Ukraine
Basic Materials | Fixed Income
Research Note

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Metinvest Eurobonds

Get ready for hard talk

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Bloomberg ticker	METINV
Outstanding, USD mln	114
Maturity	2015/05/20
Coupon	10.25%
Fitch / Moody's / S&P	C/Caa3/na
Outstanding, USD mln	290
Maturity	2017/11/28
Coupon	10.5%
Fitch / Moody's / S&P	C/na/na
Outstanding, USD mln	750
Maturity	2018/02/14
Coupon	8.75%
Fitch / Moody's / S&P	C/Caa3/na

Source: Bloomberg

Ukraine's largest steelmaker and iron ore miner Metinvest (METINV) will face a confidence vote among bondholders in two stages - today, on Apr. 29, in electronic form and on May 1, during a bondholders meeting. The holding has requested to shift 90% of the USD 114 mln Eurobonds from May 2015 to Jan. 31, 2016 and to eliminate the cross-default clauses for its bonds. The suggested maturity shift of 2015 notes is not immediately lifting the liquidity constraints, and it just sets the stage for future restructuring iterations, which might involve all the lenders across the board. The standoff between lenders and management, which has voiced the possibility of court protection against debt claims, is elevating. We reiterate our negative view on all METINV notes.

Default on PXF, instead of extension, standstill requested. The company coped with the first part of a management liability exercise in December 2014, when 77% of the holders of the USD 500 mln 2015 notes agreed to postpone their maturity to 2016-17 in exchange for a 25% advance payment. Second part, rescheduling the USD 808 mln of banking debt maturing in 2015, initially expected to be accomplished by end-2014, did not go smoothly at all. Metinvest defaulted on USD 113 mln PXF loans in March 2015 and stated that it would not be able to repay USD 114 mln Eurobonds in May, as well as another batch of PXF loans (USD 549 mln due by January 2016). Its cash balance was just around USD 170 mln, as of end-March. Hence, redemptions of principal have been halted and a standstill has been offered to all debt providers, in order to negotiate a new redemption schedule.

Maturity of the 2015 notes to be extended anyway, management claims. Voluntarily or compulsorily, the date of the 2015 Eurobond redemption has to be shifted with no more than 10% upfront payment - this seems to be the management's approach to the issue (please see page 3 below). The indication of a possible court protection request sounds like Metinvest's readiness to take proactive steps, if the situation evolves towards an acceleration of debt payments. Thus, remaining investors in METINV'15 are not likely to avoid participation in extending the maturity profile of the holding's debts. As a result, a lucrative idea of going long METINV'15, targeting its timely redemption (YTM is peaking at 520% currently), seems not to have worked out. This case and its outcome will define the future debt profile of Metinvest, with embedded features of "a-tough-guy-to-play-with".

A black swan risk tangible. There is certain risk that holders of the 2015 notes may go on principle and decline the holding's offer. In particular, they might see no radical difference between losses implied by: 1) approval of the extension offer which will open the next stage of restructuring talks on the notes; and 2) decline of the offer which will also end up in some restructuring talks. Their second choice may also force Metinvest to repay, whatever the management claims now. The holders of other METINV notes are currently the hostages of the tension between holders of the 2015 notes and the management, which might end up in court protection against all debt claims.

The debt issue won't be solved without consent of PXF holders. But even if we assume that all of the issues brought to bondholders' discretion are fully approved by May 1, this will only designate a beginning of negotiations, which will become successful only if PXF lenders agree to prolong part of their maturity. This is something which could have already been done, after public lenders contributed to the maturity extension in December 2014. However, consent of PXF providers might not be enough.

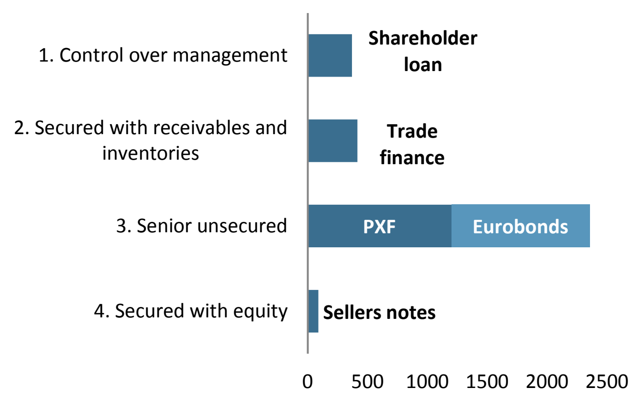
Upcoming restructuring may involve all of the stakeholders

