

Metinvest Eurobonds

Restructuring terms imply fair value of 100

Summary

Metinvest is on the verge of completing a long-awaited debt restructuring in the coming weeks, with most of the restructuring parameters not having changed much since their initial announcement in May 2016. We expect the majority of bondholders will approve the restructuring next week.

Metinvest's new Eurobonds have a complicated coupon structure and amortization that is linked to the holding's future free cash flows. They are no longer a classical fixed income instrument, which complicates their valuation.

To value Metinvest bonds, we model three possible repayment scenarios:

- Under the most pessimistic case, only minimum payments under the notes will be made, with a maximum possible delay.
- The fixed coupon case (also pessimistic) assumes the holding will pay all the coupon payments in full and on time, but won't repay any principal until maturity.

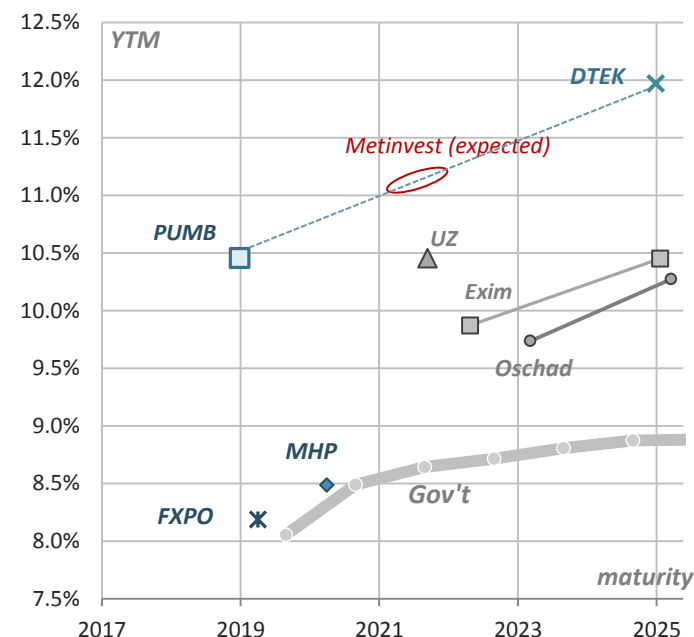
The above cases are easy to model, but they only point at the floor price of the bonds.

- The base case models coupon and principal payments by Metinvest as a function of its future free cash flows.

Our base case valuation suggests that Metinvest bonds have room for a price increase (implied NPV is 100% of par, assuming an 11% discount rate). In the worst case (much less realistic) the NPV of payments under the notes is 96% of par value.

Our conclusion is the bonds' fair value should close to par, so we reiterate our positive view on METINV.

Yield map, Feb. 02



Expected timetable of events:

2 February	Custody Instruction Deadline, Record Date
3 February	Voting Instruction Deadline
6 February	Notes Scheme Meeting, PXF Scheme Meeting
8 February	Scheme Sanction Hearing, Anticipated Scheme Effective Date
About 28 February	Anticipated Scheme Settlement Date

Restructuring terms: repayments

All Eurobonds will be combined into a single instrument with an expected total amount outstanding of USD 1.180 bln (and maximum possible amount of USD 1.225 bln).

The ultimate Eurobonds maturity is 31 Dec. 2021. (For PFX facility: 30 June 2021).

Their payment will be quarterly between May 18, 2017 and Nov. 18, 2021, with an additional payment upon maturity date.

All the payments will be made based on a cash sweep. Namely, all the payments (except guaranteed amounts) will be made only from excess cash (the amount of average cash for a quarter that exceeds USD 180 mln). The cash sweep amount is distributed between PFX lenders and the holders of Eurobonds proportional to debt amounts outstanding (or interest accrued).

The order of payments is as follows:

There is no quarterly payment cap for the debt, while there is a floor, which amounts to 2.79% annual interest for 2017-2019 and 10.88% annual interest for 2019-2021.

