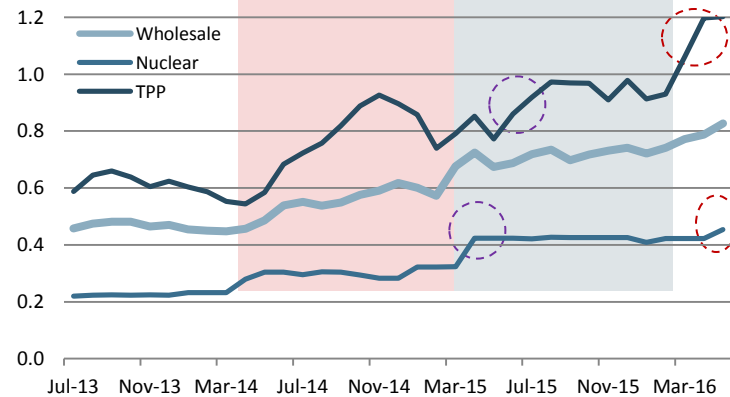


Household rate growth: much room for TPP prices to increase

Prices for final consumers, UAH/kWh



Prices of key producers, UAH/kWh



Household rates to increase

Ukraine's power sector regulator ruled to gradually increase household electricity rates by about 25% each half-year, starting April 2015.

The additional money raised from higher household rates in April 2015 and September 2015 was distributed between three key groups:

- power generators (GenCos), enabling increasing their rates;
- power DisCos, allowing for some increase in their distribution rates;
- industrial power consumers, enabling their electricity prices to grow below the rates of wholesale market price growth.

DTEK did not capitalize much, so far

As can be seen from the charts on the left, key beneficiaries of the first two waves of household rate adjustments were nuclear power plants (selling price grew 30% in Mar'15-Feb'16), as well transmission monopoly (which rate increased 38%).

DTEK claimed it benefited little from the adjustment of household rates last year. Indeed, it "bit" much less than from the "pie" as compared to state-controlled nuclear and hydro power producers and some grid operators. Nonetheless, it still benefited (its TPP selling prices grew 18% in Mar'15-Feb'16) even though it was very last in that queue.

The new adjustment of household rates (+25% since Mar'16) benefited:

- industrial consumers for a while (their projected price remained flat m/m in March-April);
- TPPs, which enjoyed a 14% m/m increase in their rates in March and another 13% m/m in April.

In 4M16, the average rate of TPPs was 26% higher yoy.

New household rate adjustment offers more chances to DTEK

The good news is there are two more 25% increases in household rates planned, and TPPs have solid chances to benefit more from each of them.

Even better news is - as of May 1, the regulator ruled to increase the benchmark electricity price (directly affecting the price for industrial consumers) based on a new methodology of calculating prices for TPPs, which should increase again as of May. See the next slide for more details.

DTEK was discussing with regulators the need to increase the average rate of TPPs to UAH 1,250/MWh (+45% yoy) in 2016.

New regulation: TPP tariffs will be calculated based on global coal prices

The Ukrainian power sector regulator approved a resolution in March to amend the methodology of calculating the benchmark retail price of electricity (the basis for calculating prices for industrial consumers) to the benefit of DTEK. In particular, resolution #289 of March 3 (valid since March 30) stipulates that TPP rates (as important part of benchmark price) will be designed to:

- Cover their fuel costs;
- Cover their fixed costs, based on historical figures adjusted for producer price inflation;
- Allow for a certain rate of profitability (the number has yet to be disclosed).

More importantly, TPP fuel costs will be based on the “market” price of coal, calculated as:

- The API2 Index, or CIF price of 6,000 kcal/kg steam coal in ARA (ports of Amsterdam/Rotterdam/Antwerp), adjusted for calorific value of Ukrainian coal;
- Plus shipment costs from ARA to Ukraine and transshipment costs in Ukrainian ports (about USD 10/t last year);
- Plus average costs to transport coal from port to TPPs (about USD 4/t last year).

All the prices should be based on average historical numbers of the last 12 months prior to their calculation.

