DTEK Energy Eurobonds

Tough talks ahead

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Summary

DTEK Energy, which is in talks with its creditors on long-term debt restructuring, offered last week its view on its debt operation, which was not supported by ad hoc committee of bondholders.

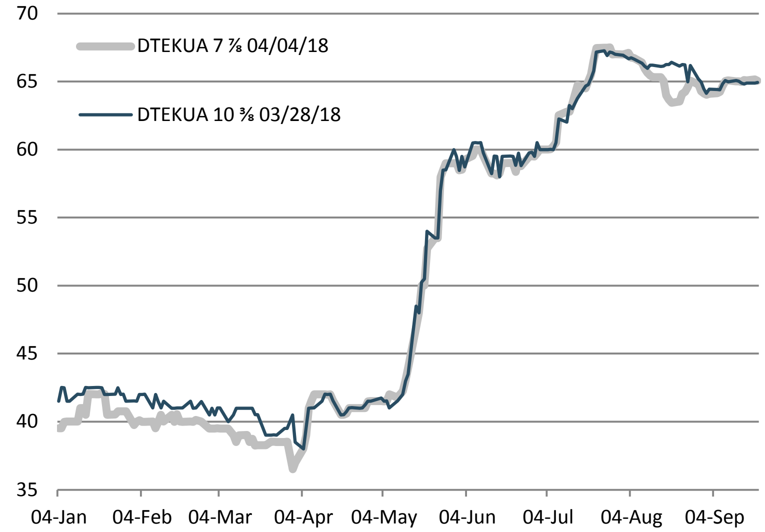
The implied NPV of DTEK Energy's Eurobonds, as can be estimated from the offer documents, is 68%-70% of the bonds' initial par value (assuming a 15% discount rate). This is largely on par with current market prices for the notes.

We believe DTEK is capable of improving its recent offer, which might increase the NPV of cash flows under the notes to 75%+ of initial par value.

At the same time, we see a risk that DTEK Energy will have more time to complete the negotiations with its creditors. The current standstill agreement assumes a long-term deal will be reached by Oct. 28. However, DTEK's peer Metinvest, which seems to be much closer to a deal with creditors, recently asked for a postponement of negotiations till late November. All this implies a DTEK deal is unlikely to be reached earlier than the last days of this year.

Thus far, we maintain our neutral view on DTEKUA Eurobonds.

Bond prices, % of par



Source: Bloomberg

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DTEK's restructuring offer for bondholders: looks better than we anticipated

On Sept. 14, DTEK presented to its bondholder ad hoc committees its view on mid-term restructuring of bonds and loans, as well as provided some mid-term financial forecasts.

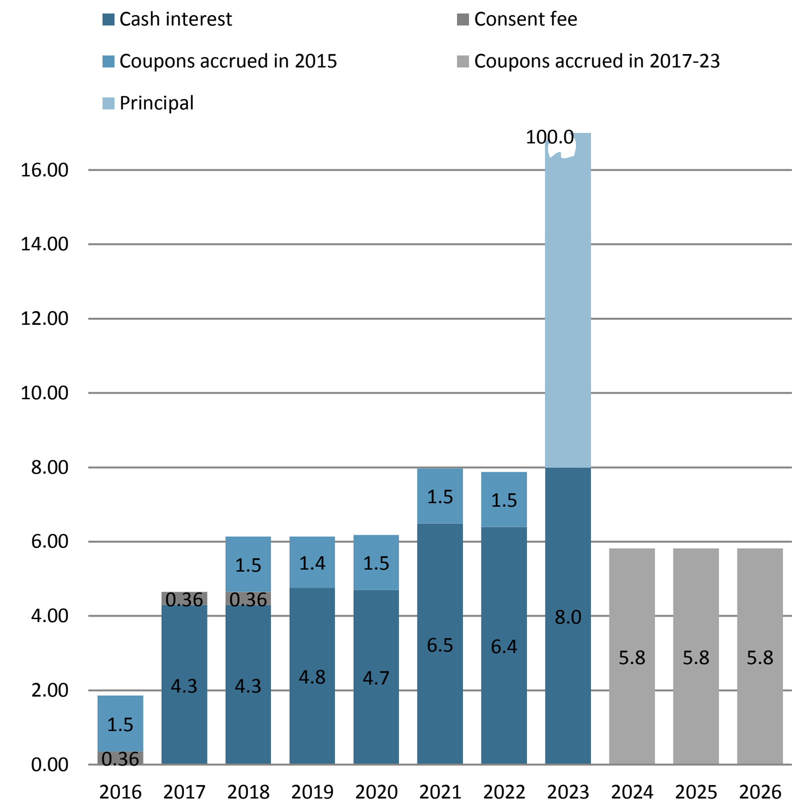
The key terms of Eurobonds restructuring were:

- Principal of bonds will be repaid in one tranche in December 2023;
- Amortization of principal will be limited to the amount of coupons unpaid during the standstill. As we estimated based on provided information, the accumulated unpaid coupons will be repaid in six equal annual tranches in 2016, 2018-2022;
- The applied interest rate on the restructured Eurobonds will be 8%. The holding did not specify whether it will apply an interest rate to the coupons unpaid during the standstill , while we assume it will;
- Cash interest to be paid will start from 4% in 2017 and will increase to 8% in 2023. Based on the holding's presentation, we estimate that the cash coupon rate will be 4% in 2017-2018, 4.5% in 2019-2020, 6.3% in 2021-2022 and 8.0% in 2023;
- Coupons accrued but unpaid during 2017-2023 will bear no interest, and will be repaid in three equal annual tranches in 2024-2026;
- DTEK will offer a 1% consent fee repayable in three annual tranches in 2016-2018. We assume it will be applied to all the amounts of Eurobonds outstanding (including unpaid interest during the standstill).

It seems like DTEK was trying to offer bondholders a payment schedule that brings the bond's NPV to about 100% of its initial par value, based on the offered interest rate of 8%.

At the "market rate", which we assume to be 15%, DTEK's Eurobonds offer about 68% of initial par for the USD 750 mln in notes and about 70% of initial par value for the USD 160 mln in notes. This is slightly higher than a possible NPV under the scenario that we initially modeled (about 66% of initial par).

Estimated repayment schedule of DTEKUA 04/04/18 bond*



** Per USD 100 of initial par value of the bond.*
Source: Company data, Reorg Research, Concorde Capital research

Bondholders ask for more

On Sept. 15, the DTEK bondholder ad hoc committee declared its opposition to the plan, claiming that "It does not give creditors a fair economic return" and it "has additional room for optimization."

The key demands of the committee are:

- The coupon needs to be increased and the postponed coupons should bear interest;
- Cash sweeps should be enhanced;
- Monetization of non-core assets should be done;
- More restrictions on investment and dividends should be placed until the company is current on all its obligations;
- A shareholder contribution may be required to support a full NPV recovery for bondholders.

Our view is DTEK indeed has the capacity to improve the offer to note holders, even without shareholder's contribution:

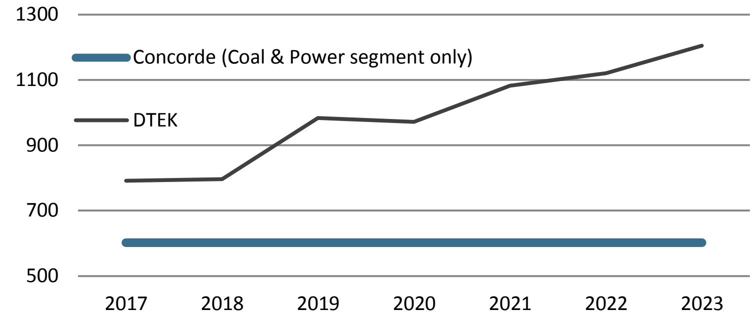
- The offered CapEx schedule looks too aggressive and should be optimized;
- DTEK's intention to continue lending to its related party USD 407 mln with interest (7% p.a.) to be capitalized and only repaid in 2023-2024 is value-dilutive and unfair.

That said, we see some room for DTEK to increase the NPV of the Eurobond repayment flow to 75%-80% of their initial par value, providing its P&L forecasts for 2017-2023 are realistic.

