Ukrainian Elections:

Implications for fixed income universe

March 19, 2019

CONCORDE CAPITAL

Executive summary

With less than two weeks until Ukraine's presidential elections, there is still little clarity about who will become the next president, with three candidates enjoying a likelihood of higher than 25% of winning. They are President Petro Poroshenko, former Prime Minister Yulia Tymoshenko and Volodymyr Zelenskiy, who has no governing experience. Among them, Poroshenko has the advantage of getting re-elected, while Tymoshenko's chances are the weakest in the vote scheduled for March 31. Zelenskiy has enjoyed a comfortable lead in the polls since January.

The elections are critical for Ukraine's fixed income universe as each candidate poses significantly varying risks. Poroshenko's re-election is the best outcome for reducing sovereign risk, while at the other extreme, Tymoshenko's victory has the potential to cause risk to surge. This is due to the varying attitudes to the core demands of the IMF, the institution that will remain the core guarantor of Ukraine's mid-term solvency.

The two most likely pairs to qualify for the second-round runoff (scheduled for Apr. 21) are:

- Zelenskiy and Poroshenko – a combination that slightly reduces risks for mid-term sovereign bonds and the longer bonds of state banks.
- Zelenskiy and Tymoshenko – a combo that boosts risks for mid-term sovereign bonds and inflates risk for DTEK, while also improving the prices of defaulted Privatbank bonds.

The current level of Ukraine's sovereign curve reflects a Zelenskiy victory, which won't reduce Ukraine's political risk by much until the parliamentary elections scheduled for October. Indeed, it's the parliament (and the Cabinet elected by the coalition majority) that determines economic policy. Given that Zelenskiy's first months may not be effective (and he's subsequently unable to field a strong party in the October elections), the parliamentary vote could turn out just as important as the presidential vote, if not more so. In contrast, his two highly experienced competitors, Poroshenko and Tymoshenko, are both likely to get the largest faction in parliament and become the key force in forming the coalition if he/she becomes president.

So far, the government is determined to smoothly service its debt. In the worst-case scenario (e.g. in case of Tymoshenko's presidency), this commitment could change only after the October parliamentary elections, or in early 2020. This implies that:

- The most sensitive Eurobonds to the outcome of the presidential elections are sovereign Eurobonds maturing in 2020-2023, the bonds of Oschadbank and Ukreximbank maturing in 2025, and the notes of DTEK Energy. Their downside risk if Poroshenko loses is high compared to the rewards from his victory.
- The least sensitive to politics are the shorter bonds of Oschadbank, Ukreximbank and Ukrainian Railway (as most of their principal will be repaid in 2019), as well as the notes of Metinvest, which demonstrate the smallest correlation to the sovereign curve.

In the universe of defaulted Eurobonds, the most sensitive paper to politics are the bailed-in notes of Privatbank. In the case of victory of Zelenskiy or Tymoshenko – whose campaigns are widely acknowledged to be backed by the bonds' largest owner, Igor Kolomoisky – the chance of these notes being recovered smoothly will increase, and will remain no less than today in the event of Poroshenko's victory.

Defining Political Risk

Summary: Political uncertainty and sovereign risk

Ukraine's smooth and timely cooperation with the IMF is the key for fiscal solvency in the mid-term, as we show on slide 13. This fundamental condition will highly depend on this year's political events, as the competing political forces will purpose different economic priorities, including varying approaches to fulfilling key IMF demands.

These key demands are the only known factors (see slide 11). The key unknown is whether Ukraine's power brokers will able to agree with the IMF to secure future loan tranches. This unknown factor be broken down into **two components**:

- Risks posed to IMF cooperation (whether and when the next tranche is possible).
- Political risk, or overall uncertainty about when the risk of cooperation will intensify or disappear. Two key events this year will directly affect political risk: the presidential elections scheduled for March 31 and April 21, and the parliamentary elections scheduled for October 27.

Currently, three candidates have strong chances to win the presidential elections in April: President Petro Poroshenko, former PM Yulia Tymoshenko and dark horse Volodymyr Zelenskiy. Former Defense Minister Anatoliy Grytsenko is a candidate worth considering, though his chances are slim.

It's worth considering how the victory of each candidate will influence the two key unknowns:

- **A Poroshenko victory** is the best outcome for IMF cooperation. **Political uncertainty** is eliminated already **in April** since Poroshenko-president will likely field the largest parliamentary faction in the October vote and eventually form the majority. Subsequently, his re-election **nearly eliminates any risk to IMF cooperation** since Poroshenko has demonstrated relative consistency in leading the government to meet IMF demands. In turn, we can expect Ukraine's sovereign yield curve to plunge by up to100-150 bps in April-May.
- **A Tymoshenko victory** will also reduce **political uncertainty in April** since she also could secure the largest parliamentary faction and eventually form the majority. At the same time, her victory **poses the highest risk to IMF cooperation** since her stated economic agenda is hostile to IMF demands. If she wins, the next loan tranche will be postponed at least. In turn, we can expect Ukraine's sovereign yield curve to increase in late April.
- **A Zelenskiy victory won't reduce political uncertainty** in April. As an inexperienced politician, he is unlikely to accomplish much in his first months nor consolidate parliament. In turn, this high uncertainty creates a **risk to IMF cooperation** since the probability of a pro-IMF and anti-IMF parliament will remain equally high**.** In such case, some upward movement of the yield curve in April-May is likely, though a downward move should not be ruled out.

Source: Concorde Capital research

Scenarios: Future president, parliament and IMF cooperation

All things being equal, Ukraine's newly elected parliament tend to be populist and resistant to difficult IMF demands. The elected parties form factions and the majority coalition, led by the prime minister, who plays the central role in setting the economic agenda.

However, the president – who appoints the heads of national security and defense, foreign policy, the prosecutor's office, and (with some limitations) the central bank governor – can steer the parliament towards either accommodating or rejecting IMF demands. A strong president like Poroshenko or Tymoshenko (whose authority won't likely be limited to these appointments) is likely to be able to form a pro-presidential parliamentary majority.

President (to be elected by late April):	Poroshenko ***IMF compliant***	Zelenskiy ***unclear***	Tymoshenko ***IMF resistant***
Most likely new parliament (to be elected in October):	Pro-Poroshenko ***IMF compliant***	Not pro-Zelenskiy ***unclear***	Pro-Tymoshenko ***IMF resistant***
Overall IMF cooperation	***Close cooperation highly likely***	***Possible delays, uncertainty remains***	***Delays highly likely, negotiations on new agenda***
Likely movement of Ukraine sovereign curve in April-May	***Down 50-150 bps***	***Down 30 – up 50 bps***	***Up 50-150 bps***

Source: Concorde Capital research

Political uncertainty may be over in April

Ukraine will hold two important elections this year, which will define the future of state policy for the next five years.

