Metinvest Eurobond

Strong commodity prices imply high refinancing risk

Andriy Perederey | aper@concorde.ua
Alexander Paraschiy| ap@concorde.ua

September 26, 2017

Summary

As soon as the price of the METINV'21 Eurobond exceeded its par value in early September, any bond purchase became associated with early repayment risk. **Metinvest** is free to redeem the bond at par value in case it secures refinancing. The holding's improved EBITDA, which resulted in reduced leverage (net debt to LTM EBITDA ratio to less than 1.7x as of end-1H17), as well as the high interest rate on the Eurobond (up to 10.88%) and decreased rates on debt market make it logical for Metinvest to consider seeking refinancing. The holding's September announcement of early repayment of part of its capitalized PIK notes and PXF interest suggests Metinvest is eager to reduce its leverage as soon as possible.

In practice, **Metinvest is limited in repaying the Eurobond** by an Intercreditor Agreement, which stipulates that the Eurobond (USD 1.2 bln outstanding) and PXF facility (USD 1.1 bln outstanding) should be repaid in equal proportion. That means that a soon repayment of the Eurobond does not look very likely for two reasons:

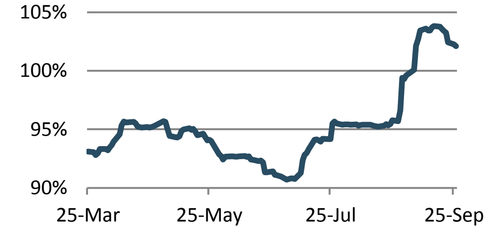
- In order to fully repay the Eurobond, Metinvest has to secure refinancing in a total amount of USD 2.3 bln, or beyond any record amount of Ukrainian borrowers. Also, it cannot attract new debt before its leverage falls below 1.5x.
- The average interest rate under both the Eurobond and the PXF is currently 8.1%, so early repayment makes sense if Metinvest secures a much smaller rate for a new loan.

Providing steel and iron ore prices remain at current levels, Metinvest would be able to fully refinance its Eurobond in late 2018. In such case, Metinvest will be able to allocate about USD 1.3 bln for deleveraging over the next 12-14 months, reducing its debt under the Eurobond and PXF to USD 1 bln by November 2018. It would make logical and possible for Metinvest to refinance the remaining debt via securing a cheaper loan for about USD 1 bln by end-2018. In such case, the fair price of the METINV'21 Eurobond should be 102.6% of par, or close to the current market price. Based on the Bloomberg consensus on global steel prices (namely, the HRC price won't decrease over the next nine months), we take this scenario as our base case.

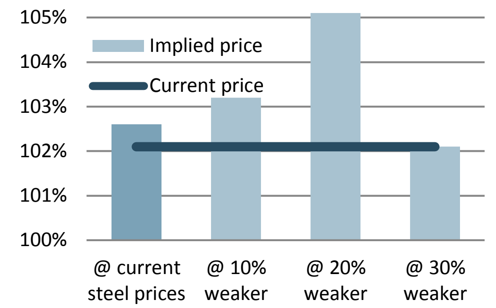
The worse the steel price, the smaller is the refinancing risk. Naturally, if Metinvest won't be able to generate cash flow at the current levels (i.e. if steel prices fall), its ability to deleverage will be much weaker due to both the higher potential amount of refinancing and the higher price of a new loan. If steel prices are 20% weaker than now in 2018, we estimate Metinvest will only gain the ability to fully refinance its Eurobond in late 2020. That is the best case for bondholders. In other words, a purchase of the METINV'21 Eurobond now is a bet on a sound downward correction of global steel prices. However, a correction by more than 25% is associated with liquidity risk for Metinvest.

Therefore, buying Metinvest bonds at the current price of over 102% can only be justified in case investors are expecting about a 20% drop in global steel and iron ore prices in the coming months. So far, we see a fair price of Metinvest bonds at 102.6% of par and we are downgrading our view on METINV'21 notes from positive to neutral.