Timing

This new methodology was brought into effect by the regulator starting May 2016. Based on it, the regulator has already upgraded the benchmark retail electricity price (which was flat at UAH 1.18/kWh since July 2015) to UAH 1.24/kWh since May, UAH 1.28/kWh since July and UAH 1.32/kWh since October 2016.

Benefits from the new coal-pricing methodology for DTEK are:

- It will enable DTEK to sell its coal to the local market at a premium to the API2 Index, in the size of logistics costs from ARA. The price should be close to USD 60-62/t (net of railway costs), or UAH 1,510-1,560/t, which is about 30% more than DTEK was able to sell in 1Q16.
- The linkage of local coal prices to global rates and freight costs will be a **hedge against currency risk, which DTEK lacked before.**

The drawback is:

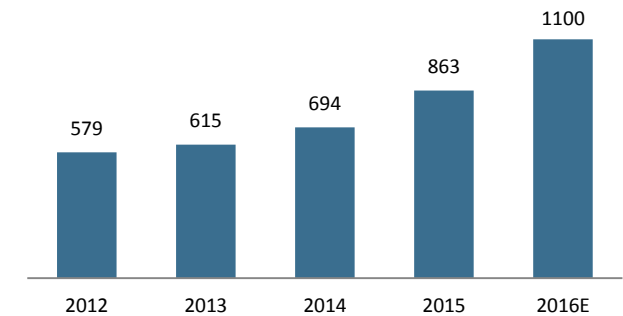
- The outlook for the API2 coal price is negative for the foreseeable future – all the forecasts point to the price remaining below USD 45/t in the next 3-4 years.

If the methodology sustains itself in the future, the “market” price of coal at TPPs would be close to:

- USD 63-65/t in 2H16, implying TPP rates of about USD 44-45/MWh (about UAH 1200/MWh);
- USD 58-60/t in 2017-2019, implying TPP rates of about USD 40-43/MWh. This looks to be not a big change from average USD 39.5/MWh in 2015, though it’s material for DTEK’s low-margin GenCos.

We forecast DTEK’s TPPs will have UAH 1,100/MWh average rates in 2016. This is remarkable 27% growth yoy, but 12% less than DTEK hopes.

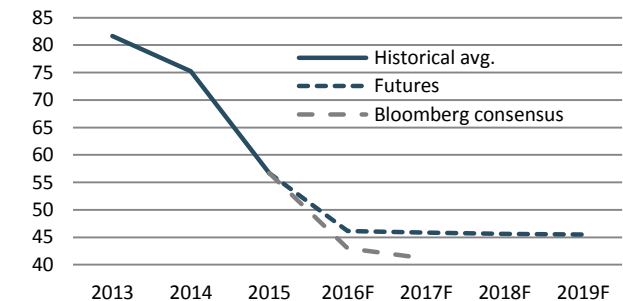
Selling price of electricity by DTEK’s TPPs, UAH/MWh



Steam coal in Rotterdam, CIF, USD/t



Steam coal in Rotterdam, USD/t



Other regulatory framework: risks and benefits for DTEK

Ukrainian power brokers announced in 2014 its “4-De” policy that should bring Ukraine out of the crisis: deoligarchization, demonopolization, deshadowing and deregulation. **Some of the declared policy priorities imply risks for DTEK Energy:**

Deoligarchization, which is understood by policy makers as efforts to restrict the economic domination of oligarchs like Rinat Akhmetov. Operating in a heavily regulated environment, DTEK is among the easiest targets of all of Akhmetov’s assets. Tough rate regulation was among the key tools of the power brokers. Thus far, it looks like rate pressures on DTEK have eased.

Demonopolization efforts is a risk for DTEK that has not surfaced yet, but is still lingering. The anti-monopoly committee of Ukraine has opened a series of investigations against DTEK in the electricity market. At this stage, we do not see any consequences from it. Though DTEK has large market share here, this market is heavily regulated nevertheless. DTEK has much bigger dominance in Ukraine’s coal sector, which is another risk. In the worst-case scenario, DTEK Energy might be forced to divest some assets to reduce its market share in the power or coal sectors. However, we do not see this happening any time soon because there are no such precedents and the president doesn’t seem to have made this a priority.