Ukraine is a **parliamentary-presidential** constitutional republic. The public elects the president, who largely oversees foreign policy. The public also elects parties to parliament, which form a coalition majority of factions. This coalition selects the Cabinet of Ministers, which determines domestic economic policy.

With presidential elections to be held first, a powerful, charismatic president (Poroshenko or Tymoshenko) will have a strong advantage to enable their party to gain the most votes in the parliamentary election and form the largest faction that will lead the agenda.

Therefore, we believe that Ukraine's mid-term future (five years) will be largely determined by April with the victory of either Poroshenko or Tymoshenko, who have strong political organizations to compete in October. With anyone else winning the presidency, it will be the October parliamentary elections that remove the remaining political uncertainty.

Three candidates have a realistic prospect to become elected president: the incumbent Petro Poroshenko, former PM and political prisoner Yulia Tymoshenko and dark horse Volodymyr Zelenskiy. The polls show Zelenskiy with a consistent lead since January, with Poroshenko and Tymoshenko competing neck-and-neck. The candidacy of former Defense Minister Anatoliy Grytsenko and former Energy Minister Yuriy Boyko are worth considering, though their chances are slim.

In our view, chances of Poroshenko/Zelenskiy/Tymoshenko to become a next president are quite comparable: 37/34/29.

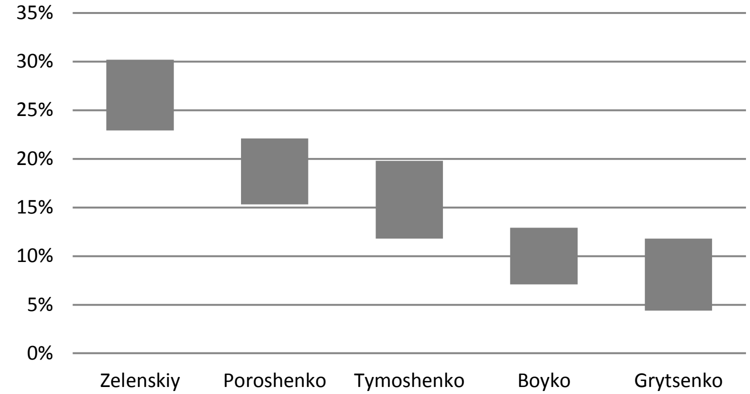
Presidential elections:
Mar. 31 – first round

Apr. 21 – second round (between two gained most in 1st round)

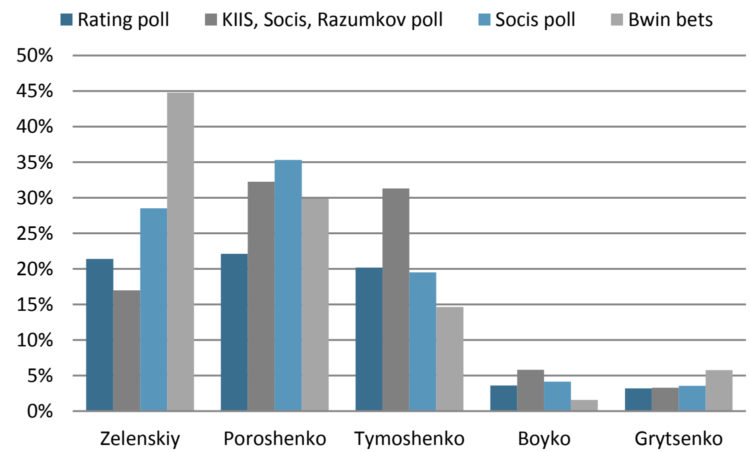
Parliamentary elections:

Oct. 27

First-round leaders: recent polls*



Likely next president, by polls and bets**



**Range of percent of decided voters in the KIIS, Socis and Rating polls, including statistical margin of error*
*** Range of percent of respondents who believe this candidate will be the next president (regardless of voting decisions)*
Source: Polling firms, bwin.com, Concorde Capital research

Meet top presidential candidates

Petro Poroshenko

President
Age: 53

Economic priorities

- Tight cooperation with West in resisting Russian aggression
- Tight IMF cooperation
- EU, NATO candidacy in five years
- Replace profit tax with tax on capital withdrawal
- Focus on developing agriculture, IT, aviation- and shipbuilding
- Establishing status as transport-logistics hub

Electoral base

- Western regions
- Army
- Public servants
- Local, national elites
- Pro-NATO voters

Yulia Tymoshenko

Former prime minister
Age: 58

Economic priorities

- EU, NATO integration
- Halve natural gas prices for households
- Cancel 37 quasi-taxes
- Replace VAT with sales tax
- Replace profit tax with tax on capital withdrawal
- Liquidate independence of central bank
- State-funded health insurance
- No land market, state control of crop rotation.

Electoral base

- Rural residents
- Low-wage workers
- Unemployed
- Low-income pensioners

Volodymyr Zelenskiy

No government experience
Age: 41

Key program themes

- Use referenda to decide key policy issues
- Involve U.S., U.K. in talks to resolve Russian aggression
- Referenda on NATO, other key issues via Internet
- Legalization of shadow wealth after 5% tax
- Replace profit tax with tax on capital withdrawal
- Personal protection guarantees to large investors
- Appointing anti-corruption activists to key posts
- Transparent land market

Electoral base

- Southeastern regions
- Youth
- Disaffected

Anatoliy Grytsenko

Former defense minister
Age: 61

Key program themes

- Tight cooperation with West in resisting Russian aggression
- Tight IMF cooperation
- 10% annual GDP growth
- Legalization of shadow wealth
- Enhanced role of Antimonopoly Committee to challenge oligarchs
- Cutting bureaucracy, raising wages
- Land market after organizing registers

Electoral base

- Intellectuals
- Pro-NATO voters

Three candidates have nearly equal chance to become president

The presidential race has been volatile as candidates have risen and sunk in the polls. Yulia Tymoshenko, who had been the leader for most of 2018, is now neck-and-neck with Petro Poroshenko for the second place. Sketch comedian Volodymyr Zelenskiy shocked both the establishment and the public when surging to lead the polls in January, even widening his lead since then. We expect this dynamic to remain in place for the next two weeks.

Meanwhile, recent polls indicate that:

- **Zelenskiy will qualify for the second-round** runoff to compete against either **Poroshenko or Tymoshenko**.
- **Zelenskiy is favored to win the runoff** against any competitor.