METINV'21 price history, % of par



METINV bond price, % of par



Metinvest EBITDA, USD mln

	2016	2017E	2018E	2019E
@ current steel prices	1153	1753	2476	2477
@ 10% weaker	- // -	- // -	1797	1777
@ 20% weaker	- // -	- // -	1329	1289
@ 30% weaker	- // -	- // -	650	589

Net debt / EBITDA ratio

	2016	2017E	2018E	2019E
@ current steel prices	2.4	1.5	0.5	n/m
@ 10% weaker	- // -	- // -	1.0	0.6
@ 20% weaker	- // -	- // -	1.7	1.4
@ 30% weaker	- // -	- // -	4.0	3.9

Source: Bloomberg, Company data, Concorde Capital research

Valuation outcome: High steel prices prompt quick repayment of Eurobond

If the current prices for Metinvest steel products sustain themselves in the next twelve months, Metinvest would be able to reduce its total debt on the PXF and Eurobond to less than USD 1 bln by November 2018. That will enable the holding to easily refinance its Eurobond and PXF by attracting a new USD 1 bln loan by end-2018. Bond repayment would be made at par, as stipulated in a 2016 debt restructuring agreement. Based on our modelling, under such a scenario the **METINV'21** Eurobond should be priced at about **102.6% of par**.

Such a scenario looks most realistic right now: according to the Bloomberg consensus, steel prices (HRC prices were used as a benchmark) will continue to grow in 4Q17 and will stay high in early 2018.

The lower steel prices, the better for METINV bondholders

If global steel prices decline, Metinvest won't be able to reduce its leverage quickly. It will also be more limited in refinancing its Eurobond. In which case, bondholders will receive their high coupons (firm amount of 10.875% as of 2019) for a longer time, generating higher NPV from holding the bonds.

However, if global prices drop below 75% of current levels, Metinvest's credit risk would significantly increase, and to remain solvent the holding will have to reduce its CapEx far below its agreed cap (see slide #5 for more details). In which case, a higher discount rate for calculating the bond's fair price should be applied.

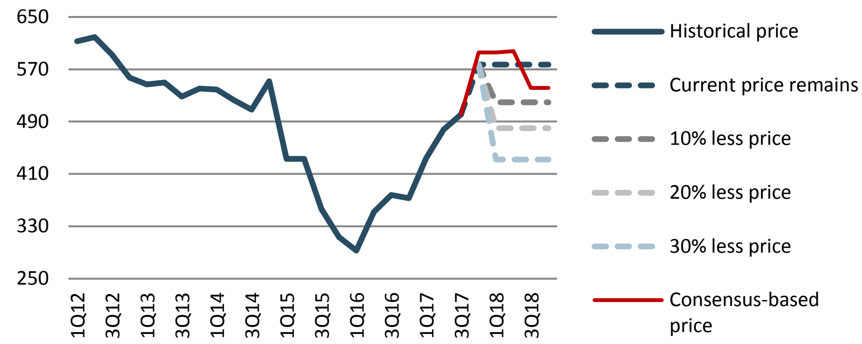
Therefore, we see that the highest possible current price of Metinvest's bond, which we estimate at 105% of par, is achievable if global steel prices will fall 20% below current levels in the short term and stay there.

Overall, we see little potential for METINV's price to increase from the current levels of 102% of par. That prompts a downgrade of our view on the METINV'21 Eurobond from positive to neutral.

Fair METINV'21 prices based on steel price scenario

Steel prices as of 2018	EBITDA in 2018	End-2018 Net Debt/EBITDA	Assumed discount rate	Refinancing possible	Implied bond price
At current level	2477	0.5	7.0%	Nov.'18	102.6
10% less	1797	1.0	7.5%	May'19	103.2
20% less	1329	1.7	8.0%	Nov'20	105.1
30% less	650	4.0	10.0%	Aug'21	102.1

Assumptions of average Metinvest steel prices, USD / t



Implied METINV'21 prices based on steel prices, discount rates and sources of bond repayment

Discount rate	Current steel prices		Prices 10% off		Prices 20% off		Prices 30% off	
	Use own funds	Refinance Nov'18	Use own funds	Refinance May'19	Use own funds	Refinance Nov'20	Use own funds	Refinance Aug'21
10.0%							103.1	102.1
9.0%					104.6	102.8	106.4	105.1
8.5%	101.7	101.2	103.0	101.9	106.0	103.9	108.0	106.6
8.0%	102.3	101.7	103.9	102.5	107.5	105.1	109.7	108.2
7.5%	102.9	102.1	104.8	103.2	109.0	106.2		
7.0%	103.5	102.6	105.7	103.8	110.5	107.4		
6.5%	104.1	103.1	106.6	104.4	112.1	108.6		
6.0%	104.7	103.5	107.5	105.1				