Privatization of the remaining 25% stakes in a series of coal and power companies, controlled by DTEK Energy, could bring more headache to the holding. The blocking stakes in five electricity companies – whose controlling stakes DTEK purchased in 2011-2012 – could cost DTEK Energy more than UAH 3.3 bln to acquire now, based on historic deal prices. In the current situation of a cash deficit, such expenditures are not desired for the holding, which won’t have additional benefits from the stakes (as it fully controls these companies today).

Another risk for DTEK Energy is the **loss of Kyivenergo’s key assets**, combined heat & power plants that Kyivenergo leases from Kyiv city. Kyivenergo’s lease agreement expires in end-2016 and there is a risk that it won’t be prolonged, or that lease/concession fees will increase for Kyivenergo. We believe the potential loss of Kyivenergo’s generating assets (which would turn the company into pure DisCo) will be neutral for DTEK Energy’s prospects/finances. In 2015, Kyivenergo generated UAH 933 mln in EBITDA (or UAH 448 mln if receivables for heat won’t be recovered by the company), or 12% (6%) of the holding’s total. The company’s CapEx of UAH 630 mln has eaten away at all its generated EBITDA.

What should clearly benefit DTEK is anticipated deregulation, or reforms of the wholesale electricity market and a planned new approach to regulating Ukrainian power distribution companies (DisCos). We have not taken into account these two reforms in our mid-term projections of DTEK Energy’s financials, but we are keeping in mind that any changes in the market rules should add more cash flow for DTEK.

Reform (liberalization) of the wholesale electricity market will be a clear benefit for DTEK, who could receive the right to sell a large part of its generated electricity to final consumers by charging non-regulated prices. This reform could take effect already in 2H16, but it’s too early for DTEK to draw benefits from it.

RAB-based pricing of power DisCos is also a part of expected reform in the sector. Changing from the current “cost+CapEx, zero free cash flow” model to a model that will enable DisCos to generate profit as a function of their asset base will also benefit DTEK Energy. Shifting to RAB-based pricing was postponed many times over the last decade, with the latest attempts being in 1Q15, 1Q16 and 2Q16. Thus far, the timing and exact effect of this reform on DTEK Energy are hard to estimate.

Financial analysis

Ability to service debt will improve starting 2016

Operating EBITDA: coal & power cycle is the key contributor now

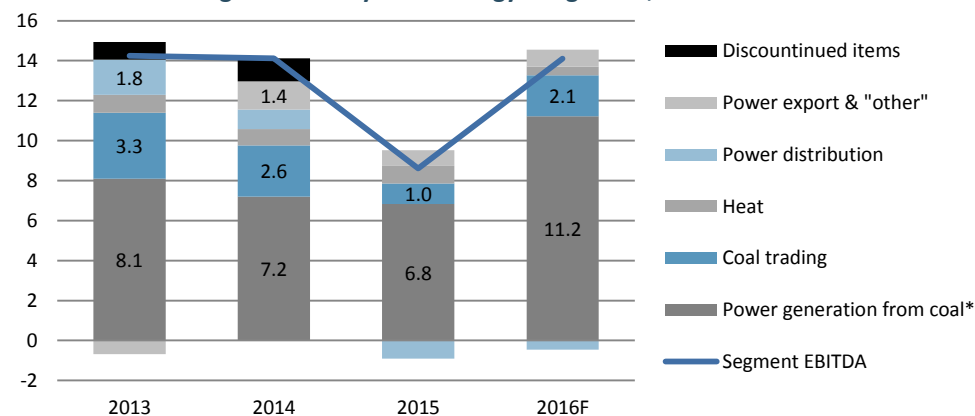
The holding's operating EBITDA (net of foreign currency and provisioning effects) decreased 41% yoy (or UAH 5.5 bln) to UAH 8.61 bln in 2015. The core contributors to the decline were:

- Coal & power segment: -25% yoy, or UAH 2.9 bln, primarily caused by a decrease of coal trading operations (estimated UAH -1.8 bln), power export (UAH -0.5 bln) and coal generation from own coal (-UAH 0.3 bln).
- Power distribution segment: EBITDA decreased UAH 1.9 bln.
- Discontinued operations of renewable power generation (UAH 0.9 bln in 2014) and Krymenergo (UAH 0.2 bln in 2014).