	For Eurobonds, quarterly in May'17-Nov.'18:	For Eurobonds, quarterly since Feb'19	For PFX loans (interest rate 5.16% *) in 2017-2018:	For PFX loans (interest rate 5.16% *) in 2019-2021:
Paid in any case:	<ul style="list-style-type: none"> 2.7930% in cash coupon 	<ul style="list-style-type: none"> 10.875% in cash coupon 	<ul style="list-style-type: none"> 1.548% cash interest (paid monthly)** 	<ul style="list-style-type: none"> 5.16% cash interest (paid monthly)
Paid if there is cash for distribution (otherwise, capitalized via issue of PIK notes):	<ul style="list-style-type: none"> 6.5795% in PIYC coupon 		<ul style="list-style-type: none"> 3.612% in PIYC PFX interest (paid quarterly) 	
Paid from remaining cash for distribution (if any):	<ul style="list-style-type: none"> Repayment of outstanding PIK notes (if any outstanding) 	<ul style="list-style-type: none"> Repayment of outstanding PIK notes (if any outstanding) 	<ul style="list-style-type: none"> Repayment of outstanding PIK interest (quarterly, if any outstanding) 	<ul style="list-style-type: none"> Repayment of outstanding PIK interest (quarterly, if any outstanding)
Paid from remaining cash for distribution (if any):	<ul style="list-style-type: none"> 1.5025% in catch-up coupon <p><i>This totals a 10.875% maximum coupon rate</i></p>		<ul style="list-style-type: none"> Catch-up PFX repayment (quarterly). Equal to a quarter of (10.875% less 5.160%*) <p><i>This equates PFX payments and the maximum coupons on Eurobonds</i></p>	
Paid from remaining cash for distribution (if any):	<ul style="list-style-type: none"> Repayment of notes outstanding 	<ul style="list-style-type: none"> Repayment of notes outstanding 	<ul style="list-style-type: none"> Repayment of PFX outstanding 	<ul style="list-style-type: none"> Repayment of PFX outstanding

Restructuring terms: repayments (example)

Let's assume that there are USD 1,180 mln in Eurobonds outstanding and USD 1,071 mln in PFX outstanding just after the restructuring.

Let's assume that in the first quarter, cash for distribution to debt holders is USD 20 mln.

This amount will only be enough to pay:

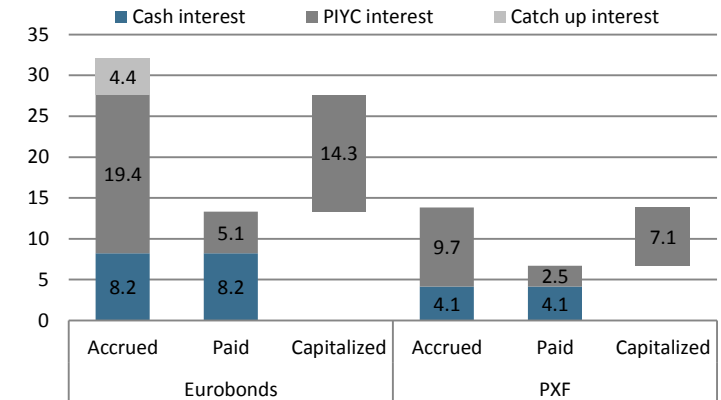
- cash interest (total amount of USD 12.4 mln) and
- the remaining USD 7.6 mln to pay 26% of accrued PIYC interest for each debt instrument. The rest of accrued PIYC interest (totaling USD 21.5 mln) will be capitalized as PIK instruments.

Let's assume that in the second quarter, cash for distribution to debt holders is USD 90 mln.

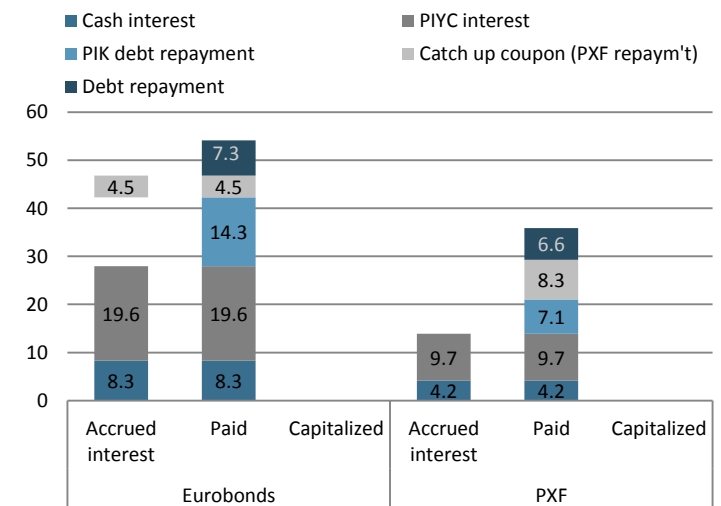
This amount will be enough to pay:

- cash interest totaling USD 12.5 mln,
- all accrued PIYC interest (USD 29.4 mln),
- repay the earlier capitalized PIK interest (USD 21.5 mln),
- pay catch-up interest on Eurobonds (USD 4.5 mln), and make catch-up repayment on PFX (USD 8.3 mln),
- and use the remaining USD 13.9 mln to partially repay the outstanding debt, each instrument by 0.615%.