The 2015 liquidity gap will expose longer maturities. Management of Metinvest have been reiterating many times that a new amortization schedule has to be worked out together with the holders of 2015 notes and banking lenders, according to the new business conditions, which evolved in 2H14. We argue that the redesigning of the redemption scheme may not leave other capital providers untouched. We project Metinvest will generate free cash flow in the range of USD 680 to 880 mln annually in 2015-18. This totals to USD 3.1 bln in available cash during next four years. This is close to the total company's debt (USD 3.2 bln end 2014 and USD 3.1 bln on February 2015).

Any substantial maturity extension of the short-term debt beyond 2018 may not get support from lenders. So, redistribution of the already missed payments or those to be defaulted on by the end of 2015 (around USD 800 mln) will be reloaded towards couple of next years. This makes repayments in 2016-18 especially exposed to another liability approach from management. For example, USD 750 mln 2018's Eurobonds stand out notably on the time line.

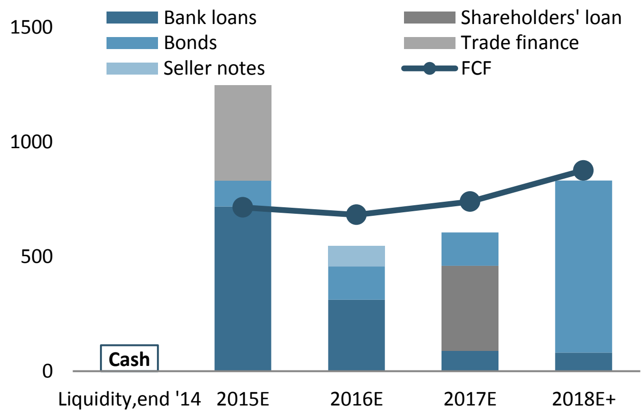
Dividends starting from 2016 will be a tough discussion point. Repayment of the USD 370 mln shareholder loan to Metinvest, maturing in 2017, can be also subject to deferral. Especially, given that shareholders are not very likely to abstain from receiving dividends in the next four years. Metinvest's shareholders have decided not to claim dividends for 2015, according to an announcement by the holding, but we strongly believe that they will insist on participating in the distribution of the free cash flow after that. This is not doable without redesigning maturities for the loans in 2016-18.

Metinvest's debt hierarchy in terms of securitization, mln USD



Source: Company data, Concorde Capital estimates

Debt repayment schedule and liquidity profile, mln USD



Source: Company data, Concorde Capital estimates

Tension between PXF lenders and bondholders may intensify. In the debt hierarchy, the most secured debt is trade finance, secured by the pledged inventories and receivables, but we rate related parties loan at first place. Bondholders, providing 35% of total USD 3.2 bln debt (as of end 2014), are ***equally standing*** with PXF lenders, providing 37% of total. Bonds are backed by guarantees from Metinvest production enterprises, and PXF loans are pledged with proceeds from revenue. So, both sides are actually on the same footing and interdependent. Banks could desire to get some priority in timing of redemptions, as historically their loans had to mature earlier, before the company defaulted.

Military background in Donbas and markets will be crucial. Other things being equal, the restoration of steel production volumes by Metinvest to levels seen in 2013, increases the average annual EBITDA to USD 2.1 bln in 2015-20, compared to USD 1.6 bln by current projections. Cash on balance by end 2020 increases to USD 4.7 bln (vs. USD 2.4 bln seen currently), given no dividend distribution during this period. This speaks for the restoration of steel production as soon as possible, which is not fully in the company's power, but secures certain upside drivers for the case. Whether the iron ore and finished steel markets have bottomed out, or they will continue the breathtaking plunge, seen in 2014, is another important question. The answer to it will define the solvency and liquidity position of Metinvest, as well as the success of the restructuring process.