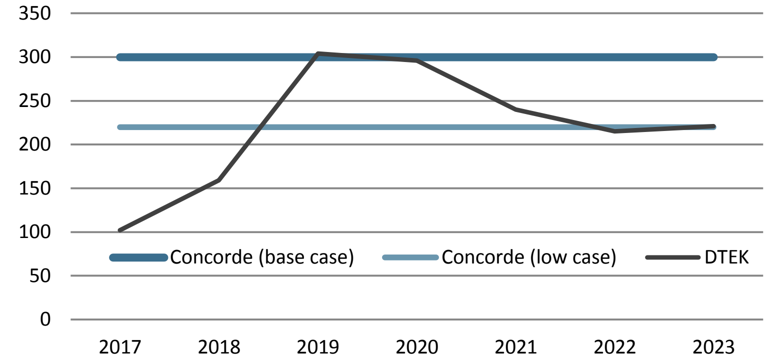
At the same time, we see a high risk that DTEK won't reach the planned level of operating profit in the future. In particular, we doubt that:

- DTEK will be able to significantly increase coal and power output in the coming years;
- DTEK's coal and electricity will be priced in the future based on the current methodology (benchmarking to the API2 coal index plus coal delivery costs from Rotterdam);
- DTEK will be able to enjoy a beneficial RAB-based approach in its power distribution segment (which, as we understand it, should become the main EBITDA growth driver for DTEK).

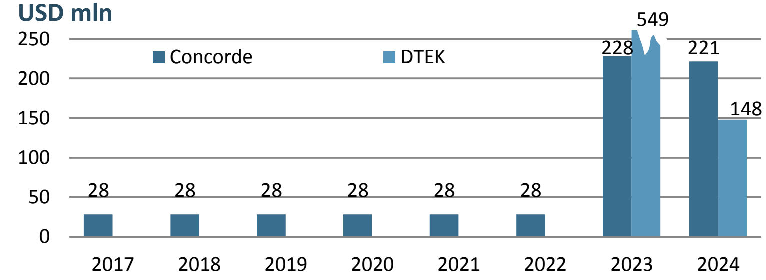
DTEK Energy's EBITDA forecast, USD mln



DTEK Energy's free cash flow forecast, USD mln



DTEK Energy's repayment schedule under lending to related party, USD mln



Source: Company data, Reorg Research, Concorde Capital research

DTEK Ukraine operations – still in line with our forecast

Based on data provided by Ukraine's Energy Ministry for 7M16:

Coal production at DTEK's mines increased by a mere 1% yoy in 7M16, mainly due to 80% yoy growth of mining of anthracite and lean coal on the occupied territories of Donbas (the industrial belt of Ukraine's easternmost Donetsk and Luhansk regions). The growth has slowed down due to emerging troubles with coal shipment from the occupied territories in June, which resulted in stoppage of coal mining (see the chart).

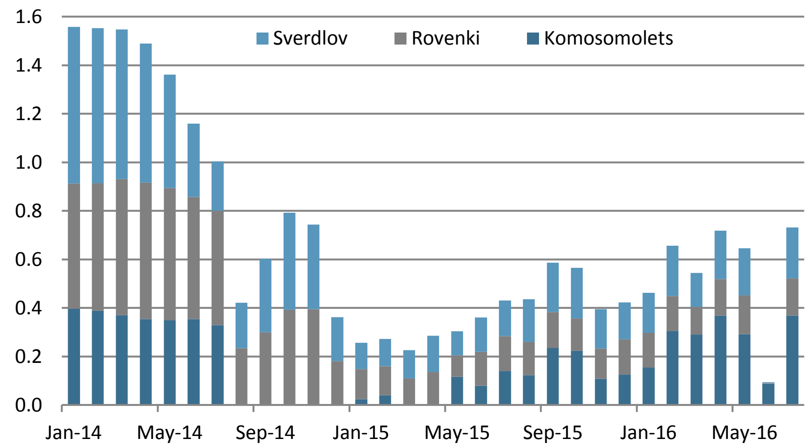
The 7M mining results are broadly in line with our view that DTEK's coal mining will be flat yoy in 2016. At the same time, we now expect that in 2H16, DTEK will intensify its coal mining to outperform the last year by 3-4%.

DTEK's power plants located outside occupied Donbas reduced their power generation by 8% yoy. Yet among those, anthracite-burning thermal power plants showed spectacular growth of 81% yoy. This is in line with our vision that power generation at DTEK's TPPs will decrease 5% yoy in 2016.

DTEK Energy's operations in Ukraine

	7M16	7M15	yoy
Coal mining, mmt	**15.44**	**15.28**	**1%**
Anthracite & lean coal (occupied zone)	3.86	2.14	80%
Hard coal	11.58	13.14	-12%
Power generation (excl.-occupied), TWh	**21.99**	**23.79**	**-8%**
From anthracite & lean coal	5.66	3.13	81%
From other fuel	16.32	20.66	-25%

DTEK Energy's coal mining in the occupied Donbas, mmt



Source: Energobiznes, Concorde Capital research

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