Source: Bloomberg, Company data, Concorde Capital research

Valuation details: current steel prices scenario

Key assumptions, general:

- Metinvest will try to minimize its interest expenses by fully refinancing its debt as soon as possible.
- Metinvest would be able to fully refinance its Eurobonds and PXF facility by attracting new debt for USD 1 bln. That means, the holding will fully repay all its Eurobonds as soon as its debt under Eurobond and PXF decreases to USD 1 bln. (Alternatively, we also model a scenario in which Metinvest counts solely on own cash flow to repay its debt). Before the holding attracts such refinancing, it services its debt solely via its own cash flow.
- Payments of interest and repayment of debt will be made in accordance with the 2016 bond restructuring agreement, as described on slide 6.
- The holding will generate cash from operations and spend it for CapEx uniformly (the same amount each day) during each quarter.
- The interest rate on the PXF (which is variable, in fact*) will stay at 5.16% .
- All the payments under Eurobond are made quarterly, according to the schedule (no monthly early payments are made).
- Metinvest's operating cash flow (before debt payments) is 83% of its EBITDA in each period (based on historical figures).
- Its CapEx is no more than the allowed level of capital expenditures, as listed in bond restructuring documents.

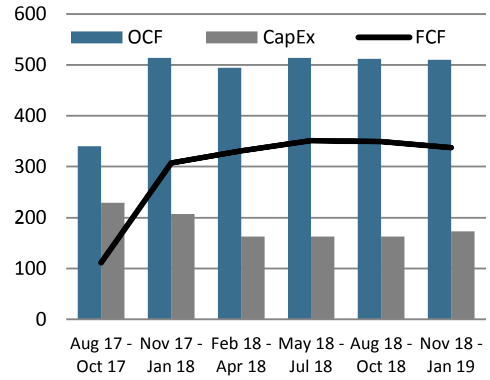
Key assumptions: Scenario of current steel prices

- Metinvest's average steel and iron ore prices will remain at current levels in all future periods.
- The discount rate applied to the Metinvest bond is 7.0%, which is about 1.0pp higher than the YTM of the Ferrexpo 2019 bond. We believe such a spread is justified by METINV'21 bond's longer designed maturity and much more complicated repayment schedule.

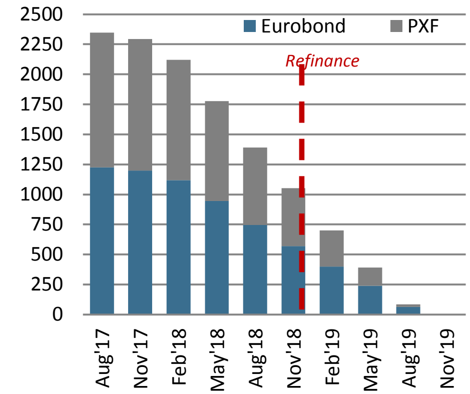
Results: Scenario of current steel prices

- Such a scenario assumes Metinvest will be able to cut its total debt under PXF and Eurobonds to USD 1.06 bln by November 2018. By that time, its net debt to EBITDA ratio will fall below 1.0. We believe that will allow the holding to easily refinance its debt at a smaller average rate (which is 8.1% for its PXF and Eurobond today and will grow to 8.2% in one year) in November 2018.
- **The implied price of the METINV'21 Eurobond is 102.6% of par.**