Key takeaways of the Metinvest conference call held on the Apr. 27

Management of Metinvest held a conference call on Apr. 27 regarding the consent solicitation offered to bondholders at the meetings scheduled for Apr. 29 and May 1, and explained its position regarding the possible future steps:

- Why everything is happening? - The holding is offering to shift the maturity of its remaining 2015 notes as well as to get waivers on cross-default from all bondholders and banking lenders. This is in order to win time and legal security to design a new amortization schedule of the debt due in May 2015, along with its PXF loans;
- If the consent is duly supported, the company says it may resume principal payments of the debt in late 2016 (!), assuming that operating constraints for its steel mills are unlocked – and the load is restored close to full capacity;
- If the approval rate of solicitation consent comes in lower than required (75% of the votes), the company would not improve the offer to holders of 2015 Eurobonds (up from a 10% outright payment), as it refers to insufficient available cash. The full-scale restructuring process would be launched, and holders of 2015 would not get any priority in terms of a redemption date compared to the holders of the notes maturing in 2017 and 2018;
- In the worst case scenario, when holders of 2015 do not support the maturity extension, no waiver for cross-default is received, and some lender triggers the acceleration - the company may ask for court protection in a suitable jurisdiction, thus enforcing a moratorium on repayments;
- So far, no lender has claimed acceleration of payments;
- Metinvest explained that the reason, why PXF lenders have not previously agreed to an extension of at least part of the loans maturing in 2015, is that they want the company to treat them as equals with the 2015 bondholders, in terms of outright payment (not very clear, please see the next point – ***Concorde Capital, CC***);
- Management has not disclosed weather or not it could immediately pay out something to PXF lenders (probably not - ***CC***), or whether repayment of the remaining 90% of 2015 debt outstanding could be postponed again (probably yes – ***CC***). Anyway, it is presumed from management's words that current holders of 2015 could have some priority over their peers holding 2017 and 2018 in terms of setting the redemption dates, if they approve the consent solicitation. Otherwise, the 2015 notes will have equal rights compared to 2017s and 2018s;
- Management stated that its integrated production cost of steel slab in 1Q15 could be close to one reported by Russian steelmakers (Severstal reported integrated cash production cost of slab at USD 169/t in 1Q15).
- Management does not expect any additional funding support from shareholders (on the top of the already provided loan of USD 370 mln maturing in 2017).

Operating model assumptions

	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E
Hryvna exchange rate, UAH/USD	8.1	8.1	12.2	24.0	24.2	24.4	24.6	24.8	25.0

Production, mmt	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Hot iron	11010	11500	9213	8162	8162	8162	8162	8162	8162
Including, marketable pig iron	585	814	1132	700	700	700	700	700	700
Steel	12459	12391	9205	7631	7631	7631	7631	7631	7631
Steel products output	11182	11325	8835	7130	7130	7130	7130	7130	7130

Sales, mmt	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Metallurgical division sales									
Pig iron	583	874	1226	700	700	700	700	700	700
Slabs	1211	1417	916	951	951	951	951	951	951
Square billets	827	773	684	690	690	690	690	690	690
Flat products, incl. from Zaporizhstal	6822	8543	7583	6528	6528	6528	6528	6528	6528
Long products	2739	2846	1965	1653	1653	1653	1653	1653	1653
Tubular products	458	82	240	205	205	205	205	205	205
Total sales of pig iron and steel products	**12640**	**14535**	**12614**	**10727**	**10727**	**10727**	**10727**	**10727**	**10727**
Mining division sales									
Iron ore concentrate	13276	13937	13571	12338	12338	12338	12338	12338	12338
Pellets	7056	7993	8390	8397	8397	8397	8397	8397	8397
Total sales of iron ore products	**20332**	**21930**	**21961**	**20735**	**20735**	**20735**	**20735**	**20735**	**20735**
Coking coal concentrate	2184	2153	1786	1764	1764	1764	1764	1764	1764