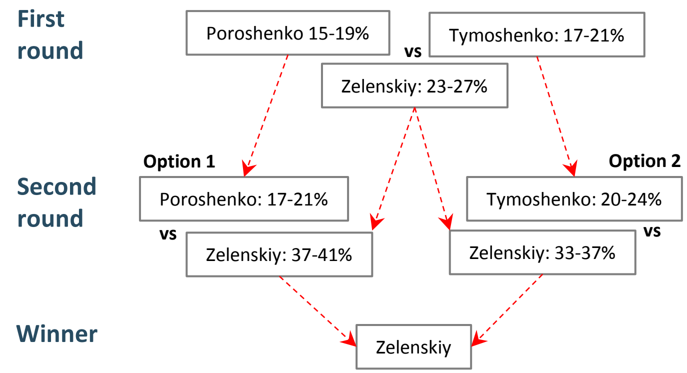
Interestingly, the polls show the public believes **Poroshenko is most likely to win the elections**, even though voters prefer Zelenskiy and Tymoshenko vs. the incumbent president in models of the runoff. Meanwhile, gamblers are betting on Zelenskiy's victory. Neither gamblers nor polls see Tymoshenko's victory as the most likely outcome.

In our view, the poll respondents' expectations about the future president is the best indicator of the actual chance of any candidate to win. At the same time, **data from polls is always outdated** (due to time lag), so online bets shouldn't be ignored.

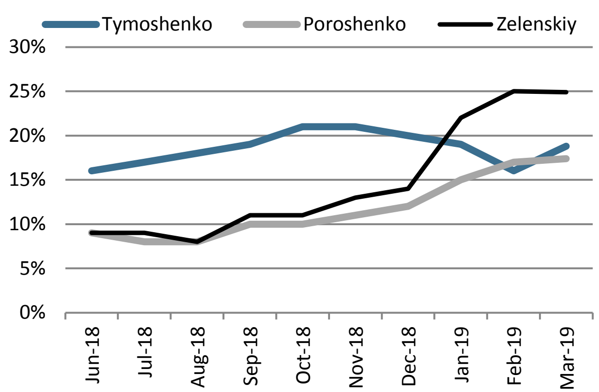
Regardless of polls and bets, we see the following picture:

- Poroshenko currently has the best odds, followed by Zelenskiy and Tymoshenko.
- Each of the top three candidates has a high chance to win (over 25%).

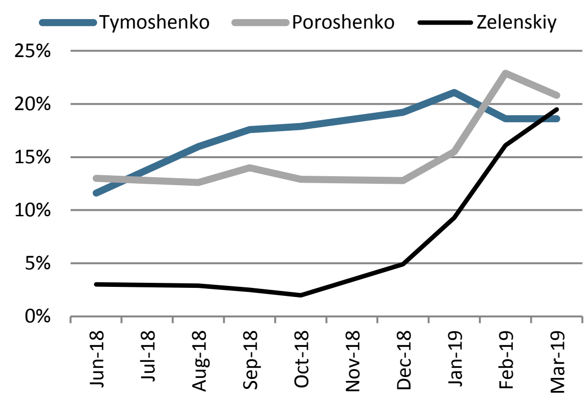
Elections modelling based on Rating poll*



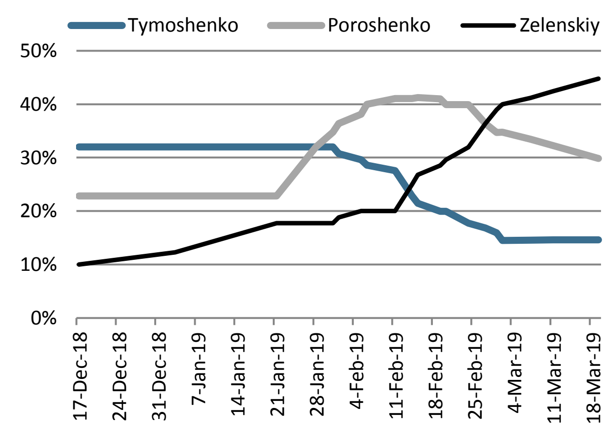
Electoral preferences, Rating polls (% of decided)**



Expected next president, Rating polls (% of polled)



Expected next president, implied by Bwin bets



** Poll released on March 19. ** First-round voting*
Source: Rating Sociological Group, bwin.com, Concorde Capital research

Final leg of campaign: Latent potential and weaknesses

We see some potential of each of three top candidates that could change the course of the vote in the remaining weeks:

Poroshenko

Latent Potential #1: Last-minute government payments

The government will pay an additional UAH 2,410 to the poorest pensioners in March–April, nearly doubling their monthly pension of UAH 1,497 per month. This will directly affect nearly 2 mln pensioners, or more than 5% of total potential voters. It's worth noting pensioners are the most disciplined voters.

The government is planning to pay utility subsidies in cash in March-May. Up to 3.7 mln households (or 18% of total) can receive such subsidies.

In addition, the military plans to raise payments for soldiers on the first- and second line on the Donbas warfront, soldiers positioning in the Azov Sea maritime zone, as well as soldiers of the mountain-storming units in the Carpathians.

Latent Potential #2: Vast access to state resources

While it's widely acknowledged that the president has enormous state resources at his disposal to influence the vote, just which levers of influence he will pull has yet to be determined.

Latent Weakness: Unfolding corruption scandals

The president's re-election prospects were hurt by an investigative news bombshell in late February that alleged his involvement in a scheme by defense officials to buy Russian military parts and resell them to the Ukrainian military at inflated prices. But new information about this scandal, and other defense-related corruption, continue to be broadcast on a weekly basis, further undermining the public trust in the nation's commander in chief. The reaction to the scandal can be clearly seen in gamblers' bets (see slide 8).

Tymoshenko

Latent Potential #1: Rural electorate, poorly covered by polls

Tymoshenko's core electorate is rural residents, who are poorly covered by election polls. They have significant potential to provide an election result greater than had been anticipated, as was the case when Tymoshenko ran for president in 2010.

Latent Potential #2: Strong political organization

Tymoshenko has led Ukraine's most powerful and resilient political party, Fatherland, for nearly two decades. The effectiveness of her political machine could overcome her lag in the polls behind Zelenskiy.

Latent Weakness: Loss of handout queen title

Tymoshenko won hearts of the poorest voters by paying "Yulia's thousand" (UAH 1,000) in 2008. Now that Poroshenko decided to use the same approach with pension payments and alleged vote-buying schemes, he may have stolen the loyalty of this electorate from her.

Zelenskiy

Latent Potential #1: Television series

Zelenskiy and his team have prepared a third season of the TV series "Servant of the People," in which he plays an honest schoolteacher who suddenly is thrust into the role of president. The series is scheduled to be broadcast in the coming weeks (most likely, in April) on the most popular TV channel in Ukraine, which will help his ratings.