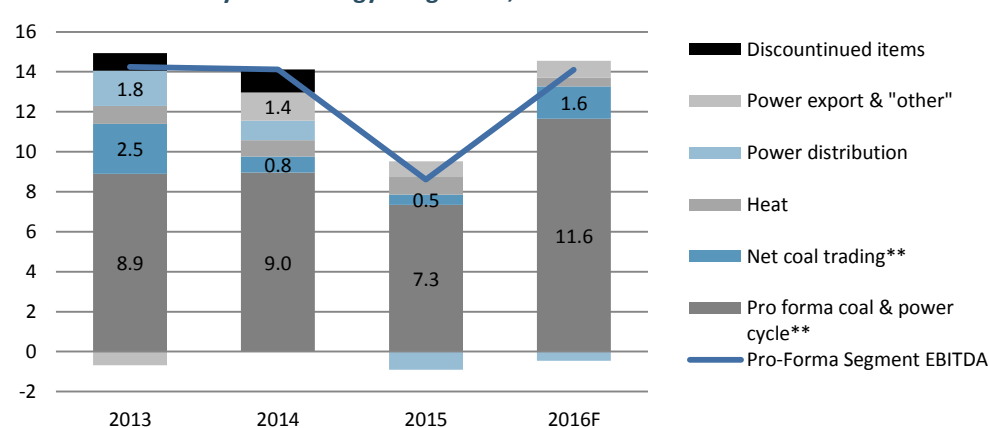
That said, we estimate that DTEK Energy's core segment, coal mining and production of electricity from coal, remained solid. Among other factors, a minor decline in the EBITDA of DTEK Energy's integrated coal & power cycle is attributable to higher use of own coal by DTEK's power plants in 2015. If we model that DTEK's power plants burn only own coal, the decline of EBITDA in such an integrated coal & power cycle would be greater in 2015 (UAH 1.3 bln, or -15% yoy). The decline is prompted by a slow increase of power rates (+24% yoy), which did not fully cover inflation in coal production costs (which rose 30% yoy, based on what DTEK Energy's management said in an annual conference call) and the power plants' decreased fuel efficiency (by 1.3% yoy).

Assuming DTEK Energy's coal production costs will increase 15% yoy in 2016 (which is rather conservative), and electricity rates for DTEK's thermal power will increase 27% yoy, we expect its integrated coal & power segment will increase its EBITDA to historically high levels, in hryvnia terms. We estimate DTEK Energy's EBITDA will reach UAH 14.1 bln in 2016.

Estimated EBITDA generation by DTEK Energy's segments, UAH bln



Restated EBITDA by DTEK Energy's segments, UAH bln



Working capital & other deductions from EBITDA

Last year was remarkable not only based on the plunge in DTEK Energy's operating profit, but also on the significant cash outflow for working capital, which added much to the deterioration of its liquidity. Before that, DTEK was efficient in collecting its bills and controlling working capital.

The most remarkable change of the last year was the worsened payment discipline of DTEK's customers. However, contrary to what DTEK was claiming, the key problem with bill collection was not with its biggest customer, wholesale market operator Energorynok (responsible for 35% of DTEK Energy's revenue in 2015), but with related parties:

Out of a UAH 3.2 bln increase in receivables and prepayments, UAH 2.0 bln were receivables due from related parties, including:

- UAH 1.2 bln due from DTEK Holding's gas company (not consolidated by DTEK Energy);
- UAH 0.5 bln due from Metinvest's Yenakiyeve Steel Plant.

Hopefully, DTEK Energy will be able to reclaim the related party receivables this year, given that the ability to generate cash flow has significantly improved recently for its related gas and steel businesses.