Distribution of USD 20 mln among debt holders in period 1



Distribution of USD 90 mln among debt holders in period 2



Restructuring terms: other

Restructuring fees and other payments to be made on about Feb. 28:

- 0.75% in restructuring fee to be paid to all noteholders
- 0.08% to 0.26% in cash interest for February
- 0 to 2.146% in partial (or full) repayment of outstanding capitalized interest since Jan. 2016.

Total amount to be paid is between 0.83% and 3.16% of notes currently outstanding.

- Also, a 1.50% fee will be paid to the bondholders who signed a “lock up agreement” before the Jan. 16 deadline.

Limit on CapEx, USD mln:

2017: 636 (+ up to 100, in case all accrued interest was fully paid in cash in 2017)

2018: 651 (+100, in case all accrued interest was fully paid in cash in 2017)

2019: 775 (+100, in case all accrued interest was fully paid in cash in 2018)

2020: 836 (+100, in case all accrued interest was fully paid in cash in 2019)

2021: 888 (+100, in case all accrued interest was fully paid in cash in 2020)

Limits on payment of dividends to Metinvest shareholders:

Dividends can be distributed only when:

- The aggregate principal amount of the bonds and PXF Loans outstanding is equal to or less than 45% of their principal amount as of the effective date (Feb. 8, 2017).
- No default has occurred.
- The dividend amount should be 40% of the amount in excess of USD 250 mln in average cash balance for a quarter.
- The maximum amount of dividends shall not exceed USD 300 mln p.a.

With such commitments made, Metinvest won't be able to explain the absence of cash flow for distribution to debt holders by making excessive CapEx or dividends. On the other hand, the holding will always have an opportunity to limit amounts distributable to debt holders via investing into working capital.

Bond valuation: implied value is 96-100 of par

We are considering three scenarios for the repayment schedule starting May 2017:

Worst case :

Only required amounts of cash coupons are paid:

- In 2017-2018, only a cash coupon of 2.793% p.a. is paid. The PIYC coupon of 6.5795% is capitalized and repaid at maturity.
- In 2019-2021, the cash coupon of 10.875% p.a. is paid.

The principal is redeemed in one installment at the end of 2021.

Worst case + :

Coupons paid in full, redeemed at maturity:

- Coupon is paid at the rate of 10.875% p.a. all the time .

The principal is redeemed in one installment at the end of 2021.

Base case :

The holding allocates payments between Eurobond holders and PXF lenders based on a cash sweep. The cash available for distribution among debt holders is estimated on slide 7. Annual cash for distribution is paid in equal amounts in each quarter of a respective year.

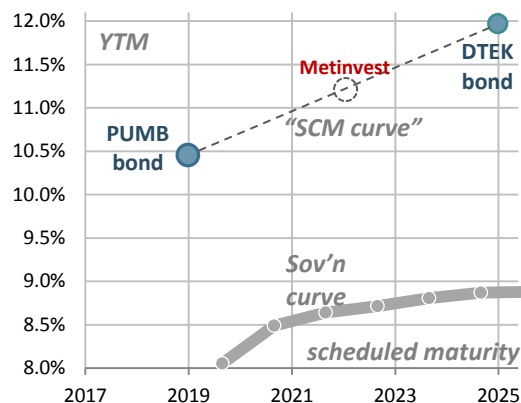
Also, we assume bondholders will receive in late February 2017:

- a 0.83% restructuring fee, and coupons for February in the worst case.
- a 3.16% restructuring fee, coupons for February and full repayment of earlier capitalized interest, in other cases.

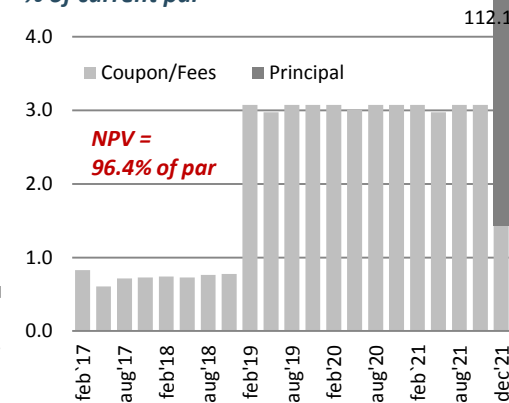
Discount rate applied: 11%

We derive the discount rate in calculating the implied price of Metinvest Eurobonds based on related issuers' yield curve. SCM, Metinvest's key shareholder, has two other companies that issued Eurobonds: First Ukrainian International Bank (PUMBUZ) and DTEK (DTEKUA). Their bonds mature in Dec. 2018 and Dec. 2024, respectively. Simply placing Metinvest's designed maturity on the PUMBUZ-DTEKUA yield curve, we derive an expected YTM of Metinvest's bond at 11.0%. That looks a bit conservative as Metinvest is not exposed to local currency risk and its business is not subject to any sector regulations, unlike DTEK and the bank.