Latent Potential #2: Reliance on protest vote

Zelenskiy is the collector of the votes of those disgusted or repelled by the latest actions or statements of the leading candidates. The more scandals and accusations that arise, the more support Zelenskiy will have.

Latent Weakness #1: Reliance on least disciplined voters

Protest voters tend to ignore elections, and so do young people.

Latent Weakness #2: Lack of political organization

Zelenskiy has no national network of experienced campaigners, observers and advocates to rely on, as compared to his highly experienced rivals.

Implications of top candidates’ victory on IMF deal / sovereign risk

Ukraine is going to repay about USD 20 bln of debt to international creditors over the next three years.

This is about the same amount as the nation’s gross foreign reserves available at the moment, meaning that without any external financing Ukraine will have exhausted its gross reserves already in 2021.

Therefore, continuing cooperation with the IMF and other IFIs is critical for the country to remain solvent. Any other reliable sources of funding are not accessible in the needed volume.

To assess how smooth Ukraine’s cooperation with the IMF can be, we analyze:

- Whether the candidates’ election programs correspond to key Ukraine’s commitments to the IMF.
- Whether the candidates’ key proposals are possible to fulfill. In particular, whether they will be capable in the presidential office to fulfill their promises. Here, we believe that only Poroshenko and Tymoshenko will have enough capability to define and influence economic policy as president.

The table below suggests that:

- Poroshenko’s declared election program says little about key IMF requirements, but his record as president indicates he is reliable and likely to implement most of the fund’s demands.
- Zelenskiy’s program says little on key issues, but most of his mentioned proposals are not contradictory to the IMF’s program.
- At the other end of the spectrum, Tymoshenko’s proposals diverge the most from the IMF’s vision, including the central bank’s independence in monetary policy, natural gas pricing, a farmland market (likely to be the next milestone in Ukraine-IMF cooperation) and social spending proposals that will swell the deficit and will be hard for the IMF to accept.

To summarize:

- Poroshenko’s victory is the least risky for Ukraine’s sovereign curve.
- Tymoshenko’s victory would be the most painful for sovereign risk. But, in our view, she not be able to realize most of her promises, so we see she won’t have any other choice but to sit at the table with the IMF. But at minimum, the short-term implications for Ukraine’s sovereign curve will be negative.
- The victory of any other candidate will imply extended uncertainty about Ukraine’s sovereign risk up until the October parliamentary vote and formation of a new coalition government by the year end.

IMF program cornerstones and how candidates’ programs address them

Key IMF policies on Ukraine	Candidate’s official position in election program				
	Poroshenko	Grytsenko	Zelenskiy	Boyko	Tymoshenko
Central bank independence in monetary policy	Unclear	Unclear	Unclear	Unclear	No
Budget consolidation	Cancel profit tax	Unclear	Cancel profit tax	Cancel pension reform	Cancel profit tax and VAT, personal pension accounts, cheap loans to business
Residential natural gas prices at import parity level	Unclear	Unclear	Unclear	Unclear	Halve gas prices
Intensifying anti-corruption efforts	Unclear	Yes	Yes	Yes	Yes
Farmland market in mid-term	Unclear	Yes	Unclear	After referendum	No

Politics and Sovereign Risk

Sovereign debt: ability to refinance depends on IFI cooperation

Ukraine enjoyed a relatively easy payment schedule on international debt in 2016-2018 after initiating the IMF's EFF loan program and restructuring sovereign and quasi Eurobonds in 2015. Most of 2016-2018 external payments were related to coupons on Eurobonds and servicing IMF loans.

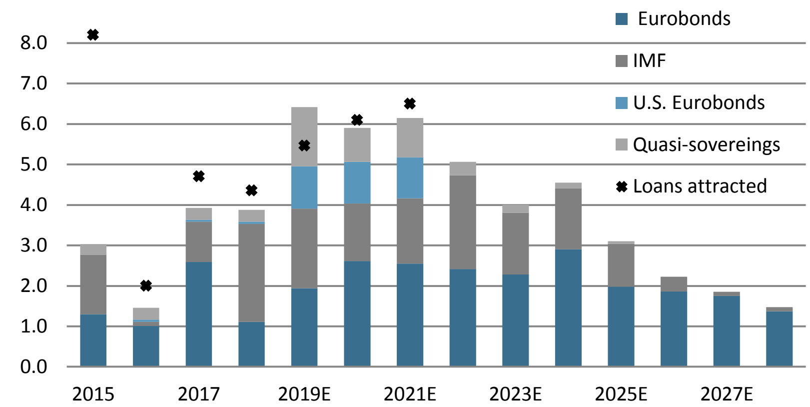
As agreed upon in 2015, the grace period concludes in 2019 and the payment schedule on international debt has become tougher.

In the years 2019-2021, the Ukrainian government, the National Bank and quasi-sovereign borrowers are scheduled to pay about USD 20 bln to international creditors and IFIs. This amount is equal to Ukraine's end-2018 gross reserves.

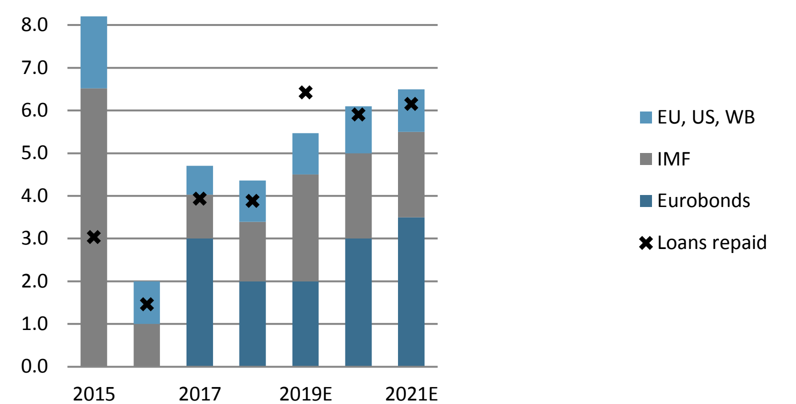
For Ukraine, whose reserves cover slightly more than three months of future imports, it's important to keep them at least at the current level. In other words, Ukraine should do all its best to **fully refinance the loans maturing in 2019-2021 with new ones.** This is **achievable, but only in case Ukraine keeps solid cooperation with the IMF.**

- In its forecasts, the National Bank sees that about half of the funds for debt refinancing in 2019-2021 will come from official lenders (USD 6.5 bln from the IMF and USD 3.2 bln from the EU and World Bank). Needless to say, the smoothness of all such financing will depend solely on Ukraine's ability to remain committed to the IMF program.
- The central bank expects the rest of its financing needs to be covered by international Eurobond placements, which are planned for USD 8.5 bln in 2019-2021. Their success will also depend directly on Ukraine's ability to comply with the IMF's program.