Receivables from Energorynok increased by just UAH 0.4 bln (1% of turnover) in 2015, and even decreased by UAH 1.4 bln in 1Q16. Moreover, it looks like Energorynok was among DTEK's key donors in 2015 – the bulk of the increase in prepayments received by the holding (UAH 2.1 bln in 2015) is likely to be money from Energorynok. That's another risk for DTEK Energy's liquidity – it will have to repay the granted prepayments in 2016. Hopefully, such payment will be made from money reclaimed from related parties, as discussed in the previous paragraph.

What's also remarkable is that UAH 0.9 bln in receivables are from customers located on the occupied territory. As DTEK is not expecting improved payment discipline in the territory, nor is it going to stop supplying power there, a risk exists that it will have to accumulate about the same amount in receivables in the coming years too.

All in all, we expect DTEK Energy will minimize the cash outflow for working capital in 2016 and further years to the level of money not received from the war zone (about UAH 0.9 bln p.a.).

EBITDA to operating cash flow, UAH bln

	2013	2014	2015
Segment EBITDA	14.55	14.11	8.06
Receivables change	-1.29	-2.15	-3.17
- With related parties	na	-0.50	-1.99
- With Energorynok wholesale market operator	na	-1.58	-0.36
ST provisions change	1.50	-0.09	-3.11
Payables & prepayments change	2.41	2.60	4.58
Inventories change	1.20	-0.74	-1.34
Other	-3.25	0.46	-0.04
OCF before interest & tax	15.12	14.20	4.98

CapEx needs – USD 0.3 bln p.a. - important part of liquidity issue

DTEK Energy operates coal, power generation and grid companies with a high level of physical wearing out. Historically, it has spent more money on improving its assets than it was able to generate from operations.

To make matters worse:

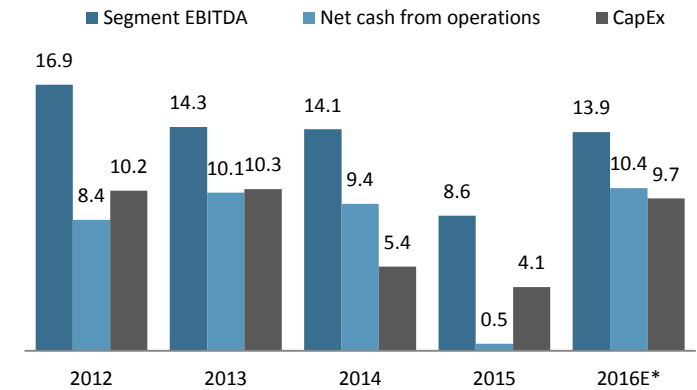
- Due to historical hyperinflation in Ukraine, D&A provisions do not fully cover the maintenance CapEx needs of Ukrainian electricity assets;
- The recent devaluation of the local currency, and the heavy link of equipment costs to hard currency (according to DTEK, about 50% of CapEx components are linked to dollars or euro) increased the CapEx burden, in local currency terms.

DTEK Energy is seeking to secure USD 30 mln in monthly CapEx during the standstill period of 2016, implying its annual plan is to spend USD 360 mln (or UAH 9.7 bln, based on an assumed UAH 27/USD average exchange rate). While in dollar terms this CapEx amount does not look significant, in UAH terms it compares to DTEK's CapEx in its most fat years. Out of the planned investment program, about UAH 1.1 bln, or USD 42 mln, is earmarked in the rates of DTEK's power distribution companies, based on our estimates.

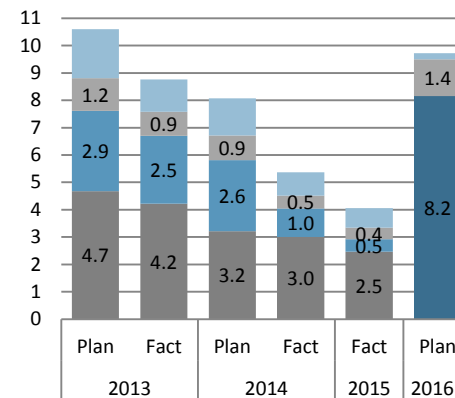
We believe DTEK Energy will be able to slightly decrease its CapEx appetites in 2016, given its tough liquidity position. Our vision is that the holding will be able to limit its CapEx to USD 300 mln this year:

- Not all the planned amount can be considered as maintenance CapEx – we assume about 20% is reserved for development. Development CapEx makes little sense in the current situation, in our view;
- In its recent history, DTEK was able to spend no more than 83% of its planned CapEx amount.