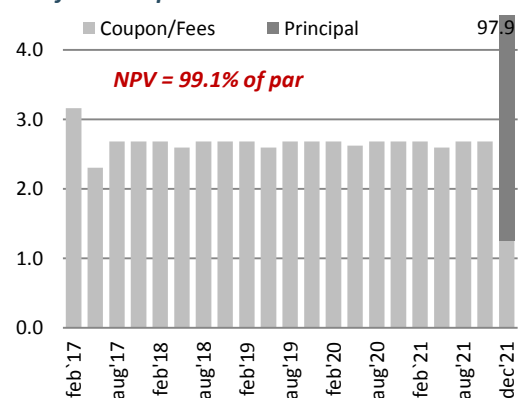
Implied YTM of Metinvest bonds: ~11%



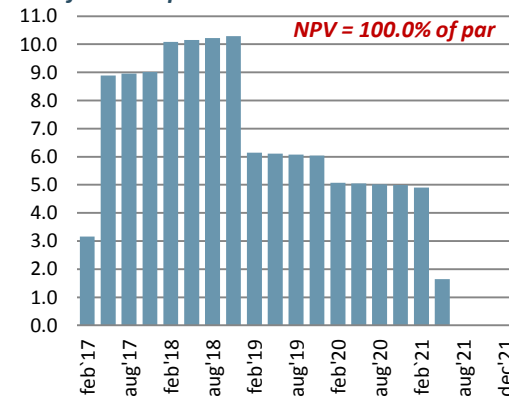
Worst case: Cash flow on bonds, % of current par



Worst case + : cash flow on bonds, % of current par



Base case: cash flow (interest and principal) % of current par



Modeling the base case

Key assumptions:

Sales volume is unchanged in 2017-2021:

- Pig iron: 1.50 mmt (+10% compared to 2016E);
- Slabs: 0.75 mmt (+7% compared to 2016E);
- Square billets: 0.30 mmt (flat compared to 2016E);
- Flat steel products: 7.27 mmt (+4% compared to 2016E);
- Long steel products: 2.19 mmt (+8% compared to 2016E);
- Iron ore products: 15.22 mmt (flat compared to 2016E).

Prices:

- Average blended prices for steel products will be 17% higher in 2017-2021 than in 2016E in dollar terms (about USD 390/t);
- Iron ore prices will be USD 60/t in 2017-2021 (+3% compared to 2016E).

The holding's EBITDA is USD 1.35 bln in 2016, and is increasing in 2017 as cost inflation (15% on average in UAH terms) will lag to hryvnia devaluation (8% vs. USD, on average) and increase in dollar prices of steel products.

- Working capital is 12% of Metinvest's revenue in 2017, and grows to 15% of revenue by 2020.
- Effective tax rate will be 13% of EBITDA since 2017.
- CapEx is made in line with Metinvest's maximum limit (see slide 5).
- USD 200 mln p.a. is reserved for other cash costs in 2017-2018 and USD 450 mln are reserved for 2019-2021, for the sake of conservatism. That may include war-affected costs (like the recent case of Avdiyivka), excessive investments into working capital, other unpredictable outflows, as well as dividend payments which would be possible since 2019.

All the free cash flow after the above-mentioned allocations are available for distribution among bondholders and PFX lenders.

Cash flow estimates, USD mln

	2014	2015	2016E	2017F	2018F	2019F	2020F	2021F
Revenue	10,565	6,832	5,795	6,811	6,811	6,811	6,811	6,811
EBITDA	2,762	804	1,350	2,219	2,199	2,181	2,159	2,135
Tax paid	-353	-39	11	-288	-286	-284	-281	-278
CapEx	-559	-237	-301	-736	-751	-875	-936	-988
Change in WC	-974	1,013	241	-353	-68	-68	-68	0
Free cash flow	876	1,541	1,301	841	1,094	955	874	869
Other cash costs				-200	-200	-450	-450	-450
Cash for distribution among debt holders				641	894	505	424	419
Bond interest				99	85	48	23	3
PXF interest & catch up repayment				81	74	19	9	1
Debt repayment, including:				461	735	438	392	136
- Bond repayment				255	396	240	215	75
- PFX repayment				206	339	198	178	62
Total payments on bonds, % of current amount outstanding				30%	41%	24%	20%	7%
Bond outstanding, eoy			1,179	925	529	289	75	0
PXF outstanding, eoy			1,070	810	437	239	62	0

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