Debt outflow structure, USD bln



Debt inflow structure, USD bln



Source: NBU, MInFin, Concorde Capital research

Ukraine sovereign curve: High since mid-2018 on IMF program delay, politics

Ukraine's sovereign curve was growing in line with the rising U.S. key rate and emerging market spread in early 2018, a trend also fueled by an inability to agree upon the next IMF loan tranche, broadly expected in early summer 2018. At that time, the government had failed to deliver on its two key commitments to the IMF – the adoption of legislation on an independent anti-corruption court and bringing natural gas prices for households to import parity level.

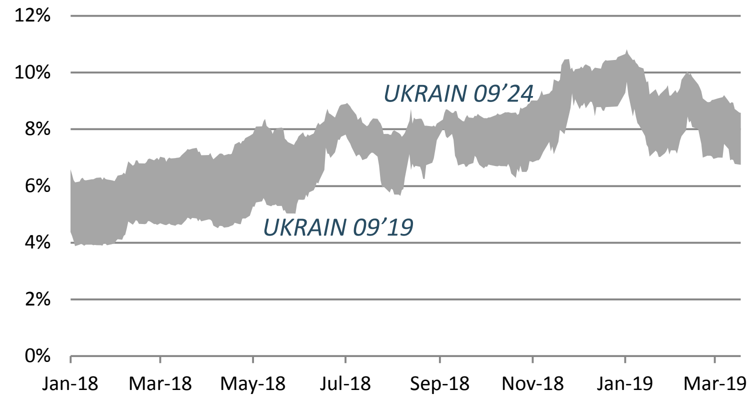
The latter commitment was fulfilled only in early November, which unblocked a new wave of cooperation with the IMF that included a USD 1.4 bln loan tranche, as well as a USD 0.75 bln guarantee from the World Bank and EUR 0.5 bln loan from the EU in December 2018.

However, the window for a sizeable positive reaction of Ukraine's yield curve had already been missed in late 2018 as the market was already preparing for a new year full of political uncertainty in Ukraine. The new year began with investors already concerned about the spring presidential elections and autumn parliamentary vote.

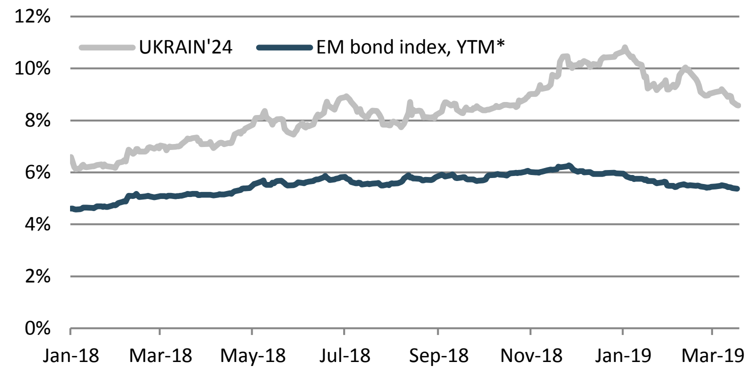
On the political side, January's declining ratings for Tymoshenko, the most IMF-hostile candidate, resulted in a slight decrease in sovereign yields. However, the unexpected surge in the poll ratings of comedian Volodymyr Zelenskiy prevented the yields from decreasing significantly. His potential presidency poses a lot of uncertainty, not only because of his lack of political experience or an economic agenda. Both his work as an entertainer, and his political campaign, have been supported by the scandalous tycoon Igor Kolomoisky, who is widely recognized as being responsible for inflicting a USD 5 bln-plus swelling of sovereign debt for bringing upon the collapse of Privatbank, Ukraine's largest commercial bank that the state nationalized in 2016.

As a result, the yield of Ukraine's five-year sovereign Eurobond has consistently hovered above 8% YTM, or much higher than those of nations with comparable credit ratings and economic risks.

Ukrainian Eurobonds YTM



Ukrainian Eurobond vs. global EM yield



** J.P. Morgan ESG EMBI Global Diversified Sovereign, yield to maturity*
Source: Bloomberg

Ukraine vs. peers: Political risk matters

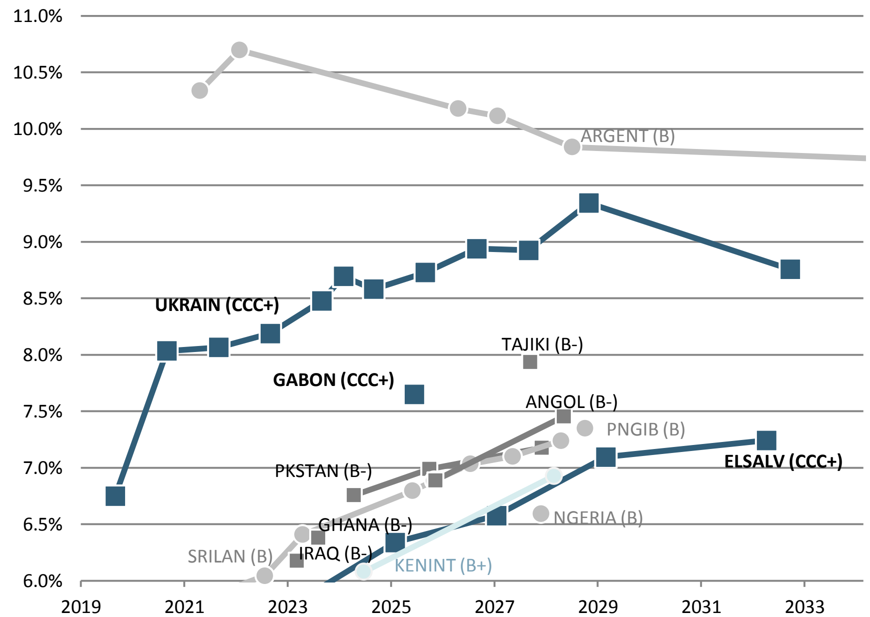
Taking into account that Ukraine's sovereign solvency through 2021 depends mostly on the nation's ability to remain compliant with the IMF loan program, the very personality and political approach of Ukraine's future president is critical in assessing solvency risk. In some cases, the elections outcome won't provide a conclusive answer on Ukraine's future cooperation with IFIs, primarily because it's not the president, but the Cabinet (appointed by parliament) that is responsible for economic policy in Ukraine. Therefore, the full elimination of political risks is possible only after the formation of the new Cabinet in late 2019.