Average selling prices*	**2012**	**2013**	**2014**	**2015E**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**
Semi-products									
Pig iron, USD/t	425	403	400	248	240	240	245	253	260
change yoy, %	-	*-5%*	*-1%*	*-38%*	*-3%*	*0%*	*2%*	*3%*	*3%*
Slabs, USD/t	569	506	527	322	312	312	318	328	338
change yoy, %	-	*-11%*	*4%*	*-39%*	*-3%*	*0%*	*2%*	*3%*	*3%*
Square billets, USD/t	580	528	513	349	338	338	345	356	366
change yoy, %	-	*-9%*	*-3%*	*-32%*	*-3%*	*0%*	*2%*	*3%*	*3%*
Rolled products									
Flat products, USD/t	773	607	600	363	352	352	359	370	381
change yoy, %	-	*-22%*	*-1%*	*-40%*	*-3%*	*0%*	*2%*	*3%*	*3%*
Long products, USD/t	754	696	619	390	378	378	386	397	409
change yoy, %	-	*-8%*	*-11%*	*-37%*	*-3%*	*0%*	*2%*	*3%*	*3%*
Tubular products, USD/t	1135	988	988	790	790	790	806	830	855
change yoy, %	-	*-13%*	*0%*	*-20%*	*0%*	*0%*	*2%*	*3%*	*3%*
Mining products									
Iron ore									
Iron ore concentrate, USD/t	106	109	85	50	49	49	49	49	49
change yoy, %	-	*2%*	*-22%*	*-41%*	*-3%*	*0%*	*0%*	*0%*	*0%*
Pellets, USD/t	138	138	116	90	87	87	87	87	87
change yoy, %	-	*0%*	*-16%*	*-22%*	*-3%*	*0%*	*0%*	*0%*	*0%*
Coal concentrate									
Coking coal concentrate, USD/t	200	128	96	87	87	87	87	87	87
change yoy, %	-	*-36%*	*-25%*	*-10%*	*0%*	*0%*	*0%*	*0%*	*0%*

**Selling prices for 2015-2020E are estimated on FOB/DAF, Ukrainian border, basis (which may deviate from official selling price, reported on other terms, leading to lower revenue, but not directly impacting EBITDA).*

Source: Company data, Concorde Capital estimates

Other assumptions and considerations include:

- Steel and steel products output is projected at the current constrained level going forward;
- Metinvest earns EBITDA of USD 31/t of pellets and USD 11/t of concentrate in 2015, against an average cash cost of USD 36/t and USD 25/t respectively;
- Integrated cash cost of slabs and billets is USD 200/t in 2015;
- Average processing cost of semi-product to flat and long steel of USD 40/t;
- Redemption of liquidity gap in 2015 is redistributed for later years;
- No dividends are paid in 2015-20.

Financials

Revenue breakdown, USD mln	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E
Semi-products									
Pig iron	248	352	490	173	168	168	172	177	182
Slabs	689	717	483	306	297	297	303	312	321
Square billets	480	408	351	241	234	234	238	245	253
Rolled products									
Flat products	4626	5182	4550	2369	2298	2298	2344	2414	2487
Long products	2064	1982	1216	645	625	625	638	657	677
Tubular products	520	81	237	162	162	162	165	170	175
Other products	664	1004	839	376	376	376	376	376	376
Subtotal for met division	**9291**	**9726**	**8165**	**4272**	**4160**	**4160**	**4235**	**4351**	**4470**
Mining division revenue									
Iron ore concentrate	1413	1518	1156	617	598	598	598	598	598
Pellets	973	1104	972	756	733	733	733	733	733
Coking coal concentrate	437	275	172	153	153	153	153	153	153
Other products	455	184	101	101	101	101	101	101	101
Subtotal for mining division	**3278**	**3080**	**2400**	**1626**	**1584**	**1584**	**1584**	**1584**	**1584**
Total revenue	**12569**	**12806**	**10565**	**5897**	**5744**	**5744**	**5820**	**5935**	**6055**

Income statement, USD mln	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E
Revenue	**12569**	**12806**	**10565**	**5897**	**5744**	**5744**	**5820**	**5935**	**6055**
COGS	-10070	-10406	-8240	-4166	-4144	-4112	-4076	-4039	-4005
Gross profit	**2499**	**2400**	**2325**	**1731**	**1600**	**1632**	**1743**	**1896**	**2050**
Distribution costs	-1123	-1121	-1063	-649	-632	-632	-640	-653	-666
G&A	-394	-391	-287	-216	-216	-215	-214	-213	-212
Other operating	7	137	130	0	0	0	0	0	0
EBIT	**989**	**1025**	**1105**	**866**	**752**	**785**	**890**	**1030**	**1172**
Finance income	52	66	25	3	12	13	15	13	39
Finance costs	-321	-341	-902	-272	-210	-144	-56	-47	-38
Associates, JV	-9	14	142	46	46	46	46	46	46
PBT	**711**	**764**	**370**	**643**	**601**	**701**	**894**	**1043**	**1218**
Income tax	-266	-373	-211	-257	-210	-210	-223	-209	-244
Net income	**445**	**391**	**159**	**386**	**390**	**490**	**670**	**834**	**975**
EBITDA	**1996**	**2291**	**2702**	**1651**	**1500**	**1500**	**1575**	**1691**	**1810**