Cash flow outlook, USD mln**

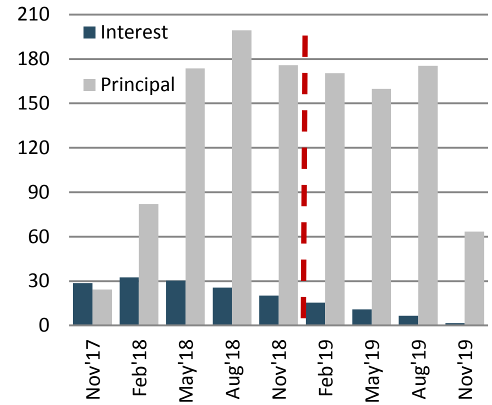


PXF & Eurobond outstanding, USD mln

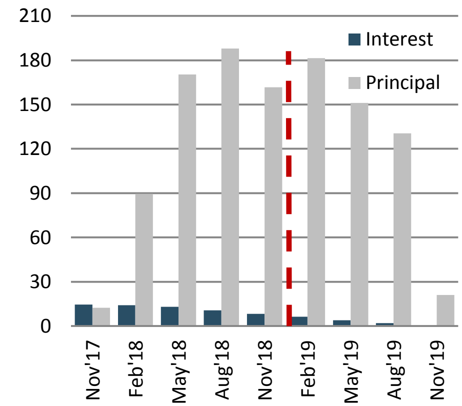


Scheduled payments, USD mln:

Eurobonds



PXF



** Interest rate on PXF is one-month LIBOR plus 4.16%, but not less than 5.16%; ** OCF – operating cash flow before interest payments*
Source: Company data, Concorde Capital research

Valuation details: scenarios of weaker prices

Key assumptions, scenarios of weaker steel prices:

- Achieved steel and iron ore prices will be **10%, 20%,** or **30%** less than the current level starting 2018.
- Discount rates applied are:
  7.5%, 8.0% and 10.0% for each price scenario, respectively. The different discount rates reflect the different possible maturities of the Eurobond, as well as different possible financial stances of Metinvest (see details below).

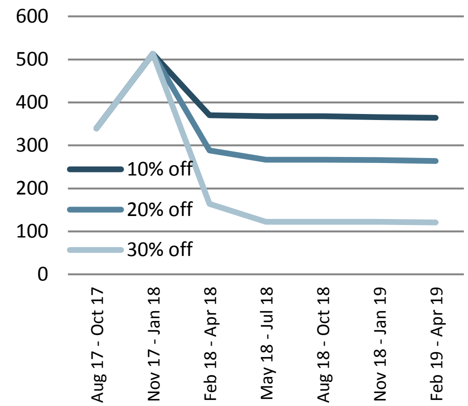
Results:

- In case steel and ore prices drop 30% from the current levels, Metinvest will face a need to reduce its CapEx below agreed-upon levels to fully comply with its debt repayment obligations starting 2019. This is why we apply a higher discount rate for the valuation of METINV'21 under such a scenario.

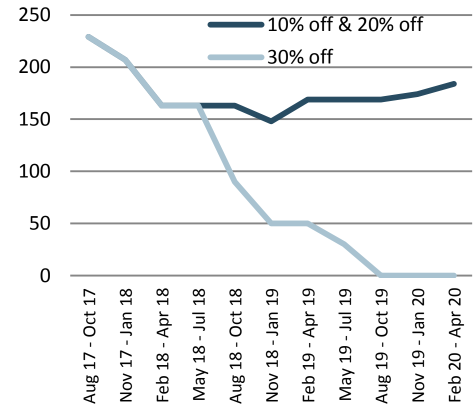
- An opportunity to refinance the PXF and the Eurobond will emerge for Metinvest in May 2019 (if prices fall 10%) and in November 2020 (20% fall). We also expect Metinvest will refinance all its Eurobond under the 30%-fall scenario in August 2021, when the PXF loan matures, raising the holding's average cost of debt to 10.8%.

The implied prices of the METINV'21 Eurobond are: 103.2%, 105.1% and 102.1%, based on the steel price assumptions, respectively.