From this standpoint, Ukraine's political situation is parallel to that of Argentina's, which will hold general elections in autumn 2019 that will determine the country's vector of economic development. As we can see from the chart to the right, Ukraine's sovereign curve offers higher returns compared to the bonds of similarly rated nations, as well as the nations with weaker economic conditions. The only two nations that offer a higher return are Argentina (due to even bigger political risk) and Zambia (yielding over 14%) which so far has failed to secure refinancing for its debt due to its inability to agree with the IMF.

The only elections outcome that will increase the chance of Ukraine's mid-term solvency is Poroshenko's re-election. In our view, such an outcome will enable Ukraine's sovereign curve to reach the levels of Gabon and Tajikistan – or about 100 bps below current levels – already in early May. But Poroshenko's victory is far from being certain.

As an opposite outcome, Tymoshenko's victory may lead to the convergence of Ukraine's sovereign curve to Argentina's level.

Map of high-yield sovereign bonds, March 19*



** Lowest rating of Moody's, S&P and Fitch showed.*
Source: Bloomberg, IMF, Concorde Capital research

Political risk, IMF and sovereign curve: peer countries' experience

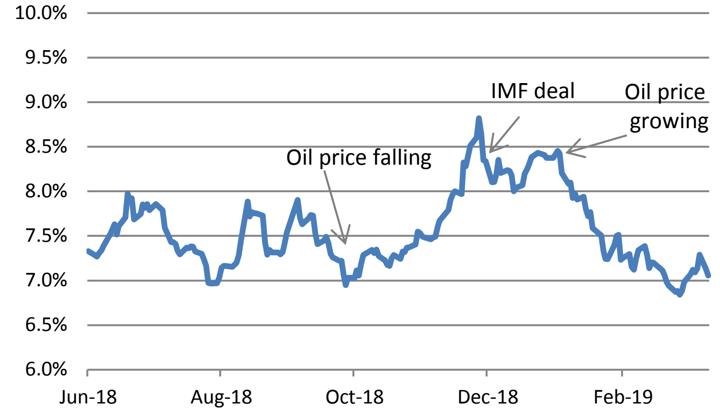
For financially weak countries like Ukraine, political risk is strongly associated with risks to cooperation with the IMF and related IFIs. From this standpoint, the experience of comparable countries can be indicative in assessing the possible performance of Ukraine's sovereign curve after the presidential elections.

Here we illustrate the recent reaction of the bond market to political and economic issues in Angola and Sri Lanka:

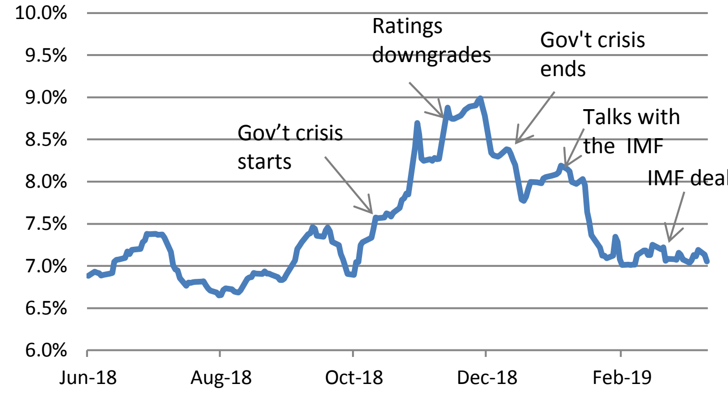
- Falling crude oil prices in October caused economic uncertainty in **Angola**, an oil-dependent country, whose yields on its 7-year bonds rose about 180 bps by early December.
- As the nation reached a new deal with the IMF in December, its bond yield underwent correction by about 80 bps by late December, before moving down further (by about 100 bps) on recovering oil prices.

- As political crisis erupted in **Sri Lanka** in early October, the nation's insolvency risk increased rapidly, supported by a ratings downgrade by three key agencies in late November and early December. All this led to about a 150 bps increase in the yield of Sri Lanka's 7-year bond.
- After the government resolved its crisis and entered into IMF talks to review its program, the market corrected the bond's yield by almost 200 bps by early February.

ANGOL'25 bond YTM



SRILAN 11'25 bond YTM



Source: Bloomberg, IMF, Concorde Capital research

Political risk implications for Ukraine sovereign curve

The intensive debt repayment schedule for 2019-2025 suggests state Eurobonds maturing in this period are most exposed to the risks of IMF program delay.

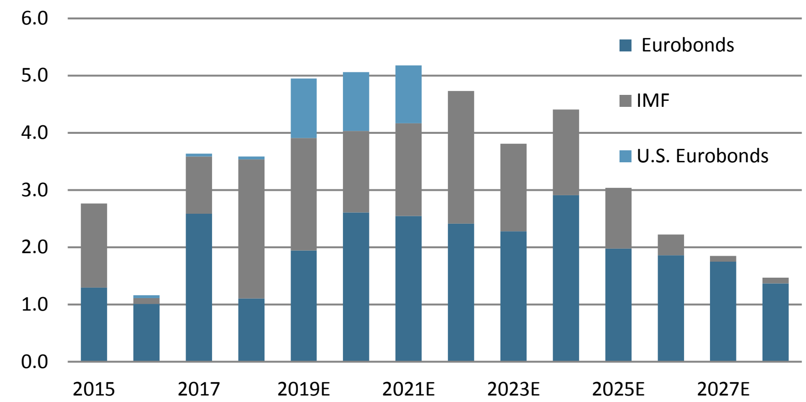
Ukraine has enough international reserves to smoothly service its debt in 2019. Therefore, we see little restructuring risk this year.

However, if there are clear signs of IMF program delays or cancellation this year, Ukraine will have limited ability to make payments on its debt in 2020, and even less ability to pay in 2021-2024. Therefore, we see that Ukraine's most risky debt instruments are those maturing in 2021-2024. In our view, such risk will be the highest in case of Tymoshenko's victory and the lowest in case of Poroshenko's.