Source: Company data, Concorde Capital estimates

Balance sheet, USD mln	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Assets									
PP&E	8152	8212	6538	6228	5956	5716	5505	5320	5156
Other non-current assets	3246	3117	2530	2530	2530	2530	2530	2530	2530
Total non-current assets	**11398**	**11329**	**9068**	**8758**	**8486**	**8246**	**8035**	**7850**	**7686**
Cash	530	783	114	442	476	521	483	1403	2444
Inventories	2113	1863	1222	1212	1202	1202	1212	1222	1232
Receivables	3194	2738	2042	2027	2014	2004	2004	2009	2019
Other	250	193	110	110	110	110	110	110	110
Total current assets	**6087**	**5577**	**3488**	**3791**	**3802**	**3837**	**3809**	**4744**	**5805**
Total assets	**17485**	**16906**	**12556**	**12550**	**12288**	**12084**	**11844**	**12594**	**13492**
Equity									
Retained earnings	7052	6277	6372	6758	7148	7639	8309	9143	10118
Other equity	3383	3354	390	390	390	390	390	390	390
Total equity	**10435**	**9631**	**6762**	**7148**	**7538**	**8029**	**8699**	**9533**	**10508**
Liabilities									
Long-term debt	2804	2500	1878	1796	1101	186	92	0	0
Other non-current liabilities	827	1058	1016	1016	1016	1016	1016	1016	1016
Total non-current liabilities	**3631**	**3558**	**2894**	**2812**	**2117**	**1202**	**1108**	**1016**	**1016**
Short-term debt	1474	1808	1354	1049	1095	1315	494	492	400
Payables	1945	1909	1546	1541	1538	1538	1543	1553	1568
Total current liabilities	**3419**	**3717**	**2900**	**2590**	**2633**	**2853**	**2037**	**2045**	**1968**
Total liabilities & equity	**17485**	**16906**	**12556**	**12550**	**12288**	**12084**	**11844**	**12594**	**13492**

Source: Company data, Concorde Capital estimates

Cash flow statements, USD mln	2012	2013	2014	2015E	2016E	2017E	2018E	2019E	2020E
PBT	**711**	**765**	**370**	**643**	**601**	**701**	**894**	**1043**	**1218**
Depreciation	900	1070	850	785	747	715	686	661	638
Other	49	107	640	0	0	0	0	0	0
Operating cash flow	1660	1942	1860	1428	1348	1415	1580	1703	1857
Working capital investments/ (outflow)	108	-147	-18	20	20	10	-5	-5	-5
Income tax paid	-622	-330	-353	-257	-210	-210	-223	-209	-244
Cash flow from operations, net	**1146**	**1465**	**1489**	**1190**	**1158**	**1215**	**1351**	**1490**	**1608**
Cash flow from investments, net	**-1094**	**263**	**-559**	**-475**	**-475**	**-475**	**-475**	**-475**	**-475**
Debt (repayment) / borrowing	221	-53	-595	-387	-649	-695	-915	-94	-92
Dividends	-575	-544	-388	0	0	0	0	0	0
Other cash flow from financial activity	41	-879	-559	0	0	0	0	0	0
Financing cash flow	**-313**	**-1476**	**-1542**	**-387**	**-649**	**-695**	**-915**	**-94**	**-92**
FX effect			**-57**						
Change in cash	**-261**	**252**	**-669**	**328**	**34**	**45**	**-39**	**921**	**1041**
Cash, bop	792	531	783	114	442	476	521	483	1403
Cash, eop	**531**	**783**	**114**	442	476	521	483	1403	2444
FCF	**52**	**1728**	**930**	**715**	**683**	**740**	**876**	**1015**	**1133**
Total debt	4278	4308	3232	2845	2196	1501	586	492	400
Net debt	3748	3525	3118	2403	1720	980	103	-911	-2044
Total debt to EBITDA	2.14	1.88	1.20	1.72	1.46	1.00	0.37	0.29	0.22
Net debt to EBITDA	1.88	1.54	1.15	1.46	1.15	0.65	0.07	-0.54	-1.13

Source: Company data, Concorde Capital estimates

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