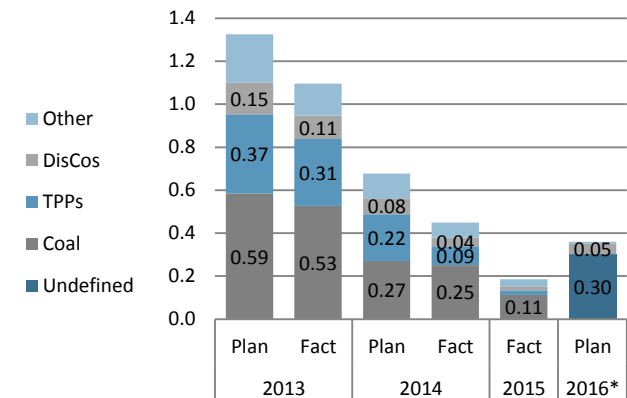
Cash from operations and CapEx, UAH bln



CapEx, UAH bln



CapEx, USD bln



Debt repayment: on average USD 0.3 bln p.a. in 7Y if Russian deal succeeds

DTEK Energy's total financial debt is reportedly USD 2,543 mln as of end-1Q16. Although it decreased by 23% in dollar terms from USD 3,476 mln as of end-2013, in local currency terms it advanced 2.4x for the period. This made the debt burden for the holding extremely heavy, with its key operations in Ukraine.

DTEK Energy reportedly stopped repaying loans in July 2015 and interest on most loans since October 2015. As of April 1, the holding has overdue payments of:

- USD 641 mln in banking loans;
- USD 80 mln in interest on loans. Most likely, this interest was accumulated over the last six months;
- A USD 8.3 mln coupon on its Mar'18 bonds ... and later a USD 29.5 mln coupon on its Apr'18 bonds.

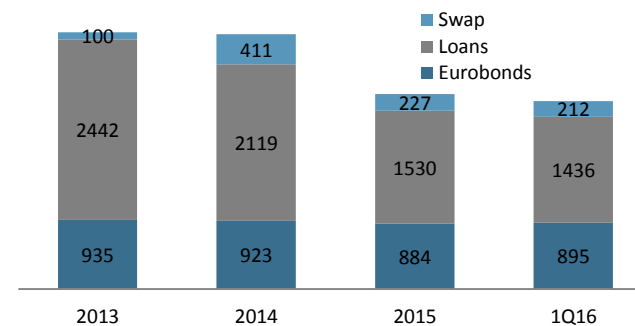
Despite being heavily indebted, DTEK Energy has outstanding loan provided to related parties (USD 407 mln as of end-2015). This debt emerged as a result of a spinoff of DTEK's oil & gas business, i.e. it wasn't a provision of cash loan. The loan generates 7% annual interest for DTEK Energy since 2015 and is recoverable in 2023-2024. While it's likely that this debt has an amortization schedule, for forecasting purposes we conservatively assume it will be repaid in two equal installments in 2023 and 2024. Based on this assumption, DTEK Energy will generate annual financial income of USD 28.5 mln p.a. from this lending in 2016-2023.

In its scheme explanatory statement, DTEK Energy:

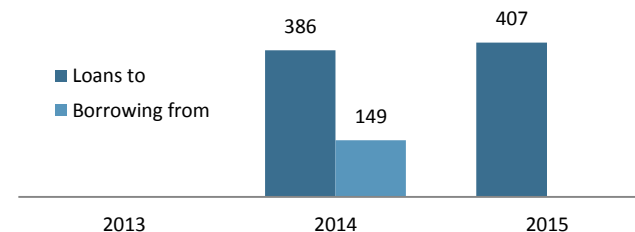
- preannounced a possible divestiture of its Russian assets, together with outstanding debt in the amount of about USD 436 mln;
- separated the holders of *essential credit lines* worth USD 36.1 mln;
- promised to pay 10% of accrued interest monthly during the standstill. That means in the next six months, DTEK Energy will accrue additionally about USD 80 mln interest on loans and USD 37.8 mln in coupons. It will pay in cash just 10% of the accrued amount monthly, and will capitalize the rest.