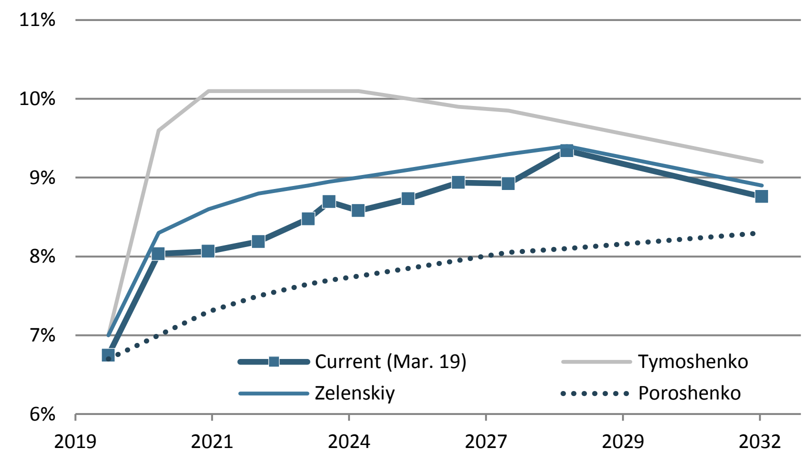
All in all, we see:

- The current level of the sovereign curve largely prices in a Zelenskiy victory and the related political uncertainty. However, some upward movement of mid-term yields is possible in case of his victory.
- Ukraine's sovereign bonds maturing in 2021-2024 will suffer in the event of Tymoshenko's victory.
    - Bonds maturing in 2020 and after 2024 are less likely to suffer.
    - Bonds maturing in 2019 are likely to be unaffected.
- **For those seriously considering Ukraine's political risk, we recommend investing in sovereign bonds maturing in 2019 and after 2026, and not investing in bonds maturing in 2021-2024**.
- The first-round elections outcome, to be clarified in the first days of April, may lead to the following shifts in the sovereign curve:
    - Zelenskiy & Poroshenko qualifying – will likely lead to a downward move of Ukraine's yield curve.
    - Zelenskiy & Tymoshenko to an upward move of the curve.

Payments on key sovereign debt, USD bln



Possible range of Ukraine's sovereign curve, May 2019



Source: IMF, MinFin, NBU, Concorde Capital research

Politics and Corporate Eurobonds

Corporate universe summary

Although private Eurobond issuers are mostly independent of Ukraine's sovereign risk, their yields correlate heavily with the Ukrainian sovereign curve (note, however, that a weaker link is observed for the Metinvest bond). Therefore, **significant movement in sovereign yields – related to politics – will have an impact on Ukraine's entire universe of solvent Eurobond issuers.**

Fundamentally, we see the following implications of the results of the presidential elections on non-sovereign Eurobond issuers:

A Poroshenko victory will:

- Reduce the fundamental risks of DTEK Energy (DTEKUA), likely narrowing its bond's spread to sovereign curve.

A Zelenskiy victory (and Tymoshenko victory, to a lesser extent) will:

- Increase the likelihood of a full recovery of the bailed-in Eurobonds of Privatbank, making bond prices grow.

Victory of Tymoshenko (and Zelenskiy victory, to a lesser extent) will:

- Increase the fundamental risks of DTEK Energy, likely widening its bond's spread.

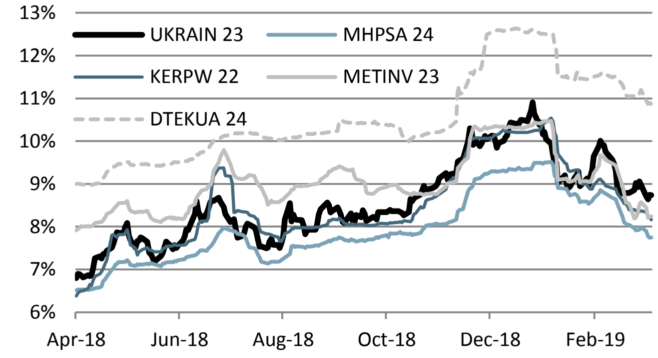
All in all:

- Only the prices of some Eurobonds of defaulted issuers (Interpipe, Ukrlandfarming, Avangardco) are likely to be indifferent to the results of the presidential elections. For Metinvest, the movements are likely to be the smallest, while for DTEK – the biggest.
- Tymoshenko's victory will cause all Eurobond yields to rise. The increase will be greater for the DTEK yield, smaller (if any) for Kernel and MHP. Privatbank's bonds will likely appreciate.
- Zelenskiy's victory will possibly lead to a slight upward movement of the entire Eurobond yield map. Bigger rises are likely for DTEK, Kernel and MHP. Privatbank's bond prices will grow.
- Poroshenko's victory will likely prompt most Eurobond yields to decline. Bigger downward movement is expected for DTEK and the longer bonds of Oschadbank and Ukreximbank, smaller movements - for Kernel and MHP.

In current circumstances, given that outcome of the elections is entirely unknown, **we recommend to**:

- Invest in the longer Eurobonds of Oschadbank and Ukreximbank, as well as the Metinvest bond, as they have the smallest downside risk and solid upside potential.
- Abstain from the DTEK bond, whose upside and downside risks are high.

Sovereign and private Eurobonds: historic YTMs



Change of YTM of selected bonds, pp

	YTD	6M	12M
UKRAIN 23	-1.73	0.63	1.97
MHPSA 24	-1.61	0.03	1.63
KERPW 22	-2.05	0.03	1.98
METINV 23	-2.10	-1.14	0.33
DTEKUA 24	-1.67	0.40	1.63

Expected movement in bond prices depending on presidential election results

	Poroshenko	Zelenskiy	Tymoshenko
Ukraine	+ +	-	- -
Ukr. Railway	+ +	-	-
Oschadbank	+ + +	-	- -
Ukreximbank	+ + +	-	- -
Metinvest	+ +	x	-
DTEK	+ + + +	- -	- - -
MHP	+	-	x
Kernel	+	-	x
Privatbank	x	+ + +	+
Ukrlandfarming	x	x	x
Avangardco	x	x	x
Interpipe	x	x	x

Source: Bloomberg, Concorde Capital research

Corporate bond universe and political risk

Issuers sensitive to political risk
Political risks may affect the fundamentals and default likelihood of some corporate issuers.

The "natural" candidates to be affected by political risk are the quasi-sovereign issuers of Eurobonds (**Ukreximbank, Oschadbank** and **Ukrainian Railway**).

- As was the case in 2015, these three issuers followed the government in its attempt to restructure Eurobonds. That means, if the government decides to restructure its debt again, these issuers may follow too.
- At the same time, we believe that any sizeable restructuring risk of Ukraine's state debt can be only realized in early 2020, in the worst-case scenario. By that time, Ukreximbank, Oschadbank and Ukrainian Railway will repay amortization of 68%-60% of their Eurobonds maturing in 2021-2023, meaning their restructuring won't bring any material effect on the issuers' balance sheet. Therefore, it will only make sense to them to restructure longer bonds, EXIMUK'25 and OSCHAD'25. See more details on the next slide.