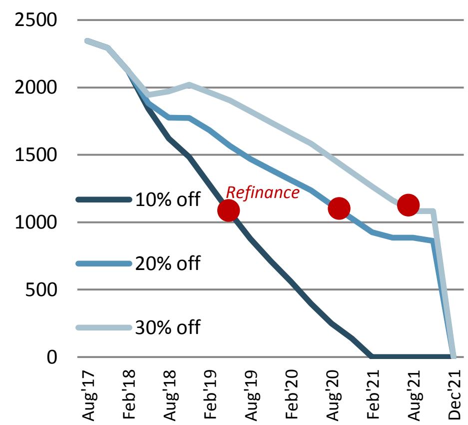
Operating cash flow*, USD mln



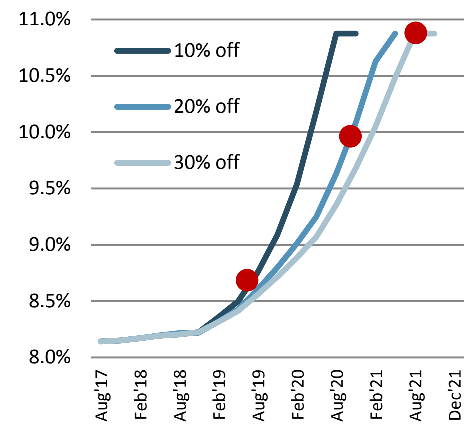
CapEx, USD mln



PXF & Eurobond outstanding, USD mln



Weighted interest rate on bonds, PXF



** Operating cash flow before interest payments*
Source: Company data, Concorde Capital research

Debt servicing and repayment structure

If any cash is available for distribution in Steps 1 – 4 below, the payments in each step are made in full or partly (on a pro rata basis for the Eurobond and PXF):

Initial period (Nov. '17 – Nov. '18, quarterly, unless otherwise specified)

	Eurobonds	**PXF loans**
Step 0. Paid in any case	2.7930% **Cash Coupon**	**Cash interest** of 30% x 5.16%** paid monthly
Step 1. Accrued and/or paid (if cash* is over USD 180 mln)	6.5795% **in PIYC Coupon** (paid or capitalized as **PIK Notes**)	70% x 5.16%** **in PXF PIYC Interest Amount** (paid or capitalized)
Step 2. (if cash* less payment under Step 1 is over USD 180 mln**)**	**Repayment** of outstanding PIK Notes (if any)	**Repayment** of capitalized PXF PIYC Interest Amount (if any)
Step 3. (if cash* less payment under Steps 1-2 is over USD 180 mln**)**	1.5025% in **Catch-up Coupon**	**PXF Catch-Up Repayment**. Amount is equal to PXF Loan outstanding x ¼ x (10.875% less 5.16%**)
Step 4. (if cash* less payment under Steps 1-3 is over USD 180 mln**)**	Partial repayment of Eurobond outstanding	Partial repayment of PXF Loan outstanding

Subsequent period (Feb. '18 – Nov. '21, quarterly, unless otherwise specified)

	Eurobonds	**PXF loans**
Step 0. Paid in any case	10.875% **Cash Coupon**	**Cash interest** of 5.16%** paid monthly Repayment of: USD 45.3 mln in Feb. & May 2019 USD 70.3 mln in Aug, and Nov. 2019, Feb. & May 2020 USD 100.3 mln in Aug, and Nov. 2020, Feb. & May 2021 Repayment equal to: PXF outstanding x ¼ x (10.875% less 5.16%**)
Step 1. Paid if cash* (net of PXF repayment amount) is over USD 180 mln	Partial repayment of Eurobond outstanding	Partial repayment of PXF Loan outstanding

On top of that, Metinvest can repay any part of its capitalized PIK notes (PXF interest) and then part of its principal each month.

** Cash is defined as average daily cash balance for the three calendar months preceding the payment date.*
*** Interest rate on PXF is in fact one-month LIBOR plus 4.16%, but not less than 5.16%.*

Disclaimer

THIS REPORT HAS BEEN PREPARED BY CONCORDE CAPITAL INVESTMENT BANK INDEPENDENTLY OF THE RESPECTIVE COMPANIES MENTIONED HEREIN FOR INFORMATIONAL PURPOSES ONLY. CONCORDE CAPITAL DOES AND SEEKS TO DO BUSINESS WITH COMPANIES COVERED IN ITS RESEARCH REPORTS. AS A RESULT, INVESTORS SHOULD BE AWARE THAT CONCORDE CAPITAL MIGHT HAVE A CONFLICT OF INTEREST THAT COULD AFFECT THE OBJECTIVITY OF THIS REPORT.

THE INFORMATION GIVEN AND OPINIONS EXPRESSED IN THIS DOCUMENT ARE SOLELY THOSE OF CONCORDE CAPITAL AS PART OF ITS INTERNAL RESEARCH COVERAGE. THIS DOCUMENT DOES NOT CONSTITUTE OR CONTAIN AN OFFER OF OR AN INVITATION TO SUBSCRIBE FOR OR ACQUIRE ANY SECURITIES. THIS DOCUMENT IS CONFIDENTIAL TO CLIENTS OF CONCORDE CAPITAL AND IS NOT TO BE REPRODUCED OR DISTRIBUTED OR GIVEN TO ANY OTHER PERSON.