That means that DTEK Energy will seek to restructure until 2023 total debt of USD 2,200 mln, or about USD 315 mln, on average, in the next seven years (providing no refinancing is available at any time). Some portion of this debt could be repaid from loans to be recovered from related parties.

DTEK Energy debt structure, USD mln



Related party balance, USD mln



DTEK Energy's debt subject to LT restructuring, USD mln

Total debt as of April 1	2543
Less deleverage of Russian assets	-436
Less essential debt	-36
Plus interest on debt accrued during standstill	80
Plus coupons accrued during standstill	76
Less repaid interest during standstill	-24
Total debt subject to restructuring as of end of standstill	2203

Mid-term minimum cash generation potential covers CapEx and debt principal

Below we offer a simple model of DTEK Energy's cash flows based on simple set assumptions, derived from the valid regulator's resolution #289 (described in more details on slide 17).

Key assumptions:

- **All of DTEK Energy's business, except its coal and thermal power plants, will generate zero free cash flow.** This assumption may be too optimistic for the short term, given that DTEK's DisCos and Kyivenergo generated negative free cash flow in recent years. However, in the mid term, such an assumption is conservative, given the unavoidable RAB regulation for DisCos, as well as possible positive cash flow from DTEK's trading operations (coal trading, power export) in the coming years.
- DTEK will be able to sell its **coal** locally at **the price based on the API2 Index** (assumed to be USD 44/t), **plus shipment and transshipment costs** (assumed to be USD 10/t), as described on slide 17.
- **DTEK's mid-term coal production costs will be USD 37.5/t** (including D&A of USD 6.5/t), which is our estimate for DTEK's 2015 costs.
- Consequently, DTEK's TPPs will have coal costs that are equal to the above-derived price, plus Ukrainian Railway payments (assumed to be USD 5/t). As we have modeled, the resulting **USD 59/t coal cost** translates into **USD 31.1/MWh of fuel cost**. Other-than-fuel costs are modeled to be 20% of the total costs of TPPs. The regulator will allow for a **5% profit spread to the total costs of TPPs**.
- DTEK Energy will **also generate USD 28.5 mln** in annual interest from a related party loan, as described on slide 23.

This results in DTEK ability to generate annually USD 630 mln in coal & power EBITDA and financial income (including USD 601.5 mln in coal & power EBITDA).

Among DTEK Energy's crucial costs are its CapEx. Based on the holding's 2016 appetite (USD 360 mln), we estimate its two segments (coal and GenCos) will need about USD 280 mln in annual investments in the future.

After deducting CapEx, net cash flow would be close to USD 350 mln p.a. – that's what is available for working capital, taxes and debt repayment.

If DTEK Energy is able to limit annual working capital, provisions and profit tax charges to USD 50-70 mln p.a. (or UAH 1.4-2.0 bln) in the mid-term, which is possible, it can allocate USD 280-300 mln in own cash flow among debt holders.

Simple model of DTEK Energy's average annual operations for 2017-2023

Coal segment	
Sellable coal output, mmt	19.0
Coal costs, USD/t	-37.5
- incl. D&A	-6.5
Coal price, USD/t	54.0
API2 Index	44.0
Plus shipment & transshipment leg	10.0
Coal EBITDA, USD mln	437.0
Power generation	
Power sale by TPPs, TWh	32.0
Costs, USD/MWh	-38.8
- incl. fuel (@ coal \$ 59/t, incl. \$ 5/t railway rate)	-31.1
- incl. D&A	-3.2
Power price, USD/MWh	40.8
- incl. profit spread 5% of total costs	1.9
GenCo EBITDA, USD mln	164.5
Total Coal & Power EBITDA, USD mln	601.5
Plus interest on related party loan, USD mln	28.5
Estimated cash inflow, USD mln	630.0
Coal & GenCo CapEx needs, USD mln	-280.0
Estimated free cash flow, USD mln	350.0