Another company that isn't immune from political risk is **DTEK Energy** (DTEKUA), primarily because its well-being depends on the regulatory environment of the Ukrainian coal and electricity markets:

- Recall, DTEK Energy has been benefitting from high electricity prices set by the state regulator in 2016 for coal-fired thermal power plants (DTEK's key profit source).
- Such preferential treatment is only guaranteed under a Poroshenko presidency. With a Zelenskiy or Tymoshenko victory, DTEK faces the risk of rates being reduced.
- The liberalization of the wholesale electricity market, scheduled for July 2019, could serve as a "natural hedge" against decreasing electricity rates for DTEK. However, there is a risk that such liberalization will be delayed. Moreover, if Poroshenko loses, it can be even canceled.

Privatbank (PRBANK) bonds might be also sensitive to politics. Namely, the chance that creditors will be able to recover any of the bank's bailed-in Eurobonds will significantly improve in the event of the victory of candidates who are considered, or confirmed, to be sponsored by Igor Kolomoisky. That's the case for two of the three leading candidates: Tymoshenko and especially Zelenskiy. Kolomoisky and his partners are among the largest holders of the bank's Eurobonds, so they are highly interested in their recovery.

The fundamental of farming companies **(MHP, Kernel)** may be also sensitive due to the candidates' varying positions on land reform. In our view, the free trade of farmland is a fundamental risk for large holding:

- A Tymoshenko victory looks most beneficial for large agri-holdings since she has distinguished herself by her fierce opposition to a farmland market.
- A Poroshenko victory (and Zelenskiy victory, to lesser extent) is worse/neutral for big farmers.

All in all, **Poroshenko's victory at the elections will:**

- reduce the default risk of state banks (especially longer bonds) along with mid-term sovereign bonds;
- reduce the risk of worsening fundamentals for DTEK Energy;
- slightly raise fundamental risks for Kernel and MHP;
- be largely neutral for other bond issuers.

A Tymoshenko victory will:

- very likely have a negative effect on the sovereign curve, as well as the 2025 bonds of Oschadbank and Ukreximbank. It may also have a negative impact on the yields of other solvent issuers (perhaps except Metinvest), as soon as the sovereign curve moves higher;
- raise the risk of worsening fundamentals of DTEK Energy;
- reduce fundamental risks for Kernel and MHP;
- possibly become positive for Privatbank bonds.

A Zelenskiy victory will:

- possibly have a negative effect on the sovereign curve, as well as the 2025 bonds of Oschadbank and Ukreximbank.
- raise the risk of worsening fundamentals of DTEK Energy.
- very likely become positive for Privatbank bonds.

Source: Company data, Concorde Capital research

Quasi-sovereign issuers: shorter bonds look safer

The grace period of restructured quasi-sovereign Eurobonds ends this year, and three state-controlled Eurobond issuers start paying large amortization amounts on their bonds. The payment schedule peaks in 2019 at USD 1.46 bln for three quasi-sovereign issuers.

Shortest quasi-sovereign bonds: we see default risk as low

As soon as the government takes care of its credit rating, it won't allow any state company to avoid smoothly servicing their international debt in 2019. In other words, we expect all three quasi-sovereign issuers (Oschadbank, Ukreximbank and Ukrainian Railway) will service their Eurobonds on time in 2019. Therefore, we see little default risk in the following Eurobonds:

- OSCHAD'23 (65% of which amortizes in 2019)
- EXIMUK'22 (58% of which amortizes in 2019)
- RAILUA'21 (60% of which amortizes in 2019)

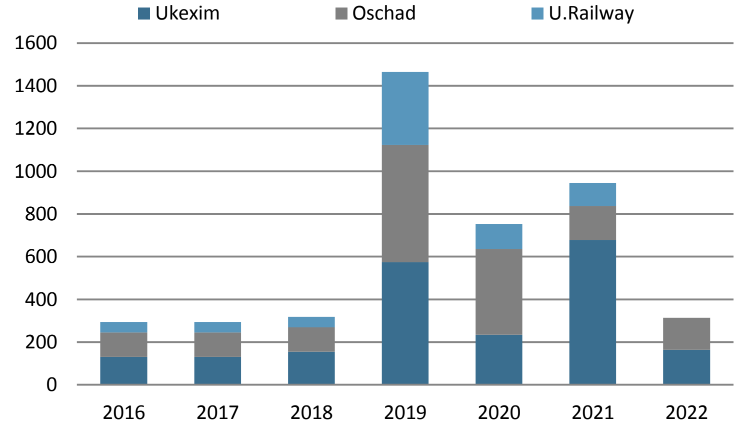
Longer quasi-sovereign bonds: more risky, but superior to sovereigns

The probability of default of longer quasi-sovereign bonds, namely OSCHAD'25 (55% of which amortizes in 2020) and EXIMUK'25 (56% of which amortizes in 2021), will depend on the government's decision to restructure its international debt in 2020-2021. Even though we believe the likelihood of such a decision is small, it is still far from being zero.

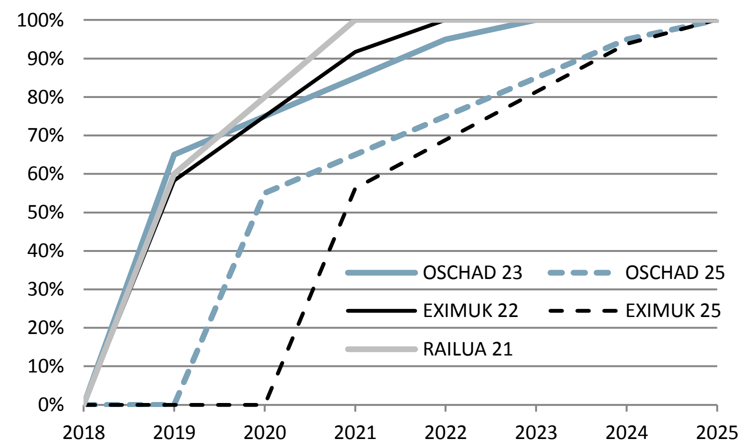
But in any case, we believe that the 2025 Eurobonds of state banks are a safer investment than Ukraine's sovereign Eurobonds of comparable maturity. Even if the government decides to restructure its debt in 2020-2021:

- This won't necessarily mean the government will force the banks to do so. In particular, we expect that the banks will form independent supervisory boards in 2019 (or 2020), which will make the bank's strategy much less dependent on the government.
- If the banks decide to follow the government in a restructuring attempt, their restructuring terms will likely be more creditor-friendly (as was the case in 2015).

Quasi-sovereign Eurobonds payment schedule, USD mln



Percent of bond amortized by year end



Source: Company data, Concorde Capital research

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