CONCORDE CAPITAL, ITS DIRECTORS AND EMPLOYEES OR CLIENTS MIGHT HAVE OR HAVE HAD INTERESTS OR LONG/SHORT POSITIONS IN THE SECURITIES REFERRED TO HEREIN, AND MIGHT AT ANY TIME MAKE PURCHASES AND/OR SALES IN THEM AS A PRINCIPAL OR AN AGENT. CONCORDE CAPITAL MIGHT ACT OR HAS ACTED AS A MARKET-MAKER IN THE SECURITIES DISCUSSED IN THIS REPORT. THE RESEARCH ANALYSTS AND/OR CORPORATE BANKING ASSOCIATES PRINCIPALLY RESPONSIBLE FOR THE PREPARATION OF THIS REPORT RECEIVE COMPENSATION BASED UPON VARIOUS FACTORS, INCLUDING QUALITY OF RESEARCH, INVESTOR/CLIENT FEEDBACK, STOCK PICKING, COMPETITIVE FACTORS, FIRM REVENUES AND INVESTMENT BANKING REVENUES.

PRICES OF LISTED SECURITIES REFERRED TO IN THIS REPORT ARE DENOTED IN THE CURRENCY OF THE RESPECTIVE EXCHANGES. INVESTORS IN FINANCIAL INSTRUMENTS SUCH AS DEPOSITORY RECEIPTS, THE VALUES OR PRICES OF WHICH ARE INFLUENCED BY CURRENCY VOLATILITY, EFFECTIVELY ASSUME CURRENCY RISK.

DUE TO THE TIMELY NATURE OF THIS REPORT, THE INFORMATION CONTAINED MIGHT NOT HAVE BEEN VERIFIED AND IS BASED ON THE OPINION OF THE ANALYST. WE DO NOT PURPORT THIS DOCUMENT TO BE ENTIRELY ACCURATE AND DO NOT GUARANTEE IT TO BE A COMPLETE STATEMENT OR SUMMARY OF AVAILABLE DATA. ANY OPINIONS EXPRESSED HEREIN ARE STATEMENTS OF OUR JUDGMENTS AS OF THE DATE OF PUBLICATION AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART WITHOUT PRIOR PERMISSION IS PROHIBITED.

NEITHER THIS DOCUMENT NOR ANY COPY HEREOF MAY BE TAKEN OR TRANSMITTED INTO THE UNITED STATES OR DISTRIBUTED IN THE UNITED STATES OR TO ANY U.S. PERSON (WITHIN THE MEANING OF REGULATION S UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”)), OTHER THAN TO A LIMITED NUMBER OF “QUALIFIED INSTITUTIONAL BUYERS” (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) SELECTED BY CONCORDE CAPITAL.

THIS DOCUMENT MAY ONLY BE DELIVERED WITHIN THE UNITED KINGDOM TO PERSONS WHO ARE AUTHORIZED OR EXEMPT WITHIN THE MEANING OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (“FSMA”) OR TO PERSONS WHO ARE OTHERWISE ENTITLED TO RECEIVE THIS DOCUMENT UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005, OR ANY OTHER ORDER MADE UNDER THE FSMA.

Contacts

2 Mechnikova Street, 16th Floor
Parus Business Centre
Kyiv 01601, Ukraine
Tel.: +380 44 391 5577
Fax: +380 44 391 5571
www.concorde.ua
Bloomberg: TYPE CONR <GO>

CEO
Igor Mazepa im@concorde.com.ua

SALES & TRADING

Alexandra Kushnir	ak@concorde.com.ua
Marina Martirosyan	mm@concorde.com.ua
Yuri Tovstenko	ytovstenko@concorde.com.ua
Alisa Tykhomirova	at@concorde.com.ua

RESEARCH

Head of Research	
Alexander Paraschiy	ap@concorde.com.ua
Macro, Utilities, Financial, Energy	
Alexander Paraschiy	ap@concorde.com.ua
Basic Materials, Consumer	
Andriy Perederey	aper@concorde.com.ua
Editor, Politics	
Zenon Zawada	zzawada@concorde.com.ua