Sensitivity of Coal & Power EBITDA, USD mln:

		API2 coal price, USD/t				
		40	42	44	46	50
<i>GenCo</i>	5.0%	526	564	602	640	716
<i>regulated</i>	7.5%	557	595	633	671	747
<i>profit spread</i>	10.0%	588	626	664	702	778

DTEK Energy financial summary

Key P&L and Cash Flow items, USD mln

	2013	2014	2015	2016E
<i>Average UAH/USD rate</i>	7.99	11.92	21.84	27.00
Net revenue	11,609	7,714	4,287	3,690
Adjusted EBITDA as reported	1,820	1,330	187	475
- margin	16%	17%	4%	13%
Adjusted EBIT	1,030	739	-206	162
Operating profit	975	545	-582	0
Net finance costs	-411	-894	-459	-254
ForEx losses	-40	-1,026	-602	-260
Profit before tax	649	-1,439	-1,643	-534
Net ptofit	417	-1,648	-1,712	-540
Operating cash flow before working capital, provisions, interest & tax	1,291	1,259	470	522
Net cash flow from operations	1,261	786	21	390
CapEx	-1,290	-450	-186	-305

Key Balance Sheet items, USD mln

	2013	2014	2015	2016E
<i>Year-end UAH/USD rate</i>	7.99	15.77	24.00	27.50
Non-current assets	8,891	4,825	3,503	3,179
- PP&E	7,846	3,859	2,841	2,480
- Loans to repated parties	0	374	369	407
Current assets	3,013	1,944	1,081	na
- Receivables	1,542	832	667	na
- Cash & equivalentents	656	513	29	na
- Loans to repated parties	0	13	38	0
- Restricted cash	7	224	63	na
Total assets	11,903	6,768	4,584	na
Equity	4,344	1,242	230	na
Non-current liabilities	4,973	1,842	1,545	2,509
- Eurobonds	936	743	884	880
- Loans	1,849	232	0	983
- Derivatives	0	411	227	212
Current liabilities	2,587	3,684	2,809	1,338
- Eurobonds	0	180	0	73
- Loans	595	1,886	1,530	82
- Payables	1,678	1,042	865	770
Total loans	2,444	2,119	1,530	1,065
Total Eurobonds	936	923	884	953
Gross derivatives	0	411	227	212
Borrowings from related parties	0	149	0	0
Cash & equivalentents	656	513	29	55
Lending to related parties	0	386	407	407

Available 1Q16 data for DTEK Energy subsidiaries

		1Q16			1Q15			yoy			Net revenue, UAH mln		EBITDA, UAH mln	
		1Q16	1Q15	yoy	1Q16	1Q15	yoy	1Q16	1Q15	1Q16	1Q15			
Coal mining in Ukraine														
Pavlohradvuhillia	mmt mined	4.42	4.66	-5%	-	-	-	5,606	4,923	559	696			
Other mines	mmt mined	2.50	1.64	52%	-	-	-	na	na	na	na			
Total	mmt mined	6.92	6.30	10%	-	-	-	-	-	-	-			
Power generation & distribution														
Dniproenergo	TWh output	2.32	2.51	-7%	-	-	-	2,390	1,804	-98	-862			
Zakhidenergo	TWh output	3.40	4.71	-28%	-	-	-	3,088	3,756	-727	-604			
Skhidenergo	TWh output	2.45*	2.52	-3%	-	-	-	na	na	na	na			
Kyivenergo	TWh output	1.05	1.12	-6%	TWh distr.	2.44	2.40	2%	7,436	6,135	270	327		
Donetskoblenergo	TWh output	0.06	0.03	76%	TWh distr.	1.16	1.68	-31%	1,239	1,193	-217	-792		
Dniprooblenergo		-	-	-	TWh distr.	5.78	5.54*	4%	6,323	5,330	69	31		
Other DisCos		-	-	-	TWh distr.	1.86*	2.40*	-25%	na	na	na	na		
Total	TWh output	9.27*	10.85	-14%	TWh distr.	11.20*	12.01*	-7%	-	-	-	-		
Combined available data														
									26,083	23,141	-144	-1,204		

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